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REDNews

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SOUTHEAST TEXAS

Office Report | 3rd Quarter 2009

Excerpts from 3rd Quarter 2009 Office Report by NAI Houston

NAI Houston
Commercial Real Estate Services, Worldwide.

TRENDS:

Vacancy Rate ↑

Net Absorption ↓

Construction ↓

Asking Rents ↓

Overview

Houston's office market ended the 3rd quarter 2009 with a vacancy of 14.2%. Overall rental rates have decreased 0.9% from last quarter, ending the 3rd quarter with an average rental rate of $23.03.

Absorption for the Houston market in the 3rd quarter 2009 was a negative (660,352) square feet compared to a positive 491,260 square feet in the 2nd quarter of 2009. Class A absorption was negative at (343,207) square feet and Class B was negative at (392,383) square feet. Class C was a positive 28,093 square feet. Tenants moving out of large blocks of space in 2009 include Transocean (207,227 SF), 15375 Memorial Dr. Tenants moving into large blocks of space in 2009 include US Oncology (196,000 SF) 10101 Woodloch Forest Place, Mustang Engineering, LP (174,295 SF) 17000 Katy Freeway and Worley Parsons Group, Inc. (141,000 SF) 575 N. Dairy Ashford. The average quoted asking rental rate for available office space, in all classes, decreased 0.9%, down from the end of the 2nd quarter 2009 to $23.03 per square foot. The Class A average quoted rental rate for the 3rd quarter was $28.16, Class B rates were $19.31, and Class C rates were $16.73.

At the end of the 3rd quarter of 2009, a total of 15 buildings delivered to the market totaling 1,141,455 square feet, with 3,829,489 square feet still under construction at the end of the quarter. The noteworthy deliveries of 2009 were Memorial Hermann Tower, a 915,034 square foot facility that delivered in the first quarter 2009 and is now 75% leased, and Energy Tower II, which is 428,831 square feet and is currently 88% leased. The largest projects underway are Main Place, which is a 972,474 square foot facility and Hess Tower, which has 844, 763 square feet and has been leased by Hess Corp. Both of these projects are located in the CBD.

Major Lease Transactions

Tenant	Building	Size (SF)	Submarket
Hess Corp	Discovery Tower	844,763 SF	CBD
The Shaw Group, Inc	Stone & Webster Building	312,564 SF	Katy Freeway West
NRG Texas	Houston Pavillions	240,000 SF	CBD
US Oncology	10101 Woodloch Forest Place	196,000 SF	Woodlands
Mustang Engineering, LP	17000 Katy Fwy	174,295 SF	Katy Freeway West
CEMEX Inc	Cemex Center	170,000 SF	Katy Freeway West
Worley Parsons Group	Energy Center Phase II	141,000 SF	Katy Freeway West

Outlook

The Houston office market is in a transitional phase from a landlord market to tenant market. Not reflected in the statistics above is the change in net effective rents, which takes into consideration the amount of concessions provided by landlords as a part of a lease transaction. During a "transitional" phase of the market, landlords prefer to provide front end loaded concessions such as free rent, free parking, and larger tenant improvement allowances, rather than to cut their face rental rates, in an attempt to maintain or create additional value in the asset once the concessions have been paid or burned off. Quoted rates appear to only have decreased slightly, but when taking the amount of concessions provided into account, the overall occupancy costs for tenants in today's market has decreased fairly significantly.

Given the state of the national economy and the losses absorbed by the oil and gas firms, we anticipate further erosion of net effective rental rates as well as lower overall face rental rates and increased vacancy. How fast these fundamentals move will depend on the submarket and the type of space being considered. We are aware of landlords that have, during the current 4th quarter, dropped their Class A face rates as much as $5.00 per square foot.

An additional 538,450 sf of sublease space was added during the 3rd Quarter of 2009 (a trend that we expect to continue); however, we have not seen many large blocks of long term space that put significant pressure on landlords to lower rates. If larger tenants don't start dumping space on the market, the supply of new space coming to market should not significantly impact rental rates.

Looking forward, 2009 and the 1st half of 2010 will be a good time for tenants to get with their NAI Houston tenant representatives to examine the market, as there will be excellent opportunities for those who take the time to consider their options. However, don't expect to see significant rental rate decreases overnight. Look for other ways to lower your occupancy costs through the aforementioned concessions.
*All rents are per SF/per YR unless otherwise noted.

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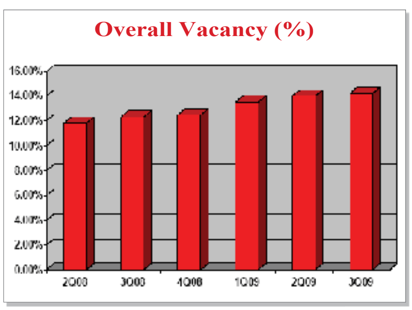

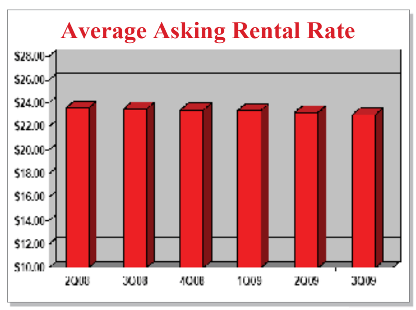

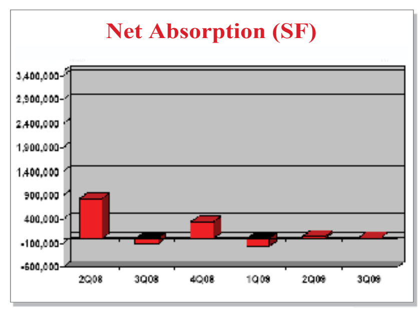

OfficeResearch

MARKET UPDATE

Marcus & Millichap | *Houston Metro Area | Fourth Quarter 2009*

Sales Trends*

- Transaction velocity in Houston dropped 29 percent in the most recent 12-month period. The frozen credit markets played a significant role in the decrease, resulting in a 67 percent decline in the number of Class A transactions. Class C deal flow only slowed 6 percent in that time.
- The median price has slipped 25 percent in the past year to $96 per square foot. During that time, the average size of Class C properties that changed hands has dropped by 55 percent to 14,000 square feet.
- Cap rates in the first three quarters of 2009 averaged in the low- to mid-8 percent range. Since midyear, initial yields have surpassed 9 percent.
- Outlook: Investors will continue to prefer smaller assets through the next several months due to tightened lending requirements. In the first half of 2010, however, some institutional investors may move off of the sidelines to take advantage of elevated cap rates.

** Data reflects a full 12-month period, calculated on a trailing 12-month basis by quarter.*

Medical Office

- Through the first three quarters of 2009, developers added 201,000 square feet of medical office space in Houston. Nearly 950,000 square feet is under way or planned in the metro, including 175,000 square feet slated for delivery in the fourth quarter of this year.
- Since year-end 2008, medical office vacancy has retreated 170 basis points to 12.4 percent due to expansion in the education and health services segment. Space demand increased by 2.4 percent during the first three quarters of this year.
- Despite falling vacancy, average asking rents have slipped 1.1 percent so far in 2009 to $22.72 per square foot.
- Deal flow in the medical office segment has declined 30 percent year-to-date when compared to the corresponding period last year. Average cap rates, meanwhile, are approaching 9 percent.

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