HOUSTON

OFFICE MARKET REPORT

Third Quarter 2020

BELVOIR

REAL ESTATE GROUP, LLC

Going Places

BROKERAGE / DEVELOPMENT / MANAGEMENT / INVESTMENT

713.332.8202 / belvoir.net

A Message from Matthew Goldsby, Belvoir Managing Director

The Houston office market continues to bear the impact of low energy prices and pandemic induced volatility. Houston's overall vacancy rate rose to 18% from 17.3% in the previous quarter, driven by 2.6 million SF of negative net absorption. Asking rental rates fell further, dropping by 0.9% during the period. Tenants renewing in place will generally expect to upgrade their spaces, sometimes with pandemic considerations, and should expect to receive concessions that may keep a lid on rising rental rates in the near term.

Year-to-date, the majority of leasing activity has transacted in 17 buildings, totaling 7.4 millon SF. The submarkets of Katy West, CBD, The Woodlands and Westchase submarkets were the major centers of leasing activity. Of note, the sluggish Greenspoint/North Belt submarket was able to capture one sizable deal: U.S. Immigration leased 70,000 SF in CityNorth. Most transaction activity was driven by financial services and energy related firms, as is typical for the Houston market. However, aggregate activity levels are down considerably this year due to uncertainty in the market, as some firms have decided to put off major business decisions in the near-term.

Total Houston Office Market	335,651,482 SF	100% of total market
YTD Leasing Activity	7,427,470 SF	2.21% of total market
QTD Leasing Activity	5,153,209 SF	1.54% of total market

The construction pipeline currently totals 28 projects underway, for a total of 1,952,690 SF. Most of these projects will deliver in the next 6 months, and are currently 64.7% pre-leased. Given the pre-lease rates, it is expected that a substantial contingent of space will be passed through to the available inventory – an additional factor keeping a lid on the prospect of rising rental rates through 2021.

In 2020, there have been seven office buildings sold for a total of 1,329,827 SF at a value of $382,889,300, equating to an average sale price of $238.86 per SF. Two sales were recorded in the third quarter: One Westchase Center (466,025 SF) and 363 North Belt (386,277 SF). 363 North Belt, located in Houston's softest submarket (Greenspoint/North Belt), had previously sold in December of 2019 for $13.0 million and was resold in August 2020 for $15.2 million.

Many major Houston companies have begun to return to the office, albeit at a more cautious pace than some smaller employers. Based on information furnished by firms and their employees, several major companies do not plan to reopen their physical offices until the first quarter of 2021.

Near-term bright spots in Houston's office market are focused on growth from the "blue ocean" of proposed life sciences and mixed-use developments in the Medical Center submarket, including Rice's Ion project and the Medical Center's TMC3. As well, as the remainder of energy excesses finish draining from the office market, population growth and the post-COVID economic recovery will position Houston as a resilient Sunbelt city with growing opportunity.

OFFICE MARKET SNAPSHOT

LEASING

Lower oil prices and the coronavirus pandemic pose serious downside risks to Houston's office market. Houston's vacancy rate has returned to 18%, ushering in a sense of renewed caution that the city's office vacancy rate has not yet peaked. Net absorption amounted to about -1.7 million SF last quarter and -2.6 million SF over the past year. However, under the baseline forecast scenario, Houston office vacancies may have more or less plateaued and by year end 2021 could begin recovering. Still, leasing activity was relatively robust last quarter. In this tenants' market, landlords must offer significant amenities and compete in terms of price.

RENT

The Houston office market may experience declining rent growth in the coming months, as the market deals with the economic and social fallout stemming from the coronavirus pandemic. Office rent growth in Houston has been lackluster at best since late 2014. Since the second quarter of 2020, however, rent growth has been back to flat territory given rising vacancies. It should be noted that Houston office rents, even for 4 & 5 Star space, are being offered at a deep discount to both the U.S. average and coastal metros, an attractive proposition for companies looking to relocate to an affordable, large U.S. metro.

CONSTRUCTION

Houston's office supply pipeline was already down significantly since the recent oil downturn of 2015–17 as the market worked through significant oversupply, prior to the coronavirus pandemic and recent oil price crash. However, there are still a few new projects underway. More than half of the 5 million SF of development is occurring in just two submarkets: Katy Freeway East and the CBD. These submarkets could be most exposed to upward pressures on vacancies, as leasing activity remains muted. That said, the recent flight to quality trend should serve as some reassurance. Among the largest projects, Hines is under construction with the 1.1 million-SF Texas Tower in Downtown Houston, where Hines will relocate its global headquarters, and where law firm Vinson & Elkins signed on as an anchor tenant.

SALES

The current outlook for transaction activity in 2020 has deteriorated rapidly due to the coronavirus pandemic and lower oil prices. And Houston is in the midst of its second oil downturn in just five years — with oil prices in the $40s/barrel range. Meanwhile, with the U.S. in a recession for the first time since 2008, quite possibly the worst since the Great Depression, this is likely to negatively impact transaction activity and the demand for Houston office properties this year.

That said, the second quarter was the worst quarter for transaction volume since the first quarter of 2010 during the Great Recession. Yet this trend is being repeated nationally during this period of significant price discovery, with transaction activity also its lowest level since the Financial Crisis. Meanwhile, approximately $300 million in confirmed second quarter transactions was enough to rank Houston seventh in the nation.

Of note, two of the largest deals last quarter were not related to energy at all. HP sold its legacy campus to Austin-based Capital Commercial Investments in June. And while no sales price was disclosed, CoStar estimates that the buyer paid approximately $39 million, or $150/SF, for the property at a 7.9% cap rate. In May, MBRE Healthcare acquired half of the Memorial Hermann Orthopedic & Spine campus from seller Welltower as part of a national portfolio trade for an undisclosed price. CoStar estimates that the buyer paid $24 million, or $245/SF, at a 7.2% cap rate.

Source: CoStar Property©

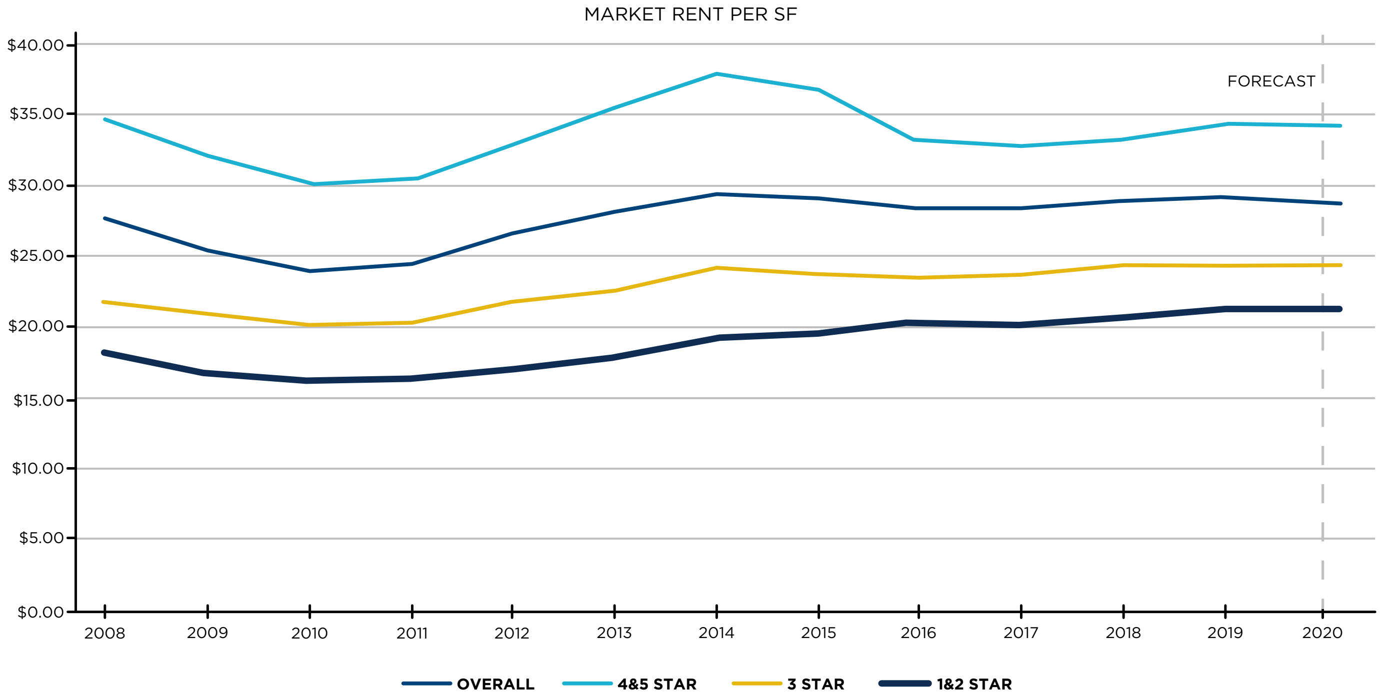
SUBMARKET STATISTICS

Q3 2020

Market	Existing Inventory		Vacancy		YTD Net Absorption	YTD Deliveries	Under Const SF (000)	Rent Per SF
	Bldgs	SF (000)	SF	Percent				
Bellaire	92	5,242	760,890	14.5%	13,752	1	53	$25.54
CBD	162	51,404	10,512,694	20.5%	(176,438)	0	1,252	$36.69
E Fort Bend Co/Sugar Land	446	10,306	1,287,941	12.5%	13,815	31	114	$27.44
FM 1960/Champions	264	4,356	677,316	15.5%	59,955	1	-	$18.79
FM 1960/Hwy 249	490	9,876	1,653,664	16.7%	29,562	34	257	$25.60
Galleria/Uptown	67	17,332	3,261,511	18.8%	(216,937)	0	70	$31.15
Greenspoint/N Belt W.	119	11,075	4,969,143	44.9%	219,733	0	-	$18.85
Greenway Plaza	273	12,635	2,053,302	16.3%	(336,375)	0	-	$30.90
Gulf Freeway/Pasadena	665	8,255	1,125,754	13.6%	(101,345)	1	64	$21.83
Katy Freeway East	270	11,870	1,328,890	11.2%	(65,700)	2	1,200	$31.21
Katy Freeway West	265	28,089	6,279,493	22.4%	354,077	3	-	$29.86
Katy/Grand Parkway W.	481	6,544	945,247	14.4%	(29,708)	10	77	$29.00
Midtown	595	10,132	1,162,334	11.5%	(235,740)	2	475	$30.12
NASA/Clear Lake	544	10,310	1,373,423	13.3%	20,625	6	70	$23.84
North Loop West	378	6,396	1,105,012	17.3%	98,806	5	4	$22.41
Post Oak Park	45	4,814	1,579,328	32.8%	(134,113)	1	-	$31.49
San Felipe/Voss	50	5,346	1,196,443	22.4%	(161,881)	0	-	$26.26
South Main/Medical Center	243	13,473	928,923	6.9%	(204,873)	4	757	$28.57
Southwest Beltway 8	192	7,336	1,522,743	20.8%	(76,449)	0	-	$17.91
Southwest/Hillcroft	111	5,323	852,880	16.0%	81,821	0	-	$17.28
The Woodlands	675	23,795	3,431,079	14.4%	(777,187)	5	628	$32.18
West Belt	116	6,335	1,641,479	25.9%	(543,755)	0	-	$28.61
Westchase	140	18,931	4,605,571	24.3%	(428,003)	0	-	$27.39

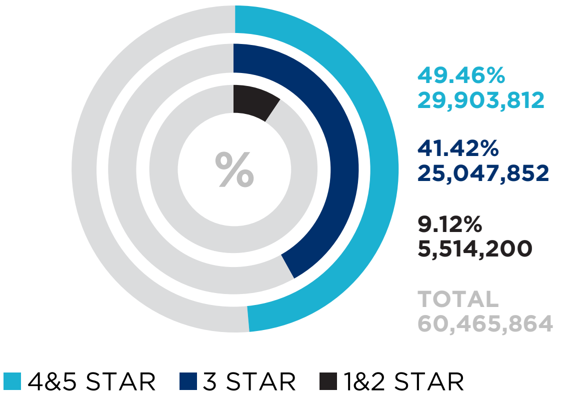
Source: CoStar Property©

HISTORICAL AND FORECAST RENTAL RATES BY CLASS



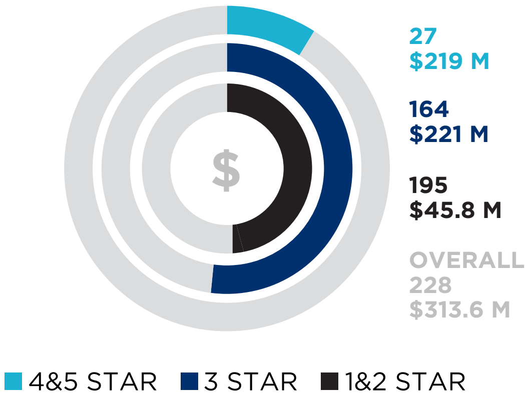
Source: CoStar Property©

VACANCY BY CLASS



Source: CoStar Property©

SALES BY CLASS



Source: CoStar Property©