

COLLIERS HEALTHCARE SERVICES GROUP - Houston Texas
HEALTHCARE MARKET COMMENTARY



Houston Medical Office Market Slowly Recovering

Houston’s medical office market closed 1Q 2011 with encouraging signs it is nearing the end of the downward shift that began in late 2008. Medical office vacancy decreased to 12.0%, 110 basis points (bps) below the 13.1% in 1Q 2010. Medical Class A vacancy decreased to 11.1%, 380 bps below the 14.9% in 1Q 2010. Healthy trends in demand were also evident with positive net absorption of 131,352 SF in 1Q 2011, marking the tenth consecutive quarter of absorption gains, with 2010 posting the highest annual net absorption since 2005. Amid ongoing concerns regarding the slow job growth, medical office landlords lowered their quoted rental rates in the first quarter. The average Class A rental rate of \$28.45/SF decreased from \$28.52/SF and the average Class B rental rate of \$21.82/SF decreased from \$21.90/SF in 1Q 2010. The average Class C rental rate at \$17.61/SF decreased 4.6% from \$18.42/SF, over the same period.

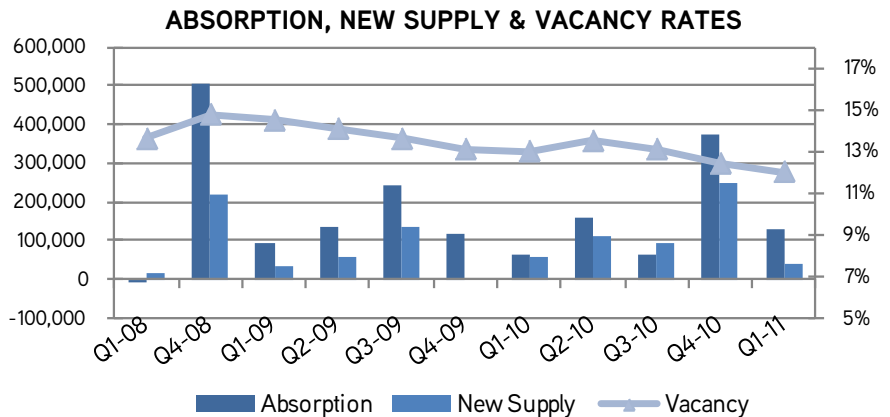
Houston’s medical office market is expected to benefit from both short- and long-term regional trends. Disciplined development, with only 574,000 SF of new medical space added in 2010, and 40,596 SF added in 1Q 2011, will relieve the pressure in filling the existing vacant lease space. It is not surprising that much of the new development activity is occurring in outlying suburban areas, particularly in West Houston, Fort Bend County and The Woodlands, where strong population growth trends are projected over the next twenty-five years.

Overall, Houston’s medical office market and economy remain among the strongest in the U.S. Recently, Forbes ranked Houston fourth among U.S. major metropolitan areas where the recession is easing, due primarily to a diversified base of solid growth industries. Macro factors driving the absorption of office space ultimately ties back to job count. According to the Texas Labor Market Review, total nonagricultural employment in Texas rose by 22,700 jobs in February, or 0.2%. Six of the eleven major industries grew over the month, with Professional and Business Service jobs contributing to more than one-half of the job gains. At the local level, Houston’s MSA had the largest monthly job increase, with 9,600 jobs added in February 2011, followed by Dallas with 7,700 jobs added.

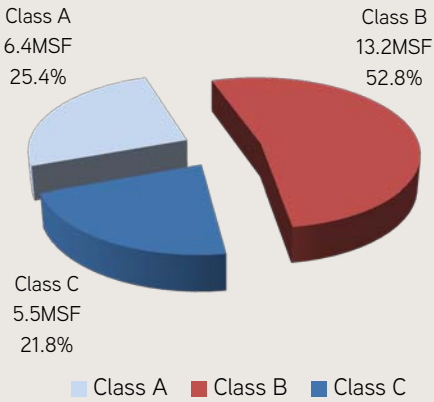
CITYWIDE MARKET INDICATORS	
1Q-10	1Q-11
QUARTERLY NET ABSORPTION	
81,135 SF	131,352 SF
QUOTED RENTAL RATE NNN	
\$22.90/SF	\$22.70/SF
VACANCY	
13.1%	12.0%
QUARTERLY DELIVERIES	
80,594 SF	40,596 SF
UNDER CONSTRUCTION	
75,000 SF	144,772 SF

UNEMPLOYMENT	1/11	2/11
HOUSTON	8.8%	8.4%
TEXAS	8.3%	8.2%
U.S.	9.0%	8.9%

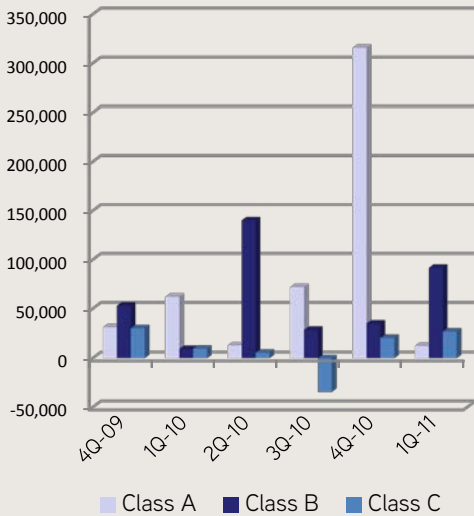
JOB GROWTH	ANNUAL CHANGE	2/11
HOUSTON	2.1%	9.6k
TEXAS	2.3%	22.7k
U.S.	1.8%	192k



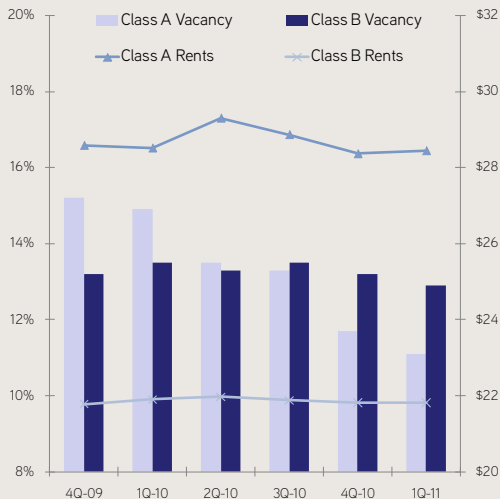
**MEDICAL OFFICE
EXISTING INVENTORY BY CLASS**



**MEDICAL OFFICE
NET ABSORPTION BY CLASS**



**MEDICAL OFFICE
CLASS A & B VACANCY VS. RENTS**



Vacancy & Availability

Houston's medical office occupancy improved for all property classes during the 1Q 2011, with the citywide average vacancy rate dropping to 12.0%, a decrease of 40 basis points (bps) from 12.4% in 4Q 2010.

By property class, Class A vacancy rates posted the largest decrease of 60 bps to 11.1% in 1Q 2011, compared to 11.7% in 4Q 2010. Class B vacancy rates decreased 30 bps to 12.9% (from 13.2%), while Class C rates fell 50 bps to 10.9% (from 11.4%).

Sublease space has not had a significant impact on current vacancy rates, remaining below 1.0% of total vacant space over the past five consecutive years. Of the 3.0M SF of vacant space on the market at the end of 1Q 2011, only 41,100 SF (or 0.2% of total vacant space) was sublease space. By property class, vacant Class A space totaled 706,800 SF, with 10,600 SF of sublease space. Vacant Class B space totaled 1,700,000 SF, with sublease space accounting for 30,500 SF.

Disciplined medical office development activity has helped prevent major upheavals in current occupancy levels. There were only three (3) new buildings (40,596 SF) added to the market in 1Q 2011 and only 10 buildings (574,000 SF) citywide in 2010. The largest project completed within the past twelve months was the Texas Children's Hospital West Campus located in the Katy Freeway West submarket.

Presently, only three medical office buildings are under construction and include: St. Luke's Vintage Park (39,069 SF), 2000 S TX-336 Loop W in Conroe (73,821 SF) and 9323 Pinecroft (31,882 SF) all 100% pre-leased and scheduled to deliver 2Q 2011.

Absorption & Demand

Houston medical office buildings recorded 131,000 SF of positive net absorption in the 1Q 2011, marking the tenth consecutive quarter of positive absorption citywide. On a year-over-year basis, net absorption rose above the 81,000 SF recorded in 1Q 2010. It is notable that net absorption for 2010 reached 678,091 SF, the highest annual gain recorded since 2005.

The majority of medical tenant move-ins during 1Q 2011 were in lease spaces under 10,000 SF. Those tenants include: The Harris County Hospital District moved into 10,000 SF in the Fairmont Healthcare Center (Gulf Freeway/Pasadena submarket); Dialyspa moved into 4,860 SF in the Kirby Glen building (South Main/Medical Center submarket)

Rental Rates

Quoted full-service rental rates for all medical office property classes averaged \$22.70/SF in 1Q 2011, a decrease of 0.9% from the \$22.90/SF in 1Q 2010. As with non-medical office space, medical office building landlords continued to offer lease concessions including free rent and generous tenant improvement packages to attract and retain creditworthy tenants.

By property class, the average Class A rental rate of \$28.45 per SF decreased from \$28.52 per SF, and the average Class B rate of \$21.82 per SF decreased from \$21.90 per SF in 1Q 2010. The average Class C rental rate at \$17.61 per SF decreased 4.6% from \$18.42 per SF, one year earlier.



Conroe Professional Building

333 N Rivershire Dr
Conroe Submarket

RBA: 37,516 SF
Built: 1980
Buyer: Vista Rivershire, Ltd
Seller: 333 RCTX, LLC
Sale Date: January 2011



Red Oak Office Building

17322 Red Oak Dr
FM 1960/I-45 North Submarket

RBA: 14,000SF
Built: 1999
Owner: L-V Properties
Sale Date: Under Contract 4/2011



Peakwood II Professional

800 Peakwood
FM 1960/I-45 North Submarket

RBA: 204,821 SF
Built: 1984
Owner: Peakwood II Partnership
Sale Date: Under Contract 4/2011

Sales Activity

Fewer quality buildings on the market and the lack of available credit kept transaction activity low during first quarter 2011. Many of the transactions were non-arms length; however, there were several significant transactions that did occur.

The 37,516 SF Conroe Professional Building in the Conroe submarket was purchased by Vista Rivershire, Ltd. For \$1.8M or \$47.98 per SF. The property was built in 1980 and was 73.7% occupied at the time of sale.

Tom Pisula Development announced the sale of five (5) medical office buildings containing 302,000 SF in The Woodlands to a large public health care REIT. The properties include: 8850 Six Pines Drive, 9303 and 9305 Pinecroft Drive, Medical Arts Center II and 9191 Pinecroft Drive. The sales price was not disclosed. The announcement also included Tom Pisula Development's plans to break ground on the 100,000 SF, LEED Silver-precertified, St. Luke's Medical Arts Center III medical office building in April 2011.

There are several buildings currently under contract including the 204,821 SF Peakwood II Professional Building (800 Peakwood Drive) in the FM 1960/I-45 North submarket. The asking price is \$16.7M or \$82 per SF. Built in 1984, the property is currently 95% leased.

Another building under contract is the Red Oak Office Building, located at 17322 Red Oak Dr. in the FM 1960/I-45 North submarket. The 12-year old building owned by L-V Properties consists of 14,000 SF and is 100% leased. The asking price is \$3.7M or \$263 per SF.

Leasing Activity

Houston's medical office leasing activity reached 99,000 SF in 1Q 2011, compared to 117,000 SF in 1Q 2010. By property class, Class A product led the market with 52,034 SF leased, followed by Class B at 41,303 SF, then Class C at 5,775 SF.

Most of the new leases that were signed in 1Q 2011 were in the 1,000 - 5,000 SF range; however, we were able to uncover a few of the larger leases signed.

The Harris County Hospital District leased 10,000 SF in the Fairmont Healthcare Center (Gulf Freeway/ Pasadena submarket); Booting and Savrick Pediatric Associates lease for 9,025 SF in University Medical Plaza on Fannin.

In addition to tenants leases in medical office buildings, The University of Texas Medical Branch at Galveston leased 45,000 SF in Victory Lakes Town Center, a community retail development located in League City, Texas.

TEXAS MEDICAL CENTER

The Texas Medical Center (TMC) – the world’s largest medical center – represents one of Houston’s major economic drivers and core industries with an estimated regional annual economic impact of \$14 billion. TMC is also one of Houston’s largest employers with 92,500 employees, including physicians, scientists, researchers and other advanced degree professionals in the life sciences.

The internationally-renowned, 1,000-acre TMC is the world’s largest medical complex with 48 member institutions, including leading medical, academic and research institutions, all of which are non-profit and dedicated to the highest standards of research, education and patient and preventive care. Member institutions include 13 hospitals and two specialized patient facilities, as well as 19 renowned academic and research institutions virtually covering all health-related careers – including two medical schools, four nursing schools, as well as schools of dentistry, public health, and pharmacy – and 15 support services organizations. Over 69,000 students – including more than 5,000 international students – are affiliated with TMC, including high school, college and health profession graduate programs. More than 5.5 million patients visited in 2009, including approximately 18,000 international patient visits.

The University of Texas M.D. Anderson Cancer Center ranked #1 by U.S. News in Best Hospitals 2010-11



In addition to the medical facilities and institutions of higher learning, TMC is also home to more than 100 professional office buildings. Overall, the complex covers over 18 miles of public and private streets and roadways, with 31 million square feet of existing patient, education, and research space.

TMC has continued to grow and expand over the past several decades with the majority of growth occurring in the past ten years. In 2006, TMC completed a 50-year Master Plan which includes nine major initiatives for future institutional growth and physical improvements designed to further strengthen the campus. In 2007, the University of Texas M. D. Anderson Cancer Center began construction of the Center for Advanced Biomedical Imaging

Research. The Center is located in the 110-acre University of Texas Research Park, a joint effort between the University of Texas Health Science Center, M.D. Anderson and General Electric Healthcare. In terms of future growth, TMC has approved \$7.1 billion in building and infrastructure investments between 2008 and 2012, with annual research expenditures estimated at \$1 billion.

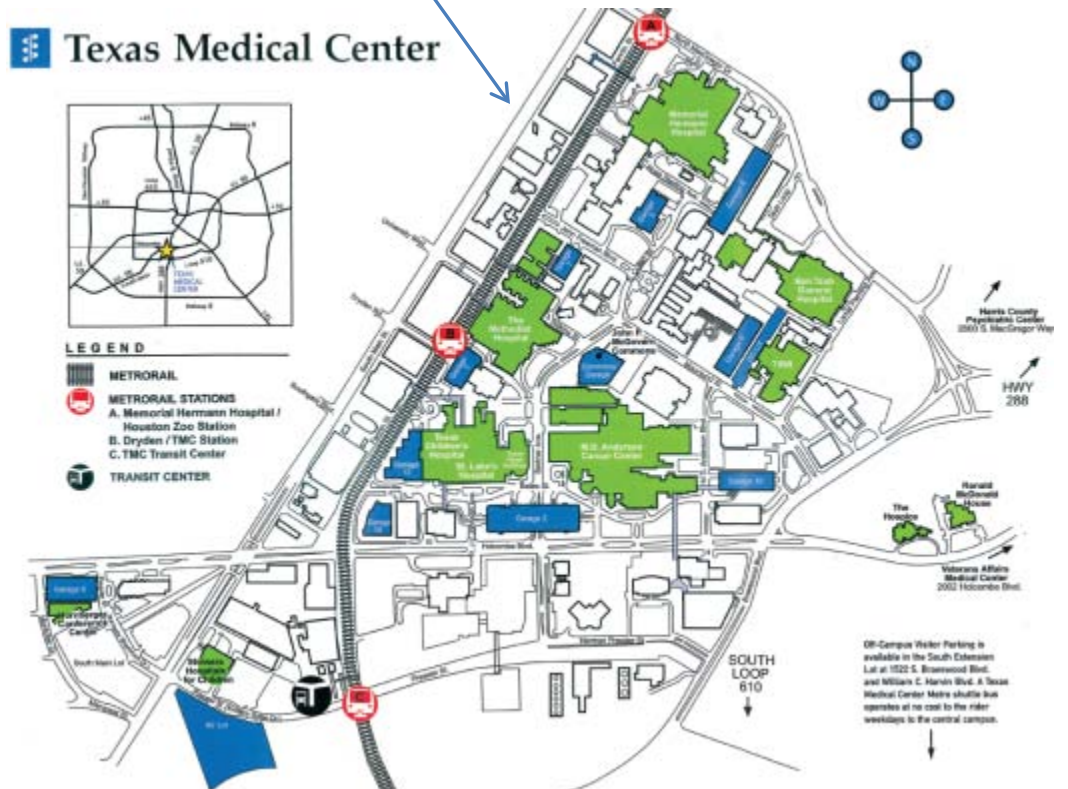
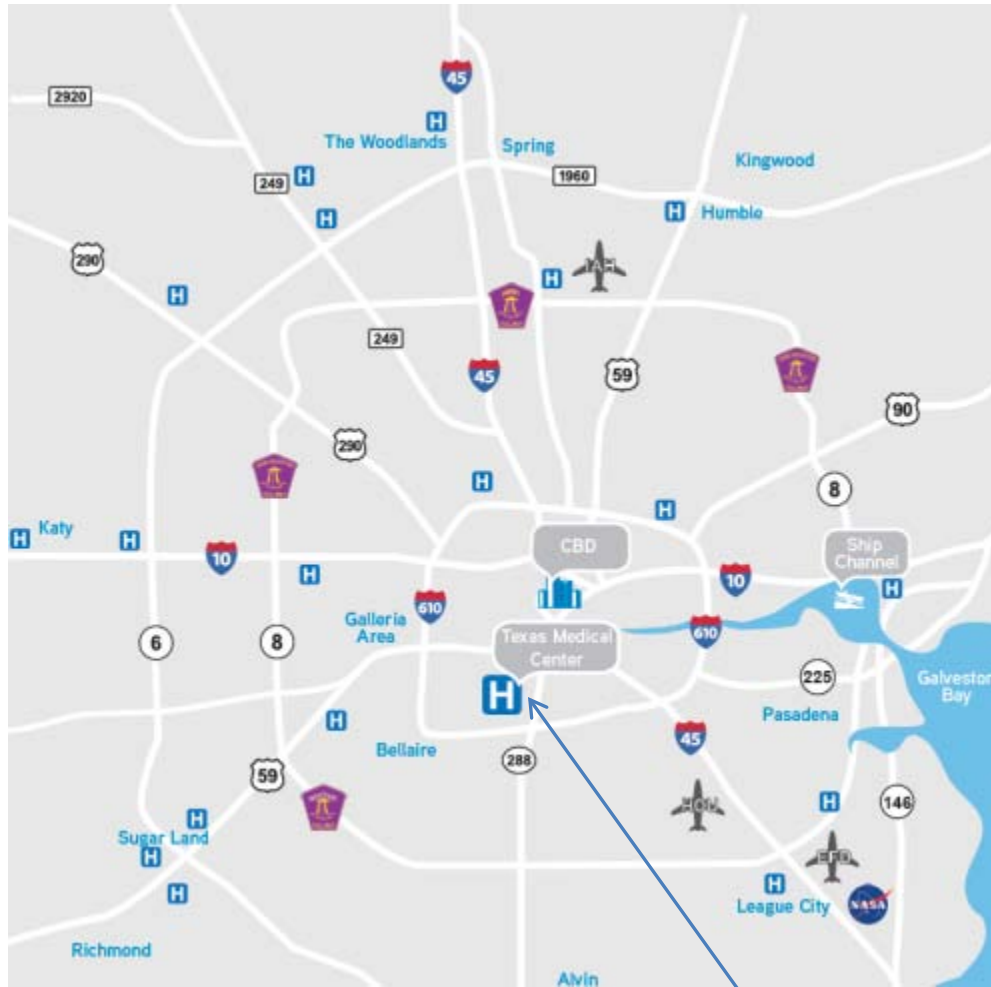
TMC Patient Care Institutions

*The University of Texas M.D. Anderson Cancer Center
Texas Children’s Hospital
Memorial Hermann Hospital System
The Methodist Hospital
St. Luke’s Episcopal Hospital
Lyndon B. Johnson General Hospital
Quentin Mease Community Hospital
Ben Taub General Hospital
The Institute for Rehabilitation and Research
The Hospice at the Texas Medical Center
Texas Heart Institute
Shriners Hospitals for Children – Houston
Veterans Affairs Medical Center in Houston*

TMC Academic and Research Institutions

*Baylor College of Medicine
The University of Texas Health Science Center at Houston
The University of Texas M.D. Anderson Cancer Center
University of Houston College of Pharmacy
Rice University
Texas A&M University Health Science Center
Prairie View A&M University College of Nursing
Texas Woman’s University Institute of Health Sciences
Texas Southern University College of Pharmacy and Health Sciences
Harris County Psychiatric Center
Houston Academy of Medicine*

Houston Area Hospital Locations



480 Offices Worldwide



61 Countries on 6 Continents

191 AMERICAS
135 USA
39 CANADA
17 LATIN AMERICA
26 ASIA
95 EUROPE/MIDDLE
EAST/AFRICA
168 AUSTRALIA/NEW ZEALAND
\$1.9 BILLION IN GLOBAL REVENUE
1.4 BILLION SQUARE FEET UNDER
MANAGEMENT
15,000 PROFESSIONALS

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