

Houston Retail Market Update

Edited by Kathryn Koepke

\$399/year

2nd Quarter 2006

Latest and Greatest

It's no surprise that older retail centers typically perform more poorly than do newer ones. The numbers are telling. Houston-area retail centers built in the 1960s, 1970s, and 1980s currently have average occupancies of 85.35%, 85.78%, and 83.14%, respectively, while those built in the 1990s and 2000s post occupancies of 88.78% and 88.37%, respectively. The effect carries over to rental rates as well. Centers constructed in the 1960s, 1970s, and 1980s have average rental rates of \$1.47, \$1.73, and \$1.24 per square foot, respectively, while those built in the 1990s and 2000s command rental rates averaging \$1.89 and \$1.86 psf, respectively.

Certainly, there are reasons newer centers have higher occupancy levels and rents. Newer retail centers are almost universally more attractive to potential tenants and appealing to shoppers, and are being developed with better visibility, lighting, and parking in mind. They also tend to have better tenant layouts giving good exposure to each tenant, with the benefit to the owner of not needing to discount rent for poor-visibility locations within the center. In contrast, older retail centers with dated facades frequently have poor layouts such as the "L" shape, with part of the center not facing the street. Ironically, those vintage centers that possess good locations often end up as targets for redevelopment.

While many poorly thought-out strip centers are still popping up around town, many retail developers are more in touch these days with what makes a good retail development with staying power. Large sites along major highways or other major thoroughfares are highly sought after because of their visibility and accessibility. Furthermore, developers understand the importance of a good design; a pleasant appearance and surroundings makes potential customers want to spend more time there. It doesn't hurt to follow the "town center" formula: national tenants including at least one big-name grocer, bookstore, home specialty or furnishings store, and maybe a clothing/shoe store, and you are well on your way to successfully leasing the rest of the center.

The benefit of the well-thought out shopping center is abundantly obvious with some centers being fully pre-leased before construction is wrapped up. Considering these factors, it is likely that the effect of age on the new generation of retail centers will be less pronounced during the years to come. However, there are those retailers that are perennially searching for the latest and greatest thing, and they will probably be a factor in the future, just as they are today.

By: [Chris Law](#)

Houston Retail Market at a Glance

	Strip	Neigh	Comm	Regional	Overall	Qtr	Yr
Occupancy	84.19%	85.22%	86.93%	85.87%	85.67%	▼	▼
Rent/SF	\$1.13	\$1.15	\$1.50	\$2.88	\$1.56	▼	▲
Absorption	75,641	270,762	216,272	-219,776	342,899	▲	▲

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Metro Occupancy Overview

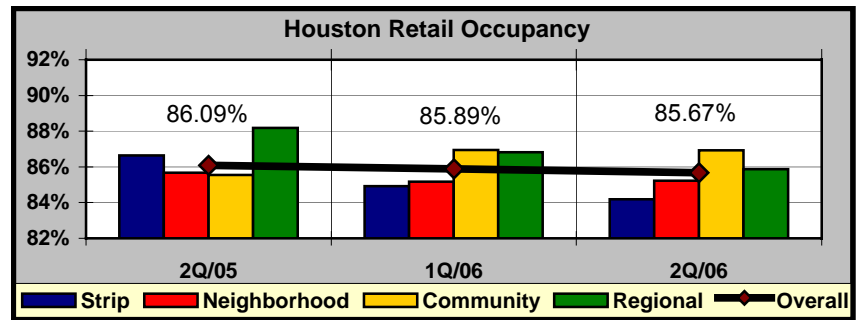
Retail occupancy fell for the second straight quarter, decreasing 0.22 points to 85.67%. Average occupancy is at its lowest level since the fourth quarter of 2003. Strip Centers and Regional Malls brought the overall average down, as average occupancy in both sectors fell substantially over the quarter.

Regional Mall occupancy dipped for the second straight quarter, due to move-outs combined with sluggish leasing activity at area malls. Average occupancy decreased 0.95 points over the second quarter to 85.87%. The **Near Southeast** sector has the highest occupancy at 93.98%, while the **Near Northwest** sector posted the lowest at 67.31%.

Community Center occupancy dipped 0.01 points over the quarter to 86.93%. However, occupancy is currently 1.39 points above levels this time last year. The **South** sector again posted the highest occupancy at 95.87%, while the lowest was recorded by the **Near North** sector at 67.78%.

Occupancy at **Neighborhood Centers** increased 0.04 points over the quarter. Currently at 85.22%, occupancy has decreased 0.46 points over the last 12 months. The **South** sector has the highest average occupancy at 90.54%, while the **Far North** sector currently has the lowest at 79.99%.

Occupancy at **Strip Centers** declined 0.74 points over the second quarter to 84.19%, and has decreased 2.45 points in the past 12 months. Average occupancy in the category has decreased steadily since the fourth quarter of 2003. The **Near North** sector currently reports the highest occupancy, at 91.64%, while the lowest occupancy is found in the **Far West** sector, at 75.84%.



Quarter	Strip	Neighborhood	Community	Regional	Overall
2Q 2005	86.64%	85.68%	85.54%	88.18%	86.09%
1Q 2006	84.93%	85.18%	86.94%	86.82%	85.89%
2Q 2006	84.19%	85.22%	86.93%	85.87%	85.67%

Metro Rent Overview

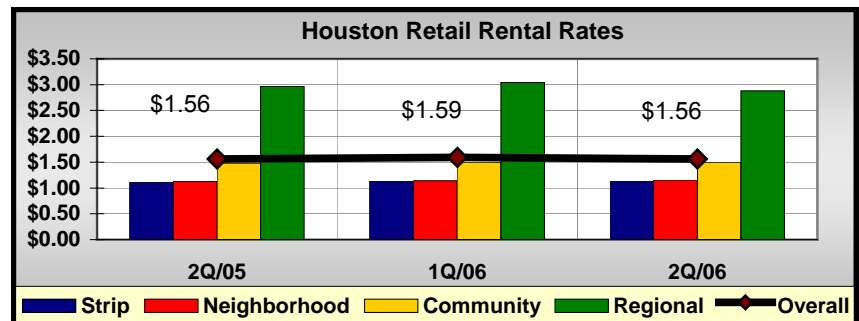
After reaching record highs in the first quarter, average rental rates fell \$0.03 per square foot (psf) over the second quarter to \$1.56 psf. Rents are unchanged over the last 12 months. The quarterly decrease was caused by a decrease in rental rates at Regional Malls, the only category to post a decrease over the second quarter. The **Near West** sector continues to post the highest overall rental rates, at \$2.93 psf.

After a substantial increase in the first quarter, **Regional Mall** rents declined \$0.16 over the second quarter to \$2.88 psf. Rents in the category have decreased \$0.09 psf since this time last year. The **Near West**, **Far North**, and **Far Northwest** sectors report the highest rents, at \$4.87, \$3.73, and \$3.50 psf, respectively, while the lowest rents are found in the **Near Northwest** sector, which includes Northwest Mall, at \$1.15 psf.

Community Center rents were unchanged over the second quarter. Currently at \$1.50 psf, rents have increased \$0.02 in the past 12 months. The **Near West** sector reports the highest average rents at \$2.19 psf, while the **Near Southeast** and **Near Northwest** sectors have the lowest rents at \$0.96 psf.

Neighborhood Center rents increased \$0.01 over the quarter to \$1.15 psf, and have increased \$0.02 since this time last year. The **Near West** sector boasts the highest rents at \$1.54 psf, while the lowest rents are found in the **Near North** sector at \$0.82 psf.

Average rental rates for **Strip Centers** were unchanged over the quarter, and are up \$0.02 over the past 12 months to \$1.13 psf. The **Near West** sector reports the highest average rents at \$1.60 psf, with the **Near Northwest** sector reporting the lowest at \$0.76 psf.



Quarter	Strip	Neighborhood	Community	Regional	Overall
2Q 2005	\$1.11	\$1.13	\$1.48	\$2.97	\$1.56
1Q 2006	\$1.13	\$1.14	\$1.50	\$3.04	\$1.59
2Q 2006	\$1.13	\$1.15	\$1.50	\$2.88	\$1.56

Metro Absorption Overview

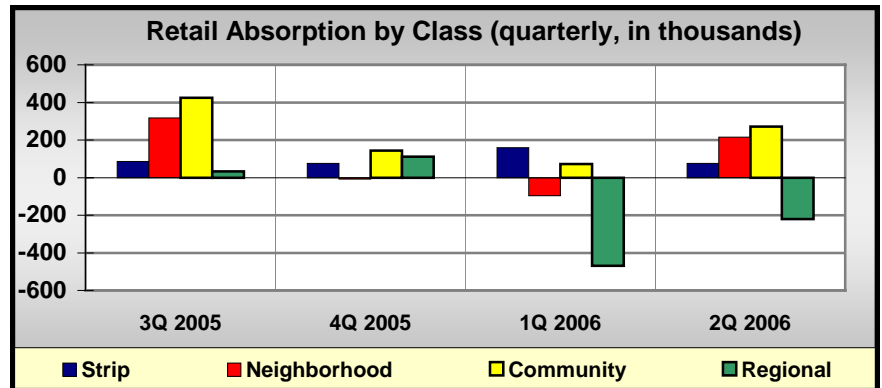
The Houston retail market bounced back from a rough first quarter, recording 342,899 square feet (SF) of absorption over the second quarter. Strong absorption figures in the Far North and Far Southeast sectors contributed to the overall figures, as the sectors absorbed 233,506 SF and 132,963 SF, respectively. Annual absorption now stands at nearly 1.2 million SF. All categories except Regional Malls posted positive absorption over the quarter, with Neighborhood Centers recording the strongest demand.

Demand for space in **Regional Malls** continued to be sluggish, as the category posted -219,776 SF of absorption over the quarter. Annual absorption remains in the red, at -544,226 SF. Much of the negative absorption was due to JC Penney vacating its space at Mall of the Mainland in the **Far Southeast** sector.

Community Centers had the strongest performance of any sector over the second quarter, absorbing 270,762 SF. Annual absorption currently stands at 652,898 SF. The **Far North** sector was the largest contributor to the gain with 109,364 SF absorbed, while the weakest absorption was found in the **Inner Loop** sector at -40,926 SF.

After a weak first quarter, **Neighborhood Centers** posted a strong second quarter, absorbing 216,272 SF to bring annual absorption to 687,548 SF. The **Far Southeast** sector posted the strongest absorption figures at 185,499 SF, while the **Far Northwest** sector struggled, absorbing -86,041 SF.

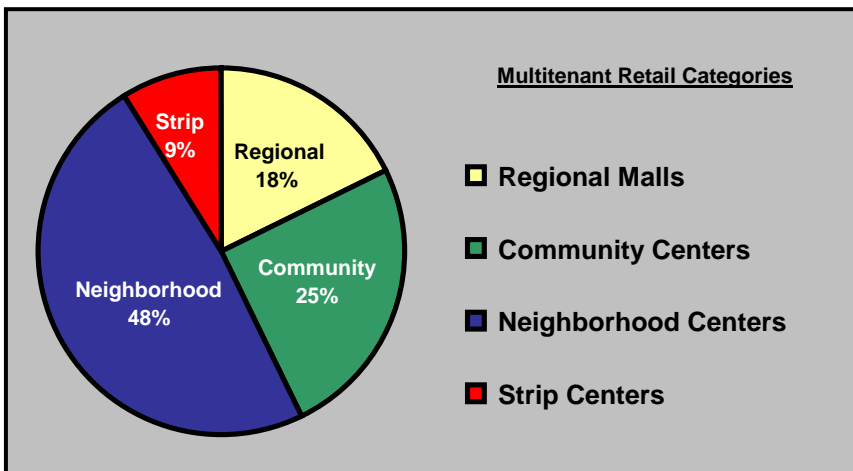
Strip Centers recorded positive overall absorption once again over the second quarter, absorbing 75,641 SF. The category has posted positive absorption every quarter for over three years. The **Near West** sector reported the strongest demand, with 31,550 SF absorbed, while the softest absorption was found in the **Far West** sector at -13,753 SF.



12-mo Ending	Strip	Neighborhood	Community	Regional	Overall
2Q 2004	907,865	2,389,668	1,709,052	818,130	5,824,715
2Q 2005	808,470	2,220,592	1,101,196	-302,452	3,827,806
2Q 2006	398,330	687,548	652,898	-544,226	1,194,550

Retail Inventory

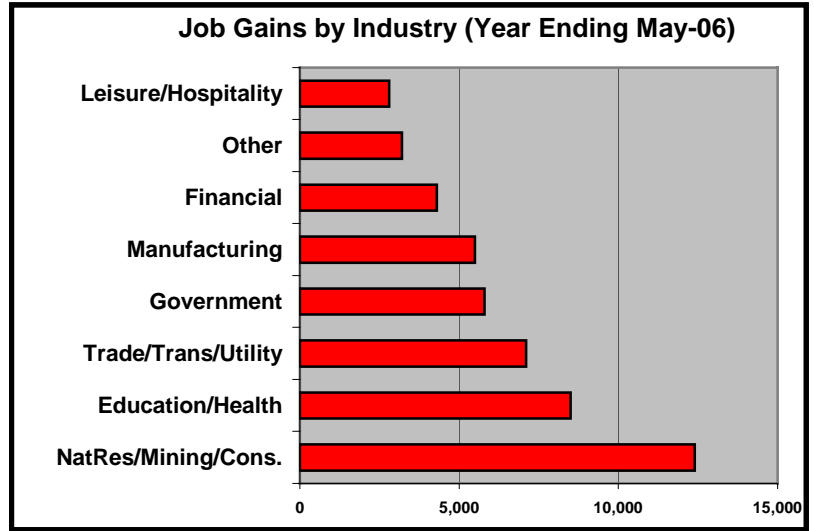
O'Connor & Associates divides multitenant retail space into four basic categories for purposes of analysis: Regional Malls, Community Centers, Neighborhood Centers, and Strip Centers. Based on the number of retail centers and square footage, Neighborhood Centers lead other categories with 48% of the overall Greater Houston retail inventory. The second largest category is Community Centers, accounting for 25% of the overall inventory.



Type	# of Centers	NRSF
Regional Mall	21	23,880,976
Community	142	33,187,515
Neighborhood	1,001	64,663,788
Strip	702	11,823,079
TOTAL	1,886	133,555,358

Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA increased to 5.0%, while the total number of nonagricultural wage and salary jobs increased to 2,410,900 in May 2006, according to the **Texas Workforce Commission**. This month's total is 68,000 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 19,400 jobs over the previous 12 months; Natural Resources, Mining, & Construction gained 12,400 jobs; Education & Health Services is up 8,500 jobs; Trade, Transportation, & Utilities added 7,100 jobs; Government added 5,800 jobs; Manufacturing gained 5,500 jobs; Financial Activities gained 4,300 jobs; and Leisure & Hospitality added 2,800 jobs. The only industry to lose jobs over the year was the Information sector with -1,000 jobs. The largest monthly gain was in the Leisure & Hospitality industry driven by seasonal factors.

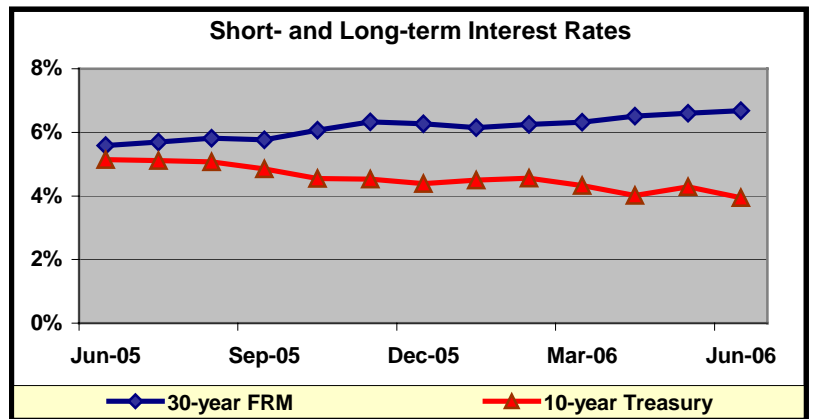


Interest Rates

The yield on the **10-year Treasury** note rose to 5.14% on the last Friday of June 2006, up 1.2 points from its 3.94% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.68% in June 2006, the highest level since January 2002. One year ago, the 30-year FRM was at 5.58%. The average for the **15-year FRM** in June was 6.31%, the highest level since January 2002 and up 1.14 points from a year ago.

The **Prime Rate** in June was reported in the Wall Street Journal at 8.25%, up 2.00 points from a year ago. It is now at the highest rate since February 2001.



Key Indicators

The latest **Conference Board Survey** indicates that the **Consumer Confidence Index** increased to 105.7 in June 2006, up 1.0 point from 104.7, in May. The index is an indicator of consumers' overall assessment of current conditions, relative to a figure of 100 in 1985, the base year.

Advance estimates reported by the **U.S. Department of Commerce** show that seasonally adjusted national retail and food services sales for June 2006 were \$363.8 billion, a decrease of 0.1% from the previous month, and up 5.9% from June 2005. Retail trade sales were down 0.1% from May, and were 5.7% above last year's level. Gasoline station sales were up 20.4% from June 2005, and sales of nonstore retailers were up 12.3% from last year.

The **U.S. Department of Commerce** reports that real GDP, the output of goods and services produced by labor and property in the United States, increased at an annual rate of 5.6% in the first quarter of 2006, up from the 1.7% growth rate recorded in the fourth quarter of 2005. The increase in GDP during the first quarter was largely attributed to increases in personal consumption expenditures, exports, equipment and software, and federal government spending.

Data Collection

Our in-house research team continuously updates data for over 2,500 retail centers in our database. We update these properties on a quarterly basis to generate accurate market trend reports on rents, occupancy, absorption, etc. Our quarterly surveys also update other property-specific data such as rent types, largest contiguous space available, leasing and management information, and owner information. We perform current and historical data audit after we close each month's survey to identify any data inconsistencies or incorrectly keyed values.

Research

We monitor various news media, press releases, marketing materials, web-sites, CAD records, permit issuance, and other sources to capture new construction, planned projects, financing, and sales. Our researchers conduct phone interviews with relevant developers, brokers, or lenders to gather information on new construction and sales. We add properties to our database on a regular basis to ensure we offer the most up-to-date and complete retail database.

Market Coverage

Our retail database covers the Greater Houston market and includes properties in Harris, Galveston, Brazoria, Fort Bend, and Montgomery counties. The market is divided into 13 submarkets that correspond to different sectors of the greater Houston area. This approach allows the user to view distinct areas of town in which properties can be identified together.

Glossary

Absorption = Change in occupied square feet, including new construction. Absorption is a proxy for demand.

Occupancy = Percentage of physically occupied square feet on property.

Rents = Market rents.

Type = Multi-tenant properties are classified as Regional Malls, Community Centers, Neighborhood Centers, or Strip Centers based on size. Strip Centers are properties that have between 10,000 and 24,999 net rentable square feet. Neighborhood Centers are properties that have between 25,000 and 149,999 net rentable square feet. Community Centers are properties that have between 150,000 and 599,999 net rentable square feet. Regional Malls are properties that have 600,000 net rentable square feet or more. Single-tenant centers are not classified.

Reporting

Occupancy, Rent, and Absorption trend data is based on Operating and Multi-Tenant Regional Malls, Community Centers, Neighborhood Centers, and Strip Centers. Single-tenant properties are excluded from the data.