



## LINCOLN HARRIS RE:SOURCE RALEIGH-DURHAM 2Q 2012

Net absorption moved back into positive territory during the second quarter after a brief dip into negative net occupancy in the first quarter of the year. These numbers seem to suggest a slowly improving picture, but the reality is more nuanced as the market is hit by large office closures, even as other companies announce large-scale expansionary efforts.

### ECONOMY

Despite the Triangle area's national renown as a resilient economic powerhouse with stellar population and business fundamentals, the region has seen employment growth stall throughout the spring of 2012 as the U.S. and the world grapples with a third summer of declining indicators and spillover European debt crisis worries. Unemployment rates have risen modestly in both the Durham and Raleigh MSAs, leading to a combined jump from 7.5 percent during March 2012 to 7.9 percent three months later. Together, the metro has created 18,300 new positions between June 2011 and June 2012, with gains of more than 4,000 jobs garnered in four broad industry segments: trade, transportation, and utilities; professional and business services; education and health services; and leisure and hospitality services. Construction and government, again, were the only categories to post job losses over the past year, falling by 700 and 2,400 jobs, respectively as building activity and government revenues have failed to return to pre-recession levels. At the end of June, the merger of Raleigh-based Progress Energy with Charlotte-headquartered Duke Energy was finalized, creating the nation's largest electric utility company. The resulting company – called Duke Energy and headquartered in Charlotte – is expected to shed close to 1,000 positions in the Triangle area over the next couple of years and has stripped Raleigh of a Fortune 500 headquarters. Much of the quarter's remaining economic news has truly been a mixed bag of highs and lows; both Connexion Technologies and smartphone-maker HTC announced near-term complete closures of their Triangle offices, while Blackberry-maker Research In Motion, with nearly 78,000 square feet in the area, faces serious downside risks associated with plummeting market share. Conversely, there was also very positive news as several technology companies with established regional presences announced major job and real estate expansions. Citrix, which purchased Raleigh-based ShareFile in 2011, has committed to creating 337 jobs over the next five years, Bandwidth.com is planning to fill 200 new positions in its move to larger space at Centennial Campus, while computer manufacturer Lenovo is expanding its real estate substantially to ease growing pains initiated by the need for 200 employees in the near-term.

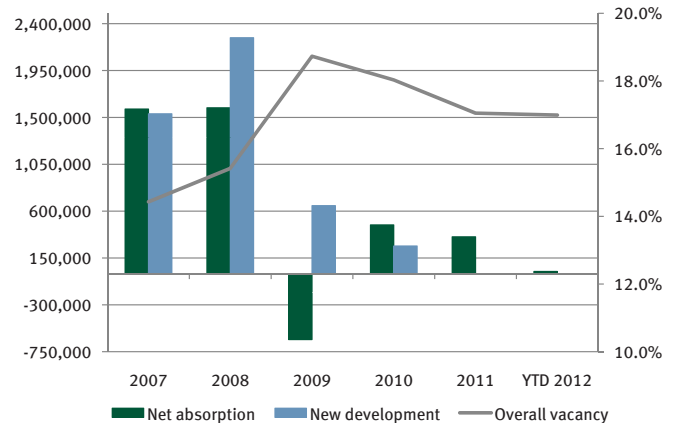
### OFFICE MARKET

#### Overview

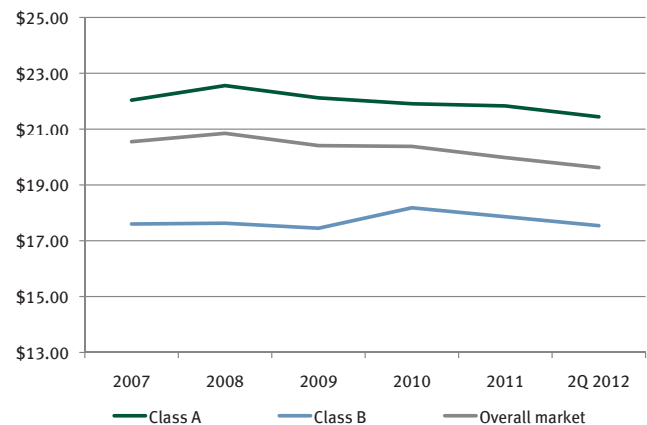
Net absorption in the Triangle office market moved back into positive territory during the second quarter after a brief dip into negative net occupancy in the first quarter of the year. With net move-in activity summing to a modest 35,096 square feet, vacancy fell by 10 basis points quarter-over-quarter to 17.0 percent. These numbers seem to suggest a slowly improving employment and occupancy picture, but the reality is more nuanced as the market is battered by large office closures, even as other companies with significant local operations announced large-scale expansionary efforts. On the downside, HTC, which only announced its new Triangle office in December 2010 and opened in March 2011, is shuttering its 47,000 square

	2Q 2011	2Q 2012	12 MONTH FORECAST
Market Supply (SF)	36,028,552	36,028,552	↕
Under Construction (SF)	0	335,185	↘
Under Construct. Preleased %	N/A	62.8%	↕
Direct Vacancy	17.3%	18.3%	↘
Total Vacancy	16.3%	17.0%	↘
Total Net Absorption (SF)	-58,923	-38,686	↕
YTD Net Absorption (SF)	-21,291	35,096	↕
Direct Asking Rent	\$20.00	\$19.62	↕
Class A Direct Asking Rent	\$21.55	\$21.44	↕
Class B Direct Asking Rent	\$18.04	\$17.54	↕

### STATISTICS AND TRENDS



### HISTORICAL VACANCY AND NET ABSORPTION



### HISTORICAL DIRECT RENTAL RATES



feet of offices at American Tobacco Campus. Connexion Technologies declared bankruptcy in April, laid off the majority of its employees, and let 33,258 square feet of its office space at 111 Corning expire at its end-of-June lease expiration. An encouraging sign is that the area's largest leases signed in second quarter were all expansionary in nature as FHI 360 looks to move from Headquarters Park to 95,000 square feet in under construction Diamond View III, Bandwidth.com plans to expand into 72,418 square feet of subleased Red Hat space at Venture Center III, and Lenovo has signaled its need for pure expansionary space on two floors at 5221 Paramount Parkway adjacent to its two primary facilities. Also in the RTP/RDU submarket, Novella Clinical is relocating from Imperial Center and inked a deal for the entire 77,239 square foot former Salix Pharmaceuticals building at 1700 Perimeter Park, which bumped Worldwide Clinical Trials into about 30,000 square feet at 3800 Paramount. Additionally, after sitting 100.0 percent vacant for almost three years, RDU Center III has secured its first tenant; Tennessee-based M\*Modal Services committed to opening a new Triangle office in 18,350 square feet on the second floor of the building.

The only broad segment of the market to experience positive net absorption was suburban Class A product, which captured 213,644 square feet of net occupancy, as tenants shied away from urban product in general for the time being – potentially waiting for top-tier product to complete construction – and from less-quality Class B buildings. The disparity in net absorption between Class A and Class B product remains quite vast, as Class A and Class B supply had positive 185,393 and negative 150,297 square feet of net activity, respectively. However, forward-looking leasing activity illuminates a more positive story as the long-beleaguered RTP/RDU area garnered the lion's share of this quarter's leasing activity in both Class A and Class B product.

### Supply

The urban submarkets, enjoying the only vacancy rates in the market under 10.0 percent, continue to encompass all of the competitive under construction office product in the area. There are currently two buildings under construction in Downtown Durham, with The Measurement Building still on track for an October 2012 opening, and the very tight American

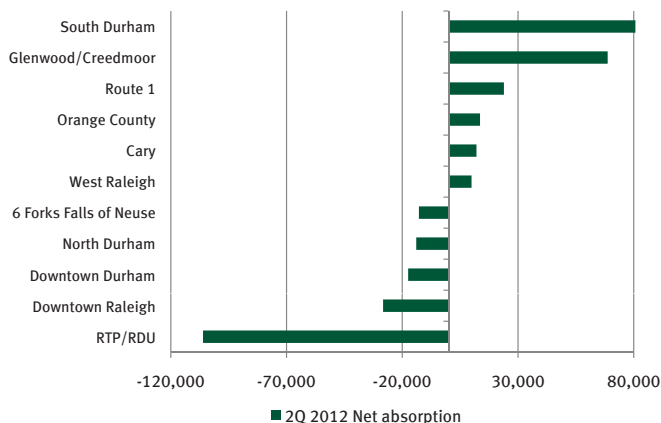
Tobacco Campus underway on 133,000 square foot Diamond View III building with an expected delivery date of June 2013. Diamond View III secured a huge win during second quarter when non-profit FHI 360 signed a lease for the entirety of the office space in the building; with a lease formally executed for 95,000 square feet, the balance of the office space is also being held off of the market for FHI. Additionally, the State Employee's Credit Union (SECU) headquarters location is under construction for year-end 2012 completion. The 12-story, 131,472 square foot building at 119 Salisbury Street in Downtown Raleigh will be primarily occupied by SECU, which is taking seven floors, but the remaining five floors are being offered to other users at \$30.00 per square foot.

### Rental rates

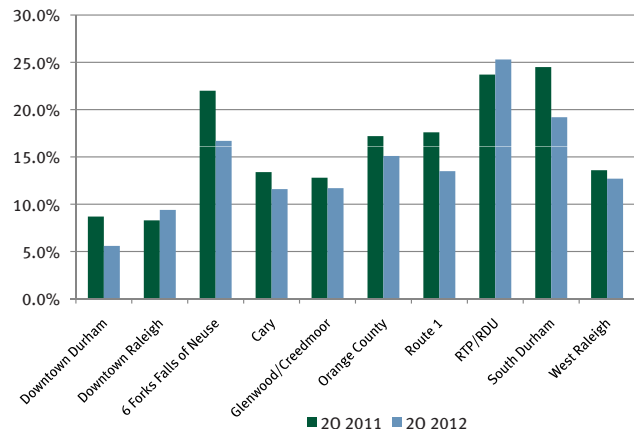
The bifurcation in urban and suburban health and leasing activity also manifests in the pace of rental rate growth. In the past quarter, Downtown Raleigh held rates steady at \$21.68 per square foot, while Downtown Durham, pushed along by rental rates at the two under construction buildings, rose 5.6 percent to \$21.49 per square foot. Route 1 was the only suburban submarket to post an uptick in asking rental rates, though this was driven by well-priced spaces coming available instead of true price increases on already available suites. Similarly – and unsurprisingly – the 6 Forks Falls of Neuse area experienced a substantial 7.1 percent downward movement in rents to average \$20.34 per square foot as locations with above-market asking rates, such as CapTrust Tower and the Forum, locked down several leases. The rest of the submarkets, as well as the market overall, were faced with rental rate malaise that resulted in incrementally declining face rents; the market's general pause in leasing activity has caused rate pressure to accelerate over the past quarter, which saw a quarter-over-quarter dip of 1.4 percent to \$19.62 per square foot that is not far off from the area's year-over-year rate decrease of 1.9 percent.

## SUBMARKET ANALYSIS

This quarter's growth popped up in unexpected submarkets, while the usual winners saw demand temporarily tamped down. South Durham had several large tenant moves, including Veritas Collaborative taking 28,800 square feet at Hock Plaza II and VCE – a joint venture between VMware, Cisco, and EMC –



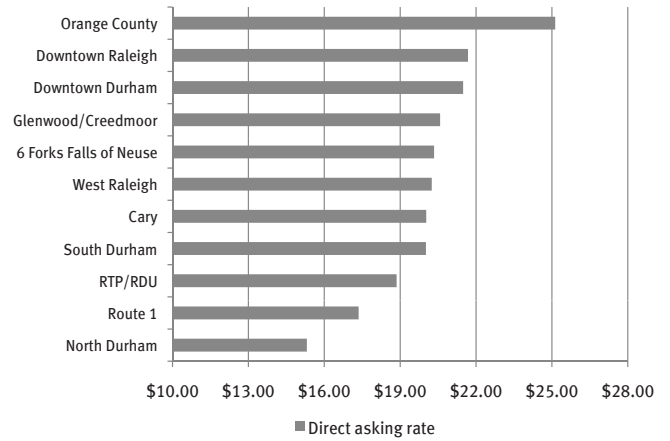
SUBMARKET-BY-SUBMARKET NET ABSORPTION



SUBMARKET-BY-SUBMARKET VACANCY TRENDS



taking possession of 30,763 square feet at 2635 Meridian. The two urban areas experienced rare drops in net absorption as Downtown Durham took a double hit as Fox50 left 17,933 square feet at Diamond View I as it consolidates facilities with WRAL in Raleigh, and the beginnings of HTC's move out of 47,000 square feet in the Crowe and Fowler buildings is also underway. In Downtown Raleigh, Progress Energy unsurprisingly let a two floor, 46,000 square foot lease at One Bank of America Plaza expire. The RTP/RDU area took another hit during second quarter with the office market's worst net absorption of negative 106,072 square feet as post-merger iContact put 35,150 square feet at 5221 Paramount on the market – to be snatched up almost immediately by Lenovo – and numerous smaller tenants moved out of the submarket. RTP/RDU continues to post the second-highest vacancy rate at 25.3 percent, while the strongest suburban areas of Cary and Glenwood/Creedmoor had vacancy rates of 11.6 and 11.7 percent, respectively.



## COMPLETED LEASE TRANSACTIONS

TENANT	BUILDING	ADDRESS	SUBMARKET	SF
FHI 360	Diamond View III	359 Blackwell Street	Downtown Durham	95,000
Bandwidth.com	Venture Center III	900 Main Campus Drive	West Raleigh	72,418
Lenovo	5221 Paramount Parkway	5221 Paramount Parkway	RTP/RDU	70,300
Novella Clinical	1700 Perimeter Park Drive	1700 Perimeter Park Drive	RTP/RDU	50,596
VCE	2635 Meridian Parkway	2635 Meridian Parkway	South Durham	30,763
Liggett Vector Brands	3800 Paramount Parkway	3800 Paramount Parkway	RTP/RDU	20,458
Sierra Nevada	1030 Swabia Court	1030 Swabia Court	RTP/RDU	19,146
M*Modal Services	RDU Center III	2121 RDU Center Drive	RTP/RDU	18,350
Local Gov't Federal Credit Union	1330 St. Mary's	1330 St. Mary's Street	West Raleigh	9,846

## RECENT INVESTMENT SALES

BUILDING/ADDRESS	SF	SALE PRICE	SALE PRICE/SF	BUYER
11000 Weston Parkway	178,300	\$32,857,143	\$184	Highwoods Properties
Former GlaxoSmithKline buildings: 52 Maughan Drive, 3030 E Cornwallis Rd	698,019	\$17,500,000	\$25	United Therapeutics Corporation

With about 40 competitive office properties with square footages of 30,000 or greater actively being marketed for sale – for a total RBA of nearly 3.5 million or almost 10.0 percent of the area's office market – the pace of completed sales slowed substantially during second quarter. The most notable transaction was Highwoods Properties' buyout of its joint venture partner's interest in 11000 Weston Parkway. The 178,300 square foot building is fully occupied by Fidelity Investments in a lease through 2013, though there is some near-term downside physical vacancy risk as Fidelity

works through its planned consolidation of employees after acquiring the former Nortel Network Campus in RTP last year. Another vacant campus comprised of office and laboratory space in RTP traded hands recently as GlaxoSmithKline divested 698,019 square feet in several buildings off Maughan and East Cornwallis. United Therapeutics Corporation, which owns and occupies several buildings in the immediate vicinity, purchased the buildings and the accompanying 55 acres of land for \$17.5 million or \$25 per square foot.



### OFFICE MARKET STATISTICS

URBAN									
	2Q 2012 Inventory (SF)	2Q 2012 Overall Vacant SF	2Q 2012 Overall Vacancy %	2Q 2012 Total Net Absorption (SF)	3Q 2011-2Q 2012 Total Net Absorption (SF)	3Q 2011-2Q 2012 Total Net Absorption (% of inventory)	2Q 2012 Overall Direct Asking Rent (PSF)	YTD Completions (SF)	Under Construction (SF)
DOWNTOWN DURHAM	2,650,611	147,857	5.6%	-17,466	83,288	3.1%	\$21.49	0	203,713
DOWNTOWN RALEIGH	2,261,558	212,801	9.4%	-28,295	-24,098	-1.1%	\$21.68	0	131,472
<b>URBAN TOTALS</b>	<b>4,912,169</b>	<b>360,658</b>	<b>7.3%</b>	<b>-45,761</b>	<b>59,190</b>	<b>1.2%</b>	<b>\$21.60</b>	<b>0</b>	<b>335,185</b>
SUBURBAN									
	2Q 2012 Inventory (SF)	2Q 2012 Overall Vacant SF	2Q 2012 Overall Vacancy %	2Q 2012 Total Net Absorption (SF)	3Q 2011-2Q 2012 Total Net Absorption (SF)	3Q 2011-2Q 2012 Total Net Absorption (% of inventory)	2Q 2012 Overall Direct Asking Rent (PSF)	YTD Completions (SF)	Under Construction (SF)
6 FORKS FALLS OF NEUSE	4,245,233	709,048	16.7%	-12,817	226,341	5.3%	\$20.34	0	0
CARY	4,129,756	478,625	11.6%	12,067	75,688	1.8%	\$20.03	0	0
GLENWOOD/ CREEDMOOR	1,578,222	184,976	11.7%	68,764	16,311	1.0%	\$20.58	0	0
NORTH DURHAM	520,872	299,019	57.4%	-13,976	-3,616	-0.7%	\$15.31	0	0
ORANGE COUNTY	1,334,698	201,700	15.1%	13,601	27,514	2.1%	\$25.13	0	0
ROUTE 1	1,646,982	221,572	13.5%	23,931	68,453	4.2%	\$17.36	0	0
RTP/RDU	9,610,134	2,433,484	25.3%	-106,072	-157,190	-1.6%	\$18.86	0	0
SOUTH DURHAM	2,668,620	513,358	19.2%	85,429	140,050	5.2%	\$20.02	0	0
WEST RALEIGH	5,381,866	681,144	12.7%	9,930	15,269	0.3%	\$20.25	0	0
<b>SUBURBAN TOTALS</b>	<b>31,116,383</b>	<b>5,722,926</b>	<b>18.4%</b>	<b>80,857</b>	<b>408,820</b>	<b>1.3%</b>	<b>\$19.50</b>	<b>0</b>	<b>0</b>
<b>TOTALS</b>	<b>36,028,552</b>	<b>6,083,584</b>	<b>16.9%</b>	<b>35,096</b>	<b>468,010</b>	<b>1.3%</b>	<b>\$19.62</b>	<b>0</b>	<b>203,713</b>

### LARGEST CONTIGUOUS SPACES

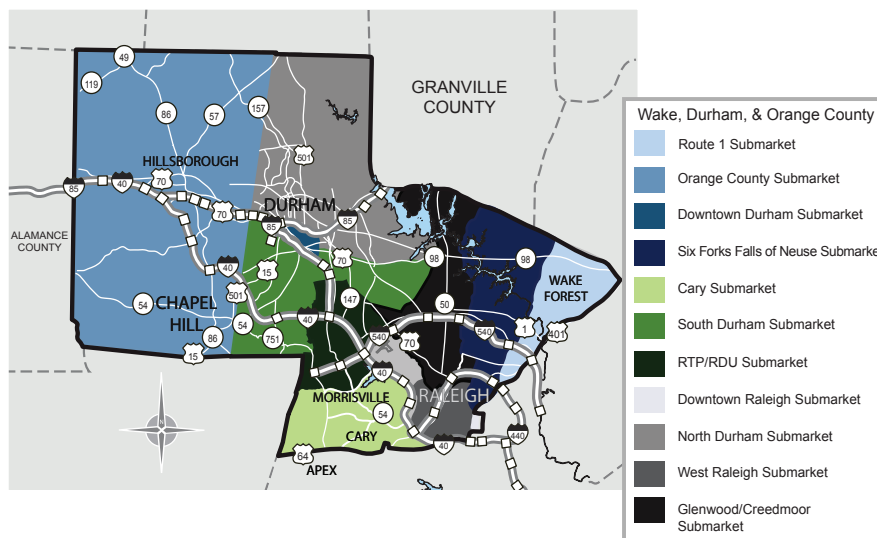
BUILDING	ADDRESS	SUBMARKET	SF Available
8001 Development Drive	8001 Development Drive	RTP/RDU	262,000
7001 Development Drive	7001 Development Drive	RTP/RDU	205,310
800 Park Drive	800 Park Drive	RTP/RDU	140,999
Signature Commons	4100 N Roxboro Road	North Durham	136,000
600 Park Drive	600 Park Drive	RTP/RDU	129,046
500 Park Drive	500 Park Drive	South Durham	125,742
700 Park Drive	700 Park Drive	RTP/RDU	120,473
RDU Center III	2121 RDU Center Drive	RTP/RDU	96,168
Pinnacle Park II	4401 Silicon Drive	RTP/RDU	80,264
Pinnacle Park III	4407 Silicon Drive	RTP/RDU	80,260



## OFFICE FORECAST

With the national and regional economic slowdown this summer, as well as the uncertainty leading up to the 2012 election, both consumer and corporate demand are anticipated to be dampened during the second half of the year. However, the signed leases already in place in the Triangle, as well as Citrix's ongoing search for 50,000 square feet in Raleigh, is expected to result in strongly positive net absorption during third quarter on the order of 125,000 square feet as signed and pending expansions are enacted. From a purely office space standpoint, the finalization of Progress Energy's merger with Charlotte-based Duke Energy was a non-event due to the steps Progress took in mid-2011 to sublease the entire 150 East Davie building, formerly Two Progress Energy Plaza, to Red Hat, which then subleased some of its Centennial Campus space to Bandwidth.com. At the time of the announcement of Progress Energy's downsize in 2011, no one could have imagined that the move would result in a net neutral office market effect in a little over a year, but the Triangle's strong companies are a constant reminder not to underestimate this market's fundamentals.

## SUBMARKET MAP



### ABOUT LINCOLN HARRIS

Lincoln Harris, an affiliate of Lincoln Property Company, is a full-service corporate real estate company focused on development, commercial brokerage, corporate real estate services, retail services, land services, project services, property management and asset management. Based in Charlotte, NC, Lincoln Harris has twenty-three service offices across the country.

More information about Lincoln Harris can be found at [www.lincolnharris.com](http://www.lincolnharris.com).

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