

# BETTS-FARBER SOUTHWEST INVESTMENT TEAM

## ANNUAL INVESTMENT REPORT

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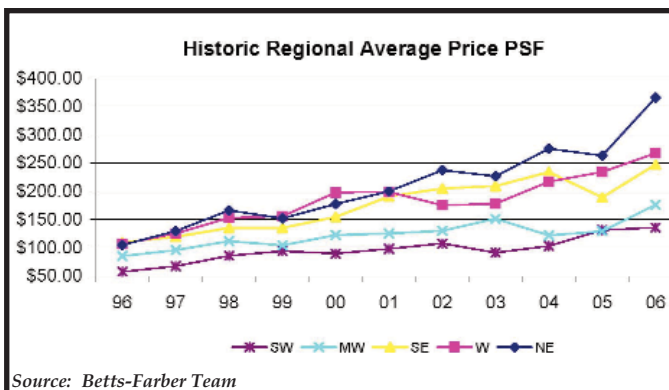
JANUARY 2007

### OVERVIEW AND FORECAST:

In retrospect, 2006 may be looked upon as the year of the "Mega Deal." In the U.S. alone, 30 properties or portfolios sold for more than \$1 billion. In Europe, the market for commercial property exceeded \$264 billion (a 28% increase over 2005).

Record breaking investment activity in the U.S. and abroad was coupled with unprecedented levels of mergers and acquisition activity within the REIT industry. Twenty-two transactions worth more than \$100 billion were completed in 2006. Most notably, The Blackstone Group, who emerged as the industry's most prolific buyer, announced the largest real estate deal in history with the now completed acquisition of Equity Office Properties. The heightened activity within the REIT community came at a time when the market for REIT shares was up almost 30%. Large dividends offered by REITs proved an attractive investment incentive in a market that saw the Dow Jones Industrial Average rise nearly 16% this year.

Over 3,000 office properties traded in 2006. Fueled by an improved national economy and strengthened leasing markets, the heightened investment activity resulted in record pricing in nearly every market and region across the country.



Private equity real estate funds raised \$55 billion from public sources in 2006. When leveraged, these funds should have buying power in excess of \$160 billion for 2007, resulting in a more competitive investment landscape.

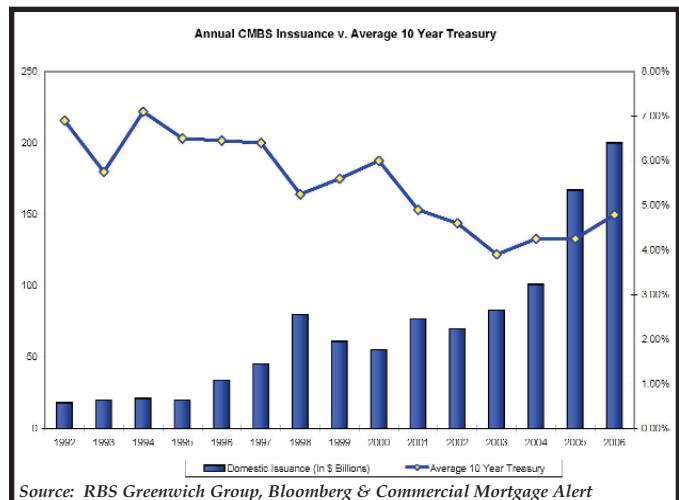
Increased capital and market competition should exert further pressure on cap rates. In 2007, expect cap rates on core and core-plus assets to drop slightly but stabilize, while value-add properties should see slight increases followed by stabilization.

Further cap rate compression will diminish the risk-premium between 10-year Treasuries and real estate returns. Should the 10-year Treasury yield move towards 5%, buyers will be forced to re-examine their investment priorities.

Other Major Markets			
Average Sale Pricing PSF: 2005 - 2006			
	2005	2006	% Change
New York City	\$385	\$633	64%
Washington D.C.	\$355	\$441	24%
San Francisco	\$335	\$357	7%
Los Angeles	\$267	\$282	6%
Boston	\$194	\$313	61%
Atlanta	\$165	\$175	6%
Chicago	\$138	\$201	46%
Houston	\$138	\$113	-5%
Dallas	\$111	\$118	15%

Average Quoted Class "A" Lease Rate: 2005 - 2006			
	2005	2006	% Change
New York City	\$58.34	\$65.80	13%
Washington D.C.	\$35.18	\$36.77	5%
San Francisco	\$34.57	\$38.03	10%
Los Angeles	\$30.48	\$33.35	10%
Boston	\$29.44	\$30.51	4%
Atlanta	\$21.57	\$21.31	-1%
Chicago	\$28.40	\$30.41	7%
Houston	\$21.14	\$22.81	8%
Dallas	\$21.50	\$22.86	6%



Keeping pace with the rest of the market, CMBS issuances topped \$200 billion in 2006. The increasing popularity of CMBS as a vehicle for packaging and reselling debt has experts predicting the market will top \$240 billion in 2007.

During the same period, the market for CDOs approached \$2 trillion. Since 1998, the market for CDOs has experienced over 150% annual market growth, with no signs of slowing in the new year.

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### MARKET UPDATES:

#### DALLAS

A robust leasing atmosphere rallied investor confidence in the Dallas market in 2006. Total market absorption in Dallas-Fort Worth exceeded 5 million square feet in 2006. The market's performance resulted in increased lease rates as area owners pushed rates by an average of \$.50 per square foot from Q1 2006 to year end.

Strong growth forecasts for the North Texas region have investors taking long term positions in the market. High profile transactions were closed in the CBD, Far North Dallas, Las Colinas, LBJ Freeway and Central Expressway submarkets. In all, 122 Class A and B properties (larger than 50,000 SF) traded in 2006. The average deal sold for approximately \$118 PSF, with a corresponding cap rate near 8%.

In 2006, the ownership composition within the Dallas CBD saw significant and dramatic changes. Traditionally a market for institutions and funds, a number of CBD buildings are now held by private groups. The significant upside potential of downtown Dallas has captured the attention of more risk tolerant private buyers.

#### HOUSTON

The Houston office market benefited in 2006 from a booming energy sector, increased demand at the Port of Houston and continued demand that has resulted after Hurricane Katrina. Much like Dallas-Fort Worth, Houston is forecast to create over 80,000 jobs in the next year.

Robust economic growth and stabilized leasing fundamentals drove the Houston market in 2006. Absorption figures eclipsed 4 million square feet, as market occupancy strengthened to 85%.

A number of significant Houston office properties trade hands in 2006. One of the largest transactions took place when a joint venture between Brookfield Properties and Blackstone Group paid \$120 million

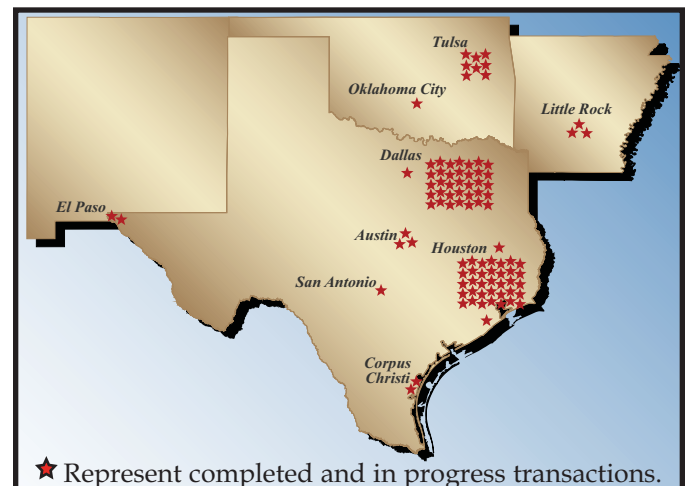
for the 1.2 million square foot Four Allen Center. In all, over 75 properties traded in 2006 with average pricing at \$113 per square foot on capitalization rates near 8%.

#### OTHER SOUTHWEST MARKETS

The Austin market thrived in 2006. Recording the highest occupancy and rental rates seen in five years, the Austin market remains one of the strongest office leasing environments in Texas. Bolstered by the leasing market, investors took down 17 significant office properties in 2006 with average pricing at \$163 per square foot.

2007 is shaping up to be an interesting year for the Austin market. Crescent Real Estate and Equity Office Properties/Blackstone both have considerable portfolios of property in Austin and have begun examining possible disposition strategies. In all, over 3 million square feet in the Austin CBD could trade if Crescent and EOP/Blackstone decided to liquidate their Austin holdings.

Like Austin, the San Antonio office market has flourished recently. Coming off of 12 consecutive quarters of positive absorption, San Antonio is currently 87% occupied. Rapid economic expansion brought intense investor interest to San Antonio, resulting in average office sale pricing at \$104 per square foot in 2006.



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Scot C. Farber, CCIM  
Senior Vice President  
972-450-3251

Tom Strohbahn  
Associate  
972-450-3217

Scot.Farber@Grubb-Ellis.com Tom.Strohbahn@Grubb-Ellis.com

**Grubb & Ellis**  
Property Solutions Worldwide

[WWW.GRUBB-ELLIS.COM](http://WWW.GRUBB-ELLIS.COM)

Darrell L. Betts, CCIM  
Senior Vice President  
713-599-5148

Lain Cimarosti  
Associate  
713-599-5138

Darrell.Betts@Grubb-Ellis.com Lain.Cimarosti@Grubb-Ellis.com