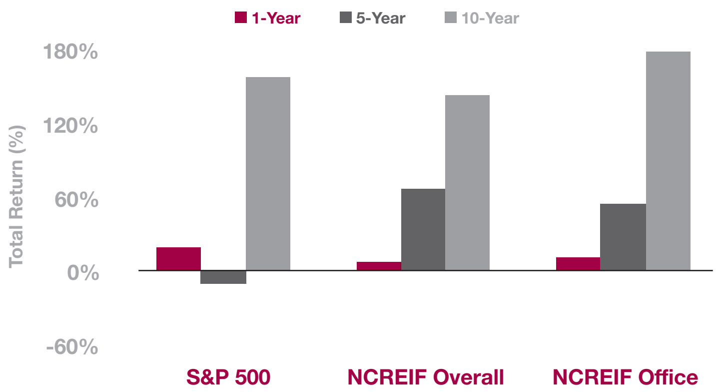
Office Returns Still Attractive



Investment Outlook: Higher Returns Drawing Investors to Office Sector

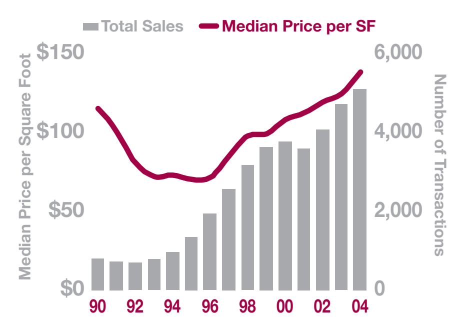
Renewed enthusiasm characterizes our office investment outlook. While investor appetites for all types of real estate have been insatiable, office properties have taken a relative back seat to apartments and retail in recent years. In 2005, however, we expect capital flows to the office sector to rise. Investors perceive that the market has passed its cyclical bottom, and the economic recovery will pay dividends in terms of occupancy and rent growth starting in 2006. This growing sense of confidence is evidenced by a significant increase in sales activity in hard-hit, tech-heavy metros. Sales volume more than doubled in areas such as Seattle, Boston and Austin last year. Additionally, the number of transactions involving large-scale properties accelerated, and the median price for top-tier assets increased 12 percent. Institutions have become more active, and private investors, including TICs, remain formidable competitors.

Fierce competition for assets located in 24-hour cities will continue, further driving up prices. In addition to geographic diversification, repositioning is gaining favor as an alternative strategy for many private investors, particularly those exchanging out of apartments and core retail. Values are at high levels, and investors must consider the impact that rent loss due to lease rollovers may have on NOIs. In some cases, this has led buyers to upgrade properties or launch aggressive marketing campaigns, or convert office properties to alternative uses. Conversions to residential has been most prevalent in New York, Los Angeles and San Diego. Midwestern cities such as Chicago and Minneapolis have been active as well. A growing repositioning play in suburban markets has been transforming traditional office into medical space, seizing the opportunity to serve the ever-expanding health care industry. Supporting investment strategies for off-campus, suburban locations is demand from specialty clinics and outpatient surgical centers.

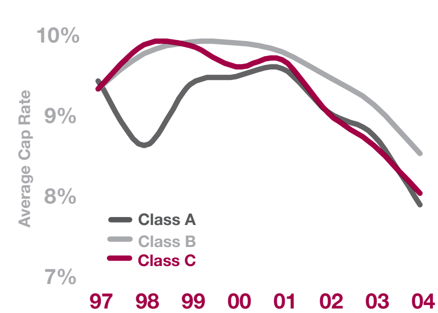
Forecast

- ▲ Portfolio Diversification Continues. Capital flows to the office sector will rise as investors dispose of other core property types to take advantage of higher yields.
- ▲ Prices to Rise. The office market recovery is under way, but occupancy improvement and rent growth have been modest so far, limiting sellers' abilities to push prices. Increased capital flows will put some pressure on prices this year.
- ▲ Out-of-Favor Markets Back in Play. Extreme competition for Class A assets in "A-list" cities will continue to push investors to urban cores in secondary markets and those that fell out of favor during the economic downturn.
- ▲ Cap Rates Tighten. The average cap rate continued to fall in 2004, down 60 basis points to 7.6 percent. CBD towers are trading below 6.5 percent, while suburban properties are selling at an average of 8 percent.
- ▲ Velocity Heats Up. Fueled by a 38 percent increase in the number of transactions over $5 million, total dollar volume increased 28 percent, to nearly $80 billion in 2004.
- ▲ Investors Consider Contrarian Markets. Sales of CBD properties in secondary markets doubled in 2004. Tertiary markets are gaining interest as well, offering cap rates that in many cases are more than 100 basis points higher than those available in primary markets.
- ▲ Price Appreciation Continues. The median price per square foot rose 13 percent to $140 in 2004, driven primarily by a 33 percent increase in the number of sales for properties valued over $25 million.

Sales Trends



Cap Rates



Large Property Sales Back to Pre-Recession Levels