

## Office Market Report

Compared to last quarter:

Vacancy

DOWN

Net Absorption

POSITIVE

Lease Rates

DOWN

Transactions

DOWN

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### Market Highlights

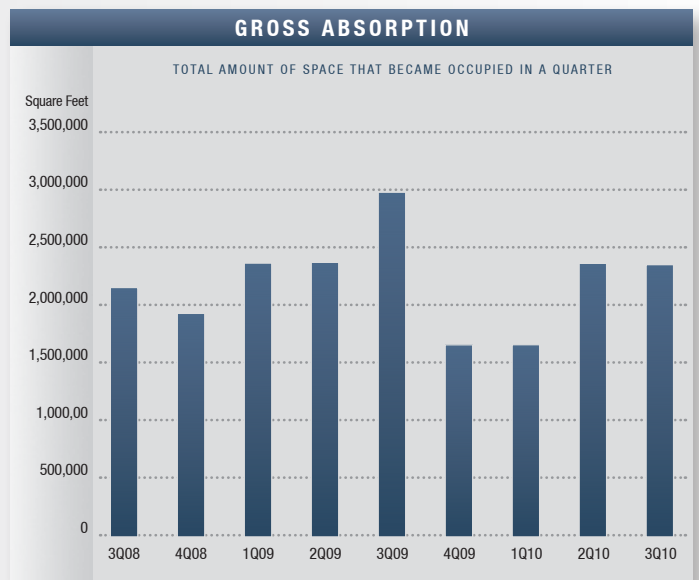
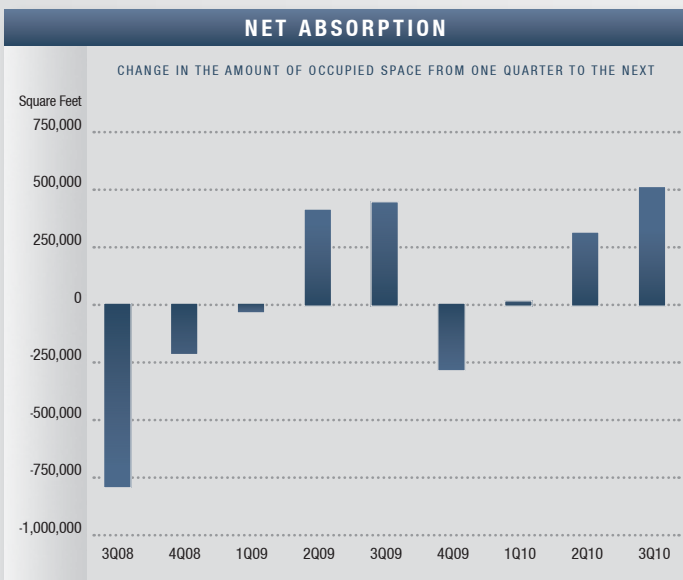
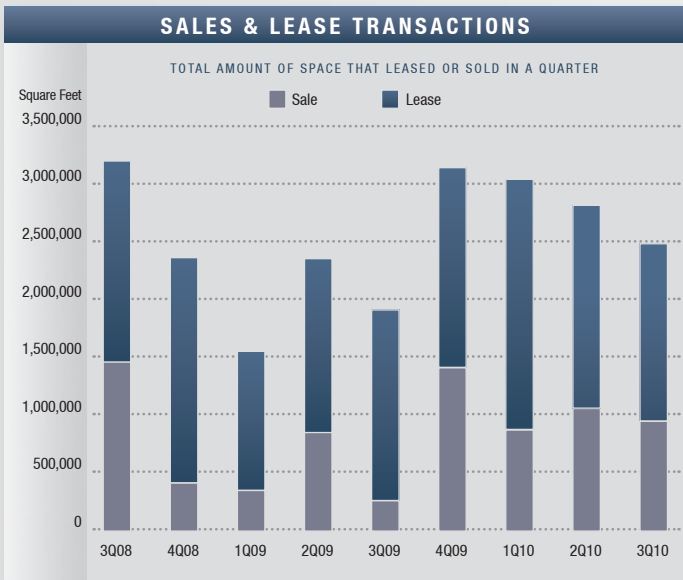
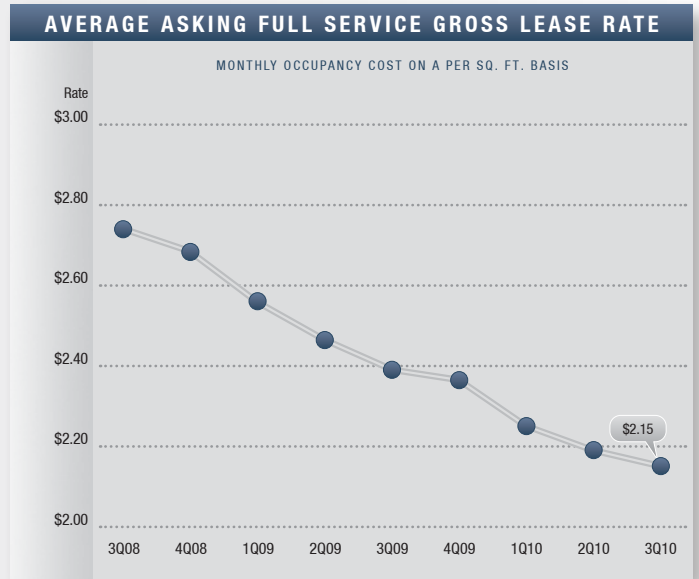
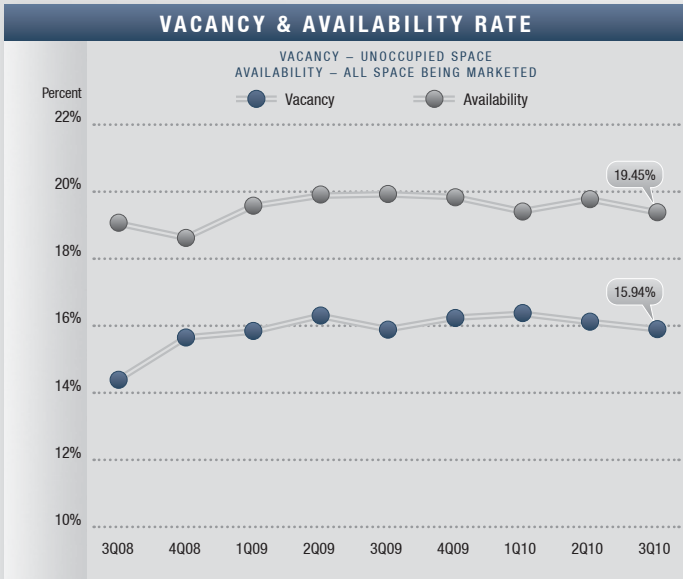
- **Bottoming Out?** — The numbers this quarter appear to be encouraging — a sign that recovery could be on the horizon. Availability showed signs of stabilization, vacancy dropped again, and net absorption posted positive numbers. With regard to sales transactions, the ask-bid gap seems to be narrowing, as evidenced by the drop in asking prices. While these are positive indications, stability will need to be sustained in following quarters to be considered recovery.
- **Construction** — Over the past four years, over 10 million square feet of new construction has been completed in San Diego County. The record year for new development was 2001, when 3.7 million square feet of new space was added. Total space under construction checked in at 438,414 square feet this quarter. The slowdown in construction has and will ease the upward pressure on vacancy going forward.
- **Vacancy** — Direct/sublease space (unoccupied) finished the quarter at 15.94%, almost equal to last year's rate of 15.90% and lower than last quarter's figure of 16.13%. The Central Suburban market posted the lowest rate in the county, coming in at 11.37%.
- **Availability** — Direct/sublease space being marketed was at 19.45% this quarter, a decrease of 2.56% when compared to the 19.96% availability rate of the third quarter of last year.
- **Lease Rates** — The average asking Full-Service Gross (FSG) lease rate per square foot per month in San Diego County was \$2.15 — a decrease of 10% over last year's rate of \$2.39 and four cents lower than last quarter's rate. The record high rate of \$2.76 was established in the first and second quarters of 2008. Class A rates for the county are averaging \$2.43 FSG, with North County noting the highest rates averaging \$2.45 FSG.
- **Absorption** — Net absorption for the county posted a positive 502,590 square feet for the third quarter of 2010,

giving the office market a total of 819,322 square feet of positive absorption for the first three quarters of 2010.

- **Transaction Activity** — Leasing activity checked in at 1.6 million square feet this quarter. Sales activity showed a year-over-year increase, posting 925,882 square feet of activity compared to 231,324 square feet in the third quarter of 2009. Details of the largest transactions can be found on the back page of this report.
- **Employment** — The unemployment rate in San Diego County was 10.6% in August 2010, down from a revised 10.9% in July 2010 and above the year-ago estimate of 10.3%. This compares with an unadjusted unemployment rate of 12.4% for California and 9.5% for the nation during the same period. According to the State of California Employment Development Department, San Diego County lost 9,700 payroll jobs over the last twelve months — 2,900 in manufacturing and 2,700 in leisure & hospitality. However, professional and business services added 3,600 new jobs. Between July 2010 and August 2010 San Diego County employment declined by 2,200 jobs overall.
- **Overall** — We are beginning to see a decrease in the amount of available space being added per quarter. Positive absorption is the big story, and with few new deliveries in the pipeline to put more upward pressure on vacancies, the market should continue to stabilize. We foresee an increase in investment activity in the coming quarters as lenders begin to dispose of distressed assets. Lease rates are expected to remain soft for the near future, and concessions in the forms of free rent, reduced parking fees, relocation funds and tenant improvement allowances should continue to increase to incentivize tenants to act immediately. We should see an increase in leasing activity as many short-term deals come up for renewal and as job creation begins in going into 2011. Once employment turns positive and consumer confidence stabilizes, the office market will regain equilibrium.

### OFFICE MARKET OVERVIEW

	3Q2010	2Q2010	3Q2009	% CHANGE vs. 3Q2009
Vacancy Rate	15.94%	16.13%	15.90%	0.25%
Availability Rate	19.45%	19.79%	19.96%	(2.56%)
Average Asking Lease Rate	\$2.15	\$2.19	\$2.39	(10.04%)
Sale & Lease Transactions	2,495,221	2,802,883	1,863,897	33.87%
Gross Absorption	2,319,933	2,379,072	2,915,423	(20.43%)
Net Absorption	502,590	315,034	446,000	N/A



	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2010	Square Feet Available	Availability Rate 3Q2010	Average Asking Lease Rate	Net Absorption 3Q2010	Net Absorption 2010	Gross Absorption 3Q2010	Gross Absorption 2010
<b>Central</b>													
Downtown	138	12,582,316	0	40,000	2,073,535	16.48%	2,652,238	21.08%	\$2.23	(36,553)	(124,725)	180,372	558,685
<b>Central Total</b>	<b>138</b>	<b>12,582,316</b>	<b>0</b>	<b>40,000</b>	<b>2,073,535</b>	<b>16.48%</b>	<b>2,652,238</b>	<b>21.08%</b>	<b>\$2.23</b>	<b>(36,553)</b>	<b>(124,725)</b>	<b>180,372</b>	<b>558,685</b>
<b>Central Suburban</b>													
City Heights/University	27	906,913	0	0	51,960	5.73%	74,329	8.20%	\$0.00	(18,177)	858	1,563	25,385
Coronado	6	124,741	0	0	8,339	6.69%	8,339	6.69%	\$2.75	(2,000)	(1,460)	250	790
Kearny Mesa	236	10,267,689	300,000	854,000	1,122,104	10.93%	1,487,437	14.49%	\$1.69	305,026	501,345	454,900	917,570
Mission Gorge	26	629,191	0	0	74,344	11.82%	57,611	9.16%	\$1.37	(12,032)	(4,958)	10,206	24,034
Mission Valley	124	6,934,376	0	55,000	1,177,962	16.99%	1,519,595	21.91%	\$1.91	23,306	(35,172)	165,962	420,105
Old Town/Point Loma	77	2,424,481	15,176	0	85,329	3.52%	355,926	14.68%	\$1.49	10,465	44,859	26,419	90,804
Park East	9	167,568	0	0	979	0.58%	14,260	8.51%	\$2.10	0	645	0	7,400
Rose Canyon/Morena	59	1,289,564	0	22,557	147,083	11.41%	165,932	12.87%	\$2.08	(41,503)	(26,375)	9,956	45,527
Uptown/Hillcrest	111	2,741,476	0	0	229,595	8.37%	394,375	14.39%	\$2.28	(20,404)	(39,292)	31,157	91,236
<b>Central Suburban Total</b>	<b>675</b>	<b>25,485,999</b>	<b>315,176</b>	<b>931,557</b>	<b>2,897,695</b>	<b>11.37%</b>	<b>4,077,804</b>	<b>16.00%</b>	<b>\$1.81</b>	<b>244,681</b>	<b>440,450</b>	<b>700,413</b>	<b>1,622,851</b>
<b>Highway 78 Corridor</b>													
Oceanside	53	1,101,365	0	455,789	220,564	20.03%	223,064	20.25%	\$0.93	4,315	36,814	12,481	65,729
San Marcos	37	1,248,037	0	158,000	293,309	23.50%	317,201	25.42%	\$1.50	12,529	17,219	19,259	48,290
Vista	47	1,090,030	0	188,350	164,503	15.09%	185,486	17.02%	\$1.46	18,618	(6,346)	41,263	66,358
<b>Highway 78 Corridor Total</b>	<b>137</b>	<b>3,439,432</b>	<b>0</b>	<b>802,139</b>	<b>678,376</b>	<b>19.72%</b>	<b>725,751</b>	<b>21.10%</b>	<b>\$1.41</b>	<b>35,462</b>	<b>47,687</b>	<b>73,003</b>	<b>180,377</b>
<b>I-15 Corridor</b>													
Escondido	73	1,530,508	44,000	331,107	316,611	20.69%	362,434	23.68%	\$1.63	(10,200)	(69,869)	12,981	32,655
Poway	31	1,385,049	0	340,570	77,570	5.60%	89,477	6.46%	\$2.22	(567)	(8,759)	12,478	17,056
Rancho Bernardo	103	6,341,973	0	1,176,827	1,060,581	16.72%	973,311	15.35%	\$1.91	87,445	365,844	140,309	631,095
Scripps Ranch	51	2,721,957	0	240,000	617,307	22.68%	1,112,520	40.87%	\$2.22	7,890	75,262	60,275	345,381
<b>I-15 Corridor Total</b>	<b>258</b>	<b>11,979,487</b>	<b>44,000</b>	<b>2,088,504</b>	<b>2,072,069</b>	<b>17.30%</b>	<b>2,537,742</b>	<b>21.18%</b>	<b>\$1.95</b>	<b>84,568</b>	<b>362,478</b>	<b>226,043</b>	<b>1,026,187</b>
<b>North City</b>													
Governor Park	19	859,834	0	0	343,447	39.94%	218,637	25.43%	\$2.00	13,204	9,367	18,310	67,166
La Jolla	61	1,783,902	0	0	162,839	9.13%	264,217	14.81%	\$2.65	4,061	(35,004)	30,396	96,231
Miramar	34	1,574,472	0	0	189,366	12.03%	226,883	14.41%	\$1.98	13,967	55,423	30,590	95,383
Sorrento Mesa	115	8,204,412	0	1,490,649	1,553,134	18.93%	1,502,996	18.32%	\$2.21	(2,437)	(114,885)	210,940	514,703
Sorrento Valley	24	721,661	0	0	78,125	10.83%	80,087	11.10%	\$1.29	17,682	18,029	26,930	46,031
Torrey Pines	49	3,658,534	0	0	224,033	6.12%	490,657	13.41%	\$3.75	(6,041)	(54,898)	23,461	68,836
UTC Center	87	8,052,862	0	594,097	1,646,696	20.45%	1,950,334	24.22%	\$2.45	131,193	(58,609)	358,093	610,720
<b>North City Total</b>	<b>389</b>	<b>24,855,677</b>	<b>0</b>	<b>2,084,746</b>	<b>4,197,640</b>	<b>16.89%</b>	<b>4,733,811</b>	<b>19.05%</b>	<b>\$2.42</b>	<b>171,629</b>	<b>(180,577)</b>	<b>698,720</b>	<b>1,499,070</b>
<b>North County</b>													
Carlsbad	154	6,170,019	79,238	792,200	1,566,745	25.39%	1,913,376	31.01%	\$2.36	(40,772)	(10,395)	145,413	506,393
Del Mar Heights/Carmel Valley	67	4,398,300	0	91,256	878,346	19.97%	980,332	22.29%	\$3.90	70,798	215,985	162,160	496,764
North Beach Cities	120	2,648,750	0	76,120	278,080	10.50%	384,152	14.50%	\$2.15	(20,141)	11,419	57,341	169,350
<b>North County Total</b>	<b>341</b>	<b>13,217,069</b>	<b>79,238</b>	<b>959,576</b>	<b>2,723,171</b>	<b>20.60%</b>	<b>3,277,860</b>	<b>24.80%</b>	<b>\$2.45</b>	<b>9,885</b>	<b>217,009</b>	<b>364,914</b>	<b>1,172,507</b>
<b>South/Southeast Corridor</b>													
Chula Vista	84	2,492,291	0	322,953	431,479	17.31%	448,733	18.00%	\$1.70	7,594	35,247	29,929	145,587
East County	156	3,447,710	0	661,700	296,943	8.61%	347,920	10.09%	\$1.11	(7,885)	31,277	34,217	128,640
National City	15	516,722	0	0	225,604	43.66%	244,875	47.39%	\$0.00	(10,936)	(2,371)	2,016	13,589
Otay Mesa	11	339,461	0	0	42,608	12.55%	51,209	15.09%	\$0.00	4,145	(4,453)	10,306	12,020
Southeast San Diego	14	427,983	0	0	111,191	25.98%	111,682	26.09%	\$1.25	0	(2,700)	0	17,900
<b>South/Southeast Total</b>	<b>280</b>	<b>7,224,167</b>	<b>0</b>	<b>984,653</b>	<b>1,107,825</b>	<b>15.33%</b>	<b>1,204,419</b>	<b>16.67%</b>	<b>\$1.37</b>	<b>(7,082)</b>	<b>57,000</b>	<b>76,468</b>	<b>317,736</b>
Class A	259	31,596,796	379,238	4,699,530	6,025,682	19.07%	6,352,394	20.10%	\$2.43	457,839	802,195	1,020,646	2,579,552
Class B	1,179	49,462,909	59,176	3,191,645	8,032,496	16.24%	10,576,620	21.38%	\$1.93	157,595	159,525	1,134,123	3,233,865
Class C	780	17,724,442	0	0	1,692,133	9.55%	2,280,611	12.87%	\$1.57	(112,844)	(142,398)	165,164	563,996
<b>San Diego County Total</b>	<b>2,218</b>	<b>98,784,147</b>	<b>438,414</b>	<b>7,891,175</b>	<b>15,750,311</b>	<b>15.94%</b>	<b>19,209,625</b>	<b>19.45%</b>	<b>\$2.15</b>	<b>502,590</b>	<b>819,322</b>	<b>2,319,933</b>	<b>6,377,413</b>

This survey consists of buildings greater than 10,000 square feet. Lease rates are on a full-service gross basis.

RECENT TRANSACTIONS

Sales Transactions

Property Address	Submarket	Class	Square Feet	Price Per SF	Buyer	Seller
3390 Carmel Mountain Rd. – 3 Properties	Sorrento Valley	B	118,030	\$231.30	KBS Real Estate Investment Trust II	RREEF America, LLC
10240 Science Center Dr.	Torrey Pines	B	49,347	\$359.70	BioMed Realty, LP	Trammell Crow Company
4995 Murphy Canyon Rd.	Kearny Mesa	A	57,685	\$173.36	NetREIT	The Muller Company
1620 5th Ave.	Downtown	B	80,320	\$124.50	Douglas Wilson Company	Robert F. Driver Office Bldg., Ltd.
9210 & 9265 Sky Park Ct.	Kearny Mesa	B	81,878	\$112.36	Omninet Capital	M. M. Financial Services
6701–6743 Convoy Ct.	Kearny Mesa	C	53,595	\$100.20	Korean United Methodist Church	AI Prince Corporation

Lease Transactions

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
10300 Campus Point Dr.	UTC	B	87,632	Sep–10	N/A	Campus Point Investors, LLC
10945 Vista Sorrento Pky. – Renewal	Del Mar/Carmel Valley	A	85,329	Jul–10	QUALCOMM, Inc.	TIAA–CREF
6310 Sequence Dr.	Sorrento Mesa	B	62,415	Sep–10	DexCom, Inc.	Kilroy Realty Corporation
9520 Towne Centre Dr.	UTC	B	39,897	Aug–10	Kyocera	The Irvine Company
8880 Rio San Diego Dr.	Mission Valley	A	38,487	Sep–10	N/A	Hyundai Translead
12225 El Camino Real	Del Mar Hts/Carmel Valley	B	37,234	Sep–10	Service–now.com	Kilroy Realty Corporation

Product Type

CLASS A

Most prestigious buildings competing for premier office users with rents above average for the area. Buildings have high-quality standard finishes, state-of-the-art systems, exceptional accessibility and a definite market presence.

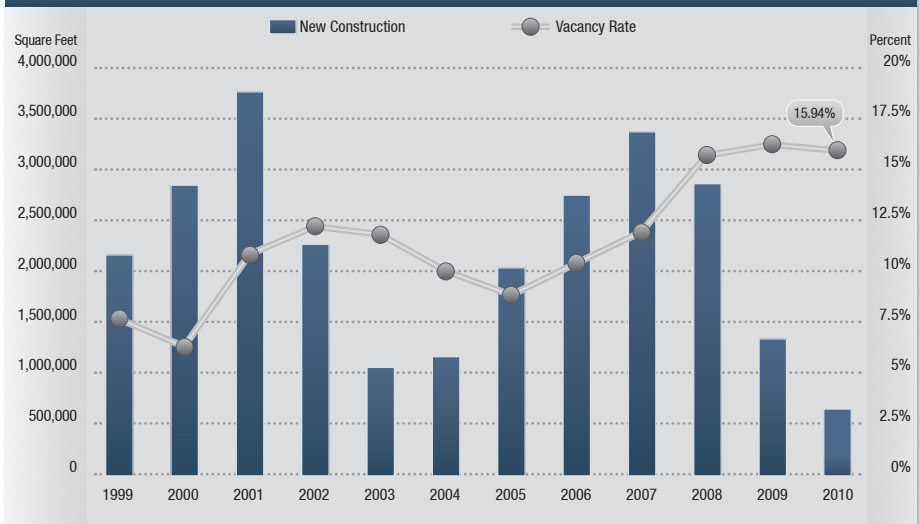
CLASS B

Buildings competing for a wide range of users with rents in the average range for the area. Building finishes are fair to good for the area, and systems are adequate. However, Class B buildings cannot compete with Class A buildings of the same price.

CLASS C

Buildings competing for tenants requiring functional space at rents below the area average.

ANNUAL OFFICE NEW CONSTRUCTION VS. VACANCY RATE



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