COLLIERS INTERNATIONAL

Our *Knowledge* is your Property

SACRAMENTO

OFFICE MARKET

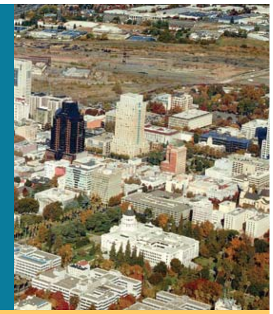
2nd Quarter 2006

OFFICE | INDUSTRIAL | RETAIL | INVESTMENT | MARKET RESEARCH office

Colliers International

Sacramento

Office Quarterly Report



Second Quarter 2006

Market Trends

	Change in Q2	Q3 Forecast
Lease Rates	↑	↑
Absorption	↓	↑
Direct Vacancy	↑	↔
Construction	↓	↑

Rental Growth Fuels New Development

Overall vacancy within the Sacramento office market currently stands at 13.3%. This marks a slight increase from the 13.0% level recorded at the close of the first quarter of this year and the first time that the market has recorded increased vacancy since the third quarter of 2004. This increase in vacancy is largely attributed to the two factors. Leasing activity cooled somewhat during the second quarter. Meanwhile, the market continues to experience significant new development.

Since 2003 over six million square feet of new office product has been delivered to the marketplace, or an average of over 430,000 square feet of space per quarter. Just under 320,000 square feet of new space came online in the second quarter adding to a year-to-date new construction total of approximately 470,000 square feet of product. While this is below recent averages, it continues a trend of what could be considered aggressive new development in light of vacancy rates in the mid-teens.

The market absorbed 75,000 square feet of space during the second quarter of this year. The year-to-date total for occupancy growth currently stands at just under 225,000 square feet. Since 2003 the

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

	2005				2006	
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr
Total Inventory	68,785,180	69,154,712	69,821,140	70,744,709	71,152,603	71,485,133
Total Vacancy	10,011,450	9,304,932	9,016,248	8,989,552	9,251,102	9,498,086
Total Vacancy Percent	14.6%	13.5%	12.9%	12.7%	13.0%	13.3%
Deliveries	288,394	369,532	691,428	1,121,569	151,994	319,110
Net Absorption (Growth)	217,023	1,076,050	780,185	950,265	146,344	75,774

COLLIERS INTERNATIONAL

www.colliers.com

Colliers International
1610 Arden Way, Suite 240
Sacramento, CA 95815-4028
Tel: 916.929.5999
Fax: 916.649.0001

1400 Rocky Ridge Drive, Suite 150
Roseville, CA 95661
Tel: 916.784.7550
Fax: 916.784.7527

market has recorded nearly five million square feet of positive net absorption or a quarterly average of over 350,000 square feet of occupancy growth. Leasing activity has cooled during the first half of 2006, although as the quarter came to an end our brokers did report an increase in tenant interest. However, this had yet to translate into deal activity as the quarter came to a close.

VACANCY TRENDS

Despite the fact that vacancy crept up slightly during the second quarter of this year current levels remain below where they stood one year ago. This is despite the fact that the market added over 2.2 million square feet of new product during this time. During this same period the market absorbed over 1.9 million square feet of space.

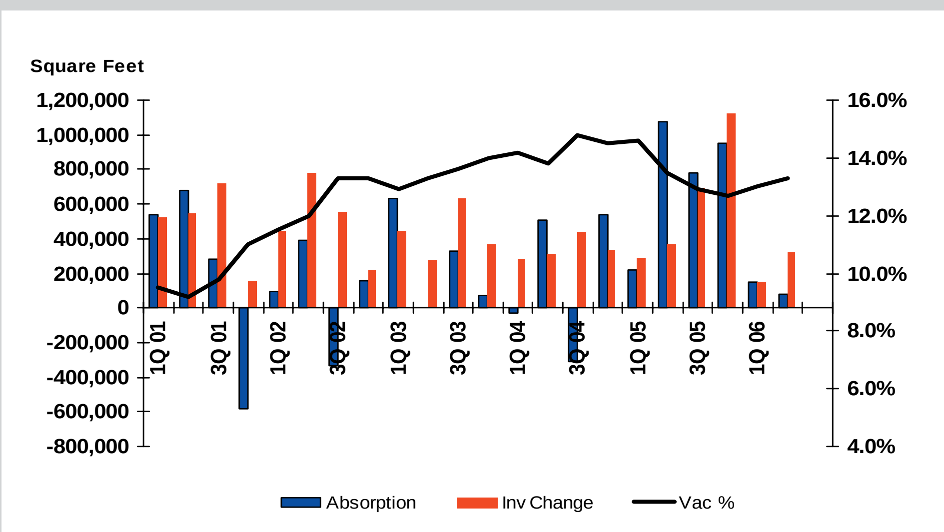
Market equilibrium—or balance between supply and demand—is generally defined by most analysts as vacancy levels that are at or near 10%. So long as vacancy is in the ten percent range there is generally enough product available in the marketplace to accommodate rapid economic expansion and growth by tenants, but not so much as to depress rental growth for landlords.

The last time that the Sacramento office market experienced vacancy in the ten percent range was prior to the economic downturn of 2001. What is unique about the Sacramento market is that even through the most recent down cycle vacancy never exceeded 15% while vacancy in other major Northern California markets reached as high as 30%.

Likewise, while new development virtually became non-existent in many markets, construction levels in Sacramento actually remained virtually constant. From 1998 to 2001 the market added approximately eight million square feet of new space. From 2002 to 2005 the market added approximately 7.6 million square feet of space. Not surprisingly, today's vacancy rate of 13.3% is at the same level recorded as of the final half of 2003. In terms of vacancy the market has made little progress in those intervening three years. Clearly aggressive new development has played a major role in this.

However, while these numbers may paint a picture of overbuilding standing in the way of a recovering market, there is one statistic that tells an entirely different tale. Despite vacancy that has hovered in the mid-teens for the better part of the last four years, the Sacramento market continues to record rental rate growth.

FIGURE 2
Sacramento Office Market
Change in Inventory, Net Absorption & Vacancy - 2nd Quarter 2006



ABSORPTION TRENDS

With just over 75,000 square feet of positive net absorption during the second quarter of this year, the market recorded its lowest levels of occupancy growth in nearly two years. This follows a lackluster first quarter in which the market experienced just 146,000 square feet of occupancy growth. Year-to-date totals are at less than 50% of the occupancy growth levels recorded in recent years. A trend line of occupancy growth would seem to paint a

Colliers International
Sacramento
Office Quarterly Report

Second Quarter 2006

Class	Bldgs	Total Invetory 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
Existing Properties											Absorption		Construction		Rents
DOWNTOWN TOTAL															
A	25	6,029,081	847,510	14.1%	42,291	0.7%	942,136	14.8%	15.6%	5,086,582	52,335	(156,175)	-	366,291	$30.00
B	56	3,756,023	534,508	14.2%	12,131	0.3%	409,431	14.6%	14.3%	3,219,092	(9,708)	13,346	-	-	$23.50
C	177	3,455,299	485,102	14.0%	-	0.0%	292,818	14.0%	8.6%	2,977,962	(188,784)	(190,126)	-	-	$19.40
Total	258	13,240,403	1,867,120	14.1%	54,422	0.4%	1,644,385	14.5%	13.4%	11,283,636	(146,157)	(332,955)	-	366,291	$25.75
SUBURBAN SECTION:															
Roseville/Rocklin															
Roseville/Rocklin															
A	50	3,423,707	618,599	18.1%	48,669	1.4%	667,268	19.5%	15.5%	2,756,439	(26,141)	96,840	131,738	507,282	$27.60
B	170	3,655,249	346,489	9.5%	34,479	0.9%	380,968	10.4%	10.8%	3,274,281	2,550	44,170	38,231	517,077	$25.80
C	108	1,824,905	188,074	10.3%	8,594	0.5%	196,668	10.8%	9.4%	1,628,237	(25,087)	(47,003)	-	-	$21.00
Total	328	8,903,861	1,153,162	13.0%	91,742	1.0%	1,244,904	14.0%	13.3%	7,658,957	(48,678)	94,007	169,969	1,024,359	$25.51
Highway 50 Corridor															
A	42	4,009,801	386,085	9.6%	62,499	1.6%	448,584	11.2%	11.1%	3,561,217	(11,259)	158,727	-	-	$22.00
B	107	5,635,588	750,455	13.3%	22,544	0.4%	772,999	13.7%	17.6%	4,862,589	220,589	249,452	-	-	$19.36
C	153	3,533,617	624,666	17.7%	-	0.0%	624,666	17.7%	16.0%	2,908,951	(58,996)	73,090	-	-	$18.50
Total	302	13,179,006	1,761,206	13.4%	85,043	0.6%	1,846,249	14.0%	15.2%	11,332,757	150,334	481,269	-	-	$19.70
Folsom															
A	22	1,329,917	129,213	9.7%	75,474	5.7%	204,687	15.4%	13.5%	1,125,230	(24,509)	(38,329)	-	172,271	$27.14
B	55	1,899,439	129,749	6.8%	-	0.0%	129,749	6.8%	6.4%	1,769,690	(7,630)	30,676	-	36,500	$26.25
C	38	811,475	116,724	14.4%	-	0.0%	116,724	14.4%	15.9%	694,751	12,504	39,404	-	-	$21.60
Total	115	4,040,831	375,686	9.3%	75,474	1.9%	451,160	11.2%	11.3%	3,589,671	(19,635)	31,751	-	208,771	$25.33
Elk Grove															
A	1	83,000	9,125	0.0%	-	0.0%	-	11.0%	0.0%	73,875	73,875	73,875	83,000		$30.55
B	39	790,430	190,390	24.1%	1,788	0.2%	192,178	24.3%	28.0%	598,252	42,842	59,647	13,795	71,500	$28.25
C	10	155,034	2,350	1.5%	-	0.0%	2,350	1.5%	1.5%	152,684	-	-	-	-	$22.00
Total	50	1,028,464	201,865	19.6%	1,788	0.2%	203,653	19.8%	23.5%	824,811	116,717	133,522	96,795	71,500	$28.00
SUBURBAN TOTAL															
A	166	13,344,108	1,844,104	13.8%	266,290	2.0%	2,110,394	15.8%	13.9%	11,233,714	(76,741)	276,338	214,738	1,327,692	$25.50
B	647	22,539,307	2,767,667	12.3%	205,323	0.9%	2,972,990	13.2%	14.0%	19,566,317	293,686	351,895	104,372	827,259	$22.50
C	1,209	22,361,315	2,455,732	11.0%	37,428	0.2%	2,493,160	11.1%	11.2%	19,868,155	4,716	(73,160)	-	-	$19.30
Total	2,022	58,244,730	7,067,503	12.1%	509,041	0.9%	7,576,544	13.0%	13.4%	50,668,186	221,661	555,073	319,110	2,154,951	$21.96
MARKET TOTAL															
A	191	19,373,189	2,691,614	13.9%	308,581	1.6%	3,000,195	15.5%	14.5%	16,372,994	(24,136)	120,163	214,738	1,693,983	$26.60
B	703	26,295,330	3,302,175	12.6%	217,454	0.8%	3,519,629	13.4%	14.1%	22,775,701	283,978	365,241	104,372	827,259	$23.00
C	1,386	25,816,614	2,940,834	11.4%	37,428	0.1%	2,978,262	11.5%	10.8%	22,838,352	(184,068)	(263,286)	-	-	$22.50
Total	2,280	71,485,133	8,934,623	12.5%	563,463	0.8%	9,498,086	13.3%	13.0%	61,987,047	75,774	222,118	319,110	2,521,242	$23.00
QUARTERLY COMPARISON AND TOTALS															
Q2-06	2,280	71,485,133	8,934,623	12.5%	563,463	0.8%	9,498,086	13.3%	13.0%	61,987,047	75,774	222,118	319,110	2,521,242	$23.00
Q1-06	2,270	71,152,603	8,702,621	12.2%	548,481	0.8%	9,251,102	13.0%	12.7	61,272,006	146,344	146,344	151,994	2,161,959	$23.00
Q4-05	2,256	70,744,709	8,400,941	11.9%	588,611	0.8%	8,989,552	12.7%	12.9	60,319,057	950,265	3,023,523	1,121,569	2,402,279	$22.90
Q3-05	2,235	69,821,140	8,359,958	12.0%	656,290	0.9%	9,016,248	12.9%	13.5	59,443,714	780,185	2,073,258	691,428	2,851,556	$22.60
Q2-05	2,218	69,154,712	8,658,143	12.5%	646,789	0.9%	9,304,932	13.5%	14.6	58,640,076	1,076,050	1,293,073	369,532	2,945,506	$22.40

picture of sharply decreased tenant demand during the first half of this year. However, the consensus from the street tells a different story.

Our brokers report tenant interest to be up from the same time last year. We are aware of at least six current requirements in the marketplace in the 75,000+ square foot range as well as a considerable number of tenants looking in the 25,000 to 50,000 square foot range. As such, we expect activity to pick up considerably over the final half of the year and for occupancy growth to pick up significantly.

CONSTRUCTION TRENDS

While absorption numbers during the first quarter may have dipped due to timing issues, new office construction in the Sacramento region continued at a strong pace. Approximately 470,000 square feet of new office space was delivered during the first half of 2006. Much of this space was speculative, with build-to-suit projects accounting for just under 25% of that total. 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. The Roseville/Rocklin submarket accounts for 250,000 square feet of new product so far this year, or well over half of what has been delivered to the marketplace.

As this report went to press we were aware of 2.5 million square feet of space currently under construction in the Sacramento region. Just over one million square feet of that total is situated in the Roseville/Rocklin submarket. Rental rate growth is fueling this current wave of development. The Roseville/Rocklin market continues to lead the region in rental rate growth, with the current direct asking rate for all classes of office space currently standing above $26.00 per square foot on an annual full service basis. Five years ago this total stood at roughly $22.00 per square foot. Class A asking rents are approaching $28.00 per square foot with new product leading the way.

Since 1999 the market has averaged has averaged approximately 2.2 million square feet of office space under construction at any given time. With 2.5 million square feet of product currently in the construction pipeline it is unlikely that we will see vacancy rates drop significantly in the immediate future. Though we expect leasing activity and occupancy growth to pick up during the final half of the year, we forecast that they will continue to chase new development totals.

RENTAL GROWTH

As already discussed, one of the primary factors that continues to drive aggressive new development is the fact that the Sacramento market continues to record rental rate growth.
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

FIGURE 3
Sacramento Office Market
Rental Rate Growth - Select Product Types

Year Built	2Q 2003	2Q 2004	2Q 2005	2Q 2006
Sacramento Overall	$20.80	$21.40	$22.40	$23.35
Sacramento Class A	$23.50	$24.00	$25.00	$26.60
Sacramento Class B	$20.00	$20.70	$21.10	$22.70
Roseville/Rocklin Overall	$22.50	$23.50	$24.85	$26.10
Roseville/Rocklin Class A	$24.50	$25.60	$25.90	$27.40
Roseville/Rocklin Class B	$23.50	$24.70	$25.20	$25.50

COLLIERS INTERNATIONAL

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 $24.00 per square foot (on an annual full service basis) range. Owners of existing buildings in all but Sacramento's weakest submarkets have responded by raising their rates. 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.

FIGURE 4

Sacramento Office Investment Market - 2000 to 2005
Average Sale Price and Cap Rates

Year Built	2001	2002	2003	2004	2005	2006 YTD
Average Sale Price PSF	$127.00	$130.00	$168.00	$155.00	$180.00	$198.00
Average Cap Rate	9.4%	9.1%	8.5%	7.7%	7.1%	6.7%

INVESTMENT TRENDS

The big story of the last few years has been the relative lack of investment opportunities available in the Sacramento marketplace. The availability of "cheap money" had a major impact on sales activity within the Sacramento market, motivating many tenants to become owners and allowing investors to consider properties with net operating incomes that would have been otherwise unthinkable were it not for extremely low debt service. This trend, along with an influx of investors fleeing an unstable stock market as well as increased national and regional investor interest in the Sacramento market led to a situation in which demand far outpaced supply. This also sent prices upward at a steady clip.

Of course, now that interest rates have been on an upward climb for the past few years, one would expect this to register some impact on pricing. But, this has yet to have taken place in Sacramento. In fact, the opposite is true. The average sale price of an office investment property in the Sacramento region has increased by over 70 percent in the past five years. Mirroring national trends, capitalization rates have been on a steady decline during this period as well and continue to go lower. While the current average is 6.7 percent, we have seen properties sold at rates of return as low as five percent. The bottom line is that investors are paying significantly more to earn substantially less on their office investments than just a few years ago. This one-two punch has significantly slowed investment sale activity, but as of yet has not impacted pricing. Subsequently, the overwhelming majority of sales activity remains focused on the owner/user market.

We track sale offerings throughout the marketplace. The number of office buildings currently offered for sale is nearly 50 percent higher than it was at this same time last year. Nearly all of this increase is in the form of office condominiums or other buildings geared towards owner/users. Quality investment properties, however, remain few and far between.

The investment market will continue to suffer from a lack of available product. Cap rates cannot go much lower, but there are no signs that they will increase any time soon either. While we expect rental growth to occur in the near future it will be nowhere near the levels needed to significantly impact cap rates. Until asking prices come down, don't expect any significant changes in cap rates. We expect the current mix of trends on the industrial investment front to continue and for activity to remain slow through the final half of the year. Sales activity will continue to be dominated by sales to owner/users at least through 2007.

Colliers International
Sacramento
Office Quarterly Report

office

Second Quarter 2006

United States

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

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 hold steady at or near current rates. 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.

For more information, contact:

Dennis Shorrock, SIOR — **Managing Director**
Garrick Brown — Research Director
David Liu — Research Analyst

Office Specialists
Doug Barnett, SIOR, CCIM
Bruce Hohenhaus, SIOR
Buz Miller
Deron Morillas
Kevin Partington, SIOR
Malcolm Rickards, SIOR
Chris Schwarze
Ron Thomas, SIOR
Rick Waterlyn
Bruce Wirt, SIOR

COLLIERS INTERNATIONAL

COLLIERS
INTERNATIONAL

Our *Knowledge* is your Property

1610 Arden Way, Suite 240 Sacramento, California 95815-4028
1400 Rocky Ridge Drive, Suite 150 Roseville, California 95661