HOUSTON POSITIONED FOR STRONG RETAIL GROWTH IN 2017

Light at the End of the Tunnel

While covering a recent CREW luncheon, the Houston Business Journal quoted Jim Gaines—chief economist at the Texas A&M University Real Estate Center—with six magic words: "The downturn seems to be over." Music to the ears of hardworking Houstonians, his words of optimism ring in the new year. Houston's retail sector continues to see strong activity amid what has been a generally down commercial real estate market over the past two years in most industry sectors. As low oil prices have impacted commercial activity, notably in the office market, retail has seen new construction numbers rivaling the good years of 2005 – 2007. 2017 proposes to be no different, with retail construction continuing at a pace not seen in a decade.

Population Growth Drives a Strong Retail Sector

As the retail industry was greeted in the first week of the new year with news of more Macy's, Sears, and KMart closings, most retailers shared good news, experiencing one of the highest overall holiday retail sales increases since 2005. This should continue to sustain the retail development boom in our market. Buoyed by continued job growth and relatively low cost of living, Houston's population is growing at a pace unmatched by most major metros across the country. Retailers generally follow rooftops. Because of the continued population growth of the metropolitan area, Houston's retail sector has been able to weather the recent storms felt by our other commercial real estate sectors. National retail chains headquartered in California and other places outside of Texas are often shocked to see the amount of quality, fundamentally sound retail development that our market has sustained over the past couple of years. With approximately 132,000 people added to the Houston metropolitan population over the course of 2016, our market continues to be an attractive target for retailer expansion.

East Side is the Right Side

Long the stepchild of the Houston commercial retail sector, the fortunes of the east side have risen significantly in recent years. Houston is currently a tale of two economies—east vs. west, upstream vs. downstream. I first saw the upstream vs. downstream dynamic described by Bill Gilmer—Director, Institute for Regional Forecasting at University of Houston's C.T. Bauer College of Business—in a post entitled "Upstream Bust Meets Downstream Boom In Houston: The East Side Earns Some Respect" (published online by Forbes December 2015). While the lower oil prices have led to workforce reductions on the upstream side of the energy industry, the downstream side has picked up the pace with cheaper product and abundant raw materials. This has led to increased job growth, more retail dollars in the pockets of consumers, and better retail options on the east side than ever before.

For example, in the roughly ¾ mile stretch along Garth Road between Interstate 10 and Hunt Road in Baytown there are three new retail projects in various stages of planning and development. Gulf Coast Commercial recently completed a new Kroger Marketplace shopping center that includes Marshalls, Ulta, Petsmart, and now a new Burlington to go with the existing Academy Sports & Outdoors. Stream Realty Partners has made a deal with H-E-B and are currently working on a junior anchor lineup to go with the grocer. And Fidelis Realty Partners closed on San Jacinto Mall last year with plans to partially demo and partially redevelop the mall, bringing new retailers to the site and trade area. Additional projects on the far east side of the Houston Metro include a new Walmart and ShowBiz Cinema on the east side of Baytown developed by NewQuest Properties, as well as a planned H-E-B shadow anchored power center scheduled to kick off in Mont Belvieu in 2018. Multiple junior anchors are in discussions with Fidelis Realty Partners, the developers.

The Fairway Plaza and Fairway Centre developments by Trammell Crow Company more than 15 years ago proved that first class retail centers can not only survive, but thrive in markets with a sizeable blue-collar component. The strength of retailer sales and the recent spate of new commercial developments in Baytown are proving that again. In Deer Park—an area also long underserved for retail—a new H-E-B opened last year and should soon be joined by multiple junior anchors as Weitzman/Cencor work on development plans for their site at the NE corner of Spencer and East Blvd.

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A little bit closer in, Fidelis Realty Partners recently opened the first phase of a 500,000 sf plus power center called Westlake Marketplace at Beltway 8 and W Lake Houston. Anchored by Kroger Marketplace, Ross, Marshalls, Old Navy, Ulta, Burlington, Michaels, and Petsmart, the project continues to add retail mass to the intersection that began with Property Commerce's H-E-B development years back. The northeast quadrant of the Beltway has received a lot of attention in recent years. Attractive master plan communities such as Fall Creek (a Johnson Development community) and Summerwood (a Newland Communities project) have spurred substantial population growth on the northeast side. Add in the major daytime population being added by McCord Development's Generation Park (FMC's new campus, additional office buildings, as well as future campuses for San Jacinto College and Lone Star College) and the northeast quadrant is in a development boom right now.

To the south of Westlake Marketplace, NewQuest Properties is in the initial planning phases of a major power center to be named New Forest Town Center, located at Beltway 8 and Hwy 90. This will be a multiple junior anchor development that will capitalize on the success of the two earlier developments at Beltway 8 and Wallisville just to the south (New Forest Crossing and Shops at Stone Park). The project, along with the new ShowBiz Cinema in BPI's project at the opposite corner, will bring multiple retailers to the trade area that do not yet have a presence in the market. Again, the success of the centers at Wallisville Road has proven the strength and spending power of the east Houston population.

Optimism for 2017 and Beyond

With a strong batch of development that kicked off all over the metropolitan area in 2016, and numerous grocery anchored and power centers planned for 2017 and 2018, Houston retail should continue to flourish. Discount general merchandise and "off price" clothing retailers such as Ross and TJX Companies continue to see high single digit and low double digit comps at most of their stores. New entries to the Houston market such as Dick's Sporting Goods, Total Wine, H&M, Aldi, and others continue to fuel new development. And the drivers for power center development have begun to change. While there are a couple of new Target and Wal-Mart anchored shopping centers under development in our market, more and more power centers are now being kicked off by massive hybrid grocer stores such as the 123,000 sf Kroger Marketplace stores and the large format H-E-B stores.

On the upscale side of the retail spectrum, new high-end retail projects such as River Oaks District have joined the Galleria Mall and existing lifestyle centers in introducing retailers to Houston that our market has never seen. The spending power of the upper class Houstonian coupled with an influx of wealthy international consumers has created a demand for high dollar retail options previously unimagined in our "muddy boots" market. If the retail sector can continue to thrive during the current malaise in the energy industry, when the oil prices come back Houston should be well positioned to continue positive retail growth throughout the current decade.

RETAIL FORECAST 2016

Category	Matt Reed - NewQuest Properties
Retail Inventory	369,830,000
Net Absorption	4,650,000
Occupancy Rate	94.7%
Asking Rental Rate PSF Anchored Center Space (>20,000 SF)	$16.67
Category	$165.25