

RetailResearch

M A R K E T U P D A T E

Marcus & Millichap

Dallas/Fort Worth Metro Area

Second Quarter 2010

MULTI-TENANT SECTOR POISED TO RECOVER IN COMING MONTHS

The Dallas/Fort Worth retail market has begun to emerge from the relatively brief, albeit sharp, local recession, with vacancy projected to stabilize by year end and rent growth anticipated to resume in early 2011. Rent renegotiations have largely dissipated, though new leases are being signed at 2004 effective rent levels. Nonetheless, an impressive economic and demographic outlook has attracted expanding retailers to the Metroplex. Grocery chain Aldi, for example, will open 27 stores this spring, and other grocers have started to expand their local footprints. Although these stores generate jobs and elevate traffic at community centers, in-line space remains difficult to fill due to hurdles in obtaining small-business loans. As a result, vacancy rates will not steady until late this year, when speculative construction winds down. In fact, development activity will reach a 20-year low in 2010 as inventory expands by less than 1 percent.

Well-located single-tenant assets continue to be the most active in the investment arena, but the multi-tenant sector appears to be on the cusp of a recovery. The expectations gap between buyers and sellers has started to close, though investors remain very selective when pursuing deals. The number of buyers seeking stabilized assets at distress-level pricing has begun to dissipate as a pricing floor emerges. Additionally, some banks have been willing to repossess high-profile developments that have fallen into financial difficulty, an indication greater returns may be achieved on the open market rather than by extending loan terms. Lower-tier properties with operational and loan issues, however, continue to receive extended terms. A change in this policy will be the first sign lenders believe the retail market is gaining sustainable momentum. Buyers targeting stabilized properties, meanwhile, will find cap rates for multi-tenant strip centers in the low-9 percent range, while single-tenant fee simple deals will likely trade from the mid-7 percent area for fast-food concepts to more than 8 percent for buildings with local or franchisee tenants.

2010 ANNUAL RETAIL FORECAST



Employment: Employers will expand payrolls by 66,000 positions in 2010, a 2.3 percent increase and the largest number of new jobs in the country. Last year, 90,900 jobs were lost, though most cuts occurred in the first half.



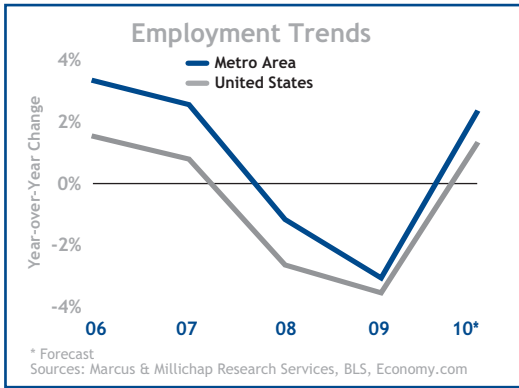
Construction: By year end, builders will add 2.4 million square feet to the market, after completing 4.7 million square feet in 2009.



Vacancy: Vacancy will reach 12.9 percent this year, a 40 basis point gain from year-end 2009 and the highest rate since the early 1990s.

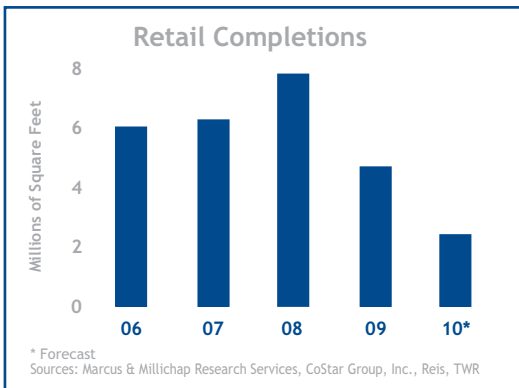


Rents: Although vacancy will begin to stabilize in the second half, rents will drop through year end. Asking rents will retreat 1.2 percent to \$15.07 per square foot, while effective rents will slide 2.4 percent to \$12.92 per square foot.



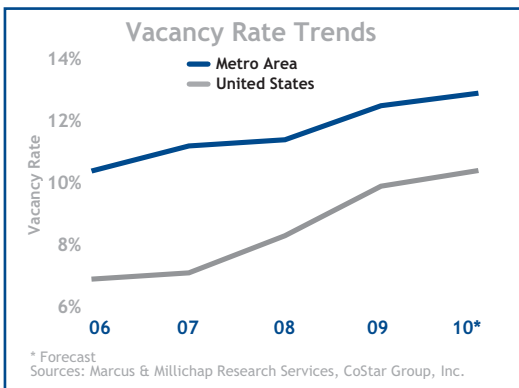
ECONOMY

- ◆ Over the past 12 months, companies have cut 46,600 positions in the Metroplex, a 1.6 percent reduction in payrolls. A recovery in the employment market has been choppy. After adding more than 14,000 jobs in the fourth quarter of last year, employers slashed nearly 1,000 positions during the first quarter of 2010.
- ◆ Although several sectors have contributed to losses in the past year, only the construction sector will shed jobs in 2010. By year end, developers will eliminate 2,600 construction positions, a 1.9 percent decrease. In 2009, the segment lost nearly 17 percent of its workers.
- ◆ Local cities have used incentives aggressively to attract businesses. Allen, for example, recently offered Experian incentives to expand its area work force by 300 people, which should boost traffic to nearby retailers. Market-wide, the professional and business services segment will expand by 14,500 positions this year, a 3.5 percent gain.
- ◆ **Outlook:** Employers will expand payrolls by 66,000 positions in 2010, a 2.3 percent increase and the largest absolute gain in the country. Last year, 90,900 jobs were lost, though most cuts occurred in the first half.



CONSTRUCTION

- ◆ Softening fundamentals have given developers pause when considering new projects. As a result, only 50,000 square feet of new retail space came online in the first quarter.
- ◆ Builders have 6.3 million square feet under way, less than half of which is slated for delivery this year. The planning pipeline contains 30 million square feet, though less than 5 percent of the proposed space has a targeted groundbreaking date.
- ◆ Most of the development in the Metroplex this year involves the build-out of power centers. The 625,000-square foot Alliance Town Center, for example, is nearly complete, and leasing activity on most of the pad sites has started to pick up as foot traffic accelerates in line with anchor openings.
- ◆ **Outlook:** By year end, builders will add 2.4 million square feet to the market, after completing 4.7 million square feet in 2009.

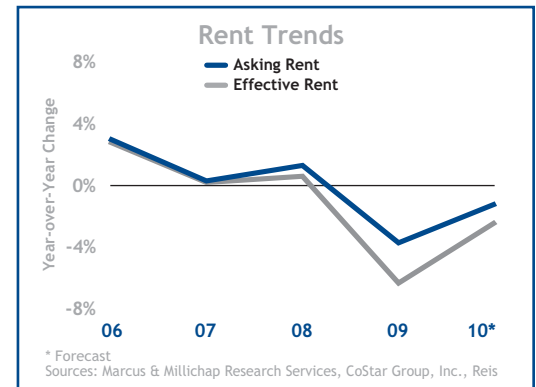


VACANCY

- ◆ In the first quarter, vacancy was flat at 12.5 percent. Over the past 12 months, vacancy has jumped 120 basis points due to heavy construction and softening demand.
- ◆ Neighborhood/community center vacancy in Dallas has climbed 150 basis points year over year to 14.3 percent. In Fort Worth, shopping center vacancy has pushed up 130 basis points to 13.8 percent. The vacancy rate in both MSAs increased 50 basis points in the first quarter.
- ◆ Shopping centers in the Far North Dallas and Southeast Dallas submarkets have reported the largest improvements in vacancy over the past year, posting declines of 230 basis points to 14.2 percent and 180 basis points to 12.6 percent, respectively.
- ◆ **Outlook:** Vacancy will reach 12.9 percent this year, a 40 basis point gain from year-end 2009 and the highest rate since the early 1990s.

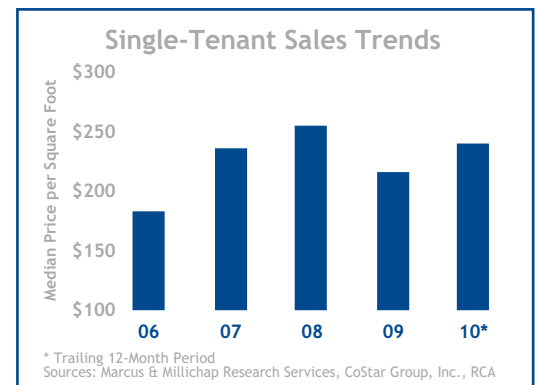
RENTS

- ◆ Asking rents slipped to \$15.19 per square foot in the first quarter, while effective rents were \$13.14 per square foot, marking annual declines of 2.6 percent and 5.3 percent, respectively. The pace of rent losses has eased, as asking rents eased by 0.4 percent in the first three months of the year, and effective rents ticked 0.7 percent lower.
- ◆ The rate of change in occupancy has been a larger driver in rent declines compared to overall vacancy rates during the past year. In the five best-performing submarkets as measured by year-over-year change in vacancy, the average effective rent has slipped just 3.9 percent, despite above-market overall vacancy.
- ◆ Concessions reached 12.8 percent of asking rents in the first quarter and will climb to more than 13 percent of asking rents by year end as owners attempt to retain tenants at a time when filling dark space remains a challenge.
- ◆ **Outlook:** Although vacancy will begin to stabilize in the second half, rents will likely drop through year end. Asking rents will retreat 1.2 percent to \$15.07 per square foot, while effective rents will slide 2.4 percent to \$12.92 per square foot.



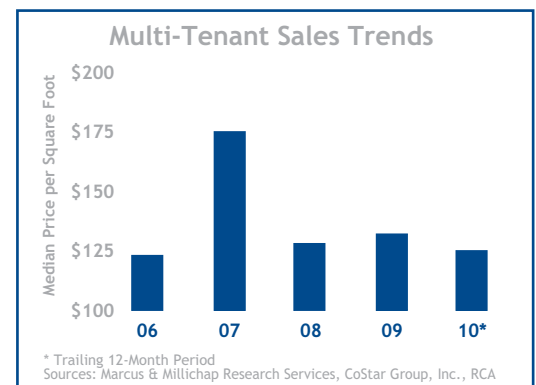
SINGLE-TENANT SALES TRENDS**

- ◆ Transaction velocity ticked up modestly in the single-tenant segment during the most recent 12-month period; the largest increase has been in fast-food and casual dining restaurants.
- ◆ The median price for all single-tenant deals made in the past year was \$225 per square foot, down 12 percent from the previous 12-month stretch.
- ◆ New offerings for ground leases have cap rates in the mid-6 percent to high-7 percent range. Cap rates for fee simple closed deals have averaged in the mid-7 percent to mid-8 percent spectrum over the last year, up 50 basis points from one year ago.
- ◆ **Outlook:** Buyers have targeted single-tenant assets with national-credit tenants when available, though the slowdown in construction activity has limited the number of listings in this segment. Owner-users have begun to re-enter the marketplace, which may help offset a decrease in sales by developers.



MULTI-TENANT SALES TRENDS**

- ◆ Sales velocity in the multi-tenant sector dropped by over 50 percent in the most recent 12-month period. Deal flow has picked up over the past three months and reached a cyclical low in the third quarter of last year.
- ◆ According to just a handful of transactions, the median sales price has fallen just 5 percent to \$130 per square foot during the past year. Overall, valuations have declined more than 13 percent.
- ◆ Average cap rates have increased 120 basis points in the last year to just over 9 percent due to uncertainty regarding tenant health and the lack of potential buyers. First-year returns are expected to average in the low-9 percent range through the end of 2010.
- ◆ **Outlook:** As distressed properties slowly move through the market this year, a pricing floor should emerge. This will help owners currently on the fence about decisions, inevitably creating more opportunities for buyers.



** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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CAPITAL MARKETS

By WILLIAM E. HUGHES, SENIOR VICE PRESIDENT, MARCUS & MILLICHAP CAPITAL CORPORATION

- ◆ After spiking to nearly 4 percent in early April, the yield on the 10-year U.S. Treasury has inched down to approximately 3.7 percent, which is still elevated compared to year-end 2009 levels. Concerns over mounting public debt may place some upward pressure on rates this year.
- ◆ Retail mortgage originations doubled last quarter when compared to year-earlier levels, but the increase was due almost entirely to a handful of large single-borrower CMBS deals involving REITs. Lenders have increased originations of new loans with the intent of ultimately securitizing the debt; however, their focus remains solely on top-quality centers.
- ◆ Loan-to-values are in the 55 percent to 70 percent range, depending on property quality, location and tenant credit. Debt-service coverage ratios remain well above levels reported a few years ago at 1.25x to 1.35x.
- ◆ All-in rates for five-year loans are in the high-5 percent to mid-6 percent range, while 10-year loans are pricing between 6.25 percent and 7.25 percent. Lenders will remain cautious this year as weak fundamentals and limited sales velocity continue to cloud value assessments. Assumable and seller financing will be involved in a large share of deals as a result.

SUBMARKET OVERVIEW

- ◆ Single-tenant velocity was relatively steady in both Tarrant and Dallas counties during the most recent 12-month stretch, though some outer stretches of the Metroplex posted declines in transactions. In Collin County, for example, deal flow slowed by nearly 50 percent as the number of developer-initiated deals dropped.
- ◆ Investors have remained focused on Denton County multi-tenant properties over the past year. Cap rates in the county have jumped 160 basis points to the high-8 percent range, despite the prevalence of newer assets.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents (psf)	Y-O-Y % Change
1	Allen/Frisco/McKinney	7.6%	110	\$18.36	-6.1%
2	Northwest Fort Worth	8.5%	-30	\$12.59	-2.3%
3	Oaklawn	8.7%	390	\$21.15	-5.3%
4	Irving	9.5%	110	\$11.27	-4.4%
5	Southwest Tarrant/North Johnson	11.3%	50	\$11.35	-4.8%
6	Plano	11.4%	0	\$14.60	-5.1%
7	Southeast Dallas	11.4%	-180	\$9.65	-2.5%
8	Arlington	11.8%	-20	\$11.53	-4.8%
9	Richardson	12.0%	70	\$13.18	-8.8%
10	Far North Dallas	12.7%	-240	\$16.84	-4.9%
11	Richland Hills	12.8%	90	\$11.24	-2.4%
12	Farmers Branch	13.6%	30	\$12.51	-6.0%
13	Northeast Fort Worth	14.2%	220	\$14.55	-8.2%
14	Northeast Dallas	15.1%	290	\$10.25	-6.0%
15	West/Southwest Dallas	15.1%	370	\$12.23	-5.4%
16	Highlands	16.0%	480	\$13.79	-5.3%
17	Carrllton/Southeast Denton	16.5%	20	\$13.27	-2.6%