RESEARCH **2Q 2020**

HOUSTON OFFICE MARKET

Newmark Knight Frank

DOUBLE BLACK SWAN IMPACTS HOUSTON MARKET

Houston's office market like much of the US, was rocked by the impact of the COVID 19 pandemic. Additionally and possibly even more painfully, Houston's office market also felt the impact of a precipitous fall in oil prices. WTI prices fluctuated during the quarter and even while rebounding to nearly $40/bbl at quarter end, still helped trigger record levels of bankruptcy filings by oil and gas companies in the market. As companies continued to give back space, the quarter saw more than 1.1M SF of negative absorption. Rental rates remained flat, with only a 1 basis point rise in overall rents to $29.42 per square foot. The supply side construction increased by 435,893 SF of space across five buildings. The SARS-CoV-2 virus will continue to be a demand driver during the remainder of 2020 and into 2021 in the Houston office market. We discuss some of the possible economic ramifications in our Economy section. As more scientific data and governmental edicts are released, we will strive to relay and inform our clients and partners.

ALL SUBMARKETS IMPACTED BY COVID

After a staggering second quarter filled with work from home becoming the new normal during the COVID 19 crisis, office buildings across Houston are currently seeing occupancy levels between 10 and 30 percent. As companies begin to examine a post-COVID business world, the Houston office market is seeing the inklings of impact. Collectively the suburban submarkets ended the quarter with a negative 953,000 SF of absorption. In comparison, the CBD saw nearly 200,000 square feet of giveback. The vast majority of the negative absorption within the CBD occurred in the older stock of Class A buildings that still needed to be brought up to efficiency and layout standards. Within the suburban markets, the give back was evenly split between Class A and B stock. However, overall a flight to quality is still seen in many submarkets as Class B stock and lower level Class A stock are shown to have more cases of negative absorption than the premiere or Trophy Class A stock in the major submarkets. The overall absorption amount marked the sixth out of the past 10 quarters where Houston's office market saw more space given back than taken up and overall, the market has seen nearly 2/3rds of the past 20 quarters close with a negative absorption total. As a result of the increases in negative absorption, vacancy levels across Houston rose during the quarter and stand at 22.4% across all property classes, with Class A rates just a shade below that at 22.2%. Leasing activity during the past 90 days in Houston was extremely muted as many companies looked to reduce headcounts, control costs and examine the feasibility of a shift towards a more permanent work from home structure for much of their workforce.

CURRENT CONDITIONS

COVID 19 impact all sectors of Houston work-life

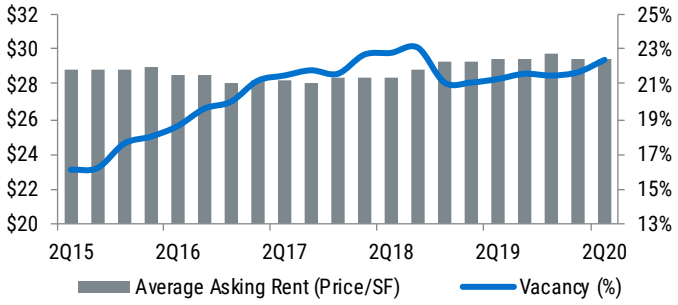
Only 30% of office occupancy has returned as economy reopens

Sublease market begins to add stock; still half of 2014 records

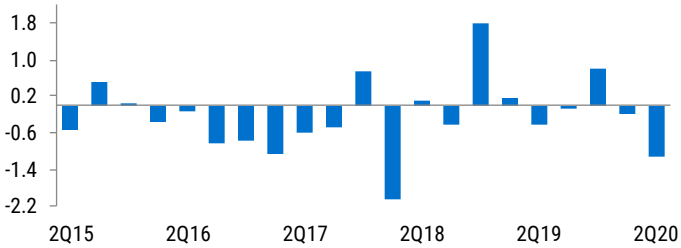
Leasing activity 1/4th of prior quarter mark

MARKET ANALYSIS

Asking Rent and Vacancy



Net Absorption (SF, Millions)



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	237.9 MSF	237.6 MSF	235.2 MSF	↑
Vacancy Rate	22.4%	21.7%	21.6%	↑
Quarterly Net Absorption	-1,141,062 SF	-193,379 SF	-737,612 SF	↓
Average Asking Rent	$29.42	$29.41	$29.55	↓
Under Construction	4.08 MSF	3.52 MSF	2.70 MSF	↓
Deliveries	5	4	5	↑

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Despite leasing activity falling off the pervertible cliff, one significant transaction did take place during the last few days of the quarter, when Occidental Petroleum, extended their Greenway Plaza headquarters lease for an additional five more years. This brings their 972,000 square foot lease through 2031 and solidifies, along with their nearly 800,000 square foot leaseback in the Woodlands, their dual headquarters within the market.

SUPPLY LINE REMAINS ACTIVE

In the construction pipeline, the market currently holds 4.08 MSF of space under construction, an increase of just over 500,000 SF from the prior quarter. Approximately seventy percent of this activity is distributed among the suburban submarkets, leaving a sizeable thirty percent of the market's construction localized in the CBD. Omitting the CBD, the Katy Freeway submarket holds the largest amount of space under construction with three buildings totaling 780,000 SF. Additionally, The Woodlands submarket is home to three buildings and over 700,000 SF of new construction as well.

OIL PRICES, BANKRUPTCIES AND DRY POWDER

Despite Houston's strides in diversifying it's economy in the past decades, for better or worse, oil and gas still drives much of the market and investors' perceptions of the city. As WTI has recovered nearly $70/bbl from its' quarterly low in the negative $30s/bbl, some oil and gas companies have stated that a prolonged pricing stabilization at $40 to $45/bbl would allow them to restart horizontal drilling. However, the prolonged exposure to low WTI pricing has caused a steady stream of oil and gas company bankruptcy filings to hit the Southern District and has begun to impact the Houston market. Fears that continued oil price instability will be present for the remainder of 2020 and into 2021 have investors monitoring if any large Fortune 500 companies within the city may be impacted on the same level as the smaller players.

With so much uncertainty, the investor sentiment in Houston is muted and the dry powder that is so often deployed on the "Energy Capital of the World" has stayed unlit. So far in 2020 Houston has recorded approximately $276 million dollars of transaction volume, with $115 million of that attributed to the disposition of Kirby Grove by JP Morgan and Midway to DWS Group Americas in the first quarter.

ECONOMICS: CONTINUED DOUBLE BLACK SWAN IMPACT FOR REMAINDER OF 2020

Coronavirus – Exogenous Shock

SARS-CoV-2 more commonly referred to as the Coronavirus, is a global health pandemic that has resulted in the halting of business and regular life as we know it. The efforts to contain the spread of the virus has led to a reduction in demand across the overall economy, with the exception of healthcare and few essential sectors. From reports published by the Brooking's Institute and the University of Houston's Bauer's Institute For Regional Forecasting (IRF), the sectors mostly likely to feel the impact from the demand reduction are passenger transportation, Hotel & Accommodation, Food & Drink, Entertainment, Retail, Education, and some professional services. Several local/state governments and employers have required that workers work remotely where possible and shuttering down factories where necessary. The public health response has disrupted the labor force in much of the country, leading to the potential for prolonged supply chain disruptions. As one company faces labor force issues as it tries to manage sick workers, its labor force issue becomes another's supply chain issue. As the condition persists the supply chain disruption can become a supply shock.

AVERAGE ASKING RENT BY SUBMARKET

Average Asking Rent ($/SF)

	Current Quarter	2Q19	12 Month Change
CBD	$39.76/SF	$41.28/SF	↓
Galleria/ Uptown	$35.87/SF	$35.87/SF	=
Allen Parkway/ Montrose	$29.35/SF	$28.60/SF	↑
Greenway Plaza	$34.72/SF	$31.81/SF	↑
The Woodlands	$33.28/SF	$30.09/SF	↑

VACANCY BY SUBMARKET

Vacancy Rate (%)

	Current Quarter	2Q19	12 Month Change
CBD	26.70%	26.00%	↑
Energy Corridor	26.50%	30.70%	↓
Galleria/Uptown	21.20%	18.50%	↑
Greenway Plaza	17.40%	16.60%	↑
Westchase	29.30%	28.0%	↑

Saudi-Russian Oil Price War – Supply Shock

Adding on to the economic headwinds facing Houston at the moment is the return of a low oil price environment. Early in March the OPEC+ talks broke down as tension between members Saudi Arabia and Russia came to a head. The organization failed to reach a deal and Saudi Arabia ramped up its oil production. A massive crude sell-off ensued resulting in oil prices plunging by 24% the following Monday. The surge in supply coupled with the demand reduction from the pandemic response placed the oil & gas sector into a new paradigm. Prior to the price war and Coronavirus, the major concern for the sector was issue of a potential credit crunch among the weaker operators. Now, with the low-price environment and the uncertainty exasperated by the pandemic the risk of a credit crunch is now spread across the industry. The Federal Reserve Bank of Dallas in their March edition of their Energy Survey highlights some of the challenging conditions that the sector is currently in. In their Business Activity index for the sector, they reported that Business Activity came in at a negative 50.9 in the first quarter, down significantly from the already negative reading of 4.2 in the fourth quarter.

The oil production index recorded 51 points decline into negative 26.4. Natural gas production also noted significant contraction dropping by 36.8 points to negative 21.2 in first quarter. Capital Expenditure and Expected level of Capital Expenditure Next Year, both barometers of future outlooks, contracted well within negative ranges. Majors such as ExxonMobil, Chevron and BP have all disclosed intentions to cut spending. Oil field services giant Halliburton has furloughed 3,500 workers in Houston and reports expect more reductions moving forward.

Ramifications For Houston

What this means for Houston's economy, unfortunately is not good. In the short to medium-term the IRF expects Houston to undergo a moderate recession. The Institute forecasts the metro losing approximately 44,000 jobs by year's end with short-term swings in employment and general business activity. Many reports predict the second quarter to be the most severe, but as the virus recedes and normalcy can return, the trend should quickly reverse.

LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Occidental Petroleum Corporation	Greenway Plaza	Greenway Plaza	Renewal	972,000
BDO	2929 Allen Parkway	Allen Parkway	New – Direct	45,063
Aximon Space	1290 Hercules	Clear Lake	New – Direct	32,000
Waste Management	800 Capitol	CBD	New – Direct	31,750
TDECU	14141 Southwest Fwy	Sugarland	New – Sublease	29,419
SPUR Energy Partners	9655 Katy Freeway	Katy Freeway	New – Direct	25,000

SELECT SALE TRANSACTIONS

Buyer/Seller	Building	Submarket	Sale Price	$/SF
Plains Capital Bank/Aque Investment Group	1500 S. Dairy Ashford	Katy Freeway	$5,500,000	$41
Plains Capital Bank/Steve Cairns	3838 N Sam Houston Pky E	Greenspoint	$5,000,000	$42
Altera/Norkus and Associates	12727 Kimberly Lane	Katy Freeway	$13,000,000	$203 (medical office)
Capital Commercial/Hewlett Packard	11403 Compaq Center West Dr.	FM 1960	Undisclosed	N/A

SUBMARKET STATISTICS

	Total Inventory (SF)	Under Construction (SF)	Total Vacancy Rate	Qtr Absorption (SF)	YTD Absorption (SF)	Direct Asking Rent (Price/SF)	Sublet Asking Rent (Price/SF)	Average Asking Rent (Price/SF)
CBD Total	**39,722,098**	**1,251,856**	**26.60%**	**-188,947**	**-467,478**	**$41.24**	**$20.91**	**$39.68**
Class A	30,370,044	1,251,856	24.30%	-209,614	-466,624	$43.98	$22.42	$42.68
Class B	8,682,771	0	35.90%	20,314	-15,103	$31.11	$20.55	$29.78
Allen Parkway / Montrose Total	**5,839,481**	**492,344**	**15.70%**	**-162,897**	**-182,344**	**$29.37**	**$26.92**	**$29.34**
Class A	2,219,879	492,344	15.30%	-169,922	-181,022	$35.50	$35.68	$35.51
Class B	2,959,864	0	3.90%	2,109	10,819	$24.78	$20.31	$24.74
Bellaire / Medical Center Total	**13,197,708**	**330,006**	**12.00%**	**-260,048**	**-168,825**	**$25.55**	**$22.55**	**$25.46**
Class A	4,921,037	213,506	11.00%	-218,059	-220,101	$30.96	$25.53	$30.50
Class B	6,870,857	116,500	13.50%	-37,099	100,392	$23.70	$13.81	$23.64
Clear Lake / SE Houston Total	**7,753,851**	**0**	**16.40%**	**7,243**	**17,933**	**$21.16**	**$18.60**	**$21.16**
Class A	2,115,825	0	16.80%	-11,889	-12.708	$26.01	-	$26.01
Class B	5,121,437	0	11.50%	19,325	39,200	$19.95	$18.12	$19.43
Conroe / Mont. Co. Total	**1,646,784**	**50,048**	**15.70%**	**13,567**	**-44,548**	**$25.17**	**$20.93**	**$24.36**
Class A	375,992	50,048	23.40%	0	0	$26.65	-	$26.65
Class B	1,073,097	0	1.60%	-13,567	-44,548	$24.59	$20.93	$23.34
East/ Pasadena / Baytown Total	**6,000,759**	**0**	**16.30%**	**82,912**	**92,715**	**$23.73**	**$28.66**	**$24.19**
Class A	464,926	0	29.70%	13,602	13,602	$38.73	-	$38.73
Class B	4,202,304	0	9.50%	44,959	66,919	$21.67	$28.66	$22.64
Energy Corridor Total	**22,104,454**	**0**	**26.30%**	**-220,270**	**-233,636**	**$29.33**	**$19.87**	**$28.64**
Class A	14,881,163	0	23.30%	-109,419	-275,430	$35.04	$26.55	$34.46
Class B	8,127,079	0	28.10%	-100,450	43,203	$22.30	$19.50	$22.15
FM 1960 Hwy 249 Total	**11,096,335**	**0**	**25.10%**	**-28,466**	**15,561**	**$21.11**	**$21.80**	**$21.17**
Class A	3,251,536	0	20.00%	28,020	13,195	$27.42	$22.05	$27.40
Class B	6,729,515	0	21.20%	-58,484	2,378	$18.34	$20.75	$18.44
Galleria / Uptown Total	**23,478,457**	**70,000**	**21.10%**	**-235,485**	**-316,355**	**$36.33**	**$23.98**	**$35.79**
Class A	18,446,900	0	22.00%	-220,872	-281,103	$38.04	$25.25	$37.47
Class B	5,210,630	70,000	9.80%	-15,579	-25,791	$26.75	$16.20	$26.32
Greenspoint / IAH Total	**11,497,940**	**0**	**48.90%**	**76,740**	**106,719**	**$18.79**	**$14.80**	**$18.77**
Class A	5,127,286	0	66.90%	-31,410	-11,095	$21.11	$11.50	$21.10
Class B	5,262,270	0	27.70%	106,993	117,245	$15.01	$10.05	$15.03
Greenway Plaza Total	**10,819,931**	**0**	**17.40%**	**47,603**	**49,034**	**$35.02**	**$28.41**	**$34.72**
Class A	6,781,494	0	18.90%	83,484	124,750	$37.75	$34.26	$37.31
Class B	3,693,313	0	6.50%	-35,998	-76,202	$29.55	$23.00	$29.10

SUBMARKET STATISTICS

	Total Inventory (SF)	Under Construction (SF)	Total Vacancy Rate	Qtr Absorption (SF)	YTD Absorption (SF)	Direct Asking Rent (Price/SF)	Sublet Asking Rent (Price/SF)	Average Asking Rent (Price/SF)
Katy Freeway East Total	**16,719,156**	**780,000**	**14.70%**	**-48,572**	**-76,427**	**$31.13**	**$30.80**	**$31.11**
Class A	8,021,449	780,000	15.60%	-10,777	2,990	$38.65	$32.68	$38.12
Class B	6,869,548	0	14.00%	-37,200	-79,393	$22.85	$20.35	$22.78
Katy Grand Parkway Total	**3,312,146**	**150,920**	**16.20%**	**781**	**-13,631**	**$29.10**	**$27.90**	**$29.04**
Class A	2,124,720	150,920	23.90%	-15,824	-19,735	$29.27	$29.27	$29.27
Class B	1,076,626	0	1.00%	16,511	6,309	$30.05	$20.92	$28.83
Kingwood / Humble Total	**1,394,017**	**39,106**	**11.40%**	**-13,351**	**-49,541**	**$23.42**	**$29.91**	**$24.31**
Class A	219,236	39,106	14.40%	1,500	1,500	$27.90	-	$27.90
Class B	1,074,366		1.85%	-14,805	-50,199	$22.25	$20.93	$21.80
Northwest Houston Total	**8,609,846**	**114,349**	**19.80%**	**-13,277**	**79,891**	**$21.47**	**$18.72**	**$21.43**
Class A	2,112,421	114,349	29.70%	21,866	69,995	$25.13	$19.79	$25.06
Class B	5,251,834	0	11.15%	-40,643	-10,643	$19.08	$24.00	$19.09
South Houston / SW Fwy Total	**12,250,787**	**48,000**	**19.60%**	**37,649**	**76,650**	**$17.60**	**$12.93**	**$17.58**
Class A	2,259,183	48,000	20.90%	-1,444	15,865	$18.35	-	$18.35
Class B	8,008,646	0	19.30%	39,231	60,555	$17.75	$12.93	$17.72
Sugar Land / E Fort Bend Total	**6,776,805**	**0**	**14.00%**	**-56,729**	**-83,541**	**$29.07**	**$17.17**	**$27.13**
Class A	3,821,835	0	12.70%	-50.394	-49,598	$32.80	$16.72	$28.76
Class B	2,800,313	0	15.20%	-6,305	-40,487	$25.20	$21.00	$24.89
West Belt Total	**5,429,953**	**0**	**25.90%**	**-124,053**	**-250,995**	**$25.83**	**$12.29**	**$24.89**
Class A	3,561,997	0	25.00%	-16,417	-155,448	$27.25	$15.00	$27.20
Class B	1,681,287	0	12.00%	-101,398	-90,988	$21.45	$12.00	$19.50
Westchase Total	**14,882,572**	**0**	**29.30%**	**714**	**-164,015**	**$28.17**	**$22.29**	**$28.00**
Class A	8,059,509	0	31.20%	81,184	-4,588	$34.88	$27.66	$34.62
Class B	6,648,113	0	20.40%	-79,532	-159,544	$22.00	$18.70	$21.92
The Woodlands Total	**14,756,360**	**702,938**	**15.90%**	**-92,650**	**17,059**	**$34.02**	**$28.93**	**$33.15**
Class A	9,464,478	137,938	13.60%	-73,201	96,499	$36.77	$29.65	$35.02
Class B	4,867,513	565,000	7.75%	-19,211	-78,205	$31.68	$22.73	$31.26
Suburban Total	**197,530,056**	**2,826,066**	**21.50%**	**-953,000**	**-938,148**	**$27.01**	**$23.36**	**$26.84**
Class A	98,147,214	1,973,086	22.80%	-486,504	-187,895	$32.03	$26.17	$31.78
Class B	87,479,744	266,939	21.00%	-463,376	-751,095	$21.52	$20.94	$21.50
Houston Market Total	**237,900,128**	**4,077,922**	**22.40%**	**-1,142,062**	**-1,335,441**	**$29.75**	**$22.62**	**$29.42**
Class A	127,560,589	3,224,942	22.20%	-506,118	-655,260	$35.24	$25.03	$34.69
Class B	96,162,515	852,980	22.40%	-635,944	-680,181	$22.40	$20.86	$22.34

SELECT TEXAS MARKETS- LARGEST SUBMARKETS

Houston, June 2020

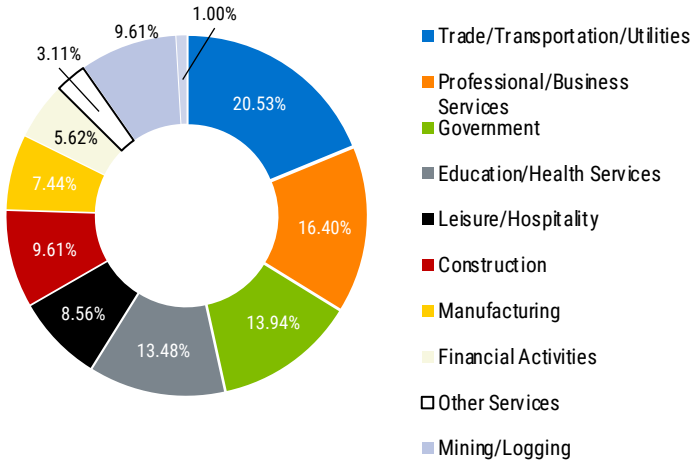
Top 10 Submarkets by Rentable Square Feet

Rank	Submarket	RSF
1	Far North Dallas	61.1 M
2	DFW Las Colinas	41.6M
3	Houston CBD	39.7 M
4	DFW Richardson/Plano	35.1 M
5	Dallas CBD	31.2 M
6	DFW Mid-Cities	28.0 M
6	HOU Galleria/Uptown	23.4 M
7	HOU Energy Corridor	22.4 M
9	DFW LBJ Freeway	21.7 M
10	Austin Northwest	18.4 M

Source: Newmark Knight Frank

EMPLOYMENT BY INDUSTRY

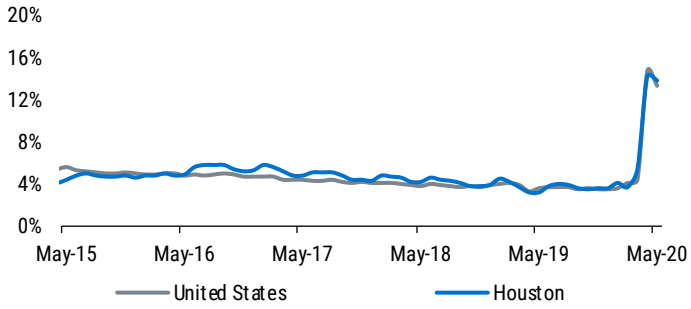
Houston, May 2020



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

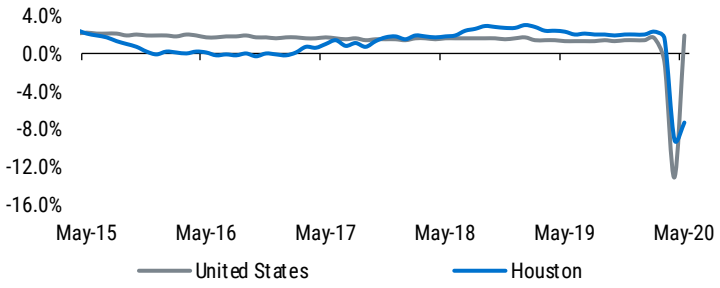
Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

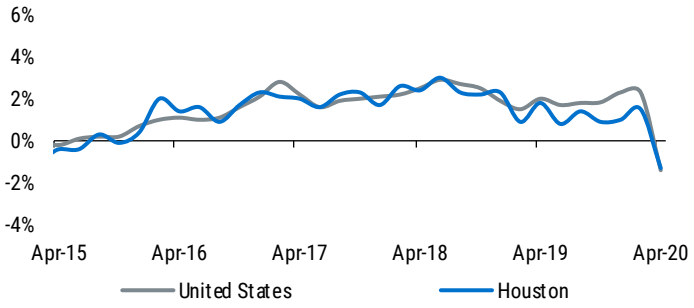
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

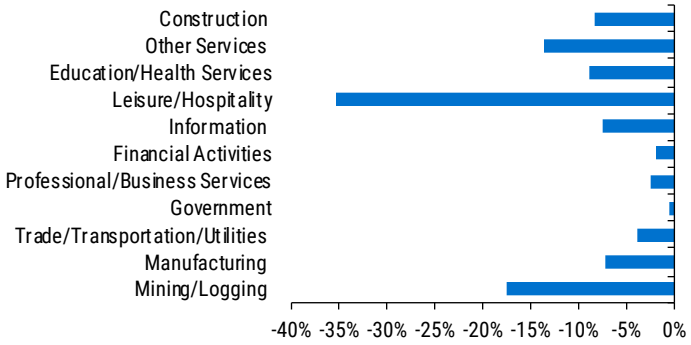
All Items, 12-Month % Change, Not Seasonally Adjusted



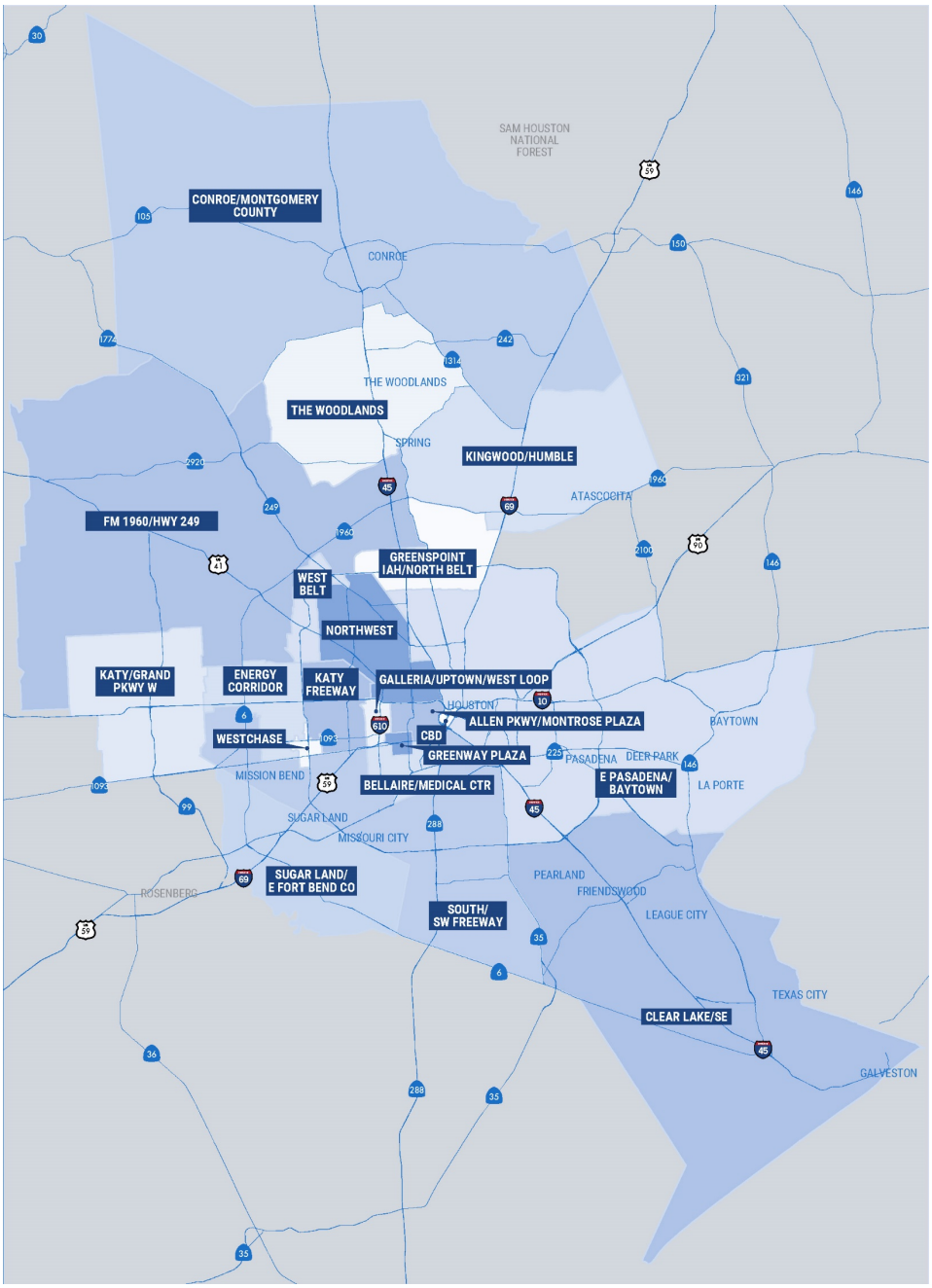
Source: U.S. Bureau of Labor Statistics

EMPLOYMENT GROWTH BY INDUSTRY

Houston, April 2020, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics



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