VEGAS VALLEY
OFFICE TEAM

Las Vegas Office Market Insight | Q1 09

TENANT NEWS

The key difference between this situation and the "Survival" scenario is that the real estate decisions are based on a longer timeline.

For example, what happens when a short term lease expires in two years? If the economy is in recovery mode, rental rates will spike as demand outstrips supply. Rental rate increases will be more dramatic than in past cycles because the lending environment has frozen almost all speculative development. The result is a two year period ("Development Lag") during which developers and lenders will scramble to catch up.

During the Development Lag period, landlords with existing product will enjoy unprecedented pricing power. In the absence of alternatives (new development), tenants will be competing for a shrinking supply of office space. Ideally, you would avoid entering a new lease during this period.

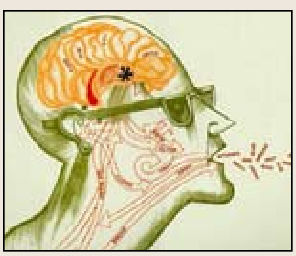
A good leasing strategy will address the short and long term factors affecting the business. For example, a 3 – 5 year lease term could include the following features:

- Reduced lease rate
- Rental abatement (free rent) in the near term
- Option to Terminate
- Option to Expand
- Option to Renew

The strategic approach will allow the business to balance real estate expenses with flexibility. Just as importantly, your business will enter the next economic phase with lower real estate expenses than the competitors who failed to take a long term approach.

Your tenant broker can provide guidance on leasing strategies that support your business model, allowing you to focus on your business.

Language of Leasing: "Class A"



The phrase "Class A" is often found on advertising materials for office projects, but what does it mean? There's no official classification system for office buildings, however the generally accepted practice is to divide office buildings into 3 categories: Class "A", "B", or "C". The definition of each class varies by market, making comparisons difficult.

In the Las Vegas market, buildings are classified as "Class A" based on the following three criteria:

1/ Construction Type
Poured-in-place concrete, or more commonly, steel frame construction. These construction methods are consistent with buildings that are 3 or more stories tall.

2/ Age
A building that was classified as "Class A" when constructed, may shift to "Class B" over time if its desirability falls behind newer Class A projects.

3/ Amenities that include most or all of the following:

- Access to dining amenities
- Parking structures
- Security services
- On-site property management

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TENANT NEWS

IN SIDE THIS ISSUE:

Marketing Buzz

Moving? Landlord Picks up the tab

Can I See your financials Mr. Landlord

In Depth: Fear of Commitment (a Guide to Lease Term)

Language of Leasing: "Class A"

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TENANT NEWS

Market Buzz

The office market continues to favor tenants. Market indicators show no immediate sign of reversing this trend. It's likely that 2009 will be remembered as "The Tenant's Year" as the real estate pendulum continues to swing in their favor. Current trends include:

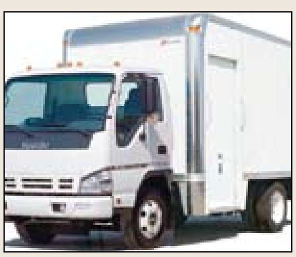
Blend and Extend
Early renewals in exchange for tenant-favorable terms.

Focus on Second Generation Space
Tenants and landlords are reluctant to part with the capital required to build tenant spaces from shell condition, especially given the many second generation options available.

Reduced Term
Uncertainty on the part of tenants and landlords has resulted in a fear of commitment. Tenants fear a long term lease liability in the face of economic uncertainty. Landlords are concerned about being locked into today's (low) rates when the economy rebounds.

Impossible to Pick the Bottom
Despite the search for a clear "turning point" at which the market shifts back to positive, a less transparent "bounce" along the bottom is more likely. In other words, we won't know that we've hit the bottom until 6 to 12 months after the fact. Tenants with lease expirations in 2009 or 2010 should be talking to their brokers about strategy; the opportunities have never been greater.

Moving? Landlords Picking Up the Tab.



In today's market, landlords are covering an increasing portion of the tenant improvement cost, often 100%. Factors that affect a landlord's willingness to cover these costs include:

- Tenant's financial strength
- Total cost to complete the tenant improvements
- Layout of the space (unique or re-leasable?)
- Lease duration

What about the other moving costs? Items such as cabling, changing stationary and moving or buying furniture are typically born by the tenant. A new trend creeping into the tenant-friendly market is the willingness of landlords to contribute to these expenses. The landlord's contribution can take several forms, including:

- A "moving allowance", to reimburse the tenant's actual moving expenses.
- The ability to apply unused tenant improvement funds to moving expenses.
- Additional free rent

Your tenant broker can provide a strategy to capitalize on current market conditions. Removing the moving costs from the equation allows a tenant to consider all of the opportunities the market has to offer.

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Can I see your financials Mr. Landlord?

Landlords review tenants' financial statements to measure risk before entering a lease transaction. Historically, financial information has typically flowed in one direction. Current market conditions have created a new question for tenants, "What is the financial strength of my landlord?"

A landlord's financial challenges can affect tenants in several ways but typically a delay or failure to make necessary repairs to the property is the most common. The issue is particularly critical at lease signing or renewal when tenant improvements are involved. The cost of the tenant improvements is usually funded to a large extent by the landlord. At the time these checks are written, the tenant has already signed the lease and there's no time to find an alternative location.

Tenants can minimize their exposure to under capitalized landlords by doing some homework before entering or renewing their lease. The use of a good tenant broker is the first step, as they have constant interaction with all major landlords in their market. Tenant brokers' fees are paid by landlords so it's in their interest to research financial solvency. As an intermediary, the tenant's broker can ask the "hard questions" about the source of funds, debt structure, and overall financial strength of the landlord.

The majority of landlords have the capital necessary to continue their operations through the down cycle. However, savvy tenants will conduct their own due diligence to ensure that the landlord is capable of fulfilling their lease obligations for the long term.

In Depth: Fear of Commitment; a Guide to Lease Term

In recent years, three to five year terms were the norm for the Las Vegas office market. In the face of uncertainty, many tenants are asking for terms of one to three years. How do you determine the "right" lease term?

Your real estate decisions should support your business plan. We'll explore how two business scenarios affect leasing strategy. Firstly, a "Survival" strategy focuses on defensive measures. The "Flexibility" strategy takes a longer term approach and is designed to take advantage of the opportunities offered by the current market.

Survival

If your business forecast includes falling income and reduced head count in the near term, the focus will be on short term survival. Priorities will include minimizing rental expenses and lease commitments.

The objective in this scenario is to negotiate the short lease term (one to three years) without incurring a substantial rate premium. Fortunately, current market conditions are conducive to this strategy as most landlords are focused on shoring up cash flow for the short term.

The sweet spot between rate and term will vary based on your landlord's (and possibly their lender's) perspective. Proposing more than one term can yield the answer.

If you're concerned about survival, a short lease term will have the additional benefit of reducing your liabilities. This is particularly relevant if your lease contains a personal guaranty (a common requirement for small businesses). In the event that you're forced to close the location, minimal liabilities (including loans, lines of credit and leases) will help reduce the effect on your business or personal credit.

Flexibility

In the second scenario, the viability of the business is secure, however there's uncertainty regarding future needs (ie contraction versus expansion). The objective is to balance cost control with flexibility.