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Seacoast NATIONAL BANK

Economic Perspectives

Trends in office real estate — *vacancies rise, absorption slows*

Employment, a key demand driver for office real estate has been softening for the last three quarters. By the first quarter of 2008, job creation was negative with a loss of 76,000 jobs in each of January and February and a loss of 80,000 in March for a net loss of 232,000 jobs in the quarter. The trend continued in April with a loss of another 20,000 jobs. Florida fared modestly better but is clearly not immune from job loss pressures as losses move from construction into finance, retail and even professional services. To put the current downward trend in perspective, the economy was creating an average of 189,000 jobs throughout 2006 and into early 2007. Demand for office real estate began to plummet in the closing months of 2007 as businesses postponed new lease commitments, the economy inched closer to recession and employers who were holding the line on employment were unable to continue to do so. Net office space absorption fell over 74% between the third and fourth quarters of 2007 and turned negative in the first quarter of 2008 as office employment finally turned negative.

Deteriorating office fundamentals are most apparent in markets where the housing downturn has been most severe and where there was a concentration of jobs in residential construction, mortgage finance and allied industries. This includes virtually every major market in Florida and most notably urban Seacoast markets including Metro Orlando, West Palm Beach and Broward County. As Seacoast does not have a presence in Miami-Dade, that county is intentionally excluded from our analysis.

Metro Orlando had negative absorption of 577,331 square feet in the first quarter. That compares to negative 97,440 square feet in the fourth quarter of 2007 when absorption first turned negative. Over half (54%) was concentrated in the Class A sector. Net absorption for Orlando's central business district was negative 96,976 square feet versus negative 480,355 in the suburban markets.

The Metro Orlando vacancy rate increased a full 100 basis points in the first quarter growing from 9.6% to 10.6%. To put that in historical perspective, the vacancy was slightly under 8% as recently as Q3 2006 but as high as 11% in Q3 2003. The class A sector has been the most volatile hitting a high of nearly 20% in Q1 2003 and a low of 8% in Q3 2006.

Metro Orlando rental rates in the first quarter averaged $22.93 per square foot broken down as follows:

Q1 2008	Class A	Class B	Class C
Average Rent	$26.85	$21.38	$18.70
Vacancy	12.9%	11.3%	7.6%

The composition of tenancy in Metro Orlando (based on square footage of tenants) is heavily skewed toward finance, insurance and real estate at 21.6%. That sector has experienced the greatest net decline in job growth. Moreover, Orlando's decline in office employment has been significantly steeper than the nation as a whole having lost roughly 7% of its office jobs since 2004. Also noteworthy is that 41% of the currently leased space based on square footage is scheduled to expire or come up for renewal in 2009 and 2010.

Capitalization rates have also been trending upward having risen on average from 6.8% in Q4 2006 to 7.12% in Q4 2007. We expect this trend to continue as investors re-price risk and base purchase decisions on what is rather than on future expectations. Financing availability (or lack thereof) particularly in the CMBS (commercial mortgage backed securities) markets will also put upward pressure on capitalization rates.

Metro Orlando has a variety of sub-markets. The following chart highlights several of its larger ones.

Sub Market	Vacancy	Net Absorption	Under Construction	Quoted Rental Rate
Winter Park	8.2%	-19,473	0	$22.91
University Research	14.1%	-36,484	65,147 SF	$20.23
Tourist Corridor	8.3%	42,562	429,782 SF	$23.46
Lake County	10.3%	11,136	38,324 SF	$21.44
Downtown	11.3%	-96,976	152,240 SF	$26.48
Kissimmee	13.4%	20,256	121,222 SF	$23.61
Lake Mary	10.4%	-55,108	175,000 SF	$22.63

Palm Beach County also experienced negative net absorption (-402,827 square feet) in the first quarter of 2008. That is over twice the negative rate in the fourth quarter of 2007.

The Class A sector experienced negative net absorption of 181,131 square feet followed by negative 154,958 square feet in the Class B sector and negative 66,738 square feet for Class C. Central business district net absorption was negative 206,793 square feet as compared to the suburban markets where absorption was negative 196,034 square feet. All sectors turned negative in late 2007 after several years of positive net absorption.

Overall Palm Beach County office vacancy stood at 13.9% at the end of the first quarter. That rate is up from 12.6% in the fourth quarter; 11.7 in the third quarter, and 10.7% in the second quarter of 2007 and is now among the highest in the state. The vacancy rate has been climbing since mid 2006 and surpassed the average national rate in the second quarter of 2007.

Average Rent and Vacancy Palm Beach County

Q1 2008	Class A	Class B	Class C
Average Rent	$32.66	$26.84	$24.17
Vacancy	20.4%	14.0%	6.1%

Class A space at $32.66 per square foot is among the highest in the state and so is the vacancy. A vacancy rate of 20+% was last experienced in Palm Beach County in 1999. Despite the rising vacancy rate, rental rates show no current signs of retreating. Similarly, capitalization rates were *lower* in 2007 averaging 6.63% as compared to 7.11% in 2007.

Palm Beach County office tenancy is skewed toward finance, insurance and real estate at 26.3%. Moreover, a full 34% of currently leased space by square footage comes up for renewal in 2009 and 2010. It is unclear whether tenants will renew or can even afford to renew at current rent levels. The fact that the amount of sub lease space current available in the county rose 33% in the first quarter suggests that many tenants are downsizing and will opt for less expensive space.

Palm Beach County Sub Market Office Activity

Sub Market activity varies significantly. Especially noteworthy is Boca Raton with the highest vacancy, negative net absorption yet over 1.4 million square feet of space still under construction. The sub market appears poised for a significant short term correction.

Sub Market	Vacancy	Net Absorption	Under Construction	Quoted Rental Rate
Jupiter	16.2%	9,135 SF	0	28.39
West Palm	12.8%	-185,968 SF	399,526	30.12
Delray	12.1%	-47283 SF	0	22.83
Boynton	12.9%	-78,837 SF	0	26.98
Boca Raton	17.3%	-128,128 SF	1,406,047	29.55

Broward County office absorption turned slightly negative (-40,081) square feet after a small positive showing of +22,249 square feet in the fourth quarter of 2007. Broward County absorption has been erratic for the last year however that appears to be largely the result of timing of deliveries which included several large projects in the last three quarters.

Q1 2008	Class A	Class B	Class C
Average Rent	$31.07	$25.19	$21.59
Vacancy	15.4%	10.0%	4.3%

The average vacancy rate in the first quarter of 2008 was 9.4%. It has been inching up modestly every quarter since the second quarter of 2007 when it was 7.7%. The upward trend was consistent through all classes of space and through all submarkets except Hollywood and Hallandale — both of which have experienced a declining vacancy rate and modestly increasing asking rents.

The composition of tenancy in Broward is skewed toward finance, insurance and real estate at 21.6% — identical to Orlando but 5% lower than Palm Beach County.

Sub Market	Vacancy	Net Absorption	Under Construction	Quoted Rental Rate
Downtown Ft. Laudle.	10.8%	10,527	0	$31.76
Sawgrass	13.0%	-25,795	239,361	$27.06
Pompano	9.3%	-35,171	385,981	$24.74
SW Broward	10.1%	34,691	510,945	$30.04
Plantation	8.3%	-38,159	39,298	$31.84
Hallandale	5.0%	26,198	0	$39.51

The average rental rate for all classes of Broward office space was $27.00 per square foot. Rates varied widely by sub market as can be seen in the accompanying table. Approximately 18% of the currently leased space in Broward County is scheduled to come off lease in 2009 and another 22% in 2010 for a total of 40%. There are approximately 1.5 million square feet of office space currently under construction. Slightly less than half of it is pre-leased. The biggest concentrations are in southwest Broward and Pompano (60%). Finally, capitalization rates trended modestly *lower* in 2007 averaging 6.84% as compared to 7.43% in 2006.

Looking Forward. All markets appear poised for negative correction. Palm Beach County has experienced the steepest growth, which, in our view, is unsustainable. The average vacancy rate is in double digits and has been steadily, though modestly, climbing for the last seven quarters. So far, rental rates have defied gravity and remain among the highest in the state, second only to Miami-Dade. Capitalization rates also appear to have defied trend by decreasing rather than increasing. Digging deeper, the data driving the apparent 2007 downward movement occurred prior to the CMBS melt down last summer. We fully expect capitalization rates to climb in the next few quarters. Palm Beach county also has over 26% of its currently leased space coming up for renewal in the next two years. Combine that with nearly two million square feet of space still under construction and downward value correction, perhaps as much as 20%, seems likely.

Metro-Orlando and Broward County are experiencing similar changes, though not as severe. Look for increasing vacancies and cap rates as well as greater rent concessions in all of these markets as we shift from a landlord to a tenant driven market.

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