

Office Market Trends Houston

Grubb & Ellis Research

First Quarter 2008



Office Leasing Market Taps on the Brakes

Executive Summary

The local office leasing market kicked off 2008 by recording 467,382 square feet of negative net absorption, the first time Houston has witnessed negative growth since early-2004. The negative absorption tally comes largely as a result of Hewlett-Packard Company placing nearly one million square feet of Class A space on the market at 20555 State Highway 249. Among all property classes, Class A type properties registered the largest quarterly deficit with 344,261 square feet. Additionally, Class B properties posted 68,137 square feet of negative growth while Class C properties recorded 54,984 square feet of negative absorption during the first quarter. Consequently, Houston's overall vacancy increased by 80 basis points to 12.6 percent, but still remains 160 basis points lower than the same time last year. Of all classes, Class A properties saw the largest quarterly vacancy increase during the quarter, rising by 150 basis points to 9.9 percent, which is largely attributed to over 1.1 million square feet of new space coming online. Following suit, Class B properties saw vacancy edge upward by 30 basis points to 15 percent while Class C vacancy increased by 40 basis points to 16 percent during the first three months of 2008. Looking ahead, expect vacancy to level off and even rise as a result of a slowing office leasing market coupled with the sheer amount of new speculative product scheduled to come online. Regardless of the slower demand witnessed during the quarter, overall full-service asking rents still managed to increase to another citywide record, improving by \$0.71 or 2.9 percent to \$25.18 per square foot per year.

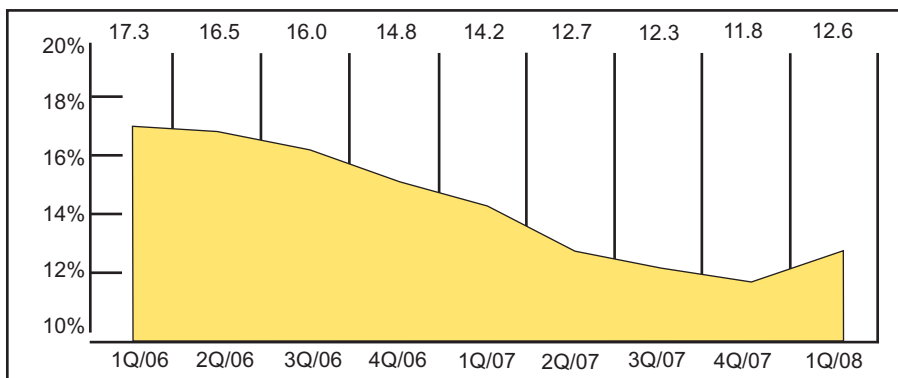
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Ariel Guerrero
Client Services Manager
E-mail: ariel.guerrero@grubb-ellis.com

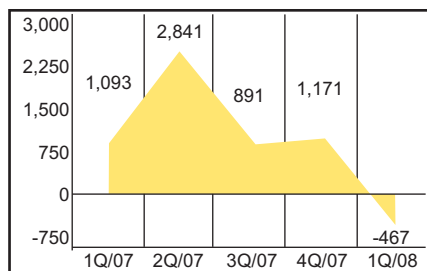
Grubb & Ellis Company
1330 Post Oak Boulevard, Suite 1400
Houston, TX 77056
Phone: 713.626.8888
Internet: www.grubb-ellis.com



Office Vacancy Rate*

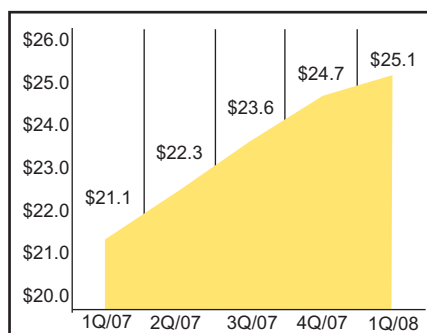
* All Classes of Space

Office Market Trends First Quarter 2008



Houston Office Absorption*

**In Thousands*



Houston Office Rents

Houston Office Market Trends Contributors

Aaron Chovanetz

Research Analyst

E-mail: aaron.chovanetz@grubb-ellis.com

Brittany White

Database Coordinator

E-mail: brittany.white@grubb-ellis.com

Doug Berry

Graphic/Web Designer

E-mail: doug.berry@grubb-ellis.com

Market Overview

Despite the overall negative absorption tally recorded during the first quarter of 2008, several of Houston's more prestigious submarkets managed to post solid growth during the quarter. Leading the way, the Katy Freeway/Energy Corridor submarket posted 301,813 square feet of black absorption ink during the survey period. The majority of the quarterly growth occurred in Class A properties with 317,633 square feet. Following suit, Class B type buildings registered 44,377 square feet of positive absorption during the quarter. On the other hand, Class C properties recorded 60,197 square feet of negative absorption. Contributing to the quarterly growth, Trammell Crow Company and Principal Real Estate Investors recently delivered a 332,000-square-foot, Class A office complex located at 585 N. Dairy Ashford. The project dubbed Energy Center I was leased to Foster Wheeler USA Corp. The tenant, who supplies construction services and equipment to the energy industry, took possession of the building upon its completion in February. Looking ahead, Technip USA Inc. will consolidate local operations from a half-dozen sites in a lease of more than 684,000 square feet in three West Houston office buildings, which included a lease renewal for 229,000 square feet at Energy Tower I, a lease for 79,000 square feet of space at the Office at Park Ten, and an agreement to lease 376,000 square feet in Energy Tower II upon its completion in September of 2009. The Katy Freeway/Energy Corridor submarket saw vacancy hold steady at 8.4 percent despite the largest positive quarterly absorption posting, which was a result of new space deliveries keeping pace with tenant demand.

Up next, the Northwest Freeway and Central Business District submarkets also contributed to the quarterly growth by posting 226,934 and 215,732 square feet of growth, respectively. Most notably, Travelers Insurance moved into the 158,000-square-foot Intellicenter Houston building located at 4650 Westway Park Boulevard. Travelers will consolidate four of its offices into this one property, which was recently delivered during the first quarter. In the Central Business District, Simmons & Co. International renewed and expanded their lease for 60,000 square feet of Class A space in the Bank of America Center while Morgan Lewis moved into 51,164 square feet of Class A space at 1000 Louisiana Street. Consequently, overall vacancy fell by 110 basis points to 21.2 percent within the Northwest Freeway submarket while the Central Business District watched vacancy slide by 60 basis points to 10.1 percent during the quarter. Most impressively, Class A vacancy currently sits at a low 6.7 percent within Houston's CBD, which is the driving factor behind the skyrocketing Class A rents.

At the other end of the spectrum, the FM 1960 Area submarket recorded 995,821 square feet of negative absorption during the quarter. The majority of the space loss occurred in Class A properties with 950,720 square feet as Hewlett-Packard Company placed nearly one million square feet of Class A

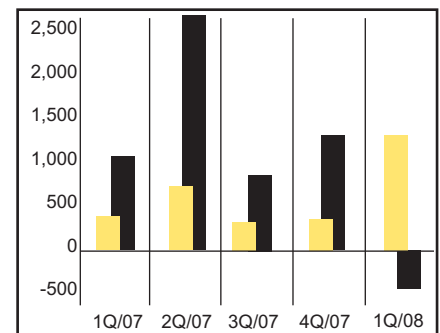
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space on the market with intentions to lease. Hewlett-Packard is consolidating employees into certain parts of its Northwest Houston campus so it can market the 2.1 million square foot office project for sale, which includes 2 million square feet of office space, a 900-seat cafeteria, a fitness center, a conference center and parking garages with nearly 6,000 spaces. Once 15 to 25 percent of the space is leased, institutional buyers will have the data they need to properly assess the campus. As a result, the FM 1960 Area submarket saw vacancy spike by 12.2 percentage points to 27.4 percent during the first quarter. Most notably, Class A vacancy within the submarket now stands at nearly 45 percent.

Landlords have been driving up asking rents in virtually every submarket as Houston's office leasing market fundamentals have steadily improved. Class A rents sustained their ascent during the quarter, surging by \$1.09 or 4.1 percent to \$31.78, with Class A rents within the Central Business District rising once again to an astounding \$37.34. Following this trend, Class B and C full-service asking rents increased by \$0.37 and \$0.14 to \$20.32 and \$15.42, respectively. The lack of quality space options coupled with the delivery of new office projects have triggered office rents to spike to record highs.

Speculative office space under construction currently stands at 7.7 million square feet, with the majority of the construction activity being found in the Katy Freeway/Energy Corridor, Central Business District and Northwest Freeway submarkets which combine to total over 5.4 million square feet underway. Recently making news, Hines commenced construction on its newest building in the heart of its hometown. The new project, to be called MainPlace, will be a 46-story, one million-square-foot office building located at 811 Main Street between Walker and Rusk. The tower will replace a series of worn-out structures, including the Montagu Hotel. Plans call for the building to be completed by early 2011. In another significant ground-breaking, construction has commenced on a 30-story, 871,000 square foot office tower called Discovery Tower, which will be built next to Discovery Green park. The structure is designed with two stories of retail and restaurant space. The Class A office building will be located 1501 McKinney and is expected to open around the second quarter of 2010. A ten-story parking garage will be developed on the block just north of the tower.

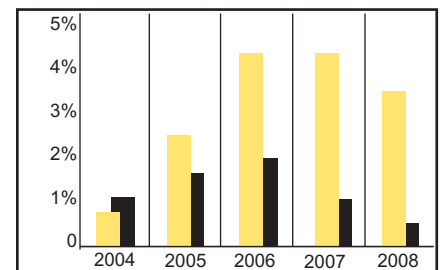
During the first quarter, new space deliveries totaled over 1.2 million square feet, the majority being Class A product with nearly 1.1 million square feet. As previously mentioned, the largest project delivered during the quarter was Trammell Crow and Principal Real Estate Investors' 332,000-square-foot Energy Center I in the Katy Freeway/Energy Corridor submarket. In addition, The Woodlands Development Company delivered a speculative 13-story, 308,000-square-foot Class A structure consisting of 268,000 square feet of office space and 40,000 square feet of retail space. The project dubbed 24



■ Completions ■ Absorption

Office Completions vs. Absorption Houston (All Classes)

**In Thousands*



■ Houston ■ United States

Employment Growth

Office Market Trends First Quarter 2008

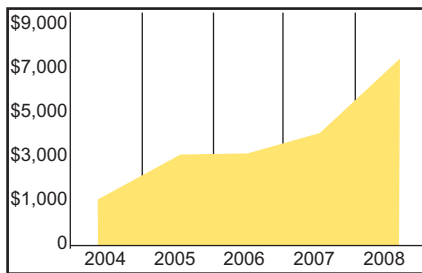
Even in a landlord's market, business owners can still take steps to ensure they sign a lease that helps their businesses thrive.

Waterway is located near the Waterway Marriott Hotel and Convention Center in The Woodlands.

As demand for more square footage continues to grow and the remaining options for large contiguous blocks of office space disappear, the Class A availability rate, especially in the CBD and Uptown/Galleria area, is expected to further subside in the months ahead. Rising rents, coupled with scarce large blocks of available space and no immediate office completions on the horizon within these submarkets, leave large tenants with limited options until new projects are delivered in the 2009 to 2010 timeframe.

Investment Market Overview

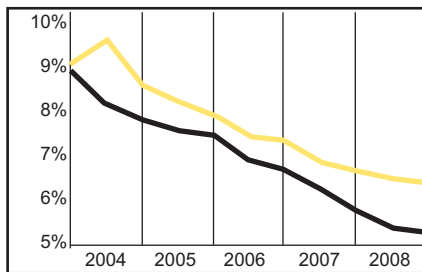
Despite a softening national economy teetering on the brink of a recession, investors remain keenly interested in Houston's commercial real estate as a result of sound local economic fundamentals such as increased occupancies and solid rent growth. According to Real Capital Analytics (RCA), private, public and institutional investors spent nearly \$600 million so far in 2008 to acquire office properties in the Greater Houston Area. Currently, newly offered office properties are trading for approximately \$192 per square foot, well below the national average of \$279 per square foot which is one reason investors are attracted to the area.



Houston Investment Volume

*In Millions
Source: Real Capital Analytics
12 month trading, reported closed or in contract

One of largest office investment sale transactions during the quarter involved Behringer Harvard REIT I Inc. acquiring the Class A, 143,000-square-foot Westway One office building located at 11210 Equity Drive for \$34.8 million or \$243 per square foot from Dienna Nelson Augustine Company. Westway One is situated on nine acres in the 150-acre Westway Business Park. Something to keep an eye on, Williams Tower, the 65-story skyscraper located in the Galleria area, is under contract by a subsidiary of Hines Real Estate Investment Trust. The sale includes an adjacent parking garage, interest in a 2.8-acre park and waterfall and 2.3 acres across the street from the 1.5 million-square-foot tower for an approximate \$271.5 million or \$181 per square foot. The deal is expected to close by May 2008.



Cap Rate Trends

Source: Real Capital Analytics

Look for Houston's office investment market to cool down from the robust pace experienced in the past few years but remain very active, as several office owners are poised to take advantage of the market and put their properties in play. For example, the 1.7 million-square-foot Wells Fargo Plaza, located in the CBD, is on the market. The property has a \$283 million tax assessment, with comparable high rises in the area trading for \$275 per square foot. The owner, New York City-based Metropolitan Life Insurance Company (MetLife) previously invested \$7 million into renovating the main lobby and sky lobby, creating a common-area executive board room and auditorium and adding the Houstonian Life fitness club.

Office Market Snapshot Houston First Quarter 2008

By Submarket (All Classes)	Total (1)	Vacant (2)	Net Absorption		Under Const. (3)	Asking Rent (4)		
	SF	SF	Vacant %	Current Qtr	Year To Date	SF	Class A	Class B
Central Business District	35,567,020	3,602,374	10.1%	215,732	215,732	2,066,871	\$37.34	\$24.53
CBD Total	35,567,020	3,602,374	10.1%	215,732	215,732	2,066,871	\$37.34	\$24.53
1960 Area	6,223,246	1,704,452	27.4%	(995,821)	(995,821)	265,027	\$25.91	\$15.98
Allen Parkway/Montrose	3,670,471	334,840	9.1%	45,236	45,236	78,966	\$30.95	\$20.51
Conroe/Montgomery County	587,641	91,923	15.6%	(113)	(113)	139,822	-	\$21.35
Far Southwest	6,827,063	834,839	12.2%	70,187	70,187	53,034	\$19.00	\$17.77
Fort Bend County	663,638	148,284	22.3%	(375)	(375)	-	-	\$18.91
Greenspoint/North Belt	10,782,740	1,530,484	14.2%	(61,199)	(61,199)	84,125	\$22.08	\$18.09
Greenway	9,626,296	1,518,804	15.8%	(190,065)	(190,065)	-	\$29.02	\$22.50
Gulf Freeway/Pasadena	1,288,296	138,442	10.7%	7,528	7,528	-	-	\$17.88
Katy Freeway	16,991,913	1,422,102	8.4%	301,813	301,813	2,272,158	\$26.88	\$20.87
Kingwood/East/Northeast	1,439,051	240,267	16.7%	24,466	24,466	-	\$21.25	\$18.32
Medical/South Main	1,525,308	126,880	8.3%	(1,413)	(1,413)	-	-	\$23.69
NASA/Clear Lake	5,269,157	579,355	11.0%	(29,611)	(29,611)	356,079	\$23.29	\$19.60
Near Southwest	3,973,900	942,138	23.7%	(15,989)	(15,989)	-	-	\$14.47
Northwest Freeway	9,381,705	1,989,368	21.2%	226,934	226,934	1,076,973	\$21.67	\$17.38
Sugar Land	3,772,501	389,291	10.3%	4,603	4,603	531,728	\$23.96	\$17.59
The Woodlands	3,759,333	394,064	10.5%	16,106	16,106	287,298	\$30.13	\$20.11
Uptown/Galleria	29,015,095	2,954,539	10.2%	21,843	21,843	-	\$30.88	\$21.27
Westchase	12,305,636	1,581,153	12.8%	(107,244)	(107,244)	470,608	\$31.59	\$20.50
Suburban Total	127,102,990	16,921,225	13.3%	(683,114)	(683,114)	5,615,818	\$28.89	\$19.44
Totals	162,670,010	20,523,599	12.6%	(467,382)	(467,382)	7,682,689	\$31.78	\$20.32
By Class (All Submarkets)							Available for Sublease	
							CBD	Suburban
Class A	78,704,054	7,772,755	9.9%	(344,261)	(344,261)	7,215,656	270,728	1,202,973
Class B	66,277,998	9,914,171	15.0%	(68,137)	(68,137)	467,033	130,673	502,643
Class C	17,687,958	2,836,673	16.0%	(54,984)	(54,984)	-	12,308	67,560
Totals	162,670,010	20,523,599	12.6%	(467,382)	(467,382)	7,682,689	413,709	1,773,176

* Grubb & Ellis statistics are audited annually and may result in revisions to previously reported quarterly and final year-end figures.

(1) Inventory includes multi-tenant and single tenant buildings with at least 20,000 sq. ft.

(2) Vacant space includes both vacant direct and vacant sublease space.

(3) Space under construction includes speculative and build-to-suit for lease projects.

(4) Asking rates are per square foot per year full service. Rates for each building are weighted by the size of the building.

Construction Watch

First Quarter 2008										
	New Speculative Development				New Build-to-Suit Development			New Owner Occupied Development		
	Under Construction	Preleased %	Completed This Qtr	Completed YTD	Under Construction	Completed This Qtr	Completed YTD	Under Construction	Completed This Qtr.	Completed YTD
CBD	2,066,871	10.5%	-	-	-	-	-	-	-	-
Suburban	5,615,818	29.4%	1,219,959	1,219,959	-	-	-	600,900	50,000	50,000
Total	7,682,689	24.3%	1,219,959	1,219,959	-	-	-	600,900	50,000	50,000