



TOP 10 MARKETS TO WATCH

FOR COMMERCIAL REAL ESTATE INVESTORS

Office Edition Through September 2008



National Outlook

Personality, vibrancy and dedication to the big picture. Regardless of their population size, U.S. office markets reflecting these characteristics not only seem to have more of an ability to avoid the subprime market turmoil some say is plaguing MSAs across the nation, they are—more often than not—thriving.

Paraphrasing a quote by Mark Doutzour, Chief Economist and Director of Research for the Real Estate Center at Texas A&M University is the idea that, when looking to expand or relocate, locals tend to determine the success of a market by looking at the past, while outsiders look at the future of a market into which they can adapt and grow. When it comes to market growth and opportunity, is an area looking ahead? Is it taking advantage of cutting-edge ideas in planning? Is it encouraging a vibrant, dynamic, creative mix of real estate product and amenities? In other words, does it offer an environment in which companies can expand, both physically and abstractly? This is a common theme within our Top 10 Markets to Watch Office Report. One exceptional example in this line of thinking: “going green.”

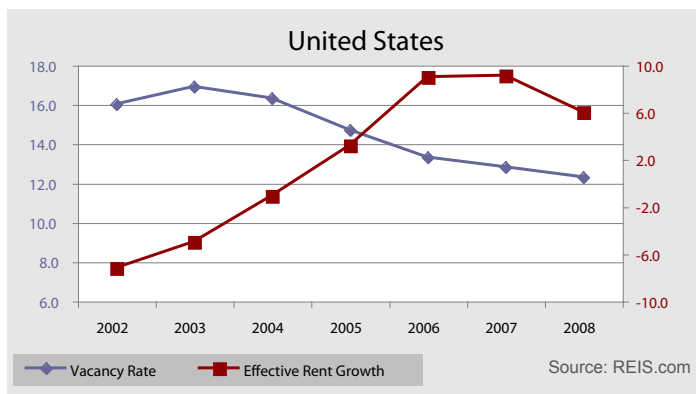
In steadily increasing numbers, owners, developers and tenants across the nation are going green by constructing or updating buildings and their operations to LEED (Leadership in Energy and Environmental Design) certified standards. Office-using tenants are seeking ecologically conscious options that leave a smaller carbon footprint. At least two of our top markets to watch, as discussed in this report, are seeing significant changes as developers focus on building more efficient office buildings and spaces.

The power behind this trend may be no more evident than in the membership rolls of the United States Green Building Council (USGBC), which from 2001 to 2006, increased from 1,126 to 7,600 members. If this historic rate of growth is any indication of growth in the future, the implementation of “green” standards may soon become an expectation, rather than a nicety. It’s not surprising to learn that the states that lead the way in the number of LEED-certified buildings – California, Texas and Florida – are also states that are flush with multi-dimensional masterplanned lifestyle developments and creative Central Business District (CBD) redevelopment efforts.

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As these trends mature, the office market must also contend with a change in the ownership of prime metro U.S. office space. The shift has recently been tagged the "EOP effect"—referring to when Equity Office Properties sold a portfolio encompassing space in major metropolitan areas across the nation to the Blackstone Group for a hefty \$39 billion sum. Blackstone then turned around and sold off buildings individually at substantial per-square-foot increases, thus fairly rapidly changing the players in the nation's owner and operator game. One particular property swept up by the "EOP effect" whirlwind that exemplifies rapid change of ownership is a high-rise, Class A building in Irvine, Calif., that changed hands three times in only four months. Between February and May 2007, the property was first sold by EOP to the Blackstone Group, then sold to landlord and developer Maguire Properties, then sold to the Muller Company, an investor/developer in Southern California.

As purchase prices for these top-notch office buildings rise, larger, atypical real estate investors have noted the potential for profit and entered the scene looking to place their excess capital. Nationwide, rents have reached an average \$23.61 per square foot per year as of second quarter 2007, up from \$20.04 per square foot per year in second quarter 2005. Tenants, as a result, are feeling the pressure on rents when looking at new space or when faced with negotiating renewals. In the same way, a broad range of tenants who enjoyed the opportunity to move into Class A space after rents dramatically dropped in 2001 and 2002 may soon be priced out of their space and forced to move to less expensive markets or to consider Class B product in and around their same market. Office space in some non-coastal markets in the Midwest are viable, cost saving alternatives, but even properties that change ownership in primary and secondary markets with double-digit vacancy rates are increasing rents to maximize their returns, particularly when they are in sought-after, forward-looking MSAs.



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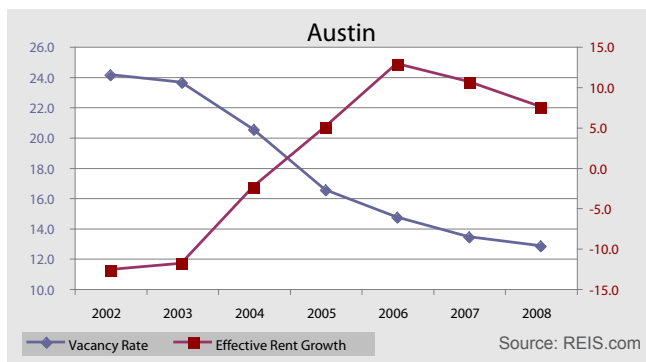
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With today's increasingly mobile global economy, companies have so many relocation options, which means owners and municipalities alike have increasing competition. Businesses want to go where cities are alive, and where the history isn't as important to consider as it has been in the past. The Sperry Van Ness Top 10 Markets to Watch Office Report highlights these markets, with the hope that this information will be used as a tool to look to the future of investing. While it is recognized that the economy is slowing overall, and that even the measured, projected fundamentals of "hot" markets show slowing, the gems included in this report do still most certainly prove to be key investment markets-to-watch.

Austin

In alphabetical order.

With the highest 2007/2008 relative population growth of all of the office markets evaluated, Austin is booming. But the benefits of this area don't stop with population growth. In addition, this market boasts a host of major office-using players, from government, education and healthcare to telecommunications, high technology and financial companies. Steady growth and steady demand have led to steady positive absorption that, quarter after quarter and year after year, have kept the vacancy rate for the Austin metro area shrinking to its current rate of just 13.4 percent. Absorption for the remainder of 2007 through 2008 is expected to top 2 million square feet each year. Concurrently, construction deliveries in both 2007 and 2008 are expected to add less square footage than will be absorbed for the same time period, making vacancy rates drop further, by almost a complete percentage point. Behind New York and San Francisco, Austin is seeing the most aggressive effective rent growth year over year of major metro markets reviewed for this report. Between 2005 and 2008, average effective rents in Austin are expected to increase by as much as 34 percent— 7.25 percent in 2008, alone! When it comes to growing frontiers for investment, this certainly puts Austin near the front of the line.



Central New Jersey

With help from nearby neighbor, New York City, Central New Jersey office activity is strong and not showing any sign of slowing. As institutional investors gobble up properties and force up average rents in New York City— where effective rents by year-end 2008 are expected to reach an average \$57.04 per square foot per year – Central New Jersey's projected \$21.21 per square foot per year by the same time in 2008 is an attractive option for tenants seeking to keep expenses down. At this price, it also is a good place for buyers to find reasonable investment opportunities that might otherwise be far out of reach in this area of the U.S. Interestingly, the percent change in key fundamentals from year over year in New Jersey is actually getting increasingly stronger, unlike most other strong major metro markets evaluated. Central New Jersey's average effective rent growth was negative for year-end 2004, yet has since outpaced asking rent increases when it ticked up positively for 2005, grew 2.31 percent in 2006, could increase by 2.86 percent before 2007 year-end, and is projected to increase by 3.62 percent for year-end 2008. Vacancy rates since 2005 through 2008 are projected to drop by 16.8 percent, for 2008 alone dropping a whopping 13.5 percent. As Central New Jersey continues to evolve, its attractive location and fundamentals should only continue to feed tenants and investors with what they need, and what New York City can't necessarily provide.

THE CAROLINAS - Charlotte, Columbia and Greenville

Looking toward the coming year, the Top 10 Office Markets to Watch include three markets between the two Carolina states – Greenville, Charlotte and Columbia. These areas are attractive to residents because of the climate, culture, charm and low cost of living. Companies are further attracted to these coastal states because of their low cost of doing business, their educated labor pools from which to pull employees and the growth of the states' economies overall.

Charlotte, NC

In addition to being ranked as a Top 10 Office Market to Watch, Charlotte is also currently ranked by Partners for Livable Communities as one of "America's Most Livable Cities." The office climate succeeds because of tenant demand, including the expansion and regional consolidation of numerous local financial-service companies and the businesses that support them. This activity should continue to reduce Charlotte's vacancy rates through 2008 from its currently low 12.5 percent to

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an even lower 11.7 percent, and precipitate an effective rent growth of 4.65 percent to \$13.96 per square foot per year. Adding to Charlotte's appeal is an ever-growing downtown urban energy that includes steady demand and development in the live-work-play arena. Recently, Charlotte became the home of the new NASCAR Racing Hall of Fame and enticed a minor league baseball team. Charlotte also is anticipating the completion of a light rail commuter system in November 2007. Along with the 2007 completion of 892,000 square feet of new office tower space, Charlotte's economic and lifestyle trends signify demand and the type of growth that will no doubt attract strong office tenants and further the success of this southern powerhouse.

Columbia, SC

Similar to its neighbor, Charlotte, Columbia is also currently ranked by Partners for Livable Communities as one of "America's Most Livable Cities." Also like its North Carolina counterpart, Columbia is a hot office market for both tenants and investors. Industries absorbing office space in Columbia are similar to the other Carolina markets in this Top 10 report, including education and health, leisure and hospitality, FIRE (finance, insurance, and real estate), and business and professional services firms. The downtown area expects to see Class A office vacancy continue to fall below its current rate of 8 percent, while non-central business district offices will drop below 13 percent. As vacancy drops, and new construction prospects are limited, effective rental rates are expected to push up by more than 3.6 percent, to \$13.48 per square foot per year, while rents will push even higher in the coveted downtown spaces. Yet with few space options and high demand continuing in the downtown area of Columbia, there is still only one project currently under construction in the Northeast - the Pinnacle Office Park, which will add 40,000 square feet upon completion. In stark contrast to slow office construction activity, investment opportunities are active, as building owners are selling and buyers keep buying in this Top 10 Market pick.

Greenville, SC

Though this smaller metro continues to feel the presence of a lagging manufacturing sector, Greenville demonstrates how diverse industry and economic strength can prevail. Where the manufacturing sector falters, the stability and strength of Greenville's leisure and hospitality, professional and business services, and healthcare and education industries rise to the top. This



has spurred a substantial drop in vacancy rates in the last three years and has given rise to expectations that vacancies will drop further, from 24 percent in 2005 to 16 percent through 2008. Further supporting this decrease is the fact that there is very little construction activity in the queue through 2008. Leading the developments that are in construction is the Point, an exciting 60-acre, mixed-use project located at the former 850,000-square-foot Hoechst-Celanese plant, just outside of the CBD. Construction on the Point will begin mid-2008, currently proposed to include new retail and residential opportunities, as well as 600,000 square feet of new, prime office space in the form of at least two offices. Most activity stems from current tenants expanding within the market; however, activity from tenants relocating to the area also continues to increase. With office-using employment increases projected to continue at just under 2 percent through 2008, Greenville garners lots of attention from Floridian investors and will continue to entice other national investors who are attracted to an ideal location between Miami and New York, Charlotte and Atlanta, making this tertiary market an attractive one for major, diverse office tenants and investors alike.

Houston

Like in neighboring Austin, it is a very good time to be in the Houston real estate business, particularly in the Houston office market. The expansion and success of Houston's office product rests largely on the energy sector, which propels the market into a great position for buyers, sellers and owners alike. As energy and related firms continue to inhale all classes of office space through 2008, the area can expect to see vacancy rates drop by 6.25 percent to an overall vacancy rate of 12 percent. And although fervent local employment growth will add

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an estimated 18,000 new office-using jobs in 2008, and Houston's economic growth is temperamental, yet steady, the new construction of office product has been relatively restrained. As the amount of available space continues to be gobbled up, two much-needed and both LEED-certified projects – the Discovery Tower by Trammell Crow and MainPlace by Hines– will break ground in 2008. This will add just less than 2 million square feet to the already hefty 157-million-square foot office inventory, at least helping to satisfy the anticipated rampant demand even at the time the projects complete. Moreover, Houston brags affordability and availability, which entices investors and tenants from both of the nation's coasts and keeps them excited about Houston's offerings, especially as sensible options become fewer and fewer in their respective markets.

Little Rock

Consistently overshadowed by other, larger metropolitan areas, Little Rock, Arkansas is considered a well-kept secret. But the secret may not stay a secret for much longer. Numerous accolades—including being recently named the second Most Diverse Economy in the United States by Moody's Investment—have served to underscore the strong activity in the marketplace and have further promoted the burgeoning area's vibrancy and success. Vacancy rates in Little Rock are currently at 10.6 percent while rental rates have climbed to a market-wide average of \$13.03 per square foot. As the year progresses, it appears that Central Arkansas will continue to see bullish activity from all real estate sectors. This may be particularly true for office product in Little Rock's Central Business District (CBD), which now has even more appeal with the opening of a popular new draw: the William J. Clinton Presidential Center. The completion of the presidential library has spurred more than \$7 billion in new downtown retail, hospitality, office and residential construction. This will certainly attract new businesses and residents to the CBD, which already is attractive to businesses with its urban feel and convenient area amenities that together help create the overall vibrancy of an active downtown environment. Major office-using industries coming to – and expanding in – the Little Rock area include state and federal governments, non-profit organizations, University of Arkansas departments, medical and research companies, as well as telecommunications and financial services firms. With such industry diversity and activity, the area can expect to see rent growth to \$13.52 per square foot per year before year-end 2008. Though the residential construction slowdown will contribute to a slowing in area job growth this coming year versus previous



years, the overall strength of the Little Rock economy makes this a solid investment market to watch.

New York

As the quintessential big picture, eye-on-the-prize office market operator, the city of New York is the life-blood of the Northeast office sector. And with help from the expansion and consolidation of more than 50 Fortune 500 companies, this epicenter remains bustling with demand for office space. As safety and costs were a major concern in recent years, some of the city's companies fled to neighboring suburbs. But while administration offices remain in the suburbs in an effort to keep costs low, the metro market is regaining strength as a hub of corporate and intelligent force. For New York City, office-using employment could expand by as much as 1.87 percent in 2008, and as demand for prime space from financial, insurance and real estate firms expand, vacancy is projected to fall to 6.6 percent, down from 9 percent in 2005. In response to demand, construction completions are expected to add 718,000 square feet in 2007 and 2.1 million square feet in 2008, when the notable LEED-certified, 51-story Bank of America Tower on Madison Avenue is slated for occupancy. Average effective rent growth between 2007 and 2008 just beats out another top market to watch, San Francisco, with the highest percent growth at 9.65 percent. While substantial, the figure is down from the percent change forecasted for 2007 – a whopping 16.04 percent! It's not surprising that, in Manhattan, three out of five residents have a college degree and one out of four residents have an advanced degree, making it one of the most educated cities in the United States as reported in the New York Times in August 2006. Combined with the power of this office market giant and its transatlantic location within the growing mobile global economy, NYC's overall stellar projections for office values and demand makes this an exciting and enticing investment market.

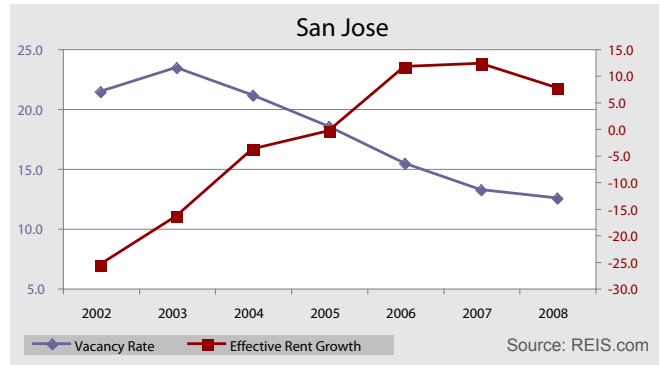
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San Francisco

The San Francisco Chronicle recently recognized the Bay Area economy as one of the strongest in the nation, and even a cursory look this market's fundamentals confirms the statement. Combined with tenants positively absorbing office space—nearly 3.5 million square feet in 2006 alone, and projected at more than one million square feet in 2007 and 2008—and the local conversion of office space into residential units—which since 2003 has outpaced new office building construction adding a new dimension of character into the urban area—San Francisco's local office inventory has diminished by nearly one million square feet. Presuming such activity continues at a steady pace, vacancy rates are expected to drop to 9.8 percent by fourth quarter 2008, which in turn will push effective rents to \$35.57 per square foot per year during this same time period. Some Class A space with a view will continue to garner rents of more than \$80 per square foot per year. As for where renters are renting, the San Francisco Business Times recently reported growing tenant interest in properties that are owned by long-term owners versus new owners. In the case of longer-term ownership, the difference in the tax base seems to be noticeable enough to affect rents, and ultimately helps to tip the scales toward where tenants sign. As for who is renting, solid demand for space continues among financial services, travel and tourism, and business and professional services. Demand for investment properties continues from venture capital and private equity firms looking to expand their presence in the marketplace. But as the only office tower currently under construction in the financial district, 555 Mission Street will add a mere 550,000 square feet of much-needed space between First and Second Streets upon completion around October 2008, leaving little doubt that demand will continue to outstrip supply in San Francisco and keep this waterfront location a top office contender.

San Jose

San Jose's fundamentals, scarcity of developable land, highly educated workforce and proven ability to reinvent itself make it both an intriguing and ideal office market to watch. More importantly, San Jose is an ideal office market right now in which to own. After a long spell of watching and waiting, both San Jose rents and the San Jose economy are in heated recovery. Those who own are thrilled. Those who do not own—particularly larger investors who can afford the local and usually unsolicited buy-in price—are looking to get into the game. Not only are investors pleased with the market's fundamentals, they



are attracted to the power of local high tech companies, who continue to drive demand and occupancy in San Jose's office sector. Of particular note are those that regularly reinvent themselves with forward-looking applications such as nano- and biotechnology, battery storage and solar technology, and those major technology players who continue to call the San Jose area home, such as Google, Yahoo!, Cisco Systems, eBay and Apple. With this strong foundation of demand, combined with new tenants constantly entering the market, vacant sublease space in San Jose—which was at 5.2 million square feet as recently as 2003—is currently at only about 1.1 million square feet, a substantial swing in a market with a total office inventory of more than 50 million square feet. With vacancy rates dropping due to strong absorption, average effective rents are expected to increase by more than 9.8 percent for 2007 and more than 7.0 percent in 2008 to \$27.22 per square foot per year. Further helping the market is an expected 1.83 percent increase in job growth through 2008, an above-average increase that will no doubt continue to spur demand. While the bulk of absorption activity this year has taken place in Class A product, San Jose's suburban office Class A and Class B products are both still ideal for attracting large institutional investors. Illustrating this projected strength, developers like Tishman Speyer and TMG Partners are looking to build office towers and speculative projects in the area. In addition, local development firm, Hunter and Storm, is proposing to break ground this year on a two-tower, 420,000-square-foot office project as a part of a larger 39-acre mixed-use development on the North First Street corridor. Based on the two- to three-year process to approve new construction, these developers have learned that patience is a virtue. For the overall market, these tight restrictions clearly remain a favorable barrier to entry and a gatekeeper of market health.

About This Report

Sperry Van Ness is proud to release the 2007 “Top 10 Markets to Watch” Report for the office sector. Sperry Van Ness analyzed more than 60 primary, secondary and tertiary markets examining economic factors that impact future office investment real estate. This report looks at future trends and the markets that show the greatest potential for income growth based on these economic movements, rather than current market data. The market rankings for this report focus on factors including population growth and inventory, vacancy factors and rental trends.

We hope you find this report is a valuable resource to you and your colleagues. For more information on Sperry Van Ness, please visit www.svn.com or call 800.353.7500.



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