TRENDLINES®

HOUSTON 2012

MINING A GROWING MARKET

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FOREWORD

November 2012

To our friends, clients and colleagues:

We are pleased to provide you this twelfth annual edition of TrendLines: Trends in Metro Houston Commercial Real Estate. This is a collaborative publication of Transwestern and its research affiliate, Delta Associates. Our purposes are to distill the trends of 2012 and to shed light on pivotal forces and issues that we believe will affect the region's economy and commercial real estate in 2013 and beyond.

Through the 3rd quarter of 2012, the Metro Houston commercial real estate market's performance ranked among the best in the nation, a reflection of the strong local economy. Office vacancy, including sublet space, is 10.9% – down from a cyclical high of 13.6% in 2010 and 12.2% a year ago. Office asking rents are rising in many submarkets and have surpassed their previous peak, which occurred in 2007. Meanwhile, the industrial market is experiencing expansive growth, with vacancy at just 4.6%, down from 5.3% a year ago.

Employment gains in Metro Houston have been among the best in the nation in 2012, and as a result, the commercial real estate market likely will continue to improve in 2013. Of note, pricing for office assets continues to rise, topping last year's record. Pricing likely will rise further in 2013 as market fundamentals continue to improve and interest rates remain low.

We expect to find significant opportunities in our industry in the period ahead, notwithstanding the sluggish pace of the national economic recovery. In 2013, we expect:

- Accelerating job growth in Metro Houston. We expect to have seen a gain of 80,000 to 85,000 payroll jobs during 2012, once the year is complete, followed by an increase of 80,000 to 100,000 jobs per annum in 2013 and 2014. These projections are supported by the sturdy performance of the energy and health sectors, as well as by the expansion of the Panama Canal, which is likely to generate growth in Houston's distribution sector. The pace of regional economic growth may be uneven as the national economy remains volatile, but Houston is likely to endure as a national leader in job creation during 2013.
- Declining vacancy and rising rents for office, industrial, and retail product. Of note, while the office pipeline of new supply is expanding, it remains limited enough to encourage rent growth.
- Declining vacancy and rising rents for apartment product, as job creation drives demand.
- Houston's commercial real estate assets to attract additional attention from investors, given the region's strong employment growth; demand for high-quality assets will remain robust in 2013.
- Commercial real estate prices to continue rising along with improving fundamentals and investor demand. As pricing for existing assets continues to rise and vacancy remains low, we expect additional spec development to ensue.

We hope the following information provides insight into our collective opportunities. All the professionals at Transwestern and Delta Associates look forward to helping you interpret the material in this report, and to being your service partner in the successes we are confident you will achieve in the period ahead. We offer you our best wishes for a successful 2013.

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Chip Clarke
President, Gulf Coast and Mountain Regions

DELTA ASSOCIATES
A Transwestern Company

Gregory H. Leisch, CRE
Chief Executive Officer

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Locke Lord | CHICAGO TITLE | HARVEY Innovation, Quality, Integrity | J.P.Morgan | Kirksey ARCHITECTURE

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Special Thank You To Our Keynote Speaker:
John Robert Bolton
John R. Bolton was appointed as United States Permanent Representative to the United Nations on August 1, 2005 and served until his resignation in December 2006. Prior to his appointment, Bolton served as Under Secretary of State for Arms Control and International Security from May 2001 to May 2005.

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HOUSTON 2012

SECTION ONE

SUMMARY

TRENDLINES®
HOUSTON 2012

NATIONAL ECONOMY: UNCERTAINTY PREVAILS, DAMPENING RECOVERY

Uncertainty remains a persistent drag on overall U.S. economic growth, which has led to below average job gains and consumer spending. This has created a lack of momentum needed to drive the economy into a more robust recovery. In comparison to the past four recessions, the current recovery remains sub-par. Consumers and businesses have had to adjust to a new economic reality of slower growth, which has been plagued recently by potential budget cuts and rising taxes at the start of 2013.

If automatic budget cuts, known as "sequestration," are avoided the national economy likely will continue to grow, albeit at a slow pace. In 2013, 2.0 million jobs would be added to economy, which would leave the unemployment rate hovering around 8.0% next year.

We believe the Congress will do what is right for the economy and ultimately avoid the "fiscal cliff." So, we believe the national economy will continue to experience slow recovery during the balance of 2012 and into 2013 and beyond.

We believe the economic outlook is as follows:

- GDP growth: 2.1% in 2012 and 2.0% to 2.5% in 2013.
- Payroll jobs: 2.0 million added in 2012 (based on a December-to-December calculation) and slightly more in 2013.
- Unemployment: hovering in the 8.0% range through 2013.
- Federal Funds Rate: 0% to 0.25% through year-end 2015.
- Long-term interest rates: steady.
- Inflation: 2.0% during 2012. Comparably low in 2013.

HOUSTON'S ECONOMIC GROWTH REMAINS STRONG

Economic growth has strengthened in the Houston metro area during 2012. The 12-month employment growth of 89,500 jobs through August is the fourth-most in the nation, trailing only the Los Angeles Basin, New York, and San Francisco. Houston's employment rose by 3.5% in that period, compared to national growth of 1.4%. The Energy and Trade/Transportation sectors are fueling growth, and most of Houston's core industries are continuing to improve:

- **Energy:** Lower oil and natural gas prices in the early summer eased investment in the industry, but the rise of hydraulic fracturing kept the sector strong. Energy continues to support growth region-wide, and rebounding oil prices will further this trend.
- **Professional Services:** 10,200 jobs were added over the 12 months ending August 2012.
- **Construction:** Projects are progressing at a consistent pace with access to financing. Jobs are being added in this industry.
- **Manufacturing:** Employment (on a trailing 12-month basis) has risen every month since October 2010.
- **Trade:** Air freight rose 5.7% in 2011, a new annual record, and 2012 remains on track to finish as the second-best year ever. Investment is rampant with Panama Canal expansion and the growth of Latin American trade spurred by the energy sector.

Metro Houston's economy is expected to experience healthy growth over the next several years, although it could be at risk due to international instability. European turmoil and a slowdown in China's economic expansion may diminish global growth. The promise of the Panama Canal expansion in 2015 will increase investment in the Port of Houston, and if the airports succeed in their bid for Latin American routes, activity could increase dramatically. Strength in the Energy, Transportation, and Professional Services sectors, underpinned by a recovering consumer sector, will fuel expansion locally over the next several years. As a result, we expect Houston's annual job growth to average close to 90,000 per annum through the end of 2014, comparable to the growth during the 2005-07 expansion period. Houston's employment growth should be among the nation's strongest.

HOUSTON METRO OFFICE MARKET: VIGOROUS GROWTH IN 2012

The Houston metro office market has experienced continued growth in 2012, as the local economy continues to expand at a steady clip. Professional/Business Services and Energy-related firms have supported the leasing activity, vacancy has continued to decline, and rents are increasing.

Net absorption totaled 2.9 million SF in the first three quarters of 2012 (3.8 million SF when annualized), compared to 3.8 million SF in all of 2011. The Class A market accounted for a majority of that total, absorbing 2.2 million SF, or 77% of activity in the Houston market.

The overall office **vacancy rate** (including sublet space) in the Houston metro area fell to 10.9% as of September, down from 12.2% a year ago. Direct vacancy is currently 10.6%, a decrease from 11.7% one year ago.

Asking **rents** for all classes of office space have risen approximately 2.4% in metro Houston during the first three quarters of 2012, after rising 0.8% in 2011. Class A asking rents are up 2.8% this year, while Class B asking rents have increased 1.7%. Asking rents have surpassed their previous peak, which occurred in 2007. Rents have pulled back slightly recently as growth in the Energy sector decelerated over the past few months, but market fundamentals suggest further asking rent growth in the period ahead. Additionally, effective rents are rising in certain submarkets as concessions decline in response to steady demand.

The Houston metro office market will likely remain strong in the period ahead, provided that the regional economy continues expanding at a healthy pace and is not disrupted by global forces. As businesses increase leasing activity, vacancy will continue declining, likely dropping below 10% over the next two years. As a result, rents will likely gain significant upward momentum in 2012-13. Office market conditions will likely turn in the landlord's favor through the rest of 2012 and into 2013, as vacancy declines and the pipeline of new supply (presently at 1.7% of the standing inventory including planned space likely to deliver within two years) remains limited.

HOUSTON METRO INDUSTRIAL MARKET FUNDAMENTALS REMAIN STURDY, SHOULD GAIN FURTHER MOMENTUM

The fundamentals of the Houston industrial market have continued to improve in 2012, with vacancy remaining among the lowest in the nation and continuing to decline. While absorption has decelerated some compared to the levels seen in 2011, performance is still strong relative to peer cities and is poised for further improvement with the expansion of the Panama Canal now underway and set to be completed in 2015. By 2013, the Port of Houston will be equipped to handle a larger volume of shipments coming from the Pacific, which should help to bolster the broader industrial market.

Net absorption of industrial space in the Houston metro totaled 3.3 million SF through the first three quarters of 2012, compared to a total of 6.3 million SF in 2011. Businesses are continuing to expand as the local economy strengthens and consumer spending gradually increases.

The overall Houston metro area industrial **vacancy rate** declined to 4.6% in September 2012 from 5.3% a year earlier. The direct industrial vacancy rate, 4.5% in September, is down from 5.2% a year earlier.

Industrial asking **rents** are up modestly in 2012. The September 2012 average asking rent for all types of industrial space was $5.32/SF, triple net.

The Houston metro industrial market will likely experience continued growth in the near term. However, global economic uncertainty remains high and could potentially check domestic economic growth. If growth accelerates, vacancy will continue to decline into 2013, as demand outpaces new supply. If construction remains minimal, industrial rents will rise, with concessions burning off quickly, as market conditions turn further in the landlord's favor. Groundbreakings are increasing, however, in response to the market's very low vacancy rate and the positive outlook of the trade/transportation sector.

INVESTMENT SALES

Investment sales of **office assets** have plateaued near 2011 levels after bouncing back in the wake of the recession. Annualized national office volume for 2012 totals $62.9 billion, compared to $64.7 billion in 2011 and $42.8 billion in 2010. Sales are keeping pace with the volume seen last year. While job growth and improving market fundamentals hold promise for investors, continued unease over the state of the national economy is preventing a faster turnaround with more robust volume.

In both the long term and short term, real estate investment has outperformed stocks and bonds. The 12 months ending June 2012 saw a 12.48% increase in the NAREIT Equity REIT Index and a 12.04% increase in the NCREIF Property Index.

Recent activity in Houston's office investment market was highlighted by the sale of Shell Plaza Towers to the Duncan Family, which closed in August for $550 million,or $307/SF. The 3rd quarter alone accounted for 56% of the $1.6 billion in total sales in 2012. Sales volume totaled $2.9 billion in all of 2011, which could be surpassed in 2012 should high profile buildings on the market like Williams Tower in the Galleria submarket and the Kinder Morgan Tower in the CBD submarket for up to $475 million and $400 million, respectively, eventually transact.

The average cap rate on a rolling three-month basis for core Houston office assets was 8.1% in June 2012. However, cap rates have covered a wide range this year depending on the location and characteristics of the properties being traded. YTD, the weighted average cap rate in Houston is 7.2%. Trophy properties have recently traded at cap rates below 7%. We expect cap rates to edge down during the balance of 2012 as market fundamentals suggest increasing investor interest in Houston's office assets.

Despite decelerating some from 2011 numbers, national **industrial investment sales** remain well above recessionary levels seen in 2008 through 2010. At the current pace, sales will total $29.3 billion in 2012, compared to $34.8 billion in 2011 and $17.2 billion in 2010.

Cap rates for recorded sales of Houston industrial product in 2012 have centered in the 6.5% to 8.5% range. There continues to be a large spread between Class A and Class B product.

MULTIFAMILY: ROBUST PERFORMANCE

The Houston metro multifamily market continues to expand due to large population increases and one of the highest job growth rates in the country. This year has seen market fundamentals strengthen, with absorption and rents up and vacancy down.

Net absorption for all classes of apartments remained strong in the Houston metro over the 12 months ending June 2012, surpassing the pace of absorption in 2011. Absorption was approximately 17,275 units over the 12 months ending in June 2012, compared to 15,591 units during 2011.

Vacancy as of June 2012 stood at 7.4%, down from 8.5% at the end of 2011 and 11.0% at year-end 2010. The vacancy rate for all classes of Houston metro apartments has continued to decline following its spike in 2009 and is now at the lowest level since 2007.

The average **rental rate** for Houston apartments was $0.98/SF/month at the end of September, up 5.1% over the past 12 months. Rents will likely increase modestly through the balance of 2012 and into 2013 as job creation continues and economic growth strengthens.

HOUSTON METRO RETAIL SECTOR EXPANDING

Metro Houston's retail market experienced steady improvement in 2012, as the economy strengthened and job growth remained strong locally. This sector's growth is supported by one of the nation's best regional economies and its solid employment gains, reinforced by hiring in the core industries.

Houston's retail **vacancy rate**, at 11.2% in the 2nd quarter of 2012, is down from 12.4% in the 2nd quarter of 2011. We expect that vacancy will remain steady or decline modestly for the remainder of 2012, as Houston's consumer sector remains strong and retailers open more stores.

Retail **rents** held in the 2nd quarter of 2012 at $1.48/SF/month, the same as in the quarter prior. Rents declined over the past year but likely will experience modest growth during the balance of 2012 and into 2013, as consumer spending gradually accelerates and market conditions continue to strengthen. The recent trends in vacancy have set the stage for rent growth.

The Houston retail market will likely undergo a sustained expansion during the remainder of 2012 and into 2013, as local job growth continues to remain strong and the consumer sector strengthens. As the regional economy grows, consumers will spend more, and a growth cycle in the retail market will likely occur over the next several years, making investment very attractive.

We expect the Houston retail market to outperform most other metro markets in the country, as the Houston metro area is a national leader in job creation and population growth. New jobs, in concert with an expanding population, will drive retail spending in the period ahead.

SECTION TWO

THE NATIONAL ECONOMY

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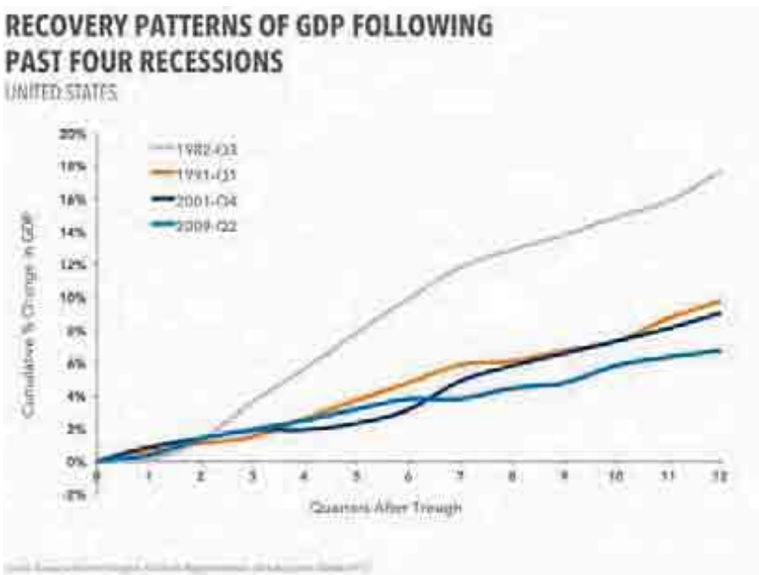
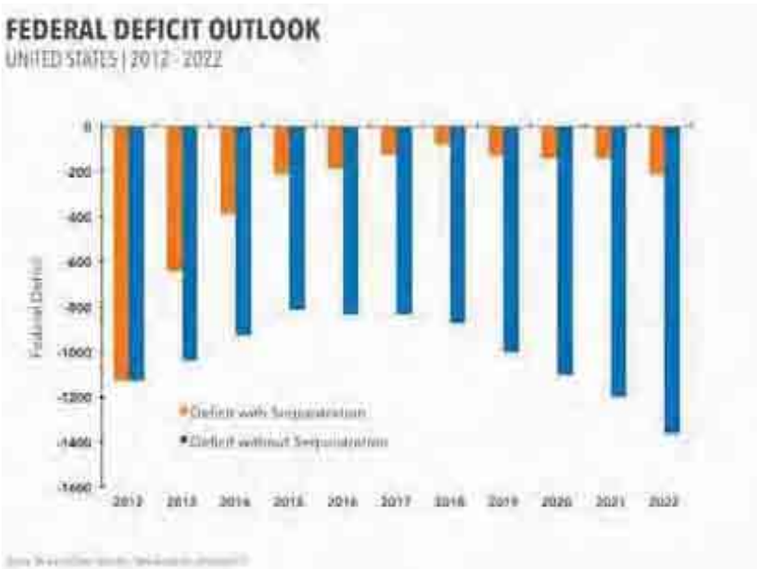
UNCERTAINTY PREVAILS, DAMPENING RECOVERY

Uncertainty remains a persistent drag on overall U.S. economic growth, which has led to below average job gains and consumer spending. This has created a lack of momentum needed to drive the economy into a more robust recovery. In comparison to the past four recessions, the current recovery remains sub-par. Consumers and businesses have had to adjust to a new economic reality of slower growth, which has been plagued recently by potential budget cuts and rising taxes at the start of 2013.





ECONOMIC OUTLOOK United States		
GDP	**2013**	**2022**
With Sequestration	-0.5%	2.3%
Without Sequestration	1.7%	2.1%
UNEMPLOYMENT RATE		
With Sequestration	9.1%	5.3%
Without Sequestration	8.0%	5.3%

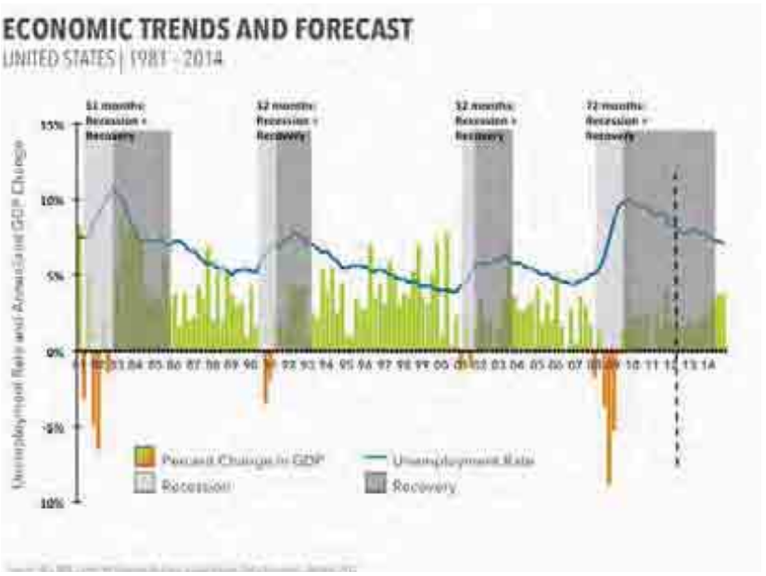
Source: Congressional Budget Office, Delta Associates; October 2012.

Congress has yet to alter the tax hikes and Federal spending cuts set to take effect in January 2013. If this plan is not altered, the national economy is headed to what has now been coined a "fiscal cliff," which may trigger another recession. In the meantime, businesses and consumers remain cautious about spending, which has created lackluster economic growth. If the scheduled tax increases and spending cuts go into effect at the start of 2013, the projected Federal deficit will be reduced. However, this improvement comes at a cost to the already sluggish economy. The Congressional Budget Office projects that if the plan goes into effect as scheduled, the GDP will decline by 2.9% during the first half of 2013 and 0.5% for the entire year. In addition, the unemployment rate would rise to 9.1% during the 2nd half of 2013.

If automatic budget cuts, known as "sequestration," are avoided the national economy likely would continue to grow, albeit at a slow pace. GDP would rise 1.7% during 2013 and 2.0 million jobs would be added to economy, which would leave the unemployment rate hovering around 8.0% next year.

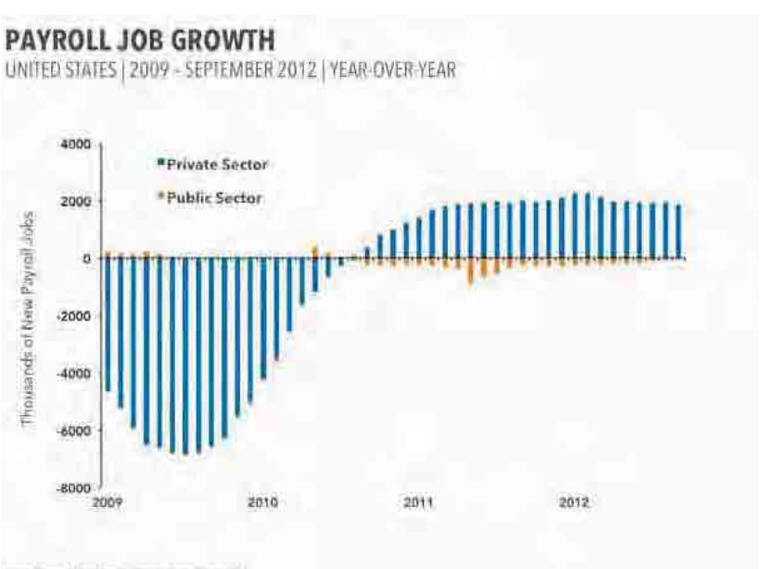
Given the enormous impact on the national economy, we do not expect Congress to allow sequestration and tax increases to take hold at the start of 2013. Congress could pass a bill to delay the start date after 2013, which would allow time to devise an alternative plan to the scheduled cuts. Or, Congress, after the November election, could pass a bill that alters the current plan, allowing the cuts to start in 2013, but with less immediate impact.

Overall, current economic conditions point to a sluggish economy – not a stalled economy. Sluggish economic growth is likely the new normal for periods of economic "expansion." So, business success could be measured by how commerce adapts to this new slower-growth economic environment, at least for the intermediate term.

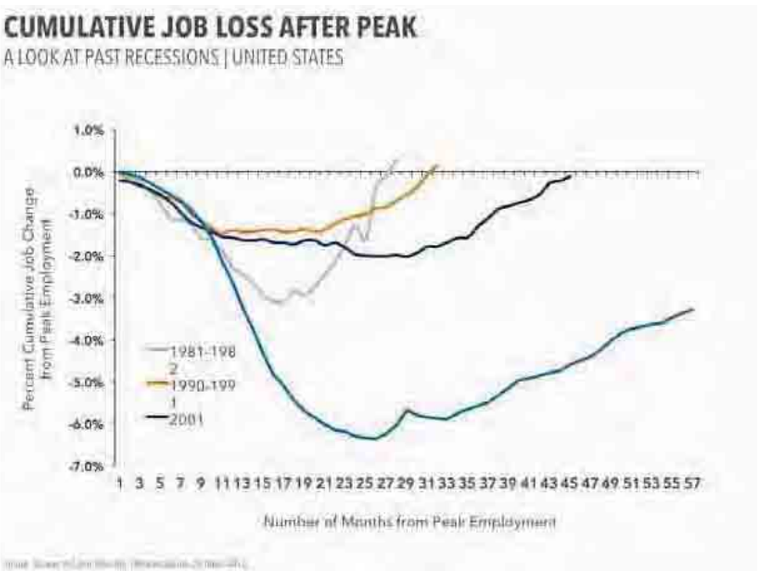


PAYROLL JOBS

The national economy added approximately 1.8 million new jobs during the 12 months ending September 2012. The private sector added approximately 1.9 million jobs during that period and the public sector shed 51,000. Month-to-month gains have been slow to progress, as 114,000 jobs were added to the economy during the month of September 2012. Job gains have been disappointing compared to past economic recoveries. Approximately 125,000 jobs must be created per month just to keep the unemployment rate steady. Although the economy continues to move forward, it does so at a sub-par pace. This sub-par pace will encourage businesses and consumers to alter spending patterns to adjust to this limited growth. We expect muted job growth in the near-term, with approximately 2.0 million jobs added to the national economy during 2012 and perhaps slightly more in 2013.

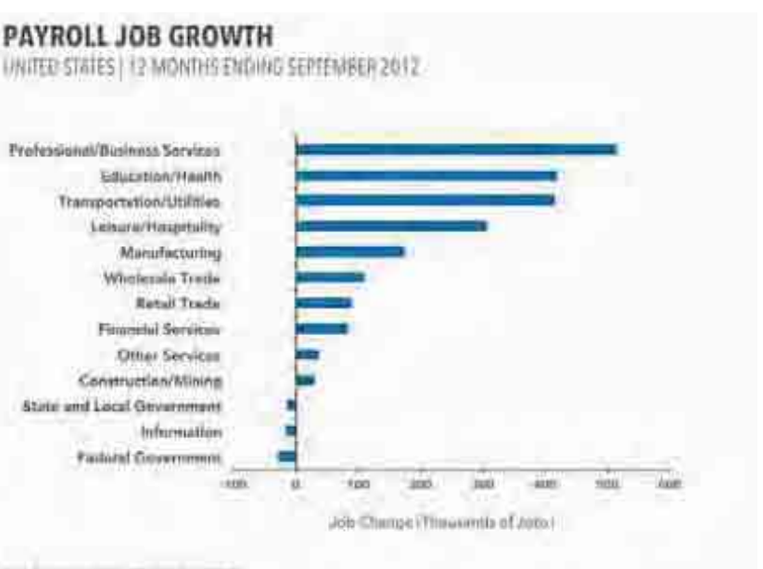


Companies remain cautious in hiring, taking a wait-and-see approach. And many companies do not need to hire back laid-off employees, as productivity gains have eliminated some jobs.

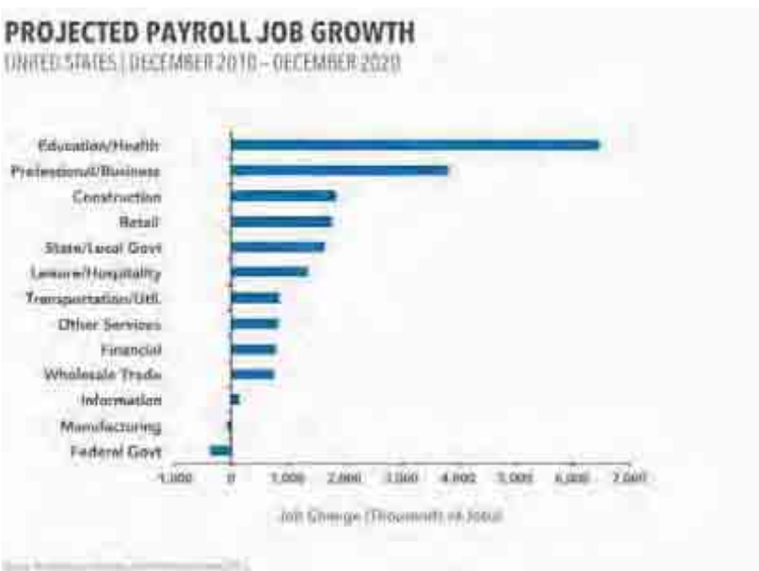


We expect more jobs to be trimmed from the public sector during the balance of 2012, as governments cut their workforces to make up for budget shortfalls. However, the national economy will continue to see net job creation as these losses will be offset by continued growth in the private sector. Although we expect the private sector to grow for all of 2012, the pace of growth will be muted. We expect the pace to improve somewhat in 2013.

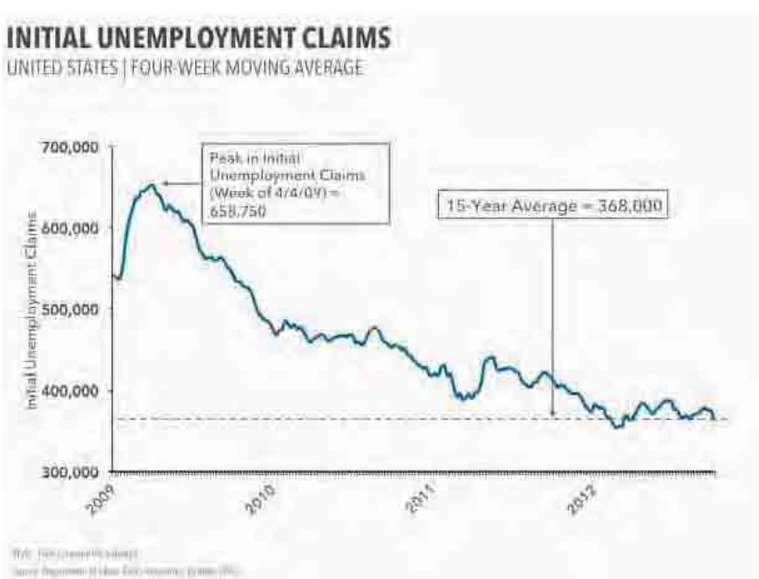
During the 12 months ending September 2012, the top three sectors in job gains were Professional/Business Services, Education/Health, and Transportation/Utilities – adding a total of 1.3 million new jobs. Government and the Information sector shed the most workers over the past year, cutting 62,000 net positions in total. The Government sector (both Federal and State/Local) is reducing its workforce as budget austerity measures are put in place.



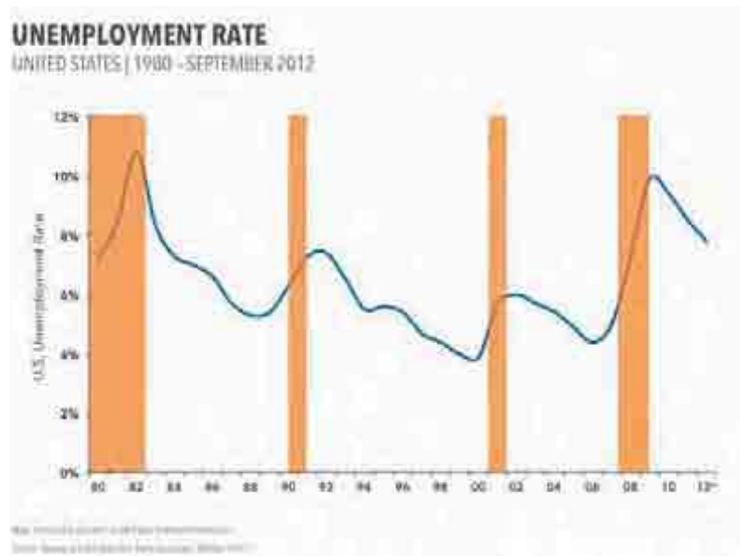
The Bureau of Labor Statistics projects the economy will add 19.7 million non-farm payroll jobs from 2010 through 2020, for an average annual growth rate of 1.4%. This growth rate compares to the 20-year average of 1.0%. Education/Health is projected to be the leader in job growth from 2010 through 2020, adding 6.5 million jobs. Professional/Business Services follows, adding 3.8 million positions. Although the Construction sector ranks third for the number of jobs added, this sector suffered severe job loss during the 2008 downturn and will remain below its pre-recession employment level in 2020.



Initial unemployment claims have bounced around the 15-year average since the start of 2012. Initial claims declined to 364,000 based on a 4-week moving average as of the start of October. This compares to the 15-year average of 368,000. We expect claims to hover at the current level during the remainder of 2012.

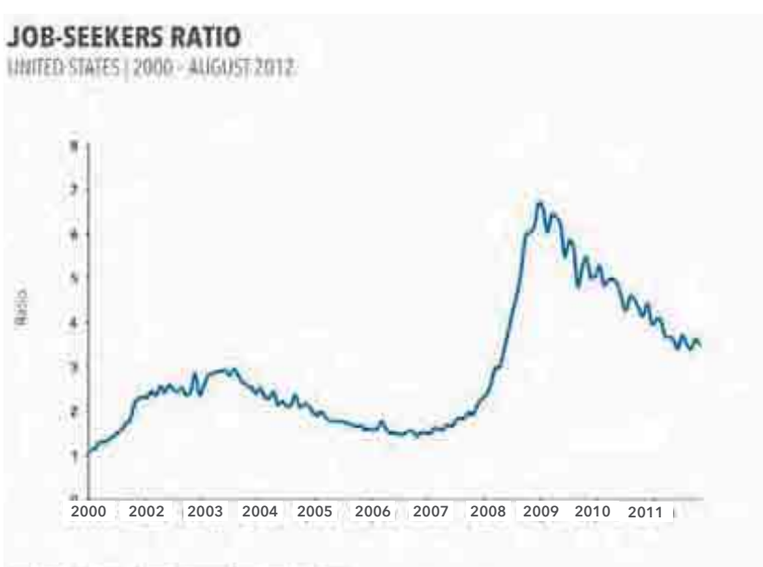


The unemployment rate has ticked down to 7.8% as of September 2012 from 9.0% one year earlier. Although this decline provides optimism for the economy, it should be observed with caution, as the decline in 2012 has been due in part to people giving up looking for work and dropping out of the workforce. However, it also has been bolstered recently by upward revisions of data for recent months as new survey data has become available. We anticipate the unemployment rate will hover around the 8% level through year-end 2013.

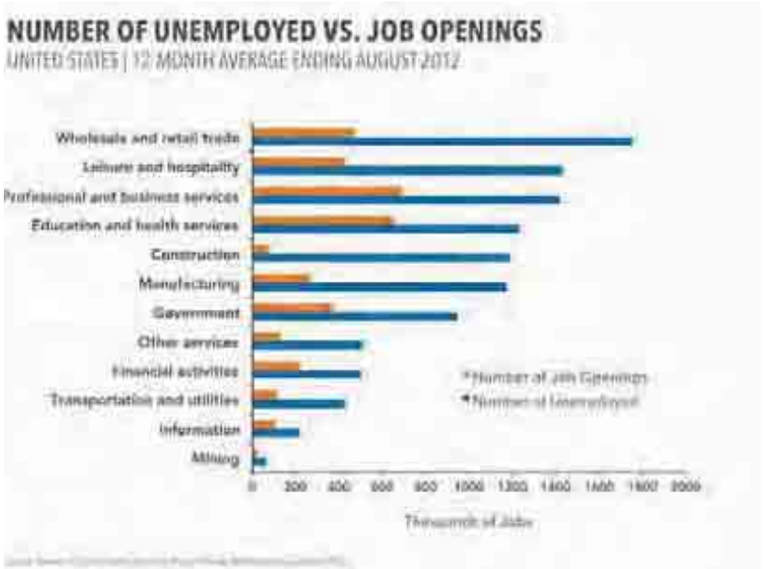


We anticipate the unemployment rate will not edge down materially in the short run, as formerly discouraged job applicants start the application process again. This could push the rate higher in late 2012 and into 2013, or at least keep it from declining materially.

As of August 2012, for every U.S. job opening there are 3.5 potential applicants. This is below the peak of 6.9 applicants for every job in July 2009, but above the 10-year average of 3.1.



Drilling down to job sectors, there are too many potential applicants for too few jobs within each sector. This gap is most apparent in the construction sector where for every job opening there are 16 potential applicants. Although BLS projects the Construction sector will add 1.8 million jobs from 2010 through 2020, this sector suffered severe job loss during the downturn and will remain below its pre-recession employment level in 2020. This loss will force many unemployed construction workers to revamp their skill set in order to be hirable by another sector. The Education and Health Services sector has just two applicants per job opening.



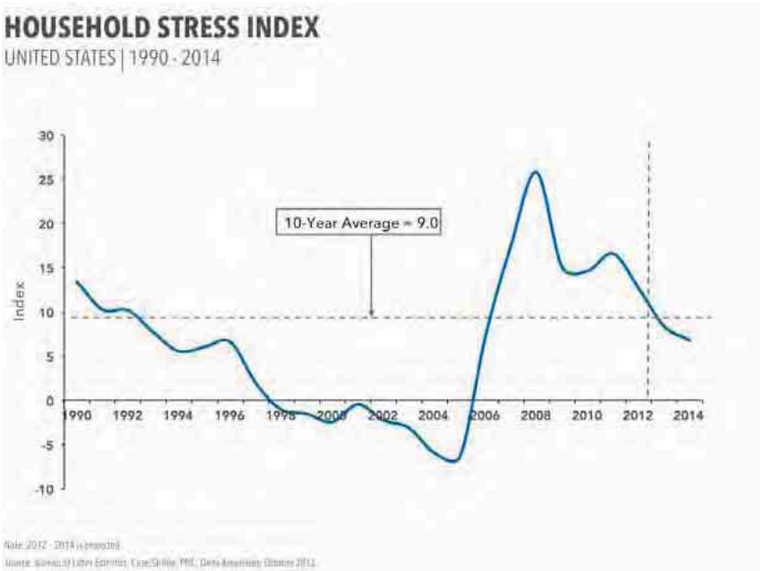
GROSS DOMESTIC PRODUCT (GDP) AND CONSUMPTION

GDP increased 1.3% (annualized rate) during the 2nd quarter of 2012, compared to rising 2.0% during the 1st quarter. GDP increased 1.7% during 2011, compared to the 20-year annual average of 2.5%. The rise in GDP during the 2nd quarter is the 12th consecutive quarter that the economy has expanded. Although the economy continues to make gains, the growth rate remains lackluster. We anticipate GDP growth to complete 2012 at around 2.1%, which is above the rise achieved during 2011, but below the pace needed to significantly lower the unemployment rate.

GDP growth during the 2nd quarter was due to personal expenditures and private domestic investment. However, the Government and exports continue to pull back, acting as a drag to overall GDP growth. Although growth has benefited from gains in consumer spending and equipment investment, these fundamentals have improved at a pace below the average of prior recoveries.

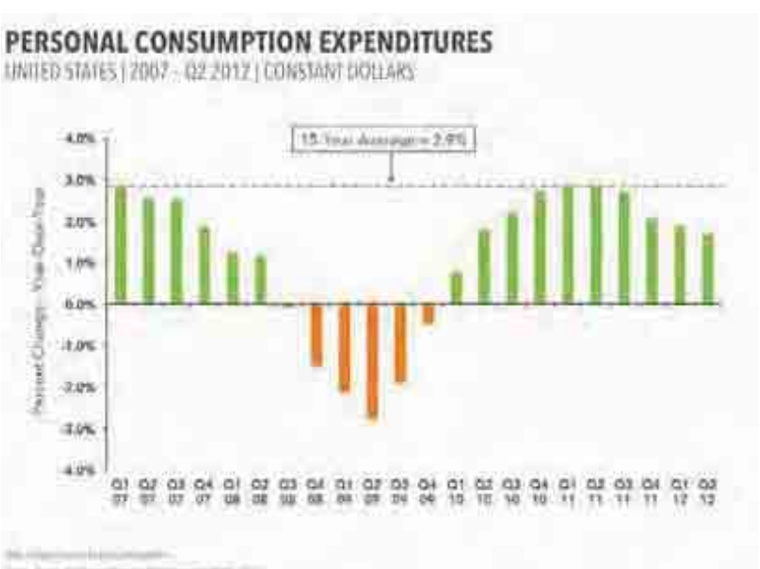
Households are currently under stress, as the unemployment rate remains elevated, prices are on the rise, and home values remain depressed, despite a modest rebound. According to the household stress index, which accounts for the rate of inflation, unemployment, and real estate values, households experienced a rise in stress during 2011.

We expect the consumer to remain under elevated stress during the balance of 2012. Stress should decline to the 10-year average during 2013, as conditions improve, and fall below this average during 2014.

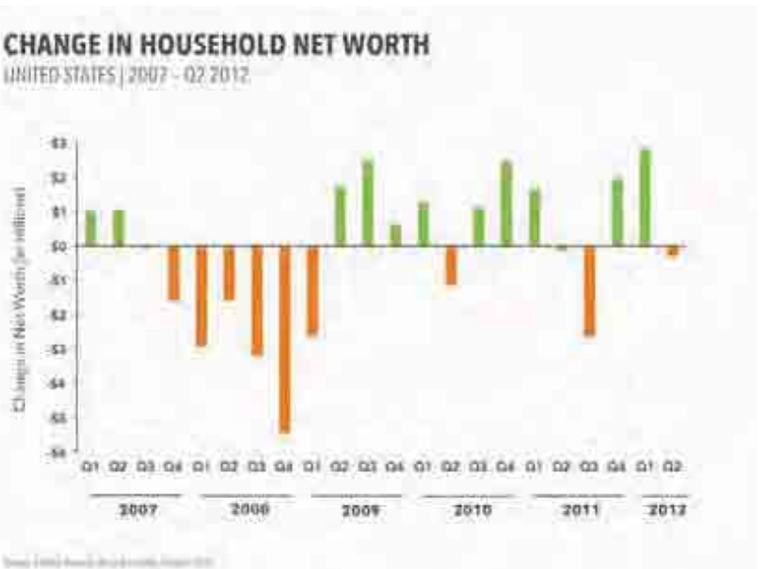


As household stress rises, consumers become less confident about their financial stability. This uncertainty causes consumers to tighten spending. Although spending has picked up pace recently, it remains sub-par. Compared to past recoveries, consumer spending will not be a strong economic driver during this recovery period. With consumer spending responsible for 70% of U.S. GDP, growth in consumer spending is essential for a more robust domestic recovery.

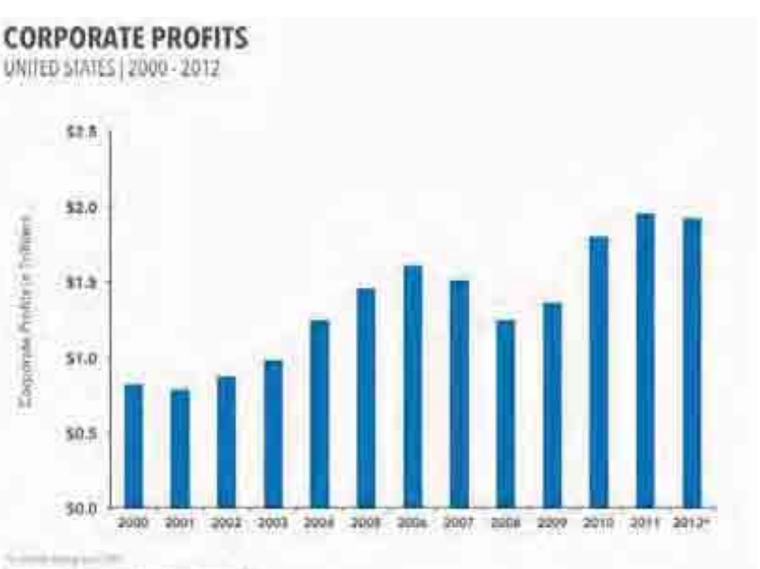
Although consumer spending is helping to boost GDP, spending has been restrained due to below average consumer confidence. Even though confidence has edged up to 74.3 as of August 2012 in the University of Michigan's index, from 55.8 at August 2011, it remains below the 20-year average of 88.2. This continues to hamper spending, as consumer expenditures rose 1.7% on a year-over-year basis during the 2nd quarter of 2012, excluding auto and gas purchases. This rate is below the 15-year average of 2.9%.



Consumer spending remains below average due in part to the decline in net worth during the recession – consumers are still digging themselves out of this hole. Households lost over $17 trillion in personal wealth from the 4th quarter of 2007 to the 1st quarter of 2009. Although households have regained some of the assets lost, gains have been uneven and it will take several more years to recoup the total amount. Household net worth increased $2.8 trillion during the 1st quarter of 2012, but declined by $0.3 trillion in the 2nd quarter. Despite the rise in net worth during the first three months of 2012, Americans continue to struggle to recover what was lost during the downturn, as median net worth dropped 40%, from $126,400 in 2007 to $77,300 in 2010, according to the Federal Reserve. This decline in net worth puts downward pressure on future spending, as Americans will remain cautious until a broader recovery is achieved.



U.S. companies are sitting on piles of cash, waiting for clear signals that the economy is on a consistent recovery path. Corporate profits rose 6.1% during the 12 months ending June 2012; U.S. companies earned $1.92 trillion in profits during that period, just below the record total for all of 2011. Companies have the resources to hire, but remain wary about future demand for their products and services. In addition, with sluggish consumer demand, companies have enough labor to keep pace.



HOUSING MARKET

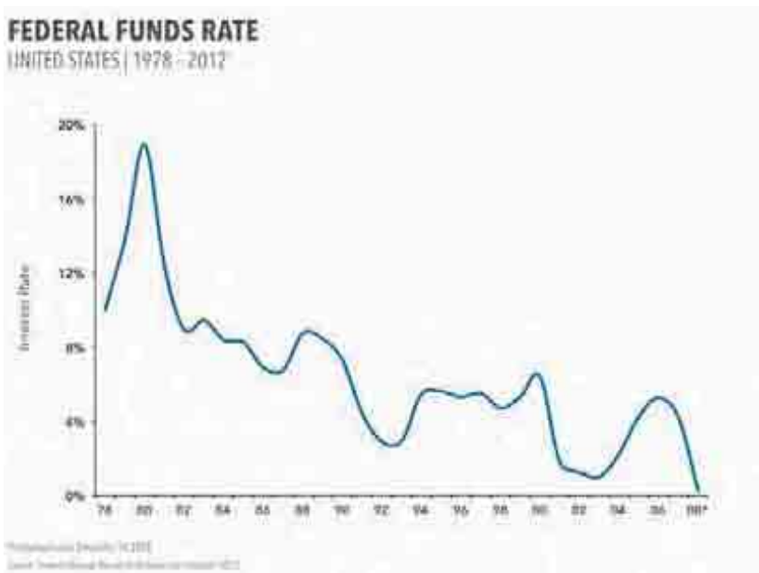
Home prices in 20 major metro areas increased an average of 1.1% during the 12 months ending July 2012, the most recent data available, according to S&P/Case-Shiller. The housing market has struggled to recover, as unemployment remains high, foreclosures dampen gains, and lending standards remain tightened. We expect home prices to stabilize during the balance of 2012, although any year-over-year gains will be muted by foreclosures that continue to plague the market.

The number of sales increased to 4.8 million (annualized) during August 2012, compared to 4.3 million during 2011. However, the number of sales is well below the level achieved at the peak of the market. The U.S. housing sales price averaged $235,300 during August 2012, up 7.2% from one year earlier, according to the National Association of Realtors. Prices have risen on existing home sales, as inventory has declined from 8.2 months of supply in August 2011 to 6.1 months at August 2012. This low level is more a reflection of homeowners not putting their house on the market given the value of their home has not increased enough to justify the sale. In many cases, homeowners have negative equity, meaning their home is worth less than the remaining balance on the mortgage. In the current economic recovery, the housing market is experiencing a long-term correction, which continues to hamper broader economic conditions.

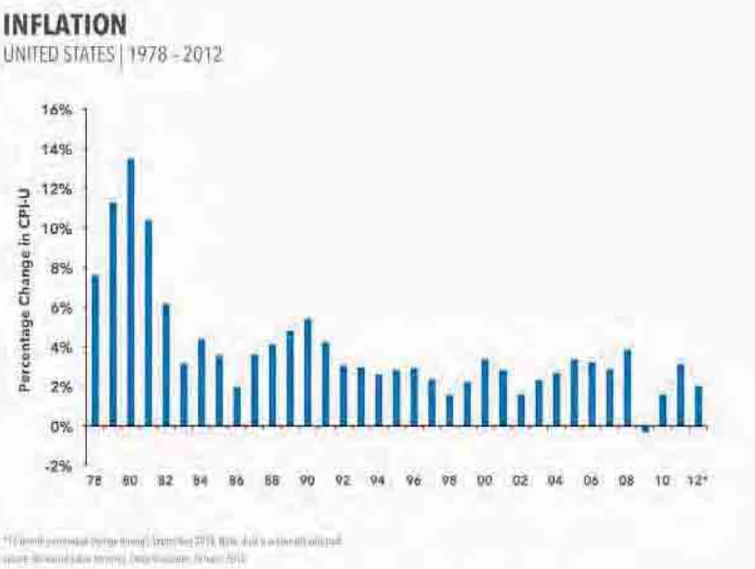
FEDERAL INTERVENTION & INFLATION

The Federal government continues to implement programs to sustain the national economy, vowing to do what it takes to keep the economy on track.

The Federal Reserve has kept the Federal Funds Rate at its current low level, as some business sectors continue to shed jobs. Given the economy continues to grow at a slow pace, the Fed plans to keep short-term rates at its current range of 0% to 0.25% through mid-2015. Between little pressure in the economy and the Fed's commitment, we see a low probability of a meaningful increase in long-term interest rates over the next few years. But that could change if our foreign bond holders trade out of our sovereign debt at an unexpected rate – and that could be related to the coming debt ceiling debate and probable display again of a dysfunctional Federal government.

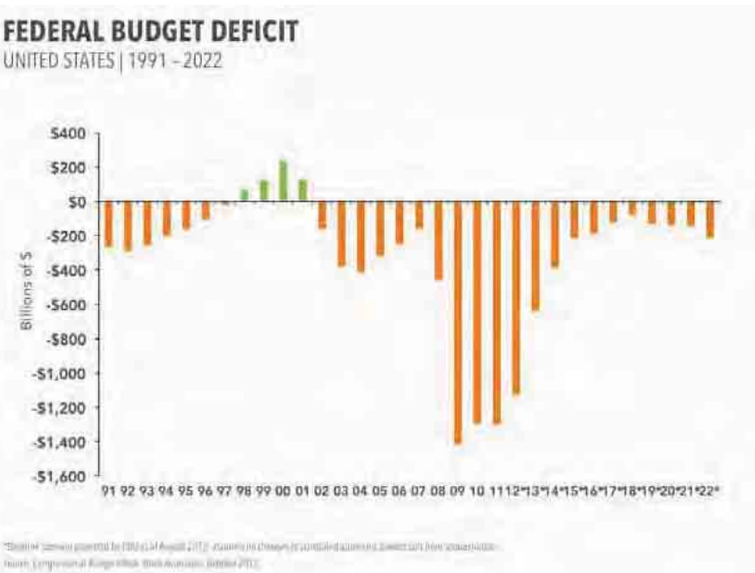


Regarding inflation, prices increased 2.0% during the 12 months ending September 2012, below the levels seen in 2011. The main driver of the lower rate is a notable decline in gas prices from April to June. Consumer food prices were also tepid. However, we expect drought conditions to push food prices higher in the short term. Overall, we expect inflation to be constrained in the near-term, due to elevated unemployment and limited income growth, which will continue to cause lackluster consumer spending. Given this, coupled with appropriate monetary measures, inflation should remain controlled around 2.0% during the remainder of 2012.



FEDERAL BUDGET AND DEBT

The Congressional Budget Office (CBO) anticipates the U.S. budget deficit for 2012 will total $1.1 trillion, compared to $1.3 trillion in 2011. As seen last year with the debt ceiling debate and the Congressional super committee, gaining Federal budget balance has generated concern by both political parties, though so far a lack of broadly acceptable solutions. A split Congress and the election of many new representatives in 2010 who campaigned on the promise to cut spending sparked heated debate on how to reduce the deficit. The debate resulted in spending reductions in the 2012 budget and implications for the proposed 2013 budget, which has yet to be approved.



Automatic across-the-board cuts, totaling $1.2 trillion over ten years, called "sequestration," are slated to go into effect at the start of 2013. This dagger has been swaying over the heads of businesses and consumers since November 2011, hampering economic growth due to uncertainty. Half of the automatic cuts will come from the Defense budget and half from the Domestic budget.

According to Dr. Stephen Fuller of the Center for Regional Analysis at George Mason University, if these cuts are allowed to take place starting in 2013, the national GDP will take a $215 billion hit and 2.15 million jobs could be lost.

This level of job loss would act as a drag on the economy, keeping the unemployment rate elevated through 2015, suppressing confidence and consumer and business spending. Much of the hit will come in 2013, as the greatest reduction in Federal spending is scheduled to take hold then. The residual impact would mean reduced demand for office space and lowered retail spending.

ECONOMIC OUTLOOK

We believe the Congress will do what is right for the economy and ultimately avoid the "fiscal cliff." So, we believe the national economy will continue to experience slow recovery during the balance of 2012 and into 2013 and beyond.

We believe the economic outlook is as follows:

- GDP growth: 2.1% in 2012 and 2.0% to 2.5% in 2013.
- Payroll jobs: 2.0 million added in 2012 (based on a December-to-December calculation) and slightly more in 2013.
- Unemployment: hovering in the 8.0% range through 2013.
- Federal Funds Rate: 0% to 0.25% through year-end 2015.
- Long-term interest rates: steady.
- Inflation: 2.0% during 2012. Comparably low in 2013.

NATIONAL PAYROLL JOB GROWTH SUMMARY

The U.S. economy gained 1.8 million payroll jobs over the 12 months ending September 2012. This represents a rise of 1.4%. This compares to the 25-year annual average of 1.3 million jobs at a 1.1% average growth rate.

U.S. PAYROLL JOB GROWTH		
YEAR	JOB CHANGE	%CHANGE
2012*	1,806,000	1.4%
2011	1,503,000	1.2%
2010	-931,000	-0.7%
2009	-6,008,000	-4.4%
2008	-800,000	-0.6%
2007	1,504,000	1.1%
2006	2,397,000	1.8%
2005	2,275,000	1.7%
2004	1,423,000	1.1%
2003	-344,000	-0.3%
2002	-1,489,000	-1.1%

*Change for 12 months ending in September 2012; others are comparisons of annual averages. Note that BLS has rebenchmarked figures since their initial publication; the figures presented above are the most recent estimates.

12-MONTH PAYROLL EMPLOYMENT CHANGE THROUGH AUGUST 2012					
	JOB CHANGE			JOB CHANGE	
METRO AREA	#	%	METRO AREA	#	%
LA Basin			Oklahoma City	20,200	3.9%
Los Angeles/Long Beach/Glendale	74,000	2.0%	Portland (OR)	20,100	2.0%
Orange County (Santa Ana/Anaheim/Irvine)	29,000	2.1%	Philadelphia	19,800	0.7%
Riverside/San Bernardino/Ontario	25,400	2.3%	San Antonio	19,800	2.3%
Subtotal LA Basin	128,400	2.1%	Minneapolis-St. Paul	18,700	1.1%
New York	117,900	1.4%	Sacramento	18,600	2.3%
San Francisco Bay Area			Tampa-St. Pete	15,700	1.4%
San Jose/Sunnyvale/Santa Clara	29,600	3.4%	Indianapolis	15,100	1.7%
San Francisco/San Mateo/Redwood City	59,400	3.2%	Salt Lake City	14,200	2.2%
Oakland/Fremont/Hayward	17,600	1.9%	Pittsburgh	13,700	1.1%
Subtotal Bay Area	106,600	2.9%	Charlotte	11,800	1.4%
Houston	**89,500**	**3.5%**	Kansas City	10,800	1.1%
Dallas/Ft. Worth	61,100	2.1%	Memphis	7,100	1.2%
Boston (Metropolitan NECTA)	52,100	2.1%	Cleveland	7,000	0.7%
Phoenix	47,200	2.8%	Detroit (Detroit/Warren/Livonia)	6,300	0.9%
Seattle	40,800	2.5%	Baltimore	5,900	0.5%
Denver-Boulder	40,000	2.9%	Jacksonville	5,600	0.9%
Chicago	38,800	0.9%	Las Vegas	5,300	0.6%
Washington, DC	38,200	1.3%	South Florida		
Atlanta	29,400	1.3%	Miami/Kendall	5,800	0.6%
San Diego	28,700	2.3%	Fort Lauderdale	1,700	0.2%
Cincinnati	27,800	2.8%	West Palm Beach/Boca Raton	(2,600)	-0.5%
Orlando	25,900	2.6%	Subtotal South Florida	4,900	0.2%
Austin	24,700	3.1%	St. Louis	2,700	0.2%
Raleigh-Durham	22,900	2.9%	Nashville	1,000	0.1%
Columbus (OH)	22,200	2.4%	New Orleans	(2,200)	-0.4%

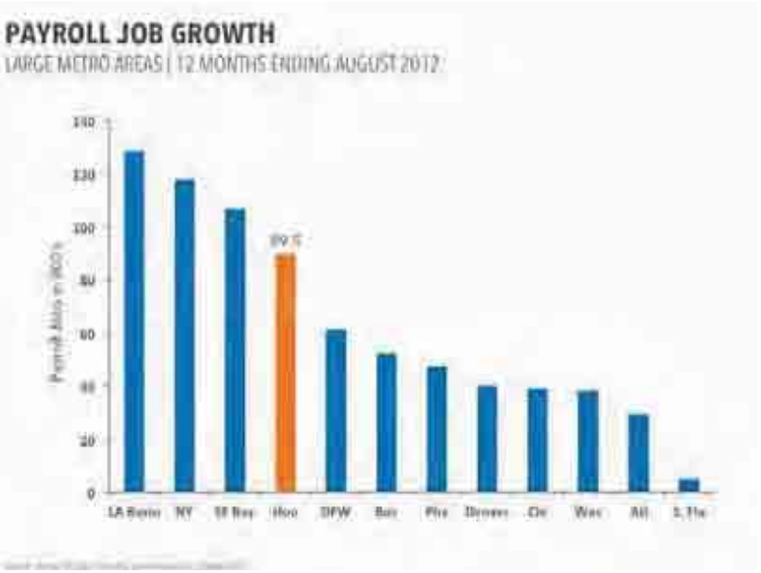
Source: Bureau of Labor Statistics, Delta Associates; October 2012.

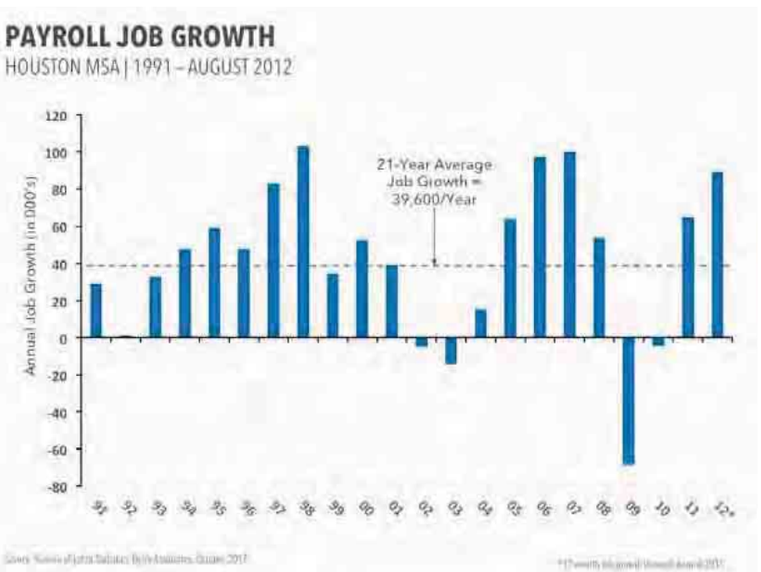
SECTION THREE

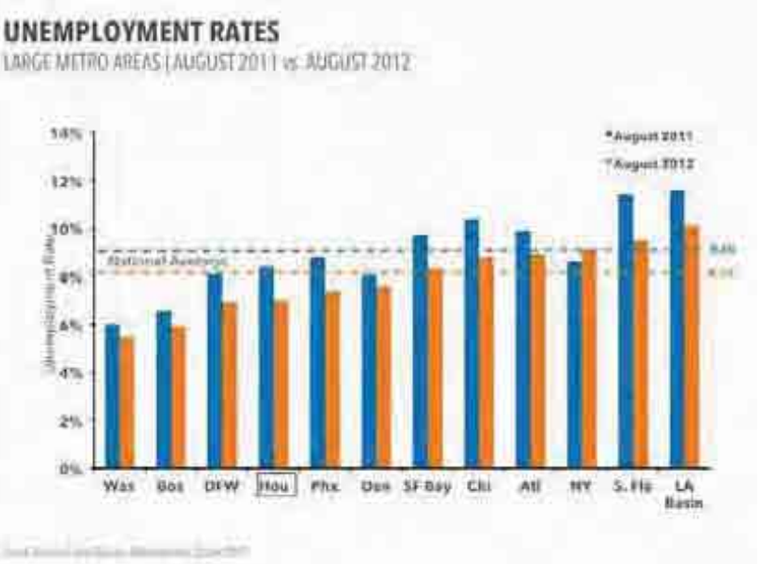
THE HOUSTON METRO ECONOMY

LOCAL ECONOMIC GROWTH REMAINS STRONG

Economic growth has strengthened in the Houston metro area during 2012. The 12-month employment growth of 89,500 jobs through August is the fourth-most in the nation, trailing only the Los Angeles Basin, New York, and San Francisco. Houston's employment rose by 3.5% in that period, compared to national growth of 1.4%. The Energy and Trade/Transportation sectors are fueling growth, and most of Houston's core industries are continuing to improve.







The Houston area unemployment rate dropped to 7.0% in August 2012, the most recent data available at this writing, from 8.4% in August 2011. The national unemployment rate was at 8.1% in August 2012, down from 9.1% one year prior.

Metro Houston's core industries continue to strengthen:

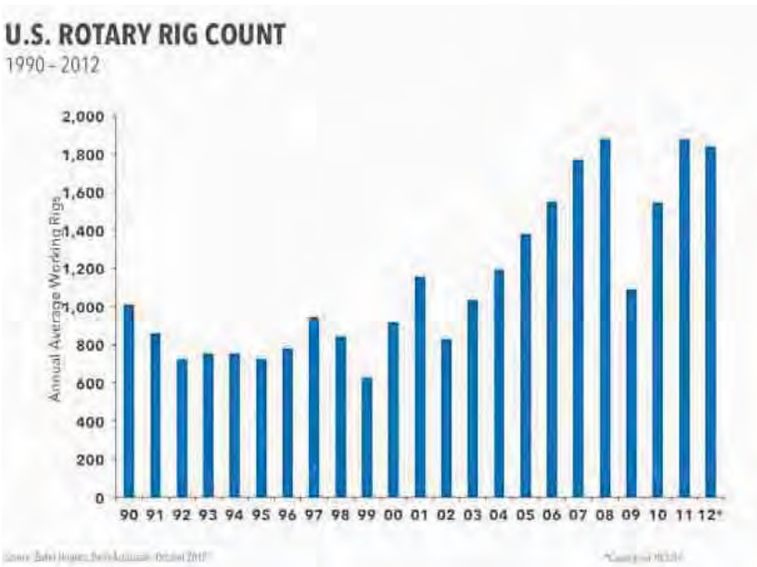
- **Energy:** Lower oil and natural gas prices in the early summer eased investment in the industry, but the rise of hydraulic fracturing kept the sector strong. Energy continues to support growth region-wide, and rebounding oil prices will further this trend. It remains to be seen what effect the instability in the Middle East and the national election will have on this sector, as deep sea drilling in the Gulf of Mexico has slowed, and the Key stone XL pipeline project remains without approval.
- **Professional Services:** 10,200 jobs were added over the 12 months ending August 2012.
- **Construction:** Projects are progressing at a consistent pace with access to financing. Jobs are being added in this industry.
- **Manufacturing:** Employment (on a trailing 12-month basis) has risen every month since October 2010.
- **Trade:** Air freight rose 5.7% in 2011, a new annual record, and 2012 remains on track to finish as the second-best year ever. Investment is rampant with Panama Canal expansion and the growth of Latin American trade spurred by the energy sector.

CORE INDUSTRIES
HOUSTON MSA | 2011

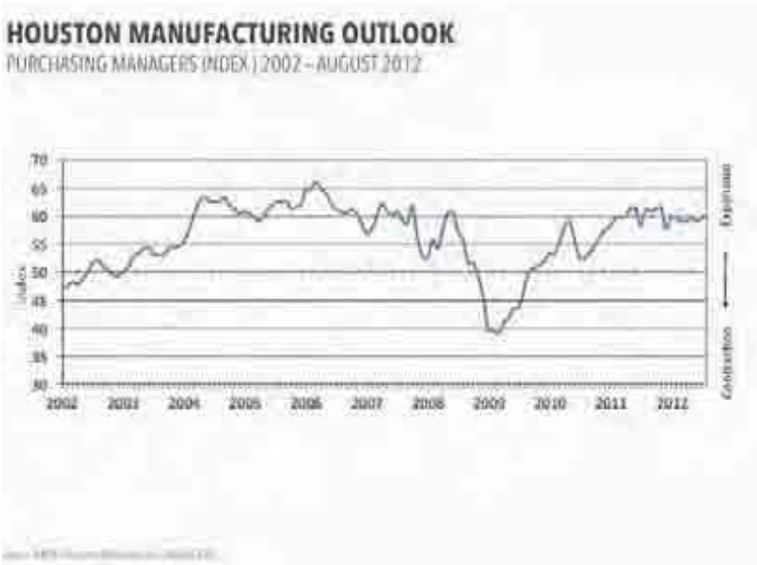
Core Industries	$ (Bil)	% GRP
Energy	$108	27%
Financial, Professional, Tech	$52	13%
Construction	$36	9%
Federal & State Government	$32	8%
Manufacturing	$24	6%
Medical/Educational	$16	4%
Trade/Transportation	$18	4%
Total Core Industries	$283	71%
Other	$110	29%

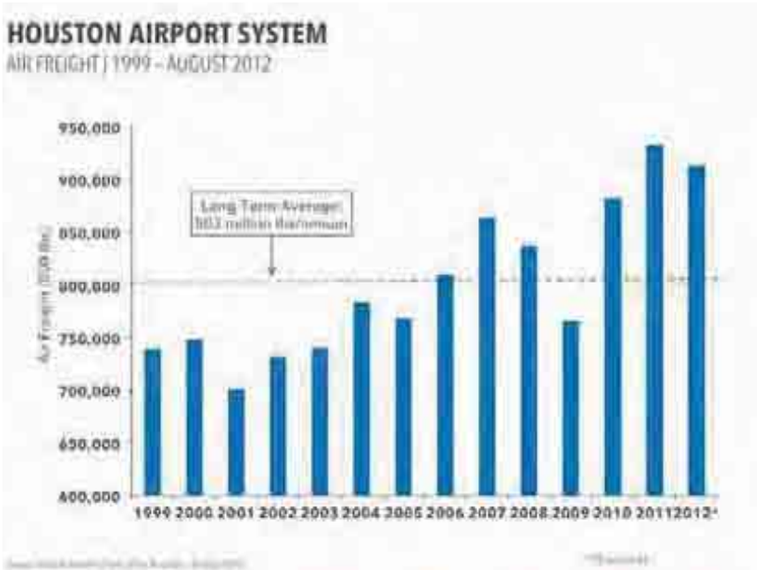
Employment in Houston's **Mining sector** increased by 6,700 jobs, or 7.5%, in the 12-month period ending in August 2012. In addition, the U.S. rotary rig count was at 1,837 in early October, down from mid-June but still comparable to the average of 1,879 in 2011. After falling to $77 per barrel in June, crude oil prices rebounded to $92 per barrel in October. This is still below the $105 per barrel seen in March, slowing the heavy investment witnessed in the first quarter of 2012 when prices were stronger, but the rebound promises to strengthen the industry's confidence. BP is continuing its plan to sell $38 billion dollars in assets by 2013, announcing in August that it is actively seeking buyers for its Texas City refinery.

The **Construction sector** added 6,900 jobs during the 12 months ending August 2012 – a 3.9% increase. As Houston's economy gains strength, commercial and residential construction are increasing. GID Partners broke ground on the Sovereign Apartments, the first building of the 24-acre Regent Square mixed-use development, located off of Allen Parkway in the Midtown submarket. Hines Global REIT began construction on Waterwall Place, a seven-story, 322-unit multifamily property located in Uptown overlooking the Gerald D. Hines Waterwall Park.



Houston's **Manufacturing** sector continues to expand. The Houston Purchasing Managers Index, a short-term leading indicator of production, measured 60.3 in August 2012 and has been in expansion every month since October 2009. (A score above 50 indicates expansion.) Manufacturing employment growth slowed slightly, adding 5,700 jobs over the 12 months ending in August 2012 – a 2.5% increase. This was the twenty-third consecutive month of positive 12-month job growth, after 19 straight months of losses from March 2009 through September 2010. Petrochemical manufacturing continues to be a source of strength, with eight new plants scheduled in the coming years, including two Chevron Phillips facilities costing over $5 billion dollars that will come online in 2017.





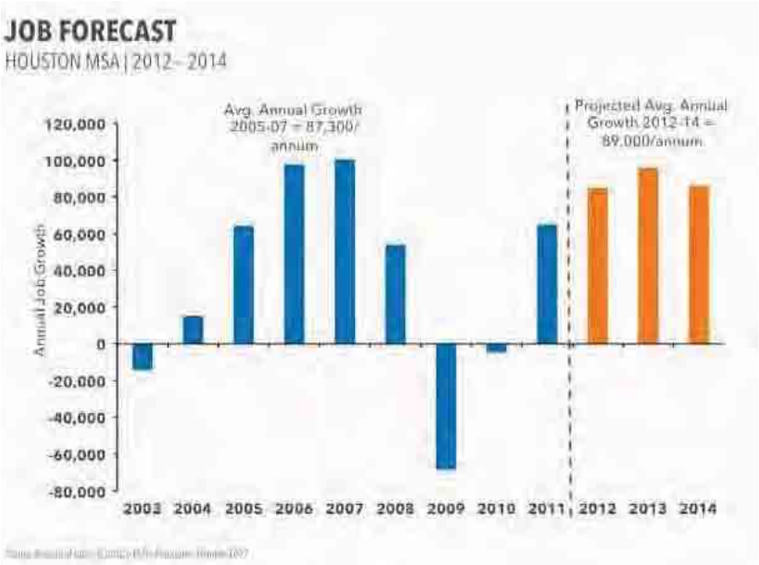
The **Education and Health Services** sector continues to grow, adding 14,900 jobs in the 12 months ending August 2012 – a 4.6% increase. Kelsey-Seybold Clinic is building a 36,400 SF new clinic which will double its existing space in Pasadena. Contracted to Gamma Construction Co., it is scheduled to be completed by spring 2013. The growing multispecialty clinic company also announced it will open a new clinic in Meyerland Plaza. The 72,000 SF facility will include 45,000 SF of clinic space and is also being constructed by Gamma Construction Co.

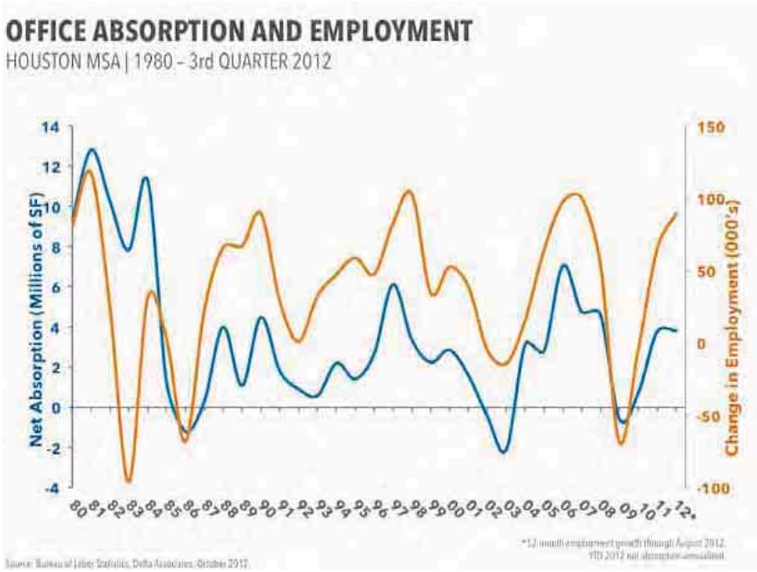
Trade/Transportation activity is growing stronger in Houston. Houston's airports handled 5.7% more air freight in 2011 than in 2010, and freight volume in 2012 is on track to post its second-strongest year on record. Meanwhile, 21,300 jobs were added in this sector during the 12 months ending in August 2012, a 4.0% increase and the largest since December 2007. The Port of Houston continues to grow, as the Panama Canal expansion is set to open in 2015. By 2013, the Port will be able to accommodate larger ships that require a deeper channel and larger cranes to unload. Further, the Port Authority declared in August that 2nd quarter revenues increased by 5% compared to the original forecast. It has been reported that a worker shortage still exists at the Port, an indication that the strong job growth will likely continue.

In **Housing**, the Houston Association of Realtors reported a 20.5% increase in single-family home sales volume in August 2012, compared to August 2011. This was the fifteenth consecutive month in which sales increased. The average single-family home sale price was $224,464 in August 2012, which is 4.0% higher than the average price for August 2011. The median price was $165,000 in August 2012, up 3.8% from August 2011. The number of active listings at the end of August 2012 fell 16.9% from August 2011, indicating there is more demand and less inventory available.

THE HOUSTON METRO AREA ECONOMIC OUTLOOK

Metro Houston's economy is expected to experience healthy growth over the next several years, although it could be at risk due to international instability. European turmoil and a slowdown in China's economic expansion may diminish global growth. The promise of the Panama Canal expansion in 2015 will increase investment in the Port of Houston, and if the airports succeed in their bid for Latin American routes, activity could increase dramatically. Strength in the Energy, Transportation, and Professional Services sectors, underpinned by a recovering consumer sector, will fuel expansion locally over the next several years. As a result, we expect Houston's annual job growth to average close to 90,000 per annum through the end of 2014, comparable to the growth during the 2005-07 expansion period. Houston's employment growth should be among the nation's strongest.





SECTION FOUR

THE HOUSTON METRO OFFICE MARKET

TRENDLINES®
HOUSTON 2012

VIGOROUS GROWTH IN 2012

The Houston metro office market has experienced continued growth in 2012, as the local economy continues to expand at a steady clip. Professional/Business Services and Energy-related firms have supported the leasing activity, vacancy has continued to decline, and rents are increasing.

CLASS A DEMAND DOMINATES

Net absorption totaled 2.9 million SF in the first three quarters of 2012 (3.8 million SF when annualized), compared to 3.8 million SF in all of 2011. The Class A market accounted for a majority of that total, absorbing 2.2 million SF, or 77% of activity in the Houston market.

Net absorption by class (SF):

	2011	YTD 2012
• Class A	3,618,000	2,217,000
• Class B	540,000	540,000
• Class C	97,000	108,000

Available sublease space in the Houston metro currently stands at 0.8 million SF – just 0.3% of the standing inventory.

Notable 2012 leases include:

- Noble Energy leased 497,124 SF at 20555 SH 249-Bldg. in the FM 1960/Hwy 249 submarket.
- LyondellBasell Industries renewed 310,178 SF at 1221 McKinney Street in the CBD.
- Phillips 66 leased 209,000 SF at 3010 Briarpark Drive in the Westchase submarket.
- Apache Corporation leased 131,068 SF at 1990 Post Oak Blvd. in the Galleria submarket.
- Schlumberger Technology Corporation leased 105,432 SF at 1200 Enclave Parkway in the Katy Freeway/Energy Corridor submarket.
- Dynegy leased 62,261 SF at 601 Travis Street in the CBD.
- IHI E&C International Corp. leased 52,148 SF at 1080 Eldridge Parkway in the Katy Fwy/Energy Corridor submarket.
- Baker McKenzie LLP leased 50,700 SF at 700 Louisiana Street in the CBD.

HOW THE MULTI-TENANT MARKET COMPARES TO OUR MARKET COVERAGE

Vacancy and absorption in the Houston metro area often are reported by brokerage firms on multi-tenant buildings only. We include owner-occupied and single-tenant buildings as well, on the basis of immediate availability, to capture more market activity. We exclude government-owned space. As a point of comparison, below is data for the Houston multi-tenant office market at Q3 2012:

	Multi-Tenant	Entire Market
Inventory:	204.6%	251.1 MSF
Overall vac. (incl. sublet):	13.6%	10.9%
YTD net absorption:	2,020,000 SF	2,865,000SF

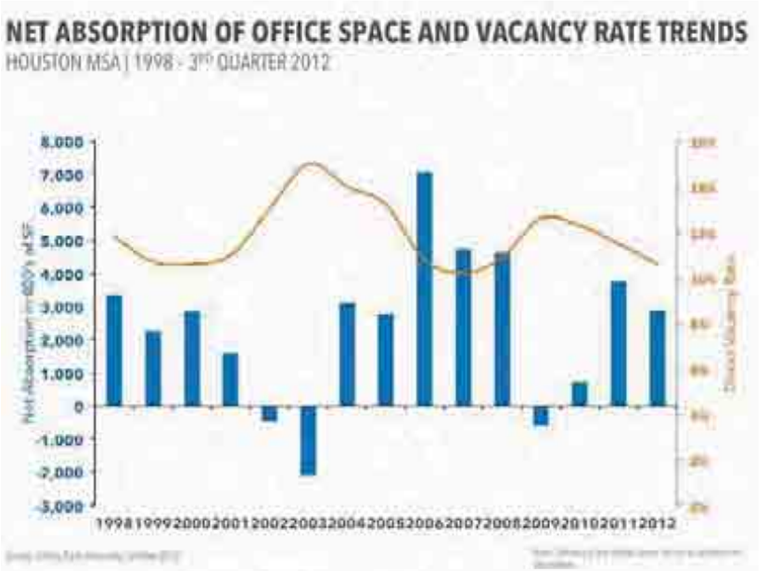
WHY THIS METHODOLOGY IS THE BEST INDICATOR OF CURRENT MARKET CONDITIONS

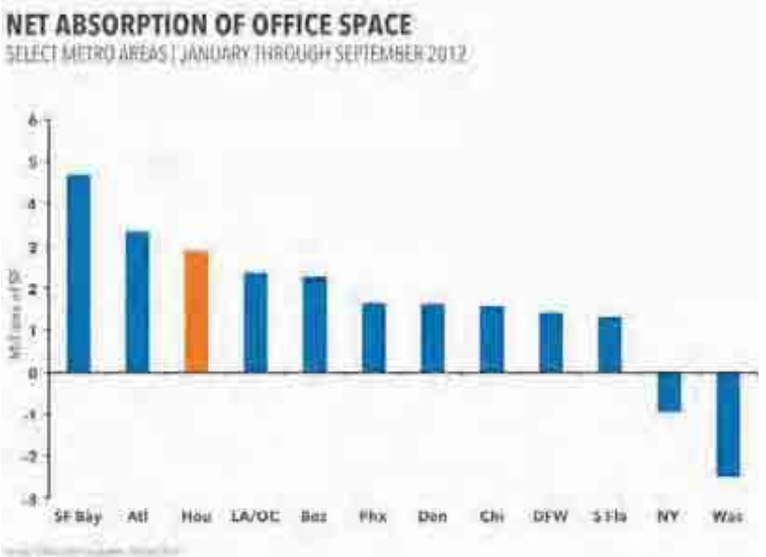
We include owner-occupied and single-tenant buildings in our inventory, vacancy, and absorption statistics. Doing so allows us to capture more market activity than many of our competitors, and to better correlate changes in the market with changes in employment. As single-tenant space does compete with multi-tenant space, we believe it is critical to understand all components of the market. We also offer wider geographic coverage than some of our competitors. The result is that the inclusion of single-tenant and owner-occupied space tends to yield lower vacancy rates and higher absorption totals than our competitors' results, but our coverage of the market is more comprehensive.

Net Absorption (SF) in Selected Submarkets:

	2011	YTD 2012
• Greenspoint/N Belt	(70,000)	109,000
• Gulf Freeway/Pasadena	(41,000)	91,000
• Katy Freeway/Energy Corridor	1,249,000	576,000
• Southwest Freeway/Sugar Land	(54,000)	261,000

Strong job creation and the continued strength of the energy sector have put Houston on pace to absorb 3.8 million SF during 2012. The San Francisco Bay Area and Atlanta lead the nation in office space absorbed this year, followed by Houston.





VACANCY CONTINUES TO DECLINE

The overall office vacancy rate (including sublet space) in the Houston metro area fell to 10.9% as of September, down from 12.2% a year ago. Direct vacancy is currently 10.6%, a decrease from 11.7% one year ago. The continued strength of the local economy is driving these figures down; direct vacancy is nearing its recent nadir of 10.2% in 2007.

The overall Class A vacancy rate is 8.6%, compared to 11.1% a year ago. Overall vacancy rates for all classes in selected submarkets:

- South Main/Medical Center 7.2%
- Katy Fwy/Energy Corridor 7.4%
- Downtown 9.8%
- West Loop 11.0%
- FM 1960 18.6%

The overall office vacancy rate (including sublet space) in the Houston metro will likely decline over the next two years, as increased demand outpaces a limited pipeline of new supply. Consequently, we expect overall vacancy to drop below 10% in two years. Without a major disruption in the regional economy, an atmosphere of rapid rent growth is on the horizon. However, the pipeline of new construction is rising along with expectations of greater demand.

CONSTRUCTION PIPELINE INCREASING

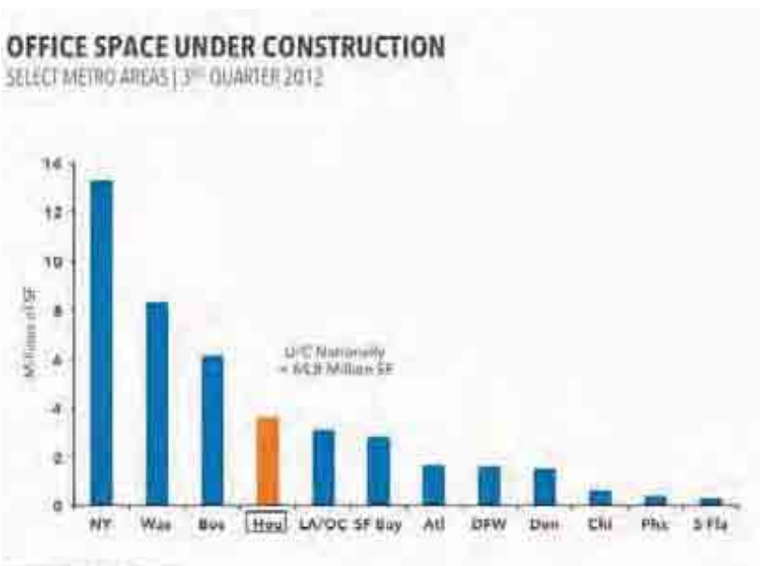
There is 3.6 million SF of office space under construction or renovation in the Houston metro area as of September, compared to 1.3 million SF one year ago. Space under construction now is 46% preleased, compared to 51% a year ago.

Anadarko Tower II at 1201 Lake Robbins Drive – a 550,000 SF build-to-suit in the Woodlands submarket – is still the largest office building under construction in the Houston metro, followed by the 428,831 SF Energy Tower III at 11740 Katy Freeway in the Katy Freeway West submarket, which is 0% preleased.

OFFICE SPACE UNDER CONSTRUCTION OR RENOVATION
Houston Metro Area

Submarket	SF	% Pre-leased
Greenspoint/N Belt	150,000	100.0%
Katy Fwy/Energy Corridor	1,135,937	25.7%
Kingwood Humble	45,000	100.0%
Northwest	159,056	0.0%
SW Fwy/Sugar Land	40,000	0.0%
West Loop	608,548	29.8%
Westchase	344,664	14.9%
Woodlands/Conroe	1,135,298	82.5%
Total	**3,618,503**	**46.0%**

Source: Delta Associates' analysis of CoStar data; October 2012.



The amount of office space under construction nationally is edging up, with market conditions gradually improving and financing becoming more available. Nationally, 64.8 million SF of office space is under construction today, compared to 50.7 million SF one year ago. Houston has the fourth-most office space under construction, and at 3.6 million SF, it represents approximately 1.4% of the current metro inventory.

Deliveries have totaled 503,549 SF since the start of 2012, with 70% leased upon delivery.

OFFICE RENTS UP IN 2012

Asking rents for all classes of office space have risen approximately 2.4% in metro Houston during the first three quarters of 2012, after rising 0.8% in 2011. Class A asking rents are up 2.8% this year, while Class B asking rents have increased 1.7%. Asking rents have surpassed their previous peak, which occurred in 2007. Rents have pulled back slightly recently as growth in the Energy sector decelerated over the past few months, but market fundamentals suggest further asking rent growth in the period ahead. Additionally, effective rents are rising in certain submarkets as concessions decline in response to steady demand.

Houston's asking rent growth looks stronger when compared to asking rent changes in other major markets. Rent growth in Houston is second in the country to San Francisco among major metros.

Asking rents average $26.82/SF, full service, for Class A buildings and $18.78/SF, full service, for Class B buildings. These are metro-wide averages; newer buildings in more desirable submarkets are outperforming these market-wide averages.

Metro-wide asking rents will likely improve during the rest of 2012 as vacancy continues to decline and demand for space remains strong. At the submarket level, asking rents may continue fluctuating, with owners reacting quickly to changes in market fundamentals. On balance, as market conditions continue to improve, concessions will continue to disappear. Given the strong demand for Class A space YTD, rents for that product type should outperform in the period ahead. The next 12 months should bring material gains in rents.

THE HOUSTON METRO AREA OFFICE MARKET OUTLOOK

The Houston metro office market will likely remain strong in the period ahead, provided that the regional economy continues expanding at a healthy pace and is not disrupted by global forces. As businesses increase leasing activity, vacancy will continue declining, likely dropping below 10% over the next two years. As a result, rents will likely gain significant upward momentum in 2012-13. Office market conditions will likely turn in the landlord's favor through the rest of 2012 and into 2013, as vacancy declines and the pipeline of new supply (presently at 1.7% of the standing inventory including planned space likely to deliver within two years) remains limited. Of note, the pipeline of new construction has been expanding in 2012 as developers have gained confidence in local market conditions and are more willing to put capital at risk.

Office submarkets likely to outperform in the months ahead, with declining vacancy and rising rents, include:

- Houston CBD
- Greenway Plaza
- South Main/Medical Center
- West Loop
- Woodlands/Conroe

West Loop in general is a candidate for strong performance over the next two years as long as infrastructure improvements keep pace with new commercial deliveries. Also, with Exxon moving to its new campus nearby, The Woodlands promises to attract more energy-related tenants.

SUMMARY OF OFFICE MARKET INDICATORS - ALL SPACE

Houston Metro Area | 2009 Through Q3 2012

	Q3 2012			Direct Vacancy Rate at the end of:				Q3 2012		Net Absorption (SF) 2/				
Submarket	Total Bldgs.	Total Rentable SF All Bldgs. 1/	SF Available Immediately All Bldgs. 2/	2009	2010	2011	Q3 2012	Vacancy Rate w/ Sublet	SF Under Constr. or Renovation	2009	2010	2011	Q3 2012	YTD 2012
Central Business District	112	48,072,971	4,182,348	8.9%	9.3%	9.5%	8.7%	9.3%	-	(71,000)	(166,000)	1,552,000	385,000	385,000
Midtown	106	7,212,574	952,060	15.0%	14.7%	13.2%	13.2%	13.2%	-	(481,000)	22,000	108,000	(65,000)	0
Downtown	**218**	**55,285,545**	**5,134,408**	**9.8%**	**10.0%**	**10.0%**	**9.3%**	**9.8%**	**-**	**(552,000)**	**(144,000)**	**1,660,000**	**320,000**	**385,000**
I-45 North	42	2,270,142	351,872	15.5%	17.9%	16.3%	15.5%	15.5%	-	28,000	(35,000)	36,000	(5,000)	18,000
FM 1960 / Champions	68	2,958,692	665,706	21.2%	18.6%	20.2%	22.5%	23.3%	-	33,000	77,000	(47,000)	(71,000)	(68,000)
FM 1960 / Highway 249	128	6,893,809	1,185,735	14.4%	30.4%	26.2%	17.2%	17.6%	-	(312,000)	120,000	134,000	14,000	669,000
FM 1960	**238**	**12,122,643**	**2,203,313**	**16.2%**	**25.5%**	**22.9%**	**18.2%**	**18.6%**	**-**	**(251,000)**	**162,000**	**123,000**	**(62,000)**	**619,000**
North Belt West/Greenspoint	90	10,688,423	1,368,118	13.7%	13.3%	13.8%	12.8%	13.8%	-	(330,000)	42,000	(28,000)	128,000	106,000
Greenspoint / IAH	31	2,745,268	356,885	10.2%	11.1%	12.6%	13.0%	13.1%	150,000	(215,000)	(47,000)	(42,000)	60,000	3,000
Greenspoint / N Belt	**121**	**13,433,691**	**1,725,003**	**13.1%**	**12.9%**	**13.6%**	**12.8%**	**13.7%**	**150,000**	**(545,000)**	**(5,000)**	**(70,000)**	**188,000**	**109,000**
Greenway Plaza	**99**	**12,166,960**	**1,143,694**	**11.4%**	**11.5%**	**9.8%**	**9.4%**	**9.5%**	**-**	**(127,000)**	**(12,000)**	**232,000**	**(61,000)**	**49,000**
Gulf Freeway/Pasadena	**109**	**4,572,000**	**484,632**	**13.6%**	**11.7%**	**12.6%**	**10.6%**	**10.8%**	**-**	**170,000**	**106,000**	**(41,000)**	**110,000**	**91,000**
Katy Freeway East	111	8,848,947	548,635	11.4%	8.5%	7.3%	6.2%	7.0%	571,776	1,042,000	331,000	105,000	18,000	98,000
Katy Freeway West	171	21,734,098	1,608,323	14.4%	14.2%	9.6%	7.4%	7.5%	564,161	(364,000)	108,000	1,144,000	109,000	478,000
Katy Fwy / Energy Corridor	**282**	**30,583,045**	**2,156,958**	**13.4%**	**12.4%**	**8.9%**	**7.1%**	**7.4%**	**1,135,937**	**678,000**	**439,000**	**1,249,000**	**127,000**	**576,000**
Kingwood / Humble	**45**	**2,121,655**	**165,489**	**7.3%**	**8.4%**	**7.3%**	**7.8%**	**7.8%**	**45,000**	**(26,000)**	**17,000**	**47,000**	**(6,000)**	**(10,000)**
NASA / Clear Lake	**171**	**9,643,387**	**1,263,284**	**8.7%**	**7.5%**	**10.6%**	**13.1%**	**13.2%**	**-**	**70,000**	**104,000**	**(140,000)**	**(48,000)**	**(241,000)**
Northeast	**46**	**2,067,508**	**258,439**	**14.9%**	**10.6%**	**12.3%**	**12.5%**	**12.5%**	**-**	**(66,000)**	**82,000**	**(35,000)**	**2,000**	**(4,000)**
North Loop West	71	5,497,896	1,077,588	18.7%	21.7%	24.9%	19.6%	19.9%	-	(36,000)	(178,000)	(175,000)	(27,000)	292,000
Northwest Near	23	1,584,574	163,211	17.2%	9.8%	10.4%	10.3%	10.3%	-	-	87,000	(10,000)	3,000	1,000
Northwest Far	96	7,828,050	962,850	20.5%	19.1%	12.2%	12.3%	12.6%	159,056	748,000	110,000	540,000	0	(8,000)
Northwest	**190**	**14,910,520**	**2,203,649**	**19.5%**	**19.1%**	**16.7%**	**14.8%**	**15.0%**	**159,056**	**712,000**	**19,000**	**355,000**	**(24,000)**	**285,000**
South Main / Medical Center	**88**	**11,135,712**	**801,771**	**6.3%**	**7.0%**	**6.9%**	**7.2%**	**7.2%**	**-**	**244,000**	**(71,000)**	**12,000**	**(11,000)**	**(33,000)**
Southwest / Hillcroft	59	4,743,707	678,350	20.6%	19.2%	16.0%	14.3%	14.3%	-	(60,000)	65,000	152,000	104,000	80,000
Southwest Beltway 8	98	7,354,337	1,264,946	14.2%	16.6%	19.2%	17.2%	17.2%	-	17,000	(190,000)	(433,000)	68,000	163,000
East Ft Bend Co. / Sugar Land	149	8,878,671	1,456,102	13.9%	18.9%	16.6%	16.4%	17.4%	40,000	179,000	(432,000)	227,000	(9,000)	18,000
Southwest Fwy / Sugar Land	**306**	**20,976,715**	**3,399,398**	**15.5%**	**18.1%**	**17.4%**	**16.2%**	**16.6%**	**40,000**	**136,000**	**(557,000)**	**(54,000)**	**163,000**	**261,000**
Bellaire	42	4,748,537	303,906	6.9%	7.0%	10.3%	6.4%	6.4%	-	(90,000)	(4,000)	(156,000)	43,000	185,000
Post Oak Park	34	4,771,860	725,323	12.2%	11.2%	9.9%	15.2%	15.5%	-	(97,000)	47,000	62,000	67,000	(253,000)
Galleria	55	15,258,806	1,388,551	13.9%	8.8%	9.0%	9.1%	9.2%	608,548	(767,000)	321,000	(31,000)	(122,000)	(15,000)
Riverway	22	3,086,415	373,456	7.7%	9.5%	10.4%	12.1%	12.3%	-	(72,000)	12,000	(28,000)	(46,000)	(52,000)
Richmond / Fountainview	44	1,783,906	351,429	11.0%	6.7%	9.9%	19.7%	19.7%	-	(23,000)	76,000	(58,000)	(9,000)	7,000
San Felipe / Voss	43	5,489,762	664,261	9.9%	11.2%	10.6%	12.1%	12.3%	-	(127,000)	(71,000)	33,000	(110,000)	(83,000)
West Loop	**240**	**35,139,286**	**3,806,927**	**11.1%**	**9.2%**	**9.7%**	**10.8%**	**11.0%**	**608,548**	**(1,176,000)**	**381,000**	**(178,000)**	**(177,000)**	**(211,000)**
Westchase	**108**	**15,513,952**	**1,303,172**	**12.3%**	**12.7%**	**11.4%**	**8.4%**	**8.5%**	**344,664**	**(258,000)**	**(62,000)**	**203,000**	**47,000**	**466,000**
The Woodlands	136	9,658,704	540,887	9.5%	9.9%	6.7%	5.6%	5.9%	1,112,693	303,000	258,000	420,000	61,000	275,000
Conroe	45	1,815,916	92,612	6.6%	7.1%	7.1%	5.1%	5.1%	22,605	102,000	(2,000)	(27,000)	231,000	248,000
Woodlands / Conroe	**181**	**11,474,620**	**633,499**	**9.2%**	**9.5%**	**6.8%**	**5.5%**	**5.8%**	**1,135,298**	**405,000**	**256,000**	**393,000**	**292,000**	**523,000**
TOTAL - Houston	**2,442**	**251,147,239**	**26,683,636**	**12.6%**	**12.3%**	**11.5%**	**10.6%**	**10.9%**	**3,618,503**	**(586,000)**	**715,000**	**3,756,000**	**860,000**	**2,865,000**
Vacancy Rate with Sublet Space				**13.5%**	**12.9%**	**12.0%**	**10.9%**							

1/ Includes buildings 15,000 SF RBA and greater. Does not include buildings under construction or buildings owned by the government.

2/ Does not include sublet space.

Source: Inventory and Vacancy from analysis of CoStar data, Net Absorption computed by Delta Associates; October 2012.

Delta Associates, the research affiliate of Transwestern, is headquartered at:

500 Montgomery Street, Suite 600, Alexandria, VA 22314; Phone: 703-836-5700; DeltaAssociates.com

SUMMARY OF OFFICE MARKET INDICATORS - CLASS A SPACE 1/

Houston Metro Area | 2009 Through Q3 2012

Submarket	Total Bldgs.	Q3 2012 Total Rentable SF All Bldgs. 1/	Q3 2012 SF Avail. Immediately All Bldgs. 2/	Q3 2012 Vacancy Rate 2/	Q3 2012 Vacancy Rate w/ Sublet	Q3 2012 SF Under Constr. or Renovation	Net Absorption (SF) 2/ 2009	Net Absorption (SF) 2/ 2010	Net Absorption (SF) 2/ 2011	Net Absorption (SF) 2/ Q3 2012	Net Absorption (SF) 2/ YTD 2012
Central Business District	31	30,200,614	1,932,839	6.4%	7.2%	-	107,000	(198,000)	1,406,000	151,000	182,000
Midtown	4	1,829,725	124,421	6.8%	6.8%	-	(313,000)	2,000	9,000	(5,000)	67,000
Downtown	**35**	**32,030,339**	**2,057,261**	**6.4%**	**7.2%**	**-**	**(206,000)**	**(196,000)**	**1,415,000**	**146,000**	**249,000**
I-45 North	2	347,015	29,149	8.4%	8.4%	-	(1,000)	(15,000)	21,000	0	(1,000)
FM 1960 / Champions	1	150,000	-	0.0%	0.0%	-	-	-	-	-	-
FM 1960 / Highway 249	17	2,725,914	656,945	24.1%	24.2%	-	(299,000)	102,000	22,000	(3,000)	672,000
FM 1960	**20**	**3,222,929**	**686,095**	21.3%	**21.4%**	**-**	**(300,000)**	**87,000**	**43,000**	**(3,000)**	**671,000**
North Belt West/Greenspoint	15	3,709,849	204,042	5.5%	6.6%	-	13,000	(18,000)	(70,000)	11,000	(19,000)
Greenspoint / IAH	5	837,397	94,626	11.3%	11.3%	150,000	(28,000)	67,000	(22,000)	23,000	8,000
Greenspoint / N Belt	**20**	**4,547,246**	**298,668**	**6.6%**	**7.5%**	**150,000**	**(15,000)**	**49,000**	**(92,000)**	**34,000**	**(11,000)**
Greenway Plaza	**15**	**6,168,363**	**499,637**	**8.1%**	**8.3%**	**-**	**(85,000)**	**44,000**	**104,000**	**(93,000)**	**204,000**
Gulf Freeway/Pasadena	**1**	**52,362**	**8,273**	**15.8%**	**15.8%**	**-**	**50,000**	**8,000**	**2,000**	**-**	**5,000**
Katy Freeway East	14	3,576,229	146,625	4.1%	5.5%	571,776	812,000	357,000	32,000	18,000	122,000
Katy Freeway West	48	11,524,605	322,689	2.8%	2.8%	564,161	(9,000)	77,000	1,095,000	23,000	426,000
Katy Fwy / Energy Corridor	**62**	**15,100,834**	**469,314**	**3.1%**	**3.4%**	**1,135,937**	**803,000**	**434,000**	**1,127,000**	**41,000**	**548,000**
Kingwood / Humble	**1**	**90,000**	**40,950**	**45.5%**	**45.5%**	**45,000**	**-**	**-**	**(70,000)**	**-**	**-**
NASA / Clear Lake	**13**	**1,914,706**	**233,594**	**12.2%**	**12.2%**	**-**	**(3,000)**	**(43,000)**	**(27,000)**	**(4,000)**	**31,000**
Northeast	**-**	**-**	**-**	0.0%	**0.0%**	**-**	**-**	**-**	**-**	**-**	**-**
North Loop West	5	1,054,498	262,570	24.9%	25.7%	-	(137,000)	1,000	21,000	(6,000)	(2,000)
Northwest Near	1	237,384	-	0.0%	0.0%	-	-	-	-	-	-
Northwest Far	15	2,520,121	284,774	11.3%	12.0%	159,056	597,000	37,000	268,000	58,000	38,000
Northwest	**21**	**3,812,003**	**547,344**	**14.4%**	**15.0%**	**159,056**	**460,000**	**38,000**	**289,000**	**52,000**	**36,000**
South Main / Medical Center	**14**	**4,474,422**	**335,582**	**7.5%**	**7.6%**	**-**	**134,000**	**39,000**	**96,000**	**13,000**	**35,000**
Southwest / Hillcroft	6	1,485,352	249,539	16.8%	16.8%	-	(54,000)	(78,000)	67,000	25,000	42,000
Southwest Beltway 8	3	573,152	96,290	16.8%	17.4%	-	(109,000)	42,000	19,000	(21,000)	(8,000)
East Ft Bend Co. / Sugar Land	22	3,705,430	867,071	23.4%	23.6%	-	(46,000)	(372,000)	52,000	19,000	115,000
Southwest Fwy / Sugar Land	**31**	**5,763,934**	**1,212,899**	**21.0%**	**21.2%**	**-**	**(209,000)**	**(408,000)**	**138,000**	**23,000**	**149,000**
Bellaire	7	1,186,294	87,786	7.4%	7.4%	-	(2,000)	(3,000)	(14,000)	21,000	(2,000)
Post Oak Park	6	1,875,413	129,403	6.9%	7.1%	-	111,000	(10,000)	(53,000)	30,000	(26,000)
Galleria	25	10,980,745	889,440	8.1%	8.3%	608,548	(463,000)	229,000	(19,000)	(66,000)	(11,000)
Riverway	8	2,038,628	254,829	12.5%	12.8%	-	(54,000)	27,000	10,000	(43,000)	(92,000)
Richmond / Fountainview	-	-	-	-	-	-	-	-	-	-	-
San Felipe / Voss	3	1,714,029	327,380	19.1%	19.1%	-	(77,000)	(46,000)	7,000	(57,000)	(78,000)
West Loop	**49**	**17,795,109**	**1,688,838**	**9.5%**	**9.7%**	**608,548**	**(485,000)**	**197,000**	**(69,000)**	**(115,000)**	**(209,000)**
Westchase	**21**	**6,636,105**	**384,894**	**5.8%**	**6.0%**	**344,664**	**(253,000)**	**(111,000)**	**363,000**	**13,000**	**384,000**
The Woodlands	20	3,814,882	137,336	3.6%	3.9%	1,082,693	128,000	248,000	303,000	17,000	125,000
Conroe	2	128,832	3,736	2.9%	2.9%	-	-	-	(4,000)	-	-
Woodlands / Conroe	**22**	**3,943,714**	**141,072**	**3.6%**	**3.9%**	**1,082,693**	**128,000**	**248,000**	**299,000**	**17,000**	**125,000**
TOTAL - Houston	**325**	**105,552,066**	**8,604,420**	**8.2%**	**8.6%**	**3,525,898**	**19,000**	**388,000**	**3,618,000**	**124,000**	**2,217,000**

1/ Class A buildings per CoStar that are greater than 50,000 SF. Does not include buildings under construction or owned by the government.
2/ Does not include sublet space.
3/ Inventory adjusted per changes in CoStar database.
Source: Inventory and Vacancy from analysis of CoStar data, Net Absorption computed by Delta Associates; October 2012.
Delta Associates, the research affiliate of Transwestern, is headquartered at:
500 Montgomery Street, Suite 600, Alexandria, VA 22314; Phone: 703-836-5700; DeltaAssociates.com

SUMMARY OF OFFICE MARKET INDICATORS - CLASS B SPACE 1/

Houston Metro Area | 2009 Through Q3 2012

	Q3 2012						Net Absorption (SF) 2/				
Submarket	Total Bldgs.	Total Rentable SF All Bldgs. 1/	SF Avail. Immediately All Bldgs. 2/	Vacancy Rate 2/	Vacancy Rate w/ Sublet	SF Under Constr. or Renovation	2009	2010	2011	Q3 2012	YTD 2012
Central Business District	41	13,812,760	1,353,650	9.8%	9.9%	-	(171,000)	(9,000)	194,000	166,000	180,000
Midtown	50	3,908,556	367,404	9.4%	9.6%	-	(13,000)	(23,000)	28,000	(66,000)	(74,000)
Downtown	**91**	**17,721,316**	**1,721,055**	**9.7%**	**9.8%**	**-**	**(184,000)**	**(32,000)**	**222,000**	**100,000**	**106,000**
I-45 North	30	1,606,441	252,211	15.7%	15.7%	-	(17,000)	(36,000)	20,000	(3,000)	14,000
FM 1960 / Champions	47	2,424,240	683,636	28.2%	28.5%	-	29,000	56,000	(51,000)	(70,000)	(77,000)
FM 1960 / Highway 249	91	3,747,871	509,710	13.6%	14.4%	-	66,000	24,000	141,000	15,000	(18,000)
FM 1960	**168**	**7,778,552**	**1,445,557**	18.6%	**19.1%**	**-**	**78,000**	**44,000**	**110,000**	**(58,000)**	**(81,000)**
North Belt West/Greenspoint	49	5,476,371	914,554	16.7%	17.7%	-	(379,000)	1,000	112,000	82,000	66,000
Greenspoint / IAH	19	1,777,081	259,454	14.6%	14.8%	-	39,000	(111,000)	(52,000)	41,000	(3,000)
Greenspoint / N Belt	**68**	**7,253,452**	**1,174,008**	**16.2%**	**17.0%**	**-**	**(340,000)**	**(110,000)**	**60,000**	**123,000**	**63,000**
Greenway Plaza	**40**	**3,988,808**	**291,183**	**7.3%**	**7.4%**	**-**	**41,000**	**(21,000)**	**17,000**	**24,000**	**(113,000)**
Gulf Freeway/Pasadena	**58**	**2,883,887**	**328,763**	**11.4%**	**11.6%**	**-**	**213,000**	**24,000**	**(20,000)**	**115,000**	**100,000**
Katy Freeway East	41	3,094,523	256,845	8.3%	9.2%	-	(46,000)	(20,000)	25,000	(3,000)	(15,000)
Katy Freeway West	102	9,622,766	1,231,714	12.8%	12.9%	-	(93,000)	61,000	(4,000)	67,000	47,000
Katy Fwy / Energy Corridor	**143**	**12,717,289**	**1,488,559**	**11.7%**	**12.0%**	**-**	**(139,000)**	**41,000**	**21,000**	**64,000**	**32,000**
Kingwood / Humble	**29**	**1,467,056**	**98,293**	**6.7%**	**6.8%**	**-**	**(7,000)**	**16,000**	**56,000**	**(6,000)**	**(8,000)**
NASA / Clear Lake	**105**	**6,811,810**	**940,030**	**13.8%**	**13.9%**	**-**	**77,000**	**123,000**	**27,000**	**7,000**	**(239,000)**
Northeast	**27**	**1,276,209**	**236,099**	18.5%	**18.5%**	**-**	**46,000**	**19,000**	**(45,000)**	**5,000**	**2,000**
North Loop West	38	3,556,405	753,958	21.2%	21.5%	-	150,000	(197,000)	(5,000)	(21,000)	249,000
Northwest Near	11	852,394	109,959	12.9%	12.9%	-	(2,000)	62,000	(1,000)	3,000	3,000
Northwest Far	53	4,411,940	617,672	14.0%	14.2%	-	249,000	29,000	(13,000)	(35,000)	(30,000)
Northwest	**102**	**8,820,739**	**1,481,588**	**16.8%**	**17.0%**	**-**	**397,000**	**(106,000)**	**(19,000)**	**(53,000)**	**222,000**
South Main / Medical Center	**39**	**4,239,998**	**322,240**	**7.6%**	**7.6%**	**-**	**46,000**	**(117,000)**	**69,000**	**(17,000)**	**(47,000)**
Southwest / Hillcroft	22	1,956,544	360,004	18.4%	18.4%	-	(59,000)	49,000	9,000	90,000	41,000
Southwest Beltway 8	60	5,268,629	1,011,577	19.2%	19.3%	-	51,000	(230,000)	(367,000)	105,000	158,000
East Ft Bend Co. / Sugar Land	110	4,779,838	573,581	12.0%	13.9%	40,000	176,000	141,000	174,000	(10,000)	(91,000)
Southwest Fwy / Sugar Land	**192**	**12,005,011**	**1,945,161**	**16.2%**	**17.0%**	**40,000**	**168,000**	**(40,000)**	**(184,000)**	**185,000**	**108,000**
Bellaire	22	2,884,038	175,926	6.1%	6.1%	-	17,000	9,000	(164,000)	23,000	112,000
Post Oak Park	24	2,653,133	586,342	22.1%	22.4%	-	(123,000)	(6,000)	31,000	45,000	(225,000)
Galleria	25	4,083,486	490,018	12.0%	12.0%	-	(344,000)	113,000	(8,000)	(49,000)	17,000
Riverway	14	1,039,510	137,215	13.2%	13.2%	-	(2,000)	(20,000)	(38,000)	(6,000)	32,000
Richmond / Fountainview	17	870,347	263,715	30.3%	30.3%	-	20,000	1,000	(24,000)	(10,000)	(2,000)
San Felipe / Voss	36	3,569,141	281,962	7.9%	8.1%	-	(48,000)	(28,000)	36,000	(43,000)	4,000
West Loop	**138**	**15,099,655**	**1,935,180**	**12.8%**	**12.9%**	**-**	**(526,000)**	**69,000**	**(167,000)**	**(40,000)**	**(62,000)**
Westchase	**67**	**7,861,837**	**849,078**	**10.8%**	**10.9%**	**-**	**21,000**	**44,000**	**(166,000)**	**16,000**	**78,000**
The Woodlands	98	5,322,791	404,532	7.6%	7.9%	30,000	175,000	29,000	82,000	21,000	132,000
Conroe	21	987,517	52,338	5.3%	5.3%	22,605	106,000	(4,000)	(22,000)	232,000	247,000
Woodlands / Conroe	**119**	**6,310,308**	**456,871**	**7.2%**	**7.5%**	**52,605**	**281,000**	**25,000**	**60,000**	**253,000**	**379,000**
TOTAL - Houston	**1,386**	**116,235,927**	**14,713,665**	**12.7%**	**12.9%**	**92,605**	**172,000**	**(21,000)**	**41,000**	**718,000**	**540,000**

1/ Class B per CoStar, and buildings under 50,000 SF even if CoStar classified them as Class A. Does not include buildings under construction or owned by the government.
2/ Does not include sublet space.
3/ Inventory adjusted per changes in CoStar database. Source: Inventory and Vacancy from analysis of CoStar data, Net Absorption computed by Delta Associates; October 2012.Delta Associates, the research affiliate of Transwestern, is headquartered at:
500 Montgomery Street, Suite 600, Alexandria, VA 22314; Phone: 703-836-5700; DeltaAssociates.com

ASKING RENTAL RATE ANALYSIS OF CLASS A & B OFFICE BUILDINGS

Houston Metro Area | 2009 Through Q3 2012

	Average Asking Rent ($'s/SF, GFS) At End Of:									
	2009		2010		2011		Q3 2012		%Change 12/11-9/12	
Submarket	**Class A**	**Class B**	**Class A**	**Class B**	**Class A**	**Class B**	**Class A**	**Class B**	**Class A**	**Class B**
Central Business District	$29.20	$23.94	$29.95	$24.97	$30.59	$25.13	$32.04	$24.87	-100.0%	-1.0%
Midtown	$26.37	$22.29	$23.54	$22.36	$25.85	$21.85	$26.78	$23.06	3.6%	5.5%
Downtown	**$28.89**	**$22.89**	**$29.23**	**$23.73**	**$30.04**	**$23.77**	**$31.45**	**$23.86**	**4.7%**	**0.4%**
I-45 North	$20.93	$16.20	$20.22	$15.18	$16.97	$16.20	$16.05	$16.97	-5.4%	4.8%
FM 1960 / Champions	-	$14.68	-	$13.40	-	$12.85	-	$13.57	-	5.6%
FM 1960 / Highway 249	$27.21	$19.94	$27.38	$20.21	$25.57	$19.67	$24.57	$19.57	-3.9%	-0.5%
FM 1960	**$26.92**	**$17.45**	**$26.96**	**$16.65**	**$25.11**	**$16.42**	**$24.11**	**$16.96**	**-4.0%**	**3.3%**
North Belt West/Greenspoint	$20.96	$16.54	$20.07	$15.80	$20.51	$16.17	$22.13	$16.64	7.9%	2.9%
Greenspoint / IAH	$21.17	$16.26	$23.23	$15.24	$22.86	$16.91	$22.89	$15.87	0.1%	-6.1%
Greenspoint / N Belt	**$20.58**	**$16.51**	**$20.49**	**$15.72**	**$20.68**	**$16.36**	**$21.81**	**$16.51**	**5.5%**	**0.9%**
Greenway Plaza	**$25.49**	**$20.95**	**$23.61**	**$21.50**	**$24.49**	**$20.52**	**$25.13**	**$20.68**	**2.6%**	**0.8%**
Gulf Freeway/Pasadena	**-**	**$18.43**	**$24.25**	**$19.95**	**$24.25**	**$20.72**	**$25.69**	**$20.57**	**6.0%**	**-0.8%**
Katy Freeway East	$23.05	$18.71	$25.35	$17.87	$25.98	$17.99	$20.19	$18.99	-22.3%	5.5%
Katy Freeway West	$24.23	$18.47	$24.46	$18.76	$25.32	$19.18	$23.53	$19.83	-7.0%	3.4%
Katy Fwy / Energy Corridor	**$24.79**	**$18.36**	**$25.31**	**$18.36**	**$26.14**	**$18.72**	**$23.05**	**$19.43**	**-11.8%**	**3.8%**
Kingwood / Humble	**$27.50**	**$16.17**	**$29.50**	**$16.49**	**$30.10**	**$16.44**	**$30.10**	**$16.43**	**0.0%**	**-0.1%**
NASA / Clear Lake	**$20.83**	**$21.44**	**$21.29**	**$20.46**	**$23.93**	**$20.82**	**$23.48**	**$20.16**	**-1.9%**	**-3.2%**
Northeast	**-**	**$13.75**	**-**	**$13.67**	**-**	**$13.55**	**-**	**$14.28**	**-**	**5.3%**
North Loop West	$20.51	$15.65	$20.96	$15.62	$19.98	$15.94	$21.22	$15.65	6.2%	-1.8%
Northwest Near	-	$14.89	-	$14.84	-	$14.39	-	$14.85	-	3.2%
Northwest Far	$25.19	$14.41	$26.79	$14.29	$25.04	$14.17	$22.53	$13.96	-10.0%	-1.5%
Northwest	**$24.11**	**$15.13**	**$25.41**	**$15.07**	**$23.96**	**$15.17**	**$23.42**	**$14.98**	**-2.2%**	**-1.3%**
South Main / Medical Center	**$29.16**	**$22.13**	**$27.65**	**$21.88**	**$28.09**	**$25.85**	**$28.20**	**$24.92**	**0.4%**	**-3.6%**
Southwest / Hillcroft	$14.80	$13.91	$14.58	$13.76	$14.98	$13.76	$15.23	$13.83	1.7%	0.5%
Southwest Beltway 8	$19.26	$17.06	$16.87	$16.45	$19.33	$17.29	$19.33	$15.87	0.0%	-8.2%
East Ft Bend Co. / Sugar Land	$29.16	$19.77	$29.21	$18.47	$27.04	$18.18	$27.38	$18.50	1.2%	1.8%
Southwest Fwy / Sugar Land	**$22.73**	**$16.58**	**$22.48**	**$15.93**	**$21.58**	**$16.33**	**$21.84**	**$15.73**	**1.2%**	**-3.7%**
Bellaire	$24.28	$16.33	$23.13	$14.77	$24.21	$14.78	$24.87	$14.65	2.8%	-0.9%
Post Oak Park	$29.67	$15.84	$30.91	$15.77	$31.47	$16.83	$32.53	$18.98	3.4%	12.7%
Galleria	$26.90	$22.41	$28.01	$20.32	$28.01	$20.40	$29.03	$20.87	3.6%	2.3%
Riverway	$25.01	$20.90	$25.47	$20.19	$27.42	$19.90	$29.66	$21.81	8.2%	9.6%
Richmond / Fountainview	-	$15.39	-	$16.69	-	$16.95	-	$17.37	-	2.5%
San Felipe / Voss	$30.19	$19.36	$29.94	$19.45	$32.37	$19.57	$33.77	$20.21	4.3%	3.2%
West Loop	**$27.14**	**$19.35**	**$27.81**	**$18.78**	**$28.53**	**$19.08**	**$29.79**	**$20.19**	**4.4%**	**5.9%**
Westchase	**$23.88**	**$19.26**	**$26.72**	**$18.89**	**$23.95**	**$17.50**	**$26.88**	**$18.12**	**12.2%**	**3.6%**
The Woodlands	$22.49	$20.34	$22.76	$20.11	$22.06	$21.16	$23.10	$22.42	4.7%	5.9%
Conroe	-	$14.57	-	$14.91	$30.67	$18.54	$29.54	$24.69	-3.7%	33.1%
Woodlands / Conroe	**$22.49**	**$19.46**	**$22.76**	**$19.34**	**$22.24**	**$21.11**	**$23.24**	**$23.02**	**4.5%**	**9.0%**
TOTAL - Houston	**$25.49**	**$18.35**	**$25.86**	**$18.30**	**$26.08**	**$18.48**	**$26.82**	**$18.78**	**2.8%**	**1.7%**

Note: Rents for properties using triple net terms have been grossed up to full service by applying operating expense data. Rents reflect full service equivalent.
Note: Due to small submarket sample sizes in some cases, particularly in Class A, rent increases and decreases may be magnified relative to other submarkets.
Source: Delta Associates analysis of CoStar data; September 2012.
Delta Associates, the research affiliate of Transwestern, is headquartered at:
500 Montgomery Street, Suite 600, Alexandria, VA 22314; Phone: 703-836-5700; DeltaAssociates.com

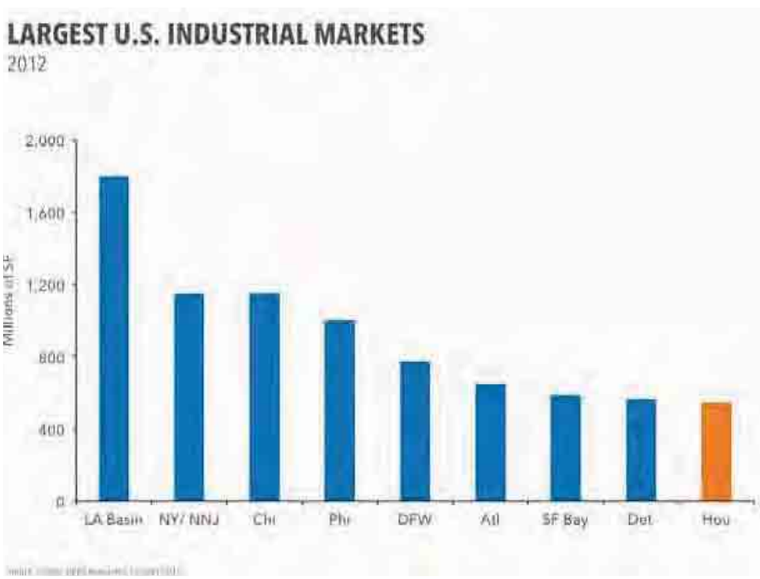
SECTION FIVE

THE HOUSTON METRO INDUSTRIAL MARKET

TRENDLINES®
HOUSTON 2012

MARKET FUNDAMENTALS REMAIN STURDY, SHOULD GAIN FURTHER MOMENTUM

The fundamentals of the Houston industrial market have continued to improve in 2012, with vacancy remaining among the lowest in the nation and continuing to decline. While absorption has decelerated some compared to the levels seen in 2011, performance is still strong relative to peer cities and is poised for further improvement with the expansion of the Panama Canal now underway and set to be completed in 2015. By 2013, the Port of Houston will be equipped to handle a larger volume of shipments coming from the Pacific, which should help to bolster the broader industrial market.



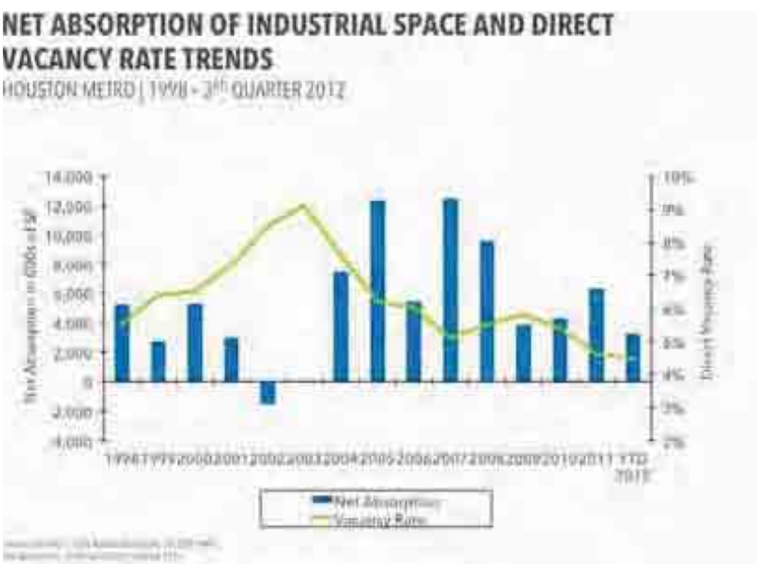
WHY THIS METHODOLOGY IS THE BEST INDICATOR OF CURRENT MARKET CONDITIONS

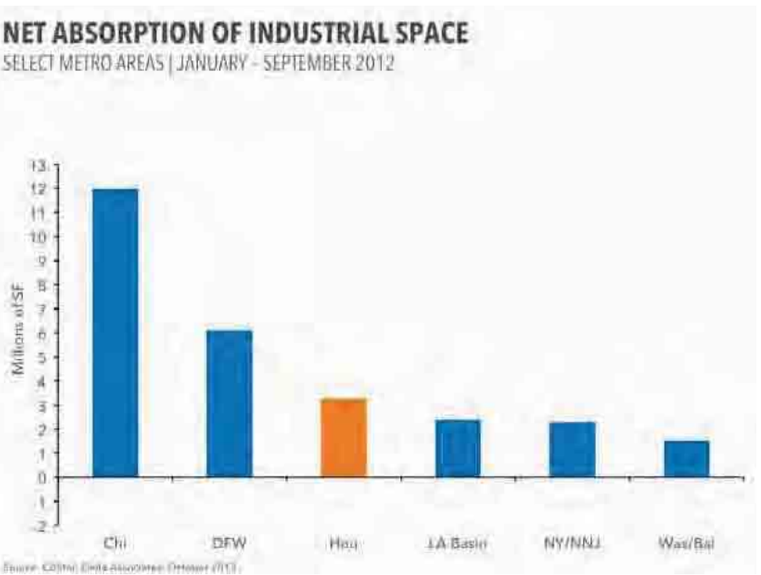
We include owner-occupied and single-tenant buildings in our inventory, vacancy, and absorption statistics. Doing so allows us to capture more market activity than many of our competitors, and to better correlate changes in the market with changes in employment. As single-tenant space does compete with multi-tenant space, we believe it is critical to understand all components of the market. We also include flex space in our industrial market analysis, and offer wider geographic coverage than some of our competitors. The result of these differences is that the inclusion of single-tenant and owner-occupied space, as well as flex space, tends to yield lower vacancy rates and higher absorption totals than our competitors' results, but our coverage of the market is more comprehensive.

ABSORPTION STEADY IN 2012

Net absorption of industrial space in the Houston metro totaled 3.3 million SF through the first three quarters of 2012, compared to a total of 6.3 million SF in 2011. Businesses are continuing to expand as the local economy strengthens and consumer spending gradually increases.

In terms of net absorption in 2012, Houston has been a steady performer among major markets, ranking behind the Chicago and Dallas/Ft. Worth markets but ahead of the LA Basin, NY/Northern NJ, and Washington/Baltimore markets. Houston's absorption may be artificially low relative to its economic performance because there is so little available industrial space to be leased.





The Houston industrial market is on pace to absorb about 4.3 million SF of space in 2012. The Warehouse/Distribution sector makes up the largest portion of the market, having accounted for 84% of the space absorbed thus far in 2012.

	2011 (SF)	YTD (SF)
• Warehouse/Dist.:	5,329,000	2,741,000
• Manufacturing:	627,000	435,000
• Flex/R&D:	349,000	80,000

Notable leases during 2012 include:

- Excel renewed 271,681 SF at 8609 Citypark Loop and 8501 N Citypark Loop in the NE Highway 90 submarket.
- Francesca's Collections leased 217,869 SF at 8760 Clay Road in the Northwest Near submarket.
- National Oilwell Varco leased 128,000 SF at 14200 Hollister Road in the North Far submarket.
- The Service Center Ltd. renewed 117,156 SF at 6450 Clara Road in the Northwest Near submarket.
- Floor & Décor Outlets of America leased 109,200 SF at 9501 Bay Area Boulevard in the East-Southeast Far submarket.
- International Distribution Corporation leased 100,000 SF at 4331 Underwood Drive in the East-Southeast Far submarket.

HOW THE MULTI-TENANT MARKET COMPARES TO OUR MARKET COVERAGE

Vacancy and absorption in the Houston metro area often are reported by brokerage firms on multi-tenant buildings only. We include owner-occupied and single-tenant buildings as well, on the basis of immediate availability, to capture more market activity. We exclude government-owned space. As a point of comparison, below is data for the Houston multi-tenant industrial market at Q3 2012:

	Multi-Tenant	Entire Market
Inventory:	187.8 MSF	547.8 MSF
Overall vac. (incl. sublet):	8.3%	4.6%
YTD net absorption:	197,000 SF	3,256,000 SF

INDUSTRIAL VACANCY TICKS UP; STILL AMONG LOWEST IN U.S.

The overall Houston metro area industrial vacancy rate declined to 4.6% in September 2012 from 5.3% a year earlier. The direct industrial vacancy rate, 4.5% in September, is down from 5.2% a year earlier.

Current vacancy rates by product type:

	Direct	Overall
• Warehouse/Dist.:	4.4%	4.5%
• Manufacturing:	1.7%	1.9%
• Flex/R&D:	9.8%	10.0%

Houston's industrial vacancy rate will likely decline to nearly 4.0% one year from now, as steady demand continues to outpace the pipeline of new supply. Vacancy will continue to decline until the development of new product escalates.

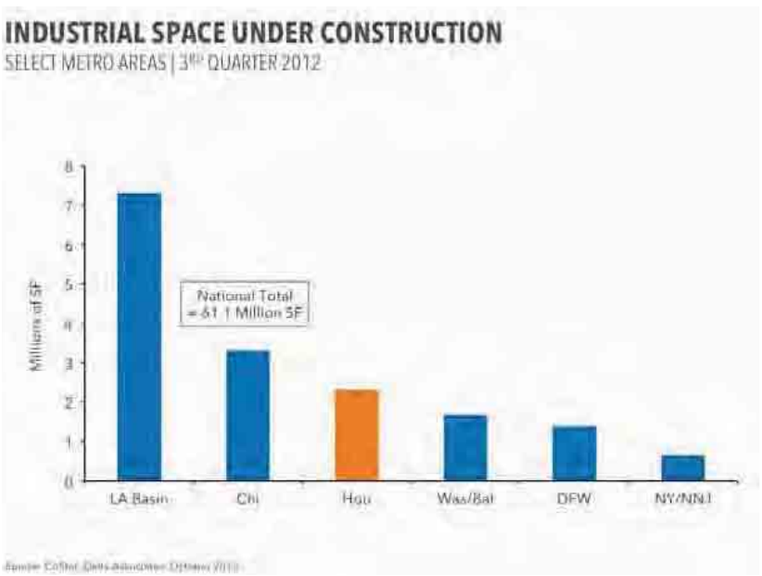
PIPELINE REMAINS STEADY

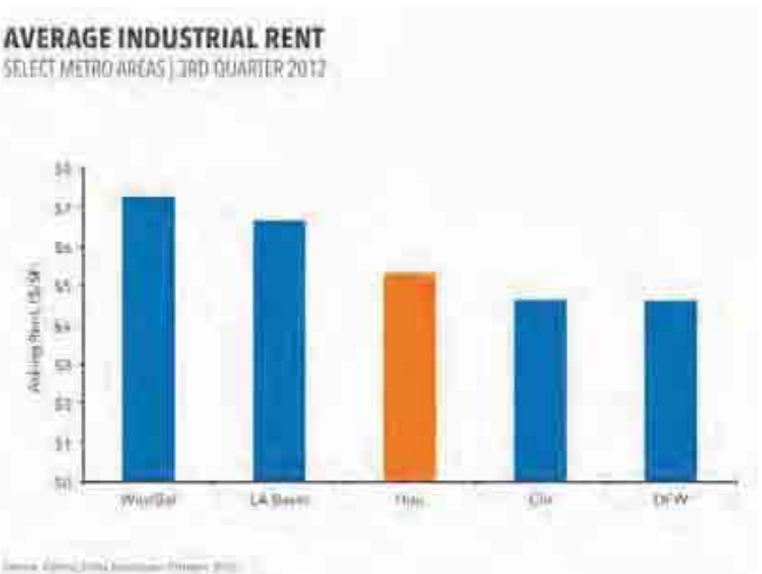
There is currently 2.3 million SF of industrial space under construction in metro Houston, similar to the 2.3 million SF under construction a year ago. Warehouse/Distribution product comprises 94% of space under construction. Space under construction today is 43% preleased, compared to 86% one year ago. Many of the spec projects built over the past two years have been free-standing user buildings for sale or lease to support the growing energy sector. With the pipeline still at only 0.7% of standing inventory, more developers are breaking ground on new projects, especially warehouse/distribution buildings. Build-to-suit projects also are moving forward.

INDUSTRIAL ASKING RENTS: RISING

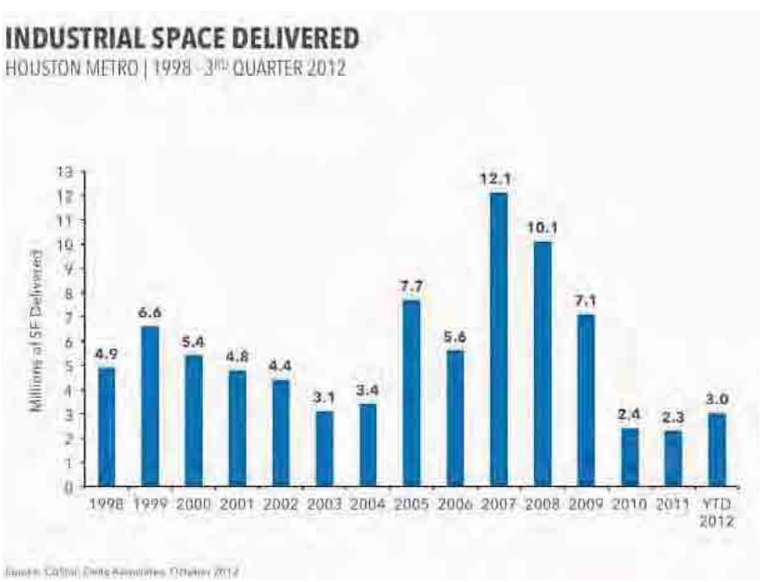
Industrial asking rents are up modestly in 2012. The September 2012 average asking rent for all types of industrial space was $5.32/SF, triple net.

Meanwhile, concessions are retreating and effective rents are under less pressure. Steady demand should support continued rent increases through the rest of 2012 and into 2013, given the already-low vacancy rate in the Houston industrial market. While some concern remains due to macroeconomic factors that could impact the distribution needs of retailers, the Houston industrial market is among the best positioned in the country for future rent growth.





Deliveries in Houston have totaled 3.0 million SF thus far in 2012, compared to 1.6 million SF at the same point last year. Even with these deliveries, the market has been underserved from a development standpoint in 2012.



METRO HOUSTON INDUSTRIAL MARKET OUTLOOK

The Houston metro industrial market will likely experience continued growth in the near term. However, global economic uncertainty remains high and could potentially check domestic economic growth. If growth accelerates, vacancy will continue to decline into 2013, as demand outpaces new supply. If construction remains minimal, industrial rents will rise, with concessions burning off quickly, as market conditions turn further in the landlord's favor. Groundbreakings are increasing, however, in response to the market's very low vacancy rate and the positive outlook of the trade/transportation sector.

Industrial submarkets likely to outperform in the period ahead, with declining vacancy and rising rents, include:

- East-Southeast Far
- North Far
- Northwest Near

SUMMARY OF INDUSTRIAL MARKET INDICATORS - ALL SPACE

Houston Metro Area | 2009 Through Q3 2012

	Q3 2012						Q3 2012						
	Total Rentable SF	SF Available Immediately	Direct Vacancy Rate at the end of:				Vacancy Rate	SF Under Constr. or	Net Absorption (SF) [2/]				
Submarket	All Bldgs. [1/]	All Bldgs [2/]	2009	2010	2011	Q3 2012	w/ Sublet	Renovation	2009	2010	2011	Q3 2012	YTD 2012
Central Business District													
Flex/R & D	886,219	70,898	13.9%	7.8%	8.4%	8.0%	8.0%	-	13,000	45,000	(5,000)	-	4,000
Manufacturing [3/]	5,883,053	111,778	1.9%	5.6%	4.3%	1.9%	1.9%	-	(8,000)	(184,000)	64,000	118,000	137,000
Warehouse/Distribution	29,871,212	1,881,886	4.5%	5.2%	4.8%	6.3%	6.3%	38,232	(134,000)	(209,000)	120,000	(119,000)	(447,000)
Total - Central Business District	36,640,484	2,064,562	4.4%	5.3%	4.8%	5.6%	5.6%	38,232	(129,000)	(348,000)	179,000	(1,000)	(306,000)
East-Southeast Far													
Flex/R & D	2,937,496	373,062	17.8%	12.0%	9.5%	12.7%	12.9%	-	(4,000)	80,000	54,000	(34,000)	(87,000)
Manufacturing	5,246,955	10,494	4.0%	2.7%	0.5%	0.2%	0.2%	32,000	(50,000)	61,000	202,000	0	16,000
Warehouse/Distribution	45,527,537	3,960,896	11.6%	11.4%	8.2%	8.7%	8.8%	75,115	2,053,000	(120,000)	965,000	830,000	472,000
Total - East-Southeast Far	53,711,988	4,344,452	11.3%	10.6%	7.5%	8.1%	8.2%	107,115	1,999,000	21,000	1,221,000	796,000	401,000
North Far													
Flex/R & D	7,639,993	710,519	10.0%	10.9%	9.3%	9.3%	9.3%	-	221,000	(197,000)	214,000	40,000	59,000
Manufacturing	5,729,238	45,834	1.0%	2.4%	2.7%	0.8%	0.8%	33,000	(27,000)	(86,000)	(17,000)	57,000	109,000
Warehouse/Distribution	47,223,058	2,125,038	9.2%	6.0%	4.3%	4.5%	4.5%	524,459	613,000	1,163,000	1,021,000	293,000	658,000
Total - North Far	60,592,289	2,881,391	8.6%	6.3%	4.8%	4.8%	4.8%	557,459	807,000	880,000	1,218,000	390,000	826,000
North Near													
Flex/R & D	1,187,582	187,638	12.2%	15.2%	22.9%	15.8%	15.8%	-	24,000	(32,000)	(92,000)	23,000	85,000
Manufacturing	2,626,374	18,385	2.4%	3.1%	0.9%	0.7%	0.7%	-	188,000	(19,000)	58,000	0	5,000
Warehouse/Distribution	15,452,192	633,540	3.8%	4.1%	4.8%	4.1%	4.1%	70,840	211,000	21,000	298,000	13,000	296,000
Total - North Near	19,266,148	839,562	4.0%	4.7%	5.4%	4.4%	4.4%	70,840	423,000	(30,000)	264,000	36,000	386,000
Northeast Far													
Flex/R & D	96,952	-	2.7%	2.7%	2.7%	0.0%	0.0%	34,261	-	-	-	-	3,000
Manufacturing	196,600	-	0.0%	0.0%	0.0%	0.0%	0.0%	-	-	-	-	-	-
Warehouse/Distribution [3/]	1,465,187	23,443	0.7%	0.3%	0.7%	1.6%	2.1%	-	(5,000)	4,000	(5,000)	-	(11,000)
Total - Northeast Far	1,758,739	23,443	1.0%	0.4%	0.7%	1.3%	1.7%	34,261	(5,000)	4,000	(5,000)	-	(8,000)
Northeast Near													
Flex/R & D [3/]	912,144	61,114	0.5%	11.8%	8.3%	6.7%	6.7%	-	29,000	(78,000)	2,000	(5,000)	17,000
Manufacturing	5,937,172	100,932	1.4%	4.9%	0.8%	1.7%	3.8%	-	(43,000)	(141,000)	244,000	6,000	(54,000)
Warehouse/Distribution	26,902,756	807,083	2.0%	3.7%	3.5%	3.0%	3.1%	61,400	603,000	(173,000)	113,000	(135,000)	173,000
Total - Northeast Near	33,752,072	969,128	1.9%	4.1%	3.1%	2.9%	3.3%	61,400	589,000	(392,000)	359,000	(134,000)	136,000
Northwest Far													
Flex/R & D	5,435,616	304,394	13.8%	5.6%	5.4%	5.6%	6.4%	-	3,000	566,000	38,000	(43,000)	59,000
Manufacturing [3/]	7,238,552	217,157	7.4%	4.2%	3.7%	3.0%	3.0%	-	(106,000)	299,000	31,000	0	44,000
Warehouse/Distribution	50,686,154	1,469,898	6.4%	5.1%	3.4%	2.9%	3.1%	303,398	(7,000)	821,000	1,203,000	133,000	608,000
Total - Northwest Far	63,360,322	1,991,450	7.2%	5.0%	3.6%	3.1%	3.4%	303,398	(110,000)	1,686,000	1,272,000	90,000	711,000
Northwest Near													
Flex/R & D	11,504,223	1,035,380	12.8%	10.5%	9.7%	9.0%	9.6%	-	(164,000)	297,000	93,000	(35,000)	80,000
Manufacturing [3/]	10,690,280	96,213	1.4%	1.7%	3.3%	0.9%	0.9%	-	21,000	(27,000)	(144,000)	53,000	224,000
Warehouse/Distribution	80,581,153	2,900,922	5.3%	4.9%	4.3%	3.6%	3.8%	372,241	(700,000)	320,000	530,000	297,000	859,000
Total - Northwest Near	102,775,656	4,032,514	5.7%	5.3%	4.8%	3.9%	4.1%	372,241	(843,000)	590,000	479,000	315,000	1,163,000

See next page for balance of Houston Industrial Summary

SUMMARY OF INDUSTRIAL MARKET INDICATORS - ALL SPACE (continued)

C-Houston Metro Area | 2009 Through Q3 2012

	Q3 2012						Q3 2012						
	Total Rentable SF	SF Available Immediately	Direct Vacancy Rate at the end of:				Vacancy Rate	SF Under Constr. or	Net Absorption (SF) [2/]				
Submarket	All Bldgs. [1/]	All Bldgs [2/]	2009	2010	2011	Q3 2012	w/ Sublet	Renovation	2009	2010	2011	Q3 2012	YTD 2012
South Far													
Flex/R & D	1,709,126	167,494	12.3%	11.0%	10.5%	9.8%	9.8%	6,333	280,000	7,000	8,000	(15,000)	12,000
Manufacturing	6,010,516	282,494	2.1%	2.9%	1.8%	4.7%	4.7%	-	-	(33,000)	61,000	30,000	(174,000)
Warehouse/Distribution	27,571,148	964,990	4.4%	4.3%	2.9%	3.5%	3.6%	27,500	226,000	33,000	521,000	(197,000)	(88,000)
Total - South Far	35,290,790	1,414,979	4.3%	4.4%	3.1%	4.0%	4.1%	33,833	506,000	7,000	590,000	(182,000)	(250,000)
South Near													
Flex/R & D	803,477	176,765	7.8%	10.3%	18.1%	22.0%	22.0%	-	30,000	(25,000)	(12,000)	(23,000)	(31,000)
Manufacturing [3/]	1,696,371	66,158	3.7%	3.8%	3.6%	3.9%	3.9%	-	15,000	(2,000)	3,000	(8,000)	(4,000)
Warehouse/Distribution	12,169,760	389,432	3.8%	1.8%	2.5%	3.2%	3.5%	-	(220,000)	244,000	(86,000)	(12,000)	(85,000)
Total - South Near	14,669,608	632,356	4.1%	2.5%	3.5%	4.3%	4.6%	-	(175,000)	217,000	(95,000)	(43,000)	(120,000)
Southeast Near													
Flex/R & D 3/	461,763	77,576	18.7%	21.3%	20.2%	16.8%	16.8%	-	(18,000)	(16,000)	6,000	1,000	18,000
Manufacturing	7,673,620	-	0.2%	0.2%	0.0%	0.0%	0.0%	-	21,000	-	14,000	-	-
Warehouse/Distribution	29,507,769	531,140	2.0%	2.7%	2.3%	1.8%	1.8%	-	175,000	(59,000)	118,000	(59,000)	148,000
Total - Southeast Near	37,643,152	608,716	1.8%	2.5%	2.1%	1.6%	1.6%	-	178,000	(75,000)	138,000	(58,000)	166,000
Southwest Far													
Flex/R & D	1,815,568	521,068	6.6%	7.9%	24.1%	28.7%	28.7%	-	222,000	(33,000)	(26,000)	(33,000)	(84,000)
Manufacturing [3/]	1,304,851	76,986	6.7%	3.8%	4.4%	5.9%	5.9%	-	133,000	35,000	64,000	(20,000)	(20,000)
Warehouse/Distribution	9,531,923	428,937	5.8%	4.3%	4.8%	4.5%	4.5%	19,264	518,000	117,000	81,000	57,000	71,000
Total - Southwest Far	12,652,342	1,026,991	6.0%	4.8%	7.7%	8.1%	8.1%	19,264	873,000	119,000	119,000	4,000	(33,000)
Southwest Near													
Flex/R & D	8,108,347	600,018	7.6%	7.0%	6.4%	7.4%	7.4%	-	195,000	45,000	5,000	(8,000)	(81,000)
Manufacturing	3,967,609	91,255	4.9%	3.6%	2.7%	2.3%	2.4%	-	-	53,000	35,000	(12,000)	60,000
Warehouse/Distribution	41,257,865	1,567,799	7.1%	5.0%	4.2%	3.8%	3.8%	683,000	(574,000)	675,000	385,000	(24,000)	290,000
Total - Southwest Near	53,333,821	2,259,072	7.0%	5.2%	4.4%	4.2%	4.2%	683,000	(379,000)	773,000	425,000	(44,000)	269,000
Sugar Land													
Flex/R & D [3/]	3,288,898	282,845	13.6%	11.9%	9.6%	8.6%	8.6%	30,000	-	47,000	64,000	(13,000)	26,000
Manufacturing	2,201,413	4,403	0.0%	0.7%	0.0%	0.2%	0.2%	-	-	(13,000)	12,000	92,000	92,000
Warehouse/Distribution	16,833,557	1,228,850	4.6%	5.9%	6.1%	7.3%	7.8%	6,011	66,000	842,000	65,000	(34,000)	(203,000)
Total - Sugar Land	22,323,868	1,516,098	5.6%	6.3%	5.9%	6.8%	7.2%	36,011	66,000	876,000	141,000	45,000	(85,000)
Total Houston													
Flex/R & D	46,787,404	4,568,771	11.2%	10.0%	9.7%	9.8%	10.0%	70,594	831,000	706,000	349,000	(145,000)	80,000
Manufacturing	66,402,604	1,122,088	2.2%	2.9%	2.1%	1.7%	1.9%	65,000	144,000	(57,000)	627,000	316,000	435,000
Warehouse/Distribution	434,581,271	18,913,853	5.8%	5.3%	4.4%	4.4%	4.5%	2,181,460	2,880,000	3,679,000	5,329,000	1,043,000	2,741,000
Total - Houston	**547,771,279**	**24,604,712**	**5.8%**	**5.4%**	**4.6%**	**4.5%**	**4.6%**	**2,317,054**	**3,855,000**	**4,328,000**	**6,305,000**	**1,214,000**	**3,256,000**
Vacancy Rate with Sublet Space			6.0%	5.6%	4.7%	4.6%							

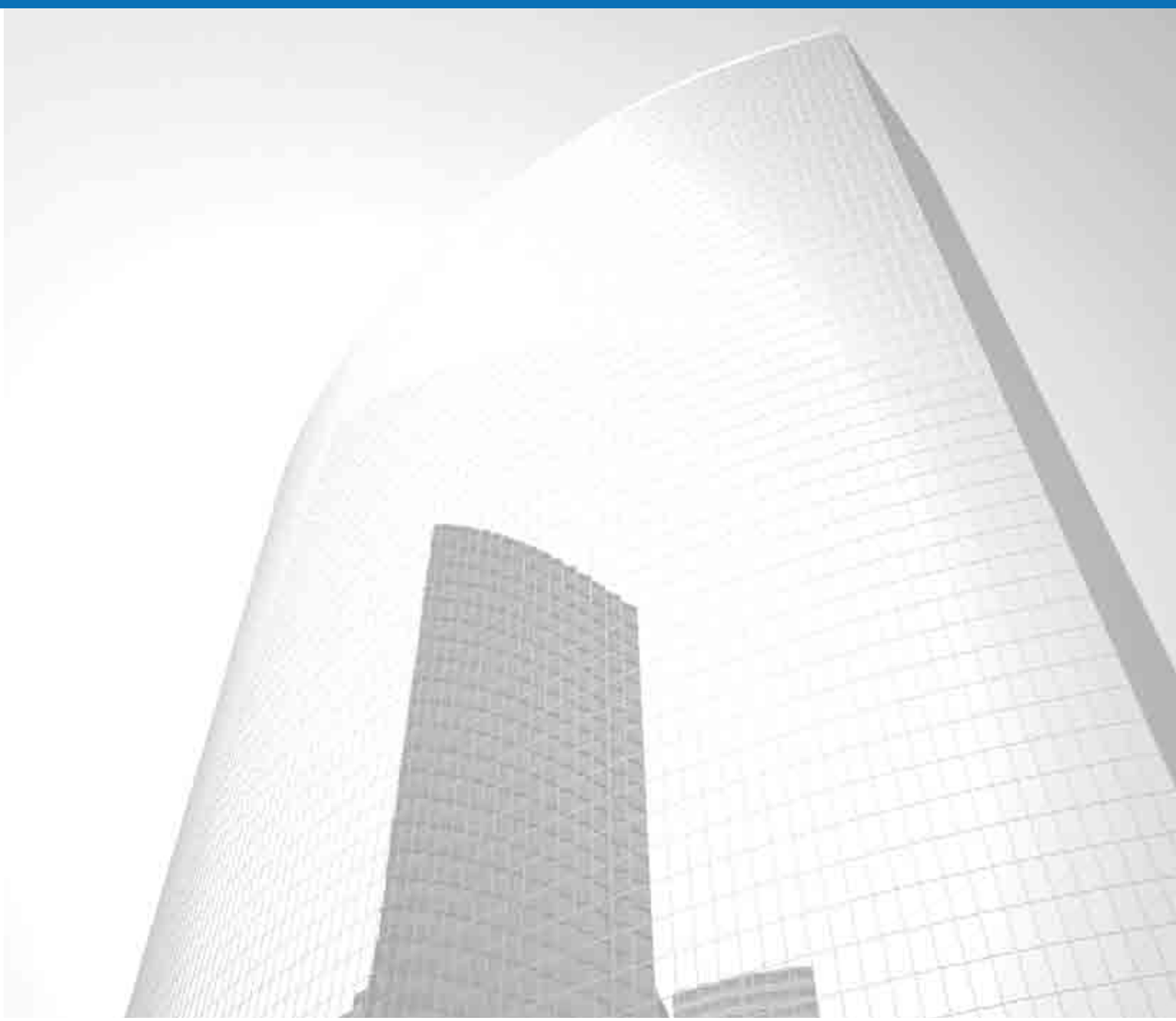
1/ Does not include buildings under construction or buildings owned by the government.
2/ Does not include sublet space.
3/ Inventory adjusted per changes in CoStar database.

Source: Inventory and Vacancy from analysis of CoStar data, Net Absorption computed by Delta Associates; October 2012.

Delta Associates, the research affiliate of Transwestern, is headquartered at:
500 Montgomery Street, Suite 600, Alexandria, VA 22314; Phone: 703-836-5700; DeltaAssociates.com

SECTION SIX

OFFICE AND INDUSTRIAL **INVESTMENT TRENDS**



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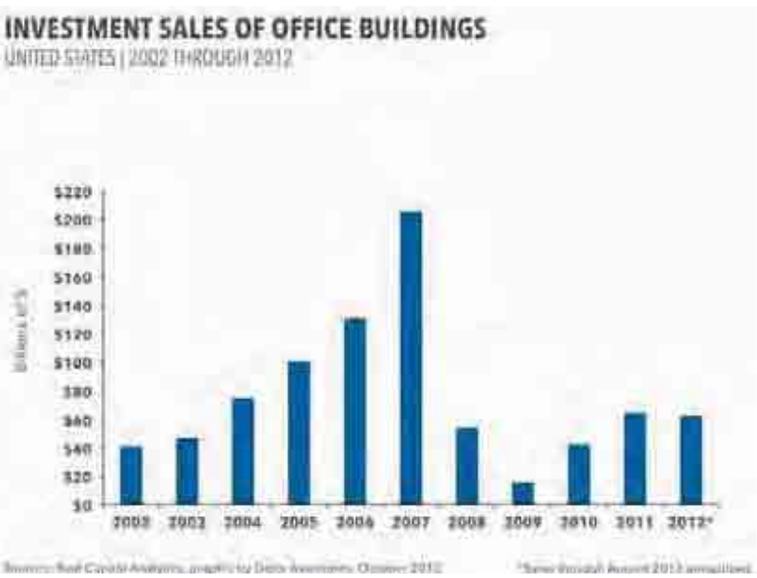
OFFICE INVESTMENT SALES

Investment sales of office assets have plateaued near 2011 levels after bouncing back in the wake of the recession. Annualized national office volume for 2012 totals $62.9 billion, compared to $64.7 billion in 2011 and $42.8 billion in 2010. Sales are keeping pace with the volume seen last year. While job growth and improving market fundamentals hold promise for investors, continued unease over the state of the national economy is preventing a faster turnaround with more robust volume.



In both the long term and short term, real estate investment has outperformed stocks and bonds. After a precipitous fall following the housing bubble and recession, real estate has again proved to be a strong investment. The 12 months ending June 2012 saw a 12.48% increase in the NAREIT Equity REIT Index. The NCREIF Property Index increased 12.04% during the same period, while stocks (as measured by the S&P 500) rose 5.45%. Direct investment in real estate is likely still undervalued at this point in the cycle compared to the alternatives. While real threats face office market investors – notably concerns about continued economic growth and job creation – returns have been solid. Loan balances coming due in 2013 remain a concern. Nationally, on balance, asset performance has improved, with vacancy trending lower. Improving performance may allow some borrowers to refinance who otherwise would not have been able.

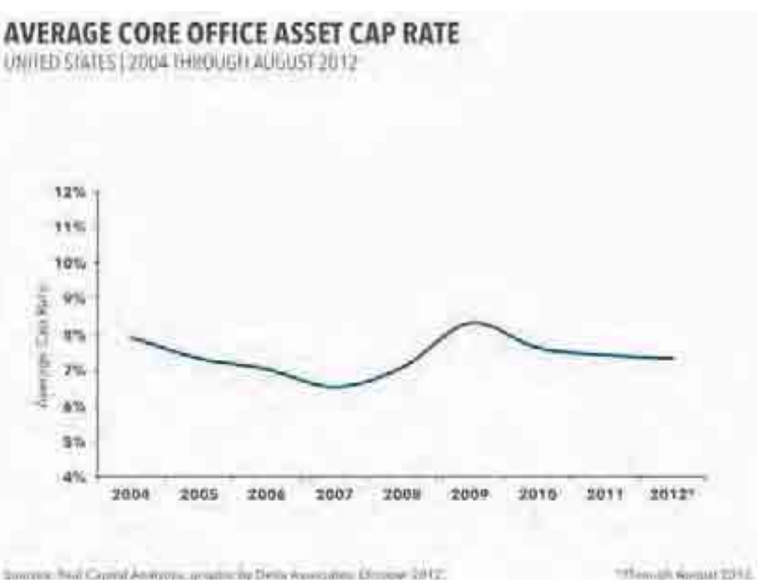
NCREIF RETURN INDEX[1/] Office Properties	
Metro Area	**12-Month Total Return at Mid-Year 2012**
San Francisco	22.75%
Boston	16.20%
Houston	**13.59%**
Denver	13.48%
Dallas	11.60%
National Average	**10.54%**
New York	10.12%
Los Angeles	8.62%
Chicago	8.48%
Washington	8.07%
Atlanta	6.16%

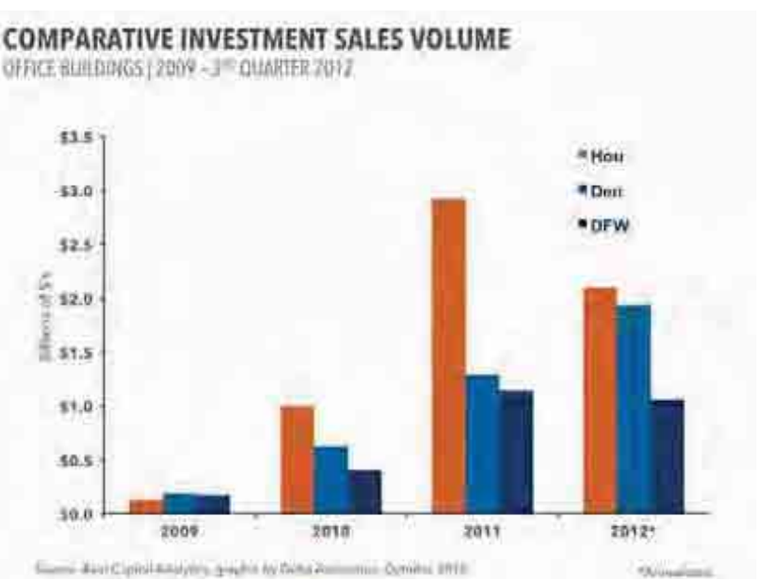
[1/]NCREIF index includes both current income and capital appreciation returns.

Source: NCREIF, Delta Assocates; October 2012.

After peaking in 2009, U.S. office cap rates began their decline and have reached their lowest level since the recession. The mean cap rate in the U.S. in 2012 is 7.3% for core office assets, down from 7.4% in 2011 and from 7.6% in 2010, according to Real Capital Analytics. We believe cap rates will remain fairly stable through the remainder of 2012 as market conditions continue to firm. Given the sluggish pace of economic recovery, we expect interest rates to remain low into 2015, helping to keep cap rates fairly stable. However, modest job growth is likely to translate into middling demand for office space in 2013, which may reduce investors' appetite for office product and cause cap rates to edge up.

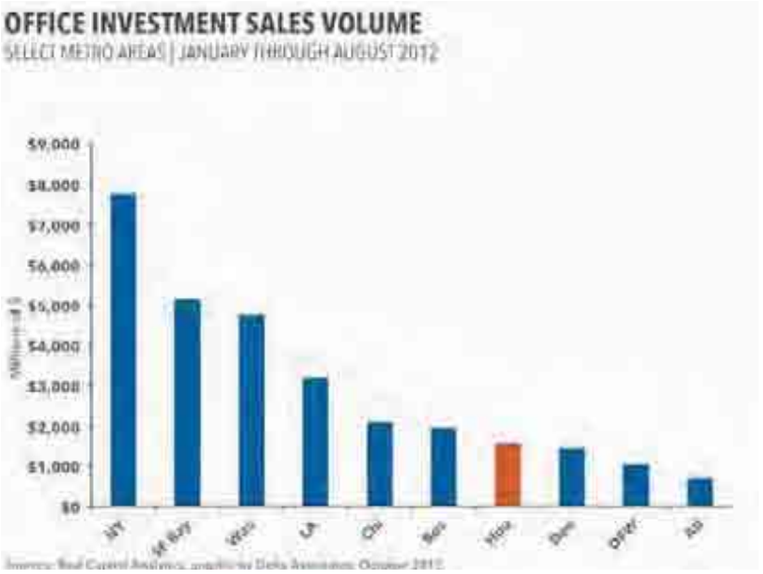
Recent activity in Houston's office investment market was highlighted by the sale of Shell Plaza Towers to the Duncan Family, which closed in August for $550 million, or $307/SF. The 3rd quarter alone accounted for 56% of the $1.6 billion in total sales in 2012. Sales volume totaled $2.9 billion in all of 2011, which could be surpassed in 2012 with Williams Tower in the Galleria submarket and the Kinder Morgan Tower in the CBD submarket on the market for up to $475 million and $400 million, respectively.





Looking at the NCREIF Property Index, total returns have improved in 2012, particularly in Houston, which saw a large jump in returns compared to 2011. Houston's office asset returns are 13.59% over the 12 months ending June 2012 after a return of 7.24% for the 12 months ending June 2011. The returns in Houston lagged behind only San Francisco and Boston and surpassed the national average of 10.54%. This robust performance can be attributed largely to the energy sector, Houston's most important core industry.

Houston's office sales volume ranks it seventh in the nation. The New York market leads in total volume in 2012 with nearly $8 billion in sales.



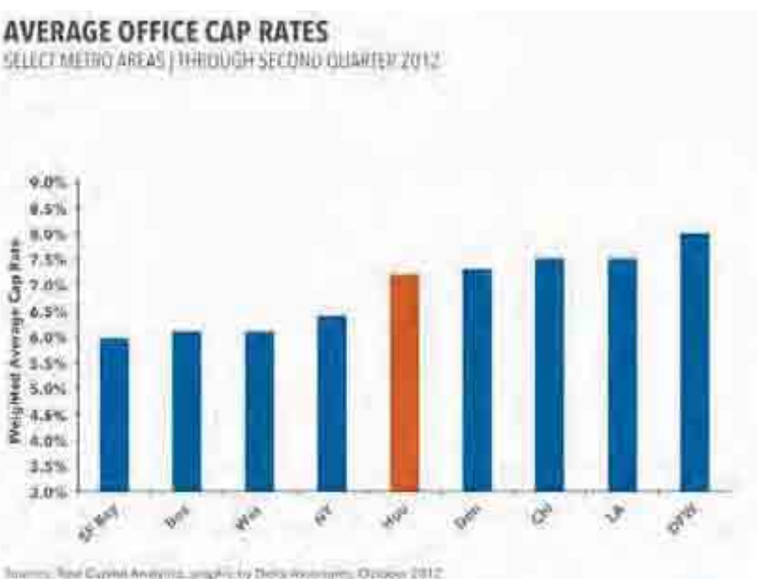
Nationally, sales prices are about even with 2011 prices, dipping slightly to $212 in the first eight months of this year, compared to $214 for all of 2011. Sales returned to peak levels in Houston faster than in other major markets in the country. Significantly improved market conditions, driven by one of the strongest local economies in the nation, continue to fuel investor interest in the Energy Capital of the World. Despite the dip in oil prices earlier this summer, the surge in hydraulic fracturing activities is giving local energy companies the confidence and incentive to expand their workforces, which is translating into greater interest in Houston office assets.

The average office sales price through the third quarter of 2012 is $216/SF, compared to $214/SF during all of 2011. With the exception of 2009 – the low point of the downturn – values in Houston have continued to rise and reached a new high in 2011, which could be surpassed in 2012. Values will likely continue growing in the period ahead, as market conditions continue to strengthen, rents rise, and competition increases for Houston's assets.

Houston's office investment sales market likely will continue to improve gradually through the remainder of 2012 and into 2013. At this point in the cycle, most U.S. markets have regained their footing and investors are finding credit more easily available. However, uncertainty within the Federal government and the larger national economy is hampering potential growth. The Houston market has the capacity to outperform the national average in the period ahead, in terms of percentage increases in both pricing and volume, due to the strength of the energy industry, its largest core sector.

The average cap rate on a rolling three-month basis for core Houston office assets was 8.1% in June 2012. However, cap rates have covered a wide range this year depending on the location and characteristics of the properties being traded. YTD, the weighted average cap rate in Houston is 7.2%. Trophy properties have recently traded at cap rates below 7%. We expect cap rates to edge down during the balance of 2012 as market fundamentals suggest increasing investor interest in Houston's office assets.

Nationally, Houston office cap rates are higher than those in gateway markets such as San Francisco Bay and New York but are lower than those in Chicago and Los Angeles.



TOP BUYERS OF OFFICE BUILDINGS

Top investors in office assets nationally in the 12 months ending in September 2012, according to Real Capital Analytics, include:

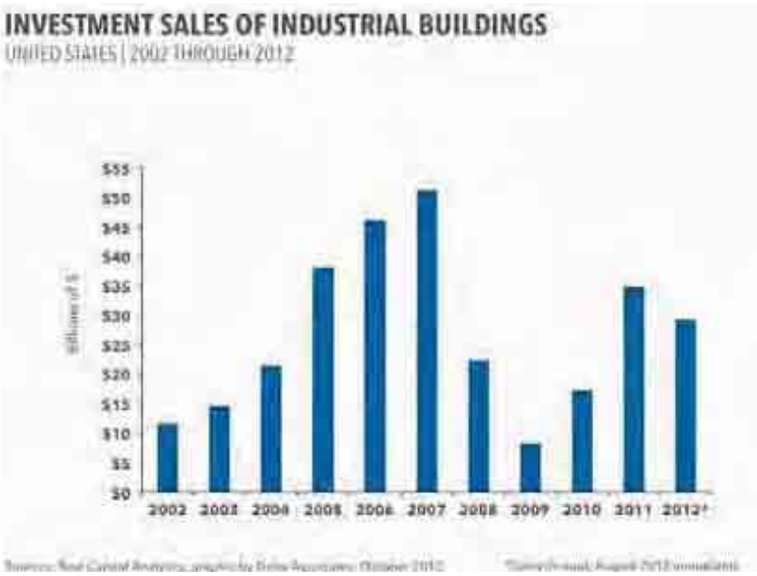
- Beacon Capital Partners
- Blackstone
- SL Green
- Tishman Speyer
- Clarion Partners
- Rockwood Capital
- Boston Properties
- RXR Realty

OFFICE INVESTMENT PROSPECTS

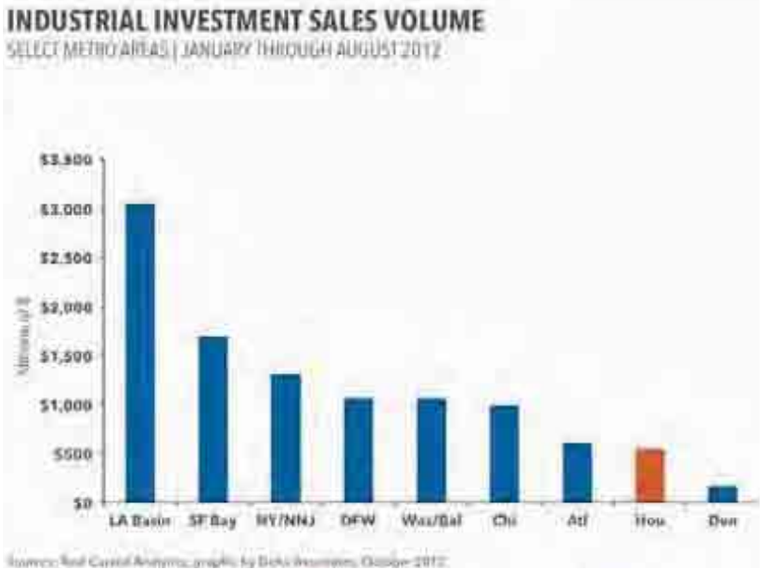
The Houston office market will continue to attract additional interest from investors so long as the energy industry continues its strong performance. Fundamentals have improved in 2012, leading to healthy volume and sales prices, though concern regarding the national economy has held both metrics in line with 2011 performance. The rising global demand for energy is likely to keep investor interest trained on Houston. Houston office assets remain a bargain compared to gateway markets, potentially allowing for further price appreciation in 2013.

INDUSTRIAL INVESTMENT SALES

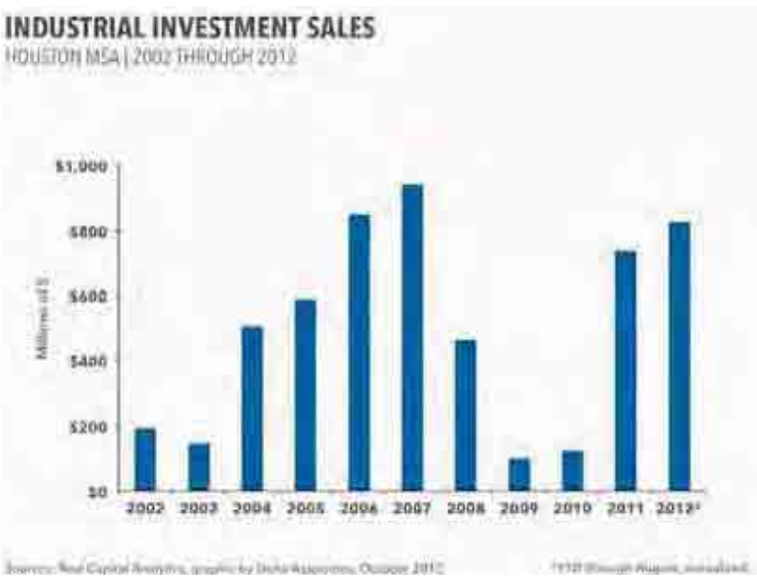
Despite decelerating some from 2011 numbers, national industrial investment sales remain well above recessionary levels seen in 2008 through 2010. At the current pace, sales will total $29.3 billion in 2012, compared to $34.8 billion in 2011 and $17.2 billion in 2010. Additionally, the Houston market has seen strong returns over the past year and is poised to see an increase in demand with the completion of the Panama Canal expansion, allowing for a larger amount of cargo from the Pacific.



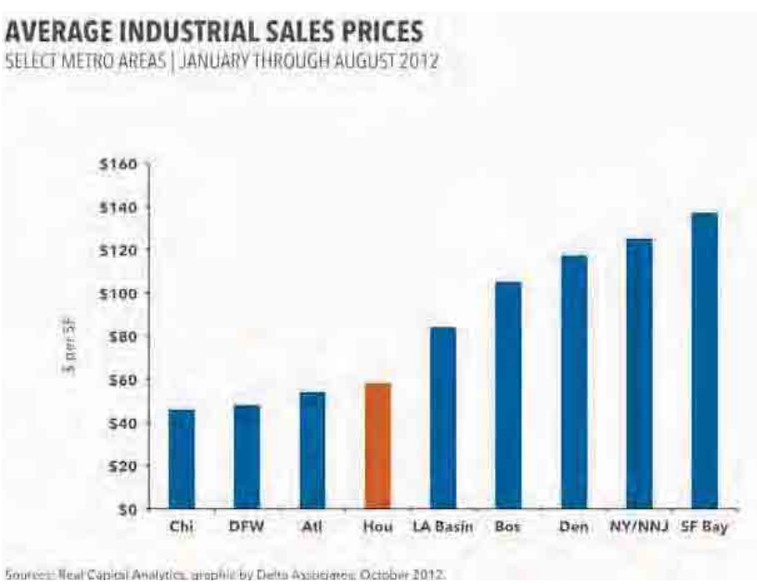
The Houston industrial market achieved total sales volume of $550 million through the first eight months of 2012. Houston's volume has yet to catch up with the market's strong performance.



Returns on industrial investments have shown continued strength in 2012. Like the office market, the Houston industrial market has performed well relative to other markets across the country. Returns in Houston measured 14.50% over the 12 months ending in June 2012, compared to the national average of 12.22%. Among major industrial markets, only San Francisco performed better during this time period. Recorded Houston industrial sales volume, at $550 million through August, is on pace to exceed the 2011 total of $737 million. The average sales price is $58/SF in 2012, up from $40/SF for all of 2011.



Cap rates for recorded sales of Houston industrial product in 2012 have centered in the 6.5% to 8.5% range. There continues to be a large spread between Class A and Class B product.



NCREIF RETURN INDEX[1/]
Industrial Properties

Metro Area	12-Month Total Return at Mid-Year 2012
San Francisco	19.15%
Houston	14.50%
Atlanta	13.68%
Dallas	13.41%
National Average	12.22%
Los Angeles	12.07%
Chicago	11.28%
Washington*	11.11%
Denver	10.53%
New York	9.65%
Boston	4.52%

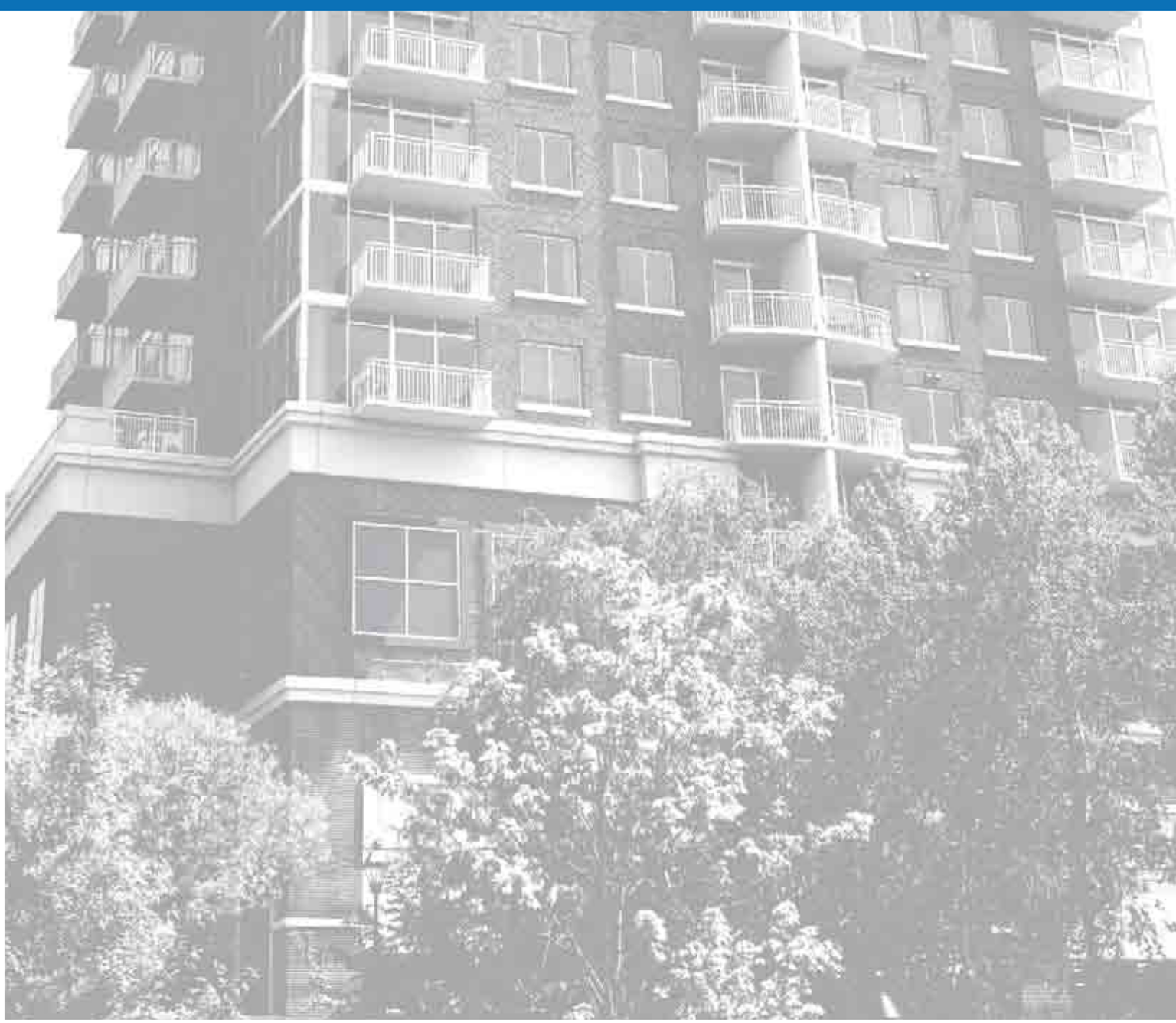
[1/] NCREIF index includes both current income and capital appreciation returns.
*Baltimore, MD.
Source: NCREIF, Delta Associates; October 2012

INDUSTRIAL INVESTMENT PROSPECTS

Demand for industrial properties in Houston will strengthen with the abundance of capital (core and value-add funds) that is chasing industrial product based on the strength of the market and the Houston economy. This abundance of capital coupled with the lack of quality product on the market will continue to put downward pressure on cap rates, particularly in the core industrial sector. Cap rates for industrial product in Houston are at historically low levels as a result of the liquidity in the capital markets, allocations, low debt rates, and long-term growth prospects for Houston. We anticipate that the expansion of the Panama Canal and its attendant benefits for the Houston industrial market will increase sales volume and pricing in 2013.

SECTION SEVEN

THE HOUSTON METRO MULTIFAMILY MARKET



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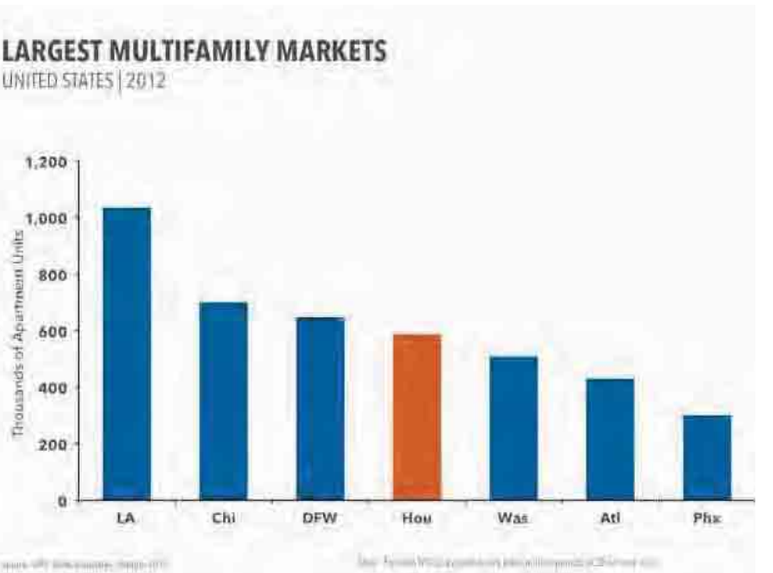
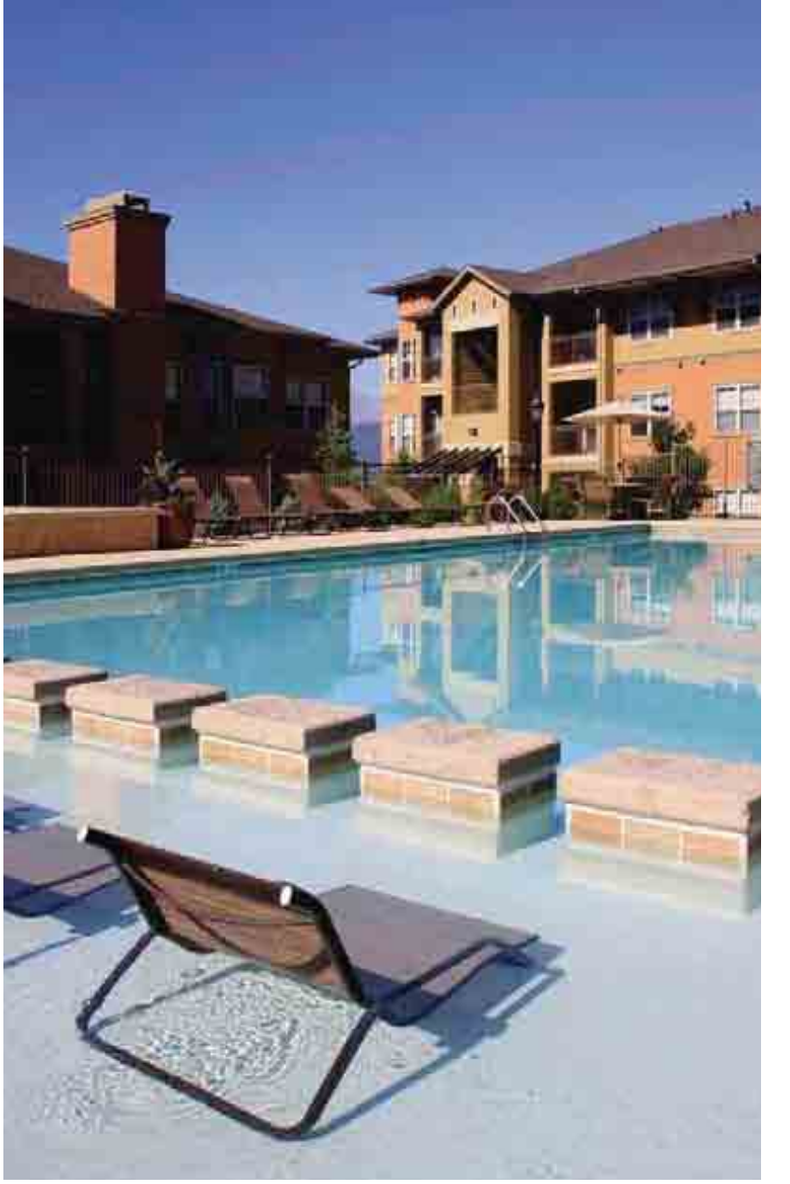
MULTIFAMILY: ROBUST PERFORMANCE

The Houston metro multifamily market continues to expand due to large population increases and one of the highest job growth rates in the country. This year has seen market fundamentals strengthen, with absorption and rents up and vacancy down. The Houston apartment market, at over 587,000 units, ranks fifth in the nation in terms of total market size (New York is not included in the accompanying graph to conserve scale).





NET ABSORPTION LEADS THE NATION

Net absorption for all classes of apartments remained strong in the Houston metro over the 12 months ending June 2012, surpassing the pace of absorption in 2011. Absorption was approximately 17,275 units over the 12 months ending in June 2012, compared to 15,591 units during 2011. The current absorption numbers are the highest in Houston since 2005, when an influx of New Orleans residents came to Houston following Hurricane Katrina. Houston's population is increasing as the availability of employment attracts new residents from other parts of the country.

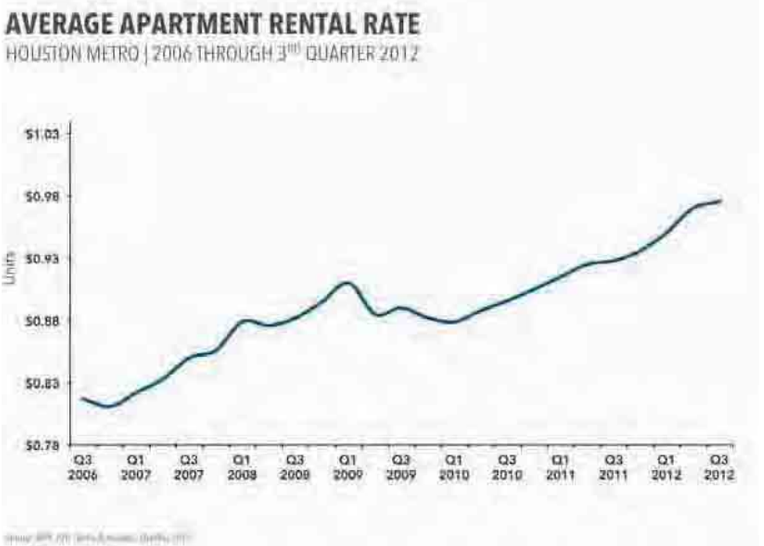
Across the U.S., apartments have proved to be a bright spot in commercial real estate in 2012. Most major metro areas have seen year-over-year increases in net absorption and financing has opened up for many new projects in the pipeline. Houston is leading this trend, with a higher net absorption of units than any other U.S. metro area for the 12 months ending June 2012.

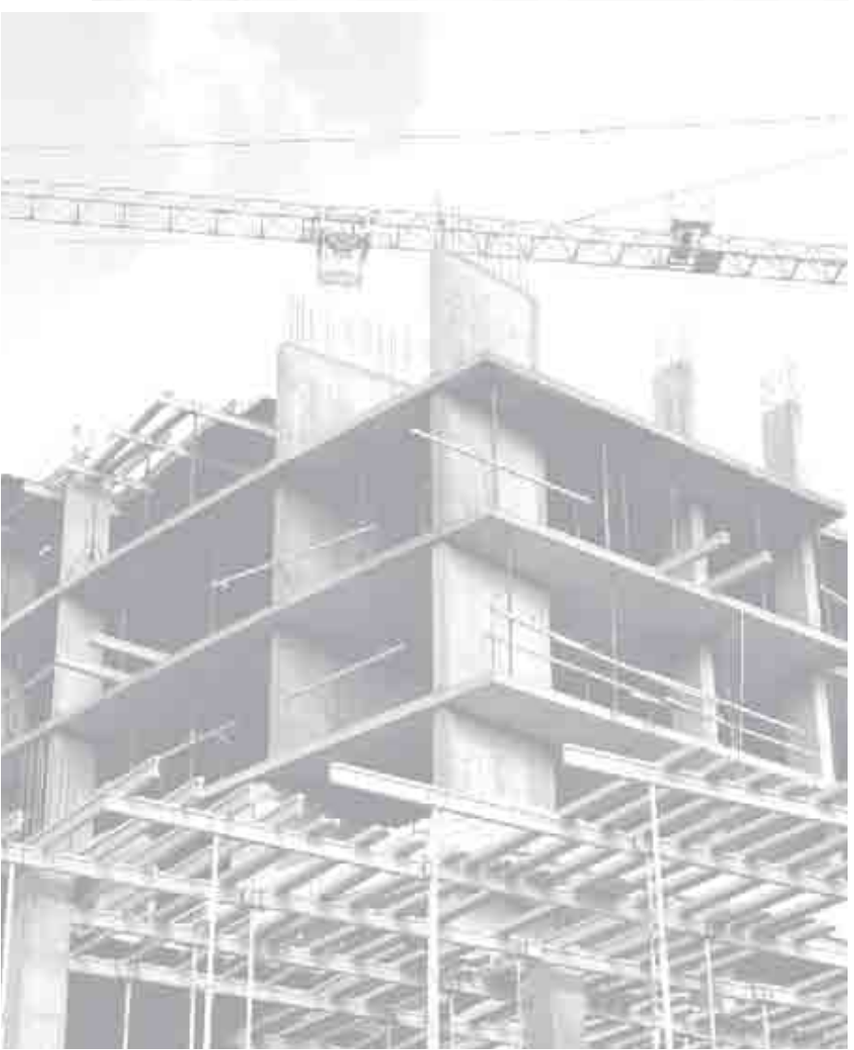
VACANCY: STILL DECLINING

The construction of new apartment units has not kept pace with demand in the past year, leading to a decrease in the number of vacancies in the area. Vacancy as of June 2012 stood at 7.4%, down from 8.5% at the end of 2011 and 11.0% at year-end 2010. The vacancy rate for all classes of Houston metro apartments has continued to decline following its spike in 2009 and is now at the lowest level since 2007. With strong job creation and population growth expected to continue, we anticipate the vacancy will edge down further over the next 12 months.

RENTS: RISING

Strong demand and declining vacancy have allowed property owners to push rents to record levels in 2012. The average rental rate for Houston apartments was $0.98/SF/month at the end of September, up 5.1% over the past 12 months. Rents will likely increase modestly through the balance of 2012 and into 2013 as job creation continues and economic growth strengthens.





HOUSTON METRO MULTIFAMILY MARKET OUTLOOK

The Houston metro multifamily market likely will continue the steady growth it has experienced during the last three years, as the regional economy adds jobs. Houston's local economic strength has benefited the apartment market, with job seekers attracted to Houston and taking rental units off the market. Rents will build on the gains already seen for the remainder of 2012 and into 2013. Improvement in the single-family housing market could temper apartment absorption in the years ahead, especially with interest rates likely to remain low, but job growth should be able to sustain continued improvement in the Houston multifamily sector.

SECTION EIGHT

THE HOUSTON METRO RETAIL MARKET

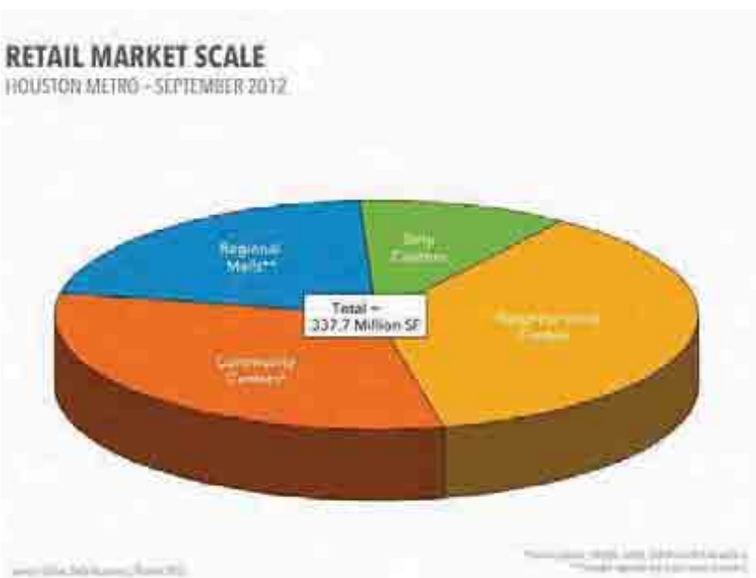
TRENDLINES®
HOUSTON 2012

RETAIL SECTOR EXPANDING

Metro Houston's retail market experienced steady improvement in 2012, as the economy strengthened and job growth remained strong locally. This sector's growth is supported by one of the nation's best regional economies and its solid employment gains, reinforced by hiring in the core industries.

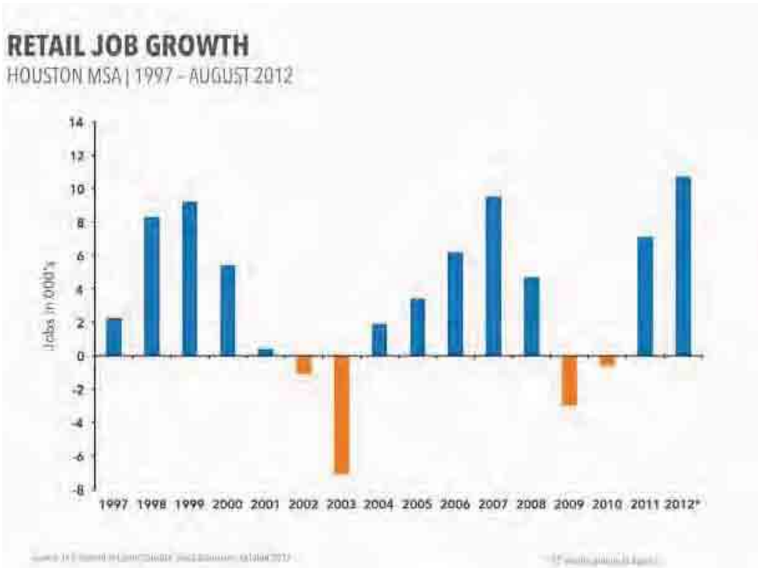
RETAIL INVENTORY: MODEST EXPANSION

The Houston metro area has approximately 338 million square feet of retail inventory. Approximately two-thirds of Houston's retail inventory consists of neighborhood and community center product types, including power, lifestyle, outlet, and theme/festival centers.



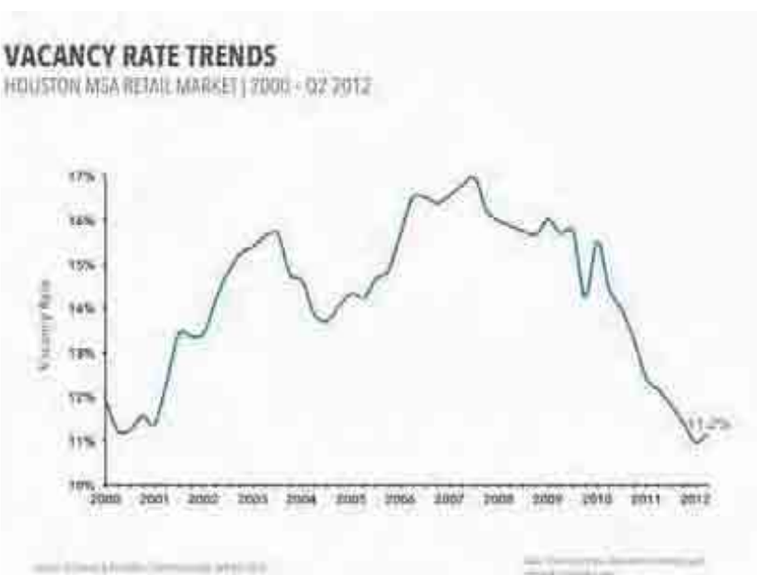
RETAIL EMPLOYMENT RISING

The Retail sector in metro Houston added 11,100 jobs over the 12-month period ending August 2012 in metro Houston, a 4.1% gain and a firm indicator of strength in this sector. On a trailing 12-month basis, retail employment in the Houston metro area increased for the 23rd consecutive month. Retail employment likely will continue to increase as consumer spending increases in 2013.



RETAIL VACANCY CONTINUES DOWNWARD TREND

Houston's retail vacancy rate, at 11.2% in the 2nd quarter of 2012, is down from 12.4% in the 2nd quarter of 2011. We expect that vacancy will remain steady or decline modestly for the remainder of 2012, as Houston's consumer sector remains strong and retailers open more stores.



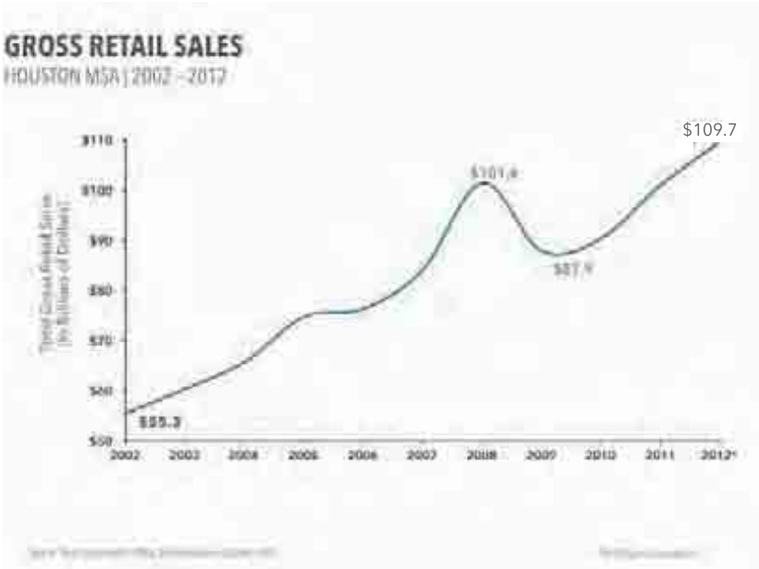
RETAIL RENTS PLATEAUING

Retail rents held in the 2nd quarter of 2012 at $1.48/SF/month, the same as in the quarter prior. Rents declined over the past year but likely will experience modest growth during the balance of 2012 and into 2013, as consumer spending gradually accelerates and market conditions continue to strengthen. The recent trends in vacancy have set the stage for rent growth.

RETAIL SPENDING CONTINUES RECOVERY

Data from the Texas Comptroller's Office show that retail sales in the Houston metro area rose to $100.4 billion in 2011, up 11.2% from 2010. Annualized information based on 1st quarter 2012 data, the most recent available, projects retail sales in 2012 of $109.7 billion, a 9.3% increase over 2011 sales.

This increase is due in part to Houston's growing population and employment base, but also its robust economic performance.



RETAIL MARKET LIKELY TO GAIN FURTHER MOMENTUM

The Houston retail market will likely undergo a sustained expansion during the remainder of 2012 and into 2013, as local job growth continues to remain strong and the consumer sector strengthens. As the regional economy grows, consumers will spend more, and a growth cycle in the retail market will likely occur over the next several years, making investment very attractive.

We expect the Houston retail market to outperform most other metro markets in the country, as the Houston metro area is a national leader in job creation and population growth. New jobs, in concert with an expanding population, will drive retail spending in the period ahead.

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