

MARKETBEAT

SAN FRANCISCO OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



1Q08

ECONOMY

The contraction of jobs in the Bay Area continues to weigh on the regional outlook. As of February 2008, San Francisco County's year-over-year unemployment rate grew from 4.2% to 4.4%. Technology, life science, healthcare and energy sectors remain strong and are generating demand for new space. Conversely, banking and financial institutions are experiencing a dearth of growth while fostering little new demand. Current real estate decisions are driven by the unpredictability of the economy and financial outlook over the next few years. Tenants are signing short-term renewals to garner more time to wait out the market and plan accordingly for the future. Few long term decisions are being made as companies avoid locking into long-term real estate obligations during this unstable and weakening market.

OVERVIEW

Consumer and business confidence began to weaken by mid-year 2007 and, at the start of 2008, confidence remained depressed. Office leasing and sales activity slowed as market fundamentals weakened this quarter. Some landlords have yet to lower asking rents while some tenants are stalling, opting for short-term commitments or waiting to see what the market will bear. As sublease space grows, landlords may be forced to lower direct asking rents on their competing spaces. There is also the threat of shadow sublease space or underutilized space not yet on the market coming online, which will increase vacancy and possibly open the door for price-sensitive tenants to enter the San Francisco market or relocate for the short term.

Investment activity slowed significantly during the second half of 2007. After the booming office investment market in San Francisco during 2005, 2006 and early 2007, the current number of class A buildings for sale remains low. Owners of premium buildings began pulling their buildings off the market as sale offers did not meet expected asking prices. Investor and owner/occupier demand for new product is declining due to higher financing costs, reduced capital availability and increasing vacancy rates. With investment capital shrinking in the market, the gap between buyer and seller perception will need to close to facilitate more deals. Sellers are still influenced by the rampant sale environment of the past five years while buyers have become more cautious and conservative. Both remain at opposite ends of the spectrum regarding pricing. This, coupled with the lack of available credit, is creating the slowdown in the real estate investment market.

FORECAST

Corporate growth will be limited in 2008 as businesses are reluctant to expand. With activity slowing and tour volume decreasing, the office market is caught in the middle of minimal positive and mounting negative outlooks. This market could well be defined by flattening asking rental rates, major adjustments in office building values, higher vacancies and tightening credit. Unemployment is growing, further emphasizing corporate America's contraction and streamlining of business practices. The only offset to this is the technology demand fueled by venture capital funding. When confidence grows, so will the push for hiring and expansion. Until then, we can expect weaker leasing and sale numbers for the better part of 2008.

BEAT ON THE STREET

"With both the economy and national financial markets in flux, landlords concerned with cash flow (not face rates) are aggressively pursuing tenants in the market and renewals. Tenants are more tentative in their planning and relocations as they watch sublease opportunities increase and softening of some CBD rents. Only SOMA/creative spaces are still a hot commodity, with tech firms still fueled by venture capital funding."

—Margaret Duskin, Senior Director

ECONOMIC INDICATORS

National	2006	2007	2008F
GDP Growth	2.9%	2.2%	1.5%
CPI Growth	3.2%	2.8%	3.0%
Regional			
Unemployment	3.9%	4.0%	4.4%
Employment Growth	2.0%	1.9%	0.2%

Source: Moody's | Economy.com

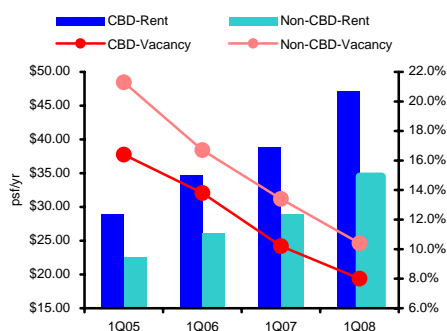
MARKET FORECAST

LEASING ACTIVITY dipped slightly, and may remain depressed, as tenants review real estate decisions in the near term. ↓

OVERALL ABSORPTION was positive during the quarter but the growing number of subleases will dilute this number in upcoming quarters. ↑

SUBLEASE SPACE: CBD class A sublease space grew 51.1% this quarter, a trend expected to continue as tenants review their current space usage. ↑

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. AVG. CLASS A GROSS RENTAL RATE*
NOMA Financial District	26,051,324	113	8.6%	7.4%	353,444	0	0	(135,573)	\$51.66
SOMA Financial District	21,470,542	97	7.4%	6.3%	756,662	547,000	321,545	417,234	\$48.90
CBD Total	47,521,866	210	8.0%	6.9%	1,110,106	547,000	321,545	281,661	\$50.34
Jackson Square	1,369,168	24	4.2%	3.7%	11,584	0	0	(7,105)	\$37.63
North Waterfront	2,394,975	31	5.6%	5.2%	63,331	0	0	65,417	\$40.00
South Beach/Rincon Hill	2,387,582	29	12.5%	8.1%	54,980	0	0	(34,563)	\$38.49
San Francisco S. of Market	4,855,126	43	15.0%	13.6%	71,854	0	0	(172,492)	\$39.79
West of Kearny	703,735	9	0.5%	0.5%	7,655	0	0	4,669	\$38.00
The Presidio	995,955	7	4.5%	4.5%	0	0	0	0	N/A
Union Square	4,035,868	58	9.3%	9.0%	88,957	0	0	23,833	\$41.39
Van Ness Corridor	4,379,522	34	9.6%	8.9%	41,274	0	0	33,238	\$34.99
Potrero Hill/Inner Mission	1,766,140	21	19.1%	15.5%	42,456	0	0	3,419	\$30.66
Mission Bay	283,000	1	0.0%	0.0%	0	718,000	0	0	N/A
Non-CBD Total	23,171,071	257	10.4%	9.1%	382,091	718,000	0	(83,584)	\$38.33
San Francisco Total	70,692,937	467	8.8%	7.6%	1,492,197	1,265,000	321,545	198,077	\$47.31

* Rental rates reflect \$psf/year

MARKET HIGHLIGHTS

SIGNIFICANT 1Q08 NEW LEASE TRANSACTIONS

BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
633 Folsom Street	SOMA Financial District	California Pacific Medical Center	175,000	A
555 Mission Street	SOMA Financial District	Gibson Dunn	60,400	A
303 Second Street	SOMA Financial District	Avenue A/Razorfish	42,659	B
100 First Street	SOMA Financial District	WTAS	38,866	A
250 Brannan Street	South Beach/Rincon Hill	Omniure	35,419	B
799 Market Street	Union Square	Monster.com	34,232	B
50 Francisco Street	North Waterfront	Comcast	33,310	A
135 Main Street	SOMA Financial District	Sedgwick, Detert, Moran & Arnold	26,410	A

SIGNIFICANT 1Q08 SALE TRANSACTIONS

BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
CSAA Headquarters	Van Ness Corridor	Vornado & Patson Van Ness Holdings	549,392	\$120,000,000
199 Fremont Street	SOMA Financial District	PNC Realty Investors	397,300	\$260,000,000

SIGNIFICANT 1Q08 CONSTRUCTION COMPLETIONS

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
400 Howard Street	SOMA Financial District	Barclays Global Investors	321,545	1/08
185 Berry Street (two-floor addition)	San Francisco South of Market	N/A	175,000	1/08

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
500 Terry Francois Boulevard	Mission Bay	N/A	268,000	4/08



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

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