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Houston Office Insight Report

Q2 2021

AVANT
by AVISON YOUNG

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Key takeaways

Economic conditions

- Reopening efforts and higher vaccination rates have allowed the Houston unemployment rate to rebound from a high of 14.7% to **6.6%**.
- Office-using job losses in Houston have totaled **3.9%** compared with 5.4% for other industries' job losses, underscoring the impact the pandemic had on the discretionary segments of the local economy.

Recovery rate

- The overall post-COVID rate of recovery based on extrapolated cell phone data is **50.9%**.
- Houston office occupiers have navigated their return-to-work strategies differently, with healthcare and residential firms returning more quickly than transit and hospitality. The overall rate of recovery is a comparatively low **22.5%**, though bellwether companies are beginning to mandate that their employees return to the office.

Office demand

- Leasing activity has paused, decreasing by **35.5%** compared with long-term historical averages.
- The flight-to-quality trend persists, with the class A segment accounting for **60%** share of post-COVID leasing activity.
- Tenants are navigating the market with more conviction, signing leases for longer terms since January 2021.

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Key takeaways

Office supply

- Direct and sublease vacancy have achieved all-time highs, totaling **22.9%**.
- The share of sublease-to-total available space of **11.7%** is trending higher after several years of declining space, following the record-setting 10.6 million square feet (msf) added to the market during Houston's energy crisis in 2015-2016.

Pricing trends

- Net effective rents decreased as landlords induced tenant commitments through record-setting concessions packages and favorable lease provisions.
- Asking rents are down about **3%** during the last six months.
- Demand is starting to increase as the economy reopens and tenants that postponed their long-term occupancy strategies re-enter the market.

Capital markets

- Office pricing has temporarily paused during the risk-pricing crisis. As a result, just **$1.4 billion** of Houston offices have been sold since 2020, a decrease of **26.1%** compared with the past five-year average.
- Cap rates have stabilized at **7.1%** provided the sizable spread from benchmark rates and investors' increased focus on core investments.
- Asset pricing has decreased by **55.1%** from December 2019 to December 2020.

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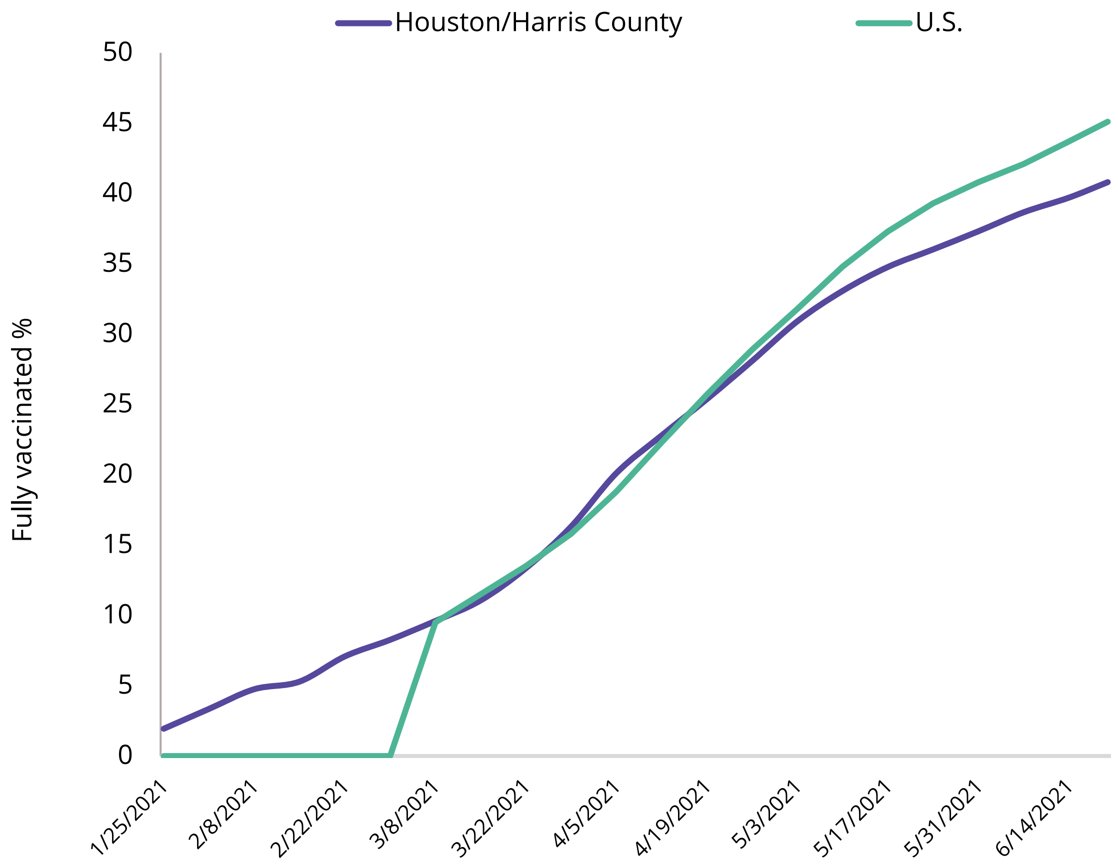
Vaccination rates

40.8%

Share of total Houston/Harris County population that is fully vaccinated

Houston/Harris County proportionate vaccination rates have remained slightly below U.S. averages, an important metric that has allowed the city and county to loosen restrictions.



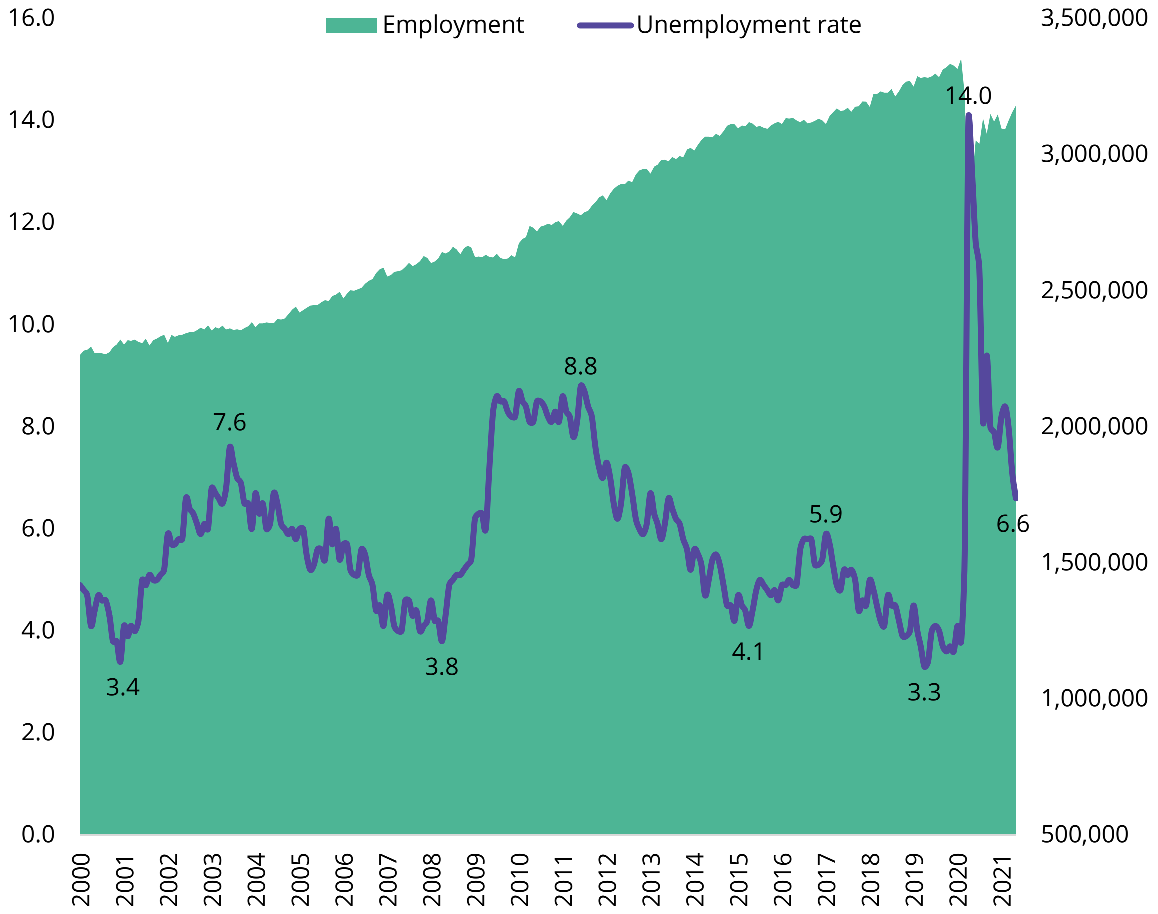
Source: CDC

Employment and unemployment rate

6.6%

Houston unemployment rate as of May 2021, dipping below the height of the Great Recession

Historically tightened labor market conditions were halted by the pandemic with nearly 361,113 job losses between February and April 2020. However, reopening efforts enabled the economy to add 12.8% more jobs year-over-year.



Note: Not seasonally adjusted data.
Source: Bureau of Labor Statistics

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Office-using job gains and losses

-3.9%

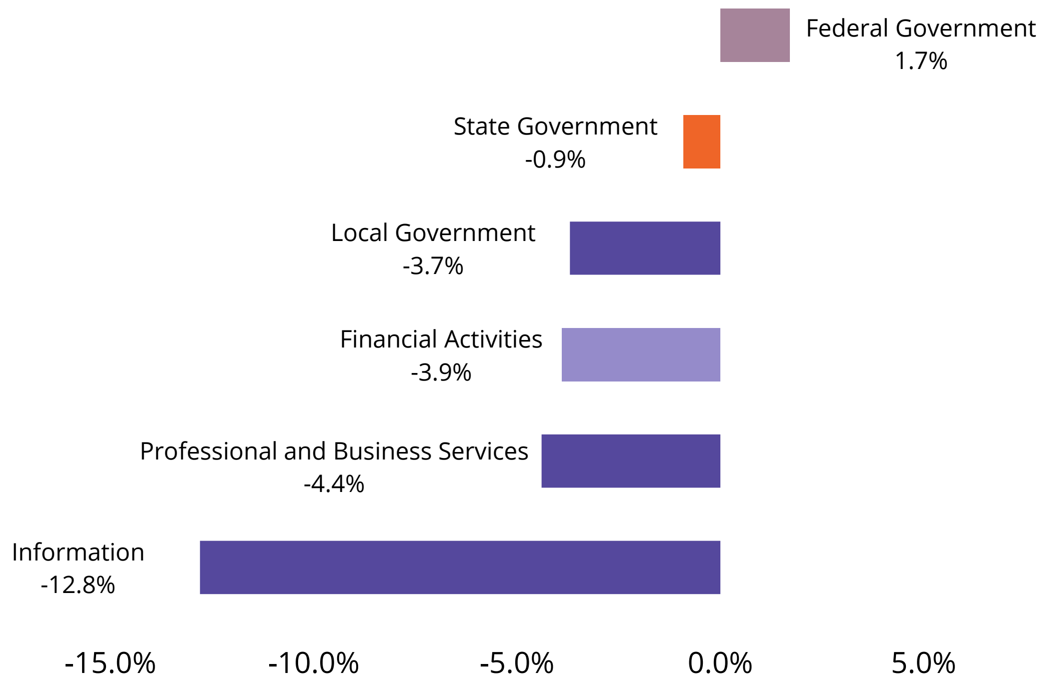
Change in office-using employment during the pandemic

Houston MSA job losses have declined by 5.4% since the start of the pandemic, though office-using jobs contracted by just 3.9%. This recession's impact on the office-using labor market has been more severe than the Great Recession, when information jobs dropped only 6.7%.

VIEW DASHBOARD

Total change in Houston MSA job gains/(losses)

February 2020 to April 2021



Note: Not seasonally adjusted data. Metropolitan statistical area.
Source: Bureau of Labor Statistics

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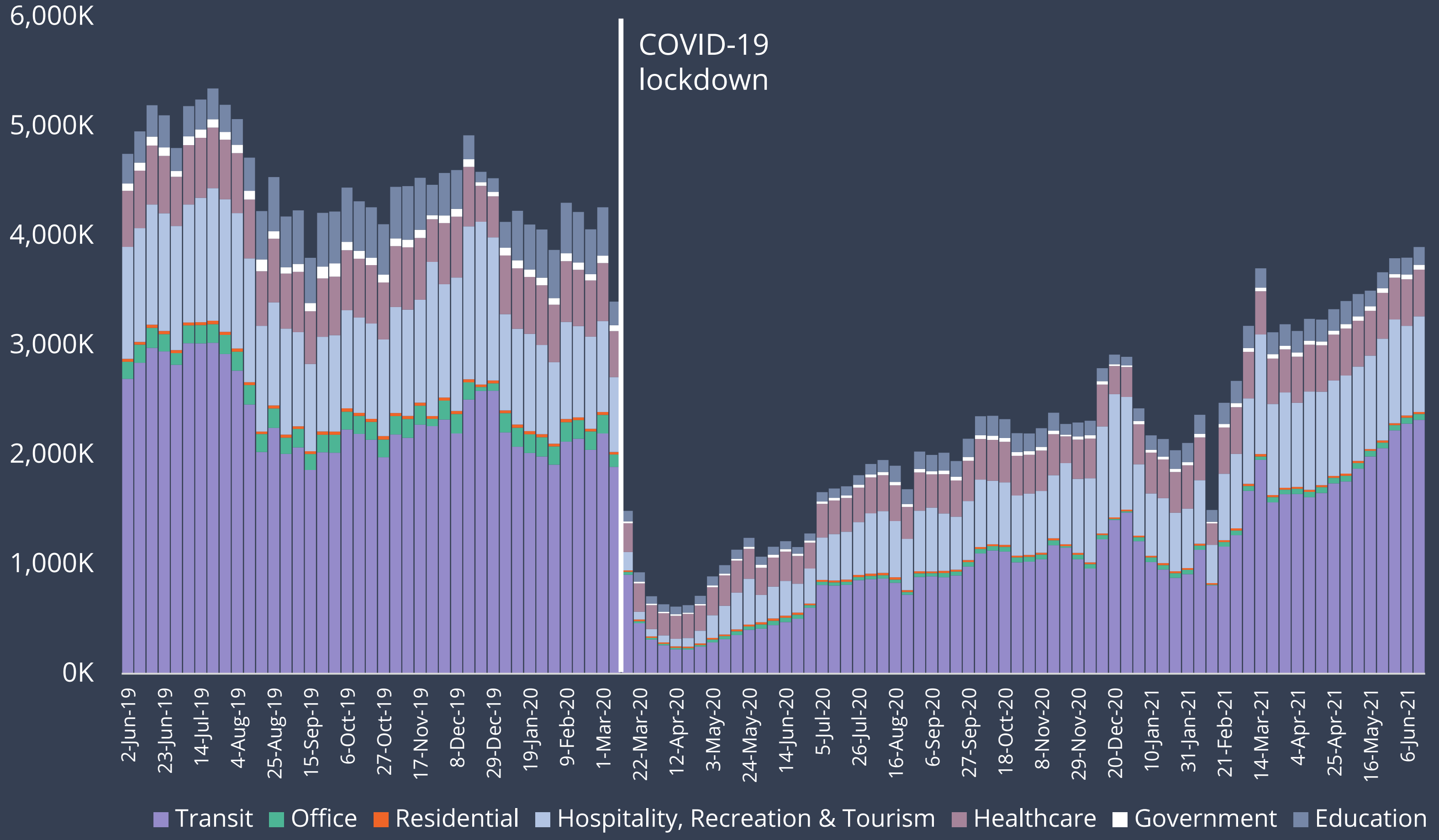
Houston recovery index

50.9%

Post-COVID rate of recovery based on representative locations through 6/20/2021

Activity levels have escalated in recent months and continue to trend upward. Activity has increased by 220.2% year-over-year, underpinned by strong growth in transit (+391.7%) and hospitality (+175.2%).



Note: Representative areas of interest.
Pre-COVID period measured as 12/1/2019 to 3/14/2020.
Post-COVID period measured as 3/15/2020 to 6/20/2021.
Source: Orbital Insights, AVANT by Avison Young

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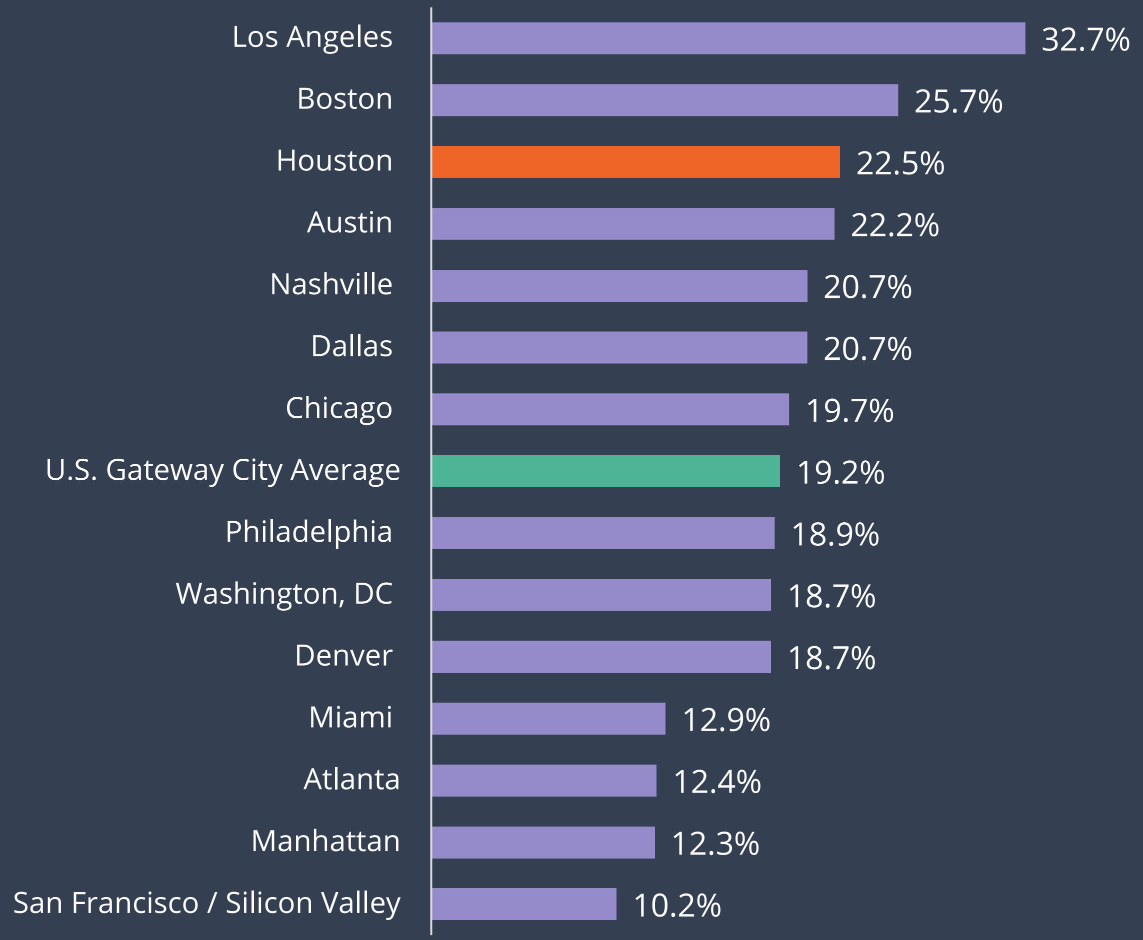
Office recoveries across U.S. gateway cities

19.2%

Average post-COVID rate of recovery for representative office employers across U.S. gateway cities

Houston office employers have been willing to return to the office, as measured by the third-highest recovery rate of 22.5% among U.S. gateway cities. Barriers early on were locally high infection and hospitalization rates, resulting in employees' reluctance to return to the office due to health safety fears.



Note: Select, representative occupiers only. Weekdays only.
Pre-COVID period measured as 12/1/2019 to 3/14/2020.
Post-COVID period measured as 3/15/2020 to 6/20/2021.
Source: Orbital Insights, AVANT by Avison Young

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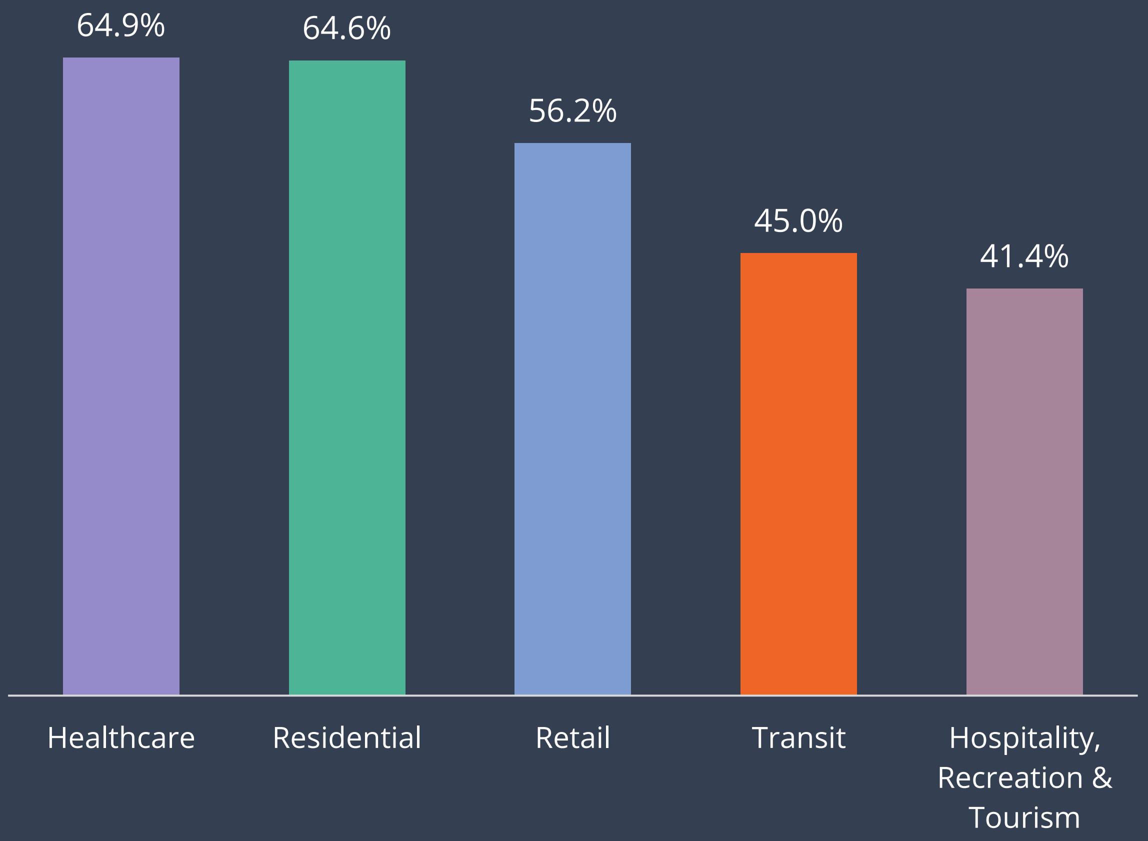
Houston office recovery index by industry

22.5%

Post-COVID rate of recovery for representative Houston office occupiers through 6/20/2021

Office employers have taken unique approaches in their return-to-work efforts, with healthcare returning more quickly than transit and hospitality. Bellwether firms, namely banks, are increasingly requesting their employees to return to the office by Labor Day, which should cause this recovery index to rise considerably.



Note: Select, major occupiers only. Weekdays only.
Pre-COVID period measured as 12/1/2019 to 3/14/2020.
Post-COVID period measured as 3/15/2020 to 6/20/2021.
Source: Orbital Insights, AVANT by Avison Young

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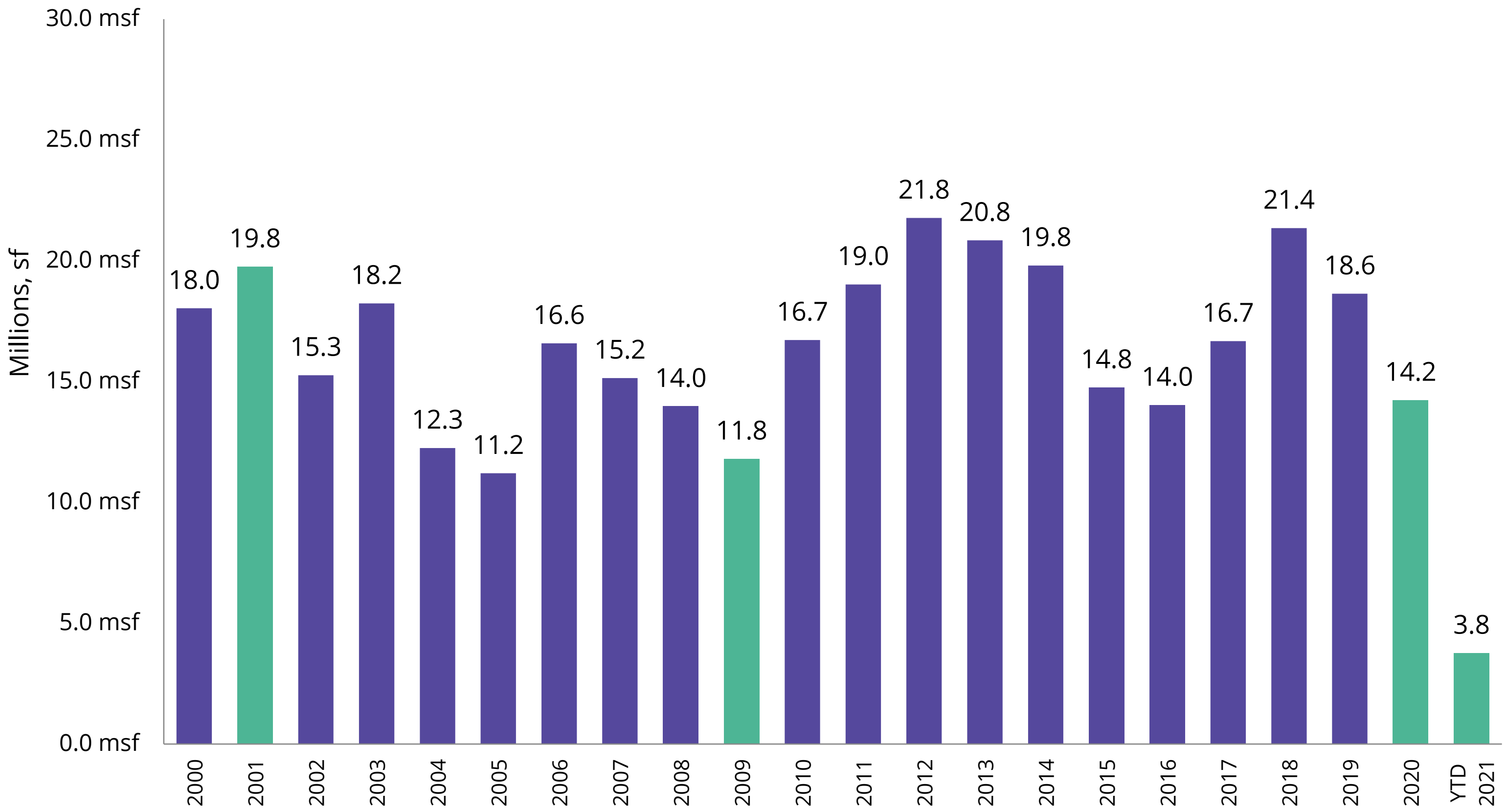
Office leasing activity

-35.2%

2020 to 2021 vs. prior 20-year annual average leasing activity

There is no modern precedent for the post-COVID slowdown in leasing activity — not even during Houston's energy downturns — to compare to the sudden change in office occupiers' future workplace strategies and the 2020 recession.



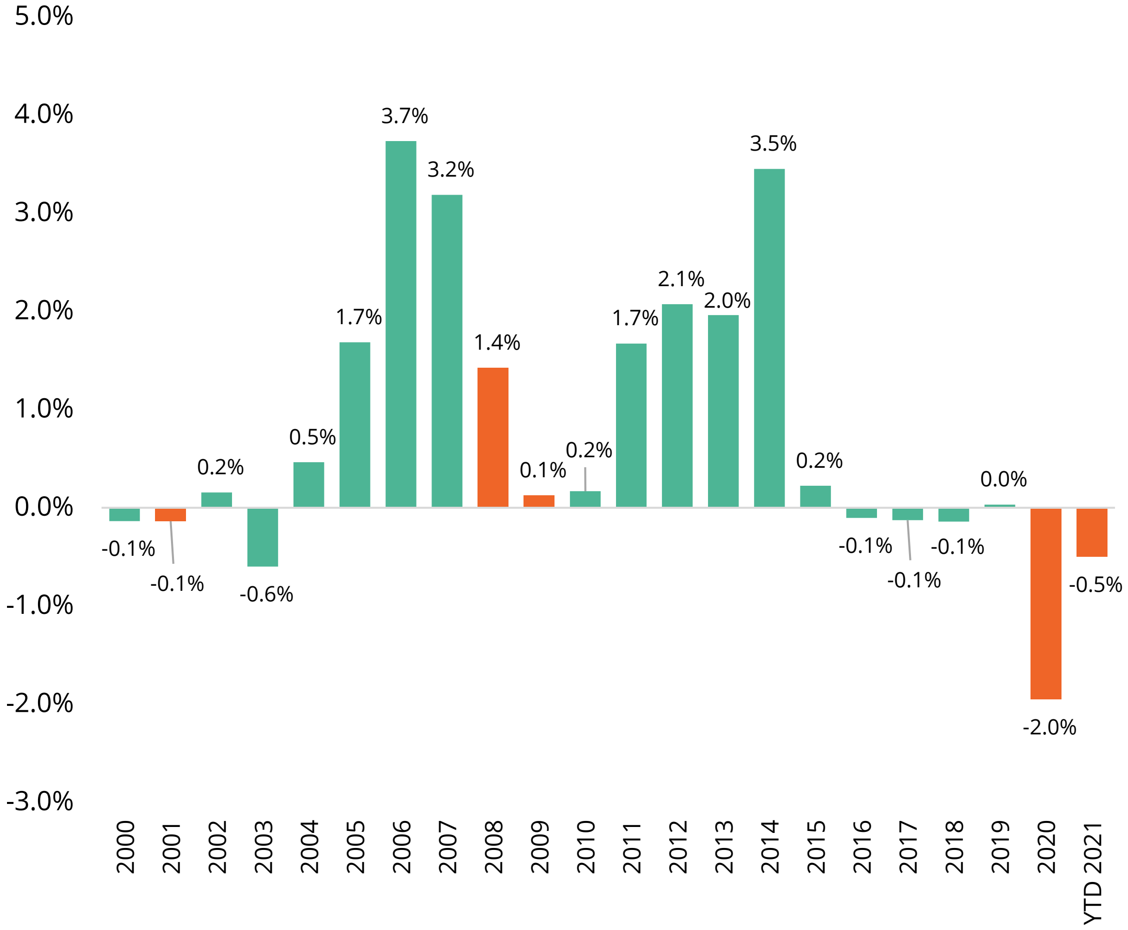
Source: AVANT by Avison Young

Absorption

-2.5%

Net absorption as a percentage of inventory, 2020 through Q2 2021

Negative absorption from 2020 to the second quarter of 2021 has totaled 5.6 msf, representing -2.5% of the existing stock. This negative absorption significantly surpasses the lows of the early 2000's recession (-0.1%), the Great Recession (1.5%) and Houston's energy crisis (-0.1%).



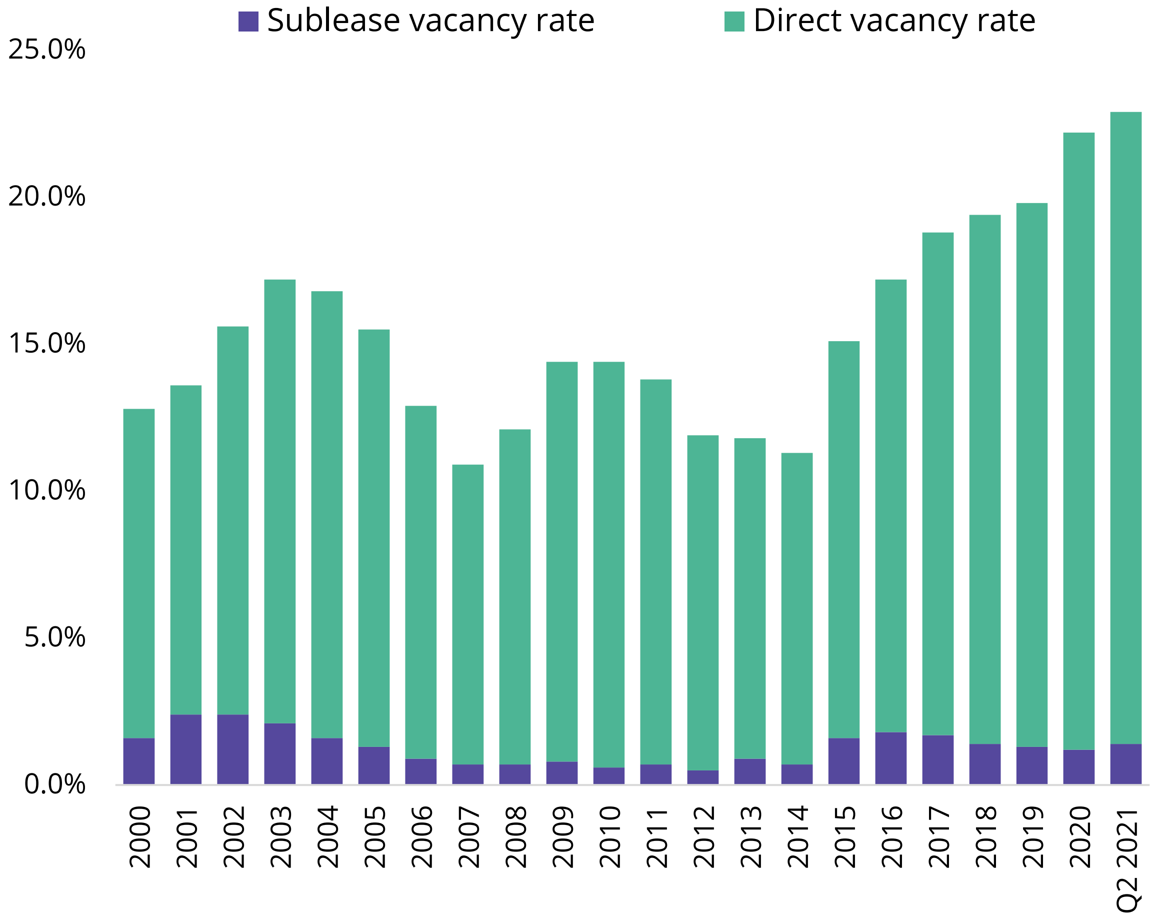
Source: AVANT by Avison Young

Vacancy rate

22.9%

Record high Houston vacancy as of Q2 2021

The second quarter of 2021 vacancy rate is a record high in terms of sublease, direct and total percentages. Sublease space accounts for only 1.4% of the total vacant space, and up until 2021, reported a decrease in square footage. Vacant direct space jumped dramatically during 2020 but has added less than 22% of that total in 2021.



Source: AVANT by Avison Young

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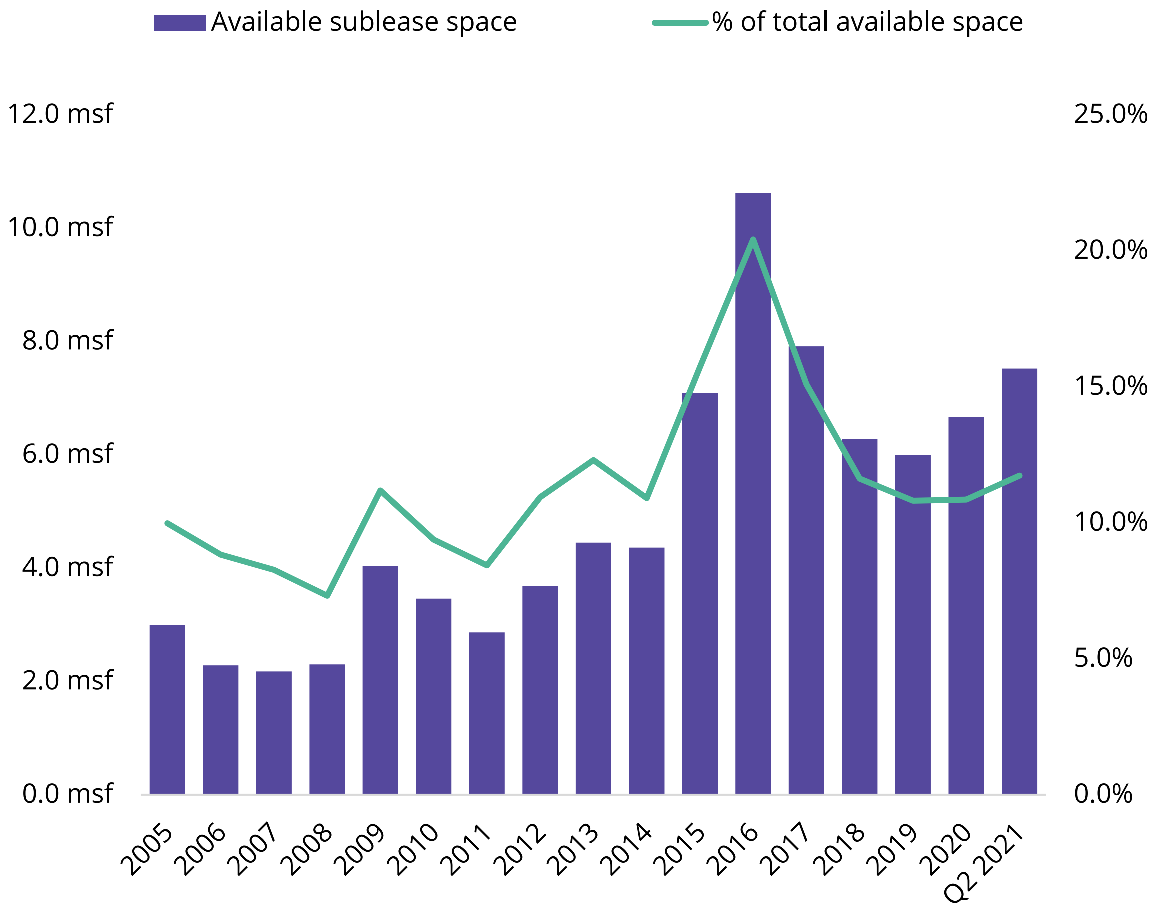
Available sublease space

7.5 msf

Increasing levels of available sublease space

The share of sublease-to-total available space of 11.7% is trending higher after several years of declining space, following the record-setting 10.6 msf added to the market during Houston's energy crisis in 2015-2016.



Source: AVANT by Avison Young

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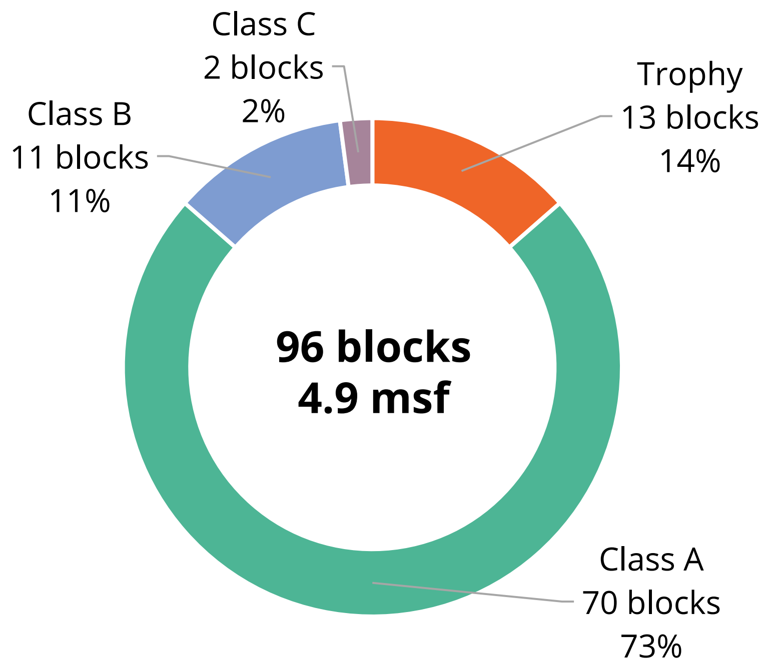
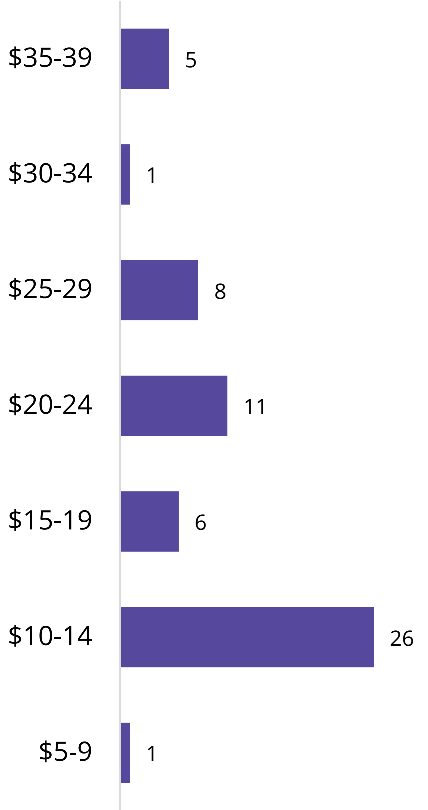
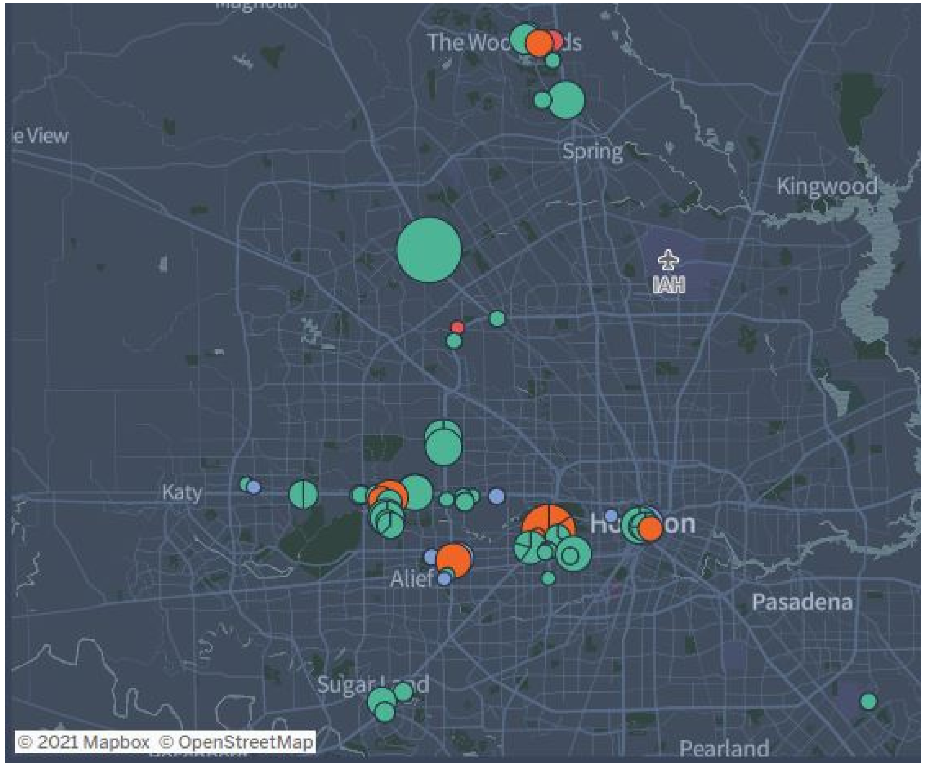
Sublease supply pipeline

Building classification



Asking rent per square foot





Source: AVANT by Avison Young

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Houston's under-construction inventory

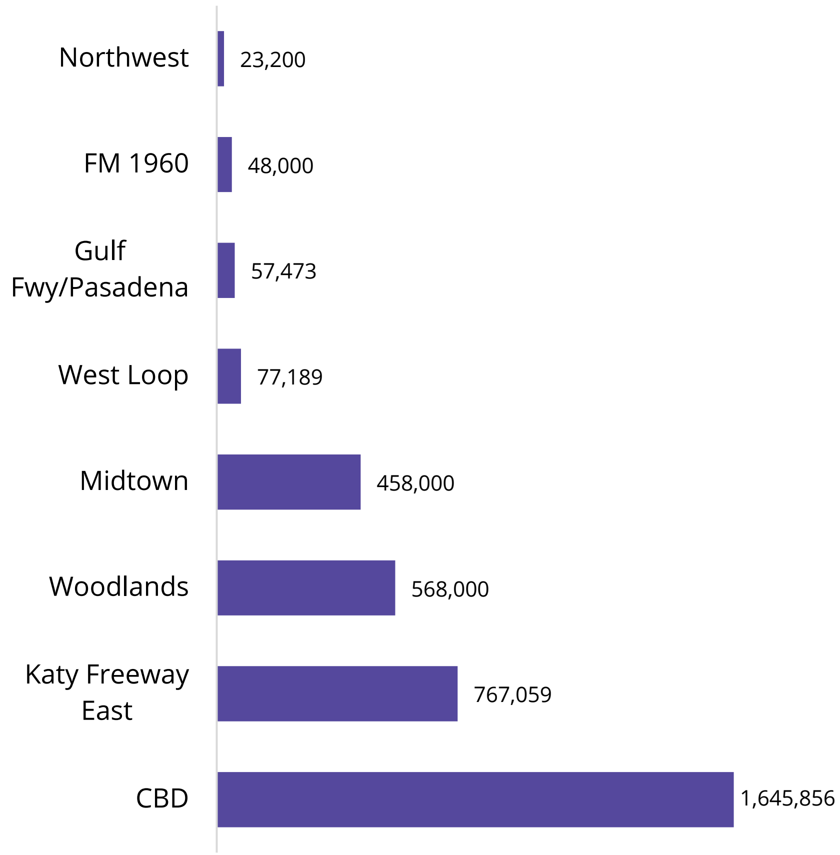
15 properties

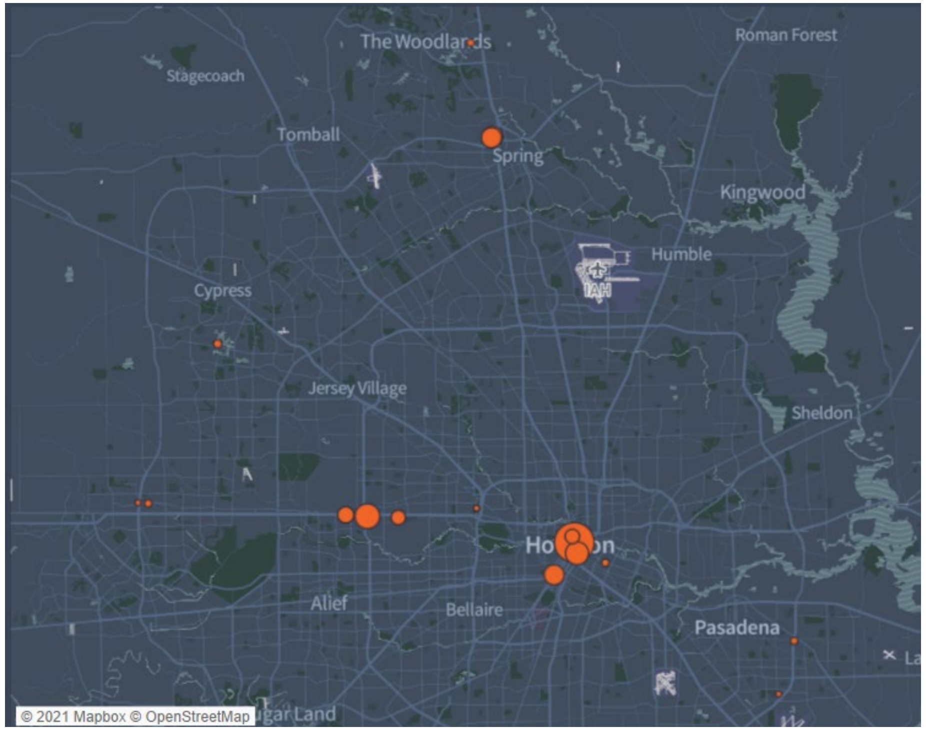
3.6 msf
under construction

1.4%
share of office inventory

52.5%
preleased

Square footage underway in submarkets





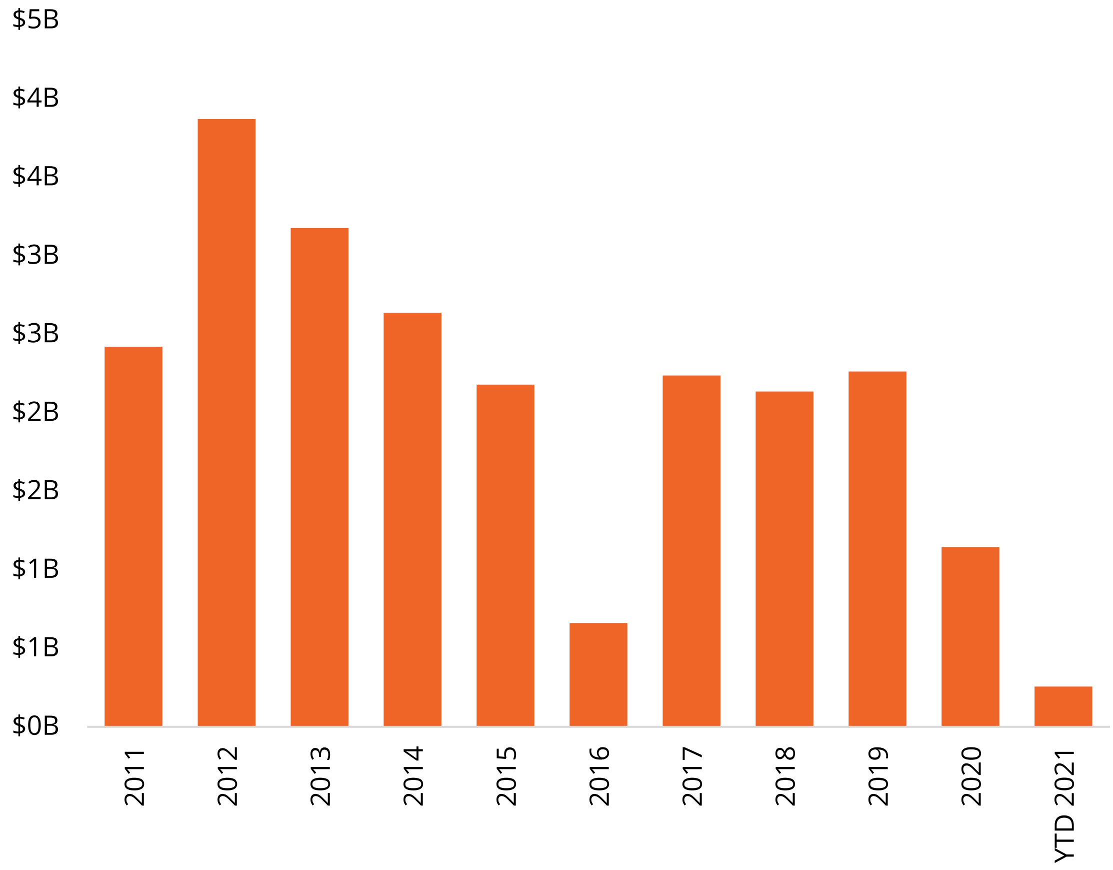
Source: AVANT by Avison Young

Office investment dollar volume

$1.4B

Houston office dollar volume 2020 to present

Office sales activity has temporarily paused during the risk-pricing crisis, decreasing by 40.9% compared with the prior five-year average dollar volume.



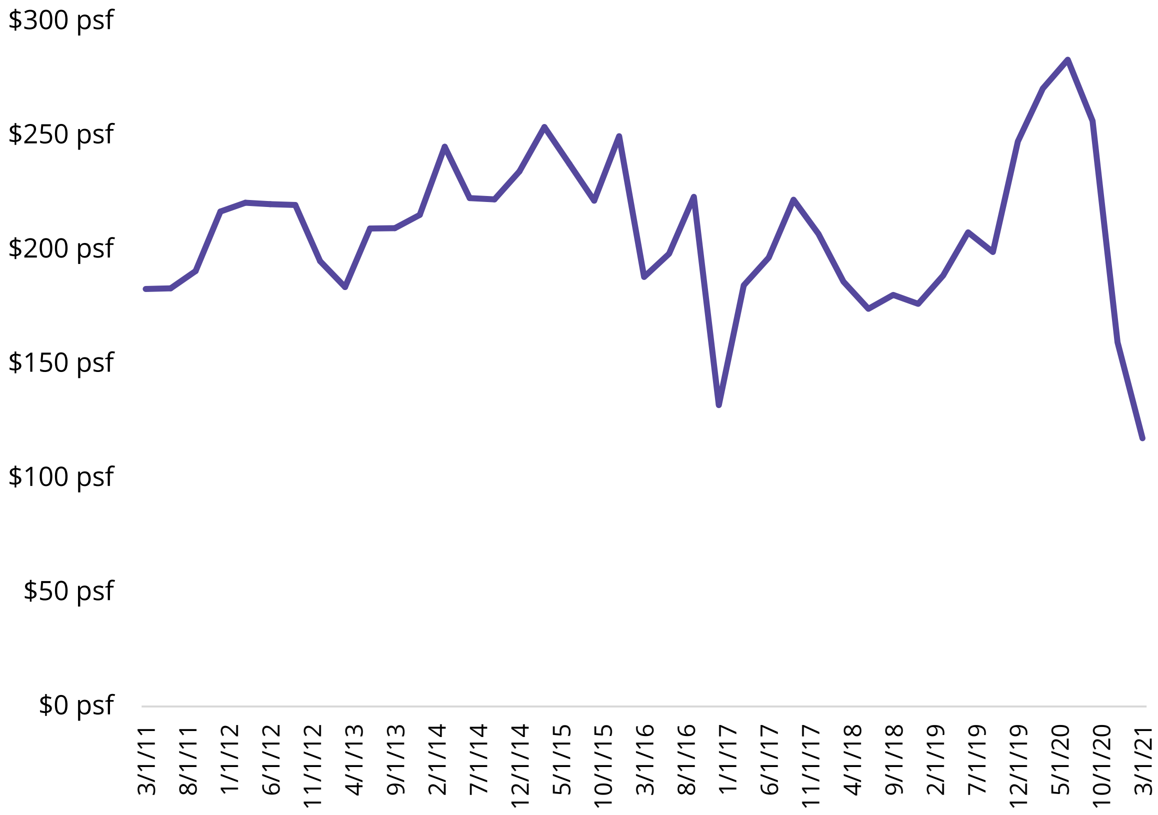
Source: AVANT by Avison Young, RCA

Office asset pricing

-55.1%

Houston office pricing from December 2019 to December 2020

Pricing has plunged during the pandemic as investors have adopted more conservative underwriting approaches, decreasing from $271 psf in December 2019 to $159 psf in December 2020. However, asset pricing has trended incrementally upward in recent months, indicating a potential stabilization.



Source: AVANT by Avison Young, RCA

Looking forward

Here's what we can expect

- A recent membership poll by the **Greater Houston Partnership** reported most firms would be back in the office by the end of June, but the number of days required of employees was a mixed bag. Over 20% of the firms are planning to eventually reduce their footprint, and that number may increase with flex schedules.
- Bellwether **companies are beginning to return to the office**, a leading indicator for rejuvenated office demand. Two leading financial services firms, Goldman Sachs and JPMorganChase, returned to work in June, which could have a trickle-down effect on other banks and industry segments.
- **Office leasing demand is incrementally rising** as indicated by increasing term lengths, though continued downward momentum is anticipated on net effective rents at commodity properties.
- **Cap rates and asset pricing are poised to remain steady** based on the sizable gap between cap rates and benchmark yields, positive occupier and economic momentum and investors' renewed focus on core transaction profiles.

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Get in touch

Patsy Fretwell

Senior Data Analyst, South Team
Innovation and Insight
+1 713 993 7151
patsy.fretwell@avisonyoung.com

Erin Potts

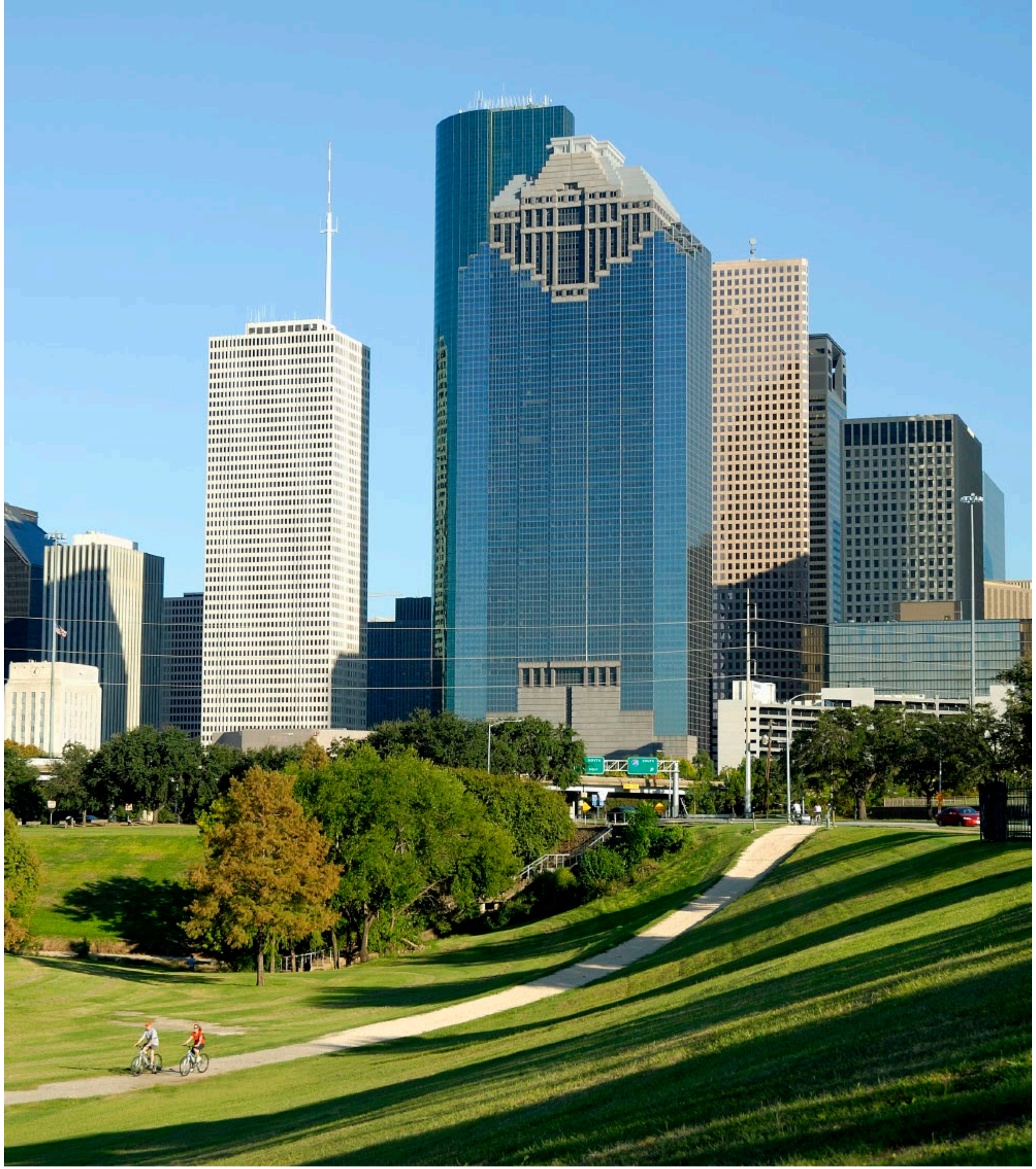
Marketing Manager
+1 713 993 7164
erin.potts@avisonyoung.com

Anthony Squillante

Principal
+1 713 993 7831
anthony.squillante@avisonyoung.com

Rand Stephens, SIOR

Principal & Managing Director
+1 713 993 7810
rand.stephens@avisonyoung.com



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Let's talk

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