

HOUSTON RETAIL Market Insight

MARCH 2017

Why Has Houston Retail Continued to Flourish Despite a Less-Than-Healthy Overall Commercial Real Estate Market?

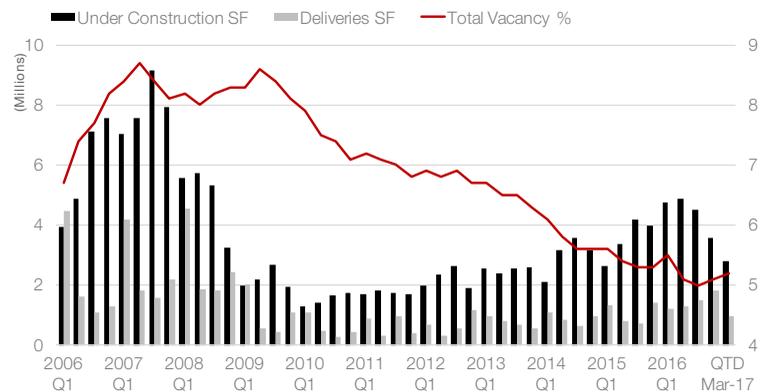
Heading into the Great Recession of 2008, the Houston metro area was looking at a glut of 16 million sq. ft. of retail space that had been delivered in the prior two years. Major retailers like Target, Walmart, and H-E-B were shifting prototype formats, catching up to consumer trends and residential shifts. In addition, there was the anticipation of almost 7 million sq. ft. per year more in the construction pipeline during the same time period.

Fast forward to mid-2014, as retail rallied, and vacancy finally dropped below 6.0%, while Houston-area home sales climbed dramatically and the need for retail space increased. This need has led to increased growth for the Houston retail and industrial sectors, which continued to exhibit positive signs even though the office sector has mostly been in decline since the oil downturn began to manifest. In fact, despite a continued rise in office vacancy rates, retail space has remained at or above 94% occupancy since the second quarter 2014.

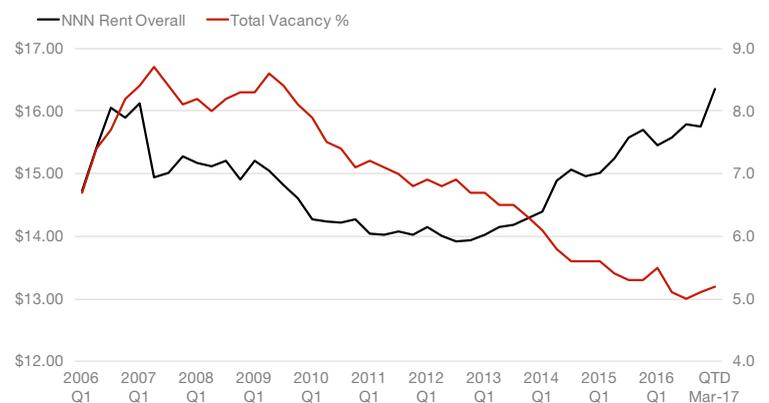
What is fueling this healthy occupancy level? Houston retail's growth during this time can largely be attributed to the fact that retail follows master-planned communities and the grocery-anchored shopping centers that come with them. Even though low energy prices and job cuts lingered in 2016, Houston is still the No. 2 homebuilding market nationally, with the greatest activity in the western suburbs, according to Metrostudy.

Even with the established Katy master-planned community Cinco Ranch having reached what many consider its full build-out, newer communities are springing up along the greater Katy area's Grand Parkway, including Newland Communities' Elyson and Johnson Development's Harvest Green. Furthermore, Houston beat its all-time record of

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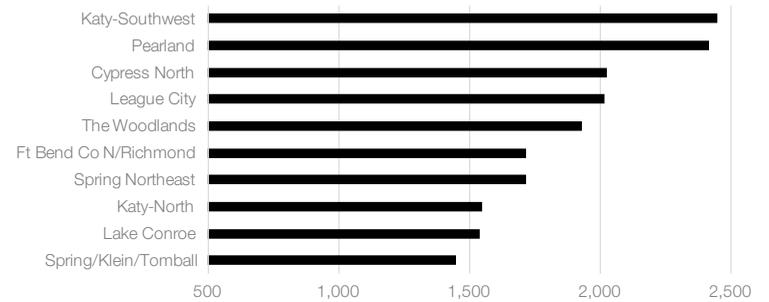
sales of new single-family homes in 2016, according to the Houston Association of Realtors, and all of those homebuyers need to be able to conveniently purchase day-to-day necessities.

In addition to a robust Houston housing market, retail fast casual chains—including restaurants like Chipotle, Panera, PDQ, and others—have exploded across the metro area; while new entertainment retail models such as Pinstripes have grown increasingly popular. The bowling and dining venue recently signed a 33,830-sq.-ft. pre-lease for its first Houston-area location, and will occupy 60% of the Kirby Collection's retail space upon completion in late 2017. Additionally, Momentum Indoor Climbing recently revealed its plans to occupy its largest footprint ever in a modified warehouse in Houston's Inner Loop; and Carvana, the "vehicle vending machine," selected Houston for its Texas debut, further contributing to the retail segment's overall health. These new concepts are all helping to meet the demand of Houston's substantial 15.2 million sq. ft. of new retail supply that has been added since third quarter 2014 when the oil downturn began.

Nearing the end of the first quarter of 2017, the tight retail market is driving up average Houston MSA asking rents to \$16.36 per sq. ft., up from \$15.76 per sq. ft. at the end of the fourth quarter of 2016. Overall, retail rates across the region range from as low as \$9 per sq. ft. to as much as \$75 for absolute sizes. While retail availability is extremely constrained across the metro, it is particularly tight inside the Loop as well as the Galleria/Uptown area, continuing a historical trend. Space is in high demand across all submarkets, and the premier centers currently have little or no availability. However, even with this high demand, retail construction activity is below the five-year average of about 3.6 million sq. ft., with 2.7 million sq. ft. in the pipeline, and much of the anchor space segments having gone to owned pieces, rather than speculative. As a result, asking rents are exceeding historical highs, on average. Currently, the Inner Loop and Galleria/Uptown areas have average rents sitting at just above \$28 per sq. ft. and occupancy levels close to 98%. While there is visible retail development activity, it remains largely led by grocers with mixed-use construction located in the far suburbs, representing almost half of the total construction at 1.2 million sq. ft.

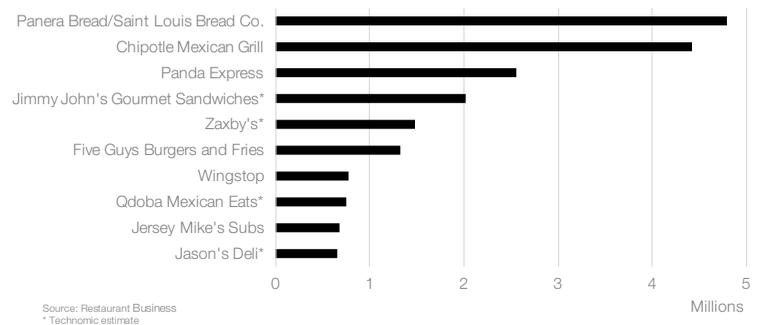
With job growth trending up and local experts believing that the worst is over, we expect retail to only continue to represent a bright spot in the Houston commercial real estate landscape throughout the conclusion of the decade.

Top 10 Houston Neighborhoods for Home Sales in 2016



Source: Houston Association of Realtors

2016 Top 500: Fast-Casual Chains U.S. Sales 2015



Source: Restaurant Business
* Technomic estimate