

# RetailResearch

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

Marcus & Millichap

Dallas/Fort Worth Metro Area

Third Quarter 2010

## NATIONAL RETAILERS SWAPPING BIG-BOX SPACE; SMALLER TENANTS YET TO EMERGE IN SUBSTANTIVE NUMBERS

While the Dallas/Fort Worth economy remains in better shape than most markets, years of speculative building and the lingering impact of the recession will delay vacancy improvements until 2011. As of the second quarter, nearly 32 million square feet of retail space stood vacant in the Metroplex, almost equivalent to the amount of new product brought online over the last five years. Given the abundance of available options for retailers, operators will continue to trim rents to compete for tenants. Rent reductions will be most aggressive in newer strip centers built in outlying areas. Northeast Tarrant County, for instance, has received nearly a quarter of the metro's new neighborhood center space since 2005, and area owners have struggled to lure smaller tenants. National chains, however, are leveraging their options and taking advantage of high-traffic sites, with several large leases recently signed. Best Buy, for instance, has moved to Addison and Crate & Barrel will relocate to Plano. In addition, Aldi grocery stores is opening several new stores, absorbing some vacant blocks of space. As the pace of construction slows, the supply and demand imbalance will start to narrow, and fundamentals should stabilize by mid-2011.

As buyers and sellers have realigned their pricing expectations, more multi-tenant investors have returned to the market and sales activity has begun to improve. Demand for the surplus of newly built assets in outlying areas remains constrained, however, due to investors' uncertainty over where falling rents will bottom. As such, properties in the Interstate 635 loop of northern Dallas will receive strong interest. Among single-tenant properties, trade volume rebounded late in 2009 as buyers rushed to acquire developer-initiated deals near large shopping centers, but the inventory of these investments has since thinned. Single-tenant assets will remain the focal point for many buyers, though as the number of quality properties on the market remains light, sale-leasebacks will begin to make up a large share of transactions and help buoy sales.

### 2010 ANNUAL RETAIL FORECAST



**Employment:** After cutting 89,600 jobs last year, local employers will create 57,100 positions in 2010, a 2 percent gain. The professional and business services sector will lead the growth, adding nearly 22,000 workers for a 5.3 percent expansion. Through the recession, professional and business services employers slashed 33,700 positions.



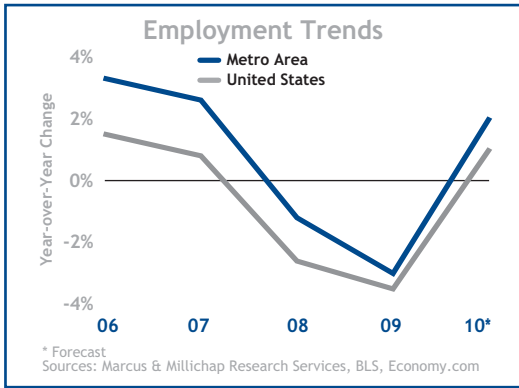
**Construction:** Builders will deliver 2.1 million square feet of retail space this year, down from nearly 4.7 million square feet in 2009. Completions averaged 6.1 million square feet annually over the past five years, but should continue to thin through 2012.



**Vacancy:** Vacancy will rise 40 basis points to 12.9 percent in 2010, with most of the year's new space coming online in the second half. In 2009, vacancy jumped 110 basis points. The Metroplex will record its eighth consecutive year of rising vacancy this year, a trend primarily driven by consistently aggressive development activity.

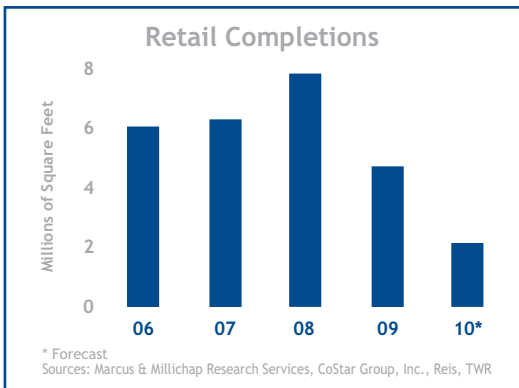


**Rents:** In 2010, asking rents will recede 1.7 percent to \$14.99 per square foot, while effective rents will drop 2.5 percent to \$12.91 per square foot. Last year, asking and effective rents fell 3.7 percent and 6.3 percent, respectively.



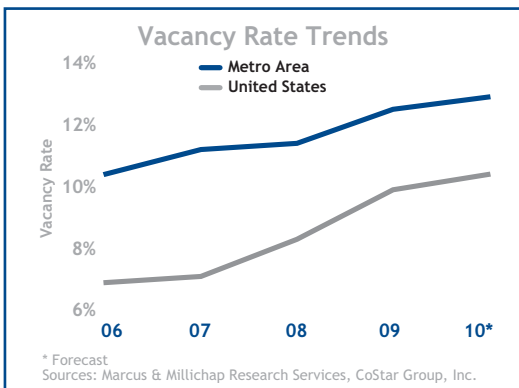
## ECONOMY

- ◆ Employers added 25,600 positions to Metroplex head counts over the past year, including 32,600 jobs in the first half, driving the year-over-year gain to 0.9 percent. In the preceding 12-month period, local companies released 127,900 workers.
- ◆ The government sector was the largest contributor to job growth during the first half of 2010, making 15,800 hires. As city officials look to close budget shortfalls, however, gains in the sector will slow. The looming \$2 billion deficit in Dallas, for instance, will result in the elimination of 500 employees by year end, providing that property taxes are not raised.
- ◆ The education and health services segment also expanded considerably in the first two quarters of the year, creating 12,500 jobs, up from 9,700 positions six month earlier.
- ◆ **Outlook:** After cutting 89,600 jobs last year, local employers will generate 57,100 positions in 2010, a 2 percent payroll increase.



## CONSTRUCTION

- ◆ Retail completions plummeted over the past year, as builders delivered 1.9 million square feet of new space, down from 7.7 million square feet in the preceding 12-month stretch.
- ◆ Nearly 1.3 million square feet of retail space is currently under way. The planning pipeline, meanwhile, contains 26 million square feet, though groundbreaking dates have been announced for less than 4 percent of that space.
- ◆ Some of the most notable completions so far this year were anchor sites at shopping centers. In the first quarter, Kroger debuted its first Marketplace store in the Metroplex at the Eldorado Crossings community center in Frisco, adding 123,000 square feet to area inventory levels. The company will open another Marketplace location at the Alliance Town Center in Fort Worth during the fourth quarter and one store each in Mansfield and Little Elm next year.
- ◆ **Outlook:** Builders will deliver 2.1 million square feet of retail space in 2010, down from nearly 4.7 million square feet last year. During the past five years, completions averaged 6.1 million square feet annually.

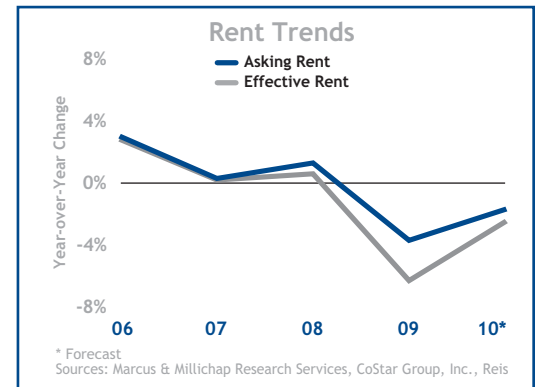


## VACANCY

- ◆ The addition of new supply amid light leasing activity caused vacancy to rise 50 basis points over the past year to 12.6 percent. The pace of weakening has eased, however, with the rate ticking up just 10 basis points year to date.
- ◆ Operational challenges are most prevalent among neighborhood centers, as many regional tenants who leased space in outlying areas continue to shutter. As a result, the regional neighborhood center vacancy rate climbed 110 basis points during the last year to 16.8 percent.
- ◆ The Northeast Fort Worth submarket posted one of the sharpest increases in neighborhood/community center vacancy in the past 12 months, with the average rate rising 330 basis points to 17.4 percent. During that time, more than 160,000 square feet of vacant space was returned to the market.
- ◆ **Outlook:** Vacancy will rise 40 basis points this year to 12.9 percent. In 2009, the vacancy rate jumped 110 basis points.

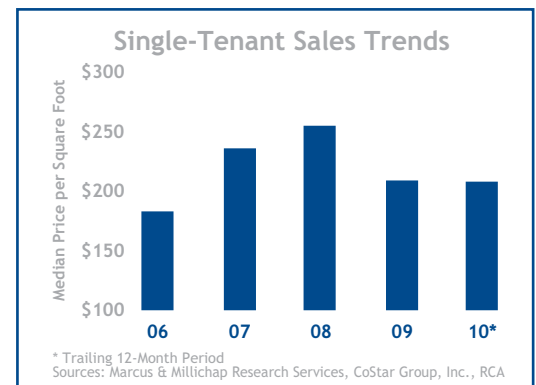
## RENTS

- ◆ Asking rents were \$15.15 per square foot in the second quarter, down 2.4 percent from year-earlier levels, while effective rents fell 4.5 percent in that stretch to \$13.04 per square foot. During the first half, asking and effective rents contracted 0.7 percent and 1.5 percent, respectively.
- ◆ With the vacancy rate in the Farmers Branch submarket the highest in the metro, area owners scaled back asking rents to \$15.03 per square foot and effective rents to \$12.33 per square foot over the past year, respective declines of 2.6 percent and 7.4 percent. As a result, concessions reached a market-high 18 percent of asking rents in the second quarter.
- ◆ Concessions hit historical highs in the second quarter as owners moved to fill dark storefronts. Average leasing incentives climbed 180 basis points during the last year to 13.9 percent of asking rents.
- ◆ **Outlook:** This year, asking rents will recede 1.7 percent to \$14.99 per square foot, while effective rents will drop 2.5 percent to \$12.91 per square foot.



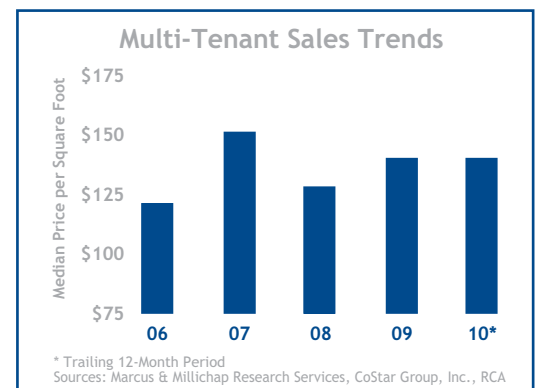
## SINGLE-TENANT SALES TRENDS\*\*

- ◆ Single-tenant sales activity increased 5 percent during the 12 months ending in the second quarter, supported by restaurant sale-leaseback deals and owner-user transactions. Further, the number of closings in the first half of 2010 were more than double transaction volume in the same period last year.
- ◆ Despite a 30 percent acceleration in restaurant property sales, the median price for these assets fell 16 percent year over year to \$324 per square foot. Single-tenant prices overall dropped 25 percent in that time to \$207 per square foot.
- ◆ Single-tenant deals conducted in the past year averaged cap rates in the mid-7 percent to mid-8 percent range, with assets backed by less-creditworthy tenants trading well above the mid-8 percent range and can get to double-digit territory.
- ◆ **Outlook:** As the local economy regains its footing and becomes more supportive of businesses, owner-users will increase their activity. Financially sound retailers continue to shop for attractively priced properties that can be re-purposed but still allow for lower operating costs than those achieved by leasing.



## MULTI-TENANT SALES TRENDS\*\*

- ◆ Multi-tenant sales activity in Dallas/Fort Worth steadied during the most recent 12-month period, driven by a considerable uptick in year-to-date closings. Despite this, multi-tenant trading remains significantly below the levels recorded at the height of the market.
- ◆ Based upon a limited number of transactions with reported prices, the median price rose 13 percent year over year to \$140 per square foot.
- ◆ Cap rates for unanchored centers average above 10 percent, though well-located, stabilized assets offer initial yields in the mid-9 percent range.
- ◆ **Outlook:** Distressed properties continue to work through the pipeline, resulting in greater price clarity. As buyers become more confident of an established pricing floor, and as the pace of rent reductions eases, multi-tenant listings in outlying areas will begin to receive more attention.



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

# Marcus & Millichap

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## CAPITAL MARKETS

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

- ◆ The yield on the 10-year U.S. Treasury fell to the mid-2 percent range in August amid stock market volatility, along with concerns regarding the durability of the economic recovery and the potential for deflation. The yield last peaked at 4 percent in early April of this year.
- ◆ During the first half of 2010, retail mortgage originations were up 27 percent from the same period in 2009. Life insurance companies increased lending activity in recent months, focusing on high-quality shopping centers and single-tenant assets with strong-credit tenants. Also, more lenders have started to originate new loans with the intent of securitizing the debt in the future.
- ◆ Loan-to-values range from 55 percent to 70 percent depending on asset quality, location and tenant strength/credit. Lenders generally underwrite new loans at debt-service coverage ratios of 1.30x to 1.40x, well above levels in 2005 to 2007, when they drifted toward break-even for the most sought-after deals.
- ◆ Mortgage rates have declined substantially for best-of-class assets in primary MSAs. On average, all-in rates for five-year retail loans fall in the low-to mid-5 percent range, while seven- and 10-year mortgages price between 5.5 percent and 6.25 percent. Location, deal quality and strength of sponsor will continue to impact rates.

## SUBMARKET OVERVIEW

- ◆ Years of building in Dallas have weakened operations at older enclosed malls and regional centers, such as the Valley View Mall. In recent years, the 1.6 million-square foot property lost anchor tenants Dillard's and Macy's, contributing to a decline in customer traffic, and, as of the third quarter, the mall reported an occupancy rate of less than 75 percent. Consequently, the property has been returned to its lenders.
- ◆ Neighborhood center inventory in Fort Worth grew by 9 percent over the past five years with the addition of approximately 1.4 million square feet. Nevertheless, demand for such space, which typically stems from smaller regional tenants, has waned, as many of these retailers have shuttered due to operational losses and an inability to secure business loans. As a result, neighborhood center vacancy in Fort Worth climbed 80 basis points year over year to 16.9 percent.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents (psf)	Y-O-Y % Change
1	Oaklawn	7.6%	30	\$21.33	-2.4%
2	Northwest	8.0%	-230	\$12.57	-1.0%
3	Allen/Frisco	8.9%	80	\$18.02	-6.3%
4	Irving	8.9%	-40	\$11.31	-3.0%
5	Arlington	10.5%	-140	\$11.69	-2.5%
6	Southeast	11.3%	-210	\$9.53	-3.4%
7	Southwest Tarrant/North Johnson	11.6%	30	\$11.25	-3.6%
8	Plano	11.7%	110	\$14.62	-2.7%
9	Far North Dallas	12.4%	-20	\$16.73	-4.1%
10	Northeast Dallas	14.5%	50	\$10.22	-3.2%