



**UNLOCKING CAPITAL & PRODUCTIVITY
THROUGH REAL ESTATE**

Downtown Chicago Office Market Report—4th Quarter 2010

Overview


Last year was another volatile year for the Chicago commercial real estate market, as many organizations struggled to deal with the lingering business challenges that began in 2007 and continued through 2009. These challenges included restricted or non-existent availability of capital, lackluster expectations for job growth, and a general uncertainty about the state of our economy.

As the majority of companies have finished making recessionary cutbacks and are no longer releasing excess space onto the market the sublease vacancy rate is declining. It is likely, however, that a substantial amount of “shadow space” remains within these organizations and it will need to be absorbed before the market experiences any significant new leasing of direct space. As a result the CBD is likely to have an extended recovery period of another four to six months.

Further adding to the recovery time is the indecisiveness among tenants generated by worry of a “double dip” recession and an uncertainty about government regulations and interventions, including the revised FASB legislation gaining ground in Congress. These tenant concerns are creating an overall sluggish environment in the CBD marked by hesitation, short-term renewals over relocations, and long-lease periods.

As for leasing activity, it was dominated by renewals in 2010 which comprised seven of the top ten lease transactions of the year. The costs required to build-out or equip new space generated a number of these early lease restructures as companies took the opportunity to use tenant-favorable market conditions to renegotiate existing leases. On the other hand, while most larger tenants chose not to relocate due to the capital expenditures necessary; many smaller tenants took advantage of aggressive rental rates.

Another nuance of today’s market is that many landlords continue to face a cash shortage which creates an issue when a potential tenant is in need of capital improvements. In fact, the disparity between landlords with capital and those with cash shortages frequently results in lease extensions of existing or contracted space rather than relocations which could incur significant costs. At the close of 2010, the CBD exhibited an increase in the number of capital challenged assets. These distressed assets, while anticipated, are now gaining momentum. Landlords of these distressed assets are often unable to fund the capital required for lease transactions, further exacerbating their already challenged positions, thus creating the inequality between well-funded properties and cash-strapped properties.

 *The CBD showed signs of slight improvement in 2010 as compared to 2009. Both the West Loop and River North sub-markets recorded positive net absorptions. The Central Loop was hit hard by the financial industry consolidations, while North Michigan Avenue was impacted by the loss of small businesses. The East Loop on the other hand saw marked improvement over 2009 as companies relocated to the sub-market to take advantage of the lower rental rates.*



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Chicago's Central Business District

- > Demand in the CBD delivered a slightly positive net absorption for Fourth Quarter 2010; and although vacancy rates at the close of 2010 were up .5% from year-end 2009, they did decline several straight quarters in 2010, a positive sign.
- > While 2010 resembled 2009 in many ways, it was an overall improvement. The negative net absorption was recorded at 162,245 square feet in 2010 as compared to a negative 1,796,429 square feet for 2009. It's likely to be another four to six quarters until the market is fully stabilized.
- > Leasing activity in the CBD was dominated by renewals, particularly among the larger corporations. Smaller businesses on the other hand were able to take advantage of market conditions and relocate to higher quality properties that would be unattainable in a healthier market.
- > The sub-lease market remains soft and will continue to compete heavily with landlords offering direct space.
- > The average rent fell in 2010 by \$1.05 per square foot. Rents are likely to stabilize in 2011, as the market experiences increasing periods of positive absorption, landlords will likely look to increase rental rates, particularly those of Class A properties.
- > As fear subsides and a more clear vision of the economy comes into focus, the market will gradually begin to gain momentum. However for now, we're about a year or so away from a full recovery.

Market Indicators

	Overall CBD		Central Loop		West Loop		East Loop		North Michigan		River North	
	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010
Vacancy Rate	16.6%	17.1%	15.1%	16.3%	18.0%	17.3%	15.8%	17.9%	15.2%	18.7%	18.1%	16.0%
Absorption (SF)	-1,796,429	-162,245	-868,943	-455,041	-985,526	312,183	-751,256	-23,639	-159,042	-335,011	941,338	339,263
Rents	\$29.65	\$28.60	\$29.15	\$29.30	\$30.06	\$29.44	\$27.87	\$27.05	\$29.87	\$24.79	\$32.19	\$31.55
Inventory (SF)	131,342,744	131,672,826	36,501,653	36,501,653	45,226,722	45,226,722	24,477,933	24,808,015	9,496,234	9,496,234	15,640,202	15,640,202

Source: CoStar



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Sources: CoStar



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Central Loop

- > The Central Loop was hit hard by the numerous bank consolidations and financial company contractions in 2010.
- > Overall vacancy increased by 1.2% in 2010, and rose from 15.6% in the Third Quarter of 2010 to 16.3% in the Fourth Quarter of 2010.
- > While the negative net absorption for the sub-market came in at 455,041 square feet for 2010, it was a significant improvement from the negative 868,943 square feet in 2009.
- > Rents unlike some of the other CBD sub-markets held steady for the year closing at \$29.30 per square foot, up \$0.15 from 2009.
- > If Northern Trust and other large banks continue to take space in 2011 as expected, and confidence in the economy continues to rise, occupancy levels in the Central Loop will stabilize.

West Loop

- > Leasing activity was strong for the West Loop in 2010 with 50% of all CBD transactions occurring in this sub-market.
- > United Continental Holdings relocated from the suburbs expanding its space by 165,000 square feet.
- > Due to the flurry of activity, vacancy rates in the West Loop fell by .7% for the year and also generated a positive net absorption of 312,835 square feet for the year.
- > Rents fell slightly in the West Loop in 2010 to \$29.44 per square foot with the largest rate decrease coming from Class B properties.
- > In 2011, West Loop landlords will vie to retain tenants and fund capital projects to attract new businesses due to the growing inequality between well-capitalized landlords and those of distressed properties which is especially prevalent in this sub-market.

East Loop

- > The East Loop demonstrated a substantial improvement from 2009 with several of the larger transactions coming from expansions and new leases due in large part to the fact that rents are on average \$2.00 per square foot less than here than in the East and Central Loop sub-markets.
- > Although vacancy rates rose from 15.8% in 2009 to 17.9% in 2010, there was a .3% decrease from Third Quarter 2010 to Fourth Quarter 2010.
- > The net absorption was registered at a positive 90,995 square feet for the Fourth Quarter of 2010 making it a negative 23,639 square feet for the year.
- > The overall rate for 2010 fell \$.82 from 2009 with the majority of the decrease in the Class A property rental rates which fell by \$1.81 from last year.
- > The East Loop will continue its economic advantage over the other markets in 2011 providing it with an opportunity to fill the excess space—particularly the 297,000 square feet entering the market at year-end within the AON Center when law firm Kirkland and Ellis' former space enters the direct market from the sublease market.





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North Michigan Avenue

- > The North Michigan Avenue sub-market closed the year with the largest vacancy in the CBD due to a number of small businesses either consolidating or closing.
- > Vacancy rates for 2010 increased by 3.5% from 2009 to 18.7%.
- > The sub-market showed a negative absorption of 351,011 square feet for 2010, slightly worse than the negative 159,042 square feet in 2009.
- > Rents decreased substantially in the sub-market due to lack of demand, closing the year at an average of \$24.79 per square foot. Rental rates for Class A properties alone fell nearly \$6.00 per square foot.
- > Activity is expected to remain low for this sub-market in 2011, with hopes of a possible increase in demand for medical offices space in 2012 as Children's Memorial opens.

River North

- > River North, like the West Loop, reported a positive net absorption for the year as well as a decreased vacancy. The sub-market's vitality was due largely to expansions within the tech industry, including a 57,000 square foot expansion by Groupon.
- > The vacancy rate for 2010 closed at 16%, down 2.1% from 2009.
- > While a negative sub-lease absorption led to a negative net absorption for the Fourth Quarter of 2010, overall absorption was a positive 339,263 square feet.
- > The average gross asking rental rates were down slightly in River North from \$32.79 per square foot in 2009 to \$31.55 in 2010.
- > River North will remain a viable player in the CBD, particularly for fast-growing and tech firms.

Forecast

Activity will remain sluggish during 2011 but upward momentum is anticipated as confidence in the economy continues to grow. However, with the unemployment level still looming near 10%, that confidence will remain tempered while excess space is consolidated to match organizational headcounts. One factor to note, is that it is believed that the unemployment level has hit the suburban markets harder than the CBD market; therefore the CBD can expect vacancy increases lower than the job market would currently indicate. As we move into 2011, landlords will continue to vie for tenants while trying to retain their existing leases, and the CBD is likely to experience alternating periods of slightly negative and slightly positive absorption over the next four to six quarters before full stabilization is achieved.



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Major Transactions of 2010

Tenant	Building Address	Class	Submarket	Size (SF)	Type	Quarter
UBS	1 N. Wacker Drive	A+	West Loop	393,000	Renewal/Contraction	1st
Northern Trust	231 S. LaSalle Street	B	Central Loop	207,000	Sublease	4th
Neal Gerber & Eisenberg, LLP	2 N. LaSalle Street	B	Central Loop	180,000	Renewal	2nd
Nuveen Investments	333 W. Wacker Drive	A	West Loop	167,000	Renewal	3rd
United Airlines	233 S. Wacker Drive	A	West Loop	165,000	Expansion	3rd
RSM McGladrey	1 S. Wacker Drive	A	West Loop	132,000	Restructure	2nd
Getco LLC	350 N. Orleans Street	B	River North	105,000	New Lease/Expansion	2nd
Akzo Nobel, Inc.	525 W. Van Buren Street	A	West Loop	90,000	Renewal	1st
Peak6 Investments L.P.	141 W. Jackson Boulevard	B	Central Loop	90,000	Renewal/Expansion	1st
Synovate, Inc.	222 S. Riverside Plaza	B	West Loop	88,000	Renewal	2nd
Northwestern University	645 N. Michigan Avenue	B	North Michigan Avenue	88,000	Renewal	4th
Barnes & Thornburg LLP	1 N. Wacker Drive	A+	West Loop	83,000	New Lease (From Sublease)	1st
Goldman Sachs Group	440 S. LaSalle Street	A	Central Loop	81,000	Renewal/Contraction	4th
Digitas/Publicis	180 N. LaSalle Street	A	Central Loop	81,000	Renewal/Expansion	4th
Traveler's Insurance	161 N. Clark Street	A	Central Loop	80,000	New Lease/Contraction	2nd
Kaplan Higher Education	225 W. Wacker Drive	A	West Loop	77,000	New Lease	1st
Fireman's Fund	33 W. Monroe Street	A	Central Loop	73,000	Renewal	4th
Allianz Global Risks	225 W. Washington	A	West Loop	73,000	Renewal/Expansion	4th
Jump Trading	600 W. Chicago Avenue	B	River North	67,000	Renewal/Expansion	3rd
Ronin Capital LLC	350 N. Orleans Street	B	River North	62,000	New Lease/Expansion	1st
R. J. O'Brien & Associates	222 S. Riverside Plaza	B	West Loop	61,000	Expansion	2nd
Ace Insurance	525 W. Monroe Street	A	West Loop	60,000	Renewal	3rd
Options Clearing Corporation	1 N. Wacker Drive	A+	West Loop	58,000	Renewal/Contraction	4th
Groupm	600 W. Chicago Avenue	B	River North	57,000	Expansion	4th
Motorola	233 N. Michigan Avenue	A	East Loop	54,000	Renewal/Contraction	4th
Environmental Systems Design	175 W. Jackson Boulevard	A	Central Loop	52,000	Renewal	3rd
Northwestern Mutual/McTigue Financial Group	1 N. Wacker Drive	A+	West Loop	50,000	New Lease/Expansion (Direct from Sublease)*	1st
General Services Administration	525 W. Van Buren Street	A	West Loop	50,000	Renewal	2nd
Kaye Scholer LLP	70 W. Madison Street	A	Central Loop	49,000	New Lease/Expansion (Direct from Sublease)*	1st
Oxford Healthcare (Help at Home)	1 N. State Street	B	East Loop	47,000	Renewal/Expansion	2nd
Accretive Health	231 S. LaSalle Street	B	Central Loop	44,000	New Lease	3rd
North American Company for Life & Health Insurance	525 W. Van Buren Street	A	West Loop	42,000	Renewal	4th
Jewish Federation of Metropolitan Chicago	216 W. Jackson Boulevard	C	West Loop	40,000	Renewal	2nd
Dyson	600 W. Chicago Avenue	B	River North	38,000	Renewal/Contraction	2nd
DeVry/Keller School	225 W. Washington Street	A	West Loop	37,000	Renewal/Expansion	3rd
Littler Mendelson P.C.	321 N. Clark Street	A	River North	37,000	New Lease	1st
Walker Wilcox Matusek	1 N. Franklin Street	A	West Loop	35,000	New Lease	4th
The American College of Health Care Executives	1 N. Franklin Street	A	West Loop	34,000	Renewal	3rd

Source: Colliers



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