

Houston Office Market

Houston Office Market Faces Headwinds in 2Q 2022

Houston's office market is still contending with setbacks from the pandemic, including an oversupply of space and diminished demand. Revised absorption totals for the first quarter of 2022 totaled 1,080,582 square feet, a stark contrast from the nearly 600,000 square feet of negative absorption which occurred in the second quarter. Supply still outpaces demand in the Houston market, particularly amongst newer product, as leasing activity has decreased by 1.2 million square feet year-over-year. Tenants put 290,479 square feet of sublease space on the market in the second quarter of 2022. Since the end of 2021, over 665,700 square feet of sublease space has hit the already-saturated market. Strong leasing in the early quarters of 2021 may help to put absorption back in the black in the second half of 2022 as those tenants begin to occupy new spaces.

Rental Rates Plateau as Vacancy Ticks Up Again

Not since the oil bust of the 1980s has Houston's office market maintained consistently high vacancies. In 2020, vacancy reached 23.4%, while 2021 closed at 25.1%. Having dipped in the first quarter of 2022, vacancy is back at 25.1% to end the second quarter of 2022. Houston continues to lead the nation with the highest overall vacancy rate. The Class A market, consisting of more than 50% of the region's building stock, has a vacancy rate of 27.9% and 2.1 million square feet of space under construction. Rental rates continue to hover in the \$29.00/SF range, where

Current Conditions

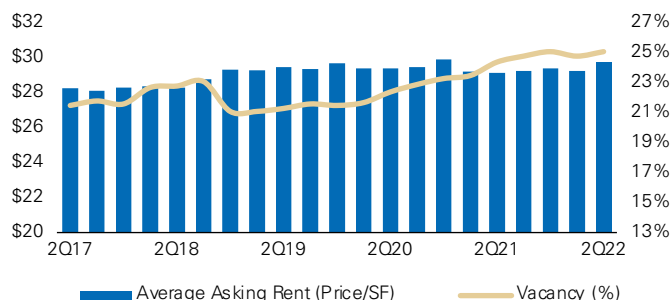
- Vacancy returns to 25.1% after dipping in the first quarter of 2022.
- 290,479 square feet of sublease space was added to the market in the second quarter, bringing the total amount of sublease space to 7.6 MSF.
- Leasing activity totaled 2.1 MSF, a 60.0% decrease from pre-COVID levels
- Across the market 2.2 million square feet of construction is underway; there were no deliveries in the second quarter of 2022.

Market Summary

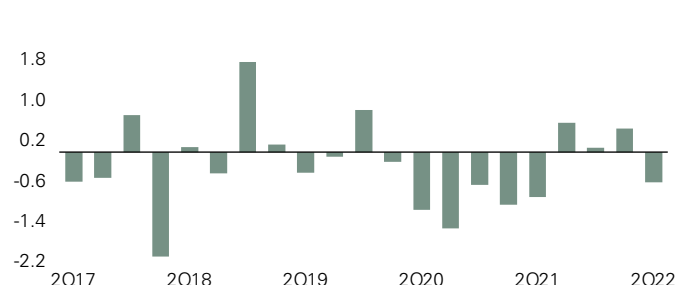
	Current Quarter	Prior Quarter	Year Ago Period	12-Month Forecast
Total Inventory (SF)	242.7 MSF	242.7 MSF	239.7 MSF	↑
Vacancy Rate	25.1%	24.9%	24.2%	↑
Quarterly Net Absorption (SF)	-595,098	1,080,582	-860,994	↑
Average Asking Rent/SF	\$29.77	\$29.41	\$29.29	=
Under Construction (SF)	2.2 M	1.9 M	3.9 M	↑

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION (SF, MILLIONS)



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they have been since 2019. The overall rental rate increased to \$29.77/SF in the second quarter of 2022, while direct rates crossed the \$30.00/SF threshold. Net absorption returned to negative territory in the second quarter after a very strong first quarter of 2022. In the second quarter of 2022, absorption totaled negative 595,098 square feet. The market only had three quarters of positive net absorption since the start of 2019. In 2021, tenants gave back 2.2 million square feet of space. At 29.2% of the market inventory, available space has increased 40 basis points year-over-year and now exceeds 71.5 million square feet.

In the Central Business District, vacancy is at 32.0% for the quarter with an availability rate of 36.2%. Year-over-year, vacancy in the submarket has increased 340 basis points. The CBD continues to struggle with an oversupply of available space and shortage of demand. Absorption suffered from tenants giving back 195,926 square feet in the second quarter, while leasing activity totaled 389,481 square feet. Rental rates are beginning to climb again, reaching \$40.36/SF overall. Direct rates jumped 3.3%, to end the quarter at \$41.28/SF. Sublease rates rose slightly to \$23.71/SF. The average price discount for sublease space in the CBD is now 42.5%.

Leasing Activity

Transactions totaled 2.1 million square feet in the second quarter of 2022 as leasing activity weakened. Leasing activity in the market is 60% below pre-pandemic levels. In the second quarter, 620 transactions took place as tenants continue to take advantage of soft market conditions and focus on right-sizing their footprints and giving back space. Cheniere Energy will move its headquarters to Texas Tower, a block away from its current location at Pennzoil Place in the CBD. The company leased 151,490 square feet on floors 12 to 16, further illustrating the market's flight-to-quality trend. After several recent transactions, Texas Tower is now 70.0% leased.

Law firms are driving much of the activity Downtown in 2022.

Munsch Hardt Kopf & Harr, P.C. is bucking recent law firm trends and doubling its size in the CBD. The firm is increasing its space at Pennzoil Place to 40,000 square feet, enough space for 80 attorneys. The firm currently offices at 2500 Fannin St. in Midtown. McDermott Will & Emery also downsized to space at Texas Tower earlier this year, taking 15,877 square feet. O'Melveny & Myers recently announced it is opening its first Houston office at the TC Energy Center, taking a full floor. This marks the firm's third office to open in Texas in the last 10 months. Across town, Wilson Cribbs & Goren will move to Park Towers North in Uptown early in 2023, where the firm will occupy a full floor.

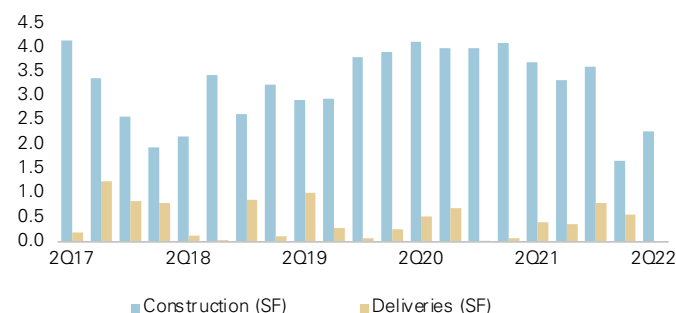
With the excessive supply of existing office space, development is expected to lag throughout 2022 as developers become more restrained, helping to reduce Houston's supply risk. There is currently 2.2 million square feet of space under construction, with projects in the Texas Medical Center accounting for 60.0% of the total. The CBD has 386,323 square feet under construction, while 188,550 square feet of construction is underway in the Katy Freeway submarket. There were no deliveries in the second quarter of 2022, marking the first quarter with no completions since the fourth quarter of 2016.

Life Sciences Strengthens Houston's Office Market

The Houston life sciences market has just over 8 million square feet of inventory, with roughly 7.5 million square feet of proposed development in the pipeline. Life science space under construction totaled 994,000 square feet in midyear 2022. The focus of life sciences in Houston centers around the Texas Medical Center expansion, where four buildings are under construction. The TMC3 Collaborative Building topped out in March with a delivery date of August 2023. The 250,000-square-foot building will feature a 43,000-square-foot research lab, which will be shared by MD Anderson, Texas A&M Health and UT Health Houston.

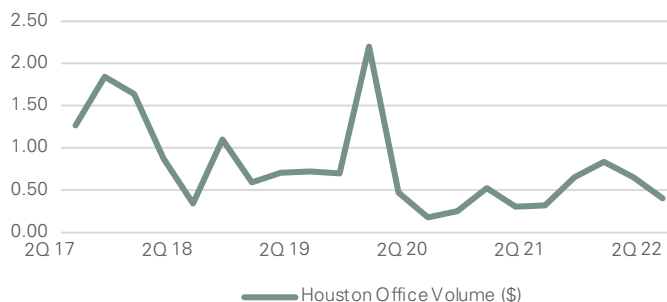
Construction and Deliveries

SQUARE FEET, MILLIONS



Office Investment Sales

SALES VOLUME (\$, BILLIONS)



Source: Real Capital Analytics

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The building will also include 85,000 square feet of lab space and office/coworking space, 7,000 square feet of lecture space and 14,200 square feet for strategic projects. Construction is also underway on the anchor facility for the first phase of TMC3, which will comprise 700,000 square feet and is being developed by Beacon Capital Partners and Braidwell.

Horizon Tower is expected to deliver in the first quarter of 2023 and will bring 521,000 square feet of medical office, research and life science space to the Texas A&M Innovation Plaza. Just down the road from Horizon Tower, construction on Levit Green is underway and is slated to wrap up by year-end. The 270,000-square-foot building is part of a nine-building master plan and will offer lab and office space, along with a 9,500-square-foot standalone vivarium.

Looking Ahead

Currently, Houston's office market performance remains near the bottom within the U.S., and the market is expected to struggle through the remainder of 2022. Demand is projected to pick up in 2023, albeit at a slower pace than previously seen. A lack of organic growth in the Houston market is a main concern, as market corrections could take longer in the absence of new industry to satisfy the amount of available space. Rental rates have likely plateaued for the foreseeable future as landlords attempt to attract tenants until demand jumpstarts. Houston office tenants will maintain the upper hand in the near- to-midterm. Reinvestment from owners into assets should be seen as a benefit rather than a concern, as it prevents a large portion of Houston's building stock from going into obsolescence.

Additionally, office space is being converted to multi-housing, life science/laboratory facilities and data centers, as owners take advantage of demand in these sectors. In past downturns, the market rebounded with a combination of economic upswing, increased investment and new development. This time around, it appears the focus will be on tending to the market's current tenants and inventory, ensuring that the building stock remains attractive and ripe for future growth.

Select Lease Transactions

Tenant	Submarket	Building	Type	Square Feet
Cheniere Energy	CBD	Pennzoil Place 845 Texas Ave	Direct – New	151,490
GEXA Energy	CBD	601 Travis St	Direct – New	62,261
Genesis Energy	CBD	811 Louisiana St	Direct – New	49,145
CTCI Americas	Katy Grand Parkway	15721 Park Row	Direct – New	26,417
Rystad Energy	Katy Freeway	920 Memorial City Way	Direct – New	23,652
Verdun Oil Company LLC	Katy Freeway	945 Bunker Hill Rd	Direct – New	23,517

Select Sales Transactions

Buyer/Seller	Submarket	Building	Type	Square Feet
CAB Enterprises/ Radom Capital	Allen Parkway	3201 Allen Parkway	\$21,975,000	\$488
Genview Corporation/ MidFirst Bank	Greenspoint	Paragaon Center I 450 Gears Rd	\$7,259,750	\$38
CAB Enterprises/ Radom Capital	South/ Southwest Freeway	Fresenius- 1830 Broadway St	\$3,350,000	\$556
Evershine/ Island Group Services LLC	Conroe	32400 SH 249	\$2,000,000	\$207

Submarket Statistics								
	Total Inventory (SF)	Under Construction (SF)	Total Vacancy Rate	Quarter Absorption (SF)	YTD Absorption (SF)	Direct Asking Rent (Price/SF)	Sublet Asking Rent (Price/SF)	Total Asking Rent (Price/SF)
CBD	40,142,235	386,323	32.0%	-195,926	-385,982	\$41.28	\$23.71	\$40.36
Allen Parkway	6,579,289	0	17.7%	-6,808	-52,767	\$35.79	\$30.08	\$35.78
Bellaire/Med Center	13,922,445	1,354,459	14.2%	103,276	208,854	\$28.92	\$21.10	\$28.30
Clear Lake	7,481,186	106,000	10.0%	-35,159	-8,080	\$22.24	\$23.16	\$22.25
Conroe	1,947,498	0	18.0%	17,452	49,255	\$27.73	\$19.25	\$26.36
East/Pasadena	6,214,184	175,000	15.9%	21,612	24,640	\$21.64	\$18.75	\$21.59
Energy Corridor	23,260,949	0	28.1%	-93,651	87,727	\$26.39	\$19.44	\$25.26
FM 1960/249	11,234,884	0	23.9%	-83,105	10,637	\$20.94	\$20.00	\$20.93
Galleria/Uptown	24,414,713	0	26.9%	-22,920	245,162	\$34.75	\$24.32	\$34.13
Greenspoint	11,904,721	0	48.1%	85,034	85,034	\$17.82	\$15.62	\$17.81
Greenway Plaza	10,960,726	0	24.3%	-11,482	51,521	\$33.75	\$28.59	\$33.57
Katy Freeway	16,873,952	188,553	15.9%	41,565	176,117	\$28.68	\$32.47	\$28.78
Katy/Grand Pky	3,567,237	20,758	17.6%	14,768	14,573	\$30.88	\$24.43	\$29.91
Kingwood/Humble	1,400,463	0	12.7%	-14,553	-5,513	\$22.73	\$18.00	\$22.61
NW Houston	8,376,066	0	20.9%	-62,653	-1,366	\$19.66	\$17.95	\$19.55
Southwest Fwy	12,225,086	0	18.4%	-119,129	-116,464	\$19.28	\$19.78	\$19.28
Sugar Land/Ft Bend	6,682,746	0	20.9%	-22,290	-48,234	\$30.30	\$29.43	\$30.27
West Belt	5,544,519	0	25.3%	-35,426	7,300	\$24.57	\$22.70	\$24.47
Westchase	15,130,866	0	33.8%	-45,052	-130,513	\$27.17	\$29.07	\$27.29
The Woodlands	14,918,930	50,400	21.1%	4,679	468,018	\$32.51	\$24.43	\$30.19
Suburban	202,640,460	1,895,170	23.8%	-399,172	871,466	\$26.95	\$22.91	\$26.68
Market	242,782,695	2,281,493	25.1%	-595,098	485,484	\$30.23	\$23.05	\$29.77

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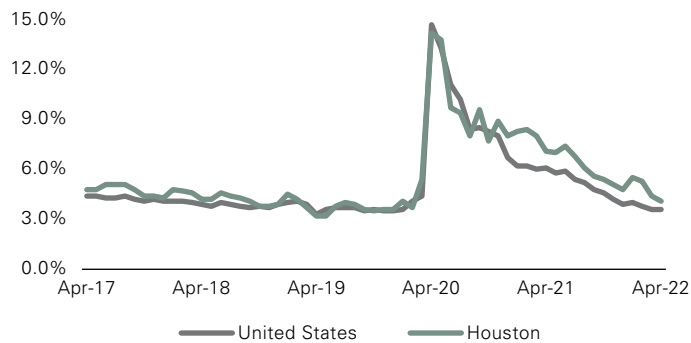
Economic Indicators

Houston remains in the recovery phase of the business cycle, but the index grew 7.5% for the three months ending in April 2022. In June, the average price of gasoline in the U.S. was \$4.93 per gallon and WTI prices averaged \$114.84 per barrel. Global demand could be reduced by inflation, higher fuel prices and the current COVID-19 restrictions in much of China. In Houston, higher oil prices should trickle down to professional services as the demand for engineers, financial and IT personnel is likely to rise. The Greater Houston Partnership is anticipating gains of 75,500 jobs in 2022. In May, the GHP reported 31,000 jobs had been created in the Houston Metro. Per the GHP, job growth has exceeded pre-pandemic averages in nine of the past twelve months. The Houston region is expected to outpace national growth in 2022, and the overall outlook for the Houston economy is positive.

In the year period ending in June, consumer prices increased 9.1% nationwide. Core inflation increased by 5.9% over the same period. In the Houston Metro, the Consumer Price Index was at 10.2% for June, which points toward stronger demand compared to the nation. The unemployment rate in Houston dropped slightly in April to 4.1% month-over-month but was down from 7.1% a year prior. All the industries tracked by the BLS for the region showed 12-month gains in employment growth in May, with mining/logging gaining the largest share at 11.4%.

Unemployment Rate

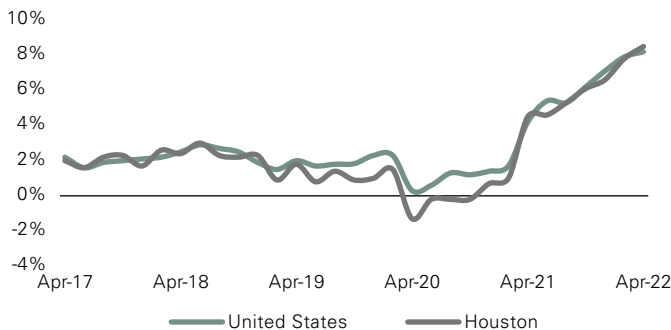
NON-SEASONALLY ADJUSTED



Source: US Bureau of Labor Statistics, June 2022

Consumer Price Index (CPI)

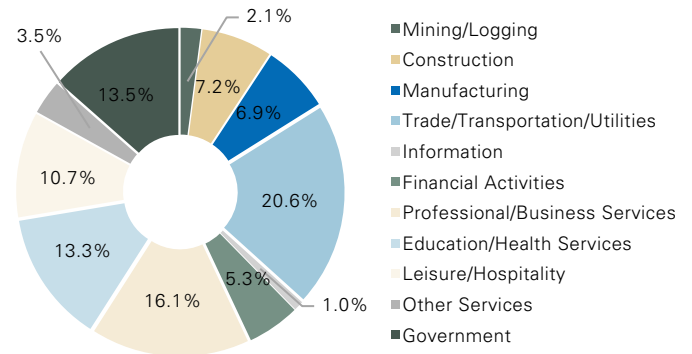
ALL ITEMS, 12-MONTH % CHANGE, NON-SEASONALLY ADJUSTED



Source: U.S. Bureau of Labor Statistics, June 2022

Employment By Industry

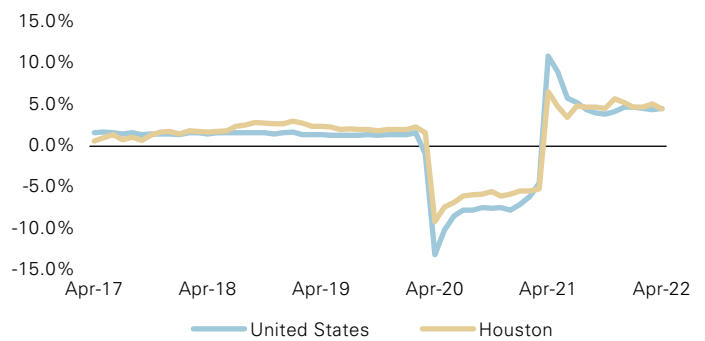
TOTAL NONFARM, NOT SEASONALLY ADJUSTED, MAY 2022



Source: US Bureau of Labor Statistics, May 2022

Payroll Employment

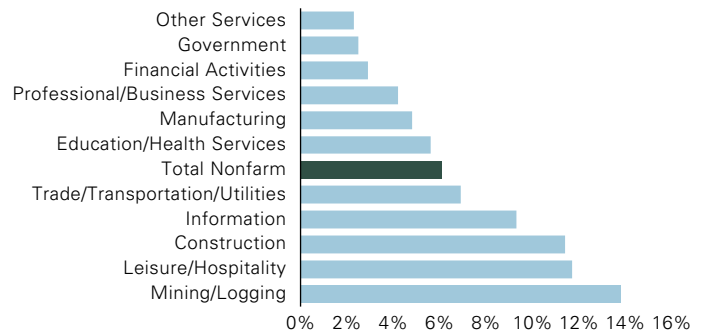
TOTAL NONFARM, NOT SEASONALLY ADJUSTED, 12-MONTH % CHANGE



Source: U.S. Bureau of Labor Statistics, June 2022

Employment Growth By Industry

HOUSTON, MAY 2022, 12-MONTH % CHANGE, NON-SEASONALLY ADJUSTED



Source: U.S. Bureau of Labor Statistics, June 2022

For more information:

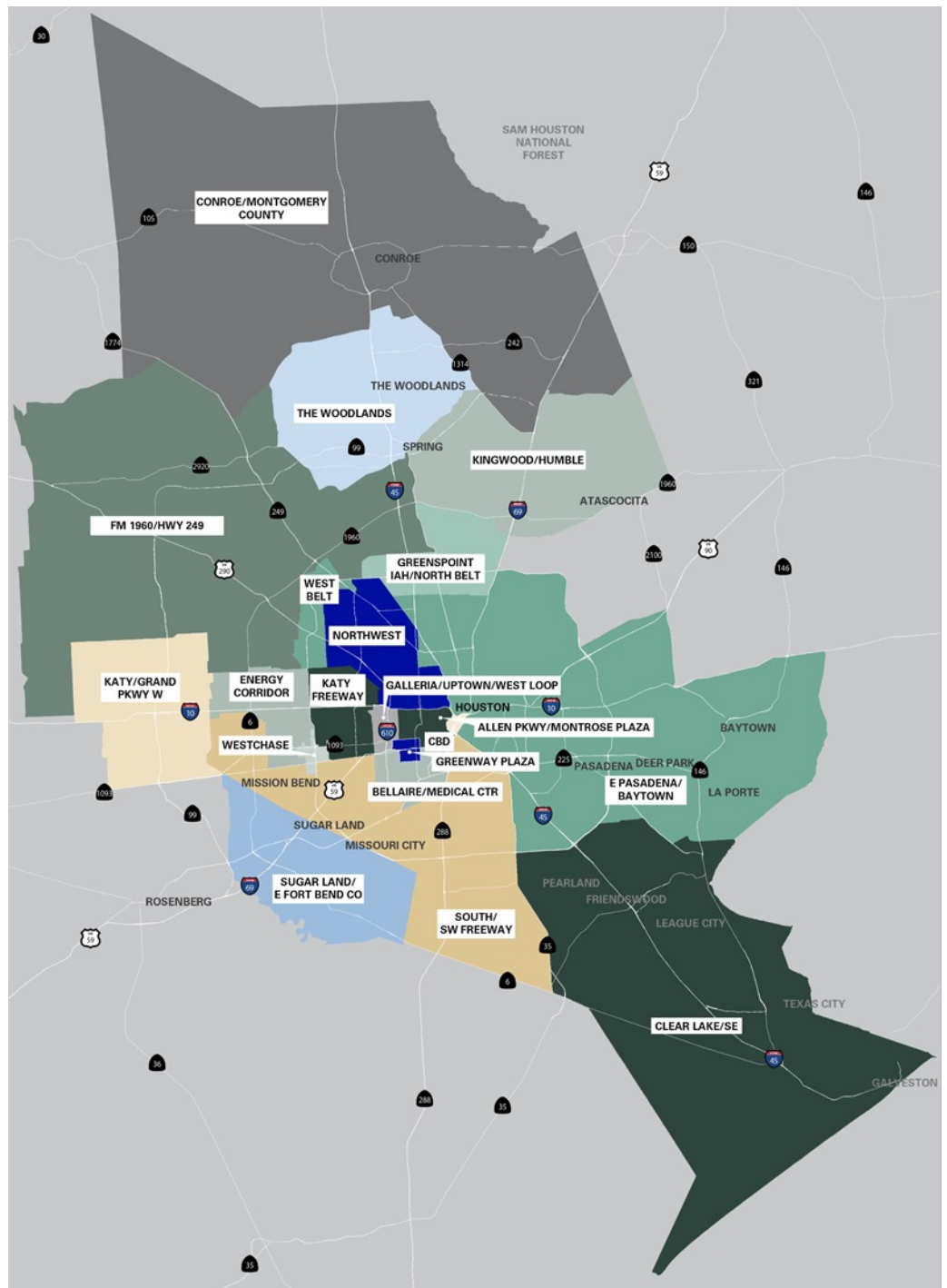
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