

MARKETBEAT

SUBURBAN MARYLAND OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



4Q09

ECONOMY

The U.S. economy ended 2009 on a positive note, as it exhibited more signs of emerging from its deep slump. Nationally, real GDP expanded in the third quarter of 2009 for the first time in more than year, and consensus estimates point to positive GDP growth in the fourth quarter as well. Additionally, the nation's unemployment rate showed an improvement in November, actually decreasing from 10.2% to 10.0%. However, signs of continuing economic weakness still abound in Suburban Maryland. The unemployment rate through November 2009 hovered close to historic highs: 5.4% in Montgomery County and 7.4% in Prince George's Counties. Even so, office-using employment in both Counties has begun to rise, primarily because of government-related jobs. Notably, both government and professional business services sectors saw a modest upturn in employment in the second half of 2009, helping to offset steep job losses posted in the financial and information systems sector.

OVERVIEW

Even though recent national economic data hint that a recovery is taking hold, the Suburban Maryland office market remains in a malaise. The overall vacancy rate for both Montgomery and Prince George's Counties rose once again, reaching a 14-year high of 15.2%. Rents have also remained on a downward track throughout the year, tipped lower by significant concession packages. On average, effective rents fell another 5.0% this year, and are now off 20.0% from their 2007 peaks.

The office market in Prince George's County continued to weaken most rapidly, posting not only the highest vacancy rate in Suburban Maryland at 23.3%, but also the highest rate recorded in the County since 1992. Stagnant demand has resulted in a continued contraction in absorption and leasing activity since 2007. Fortunately, one of the County's large tenants, the National Oceanic & Atmospheric Administration (NOAA) has extended its lease at the 137,004-square foot (sf) World Weather Building located at 5200 Auth Road in Oxon Hill, for at least a few more years. NOAA was slated to relocate in 2010 but its new facility under development at College Park was halted, with developer Opus East filing for bankruptcy. Another positive development for Prince George's: the amount of direct and sublease vacant space returned to this County began to stabilize in the fourth quarter.

Conditions in Suburban Maryland's traditional stronghold, Montgomery County, have also been on a decline. Sluggish leasing activity has kept absorption in negative territory throughout the year. Moreover, lease renewals remained the dominant option, with some tenants renewing leases as early as 12 to 24 months ahead of expiration. Not surprisingly, lease renewals of 2.1 million square feet (msf) slightly exceeded the 2.0 msf total volume of new leases inked during the year. In addition, a building boom in 2007 and 2008 has exacerbated the market surplus. Twinbrook Place in Rockville delivered empty in the fourth quarter, adding 142,928 sf to vacant space, and bringing 2009 completions up to their highest level in seven years. Approximately 938,653 sf came online for all of 2009, following deliveries of 723,826 sf and 604,106 sf in 2007 and

BEAT ON THE STREET



"Concession packages will start to diminish by fourth quarter 2010 and rental rates will stabilize thereafter, at which time large tenant requirements of 50,000 sf or more (by Montgomery County standards) that are in search of LEED class A or trophy quality buildings will begin to commit to pre-leasing for occupancy in the second half of 2010 and beyond."

— Andrew Masters, Executive Director


ECONOMIC INDICATORS


National	2008	2009F	2010F
GDP Growth	0.4%	-2.5%	2.3%
CPI Growth	3.8%	-0.4%	1.7%
Regional*			
Unemployment	3.7%	6.2%	7.2%
Employment Growth	0.3%	-3.3%	0.1%


Source: Moodys|Economy.com

*Includes Montgomery and Prince George's Counties

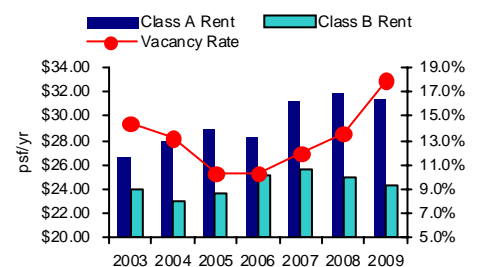
MARKET FORECAST

LEASING ACTIVITY will rise from its depressed level in 2009, but it will not be much of an upswing. A growing government sector could boost job creation and thus, leasing activity. Moreover, the abundance of attractively-priced opportunities can induce more tenants to consider relocation rather than staying put. 

CONSTRUCTION will shut down in 2010, and thus, not pose a challenge. Only two projects totaling 313,130 sf are currently under way and slated to deliver in 2010. No new project will break ground until availabilities return to "normal" levels and the credit market improves. 

RENTAL RATES will continue to slide for renewal and new leases, while incentives will remain widespread. Concession packages could ease if office market conditions begin to stabilize towards the end of 2010. 

OVERALL RENTAL VS. VACANCY RATES



2008, respectively. Most projects in Montgomery County, since 2007, were speculative and had 20.0%- 30.0% pre-leasing upon delivery. As a result, the percentage of total class A office space vacant or available for lease has nearly doubled since 2007, from 10.1% to 19.0% in 2009. Sublease offerings have also added to availabilities, rising from 985,674 sf at the end of 2008 to 1.2 msf in the fourth quarter of 2009. Hard-hit financial and information systems companies primarily located in Bethesda/Chevy Chase are largely responsible for the uptick, putting up nearly 500,000 sf for sublease this year. The overall vacancy rate in Montgomery County has been climbing steadily from 10.0% in 2007 and ending 2009 at 16.6%.

Such weak office market conditions have given tenants leverage in lease negotiations. Case in point is GXS' 11-year lease at the class A building under construction at 9711 Washingtonian Boulevard in North Rockville. This business-to-business (B2B) e-commerce solutions provider was able to secure a rental rate 10.0% below the pro forma rental rate of high \$30s and given two years of half rent for approximately 20.0% concession from pro-forma, as well as avail itself of substantial tenant improvement dollars. The company, which is downsizing from 341,192 sf to 80,000 sf, has subleased its current space at 100 Edison Park in Gaithersburg to Montgomery County in May of 2010, and is scheduled to relocate in the spring of 2010. Another example is Acacia Life Insurance Co.'s 95,436-sf renewal at the Air Rights Center. Though the company only considered green buildings, it was able to secure substantial concessions for its 11-year lease. As a result, effective rental rates were 15.0%-20.0% below those for comparable class B space in Bethesda/Chevy Chase.

Still, there has been some positive news. *First*, the second half of 2009 has been the most active leasing period since the summer of 2008, although the spike in transactions is hardly back to pre-recession levels. Leasing activity totaled just 2.5 msf for all of 2009, compared to the 3.0-4.0 msf lease totals between 2004 and 2007. Still, the uptick was welcome and is attributed to the government sector, which has lifted demand modestly particularly in Montgomery County. The most significant transaction was the U.S. Nuclear Regulatory Agency's (NRC) 358,440-sf 15-year lease that will jump start the construction of North Bethesda Center in March 2010. NRC, currently headquartered at One and Two White Flint North in Rockville, is scheduled to move to its new location in 2012. *Second*, sublease space, while a drag in traditionally strong markets such as Bethesda/Chevy Chase, remains modest, accounting for nearly 15% of overall availabilities. *Lastly*, speculative new construction has come to a halt so that new development will not be a relevant factor for two or more years.

Investment activity has been exceptionally slow in 2009. Sales of significant properties (greater than \$10.0 million) during the year slipped to a record low of \$95.5 million, with only two properties and a business park in Montgomery County changing hands. Notably, sales volume peaked at \$1.2 million in 2006, and subsequently declined to \$977 million in 2007 and \$508 million in 2008.

FORECASTS

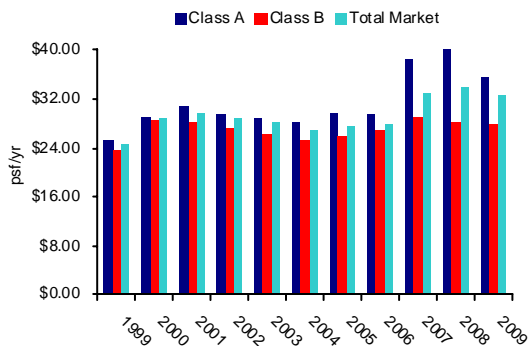
The outlook calls for a subdued and uneven recovery. While the modest economic improvement should help build momentum into 2010, risks still abound. The lingering weakness in the labor market threatens to slow the recovery. Moreover, credit remains tight and the effects of some of the government stimulus programs are ending. Nonetheless, Cushman & Wakefield (C&W) expects the economic rebound to continue for Suburban Maryland in 2010. Jobs are on the way, with more help to come from the government. Federal outlays for agencies headquartered in the area are all slated to rise in 2010, which should support job creation. In particular, the National Institutes of Health and the Department of Health and Human Services will continue to be growth drivers in Montgomery County, while other federal needs (mostly the Department of Homeland Security) will be focused on Prince George's County. Longer term, Prince George's County has the potential to boost its federal tenancy, with the political pressure that has been applied to the County over the past five years.

The softness in office market conditions will linger in 2010, with Montgomery County continuing to hold up better than neighboring Prince George's County. Even though the government will be a growth catalyst, it will not be a giant engine of new jobs. As a result, absorption will gradually improve in 2010, but it will not be sufficient to significantly chip away at high availabilities even with the absence of new construction in both Montgomery and Prince George's Counties. All the excess supply in both Counties needs to be absorbed before vacancies tighten sufficiently to warrant any uptick in rents.

Investment sales could pick up in 2010. Some buying opportunities can open up as some landlords who bought or refinanced their properties at the height of the market face debt maturity challenges starting in 2010. Though recent government initiatives have given extensions to some of these troubled loans, it will be inevitable for some of these assets to require additional equity in the future

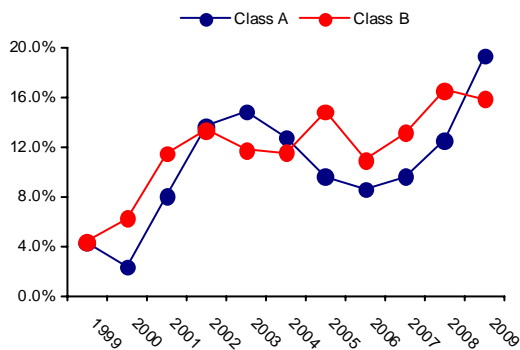
NORTH BETHESDA

DIRECT RENTAL RATE TRENDS



- Rates for class A buildings ended the quarter at \$35.48 per square foot (psf), while class B rents finished at \$27.81 psf, almost unchanged from \$27.88 psf in the third quarter. Direct asking rental rates have stayed in the low-\$30s since the third quarter of 2008, and this trend is likely to continue as landlords lower rents.
- Other than the Nuclear Regulatory Commission’s 358,440-sf pre-lease at North Bethesda Center I, leasing activity was stagnant, with no new leases signed over 10,000 sf. Government agencies led large transactions, with four of the ten largest leases this year signed by GSA tenants.

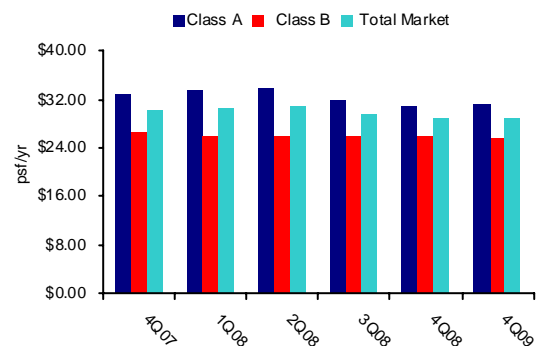
OVERALL VACANCY RATES CLASS A vs. CLASS B



- Overall and direct vacancy rates stayed virtually unchanged from the third quarter of 2009, ending the year at 18.5% and 16.7% respectively. Compared to year-ago levels, North Bethesda’s direct vacancy rate is up 3.7 percentage points and overall vacancy increased by 3.9 points.
- Expect a moderate uptick in activity as the market begins to stabilize in 2010, with government agencies at the forefront of recovery.

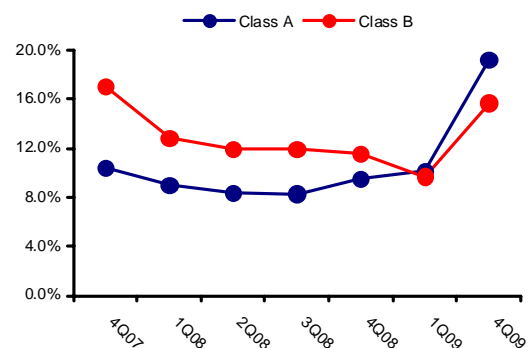
NORTH ROCKVILLE

DIRECT RENTAL RATE TRENDS



- One new building delivered this quarter in North Rockville. Uniwest’s Twinbrook Place at 12501 Ardennes Avenue added 142,928 sf of vacant space to the market with no pre-lease commitments.
- GXS signed the largest lease of the quarter, taking 80,000 sf of soon-to-deliver 9711 Washingtonian Boulevard. Leasing activity was otherwise uneventful, ending the year at 529,135 sf for the quarter, a 5,563-sf increase from year-end 2008.

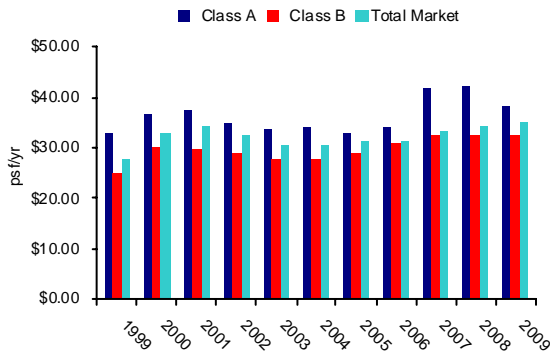
OVERALL VACANCY RATES CLASS A vs. CLASS B



- Direct and overall vacancy levels remain elevated, up 4.1 and 7.9 percentage points, respectively, from 2008 levels. Class A properties saw a steep increase, with overall vacancy ending the year at 19.2%, up 9.7 points from year-end 2008.
- Washington Property Company’s 9711 Washingtonian Boulevard (193,130 sf), originally scheduled to deliver by year-end 2009 is still awaiting the certificate of occupancy.

BETHESDA/CHEVY CHASE

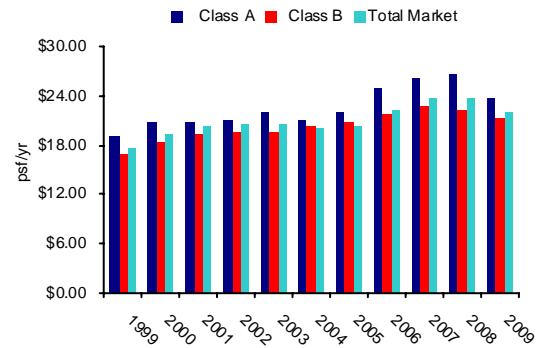
DIRECT RENTAL RATE TRENDS



- Asking rental rates declined across all classes by an average \$2.45 psf since year-ago levels. The drop was most pronounced in class A buildings, where asking rates dropped \$4.87 psf from the third quarter of 2009 to \$38.23 psf. These moves are in addition to increased concessions to attract new tenants and keep existing ones.
- Lease transactions are down 509,025 sf from their 10-year average of 727,333 sf, registering 218,308 sf for the year. The sharp drop in activity can mostly be explained by tenants continuing hold out on the sidelines as companies ride the downturn.

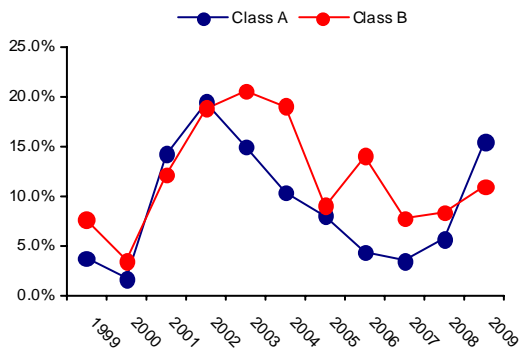
PRINCE GEORGE'S COUNTY

DIRECT RENTAL RATE TREND



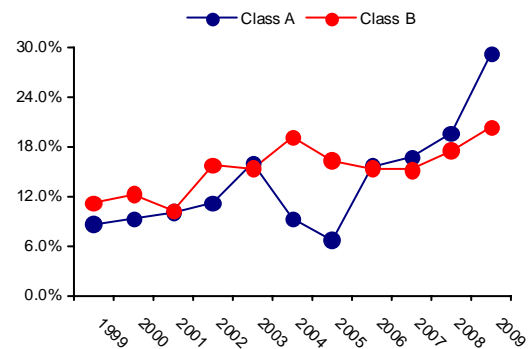
- Overall and direct vacancy rates in Prince George's County rose above 20.0% for the first time since year-end 1995 in the third quarter of 2009 and remain elevated. Submarkets with the highest vacancies include Bowie (32.7%), Greenbelt (26.9%) and Oxon Hill/Suitland (25.5%).
- Direct asking rental rates rose across all property classes by an average of \$0.40 psf through the fourth quarter. Rates rose by \$0.35 psf for all property classes combined. While rents rose moderately in the fourth quarter, rates for all classes have decreased by 8.1% since the fourth quarter of 2008, with rents for class A properties decreasing by 11.9%.

OVERALL VACANCY RATES CLASS A vs. CLASS B



- Direct vacancy held steady at 7.0% in the fourth quarter, up 3.8 percentage points since the same period last year but equal to the third quarter of this year. Although down 0.6 points from the third quarter, overall vacancy remained elevated at 13.0% due to substantial sublease availabilities.
- Expect a glimpse of stabilization in 2010 as economic recovery continues to take hold. The return of healthy job growth will continue to be a crucial factor in sustaining balance to the office market, and look for elevated overall vacancy levels to exert downward pressure on asking rents.

OVERALL VACANCY RATES CLASS A vs. CLASS B



- The only project in the pipeline is the 120,000-sf build-to-suit project at 5850 University Research Court in the Beltsville/College Park submarket. Construction work-stoppage remains in force at NOAA's project in College Park due to ongoing litigation and the liquidation of Opus East.
- Tenants watching for signs of economic recovery from the sidelines will continue to impact performance in this market. Expect government agencies to take the lead as stimulus dollars begin to flow.

MARKET/SUBMARKET STATISTICS

MARKET/ SUBMARKET	INVENTORY	NO. OF BLDGS.	OVERALL VACANCY RATE	DIRECT VACANCY RATE	YTD LEASING ACTIVITY	UNDER CONSTRUCTION/ RENOVATION	YTD CONST / RENOVATION COMPLETIONS	YTD OVERALL ABSORPTION	DIRECT WTD. AVG. CLASS A GROSS RENTAL RATE*
Bethesda/Chevy Chase	8,300,204	61	13.0%	7.0%	230,624	-	295,263	(277,894)	\$38.23
North Bethesda	7,821,446	54	18.5%	16.7%	534,091	-	-	(216,027)	\$35.48
Rockville	6,696,949	62	16.9%	16.3%	255,883	-	388,928	(207,396)	\$36.46
North Rockville	8,957,922	85	18.1%	13.9%	529,135	193,130	347,462	(105,028)	\$31.40
Gaithersburg	3,438,421	43	19.3%	18.5%	38,742	-	-	161,481	\$27.39
Germantown	1,823,431	24	18.8%	16.5%	68,998	-	-	(72,711)	\$28.89
Silver Spring	4,789,986	42	11.4%	9.8%	246,106	-	-	(119,169)	\$31.13
North Silver Spring	1,125,127	22	15.0%	13.2%	93,886	-	-	24,139	\$26.50
Montgomery County	42,953,486	393	16.3%	13.5%	1,997,465	193,130	1,031,653	(812,605)	\$33.44
Beltsville/College Park	4,070,978	67	16.6%	16.1%	95,982	120,000	-	(47,860)	\$26.14
Laurel	985,661	19	15.2%	14.4%	18,874	-	-	(95,675)	\$19.88
Greenbelt	2,837,971	31	26.9%	24.1%	187,840	-	-	(94,390)	\$23.36
Landover/Lanham/Largo	3,082,065	63	23.0%	21.6%	115,342	-	-	(124,204)	\$22.80
Bowie	780,082	12	32.7%	28.3%	15,348	-	155,000	15,499	\$23.33
Oxon Hill/Suitland	1,932,496	46	25.5%	24.8%	134,453	-	-	(24,766)	\$23.80
Prince George's County	13,689,253	238	22.3%	20.8%	567,839	120,000	155,000	(371,396)	\$23.69
Suburban Maryland	56,642,739	631	17.7%	15.2%	2,565,304	313,130	1,186,653	(1,184,001)	\$31.46

* Rental rates reflect \$psf/year

MARKET HIGHLIGHTS

SIGNIFICANT 2009 NEW LEASE TRANSACTIONS				
BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
North Bethesda Center I	North Bethesda	Nuclear Regulatory Commission	358,440	A
520 Gaither Road	North Rockville	BAE Systems	139,120	A
9711 Washingtonian Boulevard	Gaithersburg	GXS	80,000	A
SIGNIFICANT 2009 SALE TRANSACTIONS				
BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
One Market Square at Shady Grove	Rockville	JBG	228,020	\$43,500,000
Fairmont Building	Bethesda/Chevy Chase	Akridge	122,390	\$26,500,000
Cloverleaf Center	Germantown	First Potomac Realty Trust	173,923	\$25,500,000
SIGNIFICANT 2009 CONSTRUCTION COMPLETIONS				
BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
520 Gaither Road	North Rockville	N/A	208,342	6/09
530 Gaither Road	North Rockville	N/A	139,120	6/09
5404 Wisconsin Avenue	Bethesda/Chevy Chase	Microsoft Corporation	295,263	6/09
12505 Park Potomac Avenue	Rockville	Willis of Maryland	153,000	7/09
12501 Ardennes Avenue	Rockville	N/A	142,928	12/09
SIGNIFICANT PROJECTS UNDER CONSTRUCTION/RENOVATION				
BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
9711 Washingtonian Boulevard	North Rockville	GXS	193,130	1/10
5850 University Research Court	Beltsville/College Park	I.A.R.P.A.	120,000	1/10



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*Market terms & definitions based on BOMA and NAIOP standards.

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