

MARKETBEAT

NORTHERN VIRGINIA OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



4Q08

ECONOMY

The torrent of dour news about the national economy continued in the fourth quarter. The National Bureau of Economic Research officially declared that the U.S. economy has been in recession for a year. Moreover, the economy has shed jobs for 11 straight months; the national unemployment rate rose to 6.7% in November, its highest reading since October 1993. Claims for unemployment benefits reached their highest level in 26 years. Fortunately, the Northern Virginia economy continued to elude the worst effects of this economic crisis, ending the year on relatively solid footing. The area's unemployment rate of 3.0% in November is one of the lowest in the nation, although it has been creeping up over the course of the year and has reached a level not seen since the dot-com implosion in 2001. Most of the office-using sectors, particularly the area's major economic drivers, including professional/business services and government, have been expanding throughout the year and helped offset job cuts in both finance and information industries. In another sign of strength, Virginia's foreclosure rate was minuscule (3.1%); in comparison, nationwide the percentage of U.S. mortgage holders who were behind in their payments soared to a record 7.0% in the third quarter.

OVERVIEW

The Northern Virginia office market performed relatively well during 2008 compared with other suburban markets. The area consistently boasted steady rental rates and one of the lowest overall vacancy rates (12.7%) in the nation throughout the year. However, it has not been immune to broader economic pressures. Sublease availabilities have been ratcheting up throughout Northern Virginia. Nearly 1.0 million square feet (msf) have been added since the third quarter of 2007. Even so, sublease availabilities through the fourth quarter totaled 2.3 msf, just one third of the peak level seen in 2002 when 6.5 msf were listed for sublease. On the investment side, sales totaled \$800.00 million for all of 2008, down over 90% from 2007, but still one of the highest investment sales totals among suburban markets in the nation.

Markets inside the Beltway have been the region's mainstay in 2008. Tenant demand has been exceptionally strong, particularly in Arlington County where leasing activity and absorption rates were the highest in three years. Activity continues to benefit from a low concentration of finance and insurance-related employment and a high share of government and professional/business services employment. Notably, the majority of all large transactions greater than 30,000 square feet (sf) in 2008 involved the federal government and its contracting agencies. Tenants have also shown increasing propensity to renew and stay put in this skittish environment. The volume of renewals doubled in 2008, with 1.6 msf completed in both Arlington County and the City of Alexandria compared to nearly 700,000 sf in 2007. In the face of declining vacancies and the delivery of new product, asking rental rates continued to climb from 2007: from \$36.32 per square foot (psf) to \$36.62 psf in Arlington County and rising from \$30.02 psf to \$34.00 psf in the City of Alexandria.

In markets outside the Beltway, the surge in new construction continued to weigh on Fairfax and Loudoun Counties. Park Place II came online in Tysons Corner, raising total completions for the year to 2.8 msf in both Counties of which 2.0 msf remain available. Tenant demand also hit a lull this year, with notable transactions largely consisting of "no-growth" relocations such as United Healthcare's 57,377-sf lease at Two Reston Crescent in Reston, as well as renewals such as L-3 Communications' 41,156-sf lease at Campus East in Reston. The only significant transaction with some growth in the fourth quarter was Strayer Education's 103,461-sf lease at Dulles Station East in Herndon. But not all the news is negative. The rescue by the federal government of mortgage titans Freddie Mac

BEAT ON THE STREET



"2009 will be a year of transition... markets inside the Beltway will continue to experience steady demand, decreasing vacancies and stable rates. Outside the Beltway will be more challenging... the most positive news is the lack of new construction. Unfortunately we will not see the benefit of that until 2010. In the short term, we will experience a decrease in effective rents, as demand continues to lag historical averages."

— Brian McVay, Executive Vice-President

ECONOMIC INDICATORS

National	2007	2008	2009
GDP Growth	2.0%	1.2%	-1.5%
CPI Growth	2.9%	4.2%	0.9%
Regional*			
Unemployment	2.1%	2.7%	3.5%
Employment Growth	1.6%	1.0%	0.7%

Source: Moody's | Economy.com

*Includes City of Alexandria, Arlington, Fairfax and Loudoun

MARKET FORECAST

LEASING ACTIVITY will remain modest in 2009 as tenants increasingly opt for early renewals and owners acquiesce to maintain occupancy. A potential downside is the cannibalization of demand slated for 2010 and 2011.



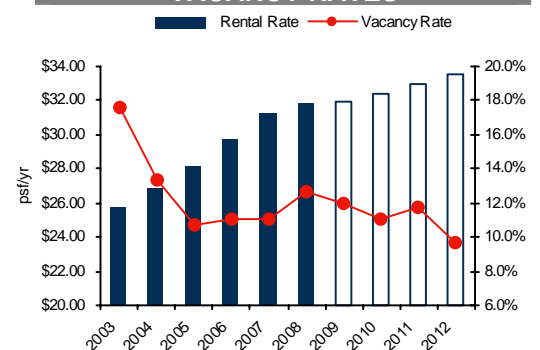
CONSTRUCTION pipeline is expected to drop precipitously and could even become empty in 2010. Completions for the region will total 1.1 msf in 2009 and 454,988 sf in 2010.



ASKING RENTAL RATES are expected to generally hold steady, and be combined with concessions in markets with an abundance of available space.



OVERALL RENTAL VS. VACANCY RATES



and Fannie Mae is definitely a positive for the office market, as both are headquartered in the Washington, D.C. metropolitan area, with Freddie Mac in McLean. Asking rental rates have held steady at their elevated levels during 2008, but owners have begun to step up rent abatements and concessions such as free rent and build-out allowances particularly for larger tenants. As a result, effective rents are down 5.0% to 10.0% from their levels in 2007.

FORECAST

National economic prospects will remain grim through 2009.

Cushman & Wakefield (C&W) forecasts the ongoing economic contraction to last at least through the second half of 2009. Though the recession is shaping up to be the longest downturn in the postwar era, we believe that there are forces at work that will eventually pull the U.S. economy out of its free fall. In particular, the massive government pump-priming measures should help both housing and financial markets to recover, and thus allow the economy to turn around towards the end of 2009 and start expanding once again in 2010. However, the end of the recession is not likely to mark the end of job losses. The U.S. unemployment rate will continue to climb through 2010 as companies continue to tighten their budgets.

Northern Virginia will be less vulnerable to the recession relative to other suburban markets.

Defense spending will provide stability to the area's economy at least through 2009. Congress approved the 2009 base budget for the Pentagon totaling \$542.50 billion, which is \$35.00 billion more than the U.S. military received for 2008. However, there is a risk that spending on defense and other discretionary outlays could ease subsequently as the new administration and Congress address other domestic needs and the burgeoning fiscal deficit. This could potentially sap the strength of Northern Virginia's primary job growth engine. Still, an outright contraction is quite unlikely. The unemployment rate is expected to rise at a measured pace and stay well below the U.S. average. Moreover, office-using employment is expected to hold steady in 2009, and possibly begin to expand modestly afterwards.

Slow job growth portends there will not be much of a bounce back in tenant demand.

Lease renewals will remain prevalent through 2009 as tenants gird for the continued downward spiral in the U.S. economy and avoid the high cost of relocation. Hence, absorption in the region will likely remain subdued through at least 2010. Even when job growth does begin to accelerate, absorption will not return to the highs experienced after the industry contraction in 2002 to 2003 – but we could expect it return to at least the historical pace of 2.5 msf. Government will continue to play a hand in employment trends, and consequently will remain a dominant player, alongside its contracting agencies, in buoying leasing activity in the near term.

Among all the area's office markets, those inside the Beltway will hold up the best during this downturn.

We expect at least another year of low vacancies and flat-to-increasing rents for markets located in both Arlington County and City of Alexandria, for the following reasons:

- *First*, the office market in Arlington County and the City of Alexandria will begin 2009 on rather firm footing; overall vacancies in these submarkets are the lowest in the entire region. The lack of new construction will also bode well and

limit the downside potential for these markets. Tight credit conditions will restrain starts at least through 2009; as such, construction completions will continue their downtrend: 450,410 sf in 2009 and 176,000 sf in 2010, which represent a mere 1.4% of the inventory for Arlington County and the City of Alexandria combined.

- *Second*, Arlington County will benefit from government policies intended to maintain financial stability. We expect one result of the current financial turmoil will be a streamlining of the regulatory structure that could boost government and private employment over the next three to five years. The impact is analogous to the creation of the Resolution Trust Corporation during the savings and loan crisis in the 1980s, when over 4,000 jobs were added to facilitate asset liquidation. Hence, we could expect the Federal Deposit Insurance Corporation, headquartered in Virginia Square at the Arlington Metro Corridor, to expand as it gets involved in the oversight of massive government equity positions in financial institutions as well as the disposition of failed assets during this contractionary cycle.
- *Third*, the City of Alexandria stands to benefit from BRAC transfers. The Department of Defense decided to move 6,400 jobs originally destined for Fort Belvoir to Mark Center (a private development owned by Duke Realty off Interstate 395 and Seminary Road). Construction of office facilities is expected to commence in 2009, and the turnover of the site to the Army is slated for 2011.

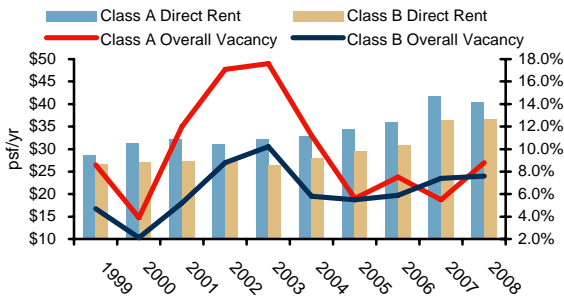
Office market conditions outside the Beltway will remain slow in the near term. Fundamentals will remain weak as both Fairfax and Loudoun Counties work off the excess supply built up since 2006. Notably, over 7.5 msf of Class A space have been added – particularly in the Reston/Herndon and Route 28 South submarkets – between 2006 and 2008. Through the fourth quarter of 2008, over 4.2 msf still remained available – enough to accommodate three years of typical Class A absorption in both counties. However, we expect the abundance of Class A availabilities (14.2% and 33.9% for Fairfax and Loudoun Counties, respectively, as of the fourth quarter) to induce a “flight to quality” that should result in declining vacancies and a firming of rents among premier properties. That, in turn, should lead to a surge in class B relet space that will be vacated as tenants upgrade to good quality space. On the positive side, the construction pipeline will continue to dwindle through 2010. The precipitous decline in starts will limit construction completions to 684,524 sf in 2009 and 278,988 sf in 2010. This should allow both Counties to restore balance more quickly upon the resumption of stronger demand.

More office space will be marketed for sublease in 2009. A sustained economic decline will continue to spur another wave of sublease space (mostly plug and play) in 2009. However, the volume will not be as substantial as in previous cycles. Companies have been more conservative in hiring and leasing space since the last recession, so “shadow space” is not preponderant this time around.

ROSSLYN-BALLSTON CORRIDOR

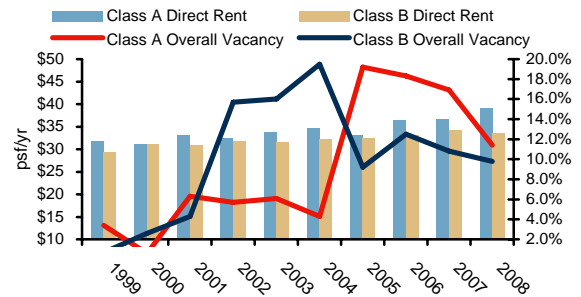
CRYSTAL CITY/PENTAGON CITY

DIRECT RENTAL VS. OVERALL VACANCY RATES



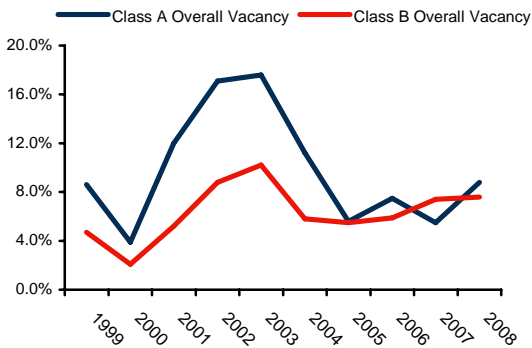
- The Rosslyn-Ballston Corridor finished the year strong, with vacancy rates dropping from the third quarter by 0.5 percentage points to 6.0% for direct space and 0.2 percentage points to 8.0% overall. Asking rental rates decreased less than 1.0% from the third quarter due to the lack of available space in high quality properties.
- Renewals continue to play a very important role in the Rosslyn-Ballston Corridor as BBN Technologies, Federal Systems Network and GSA have all renewed significant leases. Cambridge Associates signed the largest new lease of the quarter, leasing an additional 46,382 sf at 2500 Wilson Boulevard.

DIRECT RENTAL VS. OVERALL VACANCY RATES



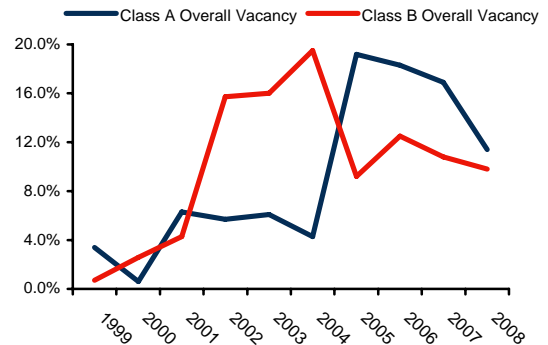
- Crystal City/Pentagon City had a healthy fourth quarter, as overall vacancy rates dropped nearly 1.0 percentage point from the third quarter to 11.3%. Asking rental rates slipped 1.4% from the previous quarter to \$35.96 psf as high quality space was leased.
- Lockheed Martin signed the largest lease of the quarter, taking roughly 225,000 sf at 2121 Crystal Drive. The 10-year deal represents a consolidation within Crystal City. For the year, nearly 1.0 msf of new leases were signed.

OVERALL VACANCY RATES



- While the pipeline currently consists of just 76,000 sf of office space at 3030 Clarendon Boulevard, the pipeline may soon expand. JBG's 270,000-sf 800 North Glebe and B.F. Saul's 94,000-sf at 3000 Wilson Boulevard are scheduled to begin construction in early 2009.
- Fundamentals should remain very strong as no new buildings will deliver before 2010. Expect vacancy rates to hold steady or marginally decrease and rents to increase slightly in 2009 in this tight market.

OVERALL VACANCY RATES

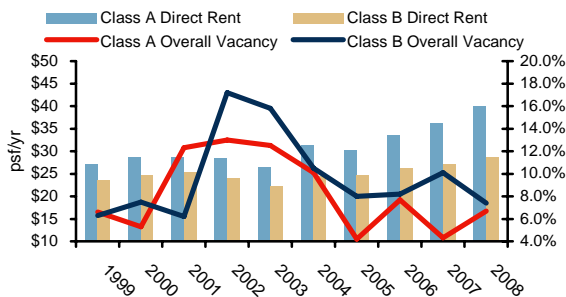


- Meridian Group's National Gateway I & II remain the only projects under construction in Crystal City/Pentagon City. These two buildings will deliver 363,505 sf of office space to the market in the fourth quarter of 2009. Asking rental rates are in the low to mid \$40s psf. To date, there has been no pre-leasing.
- Despite the BRAC regulation, government agencies have continued to renew and take new space in Crystal City/Pentagon City. Such trends validate the attractiveness of this submarket to government contractors.

CITY OF ALEXANDRIA

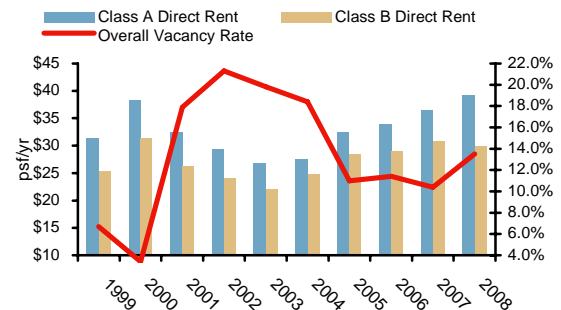
TYSONS CORNER/MCLEAN

DIRECT RENTAL vs. OVERALL VACANCY RATES



- While the City of Alexandria, particularly Old Town, remains a tight market, direct and overall vacancy rates each climbed 0.3 percentage points to 5.0% and 6.3%, respectively, from the third quarter. Overall asking rental rates increased 2.2% to \$33.84 psf over the quarter, as new, high-quality space became available and space in older buildings was leased.
- The fourth quarter delivery of 2331 Mill Road was one contributing factor in the vacancy rate increase from the third quarter. This 79,545-sf building has 44,925 sf of availability, with Reed Technology occupying the remainder.

DIRECT RENTAL vs. OVERALL VACANCY RATES



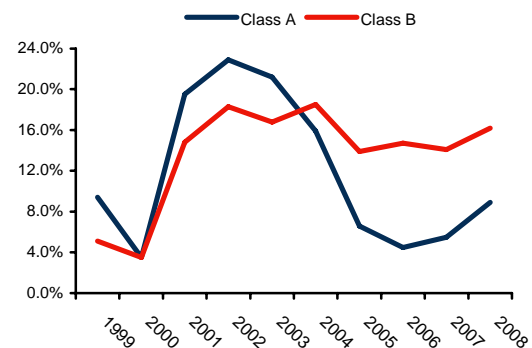
- Tysons Corner/McLean continued to struggle in the fourth quarter as vacancy rates increased from the third quarter: 1.5 percentage points to 11.8% for direct and 1.8 percentage points to 13.4% overall. A number of companies, including Arnold Worldwide and ILS, have moved out or downsized within the Tysons Corner/McLean submarket this year.
- B.F. Saul's 323,698-sf Park Place II project delivered this quarter, which helped prop up both vacancy rates and asking rental rates. One active project remains in Tysons: 1850 Towers Crescent will deliver 293,095 sf to the market in the fourth quarter of 2009.

OVERALL VACANCY RATES



- Alexandria will benefit from BRAC sooner rather than later, as the Washington Headquarters Service announced that it has chosen Duke Realty's Mark Center as its future home. The 1.7-msf project, to be owned by the Department of Defense, is scheduled to be completed in 2011 and will employ 6,400 people.
- Market fundamentals of Alexandria should benefit from the combination of the BRAC announcement and a small construction pipeline. Ballenger East and West will deliver just under 87,000 sf to the market in early 2009, and 1701 Edmonson place is slated to add 100,000 sf to the market in early 2010.

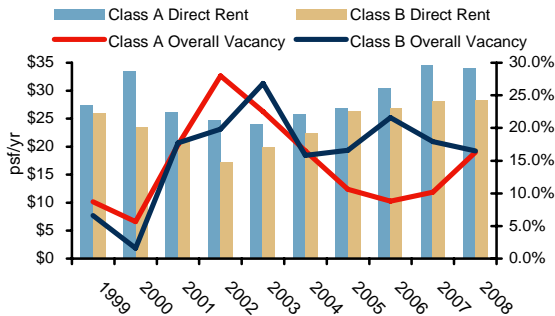
OVERALL VACANCY RATES



- Tysons Corner/McLean received good news in early December as the FTA approved the 23-mile Dulles Metrorail Extension. The project next heads to the Department of Transportation and to Congress for final approval. The project is slated to begin in March 2009.
- Tysons Corner/McLean has had a tough 2008, but 2009 could be a brighter year now that the development pipeline is quite small and the Metrorail Extension is poised to move forward.

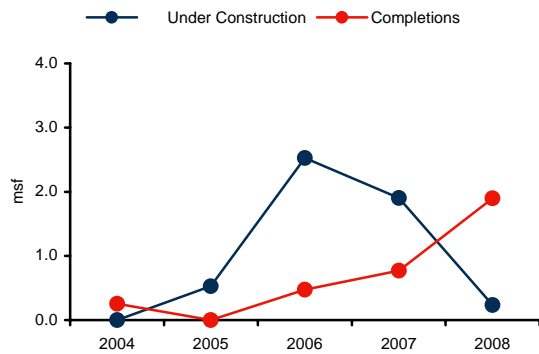
RESTON/HERNDON

DIRECT RENTAL vs. OVERALL VACANCY RATES



- Reston/Herndon has remained steady, considering it added close to 2.0 msf of new space this year. Further, this market has accounted for 1.5 msf of new leasing activity in 2008, the strongest leasing activity level in Northern Virginia.
- Reston/Herndon's strong fourth quarter can be credited to large tenants who continued to sign at brand new, high quality buildings. Strayer and United Healthcare headline these leases, taking 103,461 sf at Dulles Station East, and 57,377 sf at Two Reston Crescent, respectively.

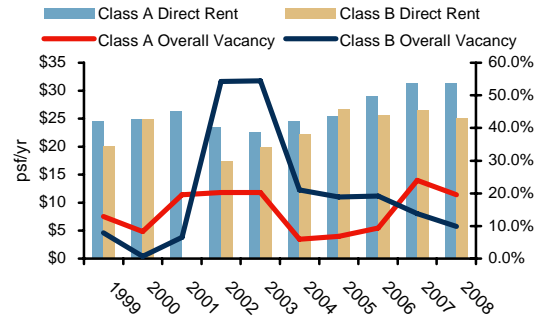
UNDER CONSTRUCTION vs. COMPLETIONS



- While vacancy rates decreased, rental rates also decreased from the third quarter. This is due to high quality space being leased, in addition to lower quality space being put on the market for sublease at deep discounts as companies continue to struggle.
- Reston/Herndon still has high vacancy levels, but many of the recent deliveries have been leased, leaving fewer options for large tenants looking for high quality space. The one delivery scheduled for 2009 delivery, Democracy Tower, is already fully pre-leased to the College Entrance Examination Board. However, should government spending stall in 2009, expect an increase in available space.

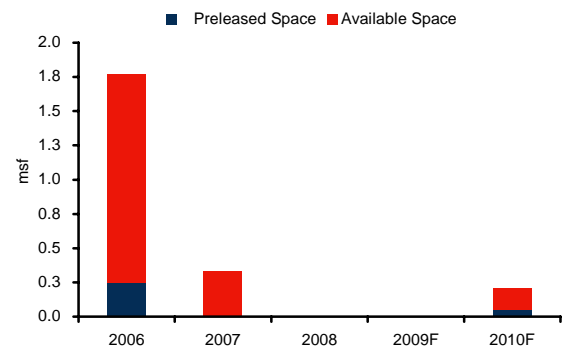
ROUTE 28 SOUTH

DIRECT RENTAL vs. OVERALL VACANCY RATES



- Route 28 South had a quiet, but healthy fourth quarter, as vacancy rates declined 0.3 percentage points to 15.6% for direct and 0.2 percentage points to 17.2% overall. Asking rental rates remained essentially unchanged from the third quarter at \$30.26 psf.
- A handful of significant new leases and renewals were signed during the quarter. GSA signed for 100,000 sf at Meadows 1 in Chantilly. Insurance giant Aetna signed for just over 25,000 sf at Glenview II. IT firm Ravenwing renewed 22,517 sf at Lincoln Park.

SPACE IN PROJECTS UNDER CONSTRUCTION



- BPG Properties' 14380 Newbrook Drive is the only project in the construction pipeline. This 158,988-sf office building is scheduled to deliver in early 2010. It is 33.0% pre-leased by government contractor CACI.
- Expect Route 28 South to suffer from slow activity in 2009. Vacancy rates are still quite high, but the glut of new space delivered in 2006 and 2007 is slowly being absorbed.

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 OVERALL ABSORPTION	DIRECT WTD AVG. CLASS A GROSS RENTAL RATE*
Rosslyn	8,245,705	38	4.7%	3.2%	492,331	0	625,000	711,847	\$46.97
Arlington Metro Corridor	4,767,672	31	17.3%	15.2%	396,140	76,000	380,198	86,404	\$38.68
Ballston	5,830,294	28	5.0%	2.5%	282,336	0	0	(8,585)	\$41.11
Crystal City/Pentagon City	11,592,875	42	11.3%	9.9%	956,086	363,505	0	188,590	\$39.17
Arlington/Non-Metro	1,203,921	8	4.4%	4.4%	193,956	0	184,380	158,871	\$35.71
Arlington County	31,640,467	147	9.1%	7.4%	2,320,849	439,505	1,189,578	1,137,127	\$39.69
Old Town	8,288,607	78	4.6%	3.2%	348,749	100,000	0	14,296	\$39.30
I-395 Corridor	2,594,397	23	6.5%	5.8%	63,072	0	0	29,383	\$29.28
Huntington/Eisenhower	2,537,859	19	11.9%	10.0%	94,618	86,905	329,545	155,509	\$41.67
Alexandria	13,420,863	120	6.3%	5.0%	506,439	186,905	329,545	199,188	\$40.23
Springfield/7 Corners/Baileys	6,259,099	52	6.3%	5.6%	379,280	156,000	0	39,272	\$33.26
Merrifield/Route 50	6,734,140	58	17.9%	15.9%	481,434	120,000	183,700	(403,132)	\$37.56
Fairfax/Oakton/Vienna	9,144,689	85	11.0%	8.5%	463,983	0	0	(238,911)	\$33.27
Tysons Corner/McLean	21,964,882	147	13.4%	11.8%	1,163,753	293,095	323,698	(438,730)	\$39.15
Reston/Herndon	24,605,357	188	16.6%	13.9%	1,504,824	235,433	2,108,465	833,134	\$33.98
Route 28 South/Chantilly	8,549,559	69	17.2%	15.6%	824,782	158,988	0	476,682	\$31.39
Fairfax County	77,257,726	599	14.4%	12.3%	4,818,056	963,516	2,615,863	268,315	\$34.35
Loudoun County	3,725,995	43	31.4%	29.1%	177,227	0	413,474	14,452	\$29.26
Northern Virginia	126,045,051	909	12.7%	10.8%	7,822,571	1,589,926	4,548,460	1,619,082	\$35.04

* Rental rates reflect \$psf/year

MARKET HIGHLIGHTS

SIGNIFICANT 2008 NEW LEASE TRANSACTIONS				
BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
13820 Sunrise Valley Drive	Reston/Herndon	Time Warner	237,675	A
2121 Crystal Drive	Crystal City/Pentagon City	Lockheed Martin	224,091	A
14370 Commonwealth Drive	Route 28 South/Chantilly	CACI	168,174	A
2800 South Randolph Drive	Arlington Non-Metro	U.S. Patent & Trademark Office	162,285	A
SIGNIFICANT 2008 SALE TRANSACTIONS				
BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
2318 Mill Road	Huntington/Eisenhower	Mass Mutual, ASCO	250,000	\$100,000,000
2260 Woodland Pointe Avenue	Reston/Herndon	Metzler North American	184,747	\$100,000,000
SIGNIFICANT 2008 CONSTRUCTION COMPLETIONS				
BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
1919 North Lynn Street	Rosslyn	Corporate Executive Board	625,000	1/08
7930 Jones Branch Drive	Tysons Corner/McLean	Chevy Chase Bank	323,698	12/08
1875 Explorer Street	Reston/Herndon	NII Holdings	234,000	3/08
SIGNIFICANT PROJECTS UNDER CONSTRUCTION/RENOVATION				
BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
1850 Towers Crescent	Tysons Corner/McLean	N/A	293,095	11/09
11955 Democracy Drive	Reston/Herndon	College Board	235,433	10/09
3500 South Clark Street	Crystal City/Pentagon City	N/A	186,529	11/09
3550 South Clark Street	Crystal City/Pentagon City	N/A	176,976	11/09
6909 Walker Lane	Springfield/Annandale/Baileys	DCS Corporation	156,000	5/09



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

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