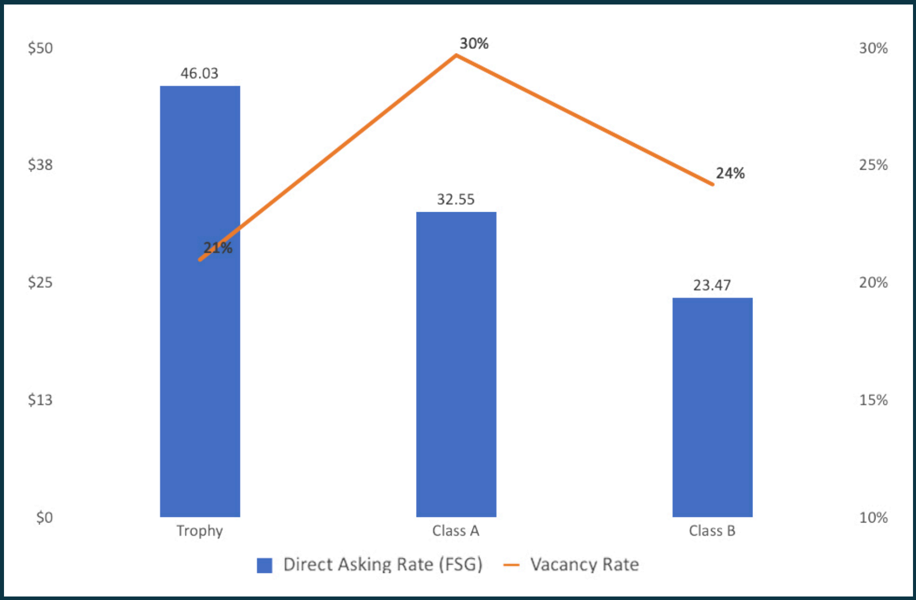
MARKET EDGE
BY partners

Houston Trophy Office Properties

The Houston office market in early 2025 shows a polarized performance amid a slow recovery. The overall market, with over 247 million square feet of inventory (65% of which was built in the 1980s or before), faces persistent challenges, including negative net absorption in 2024 and a vacancy rate holding steady at 26.1%. Class B properties—older, commodity-type office spaces—struggle with high vacancy, declining rents, and weak demand, reflecting their vulnerability to economic shifts and hybrid work trends. In contrast, trophy Class A properties shine, commanding near-record-high asking rents and strong occupancy, driven by tenant preference for premium, modern spaces.

Overall Market Overview

Trophy Properties vs Class A and B



The Houston office market spans 247.4 million SF across all property classes as of Q4 2024, dwarfing the 22.8 million SF of trophy properties.

» **Vacancy Rate**
The overall vacancy rate stood at 26.1% in Q4 2024, unchanged from Q3 but up 30 basis points from 25.9% in Q4 2023. Direct vacancy was 24.9%, with Class A at 27.5% and Class B at 24.1%. In contrast, the trophy subset (43 buildings) reported a lower 21% total vacancy, showing that premium Class A properties outperform the broader Class A average and market overall.

» **Availability Rate**
Total available space was 26.7% in Q4 2024, down from 29.4% a year prior. Direct availability was 24.5%, compared to the trophy dataset's 21.2%, indicating trophy properties have less excess space than the market norm.

» **Net Absorption**
Houston recorded negative net absorption of -269,794 SF in 2024. Class A saw -117,633 SF and Class B had -152,161 SF for the year. The trophy properties, however, had an impressive 596,044 SF for the same time period.

» **Rental Rates**
The overall average asking rent was $30.13/SF (full service gross) in Q4 2024, up 1.4% from $29.70/SF a year earlier. Class A averaged $34.87/SF and Class B $22.54/SF, compared to the trophy dataset's $46.03/SF, illustrating the premium trophy properties command.

Struggles of Class B Properties

Class B properties—older, commodity-type buildings—face ongoing difficulties:

» **High Vacancy and Availability**
As of Q4 2024 the Class B vacancy is at 24.1% for the market overall, with submarkets like Greenspoint/North Belt (35.4%) and Sugar Land/Fort Bend (31.8%) faring worse.

» **Low Rental Rates**
Class B asking rents averaged $22.54/SF in Q4 2024, down from prior years and well below the trophy average of $46.03/SF.

» **Limited Demand**
Class B recorded -152,161 SF of net absorption in 2024. Leasing activity has been muted, with tenants favoring Class A's modern amenities, as seen in the market's 21% leasing decline year-over-year.

» **Economic Sensitivity**
Houston's energy-driven economy, with oil and gas job growth at 8.5% year-over-year in October 2024, benefits Class A more. Class B struggles with hybrid work and sector volatility, evident in submarkets like CBD Class B (39.3% vacancy).

Resilience of Trophy Class A Properties

Trophy Class A properties—modern, amenity-rich buildings—stand out as a market strength:

- **Strong Occupancy:**
  The trophy properties, like Texas Tower (2021-year built) is 97% leased and 609 Main (2017- year built) is 98.03% leased. Even 811 Main (2011-year built) is healthy at 88.79% leased. Maketwide Class A vacancy (27.5%) exceeds trophy levels, highlighting the appeal of top-tier office properties.

- **Record-High Rental Rates:**
  Trophy rents hit $46.03/SF in Q4 2024, near the $47.83/SF peak reached in late 2019. Texas Tower currently commands the highest quoted rates ($54/SF NNN), which translates to about $75 per square foot (full service gross). Others trophy properties like 609 Main come in about $65 per square foot (when the rates converted to full service gross.

- **Tenant Appeal**
  Amenities like Texas Tower's sky terrace and numerous amenities drive tenant demand. Notable Q4 2024 leases, like Sheppard Mullin's 29,771 SF at Texas Tower, reinforce trophy strength, contrasting with Class B's lack of activity.

- **Submarket Strength**
  CBD Class A (29.9% vacancy) outperforms its Class B counterpart (39.3%), with trophy properties benefiting from prime locations. Suburban trophy assets like Two BriarLake Plaza (99.37% leased) also excel.

Market Dynamics and Outlook

The divergence between Class B and trophy properties underscores a broader "flight-to-quality" trend in Houston. **Tenants are gravitating toward modern, well-located spaces that support hybrid work and employee retention, leaving older Class B buildings to compete on price alone.** The overall market's recovery remains slower than bellwether markets like NYC, where Midtown saw 10.2 million SF leased in Q4 2024. Houston's energy sector exposure and hybrid work adoption continue to temper growth, with suburban submarkets like Westchase and Katy Freeway showing mixed results (e.g., Two BriarLake Plaza at 99.37% leased vs. Energy Tower II at 32.61% leased).

Looking ahead, trophy properties are poised to maintain their edge, potentially pushing rents beyond the late 2019 rate peak if demand holds steady. Class B properties, however, face a tougher road unless retrofitted to meet modern standards or repurposed. The market's overall vacancy may decline modestly in 2025 if net absorption remains positive, but a full recovery hinges on broader economic stability and a return-to-office push.

Houston's office market in early 2025 reflects a polarized landscape. Class B properties struggle with high vacancy, low rents, and weak demand, emblematic of commodity office space's challenges in a post-pandemic world. Meanwhile, trophy Class A properties shine, achieving near-record rental rates and strong occupancy driven by quality and location. This split highlights Houston's evolving office ecosystem, where premium assets lead the way while older buildings lag, awaiting reinvention or obsolescence.