

Meridian

MarketWatch

YEAR END
2008

OFFICE
MARKET REPORT

A REVIEW OF OFFICE MARKET ACTIVITY

Indianapolis, Indiana

It now appears that the failure of Lehman Brothers in mid-September triggered a gradual but massive re-pricing of commercial real estate. There are several contributing factors to this re-pricing and each has negative consequences for our industry. The TARP which was approved by Congress at the request of the Treasury Department is recapitalizing the largest banks. Unfortunately, the underwriting terms are problematic for both lenders and borrowers. New loans are surprisingly expensive to borrowers. And recasting loans is expensive to the lenders. Loan reserves and debt coverage ratios have increased dramatically and this is starting to have the effect of repricing all commercial real estate. Most lenders have discovered that it is safer to sit on the sidelines and recapitalize the balance sheet. (The TARP money was even used by PNC Bank to purchase National

City Bank). We see no evidence that banks want to loan money for real estate using the old rules in existence prior to Lehman's failure.

Commercial banks now seek debt coverage that equates to a minimum of 30% equity. Smaller community banks appear to be in much better shape but are limited to how much they can lend on a single transaction so they favor the loans of less than \$5 million for land and building. Dramatic first year increases of 25-50% in property taxes further devalue commercial real estate as landlords struggle to pass these expenses along to tenants. This is resulting in a stand-off in which there is a dramatic reduction in deal flow on the brokerage side of commercial real estate. From our preliminary research, most transactions that closed in the fourth quarter of

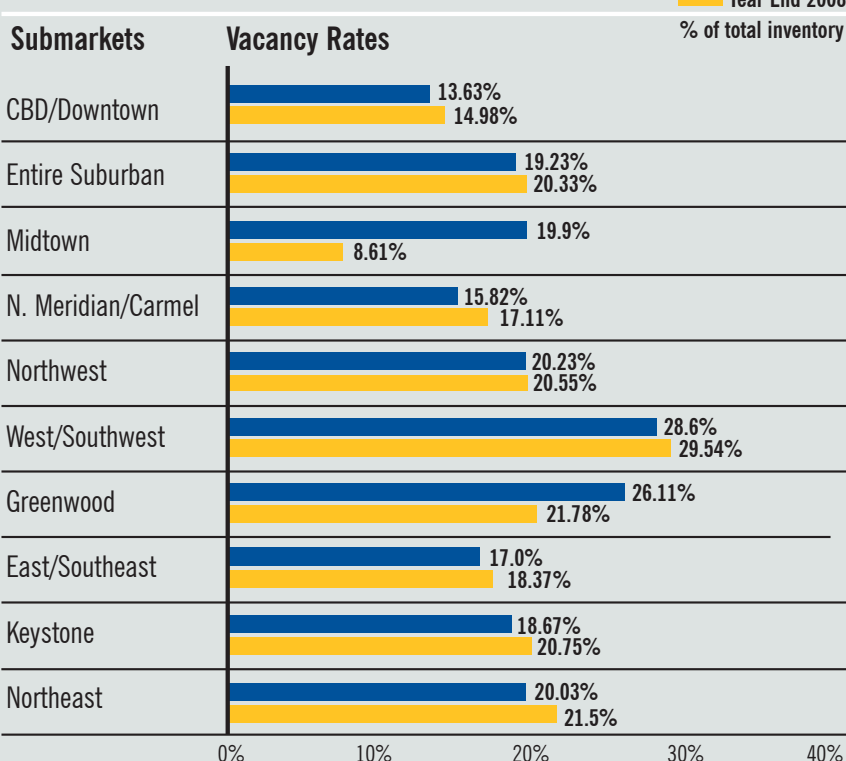
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HOT TOPICS

INDIANAPOLIS - OFFICE

- Seemingly recession-proof; health care development continues throughout Central Indiana, including the Hamilton Healthcare Campus slated to open in summer 2009, with Community Health Network as an anchor tenant for 40,000 sq. ft. within a 122,000 sq. ft. medical office building.
- Acquisition and disposition of office product has slowed dramatically with a severe lack of funding available among a majority of lenders. Despite this, certain value-add opportunities await more sophisticated, cash carrying buyers.
- A Michigan-based investment group is preparing major renovations to 500 N. Meridian Street, a 435,000 sq. ft. office building historically unavailable to the greater office market due to it being a corporate headquarters for several insurance companies.
- Local developers Edgeworth-Laskey are kicking off Concourse at Crosspoint, a new Northeast office project. The first building, set for late 2009 delivery, is reported to be a 110,000 sq. ft., four-story structure.
- Office leasing activity, albeit slower compared to this time last year, continues with a temperament toward mitigation of excess occupancy cost and greater work space efficiency.

INDIANAPOLIS OFFICE VACANCY RATES



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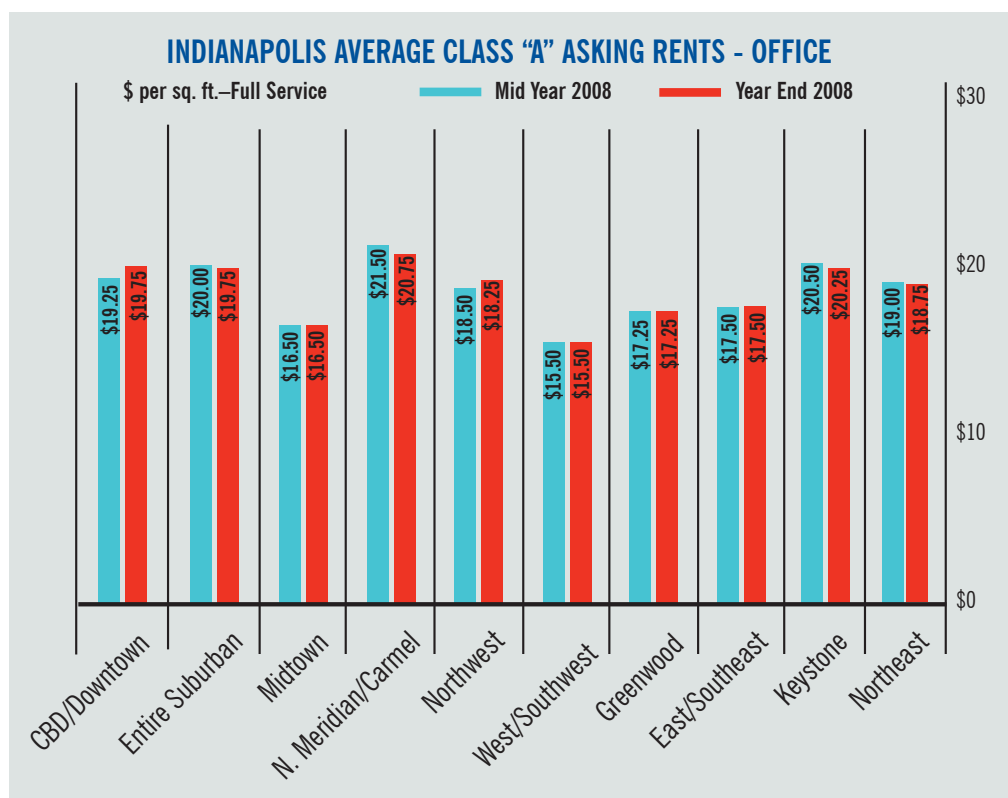
2008 were based upon purchase prices negotiated prior to September 15, 2008. We anticipate a very slow first half of 2009 as buyers and sellers come to grips with this re-pricing. Until stabilization occurs, buyers and sellers are not expected to see eye to eye.

As we move forward, we believe third quarter of 2008 will mark the beginning of the regression to the mean value of commercial real estate of the past 30 years. Properties purchased within the past 24 months, at the height of the investment frenzy, could lose 25-30% or more of their value as we return to the fundamentals. This re-pricing is going to be a slow process for most sellers to accept.

Additionally, increasing costs of capital will reduce what buyers can pay for property. Although interest rates appear to be low, the demands for higher equity and loan reserves are in excess of cash on hand for most borrowers. Reduced lines of credit further reduce what buyers can pay. Unfortunately for the buyers, sellers are seldom in a hurry to be told what they don't want to hear, so there will be fewer transactions. Most owners of commercial real estate don't become motivated sellers unless prices are increasing, so in a declining market we will see fewer sellers. Distressed sales are expected to increase as lenders and corporations with vacant and under-performing assets enter the market. Neither is interested in seller financing or lengthy sale cycles. We have not yet seen properties return to lenders in any significant volume, so it is too early to know what real impact lender-owned sales will have on the market. In the case of land, only the most heavily-leveraged land will be returned to lenders for liquidation. In central Indiana, this has been limited to the production home builders returning platted parcels to the banks. These parcels have been resold for \$.25 to \$.50 on the dollar. Buyers of these

distressed assets are speculators or competitors with cash or borrowing capacity remaining.

Further contributing to price erosion is that a surprising amount of brokerage activity in the past decade was related to Section 1031 of the IRS code. The motivation/desire to defer tax on capital gains in real estate encouraged many buyers to pay more for investment real estate and replacement property than the property may actually have been worth. Now that the air is being released from the 1031 bubble, we will see further reduction in deal flow. As fewer sellers enter the marketplace, there will be fewer investors seeking replacement property. As there are fewer buyers seeking replacement property, there are fewer motivated sellers. It is a cycle that is not expected to reverse for several years. The severity of this collapse has been exacerbated by an excessive use and availability of leveraged capital prior to last September. —Ross Reller



INDIANAPOLIS OFFICE MARKET SUMMARIES YTD

| | Total Inventory | No. of Buildings | Class "A" Vacancy | Class "B" Vacancy | Overall Vacancy | Vacant Space | 2008 New Construction |
|-----------------------|----------------------|------------------|-------------------|-------------------|-----------------|----------------------|-----------------------|
| CBD/Downtown | 12.2 million sq. ft. | 84 | 13.66 % | 14.40 % | 14.98 % | 1.83 million sq. ft. | 0 sq. ft. |
| Entire Suburban | 22.0 million sq. ft. | 363 | 17.73 % | 22.97 % | 20.33 % | 4.5 million sq. ft. | 731,343 sq. ft. |
| Midtown | 1.0 million sq. ft. | 17 | 17.13 % | 5.37 % | 8.61 % | 90,700 sq. ft. | 0 sq. ft. |
| North Meridian/Carmel | 6.8 million sq. ft. | 93 | 14.43 % | 22.11 % | 17.11 % | 1.16 million sq. ft. | 180,000 sq. ft. |
| Northwest | 3.9 million sq. ft. | 45 | 15.20 % | 26.83 % | 20.55 % | 808,000 sq. ft. | 151,343 sq. ft. |
| West/Southwest | 1.4 million sq. ft. | 25 | 39.01 % | 33.90 % | 29.54 % | 415,200 sq. ft. | 0 sq. ft. |
| Greenwood | 1.03 million sq. ft. | 27 | 7.91 % | 25.06 % | 21.78 % | 224,400 sq. ft. | 44,000 sq. ft. |
| East/Southeast | 159,000 sq. ft. | 6 | n/a | 5.85 % | 18.37 % | 29,200 sq. ft. | 0 sq. ft. |
| Keystone | 4.3 million sq. ft. | 53 | 20.86 % | 21.00 % | 20.57 % | 895,800 sq. ft. | 120,000 sq. ft. |
| Northeast | 4.4 million sq. ft. | 97 | 24.07 % | 18.59 % | 21.50 % | 954,000 sq. ft. | 236,000 sq. ft. |

Submarket Reports



Keystone Crossing



Charles Schwab purchased Woodfield Crossing I, 164,000 sq. ft., and will relocate their call center from Fishers.

Leasing activity in the Keystone submarket was, like many other areas, hit hard by the effects of the economy in the second half of 2008. Many financial services and capital market firms are either downsizing or closing their doors. Vacancy rates have increased over the last year from 18.04% at the end of 2007 to 18.67% at mid-year 2008 and finishing the year at 20.75%. Tenants were still looking for shorter terms (1-3 years) hoping to ride out the election and the recession. Some second half 2008 transactions are:

| <u>Tenant</u> | <u>Sq. Ft.</u> | <u>Park/Building</u> |
|-----------------------------|----------------|------------------------|
| City Securities | 17,900 | 8900 Keystone Crossing |
| Indianapolis Life Insurance | 7,962 | 9200 Keystone Crossing |
| Child Advocates | 9,019 | 8200 Haverstick Road |

Also noteworthy, Charles Schwab purchased Woodfield Crossing I at 8332 Woodfield Crossing. Schwab will be moving their call center operations to the 164,000 sq. ft. facility from their current location in Fishers.

Many tenants will be renewing for shorter terms as they wait for the current economic conditions to reverse.

New development by Edgeworth Laskey is the biggest news in the Northeast office market.

Edgeworth Laskey announced plans to construct Concourse at Crosspoint—a four-story office building consisting of 110,000 sq. ft. located in the Crosspoint Office Park off of I-69, between 96th and 106th Streets. USA Funds will lease one floor of the building, which is scheduled to open in late 2009.

Drury Inn & Suites Northeast was completed at 82nd Street and I-69 across from the ever-expanding Community Hospital North.

Northeast



Concourse at Crosspoint scheduled to open in late 2009.

CBD/Downtown



500 N. Meridian has 300,000 sq. ft. available for lease.

The downtown market is evolving to a case of “haves and have-nots” in the multi-tenant market. Buildings such as One America, Chase Tower, 101 W. Ohio, Market Tower and 300 N. Meridian have little, if any, vacancies. However, M&I Plaza, One Indiana, Capital Center and National City Center have large tracts of vacant space.

The highly occupied buildings are getting rents in the low \$20.00/RSF range while the buildings with large vacancies are attracting tenants with rent in the \$17.00-\$19.00/RSF range.

Safeco Insurance plans to vacate 500 N. Meridian Street. This will provide a great opportunity for a large corporate user to locate or expand downtown.

On a more positive note, the opening of Lucas Oil Stadium, demolition of the RCA Dome, continuing construction on the new 1,000-room Marriott and commencement of the Convention Center expansion will keep the hospitality industry strong for years to come.

The North Meridian/Carmel office submarket experienced a slowdown similar to the overall market. Office users in the N. Meridian Corridor have been scouting the market looking for below-market rents in either direct short-term renewals or sublease space. Tenants' awareness of the current financial and economic uncertainty is resulting in fewer new transactions in this market. That said, there were a few notable deals completed in the fourth quarter of 2008:

- City Center at Penn in Carmel leased 26,000 sq. ft. to Dealer Services Corporation.
- Bowen Engineering Corp. purchased 8802 N. Meridian, a 64,000 sq. ft. building, from GPI Properties.
- Midwest Eye Institute leased 8,500 sq. ft. at Spring Mill Medical Plaza
- Oxford Financial Group lease renewal of 37,594 sq. ft. at Meridian Mark II
- Liberty Mutual purchased 350 East 96th Street, Parkwood II from Duke Realty

N. Meridian/Carmel



City Center at Penn leased 26,000 sq. ft. to Dealer Services Corporation.

Looking forward, we expect transaction levels to be moderate by comparison to the same period last year. Occupancy/vacancy numbers are not expected to fluctuate dramatically, but owners will be digging in deeper for concessions to retain those tenants with leases expiring during the first half of 2009. Potential transactions to watch for are: 1289 City Center Drive, 101,798sq. ft. located in the heart of Conseco Campus in Carmel—the building is currently on the market. Looking at the medical inventory, 13431 Old Meridian Street is located in the Medical corridor adjacent to St. Vincent Group in Carmel. This 29,000 sq. ft. building is currently for sale or lease with great accessibility to St. Vincent Hospital. It is seeing a good amount of traffic flow, indicative of the medical product in Carmel.

Northwest



Eleven Fortune Park has a large tract of vacant, contiguous space consisting of 87,000 sq. ft.

The general tightening of the economy has had its effects on the Northwest submarket. Absorption northwest was only 15,331 sq. ft., as a lack of marquis "Class A" deals and slow local activity continued. Activity Northwest was mainly in leases under 5,000 sq. ft. Financial woes forced a few tenants to shrink or close doors entirely. Still other firms were able to take advantage of their purchasing power and find affordable deals.

Landlords are continuing to offer aggressive rates and free rent to attract tenants. The financial slowdown has, however, forced them to take a closer look at tenant financials before offering tenant improvement dollars. Just as banks are scrutinizing the borrowers, landlords are doing the same to potential tenants before investing or borrowing money for improvements that often take five or more years to recover.

Earlier in the year, the Northwest submarket attracted significant deals such as the American Cancer Institute at Northwest Tech, Woolpert Engineering and Brightpoint at Woodland Corporate Park and the GSA at Intech. Woodland Corporate Park still has a large vacancy of 25,000 sq. ft. of space due to Benicorp's financial woes and liquidation.

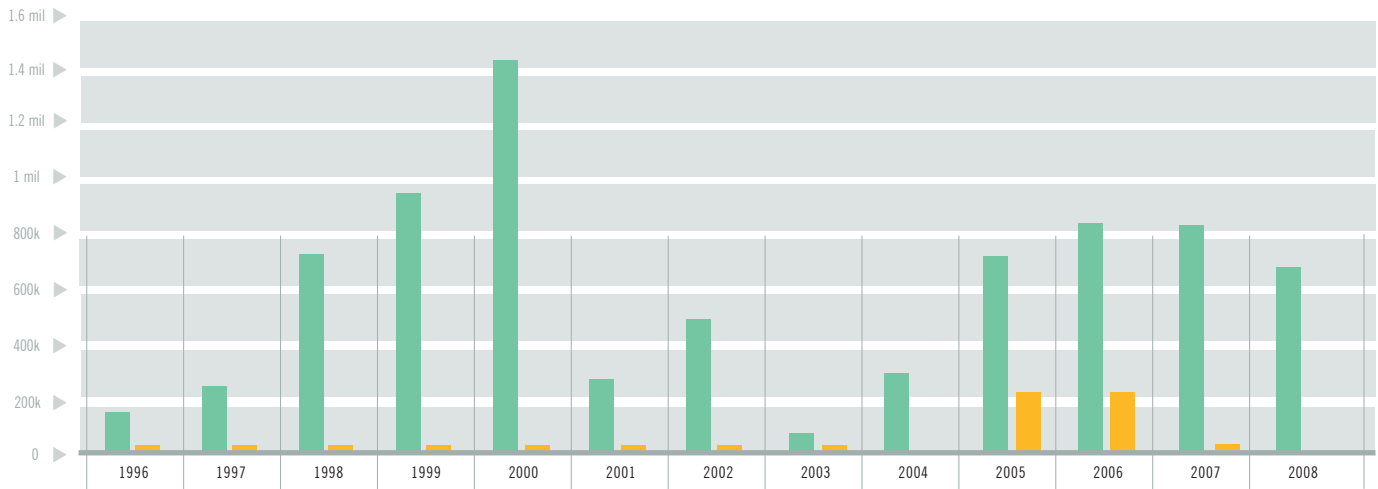
Engineering firm, Ter Horst, Lamson & Fisk, Inc. flexed its purchasing power with the purchase of 3901 W. 86th Street as its new headquarters. They will occupy roughly 15,000 sq. ft. of the 65,000 sq. ft. building. Harris Bank previously owned the building when it bought First National Bank and Trust. Harris Bank will keep a branch in the building.

ABSORPTION SUMMARY

| | CBD/Downtown | Entire Suburban | Midtown | N. Meridian/Carmel | Northwest | West/Southwest | Greenwood | East/Southeast | Keystone | Northeast |
|-------------|-------------------|-------------------|-----------------|--------------------|------------------|------------------|-----------------|------------------|------------------|------------------|
| 1st Quarter | 83,425 sq. ft. | 404,494 sq. ft. | (3,040) sq. ft. | 133,269 sq. ft. | 28,349 sq. ft. | 36,133 sq. ft. | (3,793) sq. ft. | 600 sq. ft. | 29,018 sq. ft. | 180,918 sq. ft. |
| 2nd Quarter | (39,618) sq. ft. | (25,116) sq. ft. | 100 sq. ft. | 4,718 sq. ft. | (12,712) sq. ft. | 26,324 sq. ft. | 15,457 sq. ft. | (1,670) sq. ft. | (54,520) sq. ft. | (2,713) sq. ft. |
| 3rd Quarter | 44,416 sq. ft. | 82,099 sq. ft. | 87,365 sq. ft. | 25,282 sq. ft. | 23,691 sq. ft. | 31,908 sq. ft. | 13,381 sq. ft. | (18,000) sq. ft. | 16,419 sq. ft. | (10,582) sq. ft. |
| 4th Quarter | (126,326) sq. ft. | (223,035) sq. ft. | 19,000 sq. ft. | (81,173) sq. ft. | (5,997) sq. ft. | (32,748) sq. ft. | 29,559 sq. ft. | n/a | (77,385) sq. ft. | (55,291) sq. ft. |
| YTD Total | (38,103) sq. ft. | 220,442 sq. ft. | 103,425 sq. ft. | 82,096 sq. ft. | 15,331 sq. ft. | 61,617 sq. ft. | 54,604 sq. ft. | (19,070) sq. ft. | (86,468) sq. ft. | 112,332 sq. ft. |

HISTORIC NEW CONSTRUCTION

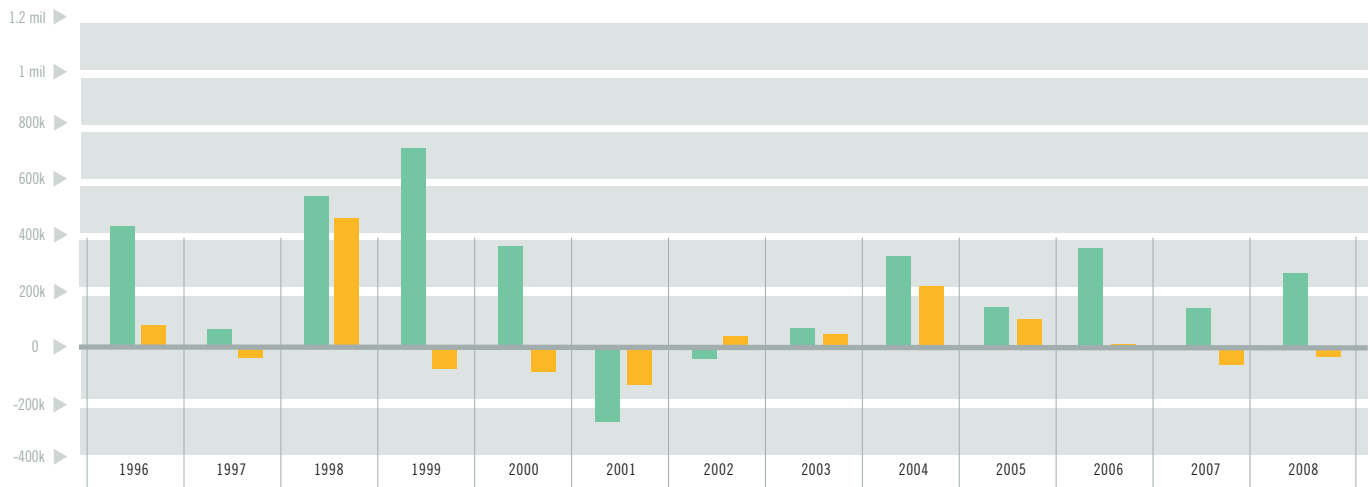
Suburban Construction
CBD Construction



HISTORIC NET ABSORPTION

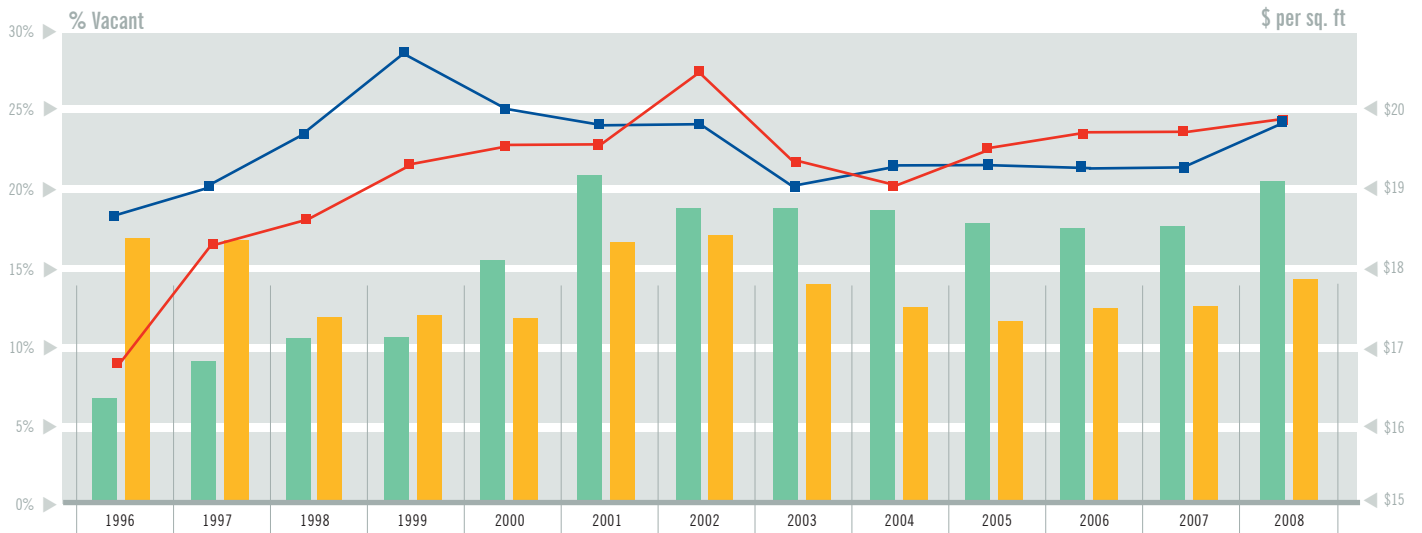
Suburban Net Absorption
CBD Net Absorption

MILLION SQ. FT.



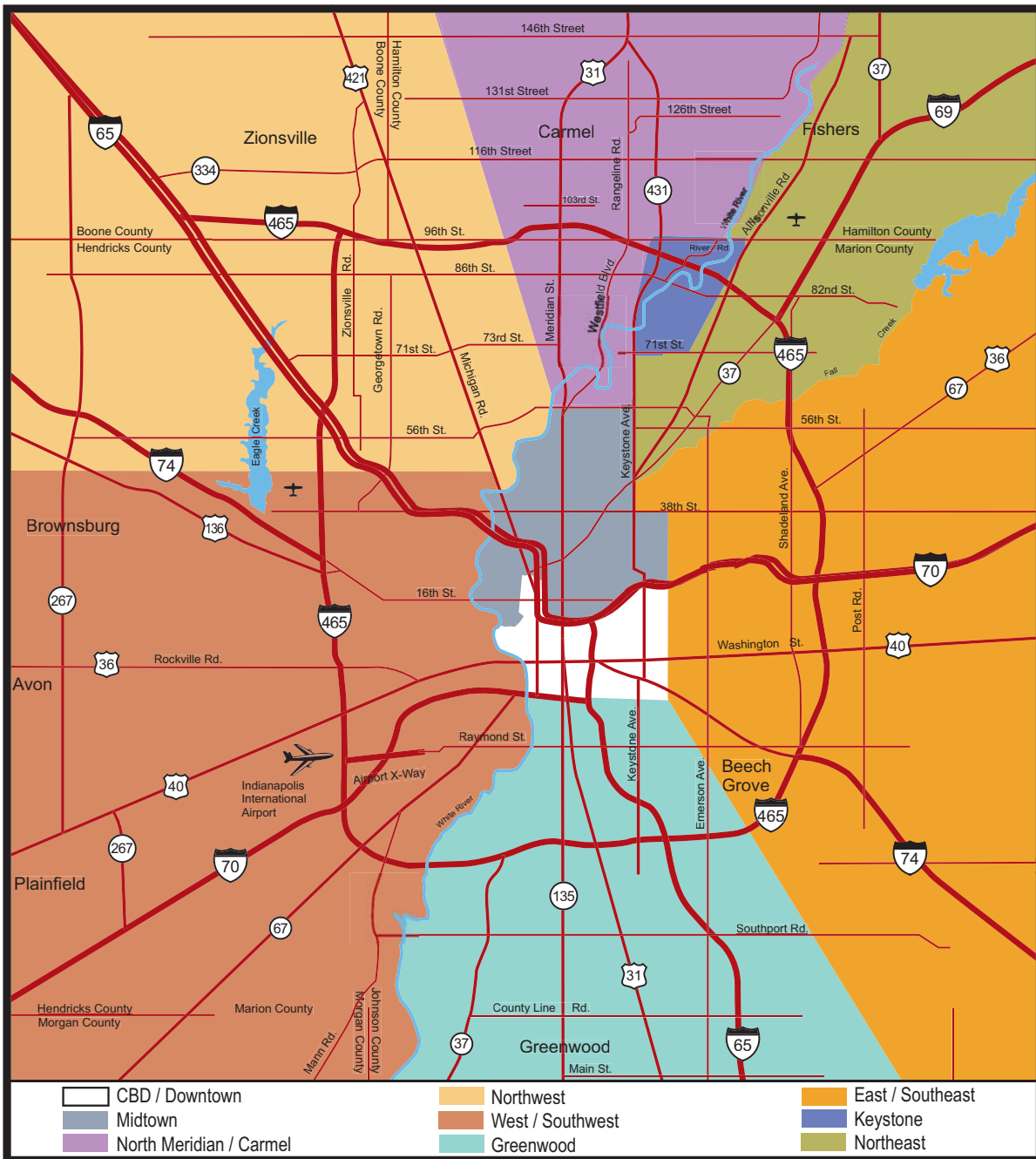
AVAILABLE SPACE VS. AVERAGE ASKING RENT

Suburban Available Space
CBD Available Space
Suburban Average Asking Rent
CBD Average Asking Rent



Submarket Map

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Meridian MarketWatch is a publication detailing current and historical real estate news and trends in Indianapolis, Indiana.

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