

MARKETBEAT

UNITED STATES OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



3Q08

ECONOMY

The U.S. economy continued to contract through the third quarter of 2008, with weakness maintaining its grip on the housing and financial sectors and spilling over into the broader economy. Job losses deepened in the third quarter; payrolls fell by another 299,000 jobs. A total of 760,000 jobs have been lost since the end of 2007. Office-using industries accounted for over half of the employment decline, reflecting a worsening trend in professional services (-297,000) and financial services (-68,000) that is spreading to other sectors such as information (-38,000). The downturn in labor markets is sapping consumer incomes as wage gains have barely kept up with increases in consumer prices. This, combined with diminishing credit availability, the continuing decline in home values, losses in the stock market, and rising anxiety, is continuing to drive down consumer spending. Meanwhile, businesses are stepping up their efforts to rein in spending. Another sign of weakness is exports, which have begun to lose steam. The bright spots amidst these faltering economic conditions are falling oil prices, combined with receding inflation risks.

OVERVIEW

The U.S. office market, reflecting general economic weakening, inevitably continued to lose momentum in the third quarter. The overall vacancy rate rose for a third consecutive quarter, posting 10.6% in Central Business Districts (CBD) and 15.6% in suburban markets. The impact of the year-long financial crisis has clearly caused demand to wane. Thus far, the financial and insurance sectors have returned nearly 7.0 million square feet (msf) to CBDs and 16.0 msf to suburban markets so that sublease vacancy rates continued their uptrend, albeit still relatively low at 1.5% for CBDs and 1.7% for suburban markets. In the CBDs, the current turmoil continued to take a sizable toll on traditional financial centers such as Manhattan, San Francisco and Orange County, where over half of the sublease options are located. Even traditional CBD bulwarks such as Seattle and Washington D.C. have grown increasingly vulnerable, as leasing activity for both markets eased to its slowest pace in over a decade. The retrenchment in suburban markets has been more broad-based as both financial and insurance sectors shed space in nearly all markets. As a result, overall absorption continued to slide through the third quarter, dipping to negative 7.8 msf in CBDs and negative 12.8 msf in suburban markets.

New construction is also partly responsible for rising vacancies this year. An additional 12.0 msf came online in both CBDs and suburban markets in the third quarter, boosting year-to-date deliveries to 36.4 msf. Notably, over half of these projects were available upon delivery, and added 19.2 msf to vacant space. One silver lining is that the decline in construction starts in the third quarter – the second steep drop in a row – should help whittle away current office availabilities. After peaking at 10.0 msf in the first quarter this year, starts totaled only 3.5 msf in the third quarter. Signs point to further declines in the fourth quarter through 2009 as demand remains soft and credit tight.

Asking rental rates have generally remained steady across most CBDs and suburban markets. However, significant transactions completed this year have shown that owners are willing to lower rates and also offer other enticements to lease space. Meanwhile, investment sales activity, which had already taken a beating over the past year, worsened during the third quarter. A dysfunctional debt market, eroding fundamentals, and uncertainty in property pricing have combined to cause sales of significant properties to plummet to their lowest quarterly volume recorded since the second quarter of 2004: \$8.3 billion for CBDs and \$5.6 billion for suburban markets. Year-to-date, the volume is down over 60% from the same period in 2007 – at \$23.9 billion for CBDs and \$26.2 billion for suburban markets. Activity in the fourth quarter is expected to remain dormant as investors wait for strains in the credit markets and overall U.S. economy to settle.

FORECAST

Against the backdrop of a potentially lengthy economic downturn, tougher times are ahead for the U.S. office market. The government has taken extraordinary measures in recent months to stem the credit crisis – and is expected to take further action to keep the economy from becoming too weak. While these efforts may provide some relief, it may take some time before they have a major impact on the economy. As such, we believe that the stress from this unprecedented financial instability is sure to continue, with financial and insurance sectors, and even law firms, expected to give back at least an additional 20.0 msf over the next 6 to 12 months. Hence, we expect overall vacancies in both CBDs and suburban markets to rise again next year before stabilizing possibly in 2010.

ECONOMIC INDICATORS

National	2006	2007	2008F
GDP Growth	2.8%	2.0%	1.9%
CPI Growth	3.2%	2.9%	4.4%
Unemployment	4.6%	4.6%	5.6%
Employment Growth	1.8%	1.1%	0.0%

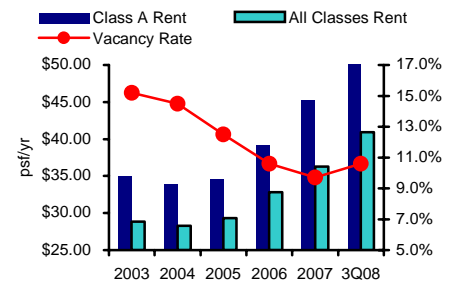
MARKET FORECAST

LEASING ACTIVITY will remain constrained through next year, due to broadening job cuts. Tenants will be less likely to expand, and renew whenever possible, as they attempt to curtail outlays amidst a reeling economy. ↓

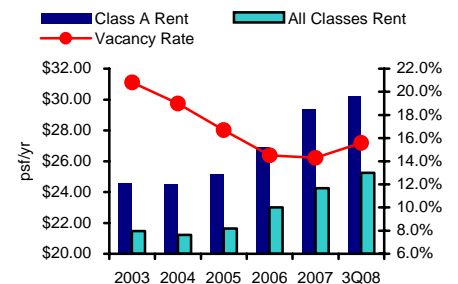
CONSTRUCTION completions are set to reach their highest level since 2002, climbing to 56.0 msf at year-end. However, expect completions to slow drastically to 42.8 msf in 2009 and 13.4 msf in 2010. ↓

RENTAL RATE growth is likely to fall through 2009, and the trend could last even longer depending on the speed of the recovery. Most owners will continue to lure and keep tenants with incentives and/or offer rent abatements. ↓

CBD RENTAL VS. VACANCY RATES



NON-CBD RENTAL VS. VACANCY RATES



MARKETBEAT

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Market	Inventory		Overall Vacancy Rate		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	
Atlanta, GA	15,567,139	122,099,597	21.1%	15.4%	\$21.20	\$25.07	856,216	6,057,875	0	1,199,433	
Austin, TX**	8,562,886	31,893,028	15.0%	18.3%	\$38.65	\$28.75	****	****	75,000	2,500,888	
Baltimore, MD	14,548,401	51,460,011	13.5%	15.3%	\$25.32	\$25.08	163,913	1,119,550	0	1,921,452	
Bellevue, WA	7,318,836	22,444,291	9.5%	12.8%	\$39.91	\$32.48	926,987	1,505,071	977,935	807,422	
Birmingham, AL**	5,165,764	12,104,133	8.9%	6.5%	\$20.19	\$21.55	****	****	****	****	
Boston, MA	58,535,840	118,667,081	7.0%	16.0%	\$66.45	\$33.04	3,308,588	6,350,203	0	1,343,702	
Buffalo, NY**	10,279,834	9,854,557	14.8%	8.8%	\$24.29	\$18.75	155,664	77,096	0	0	
Central NJ	****	73,371,100	****	19.8%	****	\$30.26	****	****	2,844,873	****	248,000
Charlotte, NC**	14,080,021	29,306,931	2.1%	16.0%	****	****	****	****	0	974,630	
Chicago, IL	117,852,873	95,883,841	11.7%	20.3%	\$37.23	\$25.76	5,680,398	4,986,627	439,436	589,572	
Cincinnati, OH**	15,229,390	17,891,088	19.8%	23.0%	\$14.77	\$16.87	226,746	299,615	0	267,162	
Cleveland, OH**	33,436,795	95,922,541	17.8%	13.9%	\$18.20	\$19.39	904,126	1,509,776	****	****	
Columbus, OH**	10,182,842	21,256,062	12.9%	17.7%	\$20.38	\$17.47	405,343	1,156,966	40,760	104,000	
Contra Costa, CA	****	31,524,431	****	15.7%	****	\$29.35	****	2,227,311	****	9,685	
Dallas, TX	28,997,589	144,209,664	26.5%	21.6%	\$24.45	\$25.51	2,688,631	9,048,958	0	1,802,110	
Denver, CO	24,797,212	70,548,535	11.2%	14.2%	\$32.98	\$23.85	2,013,312	5,736,651	167,760	404,661	
Detroit, MI**	24,387,463	64,264,076	22.7%	24.5%	\$23.02	\$20.48	****	****	0	0	
Downtown, NY	88,990,651	****	7.3%	****	\$63.51	****	2,903,994	****	0	****	
Fairfield County, CT	6,741,182	32,908,383	15.6%	13.6%	\$48.19	\$33.44	370,066	1,025,804	0	161,222	
Fort Myers/Naples FL	****	16,974,292	****	16.1%	****	\$27.75	****	707,119	****	793,212	
Fredericksburg, VA**	****	6,569,933	****	13.8%	****	\$23.77	****	380,708	****	9,392	
Ft. Lauderdale, FL	5,032,942	24,429,358	18.8%	13.3%	\$34.29	\$31.36	283,175	1,702,340	66,917	303,587	
Hampton Roads, VA**	5,031,462	36,717,963	7.9%	8.1%	\$21.45	\$20.90	60,231	896,681	0	414,513	
Hartford, CT	7,971,717	17,471,746	17.1%	15.5%	\$22.89	\$21.26	222,100	785,875	0	48,684	
Houston, TX	35,755,493	124,136,777	11.4%	13.7%	\$38.79	\$29.15	1,972,394	8,749,408	0	2,706,235	
Indianapolis, IN**	11,135,940	24,056,979	13.6%	20.9%	\$19.48	\$19.50	427,351	1,095,719	0	516,746	
Inland Empire CA	****	15,977,177	****	22.7%	****	\$27.92	****	769,723	****	1,309,158	
Kansas City, MO**	15,323,940	52,687,777	14.0%	14.6%	\$18.85	\$22.86	344,253	1,503,352	0	753,368	
Las Vegas, NV**	3,508,929	44,573,150	6.1%	17.3%	\$36.96	\$31.08	22,850	3,001,668	0	2,605,299	
Long Island, NY	****	31,355,642	****	12.0%	****	\$35.46	****	1,081,591	****	0	
Los Angeles, CA	29,018,909	30,199,543	13.7%	11.0%	\$39.46	\$33.44	1,313,613	882,637	0	26,001	
Los Angeles-North, CA	****	30,008,281	****	13.3%	****	\$33.17	****	1,242,595	****	622,384	
Los Angeles-South, CA	****	30,443,742	****	15.0%	****	\$28.61	****	2,829,076	****	0	
Los Angeles-Tri-Cities, CA	****	21,692,193	****	8.7%	****	\$38.07	****	1,147,392	****	0	
Los Angeles-West, CA	****	48,295,140	****	8.7%	****	\$51.12	****	2,982,330	****	66,899	
Louisville, KY**	9,051,547	10,604,659	13.2%	15.7%	\$20.68	\$19.34	113,813	402,059	0	123,417	
Memphis, TN**	5,529,532	20,806,299	16.0%	14.2%	\$16.72	\$22.72	100,946	379,133	0	0	
Miami, FL	12,079,331	32,686,379	13.3%	12.8%	\$44.09	\$35.70	853,062	1,542,654	20,400	489,703	
Midtown South, NY	64,744,011	****	6.0%	****	\$63.63	****	1,956,019	****	0	****	
Midtown, NY	241,251,486	****	7.8%	****	\$95.62	****	10,850,889	****	2,100,000	****	
Minneapolis, MN	33,264,136	42,563,869	16.6%	16.5%	\$27.93	\$27.85	****	****	0	822,986	
Nashville, TN**	10,501,776	41,939,226	13.1%	9.1%	\$20.50	\$22.00	236,377	1,312,758	0	1,263,027	
New Haven, CT	2,867,835	7,160,953	8.0%	17.7%	\$27.71	\$23.98	64,481	237,768	0	16,000	
Northern NJ	****	104,863,620	****	16.4%	****	\$30.00	****	3,965,010	****	316,000	
Northern VA	****	125,768,842	****	12.5%	****	\$34.99	****	5,876,241	****	3,554,859	
Oakland, CA	13,338,661	13,132,539	14.2%	17.0%	\$32.77	\$33.39	595,619	713,986	16,000	0	
Orange County, CA	35,882,324	44,866,277	17.4%	15.3%	\$36.71	\$35.08	2,755,200	2,683,327	380,488	724,084	
Orlando, FL	7,318,380	29,461,839	16.2%	15.7%	\$29.22	\$24.42	296,706	1,616,974	152,000	636,816	
Palm Beach, FL	2,944,142	21,550,590	18.8%	18.5%	\$47.03	\$34.24	82,338	1,168,073	296,000	572,787	
Philadelphia, PA	41,914,928	87,000,020	10.0%	15.2%	\$28.16	\$26.60	1,586,022	3,888,715	0	365,499	
Phoenix, AZ	15,884,372	55,849,209	13.7%	20.2%	\$29.76	\$28.14	851,049	4,341,455	94,244	3,101,544	
Pittsburgh, PA**	27,849,080	52,841,678	13.0%	12.2%	\$23.09	\$20.14	1,392,124	1,736,237	158,000	438,665	
Portland, OR	20,247,137	20,678,598	8.5%	15.3%	\$26.61	\$24.46	1,049,821	1,139,173	117,000	157,635	
Raleigh/Durham, NC**	5,132,706	33,070,808	****	****	\$22.20	\$20.92	****	****	****	****	
Richmond, VA**	10,884,719	43,382,227	13.5%	7.8%	\$22.63	\$19.15	100,370	1,038,067	76,600	514,462	
Rochester, NY**	6,441,275	7,049,449	21.3%	11.7%	\$21.00	\$19.25	****	****	****	****	
Salt Lake City, UT**	6,618,261	23,213,663	11.8%	13.4%	\$26.71	\$22.97	214,070	1,099,155	0	261,735	
San Diego, CA	10,962,353	59,285,049	14.2%	15.7%	\$35.25	\$37.93	452,959	3,531,461	0	1,255,587	
San Francisco Peninsula, CA	****	33,468,023	****	12.3%	****	\$45.27	****	1,925,103	****	211,320	
San Francisco, CA	47,533,498	23,448,827	9.9%	11.5%	\$52.76	\$40.41	2,648,189	999,693	321,545	273,272	
San Juan, PR**	6,006,667	9,689,333	11.1%	14.7%	\$20.00	\$20.00	****	****	****	****	
Seattle, WA	37,574,182	8,685,791	10.0%	17.2%	\$39.85	\$23.36	1,544,694	434,734	517,558	17,464	
Silicon Valley, CA	6,122,587	35,518,094	16.4%	16.2%	\$35.70	\$36.98	371,009	1,918,876	0	1,480,112	
Southern NH	****	11,876,431	****	18.9%	****	\$19.30	****	541,318	****	0	
St. Louis, MO**	14,314,348	37,178,216	18.1%	10.4%	\$19.12	\$24.26	502,037	2,082,028	0	247,584	
St. Petersburg/Clearwater, FL	****	12,745,967	****	19.1%	****	\$23.33	****	506,157	****	0	
Suburban MD	****	55,545,296	****	12.7%	****	\$32.93	****	2,355,336	****	724,106	
Syracuse, NY**	7,784,822	9,933,684	23.5%	13.6%	\$16.39	\$17.86	203,091	497,431	0	14,000	
Tampa, FL	6,397,980	23,861,109	17.9%	14.1%	\$24.40	\$25.95	362,985	1,447,624	0	424,749	
Tucson, AZ**	2,744,022	18,393,874	4.9%	9.2%	\$23.36	\$23.42	24,836	343,157	0	215,979	
Washington, DC	95,746,226	****	7.9%	****	\$54.74	****	4,136,737	****	1,206,978	****	
Westchester County, NY	6,239,527	22,132,760	13.1%	16.4%	\$34.66	\$31.38	239,046	724,329	0	0	
TOTAL - ALL MARKETS	1,412,625,901	2,781,452,241	11.4%	15.1%	\$44.05	\$27.75	58,834,440	124,152,622	7,224,621	40,732,809	
TOTAL - C&W MARKETS	1,143,441,880	2,026,250,907	10.6%	15.6%	\$50.12	\$30.22	53,400,212	105,341,016	6,874,261	29,507,942	

*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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