



# Real News

the silicon valley quarterly on commercial real estate

## Q209 Market Study

### Silicon Valley Economic Overview

After a year and a half of contraction, the US economy began to show signs of bottoming during the second quarter. According to the Commerce Department, gross domestic product fell at an annualized rate of 1.0 percent compared to the prior quarter's negative 6.4 percent rate, while business investment fell at a similarly slower pace. From July through September of 2009 the greatest chunk of federal stimulus money will be spent, providing further cause for optimism, although a number of detractors have expressed concern whether consumer spending – by far the biggest driver of the US economy - will rebound before the government dollars run dry.

Locally, the major tech companies in Silicon Valley announced mixed second quarter earnings. Apple reported a record non-holiday quarter, blowing past analysts estimates thanks to a 626 percent increase in iPhone sales compared to the same period last year.

Los Gatos-based Netflix Inc. also reported strong second quarter growth due to its increasingly popular Internet-based movie download services. The picture at Santa Clara-based Yahoo was murkier, where earnings exceeded estimates due to aggressive cost-cutting and layoffs but revenues slid 13 percent. Similarly, San Jose's eBay exceeded analysts estimates but reported a four percent dip in revenues and a 29% decrease in earnings.

The second quarter also brought renewed hope to the venture capital industry. Depending on the source, the flow of money from venture capital investors to entrepreneurs increased by as much as 61% over the multi-year low of the prior quarter. As much as 35% of the money invested during the second quarter went to early-stage start ups (good news for the future), while California continued to attract the overwhelming majority of venture investments.

### Economic Indicators

	Q209	Q109	Q208
<b>Unemployment Rate - Silicon Valley MSA*</b>	<b>11.8%</b>	<b>11.0%</b>	<b>6.0%</b>
<b>Unemployment Rate - Santa Clara County*</b>	<b>11.8%</b>	<b>10.8%</b>	<b>5.9%</b>
<b>Unemployment Rate - California*</b>	<b>11.6%</b>	<b>11.5%</b>	<b>7.0%</b>
<b>Unemployment Rate - National</b>	<b>9.5%</b>	<b>8.5%</b>	<b>5.5%</b>
<b>Inflation (CPI-U)*</b>	<b>3.3%</b>	<b>2.2%</b>	<b>7.9%</b>
<b>US GDP</b>	<b>-1.0%</b>	<b>-5.5%</b>	<b>2.8%</b>
<b>VC Investment National**</b>	<b>\$3.7B</b>	<b>\$3.2B</b>	<b>\$7.6B</b>
<b>VC Investment Silicon Valley**</b>	<b>\$1.2B</b>	<b>\$1.2B</b>	<b>\$3.0B</b>
<b>VC Confidence Index***</b>	<b>3.37/5</b>	<b>3.03/5</b>	<b>3.07/5</b>
<b>Job Growth - Santa Clara County</b>	<b>-13,300</b>	<b>-23,500</b>	<b>500</b>
<b>Job Growth - Silicon Valley MSA*</b>	<b>-13,700</b>	<b>-24,100</b>	<b>400</b>

\*Not seasonally adjusted

\*\*Source: PriceWaterhouseCoopers Money Tree

\*\*\*Source: USF Bloomberg ticker USFSVVIC

### Significant Large R&D Transactions in Q209

Landlord/Sublessor	Tenant	Address	City	Size
Abbott Labs	Newport	3635 Peterson Way	Santa Clara	140,000
Mission West Properties	Huawei Tech	2300 Central Expy	Santa Clara	108,860
Equastone Acquisitions, LLC	Yong Pak	1331 California Circle	Milpitas	100,041
Hewlett Packard	Symantec	466 Ellis Street	Mountain View	75,233
Xilinx, Inc	Sonicwall	2001 Logic Drive	San Jose	72,000
RREEF Funds, The	8X8 Inc	810 W Maude Ave	Sunnyvale	51,680
LBA Realty	AnaSpec, Inc.	34801 Campus Drive	Fremont	42,698
PSAI Realty Partners	UCSC	2505 Augustine Dr	Santa Clara	41,855
Agile Software	OCZ Technology	6373 San Ignacio Ave	San Jose	41,000

## Q209 R&D Highlights

### Absorption

The R&D leasing market in Silicon Valley shook itself out of its near paralysis during the second quarter of 2009, although deal volume remained at historically low levels. For the three months ending June 30th, gross absorption of R&D space in Silicon Valley increased by 47.5% over the prior period's lows. During the quarter, gross absorption totaled approximately 1.7 million square feet compared to the approximately 1.1 million square feet of space absorbed during the first quarter of the year. During the same period one year ago, gross absorption totaled approximately 2.3 million square feet. For the past ten years, R&D gross absorption Valley-wide has averaged 3.5 million square feet per quarter – more than double the most recent period's level.

Although “less bad” news brings limited solace, the pace of negative net absorption also slowed during the second quarter. During the period, negative net absorption totaled approximately 1.0 million square feet, down from last quarter's negative 2.8 million square feet. The second quarter's net absorption was also a far cry from the record set in the third quarter of 2001 when net absorption totaled negative 5.1 million square feet. All but two of the submarkets tracked by CPS experienced higher net absorption compared to the first quarter, while Milpitas (24,000 square feet) and Santa Clara (145,000 square feet) stood out for being the only two submarkets with positive R&D net absorption.

The largest lease transaction that occurred during the second quarter was Spectra Physics' (a division of Newport Corp.) sublease of 140,000 square feet of space from Abbott Labs on Peterson Way in Santa Clara. Abbott put the approximately 200,000 square foot building on the market for sublease following its acquisition of Guidant's vascular intervention and endovascular businesses in 2006. Notably, Abbott provided an extensive free rent period in lieu of a tenant improvement allowance. Aside from Spectra Physics, only two other new deals over 100,000 square feet occurred in Silicon Valley during the second quarter.

<b>31.36M sf</b>	▲	<b>Available</b>
<b>1.69M sf</b>	▲	<b>Gross Abs.</b>
<b>-1.03M sf</b>	▲	<b>Net Abs.</b>
<b>\$1.11/sf</b>	▼	<b>Avg. Rent (NNN)</b>

### Vacancy Trends

The pace of vacancy increases also slowed during the second quarter. R&D vacancy for Silicon Valley as a whole increased by 40 basis points, or 2.2 percent, between the first and second quarter of the year. By comparison, during the first quarter of 2009 the vacancy rate increased by 140 basis points, or 8.4 percent. In the core submarkets of Mountain View, Sunnyvale, Santa Clara, and the West Valley, vacancy rates held steady or decreased slightly. By comparison, vacancy increased in San Jose and Fremont.

### Significant New Q209 R&D / Office Availabilities

Building	City	Size	Availability	Type
6411 Guadalupe Mines Road	San Jose	123,000 SF	4/23/2009	Lease
45757 Northport Loop	Fremont	103,000 SF	8/1/2009	Lease
401 Ellis Street	Mountain View	100,842 SF	4/7/2009	Sublease
3165 Porter Drive	Palo Alto	91,644 SF	6/24/2009	Sublease
1421 California Circle	Milpitas	88,210 SF	4/23/2009	Sublease
2090 Fortune Drive	San Jose	71,750 SF	6/16/2009	Sublease
2241 Lundy Ave	San Jose	64,890 SF	6/16/2009	Sublease
46457 Landing Pky	Fremont	58,526 SF	8/1/2009	Lease
1870 Lundy Ave	San Jose	55,971 SF	5/11/2009	Lease/Sale
575 River Oaks Pky	San Jose	55,264 SF	4/3/2009	Lease
160 E Tasman Drive	San Jose	55,000 SF	5/28/2009	Sublease
2630 Walsh Ave	Santa Clara	55,000 SF	6/16/2009	Lease

The three weakest R&D submarkets, San Jose (21.6%), Milpitas (20.7%), and Fremont (28.6%) all have vacancy levels above 20%. Fremont's vacancy rate has increased for five consecutive quarters and six out of the past seven. If this trend continues, R&D vacancy in Fremont will approach 33.7% - the record set in the fourth quarter of 2003 - within the next 12-18 months.

#### Rent Trends

Average rents for completed R&D transactions in Silicon Valley fell by 13.5 percent from their first quarter average. During the three months ending June 30th, average R&D rents were \$1.11 per square foot triple net compared to \$1.29 per square foot during the first quarter of the year. During the same period one year ago, average R&D rents were \$1.23 per square foot. Submarkets leading the decline included Mountain View (-15.1 percent to \$1.35 per sq. ft.), Sunnyvale (-22.4% to \$1.00 per sq. ft.), and Milpitas (-14.6 percent to \$0.65 per sq. ft). Rents in Santa Clara, San Jose, and Fremont all inched up slightly. Santa Clara's average rents increased due to two large transactions, while San Jose's and Fremont's increases can mostly be attributed to statistical variability resulting from low deal volume.

### R&D Forecast for Q309

#### Absorption

R&D gross absorption should continue to recover as tenants that have been postponing real estate decisions begin to capitalize on the increased opportunities to reduce their real estate costs by

relocating to smaller, more affordable facilities. Net absorption will likely remain negative for the foreseeable future and probably will not return to positive territory until job losses cease and Silicon Valley companies begin hiring.

#### Vacancy

R&D vacancy rates are expected to continue increasing as companies shed workers and downsize to smaller buildings to increase efficiencies. The rate of increase is forecasted to slow, however, along with an expected turn-around in the economy late this year. Most economists, however, are predicting a "jobless recovery". If this holds true, vacancy rates are likely to stabilize, but not substantially improve, when the economy begins to recover, as companies tend to wait to hire more workers until after their businesses begin to strengthen.

#### Rents

Using CPI statistics to adjust for inflation, Silicon Valley R&D rents bottomed out in the previous two cycles at \$0.80 per square foot triple-net in the first quarter of 1994 (\$0.56 unadjusted) and \$0.90 per square foot in the second quarter of 2004 (\$0.80 unadjusted). Vacancy rates, respectively, were 14.6 percent and 26.0 percent. Currently, R&D vacancy stands at 18.6 percent and rents at \$1.11. It is therefore possible that average triple net rents could decrease as much as an additional 20-25 percent assuming a floor of \$0.85 per square foot before they start to recover.

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## Q209 Office Highlights

### *Vacancy Trends*

Silicon Valley office availability increased by 468,743 square feet during the second quarter of 2009. At quarter's end, the inventory of available office space stood at 12.4 million square feet. Since bottoming at 14.5% at the end of the second quarter of 2007, office availability has increased by a cumulative six million square feet, resulting in a second quarter 2009 availability rate of 26.0%. Approximately 3.6 million square feet, or 60.0%, of the six million square feet of office space added to the available inventory since Q207 is new speculative construction that remained un-leased as of the second quarter of 2009.

One of the larger office sub-markets tracked by CPS, Downtown San Jose, also experienced increased vacancy during the second quarter. Vacancy in Downtown San Jose increased from 38.2% during the first quarter of 2009 to 38.6% during the second quarter of this year. Legacy Partners' newly constructed 319,000 square foot RiverPark II tower was added to the available inventory during the first quarter, contributing substantially to the increased vacancy rate. 488 Almaden, a 17-story, 380,000 square foot tower, also continues to impact the vacancy statistics of the Downtown Class A office market.

On a more positive note, after nine consecutive periods of vacancy increases, the San Jose Airport office submarket reversed course and recorded a decrease in vacancy during the second quarter. As of June 30th, vacancy at the Airport stood at 25.5 %, a decrease of approximately 80 basis points from the first quarter's 26.3% level.

### *Absorption Trends*

Office absorption during the second quarter of 2009 reflected a retrenching leasing market. Gross absorption totaled 596,514 square feet, the lowest

quarterly total since the second quarter of 2001 and approximately 39 percent less than the 20-quarter (five-year) trailing average of 1.2 million square feet. Negative net absorption totaled approximately 596,500 square feet – the seventh consecutive quarterly period of negative net absorption and the eighth of the most recent nine quarters in which this key measure of the market's condition finished in negative territory. It is 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*

Until the first quarter of 2009, office rents bucked 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. However, reality set in during the first quarter of 2009 with average rent dropping to \$2.36 per square foot. The second quarter of 2009 witnessed an increase in average rents from \$2.36 per square foot to \$2.98 per square foot due to a combination of low new deal volume and a relatively greater concentration of transactions in the higher-priced suburbs of Mountain View and Menlo Park. Additionally, please note that CPS's aggregate rent statistics exclude data on renewal transactions. For a custom study that includes renewal transaction data please feel free to contact your CPS agent.

### *Construction*

CPS market research tracked 1.3 million square feet of office space under construction during the second quarter of 2009. This total was primarily comprised of two significant speculative



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projects: Sand Hill Properties/RREEF's Offices at Downtown Sunnyvale and Sobrato's 153,000 square foot building on Lawson Avenue. Construction on both the Sobrato project and the Offices at Downtown Sunnyvale are currently on hold.

## Submarkets

### *San Jose Airport*

The total availability factor in the Airport office market declined to 25.5% at the end of the second quarter, down from 26.3% at the end of the first quarter of 2009. Average rents decreased in the second quarter of 2009, ending at \$1.91 per square foot full service, a decrease of \$0.13. Sublease space in the Airport market was decreased to 10.4% of the total vacancy, compared to 14.1% at the end of the first quarter. There was relatively low deal volume (73,829 square feet during the quarter) with a positive net absorption of 24,211 square feet.

### *Downtown Class A*

The total vacancy factor in the Downtown Class A office market was 36.4% at the end of the second quarter of 2009, a slight increase of 0.6%. The Class A sublease space declined minimally to 0.1% of the total vacancy at the end of the second quarter, a reduction of 1.4%. The Class A average rent at the end of the second quarter of 2009 declined to \$2.36 full service, a decrease of \$0.54. The activity level in Downtown Class A office was very low with only 34,080 square feet of gross absorption in the second quarter.

## Forecast for Q309

### *Availability*

Supply will likely continue to increase during the third quarter, as more local employers shed jobs. There are a few large companies that plan on putting space on the market, and many other companies throughout the market are reducing their office footprints as their leases roll. The amount of sublease inventory is expected to

increase, but the percentage of overall vacancy comprised of sublease space should remain fairly consistent with current levels and nowhere near the rate experienced during the dot-com correction. Overall, office vacancy in Silicon Valley should continue to remain the primary province of direct owners and not users seeking to sublease surplus space.

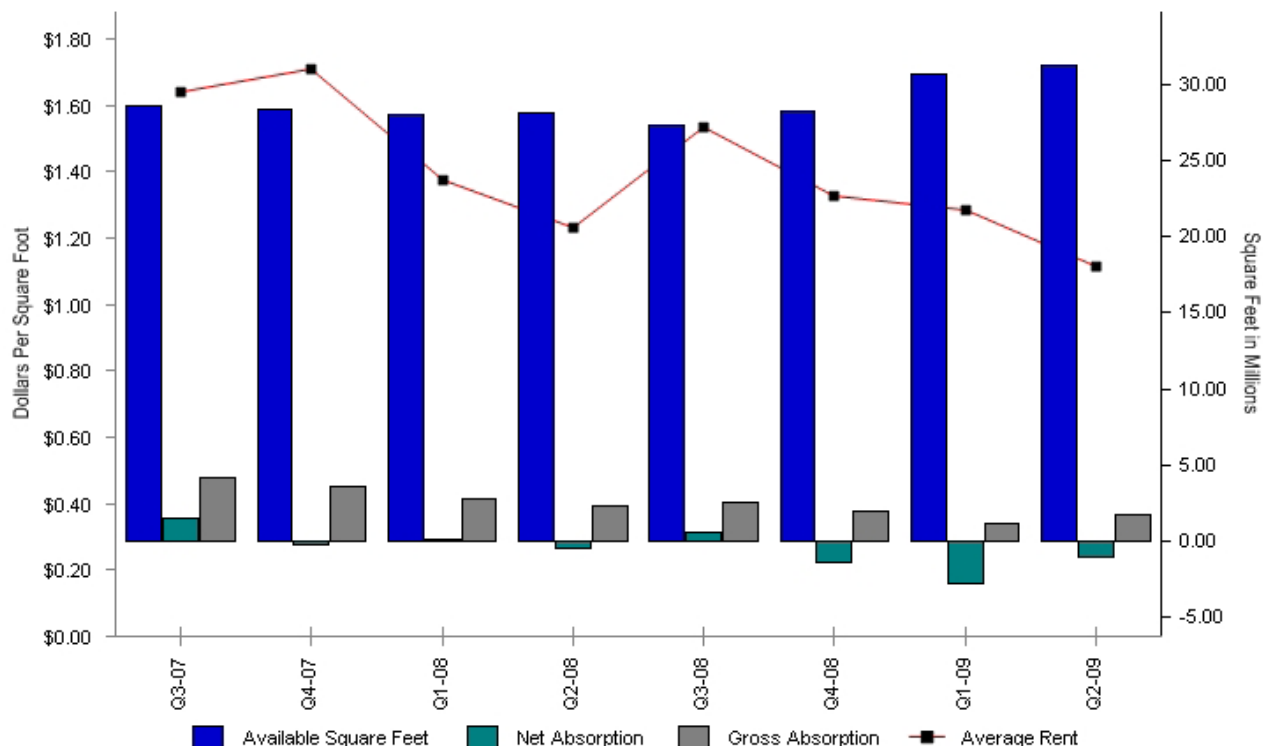
### *Absorption*

Many companies in Silicon Valley still are having a hard time making real estate decisions in light of economic uncertainty, leaving the Valley "on hold." While there continue to be a number of requirements for sizeable blocks of office space many of these tenants end up renewing, often on a smaller amount of space. The lack of decision making, combined with an increased percentage of renewals, will most likely leave gross absorption at or near historic lows and net absorption negative. Many economic signs point to the bottoming of the recession. If that is the case, and if the "jobless recovery" scenarios prove to be inaccurate, absorption figures should start to recover later in the year or early in 2010.

### *Rents*

With increasing availability and continued negative net absorption expected, office rents, in all likelihood, will continue to decline in the third quarter. Landlords are expected to continue being aggressive on pricing in the hopes of staying ahead of the market, contributing further downward pressure on rents. Even today, two to three year deals are being done at near-zero returns as owners seek to "buy time" and hold on to their properties while the worst of the storm passes.

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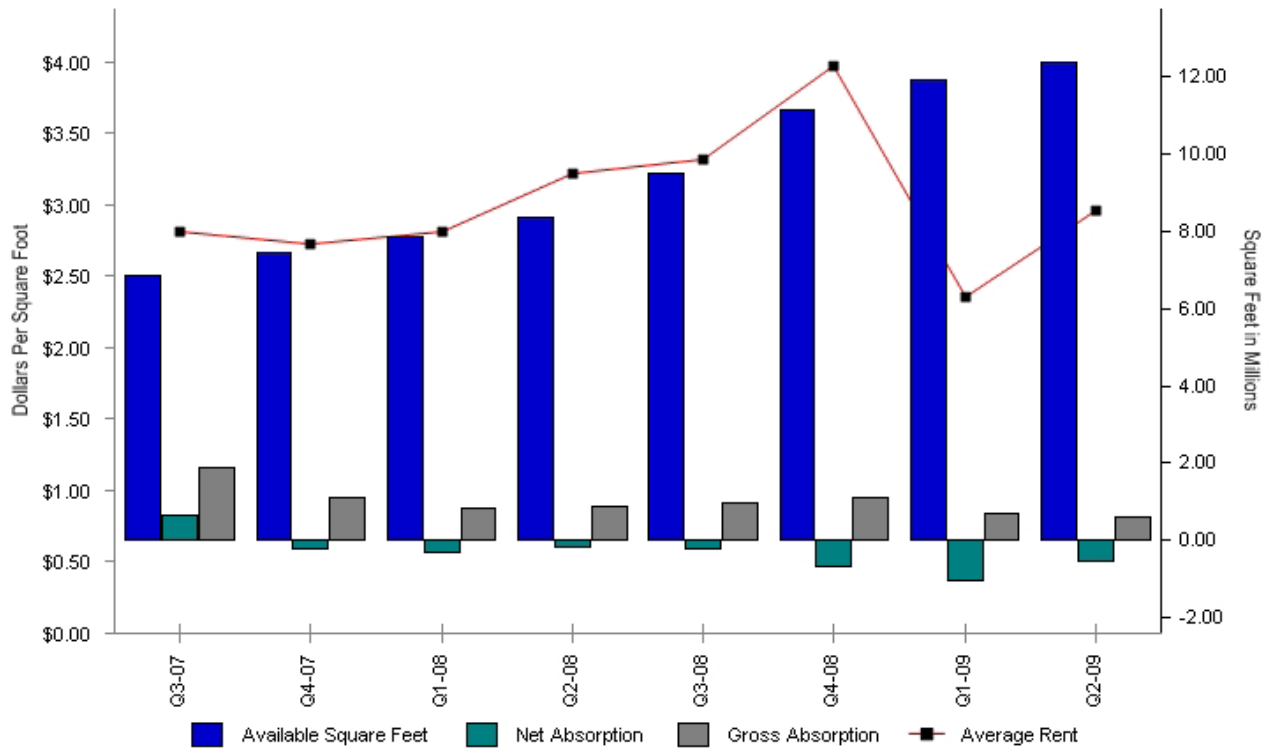


**Q209**

31.36M sf ▲ Available  
 1.69M sf ▲ Gross  
 -1.03M sf ▲ Net  
 \$1.11/sf ▼ Rent

<i>Period</i>	<i>Available sf</i>	<i>Average Rent</i>	<i>Gross Absorption</i>	<i>Net Absorption</i>
Q209	31,355,209	\$1.11	1,690,349	-1,030,864
Q109	30,688,088	\$1.29	1,146,022	-2,872,149
Q408	28,320,910	\$1.33	1,937,312	-1,378,052
Q308	27,402,891	\$1.53	2,504,993	566,411
Q208	28,165,084	\$1.23	2,343,122	-501,143
Q108	28,062,820	\$1.37	2,750,430	102,252
Q407	28,445,202	\$1.71	3,528,372	-284,303
Q307	28,598,681	\$1.64	4,200,892	1,477,475

<i>Available Supply</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Shell Direct</i>	2,480,351	2,487,505	2,686,042	2,755,293	2,569,471
<i>Shell Sublease</i>	26,028	33,558	33,558	44,482	44,482
<i>Previously Occupied Direct</i>	22,879,268	22,445,007	20,410,413	20,008,504	21,065,020
<i>Previously Occupied Sublease</i>	5,969,562	5,722,018	5,190,897	4,594,612	4,486,111
<b><i>Total Available</i></b>	<b>31,355,209</b>	<b>30,688,088</b>	<b>28,320,910</b>	<b>27,402,891</b>	<b>28,165,084</b>
<i>Available Time on Market (In Months)</i>	26.86	26.17	27.12	27.45	27.09
<i>Gross Absorption</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Shell Direct</i>	9,861	88,339	80,357	60,508	81,430
<i>Shell Sublease</i>	0	0	0	0	47,261
<i>Previously Occupied Direct</i>	1,401,042	1,035,343	1,674,052	2,126,770	1,999,131
<i>Previously Occupied Sublease</i>	279,446	22,340	182,903	317,715	215,300
<b><i>Total Absorption</i></b>	<b>1,690,349</b>	<b>1,146,022</b>	<b>1,937,312</b>	<b>2,504,993</b>	<b>2,343,122</b>
<i>Absorption Time on Market (In Months)</i>	12.82	7.69	15.22	19.50	20.19
<i>Supply Rates</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Availability Rate</i>	18.56%	18.16%	16.78%	16.25%	16.71%
<i>Vacancy Rate</i>	18.41%	17.94%	16.64%	15.81%	16.22%
<i>Sublease Factor</i>	19.12%	18.76%	18.45%	16.93%	16.09%
<i>Size Ranges</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>0 to 20,000</i>	419	386	332	303	287
<i>20,001 to 40,000</i>	231	221	203	195	200
<i>40,001 to 60,000</i>	116	115	111	109	117
<i>60,001 to 80,000</i>	70	67	60	61	64
<i>80,001 to 100,000</i>	37	36	37	33	35
<i>100,001 to 120,000</i>	24	24	21	20	21
<i>120,001 to 140,000</i>	11	9	8	7	9
<i>140,001 and Over</i>	11	13	12	12	10
<b><i>Total Buildings Available</i></b>	<b>919</b>	<b>871</b>	<b>784</b>	<b>740</b>	<b>743</b>
<i>Construction Types</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<b><i>Completed Construction:</i></b>					
<i>Build-To-Suit</i>	0	0	0	0	0
<i>Spec Construction</i>	0	116,603	100,000	118,535	123,842
<b><i>Total Completed</i></b>	<b>0</b>	<b>116,603</b>	<b>100,000</b>	<b>118,535</b>	<b>123,842</b>
<b><i>In-Process Construction:</i></b>					
<i>Build-To-Suit</i>	94,653	0	0	0	0
<i>Spec Construction</i>	0	0	116,603	237,540	321,075
<b><i>Total in Progress</i></b>	<b>94,653</b>	<b>0</b>	<b>116,603</b>	<b>237,540</b>	<b>321,075</b>



**Q209**

12.39M sf ▲ Available  
 .60M sf ▼ Gross  
 -.52M sf ▲ Net  
 \$2.98/sf ▲ Rent

Period	Available sf	Average Rent	Gross Absorption	Net Absorption
Q209	12,388,942	\$2.98	596,514	-516,493
Q109	11,920,199	\$2.36	703,862	-1,060,575
Q408	11,114,203	\$3.97	1,089,793	-670,519
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



<i>Available Supply</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Shell Direct</i>	3,811,509	3,801,712	3,717,671	2,837,256	1,994,099
<i>Shell Sublease</i>	3,200	3,200	10,200	14,864	14,864
<i>Previously Occupied Direct</i>	7,074,015	6,788,759	6,452,116	5,779,439	5,657,525
<i>Previously Occupied Sublease</i>	1,500,218	1,326,528	934,216	842,354	679,123
<b><i>Total Available</i></b>	<b>12,388,942</b>	<b>11,920,199</b>	<b>11,114,203</b>	<b>9,473,913</b>	<b>8,345,611</b>
<i>Gross Absorption</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Shell Direct</i>	13,000	18,969	6,234	94,915	35,400
<i>Shell Sublease</i>	0	0	0	0	0
<i>Previously Occupied Direct</i>	504,638	528,050	976,902	794,080	696,825
<i>Previously Occupied Sublease</i>	78,876	156,843	106,657	94,474	129,954
<b><i>Total Absorption</i></b>	<b>596,514</b>	<b>703,862</b>	<b>1,089,793</b>	<b>983,469</b>	<b>862,179</b>
<i>Supply Rates</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Availability Rate</i>	26.01%	25.02%	24.36%	20.86%	18.53%
<i>Vacancy Rate</i>	25.24%	22.72%	22.53%	18.71%	15.94%
<i>Sublease Factor</i>	12.14%	11.16%	8.50%	9.05%	8.32%
<i>Size Ranges</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>0 to 20,000</i>	513	485	473	433	416
<i>20,001 to 40,000</i>	79	75	62	67	61
<i>40,001 to 60,000</i>	18	20	22	19	18
<i>60,001 to 80,000</i>	12	8	9	5	7
<i>80,001 to 100,000</i>	4	5	4	5	3
<i>100,001 to 120,000</i>	1	1	2	1	1
<i>120,001 to 140,000</i>	0	1	0	0	0
<i>140,001 and Over</i>	13	12	9	7	6
<b><i>Total Buildings Available</i></b>	<b>640</b>	<b>607</b>	<b>581</b>	<b>537</b>	<b>512</b>
<i>Construction Types</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<b><i>Completed Construction:</i></b>					
<i>Build-To-Suit</i>	0	0	208,000	0	0
<i>Spec Construction</i>	745,950	725,340	0	378,289	369,527
<b><i>Total Completed</i></b>	<b>745,950</b>	<b>725,340</b>	<b>208,000</b>	<b>378,289</b>	<b>369,527</b>
<b><i>In-Process Construction:</i></b>					
<i>Build-To-Suit</i>	752,000	752,000	752,000	960,000	770,000
<i>Spec Construction</i>	515,195	1,312,583	2,019,998	2,013,699	2,218,549
<b><i>Total in Progress</i></b>	<b>1,267,195</b>	<b>2,064,583</b>	<b>2,771,998</b>	<b>2,973,699</b>	<b>2,988,549</b>



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## Q209 Warehouse Highlights

### Supply

The slumping economy continued to show its effect on the Silicon Valley warehouse market. While the amount of negative net absorption has slowed, the second quarter of 2009 was the third consecutive quarter with negative net absorption. In all, the market has suffered a total of 2.33 million square feet of negative net absorption over the last three quarters, resulting in a vacancy rate which has nearly doubled over that same time period, from 8.5% at the end of Q2-08, to 15.3% at the end of Q2-09. Over the last quarter, the availability increased about 13%.

### Demand

Demand during the second quarter of 2009 showed improvement over the abysmal first quarter with 462,219 square feet of gross absorption - still well below the previous eight-quarter average of 605,000 square feet. While there has been some touring by warehouse tenants, not many deals are being signed that involve relocation, and even fewer that involve expansion. Total transactions showed an increase from the first quarter's 17 (11 new leases) to 20; however, 50% of the deals were renewals. And, of the ten new leases, three were in Class C space, making the total number of new leases Valley-wide in Class A or B space a paltry seven, totaling only 176,455 square feet. Average deal size was up about 28% over the first quarter at 34,375 square feet, but below the previous eight-quarter average of 37,000 square feet. Surprisingly, the average term jumped almost 30% to 4.34 years as locking in a low rate ruled over the uncertainty that led to a 3.49 year average term in the previous 12 months.

### Rents

The long expected significant drop in rents finally occurred in Q2-09. Average rents for the quarter dropped a substantial 26% under the previous quarter's surprising \$.447 NNN and a whopping 39% under the second quarter of last year. Rents for an average Class A warehouse in the core areas of Silicon Valley's warehouse market are landing in the high \$.30's to low \$.40's NNN. Also of significance was that those low rates came with one of the lowest tenant improvement contributions by landlords in eight years at a miniscule \$.31 per square foot on average.

## Forecast for Q309

### Supply

As one might expect, the supply of warehouse space will likely continue to increase until the economy recovers. While vacancy will likely increase across the board by another 100 to 200 basis points, we believe the supply of Class B and C spaces will increase more dramatically than Class A spaces, as they are often occupied by financially weaker tenants (who may disappear) and by stronger tenants who will take advantage of opportunities to upgrade to Class A space. As has been the case for several years, no new speculative warehouse projects were constructed in the second quarter and there remains no new speculative construction planned for 2009.

### Demand

While we hear of several significant deals currently in the market, in the end, we expect another slow quarter for new leases. Renewals have been at an all time high and we don't expect that trend to change much over the next several quarters. Expansion is not often on the mind of most Valley tenants, and landlords continue to be very aggressive in their efforts to renew their



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## **Forecast for 2009, cont.**

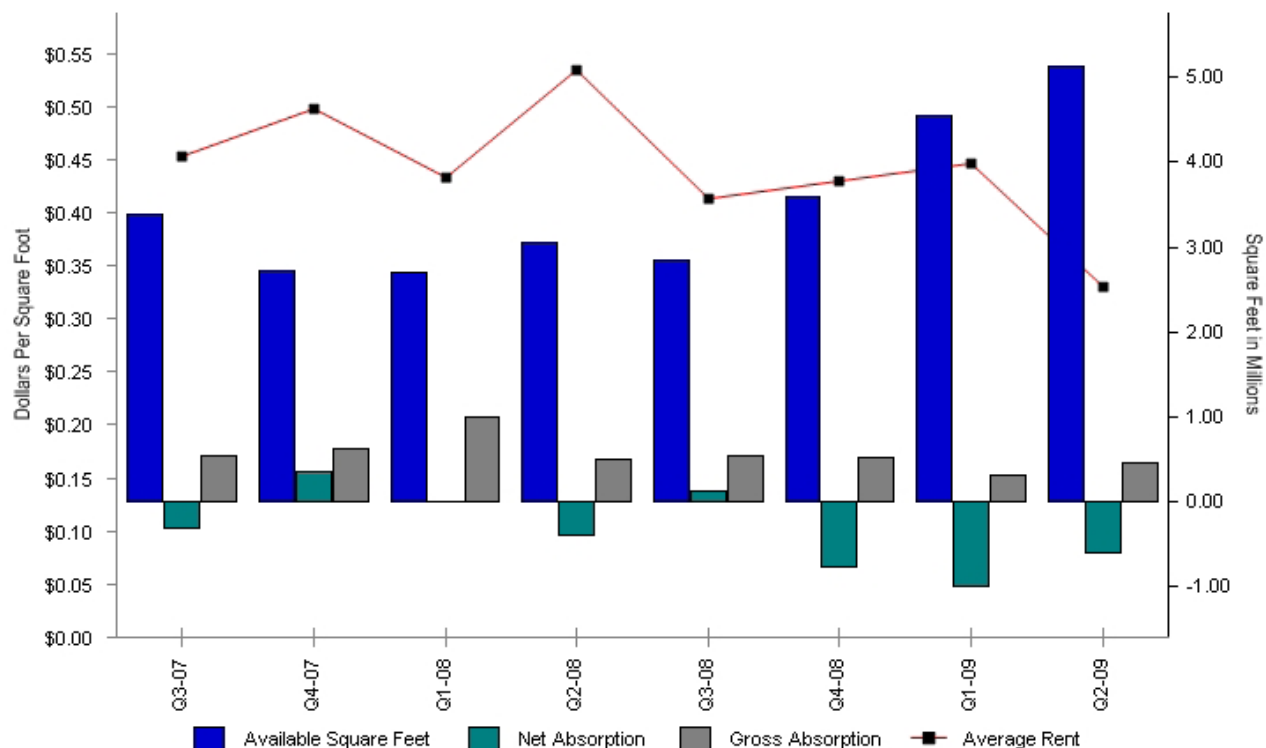
### *Demand*

existing tenants long before their current leases expire. Tenants have been out in the market touring but, unless there is a compelling reason to move (significant change in space need, desired location, problematic existing space), a large percentage of those tours will never materialize into an actual relocation.

### *Rents*

After resisting reductions in the asking rents for most of 2008, most of the Valley's larger landlords have already significantly reduced their asking rents in 2009. Asking rents of \$.55 NNN in 2008 have been replaced with new asking rents of \$.39 - \$.49 NNN in 2009 as landlords seek to stimulate demand. We still feel that the best deals cut will be for renewing tenants who, if expertly represented, should be able to not only reduce their existing rate, but also secure the same concessions as a new tenant to the project, as landlords do whatever it takes to avoid any further vacancy. By the end of the year, we expect more deals will be cut with a starting rate in the mid \$.30's with more concessions (free rent, T.I.'s, moving costs) being offered up as the number of competing spaces grows.

*By Scott Borgia - Senior Vice President / Principal Lic. 00903600*



**Q209**

5.14M sf ▲ Available  
 .46M sf ▲ Gross  
 -.59M sf ▲ Net  
 \$.33/sf ▼ Rent

<i>Period</i>	<i>Available sf</i>	<i>Average Rent</i>	<i>Gross Absorption</i>	<i>Net Absorption</i>
<i>Q209</i>	5,140,531	\$0.33	462,219	-594,758
<i>Q109</i>	4,545,773	\$0.45	306,283	-980,403
<i>Q408</i>	3,588,212	\$0.43	524,630	-754,084
<i>Q308</i>	2,845,664	\$0.41	552,446	139,361
<i>Q208</i>	3,064,733	\$0.53	501,395	-390,196
<i>Q108</i>	2,693,897	\$0.43	996,462	4,480
<i>Q407</i>	2,716,777	\$0.50	625,528	352,983
<i>Q307</i>	3,391,156	\$0.45	543,122	-303,451

<i>Available Supply</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Shell Direct</i>	0	0	0	0	0
<i>Shell Sublease</i>	0	0	0	0	0
<i>Previously Occupied Direct</i>	4,642,257	4,161,198	3,309,999	2,514,351	2,783,236
<i>Previously Occupied Sublease</i>	498,274	384,575	278,213	331,313	281,497
<b><i>Total Available</i></b>	<b>5,140,531</b>	<b>4,545,773</b>	<b>3,588,212</b>	<b>2,845,664</b>	<b>3,064,733</b>
<i>Available Time on Market (In Months)</i>	12.43	12.66	14.53	16.47	16.01
<i>Gross Absorption</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Shell Direct</i>	0	0	0	0	0
<i>Shell Sublease</i>	0	0	0	0	0
<i>Previously Occupied Direct</i>	462,219	306,283	395,431	526,477	501,395
<i>Previously Occupied Sublease</i>	0	0	129,199	25,969	0
<b><i>Total Absorption</i></b>	<b>462,219</b>	<b>306,283</b>	<b>524,630</b>	<b>552,446</b>	<b>501,395</b>
<i>Absorption Time on Market (In Months)</i>	11.28	4.70	5.49	4.41	9.11
<i>Supply Rates</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>Availability Rate</i>	15.33%	13.55%	10.70%	8.48%	9.14%
<i>Vacancy Rate</i>	15.24%	13.36%	10.70%	8.06%	8.72%
<i>Sublease Factor</i>	9.69%	8.46%	7.75%	11.64%	9.19%
<i>Size Ranges</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</i>
<i>0 to 20,000</i>	28	28	22	19	19
<i>20,001 to 40,000</i>	48	44	31	29	25
<i>40,001 to 60,000</i>	12	12	9	10	12
<i>60,001 to 80,000</i>	8	7	8	3	3
<i>80,001 to 100,000</i>	6	3	4	4	3
<i>100,001 to 120,000</i>	4	3	2	0	1
<i>120,001 to 140,000</i>	3	3	3	2	2
<i>140,001 and Over</i>	4	4	3	3	4
<b><i>Total Buildings Available</i></b>	<b>113</b>	<b>104</b>	<b>82</b>	<b>70</b>	<b>69</b>
<i>Construction Types</i>	<i>Q209</i>	<i>Q109</i>	<i>Q408</i>	<i>Q308</i>	<i>Q208</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>	0	0	0	0	0
<b><i>Total in Progress</i></b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>



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

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