Economic Overview

Houston, dominated by the energy industry, has kept a close watch on oil prices in the last 6 months of 2014. After peaking at $107 per barrel in June, prices have fallen to below $55/bbl this winter, the lowest price since the recession hit five years ago. $70/bbl is regarded as the break-even point for drilling in the Texas shale plays. Below this point, drilling is not economically feasible. Although prices aren’t expected to rebound to the $100/bbl-range anytime soon, a repeat of the 1980's oil crash is not on the horizon either. The Greater Houston Partnership (GHP) predicts that Houston will add 62,900 jobs in 2015. These jobs are expected to come from outside of Houston’s economic base in industries such as construction, health care, education, and retail. However, the GHP is predicting job losses in the energy industry. Major oil companies have already announced cuts in both jobs and budgets for 2015 amid falling oil prices, while smaller energy companies, particularly those that are over-leveraged, are prime targets for merger and acquisition activity.

Although a slowdown will undoubtedly occur in 2015, the Houston economy has a great deal of momentum going into the New Year. The metro area added 125,300 jobs in the last 12 months ending in November, the most jobs added in over 30 years. Employment grew by 4.4% this year while the unemployment rate fell to 4.7%. The energy boom that followed the recession elevated Houston to the forefront of an international audience. Population and employment rapidly expanded. Development during this time was significantly preleased, and the city remained well-capitalized. ULI and PwC named Houston as the country’s No. 1 market to watch in 2015 in their “Emerging Trends in Real Estate” report. The Houston commercial real estate market is closely tied to the energy industry. If low oil prices persist, a slowdown in the commercial real estate industry is expected in 2015.

Houston added 125,300 jobs in the last 12 months ending in November, representing the strongest job growth for Houston in over 30 years.

The Greater Houston Partnership (GHP) predicts that Houston will add 62,900 jobs in 2015.

Job growth in 2015 is expected to occur in industries such as construction, health care, education, and retail.

The GHP expects job losses to occur in Houston’s energy industry, including exploration and production, oil field services, and oil field equipment manufacturing.

After peaking at $107/bbl in June, WTI has fallen by nearly 50% to $55/bbl in December, the lowest pricing since the recession hit.

The energy industry grew by 9.4% in the last 12 months ending in November, although this will slow in 2015.

Partnership. Performance.
Office Market Overview

2014 ended as one of the recent best years in Houston commercial real estate. Large-scale office projects that have been in the works for years came to fruition, resulting in impressive numbers. The market absorbed nearly 1.4 million square feet (msf) in the fourth quarter, totaling 8.6 msf of absorption for 2014. This is over double what the market absorbed in 2013 (3.9 msf). 14.4 msf is currently under construction, and 8.4 msf has delivered this year. Even though the building boom has delivered a large amount of space this year, pent up demand and significant preleasing has resulted in a relatively steady vacancy rate throughout 2014. Vacancy increased by 10 basis points from the previous quarter to 10.4%, although it is down from 10.9% in 4Q13. Asking rates continue to grow at an accelerated pace, increasing by 5.5 % in the last 12 months to $26.64 per square foot (psf). Large-scale deals began to taper off in 2014, a trend that will continue for the next few years. 2015 will be another strong year for deliveries and absorption as the space currently under construction delivers. However, due to the economic uncertainty, new construction starts will likely be put on hold, additional sublease space will be put on the market, and the vacancy rate is expected to climb.

Office Market Overview

Vacancy Rates

Asking Rents

Net Absorption

ABSORPTION & DEMAND

The Houston office market posted nearly 1.4 msf of absorption in the fourth quarter, pushing 2014 absorption to over 8.6 msf. ExxonMobil’s 3-msf campus south of The Woodlands accounts for 3 msf of the yearly absorption, although employees will continue to take occupancy of the campus through mid-2015. Excluding Exxon’s campus, the market absorbed 5.6 msf in 2014, up from 3.9 msf in 2013. All building classes recorded positive absorption in 2014. Class A properties led the way (7.3 msf) followed by Class B properties (1.1 msf), and Class C properties recorded marginal gains (100K sf). The majority of absorption this year came from tenants occupying newly-delivered space, particularly in Katy Freeway West and The Woodlands. Going forward, demand will continue to be centered on these two submarkets, which accounted for 15% and 49% of total yearly absorption, respectively. Memorial Production Partners at One Allen Center (111,566 sf). CBD.

Memorial Production

Motiva Enterprises at One Allen Center (109,373 sf). CBD.

Kiewit Energy at 3831 Technology Forest Dr. (95,080 sf) The Woodlands.

Samsung Engineering at Briarlake Plaza (79,527 sf) Westchase.

JGC America at Granite Briarpark Green (77,000 sf) Westchase.

GSA at Greens Crossing I (68,985 sf). Greenspoint.

HOK Architects at the Phoenix Tower (49,018 sf) San Felipe.

NOTABLE FOURTH QUARTER OCCUPANCIES:

NOTABLE FOURTH QUARTER LEASES:

• Stewart Information Services renewed its 230K-sf lease at Post Oak Central.

• Bristow Group signed a 115,000-sf new lease at CityWestPlace.

• Technip preleased 103,987 sf at Energy Tower IV. The company also leased the entire 429K-sf Energy Tower III previously.

• EMAS preleased 100K sf at CityCentre Five.

• Nabors Industries signed a 98,000-sf expansion lease at One Commerce Green, taking over space vacated by Southwestern Energy in 1Q15.
Partners and Motiva Enterprises occupancies boosted CBD absorption in the fourth quarter. The CBD ended the year with 779,799 sf of net absorption. Construction has remained heavily preleased, which will translate into impressive absorption gains in Class A space as this new product delivers to the market in 2015.

**VACANCY & AVAILABILITY**

The Houston office market remains tight with a vacancy rate of 10.4%. Class A vacancy is in the single-digits, up by 30 basis points from the previous quarter to 8.0%, but down from 8.3% at this point last year. Class B vacancy continues to fall, down by 70 basis points from the previous year to 12.5%. Class C space has decreased by 70 basis points during this time to 12.6%. Houston’s building boom has caused an influx of relocations to new buildings, resulting in older buildings trying to stay competitive through renovations. This trend has been particularly prevalent in the CBD, where a substantial amount of product will become available in 2015. Renovations include 800 Bell, 600 Jefferson, 2 Shell Plaza, Pennzoil Place, and the Esperson Buildings. The CBD currently has a low vacancy rate of 7.4%, although this is expected to rise in the next few years with tenant relocations (ExxonMobil & Shell) and the delivery of 609 Main. Greenspoint continues to struggle with tenant relocations as well. Exxon vacated Five Greenspoint Place and 13401 North Freeway in the fourth quarter totaling nearly 600K sf, thereby pushing Class A vacancy up from 11.9% in 3Q14 to 20.0% in 4Q14.

The Energy-centric Katy Freeway West submarket maintained a low vacancy rate of 7.1% in the fourth quarter. Demand in this submarket has remained high; therefore low vacancy is expected to persist. Technip’s lease in Energy Tower I expired in August and a rare block of 200K sf is still available in the building. At 5.3%, the Woodlands has one of the lowest vacancy rates in Houston, which will continue into 2015 has companies are drawn to the Exxon campus.

**RENTAL RATES**

Asking rates remained nearly constant from the previous quarter, falling by just $0.01 psf to $26.64 psf in the fourth quarter. In the last 12 months, however, asking rates have risen by 5.5%. In this time, Class A asking rates have increased by 4.3% to $34.20 psf. Class B rates have increased by 3.8% to $20.62 psf, and Class C rates have increased by 3.2% to $16.01 psf. Rental rate growth has primarily come from the Katy Freeway West, Woodlands, Westchase, and West Loop submarkets. Asking rates are projected to increase in 2015, albeit at a slower pace.

**CONSTRUCTION**

Houston’s office construction boom continued into the fourth quarter with 14.4 msf currently under development. 54% of this space is preleased. The Houston office market delivered over 8.4 msf in 2014, up from 3.3 msf in 2013. The building boom has been centered around the Energy Corridor and The Woodlands. 33% of space currently under construction is occurring in the Energy Corridor, and ExxonMobil delivered its 3-msf campus in The Woodlands in 2014. Seven buildings broke ground in the fourth quarter totaling over 1.15 msf, four of which were speculative developments. Six buildings concentrated in north and west Houston delivered in the fourth quarter totaling over 1.17 msf. The buildings that delivered in the fourth quarter were only 10% preleased at the time of completion. Although this is partly due to increased speculative development, the amount of preleasing has decelerated compared with the previous eight quarters, indicating that the building boom is tapering off. In lieu of the economic uncertainty, most new construction starts will likely be put on hold until oil prices recover.
Largest Houston Transactions

<table>
<thead>
<tr>
<th>Tenant Name</th>
<th>Building</th>
<th>Submarket</th>
<th>Square Feet</th>
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<tbody>
<tr>
<td>Stewart Information Services</td>
<td>Post Oak Central</td>
<td>West Loop</td>
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<tr>
<td>Bristow Group</td>
<td>CityWestPlace</td>
<td>Westchase</td>
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<tr>
<td>Technip</td>
<td>Energy Tower IV</td>
<td>Katy Freeway West</td>
<td>103,987</td>
</tr>
</tbody>
</table>

Trends to Watch

**Employment:** Houston added 125,300 jobs in the 12 months ending in November

**Active Markets:** West Houston, The Woodlands, Downtown.

**Market Drivers:** Energy, Construction, Health Care.