2Q23

Houston Office Market Overview

Market Observations

Economy

- The market's unemployment rate ticked up by 36 basis points year over year to 4.4%, but remained well below the five-year average of 5.5%.
- Although job growth pace has slowed compared with recent highs to 3.7% year over year, employment growth continues to significantly outpace pre-pandemic levels, with 2019 growth averaging only 2.3%.
- All sectors, except other services and construction, reported employment growth, with mining and logging leading job gains at 6.1% over the past 12 months.
- Office-using jobs in the market reached an all-time historical high at 777,300 employees, reflecting 10.3% growth since 2019.

Leasing Market Fundamentals

- Annual full-service asking rental rates decreased to $29.69/SF, a 1.0% decrease year over year.
- Occupancy declined, pushing overall vacancy rates to increase by 50 basis points year over year, to 24.6%.
- The under-construction pipeline continued to remain steady, with 3.0 MSF in progress.
- Total leasing activity closed the quarter at 3.5 MSF, averaging 4,343 SF per deal and reflecting an increase in deal size by 29.9% quarter over quarter and 0.1% year over year.

Major Transactions

- LyondellBasell Industries signed the largest lease of the quarter for 318,504 SF in Williams Tower.
- The Katy Freeway submarket had several large leases signed, including Fluor Corporation, Technip Energies, Hargrove Engineers and Fugro, cumulatively accounting for 636,843 SF of leasing activity in the submarket.
- Fluor Corporation, Technip Energies and Fugro are all relocating their headquarters into higher-quality space.

Outlook

- The Houston office market will likely see continued suppressed growth this year. Office investment activity will remain low in the near term due to elevated inflation and a steeper cost of debt.
- The closing rent spread between Class A and Class B assets will likely push more tenants to shed unused space and lease smaller footprints in higher-quality assets.
- The office market is expected to remain tenant friendly with continued muted demand. As a result, overall asking rents are projected to decline in the near term.

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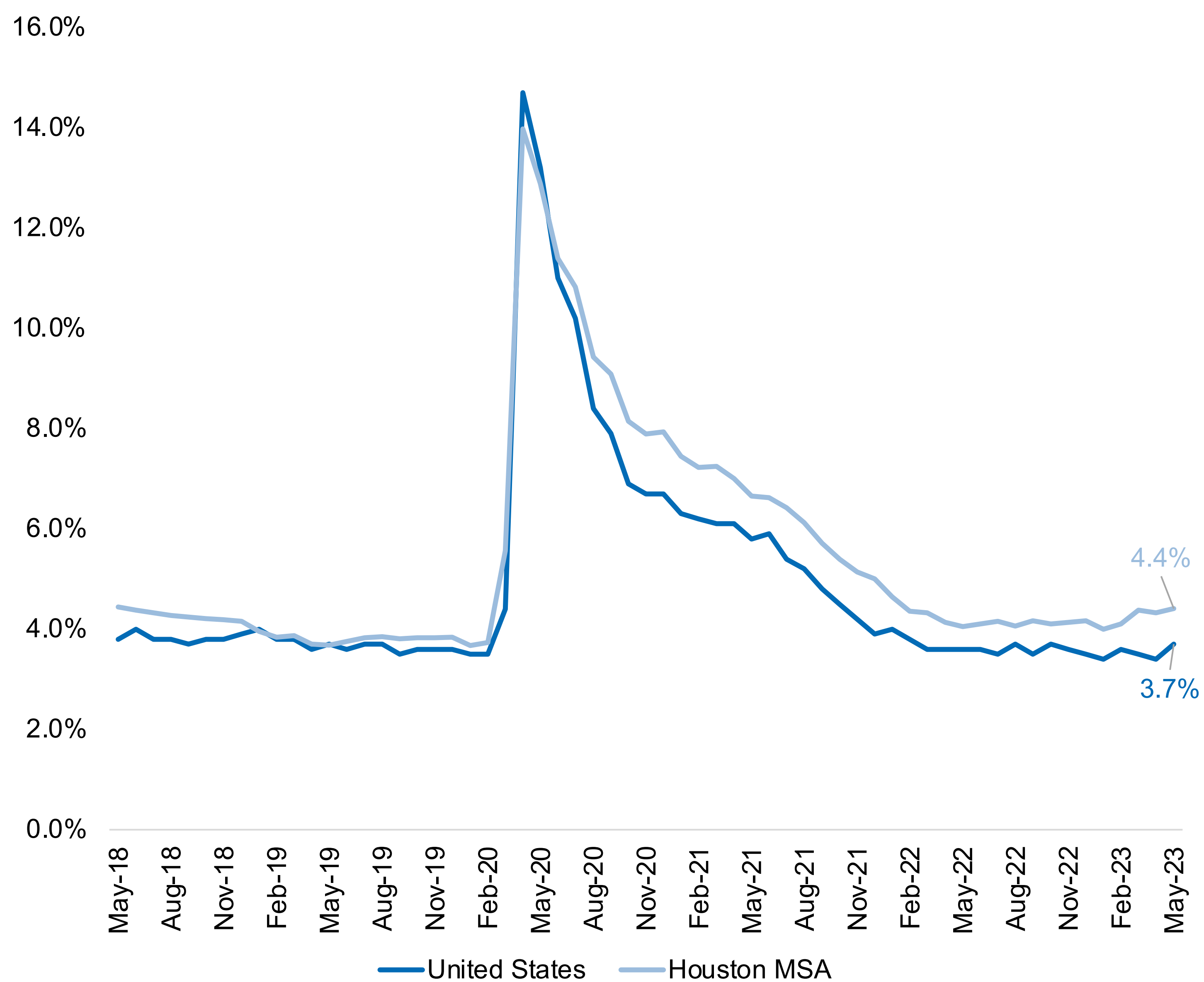
Economy

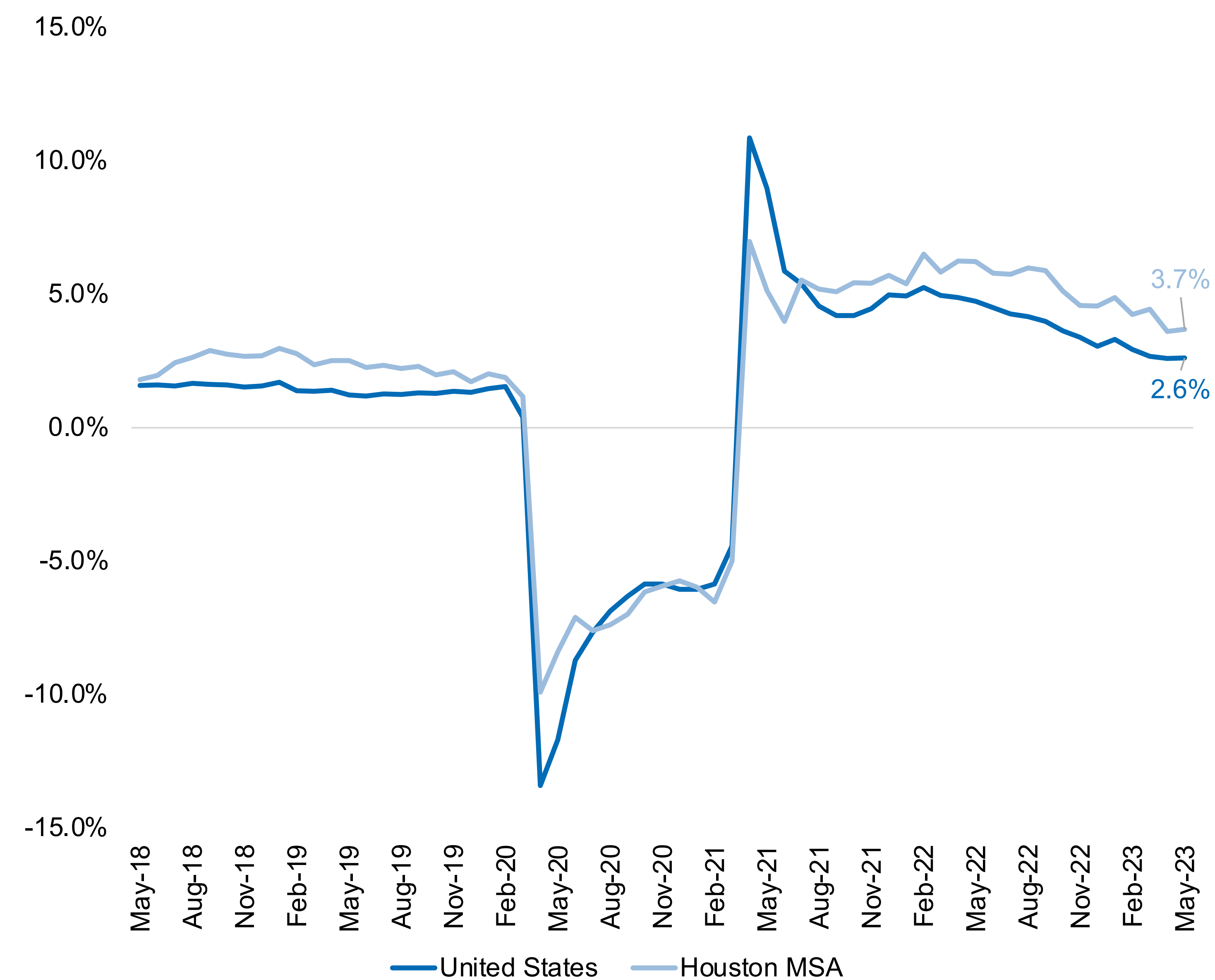
Metro Employment Trends Signal a Slowing Economy

The Houston market has generally reported higher unemployment rates compared with the national average, while being an outperformer in employment growth. Recent national economic headwinds have pushed the region's unemployment rate to increase by 36 basis points year over year, while the employment year-over-year growth rate slowed by 255 basis points compared with the previous year.

Unemployment Rate, Seasonally Adjusted



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

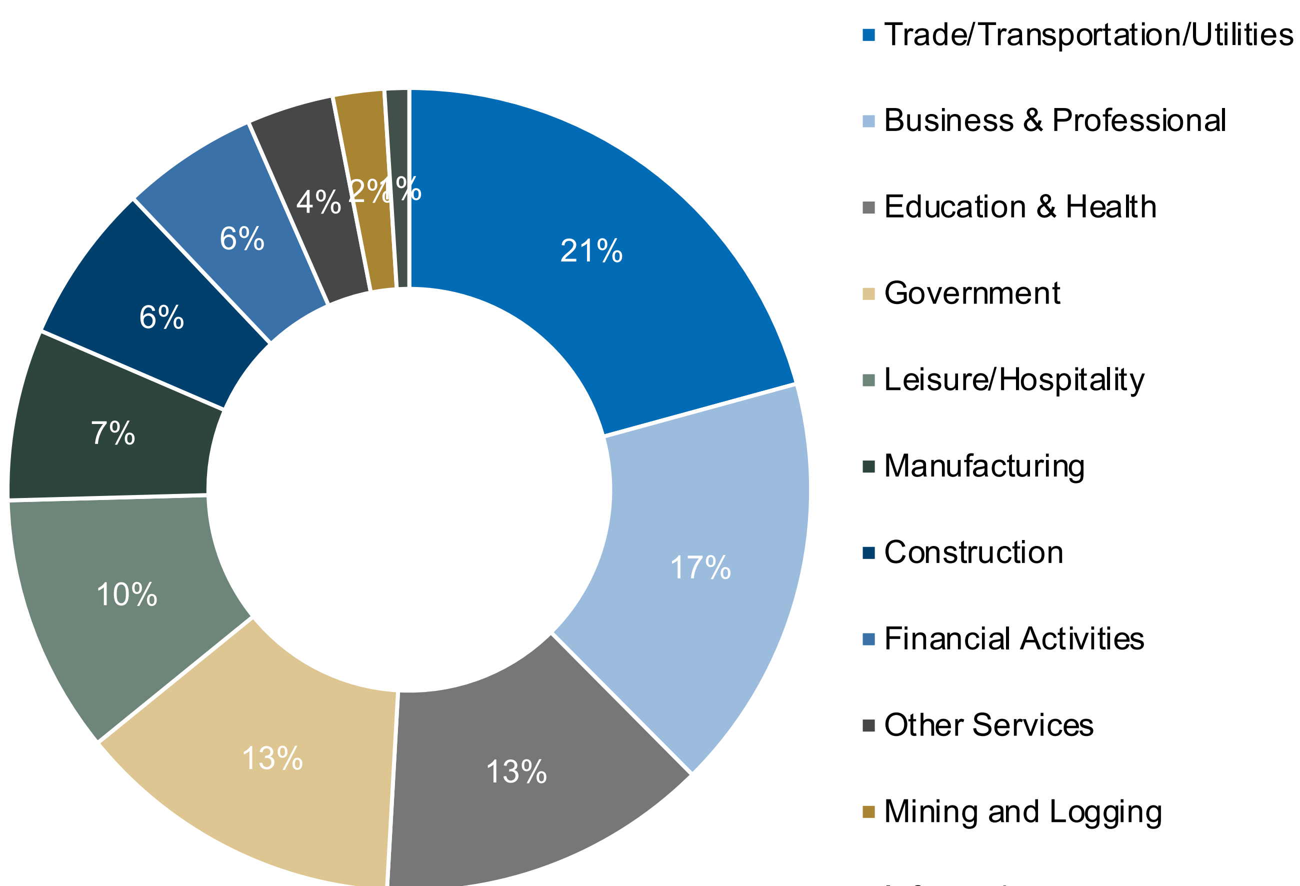


Source: U.S. Bureau of Labor Statistics, Houston MSA

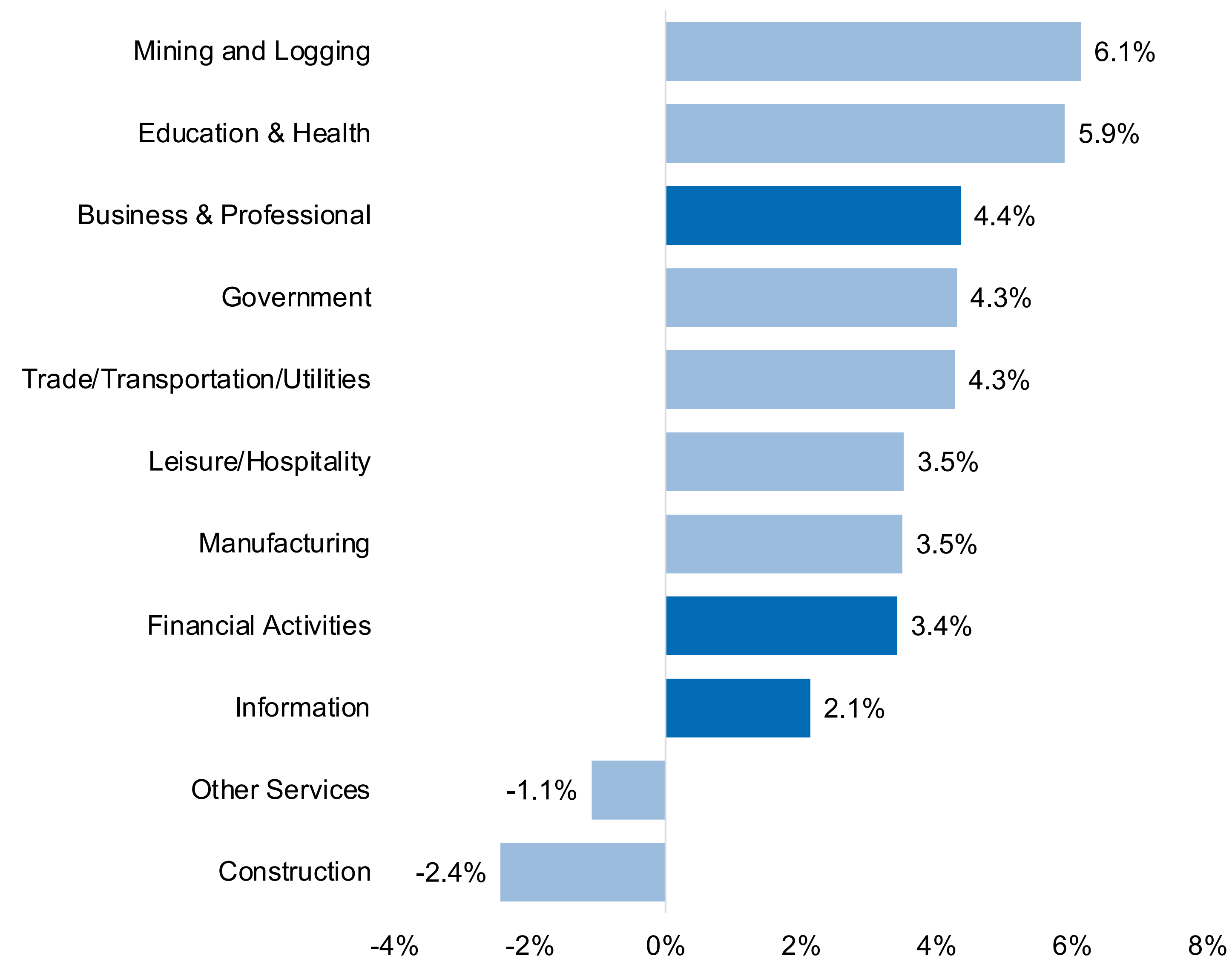
Employment Growth Continues Across Office Sectors

Known for its energy sector, the Houston market's top two employment industries account for 37.6% of market share. The office-using employment's business and professional sector is the second-largest industry sector in the metroplex at 16.8%. All industries, except for other services and construction, in the metroplex reported growth, with office-using industries reporting year-over-year growth ranging from 2.1% to 4.4%.

Employment by Industry, May 2023



Employment Growth by Industry, 12-Month % Change, May 2023

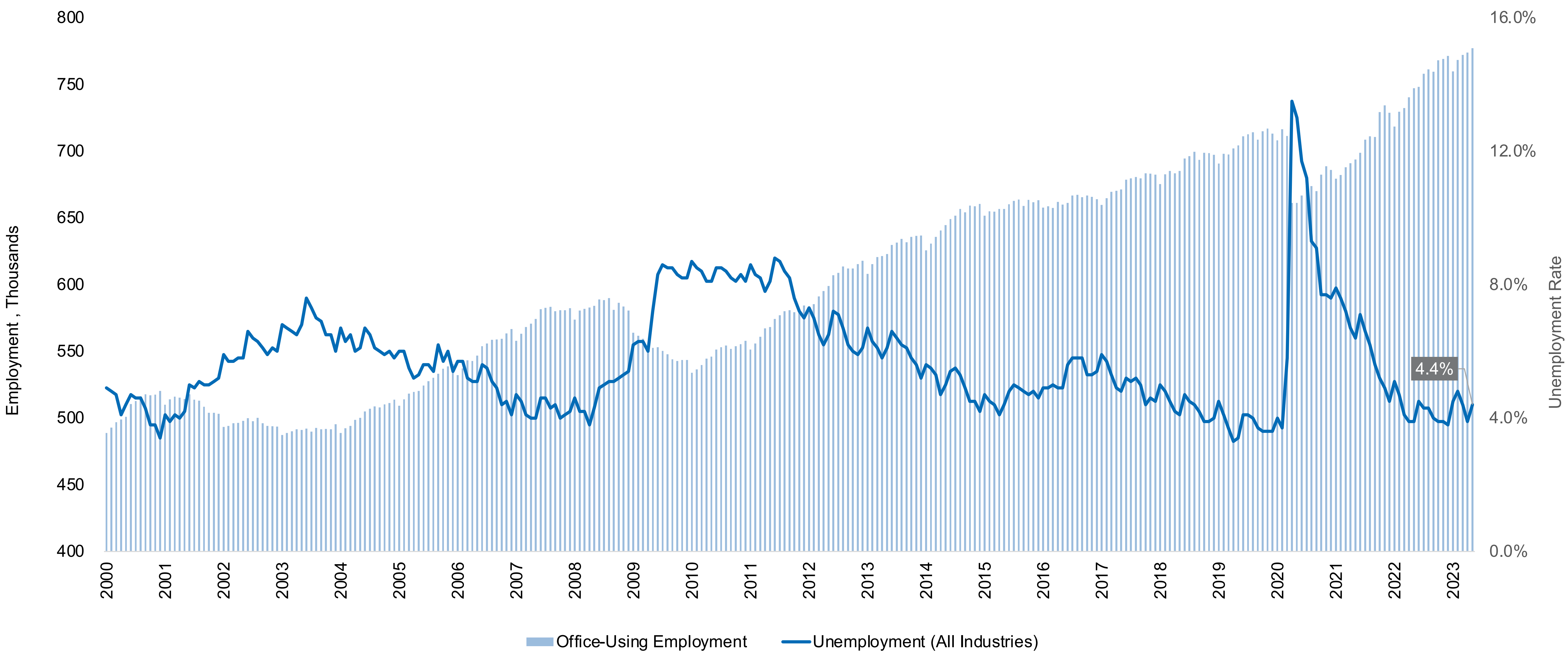


Source: U.S. Bureau of Labor Statistics, Houston MSA

Overall Office-Using Employment at Historical High

Office-using employment in the Houston market reached an all-time historical high of 777,300 employees as of the end of May 2023. Currently, the unemployment rate is at 4.4%, 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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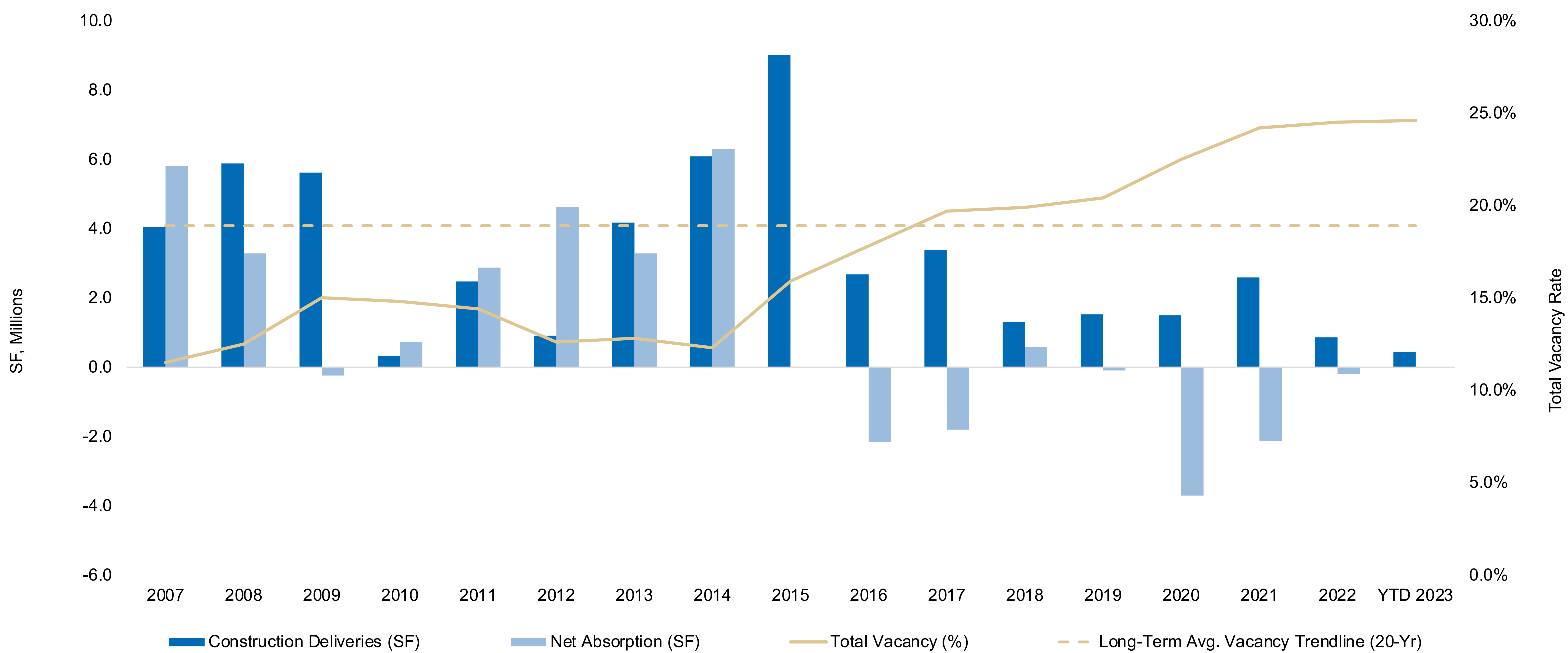
Leasing Market Fundamentals

Vacancy Increases as Construction Deliveries Outpace Net Absorption

The Houston office vacancy rate increased by 50 basis points year over year to 24.6% in the second quarter of 2023. Since the oil crash in 2016, office occupancies have slowed in the market, with continued new office supply delivering, although at a more muted pace. Vacancy rates have increased since the pandemic and, as of the second quarter of 2023, reached an all-time historical high of 24.6%, increasing by 50 basis points year over year.

Historical Construction Deliveries, Net Absorption, and Vacancy

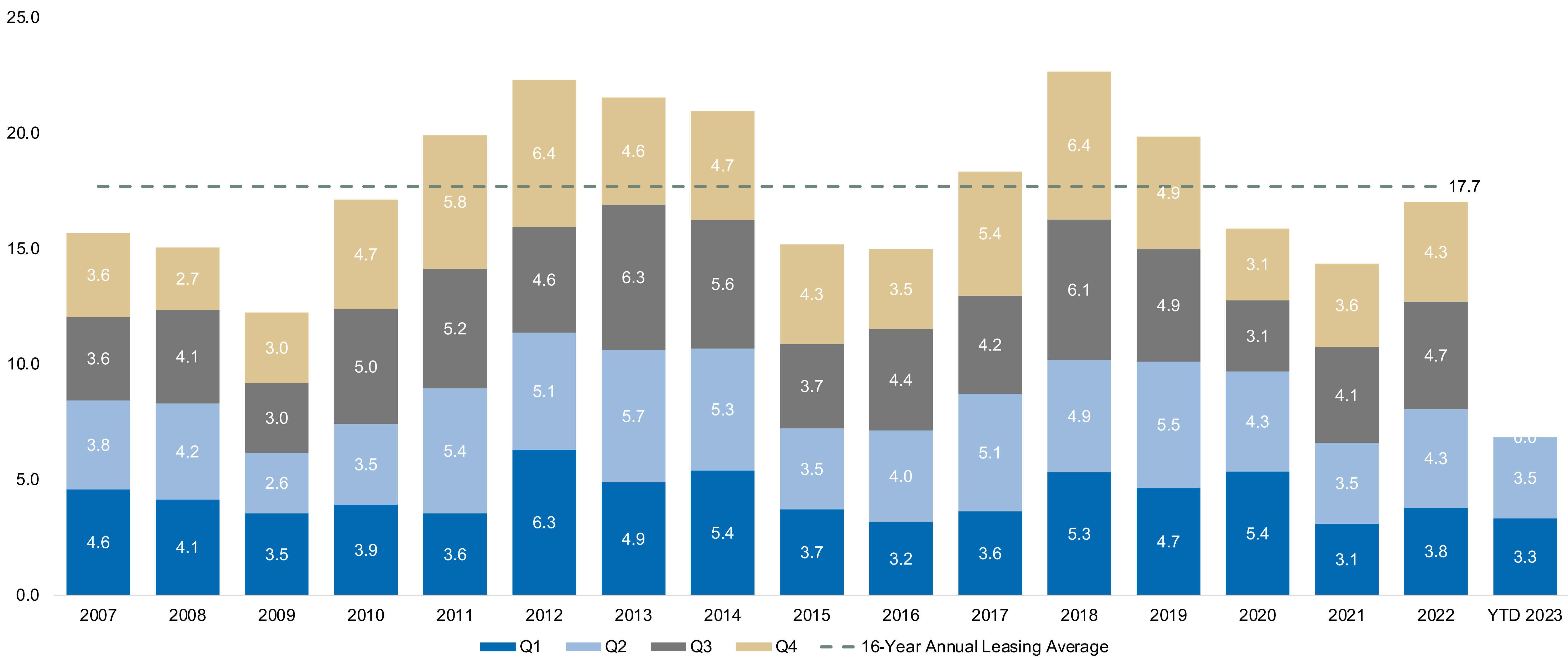


Source: Newmark Research, CoStar

Declining Deal Activity Results in Slowing Leasing Activity

Leasing activity in the market remains slower, with the first half of 2023's leasing activity slightly outpacing that of 2021 at 6.8 MSF. Since 2007, second-quarter leasing activity averaged 4.4 MSF, with the second quarter of 2023 below historical averages at 3.5 MSF. Deal size averaged 4,343 SF in the second quarter of 2023, an average of 5 SF more than a year ago and 1,001 SF more than the previous quarter. The slowing leasing activity pace is largely attributed to fewer deals being done, likely impacted by a more challenging debt liquidity environment preventing larger deals from occurring as easily.

Total Leasing Activity (msf)



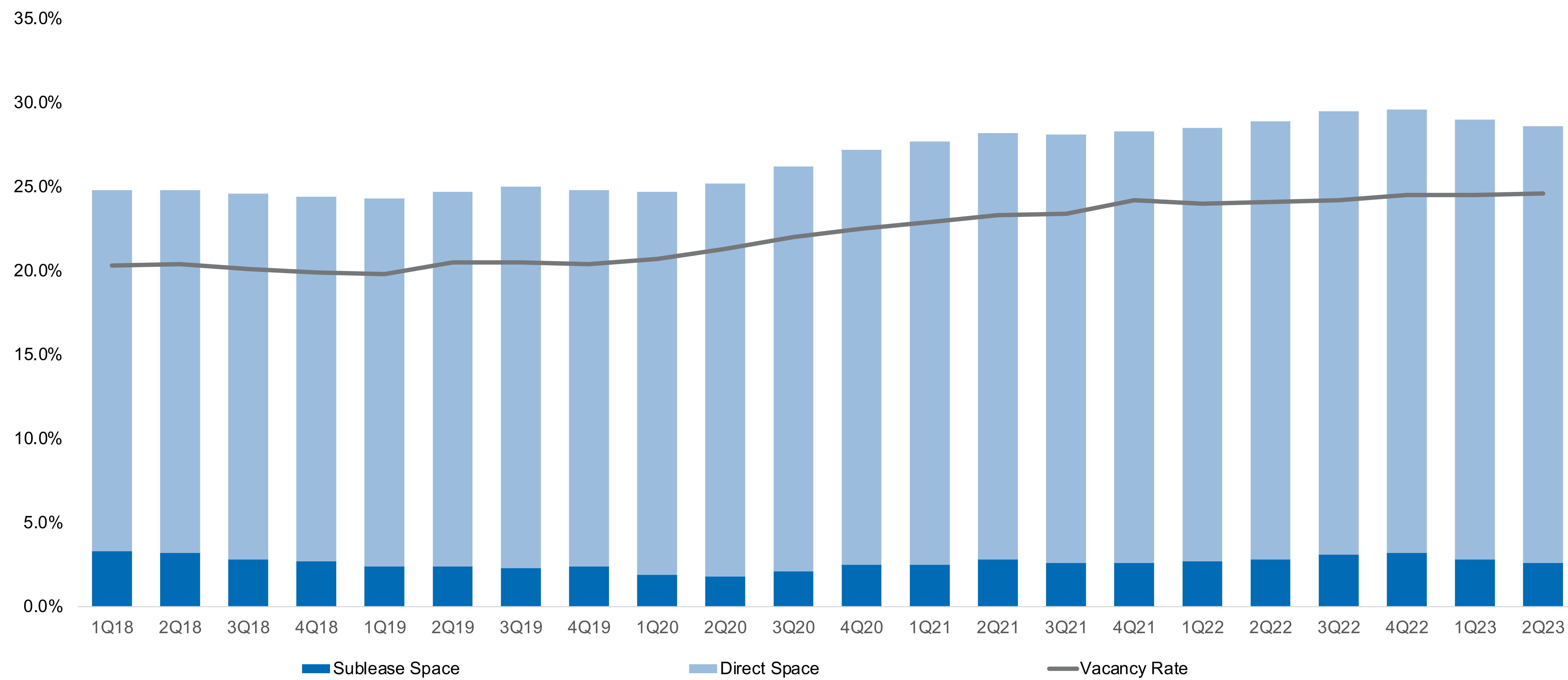
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	YTD 2023
Q1	4.6	4.1	3.5	3.9	3.6	6.3	4.9	5.4	3.7	3.2	3.6	5.3	4.7	5.4	3.1	3.8	3.3
Q2	3.8	4.2	2.6	3.5	5.4	5.1	5.7	5.3	3.5	4.0	5.1	4.9	5.5	4.3	3.5	4.3	3.5
Q3	3.6	4.1	3.0	5.0	5.2	4.6	6.3	5.6	3.7	4.4	4.2	6.1	4.9	3.1	4.1	4.7	0.0
Q4	3.6	2.7	3.0	4.7	5.8	6.4	4.6	4.7	4.3	3.5	5.4	6.4	4.9	3.1	3.6	4.3	

Source: Newmark Research, CoStar

Availability Decreases from All-Time High

Sublease availabilities in the Houston market have declined since the oil crash in 2016, remaining at a relatively steady availability pace since 2019. As of the end of the second quarter of 2023, sublease availability in the market was at 2.6%. Direct availabilities have increased since the pandemic and have decreased from all-time highs reported in the second half of 2022 at 29.3%, with current direct availability rate at 28.4%. Vacancies continue to increase alongside availabilities, reaching a new high at 24.6%.

Available Space as Percent of Overall Market

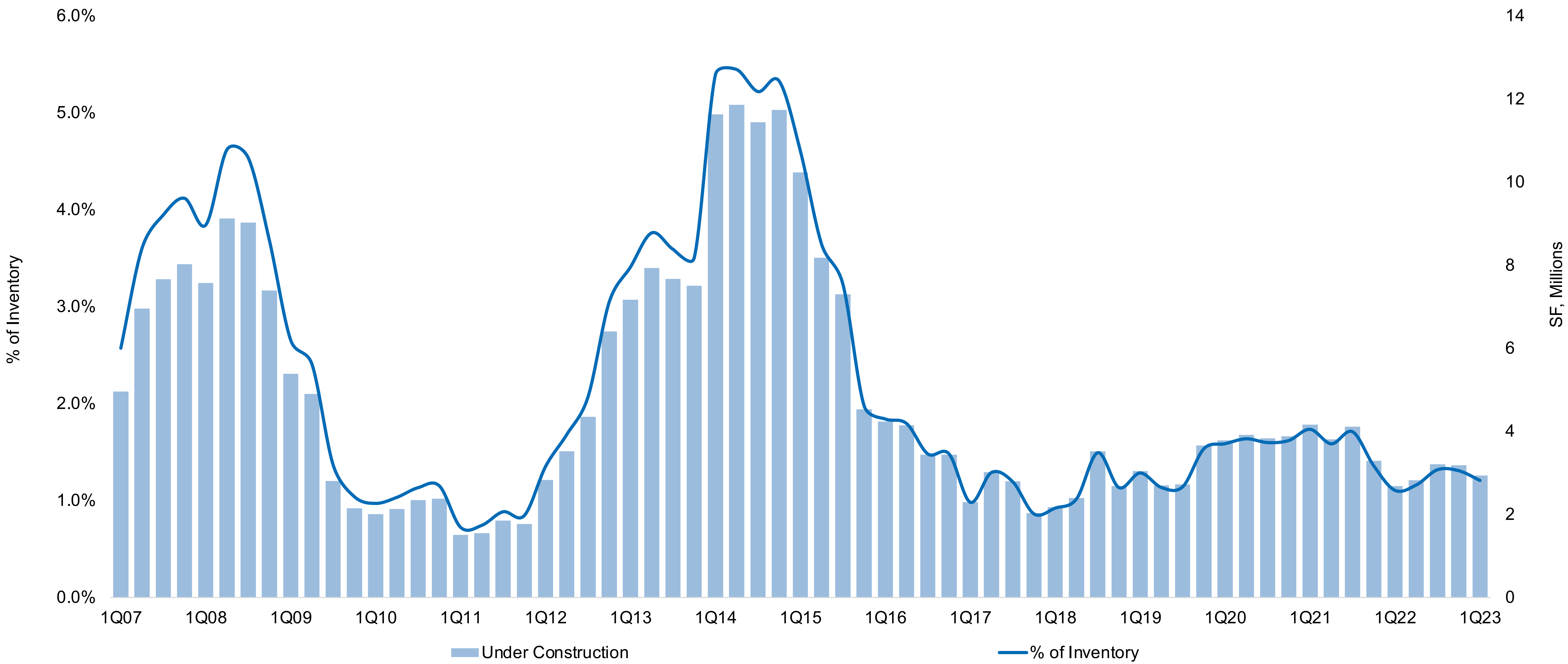


Source: Newmark Research, CoStar

Construction Activity Remains Slow

Construction activity has remained relatively muted in the market since the 2016 oil crash, impacting the energy sector's office usage. As of the second quarter of 2023, the market had 3.0 MSF under construction, accounting for 1.2% of the market's inventory, indicating there is less risk of overbuilding.

Office Under Construction and % of Inventory

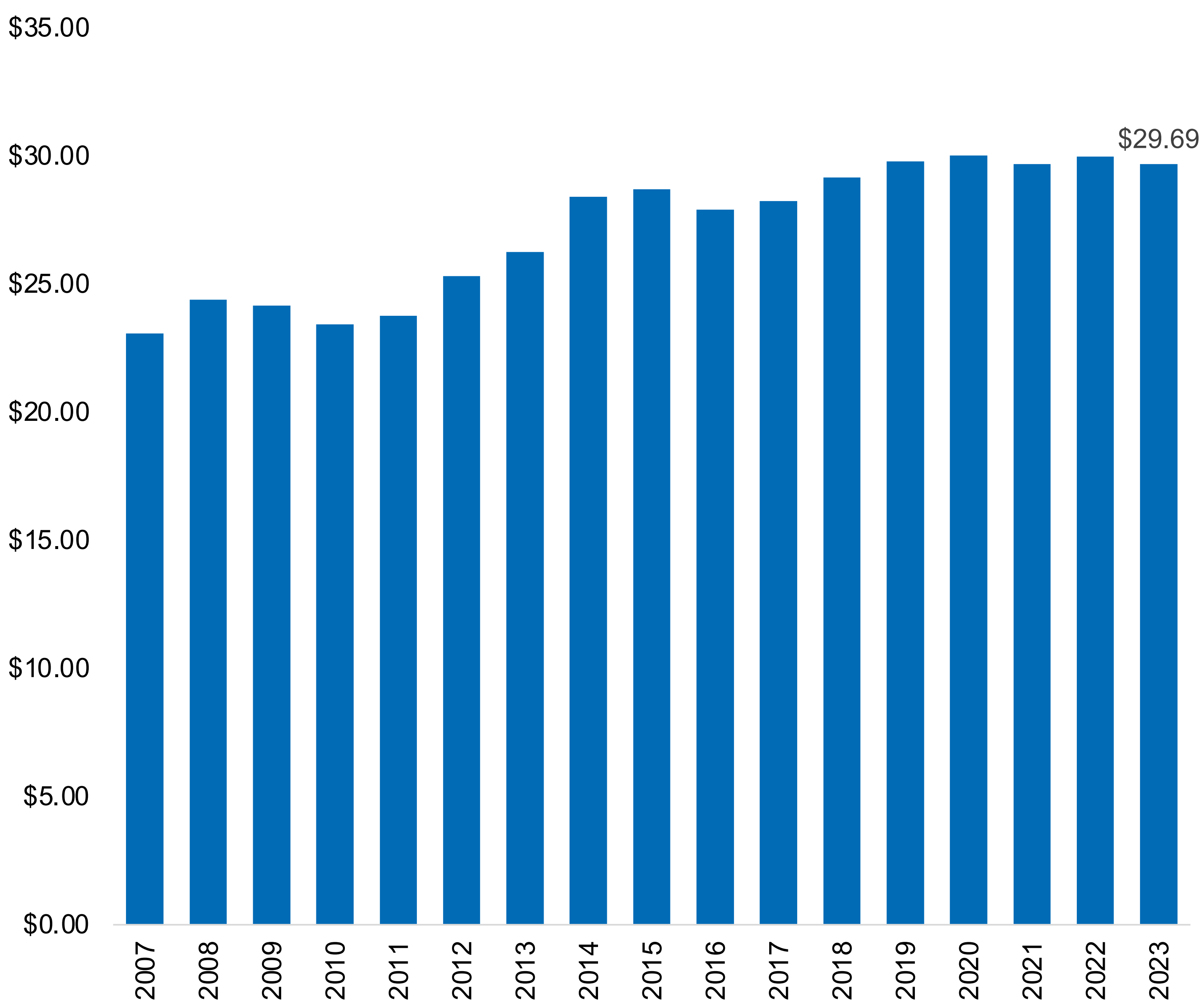


Source: Newmark Research, CoStar

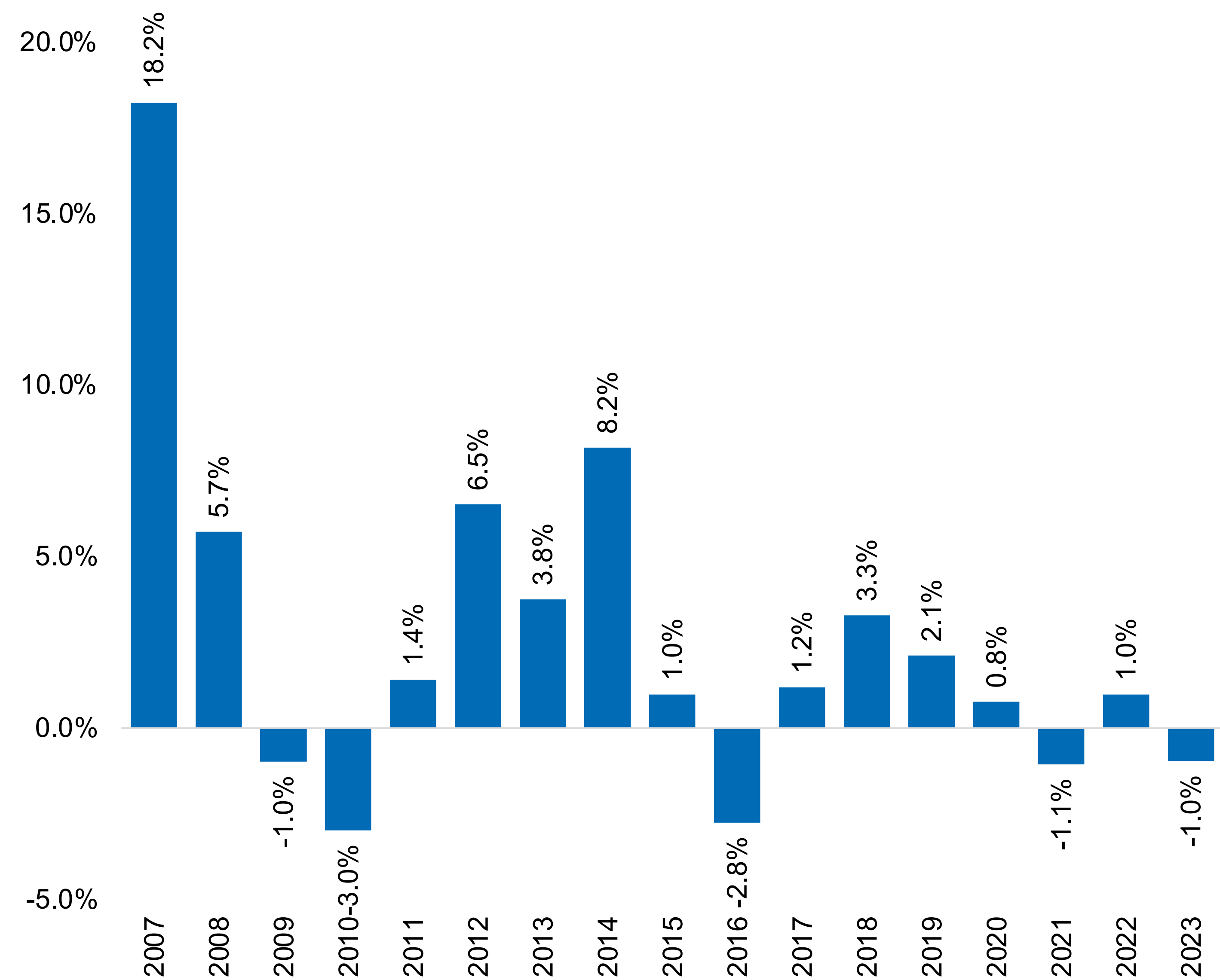
Rents Decline from All-Time High

Rents decreased in the second quarter of 2023 by 1.0% year over year to $29.69/SF, decreasing from an all-time high of $30.07/SF reported in mid-2022. 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

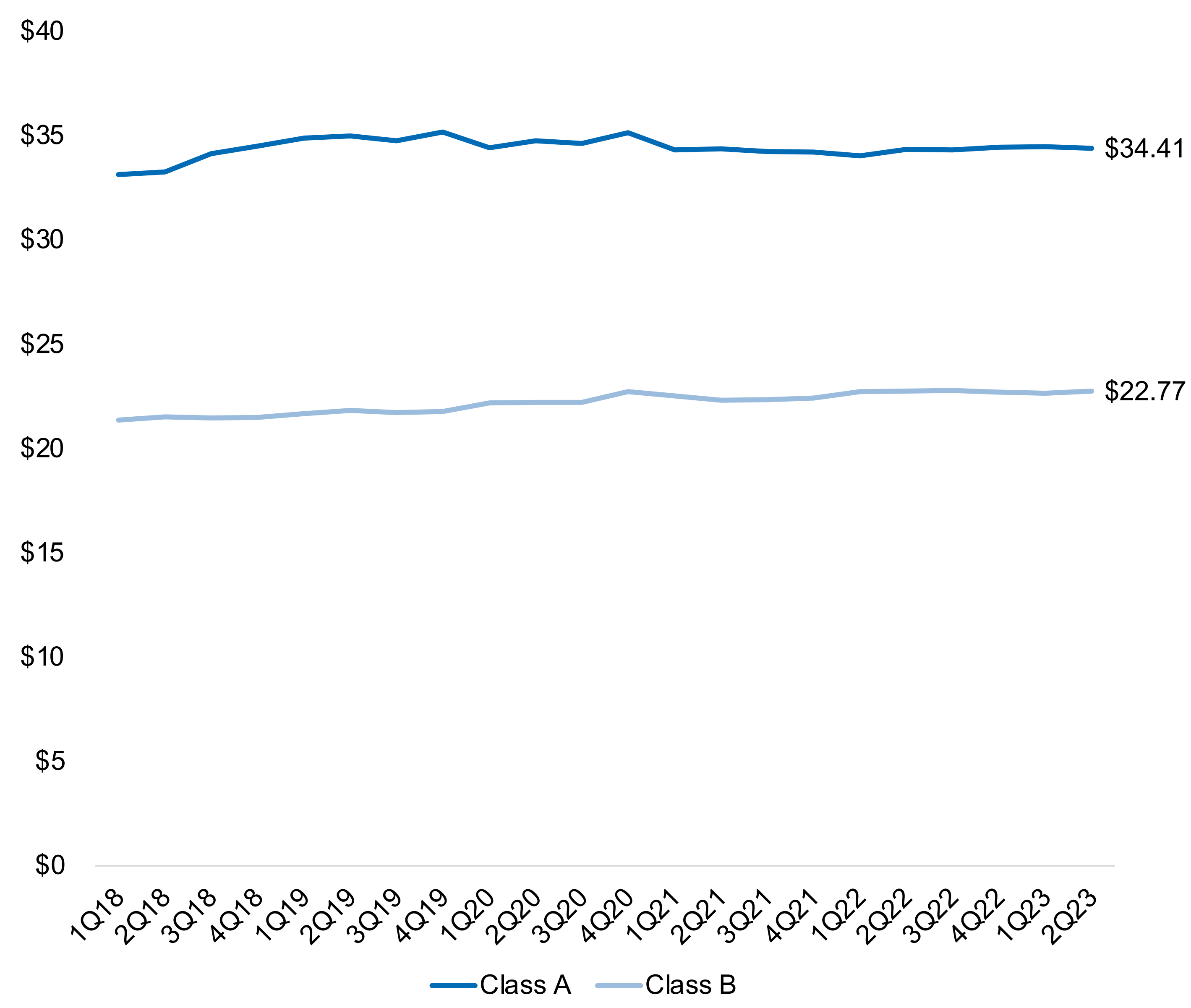


Source: Newmark Research, CoStar

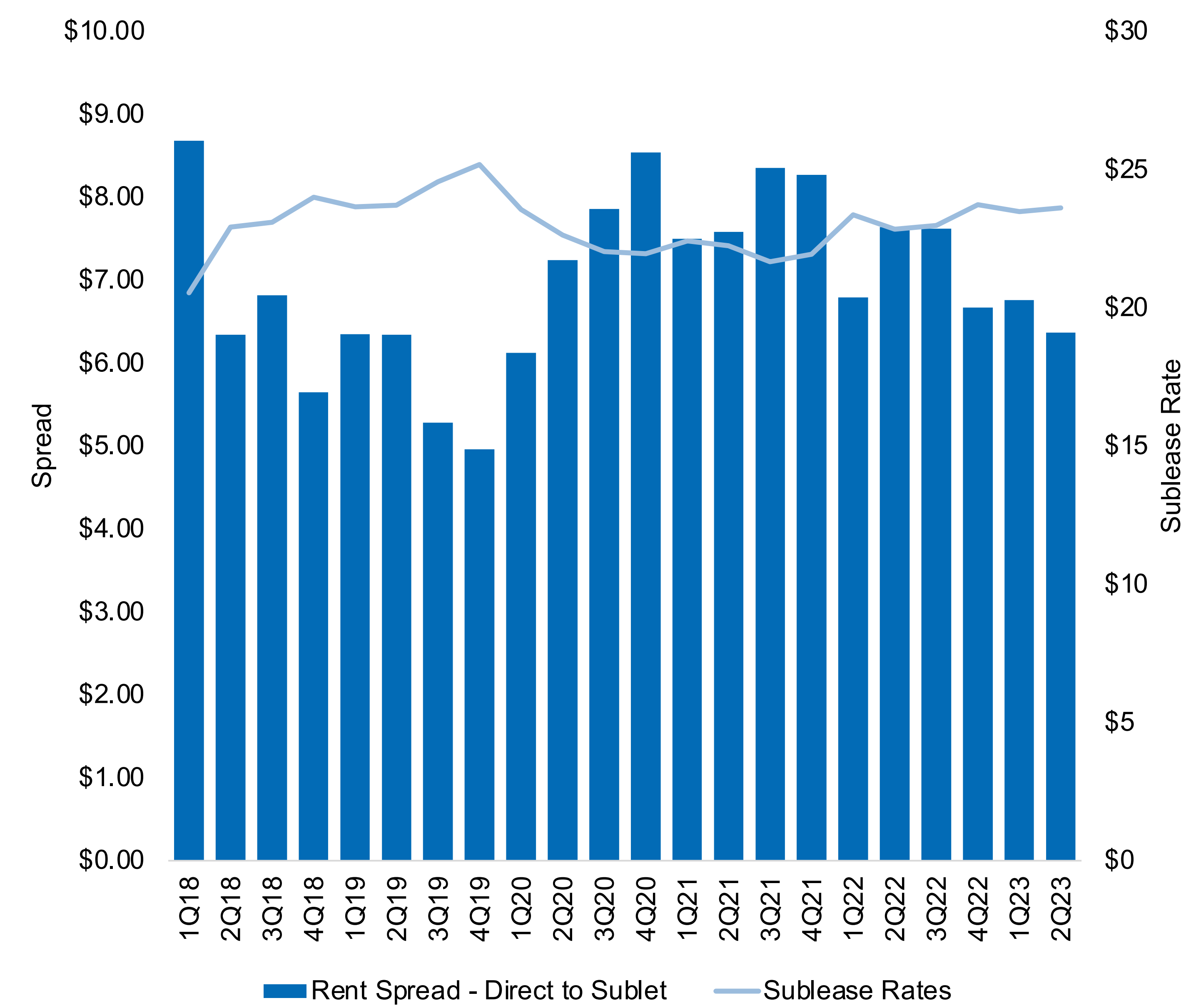
Decreasing Rent Spread on Class A Assets

As of the end of the second quarter of 2023, Class A rents ended at $34.41/SF, while Class B reported $22.77/SF. Rent difference between the two assets are at $11.64/SF, a 11.6% spread decrease since 2019. The closing rent spread between Class A and Class B assets will likely push more tenants to shed unused space and lease smaller footprints in higher-quality assets. Sublease rates have flattened in recent quarters, with asking sublease rents increasing by 0.6% quarter over quarter.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Flight-to-Quality Leasing Activity Increases

Despite slowing leasing activity in the market, flight to quality increases as a trend in the market due to the closing spread in rental rates on Class A spaces. As of the end of the second quarter of 2023, Class A space accounted for 69.0% of the market's leasing activity by SF, but only 30.2% of the market's deal volume. Average leases signed in Class A space were 9,913 SF and continue to remain larger than the average market deal size at 4,343 SF.

Notable 2Q23 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
LyondellBasell Industries	Williams Tower	Galleria/Uptown	Direct Lease	318,504
LyondellBasell Industries's new lease at Williams Tower was the largest lease signed in the second quarter of 2023.				
Fluor Corporation	Three Eldridge	Katy Freeway	Direct Lease	308,186
Fluor Corporation signed a full-building lease at Three Eldridge, where the company will be relocating in 2024 from its almost 40-year home in Sugar Land.				
Technip Energies	West Memorial Place II	Katy Freeway	Direct Lease	171,600
Technip Energies will be relocating it headquarters from Energy Tower II to West Memorial Place II, downsizing from 375,000 SF and aligning better with their sustainability initiatives in a newer workplace.				
Hargrove Engineers	15415 Katy Fwy	Katy Freeway	Direct Lease	80,581
Hargrove Engineers signed a new lease at 15415 Katy Fwy, taking 80,581 SF from the 4th to 7th floor.				
Fugro	Republic Square	Katy Freeway	Direct Lease	76,476
Fugro's long-time Americas headquarters is relocating from 6100 Hillcroft Ave to Republic Square, placing the company in closer proximity to clients in a more modern and efficient workplace for employees.				
HighRadius	CityWestPlace – Building 2	Westchase	Sublease	65,397
Following funds raised for their Series C investment, reaching a $3.1 billion valuation back in 2021, HighRadius is upgrading and relocating its headquarters in a long-term sublease at CityWestPlace-Building 2. Previously the tenant occupied a long-term sublease in 4 Westlake.				

Source: Newmark Research, CoStar

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