

## Market Focus *Chicago's Office Market*



*The \$470 million sale of Prudential Plaza is part of over \$3.5 billion of downtown Chicago office transactions so far this year.*

The Chicago downtown and suburban office markets reported improving fundamentals in the third quarter of 2006. Both markets experienced declining vacancy and continued net positive absorption — signs that the office market is turning the corner. Improving fundamentals help contribute to a record pace of office asset sales, particularly in the downtown Chicago sub-market.

### DOWNTOWN OFFICE MARKET

The downtown central business district vacancy rate recorded a modest decline to 14.3% this past quarter and almost a full percentage point drop compared to the beginning of 2006. While the third quarter demand measured only 165,000 square feet of net absorption, the year-to-date net absorption of 1.4 million square feet represents the largest net absorption of space since 2000. Rates held firm in the quarter with average asking rents for Class A at \$31.84 per square foot, Class B at \$23.38 and Class C at \$18.20. The largest third quarter transactions totaling 1.5 million square feet include law firms Winston and Strawn LLP and Wildman, Harrold, Allen & Dixon LLP, Leo Burnett Worldwide Inc. and Chicago Mercantile Exchange and Edelman Worldwide.

Two new office buildings broke ground north of the Chicago River, 351 North Clark Street with 1.2 million square feet and 300 North LaSalle Street with 1.35 million square feet. Both are expected to be delivered to the market in 2009. With no new office supply expected in the near-term, even marginal tenant demand should further reduce vacancy rates downtown.

### DOWNTOWN OFFICE SALES AT RECORD PACE

Downtown Chicago office building sales continue at a torrid pace. Sales activity in Chicago outpaced all other U.S. cities through the third quarter. Over 15 million square feet of office buildings totaling \$3.2 billion have traded so far this year, with an average sale price of \$210 per square foot. The strong investor capital is attracted to the perceived bargain pricing of office buildings as compared to other core markets nationwide.

Notable transactions this year include the pending sale of the Citadel Center at 131 South Dearborn Street for \$550 million to New York investor Robert Gans; Prudential Plaza to Bentley Forbes Holdings LLC for \$470 million; One South Dearborn Street to Olen Properties for \$344 million; 181 West Madison Street to G.E. Asset Management for \$294 million; and 311 South Wacker Drive to New York investor Mark Karasick for \$292 million.

## Rate Check

The U.S. commercial real estate market continues to enjoy record liquidity in the capital markets despite the threat of rising interest rates. Interest-only loans and looser underwriting standards have insulated borrowers from the full force of higher rates. While interest rates dipped slightly in the third quarter, economic indicators signal a trend toward higher rates.

Inflationary concerns were temporarily alleviated as oil prices dropped from \$78 per barrel to \$57, and further deterioration in the housing market. The Federal Reserve ended a string of 17 consecutive rate increases over the past two years by holding the

### SUBURBAN OFFICE MARKET

A steady rise in demand in the suburban office market contributed to the lowest vacancy rate in three years. The vacancy rate dropped to 15.9% compared to 16.4% during the prior period marking the third consecutive quarter of declining vacancy. Demand for space grew at a slower pace with over 390,000 square feet absorbed in the third quarter compared to 1.5 million square feet during the first half of 2006. Robust gains in occupancy are pushing rents higher, especially in the north, northwest and east-west corridor sub-markets. Rates increased in the quarter with average asking rents for Class A at \$22.50 per square foot, Class B at \$18.64 and Class C at \$16.67. Notable leases include Citicorp Credit Services 176,848 square foot renewal at 50 Northwest Point and Wilson Sporting Goods 105,000 square foot lease at Triangle Plaza.

The tightening north suburban market announced three new Lake County developments; the 440,000 square foot build-to-suit for HSBC by Hamilton Partners at Woodland Falls in Mettawa, the 138,000 square foot build-to-suit by Duke Realty Corporation at Conway Park for Hospira, Inc., and the 160,000 square foot speculative office development by Opus North Corporation at Opus Landmark in Lake Forest. The largest speculative office development in nearly four years is under construction in the east-west corridor — Calamos Real Estate's 213,000 square foot CityGate Centre at Interstate-88 and Route 59 in Naperville.

### ROBUST SUBURBAN OFFICE SALES ACTIVITY

Improving suburban office market fundamentals accelerated acquisitions during the third quarter. Notable transactions include the sale of Highland Pointe in Lombard for \$59.5 million and The Crossings in Oak Brook for \$41.875 million to Alliance Commercial Partners. Other sales include the sale of 263 Shuman Boulevard in Naperville to Wells REIT for \$55.3 million; and Bannockburn Corporate Center to Younan Properties for \$42.5 million.

The overall Chicago office leasing market show signs of awaking from its four year slumber. Institutional investors are aggressively placing acquisition bets, but not all are bullish on the market. Equity Office Properties Trust announced plans to pare its suburban Chicago holdings, and Beacon Capital Partners is marketing for sale its recently purchased 2 North LaSalle Street office building. Time will tell who is right about the Chicago office market.

benchmark Federal Funds rate at 5.25% in August and September. Economic indicators reported mixed signals in October. A surprising 5.9% increase in housing starts and a surge of .2% in the Core Consumer Price Index (excludes food and energy) makes the Federal Reserve "quite concerned" about inflation risks. With wages growing at the fastest pace in five years, the Federal Reserve will likely act quickly to combat any inflation risk.

The 10-year Treasury, a benchmark rate for commercial mortgages, fluctuated during the past quarter. The yield started the quarter at 5.15% and fell to

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4.55% when oil prices dropped and the housing market weakened. The yield then rose to 4.76% in October as consumer prices increased and the housing market showed signs of bottoming out. Predictions vary for the 10-year Treasury yields even as lower fuel prices boost consumer spending in the fourth quarter.

While rising rates in the second quarter temporarily reduced the pace of loan originations, the dip in 10-year Treasury yields in the third quarter accelerated demand for new commercial real estate mortgages. The U.S. commercial mortgage-backed securities (CMBS) originations soared to \$133 billion through September and is on pace for a record year. Life insurance companies, commercial banks and pension

funds all report increases in originations and are set to break 2005's record volume of \$345 billion in loans. The increasing popularity of interest-only loans and collateralized debt obligations (CDO) provides additional alternatives to conventional financings.

Investor demand for CMBS and real estate CDOs continues to drive lending activity. Even with a record volume of issuances there remains a deep pool of investors for both upper and lower end tranches helping to keep tight spreads on commercial mortgages. Continued low intermediate and long-term rates, as well as an ample supply of available capital, provide a solid footing for continued strength in the commercial and multi-family markets.

## Notes

### MJ PARTNERS SALES/FINANCINGS/LEASES

- ◆ **Life Storage Portfolio, Chicago, Elgin, Algonquin, Carpentersville, Matteson and Markham, Illinois.** Six institutional-quality facilities totaling 435,230 sq.ft. with 3,3836 units. Sale Price: \$48,500,000
- ◆ **The Clark Adams Building, 105 West Adams Street, Chicago, Illinois.** 41-story, 456,413 sq.ft. Sale Price: \$48,000,000
- ◆ **Estancia Office Complex, Burr Ridge, Illinois.** Bridge loan for 158,000 sq.ft. office complex. Loan Value: \$22,250,000
- ◆ **20 and 28 East Jackson Blvd., Chicago, Illinois.** Two multi-tenant Chicago Loop office buildings totaling 143,278 sq.ft. List Price: \$16,675,000
- ◆ **U-Stor-It Chicago Midway Portfolio.** Three institutional-quality self storage facilities totaling 171,414 sq.ft. with 1,765 units. Sale Price: \$15,000,000
- ◆ **2222-2224 N. Figueroa Street, Los Angeles, California.** Net-leased McDonald's restaurant with 54,107 sq.ft. storage facility with 649 units. Sale Price: \$13,250,000

- ◆ **Archstone Garden Glen, Schaumburg, Illinois.** Mezzanine financing for 460-unit condominium conversion. Loan Value: \$12,000,000
- ◆ **110 West Superior Street, Chicago, Illinois.** Land acquisition financing for condominium development site. Loan Value: \$5,600,000
- ◆ **645 Heathrow Drive, Lincolnshire, Illinois.** 71,566 sq.ft. single-story industrial building net-leased to Brook Electrical Distribution Co. Sale Price: \$4,985,000
- ◆ **Storage Options, South Chicago Heights, Illinois.** New single-story 61,800 sq.ft. self storage facility with 319 units. Sale Price: \$4,100,000
- ◆ **6740 South Shore Drive, Chicago, Illinois.** Land acquisition financing for condominium development site. Loan Value: \$2,750,000
- ◆ **160 Lexington, Buffalo Grove, Illinois.** 24,382 sq.ft. single-story, multi-tenant industrial building. Sale Price: \$2,100,000
- ◆ **200 South Wacker Drive, Chicago, Illinois.** 13,200 sq.ft. tenant representation of FastRoot, an on-demand technology solutions company.
- ◆ **Old Monee Road and King Road, Crete, Illinois.** 143 acre residential development site. Sale Price: \$1,875,000

### MJ PARTNERS NEW LISTINGS

- ◆ **Wildcat Self Storage, Cincinnati and Dayton, Ohio.** Seven stabilized facilities totaling 638,499 sq.ft. with 5,266 units. List Price: \$45,000,000 — Contract Pending
- ◆ **Chicago Suburban Self Storage Portfolio, Highland Park and Hoffman Estates, Illinois.** Two institutional-quality facilities totaling 170,411 sq.ft. with 575 units. List Price: \$17,500,000
- ◆ **Chicago Retail Portfolio.** Stabilized three-property retail portfolio totaling 42,781 sq.ft. adjacent to The Plaza regional mall. List Price: \$11,000,000
- ◆ **U.S. Storage, Deerfield, Illinois.** 65,675 sq.ft. facility with 521 units 89% occupied. List Price: \$8,000,000
- ◆ **Centerville Self Storage, Woodstock, Illinois.** 47,780 sq.ft. with 334 units 89% occupied. List Price: \$3,600,000

### OTHER NEWS

**Seth Bent** has joined MJ Partners as Senior Associate Specializing in investment real estate, golf course and self storage dispositions



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