

Office Market Trends Madison

Grubb & Ellis | Oakbrook Research

Fourth Quarter 2007



Misplaced Optimism?

Construction Starts Highest Since 2000, Can Market Keep Up?

The Madison office market tightened in 2007 as vacancy fell 1.4 percentage points and the 360,000 square feet of absorption easily surpassed the five-year average of 253,000 square feet. The cost of land and construction has risen quickly, which along with rising operating expenses are escalating tenant's costs even higher.

The outlook for 2008 is mixed. Landlords are displaying their optimism, as a seven-year high of nearly 763,000 square feet of new inventory is under construction. Strong pre-leasing of the buildings underway, coupled with several large users surveying the market, are indications that demand for office space is strong, but it would take record absorption to prevent vacancy from rising. We expect gross rents in Class A properties to rise by 3-4 percent in 2008, but rents should remain fairly level in Class B and C buildings.

Building sales activity increased in 2007 but the dollar volume normalized after two consecutive years of more than \$100 million in sales. Office land prices have appreciated quickly over the last seven years but prices slipped in 2007, as the average price for land fell 14 percent. The lower land prices can be attributed to the size and location of the sales that occurred in 2007 and not an overall lack of demand. We expect substantial price increases for office land in the coming years, with the scarcity of available land on the west side continuing to drive the average up.

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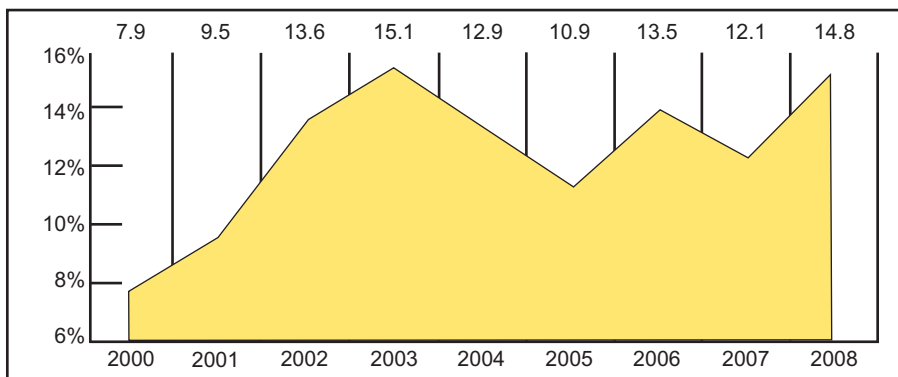
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Overall Madison Office Vacancy Rate*

* All Classes of Space

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The Madison office market tightened in 2007 as vacancy decreased and asking rents edged upward.

Office Vacancy & Rent

Tech Companies Boost Office Market

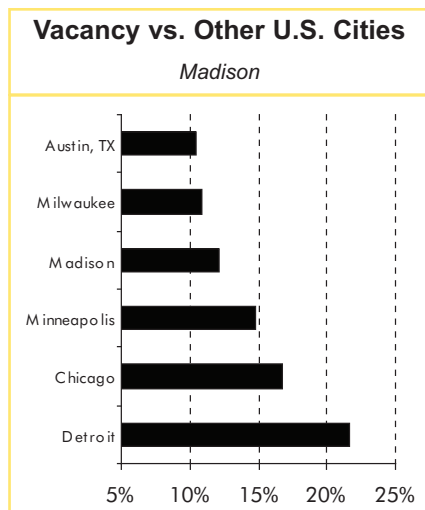
A housing slump and problems in the credit markets had no effect on Madison's office market in 2007. Epic Systems and TomoTherapy helped propel the market, consuming a combined 100,000 square feet of speculative space. Vacancy declined 140 basis points to 12.1 percent and asking rental rates rose both in the Suburbs and Downtown. The past twelve months exhibited a "flight to quality" as tenants opted for Class A and B space where vacancy fell 1.5 and 3.9 percent, respectively.

Historic Vacancy Rates			
Madison			
	2005	2006	2007
All	10.9%	13.5%	12.1%
Class A	5.0%	9.7%	8.2%
Class B	18.4%	18.9%	15.0%
Class C	16.3%	16.5%	22.3%
Downtown	8.7%	13.0%	10.0%
East	17.1%	17.5%	18.0%
Far West	7.4%	11.4%	9.8%
Near West	20.2%	16.4%	19.1%
South	10.6%	13.0%	9.8%

Submarkets: South and Downtown Most Improved

In 2007, the increased occupancy at 33 East Main Street and success in backfilling space formerly occupied by its new tenants pushed vacancy Downtown to just under 10 percent. Due to continued cuts in leasing space by the state government, the health of the Downtown Submarket is becoming more and more reliant on the expansion of law firms, financial institutions and organizations that work on government related issues. The tenant roster at 33 East Main Street is a case in point, with two financial institutions and four law firms among the tenants.

The East Submarket has plateaued around 18 percent vacancy, an increase of nearly 50 basis points from last year. The flight to quality was unmistakable in this submarket as Class A and B vacancy improved by 76 and 150 basis points led by a resurgence in demand for space on the far east side at the American Center and High Crossing, while Class C vacancy skyrocketed over 7 percentage points, ending the year at 32 percent, nearly 9 percent higher than any other subsector.



With over one-third of the entire submarket consisting of Class C space and tenants frequently opting for higher quality space, the struggles in the Near West Class C Submarket may just be starting. This past year vacancy increased 2.7 percentage points to just over 19 percent, the highest of all submarkets. The redevelopment of the Hilldale Mall area and the introduction of new Class A space will be a catalyst for growth as redevelopment of the DOT campus and the former headquarters of Marshall Erdman & Associates looms in the coming years.

Epic Systems consumed 44,000 square feet at 2908 Marketplace Drive in Fitchburg; this transaction along with the success of 26 Schroeder Court made the South Submarket the success story of 2007 as vacancy dropped

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below 10 percent for the first time since 2004, despite the addition of 138,000 square feet of newly constructed space.

The Far West rebounded from a lackluster 2006 to post a 1.6 percent decrease in vacancy. TomoTherapy's growth, including adding 43,000 square feet at 1212 Deming Way, and strong leasing of the former CUNA space in the Wisconsin Trade Center, were driving forces in the strengthening of Madison's most sought-after locale. Strong demand for Class A space has pushed vacancy to a healthy 7.1 percent and developers have responded. The strength of the Far West will be tested in the coming year as 600,000 square feet of office space enters the submarket. The former Certegy building will transition from an owner-occupied facility to a multi-tenant facility with 150,000 square feet of new space. The remaining 450,000 square feet is new construction underway now.

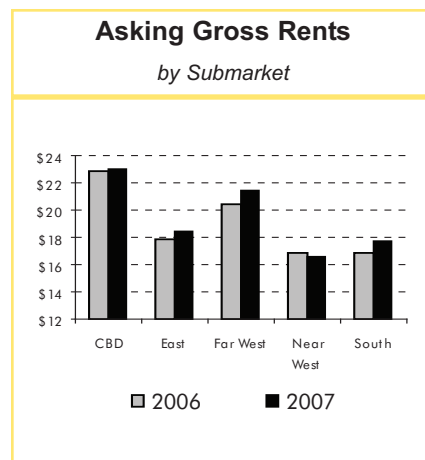
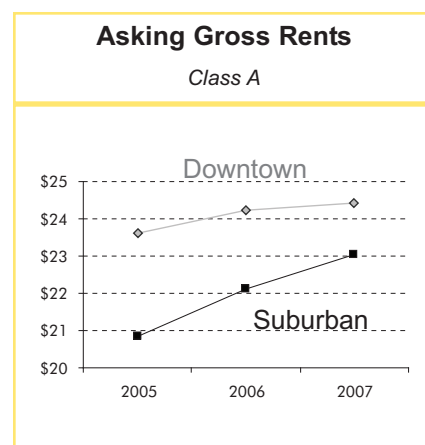
Asking Rents Continue Their Upward Trend

Asking rents in the Central Business District diverged by Class in 2007. Class A rents increased modestly to \$24.44 per square foot, while Class B rents jumped sharply by 6.4 percent to \$20.91 per square foot despite a second consecutive year of negative absorption. Class C landlords were hit especially hard in the CBD as asking rents fell to \$17.63 per square foot, its first time below \$18.00 since 2002. The recent acquisition of the U.S. Bank building by Urban Land Interests, and their multi-million dollar plan for improvements, will be a catalyst in pushing Downtown rents higher.

The Class A rent gap between the CBD and the Suburbs continues to tighten as Suburban asking rents jumped 4 percent to \$23.03 per square foot in 2007. Suburban asking rents for Class B space also increased sharply to \$17.49 per square foot on the heels of over 140,000 square feet of positive absorption. After a large increase in 2006, asking rents for Class C space leveled off at \$14.70 per square foot.

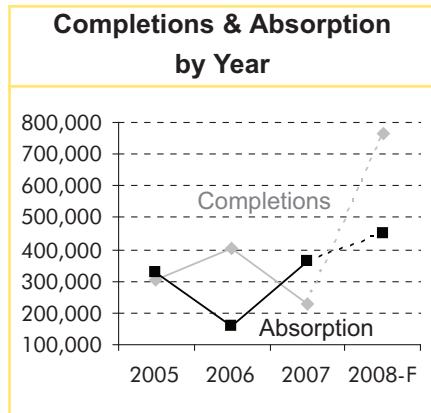
In the coming year we expect gross asking rents, which include rising costs such as utilities, to increase three to four percent. Much of the rise over the last few years stems from increased operating expenses and the rise in land values and construction costs. Nearly half of the new construction is pre-leased, a good indication of healthy demand. However, if demand for the remainder of the office space is slow we expect to see increased concessions in 2009 in the form of higher tenant improvement allowances and free rent.

Despite a projected increase in vacancy, gross rents should trend higher as land, construction and operating expenses continue to rise.



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Office Construction & Absorption



South Submarket Drives Construction Completions

New construction activity tapered off in 2007 as only 231,000 square feet entered the market, compared to 402,000 square feet the previous year. The South Submarket was the most active with five new buildings. The most visible completions occurred just off the Beltline at 26 Schroeder Court and 2450 Rimrock Road. Tenants quickly consumed the space at 26 Schroeder Court, taking advantage of the phenomenal signage opportunities. The building at 2450 Rimrock Road will welcome ITT Technology Institute in the first quarter of 2008. The Far West and East Submarkets each saw one new building in 2007 and both properties were well-received by the market.

Vacancy rates are likely to rise as 913,000 square feet will be added to the market, increasing the total market size by 7 percent to 13.1 million square feet.

Market Braces as Spec Construction Hits Highest Point Since 2000

With the national economy slowing and 763,000 square feet of new construction underway, it will take record demand to prevent vacancy from rising. In the South Submarket, two buildings are underway along the Beltline. The 215,000-square-foot Arbor Gate development on Todd Drive will house Wipfli and the Wisconsin Heart & Vascular Institute. Advanced Pain Management will anchor a 51,000-square-foot medical/office building located on Schroeder Court near Whitney Way and the Beltline.

Projects Completed in 2007

Bldg. Name	Submkt	Sq.Ft.
708 Heartland Trail	FW	48,470
Tradewinds Bus. Ctr.	E	44,733
Vincenzo Plaza	S	15,394
230 Horizon Dr.	S	13,000
New Venture Center II	S	38,322
2450 Rimrock	S	45,000
26 Schroeder Ct.	S	26,000

The Far West Submarket continues to be Madison's most active with five buildings under construction totaling 452,000 square feet. The 200,000-square-foot UW Medical Foundation building (160,000 square feet of office and 40,000 square feet of warehouse) and a 130,000-square-foot building anchored by Clifton Gunderson highlight the construction activity. The Marshall Erdman building, Madison's first speculative LEED certified facility, welcomed its namesake company in early 2008.

The American Center, home to nearly 60 businesses, is also home to the

Construction Watch

Year to Date 2007 (in Square Feet)

	Completions & Conversions				Under Construction	Proposed
	Construction Completions	Conversion to Speculative Office	Conversion From Speculative Office	Net Change in Market Size	Under Construction	Office Construction Proposed in 2008
CBD	0	0	0	0	0	0
Suburban	230,919	19,026	0	249,945	762,744	258,500
Total	230,919	19,026	0	249,945	762,744	258,500

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only office construction occurring in the East Submarket. Three single-story office buildings developed by St. John Properties are currently underway totaling 72,000 square feet. The properties are different than most multi-tenant buildings in the market, offering tenants their own exterior entrance and virtually no common area.

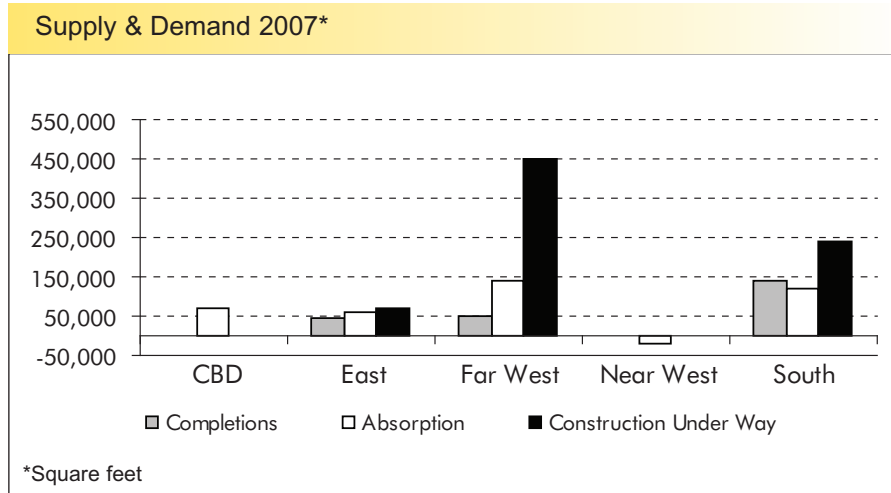
Madison's Absorption Eclipses Five-Year Average

Over the last twelve months, occupancy in Madison's office market increased by more than 360,000 square feet, well above the five-year average absorption of 253,000 square feet. The South Submarket posted 118,000 square feet of absorption or nearly 10 percent of its overall square footage, compared to negative 20,000 square feet in 2006.

After a disappointing 2006, the Far West Submarket rebounded with absorption totaling 138,000 square feet. TomoTherapy's expansion at 1212 Deming Way and strong leasing at 708 Heartland Trail were key factors in the submarket's strong performance. In the coming year, we expect absorption to nearly double in this submarket as Marshall Erdman & Associates and the UW Medical Foundation move into their new facilities.

The Downtown Submarket benefited from the occupancy at 33 East Main Street as well as the expansion of numerous law firms around the Square. After a spectacular year in 2006, the East Submarket leveled off in 2007, posting 57,000 square feet of absorption. The only submarket to post negative absorption was the Near West, with negative 19,000 square feet.

Due to strong pre-leasing and demand from several large users, we are forecasting a seven-year high of 450,000 square feet of absorption in the coming year. However, even at that level, construction will outpace absorption and vacancy rates will rise.



Absorption in the Far West and South submarkets are expected to set the market's pace in 2008.

Under Construction		
Building Name	Sub-market	Office Sq. Ft.
Arbor Gate	S	170,000
2920 Marketplace	S	17,000
Advanced Pain Mgt.	S	51,003
100 Erdman Place	FW	98,000
Blackhawk Town Ctr.	FW	40,500
UW Medical Found.	FW	160,000
8215 Greenway Blvd.	FW	130,000
8333 Greenway Blvd.	FW	24,000
5202 Eastpark Blvd.	E	30,900
4602-4610 Biltmore Ln.	E	41,341
Total		762,744

Absorption as Percentage of Total Square Footage			
	2005	2006	2007
Downtown	4.6%	1.6%	2.6%
Far West	4.5%	0.2%	2.7%
Near West	-6.8%	2.3%	-2.7%
East	1.0%	4.4%	2.3%
South	2.5%	-1.9%	9.7%
Grand Total	2.9%	1.3%	3.0%
Suburban	2.4%	1.2%	3.1%

Though preleasing levels have been healthy, developers may be ahead of demand for more Class A space on the Far West side.

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Office Building & Land Sales

Class A Sales

No. of Sales	3
Avg. Bldg. Sq. Ft.	86,463
Avg. Sale Price/ Sq. Ft.	\$84.16
Price Range/ Sq. Ft.	\$66 - \$116
Buyer Type	3 Investors 0 Occupants

Class B Sales

No. of Sales	11
Avg. Bldg. Sq. Ft.	23,033
Avg. Sale Price/ Sq. Ft.	\$86.90
Price Range/ Sq. Ft.	\$65 - \$170
Buyer Type	6 Investors 5 Occupants

Class C Sales

No. of Sales	8
Avg. Bldg. Sq. Ft.	11,726
Avg. Sale Price/ Sq. Ft.	\$69.84
Price Range/ Sq. Ft.	\$39 - \$128
Buyer Type	2 Investors 6 Occupants

Totals

No. of 2007 Sales	22
Total Bldg. Sq. Ft.	606,560
Total Dollar Volume	\$50.4 Million

Prices Drop Across All Subtypes, Activity Increases

The average sales price for office buildings declined across all subtypes in 2007. Higher average vacancy in the properties that sold was the largest factor in the lower average prices. Also contributing to the downturn in pricing was higher capitalization rates and less aggressive lending.

The largest transaction in 2007 occurred when Old Vine Property Group, a Denver-based real estate investment firm, purchased the mostly vacant Certegy building in Middleton. The 150,000-square-foot office and flex facility was purchased for \$9.5 million. The building's transition from an owner-occupied to a multi-tenant facility will require significant improvements to both the interior and exterior of the property.

Sales activity was up slightly from last year as 22 buildings changed hands. In the two previous years, investors have accounted for nearly three quarters of the market's transactions. In 2007, owner occupants and investors each accounted for half of the sales.

Beltline Office Portfolio Sells for \$6.37 Million

The Vantage Point Business Park, consisting of five Class B office buildings totaling 92,000 square feet, was sold in 2007 to a group of local investors. The buildings, formerly owned by the State of Wisconsin Investment Board, were purchased for \$6.37 million, or \$69 per square foot, with occupancy of 87 percent at the time of sale. The park's visibility and central location has attracted both local and national tenants such as TrafficCast Inc., Countrywide Home Loans, Wells Fargo and United Cerebral Palsy.

Office Market Terms and Definitions

Inventory: Office inventory includes all multi-tenant and single tenant buildings at least 10,000 square feet. Owner-occupied, government-owned and medical buildings are not included.

Construction Type: Speculative ("spec") construction is designed to attract tenants likely to be in the market when the project is leasing. Build-to-suit construction is designed for a specific tenant.

Office Building Classifications: Grubb & Ellis adheres to BOMA guidelines. Class A properties are the most prestigious buildings competing for premier office users with rents above average for the area. Class B properties compete for a wide range of users with rents in the average range for the area. Class C buildings compete for tenants requiring functional space at rents below the area average.

Vacancy and Availability: The vacancy rate is the amount of physically vacant space divided by the inventory. The amount of physical vacant space will differ from available space, which may or may not be vacant.

Net Absorption: The net change in physically occupied space over a period of time.

Asking Rent: The dollar amount asked by landlords for available space expressed in dollars per square foot per year. Office rents are reported as full service where all costs of operation are paid by the landlord up to a base year or expense stop.

Average Weighted Asking Rent: An average market rent where the asking rent for each building in the market is weighted by the building size.

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Land Activity About Average, But Prices Lower

Office land sales leveled off in 2007 as 36 acres were sold, just above the five-year average of 33 acres. The South Submarket was the most active with five of the nine transactions. Leading the way was the Fitchburg Technology Campus with three transactions totaling just over seven acres. The Far West Submarket, normally very active in office land sales, wasn't in 2007 with just one transaction.

After peaking in 2006, land prices moderated, falling 14 percent to \$6.27 per square foot. Last year's average sale price of \$7.32 per square foot was boosted by the purchase of 5.75 acres next to the Marriott Madison West for \$13 per square foot. Without that sale the average sale price was \$6.33 per square foot, suggesting that office land values have flattened but not regressed. We expect office land prices to climb in the coming years as demand continues to outweigh supply.

In 2007, UW Hospitals and Clinics closed on its second of three parcels in The American Center. The 13.6-acre parcel sold for \$4.73 per square foot. The third and final land parcel is scheduled for purchase in 2009. The American Center had one other sale, a 7.8-acre parcel at the corner of Biltmore Lane and American Parkway.

For the first time since we began tracking land sales, four transactions eclipsed \$10 per square foot. Two of the transactions occurred in the Fitchburg Technology Campus, one in the Park Towne Office Park, and one just off of the Beltline at 34 Schroeder Court. The smaller sizes of the parcels, all under three acres, strongly contributed to the premium pricing.

The lack of supply, especially in the Far West Submarket, is the continuation of a trend as developers are less likely to sell land in favor of holding out for build-to-suit opportunities. This trend has been in existence for almost ten years and we don't see it changing in the near future.

Office Land Inventory- East

Park Name	Will Sell	Acres
The American Center	Yes	149
High Crossing	No	48
Dane County Air Park	Lease	34
Innovation Springs	Yes	21
World Dairy Center	No	0
Total Inventory		252
Available for Sale		170

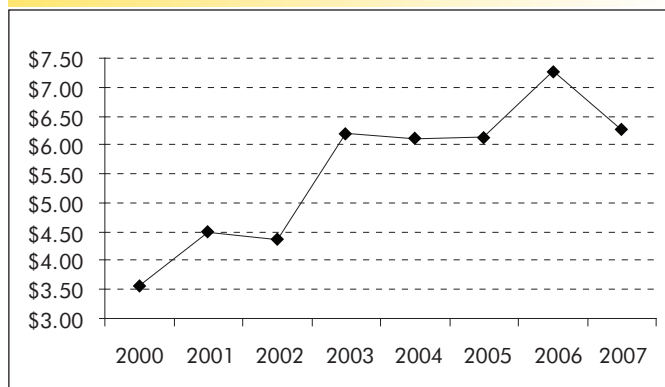
Office Land Inventory- West

Park Name	Will Sell	Acres
Airport Road Bus. Park	No	77
Discovery Springs	No	16
Greenway Center	No	6
Old Sauk Trails	No	27
Univ. Research Park	Lease	11
Total Inventory		137
Available for Sale		0

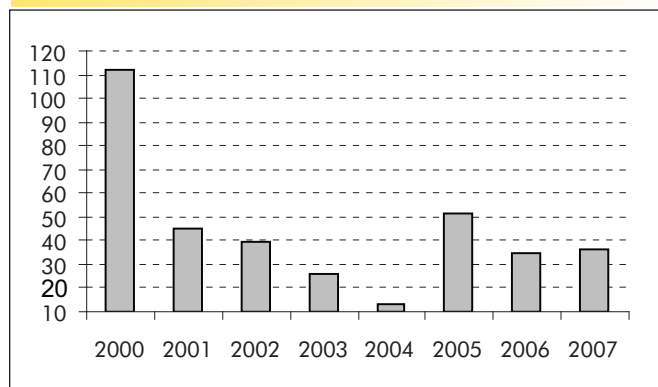
Office Land Inventory- South

Park Name	Will Sell	Acres
Fitch Research Park	Yes	12
Fitch Tech. Campus	Yes	19
Novation Tech. Campus	No	12
Total Inventory		43
Available for Sale		31

Average Office Land Prices



Acres Sold/Leased in Office Parks



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Major Transactions

Grubb & Ellis|Oakbrook is pleased to announce that it represented the following companies in 2007 transactions:

State of WI Investment Board
92,000 sq. ft. Office Park
\$6.37 Million Sale
2005 W. Beltline Hwy., Madison

Auto Glass Specialists
Tenant Representation
10,300 sq. ft. Lease Termination
\$166,000 Savings to Tenant

Menominee Investors, LLC
Landlord Representation
4,976 sq. ft. Office Lease
2802 Coho St., Madison

CUNA Mutual Insurance
Tenant Representation
44,043 sq. ft. Office Lease
5801 Research Park Blvd., Madison

South Towne Office Park
Landlord Representation
9,576 sq. ft. Office Lease
2000 Engel St., Madison

State of WI Investment Board
Landlord Representation
7,265 sq. ft. Office Lease
2801 Coho St., Madison

Beltline Madison, LLC
Office Land Sale
\$1.575 Million
34 Schroeder Ct., Madison

American Family Insurance
Office Land Sales
\$4.3 Million
Lots 27, 28, & 57, American Center

CUNA Mutual Insurance
Sublease Representation
47,670 sq. ft. Office Lease
\$943,000 Savings to Tenant

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