

# Houston Retail Market Update

Edited by Kathryn Koepke

\$399/year

3<sup>rd</sup> Quarter 2006

## Signs of Promise

The latest economic reports may have retailers a little nervous about the upcoming, make-or-break holiday season. The Commerce Department reported on Monday that consumer spending in September increased 0.1%, which was significantly lower than the predicted 0.3% gain. Further, this was the weakest showing since August 2005. Slightly more disconcerting was the Commerce Department's national retail and food sales report for September, which indicated that retail and food sales registered a 0.4% decrease from the previous month. Retail trade sales were also down 0.6% from the previous month. And on top of everything, the economy, or Gross Domestic Product, grew only 1.6% during the third quarter of 2006, the weakest quarterly growth rate in over three years.

Despite the gloom and doom in some of the reports, there are positive signs. Although overall retail sales may have been down during the month of September, several major department stores had huge months. **J.C. Penney's** same-store sales increased 8.7%, same-store sales at **Kohl's** increased by 16.3%, while **Federated Department Stores**, owners of **Macy's**, enjoyed a 6.2% gain in same-store sales in September. Personal income increased by a solid 0.5% in September, while stock market earnings, which year-to-date total \$2.7 trillion, are quite strong. Also acting to increase the amount of money in consumers pockets were the lower energy prices. In this day and age where the national savings rate is consistently negative, more money, and especially increased stock wealth, generally translates into increased consumption spending. And increased spending definitely isn't a bad thing if you're in the retail business.

Economic fundamentals are expected to improve, with fourth quarter 2006 GDP growth forecasted at 2.7%. Inflation also appears to be moderating, aided in part by the Federal Reserve's pause in interest rate hikes. The **National Retail Federation** predicts domestic retail sales, excluding automobiles, gas stations, and restaurants, in 2006 are on track to be 4.7% higher than the previous year's sales. Therefore, although we shouldn't expect to see a record breaking holiday shopping season, there's no reason to suggest it's shaping up to be the worst either.

By: [Leslie Countryman](#)

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## Houston Retail Market at a Glance

	Strip	Neigh.	Comm.	Regional	Overall	Qtr	Yr
Occupancy	84.36%	85.06%	86.45%	86.03%	85.51%	▼	▼
Rent/SF	\$1.13	\$1.15	\$1.52	\$2.89	\$1.57	▲	■
Absorption	204,614	110,896	108,572	51,324	475,406	▲	▼



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## Metro Occupancy Overview

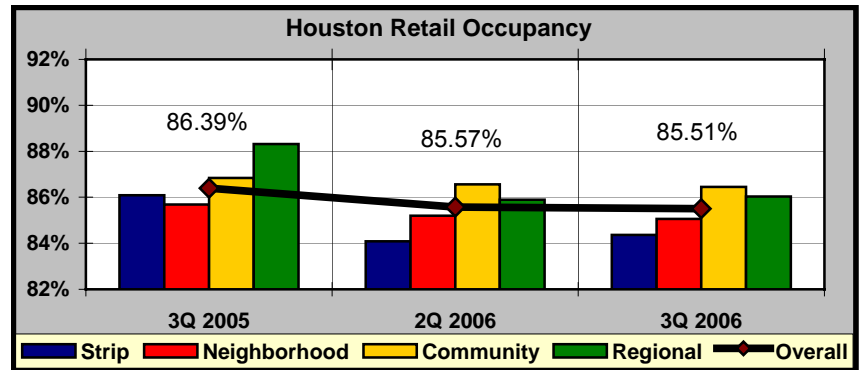
Retail occupancy fell to its lowest level in three years, dropping 0.06 points over the third quarter to 85.51%. Significant drops in both Community and Neighborhood centers contributed to the decline.

**Regional Malls** registered a 0.13-point quarterly gain. However, at 86.03%, occupancy remains 2.29 points below last year's level. The **Near Southeast** sector, which contains Almeda Mall, Gulfgate Center, and Pasadena Town Square, has the highest occupancy at 94.30%, while occupancy is lowest in the **Near Northwest** sector, which contains the Northwest and Northline Malls, at 67.31%.

**Community Center** occupancy is down 0.11 points over the quarter and 0.39 points over the year to 86.45%. The **South** sector, which has two community centers, recorded average occupancy at 98.47%. Occupancy is weakest in the **Near Southeast** sector at 74.09%.

**Neighborhood Centers** reported a 0.14-point drop in occupancy over the quarter to 85.06%, which is 2.29 points below last year's level. The **Inner Loop** sector recorded the highest occupancy, at 94.74%, while the lowest occupancy was found in the **Far North** sector, at 80.51%.

**Strip Centers** posted the strongest quarterly gain in occupancy of all categories, increasing 0.27 points over the quarter. However, at 84.36%, occupancy is down 1.73 points over the year. Three sectors boast occupancy levels greater than 90%; the **South** at 91.69%, the **Near North** at 91.64%, and the **Near Southwest** at 90.45%.



Quarter	Strip	Neighborhood	Community	Regional	Overall
3Q 2005	86.09%	85.68%	86.84%	88.32%	86.39%
2Q 2006	84.09%	85.20%	86.56%	85.90%	85.57%
3Q 2006	84.36%	85.06%	86.45%	86.03%	85.51%

## Metro Rent Overview

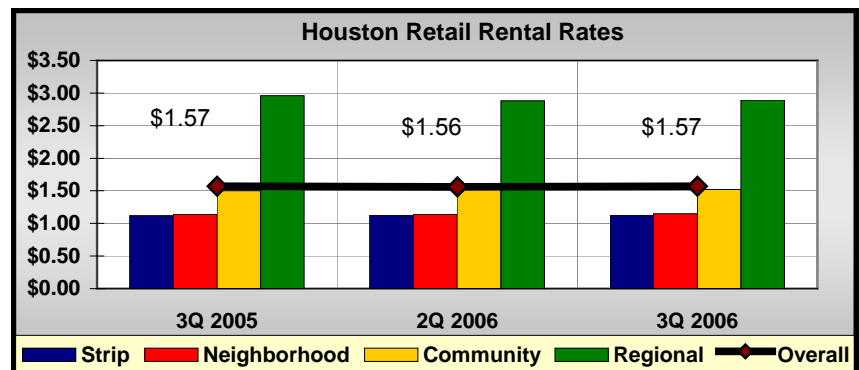
Overall rents picked up \$0.01 psf during the third quarter to reach \$1.57 per square foot (psf), which is the same rate recorded at this time last year. Regional Malls was the only category to post a quarterly rent gain. Rents in the remaining categories remained flat over the quarter.

**Regional Mall** rents reported a \$0.01 psf gain over the quarter to \$2.89 psf. Despite the gain, rents remain \$0.07 psf below last year's level. Rents are highest in the **Near West** sector, at \$4.86 psf. The **Far North** sector, which includes The Woodlands and Greenspoint Malls, also boasts strong rents, at \$3.78 psf.

Although **Community Center** rents remained flat over the quarter, they boast the largest rent increase over the past year. Currently at \$1.52 psf, community center rents are \$0.02 above last year's average. Rents range from \$0.84 psf in the **Near Northwest** sector to \$2.23 psf in the **Near West** sector.

**Neighborhood Center** rents were unchanged over the quarter, and are up \$0.01 over the past 12 months to \$1.15 psf. The **Near West** and **Inner Loop** sectors report the highest average rents at \$1.57 and \$1.52 psf, respectively, while the lowest average rents are found in the **Near North** sector at \$0.95 psf.

**Strip Centers** rents held steady at \$1.13 psf, which is \$0.01 psf higher than last year's average. The **Near West** sector leads the market with average rents at \$1.61 psf, while the **Near Northwest** sector trails the market with average rents at \$0.77 psf.

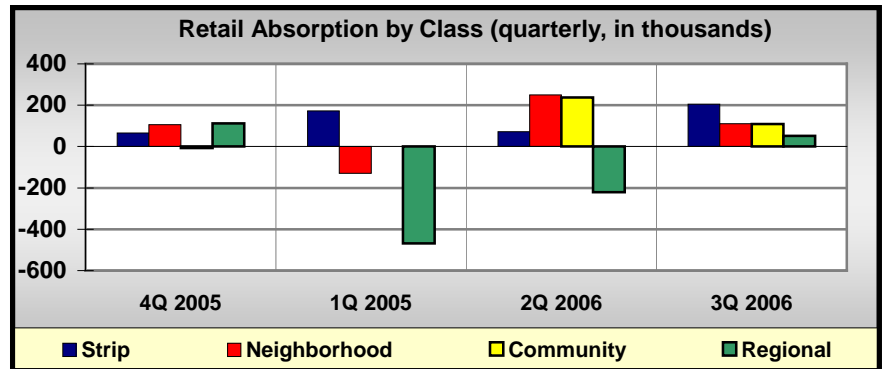


Quarter	Strip	Neighborhood	Community	Regional	Overall
3Q 2005	\$1.12	\$1.14	\$1.50	\$2.96	\$1.57
2Q 2006	\$1.13	\$1.15	\$1.52	\$2.88	\$1.56
3Q 2006	\$1.13	\$1.15	\$1.52	\$2.89	\$1.57

## Metro Absorption Overview

The Houston retail market posted a second straight quarter of positive absorption, with all categories registering gains over the third quarter. Strip Centers outperformed all retail categories, absorbing 204,614 SF over the quarter, followed by Neighborhood Centers, which absorbed 110,896 SF. Total quarterly absorption of 475,406 SF brings annual absorption up to 668,517 SF.

**Regional Malls** reported positive quarterly absorption of 51,324 SF. Despite the positive absorption during the third quarter, annual absorption remains negative, at -525,462 SF. The leading sector over the quarter was **Near West** with absorption of 37,670 SF, followed by **Far Southeast** where 24,080 SF was absorbed. **Far Northwest** posted the weakest figure with -29,395 SF absorbed.



12-mo Ending	Strip	Neighborhood	Community	Regional	Overall
3Q 2004	833,317	2,221,660	2,397,162	859,712	6,311,851
3Q 2005	638,417	2,033,424	993,470	-496,682	3,168,629
3Q 2006	515,853	338,400	339,726	-525,462	668,517

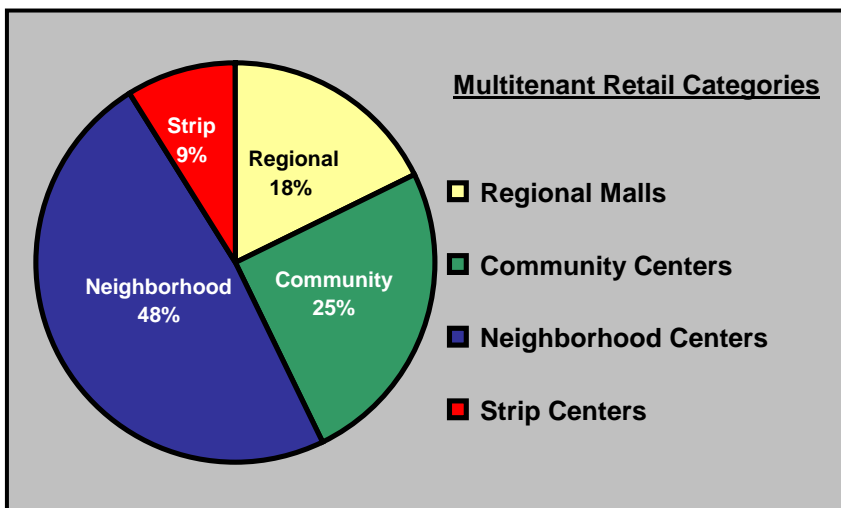
**Community Centers** continue to post robust figures with 108,572 SF absorbed over the quarter, and 339,726 SF absorbed over the year. The **Far Southeast** sector had the strongest quarterly performance, absorbing 117,221 SF, while **Far West** trailed the market with -75,367 SF absorbed.

**Neighborhood Centers** absorbed 110,896 over the quarter to bring annual absorption to 338,400 SF. Demand was highest in the **Near North** sector, as 94,372 SF was absorbed. The **Far Southeast** sector posted the strongest absorption figures at 185,499 SF, while the **Far Northwest** sector struggled, absorbing -86,041 SF. The Northeast and Far Southeast sectors each posted negative absorption in excess of 20,000 SF.

**Strip Centers** posted its highest quarterly absorption since the first quarter of 2005, absorbing 204,614 SF. Annual absorption stands at 515,853 SF, the strongest of all categories. The **Far Southeast** sector was the largest contributor to the quarterly gain with absorption of 51,542 SF, while the weakest demand was found in the **Inner Loop** with absorption of -5,186 SF.

## Retail Inventory

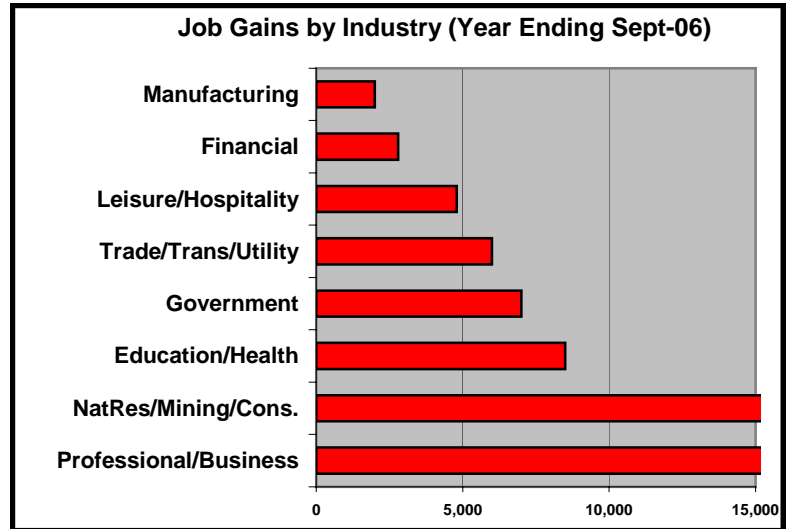
O'Connor & Associates divides multitenant retail space into four basic categories for purposes of analysis: Regional Malls, Community Centers, Neighborhood Centers, and Strip Centers. Based on the number of retail centers and square footage, Neighborhood Centers lead other categories with 48% of the 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	144	33,546,417
Neighborhood	1,007	64,826,668
Strip	737	12,044,065
<b>TOTAL</b>	<b>1,909</b>	<b>134,298,126</b>

## Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA declined to 4.7%, while the total number of nonagricultural wage and salary jobs increased to 2,442,300 in September 2006, according to the **Texas Workforce Commission**. This month's total is 66,800 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 19,200 jobs over the previous 12 months; Natural Resources, Mining, & Construction employment increased by 18,500 jobs; Education & Health Services is up 8,500 jobs; Government added 7,000 jobs; Trade, Transportation, & Utilities gained 6,000 jobs; Leisure & Hospitality added 4,800 jobs; Financial Activities is up 2,800 jobs; and Manufacturing gained 2,000 jobs. The only two industries to lose jobs over the year were Information, down 1,500 jobs, and Other Services, down 500 jobs.

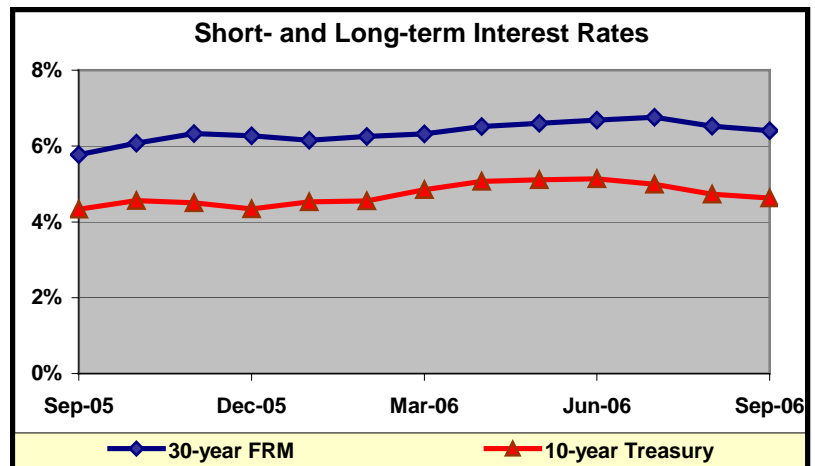


## Interest Rates

The yield on the **10-year Treasury** closed at 4.77% on October 25, 2006, up 0.26 points from its 4.51% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.40% in September 2006. One year ago, the 30-year FRM was at 5.77%. The average for the **15-year FRM** in September was 6.08%, up 0.72 points from a year ago.

The **Prime Rate** in October was reported in the Wall Street Journal at 8.25%, up 1.50 points from a year ago.



## Key Indicators

The latest **Conference Board Survey** indicates that the **Consumer Confidence Index** increased to 104.5 in September 2006, up 4.3 points from 100.2, in August. 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 September 2006 were \$366.2 billion, a decrease of 0.4% from the previous month, but up 5.5% from September 2005. Retail trade sales were down 0.6% from August, but were 5.2% above last year's level. The largest annual sales increases were found in nonstore retailers, where sales were up 12.9% from last year, and in clothing and accessories stores, where sales were up 10.7% from the 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 1.6% in the third quarter of 2006, down from the 2.6% growth rate recorded in the second quarter of 2006. The increase in GDP during the third quarter was attributed to positive contributions from personal consumption expenditures, exports, equipment and software, nonresidential structures, 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.