

National Average Vacancy

Office	11.4%	↑
Retail	6.7%	↔
Industrial	8.6%	↓

National Average Rents (/ sf)

Office	\$24.71	↑
Retail	\$18.30	↑
Industrial	\$6.17	↑

National Investment Qtr. Sales Volume

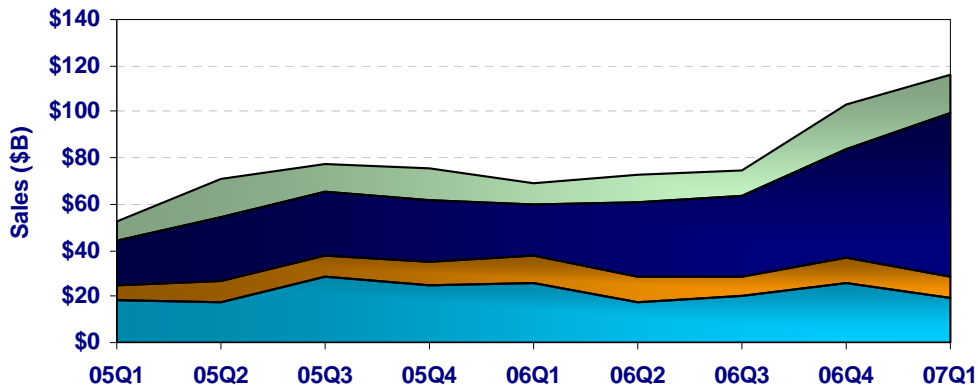
Office	\$71 billion	↑
Retail	\$17 billion	↑
Industrial	\$9.1 billion	↑

Economic Indicators <i>National</i>	Current Year Projection	2008 Projection
Non-Farm Employment	1.5%	1.5%
Gross Domestic Product	3.1%	2.7%
Retail Sales	4.0%	4.2%

NATIONAL OVERVIEW

- While the U.S. **economy** is running slower now than in the recent past, concerns with respect to a near-term recession have been allayed. Still, slow job growth is anticipated for 2007.
- The **investment sales** market rebounded in the first quarter after slowing late last year.
- The velocity of new **office** construction is increasing faster than the pace of demand resulting in an uptick in the vacancy rate.
- Signs of strain are appearing in the nation's **retail** market. While many local markets continue to perform well, negative net absorption has surfaced in a number of locales pushing the overall national vacancy rate up 20 basis points since year-end.
- New **industrial** supply has been running in excess of net absorption for the last two quarters. That said, the vacancy rate is holding steady.

Investment Sales Growth Trends



Source: RCA

OFFICE

- While a new development cycle leads the market into another expansion phase, the economic clock is ticking.
- Supply exceeded demand for the first time in a long while, signaling the possible beginning of the next phase of the real estate cycle. The volume of space being built, meanwhile, continues to increase.
- The downward trend in vacancy was reversed during the quarter by a 20-basis-point increase. Rent growth, meanwhile, stayed strong.
- Investment sales of \$71 billion during first quarter set a new single-quarter record.

SUPPLY AND DEMAND

The boom in office development continues. And as is often the case with development cycles, oversupply looms on the horizon along with economic slowdown and the erosion of demand.

At the close of first quarter, according to CoStar Group, 170.8 million square feet were under construction in the nation's aggregate office market, 14.0 more than a quarter earlier, 32.8 million more than a year before, and twice the sum underway two years prior.

Absorption, meanwhile, dropped markedly during first quarter. At 9.0 million square feet, the quarter's net was down from the 14.4 million square feet absorbed during the preceding quarter. More chillingly, the period's net demand was well under the 21.9 million of new construction arriving on line. With so much space in the pipeline, a revival of demand will be required if the market is to avoid a significant shift in the dynamics of supply and demand.

- Only the **Northeast**, thanks mainly to strong absorption in **New York City**, had a favorable ratio of net absorption to new supply during the latest quarter.
- At 78.2 million square feet, the **South**, with its many markets, claims the largest share of current construction. Large volumes are underway in areas as far apart as greater **Washington DC**, **South Florida** and the major cities of **Texas**.
- In the **West**, where 51.8 million square feet are under construction, **Southern California**, **Phoenix**, and a strongly reviving **Seattle** market claim the largest shares.

VACANCY

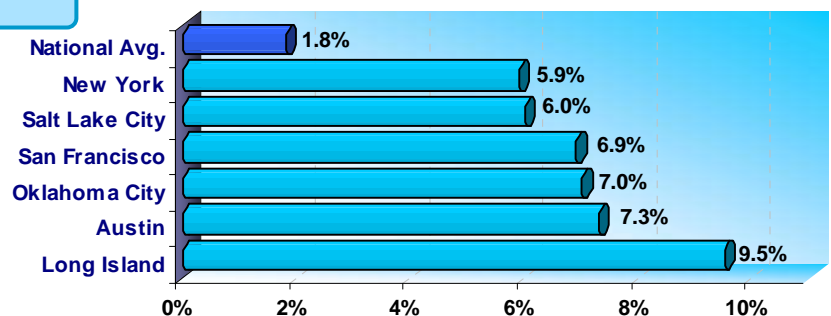
11.4%

The downward trend in vacancy, intact as recently as fourth quarter 2006, was reversed during the first quarter as absorption fell below completions. CoStar reports the quarter-end national vacancy rate at 11.4%, up 20 basis points since year-end (yet still 20 points below the rate of a year earlier).

It remains to be seen whether the upward turn taken by the vacancy curve during the latest quarter represents arrival of the next phase of the real estate cycle—or whether demand will revive and downward movement will resume. But with construction volumes increasing quarter to quarter and the national economic outlook calling for slower growth, additional increases in vacancy seem a good bet.

- All regions save the **Northeast** saw their aggregate vacancy rates increase during first quarter. At 10.3%, the rate in the Northeast was down 10 basis points for the period. At 10.2%, up 20 points since year-end, the **West** claims the nation's lowest regional rate.
- On a sub-regional basis, vacancies tend to be lowest in **South Florida**, **Southern California** and greater **New York City**, but single-digit vacancies are seen in a number of individual markets around the nation including, among others, **Orlando**, **Hampton Roads** and **Salt Lake City**.
- **Dallas** and **Detroit**, showing improvement and deterioration respectively, claim the nation's highest rates, 17.0% and 17.4%. With **Dallas** seeing robust development, however, its rate could again be on the rise before long.

Top Markets for Office Rent Growth



First Quarter Rent Change

Source: CoStar Group, Inc.

RENTS

\$24.71 psf

Statistically speaking, the reversals of the latest quarter had no discernible impact on rent growth. Of course, rents are typically a lagging indicator.

By CoStar's analysis, the asking average, now \$24.71 psf, increased 2.5% during the latest quarter and was up 7.0% year over year.

With vacancy increasing, demand slipping and construction activity on the rise, the future performance of rents comes into question.

- The 3.8% increase in the average asking rent in the **West** was the nation's best performance for the quarter. Significantly, the revival of the long-beleaguered markets of the **San Francisco Bay** area was responsible for some of the largest gains, including a 17.4% increase in **San Jose**.
- Year-over-year, the **Northeast** did best with a gain of 11.4%. **New York City's** 22.5% increase in asking rents over the past 12 months (to \$52.56 psf) led the way.
- Skewed upward by **New York**, the **Northeast's** \$31.51 psf average is the nation's highest. The **West** follows at \$25.63 with averages above \$31.00 cited for **Orange County, San Diego** and **San Francisco**.

INVESTMENT

\$71 billion in sales

According to Real Capital Analytics (RCA), the office market retains its strong attraction for investors, and CBD properties are especially desirable.

This past quarter witnessed record high sales volume of \$71 billion, more than half the sales completed in all of 2006. Even excluding the massive Equity Office Properties privatization, sales volume for the quarter still rose 34% year over year.

Prices for suburban office properties were steady during first quarter "while cap rates for CBD properties nationally fell below 6% and the average price per square foot surged to \$362," reported RCA.

- "The universe of office buyers continues to expand," states RCA in a February 2007 report, "but major equity funds and institutional investors dominated the top 100 office buyers in 2006."
- Sales in **Orange County** and **Northern Virginia** have tailed off while **Chicago** and **Washington DC** are heating up again. Meanwhile, **Manhattan** and **Phoenix** are stand-out performers.
- Sales volume in **Manhattan** and greater **Washington DC** for the 12-month period ending with first quarter are reported at \$34.47 billion and \$17.84 billion, respectively. Average cap rate and per-square-foot selling prices for **Manhattan** and **District of Columbia** assets are 5.2% and 5.7%, and \$701 and \$440.
- Average cap rates by region were lowest on average in the **Northeast** at 6.4% and the **West** at 6.7%. **San Francisco** and the **Inland Empire** see respective cap rates of 6.2% and 6.3%.
- In mid-May 2007, New York-based Broadway Partners' Real Estate Fund III completed its acquisition of a **24-building office portfolio** for a reported \$5 billion. Beacon Capital Partners was the seller. Only last December, Broadway paid \$3.3 billion for another Beacon portfolio.

RETAIL

- Rising construction activity during the quarter was accompanied by weak absorption as two of the nation's regions suffered negative totals.
- The national vacancy rate added 20 basis points during the quarter as three of the nation's four regions saw their rates rise.
- Investment sales volume picked up during first quarter following a relatively tepid 2006.

SUPPLY AND DEMAND

The slowdown in the national housing market, the related downturn in residential development and high fuel prices are matters of concern for retailers and retail real estate. These concerns, however, have yet to deter development as large-format projects—town centers, lifestyle centers, big-box centers, transit-oriented development—proliferate around the nation, confident of success.

Accordingly, CoStar reports 199.4 million square feet under construction at quarter's end, up fully 40.5 million square feet from only a quarter earlier. Oversupply grows as an increasing likelihood. The 19.2 million square feet that was completed during the latest quarter was accompanied by only 2.2 million square feet of net absorption. Further, net absorption, while stronger, also lagged completions during the previous quarter.

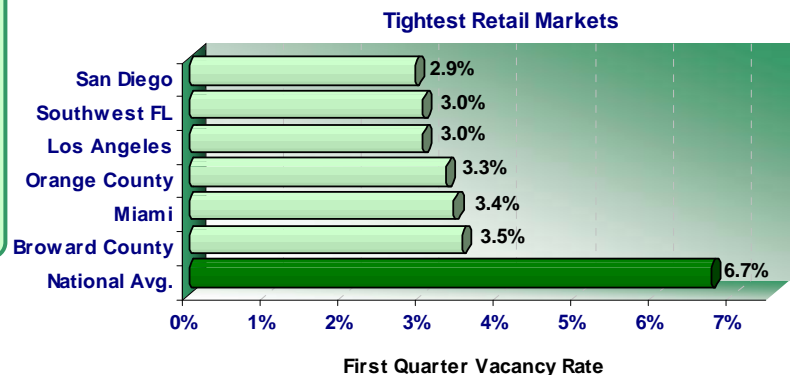
- The **South** leads the nation in retail construction underway with 76.1 million square feet, an increase of 18.7 million since year-end. **Dallas-Fort Worth** leads with 11.7 million. More than 6.0 million are recorded for each of the greater **Washington DC**, **South Florida** and **Atlanta** markets.
- The **West** follows with 62.1 million square feet under construction led by 10.8 million in **Phoenix**, 8.3 million in the **Inland Empire** and 6.1 million in **Denver**.
- Negative net absorption in the **Midwest** and **Northeast** was responsible for the nation's weak showing for the quarter. Meanwhile, the **West**, led by a strong performance in greater **San Francisco**, did best with a positive net of 6.9 million square feet.

VACANCY

6.7%

The large gap between new supply and demand during the first quarter resulted in a 20-basis point increase in the national vacancy rate, which closed the period at 6.7%. Only the West saw its rate decline during the period and year over year.

- At 4.5%, down 10 basis points since year-end, the **West** enjoys the nation's lowest retail vacancy level. Rates in the coastal **Southern California** markets run at about 3.0%.
- Difficulty in development in this region, generally speaking, is a factor. Where development is easier, vacancies are higher. Thus, **Denver**, **Sacramento** and **Phoenix** posted quarter-end rates of 8.2%, 7.1% and 6.6%.
- At 8.3%, up 30 basis points for the quarter, and 120 higher year over year, vacancy in the **Midwest** is the nation's weakest. Seven of the region's markets presently see double-digit rates; 11 recorded increases in first quarter.



Source: CoStar Group, Inc.

RETAIL

RENTS

\$18.30 psf

Rent growth, reflecting trends in supply, demand and occupancy, has slowed but remains positive. At \$18.30 psf, the national average asking price was up 1.7% from a quarter earlier but was up 9.1% over 12 months.

The downturn in demand experienced in a substantial number of the nation's markets is a source of concern with respect to rent growth in affected areas.

- At \$24.02 psf, up 1.2% for the quarter, the **West** claims the highest average retail asking rent by wide margins. This price, however, is skewed upward by the high rates seen in **Northern** and **Southern coastal California**, some of which decreased during the period.
- The **South** enjoys the nation's best rent growth with a 3.6% increase for the quarter and 11.8% growth year over year. All but two of the region's 22 markets saw their rates increase during first quarter. **San Antonio** led with an 11.9% gain. **Houston** followed at 7.3%.
- Half the markets in the **Midwest** saw their asking rents decline during the latest quarter. The best performance among major markets was **Chicago's** 2.3% increase to \$17.61 psf.

INVESTMENT

\$17 billion in sales

After a relatively flat performance last year, investment in retail properties picked up during the first quarter.

Citing an increase in large portfolio sales, RCA recorded more than \$17.1 billion in retail property transactions nationwide for the period, nearly double the total recorded for the comparable quarter of 2006. Nationally, cap rates for shopping centers remain stable at just under 7.0%.

- **Power centers** deals, averaging \$50 million, have been especially attractive to institutional and foreign investors according to RCA. The average cap rate for such transactions has been 6.5% and well below unanchored strip centers. The average price for power center assets is approaching \$200 psf.
- By region, the **West**, led by **California**, claims the lowest average cap rate at 6.4% for sales completed over the 12-month period concluding with first quarter. Rates of 5.9% are indicated for **Oakland-East Bay, San Diego, San Francisco** and **San Jose**.
- **Atlanta, Los Angeles** and **Minneapolis** were the 12-month volume leaders with respective sales totals of \$2.52 billion, \$2.29 billion and \$2.21 billion.

INDUSTRIAL

- Absorption has been running below same-term new supply now for two consecutive quarters; the West was alone among U.S. regions sidestepping this troubling trend.
- The national vacancy rate held steady at 8.6% with only the West posting a decline.
- Investment activity is up year on year. Additional increases are expected.

SUPPLY AND DEMAND

The volume of industrial construction underway increased almost 10% during first quarter to 176.2 million square feet. The latest quarter's new completions total, meanwhile, slipped to 33.2 million square feet, down from 55.6 million the quarter preceding.

Net absorption for the quarter, however, also was down, falling by half to 18.6 million square feet. This is the second consecutive period in which net absorption failed to keep up with new supply.

- The largest increase in construction during the quarter belongs to the **South**, which now has 73.5 million square feet underway, up 11.5 million from a quarter earlier. **Dallas-Fort Worth**, the combined markets of **South Florida** and **Atlanta** lead the way with respective under-construction sums of 11.9 million, 7.8 million and 6.4 million square feet.
- The **West** follows with 57.1 million square feet underway, nearly half of which (25.3 million square feet) are found in the **Inland Empire**, the nation's most active industrial market. Industrial development, remains suppressed in the **San Francisco Bay-Silicon Valley** area.
- Only in the **West** did overall net absorption, recorded by CoStar at 10.7 million square feet for the quarter (including 4.7 million in the **Inland Empire**), exceed same-term new supply. The **Midwest** came close to balancing supply and demand, but negative net absorption at 6.5 million square feet marred the performance of the **Northeast**.

VACANCY

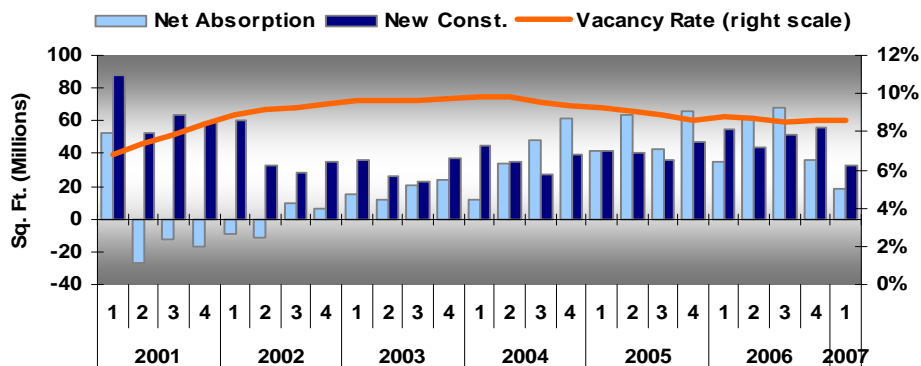
8.6%

The excess of new supply over net absorption during first quarter was not great enough to nudge the vacancy rate from the 8.6% recorded for year-end. And the rate remains down 20 basis points from first quarter 2006.

That said, if the imbalance between supply and demand persists the national vacancy level will likely begin to rise. Indeed, increases already are seen in the Northeast and South.

- At 6.4%, down 10 basis points since year-end, vacancy in the **West** is the lowest in the nation by comfortable margins. Helping keep the regional rate low are the 2.7% and 4.0% vacancies recorded for **Los Angeles** and **Orange County**. Vacancy in the boisterous **Inland Empire** market is 7.7%.
- The **South** follows with vacancy at 8.6%, up 10 basis points for the quarter yet still down 20 bps from a year earlier. Vacancy at 4.6% is cited for the combined markets of **South Florida**. The rate for **Southwest Florida** is 4.4%. Busy **Atlanta** stands at 11.3%.
- Half the markets in the **Midwest** saw their rates increase during the quarter as the regional rate held steady at 9.8%. At 10.0%, vacancy in **Indianapolis** registered a 100-basis-point decline.

Industrial Supply & Demand Trends



Source: Costar Group, Inc.

RENTS

\$6.17 psf

Despite the excess of new supply delivered over demand, the national average asking rent for industrial space grew 2.3% during the quarter to \$6.17 psf. Year over year, the average is up 6.3%. All regions saw their average rents rise during the quarter.

- At \$8.29 psf, the **West** boasts the nation's highest average asking rate. It also posted the nation's largest first-quarter increase, 4.0%. The big role played by the flex sector, along with high cost structures in many areas, contribute to the overall high rents.
- The **South** was the second-best performer: a 2.2% increase lifted asking rents to \$5.70 psf.
- At \$4.59 psf, the **Midwest** claims the nation's lowest rents. The gain for the quarter was 1.1%. **Minneapolis** leads this region with an average rent of \$6.20 psf, up 2.3% since year-end.

INVESTMENT

\$9.1 million in sales

Excluding the Centerpoint REIT privatization that occurred in first quarter 2006, investment in industrial properties at \$9.1 million nationwide during first quarter 2007 was up 10% year over year. The demand for industrial properties has gained a second wind and, in lockstep, new offerings have "spiked" during the last two quarters.

Nearly \$11 billion in property were listed during first quarter alone "including a large number of large institutional portfolios" according to RCA. This increase will "test the appetite" of industrial buyers that had complained about shortages of large, quality industrial properties available for acquisition. RCA reports capitalization rates for both warehouse and flex properties down nearly 25 basis points year over year.

- **Los Angeles** and **Chicago** led the nation in investment volume at \$2.74 billion and \$2.23 billion.
- Other metro markets with investment volumes in excess of \$1 billion include **Atlanta, Dallas-Fort Worth, Orange County, Riverside-San Bernardino** and **San Diego**.
- Major markets with average selling prices at or above \$135 psf include **Northern Virginia, San Jose, San Diego** and **Las Vegas**.
- Average capitalization rates by region for 2006 were lowest in the **West** at 6.8%. The **Inland Empire** led with 6.3%. **Los Angeles** and **Orange County** followed at 6.4%.

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