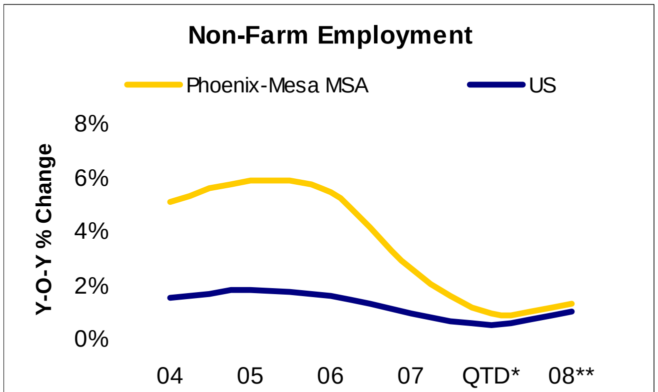
Phoenix Office Market Hangs On Tight

In the face of a softer office market, Phoenix buyers and tenants reassess business expectations and economic conditions at the start of 2008. The local office market downturn lags the nation, a recovery may be supported by a shift of focus by building owners. In the long term, opportunities to do business in Phoenix, one of the fastest growing metropolitan areas in the nation, abound. The weakened state of the national economy has taken a firm foothold into the local economy, yet existing local businesses are taking advantage of increased space availability and lower rents. While our buoyant market may not seem as strong as it had been just a year ago, Phoenix is known for its resiliency.

Local economic indicators reported modest gains in the first quarter. In a market that largely relies upon residential and employment growth, Phoenix area employers reported slower job growth at the start of the year. Non-farm employers added 3,600 new positions in a year-over-year estimate. Through February of this year, non-seasonally adjusted unemployment recorded a 30 basis point improvement from December, 2007, to 3.6 percent. Between January and February of 2008 the Professional and Business Services sector added 3,700 positions, yet still reported a decline of 80 positions from the previous year at the same time. Despite the current lag in employment growth, projected population growth and payroll additions will support the glut of new office space that continues to enter the market. However, this may not become evident until the end of 2008.

Driven by heightened demand, developers added 6 million square feet of new office space throughout the last two years. In direct response to a softer economic climate, developers have scaled back new construction endeavors until excess space is absorbed. The Valley's office inventory grew by over one million square feet in the first quarter, 2008



* Estimate ** Forecast
Sources: Prudential CRES Commercial Real Estate - Research Services, AZ DES, BLS, Economy.com

METRO TRENDS

	1Q08	Qtr	YOY
Vacancy	15.2%	↑	↑
Asking Rent	$24.40	↑	↑
Completions*	1,050,000	↑	↓
Absorption	-50,000	↓	↓
Median $/PSF*	$193	↓	↓

** YTD Estimate*

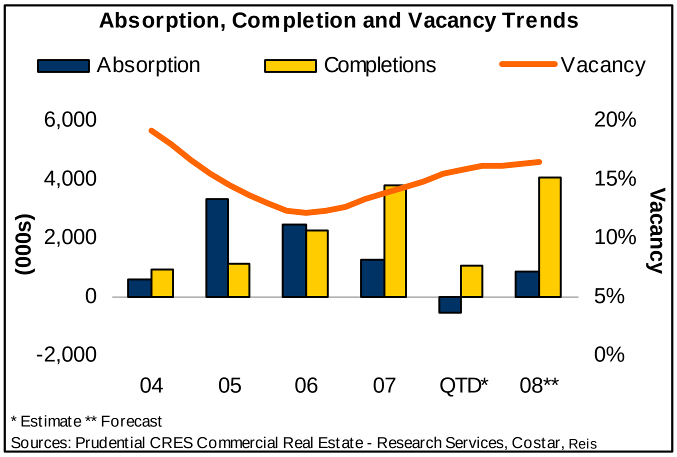
with the largest concentration of new office space delivered to the Scottsdale and West submarkets. Annual household growth in these areas are 3 and 4 percent respectively over the next 5 years and exceeds the metro's household growth over the same period of time.

Unanticipated payroll reduction amongst the Financial Activities sector has affected office occupancy levels of recent. Vacancy edged upwards from the previous quarter by 120 basis points to 15.2 percent in the first quarter, 2008. By the end of 2007, available sublease space rose swiftly; in the first quarter of this year sublease space recorded a 10 basis point increase to 2.1 percent vacancy of overall inventory and 10 percent of total vacant space. Much of the market's vacancy is attributed to new deliveries and not sublease space. Almost fifty percent of space built from 2007 through the first quarter of 2008 currently sits empty.

Opportunities are available to tenants seeking expansion in the metro. Asking rent for direct space rose by less than one percent to $24.40 per square foot in the first quarter, but declined in most submarkets. Rental rates skyrocketed over the last few years, however we expect to see tenants placing their bargaining chips on the table to re-negotiate lease terms. Concessions and free rent are offered throughout the Valley in an effort to fill the increasing direct and sublease space. Reluctant to make a firm commitment on space, some tenants looking to purchase are considering leasing opportunities that make sense to their businesses with limited risk. Owners of older, quality buildings have been able to get competitive with asking rents, especially those buildings near newly constructed developments and located in infill areas. Asking rents for sublease space increased by 2.3 percent in the first quarter to $22.85 per square foot yet is still reported well below rents of direct available space.

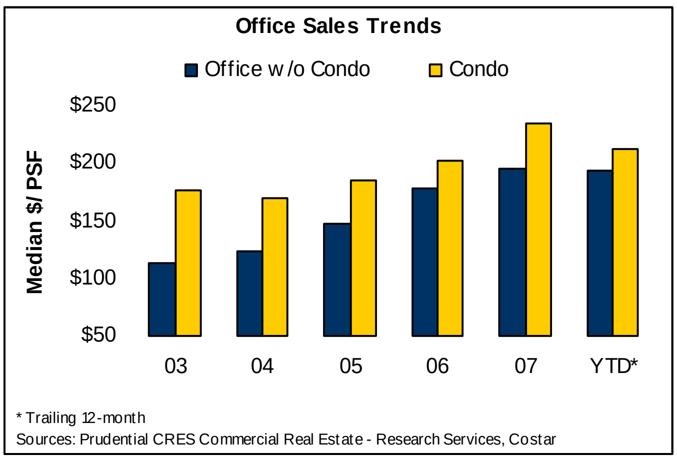
Phoenix is not immune to the economic slowdown experienced nationally. The tides have changed in favor of buyers and tenants, for now. Space delivery will slow in 2008 and many speculative office projects will be placed back into the planning stage. Slowing rent growth will allow tenants to obtain additional space, which will alleviate increasing vacancy throughout the Valley, most specifically in the suburban submarkets.

Absorption, Completion and Vacancy



- Vacancy rose by 120 basis points in the first quarter of this year to 15.2 percent. Direct class A space rose by almost 260 basis points to 16.2 percent, while class A sublease space rose to a 2.3 percent vacancy rate.
- Developers added 1,050,000 square feet of office space in the first quarter. The Valley currently has over 5 million square feet in the planning phase. Many of these projects are projected to take longer to break ground than originally anticipated.
- Leasing activity slowed, reporting the lowest negative absorption since the third quarter of 2000. Net absorption totaled approximately -50,000 square feet.
- **Forecast:** Vacancy will continue to increase this year, however can be expected to moderate by year-end into 2009. Developers are waiting to prelease buildings before breaking ground these days. New space will increase by over 4 million square feet in 2008.

Sales



- Sales velocity for office properties, not including office condo sales, decreased by almost 10 percent in the first quarter from the previous quarter. The median price per square foot among office assets decreased by almost 1 percent in the first quarter to $193 per square foot.
- Office condo sales have been gaining momentum over the past few years in the Valley. As the market moderates, pricing has adjusted. The median price reported was $214 per square foot in the first quarter, a 9 percent decrease from the previous quarter.
- Currently, cap rates are reported between the lower to mid 7 percent range. At the same time last year, cap rates were approximately 6.7 percent.
- **Forecast:** Building owners have become eager to move office assets and have been repricing to meet demand. Office condo sales are expected to grow as businesses reassess the advantages of owning versus leasing.

Market Ranking

Submarket	Vacancy	Asking Rent
Downtown	9.2%	$26.65
Camelback	10.4%	$28.08
Tempe	10.2%	$21.75
North Central	15.2%	$23.44
Uptown	15.7%	$22.07
East Central	17.4%	$21.70
Northwest	17.5%	$21.32
Scottsdale	17.8%	$27.74
Mesa/Chandler	18.3%	$21.44
West	23.8%	$19.57
Metro	**15.2%**	**$24.40**

Prudential
CRES Commercial Real Estate

14287 North 87th Street, Suite 220
Scottsdale, AZ 85260
Ph: 480.451.9077
www.prucres.com

Prudential CRES
Commercial Real Estate Solutions
David Illsley – Managing Director
Shara M. Galonsky – Director of Research

CRES Appraisal
Dan Paulus – MAI

PCRES-GPE Management Services
David Genovese - President