AVISON YOUNG

First Quarter 2017 / Industrial Research Report

Houston

Market Facts

19,300

Jobs added in the last 12 months ending in February, a 0.6% increase in employment.

5.9%

Unemployment in Houston, which is now higher than the national unemployment rate of 4.7%.

4.3

Million square feet of industrial space under construction, the smallest pipeline recorded in the past five years.

5.3%

Vacancy in Houston's industrial market remains tight.

Market Overview

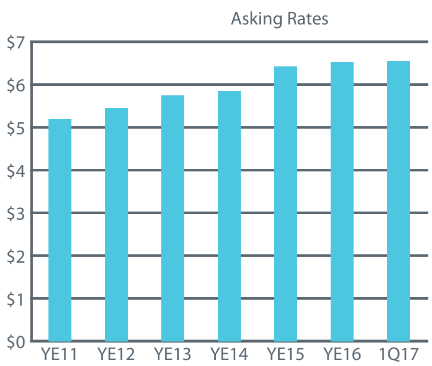
The Houston industrial market began 2017 on a positive note, with strong absorption gains, active leasing, and steadily-improving asking rates. Demand in the first quarter was driven by warehouse and distribution properties. These properties have benefited from Houston's strong population growth, the rise in on-line retail, and the downstream energy industry. Manufacturing and flex properties have been disproportionately affected by the energy downturn and will need additional time to fully recover. The current construction pipeline is the lowest recorded in the past five years. However, there are several large tenants in the market who will likely break ground on build-to-suit projects in the coming months. Vacancy increased slightly in the first quarter due to new deliveries out-pacing absorption, but remains near historically-low levels.

In the latest population estimates provided by the U.S. Census Bureau, Houston was ranked as the second fastest-growing metropolitan area in the U.S., adding 125,005 people in the last 12 months ending in July 2016. The strong population gains occurred during the height of the energy downturn, indicating that Houston will continue to grow despite volatility in the oil industry. Annualized employment in the Houston Metro remained in positive territory throughout the entire downturn, and the Greater Houston Partnership is forecasting an additional 29,700 jobs to be added in 2017. Sentiment in Houston shifted from pessimism one year ago to the current state of guarded optimism since the economic downturn is over and Houston is in recovery mode. In the past year, the industrial market was one of the best performing product types in Houston. Going forward, the industrial market is poised to continue slowly improving as Houston's economic outlook continues to brighten.

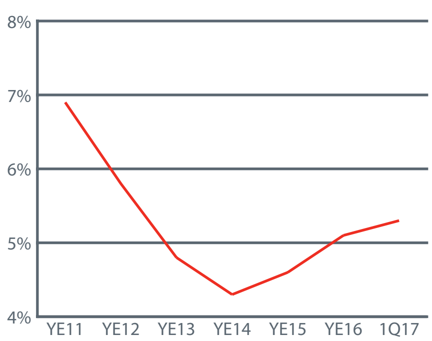
Absorption & Demand

The Houston industrial market recorded over 1.1 msf of positive net absorption in the first quarter. Demand for industrial space has varied by product type. Absorption in the first quarter was attributed to warehouse and distribution properties, which recorded over 2.1 msf. Flex and manufacturing properties recorded a negative net absorption of 596,595 sf and 393,928 sf, respectively. 78% of leasing activity

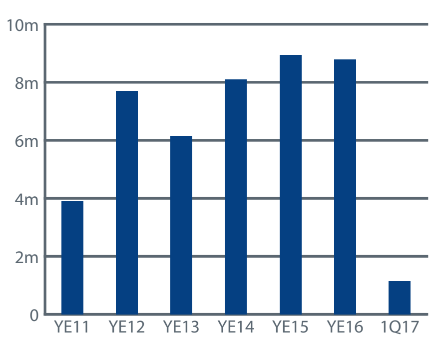
Asking Rates



Historical Vacancy Rate



Historical Net Absorption



in the first quarter occurred in warehouse and distribution properties. These properties are likely to continue posting the lion's share of absorption throughout the year.

Demand across the Houston industrial market has also varied by geographical location throughout the downturn, but these differences are beginning to even out as the energy industry continues to recover. North Houston has been plagued by oversupply concerns brought on by an abundance of crane-served buildings, while the Southeast remains a bright spot in the region due to petrochemical and trade activity. The majority of the market is experiencing positive fundamentals.

Available sublease space increased for five consecutive quarters, but began to subside in the first quarter. Available sublease inventory fell by over 1.0 msf from the previous quarter to 4.2 msf and now represents just 0.9% of the Houston market. This space will likely continue to decrease throughout 2017 as the energy recovery takes further hold.

Vacancy & Availability

New deliveries outpaced absorption, causing the vacancy rate to increase by 20 basis points from the previous quarter to 5.3%. At this point last year, vacancy was 4.9%. Although vacancy is up, the industrial market experienced years of supply struggling to meet demand, resulting in a tight market with sound fundamentals. By historic standards, the current vacancy rate is incredibly low, which is particularly significant given that over 30.0 msf of new product delivered to the market during the height of the energy downturn. The North sub-market maintains the highest vacancy rate in Houston at 8.0%. The Southeast sub-market, where the majority of activity has been occurring in the last two years, recorded a vacancy rate of just 4.6% in the first quarter. With the construction boom winding down and Houston in recovery mode, conditions are projected to remain tight throughout 2017.

Rental Rates

Average asking rates are up by 1.7% from the previous year, indicating that Houston landlords have remained optimistic about industrial product. Asking rates averaged $6.55 per square foot (psf) NNN in the first quarter. The change in asking rates was experienced differently across the different product types. Manufacturing asking rates jumped significantly in the first quarter. From the previous year, manufacturing rates have increased by 13.7% to $7.04 psf. Warehouse and distribution rates have increased by 5.7% to $6.00 psf in this time. Flex asking rates suppressed the total average. Asking rates in flex properties have decreased by 12.2% from the previous year to $9.97 psf. Throughout the downturn, landlords largely opted to maintain base rates while increasing tenant improvement allowances and free rent. Asking rates are projected to continue increasing in 2017, albeit slowly.

Construction

Over 3.3 msf delivered to the Houston market in the first quarter. Large deliveries include Ameriport Industrial Park Building VI (458,280 sf), 1919 FM 565 Road (481,000 sf), and Port Crossing Commerce Center (415,272 sf). The new buildings delivered with 66% preleasing.

A significant number of new projects delivered in the last 12 months, but new construction starts have tapered off and the current construction pipeline is the lowest recorded in the past five years. Only 4.3 msf is currently under construction. This space overwhelmingly consists of warehouse and distribution product, located primarily in the Southeast and Northwest sub-markets. The ongoing population boom is driving demand for industrial users, particularly from e-commerce suppliers as on-line shopping grows in popularity. To keep up with the growing demands of e-commerce consumers, distributors are expanding in Houston to improve connectivity and efficiency. Amazon will soon begin construction in West Houston on a 1.0-msf distribution center that is projected to create 1,000 jobs. As Houston continues to recover, new construction starts will likely pick up again in 2017.

1Q17 Deliveries

Ameriport Industrial Park Bldg VI
(458,280 sf). Southeast.

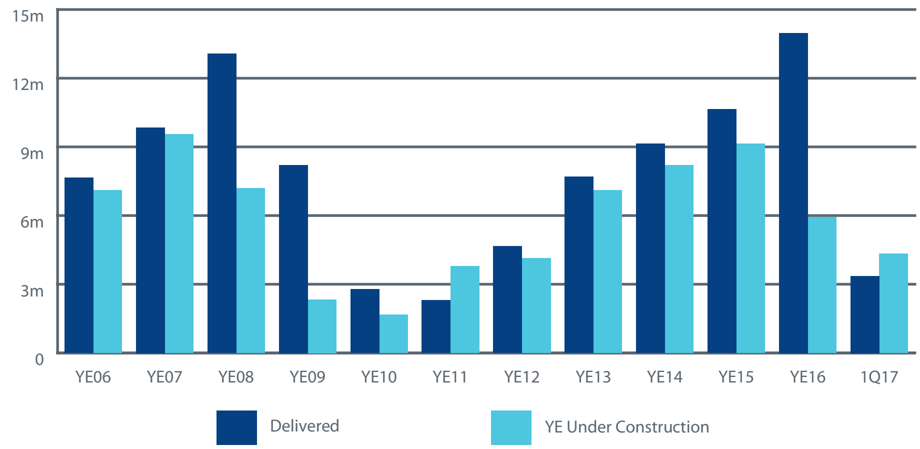
Ameriport Industrial Park Bldg V
(327,600 sf). Southeast.

1919 FM 565 Road
(481,000 sf). Southeast.

Port Crossing Commerce Center
(415,272 sf). Southeast.

Bay Area Business Park Bldg VII
(153,655 sf). Southeast.

Construction Timeline



1Q17 Highlights

- **Amazon** will begin construction soon on a 1.0-msf distribution center in Katy that is projected to create 1,000 jobs. Amazon also occupies 855,000 sf at **Pinto Business Park**.
- **Flexitallic** subleased 125,000 sf at **8203 Market Street**.
- **Hawthorne Customs & Dispatch Services** leased 96,793 sf at **IPT La Porte Distribution Center** in the Southeast submarket. The distribution center was completed in January and delivered with 50% preleasing.
- **Smurfit Kappa** leased 77,987 sf at **West Road Business Park Building 3** in Northwest Houston. The company will take occupancy in May.
- **Gulf Winds** renewed its 303,281-sf lease at **Greens Port Industrial Park** at 1755 Federal Road.
- **Buffalo Industries** leased 49,240 sf of manufacturing space at **Lone Star 3**, located at 6303-6323 Brookhill Drive in South Houston.
- **Trilliant Surgical** leased 44,966 sf at **Corporate Centre Shepherd** at 727 N Shepherd Drive.
- Canada-based **Pure Industrial Real Estate Trust** inked a deal to purchase two buildings totaling 996,482 sf that were recently developed for **Ikea** near the Port of Houston. The deal is expected to close the spring for $63.5 million ($64.00 psf).

Trends to Watch

The price of oil averaged $51.91/bbl. in the first quarter.

Economic sectors reporting growth in the last 12 months include Leisure & Hospitality (3.5%), Education & Health Services (2.8%), Government (3.3%), Information (1.6%) and Finance (0.1%).

In the latest population estimates provided by the U.S. Census Bureau, Houston was ranked as the second fastest-growing metropolitan area in the U.S.

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