

Houston



Market Facts

62,500

Jobs created during the 12 months ending March 2018.

4.2%

Unemployment rate in Houston, down from 5.6% when it peaked in January 2017.

9.9

Million square feet of industrial space under construction.

4.3%

Vacancy in Houston's industrial market remains tight.

Market Overview

Houston's industrial sector dominated the commercial market during the first quarter of 2018 with expansions in the petrochemical and logistics industries, creating strong demand and higher construction rates.

Demand and supply reached equilibrium during the first quarter as direct net absorption totaled more than 2.7 million square feet (msf), matching the more than 2.7 msf of new deliveries. Amazon led the way, occupying its newest 1.1 msf distribution center in Katy. The largest project to be completed in the first quarter, the fulfillment center reported immediate hiring of up to 400 employees with expected employment to reach 1,000.

Leasing activity remained strong at 5.2 msf, with almost double that square footage currently in the construction pipeline. About one-third of all projects underway are build-to-suit (BTS), and overall, the under-construction projects are collectively 60% preleased. New projects continue to be announced.

With the increased demand for new product to serve as distribution and logistics hubs for consumer products along with the growth in the petrochemical industries at the Port of Houston, the industrial market remains Houston's best-performing product type and will likely continue to do so throughout 2018.

Houston has maintained a vibrant, diversified economy despite a slowly recovering energy industry and a devastating hurricane last year. The price of oil reached \$65 per barrel in April, which is the highest price since the downturn took hold. The Greater Houston Partnership is forecasting Houston employment to pick up in 2018, driven primarily by the strength of the U.S. and global economies and Houston's links to them, specifically exports. Economic conditions in Houston are expected to improve and continue to diversify throughout the year.

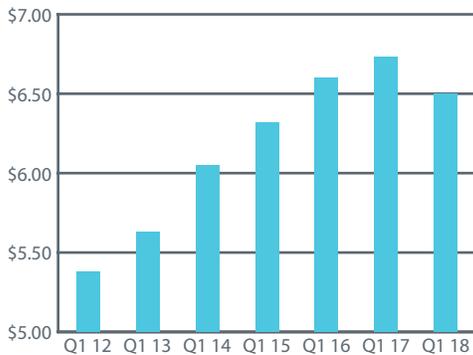
Absorption and Demand

Net absorption tripled from the previous quarter and at more than 2.7 msf, represents just slightly under the 2.9 msf recorded in first quarter of last year. This rate matched the square footage of new product deliveries this quarter, showing an equilibrium in supply and demand.

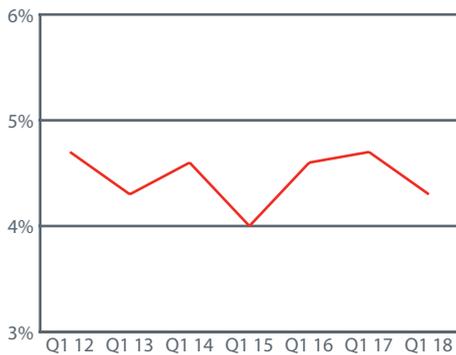
With no shortage of leasing activity, demand for industrial space remains incredibly high. Demand drivers including petrochemical expansion and the rise of e-commerce have contributed to net absorption averaging 2.9 msf per quarter during the last two years. Multiple deals were signed in the wake of Hurricane Harvey due to the increased need for building materials throughout the metro. This provided the industrial market with



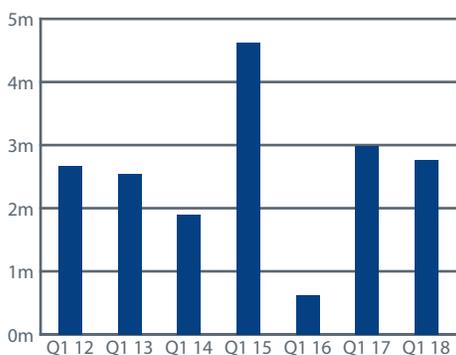
Historical Direct Asking Rates (NNN)



Historical Direct Vacancy Rate



Historical Direct Net Absorption



a short-term boost in demand late last year, but petrochemical companies have kept activity high around the Port of Houston with large industrial leases and land purchases. Many petrochemical projects are scheduled to wrap up by 2020, but petrochemical expansion is still driving development of new industrial product.

The rise of e-commerce and the effect it is having on Houston's industrial market is projected to be the main driver of growth in 2018. The need for big box distribution and warehouse product has spiked in the past year due to expansion in the consumer goods sector and rapid population growth, establishing Houston as a formidable distribution hub. To better-serve customers, many distributors have begun to open large distribution sites including Amazon, FedEx, Ikea, and Best Buy. They are among the largest distributors who have either recently opened major distribution facilities or are in the building stages.

Available sublease space has decreased for the last five consecutive quarters, with 3.2 msf reported this quarter. This decrease is a 400,000-sf drop from the previous quarter to more than a 1-msf drop since first quarter 2017. This space will continue to decrease throughout 2018 as the economic recovery continues. Since leasing activity has shifted away from existing product to new construction, the majority of absorption gains this year should coincide with the delivery timeline.

Vacancy & Availability

Overall vacancy increased by 10 basis points from the previous quarter to 4.3% at the end of the first quarter. At this time last year, vacancy registered 4.7%. Vacancy has remained below 5.0% dating back to 2012, despite Houston's industrial building boom. This quarter alone, 17 projects totaling more than 2.7 msf delivered to the market, with the largest being Amazon's 1.1-msf facility in Katy. The construction pipeline increased in the first quarter, but most of this space is preleased. Leasing activity, at 5.2 msf, slowed from both last year's fourth quarter and first quarter of more than 7.2 msf each. Although there are pockets within Houston that have been overbuilt, and, therefore, maintain high vacancy rates, the market overall is projected to remain tight in 2018.

Asking Rates

Average asking rates have remained steady during the last four quarters. The first-quarter average of \$6.50 psf NNN is slightly below the \$6.73 recorded during the same quarter last year, yet overall rates show a decreasing trend averaging 1.5% below rates reported during the same quarter in 2016.

The industrial market has remained Houston's best-performing product type for the past three years, but stagnating rates have been an area of

concern. Demand for flex and manufacturing space, which typically command the highest rates, has remained restrained with the energy industry's slow recovery. New product has shifted overwhelmingly to warehouse and distribution space, which accounts for more than 90% of all space under construction. Although demand has remained high for warehouse and distribution space, average asking rates for these properties have fallen by 6.2% from the same quarter the previous year. Overall average asking rates are projected to begin improving in 2018 due to a combination of a tight industrial market and higher land prices across Houston.

Construction

Houston's construction pipeline continues to ramp up as developers look to satisfy the demands of e-commerce suppliers and business at the Port of Houston. The under-construction total jumped to almost 9.9 msf during the first quarter after maintaining an average 6-msf throughout most of the previous year. The total remains more than 95% warehouse distribution facilities, and the 54 buildings are 60% preleased. Houston's rapidly expanding consumer base continues to expect faster delivery times, and e-commerce suppliers are responding by leasing more space in newer and more efficient buildings.

Speculative construction is increasing, with Oakmont West, a 673,785-sf project, noted as the largest project underway, followed by Port Commerce Center's 600,000-sf building along with several projects in the Northwest area. The Grand Parkway has been a game-changer in the west and northwest areas, evidenced by the 1.1-msf Amazon facility which delivered during first quarter, following on the heels of FedEx's 800,000 sf on the Grand Parkway last year. Other large build-to-suits have also entered the picture, with Emser Tile's 601,000-sf project in Pinto Park in the North submarket while Vinmar International and Best Buy have opted for facilities of 500,000 sf and 550,000 sf, respectively, in the Southeast and Southwest.

The bulk of projects under construction is concentrated in the Southeast, Northwest and North. The Port of Houston's increased petrochemical activity is responsible for the bulk of the Southeast's projects while new development for e-commerce suppliers continues in other sectors. The Southeast currently has 4.2 msf, or 42.3% of the total square footage, underway. The Northwest sector has seen many new projects recently break ground and now accounts for almost 3.4 msf, or 34.2% of the total. The North segment is the only other segment with multiple projects totaling 1.7 msf and representing 17.2% of the overall total.

Select Q1 2018 Deliveries

Amazon Dist. & Fulfillment Center
(1.1 msf). Northwest.

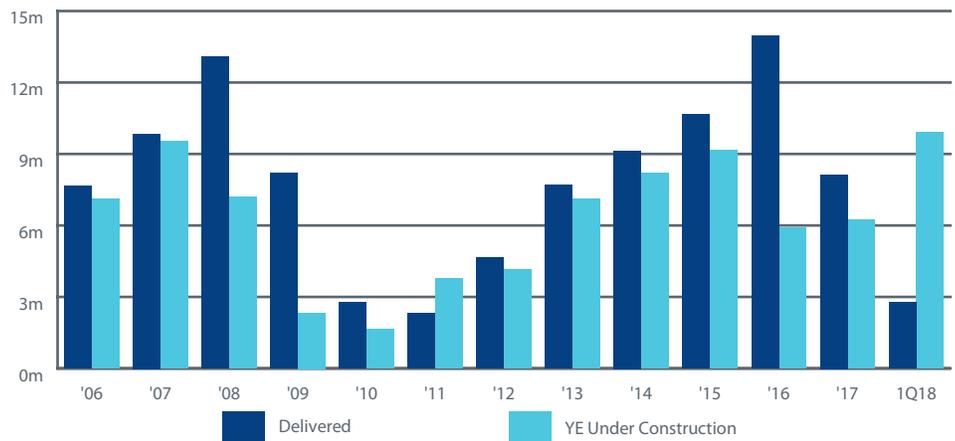
Bayport South Business Park
(257,835 sf). Southeast.

10025 Porter Road
(167,867 sf). Southeast.

6410 Langfield, Building D
(154,661 sf). Northwest.

Generation Park-GHX
(143,500 sf). Southeast.

Construction Timeline



First Quarter 2018 Highlights

- **Amazon** opened its second Houston-area and 10th Texas fulfillment center in Katy. The 1.1-msf facility will eventually employ up to 1,000.
- **Best Buy** has plans to occupy a 550,000-sf BTS project in Missouri City, scheduled for completion in October 2018.
- **Unis, LLC** signed a 257,835-sf lease at Bayport South Business Park, with a projected May 2018 move-in.
- **Richardson Steel** leased 138,921 sf at 2333 Clinton Drive in Galena Park and will move in April.
- **Flexo Converters USA** leased 112,000 at 8575 Volta in Humble for an immediate move-in.
- Liberty Property Trust broke ground on a 727,600-sf distribution center in North Houston for **Grocers Supply**, a division of C&S Wholesale

Grocers, the 10th-largest privately held company in the United States. The BTS project includes a long-term lease and the sale of 34 acres of adjacent land by Liberty to Grocers Supply. Delivery of the project is expected in the second quarter of 2019.

- **Crow Holdings Industrial** has broken ground on a new industrial project that will deliver 349,050 sf of speculative distribution space to southeast Houston. Victory Commerce Center, a cross-dock, tilt-wall distribution complex located at 2851 E. Pasadena Boulevard, is slated to deliver in the first quarter of 2019.
- **Prologis Inc.** agreed to purchase **DCT Industrial Trust Inc.** for \$8.4 billion. Both firms have large Houston portfolios of industrial projects catering to the logistics real estate market.

Trends to Watch



The price of oil rose above \$65/bbl for the first time since the downturn took hold in 2015.



All economic sectors reported growth in the last 12 months except for Information (-4.6%).



The Purchasing Manager's Index (PMI) registered 52.8 in April, indicating short-term expansion in regional production.

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