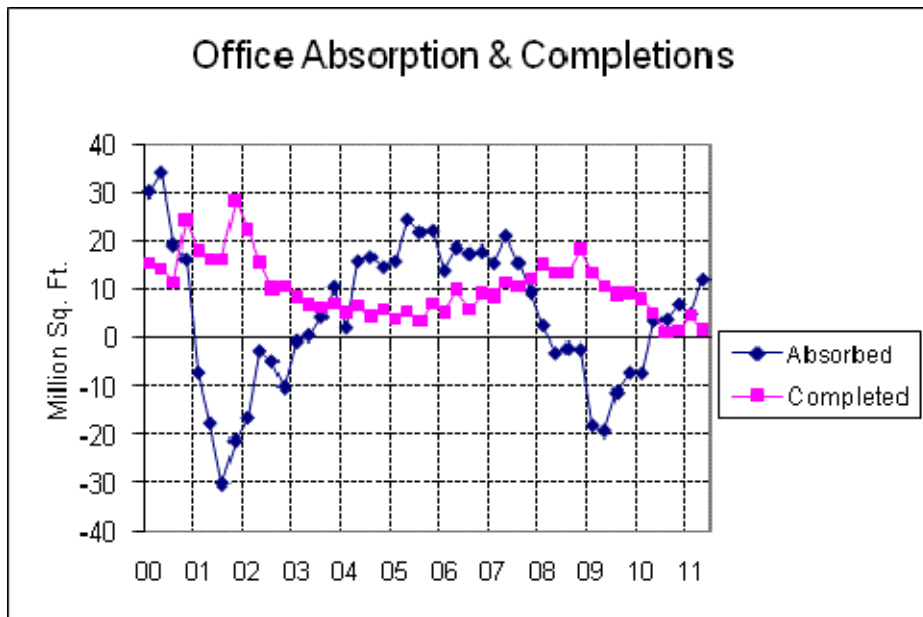


U.S. Office Market First Look: 2011-Q2

- The market took a modest and – considering the poor economic news of late – an unexpected turn for the better in the second quarter.
- The vacancy rate fell by 40 basis points, which is a pace more in line with a typical market recovery than with the numbers posted in recent quarters. However, at 17.3 percent, vacancy remains well above the 12-14 percent range that represents a balanced market.
- Absorption totaled 12.0 million square feet in the second quarter. It was the strongest performance since the third quarter of 2007, which – not coincidentally – was the quarter when the financial markets first seized up, a harbinger of the collapse in September 2008.
- At 14.7 percent, CBD vacancy remained far below the 18.7 percent rate in the suburbs, but the velocity of the recovery in the suburbs was greater in the second quarter – stronger absorption and less new space added.
- Deliveries totaled 1.7 million square feet in the second quarter with the new Hess Tower in downtown Houston accounting for about half of that. Hess will occupy the building in August, which will boost third quarter absorption at the local and national levels.
- Space still in the construction pipeline remained very low at 19.5 million square feet. More than half of the total is located in New York City and the Washington, D.C. area, each of which have just over 5 million square feet in the pipeline.
- Average rental rates showed little movement at the national level. The average Class A asking rental rate for space available at the end of the second quarter was \$31.06 per square foot per year, full service gross, a decline of 0.5 percent from the first quarter. The average Class B rate of \$22.91 was 0.1 percent below the first quarter. Preliminary numbers released last quarter suggested that rates might be turning, but those meager gains were revised away. Broadly speaking, the recovery has not progressed enough to push asking rental rates higher. But some submarkets, notably areas with growing technology companies, have already turned the corner as landlords lighten up on concessions.
- Sublease space moved lower by 1.5 million square feet to a total of 83.1 million square feet at the end of the second quarter. Sublease space has returned to a normalized level as it has been successfully leased or converted to direct available space when the leases expire.

Forecast

This may be one of those rare occasions when the performance of the office market says more about the economy than vice versa. Despite soft economic data in recent months, tenants absorbed space at a respectable clip in the second quarter, driving down the vacancy rate by 40 basis points to 17.3 percent. The office market is a lagging indicator, so this improvement could be related to the stronger labor market early this year, and it could be short-lived. But it also appears to be an indication of business confidence, a sign that companies feel good enough about their prospects that they are willing to make multi-year commitments for new space. Many economists still think that a second-half pick-up is possible, which would sustain the office market recovery. And, conversely, the willingness of businesses to expand may sustain the economy. Look for the twin recoveries of the economy and the office market to continue at a modest pace through the remainder of this year.



Source: Grubb & Ellis

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