

Summer 2001

OFFICE Market Trends

A Survey of the Nation's Office Markets

CONTENTS

Executive Summary	1
Vacancy Rates	2
Space Markets Update	3
Capital Markets Update	4
Rental Rates	5
Regional Spotlight	6-7

Office Market Trends

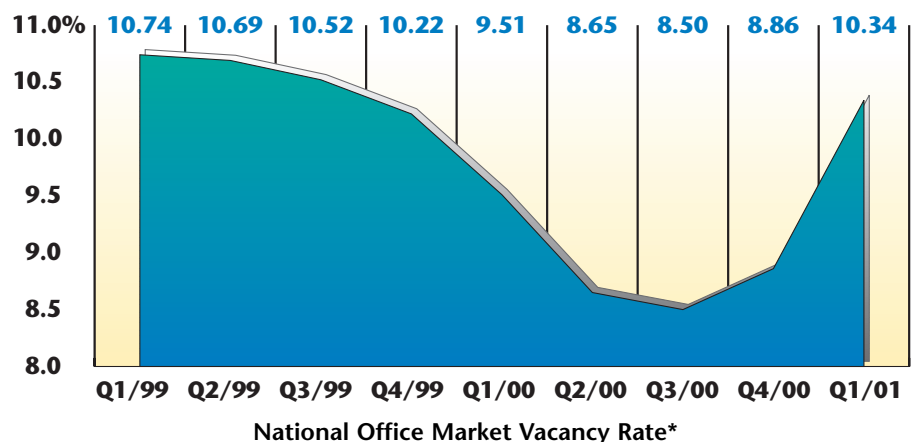
is a newsletter published semi-annually by Grubb & Ellis Company. To obtain additional copies or other Grubb & Ellis publications, please contact:

Robert Bach

National Director, Market Analysis
Grubb & Ellis Company
2215 Sanders Road, Suite 400
Northbrook, IL 60062
Phone: 847.888.7468
E-mail: research@grubb-ellis.com
Internet: www.grubb-ellis.com

The Bottom Line

After years of rewarding landlords, the office market swung dramatically in the tenants' favor during the first quarter, but tenants were too busy coping with deteriorating business conditions to do much about it. The vacancy rate increased by 149 basis points to its highest level in six quarters. Although the vacancy rate alone remains in the zone of a balanced market, other indicators such as negative absorption, a flood of sublease space and the swiftness of the market change are more worrisome. We expect the vacancy rate to rise to around 12 percent by the middle of 2002 with conditions continuing to favor tenants.



* All Classes of Space



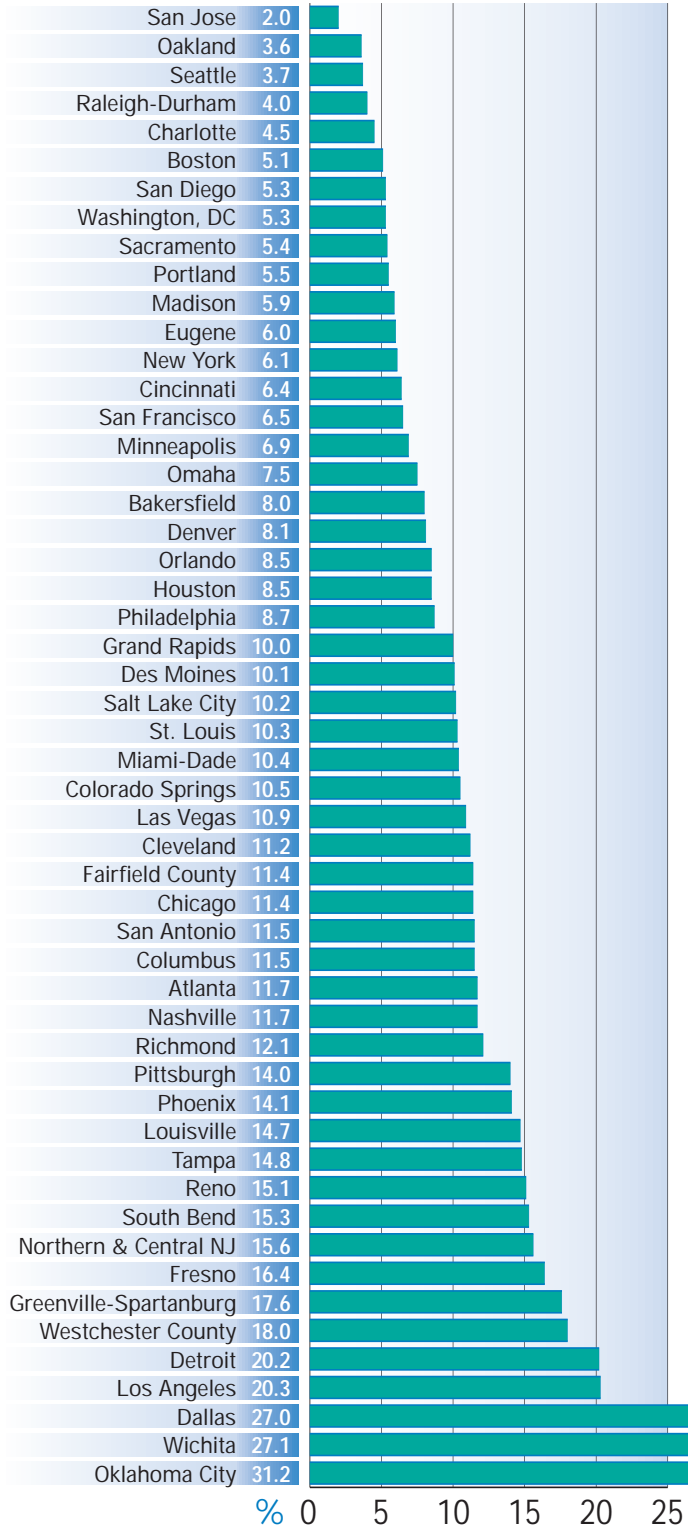
Global Alliance

Vacancy Rates

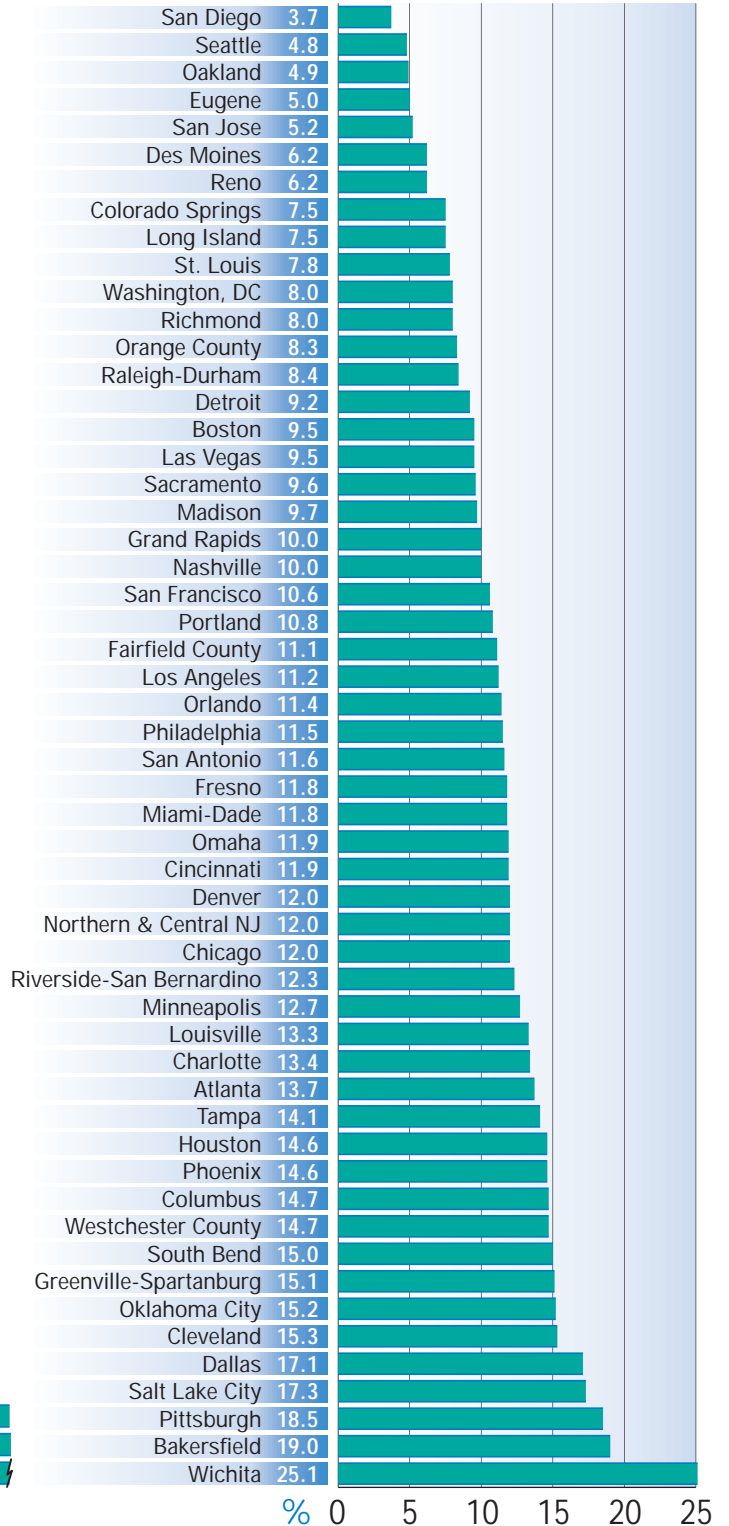
Total Market Vacancy Rates, First Quarter 2001

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 first quarter.

Market: CBD



Market: Suburban



Space Markets Update

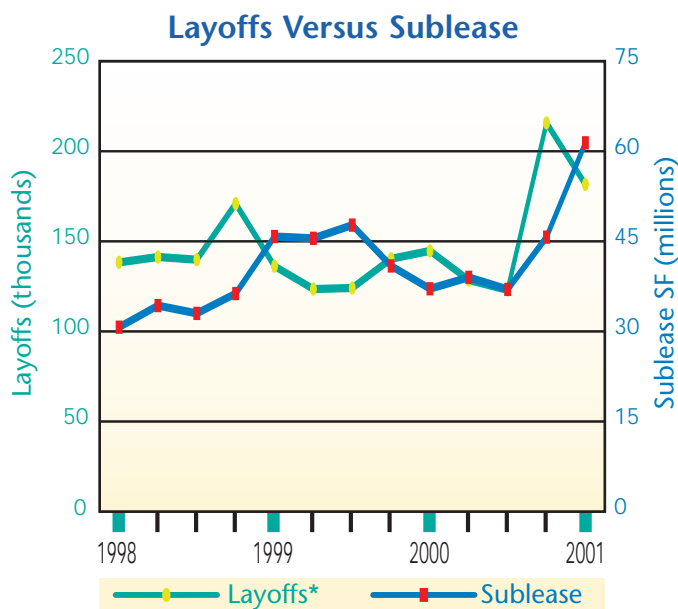
Do you remember the party line in vogue six months ago, to wit: The office market is so tight thanks to developer and lender discipline that only a complete collapse of demand could put a dent in it? Consider it dented. A lapse in developer discipline accompanied by what can only be described as a collapse of demand dragged the vacancy rate above 10 percent in the first quarter. The vacancy rate isn't the problem because, by itself, it indicates a balanced market. Other indicators paint a more ominous picture. Net absorption totaled -7.4 million square feet; sublease space soared by 34 percent, ending the quarter above 61 million square feet; and asking rents declined by 1.1 percent for Class A space and 1.3 percent for Class B space. Landlord concessions are beginning to appear. The amount of competitive space under construction at the end of the quarter totaled 114 million square feet, down from nearly 125 million square feet in the third quarter of 2000. But the level of construction isn't coming down fast enough to make up for the plunge in demand. Indeed, with first quarter absorption in the red, the vacancy

rate would have risen without any new supply delivered to the market.

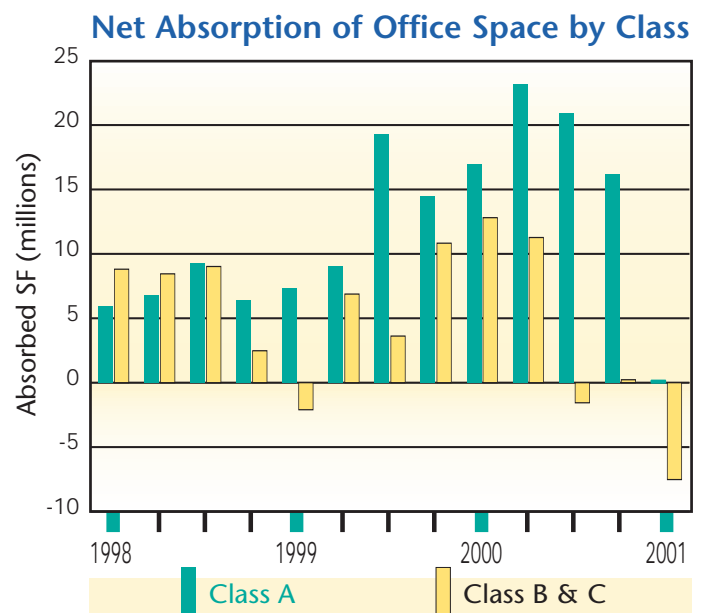
The office market is yet one more victim of the tech wreck. Grubb & Ellis estimates that companies whose primary line of business is new technology accounted for more than one-third of all leasing activity in 1999 and 2000. These companies include established blue chip hardware and software companies, telecommunications companies, newly minted (and recently terminated) dot-coms and companies engaged in biotech research and development. The grab for space, fueled by venture capital, inflated absorption to unsustainable levels in the second half of 1999 and first half of 2000. Unfortunately many of the development projects now in the construction pipeline were predicated on what proved to be an unsustainable level of demand.

Some prospective tenants are waiting to see if they can get a better deal after the downturn plays out. Others are not in a frame of mind to lease space at any price, considering that corporate earnings in the first

quarter were mired at their lowest level in nine years. There are exceptions, for which one need look no further than the oil industry in Houston. Many smaller markets in the middle of the country appear to be holding up, as discussed beginning on page 6. But in general, the poor first quarter earnings could trigger more layoffs and work against a quick restoration of prior market conditions. The loss of 223,000 jobs in April was the steepest decline since the recession year of 1991 and the second steepest decline since 1983. If layoffs continue, the office market will continue to struggle with a flood of sublease space. If the economy stops hemorrhaging jobs, net absorption could return to the black fairly quickly. Assuming no net absorption over the next six quarters, the construction pipeline would push vacancy from the current 10.34 percent to about 14.5 percent, within shouting distance of the peak of 18.0 percent that occurred in 1991. A more likely scenario is that net absorption will be low but positive, pushing vacancy into the 12 percent range by the middle of 2002.



* Average layoffs per quarter.



Source: U.S. Bureau of Labor Statistics, Grubb & Ellis

Capital Markets Update

Office investment activity held up well in the first quarter. The sluggish economy and anecdotal reports of a growing spread between buyer and seller expectations had little effect on the dollar volume of announced sales, which came in at \$9.0 billion. This was below the fourth quarter total of \$10.5 billion but well above the first quarter 2000 sales volume of \$6.0 billion. Blockbuster deals dominated the market including two high-profile Manhattan landmarks, Rockefeller Center and Citigroup Center, which together accounted for over \$2.5 billion, 28 percent of the total for the quarter. The average price per square foot paid for office assets remained quite high at \$192. The average cap rate made a surprise move to the downside, averaging 9.19 percent for assets greater than \$20 million in the first quarter compared to 9.67 percent in the fourth quarter of 2000. In the context of a weakening

market, the rise in the average price per square foot and the decline in the cap rate indicate a flight to quality assets, particularly in supply-constrained financial districts such as Boston, Manhattan and Washington, DC. The Northeast accounted for a stunning 63 percent of the value of office transactions announced in the first quarter, while the Pacific Region was a distant second with 21 percent. In another indication of the flight to quality, or at least a flight to larger assets, office deals valued in excess of \$100 million accounted for 60 percent of the total volume of deals tracked in the first quarter of 2001. By comparison, these mega-deals accounted for 47 percent of the total during 2000.

Institutional investors, including pension fund advisors and commingled funds, accounted for only 19 percent of office investment dollar volume in the first quarter of 2001

compared to 38 percent during 2000. Private partnerships, individuals and limited liability companies increased their activity dramatically from 30 percent in 2000 to 56 percent in the first quarter of 2001. Once again REITs were net sellers as they focused on development, prudent asset management and cultivating income from related activities as allowed by the REIT Modernization Act. Despite investors' stated preference for defensive assets including multi-housing and single tenant industrial, office properties captured 56 percent of the total investment volume in the first quarter, almost identical to last year's showing of 55 percent. Office properties have traded more frequently over the past few years, moving from 41 percent of the total investment volume in 1998 to the current 56 percent.

Transactions

Grubb & Ellis is pleased to announce that it represented the following companies in office transactions during the fourth quarter of 2000 and first quarter of 2001:

SSR Realty Advisors

Investment Sale - 635,000 Sq. Ft.
Norwalk, CT

IBM

Lease - 163,585 Sq. Ft.
Tampa, FL

Tyco Electronics

Lease - 326,000 Sq. Ft.
Wayland, MA

Townsend Capital

Investment Sale - 151,000 Sq. Ft.
Dublin, OH

Kilroy Realty Corporation

Lease Renewal - 157,458 Sq. Ft.
Irvine, CA

Verizon Wireless

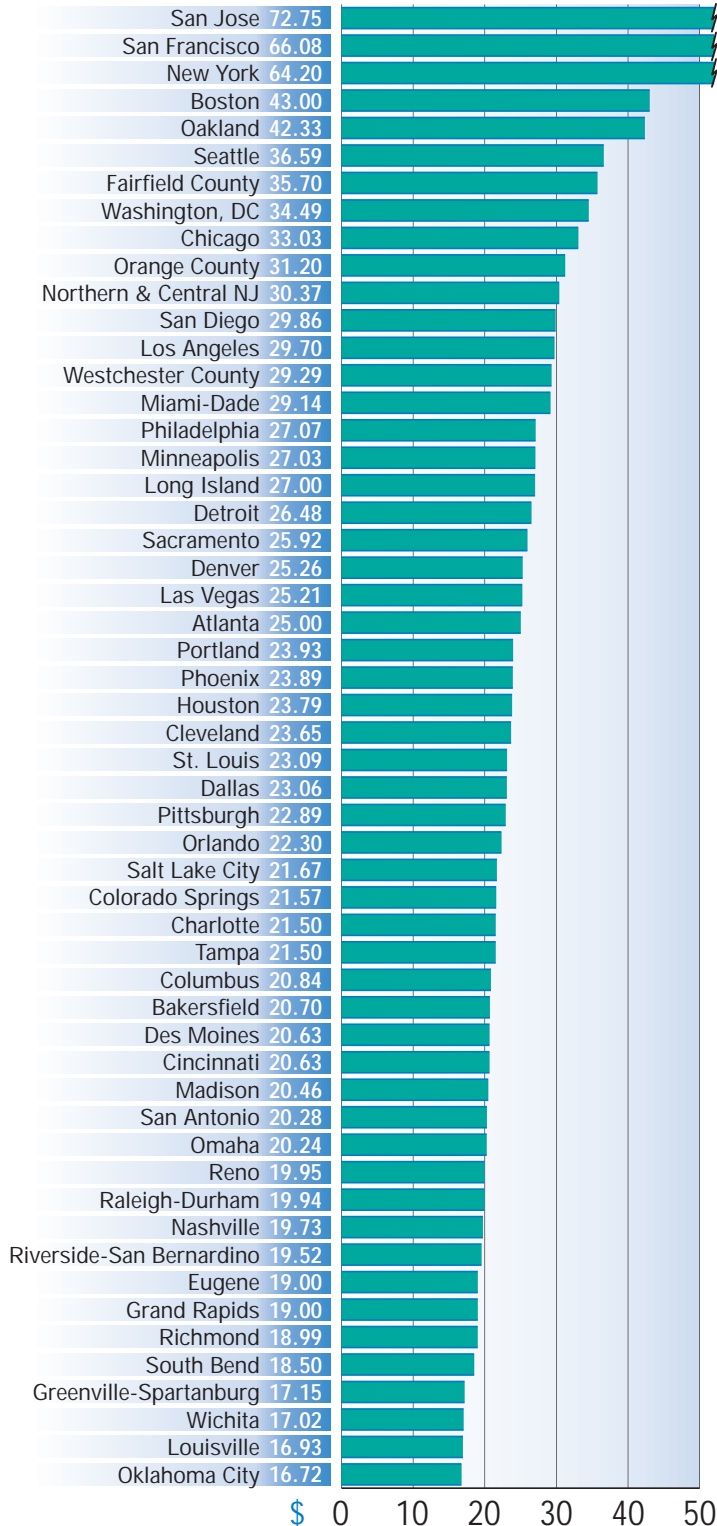
Lease - 120,000 Sq. Ft.
Salt Lake City, UT

Rental Rates

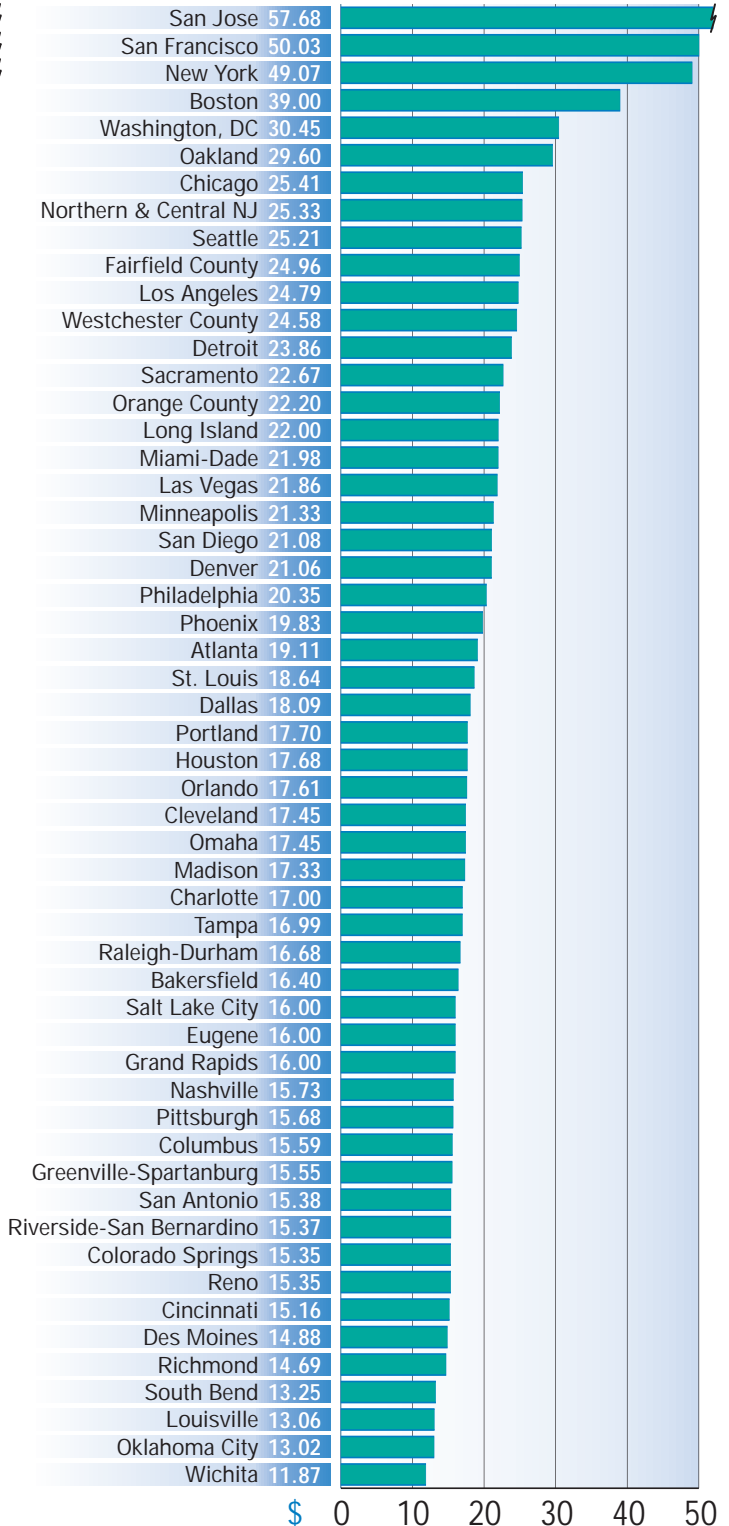
Asking Rental Rates, First Quarter 2001

Note: Rental rate data refer to asking rents for space that is available on the market at the end of the first quarter. Rates are per square foot, quoted on an annual, full service gross basis. Rates for each available suite are weighted by the size of the building in which the suite is located.

Market: Class A



Market: Class B



Pacific Northwest



Eugene: Vacancy is healthy in most areas. Class A space is in demand while B and C space has softened. The Land Use Code is hindering downtown development...

Oakland-East Bay: The Tri Valley/North I-680 market dipped. Vacancy almost doubled while rents and transaction velocity decreased... **Portland:** The diversified economy and the Urban Growth Boundary have insulated this market from drastic swings, but some tech-heavy submarkets have been hit harder than average. Modest concessions have returned in the form of free rent. Many developers have delayed their projects to wait for stronger pre-leasing or a build-to-suit tenant... **Sacramento:** The market has seen little or no effect from the national slowdown. Ten of the 11 submarkets posted lower vacancies this quarter, and rents are inching up. Over 3 million square feet is under construction... **San Francisco:** The CBD appears to be showing early signs of stabilization. The South of Market/Multimedia Gulch area continues to bear the brunt of the dot-com downturn with vacancy over 20 percent... **San Jose:** Demand softened considerably, and rents stabilized. Tenants who had been searching for space now believe they can negotiate a better deal by waiting. Several large planned developments are being delayed indefinitely... **Seattle:** Bargaining power shifted dramatically to tenants in the first quarter. Asking rates are stagnant overall and declining in certain submarkets. Boeing's surprise announcement that it will move its headquarters to Chicago is expected to create 435,000 square feet of additional vacant space, but the psychological impact of the move will be far greater.

Pacific Southwest



Bakersfield: Vacancy declined in the first quarter. The CBD is the tightest it has been in 20 years. The new University Centre submarket has absorbed almost all of its vacancy and will see new construction by the end of

2001... **Los Angeles:** Most submarkets posted negative absorption except Downtown Los Angeles and the San Gabriel Valley, which were not in vogue with the dot-coms. The market dodged the threatened writers strike, which will improve leasing conditions in the Westside and Tri-Cities... **Orange County:** Vacancy and absorption stumbled in the first quarter. The market recorded -278,000 square feet of absorption while 307,000 square feet of new space was delivered to the market. An additional 2.9 million square feet is under construction... **Riverside-San Bernardino:** The Inland Empire was one of the few markets nationwide to post positive absorption in the first quarter. In fact, it trailed

only Northern and Central New Jersey and Atlanta, much larger markets, in absolute demand for space. Absorption was buoyed by the recent completion of six projects...

San Diego: The market absorbed more than 200,000 square feet in the first quarter (the good news), but this was the lowest quarterly total in 3-1/2 years (the bad news). Sublease space jumped to more than 700,000 square feet.

Mountain Southwest



Albuquerque: The market has regained its balance following a mid-2000 correction that was accompanied by concessions and dropping lease rates. Tenants are gravitating to Class B buildings where costs are lower. The

mid-2002 completion of the Big-I reconstruction project will literally reopen the city... **Colorado Springs:** Softness in the tech sector has unleashed a flood of Class A sublease space. Vacancy rates are expected to increase in the second quarter accompanied by a decline in rents... **Dallas-Fort Worth:** Sublease space soared by 60 percent in the first quarter, flattening lease rates and handing negotiating leverage to tenants. Landlords are becoming wary of tenant credit quality... **Denver:** The market posted substantial negative absorption in the first quarter triggered by downsizings at Lockheed Martin, Level 3, Verizon Wireless, Samsonite and other local employers. Landlords responded with concessions. Even so, the amount of space under construction and planned continues to increase, raising fears of an oversupply. So far developers have pulled the plug on only a few projects such as the 800,000 square foot campus that was proposed by Janus Capital Corporation for the Lowry Redevelopment... **Houston:** The CBD remains tight with Class A occupancy above 95 percent for the past three years. Three new towers are under construction with 78 percent of the new supply pre-leased, while two other properties have undergone extensive renovations... **Las Vegas:** Development has slowed considerably over the past year primarily due to tougher lending criteria for spec projects. First quarter absorption was down... **Oklahoma City:** Bucking the national trend, the local market posted increasing occupancy, absorption and rents in the first quarter. The CBD, which has the highest vacancy, saw the greatest absorption... **Phoenix:** Businesses and investors were cautious to commit to space, lowering both leasing and sales activity. First quarter absorption was moderately negative... **Reno:** Tenants were a little slower to negotiate leases. Sublease space increased over the quarter, and several planned projects were put on hold, which should help stabilize the market... **Salt Lake City:** Activity is slowing. Asking lease rates dropped in some older properties, and recently vacated space has been slower to fill.

Midwest



Chicago: Absorption turned negative in the CBD and suburbs, pushing vacancy sharply higher. Boeing will occupy 270,000 square feet at 100 N. Riverside Dr. in the CBD...

Cincinnati: Newly constructed supply helped push absorption near the total for all of 2000... **Cleveland:** Downtown landlords await the impact of LTV's Chapter 11 filing. In the eastern suburbs, vacancy has risen sharply and could hit 19 percent by yearend... **Columbus:** Spec development has slowed dramatically in concert with tenant demand. Sublease space rose by over 25 percent in the first quarter... **Des Moines:** The CBD Class A market is very tight while B and C space is softening. Developers have responded with over 700,000 square feet of redevelopment projects slated to begin in the next 12 months... **Detroit:** Ann Arbor, Dearborn and Troy posted positive absorption, but Southfield was hit hard. More sublease space is anticipated... **Grand Rapids:** Some CBD vacancies may occur in the next 12 months due to bank consolidations and the relocation of tenants to the North Monroe district. The suburbs remain strong with several new projects under construction... **Madison:** Vacancy remains low overall, but construction is pushing vacancy higher in the Far West submarket... **Minneapolis:** Vacancy hit double digits for the first time in five years. Roughly 1.3 million square feet of space is available for sublease representing 19 percent of the vacant inventory... **Omaha:** The CBD remains very tight with no new construction scheduled for delivery until 2002. Sublease space has pushed the suburban vacancy to a five-year high... **St. Louis:** The market has been stable with a good balance of supply and demand. Construction is heaviest in Clayton. The Class B CBD market has made a terrific recovery in the last two years... **South Bend:** First quarter activity increased thanks to aggressive rental rates and concessions... **Wichita:** The CBD remains soft. Tenants view suburban space as a greater value and will pay a premium for Class A space.

Northeast



Boston: Vacancy increased more sharply than any other market, and net absorption exceeded minus 1.5 million square feet, trailing only New York. Asking rents were off by 15 to 20 percent from last year's highs but are still 15 percent above 1999. Tenants are playing the waiting game. Pre-leasing, which was running at about 70 percent last year, is now at 34 percent... **Long Island:** The limited amount of construction should help insulate the market... **New Jersey:** The market bucked the national trend by absorbing nearly 2 million square feet despite the addition

of over 1 million square feet of sublease space. A handful of large deals made the difference, including the completion and occupancy of a 788,000 square foot building on the Hudson Waterfront... **New York:** Demand for space has weakened conspicuously. Tenants are waiting in anticipation of a better deal later on. For the first time since 1996, overall asking rents decreased. For now, material slippage in rents has been limited to secondary buildings. Class B buildings accounted for 78 percent of the 2 million square feet of negative absorption in the first quarter... **Philadelphia:** Sublease space has pushed vacancy into double digits. Over 2 million square feet is under construction in the suburbs... **Pittsburgh:** The delivery of spec construction pushed vacancy up by a full percentage point... **Washington, DC:** The market slowed but not as sharply as some other areas thanks to the insulating effect of the Federal government. Sublease increased in northern Virginia and Maryland, while the District remained strong.

Southeast



Atlanta: The market posted 568,000 square feet of positive absorption in the first quarter, the second strongest performance in the nation trailing only New Jersey. Modest landlord concessions are in effect. Sublease space rose by 44 percent... **Charlotte:** First quarter absorption was positive 295,000 square feet, up slightly from the fourth quarter... **Greenville:** The economic downturn and the dissolution of Homepoint.com pushed vacancy higher. More than 533,000 square feet of construction is underway... **Louisville:** Class A suburban vacancy is increasing, exacerbated by sublease space and over 700,000 square feet of construction anticipated for delivery in the next six to nine months... **Miami:** New construction and a surge in sublease space dragged the vacancy rate almost 3 percentage points higher during the quarter... **Nashville:** Vacancy is inching up in the CBD. Demand remains strongest in Brentwood and Cool Springs. Large blocks of sublease space are available... **Orlando:** The increase in sublease space is particularly evident in southwest Orlando where many start-up tech firms were once operating. The East/University submarket continues to prosper with the expansion of defense-related companies... **Raleigh-Durham:** The anticipated slowdown came to fruition in the first quarter, generating a large amount of sublease space that is competing with first-generation space... **Richmond:** Large blocks of direct and sublease space have pushed vacancy higher. However, the CBD is enjoying its best occupancy in 20 years... **Tampa Bay:** The market is generally healthy despite the slowing economy. As elsewhere in the country, the business community has adopted a "wait and see" attitude.

Office Locations

Nationwide coverage delivered through the Grubb & Ellis System

