

Savills Studley Report

Houston office sector

Q2 2018



SUMMARY

Market Highlights

DEAL VOLUME UP SLIGHTLY

Quarterly leasing volume, which had exceeded 3 million square feet (msf) for the third consecutive quarter, rose to 3.2 msf in the second quarter. Only one lease over 100,000 sf was completed. Tenants have leased 12.2 msf in the four most recent quarters, 4.8% below the long-term market average.

CLASS A AVAILABILITY PUSHES HIGHER

The market's overall availability rate jumped by 80 basis points from 27.5% to 28.2%. The Class A availability rate increased by 40 basis points to 30.1%.

ASKING RENT UP SLIGHTLY

Average asking rent for the Houston market rose by 2.2% to \$28.43. Year-on-year average asking rent was essentially unchanged. The Class A rate rose by 4.5% to \$33.30 during the second quarter.

SUBLEASE SUPPLY INCREASES

Despite the reduction in 2017, overall sublease supply remains substantial, totaling 9.5 msf as of mid-year. The addition of Occidental's Greenway campus pushed sublet supply up from 8.9 msf in the first quarter.

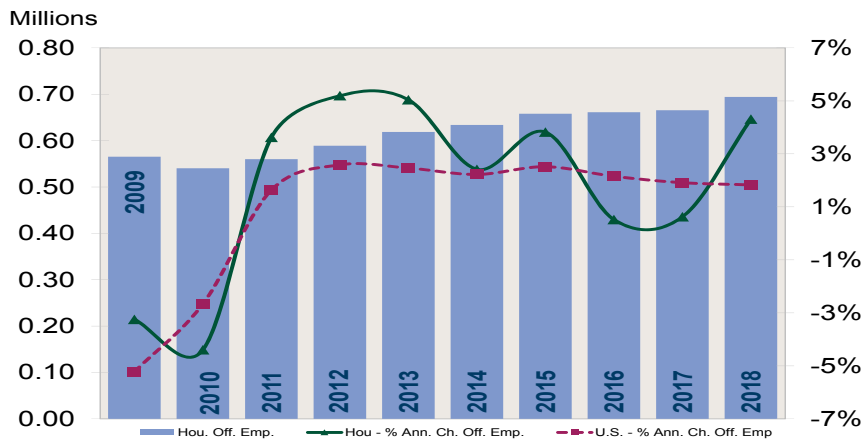
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"Enjoying ample space options and generous concessions, tenants in the Houston region are displaying both restraint and a moderate flight-to-quality. Propped up by record concessions, rental rates in the CBD are holding up. Availability rates in West Houston remain at multi-year highs, compelling landlords to be very accommodating."

Brad Hauser, Research Director

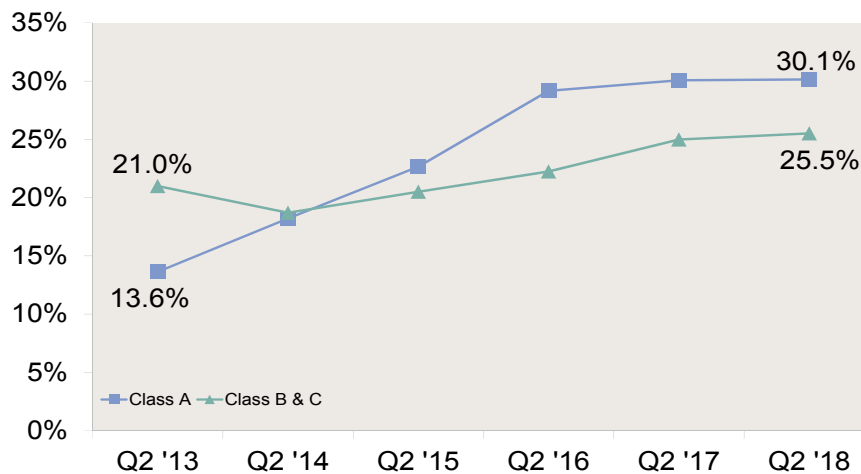
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Office-Using Employment Trends

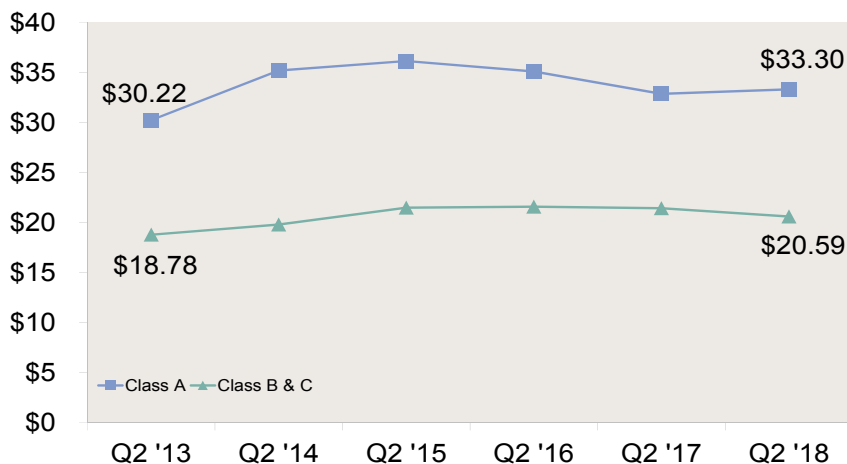


Source: Bureau of Labor Statistics^

Availability Rate Trends



Asking Rent Trends (\$/sf)



Commodity Prices Rise, but Conditions Still Favor Tenants

Houston's energy sector continues to recover. Oil prices pushed to \$72 per barrel (WTI) mark by late June as tensions with Iran increased. Even so, some top energy firms are still consolidating locally. Others are shifting operations closer to drilling and production sites. BP, for example, announced that it will reduce its upstream workforce by about 3% (540 people). It is unclear where the cuts, which are expected to be completed in July, will take place. Additionally, the company is expected to move its Lower 48 division (which employs about 200 people) from Houston to a new building underway in Denver. In contrast, ExxonMobil's XTO Energy is starting to move 1,600 employees from Fort Worth to the North Houston campus.

Flight to Quality Pushing Some to Renovate

Discounted rent, ample space options and generous concessions have supported a flight to quality. This intensifies the pressure on owners of older A/B buildings to bring their properties up to par. Ample space options ratchet up the pressure on landlords to differentiate their assets. Spear Street Capital, for example, recently unveiled a \$6-million renovation plan for 5 Houston Center that will include upgrades to its fitness center, sky lobby and office lounge. The San Francisco-based investor acquired the building along with Energy Center I and 515 Post Oak Boulevard in January 2017.

Traditional Class A buildings in CBD are struggling to compete with new trophy buildings such as 811 Main, 609 Main and the recently topped-out Capitol Tower. Landlords in older Class A second generation space continue to resist dropping their quoted rates. Rental rate adjustments might make relocation for tenants more appealing. However, concession packages and free rent are more prevalent in the older buildings.

Availability rates remain very elevated, exceeding 20% in nearly every submarket. Some energy companies are still streamlining while others are making lateral moves to higher-quality space that do nothing to absorb the excess space left behind. Enable Midstream Partners, for example, plans to move its Houston location from 46,000 sf at 1111 Louisiana Street to a 48,000-sf sublet at One Shell Plaza (910 Louisiana Street). This is just a fraction of the 900,000 sf of sublease space that Shell

Oil dumped on the market in 2016. Sublet supply in the region has had an impact on rent but has not been detrimental to overall activity. Tenants have pursued longer term subleases in quality buildings.

Several very large direct blocks of space are pushing availability rates up. For example, 800 Bell has 1.3 msf vacant. The massive block has been empty since Exxon Mobil relocated its employees to its new Springwoods Village campus. In the Energy Corridor, Energy Center Five, the 18-story tower completed in 2016, is still sitting vacant. The 524,397-sf building developed by Trammell Crow and Principal Real Estate Investors is next to ConocoPhillips Energy Center Four.

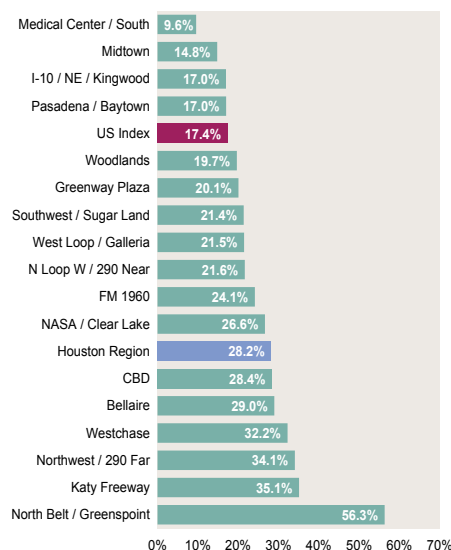
Coworking Filling in Some of the Gap

While lagging behind other metros, coworking is gaining ground in Houston and is expected to reach similar market share to other major markets in the next couple of years. Coworking space providers have supplemented leasing activity in nearly every major market, filling in some of the gap caused by the continued densification by law firms and other traditional space occupiers.

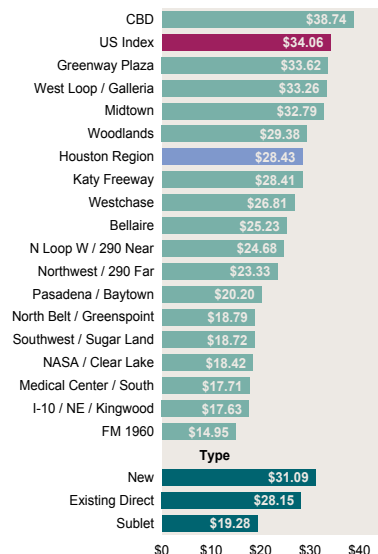
WeWork has expanded almost everywhere, including Houston. It recently opened. WeWork 708 Main Street, a nine-floor 82,000-sf center in the Great Jones Building in the CBD. This is WeWork's second location in Houston after their first center in the Galleria. WeWork also houses some tenants that offer services to startups such as Coding Academy. The school which helps people learn key computing skills leases at WeWork Houston. WeWork is also collaborating with the Houston office of Business Opportunity.

Tenants are taking advantage of an oversupply of space in both the CBD and in West Houston. This is an ideal time for firms with multiple locations to combine in one building, sometimes into smaller spaces. Goldman Sachs plans to move about 100 employees into slightly smaller space at 609 Main Street, leaving behind 50,000 sf at 1000 Louisiana. The building has seen a flurry of recent activity including leases by Simmons & Company International (31,000 sf) Royal Bank of Canada, Chicago Title Insurance Company and McKinsey & Company. Completed in 2017, the 1.07 msf property has a "hotel-style" lobby with a café and space for collaboration, a 7,000-sf fitness center, 8,000-sf conference center and full-height windows. Additionally, an

Availability Rate Comparison



Rental Rate Comparison (\$/sf)



Major Transactions

Tenant	Sq Feet	Address	Market Area
Gulf Interstate	115,000	16010 Barkers Point Ln	Katy Freeway/Energy Corridor
Carrizo Oil & Gas	83,000	500 Dallas St	CBD
Acclara Solutions	82,941	10713 W Sam Houston Pky N	Northwest/290 Far
Sidley Austin	80,000	1000 Louisiana St	CBD
Haynes and Boone	70,000	1221 McKinney St	CBD
Constellation Energy	62,000	1001 Louisiana St	CBD
PFS Group	54,891	2600 N Loop Fwy W	North Loop W/290 Near
Energy XXI	50,000	1021 Main St	CBD
Enable Midstream	45,828	910 Louisiana St	CBD
Simmons & Company International Energy Specialists	31,045	609 Main St	CBD
Sum of Top 10 Leases	674,705	Sum of 2nd Qtr Leasing Activity	3.2 MSF

underfloor air system, costing \$10 million, allows tenants to control the temperature in their area.

Ideal Conditions for tenants

Tenants have an extremely deep pool of options in suburban locations. They can generally secure generous concessions. Solaris Energy Capital signed a full floor lease totaling 20,000 sf at Air Liquide Center (9811 Katy Freeway). The private investment firm capped off strong leasing at the 597,000-sf complex completed by MetroNational in 2015. The building is now fully leased.

Leasing has been up and down in Houston during the last few quarters. In contrast, sales have been surprisingly consistent. Same local investors are making their first foray into suburban locations. Wedge Group, for example, purchased Three Sugar Creek in Sugar Land. The 154,263-sf building, constructed in 2007, was 90% leased at time of sale.

These investors, much like the steady flow of people and businesses to the Houston region, have faith in the long-term potential of the region's economy. It will take quite some time to fill much of the vacant space, particularly in West Houston, but this gives top employers plenty of options and time to gear up for the next inevitable rally.

Map	Submarket	Total	Leasing Activity	Available SF			Availability Rate			Asking Rents Per SF		
		SF (1000's)	Last 12 Months	This Quarter	% Change from Last Qtr.	Year Ago	This Quarter	pp Change from Last Qtr. ⁽¹⁾	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
1	Bellaire	2,599	132	753	61.5%	526	29.0%	12.2%	17.6%	\$25.23	2.2%	\$25.83
	Bellaire - Class A	1,169	51	243	2.1%	301	20.8%	3.2%	22.3%	\$27.29	5.7%	\$27.21
2	Central Business District	37,605	2,490	10,698	1.6%	10,629	28.4%	0.5%	27.7%	\$38.74	2.0%	\$39.19
	Central Business District - Class A	27,954	2,224	7,317	0.3%	7,182	26.2%	0.1%	25.0%	\$41.44	2.5%	\$42.82
3	FM 1960	2,861	146	691	4.6%	713	24.1%	1.1%	21.3%	\$14.95	-6.0%	\$15.02
	FM 1960 - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
4	Greenway Plaza	10,102	565	2,028	1.6%	2,141	20.1%	0.3%	19.3%	\$33.62	4.8%	\$33.89
	Greenway Plaza - Class A	7,499	406	1,572	1.8%	1,715	21.0%	0.4%	20.3%	\$35.84	5.0%	\$36.26
5	I-10/NE/Kingwood	1,277	82	217	5.6%	268	17.0%	0.9%	18.9%	\$17.63	-6.3%	\$17.96
	I-10/Northeast/Kingwood - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
6	Katy Freeway	27,465	1,798	9,641	5.6%	9,144	35.1%	1.8%	33.2%	\$28.41	8.7%	\$26.25
	Katy Freeway - Class A	18,630	1,008	7,220	5.8%	6,666	38.8%	2.1%	35.5%	\$31.50	10.9%	\$28.52
7	Medical Center/South	1,525	54	146	2.0%	149	9.6%	0.2%	10.3%	\$17.71	-14.5%	\$19.95
	Medical Center/South - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
8	Midtown	4,602	312	681	3.0%	896	14.8%	0.4%	20.2%	\$32.79	2.6%	\$30.85
	Midtown - Class A	1,773	167	377	-3.1%	672	21.2%	-0.7%	39.2%	\$33.69	5.0%	\$29.87
9	North Belt/Greenspoint	10,943	637	6,163	-8.2%	6,182	56.3%	-5.3%	57.9%	\$18.79	-7.7%	\$20.71
	North Belt/Greenspoint - Class A	5,124	273	3,347	-14.5%	3,548	65.3%	-11.1%	74.2%	\$22.33	-4.2%	\$23.65
10	NASA/Clear Lake	4,459	178	1,188	-1.2%	1,385	26.6%	-0.3%	28.5%	\$18.42	-5.0%	\$18.92
	NASA/Clear Lake - Class A	1,625	23	220	12.3%	270	13.5%	1.5%	12.4%	\$24.27	-0.4%	\$24.49
11	North Loop W/290 Near	4,677	373	1,012	9.0%	817	21.6%	1.8%	17.2%	\$24.68	0.2%	\$24.36
	North Loop W/290 Near - Class A	1,189	59	505	1.3%	386	42.5%	0.6%	32.5%	\$28.47	6.9%	\$26.81
12	Northwest/290 Far	10,893	814	3,710	9.0%	3,606	34.1%	2.8%	30.9%	\$23.33	3.6%	\$24.24
	Northwest/290 Far - Class A	6,317	529	2,459	17.5%	2,178	38.9%	5.8%	34.1%	\$26.54	4.8%	\$26.57
13	Pasadena/Baytown	2,425	118	413	13.0%	435	17.0%	2.0%	14.4%	\$20.20	-5.6%	\$20.47
	Pasadena/Baytown - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
14	Southwest/Sugar Land	13,497	558	2,886	5.0%	2,656	21.4%	0.9%	19.1%	\$18.72	-2.0%	\$20.69
	Southwest/Sugar Land - Class A	4,986	145	1,045	8.4%	869	21.0%	1.1%	16.8%	\$21.36	1.2%	\$24.90
15	West Loop/Galleria	30,038	2,596	6,451	-2.1%	7,006	21.5%	-0.4%	23.1%	\$33.26	3.7%	\$33.20
	West Loop/Galleria - Class A	19,646	2,087	4,495	-4.8%	5,121	22.9%	-1.2%	25.9%	\$36.58	5.3%	\$36.60
16	Westchase	14,679	830	4,733	2.6%	4,442	32.2%	0.9%	30.2%	\$26.81	1.3%	\$28.10
	Westchase - Class A	8,736	453	3,299	1.0%	3,125	37.8%	0.4%	35.8%	\$32.22	6.3%	\$32.87
17	Woodlands	8,188	492	1,611	-2.6%	1,958	19.7%	-0.5%	22.7%	\$29.38	2.6%	\$31.83
	Woodlands - Class A	5,072	267	989	-3.4%	1,280	19.5%	-0.7%	25.2%	\$33.33	-1.4%	\$37.85
1-17	Greater Houston Total	187,837	12,175	53,022	1.9%	52,953	28.2%	0.8%	28.0%	\$28.43	2.2%	\$28.40
	Greater Houston Total - Class A	109,998	7,709	33,162	0.4%	33,377	30.1%	0.4%	30.1%	\$33.30	4.5%	\$32.86

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(1) Percentage point change for availability rates.

Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.

Statistics are calculated using both direct and sublease information.

Short-term sublet spaces (terms under two years) were excluded.

^Unless otherwise noted, source for data is Savills Studley.

The information in this report is obtained from sources deemed reliable, but no representation is made as to the accuracy thereof. Statistics compiled with the support of The CoStar Group.

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