

## Q308 Market Summary

During the three month period ending September 30, 2008, Silicon Valley office vacancy increased as companies gave up space, newly constructed buildings were added to the available inventory, and the overall pace of deal volume as measured by gross absorption remained substantially below recent averages. Market fundamentals were more mixed for R&D space. Average rents for completed transactions increased slightly and net absorption totaled a positive 566,000 square feet. Gross absorption for R&D space, however, was nearly 30% off recent averages and the continuing downward spiral of the credit markets, venture capital, and the macro economy are contributing to increasing uncertainty in the commercial real estate community as we head towards the year end.

### Economic Indicators

	Q307	Q308
Unemployment Rate - Silicon Valley MSA*	4.9%	6.5%
Unemployment Rate - Santa Clara County*	4.9%	6.5%
Unemployment Rate - California*	5.4%	7.5%
Unemployment Rate - National	4.5%	6.0%
Inflation (CPI-U)*	1.0%	2.6%
VC Investment - National**	\$7.94B	\$7.37B
VC Investment - Bay Area**	\$2.59B	\$3.17B
VC Confidence Index***	4.14/5	2.89/5
Job Growth - Silicon Valley MSA*	1,300	-3,000
Job Growth - Santa Clara County	1,200	-3,000

\*Not seasonally adjusted

\*\*Source: Dow Jones Venture One Venture Capital Report

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

### Silicon Valley Economic Overview

During the third quarter of 2008, the consequences of impudent real estate lending, aggravated by aggressive securitization and reliance on unregulated credit default swaps, spread like a contagion throughout the U.S. financial system. The U.S. government seized control of Fannie Mae and Freddie Mac. Bank of America acquired Merrill Lynch after its CDO values plummeted. Lehman Brothers filed for the largest bankruptcy in U.S. history. Stand-alone investment banks ceased to exist as Goldman Sachs and Morgan Stanley became bank holding companies. Washington Mutual failed. The stock market posted its biggest one day point loss in history

after congress failed to pass the initial version of a \$700 billion Troubled Asset Relief Program (TARP).

As of this writing, there are signs that the TARP program has helped mitigate the financial panic and that the freeze in credit markets is slowly thawing. However, the consumer sector remains in terrible shape with spending on the decline, job losses mounting, and housing prices continuing their perilous slide. In September, homes located in the more prestigious parts of the San Francisco Peninsula that had previously appeared immune to the broader decline of the housing market began to see a retrenchment in value. In the Silicon Valley, venture capitalists are reeling from dwindling M&A and IPO prospects and from the challenges of raising new funds from their limited partners. As a consequence, start-up companies are facing tremendous pressure to cut costs and demonstrate a path to profitability. On October 7th, Sequoia Capital gave the CEOs of their portfolio companies a presentation titled "R.I.P Good times" that subsequently made the email and blogging rounds. In it, these CEOs were told to prepare for a slowdown that could last for years, not months. Fortunately, not all business leaders and economists share as pessimistic a vision as the VCs at Sequoia. Most surveys predict a recovery in late 2009 for the broader economy. Until then, companies and consumers appear resigned to hunker down, cut costs, and position themselves to weather the storm.

## Q308 R&D Highlights

27.40M sf	Y	Available
2.50M sf	A	Gross Abs.
.57M sf	A	Net Abs.
\$1.53/sf	A	Rent NNN

### Absorption Trends

The Silicon Valley R&D market experienced 566,411 square feet of positive net absorption

## Q308 R&D Highlights, cont.

### Significant Third Quarter 2008 R&D Lease Transactions

Landlord/Sublessor	Tenant	Address	City	Size
Stanford Board Of Trustees	Facebook	1601 S California	Palo Alto	137,000
Blue Coat Systems, Inc.	Trend Micro, Inc.	10201 N De Anza	Cupertino	104,990
iStar Financial	Apple Computer	18880 Homestead	Cupertino	102,588
Lane Partners	BAE Systems	2811 Orchard Pky	San Jose	84,560
South Bay Development	LGC Wireless	541 E Trimble Road	San Jose	79,780
D.R. Stephens & Company	Canaan Church	4405 Fortran Court	San Jose	66,368
Mission West Properties	Synaptics, Inc.	2251 Lawson Lane	Santa Clara	62,500
Walton Street Capital, LLC	Johnson Controls, Inc.	843 Auburn Court	Fremont	60,312

during the third quarter of 2008. This marks an improvement over the negative 501,144 square feet of net absorption that occurred during the second quarter of this year, but represents a total that is substantially less than the 1.48M square feet of positive net absorption that occurred during third quarter of last year. Gross absorption, which totaled 2.5M square feet, remained at a similarly low level experienced in the past two quarters. Compared to the 16 quarter rolling average of 3.4M square feet, gross absorption was off by 26.1% during the period. Year-to-date gross absorption stands at 7.6M square feet compared to 10.8M square feet during the same period of 2007. Ominously, R&D gross absorption for 2008 is on track to finish below the 10M square foot threshold. Since 1986, the only years gross absorption has finished below 10M square feet were 1991, 2001 and 2002.

### Gross Absorption Comparison

	Q308	Q307	16Q Avg.
Silicon Valley	2,505	4,201	3,391
Menlo Park/Palo Alto	287	680	270
Mountain View	156	323	352
Sunnyvale	270	824	595
Santa Clara	386	916	491
Cam-Cup-LG	316	45	134
San Jose	716	886	771
Milpitas	56	177	352
Fremont	317	350	452

Submarkets that experienced positive net absorption during the period included Menlo Park-Palo Alto (146,291), Sunnyvale (153,290), Santa Clara (161,782), the West Valley (308,485) and San Jose (215,633). Milpitas (-270,040), Fremont (-68,122) and Mountain View (-93,908) experienced negative net absorption, although several pending leases in Mountain View are expected to be signed early in the fourth quarter.

As evidenced in the chart above, the ratio of renewals vs. gross absorption has increased from a low of 21.0% to 38.1% for the year-to-date period. Historically in weaker markets the rate of renewals tends to increase as appears to be the case heading into 2009.

### Vacancy Trends

At the end of the third quarter, 27.4M square feet of R&D space was available in Silicon Valley, representing 16.2% of the base inventory. This marks a reduction of approximately 760,000 square feet from the 28.2M square feet available at the close of the prior period and a reduction of 1.2M square feet from the 28.6M square feet available in the third quarter of 2007. Silicon Valley R&D availability has decreased in 16 of the past 18 quarters, although that trend is in serious risk of changing given economic conditions.

### Renewals Compared to Gross Absorption

Year	Gross Absorption	Renewals	Percent
2008*	7,988	3,045	38.12%
2007	14,167	3,037	21.44%
2006	13,205	2,770	20.98%
2005	15,733	3,900	24.79%
2004	13,063	3,166	24.24%
2003	12,168	3,490	28.68%
2002	9,923	2,447	24.66%
2001	8,671	2,704	31.18%

\*Through Q308

The percentage of the available inventory comprised of sublease space is a useful indicator of the direction of the leasing market. In July of 2000, sublease space represented 17% of the total R&D space available in Silicon Valley. Fast forward fifteen months, and sublease space hit a high of at 44.2% of the available inventory, putting tremendous downward pressure on rents. At 16.9%, Q308 sublease availability of 5.5M square feet remains near historical lows. However, it has



## Q308 R&D Highlights, cont.

### Significant New Third Quarter 2008 R&D Availabilities

Building	City	Size	Availability	Type
3000 Orchard Pky	San Jose	126,244	12/1/08	Sublease
765 Sycamore Drive	Milpitas	67,760	Now	Sublease
2011 Stierlin Court	Mountain View	65,856	Now	Sublease
540 Alder Drive	Milpitas	52,812	1/1/09	Lease
3099 Orchard Drive	San Jose	51,105	Now	Sublease
2350 Zanker Road	San Jose	50,330	Now	Sublease

inched up steadily from the 14.5% level witnessed in the fourth quarter of 2007.

#### Rent Trends

Average rents for completed R&D lease transactions in Silicon Valley increased \$.30 to \$1.53 per square foot triple-net from the second quarter's average of \$1.23 per square foot triple-net. Much of this increase can be attributed to several high rent leases in Palo Alto and Menlo Park. Third quarter R&D rents also exceeded the sixteen quarter rolling average of \$1.17 per square foot triple-net. However, one year ago average rents stood at \$1.64 per square foot and CPS brokers are finding prospective tenants, particularly those that are VC-backed, under significant pressure to negotiate rents at substantial discounts to asking prices. Declines in average asking rents are being camouflaged by the increasing prevalence of "teaser" asking rates (e.g., official asking rate of \$1.50 per square foot but \$0.99 per square foot for year one for deals signed by year-end).

#### Construction

As of the third quarter of 2008, four R&D buildings totaling 237,540 square feet were under construction in Silicon Valley, including two in Sunnyvale, one in Cupertino, and another in Fremont. One property measuring 118,535 square feet located in Fremont came within nine months of completion and was added to the base inventory. A statistically insignificant number of R&D buildings have or will be added to the base inventory during this cycle as most of the new construction in the Silicon Valley is greater than five stories and is thus classified as office by CPS.

## R&D Forecast for Q408

#### Absorption

Gross absorption during the fourth quarter for R&D product will decline further from the low levels

seen in Q1-Q3 and will likely finish the year under 10M square feet. This stems from tenants postponing all but the most essential facilities decisions as they assess the impact of the current recession on their finances and adjust their forecasts going forward. Renewals will also increase.

#### Vacancy

R&D vacancy rates will increase slightly during the third quarter as tenants reduce their footprints when leases come up for renewal, put expansion plans on hold, and more space becomes available for sublease. A massive explosion of sublease availability to the extent of what occurred in late 2001 and early 2002 is not expected as the patterns of space absorption in the current cycle were much more conservative (and less speculative). Moreover, much of the absorption came from large profitable public companies such as Cisco, Apple, Google, and Lockheed as opposed to Internet companies with no stand alone viability. Submarkets where the current crop of "Web 2.0" companies are concentrated – particularly in the mid-peninsula and San Francisco – will feel the effects of the contraction in venture investment more acutely than the core areas of the Silicon Valley (Palo Alto south).

#### Rent

Landlords with low enough cost bases and/or loans that don't reset for two to three more years have begun lowering their asking rents and this trend should accelerate going into the end of the year. Given the pressure from tenants to negotiate discounts off asking rates, it is unlikely that average asking rents will likely decline too substantially unless sublease availability dramatically increases. However, average rents for completed R&D transactions may decrease between 10 and 15% from their last 12-month average of \$1.46 per square foot, as tenants



## Q308 R&D Highlights, cont.

(and their investors) demand greater concessions. Palo Alto and Mountain View will experience the greatest price stability, while the strongest downward pressure on rents will be felt in Fremont, Milpitas, and North San Jose.

### *Construction*

No new speculative R&D projects are expected to break ground until substantial improvement is witnessed in the local, regional, and national economy.

*By Gregory M. Davies - Vice President*



# Real News

the silicon valley quarterly on commercial real estate

## Q308 Office Highlights

### Vacancy Trends

The amount of office space available in the Silicon Valley increased by 8.8%, or 1.1M square feet, during the three months ending September 30, 2008. At quarter's end, the available inventory of office space stood at 9,473,913 square feet. Since bottoming at 14.51% in the second quarter of 2007, office availability has increased by a cumulative 3,186,410 square feet, resulting in a third quarter 2008 availability rate of 20.86%.

During the third 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, added to the available inventory during the second quarter of the year and continued to weigh on the downtown office market. Sobrato Development, which built the building and sold it to BEA (now Oracle) in 2007, was rumored to be negotiating a potential re-acquisition of the property at a substantial discount to the \$135,000,000 paid by Oracle. As of this writing, however, the property was officially off the market.

The West Valley sub-market was one of the lone bright spots during the quarter, despite continued downsizing of financial services and title companies. Class A and Class B office product both experienced positive net absorption during the quarter. The portion of the available inventory in the West Valley comprised of sublease space increased to 10.5% at the end of the third quarter, an increase of 2.22%, but still low by historical standards.

### Absorption Trends

During the third quarter of 2008, gross absorption, remained well off historical levels. Over the past five years, quarterly gross absorption of Silicon Valley office space has averaged 1.24M square feet per quarter. Gross absorption for the third quarter of 2008, however, totaled 983,469 square

feet, an incremental increase of 137,388 square feet from the first quarter's level of 847,091 square feet, but roughly 30% off the rolling five year average level.

Office net absorption statistics for the thirdquarter of the year were similarly uninspiring. The quarter ended with a negative net absorption of 214,186 square feet – the fourth consecutive quarterly period of negative net absorption and the fifth of the most recent five quarters in which this key measure of the market's condition finished in negative territory. On a positive note, however, the third quarter of 2008 saw the first lease signed on a speculative office project as Sand Hill Property Company leased its new 56,670 square foot Cupertino building to Apple.

### Rent Trends

Office rents continue to buck the generally negative trends of rising availability, below-average gross absorption, and negative net absorption. Average office rents at the end of the third quarter of 2008 were \$3.32 per square foot full service. This number was up from \$3.22 at the end of the second quarter of 2008 and \$5.50 from the same period one year ago. This increase was largely due to a combination of high rents in Palo Alto and the Peninsula and generally low deal volume in the lower rent submarkets including the San Jose Airport.

### Construction

CPS market research tracked 2.9M square feet of office space under construction during the third quarter of 2008. This total was primarily comprised of three significant speculative projects: Jay Paul's ongoing Moffett Towers development in Sunnyvale, Sand Hill Properties/RREEF's Offices at Downtown Sunnyvale, and Legacy Riverpark Tower Phase II in Downtown San Jose.



## Q308 Office Highlights, cont.

### Submarkets

#### San Jose Airport

The total availability factor in the Airport office market rose to 19.77% at the end of the third quarter, up from 17.75% at the end of the second quarter of 2008. The average rents increased in the third quarter of 2008, ending at \$2.59 full service, an increase of \$.44. Sublease space in the Airport market was stable at 21.27% of the total vacancy, compared to 21.58% at the end of the second quarter of 2008. Relatively low deal volume (56,277 square feet during the quarter) contributes significantly to the big swings in the quarterly airport office market statistics.

#### Downtown Class A

The total vacancy factor in the Downtown Class A office market was 25.85% at the end of the third quarter of 2008, a slight increase of 1.32%. The Class A sublease space declined minimally to 2.9% of the total vacancy at the end of the third quarter, a reduction of 1%. The Class A average rent at the end of the third quarter showed a slight decrease to \$2.82 full service, down from \$2.91 full service at the end of the second quarter of 2008.

### Forecast for Q408

#### Availability

Supply should continue to increase as a result of a lack of market demand, which is a result of the financial crisis.

#### Absorption

The low level of gross absorption should continue through July and August, typically two of the slowest months of the year. Net absorption should also continue to be slightly negative as companies downsize or elect not to renew their leases. Gross absorption should continue to be at historically low rates as companies put off their decision making. Net absorption should be negative because of economic woes.

#### Rents

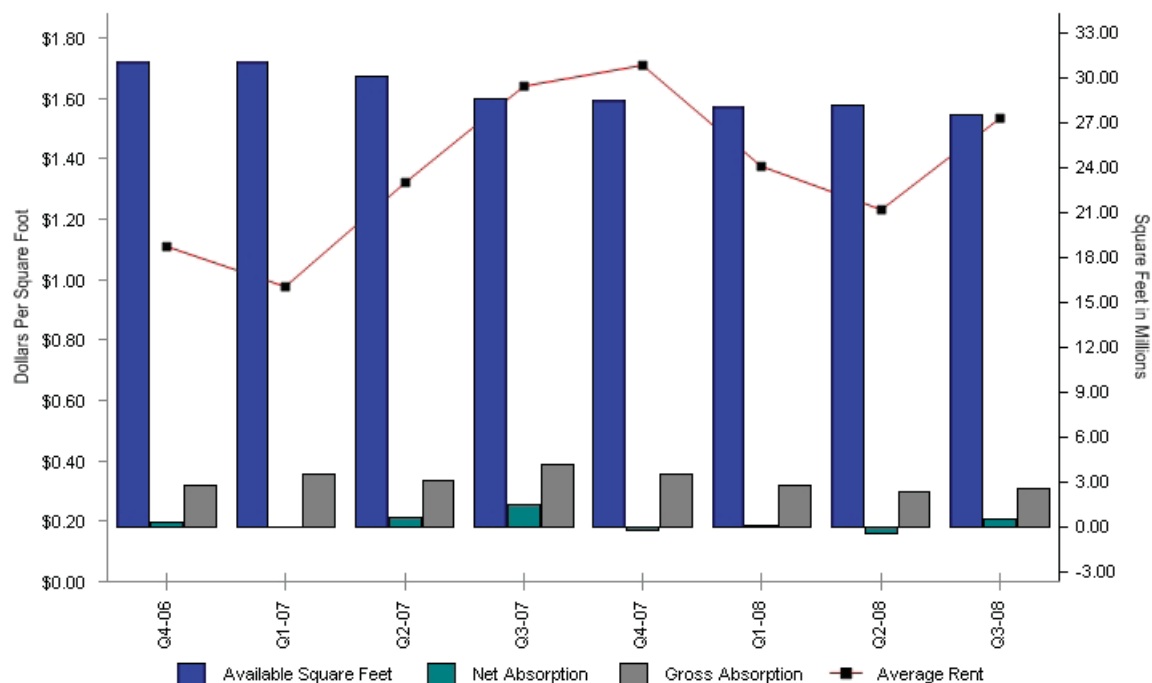
In the face of negative absorption and availability trends, it is unlikely average rents for completed office transactions will continue their increase during the fourth quarter of 2008. Instead, it is likely rents will decline as landlords get competitive for tenants in a declining market. There will most likely be a larger spread between asking lease rates and "strike" rates on deals.

*By Maryanna McSwain - Senior Vice President / Principal*

*By Erik Hallgrimson - Senior Vice President / Principal*

*By Gregory M. Davies - Vice President*





**Q308**

27.40M sf ▼ Available  
 2.50M sf ▲ Gross  
 .57M sf ▲ Net  
 \$1.53/sf ▲ Rent

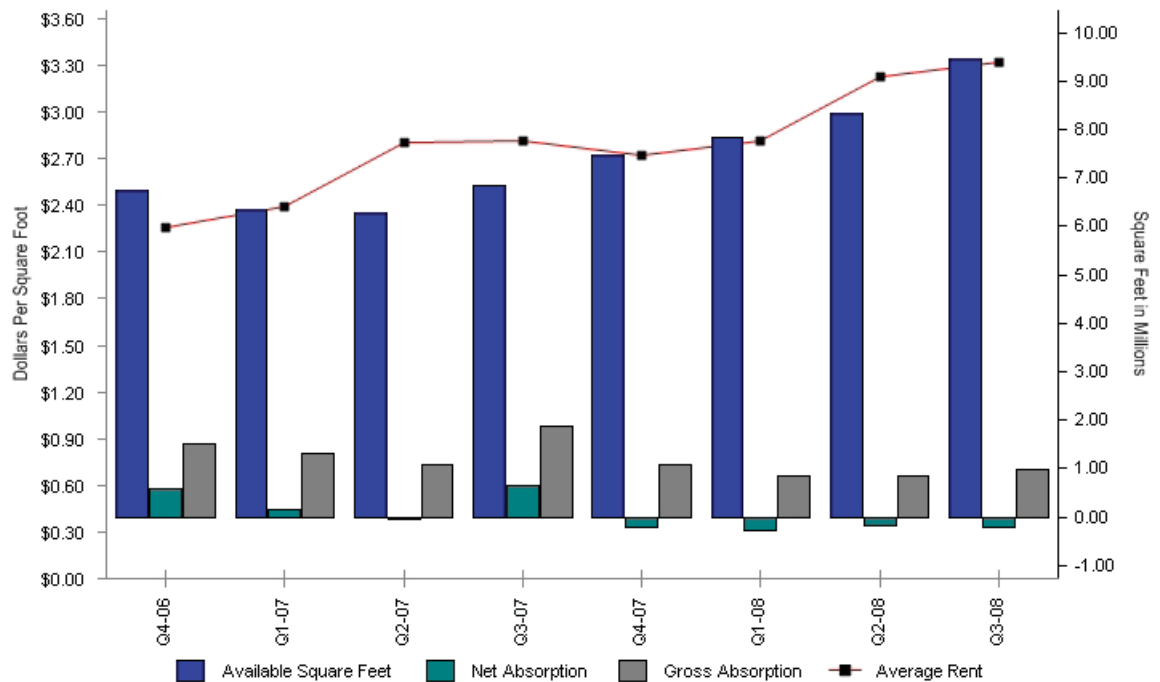
Period	Available sf	Average Rent	Gross Absorption	Net Absorption
Q308	27,402,891	\$1.53	2,504,993	566,411
Q208	28,165,084	\$1.23	2,343,122	-501,143
Q108	28,062,819	\$1.37	2,750,430	102,252
Q407	28,445,203	\$1.71	3,528,372	-284,303
Q307	28,598,681	\$1.64	4,200,892	1,477,475
Q207	30,090,527	\$1.32	3,125,857	653,150
Q107	31,101,476	\$0.98	3,496,793	-30,231
Q406	31,102,057	\$1.11	2,813,194	345,985

### 3rd Quarter 2008 R&D Silicon Valley



<b>Available Supply</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<i>Shell Direct</i>	2,755,293	2,569,471	2,500,089	2,648,307	2,761,790
<i>Shell Sublease</i>	44,482	44,482	80,272	69,348	159,348
<i>Previously Occupied Direct</i>	20,008,504	21,065,020	21,098,987	21,661,183	21,533,449
<i>Previously Occupied Sublease</i>	4,594,612	4,486,111	4,383,471	4,066,365	4,144,094
<b>Total Available</b>	<b>27,402,891</b>	<b>28,165,084</b>	<b>28,062,819</b>	<b>28,445,203</b>	<b>28,598,681</b>
<i>Available Time on Market (In Months)</i>	<b>27.45</b>	<b>27.09</b>	<b>27.29</b>	<b>28.47</b>	<b>28.44</b>
<b>Gross Absorption</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<i>Shell Direct</i>	60,508	81,430	327,907	755,070	862,942
<i>Shell Sublease</i>	0	47,261	0	0	0
<i>Previously Occupied Direct</i>	2,126,770	1,999,131	2,182,076	2,672,934	2,841,074
<i>Previously Occupied Sublease</i>	317,715	215,300	240,447	100,368	496,876
<b>Total Absorption</b>	<b>2,504,993</b>	<b>2,343,122</b>	<b>2,750,430</b>	<b>3,528,372</b>	<b>4,200,892</b>
<i>Absorption Time on Market (In Months)</i>	<b>19.50</b>	<b>20.19</b>	<b>28.44</b>	<b>17.75</b>	<b>22.62</b>
<b>Supply Rates</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<i>Availability Rate</i>	16.25%	16.71%	16.66%	16.93%	17.03%
<i>Vacancy Rate</i>	15.81%	16.22%	16.44%	16.37%	16.50%
<i>Sublease Factor</i>	16.93%	16.09%	15.91%	14.54%	15.05%
<b>Size Ranges</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<i>0 to 20,000</i>	303	287	295	300	293
<i>20,001 to 40,000</i>	195	200	191	183	193
<i>40,001 to 60,000</i>	109	117	116	123	115
<i>60,001 to 80,000</i>	61	64	61	65	64
<i>80,001 to 100,000</i>	33	35	37	35	40
<i>100,001 to 120,000</i>	20	21	17	19	21
<i>120,001 to 140,000</i>	7	9	11	10	8
<i>140,001 and Over</i>	12	10	11	11	12
<b>Total Buildings Available</b>	<b>740</b>	<b>743</b>	<b>739</b>	<b>746</b>	<b>746</b>
<b>Construction Types</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<b>Completed Construction</b>					
<i>Build-To-Suit</i>	0	0	161,500	0	255,000
<i>Spec Construction</i>	118,535	123,842	235,230	102,850	0
<b>Total Completed</b>	<b>118,535</b>	<b>123,842</b>	<b>396,730</b>	<b>102,850</b>	<b>255,000</b>
<b>In-Process Construction</b>					
<i>Build-To-Suit</i>	0	0	0	161,500	161,500
<i>Spec Construction</i>	237,540	321,075	301,932	379,107	481,957
<b>Total in Progress</b>	<b>237,540</b>	<b>321,075</b>	<b>301,932</b>	<b>540,607</b>	<b>643,457</b>

## 3rd Quarter 2008 Office Silicon Valley Summary



### Q308

9.47M sf ▲ Available  
 .98M sf ▲ Gross  
 -.21M sf ▼ Net  
 \$3.32/sf ▲ Rent

Period	Available sf	Average Rent	Gross Absorption	Net Absorption
Q308	9,473,913	\$3.32	983,469	-214,186
Q208	8,345,611	\$3.22	862,179	-187,192
Q108	7,840,841	\$2.81	847,091	-293,341
Q407	7,454,933	\$2.73	1,094,799	-225,596
Q307	6,855,349	\$2.82	1,865,566	657,998
Q207	6,287,503	\$2.80	1,085,368	-46,995
Q107	6,344,742	\$2.40	1,308,748	159,328
Q406	6,734,605	\$2.26	1,504,208	596,956

### 3rd Quarter 2008 Office Silicon Valley



<b>Available Supply</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<i>Shell Direct</i>	2,837,256	1,994,099	1,587,638	1,446,993	1,168,394
<i>Shell Sublease</i>	14,864	14,864	7,864	0	0
<i>Previously Occupied Direct</i>	5,779,439	5,657,525	5,424,712	5,059,767	4,684,437
<i>Previously Occupied Sublease</i>	842,354	679,123	820,627	948,173	1,002,518
<b>Total Available</b>	<b>9,473,913</b>	<b>8,345,611</b>	<b>7,840,841</b>	<b>7,454,933</b>	<b>6,855,349</b>
<b>Gross Absorption</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<i>Shell Direct</i>	94,915	35,400	42,734	212,960	37,764
<i>Shell Sublease</i>	0	0	0	0	0
<i>Previously Occupied Direct</i>	794,080	696,825	725,261	738,898	1,550,524
<i>Previously Occupied Sublease</i>	94,474	129,954	79,096	142,941	277,278
<b>Total Absorption</b>	<b>983,469</b>	<b>862,179</b>	<b>847,091</b>	<b>1,094,799</b>	<b>1,865,566</b>
<b>Supply Rates</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<i>Availability Rate</i>	20.86%	18.53%	17.43%	16.63%	15.69%
<i>Vacancy Rate</i>	18.71%	15.94%	16.72%	15.88%	13.42%
<i>Sublease Factor</i>	9.05%	8.32%	10.57%	12.72%	14.62%
<b>Size Ranges</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<i>0 to 20,000</i>	433	416	400	400	396
<i>20,001 to 40,000</i>	67	61	57	49	48
<i>40,001 to 60,000</i>	19	18	16	12	8
<i>60,001 to 80,000</i>	5	7	8	7	4
<i>80,001 to 100,000</i>	5	3	4	3	5
<i>100,001 to 120,000</i>	1	1	1	6	3
<i>120,001 to 140,000</i>	0	0	0	0	1
<i>140,001 and Over</i>	7	6	5	3	2
<b>Total Buildings Available</b>	<b>537</b>	<b>512</b>	<b>491</b>	<b>480</b>	<b>467</b>
<b>Construction Types</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<b>Completed Construction</b>					
<i>Build-To-Suit</i>	0	0	80,000	190,000	355,745
<i>Spec Construction</i>	378,289	369,527	692,878	0	5,690
<b>Total Completed</b>	<b>378,289</b>	<b>369,527</b>	<b>772,878</b>	<b>190,000</b>	<b>361,435</b>
<b>In-Process Construction</b>					
<i>Build-To-Suit</i>	960,000	770,000	208,000	288,000	478,000
<i>Spec Construction</i>	2,013,699	2,218,549	2,082,081	2,154,064	1,521,279
<b>Total in Progress</b>	<b>2,973,699</b>	<b>2,988,549</b>	<b>2,290,081</b>	<b>2,442,064</b>	<b>1,999,279</b>

# Real News

*the silicon valley quarterly on commercial real estate*

## Q308 Warehouse Highlights

### *Vacancy Trends*

Despite the slow down in the economy, the supply of warehouse space in the Silicon Valley actually declined slightly in the third quarter, dropping from 9.14% to 8.48%. However, it should be noted that this was due in large part to the leasing of a 194,000 square foot space in Newark. Also keeping the supply from growing were two renewals that totaled 404,000 square feet. The availability factor remains below the theoretical equilibrium line of 10% which would normally lead to rent growth. However, the lack of activity in the market, coupled with the fear landlords have of a very slow 2009, have kept rents from rising. Currently, there are 2.8 million square feet available Silicon Valley-wide, but many submarkets such as Sunnyvale and Mountain View present very few, if any, choices for tenants. Santa Clara's availability factor is, surprisingly, the highest in the Valley at 18.4%. Equally surprising is Newark's 5.3% - one of the lowest factors ever for Newark. Also of note was the average time on market of just over nine months, which resulted in the third straight quarter of spaces being leased or sold after being on the market for less than one year. The last time that occurred was Q3-02 through Q1-04.

### *Absorption Trends*

Demand remained consistent with the second quarter, finishing with 552,446 square feet of gross absorption. While this number is 32% less than the previous eight-quarter average of 789,000 square feet, it was the 20th straight quarter with at least 500,000 square feet of gross absorption. Net absorption returned to the positive side, making eight out of the last ten quarters positive. Not surprisingly, the deal volume was again light with only 26 total transactions consisting of 16 new leases, two sales and eight renewals. As has been the case for the last few quarters, renewals were a large percentage of the total deal volume, reflecting both the uncertainty in the market and the lack of choices in many size ranges and submarkets.

### *Rent Trends*

After the brief spike in rents during the second quarter, average rents dropped back down to \$413 NNN - which is almost exactly where they were at the beginning of 2007. The drop was due in large part to several deals in class "B" and "C" buildings. Class A rents still by and large start in the high \$.40's to low \$.50's. An interesting point that kept the average rent number from being lower is that there were no sublease transactions in the third quarter (in which rates are often discounted significantly compared to the current market rates). Average deal size returned to near the previous eight-quarter average at 35,736 square feet. Again, this number is somewhat skewed by the aforementioned 194,000 square feet leased in Newark.

## Forecast for Q408

### *Availability*

The supply of warehouse space should continue to stay relatively flat through the end of the year. As is usual, the submarkets of Sunnyvale and Mountain View will be very tight with little or no class A space to choose from. Joining those submarkets will be Milpitas and Newark, which are both expected to be at 5% or lower by year end. San Jose will likely see its availability factor grow to the low teens as several significant vacancies are pending. 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 2008.

### *Absorption*

While demand has been sketchy at best for the last couple of quarters, there will still be some movement, albeit not a lot of expansion, as companies both Valley- and nation-wide remain in a "hunker down" mode. Companies with expiring leases may use the opportunity to "right size" and potentially trade up in location and/or quality as landlords grow more aggressive with



## Forecast for Q308, cont.

spaces that have been sitting vacant for several quarters.

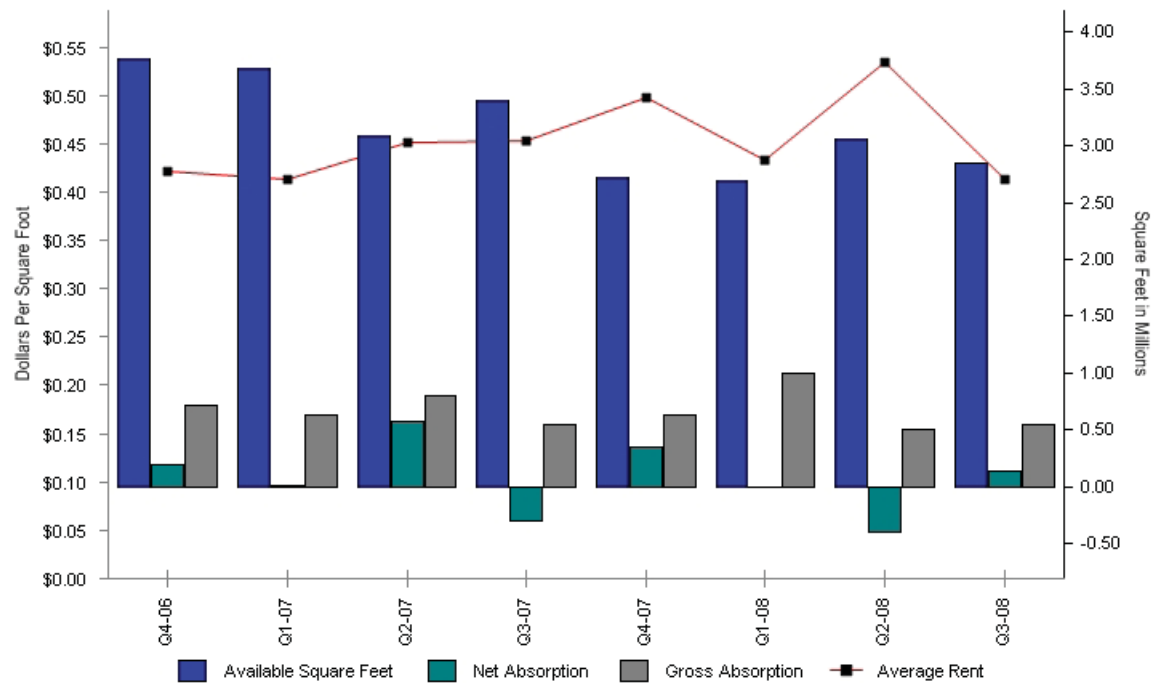
### **Rents**

We expect rents to be relatively flat as some aggressive deals for new tenants are balanced by less aggressive renewal rates. Given the cost to move – both in cash outlay and loss of productivity – we don't foresee many tenants making lateral moves just to save a few dollars on their base rent. Most budgets are very lean and landlords are only likely to partially offset moving costs through free rent or low lease rates, but not both. While the lack of volume in the market will certainly keep landlords from raising asking rates, significant landlord concessions will remain limited to larger spaces and to tenants with strong credit.

*By Scott Borgia - Senior Vice President / Principal*



# 3rd Quarter 2008 Warehouse Silicon Valley Summary



## Q308

2.85M sf  $\nabla$  Available  
 .55M sf  $\blacktriangle$  Gross  
 .14M sf  $\blacktriangle$  Net  
 \$.41/sf  $\nabla$  Rent

Period	Available sf	Average Rent	Gross Absorption	Net Absorption
Q308	2,845,664	\$0.41	552,446	139,361
Q208	3,064,733	\$0.53	501,395	-390,196
Q108	2,693,897	\$0.46	996,462	4,480
Q407	2,716,777	\$0.50	625,528	352,983
Q307	3,391,156	\$0.45	543,122	-303,451
Q207	3,087,705	\$0.45	796,130	579,795
Q107	3,677,216	\$0.41	631,068	8,318
Q406	3,770,869	\$0.42	720,146	190,838

## 3rd Quarter 2008 Warehouse Silicon Valley



<b>Available Supply</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
Shell Direct	0	0	6,400	0	0
Shell Sublease	0	0	0	0	0
Previously Occupied Direct	2,514,351	2,783,236	2,431,600	2,420,720	3,099,339
Previously Occupied Sublease	331,313	281,497	255,897	296,057	291,817
<b>Total Available</b>	<b>2,845,664</b>	<b>3,064,733</b>	<b>2,693,897</b>	<b>2,716,777</b>	<b>3,391,156</b>
Available Time on Market (In Months)	16.47	16.01	14.27	18.18	18.94
<b>Gross Absorption</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
Shell Direct	0	0	0	0	0
Shell Sublease	0	0	0	0	0
Previously Occupied Direct	526,477	501,395	922,898	609,528	503,882
Previously Occupied Sublease	25,969	0	73,564	16,000	39,240
<b>Total Absorption</b>	<b>552,446</b>	<b>501,395</b>	<b>996,462</b>	<b>625,528</b>	<b>543,122</b>
Absorption Time on Market (In Months)	4.41	9.11	10.59	8.91	18.41
<b>Supply Rates</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
Availability Rate	8.48%	9.14%	8.03%	8.10%	10.11%
Vacancy Rate	8.06%	8.72%	7.80%	8.10%	9.45%
Sublease Factor	11.64%	9.19%	9.50%	10.90%	8.61%
<b>Size Ranges</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
0 to 20,000	19	19	23	18	24
20,001 to 40,000	29	25	19	16	22
40,001 to 60,000	10	12	15	10	8
60,001 to 80,000	3	3	2	5	4
80,001 to 100,000	4	3	3	2	2
100,001 to 120,000	0	1	1	0	0
120,001 to 140,000	2	2	2	2	4
140,001 and Over	3	4	2	3	5
<b>Total Buildings Available</b>	<b>70</b>	<b>69</b>	<b>67</b>	<b>56</b>	<b>69</b>
<b>Construction Types</b>	<b>Q308</b>	<b>Q208</b>	<b>Q108</b>	<b>Q407</b>	<b>Q307</b>
<b>Completed Construction</b>					
Build-To-Suit	0	0	0	0	0
Spec Construction	0	0	0	0	0
<b>Total Completed</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>In-Process Construction</b>					
Build-To-Suit	400,000	400,000	0	0	0
Spec Construction	0	0	0	0	0
<b>Total in Progress</b>	<b>400,000</b>	<b>400,000</b>	<b>0</b>	<b>0</b>	<b>0</b>

# Real News

the silicon valley quarterly on commercial real estate

<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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