MARKETBEAT

SAN FRANCISCO OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION

CUSHMAN & WAKEFIELD®
Global Real Estate Solutions℠

3Q09

ECONOMY

As unemployment approaches a 25-year high, negative employment trends will continue to push further into late 2010. The effect of high unemployment on the current real estate market in San Francisco resulted in sparse new demand growth in leasing and little investment activity. Analysts have shied away from predicting when full recovery will occur, especially when the economy sends mixed signals regarding its health. Despite unemployment worries and mixed economic signals, some momentum is probable as transactions come together in a market waffling in this transitional period.

OVERVIEW

Overall vacancy in San Francisco has been in a holding pattern, ranging from 15.1% to 15.4% over the past three quarters. Sublease space throughout San Francisco decreased slightly during the quarter, while sublease space in the Central Business District (CBD) dropped nearly 200,000 square feet (sf) since the first quarter. Five of the top ten leases signed during the quarter were subleases, totaling 92,386 sf. There has also been some flight to quality due to space availability and affordability in trophy buildings but many tenants are renewing for shorter terms until the business environment stabilizes.

The newest downtown development, 555 Mission Street, experienced the strongest leasing activity. Newly signed leases during the quarter pushed occupancy in 555 Mission Street to nearly 50 percent. The top three leases signed during third quarter took place in this building and included CNA Insurance, Silicon Valley Bank and RCM. These leases, coupled with better leasing activity throughout the SOMA Financial District, helped to push overall absorption in this submarket to positive 78,716 sf during third quarter.

Earlier in third quarter Hines and CalPERS gave back three of the four buildings at Watergate Towers in Emeryville totaling 814,000 sf. Soon after, Hines and Sterling American Property relinquished 333 Bush Street here in San Francisco to their lenders. Hines could not keep up with their loan payments after law firm Heller Ehrman defaulted on its 250,000-sf lease in late 2008.

Determining building values in San Francisco has become a guessing game. Landlords and debt holders who have to unload debt on properties have come up against a market that lacks sufficient data from which properties can properly be valued. Price adjustments for office properties are beginning. The sale of 250 Montgomery Street, discounted by over 50% since its sale in 2006, will help set the value of many assets in the market and hopefully bring buyers and sellers closer to determining value in such a dynamic environment. The rise in mortgage defaults is directly tied to employment numbers. With unemployment on the rise and average rents falling in San Francisco, we can expect the number of defaults to climb.

FORECAST

Recovery in San Francisco will be heavily dependent on employment during the next two years. If job losses continue through 2010, the outlook for recovery in the region will remain further out on the horizon. When job losses dissipate we can expect to see a firming of the rent and sale values. Conflicting signs of decline and recovery are prevalent and will continue until measurable recovery can be sustained.

BEAT ON THE STREET

"From a tenant's perspective, the San Francisco office market has become a three-dimensional chess game of sorts. Each tenant must triangulate the factors of optimum timing to capture market cycle low occupancy costs and operational needs of its business (which can be uncertain for the short term), balanced against the toxic capital stack of many buildings/ developments being considered. For the savvy corporate real estate executive, there are some very good opportunities but you must navigate today's perilous market."

–Dan Harvey, Senior Director

ECONOMIC INDICATORS

National	2008	2009F	2010F
GDP Growth	0.4%	-2.6%	1.8%
CPI Growth	3.8%	-0.5%	1.7%
Regional			
Unemployment	5.0%	8.9%	9.8%
Employment Growth	0.6%	-4.4%	-2.6%

Source: Moody's | Economy.com

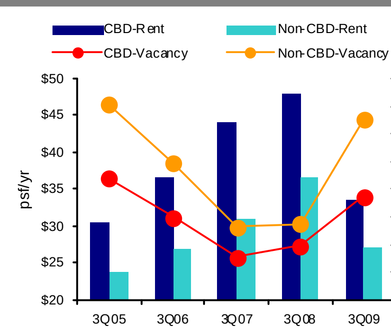
MARKET FORECAST

OVERALL ABSORPTION was a mix of positive and negative numbers this quarter but will remain depressed at year-end and well into 2010.

SUBLEASE SPACE in the CBD has fallen by 200,000 sf in 2009 and may continue to decrease as tenants take advantage of opportunities.

OVERALL ASKING RENTS marked the fifth consecutive quarter of decline. This downward trend will continue, though less severe, over the next several quarters.

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. AVG. CLASS A GROSS RENTAL RATE*
NOMA Financial District	26,006,324	112	15.8%	11.9%	897,848	0	0	(1,071,779)	$38.69
SOMA Financial District	22,032,963	98	10.9%	9.0%	874,906	0	0	(260,293)	$38.40
CBD Total	48,039,287	210	13.5%	10.5%	1,772,754	0	0	(1,332,072)	$38.57
Jackson Square	1,369,168	24	19.5%	19.3%	41,611	0	0	(89,909)	$31.64
North Waterfront	2,394,975	31	16.0%	12.3%	52,374	0	0	(168,631)	$31.11
South Beach/Rincon Hill	2,387,582	29	15.1%	10.7%	32,103	0	0	(112,700)	$35.04
San Francisco S. of Market	5,366,228	45	31.1%	27.5%	84,562	0	0	(537,674)	$34.45
West of Kearny	703,735	9	13.0%	7.9%	5,899	0	0	(79,774)	$25.15
The Presidio	995,955	7	23.5%	4.5%	40,192	0	0	(77,714)	N/A
Union Square	4,126,582	59	11.2%	9.7%	84,198	0	0	(166,196)	$28.04
Van Ness Corridor	4,384,883	34	8.8%	8.1%	23,363	0	0	(56,603)	$28.03
Potrero Hill/Inner Mission	1,831,996	22	18.3%	18.2%	24,912	0	0	(23,521)	$24.18
Mission Bay	1,006,272	4	48.1%	48.1%	0	0	0	0	N/A
Non-CBD Total	24,567,376	264	19.0%	16.1%	389,214	0	0	(1,312,722)	$31.57
SAN FRANCISCO TOTAL	72,606,663	474	15.4%	12.4%	2,161,968	0	0	(2,644,794)	$37.27

* Rental rates reflect $psf/year

MARKET HIGHLIGHTS

SIGNIFICANT 3Q09 NEW LEASE TRANSACTIONS

BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
555 Mission Street	SOMA Financial District	CNA Insurance	37,438	A
555 Mission Street	SOMA Financial District	Silicon Valley Bank	35,274	A
555 Mission Street	SOMA Financial District	RCM	35,154	A
475 Sansome Street (sublease)	NOMA Financial District	Zoosk	21,391	A
55 Second Street (sublease)	SOMA Financial District	LookSmart	19,997	A
345 California Street (22nd floor sublease)	NOMA Financial District	Exigen Capital	17,253	A
71 Stevenson Street (sublease)	SOMA Financial District	San Francisco Examiner	16,942	A
149 New Montomery Street	SOMA Financial District	Kaplan Test Prep and Admissions	16,913	B
345 California Street (10th floor sublease)	NOMA Financial District	Exigen Capital	16,803	A
One Letterman Drive, Building C	The Presidio	SteelRiver Infrastructure Partners	16,628	A
One California Street (sublease)	NOMA Financial District	Lennar Homes of California	16,416	A
One California Street	NOMA Financial District	Berman DeValerio	15,955	A
221 Main Street	SOMA Financial District	KPFF	15,445	A

SIGNIFICANT 3Q09 SALE TRANSACTIONS

BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
N/A				

SIGNIFICANT 3Q09 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 (renovation)	Union Square	N/A	91,360	1/10

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