

# HOUSTON INDUSTRIAL MARKET

## INDUSTRIAL SEES MIXED THIRD QUARTER

While not the same degree as the office market, Houston's industrial market continued to be impacted by the COVID-19 crisis through the third quarter. As the pandemic continues, this impact is now expected to persist through much of the next 12 to 18 months within the market. Examining the metrics for the quarter shows a market that continues to take "one step forward, two steps back". The market absorbed 1.1 MSF of space in the quarter which was down nearly 1.2 MSF from the prior quarter. Vacancy spiked to 8.7% due to the addition of 5.1 MSF of new inventory. More half of arriving space is not yet pre-leased and with COVID-19's economic impact, there is some market uncertainty and bracing for longer down times for vacant space. The overall market average rental rate did rise 6 points (bps) to \$7.71/SF triple-net (NNN). A potential hinderance facing the market in the medium-term could be the gap with which construction activity outpaced the market demand. Over the course of the past 18 months, the market has delivered approximately 29 MSF of new inventory and absorbed 10 MSF, roughly translated to a 33% absorption of deliveries. At the end of the second quarter, the development pipeline currently holds 17.9 MSF of space; major concerns relative to shrinking demand for large blocks of industrial space are key to the market's health during the pandemic impact. The COVID-19 impact for distribution may be seen as occupiers look for smaller satellite warehouses to get goods to market quicker as well as look to fulfill a demand spike for cold storage space to accommodate consumers changing demand and spending habits for food and grocery delivery.

### COVID-19 AND OIL

The double black swan of the COVID-19 virus shutting down the Houston economy combined with the precipitous drop in the energy markets continued in the third quarter. As large producers continued to reduce headcounts and felt impacts via demand drops from other economic sectors such as air travel and petrochem, the life blood of the Houston economy and the industrial market has been cutoff. With WTI pricing at sub \$38/bbl at the end of September, bankruptcy filing from E&P and other companies continue to dominate the news cycle. Through the end of the 3<sup>rd</sup> quarter, Haynes and Boone's bankruptcy tracker shows 36 North American exploration and production companies that have declared bankruptcy this year. As the U.S. heads into the new school year and flu season, the continued presence of COVID-19 cases in the U.S. remains a key metric to watch in the "lower longer" present day versus the hoped for spike in demand increases in the energy markets

### CURRENT CONDITIONS

Vacancy levels rose to 8.7%; availability rate within the market tops 13%

Absorption in the market falls to 1.1 MSF for the quarter; leasing falls to half the prior quarter and 20% of prior rolling average

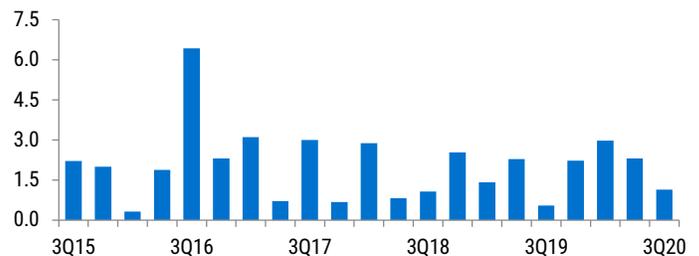
More than 17M SF of U/C space remains in the pipeline; preleasing remains strong

### MARKET ANALYSIS

#### Asking Rent and Vacancy



#### Net Absorption (SF, Millions)



### MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	622.2 MSF	617.1 MSF	592.2 MSF	↑
Vacancy Rate	8.7%	8.1%	6.6%	↑
Quarterly Net Absorption	1.1 MSF	2.3 MSF	2.9 MSF	↓
Average Asking Rent	\$7.71	\$7.65	\$7.31	↓
Under Construction	17.9 MSF	16.3 MSF	19.1 MSF	↓
Deliveries (SF)	4.4 MSF	4.7 MSF	4.5 MSF	↓

## MARKET ADAPTATIONS BECOMING PROMINENT

COVID-19's impact can most readily be seen in the trends currently underway in the Houston industrial market. Tenants and developers have begun to look at a spoke and hub set up for distribution centers to meet consumer demands for "same day service". This means that many developers and users will look at increasing their overall real estate footprint in a city not by having one or two 1M SF distribution centers, but rather look at smaller 200,000 SF satellite centers in order to meet consumer demand. COVID-19 sparked a large scale demand by purchasers for same day or immediate fulfillment of purchases, ranging from every day consumer goods to groceries to home goods, and as a result, potential tenants will be looking to meet these demands by placing 3PL and fulfillment sites closer to the roof tops to where everyone can be reached in a day (or within a 300 mile drive by a delivery driver). Additionally, as consumer purchasing habits continue to shift away from brick and mortar experiences during the COVID pandemic, industrial space that has a strong cold storage component will continue to see increases in both demand and development. With such retail giants as Amazon, Wal-mart and others, as well as grocers such as HEB, Krogers and Albertsons continuing to see increased demand via on line channels for grocery purchase and delivery, they will need larger warehouses with a significant cold storage component in order to keep up with this demand. Developers and owners will be looking to build new locations and build-out existing space to meet this demand in the next 12 months and beyond.

In terms of overall leasing demand in the Houston market, the metrics during the quarter showed a market that is slowing but stable. Just over 5 million square feet of new leases took place across 443 transactions. While the overall transaction size of 11,713 SF was below the second quarter mark of 13,000 SF, the fact that the transactional volume increased was a sign that tenants were active and looking to meet demand needs. Overall, the market saw nearly 60 total transactions greater than 40,000 square feet in nature, and more than a dozen over 75,000 square feet each. The largest two transactions in the quarter account for nearly 10 percent of the overall leasing volume as DHL and SI Warehousing took more than 250,000 square feet each.

## CAPITAL MARKETS

Houston's industrial market was long viewed as a comfortable and smart investment option for institutional and other investors looking to get value relative to the East and West coast port cities and their elevated pricing. However, 2020 saw a flatlining of dry powder being deployed, and the third quarter saw a significant drop in both number of transactions and overall sales volume relative to H1 2020. During the quarter, roughly \$35 million in transactions took place in the market, down nearly two-thirds from the second quarter and 1/10<sup>th</sup> that of the first quarter 2020. Current forecasts show a continued decrease in demand from investors through year-end 2021 with a rebound tied largely to a return spike of oil prices within the market in 2022.

## ECONOMIC LOOK AHEAD

Houston's Purchasing Manager's Index (PMI), a barometer for near-term growth within the metro's business activity, contracted severely in February to 50.2. With a mark anything above 50 indicating expansion, the most recent pre-COVID mark shows that the slowing of the economy in Houston was already here before the pandemic's full impact. However, despite the downturn in PMI seen in the second quarter during the first 90 days of COVID, the past 3 months have seen gains, with August's PMI at 52.6 and a 3 month forecast of 53.5. Combined with modest gains in the unemployment numbers within the city, it is a hopeful sign that Houston has begun to work its way out of a recession.

Houston's economic activity will continue to slowly recover, but with the continued struggles relative to the COVID impact and oil price uncertainty, the economic recovery forecast appears to be much more U shaped than originally hoped for. As a result, despite positive momentum in terms of both job growth and PMI forecasts, the overall economy may not reach pre-COVID levels until 2022 at the earliest even in an economy as diverse as Houston's.

### AVERAGE ASKING RENT BY SUBMARKET

Average Asking Rent (\$/SF)			
	Current Quarter	3Q19	12 Month Change
Southwest	\$9.48/SF	\$7.98/SF	↑
North	\$8.45/SF	\$7.95/SF	↑
Northwest	\$7.30/SF	\$7.15/SF	↑
CBD	\$6.38/SF	\$7.59/SF	↓
South	\$6.35/SF	\$5.95/SF	↑

### VACANCY BY SUBMARKET

Vacancy Rate (%)			
	Current Quarter	3Q19	12 Month Change
North	10.0%	7.6%	↑
Northwest	8.7%	7.5%	↑
Southwest	9.5%	6.2%	↑
Southeast	9.7%	6.4%	↑
CBD	5.7%	4.7%	↑

## LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
DHL	8833 Citypark Loop	Northeast	New – Direct	254,160 SF
SI Warehousing	625 Independence Parkway	Southeast	New – Direct	252,203 SF
MiTek	560 E Richey Road	North	New – Direct	156,505 SF
Lawless Group	13323 S Gessner Rd	Southeast	New – Direct	141,440 SF

## SELECT SALES TRANSACTIONS YTD 2020

Building	Submarket	Sale Price	Price/SF	Square Feet
Port 146	Southeast	\$9,500,000	\$68	140,275 SF
Bayport North Distribution Bld 2	Southeast	\$28,800,000	\$100	287,500 SF
Bayport North Distribution Bld 1	Southeast	\$27,600,000	\$100	276,000 SF
Cutten Rd Distribution Center	North	\$24,200,000	\$82	293,200 SF
10343 Ella	North	\$21,900,000	\$87	250,000 SF

## SUBMARKET STATISTICS

	Total Inventory (SF)	Under Construction (SF)	Total Vacancy Rate	Qtr Absorption (SF)	YTD Absorption (SF)	Direct Asking Rent (Price/SF)	Sublet Asking Rent (Price/SF)	Total Asking Rent (Price/SF)
<b>CBD</b>	52,740,797	0	5.7%	-217,365	-523,655	\$6.38		\$6.38
<b>North</b>	115,606,329	2,532,893	10.0%	115,795	2,259,986	\$8.82	\$5.32	\$8.45
<b>Northeast</b>	39,046,342	648,720	6.5%	36,953	450,809	\$6.32	-	\$6.32
<b>Northwest</b>	177,120,321	4,054,394	8.7%	1,557,082	1,875,699	\$7.63	\$5.77	\$7.39
<b>Southeast</b>	110,057,600	4,182,797	9.7%	-497,392	1,076,726	\$7.41	\$4.91	\$7.07
<b>South</b>	47,887,196	661,016	5.1%	275,996	669,247	\$6.42	\$5.58	\$6.35
<b>Southwest</b>	79,766,568	6,302,909	9.5%	-105,677	545,999	\$9.48	\$7.85	\$9.48
<b>Houston Market</b>	622,225,153	17,920,335	8.7%	1,165,392	6,433,252	\$7.93	\$5.44	\$7.71

## SELECT TEXAS MARKETS- LARGEST SUBMARKETS

Houston, September 2020

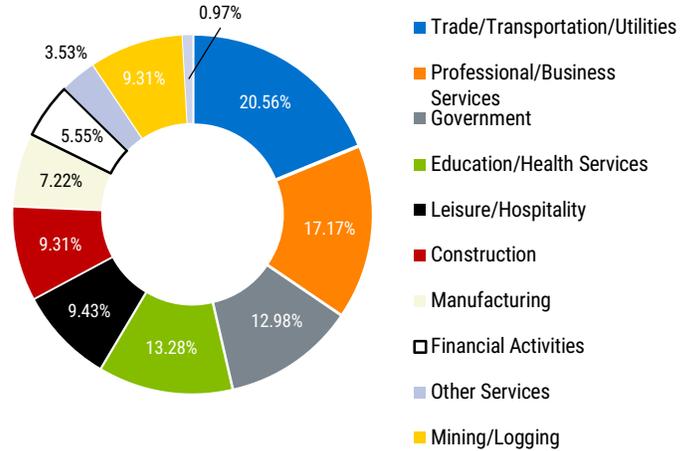
Top 10 Submarkets by Rentable Square Feet

Rank	Submarket	RSF
1	Northwest Houston	177.1 M
2	DFW South Stemmons	124.2 M
3	DFW Great Southwest	120.1 M
4	Northeast Dallas	119.9 M
5	Northwest Dallas	115.6 M
6	North Houston	115.6 M
7	South Dallas	110.0 M
8	North Ft. Worth	112.2 M
9	Southeast Houston	110.0 M
10	South Ft. Worth	90.2 M

Source: Newmark Knight Frank

## EMPLOYMENT BY INDUSTRY

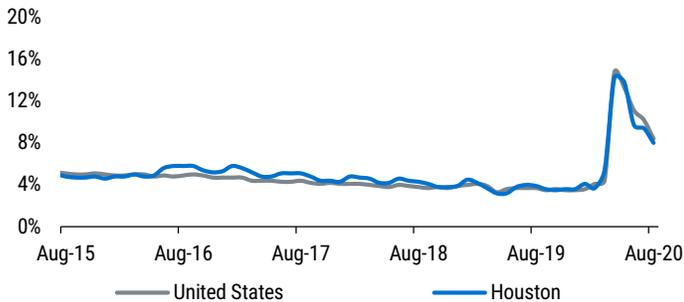
Houston, August 2020



Source: U.S. Bureau of Labor Statistics

## UNEMPLOYMENT RATE

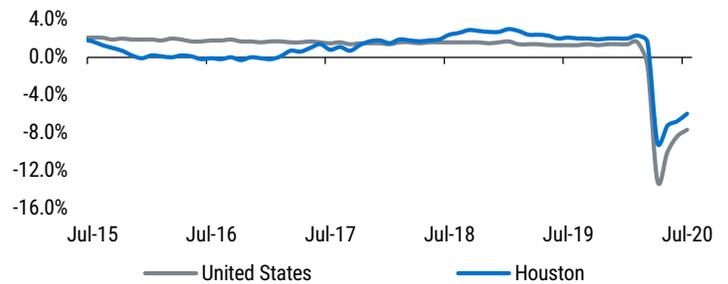
Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

## PAYROLL EMPLOYMENT

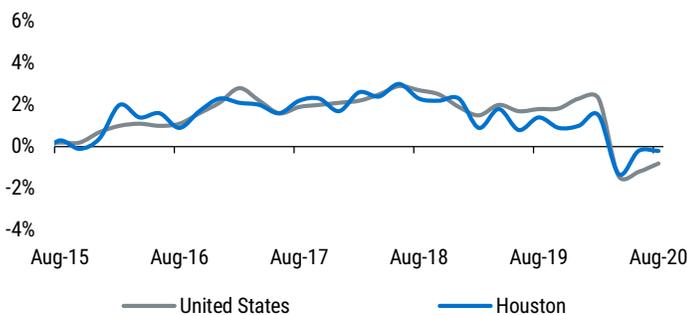
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

## CONSUMER PRICE INDEX (CPI)

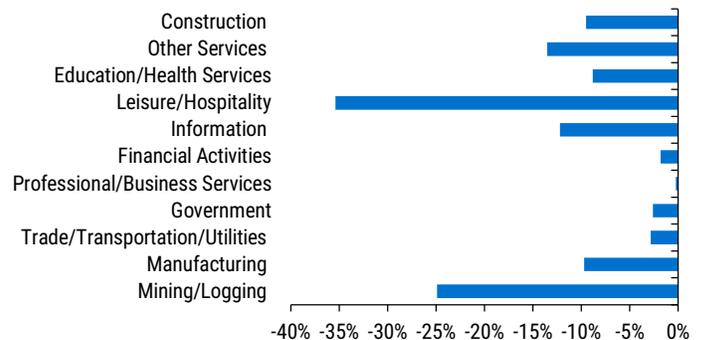
All Items, 12-Month % Change, Not Seasonally Adjusted



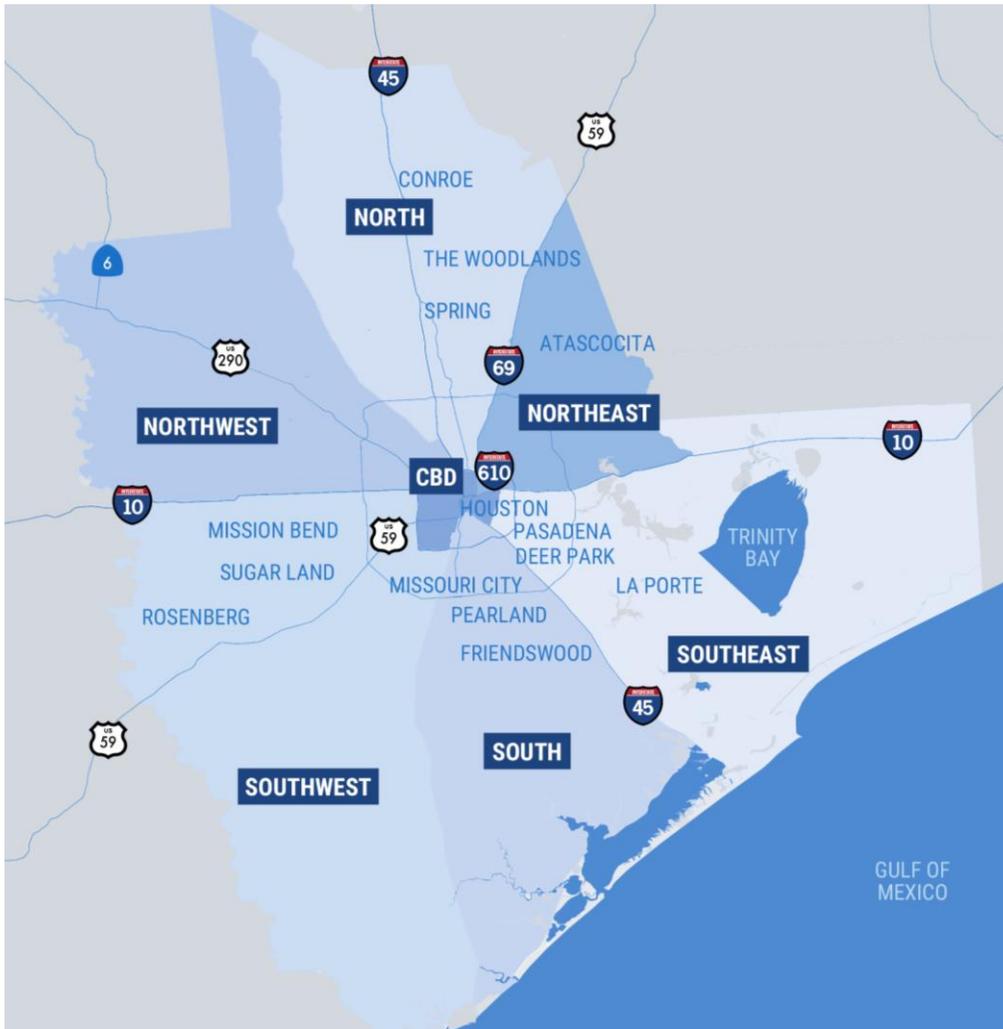
Source: U.S. Bureau of Labor Statistics

## EMPLOYMENT GROWTH BY INDUSTRY

Houston, August 2020, 12-Month % Change, Not Seasonally Adj.



Source: U.S. Bureau of Labor Statistics



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