Jones Lang LaSalle

Real value in a changing world

/pulse/

Americas Research

Northern Virginia Office Outlook Q1 2010

Quarter in review

Market conditions continued to stabilize across Northern Virginia during the first quarter, particularly in submarkets located inside the Beltway where previously signed leases materialized into occupancy gains. Consistent government demand, minimal rent depreciation, a decline in sublet inventory, reduced development activity and diminishing large-block availabilities all provided indications of stabilization.

Several tenants signed leases with built-in growth from their current footprints both inside the Beltway and along the Toll Road, providing some evidence that tenants gained confidence as economic indicators improved. However, other submarkets such as Fairfax Center and Oakton experienced rising vacancies amid several shifts in occupancy that brought large blocks of space back to the market.

Government demand remained strong, as the Department of Homeland Security leased 70,000 square feet at 1310 N. Courthouse Road in the Rosslyn-Ballston Corridor and various GSA requirements landed in Crystal City. Demand related to defense, homeland security and law enforcement materialized inside the Beltway, with agencies taking occupancy of several medium-sized blocks of space. This drove down vacancy rates and established equilibrium inside the Beltway.

Leasing activity in new construction continued, as Microstrategy leased 141,792 square feet at 1850 Towers Crescent Plaza, a 295,000 square foot trophy building in Tysons Corner that delivered last quarter. That represented an extension of a prevailing trend first seen along the Dulles Toll Road in the previous 12-18 months in which large tenants opted for new space at depressed rents, leaving behind second generation product.

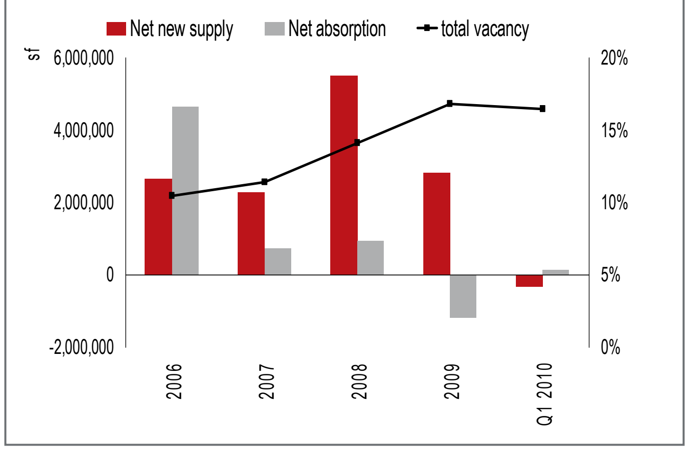
Despite several large leases being signed, overall leasing volume fell 37.4 percent below the same period last year, as many tenants continued to question their ability to sustain long-term growth. Cost control remained a priority, and tenants generally acted in a manner that emphasized fiscal responsibility rather than aggressive expansion.

Average asking rental rates, which had fallen over 10.0 percent in many submarkets during the previous 12 months, were mostly flat during the first quarter. Landlord concessions, while still high by historical standards, reached a plateau as levels of free rent and tenant improvement allowances remained constant since early-to-mid 2009.

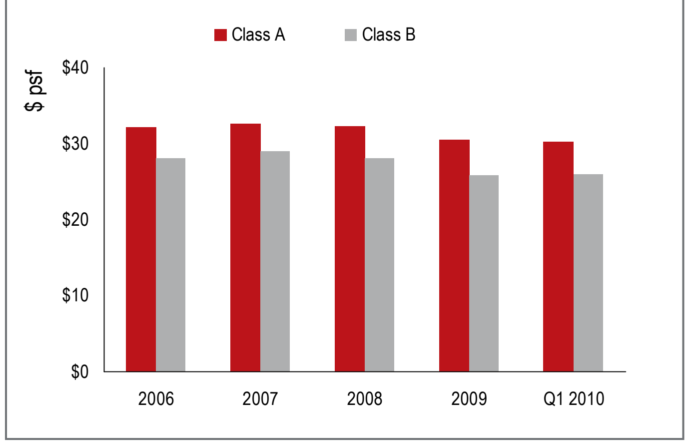
Key market indicators

	Key market indicators		12-month forecast
Supply	Supply	145,721,673 sf	Up
Supply	Direct vacancy rate	14.3%	Down
Supply	Total vacancy rate	16.5%	Down
Supply	Under construction (% preleased)	345,574 sf (38.4%)	Down
Demand	Leasing activity 12 mo. % change	-37.4%	Flat
Demand	YTD net absorption	140,574 sf	Up
Pricing	12-month overall rent % change	-5.3%	Flat
Pricing	Class A overall asking rent	$30.23 psf	Flat
Pricing	Class B overall asking rent	$26.00 psf	Flat

Net new supply, net absorption and total vacancy



Class A vs. B overall asking rents



Development activity

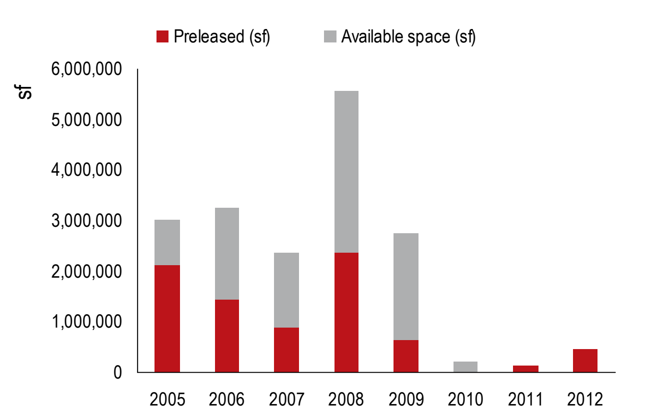
New construction activity came to a complete halt in Northern Virginia in the first quarter of 2010. No groundbreakings occurred across all submarkets. Although the 8.4 million square feet that delivered in 2008-09 represented the largest increase in supply since the 2000-01 tech bubble, the winding down of the construction cycle resulted in more stable supply.

The timing of the development pipeline in Northern Virginia served to drastically increase near term vacancy, but surely will stabilize inventories faster than other parts of the Metro DC region. Northern Virginia's pipeline pales in comparison to the District's (3.0 million square feet remaining under construction), as the available land in Northern Virginia made the market more responsive to demand than urban locales, which generally required demolition of outdated product and more site preparation prior to construction.

At the end of the fourth quarter, just 345,574 square feet were under construction in Northern Virginia, all of which was focused in core markets. The dwindling pipeline was 38.4 percent preleased, a figure well above previous quarters. The concentration of recent development in core, urban infill markets (such as Virginia Tech's build-to-suit project at 900 N. Glebe Road in Ballston) worked to increase the region's level of preleased space, as those markets have been the primary receiving zones of new government demand.

Looking ahead, the U.S. Defense Advanced Research Projects Agency (DARPA) will begin construction of a 352,750 square foot BTS in Virginia Square by mid 2010, marking the next large-scale development in the region. The agency is set to occupy the 13-story building on the former WMATA bus lot in 2012, with the complex meeting stringent new Department of Defense anti-terrorism standards. The project is part of a larger effort by the federal government to enhance security features for buildings deemed vulnerable, most of which are located inside the Beltway. VSE, Inc will also break ground on a new headquarters facility in Springfield's MetroPark, which will be a 94,280 square foot Class A building, delivering in 2012.

Development pipeline



Demand

Despite a generally cautious attitude displayed by many private sector firms in Northern Virginia during the first quarter, several tenants were able to expand their footprints through relocation or expansion of existing space. The defense contracting sector continued to demonstrate strong demand as evidenced by Booz Allen Hamilton's lease of 112,078 square feet at 575 Herndon Parkway and MITRE's lease of 79,883 square feet at 1764 Old Meadow Road in Tysons Corner, both representing pure growth.

The growth was not limited to defense, as The Potomac Institute for Policy Studies, a non-profit, doubled its occupancy at 901 N. Stuart Street in Ballston by signing a renewal with expansion for 51,138 square feet. Accounting firm Kearney & Company leased a total of 37,815 square feet at 1701 Duke Street in Alexandria, which represented growth of 18,000 square feet from its current location at 4501 Ford Avenue, also in Alexandria. This demonstrated an emerging trend of pioneering tenants seeking additional space in anticipation of future growth following a period of uncertainty. With subleases, consolidations and contractions dominating private sector activity in 2009, the first signs of growth among non-government tenants have appeared.

However, until sustained economic growth translates into job creation, likely by 2011, demand will largely be driven by healthcare, defense and large federal requirements. TRICARE, the FBI and various government agencies related to financial oversight should lead demand in 2010. Additionally, activity among defense contractors will increase in Springfield in preparation for the 2011 BRAC relocation of the National Geospatial Intelligence Agency to Engineering Proving Ground. The Washington Headquarters Service project at Mark Center in Alexandria should also materially impact the I-395 Corridor.

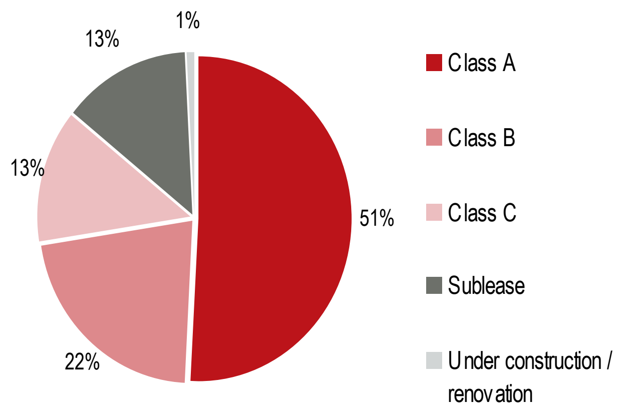
Rental rates

Responding to continued oversupply in some markets and heightened competition among owners, average asking rental rates declined by 5.3 percent on a year-over-year basis during the first quarter of 2010. However, the quarterly decline was only 0.5 percent, signaling some stabilization and a likely bottom for rental rates in Northern Virginia. Tenant improvement allowances averaging nearly $60.00 per square foot for new long-term deals, along with several months of rental abatement, continued to impact net effective rents. However, the rise in concessions appeared to hit a plateau, with recent deals matching but not exceeding comparable deals from a year earlier. Buildings inside the Beltway commanded a healthy premium to outlying locations, with average asking rents 26.9 percent above properties outside the Beltway.

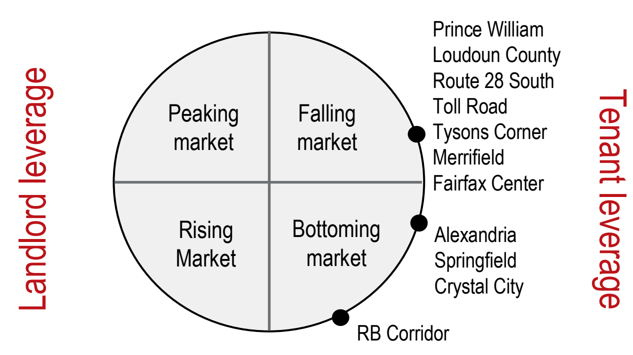
Looking ahead

Resilience has historically been a hallmark of the Metro DC region, and despite Northern Virginia's steep market cycles, it generally experiences robust economic recoveries. Proximity to a skilled workforce, access to key transportation infrastructure and dependable government growth trends will continue to drive demand in the market over the year ahead. The expanding foothold of the area's assortment of federal tenants, combined with an eventual resurgence in private sector demand, should signal a tightening of fundamentals and rebalancing of market conditions over the next 12 months.

Vacant space breakdown



Property clock – current market conditions



Vacant space – existing buildings

Building	Submarket	Owner	RBA	sf
5001 Eisenhower Avenue – Victory Center	I-395 Corridor	Spaulding & Slye / Prudential	605,998	605,998
2980 Fairview Park Drive – Park Tower	Merrifield	ING Clarion	334,385	334,385
8111 Gatehouse Road – One Jefferson Park	Merrifield	BPG Properties	274,679	274,679
12902 Federal Systems Park Drive	Fairfax Center	Colony Capital Acquisitions	220,045	220,045
2550 Wasser Terrace	Herndon	Vardell Realty Investments	217,074	217,074

Completed lease transactions

Tenant	Address	Submarket	sf	Type
ICF International	9300 / 9302 Lee Highway	Vienna	309,000	Renewal
Microstrategy	1850 Towers Crescent Plaza	Tysons Corner	141,792	Relocation
Booz Allen Hamilton	575 Herndon Parkway	Herndon	112,078	Relocation
Neustar, Inc	21575 Ridgetop Circle	Route 28 North	91,754	Relocation
Network Solutions, Inc	13861 Sunrise Valley Drive	Herndon	91,753	Renewal
U.S. Department of Homeland Security	1310 N. Courthouse Road	Clarendon/Courthouse	70,000	Relocation

Completed sale transactions

Address	Submarket	Buyer / seller	sf	$ psf
1100 N. Glebe Road	Ballston	AEW / Cornerstone Realty Advisors	309,000	$399
8008 Westpark Drive	Tysons Corner	Kaiser Permanente / West*Group	236,900	$235
1761 Business Center Drive	Reston	Pragmatics, Inc. / Americas Capital Partners	95,479	$112
2990 Telestar Court	Herndon	INOVA / Monday Properties	84,208	$119

JONES LANG LASALLE®

1801 K Street, NW
Washington, DC 20006
+1 202 719 5000

1600 Tysons Boulevard
McLean, VA 22102
+1 703 485 8800

6701 Democracy Boulevard
Bethesda, MD 20817
+1 301 214 1144

100 East Pratt Street
Baltimore, MD 21202
+ 1 410 347 0600

www.us.joneslanglasalle.com/dc