Houston Industrial Market QuickTake

April 2020

How we're advising our industrial clients during these unprecedented times

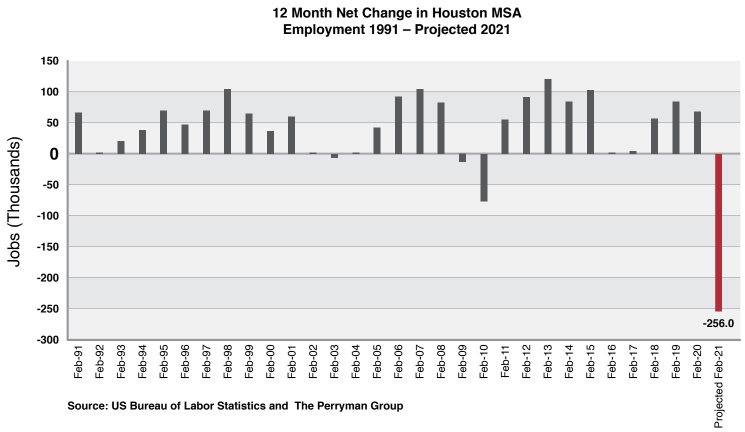
As Houstonians continue to adjust their lives under the Stay Home Work Safe Order and both the Federal Government and Houston's surrounding counties extend social distancing guidelines through the end of April, we are having a wide range of conversations with our industrial clients around the disruption to the Houston economy caused by the COVID-19 pandemic combined with the recent oil price war.

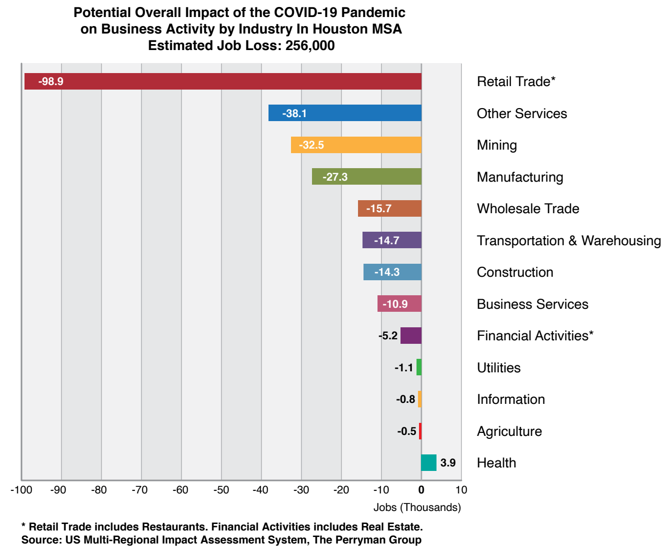
The primary topics of discussion have included 1) How COVID-19 will impact jobs; 2) What the long-term effects of COVID-19 and the decline in oil pricing will be; and, 3) Whether these unprecedented occurrences alter rent payments. We elaborate on these topics below.

I. COVID-19 Impact on Houston's Jobs

Houston is likely to see significant job losses and an extended burden on its economy from the COVID-19 coronavirus. Given the single week of job losses based on the initial claims for unemployment insurance in Texas and Houston's share of Texas' jobs, it is estimated that mid-March losses in the region will be around 37,945 jobs, reported Patrick Jankowski, Senior Vice President of Research with the Greater Houston Partnership.

The Partnership conducted a recent survey of its small business members and found that 29% were unable to deliver goods or services; 59% are operating below half capacity; and, most concerning, that 41% can survive only 1 to 4 weeks. The three industry sectors that are most at risk during this initial period (and the massive 777,000 jobs tied to those sectors) are all non-office occupying, and include: 1) retail—those impacted by social distancing; 2) plumbers and other home services—those whose services can't be delivered remotely; 3) the arts—those that aren't considered essential; and 4) most small businesses that tend to operate on thin margins.





The Perryman Group developed a possible scenario for estimating the eventual effects of the coronavirus based on a variety of public and private source materials, with projected job losses in Houston-The Woodlands-Sugar Land MSA totaling nearly 256,000.

The next Bureau of Labor Statistics' jobs report, which will include the surge of layoffs that happened during the third and fourth weeks of March, will be released in early May and will show the real impact on the job market.

II. COVID-19 Impact and Long-Term Effects of Oil Price War on Houston Industrial Market

Houston's industrial market was no doubt the metro's best-performing property sector recently, and seemed relatively unaffected by the recent oil downturn in 2014/2015. As the population in Houston and surrounding areas flourished, so did the demand to distribute goods. The previous relatively steady price of oil combined with the population growth made the Houston area a very desirable market for industrial developers, resulting in record levels of completed construction. However, Houston's industrial market does face headwinds amid the ongoing pandemic and oil price war.

While of course no one can predict precisely how long the disruption will persist, one thing we can do is make some educated predictions around possible industrial client responses during and after the pandemic runs its course.

- E-commerce. The surge in online ordering and home delivery makes last-mile distribution and logistics space all the more valued. That said, the industrial sector faces downside risks due to declining consumer demand—especially for non-essential items—and supply chain disruptions.

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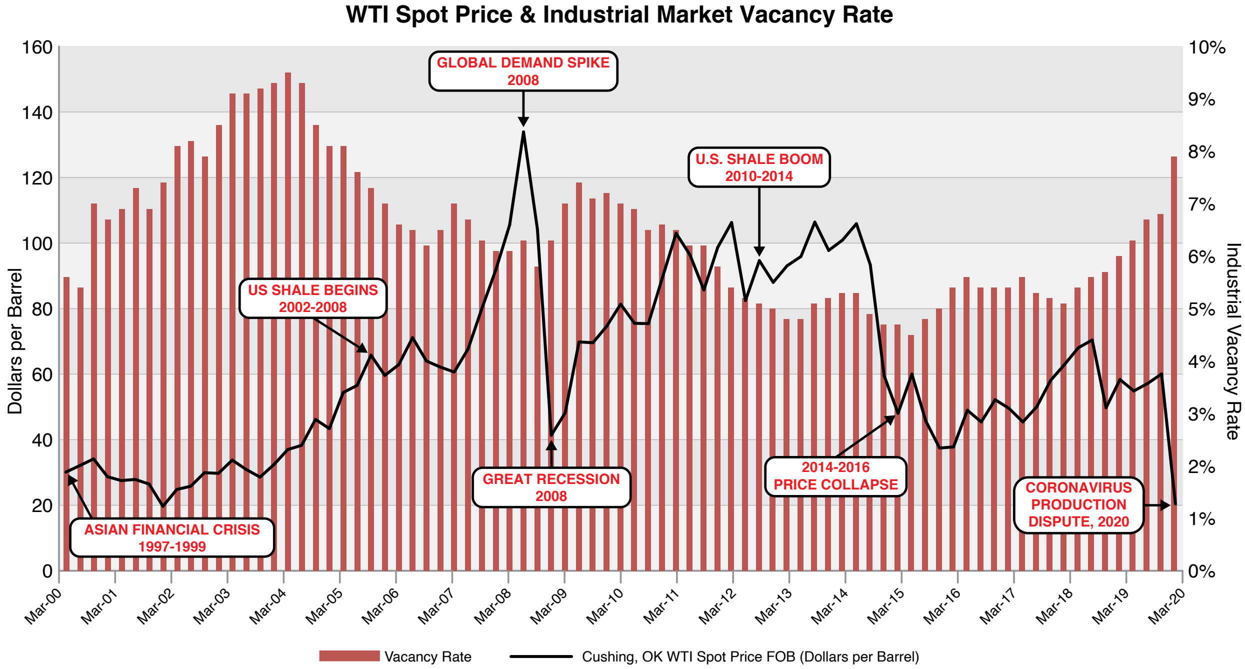

- Port Houston. Port Houston is part of a critical infrastructure industry as identified by the Department of Homeland Security, and continues to operate to keep the supply chain moving and keep commerce flowing to support our region and the nation.
- Construction. Houston has experienced record-breaking amounts of industrial product under construction with the current amount at 18.1 million sq. ft. Even prior to the coronavirus pandemic and the oil price war, there were discussions around whether our industrial market risked becoming overbuilt. The coronavirus pandemic may lead to project delays or a slowdown in groundbreakings over the next few months, as owners, lenders, and developers come to terms with the changing economic environment both locally and nationally.

III. Rent Payments

Houston's industrial market vacancy rate sits at 7.9% as of Q1 2020. With additional space likely coming available in Houston, larger industrial tenants will arguably have more leverage than at any time in the last decade with regards to negotiating rental rates, terms, tenant improvements and concessions. Disruptions from COVID-19 will also have an impact on commercial real estate landlords and tenants as difficult decisions are made to adapt to these sudden changes. Many small tenants—particularly retail tenants—have seen revenue drop 50% to 100% in some cases and simply can't pay their rent.

For companies that qualify, the CARES Act recently passed by Congress provides at least two months' rent and wage relief for companies of 500 employees or less; landlords—many of which are also struggling, as they receive multiple rent relief requests while still having to pay property expenses and mortgage payments—expect tenants who are able to do so to apply for these funds in order to pay rent.

We continue to assist our clients by evaluating their current options on a case-by-case basis, including recommending they apply for the CARES Act where applicable, restructuring leases, and reviewing loan covenants, among other solutions.

IV. Moving Forward

While there are a great many things for us all to contend with, it's also important to note that this too shall pass. As we come out on the other side of things there will be new and numerous opportunities for real estate users—and in many cases the circumstances are likely to be even more positive than many of us have seen for some time.

Please take care of yourselves and your loved ones as we get through this crisis together, like we always do: with hard work and perseverance. And don't hesitate to contact your NAI Partners broker should you need anything, as this collective experience has even further reinforced for all of us our company's most important core value: putting the client first, always.