CRESCENT REAL ESTATE EQUITIES CO
Form 10-Q
November 08, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR QUARTER ENDED September 30, 2006
COMMISSION FILE NO. 1-13038
CRESCENT REAL ESTATE EQUITIES COMPANY
(Exact name of registrant as specified in its charter)

TEXAS	52-1862813
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
777 Main Street, Suite 2100, Fort Worth, Texas	76102
(Address of principal executive offices)	(Zip code)

Registrant s telephone number, including area code (817) 321-2100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve (12) months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past ninety (90) days.

YES þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act).

YES o NO þ

Number of shares outstanding of each of the registrant s classes of preferred and common shares, as of November 2, 2006:

Series A Convertible Cumulative Preferred Shares, par value $0.01 per share:	14,200,000
Series B Cumulative Redeemable Preferred Shares, par value $0.01 per share:	3,400,000
Common Shares, par value $0.01 per share:	102,741,892

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CRESCENT REAL ESTATE EQUITIES COMPANY
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share data)
(unaudited)

	September 30, 2006	December 31, 2005
ASSETS:		
Investments in real estate:		
Land	$ 192,946	$ 183,228
Land improvements, net of accumulated depreciation of $34,783 and $29,784 at September 30, 2006 and December 31, 2005, respectively	75,402	70,494
Buildings and improvements, net of accumulated depreciation of $512,353 and $456,628 at September 30, 2006 and December 31, 2005, respectively	1,901,077	1,760,920
Furniture, fixtures and equipment, net of accumulated depreciation of $38,229 and $34,129 at September 30, 2006 and December 31, 2005, respectively	40,079	37,236
Land held for investment or development	789,549	574,527
Properties held for disposition, net	4,016	28,918
Net investment in real estate	$ 3,003,069	$ 2,655,323
Cash and cash equivalents	$ 77,231	$ 86,228
Restricted cash and cash equivalents	74,666	84,699
Defeasance investments	113,599	274,134
Accounts receivable, net	47,754	56,356
Deferred rent receivable	65,799	70,074
Investments in unconsolidated companies	388,217	393,535
Notes receivable, net	253,279	219,016
Income tax asset-current and deferred	13,994	8,291
Other assets, net	276,126	294,206
Total assets	$ 4,313,734	$ 4,141,862
LIABILITIES:		
Borrowings under Credit Facility	$ 301,000	$ 234,000
Notes payable	2,138,572	1,948,152
Junior subordinated notes	77,321	77,321
Accounts payable, accrued expenses and other liabilities	508,633	471,920
Deferred tax liability		1,093
Total liabilities	$ 3,025,526	$ 2,732,486

COMMITMENTS AND CONTINGENCIES:

MINORITY INTERESTS:

Operating partnership, 11,429,173 and 11,416,173 units, at September 30, 2006 and December 31, 2005, respectively	$	101,919	$	113,819
Consolidated real estate partnerships		54,498		53,562
Total minority interests	$	156,417	$	167,381
SHAREHOLDERS EQUITY:				
Preferred shares, $0.01 par value, authorized 100,000,000 shares:				
Series A Convertible Cumulative Preferred Shares, liquidation preference of $25.00 per share, 14,200,000 shares issued and outstanding at September 30, 2006 and December 31, 2005	$	319,166	$	319,166
Series B Cumulative Redeemable Preferred Shares, liquidation preference of $25.00 per share, 3,400,000 shares issued and outstanding at September 30, 2006 and December 31, 2005		81,923		81,923
Common shares, $0.01 par value, authorized 250,000,000 shares, 127,858,021 and 126,562,980 shares issued and 102,737,104 and 101,442,063 shares outstanding at September 30, 2006 and December 31, 2005, respectively		1,279		1,266
Additional paid-in capital		2,294,264		2,271,888
Deferred compensation on restricted shares				(1,182)
Accumulated deficit		(1,103,547)		(972,319)
Accumulated other comprehensive income (loss)		(1,162)		1,385
	$	1,591,923	$	1,702,127
Less shares held in treasury, at cost, 25,120,917 common shares at September 30, 2006 and December 31, 2005		(460,132)		(460,132)
Total shareholders equity	$	1,131,791	$	1,241,995
Total liabilities and shareholders equity	$	4,313,734	$	4,141,862

The accompanying notes are an integral part of these consolidated financial statements.

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CRESCENT REAL ESTATE EQUITIES COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars in thousands, except share data)
(unaudited)

	For the three months ended September 30, 2006	For the three months ended September 30, 2005	For the nine months ended September 30, 2006	For the nine months ended September 30, 2005
REVENUE:				
Office Property	$ 103,115	$ 96,283	$ 313,188	$ 277,849
Resort Residential Development Property	67,662	78,401	220,517	218,714
Resort/Hotel Property	33,870	35,787	104,609	105,546
Total Property revenue	$ 204,647	$ 210,471	$ 638,314	$ 602,109
EXPENSE:				
Office Property real estate taxes	$ 10,443	$ 9,509	$ 30,725	$ 29,421
Office Property operating expenses	40,863	40,574	122,006	114,446
Resort Residential Development Property expense	63,725	68,706	205,105	191,154
Resort/Hotel Property expense	25,170	26,531	78,441	81,989
Total Property expense	$ 140,201	$ 145,320	$ 436,277	$ 417,010
Income from Property Operations	$ 64,446	$ 65,151	$ 202,037	$ 185,099
OTHER INCOME (EXPENSE):				
Income from sale of investment in unconsolidated company	$ 24,249	$	$ 28,546	$
Income from investment land sales	228		228	8,424
Gain (loss) on joint venture of properties	(6)	276	(6)	1,816
Gain (loss) on property sales	(12)	(39)	286	141
Interest and other income	10,743	7,412	35,921	20,622
Corporate general and administrative	(10,937)	(11,751)	(37,575)	(33,143)
Interest expense	(34,569)	(34,076)	(100,623)	(103,434)
Amortization of deferred financing costs	(2,025)	(2,139)	(5,638)	(6,183)
Extinguishment of debt		(361)		(2,028)
Depreciation and amortization	(37,330)	(36,937)	(110,966)	(111,943)
Other expenses	(5,047)	(1,686)	(8,825)	(2,362)
Equity in net income (loss) of unconsolidated companies:				
Office Properties	2,340	3,202	7,208	9,888
Resort Residential Development Properties	(333)	(839)	(457)	(647)
Resort/Hotel Properties	(1,424)	(733)	(3,510)	28
Temperature-Controlled Logistics Properties	(1,832)	77	(4,432)	(2,266)
Other	491	210	1,016	10,971

Total other income (expense)	$ (55,464)	$ (77,384)	$ (198,827)	$ (210,116)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE MINORITY INTERESTS AND INCOME TAXES	$ 8,982	$ (12,233)	$ 3,210	$ (25,017)
Minority interests	(3,001)	641	(3,569)	150
Income tax benefit	3,337	754	7,663	2,299
INCOME (LOSS) BEFORE DISCONTINUED OPERATIONS	$ 9,318	$ (10,838)	$ 7,304	$ (22,568)
Income from discontinued operations, net of minority interests	61	811	195	4,208
Impairment charges related to real estate assets from discontinued operations, net of minority interests	(105)	(64)	(105)	(64)
Gain on sale of real estate from discontinued operations, net of minority interests	50	89,735	139	91,238
NET INCOME	$ 9,324	$ 79,644	$ 7,533	$ 72,814
Series A Preferred Share distributions	(5,991)	(5,991)	(17,972)	(17,972)
Series B Preferred Share distributions	(2,019)	(2,019)	(6,056)	(6,056)
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$ 1,314	$ 71,634	$ (16,495)	$ 48,786
BASIC EARNINGS PER SHARE DATA:				
Income (loss) available to common shareholders before discontinued operations	$ 0.01	$ (0.19)	$ (0.16)	$ (0.46)
Income from discontinued operations, net of minority interests		0.01		0.04
Impairment charges related to real estate assets from discontinued operations, net of minority interests				
Gain on sale of real estate from discontinued operations, net of minority interests		0.89		0.91
Net income (loss) available to common shareholders basic	$ 0.01	$ 0.71	$ (0.16)	$ 0.49
DILUTED EARNINGS PER SHARE DATA:				
Income (loss) available to common shareholders before discontinued operations	$ 0.01	$ (0.19)	$ (0.16)	$ (0.46)
Income from discontinued operations, net of minority interests		0.01		0.04
Impairment charges related to real estate assets from discontinued operations, net of minority interests				

Gain on sale of real estate from discontinued operations, net of minority interests				0.89				0.91
Net income (loss) available to common shareholders diluted	$	0.01	$	0.71	$	(0.16)	$	0.49

The accompanying notes are an integral part of these consolidated financial statements.

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CRESCENT REAL ESTATE EQUITIES COMPANY
CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
(dollars in thousands)
(unaudited)

Series A Preferred Shares		Series B Preferred Shares		Treasury Shares		Common Shares		Additional Paid-in Capital	Deferred Compensation on Restricted Shares	Accumulated (Deficit)
Shares	Net Value	Shares	Net Value	Shares	Net Value	Shares	Par Value			
4,200,000	$ 319,166	3,400,000	$ 81,923	25,120,917	$ (460,132)	126,562,980	$ 1,266	$ 2,271,888	$ (1,182)	$ (972,319)
						375,455	4	6,616		
								(190)		
						919,586	9	16,132		
								212		
								(1,182)	1,182	
								788		
										(114,733)
										(16,495)

4,200,000	$ 319,166	3,400,000	$ 81,923	25,120,917	$ (460,132)	127,858,021	$ 1,279	$ 2,294,264	$	$ (1,103,547)

The accompanying notes are an integral part of these consolidated financial statements.

CRESCENT REAL ESTATE EQUITIES COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

	For the nine months ended September 30, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 7,533	$ 72,814
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	116,667	121,605
Extinguishment of debt		2,138
Resort Residential Development cost of sales	114,702	112,459
Resort Residential Development capital expenditures	(342,172)	(255,585)
Impairment charges related to real estate assets from discontinued operations	125	75
Income from investment land sales	(228)	(8,424)
(Gain) loss on joint venture of properties	6	(1,816)
(Gain) loss on property sales	(451)	(107,480)
Income from sale of investment in unconsolidated company	(28,546)	
Minority interests	3,613	16,682
Non-cash compensation	10,805	7,114
Amortization of debt premiums	(1,551)	(1,845)
Equity in loss (earnings) from unconsolidated companies	175	(17,974)
Ownership portion of management fees from unconsolidated investments	5,533	5,283
Distributions received from unconsolidated companies	4,911	12,109
Change in assets and liabilities, net of acquisitions and dispositions:		
Restricted cash and cash equivalents	4,121	27,927
Accounts receivable and notes receivable	(19,001)	6,147
Deferred rent receivable	4,274	(16,987)
Current and deferred income taxes	(6,796)	(2,932)
Other assets	(9,794)	(18,455)
Accounts payable, accrued expenses and other liabilities	33,387	41,814
Net cash used in operating activities	$ (102,687)	$ (5,331)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from property sales	$ 24,335	$ 236,572
Proceeds from sale of investment in unconsolidated company and related property sales	34,313	
Proceeds from joint venture partners		144,193
Acquisition of investment properties	(30,675)	(186,901)
Development of investment properties	(107,623)	(49,177)
Property improvements Office Properties	(9,590)	(8,080)
Property improvements Resort/Hotel Properties	(19,785)	(5,076)
Tenant improvement and leasing costs Office Properties	(46,849)	(50,719)
Resort Residential Development Properties investments	(18,927)	(23,470)

Decrease (increase) in restricted cash and cash equivalents	8,913	(3,160)
Purchases of defeasance investments		(115,710)
Proceeds from defeasance investment maturities and other securities	172,845	20,430
Return of investment in unconsolidated companies	21,988	21,777
Investment in unconsolidated companies	(20,496)	(14,131)
Increase in notes receivable	(5,770)	(67,479)
Net cash provided by (used in) investing activities	$ 2,679	$ (100,931)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Debt financing costs	$ (3,785)	$ (9,867)
Borrowings under Credit Facility	284,000	550,300
Payments under Credit Facility	(217,000)	(519,800)
Notes payable proceeds	233,201	370,026
Notes payable payments	(174,082)	(257,510)
Junior subordinated notes proceeds		77,321
Resort Residential Development Properties notes payable borrowings	205,517	179,870
Resort Residential Development Properties notes payable payments	(96,269)	(85,253)
Capital distributions to joint venture partners	(9,532)	(6,271)
Capital contributions from joint venture partners	8,446	7,104
Proceeds from exercise of share and unit options	22,778	21,304
Reissuance of Treasury Shares		16
Series A Preferred Share distributions	(17,972)	(17,972)
Series B Preferred Share distributions	(6,056)	(6,056)
Dividends and unitholder distributions	(138,235)	(133,128)
Net cash provided by financing activities	$ 91,011	$ 170,084
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	$ (8,997)	$ 63,822
CASH AND CASH EQUIVALENTS, Beginning of period	86,228	92,291
CASH AND CASH EQUIVALENTS, End of period	$ 77,231	$ 156,113

The accompanying notes are an integral part of these consolidated financial statements.

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

References to we, us or our refer to Crescent Real Estate Equities Company and, unless the context otherwise requires, Crescent Real Estate Equities Limited Partnership, which we refer to as our Operating Partnership, and our other direct and indirect subsidiaries. We conduct our business and operations through the Operating Partnership, our other subsidiaries and our joint ventures. References to Crescent refer to Crescent Real Estate Equities Company. The sole general partner of the Operating Partnership is Crescent Real Estate Equities, Ltd., a wholly-owned subsidiary of Crescent Real Estate Equities Company, which we refer to as the General Partner.

We operate as a real estate investment trust, or REIT, for federal income tax purposes and provide management, leasing and development services for some of our properties.

The following table shows our consolidated subsidiaries that owned or had an interest in real estate assets and the real estate assets that each subsidiary owned or had an interest in as of September 30, 2006.

Operating Partnership	Wholly-owned assets The Avallon IV, Dupont Centre and Financial Plaza, included in our Office Segment.
	Non wholly-owned assets, consolidated 301 Congress Avenue (50% interest), included in our Office Segment. Fairmont Sonoma Mission Inn (80.1% interest), included in our Resort/Hotel Segment.
	Non wholly-owned assets, unconsolidated Bank One Center (50% interest), 2211 Michelson Office Development Irvine (40% interest), Three Westlake Park (20% interest), Miami Center (40% interest), One BriarLake Plaza (30% interest), Five Post Oak Park (30% interest), Houston Center (23.85% interest in three office properties and the Houston Center Shops), The Crescent Atrium (23.85% interest), The Crescent Office Towers (23.85% interest), Trammell Crow Center[(1)] (23.85% interest), Post Oak Central (23.85% interest in three Office Properties), Fountain Place (23.85% interest), Fulbright Tower (23.85% interest) and One Buckhead Plaza (35% interest), included in our Office Segment. AmeriCold Realty Trust (31.7% interest in 86 properties), included in our Temperature-Controlled Logistics Segment. Canyon Ranch Tucson and Canyon Ranch Lenox (48% interest), included in our Resort/Hotel Segment.
Crescent Real Estate Funding One, L.P. (Funding One)	Wholly-owned assets Carter Burgess Plaza, 125 E. John Carpenter Freeway, The Aberdeen, Regency Plaza One and The Citadel, included in our Office Segment.
Hughes Center Entities[(2)]	Wholly-owned assets Hughes Center Properties (eight office properties each in a separate limited liability company), 3883 Hughes Parkway (Office Development), included in our Office Segment.
Crescent Real Estate Funding III, IV and V, L.P. (Funding III, IV and V)[(3)]	Non wholly-owned assets, consolidated Greenway Plaza Office Properties (ten Office Properties, 99.9% interest), included in our Office Segment. Renaissance Houston Hotel (99.9% interest), included in our Resort/Hotel Segment.
Crescent Real Estate Funding VIII, L.P. (Funding VIII)	Wholly-owned assets The Addison, Austin Centre, The Avallon I, II, III and V, Exchange Building, 816 Congress, Greenway I & IA (two office properties), Greenway II, Johns Manville Plaza, One Live Oak, Palisades Central I, Palisades

		Central II, Stemmons Place, 3333 Lee Parkway, 44 Cook and 55 Madison, included in our Office Segment. Omni Austin Hotel and Ventana Inn & Spa, included in our Resort/Hotel Segment.
Crescent Real Estate Funding XII, L.P. (Funding XII)	Wholly-owned assets	Briargate Office and Research Center, MacArthur Center I & II and Stanford Corporate Center, included in our Office Segment. Park Hyatt Beaver Creek Resort & Spa, included in our Resort/Hotel Segment.
Crescent 707 17^{th} Street, LLC	Wholly-owned assets	707 17^{th} Street, included in our Office Segment and the Denver Marriott City Center, included in our Resort/Hotel Segment.
Crescent Peakview Tower, LLC	Wholly-owned asset	Peakview Tower, included in our Office Segment.
Crescent Alhambra, LLC	Wholly-owned asset	The Alhambra (two Office Properties), included in our Office Segment.
Crescent Datran Center, LLC	Wholly-owned asset	Datran Center (two Office Properties), included in our Office Segment.
Crescent Spectrum Center, L.P.	Non wholly-owned asset, consolidated	Spectrum Center (99.9% interest), included in our Office Segment.
Crescent-JMIR Paseo Del Mar, LLC	Non wholly-owned asset, consolidated	Paseo Del Mar Office Development (80% interest), included in our Office Segment.
C-C Parkway Austin, L.P.	Non wholly-owned asset, consolidated	Parkway at Oakhill Office Development (90% interest), included in our Office Segment.
Crescent Colonnade, LLC	Wholly-owned asset	The BAC-Colonnade Building, included in our Office Segment.

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Mira Vista Development Corp. (MVDC)	Non wholly-owned asset, consolidated Mira Vista (98% interest), included in our Resort Residential Development Segment.
Jefferson Station, L.P.[4]	Non wholly-owned asset, consolidated JPI (50% interest), included in our Resort Residential Development Segment.
Crescent Plaza Residential, L.P.	Wholly-owned asset the Residences at the Ritz-Carlton Development, included in our Resort Residential Development Segment.
Crescent Tower Residential, L.P.	Wholly-owned asset the Tower Residences and Regency Row at the Ritz-Carlton Development, included in our Resort Residential Development Segment.
Crescent Plaza Hotel Owner, L.P.	Wholly-owned asset the Ritz-Carlton Hotel Development, included in our Resort/Hotel Segment.
Houston Area Development Corp. (HADC)	Non wholly-owned assets, consolidated Falcon Point (98% interest) and Spring Lakes (98% interest), included in our Resort Residential Development Segment.
Desert Mountain Development Corporation (DMDC)	Non wholly-owned asset, consolidated Desert Mountain (93% interest), included in our Resort Residential Development Segment.
Crescent Resort Development Inc. (CRDI)[4]	Wholly-owned asset The Residences at Park Hyatt Beaver Creek, included in our Resort Residential Development Segment.
	Non wholly-owned assets, consolidated Brownstones (64% interest), Creekside Townhomes at Riverfront Park (64% interest), Delgany (64% interest), One Riverfront (64% interest), Beaver Creek Landing (59% interest), Eagle Ranch (76% interest), Gray s Crossing (71% interest), Hummingbird (64% interest), Main Street Vacation Club (30% interest), Northstar Highlands (57% interest), Northstar Village (57% interest), Old Greenwood (71% interest), Riverbend (68% interest), Village Walk (58% interest), Tahoe Mountain Club (71% interest) and Ritz-Carlton Highlands (71% interest), included in our Resort Residential Development Segment.
	Non wholly-owned assets, unconsolidated Blue River Land Company, LLC Three Peaks (33.2% interest), EW Deer Valley, LLC (35.7% interest) and East West Resort Development XIV, L.P., L.L.L.P. (26.8%), included in our Resort Residential Development Segment.

(1) We own 23.85% of the economic interest in Trammell Crow Center through our ownership of a 23.85%

interest in the joint venture that holds fee simple title to the Office Property (subject to a ground lease and a leasehold estate regarding the building) and two mortgage notes encumbering the leasehold interests in the land and the building.

(2) In addition, we own nine retail parcels located in Hughes Center.

(3) Funding III owns nine of the ten office properties in the Greenway Plaza office portfolio and the Renaissance Houston Hotel; Funding IV owns the central heated and chilled water plant building located at Greenway Plaza; and Funding V owns 9 Greenway, the remaining office property in the Greenway Plaza office portfolio.

(4) We receive a preferred return

on our invested capital before cash flows are allocated to the partners.

See Note 8, Investments in Unconsolidated Companies, for a table that lists our ownership in significant unconsolidated joint ventures and investments as of September 30, 2006.

See Note 9, Notes Payable and Borrowings Under Credit Facility, for a list of certain other subsidiaries, all of which are consolidated in our financial statements and were formed primarily for the purpose of obtaining secured debt.

Segments

Our assets and operations consisted of four investment segments at September 30, 2006, as follows:

- Office Segment;
- Resort Residential Development Segment;
- Resort/Hotel Segment; and
- Temperature-Controlled Logistics Segment.

Within these segments, we owned in whole or in part the following operating real estate assets, which we refer to as the Properties, as of September 30, 2006:

- **Office Segment** consisted of 74 office properties, which we refer to as the Office Properties, located in 28 metropolitan submarkets in eight states, with an aggregate of approximately 29.8 million net rentable square feet. Fifty-four of the Office Properties are wholly-owned and 20 are owned through joint ventures, two of which are consolidated and 18 of which are unconsolidated.

- **Resort Residential Development Segment** consisted of our ownership of common stock representing interests of 98% to 100% in four Resort Residential Development Corporations and three limited partnerships. These Resort Residential Development Corporations, through partnership arrangements, owned in whole or in part 28 upscale resort residential development properties, which we refer to as the Resort Residential Development Properties.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Resort/Hotel Segment consisted of five luxury and destination fitness resorts and spas with a total of 949 rooms/guest nights and three upscale business-class hotel properties with a total of 1,376 rooms, which we refer to as the Resort/Hotel Properties. Five of the Resort/Hotel Properties are wholly-owned, one is owned through a joint venture that is consolidated and two are owned through joint ventures that are unconsolidated.

Temperature-Controlled Logistics Segment consisted of our 31.7% interest in AmeriCold Realty Trust, or AmeriCold, a REIT. As of September 30, 2006, AmeriCold operated 102 facilities, of which 86 were wholly-owned, one was partially-owned and fifteen were managed for outside owners. The 87 owned and partially-owned facilities, which we refer to as the Temperature-Controlled Logistics Properties, had an aggregate of approximately 445.1 million cubic feet (17.7 million square feet) of warehouse space. AmeriCold also owned one quarry and the related land.

See Note 3, Segment Reporting, for a table showing selected financial information for each of these investment segments for the nine months ended September 30, 2006 and 2005, and total assets, consolidated property level financing, consolidated other liabilities and minority interests for each of these investment segments at September 30, 2006 and December 31, 2005.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine month period ended September 30, 2006, are not necessarily indicative of the results that may be expected for the year ended December 31, 2006.

The consolidated balance sheet at December 31, 2005, has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

You should read these consolidated financial statements in conjunction with the consolidated financial statements and footnotes thereto in our annual report on Form 10-K for the year ended December 31, 2005.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Adoption of New Accounting Standards

SFAS No. 123R. In December 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 123R (Revised 2004), *Share-Based Payment*. The new FASB rule requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. We were required to apply SFAS No. 123R beginning January 1, 2006. The scope of SFAS No. 123R includes a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS No. 123R replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes Accounting Principles Board, or APB, Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that statement permitted entities the option of continuing to apply the guidance in Opinion No. 25, as long as the footnotes to the financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Effective January 1, 2003, we adopted the fair value expense recognition provisions of SFAS No. 123 on a prospective basis. We adopted SFAS No. 123R using the modified prospective application method which requires, among other things, that we recognize compensation cost for all awards outstanding at January 1, 2006, for which the requisite service has not yet been rendered. Additionally, our prior interim periods and fiscal years do not reflect any restated amounts due to the adoption of SFAS No. 123R. We estimate an additional $1.4 million and $0.2 million of expense will be recorded for the years ended December 31, 2006 and 2007, respectively, for stock and unit options due to the adoption of SFAS No. 123R.

CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

EITF 04-5. At its June 2005 meeting, the Emerging Issues Task Force, or EITF, reached a consensus regarding Issue No. 04-5 (EITF 04-5), *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*. EITF 04-5 was effective immediately for all newly-formed limited partnerships and for existing limited partnership agreements that are modified. The guidance is effective for existing limited-partnership agreements that are not modified no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. The guidance provides a framework for addressing the question of when a general partner, as defined in EITF 04-5, should consolidate a limited partnership. The EITF has concluded that the general partner of a limited partnership should consolidate a limited partnership unless (1) the limited partners possess substantive kick-out rights as defined in paragraph B20 of Interpretation No. 46(R), *Consolidation of Variable Interest Entities* an Interpretation of ARB No. 51, or FIN 46R or (2) the limited partners possess substantive participating rights similar to the rights described in Issue 96-16, *Investor s Accounting for an Investee When the Investor has a Majority of the Voting Interest but the Minority Shareholder or Shareholders have Certain Approval or Veto Rights* (EITF 96-16). The FASB has amended Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures,* and EITF 96-16, to conform and align with the guidelines set forth in EITF 04-5. There was no impact to our financial condition or results of operations from the adoption of EITF 04-5.

EITF 06-3. At its June 2006 meeting, the EITF ratified the consensus regarding Issue No. 06-3 (EITF 06-3), *How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That is, Gross versus Net Presentation)*. EITF 06-3 is effective for interim and annual periods beginning after December 15, 2006, with earlier application permitted. The scope of EITF 06-3 includes any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and may include, but is not limited to, sales, use, value added, and certain excise taxes. The consensus indicates that gross vs. net income statement classification of those taxes within its scope is an accounting policy decision. In addition, for taxes within its scope, the consensus requires the following disclosures: the accounting policy elected for these taxes and the amounts of the taxes reflected gross (as revenue) in the income statement on an interim and annual basis. We do not believe there will be an impact to our financial condition or results of operations from the adoption of EITF 06-3.

FASB Interpretation 48. In July 2006, the FASB issued Interpretation 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109,* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes.* FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The standard also provides guidance on derecognizing, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, and are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet a more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. We are currently evaluating the impact, if any, to our financial condition and results of operations from the adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48, if any, will be reported as an adjustment to the beginning balance of accumulated deficit on January 1, 2007.

SFAS No. 157. In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. The new FASB rule defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, or GAAP, and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the impact, if any, to our financial condition or results of operations from the adoption of SFAS No. 157.

SAB No. 108. In September 2006, the Securities and Exchange Commission, or SEC, issued Staff Accounting Bulletin No. 108, *Financial Statements Considering the Effects of Prior Year Misstatements when Quantifying*

Misstatements in Current Year Financial Statements, (SAB 108), which is effective for fiscal years ending after November 15, 2006. SAB No. 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements. We do not believe there will be an impact to our financial condition or results of operations from the adoption of SAB No. 108.

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CRESCENT REAL ESTATE EQUITIES COMPANY
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Significant Accounting Policies

Earnings Per Share. SFAS No. 128, *Earnings Per Share*, specifies the computation, presentation and disclosure requirements for earnings per share, or EPS.

Basic EPS is computed by dividing net income available to common shareholders by the weighted average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted into common shares, where such exercise or conversion would result in a lower EPS amount. We present both basic and diluted earnings per share.

The following tables present the reconciliation for the three and nine months ended September 30, 2006 and 2005, of basic and diluted earnings per share from Income (loss) before discontinued operations to Net income (loss) available to common shareholders. The tables also include weighted average shares on a basic and diluted basis.

	For the three months ended September 30, 2006			2005		
(in thousands, except per share amounts)	Income (Loss)	Wtd. Avg. Shares	Per Share Amount	(Loss) Income	Wtd. Avg. Shares	Per Share Amount
Basic EPS						
Income (loss) before discontinued operations	$ 9,318	102,449		$ (10,838)	100,663	
Series A Preferred Share distributions	(5,991)			(5,991)		
Series B Preferred Share distributions	(2,019)			(2,019)		
Income (loss) available to common shareholders before discontinued operations	$ 1,308	102,449	$ 0.01	$ (18,848)	100,663	$ (0.19)
Income from discontinued operations, net of minority interests	61			811		0.01
Impairment charges related to real estate assets from discontinued operations, net of minority interests	(105)			(64)		
Gain on sale of real estate from discontinued operations, net of minority interests	50			89,735		0.89
Net income available to common shareholders	$ 1,314	102,449	$ 0.01	$ 71,634	100,663	$ 0.71

	For the three months ended September 30, 2006			2005		
(in thousands, except per share amounts)	Income (Loss)	Wtd. Avg. Shares	Per Share Amount	(Loss) Income	Wtd. Avg. Shares	Per Share Amount
Diluted EPS						

Income (loss) before discontinued operations	$ 9,318	102,449		$ (10,838)	100,663	
Series A Preferred Share distributions	(5,991)			(5,991)		
Series B Preferred Share distributions	(2,019)			(2,019)		
Effect of dilutive securities:						
Share and unit options		1,614			(1)	
Income (loss) available to common shareholders before discontinued operations	$ 1,308	104,063	$ 0.01	$ (18,848)	100,663	$ (0.19)
Income from discontinued operations, net of minority interests	61			811		0.01
Impairment charges related to real estate assets from discontinued operations, net of minority interests	(105)			(64)		
Gain on sale of real estate from discontinued operations, net of minority interests	50			89,735		0.89
Net income available to common shareholders	$ 1,314	104,063	$ 0.01	$ 71,634	100,663	$ 0.71

(1) Share and unit options are not included because the effect of their conversion would be antidilutive to loss available to common shareholders before discontinued operations.

	For the nine months ended September 30,					
	2006			2005		
(in thousands, except per share amounts)	(Loss) Income	Wtd. Avg. Shares	Per Share Amount	(Loss) Income	Wtd. Avg. Shares	Per Share Amount
Basic/Diluted EPS (1)						
Income (loss) before discontinued operations	$ 7,304	101,856		$ (22,568)	99,936	
Series A Preferred Share distributions	(17,972)			(17,972)		
Series B Preferred Share distributions	(6,056)			(6,056)		

Loss available to common shareholders before discontinued operations	$ (16,724)	101,856	$ (0.16)	$ (46,596)	99,936	$ (0.46)
Income from discontinued operations, net of minority interests	195			4,208		0.04
Impairment charges related to real estate assets from discontinued operations, net of minority interests	(105)			(64)		
Gain on sale of real estate from discontinued operations, net of minority interests	139			91,238		0.91
Net (loss) income available to common shareholders	$ (16,495)	101,856	$ (0.16)	$ 48,786	99,936	$ 0.49

(1) Share and unit options are not included because the effect of their conversion would be antidilutive to loss available to common shareholders before discontinued operations.

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CRESCENT REAL ESTATE EQUITIES COMPANY
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The effect of the conversion of the Series A Convertible Cumulative Preferred Shares and the exchange of Operating Partnership units are not included in the computation of diluted EPS for the three and nine months ended September 30, 2006 and 2005, since the effect of the conversions are not dilutive.

Supplemental Disclosure to Statements of Cash Flows

(in thousands)	For the nine months ended September 30, 2006	2005
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ (118,385)	$ (116,317)
Cash received (paid) for income taxes	$ 867	$ (633)
Interest capitalized Office	$ 3,795	$ 173
Interest capitalized Resort Residential Development	16,093	14,716
Interest capitalized Resort/Hotel	2,008	523
Total interest capitalized	$ 21,896	$ 15,412
Supplemental disclosures of non cash activities:		
Assumption of debt in conjunction with acquisition of Office Property	$ 23,605	$
Joint venture of Office Properties debt	$	$ 158,350

3. SEGMENT REPORTING

For purposes of segment reporting as defined in SFAS No. 131, we have four major investment segments based on property type: the Office Segment; the Resort Residential Development Segment; the Resort/Hotel Segment and the Temperature-Controlled Logistics Segment. Management utilizes this segment structure for making operating decisions and assessing performance.

We use funds from operations, or FFO, as the measure of segment profit or loss. FFO, as used in this document, is based on the definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts, or NAREIT, and means:

Net Income (Loss) determined in accordance with GAAP;

excluding gains (losses) from sales of depreciable operating property;

excluding extraordinary items (as defined by GAAP);

plus depreciation and amortization of real estate assets; and

after adjustments for unconsolidated partnerships and joint ventures.

We calculate FFO available to common shareholders diluted in the same manner, except that Net Income (Loss) is replaced by Net Income (Loss) Available to Common Shareholders and we include the effect of Operating Partnership unitholder minority interests.

NAREIT developed FFO as a relative measure of performance of an equity REIT to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. We consider FFO available to common shareholders diluted and FFO appropriate measures of performance for an equity REIT and for its investment segments. However, FFO available to common shareholders diluted and FFO should not be considered as alternatives to net income determined in accordance with GAAP as an indication of our operating performance.

Our measures of FFO available to common shareholders diluted and FFO may not be comparable to similarly titled measures of other REITs if those REITs apply the definition of FFO in a different manner than we apply it.

Selected financial information related to each segment for the three and nine months ended September 30, 2006 and 2005, and total assets, consolidated property level financing, consolidated other liabilities, and minority interests for each of the segments at September 30, 2006 and 2005, are presented in the following tables:

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Selected Financial Information:

	For the three months ended September 30, 2006					
(in thousands)	Office Segment[(1)]	Resort Residential Development Segment	Resort/Hotel Segment	Temperature-Controlled Logistics Segment	Corporate and Other[(2)]	Total
Total Property revenue	$ 103,115	$ 67,662	$ 33,870	$	$	$ 204,647
Total Property expense	51,306	63,725	25,170			140,201
Income from Property Operations	$ 51,809	$ 3,937	$ 8,700	$	$	$ 64,446
Total other income (expense)	(586)	(5,023)	(5,795)	(1,831)	(42,229)	(55,464)
Minority interests and income taxes	(1,399)	3,230	339		(1,834)	336
Discontinued operations net of minority interests	51				(45)	6
Net income (loss)	$ 49,875	$ 2,144	$ 3,244	$ (1,831)	$ (44,108)	$ 9,324
Depreciation and amortization of real estate assets	$ 25,937	$ 2,620	$ 4,017	$	$	$ 32,574
(Gain) loss on property sales	(9,558)	6				(9,552)
Promoted interests related to the sale of investment in unconsolidated companies	(14,742)					(14,742)
Adjustments for investment in unconsolidated companies	5,770	(3,276)	1,204	4,212		7,910
Unitholder minority interest					1,774	1,774
Series A Preferred share distributions					(5,991)	(5,991)
Series B Preferred share distributions					(2,019)	(2,019)
Adjustments to reconcile net income (loss) to funds	$ 7,407	$ (650)	$ 5,221	$ 4,212	$ (6,236)	$ 9,954

from operations available to common shareholders diluted						
Funds from operations available to common shareholders diluted	$ 57,282	$ 1,494	$ 8,465	$ 2,381	$ (50,344)	$ 19,278

See footnotes following the table.

Selected Financial Information:

	For the three months ended September 30, 2005					
(in thousands)	**Office Segment[1]**	**Resort Residential Development Segment**	**Resort/Hotel Segment**	**Temperature-Controlled Logistics Segment**	**Corporate and Other[2]**	**Total**
Total Property revenue	$ 96,283	$ 78,401	$ 35,787	$	$	$ 210,471
Total Property expense	50,083	68,706	26,531			145,320
Income from Property Operations	$ 46,200	$ 9,695	$ 9,256	$	$	$ 65,151
Total other income (expense)	(23,697)	(5,156)	(5,317)	76	(43,290)	(77,384)
Minority interests and income taxes	(1,365)	858	151		1,751	1,395
Discontinued operations, net of minority interests	106,535				(16,053)	90,482
Net income (loss)	$ 127,673	$ 5,397	$ 4,090	$ 76	$ (57,592)	$ 79,644
Depreciation and amortization of real estate assets	$ 27,208	$ 2,238	$ 4,219	$	$	$ 33,665
(Gain) loss on property sales	(105,847)		39			(105,808)
Adjustments for investment in unconsolidated companies	5,548	(2,161)	1,004	4,530		8,921
Unitholder minority interest					14,049	14,049
Series A Preferred share distributions					(5,991)	(5,991)
Series B Preferred share distributions					(2,019)	(2,019)

Adjustments to reconcile net income (loss) to funds from operations available to common shareholders diluted	(73,091)	77	5,262	4,530	6,039	(57,183)
Funds from operations available to common shareholders diluted	$ 54,582	$ 5,474	$ 9,352	$ 4,606	$ (51,553)	$ 22,461

See footnotes following the table.

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Selected Financial Information:

	For the nine months ended September 30, 2006					
(in thousands)	**Office Segment[1]**	**Resort Residential Development Segment**	**Resort/Hotel Segment**	**Temperature-Controlled Logistics Segment**	**Corporate and Other[2]**	**Total**
Total Property revenue	$ 313,188	$ 220,517	$ 104,609	$	$	$ 638,314
Total Property expense	152,731	205,105	78,441			436,277
Income from Property Operations	$ 160,457	$ 15,412	$ 26,168	$	$	$ 202,037
Total other income (expense)	(44,927)	(14,141)	(16,709)	(4,432)	(118,618)	(198,827)
Minority interests and income taxes	(2,640)	6,380	1,751		(1,397)	4,094
Discontinued operations net of minority interests	156				73	229
Net income (loss)	$ 113,046	$ 7,651	$ 11,210	$ (4,432)	$ (119,942)	$ 7,533
Depreciation and amortization of real estate assets	$ 77,374	$ 7,580	$ 12,173	$	$	$ 97,127
Gain on property sales	(13,920)	(153)				(14,073)
Promoted interests related to the sale of investment in unconsolidated companies	(14,742)					(14,742)
Adjustments for investment in unconsolidated companies	16,025	(9,276)	3,497	11,991		22,237
Unitholder minority interest					1,435	1,435
Series A Preferred share distributions					(17,972)	(17,972)
Series B Preferred share distributions					(6,056)	(6,056)
	$ 64,737	$ (1,849)	$ 15,670	$ 11,991	$ (22,593)	$ 67,956

Adjustments to reconcile net income (loss) to funds from operations available to common shareholders diluted						
Funds from operations available to common shareholders diluted	$ 177,783	$ 5,802	$ 26,880	$ 7,559	$ (142,535)	$ 75,489

See footnotes following the table.

Selected Financial Information:

	For the nine months ended September 30, 2005					
(in thousands)	**Office Segment**[1]	**Resort Residential Development Segment**	**Resort/Hotel Segment**	**Temperature-Controlled Logistics Segment**	**Corporate and Other**[2]	**Total**
Total Property revenue	$ 277,849	$ 218,714	$ 105,546	$	$	$ 602,109
Total Property expense	143,867	191,154	81,989			417,010
Income from Property Operations	$ 133,982	$ 27,560	$ 23,557	$	$	$ 185,099
Total other income (expense)	(67,411)	(13,367)	(16,487)	(2,266)	(110,585)	(210,116)
Minority interests and income taxes	(3,402)	2,899	2,923		29	2,449
Discontinued operations net of minority interests	112,135				(16,753)	95,382
Net income (loss)	$ 175,304	$ 17,092	$ 9,993	$ (2,266)	$ (127,309)	$ 72,814
Depreciation and amortization of real estate assets	$ 79,737	$ 6,954	$ 15,769	$	$	$ 102,460
Gain on property sales	(109,155)		(141)		(289)	(109,585)
Adjustments for investment in unconsolidated companies	15,627	(2,609)	2,813	13,729		29,560
Unitholder minority interest					12,849	12,849
Series A Preferred share distributions					(17,972)	(17,972)
Series B Preferred share distributions					(6,056)	(6,056)

Adjustments to reconcile net income (loss) to funds from operations available to common shareholders diluted	$ (13,791)	$ 4,345	$ 18,441	$ 13,729	$ (11,468)	$ 11,256
Funds from operations available to common shareholders diluted	$ 161,513	$ 21,437	$ 28,434	$ 11,463	$ (138,777)	$ 84,070

See footnotes following the table.

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in millions)	Office Segment	Resort Residential Development Segment	Resort/Hotel Segment	Temperature-Controlled Logistics Segment	Corporate and Other	Total
Total Assets by Segment:(3)						
Balance at September 30, 2006(4)	$ 2,104	$ 1,200	$ 367	$ 155	$ 488(5)	$ 4,314
Balance at December 31, 2005(4)	2,024	969	338	162	649(5)	4,142
Consolidated Property Level Financing:						
Balance at September 30, 2006	(972)	(252)	(128)		(1,165)(6)	(2,517)
Balance at December 31, 2005	(851)	(143)	(59)		(1,206)(6)	(2,259)
Consolidated Other Liabilities:						
Balance at September 30, 2006	(116)	(311)	(32)		(50)	(509)
Balance at December 31, 2005	(117)	(287)	(28)		(41)	(473)
Minority Interests:						
Balance at September 30, 2006	(17)	(32)	(5)		(102)	(156)
Balance at December 31, 2005	(15)	(32)	(6)		(114)	(167)

(1) The property revenue includes lease termination fees (net of the write-off of deferred rent receivables) of approximately $8.5 million and $4.9 million for the three months ended September 30, 2006 and 2005, respectively and $33.9 million and $7.0 million for the nine months ended September 30, 2006 and 2005, respectively. The 2006 lease termination fees are primarily due to the El Paso lease termination and related re-leasing.

(2) For purposes of this Note, Corporate and Other includes the total of: income from investment land sales, net, interest and other income, corporate general and administrative expense, interest expense, extinguishment of debt, other expenses and equity in net income of unconsolidated companies-other.

(3) Total assets by segment are inclusive of investments in unconsolidated companies.

(4) Non-income producing land held for investment or development of \$88.1 million and \$84.4 million at September 30, 2006 and December 31, 2005, respectively, by segment is as follows: Office \$28.0 million and \$24.3 million, Resort Residential Development \$9.6 million and \$9.6 million,

Resort/Hotel $7.3 million and $7.3 million and Corporate $43.2 million and $43.2 million, respectively.

(5) Includes mezzanine investments and defeasance investments.

(6) Inclusive of Corporate bonds, Credit Facility, Junior Subordinated Notes, the Morgan Stanley and Goldman Sachs repurchase facilities, the Funding I defeased debt and Nomura Funding VI defeased debt. Balance at December 31, 2005 also includes Funding II defeased debt.

4. ACQUISITIONS

During the nine months ended September 30, 2006, we completed the following acquisition:

(in millions) Date	Property		Location	Purchase Price
January 23, 2006	Financial Plaza	Class A Office Property	Phoenix, Arizona	$55.0[1]

(1) The acquisition was funded by the assumption of a $23.6 million loan from Allstate, a new $15.9 million loan from Allstate and a draw on our

credit facility.
This property is
wholly-owned.

5. DISCONTINUED OPERATIONS

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the results of operations of the assets sold or held for sale have been presented as Income from discontinued operations, net of minority interests, impairments on the assets sold or held for sale have been presented as Impairment charges related to real estate assets from discontinued operations, net of minority interests and gain or loss on the assets sold or held for sale have been presented as Gain on sale of real estate from discontinued operations, net of minority interests in the accompanying Consolidated Statements of Operations for the three and nine months ended September 30, 2006 and 2005. Minority interests for wholly-owned properties represent unitholders share of related income, gains and losses. The carrying value of the assets held for sale has been reflected as Properties held for disposition, net in the accompanying Consolidated Balance Sheets as of September 30, 2006 and December 31, 2005.

Assets Sold

On February 17, 2006, we completed the sale of the Waterside Commons Office Property located in the Las Colinas submarket in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately $24.8 million. We previously recorded an impairment charge of approximately $1.0 million during the year ended December 31, 2005. The proceeds from the sale were used primarily to pay down our credit facility.

CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Summary of Assets Held for Sale

The following table indicates the major classes of assets of the Properties held for sale.

(in thousands)	September 30, 2006	December 31, 2005
Land	$	$ 3,650
Buildings and improvements	3,998	31,639
Accumulated depreciation	(43)	(7,465)
Other assets, net	61	1,094
Net investment in real estate	$ 4,016	$ 28,918

The following tables present income, impairment charges and gain on sale for the nine months ended September 30, 2006 and 2005, for properties included in discontinued operations.

	For the nine months ended September 30,	
(in thousands)	2006	2005
Total revenues	$ 674	$ 16,841
Operating and other expenses	(379)	(8,335)
Depreciation and amortization	(63)	(3,555)
Unitholder minority interests	(37)	(743)
Income from discontinued operations, net of minority interests	$ 195	$ 4,208

	For the nine months ended September 30,	
(in thousands)	2006	2005
Impairment charges related to real estate assets	$ (125)	$ (75)
Unitholder minority interests	20	11
Impairment charges related to real estate assets from discontinued operations, net of minority interests	$ (105)	$ (64)

	For the nine months ended September 30,	
(in thousands)	2006	2005
Realized gain on sale of properties	$ 165	$ 107,339
Unitholder minority interests	(26)	(16,101)
Gain on sale of real estate from discontinued operations, net of minority interests	$ 139	$ 91,238

6. JOINT VENTURES

Office

Parkway at Oakhill

On March 31, 2006, we entered into a joint venture arrangement, C-C Parkway Austin, L.P. (Parkway), with Champion Partners. The joint venture has committed to co-develop a 144,380 square-foot, two-building office complex in Austin, Texas. The venture is structured such that we own a 90% interest and Champion Partners owns the remaining 10% interest. In connection with the joint venture, Parkway entered into a maximum $18.3 million construction loan with JPMorgan Chase Bank. Our equity commitment to the joint venture was $8.2 million, of which $7.0 million has been funded as of September 30, 2006. The development, which is currently underway, is scheduled for delivery in the second quarter of 2007. Upon completion, we will manage the property on behalf of the joint venture. We consolidate Parkway in accordance with FIN 46R, as it was determined to be a variable interest entity, or VIE, of which we are the primary beneficiary. JPMorgan Chase Bank has no recourse to Crescent.

Chase Tower

On June 20, 2006, we completed the sale of Chase Tower on behalf of Austin PT BK One Tower Office Limited Partnership, the joint venture which was owned 80% by an affiliate of GE and 20% by us. The sale generated proceeds to the joint venture, net of selling costs, of approximately $68.8 million and a net gain of approximately $10.1 million. Our net gain was approximately $4.3 million, inclusive of the recognition of the deferred gain from the joint venture of the property in 2001. Our share of the proceeds was approximately $5.6 million, which was used to pay down the credit facility.

**CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Four Westlake Park

On September 26, 2006, we completed the sale of Four Westlake Park on behalf of Houston PT Four Westlake Office Limited Partnership, the joint venture which was owned 80% by an affiliate of GE and 20% by us. The sale generated proceeds to the joint venture, net of selling costs, of approximately $121.3 million and a net gain of approximately $55.0 million. Our share of the net gain, including a promoted interest of approximately $14.7 million, was approximately $24.2 million. Our share of the proceeds was approximately $28.7 million, which was used to pay down our credit facility.

Resort Residential Development

Riverfront Village

On March 21, 2006, CRDI entered into a joint venture arrangement, East West Resort Development XIV, L.P., L.L.L.P. (Riverfront Village), with affiliates of Crow Holdings and our development partner. The joint venture was formed to co-develop a hotel and condominiums in Avon, Colorado. The development, which is currently underway, is scheduled for delivery in 2008. We provided 41.9% of the initial capitalization and the venture is structured such that we own a 26.8% interest after we receive a preferred return on our invested capital and return of our capital. Our equity commitment to the joint venture is $23.7 million, of which $13.5 million was funded as of September 30, 2006. We determined that Riverfront Village is a VIE under FIN 46R of which we are not the primary beneficiary; therefore we do not consolidate the entity. Our maximum exposure to loss is limited to the amount of our capital investment. We account for our interest in Riverfront Village under the equity method.

7. MEZZANINE INVESTMENTS

The following table presents our mezzanine loans entered into during the nine months ended September 30, 2006. These loans are reflected in the Notes receivable, net line item in the Consolidated Balance Sheets. Mezzanine loans are loans that are subordinate to a conventional first mortgage loan and senior to the borrower s equity in a transaction. These loans may be in the form of a junior participating interest in the senior debt or in the form of loans to the direct or indirect parent of the property owner secured by pledges of ownership interests in entities that directly or indirectly control the real property or subordinated loans secured by second mortgage liens on the property.

(in millions) **Date**	**Outstanding Loan Amount**	**Underlying Real Estate Asset**	**Maturity Date**	**Interest Rate at September 30, 2006**	**Fixed/ Variable**
January 20, 2006	$ 15.0(1)	Florida Hotel Portfolio Investment	2009	13.33%	Variable
April 12, 2006	20.0(2)	California Ski Resort	2009	9.83%	Variable
May 8, 2006	28.8(3)	New York City Residential	2007	18.16%	Variable

(1) The loan bears interest at LIBOR plus 800 basis points with an interest-only term until maturity, subject to the right of the borrower to extend the loan

pursuant to two one-year extension options.

(2) The loan bears interest at LIBOR plus 450 basis points with an interest-only term until maturity, subject to the right of the borrower to extend the loan pursuant to two one-year extension options.

(3) The loan bears interest at LIBOR plus 1,283 basis points with an interest-only term until maturity, subject to the right of the borrower to extend the loan pursuant to two one-year extension options. We determined that the entity to which the loan was funded is a VIE under FIN 46R of which we are not the primary beneficiary; therefore, we do not consolidate the entity. Our maximum

exposure to loss is limited to the amount of the loan.

In February 2006, we received approximately $56.4 million of proceeds for the repayment of two of our mezzanine investments, which included $6.2 million of prepayment fees.

At September 30, 2006, we had approximately $186.2 million of mezzanine investments outstanding which mature in 2007 through 2010 and had a weighted average interest rate of 13.47%.

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8. INVESTMENTS IN UNCONSOLIDATED COMPANIES

The following is a summary of our ownership in significant unconsolidated joint ventures and investments as of September 30, 2006.