THOUGHT LEADERSHIP SERIES

# POWERFUL PUNCH OR CASUAL TAP?

## AN OVERVIEW OF HOUSTON'S SUBLEASE MARKET

Newmark Grubb
Knight Frank

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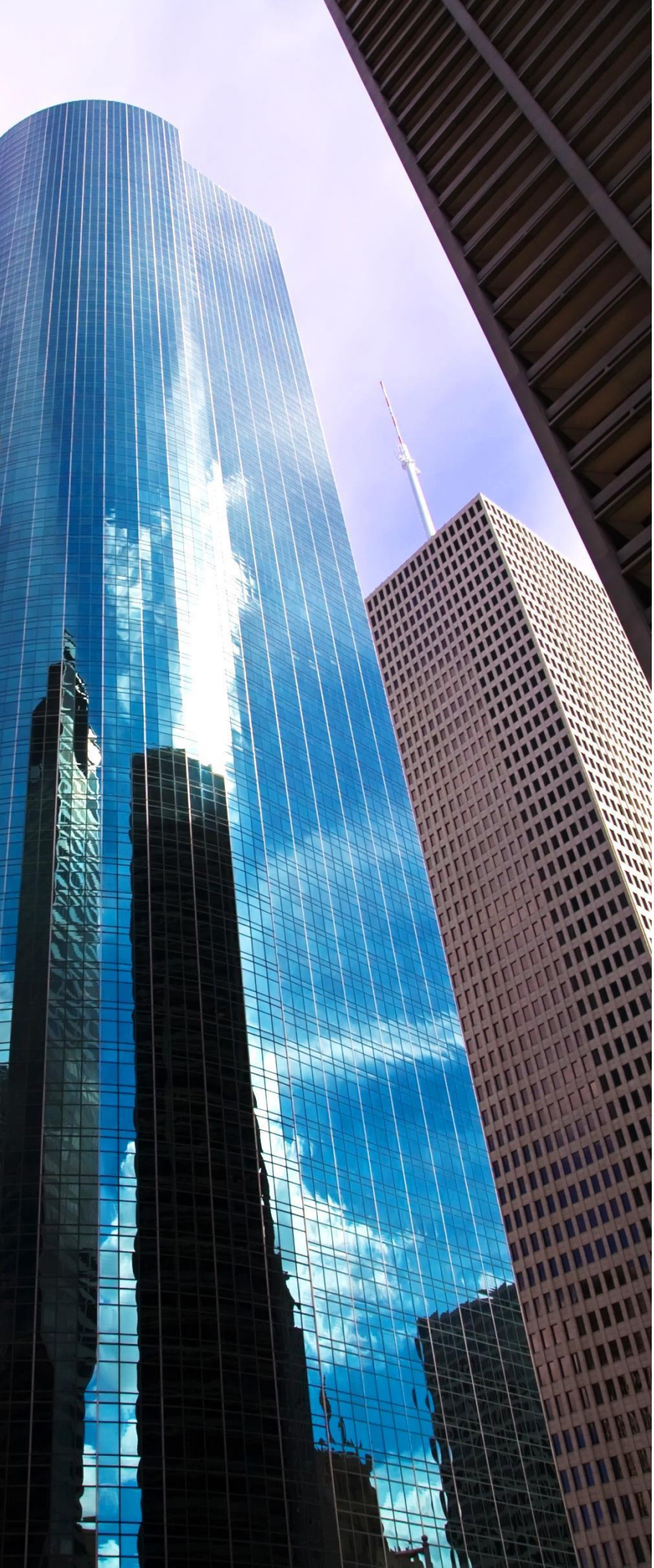
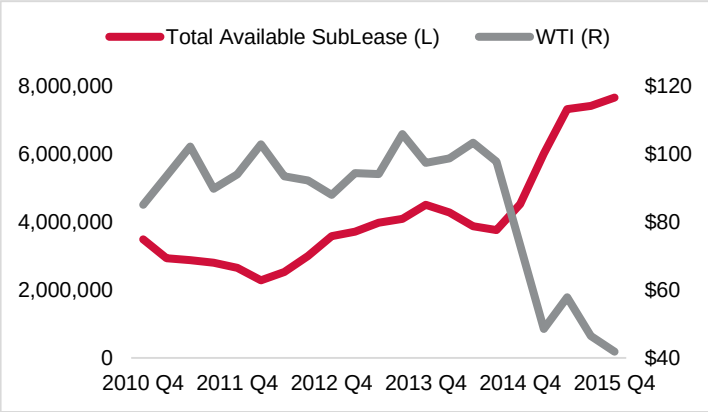


## OVERVIEW

There's no shortage of sublease office space within the City of Houston, thanks in part to lower oil prices and the prevalence of expansion plans cut short. By most accounts, lower oil prices are expected to stick around for some time, prompting questions about the vigor of the sublease market—and its subsequent impact on the market as a whole. To look ahead, we must first take a peek into the past.

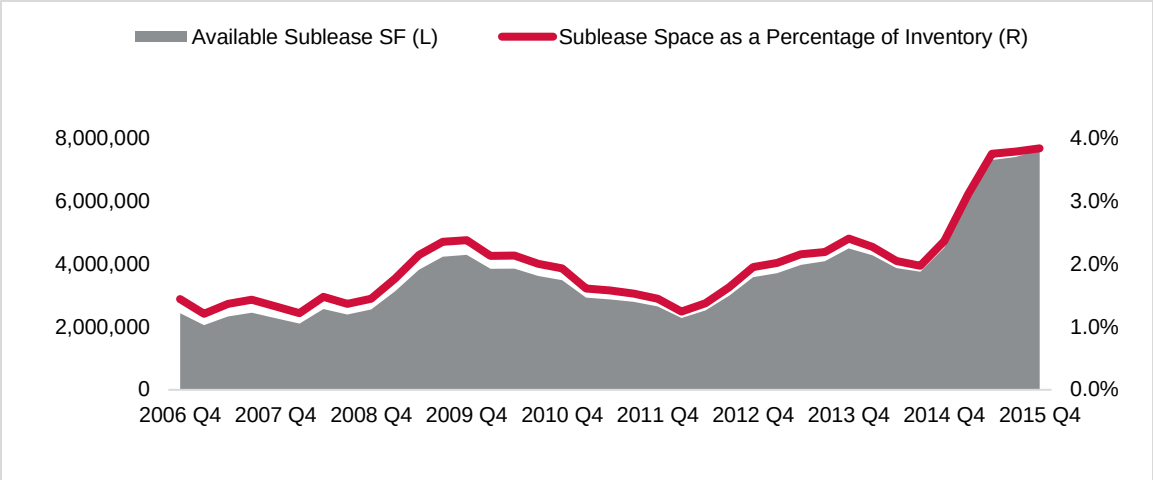
The run-up in available sublease space actually began in 2013, when companies had to factor much higher oil prices into their future plans, and accelerated with the downturn in the energy sector. By the end of 2015, the amount of available sublease space had increased to 7.7 million square feet, up from 4.5 million square feet just one year earlier. But we're not finished yet. Looming bankruptcies and an anticipated spike in M&A activity suggest the sublease market has yet to peak.

### AVAILABLE SUBLEASE SPACE V. WTI



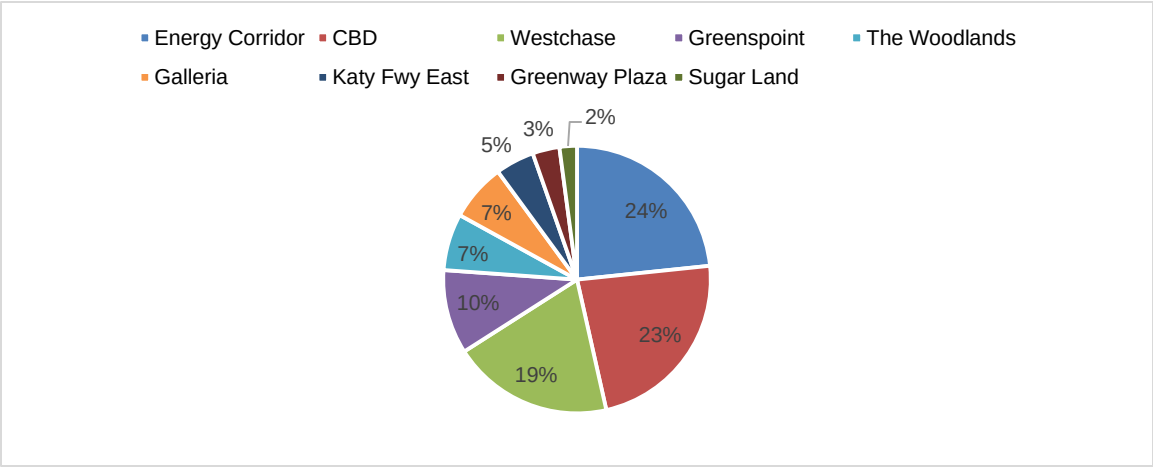
Houston's sublease market now accounts for 3.8% of total inventory, the highest level on record. Would you be surprised to learn that most of that sublease space is Class A product, which includes 11 blocks of contiguous space in excess of 100,000 square feet? All told, Class A product makes up 77% of the sublease market and represents 12.5% of all space currently being marketed for lease. In other words, the size of the sublease market and potential impact creates an interesting paradigm shift for both landlords and tenants.

## HOUSTON OFFICE SUBLEASE MARKET



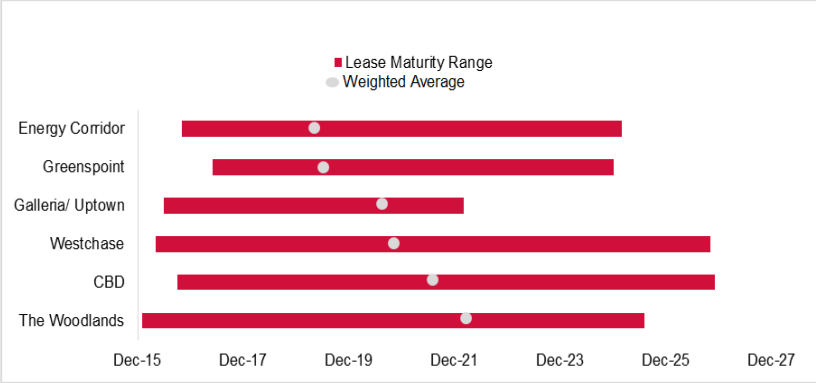

While we're referring to Class A sublease space across Houston, it's important to note not all submarkets will be impacted equally. The bulk of the sublease market is concentrated in the Energy Corridor, Central Business District and Westchase submarkets—highly desirable, work-live areas that are important to the overall health of the market. A dramatic increase in the sublease space of any of these submarkets has the potential to greatly impact the direct market, as competition for tenants heats up and/or as sublease space is returned to the landlord. However, the extent of competition between direct and sublet space depends on several key factors, namely the condition of the sublease space, the credit of the sub-landlord, the length of remaining term on the original lease and, of course, price.

## CLASS A AVAILABLE SUBLEASE SPACE

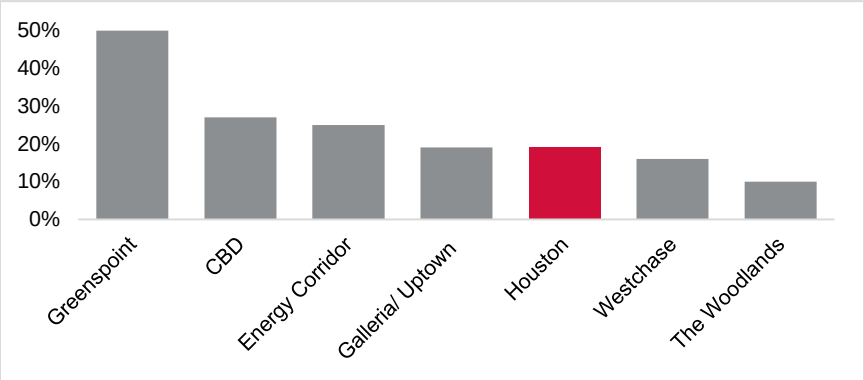


Condition of space and creditworthiness of the sub-landlord are hard to quantify holistically, but term and price are concrete. Consider this: At the end of 2015, the remaining term was four years within the Class A sublet market, on a weighted average basis. And, for the 11 big blocks of Class A contiguous space in excess of 100,000 square feet, the remaining term was roughly the same at four years. However, by submarket, the remaining term on the original lease ranged from roughly three years in the Energy Corridor to six years in the Woodlands. All else being equal, this suggests a more immediate impact in the Energy Corridor relative to The Woodlands, where landlords will be more resistant to cut asking rents until they have to.

### REMAINING TERM FOR SELECT SUBMARKETS




### ASKING RENT DISCOUNT FOR CLASS A SUBLEASE SPACE RELATIVE TO DIRECT SPACE AS OF 4Q15

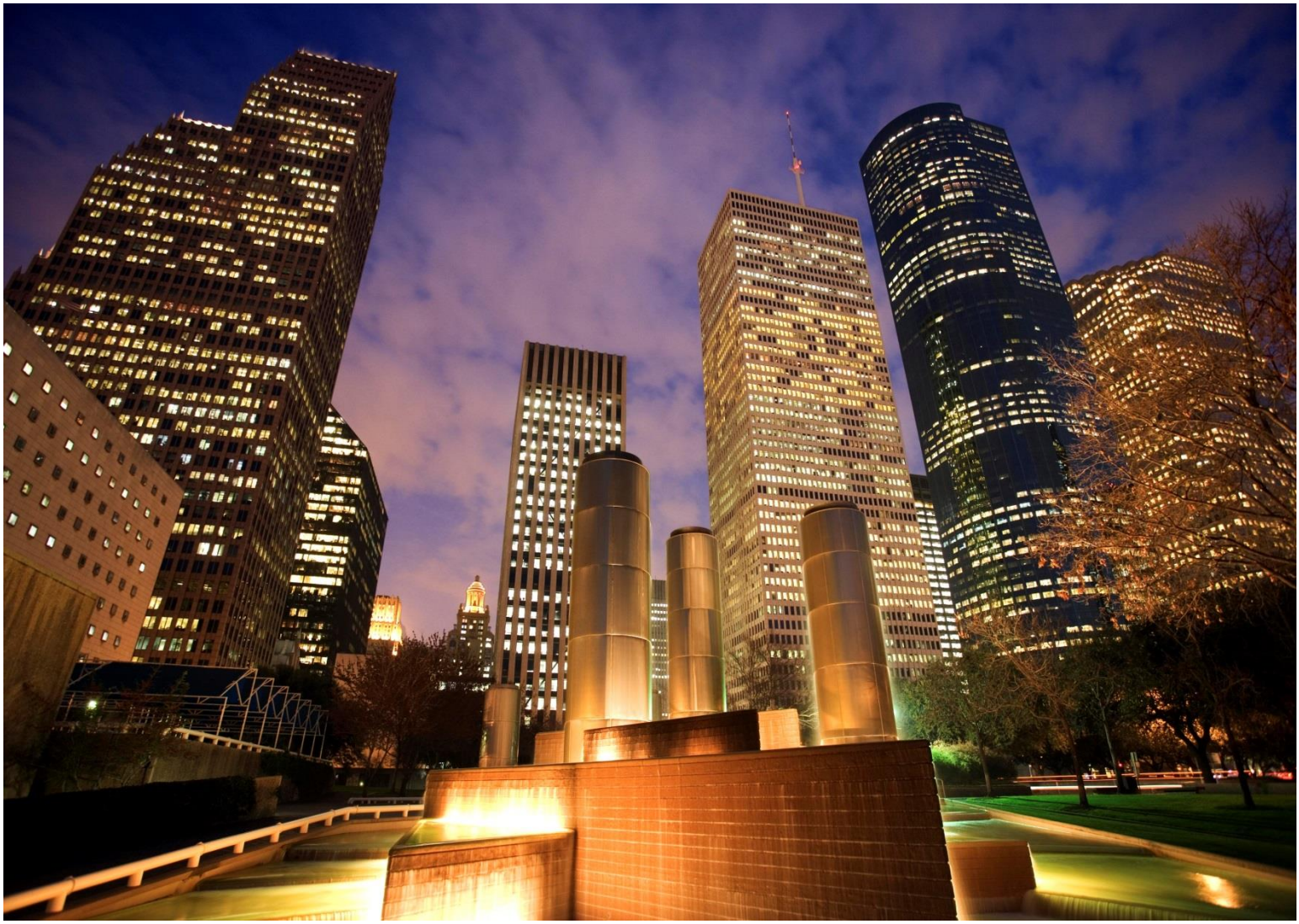



## LET'S TALK ASKING RENTS.

For Houston's office market, we are currently in a transition period where direct asking rents remain sticky, but expectations for the future are rapidly changing. One example of this trend is the increasing discount between direct and sublease asking rents. In Houston, the average discount for sublease space relative to direct space was 19% at the end of 2015, compared with 12% a year ago. Furthermore, as companies aggressively seek to reduce operating expenses, the discounts were even greater in Greenspoint (50%), CBD (27%), and Energy Corridor (25%).

## WHAT DOES IT ALL MEAN?

In short: It's a tenant's market. The current weakness in the market represents an opportunity to visit with a real estate consultant to reduce expenses, re-negotiate, or simply lock in favorable lease terms. Whether your company is facing a near-term lease expiration, is rapidly growing, or on a mission to downsize, the real estate professionals at Newmark Grubb Knight Frank can develop customized, creative strategies that best suits your needs. If history is our guide, now is the time to take decisive action, because the market tends to snap back quickly.



## FOR FURTHER INFORMATION, PLEASE CONTACT:

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