METRO BOSTON OFFICE MARKET

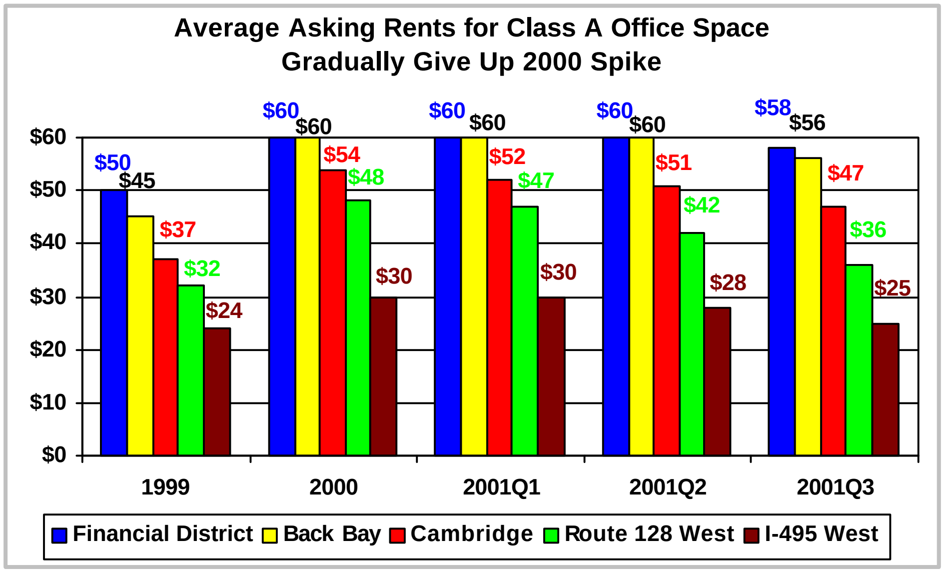
Third Quarter 2001 Report

Market Recovery Postponed

Shockwaves continue to reverberate from the terrorist attacks on the World Trade Center, the Pentagon, and other U.S. sites in September. Debates over whether or not the U.S. economy is in a recession have become moot, with the focus now on how deep and how prolonged the economic slump.

Office market statistics for the third quarter of 2001 primarily reflect market activity prior to the terrorist attacks and the subsequent war on terrorism launched by the United States in conjunction with allies around the globe. This means that the impacts of the lull in business activity throughout America following these tragic events and the gradual return to old business routines such as air travel will show up in statistics for the fourth quarter of this year and the first two quarters of 2002.

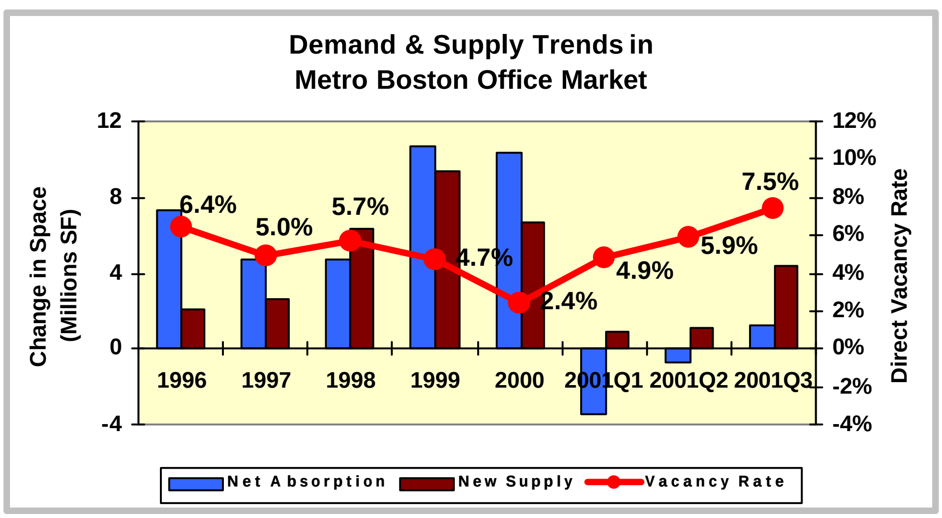
Given that office leasing activity has been very sluggish throughout 2001, the negative economic impact of the terrorist attacks is twofold. First, the period of inaction on the part of most companies regarding their real estate needs is being prolonged. Rather than gearing up for a resumption of growth in early 2002, most firms are further battening down the hatches of their enterprises to withstand an extended period of weak sales. This tactical move by most companies results in the second impact, additional space being made available for sublease by companies laying off workers and consolidating their facilities.



As the above chart illustrates, asking gross rents for office space have been gradually giving up most of the 2000 spike in rents in the suburbs while Downtown Boston landlords have tenaciously attempted to keep asking rents high. A limited supply of large blocks of space combined with concentrated institutional ownership is making this strategy possible.

Net absorption turned positive in the third quarter, but that was largely due to the practice of counting new space as becoming occupied upon completion of the building (at which point the addition to supply is also made). In general, leasing activity remained sluggish throughout all submarkets.

This process of market stabilization and repricing of asking rents is likely to continue during the next few quarters, with asking rents stabilizing around 1999 levels along I-495 and 10% above 1999 levels in the Financial District, Back Bay, and prime R128 submarkets.



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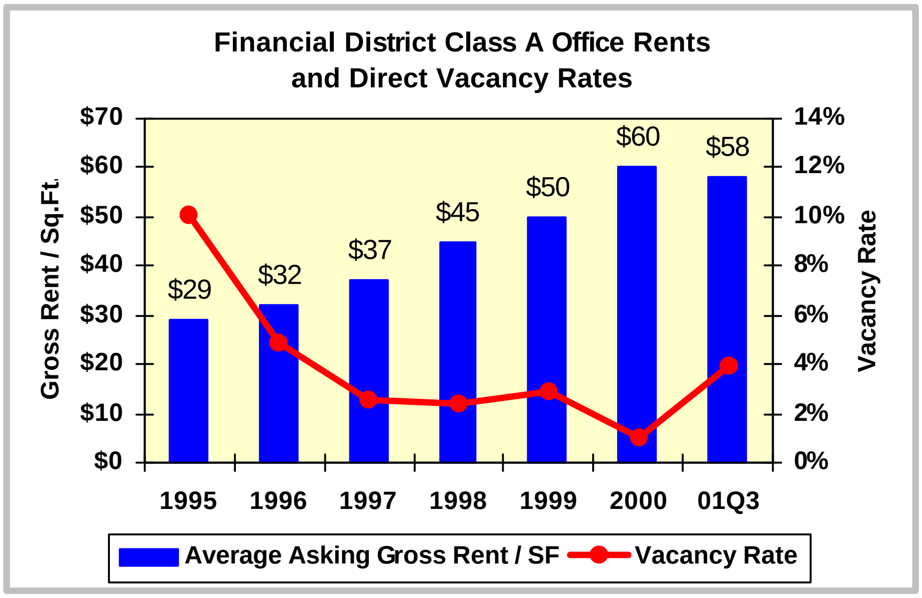
Financial District Tightens Security

Tight security is the new watchword in the Financial District (and Back Bay) as owners and tenants adjust to corporate life in the age of terrorism. Just parking your car in an underground garage now requires showing your drivers license, displaying a parking permit, and perhaps opening the trunk of your car.

With global reinsurers swearing off underwriting damage and liabilities arising from future terrorist attacks, insurance companies are quickly expanding the scope of exclusions from coverage. In some cases the inability to obtain necessary property insurance coverages may place some building owners into technical default on their mortgage loans. Required returns on "higher risk" skyscrapers and mixed-use complexes are likely to increase as investors re-evaluate the risk exposures. Operating expenses are already increasing as insurance premiums go up and security expenditures are expanded.



Tenants and their employees are also re-evaluating the pros and cons of working in the Financial District, especially in skyscrapers. The collapse of the twin towers at the World Trade Center in Manhattan confirmed the worst fears of many, namely that escape from upper floors may be impossible under some scenarios. What used to be unimaginable is now all too real. For the time being, American pride, stoicism, and existing leases are forestalling a mass exodus from the urban core. Relocation of back office operations to peripheral and suburban locations is likely to pick up speed. A tactical desire to disperse corporate facilities to increase the ability to continue operations during and following future emergencies may also result in less future growth in demand for high-rise office space than would have been the case prior to the tragic events of 9/11.

Asking rents for office space in the Financial District finally began to edge down slightly in the third quarter and further repricing may follow. Office buidling sales activity prior to 9/11 was light but healthy as buyers included Jamestown Associates (representing German investors) and Lend Lease Real Estate Investments. Demand is likely to remain active on a selective basis, with lower profile properties perhaps having greater appeal for awhile.

Upward pressure on cap rates will continue as the economy slumps and perceived risk remains higher than before. Fortunately, very low interest rates will cushion the increase, as long as insurance coverage issues can be worked out to the satisfaction of lenders and equity investors. A 4th quarter rush is unlikely this year.

Sleek 303 Congress Street has added nearly 72,000 square feet of state-of-the-art office and retail space to the historic Fort Point Channel neighborhood adjacent to the Financial District.

Back Bay Adds a New Tower

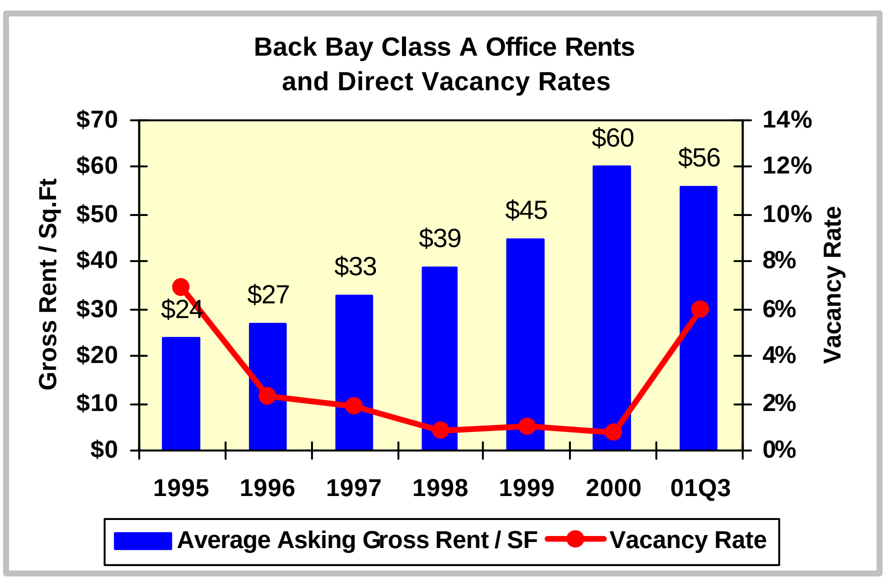
10 St. James Avenue's reign as the newest skyscraper in the Back Bay was short-lived thanks to the completion of 111 Huntington Avenue during the 3rd quarter. Boston Properties, one of the best-regarded office REITs in the nation, developed and added 111 Huntington to its portfolio of strategically-located office (and industrial) properties. The upscale retail concourse at the Prudential Center, combined with highly-rated hotels, the Hynes Convention Center, and high-rise apartment towers, offers a complete and luxurious corporate work environment. This is the essence of the American urban lifestyle.

Will the recent terrorist attacks put an end to this way of life? Very doubtful given the buzz of vibrant pedestrian activity throughout the Prudential Center and the Back Bay in recent days. Security is tight and Back Bay residents, workers, and tourists are back to enjoying a fun and exciting lifestyle.

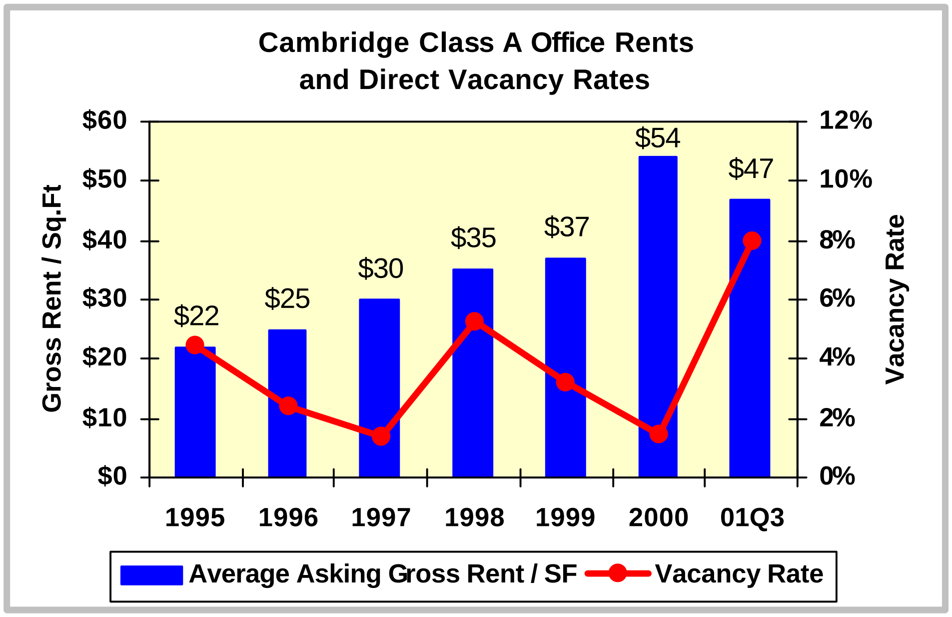
The law firm Palmer & Dodge LLP occupies over 200,000 sq. ft. at 111 Huntington Ave., with neighbors in the new tower including Bain Capital and the Federal Home Loan Bank. Several blocks to the west, Agency.com's lease of 80,000 sq.ft. at Landmark Center, 155-201 Brookline Avenue, commenced during the third quarter. In the realm of subleasing activity, Diamond Cluster began renting 13,000 sq.ft. at 10 St. James Avenue.

With demand remaining sluggish during the third quarter, some landlords lowered asking rents 5% to 10% to compete with sublease availabilities, both in the Back Bay and across the Charles River in Cambridge. On the new supply side, with most of 10 St. James Ave. and 111 Huntington Ave. leased up, there is no oversupply looming. The only office building under construction in the Back Bay at present is 131 Dartmouth Street, which will add about 369,000 sq.ft. of space to the market in early 2003. Leasing activity is likely to pick up in the Back Bay early in 2002 as this submarket remains very popular.

111 Huntington Avenue is the newest addition to Prudential Center, adding 931,000 square feet of high-rise office and retail space to the popular mixed-use complex in the heart of the Back Bay. This premier skyscraper is nearly fully leased.



From a long-term perspective, growing demand for low-rise and mid-rise office space in or near the Back Bay is likely to increase the feasibility of office and mixed-use projects in adjacent neighborhoods such as the South End, Roxbury, and Allston. Projects directed at medical office space users and biotech office/lab facilities, in particular, appear to have a captive audience near Longwood Medical Center. The gradually expanding BioSquare complex and nearby properties adjacent to the Boston Medical Center in Roxbury will be prime beneficiaries as well as the Back Bay submarket expands geographically.



Cambridge Owners Reprice Gradually

Media reports have chronicled the hard times facing numerous companies in Cambridge, including many dot-com enterprises, that urgently need to sublease much or all of their office space in Cambridge. A massive glut of sublease availabilities in the midst of temporarily weak demand for office space has forced distressed tenants to slash asking rents. Each month that goes by without a subtenant results in a more than proportional decrease in leasehold value (since rents tend to be lower on short-term subleases).

It's a different picture for property owners, however. In many cases, most of the rent roll consists of creditworthy tenants with long-term leases. Most of the space available for sublease is still paying rent to the landlord. Hence, the main exposure for owners is at the margin as leases expire or new speculative office buildings (as at Technology Square) are completed. Market rents for this space has fallen sharply, but is still well above 1999 levels.

Since few buyers in recent years used the amazingly high market rents that dot-com firms were paying when underwriting Cambridge acquisitions, few owners are "underwater" at present. Indeed, market rents are still high enough to provide attractive returns to property owners. The main question is how long until the economy strengthens and demand starts to pick up in Cambridge. In the short-run, many landlords are hoping that biotechnology and major pharmaceutical companies resume gobbling up office and office/lab space in Cambridge.

Another reason for the gradual pace of decline of asking rents in Cambridge is that this office submarket, like Boston's Financial District and Back Bay submarkets, is dominated by sophisticated, long-term institutional owners and developers. Major owners such as Boston Properties have played a lead role in creating the vibrant Kendall Square office submarket, starting from a neglected industrial and residential district as recently as the 1960s. These firms are comfortable with the ebb and tide of demand in this submarket. In conjunction with M.I.T., Harvard University, and Cambridge community leaders, these owners have essentially created and nurtured the demand base for Cambridge office space. This submarket remains a great long-term investment play.

300 Third Street is an attractive low-rise addition to the Kendall Square neighborhood in Cambridge. Struggling Palm, Inc. is offering about 93,000 sq.ft. of office space (75% of building) for sublease.

The first of three planned office buildings at Oracle's corporate campus site in Burlington, 100 Van De Graff Drive has added 170,000 sq.ft. of fully-leased office space to the Route 128 Northwest submarket.

New Supply Hits Route 128 Corridor

The primary reason that landlords along the Route 128 Corridor have been leading the way with respect to lowering asking rents is that they've known new supply was rushing through the pipeline at the same time that sublease space flooded the market earlier this year. Most of that new supply was completed during the third quarter. About 830,000 sq. ft. of Class A office space was added and over 1.5 million sq.ft. of Class B space was delivered.

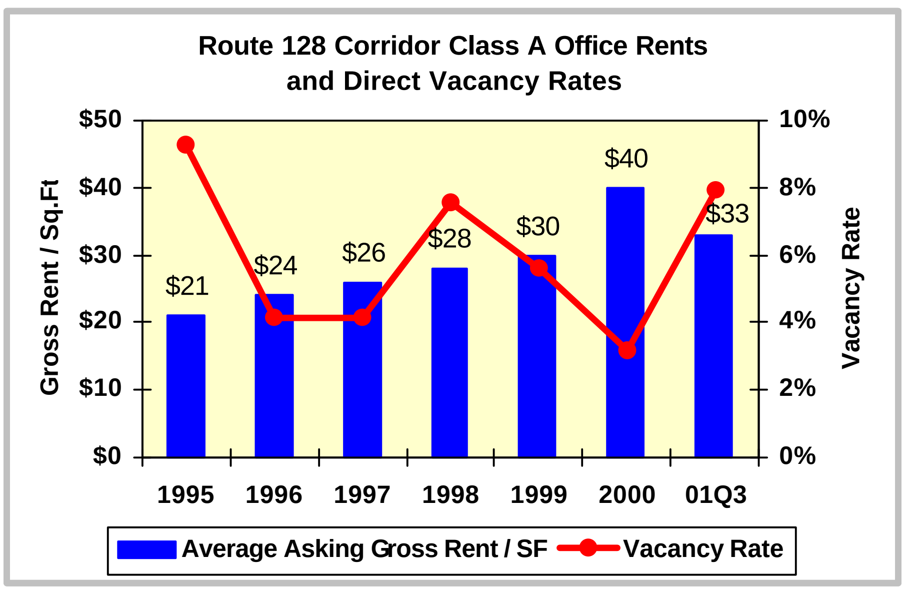
As a result, asking rents along the Route 128 Corridor have given up most of the rent spike enjoyed by landlords in 2000. Depending on how you frame the picture, the popular Route 128 West and Route 128 Northwest submarkets are either faring the best or the worst of the submarkets along Route 128. They're faring the best in terms of asking rents remaining 10% to 15% above 1999 end-of-year levels. On the other hand, they're faring the worst in terms of the degree to which rents have plummeted from 2000 peak levels.

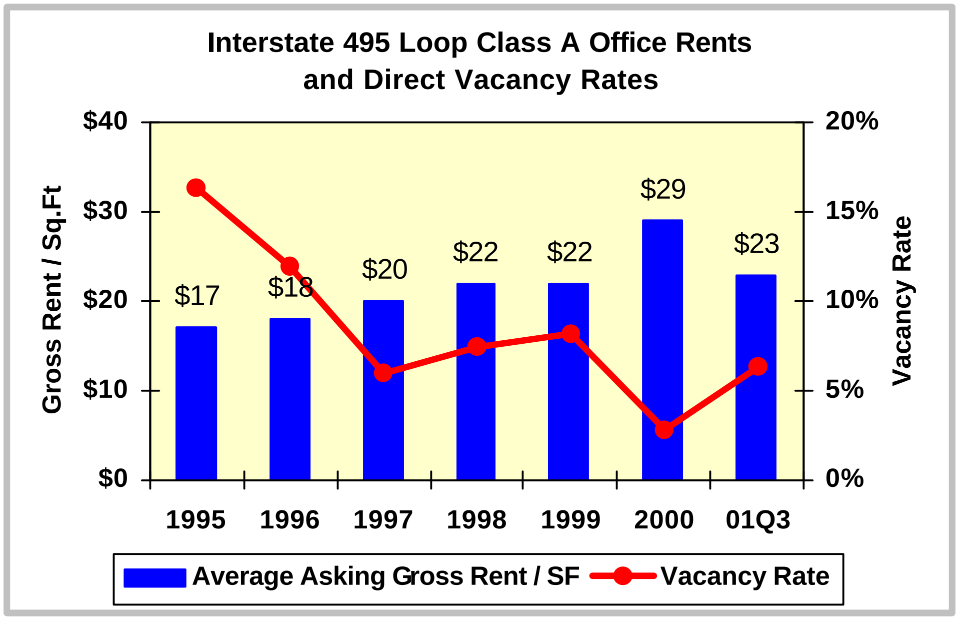
Route 128 South, the submarket centered on Braintree and Quincy which primarily hosts back office operations of financial institutions, only saw its average rent go up 10% in 2000 and that's the extent of the gain given up.

Another 1.28 million square feet of office space is scheduled for delivery during the fourth quarter along the Route 128 Corridor and a comparable amount is slated for completion next year. In the short run this will add to the current oversupply of space, but suggests submarket conditions will start improving next year soon after the economy starts to recover.

Sun Microsystems's recent decision to finally lay off a portion of its workforce, a sizeable 9%, may lead to some space consolidation locally by what has been a prized stabilizer of local employment levels. Other firms, such as Oracle Corporation, are likely to expand their new corporate campuses more slowly than originally envisioned.

Also struggling for tenants along the Route 128 Corridor are recently-completed office buildings that appeared to be "sure bets" as investments only a year ago. Ready-to-go office parks such as InWood in Woburn and Reading also may have to wait for the next property market upcycle to proceed with building development. The next six to nine months will be a great time for tenants to strike attractive deals with landlords ready to do business.





I-495 Loop Gives Up 2000 Spike

After years of gradually recovering from the excesses of the late 1980s, submarkets along the Interstate 495 Loop were the surprise beneficiaries of a high-tech land rush in 2000. Fast-growing corporations finding space scarce along Route 128 turned to the I-495 Loop as the preferred corporate campus location of the new millennium. The wide-open spaces were already fast becoming home to the highly-skilled engineers, technicians, and managers sought by these high technology firms. The logic made perfect sense.

Office space and R&D/flex space rents soared in percentage terms, providing an unexpected windfall to many landlords. Land prices also appreciated quickly as vast tracts were scooped up by corporations and developers.

As of the end of the third quarter, most of the rent spike of 2000 has been given up, and land prices have dropped considerably. Instead of representing a prized goldmine of value creation opportunity, tracts of land slated for corporate campuses suddenly look like a commodity. Even some existing corporate campuses along I-495 are now for sale (e.g., 3-Com, Compaq, Lucent).

From a long-term perspective, the rationale for future high-tech corporate growth along the I-495 Loop still is compelling. This is the only area that is still affordable to young high-tech professionals seeking the American dream of a four-bedroom, two-story house on an acre of land. In terms of the existing workforce, most of the highly-trained IT professionals around Boston live in the west, northwest, and northern suburbs, between Route 128 and I-495. I-495 locations along this arc are readily accessible by this workforce as well.

New construction has been limited along the Interstate 495 Loop this year, with only 195,000 sq.ft. of Class A space and 820,000 sq.ft. of Class B space completed during the third quarter. Nearly 2.5 million sq.ft. of new space was scheduled for delivery next year, but this total is likely to be scaled back considerably as several structures will be mothballed in shell condition. Hence, as with the other submarkets of Metro Boston, the near-term outlook is one of absorbing vacant space and stabilizing near (or a bit above) 1999 levels.

900 West Park Drive in Westborough, developed by Trammell Crow Company for the Archon Group, L.P., adds 195,000 sq.ft. of Class A office space in an attractive, wooded setting near Route 9 and I-495.

Metro Boston Office Market Conditions, 2001Q3

Office Submarket	Class A Space Inventory	Class A Vacant Space	Class A Vacancy Rate	Class A Average Gross Rent	Class B Space Inventory	Class B Vacant Space	Class B Vacancy Rate	Class B Average Gross Rent
Financial District	20,925,166	813,308	3.9%	$58	11,876,135	956,368	8.1%	$40
North Station	1,797,516	22,663	1.3%	$50	1,594,986	36,302	2.3%	$35
South Station	2,875,721	494,528	17.2%	$52	5,033,570	185,690	3.7%	$34
Charlestown	1,079,110	87,298	8.1%	$35	1,740,813	30,000	1.7%	$30
Back Bay	7,208,001	430,749	6.0%	$56	5,667,145	167,072	2.9%	$40
Downtown Boston	**33,885,514**	**1,848,546**	**5.5%**	**$55**	**25,912,649**	**1,375,432**	**5.3%**	**$38**
East Cambridge	7,072,360	688,402	9.7%	$48	1,085,810	114,797	10.6%	$36
Central Cambridge	2,748,877	55,565	2.0%	$47	2,171,678	103,607	4.8%	$35
West Cambridge	1,812,635	189,597	10.5%	$45	1,378,089	79,197	5.7%	$35
Cambridge	**11,633,872**	**933,564**	**8.0%**	**$47**	**4,635,577**	**297,601**	**6.4%**	**$35**
Route 128 North	6,427,716	687,607	10.7%	$29	7,957,026	1,325,419	16.7%	$21
Route 128 Northwest	8,831,181	494,668	5.6%	$33	7,425,295	607,864	8.2%	$23
Route 128 West	16,181,246	1,192,053	7.4%	$36	10,983,898	1,009,994	9.2%	$27
Route 128 Southwest	1,762,123	302,254	17.2%	$28	4,088,580	395,776	9.7%	$21
Route 128 South	6,397,785	440,175	6.9%	$27	4,315,186	268,576	6.2%	$20
Route 128 Loop	**39,600,051**	**3,116,757**	**7.9%**	**$33**	**34,769,985**	**3,607,629**	**10.4%**	**$23**
I-495 North	2,855,416	246,125	8.6%	$22	3,799,660	495,375	13.0%	$19
I-495 Northwest	2,681,213	147,539	5.5%	$23	6,046,308	226,954	3.8%	$20
I-495 West	5,633,383	295,602	5.2%	$25	8,211,935	798,195	9.7%	$22
I-495 Southwest	573,155	0	0.0%	$23	1,359,376	184,628	13.6%	$19
I-495 South	162,000	57,732	35.6%	$21	1,054,467	13,800	1.3%	$18
I-495 Loop	**11,905,167**	**746,998**	**6.3%**	**$23**	**20,471,746**	**1,718,952**	**8.4%**	**$20**
Metropolitan Boston	**97,024,604**	**6,645,865**	**6.8%**	**$42**	**85,789,957**	**6,999,614**	**8.2%**	**$28**

This report was researched and authored by Daniel P. Guenther, SrVP / Director of Research, in collaboration with NAI Hunneman Commercial Company office brokers, property managers, and project consultants as well as using property-level data provided by CoStar Realty Information Group. The views and opinions expressed are solely his own and are not necessarily those of NAI Hunneman Commercial Company nor its employees. For additional copies of this report, please call your NAI Hunneman office broker or Amy Szeto at (617) 457-3400. If you have questions regarding the data or analysis contained in this report, please call Dan Guenther at (617) 457-3369 or send an e-mail to dan_guenther@naihunneman.com.

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