

MARKETBEAT

SUBURBAN MARYLAND OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



4Q08

ECONOMY

2008 was a tumultuous year for the U.S. economy. The current recession, which officially began in December 2007, deepened and appears almost certain to be the longest downturn since the end of World War II. Consumer spending growth stalled and businesses began to cut back sharply on their spending. Layoff announcements continued to mount through the fourth quarter at the same time corporate profit warnings multiplied. The economic malaise has also begun to affect Suburban Maryland. While the November 2008 unemployment rates of 3.3% in Montgomery County and 5.1% in Prince George's County remain well below the national average (6.7%), they reflect a continuing increase in unemployment that began six months ago. Moreover, growth in office-using employment showed signs of cooling this year in conjunction with the nationwide slowdown. Employment was depressed by sharp declines in financial activities and professional/business services in both Counties. However, this weakness was largely offset by continued job gains in the government sector. This is not surprising as a large part of Maryland continues to benefit from government spending. According to the U.S. Census Bureau's Consolidated Federal Funds Report for Fiscal Year 2007, the state of Maryland ranked fourth in defense spending in the nation and third in the amount the federal government spends per person on grants, contracts and salaries.

OVERVIEW

The weakening economy is taking a toll on the Suburban Maryland office market. Tenant demand has begun to sputter in both Montgomery and Prince George's Counties, with leasing activity posting its lowest level in five years and overall absorption dipping into negative territory. Combined with robust construction, overall vacancies in both Counties steadily increased throughout 2008. While asking rental rates have held steady in the low-\$30s and mid-\$20s per square foot (psf) for Montgomery and Prince George's Counties, respectively, actual rents on leases signed this year are down by as much as 5.0% to 10.0% in both Counties. Notably, landlords are being far more accommodating than they were in 2007, offering rent abatements, free rent periods for up to six months and more generous improvement packages for leased space. Meanwhile, investment sales volume sank to its lowest level since 2000, totaling \$507.60 million for all of 2008, against the backdrop of a global financial turmoil and exacerbated by investors' uncertainty in property pricing and the general economy.

Montgomery County, the area's linchpin, remained healthy but showed signs of strain throughout the year. Availability was up in most of the County's office submarkets so that the overall vacancy rate for the County rose 1.0 percentage point from 2007 to 12.1%. The surge in new construction has been the main contributor to the uptick in vacancy. In the fourth quarter, Milestone Center Court in Germantown and 10001 New Hampshire Avenue in North Silver Spring delivered empty, adding 208,354 square feet (sf) to vacant space. This brings total completions to 812,460 sf this year, of which 703,960 sf still remains available. The County also saw several notable transactions close this year but those consisted largely of relocations that entailed some downsizing such as Lockheed Martin's move from 6560 Rock Spring Drive (180,000 sf) to 6901 Rockledge Drive (65,000 sf) in North Bethesda, and renewals such as the Food and Drug Administration's leases in Rockville. One submarket that continues to be a pillar of strength is Bethesda/Chevy Chase. Its vacancy rate has been rising modestly this year, but remains ultra low at 6.2%. This submarket also boasts the most notable lease of the fourth quarter: Microsoft Corporation signed

BEAT ON THE STREET



"All eyes will follow the incoming Presidential administration; its reaction to the financial crisis and the resulting effect on the local real estate market.

Questions surround Obama's potential restructuring of the healthcare system, however, it remains to be seen what impact this could have on health and federal related agencies located in Suburban Maryland."

— Dan McGivney, Associate

ECONOMIC INDICATORS

National	2007	2008	2009F
GDP Growth	2.0%	1.2%	-1.5%
CPI Growth	2.9%	4.2%	0.9%

Regional*	2007	2008	2009F
Unemployment	3.2%	3.9%	5.2%
Employment Growth	0.4%	-0.1%	-0.4%

Source: Moody's | Economy.com

*Includes Montgomery and Prince George's Counties

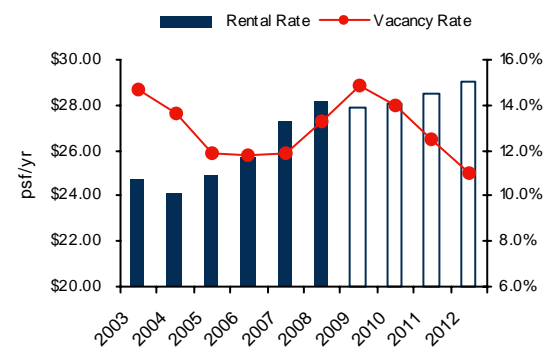
MARKET FORECAST

LEASING ACTIVITY will continue to moderate amid a prolonged economic recession. Tenants will continue to dispose of excess space and opt to renew leases rather than incur the cost of a relocation. ↓

CONSTRUCTION pipeline is expected to become empty in 2009 upon completion of 1.1 msf in Montgomery County and 413,643 sf in Prince George's County. No project is slated to commence construction in 2009. ↓

ASKING RENTAL RATES are likely to hold steady generally, but look for landlords to continue to offer incentive packages rather than lowering rates. ↓

OVERALL RENTAL VS. VACANCY RATES



a 133,725-sf lease at Wisconsin Place that is currently being developed by Boston Properties in Chevy Chase, and will also house commercial lending firm, CapitalSource. The information technology company will move its government affairs and health services offices at the Chevy Chase Pavillion to Wisconsin Place. The County received another piece of good news; in December, healthcare firm MedImmune announced its plans to nearly double its 361,000-sf Gaithersburg headquarters in the next three years. The company has hired 800 people in 2008, with most of them based in Gaithersburg, and is poised to keep hiring in 2009.

The office market in Prince George's County has weakened with the current economic climate. Demand has been lackluster throughout the year, with transactions largely limited to renewals and a handful of significant leases that even involved "no growth" relocations such as Raytheon, which vacated 236,629 sf at 1616 McCormick Drive in Landover/Lanham submarket and downsized to a 99,000-sf class A facility at 5700 Rivertech Court in Beltsville/College Park submarket. Fortunately for the submarket, The University of Maryland University College in the third quarter purchased 1616 McCormick Drive removing the recently vacated Raytheon space and largest block available in the County. Moreover, the completion of two office projects in the Oxon Hill/Suitland submarket has weighed on the market, adding 96,937 sf to available space. As such, the County's overall vacancy rate jumped over 3.0 percentage points from 2007 to 18.3%, its highest level in the past 10 years. There is, however, some positive news. The County inked two new leases with Prince George's County Public Schools Board of Education for a combined 212,000 sf at 8903 and 8905 Presidential Parkway.

FORECAST

A protracted economic recession will continue to cloud the outlook. Massive fiscal and monetary measures, including potential job-creation programs in renewable energy and infrastructure projects aimed at arresting the economy's slide are not "quick" fixes; they will take time to take effect. Hence, Cushman & Wakefield (C&W) expects the current economic downturn to last at least through mid-year of 2009. Upward pressure on unemployment will not abate; more job cuts are on the way through 2009. Suburban Maryland also faces another tough year. Potential budget cuts on discretionary expenditures are looming as the U.S. continues to grapple with mounting domestic concerns and a rising budget deficit. Hence, the heavy dependence of the area's economy on federal spending poses a downside risk; both Montgomery and Prince George's Counties could slow if this support erodes.

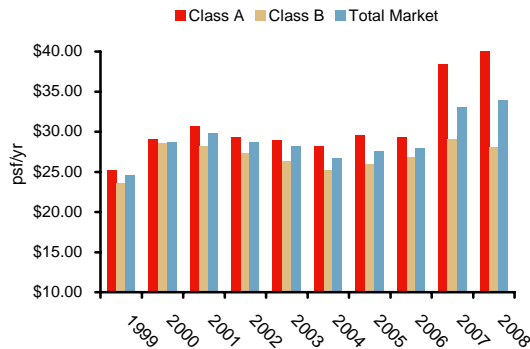
2009 could be a year of "rightsizing" for the Suburban Maryland office market. We expect some companies to continue to clear out excess space if the economy continues to deteriorate. This might involve subletting space, renewing leases or moving to smaller or cheaper quarters. As such, expect at least another year of sluggish absorption rates, flat-to-decreasing effective rental rates, and higher vacancies in both Montgomery and Prince George's Counties. A confluence of factors underpins the adoption of a relatively downbeat near-term office market forecast.

- *First*, the lack of economic growth drivers could keep office-using employment flat or modestly down from 2008. The FY 2009 Budget for the National Institutes of Health (a principal demand driver in the area) is just on par with the 2008 appropriation totaling \$29.5 billion. The absence of any budget increase for this government agency would lessen its positive multiplier effects on other sectors such as professional/business services located within Montgomery County.
- *Second*, the fallout from the U.S. financial meltdown will continue to impact the office market in the near term. The Bethesda/Chevy Chase submarket could feel the direct employment effects of the financial shakeout as Capital One Financial Corporation's acquisition of Chevy Chase Bank in the first quarter of 2009 could result in consolidation. CapitalSource and Fannie Mae are other financial institutions that are headquartered or maintain a prominent presence in that submarket, and are equally vulnerable. In the face of weaker economic conditions, we expect these financial institutions to further contract. In particular, we estimate at least 400,000 sf of trophy space could open up in 2009 as these companies continue to restructure. Notably, there has been a dearth of trophy space in close-in markets in Montgomery County, with vacancy rate hovering below 1.0% through the fourth quarter of 2008. Such impending availability of trophy space could draw some companies from Washington, D.C. to enter the high-end market and give other local tenants seeking top-tier space a chance to expand into the suburban Maryland markets rather than move to nearby Northern Virginia.

However, we believe the downside risks could be tempered by several factors in the current cycle. *First*, Suburban Maryland has no history of heavy development or overbuilding. This is nowhere more evident than in overall vacancy rates, which have averaged 9.0% to 10.0% over the past 10 years. True, there are eight buildings comprising 1.5 million square feet (msf) that will be completed in 2009 and will add over 1.0 msf to vacant space if no pre-leasing occurs through completion date. However, the volume of new supply is not an overarching concern as it can only add 1.0 to 2.0 percentage points to overall vacancies, which at 13.6% still remains well below the national average. In addition, the challenging economic environment will continue to make it difficult for speculative office buildings to move forward – which allows for a stronger upside potential once tenant demand strengthens. *Second*, overall sublease availability is not a serious risk yet. Through the fourth quarter of 2008, sublease space as a percent of total inventory has been stable at around 2.0%. Though we still expect an uptick in 2009, sublease vacancy is not likely to reach the peak of nearly 4.0% posted during the downturn in 2002 and 2003. *Lastly*, tenant demand is not likely to fall off the cliff. There are large tenants actively seeking space – particularly in Montgomery County. Based on C&W's tenants in the market survey, private sector requirements of at least 50,000 sf now range between 1.0 msf and 1.5 msf through 2012. Also, the government has an active requirement of at least 800,000 sf in 2009.

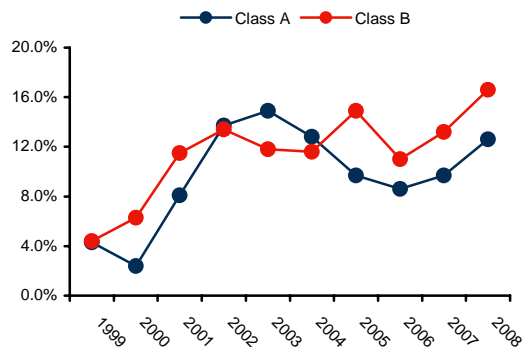
NORTH BETHESDA

DIRECT RENTAL RATE TRENDS



- The asking rental rate for the two largest blocks of space in the market, 6720 Rockledge Phase I & II (410,794 sf) are rumored to be dropping their asking rental rate from \$42.00 per square foot (psf) full service to \$38.00 psf full service.
- LCOR's project at North Bethesda Center that was scheduled to break ground in 2008 with 300,000 sf of speculative construction has been placed on hold as a significant portion of the financing for the project was from Lehman Brothers.

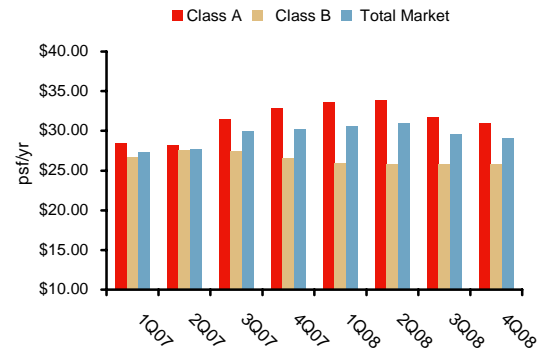
OVERALL VACANCY RATES CLASS A vs. CLASS B



- The average rental rate has remained steady at \$34.00 psf as activity in the fourth quarter slowed across all building classes. With sluggish leasing activity, average asking rents are expected to decline further in the first quarter of 2009.
- With no buildings set to deliver in 2009 through mid 2010 in the submarket, the vacancy rate is expected to decrease, although at a slower pace due to the leasing slowdown.

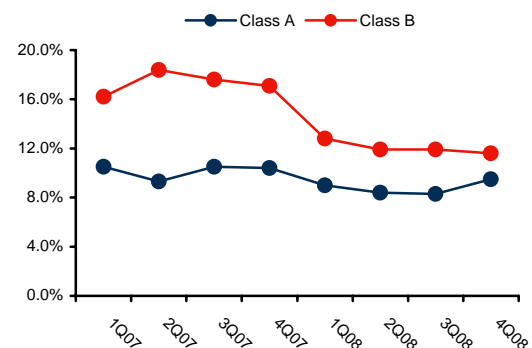
NORTH ROCKVILLE

DIRECT RENTAL RATE TRENDS



- With activity softening, tenants in the North Rockville submarket have enjoyed a notable increase in concessions from landlords. Increases in tenant improvement dollars as well as free rent will continue to become more prevalent.
- Three buildings are currently under construction in the submarket. Perseus Realty has 520 (136,430 sf) and 530 Gaither Road (210,240 sf) both slated for delivery in the summer of 2009. Washington Property Company expects 9711 Washington Boulevard to deliver in the first quarter of 2009.

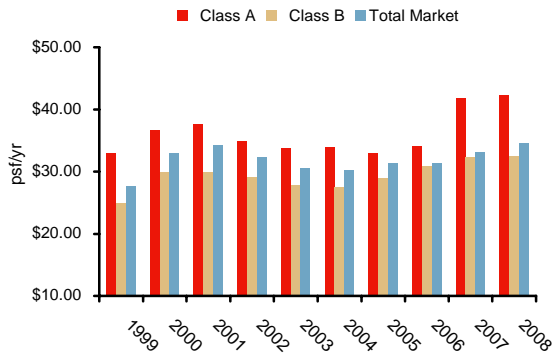
OVERALL VACANCY RATES CLASS A vs. CLASS B



- 10% of all leasing activity for the year was completed in the fourth quarter with 50,000 sf of leases signed. Due to the drop-off in activity, vacancy rates remained virtually unchanged from the third quarter – at 8.8% and 9.9% for direct and overall vacant space.
- The potential delivery of three vacant buildings in 2009 will push vacancy rates closer to a high of 14.0% in an already sluggish market but vacancy will remain at market equilibrium (10.0%).

BETHESDA/CHEVY CHASE

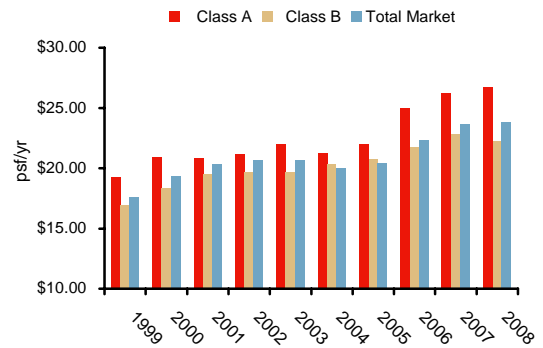
DIRECT RENTAL RATE TRENDS



- Microsoft has finally come to terms with Boston Properties for its project at 5404 Wisconsin Avenue. The company will be leasing the fifth through the ninth floors totaling 133,725 sf for 10 years after relocating from 5335 Wisconsin Avenue.
- Activity continues at 5425 Wisconsin Avenue (Simon Property sublease) where the Travel Channel took an additional 11,241 sf on the fourth floor. In addition, three tenants have signed letters of intent and are expected to sign leases by the beginning of 2009.

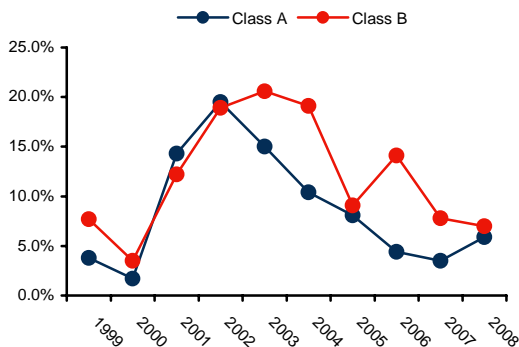
PRINCE GEORGE'S COUNTY

DIRECT RENTAL RATE TRENDS



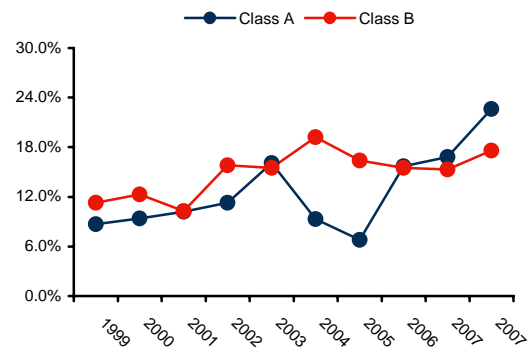
- Prince George's County continued to chip away at its vacancy rate. Direct vacancy stands at 15.0% in the fourth quarter, while overall vacancy dropped to 16.7% due largely to 212,000 sf leased by the Board of Education in Upper Marlboro, Maryland
- 5850 University Research Court, in College Park, is the only proposed building currently in the pipeline for the County and is expected to break ground in the first half of 2009. The building is fully pre-leased by Intelligence Advanced Research Projects Activity (I.A.R.P.A.).

OVERALL VACANCY RATES CLASS A vs. CLASS B



- The overall vacancy rate rose slightly to 6.2% at year-end due to additional space coming available at 7501 Wisconsin Avenue. The submarket still boasts the lowest direct vacancy rate in Montgomery County.
- Boston Properties' 5404 Wisconsin Avenue will be the only building to deliver in 2009. It is slated for delivery in May and currently has 26,776 sf available on the entire fourth floor.

OVERALL VACANCY RATES CLASS A vs. CLASS B



- The Department of Health and Human Services has issued an RFP for 800,000 sf to owners in Montgomery County and Prince George's County. Sites including Largo Town Center and the University Town Center have submitted proposals and will await GSA's decision in 2009.
- CSG in December purchased 7701 Greenbelt Road, 4301 Garden City Drive, and 4550 Forbes Boulevard from Donohoe for \$29.6 million or \$128 per square foot (psf).

MARKET/SUBMARKET STATISTICS

MARKET/ SUBMARKET	INVENTORY	NO. OF BLDGS.	OVERALL VACANCY RATE	DIRECT VACANCY RATE	YTD LEASING ACTIVITY	UNDER CONSTRUCTION	YTD CONSTRUCTION COMPLETIONS	YTD OVERALL ABSORPTION	DIRECT WTD. AVG. CLASS A GROSS RENTAL RATE*
Bethesda / Chevy Chase	8,165,848	63	6.2%	3.8%	515,584	280,000	0	(77,973)	\$42.22
North Bethesda	7,855,145	56	14.6%	13.0%	288,652	0	221,225	(78,614)	\$40.03
Rockville	6,308,021	59	10.5%	11.4%	265,922	303,000	382,881	125,685	\$37.11
North Rockville	8,660,460	85	10.2%	8.8%	543,295	539,800	0	38,302	\$31.04
Gaithersburg	3,497,870	44	27.6%	17.3%	114,035	0	0	(63,926)	\$28.41
Germantown	1,823,431	24	14.8%	14.4%	90,977	0	156,638	6,326	\$31.12
Silver Spring	4,789,986	42	8.9%	7.1%	202,636	0	0	(100,679)	\$33.06
North Silver Spring	1,125,127	22	17.2%	14.0%	52,667	0	51,716	(37,754)	\$25.00
Montgomery County	42,225,888	395	12.1%	9.8%	2,073,768	1,122,800	812,460	(188,633)	\$34.10
Beltsville / College Park	4,110,394	70	15.3%	14.4%	356,475	268,762	120,000	199,632	\$26.88
Laurel	985,661	19	5.5%	3.4%	16,689	0	0	3,331	\$22.00
Greenbelt	2,723,271	30	24.6%	21.5%	176,524	0	0	(218,097)	\$26.42
Landover / Lanham / Largo	3,098,041	64	18.6%	16.0%	148,745	0	0	(156,059)	\$26.43
Bowie	665,082	12	6.1%	5.3%	105,407	144,881	0	99,192	\$28.88
Oxon Hill / Suitland	1,912,423	46	24.5%	23.7%	234,749	0	120,000	(27,601)	\$26.95
Prince George's County	13,494,872	241	18.1%	16.3%	1,038,589	413,643	240,000	(99,602)	\$26.70
Suburban Maryland	55,720,760	636	13.5%	11.3%	3,112,357	1,536,443	1,052,460	(288,235)	\$31.92

* Rental rates reflect \$psf/year

MARKET HIGHLIGHTS

SIGNIFICANT 2008 NEW LEASE TRANSACTIONS

BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
8903/8905 Presidential Parkway	Oxon Hill / Suitland	Board of Education	212,000	A
5404 Wisconsin Avenue	Bethesda / Chevy Chase	Microsoft	133,725	New
5850 University Boulevard	Beltsville / College Park	I.A.R.P.A.	120,000	Proposed - A

SIGNIFICANT 2008 SALE TRANSACTIONS

BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
7200 Wisconsin Avenue	Bethesda / Chevy Chase	JBG Companies	276,191	\$135,000,000
Rockwall 1 & 2 Portfolio Sale	North Bethesda	JBG Companies	345,981	\$98,750,000

SIGNIFICANT 2008 CONSTRUCTION COMPLETIONS

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
6720 Rockledge Drive Phase II	North Bethesda	N/A	221,225	7/08
2000 Tower Oaks	Rockville	Lerner Enterprises/Tower Co.	199,093	8/08
1 Preserve Parkway	Boston Properties	Booz Allen Hamilton	183,788	3/08

SIGNIFICANT PROJECTS UNDER CONSTRUCTION/RENOVATION

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
5404 Wisconsin Avenue	Bethesda / Chevy Chase	CapitalSource / Microsoft	280,000	5/09
9711 Washingtonian Boulevard	North Rockville	N/A	193,130	3/09
12505 Park Potomac Avenue	Rockville	Shulman, Rogers, Gandel	153,000	7/09
16901 Melford Boulevard	Bowie	N/A	144,881	2/09



For industry-leading intelligence to support your real estate and business decisions, go to Cushman & Wakefield's Knowledge Center at www.cushmanwakefield.com/knowledge

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

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