MARKET REPORT

OFFICE

Houston Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

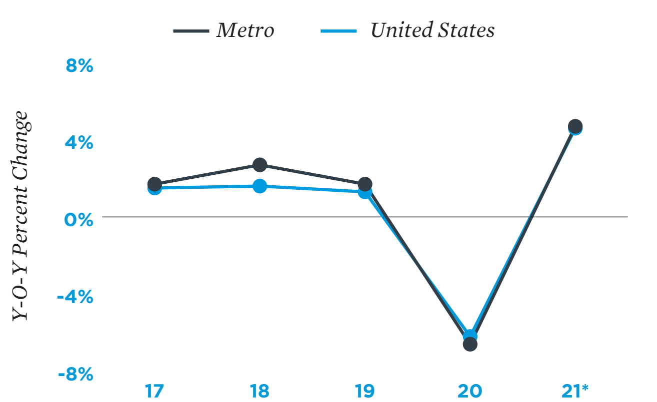
4Q/21

Energy Corridor Witnesses Stronger Demand; Overall Market Recovery Advances Slowly

Leasing activity ramps up in the Energy Corridor. From April through June of this year, the Katy Freeway submarket led the metro with 162,000 square feet of net absorption. The corridor faced significant hurdles early in the pandemic as uncertainty within the energy industry suppressed demand, so the change of momentum in the second quarter is a positive sign. Floor plans in the 10,000-square-foot to 30,000-square-foot range were favored by corporations seeking offices here. Energy industry firms that have committed to space in the Katy Freeway submarket in 2021 include AES Drilling Fluids, Wildfire Energy, Pemex and Liberty Oilfield Services. Nonetheless, vacancy here rested at 24.5 percent in June, up 350 basis points year over year. The local average asking rent also fell 6.6 percent during that span.

Nation's most vacant market to be further tested by supply. Houston was one of only two major markets in the U.S. that had a vacancy rate exceeding 20 percent in the second quarter**.** While the year-over-year jump in Houston paled in comparison to several gateway metros, conditions in Space City were impeded prior to the health crisis, and the decline in leasing exacerbated headwinds. Upward pressure to vacancy will continue in the near-term with 1.5 million square feet of speculative space scheduled to deliver in the second half of 2021. A large share is in the CBD, where vacancy stood at 25 percent in June. Next year, more firms will likely recall workers to offices and expand in dense locations, helping absorb some of the space downtown.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook

139,000 JOBS
will be created

EMPLOYMENT:

Houston employers have already added 89,000 positions through the first eight months of 2021, putting the metro on a trajectory to grow the staff count by 4.7 percent this year. Traditional office-using sectors will contribute 20,500 roles to the gain.

3,800,000 SQ. FT.
will be completed

CONSTRUCTION:

Completions in 2021 will exceed the trailing-three-year annual average by almost 1.7 million square feet as market inventory expands by 1.2 percent. The larger delivery volume could present additional obstacles for the near-term recovery in Houston.

100 BPS
increase in vacancy

VACANCY:

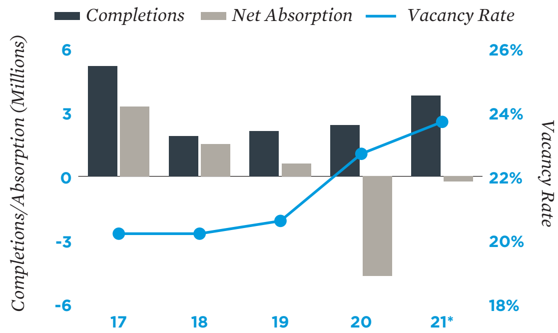
Vacancy rises at a slower pace than the 210-basis-point lift registered in 2020, but the rate is still expected to increase for the eighth time in the past nine years. Available stock will climb by 4 million square feet, pushing vacancy to 23.7 percent by year-end.

0.4% DECREASE
in asking rent

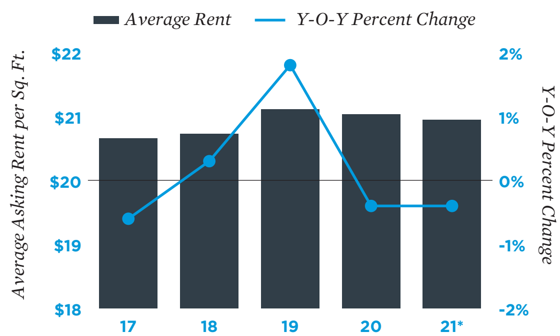
RENT:

On par with the 0.4 percent ease logged last year, the average asking rent will inch down to $20.95 per square foot in 2021. Marketed Class A space likely falls by the steepest margin as operators compete for tenants amid high vacancy.

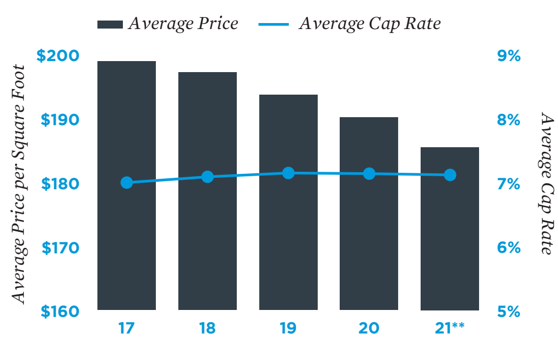
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

2Q21 — 12-Month Period

CONSTRUCTION

2,023,000 sq. ft. completed

- Deliveries over the past 12 months were dispersed, with eight different submarkets adding at least 100,000 square feet but none exceeding 400,000 square feet. Metrowide, inventory grew by less than 1 percent.
- As of July, roughly 5.5 million square feet of office space was under construction. More than half of that has already secured a tenant.

VACANCY

230 basis point increase in vacancy Y-O-Y

- Largely influenced by the 330-basis-point Class A vacancy hike, overall metro availability climbed to 23.4 percent in the second quarter. The Class B/C rate rose by a more modest 120 basis points.
- Vacancy jumped by at least 160 basis points in 10 of the 11 metro submarkets with inventories larger than 10 million square feet.

RENT

1.2% decrease in the average asking rent Y-O-Y

- The average asking rent in Houston has been on a steady downward trajectory, dropping in each of the past three quarters. In June, the average marketed rate in Houston was $20.92 per square foot.
- Rates have been more stable in the suburbs, falling 1.0 percent annually compared with a 2.1 percent retreat in the central business district.

Investment Highlights

- Houston recorded a 25 percent annual decline in transaction velocity during the 12-month period ended in June, as vacancy concerns and leasing uncertainty kept some investors on the sidelines. Institutions have been especially cautious in the market, shown by the drastic reduction in Class A assets priced above $20 million changing hands. As lower-tier properties comprised a larger share of deals, the average sale price fell 3 percent to $185 per square foot.
- The Katy Freeway and Gulf Freeway-Pasadena submarkets noted the steepest declines in trading, but buyer interest should strengthen in the coming quarters. Katy Freeway led the metro in net absorption from April through June, while the Gulf Freeway-Pasadena submarket maintains a vacancy rate that halves the market average.
- Medical office deal flow increased by about 20 percent on an annual basis during the four-quarter period ended in June. Assets with sale prices in the $1 million to $10 million range comprised the bulk of trades. Buyers accepted minimum first-year returns in the 5 percent area for medical offices with strong tenant rosters.

IPA Office

Alan L. Pontius

Senior Vice President, National Director

Tel: (415) 963-3000 | apontius@ipausa.com

For information on national office trends, contact:

John Chang

Senior Vice President, National Director | Research Services

Tel: (602) 707-9700 | jchang@ipausa.com