



# Real News

the silicon valley quarterly on commercial real estate

## 2008 Market Study

### Silicon Valley Economic Overview

The collapse of the U.S. banking industry – precipitated by a severe housing downturn and fueled by a systematic failure of financial institutions and their government overseers to manage asset-backed and derivative securities risk – left the U.S. economy teetering on the edge of the abyss at the end of 2008. As the nation stood poised to swear in its forty-fourth president, the federal government had already extended trillions of dollars in taxpayer funds in an effort to stem the continued melt down, with more economic “stimulus” promised from the incoming Obama administration.

2001’s recession, which began with the burst of a tech-driven stock market bubble, was limited in severity and duration by historical standards. However, the ubiquitous reach of the banking industry and the modern U.S. economy’s utter dependence on the accessibility of credit has ensured no industry has escaped the current downturn unscathed. That includes the technology industry, lifeblood of Silicon Valley’s economy.

While Apple, Google, and IBM managed to exceed Wall Street’s fourth quarter earnings targets, IBM, Google, AMD, Intel, Microsoft, Yahoo, SanDisk, and countless venture-backed start ups began shedding jobs and slashing capital expenditures

as 2008 came to a close. Near-term memories of the 2000-2003 tech-driven collapse have led many businesses in the Valley to make more conservative hiring and facilities decisions during this cycle, which analysts say may help soften the acuteness of the downturn. However, the unprecedented scale of the credit market collapse and fear for what the future holds are clearly driving aggressive – and in many cases pre-emptive – spending and headcount reductions across the Valley.

Of the many pressing economic concerns facing the Silicon Valley economy at the start of 2009, the state of the venture capital industry deserves particular attention. According to Dow Jones VentureSource, venture investment during 2008 rose nearly 4 percent over 2007 levels, finishing the year at approximately \$11.2 billion. Of the ten biggest venture investments in 2008, seven were energy companies and four were solar companies. Overall investments in clean-tech companies increased 50% over 2007 levels.

However, 2008 was the worst year for venture liquidity (IPOs and M&As) since the low point of the tech bust in 2003. A total of seven IPOs occurred in the U.S. in 2008, the lowest total recorded since 1992, and M&A transactions

### Economic Indicators

	2007	2008	Q408
<b>Unemployment Rate - Silicon Valley MSA*</b>	4.8%	6.2%	7.8%
<b>Unemployment Rate - Santa Clara County*</b>	4.7%	6.1%	7.7%
<b>Unemployment Rate - California*</b>	5.4%	7.2%	8.5%
<b>Unemployment Rate - National</b>	4.6%	5.8%	6.6%
<b>Inflation (CPI-U)*</b>	2.8%	3.8%	-0.6%
<b>VC Investment National**</b>	\$30.9B	\$28.3B	\$5.4B
<b>VC Investment Silicon Valley**</b>	\$11.0B	\$11.0B	\$2.0B
<b>VC Confidence Index***</b>	4.05/5	2.99/5	2.77/5
<b>Job Growth - Santa Clara County</b>	17,300+	5,900+	-2,900
<b>Job Growth - Silicon Valley MSA*</b>	17,800+	6,100+	-3,000

\*Not seasonally adjusted

\*\*Source: PriceWaterhouseCoopers Money Tree

\*\*\*Source: USF Bloomberg ticker USFSVVC1

## Significant Large R&D Transactions in 2008

Landlord/Sublessor	Tenant	Address	City	Size
Hewlett Packard	Apple	19333 Vallco Pky	Cupertino	293,407
Riggs Bank	Quanta	45275 Northport Ct	Fremont	242,000
Sobrato Development	Xenoport	3400 Central Expy	Santa Clara	161,503
Stanford Board Of Trustees	Facebook	1601 S California	Palo Alto	137,000
IStar Financial	Solyndra	1210 California Circle	Milpitas	120,576
Jay Paul Company	Blue Coat Systems	410 N Mary Ave	Sunnyvale	116,586
Blue Coat Systems, Inc.	Trend Micro	10201 N De Anza	Cupertino	104,990
IStar Financial	Apple	18880 Homestead	Cupertino	102,588
Sobrato Development	Philips Electronics	3860 N First Street	San Jose	101,582
Sobrato Development	Data Domain	2441 Mission College	Santa Clara	100,180

decreased by 29% compared to 2007.

Unsurprisingly, no IPOs occurred during the train wreck that was the fourth quarter, and venture investment plummeted: compared to the same period of 2007, the number of venture capital investments in the Silicon Valley dropped by 27 percent and the total amount invested declined 38 percent.

Given that Silicon Valley tech companies are the recipients of approximately a third of the nation's venture capital investments, many are increasingly being starved of new capital. With exit options severely limited, many will fold. Although large public companies comprise a substantial share of tech employment in the Valley, Venture funding plays a tremendously important role in nurturing innovation that bubbles up through all levels of the tech, life science, medical devices, and energy industries. Bottom line, however, an analysis of today's economic challenges brings us back to the credit crisis.

The longer it takes for banks to write down the value of their troubled assets, the longer capital markets will remain inefficient, the longer venture illiquidity will persist, and the greater the risk posed to the long term vitality of Silicon Valley's economy.

## 2008 R&D Highlights

### Absorption

Plummeting gross absorption is the lead story of the 2008 Silicon Valley R&D leasing market. Gross absorption of R&D space during 2008 totaled 9.4 million square feet, excluding renewals, compared to 2007's 14.2 million square feet. This marks only the fourth time in 23 years that annual gross

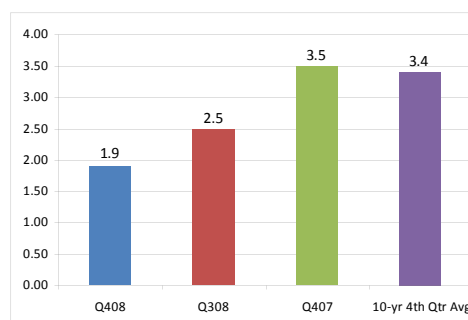
absorption for R&D product has totaled less than 10 million square feet in Silicon Valley, the previous being 1991, 2001, and 2002.

With the exception of 2001, when gross absorption totaled 8.7 million square feet, 2008's total R&D deal volume in Silicon Valley was at its lowest level since 1986.

28.32M sf	Available
9.43M sf	Gross Abs.
-1.00M sf	Net Abs.
\$1.36/sf	Rent NNN

The drop off in gross absorption was particularly acute during the fourth quarter. During the quarter, gross absorption of R&D space totaled 1.9 million square feet compared to 2.5 million square feet during the third quarter and 3.5 million square feet in the fourth quarter of 2007. By recent historical standards, the 1.9 million square feet of gross absorption during the fourth quarter of 2008 was also one of the worst on record. Over the past ten years, fourth quarter gross absorption of R&D space has averaged 3.4 million square feet, and gross absorption has totaled less than 2 million square feet in only 6 out of 92 quarters going back to the first quarter of 1986.

### Silicon Valley R&D Gross Absorption



## 2008 R&D Highlights, cont.

### Significant New 2008 R&D / Office Availabilities

Building	City	Size	Availability	Type
Legacy America Center I/II	San Jose	420,094	6/1/09	Lease
488 Almaden Blvd	San Jose	381,000	6/3/08	Sale
395 Page Mill Road	Palo Alto	224,852	10/27/08	Sublease
2375 Garcia Ave	Mountain View	127,896	12/2/08	Sublease
3000 Orchard Pky	San Jose	126,244	12/1/08	Sublease
3300 Olcott Street	Santa Clara	105,664	9/1/08	Lease
10201 N De Anza	Cupertino	104,990	6/6/08	Sublease
3100 N First Street	San Jose	103,749	6/19/08	Lease
2980 Bowers Ave	Santa Clara	102,000	10/16/08	Sale
1250 Reliance Way	Fremont	101,882	3/1/08	Sublease
2125 O'Nel Drive	San Jose	100,375	4/21/08	Sale

With the exception of the West Valley, where gross absorption growth was driven by a handful of large Cupertino transactions, every major Silicon Valley sub-market tracked by CPS experienced decreased gross absorption in 2008. Mountain View's gross absorption, for instance, totaled 668,000 square feet in 2008 – a 60 percent decrease from 2007's total of 1.6 million square feet and roughly the same level equally off the ten-year rolling average of 1.5 million square feet. San Jose and Milpitas' figures were comparably bad, while deal volume decreases were less pronounced in Santa Clara and Sunnyvale.

Unsurprisingly, R&D net absorption figures were also substantially lower in 2008 than they were in 2007. After a string of four consecutive years of positive net absorption, during which Valley-wide occupancy increased by a combined 10.4 million square feet, approximately one million square feet of property came back on the market during 2008. Most of this occurred at the end of the year, where nearly 1.4 million square feet of previously occupied space became available, erasing the modest gains of the first three quarters. The only sub-market experiencing positive net absorption of R&D space for the year was the West Valley – despite that sub-market's dramatic plunge in office net absorption (detailed later in this newsletter).

#### Vacancy Trends

For both the fourth quarter and 2008 as a whole, R&D availability increased by over 900,000 square feet during the fourth quarter of 2008, the largest increase since the 2nd quarter of 2003. While not an insignificant increase, it remains a far cry from the 6.1 million square feet of R&D space that came on the market during the third quarter of 2001. The increase in availability was highlighted by the

addition of three large blocks of sublease space during the fourth quarter – two from Google and the third from SAP/Business Objects. All together, seven R&D listings over 100,000 square feet were put on the market for lease or sublease during 2008. Significant new availabilities are indicated on the chart above.

#### Rent Trends

Rents for completed transactions are lagging economic indicators, so the severity of the present recession did not impact average annual 2008 R&D rents in a manner proportionate to the carnage inflicted on other segments of the economy during the second half of the year (although buyers who underwrote 15-20% rent growth for 2008 may have a different opinion). Average rents for completed R&D transactions decreased by a modest 4.1 percent during 2008 after increasing by 41.1 percent in 2007 and 3.0 percent in 2006. Across the various sub-markets, rents remained fairly consistent with their 2007 levels with the exception of the West Valley, where R&D rents increased by 31.5 percent to \$2.05/sf/mo triple-net, again owing to several significant Cupertino deals, including Apple's lease of Sand Hill Property Company's newly built +/- 60,000 square foot building at 10495 De Anza Boulevard at a contract rate north of \$3.00/sf triple-net and as well as a +/- 100,000 square foot lease with IStar Financial at 18880 Homestead Road. Milpitas rents, which spiked during 2007 due to several large Cisco Systems leases, retrenched 18.0 percent, finishing 2007 at \$1.17, still healthy by historical standards for that sub-market. Mountain View and Santa Clara both saw modest rent increases for 2008 as a whole.

## 2008 R&D Highlights, cont.

### Construction

During 2008, approximately 740,000 square feet of newly constructed R&D product was added to the base inventory. Of this total, 161,000 square feet was constructed on a build-to-suit basis, with the remainder built on spec.

While none of the speculative R&D space had leased by year-end, newly constructed R&D space did not materially impact 2008 vacancy rates given its minimal impact on the installed R&D base. Moreover, most of the newly built projects in the Silicon Valley were comprised 5 or more stories and are thus classified as office by CPS.

### R&D Forecast for 2009

#### Absorption

Many economists are predicting the current recession will continue through 2009. Users, therefore, will continue to pursue corporate real estate strategies that emphasize near-term flexibility and minimize capital risk. Accordingly, 2009 will see a continuation of late 2008's pattern of short-term lease renewals and low R&D gross absorption. As lease rates fall and tenants begin to perceive greater value in the marketplace, gross absorption will increase. However, it is too early to predict when job growth will resume and net absorption will return to positive territory. One relatively bright spot in 2009 may be data center space. While demand is undoubtedly impacted by recessionary forces, the growth of streaming media (e.g., YouTube, Hulu, Netflix on-demand, etc.), social networking (e.g., Facebook, MySpace, LinkedIn), the proliferation of real internet content on wireless handsets (e.g., iPhone) and the primacy of the Internet as a vehicle for service and application delivery is fueling a burgeoning demand for data center space, one which appears to be less correlated with employment than that for traditional office or R&D property.

#### Vacancy

Vacancy levels in 2009 will undoubtedly increase from 2008's 16.8%, but the extent to which it rise will depend on the severity of job losses. For an R&D building, a typical occupancy benchmark is +/- 300 square feet per employee. Based on this assumption, approximately 18,000 people occupying R&D buildings would need to lose their jobs and approximately 5.4 million square feet of negative net absorption would need to occur for

vacancy rates to reach 20%. This equates to a similar level of negative net absorption as experienced in 2003 (-5.9 million square feet), the third lowest total going back to 1986 (2001 and 2002 being the other years). Anecdotally, companies appear to have been less aggressive in their hiring and real estate decisions in this cycle compared to the dot-com era, which may soften the blow to the market in this go-around. From this viewpoint, however, it is simply impossible to tell the extent to which the recession will impact employment – and R&D vacancy – in the Silicon Valley.

#### Rent

Although rents slipped modestly in 2008 compared to the year prior, low deal volume at the end of the year portends an unstable pricing environment for R&D space in 2009. Average effective rents for completed R&D lease transactions may decrease by 15-20 percent, and possibly more, depending on the extent and duration of the downturn and its impact on the Silicon Valley. Free rent, early occupancy, and other tricks of the trade will be employed en-mass by landlords aggressively competing for deals.

#### Construction

As projects begun in 2007 and 2008 wind down, construction is set for a steep fall in 2009. Higher vacancy, tight credit, and the recession will prevent new projects from breaking ground (or in some cases, reaching completion). If any projects do commence, they will likely be by owner-occupiers, not speculative developers.

*By Gregory M. Davies - Vice President*



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## 2008 Office Highlights

### *Vacancy Trends*

The amount of office space available in the Silicon Valley increased by 362 basis points, or 1.6 million square feet, during the three months ending December 31, 2008. At quarter's end, the available inventory of office space stood at 11.1 million square feet. Since bottoming at 14.5% at the end of the second quarter of 2007, office availability has increased by a cumulative 4.8 million square feet, resulting in a year-end 2008 availability rate of 24.4%. Approximately 1.4 million square feet, or 28.2%, of the 4.8 million square feet of office space added to the available inventory since Q207 is new speculative construction that remained un-leased as of year-end 2008.

During the fourth quarter, the Downtown San Jose and the Airport Office sub-markets experienced negative net absorption, contributing to the overall increase in availability Valley-wide. 488 Almaden, a 17-story, 380,000 square foot tower, was added to the available inventory in the second quarter of 2008 and continues to impact the vacancy statistics of the downtown Class A office market, as will Legacy Partners 319,000 square foot RiverPark II tower, under construction but not part of the available inventory as of year-end 2008.

### *Absorption Trends*

For both the fourth quarter and 2008 as a whole, office leasing volume, measured by gross absorption, remained well off historical levels. Over the past ten years, fourth quarter gross absorption of office space in Silicon Valley has averaged 1.3 million square feet. Gross absorption for the fourth quarter of 2008, however, totaled 1.1 million square feet, roughly the same level as the same period of 2007, but roughly 15% off the trailing ten year average of 1.3 million square feet. Gross absorption for 2008 as a whole was even further off historical averages.

Since its recent peak of 5.6 million square feet in 2006, gross absorption has declined for two consecutive years, finishing 2008 at 3.7 million square feet, roughly in line with 1991's gross absorption total of 3.8 million square feet.

Office net absorption statistics for the fourth quarter of the year were similarly uninspiring. The quarter ended with a negative net absorption of 670,519 square feet – the fifth consecutive quarterly period of negative net absorption and the sixth of the most recent seven quarters in which this key measure of the market's condition finished in negative territory. For 2008 as a whole, net absorption of office space in Silicon Valley totaled negative 1.3 million square feet. It's worth highlighting that CPS' net absorption statistics are not affected by the addition of newly constructed space to the base or available inventory.

### *Rent Trends*

Through 2008, office rents continued to buck the generally negative trends of rising availability, below-average gross absorption, and negative net absorption. Average rents for office transactions completed during the fourth quarter of 2008 were \$3.97 per square foot full service. This number was up from \$3.32 at the end of the third quarter of 2008 and up \$1.25 from the same period one year ago. For 2008 as a whole, rents increased by 20.1 percent over 2007's average of \$2.75 per square foot. This increase in office rent was primarily due to a combination of the high rents achieved in Palo Alto and Menlo Park and the generally low deal volume in the lower rent submarkets, including the San Jose Airport and Downtown San Jose.

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## Construction

CPS market research tracked 2.7 million square feet of office space under construction during the fourth quarter of 2008. This total was primarily comprised of four significant speculative projects: Jay Paul's ongoing Moffett Towers development in Sunnyvale, Sand Hill Properties/RREEF's Offices at Downtown Sunnyvale, Legacy Riverpark Tower Phase II in Downtown San Jose and Legacy's Phase I of America Center in San Jose. For 2008 as a whole, approximately 1.7 million square feet of newly constructed office space was added to the base inventory in Silicon Valley, of which all but 348,000 square feet remained vacant as the year came to a close.

## Submarkets

### San Jose Airport

The total availability factor in the Airport office market rose to 21.85% at the end of the fourth quarter, up from 19.77% at the end of the third quarter of 2008. The average rents decreased in the fourth quarter of 2008, ending at \$2.34 per square foot full service, a decrease of \$0.25. Sublease space in the Airport market was stable at 21.94% of the total vacancy, compared to 21.27% at the end of the third quarter of 2008. Relatively low deal volume (77,575 square feet during the quarter) contributed significantly to the big swings in the quarterly Airport office market statistics. 2008 year end gross absorption was 227,015 square feet and net absorption was negative 283,355 square feet.

### Downtown Class A

The total vacancy factor in the Downtown Class A office market was 26.59% at the end of the fourth quarter of 2008, a slight increase of 0.74%. The Class A sublease space declined minimally to 1.5% of the total vacancy at the end of the fourth quarter, a reduction of 1%. The Class A average rent at the end of the fourth quarter showed a slight increase to \$2.98 full service, up from \$2.82 full service at the end of the third quarter of 2008.

## Forecast for 2009

### Availability

Supply should continue to increase as a result of a lack of market demand in this economic downturn. The percentage of space available for sublease is expected to increase as companies downsize. Sun Microsystems, Google and Yahoo! are three large companies among those putting space on the sublease market. Legacy's new tower in downtown San Jose will be nearing completion and will be added to the inventory, and the 210,000 square foot building Brocade leases at 1745 Technology Drive may also be coming available following their occupancy of their new North First Street Campus.

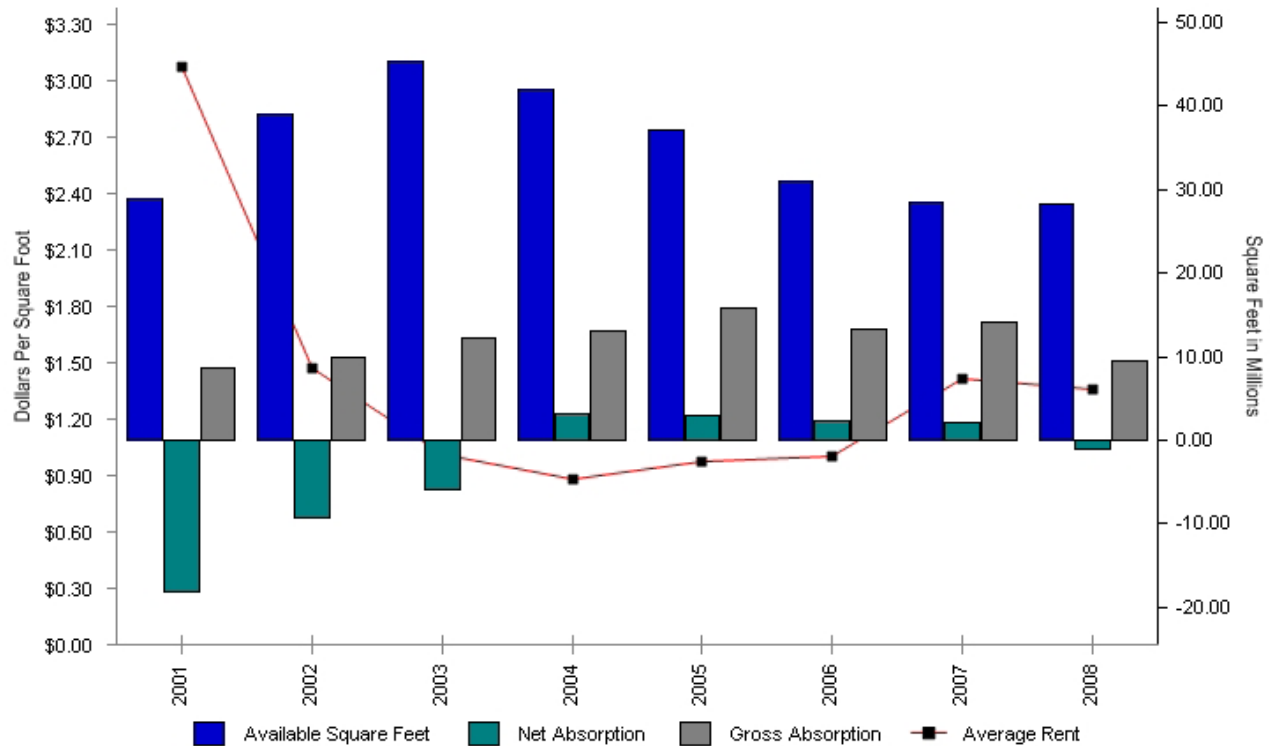
### Absorption

The historically low levels of gross absorption should continue through the first quarter as companies generally are putting requirements on hold due to economic conditions. Net absorption should also continue to be negative as companies downsize or elect not to renew their leases.

### Rents

In the face of negative absorption and availability trends, it is unlikely that average rents for completed office transactions will continue their increase during the first quarter of 2009. Instead, it is likely average rents will decline. As we anticipate, landlords will become more competitive for any viable tenant in a declining market. A large spread between asking lease rates and "strike" rates on deals will continue.

*By Maryanna McSwain - Senior Vice President / Principal  
By Erik Hallgrimson - Senior Vice President / Principal  
By Gregory M. Davies - Vice President*

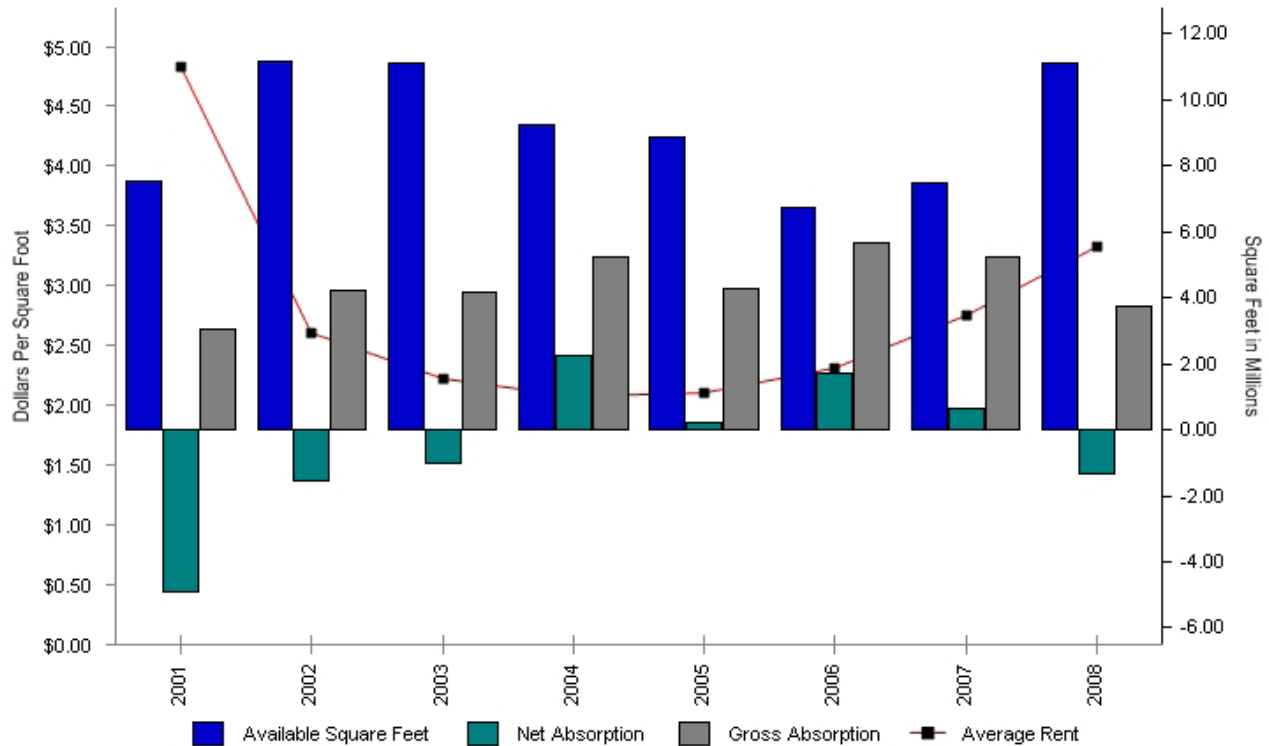


2008

28.32M sf    ∨    Available  
 9.43M sf    ∨    Gross  
 -1.00M sf    ∨    Net  
 \$1.36/sf    ∨    Rent

Period	Available sf	Average Rent	Gross Absorption	Net Absorption
2008	28,320,910	\$1.36	9,425,095	-997,276
2007	28,445,203	\$1.42	14,186,667	1,988,516
2006	31,102,057	\$1.00	13,205,210	2,288,944
2005	37,174,346	\$0.97	15,733,301	2,927,385
2004	42,012,239	\$0.88	13,063,253	3,154,067
2003	45,348,749	\$1.01	12,168,339	-5,911,225
2002	39,087,855	\$1.47	9,923,826	-9,218,463
2001	28,797,188	\$3.07	8,670,978	-18,159,341

<i>Available Supply</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Shell Direct</i>	2,686,042	2,648,307	3,776,050	3,406,311	3,955,694
<i>Shell Sublease</i>	33,558	69,348	249,980	337,141	403,489
<i>Previously Occupied Direct</i>	20,410,413	21,661,183	21,765,468	25,554,367	27,495,205
<i>Previously Occupied Sublease</i>	5,190,897	4,066,365	5,310,559	7,876,527	10,157,851
<b>Total Available</b>	<b>28,320,910</b>	<b>28,445,203</b>	<b>31,102,057</b>	<b>37,174,346</b>	<b>42,012,239</b>
<i>Available Time on Market (In Months)</i>	27.12	28.47	29.00	26.27	22.49
<i>Gross Absorption</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Shell Direct</i>	579,225	2,520,040	627,928	1,019,370	1,415,965
<i>Shell Sublease</i>	47,261	128,000	0	50,863	91,000
<i>Previously Occupied Direct</i>	7,851,537	10,051,085	10,870,229	12,797,102	9,100,557
<i>Previously Occupied Sublease</i>	947,072	1,487,542	1,707,053	1,865,966	2,455,731
<b>Total Absorption</b>	<b>9,425,095</b>	<b>14,186,667</b>	<b>13,205,210</b>	<b>15,733,301</b>	<b>13,063,253</b>
<i>Absorption Time on Market (In Months)</i>	20.15	20.81	20.52	18.15	15.72
<i>Supply Rates</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Availability Rate</i>	16.78%	16.93%	18.38%	21.99%	24.91%
<i>Vacancy Rate</i>	16.64%	16.37%	17.94%	21.73%	24.85%
<i>Sublease Factor</i>	18.45%	14.54%	17.88%	22.09%	25.14%
<i>Size Ranges</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>0 to 20,000</i>	332	300	307	430	436
<i>20,001 to 40,000</i>	203	183	220	263	309
<i>40,001 to 60,000</i>	111	123	141	139	166
<i>60,001 to 80,000</i>	60	65	65	82	78
<i>80,001 to 100,000</i>	37	35	40	55	57
<i>100,001 to 120,000</i>	21	19	22	20	22
<i>120,001 to 140,000</i>	8	10	6	9	10
<i>140,001 and Over</i>	12	11	13	21	27
<b>Total Buildings Available</b>	<b>784</b>	<b>746</b>	<b>814</b>	<b>1,019</b>	<b>1,105</b>
<i>Construction Types</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<b>Completed Construction:</b>					
<i>Build-To-Suit</i>	161,500	340,000	0	0	0
<i>Spec Construction</i>	577,607	102,850	644,731	440,399	71,393
<b>Total Completed</b>	<b>739,107</b>	<b>442,850</b>	<b>644,731</b>	<b>440,399</b>	<b>71,393</b>
<b>In-Process Construction:</b>					
<i>Build-To-Suit</i>	0	161,500	76,500	0	0
<i>Spec Construction</i>	143,424	379,107	73,792	504,560	207,489
<b>Total in Progress</b>	<b>143,424</b>	<b>540,607</b>	<b>150,292</b>	<b>504,560</b>	<b>207,489</b>



2008

11.11M sf ▲ Available  
 3.75M sf ▼ Gross  
 -1.31M sf ▼ Net  
 \$3.33/sf ▲ Rent

Period	Available sf	Average Rent	Gross Absorption	Net Absorption
2008	11,114,203	\$3.33	3,748,906	-1,310,021
2007	7,454,933	\$2.75	5,210,995	625,583
2006	6,734,605	\$2.32	5,641,541	1,737,566
2005	8,863,030	\$2.11	4,252,903	197,213
2004	9,256,507	\$2.08	5,237,357	2,243,685
2003	11,090,443	\$2.23	4,162,630	-1,003,018
2002	11,161,242	\$2.61	4,210,044	-1,569,476
2001	7,541,572	\$4.83	3,049,619	-4,906,115

<i>Available Supply</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Shell Direct</i>	3,717,671	1,446,993	643,755	985,706	1,389,774
<i>Shell Sublease</i>	10,200	0	0	6,223	56,483
<i>Previously Occupied Direct</i>	6,452,116	5,059,767	5,271,780	6,355,614	6,233,747
<i>Previously Occupied Sublease</i>	934,216	948,173	819,070	1,515,487	1,576,503
<b><i>Total Available</i></b>	<b>11,114,203</b>	<b>7,454,933</b>	<b>6,734,605</b>	<b>8,863,030</b>	<b>9,256,507</b>

<i>Gross Absorption</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Shell Direct</i>	374,023	1,041,893	409,785	525,068	823,891
<i>Shell Sublease</i>	6,807	0	0	0	0
<i>Previously Occupied Direct</i>	2,969,072	3,450,866	4,274,165	3,292,683	3,542,133
<i>Previously Occupied Sublease</i>	399,004	718,236	957,591	477,597	871,333
<b><i>Total Absorption</i></b>	<b>3,748,906</b>	<b>5,210,995</b>	<b>5,641,541</b>	<b>4,252,903</b>	<b>5,237,357</b>

<i>Supply Rates</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Availability Rate</i>	24.36%	16.63%	15.55%	20.47%	21.42%
<i>Vacancy Rate</i>	22.53%	15.88%	15.15%	20.44%	21.29%
<i>Sublease Factor</i>	8.50%	12.72%	12.16%	17.17%	17.64%

<i>Size Ranges</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>0 to 20,000</i>	473	400	361	389	377
<i>20,001 to 40,000</i>	62	49	51	75	79
<i>40,001 to 60,000</i>	22	12	18	8	19
<i>60,001 to 80,000</i>	9	7	5	10	9
<i>80,001 to 100,000</i>	4	3	2	4	5
<i>100,001 to 120,000</i>	2	6	5	8	5
<i>120,001 to 140,000</i>	0	0	1	3	1
<i>140,001 and Over</i>	9	3	2	4	7
<b><i>Total Buildings Available</i></b>	<b>581</b>	<b>480</b>	<b>445</b>	<b>501</b>	<b>502</b>

<i>Construction Types</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<b><i>Completed Construction:</i></b>					
<i>Build-To-Suit</i>	288,000	545,745	0	80,000	266,867
<i>Spec Construction</i>	1,440,694	33,404	19,063	0	7,061
<b><i>Total Completed</i></b>	<b>1,728,694</b>	<b>579,149</b>	<b>19,063</b>	<b>80,000</b>	<b>273,928</b>
<b><i>In-Process Construction:</i></b>					
<i>Build-To-Suit</i>	752,000	288,000	355,745	0	0
<i>Spec Construction</i>	2,019,998	2,154,064	9,714	19,063	9,420
<b><i>Total in Progress</i></b>	<b>2,771,998</b>	<b>2,442,064</b>	<b>365,459</b>	<b>19,063</b>	<b>9,420</b>



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## 2008 Warehouse Highlights

### Supply

The slowing economy has finally had its effect on the Silicon Valley warehouse market. After experiencing nine out of the last eleven quarters having positive absorption, the 4th quarter of 2008 ended with 754,000 square feet of negative net absorption. That total represents the largest single quarter decline in more than five years, when the second quarter of 2003 saw a negative 1.1 million square feet of absorption. However, all is not terrible as overall vacancy despite its 32% increase from Q3-08 now stands at 10.7% - more or less the theoretical equilibrium point of supply and demand. Currently, there is almost 3.6 million square feet available Silicon Valley-wide, but many sub-markets (such as Sunnyvale and Mountain View) continue to present very few, if any, choices for tenants.

### Demand

Demand for the year was almost exactly equal to 2007, finishing at 2.43 million square feet of gross absorption. Net absorption, however, declined from a positive 781,000 square feet to a negative 920,000 square feet. That difference represented the largest decline in net absorption since 1.73 million square feet of negative net absorption was experienced in 2003. Surprisingly, the deal volume for the year remained consistent with 108 total transactions. Of note (but not surprising) was the large percentage of renewals: 35% of the total deal volume was renewals compared to 23% in 2007 and 17% in 2006. Also of note was average time on the market for the year was just under nine months – surprisingly low considering the economy. That length of time on the market was the shortest – on an annual basis - in six years. Time on the market for spaces leased in the 4th quarter of 2008 was up slightly from the third quarter, but still less than six months on average.

### Rents

Warehouse rents for the year fell a meager 2% from 2007 as the lack of choices for many tenants kept landlords from having to get into a bidding war for their occupancy. The lack of sublease space that normally will drag rents down was a contributing factor, however; despite the relatively low vacancy rates for most of the year, the lack of activity in the market, coupled with the fear landlords have of a very slow 2009, kept asking rents from rising.

Average deal size was right at the previous eight-quarter average at 35,936 square feet. Tenant improvement contributions did rise significantly in 2008 as tenants were able to gain some concessions from fearful landlords. The \$2.30 per square foot average contribution was the highest since 1996 - a time when there were many deals done in shell space that required a \$4.00 - \$5.00 initial outlay for tenant improvements.

## Forecast for 2009

### Supply

The supply of warehouse space will continue to increase gradually as the effects of the economy take its toll on local warehouseers. We don't expect a significant increase as many tenants are still running at near capacity in their spaces and will most likely not shed space unless the economy worsens dramatically. Expect the supply of B and C spaces to increase more dramatically than A spaces as they are often occupied by financially weaker tenants and by stronger tenants who choose to take advantage of opportunities to upgrade to A space. As has been the case for several years, no new warehouse projects were constructed in the quarter and there remains no new speculative construction planned for 2009.

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## Forecast for 2009, cont.

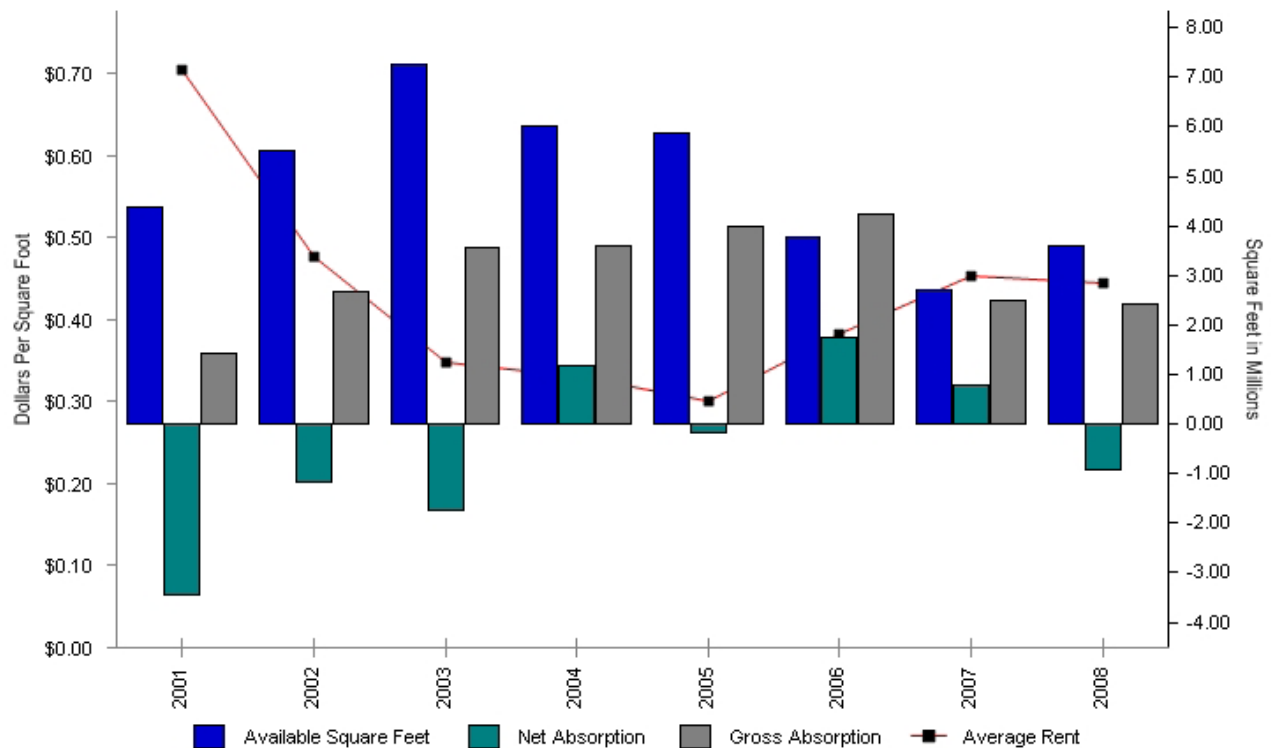
### *Demand*

While demand coming from existing Silicon Valley tenant's expansions will be rare, we still expect some movement as tenants either adjust sizing or take advantage of a more functional or better located space where the cost of the move will be absorbed by a new landlord's rental concessions. However, once a tenant has one foot out the door, current landlords will continue to be very aggressive to keep them. As such, 2009 may provide a record number of renewals as a percentage of total transactions. In the end, we expect gross demand to be again near the 2.5 million square foot level. Net will most likely again be negative but should stay under one million square feet.

### *Rents*

We expect average rents to show a noticeable decline, reflecting both the aggressiveness of brokers and the tenants they represent in demanding more concessions and lower rental rates from landlords (both new and existing). Expect the most aggressive to be the publicly traded REIT landlords as they have suffered heavy losses in stock value over the last 12 months and are graded in large part on occupancy levels. Spaces that have been vacant will provide the most in the way of rental concessions as asset managers feel more pressure from portfolio managers to fill vacancies. "Mom and Pop" landlords with no upcoming financing worries may be less likely to "give away the store", especially if they see the economy begin to turn. As always, tenants with a good track record and/or a strong balance sheet will be in the strongest negotiating position.

*By Scott Borgia - Senior Vice President / Principal*



2008

3.59M sf ▲ Available  
 2.43M sf ▼ Gross  
 -.92M sf ▼ Net  
 \$.45/sf ◀ Rent

Period	Available sf	Average Rent	Gross Absorption	Net Absorption
2008	3,588,212	\$0.45	2,431,025	-920,731
2007	2,716,777	\$0.45	2,502,209	781,121
2006	3,770,869	\$0.38	4,244,940	1,751,764
2005	5,884,872	\$0.30	3,985,573	-162,000
2004	6,000,138	\$0.33	3,584,666	1,163,872
2003	7,259,510	\$0.35	3,546,744	-1,725,473
2002	5,534,037	\$0.48	2,669,411	-1,179,143
2001	4,367,135	\$0.71	1,419,007	-3,445,063

<i>Available Supply</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Shell Direct</i>	0	0	0	0	0
<i>Shell Sublease</i>	0	0	0	0	0
<i>Previously Occupied Direct</i>	3,309,999	2,420,720	3,275,343	4,478,403	4,845,675
<i>Previously Occupied Sublease</i>	278,213	296,057	495,526	1,406,469	1,154,463
<b><i>Total Available</i></b>	<b>3,588,212</b>	<b>2,716,777</b>	<b>3,770,869</b>	<b>5,884,872</b>	<b>6,000,138</b>
<i>Available Time on Market (In Months)</i>	14.53	18.18	18.77	17.00	19.07
<i>Gross Absorption</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Shell Direct</i>	0	0	49,728	0	0
<i>Shell Sublease</i>	0	0	0	0	0
<i>Previously Occupied Direct</i>	2,202,293	2,184,173	3,941,396	3,842,118	3,489,968
<i>Previously Occupied Sublease</i>	228,732	318,036	253,816	143,455	94,698
<b><i>Total Absorption</i></b>	<b>2,431,025</b>	<b>2,502,209</b>	<b>4,244,940</b>	<b>3,985,573</b>	<b>3,584,666</b>
<i>Absorption Time on Market (In Months)</i>	8.71	17.06	10.82	17.19	13.71
<i>Supply Rates</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>Availability Rate</i>	10.70%	8.10%	11.24%	17.54%	17.89%
<i>Vacancy Rate</i>	10.70%	8.10%	11.24%	17.37%	17.89%
<i>Sublease Factor</i>	7.75%	10.90%	13.14%	23.90%	19.24%
<i>Size Ranges</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<i>0 to 20,000</i>	22	18	18	30	27
<i>20,001 to 40,000</i>	31	16	20	28	44
<i>40,001 to 60,000</i>	9	10	9	15	15
<i>60,001 to 80,000</i>	8	5	10	14	11
<i>80,001 to 100,000</i>	4	2	2	5	7
<i>100,001 to 120,000</i>	2	0	1	6	5
<i>120,001 to 140,000</i>	3	2	5	5	4
<i>140,001 and Over</i>	3	3	4	6	6
<b><i>Total Buildings Available</i></b>	<b>82</b>	<b>56</b>	<b>69</b>	<b>109</b>	<b>119</b>
<i>Construction Types</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
<b><i>Completed Construction:</i></b>					
<i>Build-To-Suit</i>	0	0	0	0	0
<i>Spec Construction</i>	0	0	0	0	0
<b><i>Total Completed</i></b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b><i>In-Process Construction:</i></b>					
<i>Build-To-Suit</i>	0	0	0	0	0
<i>Spec Construction</i>	400,000	0	0	0	0
<b><i>Total in Progress</i></b>	<b>400,000</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>



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<b>Shell</b> New, never occupied building	<b>Direct</b> Transaction with Owner	<b>Previously Occupied</b> New or old building that has been occupied at least once	<b>Gross Absorption</b> The total space sold or leased
<b>Speculative Construction</b> The amount of speculative space that commenced construction during period	<b>Net Absorption</b> The increase or decrease in occupied space	<b>Build to Suit</b> A building built specifically for a company, whether owned or leased	<b>Vacancy Rate</b> Total vacant space divided by total standing inventory
<b>Sublease Factor</b> Total available sublease space divided by total available space	<b>Standing Inventory</b> All space in market regardless of occupancy status	<b>Sublease</b> Transaction with existing tenant	<b>Availability Rate</b> Total square feet of space available divided by total standing inventory

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The information contained herein has been provided by either the property owner or sources we deemed reliable. Although CPS has no reason to doubt its accuracy, we have not independently confirmed the information and do not guarantee it. All information (including square footage) should be verified and each property should be analyzed prior to purchase or lease based on individual needs.