

Q4 2017

Office Insight

## Growing appetite for sublease space not enough to balance supply-heavy market conditions

- At 2.8 million square feet, sublease leasing activity accounted for nearly one-fourth of all leasing activity in 2017, the highest share on record.
- New deliveries and limited growth among tenants pushed total vacancy to 23.2 percent during the fourth quarter, which marks the twelfth consecutive quarter of rising vacancy.
- Minimal movement of asking rents masks growing concession packages offered by some landlords, particularly in the CBD and Galleria.

If 2016 was the year sublease space languished on the market, then 2017 was the year leasing activity finally began to make a dent in the mountain of available sublease space. Sublease leasing activity totaled 2.8 million square feet in 2017, a 46.5 percent increase over 2016's total, and accounted for nearly one-fourth of all leasing activity in 2017, compared to 14.8 percent of total leasing activity in 2016. NRG's 431,000-square-foot deal at One Shell Plaza, Motiva's 193,000-square-foot deal at Allen Center, and Stewart Title's 156,000-square-foot deal at Four Oaks Place led the charge for a banner year of sublease activity. The uptick in sublease activity, coupled with natural expirations, helped reduce the market's sublease inventory by more than 2.3 million square feet in 2017, which currently stands at 9.3 million square feet.

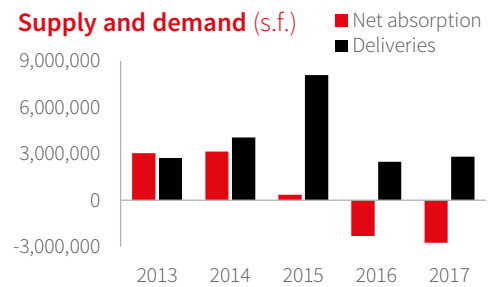
However, the boom in sublease leasing activity was not enough to counteract a market weighed down by supply-heavy conditions. Vacancy rose by 40 basis points to 23.2 percent during the fourth quarter following 460,000 square feet of new deliveries and yet another quarter of below average leasing activity. The excess in supply continues to place pressure on landlords to increase concession packages, namely in the form of free rent and tenant improvement allowances, while asking rents have remained flat.

### Outlook

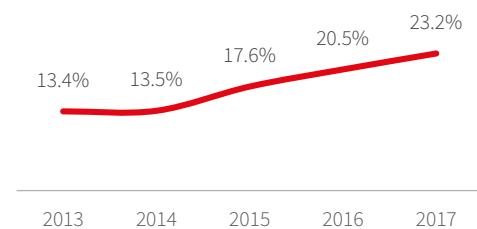
Since the fourth quarter of 2014, which roughly coincides with the downturn in oil prices, market conditions in Houston have experienced significant changes, particularly on the supply side of things: vacancy is up 970 basis points, net absorption has been negative in 9 of the last 12 quarters, and over 13.0 million square feet of new construction has delivered. Returning to a more balanced market will take time, and while 2017 showed glimpses of improving conditions, we look to 2018 to address the market's supply overhang.

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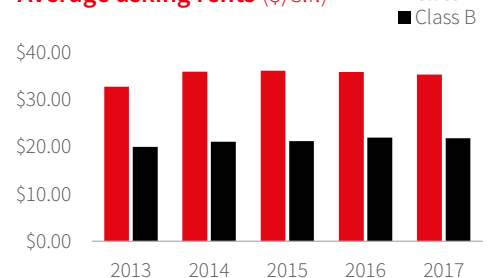
| Fundamentals                | Forecast          |
|-----------------------------|-------------------|
| YTD net absorption          | -2,758,460 s.f. ▶ |
| Under construction          | 1,978,465 s.f. ▼  |
| Total vacancy               | 23.2% ▶           |
| Average asking rent (gross) | \$30.55 p.s.f. ▼  |
| Concessions                 | Rising ▶          |



### Total vacancy



### Average asking rents (\$/s.f.)



Office Statistics

|                          | Class         | Inventory (s.f.)   | Quarterly total net absorption (s.f.) | YTD total net absorption (s.f.) | YTD total net absorption (% of stock) | Direct vacancy (%) | Total vacancy (%) | Average direct asking rent (\$ p.s.f.) | YTD completions (s.f.) | Under construction (s.f.) |
|--------------------------|---------------|--------------------|---------------------------------------|---------------------------------|---------------------------------------|--------------------|-------------------|--|------------------------|---------------------------|
| <b>Houston Totals</b>    |               |                    |                                       |                                 |                                       |                    |                   |  |                        |                           |
|                          | A             | 108,581,173        | -89,669                               | -1,500,682                      | -1.4%                                 | 20.2%              | 24.7%             | \$35.30                                | 2,736,644              | 1,978,465                 |
|                          | B             | 59,020,241         | -441,449                              | -1,257,778                      | -2.1%                                 | 19.7%              | 20.4%             | \$21.81                                | 82,800                 | 0                         |
| <b>Totals</b>            |               | <b>167,601,414</b> | <b>-531,118</b>                       | <b>-2,758,460</b>               | <b>-1.6%</b>                          | <b>20.0%</b>       | <b>23.2%</b>      | <b>\$30.55</b>                         | <b>2,819,444</b>       | <b>1,978,465</b>          |
| CBD                      | Totals        | 35,561,535         | -179,460                              | -1,170,841                      | -3.3%                                 | 17.4%              | 20.9%             | \$41.60                                | 1,056,658              | 778,344                   |
| <b>CBD</b>               | <b>Totals</b> | <b>35,561,535</b>  | <b>-179,460</b>                       | <b>-1,170,841</b>               | <b>-3.3%</b>                          | <b>17.4%</b>       | <b>20.9%</b>      | <b>\$41.60</b>                         | <b>1,056,658</b>       | <b>778,344</b>            |
| Midtown                  | Totals        | 4,120,911          | 120,104                               | 35,983                          | 0.9%                                  | 14.3%              | 15.5%             | \$31.35                                | 0                      | 0                         |
| Greenway Plaza           | Totals        | 9,928,139          | -60,456                               | -134,944                        | -1.4%                                 | 16.5%              | 16.9%             | \$34.05                                | 188,547                | 0                         |
| Greenspoint/North Belt   | Totals        | 8,920,132          | -20,952                               | -321,625                        | -3.6%                                 | 51.0%              | 54.2%             | \$20.79                                | 0                      | 0                         |
| Northwest                | Totals        | 8,551,128          | -175,257                              | -87,677                         | -1.0%                                 | 23.4%              | 26.3%             | \$23.89                                | 0                      | 0                         |
| San Felipe/Voss          | Totals        | 5,150,824          | -34,810                               | -98,954                         | -1.9%                                 | 18.0%              | 18.3%             | \$29.50                                | 0                      | 0                         |
| Southwest                | Totals        | 6,026,337          | -198,338                              | -246,954                        | -4.1%                                 | 23.9%              | 24.2%             | \$17.92                                | 0                      | 0                         |
| Galleria                 | Totals        | 22,701,426         | -136,881                              | -607,226                        | -2.7%                                 | 18.1%              | 21.2%             | \$35.61                                | 980,000                | 104,579                   |
| Bellaire                 | Totals        | 2,278,583          | -3,311                                | 21,470                          | 0.9%                                  | 10.7%              | 11.7%             | \$24.65                                | 0                      | 0                         |
| Medical Center           | Totals        | 3,928,258          | 7,697                                 | -29,471                         | -0.8%                                 | 9.0%               | 9.2%              | \$29.70                                | 0                      | 0                         |
| <b>Suburban Near</b>     | <b>Totals</b> | <b>71,605,738</b>  | <b>-502,204</b>                       | <b>-1,469,398</b>               | <b>-2.1%</b>                          | <b>22.1%</b>       | <b>24.1%</b>      | <b>\$27.28</b>                         | <b>1,168,547</b>       | <b>104,579</b>            |
| Katy Freeway East        | Totals        | 5,547,268          | -1,068                                | 27,342                          | 0.5%                                  | 14.5%              | 15.7%             | \$34.21                                | 238,173                | 0                         |
| Katy Freeway West        | Totals        | 19,700,169         | -64,928                               | -443,164                        | -2.2%                                 | 23.4%              | 32.3%             | \$30.93                                | 86,255                 | 243,583                   |
| Westchase                | Totals        | 13,012,970         | 155,976                               | 48,876                          | 0.4%                                  | 19.4%              | 24.2%             | \$29.39                                | 187,011                | 0                         |
| <b>Energy Corridor</b>   | <b>Totals</b> | <b>38,260,407</b>  | <b>89,980</b>                         | <b>-366,946</b>                 | <b>-1.0%</b>                          | <b>20.7%</b>       | <b>27.1%</b>      | <b>\$30.76</b>                         | <b>511,439</b>         | <b>243,583</b>            |
| FM 1960                  | Totals        | 5,876,912          | -24,110                               | 9,008                           | 0.2%                                  | 18.3%              | 18.9%             | \$18.16                                | 0                      | 0                         |
| Sugar Land               | Totals        | 4,232,491          | 54,984                                | 101,505                         | 2.4%                                  | 8.5%               | 10.2%             | \$26.75                                | 0                      | 147,159                   |
| Gulf Freeway/Pasadena    | Totals        | 1,516,973          | -5,307                                | -23,235                         | -1.5%                                 | 17.9%              | 17.9%             | \$21.73                                | 82,800                 | 0                         |
| NASA/Clear Lake          | Totals        | 3,260,980          | -44,996                               | -108,342                        | -3.3%                                 | 17.4%              | 18.0%             | \$20.07                                | 0                      | 0                         |
| The Woodlands            | Totals        | 7,286,378          | 79,995                                | 269,789                         | 3.7%                                  | 18.4%              | 19.2%             | \$30.79                                | 0                      | 704,800                   |
| <b>Suburban Outlying</b> | <b>Totals</b> | <b>22,173,734</b>  | <b>60,566</b>                         | <b>248,725</b>                  | <b>1.1%</b>                           | <b>16.3%</b>       | <b>17.1%</b>      | <b>\$23.99</b>                         | <b>82,800</b>          | <b>851,959</b>            |
| <b>Houston</b>           | <b>Totals</b> | <b>167,601,414</b> | <b>-531,118</b>                       | <b>-2,758,460</b>               | <b>-1.6%</b>                          | <b>20.0%</b>       | <b>23.2%</b>      | <b>\$30.55</b>                         | <b>2,819,444</b>       | <b>1,978,465</b>          |
| CBD                      | A             | 28,012,863         | -165,839                              | -935,657                        | -3.3%                                 | 17.1%              | 21.3%             | \$44.49                                | 1,056,658              | 778,344                   |
| <b>CBD</b>               | <b>A</b>      | <b>28,012,863</b>  | <b>-165,839</b>                       | <b>-935,657</b>                 | <b>-3.3%</b>                          | <b>17.1%</b>       | <b>21.3%</b>      | <b>\$44.49</b>                         | <b>1,056,658</b>       | <b>778,344</b>            |
| Midtown                  | A             | 1,853,042          | 117,497                               | 43,939                          | 2.4%                                  | 21.3%              | 22.5%             | \$32.42                                | 0                      | 0                         |
| Greenway Plaza           | A             | 7,356,944          | -68,468                               | -55,318                         | -0.8%                                 | 17.6%              | 18.1%             | \$36.09                                | 188,547                | 0                         |
| Greenspoint/North Belt   | A             | 4,646,354          | -904                                  | -179,801                        | -3.9%                                 | 57.9%              | 63.4%             | \$24.45                                | 0                      | 0                         |
| Northwest                | A             | 3,884,006          | -49,083                               | -25,588                         | -0.7%                                 | 28.6%              | 32.8%             | \$25.99                                | 0                      | 0                         |
| San Felipe/Voss          | A             | 1,720,793          | 10,729                                | 15,396                          | 0.9%                                  | 22.1%              | 22.1%             | \$35.86                                | 0                      | 0                         |
| Southwest                | A             | 1,578,768          | -79,320                               | -138,211                        | -8.8%                                 | 22.2%              | 22.8%             | \$18.41                                | 0                      | 0                         |
| Galleria                 | A             | 17,751,947         | -86,112                               | -496,624                        | -2.8%                                 | 18.9%              | 22.8%             | \$37.62                                | 980,000                | 104,579                   |
| Bellaire                 | A             | 1,091,536          | -18,293                               | 560                             | 0.1%                                  | 11.7%              | 13.5%             | \$24.31                                | 0                      | 0                         |
| Medical Center           | A             | 1,729,776          | 10,655                                | -55,907                         | -3.2%                                 | 13.3%              | 13.9%             | \$33.23                                | 0                      | 0                         |
| <b>Suburban Near</b>     | <b>A</b>      | <b>41,613,166</b>  | <b>-163,299</b>                       | <b>-891,554</b>                 | <b>-2.1%</b>                          | <b>23.9%</b>       | <b>26.8%</b>      | <b>\$31.08</b>                         | <b>1,168,547</b>       | <b>104,579</b>            |
| Katy Freeway East        | A             | 4,111,243          | -15,811                               | 30,572                          | 0.7%                                  | 15.6%              | 16.8%             | \$37.88                                | 238,173                | 0                         |
| Katy Freeway West        | A             | 14,298,117         | -76,400                               | -216,841                        | -1.5%                                 | 22.6%              | 34.8%             | \$35.57                                | 86,255                 | 243,583                   |
| Westchase                | A             | 8,792,934          | 183,428                               | 114,243                         | 1.3%                                  | 19.9%              | 26.7%             | \$34.45                                | 187,011                | 0                         |
| <b>Energy Corridor</b>   | <b>A</b>      | <b>27,202,294</b>  | <b>91,217</b>                         | <b>-72,026</b>                  | <b>-0.3%</b>                          | <b>20.7%</b>       | <b>29.4%</b>      | <b>\$35.50</b>                         | <b>511,439</b>         | <b>243,583</b>            |
| FM 1960                  | A             | 2,284,644          | 4,486                                 | 80,506                          | 3.5%                                  | 11.1%              | 12.4%             | \$28.21                                | 0                      | 0                         |
| Sugar Land               | A             | 2,924,199          | 56,893                                | 58,702                          | 2.0%                                  | 7.7%               | 8.8%              | \$31.24                                | 0                      | 147,159                   |
| Gulf Freeway/Pasadena    | A             | 0                  | 0                                     | 0                               | 0.0%                                  | 0.0%               | 0.0%              | \$0.00                                 | 0                      | 0                         |
| NASA/Clear Lake          | A             | 1,336,691          | 254                                   | -26,129                         | -2.0%                                 | 5.6%               | 6.9%              | \$24.15                                | 0                      | 0                         |
| The Woodlands            | A             | 5,207,316          | 86,619                                | 285,476                         | 5.5%                                  | 19.5%              | 20.1%             | \$33.23                                | 0                      | 704,800                   |
| <b>Suburban Outlying</b> | <b>A</b>      | <b>11,752,850</b>  | <b>148,252</b>                        | <b>398,555</b>                  | <b>3.4%</b>                           | <b>13.3%</b>       | <b>14.3%</b>      | <b>\$31.37</b>                         | <b>0</b>               | <b>851,959</b>            |
| <b>Houston</b>           | <b>A</b>      | <b>108,581,173</b> | <b>-89,669</b>                        | <b>-1,500,682</b>               | <b>-1.4%</b>                          | <b>20.2%</b>       | <b>24.7%</b>      | <b>\$35.30</b>                         | <b>2,736,644</b>       | <b>1,978,465</b>          |

|                          | Class    | Inventory (s.f.)  | Total net absorption (s.f.) | YTD total net absorption (s.f.) | YTD total net absorption (% of stock) | Direct vacancy (%) | Total vacancy (%) | Average direct asking rent (\$ p.s.f.) | YTD completions (s.f.) | Under construction (s.f.) |
|--------------------------|----------|-------------------|-----------------------------|---------------------------------|---------------------------------------|--------------------|-------------------|--|------------------------|---------------------------|
| CBD                      | B        | 7,548,672         | -13,621                     | -235,184                        | -3.1%                                 | 18.4%              | 19.4%             | \$29.53                                | 0                      | 0                         |
| <b>CBD</b>               | <b>B</b> | <b>7,548,672</b>  | <b>-13,621</b>              | <b>-235,184</b>                 | <b>-3.1%</b>                          | <b>18.4%</b>       | <b>19.4%</b>      | <b>\$29.53</b>                         | <b>0</b>               | <b>0</b>                  |
| Midtown                  | B        | 2,267,869         | 2,607                       | -7,956                          | -0.4%                                 | 8.6%               | 9.9%              | \$29.24                                | 0                      | 0                         |
| Greenway Plaza           | B        | 2,571,195         | 8,012                       | -79,626                         | -3.1%                                 | 13.3%              | 13.6%             | \$27.71                                | 0                      | 0                         |
| Greenspoint/North Belt   | B        | 4,273,778         | -20,048                     | -141,824                        | -3.3%                                 | 43.4%              | 44.2%             | \$15.79                                | 0                      | 0                         |
| Northwest                | B        | 4,667,122         | -126,174                    | -62,089                         | -1.3%                                 | 19.0%              | 20.8%             | \$20.42                                | 0                      | 0                         |
| San Felipe/Voss          | B        | 3,430,031         | -45,539                     | -114,350                        | -3.3%                                 | 15.9%              | 16.4%             | \$24.13                                | 0                      | 0                         |
| Southwest                | B        | 4,447,569         | -119,018                    | -108,743                        | -2.4%                                 | 24.6%              | 24.6%             | \$17.73                                | 0                      | 0                         |
| Galleria                 | B        | 4,949,479         | -50,769                     | -110,602                        | -2.2%                                 | 15.1%              | 15.4%             | \$26.89                                | 0                      | 0                         |
| Bellaire                 | B        | 1,187,047         | 14,982                      | 20,910                          | 1.8%                                  | 9.8%               | 10.1%             | \$25.06                                | 0                      | 0                         |
| Medical Center           | B        | 2,198,482         | -2,958                      | 26,436                          | 1.2%                                  | 5.5%               | 5.5%              | \$27.61                                | 0                      | 0                         |
| <b>Suburban Near</b>     | <b>B</b> | <b>29,992,572</b> | <b>-338,905</b>             | <b>-577,844</b>                 | <b>-1.9%</b>                          | <b>19.7%</b>       | <b>20.3%</b>      | <b>\$20.76</b>                         | <b>0</b>               | <b>0</b>                  |
| Katy Freeway East        | B        | 1,436,025         | 14,743                      | -3,230                          | -0.2%                                 | 11.2%              | 12.5%             | \$21.83                                | 0                      | 0                         |
| Katy Freeway West        | B        | 5,402,052         | 11,472                      | -226,323                        | -4.2%                                 | 25.4%              | 25.8%             | \$22.37                                | 0                      | 0                         |
| Westchase                | B        | 4,220,036         | -27,452                     | -65,367                         | -1.5%                                 | 18.2%              | 19.0%             | \$19.86                                | 0                      | 0                         |
| <b>Energy Corridor</b>   | <b>B</b> | <b>11,058,113</b> | <b>-1,237</b>               | <b>-294,920</b>                 | <b>-2.7%</b>                          | <b>20.8%</b>       | <b>21.5%</b>      | <b>\$21.45</b>                         | <b>0</b>               | <b>0</b>                  |
| FM 1960                  | B        | 3,592,268         | -28,596                     | -71,498                         | -2.0%                                 | 22.9%              | 23.0%             | \$16.73                                | 0                      | 0                         |
| Sugar Land               | B        | 1,308,292         | -1,909                      | 42,803                          | 3.3%                                  | 10.4%              | 13.3%             | \$21.75                                | 0                      | 0                         |
| Gulf Freeway/Pasadena    | B        | 1,516,973         | -5,307                      | -23,235                         | -1.5%                                 | 17.9%              | 17.9%             | \$21.73                                | 82,800                 | 0                         |
| NASA/Clear Lake          | B        | 1,924,289         | -45,250                     | -82,213                         | -4.3%                                 | 25.7%              | 25.7%             | \$18.88                                | 0                      | 0                         |
| The Woodlands            | B        | 2,079,062         | -6,624                      | -15,687                         | -0.8%                                 | 15.8%              | 16.8%             | \$26.76                                | 0                      | 0                         |
| <b>Suburban Outlying</b> | <b>B</b> | <b>10,420,884</b> | <b>-87,686</b>              | <b>-149,830</b>                 | <b>-1.4%</b>                          | <b>19.7%</b>       | <b>20.3%</b>      | <b>\$19.88</b>                         | <b>82,800</b>          | <b>0</b>                  |
| <b>Houston</b>           | <b>B</b> | <b>59,020,241</b> | <b>-441,449</b>             | <b>-1,257,778</b>               | <b>-2.1%</b>                          | <b>19.7%</b>       | <b>20.4%</b>      | <b>\$21.81</b>                         | <b>82,800</b>          | <b>0</b>                  |