

Office Market Overview

Market Outlook 2008

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Sioux Falls Office Market

The office market is determined by examining the occupancy and rental rates of all non-owner occupied buildings that exceed 1,000 square feet in size. Owner-occupied buildings are excluded due to the fact that their occupancy does not truly affect the market rental rates. As owner-occupied buildings are converted to non-owner occupied buildings, they are added to the survey. Sioux Falls experienced another exceptional year in the office market. Overall, the city added over 892,000 square feet to the office universe. This was a nearly 18% increase from 2006. The overall vacancy rate for the city of Sioux Falls was 11.48% which was below the national average of 13.2% (CB Richard Ellis).

The city is divided into four sectors, the Central Business District or CBD, the north sector and the southwest and southeast sectors. The north and south sectors are divided by 18th Street, while the east and west sectors used Minnesota Avenue as a dividing line.

Central Business District

The CBD added over 161,000 square feet to its universe in 2007. One example of a new building that was added to the CBD was Cherapa Place. Cherapa Place is a 142,000 square foot LEED certified, “green” building with very little vacancy remaining. The vacancy rate for this sector did increase from 5.6% in 2006 to 7.2% in 2007. This increase in the vacancy rate typically results in an increase in rental rates, however this did not occur in the



CBD. Rental rates increased to \$10.89 per square foot from \$9.60 in 2006. This in part is due to tenants demanding and accepting higher quality and in some cases, more energy efficient space that typically costs more to build. Even with the higher vacancy rate, the Central Business District had a positive net absorption rate of over 120,000 square feet. This in part displays the strength of Sioux Falls in that it has a very strong central corridor.

This sector will see a considerable amount of construction in 2008 with the redevelopment along “Phillips to the Falls”. One such redevelopment will be the Uptown at the Falls. The first phase of this development is expected to start in the spring of 2008 adding approximately 87,000 square feet of office space to the market.

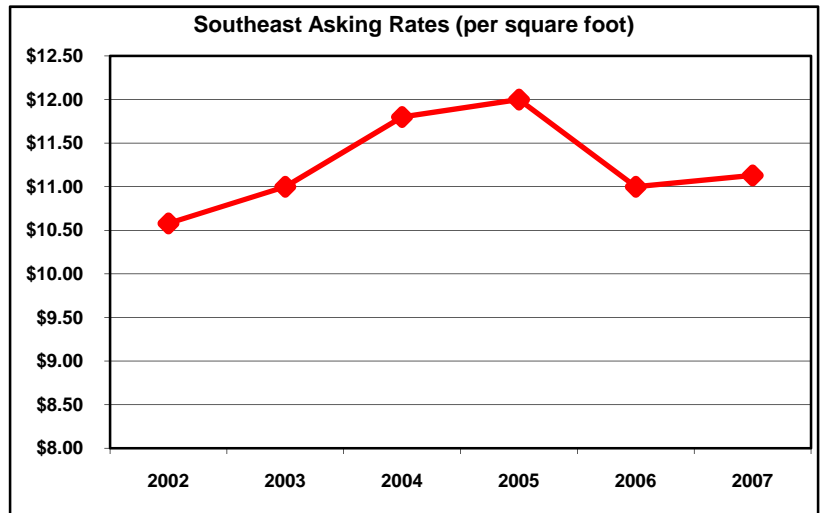
North Sector

The north sector had an increase in its vacancy rate from 5.36% in 2006 to 12.5% in 2007. Several smaller speculative office buildings that are currently vacant were added to this segment as well as

some larger, formerly owner-occupied buildings became available for lease. However, the rental rates in the north increased to \$10.00 per square foot from \$8.80 in 2006. Like the Central Business District, tenants in this sector are accepting higher quality space that developers are in response constructing. Also like the CBD, this sector has a positive net absorption even with a higher vacancy rate.

Southeast Sector

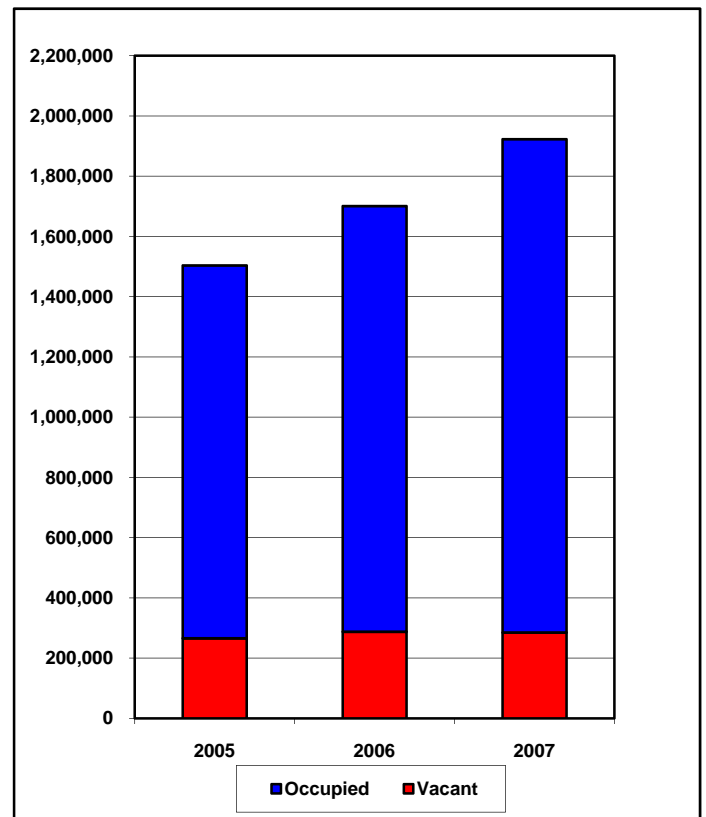
As reported last year, the southeast sector was lacking enough quality space to attract tenants. In 2007, developers responded by adding another 50,000 square feet of space. However, this new speculative construction created some vacant space. The vacancy rate for the southeast sector increased from 9.4% in 2006 to 12.25% in 2007. Typically, in a situation where the vacancy rate increases, rental rates either stabilize or decrease. The rental rate did somewhat stabilize with only a slight increase from \$11.00 per square foot in 2006 to \$11.13 in 2007.



Taking into account all the above, this sector reacted with a positive absorption of 27,500 square feet.

Southwest Sector

The southwest sector continues to be the stronger sector in the city in that it continues to see new construction every year. This sector has consistently seen an increase in its universe over the past several years and 2007 was no exception adding over 220,000 square feet. The vacancy rate in this sector also decreased to 14.8% from 16.9% in 2006. In 2005, this sector was heading towards an oversupply situation and landlords reacted appropriately by decreasing their rental rates in 2006 which led to positive net absorption. In 2007, rental rates remained steady at \$12.00 per square foot and again this sector witnessed a positive absorption of over 224,000 square feet. This sector will continue to see new construction into 2008 and 2009.



LEED or “Green” Buildings

As this nation recognizes the need to be more globally aware of our effects on the environment, many building developers are migrating to more energy and environmentally friendly construction. This trend has recently emerged in the Sioux Falls market in the construction of LEED-certified buildings. LEED stands for Leadership in Energy and Environmental Design. Currently, commercial buildings are accountable for over 60% of the nation’s electricity consumption. For a building to be LEED-certified, a licensed third party must verify the buildings qualifications. This type of construction can use up to 30% less energy and 30-50% less water. It can also divert up to 97% of its waste from landfills. For existing commercial buildings, a program (LEED-ED) has been developed to help property owners operate and/or manage the building more efficiently. Sioux Falls has two examples of LEED-certified buildings, Cherapa Place and Courthouse Square located at 12th Street and 1st Avenue in downtown Sioux Falls.

Office Real Estate Cycle

The Sioux Falls office market universe increased by 18% with 5,868,095 square feet of office space as defined by our survey. The city also experienced an increase in its overall vacancy rate from 9.9% in 2006 to 11.48% in 2007. In 2008, it is possible that the office market may bypass a decrease in rental rates and have another strong year of absorption.

