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Office Market Trends

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Robert Bach

Senior Vice President, Chief Economist
312.698.6754

Erin O'Leary

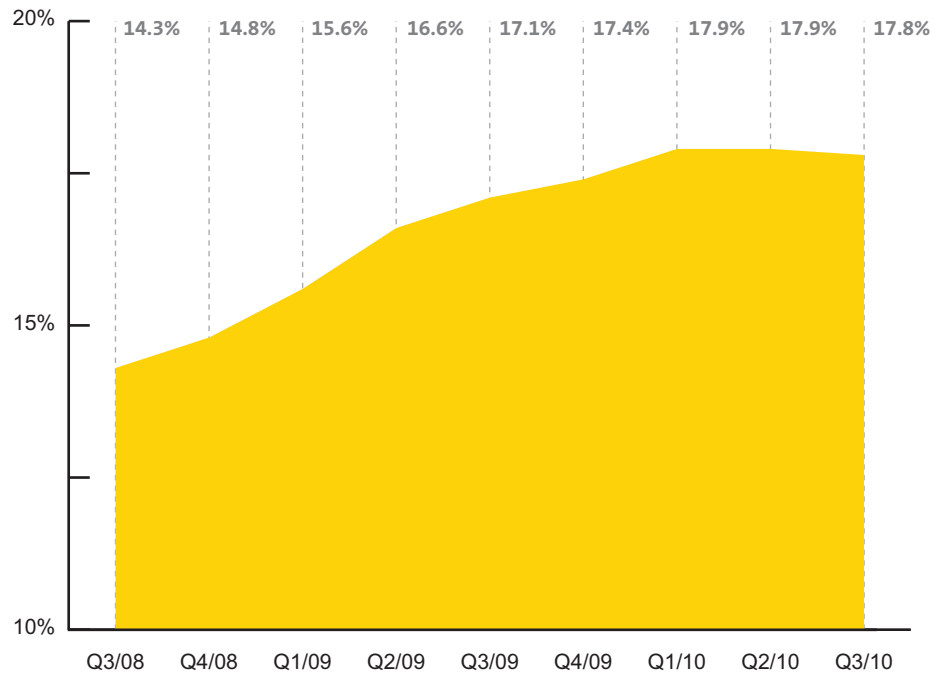
Manager, Affiliate Research Services
312.698.6789

Grubb & Ellis Company

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

Over the Hump!

US OFFICE VACANCY RATE*



* All classes of space

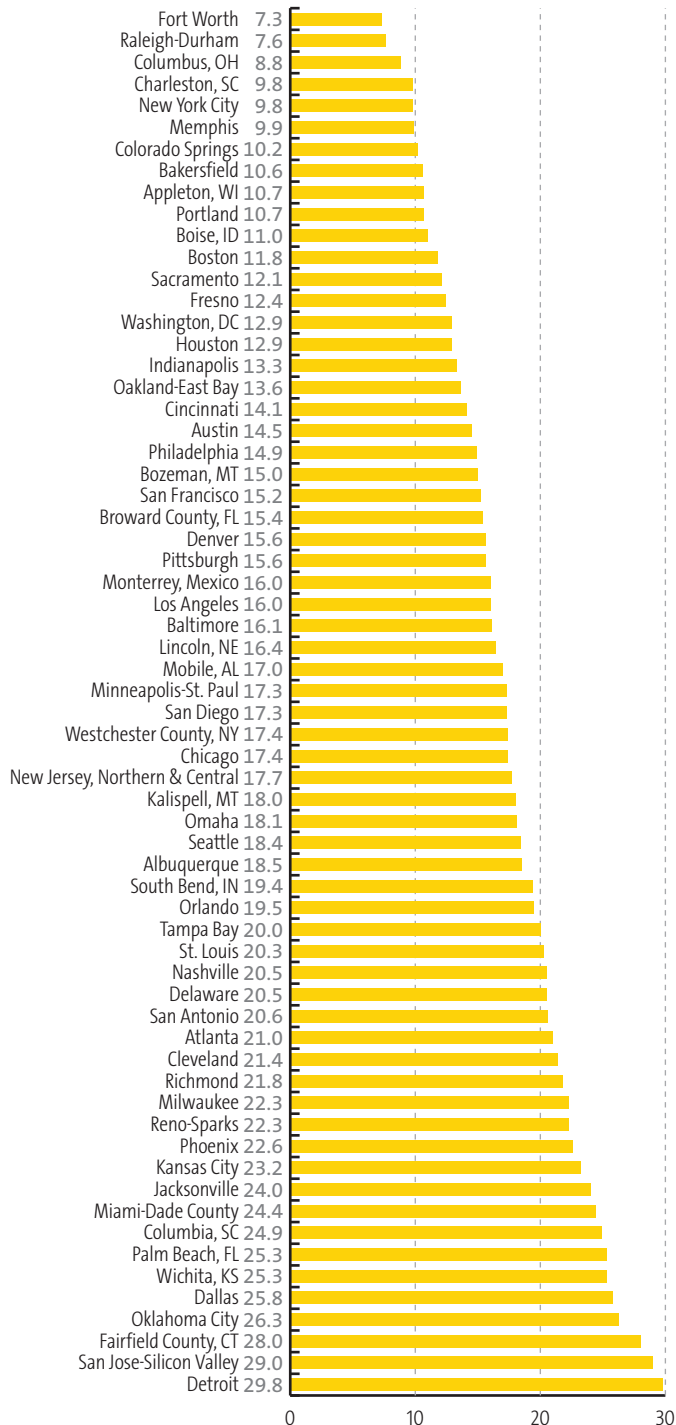
THE BOTTOM LINE

The U.S. office market has stabilized thanks to two consecutive quarters of positive absorption and the minimal construction pipeline. Asking rents have bottomed out while effective rents for Class A space are tightening in selected submarkets and properties. A robust recovery depends on job creation, which may not pick up before the second half of next year. There is also the issue of shadow space. Comparing the loss of office-using jobs with the actual negative absorption recorded in recent quarters suggests that the real vacancy rate, including cubes and floors that are empty but not offered for lease or sublease, would be 22.2 percent versus the official 17.8 percent. This is likely to dampen the rate of recovery for several quarters after the labor market finally gains traction. Look for the market to continue its gradual recovery through 2011 with a stronger performance postponed until 2012.

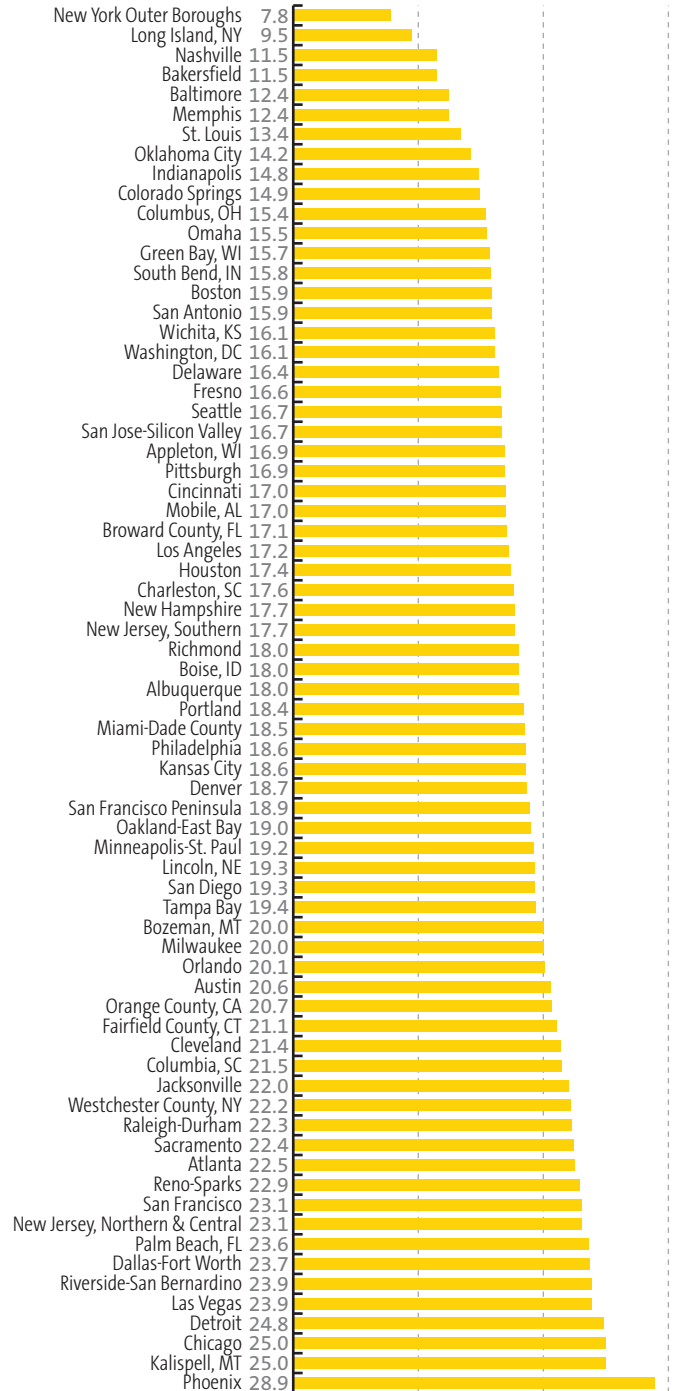
METRO VACANCY RATES

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

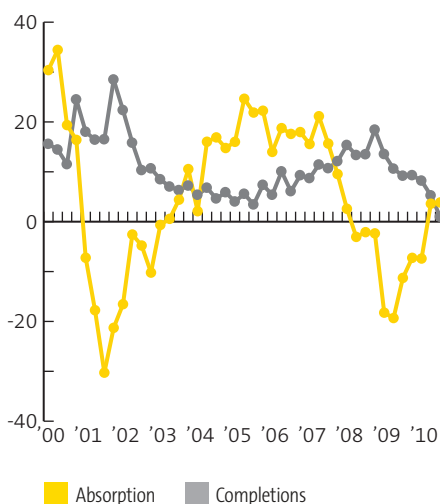


Suburban % Vacant

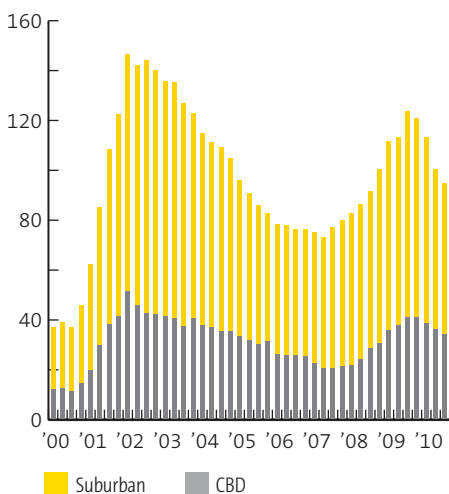


STATE OF THE MARKET

Absorption and Completions
in Millions of Square Feet



Available Sublease Space
in Millions of Square Feet



The softening cycle has ended, but a recovery worthy of the name is still on the drawing board. The vacancy rate fell to 17.8 percent in the third quarter from a revised 17.9 percent in the second quarter, which is pretty much a rounding error. The vacancy rate has not moved by more than six basis points—6/100ths of a percentage point—since the first quarter.

- The “biggest loser” was **Charleston, S.C.** where the vacancy rate fell to 16.1 percent in the third quarter, a decline of more than 500 basis points since the third quarter of 2009. Nevertheless, Charleston remains a tenants’ market with the exception of the CBD, which has a low 9.8 percent vacancy rate and a shortage of Class A space. A 66,000-square-foot speculative project, more than 50 percent pre-leased, is about to break ground—a rare sighting these days. **Omaha, San Antonio and Austin** all recorded year-over-year vacancy declines in excess of 100 basis points.

- Somewhat ironically, **Columbia, S.C.**, just up the road from Charleston, recorded the biggest year-over-year vacancy increase due primarily to the opening of a new CBD office tower last spring combined with the recession-related downsizing of some law firms. Markets posting vacancy increases of 200 basis points or more over the past four quarters included **Albuquerque, Las Vegas, Miami, San Francisco and Fresno.**

Tenants absorbed 3.9 million square feet in the third quarter, the second consecutive quarter of low but positive net absorption.

This compares with the quarterly average of 14.1 million square feet absorbed during the 2003-07 expansion.

- **Washington, D.C.**, not surprisingly, led all markets with just over 900,000 square feet of third-quarter absorption and nearly 3.8 million square feet year-to-date. The silver and bronze medals in the third-quarter absorption race went to **Boston** and **Northern and Central New Jersey** while **Pittsburgh** and **Seattle** took second and third place in year-to-date absorption. As a percentage of the occupied base, year-to-date absorption was most impressive in **Charleston** (+5.0 percent) followed by **Pittsburgh, Northern Indiana and San Antonio.**
- Negative absorption was still the norm in many markets during the third quarter led by **Los Angeles** with -656,000 square feet and **New York City** with -594,000 square feet. Year-to-date, negative absorption exceeded 1 million square feet in Los Angeles, New York and **Las Vegas.** As a percent of the occupied base, absorption fell most sharply in **Las Vegas** (-4.1 percent) followed by **Albuquerque** and **Westchester County, N.Y.**

Developers delivered less than 1 million square feet of new space, making this the first quarter in three years that demand outpaced supply. Space remaining in the construction pipeline totaled 19.4 million square feet, the lowest level since at least 1997 when Grubb & Ellis began tracking this indicator at the national level.

- **New York** led all markets with just over 6 million square feet in the pipeline including the 2.6 million-square-foot One World Trade Center and the 2.3 million-square-foot Four World Trade Center projects. **Washington, D.C.** had nearly 3.4 million square feet underway followed by **Houston** and **Seattle** with about 2 and 1 million square feet, respectively.

The office leasing market is a perfect metaphor for the economy. It is no longer shrinking, but the recovery is hard to detect in most places.

The average Class A asking rental rate for space available at the end of the third quarter was \$30.81 per square foot per year, triple net—about flat compared with the second quarter and down by 1.0 percent from the third quarter of 2009. The average Class B rate of \$22.64 was flat compared with the second quarter and down by 2.0 percent compared with the year-ago quarter. These numbers suggest that asking rental rates are close to the bottom if not already there. Class A rates are a little more firm as tenants trade up in quality.

- Though a few smaller markets such as **Omaha** and **Northern Indiana** registered year-over-year increases in Class A asking rents, those are anomalies deriving from the fluctuating mix of spaces offered on the market during the comparison periods. In other words, nearly all markets continue to favor tenants.
- Having said that, effective rates are beginning to rise as Class A landlords retract their most generous concessions. Class B landlords are in no such position, however, as they must maintain low rates so as to keep their tenants from being raided by Class A landlords—a common occurrence in the early stages of a recovery.

Sublease space offered on the market declined at a brisk clip to end the third quarter at 95 million square feet, down 23 percent from the peak exactly one year ago. Sublease space peaked well below

the level seen in the prior softening cycle, meaning that it will not weigh down the nascent recovery to the same extent as in the mid-2000s.

- To some extent, the largest markets also had the largest sublease inventories as evidenced by **New York, Washington, D.C.** and **Chicago**—the top three markets both in terms of total and sublease inventories. As a percentage of the total inventory, the story is different. The **San Francisco Peninsula** led the pack with sublease space totaling 5.3 percent of its total inventory followed by **Northern and Central New Jersey** at 3.8 percent and **New York** at 3.2 percent. The San Francisco Peninsula, sandwiched between San Francisco and San Jose, is an expansion market for large tech companies, which remain cautious about expanding. Northern and Central New Jersey is a big market for corporate headquarters, many of which downsized during the recession, while New York, though in the early stages of a rebound, remains awash in sublease space from financial firms impacted by the crisis.

FORECAST

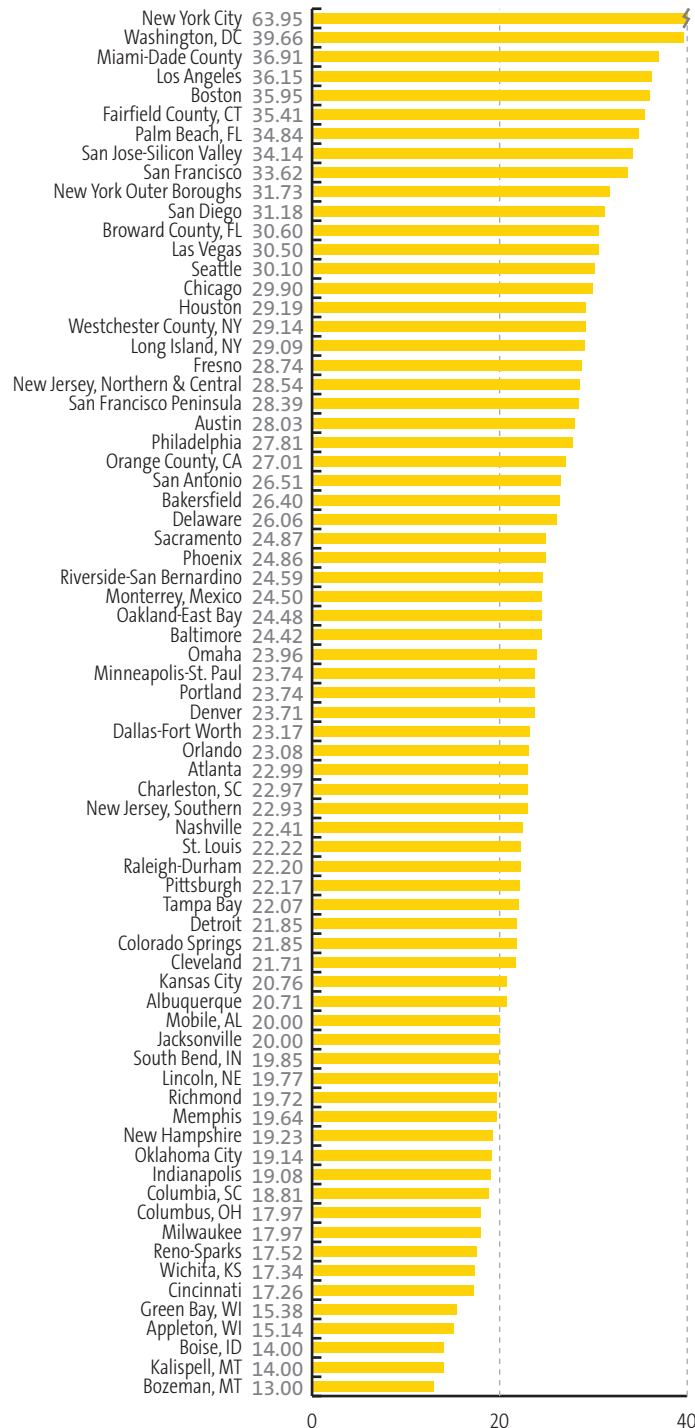
The office leasing market is a perfect metaphor for the economy. It is no longer shrinking, but the recovery is hard to detect in most places. It's clear that vacancy, absorption, rents and construction will be slow to recover until employers begin hiring more aggressively and the inventory of shadow space is filled. Other market indicators such as the average lease term and average lease size, both of which are at decade-lows, confirm that tenants remain cautious despite the once-in-a-decade deals being offered by landlords. Federal Reserve officials and private economists recently lowered their forecasts for next year, but thankfully another near-term recession, the feared double-dip, seems unlikely at this point. Expect the office market to forge ahead through the economic weeds over the next few quarters.

METRO RENTAL RATES

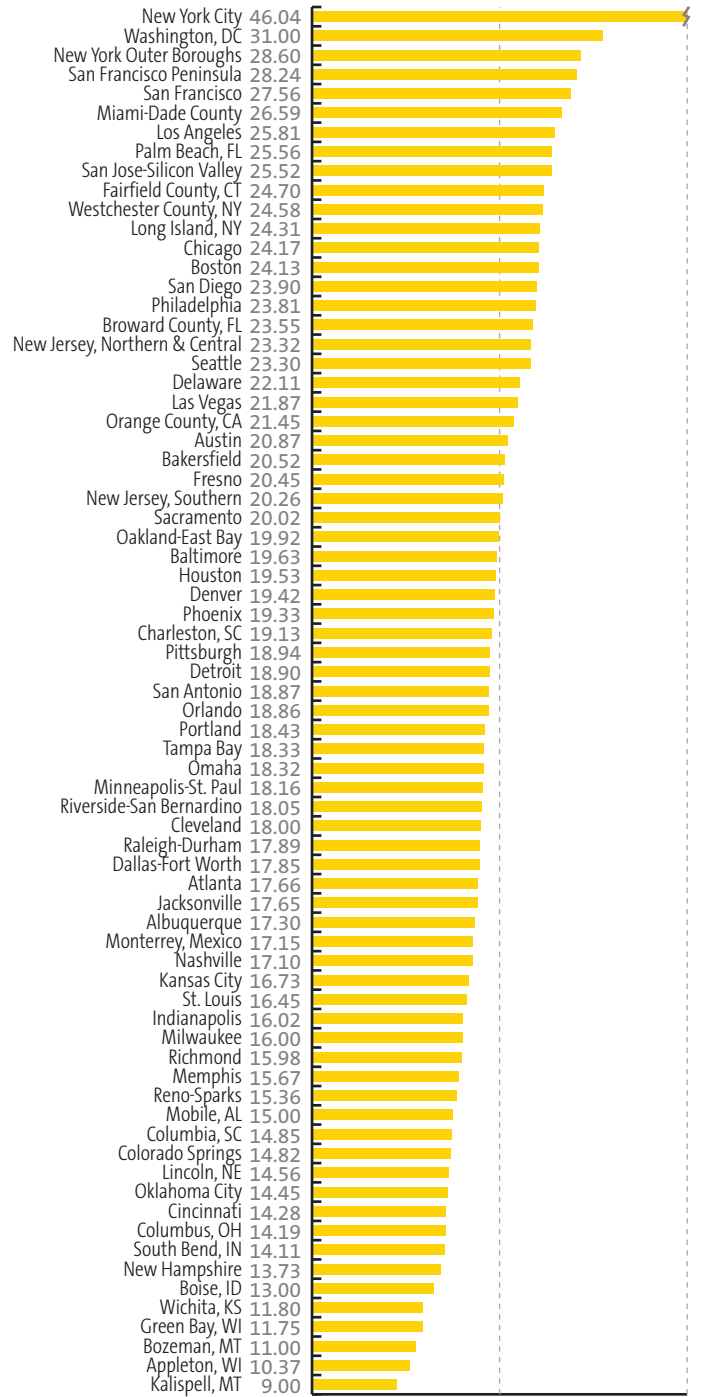
Note: Rental rate data refer to asking rates for space that is available on the market at the end of the quarter. Rates are per square foot, quoted on an annual, full service gross basis.

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: A comeback may be close at hand. Rising vacancy rates are beginning to plateau, and optimism seems to be returning... **Oakland-East Bay:** Clorox leased 356,000 square feet in Pleasanton and will move 500 to 700 workers to its new campus. Pleasanton also attracted Patelco Credit Union and Xradia, which took 56,000 and 37,000 square feet respectively... **Portland:** Despite Nike's lease of 200,000 square feet in the Sunset Corridor, the area still has significant excess inventory and will experience elevated vacancy and compressed rents for the foreseeable future... **Sacramento:** Government employment and professional and business service jobs are down significantly, constituting roughly 40 percent of the region's job losses and exerting upward pressure on vacancies. Education and health service employers are adding jobs... **San Francisco:** Tech companies competing for space in the hot SOMA (South of Market) submarket helped drive positive absorption in the market for the first time in seven quarters. Zynga signed the largest new lease since 2005 at 270,000 square feet. Other large lease requirements including Twitter, Dolby and Salesforce will likely follow suit. San Francisco has a limited number of large spaces, and tenants realize that current low lease rates may not last... **San Jose-Silicon Valley:** About 80 percent of lease transactions were less than 10,000 square feet, but there were some bigger deals such as the 77,000-square-foot Tellabs expansion in Santa Clara and AOL's 224,000-square-foot sublease in Palo Alto... **San Francisco Peninsula:** BioMed Realty Trust agreed to purchase Gateway Business Park and the Science Center at Oyster Point for \$298 million... **Seattle:** Positive net absorption in each of the past two quarters has helped the market tremendously and may signal a near-term rebound.



SOUTHERN CALIFORNIA/ PACIFIC SOUTHWEST

Bakersfield: Vacancy rates dropped minimally for the first time in the last six quarters. There have been numerous large tenant renewals and expansions in the last two quarters... **Los Angeles:** Southern California Gas Company renewed a lease for 350,000 square feet at its namesake tower downtown for 15 years. On the flipside, Boeing vacated 225,000 square feet in the South Bay... **Orange County:** Most transactions were lateral moves with tenants seeking lower rates or quality upgrades at reduced pricing. This is the first quarter of positive net absorption since the end of 2006... **Riverside-San Bernardino:** In Ontario, National University expanded its operations to 25,000 square feet while the Defense Contract Management Agency signed an 11,500-square-foot lease... **San Diego:** Year-to-date absorption totaled nearly 850,000 square feet.



MOUNTAIN/SOUTHWEST

Albuquerque: Vacancy climbed another 40 basis points this quarter. Job losses in professional and business services over the last year are contributing to the increase... **Boise:** Deals are getting done but at lower rates. The average term is only two years... **Bozeman:** Rental rates have continued to decline, helping to generate some absorption. Expect the market to remain flat for several more quarters... **Colorado Springs:** Vacancy continued to decline, and average asking rates were relatively flat... **Denver:** Fortune 500 kidney-care provider DaVita selected downtown for its new 270,000-square-foot corporate headquarters... **Kalispell:** The market is generally stagnant due to the lack of job growth... **Las Vegas:** Nevada is saddled with the highest unemployment rate in the U.S. The Cosmopolitan hotel and casino will fill 5,000 jobs when it opens in December, boosting tourism, gam-

bling revenue and retail sales... **Phoenix:** The market has stopped shrinking, but a meaningful recovery has yet to begin... **Reno:** Lease rates are holding steady with some concessions. Free rent equal to one month for every year of a new lease is the norm.



TEXAS/GREAT PLAINS

Austin: Employment growth has led companies to soak up 539,000 square feet year-to-date. For the year ending August 2010, Central Texas has gained a remarkable 18,700 jobs, which has contributed to the uptick in space demand... **Dallas-Fort Worth:** Recent corporate relocation announcements include Moneygram, Chicago Tribune, Solera Holdings, Six Flags Entertainment Corp. and Investor's Business Daily... **Houston:** With the pending merger of United Airlines and Continental, the CBD is bracing for a hit as operations move to Chicago. Shell Oil Co. plans to take over the former trading floor of Reliant Energy Inc. totaling 300,000 square feet, in the largest downtown lease signed this year... **Kansas City:** KeyBank Real Estate Capital will move to 66,470 square feet at the Sprint campus early next year, leaving nearly 75,000 square feet in downtown's Commerce Tower... **Lincoln:** Great Western Bank took over TierOne Bank, downsized and vacated approximately 45,000 square feet downtown. The CBD has lost over 147,000 square feet of occupied office space this year... **Oklahoma City:** The market rallied with over 100,000 square feet of absorption this quarter, lifting year-to-date totals out of the red... **Omaha:** Despite reasonably strong absorption, there is very little depth of new leasing activity in the market... **San Antonio:** Kohl's Department Stores occupied 102,000 square feet of Class A space in the Far West submarket. BD, a medical device company, will open a new 50,000-square foot headquarters to support its North American operations... **St. Louis:**

Armstrong Teasdale relocated from downtown's Metropolitan Square into 125,000 square feet at the new Centene Plaza in Clayton. Other tenants are lining up to occupy Centene Plaza including JP Morgan, Cassidy Turley, Centene Corporation, Stinson Morrison and UMB Bank (retail).



GREAT LAKES/ OHIO VALLEY

Chicago: The lack of big blocks of space in the CBD will limit options for tenants larger than 175,000 square feet whose leases expire in the next two to three years... **Cleveland:** Progressive Insurance and JP Morgan Chase will hire a combined 435 new employees. The Chase expansion will represent a 40 percent boost in the company's local workforce... **Detroit:** The GSA will move into 80,000 square feet at 500 Woodward Ave. in mid-2011... **Milwaukee:** Generous concessions have attracted an increase in tenant relocations... **Minneapolis:** U.S. Bancorp will move from St. Paul to 340,000 square feet at Meridian Crossings in Richfield. Available sublease space came down slightly as leases expired and the space transitioned back to landlords as direct vacant space... **South Bend:** A recent increase in activity resulted in 57,000 square feet of absorption. This includes an expansion of a local law firm downtown and a cable company's lease renewal and expansion in the suburbs.



NORTHEAST/ MID-ATLANTIC

Baltimore: Expect absorption to pick up in the next few quarters... **Boston:** Recent activity includes Biogen Idec's new 359,000-square-foot headquarters in Weston; Avid Technologies' 127,000-square-foot deal in Burlington; Microsoft's 103,000 square feet at 1 Cambridge Center; and the Office of Health and Human Services' 117,000 square

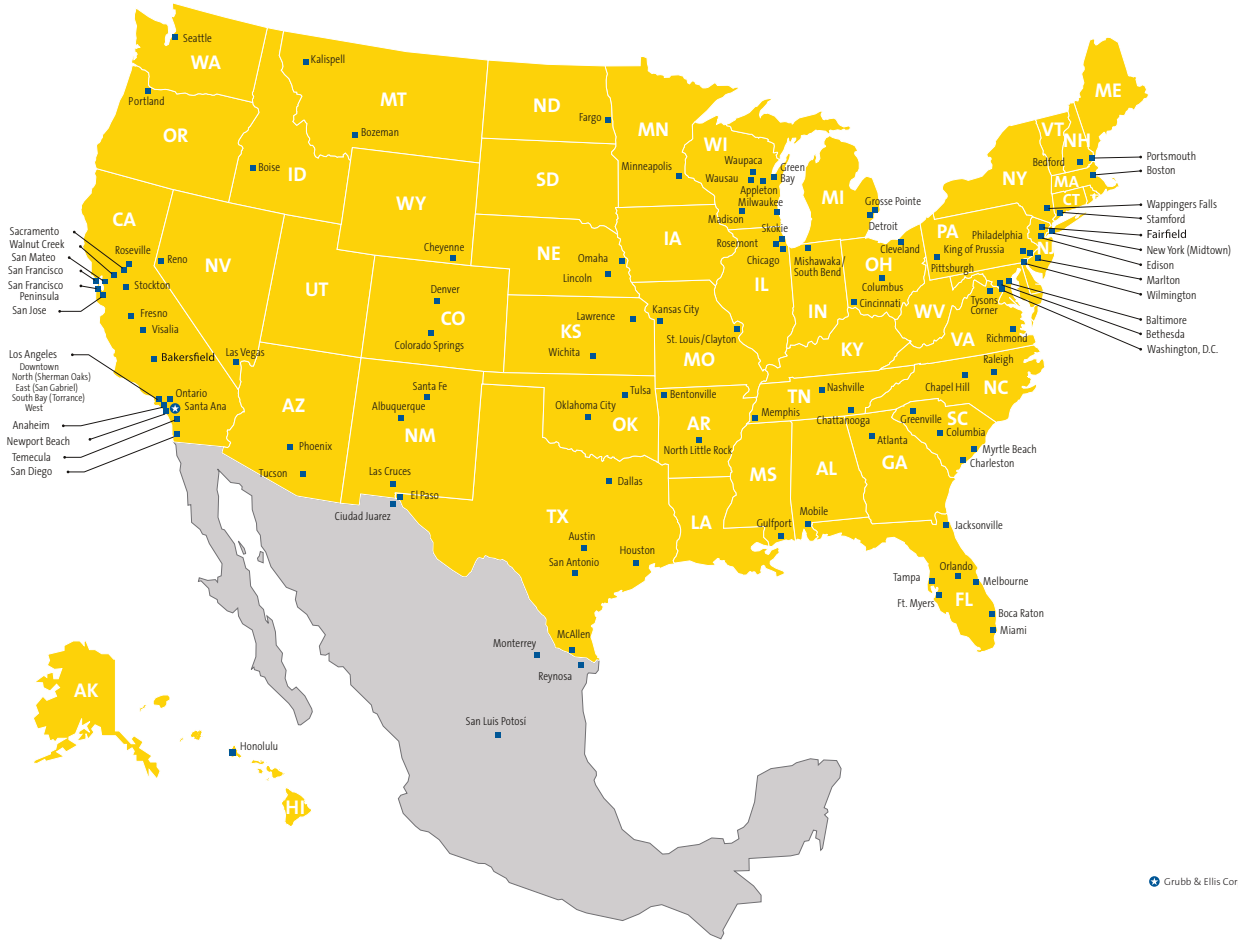
feet at 100 Hancock Street in Quincy... **Fairfield County:** Three out of the four largest leases of the quarter were renewals: Citigroup signed a five-year renewal for 81,963 square feet in Stamford; Arch Chemicals Specialty Products renewed its lease for 36,000 square feet in Norwalk; and Media Network renewed for 32,072 square feet in Stamford... **Long Island:** Vacancy dropped moderately in the third quarter. Limited new construction will set the stage for a faster recovery in 2011... **New Hampshire:** Vacancy increased from 17.3 percent in the second quarter to 17.7 percent in the third quarter... **New Jersey, Northern & Central:** More than 546,000 square feet out of the 655,200 square feet absorbed during the third quarter involved Class A product as tenants took advantage of move-up opportunities... **New Jersey, Southern:** Vacancy continued its nearly uninterrupted ascent, gaining 70 basis points to settle at 17.7 percent... **New York City:** Available sublease space slowly diminished; some firms reevaluated their real estate needs and withdrew sublease space while other companies capitalized on sublease values... **Philadelphia:** Firms engaged in financial activities and professional and business services are hiring, which should boost absorption early next year... **Pittsburgh:** There was an uptick in properties offered for sale including Gateway Center, the Regional Enterprise Tower, Macy's department store and the American Red Cross building... **Washington, DC:** Third quarter absorption totaled more than 900,000 square feet, pushing vacancy slightly lower... **Westchester County:** The two largest deals of the quarter were both renewals: PepsiCo's 75,000-square-foot renewal in Valhalla and law firm O'Connor Davies, Munns & Dobbins' lease for 32,500 square feet in Harrison... **Wilmington:** Significant available supply kept asking rents stagnant.



SOUTHEAST

Atlanta: Several notable tenants including Sony Ericsson and Wells Fargo Insurance Services occupied their new spaces in the Buckhead submarket... **Broward County:** Two investment sales closed at over \$100 million each... **Charleston:** A 66,000-square-foot office building is scheduled to break ground this month in the tony Concord Park development. The project is more than 50 percent pre-leased... **Jacksonville:** Rates and landlord concessions remain aggressive, generating an increase in activity... **Miami:** Despite the completion of 150,000 square feet of new space, robust net absorption of 282,000 square feet pushed vacancy lower for the first time in four years... **Mobile:** Activity has picked up slightly... **Palm Beach County:** Tyco International exercised an early termination option on its existing lease in Boca Raton and inked a deal to relocate within the submarket to 1501 Yamato Road... **Raleigh-Durham:** Class B buildings have taken the hardest hit as tenants upgrade to Class A space at deeply discounted prices. The 25,000-square-foot Six Forks Center III—the final project in the development pipeline—was delivered fully vacant... **Richmond:** Leasing activity consisted primarily of renewals and space-swapping, doing little to improve vacancy or net absorption. The largest lease was a renewal on 107,000 square feet at Windsor Business Park by Bon Secours Richmond Health System... **Tampa:** Landlords are still being pounded by tenants, and that trend is not expected to ease much through next year.

GRUBB & ELLIS OFFICE LOCATIONS



Office Market Trends United States Q3 2010