Q1 2017

Retail Insight

Houston

Market expected to normalize in 2017 as supply finally catches up in growth cycle

- Region's largest grocers innovate and evolve to stay in front of consumer preferences
- Construction activity declined for third consecutive quarter as supply and demand began to rebalance
- Vacancy and availability inched up in the first quarter but remained well below long-term averages

Grocery chains are modernizing to keep pace with the evolving consumer landscape, resulting in significant changes to store offerings and footprints. In a major announcement, Target has selected the Houston suburb of Richmond as the first to receive a completely redesigned concept. The company will be testing several distinctive features at the new location for potential roll-out across the U.S. This is not a one-off example as major Texas operator HEB has been a long-time innovator in the market, recently incorporating unique, sit-down restaurants in many locations and successfully utilizing neighborhood demographics to its advantage. Grocery redevelopment efforts are focusing on experiential retail to keep shoppers connected and engaged with physical stores in the age of ecommerce and grocery delivery.

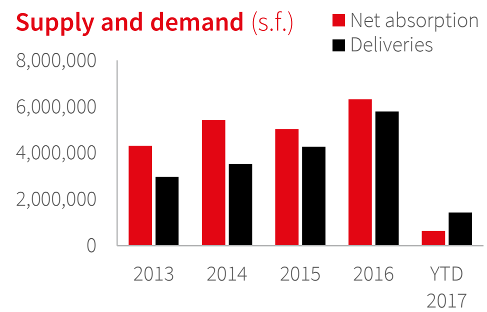
Continued tightness from an occupancy standpoint, coupled with rising land prices, is causing retailers to seek new ways to enter the Houston market. In urban areas, tenants like specialty grocers are getting creative with their concepts and partnering with multifamily developers early in the process to design ground-floor spaces in new multistory projects. The trend, already occurring in metros across the U.S., has been gaining traction in Houston of late. While vacancy and availability did rise across Houston in the first quarter, they are well below their respective 10-year averages.

Outlook

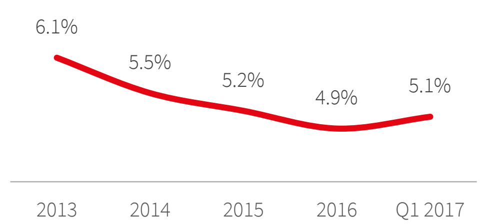
Net absorption has consistently outpaced deliveries in recent years as tenant appetite for new retail space was off the charts. But the tide is beginning to shift. After a red-hot growth cycle from 2014-2016, construction activity is beginning to normalize, falling to 2.7 million square feet in the first quarter. Demand will likely temper in 2017 as a weak office market impacts the sector, though indicators continue to point to a healthy level of growth for retail.

Fundamentals	Forecast
Total inventory	340.9 m.s.f. ▲
YTD net absorption	628,160 s.f. ▲
Under construction	2,652,204 s.f. ▼
Total vacancy	5.1% ▶
Average asking rent (NNN)	$17.00 p.s.f. ▲

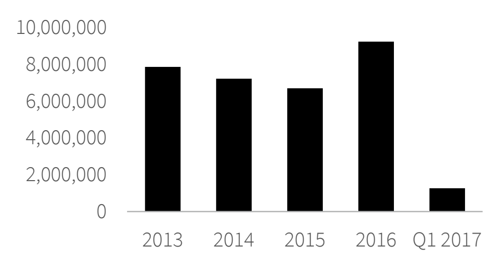
Supply and demand (s.f.)



Total vacancy



Leasing activity (s.f.)



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