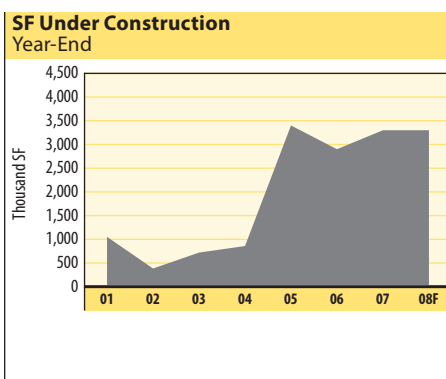
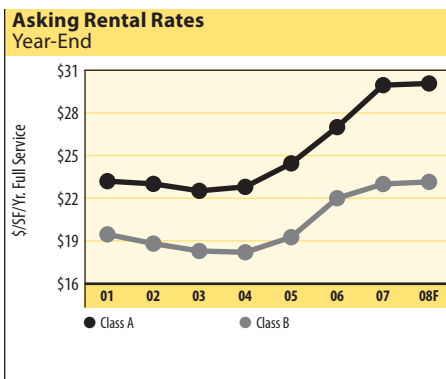
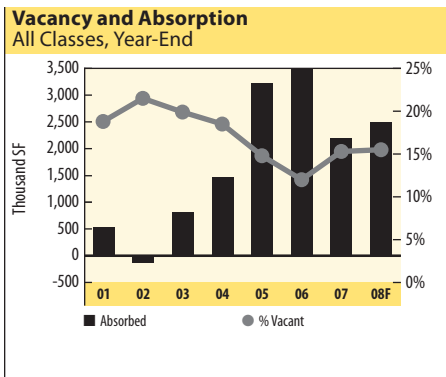


**Absorption levels and rental rates continue to increase in 2008, albeit at a slower rate than seen in previous years. Developers are being cautious about bringing new product out of the ground as to not oversupply the marketplace.**



The metropolitan Phoenix office market remains resilient as existing tenants look to expand and new businesses enter the marketplace. Office vacancy rates hit a low in 2006 and developers responded by bringing more speculative product into the market. Vacancy rates will increase slightly as completions of this product will outpace absorption levels in 2008. With nearly all of the new construction being Class A quality, developers will demand higher rental rates to cover the costs of both construction and rising land costs. However, rental rates will not increase as rapidly as in previous years as tenants look for cheaper alternatives. For the first time in many years, Class B product is absorbing more than Class A. Downtown submarkets will benefit most from this change as large chunks of Class B space is available for tenants.

High-profile submarkets such as Camelback Corridor and Scottsdale Airpark continue to demand the highest rental rates. Rental rate thresholds for the more desired submarkets are in the \$35 to \$40 range. Suburban submarkets will command a lower threshold, \$25 to \$30, but will increase more rapidly as most of the new construction is happening in the outer lying areas of town. Landlords of the newly constructed space will need to compete with existing space for tenants and higher rent concessions will creep back into deals.

With low vacancy rates and tenants looking for space to lease, developers are accommodating tenant demand by bringing more product online. However, developers are starting to be more cautious as oversupplying the market is a major concern. As landlords demand higher rates to offset their costs, tenants are adjusting to new market realities.

There is also concern about the housing market fallout. Companies associated with the housing market are going out of business as fewer new homes are being purchased by consumers. This is resulting in a glut of sublease space flooding the market. Phoenix needs to have a delicate balance between leasing up the space coming back into the market from mortgage companies and new homebuilders while also trying to lease up the newly completed space. Sublet space can be a cheap alternative to today's high rates.

Metropolitan Phoenix continues to outpace the national economy. Population will increase by over 110,000 residents. Employment continues to expand as Phoenix will add roughly 58,000 new jobs in 2008.

Tenants continue to absorb both new and existing space, although not as quickly as new space is coming online. The housing market slowdown continues to produce casualties but most economists predict the bottoming out and subsequent beginning of normalization to happen after mid-year.