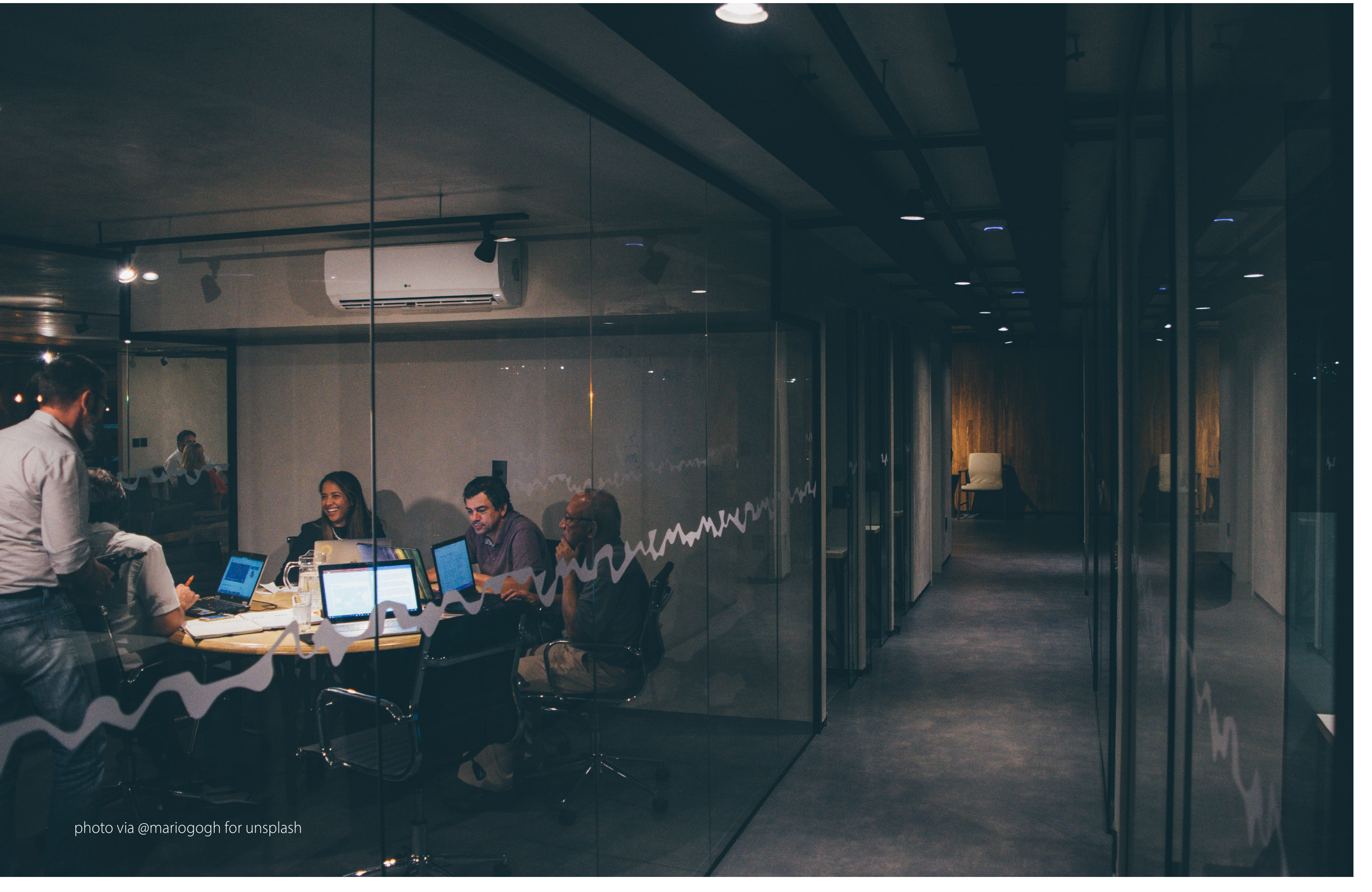
‘High Expectations’: Office prospects pursue quality in recovering market

BY BRANDI SMITH



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If there’s one thing to take away from Brandi Sikes’ analysis of the Houston office market, it’s that recovery may be slow, but the market is recovering.

“Based on what we know today, the worst is behind us,” says the Principal & Senior Advisor for SVN J. Beard Real Estate – Greater Houston, who merged Limestone Commercial Real Estate in November 2021.

Negative absorption peaked in Q3 2020 and leasing activity began to increase in Q2 2021, Sikes adds, noting Houston just posted its first quarter of positive absorption.

“Houston has one of the highest vacancy rates in the nation – 25 percent,” says Sikes. “Class A availability is closer to 30 percent, but the flight-to-quality offices with abundant amenities will help mitigate this vacancy over time.”

The demand for quality by prospective tenants almost assuredly requires buildings to offer amenities to remain competitive, she says.

“Tenants have high expectations when it comes to incentives but learn quickly that not all buildings are created equal,” Sikes points out. “Stabilized assets can hold out for better deals in better days while the less fortunate are opting to ‘buy’ tenants on a short-term lease in hope of making it up on the renewal.”

Dallas is the only Texas market with a higher vacancy rate than Houston. Sitting at 25.3 percent, CBRE reports the DFW office market "has made some positive strides toward recovery," including net absorption, new construction and deliveries picking up in Q4 2021. In Austin, new projects with minimal pre-leasing activity helped inflate the vacancy rate, which is hovering around 21 percent. Down I-35, the San Antonio market has recovered about 87 percent of the jobs lost during the pandemic, a sign the area is returning to work. That's one reason the Alamo City has the lowest vacancy rate – 17 percent – of Texas' largest markets.


Brandi Sikes

Back in Houston, Sikes says it's clear workers are coming back too.

"The best way to answer the return-to-work question is to ask, 'Are companies committing to office space?" Leasing activity is only down 17 percent from pre-pandemic conditions. We recorded 1000 less transactions in 2021 than in 2019, but we've closed over 4400 office deals," she says, adding that Houston's availability rate only increased 3 percent through the pandemic. "We entered the pandemic anemic from oil and gas, but we have already recovered almost 75 percent of the pandemic-related job losses."

According to Sikes, average deal size for office leases is down by 30 percent but most people are surprised to learn that the pre-pandemic average deal size was only 3,856 square feet. Other changes she's taken note of: the average deal term is maintaining around 3.4 years and 'force majeure' clauses now specifically reference pandemics.

When asked for an example of what the Houston office market is like on a day-to-day basis, Sikes shared that she's representing a client who wants to see everything available before making a decision.

"Touring all viable options in the Galleria office market now takes three full days and the gross spread between gross Class A rates is $28 per square feet," she says. "Stabilized assets are not moving much and we are still looking for the bottom on older, less occupied buildings."

On the topic of older buildings, Sikes says she's closely watching how the city handles its aging office inventory, 35 percent of which hit 40 years old in 2021.

"1800 West Loop South did an extraordinary job of turning the top floor of their 1982 building into cutting edge speculative space, balancing both community space and privacy," says Sikes. "On the other end of the spectrum, John Quinlan purchased 1801 Smith and is repurposing it into condos."

Whatever the path forward for those assets, Sikes and her team at SVN J. Beard Real Estate will continue to help guide their clients toward the best deals in their desired market.