Office Research
MARKET OVERVIEW
Marcus & Millichap
Salt Lake City Metro Area *Third Quarter 2012*

Sales Velocity Rising as Price Expectations Gap Narrows

Demand for Salt Lake City office space will remain healthy over remainder of the year as the professional and business services sector continues to post outsized job growth. Vacancy, however, will also trend upward. The disconnect between economic growth and office fundamentals comes as a handful of major tenants relocate to newly constructed buildings. In the first half, Questar moved into its new headquarters, which, in turn, left behind more than 200,000 square feet of vacant space at an existing nearby building. In the second half, the FBI will move into a newly built property, weighing further the metrowide occupancy rate. While major vacancies can be marketed as multi-tenant space, lease-up may require an extended amount of time, as small- to mid-sized businesses remain cautious in light of ongoing economic uncertainty. As a result of lackluster small-business expansion, Class B/C operators will report above-average vacancy in the near term, preventing owners from regaining pricing power. The Ogden/Weber area appears most affected by this trend, as Class B/C rents declined through midyear. Fortunately, with minimal speculative development in the metro, existing properties will be the beneficiaries of new space demand in coming quarters.

Many owners who held properties in recent years in hopes of recapturing value are opting to sell in order to focus on opportunities with greater near-term growth potential. As a result, velocity in the local office market has increased, a trend likely to continue through the remainder of 2012 as still-low interest rates help to elevate sellers' motivation and stimulate buyer demand. On average, cap rates in Salt Lake City have increased approximately 20 to 50 basis points over the past year, as more mid- to low-tier assets are changing hands than in previous quarters. As of second quarter, cap rates for listed office properties hovered in the 8.5 to 9 percent range. While high-occupancy Class A towers in the CBD rarely trade, they would likely generate investor attention at cap rates between 7 and 7.5 percent, while cap rates for high-quality assets in desirable suburban locations, such as South and West Jordan, hover in the high-7 to mid-8 percent range. Class B/C properties, on the other hand, typically trade upwards of 9 percent.

2012 Annual Office Forecast

2.8% increase in total employment

Employment: Payrolls will rise by 18,000 jobs in 2012, up 2.8 percent from last year. The total includes approximately 7,000 office-using positions, led by gains in the professional and business services sector.

915,000 square feet will be completed

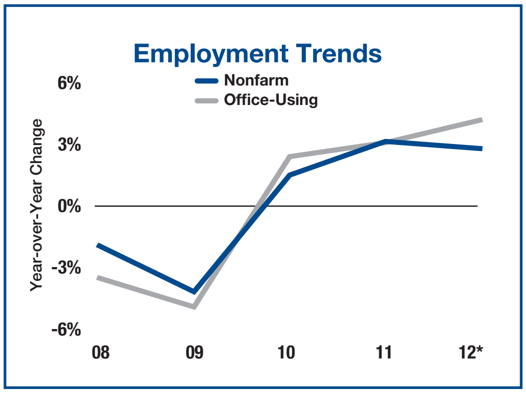
Construction: Completions, which came to a halt in 2011, will total 915,000 square feet in 2012. Leased build-to-suit properties account for a sizable share of the total. Purely speculative construction will remain limited in the near term as lenders maintain elevated preleasing requirements.

30 basis point increase in vacancy

Vacancy: Vacancy will end the year at 17.9 percent, up 30 basis points from 2011. The forecast accounts for a handful of in-town relocations, including the FBI and Questar moves, which will leave behind an estimated 300,000 square feet of vacancy in existing buildings.

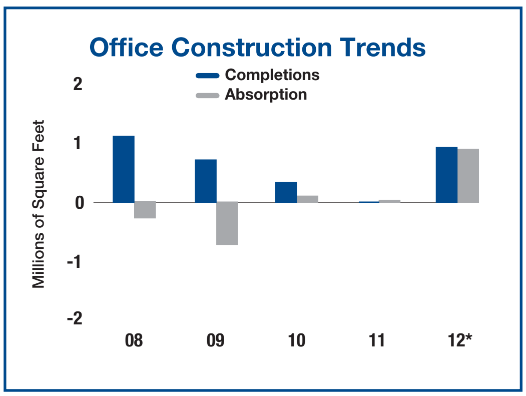
1.4% increase in asking rents

Rents: Asking rents will rise 1.4 percent this year to $18.40 per square foot, while effective rents advance 1.5 percent to $14.38 per square foot. In 2011, asking and effective rents both inched up 0.3 percent.



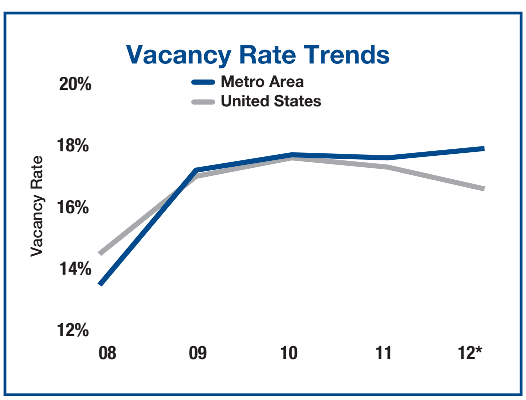
Economy

- Employment rose 3.2 percent over the past year with the addition of 20,000 jobs. Office-using sectors grew 4.5 percent as 7,350 positions were created.
- The professional and business services sector accounted for the strongest growth over the past year, as payrolls climbed by nearly 6,200 jobs. The leisure and hospitality industry followed with 4,300 new positions.
- Nearly all employment sectors posted expansion in recent quarters, including the hard-hit construction, and trade, transportation and utilities industries. Despite recent growth, these sectors have recovered just one-third of the combined 23,000 jobs lost to the recession.
- **Outlook:** Payrolls will rise by 18,000 jobs in 2012, up 2.8 percent from last year. The total includes approximately 7,000 office-using positions, led by gains in the professional and business services sector.



Construction

- Developers delivered 379,000 square feet of traditional office space to the metro over the past 12 months, up from 178,000 in the previous period.
- A significant share of new space bought to market in recent quarters came online largely preleased. The two largest deliveries include a 109,000-square foot building in Ogden leased to the IRS, and Questar's new 170,000-square foot headquarters.
- At midyear, approximately 770,000 square feet of traditional office space was under way metrowide. The pipeline of planned/proposed projects totals 5.3 million square feet, though no major projects have released start dates. The Midvale/Murray and Southeast Valley submarkets, combined, account for approximately 80 percent of the space under consideration.
- **Outlook:** Completions, which came to a halt in 2011, will total 915,000 square feet in 2012. Leased build-to-suit properties account for a sizable share of the total.



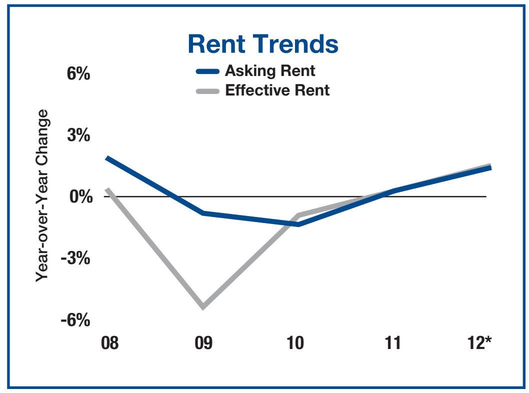
Vacancy

- At 17.8 percent, vacancy in the second quarter was equivalent to the level reported 12 months earlier, but was 20 basis points higher than at the start of this year. The recent uptick was attributable largely to Questar's move into newly built space, which left behind approximately 200,000 square feet of vacancy.
- Year over year, Class A vacancy increased 10 basis points to 17.2 percent. Despite first-half softening, the South Salt Lake City submarket maintained the tightest Class A conditions, with vacancy ending the second quarter at 9.1 percent.
- Overall Class B/C vacancy dipped 10 basis points to 18.3 percent over the past year, though submarket-level trends varied. Class B/C vacancy in the Southeast Valley, for example, tightened 500 basis points over the past year, though it remains in mid-20 percent range. Over the same period, Class B/C vacancy in the South Salt Lake City and West/Northwest submarkets softened significantly.
- **Outlook:** Vacancy will end the year at 17.9 percent, up 30 basis points from 2011. The forecast accounts for a handful of in-town relocations, including the FBI and Questar moves, which will leave behind an estimated 300,000 square feet of vacancy in existing buildings.

* Forecast

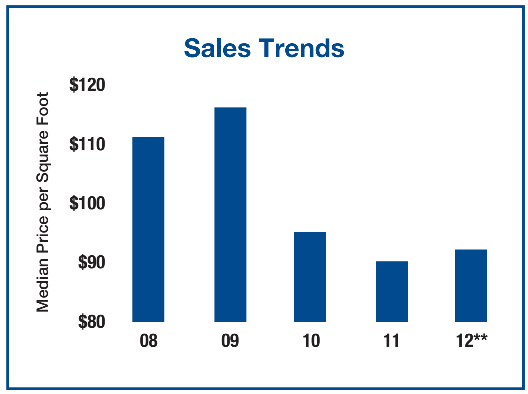
Rents

- Asking rents in the Salt Lake City metro rose 1.3 percent over the past year to $18.28 per square foot. A similar increase was reported in effective rents, which ended the second quarter at $14.28 per square foot.
- Class A asking rents rose 1.6 percent over the past year to $22.18 per square foot, though many owners of high-quality properties continue to offer generous concessions to attractive and retain tenants.
- Year over year, Class B/C asking rents increased 0.6 percent to $14.86 per square foot. This segment will lag in rent recovery until small businesses gain confidence in the economy and can better assess costs associated with healthcare reform.
- **Outlook:** Asking rents will rise 1.4 percent this year to $18.40 per square foot, while effective rents advance 1.5 percent to $14.38 per square foot. In 2011, asking and effective rents both inched up 0.3 percent.



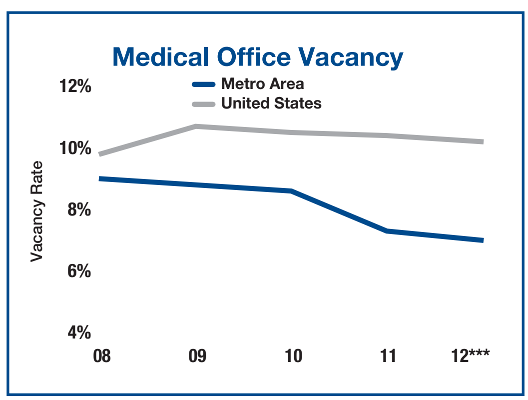
Sales Trends**

- Traditional office property sales accelerated over the past year as the gap between sellers' and buyers' price expectations narrowed. This trend will continue as many owners who had previously taken a wait-and-see approach decide to sell in order to re-deploy capital into stronger-growth opportunities.
- Increased transaction velocity in the market was attributable largely to the 10,000- to 20,000-square foot segment, which is dominated by local private investors. An increase in smaller-sized deals also occurred south of the metro in Utah County.
- With more sellers meeting market realities, cap rates for available office properties have increased roughly 20 to 50 basis points over the past year. Metrowide, cap rates average 8.5 to 9.0 percent, though strong single-tenant deals, particularly those with long-term government leases, can price between 7.5 and 8.0 percent.
- **Outlook:** Prices for local office properties may hold relatively flat in the near term, as many leases signed in recent years involved significantly discounted rents. As a result, many property owners in Salt Lake City will be unable to capitalize on rent growth until leases begin to roll over.



Medical Office

- Approximately 55,000 square feet of new medical office space was delivered to the over the past 12 months, increasing metrowide inventory just 1 percent. During the same period, local healthcare payrolls grew 2.5 percent.
- Salt Lake City medical office vacancy slipped 120 basis points over the past 12 months to 7 percent, besting the prerecession level. Compared with the early-2010 peak, the vacancy rate has dropped 360 basis points.
- The average asking rent for available medical office space in the metro reached $16.93 per square foot in the second quarter, up 2.7 percent from one year earlier.
- Medical office transaction velocity has been minimal over the past few years, due largely to limited for-sale inventory. All of the properties sold to date in 2012 were comprised of less than 50,000 square feet. Prices for deals in this segment generally fall between $125 and $200 per square foot.



* Forecast
** Trailing 12-Month Period
***As of 2Q 2012
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics

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Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- The FOMC announced after its August meeting that it would take no new steps to improve the economy before September. The Fed has pledged to maintain its lending rate near zero through at least late 2014 and has also amassed a portfolio of long-term U.S. Treasurys in an attempt to hold down long-term rates. In fact, the Fed expanded "Operation Twist" by $267 million during June of this year.

- In general, lenders continue to be discriminating. Banks remain a source of relatively low-leverage financing for acquisitions of multi-tenant properties, and will also underwrite deals for three- and five-year terms. Life companies are focused on quality assets in primary markets, while conduit lenders are more apt to loan on lesser-quality properties in primary, secondary and, in some instances, tertiary markets. Additionally, smaller, owner-user purchases are often funded using SBA 7A and 504 loans.

- Ten-year loans are available at rates in the mid-4 percent range, or roughly 250 basis points to 300 basis points above the U.S. Treasury. The rate on the benchmark 10-year U.S. Treasury hovered in the mid- to high-1 percent range throughout the second quarter and into the summer. DSCs start at 1.25x, with repayment schedules of 25 years and LTVs of up to 70 percent available.

Submarket Overview

- While CBD office vacancy increased recently, due to Questar's relocation, tenant demand for better-quality space in the area remains healthy. At City Creek, which includes an estimated 1.4 million square feet in newly upgraded buildings, more than 90 percent of the space has been leased.

- EHealth Inc. recently leased 26,000 square feet for a customer care center in the West/Northwest submarket. The area posts the highest vacancy and lowest rents in the metro, which should help to attract additional back-office operations.

- Salt Lake City claimed the number four spot in Forbes' "Best Cities for Tech Jobs" list, which noted affordable housing, low business taxes and a well-educated work force as draws for expanding tech firms. In recent years, Twitter and Electronic Arts opened local operations, and Adobe is under way on a new campus in Lehi, which should boost space demand in the Southeast Valley area as supporting firms locate nearby.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	South Salt Lake City	10.7%	230	$12.71	1.7%
2	Midvale/Murray	13.6%	-130	$15.36	1.3%
3	Periphery	16.2%	-140	$14.41	0.7%
4	Central Business District	16.8%	-10	$15.82	1.5%
5	Millcreek	17.2%	90	$14.07	2.8%
6	Southeast Valley	20.0%	-140	$14.93	0.7%
7	Davis County	20.7%	210	$12.18	1.8%
8	Ogden/Weber County	23.5%	-210	$8.04	-0.9%
9	West/Northwest	25.5%	340	$12.09	1.5%

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Notes: Employment growth is calculated using seasonally adjusted quarterly averages. Construction, rent and vacancy figures exclude build-to-suit, flex space and medical office properties unless otherwise noted.