

Q1 2018

Office Insight

Continued oversupply of space looms as tenant concessions reach their peak

- After rising steadily over the past three years, concessions such as free rent and tenant improvement allowances have begun to plateau, yet remain at elevated levels.
- Sluggish tenant demand to start the year pushes vacancy up to 23.8%, which represents the thirteenth consecutive quarter of rising vacancy.
- The Galleria submarket was one of the few bright spots in Q1, where fundamentals showed improvement.

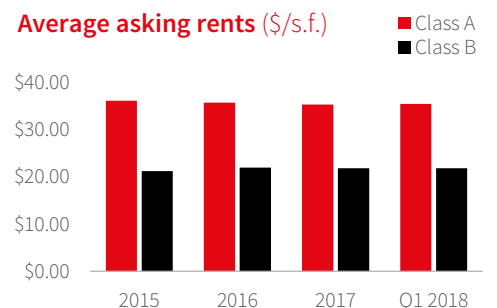
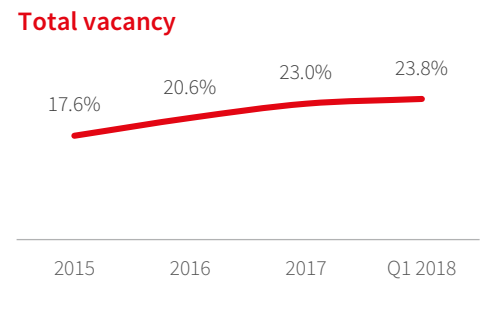
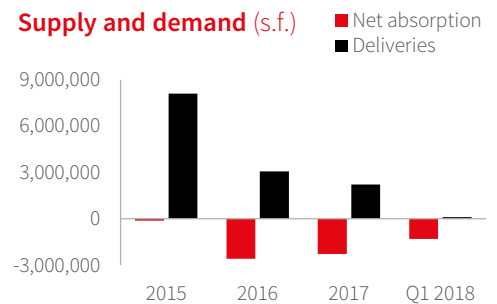
Since the fourth quarter of 2014, the Houston office market has been characterized by rising vacancy rates, flattening asking rents, growing concession packages, and a glut of sublease space. While vacancy rates and asking rents maintained these trajectories through the first quarter of 2018, concessions appear to be leveling off as more tenants engage the market to take advantage of favorable lease terms. Free rent in the neighborhood of 12 to 15 months on a ten-year deal is not uncommon for Class A space as well as tenant improvement allowances north of \$50.00 per s.f.. However, such generous concession packages will not remain indefinitely, particularly as the development pipeline tapers off, sublease space is absorbed, and the newest, most efficient space is leased.

Despite the continued uptick in vacancy, lack of growth in asking rents, and oversupply of sublease space across the market, there was one submarket that bucked each of the aforementioned trends. The Galleria was the only submarket in Houston to experience a decrease in vacancy, an increase in asking rents, and a decrease in sublease space. Additionally, leasing activity in the submarket improved by nearly 60.0% quarter-over-quarter, thanks to Apache's 515,000 s.f. renewal at Post Oak Central and several full-floor deals.

Outlook

Although there are signs of improving market conditions ahead as seen by flattening concession packages and strong performance in some areas in the first quarter, the Houston office market has a long way to go before it returns to a balanced market. As such, we expect market conditions to continue to favor tenants through the remainder of 2018 as leasing activity remains muted and the market absorbs the oversupply of space which has pushed vacancy from 14.9% in YE 2014 to 23.8% in Q1 2018.

Fundamentals	Forecast
YTD net absorption	-1,288,450 s.f. ▲
Under construction	1,654,682 s.f. ►
Total vacancy	23.8% ►
Average asking rent (gross)	\$30.80 p.s.f. ▲
Concessions	Stable ►



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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.)
Houston Totals										
	A	108,759,690	-1,085,735	-1,085,735	-1.0%	20.7%	25.5%	\$35.47	104,579	1,654,682
	B	58,931,155	-202,715	-202,715	-0.3%	20.0%	20.8%	\$21.81	0	0
Totals		167,690,845	-1,288,450	-1,288,450	-0.8%	20.5%	23.8%	\$30.80	104,579	1,654,682
CBD	Totals	35,561,112	-26,878	-26,878	-0.1%	18.2%	20.8%	\$41.78	0	778,344
CBD	Totals	35,561,112	-26,878	-26,878	-0.1%	18.2%	20.8%	\$41.78	0	778,344
Midtown	Totals	4,120,911	-97,047	-97,047	-2.4%	17.1%	17.7%	\$31.04	0	0
Greenway Plaza	Totals	9,914,670	-35,709	-35,709	-0.4%	16.3%	16.9%	\$33.98	0	0
Greenspoint/North Belt	Totals	8,901,037	54,899	54,899	0.6%	50.5%	53.6%	\$20.62	0	0
Northwest	Totals	8,551,128	-128,451	-128,451	-1.5%	25.0%	28.0%	\$24.22	0	0
San Felipe/Voss	Totals	5,150,551	-135,048	-135,048	-2.6%	20.2%	20.8%	\$29.95	0	0
Southwest	Totals	6,023,986	10,619	10,619	0.2%	24.1%	24.7%	\$17.23	0	0
Galleria	Totals	22,804,289	138,679	138,679	0.6%	17.8%	20.3%	\$36.30	104,579	0
Bellaire	Totals	2,251,747	17,515	17,515	0.8%	10.8%	12.3%	\$24.37	0	0
Medical Center	Totals	3,926,255	12,207	12,207	0.3%	8.4%	8.9%	\$29.98	0	0
Suburban Near	Totals	71,644,574	-162,336	-162,336	-0.2%	22.4%	24.3%	\$27.49	104,579	0
Katy Freeway East	Totals	5,547,268	-73,338	-73,338	-1.3%	15.0%	16.9%	\$34.86	0	0
Katy Freeway West	Totals	19,772,214	-538,430	-538,430	-2.7%	23.8%	34.8%	\$29.33	0	171,538
Westchase	Totals	13,013,919	-157,306	-157,306	-1.2%	19.9%	25.5%	\$29.80	0	0
Energy Corridor	Totals	38,333,401	-769,074	-769,074	-2.0%	21.2%	29.1%	\$29.95	0	171,538
FM 1960	Totals	5,876,912	-90,708	-90,708	-1.5%	18.1%	20.1%	\$18.26	0	0
Sugar Land	Totals	4,232,491	-196,157	-196,157	-4.6%	9.4%	14.8%	\$26.50	0	0
Gulf Freeway/Pasadena	Totals	1,516,973	-12,151	-12,151	-0.8%	18.2%	18.7%	\$21.59	0	0
NASA/Clear Lake	Totals	3,260,976	-12,774	-12,774	-0.4%	17.6%	18.2%	\$20.51	0	0
The Woodlands	Totals	7,264,406	-18,372	-18,372	-0.3%	18.0%	19.0%	\$31.31	0	704,800
Suburban Outlying	Totals	22,151,758	-330,162	-330,162	-1.5%	16.4%	18.3%	\$24.34	0	704,800
Houston	Totals	167,690,845	-1,288,450	-1,288,450	-0.8%	20.5%	23.8%	\$30.80	104,579	1,654,682
CBD	A	28,012,863	59,699	59,699	0.2%	17.8%	20.8%	\$44.37	0	778,344
CBD	A	28,012,863	59,699	59,699	0.2%	17.8%	20.8%	\$44.37	0	778,344
Midtown	A	1,853,042	-90,763	-90,763	-4.9%	26.8%	27.0%	\$31.99	0	0
Greenway Plaza	A	7,356,620	19,804	19,804	0.3%	16.5%	17.2%	\$36.02	0	0
Greenspoint/North Belt	A	4,646,354	14,779	14,779	0.3%	57.4%	62.8%	\$24.20	0	0
Northwest	A	3,884,006	-106,574	-106,574	-2.7%	31.3%	35.6%	\$26.79	0	0
San Felipe/Voss	A	1,720,793	-87,637	-87,637	-5.1%	27.1%	27.1%	\$35.91	0	0
Southwest	A	1,578,768	22,655	22,655	1.4%	22.4%	24.2%	\$18.71	0	0
Galleria	A	17,855,115	154,026	154,026	0.9%	18.5%	21.7%	\$38.19	104,579	0
Bellaire	A	1,097,167	-13,249	-13,249	-1.2%	11.3%	14.1%	\$22.25	0	0
Medical Center	A	1,727,773	3,623	3,623	0.2%	13.1%	13.7%	\$33.22	0	0
Suburban Near	A	41,719,638	-83,336	-83,336	-0.2%	24.1%	26.8%	\$31.33	104,579	0
Katy Freeway East	A	4,111,243	-78,986	-78,986	-1.9%	16.5%	18.6%	\$38.18	0	0
Katy Freeway West	A	14,370,162	-433,643	-433,643	-3.0%	22.7%	37.6%	\$33.79	0	171,538
Westchase	A	8,792,934	-223,546	-223,546	-2.5%	21.5%	29.4%	\$34.76	0	0
Energy Corridor	A	27,274,339	-736,175	-736,175	-2.7%	21.4%	32.1%	\$34.52	0	171,538
FM 1960	A	2,284,644	-108,481	-108,481	-4.7%	12.9%	17.1%	\$28.32	0	0
Sugar Land	A	2,924,199	-173,082	-173,082	-5.9%	8.5%	14.8%	\$30.10	0	0
Gulf Freeway/Pasadena	A	0	0	0	0.0%	0.0%	0.0%	\$0.00	0	0
NASA/Clear Lake	A	1,336,691	-35,698	-35,698	-2.7%	8.3%	9.6%	\$24.15	0	0
The Woodlands	A	5,207,316	-8,662	-8,662	-0.2%	18.5%	19.4%	\$33.83	0	704,800
Suburban Outlying	A	11,752,850	-325,923	-325,923	-2.8%	13.8%	16.7%	\$31.48	0	704,800
Houston	A	108,759,690	-1,085,735	-1,085,735	-1.0%	20.7%	25.5%	\$35.47	104,579	1,654,682

	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	7,548,249	-86,577	-86,577	-1.1%	19.9%	20.6%	\$29.87	0	0
CBD	B	7,548,249	-86,577	-86,577	-1.1%	19.9%	20.6%	\$29.87	0	0
Midtown	B	2,267,869	-6,284	-6,284	-0.3%	9.2%	10.1%	\$29.26	0	0
Greenway Plaza	B	2,558,050	-55,513	-55,513	-2.2%	15.7%	16.0%	\$27.26	0	0
Greenspoint/North Belt	B	4,254,683	40,120	40,120	0.9%	42.9%	43.6%	\$15.50	0	0
Northwest	B	4,667,122	-21,877	-21,877	-0.5%	19.8%	21.7%	\$20.37	0	0
San Felipe/Voss	B	3,429,758	-47,411	-47,411	-1.4%	16.7%	17.7%	\$24.91	0	0
Southwest	B	4,445,218	-12,036	-12,036	-0.3%	24.7%	24.8%	\$16.64	0	0
Galleria	B	4,949,174	-15,347	-15,347	-0.3%	15.2%	15.5%	\$26.92	0	0
Bellaire	B	1,154,580	30,764	30,764	2.7%	10.3%	10.5%	\$25.67	0	0
Medical Center	B	2,198,482	8,584	8,584	0.4%	4.6%	5.1%	\$28.13	0	0
Suburban Near	B	29,924,936	-79,000	-79,000	-0.3%	20.1%	20.8%	\$20.65	0	0
Katy Freeway East	B	1,436,025	5,648	5,648	0.4%	10.7%	12.0%	\$21.10	0	0
Katy Freeway West	B	5,402,052	-104,787	-104,787	-1.9%	26.7%	27.3%	\$21.70	0	0
Westchase	B	4,220,985	66,240	66,240	1.6%	16.5%	17.3%	\$19.77	0	0
Energy Corridor	B	11,059,062	-32,899	-32,899	-0.3%	20.8%	21.5%	\$21.09	0	0
FM 1960	B	3,592,268	17,773	17,773	0.5%	21.4%	22.0%	\$16.42	0	0
Sugar Land	B	1,308,292	-23,075	-23,075	-1.8%	11.5%	15.0%	\$22.56	0	0
Gulf Freeway/Pasadena	B	1,516,973	-12,151	-12,151	-0.8%	18.2%	18.7%	\$21.59	0	0
NASA/Clear Lake	B	1,924,285	22,924	22,924	1.2%	24.2%	24.2%	\$19.47	0	0
The Woodlands	B	2,057,090	-9,710	-9,710	-0.5%	16.7%	17.9%	\$27.26	0	0
Suburban Outlying	B	10,398,908	-4,239	-4,239	0.0%	19.3%	20.2%	\$20.19	0	0
Houston	B	58,931,155	-202,715	-202,715	-0.3%	20.0%	20.8%	\$21.81	0	0