Colliers

HOUSTON TRENDS

2022 Commercial Real Estate Market Update

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The **Speakers**

Patrick Duffy, MCR
President | Houston
Colliers

Pat has over thirty-eight years of commercial real estate experience as a producing broker, educator, sales manager, and managing broker. He specializes in developing and implementing strategic and tactical plans utilizing the resources of Colliers. He is the president of the Houston office and past Chairman of the Colliers USA Board of Advisors.

KC Conway, MAI, CRE, CCIM
Principal & Co-Founder
Red Shoe Economics

Economist and Futurist Kiernan "KC" Conway, CCIM, CRE, MAI is the mind trust behind Red Shoe Economics, LLC, an independent economic forecasting and consulting firm furthering KC's mission as The Red Shoe Economist by providing organic research initiatives, reporting and insights on the impact of Economics within the commercial real estate industry.

Event **Timeline**

2:00 - 2:20	Houston Market Overview by Patrick Duffy
2:20 - 3:00	Economic Insight by KC Conway

For a copy of today's presentation, please visit: www.colliers.com/Houston/TRENDS

Colliers

Houston

Office 21Q4

Key Takeaways

- Houston office market records positive net absorption
- Vacancy rates remain high
- 2021 leasing activity down 26% from 2020
- Tenant space improvement construction costs and time to complete increases

		YOY	FORECAST
Vacancy Rate	23.1%	▲	▲
Net Absorption	196.5K SF	▲	▼
Under Construction	2.9M SF	▼	▼
Overall Class A Asking Lease Rates (FSG)	$34.76/SF	▼	▲

Houston Highlights

Houston's office market posted positive net absorption in Q4 2021, recording 196,525 square feet, but ended the year reporting a total of 1.9 million square feet of negative net absorption. Houston's overall average vacancy rate remained at 23.1% over the quarter and the average Class A vacancy rate dropped 10 basis points. Houston's office inventory increased with 509,280 square feet of new inventory added in Q4. There is still 2.9 million SF of office space under construction and most of the new inventory is 55% pre-leased. Kastle Systems Workplace Office Occupancy Barometer places Houston in the number 2 spot just behind Austin for metros with the most tenant building card key swipes at 42.9%, up 19.3% in January from a month ago.

Market Indicators

5.1% Houston Unemployment Rate

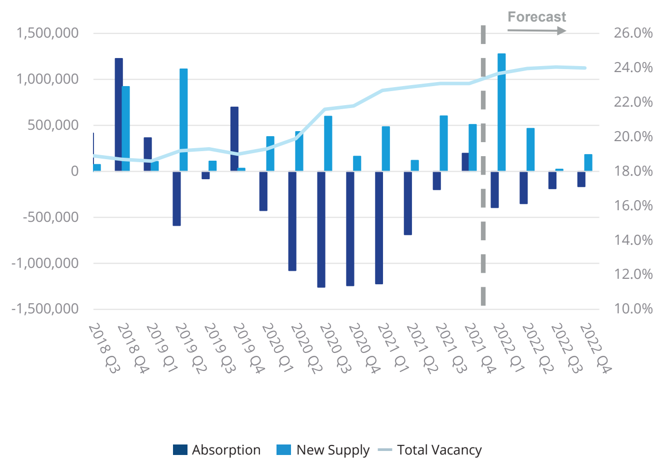
4.8% Houston annual % change in employment

$72.00 WTI Spot Price, U.S. benchmark for light sweet crude

Historic Comparison

	20Q4	21Q3	21Q4
Total Inventory (in Thousands of SF)	237,511.8	238,414.0	239,014.7
New Supply (in Thousands of SF)	164.1	601.2	509.3
Net Absorption (in Thousands of SF)	(1,241.5)	(196.8)	196.5
Overall Vacancy	21.8%	23.1%	23.1%
Under Construction (in Thousands of SF)	3,384.4	2,711.3	2,936.5
Overall Asking Lease Rates (NNN)	$20.71	$20.41	$20.62

Market Fundamentals



The forecast in the graph above is based on a trailing four quarter average.

Recent Transactions

*Colliers Transaction

Shell

Lease Renewal
1000 Main
CBD | 295k SF

LANCIUM

Lease*
The Woodlands Towers at The Waterway
The Woodlands |26.5k SF

NYDIG

Lease*
The Woodlands Towers at The Waterway
The Woodlands |26.5k SF

Sale*
1240 North Post Oak
Northwest Near | Undisclosed

Sale
Ten West Corporate Center
Katy Freeway | $337/SF

Executive Summary

Commentary by Sam Hansen, Principal

Almost two years in-

The term "new normal" wasn't coined during the Pandemic, but it was routinely bantered around as we all waited to see how the situation was going to end (remember, it was only supposed to last a few weeks or months). Now 21 months in, new behaviors and actions are present, which may shed some light on the expression "new normal". The term implies some standardized changes which can be followed to rectify or clarify situations and usher in *life* in a predictable way, (mask, social distancing, sanitizing). The world has undoubtedly adapted to and modified most aspects of daily routines to try and create some bastion of normalcy. As many permanent adaptations have shown to be elusive, some have taken root.

Businesses, schools and other institutions try to work within an ever changing set of rules and disseminated information, most have given up on a "new normal" and are content with "current normal." For example, companies continue with a variety of flexible work programs, the ongoing consolidation of offices and locations, the reduction of commercial footprints and the right-sizing of work staff while focusing on retention of "essential" employees. As it pertains to commercial office real estate, there are no easy transactions during this period. Top line revenue has been impacted for most businesses, office vacancy is high and attracting new tenants has proven to be extremely challenging. However, Houston is no stranger to cycles. We have battled energy cycles regularly and understand how to adapt and move forward. In addition to traditional concessions (free rent, rate cuts, high TI packages), landlords may repurpose or reposition an asset. A retail big box may become storage space or an office building could convert to residential condo.

Houston has proven to be a survivor, as evidenced by Texas being the #1 U-Haul one-way drop-off location in the country. More people are coming to Houston without a Plan B in order to make a better life for themselves and their families. The good news for us is that the "current normal" has shown itself to be one of continued resilience and fortitude.

Houston

Industrial

21Q4

Key Takeaways

- Robust investment activity
- Historical positive net absorption recorded
- Leasing velocity gained momentum, reaches historical high
- Vacancy rate drops on a quarterly and annual basis
- Port Houston sets records

		YOY	Forecast
Vacancy Rate	7.1%	▼	▼
Net Absorption	9.6M SF	▲	▬
Under Construction	16.7M SF	▲	▬
Overall Asking Lease Rates (NNN)	$7.88/SF	▲	▲

Houston Highlights

Houston's Industrial market continued to gain momentum as leasing velocity reached 9.0 million square feet in the fourth quarter, pushing the year-end volume to a historical record of 44.5 million square feet. The increase in demand for space continued to spur new development with over 16.6 million square feet under construction and an additional 51.1 million square feet proposed or in the final planning stage. Houston's industrial market recorded 9.6 million square feet of absorption in the fourth quarter, bringing the year-end total to a historical high of 28.5 million square feet of positive absorption. The vacancy rate decreased 140 basis points annually from 8.5% in Q4 2020 to 7.1% in Q4 2021.

Market Indicators

5.1% Houston Unemployment Rate

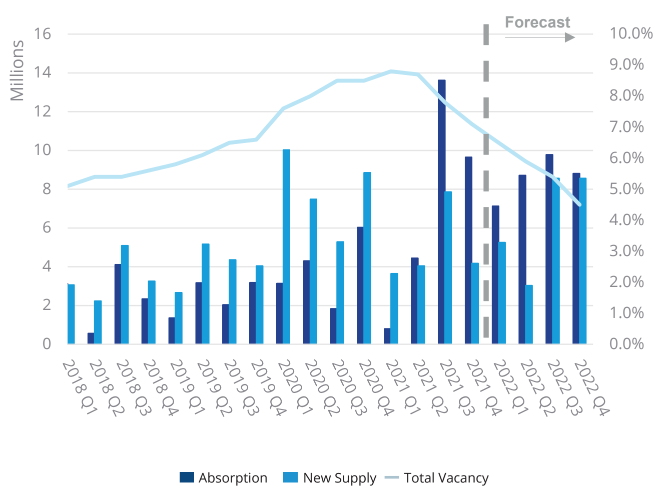
4.8% Houston annual % change in employment

$72.00 WTI Spot Price, U.S. benchmark for light sweet crude

Historic Comparison

	20Q4	21Q3	21Q4
Total Inventory (in Thousands of SF)	649,708.2	665,286.9	674,014.5
New Supply (in Thousands of SF)	8,497.8	7,865.4	4,172.3
Net Absorption (in Thousands of SF)	6,248.7	13,620.2	9,646.9
Overall Vacancy	8.5%	7.8%	7.1%
Under Construction (in Thousands of SF)	8,180.5	17,447.3	16,684.9
Overall Asking Lease Rates (NNN)	$7.34	$7.67	$7.88

Market Fundamentals



The forecast in the above graph is based on a trailing 4-quarter historical average.

Recent Transactions

Lease*
Barsan Global Logistics
Port 146
East-Southeast Far
140.3k SF

Lease*
Cadeco Industries, Inc.
Prologis PetroPort
East-Southeast Far
101.5k SF

Lease Renewal*
Delta Petroleum Co. (Greif)
Battleground DC
East-Southeast Far
104.3k SF

Lease*
Erik's North America, Inc.
Prologis PetroPort
East-Southeast Far
61.7k SF

Sale*
2413 Wilson Rod
Northeast Hwy 90
24Kk SF

*Colliers Transaction

Houston

21Q4

Industrial

Executive Summary

Commentary by Robert L. Alinger

2021 was a banner year for Houston Industrial real estate. A number of factors contributed to record setting deliveries and absorption. Among those are historically low interest rates, increased port activity, e-commerce expansion, increased capital investment in U.S. CRE, and continued pent-up consumer demand due to COVID-19. Each element contributed to what was a perfect storm, which allowed the Houston market to absorb over 28,500,000 SF, where a typical year has recorded approximately 12MM to 15MM SF. This level of growth was achieved despite labor and material shortage obstacles.

Port Houston (PH)

Houston's port has seen its busiest year ever. In November, the port surpassed its previous high-water mark of 3,001,164 TEUs by nearly 16%. Full year estimates are in excess of 3,400,000 TEUs. Material shortages, increased consumer demand, and labor shortages in other port markets are all contributing factors to the record PH growth. Developers continue to seek viable land positions in Houston's east and southeast submarkets to service this ever expanding port activity.

E-Commerce

The COVID-19 pandemic and low interest rates continue to fuel the massive e-commerce growth. Amazon and Wal-Mart have continued the rapid expansion of their distribution networks in the Houston MSA and across the U.S., with other competitors following suit to claim their piece of the pie. Same-day delivery and direct to consumer fulfillment needs are fueling the rapid increase in distribution space occupied by retailers. 2021 retail sales are estimated at roughly $4.5 trillion. Within that total is e-commerce (non-store) sales, which have grown nearly 20% to a range of $1.09 - $1.13 trillion. Developers continue to deliver new product in an attempt to meet this demand.

Capital Markets

Dry Powder has continued to flow into the U.S. real estate market. Cap rates for core product in the Houston area have now breached the high 3's. Forwards have sold at a feverish pace with investors looking to capitalize on rent growth, low interest rates and record absorption. In certain circumstances, investors will pay more for a project with some vacancy, as their rent growth projections far exceed the current market rate. This narrative is well supported in other markets (Austin, L.A., Phoenix, Chicago, etc.), but Houston has not and will not see those vast annual increases. The rent growth recorded in Houston is noticeable, but albeit subdued (5-8%), and is largely due to increased material costs, not under supply. Houston is unique in that it has few geographic constraints and even fewer political constraints when entitling new developments. Developers can have a building constructed in as little as 14 months following the land purchase. Less than double digit rent growth and impending Fed rate hikes will not, however, prevent the continued investment. Rate hikes will temper cap rate compression, but CRE investment remains an effective hedge against inflation. Looking ahead, 2022 will be another strong year.

Houston
Retail 21Q4

Key Takeaways

- Vacancy continues to decrease
- Positive absorption recorded
- Rental rates increased 5.6% in 2021
- 2021 leasing volume reaches 5.8M SF

Vacancy Rate	YOY / FORECAST	Net Absorption	YOY / FORECAST	Under Construction	YOY / FORECAST	Overall Class A Asking Lease Rates (NNN)	YOY / FORECAST
5.8%	▼ / ▼	1.3M SF	▲ / ▼	1.8M SF	▲ / ▼	$25.00-85.00/SF	▲ / —

Houston Highlights

Houston's vacancy rate decreased 40 basis points from 6.2% to 5.8% over the quarter as more inventory was leased than new inventory delivered. Houston's retail sector recorded 1.3 million square feet of positive net absorption in the fourth quarter, pushing the year-end total to 3.1 million square feet absorbed. Leasing volume reached 1.5 million square feet in Q4 bringing the year-end net total to 5.8 million square feet. The average asking rental rate rose 2.8% over the quarter and increased by 5.6% on an annual basis.

Market Indicators

5.1% Houston Unemployment Rate

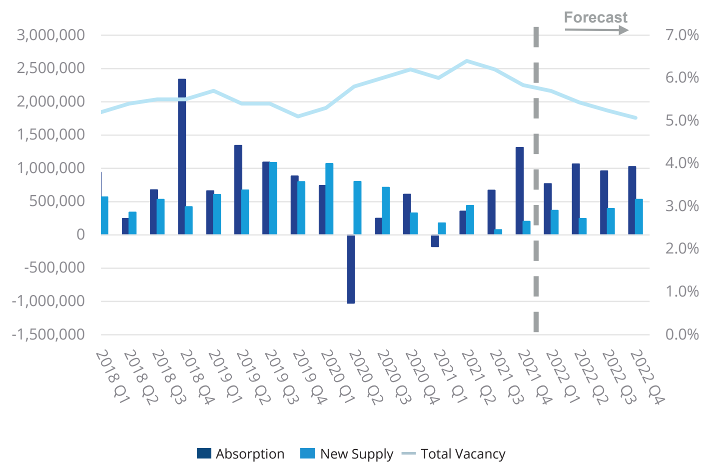
4.8% Houston annual % change in employment

$72.00 WTI Spot Price, U.S. benchmark for light sweet crude

Historic Comparison

	20Q4	21Q3	21Q4
Total Inventory (in Thousands of SF)	305,535.8	307,314.4	307,517.2
New Supply (in Thousands of SF)	326.0	106.0	202.8
Net Absorption (in Thousands of SF)	608.9	701.2	1,311.0
Overall Vacancy	6.2%	6.2%	5.8%
Under Construction (in Thousands of SF)	1,778.8	1,648.7	1,821.5
Overall Asking Lease Rates (NNN)	$18.35*	$18.85*	$19.37*

Market Fundamentals



The forecast in the above graph is based on a trailing 4-quarter average.

*The average asking rents in the table to the left are an average of all property types that are currently listed with an asking rate. This average does not include properties that are fully leased or that do not list an asking rate.

Recent Transactions

Lease*
Aviator Pizza
The Marq'E
Near Northwest | 5.4k SF

Lease*
Kids Empire
The Market at Crenshaw
NASA/Clear Lake | 12.0k SF

Lease*
Lankford Grocery Store
5208 Bissonnet
Southwest | 3.2k SF

Sale*
13742 N Eldridge
Inner Loop | 43.30K SF

Sale*
Velvet Taco
Inner Loop | 3.0K SF

Sale*
Stone Gate Center
Northwest | 11.6K SF

*Colliers Transaction

Executive Summary

Commentary by Wade H Greene IV, CCIM

Houston Finishes 2021 as One of Nation's Top Retail Markets. What Lies Ahead?

In January 2021, the word most used amongst Houston's retail experts to summarize the condition of the market and its recovery was much like that of the rest of the world; uncertain. Vacancy rose, leasing activity slowed and new developments stalled, or were put on hold. Things soon changed for the Bayou City and other major Texas markets following the end of the first quarter. Due largely to the state's position on COVID-19 restrictions, consumers started to return to the office (at a rate faster than any other city in the country) and felt safe in leaving home to eat, drink and shop. The last three quarters of 2021 brought a flurry of leasing and sales activity, resulting in Houston finishing the year as the nation's hottest retail market. In January 2022, BisNow reported that "Houston has outpaced all other U.S. major metros for retail demand and new construction deliveries. " When speaking with our peers regarding the outlook of 2022, the consensus is bullish for these trends to continue. Even with the overall positive market activity, which will continue through this year, there are several trends that brokers and retailers alike will need to navigate in 2022.

Lack of Inventory

Houston entered the pandemic as one of the top retail markets in the country. Following the rapid reabsorption of vacancy and increased new-to-market users in 2021, it became clear that there is a lack of quality space in our market. With increased competition for well-located real estate, landlords are more methodical to whom they award their sites. Creditworthiness, operating history and concept are all becoming equally as important to who will pay the highest rent. Fortunately, developers are also feeling confident in the rebound of retail, and new urban core and suburban projects are starting to come out of the ground. Several had been scheduled to break ground during the pandemic. While this should help the new site demand for many concepts, finding quality spaces will likely remain a challenge for 2022. Many users will need to exercise pertinence and creativity for the right opportunity or pipeline sites for 2023 or 2024 openings.

Rental Rates

Economics 101 tells us that prices will increase with an increase in demand and supply shortage. This has been the case in Houston throughout 2021, as rents have slowly crept up, especially in mature Inner Loop Trade Areas. With construction costs hitting all-time highs, new urban and suburban projects have seen increases in asking rental rates. While developers and landlords are achieving higher rents than in years past, we believe market rents should stabilize throughout 2022. With inflation-setting records, one rental economic trend likely to be implemented more often by property owners in 2022 is annual rent increases on new leases and renewals.

Supply Chain and Staffing

These are two COVID-19 trends that Houston's positive velocity could not outrun. It will be intriguing to see how things play out for both existing and soon to open retailers and restaurants. Throughout the pandemic, restaurant operators' staffing has been a significant issue and remains unsolved in 2022. The rising labor cost and the challenge of being fully staffed have posed a problem for many operators. Coupled with higher rents and buildout costs, the already thin margins in the F&B world become even harder to land in the black. As a result, the quality of operator, concept and positioning of real estate becomes more critical to be successful.

Throughout the history of retail, brick-and-mortar users have constantly evolved. Somehow through the supply chain issues brought on by COVID-19, retail store openings have exceeded closures for the first time in over 5 years. Retailers have used the supply chain issue as a way to use physical stores as distribution centers. Through same-day, last-mile at-home delivery and in-store pick up. Retailers have seen in-store sales increase from consumers that are picking up an item purchased online in the store. To double down on getting consumers in their locations, brands emphasize providing an experience that cannot be replicated online. We can confidently say that major retailers will remain resilient throughout 2022 and will see a second year of openings eclipsing shuttered units.

Notes:

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Executive Managing Director

Colliers is a top tier global real estate services and investment management company operating in 65 countries with a workforce of more than 18,000 professionals. We recognize the importance of serving clients while utilizing local knowledge on a global scale.

In Houston, Colliers has been providing commercial real estate solutions to leading corporations, institutions, investors, and small businesses since 1957.

Annualized Revenue
$4.0B
US$

Established in
65
Countries

Managing
2B
square feet

Lease/sale transactions
54,000

Assets under management
$46B

Comprised of
18,000
professionals

Colliers

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