

OFFICE

Washington, DC Metropolitan Area Market Review

District of Columbia, Northern Virginia, and Suburban Maryland

Third Quarter 2007

Washington, DC Metropolitan Area market indicators describe a market that remains robust, though it is not seeing the hurried growth that was occurring, even one year ago. Demand drivers are holding steady, keeping vacancy barely under equilibrium and supporting another year of strong rent growth.

METROPOLITAN AREA SUMMARY

The Washington, D.C Metropolitan Area office market remains healthy as steady employment growth and solid rent increases drive the metropolitan area. Though tenant demand picked up speed in 2006 resulting in decreased vacancy rates, a slowdown in leasing activity, during the third quarter of 2007, was a result of a dwindling job growth rate. Consequently, vacancy increased to 9.7 percent at the end of the third quarter, up twelve months ago from 8.5 percent. According to Dr. Stephen Fuller, Chief Economist, the DC Metro Area job growth rate will decrease to 44,500 new positions in 2007 from a 2006 growth rate of 47,200 positions. Reduced demand has resulted in vacancy rates increasing to 11.0 percent in Northern Virginia and 11.9 percent in Suburban Maryland. Vacancy in the District has remained relatively stable over the last year at 6.6 percent.

Commercial real estate in the Washington area continues to demand high rents, but an increase in vacancies and a slowdown in sales is a sign of a decrease in momentum. Office space demand slowed as the federal government reduced spending on contractors and several buildings in Northern Virginia were delivered fully vacant or only partially leased during the third quarter.

During this time when the leasing momentum has slowed down its steady pace, construction activity still remains robust. An additional 3.0 million square feet is scheduled to deliver by the end of 2007, which includes 1.1 million square feet in Northern Virginia, 1.1 million square feet in the District of Columbia, and 854,386 square feet in Suburban Maryland. Overall, there are 66 buildings in the Washington, DC Metro area under construction/renovation

totaling 12.3 million square feet. Among trends in new development, more condominiums are being planned in the Washington area, particularly medical condos. Doctors are finding that purchasing condo space allows them more flexibility and more time to build a professional reputation in the area. And, health care providers desire the option of being able to control their investment for the long term, given the increasing costs of construction and of building out medical space.

Condominium developments currently underway include Lowe Enterprises/Potomac Development's project at 2021 L Street. The developer is adding two stories to the eight-story downtown office building, with plans to convert the building into office condominiums. As much as a third of the condo purchasers could be health care providers, as George Washington University Hospital is in close proximity to the building.

The rise in construction costs are continuing to drive average rents up throughout the District and the neighboring suburbs. At the end of the third quarter, the area's average rent per square foot for office space was \$33.19 per square foot, an increase from \$32.41 per square foot, a year earlier.

OUTLOOK

The mayhem in financial markets is likely to cause a slowdown in economic growth and raise the risk of recession. Job growth and leasing activity still remain steady, but have dwindled over the past year. Concessions are also being trimmed.

The pace at which buildings have been leasing has slowed even as a large number of new buildings are about to come on line.

Market ^{Up} Close

- The third quarter vacancy rate for the region was 9.7 percent, up from 8.5 percent during the same period a year earlier.
- Office space demand slowed as the federal government reduced spending on contractors and several buildings in Northern Virginia were delivered fully vacant.
- The area's average rent per square foot for office space was \$33.19, an increase from \$32.41 per square foot, a year earlier.
- The mayhem in financial markets is likely to cause a slowdown in economic growth and raise the risk of recession.

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METROPOLITAN AREA MARKET STATISTICS

Office Markets	No. of Bldgs	Rentable Inventory (SF)	Avail. Vacant Space (SF)	Direct Vacancy	Vacancyw/Sublet	Class A FS Rent	Class B FS Rent	YTD Net Absorption	*Under Construction	% UC Leased
District of Columbia	608	107,408,239	7,041,571	5.9%	6.6%	\$46.53	\$41.11	2,783,470	5,396,458	24.2%
Suburban Maryland	779	67,416,253	8,003,067	10.2%	11.9%	\$28.88	\$24.27	151,405	1,540,983	24.5%
Northern Virginia	1,295	140,763,004	15,457,146	9.5%	11.0%	\$31.87	\$27.87	108,087	5,339,232	34.6%
Metropolitan Area	2,682	315,587,496	30,501,784	8.4%	9.7%	\$34.28	\$30.44	3,042,962	12,276,673	28.8%

* Includes Under Renovation

Overall construction activity will slow to meet current demand levels in the Washington, D.C metro region. But office market conditions will remain solid within the Beltway, particularly within the always bustling East End submarket and the Rosslyn Ballston Corridor.

THE DISTRICT OF COLUMBIA

Vacancy rates remained stable over the last quarter at 6.6 percent, up only slightly from a second quarter rate of 6.3 percent in the District. As was the case throughout the metropolitan area, rents increased through the third quarter of 2007, making it a lucrative time for landlords and a tough time for tenants looking for new space, particularly in Class "A" buildings. Average rents in the District increased to \$43.71 per square foot from \$42.06 per square foot, just twelve months ago. But, despite rising rates, law firms are not even blinking an eye at the close to \$80 rents the District is seeing in some of its submarkets.

While the government and government contractors seek the best economical options, law firms and lobbyists are still scrambling for amenity-rich "trophy" build-

ings in the Central Business District, East End, and West End. Perhaps, one of many reasons, rents in first-class buildings are at an all-time high.

Third quarter leasing activity included international law firm Cleary Gottlieb's renewal and expansion at George Washington University's 2000 Pennsylvania Avenue, NW office building in the Central Business District. Cleary Gottlieb will occupy 144,000 square feet under the new lease, an expansion of more than 30,000 square feet. The law firm of Morrison & Foerster is headquartered at the property.

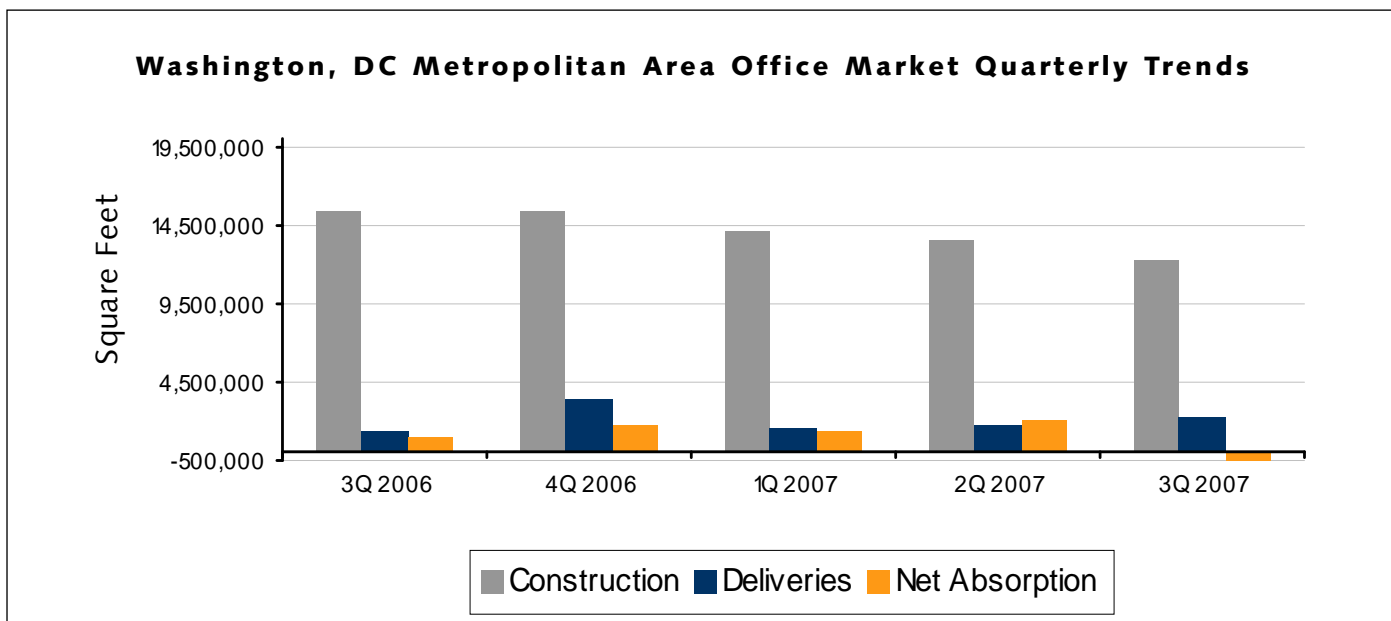
Law firm activity continued with Locke Liddell & Sapp's sublease of 30,000 square feet from Sprint Communications. The firm will move to the Market Square North office building in the East End, located at 401 9th Street, NW. The lease runs through February 2010.

Despite an overall slowdown in leasing activity by the Washington, DC government in recent months, the United States Immigration and Customs Enforcement (ICE) leased an additional 26,274 square feet at 1400 L Street NW, bringing its total

occupancy in the 169,500 square foot office building to 140,500 square feet. Furthermore, ICE signed for 90,196 square feet at 500 12th Street, in addition to the 403,000 square feet the firm already occupies in the building.

In Uptown, mortgage finance giant Fannie Mae expanded and renewed its lease to occupy all of the office space at its headquarters complex. The 53,158 square foot expansion increases the firm's occupancy to 417,000 square feet at 4000 Wisconsin Avenue, NW. As part of the new lease, Fannie Mae will convert about 32,000 square feet of ground-floor space to a new conference facility.

As of the close of the third quarter, the Washington, DC office market remained strong, but it's hard to assume that the market will absorb all the new development that is now scheduled to deliver over the next few years, which include the areas along the Potomac and Anacostia waterfronts. The third quarter ended with 5.4 million square feet under construction/renovation and a prelease rate of only 24.2 percent.



DISTRICT OF COLUMBIA SUBMARKET STATISTICS

Office Markets	No. of Bldgs	Rentable Inventory (SF)	Avail. Vacant Space (SF)	Direct Vacancy	Vacancy w/Sublet	Class A FS Rent	Class B FS Rent	YTD Net Absorption	*Under Const	% UC Leased
Central Business District	199	31,896,818	1,440,745	3.8%	4.5%	\$48.09	\$41.68	(94,478)	981,348	26.4%
East End	185	38,334,150	2,520,004	6.1%	6.6%	\$47.61	\$41.69	1,549,545	2,331,400	32.1%
Capitol Hill (NE/NoMa/SE)	70	14,206,693	1,025,334	6.7%	7.2%	\$43.89	\$42.63	1,402,790	2,083,710	14.4%
Southwest	33	10,074,899	1,040,115	10.2%	10.3%	\$47.46	\$43.31	200,718	0	-
West End/Georgetown	48	6,290,630	739,909	9.5%	11.8%	\$42.93	\$41.98	(246,998)	0	-
Uptown	73	6,605,049	275,464	3.3%	4.2%	\$43.01	\$29.95	(28,107)	0	-
District of Columbia	608	107,408,239	7,041,571	5.9%	6.6%	\$46.53	\$41.11	2,783,470	5,396,458	24.2%

* Includes Under Renovation

Among third quarter ground breakings, Tishman Speyer started construction on two office towers, 1100 and 1150 First Street, NE in the North of Massachusetts (NoMa) submarket. Each 12-story building will encompass 350,000 square feet of space. The first phase of construction is expected to be completed in April 2009. Tishman Speyer bought the land, the block at the corner of First Street NE and L Street NE, a year ago from J Street Development for \$60 million. Timing of the second phase of construction will depend on the pace of leasing on the first tower. The goal is to find a government or a private sector tenant that would occupy the whole building or even lease out both buildings. The new buildings would make it attractive to government clients looking to rent at more affordable rates.

In the neighboring market of Capitol Hill, demand for space is huge, fueled in part by the development of the Waterfront and baseball stadium. Among the projects in the planning stages, Opus East LLC will develop a \$180 million office building at 1015 Half Street, SE. The company will start construction on the 10-story, 400,000 square foot building in October, which will front L, Half and K streets. Opus East plans to apply for Silver LEED certification when the building is complete in late 2009, which will attract a higher caliber of tenants. The building is now one third leased to Parsons Corp., a worldwide engineering and construction company.

As mentioned previously, condo development has become a popular trend in the District in recent months. The District has never had much of a healthy office condo market. Now, though, there are little signs that change is ahead. The lack of available developable space and the strong interest among investors in Washington, DC has thwarted the growth of the office condo market. For the small business owner look-

ing to invest in a property, the options have been minimal. Many of the smaller buildings in the District, especially the Central Business District, are getting renovated and offered as "space for lease" instead. So, the condo provides an attractive option for small business owners.

Among the most recent condominium developments are Potomac Development Partners' and Lowe Enterprises' redevelopment of the NFL Players Association headquarters, a 53,925 square foot building at 2021 L Street, into office condos that will deliver in August 2008. Another example is 20 F Street, NW, now a parking lot in Capitol Hill. The American College of Surgeons plans to develop a 10-story, 165,000 square foot office building in which it will occupy part of the building and offer the additional space as office condominiums. Completion is slated for late 2009. This is one of the last development sites in Capitol Hill. Also, Qatar Airways is finalizing plans for the build-out of the office condo it recently acquired in the District. The company, which is the country's national carrier, acquired 12,652 square feet at 1430 K Street, which will serve as its headquarters for North America and as a base to establish a larger real estate presence in the United States. Construction should begin by the end of the year with the space ready for occupancy at some point in the first quarter of 2008. Other projects planned for condo development are 1510 H Street, 111 K Street and 100 K Street.

SUBURBAN MARYLAND

In Suburban Maryland, vacancy rates increased significantly during the third quarter, increasing to 11.9 percent from a second quarter rate of 10.7 percent, and a third quarter 2006 rate of 10.2 percent. And, as was the trend in the District and

Northern Virginia, rents increased to \$26.20 per square foot from \$25.40 per square foot, just twelve months ago.

A dip in leasing activity, the US Census Bureau's vacancy of 95,000 square feet in Prince George's County, and the delivery of a fully vacant, 220,000-square-foot building at 805 King Farm Boulevard in North Rockville, resulted in the increase in vacancy during the third quarter. Other contributing factors to the increase in vacancy included US Pharmacopeia's move from 42,033 square feet in Rockville and Broadsoft Inc's decision to put 30,000 square feet up for sublease in Gaithersburg.

Despite the increase in vacancy, leasing activity was steady in pockets of Suburban

SIGNIFICANT TRANSACTIONS

District of Columbia:

- Fannie Mae expanded and renewed its lease to occupy all of the office space at its Washington, D.C. headquarters complex. The 53,158-square-foot expansion increases the firm's occupancy to 417,000 square feet at 4000 Wisconsin Avenue, NW.
- The Peace Corps renewed for 162,764 square feet at 1111 20th Street, NW in the Central Business District.
- Clearly Gottlieb signed a renewal/expansion for 143,489 square feet at 2000 Pennsylvania Avenue, NW in the Central Business District.
- Computer Sciences Corporation renewed for 125,000 square feet at 1201 12th Street, SE in Southeast, DC.
- United States Immigration and Customs Enforcement signed for an additional 90,196 square feet at 500 12th Street, SW in Southwest, DC, bringing their total to 493,196 square feet.

SUBURBAN MARYLAND SUBMARKET STATISTICS

Office Markets	No. of Bldgs	Rentable Inventory (SF)	Avail. Vacant Space (SF)	Direct Vacancy	Vacancy w/Sublet	Class A FS Rent	Class B FS Rent	YTD Net Absorption	*Under Const	% UC Leased
Frederick County/City										
Total Frederick Co./City	48	2,719,179	163,078	5.9%	6.0%	\$24.42	\$19.30	491,567	113,800	0.0%
Montgomery County										
Bethesda/Chevy Chase	81	9,538,949	659,269	4.9%	6.9%	\$39.00	\$30.36	83,127	0	-
North Rockville/Shady Grove	101	9,709,559	1,378,967	12.1%	14.2%	\$30.60	\$24.92	(13,497)	0	-
North Bethesda/Potomac	69	8,585,574	960,369	9.9%	11.2%	\$31.94	\$28.85	89,658	187,000	0.0%
Rockville	65	6,422,606	518,963	7.5%	8.1%	\$30.25	\$26.57	(154,635)	622,099	12.7%
Silver Spring/Takoma Park	54	5,299,785	351,504	5.3%	6.6%	\$30.70	\$24.64	(95,131)	0	-
Gaithersburg/Olney	47	2,962,861	622,164	15.8%	21.0%	\$25.33	\$20.78	(198,430)	0	-
Germantown/Clarksburg	32	2,606,416	312,747	9.6%	12.0%	\$23.61	\$23.05	97,228	0	-
North Silver Spring/Route 29	30	1,415,598	101,898	5.9%	7.2%	\$25.16	\$23.04	(31,506)	79,322	0.0%
Kensington/Wheaton	24	1,275,980	48,055	3.6%	3.8%	\$25.28	\$24.73	(9,603)	0	-
Total Montgomery County	503	47,817,328	4,953,936	8.6%	10.4%	\$31.53	\$25.88	(232,789)	888,421	8.9%
Prince George's County										
Northern Market	108	8,864,557	1,398,076	13.5%	15.8%	\$23.89	\$19.43	180,318	388,762	69.1%
Central Market	79	5,906,444	1,128,296	17.8%	19.1%	\$25.86	\$20.38	(263,631)	0	-
Southern Market	41	2,108,745	359,681	16.2%	17.1%	\$22.83	\$20.22	(24,060)	150,000	20.0%
Total Prince George's Co.	228	16,879,746	2,886,053	15.3%	17.1%	\$24.41	\$19.73	(107,373)	538,762	55.5%
Suburban Maryland	779	67,416,253	8,003,067	10.2%	11.9%	\$28.88	\$24.27	151,405	1,540,983	24.5%

* Includes Under Renovation

SIGNIFICANT TRANSACTIONS

Suburban Maryland:

- Sodexho Inc. renewed for 109,072 square feet at 9801 Washingtonian Boulevard in Gaithersburg.
- Raytheon leased 98,815 square feet at 5700 Rivertech Court in College Park. The tenant will move from 1616 McCormick Drive in Landover, Maryland.
- Abt Associates Inc. will consolidate from 4800 Montgomery Avenue to the Air Rights North building in Bethesda, where it renewed its 30,794-square-foot occupancy and expanded to a new total of 92,186 square feet.
- United Communications Group leased 70,781 square feet at 9737 Washingtonian Boulevard in Gaithersburg.
- CapStar Radio Operating Company leased 63,038 square feet at 1801 Rockville Pike in Rockville.

Maryland. For example, third quarter lease signings included government and business consulting firm Abt Associates Inc's consolidation, totaling almost 100,000 square feet in Bethesda. Abt assigned its five-floor occupancy in the Hampden Square building, at 4800 Montgomery Avenue, to American Capital Services, which will occupy the 61,342 square foot space in two phases. American Capital will partially occupy the space in November and move into the remaining space in April of 2008. The lease term runs through September 2012. Abt Associates Inc. will consolidate from Hampden Square to the nearby Air Rights North building, where it renewed its 30,794 square foot occupancy and expanded onto the fourth and fifth floors for a new total of 92,186 square feet. The renewal runs through 2018. Tenants in the future Abt space will vacate by December 1, when tenant build-out will commence. Occupancy is scheduled for next April.

With the consistent increase in vacancy over the last twelve months, it cannot be ignored that the only building to deliver

during the third quarter was entirely vacant at the time of delivery. And, despite the fact that 1.5 million square feet is under construction with a prelease rate of only 24.5 percent, there are still many projects in the planning stages. For example, Washington Property Co. recently announced their plans to develop Washingtonian South, a 7.5 acre, \$100 million twin office tower site. Plans call for the development of two eight-story office buildings, the first of which will be approximately 200,000 square feet with construction slated to begin this fall and delivery expected during the first quarter of 2009. The second building is planned to be 150,000 square feet. Phase II is expected to begin during the fourth quarter of 2007.

In Montgomery County, vacancy rates ended the third quarter at 10.4 percent, up from a second quarter rate of 9.6 percent and a third quarter 2006 rate of 9.2 percent. Though vacancy rates have increased consistently over the last twelve months in Montgomery County, tenant activity still remains steady. For example, defense con-

WASHINGTON, DC METROPOLITAN AREA OFFICE MARKET REVIEW THIRD QUARTER 2007

NORTHERN VIRGINIA SUBMARKET STATISTICS

Office Markets	No. of Bldgs	Rentable Inventory (SF)	Avail. Vacant Space (SF)	Direct Vacancy	Vacancy w/Sublet	Class A FS Rent	Class B FS Rent	YTD Net Absorption	*Under Const	% UC Leased
ALEXANDRIA										
Old Town Alexandria	88	5,998,989	495,885	6.7%	8.3%	\$35.84	\$28.31	62,714	0	-
Eisenhower Avenue/I-395	48	7,669,466	348,143	4.0%	4.5%	\$28.73	\$25.00	(62,559)	348,000	43.1%
Total Alexandria	136	13,668,455	844,028	5.2%	6.2%	\$33.72	\$27.34	155	348,000	43.1%
ARLINGTON COUNTY										
Rosslyn/Ballston Corridor	105	19,343,120	1,371,404	5.9%	7.1%	\$36.04	\$34.58	175,869	1,045,493	94.2%
Crystal City/Pentagon City	57	13,142,243	1,833,950	13.2%	14.0%	\$36.23	\$33.98	(164,612)	202,234	0.0%
Total Arlington County	162	32,485,363	3,205,354	8.8%	9.9%	\$36.13	\$34.31	11,257	1,247,727	79.0%
FAIRFAX COUNTY										
Tysons Corner/McLean/Vienna	189	24,368,520	2,506,435	8.3%	10.3%	\$32.77	\$27.85	(296,514)	323,698	0.0%
Reston	125	14,278,553	1,373,912	8.3%	9.6%	\$32.50	\$25.00	107,958	1,017,109	27.5%
Herndon	96	10,345,317	1,352,131	11.7%	13.1%	\$32.35	\$24.89	121,594	812,808	2.6%
Route 28 Corridor South	102	9,604,966	1,908,300	19.3%	19.9%	\$29.95	\$24.85	378,700	787,014	33.8%
Merrifield	61	6,241,976	423,755	4.9%	6.8%	\$30.92	\$28.37	(116,286)	183,700	0.0%
Fairfax Center	56	6,581,311	725,412	6.7%	11.0%	\$29.76	\$24.27	(271,793)	0	-
Annandale/Falls Church/I-395	58	5,833,688	591,390	9.5%	10.1%	\$29.26	\$24.81	(32,786)	0	-
Springfield/Burke/Route 1	62	3,991,964	460,800	10.4%	11.5%	\$28.52	\$23.30	2,035	0	-
Fairfax City/Oakton	59	3,572,591	286,930	6.9%	8.0%	\$27.33	\$22.51	9,412	0	-
Total Fairfax County	808	84,818,886	9,629,065	9.7%	11.4%	\$30.78	\$26.03	(97,680)	3,124,329	18.1%
LOUDOUN COUNTY										
Route 28 Corridor North	64	4,406,781	1,007,678	19.3%	22.9%	\$25.38	\$21.40	31,980	358,357	0.0%
Leesburg/Route 7 Corridor	38	2,039,281	223,362	8.4%	11.0%	\$26.09	\$23.44	110,547	237,219	51.3%
Total Loudoun County	102	6,446,062	1,231,040	15.9%	19.1%	\$25.46	\$21.52	142,527	595,576	20.4%
PRINCE WILLIAM COUNTY										
Total Prince William Co.	87	3,344,238	547,659	15.0%	16.4%	\$26.03	\$21.71	51,828	23,600	100.0%
NORTHERN VIRGINIA	1,295	140,763,004	15,457,146	9.5%	11.0%	\$31.87	\$27.87	108,087	5,339,232	34.6%

* Includes Under Renovation

tractor BAE Systems of Rockville is looking around Montgomery County for a place to build a 400,000 square foot campus as part of an office space consolidation. The tenant is exploring options involving BAE's headquarters at 1601 Research Boulevard. One possibility could be to consolidate the operations in Montgomery County at a new campus. The move is driven by the 2011 lease expiration at BAE's undersea warfare business offices, headquartered in Aspen Hill. The three-story building, which dates to 1957, is antiquated and left over from when BAE absorbed the former Vitro Corp. operations in 1999. BAE occupies more than 800,000 square feet of space in

four buildings in Montgomery County and two in Northwest Washington, all of which might be consolidated to one location.

At a 17.1 percent vacancy rate, rates in Prince George's County are high, increasing over two percentage points in the last three months. Contributing to the increase in vacancy was the US Census Bureau's vacancy of 95,000 square feet at 8905 Presidential Parkway in the Pennsylvania Avenue Corridor, followed by NASA's vacancy of 28,000 square feet and Lockheed Martin's vacancy of 15,000 square feet in Greenbelt.

With little demand, development activity has remained minimal in the county, particularly in the north side of the county. However, a 2,200 -acre project and a chance to overhaul a heavily traveled corridor are making the northern part of the county an attractive area for developers and county planners.

The 40-square-mile area that borders Montgomery and Anne Arundel counties is slated for redevelopment, specifically along the Route 1 corridor. The changes would also correspond with a project to develop a town center, called the Konterra project, on the county's north side. Currently, Route 1

INVESTMENT SALES TRENDS

Market/Building Class	Year End 2004	Year End 2005	Year End 2006	YTD 2007
DISTRICT OF COLUMBIA				
Class "A" (Avg. \$ PSF RBA)	\$397.45	\$459.00	\$488.00	\$497.00
Class "B" (Avg. \$ PSF RBA)	\$279.98	\$349.00	\$360.00	\$404.00
Total No. of Transactions	50	47	57	43
Total Sales (in millions \$)	\$3,738.0	\$3,667.8	\$5,851.1	\$3,522.3
SUBURBAN MARYLAND				
Class "A" (Avg. \$ PSF RBA)	\$234.78	\$238.00	\$271.00	\$254.00
Class "B" (Avg. \$ PSF RBA)	\$168.57	\$194.00	\$191.00	\$189.00
Total No. of Transactions	29	36	38	23
Total Sales (in millions \$)	\$874.50	\$1,636.4	\$1,665.9	\$802.9
NORTHERN VIRGINIA				
Class "A" (Avg. \$ PSF RBA)	\$227.38	\$295.00	\$302.00	\$380.00*
Class "B" (Avg. \$ PSF RBA)	\$161.73	\$222.00	\$260.00	\$389.00*
Total No. of Transactions	50	82	107	95
Total Sales (in millions \$)	\$1,694.50	\$4,009.5	\$5,749.7	\$6,969.1
TOTAL REGIONAL SALES				
Total No. of Transactions	129	165	202	161
Total Sales (in millions \$)	\$6,307.0	\$9,313.8	\$13,266.7	\$11,293.3
INTEREST RATE TRENDS				
10-Year Treasury Rate	4.24%	4.39%	4.71%	4.63%

* portfolio sales aided in skewing price per square foot averages among class distinctions

SIGNIFICANT TRANSACTIONS

Northern Virginia:

- Volkswagen of America is moving its headquarters to Herndon. The news is a setback for Michigan, who has been struggling to keep the state's economy afloat. The automaker's U.S. division will fully occupy Woodland Pointe, a 184,000 square foot office building, which was completed during the third quarter.
- The College Board signed a lease for 120,000 square feet in the Reston Town Center. At the time of this writing, construction had not commenced on the proposed building.
- SRA International signed a renewal for 106,138 square feet at 8260 Willow Oaks Corporate Drive in Merrifield.
- IBM signed a renewal/expansion for 103,937 square feet at 2733 Crystal Drive in Crystal City.

is characterized by a number of commercial strip properties, as it used to be an old road for transporting people from Baltimore to Washington, DC. The Konterra project would help to give Route 1, more of a "Main Street" feel. The 488 acre town center is planned to include 1.5 million square feet of retail space, 3.8 million square feet of office space, 4,500 residential units and 600 hotel rooms. It is hoped that a fresher look and new development plans along this antiquated corridor will help to spur further demand in Prince George's County.

NORTHERN VIRGINIA

Vacancy rates continued to climb through the third quarter in Northern Virginia, resultant of the rise in speculative building, particularly along the Route 28 South Corridor in Fairfax County. Rates increased well over equilibrium to 11.0 percent at the close of the third quarter, up from a second quarter rate of 10.3 percent and a third quarter 2006 rate of 9.3 percent. Though Northern Virginia still continues to see

healthy leasing activity in pockets of the region, it is not enough to keep up with the new supply. Nevertheless, developers continue to deliver vacant buildings, with no signs of leasing activity.

Northern Virginia has also seen a decrease in the number of government contracts awarded, which in turn, has slowed down the steady pace of government leasing activity that the region has seen over the last year. Following the September 11, 2001 attacks, the federal government and its defense contractors began rapidly leasing up new office space in Northern Virginia. Today, their eagerness has faded, due to budget controls. Though the defense industry continues to expand its presence in Northern Virginia, as evidenced by third quarter lease signings by the Central Intelligence Agency for 81,085 square feet in Tysons Corner and Aerospace Corporation for 60,578 square feet in the Route 28 South Corridor, the defense sector no longer dominates the list of the largest transactions in the region. For example, one of the largest leases signed during the

SALES COMPARABLES

Property Address	Submarket	Sales Price	Sq. Ft.	\$PSF	Buyer (Comments)
DISTRICT OF COLUMBIA					
2001 Pennsylvania Avenue, NW	CBD	\$111,500,000	150,171	\$707	Louis Dreyfus Property Group (100% occupied)
1229-1231/1227 25th Street, NW	West End	\$111,000,000	346,928	\$320	Vornado (part of a 1031 Exchange)
1150 18th Street, NW	CBD	\$57,500,000	171,310	\$336	Joss Realty Partners (100% occupied)
2021 L Street, NW	CBD	\$23,420,000	53,925	\$434	Lowe Enterprises (26.0% occupied)
SUBURBAN MARYLAND					
6901/6903/6905 Rockledge Drive	North Bethesda	\$280,500,000	680,941	\$412	Prudential Real Estate Inv. (64.1% occupied)
1445-1455 Research Blvd.	North Rockville	\$60,300,000	225,245	\$268	TA Associates Realty (82.0% occupied)
7474/7500 Greenway Center Dr	Greenbelt	\$58,000,000	342,000	\$170	Cambridge Property Group (77.8% occupied)
1390 Piccard Drive	Rockville	\$16,600,000	108,000	\$154	Washington Property Co. (Vacant)
14401 Sweitzer Lane	Laurel	\$15,000,000	40,377	\$372	Trillon LLC (100% occupied)
704 Quince Orchard Road	Gaithersburg	\$14,250,000	77,000	\$185	Crown West Realty (100% occupied)
NORTHERN VIRGINIA					
10780-10790 Parkridge Blvd.	Reston	\$140,000,000	513,552	\$273	Penzance Cos. (93.3% occupied)
2980 Fairview Park Drive	Merrifield	\$105,000,000	333,402	\$315	Tennessee Consolidated Retirement
950 North Glebe Road	Ballston	\$102,916,143	250,000	\$412	Morgan Stanley (34.6% occupied)
1801 South Bell Street	Crystal City	\$100,000,000	281,087	\$356	BNA (part of a 1031 Exchange)
15020/15030 Conference Ctr. Dr.	Route 28 South	\$78,500,000	312,081	\$252	Pitcairn Cos. (Vacant)
13857 McLearn Drive	Route 28 South	\$47,000,000	202,992	\$232	ING Clarion (Vacant)
15050 Conference Center Drive	Route 28 South	\$45,650,000	141,630	\$322	Prudential Real Estate Investors (100% occupied)
3080 Centreville Road	Route 28 South	\$29,700,000	94,176	\$315	Oliver Carr Co. (100% occupied)
14100 Park Meadow (2 Properties)	Route 28 South	\$26,250,000	130,060	\$202	UBS Realty Investors (52.2% occupied)

third quarter was by the German automaker, Volkswagen of America.

Volkswagen of America will move its headquarters to Herndon, as part of a new corporate strategy to overhaul its sagging auto business. The company will bring 400 jobs to the region and invest more than \$100 million to set up operations in a new office building in Woodland Park. The move is part of a corporate restructuring that would eliminate 400 positions, leaving 600 employees and contractors in Auburn Hills, Michigan, outside of Detroit. About 150 people in Detroit are expected to move to Herndon, including much of the corporate leadership. The news is a setback for Michigan, who has been struggling to keep the state's economy afloat as its manufacturing base declines. The German automaker's U.S. division will fully occupy a six-story office building in Herndon. Known as Woodland Pointe, the 184,000 square foot facility was completed during

the third quarter. Volkswagen plans to move to its new location in March of 2008.

Other notable transactions, signed during the third quarter, included The College Board's 120,000 square foot lease at a newly proposed building in Reston Town Center and Comscore's lease for 70,000 square feet at 11950 Democracy Drive, also in Reston, which is expected to deliver in 2008. Furthermore, new tenants to Northern Virginia include a Dutch software company, Bell ID, which signed a 34,000 square foot lease at 2325 Dulles Corner Boulevard in Herndon. Bell ID, which has Boeing Co. and Hewlett Packard Co. as partners, plans to increase its corporate identification and banking businesses in the United States. Based in the Netherlands, this will be Bell ID's first office in the United States

The news of Volkswagen, The College Board and Comscore's recent transactions is

a huge plus for the Dulles corridor market, as the signs of weakening in this market have been increasingly apparent in recent months. In Herndon alone, the vacancy rate is up to 13.1 percent from 11.5 percent in the past year, with nearly 813,000 square feet under construction. And, in Reston, the vacancy closed the third quarter at 9.6 percent, up only slightly from 9.2 percent, just three months ago. No doubt, these recent transactions will help to reduce vacancy rates, as each tenant occupies their new office. It is also hoped that Volkswagen's move will spur further activity among the automotive industry and that firms headquartered outside of the United State's and considering a United State's presence, such as Bell ID, will encourage other firms to consider Northern Virginia as a viable option.

With 5.3 million square feet under construction/renovation in Northern Virginia, preleasing levels remain at a minimum at

34.6 percent, despite a number of projects still in the planning stages. Most of the new projects are concentrated in the sub-markets of Reston/Herndon and Route 28 South. The average rent per square foot in Northern Virginia was \$30.41 per square foot at the close of the third quarter, up from \$29.29, just twelve months ago.

Vacancy in Arlington County has remained relatively stable since the second quarter of 2007, increasing only slightly to 9.9 percent from a second quarter rate of 9.8 percent. However, vacancy has increased steadily over the last year from 8.7 percent. With the continued increase in rental rates, resultant of increased construction costs, leasing activity has recently tapered off in Arlington County. Average rates increased to \$35.22 per square foot and in many cases are now exceeding \$40.00 per square foot. Furthermore, the federal government's reduced spending on contractors have played a significant role in the slowdown in leasing activity, as Arlington is home to many government tenants and their contractors.

In the City of Alexandria, vacancy rates increased only slightly to 6.2 percent from a second quarter rate of 5.8 percent. Though there were a handful of small blocks that were vacated during the third quarter, Samueli Institute's absorption of 27,008 square feet at 1737 King Street aided in keeping vacancy rates from increasing further. Additionally, leasing activity remained steady with the signing of Grant Thornton's lease for 78,624 square feet at 333 John Carlyle Street and the Institute for Defense Analysis' lease for 33,960 square feet at 4900 Seminary Road.

Vacancy rates in Fairfax County increased the most dramatically, among the five counties, closing the third quarter at 11.4 percent from a second quarter rate of 10.4 percent. Contributing to the significant increase in vacancy was LCC, Inc's vacancy of over 100,000 square feet at 7925 Jones Branch Road in Tysons Corner. The company downsized substantially, signing their latest lease for 25,000 square feet at 7900 Westpark Drive. Another large vacancy was Lockheed Martin's move from 82,000 square feet at 12355 Sunrise Valley Drive in Reston, as a result of a consolidation to other area offices.

Despite some notable vacancies, the largest contributing factor to the increase in vacancy in Fairfax County was the 1.1 million square feet that delivered during the third quarter, with the occupancy rate in those

buildings at only 16.2 percent. Though Apptis, Inc's occupancy of 105,833 square feet in the Route 28 South Corridor aided in keeping vacancy rates from increasing further, the new supply in Herndon and Route 28 South surpassed third quarter occupancies, thus increasing the vacancy rate in Fairfax County.

There are also many projects still in the planning stages in Fairfax County, despite the fact that vacancy rates have surpassed equilibrium. For example, it was during the third quarter that the US Army announced it's decision to tear down an empty General Services Administration warehouse near the Franconia-Springfield Metro station to build offices. The decision is the basis of a proposal that would radically ramp back the move of 22,000 jobs to Fort Belvoir as part of the Pentagon's 2005 base closure and realignment recommendations. The relocated jobs are part of a nationwide redirecting of Army employees and bases intended to comply with tighter security guidelines established after the terrorist attacks of September 11, 2001. The move will instead put thousands of federal workers on the 70-acre GSA site, within walking distance of the Metro. The decision to build offices surrounding the metro could transform Springfield from a mishmash of retail and fast food restaurants to an economic anchor for southern Fairfax and possibly, a destination for commerce. Resultant of the Army's announcement, some of the area's biggest developer's have already purchased land sites in Springfield, including Boston Properties, Vornado Realty Trust, and ING Clarion.

Other projects in the planning stages include additional development in the Fair Lakes Office Park in Fairfax Center. At nearly 7 million square feet, the Park is reaching the limits that were imposed on its developer, The Peterson Cos., when plans for the project were laid out in 1984. The developer's plans are to add 479,000 square feet of office space, 145,000 square feet of retail space, a 105,000 square foot hotel and 650 residential units to Fair Lakes.

Vacancy rates in Loudoun County also increased during the third quarter to 19.1 percent from a second quarter vacancy of 17.9 percent and a third quarter 2006 rate of 15.0 percent. Contributing to the increase in vacancy was Option One Mortgage's decision to put 26,213 square feet on the market for sublease at 22630 Davis Drive and First American Bank's vacancy of approximately 41,000 square

feet at 45240 Business Court. New deliveries also contributed slightly to the increase in vacancy, as there was 241,801 square feet that delivered during the third quarter, only 31.5 percent of which was occupied at the time of delivery.

Loudoun County currently has 596,000 square feet of office space under construction, with plans for additional development in the near future. For example, Orbital Sciences Corp. is planning a major expansion of its Dulles campus and will add 600 jobs during the next four years. The satellite design and manufacturing company wants to build 140,000 square feet of office space at its headquarters on the Route 28 North Corridor. The new facilities would house a variety of engineering, laboratory and manufacturing operations. Work on the first office building will start in early 2008. The expansion is expected to help Orbital keep pace with a backlog of about \$4 billion in current contracts. Orbital, which has been in Dulles since 1992, has a 77-acre campus with about 1,500 employees. When the expansion is completed sometime in 2011, Orbital will have 700,000 square feet of operations at the Dulles campus.

Of the five Northern Virginia counties, Prince William was the only county to see vacancy rates decrease during the third quarter. However, with vacancy rates closing the quarter at 16.5 percent, Prince William County still maintains the second highest vacancy rate of the Northern Virginia counties, following Loudoun County's 19.1 percent vacancy.

When compared to the surrounding Northern Virginia counties, office development activity in Prince William County has been kept to a minimum. There were no deliveries to note during the third quarter and only one building, totaling 23,600 square feet, is under construction. In the planning stages, Buchanan Partners will soon break ground on a 75,000 square foot office building, one of four properties that the company plans, as part of its Corporate Center at Heritage Hunt. Corporate Center at Heritage Hunt is located at the intersection of Interstate 66 and Route 29 in Gainesville. Altogether, the Corporate Center will deliver some 350,000 square feet of Class "A" office space.

Other notable news in Prince William County included Eli Lilly and Co's decision to seek new buyers for the site it abandoned earlier this year. The pharmaceutical giant was more than halfway into the con-

struction of an insulin-manufacturing facility in Innovation@Prince William Technology Park, when the company pulled the plug in January. Since then, there has been some question as to what will happen to the 120 acres located on Prince William Parkway and the incomplete 300,000 square foot facility situated in a campus that limits occupants to those who are involved in biotech. With concern surrounding the fact that the bulk of smaller biotech operations in the region don't need a facility as large as Eli Lilly had originally contracted, Eli Lilly has opted to sell off several parcels in various sizes. It is hoped that Eli Lilly's plan to divide up the parcels will spur further biotech activity in the county.

INVESTMENT SALES

Almost \$11.3 billion worth of office property was sold in Greater Washington in the first three quarters of this year. Though the healthy sales market remained solid through the start of the third quarter, the market has already begun to taper off as the costs of financing become more and more uncertain. Transaction volume has slowed across the board from the dizzying pace earlier this year.

Over the last six years, the Washington, DC Metropolitan Area has been one of the most sought after and active markets in the country. Since 2006, the region's average price per square foot has gone from \$325 to \$386. However, as underwriting begins to tighten and money becomes more expensive, the high sales velocity the metro area has seen over the last six years has just started to slow down its usual rapid pace. Across the Washington region and the country, there are reports of sales falling through, as investors seek a lower price.

There's no doubt that cap rates are escalating and liquidity is sluggish. Values are even starting to drop in some areas of the metropolitan area, but it's not likely that values will decrease dramatically anytime soon. The good news - if you are a buyer right now, you're not competing with a large pool of buyers. And, with the costs of financing at an all time high, an all cash offer is becoming more attractive to a seller, which reduces the chances that the buyer would need a large loan to close the deal. Accordingly, the highest offer isn't necessarily the best offer.

Buildings in the District are averaging approximately \$467 per square foot, and those in the Maryland and the Virginia sub-

urbs are averaging \$230 and \$382 per square foot, respectively. At \$3.8 billion and \$5.9 billion in sales volume during the first and second quarter's, respectively, the slow down in sales activity was apparent during the third quarter, as sales dropped to \$1.5 billion. However, it was the high volume in portfolio sales, during the first six months of the year, that contributed to the higher sales volume in the first and second quarters.

Among third quarter sales, Vornado Realty Trust closed on a 1031 exchange involving the purchase and sale of four Washington, D.C.-area buildings with The Bureau of National Affairs Inc. (BNA). In the first deal, Vornado sold the 11-story office building at 1801 South Bell Street in Arlington, Virginia, to BNA for about \$100 million. Vornado realized a net gain of \$23 million on the sale. The 281,087-square-foot property is located in the Crystal City submarket and was vacant at the time of sale. In the second deal, Vornado paid \$111 million to acquire three office buildings from BNA totaling 346,928 square feet at 1227, 1229 and 1231 25th Street, NW in the District's West End submarket. Vornado plans to redevelop the buildings at 1229 and 1231 25th Street into residential properties. BNA plans to use 1801 South Bell as its new headquarters.

Despite the slowdown in sales during the third quarter, the Washington, DC market is still the strongest-demand location in the country. At the end of the third quarter of 2007, the average sales price for an office building was \$467 per square foot, with Class "A" buildings averaging \$497 per square foot and Class "B" buildings averaging \$404 per square foot.

The trend in condominium development in the District has also spurred the pick up in condo sales. Trade associations and doctors are among the most popular buyers of condos in the District. For example, The American Education Research Association is buying the top two floors of the Class "A" 1430 K Street, NW. The American Sociological Association is buying two other floors there. The other major projects are 1616 16th Street, NW, where purchasers include the Fordham Foundation and the Jesuit Conference and J Street Development's 111 K Street, NE.

Trade associations, facing skyrocketing rents, are finding condos more and more attractive. Trade associations are often eligible for tax-exempt financing, which

shaves a couple percentage points off commercial loan rates, and because the property can be the collateral, they often don't even need a down payment. And, most importantly, the District is delighted because it helps keep associations in the city.

Among third quarter sales in the District, The NFL Players Association (NFLPA) sold its downtown Washington, D.C. headquarters, located at 2021 L Street, NW in the Central Business District, for \$23.4 million, or about \$434 per square foot. NFLPA, the union for National Football League players, relocated its operations to the eight-story office building at 1133 20th Street, NW. The buyer, Lowe Enterprises, has plans to convert the eight-story building to office condos beginning in October. The conversion is scheduled to be complete in August 2008. The building was constructed in 1969 and totals 53,925 square feet. NFLPA had occupied most of the building's space.

Also located in the Central Business District, a prominent Pennsylvania Avenue building sold for \$111.5 million. Louis Dreyfus Property Group bought 2001 Pennsylvania Avenue, NW, a 157,666 square foot office building. German institutional investors advised by Prudential Real Estate Investors sold the Class "A" building for \$707 per square foot, which is more than double the \$321.43 per square foot it traded for in 2001.

Investment activity in the suburbs also continues to be extremely competitive, though at a slightly slower pace than in recent months. However, in Suburban Maryland, the pace of investments remained minimal through the end of the third quarter, as compared to Northern Virginia. Total sales volume in Suburban Maryland closed through the end of the third quarter was \$802.9 million as compared to Northern Virginia's total sales volume of \$7.0 billion. In fact, while many investors remain interested in acquiring assets in the Suburban Maryland office market, few quality properties are available for sale. The average sales price, as of the end of the third quarter, was \$230 per square foot, with Class "A" buildings averaging \$254 per square foot and Class "B" buildings averaging \$189 per square foot.

Among third quarter sales in Suburban Maryland, TA Associates Realty acquired Research Plaza in North Rockville, a Class "A" office building for \$60.3 million. It

purchased the five-story, 225,245 square foot building from a pension fund advised by LaSalle Investment Management. The building was 82.0 percent leased at the time of sale. The building's vacancy rate, both current and future, will be one avenue by which the new buyer expects to add value to its acquisition. In 2008, the lease will expire for the building's largest tenant, Thompson Information Services, which occupies half of the space. The rent they are paying is currently below market price. The new buyer is also considering developing a bank pad site on the parking lot.

Also in the North Rockville submarket, Washington Property Co. purchased the Piccard Building, a 108,000 square foot office building at 1390 Piccard Drive for \$16.6 million, or about \$154 per square foot. The sellers were Piccard Development LLC, EDB Piccard LLC, and Douglas F. Colson. Built in 1980 and renovated in 1995, the three-story Piccard Building sits on five acres. The building was vacant at the time of sale. WPC plans to spend \$2.6 million to renovate the property. While many buyers are still focusing on acquiring stable, well-leased office projects, others, such as WPC, have shifted their attention to buying value-added properties that offer income and value appreciation and higher returns through retenanting, repositioning and the re-leasing of available space.

In North Bethesda, Boston Properties Inc. sold the Democracy Center office complex to Prudential Real Estate Investors for \$280.5 million, or approximately \$412 per square foot. Boston Properties developed Democracy Center in the 1980s. It consists of three office buildings totaling more than 680,000 square feet on Rockledge Drive, near I-270 and the Washington beltway.

In Greenbelt, Cambridge Property Group LP acquired the 350,000 square foot Maryland Trade Center complex from Washington Real Estate Investment Trust for \$58 million, or about \$165 per square foot. The property is comprised of Trade Center I, a 16-story of 184,000 square feet, and Trade Center II, a 12-story office tower consisting of 158,000 square feet. The buildings are on Greenway Center Drive near NASA Goddard Space Center. Major tenants at Maryland Trade Center are Lockheed Martin and Bank of America.

The average price per square foot in Northern Virginia paid through September 30th of 2007 rose to \$382, up from the 2006 average of \$291 per square foot.

Among third quarter sales in Northern Virginia, PS Business Parks acquired a four-building office park from Carr Properties for \$25.2 million in the Fairfax Center submarket. Called Fair Oaks Corporate Center, the Class "B" complex is 125,219 square feet and located at 11200-11216 Waples Mill Road.

Also in Fairfax Center, Long & Foster sold its 91,000 square foot headquarters to T&M Fair Oaks Venture LLC, a JV of local investors that specialize in the conversion of office buildings into condos, for \$20.3 million. Long & Foster will remain in its old headquarters, located at 11351 Random Hills Road, until work on its new facilities in the Route 28 South corridor is complete. As part of the deal, Long & Foster arranged a short-term sale leaseback with the buyer. Long & Foster occupies the entire Random Hills building. Its new location, The Ellipse at Westfields, is under construction and is expected to deliver in the first half of 2008. When Long & Foster relocates, T&M Fair Oaks Venture will convert the building into office condos.

In Merrifield, wireless network giant Verizon sold its namesake office tower to a joint venture of ING Office Fund and Tennessee Consolidated Retirement System for \$105 million, or about \$315 per square foot. Verizon is leasing back portions of the tower under a plan to vacate in stages over the next five years. It currently occupies about 84 percent of the 333,400-square-foot building. Following Verizon's departure, the joint venture plans to reposition the asset into a multi-tenant property. The sale of Verizon office tower is one of many examples of buyers shifting their focus on value-added properties, particularly during a time with when credit conditions are tight.

Though the vacancy rate in the Route 28 South market is extremely high, increasing to just below 20.0 percent at the end of the third quarter, third quarter investment sales activity in this market continued to outpace other submarkets in Northern Virginia. For example, among recent sales in Route 28 South, ING Clarion purchased a newly completed 202,992 square foot office building at 13857 McLearen Road for \$47 million from a partnership between Lincoln Property Co. and Goldman Sachs. The building was part of a two-asset portfolio sale; Lincoln Park II, a 96,920 square foot office building completed in March 2006 traded for \$22 million earlier this year.

The high sales volume in the 28 South

Corridor continued through the third quarter, as a joint venture between Pitcairn Properties and GE Real Estate acquired a newly completed office complex for \$78.5 million, or \$252 per square foot, from the Carlyle Group. The two-building, 312,081 square foot development, called Mission Ridge, was designed with the aim of leasing to government contractors. This is the closest large block of space available to the National Reconnaissance Office. Located at 15020 and 15030 Conference Center Drive, the five-story buildings incorporate advanced physical security features that meet the latest Department of Defense security standards for government and government contractor facilities.

Carr Properties, as advisors to the Oliver Carr Co., acquired an office building for \$29.7 million or \$315 per square foot, also located in the 28 South Corridor. The building, which traded in a 1031 transaction, was acquired from Falcon Real Estate Investment Co. The building has a single tenant, Cox Communications, with a 9.5 year lease that is valued around the size of the transaction. Located at 3080 Centreville Road, the Cox Communications Building is a two-story, 94,176 square foot, build-to-suit office structure that delivered in 2002.

OUTLOOK

Commercial real estate is beginning a return to its norm as an income-producing investment rather than the wildly appreciating asset class it has been this decade. The expectation is that prices will start to decrease, though it won't be anywhere near as dramatic as the fallout in the residential real estate market. Since prices are often a reflection of what people can borrow and buyers can't get the level of financing that they were able to obtain six months ago, it seems inevitable that prices will start to decline at some point in the near future.

It cannot be ignored that the tighter credit standards are an advantage to investors with ample cash right now. In other words, cash talks right now. Buyers are also remaining on the fence longer and tenants are slower to negotiate leases, waiting for the dust to settle. The wait-and-see approach will most likely be the preferred option until investors get a better sense of whether the credit crunch has created a temporary slowdown or will continue to move toward a recession. The next six to 12 months should be very interesting.

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