

MARKETBEAT

SAN FRANCISCO OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



3Q08

ECONOMY

Failures in the investment banking industry, securities market and the insurance industry will further dampen the pace of commercial real estate activity in the near term. The potential give-back of office space by these industries will pose challenges to an already slowing commercial real estate market in San Francisco. The wave of sublease space coming to the market could be substantial and will add to overall availability growth and negative absorption. The impact of J.P. Morgan Chase buying Washington Mutual and the acquisition of Wachovia by Wells Fargo could add more vacancy to an already growing supply of available office space. The Lehman Brothers' bankruptcy, Bank of America's purchase of Merrill Lynch and the federal bailout of insurer AIG could, and most likely will, result in large blocks of sublease space hitting the market over the next twelve months. Stable businesses continue their reluctance in making bold real estate decisions as a result of weakened business confidence and economic instability. The depressed labor market will further weaken as more jobs are lost and unemployment grows.

OVERVIEW

The growth of sublease space this year continued to give tenants the upper hand in selecting quality spaces and in lease negotiations. This growth, coupled with upcoming construction and renovation completions, will flood the market with viable opportunities in the face of weakening demand. This will also drive asking rents down as landlords look to stay competitive in a turbulent market. Landlords may have to offer more free rent or more attractive lease concessions to entice strong credit tenants to take down space in their buildings. Unless a tenant has to move, they will stay in their current location over the short term and wait out the turbulent economic times.

Financing continues to hamper sale activity. Immediate results of the financial crisis are the further slowing of credit availability and a further reduction of real estate acquisitions. Investment and leasing deal activity will continue to slow as investors and corporate real estate decision makers prolong their "wait and see" decision-making approach.

FORECAST

What tenants will step in and absorb the quality space vacated by these troubled financial firms? Technology companies could be the crutch that helps the San Francisco market, but currently they are leasing short-term subleases. This trend is unlikely to be the driving force in absorbing top-tier view space once occupied by prominent financial firms. Despite the passage of the \$700 billion government investment plan, we expect the national economy to weaken further before stabilizing. Estimates for a turn-around range from six months to five years or more. Uncertainty remains a strong sentiment resulting in a fear about real estate decision making. This paralysis continues to pressure tenants into signing short-term renewals and extensions rather than long-term commitments. Fear prevails as the extent of the financial crisis unfolds. Clearly this is a time for conservatism and defensive tactics. Tenants will hunt for bargains as long as uncertainty remains in the market. Clearly the next year or so is going to be challenging for all office markets, including San Francisco and the Bay Area.

BEAT ON THE STREET

"San Francisco's CBD tenancies are largely within the finance and professional service sectors which will bear the brunt of the continued downturn until liquidity and confidence are restored. Firms may shelve expansion plans, may downsize, or disappear altogether which will increase the 'shadow' sublease market. This will exert downward pressure on rental rates, especially if the market activity continues its somewhat listless state."

—Dick Robinson, Executive Director

ECONOMIC INDICATORS

National	2006	2007	2008F
GDP Growth	2.8%	2.0%	1.9%
CPI Growth	3.2%	2.9%	4.4%

Regional	2006	2007	2008F
Unemployment	3.9%	4.0%	4.7%
Employment Growth	2.0%	2.3%	1.2%

Source: Moody's | Economy.com

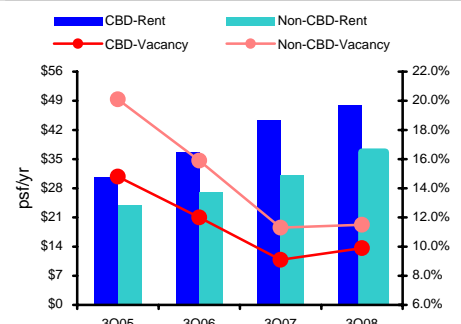
MARKET FORECAST

DIRECT ASKING RENTS for CBD class A dropped 2.2% since the second quarter, marking the first decline in four years. ↓

OVERALL ABSORPTION was negative for the second consecutive quarter due to the addition of roughly 500,000 sf of vacant space. ↓

SUBLEASE SPACE currently represents 20.4% of the total available in the CBD. This represents considerable growth over the 11.3% reported one year ago. ↑

OVERALL RENTAL VS. VACANCY RATES



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	26,051,324	113	11.0%	8.3%	1,193,465	0	0	(748,923)	\$52.95
SOMA Financial District	21,482,174	97	8.6%	7.3%	1,454,724	837,000	321,545	134,614	\$52.50
CBD Total	47,533,498	210	9.9%	7.9%	2,648,189	837,000	321,545	(614,309)	\$52.76
Jackson Square	1,369,168	24	12.3%	12.3%	60,928	0	0	(117,485)	\$33.99
North Waterfront	2,394,975	31	6.4%	6.0%	85,395	0	0	47,585	\$40.00
South Beach/Rincon Hill	2,387,582	29	10.2%	8.4%	177,268	0	0	(35,812)	\$35.10
San Francisco S. of Market	4,859,610	43	15.7%	14.7%	240,465	0	0	(221,397)	\$44.48
West of Kearny	703,735	9	1.3%	1.3%	8,039	0	0	(846)	\$37.00
The Presidio	995,955	7	7.5%	7.5%	5,925	0	0	(29,693)	N/A
Union Square	4,035,868	58	8.0%	7.7%	191,665	0	0	64,953	\$39.09
Van Ness Corridor	4,379,522	34	9.7%	9.0%	45,025	0	0	30,106	\$35.07
Potrero Hill/Inner Mission	1,766,140	21	15.2%	15.2%	184,983	0	0	68,611	\$29.46
Mission Bay	556,272	2	49.1%	49.1%	0	450,000	273,272	0	N/A
Non-CBD Total	23,448,827	258	11.5%	10.9%	999,693	450,000	273,272	(193,978)	\$40.41
San Francisco Total	70,982,325	468	10.4%	8.9%	3,647,882	1,287,000	594,817	(808,287)	\$49.68

* Rental rates reflect \$psf/year

MARKET HIGHLIGHTS

SIGNIFICANT 3Q08 NEW LEASE TRANSACTIONS

BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
303 Second Street	SOMA Financial District	Kennedy Jenks	38,175	A
301 Brannan Street	South Beach/Rincon Hill	Slide, Inc.	35,373	A
370 Third Street	San Francisco South of Market	Comcast Sportsnet	32,000	A
201 Third Street	SOMA Financial District	ON24	27,310	A
100 California Street	NOMA Financial District	Tippit, Inc.	20,173	A
251 Rhode Island	Potrero Hill/Inner Mission	Live Nation Worldwide	20,142	B
50 California Street	NOMA Financial District	Season's Capital Management	19,397	A
275 Battery Street	NOMA Financial District	Arnold & Porter, LLP	16,644	A
114 Sansome Street	NOMA Financial District	Bella Pictures	15,674	B
100 Pine Street	NOMA Financial District	Alliant Insurance	13,285	A
642 Harrison Street	South Beach/Rincon Hill	Global IP Solutions	12,448	B

SIGNIFICANT 3Q08 SALE TRANSACTIONS

BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
760 Market Street/Phelan Building	Union Square	Thor Equities	267,000	N/A

SIGNIFICANT 3Q08 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
555 Mission Street	SOMA Financial District	Gibson Dunn	547,000	10/08
370 Third Street (renovation)	San Francisco South of Market	Comcast Sportsnet	400,000	10/08
409 Illinois Street	Mission Bay	Fibrogen	239,000	12/08
499 Illinois Street	Mission Bay	N/A	211,000	12/08

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*Market terms & definitions based on BOMA and NAIOP standards.

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