

Westward migration continues; deal activity remains focused on top tier supply



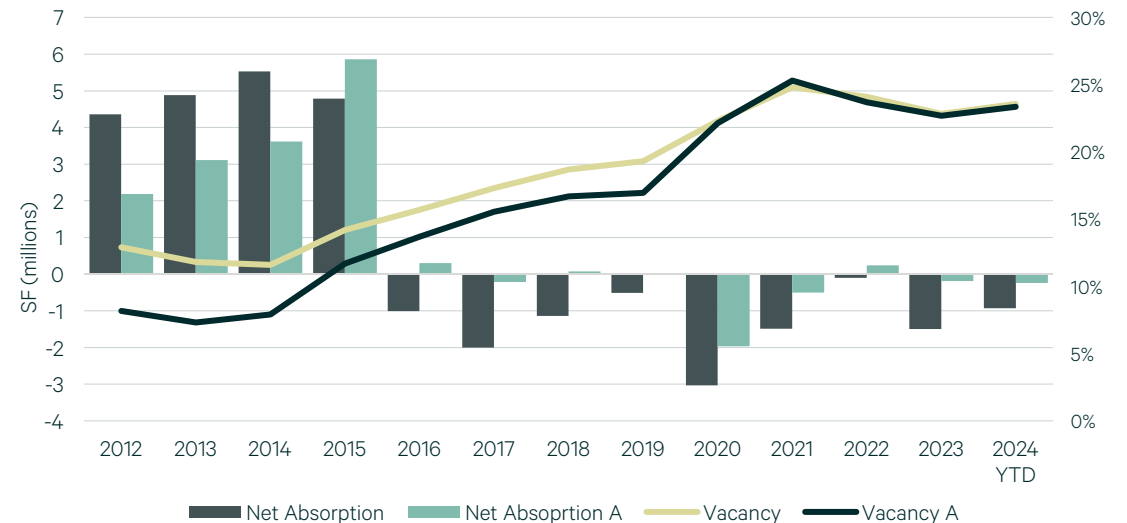
Note: Arrows indicate change from previous quarter.

Market Highlights

- The completion of Town Centre Two and 1550 on the Green added 546,331 sq. ft. to the Houston office market inventory; Q1 2024 construction pipeline muted
- Houston office contractions and relocations to upgraded space contributed to negative net absorption; primarily driven by Apache and Fugro
- West Houston captured nearly half of the 1.9 million sq. ft. of Q1 2024 leasing volume; fueled by early renewal activity and a clear trend of westward migration led by the energy industry

The ripple effect of economic woes and evolving space needs further softened the Houston office market conditions as key fundamentals declined in Q1 2024. Both leasing momentum and sales volume lagged while the office market recorded negative absorption, increasing the total vacancy rate by 50 basis points (bps). Occupier requirements remained steady, although market activity was moderate in Q1 2024, with demand for amenity-rich Class A office space becoming challenged by tightening supply. More than 50% of Q1 2024 leasing activity represented growth in the overall Houston market with the westward migration trend capturing nearly half (46.5%) of the 1.9 million sq. ft. in total volume. This included Dow Chemical’s 210,000-sq.-ft. prelease in Katy Freeway, placing CityCentre Six for 308,000 sq. ft. in the development pipeline. Town Centre Two and 1550 on the Green were delivered in Q1 2024, leaving CityCentre Six as the only new office project, slated to break ground in Q2 2024.

FIGURE 1: Historical Net Absorption and Vacancy



Source: CBRE Research, Q1 2024.

State of the Sublease Market

The Houston market reported 6.2 million sq. ft. of office sublease availability at the end of Q1 2024. Close to half of this sublease inventory is located in three submarkets; CBD, Westchase and Energy Corridor. Sublease space accounted for 10.5% of total availability this quarter, largely from energy companies including Cheniere, Technip and National Oilwell Varco. Thanks to more than 475,000 sq. ft. going direct and Fluor Corporation pulling 660,000 sq. ft. from the sublease market in 2023, sublease inventory was down 44.4% in Q1 2024, compared to the peak of 11.1 million sq. ft. in 2017.

Office Market Fundamentals

Overall leasing activity was modest in Q1 2024, recording 1.9 million sq. ft. in total volume with transactions averaging approximately 35,300 sq. ft. in size. This level of deal volume for leases 10,000 sq. ft. and above was on par with Q4 2023, although the average lease size has increased by 35% quarter-over-quarter. The largest lease signed in Q1 2024 was Dow Chemical for 210,000 sq. ft. as the anchor-tenant at Midway’s proposed CityCentre Six. This headquarter relocation amplified the success of the Katy Freeway submarket with companies placing high priority on amenity base, minimizing employee commute time and investment in the elevated workplace. Other notable leases included Arion Blue, securing 143,622 sq. ft. at 1200 Enclave, Noble Drilling leasing 110,250 sq. ft. at CityWest Place - Bldg I and Bechtel’s continued expansion taking an additional 77,262 sq. ft. at CityWestPlace - Bldg 4.

Key indicators from Q1 2024 leasing activity and tenant movement illustrated the heightened demand for more efficient and upgraded office space near their respective employee-base. Close to 60% of Q1 2024 leasing activity was recorded at newer Class A office buildings. Older Class A and Class B product largely contributed to the negative net absorption of -930,447 sq. ft. market-wide. Cheniere’s relocation from Pennzoil Place – North to Texas Tower in the CBD reflected a 24.5% contraction to their office footprint. By contrast, NextDecade expanded their downtown presence, increasing from one full floor to 90,030 sq. ft. at 1000 Louisiana.

Across suburban submarkets, the Energy Corridor posted 156,502 sq. ft. of positive net absorption largely driven by Kiewit’s expansion for 105,839 sq. ft. at Energy Center I and Fugro’s relocation to Republic Square from their formerly owned building on the Southwest Freeway. Both Fugro and Apache are the latest companies to notably downsize and migrate into the west Houston submarkets – each realized footprint contractions of 44.2% and 36.7%, respectively.

Increased demand for differentiated Class A space in amenity-rich submarkets fueled the delivery of 167,441 sq. ft. to the Katy Freeway submarket at Moody Rambin’s Town Centre Two and Skanska opened the doors to 1550 on the Green in the CBD for 379,190 sq. ft. in Q1 2024. Town Centre Two, delivered at 80.1% leased with anchor-tenant, Greystar and LPL Financial moving in this quarter. 1550 on the Green delivered 100% vacant with Norton Rose Fulbright’s anticipated commencement to occur in Q3 2024.

FIGURE 2: Sublease vs. Total Availability

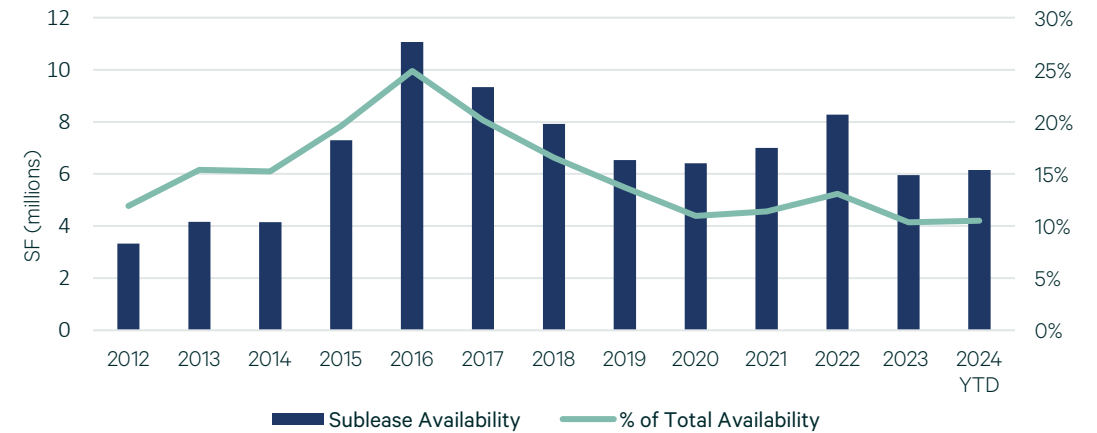
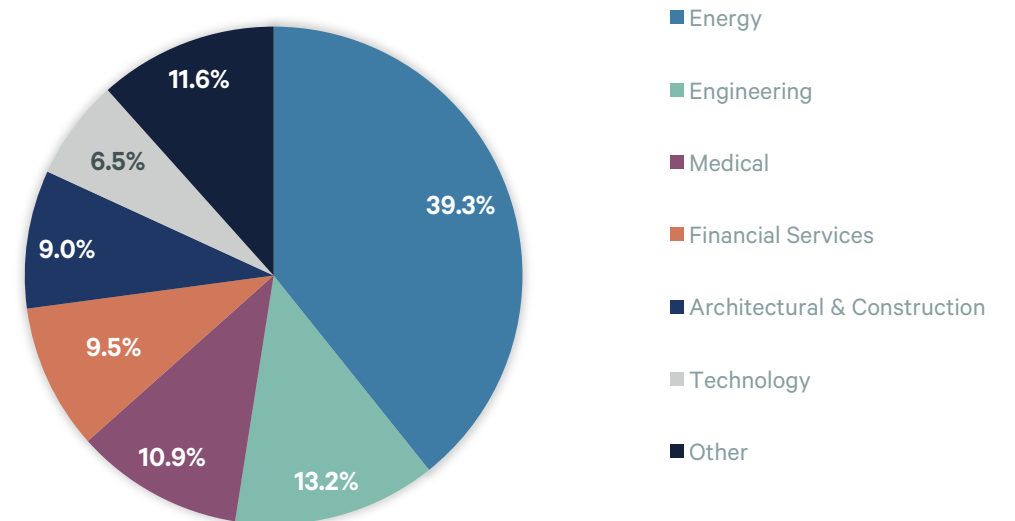


FIGURE 3: Leasing Activity by Industry



Source: CBRE Research, Q1 2024.

*Lease sizes 10,000+ sq. ft.

Economic Summary

Continued economic growth paired with the Fed signaling a more accommodative interest rate strategy all suggests the U.S. economy is heading toward a ‘soft landing’. GDP growth should be less than half the pace in 2023 when growth topped 3%. Reasons for the slowdown include a more prudent consumer spending and much weaker hiring. This latter issue is most acute within interest rate sensitive sectors, such as tech start-ups and goods manufacturing. Notable exceptions include investment in EV and microchip production capacity.

More caution from businesses means an increased share of recent hiring came from publicly funded sectors (e.g., education, healthcare, state & local governments). A key exception is leisure & hospitality, driven by continued demand for discretionary services. With many private firms on the sidelines the job openings rate declining to 5.5% from its peak of 7.8% in 2022. This has also meant the pace of wage growth has cooled, but not enough to see inflation fall quickly to 2%. With unemployment remaining below 4% and high-capacity utilization, CPI is unlikely to return to target until 2025. The Fed could potentially make three, 25-basis-point (bps) cuts this year. This outlook is putting downward pressure on longer-term rate expectations, providing some optimism for real estate capital markets, but the recovery will only begin after the first cut is actually delivered.

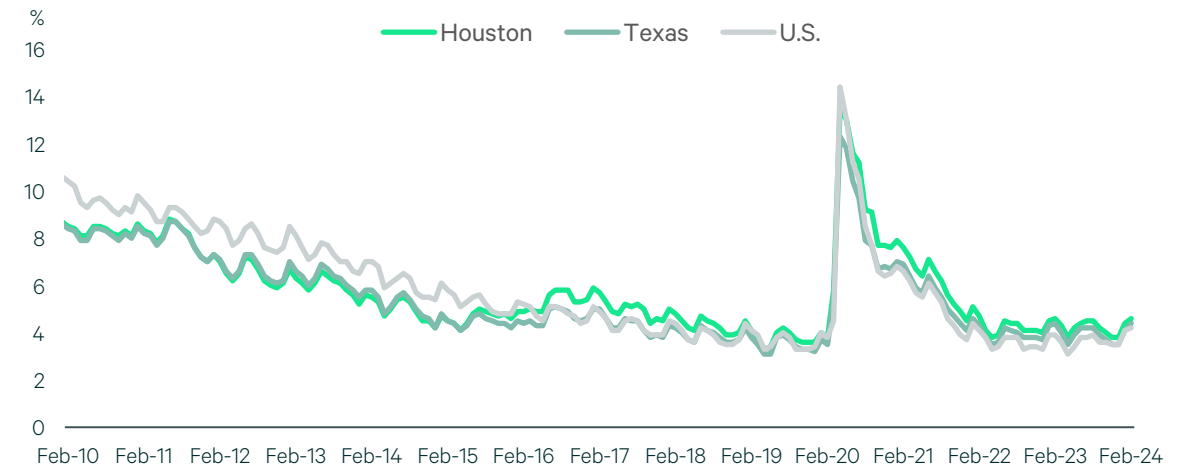
Houston Office Outlook

For the Houston office market, the landlord-tenant dynamic is shifting with increased scrutiny on the credibility of building owners and the financial viability of their office assets. This adds further uncertainty to the extended duration of executing both lease and investment sales transactions for the distressed asset type. A lofty 4.5 million sq. ft. across Houston’s Greenway Plaza complex has gone into receivership, while a handful of office buildings in the CBD and Westchase have been able to execute loan extensions.

The impact of high interest rates persist for the office sector, although Q1 2024 experienced some investment sales momentum, with the few notable deals purchased with private capital. To that end, falling values were evident, as was the case with Fertitta Entertainment’s purchase of mixed-used development, The River Oaks District in the West Loop/Galleria submarket. This three-property portfolio acquisition was made at an out-of-pocket cost of approximately \$450 million - representing a \$100-million value drop from J.P. Morgan’s initial purchase of the asset in 2016.

In light of recent top tier deliveries, the overall hit to office space demand, debt and equity scarcity, compounded by high and rising construction costs have brought Houston’s office pipeline to a near halt. Given the lingering market conditions, developers have veered away from spec office projects since 2020, with the exception of the Katy Freeway submarket, which has outperformed the overall Houston office market, while securing Dow Chemical’s build-to-suit at City Centre Six.

FIGURE 4: Unemployment Rate (%)



Source: Texas Workforce Commission, Q1 2024

FIGURE 5: Q1 2024 Lease Transactions

LEASES			
Tenant	Industry Sector	Submarket	Total Sq. Ft.
Dow Chemical	Manufacturing	Katy Freeway	210,000
Arion Blue	Engineering	Westchase	143,622
Noble Drilling	Energy	Westchase	110,250

FIGURE 6: Recent Sales Transactions

SALES				
Property	\$/SF	Submarket	Buyer	Office RBA (SF)
River Oaks District – Bldg G	\$909	West Loop/ Galleria	Fertitta Entertainment	67,060
777 Post Oak Blvd	Confidential	West Loop/Galleria	Landry’s Inc.	176,776
The Tower at 290	\$48	North Loop	DZMI	245,846

Source: CBRE Research, Q1 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	25.6%	10,799,842	31.4%	13,262,937	1,201,645	\$42.44	-	379,190	98,760	98,760
Class A	33,070,993	24.4%	8,073,124	30.3%	10,015,275	965,737	\$45.72	-	379,190	195,415	195,415
Class B	8,675,181	31.0%	2,689,862	36.7%	3,181,865	235,908	\$32.80	-	-	(113,161)	(113,161)
Clear Lake	5,800,492	13.9%	806,820	17.8%	1,034,583	142,336	\$24.49	-	-	(64,822)	(64,822)
Class A	1,829,932	19.9%	364,592	21.4%	391,935	55,922	\$27.65	-	-	(30,714)	(30,714)
Class B	3,098,238	11.2%	346,264	17.2%	532,127	86,414	\$22.75	-	-	(27,044)	(27,044)
East	2,303,632	18.7%	430,553	18.8%	432,139	14,275	\$19.75	-	-	(64,895)	(64,895)
Class A	306,622	40.1%	123,045	43.0%	131,718	-	\$24.23	-	-	(570)	(570)
Class B	1,548,414	13.9%	215,964	13.5%	208,877	14,275	\$19.08	-	-	(12,625)	(12,625)
Energy Corridor	21,749,414	23.6%	5,134,757	27.7%	6,032,499	943,988	\$27.41	-	-	156,502	156,502
Class A	16,407,733	23.8%	3,897,184	26.9%	4,413,271	909,066	\$30.37	-	-	153,511	153,511
Class B	4,732,448	24.5%	1,161,663	32.1%	1,518,083	28,400	\$24.27	-	-	14,630	14,630
Far West	1,775,003	9.0%	160,172	10.9%	192,890	104,318	\$32.86	-	-	19,260	19,260
Class A	918,354	8.6%	78,685	11.8%	108,330	48,748	\$33.56	-	-	14,198	14,198
Class B	738,214	10.4%	76,501	10.8%	79,574	55,570	\$0.00	-	-	1,429	1,429
FM 1960/Highway 249	6,805,419	22.3%	1,517,349	38.6%	2,626,218	477,953	\$20.48	-	-	(26,996)	(26,996)
Class A	2,505,787	20.7%	518,219	58.6%	1,469,514	451,897	\$26.10	-	-	(17,136)	(17,136)
Class B	3,736,678	22.8%	850,628	26.5%	990,031	26,056	\$19.27	-	-	(10,567)	(10,567)
Greenway Plaza	10,417,959	25.1%	2,614,209	28.3%	2,947,648	175,584	\$33.41	-	-	(186,684)	(186,684)
Class A	6,350,153	26.7%	1,695,939	30.3%	1,924,331	142,684	\$34.86	-	-	(192,916)	(192,916)
Class B	3,198,754	23.5%	751,476	26.8%	857,053	32,900	\$31.85	-	-	(12,910)	(12,910)
Inner Loop	5,396,591	17.2%	930,843	20.6%	1,111,225	126,863	\$31.64	-	-	592	592
Class A	3,332,708	17.6%	587,631	19.3%	643,072	120,770	\$35.27	-	-	(16,762)	(16,762)
Class B	1,884,353	17.4%	327,832	24.0%	452,773	6,093	\$26.87	-	-	13,769	13,769
Katy Freeway	7,126,518	9.4%	668,580	8.7%	622,487	139,541	\$34.40	-	167,141	(29,422)	(29,422)
Class A	5,624,966	8.8%	494,204	8.1%	453,790	131,663	\$44.42	-	167,141	(33,048)	(33,048)
Class B	690,292	10.2%	70,106	6.7%	46,197	-	\$31.12	-	-	(1,925)	(1,925)
Kingwood	1,100,262	9.3%	102,480	10.1%	111,623	-	\$20.45	-	-	(226)	(226)
Class A	536,758	8.2%	44,239	8.6%	46,039	-	\$20.64	-	-	(1,952)	(1,952)
Class B	466,254	10.9%	50,998	12.5%	58,341	-	\$20.60	-	-	6,516	6,516
North	7,211,886	7.9%	573,074	10.9%	784,933	123,692	\$24.02	-	-	(4,985)	(4,985)
Class A	5,699,594	6.1%	346,082	8.8%	503,979	77,203	\$43.73	-	-	(1,138)	(1,138)
Class B	1,440,443	15.6%	224,839	19.4%	278,801	46,489	\$21.53	-	-	(7,938)	(7,938)
North Belt/Greenspoint	11,409,333	40.5%	4,623,779	38.3%	4,366,223	70,123	\$18.63	-	-	(54,692)	(54,692)
Class A	4,358,875	41.3%	1,800,819	39.6%	1,726,856	41,389	\$22.17	-	-	(15,542)	(15,542)
Class B	5,209,698	46.0%	2,394,825	45.3%	2,358,946	28,734	\$17.02	-	-	(44,089)	(44,089)
North Loop/Highway 290	7,996,163	17.6%	1,407,443	18.7%	1,494,185	126,685	\$20.81	-	-	(53,052)	(53,052)
Class A	1,842,943	24.4%	449,644	24.3%	447,376	40,163	\$25.60	-	-	(35,697)	(35,697)
Class B	4,820,952	17.7%	853,360	19.5%	939,430	83,582	\$18.65	-	-	(22,769)	(22,769)

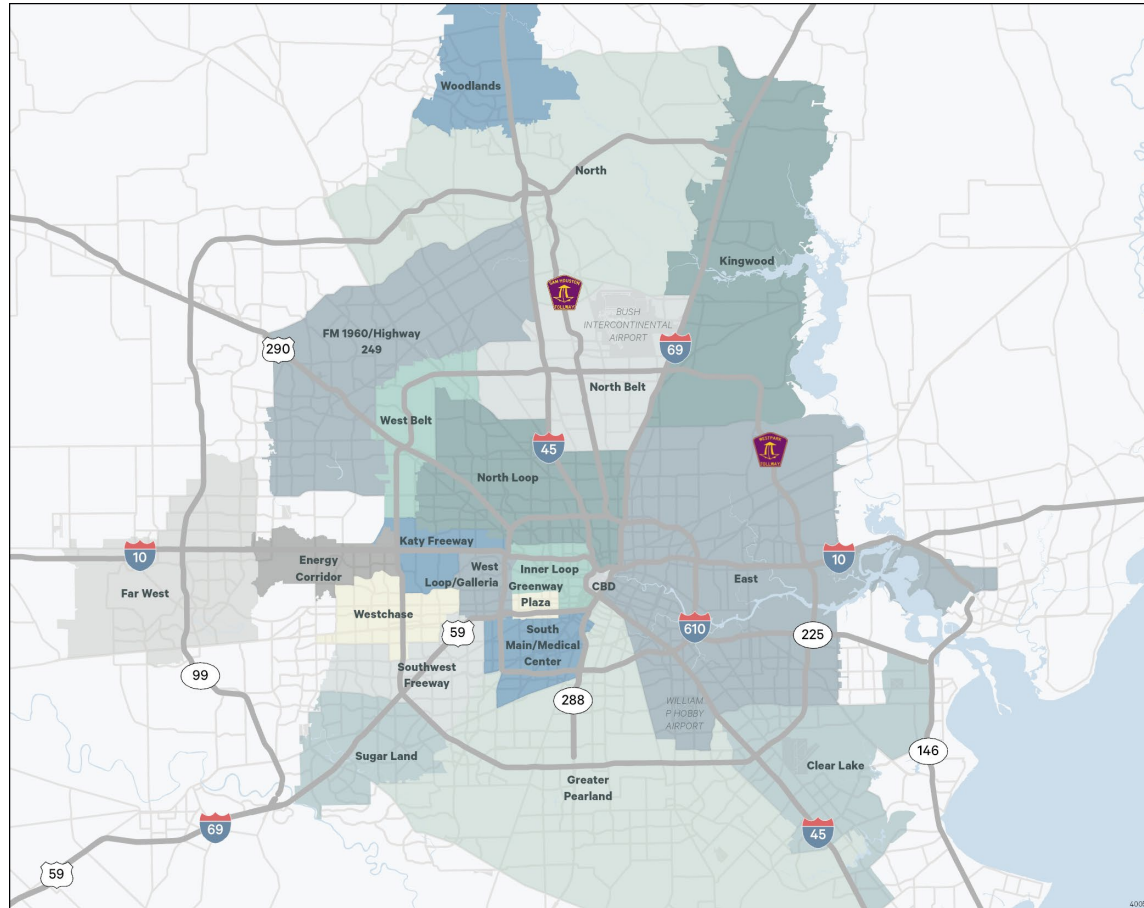
Source: CBRE Research, Q1 2024

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	13.4%	620,612	15.7%	729,967	117,778	\$25.82	-	-	(5,827)	(5,827)
Class A	-	-	-	-	-	-	-	-	-	-	-
Class B	3,426,187	14.1%	481,835	27.2%	932,227	115,692	\$30.83	-	-	(5,827)	(5,827)
Southwest Freeway	7,308,258	19.1%	1,395,982	20.6%	1,504,381	60,755	\$20.79	-	-	(212,763)	(212,763)
Class A	-	-	-	-	-	-	-	-	-	-	-
Class B	3,223,447	23.9%	771,952	28.9%	932,227	60,755	\$23.67	-	-	(172,990)	(172,990)
Sugar Land	5,320,378	16.3%	869,556	19.4%	1,029,909	69,767	\$30.28	-	-	78,897	78,897
Class A	3,682,915	18.6%	685,557	22.1%	814,808	62,147	\$34.03	-	-	73,527	73,527
Class B	1,202,907	11.6%	139,474	13.4%	161,333	7,620	\$23.98	-	-	9,052	9,052
West Belt	6,418,432	27.0%	1,730,609	35.0%	2,249,471	360,720	\$24.78	-	-	64,476	64,476
Class A	3,598,861	26.6%	955,685	38.2%	1,373,901	334,687	\$27.05	-	-	25,229	25,229
Class B	2,642,216	27.8%	734,563	31.2%	824,584	26,033	\$22.51	-	-	39,247	39,247
West Loop/Galleria	30,685,041	28.1%	8,622,444	31.3%	9,608,376	537,522	\$34.67	-	-	(510,224)	(510,224)
Class A	18,119,017	30.3%	5,483,995	34.3%	6,207,785	405,264	\$38.76	-	-	(382,790)	(382,790)
Class B	9,299,054	27.0%	2,508,679	29.9%	2,784,053	130,042	\$28.03	-	-	(119,921)	(119,921)
Westchase	19,205,001	29.7%	5,698,553	33.7%	6,464,095	970,668	\$26.19	-	-	(1,324)	(1,324)
Class A	7,381,587	23.6%	1,744,232	28.6%	2,111,082	353,734	\$36.57	-	-	216,640	216,640
Class B	9,181,628	35.2%	3,234,571	39.0%	3,580,563	461,725	\$23.27	-	-	(224,714)	(224,714)
Woodlands	8,177,900	18.7%	1,532,195	23.9%	1,957,668	388,543	\$37.29	-	-	(133,022)	(133,022)
Class A	6,397,066	17.8%	1,139,908	23.8%	1,523,416	370,211	\$40.56	-	-	(191,516)	(191,516)
Class B	1,523,516	23.6%	359,009	26.3%	400,023	18,332	\$28.14	-	-	68,042	68,042
Suburban Total	170,848,316	23.1%	39,440,010	26.5%	45,300,520	4,951,111	\$27.92	-	167,141	(1,029,207)	(1,029,207)
Class A	88,893,871	23.0%	20,409,660	27.3%	24,291,203	3,545,548	\$34.05	-	167,141	(436,676)	(436,676)
Class B	62,063,693	25.1%	15,554,539	28.3%	17,574,697	1,228,712	\$23.28	-	-	(486,667)	(486,667)
Houston Total	213,092,010	23.6%	50,239,852	27.5%	58,563,457	6,152,756	\$31.95	-	546,331	(930,447)	(930,447)
Class A	121,964,864	23.4%	28,482,784	28.1%	34,306,478	4,511,285	\$38.50	-	546,331	(241,261)	(241,261)
Class B	70,738,874	25.8%	18,244,401	29.3%	20,756,562	1,464,620	\$24.94	-	-	(599,828)	(599,828)

Source: CBRE Research, Q1 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.

Contacts

Savannah Tufts
Field Research Manager
savannah.tufts@cbre.com

Emely Villatoro
Field Research Analyst
emely.villatoro@cbre.com

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