

HOUSTON
**OFFICE MARKET
REPORT**

Second Quarter 2019



BELVOIR

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A Message from Matthew Goldsby, Belvoir Managing Director

CoStar reported a 17% net absorption rate in the City for Q2 2019, which may seem surprising given the movement of companies from one submarket to another, such as:

- TransOcean leaving 200,000 SF in Greenway Plaza for Enclave Place in the Energy Corridor;
- Direct Energy leaving Greenway for the CBD; and
- Oxy's announced purchase of Conoco's campus facility in the Energy Corridor, relocating nearly 1M SF from Greenway.

Greenway's losses were somewhat tempered by Oxy stockholder Carl Icahn's lawsuit involving Oxy's purchase of Anadarko. As a result, Oxy has delayed its relocation, staying in Greenway. Of course, Anadarko owns its building in The Woodlands whereas Oxy occupies leased space in Greenway. Once a tenant owns its own building, their building is not included in "available inventory." Therefore, Oxy's leaving Greenway creates negative absorption in that submarket but does not count as positive absorption for the Energy/Katy West submarket.

Factors driving growth include local company expansions as well as several law firms new to the City opening offices due to the mergers of midstream companies. In my opinion, one of the major boosts to new business is the rise of co-working companies. There are now 6 co-working companies in Houston, WeWorks being the major player with LifeTime close on its heels.

Where is the next round of major users to backfill the vacated space? Will it require oil at \$80 a barrel or emerge from another sector?

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OFFICE MARKET SNAPSHOT

LEASING

Net absorption totaled about 500,000 SF last quarter, representing the third consecutive quarter of positive demand after two years of losses. CoStar's forecast calls for demand to pick up, and average about 1 million SF per quarter, fairly in line with Houston's average. Houston also recorded some significant leases last quarter, including welcome signings by two energy tenants: Honeywell for 115,000 SF in CityWestPlace Building 1 in Westchase and Direct Energy for 105,000 SF at 2 Houston Center in the CBD. Total leasing volume last quarter reached 3.5 million SF, and this total is expected to rise above 4.5 million SF once all leases have been reported.

RENT

Houston's rents have stabilized over the past year after suffering losses in 2016 and 2017—the same years when most markets were posting their strongest rent growth. Houston office rents are set to continue their recovery into the forecast, with rent growth accelerating over the next three years in the CoStar Base Case. However, rents are forecast to grow by less than 1% annually, half the projected rate of inflation. Rent growth has varied across Houston's submarkets.

CONSTRUCTION

Houston's office supply pipeline is the lowest it has been since the global financial crisis. The pause in the market's normally frenetic pace of development has limited the damage from weak demand. However, it also underscores the crisis of confidence investors and developers have about Houston. Last quarter, a number of small properties delivered, totaling just 260,000 SF. But some mega developments are on the way. Skanska's 780,000-SF Capitol Tower, scheduled to open in 19Q2, is more than 80% leased, with Bank of America and Waste Management as anchor tenants.

SALES

Houston's office transaction volume totaled \$465 million 19Q1, and it is expected to rise to \$945 million once all deals are reported. Houston cap rates tend to be a bit higher than the national average, typical of a large, affordable Sunbelt market with little zoning and abundant land. And a large amount of value-add portfolio deals traded in 2017. Generally, Houston trades right in line with the national average, though cap rates have drifted higher since the energy slump.

In January, Granite Properties acquired from TIER REIT the three properties in Eldridge Place in the Energy Corridor totaling nearly 825,000 SF for \$78.4 million, or about \$95/SF. These were collectively approximately 70% occupied at the time of sale. In April 2019, Houston-based Patrinely Group sold the nearly 340,000-SF HP Buildings 1 and 2 in Springwoods Village to Washington, D.C.-based Northridge Capital for an undisclosed price. CoStar estimates that they paid around \$109 million at a 7% cap rate. The buildings, which delivered in 18Q4, are leased to HP Inc. for 12 years.

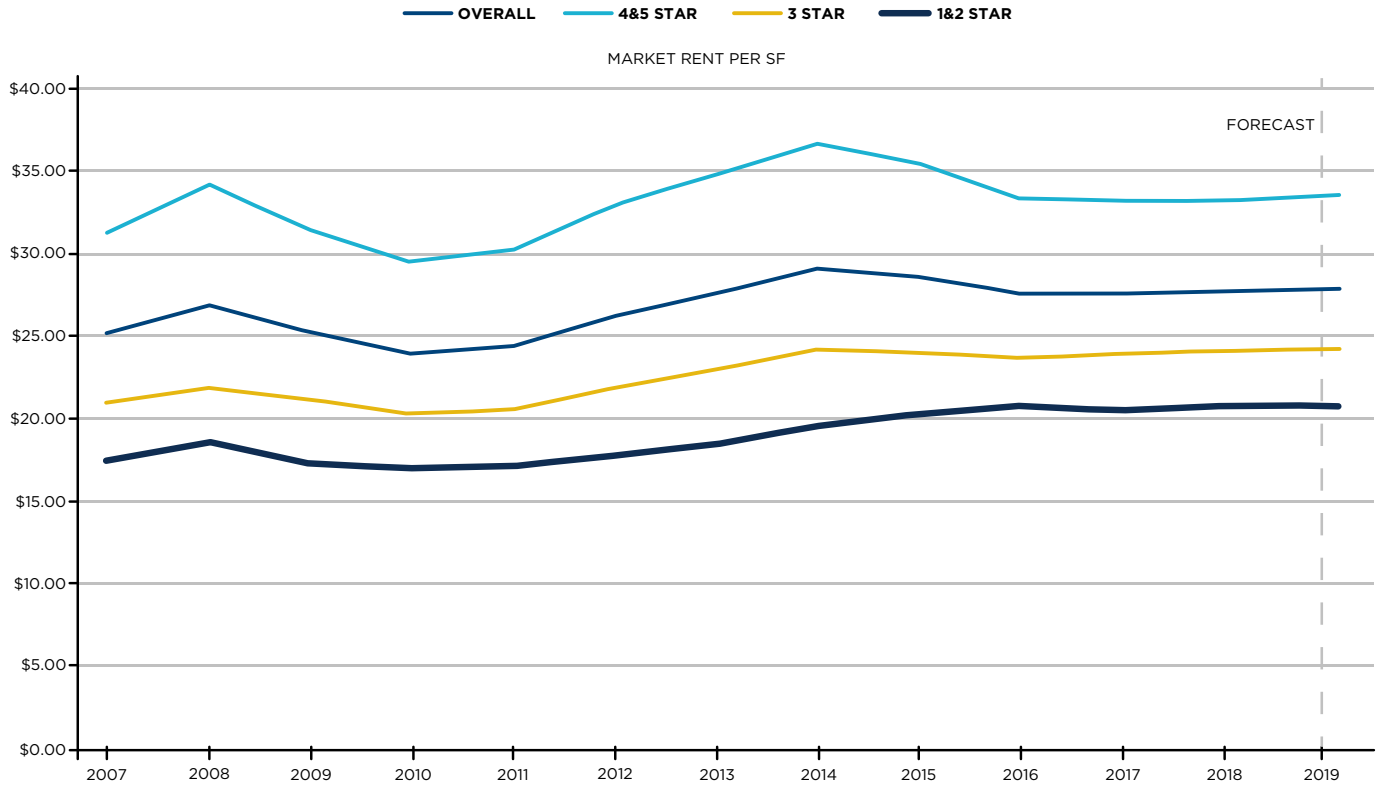
Source: CoStar Property®



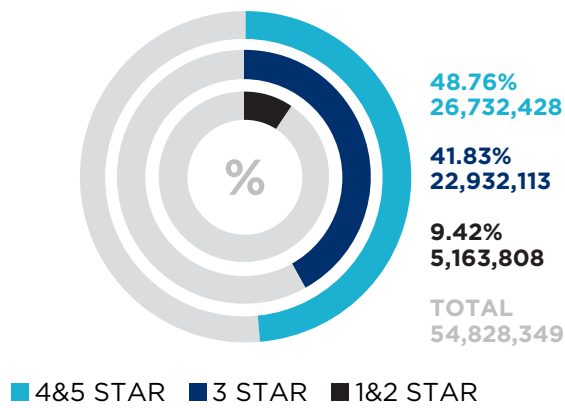
Market	Existing Inventory		Vacancy		YTD Net Absorption	YTD Deliveries	Under Const SF	Rent Per SF
	Bldgs	SF (000)	SF	Percent				
Bellaire	92	5,243	839,421	16.0%	12,308	0	5	\$25.23
CBD	161	51,441	9,904,672	19.3%	589,467	1	1,124	\$35.67
E Fort Bend Co/Sugar Land	414	10,023	1,105,121	11.0%	90,001	11	198	\$26.94
FM 1960/Champions	260	4,425	652,848	14.8%	(48,471)	1	-	\$18.75
FM 1960/Hwy 249	431	8,927	1,155,953	12.9%	(251,876)	8	358	\$24.82
Galleria/Uptown	66	16,848	2,575,859	15.3%	283,040	0	-	\$31.94
Greenspoint/N Belt W.	119	11,037	5,014,014	45.4%	37,894	0	-	\$18.40
Greenway Plaza	276	13,132	1,815,174	13.8%	159,790	0	-	\$29.76
Gulf Freeway/Pasadena	645	8,109	782,217	9.6%	141,266	1	-	\$21.27
Katy Freeway East	260	11,590	1,197,273	10.3%	93,712	1	102	\$30.77
Katy Freeway West	262	28,598	7,033,013	24.6%	340,141	2	4	\$30.58
Katy/Grand Parkway W.	442	6,261	623,675	10.0%	167,081	17	21	\$28.42
Midtown	572	9,766	982,963	10.1%	(143,686)	2	202	\$29.39
NASA/Clear Lake	532	10,390	1,498,471	14.4%	61,956	5	74	\$23.81
North Loop West	353	6,618	1,129,317	17.1%	(34,928)	3	105	\$23.28
Post Oak Park	43	4,681	1,157,593	24.7%	33,443	0	207	\$31.54
San Felipe/Voss	50	5,338	1,120,883	21.0%	(66,286)	0	-	\$26.56
South Main/Medical Center	240	13,619	720,584	5.3%	(92,430)	0	-	\$27.91
Southwest Beltway 8	191	7,470	1,389,403	18.6%	(279,711)	0	-	\$18.42
Southwest/Hillcroft	108	5,340	937,000	17.5%	67,886	0	-	\$17.32
The Woodlands	645	22,945	1,943,491	8.5%	1,146,179	15	245	\$31.61
West Belt	111	6,301	1,188,515	18.9%	343,106	2	-	\$28.14
Westchase	138	19,004	4,145,636	21.8%	(78,730)	1	-	\$26.58

Source: CoStar Property®

HISTORICAL AND FORECAST RENTAL RATES BY CLASS

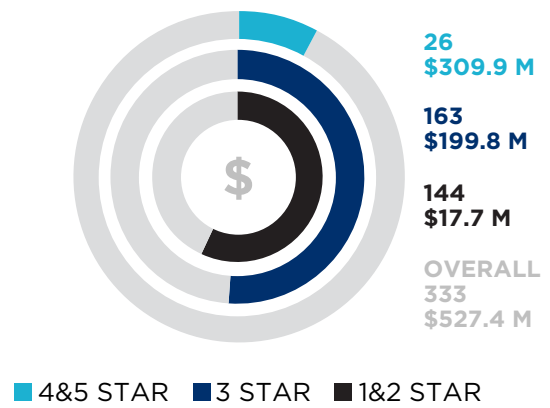


VACANCY BY CLASS



Source: CoStar Property®

SALES BY CLASS



Source: CoStar Property®

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