

Silicon Valley

Class A Office / R&D Insight

Q3 2009

Economy

M&A activity is a major component of labor force contraction occurring across the Silicon Valley. Acquiring technology IP and market share has proven to be the most important aspect of M&A activity, rather than retaining human capital. More M&A is anticipated moving into 2010, potentially including Brocade Communications, Inc. who is actively seeking a buyer. The Valley's stalwarts are sitting on stockpiles of cash reserves and are increasingly looking for acquisitions that increase market share and secure key technologies at attractive pricing.

Declining corporate information technology investment has caused San Jose's 2009 Gross Metro Product to fall into the red. Anticipated U.S. economic stability is, however, expected to spill over into the high-tech sector, boosting forecasted 2010 GMP growth to exceed 2007 levels. National venture capital investment hit a 15-year low in the third quarter, keeping organic growth soft throughout the Valley. The proportion of investment dollars in the Valley has held steady at +/- 30.0 percent, with seven of the top 10 venture recipients in 2009 being located in the Bay Area – four in Silicon Valley.

Market Conditions

Leasing activity softened further in the third quarter, which was not surprising given the cyclical nature of commercial real estate. This was the first quarter since the downturn where a block of sublease space greater than 100,000 square feet was not returned to the market. However, sublease availabilities remained prominent in nearly every Valley submarket. Renewals continued to be the most common leasing transaction type, with most being short-term deals between one to three years. Very few companies have made long-term commitments over the past few quarters, in spite of holding significant negotiating leverage and being offered cyclical low rents.

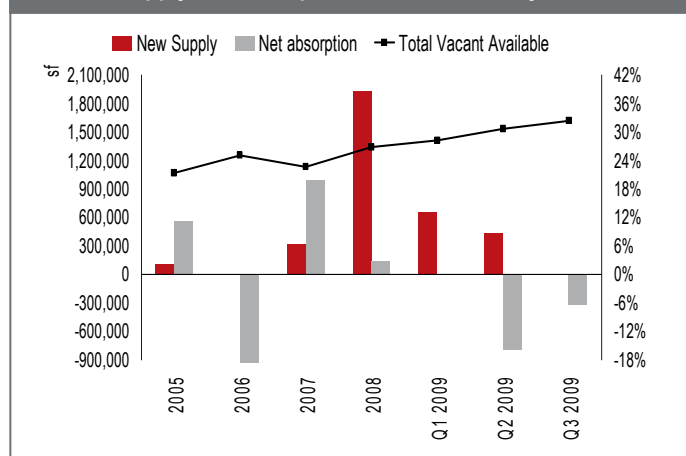
Outlook

Corporate attrition will further soften market fundamentals moving into 2010. Additional large blocks of space are likely to hit the market via lease expiration and sublease. CMBS distress has been limited to date, although several high profile projects have foreclosed. Considering the scale of capital markets activity that transpired during the last upturn, and the high acquisition basis that landlords are carrying, we anticipate significant changes to the ownership landscape in 2010 and beyond. RREEF's woes with their America REIT III have been well documented in the media and is one of many ownership entities that are being carefully watched. Consequently, future conditions are not expected to improve in the near-term, but the Valley is one of few markets in the U.S. capable of generating enormous demand based on new technologies and innovation.

Key market indicators*			12-month forecast
Supply	Supply (Office)	29,129,781 sf	▲
	Supply (R&D)	4,943,942 sf	▲
	Total available rate (Office)	34.6%	▶
	Total available rate (R&D)	47.7%	▶
	Under construction (% preleased)	65K (0%)	▼
Demand	Q-O-Q leasing activity % change (Office & R&D)	-50.7%	▶
	3Q09 net absorption (Office)	-311,247 sf	▼
	3Q09 net absorption (R&D)	-35,444 sf	▼
Pricing	Direct office asking rent (FSG)	\$2.85 FSG	▼
	Direct R&D asking rent (NNN)	\$1.38 NNN	▼
	Sublease office asking rent (FSG)	\$2.18 FSG	▼
	Sublease R&D asking rent (NNN)	\$0.93 NNN	▼

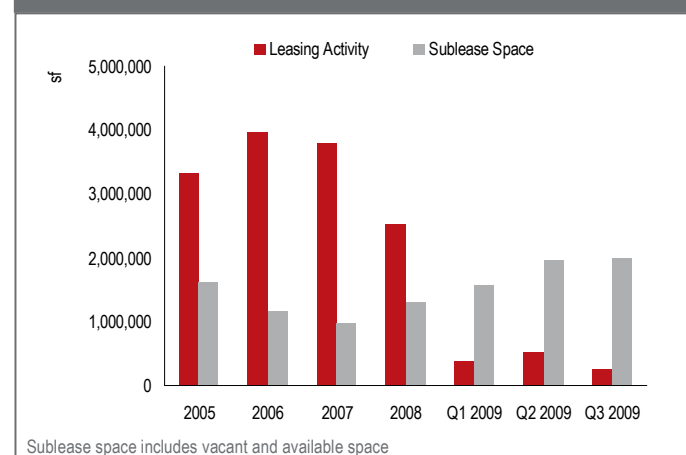
* Class A Office & R&D

Net new supply, net absorption and total vacancy*



* Class A Office & R&D

Leasing activity vs. sublease vacant available space



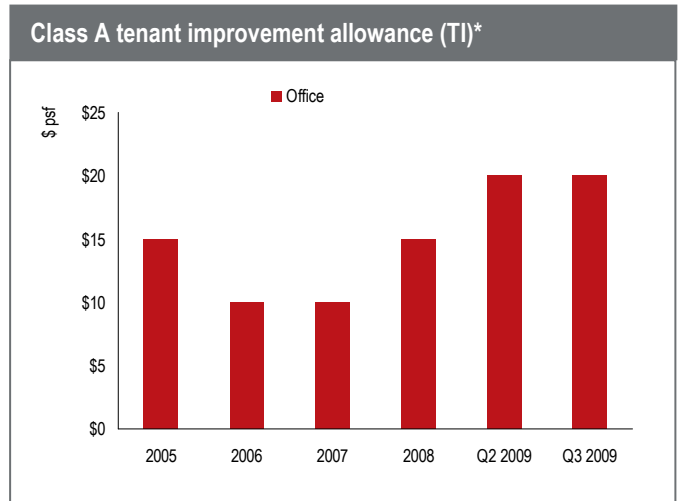
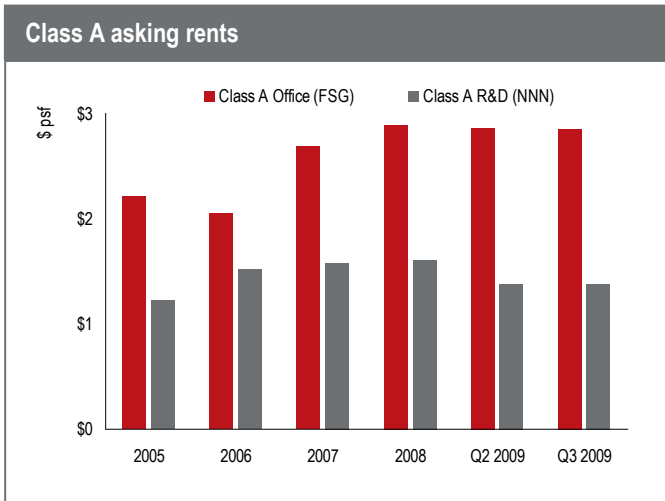
* Class A Office & R&D

Tenant perspective

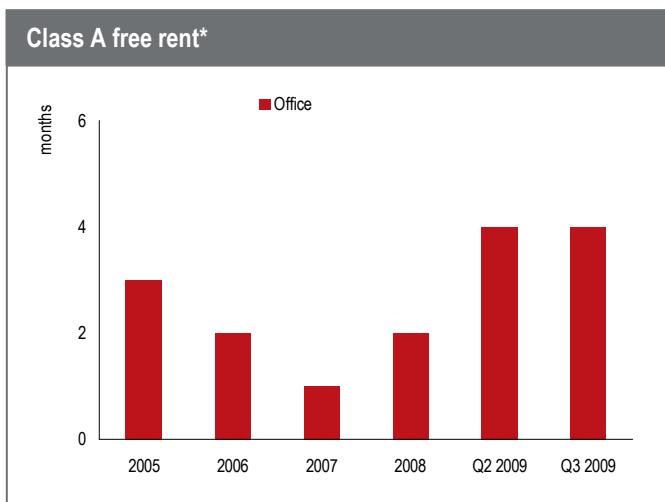
Negotiating leverage remains tenant-favorable across the Silicon Valley with micro market exceptions such as Cupertino and Downtown Palo Alto. Tenants are being welcomed by landlords to pursue 'blend & extend' deals that exchange additional lease term for a blended, but lower current rent obligation. Concession packages are increasing, particularly in the form of free rent. Landlord distress is becoming a more serious issue in the region and as a result, tenants are being increasingly advised to seek protection in the form of SNDA's (Subordination, Non-Disturbance and Attornment) and other structures. Sublease availabilities offer tenants with the opportunity to upgrade their address at substantial cost savings. However, significant capital costs (primarily lab and data center space) are dissuading relocations where lease terms are not long enough to amortize build-out investments.

Landlord perspective

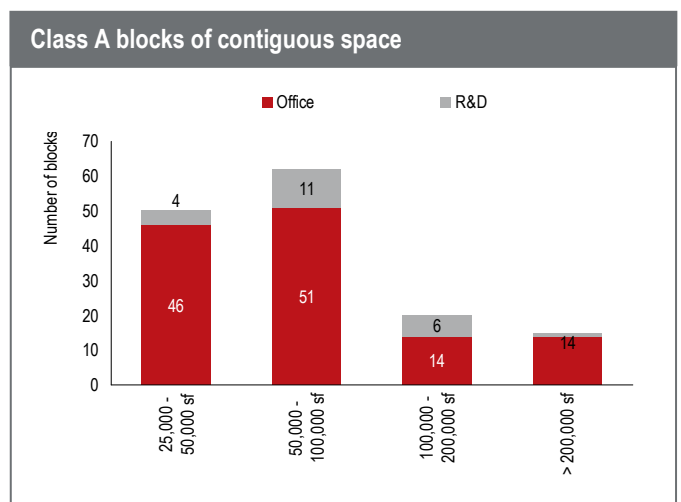
Softening transaction activity continues to hamper portfolio occupancy rates, which fell below 70.0 percent in the second quarter. Increasing sublease availability is contributing to downward pressure on rents, forcing landlords to compete more aggressively for active tenant requirements. It is widely believed that the Valley will remain in the falling market quadrant of the real estate cycle into 2011, and therefore, landlords are incentivized to be creative in structuring 'blend & extend' options well in advance of lease expirations



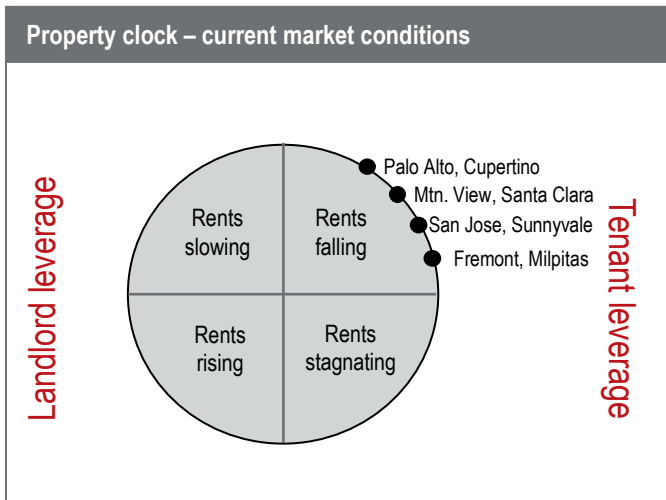
* Based on 5-year direct term in 2nd generation space



* Based on 5-year direct term in 2nd generation space



Based on available space per building. Existing buildings only.



Submarket leverage – market history and forecast

Submarket	2007	2008	2009	2010	2011
Palo Alto	Landlord-favorable	Balanced	Tenant-favorable	Balanced	Landlord-favorable
Mountain View	Balanced	Balanced	Tenant-favorable	Balanced	Balanced
Sunnyvale	Balanced	Tenant-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
Santa Clara	Balanced	Tenant-favorable	Tenant-favorable	Tenant-favorable	Landlord-favorable
San Jose	Balanced	Tenant-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
Cupertino/West Valley	Landlord-favorable	Balanced	Balanced	Balanced	Landlord-favorable
Milpitas	Tenant-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
Fremont/Newark	Tenant-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable

Landlord-favorable conditions
 Balanced conditions
 Tenant-favorable conditions

Completed Class A lease transactions

Tenant	Address	Submarket	sf	Type
Fairchild Semiconductor	3030 Orchard Parkway	North San Jose	75,354	Sublease (R&D)
Ning	285 Hamilton Avenue	Downtown Palo Alto	19,562	Sublease (Office)
TrialPay, Inc.	303 Bryant Street	Mountain View	17,589	Sublease (Office)
Sigrity	900 Hamilton Avenue	Campbell	14,546	Renewal (Office)

Completed Class A sale transactions

Address	Submarket	Buyer/Seller	SF	\$PSF
3373 Hillview Avenue	Palo Alto	Wareham Development / IDT Corp	120,000	\$523

Class A under construction

Address	Submarket	Developer / Anchor Tenant	SF	Delivery Date
300 Santana Row	San Jose	Federal Investment Realty Trust	67,500	Q4-09

Silicon Valley methodology: Inventory includes all Class A office properties > 10,000 square feet, excluding all condo, medical and government owned buildings, and owner occupied buildings (unless owner occupant is listing space for lease).



Real value in a changing world

2300 Geng Road
Suite 100
Palo Alto, CA
+1 650 815 2200

www.us.joneslanglasalle.com

©2009 Jones Lang LaSalle IP, Inc. All rights reserved. All information contained herein is from sources deemed reliable; however, no representation or warranty is made to the accuracy thereof.