



Market

S U M M A R Y U P D A T E

Third Quarter 2006

Vacancy Dips for Third Quarter; Rental Rates Flat or Falling

The one sentence summary of the quarter is that vacancy rates continue to fall, net absorption is miniscule but positive, and rents are flat or modestly falling. The snapshot view of the status of the Costar Group-defined Metro Chicago office market (Exhibit 1) shows a total of over 154 million square feet, with 14.4% vacant and 13% vacant and available. Vacant space is

actually physically vacant, whether or not it has been leased and is being remodeled for occupancy. Vacant available space takes into account that space that is actually off the market and that space that is physically occupied but on the market. Today there is practically no space vacant or available in the sublet market, that is, space being marketed by the tenant rather than the owner.

Vacancy Differences Between A and C Space: Exhibit 2

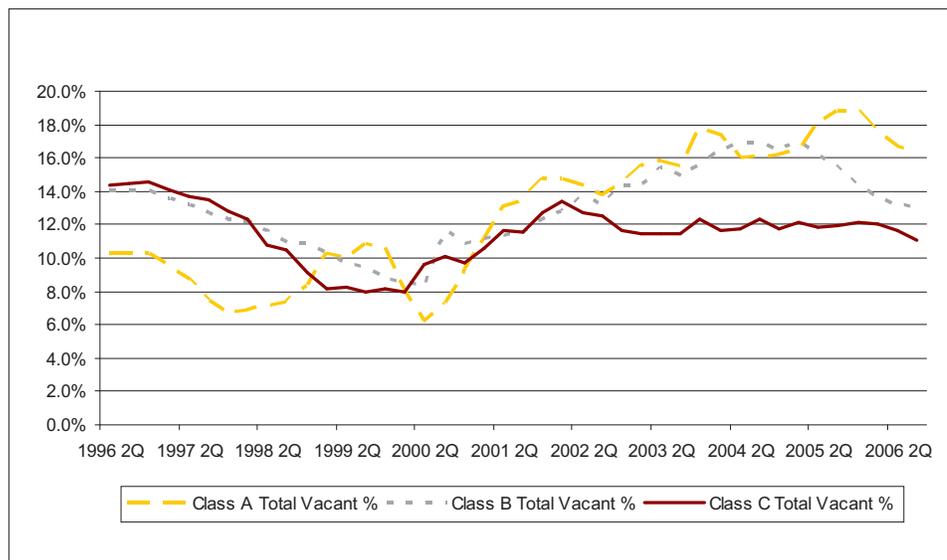
Class A, B and C buildings have different average vacancy rates, with Class A total vacancy being between about 5% higher than Class C. As Exhibit 2 shows, ten years ago Class A space averaged about 4% lower vacancy than Class C. Then for several years the differences were much smaller.

The size of the market itself has changed, along with the split between direct and sublet space. With the addition of 20 new Class A buildings from the second quarter of 1996 to the third quarter of 2006, that space market grew from

Exhibit 1. Direct and Sublet Vacancy.

	# Bldgs	Total RBA	Direct Vacant %	Sublet Vacant %	Total Vacant %	Direct Vacant Avail %	Sublet Vacant Avail %	Total Vacant Avail %
Class A	89	71,449,728	14.5%	2.0%	16.5%	12.8%	1.8%	14.6%
Class B	278	57,295,407	12.5%	0.6%	13.2%	11.5%	0.5%	12.0%
Class C	427	25,403,594	10.8%	0.3%	11.1%	10.4%	0.3%	10.7%
TOTAL	796	154,202,209	13.1%	1.2%	14.4%	11.9%	1.1%	13.0%

Exhibit 2. Total Vacancy by Class: Chicago Metro, 1996 Q2 - 2006 Q3



about the author Dr. Susanne Cannon

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Exhibit 3. Class A Direct and Sublet Vacant Space: Metro Chicago 1996 Q2 - 2006 Q3

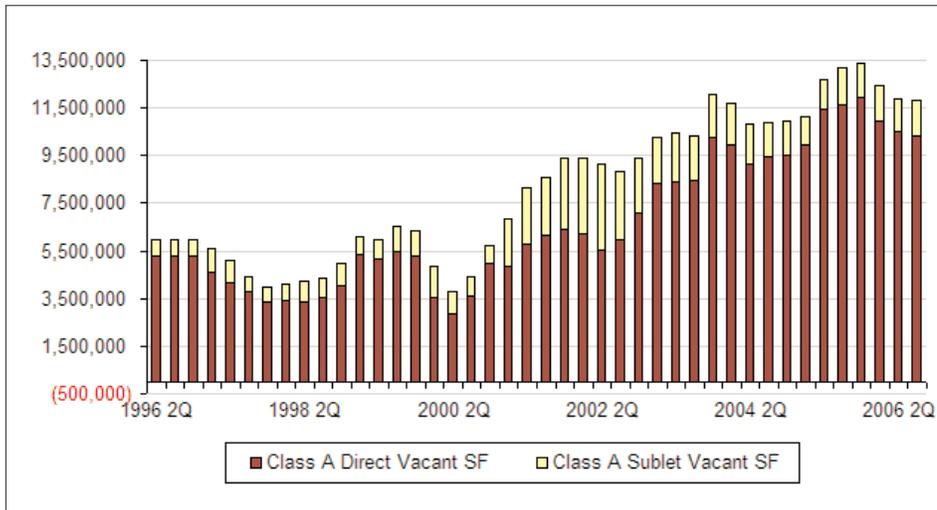


Exhibit 4. Class B Direct and Sublet Vacant Space: Metro Chicago 1996 Q2 - 2006 Q3

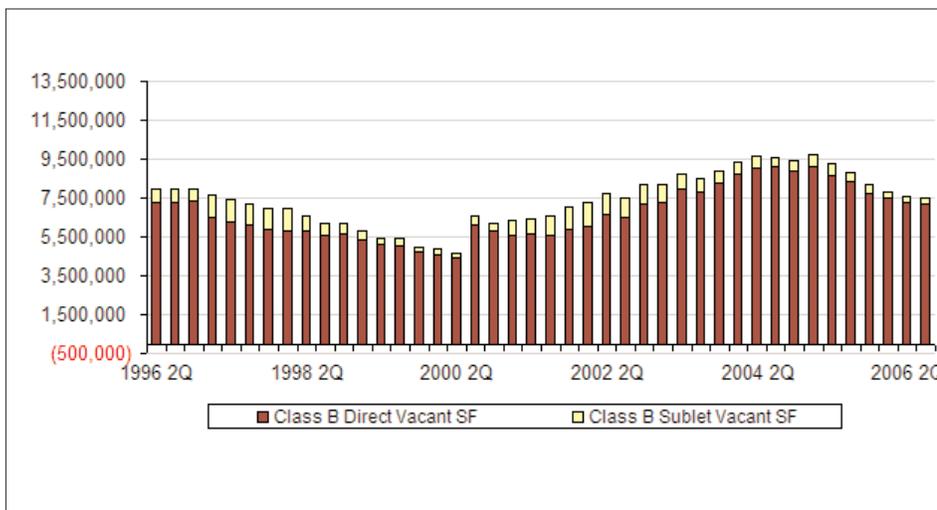
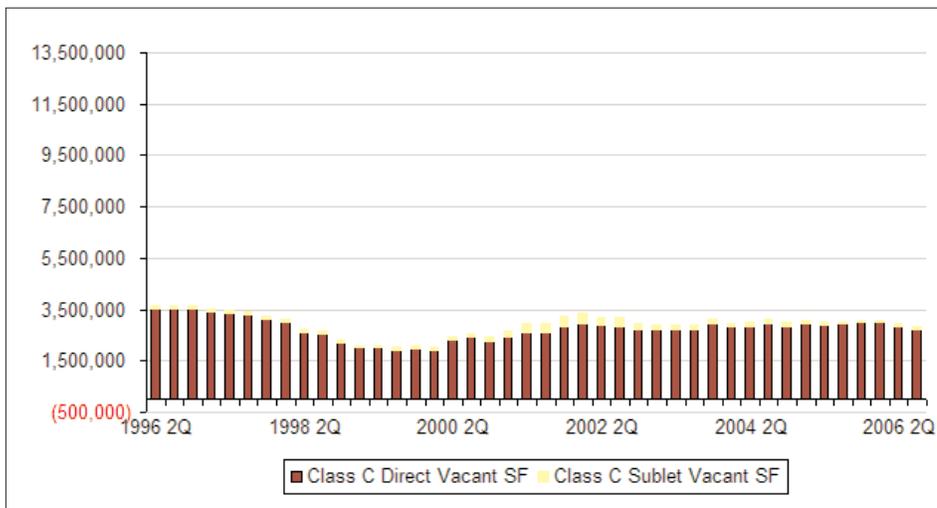


Exhibit 5. Class C Direct and Sublet Vacant Space: Metro Chicago 1996 Q2 - 2006 Q3



58.5 million to 71.5 million square feet. Class B and C space has remained essentially stable over that period at around 57 million and 25 million square feet. The impact of that new Class A space is visible in Exhibit 3, where the total vacant space grew to over 13 million square feet in 2005. The components of that vacancy have shifted. Sublet space has traditionally made up only a very small fraction of the vacancy, and it does that once again today. From 2001 to 2003, however, it accounted for a much more significant portion, particularly in the Class A market, where it reached over 3.5 million square feet in mid-2002. The difference in the total amount vacant is over 8 million square feet from 2000 to the present.

“Quoted rents are slightly down over the past four years, but the spread between the building classes has remained fairly constant.”

Impact of Changing Market Size: Exhibits 3, 4 & 5

Exhibit 3 illustrates the Class A Direct and Sublet market over the past ten years, by quarter. Exhibits 4 and 5 illustrate the Class B and C markets, where there has been no growth in the size of the market and where the total amount of Class C vacant space has remained slightly below 3 million for most of the past decade,



except for the year 1999 when it dropped to about 2 million square feet. Class B space is more volatile, and its vacancy has fallen to about the level of 10 years ago, but the sublet space (which has always been a more important part of this market) has nearly vanished.

Class A leasing activity over the

past few quarters has typically been above the 10 year average of 1.75 million square feet per quarter. The un-revised numbers for third quarter 2006 fall below that, but the past two quarters have had revisions in excess of 1 million square feet and so it is too early to tell what the year 2006 will bring.

Four Quarters of Positive Net Absorption: Exhibits 6 & 7

Net absorption is the calculation of the change in occupied space and Exhibit 7 shows that the past 4 quarters have seen positive net absorption in all three building classes.

Exhibit 6. Class A Direct and Sublet Space Leased: Metro Chicago 1996 Q2-2006 Q3

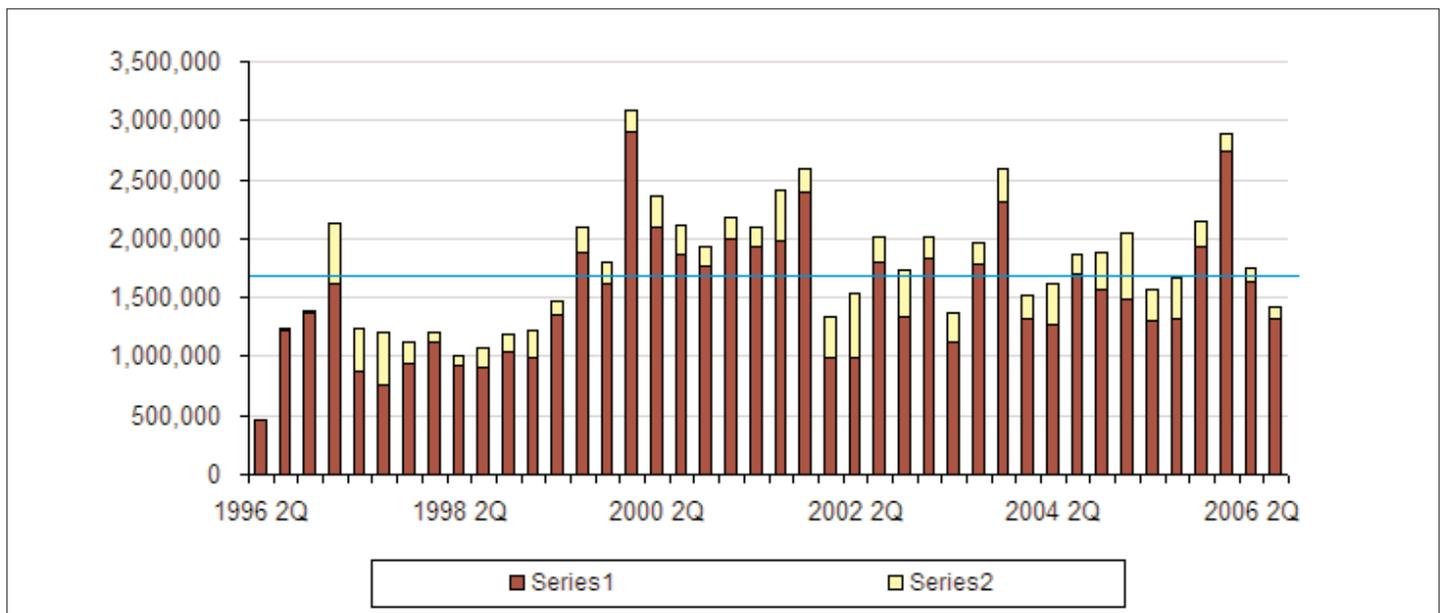


Exhibit 7. Total Net Absorption by Class: Chicago Metro 1997-2006

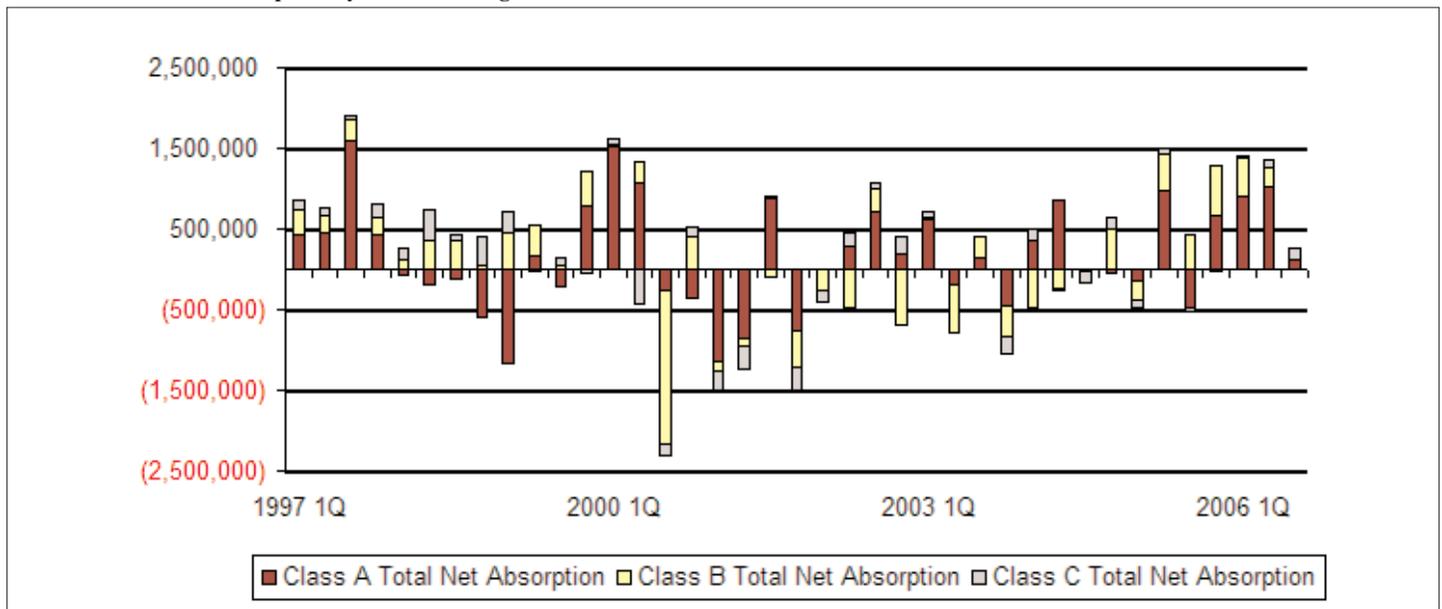
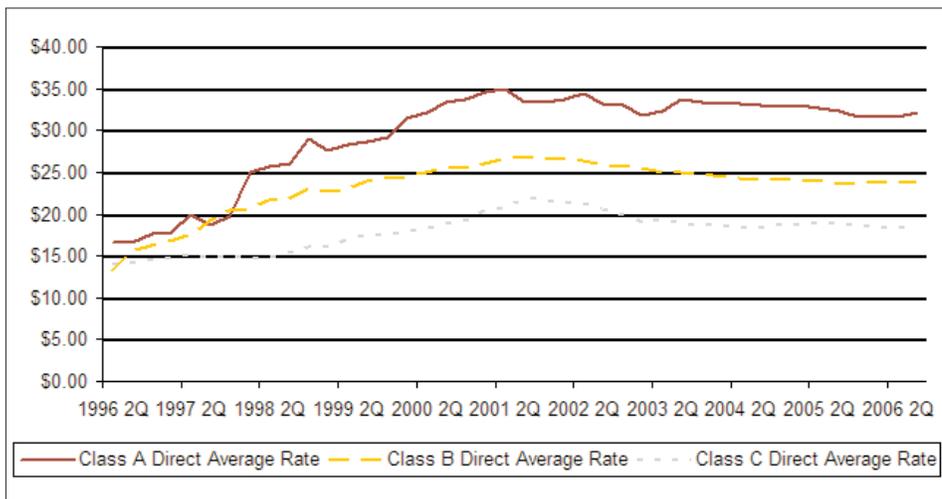




Exhibit 8. Direct Asking Rent by Class: Chicago Metro, 1996 Q2-2006 Q3

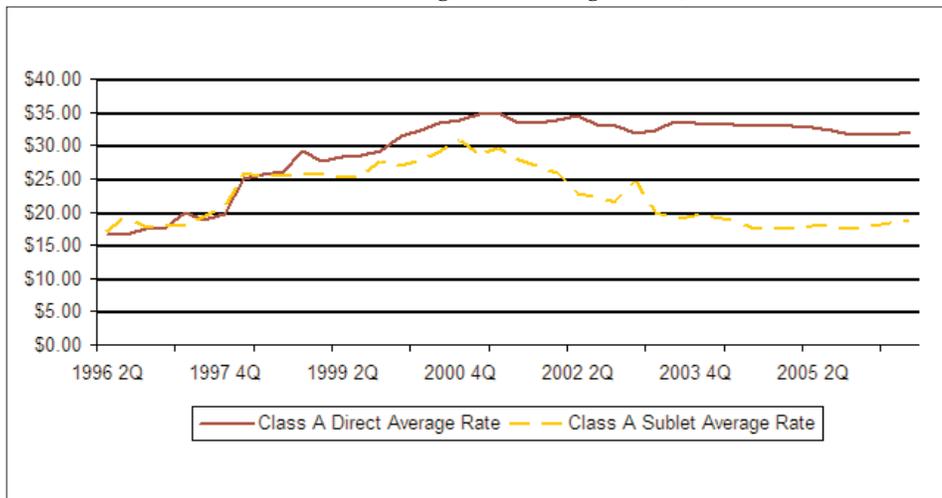


Quoted Rents Down Slightly: Exhibits 8 & 9

Although Costar does not calculate actual net effective rent, the quoted asking rents can be revealing over time. Exhibit 8 illustrates the difference by Class, and exhibit 9 shows the difference between direct and sublet asking rents for Class A office property. The quoted rents are slightly down over the past four years, but the spread between the building classes has remained fairly constant.

The difference between direct and sublet space rental rates opened up in 2000 and remains substantial. Sublet Class A space rents for about the same price as Class C space. Given that there is so little of it, we might think that the price would rise. But it is important to remember that sublet space frequently is small, awkwardly located, and may only be available for a short term.

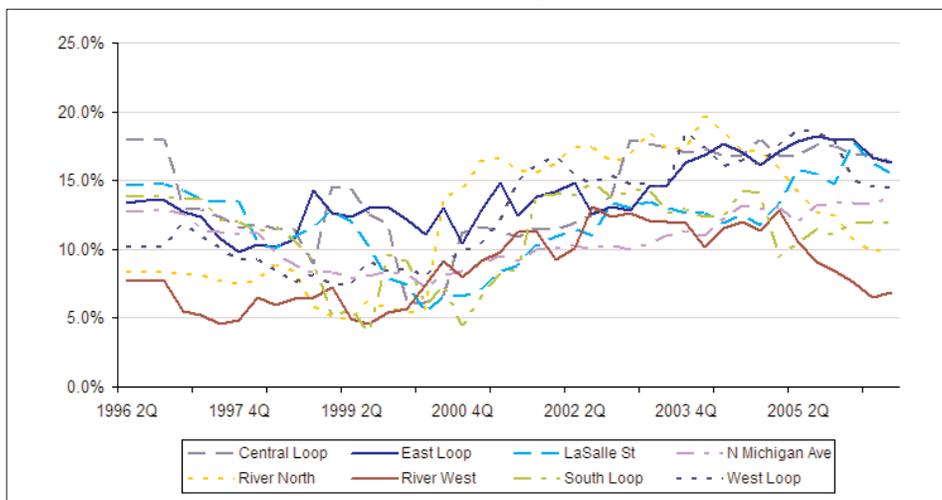
Exhibit 9. Class A Direct and Sublet Asking Rents: Chicago Metro, 1996-2005



Location, Location, Location! Exhibit 10

Of course it is not only building class that drives rents, vacancy or absorption. Geography matters. Exhibit 10 shows the band within which vacancy rates have existed in the eight submarkets that make up the Chicago Metro market over the time period from 1996 to 2006. The individual submarkets are less important here than grasping the overall picture: a fairly wide band of about 10% has been fairly constant. The two bold lines track the two markets (East Loop, 6.9% and River West, 16.3%) which are currently 10% apart. In fact, River West had its lowest vacancy rate in several quarters, but the highest vacancy rate has been West Loop, River North, South Loop or Central Loop as often as it has been the East Loop.

Exhibit 10. Total Direct Vacancy by Submarket: Chicago Metro, 1996 Q2-2006 Q3





Leased but Not Occupied:

Exhibits 11 & 12

Each of the eight submarkets has less vacant available space than actual vacant space, a signal that leasing activity is having an impact and that there are spaces that are leased but not yet occupied.

Net absorption captures this and Exhibit 12 compares this calculation with leasing. Here the leasing activity for the

Chicago Metro area total far exceeds absorption, and the West Loop dominates that equation. Total net absorption is positive, but totals less than 300,000 square feet.

All of this leads us back to the start of the story: there is some activity and vacancy rates really do seem to have turned the corner, but there isn't enough good news out there to indicate that rental rates have firmed up or that they are likely to soon.

Exhibit 11. Vacant and Available Space by Submarket: Chicago Metro

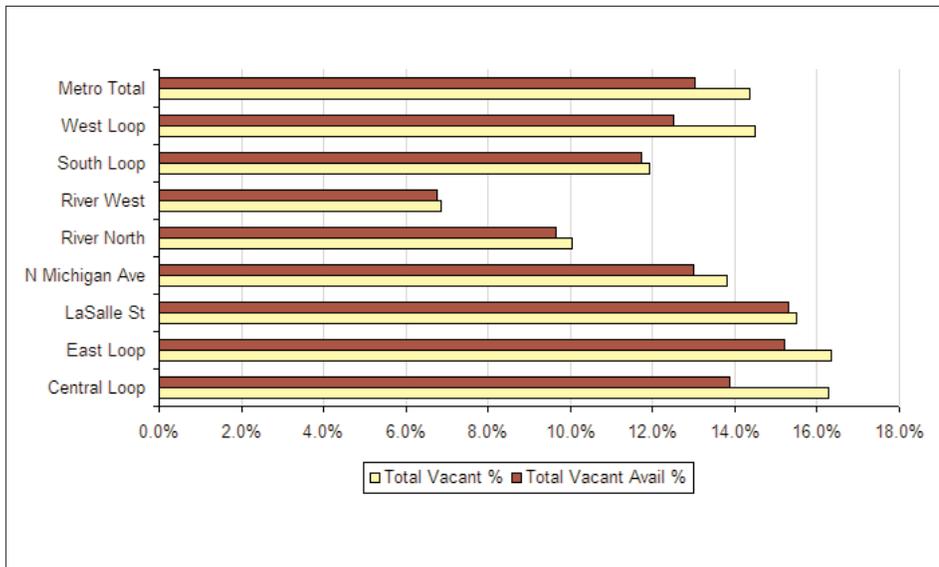
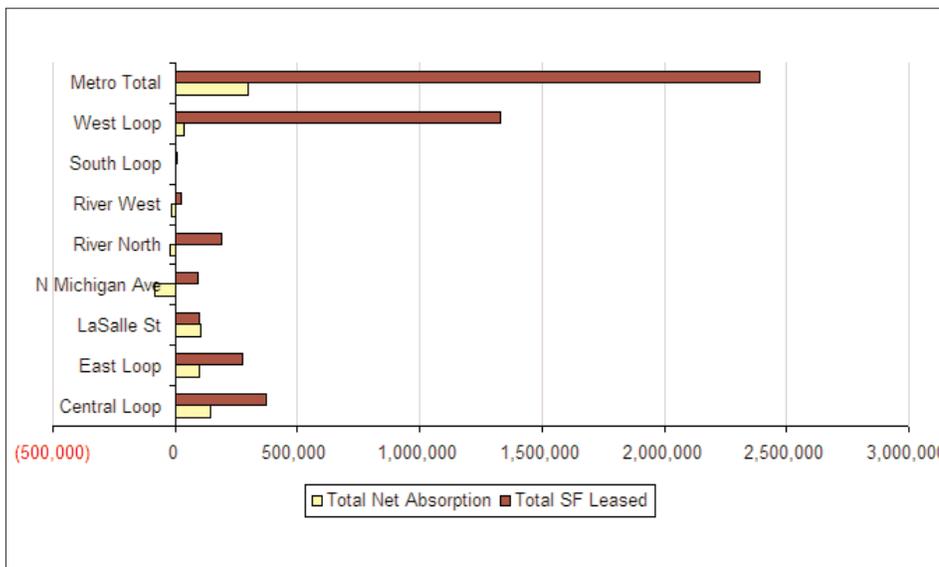


Exhibit 12. Net Absorption and Leasing by Submarket



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