

Retail Market

Excerpts from *Houston Commercial Real Estate Market: What's Ahead for 2010 Breakfast Forum* presented by Boyar Miller.

Speaker Lance Gilliam, Managing Director - Moody Rabin Interests

SOUTHEAST TEXAS

It's Not Capital, It's Income

- Consumer Income to fuel and generate retail sales

- Retail sale to pay rent

- Rent to fund debt service or rent to be capitalized to create value for a sale

- Consumers, retailers and capital markets have to have confidence in that income



Few, if any, credible sources suggest that consumer spending is poised to rebound...

- Fitch Ratings reported that retail sales from Black Friday weekend were, at best, marginal.

- The National Retail Federation reported that more people shopped but spent less money.

- "Mounting job losses, declines in wages & salaries and falling home prices prompted consumers to cut discretionary spending." Source: Wells Fargo Securities' Economics Group

- Reports from the recent Urban Land Institute Fall Meeting in San Francisco were that "not one expert was willing to predict what things will look like in 3 years other than they think it will be better." And, further, that a "...recovery will be slow. Unemployment will not drop back to more normal levels until 2013."

- Robert Bach, Grubb & Ellis' Senior Vice President & Chief Economist, included some hope in his recent Good Friday email, "The recession is over, but 2010 is not going to feel like a classic recovery. There are too many headwinds, notably lagging job creation, lingering weakness in consumer spending and tight lending conditions."

- Drew Kanaly with Kanly Trust shared the following with our peers attending Boyar Miller's breakfast last September: "Consumer spending has a long way to fall. Household balance sheet repair (more savings paying down debt) (is) likely to drive economic fundamentals over (the) next several years."

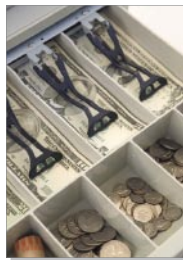
- Dr. Barton Smith included the following in the University of Houston's Institute for Regional Forecasting Houston Economic Symposium on November 5, 2009. "The Worst is Behind Us - The Wait Lies Ahead." With that framing statement, he also noted and forecast:

"job growth will begin in 2010 but not fast enough to keep the year's average from falling. Nonetheless, most sectors will show year over year job growth by fall."

"consumers continue to struggle, bargain shop only"

"retail sales would fall by 2.9% in 2009 and increase by a nominal 0.63% in 2010."

- From Wednesday's *Houston Chronicle*, "Retailing analysts at Thomson Reuters expect stores to post a 2.3 percent sales increase for November, in contrast to a 7.8 percent decline a year ago."



There is downward pressure on rents...

- "...the retail landscape will see material changes as retailers and property owners use the current environment to right size their portfolios and focus on repositioning underperforming locations. This process is healthy in the long run and will form a solid base for retail expansion as the economy rebounds... (We) work with our

client on both sides of the equation to take actions that will stabilize one another's real estate through and beyond those challenging times."

- What that means is, whatever deal you thought you had with the tenant, you don't or at least the tenant doesn't think you do.

- Requests for rent reduction and lease modifications are based on a company-wide initiative to "pay less." Today, retailers are no longer focused on growth; they are focused on profits.

- Good for the retailers' stockholders. Bad for the landlords.

NOTHING - and I mean almost "NOTHING" - needs to be built...

- Even if the capital markets would fund it, we still shouldn't build it. We need to take a step back.

- Any new construction and tenancies would likely cannibalize existing retail and restaurant sales and, as a result, further weaken existing tenants' ability to meet their current lease obligations.

- Further, the downward pressure on rent extends beyond existing leases and is very evident in conversations about new store - few of which are being constructed.

- The direction to most dealmakers is "pay less." Those numbers don't work for new construction.

- When that equilibrium returns, I do not know.

- But... retail is a competitive industry. The strong survive. The weak do not. Successful retailers and restaurateurs who are well capitalized will take advantage of their competitors' weaknesses.

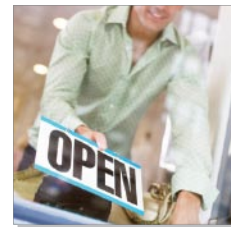
- Many retailers have remarkable liquidity. Fitch Ratings noted in a special report: The Retail Register released in September 2009 that "...liquidity is strong for the discounters as a result of solid cash flow generation. Lower capital expenditures are expected to help generate additional cash of \$1 billion each for Walmart and Target."

Limited new construction:

- Retailers', especially grocers, entries into urban markets where elevated land prices have recently posed a barrier to entry.

- Retailers' relocations to improve their location within a trade area or update the store to a current prototype.

- Smaller owner-operated retailers and restaurants and other service users.



Is it retail or is it something else?

- Look beyond reports of reports that reflect vacancy rates for "retail" or "shopping centers," in general. They overstate the problem.

- Vacancies in well-located, well-designed and responsibly owned and operated will be filled. There will be pain but the pain will pass.

- There are buildings that have significant vacancies that are "shopping centers" in name only. They no longer are or, in some cases, never were viable retail shopping environments. They are "something else."

- "Something else" represent opportunity. These projects are prime candidates for "adaptive re-use."

Reconciling Expectations... Uncertainty kills deals

- There is a wide gap between what buyers and tenants are willing to pay for properties and what sellers and landlords are willing to take for them. Until those two philosophies reconcile, completing deals will be difficult.



Office Market

Excerpts from *Houston Commercial Real Estate Market: What's Ahead for 2010 Breakfast Forum* presented by Boyar Miller.

Speaker Rudy Hubbard, Managing Director, Investment Services Group - Transwestern

SOUTHEAST TEXAS



What does this mean for Houston's future?

A Timeline for CRE Recovery 2009

- Prices fall as cap rates revert to 2002 levels
- Occupancy falls as job layoffs continue
- Rents fall as owners covet tenants
- New construction continues to add new supply
- Foreclosures increase as refinancing is precluded

A Timeline for CRE Recovery 2010

- Prices continue to fall as price discovery continues
- Occupancy falls as firms downsize staff
- Layoffs end, but downsizing continues for cost savings
- Rents fall to compete for smaller tenant base
- New projects started in 2007-08 are completed
- No new construction projects undertaken

A Timeline for CRE Recovery 2011

- Slow job growth begins to soak up space
- No new supply delivered to the market
- Rent levels stabilize at lower rates
- 2006 vintage loans fail to refinance
- Foreclosure rates decline as credit market heals
- Class A space starts to fill at expense of lesser properties

A Timeline for CRE Recovery 2012

- More rapid job growth increases absorption rate
- No new supply delivered to the market
- Rents start to rise as space starts to fill
- More foreclosures from properties bought 1H07
- Property values start to increase, anticipating positive absorption and very limited new supply

A Timeline for CRE Recovery 2013

- More rapid job growth soaks up more space
- Occupancy rate increases significantly
- No new buildings delivered to the market
- Prices continue to increase due to rising fundamentals and falling cap rates



BOYAR MILLER
ATTORNEYS AT LAW

TRANSWESTERN