

Houston's industrial market is much healthier than other CRE sectors amid \$20 oil and COVID-19

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Commentary by Walker Barnett and Patrick Duffy

Colliers generally uses this space to discuss the trends we see in market data and in conversations we have with our clients, prospects and friendly competitors. We take that data and attempt to project activity going forward. The bulk of the first quarter was, for all practical purposes, pre-COVID. Net "move in" data, as well as new leases signed were likely unimpacted for Q1 based on the virus or only marginally impacted. Our industry has a lead time of at least 4-6 months prior to a lease being signed or space made ready for occupancy. The real impact of this COVID crisis will not present in the data until later in Q2. Inertia will carry us for a few weeks.

The world is focused on the COVID driven economic slowdown. Houston has two issues to watch – COVID and a collapse in oil prices. The oil issue was driven by Saudi Arabia and Russia failing to reach an agreement on production and to a greater extent by the severe decline in oil and gas demand driven by the COVID shutdown. Oil has been in the low 20's since the collision of these two events. The Energy Information Administration is projecting that supply will continue to outpace demand for the balance of this year by nearly 20MM barrels per day. If a recent agreement between OPEC and Non-OPEC countries brokered by the US holds, that gap may fall to 5-10MM barrels. Most experts predict that our land-based storage globally will be full by early June. We will likely not see much relief in oil prices for at least 18-24 months, which means the upstream and midstream companies and the companies

Market Indicators Relative to prior period	Annual Change	Quarterly Change	Quarterly Forecast*
VACANCY	↑	↑	↓
NET ABSORPTION	↑	↑	↓
DELIVERIES	↑	↑	↓
UNDER CONSTRUCTION	↑	↓	—

*Projected

Summary Statistics Houston Industrial Market	Q1 2019	Q4 2019	Q1 2020
Vacancy Rate	6.1%	6.9%	7.9%
Net Absorption (SF)	0.7M	2.3M	3.2M
Deliveries (SF)	2.6M	3.6M	9.8M
Under Construction (SF)	13.7M	18.3M	17.8M

Asking Rents

Per Square Foot Per Year (NNN)

Average	\$7.38	\$7.52	\$7.83
Warehouse/Distribution	\$6.74	\$6.63	\$6.89
Flex/Service	\$9.48	\$9.76	\$10.16
Tech/R&D	\$9.78	\$9.16	\$9.75
Big Box	\$4.78	\$5.09	\$5.47



that support them will be under a great deal of pressure to trim costs. Many will be filing for bankruptcy protection in the near term.

Industrial CRE will outperform and recover faster than the other major sectors (office, retail, multifamily) as we are released from the shutdown. Bright spots in the recovery for industrial space will be a growing reliance on third-party logistics companies to help customers with increasing supply chain efficiency. E-commerce growth and resultant warehouse leasing will accelerate. The need for national stockpiles for public health supplies and readiness will drive warehouse demand. Also, the emerging change from “just in time” to “just in case” will increase inventory requirements and lead to additional demand for warehouse storage. Many firms will be on-shoring after years of offshoring. The increase in inventory and on-shoring alone may require as much as 1 billion square feet of industrial product in the US (according to Duke Realty Corporation). The crippling of the airline industry will have a profound impact on air cargo, especially to smaller markets. The major multi-modal cities will benefit from this issue. As a global port city and a super-regional economic powerhouse, Houston stands to benefit from the re-ordering of the global economy.



On the positive side locally, Houston was heading towards an “over-built” bulk industrial market with multiple industrial projects under construction and recently delivered. Many additional speculative (not pre-leased) projects were in the planning and preconstruction phase. The economic destruction wrought by the pandemic will substantially curtail any additional speculative inventory – and allow the demand side to catch up with the supply of available buildings. We do expect new construction, but it will be limited primarily to build-to-suit projects with a tenant secured preconstruction.

In discussions with landlords, April rent collections were better than expected, and the infusion of cash from the CARES act helped some tenants stay current. Tenant demand, in general, has dropped substantially with most renewals, relocations and new leases on hold for 60-90 days while companies stand on the sidelines to better gauge business decisions in the “new abnormal.” The most immediately impacted tenants are the smaller regional and local small businesses, while the larger national companies have more staying power.

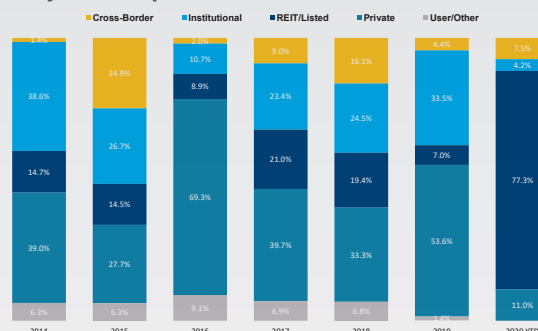
UNEMPLOYMENT	2/19	2/20
HOUSTON	4.2%	3.9%
TEXAS	3.7%	3.6%
U.S.	4.1%	3.8%

JOB GROWTH	Annual Change	# of Jobs Added
HOUSTON	2.2%	68.9K
TEXAS	2.4%	306.5K
U.S.	1.6%	2.4M

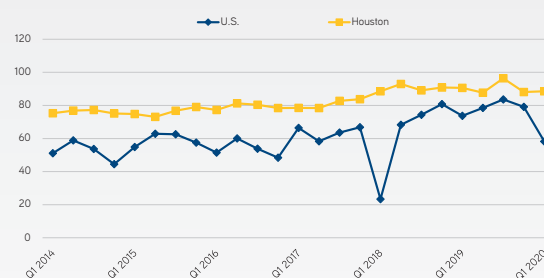
Sales Activity

Source: Real Capital Analytics	Q1 2020
NO. OF PROPERTIES:	65
SALES VOLUME:	\$1.2B
AVERAGE \$/SF:	\$95
AVERAGE CAP RATE:	6.6%

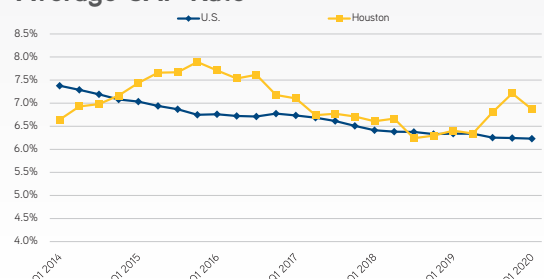
Buyer Composition



Average Price Per SF



Average CAP Rate



Vacancy & Availability

On an annual basis, Houston's average industrial vacancy rate increased 180 basis points from 6.1% in Q1 2019 to 7.9% in Q1 2020 and by 100 basis points quarterly from 6.9% in Q4 2019. At the end of the first quarter, Houston had 45.6M SF of vacant industrial space for direct lease and an additional 2.2M SF of vacant space for sublease. Among the major industrial corridors, the Inner Loop Corridor has the lowest vacancy rate at 5.3%, followed by Liberty County at 5.4%. The submarket with the largest percentage of vacant space is the North Corridor, which has a 10.0% vacancy rate.

Absorption & Demand

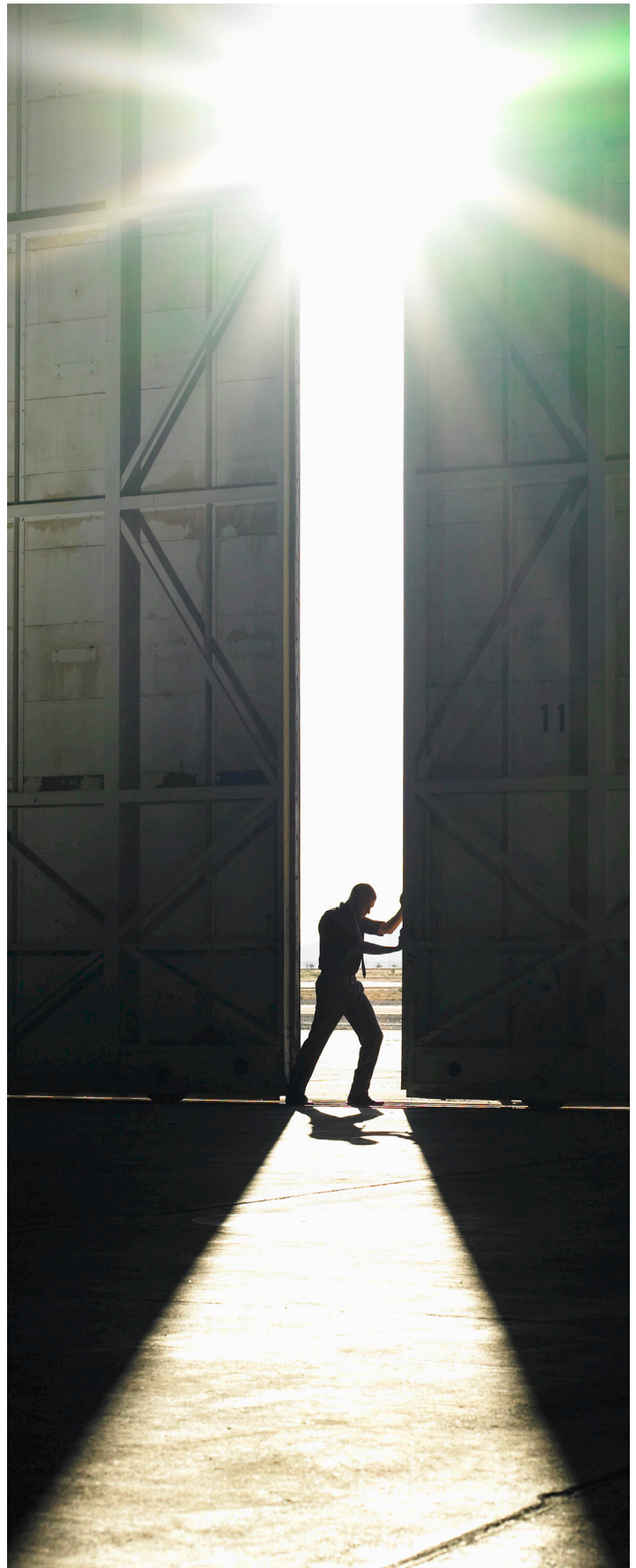
Houston's industrial market posted 3.2M SF of positive net absorption in the first quarter, an increase of 39.1% over the quarter. Some of the tenants that relocated or expanded in Q1 2020 include Home Depot, moving into 770,640 SF in the Hwy 290/Tomball Pky Corridor, Sunbelt moving into 191,175 SF in the North Inner Loop Corridor and Starplast USA moving into 168,850 SF in the North Hardy Toll Rd Corridor.

The majority of first quarter positive net absorption occurred in the Northwest Corridor, recording 1.9M SF. All of the major industrial corridors recorded positive net absorption in the first quarter, with the exception of the Inner Loop Corridor. 9.8M SF of new inventory delivered during the first quarter. The Northwest Corridor had the most significant amount of new inventory, 3.2M SF, delivered during the first quarter.

Rental Rates

According to our data service provider (CoStar Property), Houston's citywide average quoted industrial rental rate for all product types increased from \$7.52 per SF NNN to \$7.83 per SF NNN over the quarter. According to Colliers' internal data, actual lease transactions are in the \$4.68 – \$5.28 per SF NNN range for newer bulk industrial spaces, while flex rates range from \$7.20 to \$10.80 per SF NNN depending on the existing improvements or the allowance provided for tenant improvements and the age and location of the property.

Based on data from our data service provider, the average quoted NNN rental rates by property type are as follows: \$6.89 per SF for Warehouse Distribution space, \$10.16 per SF for Flex/Service space, Tech/R&D space averaging \$9.75 per SF and \$5.47 per SF for Big Box.



Leasing Activity

According to our data service provider (CoStar Property), Houston's industrial leasing activity decreased over the quarter from 6.7M SF in Q4 2019 to 5.5M SF in Q1 2020. Most of the Q1 2020 transactions consisted of leases for 50,000 SF or less; however, there were several larger deals that occurred. The table below highlights some of the larger transactions that closed in Q1 2020.

Q1 2020 Industrial Lease Transactions over 75,000 SF				
BUILDING NAME/ADDRESS	SUBMARKET	SF	TENANT	LEASE DATE
Park 249 - Bldg 1	Hwy 290/Tomball Pky	443,520	Amazon ¹	Feb-20
18140 Kickapoo Rd	Northwest Hwy 6	312,640	Goodman Air Conditioning and Heating ¹	Jan-20
9400 Telge Rd	Northwest Outlier	137,960	Eastern Metal Supply Texas ¹	Jan-20
Bay Area Business Park - PH III, Bldg 9	East-Southeast Far	137,280	Dunavant Distribution Group ^{1,2}	Feb-20
Port Crossing Commerce Center - B1	East-Southeast Far	92,750	Averitt Express Inc ^{1,2}	Jan-20
290 Northwest Business Center	Northwest Hwy 6	90,037	Paradise Grills ¹	Feb-20
Portwall Distribution Center	Northeast Inner Loop	81,800	Adams Warehouse & Delivery ¹	Jan-20
4545 Eastpark Dr	Northeast Inner Loop	81,295	Kalidwal Investments LP ¹	Jan-20

¹Direct/New

²Colliers International Transaction

Under Construction

Currently, 17.8M SF of industrial space is under construction in Houston with 50.4% of this space pre-leased. The largest project under construction is a 2,165,000-SF distribution warehouse for Ross Stores Inc., located in Brookshire, TX. The majority of projects under construction are located in the Southwest, Northwest and Southeast Corridor submarkets. Below is a partial list of the largest buildings currently under construction.

Q1 2020 Industrial Under Construction - 300,000 SF or greater						
BUSINESS PARK/ADDRESS	SUBMARKET	RBA	% LEASED/ OWNED	DEVELOPER/CONTRACTOR	DELIVERY DATE	BUILDING DESCRIPTION
31207 Kingsland Blvd	Sugar Land/Brookshire	2,165,000	100%	Ross Stores Inc	Sep-21	Ross Distribution Center
Pederson Distribution Park	Northwest Outlier	1,300,000	100%	Clay Development & Construction	Dec-20	Medline Industries
1210 Hartledge Rd	Southwest Far	1,200,000	100%	N/A	Jul-20	Dollar Tree Distribution Center
Conroe Park North Industrial Park	The Woodlands/Conroe	860,000	100%	Ryan Companies US, Inc.	May-20	BTS Five Below
Clay 99 - Peek Rd	Northwest Outlier	806,000	100%	Duke Realty Corporation	Jan-21	BTS Amazon
Bay Area Business Park	East-Southeast Far	784,000	0%	Stream Realty	May-20	Spec Distribution Warehouse
Cedar Port Logistics	East-Southeast Far	644,000	0%	Avera Companies	May-20	Spec Warehouse
1919 S Fm 565 Rd	East-Southeast Far	604,800	100%	DVO	Jun-20	BTS Katoen Natie
Boulevard Oaks Business Park	Southwest Far	534,440	0%	Hines	Dec-20	Spec Distribution Warehouse
500 Pin Oak Rd	Northwest Outlier	498,700	100%	American Furniture Warehouse	May-20	American Furniture Warehouse Showroom
Sam Houston Distribution Center	Hwy 290/Tomball Pky	494,800	0%	Transwestern Real Estate Services	Jul-20	Spec Distribution Warehouse
Park 249 - Bldg 1	Hwy 290/Tomball Pky	443,520	100%	Panattoni	May-20	Spec Distribution Warehouse leased by Amazon
Clay 99 - Bldg 5	Northwest Outlier	433,200	0%	Duke Realty Corporation	Feb-20	Spec Distribution
739 Independence Pky - Bldg B	East-Southeast Far	414,900	0%	Molto Realty	Aug-20	Spec Distribution Warehouse
Ella Logistics Center	North Fwy/Tomball Pky	358,567	0%	Hines	May-20	Spec Distribution Warehouse
Rankin 45 Distribution Center	North Hardy Toll Road	356,236	2.3%	Trammel Crow Company	Aug-20	Spec Warehouse
15130 Market St Rd - Bldg 1	East I-10 Outer Loop	316,172	0%	National Property Holdings LP	Dec-20	Spec Distribution Warehouse

Market Summary

Q1 2020 Houston Industrial Market Statistical Summary											
MARKET	RENTABLE AREA	DIRECT VACANT SF	DIRECT VACANCY RATE	SUBLET VACANT SF	SUBLET VACANCY RATE	TOTAL VACANT SF	TOTAL VACANCY RATE	1Q20 NET ABSORPTION	4Q20 NET ABSORPTION	1Q20 DELIVERIES	SF UNDER CONSTRUCTION
Houston Total	608,719,215	45,632,163	7.5%	2,188,045	0.4%	47,820,208	7.9%	3,235,477	2,339,207	9,812,551	17,796,120
CBD-NW Inner Loop	11,424,985	1,024,251	9.0%	0	0.0%	1,024,251	9.0%	(225,216)	16,969	-	-
Downtown	30,284,982	1,035,392	3.4%	104,297	0.3%	1,139,689	3.8%	(57,909)	(198,628)	-	-
North Inner Loop	5,027,305	144,633	2.9%	-	0.0%	144,633	2.9%	(5,865)	15,000	-	-
Southwest Inner Loop	5,663,903	473,175	8.4%	-	0.0%	473,175	8.4%	(251,080)	34,049	-	-
INNER LOOP CORRIDOR TOTAL	52,401,175	2,677,451	5.1%	104,297	0.2%	2,781,748	5.3%	(540,070)	(132,610)	-	-
Liberty County	1,211,891	65,900	5.4%	-	0.0%	65,900	5.4%	20,540	-	-	-
LIBERTY COUNTY TOTAL	1,211,891	65,900	5.4%	-	0.0%	65,900	5.4%	20,540	-	-	-
North Fwy/Tomball Pky	30,364,151	3,744,969	12.3%	344,617	1.1%	4,089,586	13.5%	1,161,891	194,965	1,635,958	915,557
North Hardy Toll Rd	38,068,270	3,723,007	9.8%	40,432	0.1%	3,763,439	9.9%	(278,088)	282,189	535,454	594,009
North Outer Loop	23,321,615	1,790,809	7.7%	30,037	0.1%	1,820,846	7.8%	169,346	(172,794)	524,160	484,492
The Woodlands/Conroe	19,188,976	1,319,712	6.9%	69,132	0.4%	1,388,844	7.2%	(30,651)	68,020	49,283	973,982
NORTH CORRIDOR TOTAL	110,943,012	10,578,497	9.5%	484,218	0.4%	11,062,715	10.0%	1,022,498	372,380	2,744,855	2,968,040
Northeast Hwy 321	1,549,806	23,700	1.5%	-	0.0%	23,700	1.5%	(20,000)	-	-	-
Northeast Hwy 90	20,837,727	1,573,324	7.6%	38,520	0.2%	1,611,844	7.7%	238,282	(71,651)	190,200	323,500
Northeast I-10	4,102,383	37,087	0.9%	-	0.0%	37,087	0.9%	196,207	598	-	-
Northeast Inner Loop	12,188,468	490,906	4.0%	5,000	0.0%	495,906	4.1%	44,970	110,879	-	-
NORTHEAST CORRIDOR TOTAL	38,678,384	2,125,017	5.5%	43,520	0.1%	2,168,537	5.6%	459,459	39,826	190,200	323,500
Hwy 290/Tomball Pky	26,373,620	3,106,691	11.8%	211,858	0.8%	3,318,549	12.6%	1,221,948	(193,641)	1,816,450	1,317,720
Northwest Hwy 6	12,267,222	1,175,670	9.6%	-	0.0%	1,175,670	9.6%	17,253	11,702	19,526	121,750
Northwest Inner Loop	60,378,141	4,653,638	7.7%	215,980	0.4%	4,869,618	8.1%	(626,566)	308,218	168,854	22,166
Northwest Near	18,225,446	674,870	3.7%	72,200	0.4%	747,070	4.1%	53,271	113,190	-	-
Northwest Outliers	29,413,062	2,810,252	9.6%	51,410	0.2%	2,861,662	9.7%	141,835	1,566,070	1,241,672	3,263,700
West Outer Loop	26,841,565	1,442,355	5.4%	95,626	0.4%	1,537,981	5.7%	(433,566)	117,639	-	36,875
NORTHWEST CORRIDOR TOTAL	173,499,056	13,863,476	8.0%	647,074	0.4%	14,510,550	8.4%	374,175	1,923,178	3,246,502	4,762,211
South Highway 35	35,895,671	1,871,188	5.2%	234,236	0.7%	2,105,424	5.9%	44,952	(13,220)	155,000	316,638
South Inner Loop	12,440,868	523,903	4.2%	62,738	0.5%	586,641	4.7%	(25,584)	102,180	-	-
SOUTH CORRIDOR TOTAL	48,336,539	2,395,091	5.0%	296,974	0.6%	2,692,065	5.6%	19,368	88,960	155,000	316,638
East I-10 Outer Loop	13,607,283	613,760	4.5%	-	0.0%	613,760	4.5%	(78,598)	21,862	-	395,725
East-Southeast Far	76,418,961	6,387,045	8.4%	354,517	0.5%	6,741,562	8.8%	1,637,520	(36,918)	1,922,237	3,430,322
Southeast Outer Loop	17,377,843	1,241,706	7.1%	144,796	0.8%	1,386,502	8.0%	(295,739)	12,970	176,201	-
SOUTHEAST CORRIDOR TOTAL	107,404,087	8,242,511	7.7%	499,313	0.5%	8,741,824	8.1%	1,263,183	(2,086)	2,098,438	3,826,047
Highway 59/Highway 90	24,873,873	2,146,186	8.6%	13,910	0.1%	2,160,096	8.7%	146,094	(55,905)	813,453	716,291
Southwest Far	15,502,543	1,718,927	11.1%	-	0.0%	1,718,927	11.1%	307,822	190,384	205,715	2,566,698
Southwest Outer Loop	13,164,286	1,037,088	7.9%	28,619	0.2%	1,065,707	8.1%	(131,346)	(139,228)	-	-
Sugar Land/Ft Bend Co	22,704,369	782,019	3.4%	70,120	0.3%	852,139	3.8%	293,754	54,308	358,388	2,316,695
SOUTHWEST CORRIDOR TOTAL	76,245,071	5,684,220	7.5%	112,649	0.1%	5,796,869	7.6%	616,324	49,559	1,377,556	5,599,684



Q1 Houston Industrial 2020 Highlights

TOTAL INDUSTRIAL INVENTORY

608.7M SF



- DISTRIBUTION: 17%
- MANUFACTURING: 16%
- R&D: 1%
- SERVICE/FLEX: 2%
- WAREHOUSE: 60%
- OTHER: 4%



17.8M SF



NEW CONSTRUCTION (DELIVERIES)

277%
ANNUAL INCREASE

Q1 2020	9.8M SF
Q4 2019	3.6M SF
Q3 2019	4.2M SF
Q2 2019	5.0M SF
Q1 2019	2.6M SF

Q1 2020

7.9%
VACANCY

\$7.83/SF
AVG. RENTAL RATE

LEASING ACTIVITY

-32.1%
ANNUAL DECREASE

Q1 2020	5.5M SF
Q4 2019	6.7M SF
Q3 2019	8.8M SF
Q2 2019	7.7M SF
Q1 2019	8.1M SF

FOR MORE INFORMATION

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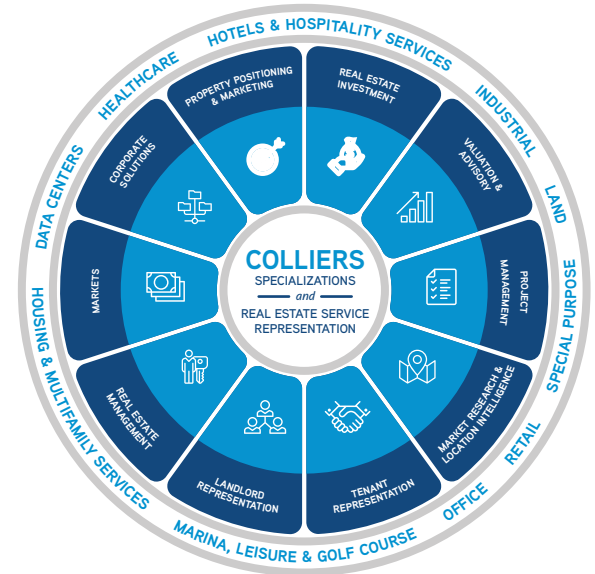
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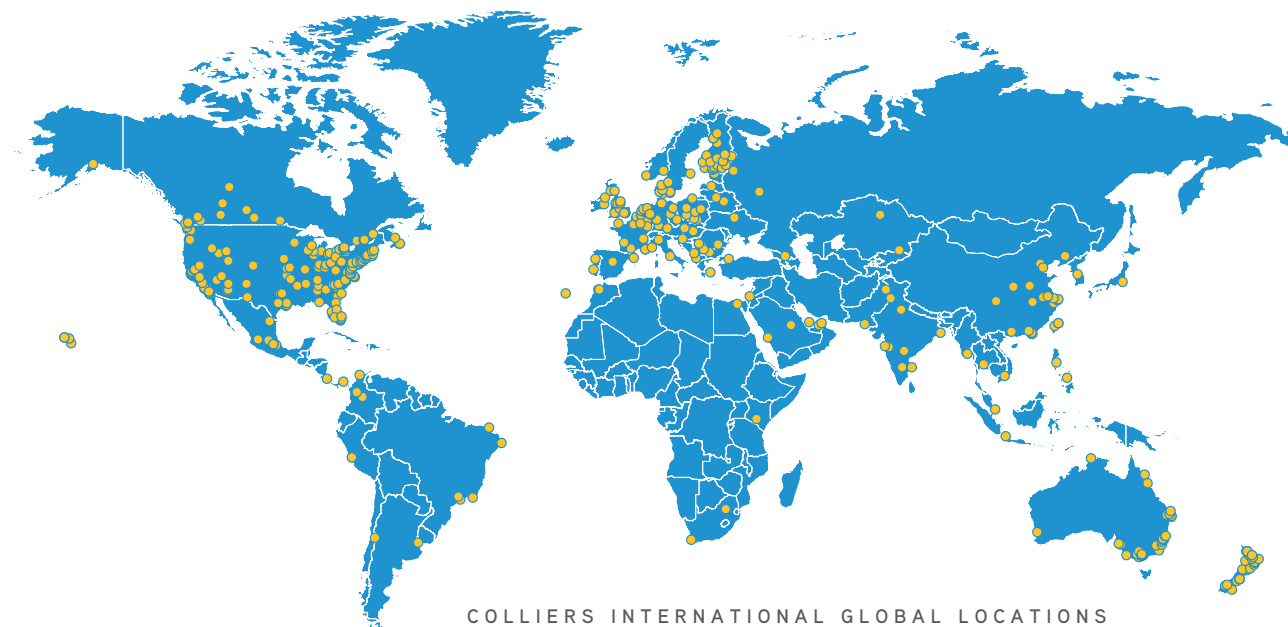
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TRANSACTION VALUE



2B
SF UNDER MANAGEMENT



\$3.3B
IN REVENUE



438
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17,300
PROFESSIONALS



340
ACCREDITED MEMBERS



68
COUNTRIES