HOUSTON ENERGY CORRIDOR

Market Insight

SEPTEMBER 2017

How long will it take sublease space in Houston's Energy Corridor to subside?

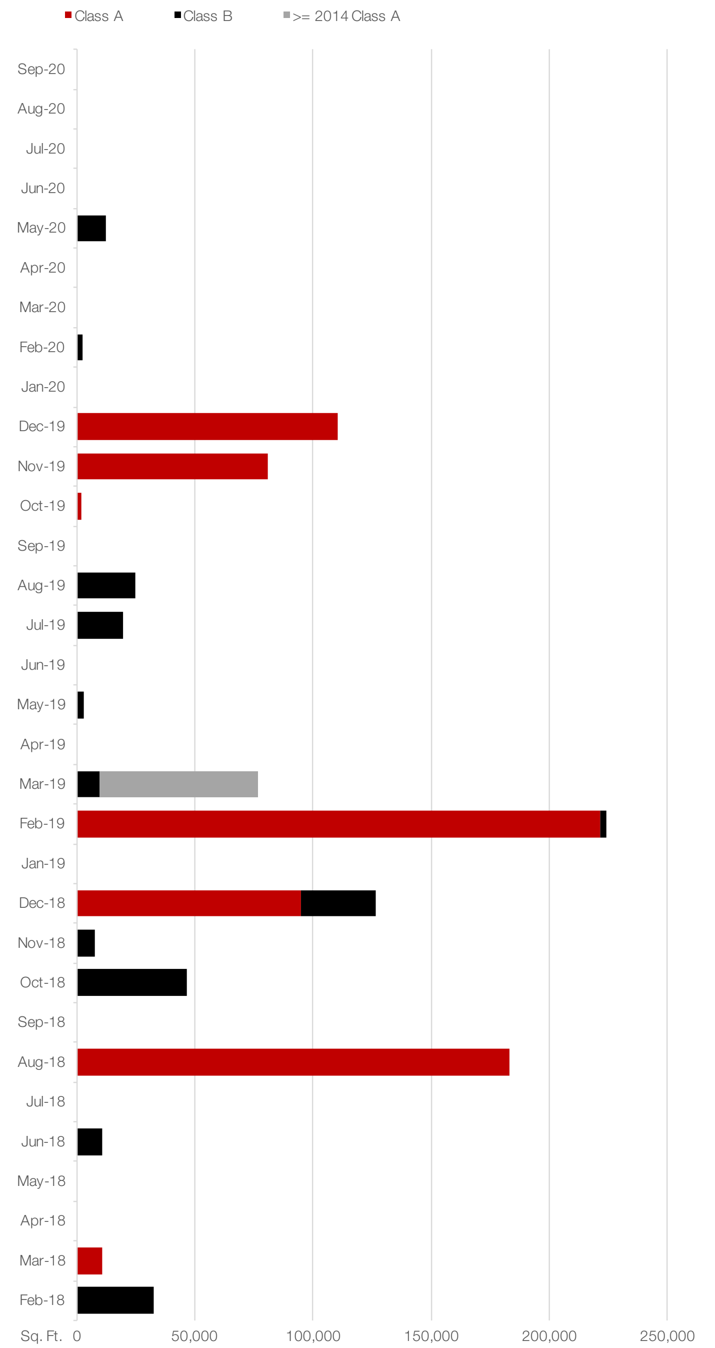
In the summer of 2014, the price of crude oil was on the decline, dropping from $107 per barrel all the way down to $26 per barrel in February 2016. Although prices have averaged around $50 per barrel in 2017, many energy companies have cut back and parted ways with substantial portions of their commercial real estate portfolios. Among the most popular tactics for doing so has been subleasing (or trying to sublease) their office space.

As we move into the fall of 2017, there is 10.4 million sq. ft. of available sublease space in Greater Houston, with the Energy Corridor representing 19%, or 2 million sq. ft. Approximately 975,000 sq. ft. of that space has terms set to expire between the next six to 36 months. A break-down of the space by class shows 72% is Class A and 28% Class B.

The largest subleases expiring include tenant Phillips 66 with 221,723 sq. ft. at Three Westlake Park - 550 Westlake Park Blvd. in the next 17 months; Amec Foster Wheeler with 182,966 sq. ft. at Energy Center I – 585 N. Dairy Ashford in the following 11 months; and Worley Parsons with 104,324 sq. ft. at the Reserve at Park Ten – 15721 Park Row in the next 27 months.

Even though this resurgence of space represents a unique opportunity for potential tenants considering leasing office space in West Houston, what exactly is going to happen if the space is returned to the landlord in the form of direct space? Many believe subleases less then two years aren't really subleases at all, they are direct space. Landlords are more concerned with the 24-36-month range subleases, with tenants that aren't in a position to buyout the lease, or particular restrictions in the loan agreements. Future tenants may hold out for a better deal, seeking more concessions from landlords. In any case, the Energy Corridor remains appealing, with high-quality, institutional office buildings built to

Energy Corridor Sublease Space Term Expirations up to 36 Months



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corporate standards, many with fully furnished space laced with amenities.

When evaluating data to ascertain possible outcomes, there are many statistics to consider, such as the typical vacancy rate and rent trend analyses to determine what is driving the market. In addition, economic trends, such as population and employment data, along with the use of historical data to provide information that assists in defining the health of a region and can be used to reflect upon the current and future demand for office space.

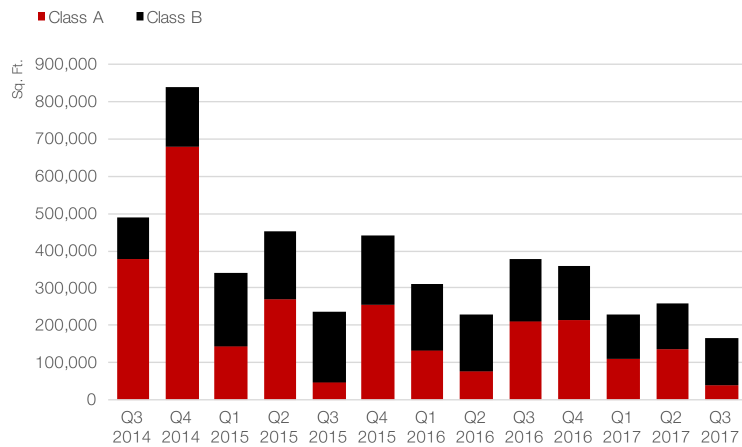
On the job front, according to the Texas Workforce Commission (TWC), Houston recorded strong growth from 2011-2014, validating the power of the fracking boom; however, the growth ended after oil prices collapsed in late 2014. The current TWC employment estimates show that Houston added 44,900 seasonally adjusted jobs through June of this year, although growth slowed in July, and pulled 2017 annualized growth down. The current estimate of job gains in the oil and gas sector for 2017 is 7,100 jobs, with most of the returning jobs in oil services or fabricated metals. The city also had 14,400 new jobs in business and professional services, and many of these jobs were likely energy-related. Conversely, a significant number of these jobs were temporary, and probably won't transfer over to permanent. The good news is that Houston is growing, but slowly. Currently, local experts aren't expecting to see a return to long-term trend rates of employment growth before 2020.

And on the data side, analyzing historical trends is a complementary method of evaluating the abundance of sublease space and the amount of time it might take for that space to be absorbed. Running the "months to lease" graph in CoStar Analytics applies the number of months between the date a space began being marketed as available until the sign date when the space was committed to by a tenant. The charts in this report representing "months to lease" are based on the dataset of Energy Corridor Class A and Class B properties with current available sublease space, tracking all lease transactions that were completed during the previous 36-month period.

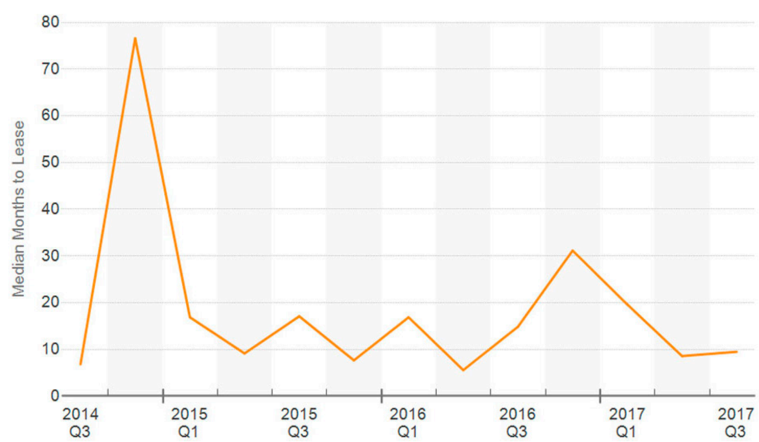
Based on the historical leasing activity the current median months-to-lease Class A space in the Energy Corridor buildings with available sublease space is close to 20 months. Class B space is faster, at around six months.

Taking the projected employment numbers, alongside the historical months-to-lease data, our recommendation is that it's not unrealistic to think that the Energy Corridor's sublease picture could look quite a bit different two years from now.

Energy Corridor Historical Leasing Activity



Energy Corridor – Class A – Properties with Current Available Sublease Space Historical Months to Lease



Energy Corridor – Class B – Properties with Current Available Sublease Space Historical Months to Lease