COVID COMMERCIAL

Industrial real estate is a rare bright spot

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JLL

Exan Capital purchased the 1.01 million-square-foot Amazon fulfillment center at 31555 U.S. 90 in Brookshire in 2020. The property is fully leased by Amazon, which is expanding rapidly across the Houston region.

The glut of office space in the Houston market saw no reprieve over the course of the last year, as the pandemic and the falloff in demand for oil made tenants rethink how – and if – they needed tony space in glitzy high-rise buildings.

The Houston area's office vacancy rate stood at 23.8 percent in the first quarter, up from 21.5 percent in the first quarter of 2020, according to NAI Partners.

The uptick reflects ongoing uncertainty. But for the expectations that the workplace of the future will be different, little is clear. While advances in technology made it possible for teams to easily connect online, working from home may not be a long-term solution.

"We're big believers in culture and people," said Jamie Bryant, president and chief operating officer of Midway, a Houston-based real estate investment company. "I just think it's hard for companies to grow people and grow their culture if they're all at home."

One of the coworking spaces at Midway's CityCentre mixed-use development in west Houston is back up to 70 percent occupancy, Bryant said. Downtown, however, it's still relatively quiet at Midway's Jones on Main, where JPMorgan Chase has gradually begun to bring back employees.

"So much of the retail and shops and restaurants downtown can't survive without the office," Bryant said. "It's starting to come back."

While some retailers and national chains closed stores permanently during the pandemic, others, including gyms and restaurants, are coming in to take their place.

Retail occupancy dropped to 93.7 percent in the first quarter, down a half a percentage point from the year earlier, according to NAI Partners.

The decline in brick-and-mortar comes as online shopping has zoomed to more than 30 percent of retail spending, more than double its pre-pandemic share, making retailers nervous about the new habit, said Jim Gaines, a research economist at the Texas Real Estate Research Center at Texas A&M University.

"People are still going to want to go shop. They want to see the product, not just see a picture of it on their computer screen," Gaines said. "So, some of that is going to come back."

If there was a bright spot in the market, one that appears to continue to shine, it was in the warehouse sector. Spurred by the spike in online sales, companies that sell everything from appliances to clothing are leasing warehouse space. Houston's strong housing market has translated into a need for industrial space among home goods and building supply companies.

"Companies are actively out in the market for space," said Rachel Alexander, senior vice president research at JLL. She said companies are out shopping for twice as much warehouse space as they were a few years ago.

To keep up with demand, Amazon is adding new fulfillment centers in Richmond and Missouri City and several last-mile delivery stations around the Houston metro area. It has more than tripled its employee count in the Houston area over the last year to 16,000, including Whole Foods employees.

Home improvement retailers are also expanding to keep up with the residential boom, which shows no sign of abating. Lowe's and Floor & Decor each broke ground on 1.5 million-square-foot distribution centers in the first quarter, accounting for more than 20 percent of the 13.3 million square feet of new space under construction across the Houston region, according to JLL.

Leasing was robust in the first quarter, with companies leasing 6.7 million square feet of industrial space, according to JLL. Driven by new space coming online to meet all this demand, industrial vacancy edged up to 9.6 percent in the first quarter and is expected to tighten during the year.

Hotels, one of the hardest hit sectors as travel stopped and companies quit holding in-person conferences during the pandemic, are in hiring mode to ramp up for leisure travel from people who are tired of staying at home and the return of business travel.

Demand for hotels is projected to recover in 2023, while close to full recovery of room rates is projected in 2024, according to STR and Tourism Economics.