INVESTMENT FORECAST

Office

Houston

IPA | INSTITUTIONAL PROPERTY ADVISORS

2022

High Vacancy Does Not Dissuade Investors Seeking Office Properties with Elevated Risk-Adjusted Returns

Houston office market grapples with supply overhang. Entering the year, the metro had the highest office vacancy in the nation due to the impacts of the pandemic, development and challenges to the energy sector during the global economic shutdown. Although availability is elevated, the market's equilibrium level is generally higher than the national average due to less-expensive holding costs. This year will mark a turning point in the office market. Development slows significantly from last year's pace, and less than 500,000 square feet of speculative space will come online. The largest project slated for completion is Hewitt Packard's 440,000-square-foot headquarters in The Woodlands. On the energy sector front, a decline in production is limiting demand for Houston office space. In late 2021, the number of rotating rigs was still more than 25 percent below the pre-health crisis level, though it was trending higher. Demand is rising worldwide for fuel, but the current regulatory environment discourages major investments in new projects.

Value-add office investors are optimistic. The disconnect between economic and demographic tailwinds amid an elevated vacancy rate has buyers moving back into the Houston market seeking properties with operational-improvement potential. Office-using jobs should surpass the pre-recession level by the end of this year, while vacancy remains 240 basis points above the rate in the first quarter of 2020. Additionally, new household formation will trail only Dallas-Fort Worth this year, encouraging space demand in population-serving office buildings. This will keep investors active in suburban office areas, where vacancy is approximately 250 basis points below the CBD. Entering 2022, the average cap rate in the low-7 percent area was slightly above the national rate. Medical office properties, meanwhile, attract plenty of investor attention when listed, particularly near the Texas Medical Center. However, the pace of deal flow is dictated by the number of listings. Regardless of operating conditions, out-of-state capital will target medical office assets.

2022 Market Forecast

Employment up 3.1% — Following the addition of 154,700 positions last year, employers expand payrolls by 95,500 jobs in 2022.

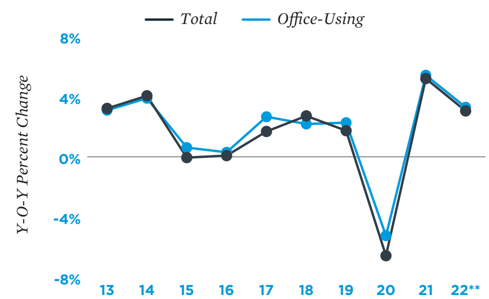
Construction 1,200,000 sq. ft. — Development decreases significantly this year as supply expands by less than 0.4 percent. In 2021, stock increased by 1.4 percent when 4.4 million square feet came online.

Vacancy down 50 bps — Vacancy will turn the corner in 2022 as the rate tightens to 23.1 percent. Between the beginning of the health crisis and the end of 2021, availability climbed 290 basis points.

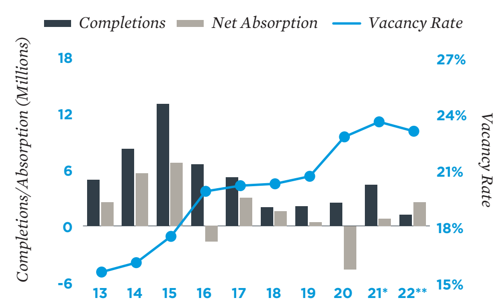
Rent down 2.2% — As operators compete for tenants looking for new space, asking rent will slip to $20.25 per square foot. Last year, the average marketed rate dipped 1.8 percent.

Investment — Both the size of the office market and the mix of available properties are keeping investors from all regions of the country interested in available assets in the business-friendly metro.

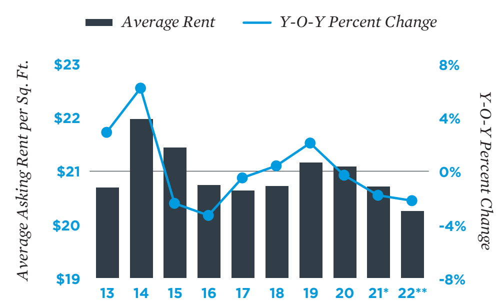
Employment Trends



Supply and Demand



Rent Trends



* Estimate; ** Forecast
Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

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