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HOUSTON OFFICE PERFORMANCE UPDATE

EDITED BY KATHRYN KOEPKE | $499 PER YEAR | VOLUME 10 NUMBER 1 | FIRST QUARTER 2006

Absorption Patterns

↑ **1,470,457 SF absorbed in 1Q-06**

↑ **2,504,176 SF absorbed over past 12 months**

Occupancy Levels

↑ **83.85% overall in 1Q-06**

Rent Growth

↑ **Rents up $0.18 to $18.40 overall**

Employment Growth[1]

↑ **10,000 jobs gained in March 2006**

↑ **Annual Job Growth up 3.1%**

1. Texas Workforce Commission, 03/06 Total non-agricultural jobs

It appears that Houston's economy wasn't as bleak as everyone was making it out to be, as the **Texas Workforce Commission** recently released revised employment numbers. Houston area employment growth figures for 2005 were revised upward from 8,500 to 46,000 new jobs. Job growth was across the board as all sectors experienced gains. According to **Dr. Barton Smith**, **Director of the University of Houston's Center for Public Policy**, who recently spoke at an O'Connor & Associates luncheon, a high percentage of the gains can be attributed to the upstream energy sector, which made a comeback in a big way in 2005. With skyrocketing gas prices and record industry profits, this really doesn't come as much of a shock to anyone.

The continued health and growth of Houston's upstream energy market is reflected in the performance of Katy Freeway West office market sector, where Houston's Energy Corridor is located. Notable companies with offices in the area include BP, ConocoPhillips, and Shell. Within the sector, vacancy is only 9.68%, compared to the 16.15% seen in the overall market while rents are at $18.61, $0.21 above the overall rental average.

Jobs and the office market are forever entwined as significant job growth typically impacts the office market. However, as Dr. Smith pointed out, Houston's economy is more diversified now than ever, and a healthy energy sector does not immediately translate into across the board economic success, which is evidenced by the vacancy rate in the overall office market. Continued steady job growth is what is needed to help elevate Houston's office market. And with expected job growth of another 3% in 2006, the office market should continue to reap the benefits.

ABSORPTION

With 1,470,457 square feet (SF) absorbed, the first quarter of 2006 marks the first time in over 4 years that the Houston office market has posted over 1 million SF of positive absorption. Class A led the market with 1,470,384 SF absorbed. Annual absorption, exceeding 2.5 million SF, is also largely the result of demand for Class A space, which absorbed nearly 2.4 million SF in over the last 12 months.

Greater Houston Office Market Absorption (12-month period)

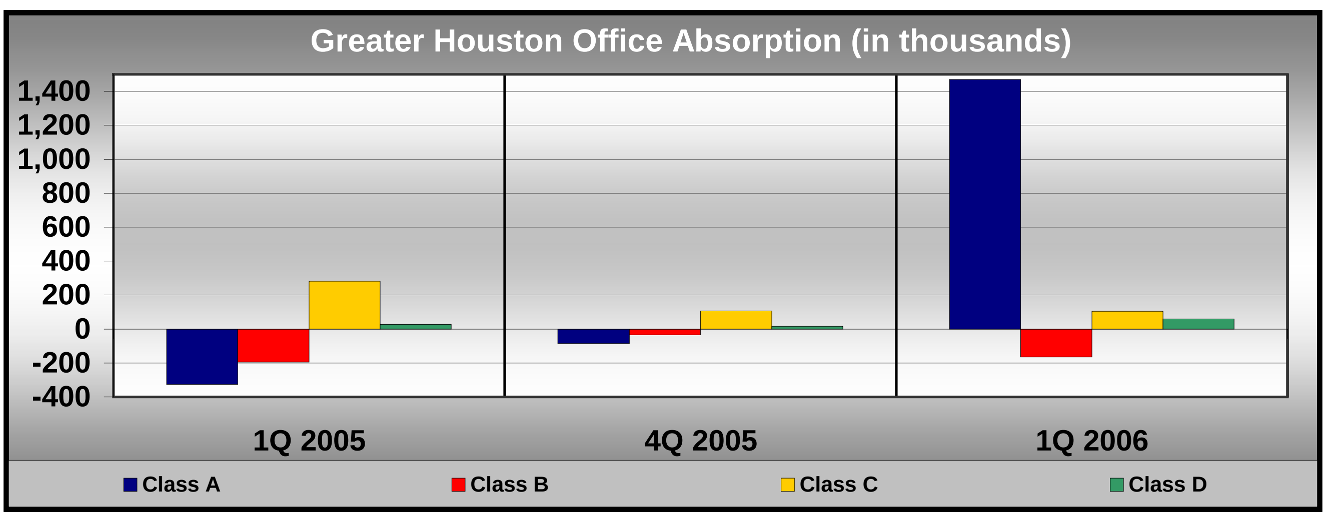
Year Ending	Class A	Class B	Class C	Class D	Overall
1Q/04	-2,030,000	-1,019,724	36,202	176,088	-2,837,434
1Q/05	223,888	467,746	134,820	76,344	-912,528
1Q/06	**2,381,208**	**11,244**	**31,146**	**80,578**	**2,504,176**

The **Class A** market brought the overall Houston office market back into the black with over 1.47 million SF absorbed over the first quarter, the strongest quarterly showing for Class A absorption since 2000. The ***Central Business District*** posted the strongest absorption with 694,610 SF absorbed.

Class B remained in the red over the last quarter, absorbing -164,060 SF. While the ***Katy Freeway West*** sector absorbed 99,925 SF, the ***Central Business District*** posted -162,759 SF absorbed, followed by the ***North Loop/Northwest Freeway*** sector with -97,489 SF absorbed.

Demand for **Class C** space continues to be healthy as 104,480 SF were absorbed over the first quarter. The ***Westchase*** and ***Southwest Freeway*** sectors were strongest with 56,603 SF and 29,179 SF, respectively, absorbed. The ***Technology Corridor/FM 1960*** sector reported the largest quarterly loss with -17,934 SF absorbed.

Class D maintained positive absorption for the fifth consecutive quarter with 59,653 SF absorbed over the first quarter, bringing annual absorption to 80,578 SF. The ***Southeast*** sector posted the largest loss with -6,313 SF absorbed, while the ***Clear Lake*** sector led the market with 33,226 SF absorbed over the quarter.



OCCUPANCY

The Houston office market continued to post increases over the last quarter. The current occupancy marks the 2nd quarter in which occupancy levels have exceeded 83% in over 2 years. At 83.85%, occupancy is 0.70 points higher than last quarter and is 1.67 points higher than levels a year ago, thanks to increases in Classes A, C, and D occupancy rates.

Greater Houston Office Market Occupancy (Quarterly)

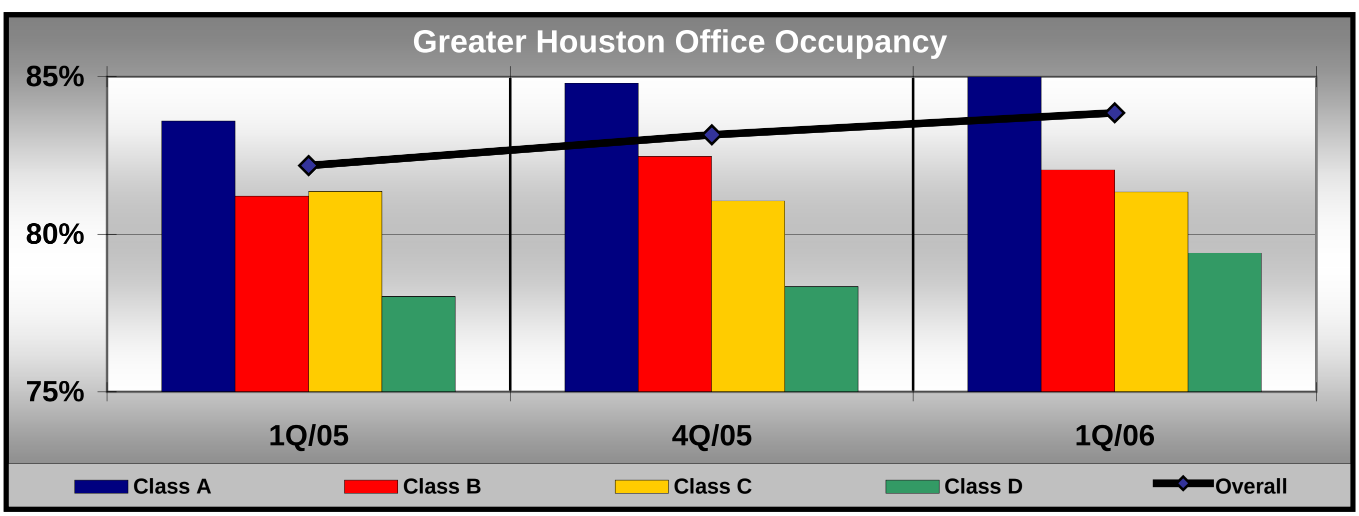
Quarter	Class A	Class B	Class C	Class D	Overall
1Q/05	83.59%	81.21%	81.36%	78.02%	82.18%
4Q/05	84.80%	82.47%	81.05%	78.34%	83.15%
1Q/06	**86.51%**	**82.05%**	**81.34%**	**79.41%**	**83.85%**

The **Class A** market saw the largest increase in occupancy as it gained 1.61 points over the last quarter to 86.51%, and is at its highest level since the second quarter of 2003. The ***Park 10*** sector led the market with 98.96%, followed by the ***Katy Freeway East*** sector with 95.61% occupancy.

Class B recorded the only decrease in occupancy. At 82.05%, Class B occupancy is down 0.42 points over the quarter, but is up 0.84 points from the this time last year. The ***Northwest*** sector posted the lowest occupancy at 68.13%, while the ***Kingwood*** sector led the market at 94.41%.

Class C occupancy continued to increase over the first quarter, as 0.29 points were gained to reach 81.34%. The ***Midtown/Allen Parkway*** and ***Southwest 2*** sectors continue to lead the market posting 97.44% and 95.62%, respectively. The two sectors also contributed with 1.19- and 0.55-point increases, respectively, over the quarter.

Occupancy in the **Class D** market also posted its 2nd consecutive increase as it gained 1.07 points from the previous quarter and is up 1.39 over the last year. The ***Westchase*** sector posted the highest occupancy at 94.93%, follwed by ***Fountainview/Gessner*** with 93.36%.



RENTAL RATES

Rental rates in the Houston office market continued on their upward trend over the quarter as they increased for the third consecutive quarter, and have gained $0.30 per square foot (psf) over the year, reaching $18.40 psf. And for at least three consecutive quarters, Classes A, B, and C have also posted rental rate increases.

Greater Houston Office Market Rental Rates (Quarterly)*

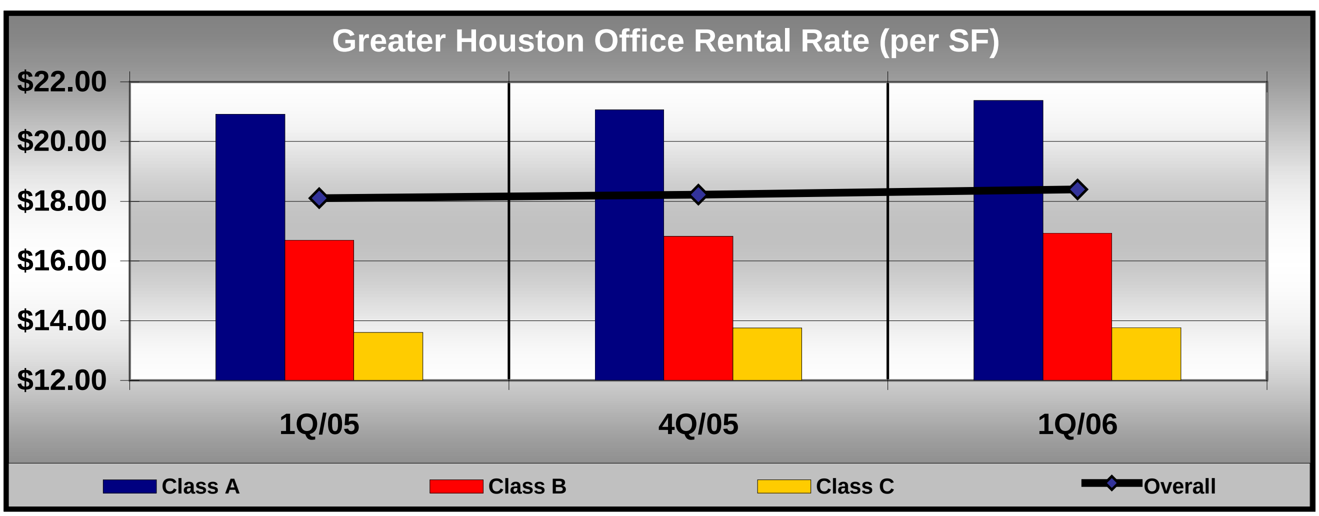
Quarter	Class A	Class B	Class C	Class D	Overall
1Q/05	$20.92	$16.70	$13.61	$11.50	$18.10
4Q/05	$21.07	$16.83	$13.76	$11.45	$18.22
1Q/06	**$21.38**	**$16.94**	**$13.77**	**$11.42**	**$18.40**

Class A rents showed the largest increases in rents over the quarter, up $0.21 psf over the quarter and $0.46 psf over the year. The highest rental rates continue to be found in ***The Woodlands/Conroe*** and ***Katy Freeway West*** sectors at $22.02 and $21.96 psf, respectively, with The Woodlands/ Conroe sector posting a $0.72 psf increase over the quarter.

The **Class B** rents are up $0.11 psf over the quarter to $16.94 psf, and up $0.24 psf since this time last year. The ***Medical Center*** continues to post the highest average rents at $21.91 psf, which are up $0.28 over the quarter.

Class C rents also posted quarterly and yearly increases of $0.01 and $0.16 psf, respectively, and are at $13.77 psf. The highest rents are still found in the ***Midtown/Allen Parkway*** sector at $18.12 psf, which remain unchanged over the quarter.

The **Class D** market was the only market to post a decrease in rents over the quarter, and is also the only market to do so over the past year, dropping $0.03 and $0.12 psf, respectively, to $11.42 psf. The ***Westchase*** sector recorded the lowest rental rates at $10.15 psf.



*For statistical purposes, Class A rents in the Central Business District are adjusted to gross, though many landlords quote net rent.

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