The Houston Office Performance Update

Edited by Kathryn Koepke | **$499/year** | **1st Quarter 2007**

Let the Good Times Roll

First quarter 2007 figures indicate that Houston's office market is on a roll. Absorption figures topped the 2-million mark for the second time in the past twelve months, as 2,102,253 square feet (SF) was absorbed over the quarter. Overall occupancy is now up to 87.37%, its highest level in five years. Occupancy stands a full 3.57 points higher than it was one year ago. Further, overall rental rates increased $0.39 over the quarter and are up $1.73 over the year to their current record high rate of $20.44 per square foot.

Class A continues to lead the market, with occupancy increasing 0.70 points over the quarter to 91.70%, which represents a 5.42-point gain over last year's figure. Quarterly absorption in the Class A market totaled 943,628 SF. Absorption was strongest in the **Park 10** sector, as 270,370 SF was abosrbed, followed by the **Central Business District** with 197,518 SF absorbed, and the **Westchase** sector with 180,035 SF abosrbed.

The tightening of the Class A market has finally pushed the Class B market to the forefront. During the first quarter, the Class B market registered record-high absorption of 984,512 SF. The sectors seeing the most activity were the **Galleria** sector where 340,446 SF was absorbed and The **Woodlands/Conroe** sector, which recorded 230,681 SF of absorption. The strong absorption pushed Class B occupancy up 1.24 points, the largest quarterly gain of all classes, to 84.74%. The Class B market also enjoyed a hefty rental rate increase, with average rents gaining $0.49 per square foot (psf). However, at $18.19 psf, average Class B rents remain roughly one-thrid below average Class A rents, which are currently at $24.37 psf.

Though not to the same degree as the Class A and B markets, the Class C market also improved during the first quarter. Class C absorption totaled 171,944 SF, which pushed occupancy up 0.78 points to 83.16%. Class C rental rates gained $0.26 psf to $14.53 psf.

Aided by a strong economy and healthy job market, we expect the office market to strengthen even further through the remainder of 2007. Class A will likely fare the best, followed by the Class B market. We expect to see slight positive movement in the Class C market, while the Class D market will likely remain relatively stable.

By: Leslie Countryman

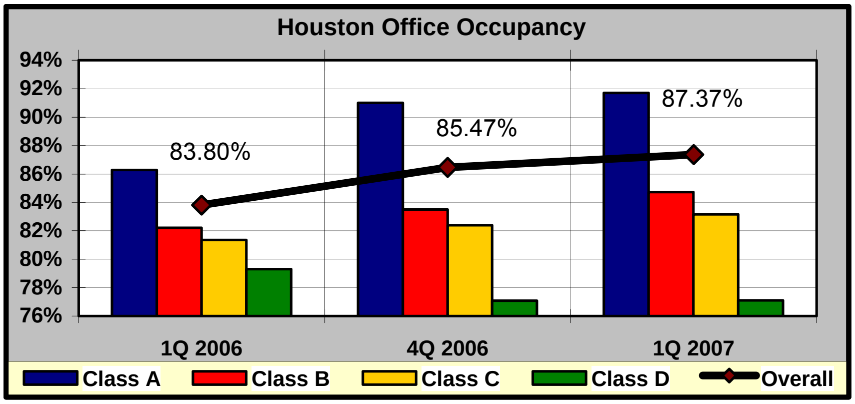
Houston Office Market at a Glance

	Class A	Class B	Class C	Class D	Overall	Qtr	Yr
Occupancy	91.70%	84.74%	83.16%	77.10%	87.37%	▲	▲
Rent/SF	$24.37	$18.19	$14.53	$11.82	$20.44	▲	▲
Absorption	943,628	984,512	171,944	2,169	2,102,253	▲	▲

In This Issue

O'Connor & Associates
Research & Consulting Services
1-800-856-REAL
www.poconnor.com
www.oconnordata.com

Metro Occupancy Overview



Quarter	Class A	Class B	Class C	Class D	Overall
1Q 2006	86.28%	82.22%	81.36%	79.30%	83.80%
4Q 2006	91.00%	83.50%	82.38%	77.08%	86.47%
1Q 2007	**91.70%**	**84.74%**	**83.16%**	**77.10%**	**87.37%**

Houston office occupancy continued on the upswing, as overall occupancy increased 0.90 points over the quarter to 87.37%. Over the last twelve months, overall occupancy has increased a full 3.57 points. Quarterly occupancy gains were recorded in all four markets, with the Class A, B, and C markets all posting annual gains, as well.

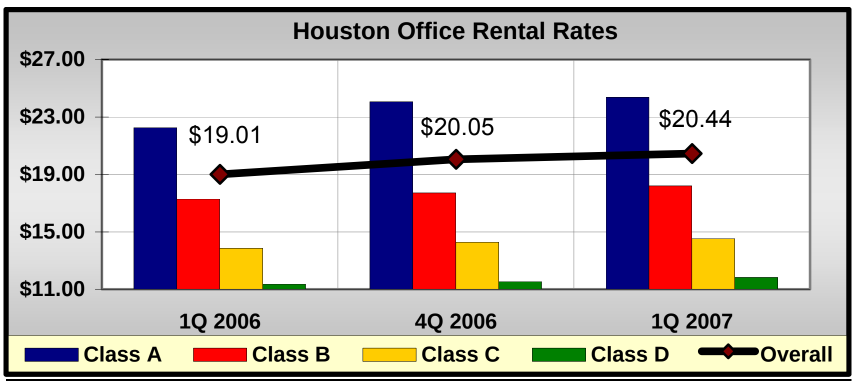
Class A occupancy recorded a 0.70-point jump over the quarter and remains the strongest of all classes, with occupancy at 91.70%. Class A occupancy has gained 5.42 points over the past year. Of sectors with more than one property, occupancy was strongest in the ***Katy Freeway-West*** sector at 97.09%, while weakest occupancy was found in the ***Southwest 1*** sector at 63.05%.

Class B occupancy posted the largest quarterly increase of all classes, gaining 1.24 points. Currently at 84.74%, Class B occupancy is 2.52 points higher than one year ago. Occupancy ranged from a low of 74.22% in the ***Katy Freeway-East*** sector to 98.92% in the ***Southwest 2*** sector.

The **Class C** market recorded a 0.78-point quarterly gain in occupancy to 83.74%, bringing the annual increase to 1.80 points. The ***Park 10*** sector posted the highest occupancy at 96.43%, while the ***Greenspoint/North Belt*** sector recorded the lowest at 76.51%.

Class D occupancy nudged up 0.02 points over the quarter to 77.10%. Despite the gain, Class D occupancy remains 2.20 points below last year's level. The ***Sugar Land/First Colony*** submarket reported being near full, while the ***Central Business District*** has the lowest occupancy at 32.62%.

Metro Rent Overview



Quarter	Class A	Class B	Class C	Class D	Overall
1Q 2006	$21.95	$17.04	$13.76	$11.36	$18.71
4Q 2006	$24.05	$17.70	$14.27	$11.53	$20.05
1Q 2007	**$24.37**	**$18.19**	**$14.53**	**$11.82**	**$20.44**

Overall rental rates recorded their seventh consecutive increase, gaining $0.39 per square foot (psf) to $20.44 psf. Rental rates are up $1.73 psf over the last twelve months. All classes recorded quarterly rent gains, with the Class B market posting the largest quarterly increase of $0.49 psf.

Class A rents increased increased $0.39 psf over the quarter to $24.37 psf. Rents are up $2.42 psf over the past year, the largest annual increase of all classes. The ***Galleria*** and ***Central Business District*** sectors reported the highest rents, at $25.83 psf and $25.57 psf, respectively, while the lowest rents were found in ***Kingwood*** at $12.00 psf.

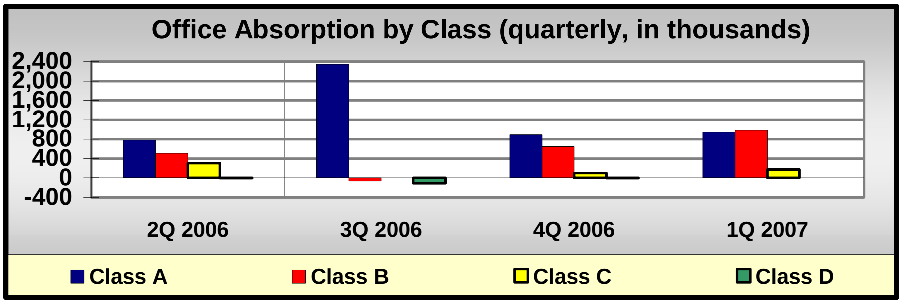
Class B rents increased to $18.19 psf, which represents a $0.49 psf quarterly gain and a $1.15 psf annual gain. The ***Medical Center*** once again posted the highest rents at $22.29 psf, while the ***Northeast 2*** sector reported the lowest rents at $12.75 psf.

Class C rents rose $0.26 psf over the quarter and are up $0.77 psf over the year to $14.53 psf. The ***Greenway Plaza*** sector reported the highest rental rates at $17.19 psf, while rents were lowest found in the ***Northeast 2*** sector at $12.00 psf.

Class D rents reported a $0.29-quaretly gain to $11.82 psf, which is $0.46 psf higher than they were one year ago. The ***Clear Lake*** sector recorded the highest rental rates at $14.71 psf, with the ***Southwest 1*** sector trailed the market at $9.89 psf.

Absorption, Inventory, & Employment

Metro Absorption Overview



The Houston office market absorbed 2,102,253 SF during the first quarter of 2007. Absorption over the last twelve months reached a remarkable 7,513,871 SF. Once again the ***Galleria*** sector posted the strongest quarterly demand figures, absorbing 397,440 SF, followed by the ***Westchase*** sector, which absorbed 262,142 SF.

12-mo Ending	Class A	Class B	Class C	Class D	Overall
1Q 2005	254,932	488,084	10,002	76,345	829,363
1Q 2006	2,645,408	253,188	79,156	80,329	3,058,081
1Q 2007	**4,962,688**	**2,085,952**	**585,562**	**-120,331**	**7,513,871**

Class A space remained in high demand, as 943,628 SF was absorbed over the quarter. Annual absorption was just shy of the 5 million mark at 4,962,688 SF. Demand was highest in the ***Park 10*** sector, with 270,370 SF absorbed over the quarter, while demand was weakest in the ***Midtown/Allen Parkway*** sector, where -33,441 SF was absorbed over the quarter.

The **Class B** market posted the strongest quarterly demand of all classes as 984,512 SF was absorbed. Absorption over the last year stands at 2,085,952 SF. The ***Galleria*** sector reported the strongest absorption, absorbing 340,446 SF, while absorption was weakest in the ***Park 10*** sector at -19,242 SF.

Class C absorption during the first quarter totaled 171,944 SF, which brought annual absorption to 585,562 SF. Quarterly absorption was highest in the ***Fountainview/Gessner*** sector at 57,971 SF, while the lowest absorption was found in the ***Greenspoint/North Belt*** sector at -20,329 SF.

Class D recorded the weakest quarterly absorption of all classes, at 2,169 SF. Class D is also the lone class to post negative annual absorption, at -120,331 SF. The strongest demand over the quarter was found in the ***Southwest Freeway*** sector, with absorption of 9,642 SF, while the weakest demand was found in **Technology Corridor/FM 1960** sector, with absorption at -6,392 SF.

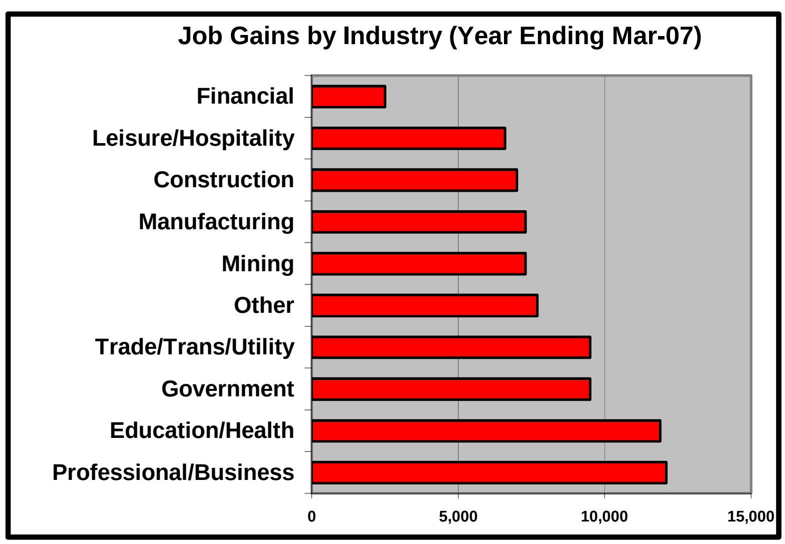
Traditional, Multitenant Office Inventory by Class

There are a total of 1,288 operating traditional, multitenant office properties in the Houston area market with total net rentable square feet of 158,163,718. Approximately 44.94% of the total office space is Class A, 36.94% of the total office space is Class B, 14.62% of the total office space is Class C, and 3.50% of the total office space is Class D.

Type	# of Properties	NRSF
Class A	226	71,074,416
Class B	485	58,428,496
Class C	423	23,117,100
Class D	154	5,543,706
TOTAL	**1,288**	**158,163,718**

Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA declined to 4.1%, while the total number of nonagricultural wage and salary jobs increased to 2,499,900 in March 2007, according to the **Texas Workforce Commission**. This month's total is 81,100 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 12,100 jobs over the previous 12 months; employment in the Education & Health Services sector increased by 11,900 jobs; Government and Trade, Transportation, & Utilities are each up 9,500 jobs; Trade, Other Services gained 7,700 jobs; Mining and Manufacturing each added 7,300 jobs; Construction employment is up 7,000 jobs, Leisure & Hospitality added 6,600 jobs; while Financial Activities is up 2,500. The only industry to lose jobs over the year was Information, down 300 jobs.



Methodology

Data Collection

Our office database contains information on over 1,800 office properties located throughout Greater Houston. Our research team updates property-specific data on a quarterly basis to generate accurate market trend reports on rents, occupancy, absorption, etc. Our surveys also update other property-specific data such as rent types, largest contiguous space available, leasing and management information, and owner information. We perform a current and historical data audit after we close each quarter's survey to identify any data inconsistencies or incorrectly keyed values.

Research

We monitor various news media, press releases, marketing materials, web-sites, CAD records, permit issuance, and other sources to capture new construction, planned projects, financing, and sales. Our researchers conduct phone interviews with relevant developers, brokers, or lenders to gather information on new construction and sales. We add properties to our database on a regular basis to ensure we offer the most up-to-date and complete office database.

Market Coverage

Our office database covers the Greater Houston market and includes properties in Harris, Galveston, Brazoria, Fort Bend, and Montgomery counties. The market is divided into 25 submarkets that correspond to different sectors of the greater Houston area. This approach allows the user to view distinct areas of town in which properties can be identified together.

Glossary

Absorption = Change in occupied square feet, including new construction. Absorption is a proxy for demand.
Occupancy = Percentage of physically occupied square feet on property.
Rents = Market rents.
Class = Properties are classified as A, B, C, & D based on various factors, such as age, location, amenities, overall condition, rents, etc. Class A properties are newer properties, have excellent amenities, prime location, and great appeal, thus they tend to have the highest rents. Class B properties are generally over 15 years old, have good locations, good level of amenities, and are in overall good condition. Class C projects are usually over 20 years old, have few amenities, are in fair locations, and are not very well maintained. Class D projects are generally more than 25 years old, in poor condition, have no or limited amenities, are in poor locations, and tend to have the lowest rents.

Reporting

Occupancy, Rent, and Absorption trend data is based on Operating, Traditional, Multitenant properties. Medical office buildings and single-tenant properties are excluded from the data.

Apartment Research

Winning in the apartment business depends on solid market knowledge.

Oconnordata.com is your source for making smart decisions in major Texas markets.

- Austin
- Dallas/Fort Worth
- Houston
- San Antonio

Most Accurate Apartment Data in Texas, Now Online.

All Apartment Types including Tax Credit, Bond and Section 8

Benefits

- **More** Owner Contact Information
- **More** User-Friendly
- **More** Affordable
- **More** Comprehensive and Accurate
- Mapping and e-mailing capability
- Sort, select and save your lists
- Custom analytical tools and **More**...

Features

- Occupancy, Rents and Specials
- Unit Mix, Fees and Policies
- Management and Owner Contact Information
- Photos and Floorplan Blueprints
- Property Comparison, Construction Pipeline Reports, Historical Trend Reports and **More**...

FREE Trial Subscription Offer!
www.oconnordata.com

For More Information

Heather Wiesner,
1-800-856-7325 x 4262.

Enhancements to a web platform previously offered by Monarch Data.

O'Connor & Associates

2200 North Loop W., Suite 200 Houston, TX 77018 • 1-800-856-7325 / 713-686-9955
www.poconnor.com • www.oconnordata.com
Houston (Corporate) • Dallas • Newport Beach • Los Angeles