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### Office Market Trends

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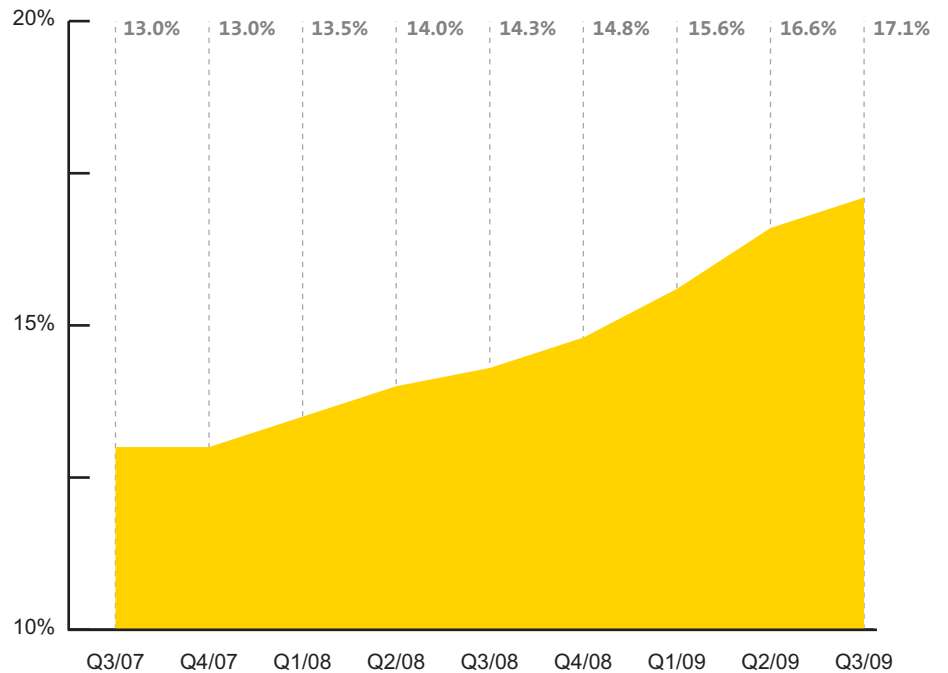
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## Bend In the Trend?

US OFFICE VACANCY RATE\*



\* All classes of space

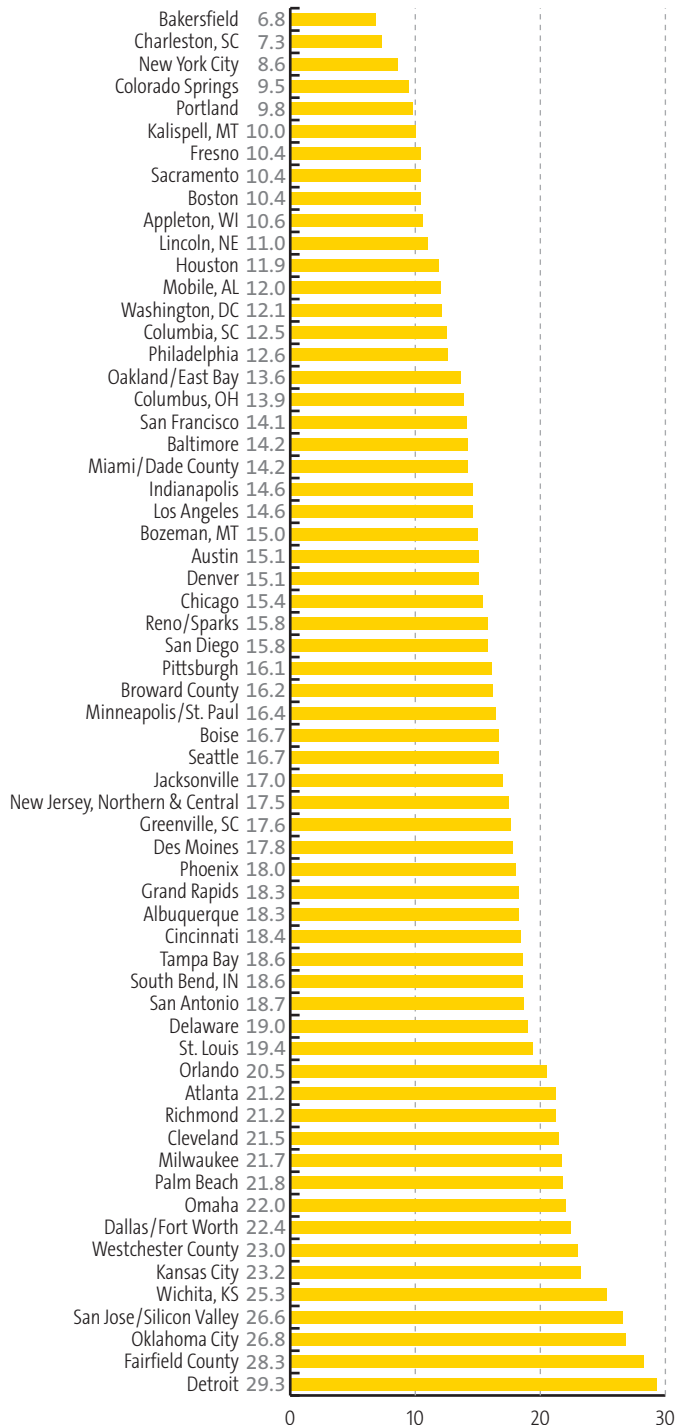
### THE BOTTOM LINE

The pace of deterioration slowed in the third quarter as vacancy rose to 17.1 percent, up 50 basis points compared with increases of 80 and 100 basis points in the first and second quarters. Absorption, though negative, was about half the pace of the prior two quarters. One theory among economists is that panicked employers “over-fired” after the credit markets froze in September 2008; the faster pace of leasing market deterioration in the first half of the year may have reflected this panic. Despite the relative improvement in the third quarter, the office market is unlikely to embark on a sustained recovery before 2011 and may not reach equilibrium for two or three years after that.

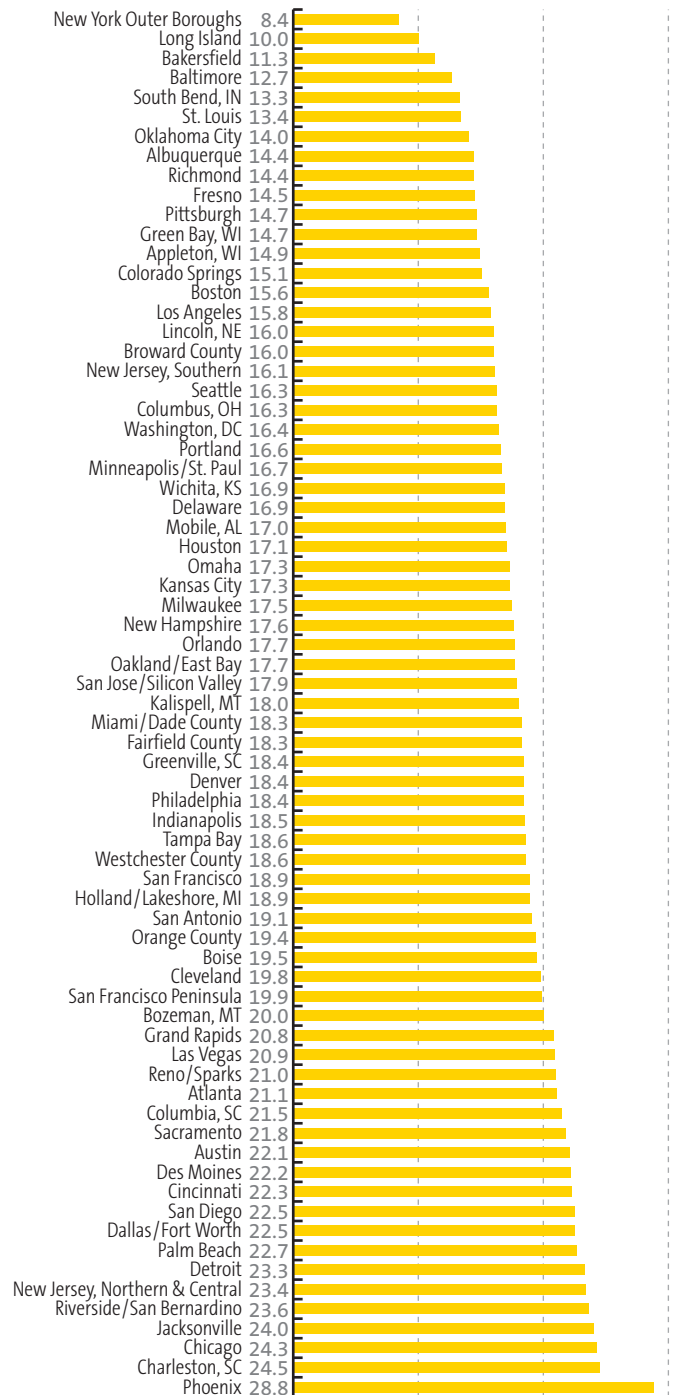
## METRO VACANCY RATES

**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



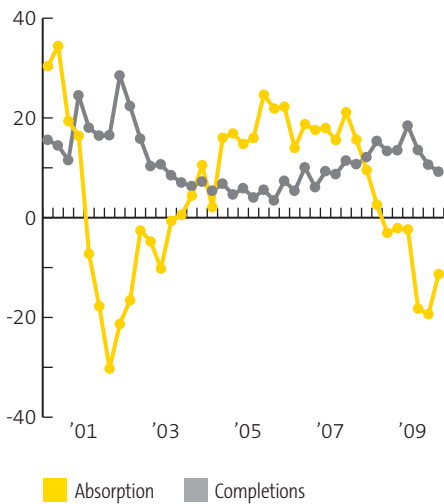
### Suburban % Vacant



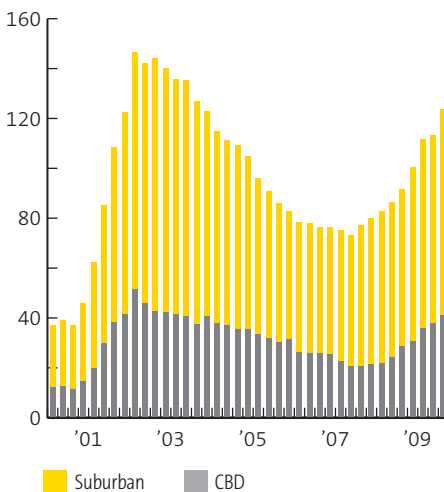
**STATE OF THE MARKET**

The vacancy rate ended the third quarter at 17.1 percent, up 50 basis points from the second quarter. By comparison, vacancy in the first and second quarters increased by 80 and 100 basis points, respectively, which suggests some moderation in the pace of softening.

**Absorption and Completions**  
in Millions of Square Feet



**Available Sublease Space**  
in Millions of Square Feet



- **Manhattan**, despite its starring role in the credit crisis, retained the second-lowest major-market vacancy rate in the nation at 8.6 percent, bested only by the adjacent **Outer Boroughs** market at 8.4 percent. This is somewhat misleading, however, in that Manhattan's availability rate, a leading indicator for the vacancy rate, was 14.5 percent, suggesting that vacancy is set to rise. Tenant move-outs scheduled over the next six months corroborate this trend. Vacancy was highest in **Phoenix** at 26.3 percent followed by **Detroit** at 24.4 percent. Over the past four quarters, vacancy in **Silicon Valley** rose by 730 basis points to 19.1 percent, the fastest increase in the nation.

Third-quarter absorption totaled negative 11.3 million square feet, an improvement over the first and second quarters when tenants gave up a combined 37.6 million square feet.

- Absorption was positive in 20 of 67 markets led by **Baltimore** with 496,000 square feet. **Pittsburgh**, **Austin** and **San Antonio** also ranked near the top, suggesting some resilience in the Mid-Atlantic and central Texas regions. At the other end of the spectrum, **Seattle** tenants vacated 1.6 million square feet, followed by **Boston** and **Chicago** each with

more than 1 million square feet of negative net absorption. In Seattle, the loss of Washington Mutual was partially offset when Russell Investments announced that it would relocate from Tacoma into 300,000 square feet at the former WaMu Center. Northwestern Mutual, Russell's parent company, bought the building as part of the deal for a surprisingly low \$115 million or \$130 per square foot.

Space under construction ended the quarter at 45.6 million square feet, its lowest level in more than four years. The pipeline will continue to empty for several more quarters as existing construction projects are finished and new starts are rare.

- **Washington, D.C.** and **Manhattan** had the most space under construction by far at 6.3 and 6.0 million square feet, respectively, followed at a distance by **Seattle**, **Chicago**, **Houston** and **Miami**, all with between 1 and 2 million square feet in the pipeline.

Last quarter, the inventory of available sublease space added a negligible 1.4 million square feet, which was a hopeful sign. Unfortunately it was a false alarm as the third quarter brought 10.5 million square feet of newly offered sublease space. The total now stands at 124 million square feet, not far from the record peak of 146 million square feet in 2002.

- The credit crisis has inflated **Manhattan's** sublease inventory to 15.7 million square feet, by far the largest in the nation. Manhattan's total, down by 463,000 square feet from the second quarter, remains nearly three times the recent low point

recorded in the third quarter of 2007 shortly after the credit markets first seized up. As a percent of total inventory, however, Manhattan's supply of sublease space ranks third at 4.3 percent. The tech-heavy **San Francisco Peninsula** and **Northern and Central New Jersey**, where corporate downsizing seems to be perpetual, are at 6.3 and 4.8 percent, respectively.

*Now that the recession appears to be winding down, tenants may feel less of a need to further slash their space requirements.*

Asking rental rates eased lower in the third quarter with Class A and B rates down by 1.9 and 1.3 percent respectively. Over the past four quarters, Class A and B rates are off by 4.3 and 3.7 percent. There is some evidence that the pace of decline is accelerating. Year-to-date effective rates, which include periods of free rent and above-standard tenant improvement allowances, are off by 15 percent compared with 2008.

- The hot markets during the most recent expansion cycle are now suffering the consequences as rental rates slide. Over the past four quarters, asking rates fell by a breathtaking 36 percent in the **San Francisco Peninsula** market and 27 percent in **San Francisco** itself. **Manhattan** and the California markets of **Orange County** and **Oakland-East Bay** also recorded double-digit drops, though in the more moderate range of 10 to 15 percent. A small handful of markets posted low but positive gains in asking rates over the past four quarters led by **San Antonio** where large tenant relocations by Medtronic and Whataburger kept a floor under demand and overcame the departure of AT&T to **Dallas** and the move by Tesoro into owner-occupied space.

The capital markets are on hold right now. The news is all about the lack of debt capital to refinance maturing loans and, on the flip side, the growing pool of equity capital waiting to invest in distressed assets, primarily debt. The standoff is because sellers don't want to sell into the biggest buyers' market since the early 1990s, and they are being enabled by banks (pretend-and-extend or pray-and-delay) and the IRS, which has relaxed the rules for amending the terms of CMBS loans. So the dollar volume of sales remains very

low, down 75 percent for all property types year-to-date and down 78 percent for office properties. Pricing on repeat sales has retreated sharply according to the Moody's/REAL commercial property index, down 37.5 percent over the past two years for all property types and 27.4 percent for office properties. Distressed assets continue to pile up, totaling \$138 billion at the end of August, of which distressed office properties comprise \$21.4 billion according to Real Capital Analytics. This is actually a relatively moderate level of distress considering that retail, hotel and apartment properties listed as distressed totaled \$34, \$28 and \$22 billion, respectively. At some point these and many more assets will begin to change hands, but whether that process resembles a dam breaking or a steady flow is uncertain.

## FORECAST

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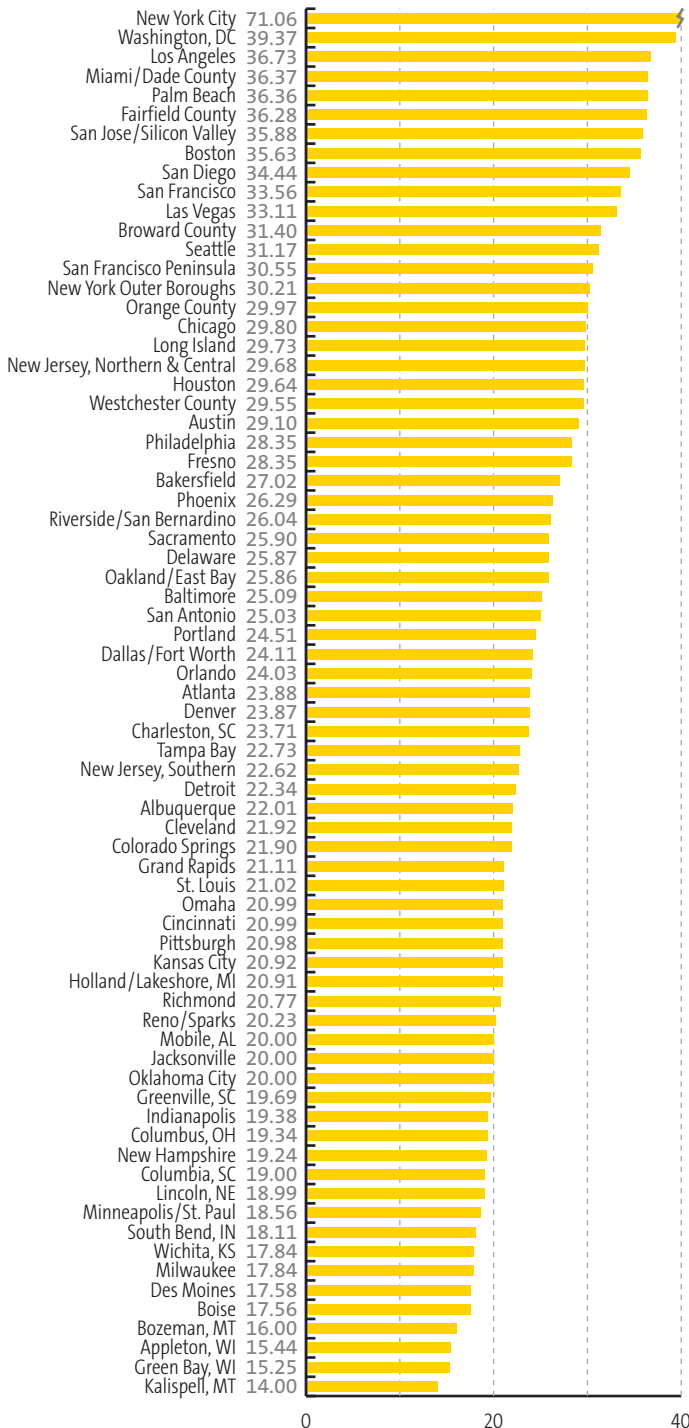
For a sustained recovery, employers must start adding jobs. Most economists think the labor market recovery will be sluggish. IHS Global Insight predicts the total number of jobs in the U.S. will not return to pre-recession levels until 2013, which implies that the office vacancy rate will not return to equilibrium until perhaps 2014. The slower pace of deterioration in the vacancy and absorption rates during the third quarter compared with the first and second quarters is a hopeful sign, though one-quarter's worth of data is not enough to declare a trend. One theory among economists is that panicked employers "over-fired" after the credit markets froze in September 2008. The faster pace of deterioration in the leasing market during the first half of 2009 may have reflected this panic. Now that the recession appears to be winding down, tenants may feel less of a need to further slash their space requirements. Nevertheless, the office market is unlikely to embark on a sustained recovery before 2011.

## METRO RENTAL RATES

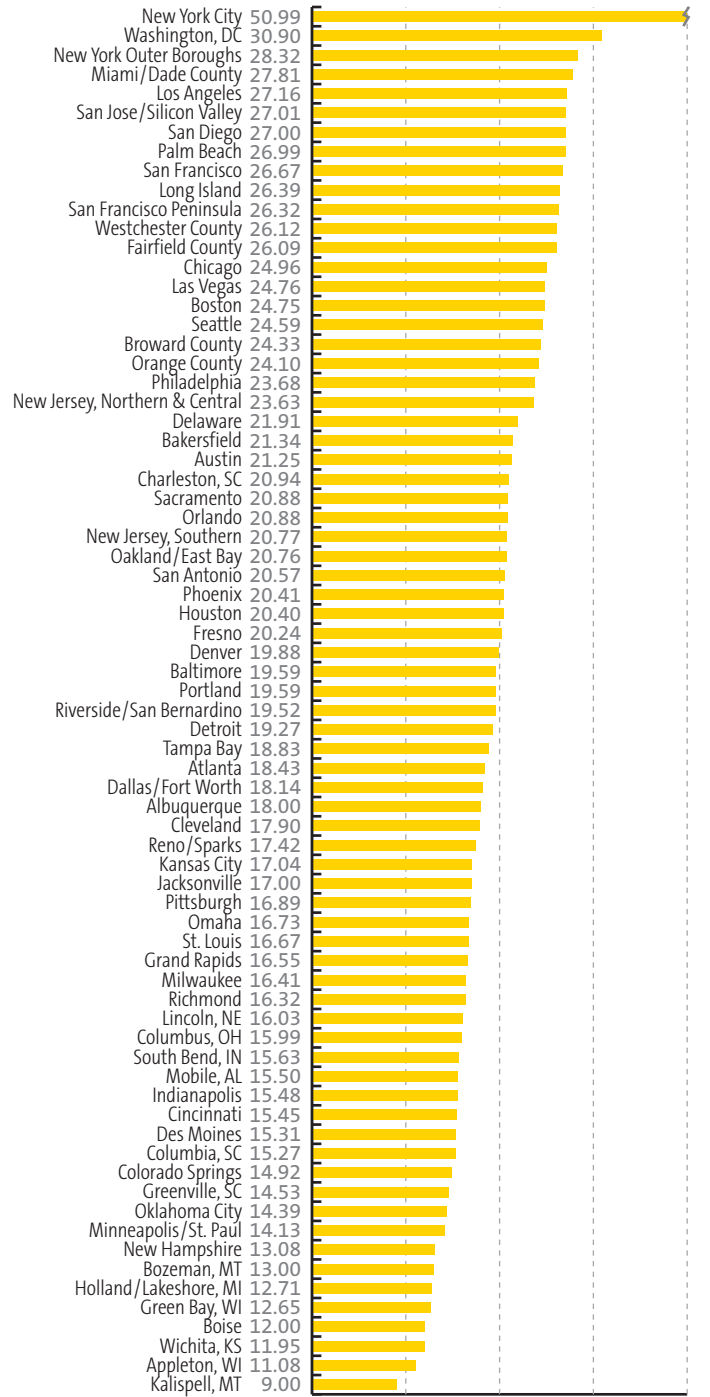
**Note:** Rental rate data refer to asking rates for space that is available on the market at the end of the quarter. Rates are per square foot, quoted on an annual, full service gross basis.

**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:** Concessions should ease as excess product is absorbed... **Oakland-East Bay:** Comcast of California occupied nearly 114,000 square feet; Cliff Bar took over 111,000 square feet... **Portland:** The federal government is the most active tenant in the market with multiple requirements totaling more than 200,000 square feet... **Sacramento:** The state plans to replenish its depleted general fund in part by selling \$2 billion in state-owned properties, three of which are in Sacramento... **San Francisco:** Nektar Therapeutics will take Pfizer's 102,000-square-foot sublease in Mission Bay; Zynga is in active negotiations for approximately 145,000 square feet at 500 Terry Francois Blvd... **San Francisco Peninsula:** Transaction velocity is increasing, driven by larger companies consolidating offices across the Bay Area... **San Jose-Silicon Valley:** The Bordeaux Centre in Sunnyvale, developed by California Bavarian Corp, was returned to its lender, Wrightwood Capital... **Seattle:** Russell Investments will relocate from Tacoma into 300,000 square feet at the former WaMu Center, which was purchased by parent company Northwestern Mutual as part of the deal.



## SOUTHERN CALIFORNIA/ PACIFIC SOUTHWEST

**Bakersfield:** New construction projects are on hold. Tenant activity has slowed, but there is no significant new sublease or dark tenant space... **Los Angeles:** Downsizing tenants threw 850,000 square feet of sublease space on the market this quarter, bringing the total to nearly 7 million square feet. Over half of the increase occurred in West Los Angeles. The growing supply of sublease space helped drive asking rental rates down by more than 12 percent from their 2008 peak. The decline was most pronounced in West

Los Angeles with an 18 percent drop. Advanced Bionics leased 144,000 square feet in Santa Clarita, an example of an established company with strong growth prospects taking advantage of a long-term deal in a newer building... **Orange County:** With no new construction on the horizon, the vacancy rate is showing signs of stabilizing... **Riverside-San Bernardino:** Leasing activity is generally lateral as current tenants right-size their operations... **San Diego:** Absorption for the third quarter was a negative 220,158 square feet, bringing the total year-to-date loss to 940,463 square feet.



## MOUNTAIN/SOUTHWEST

**Albuquerque:** Several companies that provide secondary education and health care services have been looking for space. The U.S. government issued a request for proposal for a large Forest Service operations office... **Boise:** The market is seeing improved activity. Rental rates remain low with no sign of increasing... **Bozeman:** Vacancies have increased, and rental rates have come down slightly... **Colorado Springs:** Third quarter vacancy was flat, and average asking rents were down... **Denver:** Longer term build-to-suit and downsizing activity will delay the return of market equilibrium for many submarkets... **Kalispell:** Demand for Class A and B product has decreased with no new development. The market is generally stagnant... **Las Vegas:** Increased defaults and foreclosures of office properties remain the top concerns... **Phoenix:** Projects still under construction will open next year. No new substantial construction starts are anticipated for five years or more.



## TEXAS/GREAT PLAINS

**Austin:** Signs of a recovery are visible with 276,140 square feet of positive absorption in Q3, mostly occurring in

Class A buildings... **Dallas-Fort Worth:** Leasing activity has stepped up as tenants resume making business decisions... **Des Moines:** Market activity is confined to tenant relocations... **Houston:** Negative absorption totaling 400,000 square feet coupled with 1.6 million square feet of deliveries pushed vacancy higher... **Kansas City:** Apria Health-care moved into 101,000 square feet in South Johnson County... **Lincoln:** The market remains steady, but vacancy rose slightly due to some small office consolidations... **Oklahoma City:** The market is holding up despite some recent job losses... **Omaha:** Absorption has fallen into the red for three straight quarters... **San Antonio:** Medtronic moved into 145,000 square feet at the Overlook at the Rim, and a government contractor leased 50,000 square feet in Bank of America Plaza... **St. Louis:** Vacancy rose slightly... **Wichita:** Local economists have forecasted government and health care will add 1,225 jobs in 2010. Via Christi Health recently signed a 10-year lease for 81,000 square feet.



## GREAT LAKES/ OHIO VALLEY

**Appleton:** An additional 115,000 square feet became available in the last six months mostly on the west side... **Chicago:** The market added almost 1.3 million square feet of vacant space in the third quarter, pushing the total above 45 million. Based on job losses, shadow space is estimated to comprise another 12 million square feet. Value-add buyers from 2005–2008 have seen their equity disappear and are starting to default on payments... **Cincinnati:** As the construction pipeline clears out, the trend of increasing vacancy will moderate. However, a number of large blocks of space will be vacated over the next 12 months putting additional downward pressure on effective rents... **Cleveland:** DDR will occupy half of the new Developers Diversified Building, a

140,000-square-foot property in the Eastern submarket. Move-in is expected in the fourth quarter... **Columbus:** Butler Animal Health Supply leased 62,000 square feet, and United Healthcare Services renewed a current lease but downsized to 83,000 square feet... **Detroit:** Beaumont Hospitals' lease for 86,000 square feet on Stephenson Highway and TK USA's 25,000-square-foot lease at Troy Place offset various new vacancies including the loss of World Alliance Financial Corp, which closed its headquarters in Troy... **Grand Rapids/West Michigan:** There were nine reported sales and 46 reported leases in Kent County during the third quarter. The average lease size dropped to 1,800 square feet... **Green Bay:** In the last six months, an additional 155,000 square feet became available. Both the east and west sides saw vacancies increase... **Indianapolis:** Tenants want short-term extensions while landlords look for alternatives to paying out-of-pocket for tenant improvements... **Madison:** New construction is nearly non-existent. Larger tenants are opting to wait out the recession before making any long-term commitments... **Milwaukee:** There has been an increase in blend-and-extend transactions, in which the landlord renews the tenant's lease early for a longer term in exchange for rent concessions... **Minneapolis:** The Twin Cities has nearly 1.4 million square feet of sublease space on top of 12 million square feet of direct vacant space... **South Bend:** Tenants are mostly standing pat. Those needing more space usually can be accommodated without having to move.



## NORTHEAST/ MID-ATLANTIC

**Baltimore:** Small tenants in the market are choosing shorter lease terms and renewals to carry them through the economic downturn... **Boston:** Credit Suisse bought 470 Atlantic Avenue in an all-cash deal for \$315.50

per square foot, suggesting that institutional investors have faith in the market... **Fairfield County:** The availability rate has risen to 21.8 percent, the highest of the decade... **Long Island:** Another 120,000 square feet of sublease space became available this quarter, indicating that the market has not yet bottomed... **New Hampshire:** Tenants appear to be more willing to sign leases longer than one year now that economic indicators are improving... **New Jersey, Northern & Central:** Availability has trended higher for seven consecutive quarters, driven by companies aggressively restructuring and reducing occupied space... **New Jersey, Southern:** Large new deals in the market coupled with a decelerating availability rate signal a modest upturn on the horizon... **New York City:** Pent-up demand from tenants who were trolling the market for space over the past two years finally translated into leasing activity during the third quarter, though activity remains 15 percent below the same period in 2008. The combination of maturing CMBS and bank loans will weigh heavily on the market over the next three years... **Philadelphia:** The speculative development pipeline has all but run dry, which should mitigate the run-up in vacancy... **Pittsburgh:** Westinghouse occupied 435,000 square feet in the first building of its new four-building headquarters campus in Cranberry Woods... **Washington, DC:** Tenant move-outs and downsizings persisted, resulting in quarterly absorption of negative 281,723 square feet... **Westchester County:** Con Edison moved out of the White Plains CBD and placed 45,864 square feet of space on the market... **Wilmington:** For the fourth straight quarter the New Castle County office market posted positive absorption.



## SOUTHEAST

**Atlanta:** Occupancy levels have fallen for eight consecutive quarters, attributable to companies downsizing and consolidating operations... **Broward County:** Recent lease transactions indicate a widening spread between the asking rent and the net effective rent paid... **Charleston:** Tenants have pulled back from the recent frenzied pace of consolidations and space give-backs... **Columbia:** The market is bracing for SCANA to vacate 425,000 square feet at the end of October... **Greenville-Spartanburg:** Two large speculative completions jolted vacancy higher. Sublease availabilities dropped... **Jacksonville:** Vacancy continued to rise. Landlords reacted by increasing rental concessions in the form of free rent, moving allowances and tenant improvement dollars... **Miami:** The Hogan Group delivered a 247,676-square-foot speculative building in Airport West on behalf of owner TIAA-CREF... **Mobile:** The local economy is softening. Growth projections have been pushed further into the future... **Nashville:** Absorption was negative for the fourth quarter in a row but at a slower pace than recent quarters... **Orlando:** Conditions are likely to remain iffy through year-end... **Palm Beach County:** Several recent announcements of businesses expanding and/or relocating, including TBC Corp, the parent of Tire Kingdom, could bring up to 300 new jobs to the area... **Raleigh-Durham:** The pace of deterioration in the office market slowed in the third quarter following two quarters of record-breaking negative absorption... **Richmond:** While leasing activity has picked up, there is no net new business to drive the absorption of over 4 million square feet of vacant space... **Tampa:** Tenants are accepting deals from desperate landlords, driving activity higher. Effective rents are less than advertised as landlords put every incentive in the book on the table.

