

# Houston's industrial market closes out the year with a strong finish

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## Industrial Trends Commentary by Walker B. Barnett SIOR

The resiliency of Houston's industrial real estate market is truly astounding. Outsiders have always considered Houston to be an "oil town" with our economic success tied to the geopolitical intricacies of the international oil and gas markets. Three years into the oil and gas downturn, Houston has proven yet again that we have a truly diversified economic base. As a result, Houston's industrial real estate market has enjoyed a disproportionate benefit of that concerted effort to have a truly balanced economy.

From 2009 to 2014, while the national economy sputtered along due to anti-business policies of the Obama administration, Houston enjoyed a countercyclical economic boon as all sectors of the oil and gas industry added jobs, increased investment and drove demand for oil service related real estate. Manufacturers and distributors made significant real estate commitments to manufacturing, property and equipment as they worked to meet the demand for materials and services related to the growth in domestic shale exploration and production. When the music stopped in November 2014, outsiders such as wall street analysts and CNBC pundits threw their hands in the air, called it the end of Houston's growth story and declared that it would be the 1980's all over again.

Houston real estate veterans, however, trusted in our diversified economy and found ways to meet the demand of other sectors as the national economic output increased. Certainly, the industrial real estate community had issues with subleases, defaults and other activity that arose due to the energy industry downturn. However, the growth of e-commerce, the region's natural population growth, increased Port of Houston infrastructure investment and increased consumer demand all contributed to a robust industrial market that truly reflects Houston's economic diversity and its irrepressible ability to bounce back from adversity.

Houston has been a late-comer to the unprecedented growth of e-commerce logistics. Not only have we seen multi-million SF investments by Amazon, UPS, FedEx and other providers, but we are also seeing providers to these major distributors seeking to establish regional distribution and return centers related to online sales. As an example to meet this demand, Oakmont Industrial

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

\*Projected

## Summary Statistics

Houston Industrial Market	Q4 2016	Q3 2017	Q4 2017
Vacancy Rate	5.2%	5.3%	5.4%
Net Absorption (SF)	2,340,339	3,528,679	135,652
New Construction (SF)	2,321,364	2,165,570	607,956
Under Construction (SF)	7,864,276	5,291,835	6,375,868

## Asking Rents

Per Square Foot Per Year

Average	\$7.04	\$6.89	\$6.83
Warehouse/Distribution	\$6.73	\$6.58	\$6.51
Flex/Service	\$11.02	\$10.14	\$10.18
Tech/R&D	\$12.47	\$10.95	\$10.75

Group has a speculative 700,000 SF warehouse under construction now that is designed to meet the demands of future e-commerce growth in our region.

Closely tied to e-commerce growth is the population growth in the Houston MSA. With population growth from 2010 to 2016 that averaged over 2,600 people per week and with projections that the area population will double to almost 15 million people by 2050, Houston is a major economic force with tremendous consumer buying power. While core markets such as Dallas, Atlanta, Chicago and Los Angeles have typically met the need for distribution related to consumer demand, Houston has emerged as a new core market as distributors seek to be closer to the end users of their products. Our proximity to San Antonio and Austin, our relatively low regulatory environment and the infrastructure assets including our rail network, interstate highway systems and the Port of Houston complex all work together to drive demand for Houston's industrial market.

The submarkets around the Port of Houston were the weakest in the Houston area from 2005 to 2014. A number of developers built millions of square feet of buildings on the promise that Houston's Port infrastructure development around the container handling facilities and the widening of the Panama Canal would drive demand. While some success was achieved in that area, true growth in new construction and increasing rental rates has been fairly recent. The main impetus for this growth has been the increased output of the petrochemical plants – both in chemicals and plastic resin. The abundant energy source from the domestic oil and gas shale plays around the United States led to over \$50 billion in new plant investment. Now that the expanded production capability is online, logistics providers have taken down almost all new industrial space that has been built in the Port submarkets at rental rates that have provided very solid returns to developers that built speculative buildings to meet this new demand. Also tied to the Port of Houston is continued growth in container traffic, with consumer products companies such as Wal-Mart, Home Depot and Ikea making significant investments and also considering additional real estate commitments.

Certainly, there are many promising statistics that speak to the overall strength of the Houston industrial market. In spite of tepid economic growth over the past 3 years, industrial absorption rates has remained steady as new construction has declined across the region. Houston continues to be a market leader in high 95%+ occupancy rates and in stability of rental rates.

Even with remaining uncertainty in the oil and gas sector of the economy, Houston's industrial market has shown a resilient ability to adapt to continually evolving economic forces. Looking into the future, we see continued disruption and growth in the e-commerce arena, increasing use of the Port of Houston infrastructure to handle inbound containerized consumer goods and outbound raw material shipments, natural population growth and in-bound migration that will drive increased consumer spending and eventual stabilization of the global oil and gas economy. Mainly, as has been proven for almost 180 years of Houston economic history, the economy will adapt to changing market forces and intelligent investors, whether industrial developers, private investors, or entrepreneurs that drive economic growth will benefit by making the right bet on Houston's resiliency.

## Vacancy & Availability

Houston's average industrial vacancy rate increased 10 basis points from 5.3% to 5.4% over the quarter. At the end of the fourth quarter, Houston had 28.1M SF of vacant industrial space for direct lease and an additional 1.6M SF of vacant sublease space. Among the major industrial corridors, the Northeast Corridor

## Job Growth & Unemployment

(not seasonally adjusted)

UNEMPLOYMENT	11/16	11/17
HOUSTON	5.2%	4.3%
TEXAS	4.5%	3.7%
U.S.	4.4%	3.9%

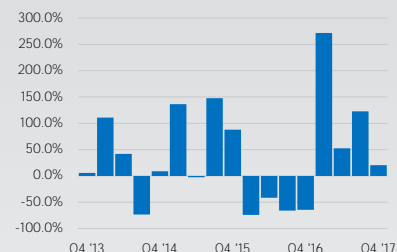
JOB GROWTH	Annual Change	# of Jobs Added
HOUSTON	1.6%	48.5K
TEXAS	2.7%	331.6K
U.S.	1.5%	2.1M

## Sales Activity

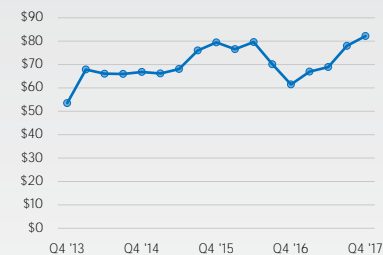
Source: Real Capital Analytics

	Q4 2017
NO. OF PROPERTIES:	39
TOTAL SF:	3.9M
AVERAGE \$/SF:	\$75
AVERAGE CAP RATE:	7.0%

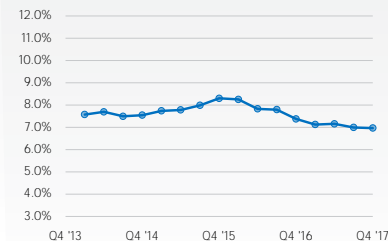
## Change in Sales (Year over Year)



## Average Price Per SF



## Average CAP Rate



has the lowest vacancy rate at 3.0%, followed by the South Corridor at 3.5% and the Southeast Corridor at 4.2%. The largest percentage of vacant space is located in the North Corridor which has a 7.7% vacancy rate.

## Leasing Activity

Houston's industrial leasing activity increased 11.8% over the quarter from 5.0M SF in Q3 2017 to 5.6M SF in Q4 2017. Total 2017 leasing activity which includes renewals reached 23.7M SF. Most of the transactions consisted of leases for 50,000 SF or less, but there were several larger deals that occurred. The table below highlights some of the larger transactions that closed in Q4 2017.

Q4 2017 Industrial Lease Transactions over 100,000 SF				
BUILDING NAME/ADDRESS	SUBMARKET	SF	TENANT	LEASE DATE
Mason Ranch Building 1	Northwest Outlier	373,860	Rooms to Go <sup>3</sup>	Dec-17
Greenspoint Business Center Building E	North Outer Loop	244,550	NFI <sup>3</sup>	Dec-17
Carson Bayport 3	East-Southeast	231,875	Palmer Logistics <sup>3</sup>	Nov-17
15894 Diplomatic Plaza Dr	North Hardy Tool Road	128,500	Transaction Packing & Houston Warehousing and Custom Crating <sup>1,4</sup>	Nov-17
960 Pleasantville Dr	Southeast Outer Loop	102,000	Metrix Logistics Group <sup>3</sup>	Nov-17

<sup>1</sup>Colliers International Transaction

<sup>2</sup>Pre-lease in a proposed/under construction building

<sup>3</sup>Direct/New

<sup>4</sup>Sublease

## Under Construction

Currently 6.4M SF of industrial space is under construction in Houston and 29.3% is pre-leased. Only 3.4% of the 4.6M SF of spec space under construction is pre-leased at this time. The largest project under construction is a 673,785-SF spec distribution warehouse located in the Northwest Outliers submarket. Below is a partial list of buildings currently under construction.

Q4 2017 Industrial Under Construction - 200,000 SF or greater						
BUSINESS PARK/ADDRESS	SUBMARKET	RBA	% LEASED	DEVELOPER/CONTRACTOR	DELIVERY DATE	BUILDING DESCRIPTION
525 Cane Island Pky	Northwest Outliers	673,785	0%	Oakmont Industrial Group	Jul-18	Spec Distribution
1302 Wharton Weems Blvd	East-Southeast Far	600,360	0%	Liberty Property Trust	Apr-18	Spec Distribution
Fallbrook Dr	North Fwy/Tomball Pky	600,000	100%	Hines	Jun-18	BTS Emser Tile
Cedar Port Distribution Park	East-Southeast Far	500,000	100%	Avera Companies	Sep-18	BTS Vinmar International
Northwest Logistics Center	West Outer Loop	411,442	0%	Stream Realty Partners, L.P.	Jun-18	Spec Distribution
Cutten Distribution Center I	North Fwy/Tomball Pky	293,280	0%	Clay Development	Jan-18	Spec Distribution
I-10 East & Thompson Rd	East-Southeast Far	294,323	0%	Pontikes	Jun-18	Spec Distribution
Bayport South Business Park 10535 Red Bluff Rd	East-Southeast Far	257,835	0%	Johnson Development	Feb-18	Spec Distribution
Energy Commerce Bldg D	East-Southeast Far	232,960	0%	Clay Development	Feb-18	Spec Distribution
22533 NW Lake Dr	Northwest Outliers	231,839	0%	The Carson Companies	Mar-18	Spec Warehouse
5121 AmeriPort Pky Bldg VII	East-Southeast Far	203,840	100%	National Property Holdings	Apr-18	Palmer Logistics

# Market Summary

## Q4 2017 Houston Industrial Market Statistical Summary

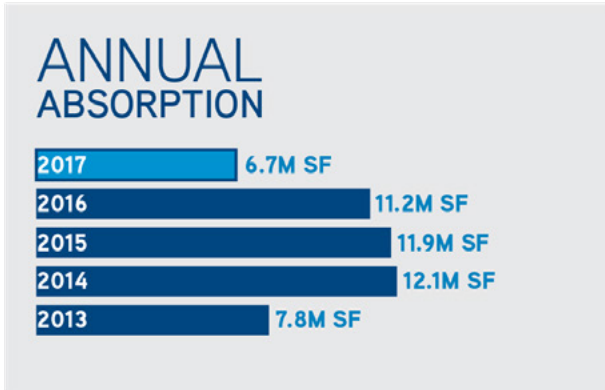
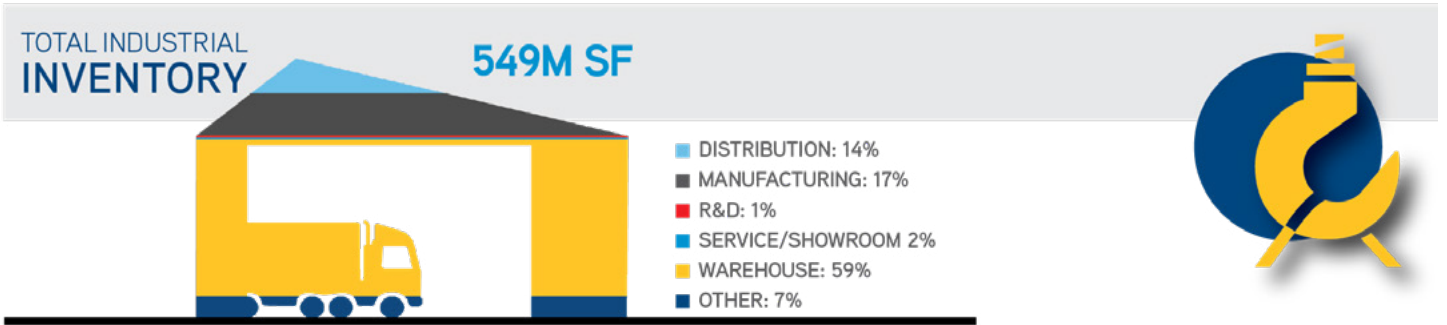
MARKET	RENTABLE AREA	DIRECT VACANT SF	DIRECT VACANCY RATE	SUBLET VACANT SF	SUBLET VACANCY RATE	TOTAL VACANT SF	TOTAL VACANCY RATE	4Q17 NET ABSORPTION	3Q17 NET ABSORPTION	4Q17 COMPLETIONS	3Q17 COMPLETIONS	SF UNDER CONSTRUCTION
<b>Houston Total</b>	<b>549,460,806</b>	<b>28,097,426</b>	<b>5.1%</b>	<b>1,648,586</b>	<b>0.3%</b>	<b>29,746,012</b>	<b>5.4%</b>	<b>135,652</b>	<b>3,538,679</b>	<b>607,956</b>	<b>2,165,570</b>	<b>6,375,868</b>
CBD-NW Inner Loop	11,550,889	640,165	5.5%	57,205	0.5%	697,370	6.0%	(85,672)	(18,707)	-	-	14,250
Downtown	31,316,411	1,457,512	4.7%	-	0.0%	1,457,512	4.7%	(66,950)	241,178	-	-	-
North Inner Loop	4,858,519	257,215	5.3%	-	0.0%	257,215	5.3%	66,564	(76,388)	-	-	-
Southwest Inner Loop	7,084,063	63,376	0.9%	-	0.0%	63,376	0.9%	12,064	(13,999)	-	-	-
<b>INNER LOOP CORRIDOR TOTAL</b>	<b>54,809,882</b>	<b>2,418,268</b>	<b>4.4%</b>	<b>57,205</b>	<b>0.1%</b>	<b>2,475,473</b>	<b>4.5%</b>	<b>(73,994)</b>	<b>132,084</b>	<b>-</b>	<b>-</b>	<b>14,250</b>
North Fwy/Tomball Pky	23,673,665	2,319,691	9.8%	36,455	0.2%	2,356,146	10.0%	131,408	991,305	11,200	875,800	937,180
North Hardy Toll Rd	33,602,530	2,435,141	7.2%	259,886	0.8%	2,695,027	8.0%	642,695	392,365	21,350	10,500	51,900
North Outer Loop	20,483,573	1,058,050	5.2%	14,560	0.1%	1,072,610	5.2%	10,629	91,146	23,645	-	-
The Woodlands/Conroe	17,584,277	1,171,601	6.7%	84,066	0.5%	1,255,667	7.1%	(135,373)	(62,614)	-	-	57,866
<b>NORTH CORRIDOR TOTAL</b>	<b>95,344,045</b>	<b>6,984,483</b>	<b>7.3%</b>	<b>394,967</b>	<b>0.4%</b>	<b>7,379,450</b>	<b>7.7%</b>	<b>649,359</b>	<b>1,412,202</b>	<b>56,195</b>	<b>886,300</b>	<b>1,046,946</b>
Northeast Hwy 321	1,298,073	51,240	3.9%	-	0.0%	51,240	3.9%	(13,540)	-	-	-	-
Northeast Hwy 90	18,155,798	431,976	2.4%	20,026	0.1%	452,002	2.5%	(187,035)	28,239	-	-	164,500
Northeast I-10	4,008,645	158,427	4.0%	-	0.0%	158,427	4.0%	(91,302)	19,196	-	-	-
Northeast Inner Loop	11,443,833	384,409	3.4%	-	0.0%	384,409	3.4%	27,231	(17,461)	-	-	-
<b>NORTHEAST CORRIDOR TOTAL</b>	<b>34,906,349</b>	<b>1,026,052</b>	<b>2.9%</b>	<b>20,026</b>	<b>0.1%</b>	<b>1,046,078</b>	<b>3.0%</b>	<b>(264,646)</b>	<b>29,974</b>	<b>-</b>	<b>-</b>	<b>164,500</b>
Hwy 290/Tomball Pky	21,165,989	872,238	4.1%	245,319	1.2%	1,117,557	5.3%	127,429	629,922	-	-	171,550
Northwest Hwy 6	9,880,024	488,806	4.9%	-	0.0%	488,806	4.9%	(30,667)	81,539	28,325	-	133,160
Northwest Inner Loop	60,005,942	3,249,057	5.4%	112,604	0.2%	3,361,661	5.6%	(323,046)	(296,847)	-	-	19,000
Northwest Near	17,960,314	726,678	4.0%	66,021	0.4%	792,699	4.4%	(162,931)	(91,072)	-	-	154,661
Northwest Outliers	21,953,829	1,795,739	8.2%	21,335	0.1%	1,817,074	8.3%	(645,083)	1,053,275	-	983,750	935,319
West Outer Loop	25,459,071	1,349,308	5.3%	91,320	0.4%	1,440,628	5.7%	70,786	(129,537)	-	-	496,542
<b>NORTHWEST CORRIDOR TOTAL</b>	<b>156,425,169</b>	<b>8,481,826</b>	<b>5.4%</b>	<b>536,599</b>	<b>0.3%</b>	<b>9,018,425</b>	<b>5.8%</b>	<b>(963,512)</b>	<b>1,247,280</b>	<b>28,325</b>	<b>983,750</b>	<b>1,910,232</b>
South Highway 35	34,872,626	945,609	2.7%	-	0.0%	945,609	2.7%	53,126	5,079	-	41,520	97,593
South Inner Loop	12,195,331	604,268	5.0%	86,318	0.7%	690,586	5.7%	(129,020)	9,833	-	-	-
<b>SOUTH CORRIDOR TOTAL</b>	<b>47,067,957</b>	<b>1,549,877</b>	<b>3.3%</b>	<b>86,318</b>	<b>0.2%</b>	<b>1,636,195</b>	<b>3.5%</b>	<b>(75,894)</b>	<b>14,912</b>	<b>-</b>	<b>41,520</b>	<b>97,593</b>
East I-10 Outer Loop	12,936,237	170,866	1.3%	-	0.0%	170,866	1.3%	(81,500)	-	-	-	-
East-Southeast Far	60,970,291	2,851,550	4.7%	341,900	0.6%	3,193,450	5.2%	1,111,798	598,935	512,900	154,000	3,071,511
Southeast Outer Loop	17,173,665	473,739	2.8%	15,000	0.1%	488,739	2.8%	(34,189)	93,176	-	-	-
<b>SOUTHEAST CORRIDOR TOTAL</b>	<b>91,080,193</b>	<b>3,496,155</b>	<b>3.8%</b>	<b>356,900</b>	<b>0.4%</b>	<b>3,853,055</b>	<b>4.2%</b>	<b>996,109</b>	<b>692,111</b>	<b>512,900</b>	<b>154,000</b>	<b>3,071,511</b>
Highway 59/Highway 90	22,645,199	1,448,144	6.4%	144,814	0.6%	1,592,958	7.0%	97,550	(119,096)	-	-	-
Southwest Far	12,543,739	1,172,429	9.3%	-	0.0%	1,172,429	9.3%	(37,513)	256,957	10,536	100,000	70,836
Southwest Outer Loop	13,400,895	807,002	6.0%	6,000	0.0%	813,002	6.1%	(164,895)	(39,855)	-	-	-
Sugar Land/Ft Bend Co	21,237,378	713,190	3.4%	45,757	0.2%	758,947	3.6%	(26,912)	(87,890)	-	-	-
<b>SOUTHWEST CORRIDOR TOTAL</b>	<b>69,827,211</b>	<b>4,140,765</b>	<b>5.9%</b>	<b>196,571</b>	<b>0.3%</b>	<b>4,337,336</b>	<b>6.2%</b>	<b>(131,770)</b>	<b>10,116</b>	<b>10,536</b>	<b>100,000</b>	<b>70,836</b>





Photo source: porthouston.com

## Q4 Houston Industrial 2017 Highlights



**FOR MORE INFORMATION**

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