

MARKETBEAT

UNITED STATES OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



2Q09

ECONOMY

While the U.S. economy is still showing signs of weakness a year and a half after the recession began in December 2007, there are some tentative signs of stabilization. Contraction in real GDP continued to moderate; consumer spending is no longer in free-fall and companies are beginning to show less urgency in their cost-cutting. Credit market conditions are marginally better, though spreads remain elevated and banks continue to tighten lending standards as credit losses and non-performing loans mount. Likewise, the securitization market appears to be on the mend with loan applications under the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) continuing to decline. Such signs of an incipient recovery are fueling optimism in the stock market, and some real estate investment trusts have reacted by issuing new stock and bonds to shore up their capital reserves. Holding back any real recovery, however, is the job market. The U.S. unemployment rate jumped to a 26-year high of 9.5% in June, as the total number of job losses in this recession hit 6.5 million. Office-using employment also continued to fall in the second quarter but, as with the rest of leading economic indicators, the downward momentum is subsiding.

OVERVIEW

The U.S. office market continued to struggle under the weight of a slowing economy and rising inventory. The overall vacancy rate climbed another percentage point from the first quarter to a four-year high of 13.7% for Central Business Districts (CBDs) and 18.3% for suburban markets. Weak demand amid depressed labor market conditions is pushing up vacancies. Leasing activity for the first half is down roughly 50% from totals for the same period in the boom years of 2004-2007 and about 30% for the same period in the previous down cycle of 2001-2003. Overall absorption further shrank in the second quarter, slipping to its lowest level – at negative 53.2 million square feet (msf) – and even surpassing full-year declines posted in prior recessions. Much of the weakness was in markets suffering from the growing supply of sublease space: Manhattan NY, Chicago, Boston, and San Francisco. New supply, though slowing, is also continuing to put a strain on both CBDs and suburban markets. Another 12.3 msf came online this quarter and added 8.5 msf to vacant space.

The decline in rents has also accelerated in the second quarter. After peaking in the second quarter of 2008, the average asking rent was down 5.0% to 10.0% in both CBDs and suburban markets in the second quarter of this year. In hard-hit markets such as New York and Boston, the decline in effective rents was even steeper – at 25.0% to 30.0%. Sublease options are also being marketed at a greater discount. This quarter, sublease space was being offered on average 25.0% to 35.0% less than for comparable space available directly from landlords. By comparison, the rent differential was just 15.0% to 20.0% a year ago. Not surprisingly, the rising availability of attractively-priced options is driving some of the large transactions as the potential for savings has propelled some tenants to lock in at substantially lower rates. Raytheon, which inked the largest lease in the second quarter, is a case in point. Lease terms show that the government contractor secured rent in the range of 20.0% to 30.0% less than the peak rate in 2008. In addition, Raytheon secured government assistance to lease 600,000 square feet (sf) put up by technology firm AOL in Loudoun County, Virginia.

For all the disheartening news, the office market had its bright spots. First, the rate at which available space is being added back to hard-hit markets in New York, California and Florida slowed in the second quarter, suggesting that the bottom of the market may be starting to form. Second, the increase in sublease space noticeably waned this quarter. Only 6.5 msf was returned to the market, compared to nearly 8.0 msf in the first quarter. Further, sublease space, at 13.0% of available space, is not an overarching concern compared to previous downturns when it accounted for nearly 25.0% of availabilities. Lastly, investment activity is showing some signs of life, an encouraging but not a definitive sign of a real recovery. True, year-to-date sales volume of \$4.9 billion is just a fraction of its level of a year earlier (\$20.0 billion), but the modest pick-up in sales throughout the quarter does offer some positive news.

FORECAST

While recent signs of economic stabilization have been encouraging, Cushman & Wakefield expects office market conditions to remain challenging for the remainder of the year. The soaring federal budget deficit – which reached almost \$1.1 trillion by the end of June – clouds the economic outlook. Moreover, the jobs picture remains grim; the national unemployment rate is likely to rise into double-digits through next year. Though no new anti-recession measures are in the works, the \$787 billion economic stimulus package will kick in over the next 6-12 months and thus help mitigate the impact of predicted job losses. Consequently, office market conditions for the balance of the year will be much like the first half: weak tenant demand, higher vacancies, lower rents and property values. Moreover, the process of getting inventories back to more “normal” levels will take 18-24 months, thus rents and values are expected to remain under pressure through 2011.

ECONOMIC INDICATORS

National	2008	2009F	2010F
GDP Growth	1.1%	-2.7%	1.3%
CPI Growth	3.8%	-0.6%	1.6%
Unemployment	5.8%	9.3%	10.0%
Employment Growth	-0.4%	-3.7%	-1.0%

Source: MoodysEconomy.com

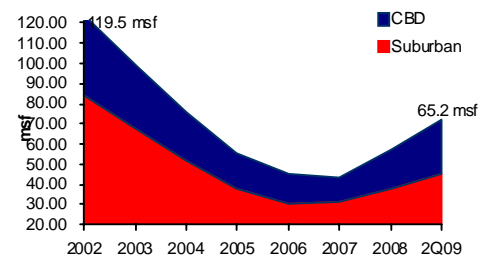
MARKET FORECAST

LEASING ACTIVITY will remain slow through the rest of 2009. Though economic stabilization is now widely expected in the second half, it will be tenuous and it will hardly make a dent in the unemployment rate and thus, unlikely to trigger a demand turnaround anytime soon. ↓

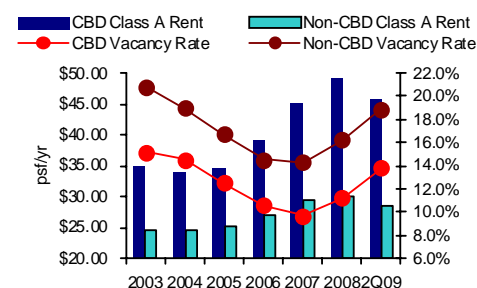
CONSTRUCTION completions are set to drop – from 23.4 msf for the balance of 2009 to 18.1 msf in 2010 and 4.4 msf in 2011. Rising vacancy rates, combined with a fragile economy and still restrictive lending standards, will continue to hold back any incentives to build office properties in the near term. ↓

RENTAL RATES will continue to slide but could trough in some markets next year. Hefty incentive packages will remain a staple in the leasing process, so owners will continue to incur higher leasing costs particularly for challenged properties. ↓

SUBLEASE AVAILABILITY



RENTAL VS. VACANCY RATES



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Market	Inventory		Overall Vacancy Rate		Sublease Vacant Space		Class A Direct Rental Rate*		YTD Leasing Activity		YTD Const. Completions	
	CBD	Non-CBD	CBD	Non-CBD	CBD	Non-CBD	CBD	Non-CBD	CBD	Non-CBD	CBD	Non-CBD
Atlanta, GA	15,567,139	123,849,278	22.1%	17.5%	425,726	2,387,702	\$21.23	\$25.16	600,983	2,704,482	0	825,820
Austin, TX**	8,734,763	34,050,046	14.2%	23.1%	165,961	1,069,719	\$38.14	\$27.24	****	****	0	390,574
Baltimore, MD	14,586,107	52,124,304	12.8%	14.9%	268,273	572,841	\$25.61	\$24.83	213,466	809,311	0	371,173
Bellevue, WA	8,161,324	22,842,105	12.7%	15.7%	231,682	633,987	\$38.11	\$31.17	188,827	480,069	748,000	117,000
Binghamton, NY**	2,281,299	2,538,458	19.0%	7.9%	****	19,500	\$11.54	\$15.48	33,008	4,915	****	****
Birmingham, AL**	5,165,764	12,084,643	9.8%	13.1%	27,710	613,632	\$21.10	\$21.22	****	****	0	0
Boston, MA	58,771,928	119,278,967	11.7%	19.4%	1,623,479	4,256,692	\$49.39	\$28.05	679,768	3,207,298	0	440,726
Buffalo, NY**	10,279,834	9,907,738	14.7%	8.9%	29,510	188,387	\$21.09	\$22.15	82,828	81,191	0	0
Central NJ	****	73,962,861	****	20.7%	****	1,956,908	****	\$24.82	****	1,146,806	****	307,000
Charlotte, NC**	14,080,021	30,155,331	3.2%	18.6%	****	****	****	****	****	1,146,806	****	0
Chicago, IL	118,769,158	95,502,990	15.4%	23.8%	2,614,325	2,800,099	\$38.45	\$26.67	2,206,295	1,913,106	1,277,368	36,392
Cleveland, OH**	33,593,873	101,813,925	14.6%	10.3%	137,543	393,509	\$20.22	\$20.79	169,445	754,638	****	****
Columbus, OH**	10,241,528	21,849,075	15.9%	16.5%	240,106	263,274	\$19.77	\$14.95	101,448	418,780	****	****
Contra Costa, CA	****	31,752,529	****	18.8%	****	1,749,996	****	\$26.64	****	1,139,256	****	0
Dallas, TX	28,997,589	147,525,286	27.1%	22.0%	195,901	2,135,593	\$25.11	\$26.22	348,129	3,827,868	0	1,630,377
Denver, CO	25,789,200	72,224,216	15.5%	17.1%	553,279	858,697	\$31.72	\$22.85	549,331	2,613,168	474,884	241,109
Detroit, MI**	24,706,410	68,269,980	18.2%	27.3%	65,629	1,455,172	\$23.45	\$20.47	213,262	1,080,742	55,966	20,872
Downtown NY	87,656,973	****	8.7%	****	2,002,234	****	\$52.79	****	1,402,913	****	0	****
Fairfield County, CT	6,741,182	33,540,247	19.8%	16.2%	361,482	1,134,657	\$48.36	\$33.89	85,453	684,092	0	158,285
Fredericksburg, VA**	****	6,878,161	****	13.1%	****	****	****	\$23.50	****	122,235	****	169,000
Ft. Lauderdale, FL	5,078,565	25,136,612	20.3%	16.9%	90,066	510,718	\$33.67	\$31.32	107,486	550,219	0	50,000
Hampton Roads, VA**	4,970,526	38,922,199	6.4%	9.6%	11,306	132,385	\$21.62	\$21.40	117,720	625,867	0	407,945
Hartford, CT	7,976,110	17,660,145	22.0%	15.5%	45,066	169,387	\$23.58	\$20.67	455,661	569,376	0	0
Houston, TX	36,055,436	129,127,666	12.8%	17.8%	456,371	1,654,202	\$39.92	\$30.59	439,520	3,623,164	0	2,649,209
Indianapolis, IN**	10,640,548	24,323,579	16.0%	23.4%	81,483	381,556	\$19.63	\$19.31	99,226	478,281	0	0
Inland Empire CA	****	16,771,478	****	25.8%	****	161,607	****	\$28.41	****	413,599	****	474,860
Jacksonville, FL	7,458,474	17,368,066	21.2%	23.7%	58,240	261,380	\$21.18	\$20.60	51,474	665,969	0	18,000
Kansas City, MO**	12,649,547	32,943,266	19.5%	17.6%	118,485	126,217	\$18.55	\$22.17	138,047	494,152	0	485,717
Long Island, NY	****	32,064,522	****	14.9%	****	1,301,672	****	****	****	580,219	****	260,000
Los Angeles-Central, CA	28,396,841	19,079,862	16.0%	10.7%	534,081	109,126	\$37.43	\$30.25	557,482	78,423	0	0
Los Angeles-North, CA	****	30,765,047	****	17.8%	****	1,042,276	****	\$32.10	****	697,741	****	0
Los Angeles-South, CA	****	30,669,349	****	18.0%	****	248,037	****	\$27.56	****	722,875	****	168,052
Los Angeles-Tri-Cities, CA	****	22,574,653	****	15.2%	****	238,531	****	\$35.29	****	311,152	****	817,401
Los Angeles-West, CA	****	49,360,222	****	13.7%	****	1,737,427	****	\$48.63	****	996,184	****	466,368
Louisville, KY**	9,043,023	10,660,264	12.3%	18.7%	80,002	22,000	\$20.21	\$18.61	20,896	240,774	0	0
Memphis, TN**	5,471,048	21,313,524	15.3%	14.7%	45,314	202,329	\$16.62	\$21.53	33,154	294,049	0	0
Miami, FL	12,387,465	34,537,928	16.1%	16.1%	310,686	317,514	\$43.77	\$34.41	371,620	1,399,323	0	673,888
Midtown South NY	64,504,640	****	8.7%	****	1,291,595	****	\$56.41	****	690,908	****	****	0
Midtown NY	240,433,464	****	11.7%	****	8,130,370	****	\$76.99	****	4,289,864	****	350,000	0
Milwaukee, WI**	13,501,586	24,016,481	17.9%	12.8%	****	****	\$19.41	\$15.68	238,246	321,359	0	50,421
Minneapolis, MN	33,264,136	43,251,069	17.5%	18.1%	354,655	920,521	\$28.35	\$27.78	****	****	0	437,200
Nashville, TN**	11,424,749	47,862,382	13.8%	9.9%	478,806	449,582	\$21.10	\$22.24	64,564	663,248	75,000	331,865
New Haven, CT	2,867,835	7,263,993	10.0%	14.4%	6,700	40,087	\$30.38	\$24.14	23,362	99,851	0	0
Northern NJ	****	106,397,930	****	17.0%	****	3,309,702	****	\$29.39	****	1,906,375	****	363,688
Northern VA	****	128,044,655	****	14.5%	****	2,572,512	****	\$33.22	****	3,537,020	****	450,670
Oakland, CA	12,998,655	13,701,052	15.8%	17.4%	118,051	110,569	\$31.17	\$29.06	265,396	399,192	110,000	28,000
Orange County, CA	35,921,330	45,179,561	21.3%	16.8%	892,050	664,275	\$32.33	\$29.33	1,166,722	1,465,155	0	0
Orlando, FL	7,390,200	30,261,855	17.6%	19.5%	179,132	685,098	\$26.90	\$23.35	188,832	1,011,109	0	290,774
Palm Beach, FL	3,005,788	22,837,901	20.9%	23.4%	76,381	298,398	\$44.78	\$33.87	80,861	545,314	0	133,550
Philadelphia, PA	42,111,555	86,968,180	11.6%	16.8%	641,869	1,547,455	\$24.63	\$23.75	275,278	1,244,182	0	214,679
Phoenix, AZ	15,575,902	58,159,859	17.4%	26.3%	193,563	1,282,959	\$28.84	\$27.01	224,582	1,485,429	0	806,249
Pittsburgh, PA**	26,596,265	47,486,259	12.9%	12.0%	257,211	447,989	\$22.42	\$20.83	375,757	1,585,637	0	257,496
Portland, OR	20,302,332	21,203,839	10.9%	18.7%	319,899	437,720	\$26.20	\$23.59	308,867	575,667	66,000	227,752
Raleigh/Durham, NC**	5,560,306	34,393,373	****	****	****	****	\$23.25	\$21.05	****	****	****	****
Richmond, VA**	11,006,199	44,342,101	13.1%	9.0%	305,590	412,572	\$22.75	\$19.31	171,556	483,251	0	112,479
Roanoke, VA**	3,391,804	4,908,667	9.1%	10.4%	****	2,975	\$19.61	\$16.92	18,681	49,884	0	0
Rochester, NY**	6,234,178	7,049,449	22.2%	12.1%	****	****	\$21.00	\$19.25	****	****	****	****
Salt Lake City, UT**	6,682,590	23,836,185	13.6%	15.7%	152,505	342,878	\$26.34	\$22.95	81,269	718,424	0	191,890
San Antonio, TX**	5,349,820	21,071,751	27.1%	19.0%	347,617	349,555	\$21.08	\$24.44	86,474	529,219	52,372	189,132
San Diego, CA	10,960,738	60,773,784	14.2%	17.4%	34,515	758,172	\$33.24	\$34.32	298,052	1,769,222	0	1,125,601
San Francisco Peninsula, CA	****	34,348,974	****	17.3%	****	1,307,806	****	\$34.74	****	917,743	****	126,018
San Francisco, CA	48,039,287	24,476,662	13.8%	18.5%	1,556,914	635,566	\$42.26	\$33.31	964,591	193,580	0	0
San Gabriel Valley CA	****	11,381,062	****	17.3%	****	329,987	****	\$31.07	****	209,769	****	0
San Juan, PR**	6,006,667	9,774,348	10.7%	15.6%	****	****	\$20.62	\$18.35	****	****	****	****
Seattle, WA	38,154,010	8,712,854	14.7%	19.1%	974,063	107,700	\$33.23	\$22.44	543,571	232,931	492,000	0
Silicon Valley, CA	6,445,711	36,639,869	22.4%	22.9%	59,403	1,277,507	\$40.82	\$36.06	141,351	1,124,948	300,000	1,180,540
Southern NH	****	12,279,124	****	19.6%	****	419,833	****	\$17.53	****	214,053	****	0
St. Louis, MO**	12,987,327	36,607,260	24.3%	12.7%	38,416	503,698	\$19.39	\$23.84	154,584	916,963	0	309,624
St. Petersburg/Clearwater, FL	****	12,895,063	****	22.7%	****	111,633	****	\$22.65	****	375,084	****	0
Suburban MD	****	56,248,833	****	16.5%	****	1,120,435	****	\$32.59	****	930,442	****	797,725
Syracuse, NY**	6,899,398	10,110,062	24.7%	13.8%	106,476	42,364	\$17.03	\$17.35	88,222	21,033	28,935	0
Tampa, FL	6,371,302	25,025,531	19.7%	18.4%	66,917	398,862	\$23.80	\$25.99	106,892	871,056	0	317,611
Tucson, AZ**	3,530,758	18,059,997	8.0%	12.8%	18,395	87,002	\$23.25	\$23.99	12,869	341,017	0	175,164
Washington, D.C.	99,075,420	****	11.7%	****	1,494,442	****	\$57.63	****	1,283,058	****	2,689,170	****
Westchester County, NY	6,239,527	22,132,760	21.5%	16.1%	405,099	521,134	\$32.32	\$30.96	60,016	352,694	0	0
TOTAL - ALL MARKETS	1,427,085,162	2,811,131,247	13.9%	17.3%	29,174,574	52,603,275	\$41.94	\$26.84	21,471,867	58,820,175	6,719,695	19,932,896
TOTAL - C&W MARKETS	1,156,055,331	2,065,902,743	13.7%	18.3%	26,566,509	45,096,980	\$45.88	\$28.62	19,170,611	48,594,516	6,507,422	16,205,717

*Full-service rental rates (psf/yr)

**Alliance Market

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*Market terms & definitions based on BOMA and NAIOP standards.

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