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HOUSTON OFFICE PERFORMANCE UPDATE

EDITED BY KATHRYN KOEPKE | $499 PER YEAR | VOLUME 9 NUMBER 4 | FOURTH QUARTER 2005

Absorption Patterns

↑ **414,678 SF absorbed in 4Q-05**

↑ **737,259 SF absorbed over past 12 months**

Occupancy Levels

↑ **82.85% overall in 4Q-05**

Rent Growth

↑ **Rents up $0.07 to $18.21 overall**

Employment Growth[1]

↑ **8,500 jobs gained in December 2005**

↑ **Annual Job Growth up 1.8%**

The downtown Houston office market is a hot topic these days. Recent months have seen a flurry of activity, whether it be leases, move-outs, or acquisitions. It's no secret that the downtown market continues to be plagued by average vacancies painfully close to 20% and stagnant rents. With the thought that things will improve in the near future, investors have been purchasing properties in earnest. The fourth quarter news was encouraging, notably EPCO, Inc.'s acquisition of 1100 Louisiana, a building in which they have subsequently occupied 300,000 square feet. Also, Wells Real Estate Funds paid the highest per-square-foot price in the Houston office market's history ($286 psf) for 5 Houston Center. Rumor has it that ChevronTexaco is interested in purchasing the remaining vacant former Enron building, while other energy companies have begun to reclaim shadow space downtown.

Unfortunately, the Central Business District's recovery is anything but a slam dunk. Two major tenants, Burlington Resources and Bank One, are expected to vacate CBD space in 2006 after acquisitions by ConocoPhillips and Chase, respectively. In the same building Burlington is expected to vacate, Calpine Corp. reduced the amount of space they lease and subsequently lost naming rights to the former Calpine Center, now known by its address, 717 Texas.

Questions still remain about when the downtown office market will see a substantial improvement. It did not happen with the recent influx of New Orleans office tenants, as some thought it would. However, strong job growth has many experts predicting a healthy 2006 for the Houston office market overall, and with the positive fourth quarter numbers, it appears the market is moving in the right direction.

1. Texas Workforce Commission, 12/05 Total non-agricultural jobs

ABSORPTION

The office market had a relatively strong showing in the fourth quarter, absorbing 414,678 square feet (SF), the market's highest quarterly absorption figure since the third quarter of 2004. Classes A and C reported positive absorption for the quarter, while all classes reported positive annual absorption, bringing overall annual absorption to 737,259 SF.

Greater Houston Office Market Absorption (12-month period)

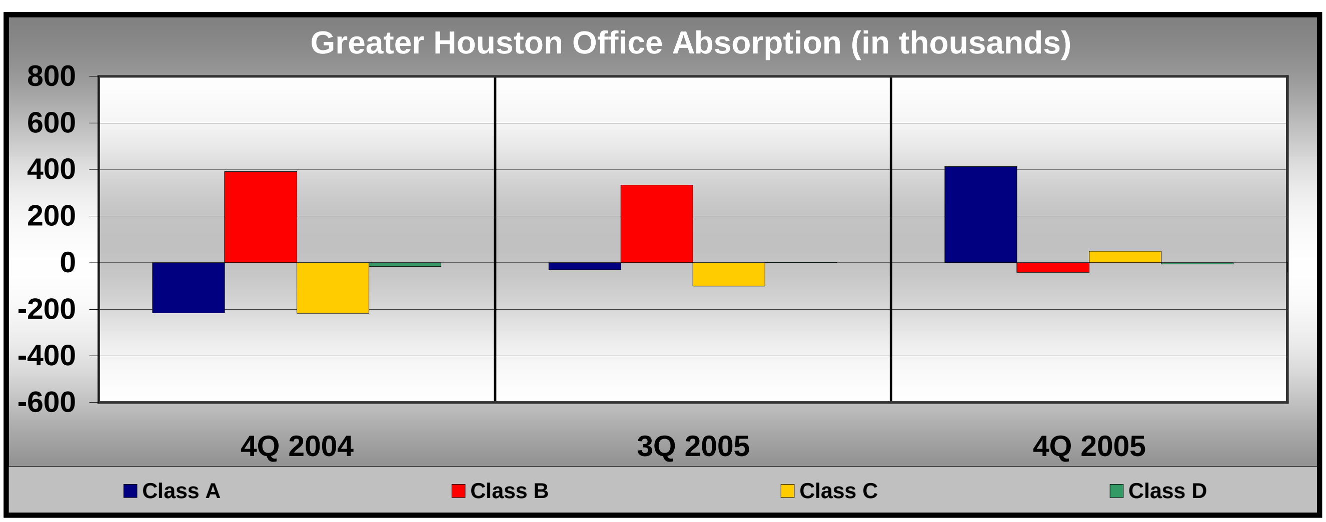
Year Ending	Class A	Class B	Class C	Class D	Overall
4Q/03	-1,574,624	-1,523,588	-534,142	34,871	-3,597,483
4Q/04	-395,912	767,424	224,160	155,848	751,520
4Q/05	**527,952**	**36,568**	**151,460**	**21,259**	**737,259**

The **Class A** market reversed its negative showing in the third quarter, absorbing 412,724 SF over the fourth quarter. Annual absorption currently stands at 527,952 SF. The ***Central Business District*** was the top-performing sector, with 423,142 SF absorbed, 300,000 of which came from EPCO's recent move into 1100 Louisiana. The ***Katy Freeway West*** sector had the second-highest absorption, at 134,682 SF.

After a strong third quarter, **Class B** absorption dipped into the red over the last quarter, absorbing -41,424 SF. Bringing down the numbers were the ***Central Business District***, which posted absorption of -184,715 SF, and the ***North Loop/Northwest Freeway*** sector, which absorbed -75,997 SF over the last quarter.

The **Class C** market bounced back this quarter, recording positive absorption of 49,488 SF, bringing annual absorption to 151,460 SF. The ***North Loop/Northwest Freeway*** sector recorded the strongest absorption at 67,388 SF, while the ***Technology Corridor/FM 1960*** sector recorded the weakest absorption, at -20,924 SF.

Class D recorded absorption of -6,110 SF over the quarter. Total absorption for the year, although unremarkable, is still positive at 21,259 SF. Reporting the greatest quarterly loss was the ***Southwest 1*** sector, with absorption of -23,083 SF.



OCCUPANCY

The Houston office market recorded its fourth consecutive quarterly increase, gaining 0.38 points over the quarter, moving occupancy up 0.52 points for the year. Quarterly decreases in the Class B and D markets were offset by larger increases in the Class A and C markets, with Class A recording a 0.84-point increase in occupancy over the quarter. Overall occupancy is at its highest level since mid-2003.

Greater Houston Office Market Occupancy (Quarterly)

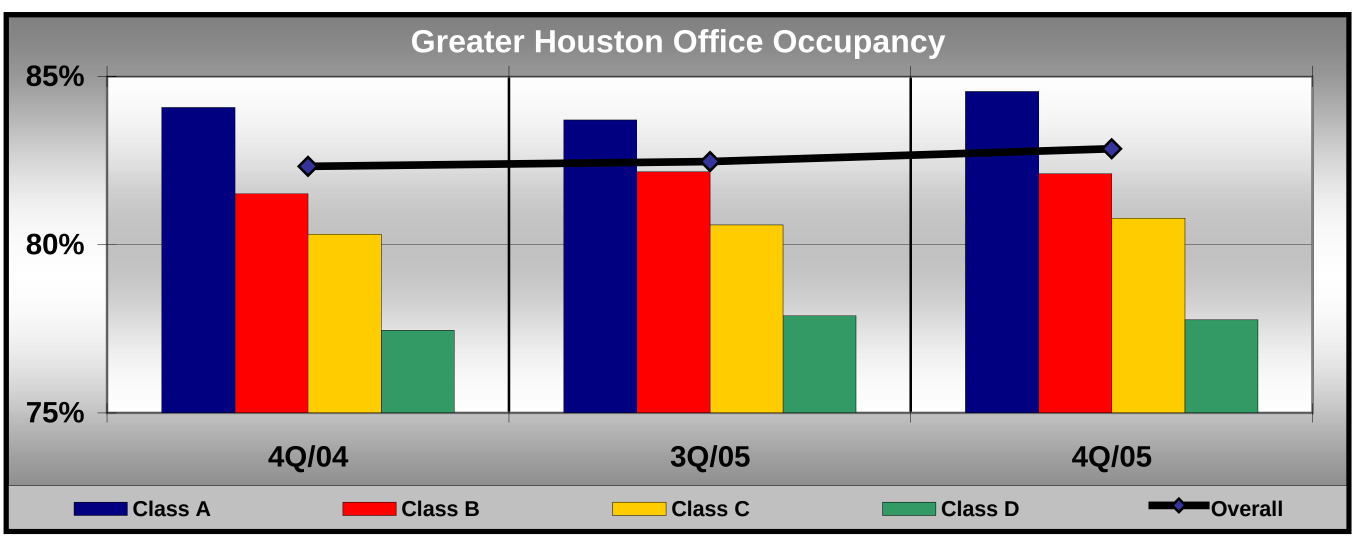
Quarter	Class A	Class B	Class C	Class D	Overall
4Q/04	84.08%	81.52%	80.31%	77.45%	82.33%
3Q/05	83.71%	82.17%	80.59%	77.89%	82.47%
4Q/05	**84.55%**	**82.11%**	**80.79%**	**77.77%**	**82.85%**

Class A occupancy rose 0.84 points over the last quarter to 84.55%, and has increased 0.47 points over the last year. Class A occupancy in the ***Central Business District*** rose 1.53 points to 81.86%, thanks to EPCO. Occupancy figures were further bolstered by a 2.93-point jump in occupancy to 94.81% in the ***Katy Freeway West*** sector.

Class B recorded a decrease in occupancy of 0.06 points over the quarter. However, occupancy is up 0.59 points over the year. A 2.12-point decrease in occupancy to 80.75% in the ***Central Business District*** was the major contributor to the quarterly decline.

Occupancy in the **Class C** market gained 0.20 points over the last quarter. Currently at 80.79%, occupancy is now 0.48 points above last year's level. The highest occupancies were found in the ***Midtown/Allen Parkway*** and ***Southwest 2*** sectors at 96.25% and 95.07%, respectively.

The **Class D** market recorded a 0.12-point drop in occupancy to 77.77%, though occupancy is up 0.32 points over the past year. The ***Southeast*** sector, which has the largest concentration of Class D buildings, posted occupancy of 80.12%.



RENTAL RATES

Average rental rates increased for the second straight quarter, gaining $0.07 psf (per square foot) to $18.21. This is the highest rate recorded since the 1st quarter of 2004. Overall rents are now $0.13 psf higher than last year's levels. Strong gains in the Class A and C markets drove the market's overall increase, offsetting the small decrease recorded in Class D.

Greater Houston Office Market Rental Rates (Quarterly)*

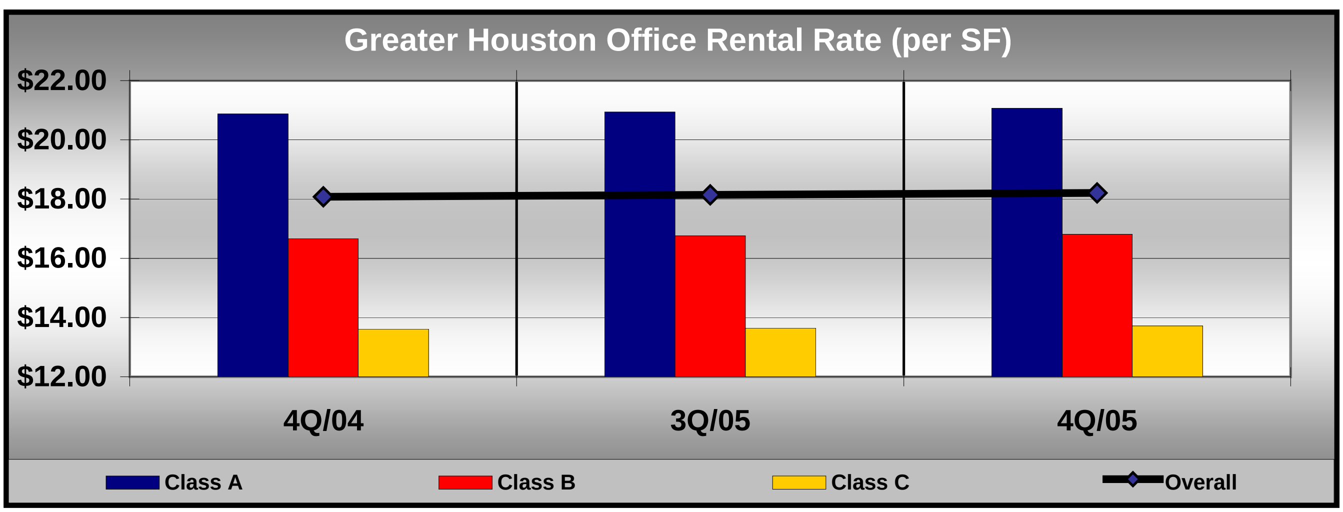
Quarter	Class A	Class B	Class C	Class D	Overall
4Q/04	$20.88	$16.66	$13.61	$11.39	$18.08
3Q/05	$20.94	$16.76	$13.64	$11.50	$18.14
4Q/05	**$21.07**	**$16.81**	**$13.76**	**$11.46**	**$18.21**

Class A rents increased $0.13 psf over the quarter, the largest increase of any of the classes. Rents have risen $0.19 psf over the last year. The highest rental rates were found in ***The Woodlands/Conroe*** and ***Katy Freeway West*** sectors at $22.02 and $21.96 psf, respectively.

The **Class B** market posted an increase in average rents of $0.05 to $16.81 psf. Rents are up $0.15 psf since this time last year. The ***Medical Center*** continues to post the highest average rents at $21.63 psf, followed by ***The Woodlands/Conroe*** sector at $18.19 psf.

Class C rents rose for the third consecutive quarter, and at $13.76 psf are at their highest level since the 2nd quarter of 2004. Rents gained $0.12 over the quarter and are up $0.15 over the year. The highest rents were found in the ***Midtown/Allen Parkway*** sector at $18.12 psf, while the ***Southwest 1*** and ***Southwest 2*** sectors had the lowest rents at $12.00 psf.

After peaking earlier this year, **Class D** rents declined for the second straight quarter, slipping $0.04 to $11.46 psf, though rents remain $0.07 above last year's level. The ***Midtown/Allen Parkway*** sector had the highest rental rates at $14.22 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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