Houston office market report

Q3 2023

AVISON YOUNG

Houston office market trends

26.4%

Vacancy rate continues climb to highest level on record

Office market fundamentals were showing signs of stabilization with positive absorption recorded during the first half of 2023 but have experienced a setback with 956k sf of negative absorption in Q3 2023. Nearly 79% of the quarterly occupancy losses occurred in class B product driven by occupiers shedding space and, in some cases, upgrading to newer space.

As a result of the significant contraction, vacancy has risen to its highest level on record, reaching 26.4%. Looking ahead, vacancy is expected to subside with the Trophy and class A segments leading in the recovery as leasing activity picks up steam.

83.0%

Trophy and class A product leading in recovery

Flight-to-quality remains a key theme as companies leverage favorable market conditions to upgrade their space design and amenity offerings for their employees. Trophy and class A properties have captured 83% of the leasing activity year-to-date by square footage.

Older vintage assets continue to battle the effects of the flight-to-quality trend and hybrid work model, as vacant space in buildings built prior to 2000 accounts for nearly 80% of all vacancy. As a result, tenants will maintain the upper hand in negotiating lower rents and attractive concessions within these assets.

$972.7M

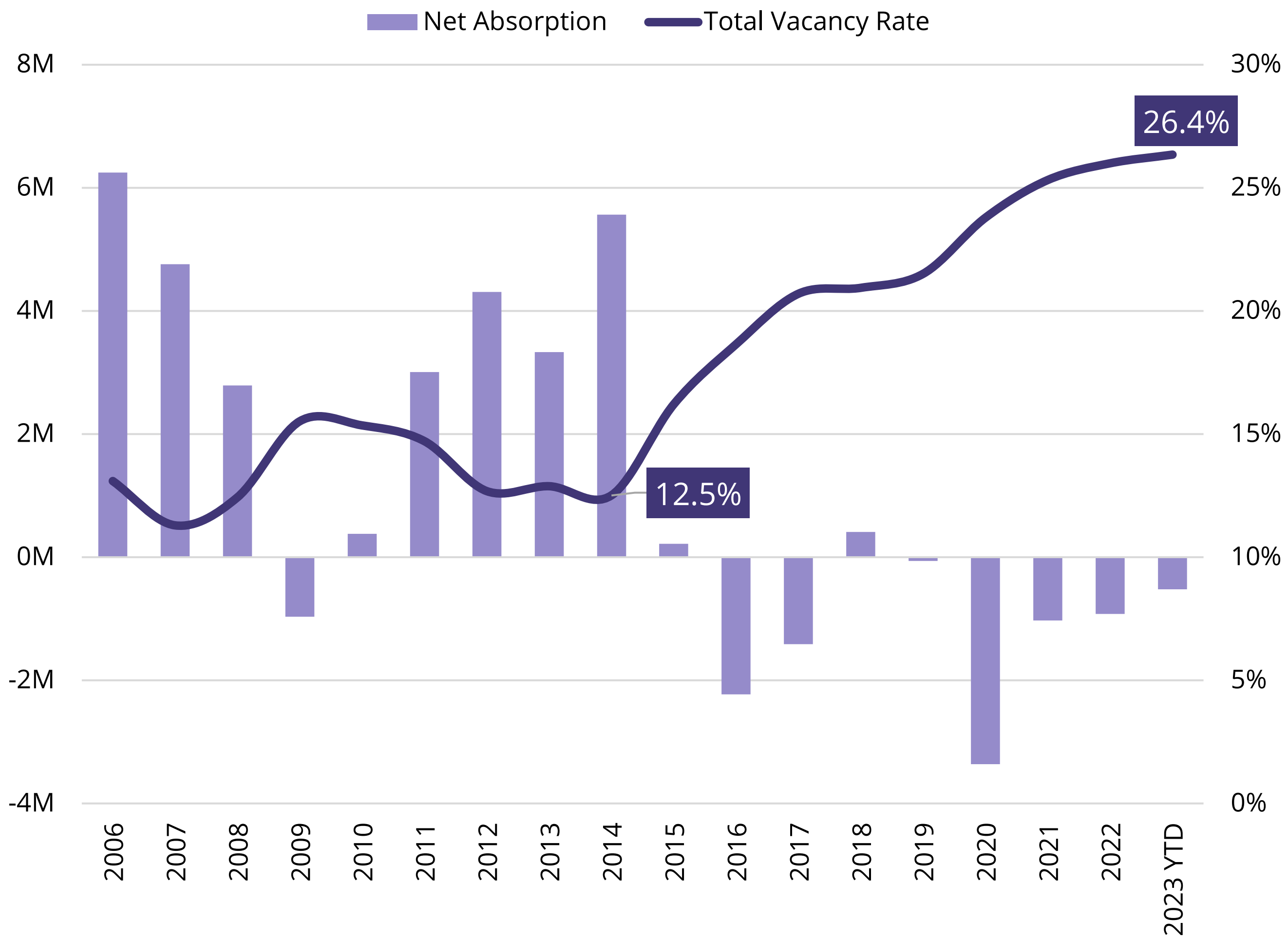
Houston office CMBS loans currently in distress

Houston has a large share of commercial mortgage-backed security (CMBS) loans with landlords facing some financial difficulties. Office CMBS loans currently in distress consist of 26 properties with a collective loan balance of $972.7 million, which accounts for 23% of all office CMBS loans in Houston.

Many of the looming loan maturities could face challenges if owners are unable to refinance or sell their assets in this tough capital markets environment. This has led to tenants becoming more cautious about signing leases and are now asking landlords to provide more financial information and leveraging their position to negotiate better lease terms.

Source: AVANT by Avison Young, Costar

Houston office market performance



Source: AVANT by Avison Young, CoStar

Office vacancy has climbed to record highs, with older vintage assets accounting for the bulk of the vacancy as tenants leave those assets for newer buildings with more amenities.

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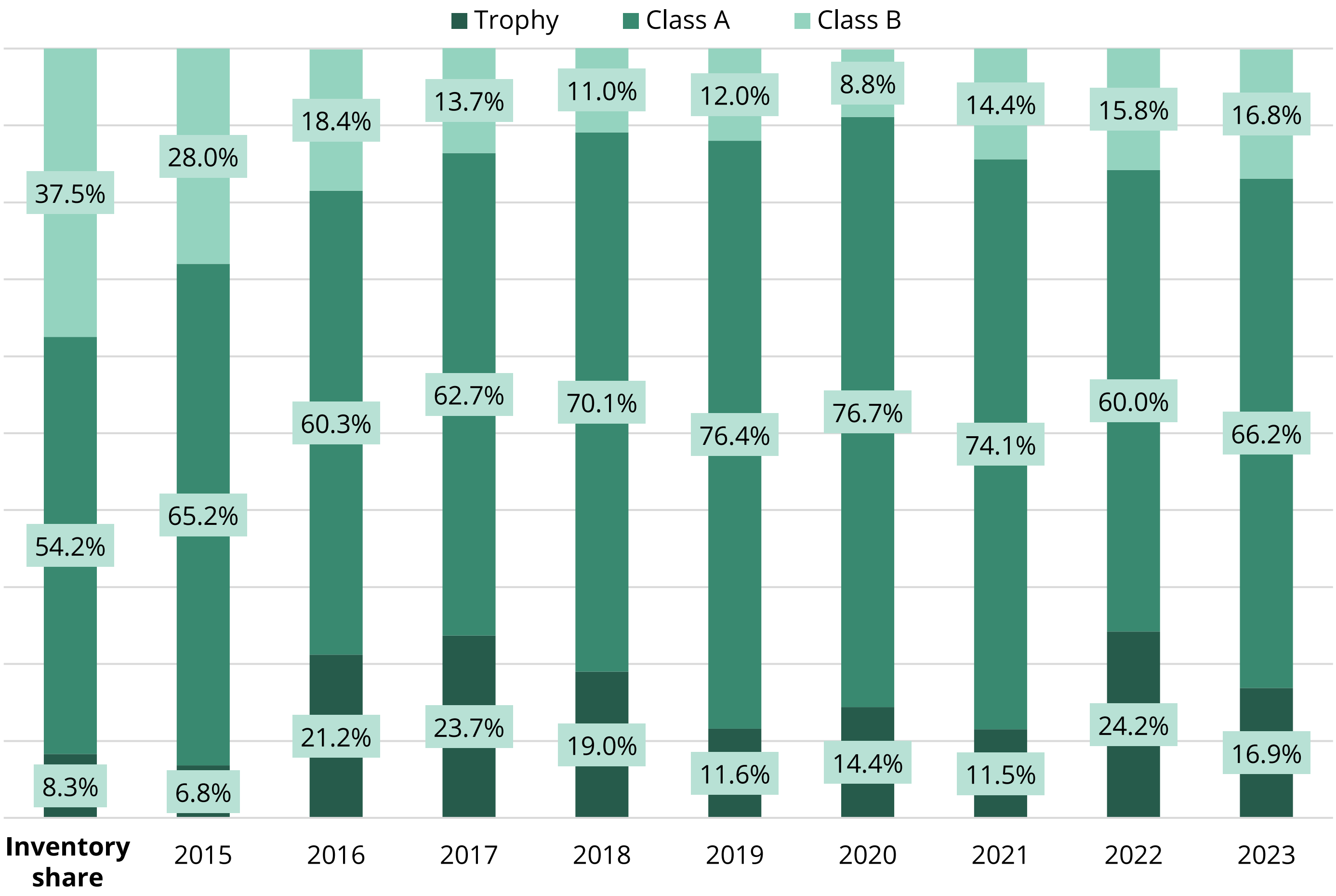
Leasing activity by asset class



Class A and Trophy assets continue to outperform the broader market, accounting for 85% of leasing activity since 2015 while making up 63% of the inventory.

Source: AVANT by Avison Young, CoStar

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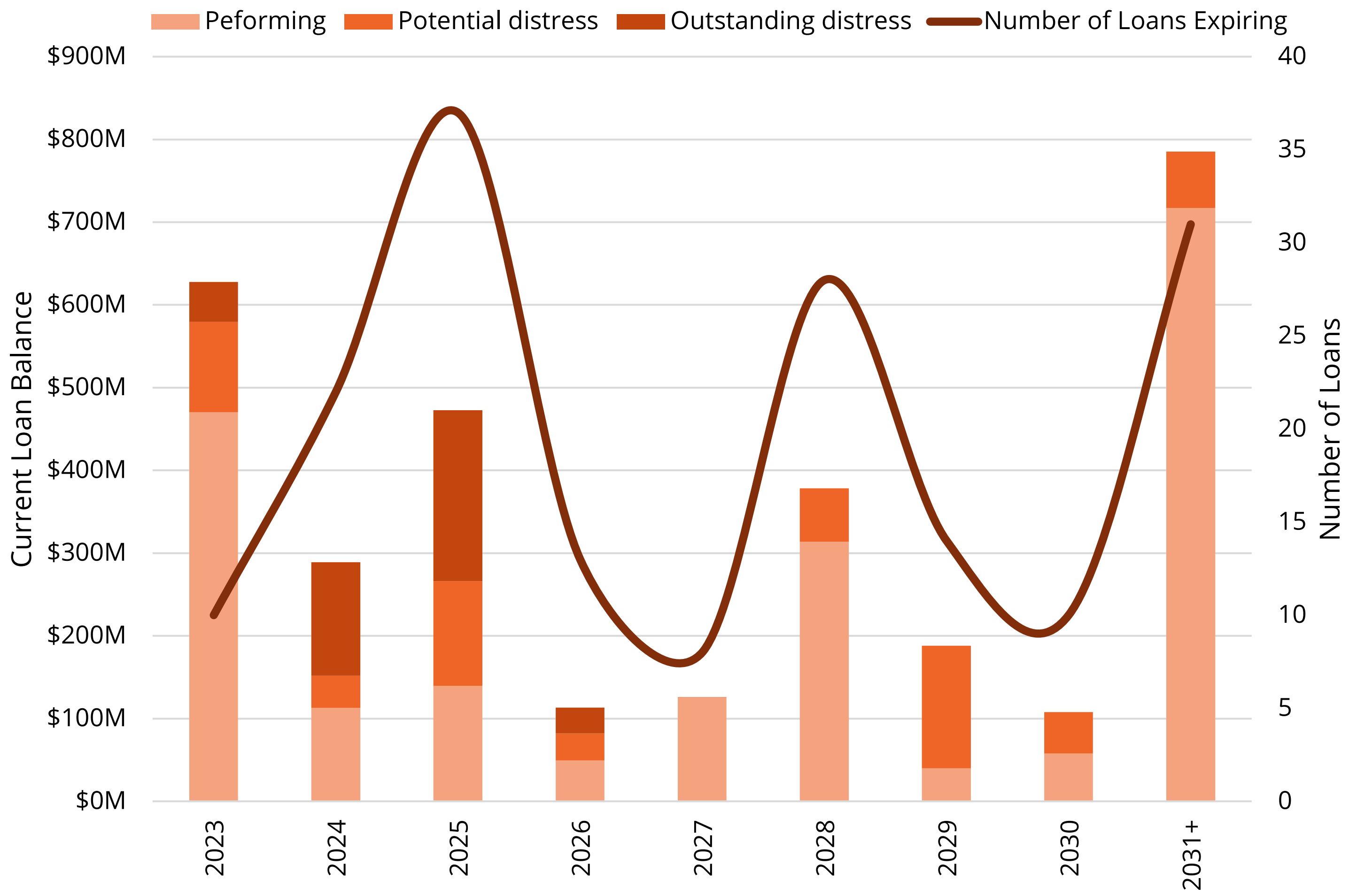
Houston fixed-rate CMBS office loan maturities



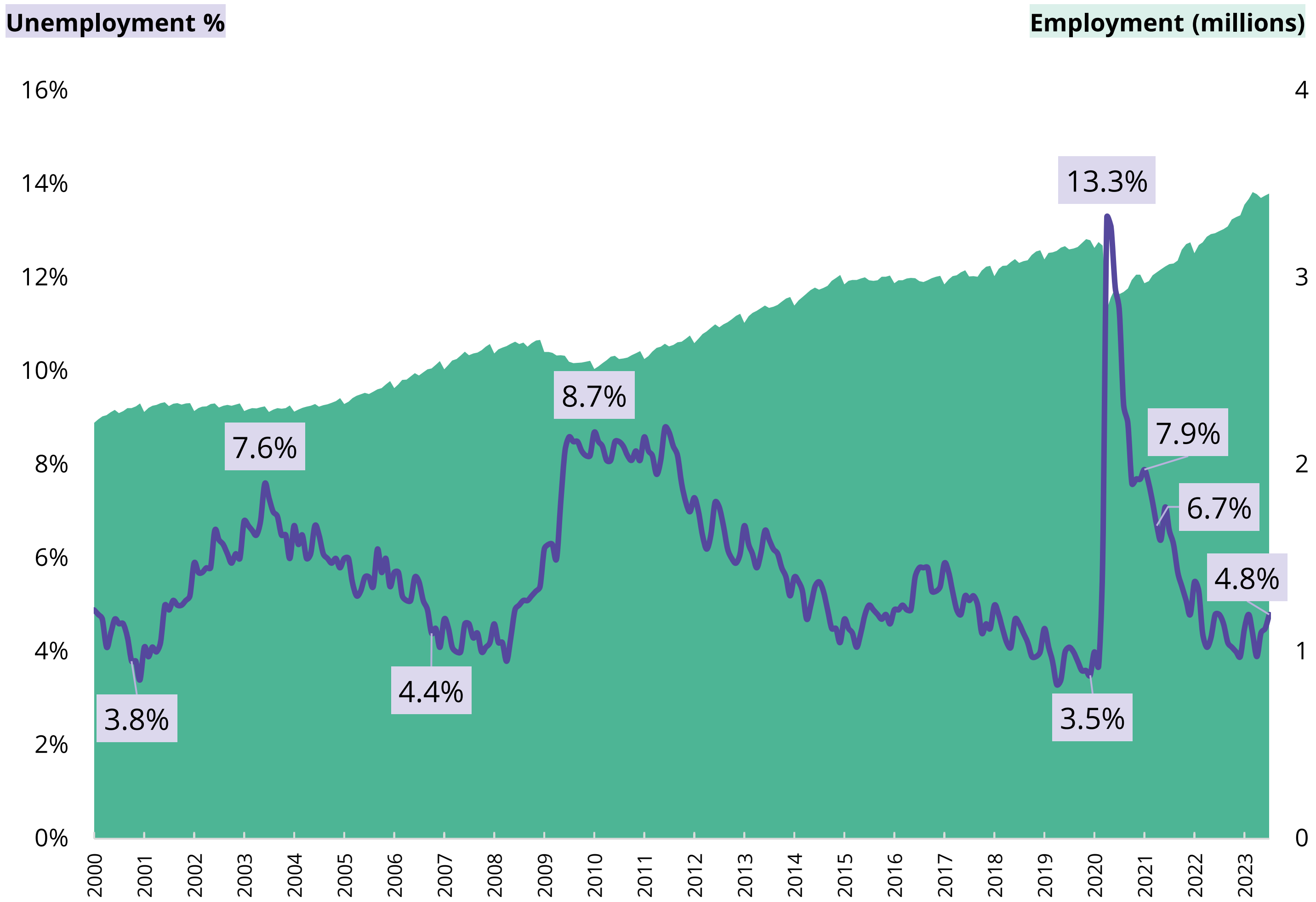
Source: Trepp

Houston's office market may face additional distress as loan maturities approach. Many of the looming maturities in distress will face some challenges in refinancing.

Houston employment trends

Let's examine the economic trends impacting the office sector

Employment and unemployment rate



Source: Bureau of Labor Statistics

Houston's employment base has expanded by nearly 88k jobs in the past 12 months, while unemployment remains relatively low at 4.8%.

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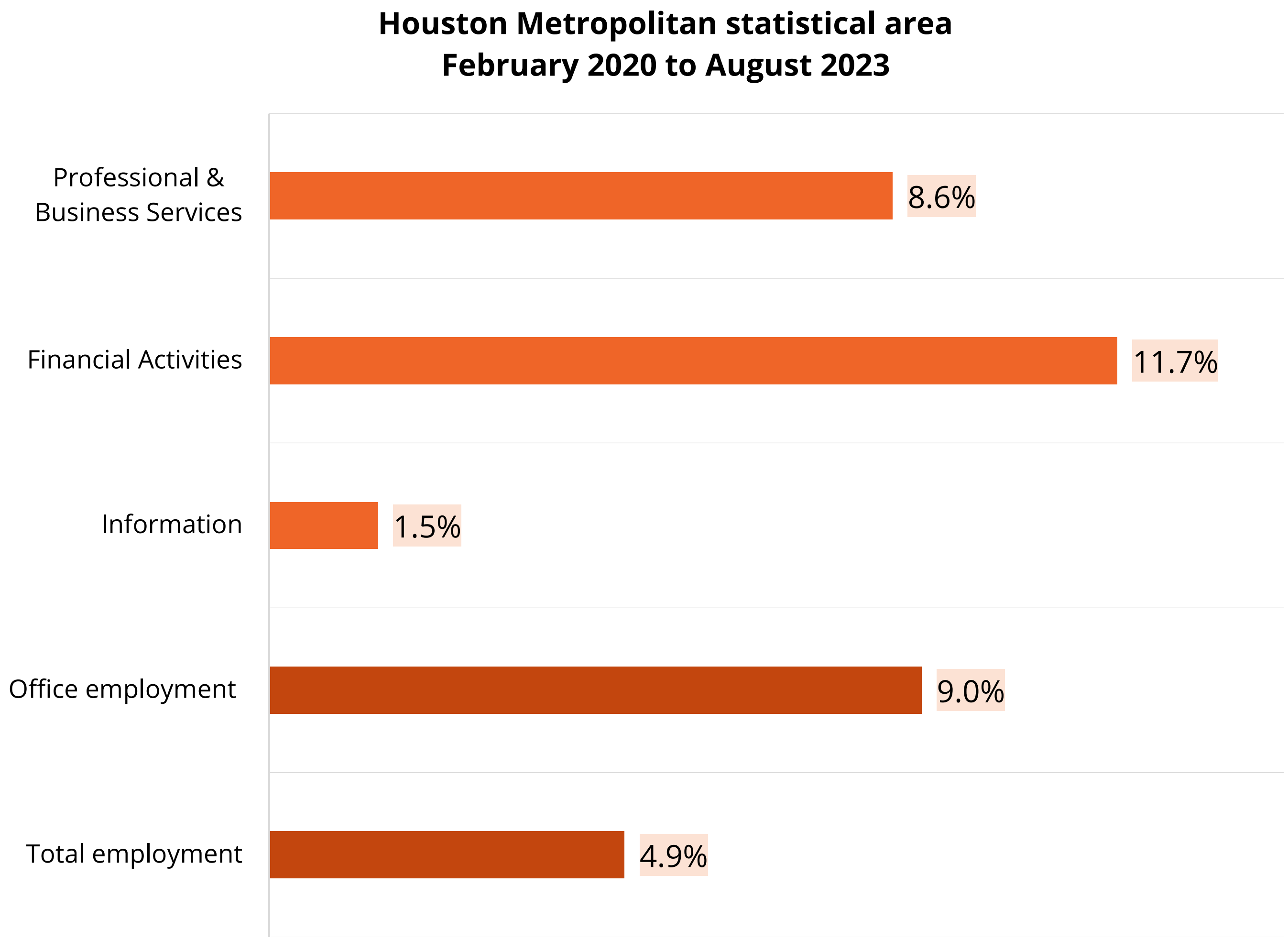
Houston office-using job gains



Source: Bureau of Labor Statistics

Strong office job growth has helped buoy the market, with 64k jobs gained since its pre-pandemic peak, but a disconnect has emerged between office job growth and office demand.

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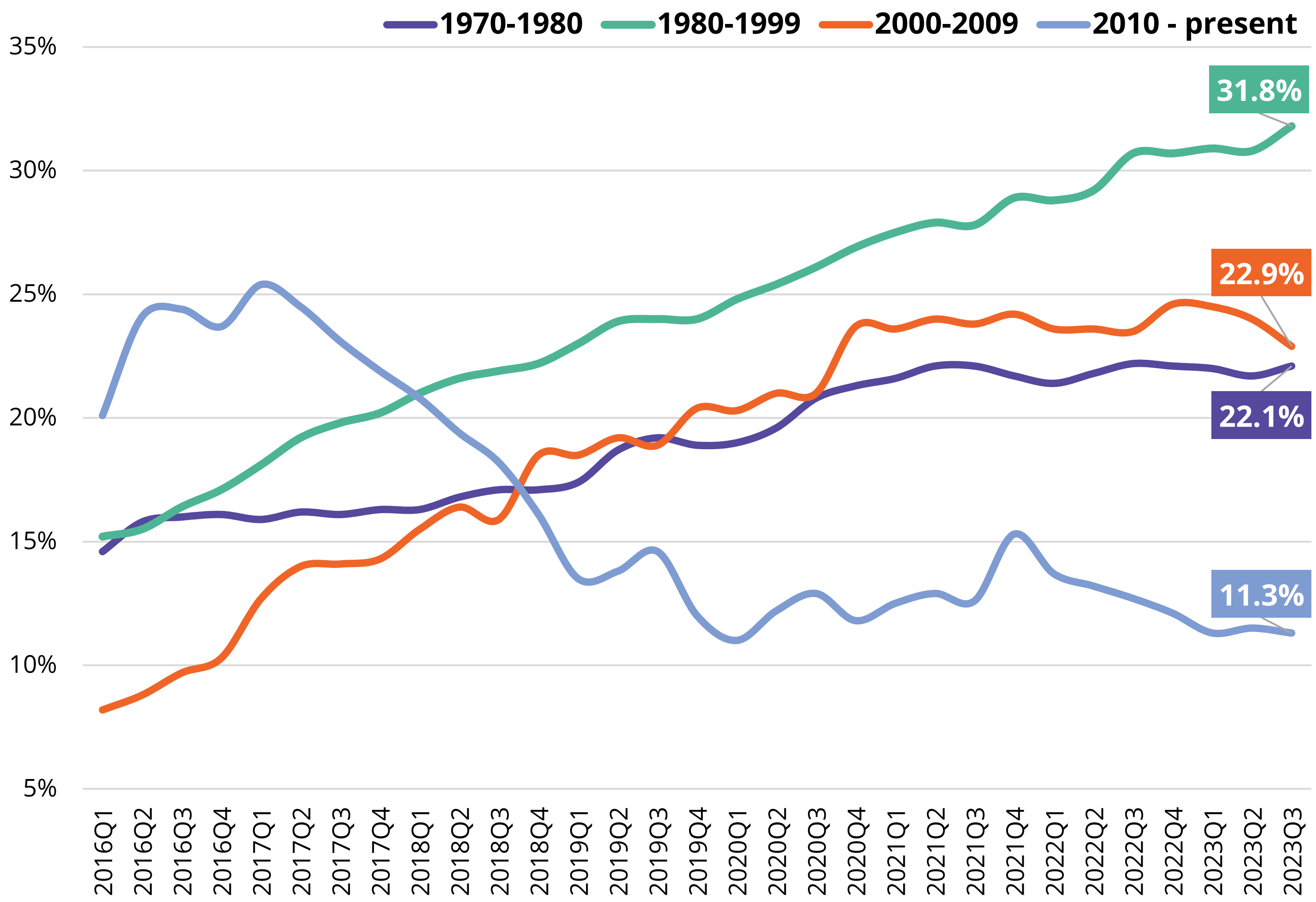
Occupier market conditions

Let’s examine more prevailing office trends

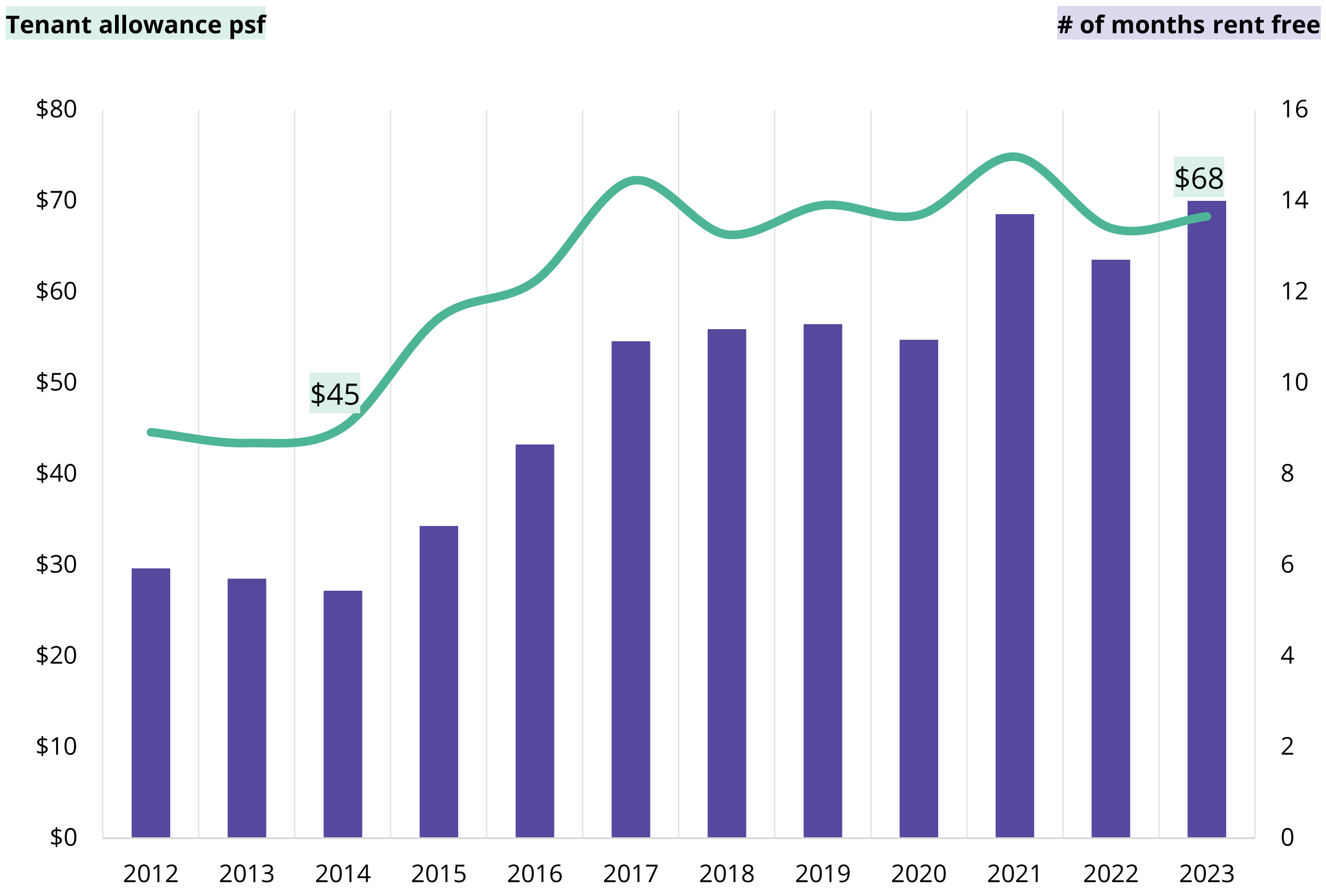
Total vacancy by vintage year



Source: AVANT by Avison Young

A persistent flight-to-quality trend is driving a significant disparity in vacancy rates with trophy and new product built since 2010 outperforming older vintage assets.

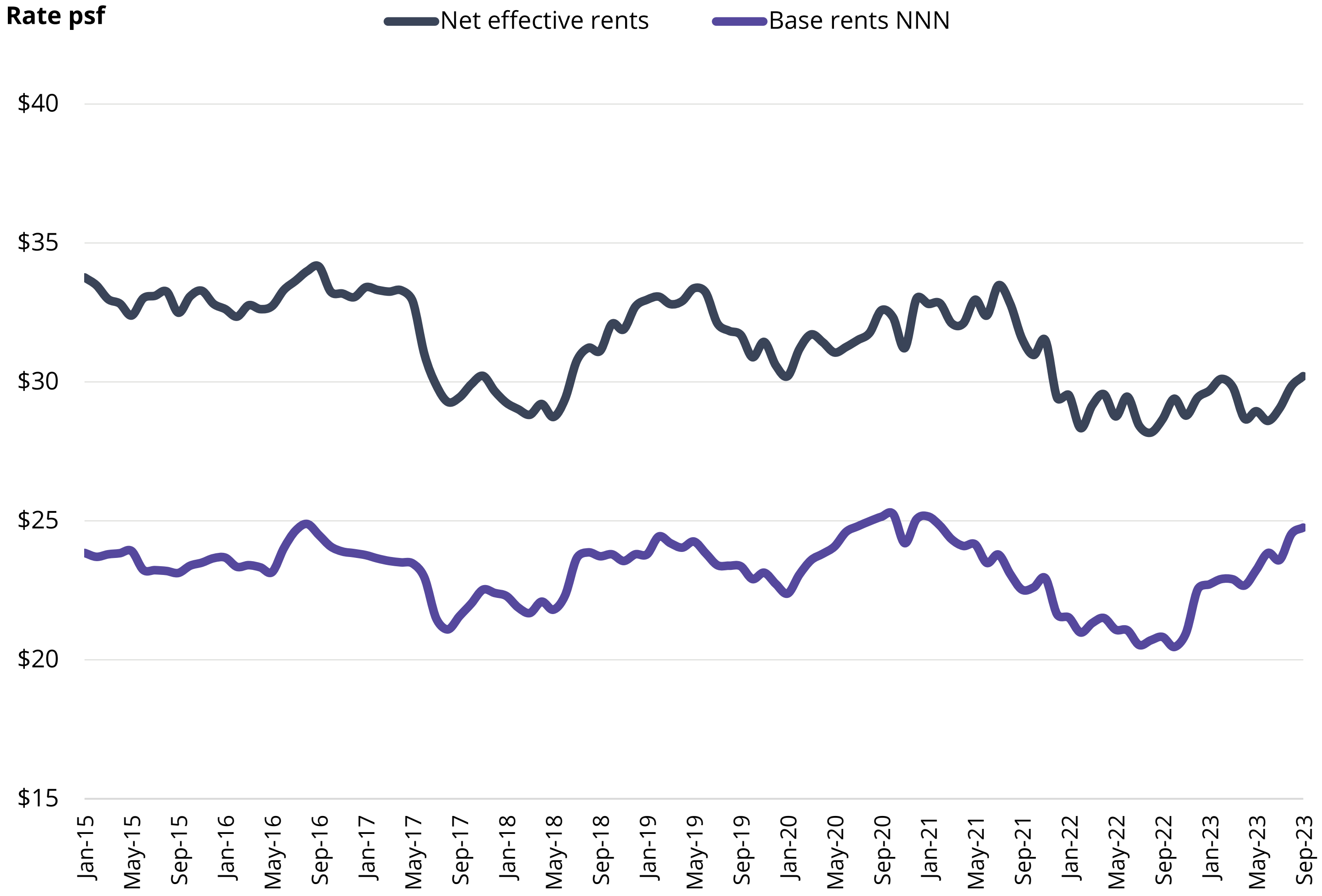
Class A office concessionary trends



Class A tenant improvement allowances and average free rent reached record highs following the 2015-16 oil bust and COVID pandemic and remain elevated to entice tenants.

Source: AVANT by Avison Young
Note: Concessions inclusive of only new direct leases & expansions greater than 10k sf, concessions normalized for a 10-year term

Trophy & Class A net effective vs. base rents



Source: AVANT by Avison Young
Note: Concessions inclusive of only new direct leases & expansions greater than 10k sf, concessions normalized for a 10-year term

Highly competitive concession packages with generous rental abatement and TI allowances have resulted in lower net effective rents.

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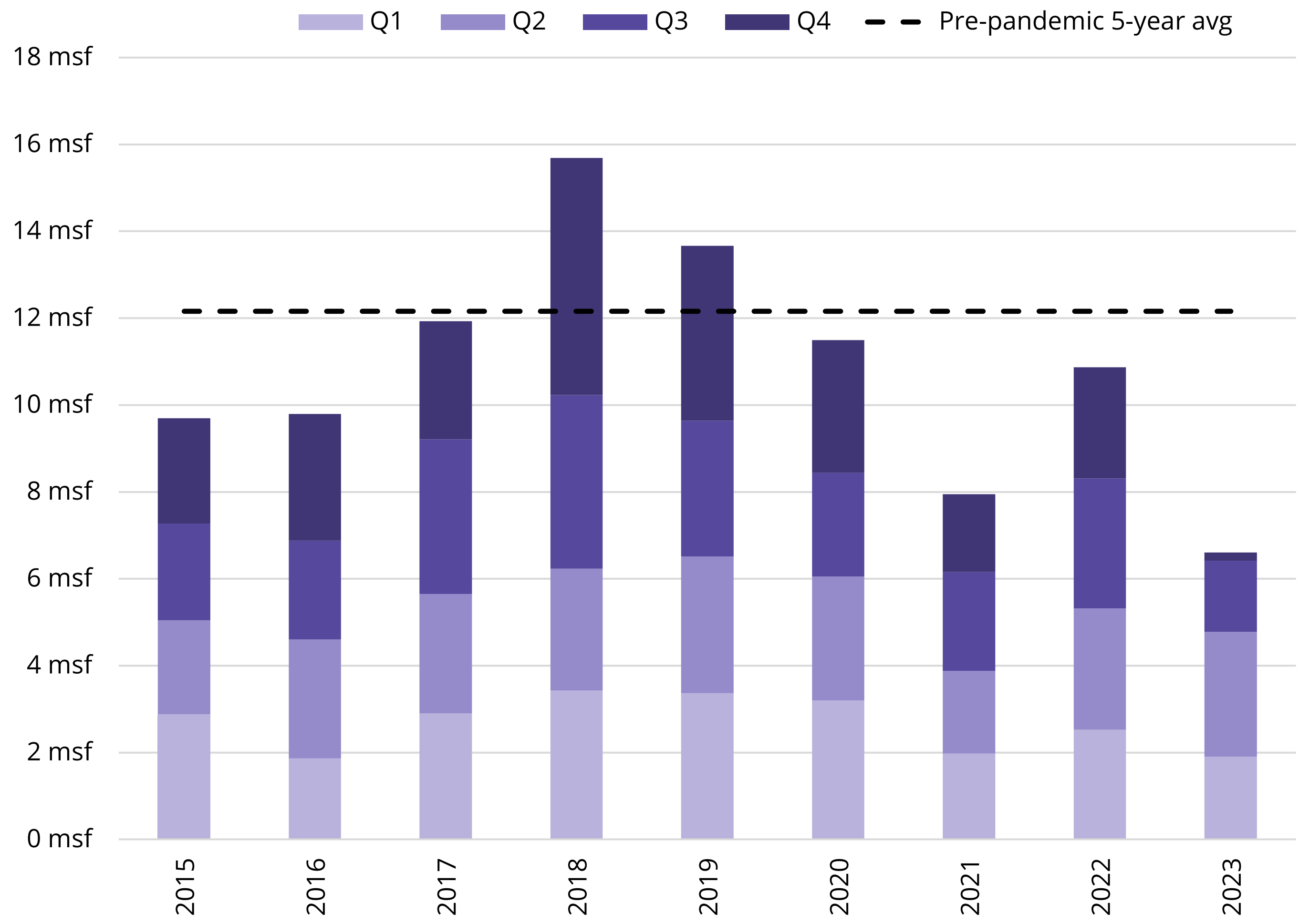
Historical office leasing activity



Source: AVANT by Avison Young, CoStar
Note: Includes relocation, renewals, expansions and subleases

Leasing activity fell by 43% from the prior quarter and year-to-date deal flow is 23% below this time last year, reflecting the broader slowdown in economic growth.

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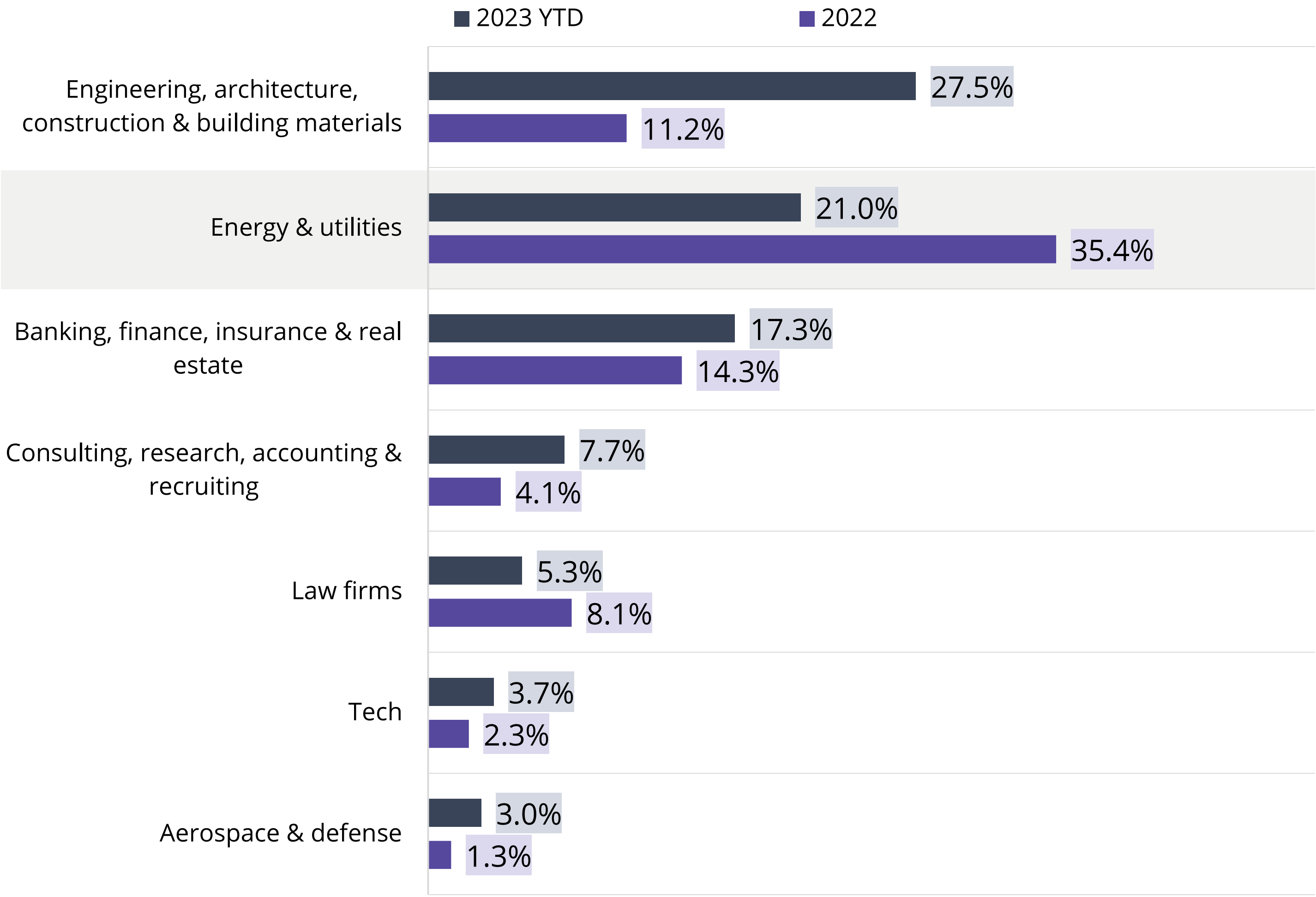
Leasing activity by industry sector



Source: AVANT by Avison Young
Note; Includes relocations, renewals, expansions and subleases above 10k sf

Engineering and energy-related firms have become increasingly active primarily in West Houston with numerous large leases signed over the past 18 months.

Transaction activity by lease type

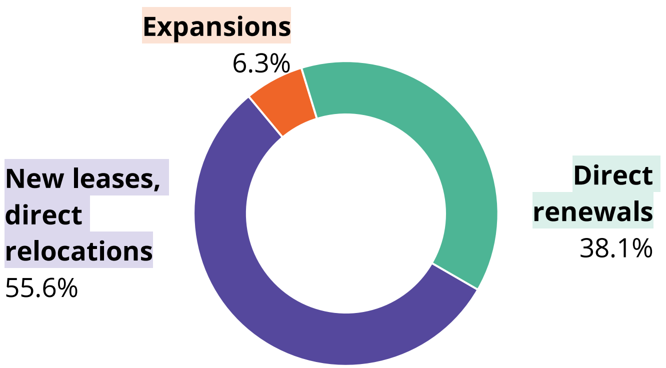
39.6%

Percent increase in new deals as a share of total leasing activity, YTD 2023 vs. pre-COVID

The distribution of transaction activity has shifted, with new deals and direct relocations accounting for 77.6% of the year-to-date transactions above 10,000 sf compared to 55.6% from 2018 to March 2020.

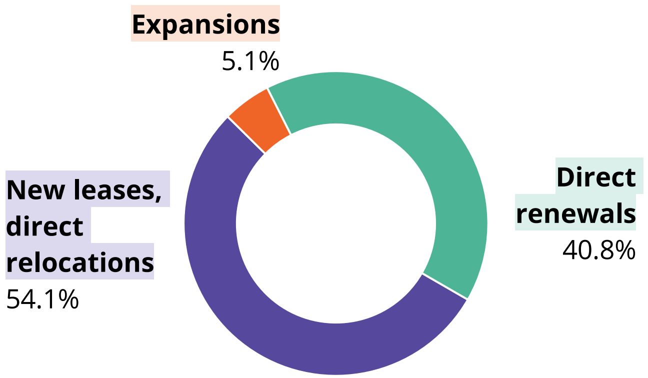
Pre-COVID

From 2018 to March 2020

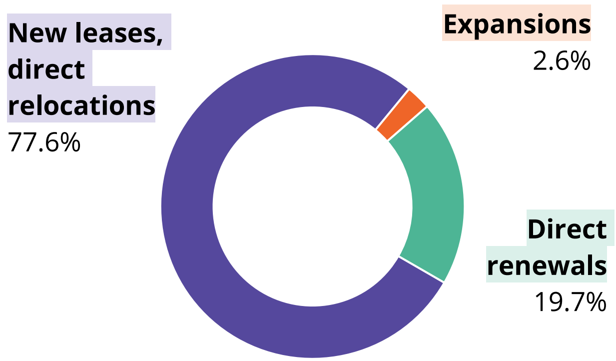


Post COVID

April 2020 to Present



YTD 2023 thru Q3



Source: AVANT by Avison Young

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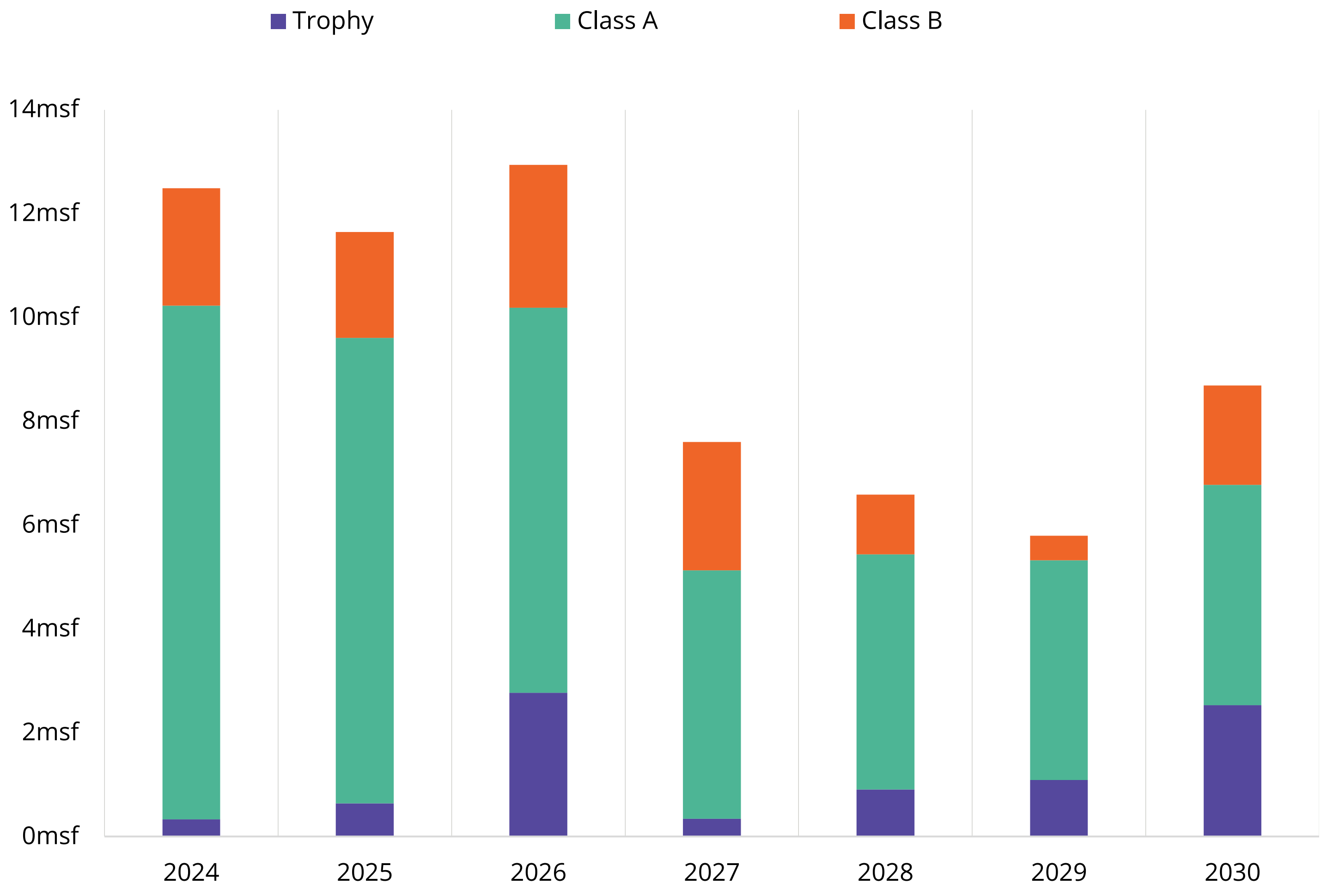
Houston office lease expirations



Source: AVANT by Avison Young
Note: Limited to office lease transactions above 10k sf

The office sector has over 12 msf per year of expiring leases through 2026, which could result in less availability of high-quality spaces and more class B vacancy if the flight-to-quality trend continues.

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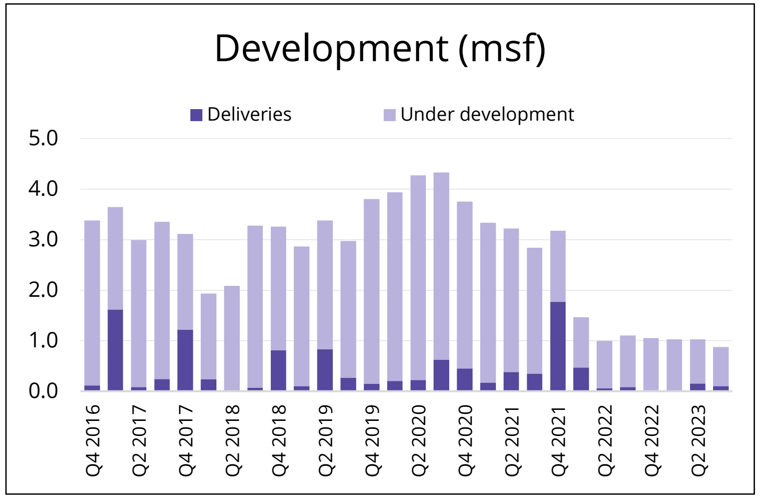
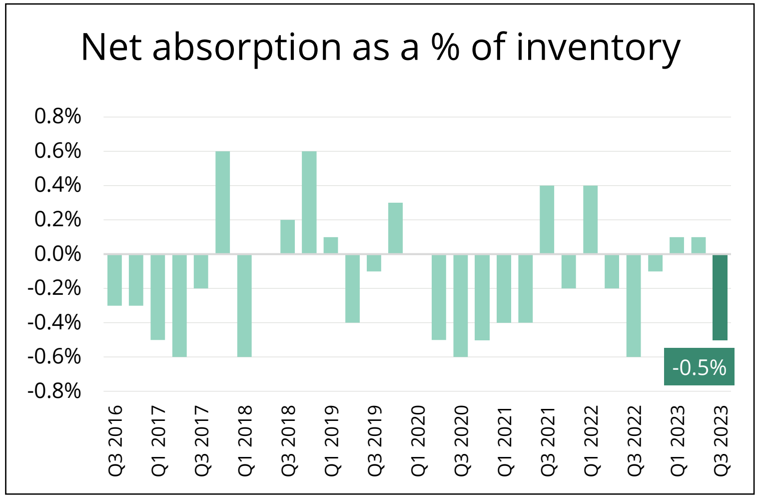
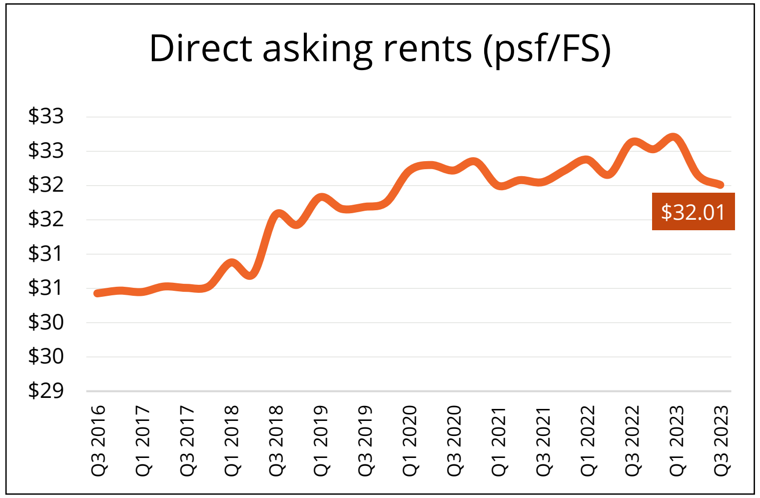
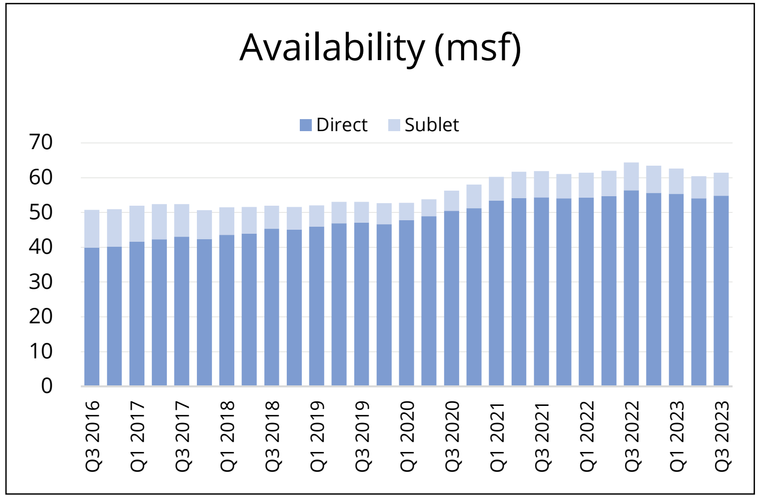
Appendix

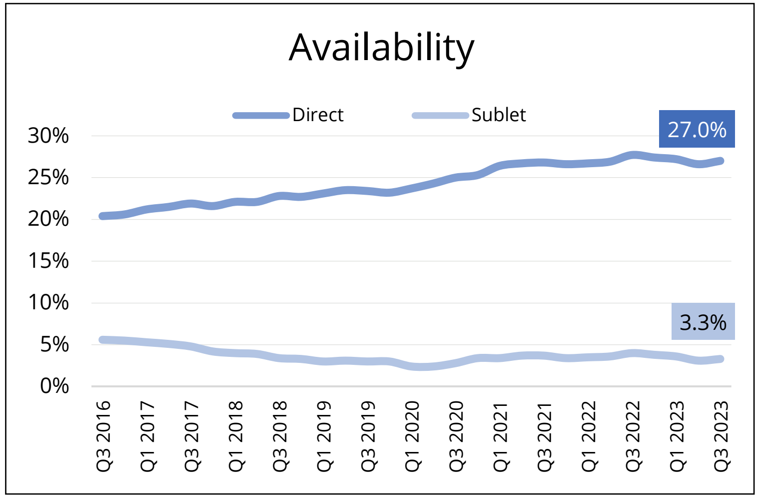
Houston office market indicators

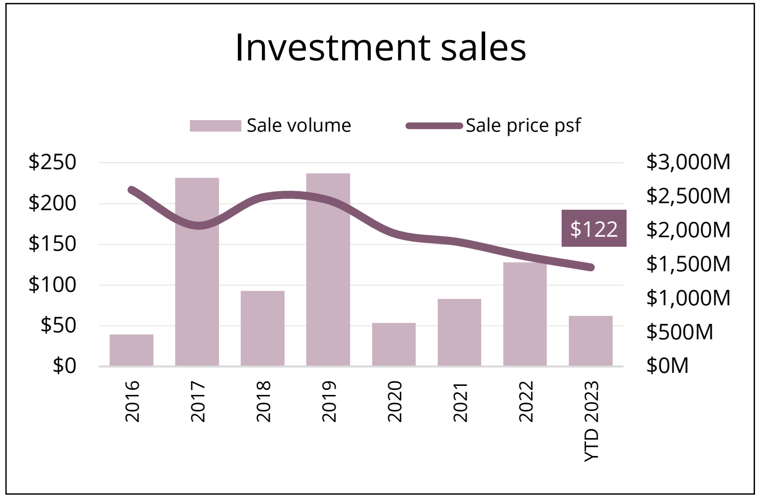












Source: AVANT by Avison Young, CoStar

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Houston office market activity

Recent leasing activity

Tenant	Address	Submarket	Sign date	Size (sf)	Transaction type	Lease type
NRG Energy	1301 McKinney St	CBD	Sep 2023	245,000	New	Direct
Waste Connections	3 Waterway Ave	The Woodlands	Jul 2023	116,817	Renewal	Direct
Stewart Title Company	1360 Post Oak Blvd	Galleria/West Loop	Aug 2023	109,000	New	Direct
NextDecade Corporation	1000 Louisiana St	CBD	Jul 2023	90,030	Renewal/Expansion	Direct
Lime Rock Partners	1111 Bagby St	CBD	Aug 2023	56,984	Renewal	Direct
Kent	2050 W Sam Houston Pky S	Westchase	Aug 2023	53,544	New	Sublease
Cobb Fendley & Associates	4424 W Sam Houston Pky N	West Belt/249	Jul 2023	50,024	New	Direct
Pape-Dawson Engineers	2107 CityWest Blvd	Westchase	Aug 2023	43,120	New	Sublease
InLight Capital	77 Sugar Creek Center Blvd	E Fort Bend Co/ Sugar Land	Aug 2023	41,596	New	Direct
Rockcliff Energy	717 Texas Ave	CBD	Jul 2023	41,102	Renewal	Direct
Morgan Stanley	845 Texas Ave	CBD	Aug 2023	38,096	New	Direct

Top projects under development

Address	Submarket	Delivery date	Building size sf	% Preleased	Developer
1550 Lamar St	CBD	Dec 2023	386,323	35%	Skanska
9753 Katy Fwy	Katy Freeway East/Memorial City	Dec 2023	188,553	95%	MetroNational Corporation
730 Town & Country Blvd	Katy Freeway East/Memorial City	Dec 2023	167,141	54%	Moody Rambin

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Houston office market stats

	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Sublet vacancy	Total vacancy	Sublet availability sf	Net absorption sf (Q3 2023)	Net absorption sf (YTD)	Annual direct asking rent psf FS
Central Business District	39,873,537	-	386,323	26.3%	1.8%	28.1%	1,336,806	(253,236)	(20,799)	$42.34
Galleria/West Loop	24,050,998	-	-	28.2%	1.5%	29.7%	585,115	2,930	(216,474)	$35.16
Greenway Plaza	10,717,724	-	-	22.3%	0.7%	22.9%	202,098	75,340	119,395	$35.40
Energy Corridor/Katy Freeway West	21,086,210	-	-	27.4%	0.7%	28.2%	1,003,580	(256,461)	(43,472)	$27.82
Katy Freeway East/Memorial City	7,104,532	-	355,694	7.8%	0.7%	8.5%	71,144	62,596	140,816	$31.67
Westchase	15,012,405	-	-	30.2%	3.2%	33.5%	761,135	(37,800)	(237,938)	$28.43
North Belt	9,662,929	-	-	48.8%	0.4%	49.2%	92,418	(26,608)	64,114	$20.30
Northwest	8,238,655	-	-	17.5%	0.9%	18.5%	129,420	(28,341)	1,618	$21.05
NASA/Clear Lake	4,033,309	-	-	11.3%	1.5%	12.8%	109,152	964	(1,259)	$25.83
E Fort Bend Co/Sugar Land	5,665,086	-	-	21.7%	1.2%	22.9%	107,084	(9,918)	11,990	$31.13
Richmond/Fountainview	1,200,647	-	-	21.4%	0.0%	21.4%	-	(16,862)	(19,758)	$18.27
San Felipe/Voss	5,284,652	-	-	30.9%	0.3%	31.3%	66,306	(64,437)	(139,892)	$30.72
Bellaire	2,686,492	-	-	13.9%	2.3%	16.1%	82,589	15,607	(5,202)	$25.93
Midtown	5,854,342	-	-	14.9%	0.7%	15.6%	58,205	10,999	14,574	$34.38
FM 1960	2,880,459	-	-	29.5%	0.1%	29.6%	5,111	(26,247)	(100,321)	$17.31
Kingwood/Humble/Northeast	1,170,336	-	-	17.1%	0.0%	17.1%	-	2,118	55,485	$21.28
Southwest	7,341,740	-	-	19.2%	5.4%	24.6%	394,203	(353,582)	(410,555)	$21.22
Medical Center/South	1,619,067	-	-	14.7%	0.0%	14.7%	-	7,038	4,338	$19.95
The Woodlands	11,829,986	-	-	15.7%	2.3%	18.0%	542,726	46,470	292,831	$36.65
Gulf Freeway/Pasadena	2,426,696	101,000	-	21.3%	1.7%	23.0%	40,662	(48,924)	(16,071)	$24.81
Katy/Grand Parkway West	2,549,480	-	-	10.9%	3.2%	14.1%	242,052	7,202	14,894	$32.33
West Belt /249	9,474,918	-	-	32.5%	1.5%	34.0%	790,611	(77,903)	(53,692)	$25.30
Southwest Far	1,146,110	-	32,200	8.3%	0.0%	8.3%	-	8,969	19,380	$22.08
Southeast Far/South Hwy 35	825,685	-	-	1.3%	0.0%	1.3%	-	(361)	(10,249)	$21.60
Conroe	574,150	-	-	20.8%	0.0%	20.8%	-	4,805	14,627	$32.12
Market total	**202,310,145**	**101,000**	**774,217**	**24.8%**	**1.6%**	**26.3%**	**6,620,417**	**(955,642)**	**(521,620)**	**$32.01**

Source: AVANT by Avison Young, CoStar

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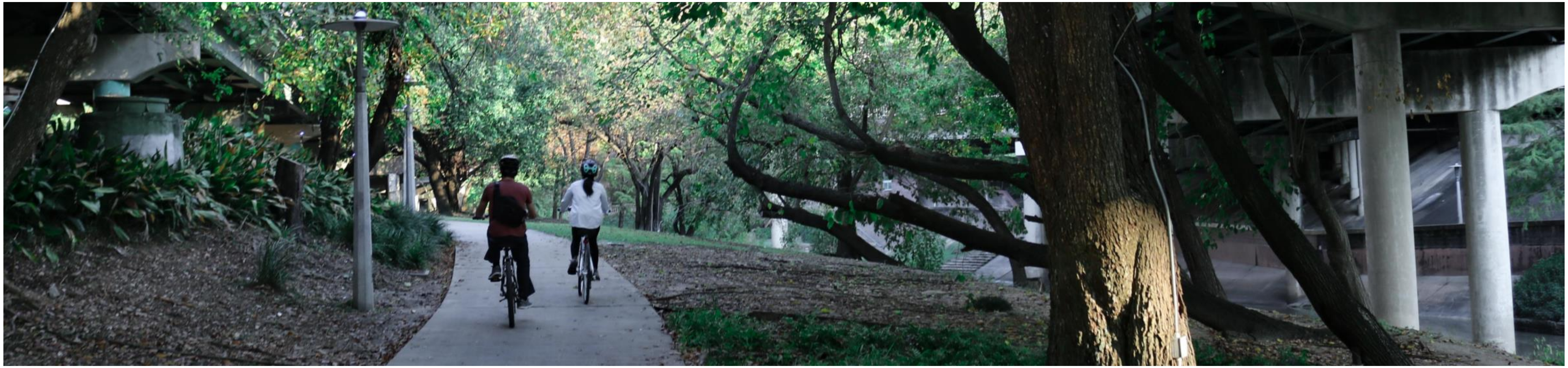
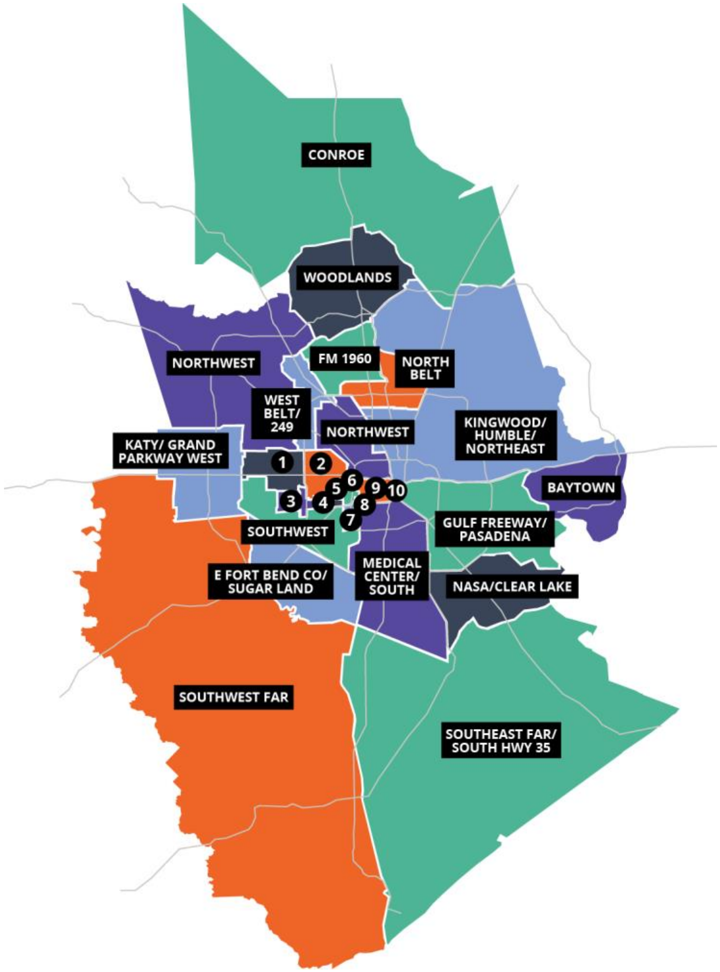
Houston office market stats by class

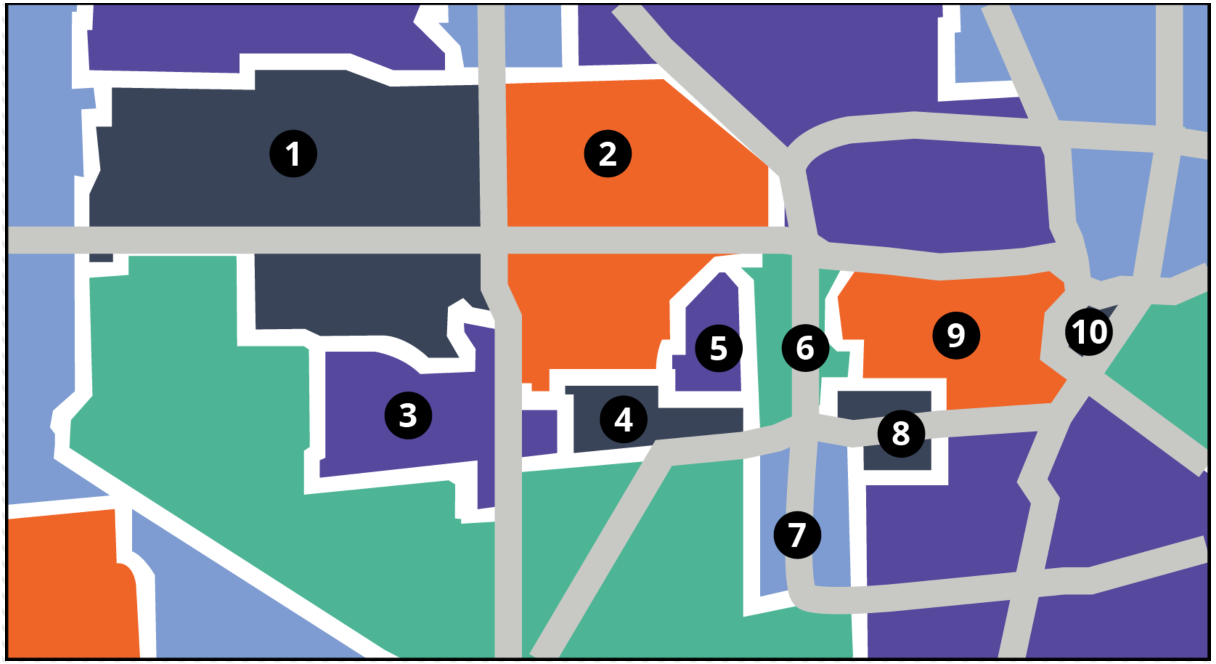
	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Sublet vacancy	Total vacancy	Sublet availability sf	Net absorption sf (Q2 2023)	Net absorption sf (YTD)	Annual direct asking rent psf FS
Trophy	16,414,192	-	386,323	15.8%	3.3%	19.1%	790,780	(25,055)	(73,330)	$52.74
Class A	109,759,127	255,000	387,894	25.9%	1.6%	27.5%	4,549,234	(180,702)	455,940	$35.46
Class B	76,136,826	-	-	25.2%	1.1%	26.3%	1,280,403	(749,885)	(904,230)	$23.65
Market total	**202,310,145**	**255,000**	**774,217**	**24.8%**	**1.6%**	**26.3%**	**6,620,417**	**(955,642)**	**(521,620)**	**$32.01**



Source: AVANT by Avison Young, CoStar

Houston submarket map





Map Key

1	Energy Corridor/Katy Freeway West	6	Galleria/West Loop
2	Katy Freeway East/Memorial City	7	Bellaire
3	Westchase	8	Greenway Plaza
4	Richmond/Fountainview	9	Midtown
5	San Felipe/Voss	10	CBD

Source: AVANT by Avison Young, CoStar

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Office insights glossary of terms

Demand

- **Leasing activity:** total square footage of relocations, renewals, expansions and subleases expressed when the leases are signed, not when tenants take physical occupancy of the space
- **Absorption:** period-over-period change in occupied square footage

Supply

- **Direct vacancy rate:** space operated by landlords that is ready for immediate occupancy
- **Sublease vacancy rate:** space operated by sublandlords that is ready for immediate occupancy
- **Total vacancy rate:** sum of direct vacancy rate and sublease vacancy rate
- **Availability rate:** space that is vacant plus space that will become vacant over an indefinite time horizon, including spaces that are occupied by vacating tenants and under-construction properties

Office rents and concessions

- **Asking rents:** pricing guidance provided by landlords to tenants for available space expressed as full service (FS)
- **Base rents:** fair market value of market-level lease pricing based on representative executed leases, expressed as full service (FS)
- **Free rent period:** months of free rent that are typically provided upfront by landlords to tenants as a concession to offset the total cost of a lease and/or the construction timeline of an office suite
- **Tenant improvement allowance:** an allowance expressed in dollars per square foot provided from landlords to tenants to offset build-out, engineering, space planning and related permit costs
- **Net effective rent:** base rents discounted by the dollar values of tenant improvement allowance and free rent concessions expressed as full service (FS)

Capital markets

- **Investment volume:** office sales dollars expressed when the transactions close and based on inventory thresholds; partial-interest sale dollar amounts are not grossed-up to reflect the 100% value of the sale
- **Asset pricing:** unweighted average per-square-foot asset pricing of market-level closed sales
- **Cap rate:** net operating income divided by sale price; this measurement of market-level investment returns is calculated as an unweighted average based on closed investment sales

For more market insights and information visit **avisonyoung.com**

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