TRANSWESTERN

House View

Economic Snapshot

HOUSTON'S ECONOMY IS STRONG

- Port Houston tonnage is setting records.
- Through the first seven months of this year, nearly $25.3 billion in construction contracts were awarded in the Houston area, which is up 35.9% from the $18.6 billion awarded over the same period last year.
- Population growth at 139,900; 66% from in-migration.
- Houston MSA gained 64,500 new jobs through September 2024.
- Strength in core industries along with emerging industries of lab and life sciences, renewable energy and aerospace.
- Carbon-based energy industry is maturing and seeing consolidation while energy demand remains high.

Transwestern is optimistic and bullish about the opportunities for our clients in the market today.

Economic Outlook

- Not withstanding domestic economic headwinds, geopolitical issues and US election uncertainty, the Houston economy will outperform its peer cities in 2025 and 2026.
- Radical shifts are being replaced by predictive cyclical market behaviors.
- Fed actions will produce directional clarity leading to improved liquidity and price discovery required to clear most asset types.
- Power grid capacity will put a non-real estate driven constraint on supply of industrial, data center and some renewable energy projects.
- Insurance costs will impact user and investor behavior.

HOUSTON

Office

Office Snapshot

- Successful assets must have some combination of quality, location, on-site and even walkable amenities.
- 25% of the existing inventory is not competitive and 10-15% of available inventory may never be leased again and should be repurposed or demolished.
- Investible universe is shrinking:
  - Assets with debt maturities in the next 24-36 months are impaired regardless of Fed actions.
  - Commoditized offerings cannot compete.

The vacancy in buildings completed since 2010 is 4x less than those built prior to 1979.

A generational shift in ownership and asset pricing will accelerate, leading to generational investment opportunities for first movers with proper targeting strategies.

Office Outlook

- Work From Work! Flexibility and environment are critical. Corporate mandates to RTO will continue.
- Flight to quality continues. Tenants are paying historically high rates for an amenitized and activated environment.
- Lower quality A & B product have to upgrade amenities and execute to perfection in order to compete.
- Bet on the CBD, Inner Loop, The Woodlands, Uptown/Galleria and West Houston submarkets.
- New demand will be flat in 2025 as use patterns continue to target efficiency and relocate to higher quality assets.

HOUSTON

Industrial

Expect shortage of product in 2025, as current deliveries are absorbed.

Industrial Snapshot

CONSUMER DEMAND STILL DRIVING ABSORPTION

- Leasing demand remains strong due to regional population growth. Additional factors include global supply chain reorganization and manufacturing, continued onshoring to North America, Port Houston expansion plus a favorable cost of living, competitive tax rates, and a strong labor force.
- 28.9 million SF of absorption in the past 12 months (Q3 2024).
- 15.6 million SF under construction to deliver in 2025.
- Land cost, capital markets and cap rate movement kept some discipline in the process which has led to supply constraints.

Industrial Outlook

- Development of new product in strategic submarkets will increase in 2025.
- Additional capital markets activity in 2025 as bid-ask tightens.
- Tenants will expand and make longer term lease commitments.
- Despite lack of supply, assets in secondary locations with poor design will struggle.
- Increased institutional acquisitions as buyers race to beat lower cap rates due to lower interest rates.
- Rent growth will slow in 2025.
- Developers should stay aggressive, but disciplined as demand continues to rise.

HOUSTON

Retail

Retail Snapshot

- Retail benefits from regional population growth, especially 'inner loop' lifestyle and hospitality establishments. The Houston MSA was the top-performing metropolitan area with 13 communities in the Top-50, representing over 4,500 sales, or almost 24% of all sales among ranked master-planned communities.
- Retail vacancy remains low and current space under construction totals less than 3.5M SF causing Q3 2024 to see the lowest net absorption rate since Q2 2020.
- Although much of the country is seeing a decline, restaurant volumes remain strong throughout the Houston MSA.

New suburban power centers and grocery-anchored developments are not expected to result in significant deliveries until well into 2026.

National Retail sales increased more than forecasted in September coming in at +0.4% and holiday spending is projected to grow by 2.5% - 3.5% over last year.

Retail Outlook

- Demand is outpacing supply and rents will continue to rise. Average market rents are 8% higher than 2019.
- Brick-and-mortar experiences continue to see an increase in demand.
- Dense urban markets with spending power and a super-regional consumer base will outperform other submarkets.
- Tenants who make meaningful connections with their customer base with an evolving e-commerce, omnichannel and social media footprint will continue to dominate the space.
- Restaurant and experiential concept sectors will continue aggressive expansion.

HOUSTON

Multifamily

Multifamily Snapshot

CLARITY RETURNS IN 2025-2026

- Houston multifamily rents are outperforming Dallas, Austin and San Antonio which are experiencing stronger declines, most notably Austin which dropped 7.8%.
- Rents in most Houston submarkets are flat but still well above pre-pandemic levels.
- Softening in Class B & C as renters take advantage of concessions in Class A assets.
- Houston and U.S. multifamily construction is slowing as investors expect rents to rise.

Interest rate stabilization will see lenders being more proactive with under-performing assets leading to more foreclosures.

During 2025, distressed properties, especially highly leveraged workforce housing, will see more properties become available creating emerging investment opportunities.

Multifamily Outlook

- Transaction volume down significantly in 2024: Owners are still seeing positive NOI growth while property values decrease.
- Population growth, home prices and elevated mortgage interest rates support demand for multifamily absorption.
- Distressed / lender owned assets will start to hit the market in 2025.
- Better assets are starting to clear as interest rates are more predictable.

HOUSTON

Healthcare

Healthcare Snapshot

- 712,000 SF of medical outpatient space under construction in Q3 2024.
- 5.6 million SF of medical outpatient product has been delivered in the past 6 years.
- 34.1 million SF of medical outpatient real estate in Houston.
- Limited new supply, system expansions, aging population and in-migration, has put upward pressure on rents.

Healthcare Outlook

- Stable demand for healthcare services and healthcare employment growth will result in continued strength in healthcare real estate.
- Sales activity will increase as the bid ask spread narrows.
- Reposition/redevelop older medical outpatient buildings into Class B+/A- product and push rents accordingly.

Look for new development starts with a significant pre-lease component as capital markets stabilize.

HOUSTON

Life Sciences

Life Sciences Snapshot

- 6.8 million SF of occupied space within 10 industry categories on an 8.4 million SF base.
- 5.2 million SF of life sciences & lab sciences product with an overall occupancy rate of 85.1% at midyear 2024.
- $50-$65 psf NNN Class A lab rents
- $150-$275 psf lab TI
- Depth of the desired biological and biomedical sciences scientific talent pool is now nationally competitive.
- Development outpaced demand in the last 3 years leading to excess supply.

As a secondary life sciences market, Houston is expected to recover from overly optimistic demand projections resulting from the pandemic. Future demand will result from the strength of the TMC, access to leading institutions, a strong talent pool, abundant VC investment and a robust ecosystem of early and mid-stage startups.

Life Sciences Outlook

- In the discovery phase regarding the depth of the Life Science demand in Houston.
- TMC adjacent properties will continue to outperform.
- 165,000 SF of completed spec lab space, with an additional 31,552 SF under construction

House View