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PPR Releases Year-End 2006 Data

Vacancy Declines Slowed in 2006

With the best part of the recovery over and conditions returning to a steadier state, vacancy declines moderated in 2006 across all four property types. The retail and warehouse markets had the biggest slowdown, and after steeper declines in 2005 of 1.4 percentage points for retail and one percentage point for warehouse retail vacancies dropped only 0.5 percentage points and warehouse vacancies fell only 0.3 percentage points in 2006. Certainly the weakening housing market and slower retail spending played a large role in slowing the vacancy decline in the retail and warehouse markets. The office market experienced the steepest drop in vacancies during 2006 (0.9 percentage points), but even this is down from a 1.2-percentage-point drop the year before. Office demand is still strong; this was the only property type in which demand growth did not fall off in 2006 compared to 2005. However, office construction is rising, and 2006 completions were more than 40% above those in 2005. Condo conversions in 2006 continued to impact the apartment market, and the net stock change was only 0.1% of inventory, which allowed vacancies to continue declining. However, demand growth fell to half of 2005 levels due to the moderating economy, and as a result, vacancy declines were only half those of the prior year.

Year	Stock Change	Demand Change	Vacancy Rate	Stock Change	Demand Change	Vacancy Rate
	Apartment			Office		
2005	0.3%	1.4%	6.2%	1.0%	2.5%	16.2%
2006	0.1%	0.7%	5.7%	1.4%	2.5%	15.3%
2007	0.8%	0.9%	5.6%	1.5%	1.5%	15.3%
	Retail			Warehouse		
2005	1.8%	3.5%	9.8%	2.0%	3.2%	8.9%
2006	2.4%	2.9%	9.3%	2.6%	2.9%	8.7%
2007	2.3%	1.9%	9.7%	2.3%	1.9%	9.0%

Source: PPR

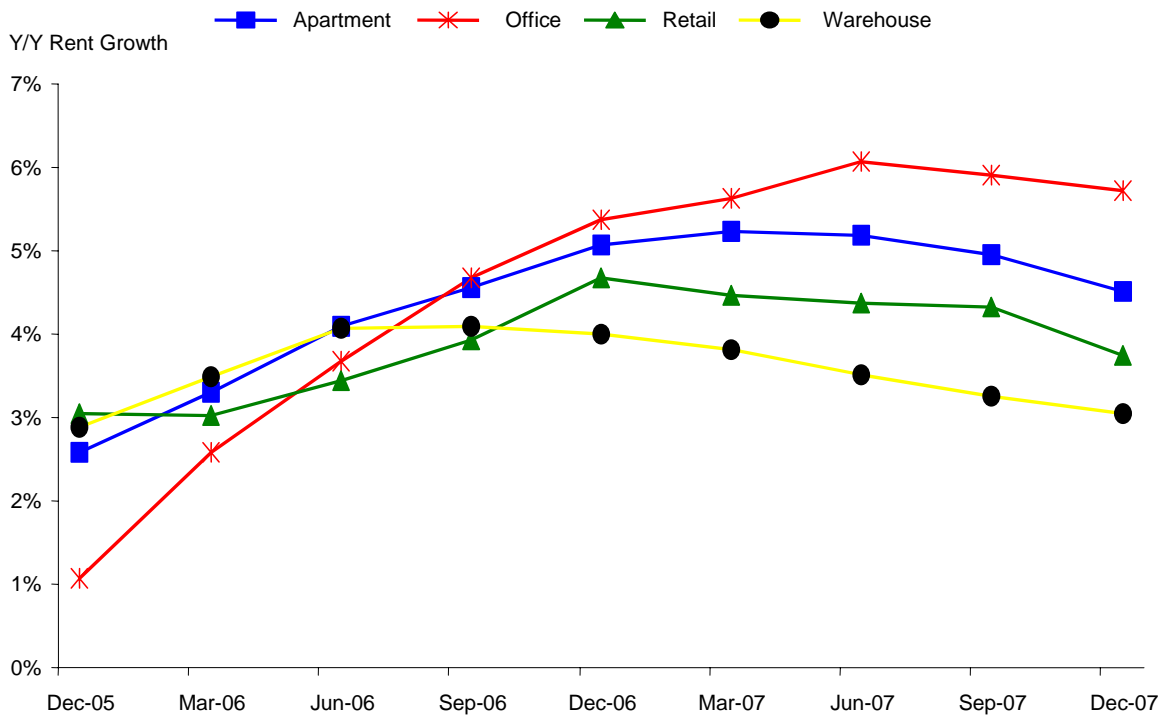
A Continued Moderation in Fundamentals Is in Store for 2007

The best of the recovery is behind us, and vacancies will continue to flatten and actually rise in some property types in the year ahead. In the apartment market, supply will remain moderate and demand growth will increase in 2007 as people await the housing market bottom, but it is the only property type expected to have a decline in vacancies over the year. Office vacancies are expected to be flat as demand growth moderates and construction continues to escalate. The year 2006 likely saw some opportunistic office leasing in some markets as rents began to surge, which will take a bite out of demand growth in the year ahead. Vacancies are slated to rise in the retail and warehouse markets in the coming year as demand growth continues to moderate.

Vacancy declines are slowing across the board. Whereas markets like Austin office, San Antonio office, and Palm Beach County apartment had vacancy declines in excess of three percentage points in 2006, the steepest declines in 2007 will be 1.6 percentage points in San Francisco retail, 1.5 percentage points in San Jose office, and 1.2 percentage points in Raleigh retail. The markets slated for the biggest increase in vacancies in 2007 are Austin retail, Inland Empire office, and Phoenix retail, all of which are facing heavy new supply.

Rent Growth Has Peaked in All Property Types Except Office

As fundamentals lose steam, so will rent growth. In the retail market, rent growth is peaking now at 4.7% and will moderate to 3.7% by the end of 2007. Warehouse rent growth peaked in mid-2006 and will fall from 4% currently to 3% over the coming year. Apartment rent growth will eke out slightly stronger gains over the next couple of quarters but will end 2007 at 4.5%, down from 5.1% currently. Office will be the only property type with slightly stronger rent growth in 2007 compared to 2006, at 5.7% versus 5.4% over the past 12 months.



Source: PPR

The best picks for rent growth in 2007 are New York office, San Jose office, and Seattle office, all with growth in excess of 10% expected during the year. There are a handful of markets where rents are expected to decline, including Detroit and Columbus office.

The recovery has lost its oomph, and 2007 will bring more moderate conditions in the commercial real estate markets. Look for fewer vacancy declines and still strong, although moderating, rent growth. Certainly, markets will differ greatly, and PPR can help you decide what markets are right for your strategy!

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