

MARKET INSIGHTS

FIRST QUARTER 2008

Overview

Much like the rest of the country, the numbers show that Maryland's office market had a difficult first quarter. Net absorption came in at negative 424,000 square feet and vacancy rose 110 basis points to 11.9 percent. However, it should be noted that a few large tenants had leases expire in the first quarter, and their subsequent move-outs had a significant impact in pushing up vacancy rates. The most significant increase was felt in Prince George's County, where vacancy shifted upwards by 250 basis points, due to Raytheon and Hewlett Packard moving out of nearly 404,000 square feet. Despite the moves, Prince George's continued to attract major tenants, as MedAssurant signed up to relocate its Annapolis headquarters to the County. Only time will tell if more users will be drawn to the sizable blocks of vacant space or if economic conditions will cause tenants to exercise more caution when deciding to change locations.

Market Activity

The largest nonrenewal lease transactions executed in the first quarter varied between 14,000 and 97,000 square feet, with MedAssurant signing the largest lease of the quarter. The healthcare provider leased 96,900 square feet at Buchanan Partners/JP Morgan's Bowie Corporate Center (4321 Collington Road) in Central Prince George's County. Federal activity remained light in the first quarter with one federal requirement making the "top ten" list. However, this is not an indication that Federal leasing has dried up in suburban Maryland. The US General Service Administration (GSA) is in a cycle of lease expirations, which should not be affected by the election this year. The Department of Health & Human Services (HHS), National Cancer Institute (NCI), and Nuclear Regulatory Commission (NRC) have requirements for a combined total of around 1.8 million square feet in the upcoming months.

Absorption and Vacancy

As mentioned above, vacancy in suburban Maryland rose from 10.8 percent at year-end 2007 to 11.9 percent in the first quarter. Vacancy shifted upwards in all nine submarkets. Bethesda/Chevy Chase (6.4 to 6.6 percent) and Silver Spring (6.8 to 7.5 percent) continued to boast the lowest rates in suburban Maryland. Market conditions remain tight in both areas, as new construction is limited, resulting in a scarcity of large blocks of vacant space. In Silver Spring, JBS International vacated 55,800 square feet, giving Silver Spring its only block of vacant/contiguous space. Rockville (93,000 square feet) and North Rockville (48,000 square feet) were the only two submarkets with positive net absorption in the first quarter.

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Deliveries and Groundbreakings

Two buildings totaling 260,000 square feet delivered in the first quarter, 47 percent available. In Montgomery County, Boston Properties brought 184,000 square feet to Rockville at 1 Preserve Parkway, 63 percent available. Additionally, DANAC Corporation delivered 9707 Key West Avenue (72,000 square feet) to North Rockville, 45 percent available. In Prince George's County, The Peterson Companies finished construction on the first office building at its National Harbor project. 174 Water Street added 60,000 square feet to Southern Prince George's County and is fully available.

A much needed slowdown in speculative construction occurred in the first quarter, after four spec buildings (805,000 square feet) broke ground in the fourth quarter of 2007. The sole speculative ground breaking occurred in Gaithersburg/Germantown, where Washington Property Company began construction of The Summit at Washingtonian. Construction also ramped up on Fougler-Pratt Companies' Building E at Park Potomac, 37 percent pre-leased.

Rents

The pace of Class A rental growth slowed throughout suburban Maryland. The normal front runners in rental growth (Bethesda/Chevy Chase and Silver Spring) experienced minimal growth from last quarter. Average Class A asking rents in Bethesda/Chevy Chase hovered around \$41.00 per square foot, where as Silver Spring rents registered at \$32.00 per square foot.

Outlook

Although the bottom line numbers in Maryland show negative absorption and rising vacancy, it is very difficult to discern if this is the beginning of a trend or simply a one-time anomaly caused by several large move-outs. It should be noted that in looking at the history of Maryland, a large negative quarter of net absorption is often followed by a positive quarter, as the DC region has a tendency to fill existing space rather quickly. One key trend to watch for is the change in sublet space available. If this shows a significant increase, then it may imply that businesses are cutting jobs and putting excess space on the market for sublease. Overall, although leasing activity should stay reasonably healthy relative to most markets in the country, given the high level of new deliveries scheduled for 2008, we expect vacancy to rise between 100 and 200 basis points for the year.