Office market continues to observe softened fundamentals at start of year

▼ 18.6% Total Vacancy

▲ 145,800 SF Net Absorption

▼ 130,000 SF Construction

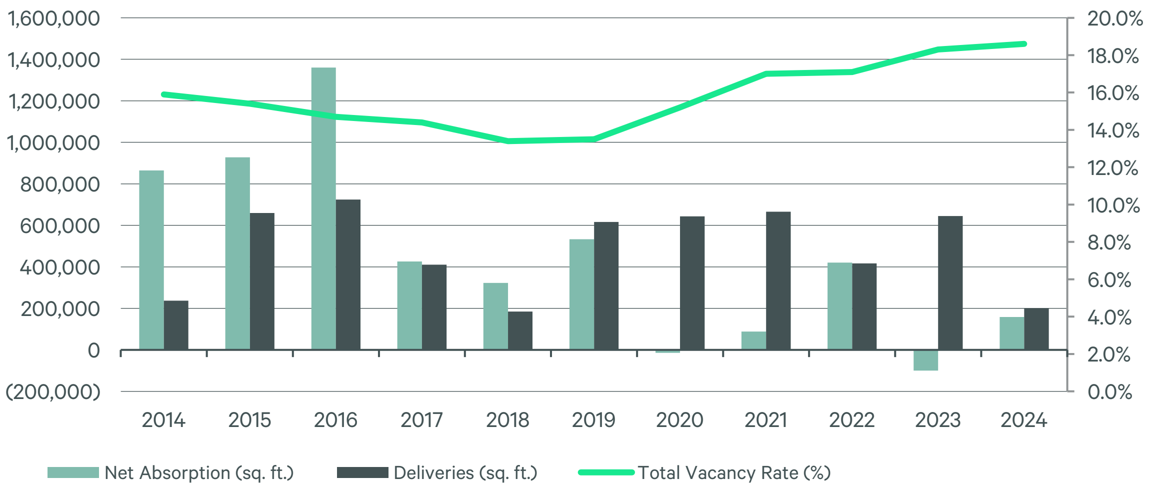
▲ $29.31 Avg. Gross Lease Rate

Note: Arrows indicate change from previous quarter.

MARKET HIGHLIGHTS

- Through the first two quarters of the year, tenants have taken occupancy of over 138,600 sq. ft., nearly all of which occurred this quarter due almost entirely to Galen College of Nursing occupying 157,000 sq. ft.
- Despite the positive absorption, vacancy ticked upward by 50 basis points (bps) since year-end 2023; this is largely due to 175,000 sq. ft. of the 200,000 sq. ft. that delivered in the first quarter remaining vacant.
- There is another 130,000 sq. ft. in the pipeline with zero preleasing in place set to deliver. River Mill in the Northeast submarket is slated for delivery next quarter, which will further elevate vacancy.
- Leasing activity has totaled over 1.0 million sq. ft. in the first half of 2024, well ahead of last year's pace.
- While the market has experienced continued softening since the pandemic, fundamentals are generally on a positive trajectory with Class A space seeing the strongest growth. The tightening in higher quality space. Since 2022, 75.3% off all occupancy gains have occurred in Class A space.

FIGURE 1: Historical Absorption, Deliveries and Vacancy



SUPPLY

Despite the occupancy gains seen in Class A space, this absorption has been offset by new development coming online. Since 2022, nearly 1.4 million square feet of Class A product has been delivered – or roughly 8.2% of inventory. Since 2022, Class A absorption has only totaled 2.6% of inventory. Although this space on the market may present challenges in the short-term, the flight to quality trend seen locally and nationally provides tenants options when looking to upgrade their space and perhaps attract tenants from out of market.

This is especially true in emerging submarkets such as Midtown, where the Class A vacancy currently sits at 6.8% and the three projects built since 2022 totaling 311,000 sq. ft. are over 86% occupied.

Additionally, with no additional ground breaks anticipated in the near future, the market should naturally start tightening again – particularly as the economy continues to improve; albeit, at a slower pace than seen prior to the Pandemic.

DEMAND

Leasing activity for through the first half of 2024 has been particularly strong compared with the prior year. Tenants have already leased over 1.0 million sq. ft. – that compares with 1.6 million square feet in all of 2023. This volume has partially been driven by outsized transactions for the market, such as Galen College of Nursing (157,000 sq. ft.) and Victory Capital (64,500 sq. ft.). So far this year, there have been 12 leases over 20,000 sq. ft.; comparatively, there were 12 leases over that threshold in all of 2023.

However, bread and butter activity remains strong as well. So far in 2024, the set of leases below 10,000 sq. ft. totals over 350,000 sq. ft., which is also what the total leasing volume for that set what in all of 2023.

PRICING

As a result of some of the underlying fundamentals that project strengthening in the future, asking rates have ticked up slightly. Rents now sit at $29.31/ sq. ft., which is an all time high for the market. This is the result of both Class A and Class B assets driving the growth amidst occupancy gains in both product Classes.

FIGURE 2: Leasing Activity

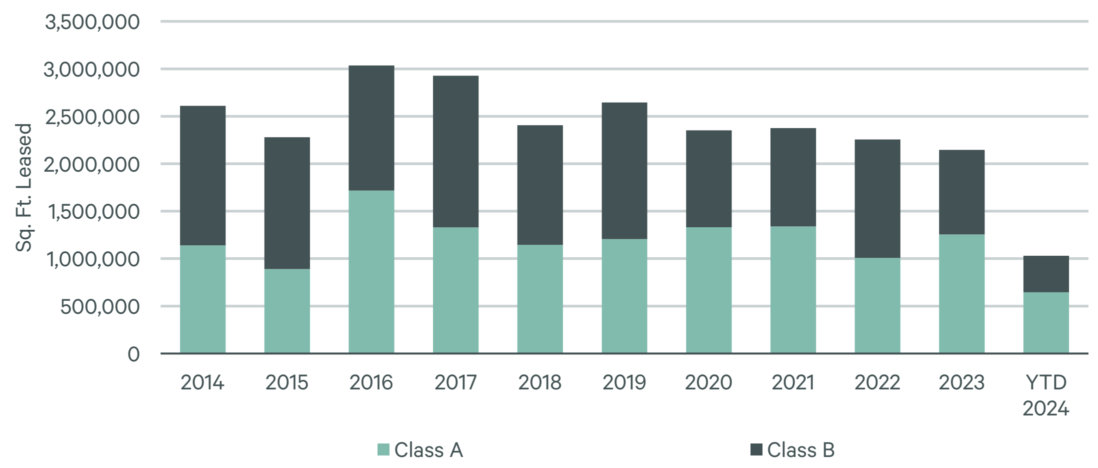


FIGURE 3: Asking Rates

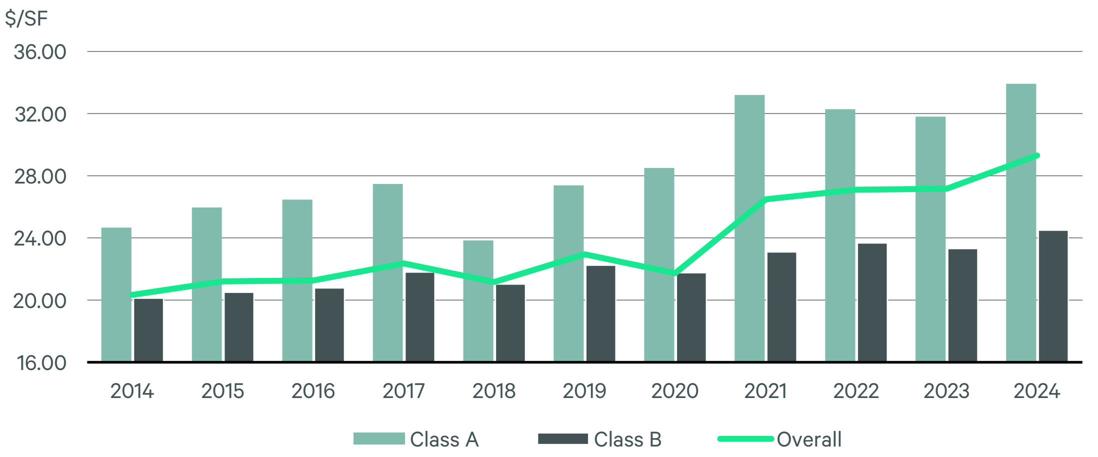


FIGURE 4: San Antonio Office Market Statistics

Submarket	Net Rentable Area (SF)	Total Vacancy (%)	Total Availability (%)	Asking Rate, Gross ($/SF)	Under Construction (SF)	Q2 2024 Deliveries (SF)	Q2 2024 Net Absorption (SF)	YTD 2024 Total Net Absorption (SF)
CBD	**5,120,200**	**22.8**	**24.9**	**32.95**	**-**	**-**	**14,400**	**(5,900)**
Class A	2,397,300	37.6	40.5	33.59	-	-	(3,300)	(46,700)
Class B	2,175,200	10.5	12.2	31.64	-	-	17,400	35,200
Far North Central	**2,623,500**	**21.7**	**24.3**	**33.80**	**-**	**-**	**49,300**	**49,600**
Class A	1,957,800	22.8	23.9	36.18	-	-	29,100	31,600
Class B	665,700	18.4	25.7	26.63	-	-	20,300	18,000
Far West	**1,284,400**	**31.5**	**31.6**	**32.52**	**-**	**-**	**-**	**-**
Class A	886,600	37.7	37.7	34.93	-	-	-	-
Class B	397,700	17.5	18.1	19.85	-	-	-	-
Midtown*	**2,266,000**	**8.1**	**10.3**	**36.57**	**-**	**-**	**(10,000)**	**14,800**
Class A	1,720,300	6.8	8.7	39.97	-	-	5,000	29,300
Class B	421,200	8.4	12.7	35.29	-	-	14,000	16,100
North Central	**8,773,100**	**16.3**	**18.6**	**25.63**	**-**	**-**	**17,600**	**15,800**
Class A	3,269,200	17.9	18.4	30.11	-	-	(33,800)	(41,500)
Class B	4,187,200	18.0	21.6	23.34	-	-	37,200	30,300
Northeast	**2,225,700**	**29.8**	**32.8**	**24.25**	**130,000**	**-**	**16,500**	**3,900**
Class A	642,000	28.6	29.0	29.75	130,000	-	0	(2,300)
Class B	1,221,600	33.8	38.2	23.67	-	-	17,100	13,700
Northwest	**11,260,400**	**15.5**	**22.6**	**28.12**	**-**	**-**	**84,400**	**107,000**
Class A	4,542,100	15.9	22.2	34.43	-	-	110,500	119,200
Class B	5,115,700	15.9	23.7	23.82	-	-	(1,800)	22,700
South	**921,600**	**26.1**	**26.1**	**35.92**	**-**	**-**	**(26,400)**	**(26,400)**
Class A	455,000	44.0	44.0	35.92	-	-	-	-
Class B	318,000	12.7	12.7	-	-	-	(26,400)	(26,400)
San Antonio Total	**34,474,900**	**18.6**	**22.3**	**29.31**	**130,000**	**-**	**145,800**	**158,600**
Class A	**15,870,400**	**22.0**	**24.7**	**33.92**	**130,000**	**-**	**107,500**	**89,500**
Class B	**14,502,400**	**17.1**	**22.0**	**24.50**	**-**	**-**	**77,800**	**109,700**

*In Q1 2024, CBRE Research added the Midtown submarket to San Antonio's office market, resulting in changes to the sizes of the CBD, North Central, and Northeast submarkets.
^Class C stats not shown, but included in total

ECOMONIC OUTLOOK

Following a year of expectation-busting growth, which has given us interest rates higher for much longer, it seems we will get 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 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. Leisure & hospitality has been a growth sector, but these cooling trends are evident here too.

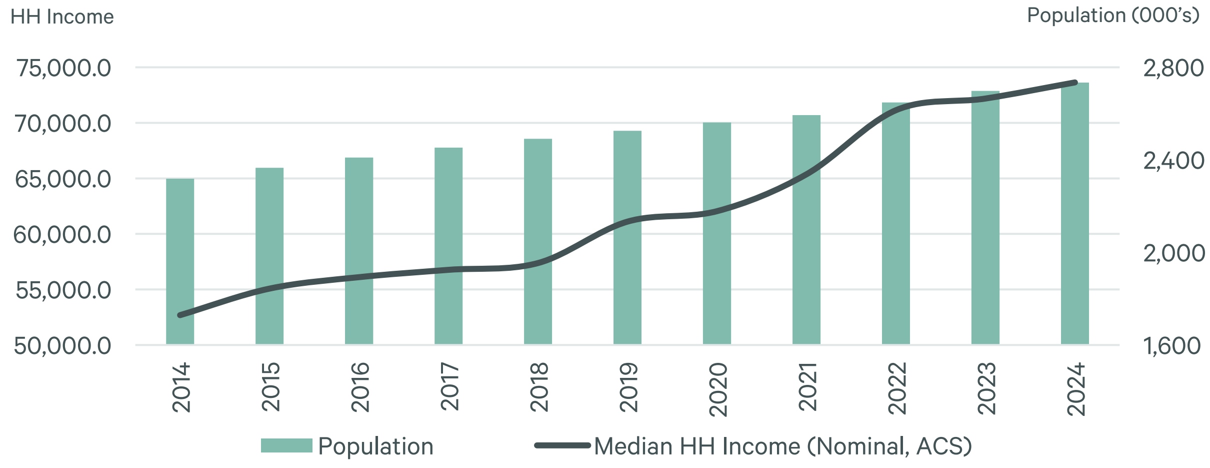
A soft landing in consumption and hiring point to further disinflation. Labor-intensive service costs are poised to soften and falling rents across the Sun Belt suggest weaker housing inflation is on the horizon. Fed rate cuts are downstream of disinflation, and a most welcome outcome within the commercial 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.

FIGURE 5: San Antonio Labor Force and Unemployment

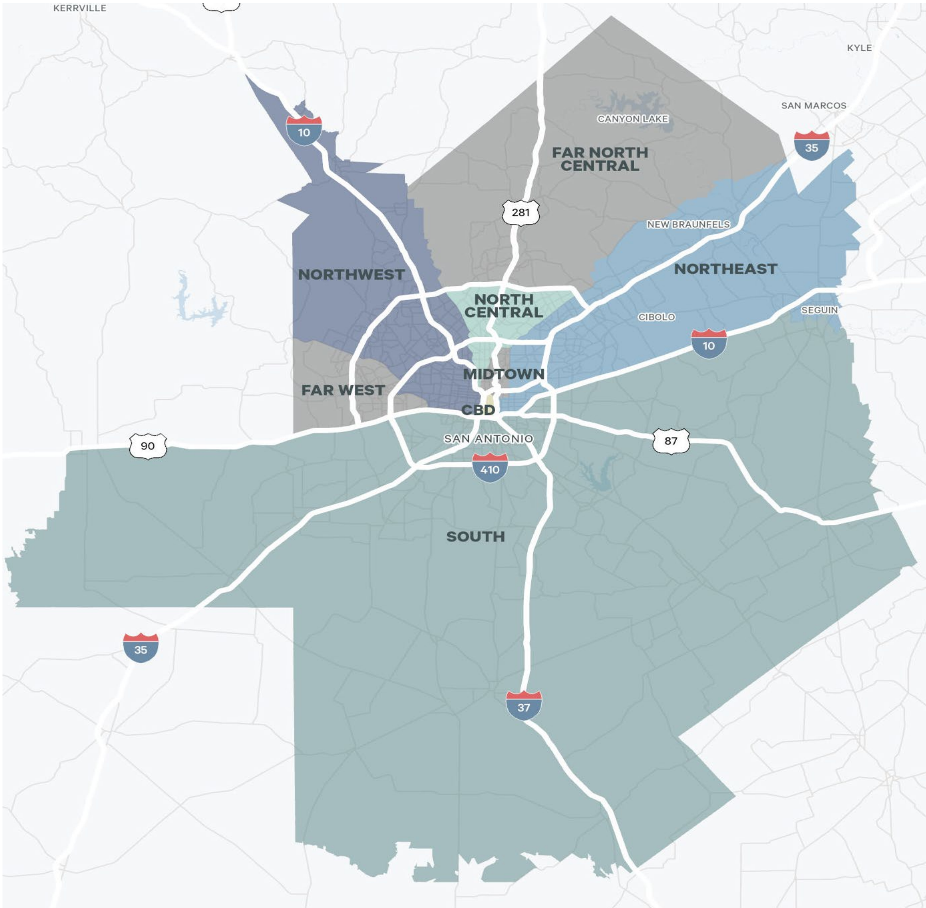
Source: Oxford Economics

FIGURE 6: Population Growth & Household Purchasing Power



Source: Oxford Economics

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. 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

Includes all non-owner occupied, non-medical office buildings 20,000 sq. ft. and greater in size in the greater metropolitan area of San Antonio, TX. Buildings which have begun construction as evidenced by site excavation or foundation work.

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