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Office Market Trends

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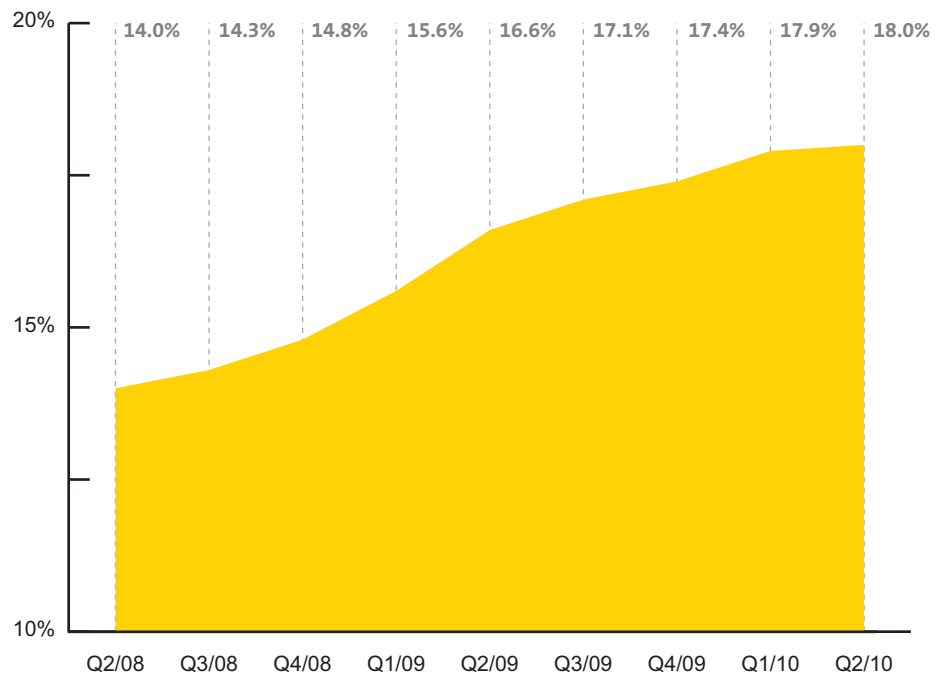
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Are We There Yet?

US OFFICE VACANCY RATE*



* All classes of space

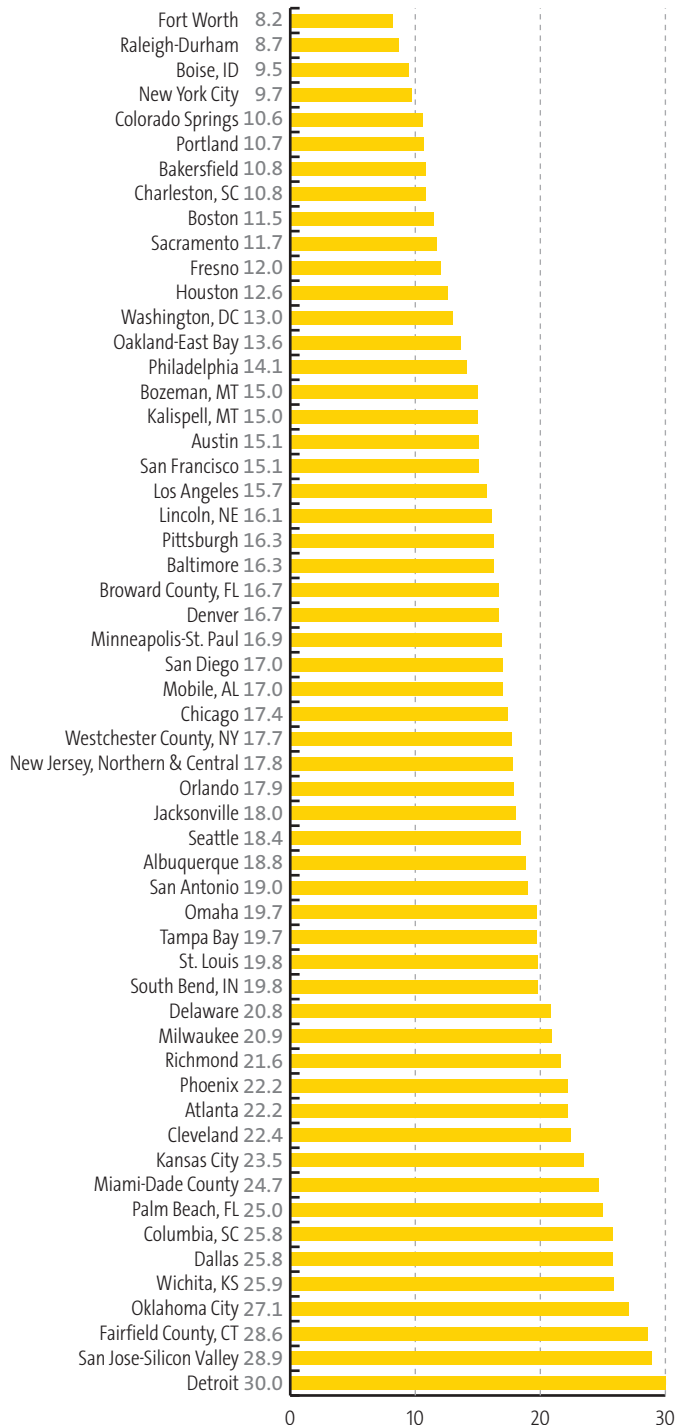
THE BOTTOM LINE

The U.S. office market pulled out of a two-year tailspin in the second quarter by absorbing 3.9 million square feet—low but thankfully positive. The vacancy rate continued to slide but only by 10 basis points, suggesting that the market is at or near the bottom. Another positive sign is that sublease space has fallen by 18 percent since peaking in last year's third quarter. Rental rates continued to slide although landlords in the best properties located in a handful of traditionally supply-constrained markets have been reducing concessions packages offered to tenants since late last year. The private sector added 593,000 net new payroll jobs in the first half of 2010—an unimpressive performance but enough to put a floor under demand for office space. The question is whether the market can begin building toward recovery even as the economy is expected to slow in the second half of the year.

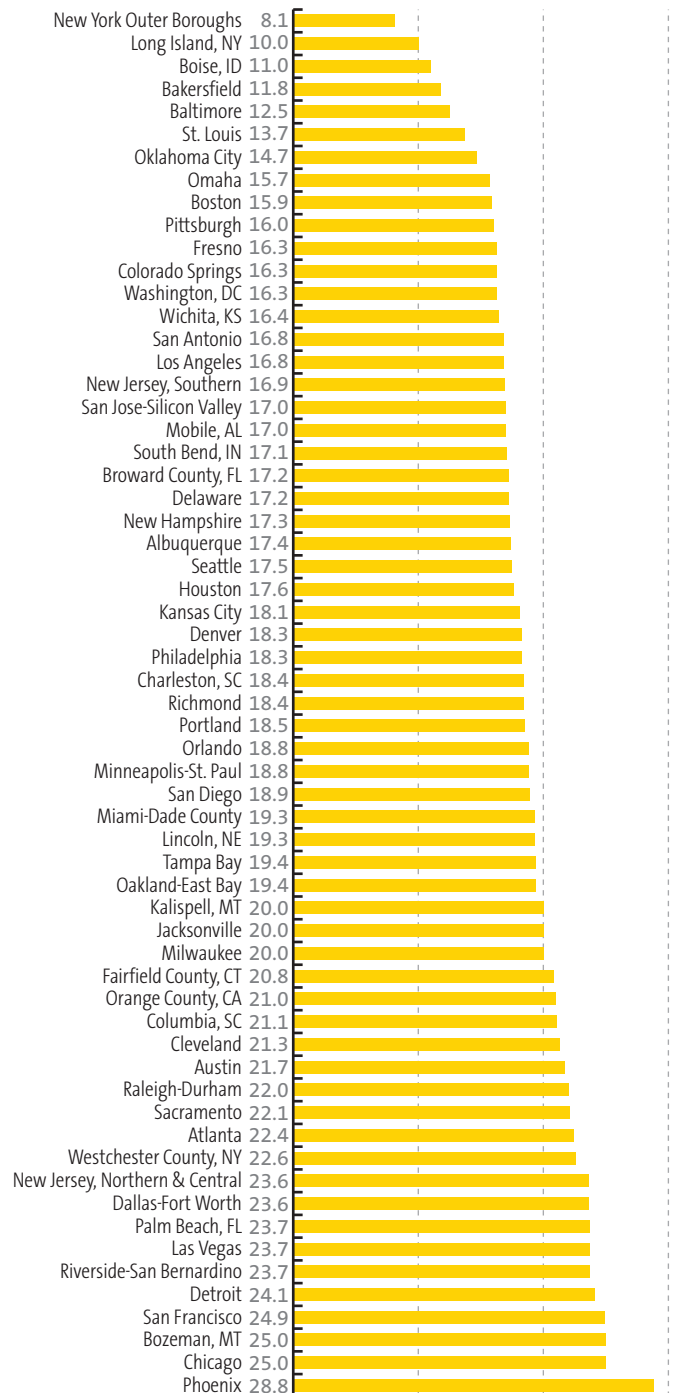
METRO VACANCY RATES

Note: Vacancy data refer to all classes of buildings with a minimum size threshold ranging from 5,000 to 30,000 square feet depending on local market conditions. The inventory includes single and multi-tenant properties and excludes owner-occupied properties and specialized properties such as medical office buildings. The data refer to direct and sublease space that is physically vacant at the end of the quarter.

CBD % Vacant

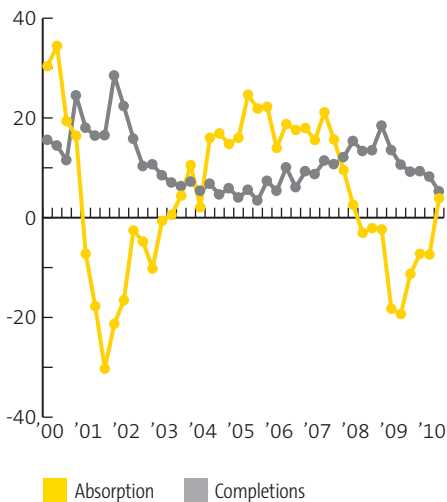


Suburban % Vacant

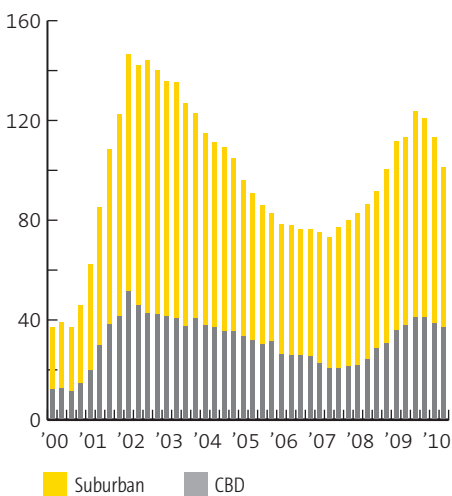


STATE OF THE MARKET

Absorption and Completions
in Millions of Square Feet



Available Sublease Space
in Millions of Square Feet



The vacancy rate crept higher in the second quarter but just barely, up a mere 10 basis points to end the period at 18.0 percent. This ties the all-time record peak in the 24-year history of Grubb & Ellis’ national office database. Previously the vacancy rate hit 18.0 percent in the fourth quarter of 1990 and again in the third quarter of 1991.

- Three of the four markets with the lowest vacancy rates are in the New York City area including **Manhattan** itself, the **Outer Boroughs** and **Long Island**, all with 10 percent or less of their inventories standing empty. The other major New York area markets, however, have among the highest vacancy rates in the U.S. including **Northern and Central New Jersey**, **Westchester County, N.Y.** and **Fairfield County, Conn.**, all posting rates above 20 percent. **Phoenix** and **Detroit** remain the softest markets in the U.S. with empty space accounting for more than 25 percent of their total inventories.
- Over the past four quarters, the vacancy rates in **Miami-Dade County** and **Columbia, S.C.** rose by more than 5 percentage points and for similar reasons. Two new towers opened in downtown Miami with a combined 1.3 million square feet of Class A space. While the two buildings are 30 to 40 percent leased, most of their tenants are relocating from older buildings, leaving behind significant holes to fill. In downtown Columbia, the National Bank of South Carolina moved into the new Tower at Main and Gervais, vacating 42,000 square feet existing space.

- At the other end of the continuum, the vacancy rate in **Charleston, S.C.** dropped by 4.6 percentage points over the last four quarters, the sharpest decline among all U.S. markets tracked by Grubb & Ellis. Charleston has seen an increase in leasing activity from companies doing business with the federal government including some that received stimulus funds.

Absorption turned positive in the second quarter following eight consecutive quarters in the red. The final tally was 3.9 million square feet—low but mercifully in the black.

- Of the 53 markets tracked by Grubb & Ellis, 28 or slightly more than half recorded positive absorption in the second quarter.
- Looking at absorption for the first half of the year, **Washington, D.C.** led all markets. Absorption in competitive properties, which exclude the city’s robust inventory of owner-occupied and government buildings, totaled nearly 2.9 million square feet. **Pittsburgh**, **Denver**, **Seattle** and **Baltimore** rounded out the top five.
- Measuring the rate of expansion, **Charleston** led all markets with first half office absorption equal to 4.2 percent of its existing inventory. Next in line were **Pittsburgh**, **Northern Indiana** and **San Antonio** with first half absorption of 1 to 2 percent of their total inventories. Pittsburgh and San Antonio benefitted from a handful of major lease deals while manufacturers in Northern Indiana saw an export-led rebound.

The second quarter results offer the best evidence yet that the market is turning the corner.

Developers completed 5.3 million square feet of new space in the second quarter, the sixth consecutive decline and the lowest rate of new deliveries in nearly five years. Space still in the construction pipeline fell for the eighth consecutive quarter to 20.4 million square feet. This is equivalent to 0.5 percent of the total inventory of office space, which is the lowest such ratio in nearly 15 years.

- **New York City** led all markets with more than 6 million square feet in the construction pipeline including One World Trade Center (Freedom Tower) with 2.6 million square feet and Four World Trade Center (150 Greenwich Street) with 2.3 million square feet as well as two large buildings in the Midtown West submarket. **Washington, D.C., Houston, Seattle and Miami** rounded out the top five markets for office space under construction.

The average Class A and B asking rental rates for space available at the end of the second quarter were \$31.24 and \$22.94 respectively. With market conditions remaining soft, it is far too early for rental rates to embark on a sustained rally.

- A handful of markets posted higher rental rates in the second quarter, such as **Miami** where the completion of new, unleased product pushed average asking rates higher even though landlords continued to offer generous concessions packages that kept effective rates under pressure.
- In other markets such as **Albuquerque**, asking rates slipped as landlords, reluctant to shell out cash for tenant improvements and other up-front costs, competed on asking rates instead of concessions.

Sublease space offered on the market fell for a third consecutive quarter to end the period at 101 million square feet, down more than 22 million square feet from the peak.

- To some extent it's the largest markets that have the largest inventories of available sublease space. **New York City**, for example, has 13.4 million square feet of available sublease space, about as much as all the vacant space in **San Diego** or **Minneapolis-St. Paul**.
- A different metric, the ratio of sublease space to the total inventory of office space, reveals the markets with a large relative share of sublease space—and, by extension, a large share of tenants who are downsizing. **Northern and Central New Jersey** tops the list at 4.0 percent followed by **New York City, Delaware, Seattle and Fairfield County, Conn.** Note that all five of these markets have a major presence in financial services, an industry that was hit hard by the recession.

FORECAST

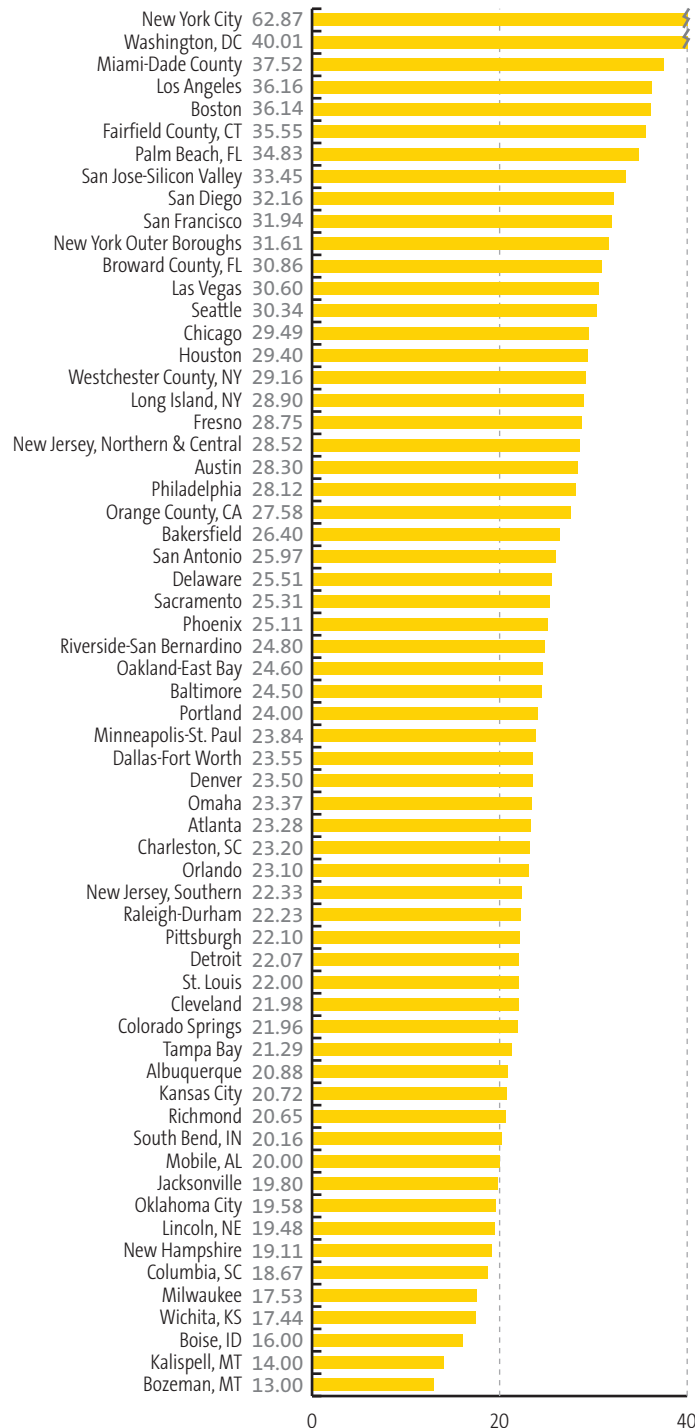
The market surprised on the upside this quarter with positive absorption and a vacancy rate that appears to be at or near its peak. Grubb & Ellis has been expecting vacancy rates to top out by the end of this year; the second-quarter results suggest this could happen even earlier. Asking rental rates, however, are likely to continue softening for a quarter or two after the vacancy rate levels off. Although the office market lags the labor market, which itself lags the broader economy, the fact that more office space was occupied at the end of the second quarter than at the beginning suggests that tenants have a measure of confidence about their revenue outlook and their ability to navigate a sluggish economy. The leasing market recovery is likely to be long and slow, but the second quarter results—positive absorption, nearly-level vacancy rate and declining sublease space—offer the best evidence yet that the market is turning the corner.

METRO RENTAL RATES

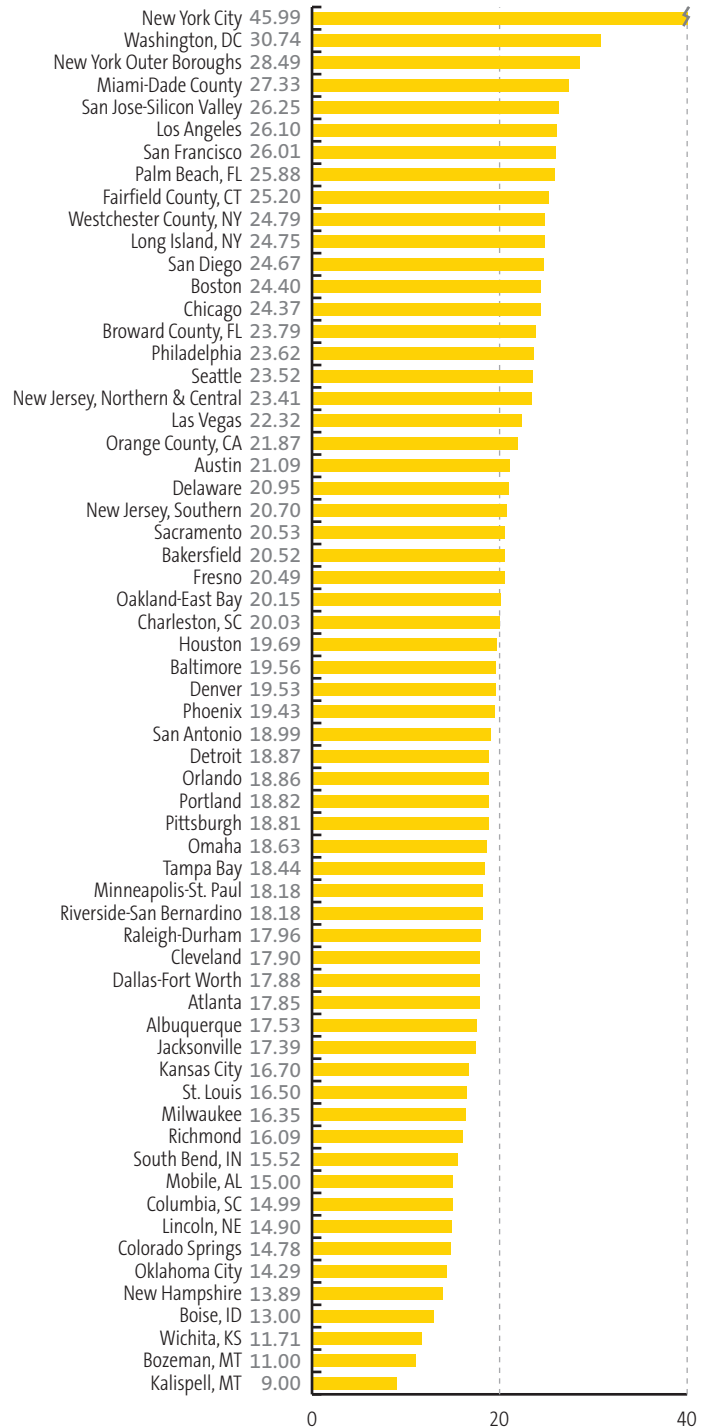
Note: Rental rate data refer to asking rates for space that is available on the market at the end of the quarter. Rates are per square foot, quoted on an annual, full service gross basis.

As of 2009-Q1, Grubb & Ellis adopted a new methodology to weight average office asking rental rates. When calculating the average for a market or submarket, we previously weighted the asking rate in each building by the size of the building. Now we weight the rate in each building by the amount of available space in the building. All historic rental rate data have been re-weighted using the new methodology, but the **rental rates in this table will not be comparable to the data in our reports published prior to 2009.**

Class A \$ Asking Rent



Class B \$ Asking Rent





NORTHERN CALIFORNIA/ PACIFIC NORTHWEST

Fresno: Negative absorption continues to be problematic. Owner-user sales are active...

Oakland-East Bay: More investors are ready to jump into the market, but the challenge is finding well-priced quality assets... **Portland:**

Most major industries are adding jobs, bolstering the view that the recovery, though slow, will be widespread across the local economy. The CBD appears to be stabilizing while the suburbs continue to struggle...

Sacramento: Positive net absorption and a lack of speculative completions pushed vacancy lower by 40 basis points... **San Francisco:** Leasing velocity improved in SOMA as technology companies competed for smaller, built-out suites. SOMA rents increased for the second straight quarter with smaller, creative spaces near Caltrain commanding the largest bumps in rents and tour activity...

San Jose-Silicon Valley: Tenants are going after premium Class A space, signing long-term leases to lock in favorable rates. The list includes Atheros, McAfee, Symantec, Netlogic and Nokia... **Seattle:** Amazon began moving into its newly completed campus in South Lake Union. Nintendo recently finished a new 280,000-square-foot headquarters in Redmond, and work continues on a new 165,000-square-foot headquarters for T-Mobile in the I-90 Corridor.



SOUTHERN CALIFORNIA/ PACIFIC SOUTHWEST

Bakersfield: Tenant activity is stagnant. Landlords are aggressively negotiating incentives for renewals... **Los Angeles:** Landlords are doing whatever it takes to renew their tenants... **Orange County:** Sublease space has dropped 39 percent to 2 million square feet since the third quarter of 2008. Demand remains spotty overall... **Riverside-San Bernardino:** Tenant activity is lackluster with the exception of a few sectors tied to the re-

gion's population gains in recent years: law, healthcare, for-profit education and engineering firms... **San Diego:** Second quarter absorption totalled nearly 252,000 square feet.



MOUNTAIN/SOUTHWEST

Albuquerque: Vacancy again moved upward to 17.7 percent, surpassing last quarter's record-setting level... **Boise:** Leasing activity has increased over the last few months, characterized by short-term leases at some of the lowest rates in years...

Bozeman: Declining rental rates have attracted some takers, triggering modest absorption... **Colorado Springs:** Vacancy edged lower, and absorption was positive for a second consecutive quarter... **Denver:** Absorption of nearly 800,000 square feet was driven by the delivery and occupancy at 1800 Larimer, the first phase of United Launch Alliance's Panorama campus move-in, and the GSA leasing binge... **Kalispell:** The market is generally stagnant with little hope of near-term improvement because of meager job growth... **Las Vegas:** The increase in investor activity this year signals confidence in the region... **Phoenix:** Second quarter absorption was low but positive, led by the Scottsdale submarket... **Reno:** The market continued to soften in the second quarter but at a slower rate.



TEXAS/GREAT PLAINS

Austin: The speculative construction pipeline is dormant, which will give the market a chance to regain its balance... **Dallas-Fort Worth:** Tenants are shuffling space. Tektronix left behind 241,000 square feet in Richardson to occupy 185,000 square feet in the West Plano/Frisco submarket, and AT&T vacated 234,000 square feet as part of its consolidation to the Dallas CBD... **Houston:** The Continental merger with United Airlines will leave Houston's CBD with more

available space in the future, but how much remains to be seen NRG Energy recently signed a 10-year deal for 230,000 square feet in the newly built Houston Pavilions project downtown... **Kansas City:** Uhlig, LLC expanded into 78,000 square feet in the former Kiewit headquarters in the Pine Ridge Business Park... **Lincoln:** Elite Professionals Home Care Company occupied the former Ritchie Brothers headquarters that stood vacant for two years... **Oklahoma City:** Chesapeake Energy recently leased a large block of space at the Valliance Tower and took another large space off the market at Enterprise Plaza... **Omaha:** Growth sectors include healthcare, insurance, energy, technology and education... **San Antonio:** Kohl's Department Stores Inc. recently inked a 102,000-square-foot lease in the Westover Hills Corporate Park. Allstate occupied 75,000 square feet at the Oaks of University Business Park... **St. Louis:** Landlords are finding it difficult to fund tenant improvements and commissions, preferring short-term as-is deals in anticipation of a market rebound in the next few years... **Wichita:** Cargill purchased a city block in downtown Wichita for a new research and development center. The facility will contain 75,000 square feet and will employ 65.



GREAT LAKES/ OHIO VALLEY

Chicago: 19 properties valued at \$1.3 billion have traded year-to-date, more than twice the total volume of 2009. The "best of the best" properties are doing well, and the "worst of the worst" are being sold at significant discounts, especially in the northwest suburbs. The pending sale of 300 N. LaSalle shows there is plenty of capital for low-risk investments... **Cleveland:** Key Bank will occupy over 200,000 square feet in downtown's Higbee Building, moving from an older property slated to become residential...

Detroit: Though it was offset by various new vacancies, the General Services Administration's lease of 18,000 square feet at Victor Park West was among the largest in the second quarter. GalaxE Solutions Inc., an IT solutions provider, announced it will occupy 28,000 square feet at 1001 Woodward and will add 500 jobs in the coming years... **Milwaukee:** A new anchored downtown office tower may be announced later this year; however, new speculative development is out of the picture for the foreseeable future... **Minneapolis:** U.S. Bancorp will move from St. Paul to 340,000 square feet at Meridian Crossings in Richfield... **South Bend:** Recent investment transactions include a 37,000-square-foot medical office building in Edison Lakes Corporate Park and a 13,000-square-foot government-occupied building near downtown South Bend.



NORTHEAST/ MID-ATLANTIC

Baltimore: Large tenants such as PNC, Miles & Stockbridge, eBay and PayPal are in the market looking for space, a sign that tenants are regaining confidence... **Boston:** Led by the life science, technology and education sectors, Massachusetts added jobs for the fourth straight year. Shire Pharmaceuticals breathed fresh air into a moribund sales market by purchasing four buildings encompassing 435,000 square feet at Lexington Technology Park for \$165 million... **Fairfield County:** Gartner, Inc.'s three lease renewals throughout Stamford accounted for nearly half of total leasing velocity for the quarter... **Long Island:** The market deteriorated further in the second quarter. Class A properties are experiencing the most stress... **New Hampshire:** While some tenants continue to seek smaller spaces, others are being lured into larger spaces by the variety of incentives on offer by landlords... **New Jersey, Northern & Central:** Nearly 235,200 square feet was ab-

sorbed in the Class A market as tenants upgraded their spaces at favorable rates. Sublease space trended consistently lower during the first half of 2010, suggesting that companies have completed the restructuring of their excess real estate holdings... **New Jersey, Southern:** Class A space is poised to lead the recovery but not until significant demand returns to the market... **New York City:** Demand for space this year is up 20 percent compared to mid-year 2009. Five transactions over 250,000 square feet were signed in the second quarter, including Proskauer Rose's 406,399-square-foot lease at 11 Times Square... **Philadelphia:** Chemical manufacturer Arkema plans to vacate 131,000 square feet in the CBD and consolidate its regional operation at its King of Prussia location... **Pittsburgh:** The explosive expansion of Westinghouse Electric Company as a result of its interests in nuclear energy and natural gas has led to several sizable transactions... **Washington, DC:** The U.S. Department of Veterans Affairs committed to 285,000 square feet in conventional office space, and the Securities and Exchange Commission signed a 10-year lease for 202,000 square feet, expanding for the second time in 12 months... **Westchester County:** Pepsi returned 424,370 square feet in Somers to the market, pushing availability up sharply... **Wilmington:** Basell North America exited over 60,000 square feet in the Northern New Castle County submarket while Red Clay School District consolidated operations into owned assets, leaving behind 35,000 square feet in Western New Castle County.

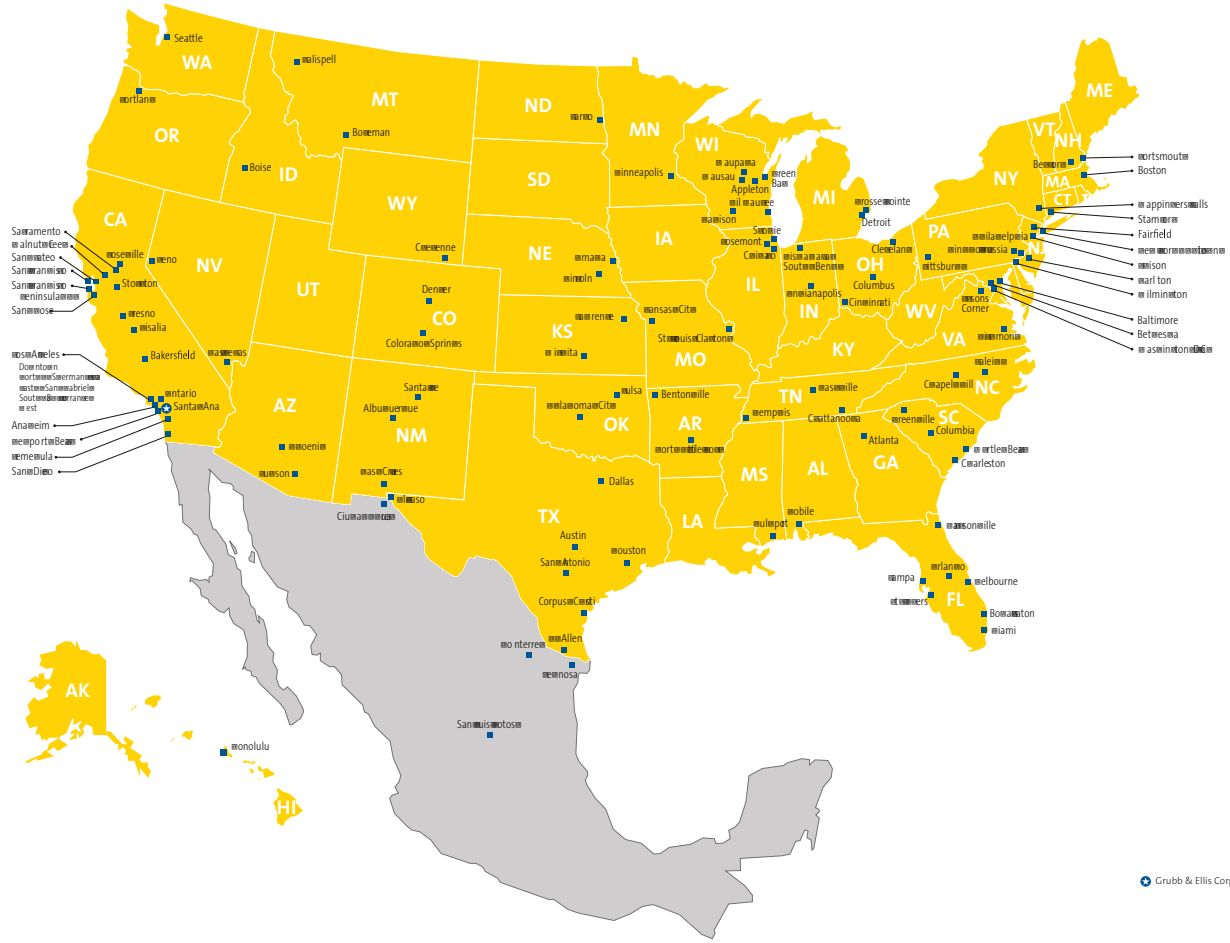


SOUTHEAST

Atlanta: Buckhead and Midtown, where developers recently delivered 1.6 million square feet of new space, will show the greatest gains in market performance over the next several months thanks to renewals and new deals recently executed...

Broward County: Wells Fargo recently took control of the 469,000-square-foot Las Olas Centre after initiating a foreclosure suit last year even though the property has been more than 90 percent leased... **Charleston:** Tenants are beginning to show a willingness to sign longer-term leases as they see the value in the aggressive incentives and lower rates. Several properties have traded hands below \$100 per square foot, which could put downward pressure on sale and lease prices in the coming quarters... **Columbia:** A consortium of tech companies announced plans to backfill space left by the McNair law firm in the Tower on Gervais... **Jacksonville:** Vacancy appears to have peaked, and the market has moved into recovery... **Miami:** Two new Class A towers in the CBD have obtained their temporary certificates of occupancy and welcomed their first tenants... **Mobile:** Activity has slowed further... **Nashville:** The market will continue to see slow but positive absorption for the remainder of 2010... **Orlando:** The CBD will lead the recovery... **Palm Beach County:** South University moved into a newly constructed 40,000-square-foot build-to-suit facility in the Royal Palm Beach/Wellington submarket... **Raleigh-Durham:** A handful of significant transactions occurred in the second quarter, but GlaxoSmithKline announced it will significantly reduce its Triangle office space later this year... **Richmond:** Armada Hoffer completed construction on a 200,000-square-foot headquarters building for Williams Mullen in the downtown submarket. The law firm moved out of 102,000 square feet in James Center Two and occupied 147,000 square feet in the new building... **Tampa:** Continuing to carry the banner for job recovery are the healthcare and private education sectors.

GRUBB & ELLIS OFFICE LOCATIONS



Office Market Trends United States Q2 2010