

# Houston



## Market Facts

**53,500**

Jobs added in the last 12 months ending in August, a 1.8% increase in employment.

**5.2%**

Unemployment rate in Houston, down from 5.8% when it peaked in July 2016.

**4.7**

Million square feet of industrial space under construction.

**4.9%**

Vacancy in Houston's industrial market remains tight.

## Market Overview

Hurricane Harvey has caused widespread devastation across the Greater Houston area and communities along the Gulf Coast. Measuring the full economic impact of the storm will take months, if not years to be realized. Initial estimates rank Harvey as the second most costly storm in U.S. history, behind Hurricane Katrina which struck New Orleans in 2005. Houston experienced massive flooding, resulting in single-family homeowners absorbing the brunt of the storm's impact. Industrial properties were among the least-impacted of product types, although distributors throughout the Houston area have been impacted by disruptions in supply chains. As Houston rebuilds, the industrial market is expected to see a slight up-tick in leasing from suppliers offering rebuilding tools and materials.

Employment and production in Houston are expected to contract in the near term while the city recovers from disruptions related to the storm. However, rebuilding has begun which is helping to spur economic activity. The Federal Reserve Bank of Dallas estimates that employment will be back to normal by

November. Houston is the nation's fourth-largest metropolitan area and a major engine of global economic activity, and Hurricane Harvey is expected to have no long-term impact on the city.

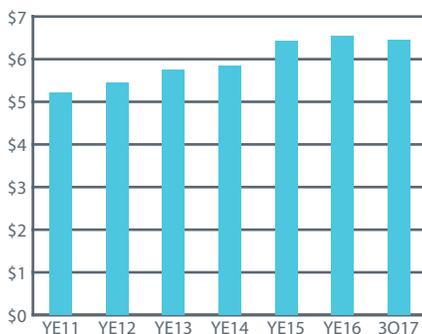
Despite disruptions from Hurricane Harvey, the Houston industrial market recorded a strong showing in the third quarter. Absorption slightly outpaced new deliveries, causing the industrial market to tighten further. The construction pipeline contracted in the third quarter but an increase in construction starts is projected in the coming quarters to address the high demand.

### Absorption and Demand

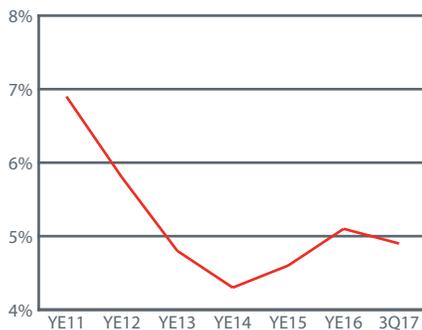
The Houston industrial market recorded 3.0 msf of positive net absorption in the third quarter, representing the best quarterly performance in the past year. Year-to-date absorption now totals over 5.8 msf. Demand for big box distribution and warehouse product has spiked in the past year due to expansion in the consumer goods sector and rapid population growth, establishing Houston as a formidable distribution hub. To better-serve customers,



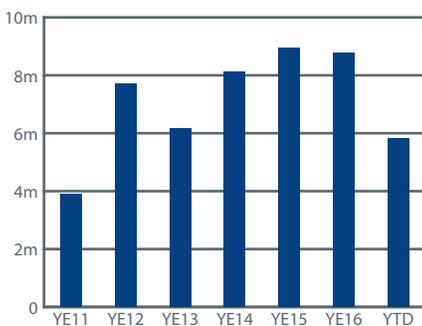
## Asking Rates



## Historical Vacancy Rate



## Historical Net Absorption



many distributors have begun to open large distribution sites in Houston when in the past they have operated out of Dallas. Amazon, FedEx, Ikea, and Best Buy are among the largest distributors who have either recently opened major distribution sites or are in the planning stages. Historically, Houston's North and Northwest sub-markets have been the primary areas of distribution within the metro area. Together, these sub-markets accounted for 80% of absorption in the third quarter.

A number of deals were signed in the wake of Hurricane Harvey due to the increased need for building materials throughout the metro area. Home Depot leased 300,000 sf, and an influx of additional deals from home improvement suppliers are expected in the near term.

Available sublease space increased for five consecutive quarters, but began to subside in early 2017. Available sublease inventory fell by over 100,000 sf from the previous quarter to 3.9 msf, representing 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 time-line.

## Vacancy & Availability

Overall vacancy decreased by 20 basis points from the previous quarter to 4.9% as a result of absorption outpacing new deliveries. Vacancy has remained around 5.0% dating back to 2011, despite Houston's industrial building boom. Over 33.0 msf of new product delivered to the market during the height of the energy downturn. The amount of space under construction continues to contract even though tenant demand remains strong. Although there are pockets within Houston that have been overbuilt and therefore maintain high vacancy rates, the market as a whole is projected to remain tight into 2018.

## Asking Rates

Average asking rates fell for the second consecutive quarter to \$6.44 per square foot (psf) NNN in the third quarter. Asking rates dropped in all product types from the previous quarter. At this point last year, asking rates

averaged \$6.45 psf NNN. Average asking rates have remained relatively stable in the past two years, with landlords largely opting to maintain base rates while increasing tenant improvement allowances and free rent. 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 appreciate in the near-term.

## Construction

Houston's construction pipeline contracted in the third quarter with 4.7 msf under construction. However, additional groundbreakings are expected within the next few quarters due to heavy demand for modern and large-format industrial space. There are currently two main drivers for new industrial product. The first belongs to consumer goods distribution, with demand mainly concentrated in North and Northwest Houston. Houston's rapidly-expanding consumer base continues to expect faster delivery times, and e-commerce suppliers are responding by leasing more space in modern and efficient buildings. Development for this product type is on the upward swing with the market playing catchup to accommodate demand. New developments have been announced along the Grand Parkway, Houston's third major highway loop.

The second main driver for new industrial product has come from petrochemical and trade activity in Southeast Houston. The majority of industrial activity occurred in this sub-market throughout the downturn as the downstream energy industry benefited from low oil prices. The Southeast sub-market currently leads in construction activity and accounts for over 50% of new deliveries this year. While the petrochemical industry along the Gulf Coast appears to be slowing, trade through the Port of Houston continues to grow, indicating that the Southeast will remain as a leader for industrial demand for the foreseeable future.

### 3Q17 Deliveries

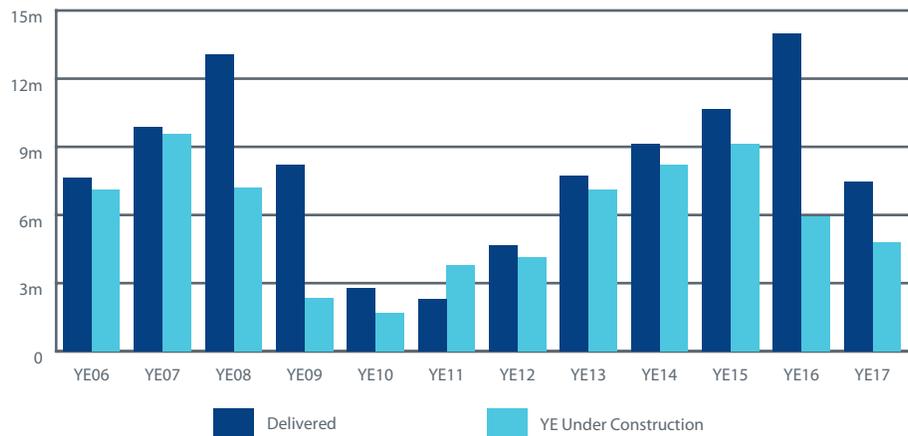
Amazon Fulfillment Center  
(855,000 sf). North.

FedEx Distribution  
(800,000 sf). Northwest.

Pepperl + Fuchs Distribution  
(110,000 sf). Northwest.

Dow Chemical Central Plant &  
Warehouse  
(100,000 sf). Southwest.

### Construction Timeline



### 3Q17 Highlights

- Houston-based **Basintek LLC**, a drilling manufacturer, leased 200,000 sf at 713 Northpark Dr. The company currently occupies 150,000 sf at the park and will move into its additional 50,000-sf space in the third quarter.
- **Amazon** continues 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.
- **GHX Industrial LLC**, a service provider to the refining, petrochemical, and oil and gas industry, will occupy 10 acres in the 25-acre Lockwood Business Park. GHX plans to build a 143,500-sf building comprised of 121,000 sf of warehouse space and 22,500 sf of office space. The company plans to consolidate four Houston locations at the site.
- **Oakmont Industrial Group** broke ground on a speculative 700,000-sf distribution facility in Katy to accommodate e-commerce suppliers. The facility is scheduled for completion in mid-2018.

### Trends to Watch



The price of oil averaged \$48.20/bbl. in the third quarter, slightly down from \$48.29 /bbl. in the second quarter.



All economic sectors reported growth in the last 12 months except for Construction (-2.1%), Information (-2.4%), and Trade, Transportation & Utilities (-0.8%).



The Purchasing Manager's Index (PMI) registered 46.5 in August, indicating short-term contraction. Respondents noted short-term disruptions to operations but expect activity to increase as Houston recovers from Hurricane Harvey.



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