1Q25

Houston Office Market Overview

Market Observations

Economy

- The Houston market's unemployment rate rose 12 basis points year over year to 4.3% but remains below the five-year average of 5.6%.
- Job growth fell by 60 basis points year over year to 1.3%, dropping below pre-pandemic levels, with February 2020 growth at 1.8%.
- All sectors, except information and financial services, reported employment growth, with other services leading job gains at 3.1% over the past 12 months.
- Office-using jobs in the market totaled 774,800 in February 2025, reflecting 8.5% growth since 2019.

Leasing Market Fundamentals

- Average annual full-service asking rental rates fell to $28.67/SF, reflecting a 2.5% decrease year over year. Direct rates dropped to $28.84/SF while sublease rents decreased to $22.88/SF, resulting in a narrowing rent spread of $5.96/SF.
- Overall vacancy rates remained at a peak of 25.9% in the first quarter of 2025, unchanged from the prior quarter and increasing by 40 basis points year over year.
- The first quarter of 2025 closed with positive absorption of 123,831 SF, as occupancies steadied and new supply modestly outpaced demand.
- Total leasing activity closed the quarter at 2.1 MSF, well below the long-term first-quarter average of 4.4 MSF. The average lease size was 3,340 SF, decreasing 27.0% quarter over quarter and 16.1% year over year.

Major Transactions

- Aramco signed the largest lease of the first quarter of 2025, renewing 246,300 SF at One Allen Center in the CBD submarket.
- Motiva Enterprises, a subsidiary of Aramco, renewed 167,000 SF at Two Allen Center for the second largest lease of the quarter.
- The renewed tenant interest in the CBD seen throughout 2024 continued in the first quarter of 2025, as three of the five-largest deals of the quarter occurred in the submarket.
- Energy-related tenants signed three of the five-largest deals of the quarter, indicating revived activity in the energy sector.

Outlook

- The Houston office market will likely continue to see subdued growth heading further into 2025, as the market continues to feel the impacts of national economic headwinds. Large transactions at the end of 2024 from energy and oil and gas companies, the market's largest sector, points to tenant optimism in the market.
- Strong demand for premier office product has continued to keep rents elevated in top-tier buildings, as flight-to-quality remains a trend in the market. However, the decrease in Class A asking rents could signal forthcoming constraints among availabilities within the asset class, as premier Class A space is taken off the market.
- The office market is expected to remain tenant friendly with continued muted demand. As financing and operating costs increase, long-term leases might become more attractive to tenants as a strategy to hedge against future rent increases.

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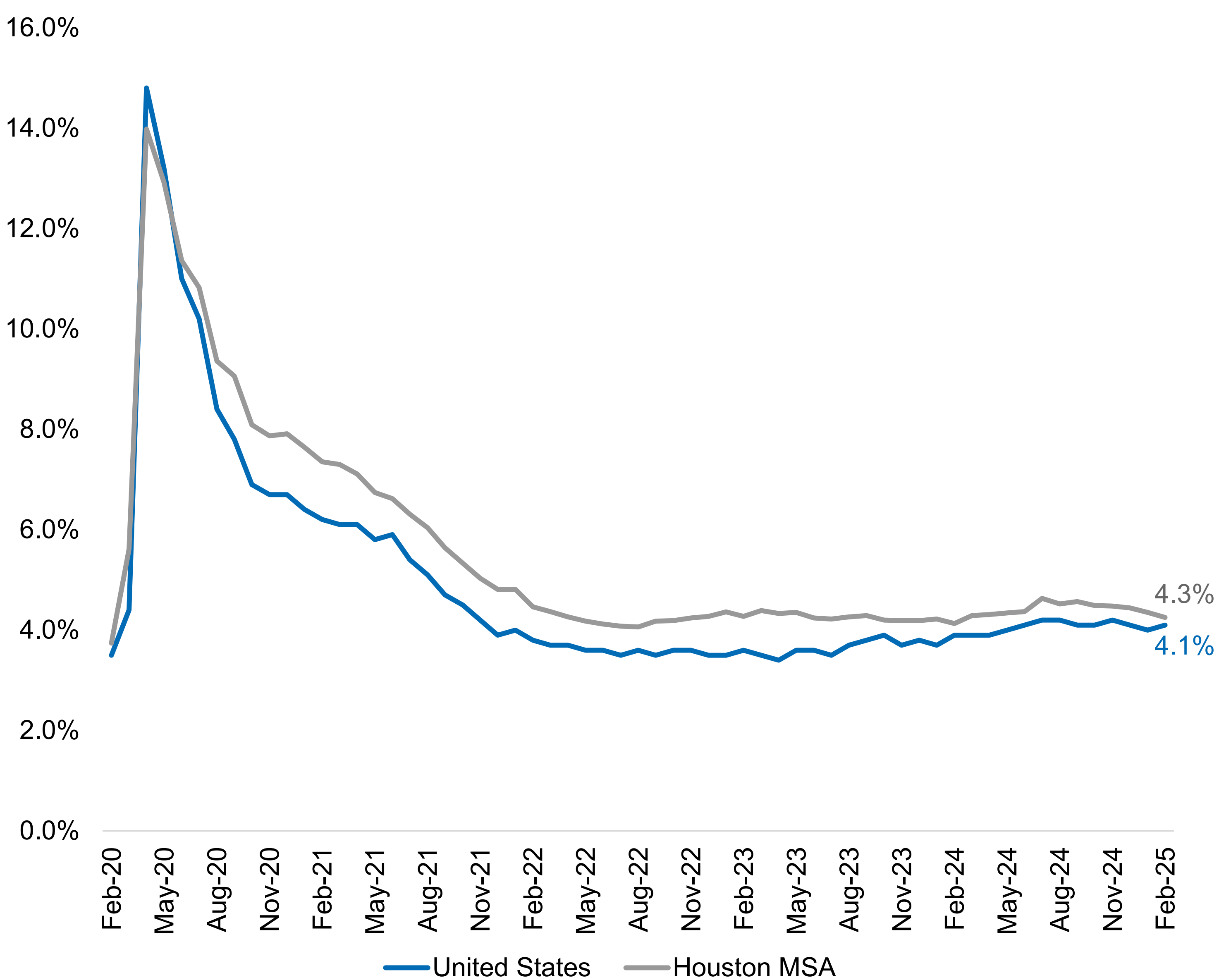
Economy

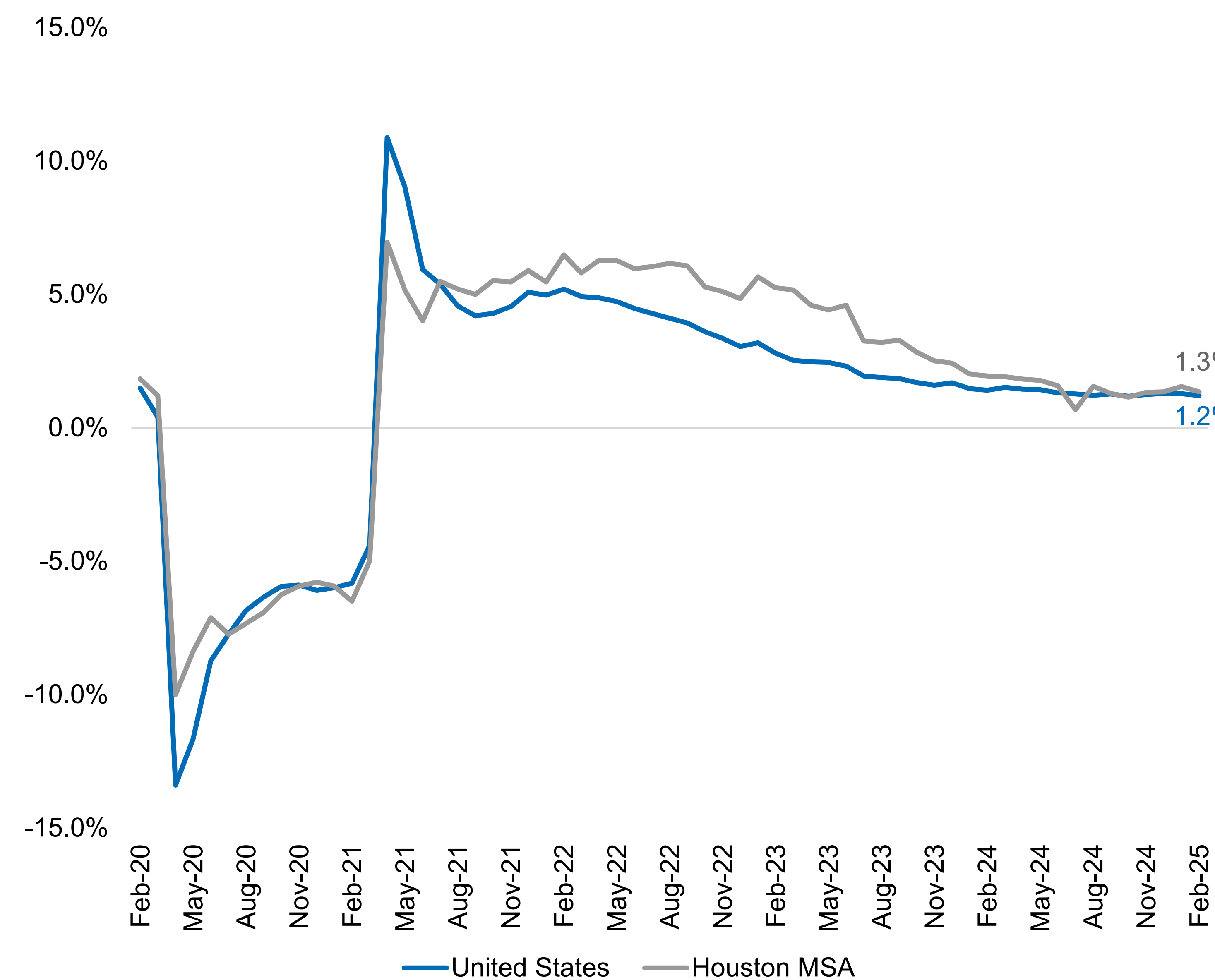
Slower Growth Continues for Metro Employment

The Houston market has generally reported slightly higher unemployment rates compared with the national average, while outperforming in employment growth. Recent national economic headwinds have pushed the local market's unemployment rate and the national average to converge, at 4.3% and 4.1%, respectively. Houston's unemployment rate increased by 12 basis points year over year for February 2025, while the employment year-over-year growth rate slowed by 60 basis points compared with the previous year.

Unemployment Rate, Seasonally Adjusted



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

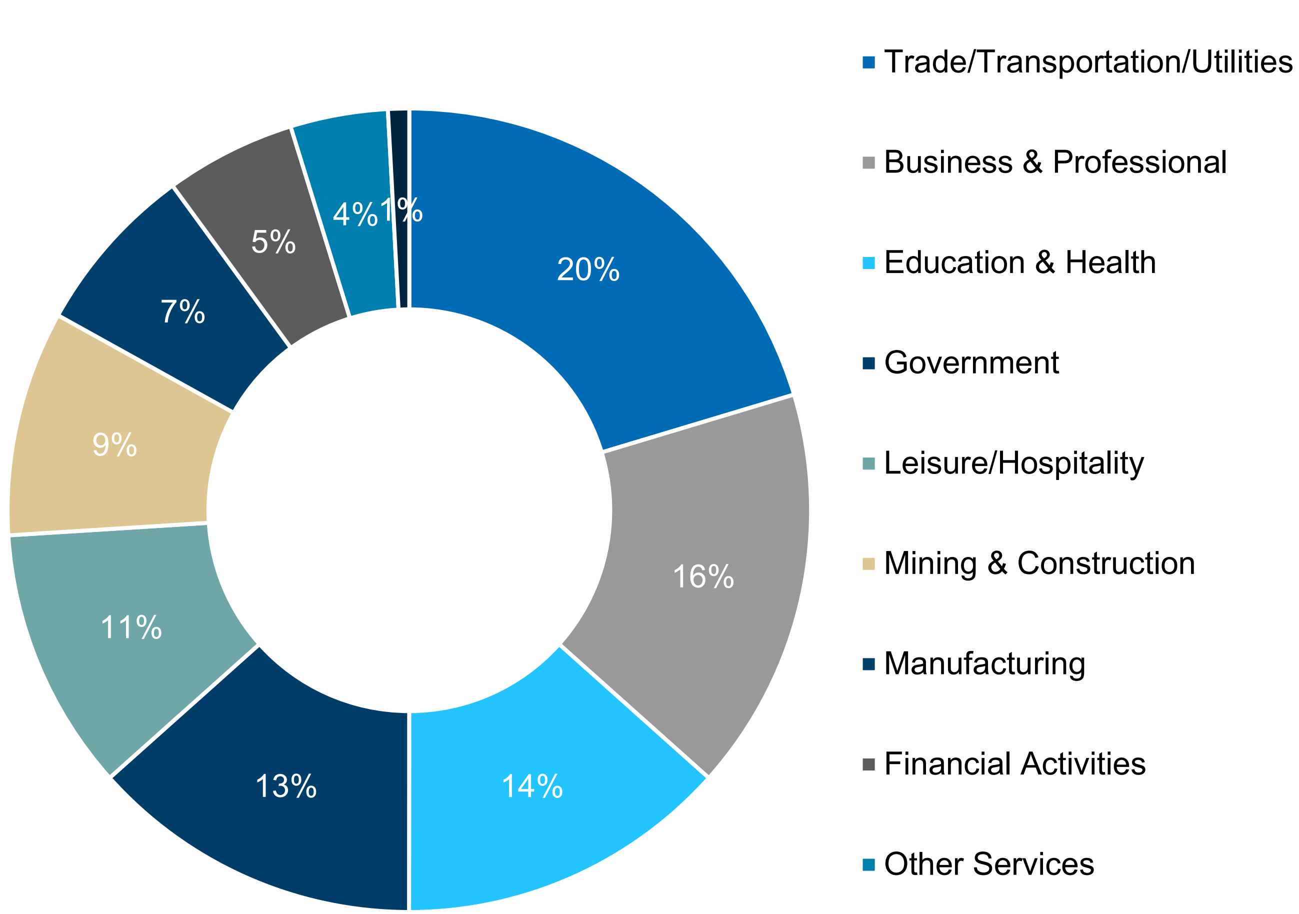


Source: U.S. Bureau of Labor Statistics, Houston MSA

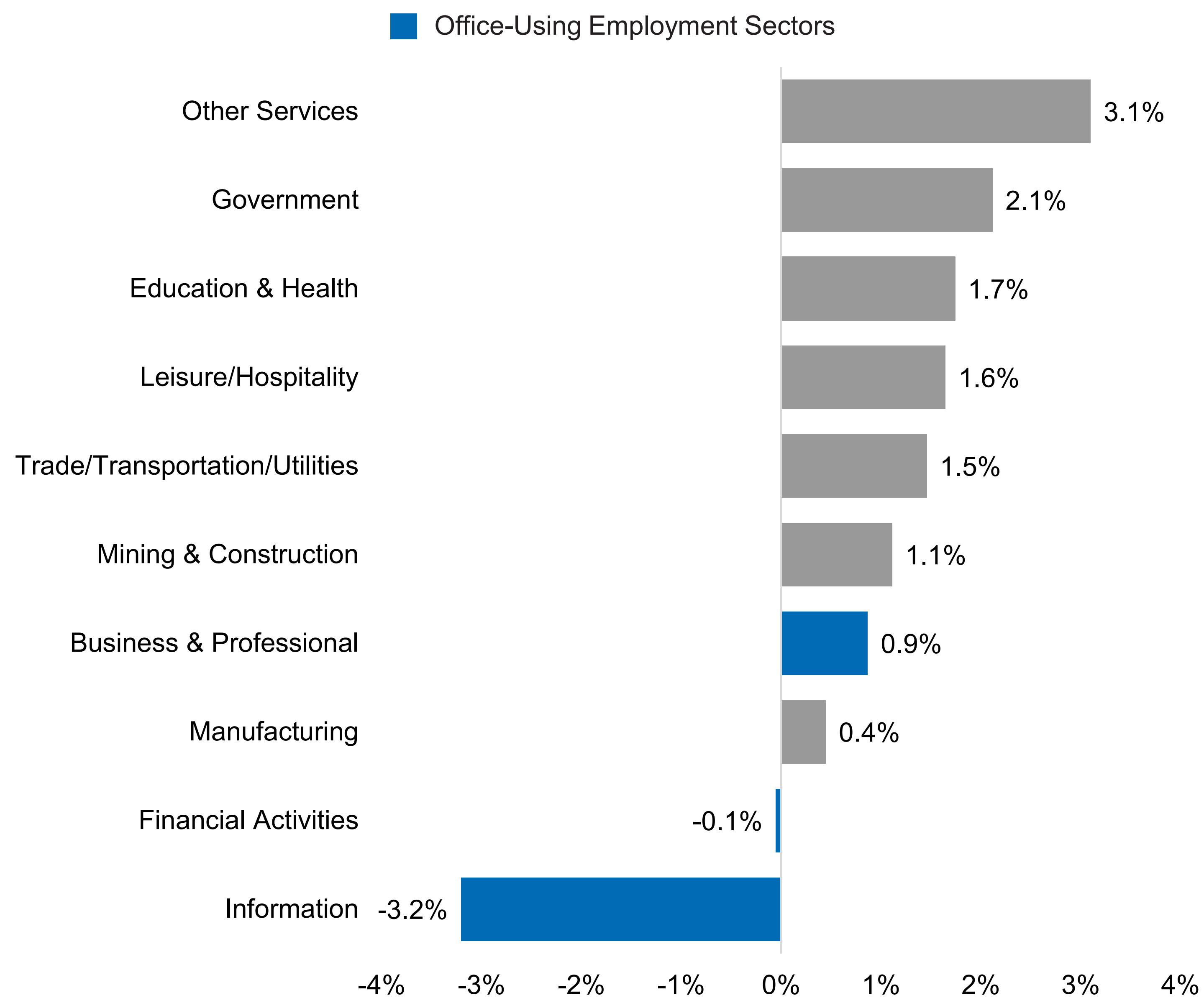
Employment Growth Slows Across Most Office Sectors

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 16.3%. While most industries in the metro continued reporting growth, two office-using sectors contracted, with the information and financial activities sectors declining by 3.2% and 0.1% year over year, respectively. Meanwhile, business and professional services had marginal growth of 0.9%.

Employment by Industry, February 2025



Employment Growth by Industry, 12-Month % Change, February 2025

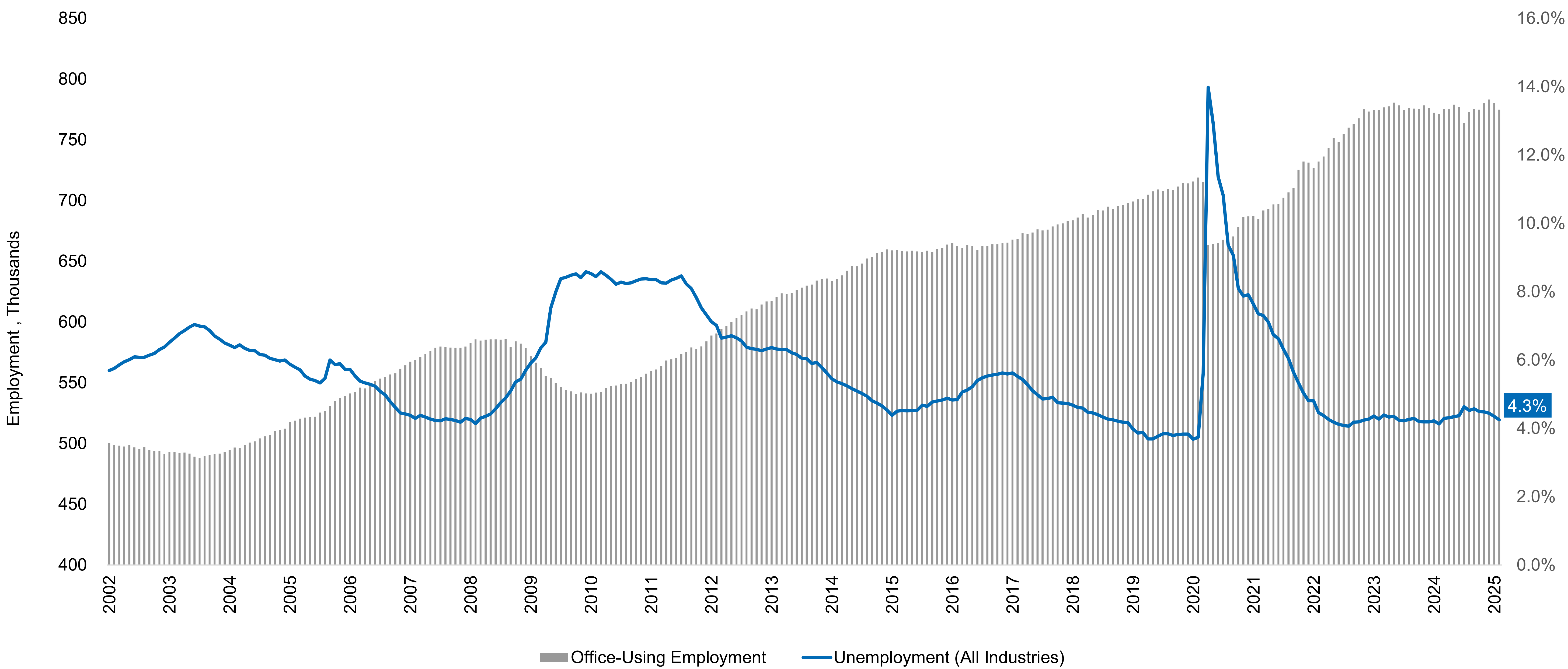


Source: U.S. Bureau of Labor Statistics, Houston MSA

Overall Office-Using Employment Eases From Historical High

Office-using employment in the Houston market as of the end of February 2025 is at 774,800 employees, falling from the all-time high in December 2024 by 8,301 jobs. Currently, the unemployment rate is at 4.3%, below the five-year average of 5.6% since February 2020. The office-using information and financial services sectors reported negative annual growth, while the business and professional services sector posted marginal gains. The lagging information sector is a contributing factor to Houston's unemployment rate and decreased office-using employment numbers.

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.

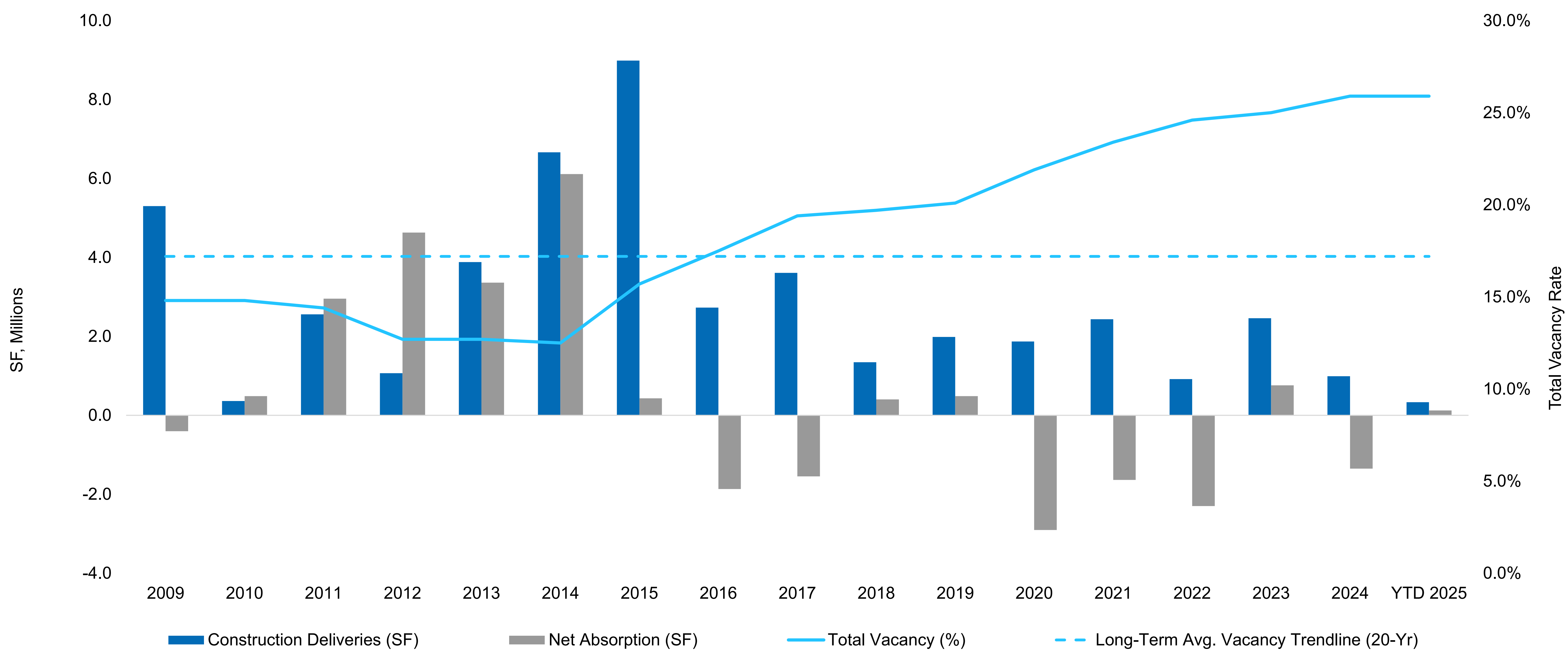
1Q25

Leasing Market Fundamentals

Demand Pushes Positive Despite Vacancy Remaining at Highest Point

In the first quarter of 2025, Houston's office space vacancy rate rose by 40 basis points from the previous year, reaching a new high of 25.9%. This figure stands significantly higher than the historical average of 17.2%, revealing a longer-term trend of increasing vacancies. Despite this year-over-year increase, the vacancy rate was unchanged from the previous quarter, indicating that office occupancies may be starting to stabilize. Since the oil downturn in 2015 and 2016, the Houston market has witnessed a persistent increase in vacancy rates. This trend was driven largely by an influx in new office deliveries, which have consistently outpaced annual absorption.

Historical Construction Deliveries, Net Absorption, and Vacancy

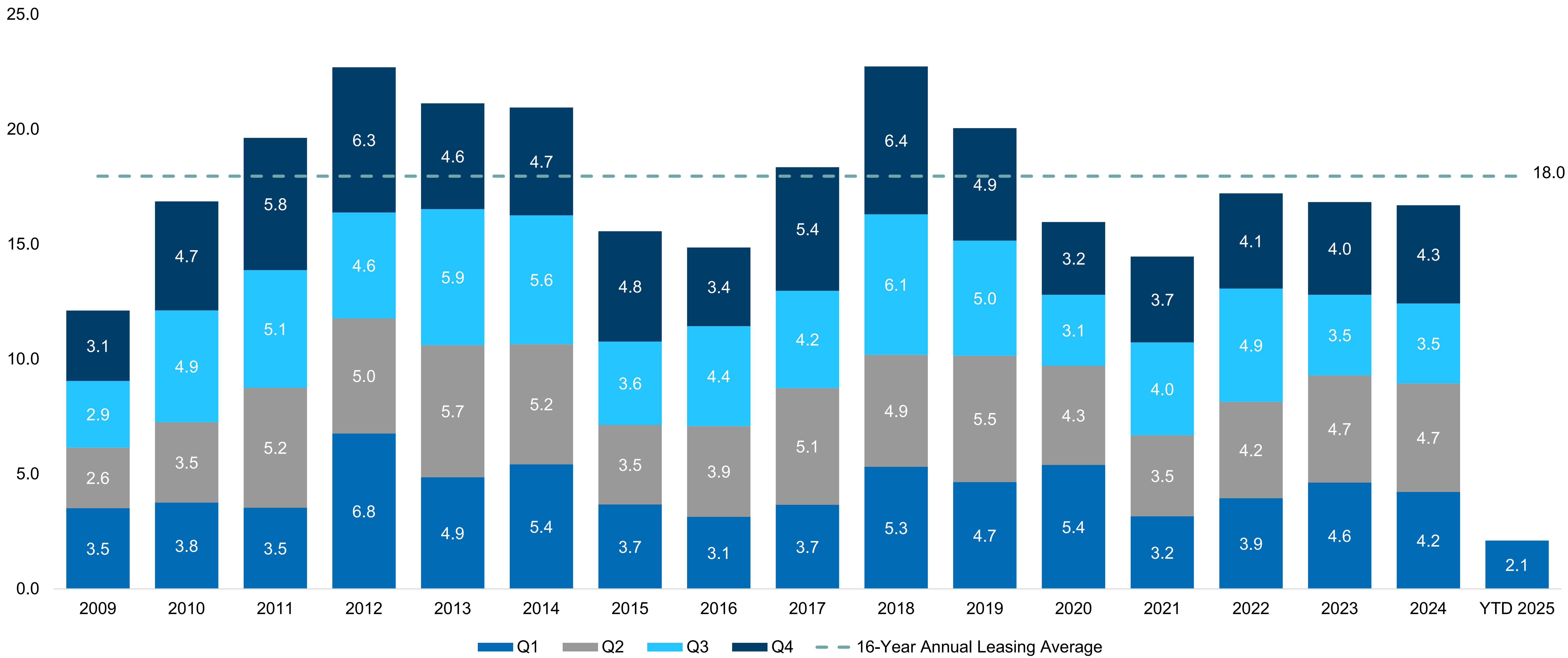


Source: Newmark Research, CoStar

Slower Deal Activity to Start the Year; Leasing Volume Well Below Quarterly Average

Leasing activity further declined in the first quarter of 2025, totaling 2.1 MSF. Since 2009, first quarter leasing activity has averaged 4.4 MSF, with activity in the first quarter of 2025 roughly 51.7% lower than the historical average. However, in recent years, annual leasing activity has displayed greater consistency, averaging 16.9 MSF annually from 2022 to 2024. Deal size averaged 3,340 SF in the first quarter of 2025, down 639 SF from a year ago. The reduction in leasing activity, which saw a 40.7% year-over-year decline in the number of deals, is largely attributed to occupiers waiting out the challenging debt environment and the impact of recent elections.

Total Leasing Activity (msf)

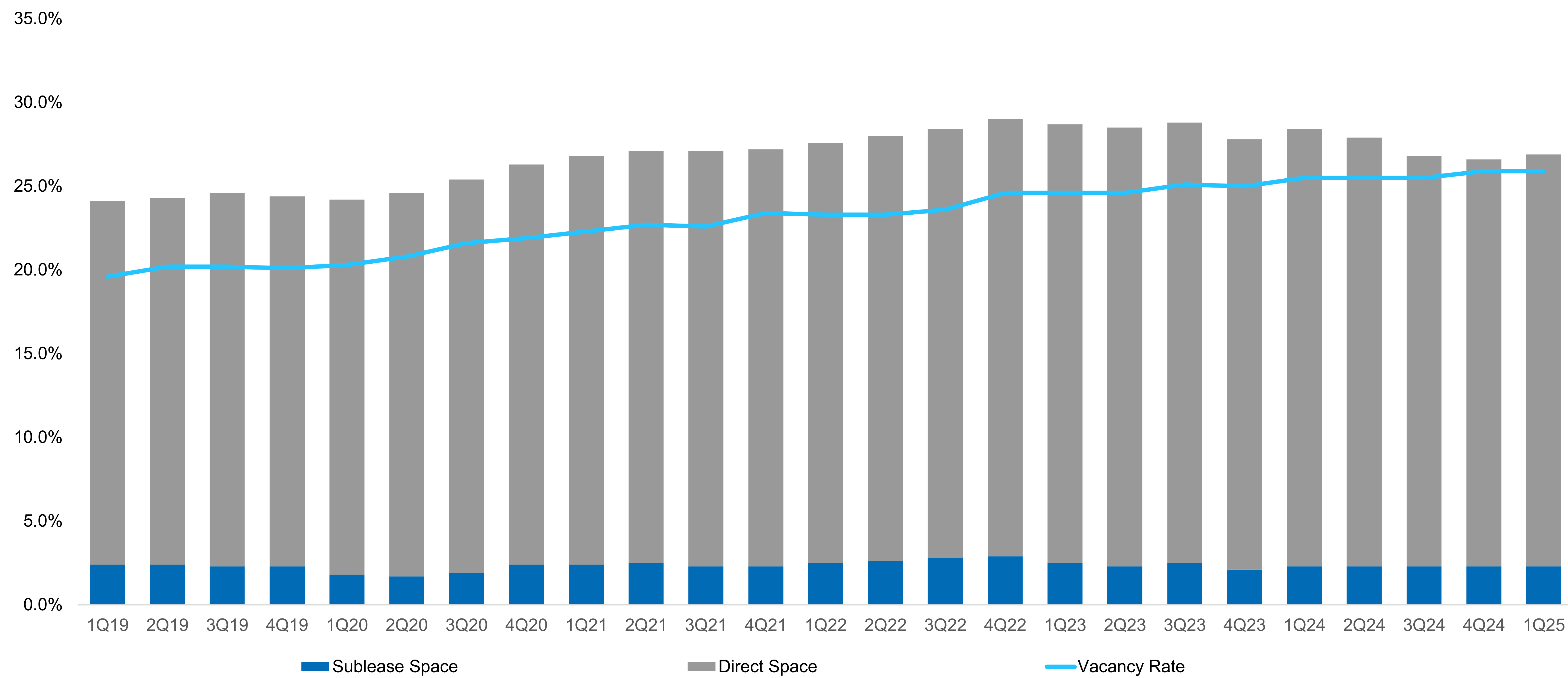


Source: Newmark Research, CoStar

Availability Continues to Fall Year Over Year

Sublease availability in the Houston market has decreased following the oil crash of 2015 to 2016 and has remained relatively stable since 2019. In the first quarter of 2025, sublease availability was 2.3%, marking the fifth consecutive quarter with no change. While direct availabilities have generally risen since the pandemic, they have decreased from a recent peak of 26.3% in the third quarter of 2023 to 24.6% currently. Vacancy rates are still high, remaining at the peak of 25.9% in the first quarter of 2025.

Available Space as Percent of Overall Market

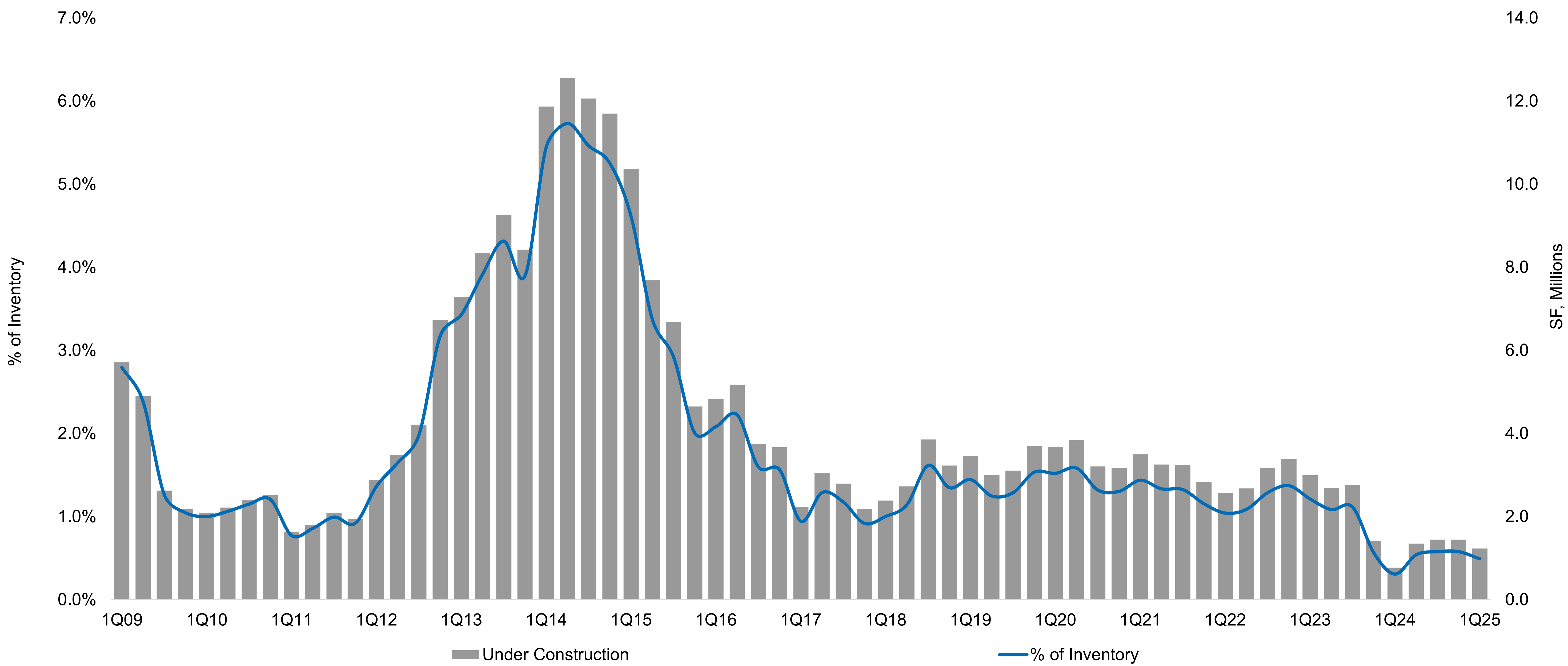


Source: Newmark Research, CoStar

Several Prominent Projects Keep Construction Pipeline Alive

Construction activity has remained relatively muted in the market since 2016. As of the first quarter of 2025, the market had 1.2 MSF under construction*, with 187,475 SF of new construction starts during the quarter. Under construction space accounts for 0.5% of the market's inventory, indicating there is less risk of overbuilding. Projects currently underway include The Ro (146,003 SF) and CityCentre Six (308,000 SF).

Office Under Construction and % of Inventory



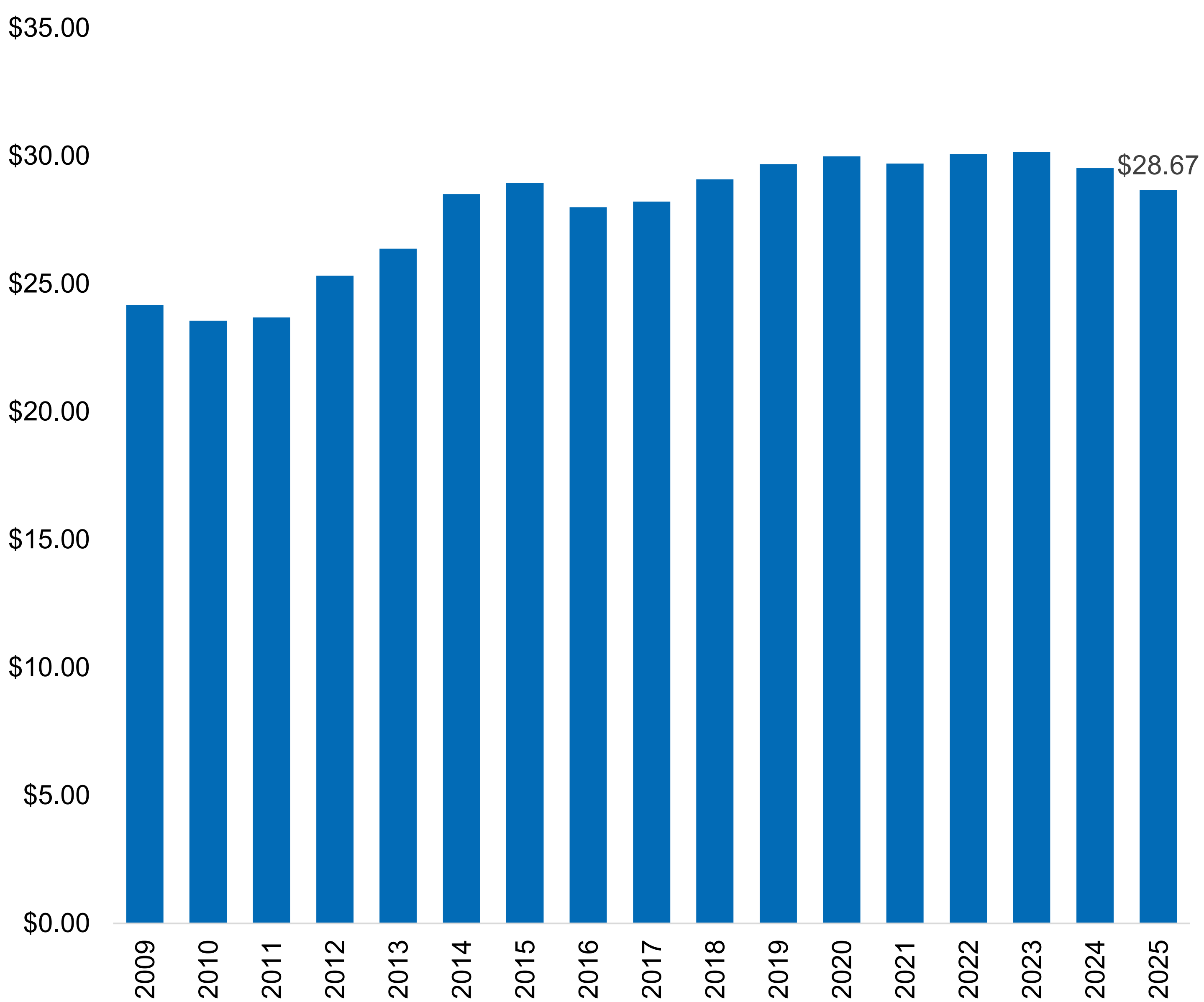
Source: Newmark Research, CoStar

* The bulk of space under construction in 4Q24 is medical office

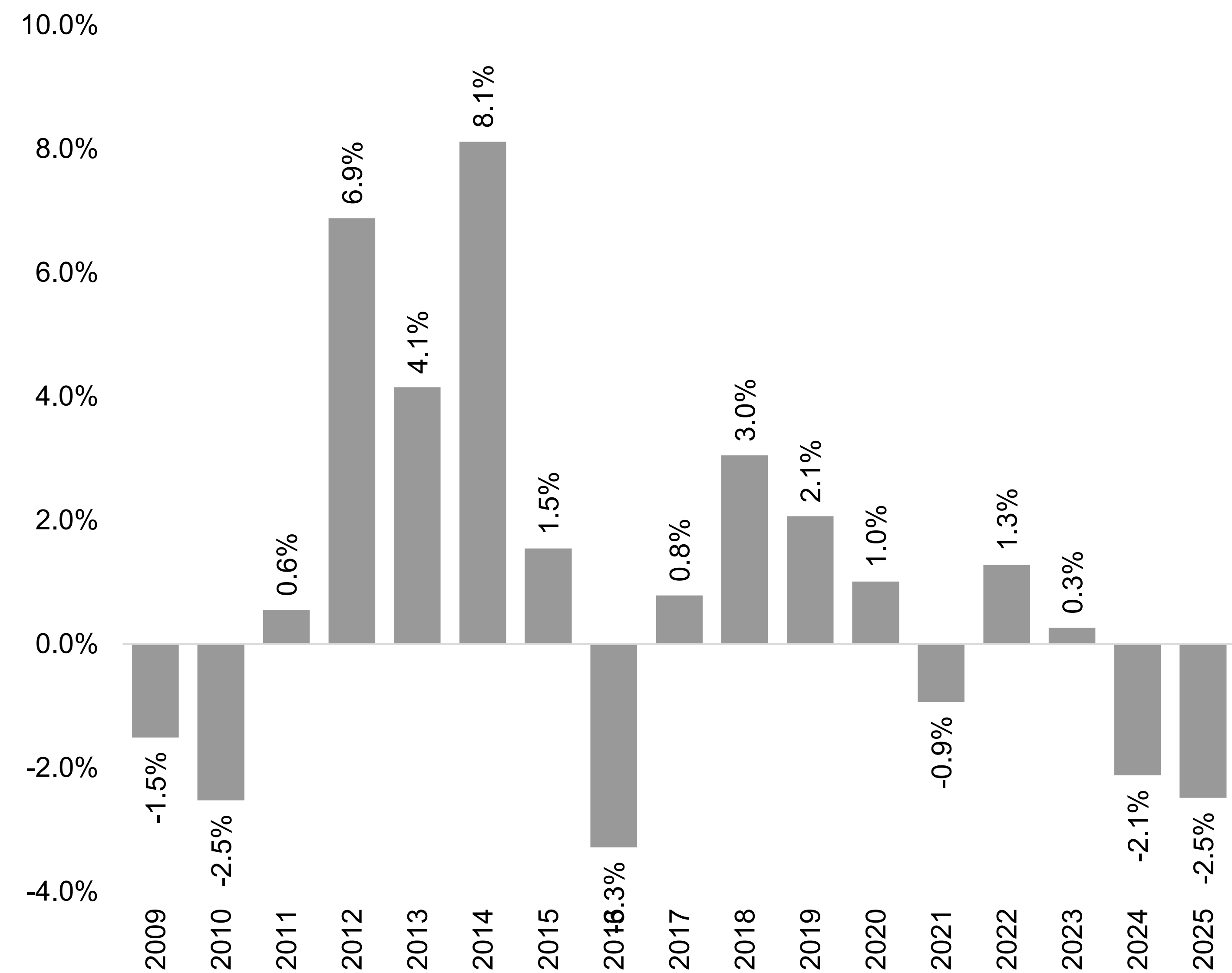
Rents Continue Trending Downward from All-Time High

In the first quarter of 2025, rents declined by 2.5% year over year to $28.67/SF and remain below the peak rental rate of $30.16/SF reported in the fourth quarter of 2023. Despite the recent dip in rental rates, tenants could see elevated asking rents in the near-term, as landlords adjust for higher operational and financing costs.

Office Average Asking Rent, $/SF, FS



Year-over-Year Asking Rent Growth Rate

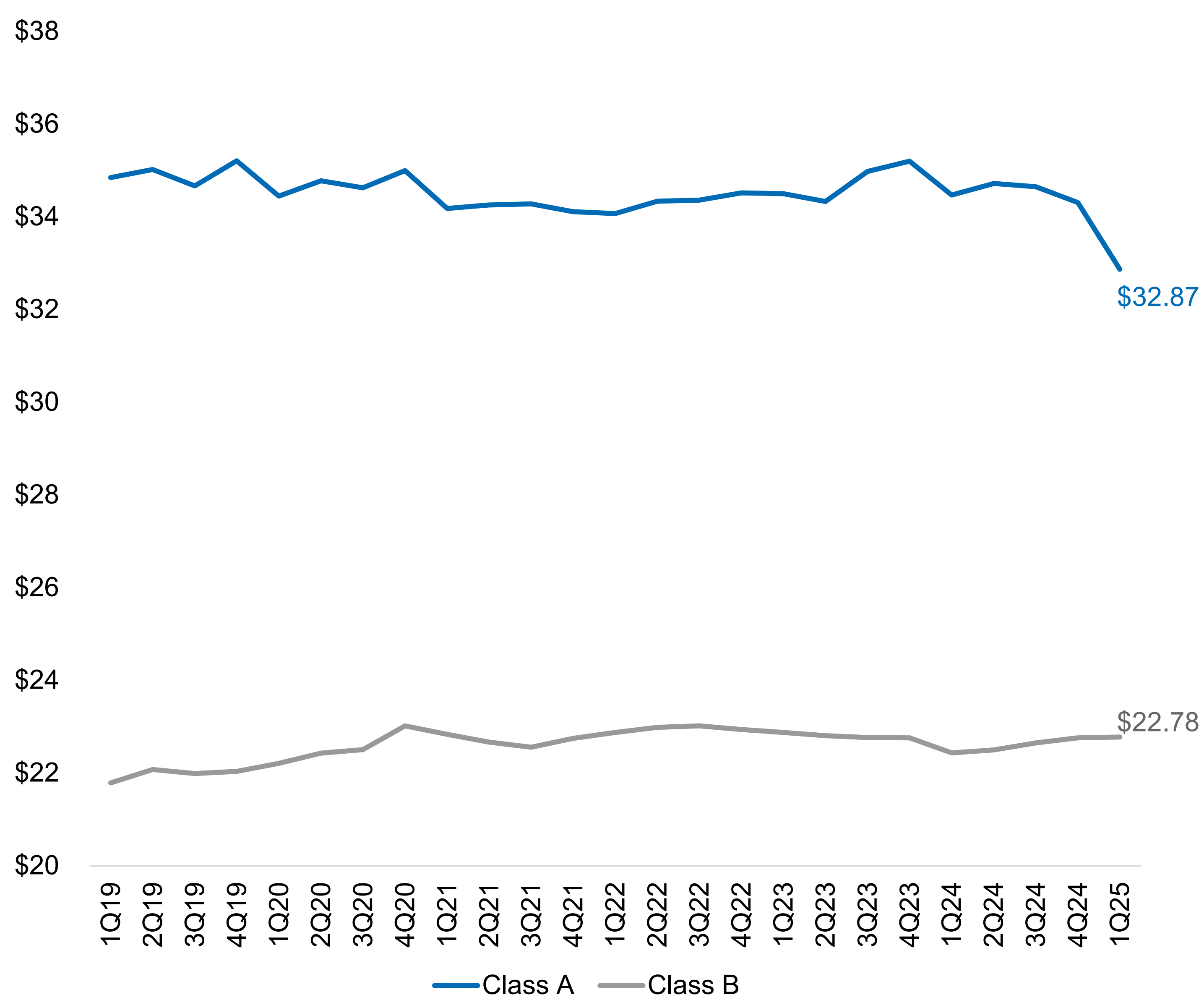


Source: Newmark Research, CoStar

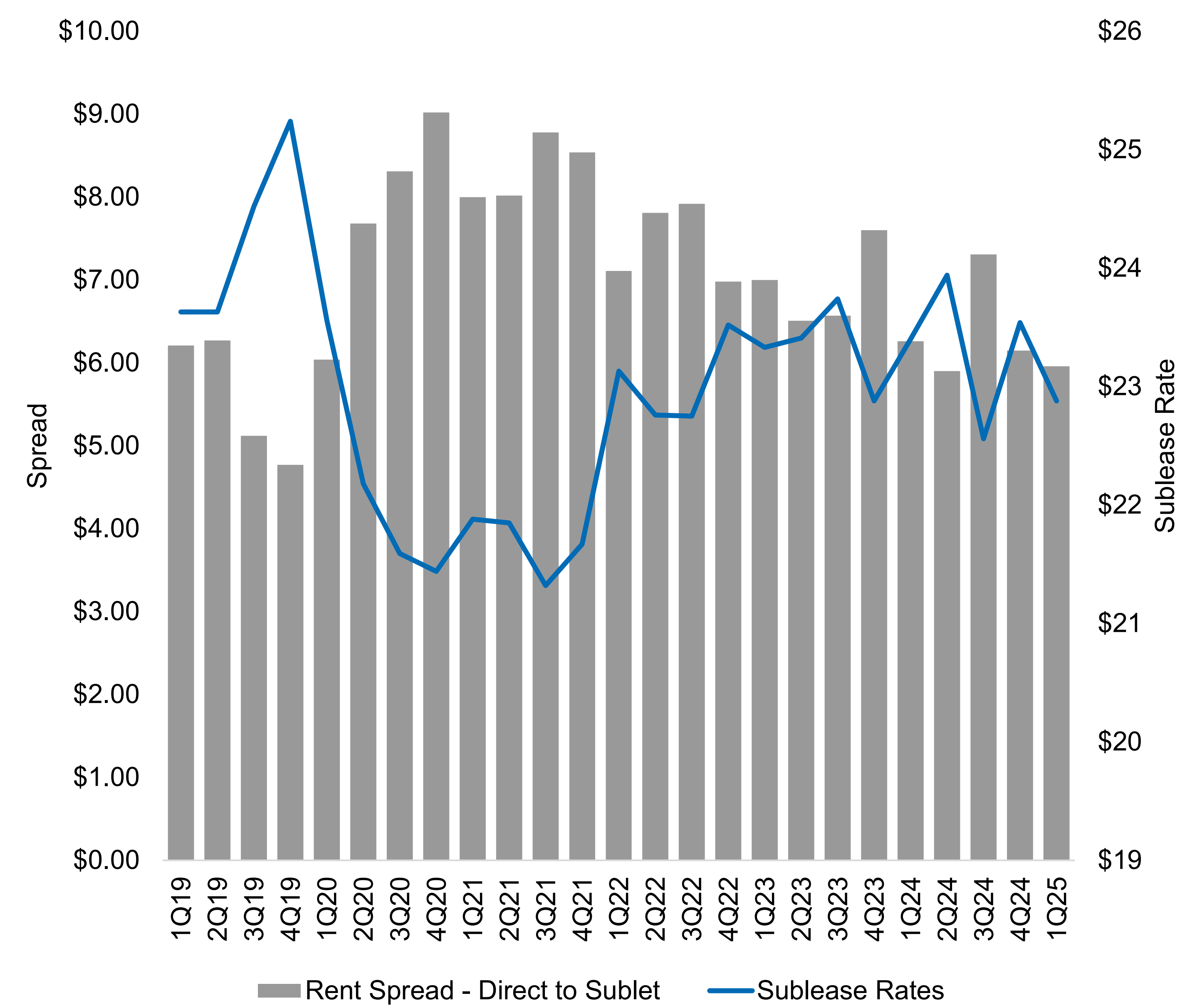
Class A Rent Premium Continues To Shrink

Class A rents ended the first quarter of 2025 at $32.87/SF, while Class B rents were $22.78/SF. The $10.09/SF spread represents a 16.1% decrease year over year. The dip in Class A asking rates underscores the flight-to-quality trend in the market, as the majority of Trophy and Class A+ spaces are now occupied, potentially leading to limited availability of Class A spaces for tenants. Sublease rates decreased to $22.88/SF in the first quarter of 2025, falling 2.8%% quarter over quarter. The rent spread between direct and sublease rates narrowed to $5.96/SF in the first quarter of 2025, a decline of 3.1% quarter over quarter.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Class A Deal Size Grows as Asset Class Continues to Lead Market Activity

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 2025, Class A space accounted for 62.8% of the market's leasing activity by SF, but only 34.5% of the market's deal volume. Average leases signed in Class A space were 6,080 SF and continue to remain larger than the average market deal size of 3,340 SF.

Notable 1Q25 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Aramco	One Allen Center	CBD	Renewal	246,300
Oil company, Aramco, renewed its lease for 246,300 SF at One Allen Center in the CBD for, inking the largest deal of the first quarter of 2025.				
Motiva	Two Allen Center	CBD	Renewal	167,000
Motiva, a wholly owned US subsidiary of Saudi Aramco, signed a renewal for 167,000 SF at Two Allen Center in the CBD.				
Mercuria	Kirby Grove	Greenway Plaza	Direct New	64,775
Mercuria, a global commodity trading firm, leased 64,775 SF at Kirby Grove in the Greenway Plaza submarket.				
Skadden Arps	Texas Tower	CBD	Direct New	52,482
Multinational law firm, Skadden Arps, signed for 52,482 SF at Texas Tower in the CBD submarket, bringing the building to 97.2% leased.				
SM Energy	One Eldridge	Katy Freeway	Direct New	41,454
SM Energy, an oil and gas exploration company, signed a new lease for 41,454 SF at 777 N. Eldridge Pkwy in the Katy Freeway submarket.				

Source: Newmark Research, CoStar

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