



Houston Office Performance Update

Edited by Kathryn Koepke

\$399/year

2nd Quarter 2007

Houston's Star Shines Nationwide

The good news keeps on coming in for Houston's office market. Second quarter figures indicate the market has absorbed over 3 million square feet through the first half of 2007. Occupancy climbed for the ninth consecutive quarter, increasing 0.57 points to 87.84%, which represents a 2.82-point annual gain. To top it all off, rental rates have also increased substantially, as they are up 14.87% over the last year to \$21.86 per square foot.

With occupancy up, strong absorption figures, and rental rates on the rise, investor activity in Houston's office market has heated up. So far this year, 25 multitenant properties have traded hands, including four Class A properties, 13 Class B properties, seven Class C properties, as well as one Class D property.

Houston's strong office performance has also enticed a considerable amount of developers into the mix. The long quiet Central Business District is now abuzz with activity. Though only two projects have been officially announced, **Trammel Crow's** 623,000-square-foot **Discovery Tower** and the 200,000 square feet of space in **Houston Pavilions, Brookfield, Hines,** and **Crescent/Morgan Stanley** are all rumored to be in planning stages for new downtown office properties. In addition, Houston's office darling, the Energy Corridor area, is pushing full steam ahead. There are seven properties containing over 1.4 million square feet of space currently under construction, while another six projects with a total of 1.7 million square feet of space are on the drawing board. In total, there are 37 single- and multitenant office properties containing 5.8-million square feet of space currently under construction in the Greater Houston area, as well as another 34 properties with 5.2-million square feet proposed for construction.

Compared to the rest of the nation, Houston is in a prime position, as 12-month payroll job growth through May is third in the nation behind the Los Angeles and Dallas/Fort Worth metropolitan areas; Houston area unemployment is below the national average of 4.5%; while, Houston job growth is estimated at around 80,000 to 100,000 jobs per year through the next three years. National investors and high profile developers have already taken note of the opportunities the market has to offer. We expect activity will increase further over the course of the year, as more companies look to move-in and take advantage of Houston's hot office market.

By: [Leslie Countryman](#)

Houston Office Market at a Glance

	Class A	Class B	Class C	Class D	Overview	Qtr	Yr
Occupancy	92.02%	85.68%	83.67%	75.14%	87.84%	▲	▲
Rent/SF	\$27.19	\$18.53	\$14.56	\$11.94	\$21.86	▲	▲
Absorption	503,104	68,116	24,638	-40,982	554,876	▲	▲

In This Issue

Occupancy & Rent Trends2
Current and Historical Trends

Absorption, Inventory & Employment.....3
Absorption, Current Market Inventory

Economic Fundamentals 3
Job Growth

Methodology 4
Research and Reporting Definitions

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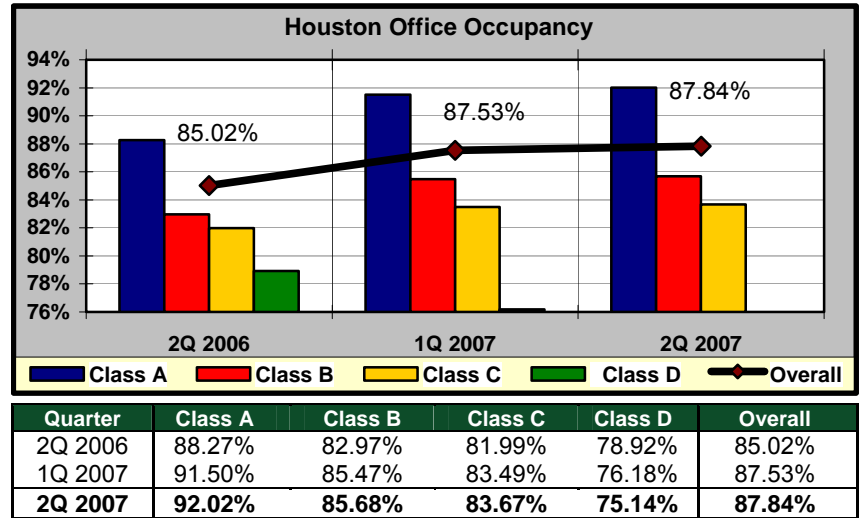


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Metro Occupancy Overview

Houston office occupancy surged ahead, increasing 0.31 points to 87.84%, its highest level since the first quarter of 2002. The increase was mainly fueled by the Class A market, where occupancy rose 0.52 points to 92.02%. Overall occupancy is up 2.82 points over the last 12 months, with the Class A, B, and C markets all posting annual gains.

The **Class A** market reported the largest quarterly and annual occupancy increases, gaining 0.52 points over the quarter and 3.75 points over the year to 92.02%. Of sectors with more than one Class A property, occupancy was strongest in the **Katy Freeway - West** sector at 97.50%, while the weakest occupancy was found in the **Northwest** sector at 63.00%.



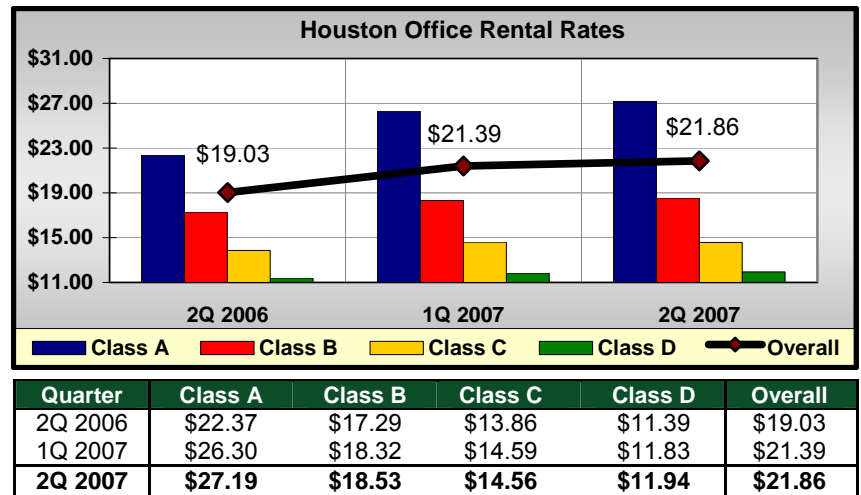
Class B occupancy rose 0.21 points during the second quarter to 85.68%, which is 2.71 points above last year's level. The **Southwest 2** sector registered the highest occupancy at 97.96%, while the **Katy Freeway - East** sector recorded the lowest at 73.31%.

Occupancy in the **Class C** market posted a 0.18-point quarterly gain to 83.67%, bringing the annual increase to 1.68 points. Occupancy ranged from a low of 78.05% in the **Central Business District** to a high of 96.70% in the **Kingwood** sector.

Class D occupancy declined 1.04 points over the quarter, and is down 3.78 points over the year to 75.14%. The **Sugar Land / First Colony** submarket reported being near full, while two in-town submarkets, the **Central Business District** and **Midtown/Allen Parkway**, reported the lowest Class D occupancies at 15.66% and 43.32%, respectively.

Metro Rent Overview

Overall rental rates jumped \$0.47 per square foot (psf) over the quarter to \$21.86. Quarterly rental rate increases were recorded in the Class A, B, and D markets. Over the last 12 months, overall rental rates are up \$2.83 psf, or an astounding 14.87%. Annual rental gains are highest in the Class A market at 21.55%, followed by the Class B market, where rents have increased 7.17%.



At \$27.19, **Class A** rents registered a \$0.89 psf quarterly increase and a \$4.82 psf annual increase. Class A rents in the **Central Business District** broke the \$30-mark and are currently at \$31.37 psf. Rents in the **Galleria** are a distant second at \$26.50 psf, while the most affordable Class A rents were found in the **Southeast** sector at \$18.32 psf.

Class B rents were up \$0.21 psf over the quarter and are up \$1.24 psf over the year to \$18.53 psf. The **Medical Center** once again posted the highest rents at \$21.79 psf, while the lowest rents were found in the **Northeast 2** sector at \$12.75 psf.

Class C rents fell \$0.03 psf over the quarter to \$14.56, but remain \$0.70 psf higher than last year's level. Class C rents range from \$12.00 psf in the **Northeast 2** and **Southwest 1** sectors to \$18.56 psf in the **Greenway Plaza** sector.

Class D rents climbed to \$11.94 psf, which represents a \$0.11 psf quarterly gain and a \$0.55 psf annual gain. The highest Class D rents were found in the **Clear Lake** sector at \$14.77 psf, with the lowest rents were found in **Southeast** sector at \$10.25 psf.

Metro Absorption Overview

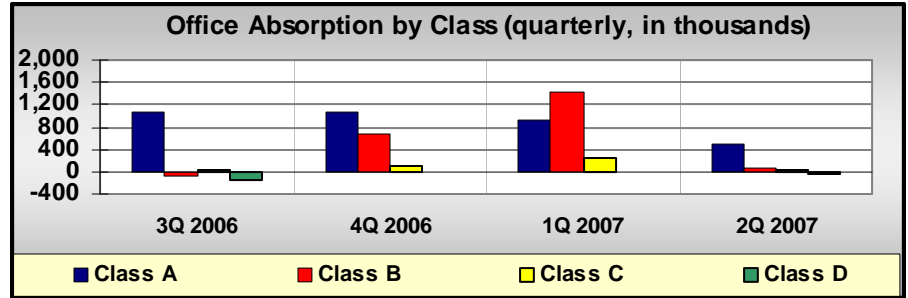
Overall absorption during the second quarter of 2007 totaled 554,876 square feet (SF), which brings annual absorption to over 5.8-million SF. The Class A market absorbed the bulk of the new space over the quarter, with 503,104 SF absorbed. Quarterly absorption was also positive in the Class B and C markets, while Class D was the lone class in the red.

The **Class A** market reported healthy quarterly absorption of 503,104 SF; annual Class A absorption stands at 3,566,872 SF, the highest of all classes. Demand was strongest in the **Central Business District** and **Galleria** sectors, with 344,704 SF and 116,121 SF absorbed over the quarter, while demand was weakest in the **Park 10** sector, with -87,899 SF absorbed.

Class B absorption was positive for the third consecutive quarter, with 68,116 SF absorbed. The Class B market has absorbed over 2.1-million SF over the last 12 months. Quarterly absorption was highest in the **Galleria** sector at 96,523 SF, while the lowest absorption was found in the **Central Business District** at -78,590 SF.

Class C absorption over the quarter was slight, though still positive, at 24,638 SF. Over the last year, the market has absorbed 375,814 SF of Class C space. The **Southwest Freeway** sector led the market, with 71,325 SF absorbed, while the **Southeast** sector trailed the market, with -43,542 SF absorbed.

The **Class D** market absorbed -40,982 SF over the quarter, which brought annual absorption down to -190,430 SF. The **Greenway Plaza** sector reported the strongest demand, absorbing 4,600 SF, while demand was weakest in the **North Loop / Northwest Freeway** sector with -33,316 SF absorbed.



2-mo Ending	Class A	Class B	Class C	Class D	Overall
2Q 2005	789,592	125,052	-68,206	42,241	888,679
2Q 2006	2,537,904	901,724	469,858	68,776	3,978,262
2Q 2007	3,566,872	2,114,744	375,814	-190,430	5,867,000

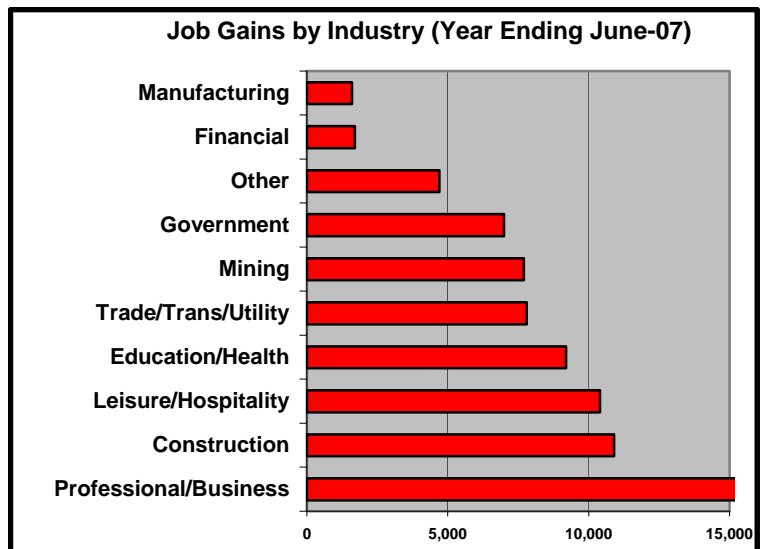
Traditional, Multitenant Office Inventory by Class

There are a total of 1,288 operating traditional, multitenant office properties in the Houston area market with total net rentable square feet of 156,775,953. Approximately 44.52% of the total office space is Class A, 37.20% of the total office space is Class B, 14.77% of the total office space is Class C, and 3.50% of the total office space is Class D.

Type	# of Properties	NRSF
Class A	228	69,799,529
Class B	483	58,324,251
Class C	425	23,158,937
Class D	152	5,493,236
TOTAL	1,288	156,775,953

Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA increased to 4.4%, while the total number of nonagricultural wage and salary jobs increased to 2,525,600 in June 2007, according to the **Texas Workforce Commission**. This month's total is 76,500 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 15,000 jobs over the previous 12 months; employment in the Construction sector increased by 10,900 jobs; Leisure & Hospitality employment added 10,400 jobs; Education & Health Services gained 9,200 jobs; Trade, Transportation, & Utilities employment is up 7,800 jobs; Mining employment increased by 7,700 jobs, the Government sector added 7,000 jobs; Other Services gained 4,700 jobs, Financial Activities employment is up 1,700; while Manufacturing employment increased by 1,600 jobs. The only industry to lose jobs over the year was Information, down 200 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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