THE IRVING GROUP

Get a New Lease on Life

1ST QUARTER LEASING TREND MAY LIMIT LANDLORD CONCESSIONS

Stronger first-quarter activity in the Class A properties in Downtown and North San Diego portends a firmer office market to come throughout the region, according to The Irving Group's analysis of more than 295 lease transactions in the first three months of 2012 throughout San Diego County. But modest office leasing across most classes and submarkets in the first quarter kept vacancies relatively high and rental rates affordable.

"Strength among San Diego's top-tier companies is offsetting the belt-tightening that some mid-size and smaller firms are still experiencing," said Craig Irving, president of The Irving Group, San Diego's premier commercial tenant-representation brokerage. "Net absorption of 177,660 square feet of the best Class A office space in the first quarter was enough to push vacancy down to 14.9%, from 15.5% at the end of 2011.

Del Mar Heights

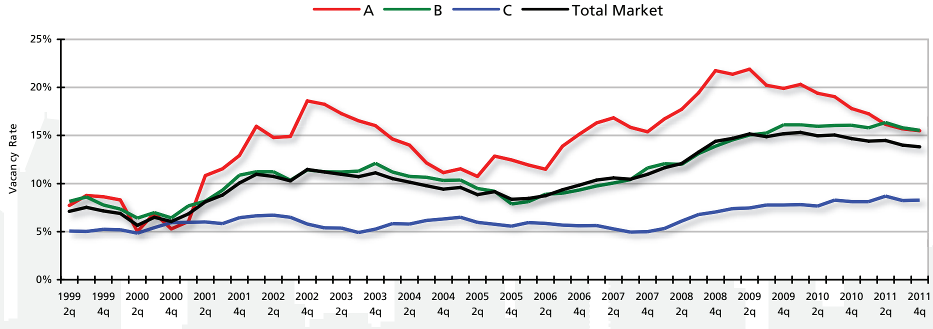
"Overall vacancy for Class A, B and C stood at 13.9% throughout San Diego County, well below the 16% peak of eight quarters ago. That's a trend that means landlords will try to make moving allowances and free rent disappear, just before they raise rates. Before that happens, now is the time to strike a deal or renegotiate a leasehold while rates are low and space is available."

Irving said the solid first quarter compared favorably with the 61,959 square feet of Class A net absorption in 2011's fourth quarter and the 146,048 square feet of net improvement in last year's third quarter. The Class A market also absorbed 417,913 square feet in 2011's strong second quarter, and 164,130 square feet in last year's first quarter. "That's nearly 1 million square feet of Class A growth in the last five consecutive quarters, a healthy indicator for San Diego's economy," said Irving.

Activity in San Diego's Class B properties, where the bulk of the work gets done, resulted in contraction of 210,518 square feet, "a tapping of the brakes," said Irving, following net expansion of 606,560 square feet in the prior four quarters throughout the county.

Irving said down-sizing and right-sizing in the first quarter better positions companies to operate efficiently, while maintaining the pressure on landlords to keep lease rates

San Diego County Vacancy Rates by Class 1999-2011



Source: CoStar Property®

low. "This is a very good situation over the next few months for companies needing to renegotiate, renew or look for new space," said Irving. "Landlords are still granting concessions, but not for long. Landlords who were asking $3.15 per square foot monthly as recently as 2008 can't expect more than $2.50 today for the best space. Tenants can still negotiate from a position of strength, especially if they're using a tenant representation company with a full roster of clients. From the landlord's perspective, that's a tenant and negotiating team with muscle." Overall average asking lease rates in the 2012 first quarter dropped slightly to $2.11 per square foot monthly, down from $2.12 at the end of 2011 and from $2.13 one year ago. Class A rates actually edged up to $2.54 per square foot in the first quarter, from $2.53 at year-end 2011 and $2.53 one year ago. Class B lease rates asked by landlords stood at $2.03 per square foot monthly in the first quarter, up from $2.01 in the prior quarter but even with the $2.03 of a year ago.

The Class C market acted much like Class B, said Irving, with negative absorption of 55,960 square feet in the first quarter.

All combined, Classes A, B and C contracted by 88,818 square feet in the first quarter, following 1.36 million square feet of net growth in the prior four quarters, for an overall vacancy rate of 13.9% of 111.6 million rentable square feet of office space throughout San Diego County at March 31, according to The Irving Group analysis of CoStar Group data.

"The market is bifurcated," observed Simon Terry-Lloyd, vice president of The Irving Group. "Landlords are seeing more general activity in the marketplace, giving them a renewed sense of confidence. Unfortunately shoppers aren't always buyers and the timing for some is premature. There is still a lot of uncertainty for businesses vis-à-vis the predictability of their models and growth prospects. This will directly impact the amount of space companies plan for and the length of term they are willing to commit."

CBD BECOMES THE CENTRAL BARGAIN DISTRICT

For tenants of San Diego's most densely developed commercial district, the Downtown office market continued to improve in the first quarter. Steve Wells, vice president of The Irving Group, says overall office vacancy in the Central Business District (CBD) remained at 16.9% in the first quarter, the same as year-end, and down slightly from 17.0% one year ago, while lease rates asked by landlords declined to an average $2.05 per square foot monthly, from $2.08 at year-end and $2.16 a year ago.

"That 11-cent decline year-to-year amounts to a 5.0% slide in lease rates," said Wells. "For a 5,000-square-foot office, that's a $6,600 savings every year, definitely good news for tenants looking for cost efficiencies."

Downtown has a lot going for it, said Wells, listing walkable neighborhoods, all forms of transportation, restaurants, theaters, hotels, meeting space, waterfront recreation, Balboa Park, Petco Park, spectacular homes and high-rise views. "Affordable office space is part of that mix," said Wells. "In no other market in San Diego County are you within walking distance of 13.5 million square feet of rentable office space and hundreds of upscale restaurants and bars. All that combines into a productive, creative urban synergy unlike anything else."

"Owners of Class B towers Downtown are having a tougher time, losing a net of 8,331 square feet of tenants in the first quarter," said Wells. "That doesn't justify the average asking price rising to $1.94 per square foot monthly in the first quarter from $1.91 at year-end," said Wells. "Of course, what a landlord is asking and what The Irving Group's tenant is willing to negotiate are different things. It's our job to extract those concessions from landlords."

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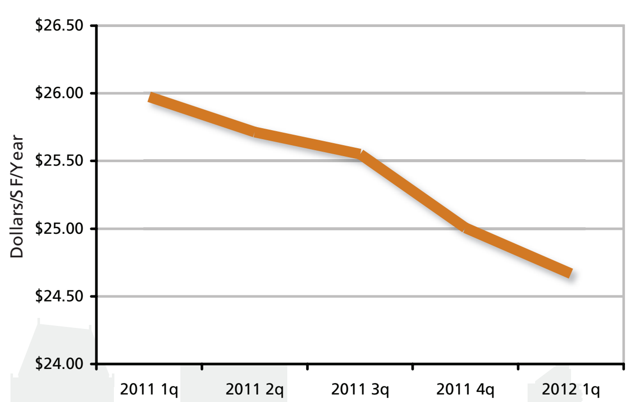
CBD Rental Rates

Historical Analysis, All Classes



Source: CoStar Property®

The best of the best, Downtown's Class A high-rise space, dropped to 17.7% vacant at March 31 from 18.5% at year-end, said Wells, meaning 1.04 million of the CBD's 5.88 million rentable square feet of Class A are available at asking rates averaging $2.32 per square foot monthly, down from $2.34 at year-end 2011. A net increase of 48,081 square feet of Class A space was leased in the first quarter, he said.

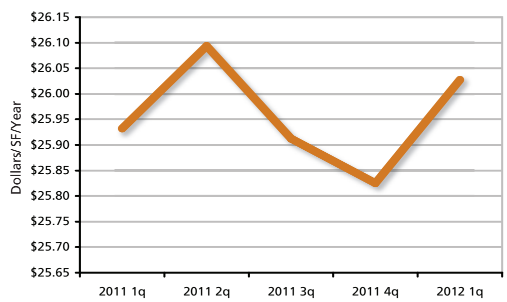
The Class C space asking price Downtown averaged $1.59 per square foot in the first quarter, said Wells, adding "There are bargains to be had, but the choices are fewest in this category." He said only 284,707 square feet of Class C space are available, reflecting a 10.8% vacancy rate Downtown.

NORTH SAN DIEGO MARKET HOLDS FIRM

North San Diego's office market remained firm and popular in the first quarter, with the vacancy rate steady at 13.2% and the "asking" lease rate edging up to $2.16 per square foot from $2.15 at year-end.

North SD Rental Rates

Historical Analysis, All Classes



Source: CoStar Property®

"North San Diego rates are still the lowest in years," said Brunson Howard, vice president of The Irving Group. "In '08, North San Diego rates averaged $2.86. We're much more affordable today." He noted that more than 470,000 square feet of new office space are under construction, the first significant addition to North San Diego since 2008.

The Class A market in North San Diego remained the tightest in the county with a vacancy rate of only 10.5%, compared to 17.7% Downtown. North San Diego's Class A enjoyed some 55,411 square feet of net absorption in the first quarter, on top of 303,429 square feet of net absorption in all of 2011, Howard said. Class A asking rates hit $2.60 per month in the first quarter, actually a 1-cent decline from 2011.

The greatest price increase in North San Diego was found in Class B properties, up 4.2% in the first quarter alone to $2 per square foot, probably an aberration since Class B landlords lost another 38,470 square feet of tenants in the first quarter, on top of 101,549 square feet lost throughout 2011, pushing the vacancy rate to 15.8% at March 31 from 15.4% at Dec. 31, 2011.

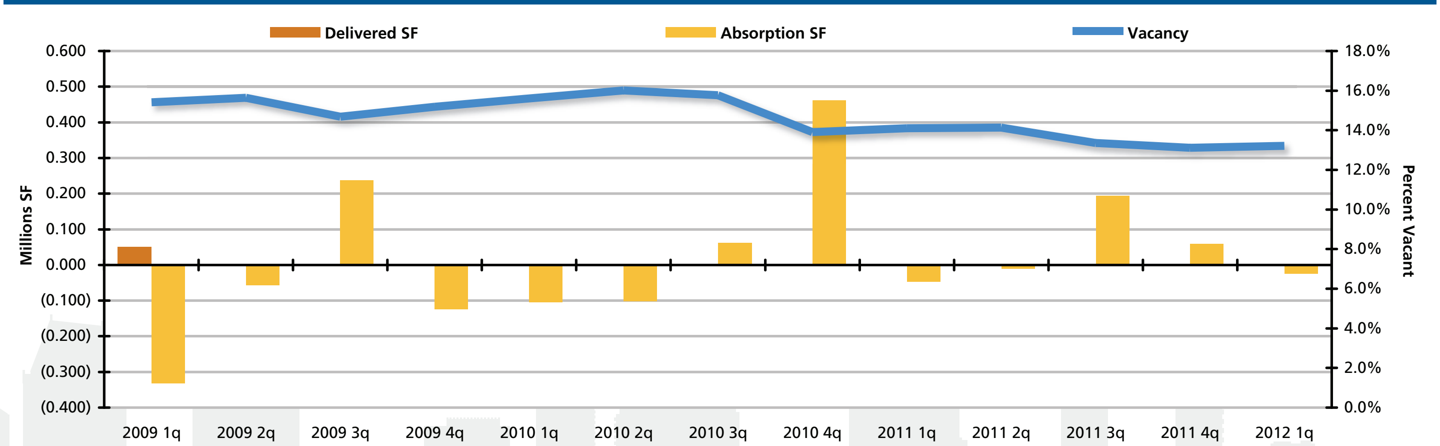
Class C space in North San Diego had one of the lowest vacancy rates at 8.8% with 191,027 square feet available. Landlords were asking $1.52 per square foot, Howard said.

La Jolla Village Drive

With 24.88 million square feet of Classes A, B and C office space, North San Diego is the largest market in San Diego County, Howard said. However, Downtown's 13.5 million rentable square feet are developed in about 2.25 square miles and contain only one market, Downtown. The North San Diego market covers roughly 100 square miles and includes the Governor Park, Sorrento Valley, La Jolla, Torrey Pines, Mira Mesa/Miramar, UTC and Sorrento Mesa submarkets. "There's a lot to choose from in an upscale coastal environment," said Howard, "No wonder the area plays host to San Diego's scientific, biotech, medical, telecommunications, research and education industries."

North SD Deliveries, Absorption & Vacancy

Historical Analysis, All Classes



Source: CoStar Property®

I-5 CORRIDOR OFFERS WINDOW OF OPPORTUNITY

The highly desirable Interstate 5 Corridor became a little easier to enter following the first quarter. Ron Magnaghi, senior vice president of The Irving Group, says the vacancy rate bumped up to 17.5% by March 30 from 17.0% at year-end 2011.

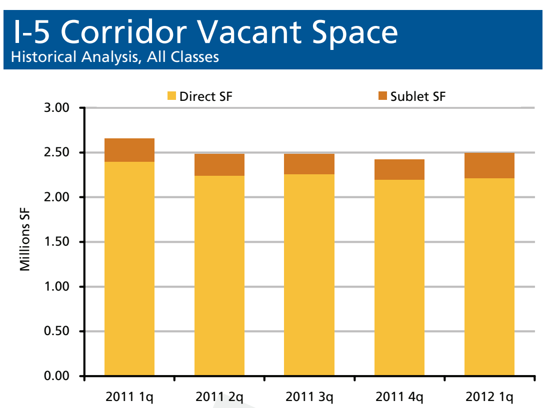
"The I-5 Corridor absorbed a net increase of more than 404,800 square feet of office tenants last year, the most absorption of any market in San Diego County in 2011," said Magnaghi. "So some softening in the first quarter shouldn't be a surprise." Some 58,600 square feet of negative absorption in the first quarter leaves more than 346,000 square foot of positive absorption in the last five quarters.

"The first quarter is good for tenants, making it a little more affordable to enter the Class A and B markets."

> *For tenants, this may be the best possible time to enter the market or renegotiate a lease.*

The I-5 Corridor includes the Del Mar Heights/Carmel Valley submarket, as well as Del Mar proper, Solana Beach, Leucadia, Encinitas and the vast Carlsbad submarket, a total of 14.2 million square feet of office space.

Simon Terry-Lloyd, vice president of The Irving Group, said the Class B market in the I-5 Corridor gave up the most, with 56,157 square feet of contraction, while Class A lost a net of 12,357 square feet of tenants in the first quarter. "Probably because the I-5 market includes some of the most expensive space in the county, Class C performed best in the first quarter with a net positive absorption of 9,862 square feet," said Terry-Lloyd. "Financiers of Class C space can hold their heads a little higher." He said the 6.2% vacancy rate for Class C space in the I-5 corridor makes it the second tightest market in San Diego County. "Only Coronado, with virtually no vacancy in its Class C space, has a tighter market," he said.



Source: CoStar Property®

Magnaghi added that Class A and B vacancies exceed 18% in the I-5 Corridor, with Class B asking rates averaging $2.25 per square foot monthly, and Class A at $2.73. "Prices aren't likely to drop much further with nearly 1 million square feet of Class A space available," said Magnaghi. "For tenants, this may be the best possible time to enter the market or renegotiate a lease."

THE IRVING GROUP

Founded by Craig Irving in 1989, The Irving Group is San Diego County's premier commercial real estate brokerage exclusively representing tenants, buyers and investors – never landlords in lease negotiations. The Irving Group also expertly manages tenant improvements and third-party construction under the direction of The Irving Group Real Estate Services President John Dempsey, a 30-year construction management veteran. The Irving Group and its team members are deeply involved in civic and community affairs, including the Naval Special Warfare Family Foundation, San Diego Police Foundation, Safety Net and others.

Craig Irving

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