

# The Houston Retail Market Update

Edited by Kathryn Koepke

\$399/year

2<sup>nd</sup> Quarter 2007

## The Ripple Effect

The housing market's recent slowdown has had a ripple effect that can be felt across all markets, and retail is no exception. Many retailers such as **Lowe's**, **Home Depot**, and **Sears** have especially been hit. The nation's number one home improvement retailer, Home Depot, recently reported that it expects earnings per share to fall between 15 and 18 percent due to the homebuilding slowdown. Other competitors, mainly Lowe's and Sears, have also reported similar shortfalls in their projected earnings for the year.

With the subprime mortgage fallout, many potential homebuyers have effectively been removed from the home buying pool, while thousands of households have been forced to foreclose on their homes. In sync with the housing market slowdown, new home construction has also fallen, as the number of builder inventory homes has increased dramatically in last few months. **Lennar Corporation**, the second largest U.S. homebuilder, reported that orders for new homes have fallen 31 percent over the quarter. Homebuilders such as **D.R. Horton** and **KB Homes** also reported such unexpected losses, attributing those losses to changing market conditions, high levels of new and existing inventory homes, and rising interest rates. This slowdown in building supply needs, as well as consumer needs, is negatively impacting the home improvement retailers.

So what does this mean for Houston's retail market? Overall occupancy is down 0.38 points for the quarter to 85.36%. In sync with the slight ease in occupancy, rental rates also dipped during the second quarter, losing \$0.02 per square foot to \$1.61. Despite occupancy and rent rate losses, demand for retail space continues at a brisk pace, as 918,383 square feet (SF) was absorbed over the quarter, and 3,316,675 SF has been absorbed over the last year. Construction activity in the Greater Houston area also indicates strong demand for retail space. **Wulfe & Co.'s Annual Retail Building Survey** indicated approximately 4.2 million SF of retail space will complete construction in 2007, which represents a 17% increase over last year's construction activity. Discount department stores will account for 17% of construction activity in 2007, while supermarkets will account for another 15% of space. Big-box retailers **Home Depot**, **Kohl's**, **Academy**, and **Best Buy** will each open at least two new stores in the Greater Houston area in 2007. Thus, although worries persist on a national level of a slowdown in the retail market due to housing market woes, Houston's retail market continues to grow and expand, benefiting from the area's comparatively affordable housing, strong population growth, as well as strong job growth.

By: [Leslie Countryman](#)

### Houston Retail Market at a Glance

	Strip	Neigh.	Comm.	Regional	Overall	Qtr	Yr
Occupancy	83.52%	84.06%	87.12%	87.46%	85.36%	▼	▼
Rent/SF	\$1.18	\$1.19	\$1.59	\$3.00	\$1.61	▼	▲
Absorption	218,513	728,280	35,470	-63,880	918,383	▲	▲

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## Metro Occupancy Overview

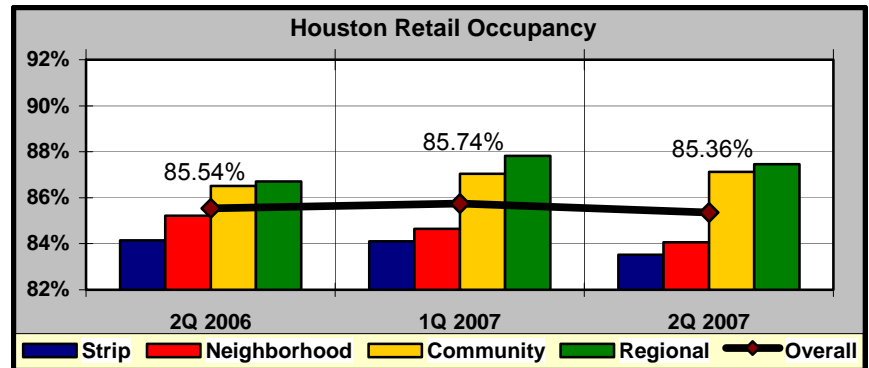
Relatively stable retail occupancy levels in the past few quarters have eased slightly to 85.36% for the second quarter of 2007, the lowest level recorded in the past three years.

After a substantial increase in the first quarter 2007, **Regional Mall** occupancy fell slightly over the quarter at 87.46%. However, occupancy is up 0.75 points over the year. The **Near Southeast** sector reported the highest occupancy, at 93.80%, while the **Near Northwest** sector recorded the lowest occupancy at 74.41%.

**Community Center** was the only retail category to post an increase in occupancy over the quarter, gaining 0.08 points to 87.12%. Occupancy has increased 0.61 points since this time last year. The highest occupancy was found in the **South** sector at 98.47%, while the **Near Southeast** sector reported the lowest occupancy at 74.09%.

**Neighborhood Centers** once again posted the largest decline over the quarter, slipping 0.59 points to 84.06%. Occupancy is now 1.16 points below its level 12 months ago. The **South** sector again recorded the highest occupancy, at 92.52%, while the lowest occupancy was found in the **Far North** sector at 76.95%.

Occupancy at **Strip Centers** declined for the third straight quarter, decreasing 0.58 points to 83.52%; occupancy has fallen 0.63 points since this time last year. The **Near Southwest** sector reported the highest occupancy at 90.42%, while occupancy was weakest in the **Far Northeast** sector at 77.10%.



Quarter	Strip	Neighborhood	Community	Regional	Overall
2Q 2006	84.15%	85.22%	86.51%	86.71%	85.54%
1Q 2007	84.10%	84.65%	87.04%	87.82%	85.74%
2Q 2007	83.52%	84.06%	87.12%	87.46%	85.36%

## Metro Rent Overview

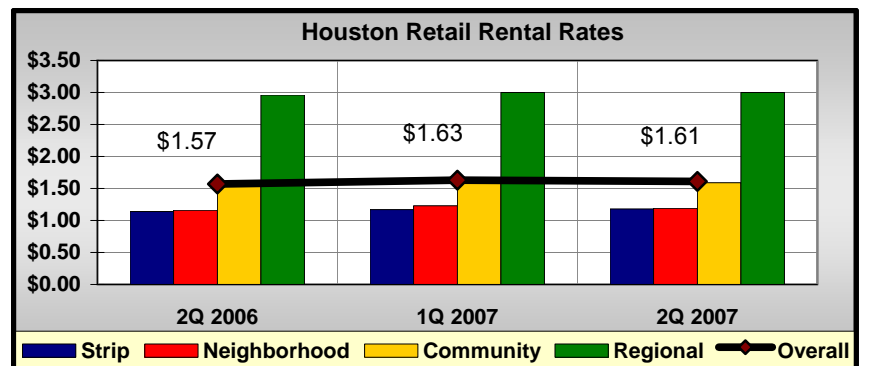
Overall rents decreased for the first time in three quarters, dropping \$0.02 per square foot (psf) over the quarter to \$1.61 psf. Rental rates are up \$0.04 points from one year ago. All four categories of retail centers posted mixed results for the second quarter.

**Regional Mall** rents were unchanged over the quarter at \$3.00 psf. However, rental rates remain \$0.04 psf above levels this time last year. The **Near West** sector recorded the highest rents at \$4.86 psf, followed by the **Far North** sector at \$3.78 psf, while the lowest rents are found in the **Near Northwest** sector at \$1.54 psf.

**Community Center** rents were also unchanged over the quarter at \$1.59 psf. Community Center rents have gained \$0.06 psf over the last 12 months. The highest rents were found in the **Near West** sector at \$2.18 psf, while the **Near Southeast** sector reported the lowest rents at \$0.88 psf.

**Neighborhood Center** rents eased slightly after recent quarterly gains, losing \$0.04 psf to \$1.19 psf; neighborhood center rents are now \$0.03 psf higher than one year ago. The **Near West** sector continues to post the highest rental rates at \$1.63 psf, while the lowest rents were found in the **Near Southeast** sector at \$0.94 psf.

**Strip Center** rents continued their upward momentum, increasing \$0.01 psf to \$1.18 psf. Rents are \$0.04 psf higher than one year ago. The **Inner Loop** sector reports the highest rents at \$1.66 psf, followed closely but the **Near West** sector at \$1.62 psf, while the **Near Northwest** sector has the lowest rents at \$0.81 psf.



Quarter	Strip	Neighborhood	Community	Regional	Overall
2Q 2006	\$1.14	\$1.16	\$1.53	\$2.96	\$1.57
1Q 2007	\$1.17	\$1.23	\$1.59	\$3.00	\$1.63
2Q 2007	\$1.18	\$1.19	\$1.59	\$3.00	\$1.61

## Metro Absorption Overview

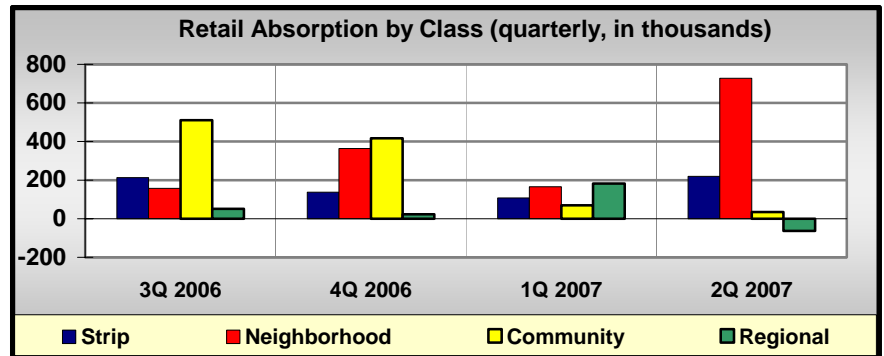
Retail demand was strong once again, as the market posted quarterly absorption of 918,383 SF. Absorption figures were mixed among categories with neighborhood and strip centers posting the strongest figures. Overall annual absorption currently stands at a healthy 3,316,675 SF.

**Regional Malls** posted their weakest absorption figures over the past year, absorbing -63,880 SF over the quarter and bringing annual absorption into the red at 192,308 SF. The **Near Southwest** sector led the way, absorbing 171,240 SF over the quarter, while the **Northeast** sector reported the weakest demand, absorbing -228,371 SF.

**Community Centers** recorded a fifth straight quarter of positive absorption, absorbing 35,470 SF, which contributed to annual absorption of 1,032,800 SF. The **Inner Loop** sector recorded the strongest quarterly absorption, with 37,716 SF absorbed, while the weakest was recorded in the **Far Southwest** sector with -48,397 SF.

**Neighborhood Centers** posted the strongest absorption for the second straight quarter, with 728,280 SF absorbed. Absorption in neighborhood centers over the last year totals 1,416,168 SF. The **Northeast** and **Far Northwest** sectors posted the strongest absorption, at 327,413 SF and 159,060 SF, respectively. The weakest demand was found in the **Near Southwest** sector, which posted absorption of -64,962 SF.

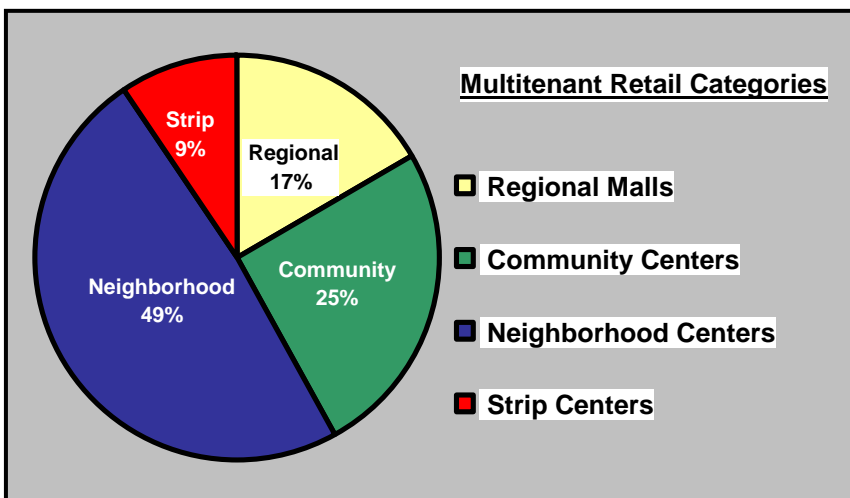
**Strip Centers** posted absorption of 218,513 SF over the first quarter, bringing year-over-year absorption to 375,399 SF. The **Inner Loop** sector posted the strongest absorption with 77,337 SF absorbed, while the weakest absorption was found in the **Near Southwest** sector with -6,944 SF absorbed.



12-mo Ending	Strip	Neighborhood	Community	Regional	Overall
2Q 2005	815,356	2,269,308	1,640,206	-285,452	4,439,418
2Q 2006	396,821	712,496	451,194	-544,236	1,016,215
2Q 2007	675,399	1,416,168	1,032,800	192,308	3,316,675

## Retail Inventory

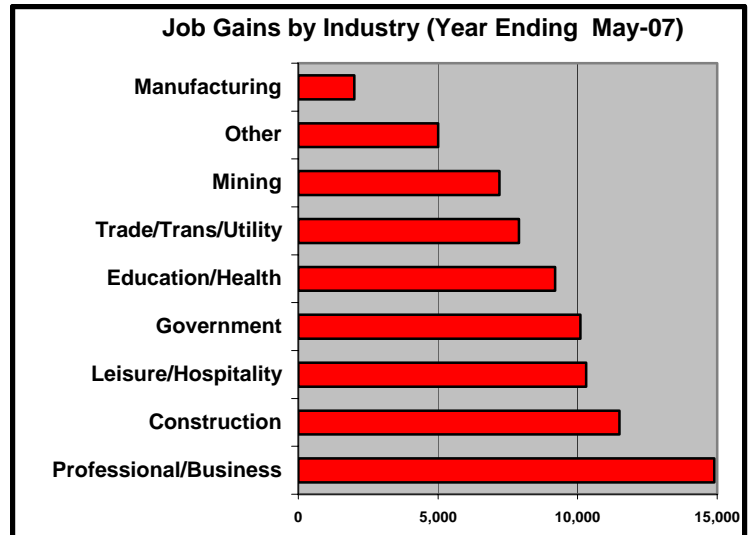
O'Connor & Associates divides multi-tenant retail space into four basic categories for purposes of analysis: Regional Malls, Community Centers, Neighborhood Centers, and Strip Centers. Based on the number of retail centers and square footage, Neighborhood Centers lead other categories with 49% of the 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	20	23,031,008
Community	147	34,569,142
Neighborhood	1,040	66,796,537
Strip	783	12,782,277
<b>TOTAL</b>	<b>1,990</b>	<b>137,178,964</b>

## Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA was flat at 3.8%, while the total number of nonagricultural wage and salary jobs increased to 2,518,500 in May 2007, according to the **Texas Workforce Commission**. This month's total is 81,100 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 14,900 jobs over the previous 12 months; Construction added 11,500 jobs; Leisure & Hospitality added 10,300 jobs; Government added 10,100 jobs; Education & Health Services is up 9,200 jobs; Trade, Transportation, & Utilities gained 7,900 jobs; Mining added 7,200 jobs; Other Services gained 5,000 jobs; Manufacturing added 2,000 jobs; and Information sector gained 100 jobs. The largest monthly gain was in the Leisure & Hospitality sector with 4,300 jobs.

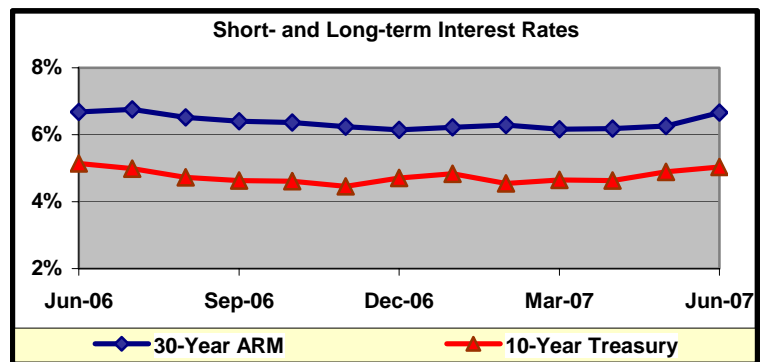


## Interest Rates

The yield on the **10-year Treasury** note rose to 5.03% in June 2007, down 0.11 points from its 5.14% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.66% in June 2007. One year ago, the 30-year FRM was at 6.68%. The average for the **15-year FRM** in June was 6.34%, up 0.03 points from a year ago.

The **Prime Rate** in June was reported in the Wall Street Journal at 8.25%, up 0.25 points from a year ago.



## Key Indicators

The latest **Conference Board Survey** indicates that the **Consumer Confidence Index** decreased to 103.9 in June 2007, down 4.6 points from 108.5, 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. The **Index of Leading Economic Indicators** increased 0.3% in May to 138. The index is an indicator of direction the economy is expected to take in coming months, relative to a figure of 100 in 1996, 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 2007 were \$373.5 billion, a decrease of 0.9% from May, but 3.8% from June 2006. Retail trade sales were down 1.0% from May 2007, but were 3.5% above last year's level.

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 1.3% in the first quarter of 2007, up from the 2.5% growth rate recorded in the fourth quarter of 2006. The increase in GDP during the fourth quarter was attributed to positive contributions from personal consumption expenditures and state and local 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.



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