

HOUSTON OFFICE | Q2 2018

# Quarterly Market Report

JULY 2018

## EXECUTIVE SUMMARY

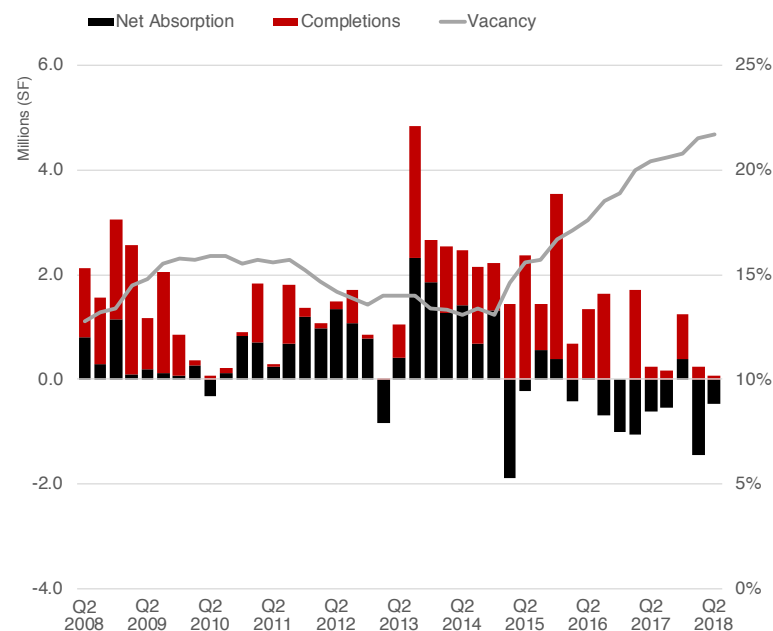
### Office market occupancy falls again

Houston's overall vacancy rate increased to 21.7% in Q2 2018, up 20 basis points quarter-over-quarter and 130 basis points year-over-year. Although net absorption ended Q2 2018 at negative 469,788 sq. ft., this was a substantial improvement from the -1,435,065 sq. ft. mark tallied in Q1. Direct space was responsible for negative 723,583 sq. ft., and sublease space represented positive 260,808 sq. ft. Overall occupancy in the Houston office market remains below 80%—the current rate of 78.3% is the market's lowest historical level recorded since NAI Partners began tracking office market activity in 1999. The overall average asking gross rent is up \$0.05 at \$28.28 per sq. ft. from last quarter, and \$0.22 from a year ago.

### Houston economic indicators suggest a continued positive outlook

In May, a landmark 3.1 million workers were on payrolls throughout the region, according to the Texas Workforce Commission. For the 12 months ending May 2018, metro Houston created 79,200 jobs, for a 2.6% increase. Employment services, construction and manufacturing led job growth with the three sectors accounting for 45.6% of the jobs created. Houston's unadjusted unemployment rate was 4.2% in May, unchanged from 4.2% in April and down from 4.8% in May 2017. In addition, the price of West Texas Intermediate crude rose from the low \$60s per barrel in the early months of 2018 to an average of \$70 in May, while growth in the U.S. rig count has picked up, reaching a near-three-year high in early June with 1,062 rigs.

## Supply & Demand



## Market Indicators

	Current Q2 2018	Prior Quarter Q1 2018	Year Ago Q2 2017
Vacant Direct	19.2%	18.9% ↑	18.3% ↑
Vacant Total	21.7%	21.5% ↑	20.4% ↑
Available Direct	22.5%	22.1% ↑	21.6% ↑
Available Total	26.4%	25.7% ↑	26.0% ↑
Net Absorption (SF)	-469,788	-1,435,065 ↑	-611,858 ↑
Leasing Activity (SF)	2,957,706	4,127,049 ↓	5,363,067 ↑
Construction (SF)	1,552,713	1,278,675 ↑	2,501,684 ↓
Deliveries (SF)	83,076	240,224 ↓	254,796 ↓
Avg Asking Rent (Gross)	\$28.28	\$28.23 ↑	\$28.06 ↑
Inventory (SF)	230,175,956	230,092,880 ↑	228,847,919 ↑

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# Broker's Perspective

The working title for Houston's office market would likely harken Charles Dickens' "A Tale of Two Cities"—an interesting dichotomy between increasingly positive economic conditions and continuously stagnant office fundamentals.

While not quite the "best of times," particularly when compared to the boom days of 2011-2014, it's hard to ignore the sustained improvement in Houston's overall economy. The second quarter saw a record 3.1 million workers on the regional payroll, with 79,200 jobs created for the 12-month period ending May 2018—a 2.6% YTY increase. With unemployment down year-over-year to 4.2% from 4.6% May 2017 (although still above the national level of 3.8%), there is a persistent level of optimism the likes of which we haven't seen in years.

Helping fuel that optimism is the relative stability of the price of oil over the past 12 months, steadily increasing along a positive pricing trendline. This time last year oil was hovering around \$45—today that number is flirting with \$75. Not to go too far out on a limb, but Houston is still an oil-and-gas town at heart, and a 60% increase in the price of oil is a sight for many sore eyes in the region.

All of the above typically wouldn't portend an erratic—often negative—office market, but the numbers certainly bear that out. And although by no means the "worst of times," we are seeing historically high vacancy, continued negative absorption including ongoing large-scale lease dispositions and an occupancy rate at its lowest level in 30-plus years. Yet, overall asking rents are up \$0.22 per sq. ft. year-over-year—talk about dichotomy.

The answer isn't as perplexing as one would think, though. Although most brokers will tell you tenant activity levels are as strong as they've seen in years, there are a handful of mitigating factors at work. One is that average deal size has dropped significantly since the boom years—companies of all types are doing more with less. Advances in technology and workforce preferences are trending to denser and more flexible office usage. Two is the undeniable reduction in major office expansions by large energy and energy-related companies, many of which are still struggling to offload significant blocks of space they leased in a starkly different environment. Take the latest—Occidental Petroleum—opting to place 814,000 sq. ft. at Greenway Plaza on the sublease market in favor of acquiring Conoco Phillips' former HQ in the Energy Corridor.

But while the market as a whole struggles to gain traction, perhaps the most interesting factor has been the unmistakable flight to quality, a trend that shows no signs of slowing down due to increasingly competitive corporate recruitment and retention. 609 Main, delivering in one of the weakest office markets in recent memory, is sitting at near-99% occupancy. Down the street, Capitol Tower is inching towards 50% preleased with delivery still a year away. Fresh off 609 Main, Hines is rumored to kick off yet another 1 million-sq.-ft. tower on Block 58, site of the former Houston Chronicle, with both a major law firm and a Big 4 accounting firm reportedly taking down a combined 50%.

This paradigm shift in the distinction between traditional Class A buildings and the newest breed of Class "AA" or "A+" towers has forced traditionally comfortable Class A landlords into reevaluating their assets, often committing to large capital improvement projects to remain competitive in the market. These capital commitments, along with competition from the more expensive "AA" towers, have allowed landlords to buoy their quoted rates even in an overall slow market. Make no mistake, though—the delta between quoted rates and actual effective rates ultimately negotiated—can be significant.

Ultimately, I believe we can expect a continuation of the current tenant-favorable market, because if there's anything these dichotomous conditions can create for the savvy tenant it's one thing—opportunity.

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**Alex Taghi**

Vice President  
NAI Partners

# MARKET OVERVIEW

## Negative net absorption decreases in Q2 2018

During the second quarter of 2018, Houston’s office market still had more tenants moving out of space than tenants moving in, but less of them compared to Q1 2018. The aggregate effect of these net occupancy losses was just under 500,000 sq. ft. of negative absorption. That lack of demand has led to vacant office space reaching 21.7%, or to put it another way: 50 million sq. ft. of office product lies empty.

More than one-quarter (26.4%) of total office inventory is being marketed for lease. The difference between this figure and the vacancy rate reflects expected future move-outs. Space being marketed for sublease represents 9.4 million sq. ft. (4.1%) of the 61.1 million-sq.-ft. total availability figure. Although vacant sublease space is still financially occupied because rent is being paid, it is available to tenants, and therefore competes with both direct and new space.

The Greater Houston area will need to start absorbing more of the vacant supply to create less risk for developers who would not want to be left sitting with empty buildings. Houston’s office market will continue to struggle through decreased absorption until increased economic growth returns long enough to stimulate ongoing demand.

## New construction remains disciplined

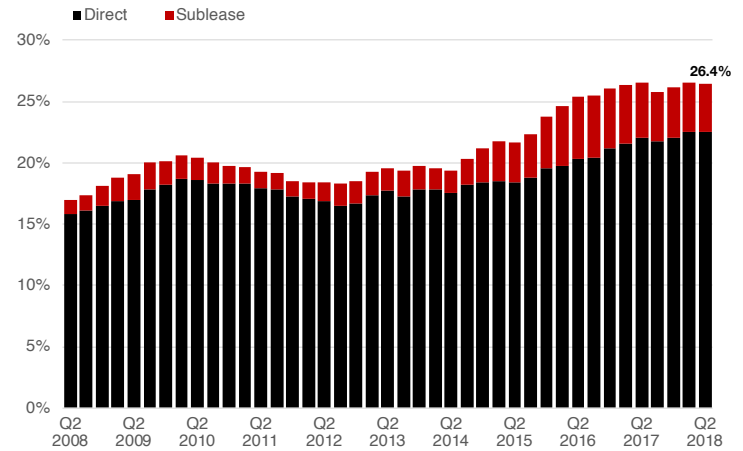
Office construction is at 1.5 million sq. ft. in eight buildings with 50% of the space underway in Capitol Tower at 800 Capitol St. The 35-story, 778,000-sq.-ft. building, includes anchor tenant Bank of America—obligated to 210,000 sq. ft.—plus future availability of 495,115 sq. ft., with a delivery date in mid-2019. Also under construction is City Place 2, at 1701 City Plaza Dr. in the Woodlands, a 10-story, 326,800-sq.-ft. office building, at 93.9% leased with a scheduled delivery date of October 2018; and City Place 1, at 1700 City Plaza Dr., a 5-story, 149,500-sq.-ft. available office building with a scheduled delivery date of April 2019.

One property delivered during Q2 2018, located at 4450 Harrisburg Blvd. in the Gulf Freeway/Pasadena submarket. The 4-story, 83,076-sq.-ft. BakerRipley Central office/retail building was approximately 65% leased at the time of completion. Over the last few years, developers have shown control as the construction pipeline has minimized and most spec developments have been put on hold, as the Houston office market tries to regain momentum.

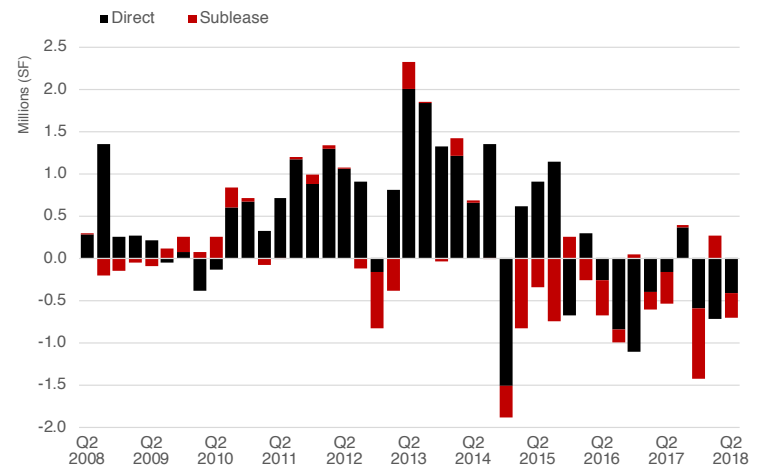
## Historic Downtown tower has new owner

One of downtown Houston’s historic office buildings, 1001 McKinney Tower, is under new ownership. TRC Capital Partners and Amstar America has acquired 1001 McKinney, a 375,440-sq.-ft., 23-story office

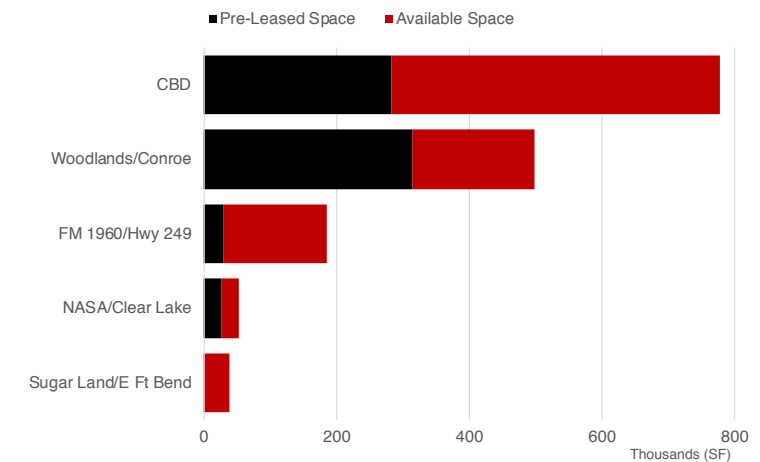
## Availability Rates



## Net Absorption Direct & Sublease



## Construction by Submarket



building in Houston’s central business district. The building is located at the corner of McKinney and Main, constructed in 1947, now a historic landmark on the National Register of Historic places. The property was sold by Cameron Management and Silverpeak Real Estate Partners and was 76% occupied at the time of the sale. Real Capital Analytics data reports year-to-date office sales volume for 2018 in the Greater Houston area at \$1.1 billion, resulting in a year-over-year change of -45.4%. The majority of the buyer composition is made up of 49% institutional and 44% private.

**Leasing activity down, NAI Partners Sublease Index up**

Leasing activity during the second quarter of 2018 was at 3.0 million sq. ft., down 28% quarter over quarter, and dropping 45% compared to the amount of activity year-over-year. Class A space fulfilled 1.5 million sq. ft., while Class B space realized 1.3 million sq. ft., with direct space representing 90% of all transactions.

The NAI Partners Sublease Index—measured by the amount of sublease space as a percentage of total available space—increased 100 basis points to 15.3% in June. Space being marketed for sublease now represents 9.3 million sq. ft. of the 61.2 million-sq.-ft. total availability figure. The Sublease Index has hovered between 14% and 16% since last October.

A significant amount of the increase is due to Occidental Petroleum placing close to 814,000 sq. ft. of sublease space on the market at 5 Greenway Plaza (746,070 sq. ft.) and 3 Greenway Plaza (67,525 sq. ft.) this month. In April, Occidental Petroleum was said to be in discussions to purchase ConocoPhillips’ Energy Corridor campus, but word on a final decision has not yet been released. In addition, Sheridan Production Co. listed 71,346 sq. ft. of sublease space at 9 Greenway Plaza.

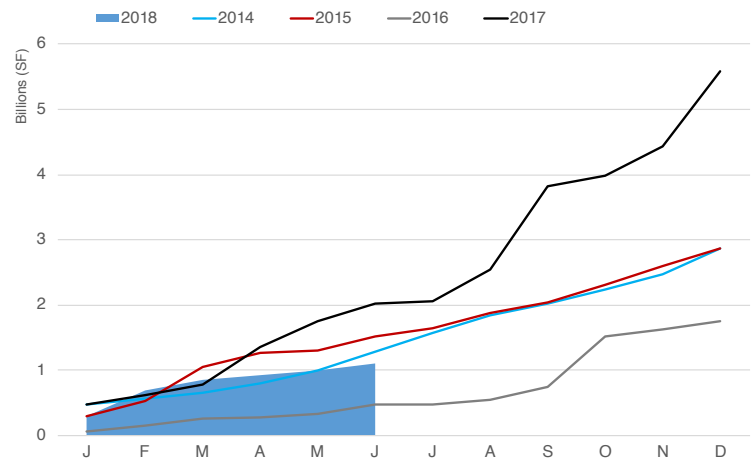
In Houston’s Energy Corridor, Kiewit Engineering Group Inc. signed a 52,834-sq.-ft. office sublease for the 14th and 15th floors of Energy Tower IV at 11750 Katy Freeway. The new office location will accommodate the company’s oil, gas and chemical engineering group. BASF, the sublessor, is the largest tenant in the 429,157-sq.-ft. Class A office building, occupying 83,000 sq. ft.

**Despite slower leasing activity, average asking rents increase**

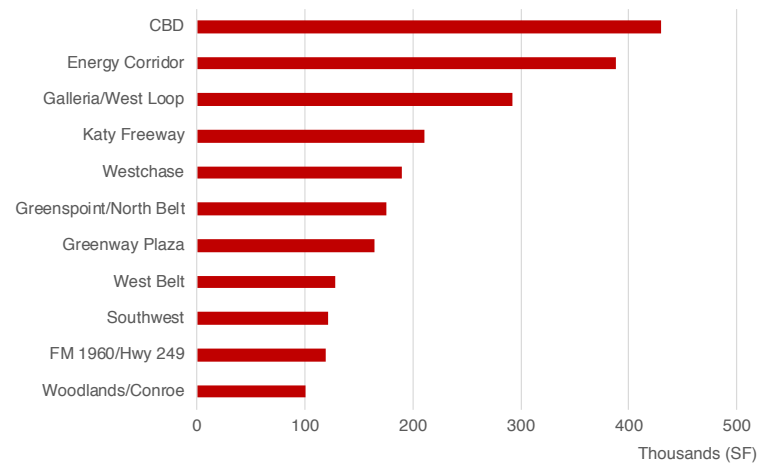
The market saw overall full-service average rates increase \$0.05 per sq. ft. quarter-over-quarter to close Q2 2018 at \$28.28 per sq. ft. Year-over-year asking rents grew by \$0.22 per sq. ft.—although concessions such as free rent and tenant improvement allowances make posted rents less meaningful as a market indicator. Brokers report net effective rents, what a landlord ultimately gets to keep from a deal, dropping significantly once negotiations begin.

**Cumulative Monthly Sales Volume Houston Office**

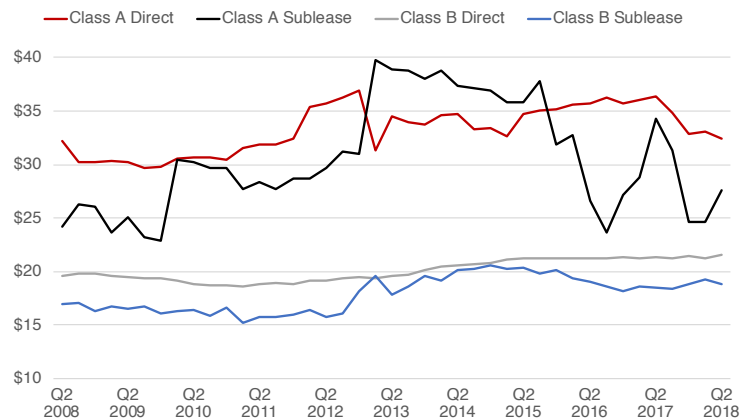
Source: Real Capital Analytics



**Total Leasing Activity by Submarket over 100,000 SF**



**Historical Average Gross Asking Rent**





## MARKET OVERVIEW

## Submarket Stats

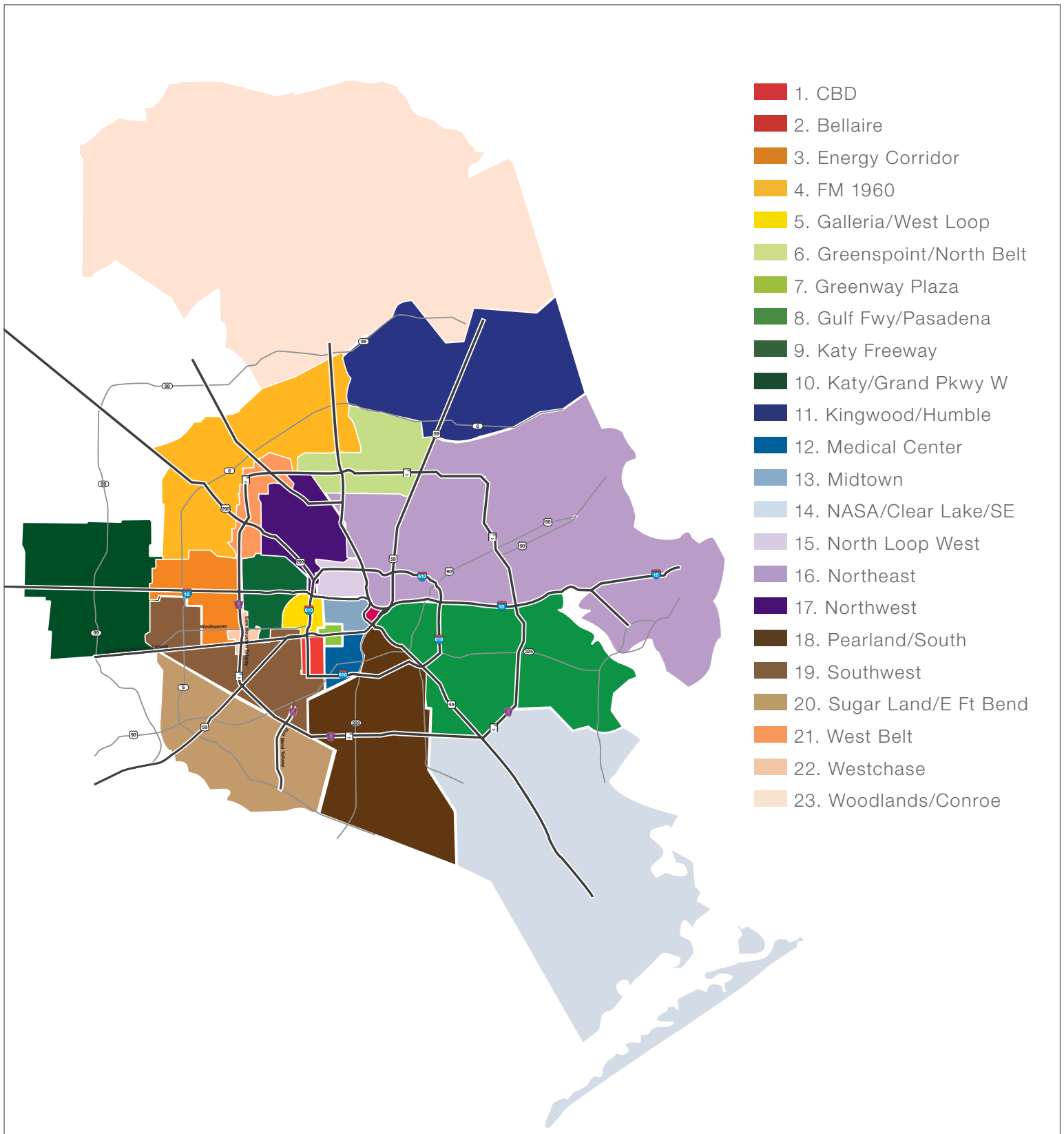
Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q2 2018 Net Absorption (SF)	2018 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>Houston Market Total</b>	<b>230,175,956</b>	<b>21.7</b>	<b>26.4</b>	<b>-469,788</b>	<b>-1,904,853</b>	<b>2,957,956</b>	<b>1,552,713</b>	<b>28.28</b>
Class A	121,145,172	24.4	30.3	289,926	-619,190	1,520,568	1,462,258	33.22
Class B	92,446,786	19.8	23.2	-703,498	-1,190,456	1,297,721	90,455	21.43

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q2 2018 Net Absorption (SF)	2018 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>CBD Total</b>	<b>39,176,220</b>	<b>24.3</b>	<b>30.5</b>	<b>130,068</b>	<b>-334,292</b>	<b>429,801</b>	<b>778,344</b>	<b>38.84</b>
Class A	29,744,993	21.4	28.5	251,841	-206,423	264,820	778,344	41.72
Class B	8,774,126	34.8	38.5	-126,823	-133,369	164,981	0	27.94
<b>Bellaire Total</b>	<b>3,392,322</b>	<b>12.4</b>	<b>14.5</b>	<b>-89,599</b>	<b>-88,102</b>	<b>61,489</b>	<b>0</b>	<b>25.97</b>
Class A	1,475,481	14.8	18.6	-28,594	-22,042	17,560	0	28.16
Class B	1,465,515	11.4	12.6	-61,005	-65,231	43,929	0	24.33
<b>Energy Corridor Total</b>	<b>20,329,509</b>	<b>32.7</b>	<b>40.5</b>	<b>-83,111</b>	<b>-636,796</b>	<b>388,384</b>	<b>0</b>	<b>28.69</b>
Class A	13,436,887	33.6	43.3	40,376	-390,097	224,893	0	32.02
Class B	6,433,491	32.0	36.1	-117,082	-205,024	162,003	0	21.79
<b>FM 1960/Hwy 249 Total</b>	<b>10,532,236</b>	<b>18.8</b>	<b>21.8</b>	<b>-23,027</b>	<b>-114,732</b>	<b>118,918</b>	<b>185,904</b>	<b>20.37</b>
Class A	2,951,510	18.1	24.9	-4,915	-23,239	29,557	156,000	27.97
Class B	6,439,153	19.2	20.7	-41,355	-104,087	72,793	29,904	18.01
<b>Galleria/West Loop Total</b>	<b>28,871,934</b>	<b>19.8</b>	<b>22.9</b>	<b>25,307</b>	<b>214,822</b>	<b>292,319</b>	<b>0</b>	<b>34.03</b>
Class A	19,608,478	21.4	23.8	139,492	391,467	206,207	0	37.23
Class B	9,146,516	16.5	21.1	-98,206	-165,373	85,527	0	26.16
<b>Greenspoint/North Belt Total</b>	<b>11,782,627</b>	<b>49.7</b>	<b>53.0</b>	<b>-350,856</b>	<b>-345,607</b>	<b>175,511</b>	<b>0</b>	<b>19.30</b>
Class A	5,072,578	68.2	69.5	-169,858	-126,627	46,013	0	21.97
Class B	5,267,080	37.3	43.1	-177,876	-196,855	95,127	0	15.92
<b>Greenway Plaza Total</b>	<b>10,852,877</b>	<b>18.5</b>	<b>27.9</b>	<b>-160,684</b>	<b>-178,662</b>	<b>164,233</b>	<b>0</b>	<b>31.11</b>
Class A	7,427,627	19.6	33.0	-162,220	-96,256	97,780	0	32.79
Class B	2,921,108	16.3	17.3	5,737	-75,361	58,428	0	25.82
<b>Gulf Fwy/Pasadena Total</b>	<b>3,854,329</b>	<b>19.4</b>	<b>22.5</b>	<b>39,765</b>	<b>6,050</b>	<b>46,669</b>	<b>0</b>	<b>21.43</b>
Class A	22,706	0.0	0.0	0	0	0	0	-
Class B	2,862,142	19.3	22.0	49,295	42,965	34,869	0	22.51
<b>Katy Freeway Total</b>	<b>10,077,797</b>	<b>11.5</b>	<b>14.2</b>	<b>155,126</b>	<b>85,555</b>	<b>210,521</b>	<b>0</b>	<b>28.73</b>
Class A	6,002,646	14.7	15.8	109,590	32,991	181,028	0	38.52
Class B	2,638,727	7.7	15.0	51,945	61,848	23,303	0	18.77
<b>Katy/Grand Pkwy W Total</b>	<b>3,404,559</b>	<b>16.7</b>	<b>17.2</b>	<b>53,193</b>	<b>111,959</b>	<b>89,416</b>	<b>0</b>	<b>28.89</b>
Class A	2,085,884	25.2	26.0	60,783	119,744	85,151	0	29.27
Class B	1,127,483	2.3	2.6	-7,039	-11,099	2,166	0	26.39
<b>Kingwood/Humble Total</b>	<b>1,461,422</b>	<b>13.6</b>	<b>14.4</b>	<b>-24,035</b>	<b>-41,089</b>	<b>15,642</b>	<b>0</b>	<b>22.68</b>
Class A	189,312	17.9	21.3	0	-24,482	0	0	27.92
Class B	1,084,604	13.6	14.2	-53,817	-46,815	15,642	0	22.48

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q2 2018 Net Absorption (SF)	2018 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>Medical Center Total</b>	<b>9,043,331</b>	<b>5.7</b>	<b>7.3</b>	<b>-17,224</b>	<b>-28,675</b>	<b>56,606</b>	<b>0</b>	<b>26.45</b>
Class A	2,808,095	8.3	11.9	-6,166	-8,325	15,972	0	33.72
Class B	5,009,641	4.1	5.1	511	-4,171	28,303	0	22.80
<b>Midtown Total</b>	<b>5,573,900</b>	<b>12.8</b>	<b>16.4</b>	<b>46,191</b>	<b>36,135</b>	<b>76,176</b>	<b>0</b>	<b>30.31</b>
Class A	2,006,668	17.2	21.2	74,753	99,173	38,434	0	32.78
Class B	2,967,743	9.3	13.2	-28,105	-62,581	37,357	0	27.97
<b>NASA/Clear Lake/SE Total</b>	<b>8,014,744</b>	<b>20.5</b>	<b>23.0</b>	<b>-24,189</b>	<b>41,875</b>	<b>97,217</b>	<b>51,614</b>	<b>20.84</b>
Class A	1,985,563	15.6	16.8	-41,044	-21,251	17,684	51,614	28.28
Class B	5,131,395	24.4	24.7	19,456	58,588	73,687	0	19.48
<b>North Loop West Total</b>	<b>4,423,520</b>	<b>19.7</b>	<b>23.7</b>	<b>-51,704</b>	<b>-32,588</b>	<b>44,986</b>	<b>0</b>	<b>24.15</b>
Class A	1,188,544	30.8	43.4	-9,875	7,504	0	0	26.34
Class B	2,767,996	17.0	17.4	-28,069	-49,577	44,249	0	22.58
<b>Northeast Total</b>	<b>2,332,510</b>	<b>14.5</b>	<b>17.2</b>	<b>-8,520</b>	<b>-20,627</b>	<b>8,208</b>	<b>0</b>	<b>18.82</b>
Class A	122,923	17.7	17.7	6,355	10,881	0	0	-
Class B	1,472,060	18.7	20.8	-13,289	-30,128	8,208	0	19.35
<b>Northwest Total</b>	<b>3,952,543</b>	<b>22.9</b>	<b>25.3</b>	<b>-14,712</b>	<b>-10,933</b>	<b>70,041</b>	<b>0</b>	<b>17.67</b>
Class A	797,237	43.4	53.2	-18,457	-9,801	12,536	0	19.44
Class B	2,277,443	20.0	20.5	47,808	42,159	56,681	0	16.30
<b>Pearland/South Total</b>	<b>1,803,710</b>	<b>8.8</b>	<b>9.5</b>	<b>-1,428</b>	<b>23,703</b>	<b>5,683</b>	<b>0</b>	<b>27.50</b>
Class A	670,318	4.3	6.1	2,284	809	5,683	0	28.20
Class B	882,785	11.9	12.1	-5,416	-14,406	0	0	27.29
<b>Southwest Total</b>	<b>11,789,711</b>	<b>18.7</b>	<b>24.2</b>	<b>61,297</b>	<b>-47,602</b>	<b>121,422</b>	<b>0</b>	<b>17.07</b>
Class A	2,053,918	22.8	29.8	31,693	49,721	12,646	0	18.81
Class B	7,148,203	20.0	25.9	40,462	-73,089	91,993	0	16.92
<b>Sugar Land/E Ft Bend</b>	<b>6,600,635</b>	<b>11.4</b>	<b>15.3</b>	<b>69,924</b>	<b>-115,253</b>	<b>66,851</b>	<b>38,599</b>	<b>25.41</b>
Class A	3,489,860	11.2	16.2	57,466	-103,814	16,658	0	26.33
Class B	2,836,057	12.4	15.5	12,458	-11,439	49,193	38,599	24.39
<b>West Belt Total</b>	<b>5,114,561</b>	<b>32.9</b>	<b>40.8</b>	<b>-253,581</b>	<b>-408,097</b>	<b>127,824</b>	<b>0</b>	<b>26.22</b>
Class A	3,359,700	36.8	45.9	-175,953	-348,097	127,824	0	29.01
Class B	1,667,232	26.7	32.7	-77,628	-60,000	0	0	19.44
<b>Westchase Total</b>	<b>15,459,683</b>	<b>22.7</b>	<b>30.3</b>	<b>-88,684</b>	<b>-223,538</b>	<b>189,875</b>	<b>0</b>	<b>27.18</b>
Class A	8,790,557	29.1	37.2	18,532	-131,906	86,961	0	31.84
Class B	6,492,461	14.5	21.4	-102,428	-91,632	102,914	0	19.14
<b>Woodlands/Conroe Total</b>	<b>12,331,276</b>	<b>14.8</b>	<b>17.3</b>	<b>140,695</b>	<b>201,641</b>	<b>100,164</b>	<b>498,252</b>	<b>29.33</b>
Class A	5,853,687	18.8	21.1	113,843	180,880	33,161	476,300	32.06
Class B	5,633,825	11.9	14.8	6,968	4,221	46,368	21,952	26.28
<b>Suburban Total</b>	<b>190,999,736</b>	<b>21.2</b>	<b>25.5</b>	<b>-599,856</b>	<b>-1,570,561</b>	<b>2,528,155</b>	<b>774,369</b>	<b>26.00</b>
Class A	91,400,179	25.4	30.9	38,085	-412,767	1,255,748	683,914	30.57
Class B	83,672,660	18.2	21.6	-576,675	-1,057,087	1,132,740	90,455	20.76

# MARKET OVERVIEW

## Houston Office Submarkets



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HOUSTON OFFICE | Q2 2018

# Quarterly Market Report

JULY 2018

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HOUSTON OFFICE | Q1 2018

# Quarterly Market Report

APRIL 2018

## EXECUTIVE SUMMARY

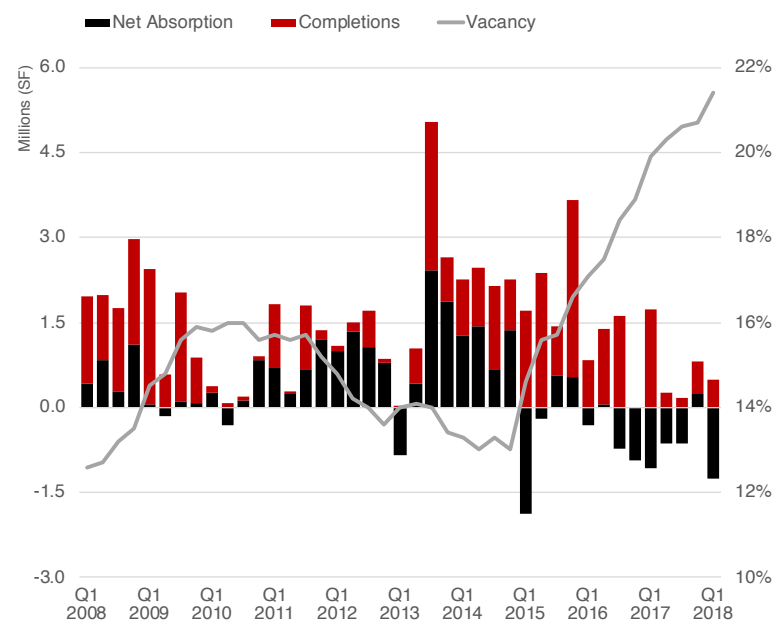
### Challenging Office Market Conditions Continue

Houston's overall vacancy rate increased to 21.4% in Q1 2018, up 70 basis points quarter-over-quarter, compared to a 150-basis-point increase year-over-year. While net absorption closed Q4 2017 at positive 238,931 sq. ft., Q1 2018 went back into negative territory at -1,245,983 sq. ft. Direct space was responsible for -441,806 sq. ft., and sublease space represented -831,015 sq. ft. Overall occupancy in the Houston office market remains below 80%—the current rate of 78.6% is the market's lowest historical level recorded since NAI Partners began tracking office market activity in 1999. The overall average asking gross rent is up \$0.14 at \$28.24 per sq. ft. from last quarter, and \$0.34 from a year ago.

### While Office Market May be Slow, Houston Economic Indicators Are Positive

As the Houston office market strives towards a gradual recovery, current economic indicators are largely optimistic, suggesting healthy economic output and future growth. Job growth, energy-related activities, and import/export trade have recorded positive results during the first quarter of the year. Houston jobs grew at a convincing annualized pace of 4.7% over the two months ending in February (23,400 jobs), with the largest increase in professional and business services (11,000 jobs). The price of West Texas Intermediate has averaged just under \$63 during 2018, and the U.S. rig count was at 993 as of March 30, up 169 rigs, or 20.5%, from 824 the same week in March 2017. In January, \$16.9 billion in goods and commodities passed through the Houston/Galveston Customs District, up 8.5% from this time last year. In addition, exports totaled \$9.7 billion, up 7.9%, and imports totaled \$7.2 billion, up 9.5%.

## Supply & Demand



## Market Indicators

	Current Q1 2018	Prior Quarter Q4 2017	Year Ago Q1 2017
Vacant Direct	18.9%	18.6% ↑	18.0% ↑
Vacant Total	21.4%	20.7% ↑	19.9% ↑
Available Direct	22.1%	21.9% ↑	21.2% ↑
Available Total	25.8%	25.4% ↑	25.6% ↑
Net Absorption (SF)	-1,245,983	238,931 ↓	-1,061,491 ↓
Leasing Activity (SF)	3,746,657	5,134,332 ↓	3,685,377 ↑
Construction (SF)	1,195,599	1,663,871 ↓	1,758,389 ↓
Deliveries (SF)	490,224	568,710 ↓	1,720,980 ↓
Avg Asking Rent (Gross)	\$28.24	\$28.10 ↑	\$27.90 ↑
Inventory (SF)	229,633,228	229,143,004 ↑	228,159,498 ↑

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# Broker's Perspective

After posting 239,000 sq. ft. of positive absorption in Q4 2017—the first quarter of positive absorption in the last few years—the road to recovery in Houston's office market appeared to be underway. Alas, it turns out the road may be bumpier than imagined.

While the general attitude from our energy industry clients in 2018 appears to be that of renewed confidence and comfort, we have not yet seen the demand for office space reflect that. So far, 2018 has seen more than 1.2 million sq. ft. of negative absorption, with over 800,000 sq. ft. coming in the form of sublease space. The result is a citywide occupancy rate of 78.6%, the lowest mark recorded in the last 19 years.

It stands to reason that the Houston office market would chronologically trail the energy industry and changes in the price of oil, as it takes time for the headcounts and spending of companies in that realm to adjust to new conditions and for the corresponding office transactions to take place. For instance, the price of West Texas Intermediate crude dropped steadily from over \$105 in the second quarter of 2014 to just over \$46 in the third quarter of 2015, yet Houston's office market only went from 19.5% availability to 21.5%; and while the price of crude has steadily increased from just over \$46 in the second quarter of 2017 to a 2018 average just under \$63, the availability rate has only decreased 0.2% in that time period.

Nonetheless, there is plenty of reason to believe that a balancing of supply and demand is on the horizon. In addition to the aforementioned increase in the price of oil, U.S. rig count is up over 20% year-over-year, and jobs in Houston grew by 23,400 in January and February. Interestingly, the average gross asking rate has increased \$0.14 since last quarter and \$0.34 in the last year (now \$28.24). Eventually, these factors should lead to absorption of much Houston's available space.

Other signs of a return to normalcy in the market include notable transactions by a few of Houston's energy giants. Apache renewed its lease for more than 500,000 sq. ft. at 1990 and 2000 Post Oak Blvd.; and Williams Companies renewed its lease for more than 350,000 sq. ft. at Williams Tower. This in addition to the rumblings of Oxy purchasing the former ConocoPhillips campus in the Energy Corridor.

In the meantime, opportunities for tenants to achieve favorable terms still abound, particularly in those areas most saturated with energy industry companies. After seeing more than 500,000 sq. ft. of negative absorption this quarter, the Energy Corridor is now at 40% availability (375,000 sq. ft. placed on sublease market by Technip FMC). Downtown, Westchase, West Belt, and Greenspoint also boast availability rates over 30%.

It will take time for Houston's office users to absorb all of that square footage. Accordingly, we expect the rest of 2018 to remain a tenant's market, and opportunistic companies to be the beneficiaries of below-market sublease terms and/or significant landlord concession packages.

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**“..opportunities for tenants to achieve favorable terms still abound, particularly in those areas most saturated with energy industry companies”**

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**Joe Bright**

Associate  
NAI Partners

# MARKET OVERVIEW

## Negative Net Absorption in Q1 2018

During the first quarter of 2018, Houston's office market had more tenants moving out of space than tenants moving in; as a result, the cumulative effect of these net occupancy losses was 1.2 million sq. ft. of negative absorption. The outcome of the slowdown in demand is vacant office space at 21.4%, or in other words, more than 49 million sq. ft. of office product sits empty.

More than one-quarter (25.8% or 59.5 million sq. ft.) of the total office inventory is being marketed for lease. The difference between this figure and the vacancy rate reflects expected future move-outs. Space being marketed for sublease represents 9.2 million sq. ft. (4%) of the 59.5 million-sq.-ft. total availability figure. Although vacant sublease space is still economically occupied because rent is being paid, it is available to tenants, and therefore competes with both direct and new space.

Metro Houston will need to start absorbing more of the vacant supply to create less risk for new developments. Houston's office market will continue to struggle through decreased absorption until increased economic growth returns long enough to stimulate ongoing demand.

## Construction Pipeline at Record Lowest Level

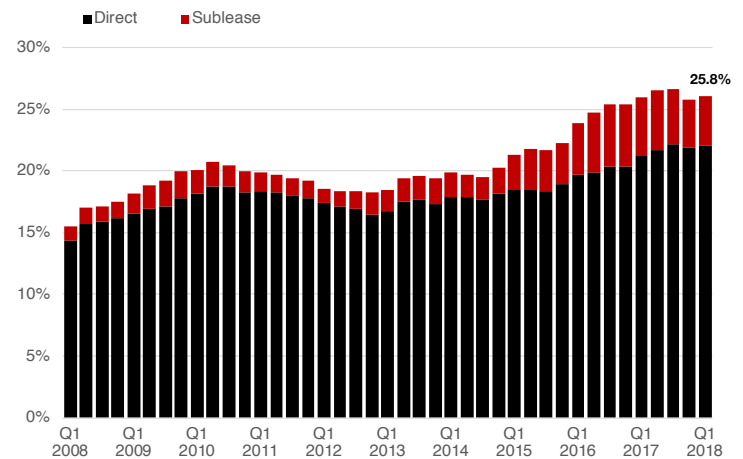
The Houston office market development pipeline is at 1.2 million sq. ft., the lowest amount documented since 1999 when NAI Partners began recording historical data. The metro reached its peak during Q4 2014 at 11.7 million sq. ft. under construction in 52 projects. Currently there are five buildings underway, with the majority of space in Capitol Tower at 800 Capitol St. The 35-story, 778,000-sq.-ft. building, includes anchor tenant Bank of America obligated to 210,000 sq. ft., plus future availability of 495,115 sq. ft., with a delivery date in mid-2019. Also under construction is City Place 2, at 1701 City Plaza Dr. in the Woodlands, a 4-story, 326,800-sq.-ft. office building, at 93.9% leased with a scheduled delivery date of October 2018.

Deliveries during 2018 include The Post Oak at 1600 West Loop South, a 36-story, 104,579-sq.-ft. building, at 67% leased; and the completion of Building 4 in Grandway West at 2322 W. Grand Parkway N., a 2-story, 72,045-sq.-ft. office property, at 93% leased. Developers have shown control over the last few years as the construction pipeline has grown smaller and most spec developments have been put on hold, as the Houston office market attempts to stabilize.

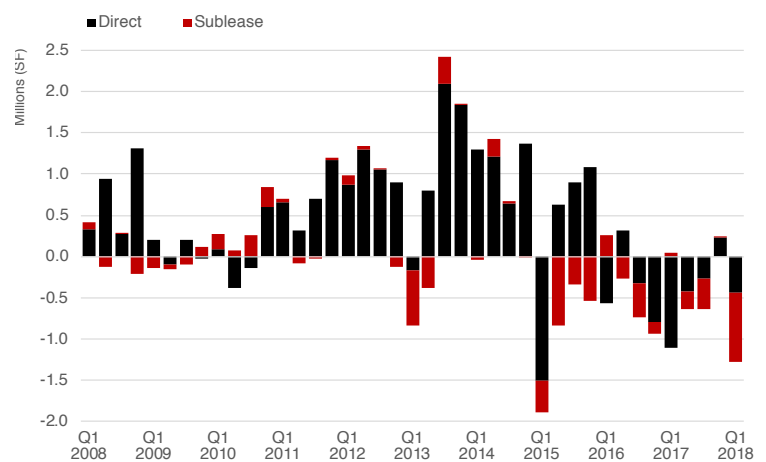
## Investment Sales Down Year-Over-Year

Real Capital Analytics data reports year-to-date office sales volume for 2018 in the Greater Houston area at \$1.1 billion, resulting in a year-over-year change of

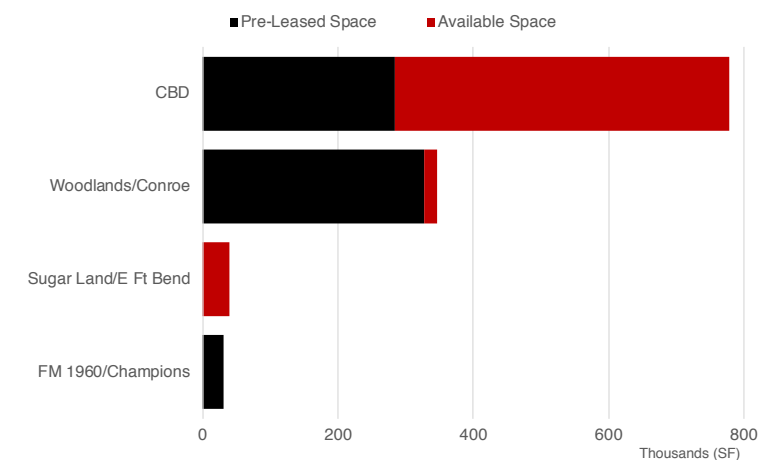
## Availability Rates



## Net Absorption Direct & Sublease



## Construction by Submarket



-34.0%. The buyer composition is made up of 62% private and 31% institutional. A recent top transaction in the Houston office market is the acquisition by Griffin Partners of Loop Central at 4848 Loop Central Drive in the Bellaire submarket. The three-building, 600,000-sq.-ft. office complex was sold by TIER REIT and was 84% occupied at the time of the sale by tenants Universal American, Service Link LP, Terra Energy Partners, and Easter Seals Of Greater Houston.

**Leasing Activity Down from Last Quarter, but Way Up in Galleria**

Leasing activity during the first quarter of 2018 was at 3.7 million sq. ft., down 27% quarter over quarter, although equal to the amount of activity year-over-year. Class A space fulfilled 2.5 million sq. ft., while Class B space realized 1.2 million sq. ft., with direct space representing 91% of all transactions.

The Galleria/West Loop submarket got a big boost during the first quarter of 2018 with Apache renewing their 524,342-sq. ft. lease. The oil and gas exploration and production company will continue to occupy all of the 24-story, 396,432-sq.-ft., Class A office building at 2000 Post Oak Blvd., and will also continue its lease of 127,910 sq. ft. at 1990 Post Oak Blvd. The 60-month renewal extends the Apache lease through 2024 in the Post Oak Central complex. In addition, namesake tenant Williams Companies renewed their 353,944-sq.-ft. lease at Williams Tower. The energy company’s subsidiary, Transcontinental Gas Pipeline, has been lead tenant in the 1.5-million-sq.-ft. building since the tower was developed in 1983, and is currently 92.3% leased.

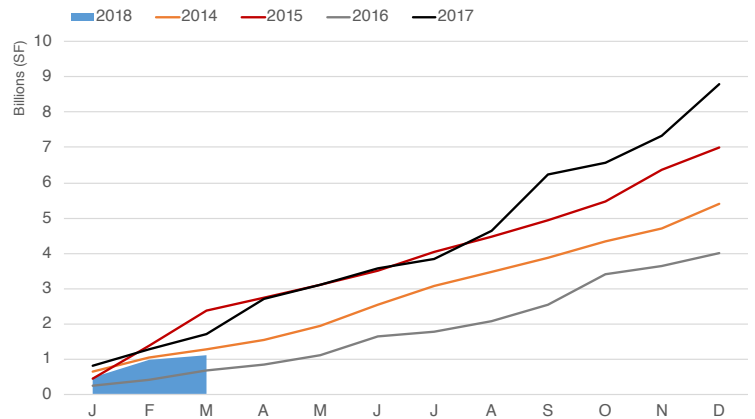
The Galleria/West Loop was only one of two Houston office submarkets with noteworthy positive net absorption during Q1 2018. Lonza Houston Inc. completed construction on a biotech facility for viral and immunotherapy development and manufacturing in Pearland’s Lower Kirby District. The project, which broke ground in March of 2017 along Kirby Drive south of the Sam Houston Tollway, has been expanded by 150,000 sq. ft. for a total of 250,000 sq. ft.

**Despite Slower Leasing and More Available Space, Average Asking Rents Rise**

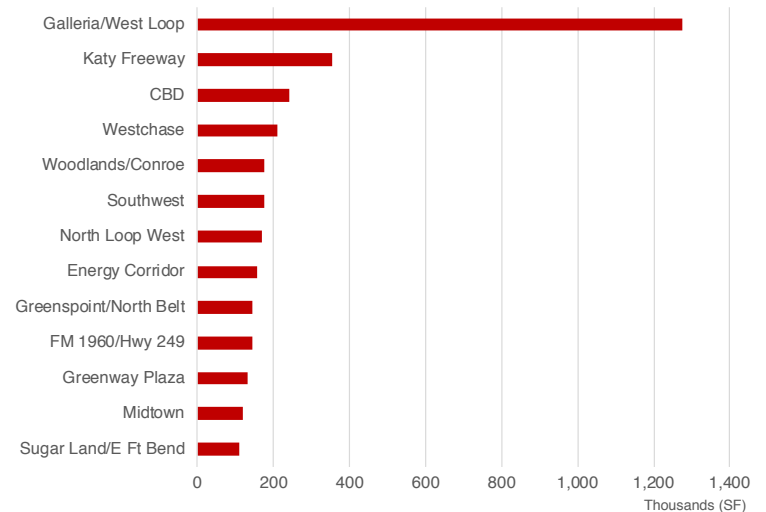
The market saw overall full-service average rates increase \$0.14 per sq. ft. quarter-over-quarter to close Q1 2018 at \$28.24 per sq. ft. Sublease rates increased to \$20.48 per sq. ft., up from Q4 2017’s \$20.29. In addition, year-over-year asking rents grew by 1.2%—although concessions such as free rent and tenant improvement allowances make posted rents less meaningful as a market indicator. Brokers report net effective rents, what a landlord ultimately gets to keep from a deal, dropping significantly once negotiations begin.

**Cumulative Monthly Sales Volume Houston Office**

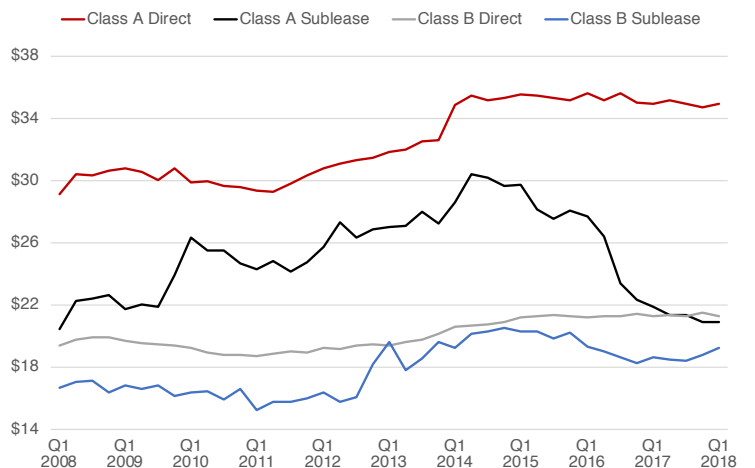
Source: Real Capital Analytics



**Total Leasing Activity by Submarket over 100,000 SF**



**Historical Average Gross Asking Rent**



## MARKET OVERVIEW

## Submarket Stats

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q1 2018 Net Absorption (SF)	2018 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>Houston Market Total</b>	<b>229,633,228</b>	<b>21.4</b>	<b>25.8</b>	<b>-1,245,983</b>	<b>-1,245,983</b>	<b>3,746,657</b>	<b>1,195,599</b>	<b>28.24</b>
Class A	119,513,846	24.8	29.8	-741,629	-741,629	2,516,760	1,105,144	33.41
Class B	93,208,025	19.0	22.7	-609,317	-609,317	1,166,139	90,455	21.34

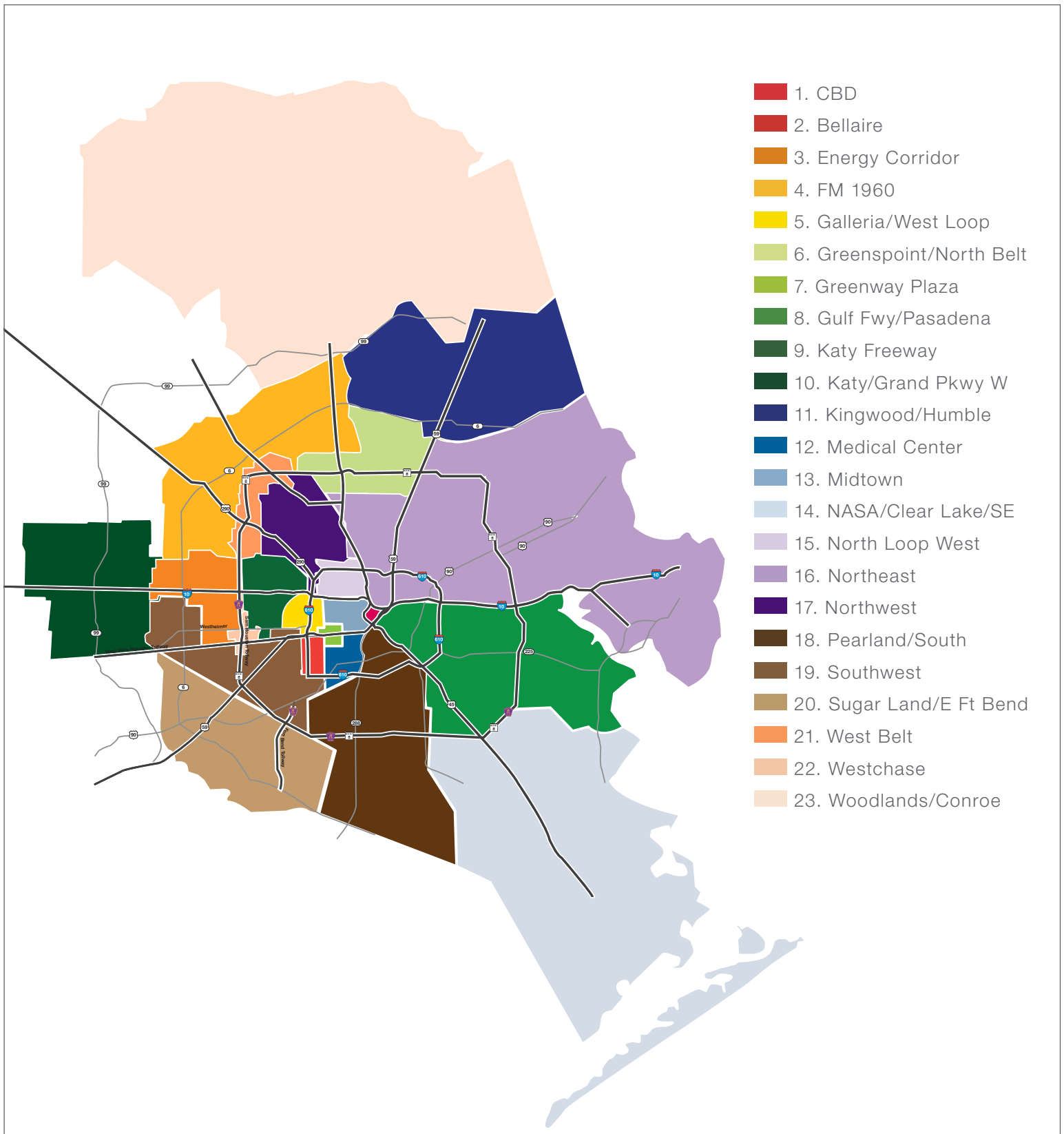
Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q1 2018 Net Absorption (SF)	2018 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>CBD Total</b>	<b>39,157,005</b>	<b>24.5</b>	<b>30.7</b>	<b>-500,837</b>	<b>-500,837</b>	<b>240,102</b>	<b>778,344</b>	<b>39.26</b>
Class A	28,697,245	22.8	30.0	-458,721	-458,721	205,983	778,344	41.84
Class B	9,802,659	30.1	34.0	-42,566	-42,566	34,119	0	28.55
<b>Bellaire Total</b>	<b>3,418,599</b>	<b>13.4</b>	<b>17.2</b>	<b>1,497</b>	<b>1,497</b>	<b>36,414</b>	<b>0</b>	<b>24.00</b>
Class A	1,475,481	12.8	18.8	6,552	6,552	1,184	0	24.04
Class B	1,491,792	15.7	18.4	-4,226	-4,226	35,230	0	23.94
<b>Energy Corridor Total</b>	<b>19,949,060</b>	<b>31.7</b>	<b>40.0</b>	<b>-539,036</b>	<b>-539,036</b>	<b>157,060</b>	<b>0</b>	<b>27.22</b>
Class A	13,053,163	33.5	43.4	-415,824	-415,824	57,162	0	30.90
Class B	6,415,108	29.4	34.6	-87,942	-87,942	97,658	0	22.42
<b>FM 1960/Hwy 249 Total</b>	<b>10,473,556</b>	<b>18.9</b>	<b>20.9</b>	<b>-85,182</b>	<b>-85,182</b>	<b>143,031</b>	<b>29,904</b>	<b>20.23</b>
Class A	2,888,985	18.1	18.2	-18,324	-18,324	36,389	0	27.75
Class B	6,474,881	19.0	21.9	-62,732	-62,732	101,174	29,904	18.04
<b>Galleria/West Loop Total</b>	<b>28,917,378</b>	<b>20.0</b>	<b>22.8</b>	<b>189,515</b>	<b>189,515</b>	<b>1,274,337</b>	<b>0</b>	<b>34.40</b>
Class A	19,525,908	22.1	24.4	251,975	251,975	1,177,874	0	37.39
Class B	9,229,530	15.7	19.9	-67,167	-67,167	96,963	0	25.45
<b>Greenspoint/North Belt Total</b>	<b>11,787,850</b>	<b>47.1</b>	<b>53.7</b>	<b>-34,349</b>	<b>-34,349</b>	<b>143,156</b>	<b>0</b>	<b>19.68</b>
Class A	5,074,225	64.4	70.3	43,231	43,231	46,602	0	22.64
Class B	5,270,656	35.0	43.9	-58,577	-58,577	85,859	0	15.67
<b>Greenway Plaza Total</b>	<b>10,853,154</b>	<b>16.7</b>	<b>19.9</b>	<b>-26,290</b>	<b>-26,290</b>	<b>130,115</b>	<b>0</b>	<b>33.29</b>
Class A	7,520,681	17.1	21.0	60,022	60,022	97,900	0	36.35
Class B	2,828,331	16.2	17.6	-83,468	-83,468	31,562	0	26.57
<b>Gulf Fwy/Pasadena Total</b>	<b>3,771,544</b>	<b>19.5</b>	<b>23.3</b>	<b>-33,715</b>	<b>-33,715</b>	<b>20,487</b>	<b>0</b>	<b>21.75</b>
Class A	22,706	0.0	0.0	0	0	0	0	19.00
Class B	2,749,546	19.8	23.0	-6,330	-6,330	20,487	0	23.08
<b>Katy Freeway Total</b>	<b>10,079,297</b>	<b>13.1</b>	<b>15.9</b>	<b>-73,634</b>	<b>-73,634</b>	<b>354,877</b>	<b>0</b>	<b>31.36</b>
Class A	5,792,926	16.6	18.8	-87,850	-87,850	318,696	0	37.35
Class B	2,823,050	10.2	15.0	17,091	17,091	33,863	0	19.12
<b>Katy/Grand Pkwy W Total</b>	<b>3,557,312</b>	<b>17.5</b>	<b>17.9</b>	<b>58,766</b>	<b>58,766</b>	<b>32,171</b>	<b>0</b>	<b>27.72</b>
Class A	2,238,637	26.2	26.5	58,961	58,961	27,692	0	27.58
Class B	1,086,241	1.5	2.1	-2,080	-2,080	1,421	0	34.33
<b>Kingwood/Humble Total</b>	<b>1,461,422</b>	<b>12.0</b>	<b>12.8</b>	<b>-17,054</b>	<b>-17,054</b>	<b>13,764</b>	<b>0</b>	<b>23.00</b>
Class A	189,312	17.9	21.3	-24,482	-24,482	0	0	27.92
Class B	1,084,604	8.7	9.3	7,002	7,002	9,586	0	23.14

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q1 2018 Net Absorption (SF)	2018 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>Medical Center Total</b>	<b>9,043,053</b>	<b>5.5</b>	<b>7.0</b>	<b>-11,451</b>	<b>-11,451</b>	<b>69,547</b>	<b>0</b>	<b>27.20</b>
Class A	2,808,095	8.1	9.7	-2,159	-2,159	48,046	0	34.27
Class B	4,902,669	3.8	5.2	-6,996	-6,996	15,488	0	22.80
<b>Midtown Total</b>	<b>5,575,923</b>	<b>15.6</b>	<b>16.3</b>	<b>-118,513</b>	<b>-118,513</b>	<b>119,659</b>	<b>0</b>	<b>29.90</b>
Class A	2,006,668	25.7	23.3	-71,745	-71,745	110,672	0	31.96
Class B	2,947,766	8.8	11.5	-44,904	-44,904	8,987	0	27.83
<b>NASA/Clear Lake/SE Total</b>	<b>8,275,613</b>	<b>20.2</b>	<b>22.3</b>	<b>66,779</b>	<b>66,779</b>	<b>56,916</b>	<b>0</b>	<b>20.02</b>
Class A	1,927,977	13.0	13.2	20,508	20,508	4,760	0	26.54
Class B	5,347,949	23.6	25.5	39,132	39,132	48,098	0	18.94
<b>North Loop West Total</b>	<b>4,499,990</b>	<b>18.0</b>	<b>22.2</b>	<b>19,016</b>	<b>19,016</b>	<b>168,655</b>	<b>0</b>	<b>24.37</b>
Class A	1,188,544	29.9	43.4	17,379	17,379	59,252	0	26.33
Class B	2,802,466	15.4	15.9	-21,608	-21,608	106,603	0	22.87
<b>Northeast Total</b>	<b>2,307,011</b>	<b>14.0</b>	<b>16.3</b>	<b>-12,107</b>	<b>-12,107</b>	<b>37,018</b>	<b>0</b>	<b>18.10</b>
Class A	121,400	23.1	17.9	4,526	4,526	6,355	0	0.00
Class B	1,472,060	17.8	19.7	-16,839	-16,839	28,215	0	18.38
<b>Northwest Total</b>	<b>3,952,543</b>	<b>22.5</b>	<b>24.6</b>	<b>-62,221</b>	<b>-62,221</b>	<b>52,048</b>	<b>0</b>	<b>17.39</b>
Class A	797,237	41.1	46.8	8,656	8,656	2,793	0	19.50
Class B	2,277,443	22.1	22.6	-71,649	-71,649	48,483	0	16.07
<b>Pearland/South Total</b>	<b>1,749,940</b>	<b>8.6</b>	<b>9.9</b>	<b>281,131</b>	<b>281,131</b>	<b>2,906</b>	<b>0</b>	<b>27.32</b>
Class A	643,548	4.8	7.3	248,525	248,525	0	0	28.48
Class B	855,785	10.9	11.8	-2,990	-2,990	2,101	0	26.92
<b>Southwest Total</b>	<b>11,682,785</b>	<b>18.4</b>	<b>22.7</b>	<b>-107,699</b>	<b>-107,699</b>	<b>176,429</b>	<b>0</b>	<b>16.88</b>
Class A	2,053,918	24.4	31.8	18,028	18,028	51,426	0	19.07
Class B	7,209,564	20.4	24.2	-113,551	-113,551	117,926	0	16.34
<b>Sugar Land/E Ft Bend</b>	<b>6,599,106</b>	<b>12.4</b>	<b>16.1</b>	<b>-185,177</b>	<b>-185,177</b>	<b>108,782</b>	<b>38,599</b>	<b>25.43</b>
Class A	3,488,331	12.9	17.1	-161,280	-161,280	60,774	0	26.41
Class B	2,788,057	11.9	15.5	-23,897	-23,897	48,008	38,599	24.82
<b>West Belt Total</b>	<b>5,108,245</b>	<b>25.1</b>	<b>31.4</b>	<b>-10,555</b>	<b>-10,555</b>	<b>22,412</b>	<b>0</b>	<b>27.18</b>
Class A	3,359,510	31.6	38.5	-172,144	-172,144	7,868	0	28.73
Class B	1,661,106	22.1	27.2	17,628	17,628	14,544	0	23.24
<b>Westchase Total</b>	<b>14,892,236</b>	<b>23.0</b>	<b>30.9</b>	<b>-134,854</b>	<b>-134,854</b>	<b>209,881</b>	<b>0</b>	<b>27.48</b>
Class A	8,791,568	29.3	36.6	-150,438	-150,438	89,664	0	32.39
Class B	5,857,701	13.9	23.0	16,996	16,996	108,542	0	19.33
<b>Woodlands/Conroe Total</b>	<b>12,520,606</b>	<b>16.0</b>	<b>17.4</b>	<b>89,987</b>	<b>89,987</b>	<b>176,890</b>	<b>348,752</b>	<b>28.65</b>
Class A	5,847,781	21.3	20.6	82,975	82,975	105,668	326,800	32.55
Class B	5,829,061	11.7	15.3	10,356	10,356	71,222	21,952	25.37
<b>Suburban Total</b>	<b>190,476,223</b>	<b>20.8</b>	<b>24.7</b>	<b>-745,146</b>	<b>-745,146</b>	<b>3,506,555</b>	<b>417,255</b>	<b>25.86</b>
Class A	90,816,601	25.4	29.7	-282,908	-282,908	2,310,777	326,800	30.68
Class B	83,405,366	17.7	21.4	-566,751	-566,751	1,132,020	90,455	20.50



# MARKET OVERVIEW

## Houston Office Submarkets



Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy.

HOUSTON OFFICE | Q1 2018

# Quarterly Market Report

APRIL 2018

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HOUSTON OFFICE | Q4 2017

# Quarterly Market Report

JANUARY 2017

## EXECUTIVE SUMMARY

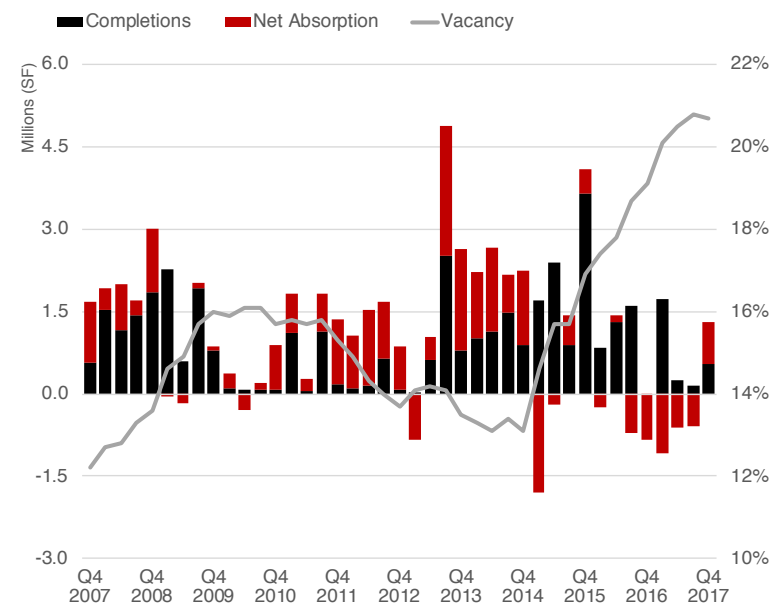
### Office Market Shows Signs of Improvement

Houston's overall vacancy rate remained relatively unchanged at 20.7% in Q4 2017, a decrease of 10 basis points quarter-over-quarter, compared to a 160-basis-point increase year-over-year. While net absorption for the quarter totaled a robust 750,016 sq. ft.—with direct space responsible for 260,977 sq. ft., and sublease space representing 480,475 sq. ft.—it wasn't enough to push the year's total into positive territory, as 2017 ended with 1.5 million sq. ft. of negative absorption being recorded. Overall occupancy in the Houston office market remains below 80%—the current rate of 79.3% is among the city's lowest historical levels. Both the Houston metro's overall rent and leasing activity are up from last quarter, and from a year ago. Everything considered, despite the uphill battle, the amount of sublease space as a percentage of the total amount of available space decreased to 15.4% at the end of December, compared to 16.0% at the end of November, while the total amount of available sublease space stands at 8.96 million sq. ft. Average asking rents grew by 0.9% year-over-year, while concessions such as free rent and tenant improvement allowances continued.

### Outlook for Houston Remains Positive

The Houston economy continued to improve nearing the end of 2017. The business-cycle index is trending upwards and employment data exceeded pre-hurricane readings. Houston's not seasonally adjusted unemployment rate was 4.3% in November, up from 4.1% in October. The November increase was driven in part by an increase in the labor force likely related to Hurricane Harvey. Fuel prices in the region jumped relative to West Texas Intermediate in September but have varied as storm-related misrepresentations lessened. Retail gasoline prices dropped back to near pre-Harvey levels from the beginning of September to the end of October, and have been moderately flat since. Overall, while the outlook for the immediate future is circumspect, forecasts for the next few years remain optimistic.

### Supply & Demand



### Market Indicators

	Current Q4 2017	Prior Quarter Q3 2017	Year Ago Q4 2016
Vacant Direct	18.5%	18.4% ↑	16.8% ↑
Vacant Direct+Sublease	20.7%	20.8% ↓	19.1% ↑
Available Direct	21.7%	22.1% ↓	20.4% ↑
Available Direct+Sublease	25.2%	26.1% ↓	24.9% ↑
Net Absorption (SF)	750,016	-576,361 ↑	-839,818 ↑
Leasing Activity (SF)	3,573,985	3,214,708 ↑	3,484,517 ↑
Construction (SF)	1,643,367	2,124,235 ↓	2,952,320 ↓
Deliveries (SF)	553,868	160,000 ↑	0 ↑
Gross Avg Asking Rent	\$28.10	\$27.92 ↑	\$27.86 ↑
Inventory (SF)	228,877,554	228,323,686 ↑	226,187,758 ↑

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# Broker's Perspective

Following another tepid year in the Houston office leasing market, the question that persists is whether we have finally reached the bottom. And, if we have, when will we see positive absorption of office space alongside a reduction in sublease space citywide?

There are early signs that the market may start trending in that direction, but it remains a steep hill to climb, with 8.9 million sq. ft. of sublease space in Greater Houston still available (compared to the historical trailing average of 4-5 million sq. ft.). However, even as 2017 closed out with 1.5 million sq. ft. of negative absorption, the end of the year still recorded some activity that portends a more positive forecast for Houston office leasing in 2018.

Despite the full-year negative absorption total, the fourth quarter posted positive absorption of 750,000 sq. ft., which was the market's first quarter in the black since Q2 2016! Additionally, sublease inventory dipped below 9 million sq. ft. for the first time in two years.

Other encouraging signs include the fact that commodity oil pricing is up over \$55/barrel of WTI (and today at \$63/barrel as this is written). While Houston is much more diversified in various other industries than just energy, it remains a driving force locally. Additionally, we have a new federal tax code forthcoming that has provided for a significant drop in tax levels for business owners. These non-real estate events are positive factors that encourage companies to hire more, spend more, and often results in companies leasing more office space.

It's a bit of a different story on the delivery side of things, as new construction for office buildings has virtually ceased citywide, except for the smaller square footage buildings (sub-100,000 sq. ft.) or the occasional preleased building. Construction is down from 12 months ago, and 2016 numbers were down from 2015 in construction square footages. This major construction slowdown during the past three years has put a cap on the square footage of office space inventory overall, for now. Interestingly, the reduction in new ground up office building construction has not put pressure on pushing construction pricing down for office interiors. In fact, these interior office space build-out costs on average continue to trend upward year over year. And user-owner office buildings (i.e., typically under 60,000 sq. ft.) continue to trade at higher and higher price-per-sq.-ft. levels over the past few years as well.

While 2017 ended with some positive indicators, we still have a significant glut of sublease space, mostly in the Downtown, Westchase and Energy Corridor submarkets. And with 20.8% vacancy across all buildings (and in some submarkets, like Energy Corridor, vacancies above 30%) we still anticipate 2018 to be a "tenant's market," where landlord concession packages will be significant and sublease deals will be done 30% to 50% below direct asking rent rates.

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**“Despite 2017’s full year of negative absorption in the office sector, the 4th quarter actually posted positive absorption of 750,000 SF.”**

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**Griff Bandy**

Partner  
NAI Partners

# MARKET OVERVIEW

## Second-Highest Quarter Ever of Sublease Leasing Activity

The overall availability rate, which measures the total amount of space being marketed for lease, sits at 25.2% as of fourth quarter 2017, down from 26.1% last quarter. Direct available space registered in at 50.1 million sq. ft., while sublease space is at 8.9 million sq. ft. Although the amount of sublease space has declined from its highest point of 12.0 million sq. ft. as of third quarter 2016, it still represents 3.9% of the market. More than 900,000 sq. ft. of sublease deals took place in Q4 2017—per our data, the second-highest quarterly tally ever recorded (following 937,000 sq. ft. in the first quarter of 2013).

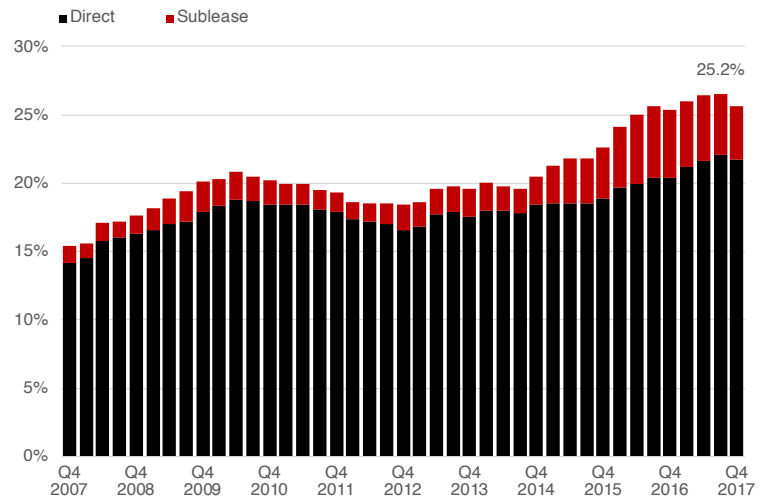
## First Quarter of Positive Net Absorption Since Q2 2016

Overall net absorption moved into positive territory for the first time since Q2 2016, following five consecutive quarters of registered negative demand. Direct space represented 260,977 sq. ft. of that total, and sublease space was responsible for 480,475 sq. ft. Accounting for some of the Class A sublease positive absorption activity, large blocks of space moved into the fourth quarter of 2017 included Aramco taking occupancy of 340,200 sq. ft. in Allen Center at 1200 Smith St.; 113,741 sq. ft. in the American General Center at 2929 Allen Parkway; and Empyrean Benefit Solutions moving into 106,904 sq. ft. on floors 7 and 8 in Pinnacle Westchase at 3010 Briarpark Dr. Direct space contributing to positive absorption includes Targa Resources occupying 127,734 sq. ft. in BG Group Place at 811 Louisiana St.; Lockton Houston moving into 116,250 sq. ft. in Lockton Place at 3657 Briarpark Dr.; and ANR Pipeline taking occupancy of 80,843 sq. ft. in Bank of America Center at 700 Louisiana St.

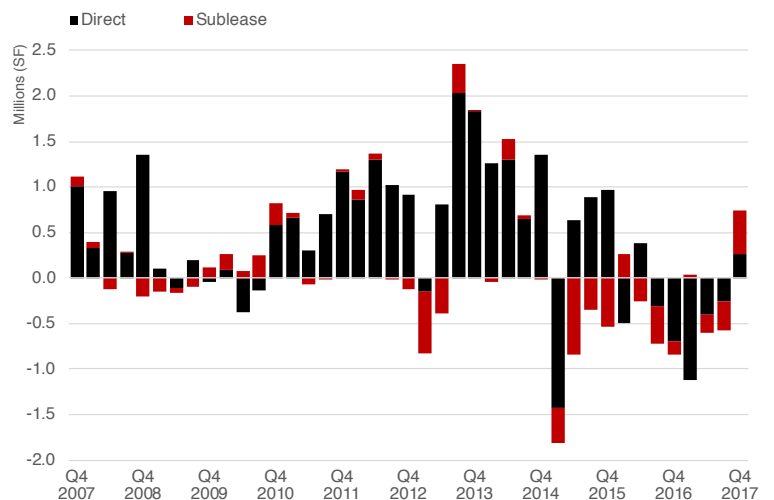
## Construction Pipeline Down 86.6% Since Q4 2014

During the fourth quarter, 553,868 sq. ft. of new supply was delivered to the Houston market, bringing the total for 2017 to 2.7 million sq. ft. Of that sum, about 40% is available for lease. Landlords are in a position to offer potential tenants concessions such as free rent and cash for moving expenses or space customization. Of the 1.6 million sq. ft. under construction, the buildings with available space include Capitol Tower at 800 Capitol St., a 35-story, 778,000-sq.-ft. building, with anchor tenant Bank of America committed to 210,000 sq. ft., plus future availability of 526,865 sq. ft., with a delivery date in the second half of 2019. In addition, City Place 2, at 1701 City Plaza Dr. in the Woodlands, a 4-story, 326,800 sq. ft. office building, at 93.9% leased with a scheduled delivery date of October 2018; and The Post Oak at 1600 Post Oak Blvd., a 36-story, 104,579-sq. ft. building, at 70% leased nearing

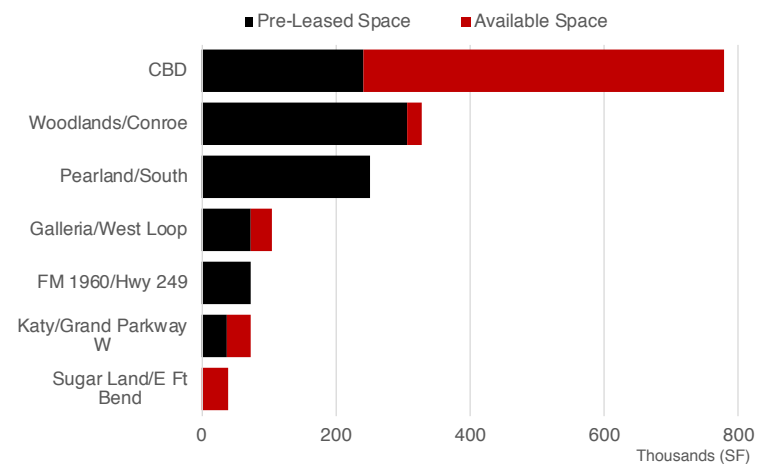
### Availability Rates



### Net Absorption Direct & Sublease



### Construction by Submarket





completion. The construction pipeline has dropped by 86.6% since hitting its peak of 12.2 million sq. ft. of office space that was underway at the end of the year 2014, when the oil downturn became apparent in the office market.

### Confident Investment Sales and Leasing Activity

Real Capital Analytics data reports year-to-date office sales volume for 2017 in the Greater Houston area at \$3,642.2 million, resulting in a year-over-year change of 256.8%. In addition, the number of properties sold increased by 49.4% and the average dollar amount per sq. ft. was up 52.9%. The buyer composition is made up of 42% cross-border, 22% private, 16% institutional, 12% user/other, and 9% public listed/REITs. Another positive sign for the Houston office market is the acquisition by Brookfield Asset Management of Houston Center, the largest commercial property in the Houston CBD. The 4.2 million-sq.-ft. office and retail complex was sold by J. P. Morgan Asset Management this December. The property encompasses a 9.2-acre, 6.5-block site and includes five properties along Fannin and McKinney streets and Lamar Ave., including three high-rise office towers and a 16-story office building over 196,000 square feet of retail space. The complex was 72% leased at the time of sale, and is home to notable tenants like Haynes and Boone, LyondellBasell Chemical, and North Rose Fulbright.

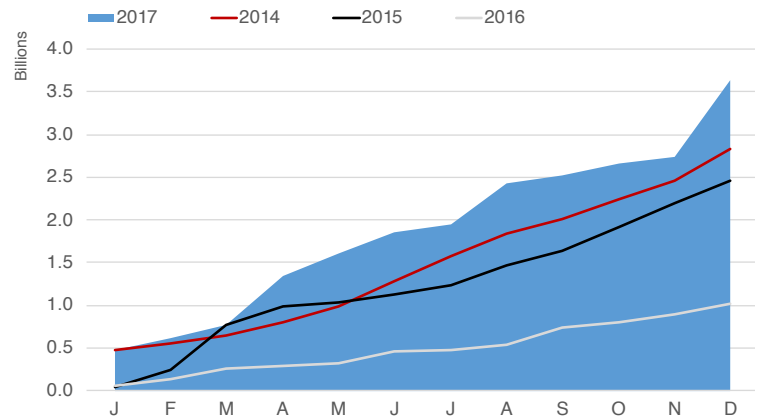
Leasing activity increased during the fourth quarter with a total of 3.57 million sq. ft. leased in the overall Houston market. Class A space fulfilled 2.21 million sq. ft., while Class B space realized 1.24 million sq. ft. These amounts are on par from 3.48 million sq. ft. at this time last year. On a percentage basis, direct space represented 78% of transactions, and sublease space was responsible for 22% of leasing activity during the fourth quarter. The largest transaction of the year was NRG Energy sealing a deal subleasing 431,037 sq. ft. from Shell Oil Co. at One Shell Plaza – 910 Louisiana in downtown Houston. NRG will occupy 18 floors within the 50-story, 1.1 million-sq.-ft. high-rise in the Houston CBD. This transaction marks the city’s largest sublease deal since the oil slump began three years ago, with a term through Dec. 31, 2025, when Shell Oil Co.’s lease expires.

### Average Asking Rents Rise

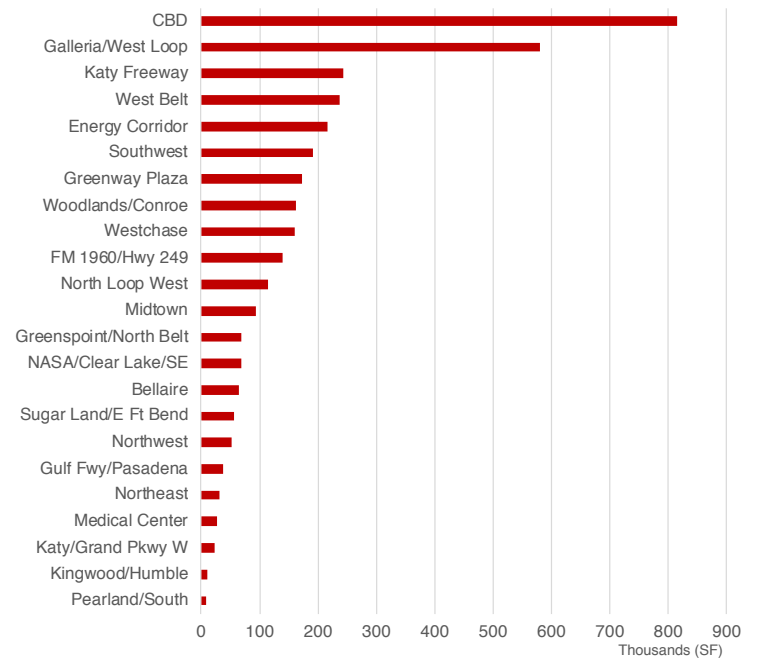
The market saw overall full-service average rates increase \$0.18 per sq. ft. quarter-over-quarter to close Q4 2017 at \$28.10 per sq. ft. Sublease rates fell to \$20.29 per sq. ft., down from Q3 2017’s \$20.47. In addition, year-over-year asking rents grew by 0.9%—although concessions such as free rent and tenant improvement allowances make posted rents less meaningful as a market indicator. Brokers report net effective rents dropping significantly once negotiations begin.

### Cumulative Monthly Sales Volume Houston Office

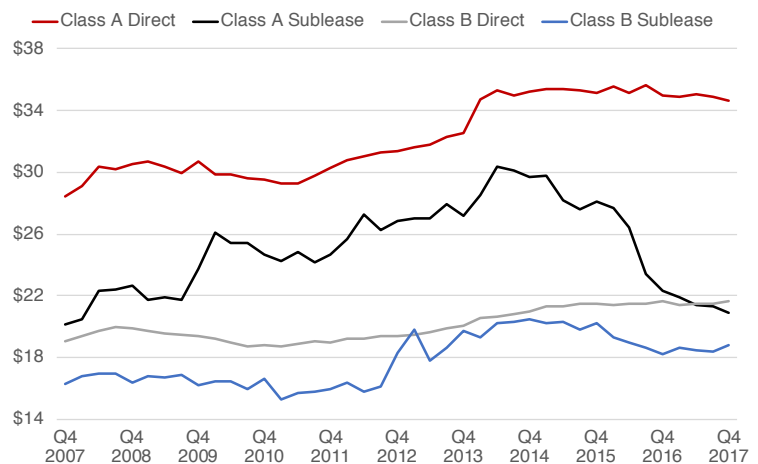
Source: Real Capital Analytics



### Leasing Activity by Submarket



### Historical Average Gross Asking Rent



# MARKET OVERVIEW

## Submarket Stats

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q4 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>Houston Market Total</b>	<b>228,862,191</b>	<b>20.7</b>	<b>25.2</b>	<b>750,016</b>	<b>-1,514,959</b>	<b>3,573,985</b>	<b>1,643,367</b>	<b>28.10</b>
Class A	119,979,053	23.6	28.5	748,508	-736,263	2,213,039	1,604,768	33.25
Class B	91,889,333	18.5	22.9	4,349	-657,634	1,241,913	38,599	21.49

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q4 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>CBD Total</b>	<b>38,821,778</b>	<b>23.2</b>	<b>28.1</b>	<b>-116,425</b>	<b>-1,109,223</b>	<b>814,588</b>	<b>778,344</b>	<b>28.91</b>
Class A	28,697,245	21.0	26.4	-101,505	-871,918	750,960	778,344	41.55
Class B	9,445,792	30.1	34.1	-14,470	-223,962	63,178	0	28.89
<b>Bellaire Total</b>	<b>3,507,381</b>	<b>13.0</b>	<b>16.3</b>	<b>5,774</b>	<b>-3,334</b>	<b>65,212</b>	<b>0</b>	<b>24.23</b>
Class A	1,470,637	13.1	19.4	-18,293	2,584	29,759	0	26.06
Class B	1,585,418	14.3	15.9	17,281	-9,398	32,054	0	23.68
<b>Energy Corridor Total</b>	<b>20,558,787</b>	<b>28.4</b>	<b>36.2</b>	<b>510,405</b>	<b>60,532</b>	<b>216,935</b>	<b>0</b>	<b>28.58</b>
Class A	13,654,210	29.7	37.8	454,842	308,249	50,930	0	32.71
Class B	6,445,446	27.3	34.7	49,933	-245,636	163,512	0	22.34
<b>FM 1960/Hwy 249 Total</b>	<b>10,512,848</b>	<b>17.5</b>	<b>20.8</b>	<b>36,301</b>	<b>-3,220</b>	<b>138,712</b>	<b>73,000</b>	<b>20.38</b>
Class A	2,824,485	16.9	17.6	-14,761	-11,037	34,483	73,000	28.21
Class B	6,558,125	17.5	21.9	92,608	70,693	100,749	0	18.37
<b>Galleria/West Loop Total</b>	<b>28,789,975</b>	<b>20.1</b>	<b>22.6</b>	<b>-116,039</b>	<b>-634,189</b>	<b>580,022</b>	<b>104,579</b>	<b>33.70</b>
Class A	19,704,330	22.5	24.2	-32,417	-451,964	408,727	104,579	36.78
Class B	8,948,245	14.9	19.2	-95,451	-213,196	162,669	0	25.24
<b>Greenspoint/North Belt Total</b>	<b>11,805,271</b>	<b>47.5</b>	<b>54.7</b>	<b>58,871</b>	<b>-287,256</b>	<b>68,853</b>	<b>0</b>	<b>19.84</b>
Class A	5,297,384	62.5	70.2	7,854	-183,036	45,259	0	22.80
Class B	4,963,800	37.2	45.4	30,444	-86,802	21,088	0	15.62
<b>Greenway Plaza Total</b>	<b>10,853,879</b>	<b>16.3</b>	<b>20.1</b>	<b>1,125</b>	<b>-17,308</b>	<b>173,505</b>	<b>0</b>	<b>33.26</b>
Class A	7,483,998	17.7	22.3	-5,185	3,884	109,532	0	35.71
Class B	2,841,199	13.2	15.3	4,638	-26,270	43,763	0	28.16
<b>Gulf Fwy/Pasadena Total</b>	<b>3,694,556</b>	<b>17.9</b>	<b>22.0</b>	<b>5,447</b>	<b>-58,464</b>	<b>37,226</b>	<b>0</b>	<b>22.24</b>
Class A	22,706	0.0	0.0	0	3,122	2,100	0	19.00
Class B	2,654,046	18.5	23.0	13,523	-44,196	32,462	0	22.43
<b>Katy Freeway Total</b>	<b>10,073,265</b>	<b>12.3</b>	<b>15.2</b>	<b>20,494</b>	<b>29,897</b>	<b>244,267</b>	<b>0</b>	<b>29.62</b>
Class A	5,786,894	15.1	18.0	-29,961	10,909	162,227	0	36.78
Class B	2,823,050	10.8	15.1	30,787	8,354	72,885	0	19.60
<b>Katy/Grand Pkwy W Total</b>	<b>3,353,691</b>	<b>18.2</b>	<b>21.4</b>	<b>-13,791</b>	<b>61,227</b>	<b>23,576</b>	<b>72,045</b>	<b>27.95</b>
Class A	2,034,864	28.3	31.2	-24,717	27	3,592	72,045	27.55
Class B	1,086,393	1.4	5.0	9,539	56,667	18,748	0	34.50
<b>Kingwood/Humble Total</b>	<b>1,481,819</b>	<b>9.9</b>	<b>14.4</b>	<b>9,046</b>	<b>11,588</b>	<b>10,249</b>	<b>0</b>	<b>22.66</b>
Class A	189,312	5.0	23.8	0	0	1,927	0	26.62
Class B	1,095,840	8.2	11.1	7,726	25,107	7,002	0	22.27

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q4 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>Medical Center Total</b>	<b>8,444,577</b>	<b>6.1</b>	<b>7.8</b>	<b>-3,205</b>	<b>34,296</b>	<b>27,809</b>	<b>0</b>	<b>27.95</b>
Class A	2,808,095	8.0	11.3	12,939	-16,503	6,684	0	24.26
Class B	4,428,029	4.8	5.3	-329	75,793	18,184	0	26.04
<b>Midtown Total</b>	<b>5,552,813</b>	<b>13.4</b>	<b>17.2</b>	<b>158,547</b>	<b>104,307</b>	<b>93,420</b>	<b>0</b>	<b>30.48</b>
Class A	2,006,668	22.1	29.7	120,649	38,758	29,020	0	32.14
Class B	2,947,766	7.9	9.6	17,916	53,159	59,420	0	28.98
<b>NASA/Clear Lake/SE Total</b>	<b>8,395,617</b>	<b>20.0</b>	<b>22.5</b>	<b>-59,676</b>	<b>-251,932</b>	<b>67,962</b>	<b>0</b>	<b>20.21</b>
Class A	2,047,977	10.5	13.8	441	-34,380	22,396	0	27.03
Class B	5,381,632	24.8	25.5	-66,313	-202,414	21,796	0	18.86
<b>North Loop West Total</b>	<b>4,499,990</b>	<b>19.2</b>	<b>24.6</b>	<b>-4,882</b>	<b>-95,626</b>	<b>114,931</b>	<b>0</b>	<b>24.71</b>
Class A	1,188,544	31.4	46.6	5,246	-25,053	93,621	0	26.66
Class B	2,802,466	15.9	18.0	-19,268	-46,624	12,909	0	22.76
<b>Northeast Total</b>	<b>2,307,011</b>	<b>13.5</b>	<b>15.7</b>	<b>22,208</b>	<b>52,898</b>	<b>30,740</b>	<b>0</b>	<b>18.67</b>
Class A	121,400	26.8	13.8	-118	52,417	15,826	0	0.00
Class B	1,472,060	16.6	18.9	28,025	8,399	12,386	0	18.21
<b>Northwest Total</b>	<b>3,952,543</b>	<b>21.8</b>	<b>24.0</b>	<b>-69,895</b>	<b>-44,063</b>	<b>51,126</b>	<b>0</b>	<b>17.27</b>
Class A	797,237	42.2	44.6	4,588	2,847	9,754	0	19.38
Class B	2,277,443	20.6	22.2	-65,549	-49,127	40,776	0	16.55
<b>Pearland/South Total</b>	<b>1,498,595</b>	<b>12.2</b>	<b>11.7</b>	<b>52,879</b>	<b>61,824</b>	<b>8,841</b>	<b>250,000</b>	<b>27.58</b>
Class A	393,548	7.5	7.6	2,044	16,772	3,705	250,000	28.63
Class B	855,785	10.6	10.9	49,635	55,789	3,936	0	27.21
<b>Southwest Total</b>	<b>11,770,037</b>	<b>17.4</b>	<b>21.5</b>	<b>-99,149</b>	<b>-19,809</b>	<b>190,992</b>	<b>0</b>	<b>17.58</b>
Class A	2,053,918	25.2	28.8	-31,903	-105,741	31,035	0	18.95
Class B	7,181,719	18.9	23.3	-39,483	64,544	142,079	0	17.41
<b>Sugar Land/E Ft Bend</b>	<b>6,579,106</b>	<b>9.3</b>	<b>12.0</b>	<b>69,123</b>	<b>151,380</b>	<b>55,406</b>	<b>38,599</b>	<b>26.25</b>
Class A	3,488,331	8.3	11.3	57,950	59,759	23,127	0	28.77
Class B	2,768,057	10.4	12.9	9,923	82,890	32,279	38,599	24.79
<b>West Belt Total</b>	<b>5,106,245</b>	<b>24.5</b>	<b>36.9</b>	<b>26,008</b>	<b>78,649</b>	<b>237,053</b>	<b>0</b>	<b>26.74</b>
Class A	3,359,510	26.5	40.0	46,663	-24,415	220,997	0	29.04
Class B	1,659,106	21.9	32.5	-20,655	103,064	16,056	0	22.17
<b>Westchase Total</b>	<b>14,935,653</b>	<b>21.3</b>	<b>30.9</b>	<b>110,743</b>	<b>4,714</b>	<b>159,711</b>	<b>0</b>	<b>27.85</b>
Class A	8,792,934	26.4	35.0	141,748	78,625	83,842	0	33.23
Class B	5,899,752	14.1	25.5	-31,005	-70,344	75,869	0	19.49
<b>Woodlands/Conroe Total</b>	<b>12,366,754</b>	<b>17.0</b>	<b>19.3</b>	<b>146,107</b>	<b>358,153</b>	<b>162,849</b>	<b>326,800</b>	<b>27.90</b>
Class A	5,754,826	23.0	23.6	152,404	409,831	73,536	326,800	32.15
Class B	5,768,164	12.4	16.2	-5,106	-44,124	88,113	0	24.99
<b>Suburban Total</b>	<b>190,040,413</b>	<b>20.2</b>	<b>24.6</b>	<b>866,441</b>	<b>-405,736</b>	<b>2,759,397</b>	<b>865,023</b>	<b>25.96</b>
Class A	91,281,808	24.4	29.2	850,013	135,655	1,462,079	826,424	30.78
Class B	82,443,541	17.2	21.6	18,819	-433,672	1,178,735	38,599	20.83



HOUSTON OFFICE | Q4 2017

# Quarterly Market Report

JANUARY 2017

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HOUSTON OFFICE | Q3 2017

# Quarterly Market Report

OCTOBER 2017

## EXECUTIVE SUMMARY

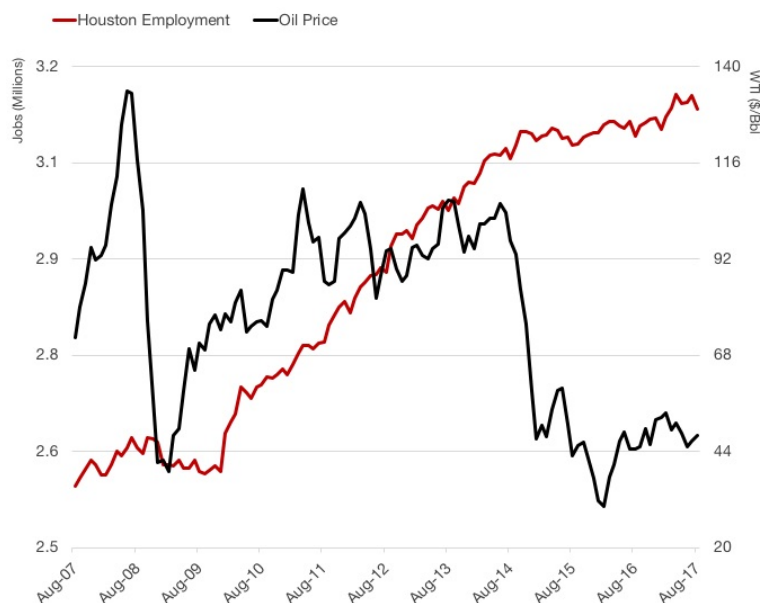
### Challenging Market Conditions Continue for Foreseeable Future

Houston's overall vacancy rate continued to rise to 20.8% in Q3 2017, an increase of 30 basis points quarter-over-quarter and 210 basis points year-over-year. Net absorption remained negative at 633,666 sq. ft. as of the quarter's end, adding up to 2.38 million sq. ft. of negative absorption year-to-date. Presently, overall occupancy in the Houston office market remains below 80%, situated at 79.2%, continuing to surpass its historical lowest levels. Both the Houston metro's overall rent and leasing activity are down from last quarter, with an even deeper gap from a year ago. However, despite the uphill battle, the amount of sublease space as a percentage of the total amount of available space decreased to 16.8%, compared to 18.4% at the end of Q2 2017, while the total amount of available sublease space stands at 10.1 million sq. ft. Average asking rents fell by 1.0% year-over-year, while concessions such as free rent and tenant improvement allowances continued.

### Hurricane Harvey Alters Economic Activity

The Houston economy sustained moderate growth, but at a slower pace through August. The business-cycle index and employment data were softer, and the energy industry provided less of a helping hand to Houston over the summer. Striking at the end of August, Hurricane Harvey was not included in the jobs data for August, however, a breakdown by the Dallas Fed suggests that while Harvey's impact will be felt deeply, Houston and the Texas Gulf Coast are expected to recover quickly. Houston's unemployment rate was 5.0% in August, up from a revised 4.6% in July. The August unemployment rate for Texas was 4.2% and 4.4% for the U.S. After the storm, the shutdown of refinery capacity drove the price of West Texas Intermediate crude oil (WTI) down, and also pushed motor fuel prices up. WTI has traded between \$45 and \$55 over the majority of the past year, while the weekly retail price of regular gasoline rose 36 cents per gallon in Houston. Overall, while the outlook for the immediate future is unsure, prospects for the next few years remain positive.

## Employment & Oil Prices



## Market Indicators

	Current Q3 2017	Prior Quarter Q2 2017	Year Ago Q3 2016
Vacancy w/Sublease	20.8%	20.5% ▲	18.7% ▲
Direct	18.4%	18.2% ▲	16.6% ▲
Availability w/Sublease	26.2%	26.1% ▲	25.0% ▲
Direct	22.2%	21.7% ▲	20.4% ▲
Net Absorption (SF)	-633,666	-682,939 ▼	-665,674 ▼
Leasing Activity (SF)	2,453,605	3,736,626 ▼	4,416,690 ▼
Construction (SF)	2,311,435	2,421,435 ▼	3,089,520 ▼
Deliveries (SF)	110,000	254,796 ▼	1,616,748 ▼
Gross Avg Asking Rent	\$27.91	\$28.00 ▼	\$28.19 ▼
Inventory (SF)	228,552,577	228,442,577 ▲	226,466,649 ▲

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# Broker's Perspective

On behalf of the entire NAI Partners team, our thoughts and prayers go out to those affected by Hurricane Harvey. Like most every organization in Houston, we had employees and associates that have had to deal with the devastation this storm brought to our region. Regardless of the impact, we are all very confident that Houston will come back stronger than ever. I am already amazed by how quickly rebuilding is taking place.

Speaking of Harvey, I have been asked quite often about the impact the storm has had or will have on the office market. Although the statistics are not yet available, our general consensus is that there were some positives coming from companies needing space after being displaced; however, most of these needs were short-term in nature and therefore will have no sustainable impact on the market. The ability to work remotely, along with the deployment of temporary power solutions for those buildings that went down, are two major factors that allowed landlords and tenants to get back to work quickly following the storm.

The Houston office market continues to be a tenant's market in almost every submarket across the city. The vacancy rate now stands at 20.8%, with overall availability in excess of 26%. On the demand side, absorption has been negative for the fifth quarter in a row, and we will likely see negative net absorption for the year in excess of three million sq. ft. As a result, landlords will continue to feel the pressure to drop rents and increase concessions for those few tenants in the market looking for space.

The good news is that there has been activity in the market. However, much of that activity has been for smaller tenants needing space of less than 10,000 sq. ft. It is impossible to make up for the millions of square feet dumped on the market as a result of the energy downturn in 5,000- to 10,000-sq.-ft. chunks. At that rate, it would take 50 years for the market to return to any type of equilibrium. The good news for landlords is that historically speaking the office market has cycles of 7 to 8 years in Houston. As such, we should begin to see some light at the end of the tunnel sometime in 2018. However, I believe we have a way to go before we pendulum will swing back in the landlords' favor.

Average asking rents continue to fall, but that statistic does not tell the real story. Landlords have a tendency to hold advertised asking rents, only to drop them significantly once they have a strong prospect to lease space. We have seen rental rates decrease by as much as 30% during the negotiation process, while concession packages will increase by that same percentage. The amount of negotiation can vary from submarket to submarket and even building to building, so it is important for tenants to consider all their options to find the best lease terms.

The overall office market continues to face new challenges. M & A activity has left companies with more excess space which has been placed in the sublease market. Examples of this include Ensco's acquisition of Atwood Oceanics and Spectra Energy's acquisition of Enbridge. Both transactions resulted in large blocks of space being put on the sublease market. The former in the energy corridor and the later in the CBD.

The rest of 2017 will likely continue with more of the same: not enough positive influences to outweigh the results of the downturn in the energy business which started roughly three years ago. However, history tells us that 2018 should be a year in which the office market will see signs of life that will lead to a gradual recovery.

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**“The Houston office market continues to be a tenant's market in almost every submarket across the city.”**

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**Dan Boyles**

Partner  
NAI Partners

## MARKET OVERVIEW

### Available Sublease Space Represents 4.4% of the Market

The overall availability rate, which measures the total amount of space being marketed for lease, remains over 26% as of third quarter 2017. Direct available space sits at 60.4 million sq. ft., while sublease space is at 10.1 million sq. ft. Although the amount of sublease space has declined from its highest point of 12.0 million sq. ft. as of third quarter 2016, it still represents 4.4% of the market. More than 3.3 million sq. ft. of this sublease space is slated to be returned to property owners in the next 24-36 months, foreshadowing financial problems for landlords who have loan payments to make. Many local experts believe subleases less than two years aren't really subleases at all, but in fact direct space. Landlords are more concerned with the 24-36-month range subleases, with tenants that aren't in a position to buyout the lease, or particular restrictions in the loan agreements. Of the 3.3 million sq. ft. scheduled to be returned to landlords between September 2019 and September 2020, 2.5 million sq. ft. is Class A space, and 800,000 sq. ft. is Class B.

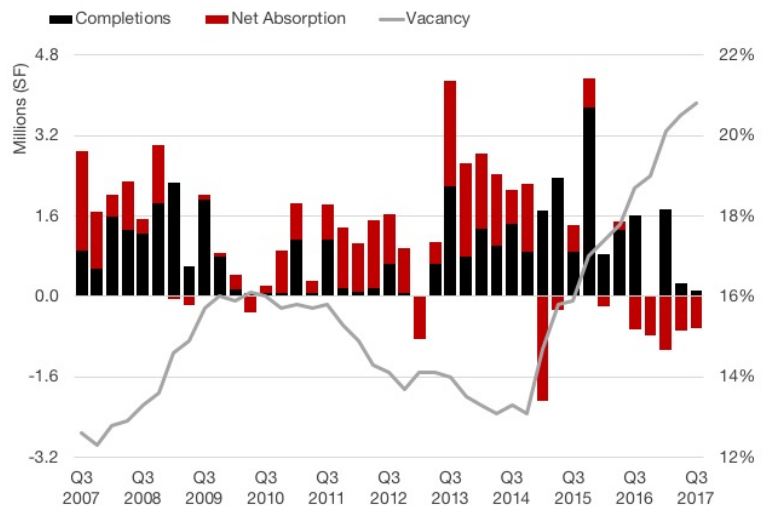
### Net Absorption Remains Unenthusiastic

Net absorption continued in negative territory for the fifth consecutive quarter, seeing 633,666 sq. ft. of net move-outs in the third quarter, representing 0.3% of Houston's total office inventory. Direct space represented negative 373,958 sq. ft. of that total, and sublease space was responsible for negative 256,224 sq. ft. Accounting for some of the Class A positive absorption activity, tenants moving into large blocks of space in the third quarter of 2017 include Kirkland & Ellis moving into 104,025 sq. ft. and Orrick, Herrington & Sutcliffe taking occupancy of 56,666 sq. ft. at 609 Main St. in the CBD; and Crestwood Partners occupying 114,870 sq. ft. and Thompson & Knight moving into 60,655 sq. ft. of sublease space at 811 Main St.

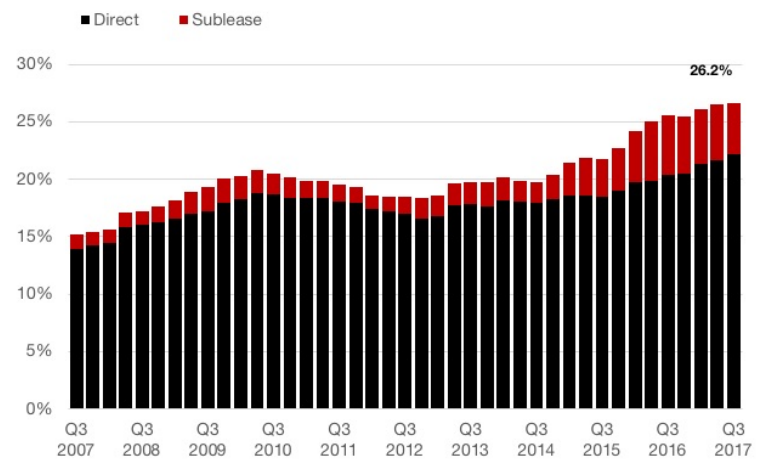
### World-Class Construction Pipeline in CBD

Buildings underway with more than 100,000 sq. ft. of available space in the Houston CBD include 3200 Kirby, a 13-story, 200,000-sq.-ft. Class A office building that is part of the Kirby Collection mixed-use development in River Oaks scheduled to deliver in the fall of 2017; and Capitol Tower at 800 Capitol St., a 35-story, 778,000-sq.-ft. building, with anchor tenant Bank of America committed to 210,000 sq. ft., and a completion date projected for the second half of 2019. As for future construction, at a recent office market event, the rumor mill was abuzz with plans for a potential new skyscraper in downtown Houston.

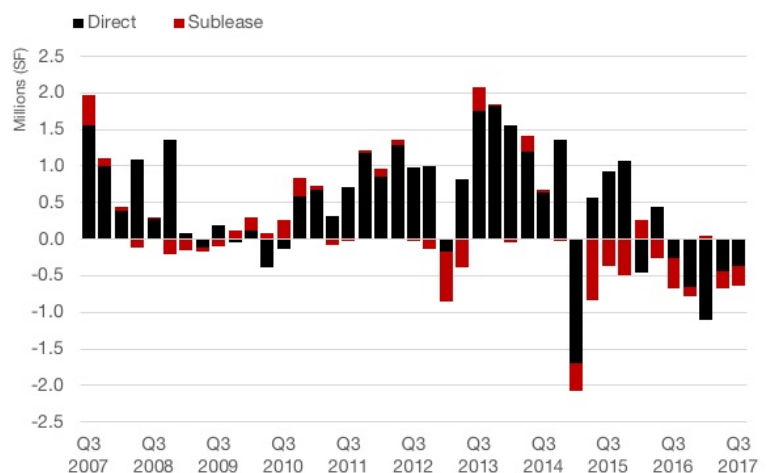
### Supply & Demand



### Availability Rates



### Net Absorption Direct & Sublease



Speculation has the high-amenity project starting by the end of next year. Currently, there is about 2.31 million sq. ft. under construction in the Houston office market, with about half of that space available for lease. Production remained basically unchanged from this time last quarter, with only 110,000 sq. ft. delivered to the market.

**Investment Sales and Leasing Activity Optimistic**

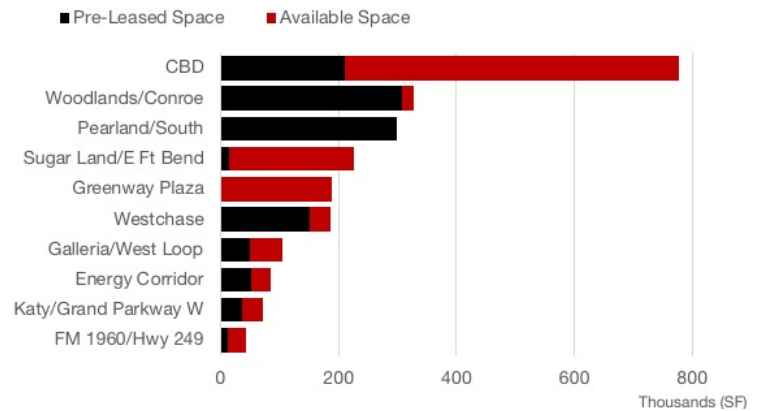
Real Capital Analytics data reports year-to-date office sales volume in the Houston area at \$2.134 billion, resulting in a year-over-year change of 196%. The buyer composition is made up of 31% cross-border, 27% institutional, 26% private, and 13% public listed/REITs. Another positive sign for the Houston office market is the Lincoln Property Co. and H.I.G. Realty Partners acquisition of Greenspoint Place, a portfolio of six office buildings and three adjacent retail centers from Northwestern Mutual Life Insurance Co. The North Houston properties are located at Interstate 45 and the Sam Houston Tollway and were built between 1978 and 1992. The portfolio went into foreclosure after Exxon Mobil, the largest tenant, vacated the buildings in 2015 and consolidated at its Springwoods campus. The six office buildings on Greenspoint and Northchase drives total more than 2 million sq. ft. and the three retail properties total more than 80,000 sq. ft.

Leasing activity slowed during the third quarter with a total of 2.45 million sq. ft. leased in the overall Houston market. Direct space fulfilled 1.78 million sq. ft., while sublease space realized about 640,000 sq. ft. These amounts are down significantly from 4.41 million sq. ft. at this time last year. On a percentage basis, transactions declined quarter-over-quarter by 34.3%, while the year-over-year drop was at 44.4%. Even so, NRG Energy sealed a deal subleasing 431,037 sq. ft. from Shell Oil Co. at One Shell Plaza – 910 Louisiana in downtown Houston. NRG will occupy 18 floors within the 50-story, 1.1 million sq. ft. high-rise in the Houston CBD. This transaction marks the city’s largest sublease deal since the oil slump began more than two years ago, with a term through Dec. 31, 2025, when Shell Oil Co.’s lease expires.

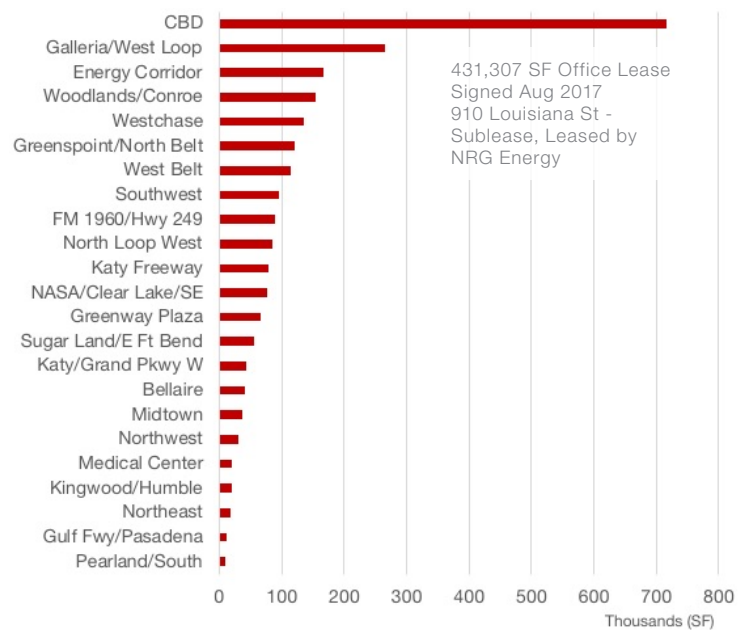
**Average Asking Rents Soften**

The market saw overall full-service average rates fall \$0.09 per sq. ft. quarter-over-quarter to close Q3 2017 at \$27.91 per sq. ft. Sublease rates increased at \$20.74 per sq. ft. compared to Q2 2017 at \$20.72 per sq. ft. In contrast, year-over-year asking rents fell by 1.0%, while concessions such as free rent and tenant improvement allowances continued.

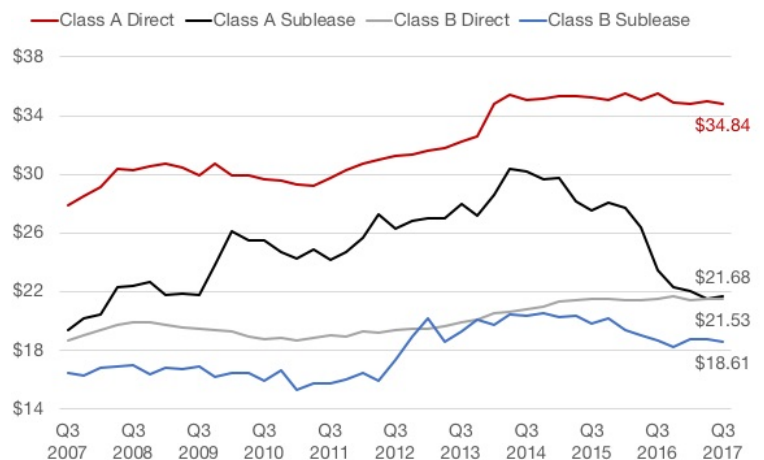
**Construction by Submarket**



**Leasing Activity by Submarket**



**Average Gross Asking Rent**





## MARKET OVERVIEW

## Submarket Stats

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q3 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>Houston Market Total</b>	<b>228,552,577</b>	<b>20.8</b>	<b>26.2</b>	<b>-633,666</b>	<b>-2,383,035</b>	<b>2,453,605</b>	<b>2,311,435</b>	<b>27.91</b>
Class A	119,458,749	23.6	29.3	-123,669	-1,297,006	1,353,484	2,087,781	33.36
Class B	92,217,500	19.1	24.2	-449,907	-955,255	1,023,605	223,654	21.34

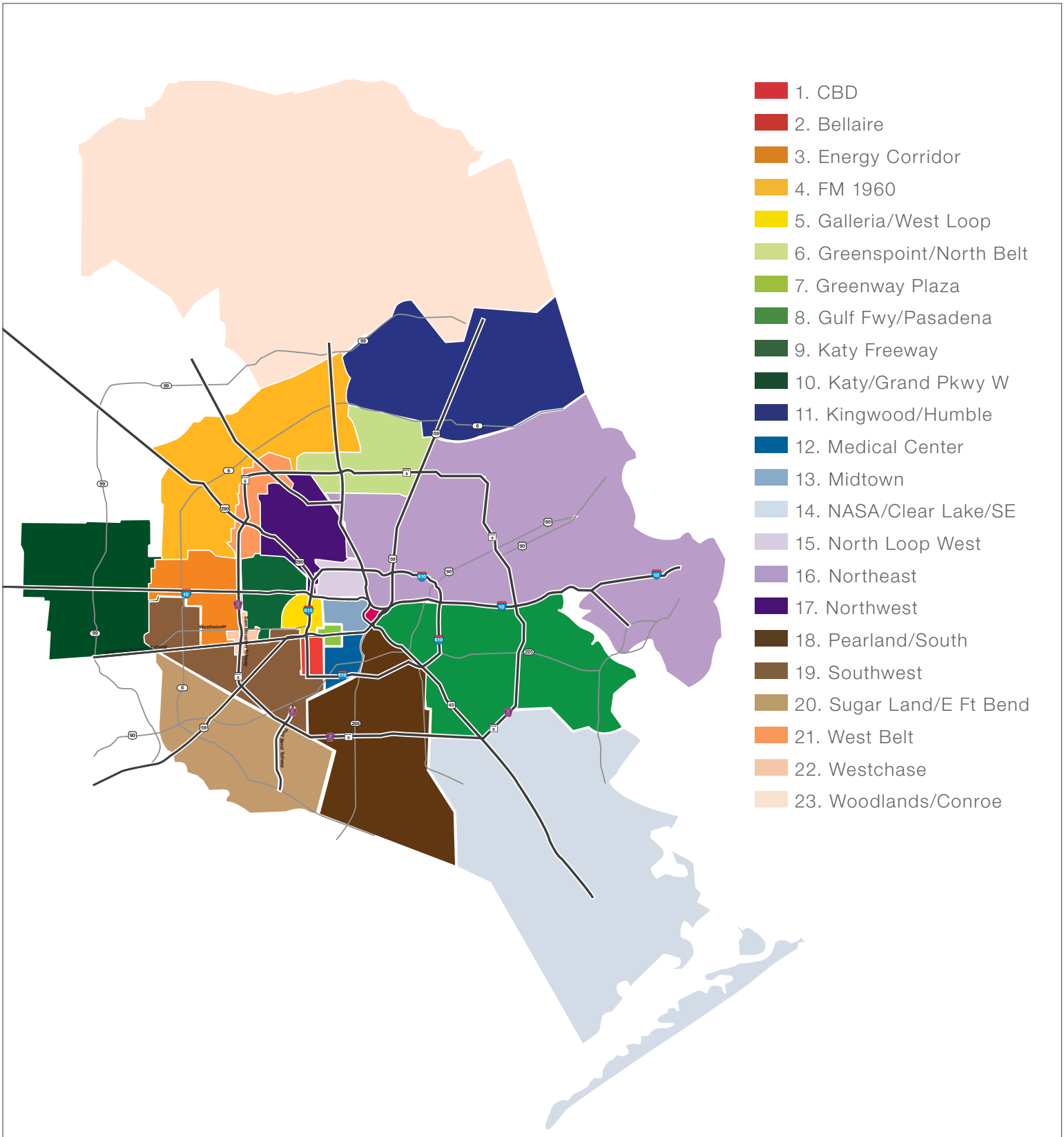
Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q3 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>CBD Total</b>	<b>38,726,840</b>	<b>22.8</b>	<b>29.0</b>	<b>-148,779</b>	<b>-993,093</b>	<b>717,573</b>	<b>778,344</b>	<b>39.46</b>
Class A	28,602,307	20.6	27.6	-216,002	-771,280	612,343	778,344	42.64
Class B	9,445,792	30.0	34.3	67,223	-208,920	105,230	0	28.55
<b>Bellaire Total</b>	<b>3,507,381</b>	<b>13.1</b>	<b>17.0</b>	<b>-32,776</b>	<b>-6,791</b>	<b>41,610</b>	<b>0</b>	<b>24.39</b>
Class A	1,470,637	12.1	23.7	10,785	20,877	31,552	0	26.40
Class B	1,585,418	15.2	15.4	-43,417	-23,709	16,790	0	23.46
<b>Energy Corridor Total</b>	<b>20,472,877</b>	<b>30.7</b>	<b>37.2</b>	<b>-123,655</b>	<b>-373,362</b>	<b>166,236</b>	<b>86,255</b>	<b>28.33</b>
Class A	13,368,300	32.5	38.5	1,548	-71,310	39,035	86,255	32.35
Class B	6,645,446	28.6	36.5	-118,194	-295,569	126,516	0	22.42
<b>FM 1960/Hwy 249 Total</b>	<b>10,412,297</b>	<b>18.8</b>	<b>22.6</b>	<b>-122,777</b>	<b>-101,621</b>	<b>88,602</b>	<b>43,600</b>	<b>20.07</b>
Class A	2,932,453	16.3	17.1	28,573	10,093	13,111	0	28.05
Class B	6,419,846	20.2	25.8	-107,604	-87,000	36,672	43,600	17.96
<b>Galleria/West Loop Total</b>	<b>28,863,808</b>	<b>19.5</b>	<b>23.4</b>	<b>-206,520</b>	<b>-517,155</b>	<b>265,610</b>	<b>104,579</b>	<b>33.22</b>
Class A	19,777,890	21.9	25.5	-110,304	-397,727	212,602	104,579	36.33
Class B	8,990,918	14.4	18.8	-109,614	-149,492	76,172	0	25.10
<b>Greenspoint/North Belt Total</b>	<b>11,778,271</b>	<b>47.0</b>	<b>54.4</b>	<b>17,694</b>	<b>-292,183</b>	<b>120,931</b>	<b>0</b>	<b>19.88</b>
Class A	5,297,384	61.2	69.5	26,259	-115,890	33,318	0	23.07
Class B	5,093,076	39.3	46.5	-36,702	-143,016	78,721	0	15.72
<b>Greenway Plaza Total</b>	<b>10,616,130</b>	<b>14.9</b>	<b>20.5</b>	<b>19,826</b>	<b>-101,360</b>	<b>67,045</b>	<b>188,547</b>	<b>33.79</b>
Class A	7,202,397	15.2	22.6	52,766	-2,601	31,697	188,547	36.68
Class B	2,884,253	14.4	16.4	-33,699	-102,165	32,699	0	27.21
<b>Gulf Fwy/Pasadena Total</b>	<b>3,663,758</b>	<b>18.0</b>	<b>23.9</b>	<b>-14,685</b>	<b>-60,060</b>	<b>12,407</b>	<b>0</b>	<b>22.22</b>
Class A	22,706	0.0	27.7	0	3,122	0	0	19.00
Class B	2,623,248	18.9	25.0	1,431	-53,868	11,287	0	22.31
<b>Katy Freeway Total</b>	<b>10,073,265</b>	<b>12.7</b>	<b>16.9</b>	<b>-55,541</b>	<b>-7,285</b>	<b>78,736</b>	<b>0</b>	<b>27.34</b>
Class A	5,786,894	14.8	19.2	-57,499	28,035	43,096	0	38.29
Class B	2,823,050	12.1	18.0	4,586	-26,286	32,384	0	20.62
<b>Katy/Grand Pkwy W Total</b>	<b>3,235,769</b>	<b>19.0</b>	<b>21.3</b>	<b>28,725</b>	<b>57,487</b>	<b>42,678</b>	<b>72,045</b>	<b>27.70</b>
Class A	1,916,942	28.7	30.4	13,924	24,744	35,515	72,045	28.00
Class B	1,086,393	3.7	7.2	14,296	31,228	5,907	0	32.01
<b>Kingwood/Humble Total</b>	<b>1,481,792</b>	<b>10.5</b>	<b>13.6</b>	<b>10,582</b>	<b>3,226</b>	<b>19,862</b>	<b>0</b>	<b>23.25</b>
Class A	189,312	5.0	24.8	0	0	0	0	27.95
Class B	1,095,813	8.9	9.8	10,274	17,381	19,862	0	22.73

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Total Vacancy (%)	Total Availability (%)	Q3 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Leasing Activity (SF)	Under Construction (SF)	Overall Gross Avg Asking Rent (\$/PSF)
<b>Medical Center Total</b>	<b>8,451,955</b>	<b>9.3</b>	<b>10.9</b>	<b>-49,081</b>	<b>-13,419</b>	<b>20,259</b>	<b>0</b>	<b>27.38</b>
Class A	2,907,001	8.6	10.6	-8,750	-21,314	8,462	0	32.92
Class B	4,212,665	11.3	11.9	-18,705	38,424	11,797	0	25.80
<b>Midtown Total</b>	<b>5,573,018</b>	<b>17.4</b>	<b>19.5</b>	<b>-184,557</b>	<b>-119,331</b>	<b>37,680</b>	<b>0</b>	<b>28.73</b>
Class A	2,006,668	28.6	33.0	-145,096	-91,688	0	0	28.81
Class B	2,947,766	10.4	11.5	-31,269	-20,051	31,789	0	29.46
<b>NASA/Clear Lake/SE Total</b>	<b>8,416,534</b>	<b>19.6</b>	<b>23.4</b>	<b>-137,871</b>	<b>-195,987</b>	<b>77,582</b>	<b>0</b>	<b>19.95</b>
Class A	2,047,977	12.0	16.3	-12,908	-34,686	19,726	0	27.18
Class B	5,347,949	23.6	25.5	-98,563	-139,567	54,025	0	18.75
<b>North Loop West Total</b>	<b>4,529,737</b>	<b>18.8</b>	<b>21.2</b>	<b>-27,160</b>	<b>-90,744</b>	<b>85,366</b>	<b>0</b>	<b>23.29</b>
Class A	1,188,544	31.1	31.1	6,165	-30,299	13,258	0	26.52
Class B	2,832,213	15.0	18.6	-19,766	-27,356	52,791	0	21.90
<b>Northeast Total</b>	<b>2,342,279</b>	<b>13.5</b>	<b>16.6</b>	<b>38,609</b>	<b>47,493</b>	<b>18,785</b>	<b>0</b>	<b>18.88</b>
Class A	121,400	26.7	26.7	52,535	52,535	0	0	0.00
Class B	1,507,328	17.0	19.4	-19,203	-2,823	18,785	0	18.43
<b>Northwest Total</b>	<b>3,952,543</b>	<b>19.5</b>	<b>25.8</b>	<b>6,758</b>	<b>25,832</b>	<b>29,541</b>	<b>0</b>	<b>17.37</b>
Class A	797,237	42.8	42.0	-13,161	-1,741	11,250	0	19.41
Class B	2,277,443	16.8	24.2	20,219	16,422	18,291	0	16.55
<b>Pearland/South Total</b>	<b>1,450,140</b>	<b>12.9</b>	<b>11.9</b>	<b>485</b>	<b>8,945</b>	<b>9,737</b>	<b>298,455</b>	<b>27.90</b>
Class A	393,548	8.1	7.4	12,278	14,728	6,560	250,000	28.17
Class B	807,330	11.4	11.3	2,207	6,154	3,177	48,455	27.96
<b>Southwest Total</b>	<b>11,862,862</b>	<b>14.7</b>	<b>21.4</b>	<b>8,391</b>	<b>76,112</b>	<b>95,479</b>	<b>0</b>	<b>17.33</b>
Class A	2,053,918	17.2	29.3	-69,952	-73,838	0	0	19.09
Class B	7,274,544	17.0	23.8	43,960	100,799	73,784	0	17.11
<b>Sugar Land/E Ft Bend</b>	<b>6,555,017</b>	<b>10.7</b>	<b>14.7</b>	<b>62,563</b>	<b>71,362</b>	<b>55,596</b>	<b>225,799</b>	<b>26.61</b>
Class A	3,488,331	10.0	13.6	25,365	-1,730	7,638	94,200	27.94
Class B	2,791,968	10.8	15.8	32,400	68,294	50,807	131,599	25.42
<b>West Belt Total</b>	<b>5,096,553</b>	<b>22.7</b>	<b>41.6</b>	<b>255,575</b>	<b>152,686</b>	<b>114,550</b>	<b>0</b>	<b>25.89</b>
Class A	3,349,818	24.3	43.2	226,845	28,967	93,704	0	27.46
Class B	1,659,106	20.7	40.5	28,730	123,719	20,846	0	22.27
<b>Westchase Total</b>	<b>14,897,289</b>	<b>21.8</b>	<b>31.3</b>	<b>-14,615</b>	<b>-155,357</b>	<b>134,493</b>	<b>187,011</b>	<b>28.83</b>
Class A	8,603,019	27.7	36.2	21,476	-108,530	81,359	187,011	34.81
Class B	6,051,303	13.8	24.9	-36,091	-43,260	53,134	0	19.00
<b>Woodlands/Conroe Total</b>	<b>12,592,462</b>	<b>17.7</b>	<b>19.2</b>	<b>35,143</b>	<b>201,570</b>	<b>153,247</b>	<b>326,800</b>	<b>29.69</b>
Class A	5,934,066	24.7	24.3	31,484	242,527	59,258	326,800	35.85
Class B	5,814,632	12.0	15.0	-2,406	-34,594	92,139	0	25.38
<b>Suburban Total</b>	<b>189,825,737</b>	<b>20.4</b>	<b>25.6</b>	<b>-484,887</b>	<b>-1,389,942</b>	<b>1,736,032</b>	<b>1,533,091</b>	<b>25.74</b>
Class A	90,856,442	24.5	29.8	92,333	-525,726	741,141	1,309,437	30.73
Class B	82,771,708	17.8	23.0	-517,130	-746,335	918,375	223,654	20.71



# MARKET OVERVIEW

## Houston Office Submarkets



Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy.

HOUSTON OFFICE | Q3 2017

# Quarterly Market Report

OCTOBER 2017

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HOUSTON OFFICE | Q2 2017

# Quarterly Market Report

JULY 2017

## EXECUTIVE SUMMARY

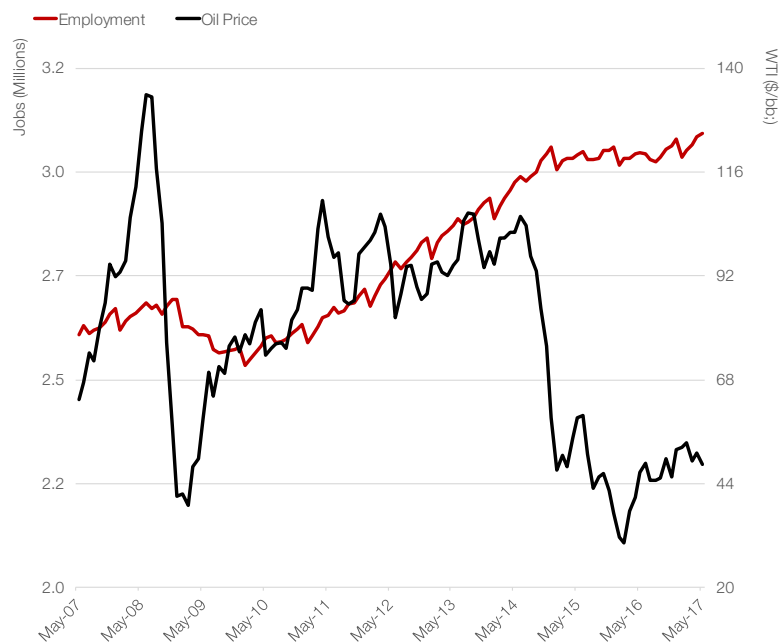
### Office market will be longest to rebound

Houston's office market has been affected by the oil decline more than other sectors in real estate, and will be the lengthiest to rebound. Houston's overall vacancy rate rose to 20.5% in Q2 2017, an increase of 40 basis points quarter-over-quarter and 260 basis points year-over-year. Net absorption remained in the red at negative 532,205 sq. ft. as of the quarter's end, adding up to 1.3 million sq. ft. of negative absorption year-to-date. Currently, overall occupancy in the Houston office market continues to drop, sitting at 79.5%, the lowest level since NAI Partners began tracking occupancy in early 1999. Both Houston citywide overall rent and leasing activity are up marginally from last quarter, but remain significantly down from a year ago. However, despite the market slowdown, available sublease space continues to ease down slightly, and the amount of space in the construction pipeline has declined by 60.0% year-over-year.

### Economy continues to grow despite low oil prices

Overall, the outlook for Houston is hopeful about the future. May data were varied for the Houston metro area. The business-cycle index continued to indicate a modest expansion. Labor market data suggested job growth, improvement in the energy sector and low fuel prices helped consumers. Houston's unemployment rate was 5.1% in May, down from 5.4% in April and below its year-to-date average of 5.5%. Other positive indicators are the Houston Purchasing Managers Index, which registered at 54.1 in May, signaling economic expansion in metro Houston for the eighth consecutive month, and the Baker Hughes U.S. Rig Count, which rose for the 23rd straight week totaling 941 rigs. Conversely, increasing costs and moderate oil prices may soften the course of the rig count. The recent forecast by the Energy Information Administration estimated oil (WTI) will average \$51 in 2017 and \$55 in 2018, while market experts state the industry needs \$60 to \$65 per barrel oil for sustained growth and success.

## Employment & Oil Prices



## Market Indicators

	Current Q2 2017	Prior Quarter Q1 2017	Year Ago Q2 2016
Vacancy w/Sublease	20.5%	20.1% ↑	17.9% ↑
Direct	18.2%	18.0% ↑	16.0% ↑
Availability w/Sublease	26.2%	25.7% ↑	24.5% ↑
Direct	21.8%	21.4% ↑	20.0% ↑
Net Absorption (SF)	-532,205	-809,215 ↑	152,635 ↓
Leasing Activity (SF)	2,733,871	2,699,945 ↑	3,696,330 ↓
Construction (SF)	2,508,163	1,912,570 ↑	4,243,764 ↓
Deliveries (SF)	254,796	1,721,132 ↓	1,319,914 ↓
Gross Avg Asking Rent	\$28.00	\$27.91 ↑	\$28.22 ↓
Inventory (SF)	228,155,352	227,900,556 ↑	224,562,676 ↑

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# Broker's Perspective

While both overall rents and leasing activity have risen slightly, the Houston office market continued at a slower pace than we have been accustomed to through the second quarter of 2017. While Houston has made significant strides in diversifying its economy, the city's fortunes remain primarily driven by activity in the energy sector. With that in mind, I predict Houston will stay entrenched as a tenant's market until commodities pricing not only stabilizes but increases.

On the availability front, sublease space still dominates the conversation between clients and real estate professionals alike. Larger blocks of sublease space are either sitting vacant or are being pulled off of the market altogether, with one or two exceptions. Conversely, smaller spaces, those less than 20,000 SF with remaining term on their leases seem to be attracting the most of amount of activity.

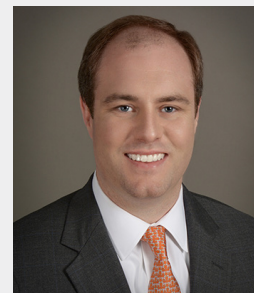
As far as direct leasing is concerned, most tenants are looking for a Class A building at Class B pricing, coupled with a healthy concession package. While those opportunities do exist, options can be limited and tenants need to be comfortable with looking toward the Energy Corridor. However, there are recent instances where tenants have chosen to upgrade without the appearance of cost-saving, underscored by two new Class A buildings in the CBD with strong direct leasing activity: at 609 Main, multiple professional services firms; and owner Hines itself—have chosen to follow United Airlines lead and lease space in the new tower. Additionally, Bank of America announced it will be relocating from its current namesake tower at 700 Louisiana to Skanska's new development located at 800 Capitol Street, where the bank has entered into a long-term lease for 210,000 sq. ft. Again, it's worth noting that these tenants were already in Class A product and are moving into newer, more sophisticated Class A product, along with the price tag that this kind of space carries. It will be interesting to see how the older CBD Class A space fares with the addition of these new buildings.

For the market as a whole unfortunately, early optimism about a full-scale market recovery in 2017 appears to be wishful thinking.

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**“I predict Houston will stay entrenched as a tenant's market until commodities pricing not only stabilizes but increases.”**

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**Taylor Wright**

Vice President  
NAI Partners

## MARKET OVERVIEW

### Heavy supply and slow demand pushing vacancy up

The overall availability rate, which measures the total amount of space being marketed for lease, rose to 26.2%, an increase of 50 basis points from the 25.7% rate it was at during the previous quarter. Available sublease space has dipped from a peak of 12.0 million sq. ft. as of third quarter 2016, down to 11.5 million sq. ft. at the end of 2016 and now staying around 11.0 million sq. ft. as of second quarter 2017. However, as we begin to see a spark of hope, the downside will be in the form of direct vacancy, with more than 2.0 million sq. ft. to be returned to landlords during the next 24 months. Of the 2.0 million sq. ft. of sublease space, 1.3 million sq. ft. is Class A space. On average, these owners of Class A direct space are now asking \$33.94 per sq. ft., compared with \$18.17 for similar sublet space. Tenants willing to sublet can get a substantial discount, sometimes in the same building.

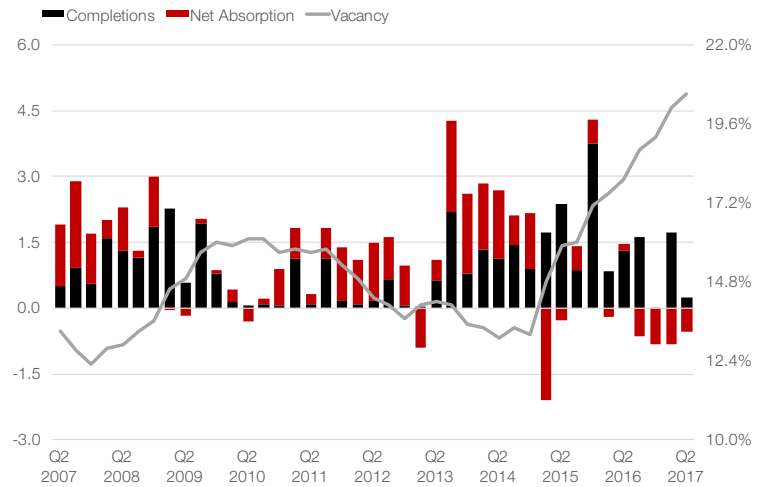
### Net absorption still negative

Houston ended the second quarter of 2017 with negative 532,205 sq. ft. of net absorption. Direct space represented negative 318,215 sq. ft. of that total, and sublease space was responsible for negative 245,166 sq. ft. This marks the fourth consecutive quarter of negative absorption. BHP Billiton, the second-largest employer in the Galleria/Uptown area according to the HBJ 2017 Largest Employers List, moved into its new 593,850-sq.-ft. tower at 1500 Post Oak Blvd. during the quarter. BHP migrated from 1360 Post Oak—also in the Four Oaks Place complex—placing 320,349 sq. ft. of sublease space on the market. Demand is measured by the change in occupied space, and given recent signs of a bottom in the oil industry and as new deliveries decline, net absorption will likely continue its current track throughout 2017, although at a less marked rate than in the last few years.

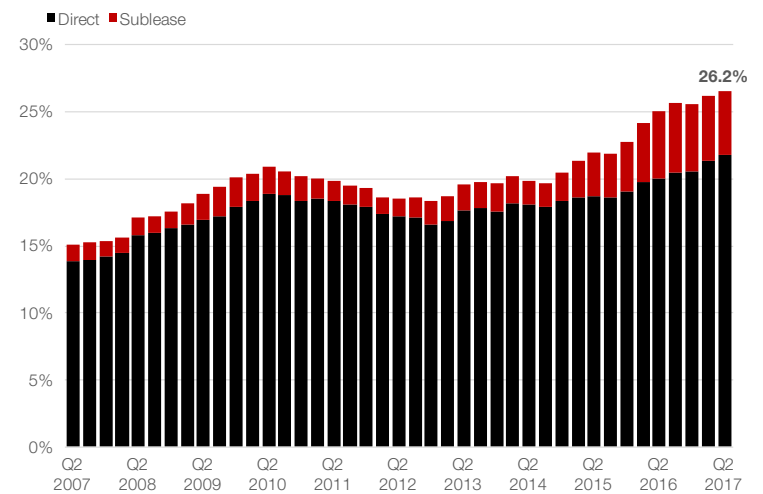
### Construction pipeline grew with start of Capitol Tower

There is currently about 2.5 million sq. ft. under construction in the Houston office market, with about half of that space available for lease. Construction is up from last quarter, in part as New York-based Skanska USA Commercial Development announced in April it will begin building Capitol Tower, the 35-story, 778,000-sq. ft. building located in the CBD, now that it has an anchor tenant. The foundation was poured at the Capitol Tower site in August 2015, but construction was halted waiting for improved market conditions and leasing commitments. Bank of America inked a deal for nearly 210,000 sq. ft., helping to get the construction started again (and also acquiring naming rights for the building). The tower is expected to take two years to

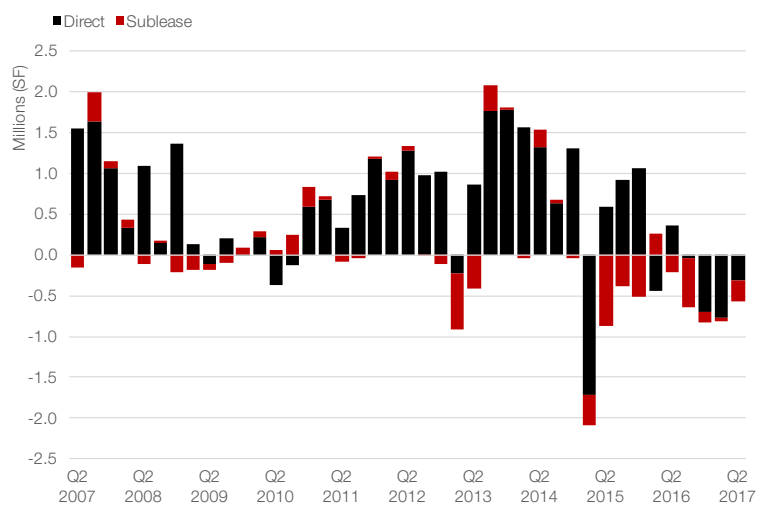
### Supply & Demand



### Availability Rates



### Net Absorption





build, with completion projected for the second quarter of 2019. The tower will be on the site of the former Houston Club Building at 811 Rusk St., which was demolished in October 2014. Buildings underway with more than 100,000 sq. ft. of available space include 3200 Kirby, a 13-story, 200,000-sq.-ft. Class A office building that is part of the Kirby Collection mixed-use development in River Oaks scheduled to deliver in the summer of 2017; and The Post Oak at 1600 West Loop South, a 38-story mixed-use tower, with more than 100,000 sq. ft. of boutique office space in the Galleria/Uptown area, scheduled to deliver in the Fall of 2017.

**Encouraging investment sales and steady leasing activity**

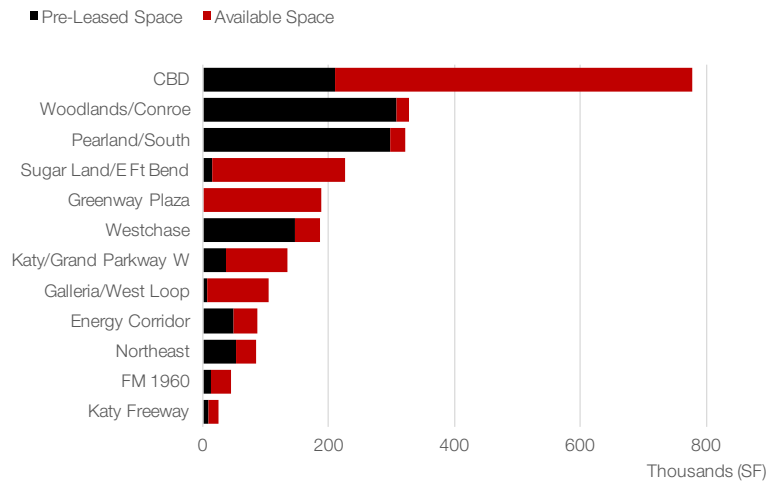
A recent \$1.2 billion deal substantiates The Bayou City’s buoyancy albeit an unsure energy industry. The Canada Pension Plan Investment Board is buying Houston-based Parkway, the owner of widely recognized Greenway Plaza. Parkway’s portfolio also includes Phoenix Tower in the Greenway Plaza submarket and CityWest Place in Westchase, in addition to Post Oak Central and San Felipe Plaza in the Galleria/West Loop area. The major tenants in Parkway’s buildings include Apache Corp., Invesco Management Group, Occidental Oil & Gas Corp., Statoil Gulf Services, and Transocean Offshore Deepwater Drilling.

Leasing activity has remained steady during the second quarter with a total of 2.7 million sq. ft. leased in the overall Houston market. Direct space fulfilled 2.4 million sq. ft., while sublease space realized about 300,000 sq. ft. These amounts are almost unchanged quarter-over-quarter, although year-over-year leasing activity is down notably from 4.1 million sq. ft. Significant tenants that signed lease agreements this quarter include Bank of America, with 210,000 sq. ft. at 800 Capitol St. in the CBD; Archrock, with 73,128 sq. ft. at 9807 Katy Freeway; and Siemens taking 29,361 sq. ft. of space at 15375 Memorial Drive. The two submarkets with the most leasing activity this quarter were the Galleria area at over 630,000 sq. ft., or 23%; and the CBD at almost 525,000 sq. ft.

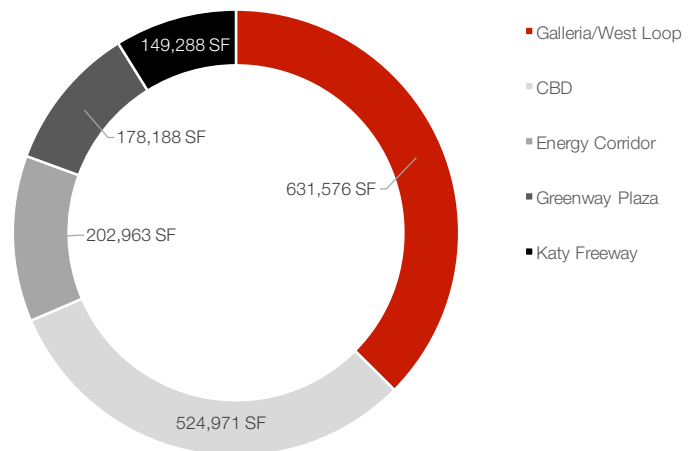
**Average asking rent remained relatively flat**

The market saw overall full-service average rates, fall \$0.09 per sq. ft. quarter-over-quarter to close at \$28.00 per sq. ft. at the end of Q2 2017. Sublease rates dropped at \$20.58 per sq. ft. quarter-over-quarter, compared to Q1 2016 at \$21.18 per sq. ft. A larger decline took place from a year ago when average rates were at \$23.71. While leasing activity remained steady quarter-over-quarter, the year-over-year decline was at 33.8%. Tenants took advantage of 300,000 sq. ft. of quality sublease space at reduced rates during the second quarter of 2017 across the Houston market.

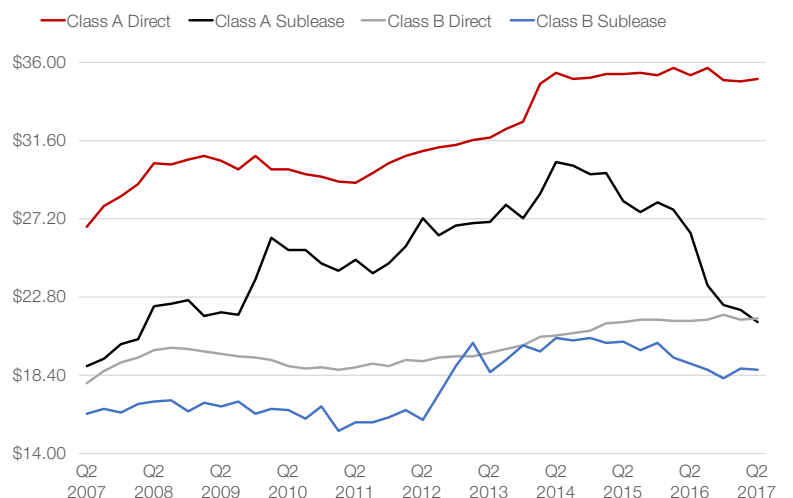
**Construction by Submarket**



**Leasing Activity by Submarket**



**Average Gross Asking Rent**



# MARKET OVERVIEW

## Submarket Stats

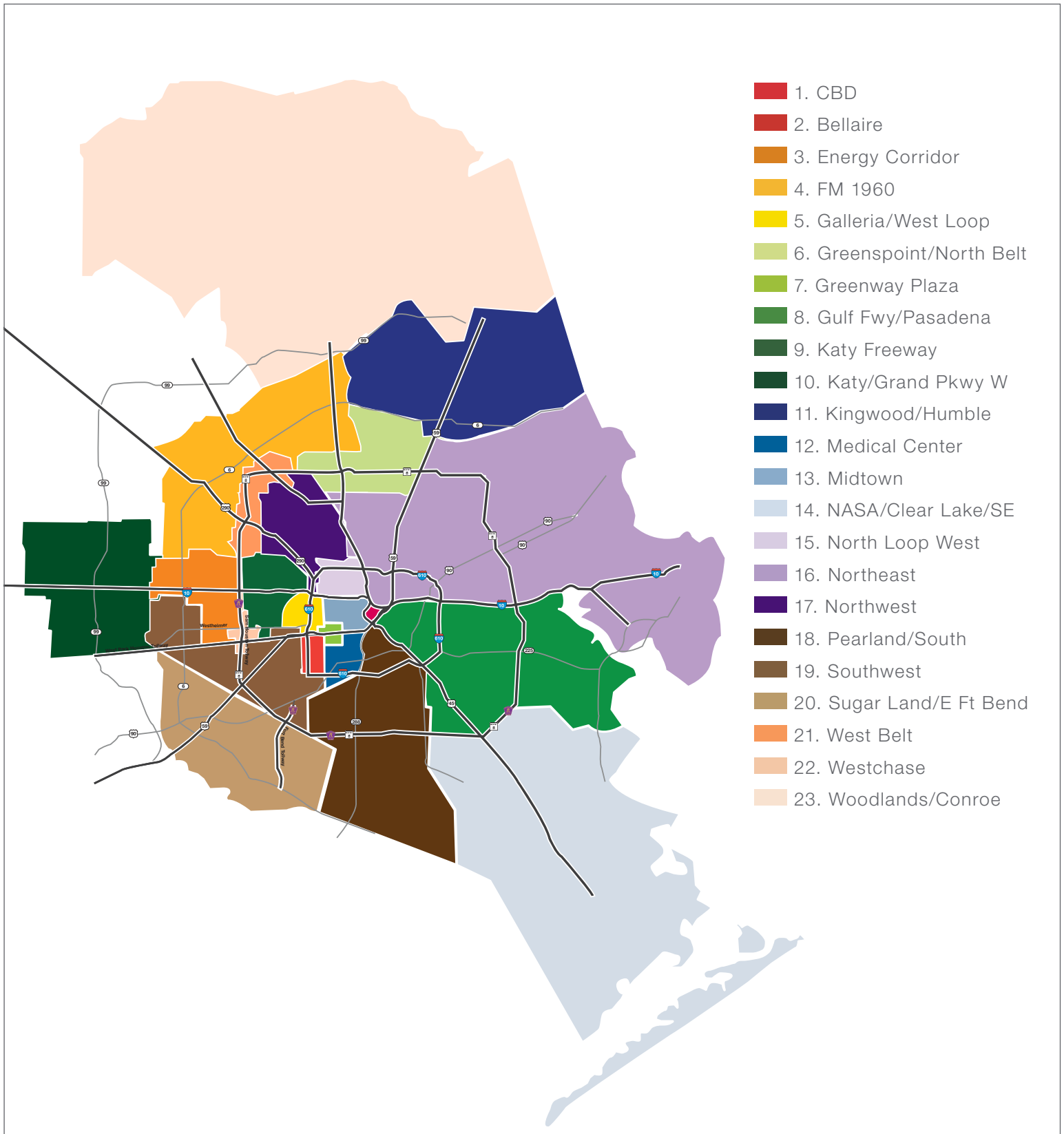
Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Q2 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Total Vacancy (%)	Total Availability (%)	Leasing Activity (SF)	Under Construction (SF)	Overall Avg Asking Rent (\$/PSF)
<b>Houston Market Total</b>	<b>228,155,352</b>	<b>-532,205</b>	<b>-1,341,420</b>	<b>20.5</b>	<b>26.2</b>	<b>2,733,871</b>	<b>2,508,163</b>	<b>28.00</b>
Class A	119,070,029	-841,049	-1,093,523	23.3	29.6	1,798,856	2,197,781	33.42
Class B	91,971,911	353,330	-178,391	18.6	23.9	819,723	310,382	21.39

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Q2 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Total Vacancy (%)	Total Availability (%)	Leasing Activity (SF)	Under Construction (SF)	Overall Avg Asking Rent (\$/PSF)
<b>CBD Total</b>	<b>38,769,338</b>	<b>-171,943</b>	<b>-812,539</b>	<b>22.4</b>	<b>29.9</b>	<b>524,971</b>	<b>778,344</b>	<b>39.92</b>
Class A	28,600,190	-80,748	-559,956	19.9	28.4	460,517	778,344	43.47
Class B	9,445,792	-80,793	-239,690	30.5	35.6	64,454	0	28.46
<b>Bellaire Total</b>	<b>3,512,108</b>	<b>21,965</b>	<b>25,985</b>	<b>11.0</b>	<b>16.9</b>	<b>25,733</b>	<b>0</b>	<b>24.57</b>
Class A	1,470,637	11,481	10,092	12.5	23.4	12,750	0	26.95
Class B	1,590,145	8,419	19,708	10.1	13.1	8,778	0	23.18
<b>Energy Corridor Total</b>	<b>20,472,865</b>	<b>-218,885</b>	<b>-231,267</b>	<b>30.0</b>	<b>37.2</b>	<b>202,963</b>	<b>86,255</b>	<b>28.06</b>
Class A	13,368,288	-237,515	-86,199	32.9	39.2	109,541	86,255	31.58
Class B	6,645,446	15,316	-145,594	25.9	35.1	93,422	0	22.31
<b>FM 1960 Total</b>	<b>10,071,302</b>	<b>23,085</b>	<b>39,574</b>	<b>18.0</b>	<b>21.9</b>	<b>121,945</b>	<b>43,600</b>	<b>20.35</b>
Class A	2,932,453	-37,106	-17,127	17.2	18.3	18,450	0	28.18
Class B	6,124,679	49,490	36,487	19.2	24.8	82,289	43,600	17.88
<b>Galleria/West Loop Total</b>	<b>28,782,864</b>	<b>-314,940</b>	<b>-310,032</b>	<b>19.0</b>	<b>23.6</b>	<b>631,576</b>	<b>104,579</b>	<b>33.42</b>
Class A	19,696,946	-286,164	-278,638	21.6	26.1	531,416	104,579	36.38
Class B	8,990,918	-30,151	-48,060	13.3	18.3	86,212	0	25.54
<b>Greenspoint/North Belt Total</b>	<b>11,793,527</b>	<b>-231,760</b>	<b>-198,084</b>	<b>46.3</b>	<b>53.0</b>	<b>115,987</b>	<b>0</b>	<b>20.17</b>
Class A	5,107,531	-215,920	-110,554	59.7	68.1	62,220	0	23.10
Class B	5,298,185	7,045	-26,116	39.4	45.1	43,314	0	16.68
<b>Greenway Plaza Total</b>	<b>10,616,996</b>	<b>-58,486</b>	<b>-112,521</b>	<b>15.0</b>	<b>21.0</b>	<b>178,188</b>	<b>188,547</b>	<b>33.79</b>
Class A	7,202,397	-46,866	-55,367	16.0	23.2	126,884	188,547	37.04
Class B	2,885,119	-18,287	-56,401	12.8	16.5	44,637	0	26.51
<b>Gulf Fwy/Pasadena Total</b>	<b>3,632,967</b>	<b>46,041</b>	<b>69,488</b>	<b>14.6</b>	<b>20.8</b>	<b>24,849</b>	<b>0</b>	<b>21.98</b>
Class A	22,706	3,122	3,122	0.0	27.7	0	0	21.00
Class B	2,602,457	42,691	59,564	14.7	21.3	17,847	0	22.22
<b>Katy Freeway Total</b>	<b>10,035,439</b>	<b>-53,146</b>	<b>18,255</b>	<b>12.3</b>	<b>14.7</b>	<b>149,288</b>	<b>25,000</b>	<b>26.56</b>
Class A	5,761,894	-35,359	35,918	14.3	14.9	131,854	25,000	38.47
Class B	2,809,778	-6,187	-4,858	11.4	18.8	10,641	0	20.62
<b>Katy/Grand Pkwy W Total</b>	<b>3,235,769</b>	<b>21,738</b>	<b>40,276</b>	<b>20.1</b>	<b>23.6</b>	<b>88,816</b>	<b>135,045</b>	<b>27.06</b>
Class A	1,916,942	17,256	10,820	29.4	30.6	88,816	72,045	27.33
Class B	1,086,393	4,482	28,743	3.9	12.6	0	63,000	28.31
<b>Kingwood/Humble Total</b>	<b>1,481,792</b>	<b>-4,084</b>	<b>-7,356</b>	<b>11.2</b>	<b>12.2</b>	<b>5,795</b>	<b>0</b>	<b>22.29</b>
Class A	189,312	0	0	5.0	5.0	0	0	25.67
Class B	1,095,813	10,379	7,107	9.9	11.3	5,795	0	22.60

Submarket Statistics (Total reflects Class A/B/C)	Total Inventory (SF)	Q2 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Total Vacancy (%)	Total Availability (%)	Leasing Activity (SF)	Under Construction (SF)	Overall Avg Asking Rent (\$/PSF)
<b>Medical Center Total</b>	<b>8,451,955</b>	<b>74,968</b>	<b>34,629</b>	<b>8.7</b>	<b>10.4</b>	<b>56,535</b>	<b>0</b>	<b>28.10</b>
Class A	2,907,001	66,365	-13,597	8.4	10.7	43,427	0	31.70
Class B	4,212,665	16,906	57,129	10.8	11.4	12,542	0	26.14
<b>Midtown Total</b>	<b>5,573,018</b>	<b>65,927</b>	<b>59,163</b>	<b>14.2</b>	<b>20.7</b>	<b>42,027</b>	<b>0</b>	<b>28.60</b>
Class A	2,006,668	27,624	47,345	21.7	37.3	19,252	0	29.50
Class B	2,926,587	42,506	11,218	9.4	11.1	17,908	0	27.87
<b>NASA/Clear Lake/SE Total</b>	<b>8,487,735</b>	<b>-12,934</b>	<b>-57,379</b>	<b>18.2</b>	<b>23.6</b>	<b>45,336</b>	<b>0</b>	<b>19.51</b>
Class A	2,046,499	-17,569	-21,778	11.3	16.9	1,416	0	27.04
Class B	5,321,939	10,033	-38,783	22.5	26.0	32,923	0	18.29
<b>North Loop West Total</b>	<b>4,495,237</b>	<b>15,676</b>	<b>-68,291</b>	<b>18.4</b>	<b>20.6</b>	<b>47,953</b>	<b>0</b>	<b>23.65</b>
Class A	1,188,544	-9,566	-38,768	31.8	32.1	6,745	0	26.22
Class B	2,797,713	23,134	-9,578	14.6	17.0	37,589	0	21.98
<b>Northeast Total</b>	<b>2,385,521</b>	<b>-4,363</b>	<b>19,926</b>	<b>11.4</b>	<b>15.7</b>	<b>13,028</b>	<b>85,000</b>	<b>18.87</b>
Class A	36,400	0	0	0.0	27.2	0	85,000	0.00
Class B	1,518,370	3,133	27,422	15.6	18.9	13,028	0	18.51
<b>Northwest Total</b>	<b>3,933,300</b>	<b>26,800</b>	<b>19,074</b>	<b>20.2</b>	<b>23.8</b>	<b>30,493</b>	<b>0</b>	<b>17.04</b>
Class A	797,237	13,535	11,420	41.1	43.2	12,247	0	18.86
Class B	2,277,443	5,841	-3,797	17.7	23.1	15,324	0	16.25
<b>Pearland/South Total</b>	<b>1,450,140</b>	<b>13,860</b>	<b>15,570</b>	<b>12.4</b>	<b>12.6</b>	<b>8,815</b>	<b>322,183</b>	<b>27.77</b>
Class A	393,548	9,702	9,702	9.3	8.1	4,472	250,000	28.10
Class B	807,330	4,158	3,805	11.7	13.7	4,343	72,183	27.79
<b>Southwest Total</b>	<b>11,883,775</b>	<b>86,160</b>	<b>27,675</b>	<b>15.7</b>	<b>22.7</b>	<b>76,233</b>	<b>0</b>	<b>17.21</b>
Class A	2,052,051	-8,804	-1,346	13.7	27.6	725	0	19.11
Class B	7,297,324	88,059	12,203	19.4	26.0	57,730	0	16.98
<b>Sugar Land/E Ft Bend</b>	<b>6,555,017</b>	<b>-4,867</b>	<b>3,380</b>	<b>12.0</b>	<b>16.5</b>	<b>69,642</b>	<b>225,799</b>	<b>26.75</b>
Class A	3,488,331	-31,320	-29,469	10.8	14.9	11,681	94,200	28.35
Class B	2,791,968	26,453	32,849	12.8	18.0	57,961	131,599	25.31
<b>West Belt Total</b>	<b>5,094,034</b>	<b>46,704</b>	<b>8,258</b>	<b>25.6</b>	<b>38.1</b>	<b>46,515</b>	<b>0</b>	<b>25.65</b>
Class A	3,349,387	-45,896	-88,915	27.8	43.3	36,645	0	27.85
Class B	1,657,018	92,600	97,173	22.3	29.7	9,870	0	20.37
<b>Westchase Total</b>	<b>14,818,839</b>	<b>-32,251</b>	<b>-128,376</b>	<b>21.8</b>	<b>30.6</b>	<b>95,780</b>	<b>187,011</b>	<b>29.06</b>
Class A	8,603,019	-33,956	-134,071	28.0	36.4	34,408	187,011	34.96
Class B	5,972,853	4,526	6,321	13.3	22.9	61,372	0	19.25
<b>Woodlands/Conroe Total</b>	<b>12,621,814</b>	<b>132,530</b>	<b>203,172</b>	<b>17.7</b>	<b>20.4</b>	<b>131,403</b>	<b>326,800</b>	<b>29.95</b>
Class A	5,932,048	96,655	213,843	25.2	26.0	85,390	326,800	35.96
Class B	5,815,976	33,577	-5,243	11.5	15.8	41,744	0	25.19
<b>Suburban Total</b>	<b>189,386,014</b>	<b>-360,262</b>	<b>-528,881</b>	<b>20.1</b>	<b>25.4</b>	<b>2,208,900</b>	<b>1,729,819</b>	<b>25.81</b>
Class A	90,469,839	-760,301	-533,567	24.4	30.0	1,338,339	1,419,437	30.70
Class B	82,526,119	434,123	61,299	17.2	22.6	755,269	310,382	20.74

# MARKET OVERVIEW

## Houston Office Submarkets



Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy.

HOUSTON OFFICE | Q2 2017

# Quarterly Market Report

JULY 2017

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HOUSTON OFFICE | Q1 2017

# Quarterly Market Report

APRIL 2017

## EXECUTIVE SUMMARY

### Office Market

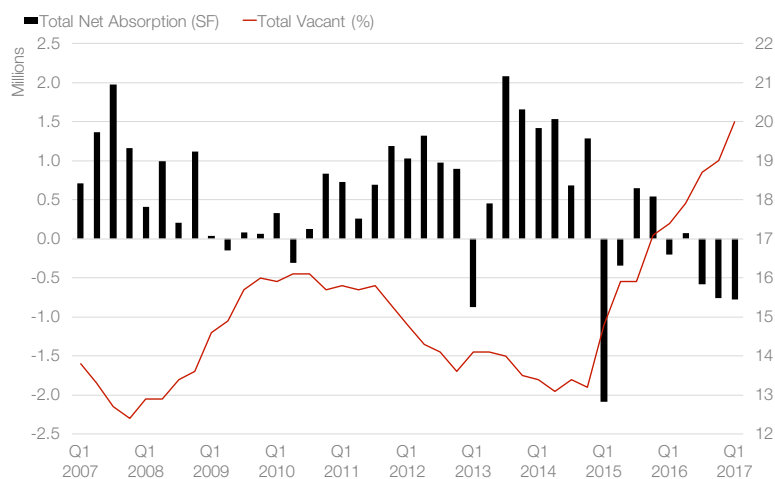
Have we reached the bottom of the office market in Houston? While many seem to be in agreement that the worst is now behind us, the city is still very much in an office market slump. Houston's overall vacancy rate rose to 20.0% in Q1 2017, an increase of 100 basis points quarter-over-quarter and 260 basis points year-over-year. Net absorption stood at negative 778,758 sq. ft. as of the quarter's end—on the heels of the more than 1.4 million sq. ft. of negative absorption for full-year 2016. In addition, both Houston citywide overall rent and leasing activity are down from last quarter, as well as from Q1 2016. However, despite some market sluggishness, available sublease space is down 3.5%, and the amount of space in the construction pipeline has declined by 40.0%, quarter-over-quarter.

### Houston Economy

The Houston metro area reported 125,005 new residents from July 1, 2015 to July 1, 2016, and Houston ranks fifth in the 10 most populous metro areas in the country. Houston job growth increased by 6,200, with Government (led by colleges and school districts) and Professional and Business Services responsible for the lion's share. Trade, Transportation, and Utilities had the largest drop. All told, the unemployment rate ticked up to 5.9%. The Greater Houston Partnership forecasts one more soft year in 2017, albeit with an encouraging job forecast of adding 30,000 new jobs. More than 7,300 of that total are expected to come from the Professional and Business Services supersector, and 2,200 in Financial Activities.

Other positive indicators are the Houston Purchasing Managers Index, which came in at 54.2 in February, signaling economic expansion in metro Houston for the fifth consecutive month; the closely tracked Baker Hughes U.S. Rig Count at 809 rigs; and the NYMEX WTI Spot Prices, closing at \$47.97/barrel. Although 2017 may not be an exceptional year for the Houston-area economy, it should be a boost on the path back to robust growth.

### Supply & Demand



### Market Indicators

	Current Q1 2017	Prior Quarter Q4 2016	Year Ago Q1 2016
<b>Net Absorption (sq. ft.) Total</b>	-778,758	-757,954	-198,686
Direct	-936,272	-625,127	-453,852
Sublease	157,514	-132,827	255,166
<b>Leasing Activity (sq. ft.) Total</b>	2,201,661	3,368,283	3,215,348
Direct	1,865,930	2,860,440	2,786,789
Sublease	335,731	507,843	428,559
<b>Availability w/Sublease (%) Total</b>	25.7	25.0	23.6
Direct	21.3	20.6	19.7
<b>Vacancy w/Sublease (%) Total</b>	20.0	19.0	17.4
Direct	17.9	16.8	15.5
<b>Avg Asking Rent (\$) Total</b>	27.76	27.83	28.58
Direct	28.55	28.66	28.93
Sublease	21.06	21.06	25.17
<b>Construction (sq. ft.)</b>	1,992,053	3,362,657	5,088,489
<b>Deliveries (sq. ft.)</b>	1,721,132	0	670,025
<b>Inventory (sq. ft.)</b>	228,097,918	226,376,786	223,443,265



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# Broker's Perspective

In the first quarter of 2017, the Houston office showed some encouraging signs as it began to lift itself out of the soft environment that has lingered in many of its submarkets. During the two years prior to 2017, we witnessed an onslaught of sublease space being added to the market, totaling more than 12 million sq. ft. Today, we are on our way down from that mark and closing in on 11.1 million sq. ft. citywide. This is due in part to the rising rig counts (nearly double that of Q1 2016), rising oil prices, other non-energy related industry growth, and natural lease expirations.

While I won't go so far as to forecast what I think will happen going forward, by recognizing trends in the market one can position oneself to take advantage when opportunity arises. Market indicators such as sublease availability, vacancy rates, and absorption rates are all critical data points when evaluating the future strength of the office market. Looking at the trends seen in 2016 and thus far in Q1 2017, I feel comfortable saying the market softening has "bottomed out." Tenants in the market for space now or over the next few years can take advantage of landlords taking an increasingly aggressive approach when vying for prospective tenants. These aggressive incentives often come in the form of rental rate reductions, large concession packages, additional free rent periods, free parking, and greater building amenities.

As the trend continues for tenants to take on new or additional space, or renegotiate existing leases, the market will once again shift back to favor landlords. A very realistic prediction of when this shift might happen is over the next 14 to 18 months (think Q2 to Q4 2018). This begs the question: why do many companies only seem to renew on high points? Based on where we are in the current market cycle—the Houston commercial real estate market historically operates in seven- to eight-year cycles—office tenants today have tremendous negotiating leverage. To that end, on average we are now seeing longer lease terms signed, even for smaller companies, who wish to capture the favorable market terms for as long as possible. Timing, as they say, is everything.

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**“Tenants in the market for space now or over the next few years can take advantage of landlords taking an increasingly aggressive approach.”**

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**Matt Gaby**

Associate Broker  
NAI Partners

## MARKET OVERVIEW

### Net Absorption

Houston ended the first quarter of 2017 with negative 778,758 sq. ft. of net absorption. Direct space represented negative 936,272 sq. ft. of that total, and sublease space was responsible for positive 157,514 sq. ft.

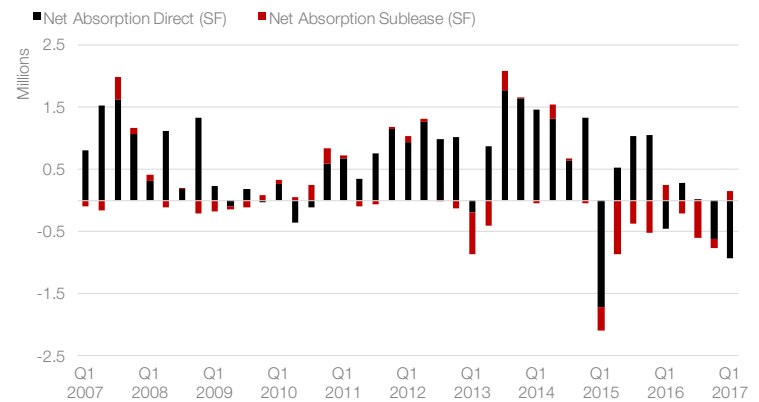
Largely contributing to the direct negative absorption was Freeport-McMorran's 355,908 sq. ft. of sublease space at 717 Texas Avenue that was released prior to the August 2018 term date, moving it over to direct space. In addition, 500 Jefferson had approximately 277,424 sq. ft. of sublease space with a lease expiration date of 2030 that was dropped when the property was recently sold, adding to the amount of direct space available. Also, 92,637 sq. ft. of direct space at 1401 McKinney became vacant in Q1, resulting in additional negative absorption.

### Availability and Vacancy

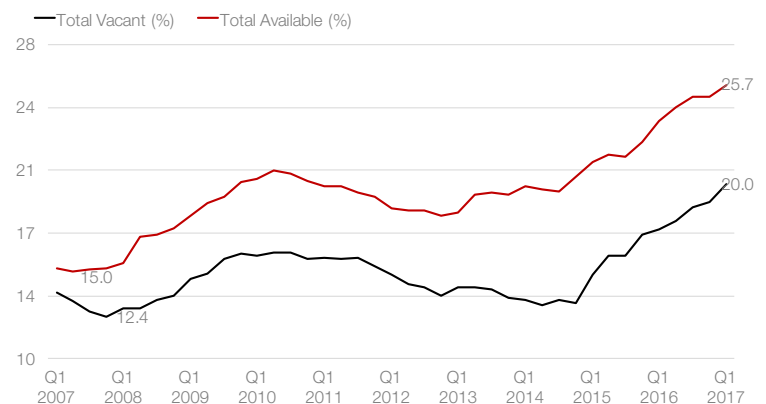
The overall availability rate, which measures the total amount of space being marketed for lease, rose to 25.7%, an increase of 70 basis points from the previous quarter's 25.0%. Available sublease space has dipped from a peak of 12.0 million sq. ft. in Q3 2016 to 11.5 million sq. ft. at the end of 2016 and now settling at 11.1 million sq. ft. as of the first quarter of 2017. Before 2014, available sublease space in Houston had been averaging about 3.3 million sq. ft. Since the oil downturn began to manifest in the office market in 2014, available sublease space in Houston has more than tripled. With everything considered, the sublease market seems to be have reached its bottom; however, there is more than 4.5 million sq. ft. of sublease space that will be returned to landlords in the form of direct space through 2019. The large sublease market is a critical element in regaining positive momentum and could be viewed as beneficial as the big blocks become more competitive.

The five largest blocks of contiguous sublease space currently available are 820,853 sq. ft. in One Shell Plaza; 510,502 sq. ft. in Two Allen Center (both in the CBD); 378,209 sq. ft. in West Memorial Plaza; 370,397 sq. ft. in Three WestLake Park; and 534,098 sq. ft. in Four WestLake Park (each in the Energy Corridor).

### Net Absorption Direct vs Sublease



### Historical Vacancy & Availability



### Select Sale & Lease Transactions

Sale/Buyer	Building/Address	SF	Submarket
<b>Spears Street Capital</b>	5 Houston Center Energy Center 1 515 Post Oak Blvd.	1,187,458	Houston
<b>Spears Street Capital</b>	3120 Buffalo Speedway 3401 W. Alabama St.	450,000	Greenway Plaza
<b>Jefferson Smith LLC</b>	500 Jefferson St. Jefferson Towers at Cullen Center	390,479	CBD
<b>KRM Properties</b>	13101 & 13105 NW Fwy Northwest Crossing I & III	382,726	Northwest

Lease/Tenant	Building/Address	Type/Deal	SF	Submarket
<b>HP</b>	City Place Drive- Springwoods Village	Direct/New	378,000	Woodlands
<b>Targa Resources</b>	811 Louisiana St.	Direct/New	127,734	CBD
<b>Crestwood Partners</b>	811 Main St.	Sublease/ New	54,215	CBD
<b>IHS, Inc.</b>	1401 Enclave Pky	Direct/New	44,846	Energy Corridor

## MARKET OVERVIEW

### Asking Rent

The market saw overall full-service average asking rates, which include real estate taxes, insurance, maintenance and any fees typically included in a lease agreement, fall \$0.07 per sq. ft. quarter-over-quarter to finish at \$27.76 per sq. ft. at the end of Q1 2017. Sublease rates remained steady at \$21.06 per sq. ft. quarter-over-quarter, although they were down 16.3% from a year ago when average asking rates were at \$25.17. The difference between quoted and negotiated rates remains substantial and makes a significant difference in lease negotiations. While leasing activity slowed by 34.6% quarter-over-quarter and 31.5% year-over-year, tenants took advantage of quality sublease space at bargain rates.

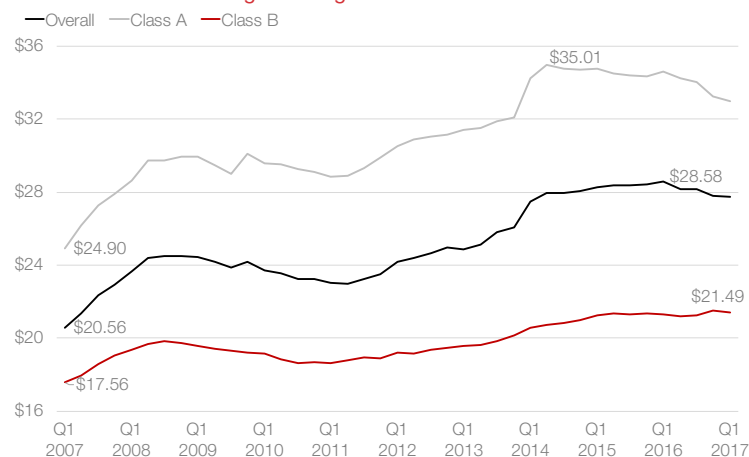
### Construction & Deliveries

There is currently about 2.0 million sq. ft. under construction in the Houston office market, with about half of that space available for lease. Buildings underway with more than 100,000 sq. ft. of available space include 3200 Kirby, a 13-story, 200,000-sq.-ft. Class A office building that is part of the Kirby Collection mixed-use development in River Oaks scheduled to deliver in the summer of 2017; One Grand Crossing, a three-story, 170,000-sq.-ft. Class A office building at the southwest corner of I-10 and Grand Parkway planned for completion in early 2018; and The Post Oak at 1600 West Loop South, a 38-story mixed-use tower, with more than 100,000 sq. ft. of boutique office space in the Galleria/Uptown area, scheduled to deliver in the Fall of 2017. Currently, overall occupancy in the Houston office market is at 80.0%, the lowest level since NAI Partners began tracking occupancy in early 1999.

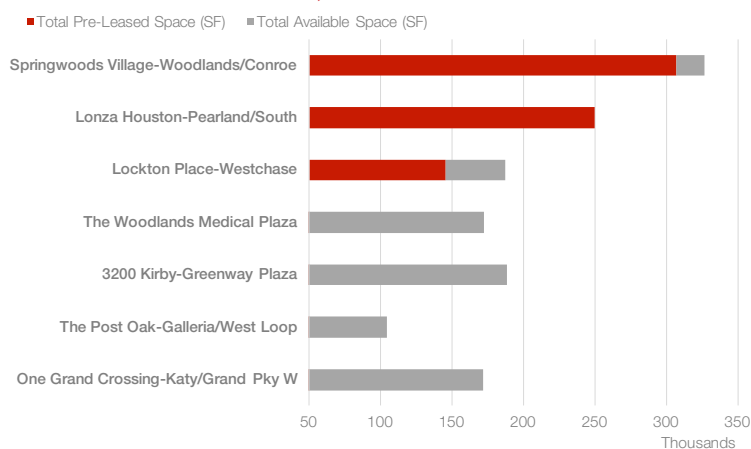
### Leasing Activity

As leasing activity has slowed, a total of 2.2 million sq. ft. was leased in the overall Houston market during Q1 2017. Class A space fulfilled 1.2 million sq. ft., while Class B space realized about 917,000 sq. ft. Overall activity was down quarter-over-quarter from 3.4 million sq. ft., and year-over-year from 3.2 million sq. ft. The average sq. ft. leased per quarter over the last ten years is approximately 4.4 million sq. ft. Notable tenants that signed lease agreements this year include HP, with 378,000 sq. ft. at City Place Drive in The Woodlands; Targa Resources, with 127,734 sq. ft. at 811 Louisiana St.; and Crestwood Partners taking 54,215 sq. ft. of sublease space at 811 Main. The latter two transactions occurred in the CBD submarket, where almost 25.0% of all leasing activity took place.

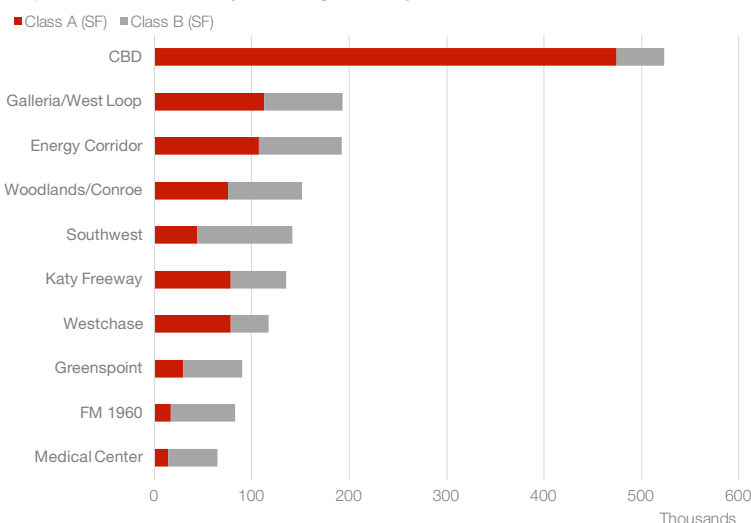
### Historical Gross Average Asking Rent



### Under Construction Over 100,000 SF



### Top 10 Submarkets by Leasing Activity



# MARKET OVERVIEW

## Submarket Stats

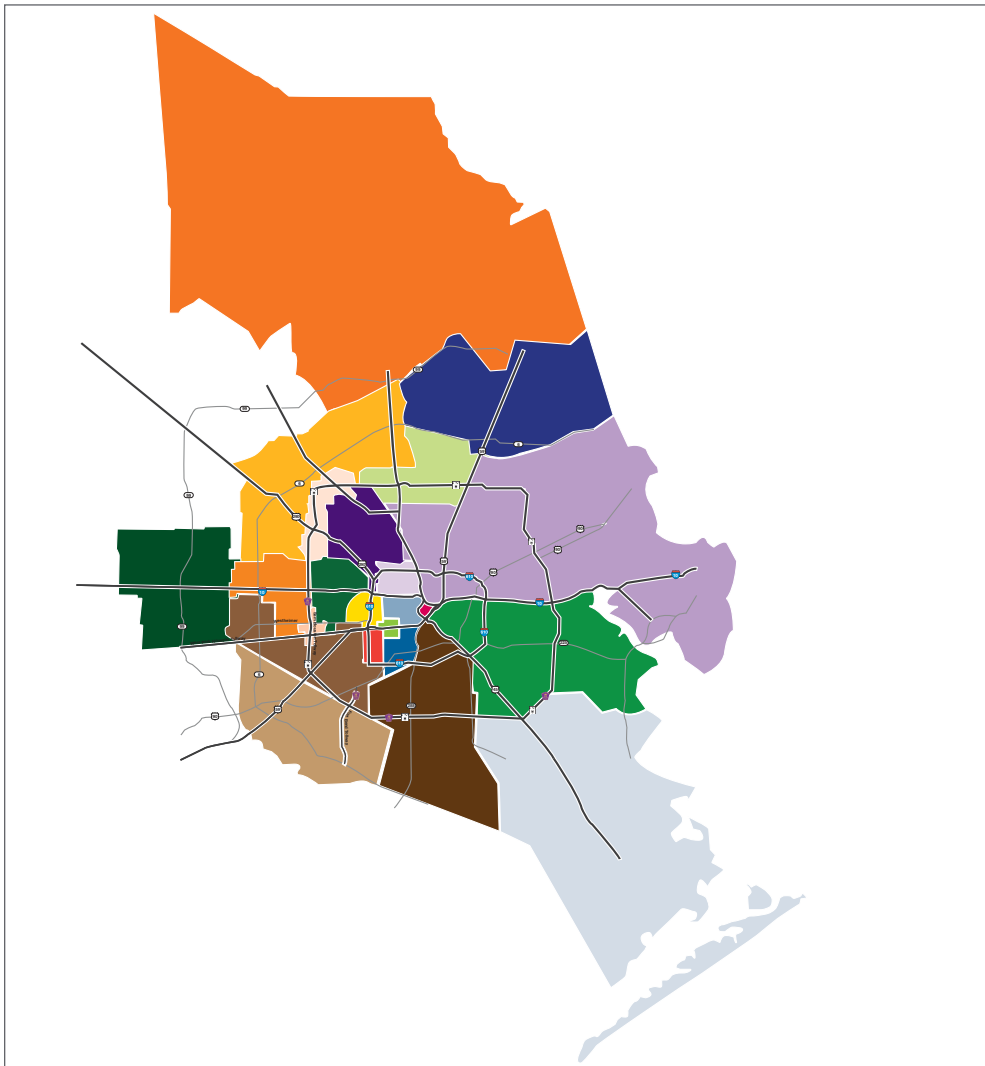
Submarket (Total reflects Class A/B/C)	Total Inventory (SF)	Q1 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Total Vacancy (%)	Total Availability (%)	Leasing Activity (SF)	Under Construction (SF)	Overall Avg Asking Rent (\$/PSF)
<b>CBD Total</b>	39,377,114	-644,093	-644,093	21.5	26.5	523,896	0	40.23
Class A	28,518,493	-447,497	-447,497	19.3	24.5	474,211	0	43.25
Class B	10,135,265	-194,105	-194,105	28.0	32.8	49,085	0	29.69
<b>Bellaire Total</b>	3,512,108	11,064	11,064	11.4	16.3	36,677	0	24.64
Class A	1,470,637	-1,389	-1,389	13.3	21.5	22,519	0	26.92
Class B	1,590,145	18,333	18,333	10.2	13.5	9,493	0	23.45
<b>Energy Corridor Total</b>	20,629,684	-6,042	-6,042	29.1	37.1	193,858	86,255	28.02
Class A	13,438,226	161,712	161,712	30.8	39.2	107,623	86,255	31.10
Class B	6,792,411	-165,503	-165,503	27.2	34.8	84,535	0	22.63
<b>FM 1960 Total</b>	9,314,006	-14,561	-14,561	18.4	22.8	93,951	0	19.28
Class A	2,767,364	17,750	17,750	13.1	15.2	16,903	0	27.82
Class B	5,619,572	-42,265	-42,265	21.6	27.7	66,064	0	17.37
<b>Galleria/West Loop Total</b>	28,852,949	47,524	47,524	17.7	23.3	207,958	104,579	33.33
Class A	19,404,701	47,514	47,514	20.1	26.4	113,019	104,579	36.19
Class B	9,353,248	-11,743	-11,743	12.7	16.8	80,321	0	25.91
<b>Greenspoint/North Belt Total</b>	11,777,896	35,459	35,459	44.0	52.7	88,653	0	20.14
Class A	5,110,988	105,547	105,547	55.6	69.2	29,579	0	22.87
Class B	5,278,216	-31,559	-31,559	38.8	44.0	60,137	0	16.70
<b>Greenway Plaza Total</b>	10,681,917	-31,169	-31,169	14.2	21.1	56,746	188,547	33.52
Class A	7,267,315	14,364	14,364	14.9	22.8	34,866	188,547	36.72
Class B	2,885,122	-38,113	-38,113	12.1	17.7	24,244	0	26.11
<b>Gulf Fwy/Pasadena Total</b>	3,459,496	24,785	24,785	14.2	20.9	67,783	82,800	21.70
Class A	22,706	3,122	3,122	0.0	9.2	0	0	30.59
Class B	2,432,657	17,943	17,943	14.1	21.4	55,653	82,800	22.10
<b>Katy Freeway Total</b>	10,223,637	66,791	66,791	11.6	16.3	139,173	25,000	26.62
Class A	5,761,894	66,667	66,667	13.7	17.8	78,059	25,000	37.97
Class B	2,881,848	1,329	1,329	10.9	18.1	57,704	0	20.43
<b>Katy/Grand Pkwy W Total</b>	3,236,036	18,538	18,538	20.7	28.9	27,018	234,538	27.65
Class A	1,917,209	-6,436	-6,436	30.3	39.0	20,204	171,538	28.09
Class B	1,086,393	24,261	24,261	4.3	12.8	6,000	63,000	27.55
<b>Kingwood/Humble Total</b>	1,510,381	-3,107	-3,107	10.7	11.7	3,429	0	22.31
Class A	189,312	0	0	5.0	5.0	0	0	25.67
Class B	1,124,402	-3,107	-3,107	10.5	11.6	6,117	0	22.63
<b>Medical Center Total</b>	8,495,246	-40,096	-40,096	9.6	11.0	69,610	0	27.34
Class A	2,907,001	-78,929	-78,929	10.6	13.1	14,072	0	29.91
Class B	4,255,956	39,433	39,433	11.1	11.0	50,495	0	26.11



Submarket (Total reflects Class A/B/C)	Total Inventory (SF)	Q1 2017 Net Absorption (SF)	2017 YTD Net Absorption (SF)	Total Vacancy (%)	Total Availability (%)	Leasing Activity (SF)	Under Construction (SF)	Overall Avg Asking Rent (\$/PSF)
<b>Midtown Total</b>	5,573,018	-26,767	-26,767	15.7	21.7	47,396	0	28.57
Class A	1,853,042	5,699	5,699	24.5	40.3	7,157	0	29.30
Class B	3,080,213	-37,269	-37,269	11.2	12.4	40,239	0	28.23
<b>NASA/Clear Lake/SE Total</b>	8,453,144	-45,865	-45,865	17.9	22.7	39,791	0	19.40
Class A	2,046,499	-4,209	-4,209	10.5	15.5	0	0	27.47
Class B	5,261,948	-50,236	-50,236	22.3	25.7	27,262	0	18.16
<b>North Loop West Total</b>	4,454,237	-85,802	-85,802	18.1	18.8	52,855	0	23.57
Class A	1,188,544	-31,428	-31,428	31.2	31.9	19,904	0	25.61
Class B	2,756,713	-32,321	-32,321	14.1	14.2	32,422	0	22.24
<b>Northeast Total</b>	2,437,981	22,212	22,212	15.9	20.2	7,077	85,000	19.19
Class A	36,400	0	0	0.0	26.7	0	85,000	0.00
Class B	1,570,830	22,212	22,212	18.8	23.0	7,077	0	18.77
<b>Northwest Total</b>	3,766,611	-8,272	-8,272	19.0	21.5	22,787	0	17.23
Class A	797,138	-2,115	-2,115	42.8	42.3	12,544	0	18.73
Class B	2,089,780	-10,184	-10,184	14.5	19.2	10,243	0	16.51
<b>Pearland/South Total</b>	1,532,836	1,710	1,710	12.7	13.2	11,103	273,728	24.00
Class A	393,548	0	0	11.8	9.7	0	250,000	27.45
Class B	890,026	-353	-353	11.0	14.0	9,040	23,728	27.06
<b>Southwest Total</b>	11,903,775	-55,368	-55,368	16.2	22.6	158,589	0	17.01
Class A	2,052,051	7,458	7,458	13.2	27.7	43,913	0	18.93
Class B	7,317,324	-69,359	-69,359	20.0	25.8	97,755	0	16.74
<b>Sugar Land/E Ft Bend</b>	6,555,017	26,536	26,536	11.4	16.7	40,687	225,799	26.57
Class A	3,488,331	26,748	26,748	9.2	14.5	11,987	94,200	28.46
Class B	2,791,968	-212	-212	13.3	19.1	28,700	131,599	24.97
<b>West Belt Total</b>	5,062,430	-58,248	-58,248	25.6	39.1	42,573	0	25.69
Class A	3,335,246	-43,019	-43,019	26.6	43.4	42,573	0	27.50
Class B	1,639,555	-15,229	-15,229	25.0	32.4	0	0	20.73
<b>Westchase Total</b>	14,820,965	-83,014	-83,014	21.6	29.6	117,539	187,011	28.92
Class A	8,603,289	-85,723	-85,723	27.5	35.0	78,760	187,011	35.21
Class B	5,974,709	514	514	13.4	22.3	38,779	0	19.20
<b>Woodlands/Conroe Total</b>	12,467,434	69,027	69,027	17.6	21.0	155,445	498,796	29.94
Class A	5,760,052	112,594	112,594	24.7	27.7	75,695	498,796	35.74
Class B	5,836,011	-43,393	-43,393	12.2	15.5	75,546	0	24.77
<b>Suburban Total</b>	188,720,804	-134,665	-134,665	19.7	25.5	1,677,765	1,992,053	25.70
Class A	89,811,493	315,927	315,927	23.2	30.5	729,377	1,690,926	30.43
Class B	82,509,047	-426,821	-426,821	17.5	22.4	867,826	301,127	20.77
<b>Houston Market Total</b>	<b>228,097,918</b>	<b>-778,758</b>	<b>-778,758</b>	<b>20.0</b>	<b>25.7</b>	<b>2,201,661</b>	<b>1,992,053</b>	<b>27.76</b>
Class A	118,329,986	-131,570	-131,570	22.3	29.1	1,203,588	1,690,926	32.97
Class B	92,644,312	-620,926	-620,926	18.7	23.6	916,911	301,127	21.40

# MARKET OVERVIEW

## Houston Office Submarkets



- 1. CBD
- 2. Bellaire
- 3. Energy Corridor
- 4. FM 1960
- 5. Galleria/West Loop
- 6. Greenspoint/North Belt
- 7. Greenway Plaza
- 8. Gulf Fwy/Pasadena
- 9. Katy Freeway
- 10. Katy/Grand Pkwy W
- 11. Kingwood/Humble
- 12. Medical Center
- 13. Midtown
- 14. NASA/Clear Lake/SE
- 15. North Loop West
- 16. Northeast
- 17. Northwest
- 18. Pearland/South
- 19. Southwest
- 20. Sugar Land/E Ft Bend
- 21. West Belt
- 22. Westchase
- 23. Woodlands/Conroe

Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy.

HOUSTON OFFICE | Q1 2017

# Quarterly Market Report

APRIL 2017

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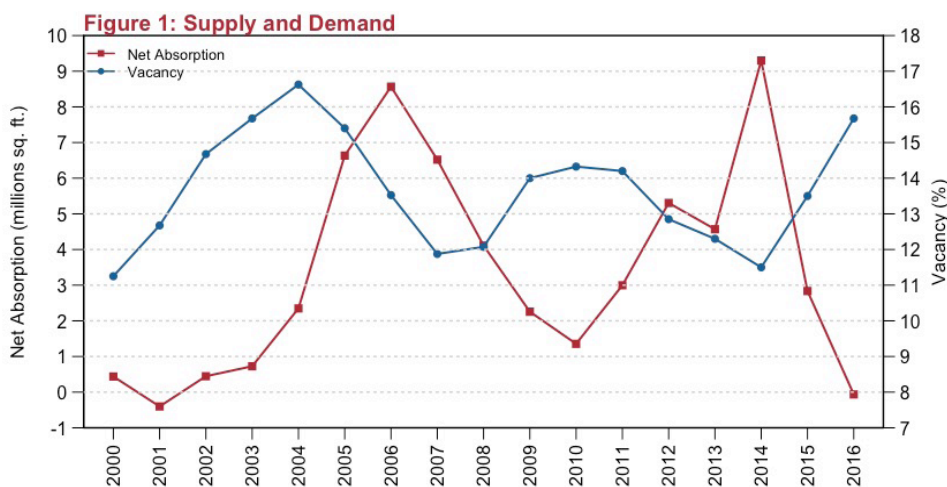


# Economic and Market Outlook:

HOUSTON OFFICE | Q4 2016

**NAI**Partners

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**Table 1. Market indicators for Q4 2016, and their percent (%) change on a quarter-over-quarter (QoQ) and year-over-year (YoY) basis.**

Market Variables	Percent Change over Time Period		
	Q4 2016	QoQ (%)	YoY (%)
Net Absorption (sq. ft.)	-165,140	-48.0 %	-123.5 %
Leasing Activity (sq. ft.)	2,393,880	-40.7 %	-52.6 %
Availability (%)	21.7 %	0.0 %	13.6 %
Vacancy (%)	16.2 %	0.6 %	11.7 %
Deliveries (sq. ft.)	100,714	-94.2 %	-97.6 %
Construction (sq. ft.)	4,086,791	-0.3 %	-50.0 %
Inventory (sq. ft.)	274,405,389	0.0 %	2.0 %
Inventory (No. of Buildings)	4,004	0.3 %	1.9 %

## Executive Summary

### Economy

- The 115th Congress is expected to see new policies and changes in the repeal/replace of Affordable Care Act, corporate and individual tax cuts and reforms, increased infrastructure spending, and trade policy and regulations.
- With increases in oil prices and rig counts, the energy sector has passed its bottom, and national, regional and local signs indicate a positive but bumpy improvement ahead.
- Gross domestic product (GDP) is anticipated to be 1.6% for 2016 and 2.1% for 2017, both slower than the 2.6% measure seen in 2015.
- U.S. employment remains steady in posting 156,000 new jobs in December, for a total of 2.2 million new jobs in 2016 (an average of 180,000 new jobs per month); though still strong, 2017 is anticipated to see a slightly lower 160,000 new jobs per month.
- Houston's economic outlook is expected to shift from negative to a positive outlook in 2017.

### Office Market

- With substantially reduced demand, as measured by negative net absorption and low leasing activity, Houston's office real estate market has likely hit the bottom of the market cycle.
- Q4 2016 posted -165,140 sq. ft. of negative net absorption, a demand for office space that is lower than average historic Q4 performance of 1,292,152 sq. ft.;
- 2016 marked the second lowest year since 2000 with negative net absorption at -65,000.
- Leasing activity of 2,393,880 sq. ft. was less than historic Q4 activity of 4.4 million sq. ft.
- Annual leasing activity of 12.7 million sq. ft. was the third lowest year since 2000.
- Vacancy continued its upward climb, now to 16.2%, with availability at 21.7%.
- The glut in office space is largely driven by the 11.9 million sq. ft. of sublease space, which represents 20% of the available market.
- Construction remains at 4.0 million sq. ft., with new deliveries anticipated in 2017.
- Houston's office market appears to have hit its bottom in 2016, as did the oil downturn and associated impacts on Houston's economy.

## Broker's Perspective

Following two years of a downturn, Houston is beginning to see some initial signs of recovery in the office market, albeit small ones. Perhaps recovery is too strong a term as the numbers show that more so than a full-blown recovery we are actually more confident in saying we have found the bottom. The deluge of sublease space that washed over Houston – particularly in west Houston and the central business district – has finally let up. In fact, the fourth quarter of 2016 was the first quarter in two years where we did not see an increase in sublease space – often cited as a barometer on the overall health of the office market. If rig counts and oil prices are any indication, then large dispositions of office space impacting the market are in all likelihood over (knock on wood).

With that said, the tune we've been humming hasn't changed all that much – we are still very much in an office market "recession," which should be music to the ears of tenants. Landlords are having to claw their way into deals as they are still very much competing with vast amounts of sublease space, more than the market can realistically absorb in the short to mid-term. Even though quoted direct rental rates haven't seen the drastic declines as one would expect given market

conditions, significant economic incentives are still being made for landlords to be competitive. The difference between quoted and negotiated rates remains substantial and other concessions including construction allowances, free rent and free parking can and definitely should move the needle for companies evaluating their current lease.

As it has been for some time now, tenants remain in a favorable position to take advantage of market conditions but the clock is ticking before Houston shifts back to a rising landlord-favored market.



**Alex Taghi**

Vice President  
NAI Partners

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“Landlords are having to claw their way into deals as they are still very much competing with vast amounts of sublease space, more than the market can realistically absorb in the short to mid-term.”

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## ECONOMIC OVERVIEW

**National Economy**

As the 115th Congress began alongside a new president-elect, some new policies and policy changes that may unfold include repealing/replacing the Affordable Care Act, corporate/individual tax cuts and reforms, increased infrastructure spending, and among others trade policy and regulations. Despite a very vibrant political cycle with some clear consequences, Trump's election is not anticipated to influence gross domestic product (GDP) in 2017, which is expected to be about 2.1%. GDP may roll in for 2016 around 1.6%, lagging behind 2.6% in 2015. Proposed tax cuts tend to mostly lead consumers to reduce their debt, rather than increase consumer spending, which accounts for about two-thirds of GDP. Consumer spending did grow by 2.8% in the third quarter of 2016.

Job growth continues to be a strength of the U.S. economy. Employment in December increased by 156,000 new jobs, with particular strengths in health care, hospitality, government and manufacturing. In 2016, there was an average of about 180,000 new jobs added per month, for a total of 2.2 million new jobs and an unemployment rate of 4.7%. Job growth in 2017 is anticipated to slow but remain strong at around 160,000 new jobs per month. Increases in job openings and turnover further suggest a tightening labor market. Nevertheless, with more people entering the labor force, unemployment is expected to drop to 4.5% in 2017. Strong employment and job growth are big contributors to the likely two-to-three interest rate hikes anticipated to occur by the Federal Reserve in 2017. Personal income also rose in every state in Q3 2016.

Core inflation, excluding food and energy, is projected to be about 2.3% in 2017, a modest increase from 2.2% in 2016. However, energy prices are likely to increase modestly in 2017, for an overall 2.5% inflation in 2017, up from 2% in 2016. The question remains as to whether OPEC's cuts will really manifest and if so, how much they will lead to the stabilization and increase in oil prices and the energy sector. Either way the oversupply of production and stored oil

still persists and needs to be burnt off for WTI prices to see substantial shifts upward. The oil markets are likely to remain volatile in 2017, possibly stabilizing some during the latter half of the year.

Business spending was largely flat in 2016, but a modest increase of 3-4% may occur in 2017. Demand for factory-produced goods continues to strengthen after a lengthy lull. The Small Business Optimism Index of the National Federation of Independent Businesses (NFIB) increased substantially by 7.9 points in December and 10.9 points in November, following decreases over the past 12-18 months. Such positive swings indicate an expected stronger economy associated with possible easing of regulations. The ISM manufacturing index rose to 54.7, a two-year high on the heels of increases in production and new orders in December. In December, the ISM non-manufacturing index was unchanged at 57.2.

Indicators such as residential construction suggest that the housing market will strengthen in 2017, despite substantial drops in housing starts in November 2016. Inventory remains low, with more people looking to buy homes than are readily available. With political headwinds in 2016 in both the U.S. and U.K. leading to uncertainty, growth in private nonresidential construction spending is anticipated to be about 7.5% in 2016. The Dodge Momentum Index of non-residential construction increased 2.9% in December after downward revisions for November.

Export prices are expected to increase with the strong value of the dollar, which in turn will produce an anticipated increase in U.S. trade deficit by 4% in 2017. Meanwhile, import prices rose 1.8% in 2016. Though all data are not yet in, it appears that international trade in 2016 will fare better than initially anticipated with the shortfall on par with that of 2015. Retail sales were weaker overall than hoped for in December, marking an increase of 0.6% in December following 0.2% in November (compared to expectations of 0.5%).

**Houston and Texas Economy**

The economies of Texas and Houston

appear to be poised to begin to see some positive changes in 2017, following the bottoming of the oil industry and its economic impacts. However, at both the state and local levels, we are likely to see some continued turbulence as we bounce back from the downturn. Oil prices and rig counts are moving in the right direction as the outlook begins to brighten. The Dallas Fed Energy Survey increased to 40.1 in the fourth quarter from 26.7 in the prior quarter, based on its responses of executives in the industry. Signs of recovery manifested in both employment and production.

Employment in Texas grew 2.1% in the second half of the year, compared to just 0.8% in the first half of the year. Overall, Texas employment will be about 1.5% for 2016, with a forecast of growth near 2.1% for 2017. From December 2014 through November 2016 Houston lost about 70,000 jobs in sectors associated with oil rigs. Of these jobs, 25,000 were from mining and 25,000 were from manufacturing. The outlook is getting better. Houston jobs grew 1.5% from August to November. Job growth remains weak in the oil and oil service fields, but is positive in leisure and hospitality, professional and business services, and trade, transportation, and utilities. Houston's unemployment was 4.6%. Service sector employment in Houston grew at 2.3%, above its average of 2.0% since 2000.

The revenue index of the Texas Service Sector Outlook survey increased from 13.7 in November to 20.6 in December. Retail sales in Texas also increased according to the Texas Retail Outlook Survey, which rose from 6.0 to 19.2. Factory activity in Texas has increased consistently over the past six months, according to the Texas Manufacturing Outlook Survey. The index which measures manufacturing conditions increased to 13.8. The Houston Business Cycle Index contracted from December 2014 to November 2016 an annualized 0.4%, but has grown 1.8% over the past five months.



## MARKET OVERVIEW

### Net Absorption

Demand for office space is measured by net absorption, the change in occupied inventory including direct and sublet space. Figure 2 shows net absorption since 2000 by year and quarter for combined Class A and B office space. The last quarter of 2016 posted -165,140 sq. ft. of negative net absorption. This amount of net absorption in Q4 2016 represents decreases of -48.0% QoQ and -123.5% YoY (Table 1). The historic Q4 average ( $\pm$  95% confidence interval) for net absorption is 1,292,152 sq. ft. ( $\pm$  507,150). We are 95% certain that Q4 net absorption typically falls between 785,002 to 1,799,302 sq. ft. Thus, with the pullback in oil and its impacts on the office market, net absorption in Q4 2016 did decrease significantly from historic Q4 performance. Nevertheless, Q4 brings total net absorption for 2016 to -64,358 sq. ft. of annual negative net absorption for Class A and B office space. This makes 2016 the second lowest year for demand in office space in the past 16 years.

### Leasing Activity

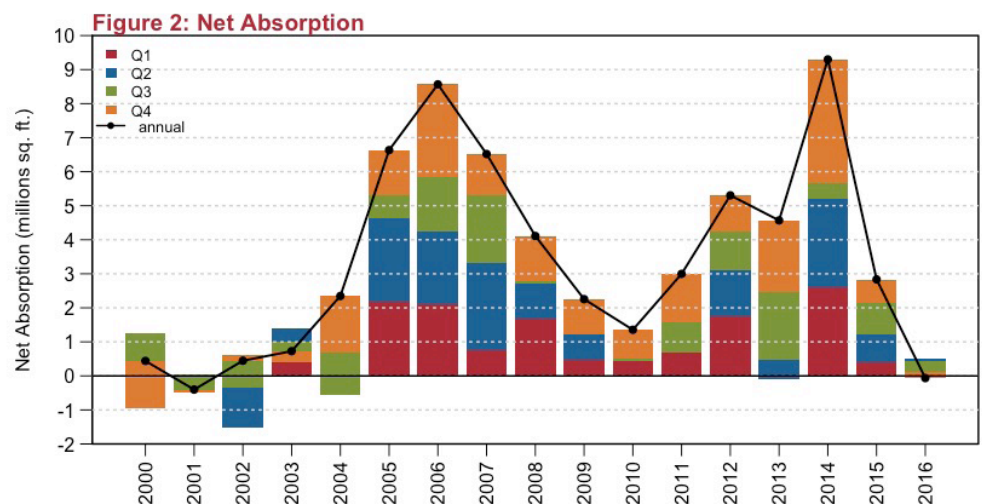
Leasing activity is another measure for the demand of office space, representing the total amount of

space for direct leases, subleases, renewals, and pre-leasing. Figure 3 reports leasing activity since 2000 by year and quarter for combined Class A and B office space. Leasing activity of 2,393,880 sq. ft. occurred in Q4 2016, yielding decreases of -40.7% QoQ and -52.6% YoY (Table 1). The historic Q4 average ( $\pm$  95% confidence interval) for leasing activity is 4,493,955 sq. ft. ( $\pm$  553,915). We are 95% certain that Q4 leasing activity typically falls between 3,940,039 to 5,004,870 sq. ft. This indicates that current leasing activity is statistically lower than historic Q4 measures since 2000. Leasing activity of 2,393,880 sq. ft. in Q4 brings total leasing activity for 2016 to 12.7 million sq. ft., the third lowest

year on record since 2000 (Figure 3). With net absorption lagging behind leasing activity, lower leasing activity in Q4 and 2016 as a whole suggests continued low absorption in quarters to come.

### Availability and Vacancy

Vacancy and availability measure the supply of office space, and as such are key indicators of shifts in the phase of the office market cycle. Availability better measures total supply because it includes vacant, occupied, and sublease space. Vacancy better measures empty space on the market, whether or not that space is leased or even for rent. Overall, office supply continued to increase in Q4 2016 (Figure 4). For

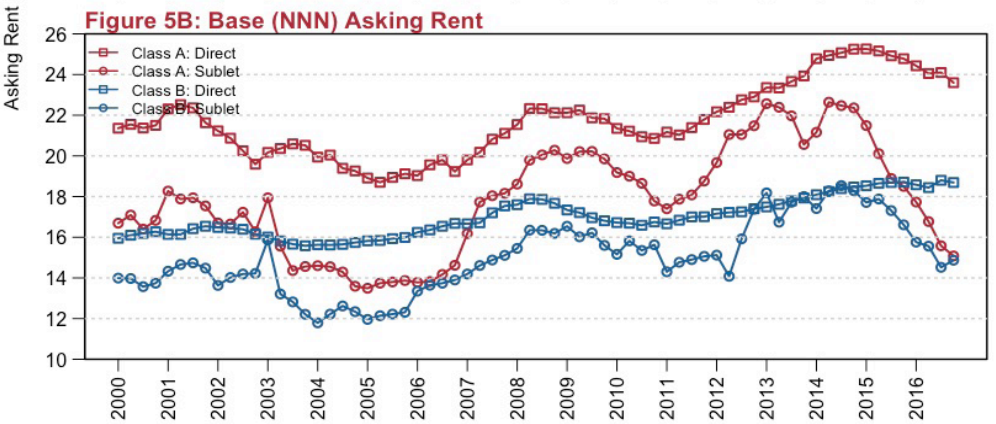
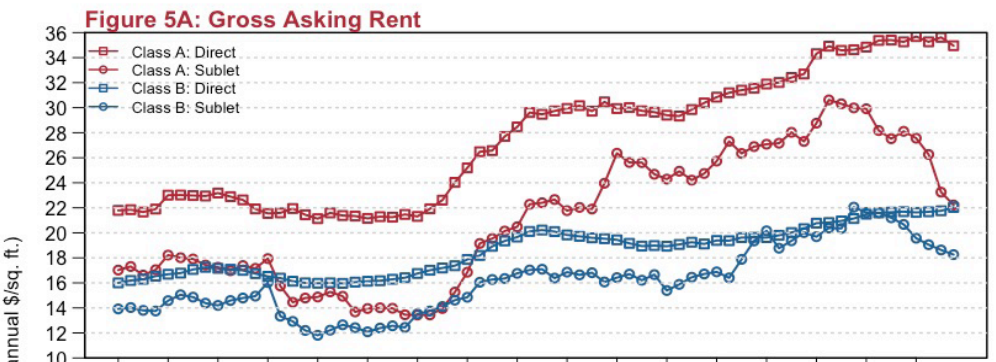
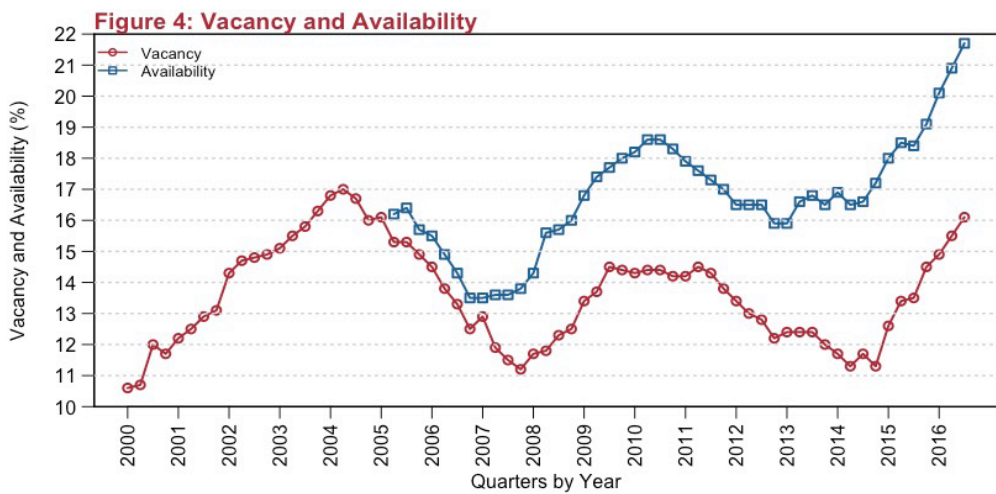
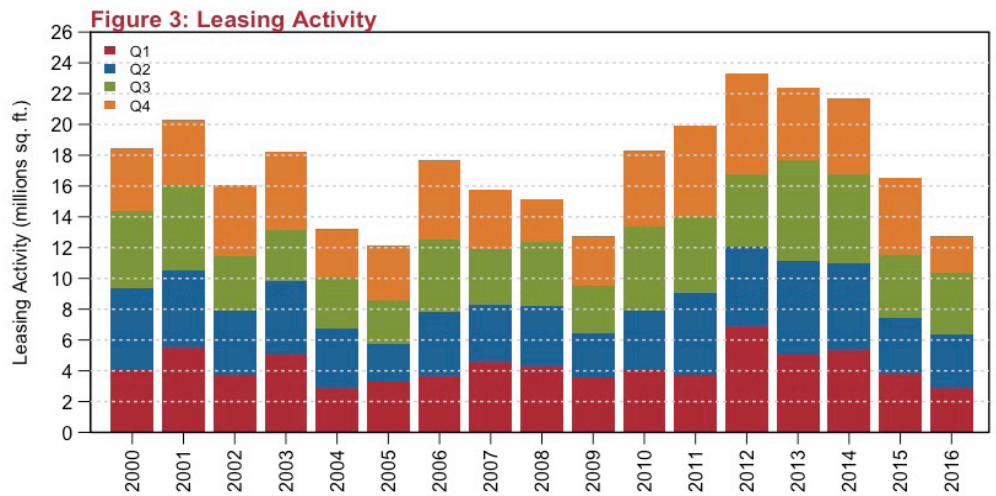


Class A and B buildings combined, availability was 21.7%, which is flat QoQ but up a modest 13.6% YoY (Table 1). Likewise, vacancy for Class A and B space combined was 16.2%, up a modest 0.6% QoQ and 11.7% YoY (Table 1). As indicated by increases in both vacancy and availability, Houston’s office products are nearing or in the bottoming phase of their market cycle.

**Asking Rent**

Figure 5 plots both gross and base (NNN) asking rents for direct and sublease space since 2000 for Class A and B buildings. Despite limitations of asking (rather than actual) rent, we can still derive information on market conditions by examining the difference between direct and sublease base rents. The greater the difference between direct and sublease asking rents, the softer the market conditions are.

Since Houston’s office market began falling in late 2014, the difference between direct and sublease base asking rents for Class A buildings has grown from \$3.77 to \$8.52 (Figure 5B). Historically, Class A buildings have shown an average difference of \$3.52 between direct and sublease base asking rents, with a 95% confidence interval of \$3.15 to \$3.89. At the current \$8.52, Houston’s Class A rents are way outside this expected range. For Class B buildings, the difference between direct and sublease base asking rents has grown from \$0.82 to \$3.82 since 2014 (Figure 5B). Historically, Class B buildings have shown an average difference of \$1.97 between direct and sublease base asking rents, with a 95% confidence interval of \$1.62 to \$2.21. At the current \$3.82 difference, Houston’s Class B rents are outside of this range. Note, Class A and Class B sublease rental rates have converged, such that the typical Class B tenant may enter the Class A market.



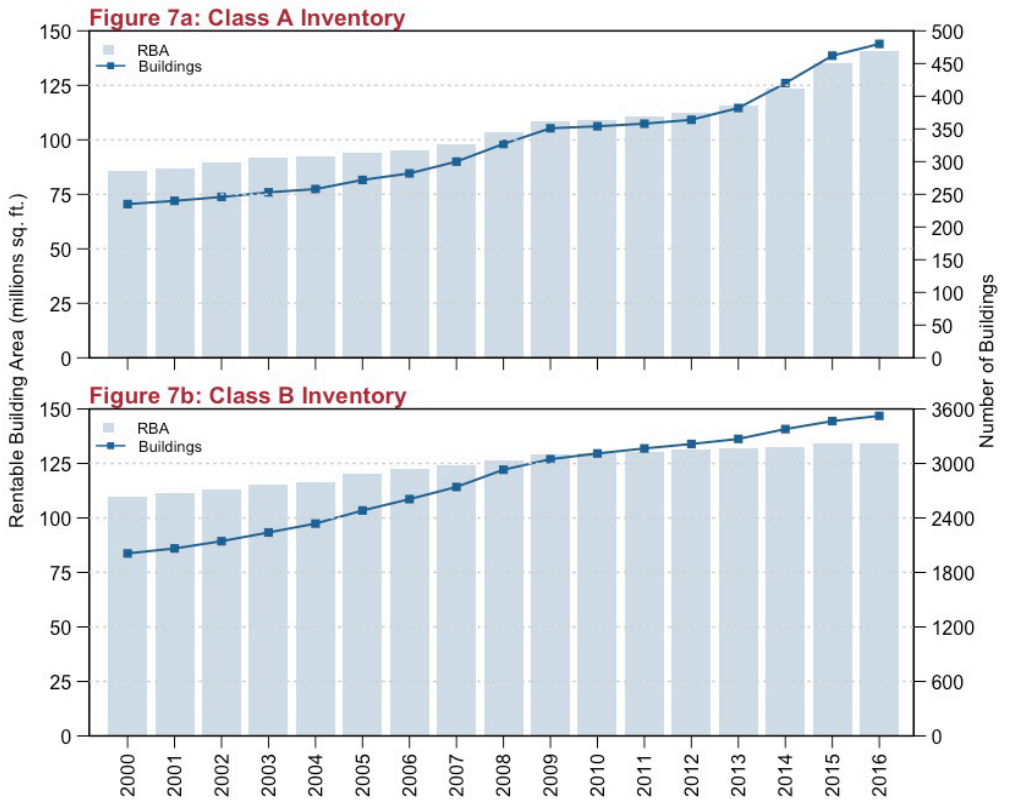
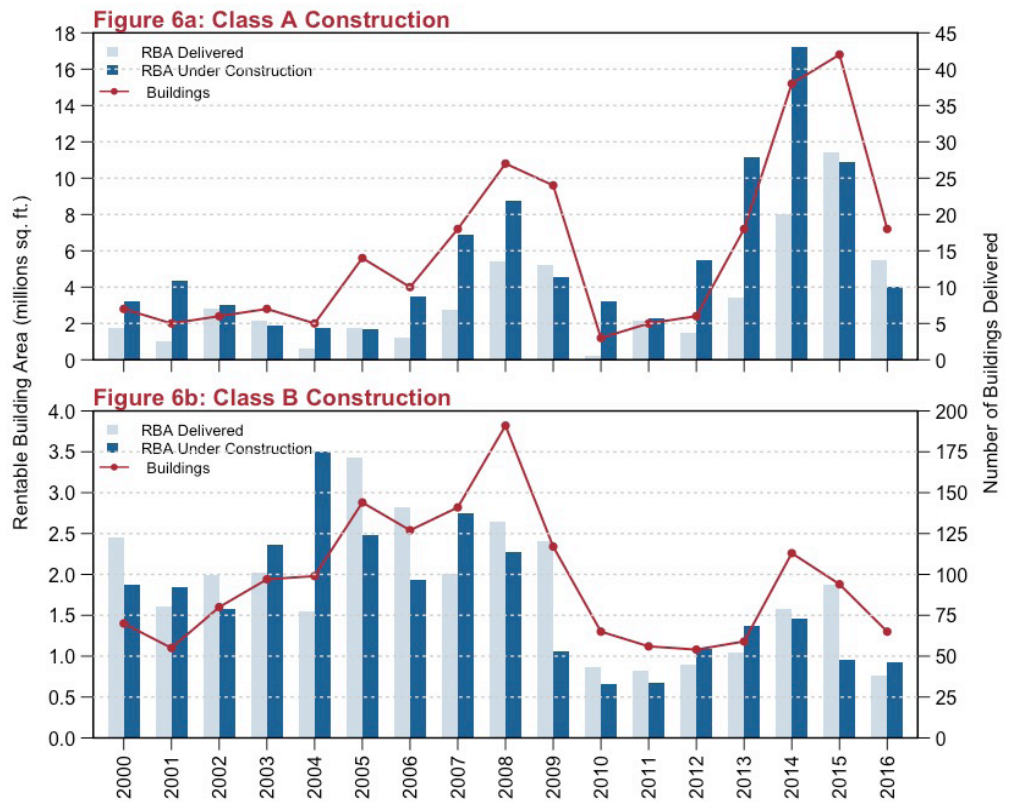


### Construction and Deliveries

Construction of new stock inventory shapes the growing supply of office space. “RBA Delivered” refers to completed construction, while “RBA Under Construction” refers to space under construction that has not yet been completed. Figure 6 breaks down deliveries and construction on an annual basis by Class A and Class B products. Deliveries in Q4 2016 were 100,714 sq. ft. of Class A and B buildings, a decrease of 94.2% QoQ and 97.6% YoY (Table 1). RBA under construction remains at 4.0 million sq. ft. in Q4 2016, a decrease of -50% YoY (Table 1).

### Inventory

Figure 7 depicts changes in the inventory of Class A and Class B buildings since 2000, both in terms of RBA and the number of buildings. Stock inventory for Class A and B office space included 274 million sq. ft. for 4,004 buildings (Table 1).



Largest Space Available By Building (AS OF END OF Q4)

Address	SF	Submarket
800 Bell St	1,314,350	Downtown
609 Main St	612,471	Downtown
909 Fannin St	533,691	Downtown
915 N Eldridge Pky	524,411	Katy Freeway
17001 Northchase Dr	450,244	North Belt
811 Louisiana St	418,292	Downtown
600 Gemini St	363,050	NASA/Clear Lake
580 Westlake Park Blvd	358,704	Katy Freeway
12450 Greenspoint Dr	356,468	North Belt
1600 Smith St	341,772	Downtown
13501 Katy Fwy	340,000	Katy Freeway
1415 Louisiana St	317,932	Downtown
2101 CityWest Blvd	305,735	Westchase
1414 Enclave	300,907	Katy Freeway
16825 Northchase Dr	273,547	North Belt
3200 Southwest Fwy	265,484	Greenway Plaza
4400 Post Oak Pky	254,509	West Loop
600 Jefferson St	252,593	Downtown
1780 Hughes Landing Blvd	249,358	Woodlands
1020 Holcombe Blvd	245,834	South Main/ Medical Center
1000 Louisiana St	245,780	Downtown
5775 N Sam Houston Pky E	244,848	West Belt
2100 Travis St	240,134	Downtown
363 N Sam Houston Pky E	229,208	North Belt
700 Milam St	227,845	Downtown
5847 San Felipe St	227,663	San Felipe/Voss
808 Travis St	225,889	Downtown
2700 Post Oak Blvd	220,372	West Loop
15377 Memorial Dr	220,156	Katy Freeway
1201 Louisiana St	219,685	Downtown
11111 S Wilcrest Dr	218,816	Southwest
16945 Northchase Dr	217,864	North Belt
4005 Technology Dr	205,000	Southwest Far
100 Glenborough Dr	204,198	North Belt
480 Wildwood Forest Dr	201,651	Woodlands
222 Benmar Dr	199,904	North Belt
5718 Westheimer Rd	198,840	San Felipe/Voss
25700 Interstate 45	197,100	Woodlands
3737 Buffalo Speedway Ave	191,494	Greenway Plaza
396 W Greens Rd	189,853	North Belt
3200 Kirby Dr	188,545	Greenway Plaza
1330 Post Oak Blvd	183,044	West Loop
6464 Savoy Dr	182,566	Southwest
811 Dallas St	182,100	Downtown

Address	SF	Submarket
1301 McKinney St	178,932	Downtown
2 Riverway	178,630	West Loop
1401 McKinney St	178,253	Downtown
9700 Bissonnet St	178,212	Southwest
11450 Compaq Center West Dr	174,896	FM 1960
17000 Katy Fwy	174,469	Katy Freeway
8800 Technology Forest Pl	173,332	Woodlands
Highway 99	171,538	Katy/Grand Parkway West
9250 Pinecroft Dr	170,329	Woodlands
333 Clay St	168,621	Downtown
10720 W Sam Houston Pky N	165,226	West Belt
1233 West Loop S	162,041	West Loop
10713 W Sam Houston Pky N	159,339	West Belt
16290 Katy Fwy	157,850	Katy Freeway
3 Greenway Plz	156,227	Greenway Plaza
10100 Katy Fwy	155,963	Katy Freeway
1311 Broadfield Blvd	155,407	Katy Freeway
15150 Memorial Dr	155,175	Katy Freeway
10700 North Fwy	154,928	North Belt
12707 North Fwy	154,454	North Belt
1333 West Loop S	151,762	West Loop
5555 San Felipe St	150,743	West Loop
5251 Westheimer Rd	150,212	West Loop
15375 Memorial Dr	149,000	Katy Freeway
550 Westlake Park Blvd	148,674	Katy Freeway
900 Threadneedle St	146,729	Katy Freeway
1709 Dryden Rd	143,546	South Main/ Medical Center
13401 N I-45	143,410	North Belt
2115 Winnie St	140,966	Southeast Outlier
2500 CityWest Blvd	140,469	Westchase
3600 W Sam Houston Pky S	140,000	Westchase
11750 Katy Fwy	137,583	Katy Freeway
16001 Park Ten Place Dr	136,954	Katy Freeway
15710 John F Kennedy Blvd	135,448	North Belt
500 N Sam Houston Pky W	135,030	North Belt
2800 N Loop Fwy W	132,849	Northwest
711 Louisiana St	132,266	Downtown
21700 Merchants Way	127,953	Katy/Grand Parkway West
2350 N Sam Houston Pky E	125,788	North Belt
3040 Post Oak Blvd	125,596	West Loop
555 Gemini St	124,908	NASA/Clear Lake
1201 Fannin St	123,614	Downtown
2727 North Loop W	123,103	Northwest

## Largest Space Available By Building (Continued)

Address	SF	Submarket
5177 Richmond Ave	121,900	West Loop
1885 Saint James Pl	116,228	West Loop
652 N Sam Houston Pky E	114,612	North Belt
24275 Katy Fwy	112,932	Katy/Grand Parkway West
1001 West Loop South	111,083	West Loop
330 Barker Cypress Rd	110,480	Katy Freeway
554 Club Dr	108,000	Outlying Montgomery Cnty
1725 Hughes Landing Blvd	107,350	Woodlands
2050 W Sam Houston Pky S	107,088	Westchase
601 Travis St	107,022	Downtown
777 N Eldridge Pky	106,256	Katy Freeway
7000 Hollister St	105,900	Northwest
1600 West Loop S	104,579	West Loop
2950 N Loop Fwy W	103,929	Northwest
500 Dallas St	100,279	Downtown
14741 Yorktown Plaza Dr	96,000	West Belt
10496 Old Katy Rd	96,000	Katy Freeway
750 Town & Country Blvd	93,826	Katy Freeway
10500 Richmond Ave	93,785	Westchase
3773 Richmond Ave	93,378	Greenway Plaza
5252 Hollister Rd	93,219	Northwest
840 Gessner Rd	91,319	Katy Freeway
198 Kempner St	90,650	E Fort Bend Co/Sugar Land
2001 Timberloch Pl	90,539	Woodlands
737 N Eldridge Pky	88,458	Katy Freeway
1401 Enclave Pky	88,419	Katy Freeway
2229 San Felipe	85,738	Downtown
1001 Louisiana St	85,530	Downtown
811 Main St	83,372	Downtown
5851 Southwest Fwy	82,500	Richmond/Fountainview
198 Kempner St	82,100	E Fort Bend Co/Sugar Land
9811 Katy Fwy	82,002	Katy Freeway
2051 S Greenhouse Rd	79,409	Katy/Grand Parkway West

Address	SF	Submarket
16900 Park Row	77,000	Katy Freeway
5151 San Felipe St	76,123	West Loop
2103 CityWest Blvd	75,059	Westchase
10205 Westheimer Rd	74,139	Westchase
11700 Katy Fwy	73,399	Katy Freeway
9009 West Loop South	73,196	Bellaire
250 Meadowfern Dr	71,208	North Belt
3663 N Sam Houston Pky E	69,999	North Belt
330 N Sam Houston Pky E	69,000	North Belt
4101 Interwood North Pky	68,350	North Belt
570 Westlake Park Blvd	67,334	Katy Freeway
1575 Sawdust Rd	65,480	Woodlands
1290 Hercules Ave	64,000	NASA/Clear Lake
5333 Westheimer Rd	63,452	West Loop
350 Glenborough Dr	63,105	North Belt
Merchants Way	63,000	Katy/Grand Parkway West
8223 Willow Place Dr S	62,001	FM 1960
412 Main St	58,635	Downtown
2000 W Sam Houston Pky S	57,304	Westchase
1775 St James Pl	56,910	West Loop
15115 Park Row	56,064	Katy Freeway
600 N Sam Houston Pky	55,700	North Belt
16285 Park Ten Place Dr	54,858	Katy Freeway
575 N Dairy Ashford	54,518	Katy Freeway
5884 Point West Dr	54,417	Southwest
222 Cavalcade St	54,200	I-10 East
3010 Briarpark Dr	53,452	Westchase
500 Jefferson St	52,172	Downtown
2222 Bay Area Blvd	52,171	NASA/Clear Lake
2929 Allen Pky	51,271	Downtown
13100 Space Center Blvd	51,072	NASA/Clear Lake
5616 Lawndale St	50,000	Gulf Freeway/Pasadena



Select Sales (AS OF END OF Q4)

Property Address	Bldg SF	Sale Date	Sale Price	Price Per SF
743 W 18th St	2,103	12/23/16	\$390,000	\$185.45
14343 Torrey Chase Blvd, E/1st Floor	3,620	12/22/16	\$58,200	\$89.54
14110 Luthe Rd	1,983	12/8/16	\$278,000	\$140.19
12812 Willow Centre Dr, C&D/1st Floor	4,050	12/6/16	\$180,000	\$133.33
19219 Katy Fwy	203,149	11/14/16	\$47,000,000	\$231.36
215 Gonyo Ln	4,256	10/28/16	\$540,000	\$126.88
4810 E Sam Houston Pky N	8,403	10/27/16	\$4,710,000	\$560.51
12603 Southwest Fwy	143,211	10/21/16	\$18,000,000	\$125.69
4501 Cartwright Rd, 505/1st Floor	6,000	10/21/16	\$179,000	\$116.99
12695 Whittington Dr	4,228	10/20/16	\$625,000	\$147.82
524 Grand Ave	972	10/14/16	\$100,000	\$102.88
11455 Fallbrook Dr	10,653	10/12/16	\$705,000	\$66.18
2244 Welch St	1,600	10/11/16	\$765,000	\$478.13
12812 Willow Centre Dr, B/1st Floor	4,050	10/11/16	\$90,000	\$133.33
5206 W FM-1960 (Part of Multi-Property Sale)	22,128	10/10/16	\$1,328,029	\$60.02
5222 W FM-1960 (Part of Multi-Property Sale)	23,700	10/10/16	\$1,031,971	\$43.54
6910 Bellaire Blvd, 7/1st Floor	6,350	10/10/16	\$165,000	\$89.19
19840 Cypress Church Rd (Part of Multi-Property Sale)	3,990	10/7/16	\$615,915	\$154.36
910 Moody Ave	4,518	10/7/16	\$398,000	\$88.09
19840 Cypress Church Rd (Part of Multi-Property Sale)	1,200	10/7/16	\$117,758	\$98.13
12516-12518 Cutten Rd, 12516-C/1st Floor	6,000	10/6/16	\$274,999	\$194.21
1411 N Bonner St (Part of Multi-Property Sale)	8,025	10/5/16	\$398,114	\$49.61

Select Top Office Leases (AS OF END OF Q4)

Tenant	Building	Square Feet
ABM Industries	14141 Southwest Freeway	62,457
Thompson & Knight, LLP	811 Main St.	60,655
Webber Construction	1725 Hughes Landing	46,614
Jones & Carter	1575 Sawdust	27,025
Middleton Raines & Zapata, LLP	11750 Katy Freeway	26,417
Trendmaker Homes*	16340 Park Ten Place	24,069
TABC	411 Lantern Bend Dr.	22,580
Bradley Arant Boult Cummings, LLP	600 Travis	22,082
AIG Asset Management (US), LLC	2929 Allen Parkway	18,265
Berkadia	2229 San Felip	18,000
Soloris	9811 Katy Freeway	12,476
Campus Living Villages*	1001 Fannin	11,729

\* Renewal

Select Largest Deliveries (AS OF END OF Q4)

Building Address	Submarket Name	Rentable Building Area	Percent Leased
915 N Eldridge Pky	Katy Freeway West	524,744	0%
1111 Travis St	CBD	406,600	96%
15377 Memorial Dr	Katy Freeway West	385,532	43%
25700 Interstate 45	Woodlands	240,470	18%
480 Wildwood Forest Dr	Woodlands	201,933	0%
3773 Richmond Ave	Greenway Plaza	182,000	49%
1885 Saint James Pl	Galleria/Uptown	165,000	30%
2002 Grand Pky N	Katy/Grand Parkway West	124,295	68%
4460 Highway 225	Gulf Freeway/Pasadena	102,000	83%
9230 Katy Fwy	Katy Freeway East	76,765	87%
129 Vision Park Blvd	Woodlands	69,510	71%

Select Under Construction (AS OF END OF Q4)

Building Address	Rentable Building Area	Submarket Name	Percent Leased
609 Main St	1,056,658	CBD	42%
1717 W Loop Fwy S	380,000	Post Oak Park	90%
10100 Katy Fwy	238,173	Katy Freeway East	35%
3200 Kirby Dr	212,878	Greenway Plaza	11%
9250 Pinecroft Dr	171,996	Woodlands	97%
One Grand Crossing	171,538	Katy/Grand Parkway West	0%
1600 West Loop S	104,579	Galleria/Uptown	0%
198 Kempner St	94,200	E Fort Bend Co/Sugar Land	13%
198 Kempner St	93,000	E Fort Bend Co/Sugar Land	3%
18211 Katy Fwy	86,255	Katy Freeway West	57%
250 Assay St	85,000	Northeast Near	62%
One Merchants Way	63,000	Katy/Grand Parkway West	0%

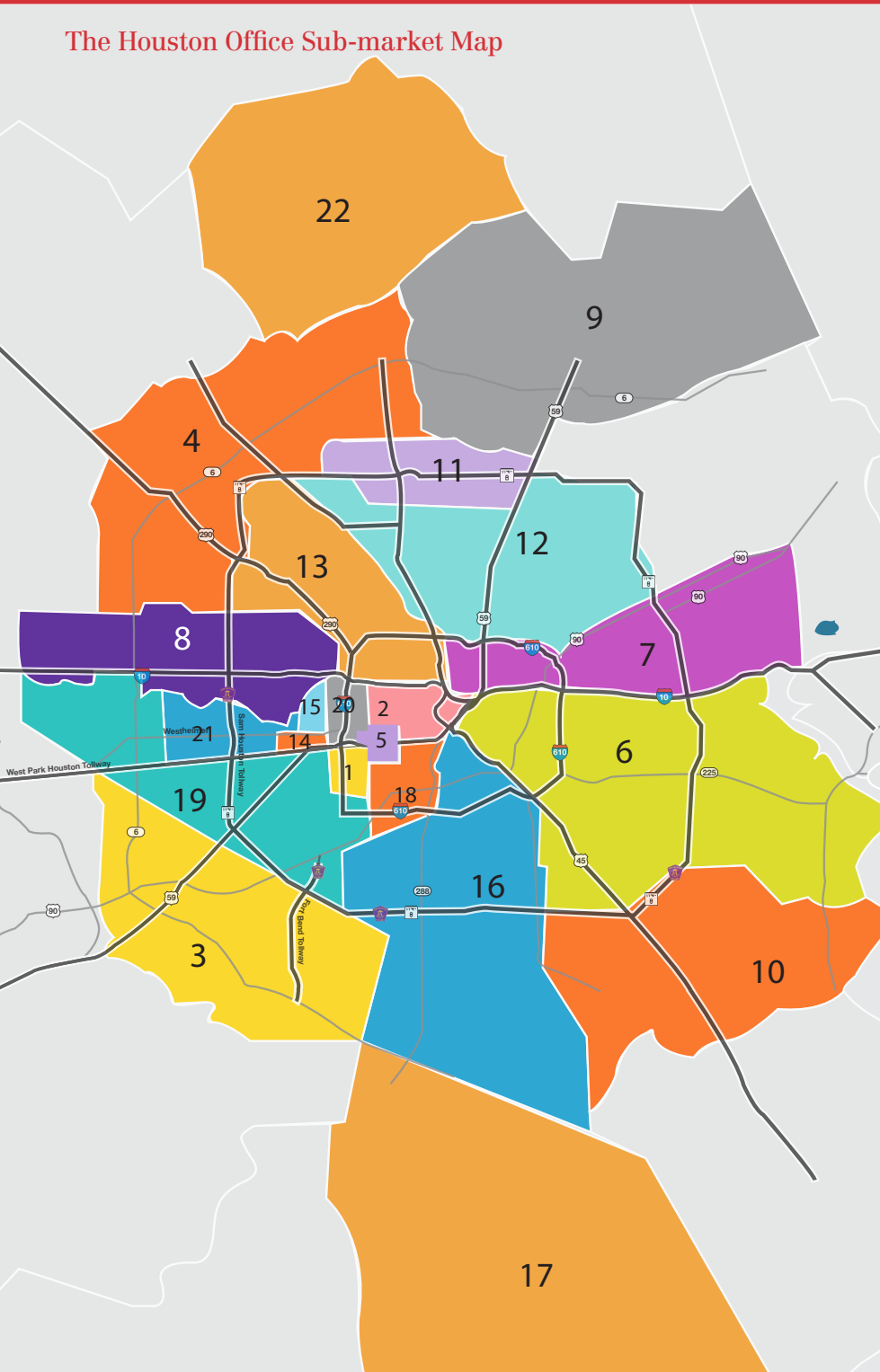
Class A Market Statistics (AS OF END OF Q4)

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	7	1,191,304	145,431	0	\$26.67
Downtown	44	34,795,502	3,789,226	1,056,658	\$41.92
E Fort Bend Co/Sugar Land	20	3,773,926	295,166	132,799	\$29.10
FM 1960	20	4,086,782	348,468	0	\$27.41
Greenway Plaza	20	7,267,315	1,079,909	212,878	\$36.72
Gulf Freeway/Pasadena	1	22,706	3,122	0	\$30.59
I-10 East	0	0	0	0	\$0.00
Katy Freeway	94	24,227,287	3,413,045	603,128	\$31.93
Katy/Grand Parkway West	23	1,899,277	525,599	171,538	\$28.31
Kingwood/Humble	3	189,312	41,275	0	\$26.42
NASA/Clear Lake	17	2,122,602	190,865	0	\$27.69
North Belt	25	5,564,959	2,486,359	0	\$24.01
Northeast Near	2	555,700	0	85,000	\$0.00
Northwest	11	2,275,066	662,345	0	\$22.48
Richmond/Fountainview	0	0	0	0	\$0.00
San Felipe/Voss	3	1,720,793	413,240	0	\$35.80
South	4	397,500	46,479	250,000	\$26.31
South Hwy 35	0	0	0	0	\$0.00
South Main/Medical Center	15	4,560,992	219,878	0	\$29.06
Southwest	9	2,052,051	278,891	0	\$19.06
West Belt	30	4,356,069	714,861	0	\$27.41
West Loop	47	17,418,908	2,933,931	484,579	\$36.52
Westchase	33	9,817,089	1,593,930	0	\$33.62
Woodlands	42	11,306,590	1,370,327	171,996	\$35.39

Class B Market Statistics (AS OF END OF Q4)

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	31	2,991,927	214,826	0	\$24.04
Downtown	190	19,686,067	3,036,036	0	\$28.68
E Fort Bend Co/Sugar Land	256	5,044,100	480,888	119,445	\$24.93
FM 1960	353	7,649,766	1,227,559	31,195	\$17.72
Greenway Plaza	49	4,093,475	309,291	4,346	\$26.45
Gulf Freeway/Pasadena	172	3,942,534	446,325	82,800	\$21.50
I-10 East	25	683,442	149,514	0	\$15.57
Katy Freeway	208	12,352,378	1,912,560	0	\$22.15
Katy/Grand Parkway West	244	3,016,996	119,692	122,786	\$27.48
Kingwood/Humble	84	2,050,740	133,324	144,450	\$21.36
NASA/Clear Lake	221	5,995,497	1,100,567	6,800	\$18.66
North Belt	74	6,458,764	1,585,675	0	\$17.06
Northeast Near	31	728,535	136,962	0	\$20.11
Northwest	149	6,935,106	981,264	15,000	\$19.33
Richmond/Fountainview	26	946,274	206,438	0	\$18.03
San Felipe/Voss	37	3,548,819	452,543	0	\$24.04
South	84	1,548,778	141,328	0	\$27.04
South Hwy 35	34	359,039	15,251	0	\$17.51
South Main/Medical Center	66	4,836,145	660,581	0	\$25.94
Southwest	127	7,818,478	1,245,702	60,000	\$16.99
West Belt	53	2,147,693	336,747	0	\$20.55
West Loop	58	6,262,578	705,851	0	\$26.49
Westchase	71	7,736,415	1,366,881	196,000	\$19.38
Woodlands	358	7,851,594	669,231	25,501	\$24.91

## The Houston Office Sub-market Map



1. Bellaire
2. Downtown - CBD + Midtown
3. E Fort Bend Co/Sugar Land
4. Fm 1960 + FM 1960/Champions + Fm1960/Hwy 249 + FM 1960/I-45 North
5. Greenway Plaza
6. Gulf Freeway/Pasadena
7. I-10 East
8. Katy Freeway = Katy Freeway East + Katy Freeway West
9. Kingwood/Humble
10. Nasa/Clear Lake
11. North Belt = North Belt East + North Belt West/Greenspoint
12. Northeast Near
13. Northwest = North Loop West + Northwest + Far\_ Northwest Near
14. Richmond
15. San Felipe/Voss
16. South
17. South Hwy 35
18. South Main/Medical Center
19. Southwest = Southwest Beltway 8 + Southwest/Hillcroft
20. Westloop = Galleria/Uptown + Riverway + Post Oak Park
21. Westchase = Westchase East + Westchase West
22. Woodlands

## Methodology

The quarterly report for the office market includes information and data for Class A and Class B buildings, but excludes Class C buildings. Buildings are not excluded on the basis of single vs. multi-tenancy, owner occupancy, or building size.

*Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy. Sources include: U.S. Bureau of Economic Analysis, CoStar, Council on Foreign Relations, Federal Reserve Bank of Dallas, Greater Houston Partnership, FiveThirtyEight.com, Houston Association of Realtors, Moody Analytics, NAI Global, National Association Realtors, Texas A&M Real Estate Center, Well's Fargo, University of Houston's Institute of Regional Forecasting, U.S. Bureau of Labor Statistics.*

# Economic and Market Outlook:

HOUSTON OFFICE | Q4 2016

**NAI**Partners

HOUSTON | AUSTIN | SAN ANTONIO

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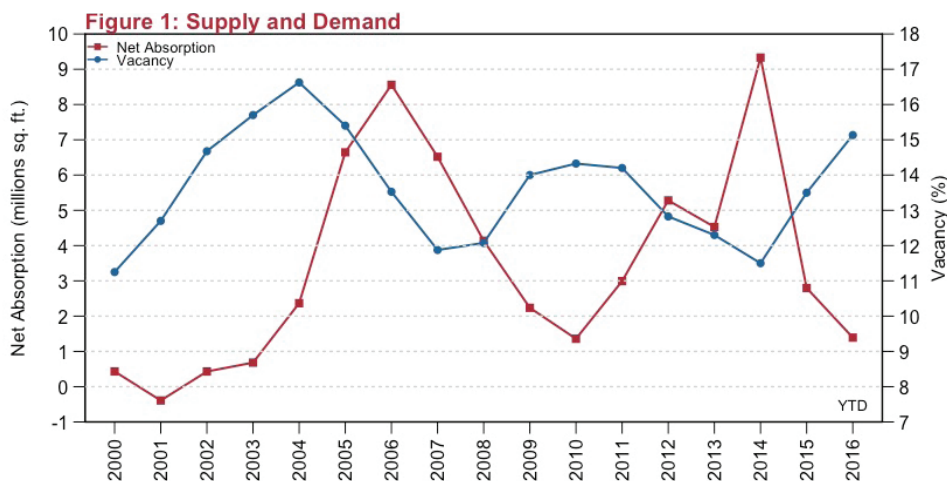


# Economic and Market Outlook:

HOUSTON OFFICE | Q3 2016

**NAI**Partners

HOUSTON | SAN ANTONIO | AUSTIN



**Table 1. Market indicators for Q3 2016, and their percent (%) change on a quarter-over-quarter (QoQ) and year-over-year (YoY) basis.**

Market Variables	Percent Change over Time Period		
	Q3 2016	QoQ (%)	YoY (%)
Net Absorption (sq. ft.)	-235,209	-139.4 %	-125.9 %
Leasing Activity (sq. ft.)	3,107,856	-7.2 %	-23.6 %
Availability (%)	21.7%	4.3 %	16.7 %
Vacancy (%)	15.8%	4.0 %	17.0 %
Deliveries (sq. ft.)	1,732,926	-30.7 %	44.3 %
Construction (sq. ft.)	3,940,716	-16.8 %	-65.6 %
Inventory (sq. ft.)	274,465,668	0.6 %	3.7 %
Inventory (No. of Buildings)	3,961	0.6 %	2.4 %

## Executive Summary

### Economy

- Economic uncertainty associated with an unprecedented presidential election cycle will continue after new administration moves in due to ongoing discontent between parties.
- U.S. energy sector has likely bottomed out; real signs of recovery have emerged over the past quarter, such as increases in rig counts.
- Gross domestic product (GDP) is anticipated to be 1.4% for 2016 and 2.0% for 2017, both slower than 2.5% in 2015.
- U.S. employment remains steady, posting 156,000 new jobs in September, after 167,000 in August. Job growth below 200,000 per month suggests tightening labor market.
- Houston technically entered an economic recession in November 2015; while the bottom has likely passed, Houston is not yet recovering.
- Houston's economic outlook is to shift from a modestly negative stance to one that is generally flat for the remainder of 2016.

### Office Market

- Houston's office real estate continues its falling phase of the market cycle with reduced demand and low leasing activity.
- Q3 2016 posted -235,000 sq. ft. of negative net absorption, a demand for office space that is lower than average historic Q3 performance of 541,000 sq. ft.
- Leasing activity of 3.1 million sq. ft. was less than historic Q3 activity of 4.4 million sq. ft.
- Vacancy continued its climb, now up to 15.8%, with availability at 22% driven largely by 12.1 million sq. ft. of sublease space.
- Construction continues its decline from 17 million sq. ft. in 2014 to under four million sq. ft. today.
- Sublease base asking rents for Class A buildings are 35% lower than direct base asking rents, the largest percent difference seen over the past 17 years.
- The Class B market has softened but with only a 22.8% difference between direct and sublease base asking rents.
- Houston's Class B market is helping to stabilize the more dramatic downturn in Class A buildings.

## Broker's Perspective

The office market is in a significant decline and everyone is searching for the "bottom". Tenants are being cautious and are trying to figure out when would be the best time to act, while landlords are offering increased concessions as they try to figure out how best to compete with the massive volume of sublease space now on the market. With such volumes of sublease space, deals are only getting cheaper as tenants vie to rid themselves of this excess space.

In my opinion, we cannot begin to talk about a bottom until the volume of sublease space flattens out and starts to decrease. The good news is that in October for the first time since late 2014, we did not see any increase in the percent of availability that is sublease space. This could be the start of a trend reversal and a bottoming out of the market or it could be a temporary pause. Only time will tell.

In the interim, we are seeing landlords heavily discounting deals primarily through the use of free rent which in some cases has been as much as 18 months free on a 10-year lease term. This is somewhat submarket specific, with the west

Houston energy corridor being the hardest hit submarket. However, in the past couple of quarters we have seen some significant deterioration in other submarkets, including Downtown and the Galleria, both of which had been slower to feel the impact of Houston's overall soft market.

The energy business appears to be bottoming out as oil prices seem to have stabilized and producers and service companies have adjusted to the lower price environment. I do not expect to see a sharp increase in activity in the next 12 to 24 months, but we are already seeing signs of improvement (e.g., increases in rig counts) which bodes well for the office market, and is further indication that we could be starting to see a bottom across the board.

I expect the first half of 2017 be a solid bottoming out in the office market with some improvement in the second half of the 2017. Unless the energy business experiences a significant upswing, I do not expect a rapid recovery in the office market. I think we are in for a two- to four-year slow recovery back to a stabilized office market.

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“...for the first time since late 2014, we did not see any increase in the percent of availability that is sublease space.”

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**Jon Silberman**  
Managing Partner  
NAI Partners

## ECONOMIC OVERVIEW

**National Economy**

With a truly unprecedented election cycle and associated economic uncertainty coming closer to an end, discontent between parties will still likely hang over policy and decision makers as a new administration takes hold. Gross domestic product (GDP) is anticipated to be 1.4% for 2016 and 2.0% for 2017, both slower than 2.5% in 2015. GDP is being led by consumer spending and job gains, but weak business, government spending, and slow export sales are holding it back. Consumer spending increased strongly by 4.3% in Q2. Revolving consumer credit continued its slow but steady increase, with August showing the largest increase in 2016. Consumer interest rates remained steady. The Consumer Sentiment index moved higher in September, rising 1.4 points to 91.2, most of which came from higher income households.

Employment continues to remain steady. September posted a solid 156,000 new jobs, following 167,000 new jobs in August. Job growth remaining below 200,000 per month is suggestive of a tightening labor market. As more people entered the labor force, unemployment moved up to 5%, which historically has been considered full employment in the labor force. Also, wage growth increased by 2.6% in September, following 2.4% in August. Some analyses still suggest that the recovery is weak and as a result interest rates may stay low. With strong September job growth, and two more job reports to go, the December FOMC meeting following the election will likely result in an interest rate hike by year's end. Nevertheless, interest rates are expected to remain low and fluctuate within a small range.

International trade continues to see slow export sales. U.S. exports are down 3.7% YoY. Yet, the negative economic impacts of falling import prices is beginning to fade, as import prices inched up 0.1% in September and are only down 1.1% relative to this time last year. The trade deficit widened modestly in August, but realized net exports are likely to make a positive contribution to GDP in Q3. Demand for U.S.-made durable goods

abroad will remain weak and flat through the end of the year and increase modestly by 3-4% in 2017. These trends may stifle U.S. business investment.

The Small Business Optimism Index of the National Federation of Independent Businesses (NFIB) continued its decrease over the past 12-18 months, declining 0.3% points in September to 94.1, but remaining unchanged relative to the past six-month average. This indicates businesses are cautious on hiring and inventories. While factory orders of durable and nondurable goods rose in Q3, business investment in capital goods fell, which signaled a softer quarter. In September the ISM manufacturing index bounced firmly back into expansion territory at 51.5.

The U.S. energy sector appears to have bottomed out, and over the past quarter or so has begun to show real signs of recovery, with consistent weekly increases in rig counts being led by the Permian Basin. Nevertheless, modest increases in drilling activity and oil production does not signal the end of the persistent oversupply and large stockpiles. Recently, the Organization of the Petroleum Exporting Countries (OPEC) has agreed to agree to cut production at the next OPEC meeting, but when it still remains unclear when the global rebalance of the oil market will occur.

More people are looking to buy homes, but home availability remains low, driving up prices. Residential housing for August, in terms of sales of both new and existing homes fell, and new housing starts declined as well. Yet, this is in the context of a strong first half of 2016 where home sales and new home construction were very strong through July 2016. The Dodge Momentum Index of non-residential construction declined 4.3 percent in September to 129, but is up 5.1% YoY. Both July and August saw pullbacks in total construction momentum across residential, nonresidential, and public spending.

**Houston and Texas Economy**

After adjusting for price effects, the Houston metropolitan area's GDP grew

4.6% from 2014 to 2015. Texas and Houston continue to have a mixed set of economic numbers, but all indications are that the bottom has come and we are now moving up. Rig count has increased every week for the past 15 of the past 16 weeks. Technically, Houston did move into an economic recession in November of 2015; while the bottom has likely come and gone, Houston is not yet recovering. The outlook for Houston is to shift from a modestly negative economic stance to one that is generally flat for the remainder of 2016.

Employment in Texas grew 2.6% in August and 3.2% in July, with an annualized increase of 0.8% for 2016 thus far. The employment forecast for Texas is 1.2% in 2016. Jobs in Houston grew 1.8% over June, July, and August, the best seen since early 2015. Job growth remains low in the oil and oil service fields, while growth was seen in leisure and hospitality, private education and health services and government, and then trade, transportation, and utilities. This is all in the context of annualized -1.0% decline in employment of about 15,000 jobs year to date. Unemployment was 4.7% in Texas.

The revenue index of the Texas Service Sector Outlook survey increased from 6.5 to 13.0 in September. Meanwhile the sales index of the Texas Retail Outlook Survey increased from -5.3 to 2.0. Factory activity in Texas did increase substantially in September, according to the Texas Manufacturing Outlook Survey. The index which measures manufacturing conditions rose 12 points to 16.7, again a substantial increase. Nevertheless, consistent with the broader U.S. economy, business conditions in Texas are mixed. The general business activity index continued into negative territory for another month at -3.7, representing almost two years in negative territory. The Houston Business Cycle Index grew 2.6% in August, following 2.0% and 2.6% in July and June, respectively. Annually, however, the index is down 2.2% YoY. Texas exports declined 7% in July, the largest drop seen since 2009.





## MARKET OVERVIEW

### Net Absorption

Demand, as measured by net absorption (direct plus sublease space), is the change in occupied stock inventory. Figure 2 shows net absorption since 2000 by year and quarter for combined Class A and B office space. Following 1.7 million sq. ft. of positive net absorption in Q1 2016, the second quarter had about -100,000 sq. ft. of negative net absorption. The third quarter had -235,000 sq. ft. of negative net absorption, representing a substantial decrease of -139% QoQ and -126% YoY (Table 1). The historic Q3 average ( $\pm$  95% confidence interval) for net absorption is 541,164 sq. ft. ( $\pm$  569,186). We are 95% certain that Q3 net absorption typically falls between -28,021 and 1,110,350 sq. ft. Thus, a negative net absorption of -235,209 sq. ft. in Q3 2016 is significantly below historic Q3 performance.

### Leasing Activity

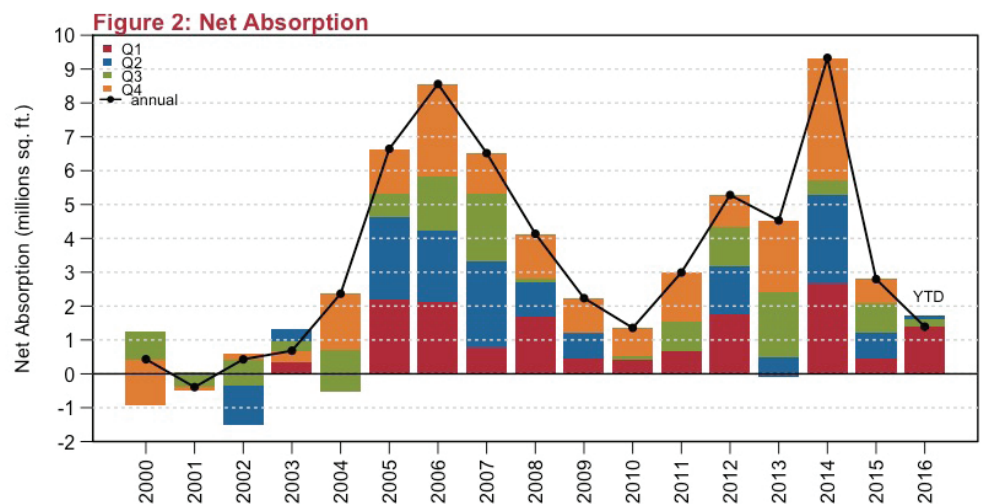
Leasing activity is another measure of demand for office space, representing the total amount of space for direct leases, subleases, renewals, and pre-leasing. Figure 3 shows leasing activity since 2000 by year and quarter for combined Class A and B office space. The third

quarters 3.12 million sq. ft. of leasing activity represented decreases of -7.2% QoQ and -23.6% YoY (Table 1). The historic Q3 average ( $\pm$  95% confidence interval) for leasing activity is 4.41 million sq. ft. ( $\pm$  575,924). We are 95% certain that Q3 leasing activity typically falls between 3,837,835 - 4,989,683 sq. ft. This indicates that current leasing activity is statistically lower than historic Q3 measures. With net absorption lagging behind leasing activity, lower leasing activity in Q3 suggests low absorption in quarters to come.

### Availability and Vacancy

Vacancy and availability measure both the supply and demand of office space, and as such are key

indicators of shifts in the phase of the office market cycle. Availability better measures total supply because it includes vacant, occupied, and sublease space. Vacancy better measures empty space on the market, whether or not that space is leased or for rent. Overall, the office market weakened in Q3 2016, as both vacancy and availability continued to increase through the falling phase of the office market cycle that began in mid-2014 (prior to the manifestation of the oil downturn) (Figure 4). For Class A and B buildings combined, availability was 21.7%, up 4.3% QoQ and 16.7% YoY (Table 1). Likewise, vacancy climbed to 15.8%, up 4.0% QoQ and 17.0% YoY (Table 1).



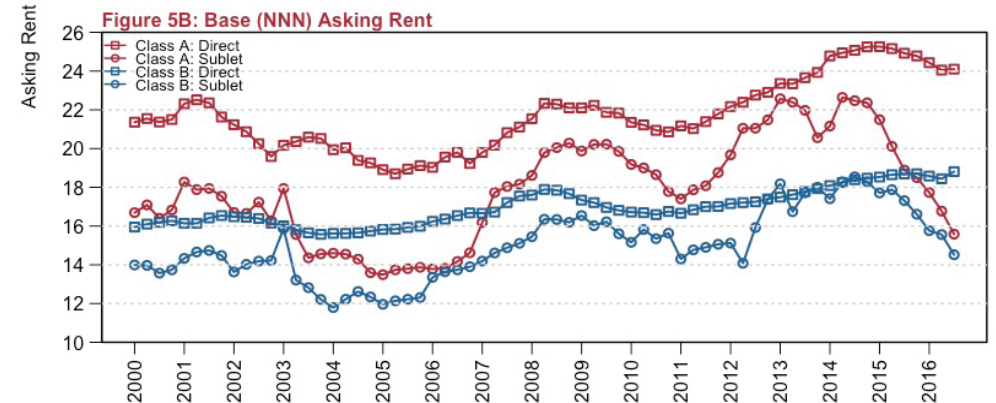
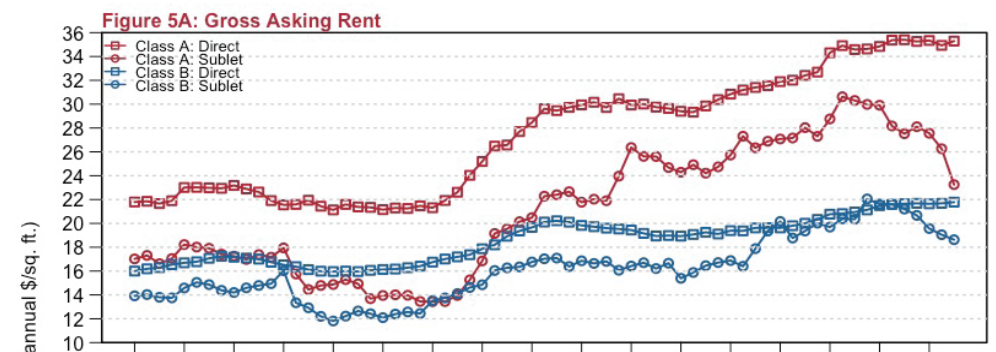
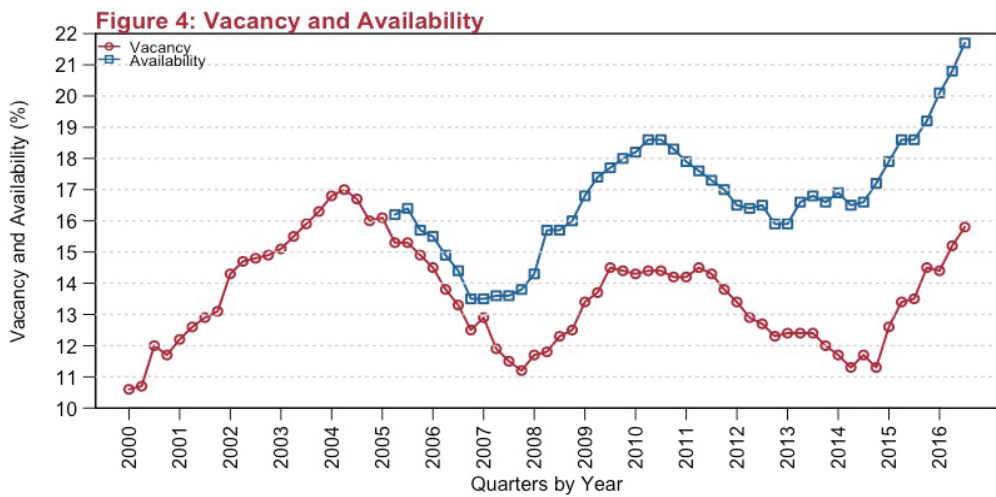
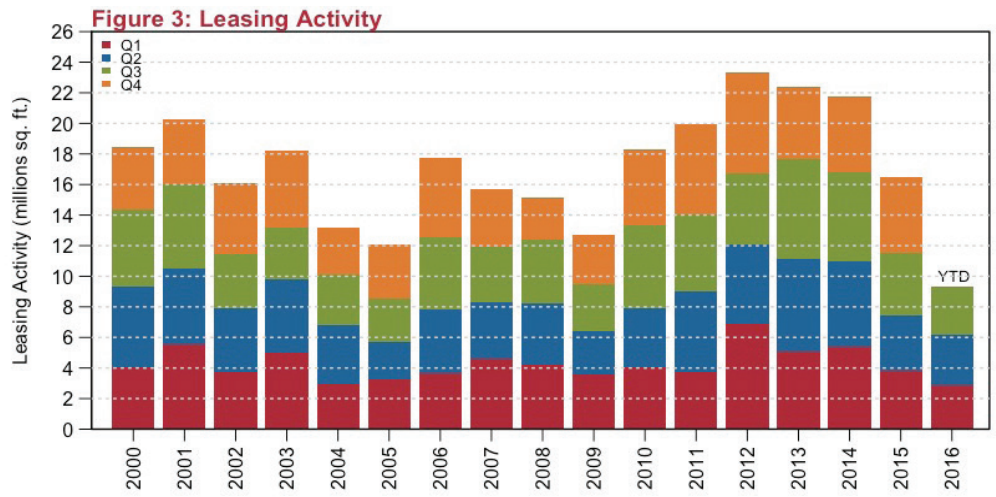
## Asking Rent

Figure 5 plots both gross and base (NNN) asking rents for direct and sublease space since 2000 for Class A and B buildings. Despite limitations of asking (rather than actual) rent, we can derive information on market conditions by examining the difference between direct and sublease base rents. The greater the difference between direct and sublease asking rents, the softer are market conditions.

Since Houston's office market began falling in late 2014, the difference between direct and sublease base asking rents for Class A buildings has grown from \$3.77 to \$8.52 (Figure 5B). Historically, Class A buildings have shown an average of \$3.52 difference between direct and sublease base asking rents, with a 95% confidence interval of \$3.15 to \$3.89. At the current \$8.52, Houston's Class A rents are way outside this expected range. For Class B buildings, the difference between direct and sublease base asking rents has grown from \$0.82 to \$4.29 since 2014 (Figure 5B). Historically, Class B buildings have shown an average of \$1.97 difference between direct and sublease base asking rents, with a 95% confidence interval of \$1.62 to \$2.21. At the current \$4.29 difference, Houston's Class B rents are outside of this range.

## Construction and Deliveries

Construction of new stock inventory shapes the growing supply of office space. "RBA Delivered" refers to completed construction, while "RBA Under Construction" refers to space under construction that has not yet been completed. Figure 6 breaks down deliveries and construction on an annual basis by Class A and Class B products. Deliveries in Q3 2016 were 1.7 million sq. ft. of Class A and B buildings, a decrease of 31% QoQ but an increase of 44% YoY (Table 1).

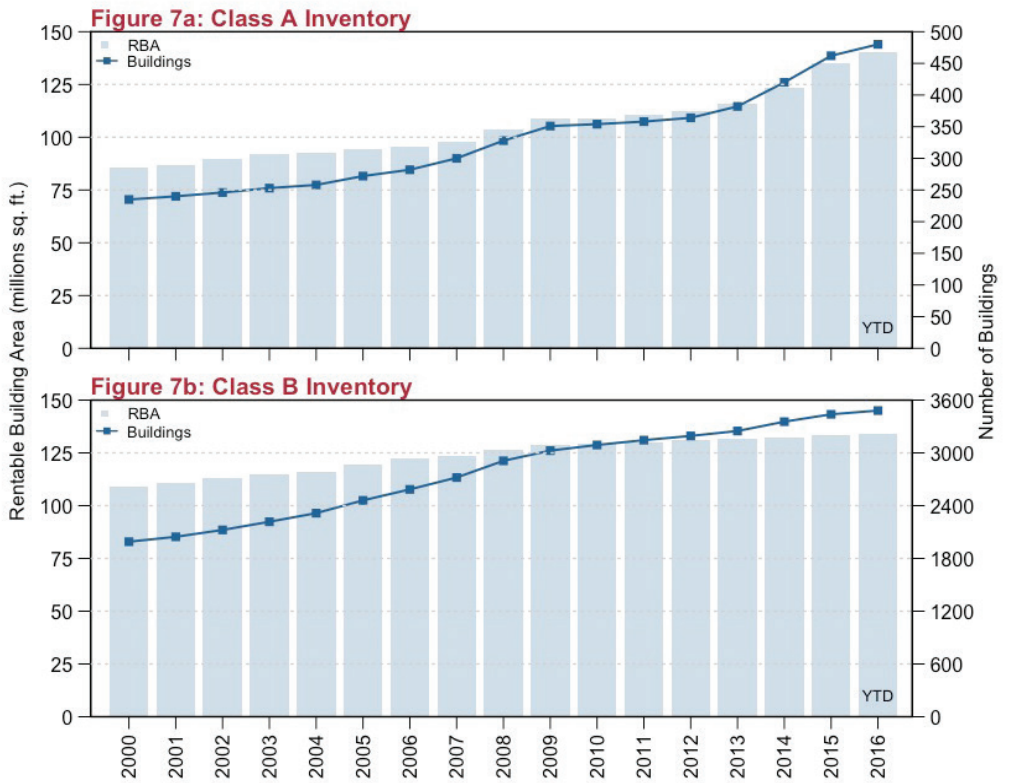
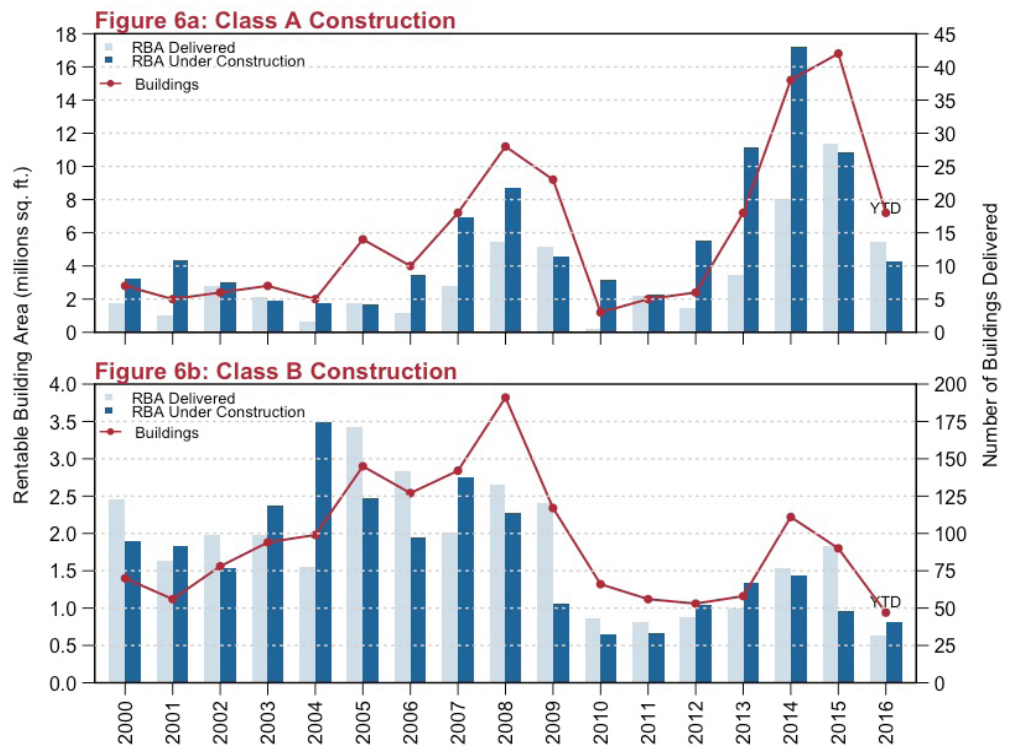




RBA under construction is now below four million square feet in Q3 2016, a decrease of -16.8% QoQ and -65.6% YoY (Table 1).

## Inventory

Figure 7 depicts changes in the inventory of Class A and Class B buildings since 2000, both in terms of RBA and the number of buildings. Stock inventory for Class A and B office space included 274 million sq. ft. for 3,961 buildings (Table 1).



Largest Space Available By Building (AS OF END OF Q3)

Address	SF	Submarket	Address	SF	Submarket
800 Bell St	1,314,350	Downtown	4400 Post Oak Pky	243,931	West Loop
800 Capitol St	748,800	Downtown	23680 Interstate 45	243,000	Woodlands
401 Franklin St	727,265	Downtown	2100 Travis St	240,134	Downtown
609 Main St	654,496	Downtown	Allen Pky	239,998	Downtown
Timberloch Pl	654,119	Woodlands	Five Chasewood Dr	236,880	FM 1960
1222 Rusk St	602,578	Downtown	5847 San Felipe St	234,668	San Felipe/Voss
909 Fannin St	538,490	Downtown	10760 N Gessner Rd	230,000	West Belt
915 N Eldridge Pky	524,411	Katy Freeway	808 Travis St	227,943	Downtown
17750 Katy Fwy	514,500	Katy Freeway	1201 Louisiana St	225,868	Downtown
10 Waterway Ave	500,000	Woodlands	7401 Katy Fwy	224,800	West Loop
Katy Fwy	481,539	Katy Freeway	2700 Post Oak Blvd	220,372	West Loop
17001 Northchase Dr	450,244	North Belt	15377 Memorial Dr	220,355	Katy Freeway
Corridor Park	445,777	Katy Freeway	16945 Northchase Dr	217,864	North Belt
811 Louisiana St	432,011	Downtown	363 N Sam Houston Pky E	217,101	North Belt
Waterway Ave & Timberloch Pl	400,000	Woodlands	1300 Woodloch Forest Dr	208,065	Woodlands
CityWestPlace 6	387,200	Westchase	700 Milam St	207,356	Downtown
Town & Country Blvd	382,197	Katy Freeway	4005 Technology Dr	205,000	Southwest Far
600 Gemini St	363,050	NASA/Clear Lake	100 Glenborough Dr	204,198	North Belt
Katy Fwy	362,830	Katy Freeway	3501 Main St	203,312	Downtown
580 Westlake Park Blvd	358,704	Katy Freeway	19219 Katy Fwy	203,149	Katy/Grand Parkway West
12450 Greenspoint Dr	356,468	North Belt	480 Wildwood Forest Dr	201,651	Woodlands
Eldridge & Enclave Pky	349,188	Katy Freeway	E Beltway 8	200,000	Northeast Near
1600 Smith St	341,772	Downtown	222 Benmar Dr	199,904	North Belt
Corridor Park	321,317	Katy Freeway	5718 Westheimer Rd	198,840	San Felipe/Voss
13501 Katy Fwy	320,000	Katy Freeway	25700 Interstate 45	197,000	Woodlands
1415 Louisiana St	317,932	Downtown	1330 Post Oak Blvd	195,404	West Loop
19400 SH 249	312,000	FM 1960	3737 Buffalo Speedway Ave	191,494	Greenway Plaza
CityWestPlace 5	306,900	Westchase	17750 Katy Fwy	190,900	Katy Freeway
1414 Enclave	300,907	Katy Freeway	17750 Katy Fwy	190,900	Katy Freeway
E Beltway 8	300,100	Northeast Near	3200 Kirby Dr	190,884	Greenway Plaza
2475 Technology Forest Blvd	299,172	Woodlands	396 W Greens Rd	189,853	North Belt
1780 Hughes Landing Blvd	290,405	Woodlands	17750 Katy Fwy	187,500	Katy Freeway
16825 Northchase Dr	273,547	North Belt	1301 McKinney St	183,488	Downtown
10496 Old Katy Rd	264,000	Katy Freeway	6464 Savoy Dr	182,566	Southwest
8800 Technology Forest Pl	260,000	Woodlands	811 Dallas St	182,100	Downtown
2101 CityWest Blvd	259,735	Westchase	2 Riverway	180,765	West Loop
5725 N Sam Houston Pky W	257,243	West Belt	3 Greenway Plz	180,566	Greenway Plaza
4477 W Sam Houston Pky N	256,000	West Belt	1401 McKinney St	178,252	Downtown
233 Benmar Dr	253,562	North Belt	9700 Bissonnet St	178,212	Southwest
600 Jefferson St	252,593	Downtown	11450 Compaq Center West Dr	174,896	FM 1960
3003 Louisiana St	246,940	Downtown	17000 Katy Fwy	174,469	Katy Freeway
1020 Holcombe Blvd	245,834	South Main/Medical Center	333 Clay St	172,613	Downtown
1000 Louisiana St	245,780	Downtown	9250 Pinecroft Dr	171,996	Woodlands
5775 N Sam Houston Pky E	244,848	West Belt	Highway 99	171,538	Katy/Grand Parkway West
			Highway 99	171,538	Katy/Grand Parkway West

## Largest Space Available By Building (Continued)

Address	SF	Submarket	Address	SF	Submarket
10720 W Sam Houston Pky N	165,226	West Belt	SH 249 & Boudreaux Pky	139,169	Northwest Outlier
Grand Pky & Franz Rd	165,000	Katy/Grand Parkway West	16001 Park Ten Place Dr	136,950	Katy Freeway
Grand Pky & Franz Rd	165,000	Katy/Grand Parkway West	15710 John F Kennedy Blvd	135,448	North Belt
10713 W Sam Houston Pky N	164,999	West Belt	500 N Sam Houston Pky W	135,030	North Belt
11750 Katy Fwy	164,000	Katy Freeway	9709 Lakeside Blvd	134,938	Woodlands
28420 Hardy Toll Rd	163,998	Woodlands	2800 N Loop Fwy W	132,849	Northwest
1233 West Loop S	162,041	West Loop	Grand Pky & Franz Rd	130,200	Katy/Grand Parkway West
18051 Saturn Ln	160,000	NASA/Clear Lake	3200 Southwest Fwy	128,084	Greenway Plaza
730 Town & Country Blvd	160,000	Katy Freeway	21700 Merchants Way	127,953	Katy/Grand Parkway West
NEC Pruitt Rd & Budde Rd	159,000	Woodlands	2350 N Sam Houston Pky E	125,788	North Belt
6004 Rogerdale Rd	158,607	Westchase	500 Dallas St	125,568	Downtown
10100 Katy Fwy	158,173	Katy Freeway	555 Gemini St	124,908	NASA/Clear Lake
19350 State Highway 249	156,000	FM 1960	2727 North Loop W	123,103	Northwest
1311 Broadfield Blvd	155,407	Katy Freeway	3040 Post Oak Blvd	121,738	West Loop
15150 Memorial Dr	155,175	Katy Freeway	2929 W Sam Houston Pky N	120,000	Katy Freeway
16290 Katy Fwy	155,050	Katy Freeway	1885 Saint James Pl	118,817	West Loop
10700 North Fwy	154,928	North Belt	W Fernhurst Dr And Grand	113,875	Katy/Grand Parkway West
12707 North Fwy	154,454	North Belt	1725 Hughes Landing Blvd	113,106	Woodlands
1333 West Loop S	151,762	West Loop	24275 Katy Fwy	112,932	Katy/Grand Parkway West
5555 San Felipe St	150,440	West Loop	652 N Sam Houston Pky E	112,281	North Belt
5251 Westheimer Rd	150,212	West Loop	777 N Eldridge Pky	110,599	Katy Freeway
16200 Park Row	150,000	Katy Freeway	330 Barker Cypress Rd	110,480	Katy Freeway
Hardy Toll Road & Riley F Rd	150,000	FM 1960	1001 West Loop South	109,676	West Loop
Waterway Ave & Timberloch Pl	150,000	Woodlands	554 Club Dr	108,000	Outlying Montgomery Cnty
Waterway Ave & Timberloch Pl	150,000	Woodlands	2050 W Sam Houston Pky S	107,088	Westchase
2465 Technology Forest Blvd	149,196	Woodlands	601 Travis St	107,022	Downtown
15375 Memorial Dr	149,000	Katy Freeway	7000 Hollister St	105,900	Northwest
550 Westlake Park Blvd	148,674	Katy Freeway	1600 West Loop S	104,579	West Loop
2200 N Sam Houston Pky E	148,563	North Belt	2950 N Loop Fwy W	103,929	Northwest
400 Sam Houston Pky	148,500	North Belt	14141 Southwest Fwy	101,019	E Fort Bend Co/Sugar Land
400 N Sam Houston Pky W	147,900	North Belt	1001 Campbell Rd	100,000	Katy Freeway
2500 CityWest Blvd	147,445	Westchase	E Beltway 8	100,000	Northeast Near
0 Creek Bend Dr	147,159	E Fort Bend Co/Sugar Land	13785 Lockwood Rd	100,000	Northeast Near
711 Louisiana St	146,871	Downtown	2103 CityWest Blvd	99,993	Westchase
900 Threadneedle St	146,729	Katy Freeway	10900 Corporate Centre Dr	98,451	West Belt
815 Northgate Crossing Blvd	144,000	Woodlands	Wallisville And E Sam Hou	98,250	I-10 East
815 Northgate Crossing Blvd	144,000	Woodlands	1575 Sawdust Rd	98,227	Woodlands
4851 W Sam Houston Pky N	144,000	West Belt	10496 Old Katy Rd	96,000	Katy Freeway
1709 Dryden Rd	143,546	South Main/Medical Center	14741 Yorktown Plaza Dr	96,000	West Belt
13401 N I-45	143,410	North Belt	3773 Richmond Ave	94,585	Greenway Plaza
Springwoods Village Pky	141,700	Woodlands	4503 Montrose Blvd	94,500	Downtown
2115 Winnie St	140,966	Southeast Outlier	9811 Katy Fwy	94,478	Katy Freeway
3600 W Sam Houston Pky S	140,000	Westchase	Merchants Way	92,250	Katy/Grand Parkway West
I 10 & Grand Pky	139,169	Katy/Grand Parkway West	840 Gessner Rd	91,319	Katy Freeway

## Largest Space Available By Building (Continued)

Address	SF	Submarket
2001 Timberloch Pl	90,539	Woodlands
1401 Enclave Pky	88,885	Katy Freeway
4480 Highway 225	86,753	Gulf Freeway/Pasadena
2229 San Felipe	86,614	Downtown
5851 Southwest Fwy	82,500	Richmond/Fountainview
Kurland Dr	82,323	Gulf Freeway/Pasadena
1720 N Sam Houston Pky W	80,075	North Belt
Hwy 59	80,000	Kingwood/Humble
2051 S Greenhouse Rd	79,409	Katy/Grand Parkway West
16900 Park Row	77,000	Katy Freeway
11700 Katy Fwy	76,631	Katy Freeway
11025 Discovery Bay Dr	75,627	South
W Fernhurst Dr And Grand	75,625	Katy/Grand Parkway West
1080 Eldridge Pky	74,336	Katy Freeway
10205 Westheimer Rd	74,139	Westchase
400 N Sam Houston W Pky	73,950	North Belt
9009 West Loop South	73,196	Bellaire
Hwy 290 & FM 1960	73,000	FM 1960
250 Meadowfern Dr	71,208	North Belt
3663 N Sam Houston Pky E	69,999	North Belt
330 N Sam Houston Pky E	69,000	North Belt
570 Westlake Park Blvd	67,334	Katy Freeway
5333 Westheimer Rd	63,452	West Loop
350 Glenborough Dr	63,105	North Belt
Merchants Way	63,000	Katy/Grand Parkway West
8223 Willow Place Dr S	62,001	FM 1960
737 N Eldridge Pky	60,667	Katy Freeway
11200 Broadway St	60,000	South
16101 Dillard Dr	60,000	West Belt
1290 Hercules Ave	60,000	NASA/Clear Lake
2828 FM 2920 Rd	60,000	Woodlands
198 Kempner St	59,650	E Fort Bend Co/Sugar Land
412 Main St	58,635	Downtown
16285 Park Ten Place Dr	58,498	Katy Freeway
11302 Tanner Rd	57,798	West Belt
5444 Westheimer Rd	57,361	West Loop
1775 St James Pl	56,910	West Loop
Beltway 8	56,100	Gulf Freeway/Pasadena
15115 Park Row	56,064	Katy Freeway
600 N Sam Houston Pky	55,700	North Belt
575 N Dairy Ashford	54,518	Katy Freeway
5884 Point West Dr	54,417	Southwest
222 Cavalcade St	54,200	I-10 East
22655 Highway 59 N	54,000	Kingwood/Humble
3010 Briarpark Dr	53,452	Westchase

Address	SF	Submarket
500 Jefferson St	52,172	Downtown
2222 Bay Area Blvd	52,171	NASA/Clear Lake
400 N Sam Houston Pky W	52,110	North Belt
400 N Sam Houston Pky W	52,110	North Belt
13100 Space Center Blvd	51,072	NASA/Clear Lake
198 Kempner St	50,700	E Fort Bend Co/Sugar Land
12300 Dundee Ct	50,000	FM 1960



**Select Sales** (AS OF END OF Q3)

Property Address	Bldg SF	Sale Date	Sale Price	Price Per SF
12516-12518 Cutten Rd, 12516-C/1st Floor	6,000	10/6/16	\$274,999	\$194.21
150 E Medical Center Blvd	10,251	9/30/16	\$2,100,000	\$204.86
18929 Eastex Fwy	8,400	8/2/16	\$865,000	\$102.98
1470 First Colony Blvd	18,939	7/29/16	\$3,300,000	\$174.24
17170 Mill Forest Rd	9,000	7/1/16	\$1,300,000	\$144.44

**Select Top Office Leases** (AS OF END OF Q3)

Tenant	Building	Square Feet
United Airlines	609 Main St.	237,708
Lloyd's Register	1330 Enclave Parkway	86,892
Orrick, Herrington & Sutcliffe, LLP	609 Main St.	56,806
Aetna*	3 Sugar Creek Center Blvd.	52,000
American Midstream	2103 CityWest Blvd.	50,929
TechSpace Holding	2101 CityWest Blvd.	46,092
Hogan Lovells US, LLP	609 Main St.	43,072
Baker Engineering	11011 Richmond	19,348
Intertek Testing*	3737 Red Bluff	18,764

\* Renewal

\*\* Construction to begin 1/2017

**Select Largest Deliveries** (AS OF END OF Q3)

Building Address	Submarket Name	Rentable Building Area	Percent Leased
1500 Post Oak Blvd.	Galleria	593,850	100%
15377 Memorial Dr.	Katy Freeway West	385,532	43%
480 Wildwood Forest Dr.	Woodlands	201,933	0%
3773 Richmond Ave.	Greenway Plaza	182,000	100%

**Select Under Construction** (AS OF END OF Q3)

Building Address	Rentable Building Area	Submarket Name	Percent Leased
609 Main St	1,056,658	CBD	38%
1717 W Loop Fwy S	380,000	Post Oak Park	90%
10100 Katy Fwy	238,173	Katy Freeway East	34%
Highway 99	222,465	Katy/Grand Parkway West	23%
3200 Kirby Dr	191,805	Greenway Plaza	48%
9250 Pinecroft Dr	171,996	Woodlands	0%
1600 West Loop S	104,579	Galleria/Uptown	0%
198 Kempner St	94,200	E Fort Bend Co/Sugar Land	46%
18211 Katy Fwy	86,255	Katy Freeway West	57%
250 Assay St	83,157	Northeast Near	62%
7619 Branford Pl	38,599	E Fort Bend Co/Sugar Land	0%
League City Pky	28,500	Southeast Outlier	12%
12525 Memorial Dr	25,000	Katy Freeway East	31%
12525 Memorial Dr	25,000	Katy Freeway East	15%



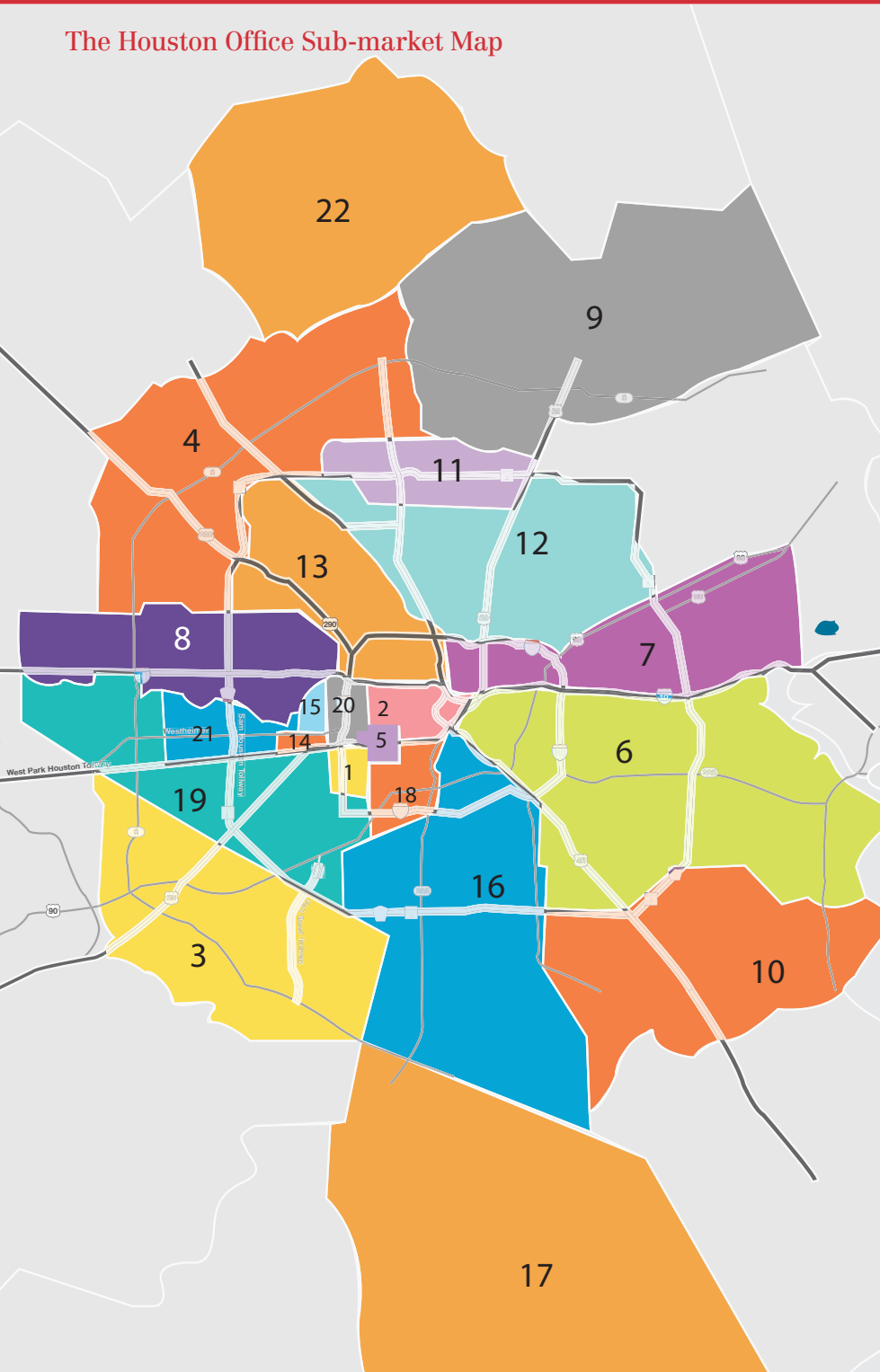
## Class A Market Statistics (AS OF END OF Q3)

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	7	1,191,304	151,910	0	\$26.71
Downtown	44	34,795,502	3,739,190	1,056,658	\$43.38
E Fort Bend Co/Sugar Land	20	3,773,926	284,645	132,799	\$30.14
FM 1960	20	4,086,782	341,398	0	\$26.89
Greenway Plaza	20	7,254,528	1,162,937	191,805	\$37.22
Gulf Freeway/Pasadena	1	22,706	3,122	0	\$30.59
I-10 East	0	0	0	0	\$0.00
Katy Freeway	94	24,226,295	3,438,708	603,128	\$30.05
Katy/Grand Parkway West	23	1,899,277	565,201	222,465	\$28.02
Kingwood/Humble	3	185,977	43,709	0	\$26.29
NASA/Clear Lake	17	2,122,602	192,346	0	\$27.63
North Belt	25	5,564,959	2,071,757	0	\$23.92
Northeast Near	2	555,700	0	83,157	\$0.00
Northwest	11	2,275,066	652,539	0	\$22.75
Richmond/Fountainview	0	0	0	0	\$0.00
San Felipe/Voss	3	1,720,793	405,476	0	\$36.07
South	4	397,500	65,033	250,000	\$27.22
South Hwy 35	0	0	0	0	\$0.00
South Main/Medical Center	15	4,560,992	198,250	0	\$28.53
Southwest	9	2,052,051	281,890	0	\$18.82
West Belt	30	4,356,093	705,207	0	\$27.16
West Loop	47	17,440,180	2,834,620	520,000	\$36.99
Westchase	33	9,815,108	1,510,278	0	\$34.50
Woodlands	42	11,306,590	1,359,176	172,000	\$35.38

## Class B Market Statistics (AS OF END OF Q3)

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	32	2,997,566	232,843	0	\$23.58
Downtown	188	20,173,338	2,943,423	0	\$28.66
E Fort Bend Co/Sugar Land	250	4,988,612	487,146	137,445	\$24.97
FM 1960	348	7,627,844	1,187,726	20,443	\$17.71
Greenway Plaza	49	4,093,475	349,959	0	\$26.22
Gulf Freeway/Pasadena	168	3,896,438	492,527	6,000	\$21.19
I-10 East	24	664,442	148,514	0	\$15.64
Katy Freeway	205	12,246,909	1,897,367	0	\$22.47
Katy/Grand Parkway West	239	2,937,750	116,762	105,934	\$26.78
Kingwood/Humble	84	2,051,951	137,476	57,352	\$22.61
NASA/Clear Lake	222	5,948,881	991,018	6,800	\$18.28
North Belt	75	6,501,923	1,504,192	0	\$16.24
Northeast Near	31	728,535	136,962	0	\$20.06
Northwest	148	6,926,675	894,718	15,000	\$18.79
Richmond/Fountainview	27	952,794	208,572	0	\$17.78
San Felipe/Voss	38	3,585,600	385,945	0	\$23.69
South	84	1,548,778	144,970	0	\$27.32
South Hwy 35	34	359,039	14,508	0	\$15.58
South Main/Medical Center	67	4,933,247	622,715	0	\$26.15
Southwest	127	7,815,385	1,184,650	60,000	\$16.46
West Belt	52	2,123,189	276,787	0	\$21.89
West Loop	58	6,262,578	680,631	0	\$26.36
Westchase	71	7,736,415	1,293,817	196,000	\$19.63
Woodlands	345	7,753,542	712,499	80,556	\$24.88

## The Houston Office Sub-market Map



1. Bellaire
2. Downtown - CBD + Midtown
3. E Fort Bend Co/Sugar Land
4. Fm 1960 + FM 1960/Champions + Fm1960/Hwy 249 + FM 1960/I-45 North
5. Greenway Plaza
6. Gulf Freeway/Pasadena
7. I-10 East
8. Katy Freeway = Katy Freeway East + Katy Freeway West
9. Kingwood/Humble
10. Nasa/Clear Lake
11. North Belt = North Belt East + North Belt West/Greenspoint
12. Northeast Near
13. Northwest = North Loop West + Northwest + Far\_ Northwest Near
14. Richmond
15. San Felipe/Voss
16. South
17. South Hwy 35
18. South Main/Medical Center
19. Southwest = Southwest Beltway 8 + Southwest/Hillcroft
20. Westloop = Galleria/Uptown + Riverway + Post Oak Park
21. Westchase = Westchase East + Westchase West
22. Woodlands

## Methodology

The quarterly report for the office market includes information and data for Class A and Class B buildings, but excludes Class C buildings. Buildings are not excluded on the basis of single vs. multi-tenancy, owner occupancy, or building size.

*Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy. Sources include: U.S. Bureau of Economic Analysis, CoStar, Council on Foreign Relations, Federal Reserve Bank of Dallas, Greater Houston Partnership, FiveThirtyEight.com, Houston Association of Realtors, Moody Analytics, NAI Global, National Association Realtors, Texas A&M Real Estate Center, Well's Fargo, University of Houston's Institute of Regional Forecasting, U.S. Bureau of Labor Statistics.*

# Economic and Market Outlook:

HOUSTON OFFICE | Q3 2016

**NAI**Partners

HOUSTON | AUSTIN | SAN ANTONIO

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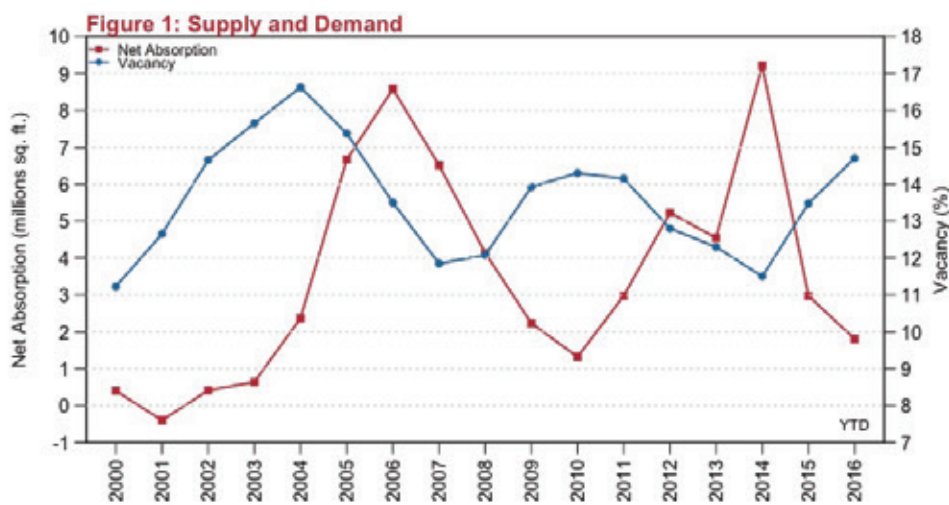
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# Economic and Market Outlook:

HOUSTON OFFICE | Q2 2016



HOUSTON | SAN ANTONIO | AUSTIN



## Executive Summary

Two quarters into 2016 and we have already seen a turbulent year, with January and February lows replaced by some rebalancing in March and April, only for volatility to return at the end of the second quarter with Brexit. While Q1 2016 was likely the bottom of the oil commodity downturn, we have again in recent weeks seen WTI prices fall. This is likely a short-term result of Brexit and the value of the dollar, but nonetheless presents further concern for local and national economies. Projected U.S. GDP for 2016 has now been revised down from 2.4% to 1.8%, with the latest revision for Q1 at 1.1%. Consumer spending and consumer credit remain strong points, fueling about two-thirds of GDP. Recent changes in national employment further underscore the volatility of the first half of the year, dropping to only 11,000 new jobs in May and then bouncing back to 287,000 new jobs in June. Brexit will likely have minimal effects on the U.S., and the world as a whole, as the United Kingdom only accounts for about 4% of global GDP. Yet, Brexit could actually catalyze U.S. commercial real estate investors to remain in the U.S. rather than Central London, where many have previously sought opportunities. The economic outlook for Texas and Houston economies is uncertain, sitting on the edge of further declines or mild to modest growth for the remainder of 2016.

Net absorption and leasing activity in Q2 2016 were among the lowest since 2000. Net absorption comes in at low 72,000 sq. ft. in Q2 2016, a demand for office space that is a substantial and significant decrease below its historic Q2 performance. Likewise, leasing activity of 2.23 million sq. ft. in Q2 2016 was significantly lower than its historic Q2 average. Vacancy ticked up above 15% for the first time since 2005, while availability continued its upward climb to 20.8%, being driven by further increases in available sublease space of 11.4 million sq. ft. Nearly 2.5 million sq. ft. of deliveries occurred in Q2 2016, leaving 4.3 million sq. ft. still under construction. As Houston's office market continues to move through the falling phase of its market cycle, attention turns to a favored tenant market and increasing landlord concessions.

**Table 1. Market indicators for Q2 2016, and their percent (%) change on a quarter-over-quarter (QoQ) and year-over-year (YoY) basis.**

Market Variables	Percent Change over Time Period		
	Q2 2016	QoQ (%)	YoY (%)
Asking Rent: Class A	\$34.93	-1.2%	-1.2%
Asking Rent: Class B	\$21.68	0.2%	0.5%
Net Absorption (sq. ft.)	72,855	-95.8%	-91.4%
Leasing Activity (sq. ft.)	2,233,096	-21.7%	-38.1%
Availability (%)	20.8%	3.5%	12.4%
Vacancy (%)	15.1%	5.6%	12.7%
Deliveries (sq. ft.)	2,491,701	33.3%	-29.9%
Construction (sq. ft.)	4,352,155	-34.1%	-64.7%
Inventory (sq. ft.)	272,944,462	0.9%	3.5%
Inventory (No. of Buildings)	3,910	0.5%	2.4%



## Broker's Perspective

As the second quarter of 2016 drew to a close, several trends have persisted since the first quarter with no signs of slowing. Landlords are still highly motivated to retain and acquire new tenants. Sublessors are lowering initial quotes and in some cases agreeing to abated rent to secure subtenants, while larger blocks of sublease space are continuing to come on the market. On the other hand, in some cases tenant confidence has started to diminish, which has caused some tenants to delay leasing decisions until expirations get closer or opt for a short-term extension to take stock of industry headwinds.

Tenants in the market can expect several important things in coming times. First, they can expect a greater sense of urgency from landlords and sublandlords to finalize a transaction. In addition to concessions, such as tenant improvement allowances and months or even a year of abated rent, we have begun to see creative deal structures serve as further landlord enticements to attract tenants and preserve cash flow. Some examples

of these creative structures include holding the starting rate for the first several years, or an instant rate reduction prior to expiration for renewals.

The sublease market continues to dominate the conversation when speaking to clients and industry colleagues alike. Unfortunately, only subtenants seeking blocks of space greater than 20,000 sq. ft. are able to truly take advantage of the current sublease offerings, of which there are plenty. Smaller tenants looking for a sublease in a desirable area with a lease term greater than two years are left feeling underwhelmed as these sublease opportunities are few and far between.

Tenants continue to be in the driver's seat when looking for new deals in the marketplace, and subtenants will achieve significant overall rent reductions below initial quotes if the right opportunity can be found. We think the next 6 to 12 months will be trying times for office landlords as rents shrink, concessions grow and deal volume continues to erode.

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“Landlords are still highly motivated to retain and acquire new tenants.”

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**Taylor Wright**  
Vice President | NAI Partners



## ECONOMIC OVERVIEW

The overall economic outlook has again declined for Texas and Houston, despite some intermittent positive signs. Brexit has increased volatility in financial markets, but could lead to increased CRE spending in U.S. as investors shift from Central London. The oil and gas downturn is now manifesting throughout Houston beyond just those direct businesses. The hopes are that the oil industry will swing back up before the national economy slows, which remains solid despite some mixed numbers and slowdowns.

### National Economy

Economic data in recent weeks and months are sending mixed messages for second quarter performance, leading many to further debate whether the economic expansion will continue or reverse course and slide downward. The Leading Economic Index (LEI) declined by a slight 0.2% in May—its third drop in six months—but overall this looks to be short lived. The U.S. gross domestic product (GDP) is now projected to be 1.8% for 2016, a modest decrease from 2.4% in 2015. GDP was revised up to 1.1% for Q1 2016, and is expected to come in around 2.4% for Q2. Strong consumer spending, which accounts for about two-thirds of GDP, will continue to fuel economic growth. Consumer credit further strengthened in May, and strong consumption in April and May will likely account for growth in Q2 2016. Consumer confidence increased 7.6 points in June, though some concern remain in the job market. International trade will continue to decline and hamper GDP with the strong dollar (up nearly 20%). Greater import growth in May led to a wider trade deficit, which is likely to increase by 4% in 2016, following a 6.2% increase in 2015.

At the center of the mixed messages in economic data are numbers on employment. Job growth in May dropped to only 11,000, but bounced back higher than expected to 287,000 new jobs in June, resulting in a three-month trend of 147,000 new jobs. With the unemployment rate remaining below 5%, the labor market continues to tighten. However, recent growth in jobs has been in industries with high and low wages, leaving middle-class wages to lag.

After a few months of growth and modest stability following lows in January and February, volatility has again returned to the financial and commodity markets,

largely as a timely result of Brexit. Since the vote for the U.K. to leave the European Union, global financial markets have settled down. Effects on the U.S. will likely be minimal over the long term, but uncertainty will continue as the UK and EU begin working out negotiations on their future economic relationships. The U.K. will likely dip into a mild recession later in 2016, but this should not have a large effect on world economics, as the U.K. only represents 4% of global GDP. With uncertainty in the U.K., investors in commercial real estate from the U.S. may shift from Central London and simply remain in the U.S. with its strong CRE industry. To wit, the Dodge Momentum Index, a 12-month leading indicator of non-residential construction spending, jumped 11.2 percent in June and overall in Q2.

The ISM non-manufacturing index increased in June to 56.5, indicating that the economy continues to expand at a moderate pace. Moreover, the NFIB Small Business Optimism Index increased in June for the third month in a row. The ISM manufacturing index indicated that in June factories grew at the strongest rate since early 2015, but growth will remain modest in months to come, as shipments, orders and inventories are still declining, though at a slower rate. Given a variety of headwinds, including low May job growth, financial volatility, and reduced manufacturing, the current speculation is for only one remaining interest rate hike by the Federal Reserve Bank, likely after the presidential election.

The housing market is yet another variable producing mixed economic signals. Both the good-time-to-buy and good-time-to-sell indices increased in June, but the Home Purchase Sentiment Index dropped to 83.2. The high value of the dollar has led the National Association of Realtors to point out that home values

by international buyers have decreased by 1.3%. This is leading such buyers to seek out lower-priced homes. Sales of new homes decreased by 6% in May.

### Houston and Texas Economy

Following the lows in oil prices of Q1, the initial months of Q2 saw prices swing up as global inventory stock piles slowed. Then Brexit and the value of the dollar saw oil prices decline again, restarting a new set of price swings and volatility in recent weeks. Due to weakness in the energy market, banks of the Eleventh Federal Reserve District have increased their funds set aside in case of loan losses, supporting recent increases in noncurrent loans associated with oil and gas companies.

Overall, Texas and Houston have a mixed set of economic numbers. Employment in Texas, despite the energy pullback, grew 0.4% in May compared to U.S. at 0.3%, with 4,400 new jobs following 14,500 new jobs in April. Unemployment in Texas remains at 4.4%, still lower than the national level of 4.7%. To this end, the Texas Leading Index, which uses key economic indicators to forecast future employment growth, did increase across sectors, suggesting some improvements ahead. Texas retail sales previously declined, but increased modestly in June as evidenced by the Texas Retail Outlook Survey. While employment growth in Houston contracted by 1.9% from April to May—with job growth coming from government, and education and health services—Houston's unemployment rate dropped to 5% in May. Layoffs in Houston are now trickling through the economy and manifesting in residential, retail, wages, and office markets. Housing remains strong in other cities and regions of Texas, but Houston's housing market has weakened substantially.



MARKET OVERVIEW

With reduced demand and low leasing activity, along with higher vacancy and availability, Houston continues its dive into the falling phase of the office market cycle. The second quarter of 2016 posted an exceptionally modest 72,000 sq. ft. of net absorption, a demand for office space that is substantially lower than historic Q2 performance of an average of 907,000 sq. ft. Similarly, leasing activity of 2.23 million sq. ft. in Q2 2016 was nearly half the historic Q2 leasing activity of 4.37 million sq. ft. Leasing activity was the lowest in 17 years. Vacancy ticked up above 15% for the first time since 2005, while availability continued its upward climb to 20.8%, which has been fueled by increases in sublease space to 11.4 million sq. ft. Nearly 2.5 million sq. ft. of deliveries occurred in Q2 2016, leaving 4.3 million sq. ft. still under construction.

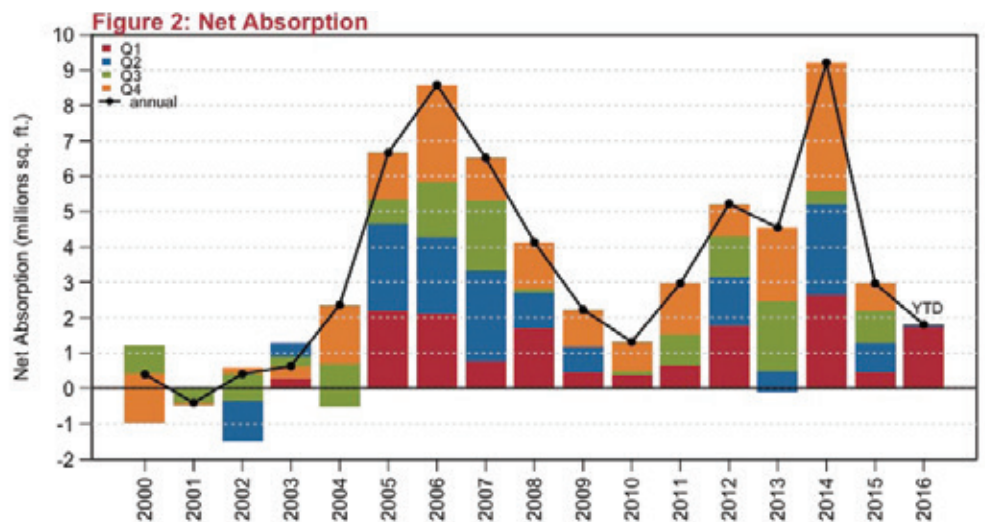
Net Absorption

Demand, as measured by net absorption (direct plus sublease space), is the change in occupied stock inventory. Figure 2 shows net absorption since 2000 by year and quarter for combined Class A and B office space. Following 1.7 million sq. ft. in Q1 2016, the second quarter's 72,000 sq. ft. of positive net absorption represented a substantial decrease of -95.8% QoQ and -91.4% YoY (Table 1). The historic Q2 average ( $\pm$  95% confidence interval) for net absorption is 907,341 sq. ft. ( $\pm$  567,163). We are 95% certain that Q2 net absorption typically falls between 340,178 - 1,474,504 sq. ft. Thus, a net absorption of merely 72,000 sq. ft. in Q2 2016 is significantly below historic Q2 performance.

Leasing Activity

Leasing activity is another measure for the demand of office space, representing the total amount of space for direct leases, subleases, renewals, and pre-leasing. Figure 3

shows leasing activity since 2000 by year and quarter for combined Class A and B office space. Q2's 2.23 million sq. ft. of leasing activity represented decreases of -21.7% QoQ and -38.1% YoY (Table 1). The historic Q2 average ( $\pm$  95% confidence interval) for leasing





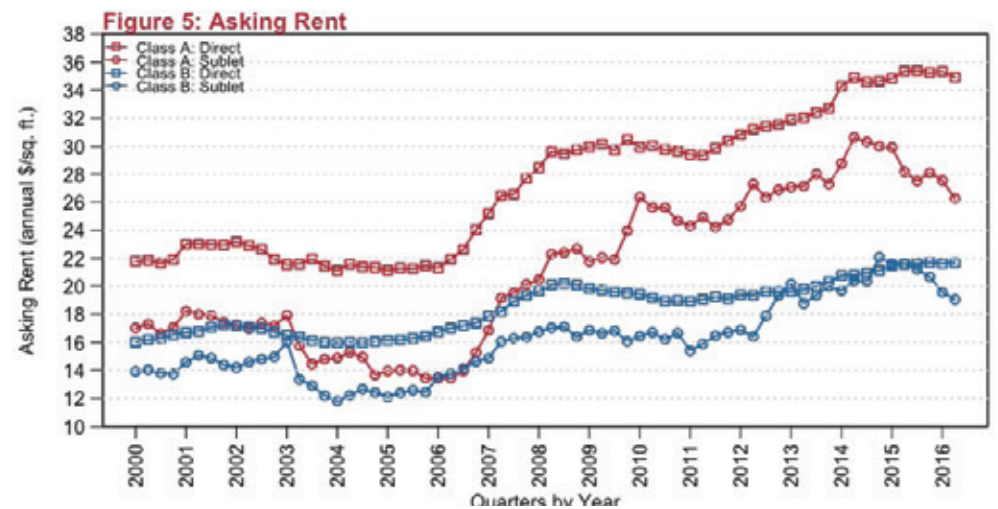
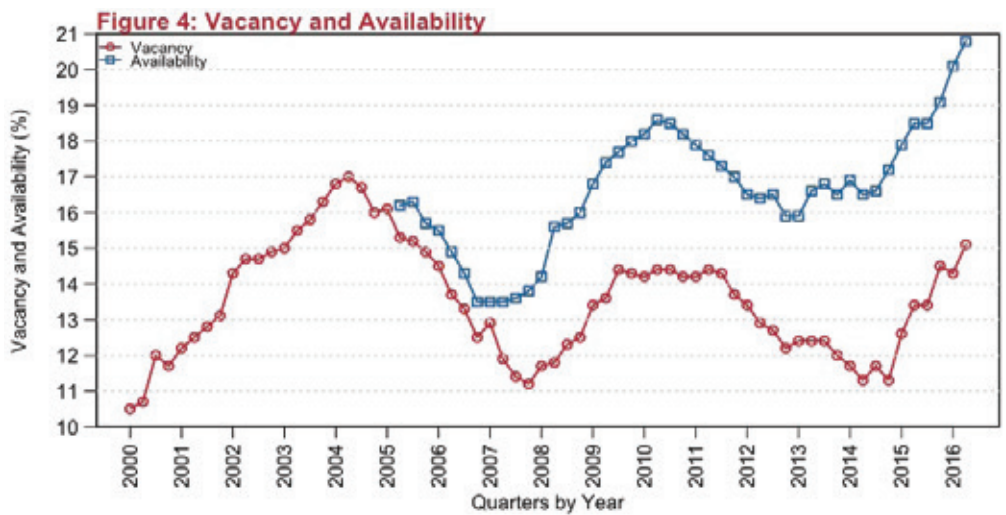
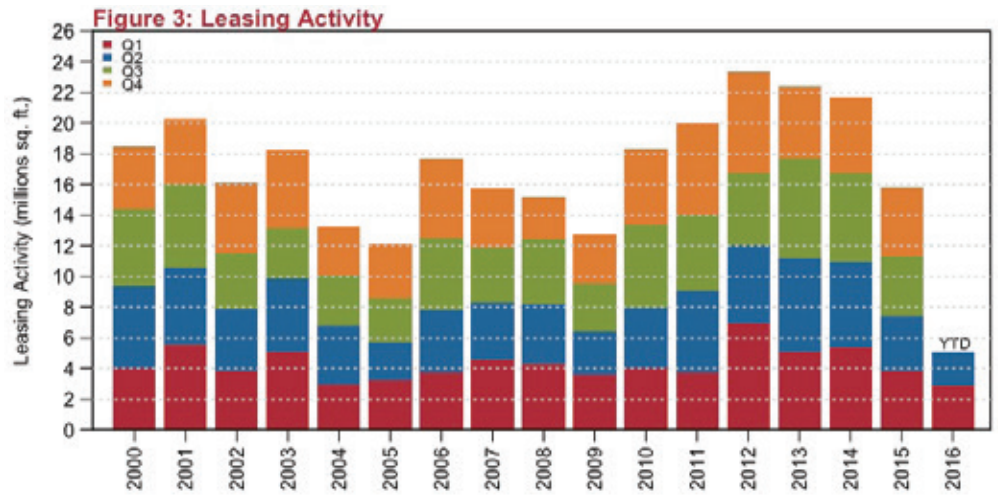
activity is 4.37 million sq. ft. ( $\pm$  535,462). We are 95% certain that Q2 leasing activity typically falls between 3,830,626 - 4,901,551 sq. ft. This indicates that current leasing activity is statistically lower than historic Q2 measures. In fact, Q2 leasing activity was the lowest on record of all prior quarters since 2000. With net absorption lagging behind leasing activity, lower leasing activity in Q2 suggests low absorption in quarters to come. This is not only indicative of the change in Houston's oil economy, but also the shift to a falling phase of the Houston office market cycle.

### Availability and Vacancy

Vacancy and availability measure the supply of office space, and as such are key indicators of shifts in the phase of the office market cycle. Availability better measures total supply because it includes vacant, occupied, and sublease space. Vacancy better measures empty space on the market, whether or not that space is leased or for rent. Overall, office supply increased in Q2 2016, continuing into the falling phase of the office market cycle that began in early to mid-2014 (prior to the manifestation of the oil downturn) (Figure 4). For Class A and B buildings combined, availability was 20.8%, up 3.5% QoQ and 12.4% YoY (Table 1). Likewise, vacancy climbed to 15.1%, up 5.6% QoQ and 12.7% YoY (Table 1). As indicated by increases in both vacancy and availability, Houston's office products march forward in the falling phase of their market cycle.

### Asking Rent

Figure 5 plots asking rent for direct and sublease space since 2000 for Class A and B buildings. In Q2 2016, both Class A and B space showed stable direct asking rents, with Class A asking rent at \$35 and Class B at \$21. However, Class A direct rents tended to be about \$5 higher than



sublets, which continued to decline in asking rates due in part to the glut of sublease space on the market. Note, sublet rather than direct asking rents tend to be more indicative of a softening market, as evidenced in Figure 5 over recent quarters.

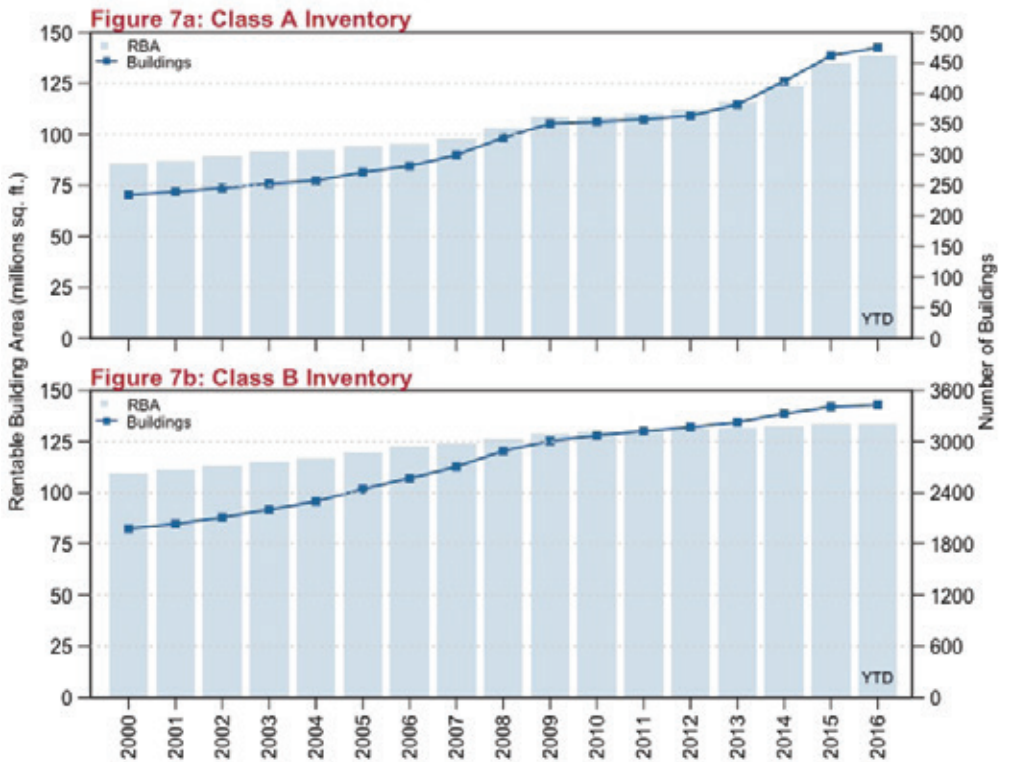
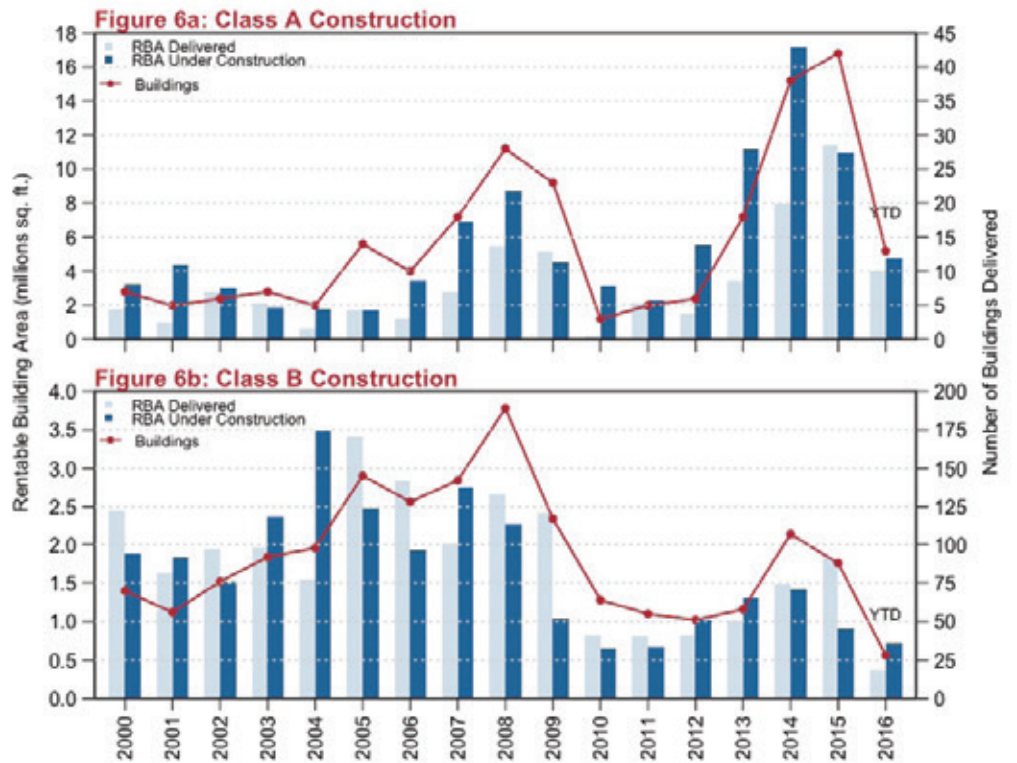
### Construction and Deliveries

Construction of new stock inventory shapes the growing supply of office space. "RBA Delivered" refers to completed construction, while "RBA Under Construction" refers to space under construction that has not yet

been completed. Deliveries in Q2 2016 were 2.49 million sq. ft. of Class A and B buildings, an increase of 33% QoQ but a decrease of 30% YoY (Table 1). RBA under construction is now down to 4.35 million sq. ft. in Q2 2016, a decrease of -34.1% QoQ and -64.7% YoY (Table 1). Figure 6 breaks down deliveries and construction on an annual basis by Class A and Class B products.

**Inventory**

Figure 7 depicts changes in the inventory of Class A and Class B buildings since 2000, both in terms of RBA and the number of buildings. Stock inventory for Class A and B office space included 272 million sq. ft. for 3,910 buildings (Table 1).





Largest Space Available By Building (AS OF END OF Q2)

Address	SF	Submarket	Address	SF	Submarket
800 Bell St	1,314,350	Downtown	16945 Northchase Dr	219,014	North Belt
609 Main St	994,648	Downtown	1021 Main St	217,541	Downtown
910 Louisiana St	829,949	Downtown	700 Milam St	212,356	Downtown
925 N Eldridge Pky	597,628	Katy Freeway	5718 Westheimer Rd	209,906	San Felipe/Voss
200 Westlake Park Blvd	559,094	Katy Freeway	500 Jefferson St	207,941	Downtown
915 N Eldridge Pky	524,474	Katy Freeway	3737 Buffalo Speedway Ave	207,713	Greenway Plaza
909 Fannin St	511,676	Downtown	100 Glenborough Dr	206,553	North Belt
580 Westlake Park Blvd	455,061	Katy Freeway	4005 Technology Dr	205,000	Southwest Far
811 Louisiana St	432,011	Downtown	480 Wildwood Forest Dr	201,651	Woodlands
1330 Post Oak Blvd	410,803	West Loop	222 Benmar Dr	198,257	North Belt
550 Westlake Park Blvd	390,726	Katy Freeway	2445 Technology Forest Blvd	192,606	Woodlands
600 Gemini St	363,050	NASA/Clear Lake	396 W Greens Rd	189,853	North Belt
12450 Greenspoint Dr	356,468	North Belt	10777 Clay Rd	189,285	Katy Freeway
1600 Smith St	341,772	Downtown	3200 Kirby Dr	188,696	Greenway Plaza
17001 Northchase Dr	336,443	North Belt	900 Threadneedle St	188,496	Katy Freeway
811 Main St	323,123	Downtown	6464 Savoy Dr	182,566	Southwest
1360 Post Oak Blvd	320,349	West Loop	811 Dallas St	182,100	Downtown
13501 Katy Fwy	320,000	Katy Freeway	2 Riverway	181,397	West Loop
2101 CityWest Blvd	305,827	Westchase	3 Greenway Plz	180,566	Greenway Plaza
1414 Enclave	300,907	Katy Freeway	2103 CityWest Blvd	179,217	Westchase
1415 Louisiana St	299,871	Downtown	9700 Bissonnet St	178,212	Southwest
1780 Hughes Landing Blvd	297,175	Woodlands	2500 CityWest Blvd	177,786	Westchase
4400 Post Oak Pky	285,871	West Loop	11450 Compaq Center West Dr	174,896	FM 1960
16825 Northchase Dr	278,225	North Belt	17000 Katy Fwy	174,469	Katy Freeway
3200 Southwest Fwy	272,597	Greenway Plaza	10713 W Sam Houston Pky N	166,325	West Belt
11750 Katy Fwy	265,688	Katy Freeway	10720 W Sam Houston Pky N	165,226	West Belt
3010 Briarpark Dr	264,187	Westchase	1111 Bagby St	162,070	Downtown
1201 Louisiana St	261,496	Downtown	1725 Hughes Landing Blvd	161,149	Woodlands
5847 San Felipe St	261,053	San Felipe/Voss	1233 West Loop S	159,787	West Loop
5555 San Felipe St	260,605	West Loop	1885 Saint James Pl	158,585	West Loop
8800 Technology Forest Pl	260,000	Woodlands	10100 Katy Fwy	158,173	Katy Freeway
2100 Travis St	255,492	Downtown	16290 Katy Fwy	156,746	Katy Freeway
233 Benmar Dr	253,562	North Belt	12707 North Fwy	155,999	North Belt
600 Jefferson St	253,042	Downtown	15150 Memorial Dr	155,175	Katy Freeway
1020 Holcombe Blvd	245,834	South Main/Medical Center	1311 Broadfield Blvd	155,040	Katy Freeway
5775 N Sam Houston Pky E	244,226	West Belt	5251 Westheimer Rd	153,603	West Loop
363 N Sam Houston Pky E	241,177	North Belt	711 Louisiana St	153,351	Downtown
1301 McKinney St	240,733	Downtown	2050 W Sam Houston Pky S	150,912	Westchase
25700 Interstate 45	240,000	Woodlands	15375 Memorial Dr	148,920	Katy Freeway
333 Clay St	239,475	Downtown	15710 John F Kennedy Blvd	145,264	North Belt
1000 Louisiana St	236,749	Downtown	1709 Dryden Rd	143,546	South Main/Medical Center
1333 West Loop S	224,975	West Loop	13401 N I-45	143,410	North Belt
15377 Memorial Dr	222,773	Katy Freeway	15721 Park Row	140,982	Katy Freeway
2700 Post Oak Blvd	220,372	West Loop	2115 Winnie St	140,966	Southeast Outlier
808 Travis St	220,183	Downtown	3600 W Sam Houston Pky S	140,000	Westchase



## Largest Space Available By Building (Continued)

Address	SF	Submarket	Address	SF	Submarket
2800 N Loop Fwy W	138,150	Northwest	2001 Timberloch Pl	90,539	Woodlands
10700 North Fwy	137,441	North Belt	1114 Texas Ave	90,000	Downtown
16001 Park Ten Place Dr	136,950	Katy Freeway	737 N Eldridge Pky	88,458	Katy Freeway
2950 N Loop Fwy W	135,343	Northwest	11000 Corporate Centre Dr	87,637	West Belt
500 N Sam Houston Pky W	135,212	North Belt	11700 Katy Fwy	87,626	Katy Freeway
500 Dallas St	134,682	Downtown	263 N Sam Houston Pky E	87,611	North Belt
10900 Corporate Centre Dr	129,505	West Belt	2229 San Felipe	86,614	Downtown
21700 Merchants Way	127,953	Katy/Grand Parkway West	5851 Southwest Fwy	82,500	Richmond/Fountainview
10000 Richmond Ave	127,674	Westchase	12700 Northborough Dr	80,000	North Belt
1080 Eldridge Pky	126,484	Katy Freeway	2900 Wilcrest Dr	79,748	Westchase
2350 N Sam Houston Pky E	125,788	North Belt	2051 S Greenhouse Rd	79,409	Katy/Grand Parkway West
555 Gemini St	124,908	NASA/Clear Lake	16900 Park Row	77,000	Katy Freeway
2727 North Loop W	123,103	Northwest	9009 West Loop South	73,196	Bellaire
1001 Fannin St	118,830	Downtown	550 Greens Pky	72,050	North Belt
24275 Katy Fwy	113,056	Katy/Grand Parkway West	250 Meadowfern Dr	71,208	North Belt
652 N Sam Houston Pky E	112,281	North Belt	812 Main St	71,000	Downtown
330 Barker Cypress Rd	110,480	Katy Freeway	330 N Sam Houston Pky E	69,000	North Belt
1001 West Loop South	109,676	West Loop	350 Glenborough Dr	68,581	North Belt
14141 Southwest Fwy	108,993	E Fort Bend Co/Sugar Land	570 Westlake Park Blvd	67,334	Katy Freeway
27700 Highway 290	108,454	Northwest Outlier	1302 Conti St	65,000	I-10 East
554 Club Dr	108,000	Outlying Montgomery Cnty	5700 NW Central Dr	64,155	Northwest
601 Travis St	107,022	Downtown	16430 Park Ten Pl	62,788	Katy Freeway
7000 Hollister St	105,900	Northwest	8223 Willow Place Dr S	62,001	FM 1960
2107 CityWest Blvd	103,018	Westchase	1290 Hercules Ave	60,000	NASA/Clear Lake
3773 Richmond Ave	102,994	Greenway Plaza	1300 Hercules Ave	60,000	NASA/Clear Lake
750 Town & Country Blvd	102,188	Katy Freeway	412 Main St	58,635	Downtown
400 N Sam Houston Pky E	101,656	North Belt	16285 Park Ten Place Dr	58,498	Katy Freeway
16676 Northchase Dr	101,111	North Belt	11302 Tanner Rd	57,798	West Belt
1401 Enclave Pky	99,548	Katy Freeway	1775 St James Pl	56,910	West Loop
3663 N Sam Houston Pky E	98,909	North Belt	2017 Preston St	56,500	Gulf Freeway/Pasadena
1575 Sawdust Rd	98,227	Woodlands	5301 Hollister Rd	56,454	Northwest
2850 Fannin St	97,000	Downtown	15115 Park Row	56,064	Katy Freeway
10496 Old Katy Rd	96,000	Katy Freeway	600 N Sam Houston Pky	55,700	North Belt
14741 Yorktown Plaza Dr	96,000	West Belt	1 Fluor Daniel Dr	54,774	E Fort Bend Co/Sugar Land
3401 Palmer Hwy	95,989	Southeast Outlier	575 N Dairy Ashford	54,518	Katy Freeway
9811 Katy Fwy	94,478	Katy Freeway	5884 Point West Dr	54,417	Southwest
9805 Katy Fwy	93,976	Katy Freeway	222 Cavalcade St	54,200	I-10 East
10500 Richmond Ave	93,785	Westchase	2222 Bay Area Blvd	52,171	NASA/Clear Lake

**Select Sales** (AS OF END OF Q2)

Property Address	Bldg SF	Sale Date	Sale Price	Price Per SF
5700 NW Central Dr	73,401	6/9/16	\$1,950,000	\$26.57
4550 Dacoma St (Part of Multi-Property Sale)	237,384	5/18/16	\$6,759,771	\$28.48
4500 Dacoma St (Part of Multi-Property Sale)	134,031	5/18/16	\$2,017,983	\$15.06
4400 Dacoma St (Part of Multi-Property Sale)	115,522	5/18/16	\$1,739,309	\$15.06
2213 Blalock Rd	1,500	5/3/16	\$450,000	\$300.00
8100 Westglen Dr	4,700	4/26/16	\$485,000	\$103.19
12929 S Main St	7,000	4/6/16	\$300,000	\$42.86
9135 Katy Fwy	15,474	4/5/16	\$1,800,000	\$116.32

**Select Top Office Leases** (AS OF END OF Q2)

Tenant	Building	Square Feet
American Bureau of Shipping	1701 City Plaza Dr. **	303,137
Aetna*	Three Sugar Creek Center	52,000
Wally Park	8787 Tallyho	35,035
Patterson - UTI Drilling Co.	10713 W. Sam Houston Parkway N.	34,227
Thompson Coe Cousins & Irons	One Riverway	30,888
Asset Plus Companies	950 Corbindale	29,026
Charter Title Co.	1717 West Loop South	24,478
Higman Marine Services	1717 West Loop South	24,478
Potts Law Firm	3737 Buffalo Speedway	19,319
Intertek Testing*	3737 Red Bluff Rd.	18,764
Bellaire Dermatology	6565 West Loop South	16,334

\* Renewal

\*\* Construction to begin 1/2017

**Select Largest Deliveries** (AS OF END OF Q2)

Building Name	Building Address	Submarket	Percent Leased
915 N Eldridge Pky	Katy Freeway	524,744	5%
25700 Interstate 45	Woodlands	240,470	20%
27700 Highway 290	Northwest Outlier	165,754	35%
1885 Saint James Pl	West Loop	165,000	4%
2002 Grand Pky N	Katy/Grand Parkway West	124,295	68%
4460 Highway 225	Gulf Freeway/Pasadena	102,000	78%
2101 CityWest Blvd.	Westchase	1,100,000	100%

**Select Under Construction** (AS OF END OF Q2)

Building Name	Building Address	Rentable Building Area	Submarket Name
609 Main St	1,056,658	CBD	6%
15377 Memorial Dr	428,565	Katy Freeway West	48%
1717 W Loop Fwy S	380,000	Post Oak Park	97%
10100 Katy Fwy	238,173	Katy Freeway East	34%
3773 Richmond Ave	210,000	Greenway Plaza	51%
480 Wildwood Forest Dr	201,933	Woodlands	14%
3200 Kirby Dr	188,696	Greenway Plaza	0%
129 Vision Park Blvd	69,510	Woodlands	71%

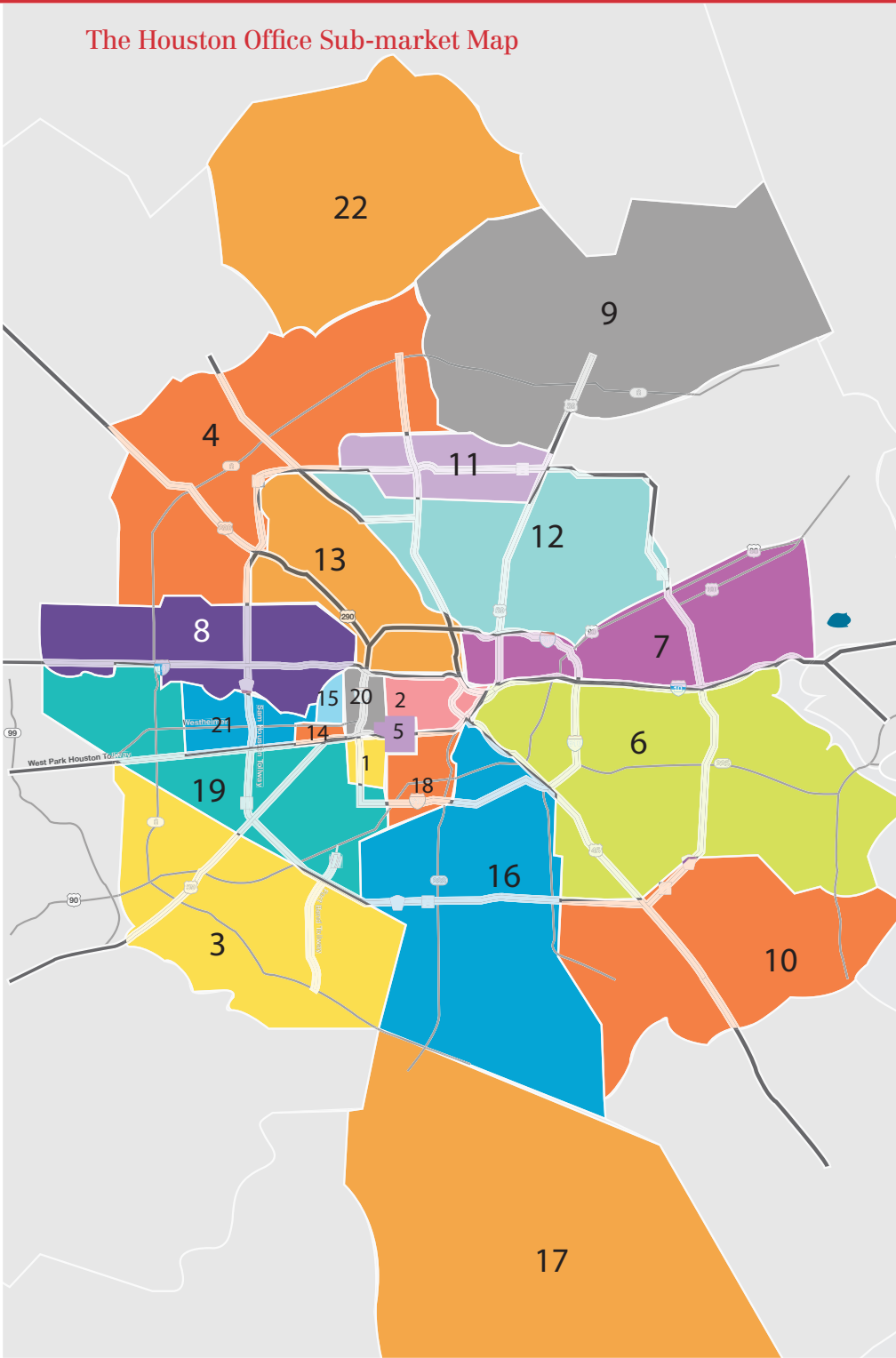
Class A Market Statistics (AS OF END OF Q2)

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	7	1,191,304	81,311	0	\$25.76
Downtown	43	34,673,964	3,581,053	1,171,658	\$42.61
E Fort Bend Co/Sugar Land	20	3,773,926	233,385	0	\$27.73
FM 1960	20	4,074,372	379,902	0	\$26.60
Greenway Plaza	19	7,072,528	1,072,932	398,696	\$37.08
Gulf Freeway/Pasadena	1	22,706	3,122	0	\$30.59
I-10 East	0	0	0	0	\$0.00
Katy Freeway	93	23,820,629	3,484,848	716,738	\$32.88
Katy/Grand Parkway West	23	1,899,277	609,683	0	\$27.45
Kingwood/Humble	3	185,977	43,709	0	\$26.29
NASA/Clear Lake	17	2,121,888	180,538	0	\$28.04
North Belt	25	5,562,674	2,019,457	0	\$24.20
Northeast Near	2	555,700	0	0	\$0.00
Northwest	11	2,282,997	659,340	0	\$22.73
Richmond/Fountainview	0	0	0	0	\$0.00
San Felipe/Voss	3	1,720,793	437,160	0	\$36.02
South	4	397,500	64,485	100,000	\$29.63
South Hwy 35	0	0	0	0	\$0.00
South Main/Medical Center	15	4,560,992	212,924	0	\$28.51
Southwest	9	2,052,051	313,466	0	\$18.77
West Belt	30	4,351,478	700,272	0	\$28.75
West Loop	46	16,846,324	2,223,727	1,120,000	\$37.17
Westchase	33	9,815,108	2,418,255	0	\$36.16
Woodlands	41	11,119,550	1,229,766	201,933	\$34.93

Class B Market Statistics (AS OF END OF Q2)

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	32	3,023,310	212,648	0	\$23.82
Downtown	185	20,143,362	2,846,957	5,800	\$28.61
E Fort Bend Co/Sugar Land	246	4,933,539	480,383	74,042	\$23.97
FM 1960	347	7,645,012	1,182,424	3,000	\$17.82
Greenway Plaza	49	4,093,475	312,084	0	\$27.10
Gulf Freeway/Pasadena	163	3,746,367	542,402	59,105	\$21.38
I-10 East	23	655,818	117,051	0	\$15.26
Katy Freeway	206	12,245,559	1,817,971	0	\$22.71
Katy/Grand Parkway West	235	2,907,280	128,890	35,484	\$28.14
Kingwood/Humble	85	2,052,400	133,663	0	\$22.22
NASA/Clear Lake	221	5,937,621	947,146	10,050	\$18.46
North Belt	75	6,676,542	1,551,065	0	\$16.46
Northeast Near	30	720,035	133,057	0	\$20.10
Northwest	145	6,961,505	926,558	15,000	\$18.18
Richmond/Fountainview	27	950,194	197,548	0	\$17.99
San Felipe/Voss	38	3,585,600	327,586	0	\$23.59
South	84	1,549,745	157,302	0	\$27.37
South Hwy 35	34	359,039	22,154	0	\$14.74
South Main/Medical Center	65	4,899,064	631,105	0	\$26.47
Southwest	126	7,793,050	1,199,555	60,000	\$16.32
West Belt	51	2,101,189	263,275	17,300	\$20.46
West Loop	58	6,262,578	703,697	0	\$26.64
Westchase	72	8,020,878	803,842	186,000	\$20.00
Woodlands	337	7,673,488	652,321	133,472	\$24.96

The Houston Office Sub-market Map



1. Bellaire
2. Downtown - CBD + Midtown
3. E Fort Bend Co/Sugar Land
4. Fm 1960 + FM 1960/Champions + Fm1960/Hwy 249 + FM 1960/I-45 North
5. Greenway Plaza
6. Gulf Freeway/Pasadena
7. I-10 East
8. Katy Freeway = Katy Freeway East + Katy Freeway West
9. Kingwood/Humble
10. Nasa/Clear Lake
11. North Belt = North Belt East + North Belt West/Greenspoint
12. Northeast Near
13. Northwest = North Loop West + Northwest + Far\_ Northwest Near
14. Richmond
15. San Felipe/Voss
16. South
17. South Hwy 35
18. South Main/Medical Center
19. Southwest = Southwest Beltway 8 + Southwest/Hillcroft
20. Westloop = Galleria/Uptown + Riverway + Post Oak Park
21. Westchase = Westchase East + Westchase West
22. Woodlands

Methodology

The quarterly report for the office market includes information and data for Class A and Class B buildings, but excludes Class C buildings. Buildings are not excluded on the basis of single vs. multi-tenancy, owner occupancy, or building size.

*Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy. Sources include: U.S. Bureau of Economic Analysis, CoStar, Council on Foreign Relations, Federal Reserve Bank of Dallas, Greater Houston Partnership, FiveThirtyEight.com, Houston Association of Realtors, Moody Analytics, NAI Global, National Association Realtors, Texas A&M Real Estate Center, Well's Fargo, University of Houston's Institute of Regional Forecasting, U.S. Bureau of Labor Statistics.*

# Economic and Market Outlook:

HOUSTON OFFICE | Q2 2016

**NAI**Partners

HOUSTON | AUSTIN | SAN ANTONIO

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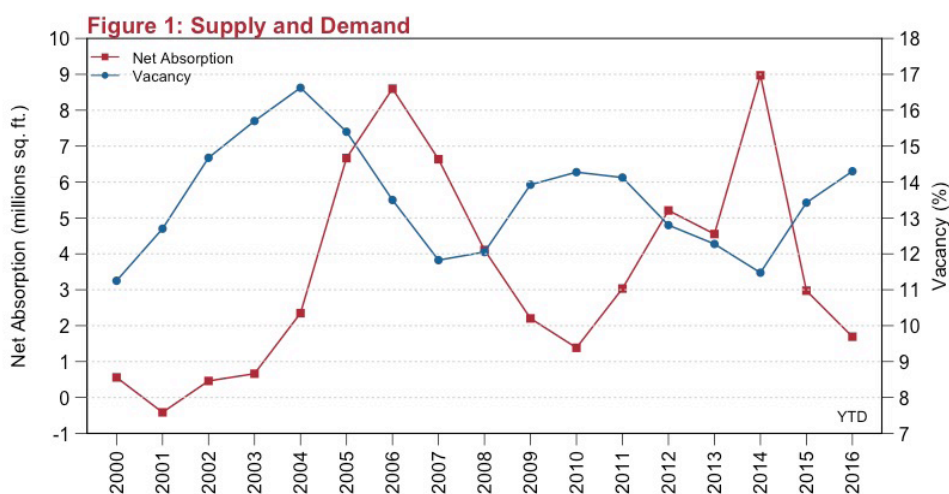


# Economic and Market Outlook:

HOUSTON OFFICE | Q1 2016

**NAI**Partners

HOUSTON | SAN ANTONIO | AUSTIN



## Executive Summary

Houston has seen sizeable slowing in job growth in February and WTI prices broke below \$27 per barrel in Q1, but have recovered to high \$30s and low \$40s. The economic outlook has bounced back from January and February lows, but remains weakened due to volatile financial markets and low prices of commodities. Yet, there seems to be a disconnect between Wall Street and Main Street, as Q1 2016 showed turmoil and volatility on Wall Street, but there was strengthening confidence by the consumer on Main Street. With much talk of an economic recession, the Fed put the probability at 10% and Wells Fargo is slightly higher at 25%. The outlook for Texas and Houston economies is positive, poised for modest growth hinging on no further retreats in the oil industry.

Net absorption was 1,691,990 sq. ft. in Q1 2016, a demand for office space that is actually a significant increase above its historic Q1 performance. Nearly 50% of such high net absorption is driven by just three deals, 25% of which is new building occupancy. Yet, leasing activity in Q1 was only 2,391,745 sq. ft., significantly lower than historic Q1 levels. The sizeable net absorption kept vacancy from increasing QoQ, leaving it at 14.3%. However, availability is at a 16-year high of 19.9%, which includes 9.3 million sq. ft. of sublease space (3x its historic average). Vacancy will increase substantially through 2016 and 2017, as sublease space moves to direct vacant space, bolstered by the pending 6.8 million sq. ft. under construction with ~50% preleased. As Houston's office market moves through the falling phase of its market cycle, attention turns to a favored tenant market and increasing landlord concessions.

**Table 1. Market indicators for Q1 2016, and their percent (%) change on a quarter-over-quarter (QoQ) and year-over-year (YoY) basis.**

Market Variables	Q1 2016	Percent Change over Time Period	
		QoQ (%)	YoY (%)
Asking Rent: Class A	\$35.29	0.3 %	1.3 %
Asking Rent: Class B	\$21.64	-0.4 %	0.7 %
Net Absorption (sq. ft.)	1,691,990	92.2 %	286.9 %
Leasing Activity (sq. ft.)	2,391,745	-45.3 %	-37.7 %
Availability (%)	19.9%	5.3 %	11.2 %
Vacancy (%)	14.3%	-0.7 %	14.4 %
Deliveries (sq. ft.)	1,846,138	-54.8 %	-56.7 %
Construction (sq. ft.)	6,801,739	-16.7 %	-56.0 %
Inventory (sq. ft.)	270,149,818	0.6 %	4.0 %
Inventory (No. of Buildings)	3,847	0.4 %	2.6 %

## Broker's Perspective

In the first part of 2016, we are seeing more motivated landlords that are willing to stretch to close transactions, both for renewals and new leases in their buildings. Sublessors are dropping asking rates, signaling that tenants are motivated and willing to negotiate in order to dispose of excess space more rapidly. The motivation of tenants trying to sublet space and landlords trying to lease space in their buildings has created a sense of urgency and focus on real deals in the market, rather than having confidence in another prospect coming up in the near term.

This focused attention on consummating transactions is resulting in:

- More rounds of negotiations, each time improving terms for the subtenant or tenant;
- More concessions attained for tenants and subtenants alike, including multiple months of free rent, free parking, increased tenant improvement allowances, and even drops in rental rates;
- More scrutiny on the credit of the tenant, once economics are agreed to by landlords, due to concern over more credit risk today with the climate of the local economy

For office tenants considering owner-occupied purchase options, prices remain stable due to a scarcity of smaller owner occupied buildings for sale. The inventory of quality owner-occupied buildings continues to be tight, with demand still fairly stable. This tight supply and consistent demand for owner-occupied buildings applies where occupancy is high and rent growth has been consistent over the years in areas like Westchase, Galleria, inside 610 Loop, and The Woodlands.

While the sublease inventory citywide continues to trend upward, transactions are being negotiated with significant concessions. Quoted rental rates are not dropping much if at all. Yet, negotiated terms can be well below quoted rates,

indicating that landlords are giving in some to make deals. The next 6 - 18 months should be interesting times in the Houston office market, as tenants should continue to have leverage in negotiating favorable terms with some landlords struggling to maintain occupancy levels.



**Griff Bandy**  
Partner | NAI Partners

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“While the sublease inventory citywide continues to trend upward, transactions are being negotiated with significant concessions.”

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## ECONOMIC OVERVIEW

The overall economic outlook has bounced back from January and February lows, but remains weakened due to volatile financial markets and low prices of commodities. The outlook for Texas and Houston economies are similar, poised for modest growth but hinging on no further retreats in the oil industry. The energy and manufacturing sectors have weighed heavily, but 2016 could see growth at both city and state levels.

### National Economy

The overall economic outlook has bounced back from January and February lows, but remains a bit weaker than could be due to volatile financial markets and the low prices of commodities. Yet, there seems to be a disconnect between Wall Street and Main Street; while the first quarter of 2016 showed turmoil and volatility on Wall Street, there was strengthening confidence by the consumer on Main Street. With much talk of an **economic recession**, the St. Louis, Atlanta, and New York branches of the Federal Reserve Bank all put the probability of an economic recession at 10%, but Wells Fargo gives a higher 25% probability over the next six months. It is important to remember that more economic recessions have been forecasted than actually manifest.

The U.S. **gross domestic product** (GDP) is projected to be 2.3% for 2016, a modest difference from 2.4% in 2015. GDP will continue to grow with pent up demand in the **housing market** and strong **consumer spending**, the latter of which accounts for about 66% of GDP. Although **consumer confidence** was down in the winter with stock market volatility, it increased 2.2 points in March to 96.6, but consumers continue to be frustrated with slow growth in income. Consumer credit increased for the 54th month in a row. Data indicate economic growth in Q1 with improving job market and lower debt burdens aiding private consumption. Yet, the strong dollar, volatile financial

markets, and low commodity prices way down the overall positive outlook.

**Employment** in March increased 215,000 jobs, with gains across many sectors, including in particular retail, health care, food services, and business services; again, the primary weakness in job growth remains with energy, manufacturing, and export industries. The ISM manufacturing index increased to 51.8 in March, indicating the first expansion in factory activity since August 2015. Nevertheless, hiring remains low in manufacturing. Unemployment increased to 5.0%, but this is likely attributed to workers re-entering the work force.

There will likely be a couple of interest rate hikes by the Fed in 2016, possibly in the summer and at the end of the year. Core **inflation** was 2.1% in 2015, and will likely rise to near 2.4% in 2016, which will also help the Fed justify increasing interest rates. **International trade** will continue to decline and hamper GDP with strong dollar (up nearly 20%) and global pullbacks, including in particular China and Brazil. The **trade** deficit is likely to increase 4% in 2016. In February the trade deficit increased 2.6% to \$47.1 billion, the highest level in past six months.

### Houston and Texas Economy

The outlook for Texas and Houston economies are similar, poised for modest growth depending on no major further retreats in the oil industry. The energy and manufacturing sectors have weighed heavily, but 2016 could

see growth at both city and state levels. U.S. rig counts continue to decline, reaching a low of 450 rigs at the end of March.

**Employment** in Texas, despite the energy pullback, grew 0.4% in February compared to U.S. at 2.0%, with 4,500 new jobs following 23,700 new jobs in January. Unemployment in Texas was 4.4% in February, still lower than U.S. level of 4.9%. Employment in Houston, however, contracted by 0.4% for the three months ending in February. What job growth did occur came from sectors of leisure and hospitality, education and health, and retail trade. Houston's unemployment remained steady at 4.7% in February, compared with 4.9% in U.S. and 4.4% in Texas. Manufacturing and in particular durable goods continued to lose jobs. However, Texas factory and manufacturing activity, as indicated by the Texas Manufacturing Outlook Survey, increased slightly in March, but was still negative.

The Houston **Business Cycle** Index of the Dallas Federal Reserve measures the Houston economy based on movements in local unemployment, nonagricultural employment, inflation-adjusted wages, and inflation-adjusted retail sales. Business growth in Houston continued its downward fall. Since 2000, the average business cycle index was 3.2% growth, which fell to 1.1% growth in 2015, but as of February 2016 was -3.6%, mostly due to job losses.





## MARKET OVERVIEW

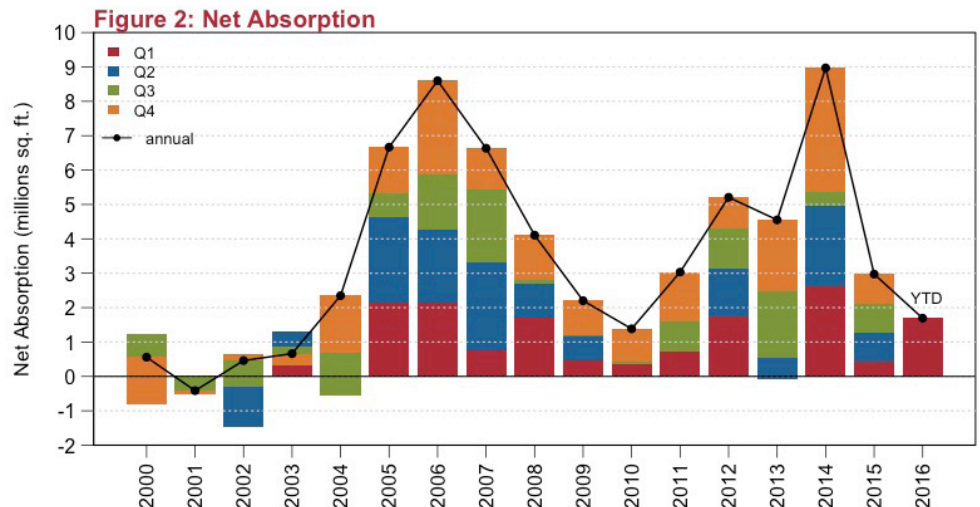
With reduced demand and low leasing activity, along with higher vacancy and availability, Houston continues its falling phase of the office market cycle. The first quarter of 2016 posted 1,691,990 sq. ft. of net absorption, a demand for office space that was greater than historic Q1 performance. Nearly 50% of such high net absorption is driven by just three deals, 25% of which is new building occupancy. However, leasing activity of 2,391,745 sq. ft. in Q1 2016 is lower than historic Q1 measures. In fact, despite strong positive net absorption in Q1, leasing activity in Q1 2016 was the lowest among all prior quarters since 2000. Reasonably strong net absorption under the economic circumstances of the oil downturn kept vacancy from ticking up much further QoQ, remaining about 14.3%. However, availability, including the 9.3 million sq. ft. of sublease space, is at high levels of nearly 19.9%. Another 6.8 million sq. ft. of construction have yet to deliver, suggesting further increases in supply under weakened demand for 2016.

### Net Absorption

Demand, as measured by net absorption (direct plus sublease space), is the change in occupied stock inventory. Figure 2 shows net absorption since 2000 by year and quarter for combined Class A and B office space. The first quarter of 2016 posted 1,691,990 sq. ft. of positive net absorption, representing a substantial increase of 92.2% QoQ and 286.9% YoY (Table 1). The historic Q1 average ( $\pm$  95% confidence interval) for net absorption is 879,823 sq. ft. ( $\pm$  569,903). We are 95% certain that Q1 net absorption typically falls between 309,920 to 1,449,726 sq. ft. Thus, in spite of the oil downturn and associated impacts on the office market, a net absorption of 1.6 million sq. ft. in Q1 2016 is actually a

significant increase above its historic Q1 performance. This is largely a result of three deals. First, National Oilwell Varco took occupancy of 415,000 sq. ft., accounting for 25%

of Q1 net absorption. Two other large blocks accounted for an additional 21% of net absorption, including Stage Stores with 167,000 sq. ft. and BMC Software with 197,000 sq. ft.

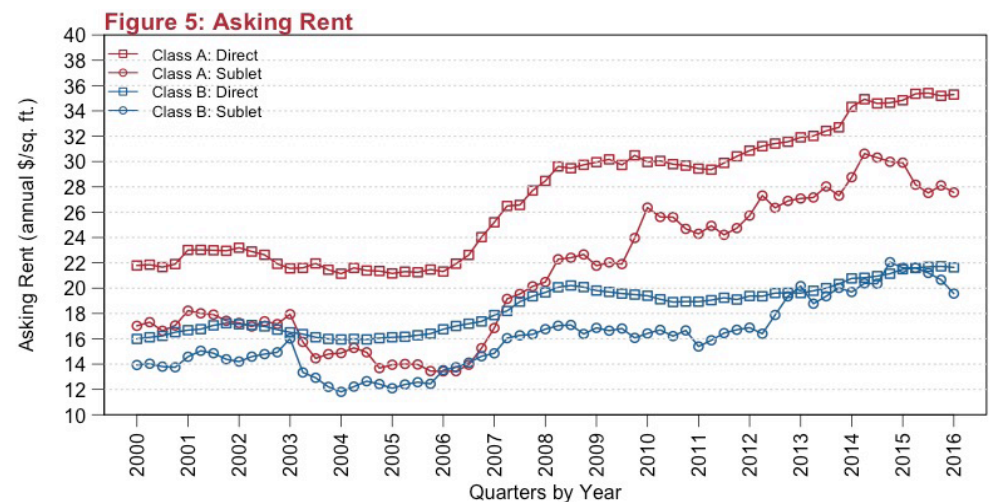
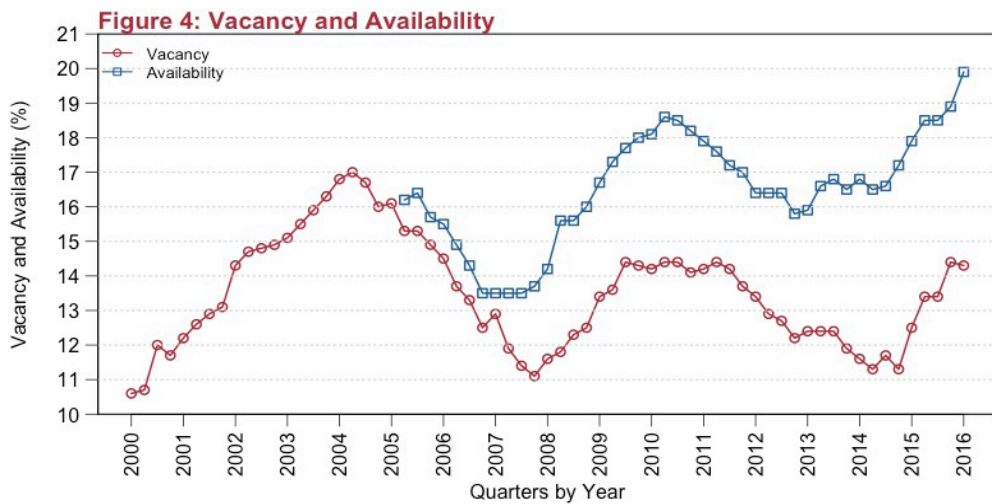
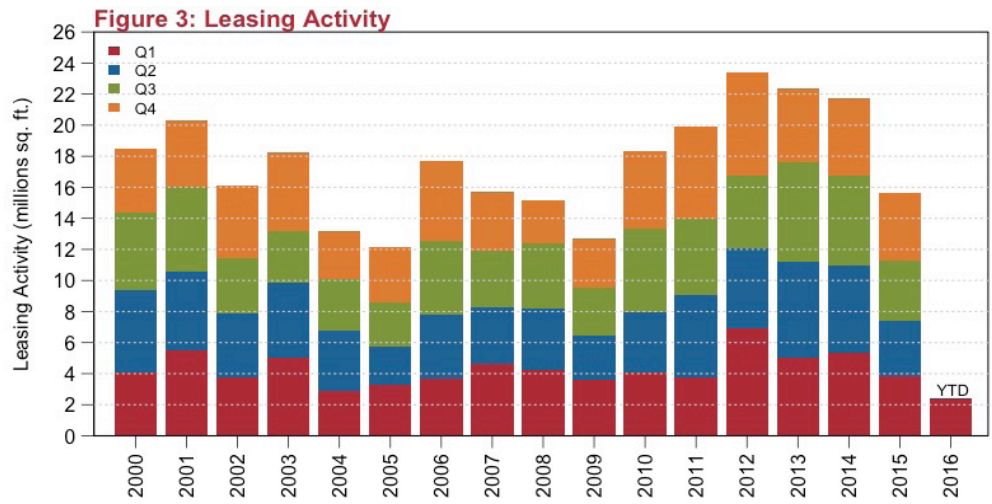


### Leasing Activity

Leasing activity is another measure for the demand of office space, representing the total amount of space for direct leases, subleases, renewals, and pre-leasing. Figure 3 shows leasing activity since 2000 by year and quarter for combined Class A and B office space. Leasing activity of 2,391,745 sq. ft. occurred in Q1 2016, yielding decreases of -45.3% QoQ and -37.7% YoY (Table 1). The historic Q1 average ( $\pm$  95% confidence interval) for leasing activity is 4,352,797 sq. ft. ( $\pm$  541,053). We are 95% certain that Q1 leasing activity typically falls between 3,811,774 to 4,893,851 sq. ft. This indicates that current leasing activity is statistically lower than historic Q1 measures since 2000. In fact, despite strong positive net absorption in Q1, leasing activity in Q1 was the lowest among all prior quarters since 2000. With net absorption lagging behind leasing activity, lower leasing activity in Q1 suggests low absorption in quarters to come. This is not only indicative of the change in Houston's oil economy, but also the shift to a falling phase of the Houston office market cycle.

### Availability and Vacancy

Vacancy and availability measure the supply of office space, and as such are key indicators of shifts in the phase of the office market cycle. Availability better measures total supply because it includes vacant, occupied, and sublease space. Vacancy better measures empty space on the market, whether or not that space is leased or for rent. Overall, office supply continued to increase in Q1 2016, compared with recent quarters (Figure 4). For Class A and B buildings combined, availability was 19.9%, up 5.3% QoQ and 11.2% YoY (Table 1). Likewise, vacancy was 14.3%, up 14.4% YoY (Table 1). As indicated by increases in both vacancy and availability, Houston's



office products are in the falling phase of their market cycle.

### Asking Rent

Figure 5 plots asking rent for direct and sublease space since 2000 for each of Class A and B buildings. In Q1 2016, both Class A and B space

showed stable direct asking rents, with Class A asking rent at \$35 and Class B at \$21. However, Class A direct rents tended to be about \$5 greater than sublets, which continued to decline in asking rates with the glut of sublease space on the market.

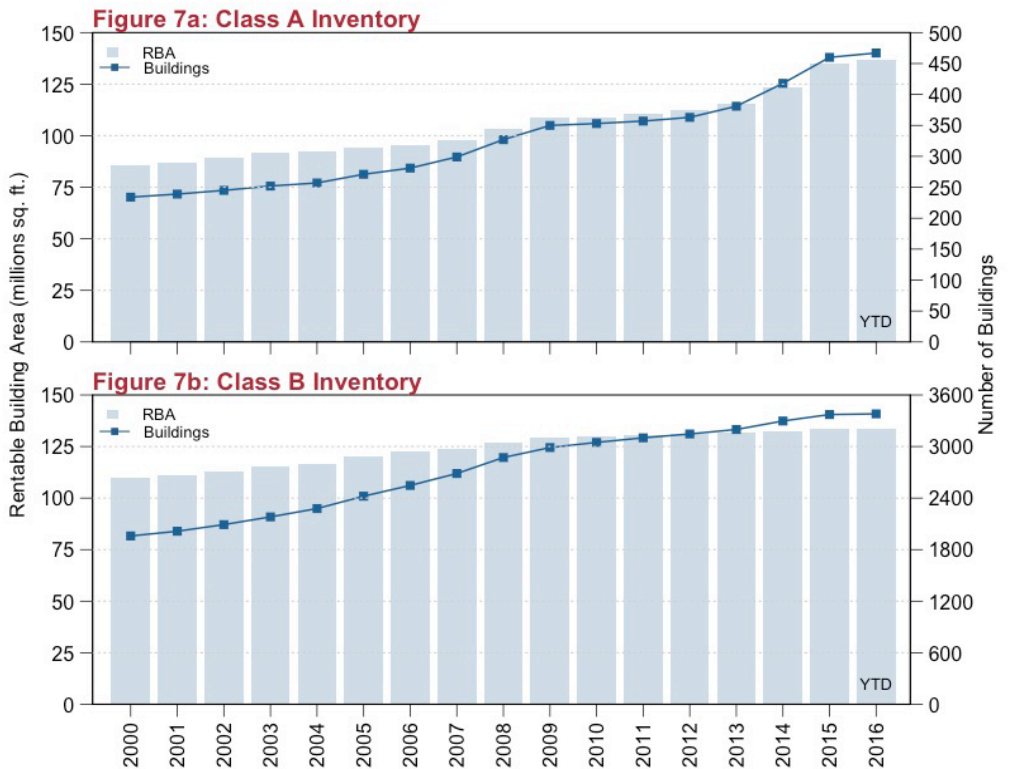
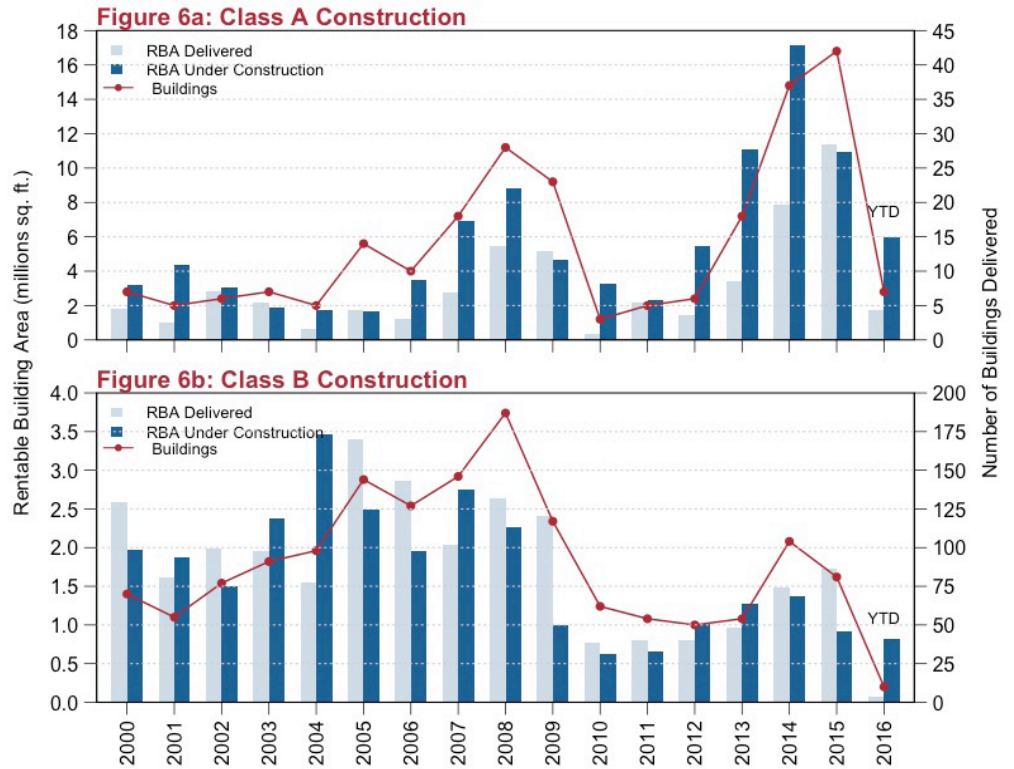


### Construction and Deliveries

Construction of new stock inventory shapes the growing supply of office space. “RBA Delivered” refers to completed construction, while “RBA Under Construction” refers to space under construction that has not yet been completed. Deliveries in Q1 2016 were 1,846,138 sq. ft. of Class A and B buildings, a decrease of -54.8% QoQ and -56.7% YoY (Table 1). RBA under construction was 6,801,000 sq. ft. in Q1 2016, a decrease of -16.7% QoQ and -56.0% YoY (Table 1). Figure 6 breaks down deliveries and construction on an annual basis by Class A and Class B products.

### Inventory

Figure 7 depicts changes in the inventory of Class A and Class B buildings since 2000, both in terms of RBA and the number of buildings. Stock inventory for Class A and B office space included 270 million sq. ft. for 3,847 buildings, an increase of 2.6% YoY (Table 1).



## Largest Space Available By Building

Address	SF	Submarket	Address	SF	Submarket
800 Bell St	1,314,350	CBD	480 Wildwood Forest Dr	201,651	Woodlands
609 Main St	994,648	CBD	10713 W Sam Houston Pky N	200,552	West Belt
915 N Eldridge Pky	524,474	Katy Freeway West	222 Benmar Dr	198,257	Greenspoint/N Belt West
580 Westlake Park Blvd	455,061	Katy Freeway West	3200 Kirby Dr	188,696	Greenway Plaza
811 Louisiana St	432,329	CBD	2500 CityWest Blvd	185,671	Westchase
600 Gemini St	363,050	NASA/Clear Lake	6464 Savoy Dr	182,566	Southwest/Hillcroft
12450 Greenspoint Dr	356,468	Greenspoint/N Belt West	396 W Greens Rd	181,646	Greenspoint/N Belt West
17001 Northchase Dr	336,443	Greenspoint/N Belt West	2 Riverway	178,677	Riverway
13501 Katy Fwy	331,707	Katy Freeway West	9700 Bissonnet St	177,362	Southwest Beltway 8
1780 Hughes Landing Blvd	313,343	Woodlands	3 Greenway Plz	175,735	Greenway Plaza
2101 CityWest Blvd	305,827	Westchase	17000 Katy Fwy	174,469	Katy Freeway West
1414 Enclave	300,907	Katy Freeway West	10720 W Sam Houston Pky N	165,226	West Belt
1415 Louisiana St	298,285	CBD	2050 W Sam Houston Pky S	162,918	Westchase
4400 Post Oak Pky	279,376	Post Oak Park	1725 Hughes Landing Blvd	162,120	Woodlands
16825 Northchase Dr	278,225	Greenspoint/N Belt West	14141 Southwest Fwy	161,972	E Fort Bend Co/Sugar Land
11750 Katy Fwy	272,888	Katy Freeway West	10100 Katy Fwy	161,710	Katy Freeway East
3200 Southwest Fwy	264,452	Greenway Plaza	1233 West Loop S	159,787	Post Oak Park
3010 Briarpark Dr	264,187	Westchase	1885 Saint James Pl	158,585	Galleria/Uptown
1201 Louisiana St	263,552	CBD	16290 Katy Fwy	156,746	Katy Freeway West
8800 Technology Forest Pl	260,000	Woodlands	15150 Memorial Dr	155,175	Katy Freeway West
2100 Travis St	257,650	Midtown	1311 Broadfield Blvd	155,040	Katy Freeway West
1301 McKinney St	256,039	CBD	5251 Westheimer Rd	153,603	Galleria/Uptown
233 Benmar Dr	253,562	Greenspoint/N Belt West	711 Louisiana St	153,351	CBD
2103 CityWest Blvd	253,455	Westchase	3600 W Sam Houston Pky S	150,000	Westchase
600 Jefferson St	253,042	CBD	15375 Memorial Dr	148,920	Katy Freeway West
1020 Holcombe Blvd	245,834	South Main/Medical Center	1709 Dryden Rd	143,546	South Main/Medical Center
3737 Buffalo Speedway Ave	245,602	Greenway Plaza	13401 N I-45	143,410	Greenspoint/N Belt West
5775 N Sam Houston Pky E	244,226	West Belt	750 Town & Country Blvd	140,579	Katy Freeway East
16945 Northchase Dr	243,972	Greenspoint/N Belt West	2800 N Loop Fwy W	138,150	North Loop West
363 N Sam Houston Pky E	240,522	Greenspoint/N Belt West	10700 North Fwy	137,441	Greenspoint/N Belt West
1000 Louisiana St	240,321	CBD	16001 Park Ten Place Dr	136,950	Katy Freeway West
25700 Interstate 45	240,000	Woodlands	2950 N Loop Fwy W	135,343	North Loop West
909 Fannin St	234,000	CBD	500 Dallas St	134,682	CBD
2700 Post Oak Blvd	231,865	Galleria/Uptown	1575 Sawdust Rd	132,581	Woodlands
1333 West Loop S	224,975	Post Oak Park	9811 Katy Fwy	128,904	Katy Freeway East
808 Travis St	222,848	CBD	10900 Corporate Centre Dr	128,039	West Belt
15377 Memorial Dr	219,369	Katy Freeway West	21700 Merchants Way	127,953	Katy/Grand Parkway West
11450 Compaq Center West Dr	218,344	FM 1960/Hwy 249	2350 N Sam Houston Pky E	125,788	Greenspoint/IAH
5718 Westheimer Rd	217,506	San Felipe/Voss	2727 North Loop W	123,103	North Loop West
700 Milam St	212,356	CBD	11700 Katy Fwy	122,261	Katy Freeway West
1021 Main St	210,470	CBD	8900 Lakes at 610 Dr	119,527	South Main/Medical Center
5555 San Felipe St	207,411	Galleria/Uptown	24275 Katy Fwy	119,174	Katy/Grand Parkway West
100 Glenborough Dr	206,553	Greenspoint/N Belt West	13131 Dairy Ashford Rd	118,269	E Fort Bend Co/Sugar Land
4005 Technology Dr	205,000	Southwest Far			
1600 Smith St	201,931	CBD			

## Largest Space Available By Building (Continued)

Address	SF	Submarket	Address	SF	Submarket
15710 John F Kennedy Blvd	114,618	Greenspoint/IAH	5851 Southwest Fwy	82,500	Richmond/Fountainview
652 N Sam Houston Pky E	112,281	Greenspoint/N Belt West	2900 Wilcrest Dr	79,748	Westchase
330 Barker Cypress Rd	110,480	Katy Freeway West	2051 S Greenhouse Rd	79,409	Katy/Grand Parkway West
100 Pasadena Town Square Mall	110,000	Gulf Freeway/Pasadena	3 Sugar Creek Center Blvd	77,862	E Fort Bend Co/Sugar Land
601 Travis St	109,734	CBD	16900 Park Row	77,000	Katy Freeway West
1001 West Loop South	109,676	Post Oak Park	9009 West Loop South	73,196	Bellaire
27700 Highway 290	108,454	Northwest Outlier	550 Greens Pky	72,050	Greenspoint/N Belt West
554 Club Dr	108,000	Outlying Montgomery Cnty	250 Meadowfern Dr	71,208	Greenspoint/N Belt West
400 N Sam Houston Pky E	105,985	Greenspoint/N Belt West	350 Glenborough Dr	68,581	Greenspoint/N Belt West
7000 Hollister St	105,900	Northwest Far	570 Westlake Park Blvd	67,334	Katy Freeway West
1201 Fannin St	105,115	CBD	5700 NW Central Dr	64,155	Northwest Far
3773 Richmond Ave	102,248	Greenway Plaza	16285 Park Ten Place Dr	63,878	Katy Freeway West
16676 Northchase Dr	101,111	Greenspoint/N Belt West	16430 Park Ten Pl	62,788	Katy Freeway West
1330 Post Oak Blvd	101,000	Galleria/Uptown	8223 Willow Place Dr S	62,001	FM 1960/Hwy 249
2115 Winnie St	100,000	Southeast Outlier	1290 Hercules Ave	60,000	NASA/Clear Lake
1401 Enclave Pky	99,548	Katy Freeway West	1300 Hercules Ave	60,000	NASA/Clear Lake
10800 Richmond Ave	99,088	Westchase	13100 Space Center Blvd	60,000	NASA/Clear Lake
6677 N Gessner Dr	96,000	West Belt	412 Main St	58,635	CBD
10496 Old Katy Rd	96,000	Katy Freeway East	11302 Tanner Rd	57,798	West Belt
3663 N Sam Houston Pky E	92,920	Greenspoint/IAH	1775 St James Pl	56,910	Galleria/Uptown
14950 Heathrow Forest Pky	91,800	Greenspoint/IAH	901 E Curtis	56,637	Gulf Freeway/Pasadena
2001 Timberloch Pl	90,539	Woodlands	15115 Park Row	56,064	Katy Freeway West
737 N Eldridge Pky	88,458	Katy Freeway West	600 N Sam Houston Pky	55,700	Greenspoint/N Belt West
2229 San Felipe	86,227	Midtown	5884 Point West Dr	54,417	Southwest Beltway 8
16801 Greenspoint Park	83,969	Greenspoint/N Belt West	222 Cavalcade St	54,200	I-10 East
2002 Grand Pky N	82,637	Katy/Grand Parkway West	2222 Bay Area Blvd	52,171	NASA/Clear Lake

## Select Sales

Property Address	Bldg SF	Sale Date	Sale Price	Price Per SF
15420 Ridge Park Dr	2,600	2/9/16	\$455,000	\$175.00
16000 Park Ten Pl, 801/1st Floor	3,698	1/22/16	\$305,000	\$254.17
820 Holman St	8,744	3/13/16	\$2,500,000	\$285.91
5450 Northwest Central Dr	56,111	1/8/16	\$1,680,000	\$29.94
10497 Town & Country Way (Part of Portfolio)	148,936	1/22/16	\$29,534,971	\$198.31
5300 Memorial Dr (Part of Portfolio)	153,626	1/22/16	\$30,465,029	\$198.31

## Select Top Office Leases

Tenant	Building	Square Feet
Bureau Veritas	16800 Greenspoint Park	43,600
Pattern Energy Group	1201 Louisiana	34,901
Mitsubishi Motors	1221 McKinney	22,920
Catholic Charities of the Archdiocese of Galveston	2707 North Loop West	21,079
InterMoor, Inc.*	900 Threadneedle	20,923
HRSS, LLP	6671 Southwest Freeway	19,384
Jones, Granger, Tramuto, Christy & Halstead*	10000 Memorial	18,308
Shellpoint Mortgage Servicing	2020 Dairy Ashford	17,927
T-Systems	12140 Wickchester	17,692
Advanced Tracking Technologies, Inc	6001 Savoy Dr.	15,000

\* Renewal

## Select Largest Deliveries

Building Name	Building Address	Submarket	Percent Leased
2002 Grand Pky N	2002 Grand Pky N	Katy/Grand Parkway West	34%
21800 Katy Fwy	21800 Katy Fwy	Katy/Grand Parkway West	29%
19701 Kingwood Dr	19701 Kingwood Dr	Kingwood/Humble	0%
The Offices at Lake Road Phase III/ Bldg C	10318 Lake Rd	FM 1960/Hwy 249	0%
8104 Spring Cypress	8104 Spring Cypress Rd	Northwest Outlier	0%
8110 Spring Cypress	8110 Spring Cypress Rd	Northwest Outlier	0%
733 E 12th	733 E 12th 1/2 St	North Loop West	100%

## Select Under Construction

Building Name	Building Address	Rentable Building Area	Submarket Name
609 Main at Texas	609 Main St	1,056,658	CBD
Energy Center Five	915 N Eldridge Pky	524,744	Katy Freeway West
West Memorial Place Phase II	15377 Memorial Dr	428,565	Katy Freeway West
Future Amegy Bk HQ	1717 W Loop Fwy S	380,000	Post Oak Park
Havenwood Office Park	25700 Interstate 45	240,470	Woodlands
10100 Katy Fwy	10100 Katy Fwy	226,511	Katy Freeway East
Regions Financial Center	3773 Richmond Ave	210,000	Greenway Plaza
Wildwood Corporate Centre II	480 Wildwood Forest Dr	201,933	Woodlands
Kirby Collection	3200 Kirby Dr	188,696	Greenway Plaza
1885 Saint James	1885 Saint James Pl	165,000	Galleria/Uptown
Deerwood Glen Business Park	4460 Highway 225	102,000	Gulf Freeway/Pasadena
Spring Valley Medical Plaza	9230 Katy Fwy	76,765	Katy Freeway East
The Entrust Building Phase II	Grand Corner Dr	20,879	Katy/Grand Parkway West



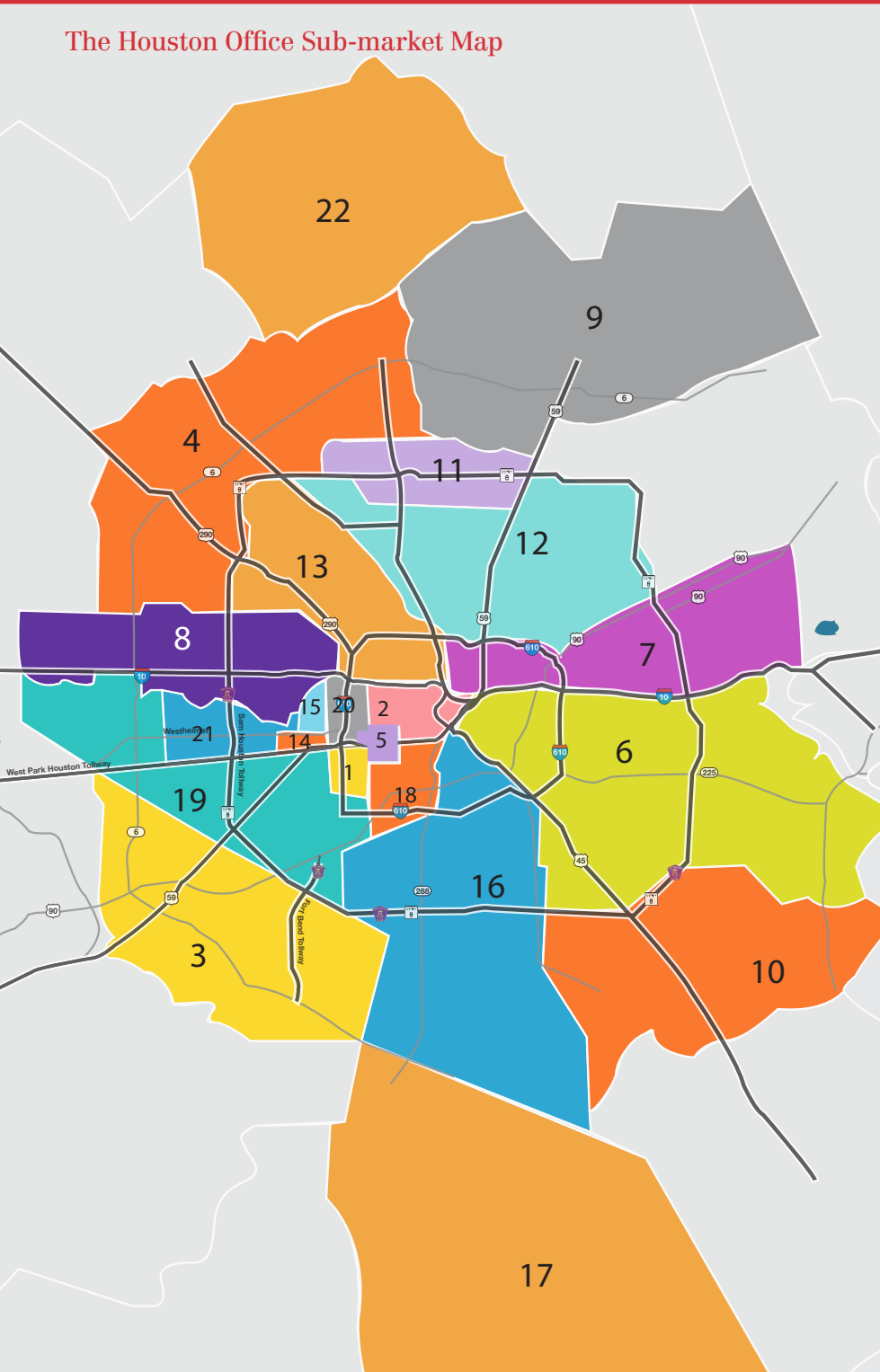
## Class A Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	7	1,191,304	90,905	0	\$25.88
Downtown	43	34,673,964	3,616,935	1,374,974	\$42.87
E Fort Bend Co/Sugar Land	20	3,773,926	356,845	0	\$26.24
FM 1960	20	4,074,372	397,981	0	\$26.48
Greenway Plaza	18	6,935,830	1,068,951	398,696	\$37.46
Gulf Freeway/Pasadena	1	22,706	3,122	0	\$30.59
I-10 East	0	0	0	0	\$0.00
Katy Freeway	90	23,228,906	2,858,035	1,256,585	\$33.95
Katy/Grand Parkway West	22	1,774,982	527,463	124,295	\$27.47
Kingwood/Humble	3	185,977	28,996	0	\$28.47
NASA/Clear Lake	17	2,121,887	174,957	0	\$26.47
North Belt	25	5,562,492	1,853,170	0	\$24.91
Northeast Near	2	555,700	0	0	\$0.00
Northwest	11	2,282,998	637,636	0	\$22.87
Richmond/Fountainview	0	0	0	0	\$0.00
San Felipe/Voss	3	1,720,793	384,560	0	\$35.43
South	4	397,500	104,202	0	\$27.50
South Hwy 35	0	0	0	0	\$0.00
South Main/Medical Center	15	4,560,992	220,141	0	\$29.13
Southwest	9	2,052,051	309,314	0	\$18.63
West Belt	30	4,349,124	688,586	0	\$30.35
West Loop	45	16,671,047	2,079,075	1,285,000	\$36.89
Westchase	32	8,725,110	1,193,543	1,100,000	\$36.57
Woodlands	40	10,881,457	952,743	442,403	\$33.21

## Class B Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	32	3,024,109	210,233	0	\$23.52
Downtown	180	20,065,997	2,862,358	5,800	\$29.08
E Fort Bend Co/Sugar Land	243	4,903,023	458,162	90,410	\$23.37
FM 1960	343	7,632,581	1,147,045	20,000	\$17.62
Greenway Plaza	50	4,226,662	258,225	0	\$27.19
Gulf Freeway/Pasadena	160	3,673,864	604,245	175,105	\$21.50
I-10 East	23	651,720	108,339	0	\$15.25
Katy Freeway	206	12,254,447	1,772,821	0	\$22.72
Katy/Grand Parkway West	225	2,823,425	111,030	123,663	\$30.51
Kingwood/Humble	81	2,028,587	139,021	6,000	\$22.43
NASA/Clear Lake	213	5,828,366	988,651	24,050	\$18.31
North Belt	73	6,711,114	1,619,206	0	\$16.12
Northeast Near	28	665,458	94,350	0	\$20.10
Northwest	144	6,927,361	952,905	15,000	\$18.12
Richmond/Fountainview	27	958,954	206,284	0	\$18.03
San Felipe/Voss	38	3,585,600	304,844	0	\$23.52
South	83	1,539,745	157,342	0	\$27.44
South Hwy 35	34	358,380	21,536	0	\$14.85
South Main/Medical Center	65	4,888,664	739,315	0	\$26.59
Southwest	126	7,758,931	1,300,290	60,000	\$16.13
West Belt	51	2,100,542	254,320	0	\$20.96
West Loop	60	6,369,675	689,965	0	\$26.41
Westchase	73	8,102,913	781,452	186,000	\$20.04
Woodlands	331	7,602,349	638,418	107,270	\$24.32

## The Houston Office Sub-market Map



1. Bellaire
2. Downtown - CBD + Midtown
3. E Fort Bend Co/Sugar Land
4. Fm 1960 + FM 1960/Champions + Fm1960/Hwy 249 + FM 1960/I-45 North
5. Greenway Plaza
6. Gulf Freeway/Pasadena
7. I-10 East
8. Katy Freeway = Katy Freeway East + Katy Freeway West
9. Kingwood/Humble
10. Nasa/Clear Lake
11. North Belt = North Belt East + North Belt West/Greenspoint
12. Northeast Near
13. Northwest = North Loop West + Northwest + Far\_ Northwest Near
14. Richmond
15. San Felipe/Voss
16. South
17. South Hwy 35
18. South Main/Medical Center
19. Southwest = Southwest Beltway 8 + Southwest/Hillcroft
20. Westloop = Galleria/Uptown + Riverway + Post Oak Park
21. Westchase = Westchase East + Westchase West
22. Woodlands

## Methodology

This office market report includes information and data for Class A and Class B buildings, but does not include Class C buildings. Buildings are not excluded on the basis of single vs. multi-tenancy, owner occupancy, or building size.

*Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy. Sources include: U.S. Bureau of Economic Analysis, CoStar, Council on Foreign Relations, Federal Reserve Bank of Dallas, Greater Houston Partnership, FiveThirtyEight.com, Houston Association of Realtors, Moody Analytics, NAI Global, National Association Realtors, Texas A&M Real Estate Center, Well's Fargo, University of Houston's Institute of Regional Forecasting, U.S. Bureau of Labor Statistics.*

# Economic and Market Outlook:

HOUSTON OFFICE | Q1 2016

## Marketing & Research Team

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Sr. Director of Marketing and Research

**NAI**Partners

HOUSTON | SAN ANTONIO | AUSTIN



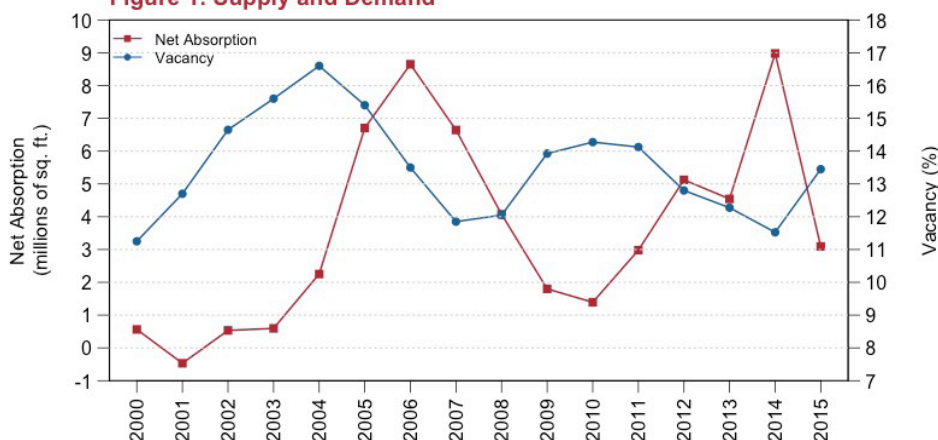
# Economic and Market Outlook:

HOUSTON OFFICE | Q4 2015

**NAI**Partners

HOUSTON | SAN ANTONIO | AUSTIN

**Figure 1: Supply and Demand**



**Table 1. Market indicators for Q4 2015, and their percent (%) change on a quarter-over-quarter (QoQ) and year-over-year (YoY) basis (Class A and B buildings combined).**

Market Variables	Q4 2015	Percent Change over Time Period	
		QoQ (%)	YoY (%)
Asking Rent: Class A	\$35.18	-0.6	1.6
Asking Rent: Class B	\$21.73	0.2	2.6
Net Absorption (sq. ft.)	1,108,987	84.8	-69.4
Leasing Activity	2,677,660	-12.6	-45.2
Availability (%)	18.8%	1.1	8.7
Vacancy (%)	14.4%	6.7	27.4
Deliveries (sq. ft.)	3,926,811	231.3	23.6
Construction (sq. ft.)	8,819,801	-28.1	-51.0
Inventory (sq. ft.)	267,556,112	1.5	5.0
Inventory (No. of Buildings)	3,799	0.7	2.8

## Executive Summary

With hope for a V-shaped recovery from the oil downturn gone, reality has settled in to a best case scenario of a U-shaped recovery. While the oversupply of oil is recognized as the key variable driving oil prices down, the most recent drop in WTI is as much a result of the soaring value of the U.S. dollar, as the oil glut persists with little recent change in supply of the commodity. The strengthening dollar is also reducing U.S. exports. While oil and exports are two prominent factors weighing down the economy, as a whole the national economy is healthy and has a strong outlook. Yet, rather than leading the nation as in years past, Texas and especially Houston are now lagging behind the nation on most economic metrics, largely due to the oil downturn. Forecasts are for the oil prices to begin to turn around in mid to late 2016, but oil forecasts are less than stellar in their performance.

Q4 posted 1.1 million sq. ft. of net absorption, a demand for office space that was on par with historic Q4 performance. Yet, total annual net absorption was only 3.1 million sq. ft., making 2015 the 8th slowest year since 2000. Leasing activity in Q4 2015 was down to 2.7 million sq. ft., significantly lower than historic Q4 levels of 4.4 million sq. ft. Leasing activity in Q4 brought total annual leasing activity to 12 million sq. ft., the second lowest year of office leasing in the past 16 years. Low net absorption, along with 3.9 million sq. ft. of new deliveries, increased vacancy in Q4 to 14.4%. Availability is at a 16-year high of 19%, which includes 7.9 million sq. ft. of sublease space. Still another 8.8 million sq. ft. of construction have yet to deliver (with yet unknown vacancies), suggesting increases in supply under weakened demand for 2016.

With Houston's office market clearly in the falling phase of market cycles, attention turns to a favored tenant market and increasing landlord concessions. Analytic forecasts of NAI Partners indicate that the falling phase of Houston's office market cycle will continue through 2016, bottoming out in mid to late 2017 with vacancies reaching peak levels of 17%.



## Broker's Perspective

When oil prices replace weather as a conversation starter, then "Houston, we have a problem". Oil prices are down to 12 year lows, but continued declines in oil is not news any longer. However, the effects of the lower prices is still real and ever changing. In commercial real estate, the slowdown in leasing activity and net absorption in 2015 has made it increasingly more difficult for Landlord Representatives that are over capacity to effectively service and perform for their clients. This is because the time required to source and finish deals has increased dramatically.

With 'tire kicker' prospects, simply wanting leverage renewing in place, the conversion rate of prospects has declined requiring incumbent buildings to work harder, give more and take less to avoid a new vacancy. For this reason, fewer new deals get done and when they do, often at lower rates and greater concessions. Instead of chasing new deals, Landlord agents are working with existing mid-term tenants for a second or third time as in-place deals now need to downsize or otherwise modify existing terms of a lease due to the

changing market conditions. Landlord agents are no longer able to perform at the same productivity level, as a building that previously took 10% of one's time may now require 35%. With this in mind, Asset Managers are incentivized to look for firms not overcommitted which will champion their asset.

This isn't the first falling market cycle in Houston and it will not be the last. Many have said that current times are not as bad as the 1980's, but the same folks now believe that it is truly worse than they thought it would be a year ago. There are approximately 7.9 million SF of sublease space and another 8.8 million SF of anticipated deliveries, leading Houston's landlord agents to stay laser focused to find ways to work smarter, more effectively, and drive business to buildings. With the logistical challenges in Houston coupled with the stifling traffic, owners will need to break the model of how they vet and hire landlord agents. Real estate markets are cyclical and oil will return, but business as usual in the landlord market may be changing for some time as we shift to a tenant favor market.



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## ECONOMIC OVERVIEW

Houston's economy remains largely flat, as substantial downturns in the oil industry are modestly buffered by growth in health, construction, and petrochemical industries. The strengthening of the U.S. dollar continues to drive oil prices downward, with WTI breaking below \$30 per barrel in January. U.S. rig counts are now down to 663, from 1750 a year ago. The strength of the dollar is also hampering exports. Despite these weaknesses in oil and export trade, the national economy has a strong healthy outlook. Employment continues to show strength, with unemployment at a low 5.0% for the nation, 4.6% for Texas, and 4.8% for Houston. Gross domestic product (GDP) is anticipated to be 2.5% for 2015, and possibly increasing to 2.7% for 2016, with strong consumer spending and a strengthening housing market.

### National Economy

With much speculation and uncertainty about a looming decline in the national economy, the numbers actually suggest a healthy and strong economic outlook with the exceptions of **energy** and **trade**. While U.S. **rig counts** had appeared to stabilize in early Fall 2015, active rig counts have continued to drop to 663 from 1750 a year ago. This decline in rig counts is manifesting as a result of the global oversupply in oil. This glut in oil is clearly the major factor driving declines in WTI prices per barrel. However, the most recent drops in WTI oil prices to \$30 per barrel is as much a result of the soaring value of the U.S. dollar (which oil trades in), as it is shifts in the excess supply of the commodity which remain largely unchanged.

Following a 5% increase in 2015, the **trade** deficit is likely to widen further in 2016 as a result of the strong dollar. The dollar is up in value by 17% since the middle of 2014. This slump in the export of goods from the U.S. is accompanied by strong export in transportation and tourism services.

Despite limitations in energy and exports, the U.S. **gross domestic product** (GDP) is on track for 2.5% for 2015, possibly increasing to 2.7% for 2016. GDP will continue to be based largely upon growth in the **housing**

**market** and strong **consumer spending**, the latter of which accounts for about 66% of GDP. Housing starts are expected to increase possibly by 13% in 2016. With the increase in interest rates, buyers will likely move forward with their home purchases before mortgage rates increase too much. **International trade** will continue to hamper GDP by discouraging export volume.

**Employment** in the U.S. increased by 292,000 jobs in December 2015, closing the year with a low 5.0% unemployment, a level the Federal Reserve sees as consistent with 'full' employment, and with 2016 looking at an even lower 4.6%. While job growth continues to churn the economic engine, salary growth remains stunted, with corporations not passing profits onto employees as much as in prior economic expansions.

The Federal Reserve did raise **interest rates** by a modest 25 basis points at their December 2015 meeting. Yet, Fed Chair Yellen strongly suggested that further rate hikes will be conditional upon data and may be some time to come, despite the contrary poll of Fed governors and bank presidents expecting four more rate hikes in 2016 alone. There is concern, however, that increasing rates too much will further strengthen the value of the dollar with more feedbacks on other economics.

### Houston and Texas Economy

The regional Houston economy appears to be staggering in neither a growth nor recession phase. The **Houston Business Cycle** Index of the Dallas Federal Reserve measures the Houston economy based on movements in local unemployment, nonagricultural employment, inflation-adjusted wages, and inflation-adjusted retail sales. Following growth of 4.7% in September, October to November declined to 0.8%, with the long-term average since 2000 being 3.3% growth. Manufacturing, both at regional and national levels, continues to decline, contrary to initial signs of stabilization at the end of last quarter. **Texas exports** declined 3.8% in October, which was 6.6% lower than a year ago.

Through November 2015, **Houston's employment** has increased by only 3,600 jobs, and will struggle to reach 2015 annual forecasts of 15,000 to 30,000. Houston area manufacturing jobs declined by 19,000 through November 2015. November unemployment increased to 4.8% for the Houston area, while Texas unemployment was 4.6%. Houston faces a rough 2016, yet forecasts are not negative, but rather just some minimal positive growth between 20,000 - 30,000 new jobs.

MARKET OVERVIEW

With reduced demand and low leasing activity, along with higher vacancy and availability, Houston is clearly in a falling market phase. Q4 posted 1,108,987 sq. ft. of net absorption, a demand for office space that was on par with historic Q4 performance. However, total annual net absorption was only 3.1 million sq. ft., making 2015 the 8th slowest year since 2000 (but still better than that of the Great Recession). Leasing activity in Q4 2015 was down to 2,677,660 sq. ft., significantly lower than historic Q4 levels of 4,455,039 sq. ft. Q4 brought total annual leasing activity in 2015 to a little over 12 million sq. ft., the second lowest year of office leasing in the past 16 years.

Combining lower net absorption with nearly 3.9 million sq. ft. of new deliveries lead vacancies in Q4 to tick up from 13.5 to 14.4%. Availability, including the 7.9 million sq. ft. of sublease space, is breaking 16-year levels of nearly 19%. Still another 8.8 million sq. ft. of construction have yet to deliver, suggesting increases in supply under weakened demand for 2016. Analyses of NAI Partners indicate the bottom of this falling phase of Houston’s office market cycle will likely occur in mid to late 2017 with vacancies reaching peak levels of 17% like that of the 2004 bottom.

Net Absorption

Demand for office space is measured by net absorption, the change in occupied inventory including direct and sublet space. Figure 2 shows net absorption since 2000 by year and quarter for combined Class A and B office space. The last quarter of 2015 posted 1,108,987 sq. ft. of positive net absorption. This 1.1 million sq. ft. of net absorption in Q4 2015 represents a key increase of 84.8% QoQ but still a -69.4% decrease YoY (Table 1). The historic Q4 average ( $\pm$  95% confidence interval) for net absorption is 1,330,149 sq. ft. ( $\pm$  537,438). We are 95% certain that Q4 absorption typically falls between 792,711 to 1,867,586 sq. ft. Thus, despite the pullback in oil and associated impacts on the office market, net absorption in Q4 2015 did not deviate statistically from that level of historic Q4 performance since 2000. Nevertheless, Q4 net absorption of 1.1 million sq. ft. brings total annual net absorption for 2015 to 3.1 million sq. ft. for Class A and B office space. This makes 2015 the 8th lowest year for demand in office space over the past 16 years, but still greater than the Great Recession.

Figure 2: Net Absorption

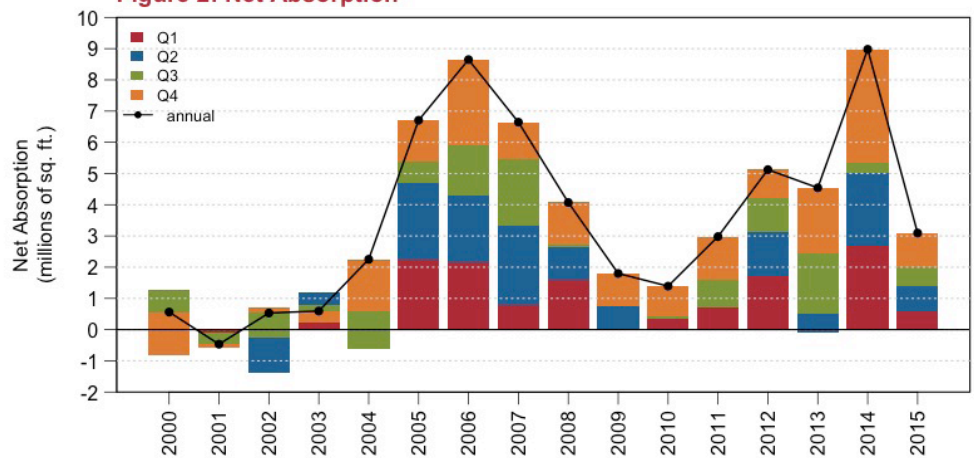
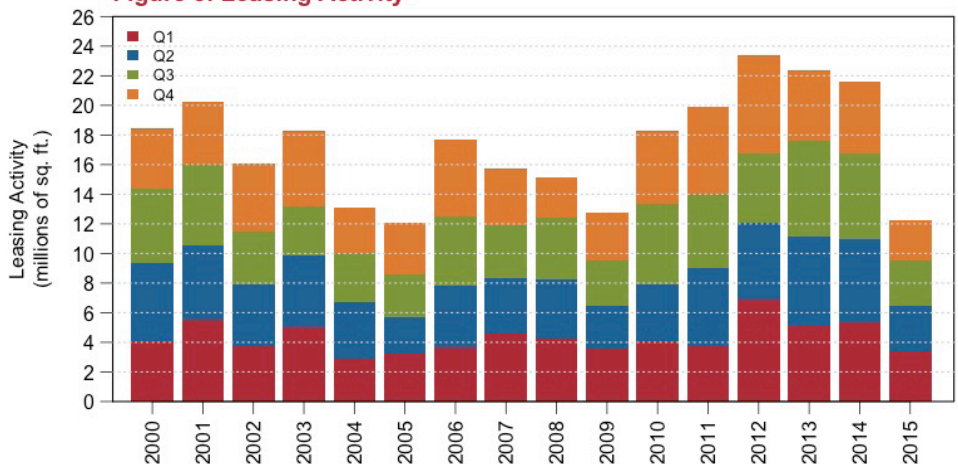


Figure 3: Leasing Activity



### Leasing Activity

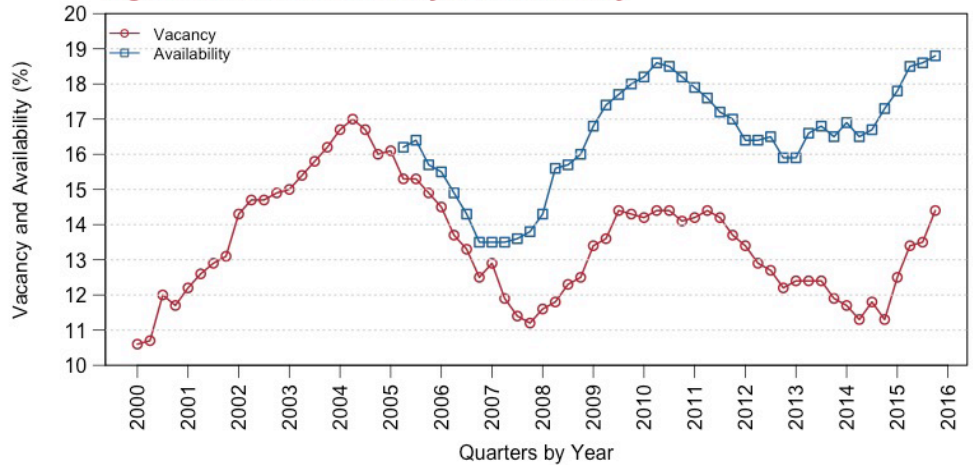
Leasing activity is another measure for the demand of office space, representing the total amount of space for direct leases, subleases, renewals, and pre-leasing. Figure 3 reports leasing activity since 2000 by year and quarter for combined Class A and B office space. Leasing activity of 2,677,660 sq. ft. occurred in Q4 2015, yielding decreases of -12.6% QoQ and -45.2% YoY (Table 1). The historic Q4 average ( $\pm$  95% confidence interval) for leasing activity is 4,455,039 sq. ft. ( $\pm$  595,069). We are 95% certain that Q4 leasing activity typically falls between 3,859,970 to 5,050,108 sq. ft. This indicates that current leasing activity is statistically lower than historic Q4 measures since 2000.

Leasing activity of 2,677,660 sq. ft. in Q4 brings total leasing activity for 2015 to 12.2 million sq. ft., the second lowest year on record since 2000 (Figure 3). With net absorption lagging behind leasing activity, lower leasing activity in Q4 and 2015 as a whole suggests continued low absorption in quarters to come. As with net absorption, this is not only indicative of the change in Houston’s oil economy, but also the shift to a falling phase of the Houston office market cycle.

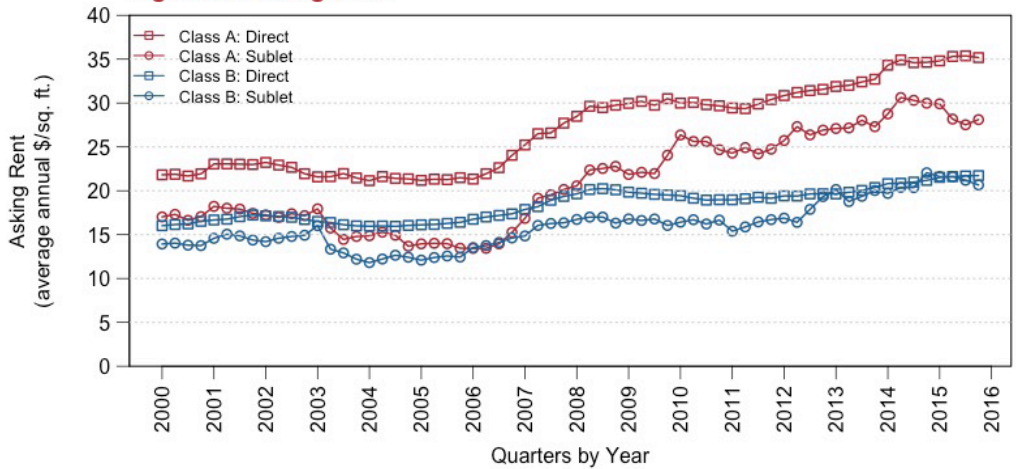
### Availability and Vacancy

Vacancy and availability measure the supply of office space, and as such are key indicators of shifts in the phase of the office market cycle. Availability better measures total supply because it includes vacant, occupied, and sublease space. Vacancy better measures empty space on the market, whether or not that space is leased or even for rent. Overall, office supply continued to

**Figure 4: Class A+B Vacancy and Availability**



**Figure 5: Asking Rent**



increase in Q4 2015, compared with recent quarters (Figure 4). For Class A and B buildings combined, availability was 18.8%, up 1.1% QoQ and 8.7% YoY (Table 1). Likewise, vacancy for Class A and B space combined was 14.4%, up 6.7% QoQ and 27.4% YoY (Table 1). As indicated by increases in both vacancy and availability, Houston’s office products are in the falling phase of their market cycle.

### Asking Rent

Figure 5 plots asking rent for direct and sublease space since 2000 for each of Class A and B space. In Q4 2015, both Class A and B space showed stable asking rents, with Class A asking rent at \$35 and Class B at \$21. Class A direct rents tend to be about \$5 greater than sublets, but this has increased with the flood of sublease space in recent quarters.



There has been a decline in asking rents of Class A sublet space, likely reflective of the oil downturn and the large 7.9 million square feet of sublease space available at end of Q4. Asking rents of Class B direct and sublet space have converged in recent years.

### Construction and Deliveries

Construction of new RBA is an important variable shaping the supply of office space. "RBA Delivered" refers to completed construction, while "RBA Under Construction" refers to space under construction that has not yet been completed. Deliveries in Q4 2015 were 3,926,811 sq. ft. of Class A and B buildings, an increase of 231% QoQ and 23.6% YoY (Table 1). RBA under construction was 8,819,000 sq. ft. in Q4 2015, a decrease of -28% QoQ and -51% YoY (Table 1). Figure 6 breaks down deliveries and construction on an annual basis by Class A and Class B products.

### Inventory

Figure 7 depicts changes in the inventory of Class A and Class B buildings since 2000, both in terms of RBA and the number of buildings. RBA inventory for Class A and B office space included 267 million sq. ft. for 3,799 buildings, an increase of 2.8% YoY (Table 1).

Figure 6a: Class A Construction

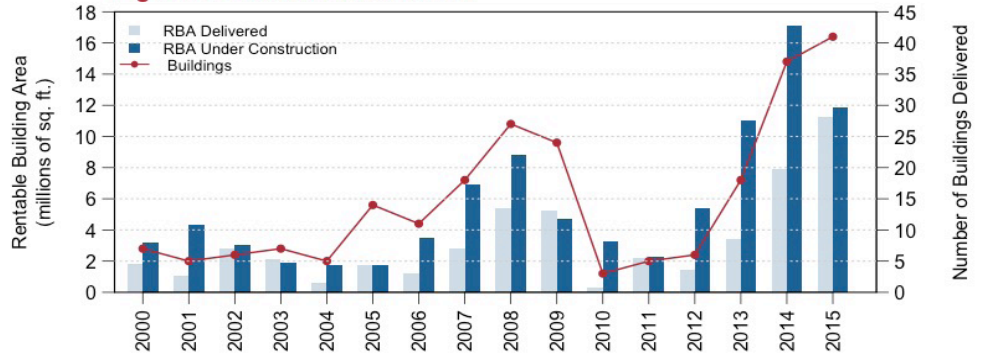


Figure 6b: Class B Construction



Figure 7a: Class A Inventory

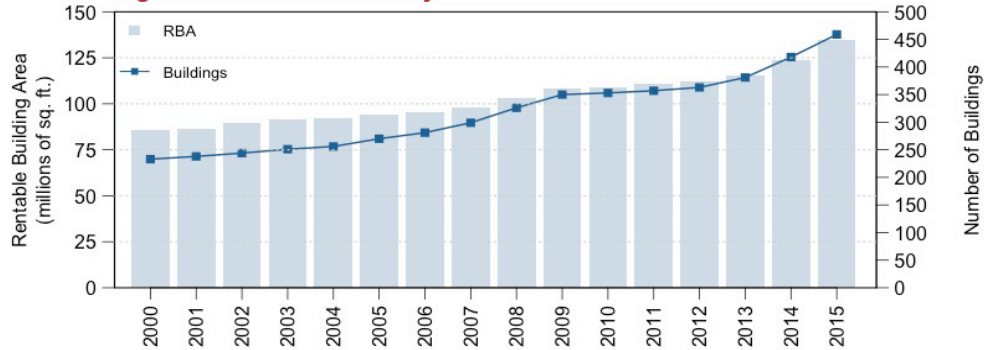
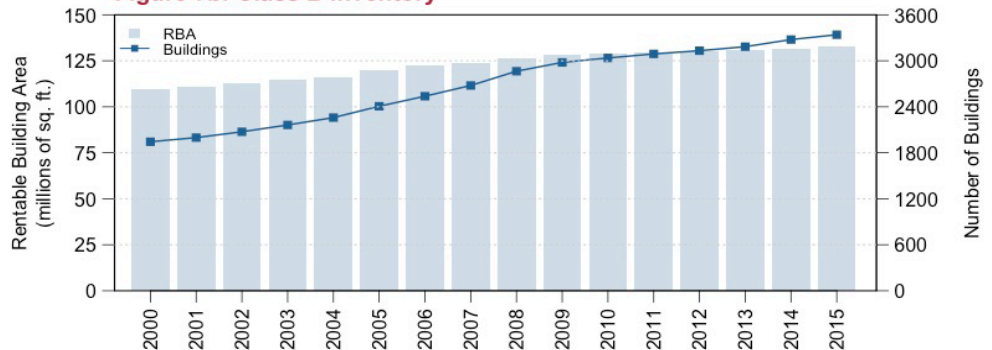


Figure 7b: Class B Inventory



## Largest Contiguous Space Available

Address	SF	Submarket
800 Bell St	1,314,350	CBD
609 Main St	981,873	CBD
915 N Eldridge Pky	524,328	Katy Freeway West
600 Gemini St	363,050	NASA/Clear Lake
12450 Greenspoint Dr	356,468	Greenspoint/N Belt West
17001 Northchase Dr	336,443	Greenspoint/N Belt West
13501 Katy Fwy	331,707	Katy Freeway West
2101 CityWest Blvd	314,316	Westchase
1780 Hughes Landing Blvd	313,343	Woodlands
1414 Enclave	300,907	Katy Freeway West
16825 Northchase Dr	276,617	Greenspoint/N Belt West
2100 Travis St	273,000	Midtown
8800 Technology Forest Pl	260,000	Woodlands
233 Benmar Dr	253,562	Greenspoint/N Belt West
1020 Holcombe Blvd	245,834	South Main/Medical Center
5775 N Sam Houston Pky E	244,226	West Belt
550 Westlake Park Blvd	242,052	Katy Freeway West
25700 Interstate 45	240,000	Woodlands
909 Fannin St	234,333	CBD
11111 S Wilcrest Dr	215,722	Southwest Beltway 8
580 Westlake Park Blvd	205,304	Katy Freeway West
4005 Technology Dr	205,000	Southwest Far
100 Glenborough Dr	204,198	Greenspoint/N Belt West
480 Wildwood Forest Dr	201,651	Woodlands
11450 Compaq Center West Dr	201,568	FM 1960/Hwy 249
10713 W Sam Houston Pky N	200,000	West Belt
15377 Memorial Dr	199,997	Katy Freeway West
222 Benmar Dr	198,256	Greenspoint/N Belt West
600 Jefferson St	192,984	CBD
10777 Clay Rd	189,285	Katy Freeway East
3200 Kirby Dr	188,696	Greenway Plaza
811 Louisiana St	188,695	CBD
9811 Katy Fwy	184,863	Katy Freeway East
6464 Savoy Dr	182,566	Southwest/Hillcroft
396 W Greens Rd	181,646	Greenspoint/N Belt West
2103 CityWest Blvd	176,193	Westchase
17000 Katy Fwy	174,469	Katy Freeway West
16945 Northchase Dr	173,480	Greenspoint/N Belt West
11750 Katy Fwy	169,942	Katy Freeway West
1725 Hughes Landing Blvd	162,120	Woodlands
3 Greenway Plz	161,343	Greenway Plaza
3010 Briarpark Dr	160,356	Westchase
1150 Gemini St	158,627	NASA/Clear Lake
1885 Saint James Pl	158,585	Galleria/Uptown
15150 Memorial Dr	155,175	Katy Freeway West
16290 Katy Fwy	155,050	Katy Freeway West
3737 Buffalo Speedway Ave	154,800	Greenway Plaza
1575 Sawdust Rd	153,810	Woodlands
5251 Westheimer Rd	153,603	Galleria/Uptown
1311 Broadfield Blvd	153,540	Katy Freeway West
3600 W Sam Houston Pky S	150,000	Westchase
2445 Technology Forest Blvd	149,988	Woodlands
15375 Memorial Dr	149,269	Katy Freeway West
1201 Louisiana St	145,352	CBD
13401 N I-45	143,410	Greenspoint/N Belt West
4400 Post Oak Pky	142,665	Post Oak Park

Address	SF	Submarket
2700 Post Oak Blvd	140,618	Galleria/Uptown
1415 Louisiana St	137,611	CBD
1111 Bagby St	137,099	CBD
16001 Park Ten Place Dr	136,950	Katy Freeway West
2800 N Loop Fwy W	134,246	North Loop West
1709 Dryden Rd	131,120	South Main/Medical Center
10720 W Sam Houston Pky N	129,767	West Belt
21700 Merchants Way	127,953	Katy/Grand Parkway West
2727 North Loop W	123,103	North Loop West
27700 Highway 290	121,513	Northwest Outlier
8900 Lakes at 610 Dr	119,527	South Main/Medical Center
2350 N Sam Houston Pky E	116,746	Greenspoint/IAH
1000 Louisiana St	114,066	CBD
1233 West Loop S	111,250	Post Oak Park
1333 West Loop S	111,250	Post Oak Park
100 Pasadena Town Square Mall	110,000	Gulf Freeway/Pasadena
10700 N I-45 Fwy	109,217	Greenspoint/N Belt West
24275 Katy Fwy	108,019	Katy/Grand Parkway West
554 Club Dr	108,000	Outlying Montgomery Only
2050 W Sam Houston Pky S	107,088	Westchase
11700 Katy Fwy	106,894	Katy Freeway West
7000 Hollister Rd	105,900	Northwest Far
2107 CityWest Blvd	103,018	Westchase
750 Town & Country Blvd	102,898	Katy Freeway East
Grand Pky & Franz Rd	102,190	Katy/Grand Parkway West
3773 Richmond Ave	101,148	Greenway Plaza
16676 Northchase Dr	101,111	Greenspoint/N Belt West
2115 Winnie St	100,000	Southeast Outlier
10800 Richmond Ave	99,088	Westchase
500 Jefferson St	97,953	CBD
1717 W Loop Fwy S	97,912	Post Oak Park
6677 N Gessner Dr	96,000	West Belt
10496 Old Katy Rd	96,000	Katy Freeway East
5718 Westheimer Rd	94,680	San Felipe/Voss
1600 Smith St	93,345	CBD
700 Milam St	91,108	CBD
2001 Timberloch Pl	90,539	Woodlands
333 Clay St	90,467	CBD
3040 Post Oak Blvd	86,962	Galleria/Uptown
2229 San Felipe	84,801	Midtown
900 Threadneedle St	83,692	Katy Freeway West
5851 Southwest Fwy	82,500	Richmond/Fountainview
711 Louisiana St	81,790	CBD
811 Main St	81,786	CBD
12700 Northborough Dr	80,000	Greenspoint/N Belt West
1330 Post Oak Blvd	79,422	Galleria/Uptown
2400 NASA Pky	78,007	NASA/Clear Lake
3200 Southwest Fwy	77,977	Greenway Plaza
515 Post Oak Blvd	77,446	Post Oak Park
16900 Park Row	77,000	Katy Freeway West
1401 Enclave Pky	74,822	Katy Freeway West
652 N Sam Houston Pky E	73,251	Greenspoint/N Belt West

Address	SF	Submarket
2051 S Greenhouse Rd	72,480	Katy/Grand Parkway West
550 Greens Pky	72,050	Greenspoint/N Belt West
250 Meadowfern Dr	71,208	Greenspoint/N Belt West
2500 CityWest Blvd	70,651	Westchase
17220 Katy Fwy	69,972	Katy Freeway West
570 Westlake Park Blvd	67,334	Katy Freeway West
1775 St James Pl	67,145	Galleria/Uptown
16800 Greenspoint Park	64,483	Greenspoint/N Belt West
10900 Corporate Centre Dr	64,188	West Belt
5051 Westheimer Rd	63,829	Galleria/Uptown
16801 Greenspoint Park	63,788	Greenspoint/N Belt West
808 Travis St	63,006	CBD
14141 Southwest Fwy	62,457	E Fort Bend Co/Sugar Land
8223 Willow Place Dr S	62,001	FM 1960/Hwy 249
350 Glenborough Dr	61,872	Greenspoint/N Belt West
363 N Sam Houston Pky E	61,034	Greenspoint/N Belt West
737 N Eldridge Pky	60,667	Katy Freeway West
13100 Space Center Blvd	60,000	NASA/Clear Lake
1400 Broadfield Blvd	59,649	Katy Freeway West
2900 Wilcrest Dr	59,566	Westchase
400 N Sam Houston Pky E	59,025	Greenspoint/N Belt West
412 Main St	58,635	CBD
4444 Westheimer Rd	58,500	Post Oak Park
2929 Allen Pky	58,451	Midtown
11302 Tanner Rd	57,798	West Belt
1001 West Loop South	57,117	Post Oak Park
14950 Heathrow Forest Pky	56,827	Greenspoint/IAH
901 E Curtis	56,637	Gulf Freeway/Pasadena
500 Dallas St	56,343	CBD
330 Barker Cypress Rd	56,292	Katy Freeway West
2950 N Loop Fwy W	56,084	North Loop West
600 N Sam Houston Pky	55,700	Greenspoint/N Belt West
1001 Fannin St	54,909	CBD
16285 Park Ten Place Dr	54,858	Katy Freeway West
5700 NW Central Dr	54,602	Northwest Far
5884 Point West Dr	54,417	Southwest Beltway 8
222 Cavalcade St	54,200	I-10 East
15115 Park Row	53,214	Katy Freeway West
654 N Sam Houston Pky E	52,645	Greenspoint/N Belt West
3663 N Sam Houston Pky E	52,401	Greenspoint/IAH
2222 Bay Area Blvd	52,171	NASA/Clear Lake
1080 Eldridge Pky	52,148	Katy Freeway West
3 Sugar Creek Center Blvd	52,000	E Fort Bend Co/Sugar Land
13131 Dairy Ashford Rd	51,781	E Fort Bend Co/Sugar Land
1301 McKinney St	51,086	CBD
1201 Fannin St	50,525	CBD
9700 Bissonnet St	50,450	Southwest Beltway 8
2707 N Loop W	50,346	North Loop West
6315-6335 Gulfton St	50,217	Southwest/Hillcroft
13131 Dairy Ashford Rd	51,781	E Fort Bend Co/Sugar Land
1301 McKinney St	51,086	CBD
9700 Bissonnet St	50,450	Southwest Beltway 8
2707 N Loop W	50,346	North Loop West
6315-6335 Gulfton St	50,217	Southwest/Hillcroft

## Select Sales

Property Address	Bldg SF	Sale Date	Sale Price	Price Per SF
801 Texas Ave (Part of Multi-Property Sale)	550,000	10/21/15	\$43,829,007	\$79.69
935 N Eldridge Pky	546,604	11/12/15	\$275,000,000	\$503.11
2200 Post Oak Blvd	326,200	10/23/15	\$172,000,000	\$527.28
16055 Space Center Blvd	149,144	12/2/15	\$21,500,000	\$144.16
681 Greens Pky	68,950	12/9/15	\$18,400,000	\$266.86
1740 W 27th St (Part of Portfolio)	54,672	10/15/15	\$2,521,176	\$94.11

## Select Top Office Leases

Tenant	Building	Square Feet
Apache Corp.*	2000 Post Oak	355,506
Bracewell & Giuliani, LLP*	711 Louisiana	189,061
Apache Corp.*	1990 Post Oak	150,020
W.D. Von Gonten & Co.	10496 Old Katy	73,000
Loomis	2500 CityWest	46,185
Rockwater Energy Solutions	515 Post Oak	32,000
SK Innovations	11700 Katy	23,608
Parallax Energy Services, LLC	1201 Louisiana	15,019
Jackson Gilmour Dobbs, PC	515 Post Oak	13,875
Angelo Gordon & Company	712 Main	11,477
Performance Spine & Sports Medicine	4126 Southwest Freeway	11,372
NorTex Midstream Partners*	1201 Louisiana	10,000

\* Renewal

## Select Largest Deliveries

Building Name	Building Address	Submarket	Percent Leased
Air Liquide Center- South	9811 Katy Fwy	Katy Freeway East	59%
Energy Tower IV	11750 Katy Fwy	Katy Freeway West	60%
3737 Buffalo Speedway	3737 Buffalo Speedway Ave	Greenway Plaza	29%
West Memorial Place	15375 Memorial Dr	Katy Freeway West	55%
1725 Hughes Landing	1725 Hughes Landing Blvd	Woodlands	51%
Three Hughes Landing	1780 Hughes Landing Blvd	Woodlands	23%
Enclave Place	1414 Enclave	Katy Freeway West	0%
Beltway Lakes Phase III	5775 N Sam Houston Pky E	West Belt	5%
Town Centre One	750 Town & Country Blvd	Katy Freeway East	44%
One Grove Street	2925 Richmond Ave	Greenway Plaza	63%
CityCentre Five	825 Town & Country	Katy Freeway East	75%
Legacy at Fallbrook	10720 W Sam Houston Pky N	West Belt	20%
Remington Square	10713 W Sam Houston Pky N	West Belt	0%
San Felipe Place	2229 San Felipe	Midtown	47%
Katy Ranch Phase I	24275 Katy Fwy	Katy/Grand Parkway West	21%
Beltway 8 Corporate Center	5060 Westway Park Blvd	West Belt	91%
Mason Creek Office Center II	21700 Merchants Way	Katy/Grand Parkway West	0%
The Offices at Sam Houston	10203 Sam Houston Dr	West Belt	89%
Gateway at Spring Valley	9090 Katy Fwy	Katy Freeway East	64%
River Oaks District	4444 Westheimer Rd	Post Oak Park	36%
2829 Technology Forest	2829 Technology Forest Blvd	Woodlands	70%
Skybox Houston One Datacenter	22000 Franz Rd	Katy/Grand Parkway West	66%
Grandway West	1904 Grand Parkway N	Katy/Grand Parkway West	89%
West Houston Medical Plaza	12121 Westheimer Rd	Katy Freeway West	50%
Deerwood Glen Phase II	4440 SH 225	Gulf Freeway/Pasadena	82%
West Houston Medical Plaza	12121 Westheimer Rd	Katy Freeway West	20%

## Select Under Construction

Building Name	Building Address	Square Feet	Submarket
609 Main at Texas	609 Main St	1,056,658	CBD
Energy Center Five	915 N Eldridge Pky	524,328	Katy Freeway West
West Memorial Place Phase II	15377 Memorial Dr	389,709	Katy Freeway West
Future Amegy Bk HQ	1717 W Loop Fwy S	380,000	Post Oak Park
Havenwood Office Park	25700 Interstate 45	240,470	Woodlands
Regions Financial Center	3773 Richmond Ave	210,000	Greenway Plaza
Wildwood Corporate Centre II	480 Wildwood Forest Dr	201,933	Woodlands
Kirby Collection	3200 Kirby Dr	188,696	Greenway Plaza
Memorial Hermann Cypress MOB	27700 Highway 290	165,754	Northwest Outlier
1885 Saint James	1885 Saint James Pl	165,000	Galleria/Uptown
Grandway West	Grand Pky & Franz Rd	124,017	Katy/Grand Parkway West
Spring Valley Medical Plaza	9230 Katy Fwy	76,765	Katy Freeway East



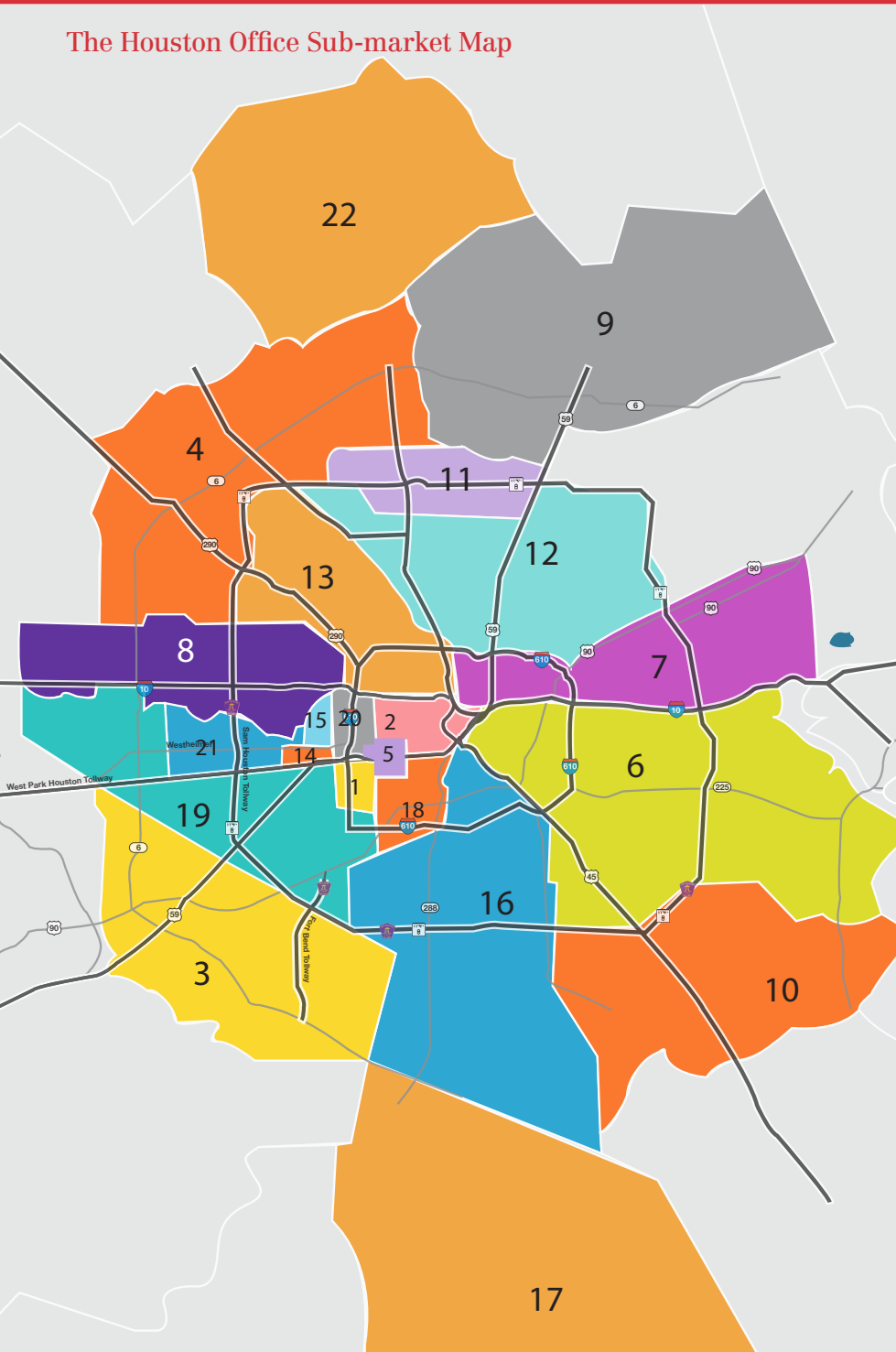
## Class A Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	7	1,191,304	80,918	0	\$24.70
Downtown	42	34,275,966	3,308,196	1,578,258	\$43.19
E Fort Bend Co/Sugar Land	20	3,773,926	383,547	0	\$26.18
FM 1960	20	4,074,372	394,718	0	\$26.29
Greenway Plaza	18	6,949,625	1,240,264	398,696	\$35.73
Gulf Freeway/Pasadena	1	22,706	3,122	0	\$30.42
I-10 East	0	0	0	0	\$0.00
Katy Freeway	90	23,228,906	2,715,386	990,802	\$36.04
Katy/Grand Parkway West	22	1,774,982	542,532	124,017	\$27.02
Kingwood/Humble	3	185,977	48,217	0	\$29.15
NASA/Clear Lake	17	2,121,887	112,330	0	\$26.78
North Belt	24	5,442,482	1,731,303	0	\$25.26
Northeast Near	0	0	0	1,700,000	\$0.00
Northwest	11	2,282,998	564,997	0	\$22.83
Richmond/Fountainview	0	0	0	0	\$0.00
San Felipe/Voss	3	1,720,793	382,314	0	\$35.64
South	3	350,000	56,702	47,500	\$27.50
South Hwy 35	0	0	0	0	\$0.00
South Main/Medical Center	15	4,560,992	190,071	0	\$29.03
Southwest	9	2,058,852	311,849	0	\$18.33
West Belt	30	4,348,572	821,230	0	\$30.76
West Loop	45	16,670,706	1,975,951	1,285,000	\$35.59
Westchase	31	8,333,300	899,265	1,545,000	\$35.29
Woodlands	38	10,581,457	875,793	592,403	\$32.65

## Class B Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	32	3,024,109	157,154	0	\$25.12
Downtown	179	20,030,408	2,738,947	0	\$28.09
E Fort Bend Co/Sugar Land	241	4,854,185	467,890	55,410	\$23.90
FM 1960	340	7,548,221	1,206,679	17,625	\$17.83
Greenway Plaza	51	4,324,968	273,197	0	\$25.77
Gulf Freeway/Pasadena	159	3,750,601	609,690	53,105	\$21.66
I-10 East	23	651,720	65,336	0	\$16.50
Katy Freeway	208	12,475,496	1,816,524	0	\$22.95
Katy/Grand Parkway West	218	2,777,739	111,208	88,832	\$30.15
Kingwood/Humble	80	1,750,587	164,995	0	\$21.96
NASA/Clear Lake	211	5,790,585	1,145,993	39,055	\$18.72
North Belt	73	6,808,935	1,602,406	0	\$16.71
Northeast Near	28	665,458	94,350	0	\$20.10
Northwest	143	6,933,009	933,338	17,640	\$18.83
Richmond/Fountainview	27	958,954	193,282	0	\$17.71
San Felipe/Voss	38	3,584,874	315,299	0	\$23.95
South	83	1,607,009	170,064	0	\$27.75
South Hwy 35	34	358,380	21,536	0	\$16.80
South Main/Medical Center	65	4,848,632	768,609	0	\$26.65
Southwest	125	7,632,309	1,502,858	0	\$16.06
West Belt	51	2,100,542	263,852	0	\$21.20
West Loop	59	6,365,275	747,625	0	\$25.84
Westchase	73	7,817,486	726,142	0	\$19.90
Woodlands	326	7,573,005	641,122	79,843	\$24.86

## The Houston Office Sub-market Map



1. Bellaire
2. Downtown - CBD + Midtown
3. E Fort Bend Co/Sugar Land
4. Fm 1960 + FM 1960/Champions + Fm1960/Hwy 249 + FM 1960/I-45 North
5. Greenway Plaza
6. Gulf Freeway/Pasadena
7. I-10 East
8. Katy Freeway = Katy Freeway East + Katy Freeway West
9. Kingwood/Humble
10. Nasa/Clear Lake
11. North Belt = North Belt East + North Belt West/Greenspoint
12. Northeast Near
13. Northwest = North Loop West + Northwest + Far\_ Northwest Near
14. Richmond
15. San Felipe/Voss
16. South
17. South Hwy 35
18. South Main/Medical Center
19. Southwest = Southwest Beltway 8 + Southwest/Hillcroft
20. Westloop = Galleria/Uptown + Riverway + Post Oak Park
21. Westchase = Westchase East + Westchase West
22. Woodlands

## Methodology

This office market report includes information and data for Class A and Class B buildings, but does not include Class C buildings. Buildings are not excluded on the basis of single vs. multi-tenancy, owner occupancy, or building size.

*Information and data within this report were obtained from sources deemed to be reliable. No warranty or representation is made to guarantee its accuracy. Sources include: U.S. Bureau of Economic Analysis, CoStar, Council on Foreign Relations, Federal Reserve Bank of Dallas, Greater Houston Partnership, FiveThirtyEight.com, Houston Association of Realtors, Moody Analytics, NAI Global, National Association Realtors, Texas A&M Real Estate Center, Well's Fargo, University of Houston's Institute of Regional Forecasting, U.S. Bureau of Labor Statistics.*

# Economic and Market Outlook:

HOUSTON OFFICE | Q4 2015

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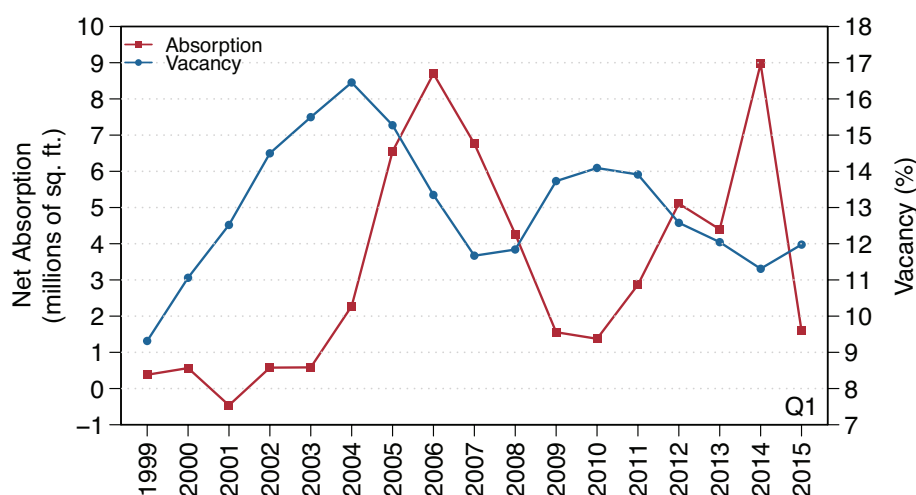
# Economic and Market Outlook:

HOUSTON OFFICE | Q1 2015



HOUSTON | SAN ANTONIO | AUSTIN

**Figure 1: Supply and Demand**



## Executive Summary

The performance of Houston's economy is strongly tied to the national economy and Texas rig counts, the latter a key indicator of our regional oil industry. The national economy continues to show strength and growth in key areas, including jobs, ending of the government's fiscal inputs, housing market picking up, bank credit flowing more freely, and yes, less expensive oil. On the other hand, while reductions in Texas rig counts are slowing, they are nonetheless down from 877 a year ago to 456 in April. Overall, the positive national economic outlook — combined with Houston's boom in downstream refining, petrochemical business, and construction — will counterbalance pullbacks in oil. Houston may have a few slower than desired quarters ahead, but collectively the outlook is for modest growth in 2015.

With the 2-3 month lag between oil prices and rig counts, and the 3-9 month lag between leasing activity and absorption, initial gloom and doom sentiment has now shifted to cautious optimism with a close eye on the next few quarters. Performance of the Class A and B office market in Q1 2015 suggests a slowing, but not catastrophic market. Demand for office space declined (but was still positive), while supply and construction continued to increase. Demand slipped to 1.6 million sq. ft. of net absorption, which is a 57.5% decrease QoQ and a 35.5% decrease YoY. Likewise, leasing activity declined to 2.6 million sq. ft., which was a decrease of 35.2% QoQ and 49.9% YoY. On the other hand, supply of office space is growing. Sublease availability is at an all time high of more than 6.0 million sq. ft., with 12% vacancy and 17% availability. Deliveries increased by 71.2% QoQ and 61.9% YoY, for a total of 4,240,504 sq. ft. There are currently >15 million sq. ft. under construction.

**Table 1. Key market indicators for Q1 2015, and their percent (%) change on a quarter-over-quarter (QoQ) and year-over-year (YoY) basis (Class A and B buildings combined).**

	Q1 2015	Percent Change over Prior Period	
		QoQ (%)	YoY (%)
Asking Rent: Class A	\$34.88	0.5	1.2
Asking Rent: Class B	\$21.48	1.1	3.3
Net Absorption (sq. ft.)	1,597,616	-57.5	-35.5
Leasing Activity	2,666,025	-35.2	-49.9
Availability (%)	16.98	6.5	5.6
Vacancy (%)	11.98	8.2	4.2
Deliveries (sq. ft.)	4,240,504	71.2	61.9
Construction (sq. ft.)	15,429,374	-11.0	-7.1
Inventory (sq. ft.)	257,240,982	1.8	4.3
Inventory (No. of Buildings)	3,670	0.7	3.1



## Broker's Perspective

In today's market, you need "real time" data, and an understanding of the motivation of the individual players. Those that have a true sense of this changing market will have a profitable advantage over those that don't. The drop in oil and gas pricing is having an interesting impact on the office building market, some of which is consistent with previous downturns, and some is not.

One important difference that makes this downturn different from some prior ones is that most building owners and landlords are in good shape with their occupancy. This extends to the majority of new construction, which is substantially preleased. Yet, there is no question that some office building owners have become amenable to discounting rental rates and increasing concessions, such as abated rent, abated parking charges, and increased leasehold improvement allowances. However, it is the other landlords (and it's a larger number than one may think) that have not been so quick to "adjust" to the market. These are the landlords that have the majority of their buildings leased (often greater than 90%) with no significantly sized near term lease expirations. For this reason, these landlords have no real motivation to reduce their rates, despite signs of a softening market. These landlords are offering some "teasers" to attract new tenants or keep those few tenants that are expiring, but nothing like those of other building owners.

The good news for tenants is that there are some building owners that do have large blocks of vacant or expiring space, and are anxious to lease space. In these cases, landlords are offering a combination of rental rate reductions and large concession packages. These are quality, institutional landlords that have taken the strategy of getting their buildings leased and lock in cash flow, rather than carry empty space for an extended period of time. Conversely, some landlords that have large vacancies are taking a different strategy, and they are not willing to meet the terms of their more aggressive competitors. Instead, these landlords would rather wait out the market with the hope of negotiating a better deal at the beginning of the next market upturn. Time will tell if this is the correct strategy. . . but it is a risky bet.

Just like the landlords, tenants also have different strategies. Many are altering their expansion plans, and electing to just keep their current space or even cut back. Some with approaching lease expirations are making the decision to extend their lease for only a short period of time, instead of the typical five or ten year term. This short term extension play allows the tenant to not only see how their business fares during the downturn, but also to position themselves to take advantage of any future significant drop in rental terms.

The tremendous influx of sublease space has created unwelcomed

competition for building owners that have space for direct lease. While the sublease options are a "hit or miss" opportunity for tenants, if the space's configuration works, it can be a tremendous option to not only lease space at an attractive rate, but also to pick up furniture, phone systems, and other benefits at minimal or no cost.

We have been in a landlord market for quite some time and, as it always does, the pendulum is shifting to the tenant. Having said that, the opportunities are not everywhere, and not all building owners have the need or the strategy to do "whatever it takes" to attract and keep tenants. Having timely market knowledge, and understanding the respective building owner's strategy will allow a tenant to match up with landlord's that are highly motivated to do a deal. In today's fluid market, real time market knowledge is critical in negotiating deal terms, and absolutely necessary in order to prevent making an expensive long-term mistake.



**Randy Wilhelm,**  
*Partner, NAI Partners*

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“ We have been in a landlord market for quite some time and, as it always does, the pendulum is shifting to the tenant. ”

## ECONOMIC OVERVIEW

Ongoing improvements in the labor market continue to support economic growth for cities, states, and the nation as a whole. Several key indicators show growth and strength in the national economy, including job growth, ending of the government's fiscal inputs, growing housing market, bank credit flowing more freely, and less expensive oil. Overall, the positive national economic outlook — combined with Houston's job and economic growth in downstream refining, petrochemical business, and construction — will counterbalance Houston's economic pullback due to oil.

### National Economy

The outlook for the national economy is strong, with key improvements including job growth, ending of QE by the federal government, signs of housing market beginning to improve, well capitalized banks with more free flowing credit, and cheaper oil prices. The U.S. **gross domestic product** (GDP) will likely be around 3% in 2015, compared to 2.4% in 2014. Slower GDP in Q1 is anticipated to be replaced by a more productive Q2 2015. National **unemployment** remains stable at 5.5%, with upward trends in professional and business services, health care, and retail, while mining jobs declined. With increasing demand for workers, employers are likely to begin increasing wages.

In the **energy sector**, eyes remain optimistically but cautiously focused on oil prices. Low oil prices will stimulate the economies of most states in 2015, with an anticipated 67 basis point bump in GDP. Yet, those few states with prominent energy sectors will experience economic slowdowns due to oil pullbacks, including Wyoming, Oklahoma, North Dakota, Alaska, Louisiana, Texas, West Virginia, and New Mexico. Gas prices remain low but will begin to increase toward \$2.60 - \$2.70 over the summer months.

While **interest rates** will likely remain unchanged in the short term, the Federal Reserve may begin to increase them by 25 basis points in the Fall. **Business activity** will remain stable

in the first half of 2015, but will likely pick up in the later half of 2015, fueled in part by cheap oil. The **Consumer Price Index** (CPI) increased by 0.2% in February, and will likely increase 1% in 2015, compared to 0.8% in 2014. **Trade** will continue to see disconnect between exports and imports, as the strong dollar and U.S. economy move ahead of international economies.

### Houston and Texas Economy

Houston's economy is strongly tied to the national economy and the regional oil industry. Reductions in **Texas rig counts** — a key indicator of our regional oil industry — are slowing, but are nevertheless down from 877 a year ago to 456 in April. The drop in oil from \$106 to \$80 per barrel was good for the economies of Houston and Texas, but the sustained drop from \$80 - \$50 per barrel is opposing, as most breakeven points for shale oil in Texas are \$50 - \$60 per barrel.

**Employment** in Texas saw February growth at an annualized rate of 1.3%. Texas unemployment in February was 4.3%, well below the national average. Houston saw an annualized rate of 1.9% job growth in February, following an employment decline of 0.3%

in January. Texas job growth is forecasted to be 1-2% in 2015. Job growth in Houston is forecasted to be 1.6 - 2.1% in 2015, with job losses on the west side due to oil countered by job growth on the east side arising from downstream refining, construction, and the petrochemical industry as a whole. Though less than the 100,000 new jobs created in each of 2012, 2013, and 2014, forecasts for Houston's job growth in 2015 still remain positive, ranging from 46,000 to 63,000.

The Houston **Business Cycle** Index of the Dallas Federal Reserve measures Houston economy based on movements in local unemployment, nonagricultural employment, inflation-adjusted wages, and inflation-adjusted retail sales. The index grew to a rate of 3.3% in February, following four months of declining business activity. There have been pullbacks in manufacturing, particularly metal products linked to oil. Monthly exports from Texas declined by 4.5% in January, a decline of 10.7% YoY.



MARKET OVERVIEW

Demand for office space softened in Q1 2015 to 1.6 million sq. ft. of total net absorption, down 57.5% QoQ and 35.5% YoY. Nevertheless, absorption was still statistically greater than the historic Q1 average of 818,886. Leasing activity, another measure of demand, dropped to 2,651,977 sq. ft., which is statistically less than the historic Q1 average of 4,847,155. Declining leasing activity suggests that coming quarters will see lower absorption, given that absorption lags 1-3 quarters behind leasing activity.

Office supply, as measured by availability and vacancy, increased in Q1 2015, but both are within their typical intervals of historic Q1 performance. Specifically, availability of Class A and B buildings was 16.5% and 17.5%, respectively. Vacancy of Class A and B buildings was 11.5 and 12.5%, respectively. Deliveries increased by 71.2% QoQ and 61.9% YoY, for a total of 4,240,504 sq. ft.; there are more than 15 million sq. ft. under construction. In Q1 2015, both Class A and B space had stable asking rents, with Class A asking rent at \$34 and Class B at \$21.

Net Absorption

Net absorption is a key metric for demand of office space. It measures the change in occupied inventory over a specific time period, including direct and sublet space and the addition and subtraction of building area. Figure 2 shows net absorption since 1999 by year and quarter for combined Class A and B office space. Positive net absorption of 1,597,616 sq. ft. occurred in Q1 2015, yielding decreases of 57.5% QoQ and 35.5% YoY (Table 1). The historic Q1 average ( $\pm$  95% confidence interval) for net absorption is 819,303 sq. ft. ( $\pm$  584,076). We are 95% certain that Q1 absorption will typically fall between 235,227 to 1,403,379 sq. ft. While net absorption in Q1 2015 was down substantially both QoQ and YoY, it was nevertheless statistically greater than historic Q1 performance since 1999.

Leasing Activity

Leasing activity, another measure of demand, is the total amount of space represented by direct leases, subleases, renewals, and pre-leasing of rentable building area. Figure 3 reports leasing activity since 1999 by year and quarter for combined Class A and B office space. Leasing activity of 2,666,025 sq. ft. occurred in Q1 2015, yielding decreases of 35% QoQ and 50% YoY (Table 1). The historic Q1 average ( $\pm$  95% confidence interval) for leasing activity is 4,284,272 sq. ft. ( $\pm$  562,882). We are 95%

Figure 2: Net Absorption

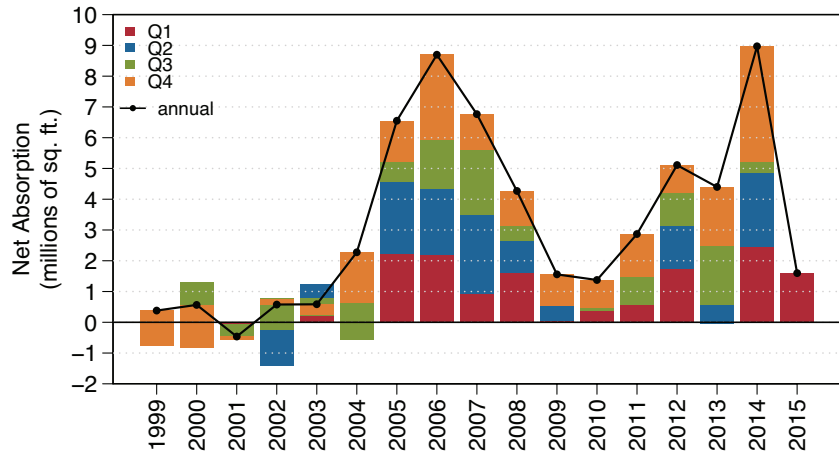
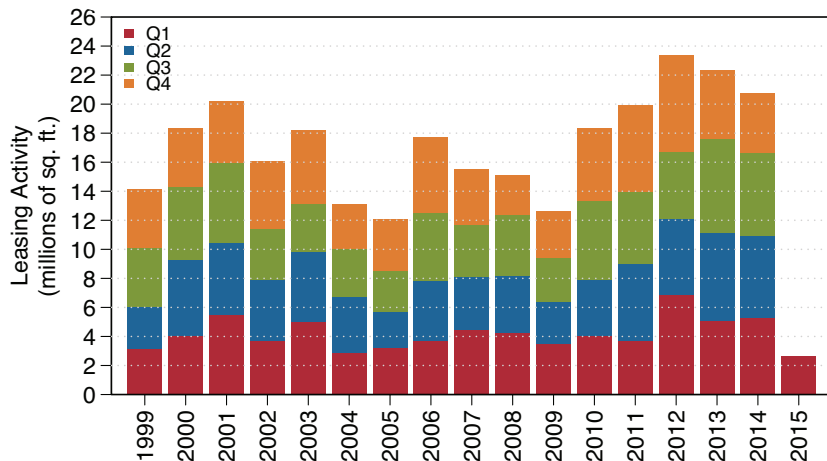


Figure 3: Leasing Activity



certain that Q1 leasing activity typically falls between 3,721,389 to 4,847,155 sq. ft.. This indicates that current leasing activity is statistically lower than historic Q1 measures since 1999. With absorption lagging 1-3 quarters behind leasing, such lower leasing activity in Q1 suggests lower absorption in quarters to come.

### Availability and Vacancy

Vacancy and availability both measure the supply of office space. Availability better measures total supply because it includes vacant, occupied, and sublease space. Vacancy better measures empty space on the market, whether or not that space is leased or even for rent. Overall, office supply increased in Q1 2015, compared with recent quarters (Figure 4). For Class A and B buildings combined, availability was 17%, up 6.5% QoQ and 5.6% YoY (Table 1). Likewise, vacancy for Class A and B space combined was 12%, up 8.2% QoQ and 4.2% YoY (Table 1).

Figure 4 shows percent availability and vacancy for each of Class A and B buildings since 1999. Table 2 summarizes availability and vacancy of Class A and B buildings separately for Q1 2015. While availability and vacancy increased in Q1 for each of Class A and B buildings, they were still within the 95% confidence intervals of historic Q1 performance (Table 2). This indicates that the decline is not a drastic deviation from prior years performance. There was a 1% difference in Q1 between Class A and B for both availability and vacancy, though vacancy runs ~5% less than availability.

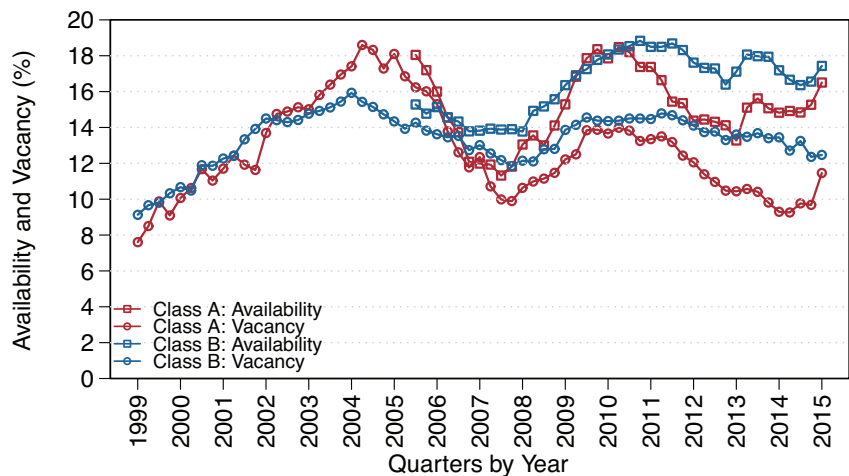
### Asking Rent

Prices reflect the relationships between supply and demand. Figure 5 plots direct and sublease asking rent prices since 1999 for Class A and B space. In Q1 2015, both Class A and B space showed stable asking rents, with Class A asking rent at \$34 and Class B at \$21. Class A direct rents tend to be about \$5 greater than sublets, and Class B direct rents tended to be about \$2 greater than

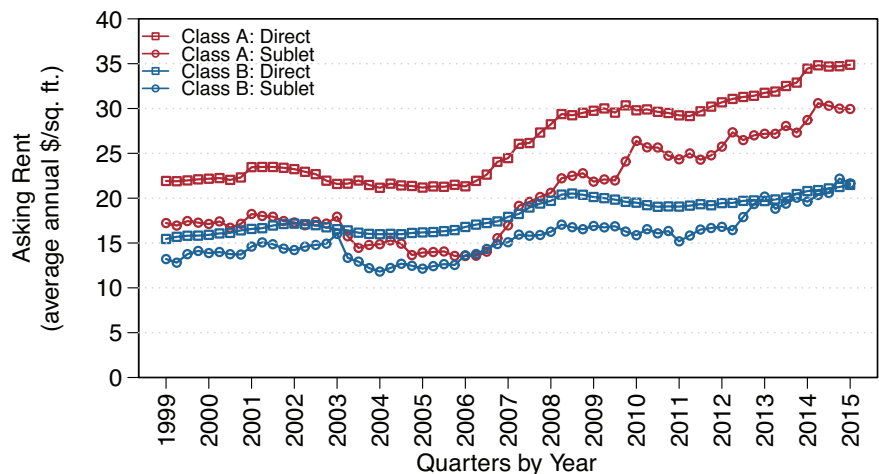
**Table 2.** Current (Q1 2015) supply of office space as measured by the availability and vacancy of Class A and Class B (% total RBA), compared to the historic first-quarter (Q1) average since 1999. The 95% confidence interval is the typical historic Q1 performance.

	Q1 2015	Historic Q1 Average	95% Confidence Interval for Q1
<b>Availability (%)</b>			
Class A	16.5	14.9	13.4 to 16.4
Class B	17.4	16.4	15.0 to 17.8
<b>Vacancy (%)</b>			
Class A	16.5	14.9	13.4 to 16.4
Class B	17.4	16.4	15.0 to 17.8

**Figure 4: Availability and Vacancy**



**Figure 5: Asking Rent**





sublets. Overall, average annual asking rents for Class A space have increased by about 60% since 1999. Yet, average annual asking rents for Class B space have increased only half as fast, about 36% since 1999.

### Construction

Construction of new RBA is another key variable shaping the supply of office space. "RBA Delivered" refers to completed construction that occurs during a given time period, while "RBA Under Construction" refers to space under construction that has not yet been completed. As detailed in Figure 6, deliveries in Q1 2015 were about 4.2 million sq. ft., an increase of 71% QoQ and 62% YoY (Table 1). RBA under construction declined to 15.4 million sq. ft. in Q1 2015, a decrease of 11% QoQ and 7% YoY (Table 1).

### Inventory

Figure 7 depicts changes in the inventory of Class A and Class B space since 1999, both in terms of RBA and the number of buildings. RBA inventory for Class A and B office space included 257 million sq. ft. for 3,670 buildings, an increase of 3% YoY (Table 1).



Figure 6a: Class A Construction

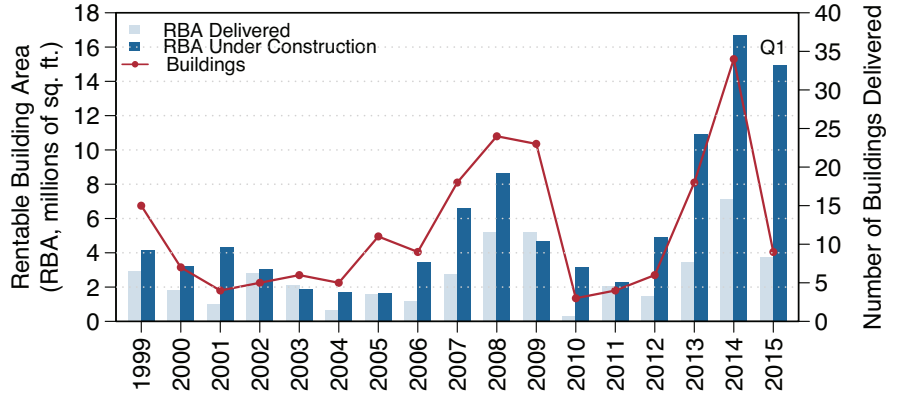


Figure 6b: Class B Construction

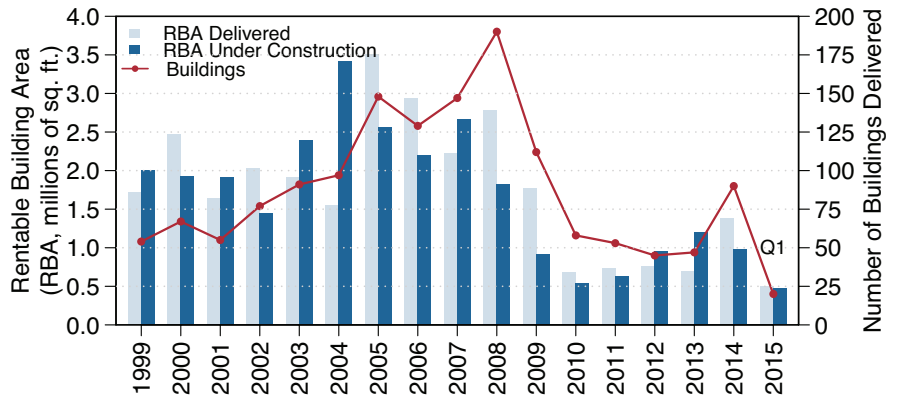


Figure 7a: Class A Inventory

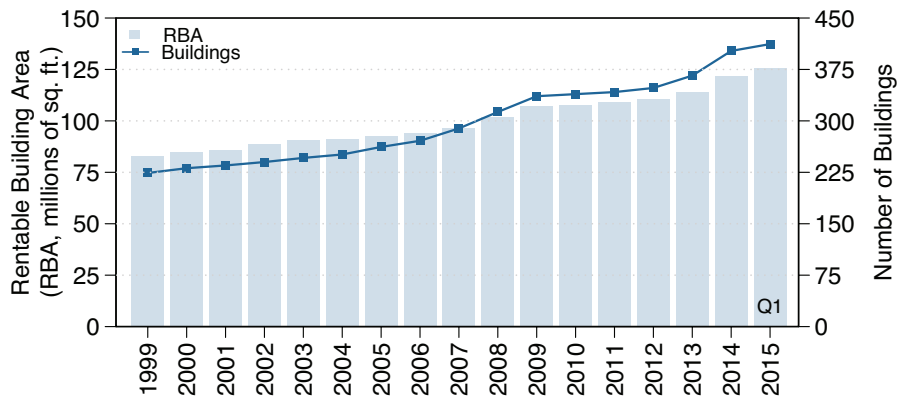
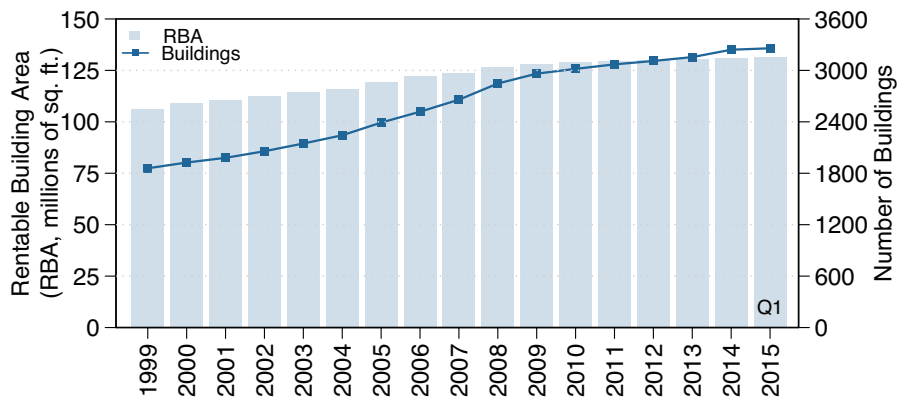


Figure 7b: Class B Inventory



## Largest Contiguous Space Available

Address	SF	Submarket	Address	SF	Submarket	Address	SF	Submarket
800 Bell St	1,314,350	Downtown	13401 N I-45	143,410	North Belt	12140 Wickchester Ln	78,291	Katy Freeway
609 Main St	1,043,873	Downtown	4400 Post Oak Pky	141,848	West Loop	3200 Southwest Fwy	77,977	Greenway Plaza
915 N Eldridge Pky	524,386	Katy Freeway	2700 Post Oak Blvd	140,618	West Loop	16900 Park Row	77,000	Katy Freeway
15377 Memorial Dr	371,423	Katy Freeway	16001 Park Ten Place Dr	136,950	Katy Freeway	16801 Greenspoint Park	76,652	North Belt
12450 Greenspoint Dr	356,468	North Belt	515 Post Oak Blvd	134,818	West Loop	3009 Post Oak Blvd	76,312	West Loop
17001 Northchase Dr	336,443	North Belt	2800 N Loop Fwy W	134,246	Northwest	1401 Enclave Pky	74,822	Katy Freeway
13501 Katy Fwy	331,707	Katy Freeway	2229 San Felipe	132,065	Downtown	1301 McKinney St	73,971	Downtown
1780 Hughes Landing Blvd	320,815	Woodlands	1709 Dryden Rd	131,120	South Main/Medical Center	652 N Sam Houston Pky E	73,772	North Belt
2101 CityWest Blvd	305,821	Westchase	21700 Merchants Way	127,953	Katy Freeway	1400 Broadfield Blvd	73,582	Katy Freeway
1414 Enclave	300,907	Katy Freeway	2727 North Loop W	123,103	Northwest	812 Main St	71,000	Downtown
600 Gemini St	300,000	NASA/Clear Lake	11929 W Airport Blvd	122,545	E Fort Bend Co/Sugar Land	1001 West Loop South	70,802	West Loop
16825 Northchase Dr	275,584	North Belt	8900 Lakes at 610 Dr	119,527	South Main/Medical Center	17220 Katy Fwy	69,972	Katy Freeway
1020 Holcombe Blvd	275,000	South Main/Medical Center	2350 N Sam Houston Pky E	116,746	North Belt	654 N Sam Houston Pky E	69,546	North Belt
6330 West Loop South	274,488	Bellaire	1000 Louisiana St	114,066	Downtown	2900 Wilcrest Dr	69,454	Westchase
2100-2120 Travis St	273,000	Downtown	1233 West Loop S	111,250	West Loop	2850 Fannin St	67,000	Downtown
5775 N Sam Houston Pky E	271,384	Northwest	1333 West Loop S	111,250	West Loop	16200 Park Row	66,898	Katy Freeway
11750 Katy Fwy	260,249	Katy Freeway	100 Pasadena Town Square Mall	110,000	Gulf Freeway/Pasadena	1302 Conti St	65,000	I-10 East
233 Benmar Dr	253,562	North Belt	10700 N I-45 Fwy	109,470	North Belt	16800 Greenspoint Park	64,483	North Belt
550 Westlake Park Blvd	242,052	Katy Freeway	3773 Richmond Ave	109,317	Greenway Plaza	16416 Northchase Dr	64,068	North Belt
25700 Interstate 45	240,000	Woodlands	554 Club Dr	108,000	Outlying Montgomery Cnty	1300 Hercules Ave	64,000	NASA/Clear Lake
11450 Compaq Center West Dr	236,016	FM 1960	2050 W Sam Houston Pky S	107,088	Westchase	1430 Enclave Pky	63,541	Katy Freeway
909 Fannin St	234,333	Downtown	811 Main St	106,005	Downtown	900 Threadneedle St	63,037	Katy Freeway
16200 Park Row	230,000	Katy Freeway	580 Westlake Park Blvd	104,339	Katy Freeway	808 Travis St	63,006	Downtown
3737 Buffalo Speedway Ave	217,400	Greenway Plaza	2107 CityWest Blvd	103,018	Westchase	19219 Katy Fwy	62,632	Katy Freeway
2425 West Loop South	211,702	West Loop	16676 Northchase Dr	101,111	North Belt	14141 Southwest Fwy	62,457	E Fort Bend Co/Sugar Land
3 Greenway Plz	207,441	Greenway Plaza	2115 Winnie St	100,000	Southeast Outlier	8223 Willow Place Dr S	62,001	FM 1960
10496 Old Katy Rd	207,000	Katy Freeway	411 N Sam Houston Pky E	99,524	North Belt	1 Riverway	60,779	West Loop
4005 Technology Dr	205,000	Southwest Far	10800 Richmond Ave	99,087	Westchase	737 N Eldridge Pky	60,667	Katy Freeway
100 Glenborough Dr	204,198	North Belt	500 Jefferson St	97,953	Downtown	2901 Louisiana St	60,000	Downtown
10713 W Sam Houston Pky N	200,000	FM 1960	1717 W Loop Fwy S	97,912	West Loop	4440 SH 225	59,401	Gulf Freeway/Pasadena
1121 Walker Ave	200,000	Downtown	6677 N Gessner Dr	96,000	Northwest	400 N Sam Houston Pky E	59,025	North Belt
11700 Katy Fwy	198,676	Katy Freeway	5718 Westheimer Rd	94,680	San Felipe/Voss	4444 Westheimer Rd	58,500	West Loop
16945 Northchase Dr	190,564	North Belt	10500 Richmond Ave	93,614	Westchase	2929 Allen Pky	58,451	Downtown
811 Louisiana St	188,695	Downtown	2445 Technology Forest Blvd	93,557	Woodlands	14950 Heathrow Forest Pky	58,327	North Belt
9811 Katy Fwy	187,608	Katy Freeway	1600 Smith St	93,345	Downtown	1775 St James Pl	56,910	West Loop
6464 Savoy Dr	182,566	Southwest	700 Milam St	91,108	Downtown	901 E Curtis	56,637	Gulf Freeway/Pasadena
2707 N Loop W	181,586	Northwest	5060 Westway Park Blvd	91,098	Northwest	14511 Falling Creek Dr	55,970	FM 1960
2103 CityWest Blvd	176,193	Westchase	1114 Texas Ave	90,000	Downtown	600 N Sam Houston Pky	55,700	North Belt
10720 W Sam Houston Pky N	175,806	Northwest	2001 Timberloch Pl	87,855	Woodlands	5757 Woodway Dr	55,069	San Felipe/Voss
750 Town & Country Blvd	172,907	Katy Freeway	3040 Post Oak Blvd	86,710	West Loop	16285 Park Ten Place Dr	54,858	Katy Freeway
1885 Saint James Pl	164,942	West Loop	333 Clay St	84,508	Downtown	5700 NW Central Dr	54,602	Northwest
1150 Gemini St	158,627	NASA/Clear Lake	5851 Southwest Fwy	82,500	Richmond/Fountainview	717 Texas Ave	54,575	Downtown
5251 Westheimer Rd	158,084	West Loop	711 Louisiana St	81,790	Downtown	5884 Point West Dr	54,417	Southwest
19350 State Highway 249	156,000	FM 1960	5051 Westheimer Rd	80,020	West Loop	222 Cavalcade St	54,200	I-10 East
16290 Katy Fwy	155,050	Katy Freeway	12300 Parc Crest Dr	79,566	E Fort Bend Co/Sugar Land	12141 Wickchester Ln	54,058	Katy Freeway
1575 Sawdust Rd	153,810	Woodlands	2400 NASA Pky	79,451	NASA/Clear Lake	4015 Interstate 45 N	53,722	Conroe
27245 Katy Fwy	151,185	Southwest Outlier	10500 Forum Place Dr	78,888	Southwest	2222 Bay Area Blvd	52,171	NASA/Clear Lake
3600 W Sam Houston Pky S	150,000	Westchase	1301 Fannin St	78,668	Downtown	1700 West Loop S	52,016	West Loop
15375 Memorial Dr	149,269	Katy Freeway	14100 Southwest Fwy	78,405	E Fort Bend Co/Sugar Land	5847 San Felipe St	51,638	San Felipe/Voss
15150 Memorial Dr	146,760	Katy Freeway				825 Town & Country	50,716	Katy Freeway
1201 Louisiana St	145,352	Downtown				9700 Bissonnet St	50,450	Southwest
						128 Vision Park Blvd	50,000	Woodlands
						16850 Buccaneer Ln	50,000	NASA/Clear Lake

## Select Sales

Property Address	Sale Date	Sale Price	Price Per SF
1000 Main St	3/31/15	\$435,500,000	\$520.21
3990 Rogerdale Rd	3/5/15	\$34,319,737	\$274.56
1250 W Sam Houston Pky	2/4/15	\$28,000,000	\$180.28
22710-22730 Professional Dr	3/11/15	\$14,949,000	\$347.65
1505 E Winding Way (Part of Portfolio)	2/26/15	\$5,621,132	\$205.11
2234 Richmond Ave	2/22/15	\$720,000	\$348.84
208-210A Morton St	1/20/15	\$545,000	\$117.08
1211 Antoine Dr	1/30/15	\$500,000	\$208.33
6811 Stewart Rd	2/20/15	\$335,000	\$107.75
8191 Southwest Fwy, 106/1st Floor	1/7/15	\$305,000	\$152.50
311 Commerce St	3/9/15	\$195,000	\$99.09

## Select Top Office Leases

Tenant	Building	Square Feet
CPL Retail Energy LP*	12 Greenway Plaza	191,893
Swift Energy Company	5 Greenspoint	113,801
Lennar Homes	400 N. Sam Houston Parkway W.	67,500
Superior Energy Services	11330 Clay Rd.	64,018
Regions Bank	3773 Richmond Ave.	62,363
LTD Financial Services, LP*	7322 Southwest Freeway	61,461
US Physical Therapy, Inc.	1300 W. Sam Houston Parkway S.	39,471
RigNet, Inc.*	1880 S. Dairy Ashford	34,611
U.S. Capital Advisors	4444 Westheimer	33,500
Morgan Stanley	1330 Post Oak Blvd.	29,990
CARBO Ceramics*	575 N. Dairy Ashford	27,259
Cox Radio*	1990 Post Oak Blvd.	23,864
Shannon, Martin, Finkelstein & Alvarado, PC*	1001 McKinney	20,001

## Select Largest Deliveries

Building Name	Building Address	Submarket	Percent Leased
Energy Tower IV	11750 Katy Fwy	Katy Freeway	39%
West Memorial Place	15375 Memorial Dr	Katy Freeway	55%
Beltway Lakes Phase III	5775 N Sam Houston Pky E	Northwest	0%
Town Centre One	750 Town & Country Blvd	Katy Freeway	27%
Legacy at Fallbrook	10720 W Sam Houston Pky N	Northwest	15%
5060 Westway Park Blvd	5060 Westway Park Blvd	Northwest	9%
2829 Technology Forest Blvd	2829 Technology Forest Blvd	Woodlands	48%
1904 Grand Parkway N	1904 Grand Parkway N	Katy Freeway	80%

## Select Under Construction

Building Name	Building Address	Square Feet	Submarket
Three Hughes Landing	1780 Hughes Landing Blvd	320,815	Woodlands
Enclave Place	1414 Enclave	300,907	Katy Freeway
Kirby Grove	2529 Richmond Ave	248,275	Greenway Plaza
Havenwood Office Park	25700 Interstate 45	240,470	Woodlands
CityCentre Five	825 Town & Country	227,063	Katy Freeway
Phase II	10713 W Sam Houston Pky N	200,000	FM 1960
Regions Financial Center	3773 Richmond Ave	185,000	Greenway Plaza
San Felipe Place	2229 San Felipe	167,562	Downtown
	1885 Saint James Pl	165,000	West Loop
Chasewood Crossing Three	19350 State Highway 249	156,000	FM 1960
Katy Ranch Phase I	27245 Katy Fwy	151,187	Southwest Outlier
Phase II	16200 Park Row	150,000	Katy Freeway
Mason Creek Office Center II	21700 Merchants Way	127,955	Katy Freeway
The Offices at Sam Houston	10203 Sam Houston Dr	108,633	Northwest
Westland Bunker	554 Club Dr	108,000	Outlying Montgomery Cnty

## Class A Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	7	1,191,304	100,049	0	\$24.20
Downtown	39	33,047,224	2,717,296	1,630,820	\$41.18
E Fort Bend Co/Sugar Land	20	3,769,776	396,126	0	\$25.77
FM 1960	21	3,854,007	437,747	1,126,000	\$27.33
Greenway Plaza	16	6,287,231	631,902	833,275	\$36.03
Gulf Freeway/Pasadena	1	22,706	526	0	\$27.59
I-10 East	0	0	0	0	\$0.00
Katy Freeway	89	21,443,109	1,787,942	4,354,141	\$35.28
Kingwood/Humble	2	131,665	42,001	40,000	\$29.01
NASA/Clear Lake	15	2,024,514	55,395	0	\$25.28
North Belt	24	5,441,523	1,701,571	0	\$29.02
Northeast Near	0	0	0	1,700,000	\$0.00
Northwest	28	5,477,586	1,064,363	108,633	\$26.29
Richmond/Fountainview	0	0	0	0	\$0.00
San Felipe/Voss	3	1,720,793	272,414	0	\$35.87
South	2	250,000	5,941	100,000	\$26.98
South Hwy 35	0	0	0	0	\$0.00
South Main/Medical Center	15	4,560,992	266,458	0	\$28.95
Southwest	9	2,058,852	261,851	0	\$17.73
West Loop	44	16,548,108	1,430,393	1,237,021	\$35.42
Westchase	30	8,169,697	1,227,476	1,545,000	\$37.45
Woodlands	33	8,971,122	385,151	1,976,677	\$33.25

## Class B Market Statistics

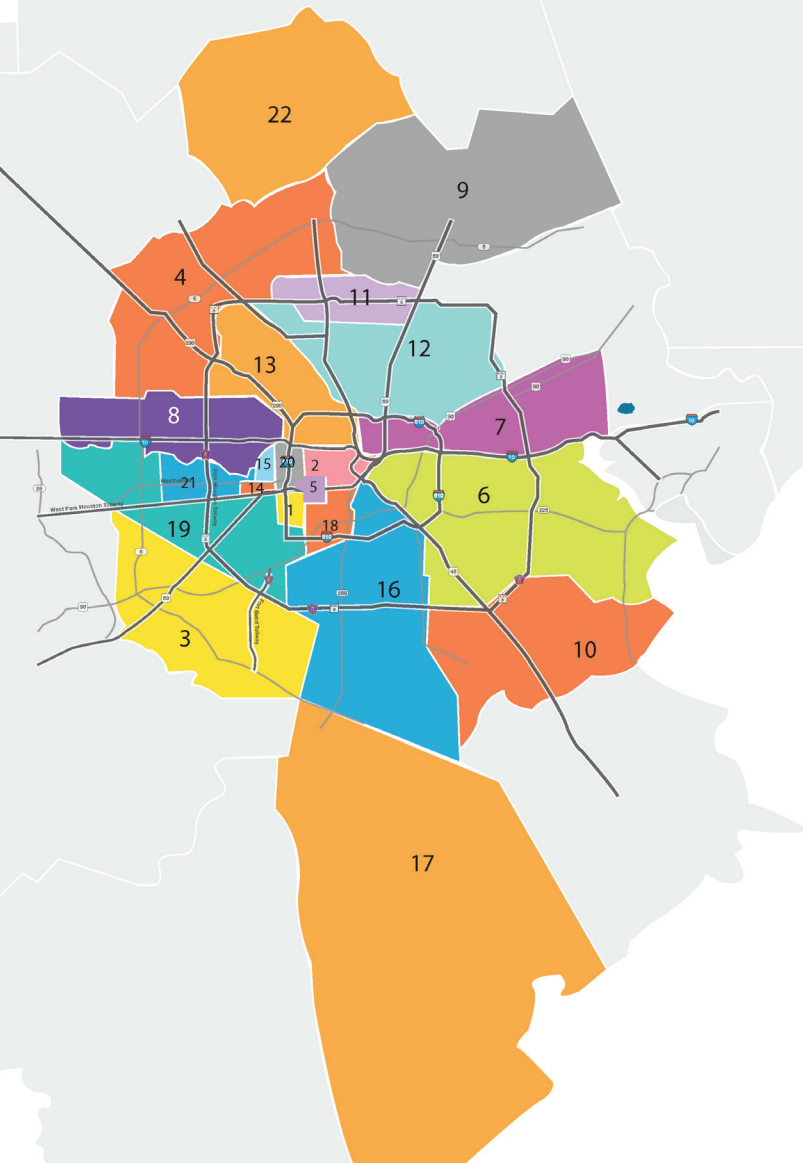
Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
Bellaire	32	3,023,265	157,055	0	\$25.57
Downtown	173	19,638,789	1,616,469	0	\$26.50
E Fort Bend Co/Sugar Land	234	4,646,844	556,028	155,272	\$23.91
FM 1960	366	8,542,000	1,241,676	15,400	\$17.43
Greenway Plaza	52	4,336,268	291,214	0	\$22.23
Gulf Freeway/Pasadena	156	3,751,098	665,138	0	\$21.44
I-10 East	24	666,613	76,009	0	\$15.50
Katy Freeway	324	13,417,958	1,349,259	22,849	\$23.82
Kingwood/Humble	72	1,624,169	96,143	30,000	\$21.41
NASA/Clear Lake	211	5,762,825	1,160,521	3,300	\$19.73
North Belt	79	6,981,777	1,133,670	68,950	\$15.96
Northeast Near	27	662,292	97,265	0	\$19.35
Northwest	166	8,177,091	1,089,225	0	\$19.00
Richmond/Fountainview	28	978,120	201,472	0	\$17.76
San Felipe/Voss	38	3,575,400	280,874	0	\$23.35
South	81	1,594,406	202,910	0	\$26.90
South Hwy 35	34	358,380	17,622	0	\$15.14
South Main/Medical Center	65	4,834,403	768,538	0	\$25.80
Southwest	143	7,710,644	1,628,556	0	\$15.83
West Loop	59	6,380,486	682,673	0	\$26.01
Westchase	73	7,884,767	835,184	0	\$20.45
Woodlands	314	7,649,072	618,636	29,050	\$25.59



## Total Class A &amp; B Office Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Quoted Rates
	# Blds	Total RBA			
<b>Bellaire</b>	39	4,214,569	257,104	0	\$24.26
<b>Downtown</b>	212	52,686,013	4,333,765	1,630,820	\$37.77
<b>E Fort Bend Co/Sugar Land</b>	254	8,416,620	952,154	155,272	\$24.64
<b>FM 1960</b>	387	12,396,007	1,679,423	1,141,400	\$19.88
<b>Greenway Plaza</b>	68	10,623,499	923,116	833,275	\$33.09
<b>Gulf Freeway/Pasadena</b>	157	3,773,804	665,664	0	\$21.35
<b>I-10 East</b>	24	666,613	76,009	0	\$15.50
<b>Katy Freeway</b>	413	34,861,067	3,137,201	4,376,990	\$31.24
<b>Kingwood/Humble</b>	74	1,755,834	138,144	70,000	\$23.57
<b>NASA/Clear Lake</b>	226	7,787,339	1,215,916	3,300	\$20.08
<b>North Belt</b>	103	12,423,300	2,835,241	68,950	\$24.87
<b>Northeast Near</b>	27	662,292	97,265	1,700,000	\$19.35
<b>Northwest</b>	194	13,654,677	2,153,588	108,633	\$22.71
<b>Richmond/Fountainview</b>	28	978,120	201,472	0	\$17.76
<b>San Felipe/Voss</b>	41	5,296,193	553,288	0	\$30.23
<b>South</b>	83	1,844,406	208,851	100,000	\$27.31
<b>South Hwy 35</b>	34	358,380	17,622	0	\$15.14
<b>South Main/Medical Center</b>	80	9,395,395	1,034,996	0	\$26.84
<b>Southwest</b>	152	9,769,496	1,890,407	0	\$16.33
<b>West Loop</b>	103	22,928,594	2,113,066	1,237,021	\$33.13
<b>Westchase</b>	103	16,054,464	2,062,660	1,545,000	\$31.01
<b>Woodlands</b>	347	16,620,194	1,003,787	2,005,727	\$28.91

## The Houston Office Sub-market Map



1. Bellaire
2. Downtown - CBD + Midtown
3. E Fort Bend Co/Sugar Land
4. Fm 1960 + FM 1960/Champions + Fm1960/Hwy 249 + FM 1960/I-45 North
5. Greenway Plaza
6. Gulf Freeway/Pasadena
7. I-10 East
8. Katy Freeway = Katy Freeway East + Katy Freeway West
9. Kingwood/Humble
10. Nasa/Clear Lake
11. North Belt = North Belt East + North Belt West/Greenspoint
12. Northeast Near
13. Northwest = North Loop West + Northwest + Far\_ Northwest Near
14. Richmond
15. San Felipe/Voss
16. South
17. South Hwy 35
18. South Main/Medical Center
19. Southwest = Southwest Beltway 8 + Southwest/Hillcroft
20. Westloop = Galleria/Uptown + Riverway + Post Oak Park
21. Westchase = Westchase East + Westchase West
22. Woodlands

## Methodology | Definitions

### Asking Rental Rate

Rental rate as quoted from each building's owner/management company. For office space, a full service rate was requested; for retail, a triple net rate requested; for industrial, a NN basis.

### Building Class

Class A Product is office space of steel and concrete construction, built after 1980, quality tenants, excellent amenities & premium rates. Class B product is office space built after 1980, fair to good finishes & wide range of tenants.

### Market Size

Includes all existing and under construction office buildings (office, office condo, office loft, office medical, all classes and all sizes, both multi-tenant and single-tenant, including owner-occupied buildings) within each market.

### SF/PSF

Square foot/per square foot, used as a unit of measurement.

*Information and data within this report were obtained from sources deemed to be reliable. However, no warranty or representation is made as to guarantee its accuracy. Sources include: U.S. Bureau of Economic Analysis, CoStar, Council on Foreign Relations, Federal Reserve Bank of Dallas, Greater Houston Partnership, FiveThirtyEight.com, Houston Association of Realtors, Moody Analytics, NAI Global, National Association Realtors, Texas A&M Real Estate Center, University of Houston's Institute of Regional Forecasting, U.S. Bureau of Labor Statistics.*

# Economic and Market Outlook:

HOUSTON OFFICE | Q1 2015

## Marketing & Research Team

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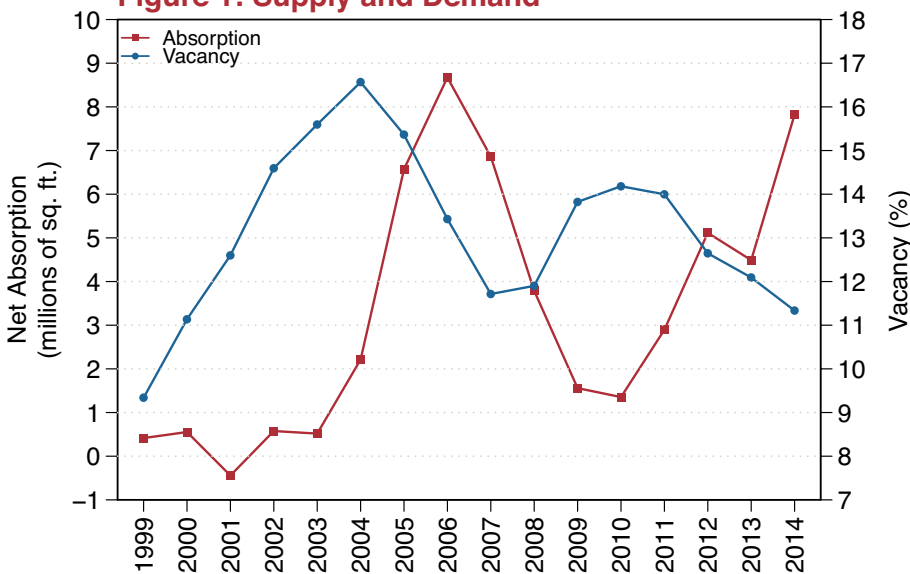
HOUSTON | SAN ANTONIO | AUSTIN



## Economic and Market Outlook:

HOUSTON OFFICE | Q4 2014

**Figure 1: Supply and Demand**



### Executive Summary

Houston's economy is healthy and diversified, and is anticipated to continue to grow in 2015, but at a slower pace due to the recent decline in oil prices. Local, state, and national economies are growing from improvements in GDP (gross domestic product), employment, energy costs, and business activity. Even though lower oil prices and reduced energy costs can stimulate economic growth, there is appropriate concern for Houston and Texas economies given the prominence of the energy sector.

Demand for office space, as measured by net absorption, remained strong in the Q4 2014, with 2.8 million sq. ft. being absorbed, the highest fourth quarter net absorption in the past 16 years (Figure 1, Table 1). Moreover, 2014 posted the second highest year of net absorption since 1999 at 7.8 million sq. ft. Supply, as measured by vacancy, was 11.1% for Class A and B. The quarter saw deliveries increase by 152% YoY and construction increase 38% YoY. Asking rents continued to rise, particularly for Class A space, which is up 5.8% YoY. Despite the strong numbers reported for the end of 2014, our professionals are seeing some fall out from lower oil prices, including delayed transactions and large subleasing.

**Table 1. Key market indicators for Q4 2014, and their percent (%) change on a quarter-over-quarter (QoQ) and year-over-year (YoY) basis (Class C excluded herein).**

	Percent Change over Prior Period	
	Q4 2014	YoY (%)
Asking Rent: Class A	\$34.69	5.8
Asking Rent: Class B	\$21.31	4.2
Net Absorption (sq.ft.)	2,804,901	45.8
Leasing Activity	2,600,147	-45.0
Availability (%)	16.0	-2.9
Vacancy (%)	11.1	-5.8
Deliveries (RBA, sq.ft.)	2,477,313	151.7
Construction (RBA, sq.ft.)	18,456,011	37.7
Inventory (RBA)	249,541,412	2.9
Inventory (No. Buildings)	3599	3.2



## ECONOMIC OVERVIEW

**While some global slowdowns are occurring, the economic profiles of the U.S., Texas, and Houston remain strong with continued growth. Houston and Texas are among the leaders in the U.S. economy, despite declines in the energy industry. Positive outlook is carried by improvements in GDP, employment, energy costs, and business activity, while a slightly negative outlook, for Houston and Texas in particular, is due to declines in both energy and Texas exports.**

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### Energy

The global supply of 92 million barrels of oil per day (mb/d) in 2014 is projected to exceed demand (91.4 mb/d), with the U.S. contributing +1.5 mb/d to the surplus. By mid-January 2015, the price of West Texas Intermediate (WTI) fell below \$50. Natural gas prices are down \$0.71, with an average \$3.40 per MMBtu. Drops also occurred in ethane and propane, with prices at their lowest in over a decade. A gallon of retail regular gasoline on the Gulf Coast dropped to \$2.31 in December 2014, lowest since mid-year 2009. U.S. oil and gas rig count was down from an average of 1,925 in October to 1,882 in December. In Texas, rig counts declined from 904 in November to 855 in December. With an approximate three month lag between energy prices and active rigs, coming weeks and months may see further reductions.

As of early January 2015, the US Energy Information Administration (EIA) has revised its 2015 projection for WTI downwards to \$62, Goldman Sachs has it at \$47, and Citi at \$55. Often, however, predictions for oil are incorrect. In 2008 it was forecast that U.S. oil production was in a decline that would never recover, with production at five mb/d compared with 10 mb/d at its peak in the early 1970s. An increase in oil production was not considered feasible by any forecast. Then, in 2014, oil production in the U.S. exceeded 8 mb/d. Similarly, forecasts for 2014 did not predict the later decline in prices. Simply put, forecasting oil is a complex problem.

While Houston's economy varies with the performance of its energy sector, it would be misleading to equate the decline in recent oil prices with a pending decline in Houston's overall economy. For example, consider the projected changes in GDP due to the recent decline in oil prices. It is anticipated that reduced oil prices and lower prices at the pump will lead to an increase of approximately 0.3 to 0.4% in GDP, while the pullback in oil will reduce GDP by only 0.1%. Moreover, consumer spending accounts for ~60% of GDP. Reductions in oil prices stimulate consumer spending, and in turn consumer spending stimulates demand for oil. Overall, economic forecasts for Houston, Texas and the U.S. are for continued healthy growth. Certainly, the growth in Houston's economy will not be as strong had oil prices not fallen, but Houston's economy is diversified and is anticipated to continue to grow.

### Gross Domestic Product (GDP)

While Europe's GDP in Q3 2014 came in at just 0.6%, the GDP of the U.S. exceeded expectations at 5.0% growth for the same period. Personal consumption expenditures (PCE) and exports were key contributors to the increase.

### Employment

Ongoing improvements in the labor market continue to support economic growth at national, state, and city levels. For the 11th consecutive month, job growth increased by more than 200,000 jobs. National unemployment in December 2014 declined 0.2% to an overall 5.6%, the lowest it has been since June 2008. Despite

largely positive employment numbers, average wages have largely been stagnant, only up by \$0.40 year-over-year.

Houston and Texas continue to outperform national labor markets. Unemployment in November 2014 remained steady at 4.9% in Texas and 4.8% in Houston. Employment in Texas and Houston in November 2014 grew 3.2% and 4.4%, respectively, compared to the nation's 2.8%. The energy industry in Houston had an increase in jobs in November, when Houston's payroll employment increased 3.9%, dominated by construction and mining and leisure and hospitality. Financial activities showed declines in payroll employment. Job growth in energy extraction and pipeline increased by 7.6%, but job growth in support activities slowed to 6.6%. Job growth in Texas and Houston are expected to be ~2.7% in 2015. This is ~1% less than 2014 but still higher than the long term average of 2.1%.

### Interest Rates

While interest rates continue to remain unchanged, the Federal Reserve may begin to increase them in 2015, through relatively small and incremental changes.

### Consumer Price Index

The Consumer Price Index (CPI) for Urban Consumers (CPI-U) is a key measure of inflation, and when reported as the core inflation rate does not include the volatility of short-term food and energy prices. The CPI-U for all items decreased 0.4% in December 2014, the biggest drop in six years, and increased only 0.8% for the past 12 months, compared to 1.3% for 12 months ending November 2014. Excluding food and

energy, the index remained unchanged in December. The energy index declined 10.6% over the 12 months ending December 2014. As the economy continues to grow, so will inflation, though probably not sooner than a year or two.

### Business Activity

The Dallas Federal Reserve reports the Production Index for Texas Manufacturing, which subtracts the percentage of firms reporting a decrease in manufacturing from those reporting an increase. Positive values represent increases in manufacturing, negative values decreases. The Production Index increased sharply from 6.0 in November to 15.8 in December 2014. At the national level, factories are at 77.2% capacity (compared to 63.9% in early 2009), indicating near term expansion to meet demands.

The Houston Business-Cycle Index of the Dallas Federal Reserve is a single measure assessing the Houston-Sugar Land-Baytown economy based on movements in local unemployment, nonagricultural employment, inflation-adjusted wages, and inflation-adjusted retail sales. The index shows that, while the business growth rate

in Houston remains positive, it declined to 6% in November from 7.4% in October. Inexpensive oil and a growing economy are expected to support continued growth in manufacturing.

### Exports/Trade

In November 2014, monthly exports from Texas declined 2.4%, following a 5.2% decline in October. Year-over-year, Texas exports were down 8.6%.

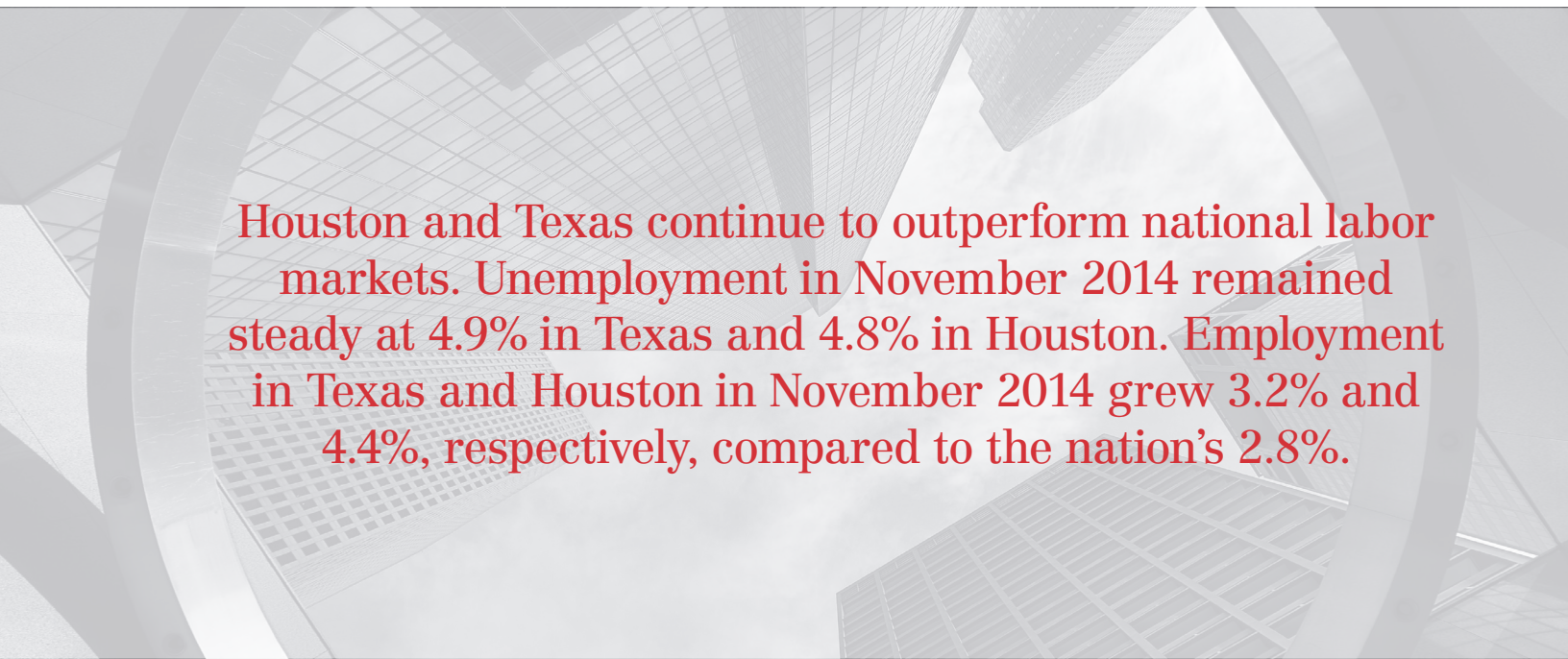
### Housing

National home prices gained 4% in 2014, and sales are expected to grow 8% in the coming year. Fannie Mae and Freddie Mac reduced down payments from 5% to 3%, indicating that rules for mortgage lending may begin to relax. In Texas, existing home sales decreased 0.3% in November, but they were up 7.6% year-over-year. Permits for construction of single-family homes in Texas dropped 4.4% in November (compared to 2.2% increase in October), but they are up 5.6% year-over-year. With high demand and low inventory for single family homes, there has been a strong rental market that has increased multifamily construction. However, Texas housing starts (both single

and multi-family) were down 12.2% in November and 14.7% year-over-year. Texas home inventory was down to 3.4 months in November 2014, compared to 3.7 months a year ago. Demand for housing in 2015 is likely to increase as unemployment declines and incomes increase.

### Retail

National retail and food service sales decreased 0.9% in December 2014, but were up 3.2% year-over-year. The revenue index for the Texas Retail Outlook Survey (TROS) shows strong growth in recent months, with highs not seen since 2007. Retailers appear optimistic about business.



**Houston and Texas continue to outperform national labor markets. Unemployment in November 2014 remained steady at 4.9% in Texas and 4.8% in Houston. Employment in Texas and Houston in November 2014 grew 3.2% and 4.4%, respectively, compared to the nation's 2.8%.**

MARKET OVERVIEW

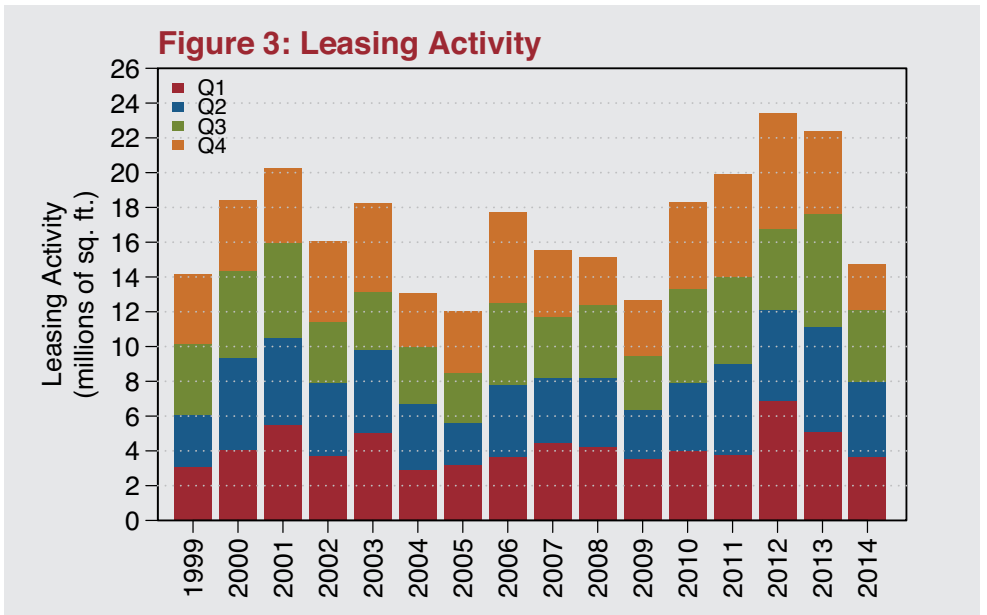
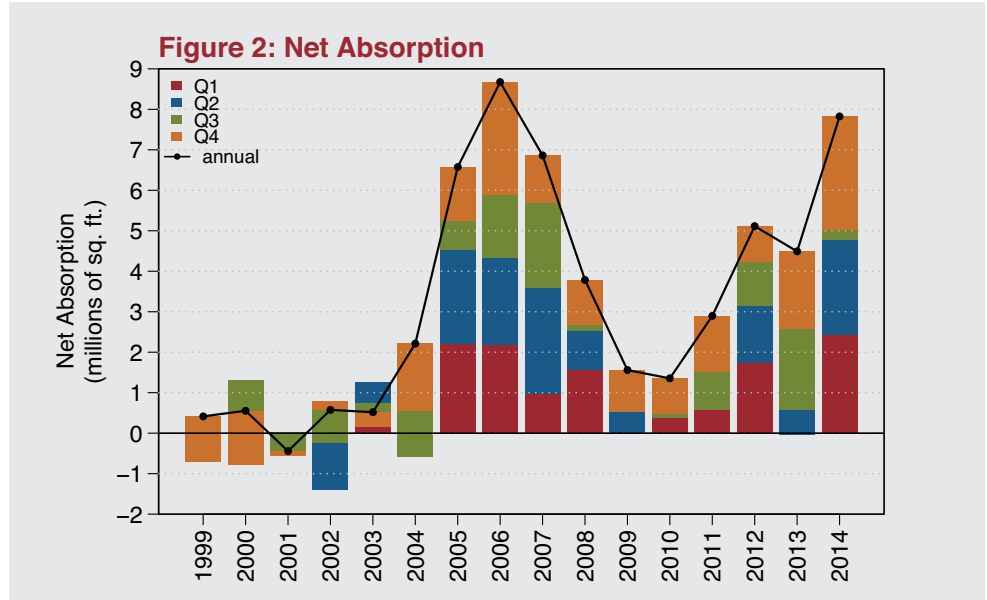
Demand for office space continued to remain strong with 2,804,901 sq. ft. absorbed in Q4 2014, a 45% increase YoY. The year of 2014 was the second highest for net absorption since 1999 at 7,823,946 sq. ft. Supply, as measured by vacancy, for the Q4 2014 was 11.1% for Class A and B, yielding a 4.9% and 5.8% decrease QoQ and YoY, respectively. The Q4 saw deliveries and construction increase by 152% and 38% YoY, respectively. Asking rent for Class A space is up 5.8% YoY.

Net Absorption

Net absorption is a key metric that shows actual demand for office space. Net absorption measures the change in occupied inventory over a specific time period, including direct and sublet space and the addition and subtraction of building area. Figure 2 shows net absorption from 1999-2014 by year and quarter for combined Class A and B office space. Net absorption of 2,804,901 sq. ft. occurred in Q4 2014, yielding a 1066% and 45% increase QoQ and YoY, respectively (Table 1). The unusually high QoQ percent change occurred because of a very low net absorption in the third quarter of 2014. The Q4 2014 posted the highest Q4 absorption in the 16 year history since 1999, with the next highest Q4 absorption having been in 2006 with 2,775,519 sq. ft. Despite exceptionally low net absorption in the third quarter, 2014 posted the second highest year of net absorption at 7,823,946 sq. ft. since 1999, following 2006 at 8,673,797 sq. ft.

Leasing Activity

Leasing activity, another measure of demand, is the gross amount of space represented by direct leases, subleases, renewals, and pre-leasing of rentable building area (RBA) under construction. Figure 3 reports leasing activity from 1999-2014 by year and quarter for combined Class A and B office space. Leasing activity for Q4 2014 was 2,600,147 sq. ft., yielding a 37% and 45% decrease QoQ and YoY, respectively (Table 1). Leasing activity in each quarter of 2014 was lower than each respective quarter for the past five years, although not abnormally low relative to other years dating back to 1999.



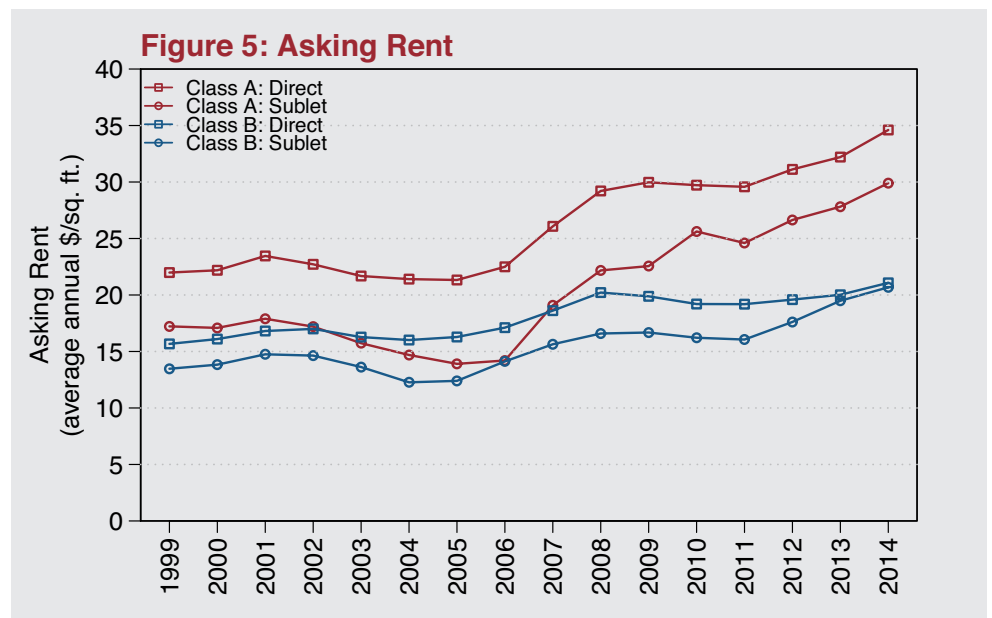
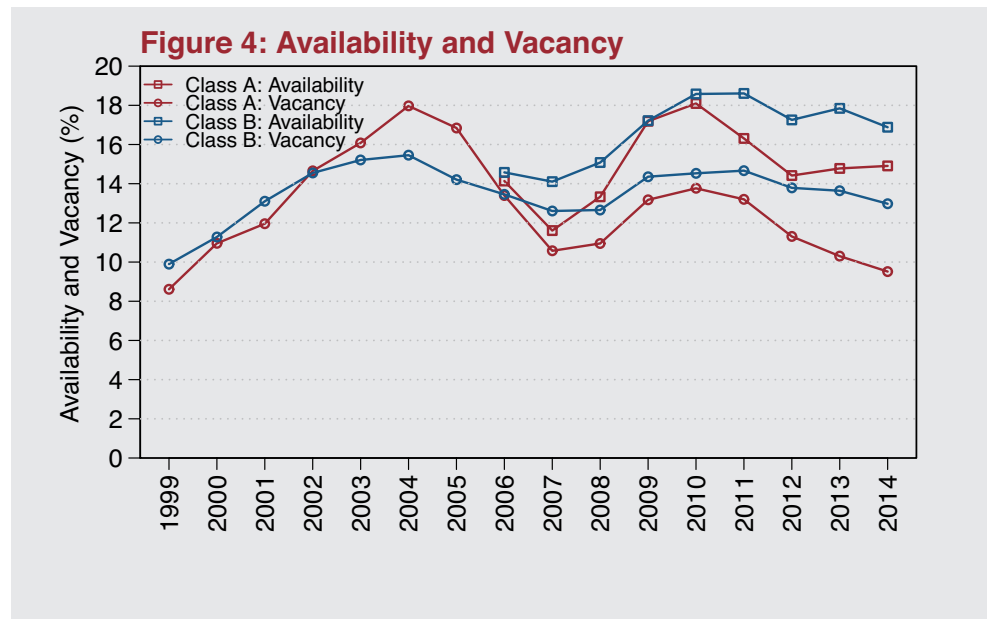
## Availability and Vacancy

Vacancy and availability are two different measures of the supply of office space. Vacancy (%) is the amount of space that is not occupied by a tenant relative to the total rentable space of the market. Vacancy is independent of whether or not the space has a paid lease or is even available for lease. Availability (%) is the amount of space currently available for lease relative to the total rentable space, whether or not the space is vacant, occupied, sublet, or becoming available in the near term. In this way, vacancy under estimates supply by not including space for lease that is still occupied, while availability does little to evaluate how much space is sitting empty.

Figure 4 shows the availability and vacancy of office space over the past 16 years for each of Class A and B office space. Availability tends to be ~5% greater than vacancy. Class A space tends to have ~2-3% lower availability and vacancy rates than Class B. Availability for the Q4 2014 was 16% for Class A and B combined, while vacancy was 11.1% (Table 1). Vacancy of Class A space was 9.5% in 2014, just 0.9% greater than 1999, the lowest on record since then.

## Asking Rent

Prices reflect the relationships between supply and demand. Figure 5 plots direct and sublet asking rent prices from 1999 - 2014 for Class A and B space. In Q4 2014, both Class A and Class B show an increase in asking rent, with Class A asking rent at \$34.69 and Class B asking rent at \$21.31. Class A direct rents tended to be ~\$5 greater than sublets, and Class B direct rents tended to be ~\$2 greater than sublets. However, this was not the case in 2013 or 2014 for Class B space in which direct and sublet asking rents were indistinguishable. Overall, average annual asking rents for Class A space have risen 59.3% in 16 years, from \$21.44 in 1999



to \$34.15 in 2014. Yet, average annual asking rents for Class B space have risen only about half as fast, 35.7% from \$15.52 in 1999 to \$21.06 in 2014.

## Construction

Construction of new RBA is another key variable determining the supply of office space. RBA delivered refers to completed construction that occurs during a given time period, while RBA under construction refers to space not yet completed construction. As detailed in

Figure 6, deliveries in Q4 2014 increased to just over 2.4 million sq. ft. and RBA under construction rose to nearly 18.5 million sq. ft. Class A construction shows record levels of new buildings and RBA under construction since 1999. Supply of Class A and B office space is increasing substantially through the construction of new buildings.

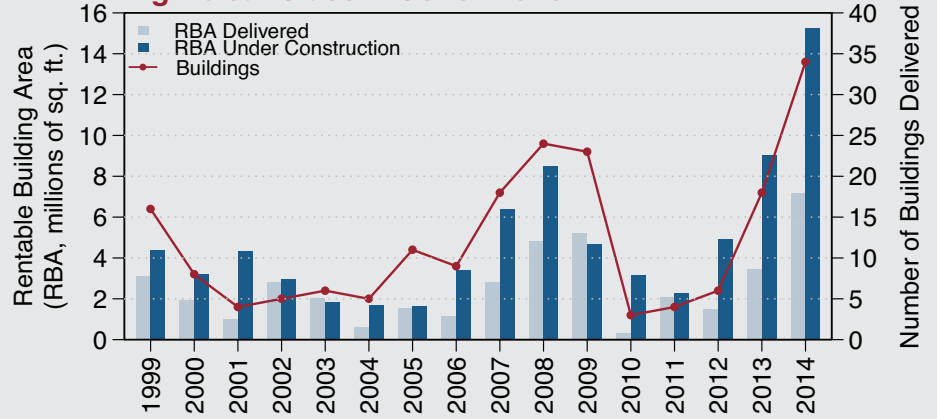


**Inventory**

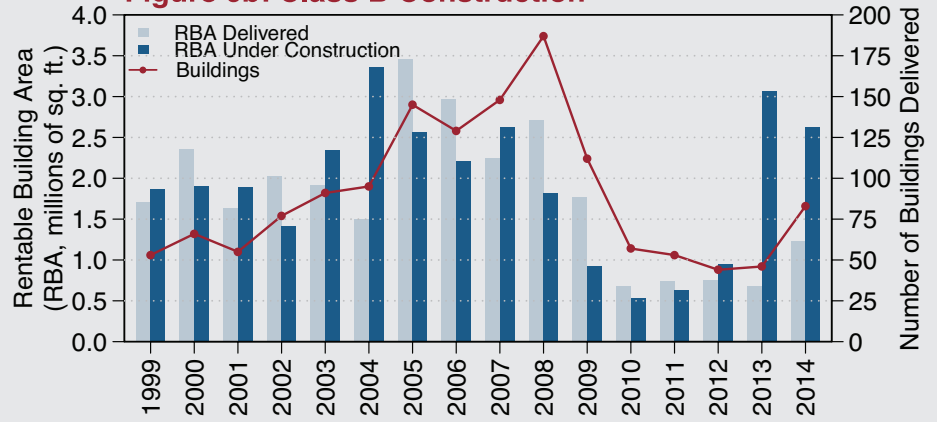
Figure 7 depicts changes in the inventory of Class A and Class B space over the past 16 years, both in terms of the number of buildings and the RBA of that space. RBA inventory for Class A and B office space included 249 million sq. ft. for 3,599 buildings, an increase of about 0.6% and ~3% QoQ and YoY, respectively (Table 1).

**RBA inventory for Class A and B office space included 249 million sq. ft. for 3,599 buildings, an increase of about 0.6% and ~3% quarter-over-quarter (QoQ) and year-over-year (YoY), respectively.**

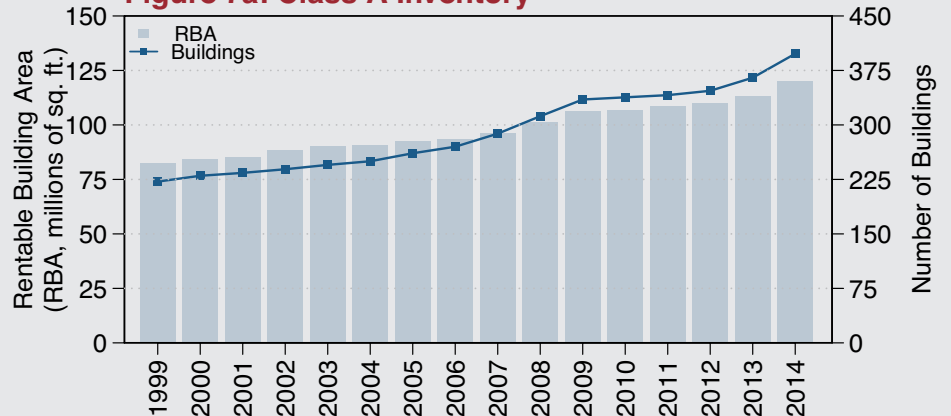
**Figure 6a: Class A Construction**



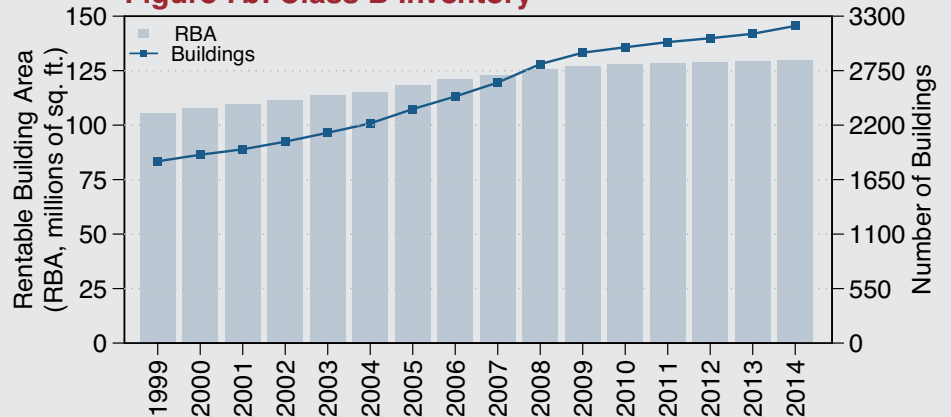
**Figure 6b: Class B Construction**



**Figure 7a: Class A Inventory**



**Figure 7b: Class B Inventory**



## Largest Contiguous Space Available

Address	SF	Submarket	Address	SF	Submarket	Address	SF	Submarket
800 Bell St	1,314,350	CBD	24275 Katy Fwy	151,185	Southwest Outlier	10500 Forum Place Dr	78,888	Southwest Beltway 8
609 Main St	1,044,883	CBD	15375 Memorial Dr	149,269	Katy Freeway West	1301 Fannin St	78,668	CBD
915 N Eldridge Pky	524,396	Katy Freeway West	550 Westlake Park Blvd	148,674	Katy Freeway West	2929 Allen Pky	78,300	Midtown
17001 Northchase Dr	450,244	Greenspoint/N Belt West	2800 N Loop Fwy W	147,183	North Loop West	12140 Wickchester Ln	78,291	Katy Freeway West
15377 Memorial Dr	371,423	Katy Freeway West	15150 Memorial Dr	146,760	Katy Freeway West	4440 SH 225	78,000	Gulf Freeway/Pasadena
12450 Greenspoint Dr	356,468	Greenspoint/N Belt West	1201 Louisiana St	145,352	CBD	16900 Park Row	77,000	Katy Freeway West
1414 Enclave	300,907	Katy Freeway West	515 Post Oak Blvd	144,905	Post Oak Park	3009 Post Oak Blvd	76,312	Galleria/Uptown
600 Gemini St	300,000	NASA/Clear Lake	13401 N I-45	143,410	Greenspoint/N Belt West	1401 Enclave Pky	74,822	Katy Freeway West
3600 W Sam Houston Pky S	300,000	Westchase	2700 Post Oak Blvd	140,618	Galleria/Uptown	1301 McKinney St	73,971	CBD
16825 Northchase Dr	275,584	Greenspoint/N Belt West	2229 San Felipe	139,023	Midtown	652 N Sam Houston Pky E	73,772	Greenspoint/N Belt West
1020 Holcombe Blvd	275,000	South Main/Medical Center	16001 Park Ten Place Dr	136,950	Katy Freeway West	825 Town & Country	72,119	Katy Freeway East
6330 West Loop South	274,488	Bellaire	1709 Dryden Rd	131,120	South Main/Medical Center	1001 West Loop South	70,802	Post Oak Park
5775 N Sam Houston Pky E	271,384	Northwest Far	21700 Merchants Way	127,953	Katy Freeway West	14950 Heathrow Forest Pky	70,482	Greenspoint/IAH
11750 Katy Fwy	260,249	Katy Freeway West	2727 North Loop W	123,103	North Loop West	17220 Katy Fwy	69,972	Katy Freeway West
700 Town & Country Blvd	254,466	Katy Freeway East	11929 W Airport Blvd	122,545	E Fort Bend Co/Sugar Land	2900 Wilcrest Dr	69,454	Westchase
233 Benmar Dr	253,562	Greenspoint/N Belt West	5051 Westheimer Rd	120,723	Galleria/Uptown	2200 Post Oak Blvd	67,523	Galleria/Uptown
1780 Hughes Landing Blvd	249,996	Woodlands	8900 Lakes at 610 Dr	119,527	South Main/Medical Center	16200 Park Row	66,898	Katy Freeway West
25700 Interstate 45	240,000	Woodlands	2350 N Sam Houston Pky E	116,746	Greenspoint/IAH	19219 Katy Fwy	65,698	Katy Freeway West
11450 Compaq Center West Dr	236,016	FM 1960/Hwy 249	1000 Louisiana St	114,066	CBD	16416 Northchase Dr	64,068	Greenspoint/N Belt West
909 Fannin St	234,333	CBD	1233 West Loop S	111,250	Post Oak Park	1300 Hercules Ave	64,000	NASA/Clear Lake
16200 Park Row	230,000	Katy Freeway West	1333 West Loop S	111,250	Post Oak Park	5847 San Felipe St	63,980	San Felipe/Voss
4005 Technology Dr	220,966	Southwest Far	10700 N I-45 Fwy	109,470	Greenspoint/N Belt West	900 Threadneedle St	63,037	Katy Freeway West
3737 Buffalo Speedway Ave	217,400	Greenway Plaza	554 Club Dr	108,000	Outlying Montgomery Cnty	11330 Clay Rd	63,000	FM 1960/Hwy 249
2425 West Loop South	211,702	Post Oak Park	2050 W Sam Houston Pky S	107,088	Westchase	808 Travis St	63,000	CBD
3 Greenway Plz	207,441	Greenway Plaza	811 Main St	106,005	CBD	4444 Westheimer Rd	63,000	Post Oak Park
10496 Old Katy Rd	207,000	Katy Freeway East	14100 Southwest Fwy	104,391	E Fort Bend Co/Sugar Land	14141 Southwest Fwy	62,457	E Fort Bend Co/Sugar Land
100 Glenborough Dr	204,198	Greenspoint/N Belt West	16676 Northchase Dr	101,111	Greenspoint/N Belt West	8223 Willow Place Dr S	62,001	FM 1960/Hwy 249
10713 W Sam Houston Pky N	200,000	FM 1960/Hwy 249	2115 Winnie St	100,000	Southeast Outlier	737 N Eldridge Pky	60,667	Katy Freeway West
11700 Katy Fwy	198,676	Katy Freeway West	411 N Sam Houston Pky E	99,524	Greenspoint/N Belt West	400 N Sam Houston Pky E	59,025	Greenspoint/N Belt West
16945 Northchase Dr	190,564	Greenspoint/N Belt West	10800 Richmond Ave	99,087	Westchase	16430 Park Ten Pl	58,805	Katy Freeway West
811 Louisiana St	188,695	CBD	6677 N Gessner Dr	96,000	Northwest Far	901 E Curtis	56,637	Gulf Freeway/Pasadena
9811 Katy Fwy	187,608	Katy Freeway East	2525 Richmond Ave	95,502	Greenway Plaza	14511 Falling Creek Dr	55,970	FM 1960/Champions
6464 Savoy Dr	182,566	Southwest/Hillcroft	5718 Westheimer Rd	94,680	San Felipe/Voss	600 N Sam Houston Pky	55,700	Greenspoint/N Belt West
2707 N Loop W	181,586	North Loop West	2445 Technology Forest Blvd	93,557	Woodlands	5757 Woodway Dr	55,069	San Felipe/Voss
10720 W Sam Houston Pky N	175,806	Northwest Far	1600 Smith St	93,345	CBD	16285 Park Ten Place Dr	54,858	Katy Freeway West
Highway 99 @ I-10	171,538	Southwest Outlier	700 Milam St	91,108	CBD	5700 NW Central Dr	54,602	Northwest Far
3773 Richmond Ave	168,180	Greenway Plaza	5060 Westway Park Blvd	91,098	Northwest Far	717 Texas Ave	54,575	CBD
1885 Saint James Pl	164,942	Galleria/Uptown	2001 Timberloch Pl	87,855	Woodlands	5884 Point West Dr	54,417	Southwest Beltway 8
1150 Gemini St	158,627	NASA/Clear Lake	3040 Post Oak Blvd	86,710	Galleria/Uptown	222 Cavalcade St	54,200	I-10 East
5251 Westheimer Rd	158,084	Galleria/Uptown	580 Westlake Park Blvd	85,065	Katy Freeway West	12141 Wickchester Ln	54,058	Katy Freeway West
19350 State Highway 249	156,000	FM 1960/Hwy 249	333 Clay St	84,508	CBD	4015 Interstate 45 N	53,722	Conroe
1575 Sawdust Rd	153,810	Woodlands	5851 Southwest Fwy	82,500	Richmond/Fountainview	2222 Bay Area Blvd	52,171	NASA/Clear Lake
5959 Corporate Dr	153,273	Southwest Beltway 8	711 Louisiana St	81,790	CBD	1700 West Loop S	52,016	Galleria/Uptown
1430 Enclave Pky	152,790	Katy Freeway West	12300 Parc Crest Dr	79,566	E Fort Bend Co/Sugar Land	3200 Southwest Fwy	50,568	Greenway Plaza
			2400 NASA Pky	79,451	NASA/Clear Lake	9700 Bissonnet St	50,450	Southwest Beltway 8
						128 Vision Park Blvd	50,000	Woodlands

## Select Sales

Property Address	Sale Price	Sale Date	Price Per SF
1111 Bagby St (Part of Multi-Property Sale)	\$409,183,946.00	2/20/14	\$374.85
3000 Post Oak Blvd	\$170,000,000.00	11/14/14	\$385.03
3040 Post Oak Blvd	\$126,000,000.00	8/19/14	\$294.75
580 Westlake Park Blvd	\$120,000,000.00	7/25/14	\$263.83
3050 Post Oak Blvd	\$100,000,000.00	5/19/14	\$295.29
3505 W Sam Houston Pky N	\$76,000,000.00	9/12/14	\$334.74
600 Jefferson St	\$69,000,000.00	10/31/14	\$153.65
10111 Richmond Ave	\$55,277,700.00	8/18/14	\$300.00
2200 West Loop South	\$47,000,000.00	10/6/14	\$233.00
10333 Richmond Ave	\$46,300,000.00	7/8/14	\$211.72
13131 Dairy Ashford Rd (Part of Multi-Property Sale)	\$41,416,864.00	4/15/14	\$202.24
13135 Dairy Ashford Rd (Part of Multi-Property Sale)	\$41,333,136.00	4/15/14	\$202.24
1433 West Loop S (Part of Portfolio)	\$36,166,108.00	12/16/14	\$262.07
5420 West Loop S (Part of Multi-Property Sale)	\$32,776,187.00	5/23/14	\$328.52
222 Benmar Dr	\$30,000,000.00	5/30/14	\$151.32
9801 Westheimer Rd	\$29,000,000.00	3/19/14	\$137.36
2000 Bering Dr	\$28,831,650.00	11/17/14	\$150.00
1800 Bering Dr	\$27,800,000.00	6/17/14	\$162.09
6001 Rogerdale Rd	\$27,425,000.00	5/15/14	\$181.62
10343 Sam Houston Park Dr	\$26,200,000.00	12/9/14	\$164.60
4801 Woodway Dr	\$23,600,000.00	10/15/14	\$106.99
5300 W Sam Houston Pky N	\$21,650,000.00	1/10/14	\$214.27
1325 S Dairy Ashford Rd	\$17,000,000.00	9/4/14	\$109.45
20455 State Highway 249 (Part of Multi-Property Sale)	\$15,675,860.00	2/26/14	\$203.53
7700 San Felipe St	\$15,500,000.00	2/13/14	\$153.90
10500 Richmond Ave	\$15,000,000.00	10/8/14	\$156.75
12012 Wickchester Ln	\$15,000,000.00	1/14/14	\$137.02
2900 Wesleyan St	\$14,075,000.00	2/25/14	\$102.96
16010 Barkers Point Ln	\$13,950,000.00	3/11/14	\$115.62
1485 FM 1960 Byp E	\$13,700,000.00	4/1/14	\$304.44
15990 N Barkers Landing Rd (Part of Portfolio)	\$12,463,225.00	12/9/14	\$134.20
11410 Greens Crossing Blvd (Part of Portfolio)	\$10,467,797.00	12/9/14	\$132.68
11310 Greens Crossing Blvd (Part of Portfolio)	\$10,467,797.00	12/9/14	\$132.68
15990 N Barkers Landing Rd (Part of Portfolio)	\$9,727,332.00	12/9/14	\$104.74
20465 State Highway 249 (Part of Multi-Property Sale)	\$9,008,023.00	2/26/14	\$125.22
20475 State Highway 249 (Part of Multi-Property Sale)	\$8,973,713.00	2/26/14	\$125.22
3000 Research Forest Dr	\$8,450,000.00	2/28/14	\$330.98
11410 Greens Crossing Blvd (Part of Portfolio)	\$8,215,080.00	12/9/14	\$104.13
11310 Greens Crossing Blvd (Part of Portfolio)	\$8,215,080.00	12/9/14	\$104.13
917 Franklin St	\$5,000,000.00	4/2/14	\$129.13
11250 Fallbrook Dr	\$4,450,000.00	7/31/14	\$326.13
24124 Cinco Village Ranch Blvd (Part of Multi-Property Sale)	\$2,921,565.00	3/28/14	\$265.60
23855 Cinco Ranch Blvd (Part of Multi-Property Sale)	\$2,921,565.00	3/28/14	\$265.60
900 Lovett Blvd	\$2,900,000.00	4/28/14	\$191.98
2158 Northpark Dr	\$2,100,000.00	7/19/14	\$350.00
3701 Center St	\$1,950,000.00	7/29/14	\$300.00
25410 I-45	\$1,350,000.00	8/12/14	\$246.58
5428 FM 1488	\$1,200,000.00	3/25/14	\$195.41
6110 FM 1488 Rd	\$1,200,000.00	6/23/14	\$113.49
3231 Audley St	\$950,000.00	3/5/14	\$135.71
1458 Campbell Rd	\$796,875.00	9/29/14	\$138.35
2222 Greenhouse Rd	\$660,000.00	9/9/14	\$113.79
602 Lawrence St	\$660,000.00	1/9/14	\$106.45
335 W 21st St	\$562,500.00	10/14/14	\$225.00
424 Park Grove Ln	\$439,820.00	7/16/14	\$175.93
2219 Sawdust Rd, 601/Ground	\$310,000.00	7/3/14	\$251.01
25329 Budde Rd, 704/1st Floor	\$295,000.00	10/31/14	\$240.82
25511 Budde Rd, 2703/1st Floor	\$287,306.00	11/11/14	\$181.38
16000 Park Ten Pl, 404/Ground	\$266,900.00	2/17/14	\$222.42
11615 Spring Cypress Rd, E/1st Floor	\$255,000.00	5/29/14	\$171.26
11615 Spring Cypress Rd, A/1st Floor	\$244,000.00	9/22/14	\$187.69
1716-1722 Washington Ave, 1716B/1st Floor	\$172,500.00	6/19/14	\$298.96
1716-1722 Washington Ave, 1722-B/1st Floor	\$155,000.00	9/26/14	\$281.31
11615 Spring Cypress Rd, D/1st Floor	\$127,000.00	5/21/14	\$169.11
1820 Snake River Rd, F/1st Floor	\$90,900.00	5/28/14	\$134.67
12816 Willow Centre Dr, C/1st Floor	\$85,500.00	3/31/14	\$126.67

## Select Top Office Leases

Tenant	Building	Square Feet
Energy XXI Services	One City Centre	171,216
Sasol North America	Woodbranch Plaza IV	168,050
GE Oil & Gas	Beltway @ Clay	150,000
Memorial Development	One Allen Center	111,566
Motiva Enterprises	One Allen Center	109,373
Technip	Energy Tower IV	103,987
EMAS	City Centre 5	100,000
Det Norske Veritas	Det Norske Veritas - Phase 1	89,750
JGC America	3151 Briarpark Dr	77,625
Pacific Drilling	11700 Katy Freeway	77,296
Gardere Wynne Sewell	1000 Louisiana	74,975
Devon Energy	460 Wildwood Forest Drive	63,259
IHI	One Eldridge Place	61,455
Capital One	5444 Westheimer	58,061
Blinds.com	10255 Richmond	55,470
NetIQ	515 Post Oak Blvd	55,380
Phillips 66	3010 Briarpark Dr	53,245
Clear Channel Communications	2000 West Loop	50,180
Coats Rose	9 Greenway	50,000
HOK	Phoenix Tower	49,018
National Oilwell Varco	2500 CityWest	47,136

## Select Largest Deliveries

Building Name	Building Address	Submarket	Percent Leased
Two BriarLake Plaza	2050 W Sam Houston Pky S	Westchase	67.9%
Energy Crossing II	15011 Katy Fwy	Katy Freeway West	90.6%
Westchase Park II	3600 W Sam Houston Pky S	Westchase	0.0%
Beltway Lakes Phase III	5775 N Sam Houston Pky E	Northwest Far	0.0%
The Offices at Greenhouse	19219 Katy Fwy	Katy Freeway West	67.7%
Two Hughes Landing	1790 Hughes Landing Blvd	Woodlands	84.8%
Woodbranch 3	12140 Wickchester Ln	Katy Freeway West	54.9%
Sierra Pines II	1575 Sawdust Rd	Woodlands	0.0%
Katy Ranch Offices Phase 1	24275 Katy Fwy	Southwest Outlier	0.0%
Phase II	16200 Park Row	Katy Freeway West	0.0%

## Select Under Construction

Building Name	Building Address	Square Feet	Submarket
609 Main at Texas	609 Main St	1,057,668	CBD
Energy Center Five	915 N Eldridge Pky	526,637	Katy Freeway West
Air Liquide Center- South	9811 Katy Fwy	452,370	Katy Freeway East
Energy Tower IV	11750 Katy Fwy	429,157	Katy Freeway West
3737 Buffalo Speedway Ave	3737 Buffalo Speedway Ave	400,000	Greenway Plaza
West Memorial Place Phase II	15377 Memorial Dr	389,709	Katy Freeway West
West Memorial Place	15375 Memorial Dr	334,147	Katy Freeway West
Westway Plaza	11330 Clay Rd	312,000	FM 1960/Hwy 249
Enclave Place	1414 Enclave	300,907	Katy Freeway West
Town Centre I	700 Town & Country Blvd	254,489	Katy Freeway East
Three Hughes Landing	1780 Hughes Landing Blvd	250,000	Woodlands
Kirby Grove	2525 Richmond Ave	248,275	Greenway Plaza
Havenwood Office Park	25700 Interstate 45	240,470	Woodlands
CityCentre Five	825 Town & Country	227,063	Katy Freeway East



## Class A Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Asking Rent
	# Blds	Total RBA SF			
<b>Bellaire</b>	7	1,190,517	80,596	0	\$25.05
<b>Downtown</b>	39	33,047,224	2,399,162	1,631,830	\$41.96
<b>E Fort Bend Co/Sugar Land</b>	21	3,893,653	502,372	0	\$26.83
<b>FM 1960</b>	21	3,854,007	433,653	1,124,000	\$27.77
<b>Greenway Plaza</b>	16	6,224,406	427,624	833,275	\$36.66
<b>Gulf Freeway/Pasadena</b>	1	22,706	526	0	\$27.59
<b>I-10 East</b>	0	0	0	0	\$0.00
<b>Katy Freeway</b>	83	19,341,460	967,541	6,177,505	\$35.04
<b>Kingwood/Humble</b>	2	131,665	33,575	40,000	\$31.98
<b>NASA/Clear Lake</b>	15	2,023,551	84,900	0	\$25.06
<b>North Belt</b>	24	5,438,248	1,106,364	0	\$28.43
<b>Northeast Near</b>	0	0	0	0	\$0.00
<b>Northwest</b>	23	4,042,573	458,958	1,357,222	\$25.43
<b>Richmond/Fountainview</b>	0	0	0	0	\$0.00
<b>San Felipe/Voss</b>	3	1,720,793	286,055	0	\$35.58
<b>South</b>	2	250,000	5,941	100,000	\$26.98
<b>South Hwy 35</b>	0	0	0	0	\$0.00
<b>South Main/Medical Center</b>	15	4,508,415	273,043	0	\$29.14
<b>Southwest</b>	9	2,058,852	293,284	0	\$17.03
<b>West Loop</b>	43	16,382,709	1,427,539	864,826	\$35.37
<b>Westchase</b>	30	8,160,813	994,113	1,545,000	\$37.18
<b>Woodlands</b>	30	6,782,083	445,652	1,651,891	\$33.90

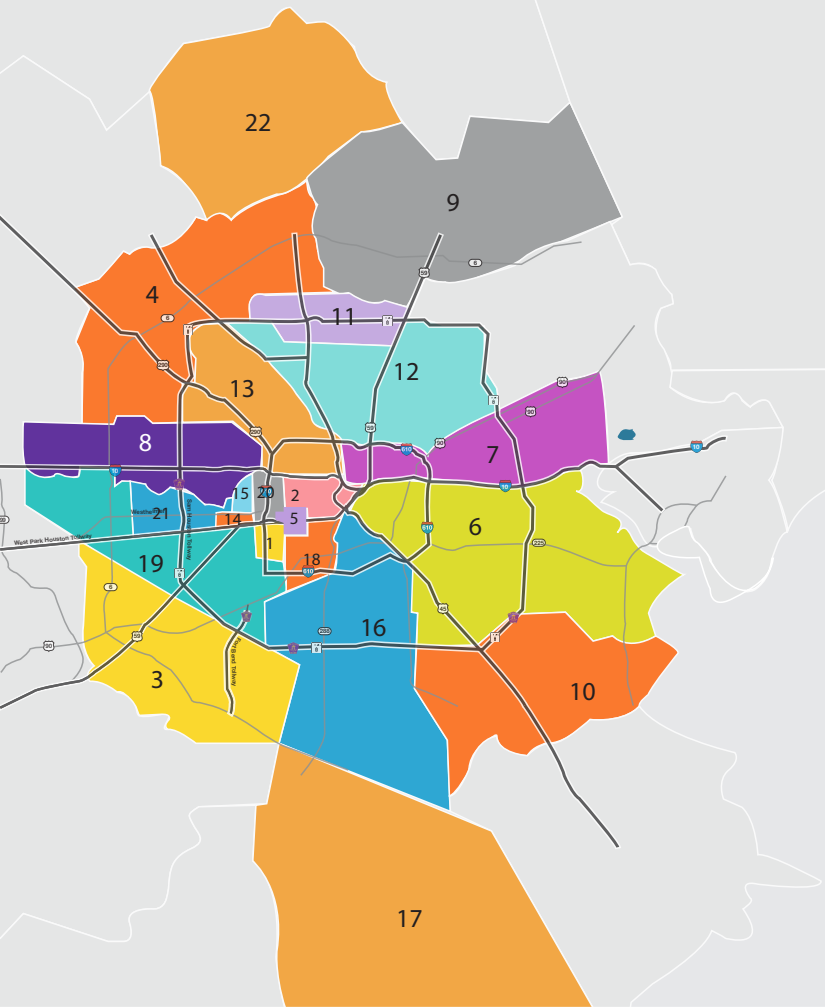
## Class B Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Asking Rent
	# Blds	Total RBA SF			
<b>Bellaire</b>	32	3,019,949	138,780	0	\$25.62
<b>Downtown</b>	170	19,562,345	1,566,204	0	\$26.95
<b>E Fort Bend Co/Sugar Land</b>	230	4,482,179	509,170	149,624	\$23.36
<b>FM 1960</b>	358	8,480,482	1,333,688	34,194	\$17.24
<b>Greenway Plaza</b>	51	4,271,684	289,181	0	\$24.81
<b>Gulf Freeway/Pasadena</b>	151	3,363,363	443,573	158,000	\$21.92
<b>I-10 East</b>	25	731,906	89,016	0	\$20.82
<b>Katy Freeway</b>	322	13,380,877	1,334,665	150,804	\$23.29
<b>Kingwood/Humble</b>	69	1,586,613	104,278	30,000	\$21.47
<b>NASA/Clear Lake</b>	209	5,755,350	1,144,489	0	\$19.87
<b>North Belt</b>	78	6,956,876	1,044,691	0	\$15.42
<b>Northeast Near</b>	27	662,292	93,603	0	\$20.30
<b>Northwest</b>	163	8,598,813	1,073,947	0	\$19.42
<b>Richmond/Fountainview</b>	27	972,320	196,809	0	\$17.56
<b>San Felipe/Voss</b>	38	3,574,555	288,546	0	\$23.29
<b>South</b>	79	1,582,843	196,986	7,700	\$27.49
<b>South Hwy 35</b>	34	358,380	17,622	0	\$16.70
<b>South Main/Medical Center</b>	64	4,359,403	554,038	0	\$26.04
<b>Southwest</b>	143	7,672,891	1,864,774	0	\$15.60
<b>West Loop</b>	60	6,552,013	702,135	0	\$26.71
<b>Westchase</b>	73	7,888,602	887,740	0	\$20.55
<b>Woodlands</b>	307	7,585,893	571,015	2,046,950	\$26.16

## Total Class A &amp; B Office Market Statistics

Submarket	Existing Inventory		Vacancy Direct SF	Under Const SF	Asking Rent
	# Blds	Total RBA SF			
<b>Bellaire</b>	39	4,210,466	219,376	0	\$24.11
<b>Downtown</b>	209	52,609,569	3,965,366	1,631,830	\$36.57
<b>E Fort Bend Co/Sugar Land</b>	251	8,375,832	1,011,542	149,624	\$24.10
<b>FM 1960</b>	379	12,334,489	1,767,341	1,158,194	\$19.42
<b>Greenway Plaza</b>	67	10,496,090	716,805	833,275	\$30.61
<b>Gulf Freeway/Pasadena</b>	152	3,386,069	444,099	158,000	\$18.71
<b>I-10 East</b>	25	731,906	89,016	0	\$16.04
<b>Katy Freeway</b>	405	32,722,337	2,302,206	6,328,309	\$28.49
<b>Kingwood/Humble</b>	71	1,718,278	137,853	70,000	\$22.09
<b>NASA/Clear Lake</b>	224	7,778,901	1,229,389	0	\$19.32
<b>North Belt</b>	102	12,395,124	2,151,055	0	\$23.66
<b>Northeast Near</b>	27	662,292	93,603	0	\$17.95
<b>Northwest</b>	186	12,641,386	1,532,905	1,357,222	\$22.70
<b>Richmond/Fountainview</b>	27	972,320	196,809	0	\$15.71
<b>San Felipe/Voss</b>	41	5,295,348	574,601	0	\$27.08
<b>South</b>	81	1,832,843	202,927	107,700	\$24.10
<b>South Hwy 35</b>	34	358,380	17,622	0	\$15.56
<b>South Main/Medical Center</b>	79	8,867,818	827,081	0	\$24.85
<b>Southwest</b>	152	9,731,743	2,158,058	0	\$16.30
<b>West Loop</b>	103	22,934,722	2,129,674	864,826	\$32.43
<b>Westchase</b>	103	16,049,415	1,881,853	1,545,000	\$30.88
<b>Woodlands</b>	337	14,367,976	1,016,667	3,698,841	\$29.89

## The Houston Office Sub-market Map



1. Bellaire
2. Downtown - CBD + Midtown
3. E Fort Bend Co/Sugar Land
4. Fm 1960 + FM 1960/Champions + Fm1960/Hwy 249 + FM 1960/I-45 North
5. Greenway Plaza
6. Gulf Freeway/Pasadena
7. I-10 East
8. Katy Freeway = Katy Freeway East + Katy Freeway West
9. Kingwood/Humble
10. Nasa/Clear Lake
11. North Belt = North Belt East + North Belt West/Greenspoint
12. Northeast Near
13. Northwest = North Loop West + Northwest + Far\_ Northwest Near
14. Richmond
15. San Felipe/Voss
16. South
17. South Hwy 35
18. South Main/Medical Center
19. Southwest = Southwest Beltway 8 + Southwest/Hillcroft
20. Westloop = Galleria/Uptown + Riverway + Post Oak Park
21. Westchase = Westchase East + Westchase West
22. Woodlands

## Methodology | Definitions

### Absorption (Net)

The change in occupied space in a given time period.

### Available Square Footage

Net rentable area considered available for lease; excludes sublease space.

### Average Asking Rental Rate

Rental rate as quoted from each building's owner/management company. For office space, a full service rate was requested; for retail, a triple net rate requested; for industrial, a NN basis.

### Building Class

Class A Product is office space of steel and concrete construction, built after 1980, quality tenants, excellent amenities & premium rates. Class B product is office space built after 1980, fair to good finishes & wide range of tenants.

### Direct Vacancy

Space currently available for lease directly with the landlord or building owner.

### Market Size

Includes all existing and under construction office buildings (office, office condo, office loft, office medical, all classes and all sizes, both multi-tenant and single-tenant, including owner-occupied buildings) within each market.

### Overall Vacancy

All physically unoccupied lease space, either direct or sublease.

### SF/PSF

Square foot/per square foot, used as a unit of measurement.

### Sublease

Arrangement in which a tenant leases rental property to another, and the tenant becomes the landlord to the subtenant.

### Sublease Space

Total square footage being marketed for lease by the tenant.

### Sublease Vacancy

Space currently available in the market for sublease with an existing tenant within a building acting as the landlord.

### RBA (Rentable Building Area)

Expressed in square feet, this area includes the usable area and its associated share of the common areas.



## Marketing & Research Team

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*Information herein was obtained from sources deemed to be reliable. However, no warranty or representation is made as to guarantee its accuracy.*

*Sources include: U.S. Bureau of Economic Analysis, CoStar, Federal Reserve Bank of Dallas, Greater Houston Partnership, FiveThirtyEight.com, Houston Association of Realtors, National Association Realtors, Texas A&M Real Estate Center, U.S. Bureau of Labor Statistics.*

## Economic and Market Outlook:

HOUSTON OFFICE | Q4 2014

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