

1Q24

Houston Office Market Overview



NEWMARK

Market Observations

Economy

- The Houston market’s unemployment rate ticked up by 12 basis points year over year to 4.0% but remains well below the five-year average of 5.5%.
- Job growth has slowed compared with recent highs to 2.6% year over year, and is trending toward pre-pandemic levels, with 2019 growth averaging only 2.3%.
- All sectors, except information, reported employment growth, with education and health leading job gains at 5.6% over the past 12 months.
- Office-using jobs in the market reached an all-time high of 785,334 employees reflecting 10.1% growth since 2019.

Major Transactions

- Noble Drilling signed the quarter’s largest deal, taking 110,250 SF at 2101 CityWest Blvd. in the Westchase submarket.
- Bechtel expanded again, taking an additional 82,000 SF at 2103 CityWest Blvd. for the second largest lease of the quarter.
- Tenants continue to favor Houston’s west side, with several of the quarter’s most notable deals taking place in western submarkets, including Westchase and Katy Freeway.
- Expansion activity from prominent firms, including Noble and Bechtel, indicate positive activity in the market’s oil and gas sector.

Leasing Market Fundamentals

- Average annual full-service asking rental rates decreased from an all-time high last quarter to \$29.77/SF but reflecting a 0.7% increase year over year.
- Overall vacancy rates rose in the first quarter of 2024 to 25.1%, increasing by 30 basis points quarter over quarter and increasing by 80 basis points year over year.
- The under-construction pipeline remains muted, with 1.0 MSF in progress.
- Total leasing activity closed the quarter at 2.5 MSF, well below the long-term first-quarter average of 4.3 MSF. The average lease size was 3,866 SF, a decrease of 12.3% quarter over quarter and 1.8% year over year.

Outlook

- The Houston office market will likely continue to see subdued growth in 2024. Office investment activity will remain low in the near term due to elevated inflation and a steeper cost of debt.
- Strong demand for premier office product has continued to keep rents elevated in top tier buildings, increasing the rent spread between Class A and Class B assets, with flight-to-quality expected to remain a trend in the market.
- The office market is expected to remain tenant friendly with continued muted demand. As a result, overall asking rents in non-premier buildings are projected to remain flat in the near term.

1. Economy
2. Leasing Market Fundamentals

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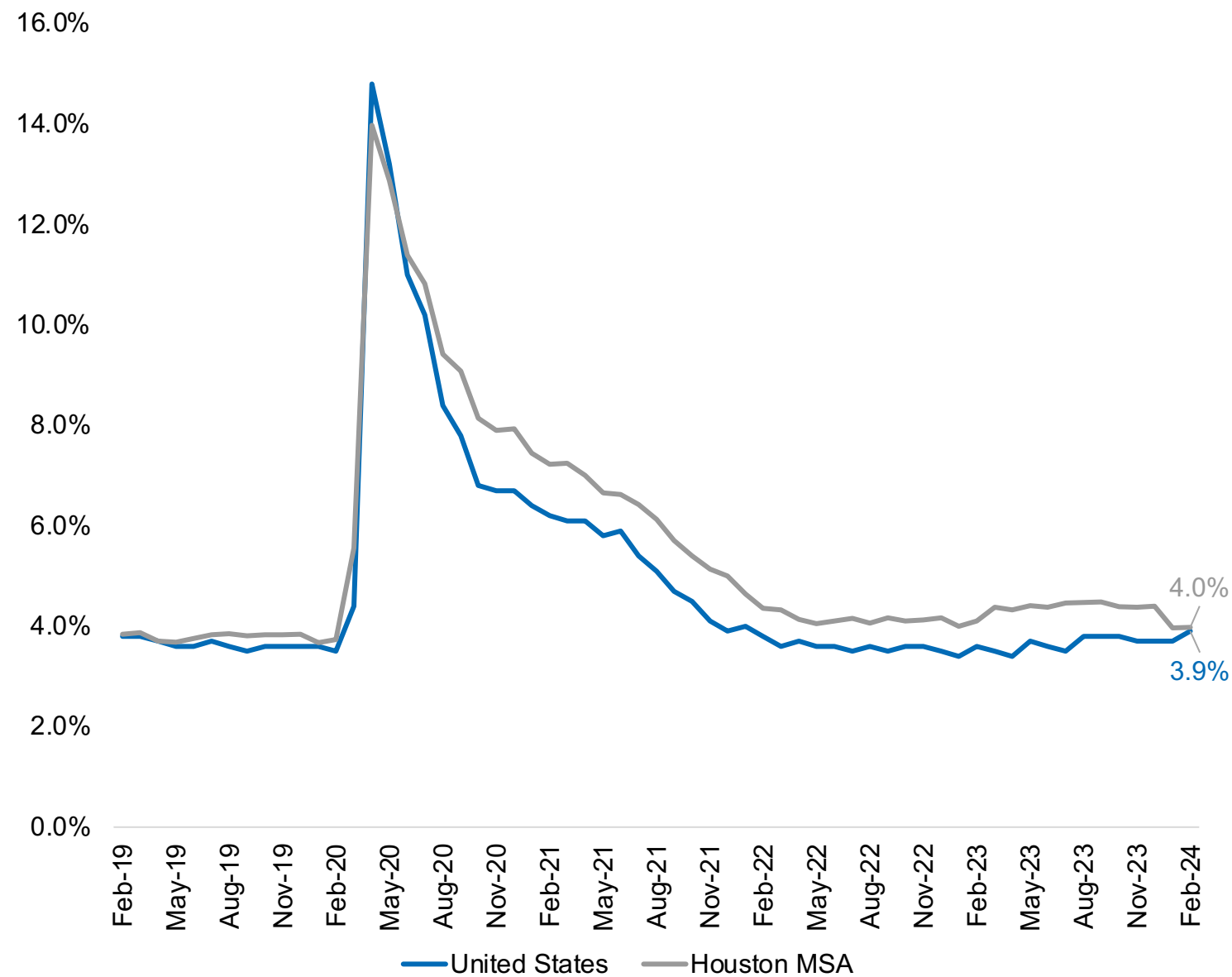
Economy



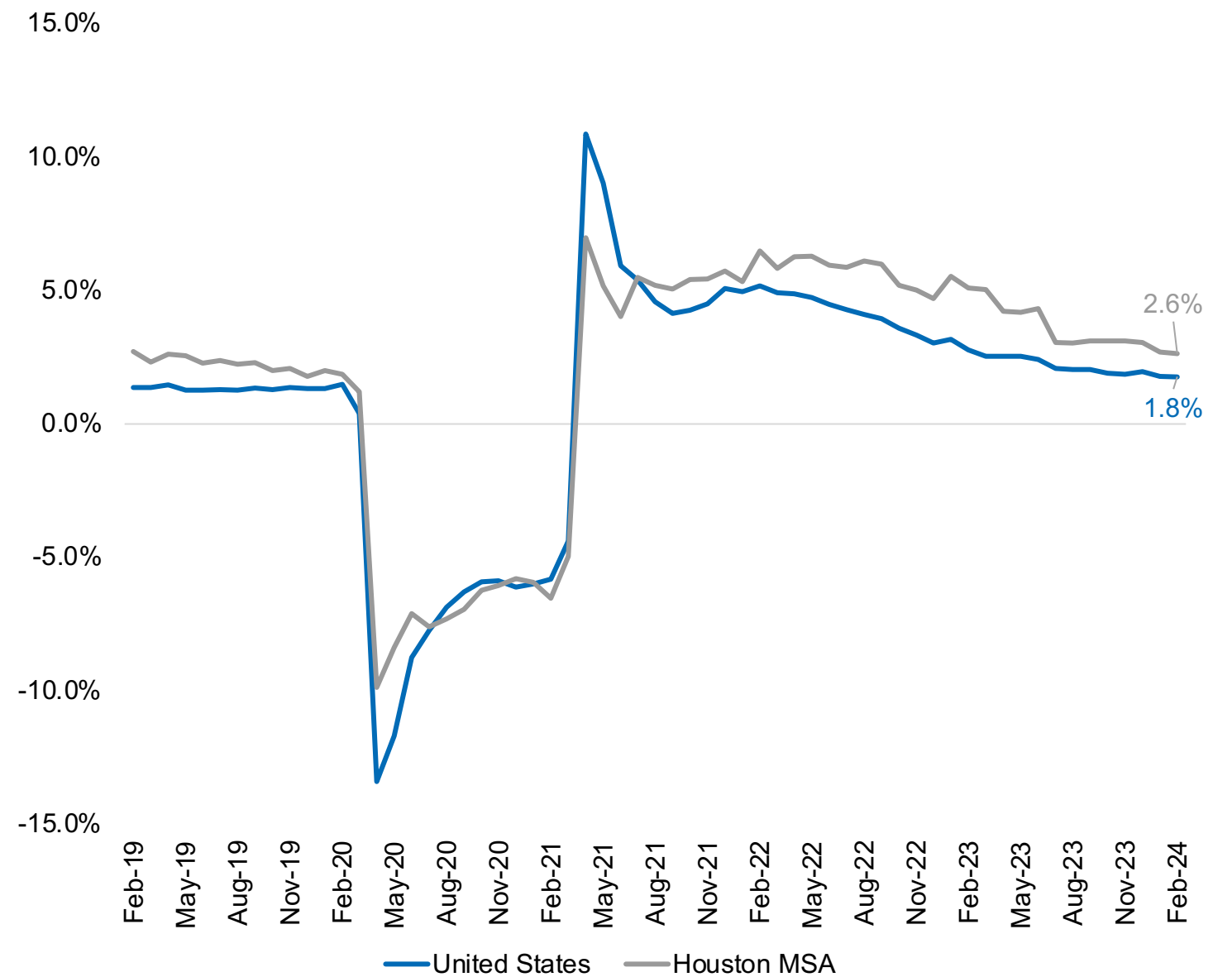
Metro Employment Trends Continue Slow Growth

The Houston market has generally reported higher unemployment rates compared with the national average, while outperforming in employment growth. Recent national economic headwinds have pushed the region's unemployment rate and the national average to converge, at 4.0% and 3.9%, respectively. Houston's unemployment rate decreased by 12 basis points year over year, while the employment year-over-year growth rate slowed by 246 basis points compared with the previous year.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Seasonally Adjusted, 12-Month % Change



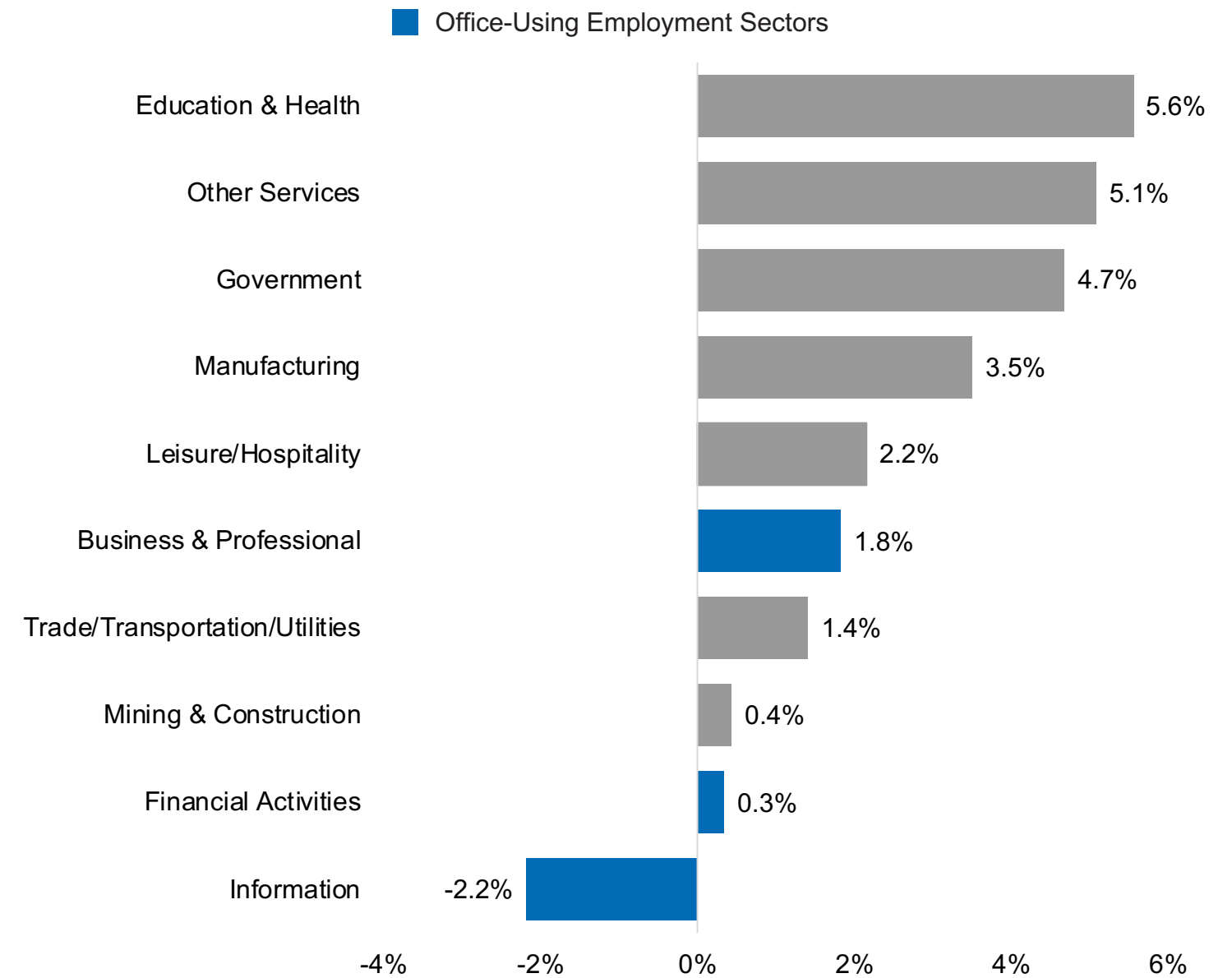
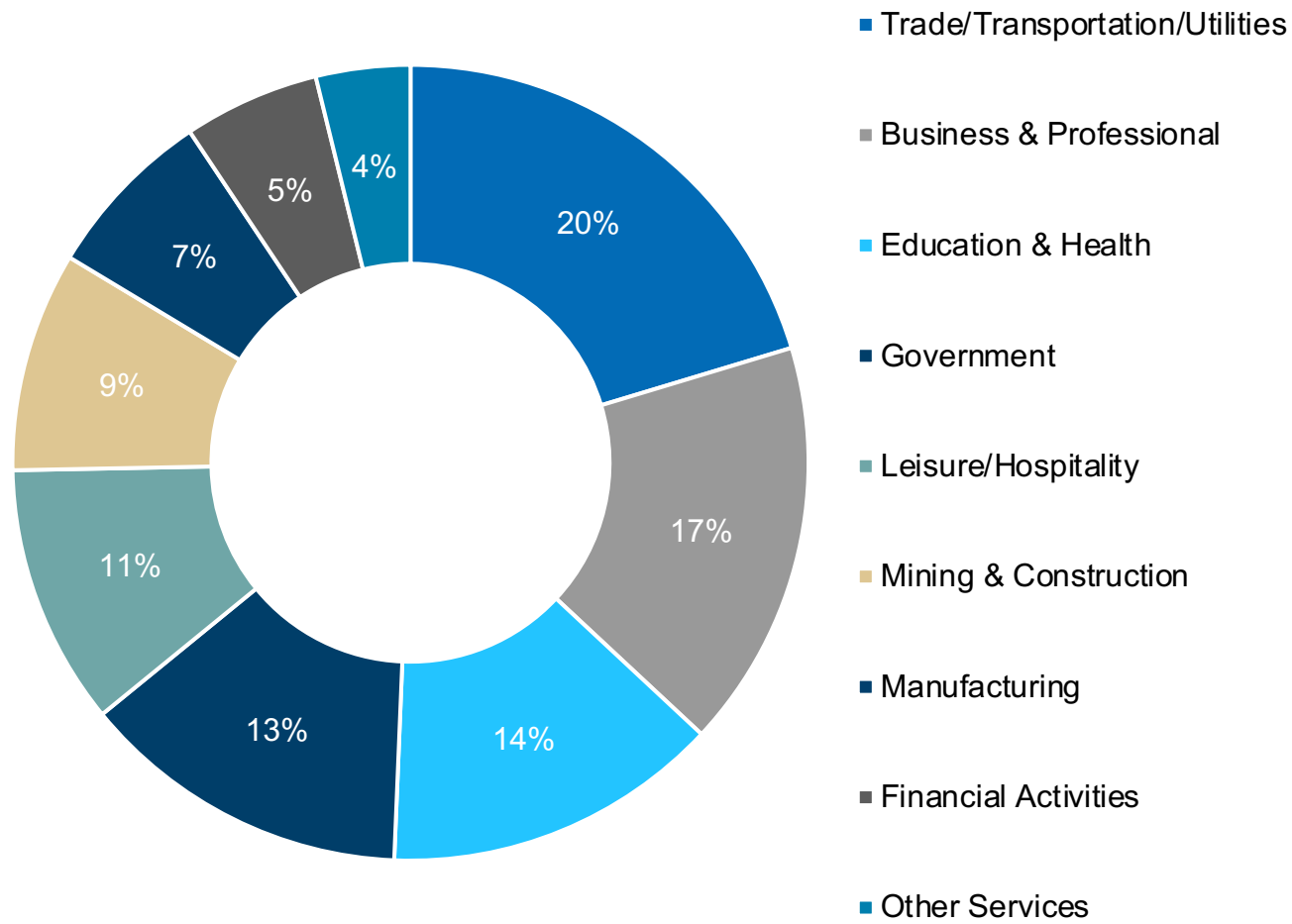
Source: U.S. Bureau of Labor Statistics, Houston MSA

Employment Growth Continues Across Most Office Sectors

Known for its energy sector, the Houston market's top two employment industries account for 36.6% of market share. The office-using employment's business and professional sector is the second-largest industry sector in the metroplex at 16.5%. All industries in the metro, except for information, reported growth with office-using industries reporting year-over-year gains ranging from 0.3% to 1.8% with the information sector reflecting a decline of 2.2%.

Employment by Industry, February 2024

Employment Growth by Industry, 12-Month % Change, February 2024

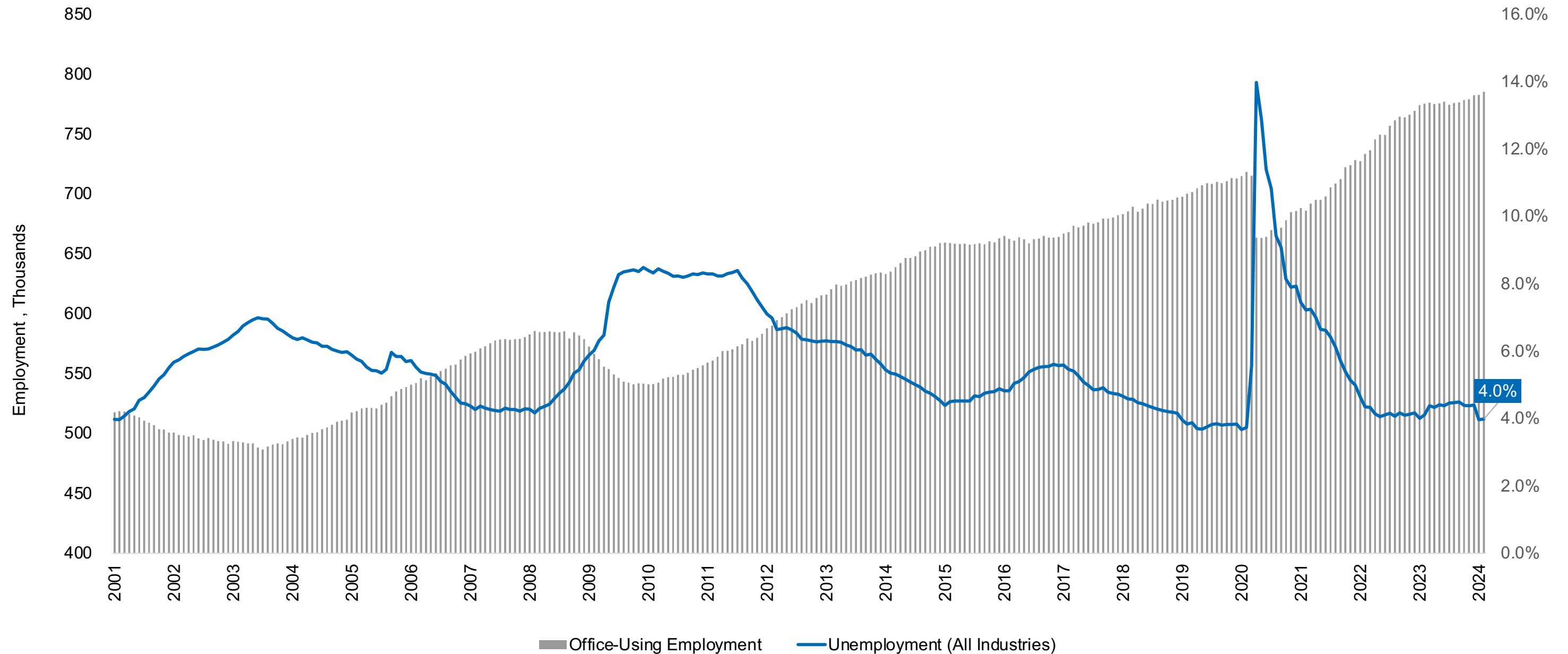


Source: U.S. Bureau of Labor Statistics, Houston MSA

Overall Office-Using Employment at Historical High

Office-using employment in the Houston market as of the end of February 2024 is at 785,334 employees, a new all-time historical high. Currently, the unemployment rate is at 4.0%, above the 3.8% average levels reported in 2019, indicating that other industries outside of office-using jobs likely contribute to most of the unemployment rate.

Office-Using Employment* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, Houston MSA

*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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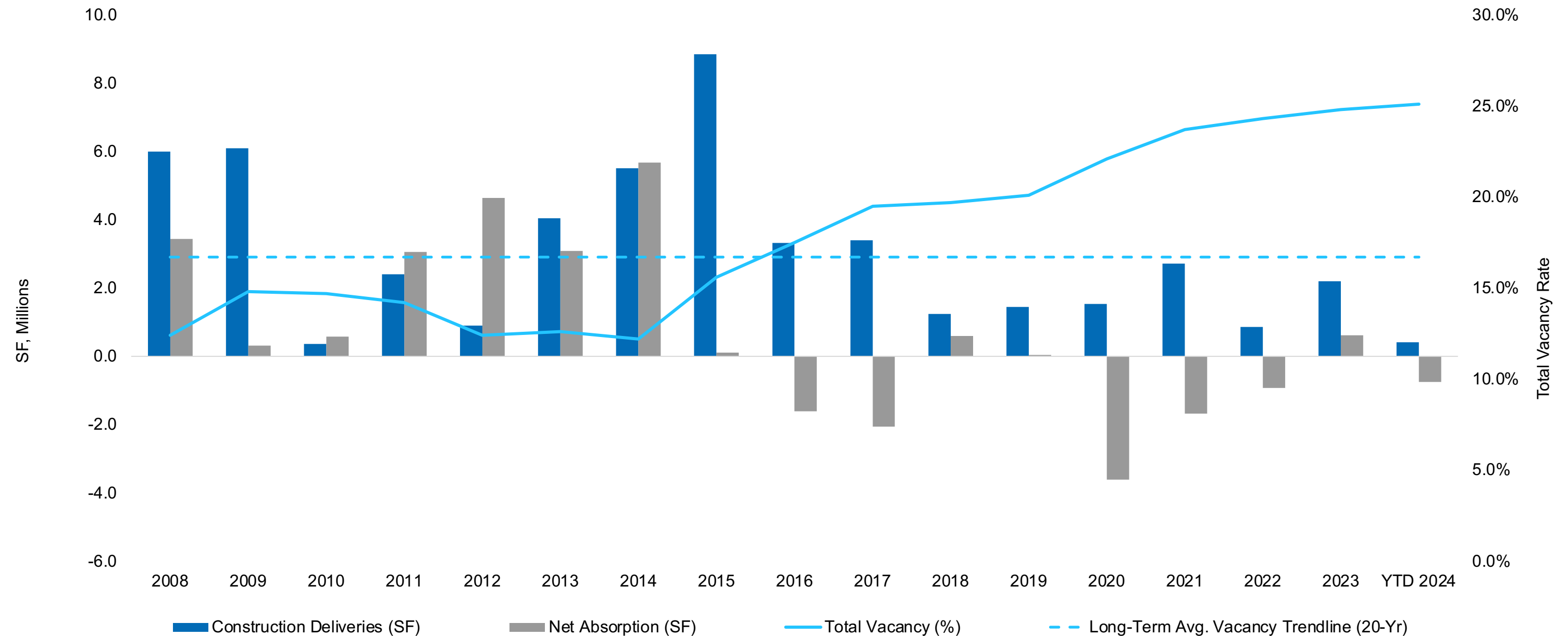
Leasing Market Fundamentals



Vacancy Rises as Construction Deliveries Outpace Net Absorption

The Houston office vacancy rate increased by 80 basis points year over year to 25.1% in the first quarter of 2024, well above the long-term average of 16.7%. Since the oil crash in 2016, vacancy rates have steadily increased in the market as new deliveries outpaced annual absorption. Despite a sharp decline in quarterly office deliveries, supply continued to outpace demand as 2024 opened with negative absorption.

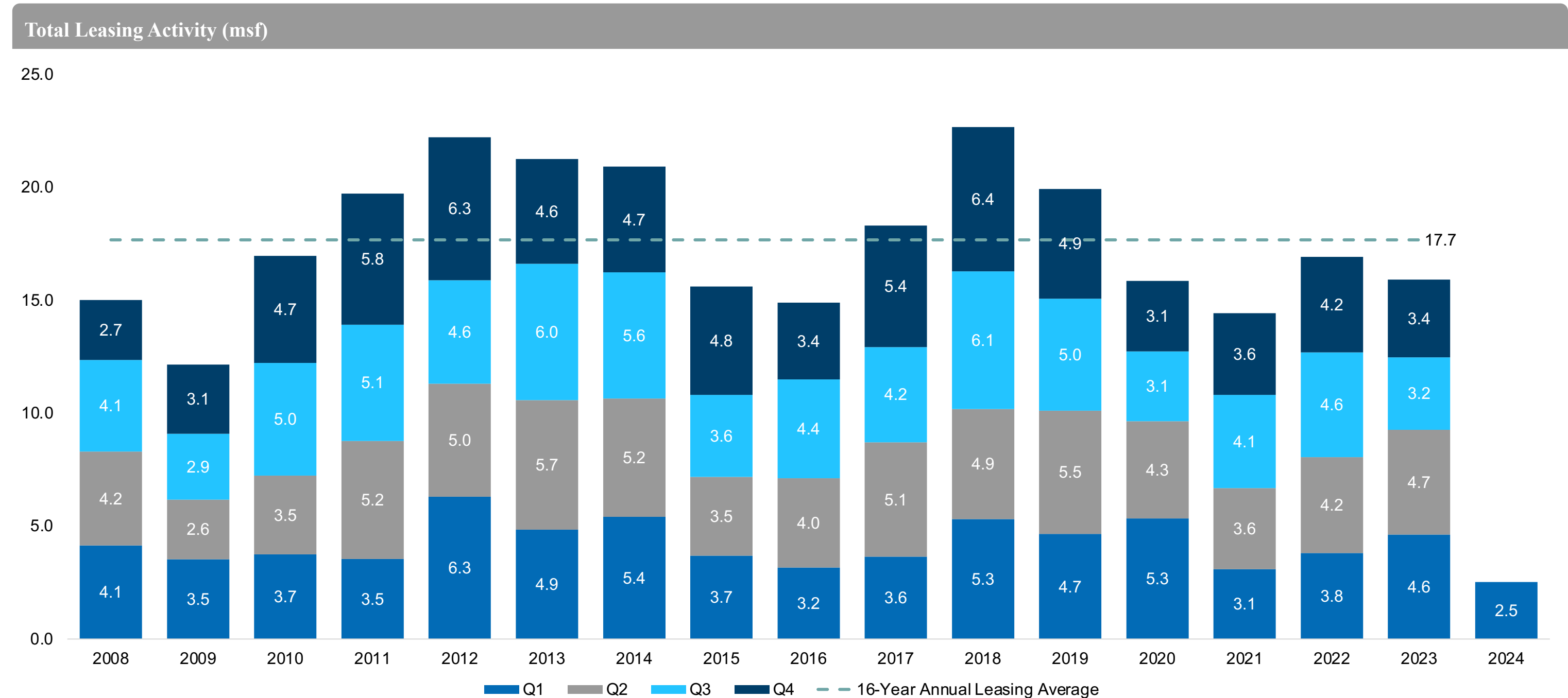
Historical Construction Deliveries, Net Absorption, and Vacancy



Source: Newmark Research, CoStar

Declining Deal Activity Results in Slowing Leasing Activity

Leasing activity in the market remains slower, with leasing activity in the first quarter of 2024 totaling 2.5 MSF. Since 2007, first-quarter leasing activity averaged 4.3 MSF, with the first quarter of 2024 well below the historical average. Deal size averaged 3,866 SF in the first quarter of 2024, an average of 543 SF less than the previous quarter and 72 SF less than a year ago. The slowing leasing activity pace is largely attributed to fewer deals being done, likely because of a more challenging debt liquidity environment.

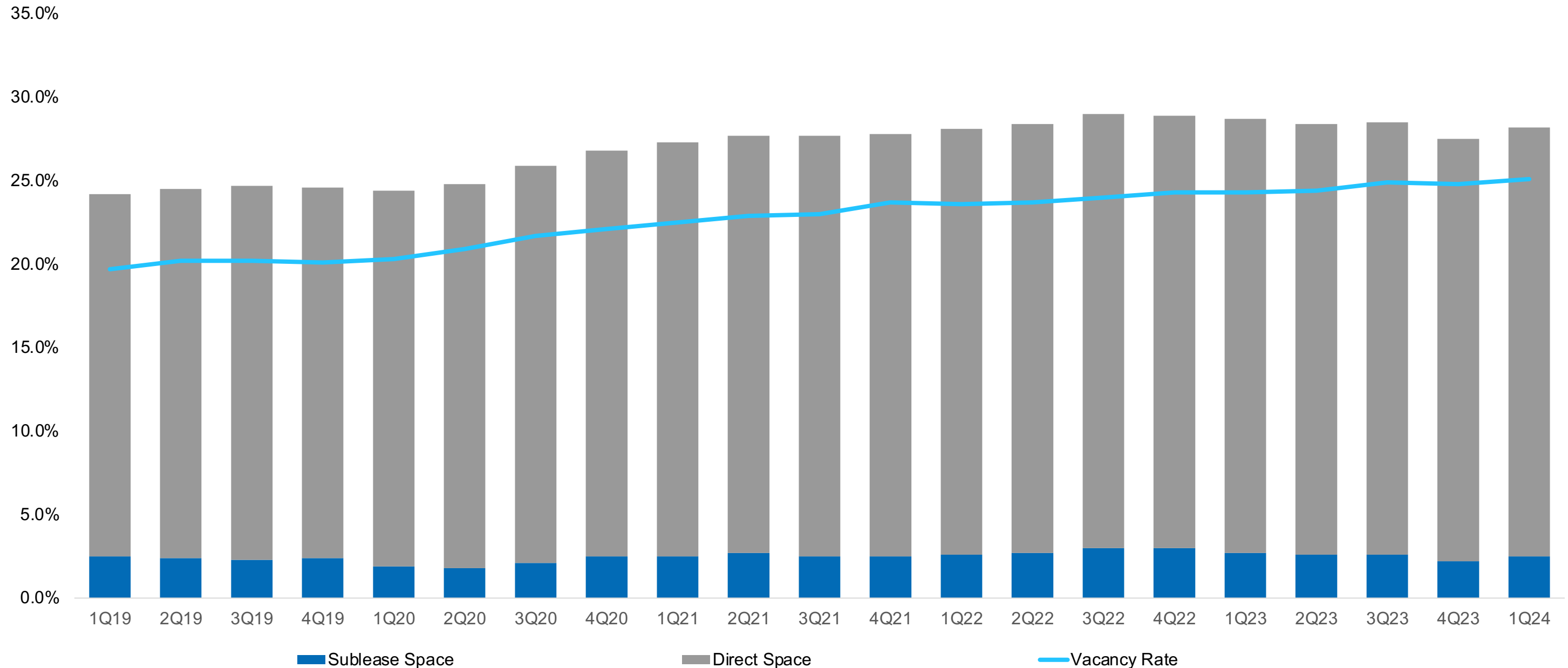


Source: Newmark Research, CoStar

Availability Increases but Remains Below Record High

Sublease availabilities in the Houston market have declined since the oil crash in 2016, remaining at a relatively steady level since 2019. As of the end of the first quarter of 2024, sublease availability in the market was at 2.5%. Direct availabilities have generally increased since the pandemic but have decreased from all-time highs reported in the second half of 2022 at 26.0%, with the current direct availability rate at 25.7%. At 25.1%, vacancies continue to remain elevated alongside availabilities.

Available Space as Percent of Overall Market

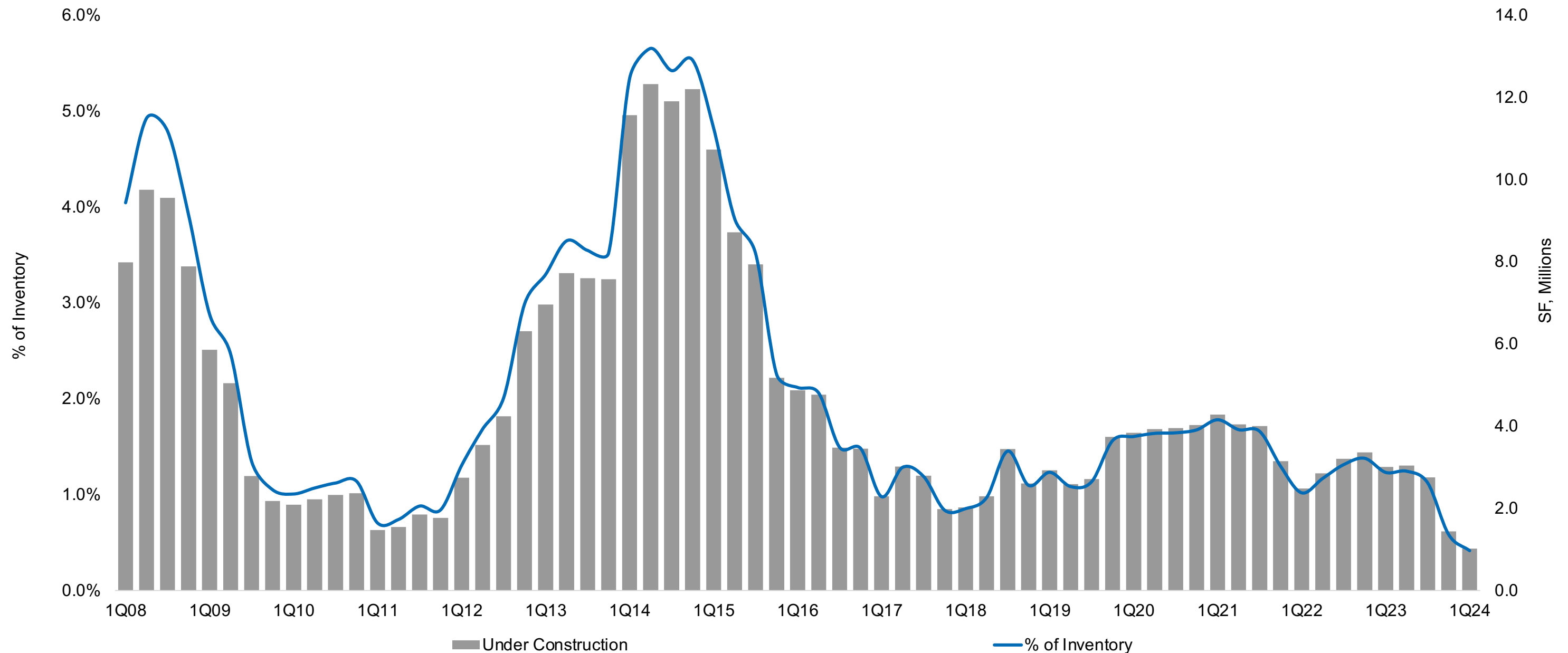


Source: Newmark Research, CoStar

Construction Activity Remains Slow, Reaches New Low

Construction activity has remained relatively muted in the market since 2016. As of the first quarter of 2024, the market had 1.0* MSF under construction, accounting for 0.6% of the market's inventory, indicating there is less risk of overbuilding.

Office Under Construction and % of Inventory



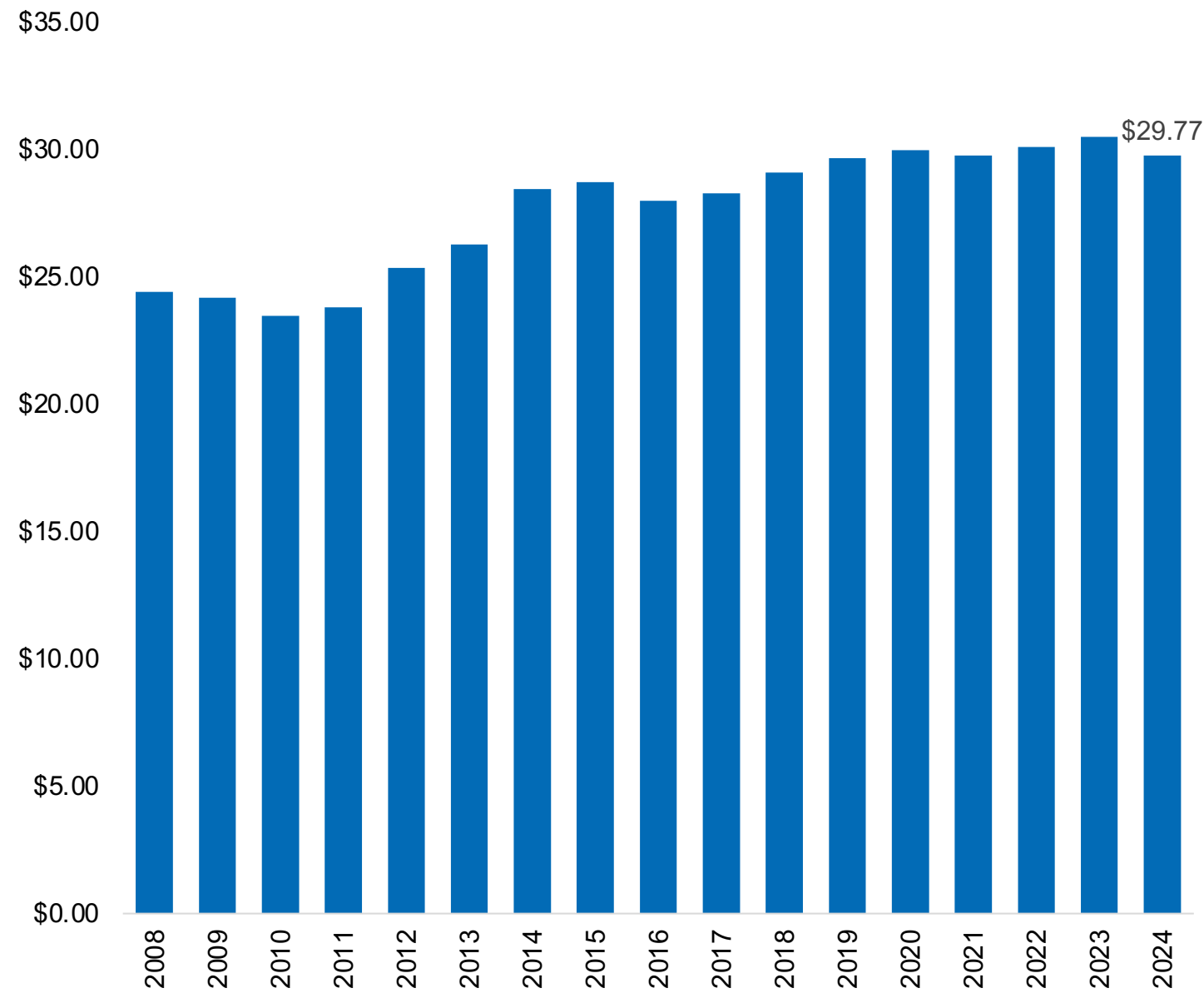
Source: Newmark Research, CoStar

* The bulk of space under construction in 1Q24 is medical office

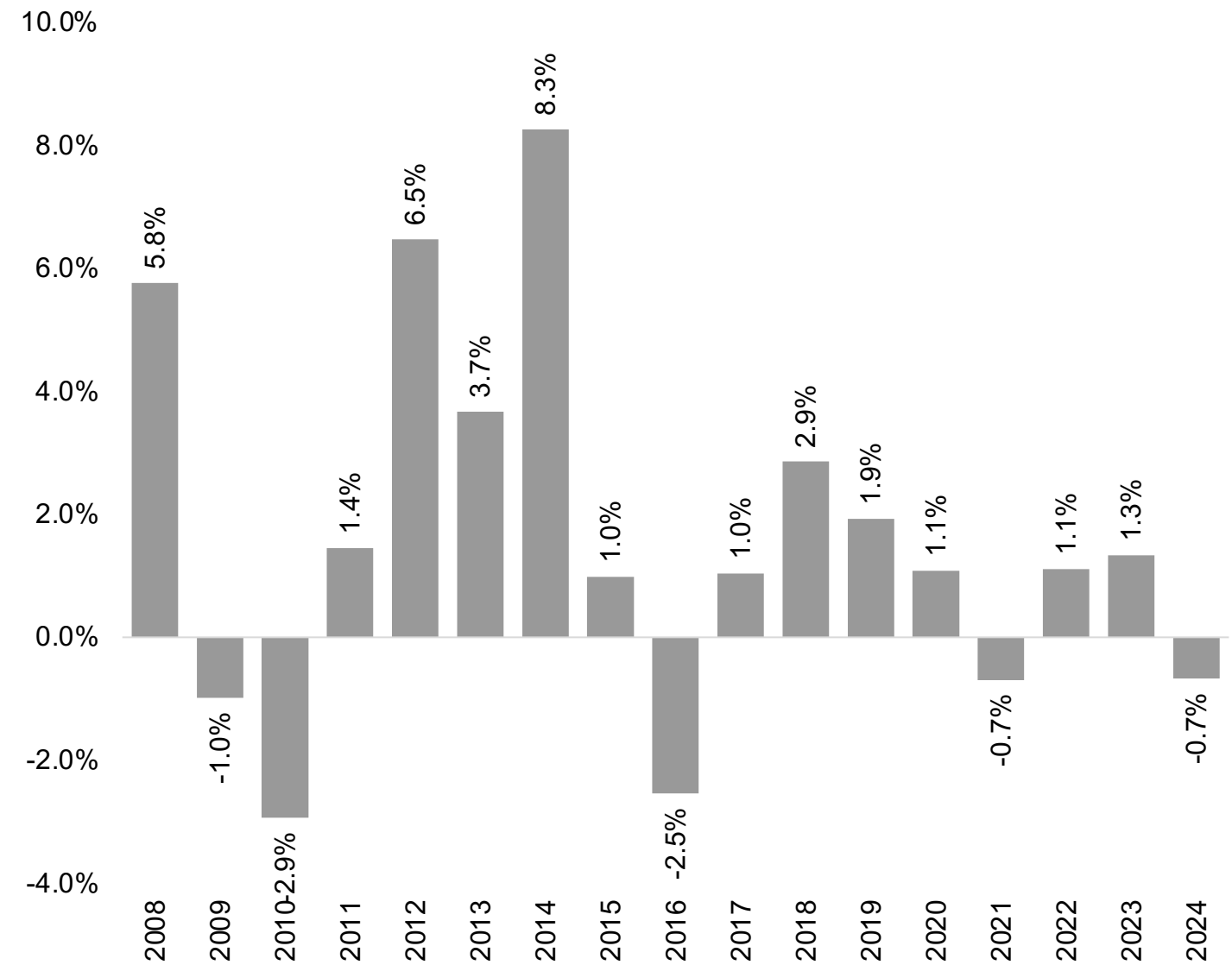
Rents Fall Slightly from All-Time High

Rents declined slightly in the first quarter of 2024 by 0.7% year over year to \$29.77/SF, falling from the all-time high of \$30.50/SF reported a quarter ago. Generally, asking rents are likely to remain elevated in a market impacted by inflation and increasing operating costs.

Office Average Asking Rent, \$/SF, FS



Year-over-Year Asking Rent Growth Rate

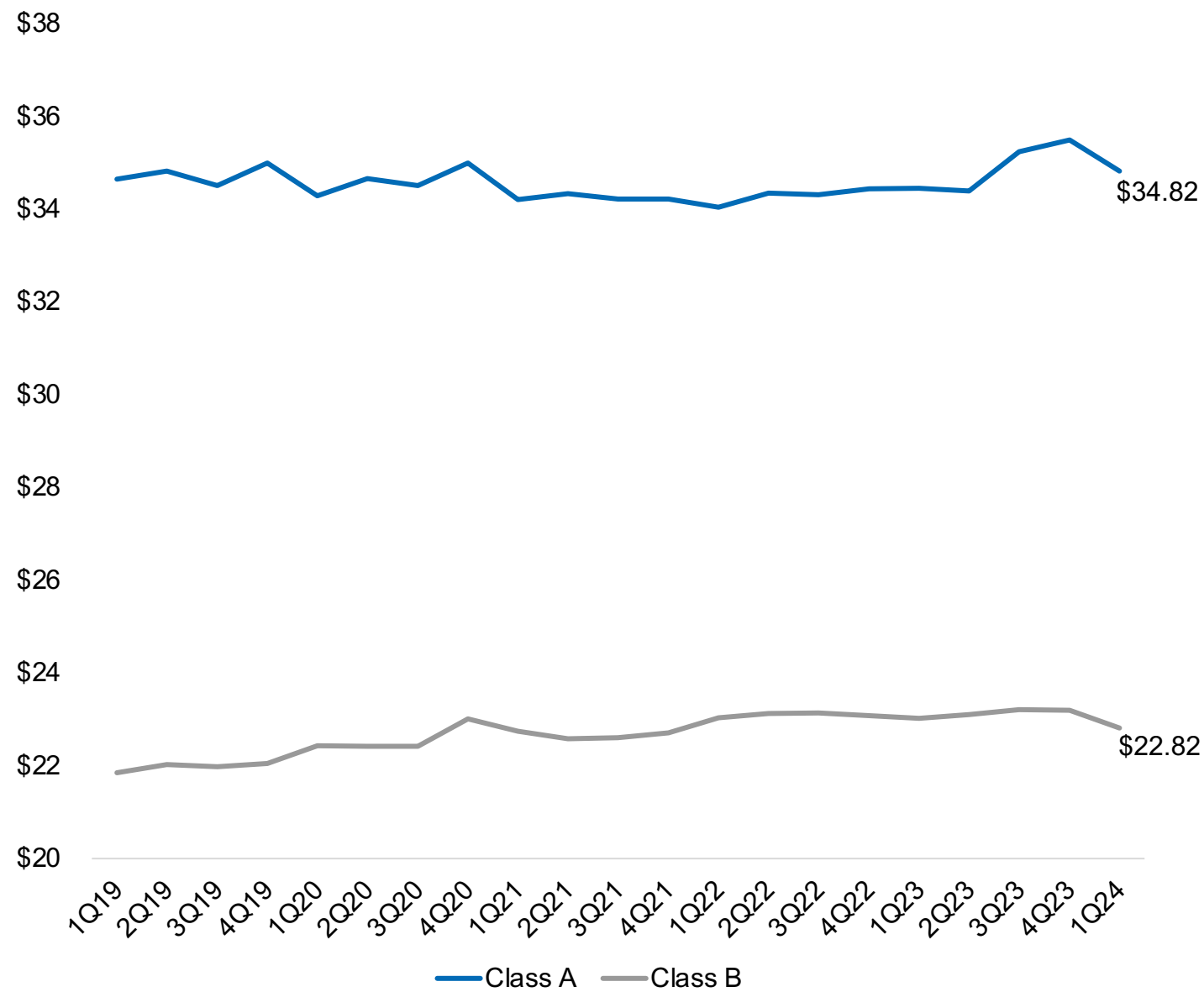


Source: Newmark Research, CoStar

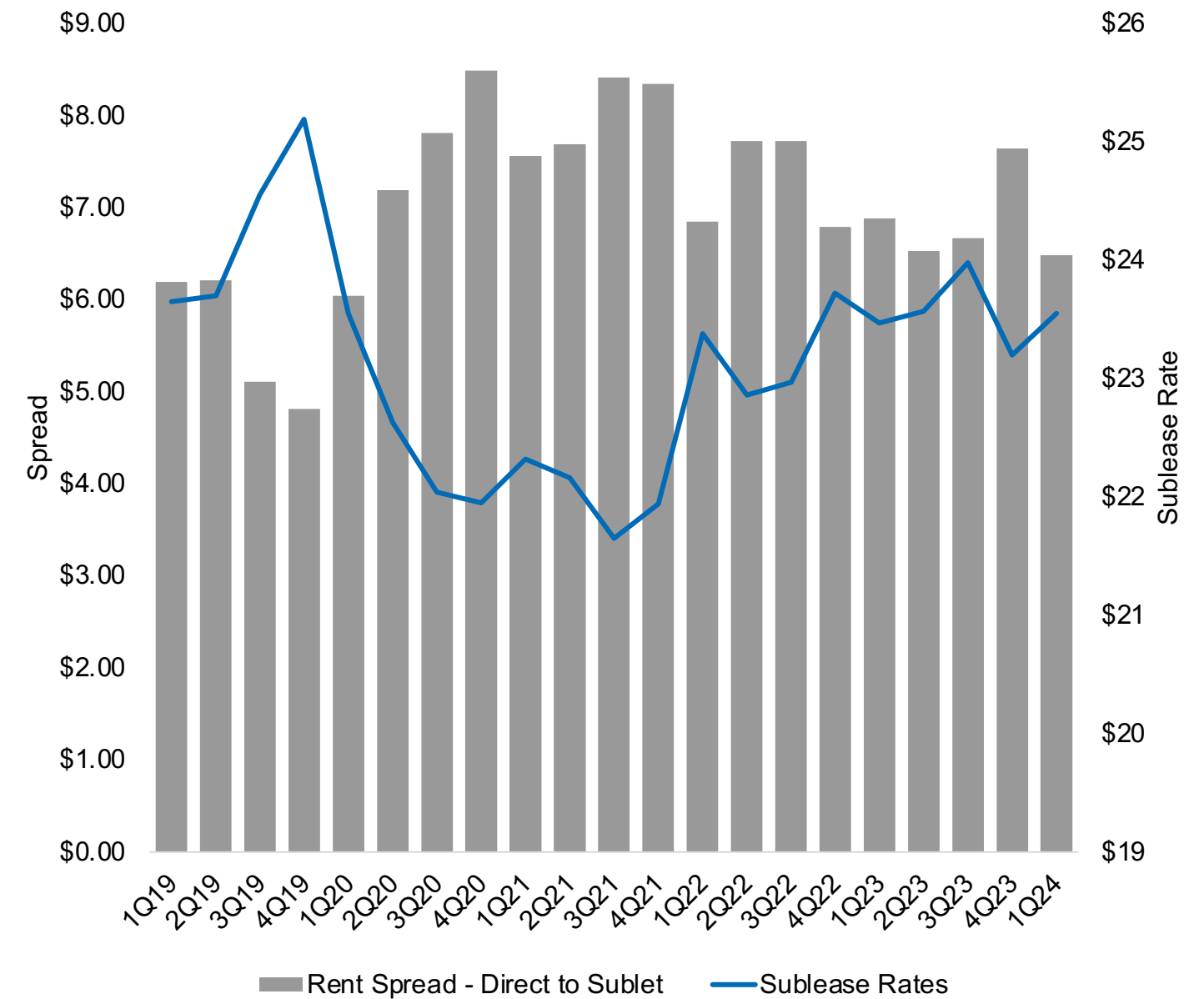
Class A Assets Maintain Rent Spread

As of the end of the first quarter of 2024, Class A rents ended at \$34.82/SF, while Class B reported \$22.82/SF. The \$12.00/SF spread represents a 5.0% increase year over year and reflects the greater demand for higher quality assets. Sublease rates averaged \$23.55/SF in the first quarter of 2024, a 1.5% decrease quarter over quarter. The rent spread between direct and sublease rates is \$6.48/SF at the end of the first quarter of 2024, a decrease of 15.2% from the previous quarter.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Flight-to-Quality Leasing Activity Persists

Despite slowing leasing activity, flight to quality continues as a trend in the market even as the rent spread in Class A spaces remains elevated. As of the end of the first quarter of 2024, Class A space accounted for 61.8% of the market's leasing activity by SF, but only 34.4% of the market's deal volume. Average leases signed in Class A space were 6,959 SF and continue to remain larger than the average market deal size at 3,866 SF.

Notable 1Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Noble Drilling	2101 CityWest Blvd	Westchase	Direct New	110,250
<i>Noble Drilling signed for 110,250 SF at 2101 CityWest Blvd as the firm prepares to move its HQ to the Westchase submarket from Sugar Land.</i>				
Bechtel	2103 CityWest Blvd	Westchase	Direct New	82,000
<i>Bechtel leased an additional 82,000 SF at 2103 City West Blvd, where it will occupy a total of 157,896 SF. The company will move into its expanded space in July 2024.</i>				
Axiom Space	1290 Hercules Ave	Clear Lake	Renewal	63,716
<i>Axiom Space renewed its lease at 1290 Hercules Ave, where it occupies 63,716 SF.</i>				
EnLink Midstream	1501 McKinney	CBD	Sublease	61,682
<i>Oil and gas firm EnLink Midstream took 61,682 SF of sublease space at 1501 McKinney in the CBD submarket.</i>				
Kraken	945 Bunker Hill Rd	Katy Freeway	Direct New	48,040
<i>Kraken, an oil and gas exploration company, leased 48,040 SF on the 11th and 12th floors at 945 Bunker Hill Rd. in the Katy Freeway submarket.</i>				
EnStor	2107 CityWest Blvd	Westchase	Sublease	43,598
<i>Natural gas storage operator, Enstor, leased 43,598 SF at 2107 CityWest Blvd in the Westchase submarket.</i>				

Source: Newmark Research, CoStar



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