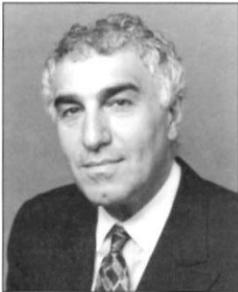


FOCUS ON OFFICE MARKETS

RECORD OFFICE RENT DECLINES RECORDED IN 2001

by Raymond G. Torto, CRE



On the tail end of double-digit rent growth in 2000, office rents declined at a record pace in 2001. The TW Office Rent Index retreated to levels seen at the end of 1999 (or 1998 levels when accounting for inflation). This decline constituted a 10.9 percent decrease in the TW Rent Index for the year, bringing the current level of the index 3.2 percent below the long-term real average. The only previous year with a similar decline is 1992 when the index dropped 10.6 percent.

While the rates of decline are similar between 1992 and 2001, how the markets entered into these declines is very different as are the growth paths for the markets going forward. (See Exhibit 1).

Office rents were brought down to such low levels in the early 1990s by the convergence of excessive overbuilding over a number of years, reduced demand following a recession, and elements of corporate reorganization. While there are some similarities, the rent declines seen in 2001 are driven by a different combination of the factors seen in the early 1990s, plus some new ones. The following table highlights some of the different factors in each period, noting the positive (+) and negative (-) aspects of the rent declines in each period.

In brief, the office market is not due for years of continued rent declines as the trends in supply are not as extreme, while demand, from both a space use and an economic perspective, is not likely to be hit as hard. The declines in 2001 were, in part, exacerbated by the strong gains of 2000. With the supply and economic conditions of 2001 alone, the TW Rent Index would not have seen such an intense decrease in 2001. (See Exhibit 2).

Looking at changes in individual markets in 2001, the usual suspects come in at the top of the list when looking at year over year changes. The high profile markets that exhibited rent surges in 2000 are generally those that saw the largest rent declines in 2001. (See Exhibit 3).

Some exceptions stand out, however. Columbus is generally not thought of as a market driven by the high-tech sectors, but the TW Rent Index declined some 13 percent in 2001 in this market. Here the culprit is largely supply, not demand, with construction of nearly 1.8 million square feet last year, in a market that would normally deliver on the order of 700,000 square feet. Following a few years of stronger than average construction in Columbus, rent growth in the near term will be hampered by this excess supply.

Exhibits 1 - 3

Exhibit 1

**National Office, Rent Index
Retreats to 1998-1999 levels**

Source: Torto Wheaton Reserach

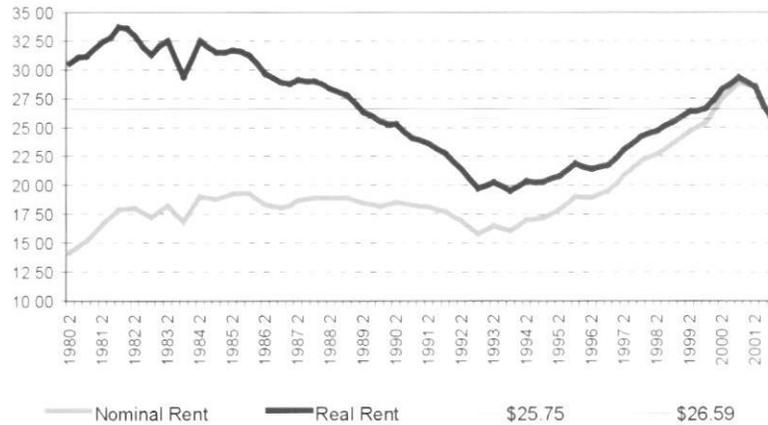


Exhibit 2

Early 1990s

- Stock of office space grew 93% in preceding decade and continued strong for some time into early 1990s
- Office using job declines of 270,200 represented a 3.2% reduction in employment base
- Demand growth post recession limited as firms became lean and mean on space use
- + Speculative leasing not a feature of market, wasn't needed then always a developer ready to build

2001

- + Stock of office space grew 14% in preceding decade and market not gearing up to build much space
- + Declines to date less severe but even if they come to 270,200 would represent only a 2.3% reduction
- + Firms mostly lean and mean, fewer cuts to make post-recession however...
- Technology boom in 2000 spurred speculative leasing and rent spikes exacerbating 2001 declines

Exhibit 3

**Rent Changes in
Selected Markets: 2001**

	<u>2001.4</u>	<u>2001.2</u>	<u>2000.4</u>	<u>Six Month Change</u>	<u>Annual Change</u>
San Jose	\$32.65	\$47.28	\$52.67	-30.9%	-38.0%
Boston	31.75	37.55	42.30	-15.4%	-24.9%
San Francisco	33.22	37.37	43.12	-11.1%	-23.0%
Austin	19.70	22.79	25.32	-13.6%	-22.2%
Miami	23.06	24.55	28.18	-6.1%	-18.2%
Sacramento	19.55	19.63	18.51	-0.4%	5.6%
Philadelphia	24.74	24.31	23.28	1.8%	6.3%
Minneapolis	20.52	20.56	19.12	-0.2%	7.3%
Honolulu	26.74	25.38	24.19	5.4%	10.5%
Northern New Jersey	28.64	25.61	25.81	11.8%	11.0%

Exhibit 4

TW Rent Index by Market Sorted by Market Name		<u>2001.4</u>	<u>2001.2</u>	<u>2000.4</u>	Six Month <u>Change</u>	Annual <u>Change</u>
Albuquerque		14.38	14.56	14.60	-1.2%	-1.5%
Atlanta		20.96	20.92	21.51	0.2%	-2.6%
Austin		19.70	22.79	25.32	-13.6%	-22.2%
Baltimore		22.96	23.54	23.65	-2.4%	-2.9%
Boston		31.75	37.55	42.30	-15.4%	-24.9%
Charlotte		18.03	18.31	18.22	-1.5%	-1.0%
Chicago		23.75	24.64	23.49	-3.6%	1.1%
Cincinnati		15.95	16.16	16.73	-1.3%	-4.7%
Cleveland		19.37	19.79	20.05	-2.1%	-3.4%
Columbus		16.96	18.39	19.51	-7.8%	-13.1%
Dallas		22.82	22.96	23.20	-0.6%	-1.7%
Denver		18.10	18.87	19.56	-4.1%	-7.5%
Detroit		18.15	20.13	19.78	-9.8%	-8.2%
Fort Lauderdale		20.23	22.00	22.10	-8.0%	-8.5%
Fort Worth		16.71	17.00	17.50	-1.7%	-4.5%
Fresno		16.09	16.32	16.37	-1.4%	-1.7%
Hartford		17.10	18.03	18.04	-5.1%	-5.2%
Honolulu		26.74	25.38	24.19	5.4%	10.5%
Houston		18.49	18.99	19.09	-2.6%	-3.1%
Indianapolis		14.23	14.23	14.14	0.0%	0.6%
Jacksonville		17.22	17.79	18.21	-3.2%	-5.4%
Kansas City		15.45	14.92	15.06	3.6%	2.6%
Las Vegas		22.79	24.46	24.43	-6.8%	-6.7%
Long Island		25.74	26.07	25.68	-1.3%	0.2%
Los Angeles		23.81	25.15	24.76	-5.3%	-3.8%
Miami		23.06	24.55	28.18	-6.1%	-18.2%
Minneapolis		20.52	20.56	19.12	-0.2%	7.3%
Nashville		18.96	18.27	18.83	3.8%	0.7%
New York		43.01	54.42	52.13	-21.0%	-17.5%
Northern New Jersey		28.64	25.61	25.81	11.8%	11.0%
Oakland		29.29	29.95	29.27	-2.2%	0.1%
Oklahoma City		12.59	12.42	12.24	1.4%	2.9%
Orange County		26.24	26.44	26.09	-0.8%	0.6%
Orlando		19.41	19.28	19.85	0.7%	-2.2%
Philadelphia		24.74	24.31	23.28	1.8%	6.3%
Phoenix		19.57	20.15	19.78	-2.9%	-1.1%
Portland		22.03	21.94	21.89	0.4%	0.6%
Riverside		16.55	16.29	15.89	1.6%	4.2%
Sacramento		19.55	19.63	18.51	-0.4%	5.6%
Salt Lake City		16.23	16.70	16.76	-2.8%	-3.2%
San Diego		29.33	29.15	30.35	0.6%	-3.4%
San Francisco		33.22	37.37	43.12	-11.1%	-23.0%
San Jose		32.65	47.28	52.67	-30.9%	-38.0%
Seattle		22.25	24.22	25.44	-8.1%	-12.5%
St. Louis		19.52	20.27	20.52	-3.7%	-4.9%
Stamford		26.40	26.79	28.12	-1.5%	-6.1%
Tampa		19.62	18.82	20.46	4.2%	-4.1%
Tucson		19.55	20.27	20.50	-3.6%	-4.6%
Ventura County		21.31	22.12	21.92	-3.7%	-2.8%
Washington, D.C.		29.15	31.01	32.33	-6.0%	-9.8%
West Palm Beach		26.46	25.90	28.88	2.2%	-8.4%
Westchester County		22.03	23.24	25.42	-5.2%	-13.3%
Wilmington		18.90	19.69	19.23	-4.0%	-1.7%
National Model		25.75	28.60	28.90	-10.0%	-10.9%

Northern New Jersey comes in at the bottom of the list, which, given the sorting, is actually a good thing. This market saw an 11 percent increase between the 4th quarter of 2000 and the 4th quarter of 2001. Compared to the other markets, this growth would seem to be overstated—perhaps some calculation or numerical error. However, much of this growth happened in the last two quarters of 2001, and was mostly a function of an influx of demand.

In their Précis reports, Economy.com notes that in the Jersey City MSA, industry payrolls grew 11 percent between August and December in 2001 because of Manhattan relocations. Also, the 4th quarter employment data shows a 12.6 percent growth (4750 jobs) in the FIRE sector in the 4th quarter after growing between 2 percent to 3 percent per quarter for last few years. Across the six metropolitan areas we call Northern New Jersey, 11,115 FIRE sector jobs were added in the 4th quarter, after average growth of between 1,000 to 2,000 jobs per quarter since 1998.

Overall 2001 was as bad as 2000 was good. But the numbers show great variation around the country. For 2002 the numbers should be tamer!^{REI}

ABOUT OUR FEATURED COLUMNIST

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