

Sacramento Office Insight Q4 2009

Economy

In large part due to seasonal hiring, job growth in the six-county Sacramento Region was slightly positive in the fourth quarter of 2009. Preliminary data shows that, between November 2008 and 2009, the Region lost 46,300 jobs, reflecting a 5.1 percent annual rate of loss, up from 5.4 percent in the previous month. As job growth displayed marginal improvement, unemployment showed signs of stabilization; dropping from 12.7 percent in October of 2009 to 12.5 percent in November. Unemployment in the Sacramento region had been steadily rising for almost 20 months prior to the small drop in November. Despite uneven housing numbers the service sector appears to have adapted to current market conditions, however lack of clarity with the State budget and infighting at the State Capitol continues to drive uncertainty.

Market Conditions

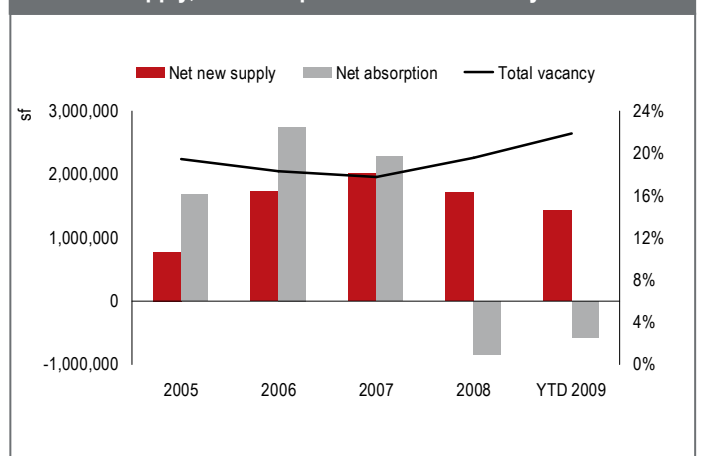
In the fourth quarter the Sacramento office market experienced its first, and only, quarter of positive absorption in 2009. Albeit a small amount of 153,176 square feet, the news was a shimmer of good news in an otherwise difficult year. Final year-to-date direct absorption totaled negative 574,228 square feet in 2009. While developers cancelled or delayed the majority of new construction projects planned in 2009, 1.4 million square feet of new office space was delivered within the last year. Minimal absorption, coupled with newly delivered stock, kept direct vacancy hovering at 20.7 percent, notably higher than the 17.09 percent recorded a year ago. Sacramento's average asking rents decreased slightly in the fourth quarter, while net effective rates were estimated to have declined by almost 10 percent due to a significant increase in free rent being offered by landlords. The continued supply of quality subleases and extended periods of downtime has forced landlords to lower their rents and offer ever-competitive lease terms marked by large amounts of free rent and increased tenant improvement allowances.

Outlook

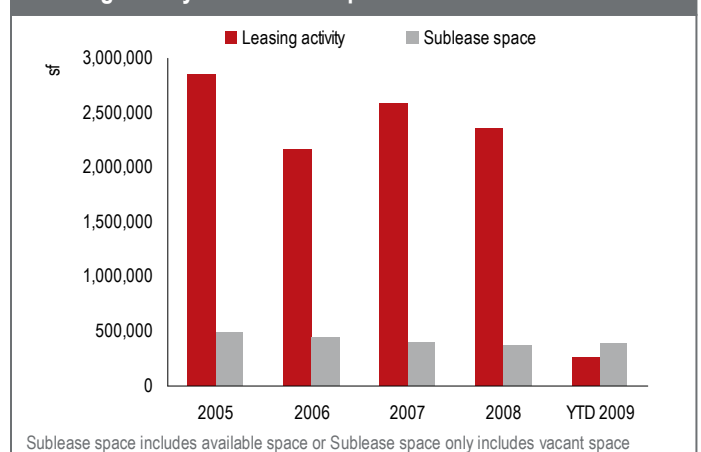
While the overall Sacramento economy showed improvement in the fourth quarter, the outlook for the region's commercial real estate market is mixed. The end of 2009 has provided some hope that office fundamentals will stabilize throughout 2010. On the other hand, the large amount of inventory delivered in 2009 will leave vacancy numbers forcing Landlords to further discount rates in order to compete in 2010. The current State budget constraints have also added to the region's economic challenges. While some State agencies have been searching the market for expansion opportunities, other government tenants are expected to reduce occupancy in mid-2010 and possibly give back large chunks of space.

Key market indicators			12-month forecast
Supply	Supply	44,495,419 sf	▲
	Direct vacancy rate	20.7%	▲
	Total vacancy rate	21.8%	▲
	Under construction (% preleased)	.25 msf (31.7%)	▼
Demand	Leasing activity 12 mo. % change	-12.8 %	▲
	YTD net absorption	-574,228 sf	▶
Pricing	12-month overall rent % change	-3.8%	▶
	Class A overall asking rent	\$27.43 psf	▼
	Class B overall asking rent	\$22.38 psf	▼

Net new supply, net absorption and total vacancy



Leasing activity vs. sublease space

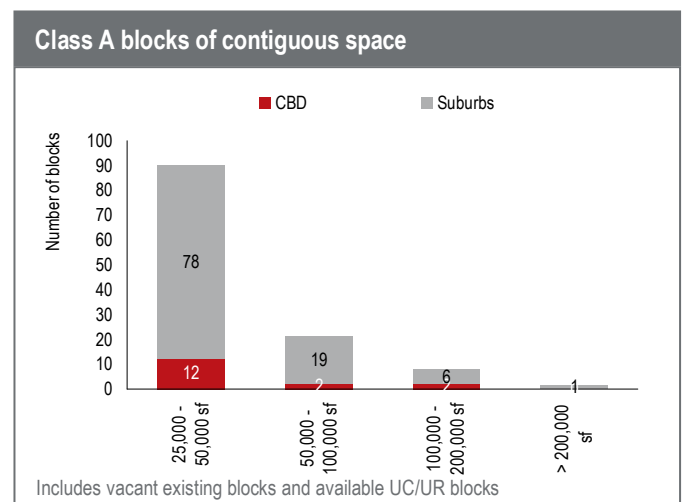
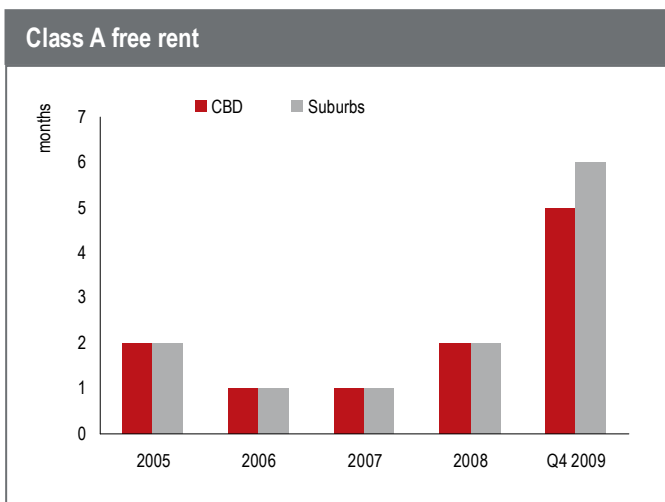
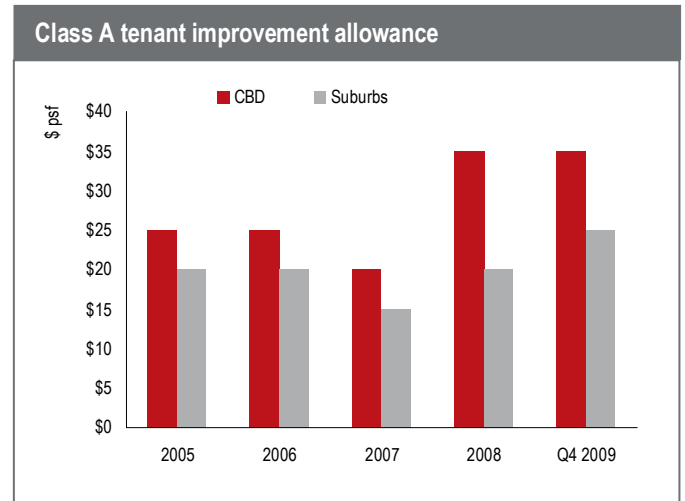
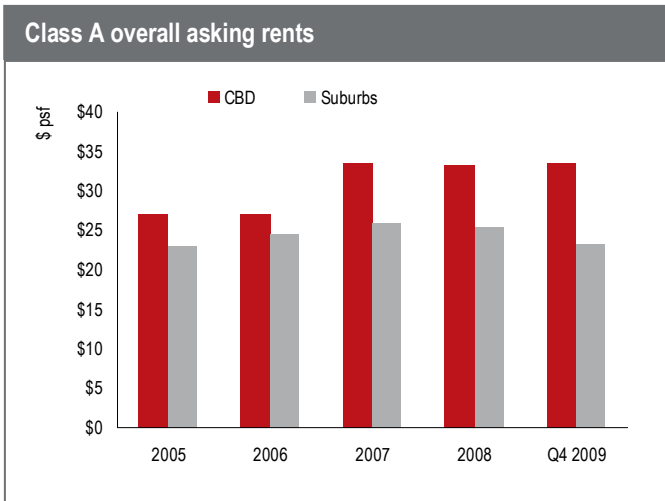


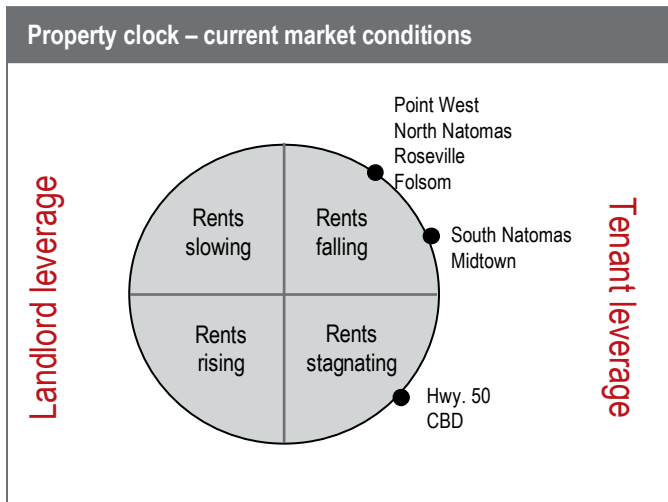
Tenant perspective

Uncertainty with the local and national economies, combined with the recently completed office stock, has created ideal conditions for tenants in the Sacramento region. With a record amount of office space available, tenants are able to take advantage of the market by benefiting from competitive rates, increased concessions and higher tenant improvement allowances. Average Class A suburban office rates have declined by 3.7 percent since the fourth quarter of 2008, while vacancy has increased by 4 percent. Class A CBD office rates have remained more stable, but with the recent completion of 500 Capitol Mall, and 2020 West El Camino, concessions are on the rise. Additionally, Class A “plug and play” space is being offered throughout the region, providing tenants with additional cost effective ways to upgrade their space and reduce occupancy costs. Overall, office rates will remain under pressure providing tenants with a great opportunity to lock in long term cost savings.

Landlord perspective

Landlords continued to feel the crunch of steep vacancy through the fourth quarter of 2009. Downward pressure on rents, increased concessions and a fiercely competitive marketplace are expected to continue into the foreseeable future. The amount of free rent being offered for new leases has jumped over the last 12 months, currently averaging 1.5 months per year of lease term. Tenant improvement allowances have also increased with landlords offering aggressive concession packages in order to stay competitive with newly introduced office supply and contend with the increased amount of “plug and play” sublease space. As the struggling economy forces more companies to reevaluate their occupancy needs, tenant retention has become owners’ main point of emphasis. A handful of Landlords are more aggressively pursuing renewals and offering “blend and extend” options to tenants with expiration dates well into the future.





Submarket leverage – market history and forecast

Submarket	2007	2008	2009	2010	2011
CBD	Landlord-favorable	Landlord-favorable	Balanced	Balanced	Landlord-favorable
Highway 50 Corridor	Landlord-favorable	Balanced	Tenant-favorable	Balanced	Landlord-favorable
Folsom	Landlord-favorable	Balanced	Tenant-favorable	Tenant-favorable	Balanced
Roseville	Landlord-favorable	Landlord-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable
Point West	Balanced	Balanced	Tenant-favorable	Tenant-favorable	Tenant-favorable
Midtown	Balanced	Balanced	Tenant-favorable	Tenant-favorable	Balanced
South Natomas	Landlord-favorable	Balanced	Tenant-favorable	Tenant-favorable	Tenant-favorable
North Natomas	Balanced	Tenant-favorable	Tenant-favorable	Tenant-favorable	Tenant-favorable

■ Landlord-favorable conditions
 ■ Balanced conditions
 ■ Tenant-favorable conditions

Completed lease transactions

Tenant	Address	Submarket	sf	Type
Kronick	400 Capitol Mall	CBD	41,000	Renewal
Sierra Nevada	145 Parkshore Drive	Folsom	40,000	New
National Career Education	11080 White Rock Road	Hwy. 50 Corridor	31,000	New
HDR	2379 Natomas Park	South Natomas	30,000	Consolidation
Montgomery Watson & Harza (MWH)	3321 Power Inn Road	Hwy. 50 Corridor	30,000	Renewal
Benefit and Risk Management Services	80 Iron Point Circle	Folsom	25,000	New
Seyfarth Shaw	400 Capitol Mall	CBD	15,000	Renewal
The Department of Military Recruiting	2880 Prospect Park	Hwy. 50 Corridor	14,500	New
Placer Insurance Agency	5 Sierra Gate Plaza	Roseville	14,000	Renewal

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



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