

Houston Office Performance Update

Edited by Kathryn Koepke

\$499/year

2nd Quarter 2006

All Signs Point Up

Houston's office market has steadily gained strength over the last two years. This fact is evident in the hard statistics; occupancy, rent, and absorption. Occupancy has come a long way from when it bottomed out two years ago at 81.99%. Current occupancy stands at 84.24%, which represents a 0.40-point hike over the quarter, a 1.88-point gain over the year, and a full 2.25-point increase over rock bottom from two years ago. The Class A market recorded the highest occupancy at 87.02% over the second quarter. In comparison, occupancy for Class B, C, & D space ranges from 79% to 82%. Absorption figures are also very telling. Boosted by this quarter's absorption of 890,680 square feet, absorption over the last year is at 3,117,897 square feet. This is the strongest annual absorption figure in five years.

Average rental rates have once again climbed back up to levels not seen in a couple of years. Current rents are at \$18.44 per square foot (psf), representing a \$0.04 psf gain over the quarter and a \$0.38 psf, or 2.1%, gain over the year. Class B rents, which are at \$17.17 psf, have risen the fastest. Over the last year Class B rents have gained \$0.46 psf (2.75%) compared to Class A which gained \$0.30 psf (1.44%), while Class C and D rents have remained relatively flat.

Not only is it evident the market is gaining strength through hard statistics, it is also showing up in sales activity. Since the beginning of this year, Houston has already registered 29 sales of multitenant office properties. Thirteen of the buildings that traded hands are classified as A, with another 11 of the sales being Class B properties. These properties were likely targets as they are currently outperforming market averages, with average occupancy at 90% and average rents at \$20.46 psf.

Some of the more notable deals that have occurred this year include **Brookfield Properties Corp.** in partnership with **Blackstone Group's** buyout of **Trizec Properties**, who owned seven high-profile properties in Houston's Central Business District, including **Continental Centers I & II**; **One, Two**, and **Three Allen Center**; **500 Jefferson Building**; and the **Kellog, Brown, & Root Tower**. Also of significance was **Thomas Properties Group, Inc.'s** purchase of four **BMC Software** buildings in the Westchase area. Recent sales information is a clear indicator that investors are once again interested in the high quality products Houston has to offer at a relatively affordable price compared to coastal markets. And when combined with the increasing health of the market, it is likely that investors' interest will only continue to rise.

By: [Leslie Countryman](#)

Commerical Office Data Survey

O'Connor & Associates would like to know what you want in an office data product. As a long-time key source of office data for the Houston market, O'Connor & Associates wants to continue to provide the highest quality data and meet the needs of valued data users.

Please click on the link below to participate in our survey and help to better serve your office data needs.

<http://www.surveymonkey.com/s.asp?u=23752322833>

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Houston Office Market at a Glance

	Class A	Class B	Class C	Class D	Overall	Qtr	Yr
Occupancy	87.02%	82.29%	81.89%	79.29%	84.24%	▲	▲
Rent/SF	\$21.15	\$17.17	\$13.77	\$11.27	\$18.44	▲	▲
Absorption	446,892	180,732	269,726	-6,670	890,680	▼	▲



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Metro Occupancy Overview

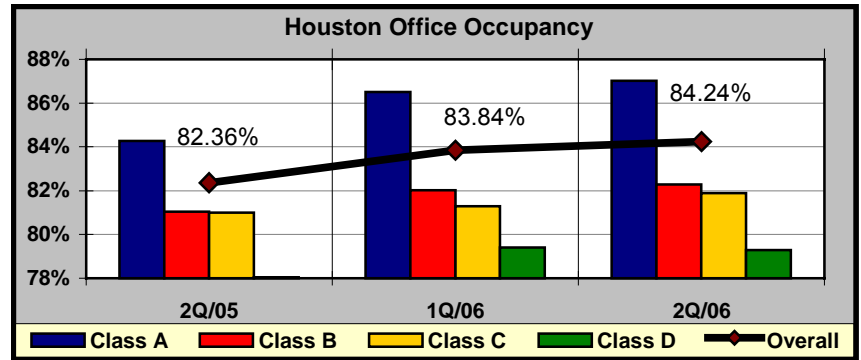
Overall occupancy picked up 0.40 points over the quarter to 84.24%. Occupancy is an impressive 1.88 points higher than it was at this time 12 months ago, and is at its highest level in two years. Classes A and C made the largest strides over the quarter, gaining 0.51 and 0.59 points, respectively, with Class B posting modest quarterly gains.

Class A reported a 0.51-point increase in occupancy over the quarter and a 2.75-point increase over the year to 87.02%, which is the highest it has been since the second quarter of 2003. Occupancies in the three largest sectors, **Galleria**, **Central Business District**, and **Westchase**, stand at 86.93%, 84.38%, and 89.88%, respectively.

Class B posted a quarterly gain of 0.26 points and an annual gain of 1.25 points to bring occupancy up to 82.29%. The **Northwest** sector posted the lowest occupancy at 67.00%, while the **Northeast 1** sector led the market with occupancy at 96.56%.

Class C occupancy recorded the largest increase of all categories over the last quarter with a gain of 0.59 points to 81.89%. Over the year, occupancy is up 0.89 points. **Southwest 2** and **The Woodlands/Conroe** posted the area's strongest occupancy levels at 95.62% and 94.29%, respectively. **Greenspoint/Northbelt** posted the weakest occupancy level just under 75%.

Class D was the only class to register a quarterly drop in occupancy and continues to post the lowest occupancy of all classes. Occupancy in the **Class D** market declined 0.11 points over the quarter to 79.29%. In spite of the loss, average occupancy remains 1.24 points above last year's level.

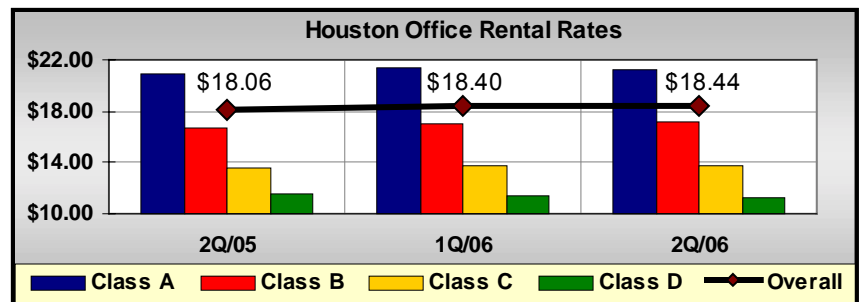


Quarter	Class A	Class B	Class C	Class D	Overall
2Q 2005	84.27%	81.04%	81.00%	78.05%	82.36%
1Q 2006	86.51%	82.03%	81.30%	79.40%	83.84%
2Q 2006	87.02%	82.29%	81.89%	79.29%	84.24%

Metro Rent Overview

Overall rental rates recorded their fourth consecutive quarterly gain, increasing \$0.04 psf over the 2nd Quarter of 2006 to \$18.44 psf. The increase was fueled by the Class B market, which was the only class to post a quarterly gain in rents. Rents in both Class A and D declined over the quarter, while rents in the Class C market remained flat.

Class A rents dropped \$0.23 psf over the quarter. However, at \$21.15 psf, rents remain \$0.30 psf higher than last year's level. Rents were highest in **The Woodlands/Conroe** and **Katy Freeway West** sectors at \$22.59 psf and 22.27 psf, and lowest in **Kingwood** at \$12.00 psf.



Quarter	Class A	Class B	Class C	Class D	Overall
2Q 2005	\$20.85	\$16.71	\$13.65	\$11.50	\$18.06
1Q 2006	\$21.38	\$16.94	\$13.77	\$11.42	\$18.40
2Q 2006	\$21.15	\$17.17	\$13.77	\$11.27	\$18.44

Class B posted the largest quarterly increase in rents, up \$0.23 to \$17.17 psf. Class B also posted the largest 12-month gain in average rental rates, increasing \$0.46 psf. Major contributors to the strong rental rates are the **Medical Center** and **Midtown/Allen Parkway** where rents average \$22.04 and \$18.59 psf, respectively.

Class C rents held steady over the last quarter at \$13.77 psf, and are up \$0.12 psf over the last year. Rents ranged from \$12.00 psf in the **Southwest 1 & 2** and **Northeast 2** sectors to \$16.25 psf in **Greenway Plaza**.

Class D rents, at \$11.27 psf, registered a \$0.15 psf quarterly decline, and a \$0.23 psf annual decline. Class D was the only class to post both a quarterly and annual decline in rents. The highest Class D rents were found in **Katy Freeway East** at \$13.58 psf, while the lowest rents were found in the **Southeast** at \$9.86 psf.



Absorption, Inventory, & Employment

Metro Absorption Overview

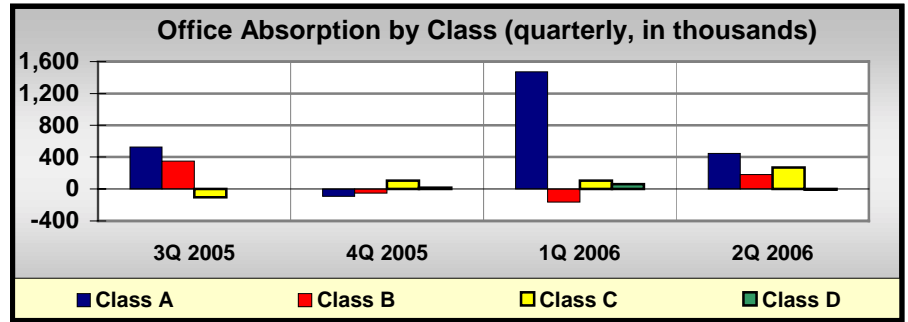
Fueled by positive figures in the Class A, B, & C markets, overall quarterly absorption reached 890,680 SF. The **Galleria** enjoyed the largest quarterly gain, with 357,390 SF absorbed. Overall annual absorption is beyond 3 million SF, a milestone of health in this market where annual absorption just two years ago registered -2.4 million SF.

Class A had another strong showing, absorbing 446,892 SF over the quarter, the most of all classes. Absorption over the year is now totals over 2.3 million SF. Demand for office space was greatest in the **Galleria** and **Sugar Land/First Colony**, where quarterly absorption was 259,555 SF and 119,902 SF, respectively.

The **Class B** market rebounded this quarter, absorbing 180,732 SF. Annual absorption stands at 314,900 SF. The positive turn over the last quarter was largely driven by the **Westchase** sector, which posted absorption of 89,310 SF. The **Clear Lake** sector recorded the greatest loss this quarter with absorption of -19,189 SF.

The **Class C** market posted yet another quarter of positive absorption, with 269,726 SF absorbed. Positive absorption over the last three quarters has boosted 12-month absorption up to 378,684 SF. The **Southeast** market outperformed all other sectors with 160,401 SF absorbed, while the **North Loop/Northwest Freeway** trailed the market with -27,851 SF absorbed.

Class D absorbed -6,670 SF over the quarter. Despite the loss, annual absorption remains in the black with 72,129 SF absorbed. The **Clear Lake** sector posted the largest loss with -5,927 SF absorbed, followed by **Fountainview/Gessner** with negative absorption of 5,465 SF.



12-mo Ending	Class A	Class B	Class C	Class D	Overall
2Q 2004	-2,406,424	-418,612	-44,462	420,931	-2,448,567
2Q 2005	714,784	135,564	43,832	42,235	936,415
2Q 2006	2,352,004	314,900	378,684	72,129	3,117,897

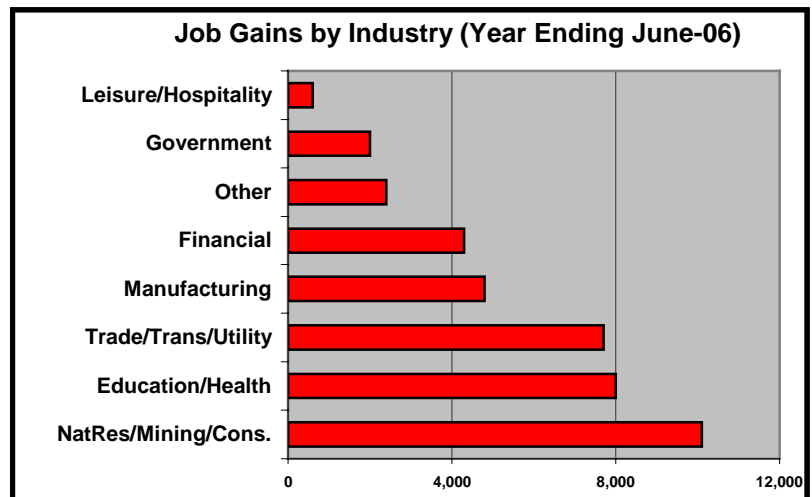
Traditional, Multitenant Office Inventory by Class

There are a total of 1,282 operating traditional, multitenant office properties in the Houston area market with total net rentable square feet of 157,458,306. Approximately 44.79% of the total office space is Class A, 36.81% of the total office space is Class B, 14.82% of the total office space is Class C, and 3.58% of the total office space is Class D.

Type	# of Properties	NRSF
Class A	212	70,522,563
Class B	485	57,957,116
Class C	427	23,345,854
Class D	158	5,632,773
TOTAL	1,282	157,458,306

Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA increased to 5.6%, while the total number of nonagricultural wage and salary jobs increased to 2,411,800 in June 2006, according to the **Texas Workforce Commission**. This month's total is 59,400 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 20,300 jobs over the previous 12 months; Natural Resources, Mining, & Construction gained 10,100 jobs; Education & Health Services is up 8,000 jobs; Trade, Transportation, & Utilities added 7,700 jobs; Manufacturing added 4,800 jobs; Financial Activities gained 4,300 jobs; Other Services gained 2,700 jobs; Government employment increased by 2,000 jobs; and Leisure & Hospitality added 600 jobs. The only industry to lose jobs over the year was the Information sector with -1,100 jobs.





Data Collection

Our office database contains information on over 1,800 office properties located throughout Greater Houston. Our research team updates property-specific data on a quarterly basis to generate accurate market trend reports on rents, occupancy, absorption, etc. Our surveys also update other property-specific data such as rent types, largest contiguous space available, leasing and management information, and owner information. We perform a current and historical data audit after we close each quarter's survey to identify any data inconsistencies or incorrectly keyed values.

Research

We monitor various news media, press releases, marketing materials, web-sites, CAD records, permit issuance, and other sources to capture new construction, planned projects, financing, and sales. Our researchers conduct phone interviews with relevant developers, brokers, or lenders to gather information on new construction and sales. We add properties to our database on a regular basis to ensure we offer the most up-to-date and complete office database.

Market Coverage

Our office database covers the Greater Houston market and includes properties in Harris, Galveston, Brazoria, Fort Bend, and Montgomery counties. The market is divided into 25 submarkets that correspond to different sectors of the greater Houston area. This approach allows the user to view distinct areas of town in which properties can be identified together.

Glossary

Absorption = Change in occupied square feet, including new construction. Absorption is a proxy for demand.

Occupancy = Percentage of physically occupied square feet on property.

Rents = Market rents.

Class = Properties are classified as A, B, C, & D based on various factors, such as age, location, amenities, overall condition, rents, etc. Class A properties are newer properties, have excellent amenities, prime location, and great appeal, thus they tend to have the highest rents. Class B properties are generally over 15 years old, have good locations, good level of amenities, and are in overall good condition. Class C projects are usually over 20 years old, have few amenities, are in fair locations, and are not very well maintained. Class D projects are generally more than 25 years old, in poor condition, have no or limited amenities, are in poor locations, and tend to have the lowest rents.

Reporting

Occupancy, Rent, and Absorption trend data is based on Operating, Traditional, Multitenant properties. Medical office buildings and single-tenant properties are excluded from the data.

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