

Texas Real Estate Business

Houston Office Real Estate Forecast 2017

January 2017



Overview

The Valbridge Property Advisors Houston/DFW Office Valuation Group, led by Paul Gilliam, MAI and Lissa A. Traber, was on hand to hear several of Houston's top office market experts share their opinions and outlook for the sector's coming year at the Texas Real Estate Business Houston Office Real Estate Forecast 2017. The event included an economic overview for the Houston area followed by two panel discussions with experts in office construction, brokerage, and research.

Keynote Address – Economic Overview

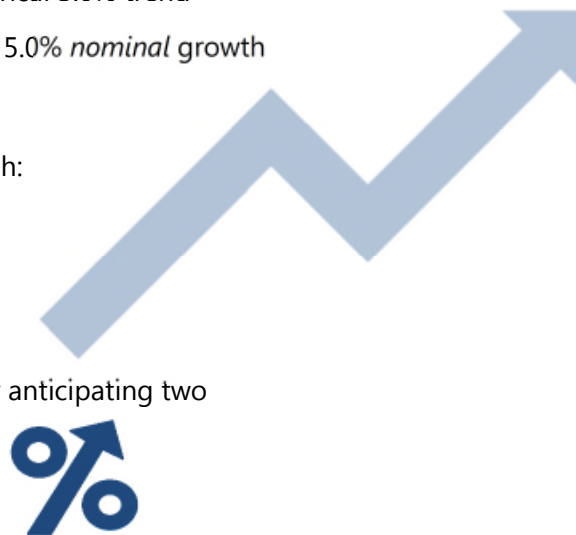
Brian Sharpe, Market Investment Executive
U.S. Trust

2015-16 Review

- Last few years characterized as stagflation
- 'New normal' characterized as 1.0% *real* growth versus historical 3.0% trend
- Mid-2016 moved closer to a return to 3.0% *real* growth and 5.0% *nominal* growth

2017 Outlook

- Positive for overall economy, with several stimulants to watch:
 - Corporate tax rate reduction
 - Repatriating offshore income
 - Oil to maintain level of \$50 per bbl.
- Three Federal funds rate increases being discussed, but only anticipating two
- Federal funds rate expected to move from 2.4% to 3.0%
- Libor likely to experience 50-basis point increase



Panel One - Researcher's Forecast

Robert Kramp, Director of Research & Analysis
CBRE

Michael Scheurich, President & CEO
Arch-Con Construction

Deniese Palmer-Huggins, Senior Energy Advisor
UT – Center for Energy Economics

Stuart Showers, Director of Research
Transwestern

Market Trends

- 2016 viewed as pivot year with positive absorption expected by year-end 2017
- Efficient workplace environments reducing old metric of 250 – 300 sf per employee to 125 sf
- Users don't want large empty lobbies; users want social spaces with services
- Construction costs rise faster than they fall, but declined 3% to 5% over 2016
- Oil prices stabilized, but face resistance at \$55 per bbl. as shale players return to market at this level

Sublease Market

- 12 million sf available is highest ever recorded in Houston
- Largely concentrated in CBD and West Houston
- Primarily consists of large blocks of Class A space
- 25% expires in 2025 or later
- 18 to 24 months before significant progress is made

Concessions

- Face rates unchanged, but effective rates lower due to concessions
- Early 2016 – 3 to 5 months free rent common with \$15 psf TI's
- Late 2016 – As high as 15 months free rent with \$25 TI's
- Direct result of sublease competition

Sales Transactions

- Sales transaction volume low
- Bid-ask spread remains too wide
- Sellers don't want to be caught selling at 'bottom'



Panel Two - Office Real Estate Outlook

Tim Relyea, Executive Vice Chairman
Cushman & Wakefield

Kevin Wyatt, Senior Vice President
Lincoln Property Company

Brandi McDonald, Executive Managing Director
Newmark Grubb Knight Frank

Rand Stephens, Principal & Managing Director
Avison Young

Paul Frazier, Executive Vice President
Brookfield Property Partners

Charles Fertitta, Principal & Director
Colliers International

David Baker, Executive Vice President
Transwestern

State of the Market

- Houston economy still too heavily tied to energy
 - 70% to 80% tied to energy in 1980's, now close to 50%
 - Texas Medical Center and the Port are good starts, but more diversification needed
- Mass transit must improve to effectively compete with other markets
- Energy M&A activity will lead to consolidation, which is bad for real estate
- Moody's projects 100,000 office jobs over next five years, but 365,000 needed to absorb sublease inventory
- Demand will not support significant speculative development until 2020
- Energy Corridor leasing demand is hardly existent and only a few large Westchase deals completed in 2016
- Top three leases in 2016 were not tied to energy sector
- Operating expenses are expected to fall for the first time in 10 years, primarily due to occupancy loss



User Behavior

- Users do not want large granite lobbies or offices with limited natural light
- Many users view Class A buildings of the 1980's as junk and want new space
- Entering era of repositioning existing assets to meet demands of modern users

Landlord Behavior

- Foreign investors entered market and are not aggressive landlords, exacerbating sublease issues
- Local landlords more aggressive and actively helping tenants sublease space expiring in less than five years

Construction Trends

- Tilt-wall buildings offer good value in suburban areas
- Efficient common areas
- 10' ceiling heights
- Upscale restrooms
- Underfloor HVAC



Valbridge Property Advisors – Houston/DFW Office Valuation Group

For additional insight into the state of the Houston Office Market or to discuss your valuation needs, please contact the Valbridge Property Advisors Office Valuation Group. We have experience in the valuation of a variety of property types, but specialize in the Houston/DFW office market. Our office valuation experience includes high-rise institutional assets, sprawling corporate campuses, medical offices, business parks, atrium buildings, tilt-wall buildings, GSA assets, owner-user properties, and many more. Please see the following page for a representative list of significant valuation assignments completed by our team.



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Director - Office Valuation Group

Vice President - Financial Modeling

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VPA Office Valuation Group – Significant Assignments

Property Type	MSA	Submarket	Approx. Size
Professional Office	Bryan-College Station	Bryan	110,000
Professional Office	Dallas-Fort Worth-Arlington	CBD	965,000
Professional Office	Dallas-Fort Worth-Arlington	Central Expressway	280,000
Professional Office	Dallas-Fort Worth-Arlington	DFW Freeport-Coppell	100,000
Professional Office	Houston-The Woodlands-Sugar Land	CBD	2.4 million
Professional Office	Houston-The Woodlands-Sugar Land	CBD	1.8 million
Professional Office	Houston-The Woodlands-Sugar Land	CBD	1.7 million
Professional Office	Houston-The Woodlands-Sugar Land	CBD	1.4 million
Professional Office	Houston-The Woodlands-Sugar Land	CBD	1.25 million
Professional Office	Houston-The Woodlands-Sugar Land	CBD	1.15 million
Professional Office	Houston-The Woodlands-Sugar Land	CBD	1.1 million
Professional Office	Houston-The Woodlands-Sugar Land	CBD	975,000
Professional Office	Houston-The Woodlands-Sugar Land	CBD	940,000
Professional Office	Houston-The Woodlands-Sugar Land	Champions-Klein-Willowbrook	155,000
Professional Office	Houston-The Woodlands-Sugar Land	Clear Lake	110,000
Professional Office	Houston-The Woodlands-Sugar Land	Galleria-Uptown	300,000
Professional Office	Houston-The Woodlands-Sugar Land	Galleria-Uptown	175,000
Professional Office / Industrial	Houston-The Woodlands-Sugar Land	Greenspoint-IAH	1.5 million
Professional Office	Houston-The Woodlands-Sugar Land	Greenspoint-IAH	165,000
Professional Office	Houston-The Woodlands-Sugar Land	Greenway	145,000
Professional Office / Retail	Houston-The Woodlands-Sugar Land	Memorial	710,000
Medical Office	Houston-The Woodlands-Sugar Land	Midtown	135,000
Medical Office	Houston-The Woodlands-Sugar Land	Sugar Land	130,000
Medical Office	Houston-The Woodlands-Sugar Land	Texas Medical Center	500,000
Medical Office	Houston-The Woodlands-Sugar Land	Texas Medical Center	450,000
Medical Office	Houston-The Woodlands-Sugar Land	Texas Medical Center	320,000
Professional Office	Houston-The Woodlands-Sugar Land	Texas Medical Center	275,000
Medical Office w/Non-Monetization of Land	Houston-The Woodlands-Sugar Land	Texas Medical Center	200,000
Professional Office	Houston-The Woodlands-Sugar Land	Westchase	1.5 million
Professional Office	Houston-The Woodlands-Sugar Land	Westchase	630,000
Professional Office	Houston-The Woodlands-Sugar Land	Westchase	500,000
Professional Office	Houston-The Woodlands-Sugar Land	Westchase	470,000