BELLA TERRA PARTNERS
BALANCED REAL ESTATE SOLUTIONS

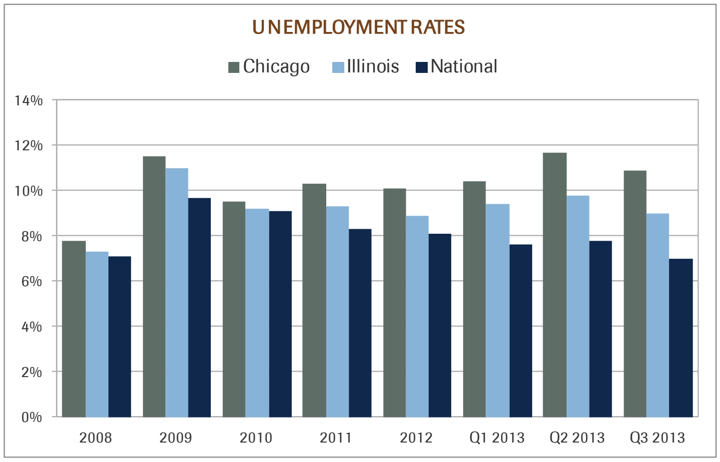
DOWNTOWN CHICAGO MARKET

Third Quarter 2013 MarketLens

DOWNTOWN OPTIMISM CONTINUES

Chicago's downtown office leasing market and economy is steady with pockets of growing optimism.

Important indicators, like vacancies and absorption have been improving for the last year. Suburban-based companies continue their migration downtown to tap into a more robust and younger talent pool and there is strong demand from a growing technology sector. At the same time, the unemployment numbers of those living within Chicago and Illinois have increased slightly albeit only slightly. This signifies that rather than the overall economy of the region growing, there is a growing shift of employers operating out of the downtown core. While this may not bode well for other cities in the state, it certainly benefits downtown Chicago.



Source: Illinois Department of Employment Security (IDES), US Bureau of Labor Statistics

Chicago's volatile 2009 - 2013 job market continues to influence employers to be cautious in making real estate commitments.

	Q3 2013	2012
Chicago Unemployment Rate	▲ 10.9%	10.1%
National Unemployment Rate	▼ 7.0%	8.1%
Direct Vacancy	▼ 14.5%	14.7%
Gross Average Asking Rent	▲ $29.45/RSF	$28.40/RSF
Sublease Vacancy	▼ 2,803,265 RSF	2,931,228 RSF

THE CHICAGO ECONOMY

Chicago's unemployment rate moved down from 11.7% at the end of Q2 2013 to 10.9% at the end of August. This may have been due to the end of seasonal summer employment. However, the rate is still higher than what it was in 2012. At the end of August 2013, the Illinois unemployment rate was 9.0%. That is down from the previous quarter, but up .1% from 2012 when it was 8.9% on average. Meanwhile, the national unemployment continued to decrease as it was 7.0% for Q3 2013. That is down 1.1% from 2012 when it was 8.1% on average. So, while the economy is moving in a positive direction nationally, the Chicago and Illinois economy continues in a bit of a one-step-back-two-steps-forward trend.

NOTE: Recognizably, unemployment data is opaque and can be misleading. There is rarely consensus about the exact reasons behind changes in the unemployment rate. When it shows improvement, it is often not because of workers finding work, but because of people dropping out of the labor force.

OUTLOOK

While there are not enough jobs currently to sustain a strong economic recovery, a significant proportion of the jobs available are in occupations whose growth bodes well for the Chicago Business District (CBD). One analysis shows that approximately 70% of the available jobs are in information technology, management, sales, business and financial, office and administrative and healthcare fields.[1] With job gains distributed among these fields, small increases in employment will result in increased demand for downtown office space.

Chicago's volatile 2009 - 2013 job market continues to influence employers to be cautious in making real estate commitments. Overall, the city's economic recovery continues to grind along and is expected to be drawn out over many years.

1 *Where Are the Jobs in Cook County,* Q3 2013, The Chicago Cook Workforce Partnership

DEMAND RISES IN CHICAGO'S CENTRAL BUSINESS DISTRICT

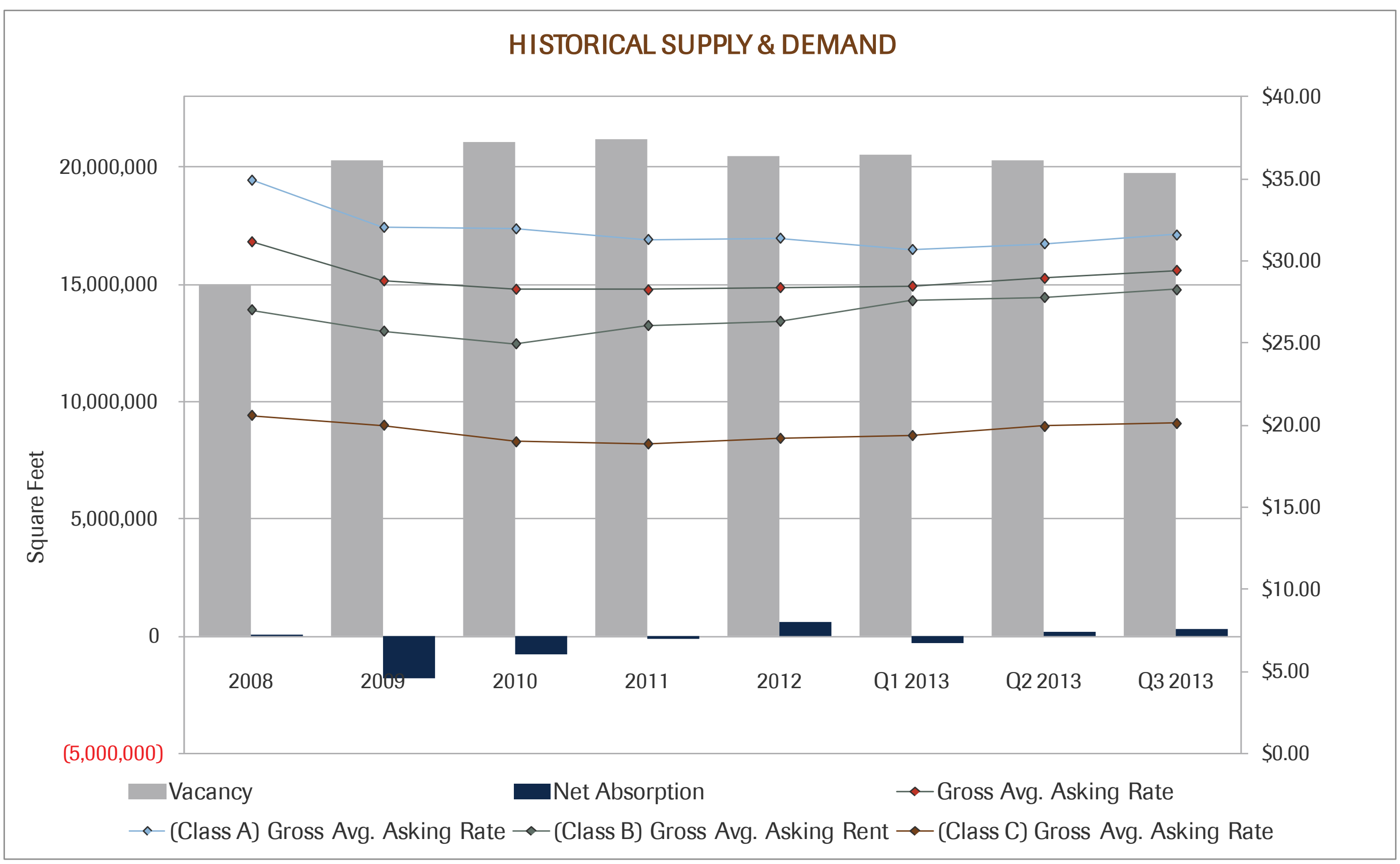
Small changes continue in CBD real estate indicators. This quarter, vacancy declined from 14.7% in Q2 to 14.5%. This is the lowest it has been since Q3 of 2009 when it was 13.9%. In fact, vacancy in the CBD has been steadily dropping since last year. This drop in vacancy is due to a number of factors: lack of new supply, some employers are hiring or rehiring, some are hanging onto leases in anticipation of being able to return to a pre-recession workforce, and some are entering the CBD real estate market for the first time, relocating from suburban markets.

The changes in demand stand out more clearly within each of the three divisions of downtown real estate. Direct vacancy in Class A (prime space) has decreased significantly from 14.8% in Q3 2012 to 13.9% for Q3 2013. Vacancy in Class B (space that's good but not spectacular) is slightly higher than what it was last year at this time. This quarter, it is at 14.8% compared to 14.5% for Q3 2012. Class C space (the lowest-rung) demand continues to remain weak at 17.2%, but its vacancy is down from the 19% it was hovering around in 2012. The River North submarket has the lowest vacancy rate at 8.7% with the West Loop following behind with a rate of 12.7%.

Absorption, which is the difference between the amount of space leased (and therefore taken off the market) and the amount put back on the market, paints a similar picture. Class A absorption is highest at 314,315 square feet (sf). Class C shows a slight positive absorption of 61,268 sf. And, Class B has absorption of negative 32,601 sf for the quarter. Overall, absorption is positive this quarter at 342,982 sf. In fact, eight of the last nine quarters have shown positive absorption for the CBD. This swings the pendulum in landlords' favor.

With absorption up and vacancy continuing to make a downward descent, the overall gross rental rate for direct space increased this quarter. The rate increased from $28.96 at the end of Q2 to $29.45 at the end of Q3. This is the highest it has been since mid-2009. Contributing significantly to this change is the rise in rates in Class B space, particularly in the River North submarket. There, Class B, brick and timber buildings are in high demand among Chicago's booming technology and creative companies. Meanwhile, rates increased in Class C space to $20.12 per sf (this reflects the low rents in many Class C properties, which in many cases can't be further reduced.). Class B rates continue to inch closer to Class A rents. This quarter, the average gross rental rate for direct space in Class A buildings is $31.60 and in Class B buildings it is $28.26. This may inspire some Class B tenants to make a leap up to Class A. For a price differential that's at a historic low, they would achieve a sizable upgrade in their surroundings.

...vacancy in the CBD has been steadily dropping since last year.

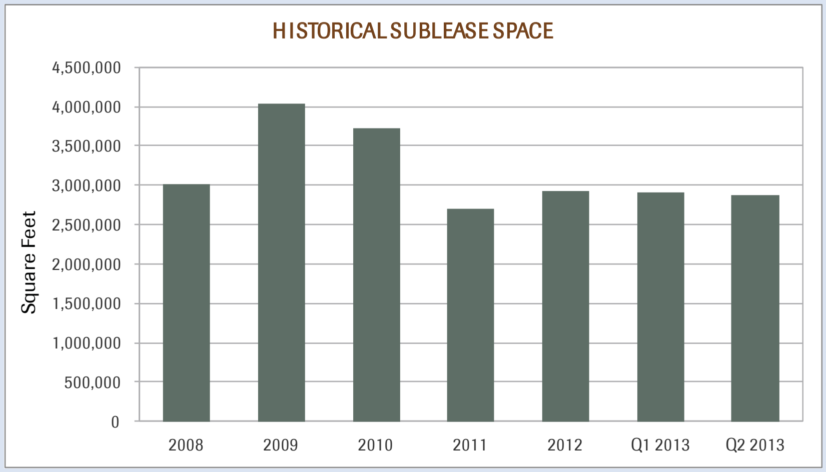


Source: CoStar Group, BTP Research

SUBLEASE SPACE

This quarter, the amount of space available for sublease decreased nearly 100,000 square feet (sf) to 2.8 million sf. This decrease was more than the previous three quarters and was caused by GoHealth subleasing 90,000 sf from Career Education at The Merchandise Mart.

As economic prospects improve, employers will either feel less need to cut internal expenses by leasing out their space or they will start using the space themselves for additional employees as their businesses expand. Despite this, the shifting economic climate may encourage some companies to shed more space as they no longer need as much space per employee due to alternative workplace strategies.



Source: CoStar Group, BTP Research

NEW DEVELOPMENTS

There are currently 12 proposed developments for the Chicago Business District (CBD). Many of these will likely secure an anchor tenant over the next year, but competition for prime space will remain tight. For high-rise premium space at the top of the market, demand rarely lags regardless of economic conditions. Because of the increasing constraint in amounts of large blocks of space available, some of the proposed developments are progressing Earlier in 2013, Hines broke ground on their 45-story office tower at 444 W Lake St (River Point). They are securing anchor tenants, McDermott, Will & Emery (occupying about 225,000 sf) and DLA Piper (occupying about 200,000 sf). The building is slated to be completed mid-2016. A large redevelopment is still underway The Fulton Cold Market Storage at 1000 W Fulton St which is being converted to loft-style office space that is in high demand among the tech sector. In fact, they already have commitments from Google (200,000 sf) and SRAM (77,000 sf) to occupy the building once it is finished in 2014. More of these proposed buildings will progress as large blocks of class A space decrease and financing requirements ease for developers.

TOP PROPOSED OFFICE DEVELOPMENTS/REDEVELOPMENTS Q3 2013

ADDRESS	SIZE (RSF)	DEVELOPER
Wolf Point	up to 3 million	Hines/Magellen
150 N Riverside Plz	up to 1.4 million	O'Donnell Investments
601 & 625 W Monroe St	up to 1.4 million	CBRE/Fifield
444 W Lake St (River Point)	1.1 million	Hines/Levy
301 S Wacker Dr	1 million	InSite/Trammell Crow
130 N Franklin St	1 million	CC Industries/Tishman Speyer
401 S Wacker Dr	863,000	DRI/Oak Tree Capital Partners
151 N Franklin St	825,000	John Buck

Source: BTP Research

WHO IS MOVING THE MARKET?

This quarter, law, insurance, medical and technology companies led the way. Two law firms, McDermott Will & Emery and DLA Piper made commitments to lease significant amounts of space in the new office building being constructed at 444 W Lake St. Both of these firms plan to reduce their footprint and become more efficient in their new spaces. Following this trend, another law firm, Locke Lord, renewed its lease at 111 S Wacker Dr through 2027, but gave back an entire floor of space. This 55,400 sf block of space is already set to be leased by Harris Associates in 2017. Also this quarter, Zurich American Insurance decided to move its Chicago operations from 10 S Riverside to 300 S Riverside and increase its space to make way for their planned addition of 150 employees by 2015. Space expansions were also seen by healthcare insurance provider, Humana, and numerous technology companies. The firm to make the largest leap was GoHealth. By subleasing 93,755 sf at The Merchandise Mart, they opened their fourth location in Chicago and increased their overall space in the city to about 166,000 sf.

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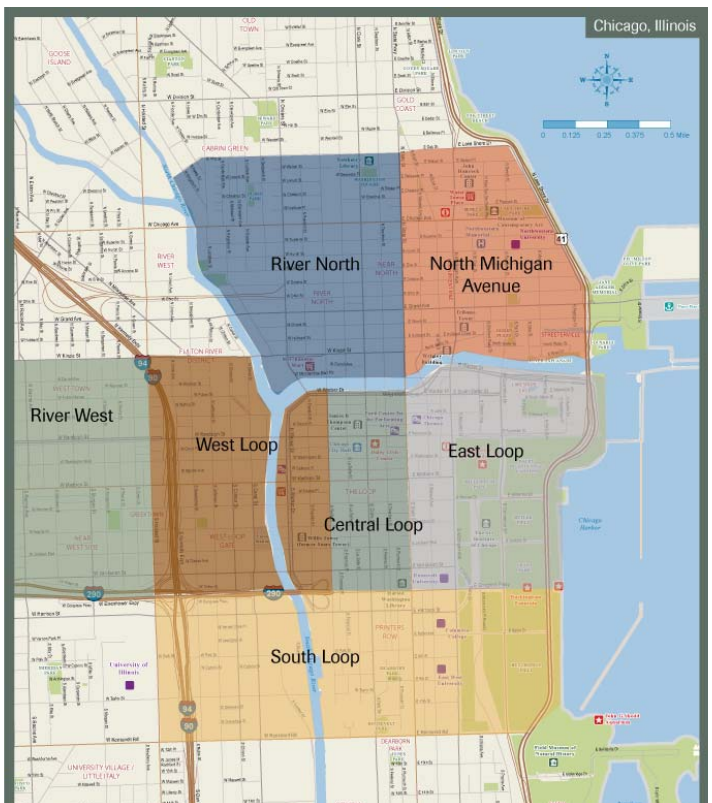
TOP CHICAGO BUSINESS DISTRICT LEASE TRANSACTIONS Q3 2013

TENANT	TYPE	ADDRESS	SIZE (RSF)
McDermott Will & Emery	New	444 W Lake St	225,000
DLA Piper	New	444 W Lake St	200,000
Locke Lord	Renewal/Contraction	111 S Wacker Dr	116,300
Zurich American Insurance	New	300 S Riverside Plz	107,852
Humana	Renewal/Expansion	550 W Adams St	97,000
GoHealth	Sublease	222 Merchandise Mart Plz	93,755
Cleversafe	Renewal/Expansion	222 S Riverside Plz	35,309

Source: BTP Research



Chicago Business District Submarkets

WHERE IS THE OPPORTUNITY?

It continues to be an opportune time for tenants looking for office space in the Chicago Business District. Rents are still slightly lower than pre-downturn levels and landlords are offering generous concessions to lure creditworthy tenants. Class A space rents are closer to Class B prices than they have been for several years. This provides opportunity for companies currently occupying Class B or C space to significantly upgrade their aesthetic without breaking their budgets. Small to mid-sized companies, particularly, have broad space options downtown. If they are creditworthy, they have the upper hand in negotiating favorable rates and concessions with landlords.

As more companies flock to downtown to attract young talent we predict landlords will continue to get more bullish in the next few years. In fact, we have already seen many of them pushing back on rents and concessions in our recent negotiations.

NOW is the time.

NOTE: The information contained in this report was provided by sources deemed to be reliable, however, no guarantee is made as to the accuracy or reliability of the data. As new, corrected or updated information is obtained, it is incorporated into both current and historical data, which may invalidate comparisons to previously issued reports.