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WASHINGTON, DC AREA OFFICE MARKET DECLINES ARE SLOWING

Market Appears to be Bottoming Out; Declines Uneven Around Region

Washington, DC, (October 2, 2009)… Although vacancy rates continued to climb around the region in the third quarter and demand was low, the steep market declines of previous quarters seem to be slowing, suggesting that the market is or is close to bottoming out, according to third quarter research reports released today by CB Richard Ellis. The picture around the region continued to be uneven.

In the District, vacancy rates jumped to 11.2%, a number that is expected to continue to rise as more than four million square feet of new deliveries are expected to come to the market in 2010. A hopeful sign, however, was that in the third quarter tenant leasing activity increased and more than 300,000 sq. ft. of expansion space was committed. In Northern Virginia, new leases signed by the federal government and related firms moderated the drop in demand. However, Northern Virginia also saw its fifth consecutive quarter of negative net absorption. Suburban Maryland continues to see weak market fundaments as the lack of new tenant demand persists and concession packages remained at an all-time high.

"It would appear that we have averted Armageddon. We've seen glimpses of clearing skies as evidenced by several large transactions this past quarter. The real estate market here in the region continues to be one of the strongest markets in the country," said Ernest D. Jarvis, Managing Director of CBRE's Washington, DC office.

INDIVIDUAL MARKET SUMMARIES

Washington, DC

- Net Absorption

  Net absorption was negative for the fifth consecutive quarter, returning 12,237 sq. ft., but was considerably higher than the negative net absorption experienced in the past three quarters. While tenants did contract throughout the quarter, the contractions were offset by substantial growth among a number of tenants including Kaiser Permanente, at 700 2nd Street, NE.

- Vacancy Rates

  Overall vacancy rates in the third quarter in the District rose. Almost 1 million square feet of vacant space was from new deliveries during the quarter, which pushed the vacancy to 11.2% from 10.2% in the second quarter. Because of this trend, the highest vacancy rate among all classes was in Class A product, which climbed to 13.4% from the 8.5% rate experienced one year ago. Although the number of tenants closing shop has tapered off, many others are re-evaluating their real estate needs and are marketing sublet space to reduce costs. Sublease space has increased 122% from 875,000 square feet a year ago to 1.9 million square feet in the third quarter.

- Rental Rates

  Full service asking rental rates continued to decline, dropping for the fifth consecutive quarter to $48.16 from $48.59 in the second quarter. These asking rates do not account for the increasingly aggressive rent concessions that landlords are offering as a means to lure tenants to their buildings. Class A rates remained relatively unchanged from the second to third quarters but, when comparing rates year-over-year, there has been significant downward pressure from the peak which occurred at the end of the third quarter of 2008. The downward pressure on direct rents correlates to the significant amount of Class A sublease space on the market in the same period. Sublease space continued to be more competitive with direct space as the majority of the space had term remaining for over four years.

- New Construction

  There was only one building—1000 Connecticut Avenue, NW in the CBD—that began construction during the quarter. The 368,151-square-foot building is 67.9% pre-leased to Arent Fox and will deliver in late 2012. Four buildings delivered to the market in the third quarter—901 K Street NW, 1999 K Street, NW, 375 E Street SW, and 355 E Street SW, adding a total of 1.4 million square feet of new inventor to the District. Only 1999 K Street was fully committed at the time of delivery. There is 4 million square feet of new construction to deliver by the end of 2010, of which 1.4 million will deliver at the end of 2009.

Northern Virginia

- Net Absorption

  Net absorption remained negative in the third quarter totaling 123,144 square feet. Some bright spots were Crystal City, which has maintained positive net absorption since third quarter of 2007, and Fairfax, Arlington and Loudoun Counties, which each posted positive net absorption, although all under 100,000 square feet. These minor gains were offset by negative net absorption from the City of Alexandria and Prince William

County. New government leases signed in Arlington County were not enough to offset contractions from the private sector.

- Vacancy Rates
  Office vacancy rates increased to 14.2% in the third quarter, up from 13.9% in the last quarter. Sublet vacancy rate remained at 1.6%, virtually unchanged from the previous two quarters. Class A vacancy increased for the ninth consecutive quarter.

- Rental Rates
  Overall asking rental rates continued to feel downward pressure for another quarter with average direct asking rents falling by $0.30 to $28.89 from $29.19 last quarter on a full-service basis. Demand in Fairfax County remained stable and landlords there were able to push for slightly higher rents.

- New Construction
  No new major development projects broke ground as developers continued to idle or delay new projects due the restrictive credit environment and current economic conditions. The construction pipeline shrank to just shy of 1.4 million square feet. Of that number, 82% is scheduled to deliver year-end 2009, leaving only 250,000 sq. ft. in the pipeline for delivery in 2010.

Suburban Maryland

- Net absorption
  Net absorption in the second quarter was negative 240,177 square feet due to space returned by tenants in the majority of submarkets. Year-to-date net absorption for the market totals negative 752,532 square feet.

- Vacancy Rates
  Vacancy rates in Suburban Maryland rose to 14.9% in the third quarter from 13.9% in the second quarter due to the delivery of new space and new blocks of sublease space returning to the market. Accounting for 60 percent of the increase in vacancy is 400,000 square feet of new deliveries 91,000 square feet of sublease space Fannie Mae vacated in Bethesda/Chevy Chase and 400,000 square feet of vacant space in the new deliveries.

- Rental Rates
  Average asking rental rates dropped slightly to $26.46 per square foot from $26.53 in the previous quarter. Rates fell for the third time in the past four quarters.

- New Construction
  Three speculative buildings in North Rockville delivered a total of 540,661 square feet in the third quarter. Two buildings were Phases II and III at Redlands Corporate Center

and the third was The Summit at Washingtonian. While Phase III, the smallest of the buildings, was 100% committed to BAE Systems, the other two added a total of 401,541 square feet of vacant space. New construction in Suburban Maryland has seen a dramatic slowdown in activity –with just over 600,000 square feet in the construction pipeline today compared to 2.6 million square feet under construction a year ago.

For the complete Third Quarter 2009 reports detailing the state of office as well as the industrial markets throughout the Greater Washington Region, go to http://www.cbre.com/USA/Research.

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