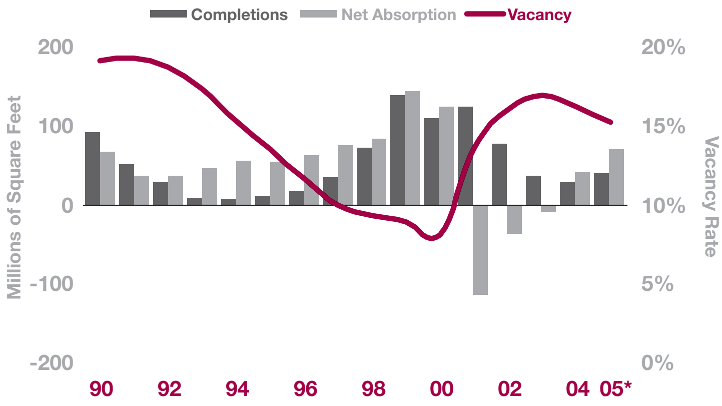
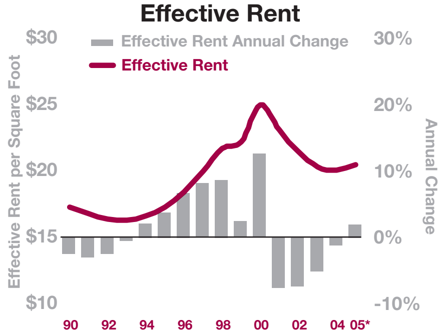
National Office REPORT

- ▲ Recovery Takes Shape. The majority of office markets posted improvement in 2004, led by coastal regions, including South Florida, New York and Orange County.
- ▲ Construction Slows. Only 29 million square feet was delivered last year, as developers scaled back and postponed new projects due to only modest growth in demand. Planning activity, however, is increasing, as developers await a recovery.
- ▼ Rents Slip. Effective rents eased 1.1 percent in 2004, compared to 5 percent the previous year. Concessions peaked, however, and we expect owners to scale back incentives this year.
- ▲ Vacancy Embarks on Positive Trend. Leasing activity began to show signs of life late last year, resulting in a drop in vacancy of 70 basis points to 16.2 percent. Supporting the improvement was a combination of minimal new supply and elevated demand from law firms, financial services and health care companies.

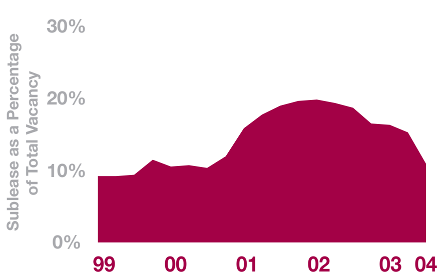
Office Supply and Demand



Effective Rent

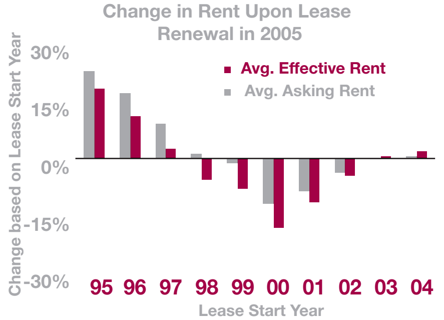


Sublease Space as a Proportion of Total Vacant Space



2005 Lease Rollover

Change in Rent Upon Lease Renewal in 2005



*Forecast

Office Overview: Stage Set for Comeback

The nation's office market moved through its cyclical bottom last year and is now on its way to recovery. Construction continued to ease last year, totaling less than 1 percent of total inventory. Net absorption reached 40 million square feet and is expected to increase to 70 million square feet in 2005 as job growth accelerates in office-using sectors. As a result, we expect greater vacancy improvement this year, with the average falling 100 basis points to 15.2 percent. While we expect fundamental improvement across metropolitan areas, CBDs located in 24-hour cities will outperform. With tenant demand rising, owners will begin to pull back on concessions, resulting in a 2 percent gain in effective rents. We do not expect significant concession burn to commence until well into 2006. NOIs remain subject to near-term declines in select markets, such as San Francisco and San Jose, due to rent losses caused by lease rollover. This could equate to a reduction in collected rent of anywhere from 5 percent to 50 percent for the space, depending on the market. This phenomenon will be limited to specific markets and impact predominantly Class A buildings.

Increased levels of planned construction loom over the market, but pre-leasing requirements by lenders will continue to force discipline in 2005. We do not expect a rapid run-up in construction activity over the next 12 to 18 months. Projects scheduled to open in 2005 are reporting an average pre-leased occupancy of 75 percent, the highest level in at least five years. Restrained construction and accelerating job growth in 2005 underpin our forecast for recovery in the office market, although substantial improvement leading to meaningful rent growth remains on the horizon.

Forecast

- ▲ Job Growth Accelerates. Office-using sectors will be the primary driver of employment growth this year, increasing by 3.5 percent or 1 million jobs.
- ▲ Occupancy Gains Accelerate. Coastal markets will see the greatest increases, while Midwest markets continue to be challenged with below-average job growth.
- ▲ Owners Begin Limiting Concessions. Effective rents will grow by 2 percent in 2005, as owners begin to tighten the reigns on tenant concessions. Lease rollover will remain the greatest threat to the stability of NOIs.