Office Market Trends Q4 2011
United States

GRUBB & ELLIS
From Insight to Results

In This Issue

Office Market Trends
is a newsletter published quarterly by Grubb & Ellis Company. To obtain additional copies or other Grubb & Ellis publications, please contact:

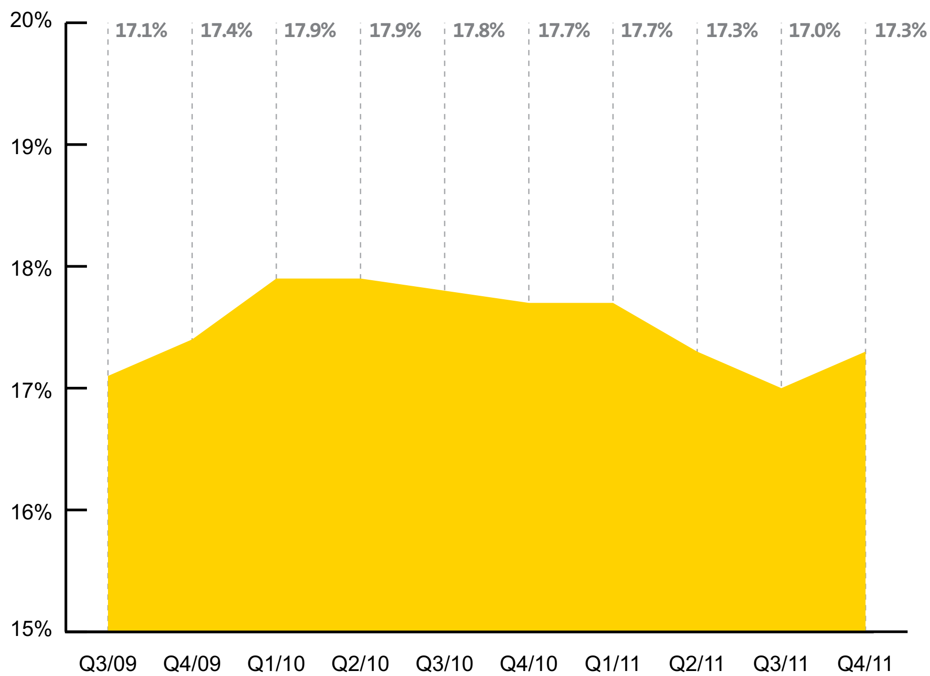
Robert Bach
Senior Vice President, Chief Economist
312.698.6754

Erin O'Leary
Manager, Affiliate Research Services
312.698.6789

Grubb & Ellis Company
1551 N. Tustin Avenue
Suite 200
Santa Ana, CA 92705
E-mail: research@grubb-ellis.com
www.grubb-ellis.com

Hiccup on the Road to Recovery

US OFFICE VACANCY RATE*



*All classes of space

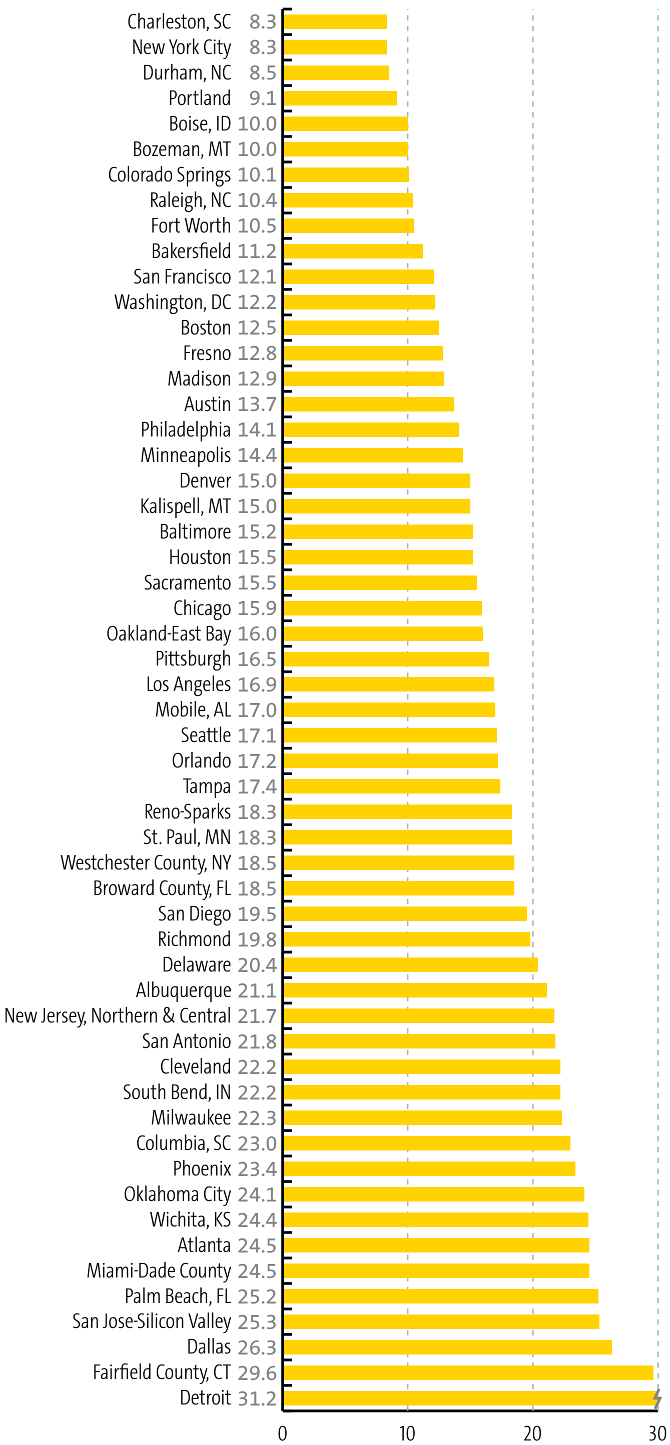
THE BOTTOM LINE

The office market has seemed out-of-sync with the economy in recent quarters, and the fourth quarter was no exception. Gross domestic product expanded at an annualized rate of 3.0 percent, the strongest pace since the second quarter of 2010, yet office net absorption barely registered in the black, and the vacancy rate increased by 10 basis points. The economy continues to generate better-than-expected readings in a variety of categories including job creation, a key leading indicator of demand for office space. Expect the market to resume its steady recovery through the remainder of 2012 with vacancy sinking from 17.3 percent at year-end 2011 to 15.7 percent by the end of this year.

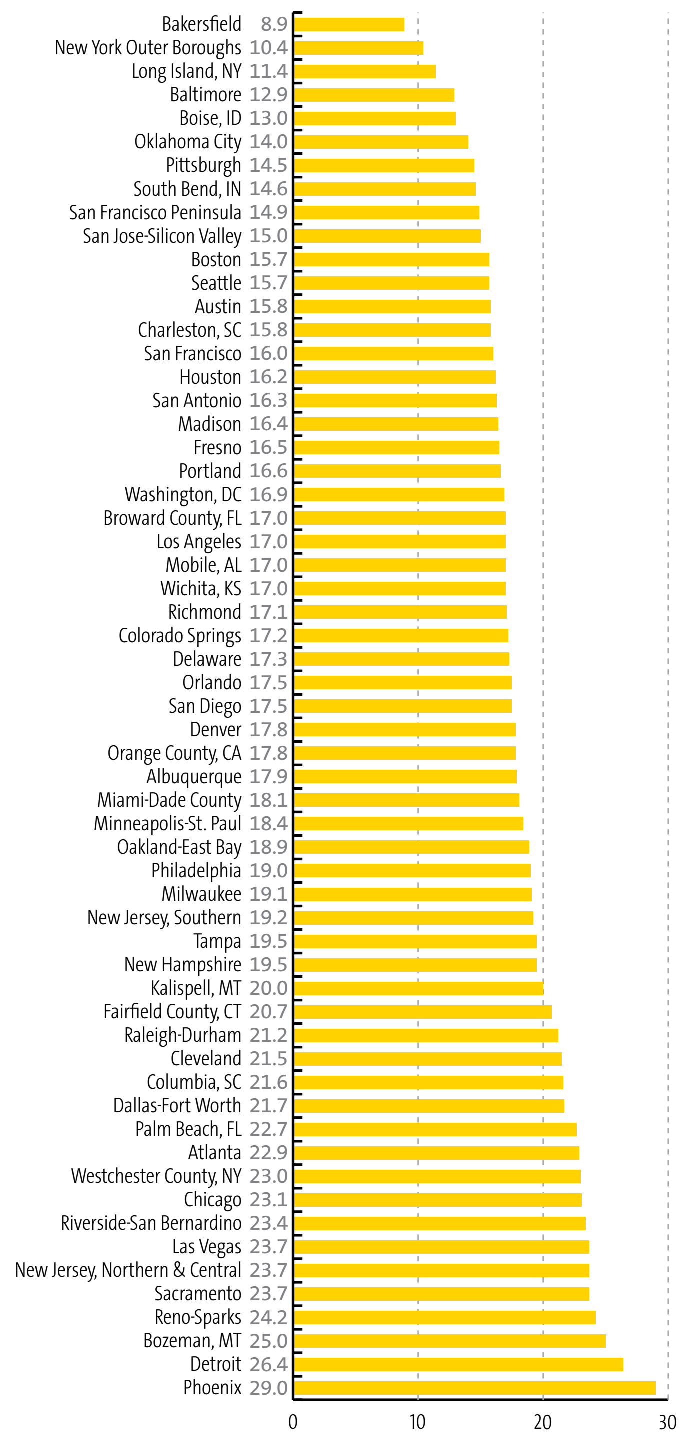
METRO VACANCY RATES

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



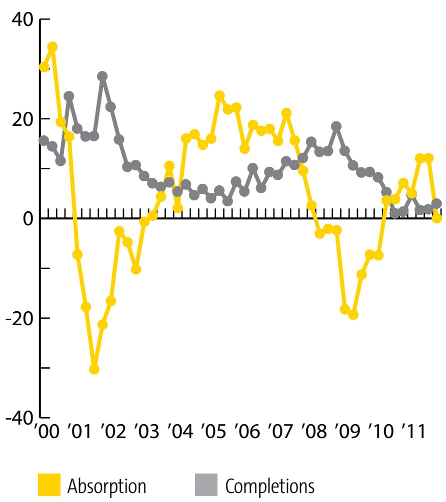
Suburban % Vacant



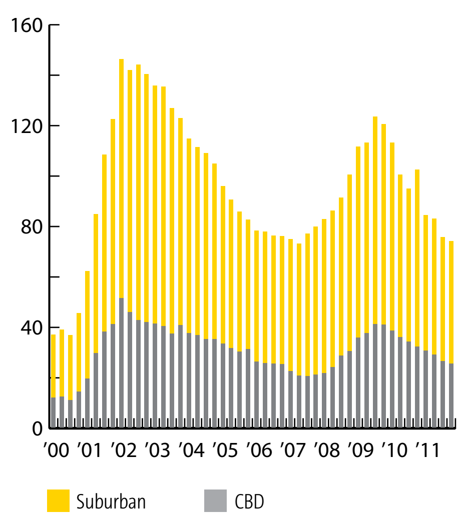
GRUBB & ELLIS. From Insight to Results

STATE OF THE MARKET

Absorption and Completions
In Millions of Square Feet



Available Sublease Space
In Millions of Square Feet



The office market slowed to a crawl in the fourth quarter, absorbing just 36,000 square feet of space while adding nearly 3 million square feet of new inventory. Central business district markets absorbed 3.2 million square feet while suburban markets gave back nearly the same amount. The imbalance between demand and new supply pushed the vacancy rate higher by 10 basis points during the fourth quarter to end the year at 17.3 percent. The average asking rental rate for Class A space rose by 0.5 percent in the quarter and by 1.7 percent year-over-year. Nearly all of these gains occurred in CBD markets, where Class A product posted increases of 1.5 percent for the quarter and 4.0 percent for the year. The so-so momentum in the market has yet to move the needle for Class B rents, where the average slipped by 0.3 percent in the fourth quarter and remained flat for the year. A modest increase for Class B rents in CBD markets was offset by a modest decline in suburban markets, both for the fourth quarter and for the year. The inventory of available sublease space fell to 74.4 million square feet, the lowest level since the second quarter of 2007.

The office market recovery accelerated in 2011 but only to about 25 in a 60-mile-per-hour zone, leaving motorists frustrated. The vacancy rate fell 40 basis points from 17.7 at year-end 2010 to 17.3 percent. While this certainly beat the increases registered in the prior three years, it fell short of the 200-basis-point decline that is the norm for a steady recovery. Net absorption last year totaled 26.6 million square feet, well ahead of the 9 million square feet registered in 2010 but trailing the 62 million square feet posted in 2007, the last year of the expansion. Some landlords began retracting concessions last year, pushing effective rents higher, but these moves typically were confined to Class A properties in the most desired submarkets, and then only after those landlords had kept concessions in place long enough to lure tenants from lesser-quality buildings. This trend, labeled "flight to quality," remains common in virtually every market across the U.S. Asking rent gains last year, though anemic overall, were powered by Class A space in technology and energy markets including San Francisco (+18.6 percent), San Jose (+4.8 percent) and Austin, Texas (+3.2 percent), as well as supply-constrained Manhattan (+10.5 percent). Speculative and build-to-suit construction starts increased slightly last year but remained near historic lows. The only market firmly in the expansion cycle was Washington, D.C., where developers delivered 18 new buildings with a combined 2.9 million square feet of space, nearly two-thirds of it preleased. In many markets, tenants continued to choose shorter-term (sub-five year) leases in order to keep their options open, forgoing more lucrative terms on offer for those willing to sign longer term leases.

New York led all markets with annual absorption of 7.7 million square feet, pushing vacancy lower by a full percentage point. Chicago captured the runner-up position followed by growth markets in Texas (think energy) and California (think technology) taking the third through eighth slots. But these markets were offset by Westchester County, N.Y. where occupied space declined by 1.2 million square feet during the year as Citibank and Bank of New York closed some local operations. Long Island, N.Y., New Hampshire, Oakland-East Bay and Detroit contributed to the red ink with 2011 absorption in the range of minus 500,000 to 600,000 square feet.

The outlook is more opaque than usual this year given the ongoing turmoil in the eurozone and its potential to create a financial market contagion. This would have an especially harsh impact on New York's financial sector, and market participants there are cautious about prospects for the coming year. A European recession, which is rolling across the continent, will crimp U.S. exporters selling into the region, which could, in turn, cool down some of the hot technology markets in the U.S., such as San Jose, Calif., the San Francisco Peninsula, Austin and Boston.

From the grass-roots level, the outlook is for stronger – not weaker – activity in 2012, and recent U.S. economic indicators seem to bear that out.

However, from the grass-roots level, the outlook is for stronger, not weaker, activity in 2012, and recent U.S. economic indicators seem to bear that out. Expect the national vacancy rate to end the year at 15.7 percent, propelled by net absorption totaling 52 million square feet combined with minimal new deliveries totaling 9 million square feet. This assumes that employers add 125,000 net new payroll jobs per month, 20 percent of which will be in office buildings at a ratio of 175 square feet per new employee. The job growth estimate could be low, however, in light of January's unexpectedly strong performance of 243,000 new jobs coupled with recent declines in first-time jobless claims. The forecast further assumes that shadow space created during the recession will accommodate 25 percent of the net new demand. The national rental rate indexes will firm up by the end of the year, but landlord-pleasing increases are unlikely to appear before 2013 or 2014. Technology companies will drive demand in the markets where they are located. The healthcare sector will continue its inevitable expansion, pushing vacancy lower in medical office buildings, clinics and related properties. Cities with energy companies well-represented in their tenant bases will continue to expand, including major markets in Texas and Oklahoma and some surprising newcomers such as Pittsburgh.

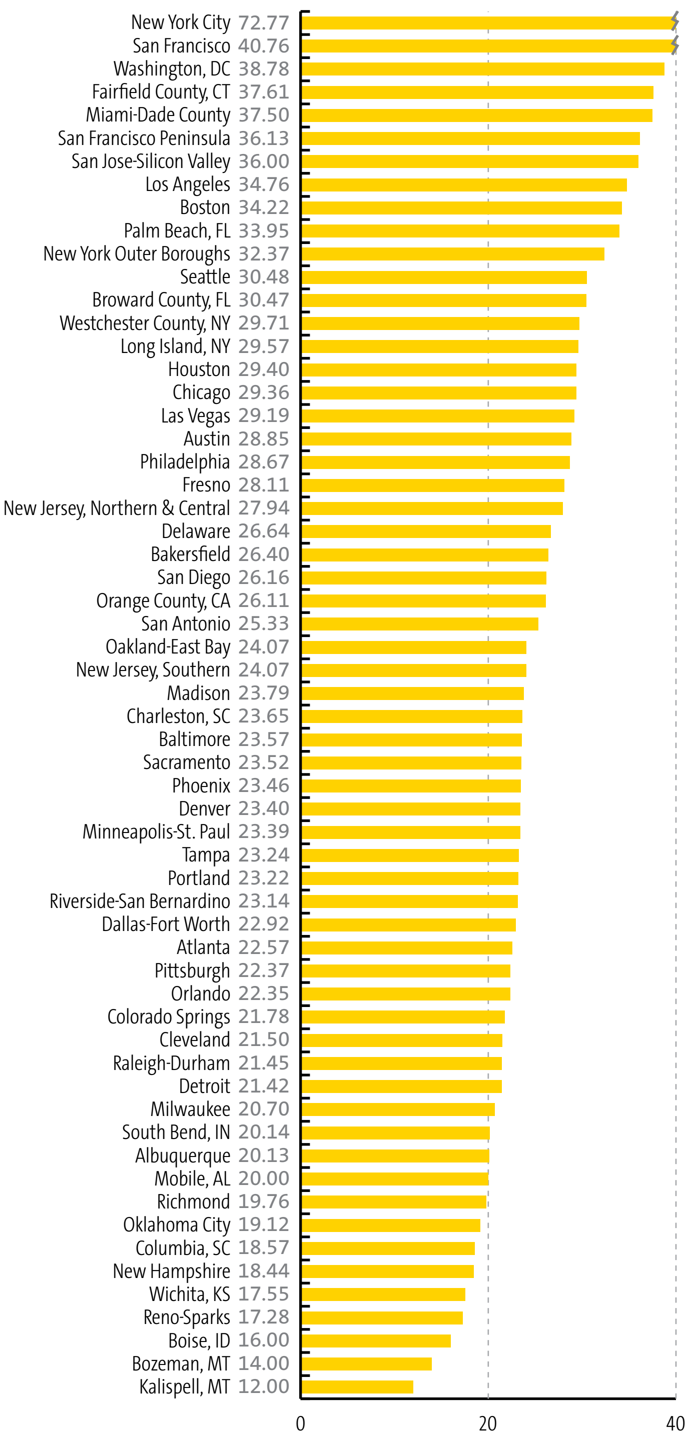
By year-end 2012, assuming the financial markets can avoid a meltdown, the office market will be in better shape. However, equilibrium at the national level will remain elusive for at least one more year after that. Class A properties in most markets will continue to outperform, but only a small handful of markets will tighten to the point where opportunities arise for the owners of Class B properties to cut concessions, raise rental rates or upgrade their properties to Class A-minus status in order to recapture some of the tenants lost during the flight-to-quality cycle.

GRUBB & ELLIS
From Insight to Results

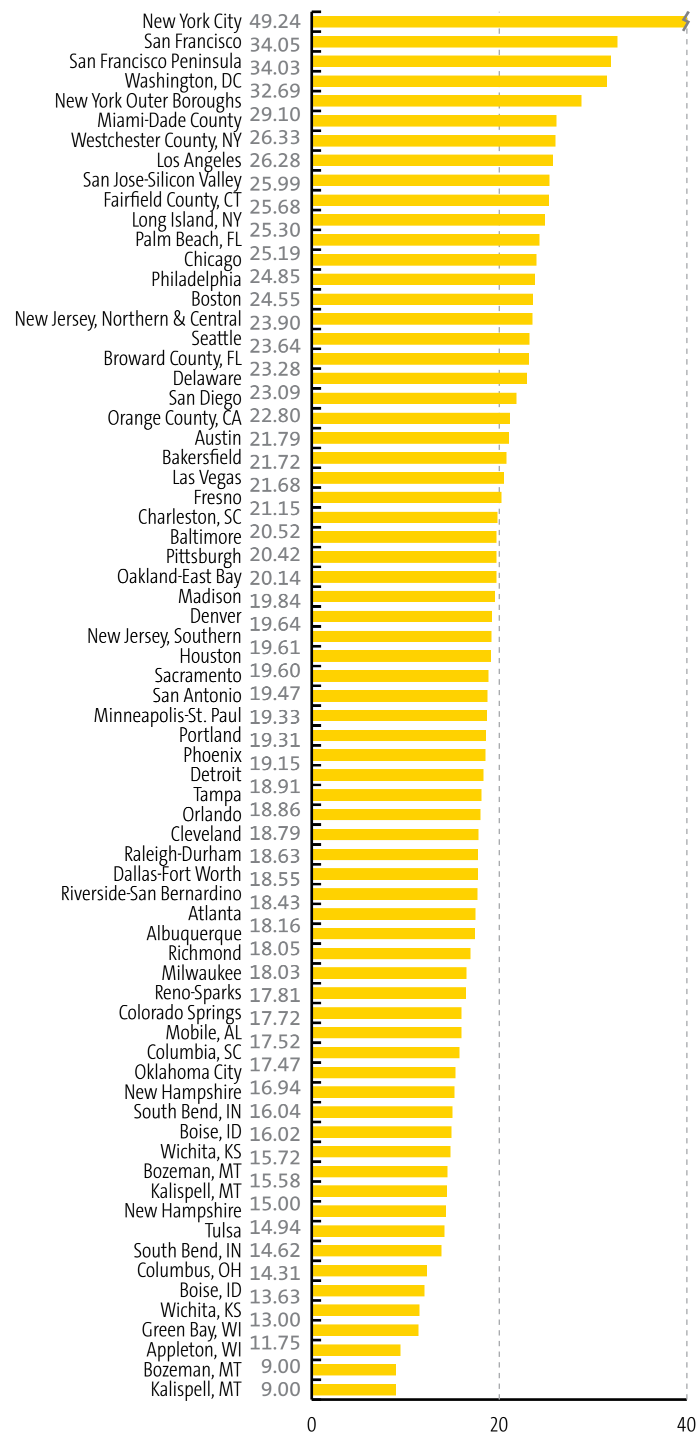
METRO RENTAL RATES

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. The rate in each building is weighted by the amount of available space in the building.

Class A $ Asking Rent



Class B $ Asking Rent



NORTHERN CALIFORNIA/ PACIFIC NORTHWEST

Fresno: The office market is poised for gradual, sustainable growth given a) little new product, b) the slight decrease in sublease space and c) the trickle of jobs returning to the area... **Oakland-East Bay:** Vibrant activity during the fourth quarter accounted for almost all the rent gains for the year. In the Oakland CBD, State Farm signed a five-year lease for 14,846 square feet... **Portland:** Portland has regained 40 percent of the office jobs lost during the Great Recession. Moody's estimates full employment in the office-using sectors should return by the second quarter of 2013... **Sacramento:** Leasing activity was mostly renewals or relocations focused around downsizing or economic incentives rather than net new business growth... **San Francisco:** Solution Set leased 50,874 square feet from Hines in the Equitable Life Building. Digital Realty Trust took down two floors totaling 50,000 square feet in the Embarcadero 4 building from Boston Properties... **San Jose-Silicon Valley:** Zynga took 60,000 square feet, Omnicell signed a build-to-suit deal for 99,800 square feet and Synopsys inked a long-term deal for 340,000 square feet... **San Mateo:** Facebook settled into its new campus at the former Sun Microsystems in Menlo Park. The space will accommodate up to 2,000 workers... **Seattle:** Tenant interest drove available sublease space down by nearly 20 percent in the past year, indicating that some businesses ceased operational contraction.

SOUTHERN CALIFORNIA/ PACIFIC SOUTHWEST

Bakersfield: Large transactions in the suburban submarkets reduced overall vacancy to less than 10 percent. Rents are steady and new development could break ground this year... **Los Angeles:** Santa Monica, Hollywood/WeHo and Burbank fared well due to tenant demand from the entertainment industry. Businesses are focused on their balance sheets, which sustains the cautious behavior that has characterized the leasing market over the past four years... **Orange County:** The market racked up a sixth consecutive quarter of positive net absorption while asking rents have increased for two consecutive quarters... **Riverside-San Bernardino:** Renewed vitality will be tied to the local housing market, but a recovery for the latter is not expected until 2015... **San Diego:** Although most leases signed in 2011 were lateral moves and renewals, overall office vacancy decreased by 50 basis points from 2010, ending the year at 17.8 percent. Class A owners dropped rental rates an average of $0.10 per square foot per year since 2008, which has attracted move-up activity.

MOUNTAIN/SOUTHWEST

Albuquerque: Three large deals were signed totaling almost 93,000 square feet. Two were expansions, Innovasic and the American Red Cross, and the third was a new call center for Lowe's... **Boise:** Vacancy rates are declining, but lease rates remain flat and are too low for developers to start building again... **Bozeman:** Rental rates were unchanged last quarter. While there has been some absorption in the CBD, the next few quarters should remain flat... **Colorado Springs:** Tenants continued to cut existing lease burdens through renegotiating rates at current locations or relocating to quality locations at a discount... **Denver:** Momentum continues to build as evidenced by new projects including the redevelopment of Union Station, the DaVita build-to-suit project in LoDo and Opus's spec building... **Kalispell:** Demand for Class A and B product has increased over the past quarter. Vacancy rates have stabilized with some tenant movement... **Las Vegas:** Over the next few years as more REO properties are purchased, there will be less competition between distressed and non-distressed office buildings and sales prices will slowly return to more realistic levels... **Phoenix:** The largest move this quarter was the 165,000-square-foot United Healthcare lease at Cotton Center in the Airport Area submarket... **Reno:** Tenant inquires for this time of year are at a 10-year high.

TEXAS/GREAT PLAINS

Austin: Vacancy retreated 60 basis points to end the fourth quarter at 15.4 percent, the lowest level since 2007... **Dallas-Fort Worth:** The market absorbed more than 2.1 million square feet last year, the best performance since 2006... **Houston:** Humming with activity from shale gas exploration and deep water drilling, the energy industry generated a flurry of relocation and expansion activity... **Oklahoma City:** Oil giant Chesapeake Energy purchased the 276,000-square-foot, multi-tenant Caliber Center. Possible buyouts to tenants with long-term leases could pave the way for the Class A suburban market to grow even more competitive... **San Antonio:** Overall positive absorption during the fourth quarter can be traced to HVHC Inc's lease of 112,678 square feet of former AT&T space at IBC Centre Tower... **Wichita:** Vacancy rates for both CBD and suburban office space have remained virtually unchanged since the end of 2010.

GREAT LAKES/OHIO VALLEY

Chicago: Sara Lee will redevelop 200,000 square feet, the American Medical Association leased nearly 300,000 square feet, and GE Capital renewed 292,000 square feet with an expansion of 79,000 square feet, all in the downtown market... **Cleveland:** $2 billion in public/private sector development projects are underway including the new medical mart/convention center, the first phase of the Horseshoe Casino, the Flats East Bank project and the new inner-belt bridge... **Detroit:** While most submarkets were in negative territory, Farmington Hills finished the year on a positive note with 150,000 square feet of absorption as Greenpath occupied its new headquarters... **Madison:** The market is improving, with lower vacancy and positive absorption over the last year, although the improvement is modest and the pace of recovery is slow thus far... **Milwaukee:** Washington Square, a proposed 24-story, 300,000-square-foot, downtown office building, continues to pursue all possible anchor tenants but has not been successful so far... **Minneapolis:** Improvement continued through the end of 2011 with multiple consecutive quarters of positive absorption and declining vacancy rates... **South Bend:** In 2011 two major office buildings totaling 220,000 square feet were put into receivership due to increased vacancy coupled with insurmountable debt.

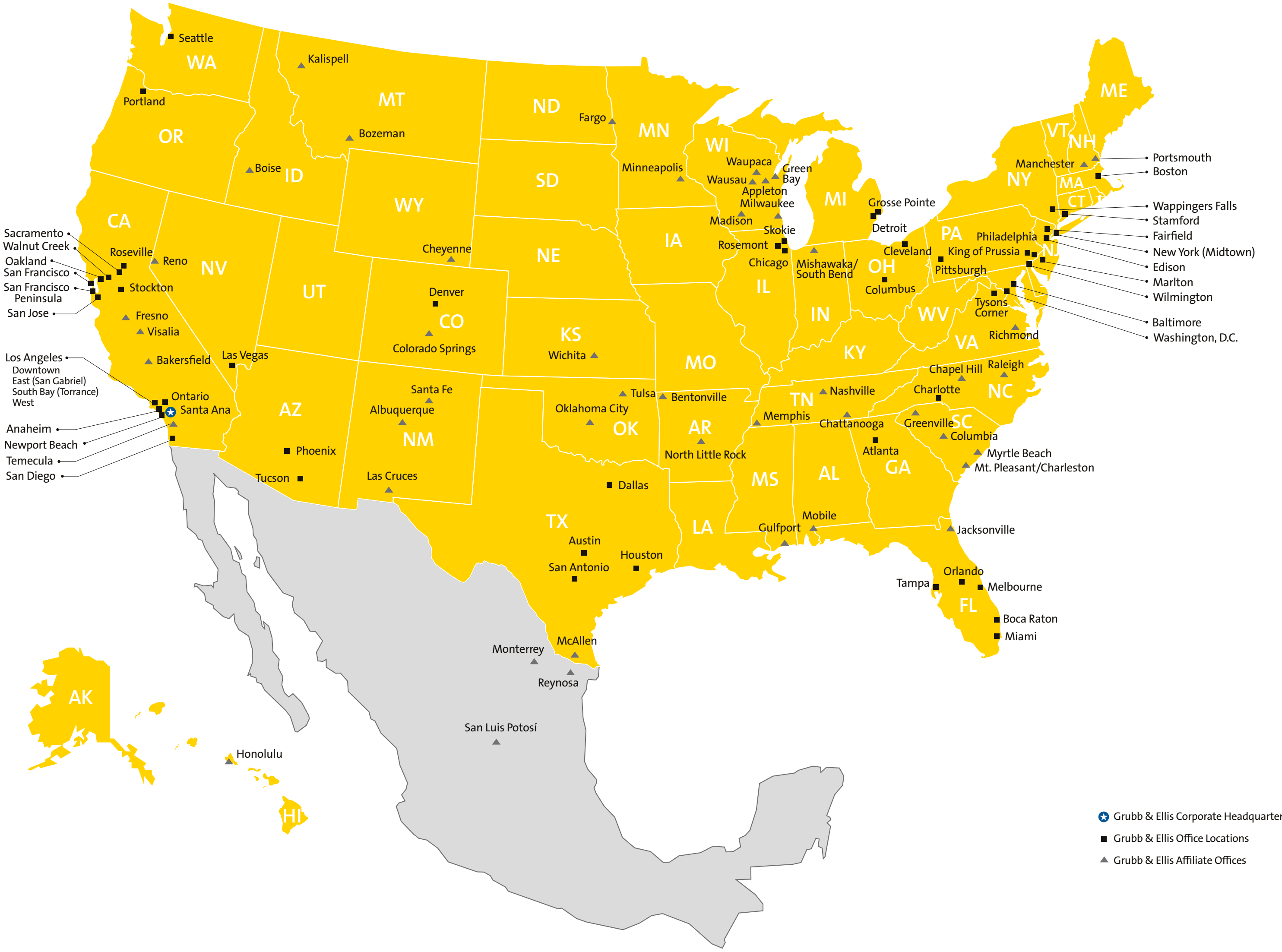
NORTHEAST/ MID-ATLANTIC

Boston: Growth was primarily driven by tenants absorbing 1 million square feet of Class A space in a flight-to-quality trend most evident in the Back Bay, Cambridge and the Longwood Medical Area... **Fairfield County:** Leasing activity declined for the third consecutive quarter, totaling nearly 389,000 square feet in the fourth quarter, a 61 percent drop year-over-year... **New Hampshire:** Prospective tenants are responding to the improving economy by looking for better opportunities in the market... **New Jersey, Northern & Central:** Nearly 1.5 million square feet of negative net absorption occurred in the fourth quarter, the largest volume of negative quarterly activity since the second quarter of 2009... **New Jersey, Southern:** The 70,000 square feet of absorption in 2011 offset just 10 percent of the occupancy losses suffered over the prior three years, but it was a welcome turnaround for a market with high exposure to the residential mortgage sector. ..**New York City:** Record high transaction volume of 39.2 million square feet fueled the minor 20-basis-point recovery in availability to 13 percent year-over-year... **Philadelphia**: Pharmaceutical stalwarts such as GlaxoSmithKline and Sanofi-Aventis gave back significant portions of space, tapping the brakes on the long awaited suburban recovery... **Pittsburgh:** PNC Financial Services will again alter the skyline with its new 800,000-square-foot headquarters. Construction will begin in 2012 with completion in 2015... **Washington, DC:** Despite 900,000 square feet of negative absorption in Q4, the market recorded nearly 386,000 square feet of positive absorption for 2011... **Westchester County:** Wilson Elser Moskowitz Edelman and Dicker LLP, the county's largest law firm, signed for 124,000 square feet, contributing 41 percent to the total activity for the quarter... **Wilmington:** A strong fourth quarter, with vacancy shrinking by 45 basis points, was not enough to erase the losses suffered earlier in the year when corporate downsizing by AstraZeneca, Barclay Bank and Cigna Corporation added to an already saturated supply.

SOUTHEAST

Atlanta: Overall absorption for the fourth quarter was negative 242,262 square feet and rental rates continued to decline to $20.33 (all classes of space). Tenant concessions remain considerable with free rent standard for sizable deals... **Broward County:** Office closures and downsizings by firms including Kaplan University, AT&T and Sun-Sentinel contributed to over 400,000 square feet of returned vacant inventory in 2011... **Charleston:** Financial/securities firms and government contractors are still active in the market and absorbing space thanks to the bullish stock market and continued government spending... **Columbia:** Over the last two years, the amount of space leased by the state government in private office buildings has declined by 6 percent... **Miami:** Forum Development's completion of the Miami World Center added 591,000 square feet of available space in the fourth quarter, negating the half a million square feet of positive absorption seen for 2011... **Mobile:** The market remains limp with little enthusiasm for long-term leases. Small, moderately priced offices have been generating some activity... **Orlando:** The largest leases were Raytheon's 65,147-square-foot renewal at Research Pointe II and the renewal of PEO STRI's 65,044-square-foot space at Research Commons... **Palm Beach County:** Class B space dominated transaction activity with over 1 million square feet leased in 2011, outpacing Class A activity totaling 796,000 square feet... **Raleigh-Durham:** The Triangle ended the year with absorption in the black and overall vacancy below 20 percent for the first time since late 2009... **Richmond:** Overall office vacancy declined 90 basis points from one year ago but remains stubbornly high at 17.9 percent... **Tampa:** No new development was completed in 2011 and speculative projects are not expected in the near future. Only two new buildings which total 115,000 square feet will be delivered in 2012.

GRUBB & ELLIS OFFICE LOCATIONS



GRUBB & ELLIS
From Insight to Results

Office Market Trends

United States Q4 2011