

Houston's retail landlords work creatively but cautiously with vetted tenants to close the deal

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Retail Trends

Commentary by Hannah Tosch

As COVID-19 continues to press on, tenants and landlords are working on their real estate strategy for the future. Many months later, we must all now accept the fact that COVID-19 has made its permanent imprint on the real estate decision-making process. As a result of this impact, we see a discrepancy between landlord and tenant expectations for new leases. To state the obvious, the active tenants in today's market are looking for deals. Deals can come in many forms, whether it be percentage rent, step rent, flexible commencement dates, more substantial landlord concessions, etc. While it certainly is a tenant's market right now, the tenant does not necessarily hold all the cards. Based on what Colliers sees in the Houston market, there is a misconception that the tenant is entirely in the driver's seat. What is not evident is that most landlords are not desperate for just any deal put in front of them. In fact, their approach proves to be far from that.

The majority of the real panic around COVID-19 has mostly settled, and landlords are no longer making rushed decisions to keep their centers full. In fact, many landlords are becoming extra cautious about which tenants they allow in their centers. We see stronger landlord involvement in vetting and interviewing prospective tenants. Landlords want to know a tenant's marketing plan, how they intend to achieve success and how their other locations are performing. Of course, these are all boxes they have always checked, but not quite to this degree. They need to know that a prospective tenant is substantial and qualified.

Not only are landlords becoming more methodical on who they allow in, but many are actually more interested in short-term leases to give themselves more flexibility for the future. Brokers are getting creative in structuring deals right now, especially when talking about rent for the beginning of the term. Of late, we have often seen percentage rent at the beginning of the lease term in order to get tenants comfortable enough to move forward. While this structure is often bridging the gap to make deals, this is not something a landlord would want to entertain long-term.

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

*Projected

Summary Statistics Houston Retail Market	Q3 2019	Q2 2020	Q3 2020
Vacancy Rate	5.3%	5.9%	6.1%
Net Absorption (SF) (million square feet)	1.0M	-1.4M	0.08M
Deliveries (SF) (million square feet)	1.2M	0.4M	0.4M
Under Construction (SF) (million square feet)	2.7M	1.6M	1.6M

Asking Rents Per Square Foot Per Year	Q3 2019	Q2 2020	Q3 2020
Average NNN	\$16.65	\$17.36	\$16.78
Neighborhood Centers	\$15.87	\$15.43	\$15.76
Strip Centers	\$19.35	\$19.31	\$19.35

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

A landlord wants to feel 100% confident that their tenant will succeed before signing a lease. There is little room for error right now after what landlords have been dealing with over the past eight months. The landlord cannot afford to invest capital and resources into a new tenant space, only for them to fail in a few years. Therefore, the new deals that are being made are happening with strong vetted tenants. Ultimately, this will allow for an unprecedentedly sustainable retail market with fewer closures, stable tenants with robust business plans, and eventually fewer vacancies, which might drive rents up again in the coming years.

Vacancy & Availability

Houston's average retail vacancy rate rose 20 basis points from 5.9% in Q2 2020 to 6.1% in Q3 2020. At the end of the third quarter, Houston had 18.2M SF of vacant retail space on the market. Among the major property types, Theme/Entertainment, Single-Tenant retail and Malls had the lowest vacancy rates of 1.0%, 2.2% and 2.8%, respectively, followed by Lifestyle Centers at 3.6% and Power Centers at 5.1%. Neighborhood centers have the highest vacancy rate of 10.6%, followed by strip centers with a vacancy rate of 9.7%.

Approximately 393,500 SF of new inventory delivered during the third quarter and currently there is 1.6M SF of retail space under construction, of which 58% is pre-leased. One of the larger projects under construction is a Life Time Fitness located at 9000 Six Pines Drive in the Montgomery County submarket. The development is expected to deliver in April 2021.

Rental Rates

According to CoStar, our data provider, Houston's citywide average quoted retail rental rate for all property types dropped from \$17.36 per SF NNN in Q2 2020 to \$16.78 per SF NNN in Q3 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.

Absorption & Demand

Houston's retail market posted 80,417 SF of positive net absorption in the third quarter. The retail sector posting the largest amount of positive absorption in Q3 2020 was Power Centers, with 190,160 SF of positive net absorption. Neighborhood Centers recorded the largest amount of negative absorption posting 237,600 SF of negative net absorption. Neighborhood centers usually have one anchor and the balance of the center is occupied by smaller retailers offering services from nail salons to casual dining.

Job Growth & Unemployment

(not seasonally adjusted)

UNEMPLOYMENT		
	8/19	8/20
HOUSTON	4.1%	8.1%
TEXAS	3.7%	7.0%
U.S.	3.8%	13.9%

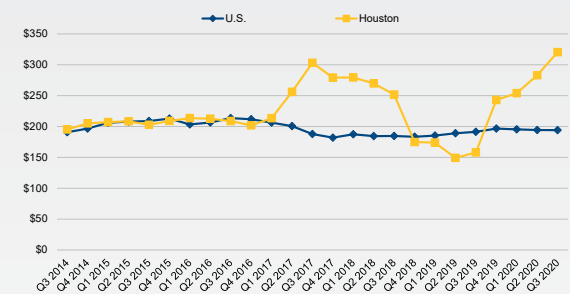
JOB GROWTH		
	Annual Change	# of Jobs Lost
HOUSTON	-5.8%	-182.8K
TEXAS	-4.9%	-628.8K
U.S.	-6.9%	-10.4M

Sales Activity

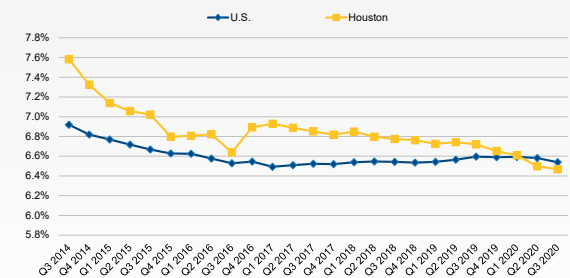
Source: Real Capital Analytics

	Q3 2020
NO. OF PROPERTIES:	16
TOTAL SF:	4.1M
AVERAGE \$/SF:	\$320
AVERAGE CAP RATE:	6.5%

Average Price Per SF



Average CAP Rate



Leasing Activity

Houston's retail leasing activity, which includes renewals, rose 4.3% over the quarter from 1.0M SF in Q2 2020 to 1.1M SF in Q3 2020. Looking forward, we expect leasing activity to remain flat through year-end. Some of the tenants that signed leases during the third quarter are listed in the table below.

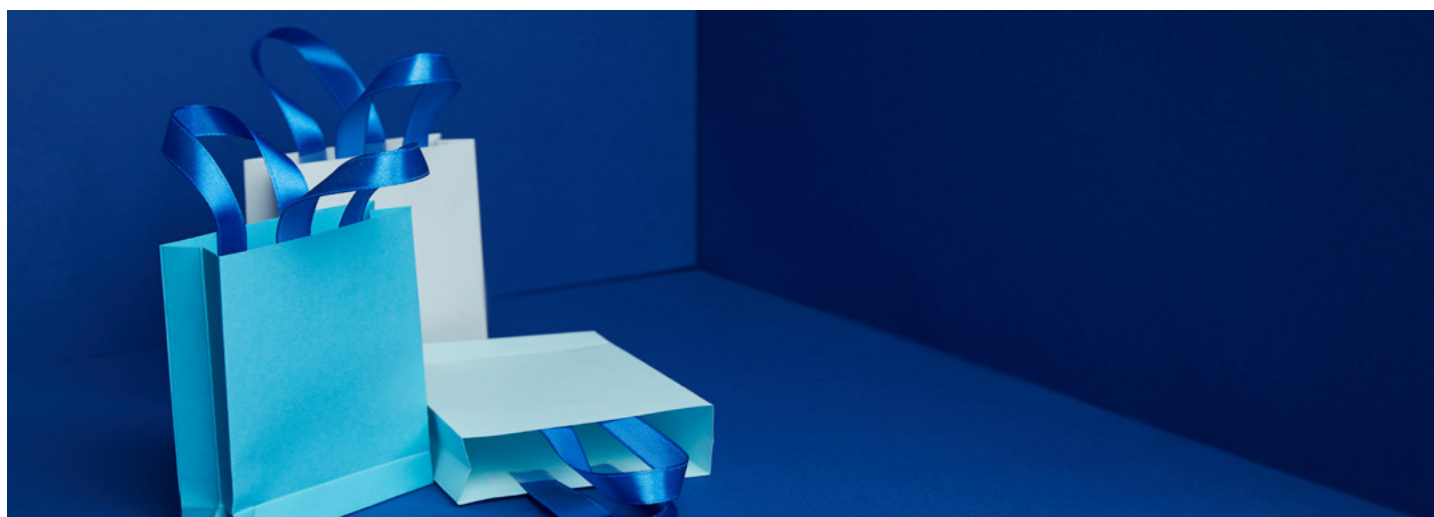
Q3 2020 Select Retail Lease Transactions				
BUILDING NAME/ADDRESS	SUBMARKET	SF	TENANT	LEASE DATE
Spring Village Center 1	North	20,000	Rowdy's ^{1,2}	Aug-20
Fondrenwood Shopping Center	Southwest	15,000	Black Friday Deals ¹	Aug-20
Fairway Plaza	Southeast	11,998	La Michoacana Meat Market ¹	Jul-20
Almeda Crossing	Southeast	10,481	52 Card Poker ¹	Aug-20
Waterside Commons	Southwest	10,159	Dollar Tree ¹	Jul-20
Fairway Marketplace	Southeast	9,590	Spirit Halloween ¹	Aug-20
Cullen Boulevard Shopping Center	South	9,000	Jolla Bella 3 ¹	Sept-20

¹Direct/New

²Colliers Transaction

Market Summary

Q3 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	3Q 2020 NET ABSORPTION	CLASS A RENTAL RATES (IN-LINE**)
Strip Centers (unanchored)	38,310,962	3,687,943	9.6%	24,832	0.1%	3,712,775	9.7%	41,060	\$25.00-\$42.00
Neighborhood Centers (one anchor)	68,747,874	7,162,504	10.4%	112,996	0.2%	7,275,500	10.6%	(237,600)	\$28.00-\$46.00
Community Centers (two anchors)	47,846,251	2,703,903	5.7%	140,268	0.3%	2,844,171	5.9%	(3,251)	\$28.00-\$45.00
Power Centers (three or more anchors)	29,991,140	1,494,232	5.0%	46,620	0.2%	1,540,852	5.1%	190,160	\$28.00-\$45.00
Lifestyle Centers	6,695,527	240,555	3.6%	-	0.0%	240,555	3.6%	(68,591)	\$40.00-\$85.00
Outlet Centers	1,321,772	82,654	6.3%	-	0.0%	82,654	6.3%	(27,129)	\$20.00-\$40.00
Theme/Entertainment	717,303	7,238	1.0%	-	0.0%	7,238	1.0%	-	\$25.00-\$35.00
Single-Tenant	83,699,603	1,740,575	2.1%	118,582	0.1%	1,859,157	2.2%	177,268	N/A
Malls	22,148,960	618,767	2.8%	3,397	0.0%	622,164	2.8%	8,500	N/A
GREATER HOUSTON	299,479,392	17,738,371	5.9%	446,695	0.1%	18,185,066	6.1%	80,417	



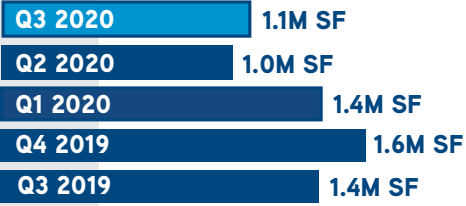


Q3 2020 Houston Retail Highlights

TOTAL RETAIL INVENTORY **299.5M SF**



93.9%
OCCUPANCY



CURRENT
6.1%
VACANCY

80,417 SF
NET ABSORPTION



UNDER CONSTRUCTION
1.6M SF

FOR MORE INFORMATION

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