

# Houston



## Market Facts

**43,500**

Jobs added in the last 12 months ending in May, a 1.5% increase in employment.

**5.1%**

Unemployment rate in Houston, down from 5.8% when it peaked in July 2016.

**10.7**

Million square feet of space now listed on the sublease market.

**16.8%**

Vacancy in Houston's office market, the highest recorded in the past decade.

## Market Overview

At mid-year 2017, Houston's economic downturn is over and the recovery that began a year ago continues to gain traction. The lingering effects from the downturn continue to play out for Houston's office market, with rising vacancy and negative net absorption recorded in the first half of the year. Although Houston is in recovery mode, indicators in the office market will take additional time to reflect the current economic outlook. In the near-term, the office market will continue to be weighed down by a glut of available space. However, a renewed sense of optimism in Houston has led to an increase in leasing activity, which will help in alleviating the oversupply concerns going forward.

Evidence of Houston's recovery continues to show up in an increasing number of economic indicators. The Purchasing Manager's Index registered 54.1 in May, indicating short-term expansion. Employment has picked up with 45,300 jobs added in the last 12 months ending

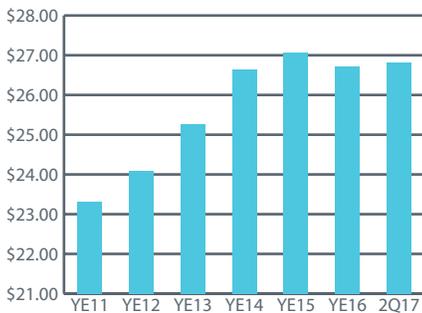
in May, a 1.5% increase in employment. Houston's single-family housing market remains strong. According to Metrostudy, Houston ranks No. 2 in housing starts in the nation. Houston also ranks No. 2 in population growth. The rig count has more than doubled in the last year with 952 in operation as of early July. Even though Houston's economy continues to improve, a full recovery will take additional time. The price of oil has remained around \$45.00 per barrel since the beginning of 2016 and most energy analysts project that it will remain around that price through 2017. The Houston economy has managed to grow despite a stagnating energy industry, placing the city in a favorable position once oil prices finally turn around.

### Absorption & Demand

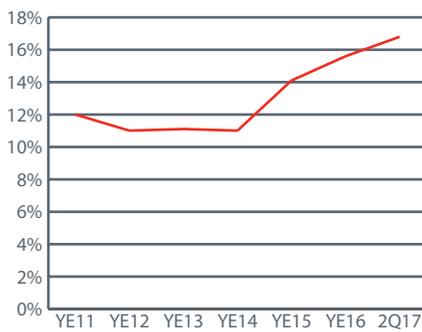
The Houston office market recorded a negative net absorption of 648,886 sf in the second quarter, marking the fifth consecutive quarter of negative net absorption. At the mid-year point,



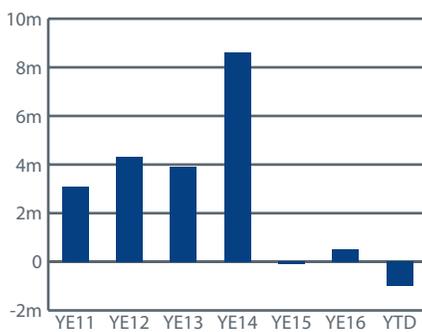
### Asking Rates



### Historical Vacancy Rate



### Historical Net Absorption



absorption totals nearly -1.0 msf. Half of Houston’s submarkets have recorded negative net absorption this year, and only one submarket- The Woodlands- has recorded over 100,000 sf of positive net absorption. Houston is in recovery mode, but indicators such as absorption and vacancy take about 9 to 12 months to reflect current economic conditions. From the start of the downturn that began three years ago, supply has greatly exceeded demand. This imbalance is beginning to even out with an uptick in demand for office space and a decrease in the amount of new supply coming online. Leasing activity improved at the start of the year, particularly in Class A space. Absorption will likely lag over the next few quarters until these new leases take effect.

### Vacancy & Availability

An imbalance of supply and demand in the Houston office market caused the vacancy rate to rise by 60 basis points from the previous quarter to 16.8%. This represents the highest vacancy rate to be recorded in the past decade, and comes on the heels of 10 quarters of below-average leasing activity and a record amount of new supply from construction deliveries and sublease listings. Even though Houston is in recovery mode, a further rise in vacancy is expected throughout the remainder of 2017. However, Houston’s brightening economic outlook is giving companies a renewed sense of optimism, leading to an uptick in leasing activity and an increase of tenants in the market. Conditions are also improving on the supply side. This quarter’s construction pipeline is one of the lowest to be recorded in the last five years, and sublease inventory fell for the third consecutive quarter.

While vacancy has reached record-highs, available space in Houston has a tendency to quickly disappear in favorable market conditions.

### Asking Rates

Overall average asking rates increased by \$0.12 psf from the previous quarter to \$26.82 psf gross. Asking rates have held relatively steady throughout the downturn with landlords offering abatements in the form of tenant improvements and free rent. Leasing activity continues to trend towards smaller footprints in newer and more efficient space. The flight to quality has put a slight upward pressure on Class A asking rates, despite volatility in the market. In the past year, Class A asking rates have increased by 1.7% while Class B asking rates have contracted by 1.9%. This trend is projected to continue throughout the recovery.

### Construction

A number of buildings broke ground in the second quarter, consisting of a mixture of build-to-suits and speculative construction. The current construction pipeline now totals 2.9 msf, up from 2.3 msf in the first quarter. 45% of the space currently under construction is preleased. Even though Houston saw an uptick in construction activity in the second quarter, the construction boom is nearly over with the majority of remaining space set to deliver in 2017. New construction deliveries, which have contributed greatly to Houston’s oversupply concerns, will have less of an impact going forward. Additional construction starts are not anticipated for years to come without a considerable amount of preleasing.

## Major 2017 Deliveries

609 Main  
(1,000,00 sf) CBD

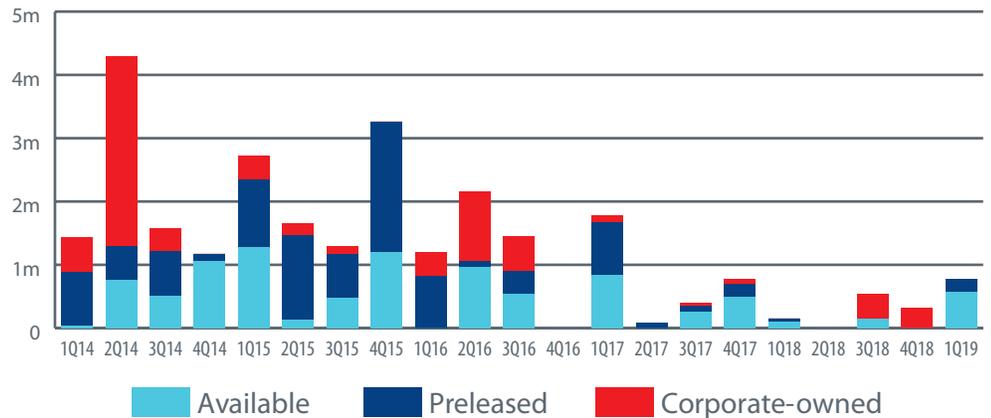
Amegy Bank Headquarters  
(380,000 sf) West Loop

Memorial City  
(238,173 sf) Katy Freeway East

Insperty Center 4  
(100,000 sf) Kingwood / Humble

Park 225  
(82,800 sf) Gulf Freeway/Pasadena

## Construction Timeline



## 2Q17 Highlights

- Apache Corp. extended its 524,000-sf lease through 2022 at 2000 Post Oak Blvd in the **West Loop** submarket. According to the oil company, the extension provides them time to evaluate the best long-term, cost effective solution for their headquarters while the recovery in the energy markets continues.
- Archrock subleased 73,000 sf at Air Liquide Center North and will take occupancy of the space in September.
- Hertz Investments is under contract to purchase Marathon Oil Tower for \$195 million (\$163 psf). The building totals over 1.2 msf and is 90% leased to tenants including Marathon Oil, Aon, and Baker Hughes
- Two office buildings broke ground in **Springwoods Village**, a development located just south of **The Woodlands**. HP began construction on a 387,000-sf office campus, and American Bureau of Shipping started in late April on a 326,000-sf build-to-suit.
- A Chinese development company is in negotiations to purchase Halliburton's Oak Park Campus in the **Westchase** submarket in a deal that is expected to close at roughly \$30 million.
- WeWork, a coworking office space company, leased 86,000 sf at Jones at Main in Houston's **CBD**. The building is currently being redeveloped by Midway and Lionstone Investments.

## Trends to Watch



The price of oil averaged \$48.29/bbl. in the second quarter, down from \$51.91 /bbl. in the first quarter.



Economic sectors reporting growth in the last 12 months include Manufacturing (4.6%), Professional & Business Services (4.1%), Education & Health Services (4.0%), Leisure & Hospitality (3.1%), Government (2.7%), and Finance (0.5%).



According to Metrostudy, Houston ranks No. 2 in housing starts in the nation. The metro area recorded 25,789 housing starts in the last 12 months ending in March. Dallas led the nation in housing starts during this time.



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