

COMMERCIAL REAL ESTATE REPORT | *The Region*

Metro Area | *The CoStar Office Market Watch*

Submarket	Market size (millions of square feet)	Space available (millions of square feet)	Vacancy rate	Asking rent (per square foot)	Under construction (square feet)	Percent leased
DISTRICT						
Downtown	82.7	7.2	8.7%	\$41.37	2,384,627	60.0
Capitol Hill/Southwest	24.0	1.8	7.5	\$43.56	3,619,873	48.4
Georgetown/Uptown	13.5	0.6	4.2	\$31.94	172,556	23.5
Northeast/Southeast	0.7	0.1	12.8	\$27.70	0	0
MARYLAND						
Bethesda/Chevy Chase	11.5	1.2	10.5%	\$28.92	412,000	93.0
I-270 Corridor	37.6	4.5	12.1	\$25.33	132,180	31.1
Southeastern Montgomery County	12.0	.9	7.3	\$23.43	0	0
Eastern Prince George's County	1.3	.1	4.6	\$26.91	130,650	0
Northern Prince George's County	16.8	2.0	11.9	\$20.21	64,900	100.0
Southern Prince George's County	3.5	0.3	9.1	\$16.93	0	0
Frederick County	4.9	0.5	10.1	\$21.86	85,200	22.3
Columbia/Ellicott City	11.8	1.0	8.4	\$22.18	940,264	31.5
BWI	6.2	0.3	5.4	\$23.52	664,135	46.3
Southern Anne Arundel County	6.1	0.6	10.0	\$23.69	164,700	57.5
VIRGINIA						
Alexandria/I-395	34.4	4.6	13.3%	\$30.67	964,159	56.9
Dulles Corridor	43.4	5.8	13.4	\$24.46	746,964	45.1
Greater Fairfax County	53.6	5.8	10.8	\$25.82	603,714	39.3
Leesburg/Route 7	3.2	0.1	3.4	\$26.97	1,037,073	87.5
Manassas/Route 29/I-66	2.8	0.2	7.1	\$23.62	603,053	5.4
Rosslyn-Ballston Corridor	19.8	1.4	6.9	\$31.54	993,275	41.5
Woodbridge/I-95	1.7	0.1	2.9	\$21.67	82,618	26.7
Southeastern Fairfax County	6.3	0.4	6.7	\$23.53	326,485	0.5

Terminology: Space available includes direct and sublet; rent is average asking rent; vacancy rate includes sublet for existing properties; space includes all classes; construction includes projects currently under construction and/or renovation. It does not include pipe-line development. Figures only reflect non-owner-occupied construction. All numbers are rounded up.

Submarket definitions: Alexandria/I-395: Old Town, Pentagon City, Crystal City, Eisenhower Avenue; Dulles Corridor: Great Falls, Herndon, Reston, Route 28 Corridor; I-270 Corridor: Gaithersburg, Germantown, I-270 Corridor North, North Bethesda, Potomac, North Rockville, Rockville; Southeastern Montgomery County: Kensington, Wheaton, Silver Spring, Route 29; Eastern Prince George's County: Bowie, Upper Marlboro area; Northern Prince George's County: Beltsville, Calverton, College Park, Greenbelt, Landover, Largo, Lanham, Laurel, Capitol Heights; Southern Prince George's County: Oxon Hill, Fort Washington, Pennsylvania Avenue, Branch Avenue; Southern Anne Arundel County: Annapolis, Crain Highway Corridor, Southern Anne Arundel County; Downtown: East End, West End, Central Business District. Note: Data as of June 30

SOURCE: CoStar Group Inc.

Office Vacancy Rates on the Decline

Occupancy Increases Just About Everywhere but Prince George's County as Market There Slows

Montgomery County

The commercial real estate market in Montgomery County is holding steady.

Office space available in the county grew by nearly 1 million feet in the second quarter from a year earlier — to just over 62 million square feet — but the vacancy rate declined to 10.6 percent from 11.8 percent, according to research firm CoStar Group.

"I think the market is doing fine," said Lawrence E. Thau, managing director of the Bethesda office of CB Richard Ellis. "I think we're okay."

But he didn't say great. There was a negative net absorption — a decrease in the total space leased — of 20,000 square feet in the quarter. Asking rents rose just two cents, to \$25.71 a square foot, from the same quarter a year ago.

"Companies are taking a close look at total square feet and how it relates to the number of people they employ and how they can become more efficient," Thau said. "Decisions are being made about what the total cost is needed to run the operation."

Thau said the market's figures were being dragged down a bit by aging buildings that lack much appeal to potential tenants.

However, new buildings in Silver Spring, North Bethesda, and portions of Greenbelt remain hot. Bethesda also seems to have recovered from a slowdown that dates back a few years.

"Bethesda is a solid market again," said Brendan Cassidy, senior vice president of Cassidy & Pinkard, a commercial brokerage firm. "You're seeing some significant vacancy declines there, and that's propping up the rents again."

— Michael S. Rosenwald

Howard County

The office vacancy rate in Howard County fell to 8.3 percent in the second quarter from 12.7 percent a year earlier, as construction continued to pick up.

Among new tenants, GloboMax, a firm that helps pharmaceutical companies expedite drug development, leased 30,000 square feet at the Columbia Corporate Park in Ellicott City.

In Columbia, CoStar Group, which tracks commercial real estate activity nationwide, including the statistics in this report, leased 33,000 square feet of office space in a new building in Columbia Gateway office park on Samuel Morse Drive. In the same building, American Healthways Inc. leased 33,000 square feet for a call center where dozens of nurses offer advice by phone to Medicare beneficiaries with diabetes or congestive heart problems.

Federal contractors continued to come to Howard County to settle near Fort Meade, the Army base in Anne Arundel County that houses the National Security Agency. Interest in the area's office market is expected to increase now that a federal base realignment panel has recommended transferring more than 5,000 jobs to Fort Meade.

The number of square feet under construction more than doubled, to 901,064 from 415,416 a year earlier. The average asking price was \$21.77 a square foot, up from \$20.69.

— Dina ElBoghady

Prince George's County

There was more office space available in Prince George's County in the second quarter than there was in the same time last year.

The vacancy rate climbed to 11.2 percent in the quarter, up from 10.5 percent a year ago.

Dean F. Morehouse, president of MTM Builder/Developer Inc. said the uptick in vacancies reflects a slowdown in the county's market.

"There are more small users than large users," Morehouse said in an e-mail response to a question. "Currently, we are working with Prince George's County to attract more employment-based large users."

Still, the average asking rent jumped to \$20.15 a square foot from \$19.36.

Morehouse said zoning laws need to be adjusted to attract the "the new urbanism" and the transit-oriented development that the county desires.

But Morehouse said he is bullish about the county's future. His firm plans to build commercial office buildings at the Ingewood Business Park and at the Maryland Science & Tech Center.

— Dina ElBoghady

The District

Demand for commercial real estate in the District showed no signs of slowing during the second quarter, as investors and developers continued to build speculative projects.

The vacancy rate for the second quarter was 8 percent, down slightly from 8.2 percent for the second quarter of 2004, according to data provided by CoStar Group. The asking price was \$40.79 per square foot, up slightly from \$39.76 per square foot a year earlier.

Among major deals, law firm Piper Rudnick Gray Cary leased 231,748 square feet at 505 9th St. NW, and U.S. Immigration & Customs Enforcement leased 114,710 square feet at 1400 L St. NW, according to real estate brokerage Staubach.

The pace of construction of new buildings held steady during the quarter, with 19 buildings, representing about 6.2 million square feet, in the works, up from 16 buildings during the second quarter of 2004.

Buildings under construction included several speculative projects in NoMa, the area north of Massachusetts Avenue near Union Station. Carter Cafritz Development plans to build a 12-story, 344,000-square-foot office building at 77 K St. NE called Capitol City Plaza. Stephen A. Goldberg Co is building Capital Plaza at 1200 First Street NE, due to be complete in the fourth quarter of 2006. Land in NoMa continues to be in high demand because the central business district and the East End are largely built out. In Southeast near the proposed stadium site for the Washington Nationals, "you're going to see more land traded and development plans," said Margaret Donkerbrook, CB Richard Ellis's director of marketing.

Margarita Foster, director of research at Cassidy & Pinkard, predicted that the District's "vacancy rate will hover around 7 percent for some time." The only clouds on the horizon Foster sees are the empty buildings in Northern Virginia that would result from the Pentagon's plans to move out of leased space in Arlington and Alexandria. "Tenants in D.C. may take a harder look at options across the river," she said.

— Annys Shin

Arlington County and Alexandria

The commercial real estate market in Arlington and Alexandria has remained steady, with vacancy

rates hovering in the 10 to 11 percent range for the past two years. In the second quarter, the average vacancy rate was 11.3 percent, down from 11.6 percent in the previous quarter but up from 10.3 percent in the same quarter last year.

Average asking rates per square foot have been relatively stable as well, at \$31.16 in the second quarter, up from \$30.03 a year earlier.

When the technology bubble burst in 2001, the area was not hit as hard as neighboring Fairfax County.

"Arlington and Alexandria did not drop as far, so as a result, they haven't had as far to recover," said Paul S. Schweitzer, executive vice president and branch manager for Studley Inc., a commercial real estate firm focused on tenant representation.

The area's stability has come from its desirable location, superior access to public transportation, and reliance on big government agencies as tenants — at least until now.

The area's stability will be tested by the Pentagon's recommendation, recently seconded by the federal base closure commission, to move about 20,000 defense-related jobs out of leased space in the two jurisdictions. The move would affect more than 3 million square feet of real estate in Arlington alone.

Given the area's assets, however, commercial real estate experts think it will continue to thrive after some short-term pain. They point to moves by the Public Broadcasting Service and Bureau of National Affairs into a spiffed-up Crystal City. "What we're seeing now in a lot of the market is deals from 5,000 to 40,000 and 50,000 square feet," Schweitzer said.

— Elissa Silverman

Fairfax County

The vacancy rate in Fairfax County continued its steady decline in the second quarter, sending average rates per square foot in the opposite direction. With a single new building adding 66,207 square feet to the commercial real estate market and healthy demand from government contractors and ancillary businesses, the vacancy rate fell to 11.4 percent in the second quarter, down from 12.3 percent in the first quarter and 16.2 percent in same quarter last year.

Strong demand with little new supply meant that the average asking rate per square foot climbed to \$25.29 from \$23.04 a year earlier.

"What it indicates is that the recovery that started in 2002 has made a significant dent," said Jim Hunter, a senior vice president at Cassidy & Pinkard.

Fairfax County's vacancy rate hasn't been this low since the 6.9 percent rate in the first quarter of 2001. Prices still haven't reached the average high of \$31.32 per square foot in that quarter.

Hunter said that developers remain cautious, especially in the more western reaches of the county, but that there will be new additions to the skyline soon. Lerner Enterprises plans to build a 20-story, 483,000-square foot office building at 1801 Tysons Boulevard in the Tysons II development. New buildings are also planned by other developers for Fairview Park in Falls Church and for Fair Oaks for late 2006 and 2007.

"What drives the office market is the creation of jobs," Hunter said. "In 2004 and late 2003, defense contractors started taking space. When the contracts kicked in, the big contractors started hiring

small contractors."

The good times have started to jumpstart other sectors, as well. "Now as the recovery goes into the second phase, we're seeing a much broader cross-section of businesses looking for space," said Paul S. Schweitzer of Studley Inc.

— Elissa Silverman

Prince William County

Prince William is Northern Virginia's most far-flung county, but its location is luring employers who want to shorten commute times for many of their employees who live far from the District.

"What you're continuing to see is a migration west by businesses that want to be closer to their employee base," said Larry FitzGerald, senior vice president at Grubb & Ellis Co. in Tysons Corner.

The county's office vacancy rate dropped to 5.7 percent in the second quarter from 8.6 percent in the second quarter of last year. In response to the tightening market, 548,703 square feet of office space is under construction in the county.

The vacancy rate in Prince William County can easily swing in one direction or another because it has the least square footage in the area, with just 3.2 million square feet of office space.

Brokers expect the vacancy rate will continue to decline because Fortress Development Co., an affiliate of Rockville-based BECO Management Inc., leased its data center, commonly known as "Fortress Manassas" or "Cyberfortress," to a tenant that has not been identified. The 109,800-square-foot facility should be occupied by the end of the year.

Office rents are on the rise as well, increasing to an average rate of \$23.27 a square foot from \$19.10 a square foot a year earlier. "The new buildings are driving the market rates up," said Jay Norman, president of Manassas-based Norman Realty.

— Jenalia Moreno

Loudoun County

The office market continues to improve for landlords in Loudoun County, as vacancy rates dropped to their lowest levels since early in 2001. Vacancies fell to 11.2 percent in the second quarter from 15.4 percent in the same period last year.

Asking prices continued their year-long pattern of inching up. Rates increased to \$23.86 a square foot in the second quarter, compared with \$21.15 a year ago.

"The market is good all the way around," said Allen Tucker, a consultant with the McLean offices of Staubach Co. He said continued corporate and government expansion are pushing rental rates up and vacancy rates down.

Many of the offices leased were small spaces of 10,000 to 15,000 square feet as opposed to a few large deals, he said. Space along the Dulles corridor was popular with office tenants.

In the past few years, low interest rates persuaded many small-business owners to buy office space. Now, they are renting offices again.

"As interest rates rise, it stimulates the leasing rate," said Larry FitzGerald, senior vice president for Grubb & Ellis Co. in Tysons Corner. "They have to lease space instead of buying condos."

Another 1.3 million square feet of office space is under construction, adding to the 10.3 million square feet of space already completed.

— Jenalia Moreno