The market is starting to shift in favor of landlords over tenants as rents have begun to trend upward. Even with moderate growth and no new development until 2009, the office market will continue to tighten and rents will continue to increase.

**DOWNTOWN BOSTON**

The Main Event: Rising rents and increased leasing activity have contributed to a shift in market dynamics geared towards favorable conditions for landlords.

Vacancy/Availability: In the last two quarters, net absorption has been positive 931,000 square feet and Class B vacancies have steadily improved to an upward trend, while residential conversions have slowed.

**Average Asking Rents:** Current Class A average asking rents are $37.89 per square foot, which represents a 10.5 percent increase from $34.28 per square foot in the third quarter of 2005. During the same time period, the North Station/North End submarket experienced an astounding 37 percent rent increase while the South Station/Fort Point Channel experienced a 20 percent rent increase. Meanwhile, the Class B market continues to slowly improve with an average of $25.71 per square foot, which is almost a 3 percent increase from its rate a year ago. In the Fort Point Channel/Seaport area Class A rents average $35 per square foot, Class B average $27 per square foot and Class C average $21 per square foot.

**Noteworthy Deals:**
- Children's Hospital Boston will occupy 100,000 square feet of sublease space at the Prudential Center (Proctor & Gamble) as well as other recent surprise additions to the Boston inventory (127,000 square foot Park Square Building by First Marblehead). Most observers believe that the market is strong enough to absorb these additions to the overall supply.

**Demand Drivers:**
- Financial services, specifically mutual funds, medical science, technology, education and biotech companies have been the most active sectors in driving demand for commercial space in the downtown markets during the third quarter of 2006. Additionally, there has been a large amount of organic growth coupled with a lack of quality supply that is helping to drive down vacancy levels and increase rental rates, thereby creating favorable conditions for downtown landlords.

**Forecast:** A supply-constrained market, coupled with an economy that appears to be stable if not robust, will continue to put pressure on rents in all sectors of the Boston market. Several new development projects are in various stages of approval, but will have little or no impact on market conditions in the immediate future. Berkeley Investments will flip about 80 percent of its portfolio, specifically in the Fort Point Channel/Seaport area, while Archon is more interested in redevelopment in this area. No new office space will come into the market until 2009, when The Fallon Company will develop an office tower on Fan Pier. They are already pre-leasing the space to prospective tenants. Even with moderate growth and no new development until 2009, the office market will continue to tighten up as rents continue to increase. The only unknown factor is the impact of the long-anticipated addition of 350,000 square feet of sublease space at the Prudential Center (Proctor & Gamble) as well as other recent surprise additions to the Boston inventory (127,000 square foot Park Square Building by First Marblehead). Most observers believe that the market is strong enough to absorb these additions to the overall supply.

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**Class A Office Average Asking Rents & Vacancy Rates DOWNTOWN BOSTON**

- **Q1 2006:** $34.95
- **Q2 2006:** $37.89
- **Q3 2006:** $36.51

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**Other Trends:** During the housing boom, the downtown markets witnessed a trend of converting older, low quality office buildings to residential condominiums. As housing sales slow, so has the conversion trend and the more recent residential developments projects are coming under significant pricing pressure. In response, some developers, such as Berkeley Investments, who purchased a large number of Fort Point and Seaport buildings in 2005, may simply hold off on residential conversions. Others have shifted their interest away from the residential play and are now considering conversion of these Class B/C office buildings to commercial and office condominiums. Rising office rents in the Downtown markets has caused smaller, privately held companies to consider office condominium ownership as an opportunity to control occupancy costs and build equity for partners. As a result of all of these factors, there is heightened interest in the marketplace in the progress at 185 Devonshire Street, Boston's first office condominium in several years.

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**Cambridge**

Continued growth in the life science sector fuels a bullish mentality for landlords. Institutional investors continue to acquire assets and aim to convert them into state-of-the-art laboratory and office space to meet the demands of the market.

**Noteworthy Deals:** A continued need for Class A laboratory space has been filling quickly, Class B laboratories are not moving as fast. It is our belief that this is a direct reflection of the more sophisticated demands of today’s life science companies. Demand Drivers: Cambridge has secured a top tier reputation as a center for pharmaceutical and large scale biotech companies and is able to attract the industry’s most influential and successful players from the United States and abroad. It is our belief that this reputation, combined with the Commonwealth of Massachusetts’ marketing efforts which position Massachusetts as a world class location for R&D and manufacturing companies, will contribute to Cambridge’s future success as an investment market for landlords.

**Forecast:** At this point, it is clear that the Cambridge market will continue to grow in the life sciences sector. Landlords holding laboratory space remain bullish and are actively acquiring assets for conversions and constructing new high-tech A level space. NAI Hunneman believes that Class A space will continue its upward trend eventually reaching the $60 NNN per square foot. Within the Cambridge submarkets, tight vacancy rates and increasing rents in East Cambridge will eventually lead to added volume in the Alewife and nearby submarkets such as Watertown and Lechmere. Additionally, it is our belief that, as a natural supporting infrastructure, the conditions for Cambridge office space will stabilize after some additional growth in 2006.

**The Main Event:** Speculation has paid off for life science owners in the Cambridge market this year. Developers such as Alexandria Equities, Biomed and the Best Companies have been aggressively acquiring laboratory buildings and office space for lab space conversions. Some examples of these acquisitions include Technology Square, One Kendall, 161 First Street, and 167 Sidney Street. There continues to be an influx of foreign life science companies that are eager to join this hub of activity in Kendall Square. Additionally, due to increased demand for their products and services, established life science companies such as Schering-Plough, Sanofi-Aventis, Altus, Momenta, Archimex, Amgen and Microbia have all recently expanded or seek to expand their office and lab space in the Cambridge area. As large laboratory space has become more difficult to secure, Lyme Properties has begun construction of 301 Binney Street that will, upon completion, offer 450,000 square feet of state-of-the-art lab and office space.

**Vacancy/Availability:** Cambridge vacancy rates have steadily declined in 2006. Class A office vacancies in the third quarter measured 12.6 percent, compared to 19.4 percent in the same period last year. East Cambridge continues to drive demand as the area’s Class A office market has experienced a positive net absorption of approximately 860,000 square feet since the second quarter of 2005, causing vacancy rates to fall from 24.1 percent to 13.8 percent during the same time period. Class B vacancies are currently at a healthy 8.1 percent while laboratory vacancy rates are at 10.7 percent including space that is either under construction or proposed.

**Average Asking Rents:** Rental rates in Cambridge have continued to increase throughout 2006. Mirroring the fall in vacancy rates, East Cambridge has experienced the highest growth as Class A office space gross rates have increased from $30 per square foot to $34 per square foot this year. Class A lab space in Kendall Square currently rents in the $55 NNN per square foot range, while Class B lab space is listed at approximately $40 NNN per square foot. Rental rates for Class B office space in the area have remained steady in 2006 with an average asking rate of $26 per square foot.

**Other Trends:** Office users are finding fewer options for requirements under 10,000 square feet. While Class A office space in the Cambridge market has been filling quickly, Class B laboratories are not moving as fast. It is our belief that this is a direct reflection of the more sophisticated demands of today’s life science companies.

**Suburban Route 128**

Waltham leads the way for a broad based recovery in the suburban markets. As rents continue to increase and large Class A users find fewer options, expect the tightening to continue through the end of 2006 and the start of 2007.

**The Main Event:** The 128 West office market, particularly Waltham, continues to fuel the recovery in the suburbs with high rent appreciation, limited options for large Class A users and record sales prices for trophy properties. Waltham continues to be the hotbed for new development. Currently, developers have plans to construct 1.6 million square feet of speculative space in Waltham alone. Some examples include Davis Marcus Partners’ plans to develop 626,000 square feet of speculative space, which includes a 185,000 square foot office building, at Reservoir Woods and Duffy Associates’ plans to build a 143,000 square foot speculative office building at Waverly Oaks Office Park. There is also the possibility of Boston Properties building a 350,000 square foot Class A office park on the site of the former Massachusetts Broken Stone Company quarry, which is located at the intersection of Routes 20 and 128.

**Vacancy/Availability:** Since the third quarter of 2005, Class A vacancy for the Route 128 market has dropped significantly from 17.0 percent to a current rate of 13.6 percent. During the same time period, the 128 West market also experienced a significant drop in vacancy to 8.9 percent from 14.8 percent. This submarket has absorbed close to 630,000 square feet since the third quarter of 2005. The Route 128 Class B market also experienced a drop in vacancy from 14.9 percent a year ago to 14.3 percent.

**Average Asking Rents:** Class A office rents in the 128 West market range from $27 to $35 per square foot, and in some cases are pushing $40 per square foot. The rest of the submarkets range from $23 to $26 per square foot. Over the last 12 months, rents in Waltham have risen 10–20 percent. With construction costs continuing to rise, landlords are pricing rents to fuel the recovery in the suburbs with high rent appreciation, limited options for large Class A users and record sales prices for trophy properties.

**Other Trends:** 128 South is also experiencing a tightening of the market, especially for tenants seeking large blocks of high-quality space. NAI Hunneman believes that this trend can be attributed to the combination of this submarket’s proximity to Boston and reasonable housing costs for employees. On the other hand, 128 North’s office market is relatively stagnant with vacancies still close to 20 percent. One trend throughout 128 seems to be the surge in demand for high-quality office space, some market observers speculate that the vast amount of additional square footage may create strain on the already overburdened infrastructure. To combat this issue, planning efforts are underway to update roadway systems to meet the needs of these future developments.
Suburban Route 128 continued

Demand Drivers: In the 128 North market, the health care industry and the national defense contractors are driving demand, while in the 128 West market defense, technology and medical device industries continue to fuel the increased need for space. While the 495 and 128 South market areas have plans for office, flex and warehouse space towards retail and residential use on University Avenue, Westwood Station has reduced inventory in the area and is causing tenants to find space elsewhere. The 203,000 square feet being vacated next year at 100 Hancock Street in Quincy by Blue Cross Blue Shield to move into its new headquarters in Hingham may help somewhat, but most tenants locat- ed in Westwood would prefer not to relocate to Quincy.

Forecast: Through the end of 2006 and beginning of 2007, NAI Hunneman believes there will be continued tightening of the markets for the 128 West and 128 South Regions. Rents will increase, and vacancies will continue to decline as limited options for large blocks of high-quality space will be available. Increased job openings, especially in the 128 South/Southwest markets, by a number of major companies will increase absorption especially in the Westwood area south to Quincy and Braintree. In the 128 West market, development will increase with more amenities being the new trend. Tenants will continue with their flight to quality, and investors’ interests will remain strong for the area. The 128 North market will remain steady with a slight increase in demand, rents and occupancy.

Noteworthy Deals: Despite Tufts Health Plan recently renewing its headquarters lease for 150,000 square feet at Hobbs Brook Office Park in Waltham, they just announced that they will be vacating their Waltham premises next year to consolidate their operations in Watertown in order to cut costs. The Registry of Motor Vehicles has moved from Boston to 98,000 square feet in the former Blue Cross Blue Shield building at 25 Newport Avenue in Quincy. Intuit will lease 39,000 square feet at 100 Fifth Avenue in Waltham, and Rytec will lease 39,000 square feet at Stony Brook in Waltham. On the sales side, Bennwil Property Group purchased Tollten Pond Office Center for $44.3 million or $150 per square foot. After just four weeks on the market, NFP/Direct Invest, LLC purchased 2 & 3 University Office Park for $20 million or $135 per square foot, which is slightly skewed since the deal included a ground lease. Transwestern, the seller, originally purchased these two properties for over $40 million in 1989. Nordic Properties paid $18.5 million for the empty 55 Walkers Brook Drive in Reading, hoping to reposition the existing property as general office and medical office space.

Route 495

Local companies experiencing growth and large corporate relocations led to a reduction in vacancy rates. The decline in vacancies is expected to continue and with no new developments on the horizon, prices are beginning an upward trend.

Jackson Technology Park, Devens

The Main Event: Vacancy rates in the 495 Market have dropped as a result of space being absorbed by local companies that have experienced solid growth. An example of this trend includes Bose signing on for 150,000 square feet at 9 Technology Drive in Westbrook. Other companies expanding are Iron Mountain and Boston Scientific. Meanwhile, Scom has decided to stay in Marlborough, which NAI Hunneman believes is a positive sign for the market. 495 West continues to benefit from a tight Framingham/Natick market where increasing rents are pushing tenants seeking lower cost alternatives towards 495. In the 495 South market, rents are rising as the area tightens with strong leasing activity. Tenants seeking less than 5,000 square feet are finding few high-quality options in the market, but there are some larger blocks of space still available. While the 495 North/Northwest market continues to have a high level of vacancy, signs of improvement are starting to be seen. Major companies moving into the area include Motorola’s commitment for 225,000 square feet at Cross Point in Lowell and Novera Fuel’s recent lease for 100,000 square feet in Billerica.

Vacancy/Availability: Class A Vacancy continues to drop from a rate of 24.0 percent in the first quarter of 2005 to 19.3 percent currently, with 495 West experiencing a significant drop from 17.9 percent to 14.5 percent during the same time period. The 495 North and Northwest markets have also experienced declining vacancies over the past year but still remain high at 26.9 percent and 23.2 percent, respectively. Class B vacancy rates also dropped from 19.8 percent a year ago to a current rate of 15.6 percent.

Average Asking Rents: Class A office rents range from $16 to $23 per square foot, and Class B rents range from $16 to $19 per square foot. These rents have remained steady over the last few quarters and are continuing to attract tenants from higher rent areas such as Framingham/Natick.

Other Trends: On the investment side, NAI Hunneman has seen a decline in interest for non-trophy assets that are now remaining on the market for longer periods of time. This decline seems to be the result of a price gap between buyers and sellers, with sellers holding firm on their asking prices.

Demand Drivers: Demand for office space is mainly coming from companies in several industry sectors, including life sciences, defense, medical device manufacturing and other advanced technology areas. The continued decline in vacancies along Route 128 is also continuing to push tenants to seek space within the 495 Markets.

Forecast: Vacancies will continue to drop as space continues to come off the market and with no new development coming online in the near future, pressure will move rental rates higher. Activity will continue to increase through the end of 2006 and into 2007. A key project to watch is The Campus at Marlborough, recently acquired by an affiliate of Eaton Vance Management. The new owners have expressed an interest in plans to develop an additional 670,000 square feet to be added to the fully leased 532,000 existing square feet. Other projects are getting onto the drawing boards as developers anticipate market conditions which will support new development. Even if those conditions were present now, it would take at least 24 months for new product to be delivered ready for occupancy.

Noteworthy Deals: In the third quarter of 2006, Motorola announced plans to lease 225,000 square feet at Cross Point Towers in Lowell. They are relocating 474 employees from their Marlborough, Tewksbury, Lexington and Andover facilities to Cross Point but will also add 120 new jobs. Motorola could house up to 900 employees at Cross Point by the time they are done with the expansion. This transaction was a major win for Massachusetts as Motorola had been considering relocating their operations to North Carolina. Another major win for Massachusetts was Bristol-Myers Squibb’s decision to build its 750,000 square foot bio-pharma manufacturing plant at Devens. Devens was chosen over locations in North Carolina and New York because of its 75-day permitting and access to the scientists and skilled labor that form Massachusetts’ extraordinary cluster of life science companies. NAI Hunneman believes that these transactions represent an increased interest in large companies doing business in Massachusetts and that companies involved in the commercialization of medical science technologies will continue to do well in the region. Additional deals in the 495 market include Innovative Spiral Technologies and Proven Process Medical Devices each deciding to move into 30,000 square feet on Forbes Road in Mansfield.

Industrial Market

Activity should increase in both the industrial and flex/R&D markets through 2006 and into 2007.

The Main Event: There is increased activity in the 128 South, 495 South and 495 West markets, while the 128 North has experienced a fairly modest increase in volume. Much of the activity taking place in the southern submarkets can be attributed to the displacement of tenants caused by the Westwood Station project, where flex and warehouse space is being repositioned as residential, office and retail space. NAI Hunneman has also observed organic growth in mid-size manufacturing and larger distribution companies. On the investment side the market has slowed down significantly as investors are being much more selective and looking for higher operating income. Smaller
users continue their search for condominiums or buildings to purchase as interest rates continue to remain attractive and users can sometimes pay a premium over investors.

Vacancy/Availability: The current industrial vacancy rate is 9.5 percent which remains relatively flat compared to 9.3 percent in the same period last year. The 128 West submarket remains attractive with a low vacancy rate of 2.7 percent. The flex/R&D market has continued to improve as vacancies fell to a current rate of 15.3 percent from 15.6 percent last quarter and 16.6 percent a year ago. Within the submarkets, the 495 South market has the lowest vacancy rate at 4.9 percent.

Average Asking Rents: Average overall industrial asking rates range from $5.00 to $9.00 per square foot NNN. This rental rate range has remained steady with the Greater Boston Metro market showing a modest 2 percent increase over the 12 months. The flex/R&D asking rents range greatly from $6.65 per square foot NNN to as high as $23.80 per square foot NNN depending on the quality of space and location.

Other Trends: Inside of the industrial markets, tenants are following the trend of seeking higher quality, modern space that meets their particular specification needs. NAI Hunneman has observed a trend of older, out-of-date buildings being converted for residential use. This trend seems to be most active within the 128 Corridor and we believe that the 495 loop may soon follow suit with conversions occurring along Route 20 in Westborough, Shrewsbury and Northborough.

Demand Drivers: Demand is coming from midsize companies who are experiencing organic growth. Location, in terms of highway access, remains an important consideration. Additionally, tenants continue to seek warehouse space that is high stud, wide bay with ample outside storage, enough docks, clear heights of 30–36 feet and even 40 feet as opposed to 22 feet, large truck courts, even as long as 160 feet with concrete, anti-static flooring, ESFR sprinkler systems and efficient power. Ikon and Victory Packaging are currently looking at 100,000 to 150,000 square feet of distribution space with significant loading capacity. NAI Hunneman believes that demand may also begin emerging from the high-tech, electronics and healthcare-related industries. Investors are in the market seeking buildings that are high quality with strong leasing fundamentals. However, as with other markets, NAI Hunneman has observed the emergence of a price gap between buyers and sellers.

Forecast: NAI Hunneman believes that there will be a continued increase in activity for both the industrial and flex/R&D markets through the remainder of 2006 and into 2007 with particular strength in the markets related to life science manufacturing. Medical device companies will also continue to be attracted to the region, especially north and south of Boston. Additional factors that could help absorb existing space include the lack of new development in the industrial markets as construction costs are approaching $60 per square foot.

Noteworthy Deals: Tyco Healthcare has signed a 15-year lease renewal for 315,000 square feet in the Cabot Business Park in Mansfield, where a majority of their space will be used for manufacturing. Cytc Corporation, a medical device firm, recently signed a lease for 150,000 square feet at 445 Simarano Drive in Marlborough, and they have plans to develop a 175,000 square foot state-of-the-art manufacturing plant at this former distribution center, which is owned by RAM Management. Autopart International, owned by Advance Auto Parts, signed a 10-year lease for 347,500 square feet at 192 Mansfield Street in Norton, averaging $4.91 per square foot NNN. The 324,500 square foot Class A industrial building will be expanded with 23,000 square feet of office space to accommodate Autopart. Empire Auto Parts will move into a newly purchased 80,000 square foot building at 61 Robert Treat Drive in Taunton. Tenants continue to be attracted to the southern submarkets due to their accessibility to both Boston and Providence.

**Investment Market**

Despite an apparent slowdown, capital is still searching for the right deal. Expect the price gap between buyers and sellers to narrow through 2007.

The Main Event: In the third quarter of 2006, the investment sales market has exhibited signs of a weakening due to an unresolved price gap between buyers and sellers. The condominium market is softening and this has affected the value model previously factored in for conversion assets. However, NAI Hunneman has also observed that trophy assets, with strong leasing fundamentals, are still attracting top dollar sales figures.

Other Trends: As trophy assets in downtown Boston remain hot, their high asking prices have pushed some buyers to look to the suburban markets. Some buyers are now looking to buy half-empty suburban properties at a lower price, hoping to eventually lease them up in a recovering commercial real estate market. For example, New York-based Gale International has recently purchased seven buildings in Bedford, Billerica and Andover for $50 million, totaling 667,000 square feet. In this transaction, Gale paid approximately $75 per square foot. Even though some of the buildings need work and capital investment, Gale believes their strategy will pay-off in the long run as suburban markets recover.

Demand Drivers: Properties with credit-quality tenants that are in good locations are still attracting investment capital. NAI Hunneman has observed that private investors are still searching for value-add opportunities and, despite a softening market, there is still a large amount of capital working in the investment market looking to source deals.

Forecast: Capitalization rates will rise if interest rates rise again. For both the flex and warehouse properties in the Boston Metro area, we have witnessed a decline in capital rates over the last 12 months. However, if interest rates do rise again, capital rates for these properties types could increase by as much as 25 to 50 basis points. Despite recent signs of a slowdown in the investment market, there is still a lot of capital out there looking to invest in assets around Boston, and NAI Hunneman believes that the price gap between buyers and sellers may have to narrow in order to fuel growth for more deals.

Noteworthy Deals: Nordic Properties paid $18.5 million (or $100 per square foot) for the empty 55 Walker’s Brook Drive in Reading hoping to reposition the existing property to general office and medical office space. Boston-based FFP Advisors and Juniper Advisory Services of Winchester purchased the former Saucony headquarters property in Peabody for $7.85 million (or $60 per square foot) from Strobe Rite Corporation. Even though the property is currently vacant, it is located right at the entrance of Centennial Park. Everest Partners purchased four buildings totaling 330,000 square feet for $37.8 million in Boston, Andover, Westminster and Framingham from Essex River Ventures and Berkeley Investments. Berkeley has been divesting of its portfolio in this area to concentrate on two major redevelopment projects, one in Fort Point Channel in Boston and the other in downtown Worcester.

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For further information on NAI Hunneman’s services, please call the following contacts at 617 457 3400:

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**Boston Metro Industrial**

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**Metro Boston Real Estate MARKET UPDATE**

**INDUSTRIAL MARKET**

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**Metro Boston Flex / R&D Rates**

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