



2018 MARKET OUTLOOK

Houston Commercial Real Estate

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ATTORNEYS AT LAW

Friends,

We've been hosting the annual BoyarMiller Real Estate Forum for a long time bringing together market experts who share their insights and knowledge about the industry. Throughout the years, there have been up cycles and downturns affecting this important sector of our economy. Admittedly, it was much more exciting to hear an optimistic panel reveal several 2018 positive trends in commercial and industrial real estate.

The goal of our breakfast forums and this eBook is to share information and knowledge because we believe continuous learning is one of the keys to success in life, no matter what you do. It is one way we spotlight the trends that impact the Houston business landscape and may affect your business directly.

This edition of our eBook summarizes the 2018 market outlook for Houston's commercial real estate industry as presented by Jimmy Hinton with HFF, Jonathan Brinsden with Midway Companies, and John Nicholson of AVERA Companies. We thank them for sharing their wisdom as we all breathe a collective sigh of relief that the forecast for Houston's commercial real estate market is excellent.

Feel free to forward this eBook to others who may find the information of value. And let us know how we can help you reach your goals for this year and beyond.



My best,

Chris Hanslik

CHRIS HANSLIK
Firm Chairman

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TABLE OF CONTENTS

- 03 : The Breakfast Forum Snapshot
- 04 : Houston Commercial Real Estate At-a-Glance
- 05 : Expert Insights
Houston Real Estate Overview
Office Market and Mixed-Used Development
Industrial Real Estate
- 08 : Attorney Insights
Houston — A Tale of Two Cities: Through the
Looking Glass of Residents and Outside Investors
- 10 : BoyarMiller Real Estate Practice Leaders
- 12 : BoyarMiller Real Estate Attorneys



The Breakfast Forum Snapshot

If there was anything good that came out of the financial crisis, it was lower leverage, more equity, says Jonathan Brinsden

@MidwayCompanies
#CRE forum @boyarmiller

KATHERINE FESER
Houston Chronicle
<https://twitter.com/kfeser>



As 2018 began, institutional investors are focused on Houston again, while the industrial and multifamily markets still have room to run.

MICHELLE LEIGH SMITH
RealtyNewsReport
<http://realtynewsreport.com/2018/01/18/out-of-the-deep-freeze-houston-real-estate-is-heating-up-in-2018/>



In 2018, 'there's so much capital earmarked for real estate' in Houston.

CARA SMITH
Houston Business Journal
<http://bizj.us/1pgv0w>





Houston Commercial Real Estate At-a-Glance

\$150 billion



Capital in the U.S. ready to be deployed for office investment

TAKEAWAY:
there is so much capital earmarked for real-estate

only 3 percent



Amount of all retail spending done online in U.S.

TAKEAWAY:
brick and mortar still has a place in retail!

15 percent



Growth in container shipping from the Port of Houston

TAKEAWAY:
and will continue to increase over next couple of years as more petrochem plants come online

8,000



Number of available multifamily units in Houston

TAKEAWAY:
but we still need 15,000 units a year to meet Houston's expected rental growth to 2030



Expert Insights



ABOUT JIMMY

Jimmy Hinton serves as Managing Director of HFF and is responsible for the firm's research efforts. He works with the executive management team to assist in investor relations and to inform both HFF staff and firm clients with in-depth analysis of economic, property and capital market trends. He also provides extensive market reports, presentations and deal-specific analysis for debt placement and investment sales assignments.

Houston Real Estate Overview

JIMMY HINTON

Managing Director, Research, HFF

- When you step back, you can see our market more clearly. There is a lot of capital earmarked for commercial investment in Houston.
- Pure play online retail is the hockey stick in terms of growth. It accounts for three percent of retail spending, which is not very much. There is a long way to go before brick and mortar retail is exposed fully.
- We are seeing obvious signs of retail weakness in some regional malls. However, experiential retail outperforms the industry. The average return from an online purchase to a retail store results in 140 percent of the spend. That is creating top-line revenue growth.
- There is a larger market for residential growth among baby boomers as they consider high-end multifamily property.
- Co-working space is a trend that affects all asset classes. A lot more people work for themselves or in small businesses and want nimbleness and flexibility. Commercial real estate needs to adapt to operate assets that accommodate this big trend.

“There is tremendous opportunity in Houston. We are quite bullish for 2018.”



Expert Insights



ABOUT JONATHAN

Jonathan Brinsden is CEO of Midway Companies and guides its overall business strategy and operations.

He is member of the Urban Land Institute Board of Directors, Board of Trustees and the Governance Committee, and past Chair of ULI Houston. He is also a board member of NAIOP and an active member of International Council of Shopping Centers.

“A lot of positive things are happening as we look forward.”

Office Market and Mixed-Used Development

JONATHAN BRINSDEN
CEO, Midway Companies

- Hurricane Harvey did not have a long-term impact on commercial real estate with most ground-level damage repaired by the end of 2017.
- The office market will be better than last year. There is still a lot of sublease space in the market, although it is dwindling or being absorbed as direct space.
- In the past, mixed-use was looked at as risky, so capital was skeptical. Now, those with capital understand the trends of what an office or multifamily tenant wants. We'll see more people willing to engage and invest in mixed-use.
- The multifamily market has weathered the oil and gas downturn and is improving as units are absorbed. Developers have managed the number of units so the sector does not have a black eye to investors.
- By 2030, Houston is expected to have 3.8 million more renters, which means we need 15,000 more units a year to accommodate growth. Starting new multifamily development today with a delivery window of 2-3 years is attractive.
- Urban residential was being built for millennials but the average age in these upscale units is much higher than expected. It has transitioned from renting by necessity to renting by choice.



Expert Insights



ABOUT JOHN

John Nicholson serves as Executive Vice President of Development at AVERA Companies. Over the last 16 years, he has negotiated more than 700 transactions providing in excess of \$750 million in transaction value.

Industrial Real Estate

JOHN NICHOLSON

Executive Vice President, AVERA Companies

- Vacancies in Houston's industrial market hover around six percent, which is great. We will continue to see positive lease activity for both petrochemicals and consumer products.
- The big story now is the trend for more warehouse amenities. Tenants are requesting larger truck ports, higher ceilings and more office area. Some of the buildings that were built in the 1980s are not satisfying those demands. So many of them will be redeveloped going forward.
- Industrial market expansion continues in 2018 because shippers have changed their routes with the expansion of the Panama Canal. One example: Best Buy announced a large transaction and those type of big-box retailers will continue to come through Houston.
- In 2018, it's a race among industrial developers to identify developable sites.
- Petrochemical exports out of the Port of Houston is still in its early stages and will only get stronger as more plastic resin plants come on line.

"2017 was a great year for absorption in the industrial market."



Attorney Insights

Houston — A Tale of Two Cities: Through the Looking Glass of Residents and Outside Investors

LYNDSAY FINCHER
Associate, Business Group

BLAKE ROYAL
Shareholder, Business Group

“If you change the way you look at things, the things you look at change.” –Wayne Dyer

With everything that has occurred in Houston over the past few years, it can be difficult for its residents to understand the opportunities that are seen by those viewing the city from the outside. Houston can be characterized as the tale of two cities: the city seen from the perspective of its residents versus the city seen from the perspective of outside investors. For those of us living in Houston, many experienced first-hand the effects of the energy downturn and Hurricane Harvey, which resulted in vacant office buildings, retail and multi-family in the Energy Corridor and flooded residential homes. As a result, it is understandable that some Houstonians have a pessimistic view of our current situation, a World Series championship notwithstanding.

However, for those outside of the city, Houston is an attractive investment opportunity and investors are speaking with their dollars. For them, Houston is a good value-add proposition for many types of real estate—, including industrial and multi-family, while the office and retail segments are adapting to new challenges.

INDUSTRIAL

The industrial market is currently Houston’s most dynamic market segment, with explosive growth in development over the past five years. Developments that, in the past, might have gone to Dallas, Los Angeles, Chicago or Atlanta have come to Houston. The developments are also getting larger; where the average square footage of projects was approximately 35,000 sq. ft. just a few years ago, the average size has essentially doubled to approximately 70,000 sq. ft. in recent years.

The explosion in the industrial market is driven by a number of factors: the expansion of e-commerce, new housing development and redevelopment in the Greater Houston area, the expansion of the Panama Canal, and new petrochemical plants and refineries coming online. An unlikely foe, Harvey, has resulted in major retailers such as Home Depot and Lowes opening new distribution centers to serve the need for increased housing materials. One of the biggest changes in the industrial market is the expansion of requested amenities, ranging from higher ceilings to wider column spacing. In addition to the new development, Houston can expect to see redevelopment of older buildings to meet tenants’ demands.

With all of the growth in the industrial market, sites are becoming harder to find in rail-served areas such as Baytown, LaPorte and Deer Park. Whereas industrial was once the highest and best use of land in those areas, there is now competition for multi-family and single-family residential developments. In response to the scarcity of

land, developers are looking beyond traditional, rail-served industrial areas to Katy and Brookshire, which are further from downtown, the Port of Houston and railyards.

MULTI-FAMILY

It may come as a surprise that Houston may actually be on the precipice of an undersupply of multi-family units in light of the numerous new developments that have been delivered in the past few years. As the number of new projects has slowed, the excess units have been absorbed and the market is stabilizing. With fewer new units slated to come into the market over the next few years and the high projected growth of Houston's population, the existing multi-family units will quickly be absorbed.

Interestingly, while many of the new multi-family projects included higher-end amenities targeted towards millennials, these developments are in fact attracting older generations who enjoy the amenities and, in mixed-use developments, the ability to walk to restaurants, stores, and other destinations right outside of their front door.

OFFICE

The Houston office market continues to face challenges, but while some are unique to Houston, many are the same challenges being addressed in markets worldwide. A challenge that is particular to Houston is the oversupply of sublease space, which is a remnant of the drop in oil prices that left a glut of unused office space. While the sublease market may be healthy, subleases do not impact the overall net absorption of office space.

Now that oil prices are stabilizing – hopefully, for the long run – we are seeing a secondary effect on the office market. This effect is being seen on a national and worldwide level: companies are changing the way they are structured, which is changing the use of their offices. Business owners, especially small business owners, are hesitant to commit to long-term or large-scale leases because their use will fluctuate. In addition, companies are utilizing more contract labor than before, which allows their workforce to constrict and expand to meet their needs. The net result is that leases are for smaller spaces and shorter timelines.

From an investment standpoint of a small business owner, a 10-year lease may seem too risky, but a shorter lease, or even a month-to-month lease, may be an easier commitment. At the extreme end of this shift is the rise of flexible collaborative office space providers, such as WeWork and Spaces. With all of these perceived challenges, however, Houston is seeing an increased investment in its office market from institutional investors, which speaks to the confidence that those outside of Houston have in the region.

RETAIL

The story in retail continues to be impacted by e-commerce. There continues to be a vast sales gap between e-commerce and brick-and-mortar stores, but it is a shrinking one, and savvy retailers (and retail developers) are making adjustments to account for this growing challenge. Consumers who enjoy the experience of high-end shopping will continue to go to the stores they enjoy, but those retailers are making adjustments to ensure that their customers continue to enjoy shopping in an interactive way.

For day-to-day items like diapers and dog food, however, consumers are increasingly turning to online, automatic delivery options. In response, retailers are integrating automated and online interfaces with their physical locations, such as grocery stores providing internet ordering and curbside pick-up, and soft goods retailers providing for more easily accessible in-store returns for items purchased online. The rise in online purchases will also have other effects, such as smaller footprints for “big box” retailers, and the rise of “lifestyle” centers that provide experiences rather than mere shopping.

CONCLUSION

Houston is overcoming its perception as a city whose economic health is solely tied to the price of oil. Despite all of the recent travails our city has dealt with – and continues to deal with – there are many reasons to be optimistic about the Houston real estate markets and to see ourselves as others see us – a great real estate opportunity.

Real Estate Practice Leaders



BILL BOYAR

Founding Shareholder, Business Group

Bill's practice focuses on representing parties involved in the acquisition, disposition, capitalization and financing of assets and businesses on a national and international level. He has served as lead counsel on numerous complex, multi-party acquisitions and project financings, with significant experience in corporate finance, private equity, mergers and acquisitions, real estate and hospitality.



LEE COLLINS

Shareholder, Litigation Group

The goal of Lee Collins' practice is to provide innovative and value-driven solutions to the litigation-related problems facing the client. This objective has been successfully achieved through his direct and open communication with the client, an early and immediate assessment of the issues, strategic evaluation of the problem and its solution, and aggressive representation.



BLAKE ROYAL

Shareholder, Business Group

Blake's practice includes acquisitions and dispositions of equity and assets, including recapitalization transactions with venture capital and private equity funds; entity and capital formation, including private placements, in domestic and international jurisdictions; and general contractual drafting and negotiation.



HILARY TYSON

Shareholder, Business Group

Hilary Tyson’s practice focuses on commercial real estate and business transactions. She joined the firm and returned to Houston in June 2015 after practicing in the Dallas area for more than 11 years. She represents developers, home-builders and equity investors in a wide range of real estate related transactions including land acquisition and dispositions, residential subdivision development, financing, entity formation, and office development and leasing.



CASSIE STINSON

Senior Counsel, Business Group

Cassie Stinson’s practice is focused on commercial real estate and finance, public/private projects, business transactions and public law, with a particular emphasis on complex projects and multi-party transactions. She handles real estate acquisitions and dispositions; leasing; project structuring, development, design and construction; formation of business and non-profit entities, corporate governance, and business contracts; and foreign investment in US real estate and businesses.



Real Estate Attorneys

**ROBERT ARTHUR**

Associate, Litigation Group

Robert Arthur clerked with BoyarMiller during law school and then joined the firm in 2014. He has represented clients in a wide variety of business and commercial disputes. Robert has represented developers of commercial properties in disputes against contractors or breach of contract.

**KASI CHADWICK**

Associate, Litigation Group

Kasi Chadwick's practice spans the full gamut of commercial and business litigation and includes business torts, contracts, trade secrets, non-compete agreements and other employment-related disputes. Licensed in Texas, Kasi practices in both state and federal courts pursuing everything from emergency injunctive relief to the finalization of suits through post-judgment and appellate matters. She also pursues her client's litigation goals through alternative dispute resolution vehicles such as mediations and arbitrations.

**CYRUS CHIN**

Associate, Business Group

Cyrus Chin has been with the firm for five years. His practice consists of representing clients in a broad range of corporate matters, including complex merger and acquisition transactions, corporate formation and restructuring, corporate governance, real estate transactions, contract negotiation and other general business matters.



CALEB DUNSON

Associate, Business Group

Since joining BoyarMiller in 2017 after participating in the Summer Associate Program, Caleb Dunson has been involved in a wide range of corporate and real estate matters. His practice includes representing foreign and domestic clients in general business matters, corporate formation and restructuring, complex mergers and acquisitions, leasing and land acquisition, disposition and development.



LYNDSAY FINCHER

Associate, Business Group

Lyndsay Fincher has been with BoyarMiller since 2013. Her practice is primarily devoted to representing companies and individuals in a wide range of corporate and real estate matters including private securities, complex mergers and acquisitions, corporate formation and restructuring, leasing and land acquisition, disposition and development.



MOLLY HUST

Associate, Litigation Group

Molly Hust joined BoyarMiller's Litigation Group in August 2015 after participating in the firm's Summer Associate Program. Molly's practice is primarily focused on serving clients in a wide range of complex commercial and employment law disputes. Molly successfully represented a mixed-use real estate developer in claims for breach of contract, breach of warranty and construction defect against its former general contractor involving substantial water infiltration in two luxury apartment buildings.



TAYLOR LAMB

Associate, Business Group

Taylor Lamb joined BoyarMiller in 2016. Her practice consists of various corporate and real estate matters including entity formation, corporate governance, acquisitions and leasing. She has represented various landlords and real estate developers in office and retail lease negotiations with national chains and local tenants.

**CRAIG LAUCHNER***Associate, Litigation Group*

Craig joined BoyarMiller's Business Group in September 2016 after participating in the firm's Summer Associate program. His practice consists of representing clients in a wide range of business, commercial, and employment disputes.

**ALEX PARKER***Associate, Business Group*

Alex Parker joined BoyarMiller last year. Her practice is primarily devoted to representing clients in a broad range of corporate and real estate transactions including complex mergers and acquisitions, corporate formation and restructuring, corporate governance, leasing and land acquisition.

**CORINNE SULLINS***Associate, Business Group*

Corinne Sullins joined BoyarMiller in 2016 after participating in the firm's Summer Associate program the previous year. Her practice consists of representing clients in a broad range of corporate matters, mergers and acquisitions, corporate formation and restructuring, corporate governance, real estate transactions, contract negotiation and other general business matters.