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ANALYSIS

Office: Constrained Space, More Construction

By **Amy Wolff Sorter** | Houston

One Hughes Landing in The Woodlands.

HOUSTON-Anyone traveling around the region on any given day, whether driving west on Interstate 10 near Katy, TX or moving far north of the CBD on Interstate 45 to The Woodlands, will see a lot of cranes. The reason for those cranes is that demand for office space in those and other submarkets has led to a variety of construction launches – and experts tell **GlobeSt.com** to expect more of that to happen in 2013.

Within the past several months, ground has broken on the 450,000-square-foot Energy Tower III on the far west side along Interstate 10 and the 197,000-square-feoot One Hughes Landing in The Woodlands – both buildings are scheduled for a 2014 delivery. **Redstone Cos**. and **Stream Realty Partners LP** launched construction on a 320,000-square-foot building in the Galleria submarket, of which **BBVA Compass** is the anchor tenant while, less than a mile away, **Skanska USA Commercial** broke ground on a 302,000-square-foot speculative office building.

This has been one the year's surprises, in fact – spec space going north in the Galleria. "There hasn't been new construction there since the early 1980s, and that's a pretty big deal," **observes Michelle Wogan, Transwestern's** executive vice president. "Of the new product that's under construction, about half of it is already leased – and it's not even completed yet."

There is good reason why the climbing crane could be considered Houston's official "city bird" both now and into 2013. **Edna Meyer-Nelson**, founder, president and CEO of **Richland Cos**. in Houston noted that demand for the office space can be attributed to growth areas in Houston, most notably, energy and medicine. "The private sector is finally getting wind of things and deciding what they need to do about space," she adds. As a result, "the trend is that tenants are renewing if they can, they're expanding if they can, and building if they can," Wogan remarks.

This speaks to one issue the region is facing, that of space constraint. "You're not seeing much new development, especially when you compare it to the demand right now," remarks **Ryan Bishop**, managing director-office with Stream Realty Partners. "It's tough to get a construction loan without preleasing, and that's what's causing imbalance in supply and demand, and that's favoring the landlords."

Trammell Crow Co.'s city leader and senior managing director of Houston development and investment division **Jim Casey** points out that some of the space taken is due to consolidation of older, multiple leases into single locations. Wogan also points out that the demand growth can be attributed to the 70,000 new jobs created in the Houston area. Those jobs, she goes on to say, will lead to an estimated 4 million square feet of net absorption during 2012. "We had the second-lowest vacancy in the U.S. during the past year," she explains.

This has meant a slow shift to a landlord market, especially when it comes to class A and B product. "It's resulting in more return leases, fewer concessions and more security than in the past," Bishop says. "That's been cause for some pretty impressive sales comps on the cap rates and per square foot numbers in major markets with long-term leases."

But not all investment is rosy. Meyer-Nelson points out that the focus isn't so much on the value-add opportunities – what she calls the "bottom feeders" – as much as investors want the properties with less risk. "They're not buying value-add as they did two or three years ago," she says.

The experts note that things will be a little shaky during the early part of 2013, as fallout from budget discussions in Washington continue. "People are wanting to get the first quarter behind them," Meyer-Nelson remarks. "Everyone knows they made it through the difficult years, but aren't eager to go jumping off the deep end and taking more risks just yet."

Wogan and Casey believe that, if the energy sector remains strong, the office sector will continue to see dropping vacancies and increasing rents, especially as companies move toward consolidation and better efficiencies.

Bishop agrees, pointing out that once new development in the Gallera, on the west side and even in The Woodlands starts leasing up, landlords with existing product will start pushing rental rates. This, in turn, will likely lead to even more construction, he added.

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