

Savills Studley Report Houston office sector

Q1 2018



SUMMARY

Market Highlights

LEASING ACTIVITY DECLINES

Following a strong quarter of activity, with 3.6 million square feet (msf) leased – quarterly activity dropped to 3.1 msf. Tenants have leased 11.1 msf in the four most recent quarters, 13.5% below the long-term market average.

CLASS A AVAILABILITY INCREASES

The market's overall availability rate increased by 10 basis points from 27.6% to 27.7%. The Class A availability rate increased by 50 basis points to 30%.

ASKING RENT NUDGES LOWER

Average asking rent for the entire region decreased by 3% to \$27.74; year-on-year, average asking rent decreased 2.8%. The Class A rate fell by 4.3% to \$31.81 during the first quarter.

SALES SPIKE

Office property sales during the last six months (through February 2018) totaled \$3.7 billion, an impressive 87% increase compared to the previous six-month total of \$2.0 billion.

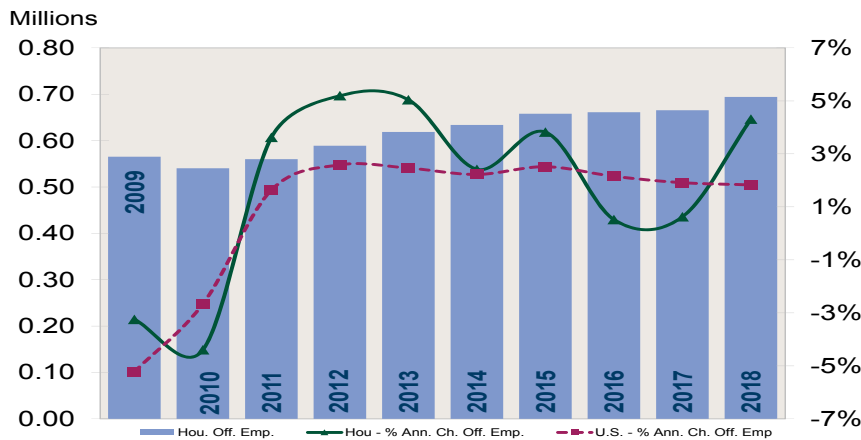
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"Global oil markets have slowly reined in the issue of excess supply in the last few quarters. The threat of a glut in production has not been fully put to rest, though. Similarly, Houston is just starting to work through its ample excess availability, putting tenants in the driver's seat."

Brad Hauser, Research Director

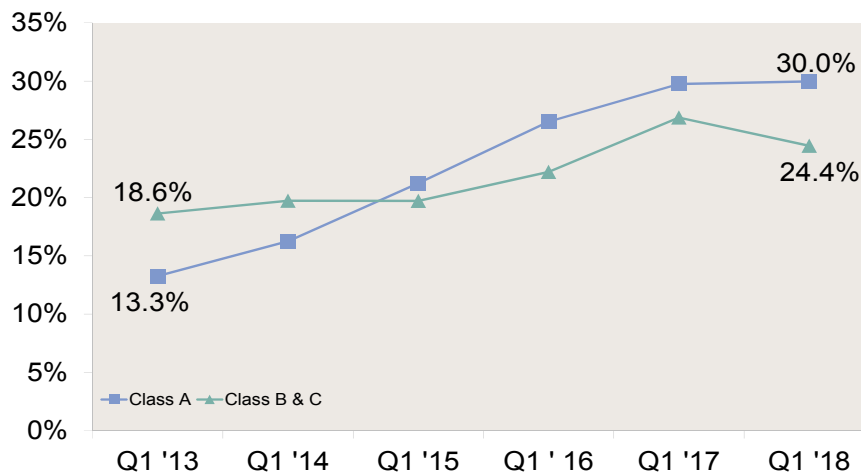
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Office-Using Employment Trends

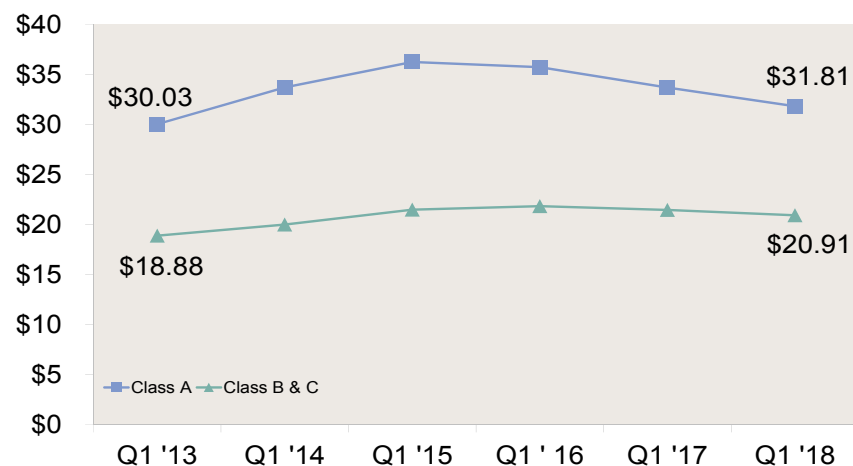


Source: Bureau of Labor Statistics^

Availability Rate Trends



Asking Rent Trends (\$/sf)



Efficiency Fuels Excess Supply

Oil and gas may make the world go round, but the price of commodities sometimes moves in the opposite direction from the broader economy. Houston appears to be nearing the tail-end of one such countercyclical phase. In this most recent pullback, oversupply has been the culprit – the exceptional efficiency of the latest fracking technology, coupled with the resumption of production in Iraq, boosted supply. Recent cuts in OPEC production and improving global demand have pushed the price for WTI from a low of \$30 in late 2016 to just over \$65 per barrel in early 2018. The market has stabilized, but oversupply will not go away. The technological innovations in shale extraction should position the U.S. for a growing market share, but it also increases the the potential for future gluts.

Houston's office market is also dealing with oversupply issues. During the last two years many energy companies abandoned their usual aggressive leasing habits, instead implementing space efficiency measures that have been the norm among most office space occupiers. The pullback has had a big impact on the office market, particularly in West Houston, which is dealing with oversupply in office space. The overall availability rate in Class A buildings at the end of the first quarter stood at 30%, a spike of nearly 900 basis points from its low of 21.2% in 2015. Conditions diverge between the Central Business District (CBD) and West Houston. With a Class A rate of 26%, tenants have quite a few options in the (CBD), but Class A availability is even more elevated in Katy Freeway (36.6%) and Westchase (37.4%). In general, across the entire region, landlords are still extending very generous terms to tenants as they do their best to fill space.

Market on the Mend

The region's economy appears to be on the mend though. Local construction and manufacturing companies are benefit from the post-Harvey recovery efforts as well as the rebounding energy sector. Following a trend seen in many markets that have extensive port and infrastructure networks, Houston's logistics sector is also perking up. Statewide exports have jumped by more than 20% year-over-year. Tonnage in 2017 was roughly on par with 2016, but increased demand for crude oil, refined products and petrochemicals should spur further increases in goods flowing through the ship Channel.

Business services are also heating up. Office-using employment seems to be making up for lost time—it spiked by 3.3% during the last 12 months, eclipsing the 0.2% growth in the prior 12 months. Leasing activity reflects a market on the mend and some pent-up demand that built up during last year. In addition to Apache's massive renewal and a 353,944-sf lease by Williams (both within West Loop/Galleria), several mid-sized deals were completed in the quarter.

Trimming Their Sails

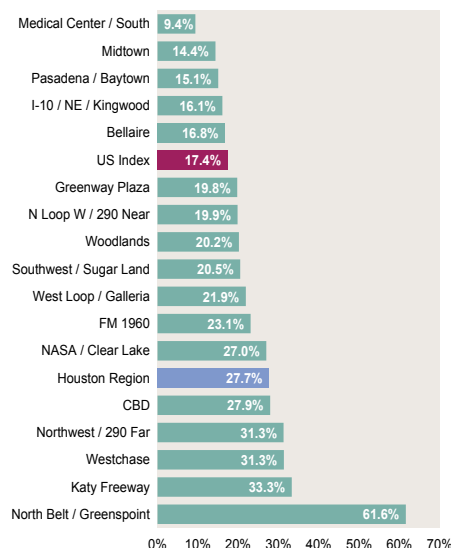
During the two-year pullback, energy firms applied cost management measures more rigorously. Cost consciousness is old news in most markets and many industries. The banking, legal and general business services have faced pressures to cut costs over the last 10 years. Halliburton, for example, is auctioning off its Oak Park Campus as part of the company's "ongoing cost-management efforts." The current conditions are less than ideal for sellers – fortunately there is a lot of global and domestic capital banking on the long-term prospects of the Houston market. The 48-acre site is improved with a 605,261-sf building constructed in 1979.

A Measured Approach

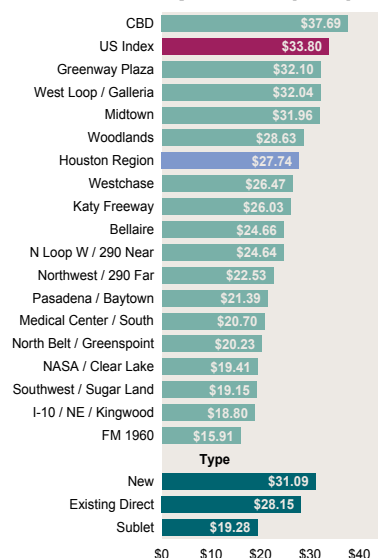
Such efficiency and restraint is a bit of a twist for Houston's energy sector, which has never fully abandoned its wildcat heritage. In prior years energy firms could always be counted on to opt for redevelopment or a build-to-suit, now more are choosing a more conservative approach. Apache Corp, for example, decided to extend its massive 514,292-sf lease at Post Oak Central through 2024, saying it provides a stable and economically viable location as recovery in the markets continue." The oil and gas exploration company will hold off on construction of new headquarters at 1770 Post Oak Boulevard until it sees stronger prospects in the broader energy industry.

Meanwhile, Occidental Petroleum Corp is reportedly in talks to acquire ConocoPhillips' campus in the Energy Corridor. The transaction is expected to be finalized once Conoco occupies its new headquarters, Energy Center 4. Conoco's former campus at 600 N. Dairy Ashford contains 1.4 msf of office space on 62 acres. Occidental leases 961,000 sf at 3 Greenway and 5 Greenway through 2026, giving it quite some time to plan occupancy for the Conoco site.

Availability Rate Comparison



Rental Rate Comparison (\$/sf)



Major Transactions

Tenant	Sq Feet	Address	Market Area
Apache Corporation	514,292	Post Oak Central	West Loop/Galleria
Williams	353,944	2800 Post Oak Blvd	West Loop/Galleria
Fairfield Nodal	46,720	9811 Katy Fwy	Katy Freeway/Energy Corridor
KHOU	42,999	5718 Westheimer Rd	West Loop/Galleria
Yetter Coleman	24,494	811 Main St	CBD
Cardno	23,652	920 Memorial City Way	Katy Freeway/Energy Corridor
Solaris Energy Management	23,588	9811 Katy Fwy	Katy Freeway/Energy Corridor
Hancock Whitney Bank	23,324	3200 Kirby Dr	Greenway Plaza
Foster LLP	23,049	3 Greenway Plz	Greenway Plaza
Asurion LLC	19,816	500 Jefferson	CBD
Sum of Top 10 Leases	1,095,878	Sum of 1st Qtr Leasing Activity	3.1 MSF

West Houston Reset

West Houston, which was the recipient of much of the inter-market movement and then development during the boom days, is now at the heart of the snapback in demand. As energy firms contracted and consolidated they left behind massive vacancies. More than 75% of Class A space in North Belt/Greenspoint is available for lease. A few owners must take the challenge of leasing space at some complexes that had not been renovated in decades. Some owners have barely started to lease space at rents that are well below market. In Greenspoint, Elementia USA leased 16,505 sf at 396 W. Greens Road, a former Exxon building that has been vacant since Exxon relocated to its new Springwoods Village campus in 2015. The owner GWL Realty Advisors undertook a \$2.8 million renovation at the building in 2016 that was completed last summer. Renovations included upgrades to elevator banks, restrooms and the entryway.

Lincoln Property Companies, which bought the former Exxon campus in Greenspoint, unveiled plans for a \$100 million renovation of landscaping, building exteriors and lobbies at Greenspoint Place. The new owner is renaming the complex, calling it CityNorth. Lincoln Property also plans to change the complex's restaurant and retail roster. Initial renovations include the addition of an outdoor running track and developing a 6,000-sf open concept hub called Third Place. The six-building complex is only 40% leased.

Meanwhile the CBD still has quite a few big blocks of available space, but conditions are not as soft. The Class A availability rate was still elevated, ending the quarter at 26.0%, but has essentially held flat over the last few quarters. It remains to be seen whether firms will become more aggressive in submarkets with elevated availability and very generous lease terms.

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	2,801	149	470	-3.7%	493	16.8%	-0.6%	17.6%	\$24.66	-0.6%	\$24.74
	Bellaire - Class A	1,371	79	242	-0.3%	260	17.6%	0.0%	19.0%	\$25.74	-1.3%	\$26.13
2	Central Business District	38,389	2,242	10,724	2.3%	10,558	27.9%	0.6%	27.5%	\$37.69	-2.9%	\$40.35
	Central Business District - Class A	28,738	1,998	7,486	3.7%	7,494	26.0%	0.9%	26.1%	\$40.02	-3.5%	\$42.91
3	FM 1960	2,861	175	660	-16.8%	728	23.1%	-4.7%	25.4%	\$15.91	-1.8%	\$15.17
	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	586	1,997	-3.4%	2,001	19.8%	-0.7%	19.8%	\$32.10	-4.1%	\$33.86
	Greenway Plaza - Class A	7,499	447	1,544	-6.4%	1,575	20.6%	-1.4%	21.0%	\$34.12	-3.9%	\$36.72
5	I-10/NE/Kingwood	1,277	83	206	-3.5%	262	16.1%	-0.6%	20.5%	\$18.80	0.1%	\$18.61
	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	27,607	1,494	9,192	0.6%	9,743	33.3%	0.2%	35.3%	\$26.03	-4.7%	\$28.55
	Katy Freeway - Class A	18,630	859	6,827	1.9%	7,241	36.6%	0.7%	38.9%	\$28.40	-6.3%	\$31.17
7	Medical Center/South	1,525	51	143	1.0%	392	9.4%	0.1%	25.7%	\$20.70	0.5%	\$26.56
	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	261	662	-11.7%	819	14.4%	-1.9%	17.8%	\$31.96	-3.8%	\$30.11
	Midtown - Class A	1,773	110	389	-21.5%	341	21.9%	-6.0%	19.2%	\$32.08	-5.0%	\$29.04
9	North Belt/Greenspoint	11,032	420	6,793	-3.8%	6,532	61.6%	-2.4%	59.2%	\$20.23	-1.5%	\$20.69
	North Belt/Greenspoint - Class A	5,124	23	3,913	-3.9%	3,305	76.4%	-3.1%	64.5%	\$23.32	-1.1%	\$23.89
10	NASA/Clear Lake	4,509	156	1,217	-4.8%	1,671	27.0%	-1.4%	37.1%	\$19.41	0.2%	\$18.62
	NASA/Clear Lake - Class A	1,625	4	196	-10.3%	228	12.0%	-1.4%	14.1%	\$24.38	1.6%	\$24.46
11	North Loop W/290 Near	4,677	353	929	-5.2%	801	19.9%	-1.1%	17.1%	\$24.64	-1.4%	\$24.02
	North Loop W/290 Near - Class A	1,189	59	498	-8.2%	385	41.9%	-3.7%	32.4%	\$26.63	-1.7%	\$25.82
12	Northwest/290 Far	10,893	718	3,405	4.3%	3,778	31.3%	1.3%	34.7%	\$22.53	-4.6%	\$24.16
	Northwest/290 Far - Class A	6,317	432	2,093	8.7%	2,332	33.1%	2.7%	36.9%	\$25.33	-6.7%	\$27.24
13	Pasadena/Baytown	2,425	145	365	-6.0%	438	15.1%	-1.0%	18.1%	\$21.39	-1.9%	\$20.45
	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	13,547	509	2,778	10.3%	2,691	20.5%	1.9%	19.9%	\$19.15	-5.1%	\$20.21
	Southwest/Sugar Land - Class A	4,986	106	990	31.2%	818	19.9%	4.7%	16.4%	\$21.19	-14.7%	\$23.94
15	West Loop/Galleria	30,154	2,470	6,606	4.5%	6,776	21.9%	1.0%	22.5%	\$32.04	-4.5%	\$32.54
	West Loop/Galleria - Class A	19,646	1,976	4,723	3.1%	4,710	24.0%	0.7%	24.0%	\$34.73	-4.8%	\$36.10
16	Westchase	14,722	747	4,613	-2.1%	4,292	31.3%	-0.7%	29.2%	\$26.47	-4.8%	\$28.46
	Westchase - Class A	8,736	427	3,267	3.5%	2,840	37.4%	1.3%	32.5%	\$30.30	-6.6%	\$33.73
17	Woodlands	8,188	552	1,653	-3.3%	2,091	20.2%	-0.7%	25.5%	\$28.63	-0.5%	\$29.09
	Woodlands - Class A	5,072	325	1,023	-3.8%	1,405	20.2%	-0.8%	27.7%	\$33.79	-3.5%	\$36.78
1-17	Greater Houston Total	189,313	11,095	52,412	0.2%	54,065	27.7%	0.1%	28.6%	\$27.74	-3.0%	\$28.53
	Greater Houston Total - Class A	110,984	6,859	33,263	1.7%	33,018	30.0%	0.5%	29.8%	\$31.81	-4.3%	\$33.68

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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.

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