Fourth Quarter 2017 / Industrial Research Report

Houston

Market Facts

46,000

Jobs added in 2017, a 1.5% increase in employment.

4.3%

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

6.2

Million square feet of industrial space under construction.

4.8%

Vacancy in Houston's industrial market remains tight.

Market Overview

The industrial market remained as Houston's best-performing product type through the end of 2017. While absorption slowed in the fourth quarter, the industrial market ended the year with a surge in leasing activity, which will lead to sizable absorption gains in 2018. Market conditions tightened throughout the year. Although the construction pipeline ticked up in the fourth quarter, the majority of this space is already preleased and market conditions are projected to remain tight through 2018. Houston's industrial market has seen no shortage of activity, but asking rates continue to stagnate despite the sustained demand. Asking rates will likely begin appreciating in 2018, due to continued tight market conditions and higher land prices across Houston.

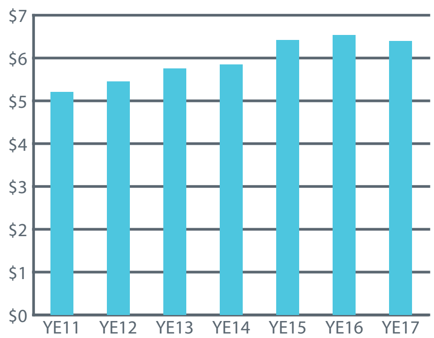
Despite difficulties related to a slowly recovering energy industry and a devastating hurricane, Houston managed to maintain a vibrant, diversified economy. The price of oil rose by 20% in the past year and reached the $60 per barrel mark in late 2017- the highest price since the downturn took hold. 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. Economic conditions in Houston are expected to continue improving throughout 2018.

Absorption and Demand

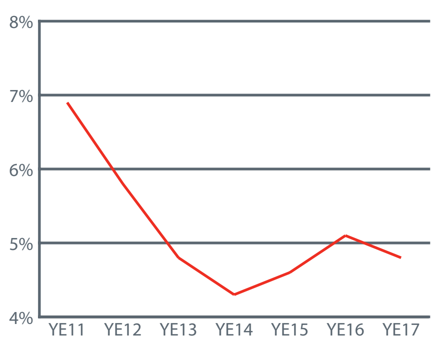
Absorption slowed in the fourth quarter with a limited amount of new product deliveries and planned tenant occupancies, along with a few major move-outs. Net absorption totaled just 64,984 sf in the fourth quarter. This comes on the heels of the 3.0-msf absorbed in the third quarter, which was the best quarterly performance in the past year. Absorption totaled nearly 5.9 msf through year-end 2017.

While absorption was relatively flat in the fourth quarter, demand for industrial space remains incredibly high. Three major demand drivers have emerged: Hurricane Harvey, continued petrochemical expansion, and the rise of e-commerce in Houston. A number of deals were signed in the wake of Hurricane Harvey due to the increased need for building materials throughout the metro area, providing the industrial market with a short-term boost in demand. Petrochemical companies have

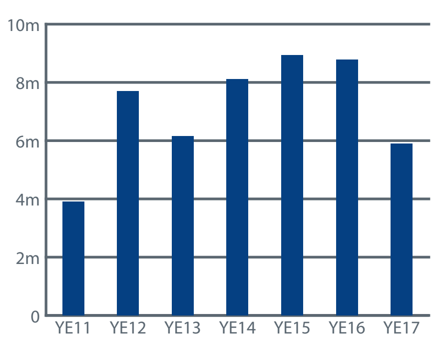
Asking Rates



Historical Vacancy Rate



Historical Net Absorption



kept activity high around Port Houston with large industrial leases and land purchases. The majority of petrochemical projects will wrap up by 2020, but petrochemical expansion is still driving development of new industrial product.

The rise of e-commerce and the effect it's 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 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.

Available sublease space increased for five consecutive quarters, but began to subside early in 2017. Available sublease inventory fell by over 400,000 sf from the previous quarter to 3.5 msf, representing 0.7% of the Houston market. This space will likely continue to decrease throughout 2018, as the economic recovery continues. 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 10 basis points from the previous quarter to 4.8%. At this point last year, vacancy registered 5.1%. Vacancy has remained around 5.0% dating back to 2011, despite Houston's industrial building boom. Over 33.5 msf of new product delivered to the market during the height of the energy downturn. The construction pipeline ticked up in the fourth quarter, but the majority of this space is either build-to-suit projects or heavily preleased. 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 in 2018.

Asking Rates

Average asking rates fell for the third consecutive quarter to $6.39 per square foot (psf) NNN at year-end 2017. From the previous year, rates have dropped by 2.1%. The industrial market has remained as Houston's best-performing product type for the past three years, but stagnating rates have been an area of concern in 2017. Demand for flex and manufacturing space, which typically command the highest rates, has remained tepid with the energy industry's slow recovery. New product has shifted overwhelmingly to warehouse and distribution space. Although demand has remained high for warehouse and distribution space, average asking rates for these properties have fallen by 2.7% from 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 contracted throughout 2017, but several large groundbreakings in the fourth quarter reversed this trend with 6.2 msf under construction at year-end, up from 4.7 msf in the third quarter. 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. While new development for e-commerce suppliers is gaining traction, the majority of construction is still centered around Port Houston due to petrochemical activity. The Southeast submarket accounts for over 50% of construction activity in Houston's industrial market.

Major 2017 Deliveries

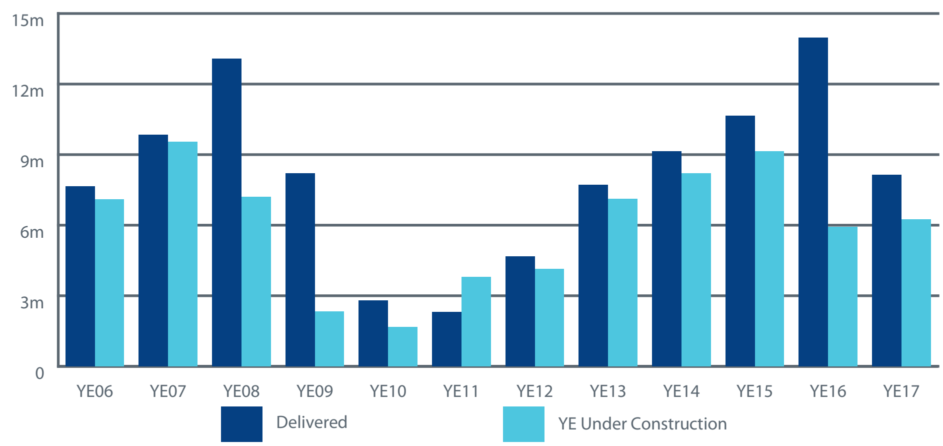
Amazon Distribution & Fulfillment Ctrs
(1.9 msf). North.

Cedar Port Dist. Park Bldgs. I & II
(1.0 msf). Southeast

FedEx Distribution
(800,000 sf). Northwest.

Ameriport Industrial Park Bldgs V & VI
(785,000 sf). Southeast.

Construction Timeline



4Q17 Highlights

- **Pontikes Development** ANNOUNCED plans to develop a 3.0-msf distribution center in Baytown to serve the petrochemical industry and trade through Port Houston. The Port 10 Logistics Center will total eight buildings and two-thirds of the space will be rail-served.
- **American Furniture Warehouse Co.** intends to purchase 23 acres at 21404 Gulf Fwy. in Southeast Houston to build a 350,000-sf showroom, distribution center and warehouse. When completed in early 2019, the $50 million project will create 350 jobs.
- **Oakmont** is developing a 673,785-sf warehouse facility in Katy to cater to brick-and-mortar retailers.
- **MRC Global** took occupancy of 415,000 sf at Port Crossing Commerce Center in Southeast Houston.
- **Rooms To Go** leased 374,000 sf of warehouse space at Mason Ranch Bldg. 1 in Northwest Houston.

Trends to Watch

The price of oil rose above $60/bbl for the first time since the downturn took hold in 2015.

All economic sectors reported growth in the last 12 months except for Construction (-0.4%), Information (-3.3%), and Trade, Transportation & Utilities (-0.1%).

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

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