

## San Francisco Office Insight Q3 2009

### Economy

Although many signs are pointing toward an economic recovery nationally and in San Francisco, conditions remained strained during the third quarter of 2009 proving that a rebound to pre-recession levels will not occur as quickly as the economy declined. Unemployment in San Francisco rose further during the quarter to reach 10.1 percent due, in part, to cuts in education, government, and trade, and is expected to continue to increase through the remainder of the year.

### Market Conditions

The San Francisco office market experienced its fourth consecutive quarter of weak tenant demand which contributed to additional discounts in rental rates, and increased vacancy rates. With some tenants still hesitant to make long term decisions and others shedding excess space as a result of layoffs or cost reductions, direct net absorption for the quarter was -59,912 square feet. Sublease net absorption, however, contributed positively bringing overall net absorption to 48,584 square feet, a clear indicator that leasing decisions are largely being driven by price. In addition to pricing, a significant driver of demand in the market has stemmed from office lease expirations rather than growth or migration into San Francisco.

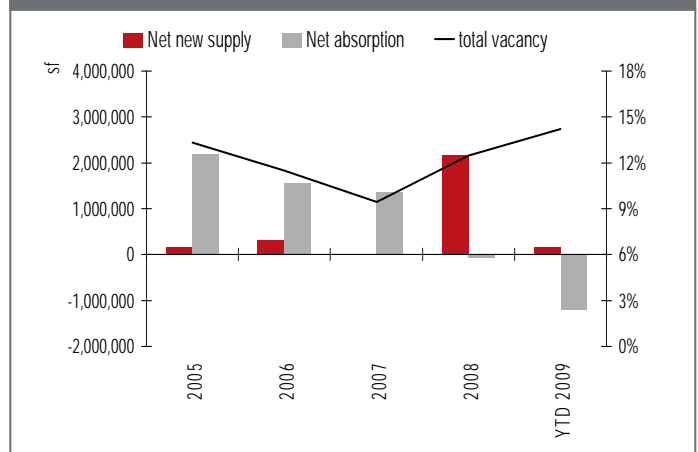
While the market experienced its first quarter of positive absorption in a year, increased activity was unable to reduce vacancy rates, which rose to 14.2 percent. This rise in vacancy contributed to a further decline in rental rates, to \$31.95 at the end of the third quarter, down 23.7 percent from this time last year. Though rental rates have fallen by nearly \$10.00 since their peak in the first quarter of 2008, landlords were still met with competition from low cost sublease spaces of all sizes and conditions.

### Outlook

Moving into the final quarter of 2009, the San Francisco office market can expect to see persistence among vacancies as companies continue to wait out long term decisions until recovery in the economy is more certain. Additionally, rental rates will remain weak until activity in the market begins to increase. Growth in unemployment may be slowing, but more job losses are expected over the next six to nine months and jobs already lost will not be replenished in the near term.

Key market indicators			12-month forecast
Supply	Supply	79,495,978 sf	▲
	Direct vacancy rate	11.9%	▲
	Total vacancy rate	14.2%	▲
	Under construction (% preleased)	310,000 (33.8%)	▶
Demand	Leasing activity 12 mo. % change	-39.0%	▼
	YTD net absorption	-1,212,279 sf	▼
Pricing	12-month overall rent % change	-23.7%	▼
	Class A overall asking rent	\$36.61 psf	▼
	Class B overall asking rent	\$26.30 psf	▼

### Net new supply, net absorption and total vacancy



### Leasing activity vs. sublease vacant space

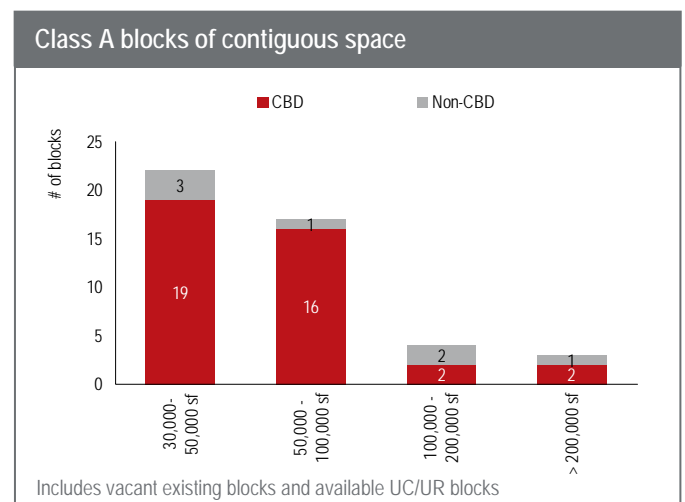
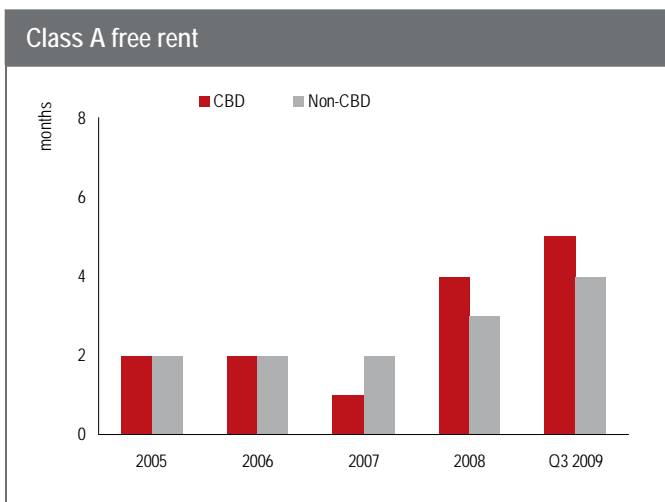
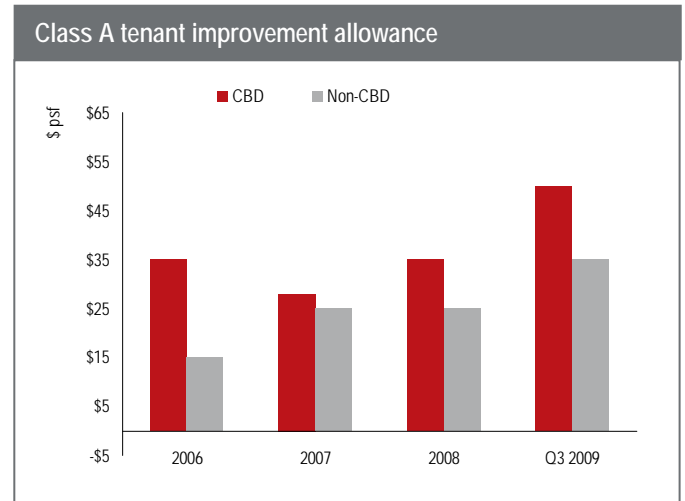
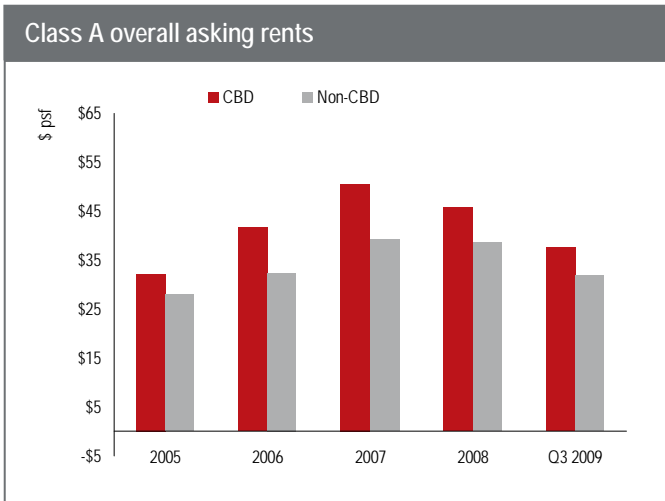


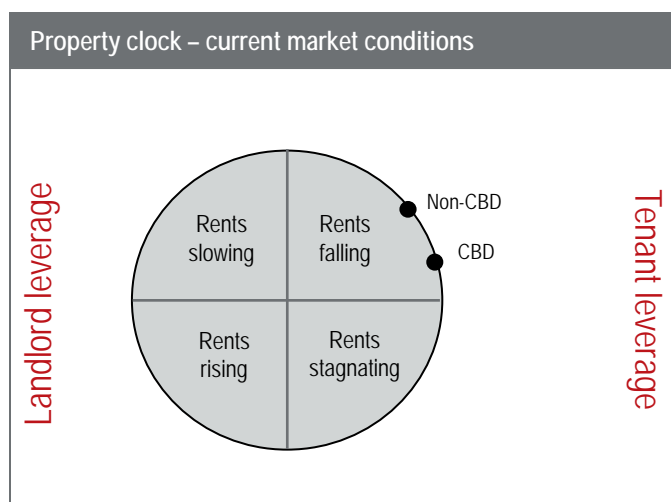
### Tenant perspective

Tenants continue to enjoy a favorable marketplace amidst further declines in market fundamentals. Rental rates in Class A buildings in the Central Business District have decreased by 23.6 percent since the third quarter of 2008 and competition among landlords has resulted in generous concessions packages for tenants. In addition, tenants also have a large supply of options to choose from. With more than 11 million square feet of vacant space on the market and 6.8 million square feet of that in Class A buildings, tenants have been given more bargaining power with landlords. Tenants looking to make a deal will continue to be met by favorable conditions while the market moves toward its bottom. As San Francisco and the country move into an economic recovery tenants will still be able to capture competitive lease terms until conditions in unemployment and consumer spending begin to strengthen.

### Landlord perspective

Landlords still face challenges in the current economic climate as they work to balance deteriorating fundamentals against the need to maintain their bottom line. With 1.7 million square feet of vacant sublease space on the market and total sublease availability at 2.3 million square feet, landlords must find ways to maintain a competitive edge. Aside from lowering rental rates, tenant improvement allowances have become increasingly more common and more generous, and some landlords have been assuming all of the risk by providing turnkey tenant improvements. Additionally, rent abatement has also become a steady trend among landlords. Tenants willing to sign long term leases have been granted rent abatement of up to one year, and shorter lease terms have been given between two and four months on average. The decline in the market may be slowing, but as long as vacancy rates remain high landlords will continue to be met with pressure from the market.





**Submarket leverage – market history and forecast**

Submarket	2007	2008	2009	2010	2011
CBD	Landlord-favorable conditions	Landlord-favorable conditions	Tenant-favorable conditions	Tenant-favorable conditions	Balanced conditions
Non-CBD	Landlord-favorable conditions	Landlord-favorable conditions	Tenant-favorable conditions	Tenant-favorable conditions	Balanced conditions

■ Landlord-favorable conditions   
 ■ Balanced conditions   
 ■ Tenant-favorable conditions

**Completed lease transactions**

Tenant	Address	Submarket	sf	Type
Brown & Toland	160 King Street	Rincon/South Beach	51,871	Renewal
Cisco	185 Berry Street	Mission Bay/China Basin	37,500	New
Silicon Valley Bank	555 Mission Street	South Financial District	35,274	New
RCM	555 Mission Street	South Financial District	35,150	New
24 Hour Fitness	100 California Street	North Financial District	29,776	Renewal
Kasowitz Benson Torres	101 California Street	North Financial District	25,037	New
Burrill & Company	1 Embarcadero Center	North Financial District	20,761	Renewal
LookSmart	55 Second Street	South Financial District	19,997	Sublease
MarkMonitor	303 Second Street	Rincon/South Beach	19,313	New

**Completed sale transactions**

Address	Submarket	Buyer / Seller	sf	\$ psf
250 Montgomery Street	North Financial District	Argonaut Capital/Realty Finance Corporation	116,078	\$171
562-566 Market Street	South Financial District	Chelsea Pacific Holdings LLC/Genaro Mendoza	64,955	\$142



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Julia Kilpatrick  
+1 415 354 6908  
Julia.Kilpatrick@am.jll.com

One Front Street  
Suite 300  
San Francisco, CA 94111  
+1 415 395 4900

[www.us.joneslanglasalle.com](http://www.us.joneslanglasalle.com)

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