MARKET REPORT

Office

Houston Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

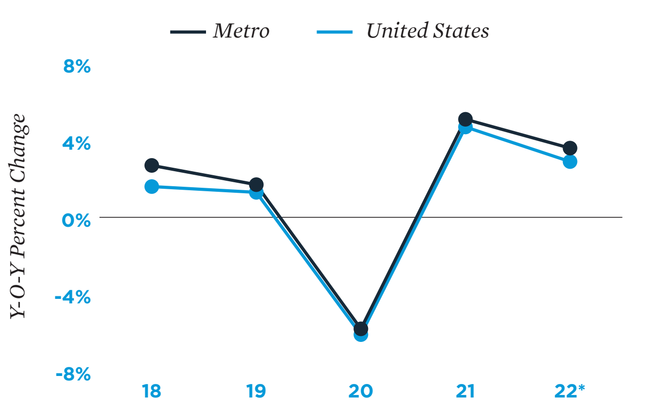
2Q/22

Global Energy Market Shake-Up Cues Leasing, Serving as Needed Demand Boost

U.S. and allies look to Texas and the Gulf for oil production. The Russian invasion of Ukraine and corresponding sanctions on oil imports enacted by nations across the world had an abrupt impact on global energy trade and prices. Russian oil production fell by about 1 million barrels per day in April, shooting the average price above $100 per barrel. By mid-May, the U.S. Strategic Petroleum Reserve reached the lowest point since 1987, contributing to the Texas rig count climbing from 277 entering this year to 357 during that month. Foreign allies are eager to secure a reliable supply of oil and gas as well, verified by recent statements from Schlumberger, the world's largest oil-field service company stationed in Houston. Major firms are ramping up production and labor counts as these trends play out. BP is expecting to double crude output at the Thunder Horse project, and open Argos, its fifth platform in the Gulf.

Energy Corridor in a better near-term position. Houston's Katy Freeway area, the primary hot bed for energy corporation offices and the second-largest submarket by inventory, stands to benefit from current industry trends. In the months of March and April, Enbridge Inc., CTCI Americas and Rystad Energy each signed on for at least 20,000 square feet here. In the case of Enbridge Inc., it took up almost 300,000 square feet of sublet space, a welcomed sign after the volume of available sublease space soared during the pandemic. Meanwhile, the CTCI Americas move-in exemplifies downstream ripples, as the firm is in a joint Gulf Coast venture with ExxonMobil.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

112,000 JOBS
will be created

EMPLOYMENT:

The traditional office-using personnel tally eclipsed the pre-pandemic peak in February, and the segment is expected to grow 2.0 percent annually in 2022. The overall job count will climb by 3.6 percent, as warehousing and service-industry jobs are added.

2,500,000 SQ. FT.
will be completed

CONSTRUCTION:

Annual delivery volume falls below 3 million square feet for the fourth time in five years, with 2022 completions equating to 0.8 percent of existing inventory. As of May, approximately 70 percent of scheduled additions had secured a tenant commitment.

10 BASIS POINT
increase in vacancy

VACANCY:

Solid pre-leasing and demand tailwinds in the energy sector help the market find steadier ground. The vacancy lift in 2022 extends a streak of annual rises dating back to 2013, but pales in comparison to the 260-basis-point hike from 2020 through 2021.

0.3% DECREASE
in asking rent

RENT:

Vacant stock has grown 10 million square feet since the start of 2020, reaching a new record high in March. This sizable block of available space places downward pressure on rates, tapering the average asking rent to $20.85 per square foot in 2022.

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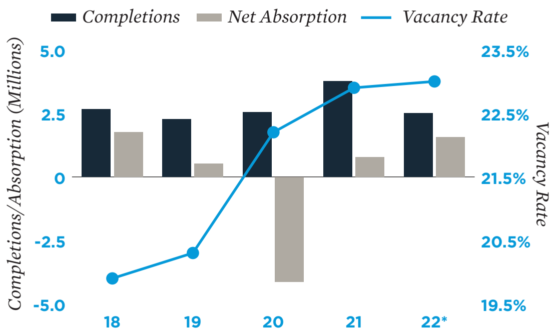
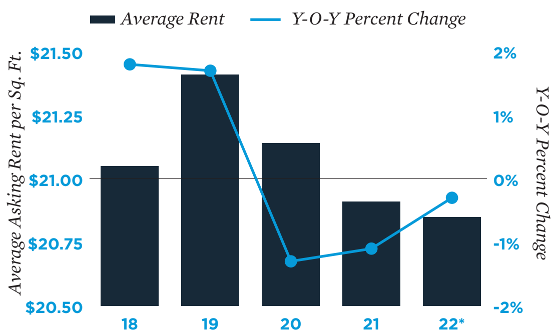
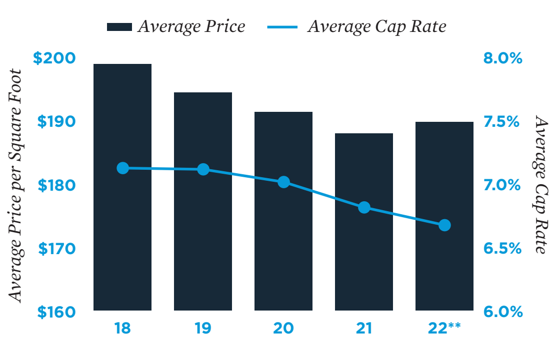
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: $250

1Q 2022 - 12-Month Period

CONSTRUCTION
4,045,000 **sq. ft. completed**

- Houston's largest submarket by inventory got even bigger over the past year as stock Downtown grew by 2.9 percent. Here, roughly 1.7 million square feet finalized and a net of 1.1 million square feet was absorbed.
- About 1.2 million square feet of medical office space will finalize in the final nine months of 2022, the largest share of which is near the Medical Center.

VACANCY
30 **basis point increase in vacancy Y-O-Y**

- Among the 11 submarkets with local inventories larger than 10 million square feet, vacancy declined in three of those areas. Availability fell the fastest in the FM 1960 and Southwest Houston locales.
- South Main-Medical Center, a hub for medical office users, maintained sub-10 percent vacancy, as demand held steady through the pandemic.

RENT
1.0% **decrease in the average asking rent Y-O-Y**

- After being largely unscathed during the first year of the pandemic, head-winds in the Class A segment trickled through during the past four quarters. The segment's asking rate fell 2.4 percent to $23.42 per square foot.
- The average Class B/C asking rent inched up, piloted by 5-plus percent annual gains in South Main-Medical Center and Southwest Houston.

Investment Highlights

- Boosted by a very active trading period during the fourth quarter of 2021, traditional office transaction velocity over the yearlong interval ended in March eclipsed the previous 12-month span by about 10 percent. The average sale price, however, fell marginally to $190 per square foot as the mean cap rate slid down to 6.7 percent. Relative to the other three major Texas markets, the average price figure is the lowest by more than 20 percent.
- Class B traditional offices transacted more than twice as often during the four-quarter period ended in March as they did in the prior 12-month frame. Buyers seeking mid-tier offices honed in on the Katy Freeway and Northwest Houston submarkets. Local investors were particularly active in these areas, acquiring properties on an individual and portfolio basis, with average first-year returns in the mid-5 to mid-6 percent band.
- During the 12-month stretch ended in the first quarter, more medical offices changed hands than in either 2019 or 2020. Robust population growth and the segment's comparative resilience during the pandemic punctuated medical offices as an investor favorite in Space City. The NASA-Clear Lake and FM 1960 submarkets recorded the most trades of these assets in recent quarters, with an average entry cost near $300 per square foot.