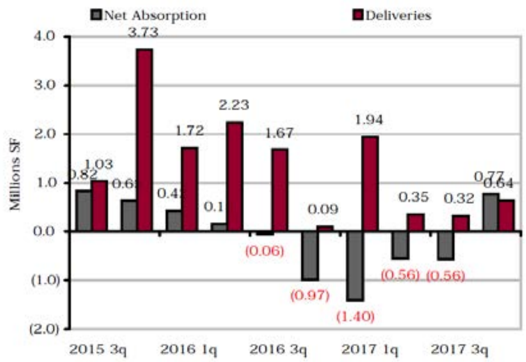
Q4 2017

MARKET REPORT | HOUSTON **OFFICE**

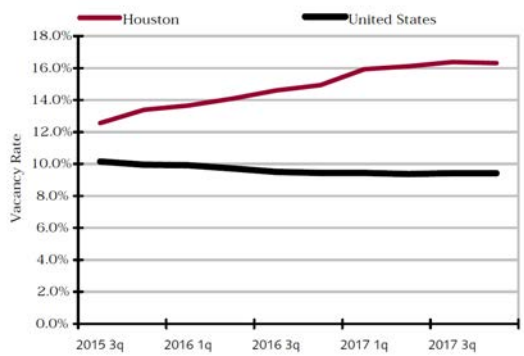
LEE & ASSOCIATES

COMMERCIAL REAL ESTATE SERVICES

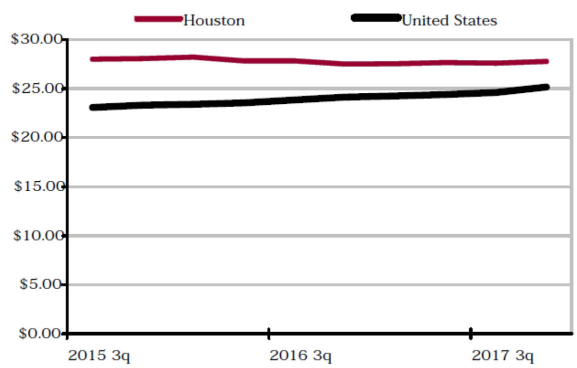
Absorption & Deliveries



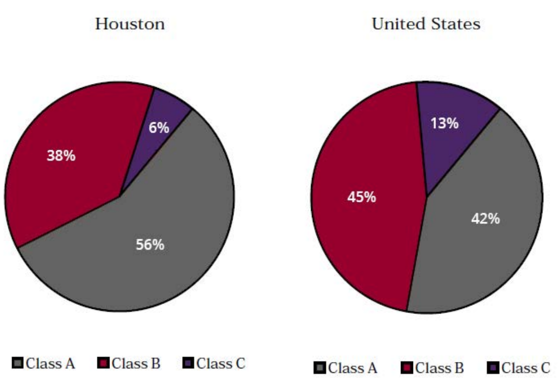
U.S. Vacancy Comparison



U.S. Rental Rate Comparison



Vacancy by Class



Trending Now

Written by Travis Taylor

The period between early 2012 through 2014 experienced the strongest burst of economic growth in Houston since 1983. During the peak of construction in late 2014, there was over 14 million square feet of office space in the pipeline as new developments were poised to take advantage of aggressive hiring and record spending during the oil boom. According to an office overview and forecast published in 2014, a local real estate firm made the bold prediction that the period between 2015 through 2017 will be the "strongest years of economic growth in the U.S. since New York's financial boom between 2004 to 2006."

Fast forward to 2018 and those same developments account for a substantial portion of the 52 million square feet of vacant office space. Companies are either scrambling to slash their budgets or capital spending decisions are moving like a herd to turtles – resulting in shedding excess space and short-term renewals. In addition to local market cycles, basic requirements of the work place are changing among large corporations trying to reduce overhead while still attracting talent. Technology, economic pressure, and radical changes in work culture have come together to drive down the amount of square feet allocated per person in the average office. The average space per employee has tightened in the last 10 years with a typical target of 250 to 300 square feet to around 175 square feet today.

Commuters will continue to take advantage of readily available technology – ride sharing and eventually self-driving cars will reduce the demand for parking. Office job growth has outstripped office growth within America's 11 largest cities, with office job growth increasing at a rate of nearly 8% to office growth only increasing by 3% over the last 10 years. According to local job statistics, Houston office job growth through its peak and valleys has increased an average of 2% (42,020 new jobs according to the TWC) per year over the past 10 years, while the office market has grown about the same.

On the bright side, for the first time in 18 months, market sentiment flipped in Q4 as there was a positive net absorption of office space. Q4 saw direct vacancy fall by 655,000 square feet and sublease by almost 1.3 million square feet. Average office base rent remained stable after a streak of dropping an average of $0.10 per quarter. It is worth noting that building operating expense are estimated to drop an average of $0.20 per square foot in 2018. In some cases, we are seeing estimated property taxes being reduced by $1.00 per square foot.

Notable transactions during the Q4 include Stewart Title subleasing 156,000 square feet from BHP Billiton's at Four Oaks Place and Talos Energy leased 97,934 square feet at Three Allen Center after acquiring Stone Energy, formerly based in Lafayette, LA.

In summary, the office market fundamentals remained consistent with the last two years, but have recently demonstrated encouraging signs of turning the corner. Subleases will continue to roll over to direct space as it expires, which will perpetuate the flight to quality Class A space at Class B economics. We are seeing older buildings advertise significant capital improvement programs in order to retain and attract tenants.

Q4 2017 Office Market Statistics

16.3%	$27.76	(1,754,496)	306,857,949	2,479,402
Vacancy ▼	Avg. SF Rental Rates ▲	Net SF Absorption ▼	SF Inventory ▲	SF Under Construction ▼

Q4 2017 Houston Office Market Report

Market	Existing Inventory		Vacancy			"YTD Net Absorption"	"YTD Deliveries"	"Under Const SF"	"Quoted Rates"
	# Blds	Total RBA	Direct SF	Total SF	Vac %				
Austin County	36	237,688	6,678	6,678	2.8%	(6,048)	0	0	$15.27
Bellaire	81	4,956,294	455,854	479,774	9.7%	6,434	0	0	$24.20
CBD	159	50,170,987	7,864,118	9,168,524	18.3%	(1,184,434)	1,056,658	778,344	$38.82
E Fort Bend Co/Sugar.	390	9,797,981	702,218	775,231	7.9%	143,374	33,049	130,599	$26.33
FM 1960/Champions	250	4,318,858	706,587	707,600	16.4%	(42,736)	80,035	29,904	$15.14
FM 1960/Hwy 249	395	8,280,692	742,347	765,367	9.2%	69,450	60,731	122,687	$24.39
FM 1960/I-45 North	103	2,473,811	533,896	537,725	21.7%	(47,951)	0	0	$18.99
Galleria/Uptown	65	16,736,606	2,431,716	2,998,321	17.9%	(303,652)	0	104,579	$36.32
Greenspoint/IAH	54	3,132,119	797,254	808,904	25.8%	(183,809)	0	0	$18.72
Greenspoint/N Belt W.	117	10,868,619	4,484,193	4,848,564	44.6%	(110,081)	0	0	$19.88
Greenway Plaza	274	13,051,667	1,789,843	1,839,227	14.1%	(54,883)	238,547	0	$33.11
Gulf Freeway/Pasadena	608	7,783,259	941,871	941,871	12.1%	(41,029)	107,510	23,604	$20.73
I-10 East	126	1,293,524	142,781	142,781	11.0%	24,548	0	0	$17.66
Katy Freeway East	256	11,733,954	1,210,456	1,345,259	11.5%	(175,303)	303,647	0	$28.71
Katy Freeway West	253	28,268,655	4,607,776	5,854,380	20.7%	79,948	86,255	4,320	$28.54
Katy/Grand Parkway W	384	5,869,369	736,381	761,456	13.0%	94,529	95,436	115,745	$27.33
Kingwood/Humble	213	3,365,577	229,118	230,532	6.8%	158,260	144,450	100,000	$23.24
Midtown	529	9,510,000	805,647	856,336	9.0%	116,109	6,300	0	$29.96
NASA/Clear Lake	514	10,417,486	1,778,800	1,797,094	17.3%	(200,173)	26,010	7,400	$20.53
North Loop West	325	6,093,943	921,834	933,789	15.3%	(100,742)	0	25,020	$24.85
Northeast Near	141	2,210,329	157,871	157,871	7.1%	53,918	85,000	0	$18.73
Northwest Far	131	4,407,279	879,331	888,412	20.2%	(32,254)	0	0	$17.25
Northwest Near	53	1,671,467	101,753	101,753	6.1%	(5,615)	0	0	$15.63
Post Oak Park	43	4,775,644	1,125,335	1,229,943	25.8%	1,372	380,000	0	$33.63
Richmond/Fountainview	115	2,157,383	162,811	162,811	7.5%	80,529	0	0	$21.52
Riverway	23	3,084,567	585,889	614,161	19.9%	(209,782)	0	0	$30.71
San Felipe/Voss	49	5,339,957	932,320	951,795	17.8%	(118,191)	0	0	$28.77
San Jacinto County	3	39,139	0	0	0.0%	0	0	0	$0.00
South	243	2,875,833	281,450	281,450	9.8%	60,285	68,849	300,000	$25.01
South Hwy 35	145	784,995	40,015	40,015	5.1%	5,315	0	0	$17.54
South Main/Medical C.	230	12,246,705	531,647	547,518	4.5%	22,752	0	0	$27.68
Southwest Beltway 8	192	7,613,334	1,060,983	1,066,385	14.0%	72,142	67,600	0	$17.59
Southwest/Hillcroft	107	5,347,287	926,352	934,424	17.5%	(90,127)	0	0	$17.77
West Belt	102	6,747,137	948,400	1,266,444	18.8%	71,616	0	6,000	$26.64
Westchase	137	18,727,139	3,209,086	3,811,217	20.4%	(7,021)	187,011	0	$27.70
Woodlands	588	20,468,665	2,019,204	2,163,649	10.6%	98,754	217,328	731,200	$27.63
Totals	**7,434**	**306,857,949**	**44,851,815**	**50,017,261**	**16.3%**	**(1,754,496)**	**3,244,416**	**2,479,402**	**$27.76**

Source: CoStar Property®

Looking Ahead at Q1 2018:

- Increased institutional and private capital entering Houston to acquire office properties.
- Market conditions will continue to favor the tenant for the next 18 months.
- Sublease opportunities are mostly opportunistic options for larger tenants, which hinders the ability for smaller firms to take advantage of attractive deal terms.
- Landlords are eager to strike competitive deals with quality credit tenants.
- Rental rates have declined in energy-heavy submarkets but will continue to stabilize.

About This Report

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The Houston Office Market Report compiles relevant market data by using a third-party database for the proprietary analysis of specific office properties in the Houston Area.

Q4
2017

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