JONES LANG LASALLE
Real value in a changing world

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Americas Research

San Francisco Peninsula Class A Office / R&D Insight Q3 2009

Economy

The pace of jobless claims has slowed in San Mateo County, providing optimism that the worst is behind us looking ahead to next year. There's still much healing needed as unemployment remained at an all-time high of 9.0 percent in September. Several marquee Peninsula-based companies are rumored to be on the acquisition block including salesforce.com (by Dell) and Electronic Arts (by Microsoft), which could cause additional job cuts. Oracle, Genentech and Sun Microsystems (pending EU approval) have also been involved in major M&A's in 2009.

The AMEX Biotechnology Index was up by 43.0 percent at the end of the third quarter. It's a positive sign for the Peninsula, which is the global epicenter of the Life Sciences industry. Furthermore, U.S. Venture Capital (VC) investment into Life Sciences exceeded Software for the first time on record, highlighting VC's commitment to the industry and its future in the Bay Area. Actelion Pharmaceuticals U.S., Inc. was the second life sciences company to purchase Class A space in 2009 and the only buyer on the Peninsula during the third quarter. Actelion acquired the 138,000-square-foot 5000 Shoreline Court from the Archon Group, which they already partially occupy. Gilead Sciences expanded their Foster City footprint in the first quarter, purchasing a building and access land from Electronics for Imaging.

Market Conditions

An abundance of high quality, large block availabilities throughout the County is keeping vacancy levels elevated and placing downward pressure on rental rates. Despite mounting quarters of negative net absorption and five year high sublease availability, several large tenants have made recent space commitments. Roche/Genentech signed the quarter's largest deal, leasing 75,000 square feet of office space from Boston Properties at 601 Gateway Boulevard in South San Francisco. It is anticipated that Roche will continue to expand in South City as it begins to relocate professionals from their 974,000-square-foot Palo Alto campus. Several other high profile direct and renewal transactions have provided a much needed boost for the Peninsula, and a handful of others are nearly across the goal line. That being said, tenants will keep their favorable negotiating leverage moving into 2010 and potentially into 2011. Rental rates may edge downward, but appear to be stabilizing.

Outlook

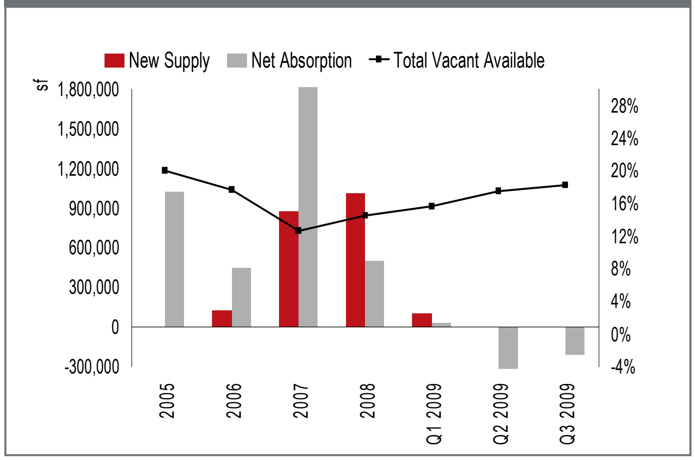
Tenant-favorable market conditions will persist well into 2010 given the volume of large block availabilities and suppressed demand. Certain micro markets are likely to begin recovery sooner than others due to their stronger tenant bases and smaller inventories.

Key market indicators*

	Key market indicators*		12-month forecast
Supply	Supply (Office) Supply (R&D)	19,384,246 sf 4,963,093sf	↑
Supply	Total available rate (Office) Total available rate (R&D)	25.1% 26.0%	→
Supply	Under construction (% preleased)	184K (100%)	↓
Demand	Q-O-Q leasing activity % change (Office & R&D)	- 58.5%	→
Demand	3Q09 net absorption (Office) 3Q09 net absorption (R&D)	-132,912 sf -75,072 sf	↓
Pricing	Direct office asking rent (FSG) Direct R&D asking rent (NNN)	$2.94 FSG $2.97NNN	↓
Pricing	Sublease office asking rent (FSG) Sublease R&D asking rent (NNN)	$2.32 FSG $2.56 NNN	↓

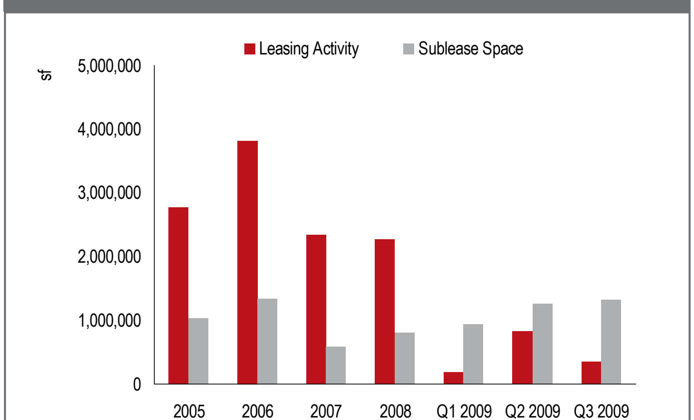
* Class A Office & R&D

Net new supply, net absorption and total availability*



* Combined Class A Office & R&D

Leasing activity vs. sublease available space



Sublease space includes vacant and available space

* Combined Class A Office & R&D

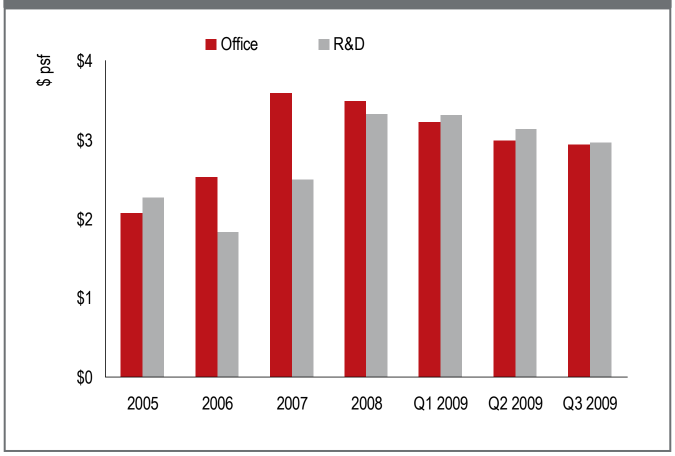
Tenant perspective

Tenants are being offered unprecedented leasing options across all size ranges in best-in-class office and R&D projects. Tenants are leaning towards sublease alternatives, which offer high-quality existing improvements at discounted rental rates. Negotiating leverage is expected to remain tenant-favorable throughout 2010. Headcount growth or in-migration are the two primary factors that will eventually swing the pendulum to stability and rebalance market conditions. Two of the Peninsula's marquee tenants sealed their out-migration plans during the third quarter, with Tesla Motor's leasing space in the Stanford Research Park in Palo Alto and Nektar subleasing space at Mission Bay in San Francisco.

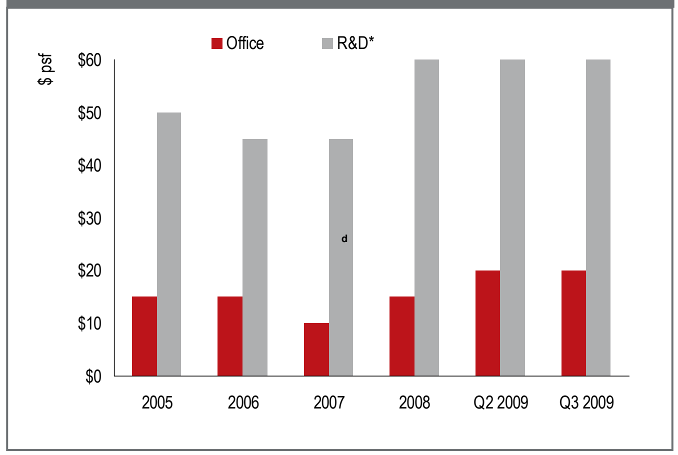
Landlord perspective

Lease expiration driven tenant requirements are keeping touring activity stable across the Peninsula. Tenants are leveraging relocation alternatives to drive down occupancy costs, spurring landlords to respond to renewals more favorably. Securing tenants long term at face rents that position rent rolls to support future refinancing or exit strategies have become a major objective of landlords. Even though recovery is expected to occur in the Peninsula ahead of San Francisco and the Silicon Valley, landlords are willing to cut shorter term deals at today's steeply discounted rents, rather than banking occupancy to capture the impending rising market. The lack of new construction, particularly in the Central and South Counties will enable these markets to recover more quickly than South San Francisco. That being said, curtailed employment growth in business services, gaming and biotechnology will keep the market from quickly moving into the stable market quadrant of the property clock near-term.

Class A asking rents

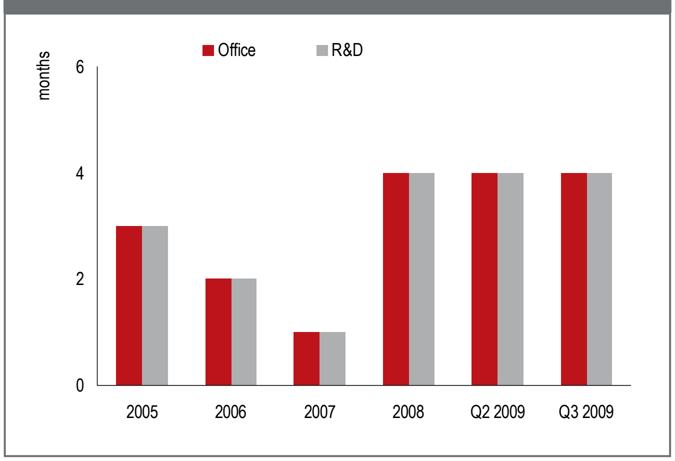


Class A tenant improvement allowance

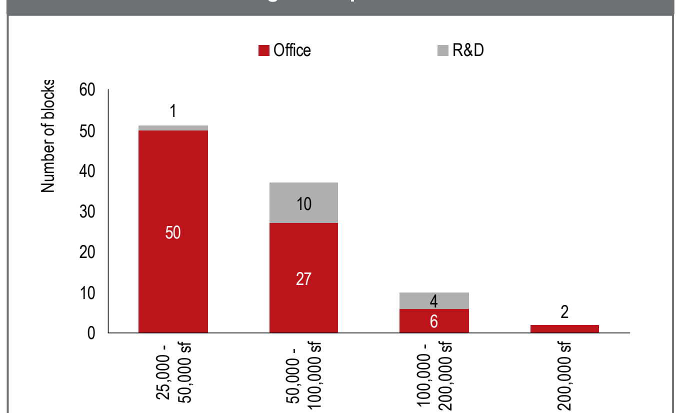


* The quoted R&D TI Allowance is a benchmark on 2nd generation wet lab/life science space. Allowances can vary significantly higher or lower based on the laboratory users needs and if existing improvements can be utilized

Class A free rent

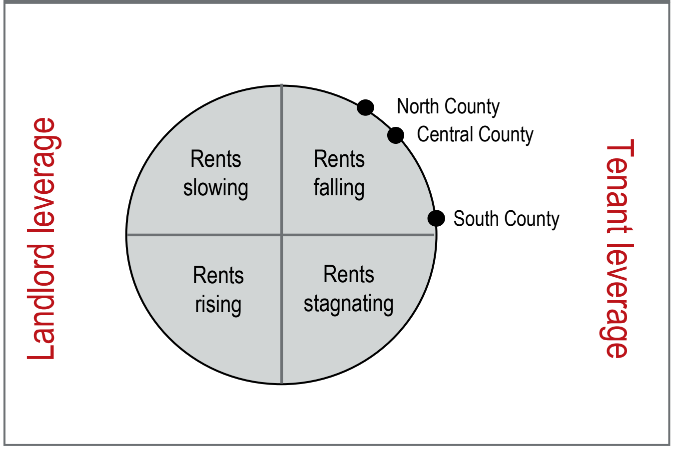


Class A blocks of contiguous space

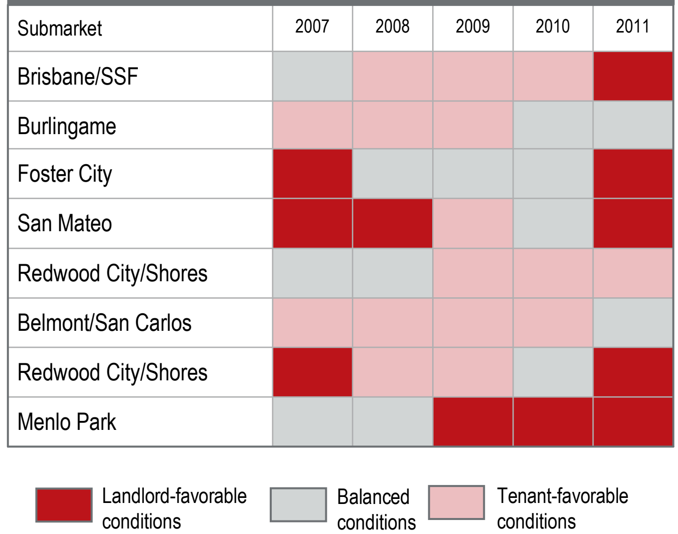


Based on available space per building. Existing buildings only.

Property clock – current market conditions



Submarket leverage – market history and forecast



Completed Class A lease transactions

Tenant	Address	Submarket	sf	Type
Genentech	601 Gateway Boulevard	South San Francisco	74,440	New
Daughters of Charity	203 Redwood Shores Parkway	Redwood Shores	50,015	Renewal
CAMICO Mutual Insurance Company	1800 Gateway Boulevard	San Mateo	38,526	New
Quinn Emanuel, LLC	555 Twin Dolphin Plaza	Redwood Shores	34,295	Renewal/Expansion
Konica Minolta	2855 Campus Drive	San Mateo	15,246	New
Golub Group, LLC	1850 Gateway Drive	San Mateo	14,806	New
Right Now Technology	999 Baker Way	San Mateo	13,510	New

Completed Class A sale transactions

Address	Submarket	Buyer/Seller	SF	$PSF
5000 Shoreline Court	South San Francisco	Actelion / Archon Group	138,399	Confidential

Class A Under Construction

Address	Submarket	Developer / Anchor Tenant	SF	Delivery Date
180 Oyster Point Boulevard	South San Francisco	Chamberlain Associates / Elan Pharmaceuticals	100,000	Q2 2009
200 Oyster Point Boulevard	South San Francisco	Chamberlain Associates / Elan Pharmaceuticals	84,000	Q4 2009

San Francisco Peninsula methodology: Inventory includes all Class A office properties > 10,000 square feet, excluding all condo, medical and government owned buildings, and owner occupied buildings

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