

MARKETBEAT

SUBURBAN MARYLAND OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



2Q10

ECONOMY

The U.S. economy continued its gradual pace of recovery. Real GDP has grown for three consecutive quarters thanks to the modest pick-up in consumer and business spending. Such positive momentum is helping spur a slow improvement in the jobs market. The unemployment rates in Montgomery and Prince George's Counties trended down for a fourth straight month although to a still-high 5.1% and 6.7%, respectively, in April. For office-using employment, the federal government remains the key engine of growth, generating over 5,000 jobs during the past 12 months ending in May. Moreover, job creation in the private sector is beginning to gain traction. The professional and business services sectors have consistently added jobs since the start of the year, while job losses in the information sector continued to abate.

OVERVIEW

Signs of strain in the Suburban Maryland office market continued through the second quarter of 2010 despite a gradually improving labor market. The overall vacancy rate rose again, reaching a 14-year high of 17.8% during the second quarter. This weakness reflects the ongoing contraction in absorption in Montgomery County as various tenants continued to downsize and return space to the market. As a result, the overall vacancy rate in Montgomery County edged up from 15.7% from the first quarter of this year to 16.3% in the second quarter. Likewise, lackluster tenant demand has kept vacancies the highest in Prince George's County at 22.2%.

Mid-level quality buildings, or class B structures, are showing the most strain. Notably, the vacancy rate for such assets in both Counties jumped to 18.6% from 14.9% in the first quarter. This increase is due largely to the continuing trend among tenants to gravitate towards class A towers in order to take advantage of attractive lease terms. Case in point is CW Financial Services LLC, which leased 47,700 square feet (sf) at the former Chevy Chase Bank space at 7501 Wisconsin Avenue in Bethesda. The commercial real estate finance company, which is currently located at 11200 Rockville Pike and 701 13th Street NW in Washington, D.C., was able to secure a rental rate in the high-\$30s, a significant discount from the high-\$40s at which the space was originally marketed at the height of the market in 2006-2007. Additionally, the company was able to avail itself of substantial tenant improvement allowances and a free rent period of nine months.

Nonetheless, there were bright spots during the second quarter. Leasing activity rebounded from its sharp fall over the past year, which should positively impact absorption in the next few quarters. The volume of new leases year-to-date totaled 1.8 million square feet (msf) – on a par with the historic average – as compared to 1.2 msf over the same period in 2009. Moreover, new construction has been constrained, face rental rates have continued to stabilize although concessions abound, and year-to-date investment sales totaling \$92 million were up from their lows of \$70 million over the same period in 2009. On another positive note, the new health care legislation is positively impacting the market. The General Services Administration leased more than 70,000 sf at 7501 Wisconsin Avenue in Bethesda on behalf of the Department of Health and Human Services. The federal agency plans to hire 300 employees to help implement this new legislation.

FORECAST

Prospects for a sustained economic recovery remain intact for the remainder of the year. The U.S. economy will continue to grow at a modest pace over the next two quarters, and bring about a continued moderate reduction in unemployment. However, significant downside risks still remain and will keep this economic recovery fragile. The impact of federal spending is expected to fade as calls for fiscal austerity could rein in government spending. Already, President Obama has invoked cutbacks in the use of federal space in the region in order to save \$3.0 billion by 2012. For the Suburban Maryland office market, such action could stall its main engine of demand growth and in turn, deter any incipient recovery in leasing activity. Consequently, Cushman & Wakefield expects this office market to bump along for the remainder of the year, with the overall vacancy rate remaining at elevated levels for both Counties through year-end, but look for them to begin a slow descent in 2011. Longer term, both Counties will benefit from the Transit-Orientated Development Designation Initiative, a transit program that is aimed at reducing sprawl, increasing transit ridership, and luring government offices to move to projects near transit.

BEAT ON THE STREET



"Significant absorption shall be enjoyed in Class A, tier one locations, as tenants continue their flight to quality. Recovery for B & C and tier 2 locations will not be experienced for another 3+ quarters. Outlying suburban submarkets will continue to struggle with declining to moderate velocity."

– Niel Beggy, Senior Director


ECONOMIC INDICATORS


National	2009	2010F	2011F
GDP Growth	-2.4%	3.1%	3.9%
CPI Growth	-0.3%	1.8%	2.1%
Unemployment	6.1%	6.9%	6.9%
Employment Growth	-3.5%	-0.3%	0.1%


Source: Moodys|Economy.com

*Includes Montgomery and Prince George's Counties

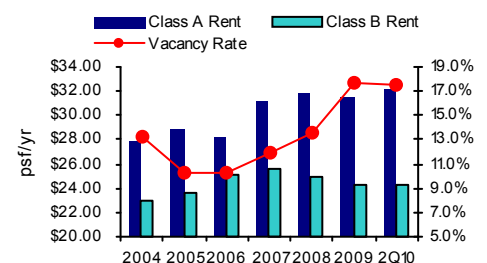
MARKET FORECAST

LEASING ACTIVITY should steadily improve through the remainder of the year but will not likely put a significant dent in vacancies. Job growth will have to improve appreciably in order for any sustainable recovery in tenant demand to occur. 

CONSTRUCTION deliveries will be nil for the balance of the year. However, the construction of the 358,440-sf headquarters of the U.S. Nuclear Regulatory Commission and the 575,000-sf NCI facility is expected to commence in the third quarter. 

EFFECTIVE RENTAL RATES will continue their gradual decline in both Counties through year-end as availabilities will remain relatively high. However, the continued "flight to quality" will chip away at class A vacancies so that effective rents could begin to stabilize for high-end space in Montgomery County. 

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 CONST./RENOVATION COMPLETIONS	YTD DIRECT ABSORPTION	YTD OVERALL ABSORPTION	DIRECT WTD. AVG. CLASS A GROSS RENTAL RATE*
Bethesda/Chevy Chase	8,300,204	61	15.9%	15.5%	268,978	0	0	(207,870)	(160,448)	\$40.50
North Bethesda	7,821,446	54	12.6%	10.5%	116,818	0	0	735	(35,101)	\$36.61
Rockville	6,623,949	60	18.4%	16.2%	190,519	0	0	98,989	118,355	\$36.46
North Rockville	8,681,777	78	20.1%	17.2%	788,357	0	193,130	3,218	40,115	\$32.21
Gaithersburg	2,291,033	35	13.4%	9.4%	27,520	0	0	(13,635)	(14,629)	\$25.03
Germantown	1,747,131	23	17.9%	16.4%	37,225	0	0	(17,626)	(28,800)	\$31.59
Silver Spring	4,789,986	42	20.5%	20.0%	19,663	0	0	(40,728)	(87,146)	\$30.38
North Silver Spring	1,055,127	20	15.3%	13.3%	64,494	0	0	7,023	7,023	\$25.00
Montgomery County	41,310,653	373	16.3%	14.3%	1,513,574	0	193,130	(169,894)	(160,631)	\$34.39
Beltsville/College Park	4,190,978	68	15.6%	15.4%	8,557	0	120,000	124,736	136,965	\$25.50
Laurel	972,061	18	14.9%	14.1%	3,867	0	0	19,034	19,034	\$19.08
Greenbelt	2,837,971	31	25.4%	25.3%	73,261	0	0	6,808	17,536	\$24.17
Landover/Lanham/Largo	3,082,065	63	23.8%	23.0%	132,410	0	0	(31,442)	(9,869)	\$23.59
Bowie	780,082	12	37.6%	33.6%	44,179	0	0	(21,381)	(21,381)	\$31.12
Oxon Hill/Suitland	1,932,496	46	27.1%	26.5%	40,691	0	0	(44,667)	(41,888)	\$23.26
Prince George's County	13,795,653	238	22.2%	21.6%	302,965	0	120,000	53,088	100,397	\$24.82
Suburban Maryland	55,106,306	611	17.8%	16.1%	1,816,539	0	313,130	(116,806)	(60,234)	\$31.76

* Rental rates reflect \$psf/year

MARKET HIGHLIGHTS

SIGNIFICANT 2Q10 NEW LEASE TRANSACTIONS

BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
12420 Parklawn Drive	Rockville	GSA - Food and Drug Administration	93,000	B
7501 Wisconsin Avenue	Bethesda/Chevy Chase	GSA - Dept. of Health & Human Services	70,000	A
7501 Wisconsin Avenue	Bethesda/Chevy Chase	CW Financial Services	47,700	A
9737 Washingtonian Boulevard	North Rockville	BroadSoft, Inc.	29,947	A

SIGNIFICANT 2Q10 SALE TRANSACTIONS

BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
11820 Parklawn Drive	North Bethesda	PS Business Parks	59,000	\$6,958,343
11900 Parklawn Drive	North Bethesda	PS Business Parks	48,810	\$5,756,555
11821 Parklawn Drive	North Bethesda	PS Business Parks	40,000	\$4,717,521

SIGNIFICANT 2Q10 CONSTRUCTION COMPLETIONS

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
*No construction completions				

SIGNIFICANT PROJECTS UNDER CONSTRUCTION/RENOVATION

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
*No projects under construction				



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

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