

# MARKETBEAT

## SAN FRANCISCO OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



2Q09

### ECONOMY

The U.S. economy seems to be nearing a critical turning point: although unemployment continues to rise, most leading economic indicators exhibited growth during the second quarter of 2009.

The financial, professional and business service sectors in San Francisco Metro have lost a combined 13,800 jobs year-over-year, which has strongly impacted San Francisco's Central Business District (CBD) due to the large concentration of financial, legal and retail tenants.

### OVERVIEW

Many businesses are sitting on the sidelines, waiting for the best opportunity to negotiate a deal, or they are currently unable to act due to unstable economic conditions. However, the gap between asking rental rates and taking rental rates continues to shrink, having a positive effect on leasing activity. The amount of space shed during the second quarter had less negative impact due to this slight uptick in leasing activity. This leasing activity is indicative of tenants taking advantage of the favorable leases that can be negotiated right now.

There continues to be a downward pressure on asking rents as landlords strive to fill vacancies and compete with the low rents offered by sublandlords. Overall sublease space throughout the city did grow 3.4%, or 72,000 square feet (sf), although that number is easily dwarfed by the 76.4% increase seen during the first quarter. After calculating in the added risk of sublandlord financial stability and the limitations of the remaining term on subleases, direct asking rents have fallen enough to become more competitive with subleases. The direct weighted average class A full service asking rental rate in San Francisco's CBD was \$42.26 per square foot per year (psf/yr), down from \$44.03 psf/yr in the first quarter and \$53.97 psf/yr one year ago. This compares to a sublease weighted average class A full service asking rental rate of \$24.24 psf/yr at the end of the second quarter.

The South of Market Financial District saw the majority of the leasing activity this quarter, including eight of the top ten leases in San Francisco's CBD, pushing absorption in that submarket into positive numbers. Reed Smith, LLP signed the largest non-renewal lease this quarter at 109,994 sf, in a market that has recently been dominated by renewals and deals under 5,000 sf. Reed Smith will occupy the former Thelan Reed space in 101 Second Street in the fall of this year, while gradually vacating five full floors at 1999 Harrison Street in downtown Oakland. The North of Market Financial District saw less positive activity this quarter and overall availabilities increased by 1.0%, or 40,000 sf.

Even as the count of troubled assets in San Francisco continues to rise, capital markets are still unwilling to invest in large office, residential or hotel development projects. Developers predict that large-scale projects will not take shape any time within the next five years. Weakened demand, rising vacancy and falling asking rents will continue to postpone interest in new development, and the money sitting on the sidelines will most likely go into existing, bargain properties.

### FORECAST

Some executives think we are at or near the bottom of the recession cycle. Others point to continued job losses as a sign that demand for office space in San Francisco will continue to decline for at least three more quarters before we see a recovery.

### BEAT ON THE STREET

"The good news this quarter is that the bid-ask spread narrowed, there was good leasing activity, and the stock market showed some recovery and stability. The bad news is that unemployment is rising, causing more sublease space to hit the market and tenants in the market to look for less space than they currently occupy. Due to those trends, we expect vacancy to increase during the next several quarters."

—Mark McGranahan, Executive Vice President

### ECONOMIC INDICATORS

National	2008	2009F	2010F
GDP Growth	1.1%	-3.0%	1.2%
CPI Growth	3.8%	-0.6%	1.7%

Regional	2008	2009F	2010F
Unemployment	5.0%	8.7%	9.3%
Employment Growth	0.6%	-4.7%	-2.9%

Source: Moody's | Economy.com

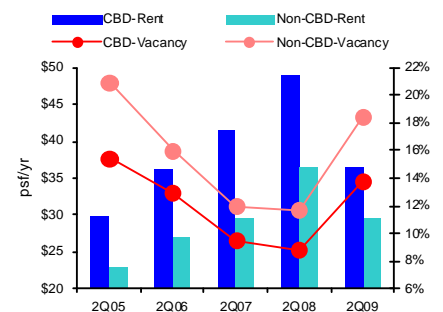
### MARKET FORECAST

**LEASING ACTIVITY** increased slightly during the second quarter, and should continue to follow this trend as rental rates come down.

**OVERALL ABSORPTION** is expected to remain negative throughout the remainder of 2009 as more space is being shed than leased.

**RENTAL RATES:** New sublease space and lack of tenant demand will continue to put downward pressure on rental rates.

### OVERALL RENT VS. VACANCY



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## MARKET/SUBMARKET STATISTICS

MARKET/ SUBMARKET	INVENTORY	NO. OF BLDGS.	OVERALL VACANCY RATE	DIRECT VACANCY RATE	YTD LEASING ACTIVITY	UNDER CONSTRUCTION	YTD CONSTRUCTION COMPLETIONS	YTD OVERALL ABSORPTION	DIRECT WTD. CLASS A GROSS RENTAL RATE*
NOMA Financial District	26,006,324	112	15.7%	11.4%	495,868	0	0	(1,030,276)	\$42.33
SOMA Financial District	22,032,963	98	11.5%	9.5%	468,723	0	0	(339,825)	\$42.18
<b>CBD Total</b>	<b>48,039,287</b>	<b>210</b>	<b>13.8%</b>	<b>10.5%</b>	<b>964,591</b>	<b>0</b>	<b>0</b>	<b>(1,370,101)</b>	<b>\$42.26</b>
Jackson Square	1,369,168	24	18.2%	17.9%	10,875	0	0	(71,339)	\$32.35
North Waterfront	2,394,975	31	15.3%	11.5%	30,927	0	0	(150,665)	\$30.57
South Beach/Rincon Hill	2,387,582	29	14.8%	10.3%	21,795	0	0	(101,371)	\$35.26
San Francisco S. of Market	5,366,228	45	32.2%	27.8%	24,829	0	0	(591,214)	\$35.23
West of Kearny	703,735	9	13.2%	8.2%	5,899	0	0	(81,416)	\$28.66
The Presidio	995,955	7	17.0%	8.5%	23,564	0	0	(12,650)	\$44.12
Union Square	4,035,868	58	9.9%	8.7%	44,968	91,360	0	(74,863)	\$30.50
Van Ness Corridor	4,384,883	34	8.2%	7.5%	13,847	0	0	(29,332)	\$29.44
Potrero Hill/Inner Mission	1,831,996	22	18.2%	18.1%	16,876	0	0	(21,446)	\$25.54
Mission Bay	1,006,272	4	48.1%	48.1%	0	0	0	0	N/A
<b>Non-CBD Total</b>	<b>24,476,662</b>	<b>263</b>	<b>18.5%</b>	<b>15.9%</b>	<b>193,580</b>	<b>91,360</b>	<b>0</b>	<b>(1,134,296)</b>	<b>\$33.31</b>
<b>SAN FRANCISCO TOTAL</b>	<b>72,515,949</b>	<b>473</b>	<b>15.4%</b>	<b>12.3%</b>	<b>1,158,171</b>	<b>91,360</b>	<b>0</b>	<b>(2,504,397)</b>	<b>\$40.28</b>

\* Rental rates reflect \$psf/year

## MARKET HIGHLIGHTS

### SIGNIFICANT 2Q09 NEW LEASE TRANSACTIONS

BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
101 Second Street	SOMA Financial District	Reed Smith	109,994	A
303 Second Street	SOMA Financial District	United Biosource	30,000	A
620 Folsom Street	SOMA Financial District	ICF Consulting	15,757	B
199 Fremont Street	SOMA Financial District	Aptimus	15,200	A
343 Sansome Street	NOMA Financial District	MyNewPlace	14,781	A
580 California Street	NOMA Financial District	Federal Home Loan Bank	14,105	A
Market Center - 575 Market Street	SOMA Financial District	Perry Smith	12,715	A
Market Center - 575 Market Street	SOMA Financial District	Marsys International	12,692	A
455 Market Street	SOMA Financial District	Chicago Title	12,397	A
Market Center - 575 Market Street	SOMA Financial District	HDR Engineering, Inc.	12,110	A
150 Spear Street	SOMA Financial District	Brighterion	11,881	A
Market Center - 555 Market Street	SOMA Financial District	Tetra Tech, Inc.	11,102	A
539 Bryant Street	South of Market	Scribd	10,956	B

### SIGNIFICANT 2Q09 SALE TRANSACTIONS

BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
N/A				

### SIGNIFICANT 2Q09 CONSTRUCTION COMPLETIONS

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
N/A				

### SIGNIFICANT PROJECTS UNDER CONSTRUCTION/RENOVATION

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
One Kearny Street	Union Square	N/A	91,360	10/09

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