

The Houston Retail Market Update

Edited by Kathryn Koepke

\$399/year

4th Quarter 2006

Going Up

The Houston retail market ended 2006 on a high note. Fourth quarter numbers were encouraging, as demand was relatively robust, pushing overall occupancy up for the quarter, and rents increased enough to send the yearly change into positive territory. However, despite strong demand, overall retail occupancy may drop in 2007 as construction ramps up; over 11 million SF of new retail space is currently in the works.

Much of the new construction is located where one might expect. The Far Southwest submarket leads the pack with over 3 million SF of space under construction, with NewQuest Properties accounting for 1.7 million SF with Brazos Town Center and Brazos Town Commons in the booming Rosenberg area. These two developments will bring several new major retailers to Rosenberg, including Best Buy, Target, and Academy. Also in the works is an expansion of First Colony Mall in Sugar Land. The South sector is not too far behind, with over 2 million SF underway. More than half of the new development is occurring at the busy intersection of FM 518 and Highway 288, with Pearland Town Center, anchored by Dillard's and Macy's, and Shadow Creek Ranch Town Center going up.

It is unlikely that occupancy in these fast-growing sectors will decrease as the new space comes online. The previously described projects are high-profile projects in booming, retail-starved areas, and they will likely open with nearly every last square foot spoken for. However, while some of Houston's outlying suburbs are growing very quickly, Houston as a whole probably can't keep up with the current frantic pace of retail construction. Areas of Houston proper outside the Inner Loop and Galleria areas could continue to see something of a slide, as many of these areas have mostly older centers, sometimes plagued by poor locations and unappealing designs, and demographics are not nearly as attractive as in Pearland, Sugar Land, The Woodlands, or far northwest Houston.

While occupancy may be soft in the near future, rental rates probably won't follow suit. Rents for the deluge of new space hitting the market will be fairly high, meaning increases in overall rental rates are likely in the cards. As the case may be with occupancy, rental rates may drop in some areas. Any bargains available to potential tenants are likely to be in older centers in locations not quite as desirable, as the suburbs continue their rapid growth.

By: [Chris Law](#)

Houston Retail Market at a Glance

	Strip	Neigh.	Comm.	Regional	Overall	Qtr	Yr
Occupancy	84.20%	85.34%	86.77%	86.16%	85.75%	▲	▼
Rent/SF	\$1.14	\$1.16	\$1.55	\$2.97	\$1.59	▲	▲
Absorption	138,341	395,436	413,432	23,260	970,469	▲	▼

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Metro Occupancy Overview

Retail occupancy increased for the second straight quarter, gaining 0.20 points over the fourth quarter to 85.75%. Occupancy increases in three of four retail types bolstered the market. Since this time last year, occupancy has decreased 0.69 points.

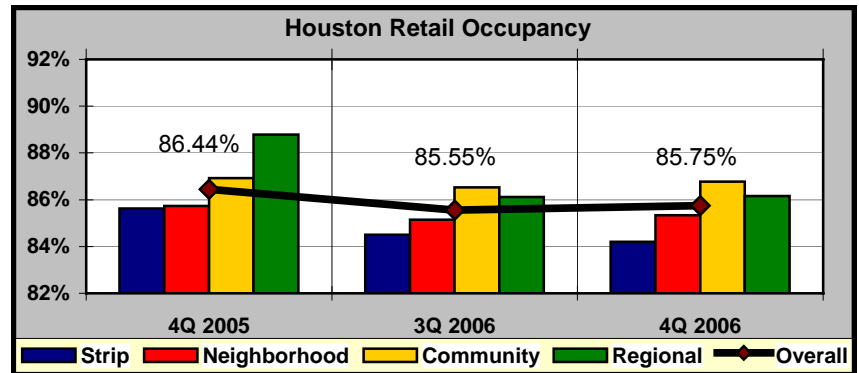
Occupancy at **Regional Malls** posted a modest increase of 0.04 points to 86.16%, but has fallen 2.63 points over the last year. The **Near Southeast** sector once again posted the highest occupancy at 94.48%, while the **Near Northwest** sector, which includes the Northline and Northwest Malls, recorded the lowest at 69.57%.

Community Center occupancy increased 0.24 points over the quarter. Over the last 12 months, occupancy has decreased 0.16 points to 86.77%.

The highest occupancy was found in the **South** sector at 98.13%, while the **Near Southeast** sector reported the lowest at 74.09%.

Neighborhood Centers rebounded after registering a decrease in occupancy in the third quarter, posting a 0.19-point increase over the fourth quarter to 85.34%. Occupancy has decreased 0.39 points over the last year. The **South** sector recorded the highest occupancy, at 93.40%, while the **Far North** sector had the lowest at 81.10%.

Strip Centers was the only category to see a decrease in occupancy over the quarter, decreasing 0.31 points. Occupancy has decreased 1.42 points since this time last year to 84.20%. Leading the way was the **Near Southwest** sector at 90.65%, while the **Near West** sector posted the weakest occupancy at 76.72%.



Quarter	Strip	Neighborhood	Community	Regional	Overall
4Q 2005	85.62%	85.73%	86.93%	88.79%	86.44%
3Q 2006	84.51%	85.15%	86.53%	86.12%	85.55%
4Q 2006	84.20%	85.34%	86.77%	86.16%	85.75%

Metro Rent Overview

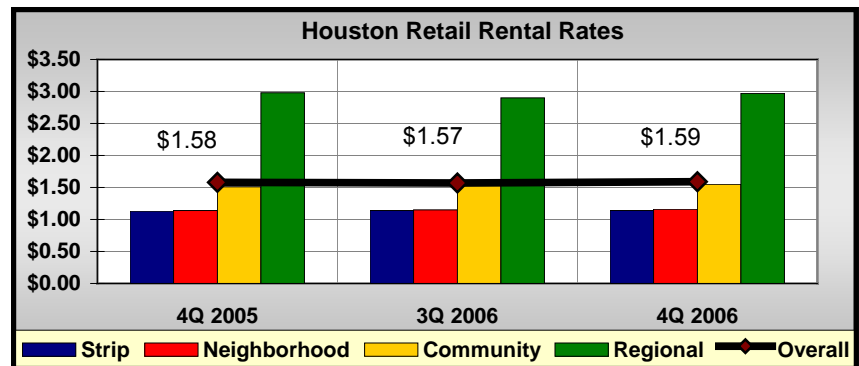
Overall rents gained \$0.02 psf during the fourth quarter to \$1.59 per square foot (psf), bringing the year-over-year increase to \$0.01 psf. Rents in three of four categories posted a quarterly increase, with Strip Center rents remaining flat.

Regional Mall rents jumped \$0.07 psf over the quarter to \$2.97 psf. However, rents remain \$0.01 psf below levels at this time last year. The **Near West** sector, which includes The Galleria and Memorial City Mall, continues to post the highest rents at \$4.87 psf, while the lowest rents are found in the **Near Northwest** sector at \$1.91 psf.

Community Center rents increased for the second straight quarter, gaining \$0.02 psf over the quarter. Currently at \$1.55 psf, community center rents have increased \$0.04 psf over the last 12 months. The **Near West** sector has the highest rents in this category as well, at \$2.23 psf, while the lowest rents are found in the **Near Northwest** sector at \$0.84 psf.

After holding steady for two quarters, **Neighborhood Center** rents gained \$0.01 psf over the fourth quarter to \$1.16 psf, bringing the yearly increase to \$0.02 psf. The **Near West** sector recorded the highest rents at \$1.62 psf, followed by the **Inner Loop** sector at \$1.54 psf. The **Near Northwest** sector posted the lowest rents at \$0.95 psf.

Strip Centers was the only category not to record a rent increase, as rents were unchanged over the quarter at \$1.14 psf. Rents have gained \$0.01 psf over the last year. Rents are highest in the **Near West** sector at \$1.61 psf, while the **Near Northwest** sector reports the lowest rents at \$0.77 psf.

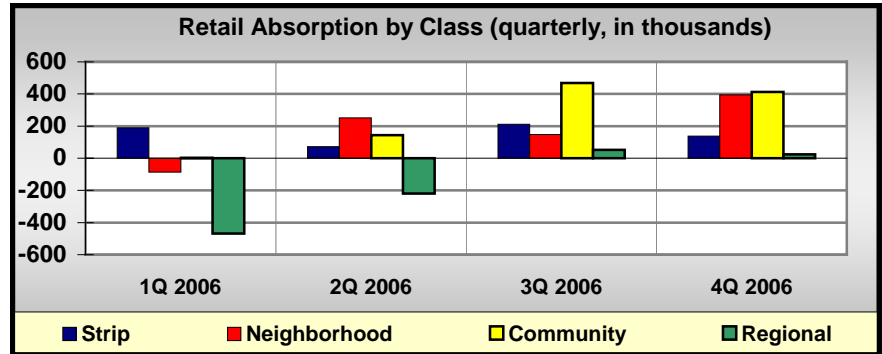


Quarter	Strip	Neighborhood	Community	Regional	Overall
4Q 2005	\$1.13	\$1.14	\$1.51	\$2.98	\$1.58
3Q 2006	\$1.14	\$1.15	\$1.53	\$2.90	\$1.57
4Q 2006	\$1.14	\$1.16	\$1.55	\$2.97	\$1.59

Metro Absorption Overview

Houston retail absorption was strong for a second straight quarter, as the market absorbed 970,489 SF over the fourth quarter, with all four categories posting positive absorption. Community Centers led the way with another strong quarter, followed closely by Neighborhood Centers. Absorption since this time last year stands at 1,730,733 SF.

Absorption at **Regional Malls** was in the black for a second consecutive quarter, as fourth quarter absorption was 23,260 SF. However, annual absorption remains negative at -612,624 SF. The **Near Northwest** and **Near Southeast** sectors posted positive absorption, absorbing 35,792 SF and 6,750 SF, respectively, while the **Near Southwest** sector recorded negative absorption on -19,281 SF.



12-mo Ending	Strip	Neighborhood	Community	Regional	Overall
4Q 2004	609,414	1,429,576	2,125,288	271,404	4,435,682
4Q 2005	574,325	1,659,480	696,246	-216,452	2,713,599
4Q 2006	612,223	706,940	1,026,194	-614,624	1,730,733

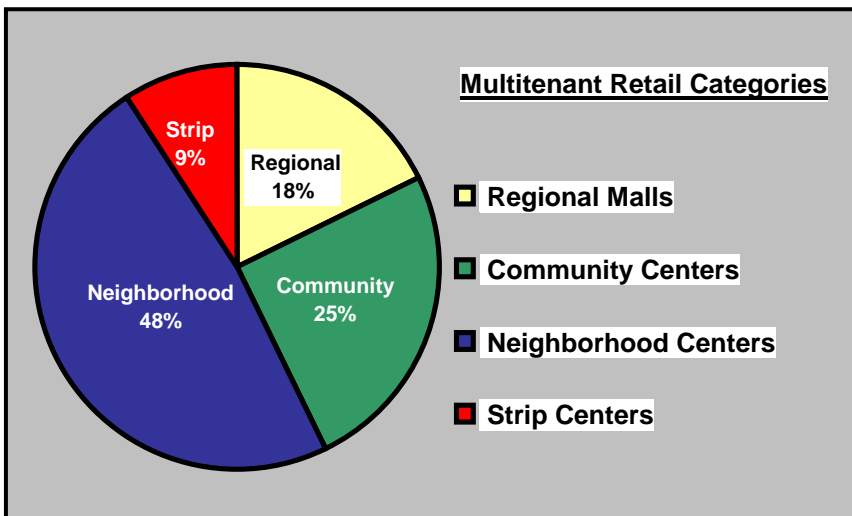
Community Centers posted the highest quarterly absorption figures of any category, absorbing 413,432 SF, bringing year-over-year absorption to 1,026,194 SF. The market was bolstered by strong figures in the **Far North** sector, which absorbed 347,319 SF over the quarter. The weakest absorption was found in the **Far Northwest** sector at -68,518 SF.

Neighborhood Centers recorded quarterly absorption of 395,436 SF. Since this time last year, the category has absorbed 706,940 SF. The strongest quarterly figures were found in the **Far North** and **Far West** sectors, posting absorption of 116,112 SF and 94,343 SF, respectively. Trailing the market was the **Near Northwest** sector, which absorbed -27,552 SF.

Strip Centers absorbed 138,341 SF over the quarter, and have absorbed 612,223 SF over the past four quarters. Demand was strongest in the **Inner Loop** sector, which recorded quarterly absorption of 40,766 SF, while the **Far Southeast** sector had the weakest absorption at -3,636 SF.

Retail Inventory

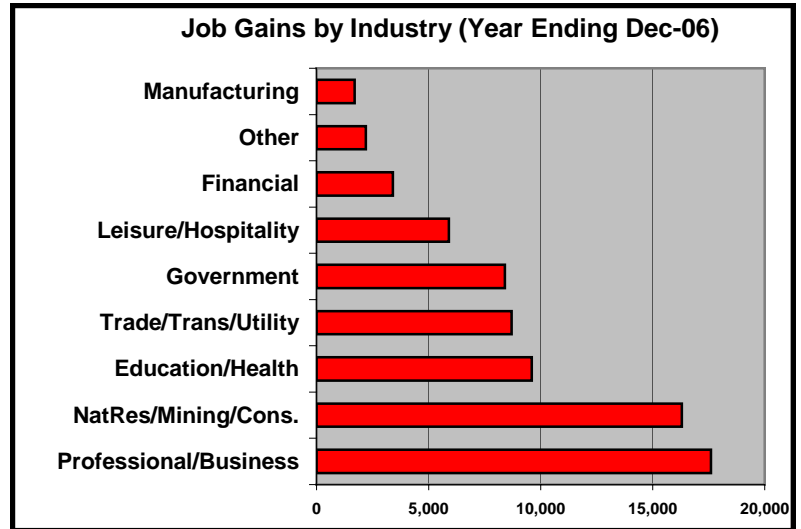
O'Connor & Associates divides multitenant retail space into four basic categories for purposes of analysis: Regional Malls, Community Centers, Neighborhood Centers, and Strip Centers. Based on the number of retail centers and square footage, Neighborhood Centers lead other categories with 48% of the 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	23,881,008
Community	145	33,962,881
Neighborhood	1,012	64,996,036
Strip	751	12,286,882
TOTAL	1,929	135,126,807

Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA declined to 4.0%, while the total number of nonagricultural wage and salary jobs increased to 2,477,200 in December 2006, according to the **Texas Workforce Commission**. This month's total is 73,100 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 17,600 jobs over the previous 12 months; Natural Resources, Mining, & Construction employment increased by 16,300 jobs; Education & Health Services is up 9,600 jobs; Trade, Transportation, & Utilities gained 8,700 jobs; Government added 8,400 jobs; Leisure & Hospitality added 5,900 jobs; Financial Activities is up 3,400 jobs; Other Services gained 2,200 jobs, and Manufacturing gained 1,700 jobs. The only industry to lose jobs over the year was Information, down 700 jobs.

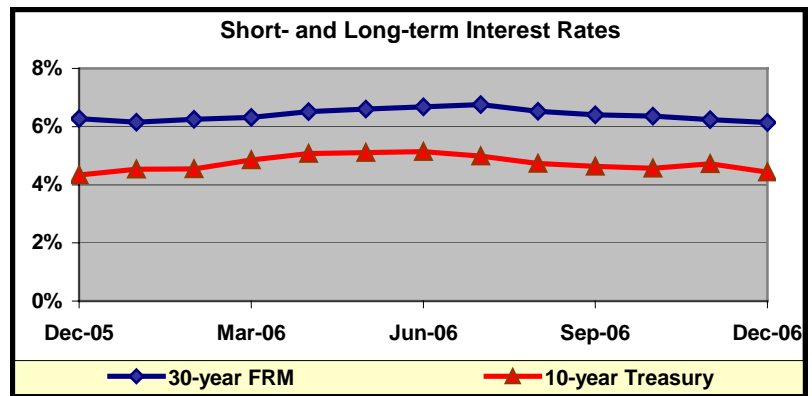


Interest Rates

The yield on the **10-year Treasury** note rose to 4.62% on January 4, 2007, up 0.26 points from its 4.36% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.14% in December 2006. One year ago, the 30-year FRM was at 6.27%. The average for the **15-year FRM** in December was 5.88%, up 0.06 points from a year ago.

The **Prime Rate** in January was reported in the Wall Street Journal at 8.25%, up 1.00 points from a year ago.



Key Indicators

The latest **Conference Board Survey** indicates that the **Consumer Confidence Index** increased to 110.3 in January 2007, up 0.3 points from 110.0, in December. 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 December to 138.0. 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 December 2006 were \$369.9 billion, an increase of 0.9% from the previous month, and up 5.4% from December 2005. Retail trade sales were up 0.7% from November, and were 4.9% 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 3.5% in the fourth quarter of 2006, up from the 2.0% growth rate recorded in the third quarter of 2006. The increase in GDP during the fourth quarter was attributed to positive contributions from personal consumption expenditures, exports, state and local government spending, 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.



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