

Flight-to-environment propels consistent office demand for Houston market



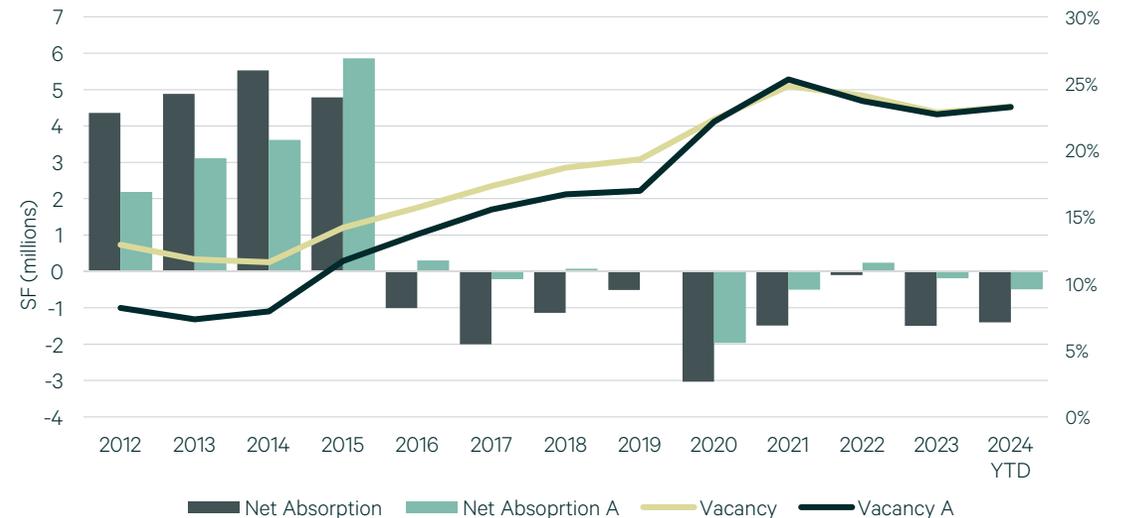
Note: Arrows indicate change from previous quarter.

Market Highlights

- Top tier office demand continued as new construction availability tightened, only one project at 308.0k sq. ft. (68.2% preleased) of Class A space is currently in the development pipeline
- Led by Ovintiv’s lease renewal for 168.6k sq. ft. in the Woodlands – more than 2.0 million sq. ft. of total leasing volume was recorded in Q2 2024 across the Houston office market
- Merger & acquisition activity resulted in additional sublease inventory on market with more on the scope, as energy companies continue to consolidate office operations

With relatively modest market activity in Q2 2024, key indicators point toward some stability for the Houston office market, recording approximately 2.0 million sq. ft. of lease transaction volume for the third consecutive quarter. Compared to the nationwide office market, Houston has proven resilient rising out of an unprecedented downturn for office players, still facing economic headwinds. One leading example is the lack of capital, limiting new construction and as a result has tightened inventory across top tier office space. While overall office demand is showing signs of recovery for the Houston market, this has created a lag for leasing activity momentum. Given elevated construction costs and extended completion timing, spec office development has been muted with Dow Chemical’s 308.0k sq. ft. built-to-suit (68.2% anchored) at CityCentre Six as the one office project currently underway.

FIGURE 1: Historical Net Absorption and Vacancy



Source: CBRE Research, Q2 2024.

State of the Sublease Market

This quarter marked Houston’s lowest office sublease inventory since Q2 2020, thanks to roughly 250,000 sq. ft. taken down by sublease tenants and more than 300,000 sq. ft. turning to direct availability, primarily driven by TechnipFMC’s space at Energy Tower II. At the close of Q2 2024, a total of 5.8 million sq. ft. of sublease inventory was on market and accounted for just over 10.0% of total availability. A healthy level of sublease space was reported this quarter with the most notable addition from Callon Petroleum for 107.2k sq. ft. at the recently delivered 9753 Katy Fwy, following their acquisition by Apache in a \$4.5-billion-dollar deal earlier this year.

Large blocks of sublease space remained in Q2 2024 total availability, led by Noble Energy Center II with 447.7k sq. ft. and 218.8k sq. ft. of ExxonMobil’s former space at 1735 Hughes Landing in north Houston. Additionally, nearly 600.0k sq. ft. of large sublease blocks are downtown – including the Kinder Morgan Building with 221.2k sq. ft. as well as 189.0k sq. ft. at Pennzoil Place-North following Cheniere Energy’s relocation to Texas Tower.

Office Market Trends

For an office market with a total vacancy rate of 23.2%, new office construction (built since 2014) in Houston sits at 90.1% occupied as of Q2 2024, with Texas Tower and 1550 on the Green inking notable leases this quarter, including Fayez Sarofim & Company’s planned relocation to Texas Tower for 60.7k sq. ft. and Boston Consulting Group leasing 53.1k sq. ft. at 1550 on the Green. Following Norton Rose Fulbright, who commenced in Q2 2024, BCG will be the second tenant at Houston’s newest downtown office tower. Market-wide, lease transaction volume came in at 2.0 million sq. ft. with four deals above 100.0k sq. ft. in size; Ovintiv renewed for 168.6k sq. ft. at 4 Waterway Square in the Woodlands, Blue Cross Blue Shield’s planned move and consolidation into Westbelt Office Center I for 136.8k sq. ft., and TDECU took down roughly 135.0k sq. ft. of former Apache space at One Post Oak Central in the West Loop/Galleria.

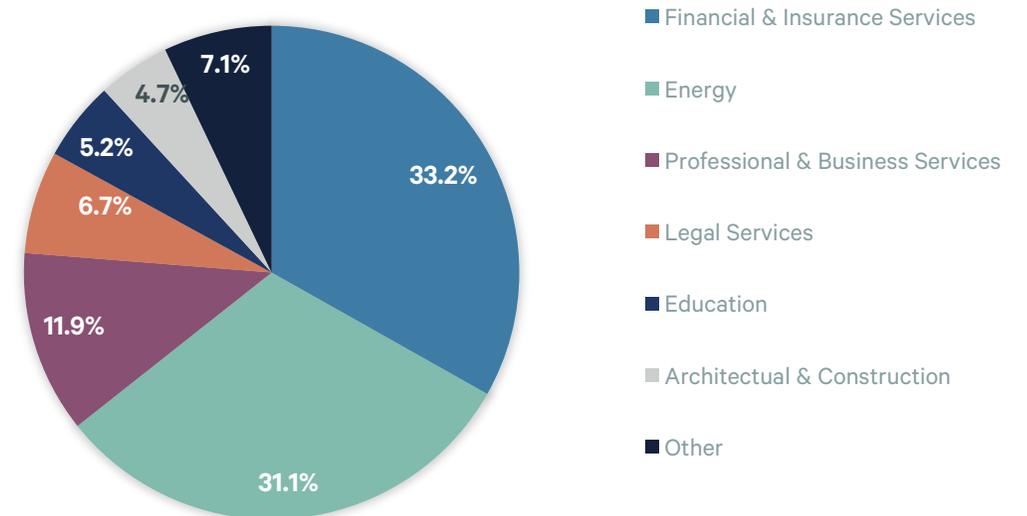
Across the Houston office market, energy companies hold the most sizable footprint among the diverse industry make-up of the metro. In recent years, major energy firms have fueled leasing activity in a migration to west Houston submarkets for upgraded space. Both energy and law firms have done the same in the CBD, continuing the flight-to-environment trend. This quarter, Norton Rose Fulbright downsized and relocated within the CBD from their former namesake tower to 1550 on the Green, representing a decrease to their Houston footprint by more than half.

Ongoing headwinds from the current economic environment have resulted in the drawdown for the overall office sector. While Houston office demand is at a modest level with more than 3.1 million sq. ft. of active tenants in the market, it is still trending toward flight-to-quality. At a time when capital costs remain high, new office development is extremely difficult, further tightening availability across top tier office space. .

FIGURE 2: Sublease vs. Total Availability



FIGURE 3: Leasing Activity by Industry



Source: CBRE Research, Q2 2024.

*Lease sizes 10,000+ sq. ft.

Economic Summary

Following a year of sustained and high interest rates, Houston appears to be experiencing a “soft landing” in 2024. Last year’s expansion was almost certainly driven by fiscal stimulus that far exceeded other western countries. Today, stimulus effects are fading, and higher interest rates continue to bite. There is evidence of this on the consumer front, wherein delinquency rates are trending upward, and credit growth is quickly slowing. The latter signals that consumption—a key driver of GDP growth in recent quarters—is poised to slow further. This partly explains why we believe growth will settle at the mid-1% range this year.

A more severe contraction in consumption would require the labor market to further contract. Presently, conditions are merely softening. Both job openings and hours worked are falling. Also, most of the job growth is clustered in sectors that are immune to higher interest rates and receive at least some public funding, such as education, healthcare and government jobs.

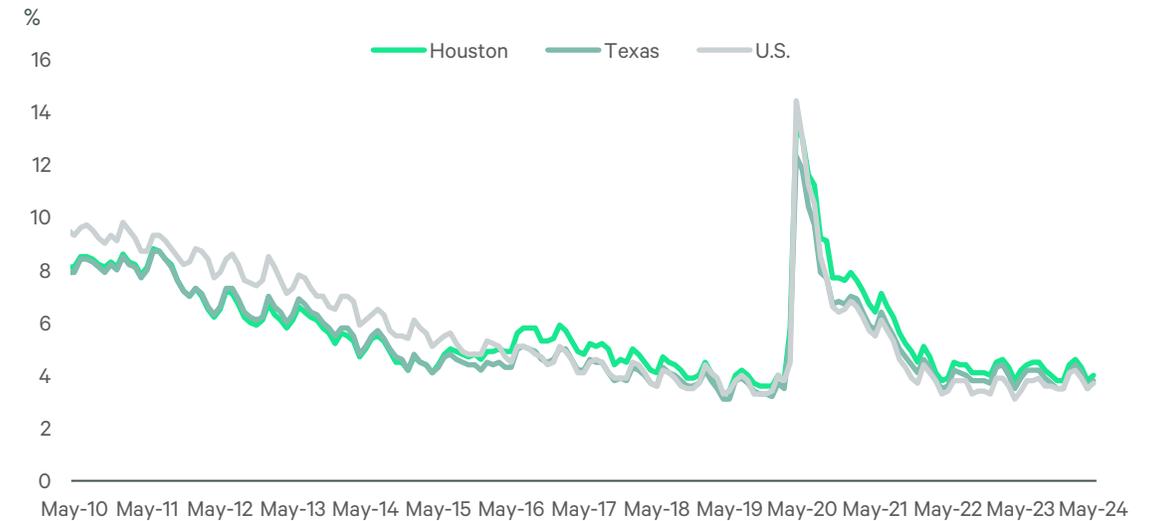
The soft landing in consumption and hiring point to further disinflation. Fed rate cuts are downstream of disinflation, and a most welcome outcome within the commercial real estate space where higher financing costs and devaluations are triggering distress. The prospect of a rate cut this autumn will at least help ease rate volatility, put cap rates on a slight downward trajectory, and generate more common ground between buyers and sellers in coming quarters.

Houston Office Outlook

Although key indicators point to a weak office market, Houston shows signs of optimism with an uptick in tours, combined with new-to-market activity and stabilizing footprints. By contrast, the momentum for office investment sales is unlikely to gain traction with little to no sign of interest rate cuts by year-end. Compounded challenges of the current office market have led to a growing number of office assets entering receivership territory, giving occupiers more leverage than they have held in the past.

With the weakened financial sector, Houston – the energy capital of the world – has seen continued merger & acquisitions activity among household energy names, posing an impact to the office sector which has yet to be fully realized. From the Woodlands to the CBD, and into the west Houston submarkets, increased sublease inventory is anticipated where energy industry office presence is most dense. Beginning in Q2 2024 with Callon Petroleum’s space at 9753 Katy Freeway, additional sublease space could become available at Hess Tower in the CBD and Marathon’s tower at One MRO in Katy Freeway, helping satisfy the appetite for amenity-rich office space. On a positive note, this could bridge the gap considering the limited top tier space options with just 308.0k sq. ft of new construction underway at CityCentre Six, of which is anchored by Dow Chemical. Houston’s office development pipeline has lacked velocity for several years now due to reduced energy prices, navigating out of the pandemic and more recently, stagnant capital and interest rate uncertainty.

FIGURE 4: Unemployment Rate (%)



Source: U.S. BLS, Current Population Survey not seasonally adjusted; Texas Workforce Commission, May 2024

FIGURE 5: Q2 2024 Lease Transactions

LEASES			
Tenant	Industry Sector	Submarket	Total Sq. Ft.
Ovintiv*	Energy	Woodlands	168,598
Blue Cross Blue Shield	Finance and Insurance Services	Westchase	136,800
Camden Property Trust	Finance and Insurance Services	West Loop/Galleria	104,013

*Indicates renewal transaction

FIGURE 6: Recent Sales Transactions

SALES				
Property	\$/SF	Submarket	Buyer	RBA (SF)
Waterway Plaza Two	\$135	Woodlands	The Howard Hughes Corporation	142,448
Energy Center II	\$143	Energy Corridor	Goddard Investment Group	306,721
River Oaks District – Bldg G	\$909	West Loop/ Galleria	Fertitta Entertainment	67,060

Source: CBRE Research, Q2 2024.

FIGURE 7: Houston Office Market Statistics

Submarket	Total Inventory (SF)	Total Vacancy (%)	Total Vacancy (SF)	Total Availability (%)	Total Availability (SF)	Sublease (SF)	Gross Asking Rate (\$/PSF)	Under Construction (SF)	Deliveries (SF)	Net Absorption (SF)	2024 Net Absorption (SF)
CBD	42,243,694	25.9%	10,926,958	30.6%	12,992,891	1,193,475	\$42.21	-	-	(165,142)	(66,382)
Class A	33,070,993	24.8%	8,189,613	30.0%	9,993,731	1,051,751	\$45.21	-	-	(134,155)	61,260
Class B	8,675,181	31.1%	2,698,500	33.6%	2,914,285	141,724	\$33.38	-	-	(28,998)	(142,159)
Clear Lake	5,800,492	13.7%	797,309	16.7%	965,894	81,380	\$24.72	-	-	9,511	(55,311)
Class A	1,829,932	19.1%	348,730	22.0%	402,050	54,884	\$28.67	-	-	15,862	(14,852)
Class B	3,098,238	11.4%	352,835	14.1%	437,352	26,496	\$22.71	-	-	(6,571)	(33,615)
East	2,303,632	18.4%	423,397	16.0%	367,513	20,324	\$21.84	-	-	7,156	(57,739)
Class A	306,622	36.4%	111,561	23.7%	72,786	16,071	\$22.98	-	-	11,484	10,914
Class B	1,548,414	14.2%	220,292	13.1%	203,183	4,253	\$22.11	-	-	(4,328)	(16,953)
Energy Corridor	21,677,024	23.1%	5,001,326	25.4%	5,499,295	445,010	\$27.56	-	-	(165,426)	(8,924)
Class A	16,335,343	22.9%	3,733,666	24.5%	3,999,767	410,582	\$30.76	-	-	(72,836)	80,675
Class B	4,732,448	25.2%	1,190,580	29.6%	1,400,356	29,394	\$23.89	-	-	(91,420)	(76,790)
Far West	1,775,003	5.6%	99,992	7.4%	131,126	57,989	\$34.15	-	-	13,429	32,689
Class A	918,354	3.0%	27,350	6.2%	57,296	2,419	\$34.28	-	-	8,152	22,350
Class B	738,214	8.9%	65,701	8.9%	65,701	55,570	\$0.00	-	-	7,232	8,661
FM 1960/Highway 249	6,805,419	22.3%	1,515,651	38.8%	2,639,080	485,466	\$20.57	-	-	(32,878)	(59,874)
Class A	2,505,787	19.1%	477,986	58.4%	1,463,288	462,349	\$25.91	-	-	5,657	(11,479)
Class B	3,736,678	23.6%	880,919	26.2%	979,469	21,081	\$19.72	-	-	(30,291)	(40,858)
Greenway Plaza	10,417,959	25.4%	2,643,278	29.8%	3,099,515	238,242	\$34.36	-	-	33,331	(153,353)
Class A	6,350,153	27.5%	1,749,136	33.3%	2,113,588	198,598	\$35.90	-	-	9,203	(183,713)
Class B	3,198,754	24.1%	769,406	26.9%	860,964	39,644	\$31.16	-	-	(17,930)	(30,840)
Inner Loop	5,396,591	15.1%	813,533	17.5%	945,978	142,553	\$33.06	-	-	(2,770)	(2,178)
Class A	3,332,708	17.3%	576,567	18.4%	612,739	131,419	\$35.31	-	-	(790)	(17,552)
Class B	1,884,353	11.8%	222,966	16.9%	319,239	11,134	\$28.97	-	-	(3,360)	10,409
Katy Freeway	7,126,518	7.1%	506,688	11.7%	832,244	278,543	\$34.70	308,000	-	57,217	27,795
Class A	5,624,966	6.6%	370,068	11.2%	628,647	231,175	\$45.43	308,000	-	43,370	10,322
Class B	690,292	5.9%	41,071	12.2%	84,467	39,490	\$30.66	-	-	5,126	3,201
Kingwood	1,100,262	8.7%	96,262	9.4%	103,087	-	\$20.93	-	-	6,218	5,992
Class A	536,758	8.1%	43,418	9.6%	51,364	-	\$21.11	-	-	821	(1,131)
Class B	466,254	10.2%	47,400	11.1%	51,579	-	\$20.70	-	-	3,598	10,114
North	7,221,416	8.4%	604,041	9.7%	699,161	42,204	\$23.01	-	-	(21,437)	(26,422)
Class A	5,709,124	6.5%	369,489	7.2%	411,858	4,138	\$45.36	-	-	(13,877)	(15,015)
Class B	1,440,443	16.1%	232,399	19.8%	285,150	38,066	\$22.72	-	-	(7,560)	(15,498)
North Belt/Greenspoint	11,237,327	39.5%	4,438,123	40.9%	4,593,469	56,681	\$18.68	-	-	(1,710)	(56,402)
Class A	4,358,875	42.1%	1,836,562	40.2%	1,754,137	21,939	\$22.90	-	-	(11,343)	(26,885)
Class B	5,209,698	45.7%	2,381,818	49.6%	2,582,158	32,918	\$16.94	-	-	(16,161)	(60,250)
North Loop/Highway 290	7,891,503	16.3%	1,282,637	17.7%	1,398,832	107,050	\$21.09	-	-	30,976	(22,076)
Class A	1,842,943	23.9%	439,620	24.1%	444,777	22,093	\$25.19	-	-	(9,937)	(45,634)
Class B	4,716,292	15.9%	750,450	18.3%	861,488	84,957	\$19.07	-	-	36,326	13,557

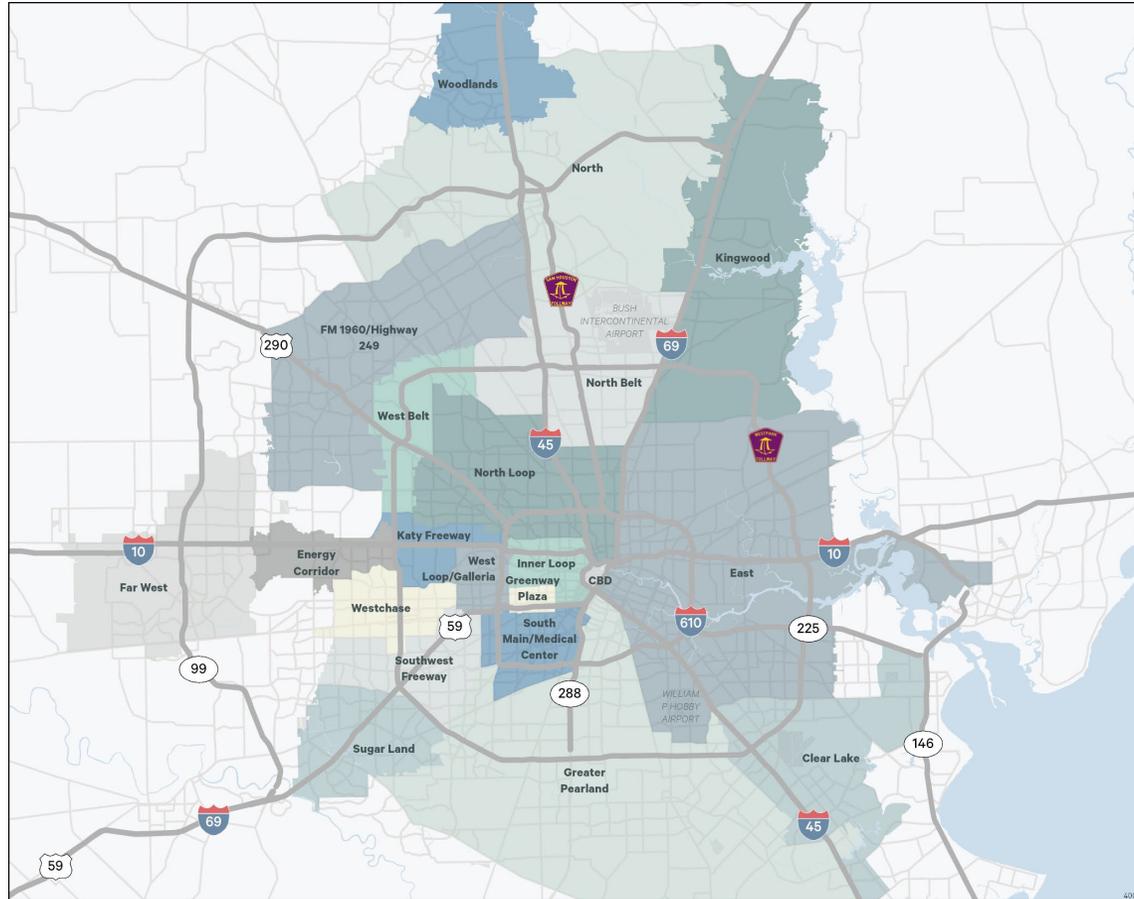
Source: CBRE Research, Q2 2024

FIGURE 7: Houston Office Market Statistics (continued)

Submarket	Total Inventory (SF)	Total Vacancy (%)	Total Vacancy (SF)	Total Availability (%)	Total Availability (SF)	Sublease (SF)	Gross Asking Rate (\$/PSF)	Under Construction (SF)	Deliveries (SF)	Net Absorption (SF)	2024 Net Absorption (SF)
South Main/Medical Center	4,640,634	13.8%	640,416	16.4%	759,971	129,878	\$25.92	-	-	(19,804)	(25,631)
Class A	-	-	-	-	-	-	-	-	-	-	-
Class B	3,426,187	14.5%	496,458	17.5%	599,532	127,792	\$30.74	-	-	(14,623)	3,517
Southwest Freeway	7,308,258	19.3%	1,413,446	20.5%	1,499,285	107,276	\$20.16	-	-	(17,464)	(230,227)
Class A	-	-	-	-	-	-	-	-	-	-	-
Class B	3,223,447	25.0%	805,799	29.5%	950,430	107,276	\$22.88	-	-	(33,847)	(206,837)
Sugar Land	5,320,378	17.8%	949,199	21.3%	1,131,923	64,504	\$31.34	-	-	(79,643)	(746)
Class A	3,682,915	21.3%	783,631	25.3%	931,856	64,504	\$34.20	-	-	(98,074)	(24,547)
Class B	1,202,907	10.2%	122,515	12.0%	144,865	0	\$24.50	-	-	16,959	26,011
West Belt	6,317,713	28.0%	1,767,425	35.5%	2,243,420	371,072	\$25.38	-	-	(36,816)	27,660
Class A	3,598,861	26.6%	958,708	38.1%	1,372,124	334,687	\$27.78	-	-	(3,023)	22,206
Class B	2,541,497	30.0%	762,497	32.3%	822,035	36,385	\$23.10	-	-	(27,934)	11,313
West Loop/Galleria	30,685,041	27.7%	8,508,295	29.5%	9,051,717	500,748	\$34.83	-	-	(69,109)	(579,333)
Class A	18,119,017	30.6%	5,540,514	32.6%	5,903,743	353,597	\$38.83	-	-	(33,695)	(416,485)
Class B	9,578,185	25.0%	2,393,450	27.2%	2,607,872	142,970	\$28.47	-	-	(44,911)	(164,832)
Westchase	19,092,938	28.5%	5,448,581	33.6%	6,410,931	1,088,931	\$26.07	-	-	(203)	(1,527)
Class A	7,364,567	22.4%	1,651,267	29.7%	2,187,547	340,071	\$35.26	-	-	24,124	240,764
Class B	9,086,585	34.1%	3,100,709	38.3%	3,480,355	593,648	\$23.08	-	-	(47,475)	(272,189)
Woodlands	8,177,900	18.6%	1,522,892	23.6%	1,927,916	396,999	\$37.44	-	-	(18,087)	(151,109)
Class A	6,397,066	17.3%	1,108,554	23.4%	1,497,077	370,618	\$40.98	-	-	3,964	(187,552)
Class B	1,523,516	24.5%	373,057	25.4%	386,243	26,381	\$28.61	-	-	(14,048)	53,994
Suburban Total	170,250,553	22.6%	38,472,491	26.0%	44,300,357	4,614,850	\$28.00	308,000	-	(307,509)	(1,336,716)
Class A	88,768,536	22.7%	20,126,827	26.9%	23,904,644	3,019,144	\$34.25	308,000	-	(120,938)	(557,614)
Class B	62,042,402	24.5%	15,210,322	27.6%	17,122,438	1,417,455	\$23.18	-	-	(291,218)	(777,885)
Houston Total	212,494,247	23.2%	49,399,449	27.0%	57,293,248	5,808,325	\$31.84	308,000	-	(472,651)	(1,403,098)
Class A	121,839,529	23.2%	28,316,440	27.8%	33,898,375	4,070,895	\$38.32	308,000	-	(255,093)	(496,354)
Class B	70,717,583	25.3%	17,908,822	28.3%	20,036,723	1,559,179	\$24.91	-	-	(320,216)	(920,044)

Source: CBRE Research, Q2 2024

Market Area Overview



Definitions

Available Sq. Ft.: Space in a building, ready for occupancy within six months; can be occupied or vacant. Availability Rate: Total Available Sq. Ft. divided by the Total Building Area. Average Asking Lease Rate: A calculated average that includes net and gross lease rate, weighted by their corresponding available square footage. Total Building Area: The total floor area sq. ft. of the building, typically taken at the “drip line” of the building. Gross Lease Rate: Rent typically includes real property taxes, building insurance, and major maintenance. Net Absorption: The change in Occupied Sq. Ft. from one period to the next. Net Lease Rate: Rent excludes one or more of the “net” costs (real property taxes, building insurance, and major maintenance) typically included in a Gross Lease Rate. Occupied Sq. Ft.: Building Area not considered vacant. Vacancy Rate: Total Vacant Sq. Ft. divided by the Total Building Area. Vacant Sq. Ft.: Space that can be occupied within 30 days.

Survey Criteria

CBRE’s market report analyzes existing single- and multi-tenant office buildings that total 20,000+ sq. ft. in the Houston market, some owner-occupied buildings and campuses are included. CBRE assembles all information through telephone/email canvassing, third-party vendors, and listings received from owners, tenants and members of the commercial real estate brokerage community.

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