RESEARCH **2Q 2020**

Newmark Knight Frank

HOUSTON INDUSTRIAL MARKET

COVID-19 AND OIL IMPACT INDUSTRIAL HOUSTON

Despite a strong start to the quarter, Houston's industrial market was impacted in March by both COVID-19 and more crucially, the oil price wars. These twin economic impacts are poised to strain the industrial market for the remainder of 2020 and into 2021. Examining the metrics for the quarter shows a market that was starting to stagnate. The market absorbed 2.3 MSF of space in the quarter which was down nearly 600,000 SF from the prior quarter. Vacancy spiked to 8.1% due to the addition of 4.6 MSF of new inventory. More than 60 percent of the newly 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 26 points (bps) to $7.65/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 24 MSF of new inventory and absorbed 9 MSF, roughly translated to a 38% absorption of deliveries. At the end of the second quarter, the development pipeline currently holds 16.3 MSF of space; major concerns relative to shrinking demand for large blocks of industrial space are key to the market's health during 2020 and 2021. 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

As previously mentioned, the dual impact of the COVID-19 virus shutting down the Houston economy combined with the precipitous drop in both natural gas and WTI pricing in March has led to a period of uncertainty in the market. With large scale oil and gas producers such as Occidental, Schlumberger, Halliburton, and Marathon cutting both capital expenditures and employee headcounts; and other firms shutting down drilling rigs around the various reserves, the life blood of the Houston economy and the industrial market has been cutoff. With WTI pricing at sub $42/bbl at the end of June, it is forecast that Houston will again lead the nation in terms of oil and gas bankruptcies during the upcoming down cycle in the market.

CURRENT CONDITIONS

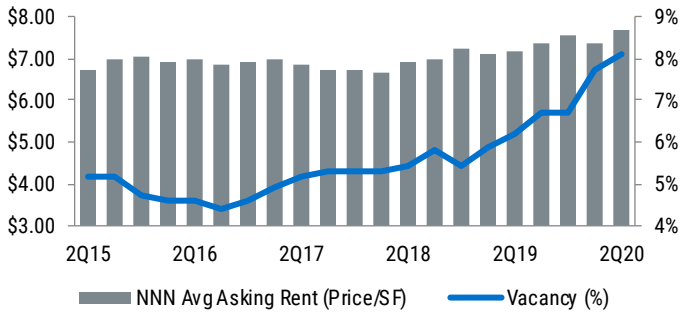
Vacancy levels rose to 8.1% across the market companies reassess needs during COVID crisis

Absorption in the market falls to 2.3 MSF for the quarter; leasing falls to half the 12 quarter average of 6.2 MSF

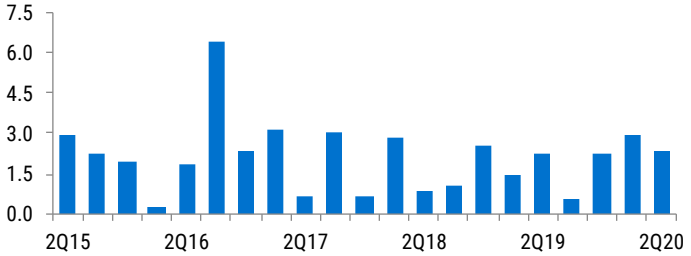
More than 16M SF of U/C space remains in the pipeline

MARKET ANALYSIS

Asking Rent and Vacancy



Net Absorption (SF, Millions)



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	614.1 MSF	609.1 MSF	590.8 MSF	↑
Vacancy Rate	8.1%	7.7%	6.2%	↑
Quarterly Net Absorption	2.3 MSF	2.9 MSF	2.7 MSF	↓
Average Asking Rent	$7.65	$7.39	$7.35	↓
Under Construction	16.3 MSF	19.2 MSF	14.1 MSF	↓
Deliveries (SF)	4.7 MSF	8.8 MSF	5.0 MSF	↓

LEASING POCKETS OF STRENGTH

The Northwest and Southeast submarket saw strong leasing even in a slowing second quarter. The Northwest saw strong activity during much of the quarter with just over 1.1M SF of leasing transaction. Of the top 5 leases signed in the quarter, 3 took place in the Southeast submarket and totaled nearly 430K SF. The Southeast continues to see robust activity thanks mainly to the activity at the Port of Houston. The port was ranked 6th in the nation for loaded containers and recognized as the fastest growing port among container ports in the U.S. Container volume at the Port of Houston reached all time highs at the end of 2019 and is a showcase of the solid business activity found within the Southeast submarket. These two submarkets are expected to remain somewhat insulated during the remainder of 2020. One trend to look for in the coming 12 to 18 months as a result of the COVID-19 impact is the shift by many tenants and developers towards a "300 miles in a day" set up for distribution centers. 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.

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. Pre-COVID in 2020, Houston's industrial market saw much of that same momentum with a variety of transactions taking place throughout the market place with an average transaction size of approximately 240,000 square feet and an average per square foot sales price of $100. The prolonged impact of the double swan event in the Houston market has placed investors' deployment of dry powder on pause as the second quarter saw minimal sales activity. This depression of opportunities within the Houston industrial market is forecast to remain in place for much of the remainder of 2020 and into 2021 pending the resolution of the COVID pandemic, investor comfort on pricing and value, and the stabilization of the WTI pricing in the market.

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 mark shows that the slowing of the economy in Houston was already here prior to the COVID-19 impact. However, this now is the high water mark, as the PMI has plummeted over the past 3 months as the Houston economy contracts severely during the work safe, stay home quarantine during the COVID crisis.

Houston's economic activity will continue to slowly recover, but not in all likelihood until 2021 as the city, state and nation all look to emerge into a new normal following the COVID-19 impact. Houston's outlook is especially grim due to the additional burden of low oil on our economy. Without long term production cuts and an increase in demand for oil from re-opening of the economy in H2 2020, Houston's industrial outlook is shaky at best for 2020.

AVERAGE ASKING RENT BY SUBMARKET

Average Asking Rent ($/SF)

	Current Quarter	2Q19	12 Month Change
Southwest	$9.39/SF	$8.01/SF	↑
North	$8.56/SF	$7.56/SF	↑
Northwest	$7.53/SF	$7.08/SF	↑
CBD	$6.07/SF	$8.17/SF	↓
South	$6.38/SF	$5.98/SF	↑

VACANCY BY SUBMARKET

Vacancy Rate (%)

	Current Quarter	2Q19	12 Month Change
North	10.0%	6.3%	↑
Northwest	8.9%	7.6%	↑
Southwest	7.6%	5.7%	↑
Southeast	8.4%	6.5%	↑
CBD	5.3%	4.2%	↑

LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
China Manufacturers Alliance	4300 Malone	Southeast	New – Direct	183,289 SF
A&R Logistics	703 Logistics Dr S	Southeast	New – Direct	133,333 SF
Nacc Disaster Services	16605 Air Center Blvd Bld 5	North	New – Direct	114,400 SF
Dunavant Distribution Group	10619 Red Bluff Dr	Southeast	New – Direct	114,400 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)
CBD	52,635,428	0	5.3%	-32.022	-306,290	$6.07		$6.07
North	114,412,272	1,870,270	10.0%	1,210,526	2,144,191	$9.07	$4.63	$8.56
Northeast	38,661,337	279,500	5.9%	-45,873	413,856	$5.70	$4.26	$5.61
Northwest	175,421,204	5,097,548	8.9%	128,083	396,794	$7.84	$5.50	$7.53
Southeast	108,479,450	3,130,685	8.4%	606,511	1,574,118	$7.19	$5.01	$6.93
South	47,764,842	289.,358	5.3%	413,883	393,251	$6.48	$5.42	$6.38
Southwest	76,664,024	5,666,474	7.6%	29,207	651,676	$9.39	$8.64	$9.39
Houston Market	614,038,557	16,333,845	8.1%	2,310,335	5,267,860	$7.91	$5.15	$7.65

SELECT TEXAS MARKETS- LARGEST SUBMARKETS

Houston, June 2020

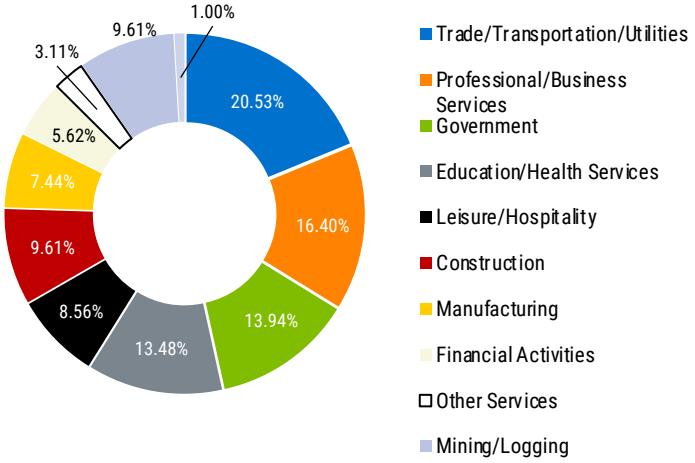
Top 10 Submarkets by Rentable Square Feet

Rank	Submarket	RSF
1	Northwest Houston	173.3 M
2	DFW South Stemmons	121.7 M
3	Northeast Dallas	119.5 M
4	DFW Great SW- Arlington	117.9 M
5	Northwest Dallas	114.3 M
6	North Houston	110.4 M
7	South Dallas	108.0 M
8	North Ft. Worth	106.9 M
9	Southeast Houston	106.7 M
10	South Ft. Worth	87.1 M

Source: Newmark Knight Frank

EMPLOYMENT BY INDUSTRY

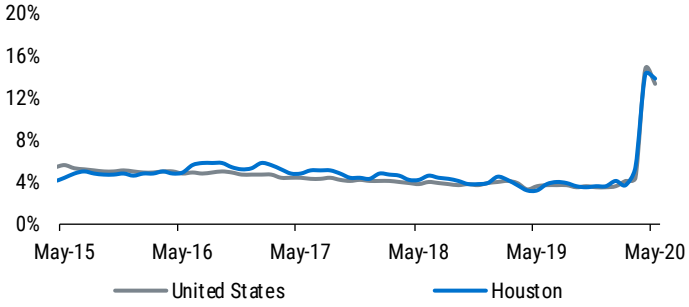
Houston, May 2020



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

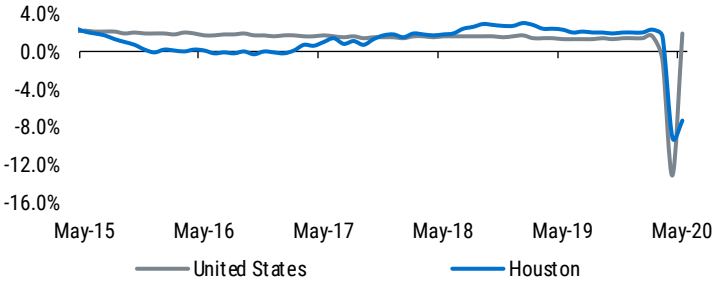
Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

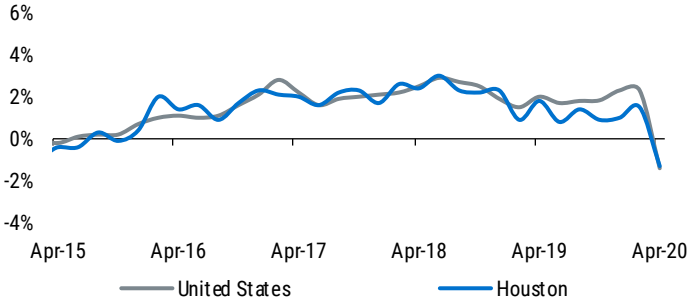
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

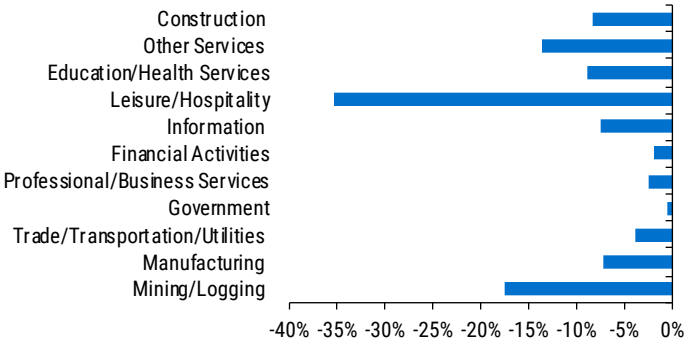
All Items, 12-Month % Change, Not Seasonally Adjusted



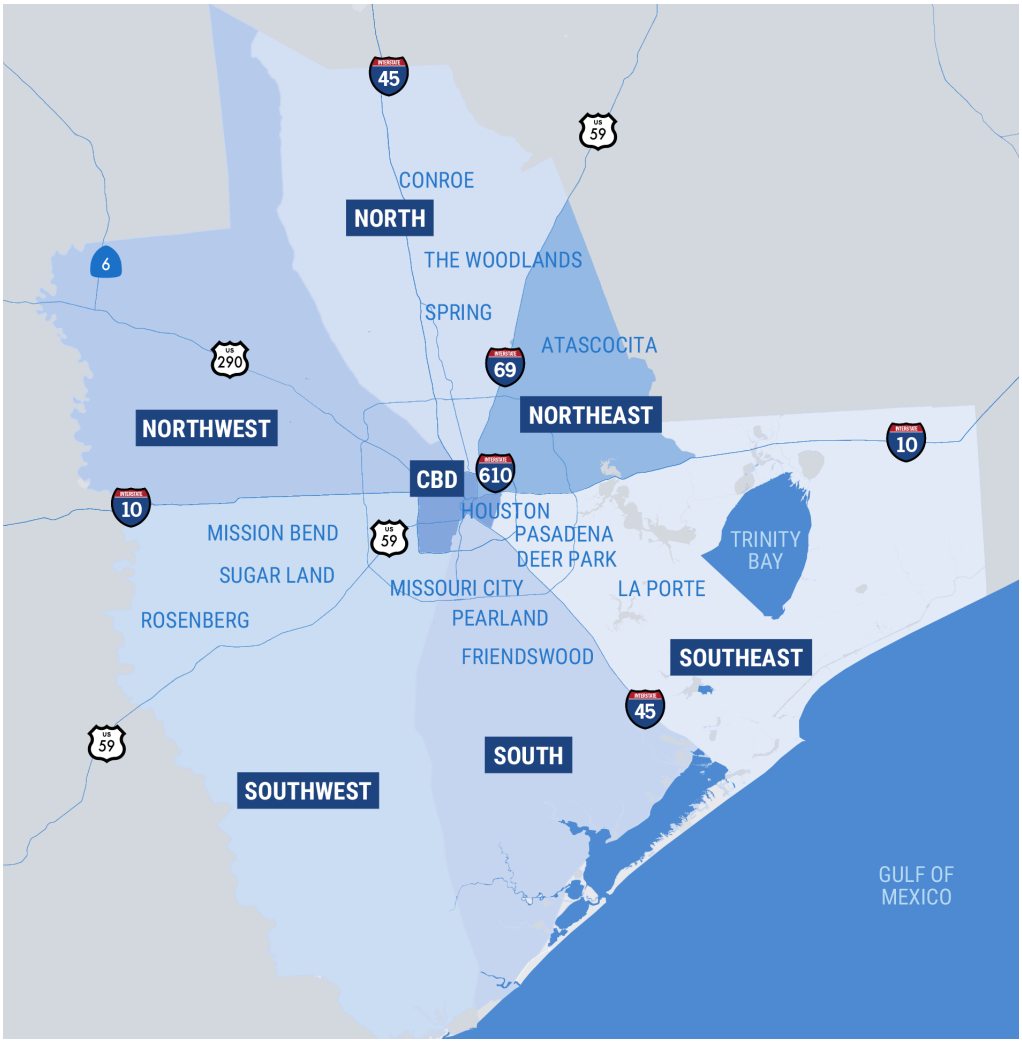
Source: U.S. Bureau of Labor Statistics

EMPLOYMENT GROWTH BY INDUSTRY

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



Source: U.S. Bureau of Labor Statistics



HOUSTON
1700 Post Oak Blvd
2 BLVD Place, Suite 250
Houston, TX 77056
713.626.8888

GRAHAM HILDEBRAND
Director –Texas Research
713.599.5151
Graham.hildebrand@ngkf.com

WALTER BRUTON
Coordinator – Texas Research
469.467.2042
Walter.bruton@ngkf.com

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