Houston office market report

Q2 2024

AVISON YOUNG

Houston office market trends

385k sf

Trophy assets leading recovery with strong absorption gains

The trophy segment absorbed 385k sf during Q2 2024, outperforming the broader Houston office market which experienced a net occupancy loss of 237k sf in Q2 2024. While the class A sector experienced negative absorption during the quarter, the bulk of the losses occurred in older vintage assets built prior to 1990. This negative absorption reflects large tenants like Norton Rose Fulbright and Apache Corp. relocating to higher quality spaces and reducing their footprints. However, there are some expansions in the market such as Vitol's recent 150k sf pre-lease at The RO, a mixed-use development, that will accommodate their future expansion in 2026.

14.2%

Trophy assets continue to boast lower vacancy rates

The Houston office market's overall vacancy rate is at 26.6%, reflecting a 10-basis point (bps) increase year-over-year. There is a significant spread in vacancy rates between older and newer buildings. Office buildings constructed in the 1980s have the highest vacancy rate at 31.3%. In contrast, buildings built since the 2000s have much lower vacancy rates, ranging from 11.4% to 12.2%. Well-capitalized landlords that have been able to renovate their older properties with improved amenity offerings are expected to capture a larger share of the demand as the trophy and Class A+ segment tightens further.

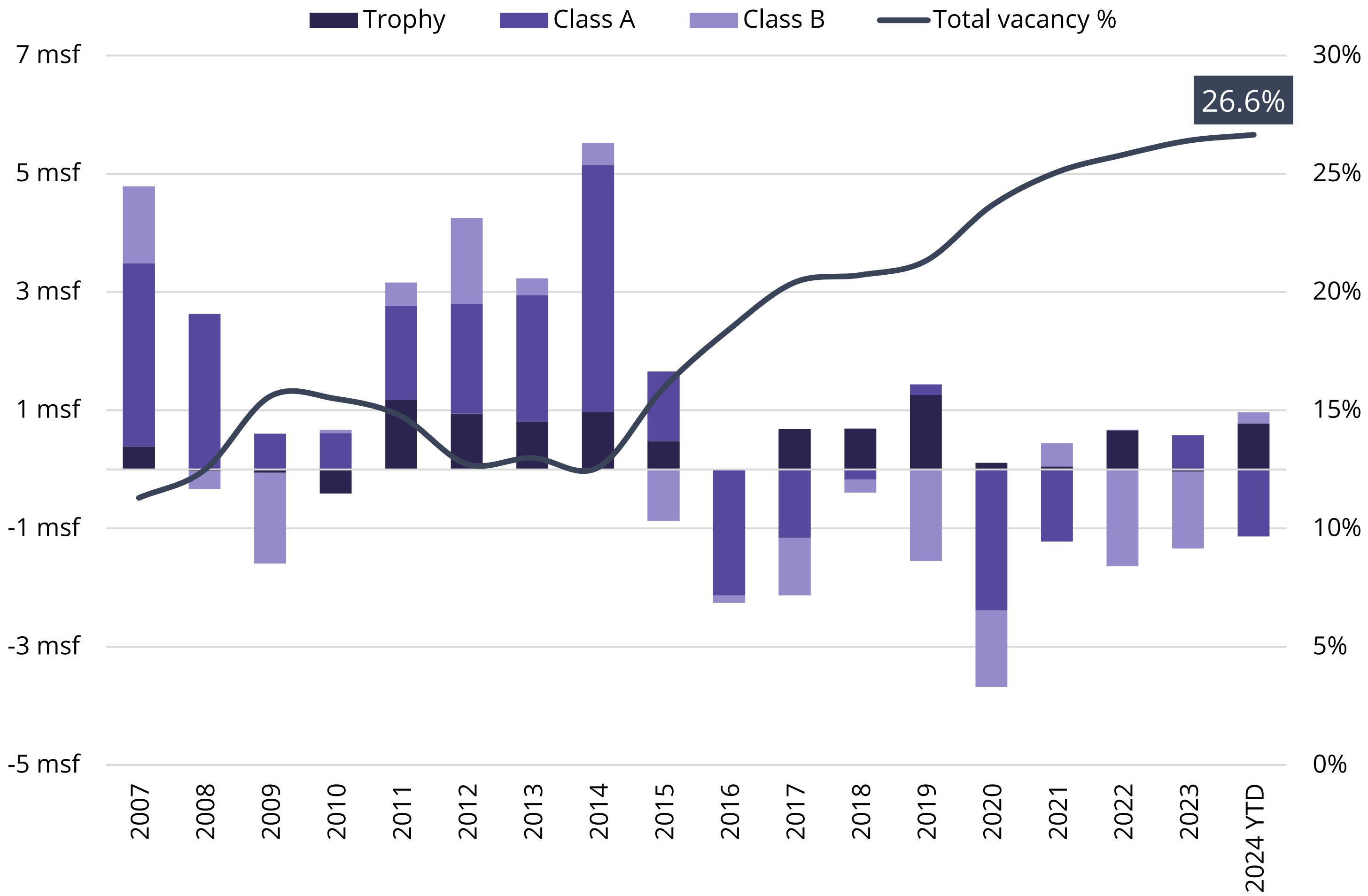
5.2 msf

Leasing activity slowdown during first-half of 2024

Houston's office leasing activity reached 2.7 msf in Q2, bringing the first half of 2024 to a total of 5.2 msf leased, reflecting a significant 34.0% decline compared to the strong leasing activity observed in the same period of 2023. The energy and engineering sectors, as expected for Houston's energy-driven economy, continued to lead the market, leasing a combined 44.7% of the total space leased. The overall decline in office leasing demand is likely due to companies embracing new technologies that streamline operations and optimize workforces, along with use of hybrid and remote work models.

Source: AVANT by Avison Young, CoStar

Houston office net absorption by class



The trophy office segment continues to perform well, with 778k sf of positive absorption recorded during the first-half of 2024, demonstrating strong demand for high-quality space, with tenants prioritizing modern amenities and functionality.

Source: AVANT by Avison Young, CoStar

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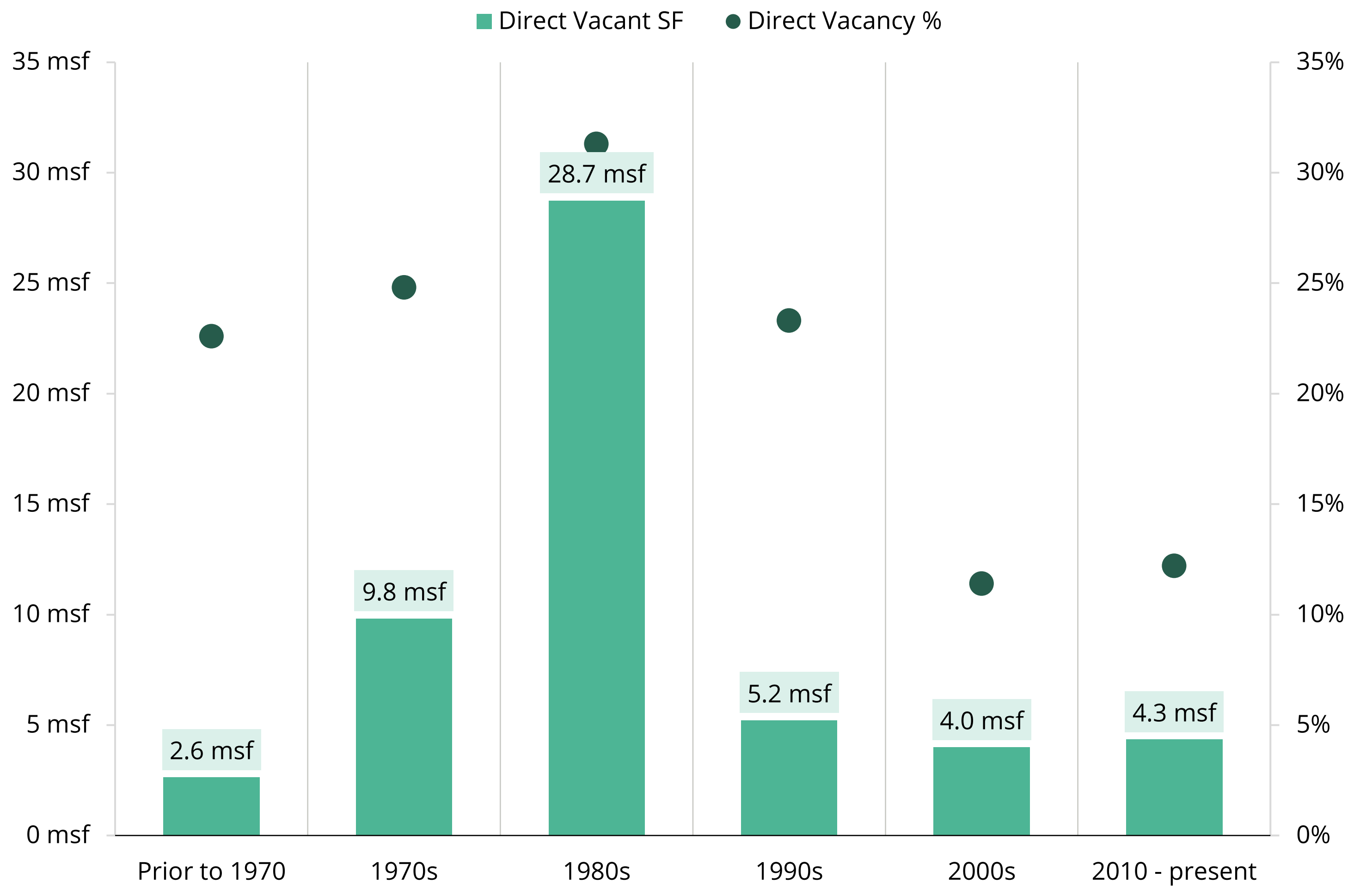
Houston office vacancy by vintage



Houston's office market is adapting to new realities. While citywide vacancy rates are at an all-time high, tenants are clearly shifting their preference for high-quality buildings with modern amenities and functionality as evidenced in the year-built vacancy disparity.

Source: AVANT by Avison Young, CoStar

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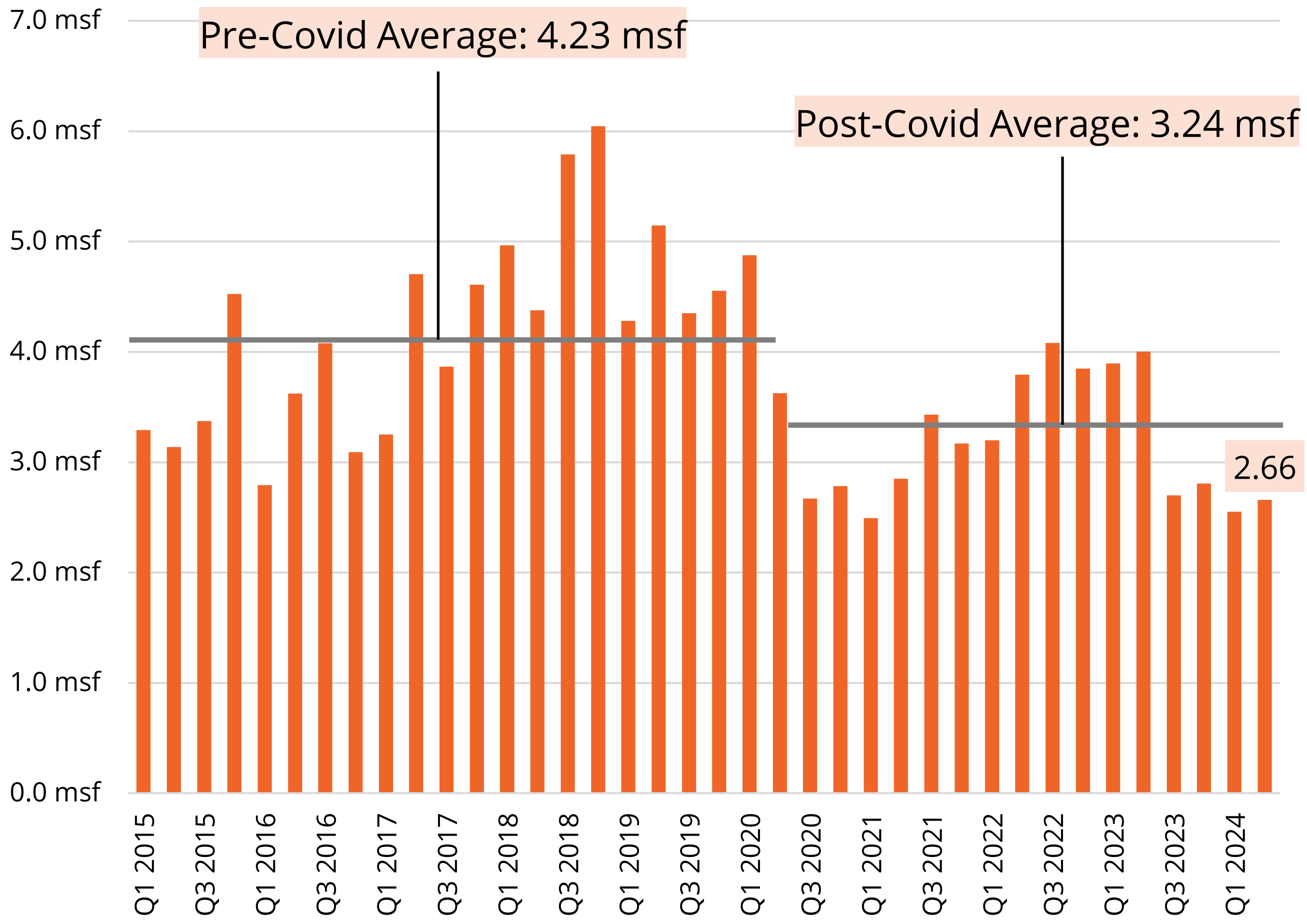
Houston office leasing activity



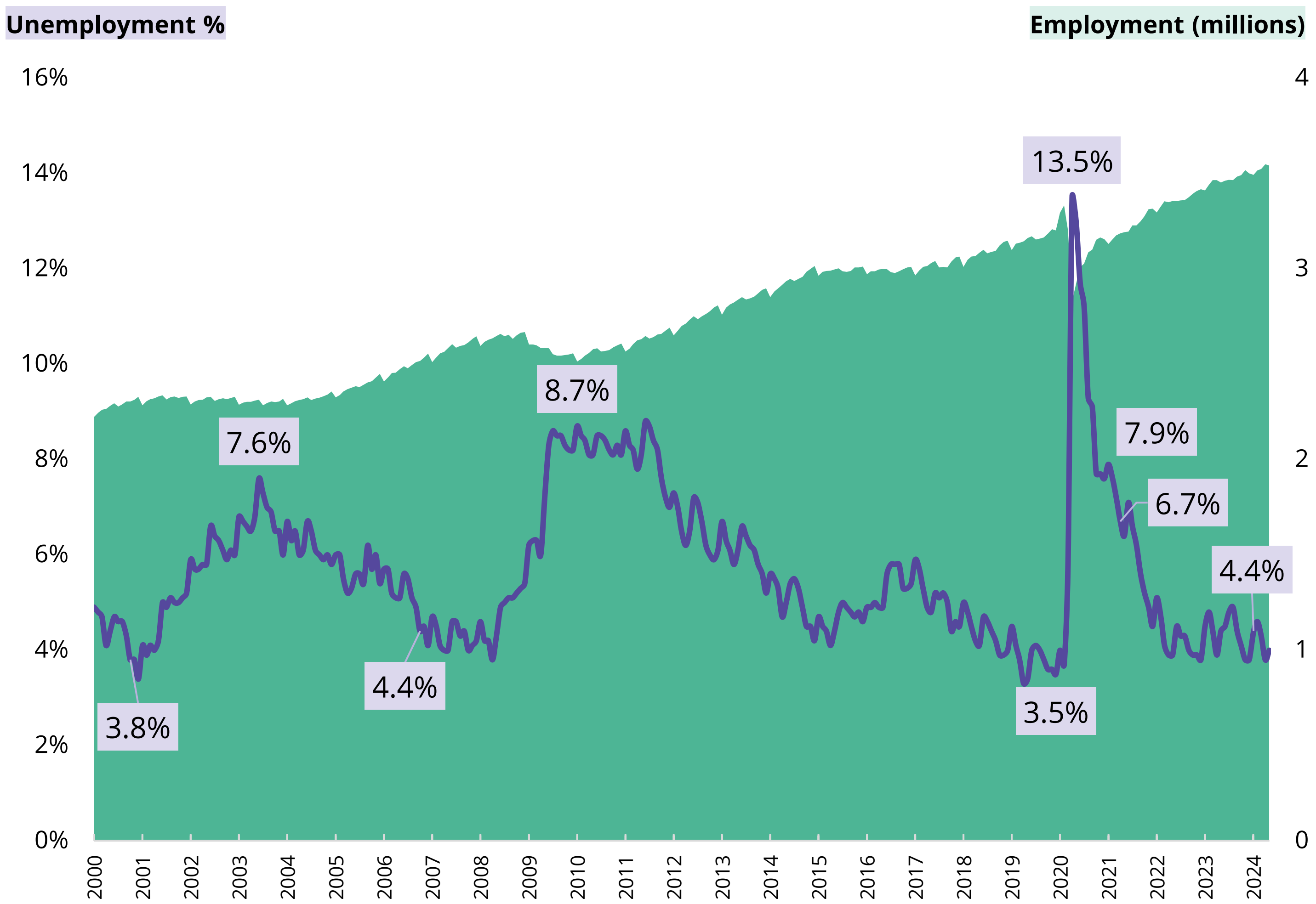
Leasing activity in Q2 totaled 2.7 msf, which remains 36% below the 5-year pre-Covid leasing average. The slower pace in leasing activity has likely been impacted by a more challenging debt and liquidity environment for building owners, preventing larger deals from occurring as easily with their lenders, and the use of hybrid and remote work.

Source: AVANT by Avison Young, CoStar

Houston employment trends

Let's examine the economic trends impacting the office sector

Employment and unemployment rate



Source: Bureau of Labor Statistics, Texas Workforce Commission.

While employment gains are starting to slow down to a more normalized pace compared to the rapid rebound experienced in years immediately following COVID, Houston's economy remains strong with nearly 90,000 jobs created over the past year. Further, the unemployment rate remains relatively low at 4.0%.

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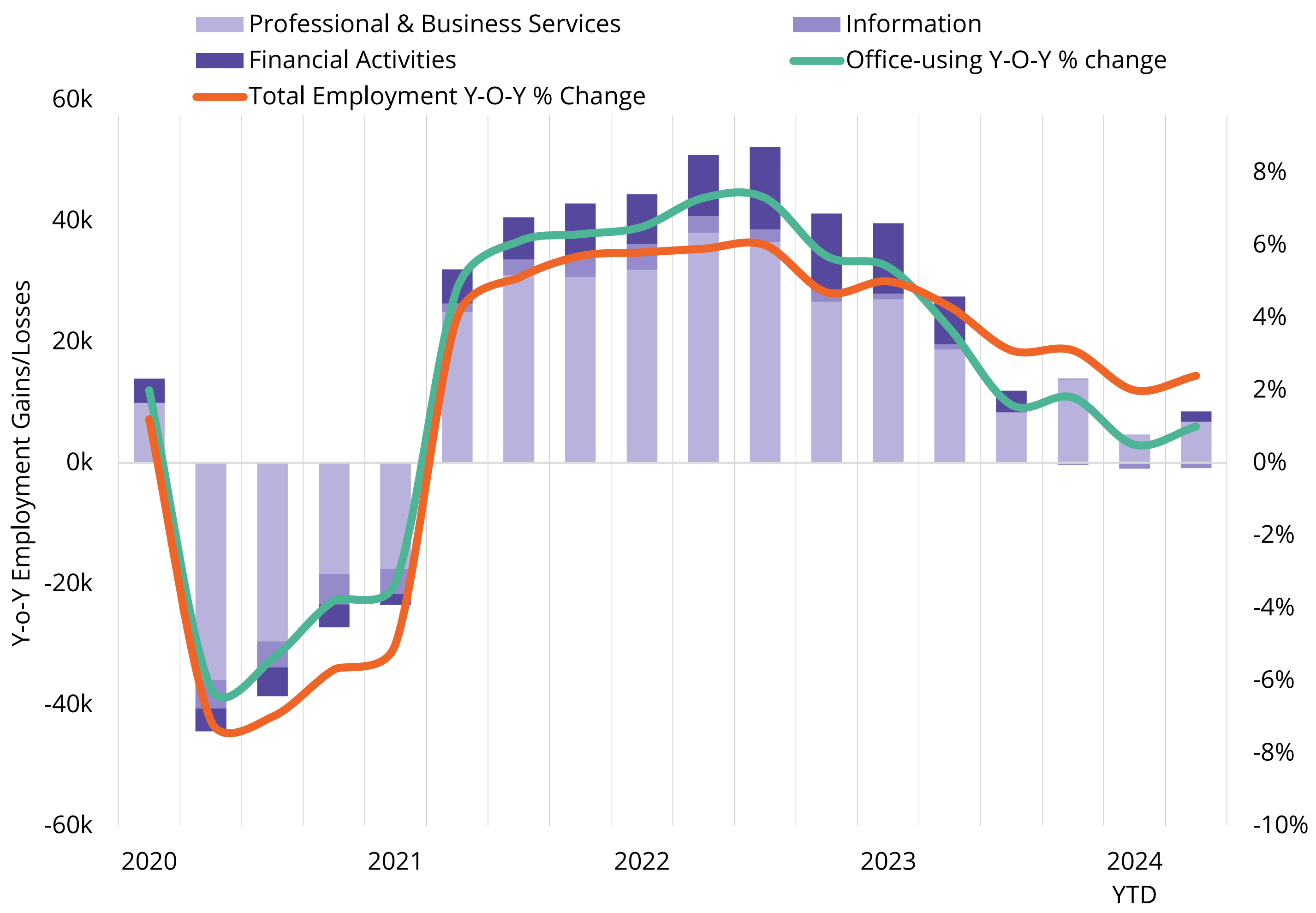
Houston office-using job gains



Strong office job growth has helped buoy the Houston metro economy, with 65k jobs gained since its pre-pandemic peak in February 2020. However, office job growth has not created a direct correlation between it and office space demand.

Source: Bureau of Labor Statistics

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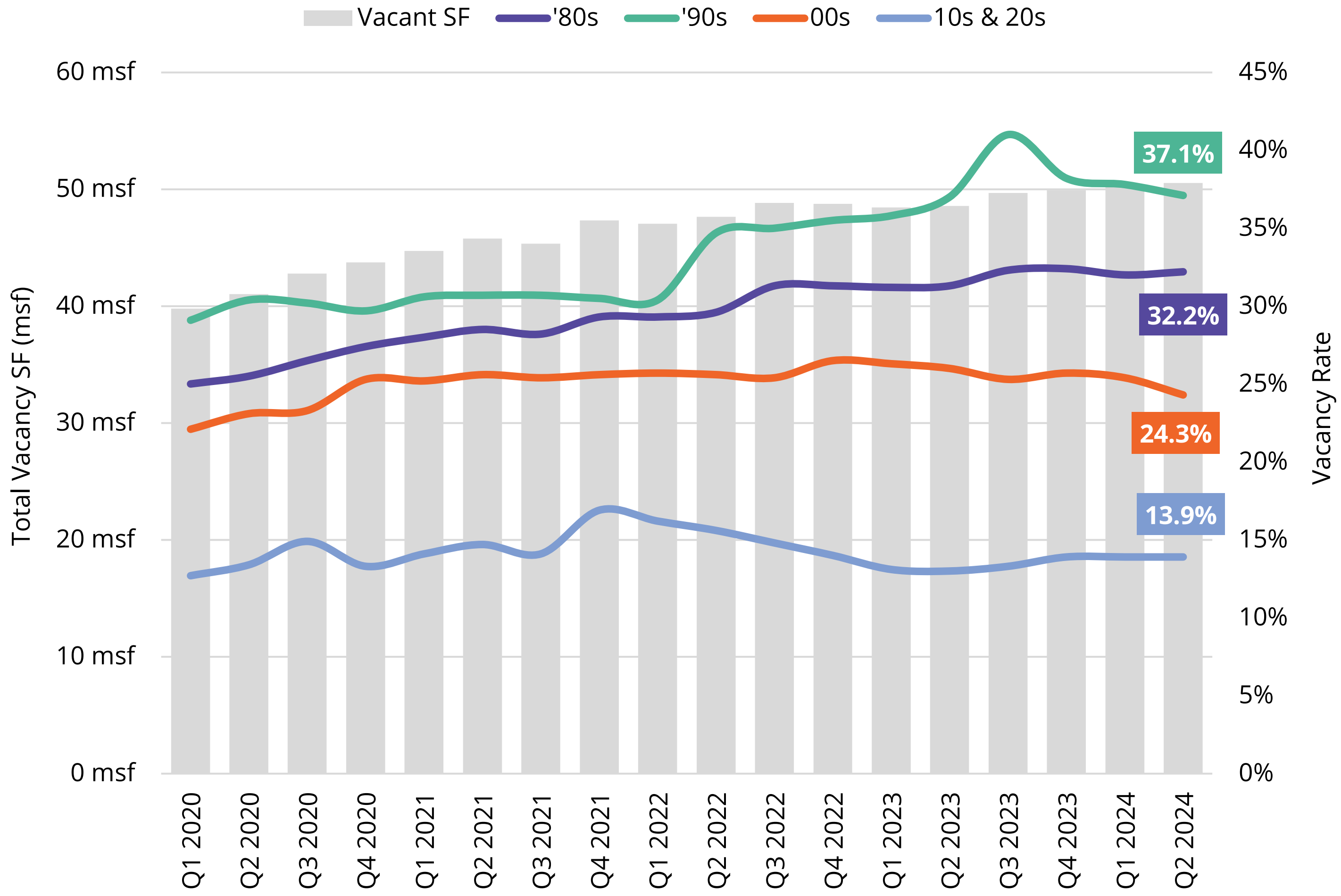
Occupier market conditions

Let's examine more prevailing office trends

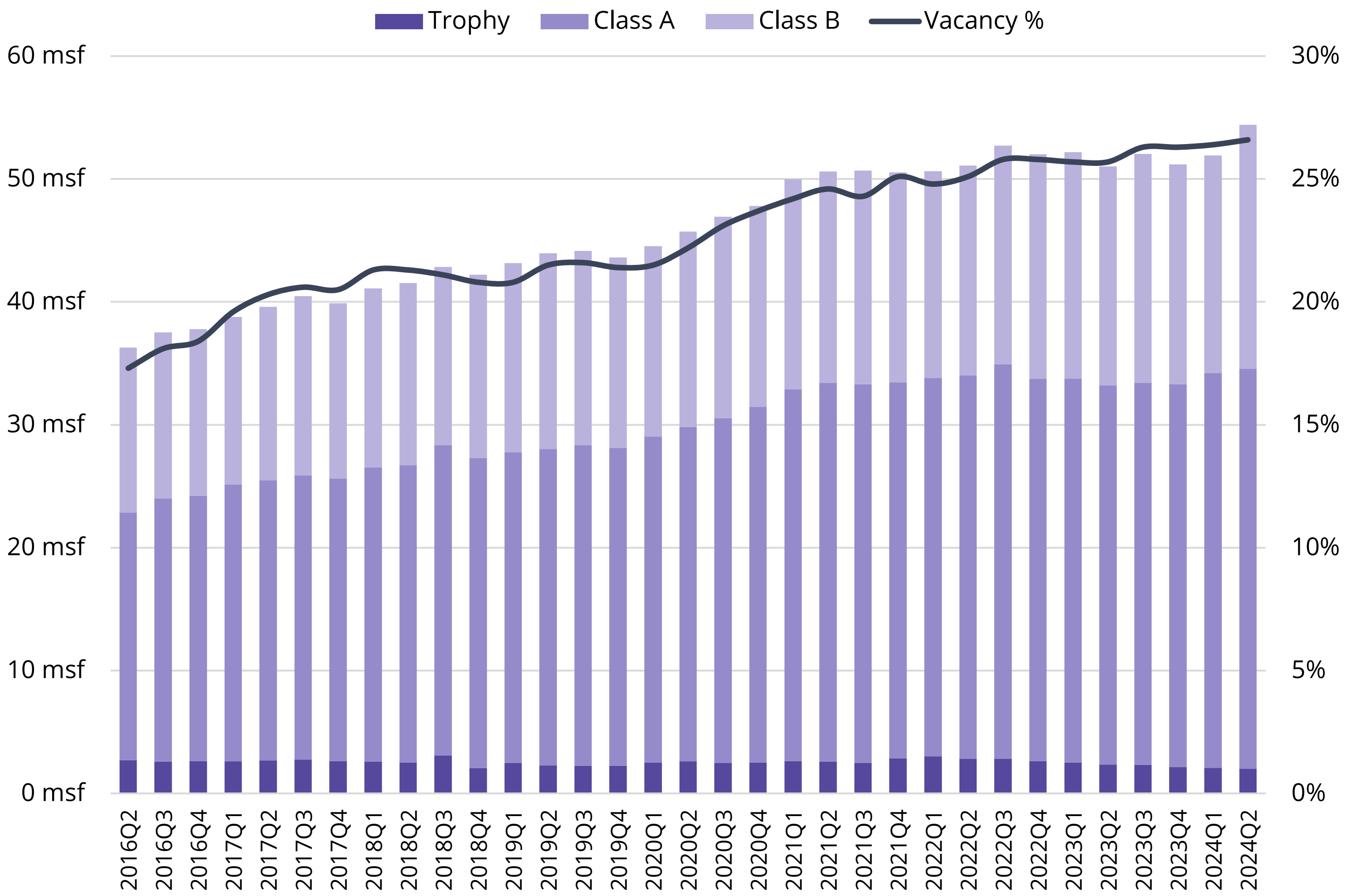
Total vacancy by building age group



Source: AVANT by Avison Young, CoStar

A stark divide is emerging in Houston's office market. Newer office buildings constructed since 2010 boast significantly lower vacancy rates at just 13.9% compared to a much higher vacancy rate exceeding 32.2% for older vintage assets built prior to 2000.

Direct availability by class vs vacancy



As flight-to-quality persists and the construction pipeline remains limited, a diminishing supply of high-quality space options is being experienced. With a tightening market for premium spaces, tenants will be forced to consider the next highest quality tier of space, causing a trickle-down effect.

Source: AVANT by Avison Young, CoStar

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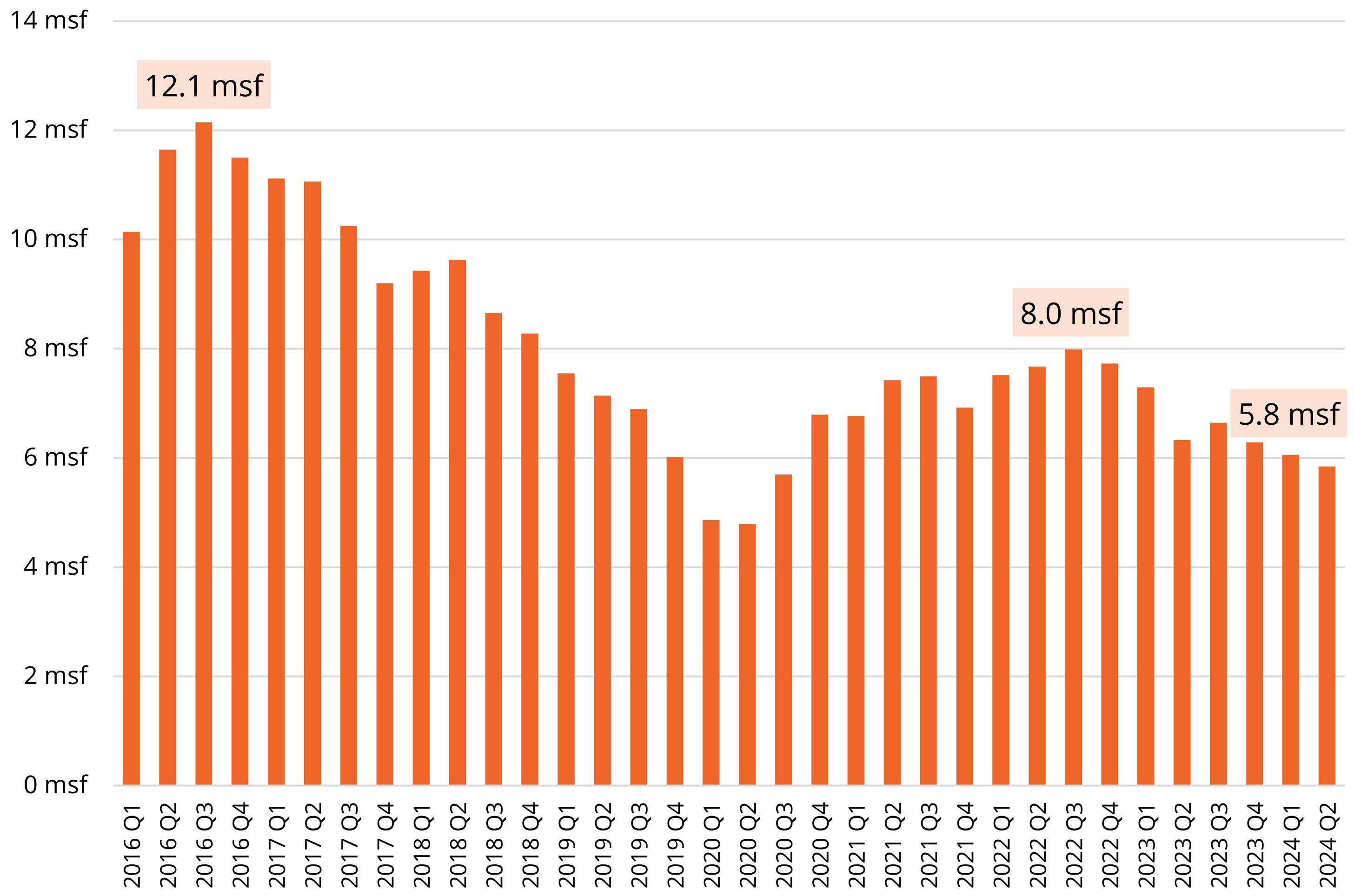
Available sublet space



Houston's available sublease space has declined by 7.6% over the past year, reaching 5.8 msf – its lowest level since 2020. The current amount of sublease space available is indicative of a dramatic drop from the city's all-time high of 12.1 msf recorded in Q3 2016, marking a 45% decrease from the peak following the oil bust.

Source: AVANT by Avison Young, CoStar

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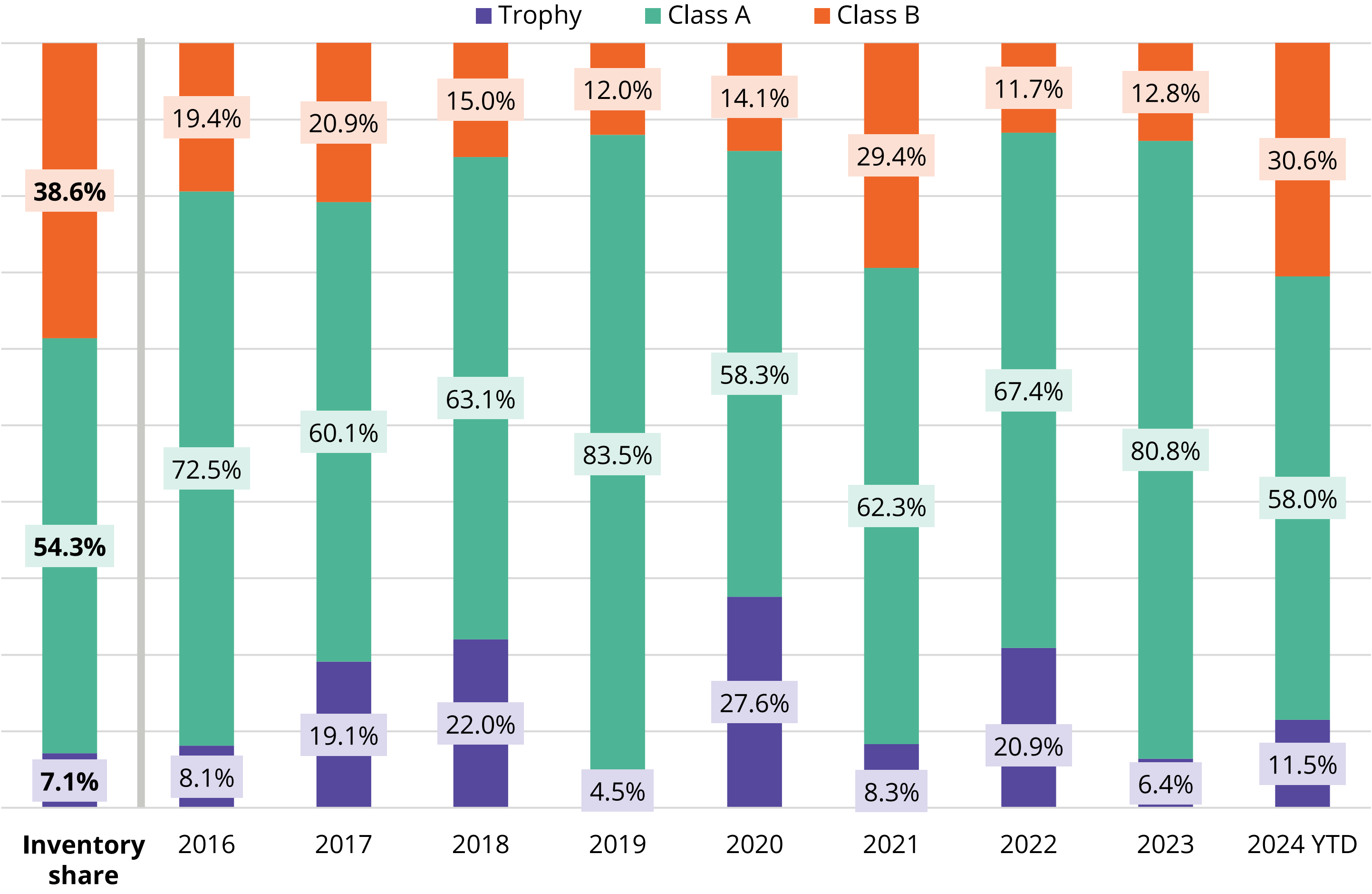
Leasing activity by asset class



Trophy and class A assets continue to outperform the broader market, accounting for 83% of leasing activity since 2016 while making up 61% of the inventory.

Source: AVANT by Avison Young, CoStar

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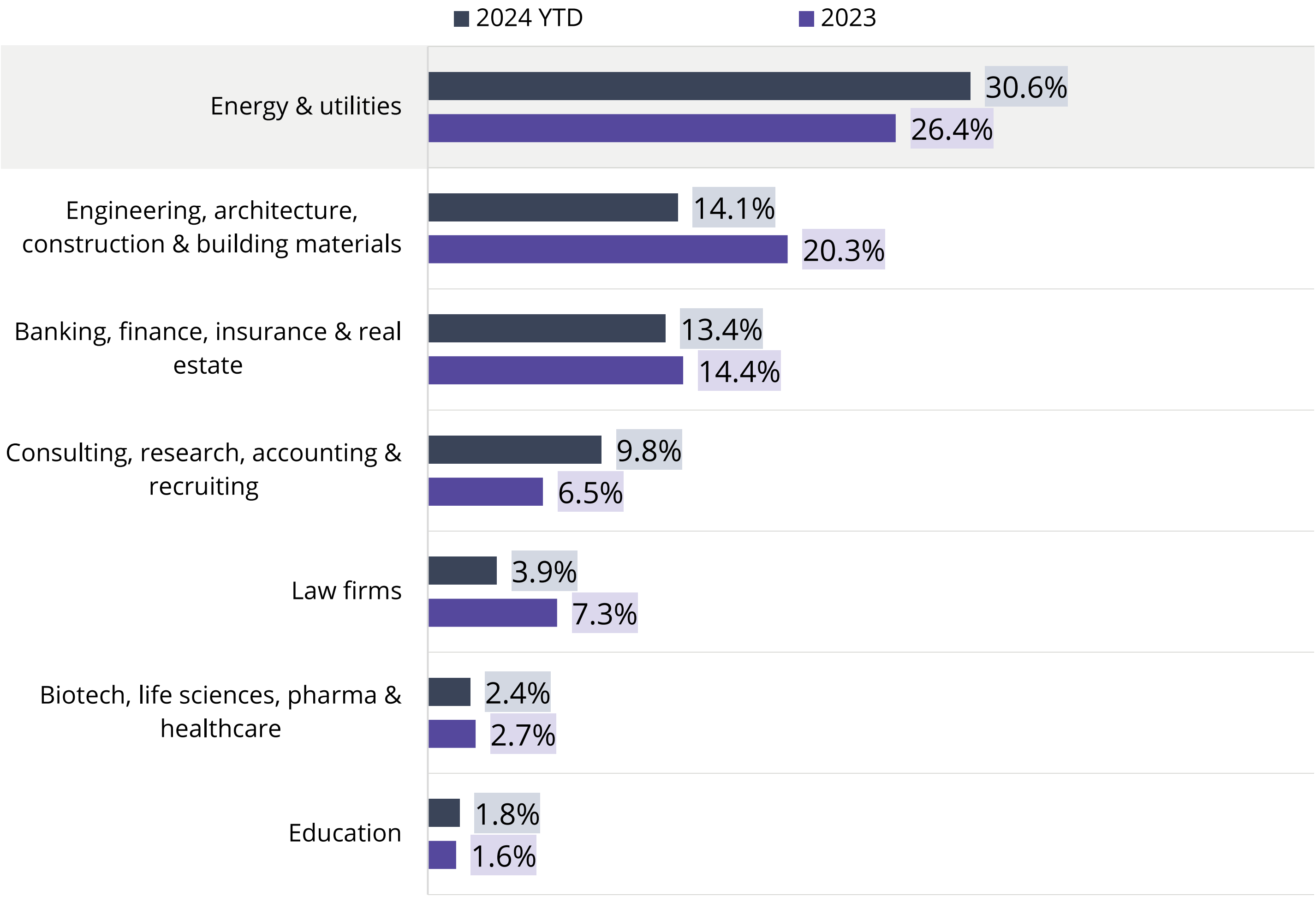
Leasing activity by industry sector



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

Energy-related firms continued to dominate in office leasing activity during the first-half of 2024, accounting for 30.6% of such leasing, followed by engineering, architecture and construction firms at 14.1% of total leasing volume.

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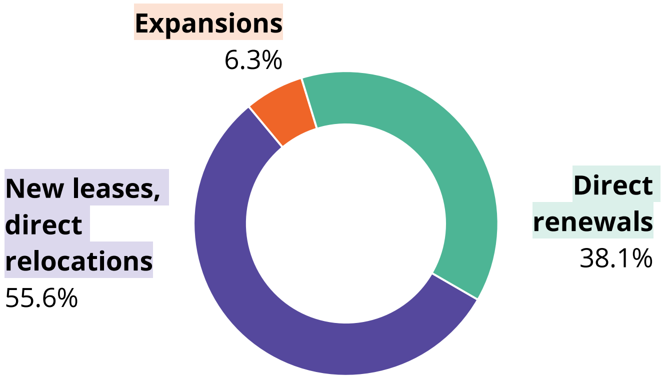
Transaction activity by lease type

26.0% Percent increase in new deals and expansions as a share of total leasing activity, 2024 vs. pre-COVID

The distribution of transaction activity has shifted, with new deals and direct relocations accounting for 67.0% of the year-to-date transactions above 10,000 sf, compared to 55.6% from 2018 to March 2020.

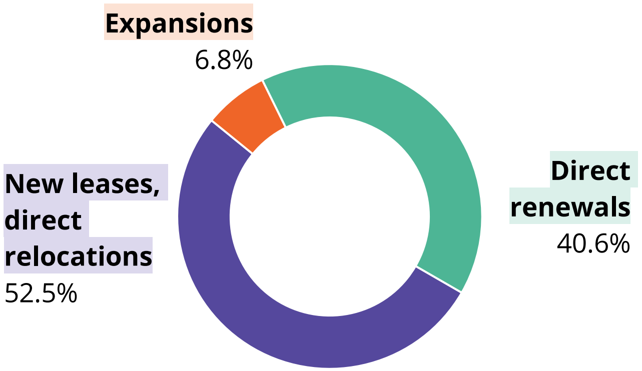
Pre-COVID

From 2018 to March 2020

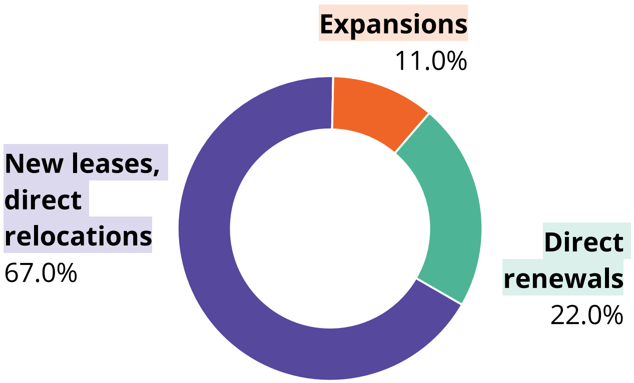


Post COVID

April 2020 to Present



YTD 2024



Source: AVANT by Avison Young

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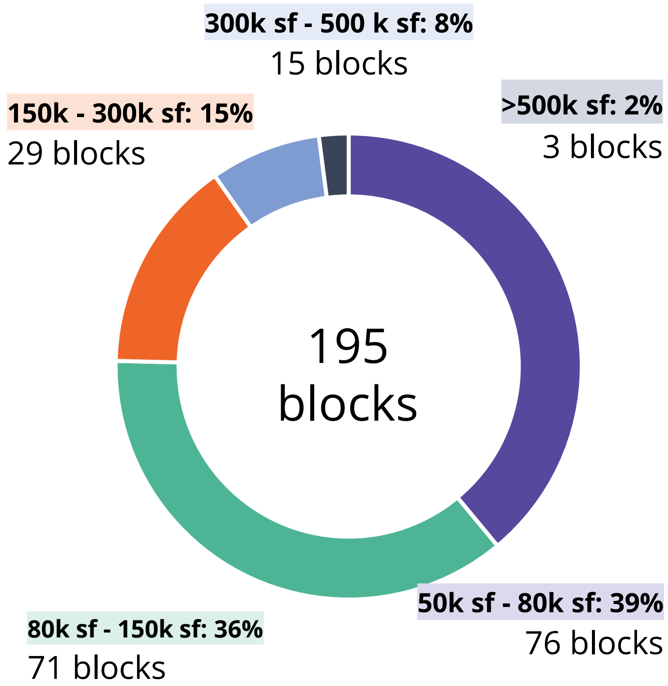
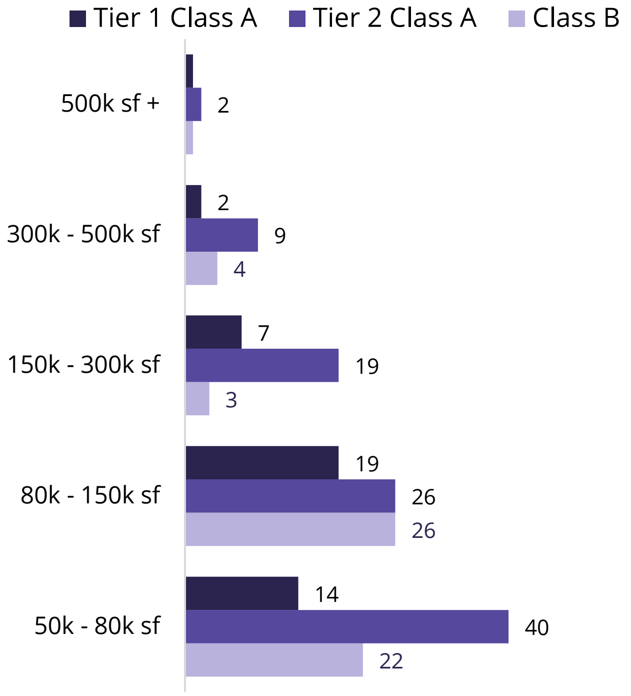
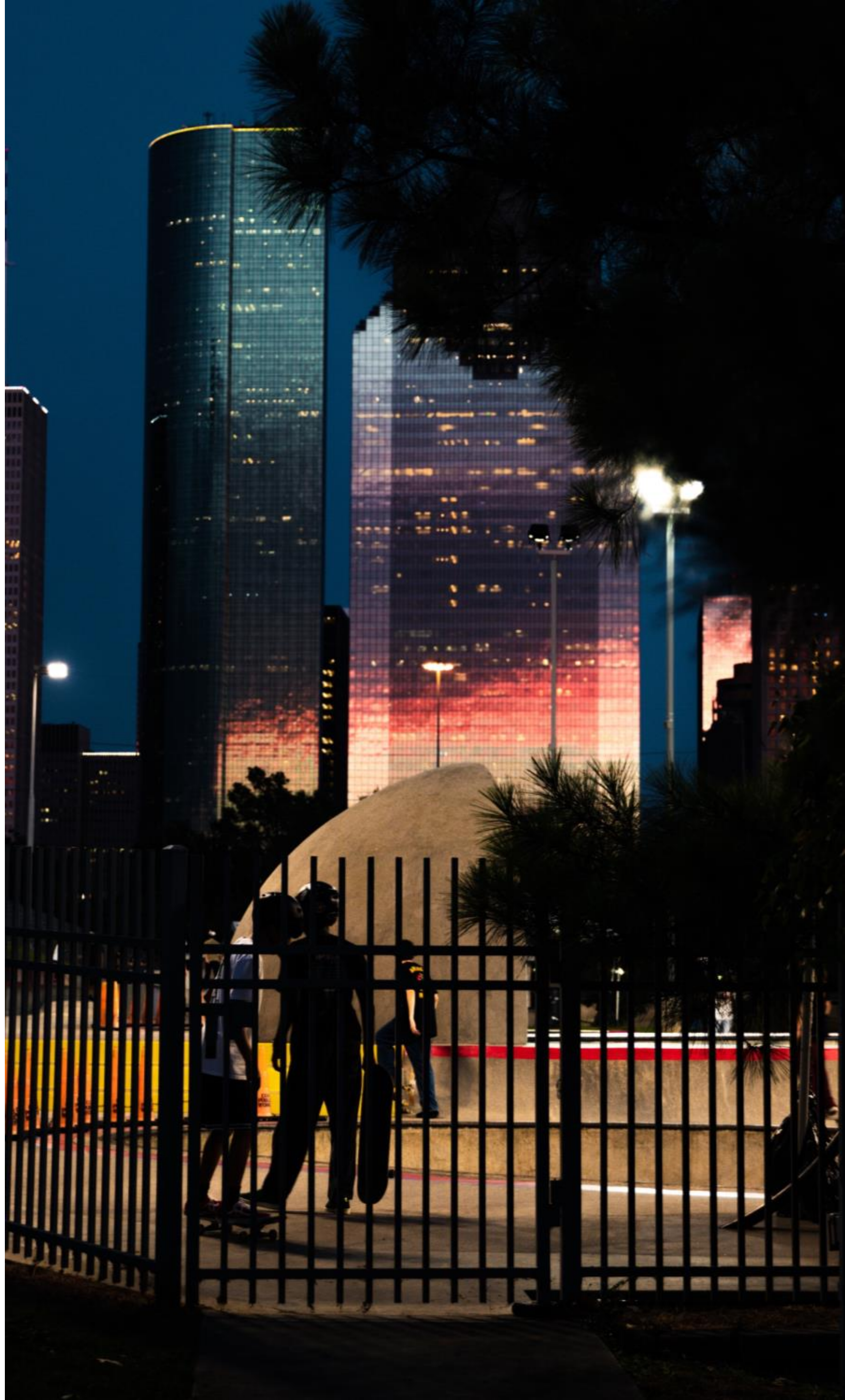
Houston office large block availability

Number of blocks by size



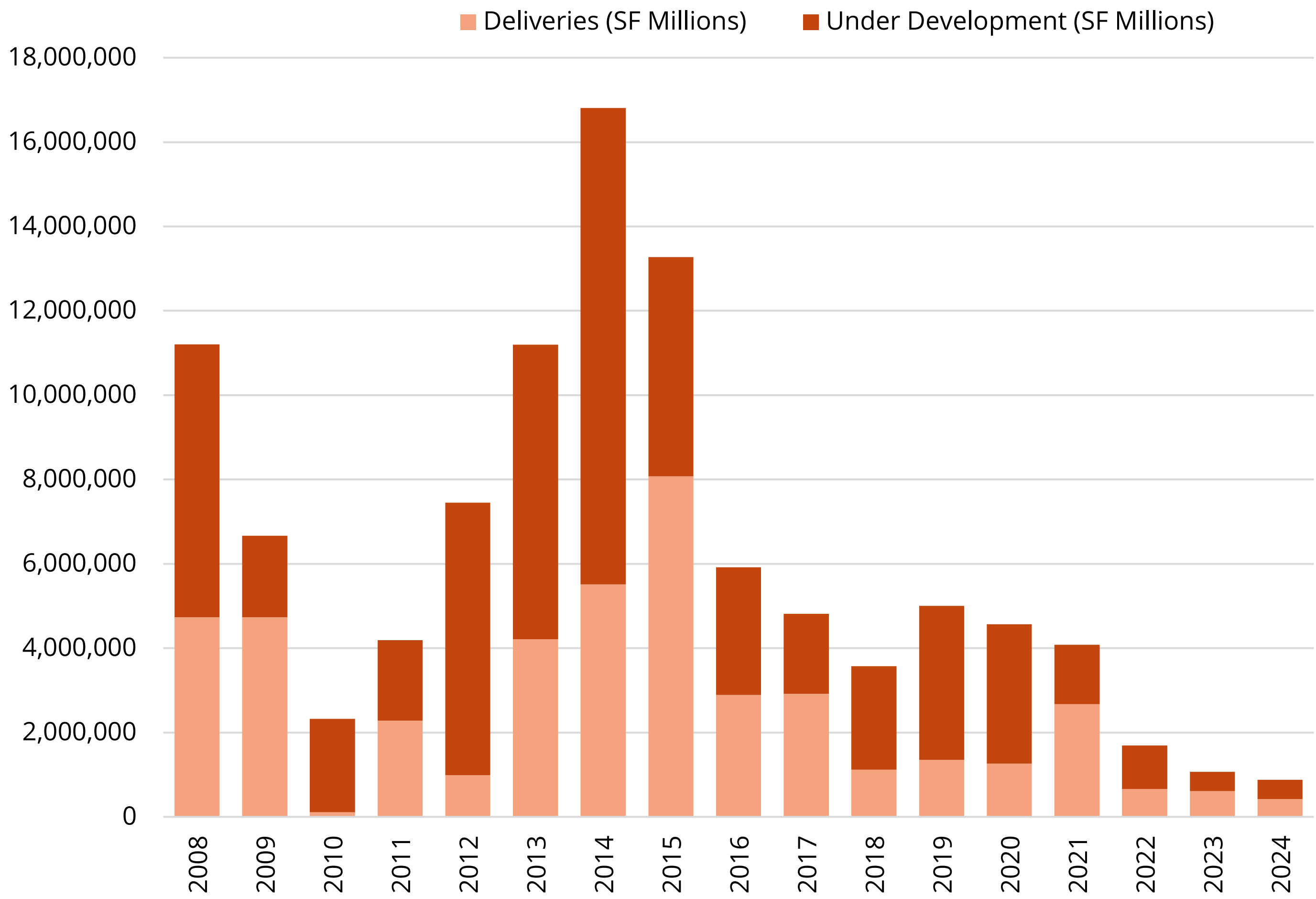
Blocks by quality of building





Source: AVANT by Avison Young, Costar.

Houston office development pipeline



A suppressed office construction pipeline and strong leasing demand for newer product has led to limited options for larger tenants. Highlighting this trend, CityCentre Six and The RO, both amenity-rich, mixed-use projects, secured significant pre-leases and have begun construction.

Source: AVANT by Avison Young, CoStar

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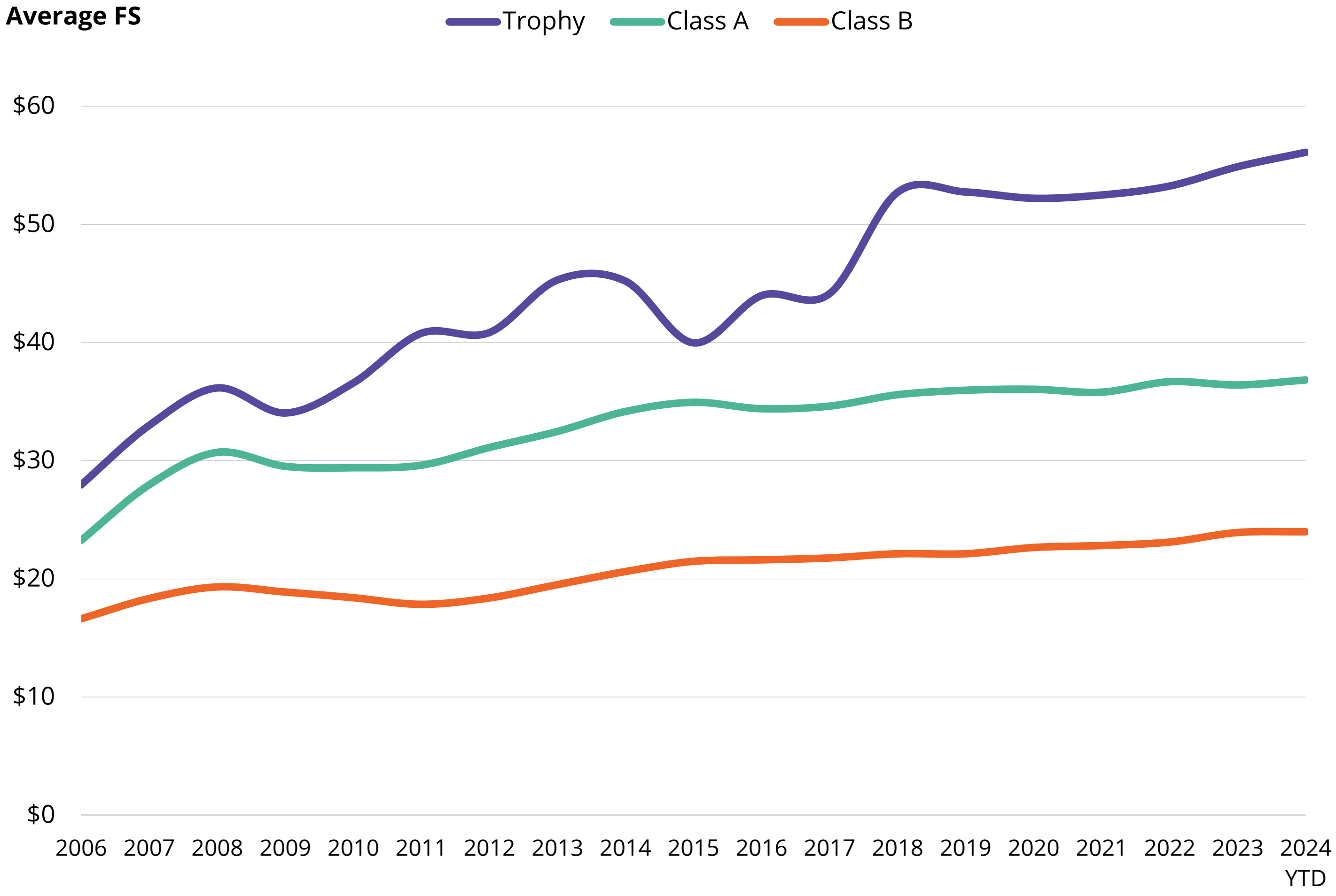
Houston office annual asking rents by class



Strong leasing demand for top quality spaces and fewer options is beginning to lead to asking rent growth within the trophy and class A+ segment of the market. However, asking rents in lower quality buildings are expected to remain flat (at best) in the near term due to an abundance of space options.

Source: AVANT by Avison Young

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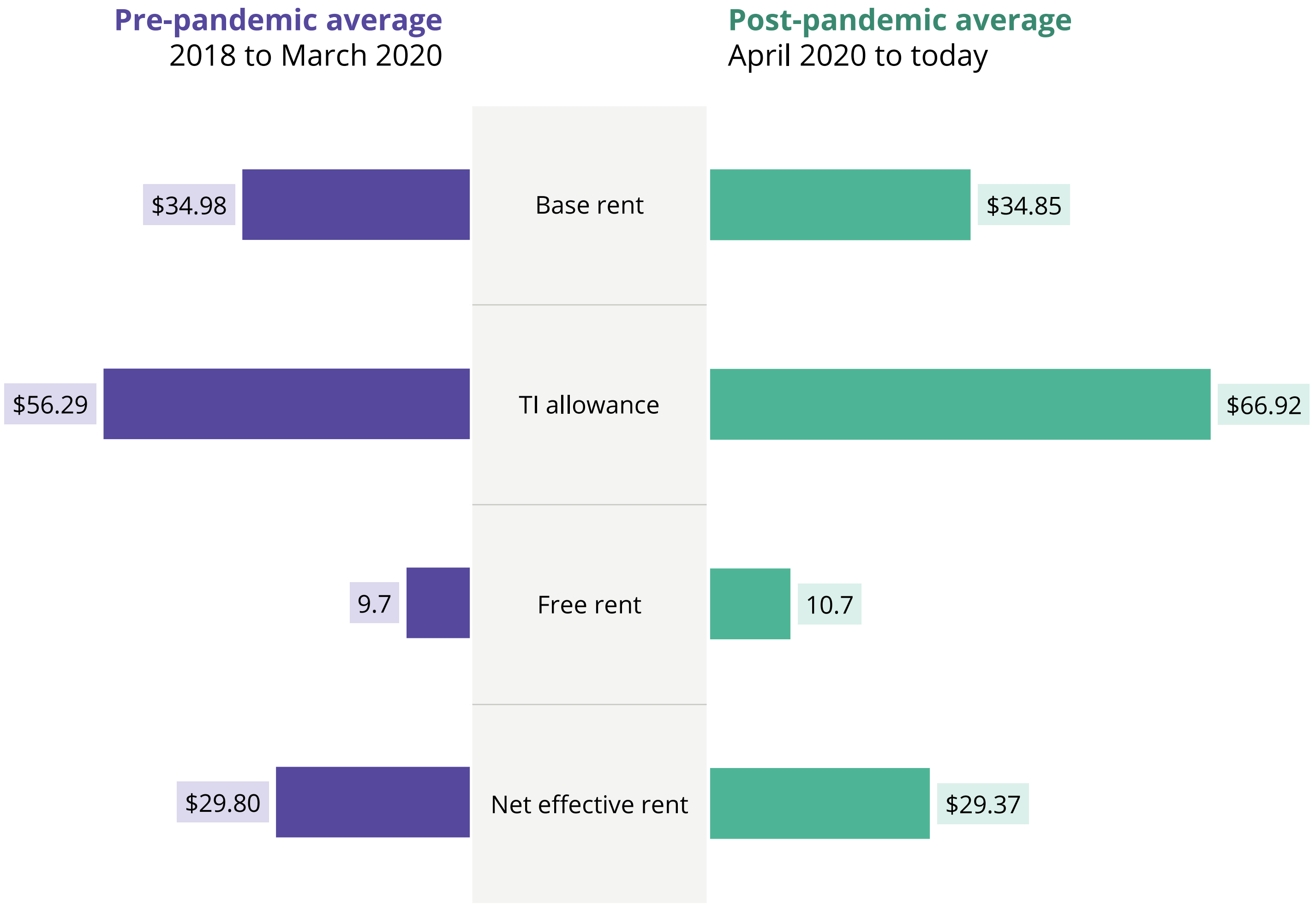
Houston office concessionary trends



Concession packages remain significantly higher than they were pre-pandemic pushing down effective rents. Tenant improvement allowances are 19% higher than they were pre-pandemic on average, but rising costs of capital and construction may limit future concessions.

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

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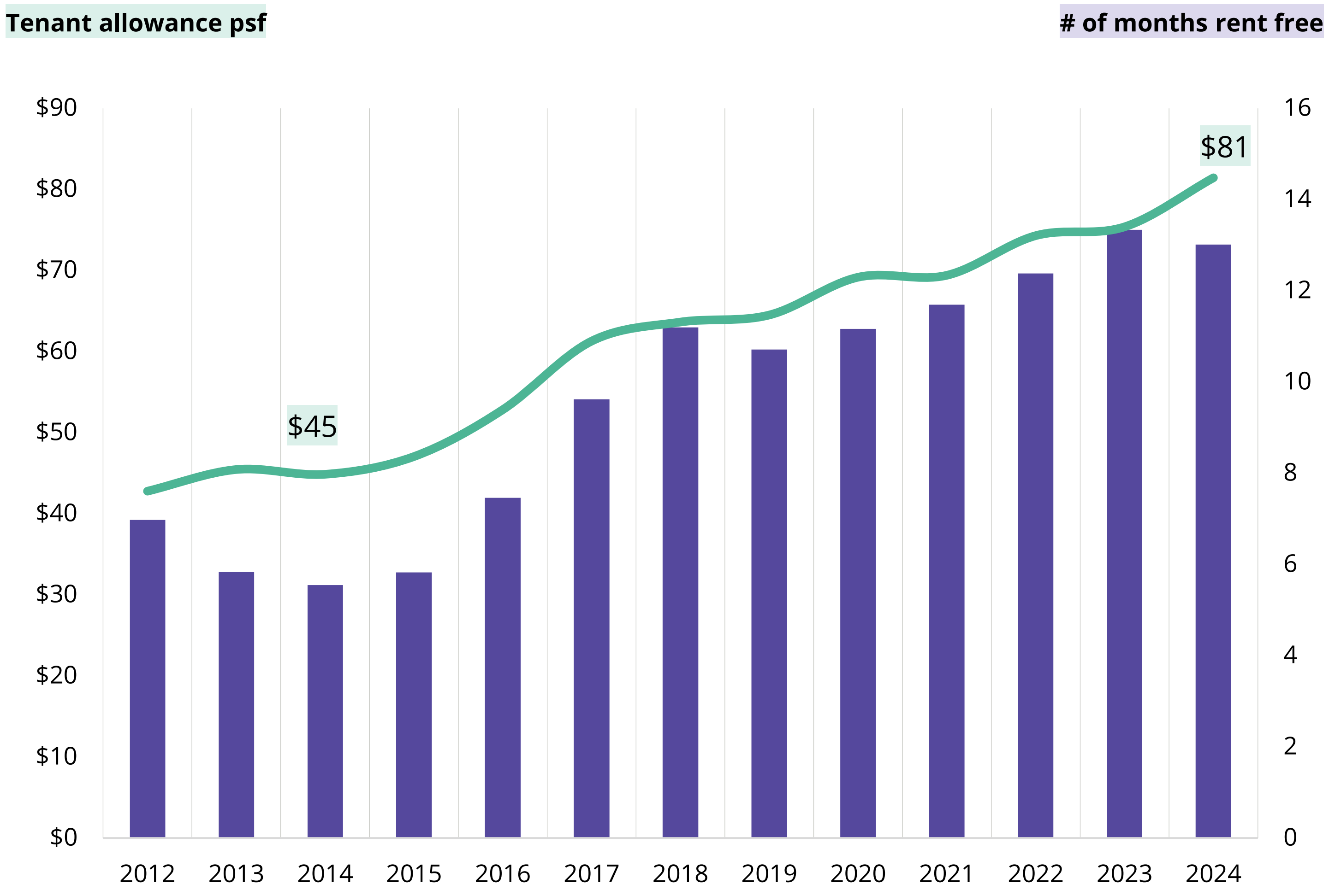
Class A office concessionary trends



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

Landlords are motivated to strike deals, but their ability to provide tenant incentives such as improvement packages and rent abatements can be constrained by underlying building loans or financial limitations.

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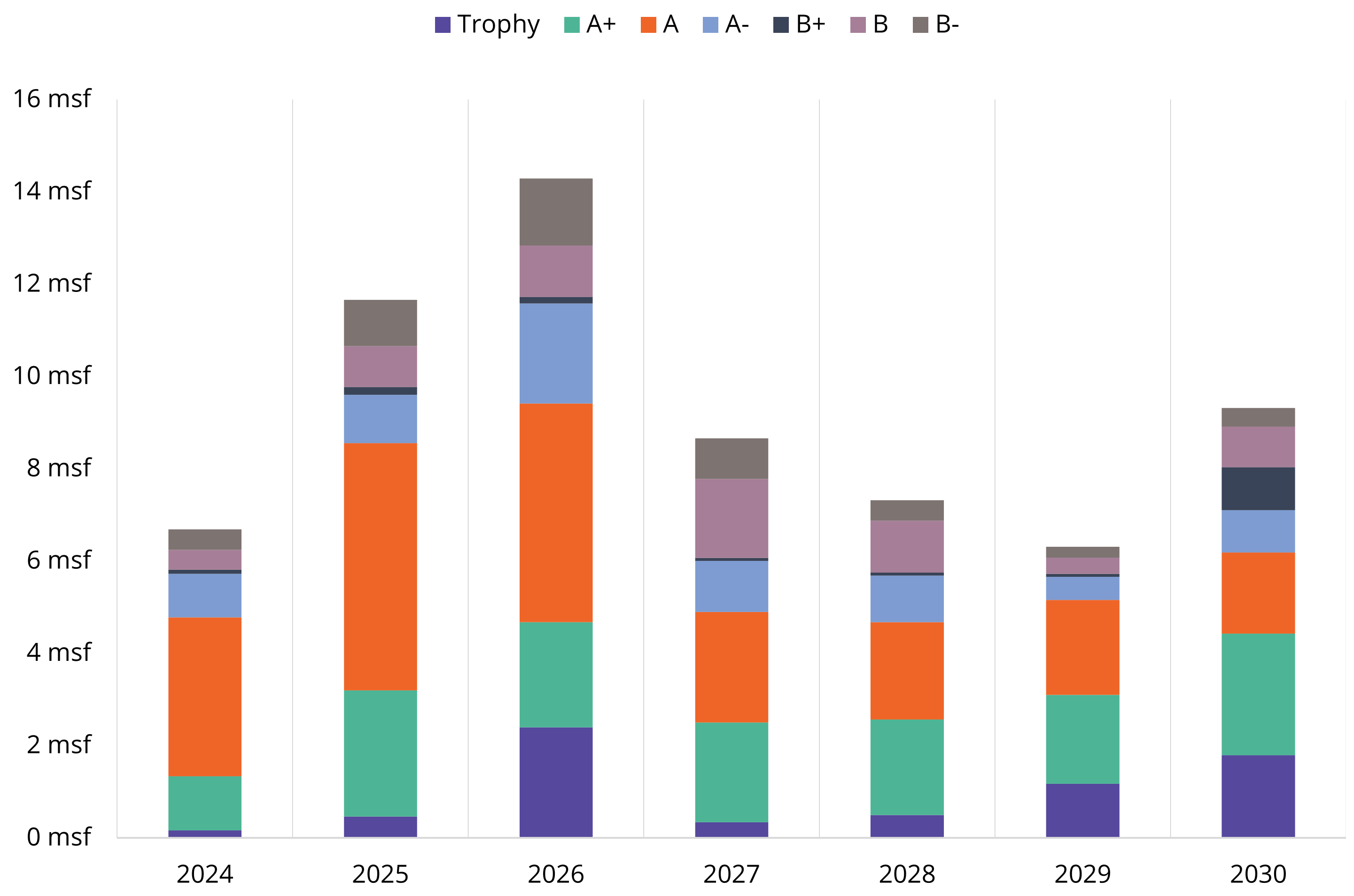
Houston office lease expirations

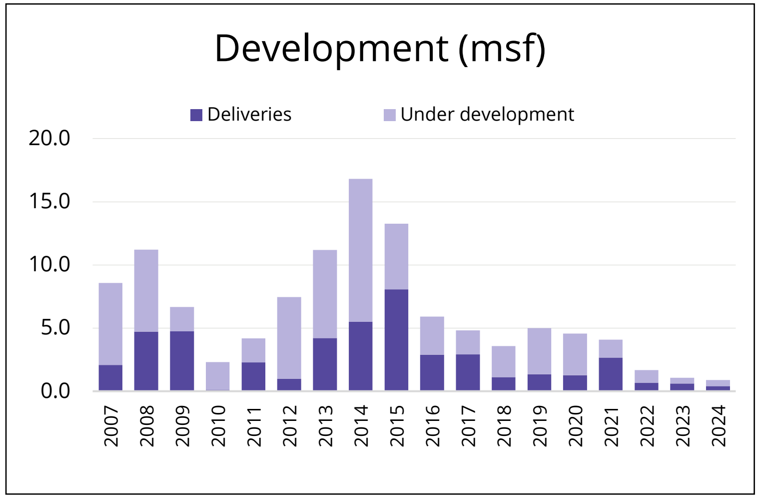


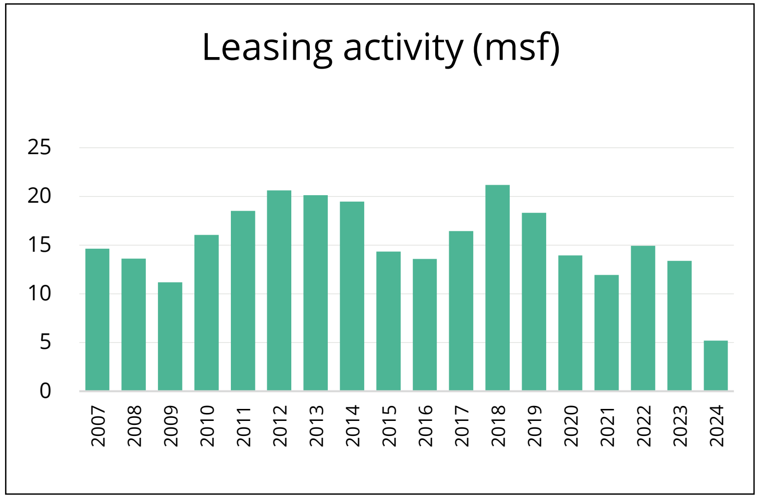
Source: AVANT by Avison Young
Note: Limited to office lease transactions above 10k sf

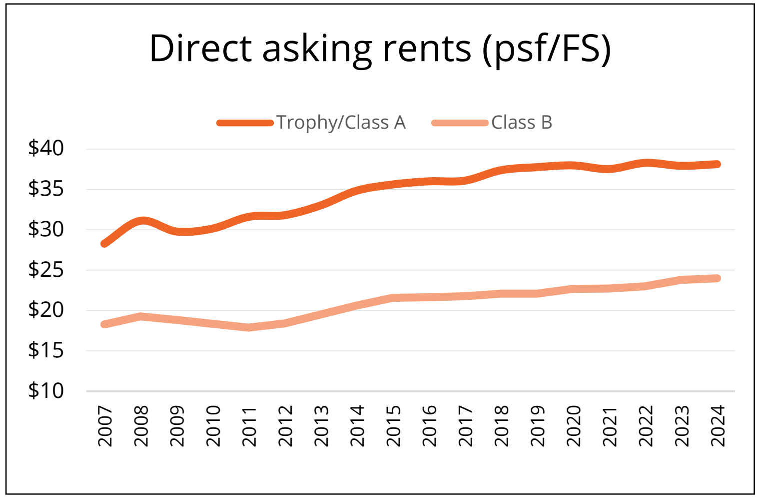
Houston's office sector has over 32.6 msf of leases expiring through 2026. With tenants prioritizing high-quality space, this expiring inventory could exacerbate the existing flight-to-quality trend, putting a premium on well-equipped offices.

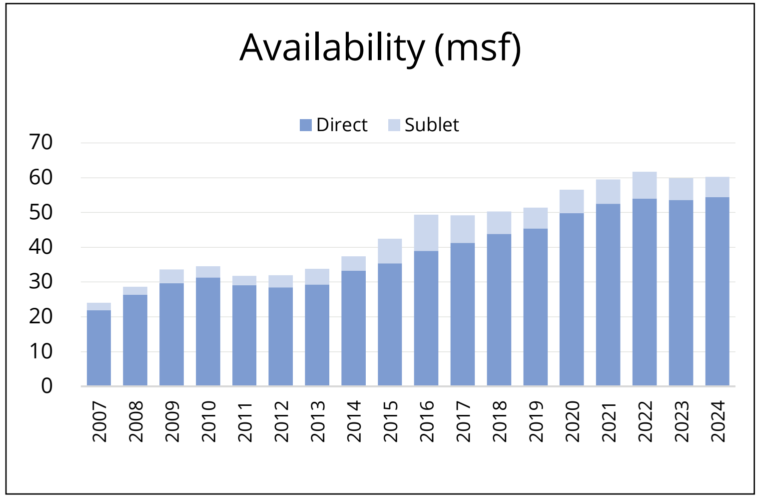
Appendix

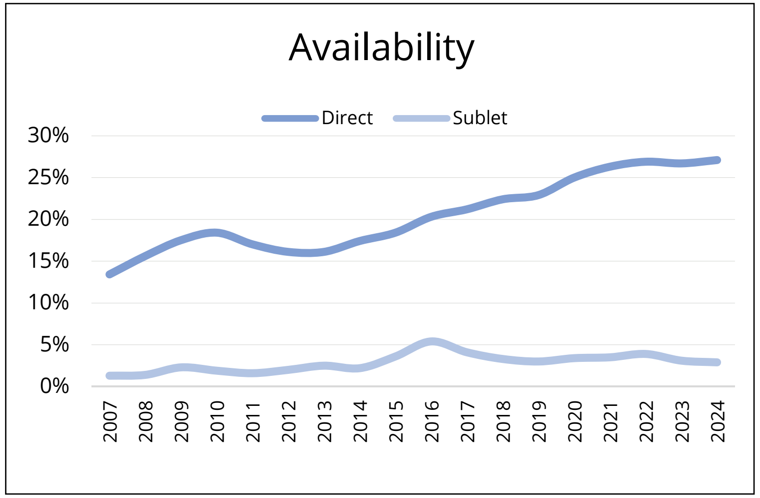
Houston office market indicators

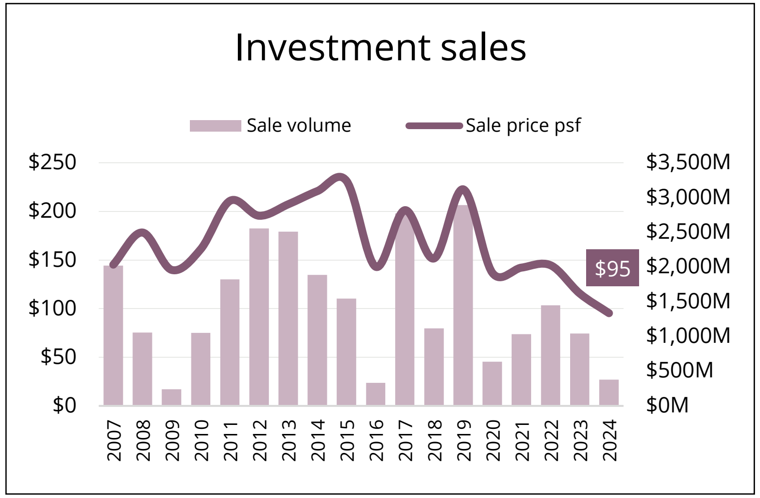












Source: AVANT by Avison Young, CoStar

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Houston office market activity

Recent leasing activity

Tenant	Address	Submarket	Sign date	Size (sf)	Transaction type	Lease type
Ovintiv	4 Waterway Avenue	Woodlands	April 2024	168,805	Renewal	Direct
Vitol	3120 Buffalo Speedway	Greenway Plaza	March 2024	150,000	New	Direct
Blue Cross Blue Shield	8101 W Sam Houston Parkway S	Southwest	May 2024	136,800	New	Direct
OneSubsea	915 N Eldridge Parkway	Energy Corridor/Katy Freeway West	April 2024	99,501	New	Sublease
Higginbotham	4424 W Sam Houston Parkway E	West Belt/249	April 2024	75,036	New	Direct
Up Excellence Academy	330 N Sam Houston Parkway E	North Belt	April 2024	66,836	New	Direct
Orion Group Holdings	2940 Riverby Road	Gulf Freeway/Pasadena	June 2024	63,519	New	Direct
Boston Consulting Group	1550 Lamar Street	CBD	June 2024	53,007	New	Direct
McDermott International	1725 Hughes Landing Boulevard	Woodlands	May 2024	43,000	New	Direct
Empyrean Benefit Solutions	2103 CityWest Boulevard	Westchase	May 2024	41,667	New	Direct
Axens North America	1800 St James Place	Galleria/West Loop	April 2024	32,674	New	Direct
Questco Companies	480 Wildwood Forest Drive	Woodlands	April 2024	27,998	New	Sublease

Top projects under development

Address	Submarket	Delivery date	Building size sf	% Preleased	Developer
903 Town and Country Boulevard	Katy Freeway East/Memorial City	March 2026	308,000	65.3%	Midway
20203 Bridgeland Creek Parkway	Northwest	July 2025	49,117	62.4%	Howard Hughes
6932 Brisbane Court	E Fort Bend Co/Sugar Land	October 2024	40,000	56.7%	Modi Capital

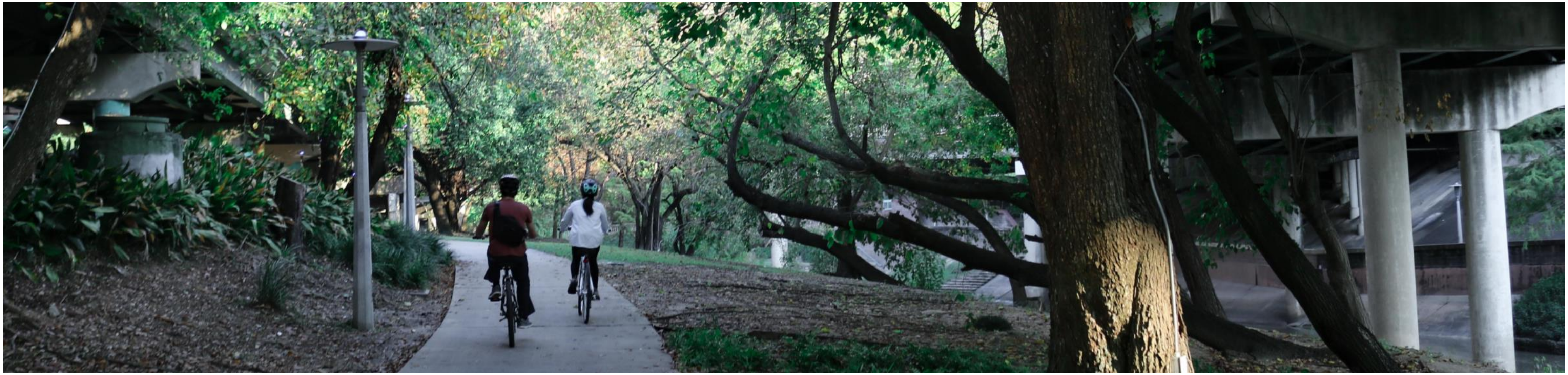
Houston office market stats

	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Direct available	Total vacancy	Total available	Sublet available sf	Net absorption sf (Q2 2024)	Net absorption sf (YTD)	Annual direct asking rent psf FS
Central Business District	40,180,510	386,323	-	27.5%	30.7%	28.8%	33.7%	1,239,626	(212,077)	(102,171)	$43.22
Galleria/West Loop	24,018,058	-	-	29.6%	29.3%	30.6%	31.2%	433,111	(316,954)	(387,268)	$36.94
Greenway Plaza	10,717,724	-	-	24.4%	26.7%	25.0%	29.0%	242,960	18,070	(193,041)	$34.88
Energy Corridor/Katy Freeway West	20,138,352	-	-	25.9%	25.1%	27.2%	27.1%	413,468	(215,761)	16,702	$30.11
Katy Freeway East/Memorial City	7,451,044	-	308,000	9.2%	10.6%	11.6%	14.2%	282,078	65,461	51,232	$40.39
Westchase	14,913,728	-	-	29.2%	33.3%	31.8%	37.6%	643,891	209,889	227,045	$28.30
North Belt	9,362,566	-	-	47.7%	46.0%	48.0%	46.6%	56,681	41,679	7,059	$20.92
Northwest	8,060,769	-	114,543	18.1%	20.2%	19.3%	21.5%	112,750	51,409	96,916	$21.41
NASA/Clear Lake	4,033,309	-	-	14.2%	17.4%	15.0%	19.4%	82,418	21,109	18,559	$26.27
E Fort Bend Co/Sugar Land	5,665,086	-	40,000	21.6%	23.3%	22.0%	24.5%	64,504	(47,552)	19,579	$31.18
Richmond/Fountainview	1,200,647	-	-	20.9%	23.5%	20.9%	23.5%	-	23,787	12,300	$17.96
San Felipe/Voss	5,284,652	-	-	30.3%	31.0%	30.9%	32.9%	97,570	(9,066)	4,106	$30.88
Bellaire	2,686,492	-	-	12.5%	16.0%	13.4%	17.7%	46,425	12,300	65,379	$29.90
Midtown	5,768,327	-	-	13.5%	13.5%	15.3%	15.9%	140,000	119,713	103,497	$36.59
FM 1960	2,727,240	-	-	28.6%	34.7%	28.7%	34.8%	3,435	(14,819)	(24,413)	$17.54
Kingwood/Humble/Northeast	1,206,453	-	-	17.3%	17.9%	17.3%	17.9%	-	(5,874)	(3,664)	$19.88
Southwest	7,206,929	-	-	21.7%	23.7%	28.2%	30.9%	517,741	9,905	(81,612)	$20.71
Medical Center/South	1,379,067	-	-	12.9%	13.6%	12.9%	13.6%	-	(4,473)	(16,214)	$19.99
The Woodlands	11,829,986	-	-	16.2%	19.3%	18.5%	22.9%	431,954	29,673	(33,495)	$35.34
Gulf Freeway/Pasadena	2,360,196	-	-	19.9%	17.0%	20.1%	17.9%	20,324	25,784	32,823	$26.21
Katy/Grand Parkway West	2,307,111	-	-	4.6%	8.9%	6.7%	17.1%	188,696	11,137	36,599	$33.72
West Belt /249	9,253,540	-	-	34.7%	43.2%	36.6%	47.6%	827,756	(57,484)	(5,436)	$25.12
Southwest Far	1,201,110	32,200	-	12.5%	10.8%	12.5%	10.8%	-	4,814	(6,434)	$25.11
Southeast Far/South Hwy 35	825,685	-	-	1.6%	3.6%	1.6%	3.6%	-	490	(1,279)	$31.72
Conroe	574,150	-	-	15.5%	19.4%	15.5%	19.4%	-	1,769	(9,436)	$27.25
Market total	**200,352,731**	**418,523**	**462,543**	**25.1%**	**27.1%**	**26.6%**	**29.8%**	**5,845,388**	**(237,071)**	**(172,667)**	**$32.96**

Source: AVANT by Avison Young, CoStar

Houston office market stats by class

	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Direct available	Total vacancy	Total available	Sublet available sf	Net absorption sf (Q2 2024)	Net absorption sf (YTD)	Annual direct asking rent psf FS
Trophy	14,296,879	386,323	-	13.6%	14.1%	14.2%	16.3%	319,351	385,042	777,989	$56.11
Class A	108,696,184	32,200	422,543	26.4%	29.8%	28.3%	33.1%	4,098,865	(805,468)	(1,135,740)	$36.85
Class B	77,359,668	-	40,000	25.5%	25.7%	26.6%	27.5%	1,427,172	183,355	185,084	$24.00
Market total	**200,352,731**	**418,523**	**462,543**	**25.1%**	**27.1%**	**26.6%**	**29.8%**	**5,845,388**	**(237,071)**	**(172,667)**	**$32.96**



Source: AVANT by Avison Young, CoStar

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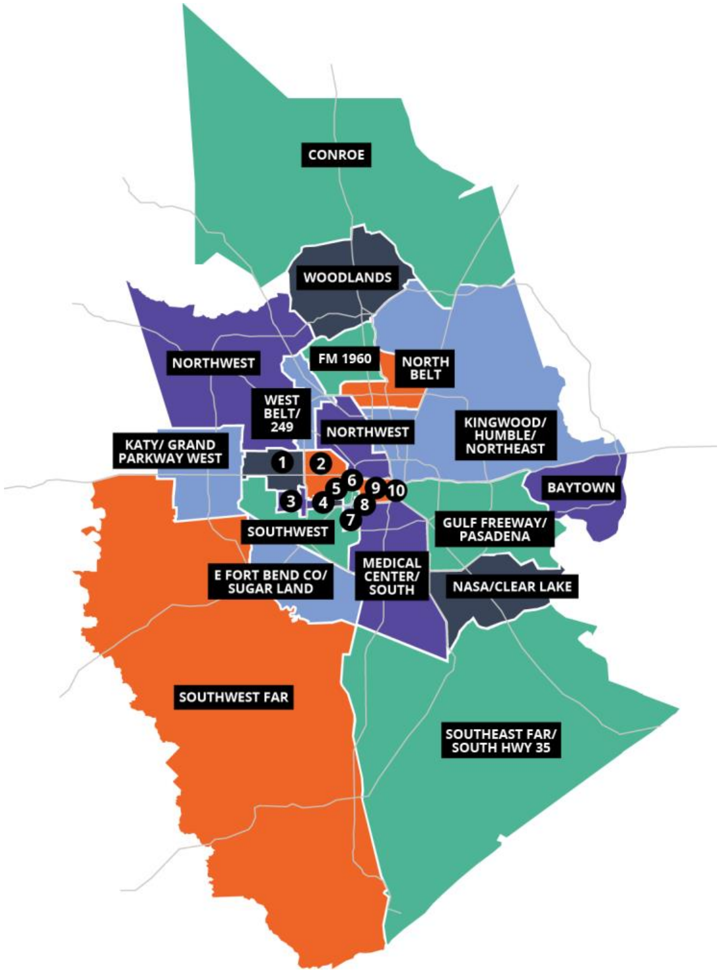
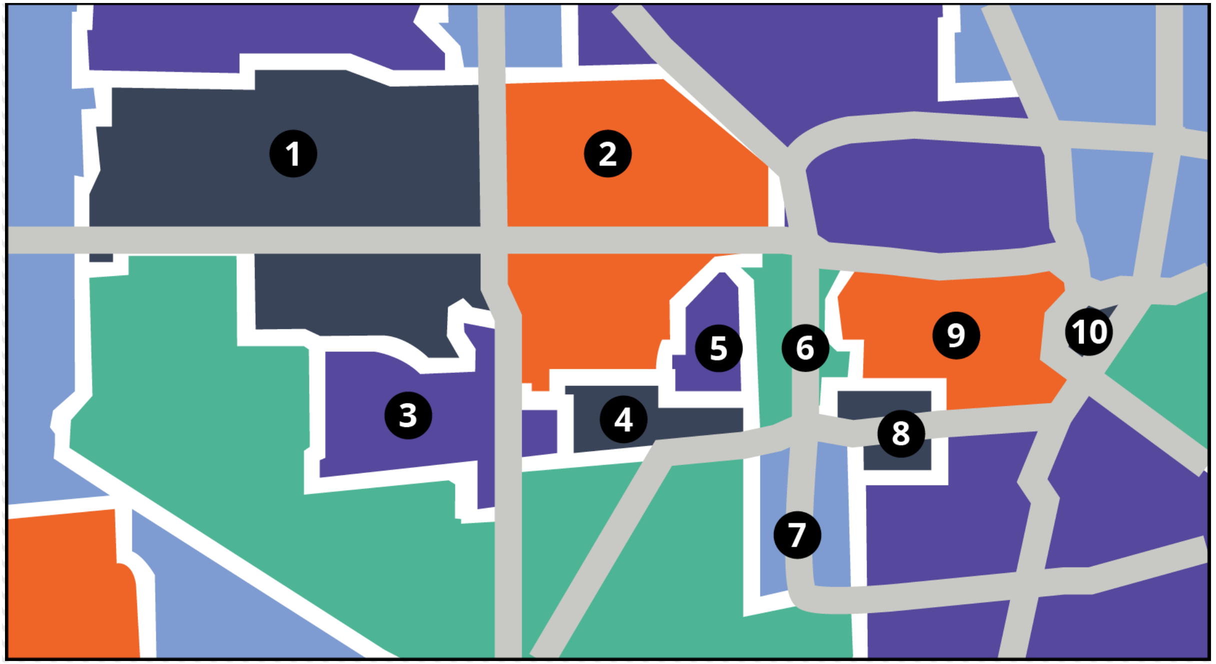
Houston submarket map





Map Key

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