

Q2

COLLIERS INTERNATIONAL SECOND QUARTER - 2004 MARKET REPORT

SILICON VALLEY

JULY 2004

450 West Santa Clara Street • San Jose, CA 95113 • Tel: (408) 282-3800 • Fax: (408) 292-8100

And the Beat Goes On

With a continuing air of trepidation, the second quarter produced yet another positive signal that Silicon Valley's commercial real estate market is on the rebound. Total gross absorption measured 7.27 million square feet in Q2, continuing a resurgence that now spans one year. Silicon Valley has generated nearly 27.8 million square feet of gross absorption over the last four quarters, a figure that exceeds total gross absorption measured in six out of the last ten calendar years. That figure also well exceeds the results of 2002 and 2003, each of which produced less than 23.0 million square feet of gross absorption.

The robust level of activity is fueled by many factors. The economy continues to improve in spite of mixed sales and profitability reports that came out in Q2. While the Q3 outlook is guarded, momentum is building in the semiconductor sector, where orders are at a three-year high. GDP growth has been slightly below forecasts, but consumer spending, inventory investment, equipment & software spending and federal government spending continue to fuel growth. On the real estate side, attractive rent opportunities, low (albeit rising) interest rates, and premium quality space are continuing to spark demand.

The second quarter also produced slightly improved signals for positive net absorption. Santa Clara County added 4,300 jobs in May, lowering the unemployment rate to 5.9%, the lowest it has been since July 2001. While job growth is expected to be modest through the remainder of the year, it nevertheless sends a signal that Silicon Valley companies are once again beginning to grow. Although venture capital investment was flat in the second quarter, the numbers are still up from one year ago and Colliers agents are beginning to see more companies in the market with recent infusions of capital. As a result of these and other factors, Colliers reported positive quarterly net absorption in Q2 for the first time since the fourth quarter of 2000.

The total current supply of available space declined in Silicon Valley by 2.91 million square feet in the year's second quarter. This marks the third consecutive quarter in which available space has been reduced, from its high-water point of 68.96 million square feet after the third quarter of 2003. In that time, the overall availability rate has been reduced from

22.05% to 20.19%. The trend lines are clearly improving, but momentum is slow and optimism for sustainable growth marked by large employment gains (and significantly lower vacancy rates) is guarded.

For a better understanding of availability and net absorption trends, see our "Understanding Absorption" overview on page 4.

R&D Market

It was a good quarter for the R&D sector, where gross absorption soared to 3.37 million square feet, the most activity since the fourth quarter of 2001. For the year, R&D gross absorption stands at 6.13 million square feet, on pace for a 22% improvement over 2003, which produced 10.0 million square feet of R&D gross absorption. While deal flow in the R&D sector is still well below the levels of 1999 and 2000, it has now returned to a level that is very consistent with what Silicon Valley experienced from 1988-1998.

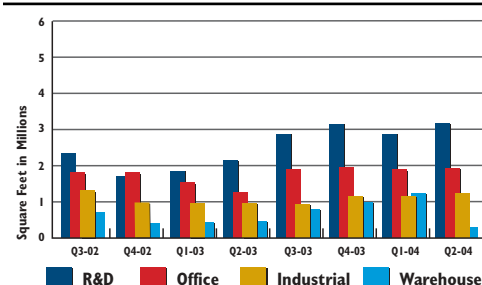
The steady stream of activity was enough to make a dent, albeit a small one, in the available supply of R&D space. Available product was reduced by slightly more than 1.0 million square feet in the

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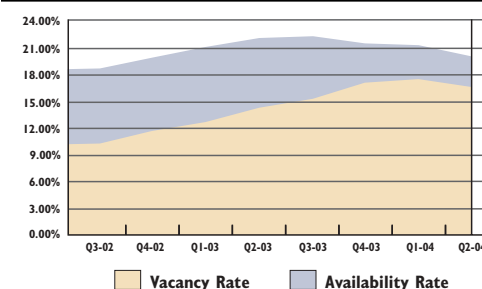
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SILICON VALLEY GROSS ABSORPTION



SILICON VALLEY AVAILABILITY



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Office gross absorption
totaled 7.12 million
square feet, a figure
that exceeds calendar
year 2003 results by
more than one million
square feet. With six
months to go, it is likely
that total Silicon Valley
Office absorption will
better all prior years
on record except
for 2001.

quarter, from 40.28 million square feet, to 39.19 million square feet. The R&D availability rate now stands at 24.49%, still a big number with a long road ahead.

San Jose and Fremont were on the receiving end of a very solid quarter of activity. San Jose generated 1.24 million square feet of gross absorption, a 58.1% improvement from the prior quarter, which had been the strongest quarter for R&D gross absorption since the fourth quarter of 2001. Of particular note in San Jose is the fact that the four largest transactions were all building sales to users, including two acquisitions by churches. Family Community Church acquired two buildings on Piercy Road totaling 129,000 square feet, and Jubilee Christian Center purchased a 72,600 square foot building on Nortech Parkway.

Fremont achieved 615,582 square feet of R&D gross absorption, besting Q1 results by 46.1% and surpassing the totals of each of the last fifteen quarters. The largest R&D transactions in Fremont during Q2 were a 105,797 square foot lease to Auction Drop and the purchase of a 64,000 square foot building on Milmont Drive by Romulus Investments, LLC.

Despite the solid quarter of R&D activity, the inventory of available space only dropped modestly in the largest cities of Silicon Valley. Fremont posted the strongest results, as available supply dropped by 423,586 square feet, enough to lower Fremont's R&D availability rate from 30.7% to 28.4%. San Jose's supply of available space dropped by 350,945 square feet, reducing the availability rate in that city from 23.9% to 23.1%.

Starting rents for completed transactions are still trending downward in Silicon Valley, in part due to low "going-in" rates that are being negotiated. In the R&D sector, the average start rate for Q2 leases was \$0.76 per square foot, triple net (NNN), down slightly from the \$0.79 average in the year's first quarter.

Office Market

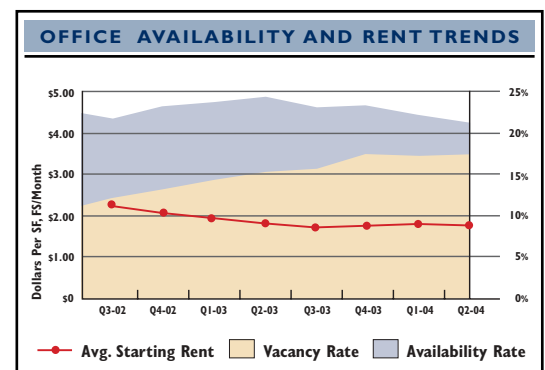
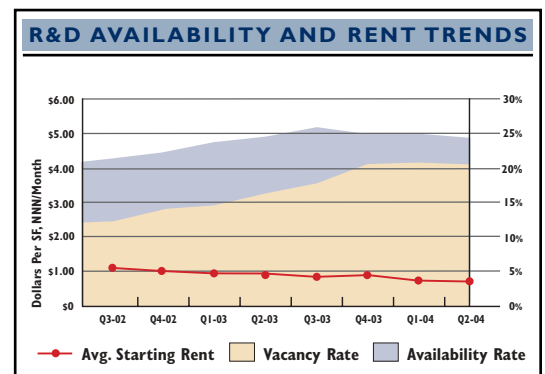
The fourth straight quarter of consistent and solid gross absorption highlighted the Office market's most recent results. Each of the last four quarters have now produced between 1.72 and 1.85 million square feet of Office gross absorption, with the Q2 figure settling at 1.83 million square feet. In the last twelve months, Office gross absorption totaled 7.12 million square feet, a figure that exceeds calendar year 2003 results by more than one million square feet. With six months to go, it is likely that total

Silicon Valley Office absorption will better all prior years on record except for 2001. In digesting that statistic, readers should bear in mind that much of the dot-com boom development consisted of fully improved buildings designed for a research/software user base.

There was some chipping away at the Office supply iceberg in the year's second quarter. Total available supply of Office space was reduced from 12.94 million square feet to 12.37 million square feet during the quarter, reducing the Office availability rate from 22.4% to 21.4%. It was the fourth consecutive quarter in which the Office availability rate has declined, from its high point of 24.4% one year ago.

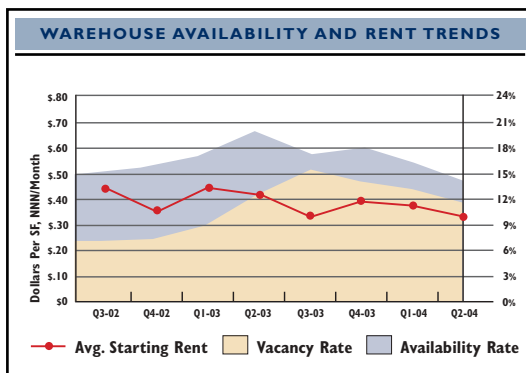
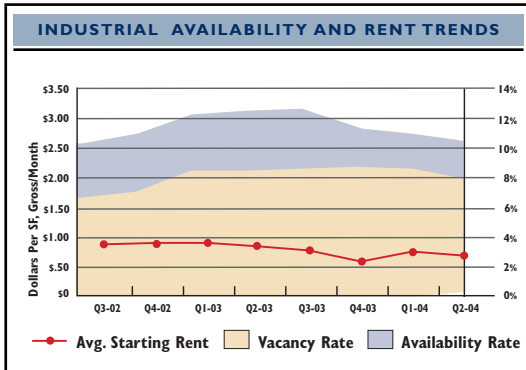
Santa Clara was the big fish in the Office pond during the second quarter, thanks to a 161,390 square foot lease by WebEx Communications at Mission Towers II. In sum, Santa Clara generated 691,956 square feet of Office gross absorption in the quarter, the best results in that city since the second quarter of 2002. For San Jose, Palo Alto, Cupertino, and Sunnyvale, Office activity was on par, or slightly below recent quarters. San Jose's 451,446 square feet of Office activity was its lowest since the first quarter of 2003.

Average starting rents in the Office sector have not moved much in the last fifteen months. The average start rate of a Q2 Office lease was \$1.80 per square



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absorption figures in San Jose dating back to the first quarter of 1994. San Jose industrial transactions included a 46,208 square foot purchase on Quinn Avenue by Do Tran, and leases by AF Associates and Industrial Machining Corporation of 33,280 square feet and 31,065 square feet respectively. Industrial gross absorption was decent, though not spectacular in the cities of Santa Clara and Fremont, where 236,236 square feet and 172,044 square feet of activity were tallied.

Industrial rents settled a bit in the second quarter, with the average starting rate dropping from \$0.66 per square foot, NNN, to \$0.62 per square foot. Despite the relatively strong market, Industrial rents are nevertheless down 17.3% in the last twelve months, though much of that reduction took place in the latter half of 2003.

Warehouse Market

The Warehouse sector was the only product type that experienced less activity in Q2 than Q1. Nevertheless, it was a solid quarter of gross absorption, measuring 784,721 square feet. That figure is well shy of the prior two quarters, each of which were a hair above 1.0 million square feet. But it continues a trend that started in the third quarter of 2003, when activity suddenly and dramatically picked up in the Warehouse market. In the last twelve months, Warehouse gross absorption totals 3.67 million square feet. The four quarters prior produced a grand total of 1.55 million square feet of Warehouse gross absorption. Total gross absorption for the calendar year is on pace to exceed 3.5 million square feet, which would be the best year since 2000, and on par with the results of 1998 and 1999.

The Warehouse availability rate dropped from 16.7% to 14.8% during the year's second quarter. Measured in square footage, available inventory was reduced by nearly 800,000 square feet, from 6.59 million square feet, to 5.79 million square feet. Warehouse availability has now been reduced in the last four quarters, from a high of 7.88 million square feet.

Fremont's impressive results during the second quarter were due in large part to a 246,450 square foot lease by CyberHome Entertainment, on Fremont Boulevard. The CyberHome deal pushed Fremont's gross absorption to 311,670 square feet for the quarter, the most impressive results since the third quarter of 1999. It was also a good quarter for San Jose, with 319,507 square feet of Warehouse gross absorption. San Jose's activity was led by a 143,896 square foot lease to Legacy Transportation Services on McLaughlin Avenue, and a 68,502 square foot lease to Gargano Enterprises on Charcot Avenue.



Warehouse rents have settled a bit in the last year. The average start rate of Q2 Warehouse leases was \$0.35 per square foot, NNN. That figure is down four cents per square foot from the prior quarter, but it is still one cent higher than the average start rate recorded in the same quarter last year.

foot, full service. That figure is just one cent below the prior quarter and two cents below the average start rate from one year earlier.

Industrial Market

The Industrial marketplace continues to outpace the other sectors of the market, with an availability rate that has now fallen below 11.0%. Second quarter activity was solid, checking in at 1.30 million square feet. It was the second best quarter of activity in the Industrial sector in the last sixteen quarters and it continued a trend of ten consecutive quarters of industrial gross absorption above 930,000 square feet. At its current pace, Industrial gross absorption could exceed 4.50 million square feet for the year, which would be the best year since 2000, and the second best year dating back to 1995.

Currently, there is 5.87 million square feet of Industrial space available throughout Silicon Valley, down from 6.33 million square feet one quarter prior and 7.00 million square feet a year ago. Total Industrial availability is at its lowest since the third quarter of 2002. The Industrial availability rate has fallen in each of the last three quarters, from a high of 12.6%, to the current rate of 10.5%.

San Jose led the way in the second quarter, generating 676,612 square feet of Industrial gross absorption. That was enough to surpass even the 1999-2000 results, eclipsing all prior gross

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REGIONAL OFFICES

SILICON VALLEY/SAN JOSE
450 West Santa Clara Street
San Jose, CA 95113
(408) 282-3800 Main
(408) 292-8100 Fax

PENINSULA/PALO ALTO
Two Palo Alto Square, Suite 200
3000 El Camino Real
Palo Alto, CA 94306
(650) 813-0560 Main
(650) 813-0564 Fax

SOUTH VALLEY/GILROY
8339 Church Street, Suite 101
Gilroy, CA 95020
(408) 842-7000 Main
(408) 842-1141 Fax

EAST BAY/PLEASANTON
5050 Hopyard Road, Suite 180
Pleasanton, CA 94588
(925) 463-2300 Main
(925) 463-0747 Fax

EAST BAY/OAKLAND
1999 Harrison Street, Suite 1750
Oakland, CA 94612
(510) 986-6770 Main
(510) 986-6775 Fax

EAST BAY/WALNUT CREEK
1850 Mt. Diablo Boulevard, Suite 200
Walnut Creek, CA 94596
(925) 279-0120 Main
(925) 279-0450 Fax

NORTH BAY/FAIRFIELD
360 Campus Lane, Suite 101
Fairfield, CA 94534
(707) 863-0188 Main
(707) 863-0181 Fax

CENTRAL VALLEY/STOCKTON
3414 Brookside Road, Suite 300
Stockton, CA 95219
(209) 475-5100 Main
(209) 475-5102 Fax

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and Las Vegas, NV.
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located throughout the U.S.
and abroad.



SELECTED
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TRANSACTIONS, Q2 2004

WebEx Communications signed a long term, 161,390 square foot office lease at Mission Towers, 3979 Freedom Circle Drive, in Santa Clara. **Mission Towers LLC** is the landlord.

Google, Inc., leased a 67,000 square foot office/R&D building at 1625 Charleston Road in Mountain View. **Mozart Development** is the landlord.

Agere Systems inked a 76,410 square foot office lease at 250 Holger Way in San Jose, with **GMAC**.

Family Community Church acquired two R&D buildings, totaling 129,999 square feet, at 474 Piercy Road in San Jose, from **Legacy Partners**.

HTL Property, LLC, sold a 71,958 square foot R&D building at 988 Rock Avenue in San Jose to **Super Micro Computer, Inc.**

Netflix, Inc., signed a 115,000 square foot R&D lease at 545 Oakmead Parkway in Sunnyvale, with **Sobrato Development Companies**.

Irwin Eskanos leased a 49,080 square foot industrial building at 8100 Camino Arroyo in Gilroy, to **Eldorado Technical Services**.

Smucker Fruit Processing Company sold its 126,000 square foot industrial building at 423 Salinas Road in Watsonville to **Falcon Trading Company, Inc.**

Cencon Invest LLC purchased a 64,000 square foot industrial building at 2302 Trade Zone Boulevard in San Jose. **GMAC** was the seller.

Green Valley Corporation purchased a 158,200 square foot warehouse building at 1989 Little Orchard Street in San Jose, from **Little Orchard Realty Company**.

Legacy Transportation Services, Inc., signed a long term, 143,996 square foot warehouse lease at 935 McLaughlin Avenue in San Jose, with landlord **Morgan Stanley**.

Pinole Point Properties inked a 246,450 square foot warehouse lease at 48350 Fremont Boulevard in Fremont with **CyberHome Entertainment, Inc.**

Commerce Communities sold its 83,055 square foot, R&D leased investment property at 2040, 2050, and 2074 Martin Avenue in Santa Clara, to **DR Stephens & Company**.

UNDERSTANDING
ABSORPTION

Colliers uses several measurements to track market conditions and deal flow. While related, the formulas to arrive at these measurements differ. Using the results of the most recent quarter, here is how Colliers measures change in availability, net absorption and effective net absorption*.

Change in Availability: This measurement is simply the difference between the amounts of space available at the end of one period to the next. The table below shows that total available space was reduced by 2.9 million square feet in the year's second quarter. Note that "change in availability" includes adjustments for space that is "taken off the market". Space "taken off the market" is not a factor in net absorption measurements.

Total Available end of 1Q04	66,139,306
Plus: Vacant & occupied space that came available Q204	6,034,476
Q1 Available + Newly Available in Q2 =	72,173,782
Less: 2Q04 Gross Absorption	-7,273,177
Less: 2Q04 Taken off the Market	-1,676,339
Total Available end of 2Q04	63,224,266

Net Absorption: Net absorption measures the change in occupied space from one period to the next. In this measurement, it is important to distinguish that a building may be "available", but not vacant (often the case in a sublease situation, for example). Therefore, occupancy is not reduced (negative net absorption) until the space is vacated, and sometimes that does not happen until the space is leased, creating a net absorption "wash" for the deal and for that particular period.

Vacant space that came available Q204	-2,935,999
Previously available space that was vacated in Q204	-4,284,007
2Q04 Total Vacant Added (occupancy loss)	-7,220,006

2Q04 Gross Absorption (occupancy gain)	7,273,177
2Q04 Net Absorption (change in occupancy)	53,171

Effective Net Absorption: In 2003, Colliers created a measurement of "effective net absorption". Effective net absorption uses the same formula as the net absorption formula, except that it treats any space that comes available as if it is vacant, whether it is or it isn't. The purpose of the measurement is to get a better, "real time" gauge of occupancy flow in and out of the market, acknowledging that space that is available for lease is likely to be vacated shortly and underutilized presently.

Vacant space that came available Q204	-2,935,999
Occupied space that came available Q204	-3,098,477
2Q04 Total Available Added	-6,034,476

2Q04 Gross Absorption	7,273,177
Effective Net Absorption	1,238,701

*For more analysis, refer to our market statistics report which can be found at : <http://www.colliersparrish.com/newsletters/sjc.all.stats.Q2-04.pdf>

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