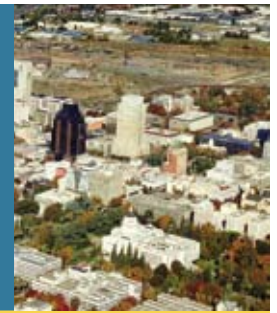




Colliers International Sacramento Office Quarterly Report



First Quarter 2006

Market Trends

	Change in Q1	Q2 Forecast
Lease Rates	↑	↑
Absorption	↓	↑
Direct Vacancy	↑	↑
Construction	↓	↑

New Construction Remains Aggressive; Vacancy Ticks Upward

Overall vacancy within the Sacramento office market currently stands at 13.4%. This marks a slight increase from the 13.0% level recorded at the close of 2005. This increase in vacancy is largely attributed to the substantial amount of new product that came online during the first three months of the year. Over 517,000 square feet of space came online during that time. This follows a fourth quarter in which over 945,000 square feet of space was delivered to the marketplace. The market absorbed 140,000 square feet of space during this time. This marks a significant drop in net absorption from the fourth quarter of 2005 when the market recorded occupancy growth to the tune of over 950,000 square feet of space.

FIGURE 1 Sacramento Office Market Inventory, Vacancy, Construction and Absorption

	2004		2005			2006
	4 th Qtr	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	1 st Qtr
Total Inventory	68,352,914	68,633,126	68,976,658	69,494,159	70,424,221	70,882,416
Total Vacancy	9,927,301	9,993,050	9,532,944	9,175,102	9,152,215	9,470,246
Total Vacancy Percent	14.5%	14.6%	13.8%	13.2%	13.0%	13.4%
Deliveries	335,571	280,212	369,532	516,501	945,062	517,499

VACANCY TRENDS

Despite the fact that vacancy crept up by nearly half a percentage point during the first quarter of this year current levels remain below where they stood one year ago despite the fact that the market has added over 2.6 million square feet of new construction since January 2005. During this same period the market absorbed over 2.9 million square feet of space, hence the general trend of decreasing vacancy that we experienced throughout 2005. Yet, vacancy increased this quarter after four consecutive quarters in decline. Ultimately the question is whether the trend of declining vacancies that marked activity throughout 2005 is over, or whether this is just a bump in the road.



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ABSORPTION TRENDS

With just over 140,000 square feet of positive net absorption during the first quarter of this year, the market recorded its lowest levels of occupancy growth in 18 months. A trend line of occupancy growth would seem to paint a picture of sharply decreased tenant demand during the first quarter of this year. However, the consensus from the street tells a different story.

Our brokers report tenant interest and activity to be up from the same time last year. We are aware of at least four current requirements in the marketplace in the 100,000 square foot range as well as a considerable number of tenants looking in the 25,000 to 50,000 square foot range. Active requirements in the marketplace are currently up approximately 25 percent from the same time last year. Yet net absorption in the Sacramento region has averaged approximately 370,000 square feet per quarter since 1999. So why did occupancy grow by less than half that amount during the first three months of the year?

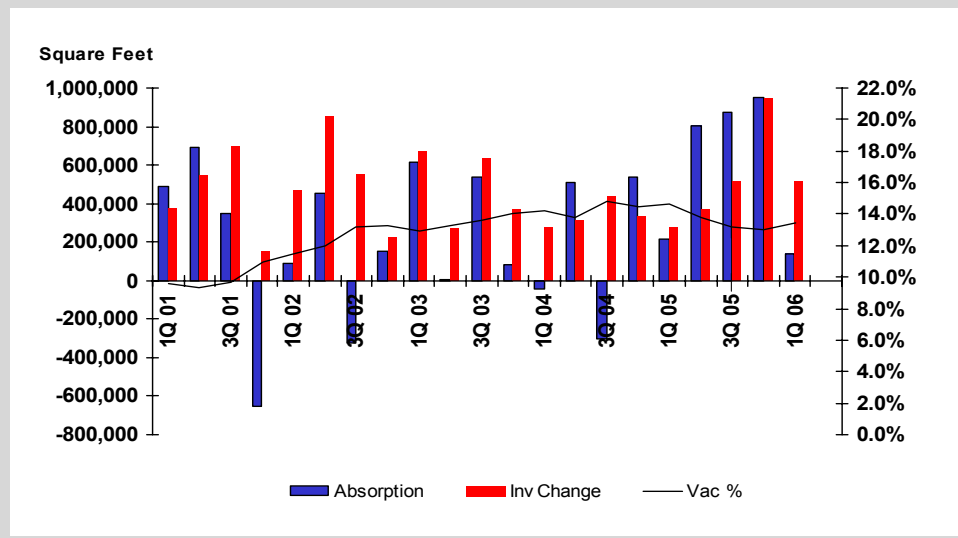
We believe the issue is as simple as timing. We are aware of over 200,000 square feet of deals that were signed during the first quarter of this year where occupancy was not slated to occur until after the close of the first quarter. Likewise, the market recorded over 950,000 square feet of occupancy growth during the final three months of 2005. This marked the largest amount of net absorption that the market had recorded since the fourth quarter of 2000 when the market was at the peak of the last growth cycle. Taking these factors into account it becomes clear that demand in the Sacramento region has not moved backwards, but continues to be at healthy levels.

CONSTRUCTION TRENDS

While absorption numbers during the first quarter may have dipped due to timing

FIGURE
2

Sacramento Office Market
 Change in Inventory, Net Absorption & Vacancy - 1st Quarter 2006



issues, new office construction in the Sacramento region continued at a strong pace. Since 1999 the Sacramento region has averaged approximately 495,000 square feet of new construction per quarter. With approximately 517,000 square feet of new office space delivered during the first three months of 2006, the market surpassed its average—but not by much. What is most interesting is the return of significant speculative development to the region. Of the 517,000 square feet of new office space completed in the first quarter, all but approximately 70,000 square feet of space was delivered on a speculative basis. Since 2002, the ratio of build-to-suits versus speculative projects had been closer to a ratio of one to three and even those speculative projects that went forward generally had large commitments in place before construction began. This is no longer the case, particularly in the Roseville/Rocklin market which remains Sacramento's strongest office submarket in terms of tenant demand, rental growth and new construction.

New development in the region remains evenly split between Class A and Class B office product, but is overwhelmingly occurring in a few select Sacramento submarkets. Just over 270,000 square feet of Class A product and approximately 246,000 square feet of Class B space was delivered during the first quarter. While Downtown currently has two projects under construction for a total of roughly 461,000 square feet, no new space came online in the CBD during the first quarter.

The Highway 50 Corridor led all suburban markets in terms of deliveries with the completion of the 198,000 square foot Golden I Credit Union Building at 8945 Cal Center Drive. This building was approximately 70 percent leased as of the





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First Quarter 2006

Existing Properties											Absorption		Construction		Rents
Class	Bldgs	Total Inventory Sq. Ft.	Direct Vacant Sq. Ft.	Direct Vacancy Rate	Sublease Vacant Sq. Ft.	Sublease Vacancy Rate	Total Vacant Sq. Ft.	Total Vacancy Rate	Vacancy Rate Q4-05	Occupied Space Sq. Ft.	Net Absorption Current Sq. Ft.	Net Absorption YTD Sq. Ft.	Completions Current Qtr. Sq. Ft.	Under Construction Sq. Ft.	Avg Asking Rate

DOWNTOWN TOTAL

A	25	6,028,718	912,830	15.1%	29,306	0.5%	942,136	15.6%	12.2%	5,086,582	(208,510)	(208,510)	-	366,291	\$30.60
B	54	3,628,523	395,700	10.9%	13,731	0.4%	409,431	11.3%	11.9%	3,219,092	23,054	23,054	-	95,455	\$25.20
C	175	3,270,780	292,818	9.0%	-	0.0%	292,818	9.0%	8.9%	2,977,962	(1,342)	(1,342)	-	-	\$19.20
Total	254	12,928,021	1,601,348	12.4%	43,037	0.3%	1,644,385	12.7%	11.3%	11,283,636	(186,798)	(186,798)	-	461,746	\$26.20

SUBURBAN SECTION:

Roseville/Rocklin

A	45	3,121,268	483,646	15.5%	15,984	0.5%	499,630	16.0%	19.5%	2,621,638	126,601	126,601	20,000	495,500	\$27.60
B	176	3,887,076	450,833	11.6%	18,163	0.5%	468,996	12.1%	10.8%	3,418,080	38,473	38,473	100,088	513,214	\$25.80
C	110	1,889,749	165,449	8.8%	7,286	0.4%	172,735	9.1%	7.9%	1,717,014	(23,070)	(23,070)	-	-	\$21.00
Total	331	8,898,093	1,099,928	12.4%	41,433	0.5%	1,141,361	12.8%	13.3%	7,756,732	142,004	142,004	120,088	1,008,714	\$25.41

Highway 50 Corridor

A	42	4,210,841	642,659	15.3%	44,666	1.1%	687,325	16.3%	16.4%	3,523,516	169,986	169,986	198,000	-	\$21.60
B	106	5,605,368	916,624	16.4%	76,964	1.4%	993,588	17.7%	18.2%	4,611,780	28,863	28,863	-	-	\$18.60
C	153	3,544,633	565,670	16.0%	-	0.0%	565,670	16.0%	15.6%	2,978,963	(14,094)	(14,094)	-	-	\$17.40
Total	301	13,360,842	2,124,953	15.9%	121,630	0.9%	2,246,583	16.8%	17.0%	11,114,259	184,755	184,755	198,000	-	\$19.23

Folsom

A	21	1,281,328	107,020	8.4%	63,046	4.9%	170,066	13.3%	10.6%	1,111,262	(13,820)	(13,820)	52,790	123,680	\$25.80
B	55	1,899,439	120,193	6.3%	1,926	0.1%	122,119	6.4%	8.4%	1,777,320	38,306	38,306	28,000	37,500	\$24.60
C	38	811,475	129,228	15.9%	-	0.0%	129,228	15.9%	19.2%	682,247	26,900	26,900	-	-	\$21.00
Total	114	3,992,242	356,441	8.9%	64,972	1.6%	421,413	10.6%	11.3%	3,570,829	51,386	51,386	80,790	161,180	\$24.25

Elk Grove

A	-	-	-	0.0%	-	0.0%	-	0.0%	0.0%	-	-	-	-	159,000	\$32.43
B	35	753,572	198,268	26.3%	-	0.0%	198,268	26.3%	28.0%	555,304	16,805	16,805	32,355	56,966	\$27.60
C	10	155,034	2,350	1.5%	-	0.0%	2,350	1.5%	1.5%	152,684	-	-	-	-	\$24.00
Total	45	908,606	200,618	22.1%	-	0.0%	200,618	22.1%	23.5%	707,988	16,805	16,805	32,355	215,966	\$26.99

SUBURBAN TOTAL

A	159	13,196,710	1,943,827	14.7%	209,933	1.6%	2,153,760	16.3%	16.8%	11,042,950	356,430	356,430	270,790	985,180	\$25.20
B	639	22,315,649	2,913,372	13.1%	259,699	1.2%	3,173,071	14.2%	14.0%	19,142,578	49,562	49,562	246,709	850,370	\$22.20
C	1,210	22,442,838	2,463,218	11.0%	35,812	0.2%	2,499,030	11.1%	10.8%	19,943,808	(79,030)	(79,030)	-	-	\$18.84
Total	2,008	57,955,197	7,320,417	12.6%	505,444	0.9%	7,825,861	13.5%	13.4%	50,129,336	326,962	326,962	517,499	1,835,550	\$21.58

MARKET TOTAL

A	184	19,224,626	2,856,657	14.9%	239,239	1.2%	3,095,896	16.1%	15.4%	16,128,730	147,920	147,920	270,790	1,351,471	\$26.52
B	693	25,944,172	3,309,072	12.8%	273,430	1.1%	3,582,502	13.8%	13.7%	22,361,670	72,616	72,616	246,709	945,825	\$22.56
C	1,385	25,713,618	2,756,036	10.7%	35,812	0.1%	2,791,848	10.9%	10.5%	22,921,770	(80,372)	(80,372)	-	-	\$18.72
Total	2,262	70,882,416	8,921,765	12.6%	548,481	0.8%	9,470,246	13.4%	13.0%	61,412,170	140,164	140,164	517,499	2,297,296	\$22.24

QUARTERLY COMPARISON AND TOTALS

Q1-06	2,262	70,882,416	8,921,765	12.6%	548,481	0.8%	9,470,246	13.4%	13.0%	61,412,170	140,164	140,164	517,499	2,297,296	\$22.24
Q4-05	2,250	70,424,221	8,563,604	12.2%	588,611	0.8%	9,152,215	13.0%	13.2%	61,272,006	952,949	2,846,294	945,062	2,276,767	\$22.80
Q3-05	2,228	69,494,159	8,518,815	12.3%	656,290	0.9%	9,175,105	13.2%	13.8%	60,319,057	875,244	1,893,345	516,501	2,763,007	\$22.32
Q2-05	2,210	68,976,658	8,886,155	12.9%	646,789	0.9%	9,532,944	13.8%	14.6%	59,443,714	803,638	1,018,101	369,532	2,806,179	\$22.08
Q1-05	2,195	68,633,126	9,227,782	13.4%	765,268	1.1%	9,993,050	14.6%	14.5%	58,640,076	214,463	2,144,633	280,212	2,287,304	\$21.96



time of this report and played a significant role in this submarket's strong net absorption this quarter. With the delivery of this project, the Highway 50 submarket currently has no major office projects under construction.

The Roseville/Rocklin submarket has been Sacramento's strongest growth office submarket for much of the past decade and added over 120,000 square feet of space during the first three months of the year. There is an additional one million square feet of projects currently under construction in this market, with deliveries slated through early 2007.



As this report went to press we were aware of 2.2 million square feet of space currently under construction in the Sacramento region. As previously stated, nearly half of this space is in the Roseville/Rocklin submarket. This amount of new development is on par with historical averages for the market as a whole. Since 1999 the market has averaged approximately 2.2 million square feet of office space under construction at any given time. However, what is more important to note is what today's numbers tell us about the continued dominance of the Roseville/Rocklin suburban office market. This submarket has historically averaged about 580,000 square feet of new office construction in the pipeline since 1999. With just over one million square feet of product in the development pipeline,

FIGURE
3

Sacramento Office Market
 2006 Leasing Activity (YTD)

	Building Name Building Address	Submarket	SF Leased	Tenant
1.	1375 Exposition Boulevard	Point West	31,859	K. Hovnanian Homes
2.	1415 L Street	Downtown	29,500	Bullivant Hauser Bailey
3.	U.S. Bank Tower 621 Capitol Mall	Downtown	20,420	Downey, Brand, Seymour & Rohwer
4.	U.S. Bank Tower 621 Capitol Mall	Downtown	19,528	California Restaurant Association
5.	Natomas Gateway 2379 Gateway Oaks Drive	South Natomas	14,693	Harris & Sloan
6.	Lake Forest Tech Center 81 Blue Ravine Road	Folsom	12,287	Confidential
7.	Country Club Centre 3464 El Camino Avenue	Watt Avenue	17,000	Confidential
8.	Point West Corporate Center 1610 Arden Way	Point West	14,603	Confidential
9.	Depot Park 15 Business Park Way	South Sacramento	11,600	Confidential
10.	McClellan Park 3140 Peacekeeper Way	Rio Linda/North Highlands	10,658	McClellan Park, LLC

Roseville/Rocklin is on pace to surpass previous development levels by nearly 50 percent.

RENTAL GROWTH

One of the primary reasons why the Roseville/Rocklin market is experiencing such significant growth is the fact that it has been one of the strongest performers in terms of both occupancy growth and rental rate growth.

Since 1999, the Roseville/Rocklin market has averaged just under 150,000 square feet of positive net absorption per quarter. In the first quarter of this year it accounted for 142,000 square feet of occupancy growth, or more than the entire market combined. Most enticing to developers is

the fact that this market has been able to achieve significant rental growth over the past five years while most of Sacramento's submarkets have recorded minimal growth. The average asking rent for Class A space in Roseville is now averaging over \$2.30 per square foot monthly on a full service basis. Just five years ago this rate would have been closer to the \$1.85 mark.

The only other submarket to record rental growth at similar rates has been the emerging Elk Grove submarket. This market has experienced a surge in office



United States

Akron, OH	Minneapolis, MN
Allentown, PA	Nashville, TN
Atlanta, GA	New Haven, CT
Austin, TX	New Jersey, NJ
Bakersfield, CA	New York, NY
Baltimore, MD	Oakland, CA
Beachwood, OH	Ogden, UT
Bellevue, WA	Orlando, FL
Boca Raton, FL	Palo Alto, CA
Boise, ID	Park City, UT
Boston, MA	Philadelphia, PA
Carlsbad, CA	Phoenix, AZ
Charleston, SC	Pittsburgh, PA
Charlotte, NC	Pleasanton, CA
Chicago, IL	Plymouth Meeting, PA
Cincinnati, OH	Portland, OR
Clearwater, FL	Provo, UT
Cleveland, OH	Raleigh, NC
Columbia, SC	Reno, NV
Dallas/Ft. Worth, TX	Roseville, CA
Dayton, OH	Sacramento, CA
Denver, CO	Salt Lake City, UT
Detroit, MI	San Diego, CA
Fairfield, CA	San Francisco, CA
Fort Myers, FL	San Jose, CA
Fresno, CA	San Mateo, CA
Ft. Lauderdale, FL	Scottsdale, AZ
Gilroy, CA	Seattle, WA
Greenville, SC	St. Charles, MO
Hartford, CT	St. George, UT
Honolulu, HI	St. Louis, MO
Houston, TX	St. Paul, MN
Indianapolis, IN	Stamford, CT
Jacksonville, FL	Stockton, CA
Kansas City, MO	Sun Valley, ID
Las Vegas, NV	Tacoma, WA
Los Angeles, CA	Tampa, FL
Louisville, KY	Walnut Creek, CA
Memphis, TN	Washington, DC
Miami, FL	Wilmington, DE
Milwaukee, WI	

demand over the past year with little in the way of traditional suburban office inventory to meet demand. Rents for some projects in this market have topped \$2.75. There is little historically to compare current rents to because office product in this market had traditionally been in the form of older flex or office/retail space. There is approximately 216,000 square feet of space currently under construction including a 159,000 square foot Class A office project. What remains to be seen is whether this emerging trade area will be able to sustain anything close to the levels of demand that the Roseville/Rocklin submarket has sustained over the better part of the last decade.

Ironically, while new construction continues to add competitive space to the market and has been the primary factor keeping vacancy rates in the mid-teens despite significantly increased demand, they have had a positive impact in general on rental rate growth. Construction costs in the region have increased by as much as 17 percent annually for each of the past two years. The cost of land and rising costs for materials have all been factors in this. As a result, the overwhelming majority of new buildings being delivered in the region (even Class B properties in relatively mature submarkets) have come to market with asking

rents above the \$2.00 per square foot range. Owners of existing buildings in all but Sacramento's weakest submarkets have responded by raising their rates. As a result, the average asking rent for all submarket and all product types in Sacramento currently stands at approximately \$1.92 per square foot. Just two years ago it stood at \$1.74 per square foot. While new buildings and a few select submarkets have led the way, the entire market has been impacted by this trend despite the fact that vacancy has hovered in the mid-teens throughout this entire period. We expect this trend to continue going forward.

LOOKING AHEAD

New development will continue to be the wildcard in determining local vacancy trends. While we expect second quarter absorption numbers to be up significantly from the levels recorded during the first three months of the year we also expect new deliveries to be up as well. In the short term we expect vacancy levels to rise slightly during the second quarter of this year as a result. Yet, we also expect new construction to continue to set the pace for rents and for rental growth to continue to occur—particularly in the region's strongest submarkets.

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