Lee & Associates is pleased to present our mid-year report with the latest market conditions and trends.

There are signs of life in the Chicago real estate market, but indicators are mixed. Many economists believe the Chicago real estate market is finding its bottom. Vacancy is tied to employment and June’s Metro Chicago unemployment dipped to 10.6%. The stock market, often a bellwether, is sharply up compared to last year.

Federal Reserve Chairman Ben Bernanke told the Senate Banking Committee on July 20 that he is cautiously optimistic about the economy. However, Bernanke said the economic outlook remains “unusually uncertain”. Bernanke told the lawmakers the Fed was ready to step in if further action was needed.

2010 has been a better year for the economy than 2009. However, the market has and most likely will continue to favor tenants for the rest of this year as well as the first half of 2011.

The motto: “Blend and extend – Don’t spend!” still rules. Many tenants are staying put in exchange for lower rates and free rent. It’s a strategy that satisfies the financial objectives of many tenants and landlords. Landlords who are in a stronger economic position are trying to lure new tenants with hefty economic packages. Owners without that luxury have no choice but to remain on the sidelines because of financing concerns.

2009 saw only one small building trade in the Central Business District (CBD). In contrast, 2010 has seen one Class A+ building fetch a higher price than it would have even at the peak of the market. There are indications that lesser quality buildings are jumping on the bandwagon in an effort to realize similar gains.

Economic indicators are inconsistent not only in our area, but throughout the nation. True growth is still in question. *One fact that is certain: Tenants should evaluate their real estate portfolio before the climate changes.*

**VACANCY**

The two-year rise in downtown vacancies has stopped—at least for the moment. For the first time since second quarter 2008, the CBD vacancy rate has declined. Second quarter 2010 vacancy rates in Chicago’s CBD decreased to 14.9%. That’s down 0.2% from the first to second quarter as compared to a 3.3% jump over the past year. The East Loop submarket had the highest vacancy rate.

Net absorption for the CBD was positive (428,898 square feet) in the second quarter 2010. That also reverses a negative trend that began in late 2008.
The newest and most-prestigious office buildings are well leased with substantial rental structures. Class B and C buildings showed the most strain. Sublease space declined slightly over the previous quarter.

The suburban market was less positive. There, vacancy rates continued to climb for the 13th consecutive quarter to 16.8%, including subleases. Net absorption was also negative (279,872 square feet).

High vacancy rates relate to high unemployment and a sluggish economy. Chicago-based economist Diane Swonk says, “Large companies are regaining confidence and appear to be dipping their toes back in the water of hiring again. Small businesses, which generate the lion’s share of new jobs in the U.S., however, remain hesitant to hire.” According to the Chicago Business Activity Index, the local economy has taken a step backward after growing earlier in the year.

Most observers believe the market has stabilized and anticipate an improvement in the next 18 months. According to Chicago’s Sam Zell, the lack of new construction since 2007 should help fill properties within the next 18 months.

Chris Cornell of Economy.com sees a more mixed picture. He predicts local companies will add more than 24,000 jobs in the second half of the year--increasing Chicago’s job growth by 3.2%. Nonetheless, he thinks unemployment will continue to rise--peaking at 11.4%.

The state’s $13 billion budget deficit and downgraded credit rating will also challenge economic growth.

On a brighter note, the sales tax in Cook County dropped by a half a percentage point in July ---10.25% to 9.75%. Even with the drop, Chicago still ties LA for having the highest sales tax among major cities.

There’s also good news for many small businesses with less than 25 full-time employees. Crain’s reports that a new study shows that 79% of those businesses will be eligible for a new federal tax credit to defray the cost of employee health coverage.
RENTS

Downtown office rents are expected to continue to drop through 2010. The drop in rents, which began in mid-2007, is expected to moderate somewhat this year as the economy struggles to recover.

For landlords, average net rents plummeted 35.2% in 2009 after concessions were deducted. The value of concessions rose by 16.7%. Generous rent abatements were the major concession. Cash-strapped landlords prefer abatements because they cost nothing out-of-pocket. Crain’s predicts the possibility of an additional 5 -10% reduction in rents by the end of the year.


6 months while it underwent a loan restructuring. Eventually, Tishman reached an agreement with lenders, including the Federal Reserve Bank of New York, to restructure a $1.4 billion loan for five local properties of more than 6 million square feet. The agreement enables Tishman to fulfill existing financial obligations and fund expenses related to leasing. The company’s problems stem from the purchase of the former Equity Office Properties portfolio from Blackstone. Tishman bought the portfolio at the height of the market for $1.72 billion.

Crain’s recently reported that Behringer Harvard is facing a similar dilemma. The company missed May and June mortgage payments on its $95.5 million loan at 200 S. Wacker. Consequently, building owners have not been able to pay for expenses that might lure tenants. Such situations often begin a downward spiral. Other landlords with upcoming vacancies or notes due could follow.

FOR SALE

There has been some positive movement in building sales. Pent-up capital seems to be finding its way to Chicago. Real Estate Investment Trusts (REITS), both private and public, have accounted for about $3.35 billion of investment activity. There has also been significant activity among private equity and pension funds.

According to Costar, there is strong competition for high-grade properties with high occupancies and long-term leases.

300 North LaSalle, developed by Hines, recently sold for a record $655 million. Hoping to cash in on its neighbor’s success, 353 North Clark recently hit the market. Rumors are that it could sell for $500 million.

LANDLORDS

A new term “Zombie Buildings” has entered the vernacular thanks to the real estate bubble of 2007-2009. The term refers to buildings owned by cash-strapped landlords who bought at the peak of the market and need, but can’t get, refinancing. In turn, the landlords cannot pay real estate commissions to bring in new tenants or fund necessary tenant improvements.

The most-publicized case this year has been that of Tishman Speyer. Tishman, a major owner of property nationally, had its hands tied in Chicago for more than
The owners of an older and smaller property, 550 West Jackson, are seeking $140 million for their location.

A fully leased building at 550 West Washington is also on the market. Owners hope to fetch $110 million. The CME Group occupies about two thirds of the building.

A non-traditional building at 600 West Chicago is expected to be on the market soon. That’s the office portion of the former Montgomery Ward catalog site. The owners are hoping to get $425 million for the 1.6 million square feet of office space.

2009 saw only one downtown Chicago building trade: 303 West Madison. At the mid-year point, 2010 has already had more sales than 2009. The following buildings are among those that have had a change of ownership.

1. **180 LaSalle St.** - 38-story building in Central Loop sold for $72.5 million.
2. **29 North Wacker Dr.** - sold for $13.4 million.
3. **203 North Wabash Ave.** - transfer of deed in lieu of foreclosure after a default on a $9-million loan.

**LEE & ASSOCIATES OF ILLINOIS**

Lee & Associates urges all decision makers to take a proactive approach to real estate in an effort to capitalize on current market conditions.

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