2021 Mid-Year Texas Commercial & Economic Outlook

TEXAS A&M UNIVERSITY
Texas Real Estate Research Center

TECHNICAL REPORT
2323
SEPTEMBER 2021
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EST 1971

September 2021

The economic recovery continues due to increasing COVID-19 vaccination rates that have allowed the reopening of the economy. Based on the most current data from the Texas Department of State Health Services, 54.5 percent of the state's population is fully vaccinated. Unfortunately, after months of decline in COVID-19 cases, the number of new cases has increased because of the number of people not yet vaccinated. Also, the Delta variant has shown to be more contagious than previous COVID strains. This has increased uncertainty surrounding the end of the pandemic. Until the virus is beaten, a full recovery cannot be secured.

Growth prospects for the Texas economy have improved for 2021 because of the economy's reopening and, to some extent, the uptick in the oil industry. The strong recovery has caused supply-chain bottlenecks, putting upward pressure on prices and raising inflation concerns. Whether inflationary pressures are transitory is uncertain because of unknowns regarding whether the economy is fundamentally different coming out of the pandemic and the uncharted territory of recovering from a health crisis.

Some changes in the economy will become permanent. Furthermore, some structural forces (e.g., the traditional work environment, digital divide) that were prevalent before the pandemic may no longer hold after it ends. Because this recession was caused by a catastrophic health crisis, the recovery path will probably be different than that of previous recessions.

Office Market

The office market has been exposed to some pervasive underlying changes in where and how work is performed. The longer the pandemic persists, the more likely the market will see transformative, lasting changes. The Delta variant has delayed the safe return of employees to the office. Occupancy cannot improve until COVID-19 variants are subdued, and even then there is no guarantee that it will return to pre-COVID levels. Uncertainty surrounding the future hybrid work landscape will probably cause vacancies to remain high, resulting in subdued rent growth in the coming years. Firms and their employees will have to determine the optimal form and amount of office space.

In the past, strong economic growth accompanied by solid employment in sectors like professional business services have been a boost to office leasing. This relationship has become somewhat weaker since the pandemic began as more and more employees have the option of working from home completely or partially. The change in the relationship between business employment growth and office demand in 2021 is apparent in how office vacancy rates increased even though professional business services employment registered strong growth. This demonstrated that firms can hire employees without increasing the demand for office space. This also implies that once the pandemic is over, job gains in sectors like professional business services won’t necessarily translate into more office leasing demand for new hires. It is too soon to tell if the hybrid work arrangement will cause a long-run structural decline in office demand.

However, on-site office work will not completely disappear. Office space will still be needed in sectors such as energy, life sciences, professional business, and financial activities.

Retail Market

The pandemic has accelerated the shift to e-commerce from brick and mortar retail. Still, some purchasing experiences cannot be duplicated online. About 40 percent of online clothing purchases are returned. Knowing this, retailers are increasingly using a hybrid store model that integrates the on-site experience with the online one. Amazon recently announced it will open large physical stores that operate similarly to department retailers, allowing them to expand their footprint in brick-and-mortar retail. This hybrid retail model will probably cause other retailers to rethink stores size, location, and use. These factors suggest brick-and-mortar retail will continue for the foreseeable future.

The reopening of the economy due to the vaccines has led to strong economic growth and solid consumer demand. Household preference for social interaction after being locked up during the pandemic has so far aided the retail sector in 2021 and should continue into 2022. Going forward, retail that is more convenient, attractive, engaging, or entertaining should flourish. In contrast, outdated retail that does not adapt to the new consumer shopping trends will disappear.

Industrial Market

This sector has benefited greatly from the shift to e-commerce and the need for distribution and warehousing centers. Companies are looking to spread their risk geographically and minimize the impact of supply-chain issues that have affected the distribution of goods since the reopening of the economy. Industrial space will continue to be aided by the shift to e-commerce, increased inventory requirements, and supply-chain diversification in the coming years. A possible future concern could be overbuilding driven by increasing investor interest in the sector. This occurred in the Houston warehouse market during the last part of 2019 and 2020, causing vacancy rates to reach double-digit levels and rent growth to moderate, in some cases severely.

The Texas Real Estate Research Center estimated 2021, 2022, and 2023 vacancy rates and asking rent percent changes for the different commercial markets and major Metropolitan Statistical Areas (MSAs) (Tables 1-3).

Table 1A. Forecasted Overall Office Vacancy Rates, Asking Rents

MSA	Natural Office Vacancy Rate	Vacancy Rates (%)				Asking Rents (y-o-y %)			
		2020	2021	2022	2023	2020	2021	2022	2023
Austin	13.0	12.7	16.3	16.7	16.8	4.7	2.2	2.1	2.0
Dallas-Fort Worth	18,0	19.2	21.7	22.5	22.8	3.2	2.0	1.6	0.5
Houston	14.0	21.2	22.8	23.2	23.3	0.2	-1.0	1.6	1.5
San Antonio	12.0	12.1	13.3	13.5	13.7	4.7	1.7	-0.4	0.5

Note: Annual numbers are the four-quarter average of the seasonally adjusted data. The rent growth is nominal and estimated from the previous year's average.

Source: Texas Real Estate Research Center at Texas A&M University

Table 1B. Forecasted Class A Office Vacancy Rates, Asking Rents

MSA	Natural Office Vacancy Rate	Vacancy Rates (%)				Asking Rents (y-o-y %)			
		2020	2021	2022	2023	2020	2021	2022	2023
Austin	15.0	12.8	17.1	18.2	18.4	3.3	2.5	2.1	3.0
Dallas-Fort Worth	21.0	22.9	25.7	26.7	26.9	2.8	1.5	0.4	0.4
Houston	16.0	24.5	26.6	27.3	28.3	-1.4	-1.5	0.7	0.3
San Antonio	14.5	14.7	15.6	15.7	15.8	6.1	0.3	-0.6	0.4

Note: Annual numbers are the four-quarter average of the seasonally adjusted data. The rent growth is nominal and estimated from the previous year's average.
Source: Texas Real Estate Research Center at Texas A&M University

Table 2. Forecasted Overall Retail Vacancy Rates, Asking Rents

MSA	Natural Retail Vacancy Rate	Vacancy Rates (%)				Growth Asking Rents (y-o-y %)			
		2020	2021	2022	2023	2020	2021	2022	2023
Austin	6.0	4.6	4.8	4.6	4.3	-0.1	0.6	0.8	1.0
Dallas-Fort Worth	8.0	6.5	7.0	6.9	6.8	-0.5	0.2	0.8	0.9
Houston	7.0	6.8	6.8	6.5	6.2	3.7	3.4	2.4	2.9
San Antonio	6.0	5.8	6.1	6.2	6.4	1.8	0.3	1.1	1.0

Note: Annual numbers are the four-quarter average of the seasonally adjusted data. The rent growth is nominal and estimated from the previous year's average.
Source: Texas Real Estate Research Center at Texas A&M University

Table 3. Forecasted Overall Warehouse Vacancy Rates, Asking Rents

MSA	Natural Warehouse Vacancy Rate	Vacancy Rates (%)				Growth Asking Rents (y-o-y %)			
		2020	2021	2022	2023	2020	2021	2022	2023
Austin	11.0	8.5	6.3	5.9	5.7	5.4	4.3	3.9	3.8
Dallas-Fort Worth	11.0	8.4	7.4	7.2	7.0	14.3	4.6	4.2	3.9
Houston	8.0	11.5	12.6	12.3	11.6	0.9	1.5	1.9	2.2
San Antonio	8.0	6.8	5.8	5.6	5.7	4.3	9.2	3.2	2.4

Note: Annual numbers are the four-quarter average of the seasonally adjusted data. The rent growth is nominal and estimated from the previous year's average.
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