

MARKET REPORT

Office
Houston Metro Area

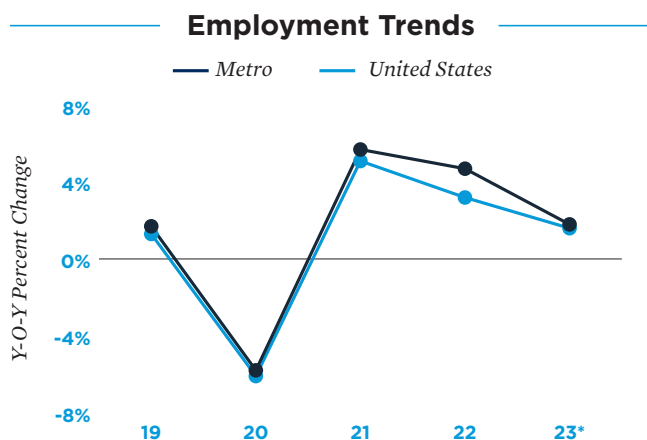
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4Q/23

Several of Houston's Historically Strong Office Hubs Bounce Back, Helping Stabilize Metro Vacancy

Three major submarkets are outperforming. Houston's positive net absorption streak extended to three quarters through June 2023, with total occupied stock growing by 2.7 million square feet across those nine months. Roughly two-thirds of that net absorption took place in just a trio of Houston's 37 submarkets — Katy Freeway, West Loop and the Woodlands. Each of these three areas registered annual vacancy declines of at least 60 basis points in June 2023 as a result, with Katy Freeway's 270-basis-point reduction leading the charge, and the Woodlands' 16.1 percent rate ranking as the lowest of that bunch. Strength in these areas is particularly important for metro fundamentals, as they are all among the top four largest by inventory. Nonetheless, the one location absent from this trend is Houston's urban core, which holds the most supply in the market and continues to face distinct headwinds.

Downtown Houston is still facing friction. Urban core offices have been among the most challenged real estate segments nationally since the onset of the pandemic, and that dynamic holds true in Houston. Vacancy downtown crossed the 26 percent mark in June 2023, the highest measure on record and more than 800 basis points above the area's long-term average. At the same time, subsiding development may provide some stability. Local inventory grew just 0.1 percent over the past 12 months, and the only major project in the active pipeline secured a multi-floor commitment from a law firm.



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2023 Outlook



**58,000
JOBS**

will be created

EMPLOYMENT:

Wholesale and retail trade, and the health care and social assistance sectors, contributed more than half of all jobs added through August. Traditional office-using fields also help drive an overall 1.8 percent lift this year.



**4,350,000
SQ. FT.**

will be completed

CONSTRUCTION:

The 2023 supply addition will be Houston's largest in six years and more than double 2022's volume. South Main-Medical Center and NASA-Clear Lake combine for about 1.8 million square feet of new stock.



**30
BASIS POINT**

increase in vacancy

VACANCY:

While vacancy is set to rise for a fifth straight year in 2023, the pace of increase will be the slowest it has been since 2019. Still, a projected year-end rate of 23.3 percent is the second highest among major U.S. markets.



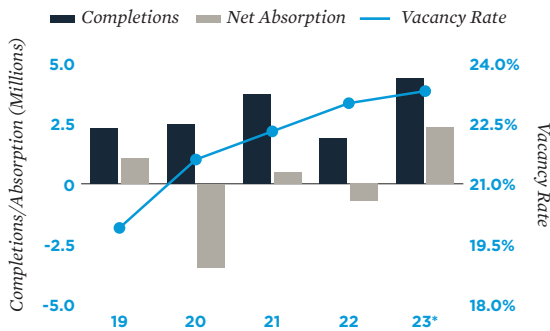
**0.7%
INCREASE**

in asking rent

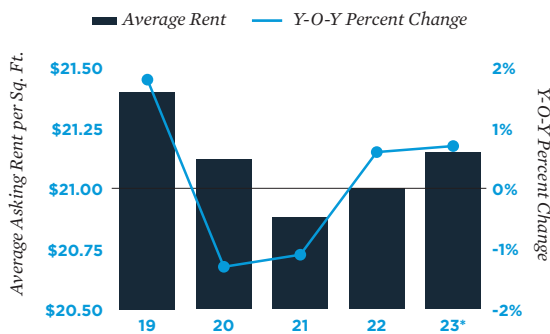
RENT:

Rent increases will be moderate in Houston, but its pace of growth will rank second to only Dallas-Fort Worth among the major Texas markets in 2023. The figure is expected to close out this year at \$21.15 per square foot.

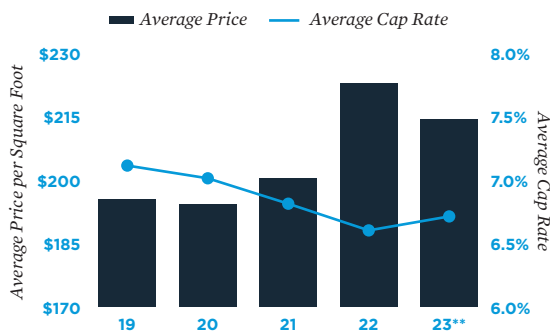
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 2Q

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: \$250

2Q 2023 - 12-Month Period

CONSTRUCTION

1,801,000 sq. ft. completed

- Only 394,000 square feet finalized in the second half of last year, compared to 1.4 million square feet in the opening six months of 2023. The next two quarters' projected 2.9 million square feet will exceed that combined total.
- During the past year, local inventory grew the fastest in Outlying Montgomery County, while NASA-Clear Lake added the most square feet.

VACANCY

0 basis point change in vacancy Y-O-Y

- Metro vacancy remained unchanged from one year ago at 22.6 percent in the second quarter of 2023. Including Houston, only 10 major markets in the country noted a decline or held a flat rate during that span.
- Among Houston's 11 submarkets with at least 10 million square feet of local supply, only Downtown, FM 1960 and Westchase recorded vacancy hikes.

RENT

0.3% increase in the average asking rent Y-O-Y

- The average asking rent ticked up to \$21.10 per square foot in June 2023. Houston's mean marketed rate has not deviated outside of the \$20.50 to \$21.50 per square foot range in any quarter going back to 2016.
- South Main-Medical Center – the highest cost area in the market for office space – registered a 9 percent annual drop to \$2745 per square foot.

Investment Highlights

- Conservative underwriting amid higher interest rates has compounded headwinds presented by post-pandemic shifts in office needs, placing a weight on deal flow. Trading in Houston held up relatively well during the first quarter of 2023, but dropped sharply in the subsequent three months. As a result, first half transaction velocity was down about 60 percent from the same stretch of 2022. Preliminary July and August data indicates that the broad-based deceleration persisted, although more 100,000-square-foot-plus assets changed hands than in the prior two months.
- Houston's average sale price for office transactions completed during the yearlong period ending in June 2023 measured at \$214 per square foot, maintaining the lowest entry cost among the four major Texas markets. An average cap rate of 6.7 percent also ranks as the highest in the state, offering greater yield potential for risk-tolerant investors.
- Katy Freeway, North Belt, FM 1960 and the Woodlands remain the focal points for office investors in Houston. Buyers seeking higher-end properties look to Katy Freeway and the Woodlands, while mid-tier trades are common in the North Belt. Medical offices in FM 1960 are popular as well.

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Metro-level employment growth is calculated based on the last month of the quarter/year. Sales data includes transactions sold for \$1 million or greater unless otherwise noted. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice. Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics

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