

### METROPOLITAN WASHINGTON, DC OFFICE MARKET

The Washington, DC metropolitan office market consists of approximately 398 million square feet of office space and spans the District of Columbia, Northern Virginia, and Suburban Maryland. The Washington, DC area saw mixed results in all major leasing statistical categories within the three major markets. While Washington, DC and Suburban Maryland witnessed poor lackluster leasing activity, Northern Virginia improved in its leasing categories. Looking towards the near term, we are foreseeing that it will be difficult to achieve any significant improvements due to cutbacks in GSA leasing, which for the past year has been the main driver in the three major markets. The federal government, which leased 5 million new square feet in 2010, has already cancelled 3 million square feet of Federal requirements in 2011. Recent unemployment numbers at the national level remain stagnant; however, they would lead one to speculate that a double-dip recession is not likely to occur. According to the Labor Department, the national unemployment rate remains the same from last quarter at 9.1% in September of 2011. The latest unemployment rate for the Washington, DC metro area shows a slight increase to 7.5% from May to September of 2011. Until there is greater clarity established with regard to the National Budget, tenants are likely to be reluctant to hire and lease new office space.

### TOTAL VACANCY RATE

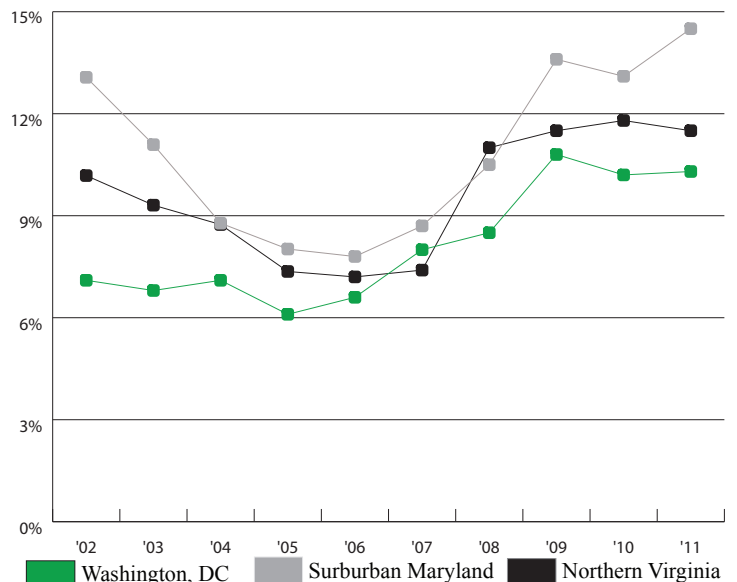
DC 11.2% ▲

VA 12.6% ▼

MD 14.6% ▲

The direct vacancy rate in the Washington, DC office market increased to 10.3%, up from 9.3% in the second quarter 2011. The direct vacancy rate also saw a major increase in Suburban Maryland to 14.6% from 14.0%, while Northern Virginia dropped slightly from 11.6% to 11.5%, coming back to where it was at the end of 2010. The total vacancy rates in both DC and Suburban Maryland increased from last quarter, DC increasing to 11.2%, where it stood in the first quarter of 2011 and Suburban Maryland increasing from 14.0% to 14.6%. Northern Virginia saw a slight decrease in total vacancy, bumping down to 12.6% from 12.7%. Overall, the Washington, DC metro area is feeling the effects of austerity measures taken on Capitol Hill, as the Government and its supporting contractors seek to reduce their space occupancies.

### DIRECT VACANCY HISTORICAL CHART



# WASHINGTON, DC REGIONAL QUARTERLY OVERVIEW

## 3RD QUARTER 2011

### TOTAL NET ABSORPTION YTD

DC	1 MIL SF	NOVA	832,324 SF	MD	(182,044) SF
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The Washington, DC metropolitan area experienced 941,206 square feet of total net absorption over the course of the third quarter 2011. The District registered 108,390 square feet of positive total net absorption, Northern Virginia recorded 497,411 square feet and Suburban Maryland witnessed 335,405 square feet. Washington, DC and Northern Virginia continue to see positive absorption due to numerous tenants occupying space (i.e. law firms Vinson & Ekins and Hunton & Williams occupying 2200 Pennsylvania Avenue, NW, Northrop Grumman occupying space in Merrifield, VA and Co-operative Finance Corporation (CFC) moving into its space in the Route 28 North Corridor). Although we saw positive absorption for this quarter in Suburban Maryland, due to a number of mid-size tenants occupying space, we are still registering negative absorption for the year. Since leasing activity has been decreasing for past three quarters, this may bode poorly for absorption down the road.

### 3Q CONSTRUCTION

DC	1.3 MIL SF	NOVA	2.1 MIL SF	MD	1 MIL SF
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In the third quarter of 2011, twenty office buildings (7 in DC, 9 in VA, and 4 in MD) in the metropolitan region were under construction, totaling 4.45 million square feet. Construction activity in the DC metropolitan area experienced a slight increase in activity since the second quarter of 2011, due to three new construction starts in Northern Virginia. While Maryland and Washington, DC are not expected to see much new construction within the near future, Northern Virginia is seeing new development occurring in healthy core markets or in those with unique drivers, such as the impending Metro arrival in Tysons Corner or BRAC demand in Springfield. Examples of this include Lerner Enterprises' 1775 Tysons Boulevard in Tysons Corner and Halle Enterprises' Kingstowne Ridge project in Springfield.

### 3Q DELIVERIES

DC	414,029 SF	NOVA	1.8 MIL SF *	MD	0 SF
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Three buildings delivered during the third quarter 2011 (1 in DC, 0 in MD and 2 in VA) adding 2.2 million square feet of new office supply to the region. The DoD's BRAC-133 project at Mark Center delivered 1.7 million square feet to the I-395 submarket this quarter. Defense employees will occupy this project in three stages starting now through 2012. The National Rural Utilities Cooperative Finance Corporation (CFC) delivered its 120,000 square foot building to the Route 28 North submarket as well.

\* Because BRAC 133 at Mark Center is a Federally owned building, it will not be added to the overall inventory.

### INVESTMENT SALES

We are once again seeing strong activity on the investment sales front throughout the third quarter 2011, proving that future quarters will remain healthy. Core assets continue to draw interest from multiple bidders, local and foreign, driving demand as investors see sustainability throughout this market. Given the current environment on Capitol Hill, it will be interesting to see what happens between now and year-end on the buildings in outer tier markets that are largely occupied by Government Contractors.

# WASHINGTON, DC REGIONAL QUARTERLY OVERVIEW

## 3RD QUARTER 2011

The investment sales market in Washington, DC slowed in the third quarter with only three sales closing. 1200 First Street, NE or Capitol Plaza I sold for the highest per square foot rate at \$512. Principal Real Estate Investors bought the 98% leased building from Polinger Shannon & Luchs Co. Shorenstein bought 1301 and 1317 Connecticut Avenue, NW for \$410 per square foot and Beacon Capital Partners bought 700 13th Street, NW for \$492 per square foot. The price for the 97% leased Class A building in the heart of Metro Center may appear a bit low, but approximately half of the Building's 243,000 square feet will be vacated in 2012.

Northern Virginia witnessed nine significant sales transactions this past quarter, with six of them exceeding \$50 million in total value. The majority of the buildings sold were inside of the beltway, highlighted by TIAA-CREF's \$146 million purchase of 1616 N Fort Myer Dr in the Rosslyn submarket.

Suburban Maryland saw a flurry of activity over the third quarter with eight buildings sold, and two more under contract. The largest transaction was the sale of 3 Bethesda Metro Center, which sold for \$150 million (\$407.44 psf). This 368,400 square foot, Class A office building is 89.1% leased and was sold by The Meridian Group to Brookfield Office Properties. In Rockville, the Shady Grove Plaza located at 15245 Shady Grove Road was sold by TA Associates Realty to Meritage Properties, LLC for \$32 million (\$175.19 psf). Built in 1989, this North Rockville property is currently 83% leased.

ADDRESS	SUBMARKET	PRICE	BUYER	SELLER	CLASS	% LEASED
1200 1st Street, NE	NoMa, DC	\$149.5 Million \$512.27 psf	Principal Real Estate Investors	Polinger Shannon & Luchs	A	98%
1616 N Fort Myer Dr	RB Corridor, VA	\$146 Million \$480 psf	TIAA-CREF	Beacon Capital	A	100%
3 Bethesda Metro Center	Bethesda, MD	\$150.1 Million \$407.44 psf	Brookfield Office Properties	Meridian Group	A	89%

## GOVERNMENT

Suburban Maryland was home to the largest GSA deals this quarter. Despite numerous protests that have come and gone, it looks like the renewal for the Department of Health and Human Services headquarters will stand at 5600 Fishers Lane. This 1.1 million square foot renewal had been contested for months, but has been upheld by GAO and GSA. Another large deal, a 491,000 square foot consolidation of the National Institute for Allergic and Infectious Diseases (NIAID), will go across the street to 5601 Fishers Lane. This group will be coming out of numerous leases, the largest being at 6700 Rockledge Drive.

In Washington, DC, the largest new deal was a move of the Customs and Border Patrol out of 799 9th Street, NW to 90 K Street, NE in NoMa for 97,000 square feet. The trend is towards renewals, as Congress and the White House trim the budgets of agencies across the board. In Northern Virginia, the news is all about BRAC, as the relocations have begun for numerous Department of Defense tenants heading to their new locations at the Mark Center and in and around Fort Belvoir.

## MARKET SUMMARY

The Washington, DC office market consists of 780 buildings over 25,000 square feet for a total inventory of approximately 138.9 million square feet. National growth and economic improvement remain at a standstill as the unemployment rate inches higher each month. The District unemployment rate was 11.1% in August of 2011, according to the Bureau of Labor Statistics. This is compared with the national unemployment rate of 9.1%, which has remained constant since June 2011.

As government stimulus money from 2008-2009 dries up, we see fewer government organizations leasing swing space and much less expansion. New renovations to government buildings have come to an end. Furthermore, budgetary issues threaten many contractors and small businesses. Leasing activity this quarter (1.9 million square feet) was the lowest in nine quarters which backs the anecdotal evidence of the reduced number of prospective tenant tours and leasing activity that brokers have reported.

GSA activity continued to decline this quarter. Only two GSA leases made the top ten report - US Department of Treasury renewed for 52,028 square feet at 1750 Pennsylvania Avenue, NW and US Customs & Border Protection signed a new lease for 97,000 square feet at 90 K Street, NE downsizing from 99,408 square feet at 799 9th Street, NW. Such was the trend for top leases this quarter most opting to renew at their current locations and giving back space. CareFirst renewed at 840 1st Street, NE but consolidated from 248,314 square feet down to 204,314 square feet. Seven out of the top ten leases renewed this quarter with four of those renewals being contractions. Vacancy rates did not change much, with a slight increase since second quarter 2011, although we can look at this in a positive light considering 400,000 square feet of vacant space delivered this quarter. Absorption remains positive for the tenth straight quarter, but dipped slightly (108,390 square feet) below last quarter's rates (218,819 square feet) as a result of decreased government leasing.

## 3Q 2011 DC HIGHLIGHTS

**DIRECT VACANCY RATE:**  
**10.3%**

**TOTAL VACANCY RATE:**  
**11.2%**

**UNDER CONSTRUCTION:**  
**1.3 MILLION SF**

**DIRECT NET ABSORPTION:**  
**-26,913 SF**

**TOTAL NET ABSORPTION:**  
**108,390 SF**

**% PRE-LEASED:**  
**33%**

**TOTAL RENTAL RATE:**  
**\$49.04 PSF FS**

**TOTAL LEASING ACTIVITY:**  
**1.89 MILLION**

**DELIVERIES:**  
**414,929 SF**

# WASHINGTON, DC QUARTERLY OVERVIEW

## 3RD QUARTER 2011

### VACANCY RATE

In the third quarter of 2011, direct vacancy and total vacancy rates increased for the first time since second quarter of 2010. The minor increase brought direct vacancy and total vacancy rates back to first quarter of 2011 numbers which were 10.3% and 11.2%, respectively. More telling of the market is the comparison between third quarter 2010 and third quarter 2011. Direct vacancy has fallen from 12.1% in third quarter of 2010 to 11.2% in third quarter of 2011. The long term decrease in vacancy rates shows the market beginning to turn around and tighten up, despite minor fluctuations due to consolidations. In the top ten leases this quarter, we saw seven renewals with four of those being reduction in space. Government did not play a large role in leasing this quarter as budgetary issues forced agencies to regulate their space needs and pull back from decision making. Tenants in the private sector postponed many decisions due to uncertainties about the economy and as a result there was not much growth.

#### WASHINGTON DIRECT VACANCY RATES

CBD - 9.4%

EAST END - 8.5%

CBD/EE CLASS-A - 10.3%

CBD/EE CLASS-B - 6.9%

CAP HILL/ NoMA - 14.4%

WEST END/GEORGETOWN - 9.4%

SOUTHWEST - 14.7%

CAPITOL RIVERFRONT - 15.3%

### ABSORPTION AND GROSS LEASING

Absorption this past quarter was 108,390 square feet due largely to leasing activity outside the Primary Business District (EE, CBD, Capitol Hill). While absorption remained positive for the tenth quarter in a row, this is the lowest number seen since third quarter of 2009 when absorption rates dipped to positive 79,601 square feet. We do not expect this year's total absorption to surpass rates from last year (3.2 million square feet) as we head into the fourth quarter with only one million square feet of absorption year-to-date. We can, however, expect total absorption to surpass the total amount of new office space delivered in 2011 (1.1 million square feet). The Capitol Riverfront and Southwest submarkets both had negative absorption and the remaining four submarkets were positive. Negative absorption in the Southwest submarket was due to GSA movement into NoMa.

### 3Q 2011 SIGNIFICANT SALES TRANSACTIONS

1301 & 1317 CONNECTICUT AVE, NW

SELLER: NORVIN PARTNERS, LTD

BUYER: SHORENSTEIN REALTY SERVICES

\$409.77 PSF

1200 1ST ST, NE- CAPITOL PLAZA I

SELLER: POLINGER SHANNON &

LUCHS Co.

BUYER: PRINCIPAL REAL ESTATE

INVESTORS

\$512.27 PSF

700 13TH ST, NW-

METRO CENTER I

SELLER: CHARTER HALL OFFICE REIT

BUYER: BEACON CAPITAL

PARTNERS, LLC

\$492.37 PSF

# WASHINGTON, DC QUARTERLY OVERVIEW

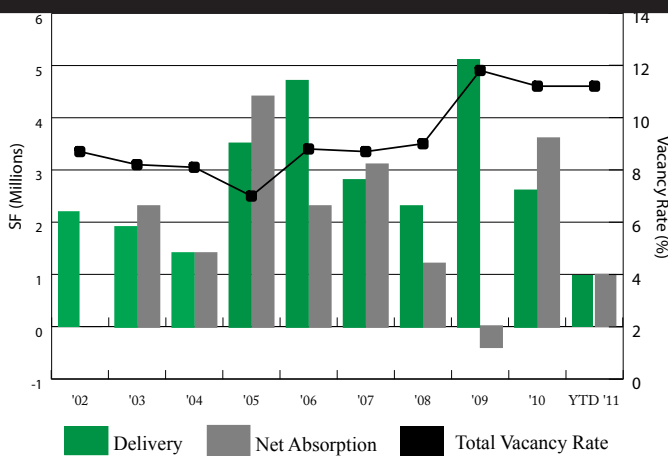
## 3RD QUARTER 2011

### CONSTRUCTION

1015 Half Street, SE delivered this quarter with 100% vacancy in its 414,029 square feet of space in the Capitol Riverfront submarket. There has been a total of 986,929 square feet of delivered space this year, 45% (442,047 square feet) of which was vacant space. When 733 10th Street, NW delivers next quarter in the East End, the DC market will have delivered a total of one million square feet for the year, which is the lowest amount of space since 2004.

Buildings under construction this quarter include: 462,528 square feet at City Center (800 and 850 10th Street, NW); 121,000 square feet at 1805 7th Street, NW in the Uptown submarket (60% preleased to The United Negro College Fund); 1000 Connecticut Avenue, NW (394,145 square feet, 62% preleased), 1111 N. Capitol Street, NE (450,000 square feet, 100% preleased to NPR), 733 10th Street, NW (169,038 square feet, 85% preleased), 1307 L Street, NW (75,000 square feet, 100% preleased), and 440 1st Street, NW (104,746 sf, 0% preleased).

#### DC HISTORICAL STATS 2002-2011



### POTENTIAL SPACE AVAILABLE

There are currently 11.2 million square feet of vacant space in the District of Columbia, of which approximately 1.1 million square feet is sublease space. Approximately 19 million square feet are being marketed for lease within the next 24 months. This includes pending lease expirations, new construction, buildings under renovation, and proposed buildings which have not yet begun construction.

### OUTLOOK

It is all about demand. Leasing activity in the third quarter was the lowest it has been in nine quarters and absorption was the lowest it has been in eight quarters, both continuing downward trends that began in 2010. The largest tenant in the market (GSA) is taking a breather after several years of aggressive leasing activity and the private sector has not stepped into the void the way it has in past cycles. It is still very much a tenant's market and landlords in all types of buildings are competing aggressively for expiring leases. However, there are signs that changes are in the offing. First and foremost is the limited amount of new development delivered in 2011 and expected to deliver in 2012. Barely 1 million square feet will deliver in 2011 of which over 55% is preleased, and only 1.2 million square feet are expected to deliver in 2012 and over 60% of that space is preleased. Much of the 9 million square feet that delivered in 2009 and 2010 has been leased and the number of options in new buildings at the higher end of the market are shrinking. The same can be said of the lower end of the market – finding 30,000 sf of space for under \$45.00 psf is not as easy as it used to be. There are still plenty of opportunities to be found in the mid-range Class B and A buildings (think 20 to 30 year old buildings at Metro Center) that have been vacated by tenants moving into new buildings, but just a slight uptick in demand could put a dent in this vacancy relatively quickly.

#### 3Q 2011 SIGNIFICANT LEASE TRANSACTIONS

CAREFIRST  
204,314 SF  
840 FIRST ST, NE  
RENEWAL

DC DEPT OF HUMAN SERVICES  
125,000 SF  
64 NEW YORK AVE, NE  
RENEWAL

KELLY DRYE & WARREN  
107,102 SF  
3050 K ST, NW  
RENEWAL

## MARKET SUMMARY

The Northern Virginia office market, which consists of 176 million square feet in Arlington, Alexandria, Fairfax, and Loudoun counties, experienced another quarter of moderate improvement in almost all leasing categories during the third quarter 2011. Almost one-third of the Northern Virginia office market is driven by the government or government contractors, and the uncertainty swooning on Capitol Hill is impacting the leasing decisions of contractors as they are scaling back operations in preparation for significant cutbacks from the federal government. Although Northern Virginia maintains one of the healthiest unemployment rates in the nation, it saw the unemployment rate increase from 4.5% at the end of May of 2011 to 4.8% at the end of August of 2011. Alexandria's unemployment rate stood at 4.8% (up from 4.2% at the end of the second quarter of 2011), Arlington's increased to 3.8% (up from 3.7%), Fairfax County saw a rate of 4.5% (up from 4.3%), and Loudoun County experienced a rate of 4.4% (up from 4.1%).

Northern Virginia's total vacancy of 12.6% has dropped to its lowest mark since the fourth quarter 2008. The Northern Virginia office market witnessed another quarter of positive total net absorption bringing the year-to-date total absorption in excess of 830,000 square feet. The average asking rental rate for Northern Virginia continues to increase as it reached \$30.76 per square foot (psf), up from \$30.41 psf at the end of the second quarter 2011, and is up from \$30.15 psf at the end of the fourth quarter 2010. Northern Virginia witnessed a transfer of market fundamentals from markets inside the beltway to markets outside the beltway during the third quarter of 2011. The first BRAC relocations were initiated in Arlington and Alexandria, creating several pockets of vacant space in the respective markets, driving vacancy rates higher, while many of the vacancy rates in the outer markets witnessed slight improvement. Leasing activity during the third quarter of 2011 illustrated a sentiment of uncertainty among tenants as there were just 2.2 million square feet leased in Northern Virginia bringing the year-to-date to 8.2 million square feet compared to 8.7 million square feet leased this time last year. Five private sector leases in excess of 100,000 square feet led the way including Systems Planning & Analysis' extension of 149,243 square feet at 2001 N. Beauregard Street in the I-395 submarket; Boeing's extension at 460 Herndon Parkway in the Herndon submarket for 134,776 square feet; Capital One's relet lease totaling 129,619 square feet at 8020 Towers Crescent Drive in the Tysons Corner submarket; NJVC's new lease at Plaza East for 120,000 square feet in the Route 28 South submarket; and Mantech's extension and expansion of 109,736 square feet at 2251 Corporate Park in Herndon.

## NOVA HIGHLIGHTS

2011	DIRECT VACANCY RATE:	11.5%
2011	DIRECT NET ABSORPTION:	919,258 SF
2011	TOTAL NET ABSORPTION:	832,324 SF
2011	GROSS LEASING ACTIVITY:	8.2 MILLION SF
2011	AVERAGE DIRECT RENTAL RATE:	\$30.76 PSF FS
	UNDER CONSTRUCTION:	2.1 MILLION SF
2011	PRE-LEASED:	27%
2011	DELIVERIES:	449,539 SF

## 3RD QUARTER CONSTRUCTION STARTS



1776 Tysons Blvd  
476,000 square feet  
0% Leased



Kingstowne Ridge  
110,000 square feet  
0% Leased



Penrose III  
100,000 square feet  
0% Leased

# NORTHERN VIRGINIA QUARTERLY OVERVIEW

## 3RD QUARTER 2011

### VACANCY RATE

The direct vacancy rate in the Northern Virginia office market decreased slightly to 11.5% this quarter from 11.6% last quarter along with year-end 2010. Total vacancy also decreased slightly to 12.6% this quarter compared to 12.7% last quarter and was equal to the 12.6% rate at year-end 2010.

<b>NOVA DIRECT VACANCY RATES</b>	ALEXANDRIA - 13.9%	↑	MERRIFIELD - 10.1%	↓	RT. 28 SOUTH - 13.7%	↓
	CRYSTAL CITY - 8.9%	↓	R-B CORRIDOR - 7.8%	↑	SPRINGFIELD - 9.5%	↓
	FAIRFAX - 12.4%	↓	RESTON/HERNDON - 12.8%	↓	TYSONS CORNER - 12.5%	↓
	LOUDOUN COUNTY - 14.4%	↓	RT. 28 NORTH - 13.2%	↓		

### ABSORPTION

The Northern Virginia office market experienced its second consecutive quarter of positive net absorption. Positive absorption that occurred in the second and third quarters outweighed the negative absorption felt during the first quarter 2011 bringing the year-to-date tally to 832,324 square feet of total positive net absorption. The positive absorption realized past quarter may be attributed to several large move-ins, including Northrop Grumman and National Rural Utilities Cooperative Finance Corporation. Northrop Grumman moved into 328,851 square feet at their new headquarters at 2980 Park Tower Drive after they purchased the building in October of 2010. A total of 500 employees will move into the Merrifield building which will consist of employees from their former headquarters in California, workers in Rosslyn offices, and new hires from the DC metro area. The National Rural Utilities Cooperative Finance Corporation (CFC) moved into its new headquarters, which delivered 120,000 square feet this past quarter to the Route 28 North submarket at 20701 Cooperative Way.

### SALES

Northern Virginia continues to see an abundance of sales activity within the market and remains one of the premier markets for buying real estate. Investors are pouring capital into real estate funds as a healthy alternative to investing in stocks and bonds. As has been the case in the past, fierce competition exists for well-leased assets in core markets within Northern Virginia. This is evident by examining the pricing on several recent deals. TIAA-CREF purchased 1616 N. Fort Myer Drive in Rosslyn from Beacon Capital for \$145.5 million (\$480 psf) at a 5.6% cap rate. 1555 Wilson Boulevard sold in the Rosslyn submarket as well to Penzance for \$67 million (\$437 psf) at a 6% cap rate. Goldman Sachs is negotiating the purchase of a 75% stake in Monday Properties' 10-building portfolio from Lehman Brothers. It was reported that the purchase price was going to be close to \$385 million, although it has still yet to close. High-quality assets outside of the beltway are also drawing attention from investors. An example of this is Spear Street Capital's purchase of the fully-leased 1881 Campus Commons Drive in the Reston submarket for \$64.4 million (\$263 psf) at a 6.8% cap rate from ING Clarion. There is evidence that suggests that buyers are skeptical of future market conditions. For example, Centerpointe I & II and 12601 Fair Lakes Road are two well-leased projects in Fairfax Center which drew large interest when they first hit the market earlier this year, but investors have since come down from offers as austerity talks on the Hill have taken shape.

### 3Q 2011 SIGNIFICANT LEASE TRANSACTIONS

**SYSTEMS PLANNING & ANALYSIS**  
149,243 SF  
MARK CENTER OFFICE PARK -  
2001 N BEAUREGARD ST  
EXTENSION

**BOEING**  
134,776 SF  
PARKWAY SQUARE -  
460 HERNDON PARKWAY  
EXTENSION

**CAPITAL ONE**  
125,000 SF  
8020 TOWERS CRESCENT  
RELET

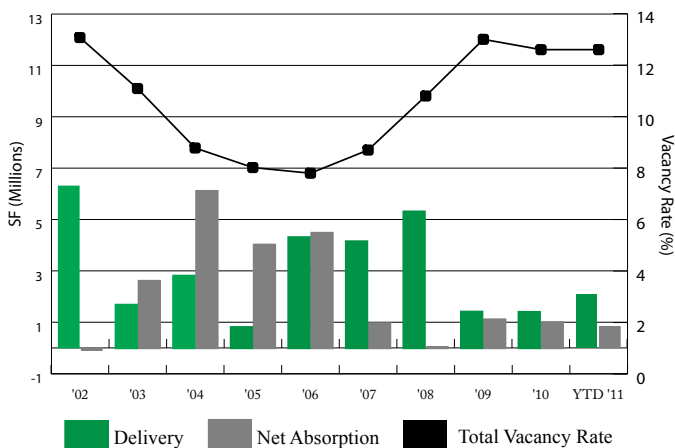
# NORTHERN VIRGINIA QUARTERLY OVERVIEW

## 3RD QUARTER 2011

### CONSTRUCTION

At the close of the third quarter 2011, there were nine buildings that were under construction in Northern Virginia for a total of 2.1 million square feet, of which 27% were pre-leased. The DoD's BRAC-133 project at Mark Center delivered 1.7 million square feet to the I-395 submarket this quarter, but will not be included in the inventory since it is federally owned. Defense employees will occupy this project in three stages starting now through 2012. The National Rural Utilities Cooperative Finance Corporation (CFC) delivered its 120,000 square foot building to the Route 28 North submarket as well. Office development has been minimal for the most part during the past two years which has helped to keep vacancy rates stabilized, but several projects broke ground this past quarter with several more planned projects set to break ground within the next couple of quarters. Projects starting construction this quarter include Penrose III – 14399 Penrose Boulevard in the Route 28 South submarket for 104,000 square feet developed by Zumot Real Estate; Kingstowne Ridge – 5860 King Centre Drive for 110,000 square feet in the Springfield submarket developed by Halle Enterprises, in speculation of demand resulting from Fort Belvoir relocations; and 1775 Tysons Boulevard for 476,000 square feet in the Tysons Corner submarket developed by Lerner Enterprises. Surprisingly, all three projects commenced construction on a speculative basis despite market conditions and the negative outlook for the national economy.

### NOVA HISTORICAL STATS 2002-2011



### OUTLOOK

The Northern Virginia office market witnessed improvements in absorption and vacancy statistics during the third quarter 2011; however, there is reason to believe that the market is in for an abrupt shift towards a weakening leasing climate in the quarters to come. There are several factors which may undermine a real estate recovery. Congress has proposed \$2.4 billion in spending cuts over the next decade with \$900 billion in federal agency cuts and close to \$400 billion of that being allotted to the Department of Defense. These measures are undoubtedly going to affect real estate activity within NOVA. Contractors are reevaluating their space needs as federal contracts expire, and this may result in these companies consolidating space and shrinking their presence, or trimming jobs at a worst case scenario. The unemployment rate continues to tread water at a national level, and at a

regional level, we are starting to see unfamiliar increases as well. Economic instability and discord amongst Congress have led many economists to predict that the unemployment rate will remain close to 9% through 2012. BRAC movements are going to continue impacting the market as defense agencies begin to relocate to new locations at Fort Belvoir, Quantico Marine Base, and Fort Meade, among others. Finally, 2012 brings an election year, which historically lends itself to a slow-down in leasing activity.

Although there are several factors that may negatively affect the Northern Virginia office market, there are many reasons that would lead one to maintain the belief that NOVA is one of the top performing markets in the country. The unemployment rate remains at 9.1% in the US, but it is still sub-5% in Northern Virginia and remains one of the lowest among any market in the country. Federal austerity measures have been highly publicized, but they may not have as large of an impact on the economy as expected. Although significant spending cuts have been announced, the government defines these cuts as a reduction in the rate of spending increases as opposed to a decrease in budget allotment. Even so, federal contractors within the area are versatile enough to divest operations in order to focus on operations such as IT or cyber-security which may not be directly hurt by government cuts. The technology sector alone is diversified enough to absorb jobs, and investment banking in the area will hold strong – this is exhibited by such recent expansion requirements by Capital One and PNC Bank. Moreover, when the so-called Super Committee meets in mid-October to establish its budgetary plans, contractors will be able to formulate a sound operating plan as opposed to just speculating on how far the government will take their cuts. This clarity will hopefully ease concerns and solidify the fact that we are nowhere near a double-dip recession.

### MARKET SUMMARY

The Suburban Maryland office market consists of 869 office buildings, totaling approximately 82.3 million square feet located in Montgomery and Prince George's Counties. Over the third quarter of 2011, the direct vacancy rate in the Suburban Maryland office market decreased to 14.6% while the total vacancy rate also decreased to 15.5%. Throughout the third quarter, Suburban Maryland witnessed 188,325 square feet of direct net absorption. Total net absorption in the third quarter of 2011 was 294,154 square feet, which included 105,829 square feet of sublet space. The average direct rental rate in the office market decreased \$0.09 to \$26.23 per square foot. The Class A average rate increased \$0.06 over the third quarter to \$29.70 per square foot which is a positive sign for the office market. This slight decrease in average rental rate comes directly after the market witnessed an increase in rates for two consecutive quarters for the first time since 2008.

### VACANCY RATE

Impacted by the absence of new buildings being delivered to the market and relatively low, yet steady absorption of existing space, vacancy rates for the Suburban Maryland market have decreased over the past quarter. The direct vacancy rate decreased by 0.2% over the third quarter to 14.6%. With the sublet vacancy rate decreasing by 0.1%, the total vacancy rate over the third quarter decreased by 0.3% to 15.5%. Staying consistent with the trend, the direct vacancy rate for Class A buildings decreased over the third quarter from 14.9% to 14.3%, while the Class A total vacancy rate closed the third quarter down 0.9% at 15.7%. There are currently 89 existing office buildings, 61 in Montgomery County and 28 in Prince George's County, marketing contiguous blocks of space 30,000 square feet or greater in the Suburban Maryland market accounting for 10.2% of the number of buildings in the market.

## MD HIGHLIGHTS

2011  
DIRECT VACANCY RATE:  
14.6 %

2011  
DIRECT NET ABSORPTION:  
188,325 SF

2011  
TOTAL NET ABSORPTION:  
335,405 SF

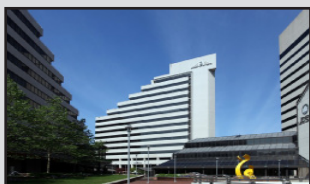
2011  
GROSS LEASING ACTIVITY:  
3,003,726 SF

2011  
AVERAGE DIRECT RENTAL  
RATE:  
\$26.23 PSF FS

UNDER CONSTRUCTION:  
1,019,322 SF

2011  
PRE-LEASED:  
91%

### MARYLAND OFFICE SALES



3-Bethesda Metro Center  
368,400 square feet  
\$150.1 Million (\$407.44 psf)

# SUBURBAN MARYLAND QUARTERLY OVERVIEW

## 3RD QUARTER 2011

### ABSORPTION

During the third quarter of 2011, direct net absorption in the Suburban Maryland office market was 188,325 square feet, bringing the year to date direct net absorption to negative 2,933 square feet. When taking into account the 105,829 square feet of sublet net absorption over the third quarter, the market's third quarter total net absorption was 294,154 square feet. This brings the year to date total net absorption for Suburban Maryland to 335,405 square feet. Montgomery County had a third quarter direct net absorption of 159,826 square feet. With sublet net absorption at 75,923 square feet, the total net absorption for the third quarter was 235,758 square feet. The direct net absorption for Prince George's County in the third quarter was 28,499 square feet. With a sublet net absorption of 29,897 square feet, the total net absorption for the third quarter was 58,396 square feet. The number of leases signed in the third quarter, 234, is slightly less than the number of leases signed in the second quarter (250) resulting in the total number of square feet leased decreasing 192,892 square feet. There were several deals of note during the third quarter impacting absorption. One noteworthy transaction came in the form of a prelease deal. The National Institute of Allergy and Infectious Diseases took 490,998 square feet at 5601 Fishers Lane, accounting for the entire proposed Class A office building in Rockville which is scheduled to break ground in June 2012. Host Hotels and Resorts renewed and expanded at 6903 Rockledge Drive in North Bethesda, growing from 68,737 square feet to 80,136 square feet. This 311,000 square foot Class A Building is now 91% leased. DRS Defense Solutions signed a new lease taking 23,033 square feet at 530 Gaither Road in North Rockville. This Class A office Building is now 64.1% leased.

#### MARYLAND DIRECT VACANCY RATES

BETHESDA/CHEVY CHASE - 8.9 %

NORTH ROCKVILLE - 14.8%

NORTH BETHESDA - 12.9%

GAITHERSBURG/GERMANTOWN - 12.8%

ROCKVILLE - 12.6%

PRINCE GEORGE'S CO. - 19.2%

### CONSTRUCTION

Upon the close of the third quarter, four office buildings are under construction in the Suburban Maryland market. Scheduled to deliver in October of 2012, North Bethesda Center 1 on Rockville Pike, a Class A building owned by USAA Real Estate Company and developed by LCOR, consists of 358,440 square feet and is fully leased to the US Nuclear Regulatory Commission to serve as its headquarters. 5830 University Research Court in College Park is a 268,762 square foot office building scheduled to deliver in first quarter 2012. COPT is the developer of this Class A building which is fully leased by NOAA. MEPT/New Tower Trust is currently developing a 194,400 square foot building in Germantown. 12409 Milestone Center Court, which is 83.3% preleased to Digital Receiver Technology, is scheduled to deliver first quarter 2013. The Foulger Pratt Companies is developing a 197,720 square foot Class A building scheduled to deliver in the second quarter of 2013. This building, Rockville Metro Plaza II, will be located in the Rockville Town Square at 121 Rockville Pike. It is already 69.4% preleased with Choice Hotels International, Inc. taking 136,362 square feet.

### POTENTIAL SPACE AVAILABLE

In addition to the 12 million square feet available immediately in Suburban Maryland, another 7 million square feet are being marketed as potentially available over the next 12 months. Among several major proposed projects in the market, Konterra Realty has a project slated to begin construction in 2012. This project consists of 3.8 million square feet of Class A office space on 488 acres in Laurel. Donohoe Construction Co./ TIAA-CREF are in the process of expanding Air Rights Center Bethesda into a 150,000 square foot office building at 7300 Pearl Street in Montgomery County's new Commercial/Residential Zone category. Although there is no start date, this Donohoe/ TIAA-CREF project as well as the 227,900 square foot proposed Carr Properties office redevelopment project at 4500 East West Highway are next in line to begin construction.

# SUBURBAN MARYLAND QUARTERLY OVERVIEW

## 3RD QUARTER 2011

### SALES ACTIVITY

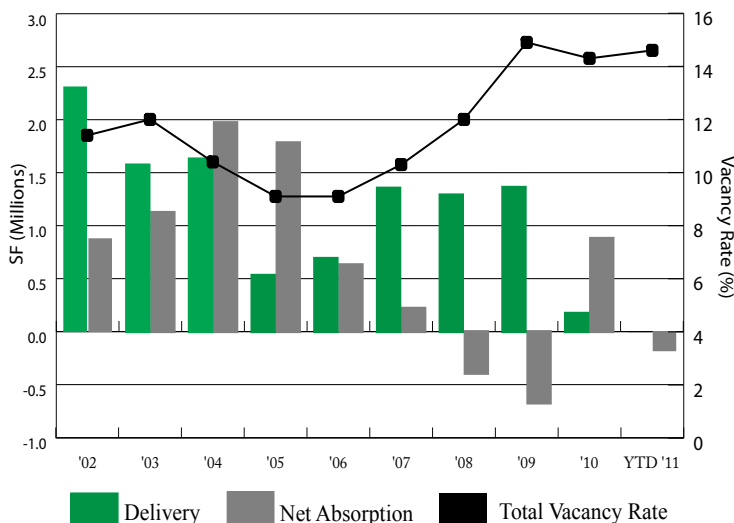
The third quarter saw great activity on the sales front in Suburban Maryland. In total there were eight buildings sold, with two more under contract. By far the biggest sale was at 7450 Wisconsin Avenue— 3 Bethesda Metro Center. This 368,400 square foot, Class A office building located in the heart of downtown Bethesda was sold by The Meridian Group to Brookfield Office Properties for \$150,100,000 (\$407.44/psf). It is currently 89.1% leased. The largest sales transaction in Rockville happened at 15245 Shady Grove Road—Shady Grove Plaza. TA Associates Realty sold the 182,868 square foot Class A office building for \$32,036,000 (\$175.19/psf) to Meritage Properties, LLC. Built in 1989, this North Rockville property is currently 83% leased. In Landover, Advance Realty sold 8301 Professional Place to Persimmon Capital Partners for \$23,290,000 (\$170/psf). This 137,000 square foot Class B office building is 97.2% leased. Another noteworthy Suburban Maryland transaction took place in Germantown where Montgomery College purchased 20271 Glenwood Lane—Germantown Technology Center 1—from Royco, Inc. The sale price was \$15,035,688 (\$222.36/psf) for this 67,619 square foot Class B office building. Montgomery College will use the entire building as part of their campus.

### OUTLOOK

In attempt to rebound from a relatively slow second quarter, the office market in Suburban Maryland produced positive results over the third quarter of 2011 posting declining vacancy rates, stabilizing rental rates, and positive absorption. Although there were a few substantial tenants that vacated space, such as NASDAQ (71,000 sf at 9600 Blackwell Rd.) and Henry M. Jackson (61,500 sf at 1401 Rockville Pike) that negatively impacted the absorption. There were also several renewals/expansions, such as Host Hotels & Resorts (80,136 sf at 6903 Rockledge Dr.) and HHS (935,000 sf at 5600 Fishers Ln.), that kept the numbers in the black. Activity on the sales front remained sound as it has throughout 2011

with several transactions providing benchmarks in which to build off. The sale of 3 Bethesda Metro Center to Brookfield Office Properties for \$150,100,000 drew a per square foot price of \$407.44 establishing a high-water mark for the suburban Maryland office market. The sale of 8301 Professional Place (\$170.00/sf) in Landover and 15245 Shady Grove Road (\$175.19/sf) in North Rockville proved there is investment demand for well leased buildings in quality locations. Although leasing activity remains bright for the market, the government budget cuts will continue to be felt through a decrease in the number and size of public sector tenants as well as a decline in the number of government contractors with space requirements, all which previously played a significant role in driving the market. These budget cuts should have a temporary negative impact on the market in which landlords will look to the private sector to compensate. Although this market is slowly moving in the right direction, demand for space will not significantly increase until the economy stabilizes, driving the expansion of the number of jobs thus requiring space to place new employees.

MD HISTORICAL STATS 2002-2011



With minimal new construction and tenant activity building, the suburban Maryland office market will be well positioned to capitalize on the momentum providing a sturdy foundation of market fundamentals including well leased buildings and a good mix of credible tenants.