

MARKETBEAT

WASHINGTON, D.C. OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



1Q09

ECONOMY

Despite some hints of stabilization, the U.S. economy still took quite a tumble in the first quarter of 2009. Job losses continue to mount, with the unemployment rate breaching 10.0% in seven states. Even the District of Columbia has not been immune to economic challenges. The District's unemployment rate has been climbing higher by the month, registering 9.9% in February – the highest it has been since January 1984. The rate is likely to rise even further as the city recently announced it would lay off 776 employees to close a budget gap. Though weakness among office-using sectors was broadly based, the federal government remains the sole bright spot, continuing to add jobs this year.

OVERVIEW

While faltering economic conditions have sent the U.S. office market into retreat, Washington, D.C. remains one of the better performers so far this year. The overall vacancy rate in the first quarter edged up more than a full percentage point from year-end 2008 to 9.4% but remains one of the lowest in the nation. Moreover, actual rental rates for the D.C. office market have declined only an average of 5.0%-10.0% from their peak rates in 2008 compared to 20.0%-30.0% in other markets. However, actual rates have dropped more steeply for non-core submarkets (Capitol Hill/NOMA, West End/Georgetown, Uptown, Southwest and Capitol Riverfront), where they have slipped as much as 30.0%. On the positive side, the federal government's initiatives to bolster the economy are also beginning to impact the D.C. area. The first quarter saw the initial tranch of leasing requirements stemming from the Troubled Assets Relief Program (TARP). The General Services Administration signed a lease for 71,000 square feet (sf) at 1801 L Street to accommodate around 200 TARP employees. In addition, most projects that are already under construction in the city are still proceeding as scheduled in the midst of the current credit crisis, indicating a vote of confidence for the city. Developer StonebridgeCarras secured construction financing for Two Constitution Square, its 521,000-sf project for the Department of Justice. While all of these events do not necessarily indicate a resounding show of strength, they do come at a pivotal time.

Nonetheless, Washington, D.C. had its fair share of bad news. Tenant demand hit a lull in the first quarter. The volume of new leases totaled nearly 790,000 sf, while absorption dipped into negative territory – the weakest showing in nearly 15 years. The supply of sublease space is also on the rise as more troubled firms – particularly in the legal sector – are shedding space. The legal sector accounted for roughly half of the sublease options totaling 1.1 million square feet (msf) in D.C. Sublease availability will continue to swell as shrinking law firms will sublet at least another 300,000 sf over the next 6-9 months. But so far during this 16-month recession, the amount of sublease space remains relatively modest in comparison to other major markets. In previous downturns, sublets accounted for 30.0% of available space; currently, they represent a mere 13.0%. The strain on demand and the spate of new construction are causing an upward pressure on vacancies. The five projects that came online this quarter had moderate pre-leasing and added nearly 800,000 sf to the area's vacant space. Meanwhile, investment activity continues to be hampered by a dysfunctional financial system. Closed investment sales transactions through March totaled over \$508 million and involved only three properties. Even so, there has been a noticeable increase in investor interest as bids have escalated for properties on the market.

FORECAST

Even though the U.S. economy will continue to face significant challenges this year, there are reasons for muted optimism regarding prospects for the Washington, D.C. office market. *First*, massive policy efforts to unclog the credit markets and revive housing and the broader economy are improving the chances for some stabilization later this year. That should help jump-start the rebuilding process for hard-hit sectors in this recession. *Second*, Cushman & Wakefield (C&W) believes that the Washington, D.C. market in particular will show "some degree of recovery" as the government embarks on a new regime of tighter regulation this year. C&W expects another wave of leasing requirements as the proposed regulatory reforms come to fruition. *Third*, the just-enacted \$787-billion stimulus package provides for \$5.5 billion for capital improvements to GSA structures and \$4.5 billion for retrofitting buildings to LEED requirements, of which \$1.2 billion is expected to be spent on federal structures located in D.C. This should spur job creation in contracting industries such as construction and other professional business services sectors (e.g., architectural firms), and potentially inhibit any increases in D.C. unemployment. *Lastly*, the proposed 2010 federal budget shows an uptick in defense expenditures. If approved, the entire Washington, D.C. metropolitan area stands to benefit as defense dollars flow to the region at least for another year, helping to offset the ongoing economic downturn.

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BEAT ON THE STREET



"Recently, we have seen a quiet increase in the Government's appetite for office space in the District. This trend should continue as Federal regulation joins homeland security as a spending priority.

This translates into opportunities for both Lessors needing to fill vacant space and Federal agencies experiencing growing pains"

–Pete Marcin, Managing Senior Director

ECONOMIC INDICATORS

National	2008	2009F	2010F
GDP Growth	1.1%	-2.9%	1.8%
CPI Growth	3.8%	-1.0%	1.9%
Regional (District of Columbia)			
Unemployment	6.8%	10.2%	10.3%
Employment Growth	0.4%	-3.4%	0.3%

Source: Moody's | Economy.com

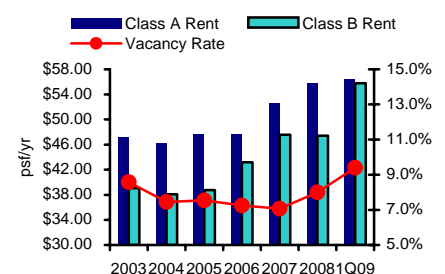
MARKET FORECAST

LEASING ACTIVITY will not have any meaningful improvement at least through mid-year, but the proposed revamp of the current regulatory structure will likely serve as a potent impetus as soon as it is in place. ↓

DEVELOPMENT ACTIVITY remained the most robust in the U.S., with 7.7 msf under construction and renovation. The downside risk is greatest for non-core markets, where over 60% of the projects are located and largely remain available. Though starts have ceased, completions will remain high through next year: 3.5 msf for the balance of 2009, 4.2 msf in 2010, and 431,000 sf in 2011. ↓

RENTAL RATES will moderate across the board, and will be combined with generous concession packages, as more availabilities hit the market this year. Hence, the case of renewal providing the greatest cost savings may no longer hold true. ↓

OVERALL RENTAL VS. VACANCY RATES



MARKET/SUBMARKET STATISTICS

MARKET/ SUBMARKET	INVENTORY	NO. OF BLDGS.	OVERALL VACANCY RATE	DIRECT VACANCY RATE	YTD LEASING ACTIVITY	UNDER CONSTRUCTION/ RENOVATION**	YTD CONSTRUCTION COMPLETIONS**	YTD OVERALL ABSORPTION	DIRECT WTD. AVG. CLASS GROSS RENTAL RATE*
Capitol Hill / NoMa	9,660,714	38	9.3%	9.1%	34,524	2,723,326	0	25,249	\$48.32
East End	35,096,877	149	8.8%	7.5%	271,236	694,560	232,900	2,655	\$54.81
CBD	31,137,452	181	9.6%	8.0%	348,257	1,356,888	554,742	(331,675)	\$53.83
West End/Georgetown	5,225,062	34	13.4%	12.6%	68,644	0	0	(49,350)	\$46.83
Uptown	3,528,736	31	8.3%	5.4%	28,349	0	0	546	\$35.64
Southwest	8,433,376	29	7.9%	7.9%	35,899	2,671,606	0	(11,058)	\$51.42
Capitol Riverfront	4,021,639	10	10.8%	10.7%	2,556	652,687	244,526	90,552	\$42.12
Total	97,103,856	472	9.4%	8.2%	789,465	8,099,067	1,032,168	(273,081)	\$51.79
Class A									
Capitol Hill/NoMa	3,045,954	9	24.5%	24.5%	0	2,723,326	0	0	\$49.66
East End	19,512,645	64	9.9%	8.5%	128,689	694,560	232,900	132,603	\$59.39
CBD	8,513,986	33	17.0%	15.2%	76,864	1,356,888	554,742	(125,316)	\$60.26
West End/Georgetown	1,437,437	7	6.3%	6.3%	7,607	0	0	(40,551)	\$57.53
Uptown	365,367	2	6.5%	3.4%	13,222	0	0	13,222	\$40.89
Southwest	5,194,371	13	11.9%	11.9%	35,899	2,671,606	0	2,280	\$51.60
Capitol Riverfront	2,944,077	8	11.8%	11.7%	2,556	652,687	244,526	90,552	\$46.50
Total	41,013,837	136	12.7%	11.6%	264,837	8,099,067	1,032,168	72,790	\$56.19

* Rental rates reflect \$psf/year

** Includes renovations

MARKET HIGHLIGHTS

SIGNIFICANT 1Q09 NEW LEASE TRANSACTIONS				
BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
1801 L Street, NW	CBD	Troubled Assets Relief Program (TARP)	71,000	B
1101 K Street, NW	East End	DC Bar	50,453	B
2175 K Street, NW	CBD	European Union	50,453	B
425 3rd Street, SW	Southwest	Association of American Railroads	33,619	A
131 M Street, NW	Capitol Hill/NoMa	GSA - DHS	28,558	B
SIGNIFICANT 1Q09 SALE TRANSACTIONS				
BUILDING	SUBMARKET	BUYER	SQUARE FEET	PURCHASE PRICE
Techworld	East End	Akridge jr. Seaton Benkowski	757,904	\$265,000,000
1615 L Street, NW	CBD	Spitzer Engineering	414,195	\$180,000,000
1300 Connecticut Avenue, NW	CBD	Divident Capital Realty Trust	117,594	\$63,600,000
SIGNIFICANT 1Q09 CONSTRUCTION COMPLETIONS				
BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
100 M Street, SE	Capitol Riverfront	Parsons Corporation	244,526	1/09
801 17th Street, NW	CBD	N/A	240,180	3/09
1155 F Street, NW	East End	Bryan Cave, Shook Hardy	232,900	3/09
1775 Pennsylvania Avenue, NW	CBD	Rockport Capital, Archon Group	151,208	3/09
SIGNIFICANT PROJECTS UNDER CONSTRUCTION/RENOVATION				
BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
Constitution Center	Southwest	N/A	1,500,000	10/10
Patriots Plaza II & III	Southwest	N/A	706,606	9/09
Constitution Square	Capitol Hill/NoMa	GSA - DoJ	589,916	6/10
Station Place III	Capitol Hill/NoMa	American Chemistry Council	508,313	7/09
2200 Pennsylvania Avenue	CBD	Hurton & Williams	434,965	12/10



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

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