

Houston Office Insight Q4 2009

Economy

Although recent national economic indicators suggest that a recovery is beginning to take hold, the recession continued to run its course on the Houston economy during the fourth quarter. Houston lost a net 88,900 jobs (3.4 percent) from November 2008 to November 2009 with more than half of the losses coming from construction, manufacturing, and mining and logging. However, some sectors still continued to post over-the-year job growth including health care and social assistance, government and educational services. Additionally, the Baker Hughes active domestic rotary rig count, one of the most important leading economic indicators for Houston, ended the year up 36.0 percent from the recent low recorded last June. This upward trend, combined with the significant increase in oil prices (up 38.0 percent from December '08), bodes well for Houston's economic stability and recovery. While as high as it's been in almost 16 years, the local unemployment rate of 8.2 percent in November remained below the national rate.

Market conditions

In 2009 the Houston office market shed nearly two million square feet of occupied space marking the first year of negative absorption since 2003 and the market's worst performance dating back to 2002. This occupancy loss, combined with the delivery of 4.3 million square feet of mostly vacant new construction, caused the vacancy rate to climb 370 basis points over the year to 17.6 percent, its highest level since early 2006.

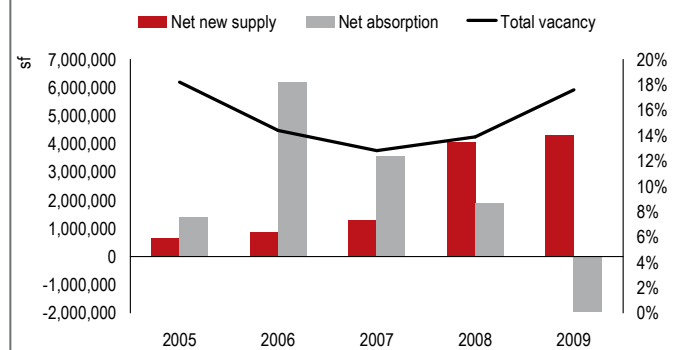
In the second half of the year a few tenants began to take advantage of the bargain opportunities in the aggressively-priced sublease market. Quoted rental rates dropped 2.0 percent over the year, a nominal decline explained by higher quoted rents for new building vacancies and landlords offering non-reported concessions in lieu of lower face rates. The most significant capital markets event in the fourth quarter was Barclays Capital taking control of Morgan Stanley's Crescent portfolio, including Houston's Greenway Plaza, Post Oak Central and Houston Center. It is expected that this shift will bring about a more aggressive leasing strategy to accelerate absorption of vacant space in the portfolio.

Outlook

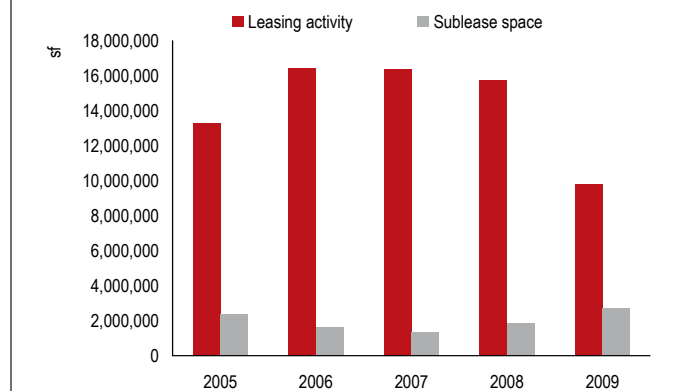
The Greater Houston Partnership (GHP) recently reported that "Houston's recovery has begun" and that the city's employment outlook will improve in 2010. The forecast anticipates Houston will post a net gain of 1,900 jobs in the coming year. With steadily increasing sublease availabilities, newly constructed buildings offering more efficient space, and falling rents, tenants positioned to act in 2010 will have more higher quality options from which to choose at more attractive lease terms than the market has offered in several years.

Key market indicators			12-month forecast
Supply	Supply	151,877,392 sf	▲
	Direct vacancy rate	15.8%	▲
	Total vacancy rate	17.6%	▲
	Under construction (% preleased)	2.0 msf (51%)	▼
Demand	Leasing activity 12 mo. % change	-34.8%	▼
	YTD net absorption	-1,956,226 sf	▼
Pricing	12-month overall rent % change	-2.0%	▼
	Class A overall asking rent	\$30.27 psf	▼
	Class B overall asking rent	\$19.52 psf	▼

Net new supply, net absorption and total vacancy



Leasing activity vs. sublease available space



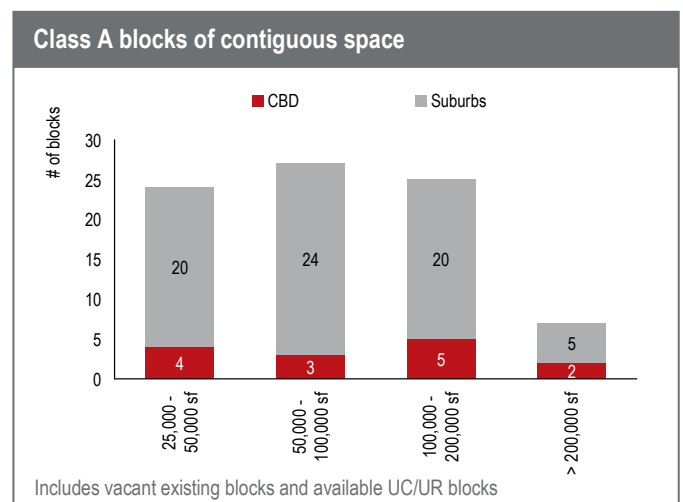
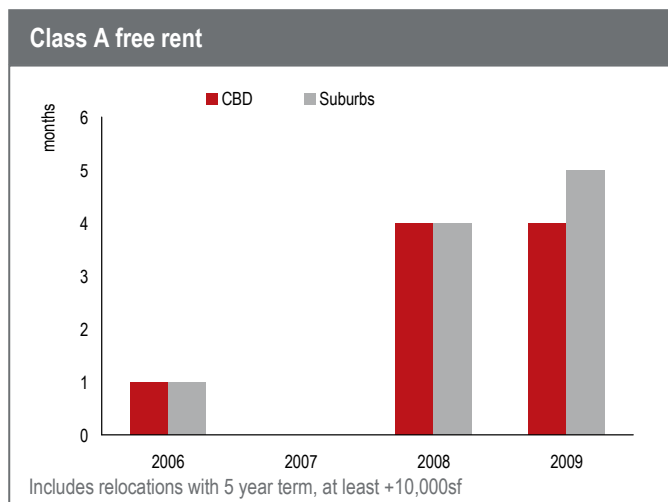
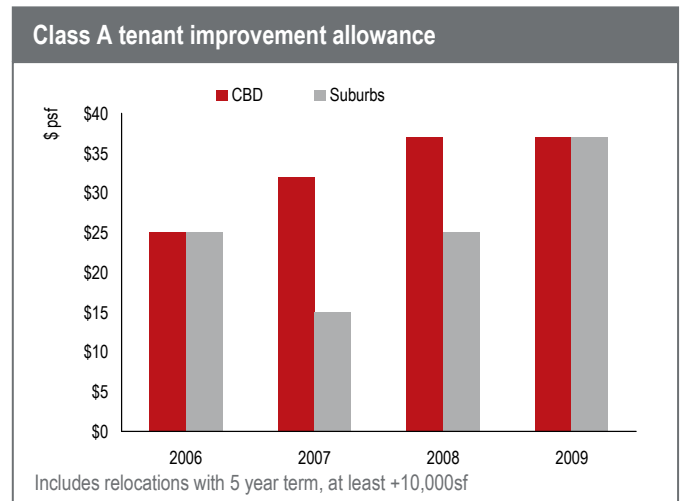
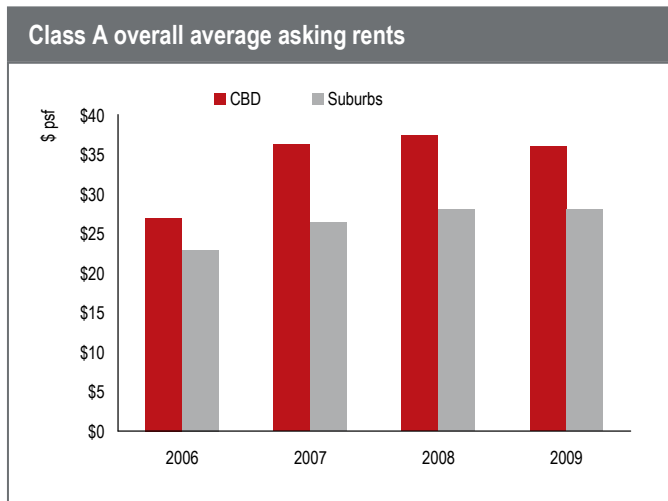
Sublease space includes available space

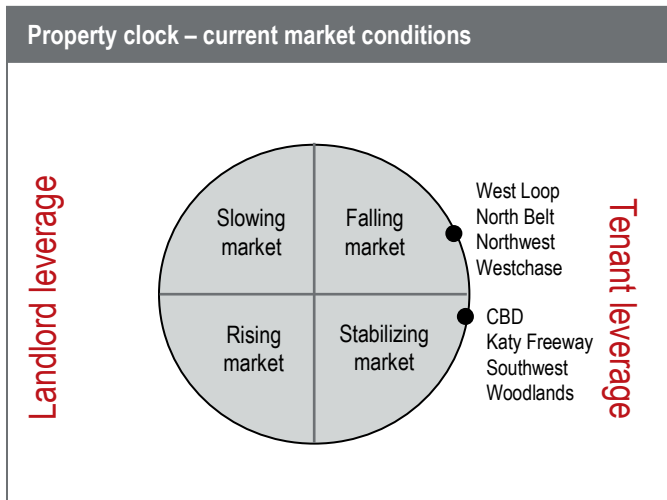
Tenant perspective

2010 is likely going to be an ideal time for tenants to transact and lock in favorable leasing terms, as the window of opportunity will begin to close within the next 18 months. Large users in particular will have increased negotiating leverage given the multitude of viable alternatives and the competition between landlords trying to capture a dwindling tenant base. Higher leasing activity levels are anticipated in the latter half of the year as tenants become acclimated with the new economic reality and the direction of their businesses. However, until job growth returns to consistent positive territory, transactions will probably be limited mostly to subleases, short-term renewals and consolidations. Continued aggressive concession packages from landlords will offer tenants the opportunity to creatively structure their leases in ways that optimally align with their business models. It will also remain critical for tenants to analyze their landlord's financial stability, a concept that was previously unheard of and is now nearly commonplace.

Landlord perspective

Landlords continue to experience deteriorating office market fundamentals including weak demand, declining rents, and rising vacancy rates. While quoted rental rates held up in 2009, as the year ended the sluggish economy and slow demand forced landlords to begin offering concessions. As the year unfolded, some landlords decided to be more proactive. In the West Loop submarket, where negative net absorption was highest in 2009, The Marathon Oil Tower (5555 San Felipe Street, Class A) led the way by cutting asking rates by 25.0 to 35.0 percent. This strategy signaled a shift in the way prudent landlords were going to approach a more challenging market for the foreseeable future. Landlords will be forced to offer more aggressive concession packages in order to capture what little demand exists and retain existing tenants. Until we see more business capital spending, job growth and confidence work its way through the Houston economy, landlords will be faced with a significantly more challenging environment resulting in downward rent and occupancy pressures during the first half of 2010.





Submarket leverage – market history and forecast

Submarket	2007	2008	2009	2010	2011
CBD	Landlord-favorable	Landlord-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
Katy Freeway	Landlord-favorable	Landlord-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
North Belt	Landlord-favorable	Landlord-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
Northwest	Landlord-favorable	Landlord-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
Southwest	Landlord-favorable	Balanced	Tenant-favorable	Tenant-favorable	Tenant-favorable
Westchase	Landlord-favorable	Landlord-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
West Loop	Landlord-favorable	Balanced	Tenant-favorable	Tenant-favorable	Tenant-favorable
Woodlands	Landlord-favorable	Landlord-favorable	Tenant-favorable	Tenant-favorable	Balanced

■ Landlord-favorable conditions
 ■ Balanced conditions
 ■ Tenant-favorable conditions

Completed lease transactions

Tenant	Address	Submarket	sf	Type
CB&I	6001 Rogerdale Road	Westchase	120,000	Sublease
NRG	1301 Travis Street	CBD	84,644	Relocation
Spark Energy	2105 Citywest	Westchase	61,293	Sublease
Eagle Rock Energy Partners LP	1415 Louisiana Street	CBD	53,000	Sublease
Willis of Texas	920 Memorial City Way	Katy Freeway	45,766	Sublease
ACS	9800 Centre Parkway	Southwest	40,000	Renewal
Sigue Corporation	11310 Greens Crossing	North Belt	35,790	Sublease
Excelebrate Energy	1450 Lake Robbins Drive	The Woodlands	23,242	Relocation
Linn Energy	600 Travis Street	CBD	21,503	Relocation

Completed sale transactions

Address	Submarket	Buyer / Seller	sf	\$ psf
601 Travis Street	CBD	Hairi Interests Inc. / J.P. Morgan Chase & Co.	450,000	\$113
10101 Woodloch Forest Drive	The Woodlands	W.P. Carey / U.S. Oncology	204,000	\$221
13100 Northwest Freeway	Northwest	Fausset-Neely / RPD Catalyst	126,015	\$40
6001 Savoy Drive	Southwest	Khoshbin Properties / BGK Equities	121,603	\$36
3027 Marina Bay Drive	NASA / Clear Lake	Emor Enterprises / One Harbour LP	58,204	N/A

Houston, TX methodology: Inventory includes all Class A & B office properties > 50,000 square feet, excluding all condo, medical, single tenant/owner occupied buildings and government owned buildings



Real value in a changing world

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