HOUSTON

MARKET REPORT

First Quarter 2021

BELVOIR

REAL ESTATE GROUP, LLC

Going Places

BROKERAGE / DEVELOPMENT / MANAGEMENT / INVESTMENT

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Commercial Real Estate Message from Matthew Goldsby, Belvoir Chief Executive Officer

TURNING POINT

As the second wave of the pandemic recedes and vaccination efforts ramp up to more than 4 million doses per day, it is undeniable that our communities and the nation have reached a turning point in the fight against COVID-19, leaving behind the previous year of uncertainty and fear. All the while, increasing proportions of businesses, workers and investors have shown the desire to begin breaking the holding pattern mentality that dominated this previous year. Major global companies such as Microsoft, Goldman Sachs and KPMG have announced accelerated plans to return their workforces to business as usual. Others, such as Google, Oracle, Tesla and Amazon, have announced tens of billions in in new facilities and workforce investments. While these public intentions are by no means all-inclusive, they are representative of an economy that is rapidly regaining its confidence.

INDUSTRIAL HUMS ALONG

Economic growth and momentum have continued to build through the end of 2020 and early 2021. With that come widespread expectations for an economic boom well into 2023, based on catch-up demand alone. While some business and real estate sectors have struggled, others have thrived, and even more are bouncing back with the prospect of a full reopening of the economy. Industrial, logistics and manufacturing businesses have largely capitalized on pandemic-driven changes to great success, contributing to the strength of industrial real estate assets. In particular, e-commerce providers were a major driving force behind industrial growth in 2020, translating into correspondingly high demand for real estate: Amazon's leasing alone accounted for 12% of the industrial leasing in 2020. Through the first quarter of 2021, a total of 2.9 million square feet of industrial leases were signed, including Amazon's taking of an additional 700,000 square feet around the Houston area.

OFFICE SLOWER TO REGAIN FOOTING

With the pandemic's effects still lingering and uncertainty continuing to affect some industries, including energy, it is no surprise that Houston's office market experienced several million square feet of negative net absorption over the past year, substantially increasing overall vacancy rates. Many companies have continued to postpone both office move-ins and leasing decisions, driving down activity rates through the end of 2020 but leaving potential for increased catch-up activity during 2021. With the pre-pandemic work return levels happening earlier than expected, given widespread vaccine availability, the major Texas markets — Houston, Dallas and Austin — led the country in returning-to-work initiatives. In addition, another bright spot for the Texas markets includes a growing roster of corporate relocations. Recently, Dallas has notched more than 90 relocations of corporate headquarters or manufacturing companies, while Austin continues to lure tech with attractive tax incentives, recently capturing Tesla's newest Gigafactory plant and headquarters. Despite the energy headwinds, Houston has secured Hewlett Packard back into its sphere with a new campus in the North Houston area of Springwoods Village.

HOUSTON'S OUTLOOK

Houston now has more than 30 startup development organizations (SDOs) that have already opened or announced plans to open, and are critical to the city's development in the tech economy. SDOs include incubators and accelerators, co-working and maker spaces for start-up development. Notable tech development platforms include The Cannon, Downtown Launchpad, East End Maker Hub and Rice University-backed ION in Midtown. This March, CTV announced a new $300 million fund focused on technologies that have the potential to enable affordable, reliable, clean energy, with primary offices at The Cannon in the Energy Corridor. Focused tech investment, energy sector recovery and return-to-work efforts will continue to propel the Houston rebound in the near-term and into the future.

INDUSTRIAL MARKET SNAPSHOT

LEASING

Leasing volumes grew by 6% in 2020, despite the pandemic. Even after briefly dipping in the second quarter, leasing activity skyrocketed to a record high of more than 4 million square feet in December. Houston's industrial market also absorbed 6.6 million square feet in the fourth quarter of 2020, the second-best quarter on record. Vacancies increased significantly, from 5% in 2018 to 8.8% in 2021's first quarter. This was due to an unprecedented amount of speculative supply that delivered in 2020. An abundance of affordable land and a relatively easy entitlement process mean that new speculative supply could continue to come on line in the coming years as developers capitalize on new ground-up developments.

RENT

Last year marked the first year that rents declined in a decade since the Great Recession. This likely had to do more with the onslaught of new speculative supply than the pandemic. Rent declines were felt across the board in Houston, with just one submarket, South Highway 35, experiencing positive rent growth over the past 12 months. And South Highway 35 possessed the largest spread between net absorption and new deliveries in 2020. Otherwise, rent growth in Houston had been steady ever since the global financial crisis and even through the recent oil downturn. This is indicative of how globally and nationally oriented Houston's economy and particularly its industrial sector have become.

CONSTRUCTION

The fourth quarter of 2020 was the second highest on record for net deliveries, with 9 million square feet coming on line. 2020 was a historic year for new deliveries, with about 25.7 million square feet delivered over the past year in Houston. The metro still has 14.7 million square feet under construction today. Of the new projects that delivered or were under construction in 2020, more than three quarters are rated 4-and 5-star. This raises some concerns, since most leasing activity last year occurred in 1- to 3-star product. Thus, it is likely that developers overshot speculative demand for 4- and 5-star space prior to the pandemic.

SALES

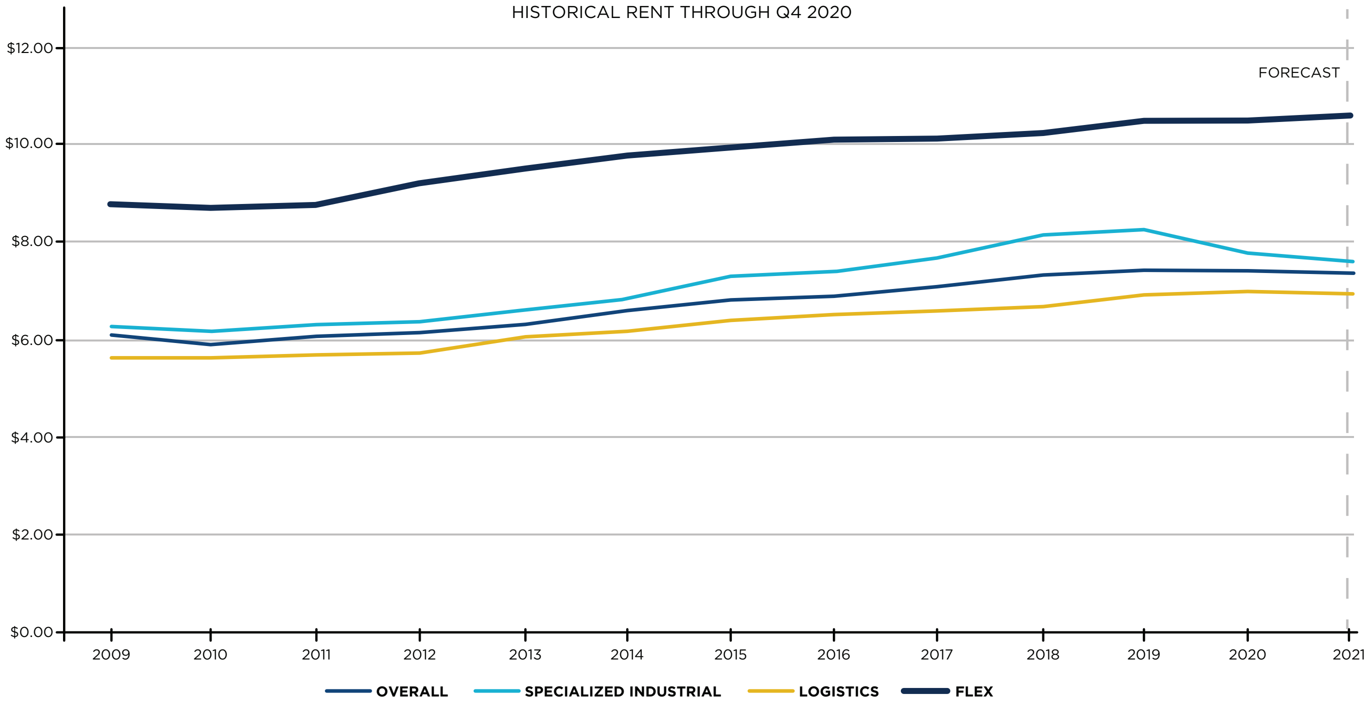
Prior to the onset of the pandemic, the first quarter of 2020 set a record for transaction volume thanks to national portfolio deals. By year end, Houston experienced over $3 billion in transaction volume, as it did in the two years prior. Houston saw a dip in transactions in the second and third quarters during the period of price discovery before volumes rocketed back in the fourth quarter. The end of the year saw a return to large portfolio deals. Among the largest trades in the first quarter, two were part of national acquisitions by San Francisco-based Prologis. During the first two months of the year, Prologis acquired more than 13 million SF in Houston, representing a third of the total footprint sold last year and about 10 times the next-largest buyer, Exeter.

Source: CoStar Property©

Market	Existing Inventory		Vacancy		YTD Net Absorption	12 Month Deliveries SF (000)	Under Const SF (000)	Rent Per SF
	Bldgs	SF (000)	SF	Percent				
Downtown Houston	897	32,061	1,569,869	4.9%	(357,652)	0	-	$5.47
East-Southeast Far	2,431	87,993	8,724,692	9.9%	2,511,216	4,706	2,831	$7.20
Hwy 290/Tomball Pky	715	29,728	4,781,319	16.1%	21,672	1,529	1,170	$7.51
Hwy 59/Hwy 90 (Alt)	1,082	28,334	2,210,249	7.8%	563,242	636	1,146	$7.66
North Fwy/Tomball Pky	1,225	36,664	4,205,720	11.5%	2,708,638	2,867	291	$7.90
North Hardy Toll Road	934	41,940	5,717,437	13.6%	(483,732)	1,412	24	$7.42
North Outer Loop	1,126	27,359	2,713,997	9.9%	345,469	1,119	-	$6.97
Northeast Hwy 90	707	23,945	2,979,892	12.4%	(251,317)	974	-	$7.11
Northwest Inner Loop	1,823	64,082	5,148,555	8.0%	(274,154)	24	-	$7.25
Northwest Near	842	20,300	851,240	4.2%	51,549	135	-	$6.95
Northwest Outliers	756	35,785	4,419,647	12.4%	3,520,158	4,988	100	$8.39
South Hwy 35	1,874	41,511	1,663,949	4.0%	1,198,994	638	478	$7.23
Sugar Land	561	26,287	1,019,354	3.9%	2,173,642	2,450	2,984	$7.83
The Woodlands/Conroe	1,349	26,904	1,858,879	6.9%	1,607,202	1,642	3,180	$9.25
West Outer Loop	869	28,940	1,765,385	6.1%	(175,188)	35	31	$7.67

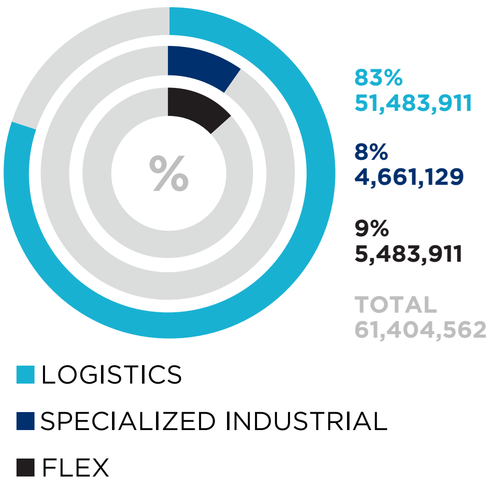
Source: CoStar Property©

HISTORICAL AND FORECAST RENTAL RATES BY CLASS

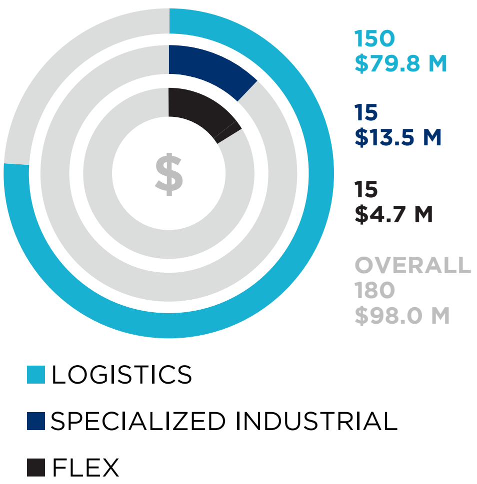


Source: CoStar Property©

VACANCY BY CLASS



SALES BY CLASS



OFFICE MARKET SNAPSHOT

LEASING

Leasing volumes were down more than a third in 2020 compared with 2019, as tenants delayed leasing decisions during the pandemic. Houston's office market experienced -4.2 million SF of net absorption in 2020 — across all asset classes — which was the worst year on record, and more than double the move-outs during the worst of the shale bust in 2017. And a vacancy rate of 18.5% today is among the highest out of all 390 markets that CoStar tracks. On a positive note, Houston did not see the increase in sublease space that other markets experienced last year, although the nominal increase from 19Q4-20Q4 did make the top 20 in the U.S. That is likely because much of the sublease space that went on the market during the shale bust was either converted to direct vacancy or absorbed.

RENT

Houston office rents have stagnated since oil prices crashed in late 2014 and have yet to return to their recent peak. Rents have also trended down in each of the past three local economic cycles — not a great sign for Houston landlords, as owners have had to contend with successive supply waves and waning energy tenant demand. The submarkets that are seeing positive rent growth are typically smaller submarkets that have not experienced much new supply or large-scale move-outs. Alternatively, the submarkets seeing the biggest rent declines are mostly the larger, institutional submarkets that have seen a recent wave of new supply and large move-outs, with few exceptions.

CONSTRUCTION

Along with slower than normal leasing, the Houston market still has a sizable construction pipeline to contend with. Today there are 5.4 million square feet under construction. Much of the new construction is concentrated in three submarkets: The CBD, South Main/Medical Center and Katy Freeway East. Overall, new development activity is down considerably from 2014 highs. Houston's office supply pipeline was already down significantly since the recent oil downturn of 2015–17 as the market worked through significant oversupply, prior to the coronavirus pandemic and recent oil price crash. However, there are still a few new projects underway. Houston, home to the largest medical center in the world at the Texas Medical Center, may also soon welcome several million SF of new life science-oriented mixeduse projects along a two-mile stretch of Holcombe Boulevard. These projects could raise Houston's profile as a burgeoning commercial life sciences and tech hub, and could inject billions into the local economy.

SALES

Following 2019's fourth quarter, one of the best quarters on record for transaction volume in Houston, transaction activity plummeted during the pandemic. The fourth quarter of 2020 saw investors stage a modest yet otherwise unremarkable comeback in transaction volume. However, annual transaction volume had fallen by more than half from the prior year's level. This was still enough to rank Houston in the top 15 markets by sales volume in 2020. In 2020, local buyers made up half of the square footage sold vs. one quarter for national buyers, as outside capital took more of a backseat during the pandemic. Cap rates held steady for confirmed trades year over year, and average sales price per square foot also held steady around $200. Houston's office sector vacancy never quite recovered from the oil downturn of 2015-17. This has placed downward pressure on rents, and therefore NOI and prices, and slightly increased pressure on cap rates ever since 2014. As a result, a mix of private equity, private, REIT/public, and institutional investors swooped in to capitalize on value-add and opportunistic plays, especially portfolio deals of older 4-star assets in core and core plus locations.

Source: CoStar Property©

Market	Existing Inventory		Vacancy		YTD Net Absorption	YTD Deliveries	Under Const SF (000)	Rent Per SF
	Bldgs	SF (000)	SF	Percent				
Bellaire	93	5,325	543,585	10.2%	218,258	1	-	$26.16
CBD	164	51,463	11,335,910	22.0%	(731,850)	0	1,271	$36.04
E Fort Bend Co/Sugar Land	461	10,455	1,374,462	13.1%	(22,778)	23	23	$28.01
FM 1960/Champions	307	4,417	638,991	14.5%	186,187	31	3	$18.79
FM 1960/Hwy 249	496	9,856	1,612,056	16.4%	(15,844)	20	190	$25.89
Galleria/Uptown	67	16,950	3,445,670	20.3%	(523,070)	1	-	$32.40
Greenspoint/N Belt W.	119	11,024	4,983,606	45.2%	29,848	0	-	$18.76
Greenway Plaza	274	12,689	2,292,199	18.1%	(354,993)	0	-	$31.30
Gulf Freeway/Pasadena	672	8,350	1,059,196	12.7%	(14,002)	0	64	$21.98
Katy Freeway East	271	11,925	1,511,412	12.7%	(272,969)	2	965	$32.88
Katy Freeway West	266	28,087	6,474,568	23.1%	(624,533)	4	-	$29.35
Katy/Grand Parkway W.	493	6,615	1,027,873	15.5%	(29,520)	11	144	$28.86
Midtown	606	11,067	1,251,509	11.3%	(151,573)	2	458	$29.92
NASA/Clear Lake	548	10,330	1,364,626	13.2%	12,626	4	17	$23.92
North Loop West	387	6,420	1,126,409	17.5%	(5,452)	5	-	$22.64
Post Oak Park	45	4,820	1,592,985	33.1%	(182,342)	1	77	$32.18
San Felipe/Voss	50	5,347	1,358,036	25.4%	(229,842)	0	-	$26.37
South Main/Medical Center	246	13,909	1,063,049	7.6%	(222,000)	1	1,216	$29.57
Southwest Beltway 8	193	7,294	1,482,207	20.3%	(104,140)	1	-	$18.33
Southwest/Hillcroft	111	5,362	829,371	15.5%	33,582	1	-	$17.46
The Woodlands	690	23,994	3,702,843	15.4%	(1,024,141)	13	603	$32.50
West Belt	118	6,405	1,607,040	25.1%	(283,543)	2	-	$28.95
Westchase	139	20,383	4,693,659	23.0%	(165,887)	0	-	$27.20

Source: CoStar Property©

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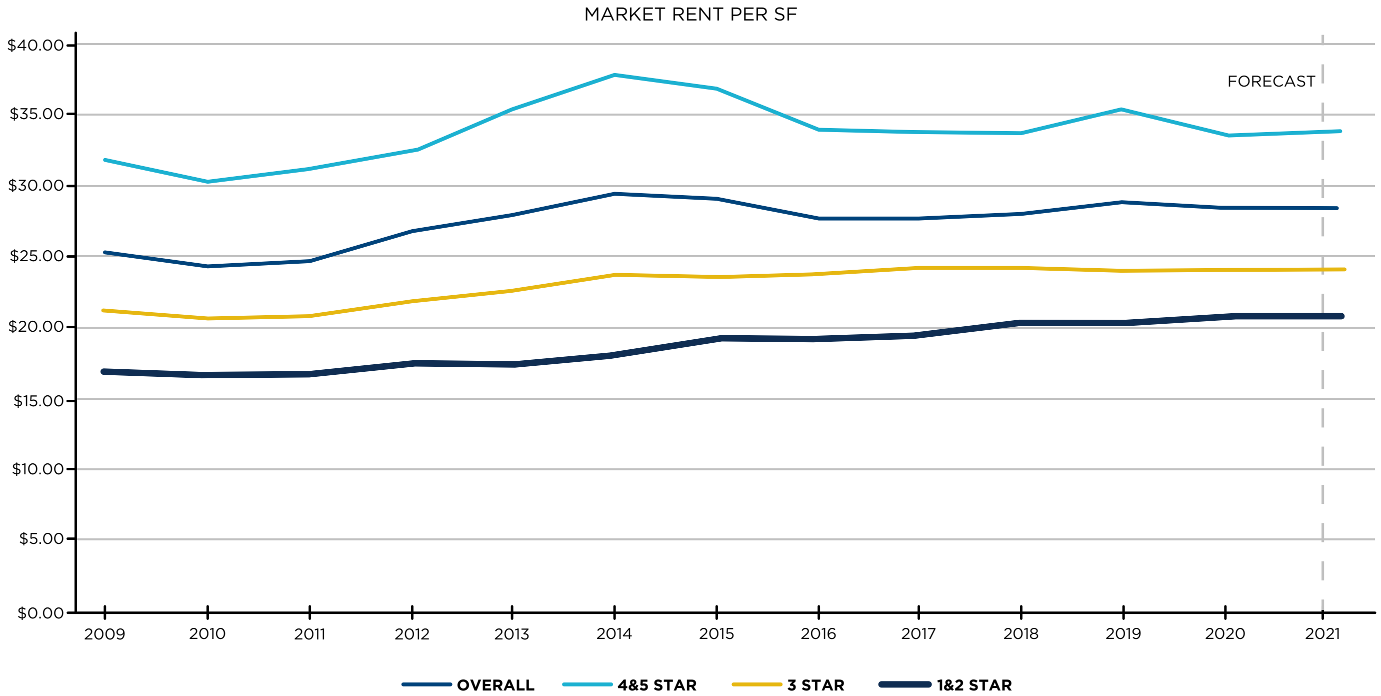
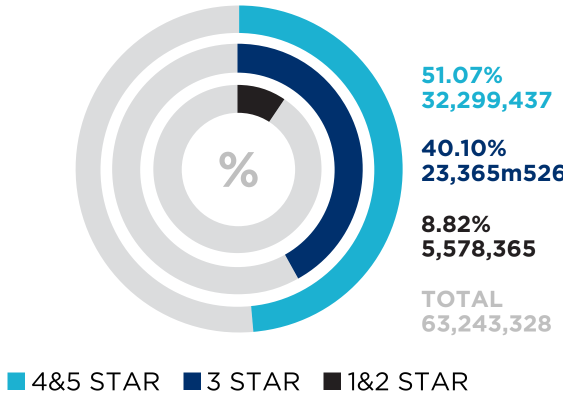


Source: CoStar Property©

VACANCY BY CLASS



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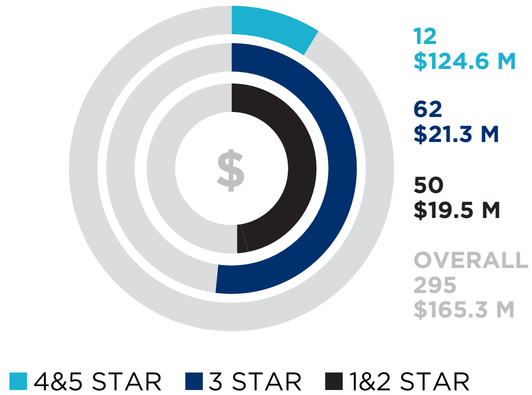
SALES BY CLASS



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LET'S GO PLACES.

Belvoir's team of experts are ready to answer your commercial real estate and brokerage questions.
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