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HOUSTON RETAIL PERFORMANCE UPDATE

EDITED BY KATHRYN KOEPKE | $499 PER YEAR | VOLUME 9 NUMBER 4 | FOURTH QUARTER 2005

Absorption Patterns

- **275,988 SF absorbed in 4Q 2005**
- **2,634,104 SF absorbed in the last 4 quarters**

Occupancy Levels

« **86.52% overall in 4Q 2005**

Rent Growth

« **Overall rents flat at $1.57 psf**

Employment Growth[1]

- **8,500 jobs gained in December 2005**
- **42,500 jobs gained since December 2004**

1. Texas Workforce Commission, 12/05 total non-agricultural jobs

Some of the most venerable names in the Houston retail landscape are passing from the scene. Foley's nameplate will disappear in 2006, along with the Heights institution, Kaplan's Ben-Hur. The local retail market, however, is nothing if not resilient. Foley's entrance into the Federated retail empire will be rebranded as Macy's, a name not entirely unfamiliar to Houstonians. Lord & Taylor is but a memory, with JCPenny to fill its Memorial City Mall store and Borders to anchor the wing it has vacated in the Galleria. Wulfe & Co. has announced plans to demolish the long-underperforming Pavilions center; word on the street is that Whole Foods will anchor the much-anticipated mixed-use redevelopment of the prominent site. A high profile lifestyle center downtown is also slated to break ground this year.

Exciting new developments have reached the suburbs, as well. Market Street and The Woodlands Mall expansion have brought an upscale, urban feel to Houston's far northern expanse, while Sugar Land Town Square and First Colony Mall expansion bring the same to Fort Bend County. A major lifestyle project is also on tap for the prime Beltway 8/SH 288 intersection. Even traditional outlying power centers are gaining a more refined look and feel, as developers have become more conscious of creating a sense of place to draw shoppers.

Challenges remain. Randalls and Toys 'R 'Us continue to struggle, closing stores and fueling further speculation. Aging malls remain troubled, although- as the recent demolition and coming rebirth of Town & Country shows- this too can be an opportunity. As consumer confidence continues to soar, we can rely on savvy retailers and developers to devise increasingly appealing locations to help shoppers spend their money.

ABSORPTION

The Houston retail market continues to post positive absorption figures, as nearly 276,000 square feet (SF) were absorbed over the quarter, bringing annual absorption to over 2.6 million SF. New shopping centers are fueling the healthy absorption, as suburban growth continues to open new retail frontiers.

Greater Houston Retail Absorption (12-month Period)

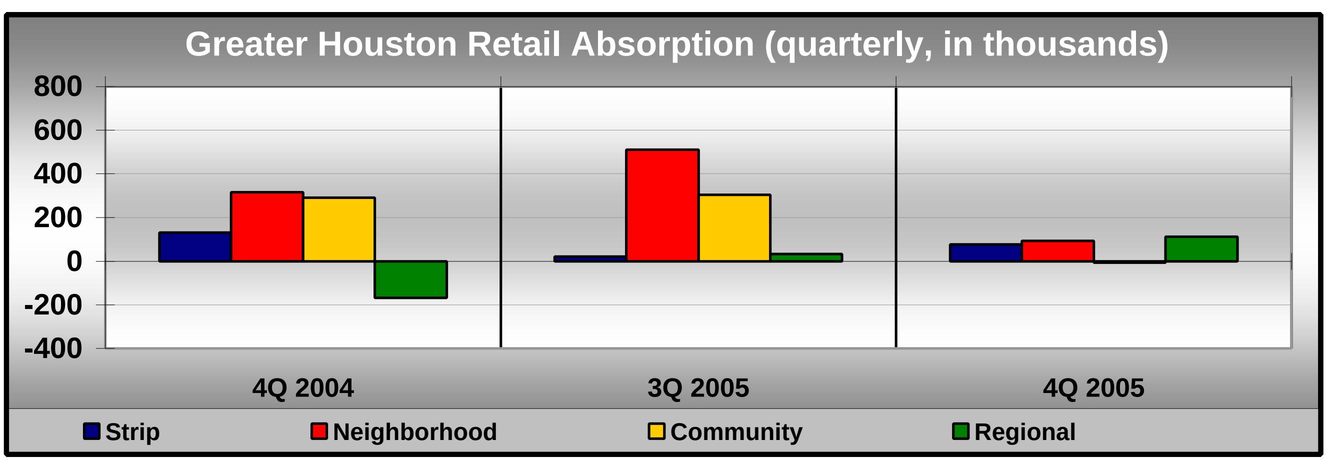
Year Ending	Strip	Neighborhood	Community	Regional	Overall
4Q 2003	842,477	2,899,444	751,732	1,020,828	5,514,481
4Q 2004	595,655	1,209,644	2,066,898	271,404	4,143,601
4Q 2005	**505,580**	**1,747,792**	**597,184**	**-216,452**	**2,634,104**

Regional Malls outperformed all retail categories over the last quarter with 112,454 SF absorbed, its strongest performance of the year. Annual absorption (-216,452 SF), however, remains in the red. The ***Near West*** sector recorded the strongest absorption with 156,845 SF absorbed, while the ***Northeast*** sector recorded the weakest with -44,392 SF absorbed.

Community Centers saw sluggish demand with -7,160 SF absorbed during the fourth quarter after two straight quarters in the red. Several sectors reported negative absorption with the ***Far Northwest*** sector trailing the market with -180,785 SF absorbed, while the ***Near Southeast*** led the market with over 115,000 SF absorbed.

Neighborhood Centers posted their seventh consecutive quarter of positive absorption with 93,556 SF absorbed, although this quarter's performance was the most tepid in nearly two years. Annual absorption stands at over 1.7 million SF, the strongest of all categories. The ***Southwest*** sector had the strongest demand with over 114,000 SF absorbed, while the ***Far West*** and ***Far Southwest*** sectors each posted negative absorption in excess of 45,000 SF.

Strip Centers continue to post positive absorption with 77,138 SF absorbed over the quarter. The ***Far North*** sector was the major contributor to the gain with 25,860 SF absorbed, followed by the ***Far Northwest*** sector, which absorbed 16,484 SF. The weakest demand was recorded in the ***Far Southwest*** sector with -5,969 SF absorbed.



OCCUPANCY

Houston area multitenant occupancy remained flat over the quarter at 86.52%, though overall occupancy remains 0.05 points above last year's level. Regional Malls recorded the only quarterly gain, offsetting losses in all other categories over the fourth quarter.

Greater Houston Retail Occupancy (Quarterly)

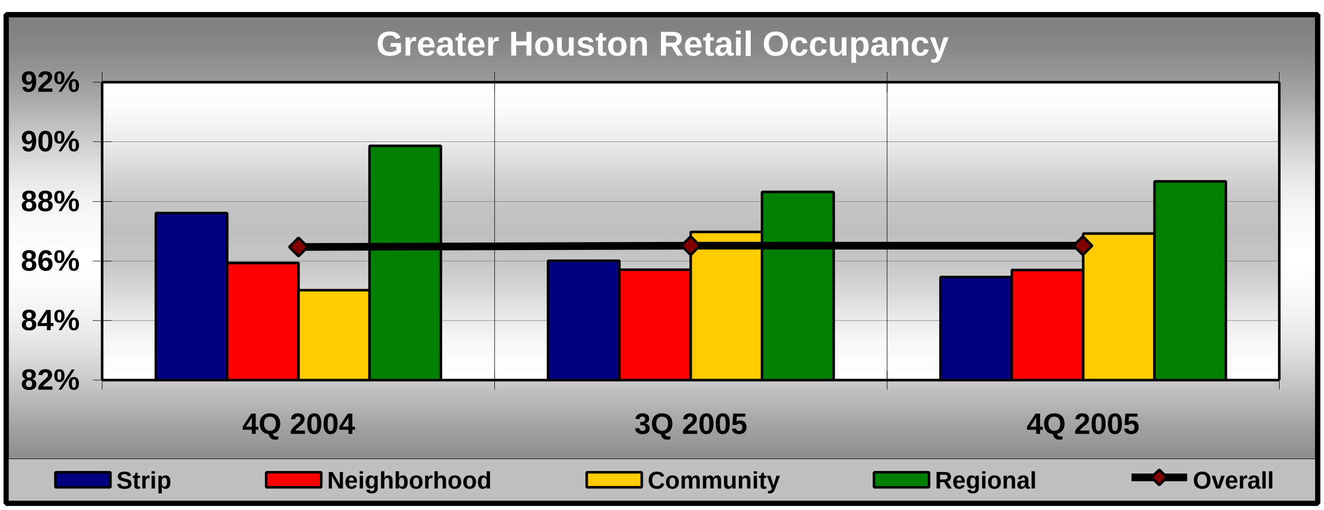
Quarter	Strip	Neighborhood	Community	Regional	Overall
4Q 2004	87.61%	85.94%	85.02%	89.86%	86.47%
3Q 2005	86.01%	85.71%	86.98%	88.32%	86.52%
4Q 2005	**85.46%**	**85.70%**	**86.92%**	**88.67%**	**86.52%**

Regional Mall occupancy increased 0.35 points over the quarter. Despite the quarterly gain, occupancy is 1.19 points below last year's level. The single mall in the ***Far Southwest*** sector, First Colony, boasts the highest occupancy at 98.50%, while the ***Near Northwest*** sector trails the market, recording an average occupancy just over 65%.

After reaching its highest level in over four years in the third quarter, **Community Center** occupancy declined slightly (0.06 points) over the last quarter. However, at 86.92%, occupancy remains 1.90 points above levels this time last year. Occupancies range from 94.36% in the ***Inner Loop*** sector to 67.78% in the ***Near North*** sector.

Occupancy at **Neighborhood Centers** dipped slightly (0.01 points) over the quarter to 85.70% and is down 0.24 points since this time last year. The ***Near Southwest*** sector posted the highest occupancy at 89.93%, while the ***Far North*** sector trailed the market at 79.41%.

Strip Centers posted the largest decrease in occupancy over the quarter, dropping 0.55 points to 85.46%. This marks the seventh consecutive quarter of declining occupancy figures for a market segment that has seen new supply outpace demand. Of the thirteen sectors, only the ***South***, ***Near Southwest***, and ***Near North*** sectors carry occupancies of 90% or higher.



RENTAL RATES

Overall rental rates were unchanged at $1.57 per square foot (psf) over the last quarter, continuing a lackluster trend. While new centers continue to come online with rents above the citywide average, same-store rents remain flat. Rents in properties built since 1990 average $1.87 per square foot, while properties built before 1990 are averaging $1.49 per square foot.

Greater Houston Retail Rental Rates (Quarterly)

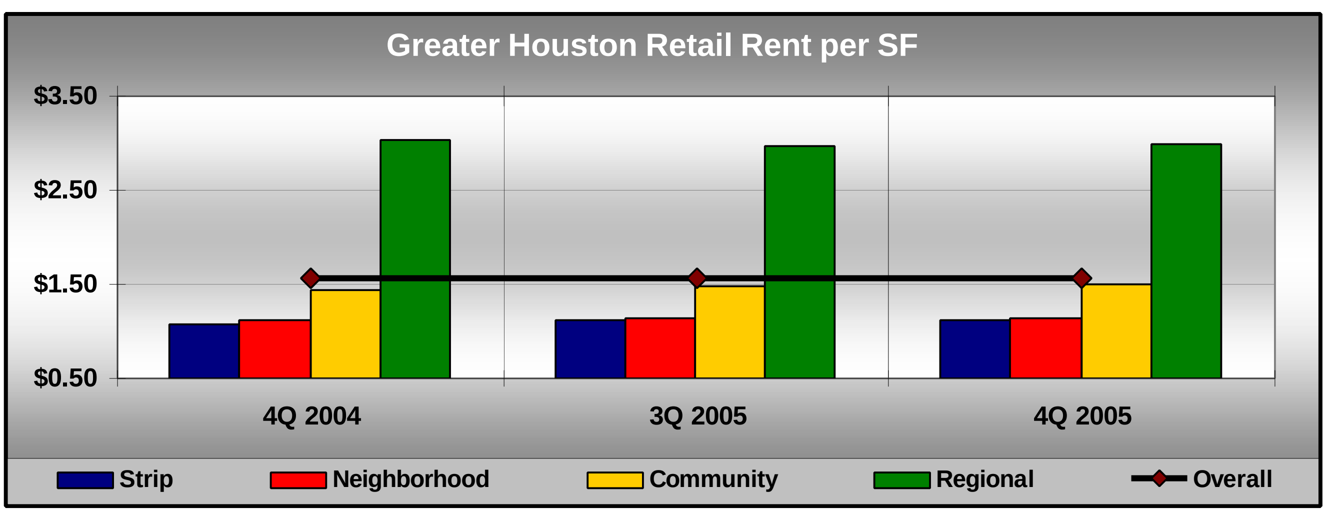
Year	Strip	Neighborhood	Community	Regional	Overall
4Q 2004	$1.07	$1.12	$1.44	$3.03	$1.56
3Q 2005	$1.11	$1.13	$1.48	$2.96	$1.57
4Q 2005	**$1.11**	**$1.14**	**$1.49**	**$2.98**	**$1.57**

Regional Mall rents picked up $0.02 over the quarter to $2.98 psf; however, they remain $0.05 below figures posted at this time last year. The ***Near West*** sector, which includes the Galleria and Memorial City Malls, boasts the highest average rents at $5.59 psf.

Community Center rents continue to slowly climb, increasing $0.01 over the quarter. At $1.49 psf, rents are $0.05 above last year’s level and are at the highest level on record. The ***Near West*** sector is commanding the highest average rental rates at $2.18 psf.

Neighborhood Center rents posted a $0.01 psf increase over the quarter, and are up $0.02 over the year to $1.14 psf. Once again, the ***Near West*** sector leads this category with average rents at $1.53 psf, while the ***Near North*** sector trails the market with average rents at $0.82 psf.

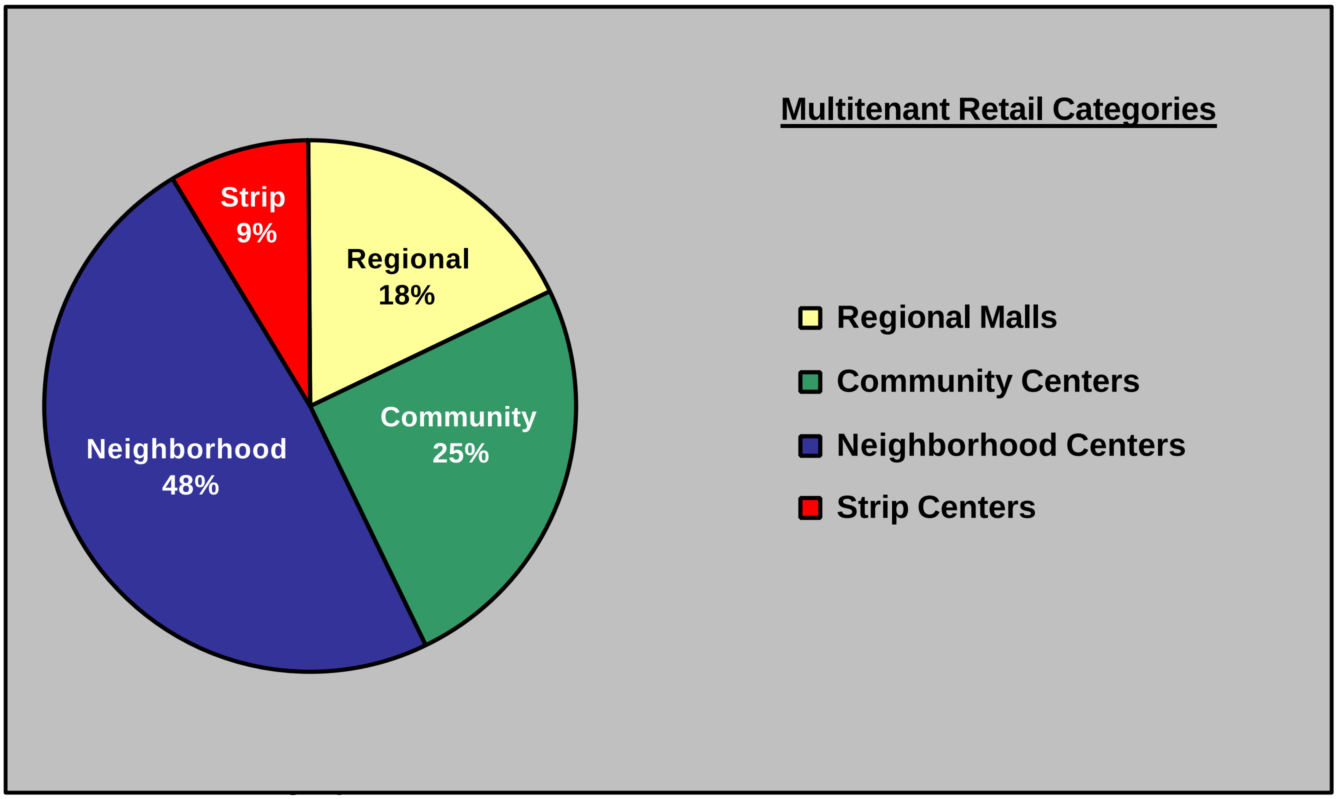
Strip Center rents remained flat at $1.11 psf this quarter, but are up $0.04 over the last twelve months. Strip centers in the ***Inner Loop*** sector are enjoying the highest average rents at $1.59 psf, follwed by the ***Near West*** sector with rents averaging $1.53 psf.



MULTITENANT RETAIL SPACE BY CATEGORY

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	Number of Centers	Net Rentable SF
Regional Mall	21	23,880,976
Community Center	139	32,578,849
Neighborhood Center	992	64,103,013
Strip Center	689	11,241,831
Total	**1841**	**131,804,669**



Regional Mall – Contains 600,000 or more net rentable square feet.

Community Center – Contains 150,000 to 599,999 net rentable square feet.

Neighborhood Center – Contains 25,000 to 149,999 net rentable square feet.

Strip Center – Contains 10,000 to 25,000 net rentable square feet.

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