INVESTMENT FORECAST

OFFICE

Houston Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

2020

Consolidation Among Energy Firms Leaves Large Blocks Of Available Space in Houston's Major Office Districts

Supply overhang resulting in elevated competition for tenants. Houston developers have expanded office stock by 9 percent over the past five years, significantly outpacing the 3 percent demand growth recorded over the same period. That trend will persist into this year, keeping vacancy above the 20 percent threshold. As a result, rent growth will remain relatively muted as operators leverage significant concessions to attract firms seeking space in the market. Although elevated vacancy persists, most of the dark space is located in major office districts that could turn around in short order if accelerated hiring encourages more leasing activity, particularly in the energy sector. Among the seven largest submarkets, six have vacancy well above 20 percent entering the year. Global tensions in oil-producing regions could buoy energy prices in 2020, though the long-term outlook remains steady. Medical office, on the other hand, continues to shine in the metro, supported by demand around the Texas Medical Center, northern suburbs and west Houston.

Investors undaunted by short-term weakness in office fundamentals. Deal flow should stay brisk across the metro, particularly for Class B offerings. Buyers are scouring the market for mid-tier properties that are roughly 50 percent vacant. In fact, the average vacancy for these deals has climbed for each of the past three years, while Class A and Class C averages have held relatively steady. Investors' willingness to acquire value-add properties highlights their confidence in the long-term outlook in the local office market. Listings in The Woodlands and Energy Corridor attract the greatest interest among mid-tier buyers with an average cap rate in the low-7 percent range entering the year. These two regions also account for approximately 40 percent of Class A deals. In the Class C sector repositioning plays move to the center stage this year. Attractively priced properties near downtown are primed for investors willing to make capital improvements.

2020 Market Forecast

Employment up 2.0% — Employers will add 63,200 jobs in 2020, less than the 90,000 posted in 2019. Office-using payrolls expand 2.7 percent as 19,500 spots are created.

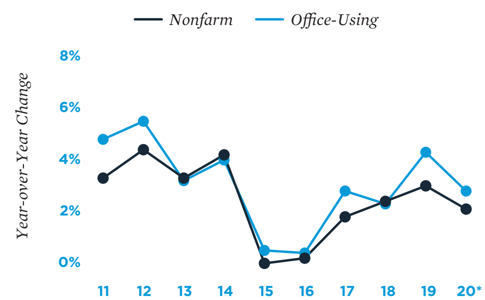
Construction 2.6 million sq. ft. — The metro will see 2.6 million square feet delivered in 2020, approximately 500,000 more feet than was completed in 2019.

Vacancy up 20 bps — Vacancy will build off the 70-basis-point increase in 2019, rising to 21.1 percent in 2020.

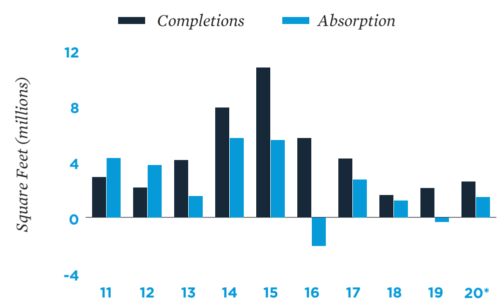
Rent up 0.8% — Average asking rent in Houston will ascend slightly to $29.54 per square foot in 2020.

Investment — Overall, the average cap rate in Houston finished last year in the low-7 percent range, up modestly from one year earlier. Buyers and sellers will monitor interest rates closely as the cost of capital increasingly becomes a motivator.

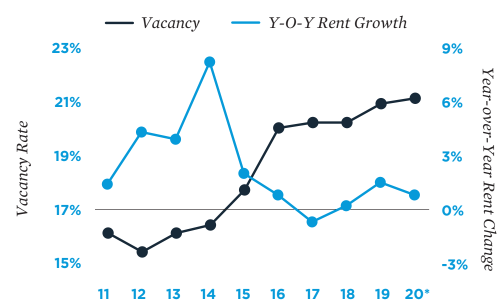
Employment Trends



Office Supply and Demand



Vacancy and Rent Trends



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

Alan Pontius

Senior Vice President | Director
Office and Industrial Properties Division
(415) 963-3000
apontius@ipausa.com

Metro-level employment, vacancy and asking rents are year-end figures and are based on the most up-to-date information available as of December 2020. Asking rent is based on the full-service marketed rental rate. Average prices and cap rates are a function of the age, class and geographic area of the properties trading and therefore may not be representative of the market as a whole. Sales data includes transactions valued at $1,000,000 and greater unless otherwise noted. Forecasts for employment and office data are made during the fourth quarter and represent estimates of future performance. No representation, warranty or guaranty, express or implied may be made as to the accuracy or reliability of the information contained herein. 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.