

Peninsula Report

MARKET OVERVIEW | FOURTH QUARTER | 2008



MARKET INDICATORS

	3Q 2008	4Q 2008	
VACANCY RATE	12.6%	14.4%	↑
DIRECT VACANCY	3,745,875 SF	4,458,915 SF	↑
SUBLEASE VACANCY	1,548,989 SF	1,633,371 SF	↑
GROSS ABSORPTION	928,595 SF	666,787 SF	↓
NET ABSORPTION	(186,956) SF	(456,847) SF	↓
WTD AVG ASKING RENT	\$3.59 FS	\$3.18 FS	↓

Office Overview

This year will certainly be remembered for the severe downturn that touched all sectors of the economy. While most pundits believe that the Silicon Valley and San Francisco Peninsula will likely escape the worst of the damage, there is no denying the ripples that have and will be felt by our local real estate markets.

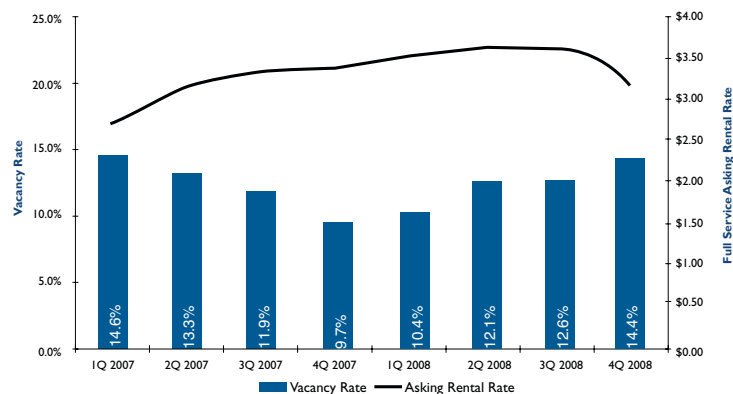
The fourth quarter of 2008 was the third consecutive quarter of negative net absorption in the Peninsula office submarket, with 456,847 square feet of vacant space added to the market. However, a closer look at the underlying statistics reveals that this was the first quarter with a broad, noteworthy increase in available space. Negative net absorption for all of 2008 totaled 1,287,688 square feet, pushing the office vacancy rate from 9.7% a year ago to its current level of 14.4%. Myers Development's completion of the 319,000 square foot first phase of Centennial Towers was a significant driver to this increase in vacancy.

Perhaps a more telling indicator of a weakened market is the recent decline in lease rates. Since peaking in the second quarter of 2008, average asking rates for office product have decreased 12% off their highs to their current level of \$3.18 Full Service. Sluggish activity in the latter portion of 2008 strongly suggests further softening in the coming months. The slowdown in deal velocity, as opposed to any substantial increase in inventory, will be the likely driver for any degradation to the local market in 2009.

However, the most desirable core markets have held up surprisingly well. Lease rates in Mountain View, particularly within the downtown area, have been virtually flat over the course of 2008, and deal flow remains relatively solid. The broad vacancy rates in Palo Alto have been similarly spared any consequential impact. In Redwood Shores—a market driven by smaller square footage deals—building owners have adjusted asking rates to suit current market conditions, stemming any significant erosion to occupancy rates.

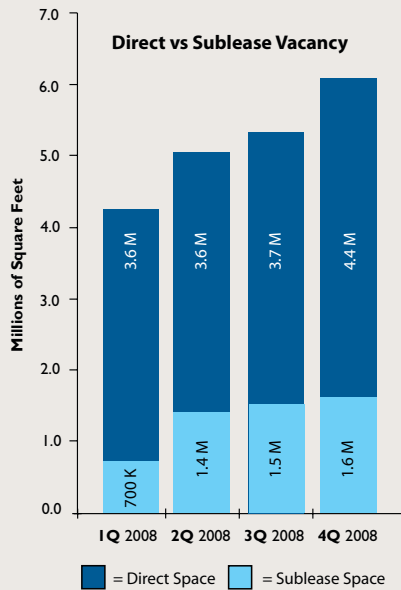
“The slowdown in deal velocity, as opposed to any substantial increase in inventory, will be the likely driver for any degradation to the local market in 2009.”

PENINSULA OFFICE MARKET - VACANCY VS. RENT



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The elephant in the room remains the growing supply of sublease space coming to market. As sublease availability increases as a percentage of the broader market, lease rate volatility tends to accelerate. This phenomenon last manifested itself in the wake of the ‘dot com’ bust of 2001, where the collapse in lease rates occurred rapidly and dramatically once available sublease square footage exceeded the inventory of direct space. While sublease space availabilities have increased, this still only represents 27% of the market. If this percentage remains stable, a repeat of the commercial real estate ‘dot com’ bust may be avoided.

A scattering of high profile deals in late 2008 belie the sense of an inactive market. The 107,000 square foot Menlo Park availability recently vacated by Heller Ehrman LLP was quickly absorbed by the law firm of McDermott Will & Emery and Arista Networks. Additional noteworthy transactions in the fourth quarter included Audience Inc. in Mountain View and Dun & Bradstreet in San Mateo.

While it is virtually certain that 2009 will be a challenging year for the local commercial real estate markets, there is cause to believe that the recovery will be less difficult than in previous cycles. A lack of new building construction over the past seven years has left some constraint on the supply side of the equation, and, barring a significant influx of new sublease space, it is likely that a large spike in vacancy rates will be avoided if not at least mitigated.

R&D and Industrial Overview

The Peninsula R&D and Industrial markets are reflective of the current Bay Area economy – no growth and much indecision. The Southern Peninsula R&D market has remained in a more consistent position compared to the softening Northern Peninsula region while the credit crisis has all but halted investment sales.

Gross absorption for both the Peninsula R&D and Industrial markets has not changed substantively from the three previous quarters of 2008. During the fourth quarter, R&D gross absorption was 334,778 square feet compared to an average of 375,000 square feet in the first through third quarters, while Industrial gross absorption was 344,945 square feet compared to a previous quarterly average of 400,000 square feet.

“The elephant in the room remains the growing supply of sublease space coming to market.”

MARKET ACTIVITY

SIGNIFICANT FOURTH QUARTER TRANSACTIONS

SIGNIFICANT LEASES

PROPERTY ADDRESS	DATE	SQUARE FEET	TENANT	TYPE
275 Middlefield Road, Menlo Park	11/08	85,000	McDermott Will & Emery LLP	Office
275 Middlefield Road, Menlo Park	11/08	41,000	Arista Networks	Office
2211 Bridgepointe Parkway, San Mateo	10/08	30,718	Dun & Bradstreet	Office
405 Victory Avenue, South San Francisco	11/08	31,008	American Wine Distributors	Warehouse
431 E. Grand Avenue, South San Francisco	11/08	23,200	SDV International Logistics	Warehouse
440 Clyde Avenue, Mountain View	10/08	35,411	Audience Inc.	R&D

SIGNIFICANT SALES

PROPERTY ADDRESS	DATE	SQUARE FEET	BUYER	TYPE
1080 Linda Vista Avenue, Mountain View	10/08	33,671	Church of Scientology	R&D/Office
4025 Bohannon Drive, Menlo Park	11/08	15,000	Novo Construction	R&D/Office

OFFICE MARKET STATISTICS
FOURTH QUARTER 2008

EXISTING PROPERTIES			DIRECT VACANCY		SUBLEASE VACANCY		TOTAL VACANCY			NET ABSORPTION		RENT	
Class	Bldgs	Total Inventory Sq Ft	Sq Ft	Rate	Sq Ft	Rate	Sq Ft	Current Occupied Sq Ft	Rate Q4-2008	Rate Q3-2008	Q4-2008	YTD	Wtd Avg Asking Rate
SUB MARKETS													
MOUNTAIN VIEW/LOS ALTOS													
A	31	2,427,929	140,921	5.8%	7,069	0.3%	147,990	2,279,939	6.1%	5.3%	(16,698)	(16,306)	\$3.93
B	63	1,466,642	202,553	13.8%	9,740	0.7%	212,293	1,254,349	14.5%	13.0%	(4,958)	(74,475)	\$3.30
Total	94	3,894,571	343,474	8.8%	16,809	0.4%	360,283	3,534,288	9.3%	8.2%	(21,656)	(90,781)	\$3.56
PALO ALTO													
A	63	2,806,466	138,978	5.0%	34,431	1.2%	173,409	2,633,057	6.2%	6.1%	(1,297)	(13,831)	\$4.24
B	104	2,400,415	186,308	7.8%	30,112	1.3%	216,420	2,183,995	9.0%	8.4%	(14,258)	(118,191)	\$4.17
Total	167	5,206,881	325,286	6.2%	64,543	1.2%	389,829	4,817,052	7.5%	7.1%	(15,555)	(132,022)	\$4.20
MENLO PARK													
A	31	1,496,965	17,327	1.2%	17,134	1.1%	34,461	1,462,504	2.3%	1.5%	(12,285)	57,008	\$8.25
B	69	2,125,648	194,447	9.1%	69,878	3.3%	264,325	1,861,323	12.4%	12.5%	1,948	(78,889)	\$3.16
Total	100	3,622,613	211,774	5.8%	87,012	2.4%	298,786	3,323,827	8.2%	8.0%	(10,337)	(21,881)	\$3.58
REDWOOD CITY													
A	20	2,440,446	169,948	7.0%	548,702	22.5%	718,650	1,721,796	29.4%	27.3%	(51,822)	(295,881)	\$3.13
B	36	1,336,245	246,851	18.5%	13,453	1.0%	260,304	1,075,941	19.5%	19.4%	(1,062)	6,517	\$2.45
Total	56	3,776,691	416,799	11.0%	562,155	14.9%	978,954	2,797,737	25.9%	24.5%	(52,884)	(289,364)	\$2.73
BELMONT/SAN CARLOS													
A	9	881,679	320,563	36.4%	58,497	6.6%	379,060	502,619	43.0%	43.0%	0	(52,497)	\$3.25
B	12	660,789	51,795	7.8%	0	0.0%	51,795	608,994	7.8%	7.8%	0	13,693	\$3.18
Total	21	1,542,468	372,358	24.1%	58,497	3.8%	430,855	1,111,613	27.9%	27.9%	0	(38,804)	\$3.24
REDWOOD SHORES													
A	49	5,347,940	461,272	8.6%	42,064	0.8%	503,336	4,844,604	9.4%	8.3%	(58,891)	143,402	\$3.50
B	5	172,852	17,259	10.0%	4,626	2.7%	21,885	150,967	12.7%	16.5%	6,564	18,483	\$2.90
Total	54	5,520,792	478,531	8.7%	46,690	0.8%	525,221	4,995,571	9.5%	8.6%	(52,327)	161,885	\$3.48
SAN MATEO													
A	24	2,709,117	321,890	11.9%	91,942	3.4%	413,832	2,295,285	15.3%	13.3%	(54,088)	(135,459)	\$3.21
B	68	3,956,698	697,982	17.6%	87,324	2.2%	785,306	3,171,392	19.8%	17.4%	(98,298)	(132,875)	\$2.83
Total	92	6,665,815	1,019,872	15.3%	179,266	2.7%	1,199,138	5,466,677	18.0%	15.7%	(152,386)	(268,334)	\$2.95
FOSTER CITY													
A	14	2,686,494	114,485	4.3%	102,002	3.8%	216,487	2,470,007	8.1%	6.2%	(50,177)	(183,648)	\$4.30
B	14	576,068	71,335	12.4%	21,031	3.7%	92,366	483,702	16.0%	12.2%	(22,315)	(27,725)	\$2.50
Total	28	3,262,562	185,820	5.7%	123,033	3.8%	308,853	2,953,709	9.5%	7.2%	(72,492)	(211,373)	\$3.61
BURLINGAME													
A	6	758,931	225,860	29.8%	14,861	2.0%	240,721	518,210	31.7%	29.1%	(19,701)	(84,277)	\$2.64
B	24	1,047,180	105,753	10.1%	1,835	0.2%	107,588	939,592	10.3%	8.5%	(18,375)	(47,679)	\$2.16
Total	30	1,806,111	331,613	18.4%	16,696	0.9%	348,309	1,457,802	19.3%	17.2%	(38,076)	(131,956)	\$2.49
SAN BRUNO/MILLBRAE													
A	9	1,132,078	93,082	8.2%	74,129	6.5%	167,211	964,867	14.8%	16.9%	24,313	(79,591)	\$2.88
B	11	371,840	25,838	6.9%	0	0.0%	25,838	346,002	6.9%	5.8%	(4,425)	(6,548)	\$2.79
Total	20	1,503,918	118,920	7.9%	74,129	4.9%	193,049	1,310,869	12.8%	14.2%	19,888	(86,139)	\$2.86
DALY CITY													
A	4	668,291	24,159	3.6%	1,400	0.2%	25,559	642,732	3.8%	3.0%	(5,756)	15,516	\$2.80
B	10	285,853	36,376	12.7%	0	0.0%	36,376	249,477	12.7%	12.1%	(1,735)	(212)	\$1.95
Total	14	954,144	60,535	6.3%	1,400	0.1%	61,935	892,209	6.5%	5.7%	(7,491)	15,304	\$2.29
SOUTH SAN FRANCISCO													
A	16	2,689,888	417,956	15.5%	107,599	4.0%	525,555	2,164,333	19.5%	9.1%	8,436	8,875	\$3.12
B	14	952,918	47,060	4.9%	261,914	27.5%	308,974	643,944	32.4%	27.4%	(47,825)	(220,910)	\$2.89
Total	30	3,642,806	465,016	12.8%	369,513	10.1%	834,529	2,808,277	22.9%	14.3%	(39,389)	(212,035)	\$3.10
BRISBANE													
A	5	674,888	106,850	15.8%	33,628	5.0%	140,478	534,410	20.8%	18.2%	(17,751)	14,619	\$3.20
B	4	176,587	22,067	12.5%	0	0.0%	22,067	154,520	12.5%	14.5%	3,609	3,193	\$1.95
Total	9	851,475	128,917	15.1%	33,628	3.9%	162,545	688,930	19.1%	17.4%	(14,142)	17,812	\$2.99
MARKET TOTALS													
A	281	26,721,112	2,553,291	9.6%	1,133,458	4.2%	3,686,749	23,034,363	13.8%	11.8%	(255,717)	(622,070)	\$3.36
B	434	15,529,735	1,905,624	12.3%	499,913	3.2%	2,405,537	13,124,198	15.5%	14.1%	(201,130)	(665,618)	\$2.93
Total	715	42,250,847	4,458,915	10.6%	1,633,371	3.9%	6,092,286	36,158,561	14.4%	12.6%	(456,847)	(1,287,688)	\$3.18

R&D MARKET STATISTICS FOURTH QUARTER 2008

City	Total Inventory Sq Ft	Direct Vacant Space	Sublease Vacant Space	Total Vacant Space	Direct Vacancy Rate	Sublease Vacancy Rate	Overall Vacancy	Average Asking Rent	Net Absorption
SUB MARKETS									
BRISBANE	34,880	0	0	0	0.00%	0.00%	0.00%	N/A	0
SOUTH SAN FRANCISCO	5,030,121	96,614	278,392	375,006	1.92%	5.53%	7.46%	\$1.36	(100,477)
SAN BRUNO	135,182	3,275	3,200	6,475	2.42%	2.37%	4.79%	\$1.05	0
BURLINGAME	591,560	11,500	0	11,500	1.94%	0.00%	1.94%	\$1.00	0
SAN MATEO	219,043	0	0	0	0.00%	0.00%	0.00%	N/A	0
FOSTER CITY	1,402,697	116,346	0	116,346	8.29%	0.00%	8.29%	\$1.38	834
BELMONT / SAN CARLOS	1,776,052	125,353	10,483	135,836	7.06%	0.59%	7.65%	\$1.24	6,765
REDWOOD CITY	2,351,929	208,509	164,639	373,148	8.87%	7.00%	15.87%	\$1.94	99,504
MENLO PARK	2,339,915	214,494	13,297	227,791	9.17%	0.57%	9.74%	\$1.89	(72,315)
PALO ALTO	10,292,315	67,390	323,245	390,635	0.65%	3.14%	3.80%	\$3.47	(293,177)
MOUNTAIN VIEW	13,971,801	773,388	552,011	1,325,399	5.54%	3.95%	9.49%	\$1.95	(72,299)
GRAND TOTAL	38,145,495	1,616,869	1,345,267	2,962,136	4.24%	3.53%	7.77%	\$1.86	(431,165)

INDUSTRIAL MARKET STATISTICS FOURTH QUARTER 2008

City	EXISTING PROPERTIES		DIRECT VACANCY		SUBLEASE VACANCY		TOTAL VACANCY				NET ABSORPTION		AVG. RENT
	Bldgs	Total Inventory Sq Ft	Sq Ft	Rate	Sq Ft	Rate	Sq Ft	Current Occupied Sq Ft	Rate Q4-2008	Rate Q3-2008	Q4-2008	YTD	Avg. Rental Rate
SUB MARKETS													
BRISBANE	86	4,373,892	354,582	8.1%	21,605	0.5%	376,187	3,997,705	8.6%	7.3%	(57,765)	(163,429)	\$0.89
DALY CITY	5	431,050	-	0.0%	-	0.0%	-	431,050	0.0%	0.0%	-	-	-
SOUTH SAN FRANCISCO	405	16,815,790	1,196,524	7.1%	80,578	0.5%	1,277,102	15,538,688	7.6%	7.2%	(68,400)	(240,366)	\$0.91
SAN BRUNO	16	511,514	-	0.0%	-	0.0%	-	511,514	0.0%	0.0%	-	-	-
MILLBRAE	10	286,683	10,466	3.7%	-	0.0%	10,466	276,217	3.7%	3.7%	266	7,534	\$1.16
BURLINGAME	159	4,637,562	310,871	6.7%	42,000	0.9%	352,871	4,284,691	7.6%	8.9%	59,768	26,850	\$0.87
SAN MATEO	48	837,073	94,902	11.3%	-	0.0%	94,902	742,171	11.3%	11.3%	-	(94,902)	\$1.13
FOSTER CITY	15	432,336	2,700	0.6%	-	0.0%	2,700	429,636	0.6%	0.0%	(2,700)	20,452	\$1.25
BELMONT/SAN CARLOS	221	5,464,194	123,206	2.3%	-	0.0%	123,206	5,340,988	2.3%	2.0%	(14,190)	(11,990)	\$1.44
REDWOOD CITY	176	4,157,999	148,374	3.6%	101,633	2.4%	250,007	3,907,992	6.0%	4.9%	(46,405)	(74,843)	\$0.97
MENLO PARK	91	2,823,715	123,494	4.4%	11,904	0.4%	135,398	2,688,317	4.8%	4.2%	(16,900)	34,378	\$0.94
MOUNTAIN VIEW	148	2,698,054	153,976	5.7%	-	0.0%	153,976	2,544,078	5.7%	6.6%	24,124	(99,521)	\$1.33
GRAND TOTAL	1,380	43,469,862	2,519,095	5.8%	257,720	0.6%	2,776,815	40,693,047	6.4%	6.1%	(122,202)	(595,837)	\$0.97

R&D produced a negative net absorption in the fourth quarter of 431,165 square feet resulting in an increase of the vacancy rate to 7.8% from 6.8% at the end of the third quarter. Industrial vacancy saw a nominal increase of 0.3% to 6.4% over the same period. However, a closer look reveals that the bulk of the negative absorption for both product types can be traced back to three large direct spaces coming to market for Industrial in South San Francisco and Brisbane, and one R&D sublease of 240,000 square feet in Palo Alto. Adjusting for these events shows a relatively flat market for the second half of 2008.

The vacancy rate of sublease space increased from 2.8% in the third quarter to 3.5% in the fourth quarter and average asking rents for R&D dipped from \$1.89 Triple Net (NNN) in the third quarter to \$1.86 NNN in the fourth quarter. Industrial average asking rents remained stable, going from \$.98 NNN in the third quarter to \$.97 NNN in the fourth quarter.

Looking forward, the Industrial sector should remain stable due to a consistent lack of new supply and relatively steady demand from tenants. The outlook for R&D, especially in the North Peninsula, is not as easily predictable. Large blocks of sublease space, such as the Amgen and FibroGen space, remain on the market with little activity. Additionally, over 700,000 square feet of Life Science product is under construction at the HCP Britannia and Alexandria projects in South San Francisco, which will contribute to a softer market for this sector.

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293 OFFICES IN 61 COUNTRIES
ON 6 CONTINENTS

USA 99
Canada 19
Latin America 18
Asia Pacific 62
EMEA 95

\$73 billion in annual transaction
volume
868 million square feet under
management
11,000 Professionals

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