Second Quarter 2017 / Industrial Research Report

Houston

Market Facts

45,300

Jobs added in the last 12 months ending in May, a 1.5% increase in employment.

5.1%

Unemployment in Houston, which is now higher than the national unemployment rate of 4.4%.

5.3

Million square feet of industrial space under construction.

5.1%

Vacancy in Houston's industrial market remains tight.

Market Overview

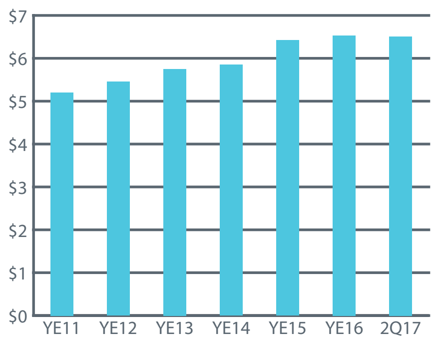
Mid-year 2017 marks the third anniversary since oil began its precipitous decline. While the energy industry continues to make its slow recovery, Houston's industrial market has been able to find other avenues to facilitate growth despite volatility in the economy. This has made the industrial market Houston's best-performing property type throughout the entire downturn. Select pockets of the industrial market continue to be disproportionately affected by the energy industry. However, Houston's industrial market as a whole has benefited from strong population growth, changing dynamics associated with e-commerce, continued strong trade through the Port of Houston, and the ongoing petrochemical boom. These factors have somewhat insulated the industrial market from the energy downturn. Going forward, the industrial market is poised to continue slowly improving as Houston's economic outlook continues to brighten.

Evidence of Houston's recovery continues to show up in an increasing number of economic indicators. The Purchasing Manager's Index registered 54.1 in May, indicating short-term expansion. Employment has picked up with 45,300 jobs added in the last 12 months ending in May, a 1.5% increase in employment. Houston's single-family housing market remains strong. According to Metrostudy, Houston ranks No. 2 in housing starts in the nation. Houston also ranks No. 2 in population growth. The rig count has more than doubled in the last year with 952 in operation as of early July. Even though Houston's economy continues to improve, a full recovery will take additional time. The price of oil has remained around $45.00 per barrel since the middle of 2016 and most energy analysts project that it will remain around that price through 2017. The Houston economy has managed to grow despite a stagnating energy industry, placing the city in a favorable position once oil prices finally turn around.

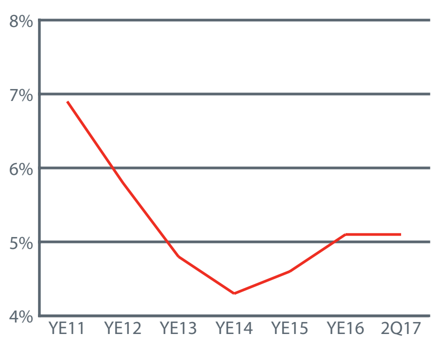
Absorption and Demand

The Houston industrial market recorded 949,791 sf of positive net absorption in the second quarter, totaling over 2.7 msf at the mid-year point. This quarter's strong absorption gains were mainly attributed to the delivery of several large build-to-suits. Demand for

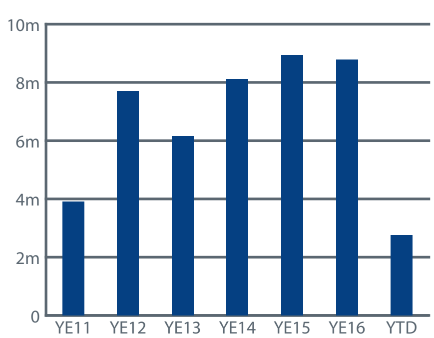
Asking Rates



Historical Vacancy Rate



Historical Net Absorption



big box distribution and warehouse product has spiked in the past year due to expansion in the consumer goods sector. Two factors have contributed most to this increase in activity- strong population gains and the rise of e-commerce. To better-serve customers, many distributors have begun to open large distribution sites in Houston when in the past they have operated out of Dallas. In addition to new major build-to-suits, this trend has had the added benefit of giving older and smaller warehouses a new lease on life. With consumers demanding faster delivery times, distributors have begun to lease smaller warehouses near targeted neighborhoods as well.

Even though the rise in consumer goods distribution has energized the market, industrial space continues to be largely driven by trade and petrochemical activity near the Port of Houston. The Southeast market accounted for 80% of the total industrial market's year-to-date absorption. Rail-served land has become particularly valuable.

Available sublease space increased for five consecutive quarters, but began to subside in the early in 2017. Available sublease inventory fell by over 200,000 from the previous quarter to 4.0 msf and now represents just 0.8% of the Houston market. This space will likely continue to decrease throughout 2017 as the economic recovery takes further hold. Leasing activity shifted away from existing product to new construction, indicating that the majority of absorption gains in the next year will coincide with the delivery timeline.

Vacancy & Availability

Overall vacancy decreased by 20 basis points from the previous quarter to 5.1%. 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. Vacancy in North Houston fell by 40 basis points from the previous quarter, but still remains as the highest vacancy in the city at 7.6%. The Southeast submarket, where the majority of activity has been occurring in the last two years, recorded a vacancy rate of just 4.4% in the second quarter. With the majority of space under construction heavily preleased and Houston in recovery mode, conditions are projected to remain tight throughout 2017.

Asking Rates

Average asking rates have remained relatively stable in the last two years. Throughout the downturn, landlords largely opted to maintain base rates while increasing tenant improvement allowances and free rent. Rates fell slightly from the previous quarter to $6.51 per square foot (psf) NNN, but are still up by 1.2% from the previous year. Manufacturing and flex space, still struggling relative to the booming warehouse and distribution sector, accounted for the drop in rates. The industrial market is well-positioned to take advantage of Houston's improving economy. Asking rates in manufacturing and flex space will likely remain flat throughout the remainder of the year while rates in warehouse and distribution product are projected to continue appreciating in the near-term.

Construction

Construction activity had been lagging behind the historic average at the start of 2017, but a number of ground breakings in the second quarter boosted Houston's industrial pipeline back to normal. Over 5.3 msf is currently under construction. This space overwhelmingly consists of warehouse and distribution product, located primarily in the Southeast and Northwest submarkets. Amazon began construction on its 1.0-msf distribution center in Katy. When complete, the site is projected to create 1,000 jobs. Avera is developing a 500,000-sf build-to-suit industrial building for Vinmar International, a petrochemical marketer and distributor. The building is located in Baytown in the Cedar Port Industrial Park. Over 4.8 msf delivered to the Houston market in the first half of the year. Demand remains high for Houston's industrial product, and additional new construction starts will continue to make headlines throughout the year.

2Q17 Deliveries

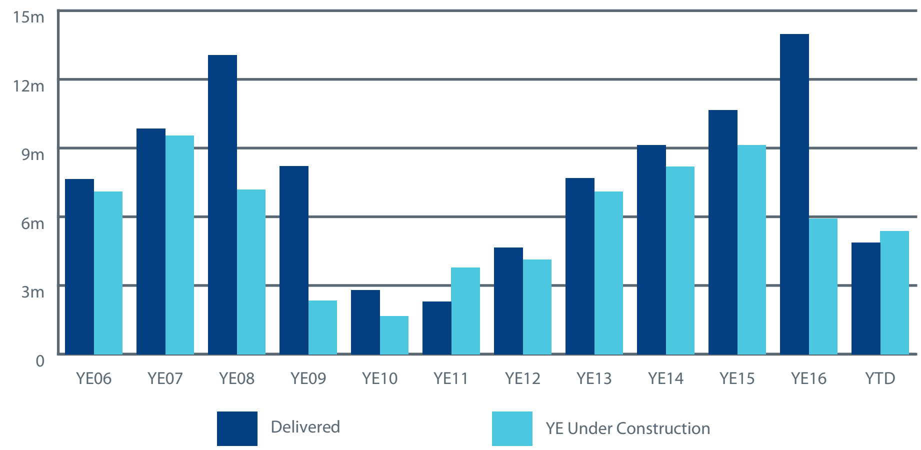
Port Crossing Commerce Center
(415,272 sf). Southeast.

Bayport North Industrial Park
(339,273 sf). Southeast.

Bay Area Business Park Bldgs IV & VII
(263,655 sf). Southeast

Dow Chemical Co. R&D Building
(100,000 sf). Southwest

Construction Timeline



2Q17 Highlights

- Bel Furniture purchased buildings 1 and 2 at **West Ten Distribution Center** in Katy. The occupancy totals 415,296 sf and the company took occupancy in June. They join other companies that have opened distribution centers along I-10, including Rooms-To-Go, Igloo, and Medline.
- **Amazon** began construction on a 1.0-msf distribution center in Katy that is projected to create 1,000 jobs.
- Avera is developing a 500,000-sf build-to-suit industrial building for Vinmar International, a petrochemical marketer and distributor. The building is located in Baytown in the Cedar Port Industrial Park.
- Bayport North Industrial Park delivered two warehouse buildings totaling 339,273 sf. Both buildings delivered fully available for lease.
- Kuraray America, a Japanese chemical corporation, preleased 466,000 sf in two build-to-suits located in Avera's new 185-acre **Bayport Logistics Park** in Pasadena.
- Dupuy Group leased 213,000 sf of industrial space at 3240 South Loop.

Trends to Watch

The price of oil averaged $48.29 /bbl. In the second quarter.

Economic sectors reporting growth in the last 12 months include Manufacturing (3.9%), Leisure & Hospitality (3.8%), Education & Health Services (2.6%), Government (2.9%), Professional & Business Services (2.5%) and Finance (1.0%).

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

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