

MARKET INSIGHTS

FIRST QUARTER 2008

Overview

On the backdrop of an ailing national economy, the Washington, DC office market continues to demonstrate resiliency. Net absorption came in at a positive 212,500 square feet in the first quarter of 2008, the 21st straight quarter of positive absorption. Although this pace is below the historical ten-year first quarter average of 445,000 square feet, the fact that DC is still expanding—while many other markets are contracting—is a testament to DC's solid economic fundamentals. Across the District, vacancy increased 10 basis points to 7.5 percent, due in part to the delivery of a 100 percent vacant building in the East End and a large tenant move-out in the CBD. Nevertheless, DC continues to have one of the lowest vacancy rates in the country.

Market Activity

A trend throughout the first quarter was the proactive leasing role of the Federal Government, which signed three nonrenewal leases of 100,000 square feet or more. Accordingly, the Federal Government has separated itself as the leading tenant for the District's emerging submarkets and, along with increased Federal spending, has helped maintain investor confidence in the DC market as a whole. As for the Federal leases, the highlight of the first quarter was the Department of Justice preleasing 521,000 square feet at StonebridgeCarras' Two Constitution Square, 145 N Street, NE. Helping offset the major vacate of the Corporate Executive Board to Rosslyn, VA, the General Services Administration signed for 117,000 square feet in the CBD with the tenant yet to be determined. In Southwest/Southeast, the Federal Aviation Administration (FAA) signed for 100,000 square feet at 950 L'Enfant Plaza, SW.

Absorption and Vacancy

Positive net absorption in Southwest/Southeast (189,000 square feet) and the East End (218,000 square feet) led the way during the first quarter. As mentioned earlier, the delivery of ASB Capital Management's 455 Massachusetts Avenue, NW, 100 percent vacant, pushed vacancy rates up in the East End. The submarket that experienced the greatest jump in vacancy rates was the CBD, which suffered from not only the Corporate Executive Board and the FAA vacating well over 100,000 square feet, but also the delivery of two vacant floors totaling 52,000 square feet at ING Clarion Partner's renovated 2121 K Street, NW. As a result, the CBD's vacancy rate rose 110 basis points to 8.3 percent. On a brighter note, the FAA's relocation to Southwest/Southeast decreased the submarket's vacancy rate 140 basis points to 8.7 percent.

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Deliveries and Groundbreakings

Three projects totaling 392,000 square feet delivered in the first quarter, 23 percent preleased. In addition to the delivery of 455 Massachusetts Avenue, NW, Quadrangle Development delivered the first phase of the Mount Vernon Place project, 251 H Street, NW, a 90,000 square foot building 100 percent leased to the American Israeli Public Affairs Committee (AIPAC). Finally, ING Clarion Partners completed its renovation at 2121 K Street, NW, which included the addition of two fully available floors totaling 52,000 square feet.

Three buildings broke ground during the first quarter of 2008. Tishman Speyer began construction at 1775 Pennsylvania Avenue, NW, a 153,000 square foot renovation project that includes an expansion of the top two floors. PN Hoffman broke into the commercial market this quarter and commenced construction on its 140,000 square foot project at 733 10th Street, NW. Lastly, the Lenkin Company broke ground on its 136,000 square foot redevelopment at 440 1st Street, NW.

Rents

With a limited amount of new construction coming to the market in 2008, it is reasonable to expect that rental rates will continue to increase, at least until 2009, when over four million square feet is scheduled to deliver. Currently, rental rates are averaging between \$50 and \$75 per square foot full service for existing Class A product in the core markets, with tenant improvement (TI) packages ranging from \$40 to \$75 per square foot. For Class B product, rental rates range from the mid-\$30s to the mid-\$40s per square foot full service, with TI packages between \$25 and \$60 per square foot.

Outlook

Opening the year with over 200,000 square feet of positive net absorption demonstrates the strong economics of the DC market amidst a tightening national economy. At a time when many firms across the country are downsizing and cutting jobs, the District's tenant base remains in expansionary mode. Moreover, a great deal of the momentum in the first quarter was provided by the Federal Government, which demonstrated its commitment to building up the non-core markets. Although net absorption was lower than the past three quarters, preleasing activity was strong this quarter, which bodes well for the market as a limited supply is scheduled to deliver this year. As a result, expect the District to continue to outperform the rest of the country, as rental rates continue to increase and vacancy remains relatively constant.