

# StudleyReport

STUDLEY OFFICE MARKET AND SPACEDATA REPORT

## MARKET HIGHLIGHTS

### AVAILABILITY RATES CONTINUE DESCENT

The region's overall availability rate, 17.9%, registered a quarterly decrease of 0.4 pp. The Class A rate, 16.3%, dropped by 0.7 pp.

### RENTS RISE SLIGHTLY

Overall rent, \$22.89, inched up for the second straight quarter (+0.4%). The Class A rate, \$28.73, displayed a quarterly increase as well (+1.2%).

### JUMP IN QUARTERLY LEASING

Overall leasing totaled 3.3 msf, up by 28.8% from last quarter. On a trailing four-quarter basis, overall leasing attained 12.5 msf, falling by 1.6% for the quarter.

### LARGE BLOCK INVENTORY SHRINKS

The number of large contiguous blocks of Class A space (50,000 sf or more) decreased to 49 from 57 last quarter. The number of large blocks of Class B and C space (50,000 sf or more) dropped to 44 from 45.

## Optimism Prevails, At Least for Now

Houston's economy appears to be once again separating from the nation's. Strong leasing activity in the last several months, propelled primarily by strength in the energy sector, is boosting optimism and leading landlords to think that a steady recovery is at hand. Markets such as the Energy Corridor and Westchase are tightening up quickly. Additionally, Exxon's much-anticipated move to The Woodlands has spurred rumors that several other energy companies will follow suit, creating a second energy corridor to the north. Even the space Exxon will leave behind in Greenspoint is attracting interest. However, the region's dependency upon the energy sector in this recent upswing underscores the precarious nature of the market. With the economy flailing in both the U.S. and Europe and the possibility that the U.S. economy may have already slipped back into recession, energy prices could drop, quelling momentum and setting the market back.

For now, spirits are high in Houston, a stark contrast to sentiment in the rest of the U.S. as conditions in the U.S. economy have deteriorated since July. Manufacturing production fell, retail sales declined and business as well as consumer confidence weakened. European markets are dangerously close to recession with serious concerns about the stability of sovereign debt markets. The sharp sell-off in U.S. equity markets combined with three straight months of disappointing employment numbers, culminating in August's report showing zero job growth, prompted most economists to slash their forecasts for growth in the rest of 2011 and 2012.

While the national economy seems to be retreating, most signs in Houston point to growth. The region's core fundamental, WTI \$ per barrel, is continuing to perform at a level that supports E&P activity, sparking local employment growth. Commercial real estate indicators have also been positively impacted as leasing remains strong (primarily driven by oil and gas firms) and investor activity has continued to increase. The biggest threat to this brightening picture is a double-dip recession that curbs demand for oil and gas. In late September, oil prices took a dive, coming precariously close to dipping below \$80 a barrel. Tenants now face the challenge of when to renew their lease. Current asking rental rates have risen significantly for tenants who are in the latter stages of 10-year leases, creating a quandary for some companies. Tenants are weighing the option of extending their lease early and locking in current market rates to mitigate further rent appreciation, or instead playing the market to see if broad economic concerns could drive rental rates lower. Given enacted and proposed tax law changes and the uncertainty in the marketplace, strong tenant representation is vital to successfully navigating today's space-use decisions.

### CBD TRANSACTION BAROMETER

	Under 50,000 sf	OneQtr Change	Over 50,000 sf	One Qtr Change
Average Term:	7 years	◀▶	10 years	◀▶
Concessions:				
Free Rent	3 months	▼	7 months	▼
Tenant Improvements	\$35.00	◀▶	\$45.00	◀▶
Parking	3-5 months	◀▶	5-7 months	◀▶
Refurbish Allowance	\$3.00-\$5.00	◀▶	\$5.00-\$7.00	◀▶

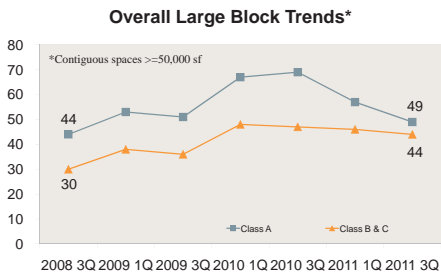
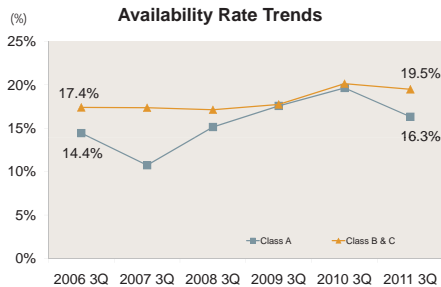
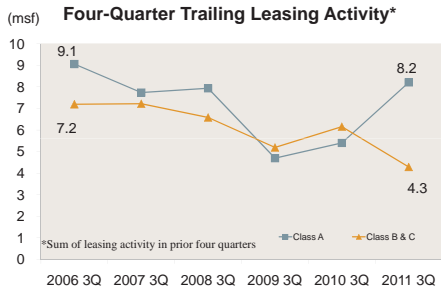
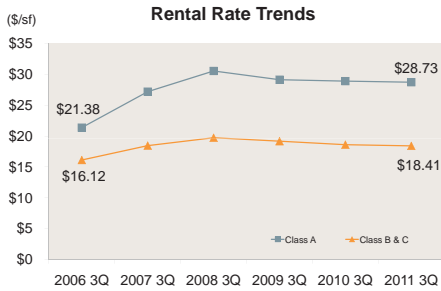
**Outlook:** While the strong leasing activity of late has sparked optimism among landlords, currently available blocks in conjunction with pending space availabilities should help to keep rents relatively flat over the near term.

### WEST LOOP/GALLERIA TRANSACTION BAROMETER

	Under 50,000 sf	OneQtr Change	Over 50,000 sf	One Qtr Change
Average Term:	7 years	◀▶	10 years	◀▶
Concessions:				
Free Rent	6 months	◀▶	6 months	◀▶
Tenant Improvements	\$33.00	◀▶	\$45.00	◀▶
Parking	1-3 months	◀▶	1-5 months	◀▶
Other	None	◀▶	\$5.00	◀▶

**Outlook** New development in the submarket for the first time in over 20 years will have a negative impact on second-generation space and could potentially create significant vacancy, resulting in downward pressure on rental rates.

▲ Up ▼ Down ◀▶ Unchanged



Although concerns regarding the national economy are elevated, the only scenario that would lead to lower rents and higher concessions is a sharp double-dip recession. Some landlords are already starting to rein in concessions and stick to their asking rents as they witness Houston's surging fundamentals. Employment growth has accelerated. Earlier in the year, Houston was in an unfamiliar position as job growth lagged other Texas markets. Over the last few months, though, the region has vaulted to the top spot nationally in terms of overall job growth. As of August, it had recovered 50.2% of the office-using jobs lost during the recession, well above the national recovery rate of 22.3%.

Leasing activity and investment sales in the Houston region remained very fluid in the third quarter. Several of the market's largest firms followed Exxon's move and committed major resources to the region, including shifting many employees to Houston. This is a reversal of the decision some companies made in 2009 to move employees to international markets. Recently, BP expanded its lease at Three Eldridge Place to take the full building which will house local employees as well as nationwide transfers. BP's lease will fill in a major hole in the Energy Corridor – since Behringer Harvard completed the building in late 2009, it has been completely vacant. BP, like Exxon, is in the early stages of a substantial multi-year effort to consolidate locations and employees. The firm has 7,640 employees as well as 5,000 contract workers working in more than 2.4 msf of office space in the region.

Energy firms were extremely active over the quarter. Nexen Petroleum announced that it would move its headquarters from Plano to Houston. The Calgary, Canada-based company, which already occupies 65,000 sf at 2000 W. Sam Houston Parkway South, will consolidate several hundred employees from multiple cities, including Plano, into approximately 200,000-sf at a new 14-story 330,000-sf property to be developed in West Houston by MetroNational Corp. In Westway Park, Cameron purchased an 86,000-sf property adjacent to its existing 215,000-sf property at 4646 W. Sam Houston Parkway North. Carrizo Oil & Gas will almost double the size of its office space, moving from approximately 65,000 sf in Wells Fargo Plaza to 110,812 sf at 500 Dallas Street (One Allen Center). GE took down the remaining space in Westway II (50,000-sf) and also leased all of Westway III (180,000-sf).

Professional/business services firms are starting to feed on the burst in the energy sector. Accounting firm Gainer, Donnelly & Desroches leased nearly 45,000 sf at Two Riverway, a slight expansion from its 31,000-sf space at San Felipe Plaza. Investment banking, a sector that has struggled to maintain the record profits registered in 2009 and 2010, has been eager to tap into the energy sector. Citigroup's energy investment banking group has quintupled from 20 people to more than 100 currently, spurring a move from Williams Tower in the Galleria to a 54,800-sf space at BG Group Place. The investment unit hopes to hire another 20 to 25 people in the next year.

Such activity is pushing availability down. The overall availability rate decreased for the second straight quarter, sliding by 0.4 pp from 18.3% to 17.9%. The Class A rate declined by 0.7 pp to 16.3%. Even with the pickup in market activity, the Houston region still offers ample opportunities for smaller and mid-sized users. The supply of big blocks has been falling, though. Larger firms with very specific geographical needs face a tighter market but these companies can also consider build-to-suits or property purchases. Larger tenants have become increasingly aggressive. Many of them are getting out in the market earlier than in

## MAJOR TRANSACTIONS

Tenant	Sq Feet	Address	Market Area
Chevron	311,000	1600 Smith St	CBD
Nexen	190,000	945 Bunker Hill	Katy Freeway
GE Oil & Gas	181,814	4425 Westway Park Blvd	Northwest/290 Far
Carrizo Oil & Gas, Inc.	110,812	500 Dallas St	CBD
Occidental Energy Marketing, Inc.	87,354	5 Greenway Plz	Greenway Plaza
PROS Holdings, Inc.	83,700	3100 Main St	Midtown
PSC	71,913	5151 San Felipe St	West Loop/Galleria
W&T Offshore	71,289	9 Greenway Plz	Greenway Plaza
Burns & McDonnell	59,174	1700 West Loop S	West Loop/Galleria
Citigroup	54,800	811 Main St	CBD
Worley Parsons	53,700	12141 Wickchester Ln	Katy Freeway
Bristow Group Inc.	50,544	2103 CityWest Blvd	Westchase
Twin Eagle Resource Management	50,000	8847 W Sam Houston Pky N	Northwest/290 Far
GE Oil & Gas	49,804	4424 W Sam Houston Pky N	Northwest/290 Far
Cornerstone Mortgage Company	49,574	1177 West Loop S	West Loop/Galleria
<b>Sum of Top 15 Leases</b>	<b>1,475,478</b>	<b>Sum of 3rd Qtr Leasing Activity</b>	<b>3.3 MSF</b>

recent history in order to determine their options well in advance of lease expiration. Companies familiar with the speed of the Houston office market can be expected to adopt "anticipatory leasing" as they try to avoid the problem of not having enough space to grow into and then paying the penalty of being caught in a competitive bidding environment.

The surge in demand for big blocks of space has revived Houston's development pipeline as well. Optimism is underscored by the amount of construction coming out of the ground, a major shift from just a few months ago. With BBVA Compass as the lead tenant at 2200 Post Oak Blvd in Galleria/Uptown (the first new project for this submarket in more than two decades) and Nexen as the lead in a Katy Freeway property, new construction is no longer years off. Plenty of other projects are poised to break ground if they can secure an anchor tenant.

NASA/Clear Lake is scrambling to deal with the loss of jobs and depleted demand for office space due to cuts at NASA. The submarket has seen a resurgence in the short term band-aid leases that were prevalent in the recession. NASA/Clear Lake has concentrations in other sectors such as healthcare, transportation and chemical manufacturing that could help offset some of the lost business. However, lack of clarity regarding federal spending is still generating a lot of uncertainty for area companies. At its peak, NASA employed 18,000 workers in the region, but stands to lose 4,200 jobs (about half of the cuts have already occurred) due to the recent end of manned space flight. As the federal government starts to consider ways to reduce costs the Houston region, areas such as NASA/Clear Lake that have a lot of federal facilities should certainly be prepared for what is likely to be several years of further cuts.

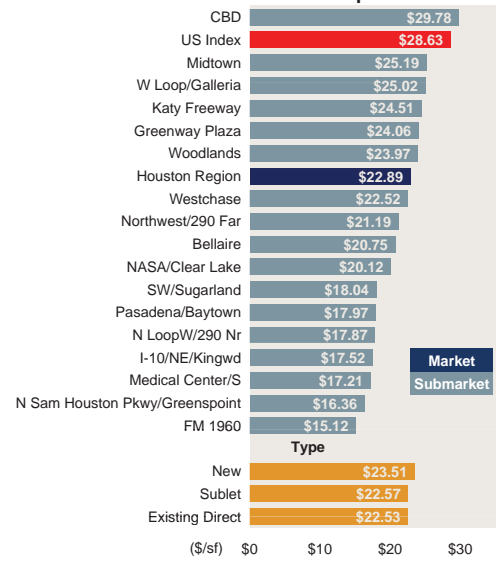
### Looking Forward

The region is not immune to the recent deterioration in the U.S. and European economy. The short term has become even murkier of late as we await the market's response to foreign and domestic events. At this point, the specter of a double-dip recession or another major external shock that threatens demand for oil represents the primary short-term obstacle to a solid rebound in the energy sector and the Houston economy. Barring a collapse in the economy, Houston is expected to experience employment growth that outpaces the weak national growth rate, with 50,000 jobs added in 2011, ramping up to 65,000 to 80,000 in 2012. Over the next two years, except in the event of a broad double-dip recession, we anticipate a modest appreciation in rents and a decline in concessions.

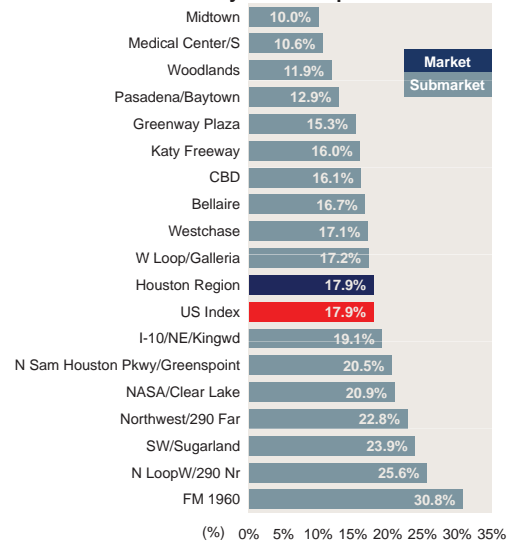
### ABOUT OUR FIRM

**Studley** is the only global tenant advisory firm with a pure tenant representative delivery platform. Founded in 1954, Studley pioneered this conflict-free business model. Today, with 19 offices nationwide and an international presence through its London office and AOS Studley throughout Europe, Studley provides strategic real estate consulting services to top-tier corporations, law firms, nonprofits, government agencies and institutions of higher education. Information about Studley is available at [www.studley.com](http://www.studley.com).

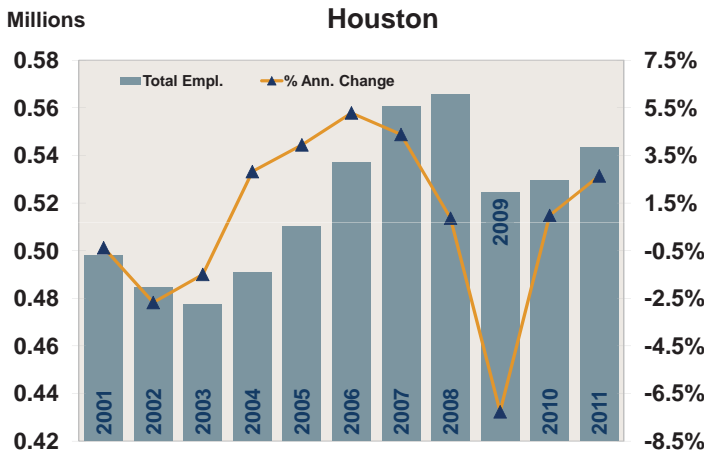
### Overall Rental Rate Comparison



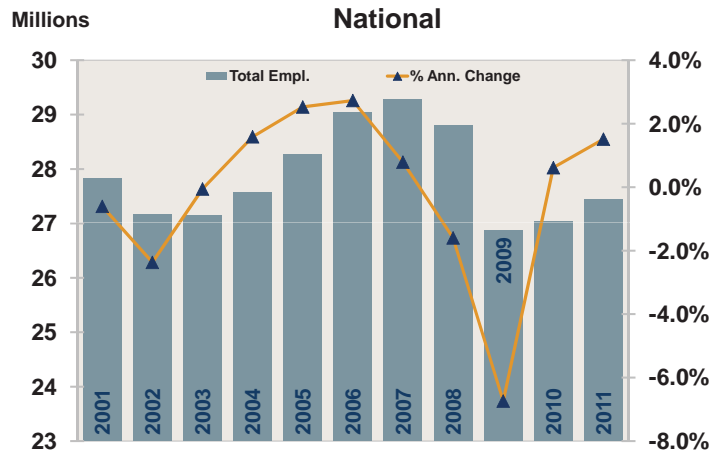
### Availability Rate Comparison



### OFFICE-USING EMPLOYMENT TRENDS



Source: Bureau of Labor Statistics



MARKET SNAPSHOT: 3Q 2011

MAP	SUBMARKET	TOTAL	LEASING ACTIVITY			AVAILABLE SF			AVAILABILITY RATE			ASKING RENTS PER SF				
			Inventory SF (1,000's)	Last 12 Mos	5 Yr Average	This Qtr	% Change from Last Qtr	Yr Ago	5 Yrs Ago	This Qtr	pp Change from Last Qtr <sup>(1)</sup>	Yr Ago	5 Yrs Ago	This Qtr	% Change from Last Qtr	Yr Ago
1	<b>Bellaire</b>	2,786	56	231	465	15.8%	408	792	16.7%	2.3%	14.6%	30.2%	\$20.75	-0.9%	\$20.95	\$17.51
	Bellaire - Class A	523	1	27	145	-2.3%	120	74	27.8%	-0.7%	23.0%	23.9%	\$23.99	0.1%	\$24.20	\$17.00
2	<b>Central Business District</b>	40,686	2,590	3,124	6,558	0.7%	7,768	7,226	16.1%	0.1%	19.1%	18.6%	\$29.78	0.6%	\$30.39	\$20.49
	Central Business District - Class A	28,893	2,210	2,478	4,197	1.0%	5,119	4,882	14.5%	0.1%	17.7%	18.2%	\$34.01	0.7%	\$34.98	\$21.89
3	<b>FM 1960</b>	4,214	153	279	1,296	-6.2%	1,242	938	30.8%	-2.0%	29.5%	26.4%	\$15.12	-0.7%	\$14.85	\$14.07
	FM 1960 - Class A	298	12	13	196	-0.9%	203	40	65.8%	-0.6%	67.9%	28.4%	\$18.98	0.2%	\$17.87	\$16.50
4	<b>Greenway Plaza</b>	9,840	1,208	760	1,508	-15.0%	1,756	1,887	15.3%	-2.7%	17.8%	19.2%	\$24.06	0.2%	\$24.54	\$19.47
	Greenway Plaza - Class A	6,071	1,048	501	882	-16.1%	1,190	1,016	14.5%	-2.8%	19.6%	17.0%	\$27.07	1.4%	\$26.92	\$21.21
5	<b>I-10/NE/Kingwood</b>	1,570	68	53	300	-3.5%	298	131	19.1%	-0.7%	19.0%	9.6%	\$17.52	1.6%	\$16.55	\$17.51
	I-10/Northeast/Kingwood - Class A	20	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
6	<b>Katy Freeway</b>	21,053	2,029	1,551	3,369	-7.4%	3,795	1,476	16.0%	-1.3%	18.0%	9.2%	\$24.51	1.8%	\$24.21	\$18.30
	Katy Freeway - Class A	12,724	1,553	1,001	2,007	-6.9%	2,531	405	15.8%	-1.2%	19.9%	4.7%	\$28.52	2.2%	\$27.65	\$22.81
7	<b>Medical Center/South</b>	2,967	31	135	315	3.7%	259	205	10.6%	0.4%	8.7%	8.1%	\$17.21	-1.1%	\$16.14	\$14.11
	Medical Center/South - Class A	379	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
8	<b>Midtown</b>	5,078	194	168	507	-1.8%	660	488	10.0%	-0.2%	13.0%	9.7%	\$25.19	2.8%	\$24.29	\$19.45
	Midtown - Class A	1,221	13	44	269	2.3%	333	92	22.0%	0.5%	27.3%	7.7%	\$28.40	4.9%	\$26.17	\$21.34
9	<b>N. Sam Houston Pkwy/Greenspoint</b>	11,324	280	729	2,327	12.1%	2,143	1,609	20.5%	2.2%	19.1%	15.2%	\$16.36	-1.0%	\$16.10	\$15.36
	N. Sam Houston Pkwy/Greenspoint - Class A	4,247	65	253	480	27.4%	412	309	11.3%	2.4%	9.7%	7.4%	\$20.67	0.0%	\$20.16	\$18.57
10	<b>NASA/Clear Lake</b>	5,650	236	217	1,183	-0.2%	821	652	20.9%	0.0%	15.9%	13.4%	\$20.12	-1.0%	\$19.14	\$14.92
	NASA/Clear Lake - Class A	830	143	78	186	-14.6%	69	53	22.4%	-3.8%	9.5%	7.7%	\$22.27	-2.8%	\$20.57	\$21.27
11	<b>North Loop W/290 Near</b>	5,527	155	322	1,414	-1.2%	1,487	1,233	25.6%	-0.3%	26.9%	22.9%	\$17.87	-1.9%	\$17.89	\$17.00
	North Loop W/290 Near - Class A	802	15	111	89	-11.5%	118	248	11.0%	-1.4%	14.7%	30.9%	\$21.89	0.6%	\$21.34	\$18.61
12	<b>Northwest/290 Far</b>	9,296	703	530	2,118	2.4%	2,502	841	22.8%	0.5%	28.1%	13.4%	\$21.19	-1.1%	\$22.69	\$16.97
	Northwest/290 Far - Class A	3,947	440	313	912	1.7%	1,198	268	23.1%	0.4%	30.3%	13.7%	\$23.39	-1.2%	\$25.05	\$19.56
13	<b>Pasadena/Baytown</b>	2,505	64	100	324	-2.6%	323	330	12.9%	-0.3%	12.9%	13.6%	\$17.97	-3.6%	\$17.84	\$14.17
	Pasadena/Baytown - Class A	88	N/A	N/A	35	0.0%	44	N/A	39.4%	0.0%	50.0%	0.0%	\$26.00	0.0%	\$25.00	N/A
14	<b>Southwest/Sugarland</b>	16,799	534	1,030	4,015	-2.5%	4,491	2,886	23.9%	-0.6%	26.7%	19.4%	\$18.04	-1.5%	\$18.18	\$14.82
	Southwest/Sugarland - Class A	4,592	168	183	1,195	-10.4%	1,504	920	26.0%	-3.0%	32.7%	23.6%	\$22.20	-3.6%	\$22.29	\$17.74
15	<b>West Loop/Galleria</b>	28,780	2,399	2,196	4,952	0.0%	5,263	4,296	17.2%	0.0%	18.3%	15.0%	\$25.02	1.7%	\$25.42	\$19.17
	West Loop/Galleria - Class A	17,728	1,410	1,231	3,085	-0.3%	3,051	2,344	17.4%	-0.1%	17.2%	13.2%	\$28.66	1.5%	\$29.00	\$20.91
16	<b>Westchase</b>	14,812	1,374	1,073	2,528	-6.8%	3,087	1,832	17.1%	-1.3%	20.8%	13.9%	\$22.52	0.3%	\$23.87	\$19.51
	Westchase - Class A	7,862	916	551	1,128	-13.9%	1,686	805	14.3%	-2.3%	21.4%	12.6%	\$28.34	0.1%	\$28.94	\$23.62
17	<b>Woodlands</b>	6,803	426	335	809	-27.4%	1,133	532	11.9%	-4.5%	17.3%	10.9%	\$23.97	-1.5%	\$24.98	\$20.39
	Woodlands - Class A	2,564	208	140	325	-24.6%	593	121	12.7%	-4.1%	23.7%	8.2%	\$27.79	0.2%	\$28.46	\$26.82
1-17	<b>GREATER HOUSTON TOTAL</b>	189,688	12,490	13,043	33,990	-2.4%	37,436	27,355	17.9%	-0.4%	19.9%	16.0%	\$22.89	0.4%	\$23.25	\$18.32
	GREATER HOUSTON TOTAL - Class A	92,789	8,202	6,831	15,130	-4.0%	18,170	11,577	16.3%	-0.7%	19.6%	14.4%	\$28.73	1.2%	\$28.92	\$21.38

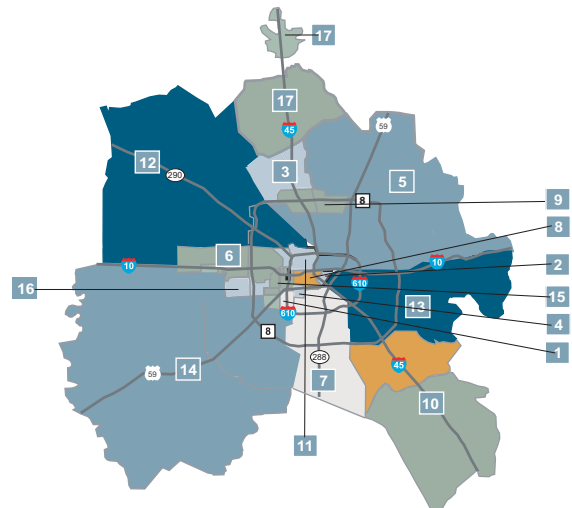
(1) Percentage point change for availability rates. Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf. Statistics are calculated using both direct and sublease information.

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