

Houston Retail Market Report

Marcus & Millichap

Lower Rents Expected in City Core; Higher Vacancy in the Suburbs

Weakness in Houston's retail sector will be bifurcated this year as rents drop in high-end areas while occupancy levels remain low near suburban master-planned communities. Favorable demographics in core submarkets are attracting cash-heavy retailers that have fared well during the recession, though the amount of dark space prevalent in infill areas is creating competition for tenants. As a result, owners are lowering rents, and some big-box users, including Ashley Furniture and Nordstrom Rack, are taking advantage of concessions and tenant improvement offerings to move into desirable locations. In the Houston suburbs, where more master-planned communities exist than anywhere else in the nation, the amount of available in-line space is keeping vacancy elevated. Slower household growth resulting from a setback in the once-robust employment climate has caused hesitation among small-space retailers, while a lack of startup funding from traditional lenders is preventing new users from emerging. As traffic counts escalate and the credit markets thaw in the second half of the year, leasing activity should gain momentum.

Sales velocity will begin 2010 slowly as only owners who are forced to sell list assets. Capital will move off the sidelines as the year progresses, however, and deal flow is anticipated to peak in the fourth quarter. Nonetheless, local lenders will be the primary source of financing, with 20-year amortization requirements and a debt-service coverage ratio of nearly 1.3 forcing buyers to bring more cash to deals. As a result, cap rates for multitenant properties will rise into the high-9 percent range, though some highly sought-after assets with modest vacancy rates and room for rent growth could trade as much as 100 basis points below that level. In the single-tenant arena, cap rates may exceed 8 percent before returning to the high-7 percent range if credit becomes more easily available.

2010 Market Outlook

• **2010 NRI Rank:** 21, Up 3 Places. Healthy demand-side fundamentals, including strong employment gains and expanding retail sales, pushed up Houston three spots in this year's NRI.

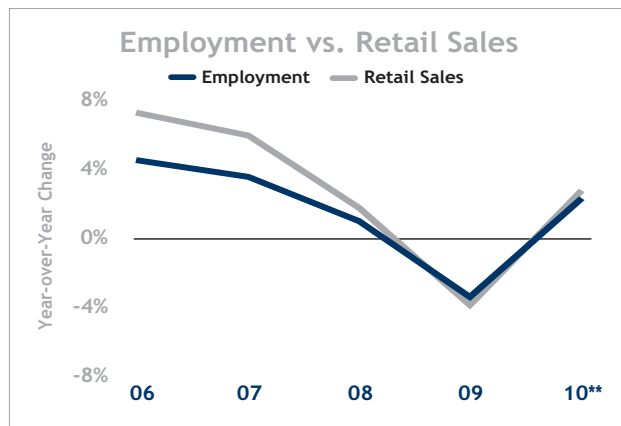
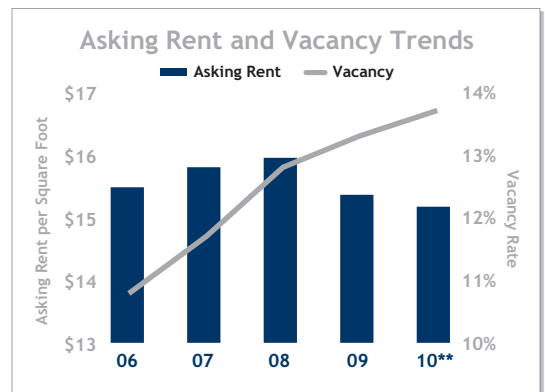
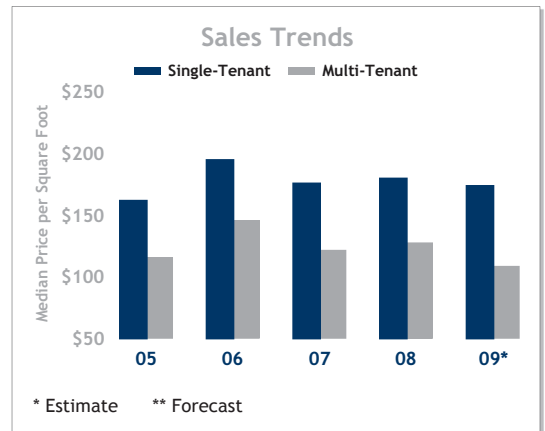
• **Employment Forecast:** The employment market is anticipated to gain steam in 2010, resulting in 54,000 new jobs, a 2.1 percent expansion in payrolls. Last year, 91,700 positions were cut.

• **Construction Forecast:** Development will fall to 1.5 million square feet this year, adding 0.6 percent to stock.

• **Vacancy Forecast:** Vacancy is forecast to peak in the third quarter before retreating to 13.7 percent by year end, 40 basis points above the rate at the close of 2009.

• **Rent Forecast:** Rent renegotiations in high-priced space will drag down asking rents to \$15.13 per square foot and effective rents to \$12.69 per square foot, annual losses of 1.2 percent and 3.6 percent, respectively.

• **Investment Forecast:** Nearly 70 percent of the new retail space delivered this year will be in the Fort Bend County submarket. The area's healthy employment market should mitigate pressure from new stock, helping to balance supply and demand metrowide by year end.



Market Forecast

Employment: 2.1% ▲

Construction: 29% ▼

Vacancy: 40 bps ▲

Asking Rents: 1.2% ▼