

ECONOMY, OFFICE MARKET REELING AFTER AUTO BANKRUPTCIES

The second quarter bankruptcy filings of Chrysler and General Motors have heightened the uncertainty surrounding Detroit's economy and office fundamentals. Severe job losses persist throughout the metro area, with additional contraction forecast as the automakers restructure and suppliers attempt to tread water amid declining demand. As a result, negative net absorption of office space will continue, generating further vacancy rate increases and rent cuts. Areas most impacted by the restructuring of the Big Three will likely include the Detroit CBD and the North Troy and South Troy submarkets, which have traditionally contained a high concentration of auto suppliers and auto-related firms. In the coming months, the primary driver of property performance will likely be the fallout from the auto restructurings. City officials in Warren recently submitted a proposal to GM featuring significant tax incentives to relocate the company's headquarters, and officials in Detroit made a similar offer to retain the automaker. Additional bankruptcy filings are likely among a number of suppliers, which could allow tenants to void leases and ultimately renegotiate terms, putting downward pressure on rents. In the near term, areas such as Ann Arbor and Southfield will likely record some of the metro's strongest operating fundamentals due to more diversified population-serving tenant mixes.

Lenders are increasingly hesitant to offer financing on Detroit office properties in the current climate, and potential buyers are remaining on the sidelines or targeting assets in less risky metro areas. In the next few months, investors will likely avoid assets that have a number of tenants with ties to the auto industry, although some aggressive buyers may target deeply discounted and distressed properties. While cap rates for the best assets start in the low- to mid-8 percent range, the average initial yield could exceed 10 percent by the end of the year, and some REO properties are expected to change hands at prices below replacement costs.

2009 ANNUAL OFFICE FORECAST



Employment: Ongoing distress in the economy and the auto industry will result in the loss of 136,000 jobs this year, a 7.4 percent decline. Office-using sectors are expected to contract by 8.6 percent, or 38,200 positions.



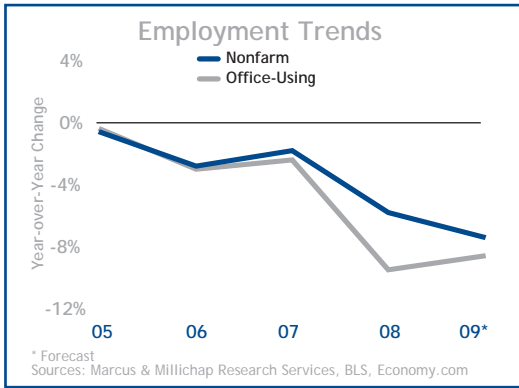
Construction: Just 150,000 square feet of new construction is forecast in 2009, down from 281,000 square feet last year. Even as Detroit employers have shed jobs, developers have averaged deliveries of 500,000 square feet annually during the past five years.



Vacancy: Negative net absorption is expected to total approximately 3.3 million square feet in Detroit this year, driving a 460 basis point increase in vacancy to 29.2 percent. In 2008, vacancy rose 360 basis points.

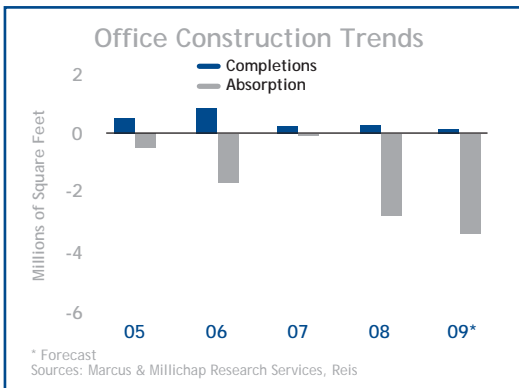


Rents: Bankruptcies at GM and Chrysler, accompanied by further job losses, will prompt owners to implement the deepest rent cuts in years. Asking rents are forecast to decline 5.6 percent to \$18.30 per square foot in 2009, while effective rents are expected to contract 7.4 percent to \$14.28 per square foot.



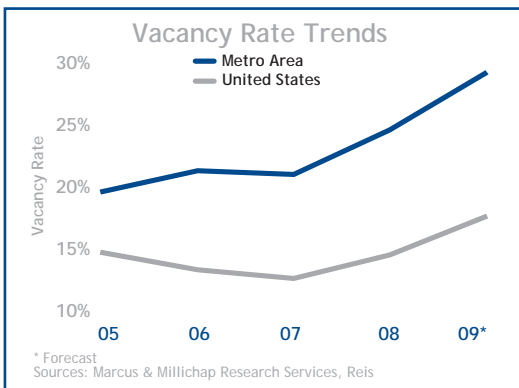
ECONOMY

- ◆ During the past 12 months, the Detroit employment market has contracted by more than 150,000 jobs, or 7.9 percent, according to second quarter estimates. Nearly 80,000 jobs were lost in the first six months of 2009.
- ◆ Widespread distress in the local economy and manufacturing base has spilled over into white-collar employment. Year over year, office-using employment has declined by approximately 59,000 workers, or 12.3 percent.
- ◆ While losses have been recorded across nearly every job category, the manufacturing and professional and business services sectors have accounted for approximately 60 percent of jobs cut in the past year. During the last 12 months, losses in these sectors have totaled more than 90,000 positions.
- ◆ **Outlook:** Ongoing distress in the economy and the auto industry will result in the elimination of 136,000 jobs this year, a 7.4 percent decline. Office-using sectors are expected to contract by 8.6 percent, or 38,200 positions.



CONSTRUCTION

- ◆ As tenant demand for space has waned, developers have been hesitant to deliver new properties; completions have totaled just 72,000 square feet in the past 12 months. Metrowide inventory has declined during that time, however, as obsolete buildings have been razed.
- ◆ Approximately 175,000 square feet of office space is under construction in the metro. The development pipeline consists of 2.2 million square feet of planned space, although strong tenant commitments will need to be secured before any of these projects break ground.
- ◆ The largest project under way is the 120,000-square foot building at 1939 S. Telegraph Road in the North Oakland submarket. Pre-leasing at the property has been limited, which could push completion past the scheduled fourth quarter date.
- ◆ **Outlook:** Just 150,000 square feet of new construction is forecast in 2009, down from 281,000 square feet last year. Even as Detroit employers have shed jobs, developers have averaged deliveries of 500,000 square feet annually during the past five years.

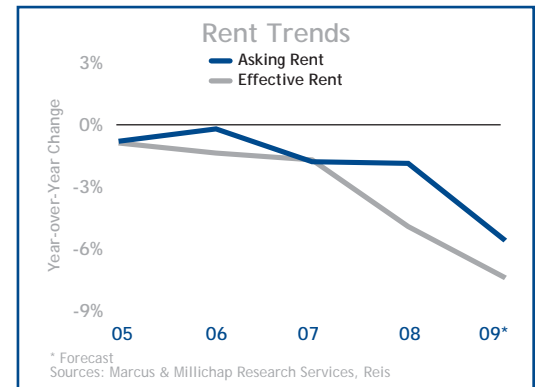


VACANCY

- ◆ Vacancy continues to climb in Detroit. Based on early estimates for the second quarter, the average rate increased 410 basis points during the past year to 26.5 percent.
- ◆ Corporate cost-cutting measures are weighing on Class A vacancy, which, at 26.8 percent, is up 550 basis points year over year and 310 basis points year to date.
- ◆ Vacancy in the lower tiers has risen 330 basis points to 26.3 percent in the last 12 months, despite the removal of outdated stock from inventory.
- ◆ **Outlook:** Negative net absorption is expected to total approximately 3.3 million square feet in Detroit this year, driving a 460 basis point increase in vacancy to 29.2 percent. In 2008, vacancy pushed up 360 basis points.

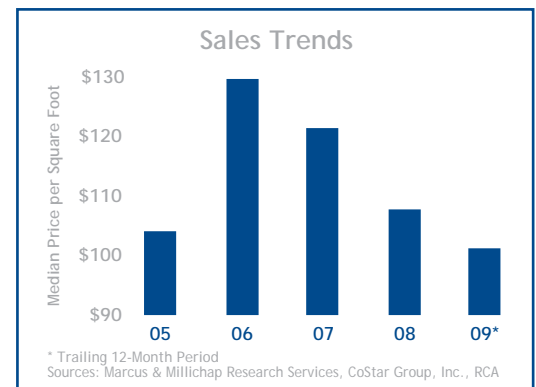
RENTS

- ◆ Owners are dropping rents in response to receding tenant demand. In the past 12 months, asking rents have declined 3.9 percent to \$18.88 per square foot, while effective rents have contracted 6.8 percent to \$14.86 per square foot. Concessions ended the second quarter at more than 21 percent of asking rents and are expected to continue to edge higher.
- ◆ In the second quarter, Class A asking rents were down 3.2 percent from year-earlier levels at \$21.90 per square foot. Given the severe distress in the local economy, asking rents in the metro's top-tier space are expected to retreat at a more significant pace in the next few quarters.
- ◆ Asking rents for Class B/C assets have dropped 4.4 percent in the last 12 months to \$17.27 per square foot.
- ◆ **Outlook:** Asking rents are forecast to decrease 5.6 percent to \$18.30 per square foot in 2009, while effective rents are expected to contract 7.4 percent to \$14.28 per square foot.



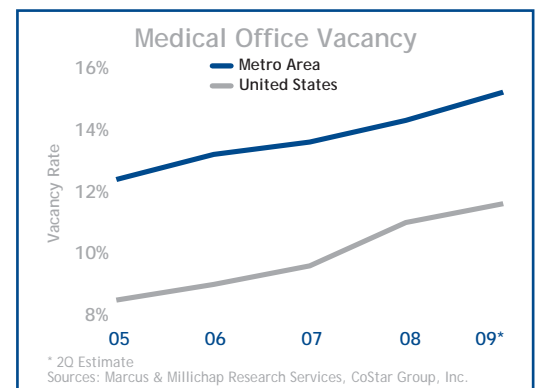
SALES TRENDS**

- ◆ Sales velocity has declined nearly 55 percent year to date compared to the same period in 2008. Buyer demand for traditional office properties has waned significantly; approximately half of the deals closed so far in 2009 involved medical office assets.
- ◆ The median price for all transactions made in the past 12 months is \$101 per square foot, down 9 percent from the preceding year. Year to date, the median price is \$93 per square foot.
- ◆ Uncertainty surrounding the near-term and extended local economic outlooks is pushing cap rates higher. During the last 12 months, cap rates have averaged in the mid-9 percent range, but several properties with initial yields above 10 percent have been listed in recent months.
- ◆ **Outlook:** Lenders have been hesitant to underwrite loans on office assets in the metro. In the coming months, assets in the Southfield submarket, which typically has a minimal concentration of auto-related tenants, may generate some investor interest.



MEDICAL OFFICE

- ◆ Until recently, the healthcare sector was the only expanding industry in the metro. As such, developers have delivered approximately 140,000 square feet of medical office space in the past 12 months. The pace of completions is decelerating, as only 12,000 square feet is currently under construction.
- ◆ Vacancy in medical office space has risen 100 basis points year over year to 15 percent, including a 90 basis point increase so far in 2009. Further significant upward bumps are unlikely due to slowing construction.
- ◆ With vacancy largely in check, medical office asking rents have ticked down just 2.9 percent during the last year to \$20.45 per square foot.
- ◆ Year-over-year sales activity for medical office properties has been fairly steady, despite a modest decline in recent months. The median sales price has increased 12 percent to \$144 per square foot, as buyers have targeted newer assets.



** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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CAPITAL MARKETS

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- ◆ New mortgage originations for office properties in the first quarter of 2009 were down 66 percent from one year earlier and were 93 percent below their peak in late 2006. Commercial banks are the primary source of capital in the marketplace today, with conduit lending still nonexistent and life insurance companies remaining on the sidelines.
- ◆ Financing for office properties is being issued at all-in rates ranging from 6.50 percent to 8.25 percent, with maximum leverage of 60 percent to 65 percent. Debt-service coverage requirements have increased to approximately 1.3x.
- ◆ Lenders are increasingly concerned with tenant rolls due to the likelihood of rent reductions. For properties with lease expirations in the next three years, lenders would, at best, mark the leases to market and consider it a high probability that the tenant will vacate altogether. Tenants occupying over 20 percent of the space or accounting for over 20 percent of revenue will be subject to intense scrutiny.
- ◆ The Term Asset-Backed Loan Facility (TALF) was expanded recently to include highly rated CMBS. Modifications to risk-assessment methodologies could reduce the share of legacy CMBS that qualify for TALF; however, the inclusion of newly issued CMBS to TALF has led some lenders to consider originating new commercial mortgages for securitization.

SUBMARKET OVERVIEW

- ◆ The fallout from the bankruptcy of GM will have a far-reaching impact on a number of the local submarkets. The city of Detroit has offered significant tax incentives to keep the company in its downtown headquarters, while the city of Warren, located in the Macomb submarket, has made similar offers in an effort to lure the company to the area.
- ◆ While job cuts capture most of the headlines in the metro, the Detroit/CBD submarket may receive a boost in the coming months from General Warranty Systems, which could move as many as 1,000 employees to the area.
- ◆ The South Troy and North Troy submarkets have been hit hard by the weakness in the auto industry, recording year-over-year vacancy increases of 820 basis points and 780 basis points, respectively. Vacancy in these areas is currently in the low-30 percent range.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents (psf)	Y-O-Y % Change
1	Birmingham/Bloomfield	14.3%	410	\$19.56	-6.3%
2	Ann Arbor	18.4%	140	\$17.48	-4.4%
3	West Wayne County	19.5%	250	\$14.86	-6.0%
4	Farmington Hills/Novi	19.8%	340	\$15.48	-6.6%
5	Royal Oak/Oak Park	20.1%	420	\$10.74	-6.8%
6	Macomb	25.8%	390	\$14.06	-6.3%
7	Detroit/CBD	28.1%	170	\$13.32	-6.3%
8	South Southfield	29.7%	440	\$13.44	-5.3%
9	North Oakland	30.1%	160	\$15.75	-4.1%
10	North Southfield	31.3%	460	\$14.27	-8.5%

Notes: Employment growth is calculated using seasonally adjusted quarterly averages. Construction, rent and vacancy figures exclude build-to-suit, flex space and medical office properties unless otherwise noted.

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Sources: Marcus & Millichap Research Services, Bureau of Labor Statistics, CoStar Group, Inc., Economy.com, Real Capital Analytics, Reis, Torto Wheaton Research Services.