Houston Office Market Overview

Market Observations

Economy

- The Houston market's unemployment rate ticked up by 25 basis points year over year to 4.4% but remains well below the five-year average of 5.5%.
- Job growth has slowed compared with recent highs to 2.3% year over year, and is trending toward pre-pandemic levels, with 2019 growth averaging only 2.3%.
- All sectors, except information and mining and construction, reported employment growth, with education and health leading job gains at 5.3% over the past 12 months.
- Office-using jobs in the market reached an all-time high of 783,518 employees reflecting 9.9% growth since 2019.

Leasing Market Fundamentals

- Average annual full-service asking rental rates increased to an all-time high of $30.42/SF, a 1.3% increase year over year.
- Overall vacancy rates fell from the previous quarter's historical high, decreasing by 30 basis points quarter over quarter and increasing by 30 basis points year over year.
- The under-construction pipeline remains stable, with 1.5 MSF in progress.
- Net absorption totaled 1.5 MSF for the fourth quarter of 2023 and annual net absorption turned positive for the first time since 2019 at 755,739 SF for 2023.

Major Transactions

- An undisclosed tenant signed the quarter's largest deal, pre-leasing 208,000 SF at CityCentre Six, which is set to begin construction in April 2024.
- Calpine renewed for 125,000 SF at 717 Texas Ave in the CBD for the second largest lease of the quarter.
- Tenants are still favoring Houston's west side, with several of the quarter's most notable deals taking place in western submarkets including Westchase and Katy Freeway.
- Activity from prominent firms Bechtel and Fluor are an indicator for economic expansion in the market's oil and gas sector.

Outlook

- The Houston office market will likely continue to see suppressed growth this year. 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 pushed rents to an all-time high, leading to an increasing 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 flatten in the near term.

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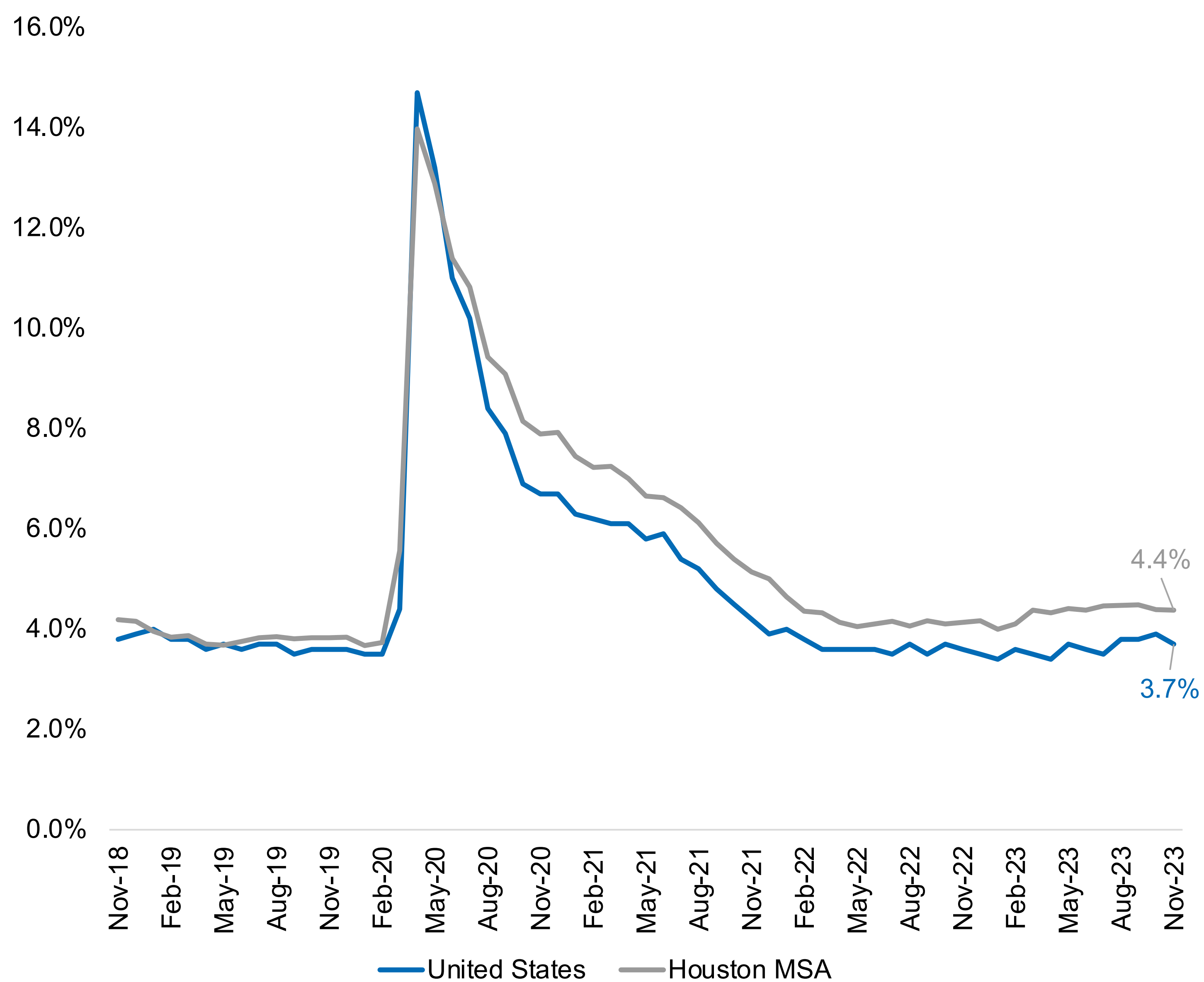
Economy

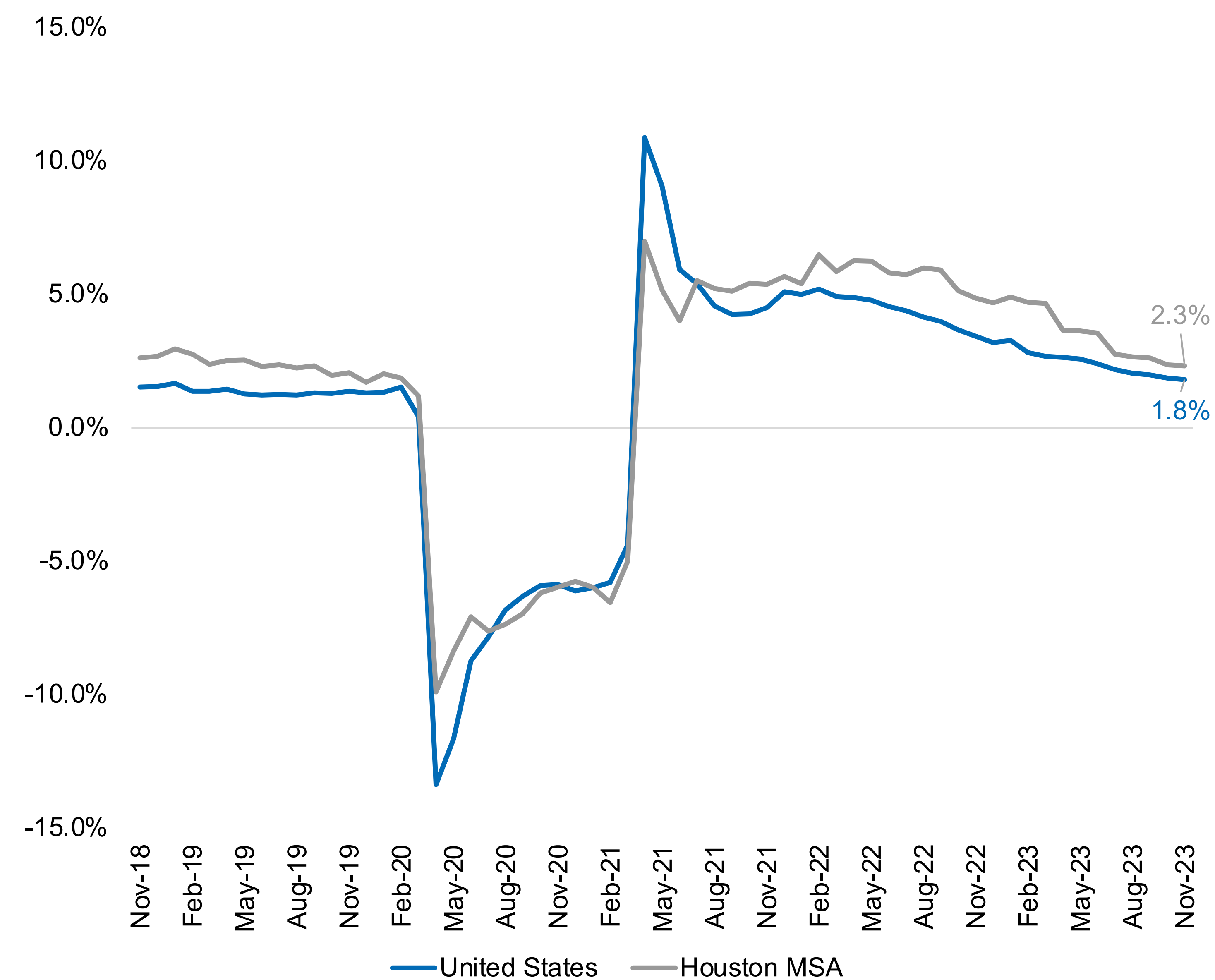
Metro Employment Trends Signal a Slowing Economy

The Houston market has generally reported higher unemployment rates compared with the national average, while outperforming in employment growth. Recent national economic headwinds have pushed the region's unemployment rate to increase by 25 basis points year over year, while the employment year-over-year growth rate slowed by 253 basis points compared with the previous year.

Unemployment Rate, Seasonally Adjusted



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

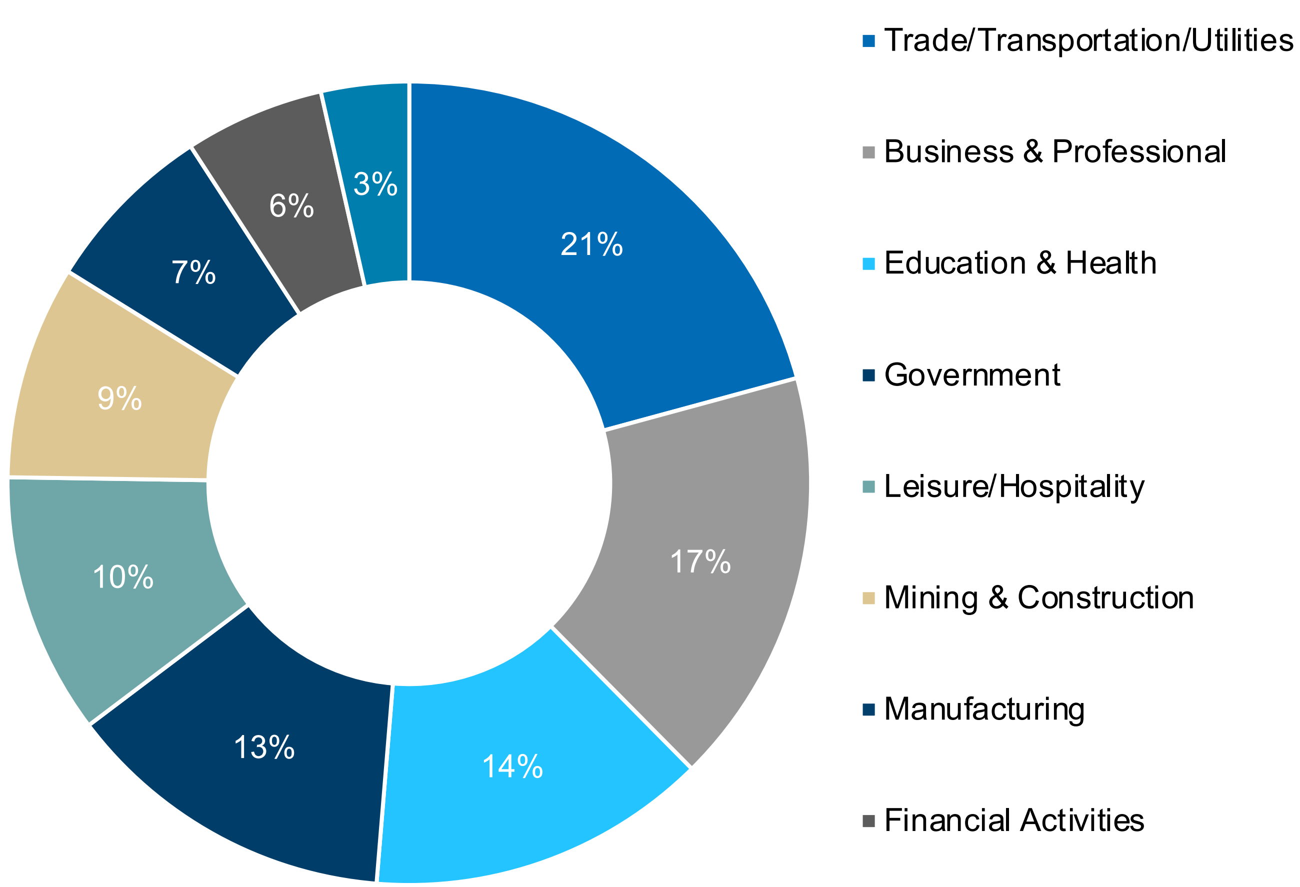


Source: U.S. Bureau of Labor Statistics, Houston MSA

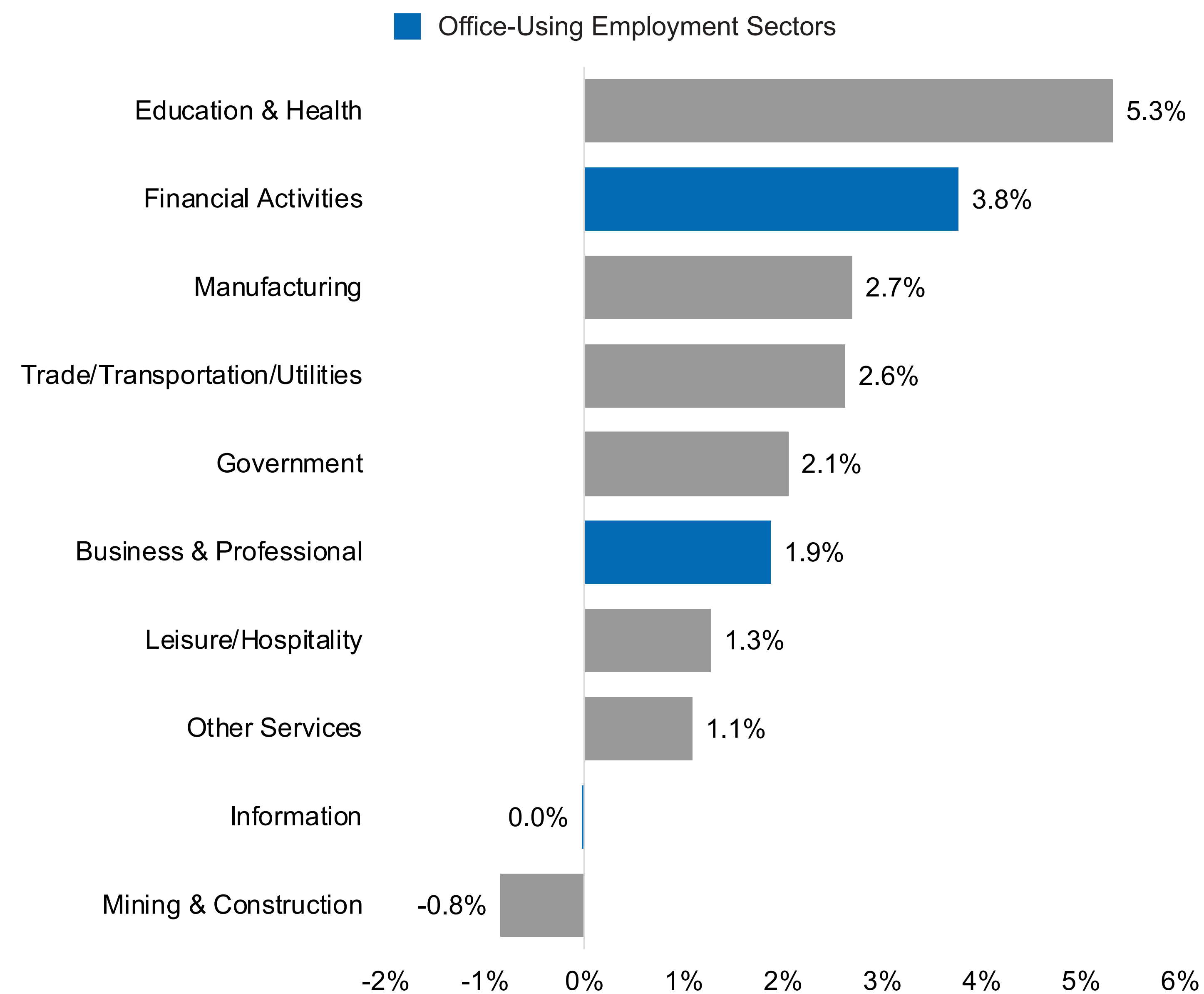
Employment Growth Continues Across Most Office Sectors

Known for its energy sector, the Houston market's top two employment industries account for 37.2% of market share. The office-using employment's business and professional sector is the second-largest industry sector in the metroplex at 16.6%. All industries in the metro, except for information and mining and construction, reported growth with office-using industries reporting year-over-year gains ranging from 1.9% to 3.8% with the information sector reflecting no change.

Employment by Industry, November 2023



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

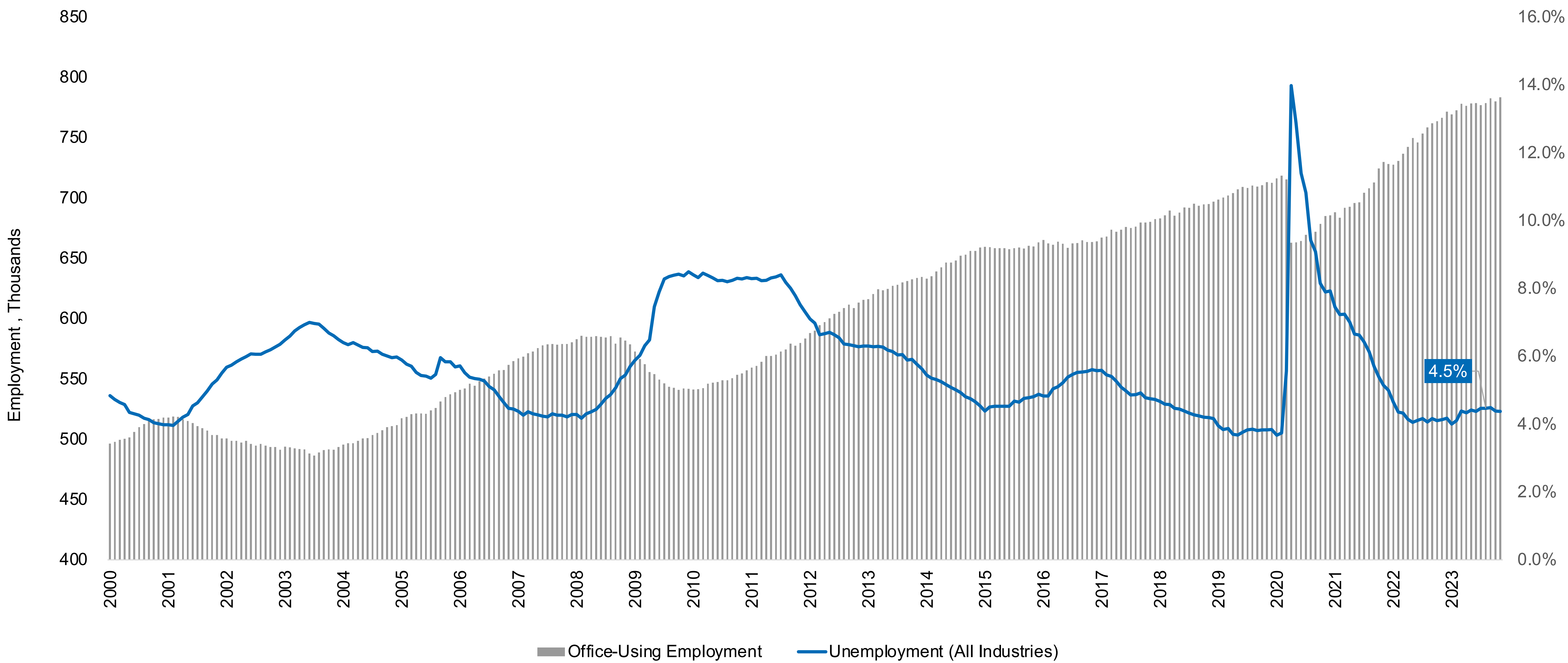


Source: U.S. Bureau of Labor Statistics, Houston MSA

Overall Office-Using Employment at Historical High

Office-using employment in the Houston market as of the end of November 2023 is at 783,518 employees, a new all-time historical high. Currently, the unemployment rate is at 4.5%, 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.

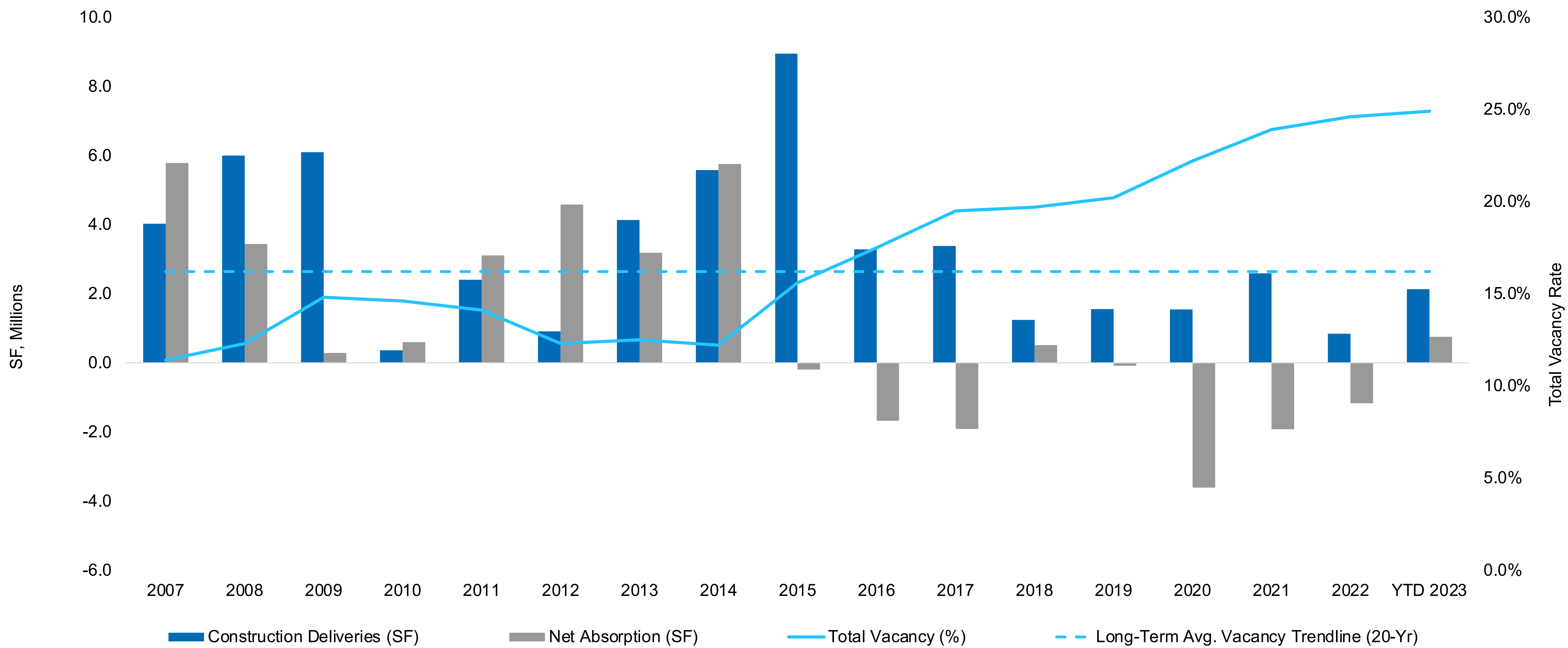
4Q23

Leasing Market Fundamentals

Net Absorption Turns Positive Despite Increased Deliveries

The Houston office vacancy rate increased by 30 basis points year over year to 24.9% in the fourth quarter of 2023, falling slightly from the all-time historical high of the previous quarter. Since the oil crash in 2016, office occupancy has declined steadily. New supply continues, albeit on a muted basis, for those tenants seeking new construction and willing to pay the associated premium. Despite rising vacancy rates, demand in the market is picking up as 2023 closed with positive annual net absorption.

Historical Construction Deliveries, Net Absorption, and Vacancy

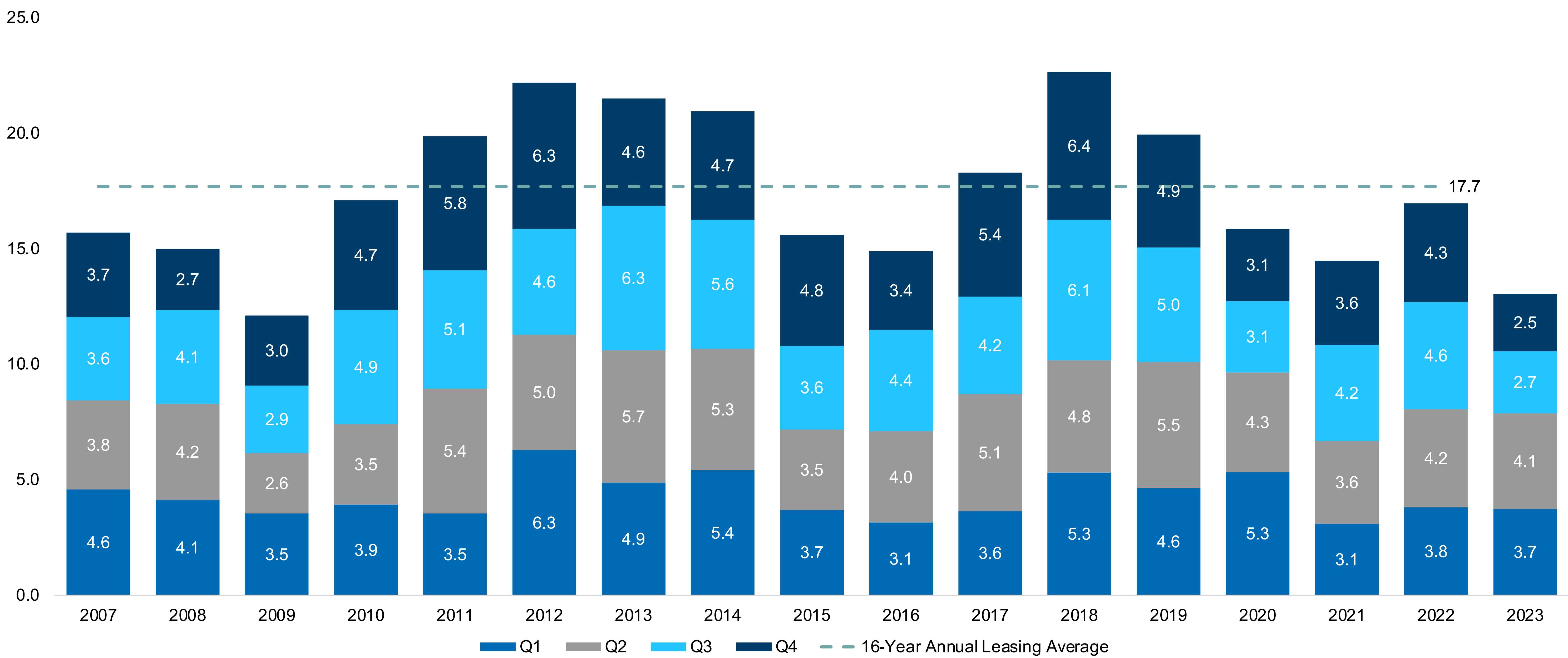


Source: Newmark Research, CoStar

Declining Deal Activity Results in Slowing Leasing Activity

Leasing activity in the market remains slower, with the second half of 2023's leasing activity falling below that of 2022 at 5.2 MSF. Since 2007, fourth-quarter leasing activity averaged 4.5 MSF, with the fourth quarter of 2023 well below historical averages at 2.5 MSF. Deal size averaged 4,250 SF in the fourth quarter of 2023, an average of 16 SF more than the previous quarter and 559 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.

Total Leasing Activity (msf)

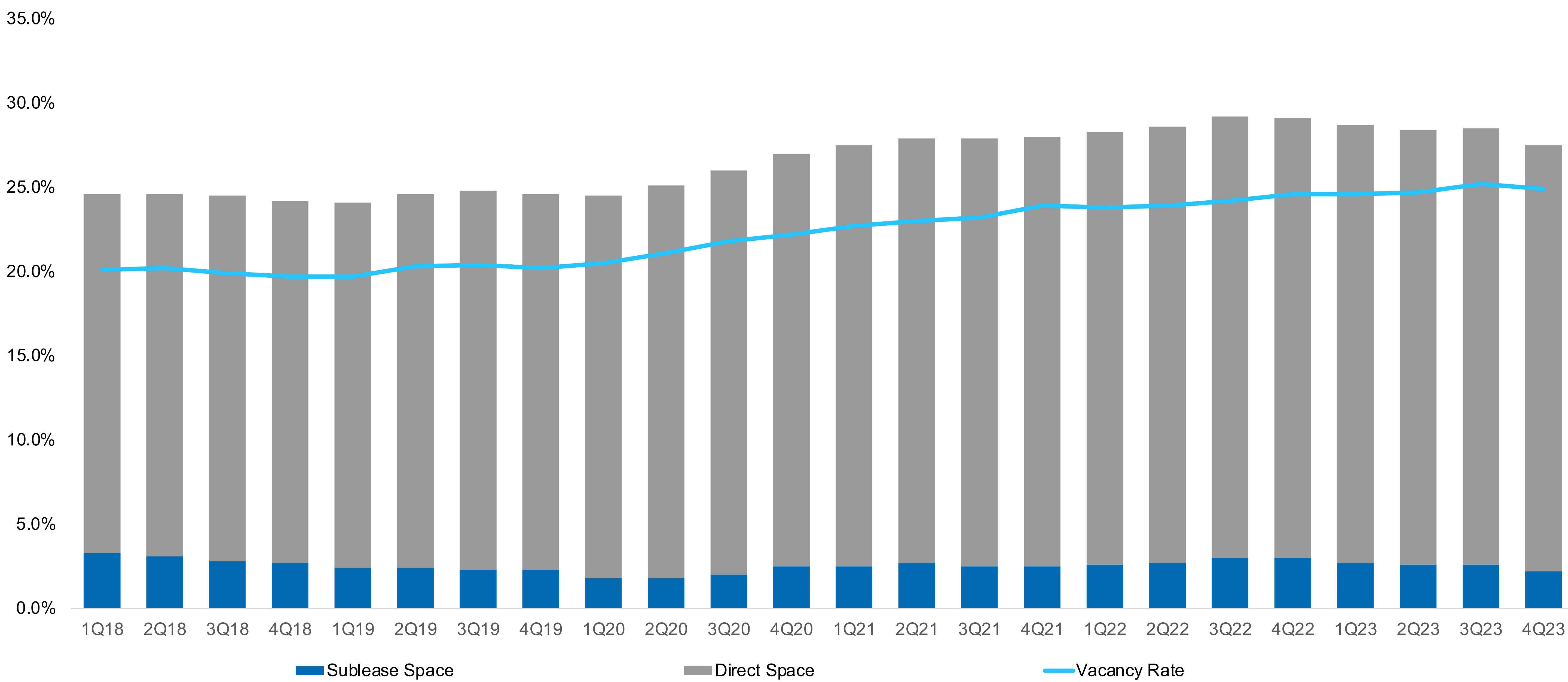


Source: Newmark Research, CoStar

Availability Begins to Decrease

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 fourth quarter of 2023, sublease availability in the market was at 2.2%. Direct availabilities have increased since the pandemic but have decreased from all-time highs reported in the second half of 2022 at 26.2%, with current direct availability rate at 25.3%. At 24.9%, vacancies continue to remain elevated alongside availabilities.

Available Space as Percent of Overall Market

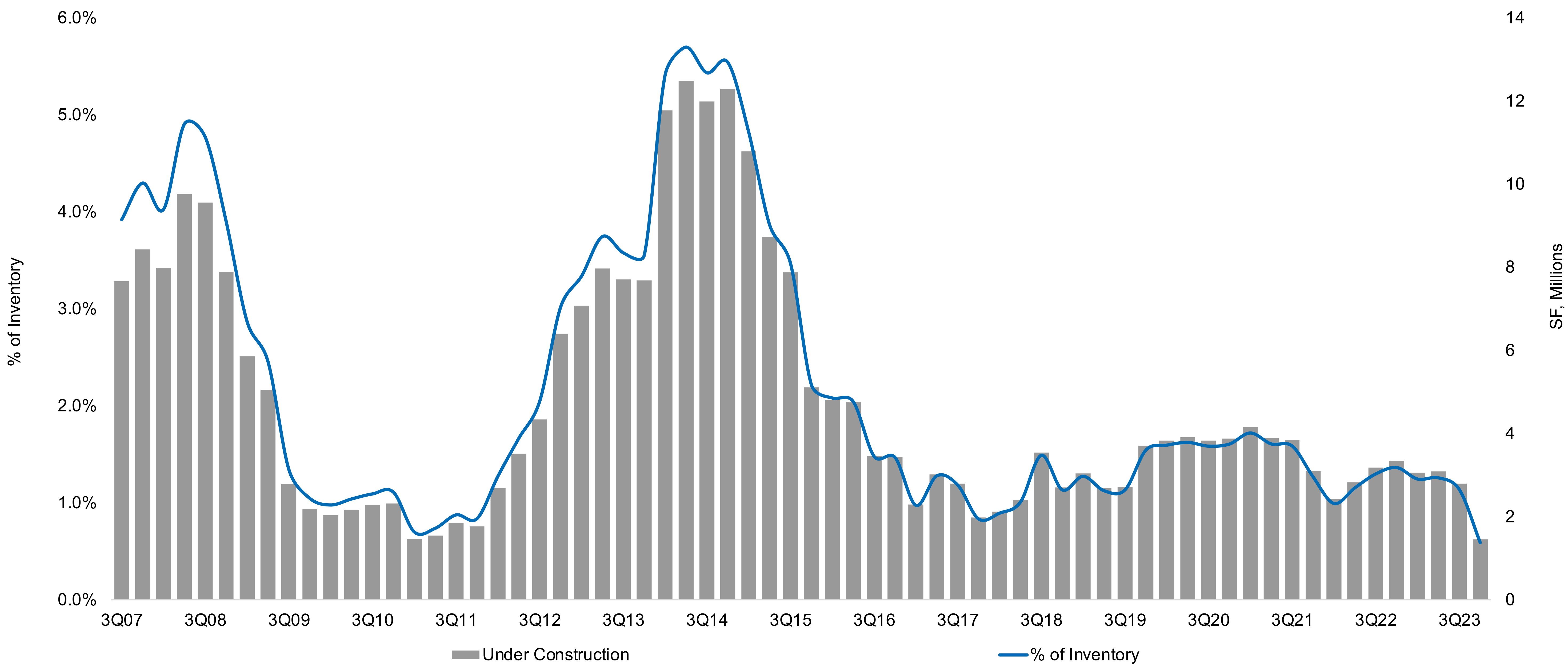


Source: Newmark Research, CoStar

Construction Activity Remains Slow

Construction activity has remained relatively muted in the market since 2016. As of the fourth quarter of 2023, the market had 1.5 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

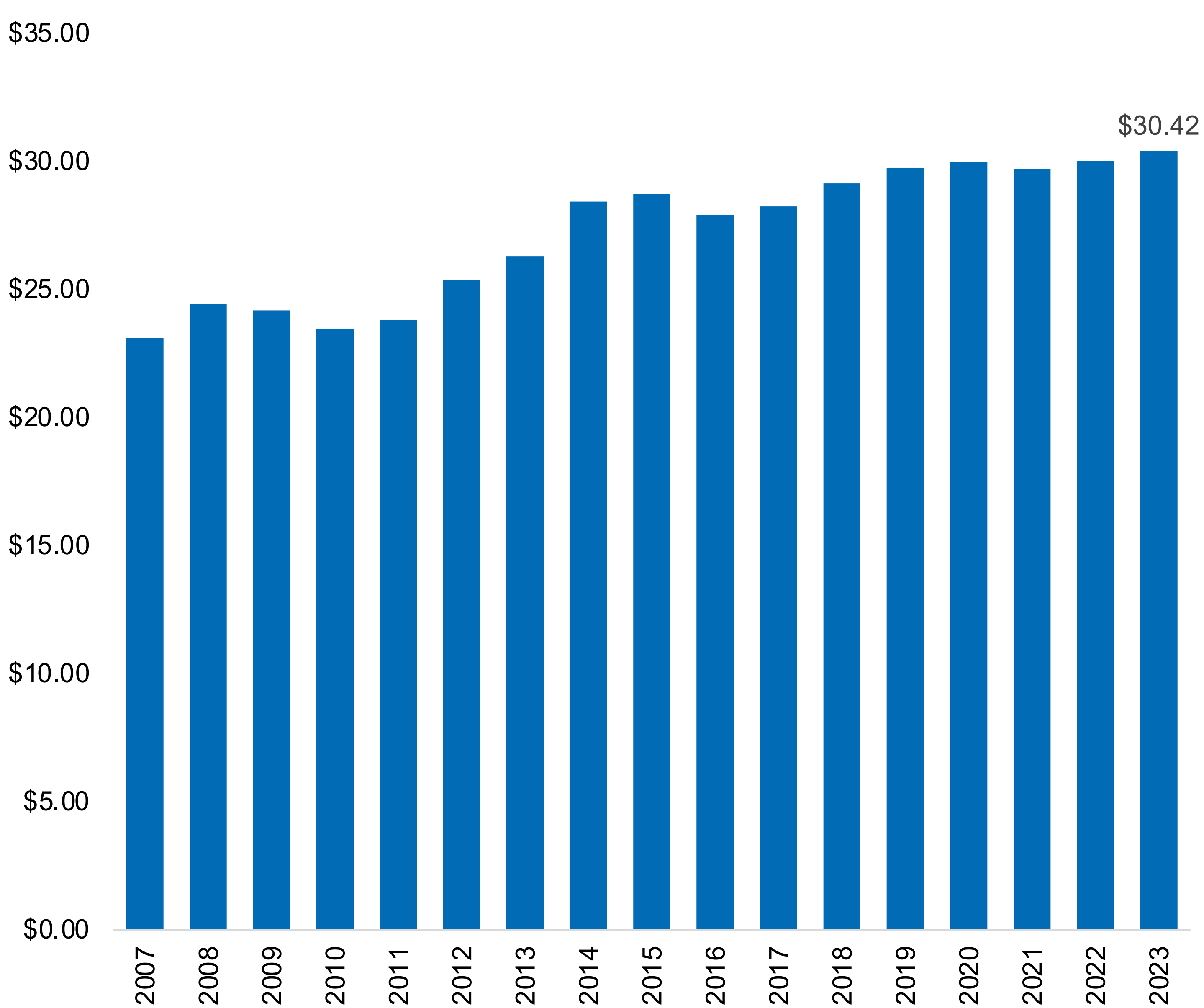


Source: Newmark Research, CoStar

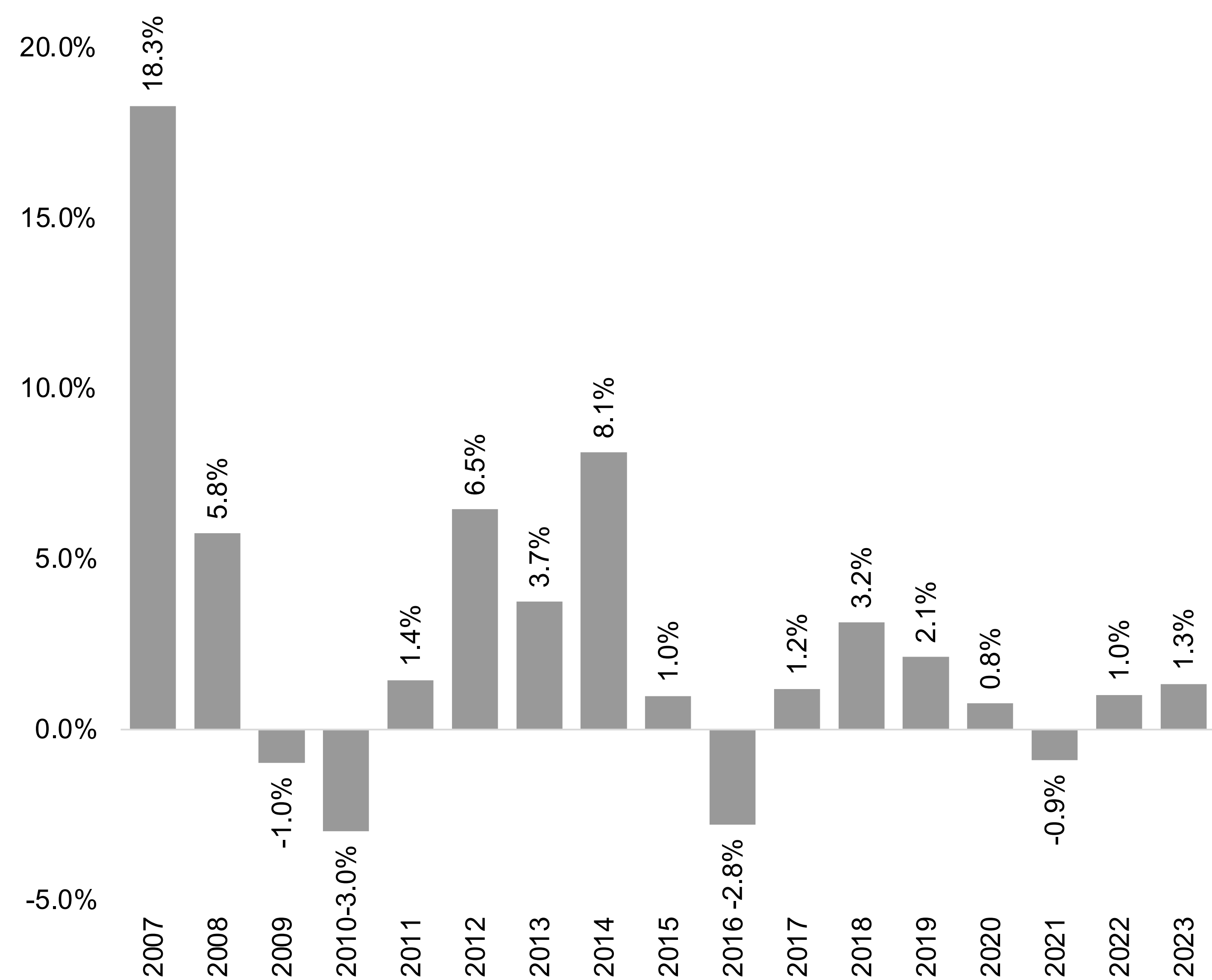
Rents Reach New All-Time High

Rents increased slightly in the fourth quarter of 2023 by 1.3% year over year to $30.42/SF, increasing to a new all-time high over the $30.24/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

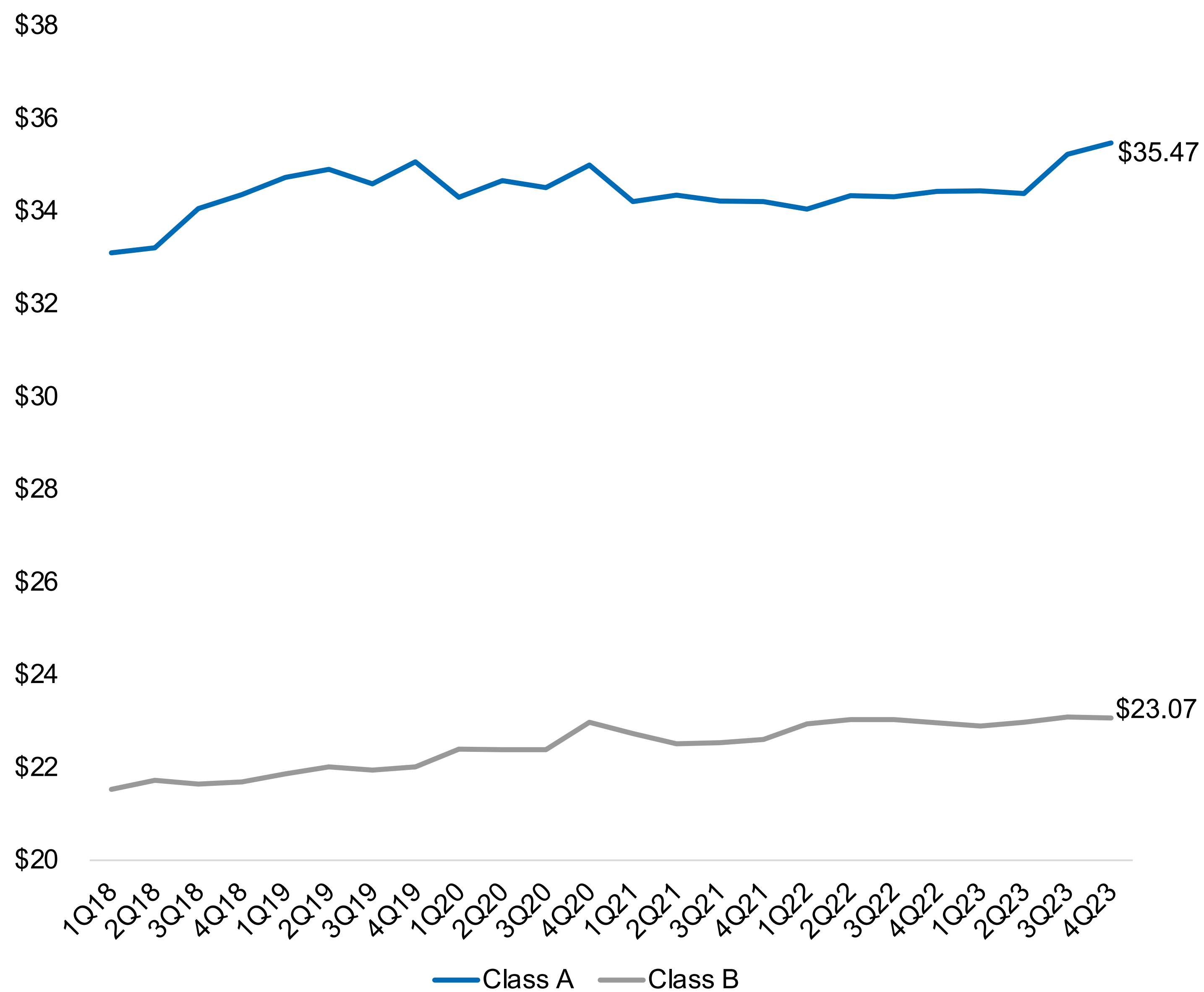


Source: Newmark Research, CoStar

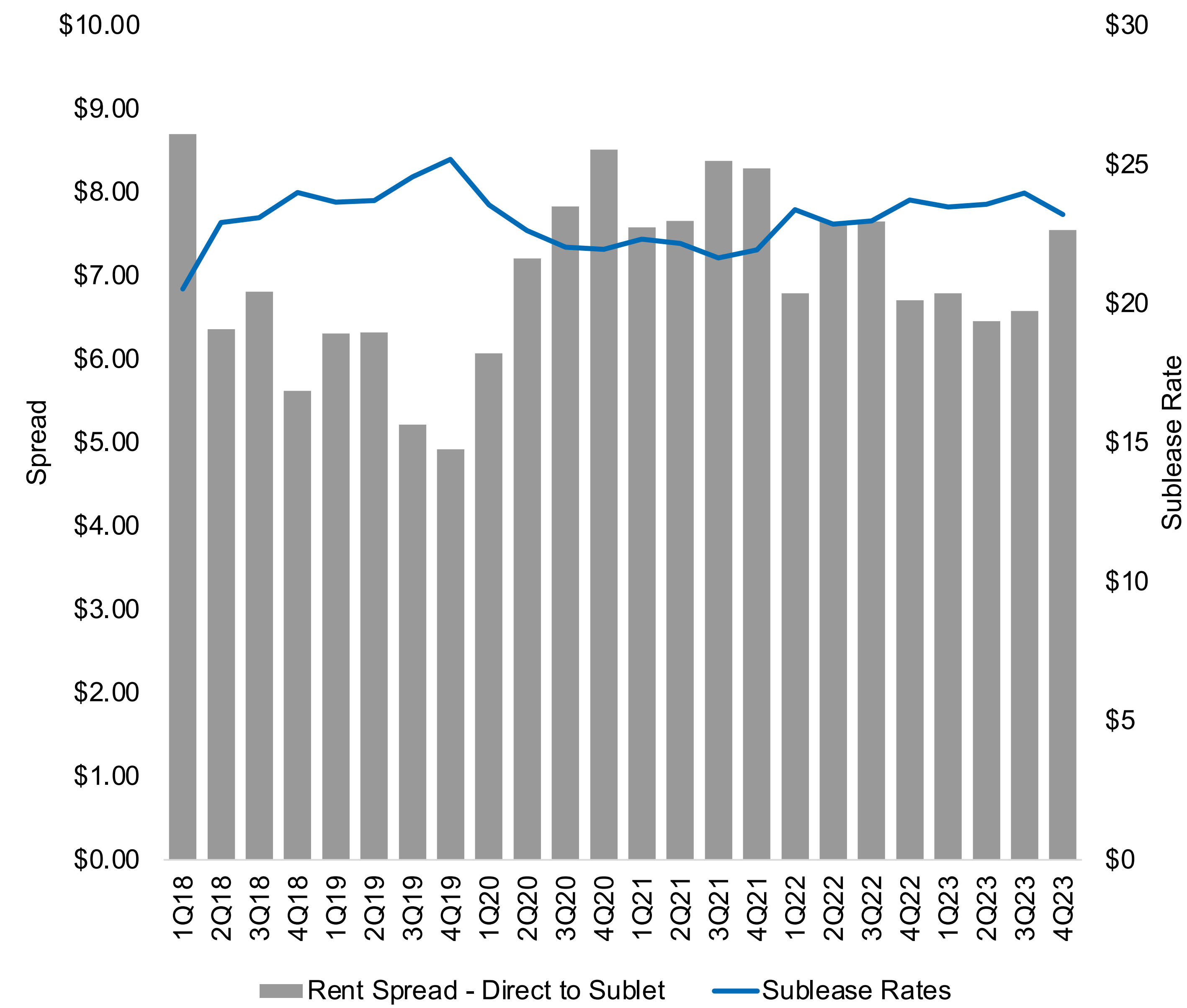
Increasing Rent Spread on Class A Assets

As of the end of the fourth quarter of 2023, Class A rents ended at $35.47/SF, while Class B reported $23.07/SF. The $12.40/SF spread represents an 8.1% increase year over year and reflects the greater demand for higher quality assets. Sublease rates averaged $23.20/SF in the fourth quarter of 2023, a 3.3% decrease quarter over quarter. The rent spread between direct and sublease rates is $7.60/SF at the end of the fourth quarter of 2023.

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 increases. As of the end of the fourth quarter of 2023, Class A space accounted for 67.0% of the market's leasing activity by SF, but only 36.7% of the market's deal volume. Average leases signed in Class A space were 7,761 SF and continue to remain larger than the average market deal size at 4,250 SF.

Notable 4Q23 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Undisclosed Tenant	CityCentre Six	Katy Freeway	Direct New	208,000
An undisclosed tenant pre-leased 208,000 SF at CityCentre Six in the Katy Freeway submarket. The building is being developed by Midway and is set to begin construction in April 2024.				
Calpine Energy Solutions	717 Texas Ave	CBD	Renewal	125,000
Calpine Energy Solutions renewed 125,000 SF at 717 Texas Ave in the CBD where the company has been a tenant since 2018.				
Lockton	3657 Briarpark Dr	Westchase	Renewal	112,000
Insurance company Lockton signed a renewal for 112,000 SF at 3657 Briarpark Dr in the Westchase submarket.				
Bechtel	2103 CityWest Blvd	Westchase	Direct New	109,000
Bechtel expanded with an additional 109,000 SF of project space at 2103 CityWest Blvd in the Westchase submarket.				
Fluor	Two Eldridge	Energy Corridor	Direct New	104,677
Engineering and construction company Fluor leased 104,677 SF at Two Eldridge, next door to Three Eldridge where the company signed for 308,186 SF in the second quarter of 2023.				
Norton Rose Fulbright	1301 McKinney	CBD	Renewal	75,000
Norton Rose Fulbright signed a short-term lease extension for 75,000 square feet in 1301 McKinney as the company awaits its move-in date to 1550 on the Green in May 2024.				

Source: Newmark Research, CoStar

Please reach out to your
Newmark business contact for this information

For more information:

Kirsten Kempf
Senior Research Analyst
Kirsten.Kempf@nmrk.com

Ching-Ting Wang
Head of Southeast Research
ChingTing.Wang@nmrk.com

Houston
1700 Post Oak Blvd.
2 Blvd. Place, Suite 250
Houston, TX 77056
t 713-626-8888

New York Headquarters
125 Park Ave.
New York, NY 10017
t 212-372-2000

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Newmark has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Research Reports are available at nmrk.com/insights.

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