



Published by:
O'Connor & Associates
2200 N. Loop West, Suite 200
Houston, TX 77018
713.686.9955

HOUSTON OFFICE PERFORMANCE UPDATE

EDITED BY RICHARD ZIGLER

\$499 PER YEAR

VOLUME 9 NUMBER 3

THIRD QUARTER 2005

Absorption Patterns

↑ **120,749 SF absorbed
in 3Q-05**

↑ **454,372 SF absorbed
over past 12 months**

Occupancy Levels

↑ **82.65% overall in
3Q-05**

Rent Growth

↑ **Rents up \$0.07 to
\$18.12 overall**

Employment Growth¹

↑ **18,600 jobs gained
in September 2005**

↑ **Annual Job Growth
up 1.8%**

In the wake of Hurricane Katrina, as companies and their respective employees were displaced from New Orleans and surrounding areas, many expected Houston's office market to see dramatic improvement. Houston's office market, which has been hobbling along for the past several years, steadily declining in occupancy and rental rates, was poised to be able to accommodate over 27 million square feet (SF) of new demand.

What actually has happened is somewhat of a different story. The major influx of those needing office space simply did not occur. Mark Preston, Senior VP of Office Services at Moody Rabin and former broker in New Orleans, predicted at the O'Connor & Associates' Office Forecast luncheon that the hurricane's impact would be minimal. He noted that the New Orleans office market was roughly 12.5 million SF in size, miniscule compared to Houston's 156 million-square-foot market. Even if all of the New Orleans office tenants moved to Houston (which they didn't and won't), it would only boost our occupancy by less than 8%. Preston projects that 1-2 million SF maximum will be absorbed in Houston as a result of Katrina, significantly lower than what many originally speculated.

Over the quarter, the local office market did see some minor signs of improvement. Overall market occupancy increased from 82.57% to 82.65%, as 120,749 SF was absorbed. The relatively little movement in the market seems to validate Preston's belief that many companies would make due with the space they already occupied and/or take advantage of telecommuting options.

1. Texas Workforce Commission,
09/05 Total non-agricultural jobs

ABSORPTION

Despite significant negative quarterly absorption in the Class A and C markets, overall quarterly absorption remains positive with 120,749 SF absorbed. Overall annual absorption is also positive, and stands at 545,372 SF. Contributing considerably to the market gains was the Class B market, where 521,764 SF was absorbed over this last quarter.

Greater Houston Office Market Absorption (12-month Period)

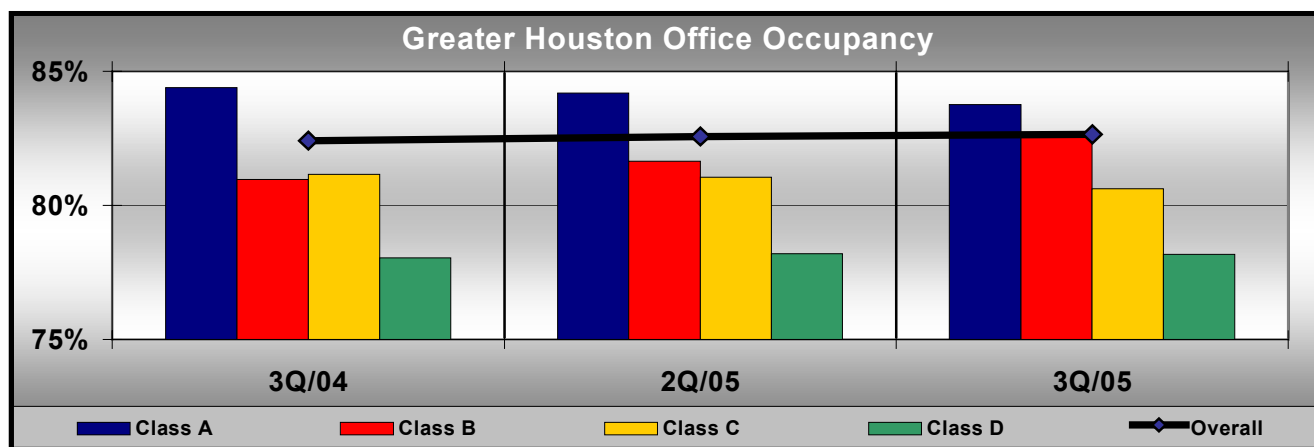
Year Ending	Class A	Class B	Class C	Class D	Overall
2Q/03	-1,274,017	-957,177	-785,018	-202,430	-3,218,642
2Q/04	-521,560	-43,924	396,970	321,521	153,007
2Q/05	-375,480	925,104	-102,366	7,114	454,372

After a strong 2nd Quarter showing, **Class A** absorption dipped into the red over the quarter with -298,276 SF absorbed. Annual absorption is also in the red, at -375,480 SF. **Greenway Plaza** recorded the greatest loss this quarter with -473,595 SF absorbed, largely due to **El Paso Corp.'s** lease termination of 888,000 SF in several Greenway Plaza buildings. The best performing sector was the **Galleria** with 203,932 SF absorbed. *Note: the statistics do not reflect Shell reportedly pulling 500,000 SF from downtown's sublease market to house their displaced New Orleans employees.*

The **Class B** market made substantial gains over the quarter, absorbing 539,732 SF, outperforming all classes. Annual Class B absorption, at 925,104 SF is also the highest annual absorption figure of all classes. The most significant gains were made in the **Katy Freeway West** sector, which absorbed 161,087 SF, and the **Greenspoint/North Belt** sector, which absorbed 142,048 SF.

Class C posted its second consecutive quarter of negative absorption, with -101,220 SF absorbed. The **Greenway Plaza** sector recorded the largest losses with absorption of -111,577 SF, followed by the **Southwest Freeway** sector, which absorbed -54,726 SF.

Class D absorbed -1,519 SF over the quarter. Despite the loss, annual absorption remains in the red with 7,114 SF absorbed. Demand was strongest in the **Fountainview/Gessner** sector, as 32,197 SF was absorbed over the quarter.



OCCUPANCY

Overall occupancy recorded its second consecutive quarter of gains, picking up 0.08 points over the quarter and 0.23 points over the year. A 0.44-point quarterly decrease in occupancy in the Class A market was made up by a significant increase in occupancy in the Class B market. Overall occupancy, at 82.65%, stands at its highest level since the 3rd Quarter of 2003.

Greater Houston Office Market Occupancy (Quarterly)

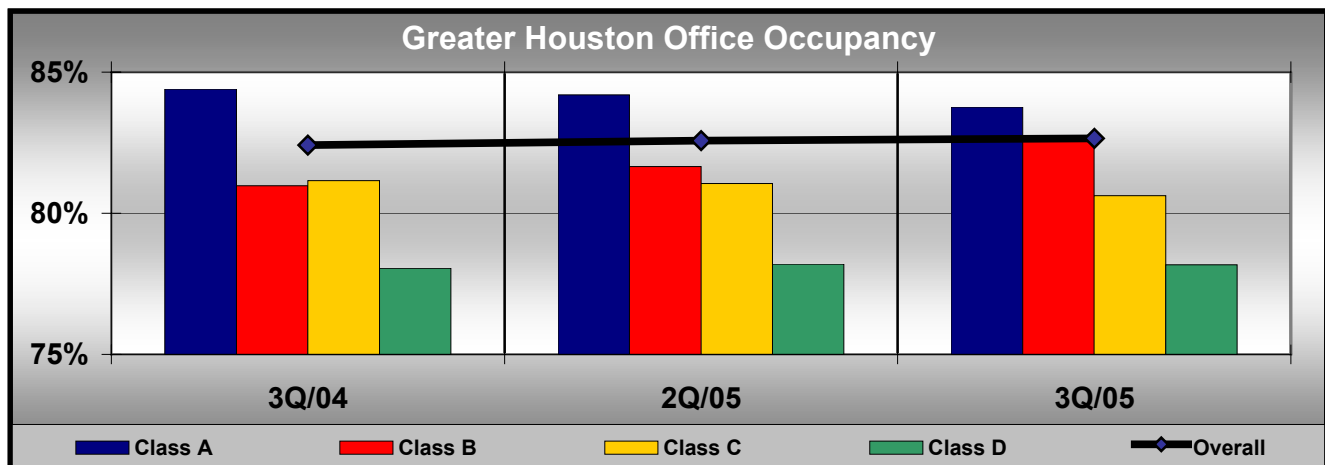
Quarter	Class A	Class B	Class C	Class D	Overall
3Q/04	84.40%	80.98%	81.16%	78.05%	82.42%
2Q/05	84.20%	81.65%	81.05%	78.20%	82.57%
3Q/05	83.76%	82.58%	80.62%	78.17%	82.65%

Class A occupancy posted a 0.44-point decline over the quarter to 83.76%. Occupancy is down 0.64 points from this time last year. As mentioned previously, **El Paso Corp.**'s lease termination was the major cause of the decline. The move-out caused occupancy in the **Greenway Plaza** sector to drop 8.54 points over the quarter to 81.33%, it's lowest level since early 1997. Occupancies in the two largest sectors, the **Central Business District** and the **Galleria**, both posted quarterly increases in occupancy.

Class B recorded a 0.93-point increase in occupancy over the quarter, and a 1.6-point increase over the year. At 82.58%, Class B occupancy is at its highest level since the 1st Quarter of 2003. With 40 Class B buildings, Houston's second highest concentration, the **Greenspoint/Northbelt** sector's 2.55-point climb to 84.93% was a primary factor in Class B's occupancy increase.

Class C occupancy slid 0.43 points over the last quarter to 80.62%, and is 0.54 points below last year's level. The highest Class C occupancies are found in the **Midtown/Allen Parkway** and **Kingwood** sectors at 98.21% and 93.66%, respectively. The lowest occupancy is found in the **Greenspoint/Northbelt** sector at 71.12%.

Occupancy in the **Class D** market declined 0.03 points to 78.17%. In spite of the loss, average occupancy remains 0.12 points above last year's level.



RENTAL RATES

Overall rents bounced back this quarter, gaining \$0.07 per square foot (psf). At \$18.12 psf overall rents are \$0.06 psf higher than were this time last year, and are at their highest level in five quarters. The increase was facilitated by rental gains made in the Class A, B, and C markets.

Greater Houston Office Market Rental Rates (Quarterly)*

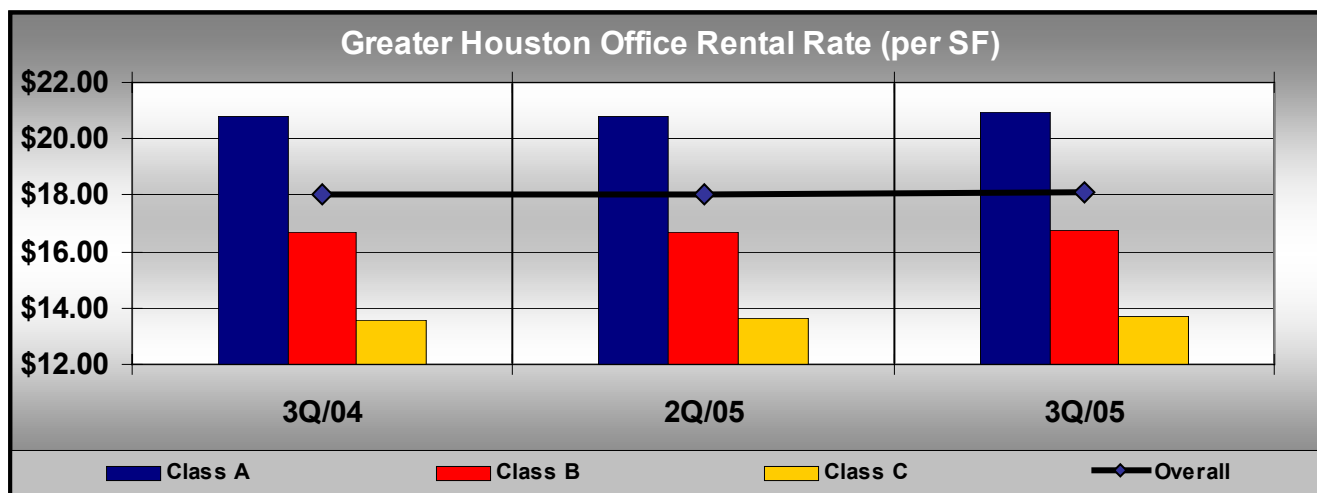
Quarter	Class A	Class B	Class C	Class D	Overall
3Q/04	\$20.82	\$16.66	\$13.59	\$11.37	\$18.06
2Q/05	\$20.81	\$16.71	\$13.64	\$11.51	\$18.05
3Q/05	\$20.94	\$16.76	\$13.72	\$11.50	\$18.12

Class A recorded the largest quarterly increase in rents, up \$0.13 psf to \$20.94 psf. Rents are up \$0.12 psf over the last twelve months, and are at their highest level since the 2nd Quarter of 2004. Major contributors to the increases were the strong showings by the **Katy Freeway East** and **Woodlands/Conroe** sectors, which posted average rents of \$21.87 psf and \$21.61 psf, respectively.

Class B rents increased \$0.05 psf over the quarter to \$16.76 psf. Average Class B rents are a full \$0.10 higher than what they were one year ago. The highest rents are found in the **Medical Center** and **Woodlands/Conroe** sectors, at \$21.63 psf and \$18.28 psf, while the lowest rents are found in the **Southwest Freeway** and **Northeast 2** sectors at \$14.74 psf and \$11.50 psf.

Class C posted its fourth consecutive increase in rents over the quarter. Average rents gained \$0.08 psf over the quarter and \$0.13 psf over the year to \$13.72 psf. Rents range from \$17.98 psf in the **Midtown/Allen Parkway** sector to \$12.00 psf in the **Southwest 1** and **Southwest 2** sectors.

Class D was the only class to register a decline in rents, as average rents dipped \$0.01 psf to \$11.50 psf. The dip is minimal, and rents are up \$0.13 psf since this time last year and are at their second highest level on record.



*For statistical purposes, Class A rents in the Central Business District are adjusted to gross, though many landlords quote net rent.

Apartment Data Online for Texas

O'Connor Data, Your Apartment Knowledge Source



Austin — Dallas — Fort Worth — Houston — San Antonio

- ◆ Detailed Property Information
- ◆ Floorplans , Maps, and Photos
- ◆ Occupancy and Rent Data
- ◆ Historical Trend Reports
- ◆ Management Contact Information
- ◆ Now with Owner Contact Information
- ◆ Property Comparison Reports
- ◆ And much more...

O'Connor & Associates is pleased to re-launch an **upgraded** version of the **Monarch Data** online apartment data platform.

Sign up today to receive our introductory pricing!

713-686-9955 or 1-800-856-REAL

rzigler@poconnor.com

Ask for Richard Zigler or Maria Fernandez



www.oconnordata.com



www.poconnor.com