

Houston's retail sector healthy in Q1, but its future will be negatively impacted by COVID-19

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Retail Trends Commentary by Patrick Duffy MCR

Colliers generally uses this space to discuss the trends we see in market data and in conversations we have with our clients, prospects and friendly competitors. We take that data and attempt to project activity going forward. The bulk of the first quarter was, for all practical purposes, pre-COVID. Net "move-in" data, as well as new leases signed, were likely unimpacted for Q1 based on the virus, or only marginally impacted. Our industry has a lead time of at least 4-6 months prior to a lease being signed or space made ready for occupancy. The real impact of this COVID crisis will not present in the data until Q2 and Q3. Retail is the sector hardest hit by the economic shutdown that came from the social distancing strategy to mitigate the impacts of the virus.

Some restaurants have tried to keep revenue generation in place through curbside service and home delivery. The bulk of the traditional dine-in concepts are reporting a drop in revenue of as much as 90%. Only food and essential supply retailers have been able to maintain anything approaching normal revenue during this lockdown. Amazon has been the big winner. Smaller "mom and pop" retailers will be the hardest hit as most lack the financial reserves to weather this shutdown. A recent survey showed that most smaller retailers had only two to six weeks of cash on hand when the shutdown started. Government programs will provide some relief in the form of low-interest loans, some of which may be forgiven. The Payroll Protection Program requires that the employer maintain 75% of their payrolls for two months after the loan is given to qualify for forgiveness. Most retailers will not be able to leverage that program.

Another issue to watch is tenants unable to make rent payments, or making reduced rent payments if possible, and the impact on the owners of retail properties. There is a potential domino scenario where rent payments are delayed or lost altogether. Owners are then unable to cover their debt, and a loss of liquidity is created that could easily translate into owners being unable to fund tenant improvements and commissions for new leases. It is a little too early to tell how significant an impact this scenario will have.

Market Indicators Relative to prior period	Annual Change	Quarterly Change	Quarterly Forecast*
VACANCY	↓	↑	↑
NET ABSORPTION	↓	—	↓
DELIVERIES	↑	↑	↓
UNDER CONSTRUCTION	↓	↓	—

*Projected

Summary Statistics Houston Retail Market	Q1 2019	Q4 2019	Q1 2020
Vacancy Rate	5.7%	5.3%	5.4%
Net Absorption (SF) (million square feet)	0.7M	0.4M	0.4M
Deliveries (SF) (million square feet)	0.6M	0.8M	1.0M
Under Construction (SF) (million square feet)	3.1M	2.5M	1.7M
Asking Rents Per Square Foot Per Year			
Average NNN	\$15.68	\$16.87	\$16.71
Neighborhood Centers	\$15.39	\$15.67	\$15.25
Strip Centers	\$19.47	\$19.28	\$19.07

The above asking rents are an average of all property types and classes that are currently listed with an asking rate. This average does not include properties that are fully leased or that do not list an asking rate. Please see page 2 of this report for an expanded discussion of retail rental rates.

Commentary - continued

The good news for retail owners is that the market was very healthy at the end of Q1, with only 5.4% overall vacancy and only 1.7 million square feet under construction, the lowest number we have seen in a few years. The bad news is that there are predictions that as many as 40% of shuttered retailers will not be able to reopen. The big box national chains are lining up to file Chapter 11 bankruptcy as a vehicle to hold off creditors long enough to get up and running. They will use the bankruptcy filing to shed underperforming locations and negate the leases associated with those locations. It is very difficult in this environment to predict where the Houston retail market will be by the end of the year. Still, our best guess is that vacancy will spike to well over 12% with the failure of the smaller retailers, restaurants and, in some cases, shuttered big box tenants. This will put downward pressure on rents. How much is anyone's guess.

The lasting impact of this event is also difficult to predict but, one thing is clear, this COVID shutdown has accelerated e-retail by several years. Most retailers are going to need to accelerate their omni-channel efforts or they will not survive in the mid-term.

Vacancy & Availability

Houston's average retail vacancy rate rose 10 basis points from 5.3% in Q4 2020 to 5.4% in Q1 2020. At the end of the first quarter, Houston had 15.8M SF of vacant retail space on the market. Among the major property types, theme/entertainment and single-tenant retail had the lowest vacancy rate of 1.1% and 1.7%, respectively, followed by malls at 2.3% and Lifestyle Centers at 2.9%. Neighborhood centers have the highest vacancy rate of 9.1%, followed by strip centers with a vacancy rate of 8.7%.

Approximately 1,020,454 SF of new inventory delivered during the first quarter. There is currently 1.7M SF of retail space under construction, of which 67% is pre-leased. One of the larger projects under construction is Brookhollow Marketplace located on a former Exxon campus in northwest Houston. The Fidelis owned development is approximately 190,000 SF and 100% pre-leased. Some of the tenants that will occupy space in the center include Burlington, Michael's, Ross, T.J. Max, Old Navy, Ulta, Five Below, Rack Room Shoes and Bath & Body Works. Brookhollow Marketplace is expected to deliver in September 2020.

Rental Rates

According to CoStar, our data provider, Houston's citywide average quoted retail rental rate for all property types decreased from \$16.87 per SF NNN in Q4 2019 to \$16.71 per SF NNN in Q1 2020. These average rental rates are typically much lower than actual deal rates since they include all retail property types and classes, the majority of those properties are not well leased and are listed with discounted asking rates. According to Colliers' internal data, Class A in-line retail rental rates can vary widely from \$20.00 to \$85.00 per SF, depending on location and property type.

Job Growth & Unemployment

(not seasonally adjusted)

UNEMPLOYMENT	2/19	2/20
HOUSTON	4.2%	3.9%
TEXAS	3.7%	3.6%
U.S.	4.1%	3.8%

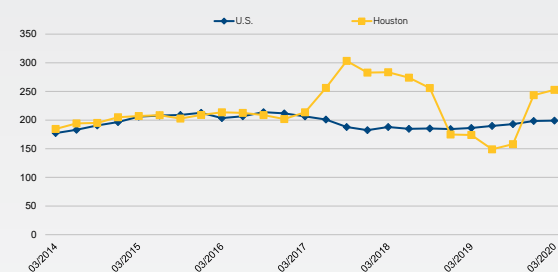
JOB GROWTH	Annual Change	# of Jobs Added
HOUSTON	2.2%	68.9K
TEXAS	2.4%	306.5K
U.S.	1.6%	2.4M

Sales Activity

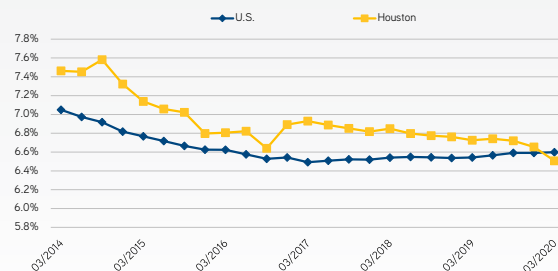
Source: Real Capital Analytics

	Q1 2020
NO. OF PROPERTIES:	28
TOTAL SF:	0.9M
AVERAGE \$/SF:	\$253
AVERAGE CAP RATE:	6.5%

Average Price Per SF



Average CAP Rate



Absorption & Demand

Houston's retail market posted 429,013 SF of positive net absorption in the first quarter, less than the 1,020,454 SF posted in the previous quarter. Some of the positive absorption can be attributed to tenants that expanded into new locations. Among those tenants are Dave & Buster's, LA Fitness, Pottery Barn Outlet, Bond Collective, Melrose, Northern Tool & Equipment and The Learning Experience.

Leasing Activity

Houston's retail leasing activity, which includes renewals, decreased 18.8% over the quarter from 1.6M SF to 1.3M SF. Looking forward, we expect leasing activity to decline during Q2 due to COVID-19. Some of the tenants that signed leases during the first quarter are listed in the table below.

Q1 2020 Select Retail Lease Transactions

BUILDING NAME/ADDRESS	SUBMARKET	SF	TENANT	LEASE DATE
Shepherd Square Shopping Center	Inner Loop	63,190	Target ¹	Feb-20
Windvale Shopping Center	North	56,911	Star Cinema Grill ¹	Mar-20
Mall of the Mainland	Southeast	50,000	Odyssey Academy ¹	Feb-20
The Village at West Oaks	West	40,000	Seismique ¹	Jan-20
Corum Station I	North	26,152	Kids Empire ¹	Jan-20
Alameda Road Shopping Center	South	13,031	Family Dollar ²	Feb-20
Katy Grand	Northwest	11,800	Gloria's Latin Cuisine ¹	Jan-20
Township Plaza I	North	11,206	Spec's ¹	Jan-20

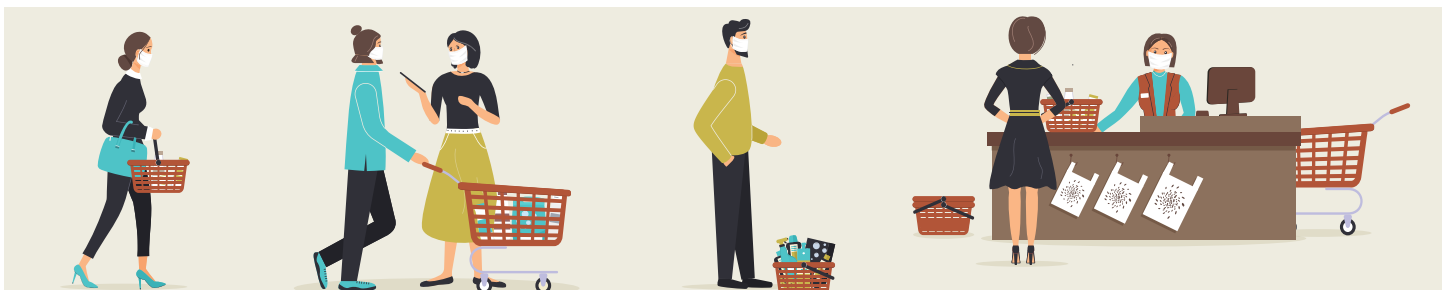
¹Direct/New

²Renewal

Market Summary

Q1 2020 Retail Market Statistical Summary

PROPERTY TYPE	RENTABLE AREA	DIRECT VACANT SF	DIRECT VACANCY RATE	SUBLET VACANT SF	SUBLET VACANCY RATE	TOTAL VACANT SF	TOTAL VACANCY RATE	1Q 2020 NET ABSORPTION	CLASS A RENTAL RATES (IN-LINE*)
Strip Centers (unanchored)	37,940,570	3,244,612	8.6%	44,734	0.1%	3,289,346	8.7%	63,960	\$27.00-\$45.00
Neighborhood Centers (one anchor)	68,928,849	6,147,070	8.9%	139,922	0.2%	6,286,992	9.1%	(114,782)	\$28.00-\$46.00
Community Centers (two anchors)	48,099,209	2,189,265	4.6%	142,642	0.3%	2,331,907	4.8%	246,346	\$28.00-\$45.00
Power Centers (three or more anchors)	29,723,722	1,798,200	6.0%	7,641	0.0%	1,805,841	6.1%	(25,729)	\$28.00-\$45.00
Lifestyle Centers	6,539,741	187,239	2.9%	1,000	0.0%	188,239	2.9%	133,520	\$40.00-\$85.00
Outlet Centers	1,166,886	62,867	5.4%	-	0.0%	62,867	5.4%	(5,485)	\$20.00-\$40.00
Theme/Entertainment	792,544	8,859	1.1%	-	0.0%	8,859	1.1%	3,500	\$25.00-\$35.00
Single-Tenant	78,810,114	1,283,452	1.6%	44,053	0.1%	1,327,505	1.7%	111,057	N/A
Malls	23,005,095	523,189	2.3%	3,397	0.0%	526,586	2.3%	16,626	N/A
GREATER HOUSTON	295,006,730	15,444,753	5.2%	383,389	0.1%	15,828,142	5.4%	429,013	\$20.00-\$85.00





Q1 2020 Houston Retail Highlights

TOTAL RETAIL
INVENTORY

295M SF



95%
OCCUPANCY

LEASING
ACTIVITY



Q1 2020	1.3M SF
Q4 2019	1.6M SF
Q3 2019	1.4M SF
Q2 2019	1.4M SF
Q1 2019	2.0M SF

CURRENT

5.4%
VACANCY

429,013 SF
NET ABSORPTION



1.7M SF

FOR MORE INFORMATION

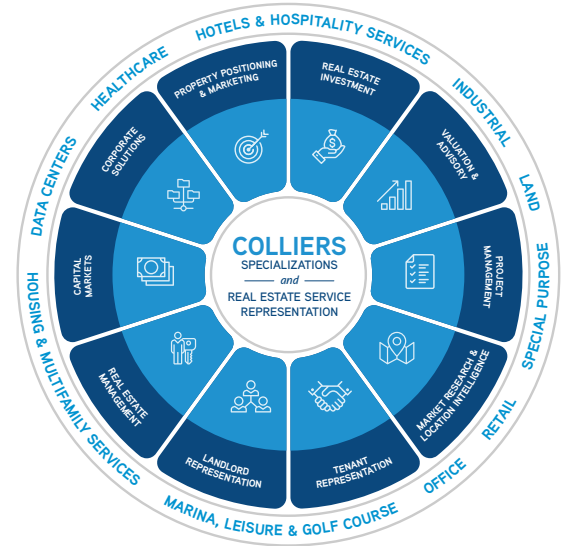
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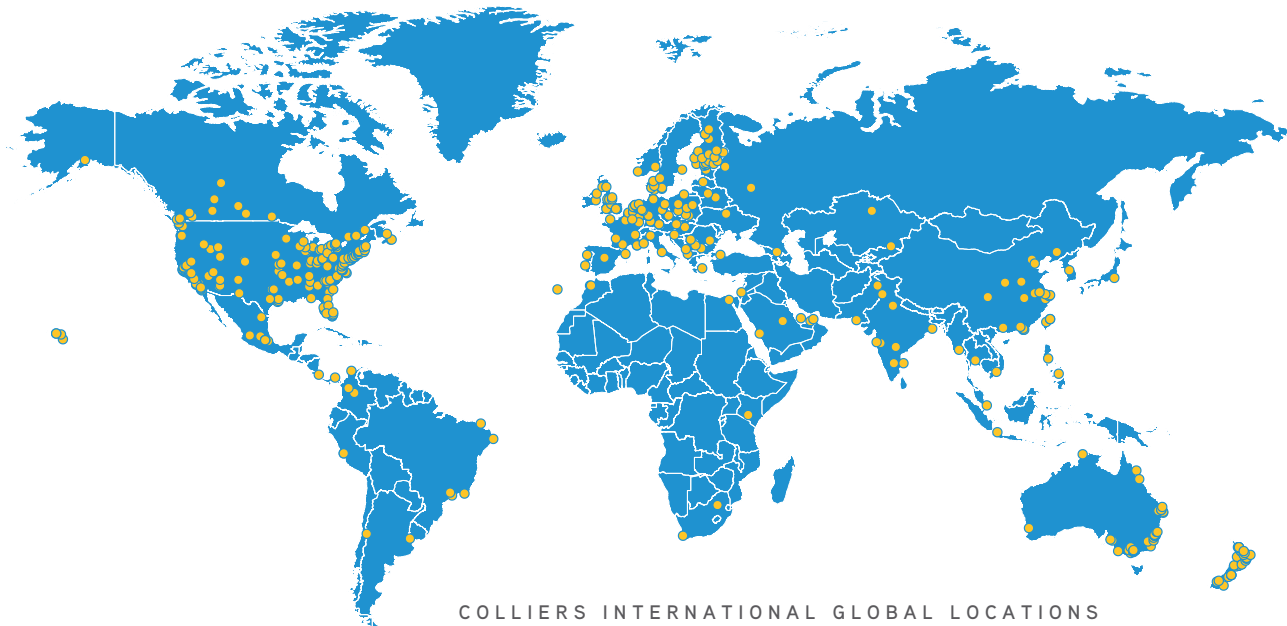
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\$129B
TRANSACTION VALUE



2B
SF UNDER MANAGEMENT



\$3.5B
IN REVENUE



443
OFFICES



18,700
PROFESSIONALS



430
ACCREDITED MEMBERS



68
COUNTRIES