

# Texas Retail Roundtable

Retail real estate professionals from across the state discuss the industry's performance in 2010 compared to last year, and what they foresee in 2011

By Daniel Beard

Retail in Texas is improving ahead of the rest of the nation. Texas Real Estate Business recently spoke with several retail real estate executives in the state to get their impressions of the market. Participants were: Bryan Cornelius, partner, Venture Commercial Real Estate; Daniel Harris, senior vice president, Henry S. Miller Brokerage, Retail Division; Gar Herring, president, The MGHerring Group; Gavin Kam, president, Net Realty Advisors; Tim McNutt, director of leasing and sales, Bright Realty; Eric DeJernett, senior vice president, CB Richard Ellis — Austin; Chris Ellis, managing principal, Endeavor Real Estate Group — Austin; Keith McRee, vice president, NAI REOC — San Antonio; John Wright, associate, CB Richard Ellis — San Antonio; Shawn Ackerman, executive vice president, Henry S. Miller Brokerage, Retail Division; Jason Baker, co-founder and principal, Baker Katz; Jerry Goldstein, senior director — National Retail Group, Marcus & Millichap; Matthew Keener, senior vice president — Retail, CB Richard Ellis; Randy Summers, vice president, Davis Equity Realty — Rio Grande Valley; Steve Rogers, J Gaut — Amarillo; Scott Walker, director of leasing, MIMCO — El Paso; and Gary Davis, president, First Advisors.

## Dallas/Fort Worth

From the Dallas/Fort Worth Metroplex, the following professionals participated in the roundtable discussion: Bryan Cornelius, Partner, Venture Commercial Real Estate; Daniel Harris, Senior Vice President, Henry S. Miller Brokerage, Retail Division; Gar Herring, President, The MGHerring Group; Gavin Kam, President, Net Realty Advisors; and Tim McNutt, Director of Leasing and Sales, Bright Realty

TREB: What is the current state of retail activity in Dallas-Fort Worth?

Cornelius: We are seeing good retail activity in the Dallas-Fort Worth market and although retailers are still being cautious, they will continue to open new stores in this market. The most active retailers right now are in the

discount category. There has been an increase in market planning activity from retailers, which would indicate a push for store openings in 2011 and 2012. The most active sector in our market is grocery stores. Kroger, Tom Thumb, Save-A-Lot, Aldi and neighborhood Walmart grocery stores are all actively opening stores. Walmart has been active with Walmart Super Centers as well.

The quick serve and fast food restaurants are also still active in this market. This includes In N Out Burger, Carl's Jr., Mooyah Burgers, SmashBurger, Panda Express and Chipotle. Full service restaurants have been active as well, such as Logan's Road House, BJ's Brewery, Olive Garden and Red Lobster.

Harris: Retail leasing remains relatively flat in the Dallas-Fort Worth Metroplex, with mostly positive absorption in Class A anchored centers offset by continuing vacancy loss in Class B and C centers, but this is expected to stabilize by year's end or into the first quarter 2011. Empty Class B and C big box centers will continue to struggle with vacancy until replacement anchors can be found to increase draws in traffic.

Herring: We are fortunate to be located in North Texas where the market has fared much better than other areas of the country. We are finding that while retailers are opening fewer stores, they continue to recognize Dallas-Fort Worth as one of the strongest retail markets and are still expanding in our area.

Dillard's opened this March at our project, The Village at Fairview, and it is one of only two new stores that Dillard's opened this year. Whole Foods Market will open in November. In addition, several retailers in the Best Southwest area (cities of Cedar Hill, Duncanville, Lancaster and Desoto) have relocated to our Uptown Village at Cedar Hill project within the past year. These retailers include Justice, The Children's Place and Old Navy, which built its newest prototype store at Uptown Village.

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**Kam:** From an investment sales perspective, the market has picked up significantly over the past few months. There is a shortage of high quality single tenant properties, especially those absolute net leased to credit tenants. With interest rates low, the returns are attractive when compared to similar credit bonds and other fixed income investments.

**McNutt:** There is little doubt that retail has suffered over these last 2 years of economic recession. Texas has been stronger than the national market but we have seen a significant slowdown in our market. Sales tax revenues are up over 2009 so we can claim modest growth over historic lows this year. Consumer confidence continues to struggle and until job growth continues, I believe it will be a much softer market for the next year. However, there are signs of optimism and an increase in activity in local and regional tenants making opportunist efforts to gain market share.

**TREB:** What retail leasing/development trends have surfaced during the economic downturn?

**Cornelius:** Landlords tried to hold rents where they were the last few years, but just recently we have seen developers get more aggressive to fill vacant space. Also, landlords have gotten more creative in marketing their properties and are becoming more broker-friendly with respect to fees and leasing bonuses. Another trend is the landlord's willingness to give free rent in lieu of tenant improvement allowances, sometimes as much as 6 to 12 months of free rent.

**Harris:** The heavy amount of active term rent reduction negotiations between tenants and landlords has dissipated to a great degree, reflecting renewed confidence that by both sides of the economy and sales have stabilized, and will slowly improve. Strong leasing activity with discount and value-added retailers continues. Leasing to non-traditional tenants such as office users or even warehouse users has seen an uptick during this downturn.

Some other trends of note are the increased use of retail centers for dental and medical users, and a fairly strong increase in percentage of restaurants occupying former retail space. Payday loan and pawn shops continue to thrive and grow in the downturn. Temporary concept store leases in malls are also popping up with landlords finding creative ways to fill spaces and structure novel leases. New retail development has, for the most part, come to a halt during this downturn with the majority of development seen in the remaining completion of high profile power centers. Alliance Town Center, The Village at Allen and The Village at Fairview are examples of this.

**Herring:** Retail projects that have sustained throughout the economic downturn are opening in phases. In addition, some developers are finding alternative and creative uses for additional space, which benefits both the shopping center and the community. For example, The MGHerring Group has incorporated many community features in our development of The Village at Allen, The Village at Fairview and Uptown Village at Cedar Hill. We recently opened a community garden and beach area with sand volleyball courts and kids' play area at The Village Fairview. A 10-acre park is opening in November.

The benefits of these community features are two-fold. We want our shopping centers to serve as gathering places for the community, which is why we offer much more than just shopping and dining. Residents view the shopping center as their own when they can bring their kids to play in the park or the interactive fountain, take their dog to the onsite dog park, plant their own vegetables in the community garden, and attend free events with friends and family.

Retailers have become more conservative in their expansion plans, but they are still opening new stores, particularly in markets such as Dallas-Fort Worth where retail activity is outperforming other regions of the country. Retailers are selecting shopping centers with solid anchors and prominent locations in markets with strong demographics for population and income growth.

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McNutt: New development has for all practical purposes stopped. Reasonable credit and financing is almost non-existent. The Federal Reserve continues to attempt to rectify the uncertainty in the market but very little clarity has manifested as a result of those efforts. Those projects that were ramping up in 2007 have been difficult to lease up. Navigating the waters where tenants and landlords expectations are very far apart has resulted in all deals taking much longer than in previous cycles. However, we have managed to lease up a couple of challenging properties even during this difficult time. Identifying the uses desired and hitting the streets enabled us to lease over 30,000 square feet of space in the Southwest Center Mall in the last 90 days.

TREB: Have any major developments come online this year? Are any planned?

Cornelius: The new developments we have seen come online this year in the Dallas-Fort Worth market have been grocery store and Walmart driven. All things considered, this has been a very active market for new grocery anchored developments.

In September, HEB Grocery Store opened in Burleson, a suburb of Fort Worth. The first phase of retail adjacent to the HEB has approximately 14,000 square feet of small shop space with plans to add additional space as leasing permits. HEB announced another store planned for Granbury, 30 minutes southwest of Fort Worth.

A Kroger Marketplace opened in early January of this year in Frisco, which is Kroger's latest concept. The marketplace is 123,429 square feet and includes hard goods. The small shop space leasing appears to be getting some traction. Kroger will be opening Kroger Marketplaces later this year in North Fort Worth at Heritage Market Place located at Heritage Trace and IH-35W. They've also broken ground in Little Elm with a projected opening of summer 2011. Pads and small shop space are also planned. There is a planned Kroger Marketplace for US-75 (Central Express Way) and Haskell Avenue in Dallas as well.

Tom Thumb opened in May of this year in Rockwall, a suburb of Dallas. A Kroger Marketplace is under construction in Rockwall as well. A Tom Thumb-anchored shopping center broke ground at the corner of FM 423 and Lebanon in Frisco. This will be a 70,000-square-foot Tom Thumb with 94,000 square feet of shop space.

Walmart will be opening a Walmart Super Center in Benbrook in mid November. Walmart also has stores under construction at Skillman and NW Highway in Dallas, IH-35 and US 380 in Denton, and Preston Road and Hickory Creek in north Frisco. There are plans for future Walmart Super Centers at U.S. 287 and Avondale Haslet Road in North Fort Worth, and FM 1187 and Main Street in Crowley.

Target has also been approved at the intersection of U.S. 287 and Harmon Road in North Fort Worth.

Harris: There is over 20 million square feet of development in the planning stages, but this mostly remains unfunded. Population increases will continue, even if unemployment holds steady, and as the credit market slowly thaws, we can expect development to pick up again when the time is right.

Herring: We launched the second phase of The Village at Fairview in March and have welcomed more than 40 new tenants this year. More than 100,000 square feet of new retail will open between late October and December.

MGHerring is one of the only developers pursuing ground-up regional development projects in Dallas-Fort Worth and other markets. Tenants will be looking for new locations in 2011.

McNutt: Once again, projects that were underway as the recession began have come online and continued to struggle with leasing and financing. Bright Realty has a large mixed-use project slated for a 2011/2012 start but so much is contingent on the retail growth plans and credit markets for the next 5 years. I believe this holiday season will play a large part in the growth plans for retail in the

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in the near future.

**TREB:** What submarkets are performing best?

**Cornelius:** The submarkets that are performing best are the middle to high income suburban markets like Southlake, Keller, Rockwall, North Fort Worth and Mansfield. The urban inner city markets such as the Uptown area of Dallas are still seeing strong occupancies and rents mainly driven by restaurants.

**Harris:** The uptown area of Dallas is always strong. North Dallas, Plano, Allen, North and Southwest Fort Worth, Alliance, Las Colinas, Flower Mound and Southlake continue to do well, as do some smaller pockets in the southern sector. Some of the outlying communities are struggling as housing starts failed to keep pace with retail development, and as such, vacancy rates remain up and downward pressures on rent rates continue.

**Herring:** Retail activity in the Dallas-Fort Worth market continues to perform above other areas of the country. The submarket of Collin County (specifically the cities of Allen and McKinney) continues to be one of the fastest growing markets in the U.S. in terms of income and population.

Money Magazine ranked McKinney fifth and Allen 16th on its 2010 list of “Best Places to Live”. The City of Allen is also one of the few cities to see an increase in sales tax revenue this year.

**Kam:** Recently an investor told me “where the big planes fly, I will by.” This seems to be the general consensus in the market right now. Buyers want major markets and high traffic locations with good access and visibility. Just as important, they are looking to buy with reasonable rents in place, preferably leased to second or third generation tenants. They are not willing to buy with high rents, many reflecting amortizing TI allowances.

**McNutt:** Where the basic fundamentals of retail are in place such as high density, high income and high traffic, activity continues to be strong and retailers continue to

seek space in these locations. The second opportunity is on the very low end of the retail spectrum – owners who have an extremely low basis in the property and can offer an exceptional value to the tenants with aggressive terms.

**TREB:** Have any major retailers entered/exited your market?

**Cornelius:** Aldi Grocery stores is one of the only major retailers to enter this market, opening multiple stores earlier this year. There also has been a big push for restaurants entering the market, such as In N Out Burger and Carl’s Jr.

There have been no major retailers exiting our market since Circuit City and Linens ‘n Things exited last year.

**Harris:** Asian big box grocers such as 99-Ranch and H-Mart have entered the Dallas-Fort Worth market and this will be a continued growth story. Existing retailers have also brought new specialty brand stores to market.

**McNutt:** Most national retailers we have had discussions with continue to be bullish on the Texas market. Food service seems to be leading the pack of new inquiries. In N Out Burger coming to town is a positive sign for Texas. QSR’s continue to inquire about pad sites and inline opportunities.

**TREB:** How is the second half of 2010 performing compared to the first half?

**Cornelius:** In the first half of the year, we saw a lot of deals that had been in the works get completed. Overall, the first half of the year was pretty good and this activity has continued through the third quarter. However, the fourth quarter is typically a slow time of the year as retailers focus on holiday sales. There is optimism regarding 2011 coming from brokers and retailers alike.

**Harris:** Rent rates appear to have declined slightly for the second half of the year with occupancy holding steady for the most part. Activity appears to show a slight uptick and

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optimism is definitely increasing. The Dallas-Fort Worth market remains one of the strongest and most resilient retail markets in the country.

Herring: Yes. We are seeing more activity with new tenants coming to The Village at Allen, The Village at Fairview and Uptown Village at Cedar Hill that want to be open in time for the holidays. More than 100,000 square feet of new retail will open at The Village at Fairview between late October and December.

McNutt: We have seen a steady increase in activity in both leasing and land sales in the last quarter and expect that trend to continue through the fourth quarter.

TREB: Do you believe things will turn around in Dallas-Fort Worth in 2011? Why or why not?

Cornelius: Our market should see improvement in 2011, but I believe it will be slow and steady at first. The Dallas-Fort Worth markets continue to be two of the best retail real estate markets in the country.

We have seen some improvement in job growth in our market, which is a good economic indicator. This should lead to store for store sales increases for our retailers, which in turn should lead to expansion.

We have also seen the capital markets coming back, which should help spur new developments. The deals still have to be the right deals and underwriting will be more rigorous, but there will be opportunity for developments in 2011.

Harris: Yes, I do; slowly, but definitely. Positives are an expected thaw in the credit markets, pressures to kick-start the SBA loans to small business, improving employment rates, population growth in the Metroplex, and the entrepreneurship of the American people. Retail shopping is changing, and changing dramatically. Online shopping will continue to increase, and the face of bricks and mortar retail will undergo a radical shift in the coming

years. Those who can adapt to this will thrive.

Kam: I believe that 2011 will be better than 2010, although I do believe next year will still be challenging. It will take time for the market to absorb the decline in fundamentals and cap rates. On the bright side, the risk premium that has factored into the market has created attractive investment opportunities for investors who will be able to purchase high quality properties at attractive yields, leveraging historically low interest rates.

McNutt: In my opinion, there are two major factors that will influence activity in the coming year. Holiday sales and job growth. Strong holiday sales news will influence consumer confidence but until the market sees the high unemployment figures start to drop, the consumer will continue to be frugal with discretionary spending. I anticipate the recovery in Texas to lead the way as immigration and favorable business climates improve. Removing any uncertainty in the tax/regulatory issues facing us in the future should enable the large amounts of cash sitting on the sidelines to be put to work. As always, we are hoping for a solid rebound in 2011 but will remain lean and mean until the trends solidify.

## Central Texas

From Austin and San Antonio, the following professionals participated in the roundtable discussion: Eric DeJernett, Senior Vice President, CB Richard Ellis — Austin; Chris Ellis, Managing Principal, Endeavor Real Estate Group — Austin; Keith McRee, Vice President, NAI REOC — San Antonio; and John Wright, Associate, CB Richard Ellis — San Antonio

TREB: What is the current state of retail activity in Central Texas?

DeJernett: If I were asked to sum up the current state of the retail market in one word it would be flux. We are simultaneously seeing tenants with increasing sales and tenants closing stores or looking for rent relief. This is

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creating an environment of uncertainty that is providing the more astute retailers the ability to capitalize on quality spaces opening up in locations that were extremely hard to find only a few years ago.

Ellis: Retail is relatively stable in Austin right now. Occupancies are strong in most Class A centers and in the market as a whole. There has been a decent amount of leasing activity from local and regional tenants during the downturn and now we are seeing some national restaurants come back to the market.

McRee: Activity has slowly increased throughout the year and in the last 2 months we have really seen an increase in the number of deals that we have working across the company. This has not yet resulted in a large number of completed deals but we have seen more new transactions year-to-date for 2010 than we saw at this time last year. Last year was more renewals and shorter term deals.

Wright: In San Antonio, we have seen an improvement in retail activity over the past 12 months. Thanks to the fundamentals of the market and the diverse nature of our economy, the long-term prognosis for the San Antonio retail market is excellent. The military's Base Realignment and Closure (BRAC) plan and new jobs created by the Eagle Ford Shale activity will continue to positively impact our economy and our market in 2011 and beyond. Nevertheless, there remains uncertainty in the near term regarding the pace and strength of the recovery. On one hand, retailer sales have improved slightly as consumer confidence and spending have increased, but on the other hand, a few retailers have closed locations either as a means to purge underperforming stores from their portfolio or to relocate into better quality real estate. As employment rates and consumer spending increase, the level of retail activity will also increase.

TREB: What retail leasing/development trends have surfaced during the economic downturn?

DeJernett: There is no question that there has been a decrease in rental rates and/or increase in finish out allowances for most retail centers. The drop in consumer confidence associated with the economic downturn has had a direct impact on the effective rate landlords have been able to achieve in the past 18 to 24 months. However, this trend seems to be stabilizing along with the economy.

Ellis: National tenants all but disappeared from the new deal market, but significant leasing took place in the last 2 years from local and regional tenants. No new development of any scale is expected any time soon, but most vacancies created by tenants closing large format locations have now been backfilled.

McRee: Established tenants have really been able to drive the deals over the last 2 years. Tenants with good financials or operations have been able to demand significant concessions on renewals and new leases. Established tenants have been trying to secure longer term leases to try and lock into lower rates for a longer period time. On the other hand, landlords have been trying to limit the length of these deals so that when the market recovers they can take advantage of renewals in a stronger market. But, in general, landlords are doing what they can to get deals done.

Wright: The prevailing trend that emerged during the economic downturn, and continues to impact the retail market, is a flight to quality and value by consumers and retailers. As consumer discretionary spending tightened, weaker retailers were forced to close stores, which presented their stronger competitors with an opportunity to relocate stores from A-minus locations to A-plus locations and improve the quality of their real estate, frequently at better economic terms. At the same time, the vacancies left behind by those strong retailers have presented an opportunity for other retailers to improve their real estate by moving upstream into an A-minus center. The overall flight to quality and value has affected all types and sizes of retailers and will continue to have a

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trickle down effect that will impact our market in the short term.

TREB: Have any major developments come online this year? Are any planned?

DeJernett: The second phase of the Domain developed by Simon Properties has come on line this year and we will have a new Walmart open on West Anderson Lane to anchor the Northcross redevelopment. HEB has also opened a new location with some small shop space in Dripping Springs.

McRee: Locally-based HEB Grocery has opened a couple of new stores over the last year and has really been the only major anchor opening new locations in the market. This has allowed new opportunities to come to the market for pad sites and inline retail. There are several developments that are planned at this point – the question will be which developments will actually happen.

Wright: Other than single tenant and user driven development, few new projects have come online in 2010. Grocery-anchored developments are the exception to this rule, as they have either partnered with developers or developed new centers themselves in New Braunfels, Bulverde and La Vernia. Additionally, an existing HEB store in west San Antonio on Marbach Road is being replaced with a new HEB Plus-anchored center.

A few new developments will come online in late 2011 or 2012. These include Cameron Crossing, the Bass Pro Shops-anchored project in Harlingen as well as a few HEB-anchored developments in the greater San Antonio area.

TREB: What submarkets are performing best?

DeJernett: The question is really what projects are performing the best. We are seeing a clear flight to quality locations and anchor tenants. The secondary and tertiary projects are definitely experiencing greater stress than the

primary projects regardless of the submarket.

Ellis: The usual submarkets of Sunset Valley and the Domain/Arboretum remain retailers' first choice when they come to Austin, but all submarkets are performing fairly well and have stayed well occupied considering the economic downturn that we have gone through.

McRee: I don't think you can really say that one submarket is performing better over the others. Each submarket has its winners and its losers. It has been more of what type of product has performed better than others.

Wright: While every submarket has its relative strengths and weaknesses, the Northwest and North Central submarkets have historically been strong performers with lower vacancy rates and slightly higher rents than the general market. In addition to the infill nature of these submarkets, the strong demographics that they offer make them consistently strong retail trade areas.

TREB: What types of retail product are performing?

DeJernett: The grocery-anchored neighborhood center without a large percentage of shadow anchor space is obviously the most stable asset in the current market. Lifestyle, power and mixed-use projects are all very location- and anchor-sensitive at this point.

Ellis: All grocery-anchored centers have remained relatively fully leased. Other product types have remained strong as long as they have had strong anchor tenants. We have seen less problem tenants than we have expected in our portfolio.

McRee: Grocery-anchored centers and power centers have performed better at attracting more attention than non-anchored projects over the last year. Active tenants have taken a flight to quality rather than quantity.

Wright: Grocery-anchored centers will typically be the most stable retail product types, but generally speaking,

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good locations, excellent visibility and access to traffic, straight-forward site plans, reasonable anchor-to-shop space ratios and a diverse tenant mix that meet the needs of consumers in the trade area will continue to perform well. Over the past few years, centers with value-oriented retailers have benefitted as consumers looked for ways to stretch their discretionary dollars.

**TREB:** Have any major retailers entered/exited your market?

**DeJernett:** Over the past year Central Texas has followed the regional trend of losing major electronics and home goods retailers, video stores and a number of other weak retailers or weak locations within a chain. We have been lucky to have enough demand that many of these spaces have been filled or will be filled within the next year. Retailers such as health food stores and women's accessories outlets, have been primary candidates for junior anchor spaces while we have seen a lot of activity in restaurant, quality liquor/wine, and medical uses looking at former video store locations.

**Ellis:** We have seen the casualties that other markets have seen, namely Circuit City and Linens 'n Things. However, we have seen many new tenants enter the market including Sprouts, Sam Moon, Nordstrom Rack, Kreiss Furniture, Home Goods and Buy Buy Baby.

**McRee:** There have been a few new restaurant concepts open in the market such as BJ's Brewhouse, Smash Burger and Five Guys Burgers. One category that has been very active is the dental clinics. Several new groups have opened and/or secured sites in the San Antonio market.

**Wright:** Over the past few years, several big box tenants, including major electronics and clothing retailers, have completely closed their doors, while smaller video rental and coffee shops and others have closed multiple locations in the market. Several of the vacant spaces left by these tenants have been re-tenanted by a number of

active tenants. Other active categories include restaurants, medical/dental uses, wine/liquor, fitness and retailers focused on capturing a share of the Latino retail market.

**TREB:** What is vacancy like? Are rental rates holding steady?

**DeJernett:** The overall occupancy for Central Texas is hovering around 90 percent occupied. Stated rates have held steady but effective rates, especially when you consider tenant improvement allowances, are softer than they were at the peak a couple of years ago. Combining all property types and markets would yield an average rental rate of approximately \$20 per square foot plus NNN, but the market is so incredibly project sensitive that this is not a reliable indicator for specific shopping centers.

**Ellis:** Occupancy rates are in the low 90 percent range and rental rates have stayed strong even though they have decreased probably 5 percent from the top of the market. We are seeing some pressure to reduce rental rates when national tenants are looking to renew. They are taking this opportunity to try to reduce their rents during option periods.

**McRee:** When comparing end of third quarter 2010 to the end of third quarter 2009, citywide vacancy actually decreased by 0.5 percent to 13.4 percent and the average quoted NNN rental rate increased by \$.01 per square foot to \$17.92.

**Wright:** The retail vacancy rate in San Antonio is approximately 13 percent and has decreased slightly over the past 12 months. Rental rates have declined slightly over the past year but are beginning to stabilize. Landlord concessions have increased during that same timeframe but have also begun to stabilize. The average asking rental rate for the entire market is approximately \$18 per square foot NNN. This rate varies greatly depending on the type, location and quality of a retail center.

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TREB: How is the second half of 2010 performing compared to the first half? Is there more activity/optimism?

DeJernett: The market feels like it is slowly improving and probably starting to pull up from the bottom. Retailers are driven by sales and sales are driven by income. As the employment rate goes up, we will see continued improvement in the retail market.

Ellis: I would expect the second half of the year to perform at about the same clip as the first half of the year and if this happens we will all be pretty happy.

McRee: We started to see an increase in activity at the beginning of 2010 and it has kept increasing throughout the year. We have started to see this increase in activity turn into more new leases signed especially in the second half of the year.

Wright: The second half of the year has seen continued, albeit slight, improvement in activity and optimism. Leases are still getting signed and the volume of sales transactions has improved. San Antonio and Texas, in general, have benefitted from the perception that it has largely avoided the worst effects of the recession and that it will rebound more quickly.

TREB: Do you believe things will turn around in Central Texas in 2011? Why or why not?

DeJernett: I believe the market is already turning around but it will not turn back to what it was. We will see shifts in how retailers operate as they take the hard lessons learned over the past couple of years and infuse them into operations. In general, we will see tenants reducing the size of their spaces, more emphasis on value, greater connection between traditional sticks/bricks and e-commerce and better customer service at the higher end.

McRee: I don't necessarily think that 2011 is going to see a big turnaround from 2010. I think we are going to see

a slow and steady improvement in the market similar to what we have seen this year. I still think we have another 18 to 24 months ahead of us before we are really going to see a drastic improvement and return to business as usual. There is still a large amount of vacancy in the market and capital is still hard to come by. Some of the large anchors are starting to get active again but it will be 12 to 24 months before that activity turns into new store openings.

## Central Texas' Secondary and Tertiary Markets

Gary Davis, President of First Advisors in Austin, participated in the roundtable by answering questions about Central Texas' secondary and tertiary markets, a specialty of First Advisors.

TREB: What is the current state of retail activity in Texas' secondary markets?

Davis: Secondary and tertiary markets in Texas are beginning to see some interest by national and regional retailers interested in planning for store openings in 2012 and beyond. The activity for smaller county seat towns is mixed, depending on their proximity to major metropolitan areas.

TREB: What retail leasing/development trends have surfaced during the economic downturn?

Davis: Tenants are not negotiating for lower rents on existing space, but it takes much longer to lease vacant space. Due to the lack of financing, developers are negotiating to sell land (both anchor positions and out parcels) to the stronger tenants who can finance their own store expansion and will own the real estate, instead of doing build to suits. Smaller tenants are using SBA guaranteed loans for store expansion.

TREB: Which secondary markets are performing best?

Davis: Markets with a strong military presence, especially the Killeen/Fort Hood area, has outperformed other

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markets based on statistical comparisons, such as job and income growth, housing starts and retail sales. Otherwise, the edge cities to the Dallas-Fort Worth and Houston metro areas have held up reasonably well.

**TREB:** Have any major retailers entered/exited secondary markets?

**Davis:** Many of the secondary, tertiary and county seat markets have seen store closings from retailers such as Goody's, Circuit City, Blockbuster, Movie Gallery, Starbucks and other casual dining and fast food chains. In the smaller markets, any national chain, large or small, is a big deal for the trade area. So, when they close, it is noticed.

**TREB:** How is the second half of 2010 performing compared to the first half? Is there more activity/optimism?

**Davis:** It appears that those of us who have chosen to stay in this business have mostly decided that the world has not come to an end. In the context of how retail development was previously done and how it will be done in the future, the world has drastically changed, probably for at least our remaining lifetimes. I think the survivors will figure out how to partner up and move forward, but in a different way from past practices.

**TREB:** Do you believe things will turn around in your market in 2011? Why or why not?

**Davis:** I believe 2011 will be better in terms of deal making, setting the stage for new development in 2012 and beyond. We probably need another year for the economy to turn the corner and for the banks to get over the shocks of 2008 and 2009. With the passage of time, everything that was once bad always gets better.

— Gary J. Davis is president of First Advisors in Austin.

## Houston

From Houston, the following professionals participated in the roundtable discussion: Shawn Ackerman, Executive Vice President, Henry S. Miller Brokerage, Retail Division; Jason Baker, Co-Founder and Principal, Baker Katz; Jerry Goldstein, Senior Director — National Retail Group, Marcus & Millichap; and Matthew Keener, Senior Vice President — Retail, CB Richard Ellis

**TREB:** What is the current state of retail activity in Houston?

**Baker:** If the market has improved at all, it has only improved marginally. Retail activity is still lacking, but maybe now for the first time in a couple of years, retailers are dipping their toes back in the water and talking about adding or expanding stores.

**Goldstein:** Investment sales have declined as financing has remained difficult for all investors, and retail properties remain challenging as a result of rental rate instability and market vacancy. Single tenant deals have dropped 40 percent over the past year. Texas based buyers have largely moved to the sidelines as velocity among these investors plunged 50 percent. Single-tenant cap rates for pending sales average in the mid 8 percent, and eighty of this year's multi-tenant deals have closed in the past 6 months, up from a low velocity period in 2009. Average cap rates rose slightly to a mid to low 9 percent range. Well located grocery-anchored and power and regional centers are trading at a premium.

**Keener:** Activity in Houston has increased slowly and steadily since 2009, but we are still at half of pre-recession volumes.

**TREB:** What retail leasing/development trends have surfaced during the economic downturn?

**Ackerman:** National tenants have used this opportunity to reposition their stores into better areas and renegotiate

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lower rents on renewals. Regional and local tenants are able to penetrate the market more easily; however tenant allowance has shrunk substantially. First-time franchisees and new businesses have seen a significant increase due to companies laying off employees, who in turn, began to seek their own startup businesses.

**Baker:** Because of the dramatic reduction in new retail construction, many retailers have had a difficult time finding quality sites to pursue. Retailers are also taking a hard look at their existing store base and as leases come up they no longer automatically exercise their renewal option. Retailers are taking advantage of their human resources and real estate departments to more closely scrutinize leases as they come up and are doing their best to renegotiate their rent structure if justified by submarket conditions.

**Goldstein:** Over the past year, nearly 1.1 million square feet of new retail space came online in Houston. The pace of deliveries has slowed drastically in 2010. Only 180,000 square feet was completed in the first half. Inventory expanded by a modest 0.3 percent. Developers continue to venture into outlying areas of Houston such as Fort Bend County and Montgomery County.

**Keener:** Leasing trends have been driven by the fewer healthy retailers leveraging the market to upgrade their locations and/or current lease terms. Landlords are focusing on existing tenant retention and aggressive new tenant recruitment through the offering of significantly greater lease concessions all while receiving less rent. Developers have been focused on restructuring existing debt and waiting for the key development drivers of favorable financing, key retailer demand for space and market-adjusted land pricing to come back into equilibrium.

**TREB:** Have any major developments come online this year? Are any planned?

**Baker:** A project in the works that has been delayed for

5 years appears to be making some headway. It is called BLVD Place and is located at San Felipe at Post Oak Boulevard, and will be anchored by Whole Foods Market. Five years ago, Whole Foods Market had site plans for up to 90,000 square feet but they have gone back to the drawing board to open a store much closer to 46,000 square feet.

**Keener:** There have been a couple grocery-anchored projects of note, but nothing major. Of the 13 new developments that will actually be built from 2010 to 2013, 12 projects are grocery-anchored and the 13th is a second phase to an existing development. This really clarifies and underlines the consumers' movement to value versus more discretionary spending. HEB, in particular, is making a major push during the next few years with at least six new units.

**TREB:** What submarkets are performing best?

**Baker:** Retailers are consistently interested in the Inner Loop area, including the Galleria area. Other areas doing well include The Woodlands and West Houston, including Katy and Cinco Ranch. Performance in these areas goes beyond retailer performance. These areas have consistent occupancy, sustainable rents, residential and general growth, and each has a live/work/play component that is working well.

**Keener:** The core, high-income submarkets around the Inner Loop continue to do well due to the limited supply of space as well as stronger residential and daytime generators in the area. The high-supply suburban markets have seen significant vacancy increases, from 4 to 6 percent, but it is the low income submarkets that have experienced the worst deterioration due to higher levels of unemployment and lower consumer dollars in those areas.

**TREB:** What types of retail product are performing?

**Ackerman:** Neighborhood centers are the ones that have seen the most action. Grocery anchored will always be the

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strongest of the different flavors because customers need to eat. The worst hit are mid-block strip centers that are a dime-a-dozen in Houston.

**Baker:** Neighborhood centers, particularly grocery-anchored centers, are performing well. HEB and Kroger are very active in our market. They are holding sites for future development, are under construction in a number of locations and are rolling out new concepts.

**Goldstein:** New development is retailer driven and moving at a slow pace. Walmart continues its push into urban markets in Houston. Notably with their development plan in conjunction with the Ainbinder Development for an Interstate 10 West location in the Heights. Most lifestyle centers are on hold.

**Keener:** It's all about grocery-anchored community centers for the next 3 to 4 years. We won't be hearing much if anything about the previously highly publicized lifestyle and mixed-use projects as luxury and non-essentials retailers re-tool and wait for the economy to fully recover.

**TREB:** Have any major retailers entered/exited your market?

**Ackerman:** Many new restaurant franchisors like Qdoba, Fuzzy Taco, Tuti Fruti, Mooya Burger and Five Guys Burgers have entered the market. Exiting are the non-essential tenants like Curves and Weight Watchers.

**Goldstein:** Upscale restaurants like Eddie V's and many more generic eating establishments are coming into the market.

**TREB:** What is vacancy like? Are rental rates holding steady?

**Ackerman:** Rates are all over the board. In high profile markets like the Galleria, rents are holding, however landlords are more skeptical about tenants' financial

backing more than in the past. In the suburban market, rents are down slightly and landlords are willing to take more risk on the financials of the tenants but are scaling back the tenant improvement allowance significantly.

**Baker:** With a market of our size, as much retail as we have here and relative to our historical vacancy rate, vacancy is at a surprisingly reasonable level – around 13 to 14 percent. Rents among junior anchors have probably dropped the farthest and the fastest; dependent upon the trade areas, some junior anchor rents are off 70 to 80 percent. However, there has been very little movement in rental rates for smaller spaces that are well located.

**Keener:** I don't think there is any accurate data available as to the real vacancy rates in Houston right now. Most of companies that gather this data have us around 15 to 16 percent vacant across the MSA; however, as a broker who makes a living driving the city on a daily basis, I put the rate closer to 25 percent. Further, if economic vacancies are added to the actual vacancy rate, we are looking at fully one-third of all space in Houston being dark or not paying its contractual rents. Rents are not increasing anywhere, relative to pre-recession levels, and are holding steady in only a few exceptionally located and anchored projects. Otherwise, rents have fallen 10 to 15 percent on the better Class A product, and completely off the cliff in the rest of the projects.

**TREB:** How is the second half of 2010 performing compared to the first half? Is there more activity/optimism?

**Ackerman:** The beginning of the year was a holding pattern. Tenants took much longer to act because they didn't know how to react to the market. The second half has been a lot more active while tenants are getting ready for the holiday season. The biggest factor on both accounts was information. Everyone wanted up-to-date market information throughout the process to ensure they were making the best decision.

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Baker: The mood for the second half of the year may be a little better as some retailers seem more optimistic but the market is relatively comparable.

Goldstein: Velocity has increased from the first half of the year but buyers remain cautious. Though there is an emphasis on distress opportunities there is still a demand for properties that are really stabilized with a rental structure that is not above actual market.

TREB: Do you believe things will turn around in your market in 2011? Why or why not?

Baker: We are cautiously optimistic. There are still a lot of fundamental changes that need to occur and concern for weakness in some segments. As a result, some retailers are hesitant to expand aggressively. There is still concern over more vacancy hitting the market. Many retail segments, including fitness, books and office supplies are overcrowded and weak. There is a general concern that there may be more fallout. It's too difficult to predict with any degree of certainty.

Goldstein: I expect more of the same in 2011 though more investors will want to buy properties because of the low interest rate environment for alternative investments. The velocity will not increase dramatically because of the availability of financing.

Keener: The turnaround has already occurred as anticlimactic as that sounds. The current sluggish market is our reality for the next few years. Barring another macroeconomic ambush, somewhere in the year 2014 to 2015 range is when we'll see the real inflection point in the market metrics that signals a return to the more robust and expansive retail market we became accustomed to over the last decade.

## West Texas and the Rio Grande Valley

From the Rio Grande Valley, Amarillo and El Paso, respectively, the following professionals participated

in the roundtable discussion: Randy Summers, Vice President, Davis Equity Realty — Rio Grande Valley; Steve Rogers, J Gaut — Amarillo; and Scott Walker, Director of Leasing, MIMCO — El Paso

TREB: What is the current state of retail activity in your market?

Summers (RGV): Although down compared to the high we were on, the retail sales activity is still very healthy. Year-to-date sales tax revenue is increasing at a steady and sustainable pace.

Rogers (Amarillo): Retail activity is up with local tenants providing the most action. There is very limited national tenant activity.

Walker (El Paso): El Paso in general has remained very stable. Mom-and-pop operations are continuing to open more locations throughout El Paso. Regional and national retailers continue to open and expand in the area.

TREB: What retail leasing/development trends have surfaced during the economic downturn?

Summers: The Rio Grande Valley continues to be healthy albeit the leasing activity has been flat. Leases that are being accomplished have had considerable free rent or tenant finish allowance.

Rogers: Landlords are reluctant to provide extensive tenant finish in this market. Rent abatements are more common.

Walker: Approximately 80,000 people have moved from Juarez into El Paso over the last couple of years due to the continued violence in Juarez. As one can imagine, they have moved many businesses/restaurants from Juarez and the economic impact for El Paso has been significant. Additionally, the Fort Bliss military base, which is located in the northeast part of El Paso, is the fastest growing military base in the country. As a result, El Paso expects

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to have an additional 50,000-plus troops and related residents by 2013. The recently developed Texas Tech University Health Sciences Center, Paul L. Foster School of Medicine is expected to have a \$1.5 billion impact on the community and will create more than 500 jobs.

TREB: Have any major developments come online this year? Are any planned?

Summers: Ground was recently broken for a new Academy and Olive Garden in Weslaco. TJ Maxx and Anna's Linens opened this year as well in Weslaco. Pappadaux's Restaurant opened in Pharr. Bass Pro Shops announced they would be coming to Harlingen, which should spur additional retail and restaurant development in the area.

Rogers: No new developments planned in Amarillo. Some small redevelopment projects are in progress.

Walker: There are several new developments coming online this year or planned to come online soon. Among them, Walmart is opening a new site at the Montana and Highway 375 intersection, which should open the last quarter of this year. Along with them, Lowe's, Chase Bank, Taco Bell and Peter Piper Pizza have already opened. Pad sites remain along with a 10,000-square-foot building that has small space available. Another exciting development in the works is The Fountains at Farah, which is at the North East Corner of Hawkins and Interstate 10, which will be approximately 600,000 square feet. Freedom Crossing which is located on Fort Bliss is a 455,875-square-foot shopping center that is in its last phase with the Grand Theatre, The Exchange, Buffalo Wild Wings, Smashburger, Sarku Japan, Junga Juice, Arby's, Einstein Bros. Bagels, GameStop and Val Verde opening in November.

TREB: What submarkets are performing best?

Summers: Weslaco, Harlingen, north McAllen and north Brownsville are all markets which are doing very well.

Rogers: The mature, high traffic intersections are showing the most activity. These spaces are finished and both the landlord and tenant prefer updating to finishing new space. Also, the mature locations seem a safer play for the tenants.

Walker: The entire city is doing very well with all of the growth from former Juarez residents. However, the far eastside and northeast continue to be the largest areas of growth and seem to have the most new developments coming on board.

TREB: Have any major retailers entered/exited your market?

Summers: Bass Pro Shops will be the first major retailer to enter our market in quite some time.

Rogers: New health club tenants Anytime Fitness and Planet Fitness have entered Amarillo, and there haven't been any major exits in past year.

Walker: Some of the new retailers to the market include Pot Belly Sandwiches, Five Guys Burgers, Smashburger, Panda Express and the Vitamin Shoppe. There are rumors of several others that have tied up land or are doing due diligence in El Paso but not yet fully committed.

TREB: What is vacancy like? Are rental rates holding steady?

Summers: Overall, I would estimate vacancies are about 15 to 18 percent. After dropping in 2009 and first quarter of 2010, rental rates are holding steady. Renewals are being renewed at current rate or with a slight 2 to 3 percent increase.

Rogers: Vacancy is dropping slowly and there is some absorption of existing, mature space. I would estimate 90 percent occupancy in the suburban markets of Amarillo.

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Walker: El Paso does not keep an overall vacancy number for the retail market, but I would guess, based on our portfolio, El Paso vacancy rates are somewhere between 6 and 8 percent.

TREB: How is the second half of 2010 performing compared to the first half? Is there more activity/optimism?

Summers: The second half of the year is definitely trending better than the first. There is more activity, less tire kicking, and people in general are feeling more optimism about the future. The election will have taken place by the time this is printed and I am sure the optimism will continue and hopefully a sense of uncertainty removed. Hopefully banks will decide to play ball once again and participate in economic growth.

Rogers: The second half of year has been much better. More activity and some more optimism as evidenced by the number of local startups in Amarillo.

Walker: Again, El Paso in general has been very stable. Regional and national tenants continue to analyze the market and continue to open here, which tells me retailers in El Paso are doing well.

TREB: Do you believe things will turn around in your market in 2011? Why or why not?

Summers: Yes, I feel things will improve in 2011. Teleperformance has announced it will hire 800 employees in Edinburg. Slow steady growth continues as small business are gaining more confidence, which will allow job growth to continue. I feel there will be a tidal wave of a change in Washington, D. C., which will add a tremendous amount of optimism and confidence to the markets.

Rogers: I would not characterize Amarillo as in need of a turnaround as much as steady improvement. We never had wholesale tenant loss, other than the typical national

tenant losses. Rather, we had a gradual loss in occupancy. Therefore, we are currently experiencing a gradual return to healthy occupancy.

Walker: I believe things will continue in the same direction they have been going — a positive one. My enthusiasm for the city in 2011 is very high.