

# MARKETBEAT

## UNITED STATES OFFICE REPORT

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2Q08

### ECONOMY

The U.S. economy continued to struggle in the second quarter. Real GDP posted a seasonally adjusted annual gain of 1.9% from April to June, following a 0.9% growth rate in the first quarter. Increased consumer spending fueled by the tax rebates combined with the continuing expansion of exports aided by a weak dollar has helped the economy to post modest gains this year. Moreover, the labor market continued to weaken. Continued job cuts through the second quarter and more young people streaming into the labor market unable to find jobs pushed the unemployment rate up to a four-year high of 5.7%. In office-using sectors, payrolls declined 111,000 from April to June, though these office job losses were lower than the 143,000 lost in the previous quarter. Job losses remained heaviest in industries hard hit by the housing and financial crises.

### OVERVIEW

Fundamentals in the U.S. office market remained solid, although they continued to show signs of moderation through mid-year. The overall vacancy rate edged up for the second consecutive quarter, to a still-low 10.2% in Central Business Districts (CBDs) and 15.2% in suburban markets. Demand continued to cool, with overall absorption registering a negative 4.2 million square feet (msf) for CBDs and negative 10.7 msf for suburban markets. Much of this decline in demand continued to reflect the impact of adverse financial trends. In Downtown and Midtown NY, over 1.0 msf were put up for sublease by financial institutions so far this year, and sublease availability is at a two-year high. Similarly, the correction in the financial sector continued to reverberate in suburban Chicago, resulting in an influx of class A sublet space in the second quarter. Furthermore, the completion of 24.5 msf at a time of weakening demand has taken a toll on the U.S. office market. Nearly half of the newly built office space was available upon delivery, adding 1.5 msf and 10.8 msf to vacant space in the CBDs and suburban markets, respectively. Fortunately, tight credit conditions have caused developers to cut back sharply on new construction. Through the second quarter, construction starts have totaled only 20.6 msf compared to 40.6 msf over the same period in 2007. As a result, the construction pipeline dipped to 32.2 msf in the CBDs and 53.5 msf in suburban markets during the second quarter.

However, some bright spots still exist. First, the amount of space givebacks is beginning to show signs of easing in hard-hit markets such as Orange County, CA. Second, while overall sublease vacancy rates for both CBDs and suburban markets are up modestly from 12 months ago, they remain historically low at 1.2% and 1.8%, respectively, and well below their peak rates of 4.0%-5.0% in 2003. Third, rental rates have generally remained steady, except in some markets that have a supply overhang. While landlords are luring tenants with more generous concession packages and have shown more willingness to negotiate, they remain less inclined to reduce rates. Hence, asking rents remain close to or at their peak levels in most markets, averaging \$40.19 per square foot (psf) in CBDs and \$25.24 psf in suburban markets. Lastly, while the year-to-date volume of investment sales is down dramatically (off nearly 70% from this time last year), there is still a reasonable level of activity. Notably, the second quarter showed an improvement despite continued strains in the credit markets; the volume of deals in CBDs and suburban markets combined rose from \$14.1 billion in the first quarter to \$16.25 billion in the second.

It is also worth noting that many markets are defying expectations and holding up well, posting below average vacancies, higher rents and positive absorption. Washington, D.C., Seattle, Portland, and Boston led CBDs as their local economies continued to benefit from stable or growing employment bases including professional and business services and government sectors. Similarly, Cleveland, Northern Virginia, Houston, Denver, Bellevue, Kansas City, and Richmond have outpaced other suburban markets thanks to their significant exposure to defensive sectors such as energy, healthcare, government and information technology.

### FORECAST

The U.S. office market's ability to build upward momentum will hinge on the economic outlook. The growing concern is that tighter credit, combined with a weak job market and rising inflation could depress household wealth and thus further curb consumer spending. At the same time, a slowing global economy threatens to dampen the contribution from U.S. exports. Such a faltering economic backdrop could lead to a prolonged slump in the labor markets—and overall weakness in office demand. Hence, the economy would need to show signs of stabilization before the U.S. office market returns to robust health.

### ECONOMIC INDICATORS

National	2006	2007	2008F
GDP Growth	2.9%	2.2%	1.6%
CPI Growth	3.2%	2.9%	3.6%
Unemployment	4.6%	4.6%	5.5%
Employment Growth	1.8%	1.1%	0.1%

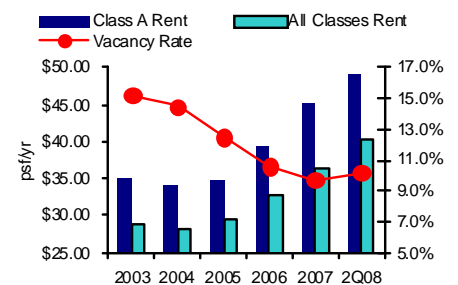
### MARKET FORECAST

**LEASING ACTIVITY** will remain modest and keep absorption well below completions through the balance of the year. Continued economic uncertainty should continue to foster business caution and dampen expansion plans. ↓

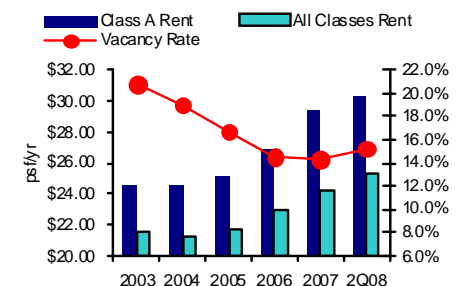
**CONSTRUCTION** completions will continue to rise and reach 58.4 msf at year-end, the highest level in six years. However, expect a rapid slowdown over the next two years: 38.3 msf in 2009 and 9.3 msf in 2010. ↓

**RENTAL RATE** growth is expected to moderate as vacancy rates continue their uptrend through next year. Most owners will continue to lure and keep tenants with generous concession packages rather than offering rent discounts. ↓

### CBD RENTAL VS. VACANCY RATES



### NON-CBD RENTAL VS. VACANCY RATES



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	117,614,136	21.7%	16.0%	\$20.63	\$25.40	452,500	3,881,765	0	1,044,313
Austin, TX**	8,562,886	31,085,573	15.6%	16.7%	\$37.11	\$28.61	****	****	75,000	1,613,251
Baltimore, MD	14,548,401	50,768,611	11.0%	13.9%	\$25.51	\$24.67	140,909	771,262	0	1,230,052
Bellevue, WA	6,735,285	22,247,173	7.1%	11.2%	\$39.69	\$31.08	789,207	1,017,236	406,129	643,540
Birmingham, AL**	5,165,764	11,906,674	8.7%	6.3%	\$20.68	\$21.28	****	****	****	****
Boston, MA	58,604,920	118,568,180	6.6%	15.9%	\$67.82	\$34.09	2,433,725	4,296,478	0	966,702
Buffalo, NY**	10,279,834	9,854,557	15.8%	9.2%	\$24.29	\$17.65	82,769	19,486	0	0
Central NJ	****	73,461,515	****	20.0%	****	\$29.68	****	2,173,418	****	195,000
Charlotte, NC**	14,080,021	28,672,636	2.3%	15.3%	****	****	****	****	0	340,335
Chicago, IL	118,426,722	95,417,610	12.1%	19.7%	\$37.18	\$25.70	3,448,416	3,060,825	413,631	100,000
Cincinnati, OH**	15,207,922	17,725,412	19.9%	22.5%	\$14.46	\$17.10	140,078	183,058	0	267,162
Cleveland, OH**	31,637,568	93,687,378	18.8%	13.9%	\$18.25	\$19.78	578,741	1,001,638	****	****
Columbus, OH**	10,191,717	21,599,715	12.0%	16.9%	\$20.50	\$17.87	303,252	880,673	40,760	104,000
Contra Costa, CA	****	31,524,431	****	15.8%	****	\$29.56	****	1,597,364	****	9,685
Dallas, TX	27,976,098	143,448,311	27.4%	21.6%	\$23.64	\$25.20	1,038,197	6,337,442	0	1,050,110
Denver, CO	24,646,756	69,848,936	10.1%	14.2%	\$32.92	\$23.36	1,648,219	3,907,645	17,304	186,926
Detroit, MI**	24,396,493	64,380,056	22.8%	23.7%	\$21.93	\$20.90	0	247,063	0	0
Downtown, NY	88,990,651	****	7.7%	****	\$62.69	****	2,484,126	****	0	****
Fairfield County, CT	6,741,182	32,747,161	13.8%	13.1%	\$46.71	\$33.01	292,219	746,714	0	0
Fort Myers/Naples FL	****	16,355,402	****	15.1%	****	\$29.06	****	440,707	****	377,445
Fredericksburg, VA**	****	5,501,872	****	17.5%	****	\$25.15	****	208,789	****	0
Ft. Lauderdale, FL	5,032,942	24,349,778	19.1%	13.4%	\$34.80	\$31.74	206,724	1,101,437	66,917	303,587
Hampton Roads, VA**	4,998,848	35,518,465	7.7%	8.2%	\$21.45	\$20.81	18,561	603,096	0	278,859
Hartford, CT	7,891,438	17,307,818	17.6%	14.8%	\$22.59	\$21.41	163,042	650,578	0	48,684
Houston, TX	35,755,493	123,322,591	11.5%	13.2%	\$38.47	\$28.77	1,525,328	6,397,925	0	1,837,319
Indianapolis, IN**	10,653,727	23,244,701	13.6%	19.9%	\$20.27	\$19.29	279,641	644,127	0	223,746
Inland Empire CA	****	15,141,415	****	19.3%	****	\$28.72	****	395,278	****	511,499
Kansas City, MO**	15,512,160	46,883,356	13.8%	13.8%	\$18.61	\$22.28	53,291	610,763	0	392,641
Las Vegas, NV**	3,506,029	43,924,977	6.2%	17.5%	\$40.20	\$32.52	****	****	0	1,966,513
Long Island, NY	****	31,160,790	****	11.5%	****	\$36.05	****	739,147	****	0
Los Angeles, CA	28,628,909	30,361,262	13.0%	10.0%	\$38.93	\$30.80	882,633	602,170	0	26,001
Los Angeles-North, CA	****	29,621,419	****	12.3%	****	\$33.06	****	713,559	****	255,192
Los Angeles-South, CA	****	30,288,329	****	14.5%	****	\$27.96	****	2,270,017	****	0
Los Angeles-Tri-Cities, CA	****	21,836,296	****	8.5%	****	\$38.92	****	912,023	****	0
Los Angeles-West, CA	****	48,575,640	****	8.8%	****	\$50.77	****	2,182,186	****	66,899
Louisville, KY**	9,051,547	10,565,509	12.9%	14.6%	\$20.43	\$19.33	96,509	351,065	0	84,267
Memphis, TN**	5,528,176	21,089,049	16.0%	14.1%	\$16.67	\$23.35	87,067	191,990	0	0
Miami, FL	11,914,331	32,454,798	13.0%	12.1%	\$45.49	\$36.83	539,014	1,056,775	20,400	362,246
Midtown South, NY	64,744,011	****	5.9%	****	\$67.95	****	1,575,264	****	0	****
Midtown, NY	241,151,199	****	7.1%	****	\$94.01	****	7,496,609	****	2,100,000	****
Milwaukee, WI**	20,774,219	86,047,383	17.0%	10.4%	\$17.25	\$15.92	367,126	851,824	0	280,537
Minneapolis, MN	33,264,136	42,165,226	16.4%	15.5%	\$27.29	\$27.85	****	****	0	424,343
Nashville, TN**	10,126,543	46,415,688	9.5%	9.0%	\$20.55	\$21.62	96,476	517,114	0	336,429
New Haven, CT	2,867,835	6,969,652	7.7%	16.5%	\$27.41	\$23.23	54,579	159,725	0	16,000
Northern NJ	****	104,563,983	****	16.2%	****	\$30.08	****	2,669,463	****	196,000
Northern VA	****	124,991,452	****	12.2%	****	\$35.27	****	3,589,906	****	2,980,796
Oakland, CA	12,785,376	13,213,106	15.4%	16.2%	\$33.77	\$32.88	306,137	498,127	0	0
Orange County, CA	35,831,625	44,720,858	17.1%	15.0%	\$37.55	\$36.40	1,921,891	1,840,803	340,488	649,084
Orlando, FL	7,268,802	29,317,796	15.2%	14.9%	\$28.66	\$24.62	197,918	868,924	152,000	501,759
Palm Beach, FL	2,944,142	21,136,641	16.2%	16.2%	\$46.65	\$33.75	88,439	669,862	296,000	210,000
Philadelphia, PA	41,890,928	86,832,082	9.5%	14.8%	\$27.74	\$26.70	1,347,361	2,609,518	0	324,226
Phoenix, AZ	15,844,953	54,837,626	13.5%	18.3%	\$29.50	\$28.65	600,878	3,129,419	100,000	2,240,867
Pittsburgh, PA**	31,229,812	78,656,301	12.6%	10.8%	\$22.98	\$19.95	964,197	1,103,016	158,000	438,665
Portland, OR	20,140,487	20,500,797	9.1%	13.5%	\$26.49	\$24.47	609,110	794,775	117,000	63,960
Raleigh/Durham, NC**	5,132,706	32,923,116	****	****	\$22.12	\$20.75	****	****	****	****
Richmond, VA**	10,881,928	42,786,236	10.1%	7.2%	\$22.63	\$18.95	34,565	635,503	76,600	444,462
Rochester, NY**	6,815,847	7,049,449	23.7%	11.1%	\$21.00	\$19.25	****	****	****	****
Salt Lake City, UT**	6,477,773	23,158,240	9.4%	13.0%	\$26.67	\$22.86	130,264	764,032	0	163,282
San Diego, CA	11,052,353	58,671,268	12.6%	14.1%	\$35.40	\$37.68	292,518	2,580,876	0	638,908
San Francisco Peninsula, CA	****	33,410,434	****	12.9%	****	\$46.64	****	1,086,820	****	169,858
San Francisco, CA	47,521,866	23,444,343	8.8%	11.7%	\$53.97	\$40.34	1,947,262	720,739	321,545	273,272
San Juan, PR**	5,987,647	9,689,333	11.3%	14.5%	\$20.00	\$20.00	****	****	****	****
Seattle, WA	37,212,516	8,668,811	8.3%	16.2%	\$38.88	\$23.50	912,517	369,062	177,200	17,464
Silicon Valley, CA	6,122,587	34,633,044	16.9%	13.6%	\$35.36	\$36.88	243,103	1,321,027	0	680,400
Southern NH	****	11,731,726	****	17.9%	****	\$19.50	****	420,654	****	0
St. Louis, MO**	14,320,348	37,171,863	17.5%	10.9%	\$18.99	\$23.79	305,274	1,388,018	0	247,584
St. Petersburg/Clearwater, FL	****	12,755,447	****	18.3%	****	\$23.13	****	339,048	****	0
Suburban MD	****	55,410,597	****	13.1%	****	\$31.61	****	1,503,328	****	303,788
Syracuse, NY**	7,697,415	10,042,853	24.1%	13.8%	\$16.37	\$17.88	154,122	395,912	0	14,000
Tampa, FL	6,397,980	23,523,936	18.3%	12.3%	\$23.60	\$25.16	181,571	1,084,790	0	194,472
Tucson, AZ**	2,761,740	17,139,560	5.1%	9.3%	\$23.36	\$23.42	16,145	282,210	0	169,601
Washington, DC	95,410,764	****	7.7%	****	\$54.80	****	3,331,463	****	871,516	****
Westchester County, NY	6,239,527	22,132,760	12.5%	14.9%	\$35.55	\$31.33	159,492	484,497	0	0
<b>TOTAL - ALL MARKETS</b>	<b>1,431,130,024</b>	<b>2,866,773,139</b>	<b>11.1%</b>	<b>14.5%</b>	<b>\$42.70</b>	<b>\$27.46</b>	<b>41,018,449</b>	<b>82,872,691</b>	<b>5,750,490</b>	<b>26,465,731</b>
<b>TOTAL - C&amp;W MARKETS</b>	<b>1,140,151,354</b>	<b>2,010,053,187</b>	<b>10.2%</b>	<b>15.2%</b>	<b>\$49.15</b>	<b>\$30.27</b>	<b>37,310,371</b>	<b>71,993,314</b>	<b>5,400,130</b>	<b>19,100,397</b>

\*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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