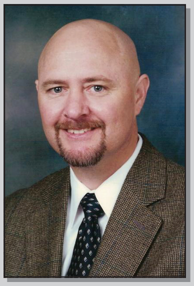
Is There Hope For The Future?



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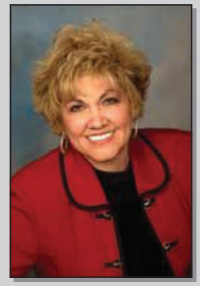

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We asked our panel of experts to weigh in on that and other trends.

REDNews: ***Last year, the consensus from retail brokers was that many of their tenants were having financial problems. Does it appear that "survival of the fittest" has transpired? Do you still have tenants on your watch list?***

Robinson: Our company is involved more on the site acquisitions side of retail. We work with very few retail tenants. Most of our clients have scaled back expansion due to slower sales and difficulty obtaining financing. My customers tell me their business is off 35% from 2008.

Keener: There was certainly some fall-out in the retailer ranks, but frankly the biggest surprise is how few, rather than how many, of the mainstream nationals, fell-out. Most that did were on the rocks prior to the recession. The primary issue deflating retailer roll-out volume is general market caution and inability to get credit from their respective suppliers. Thus, the universe of retailers is still probably larger than predicted with many concepts that are generally unhealthy but making it work.

Ghabriel: I think many tenants are still having financial problems, but I am not really sure that 100% of their problems can be attributed to the state of the economy. The issue that we face in some instances is what to do with "watch list" tenants. You have two options: work with them or face the prospect of having a vacancy which may be hard to fill.

Ackerman: We are still seeing tenants requesting rent relief and not just the mom and pops. The active tenants are pushing for long term leases with significantly lower rents, some as much as 50%. Lease renewals are a constant battle over rent reduction regardless of tenants' sales. This trend will continue until the market tightens. I believe this trend will have a significant impact on the less quality projects as tenants also trade up to the higher class shopping centers. Every tenant is on everyone's watch list. Communication is on the rise. Landlords want up-to-date information and to be more involved in the marketing/leasing efforts. Tenants want detailed market and competition studies even before entering a market. We are seeing more technical expertise and less "gut feelings". It is important to keep track of tenants' trends in every market if they are successful in getting concessions in one market, they expect it in all the markets.

Williams: Nationally, I don't believe we have truly seen the bottom of the market. National and regional tenants are still beating the drum of lower consumer spending and leveraging than to lower rents across the board. Locally, we feel that rents are starting to stabilize and we are seeing an up tick in leasing activity.

Meyer-Nelson: I still have tenants on my watch list and I still have tenants having problems. Those who could cut back have and the ones hanging on are doing just that, hanging on. I feel business is still off approximately 25%.

Quick: Economic Darwinism has been witnessed to some extent in the greater Austin area. However, many of the tenants were better prepared this time versus the 1980s when all the banks folded. There are some tenants on our watch list as we have a property management "wing" (D Quick Commercial Management, Inc.) that collects rent from over 150 tenants state wide in retail centers, office centers, office buildings, and industrial buildings. I would say that 95% of the tenants are OK and the worst is OVER! (We hope).

Adams: No tenants on our watch list at this time.

Frankoff: No, the "survival of the fittest" process is ongoing and yes we still have tenants on the watch list.

REDNews: ***How do your 2009 first quarter vacancy rates compare to 2010?***

Robinson: N/A

Keener: Frankly, I have not read the latest stats, but from us driving the market, day after day, there is generally positive absorption taking place in the top tier centers and with no new product to speak of coming out of the ground. I predict your class A product will stay well-leased, particularly in the dominant grocer-anchored projects. The class A laggards will be the higher-priced lifestyle projects where restaurant tenancy has already been maxed-out and the remaining space targeted for higher-end traditional retail will be slow to move. However, once the lifestyle retailers begin their move back into the market predictably late this year or early next, the lifestyle projects that are out of the ground will be the immediate and strong benefactors of what could be a healthy surge.

Ghabriel: About the same for the majority of properties. It depends on the location of the property. Some locations have been consistent while others have suffered a bit.

Ackerman: 1st quarter 2009 was a shock for everyone, not just tenants. Never before have sales dropped so quickly. They were being hit with much lower than expected sales and did not know how to react. 2009 growth was flat and the tenants who couldn't sustain, folded. Compared to 2009, 2010 was like playing Whack-a Mole. Tenants popped their heads out to look but jumped right back in. The only real activity was rent reduction renewals and out-of-state tenants looking to expand their operations in Houston. The big attraction was lower rents, high population and the job/housing market was not as decimated as other cities.

Williams: The woes of 2009 are apparent in our 1st quarter 2010 rent rolls. Activity is, however, picking up and we are optimistic for the rest of the year and moving forward.

Meyer-Nelson: We are still flat. Our vacancy on 31 properties still remains high overall, but we have had to make a number of concessions for free rent as well as lower rental rates.

Quick: As a response by a "leasing broker" and "property manager" we see the vacancy in the regional area outside of Austin still about the same with the exception of some of the larger big box industrial showing some vacancy. We don't try to measure Austin as there are folks that gather data there that have a much more accurate picture than we do. In December 2009, our phone began to ring and we are doing more industrial leasing than retail. The retail calls/prospects are mom and pops with startups, a few broker calls dragging along a national tenant that is looking (or rather, kicking up tires and dust) to test the market for locations. As I travel the area, snoop, test the market, weekends and during work breaks at the office, I visibly see fewer cars in the retail centers and perhaps this is a sign of negative or restrictive spending by the buying public.

Adams: Our vacancy has decreased.

Frankoff: We have lost some tenants in the first quarter of 2010 but we have also picked up some new ones. Our overall vacancy rate is the same range as first quarter 2009.

REDNews: ***Are your remaining tenants experiencing an increase in sales? Which retail industry is doing the best? Which is doing the worst? Which locations are the best? Which are the worst?***

Robinson: N/A

Keener: Retailer sales performance appears to directly mirror the category of goods and services they are selling. The discounters and staple purveyors are seeing the strongest sales, with many having banner years and the luxury retailer and discretionary service providers seeing the most challenging sales situation. The locations we thoughtfully selected for their dominant trade area positioning via visibility and superior co-tenancy will be doing the best from a real estate standpoint. Those retailers that took secondary locations will be suffering and many are using this tenant-driven market to relocate to better locations.

Ghabriel: Everyone is complaining about sales right across the board. Inner loop properties in general are fairing better. The properties that have consistently had high occupancies are ones in areas where there aren't many competing properties, thereby limiting the tenants' options.

Ackerman: Tenants' sales are down across the board compared to 2008 but slightly up over 2009. The biggest hits were non essential tenants like clothing, accessories and even hair/nail salons. The area holding its own or slightly inching forward is medical. Seems like every project has a dentist, chiropractor or GP involved. The best locations are the suburban grocery anchor markets. People still need to eat. Therefore, they are cooking more and dining out less.

Williams: Our local tenants have seen a slight increase in activity and sales for 1Q 2010. Well established food service tenants seem to be holding their own in the market, while specialty boutiques have fared the worse. Grocery anchored and well positioned neighborhood centers are among the best performing centers, while the newer centers that did not have positive momentum coming into the recession have struggled to maintain or gain occupancy, especially centers with no anchor and no frequency generator.

Meyer-Nelson: All of my discount stores are doing the best. Also, medical seems to have faired the storm well. The hair salons and nail salons seem to be off somewhat and restaurants are still down about 10%. The best locations are in Houston, north and southwest. It seems slow in the Pearland, Friendswood area. Houston by far is doing better than Dallas for me. San Antonio continues to have a steady growth with Tennessee and Oklahoma picking up.

Quick: In my tenant visits, the sales are mundane and appear to be flat for most retailers, but the optimism is still there and attitude determines one's altitude so to speak. Food service is still OK as we all are trying to gain weight... HA. HA. HA. Clothes seem to be holding their own. Wal-Mart and Lowe's seem to have an abundance of weekend and steady weekday traffic. I can't speak to who is suffering the knockout punches yet or which is the worst retail sales unit. As to the best locations, I don't know this either; do you? Seems like the "clustered" retail areas or centers are still vital. Perhaps the Simon Mall, north of RR, is doing OK. Lots of weekend traffic and lots of different languages, i.e. German, French, Spanish and Texan...HA.

Adams: Most of our tenants report the same in sales. Restaurants and auto services seem to be doing the best. In Houston, we are not seeing best and worst locations.

Frankoff: Sales are pretty flat with some modest increases in some areas; however, the increases still reflect sales far below the historical averages. Floor covering and home furnishings are the worst with low end food service doing the best. Highly visible, grade A, inner city/freeway locations are doing the best.

REDNews: ***Are concession requests over? Are you still providing concessions? Are more of your tenants asking for permanent changes in their leases in exchange for longer contracts?***

Robinson: N/A

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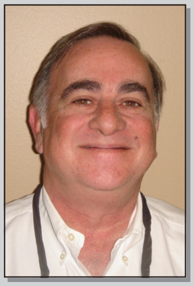

Mike Frankoff
Center Real Estate Group
Bellaire

Keener: Tenant-driven concessions have really slowed to a trickle at this point. This is particularly true of non-anchor tenants. Anchors are still aggressively engaging landlords in early renewal discussion in order to leverage the current market before it wanes.

Ghabriel: Concession requests are still coming in. Tenants do ask for permanent changes, but the way these requests are being handled is by granting the concessions on only a year-by-year basis.

Ackerman: We always had rent concessions in Houston. How many times has a tenant relocated to a new or competing project because of another landlord's willingness to give them a cheaper deal or a high tenant improvement allowance? I think most landlords are willing to work with their long standing tenants. It makes more sense to give a tenant some rent relief rather than lose them and wait for a replacement. We are negotiating some rent relief; however, the tenant is having to give a bit as well, such as extending its lease term. There is a misconception that everyone is getting rent relief. I do not see how landlords can give long term rent concessions and at the same time cover their mortgage on some overpriced property they purchased around three years ago.

Williams: Absolutely not. Concessions are a main stay to retain and lure prospective tenants to almost any center, probably throughout at least all of 2010, maybe longer.

Meyer-Nelson: We are still granting concessions for longer leases. The tenants have been made aware of this through the media as well as tenant reps and they are knowledgeable about what they want and can get in this market.

Quick: No. Everybody wants a DEAL. Yes. Just ask us for a DEAL!!!! You want a concession, we hold a western style, single action 45 pistola to the landlord's head or tie up his secretary to the railroad tracks. You've heard this one before... HA. Some new tenants are requesting shorter term leases, 36 months versus 60. They can't see too far into the Obamaism charasmistic future???

Adams: It appears that concession requests are over. We have not given many concessions or changes to existing leases.

Frankoff: No. Yes. Yes.

REDNews: ***If you live in Houston: Ed Wulfe expects a shortage of retail space in Houston at the end of 2010. Do you agree or disagree?***

Robinson: There may be openings in a few submarkets but I believe most of Houston will be stagnant.

Keener: There already is a shortage of good retail real estate it the market and so Ed is totally correct. It will just get more acute.

Ghabriel: While that is true for many locations, especially in high density areas and inner city centers, we still see buildings with high vacancies in some neighborhoods - mostly in outlying areas. I cannot speculate on how these centers will perform. Even with a down economy some retail trade areas are still doing better than others and will continue to do so.

Ackerman: Agree 100%. With the lack of new projects under construction, Houston can finally fill those empty spaces we have seen for so many years. Without some sort of restriction such as zoning, this is our only time in recent history that the breaks are on construction. The "if you don't like what you see, we will build it for you" philosophy is gone. They can either take it or leave it.

Williams: (no answer)

Meyer-Nelson: I think it depends on the area Mr. Wulfe is talking about. There may be a shortage in the Galleria area but I do not feel there will be a shortage in the Pearland- Friendswood area.

Quick: I'd like to see Ed's crystal ball. The one we had, a prospect pushed off the conference room table and it has a very large crack in it. That ruins the demographics and alters the little lightning flashes we have seen.

Adams: Yes, I agree.

Frankoff: Disagree

REDNews: ***According to Motorola, during the 2009 holiday shopping season, 51 percent of consumers used their phones for shopping while inside stores. Smart phone users compared prices, searched for coupons and read product reviews. What effect do you think this will have regarding pricing and in-store overall sales over the next five years?***

Robinson: It will definitely create more sales opportunities for the merchants with the best web sites and email campaigns and text messaging. This will probably also bring about smaller margins due to customers' ability to shop and compare online.

Keener: I predict that this form of technology application will follow internet sales at similar but more accelerated rate. There is an increasing adoption of technology to drive retail sales and we now have 2-3 generations of consumers that are techno-savvy and avowed technophiles. Whether it be the couponing or price-comparing that today's technology provides or the next evolution of such, this wireless-driven due diligence and marketing will become bigger and bigger as a greater percentage of the shopping public adopts it.

Ghabriel: It will create more competition and better deals for the consumer. Retailers will have to offer reduced pricing and better incentives in order to maintain their customers or capture new ones.

Ackerman: Store sales can never compete with on-line. The only difference is the return policy and shipping costs. The only way store sales can compete is to not let anyone touch the merchandise. The trend will continue so long as the consumers feel that what they are buying on-line is worth the wait and hassle.

Williams: This is an extremely interesting trend and technology (while pretty much monopolized by Apple and AT&T right now) will continue to expand and become more widespread to the general public. This will forever change the competitiveness of all retailers for the future. All will have to adapt (outside of high demand, specialty or destination oriented retailers).

Meyer-Nelson: There will be some shortfall in overall sales in the stores, but more and more people still enjoy going to the bricks and mortar place to shop. The decrease may come in the number of stores that retailers have overall.

Quick: Did Motorola actually count the kids under 12 with the phones in use? Smart kids with smart phones are what we see. Store sales may remain constant or increase as people love to mingle, and shopping is where you mingle and see friends (new and old).

Adams: We have already seen an impact on sales due to smarter shoppers and price comparison and I think we will continue to see this in the coming years.

Frankoff: Retailers will need to find new ways to compete with the online marketing of same or similar goods. Private labeling of goods, higher level of service, as well as exclusive rights to products and brands will become more important if the traditional sticks and bricks retailers are to survive.

REDNews: ***What projects in your city are planned/under construction/ cancelled?***

Robinson: Waterlights District, a mixed use commercial residential project. Poag and McEwen Lifestyle Center at Beltway 8 and Hwy 288.

Keener: (no answer)

Ghabriel: I don't know of any that have not already been published or talked about in our community. But we certainly look forward to the start/ completion of the construction on the passenger light rail lines, Metro's Intermodal Facility, and the Dynamo Stadium on the east side of downtown, among others.

Ackerman: We are a redevelopment company and all our projects have been completed.

Williams: All speculative construction projects are still on permanent hold for the time being. A few projects along the I-10 corridor in San Antonio have an opportunity to capitalize on local growth trends in the market.

Meyer-Nelson: Not aware.

Quick: New college: ACC, new medical school: Texas A&M, new nursing college: Texas State, new medical centers, several new skilled nursing centers, new assisted living centers, new single tenant office buildings for doctors or dentists. Cancelled: several projects, can't tell you, I might be shot!

Adams: This I cannot answer on an overall basis for Houston.

Frankoff: I have investors who are waiting in the wings looking for the distressed properties to hit the market.

REDNews: ***According to the Congressional Oversight Panel report, Commercial Real Estate Losses and the Risk to Financial Stability, $1.4 trillion in CRE loans that were made in the last decade will require refinancing in 2011 through 2014 and "nearly half (of the loans) are, at present, underwater." Panel members said they were concerned the loan losses could jeopardize the stability of many banks and prolong the recession. Do you agree?***

Robinson: Many banks have already failed and others are just hanging on. The Federal Government should help refinance viable projects and assist banks with liquidating those that were ill conceived. Private investors will absorb the liquidated assets.

Keener: I agree that there are many projects in the red and that more over-exposed lenders will fail. I do not think that this will have too deleterious an effect on the overall market given its proven resilience after almost two years of other similar issues. There is a huge amount of capital that has built up in anticipation of this and is waiting on the sidelines to enter the market for the better assets that may come available through this process. The bargaining should be competitive enough that the holder of notes for decent projects should be able to mitigate their damages.

Ghabriel: The banks will have to carry write-offs on their balance sheets for many quarters to come, yet are simultaneously being faced with the oversight of regulators. That puts them in jeopardy unless they are well capitalized. It will take them many more quarters to recoup their losses.

Ackerman: Absolutely. Cash is king. If there is no cash, their can be no kingdom. Unless the government allows banks the latitude to renegotiate these loans, the cycle will continue. We might as well correct the problem while we know there is a problem than let the hole get any deeper. Take the hit because we expect it and move on is what is going to jump start this economy. The problem is who is going to take the hit. Might as well lay it on the table and admit that it will be the tax payers.

Williams: The tidal wave of defunct CRE loans that looms unseen in the distance is of great concern to the health of the retail and commercial real estate market. No one can predict how the outcome of this anomaly will truly affect the return of a positive real estate cycle.

Meyer-Nelson: I personally believe the banks need to work with the borrower and the appraiser to hit a happy medium. If a property is underwater, it may need a pay down over time and possibly two notes instead of one to keep from being criticized by the examiners. We did not get into this mess overnight and we are not going to get out by everyone demanding monies all at once. Bankers need to not be unreasonable and borrowers need to understand that the banker is only doing his or her job.

Quick: Yes; with the Bear and Lehman downfall, the market is now wise to the CMBS and RMBS and CDO and Swaps and the new language that spells bad news in refinance and new loan capital availability. I have faith in the American way that we will move on through the fog as we don't have a lot of options, do we? Texas, oh Texas, thanks for where we are. Thanks for the opportunities that are still here and growing.

Adams: If these facts are correct then yes, I would agree. Look at what happened in the '80s and compare.

Frankoff: Yes, but I don't see any way around allowing the market to absorb these assets as prospective purchasers will not become active as long as the threat/promise of distressed inventory remains. In addition sellers will not reduce prices to reflect the current market conditions until they have to, which will be when the under-performing assets are placed on the market. As a result, we in Houston are experiencing a prolonged period of relative inactivity.