A year like no other: Reviewing 2020's impact on three Texas markets

BY MATT BAKER

What a year. The pandemic, civil unrest, a retreating economy, plummeting oil prices and more have all had varied impacts on Texas' markets. While everyone is eager to leave 2020 behind, what are the real estate prospects for the state's largest metros in 2021?


Michael Caffey

Dallas-Fort Worth

According to Michael Caffey, president, advisory services, South-Central Division and Latin America at CBRE, investment activity in the Dallas-Fort Worth area hasn't tapered off as much as many may have feared.

"Investor activity in Dallas-Fort Worth has continued throughout the year," Caffey said. "While activity is down overall, we're still a top-four market for total investment volume behind New York, Los Angeles and the Bay Area."

There is one main attraction, of course. As logistical warehouses remain the most sought-after and dynamic commercial property type, DFW's industrial sector has been immune to the headwinds of 2020 and seen year-over-year growth. In fact, demand among e-commerce tenants, 3PLs and the food and beverage industry has increased rents and sent vacancy rates to a near all-time low.

Industrial submarkets have all remained remarkably stable, with activity largely driven by the amount of available space. For example, in the GWS/Arlington submarket, where the vacancy rate is 4.7 percent, there is naturally less activity than in submarkets that have more available space like South Dallas or North Fort Worth.

It's not just investors who are eager to tap into the Metroplex's strong industrial performance. Developers have hardly slowed down, even as the pandemic ravaged the world's economy. To date, 18.8 million square feet of industrial product has been delivered to the local market in 2020.


Patrick Duffy

"The DFW development pipeline has remained relatively robust throughout the year, particularly in the industrial sector where we're tracking about 22.3 million square feet under construction," Caffey said. "Continued economic growth will drive supply chain activity in Dallas-Fort Worth and across the country, and spur demand for logistics real estate in an already supply-constrained environment."

Caffey said that he and his team are also seeing investor activity pick up for multifamily assets, with construction activity matching in an attempt to keep pace with continued population growth. While there is still capital market activity for office and retail space, demand for those product types isn't nearly as strong as for industrial and multifamily assets.

Office groundbreakings have slowed down, however there are still more than 4 million square feet under construction, following several projects delivered in Q3. Historically strong submarkets like far North Dallas, Preston Center, Richardson/Plano, as well as North Fort Worth, all saw positive office absorption so far in 2020. Though overall activity remains depressed, buildings in these submarkets are still well-leased.

Houston

Year over year, the data shows that office investment rose in the Houston metro during the 12-month period ending in Q3 2020. However, that activity is really buoyed by two monster deals in December 2019.

Following Occidental Petroleum Corporation's acquisition of Anadarko Petroleum, Howard Hughes Corp.—looking to maintain its near monopoly in the submarket—acquired two towers in The Woodlands from Occidental in a $565 million sale-leaseback. Separately, Skanska divested its 90 percent interest in the Bank of America Tower, with Beacon Capital Partners picking up the asset in a record $373 million transaction.


Ryan Bohls

"If you take those two deals out of what we're looking at for 2020, it's pretty dismal," said Patrick Duffy, president of the Houston office of Colliers International. "Underwriting the office market right now is extremely difficult, especially as people have time to digest the impact of work from home and what that does to the long-term occupancy of these buildings."

According to Duffy, the pandemic caused owners, investors, developers and tenants alike to pause all real-estate-related decisions, waiting to see how the situation unfolded. As a result, he instructed his sales team to start keeping track of sidelined deals.

"I've been doing this for 38 years I've never had to ask anybody to reclassify a deal that was in negotiation or was pending as 'on hold'," Duffy said, "but we started seeing a lot of deals just locking up."

The Colliers Houston team shifted more than $6 million worth of revenue into this new 'on hold' category. The good news now is that this figure has fallen to approximately $3.4 million. Some of that is due to transactions that have died, but also because previously frozen deals are back at the negotiating table.

The pandemic hit U.S. markets more or less equally,

but Houston has the misfortune—this year, anyway—of being dominated by the oil and gas industry. With flights grounded and commuters staying home, gas prices plummeted, and the effects could be felt in Houston's CRE industry. Layoffs at Exxon, Shell and other O&G firms continue to drive up office vacancy.

Similar to the office sector, Houston's industrial investment activity is skewed by one major transaction, Prologis' acquisition of Liberty Property Trust. If it weren't for one REIT buying another REIT and recording it as real estate sales, activity would appear to be very slow in Houston's industrial market.

"That's not a lack of interest on the investor side of the equation, that's a lack of available property. Nobody wants to sell," said Duffy. "Really, the industrial market here has been fairly robust."

Austin

Austin has been in growth mode the past few years, which has led to an explosion in office development. According to Ryan Bohls, director in NAI Partners' Austin office, the metro had more than 8 million square feet of office product underway pre-pandemic, virtually all of which is still slated to deliver over the next two and a half years. The events of 2020 may cause a crunch with all of this new product, however.

"An additional 7 million square feet of new construction has been in the pipeline and that's where we get a little more iffy, with developers and financiers requiring more preleasing activity prior to making hard commitments to go vertical," said Bohls. "That's a tall task when some of these new buildings may experience significant downtime in advance of tenanting up."

A heavy concentration of tech tenancy in the CBD could hurt downtown's office figures the most, as these firms are more readily able to work from home. Bohls notes, however, that a correction in the office market was needed, with a 3-million-square-foot deluge of space being deployed at precisely the wrong time.

As is the case elsewhere, industrial is the most unwavering asset class. Austin trails only Atlanta and the Inland Empire for leasing activity as a percentage of inventory with over 4 million square feet since the first quarter.

Big firms are having big effects on Austin's industrial market. Amazon has leased over 6 million square feet marketwide, though a slowdown seems imminent. However, Bohls expects a "multiplier effect" as suppliers look to locate within a tight radius of Tesla's recently announced Gigafactory.

Hotel room rental rates were absolutely slashed around the country following the initial outbreak of COVID-19. With the cancellations of festivals like South by Southwest and Austin City Limits—in addition to business conferences—Austin's hospitality industry took a massive hit. Bohls pointed out that more than a third of CMBS-backed loans on buildings near Power Five school stadiums are delinquent, which is a trend worth watching as the University of Texas has capped football attendance.

"Austin, and Texas in general, are probably the best suited state/city in the country to weather a storm like this," Bohls said. "We recovered from the Great Recession in record time (20 months compared to 53 months nationally) and post-pandemic circumstances in coastal markets should result in a groundswell of continued activity in Central Texas."