

# StudleyReport

STUDLEY OFFICE MARKET AND SPACEDATA REPORT

## MARKET HIGHLIGHTS

### Leasing Activity Falls

Leasing activity retreated in the second quarter, down approximately 20% from the first quarter to 1.4 msf. On a trailing four-quarter basis, approximately 5.5 msf has been leased, up slightly from the previous quarter's trailing year total, but 31% below the market's historical average of 7.8 msf annually.

### Asking Rents Rise

Average asking rents increased for the first time in two years. While some landlords lowered rents in order to attract tenants and fill available space, other landlords appeared to anticipate a market recovery and attempted to push rents higher. Average asking rents increased 2.3% in the quarter, particularly in buildings South of Market with creative space layouts desired by technology companies, and in prime view space. Effective rents of completed leases, however, have yet to find traction in a market maintaining availability rates near all-time highs.

### Availability Stagnant

San Francisco's overall availability rate, 19.7%, fell just slightly from the previous quarter and remained near the all-time high of 20.2% reached one year ago. The Class A availability rate increased 0.3 pp in the second quarter and Class B availability rate declined 0.6 pp.

## Optimism Ahead of Reality, Except for SOMA/Technology Sector

The anticipation of a market recovery by bullish landlords and optimistic economists appeared to be ahead of reality in the second quarter of 2010. San Francisco's commercial real estate fundamentals remain weak, with total availability hovering just below 20%. Nearly 16 msf of office space is currently available for lease. Tenant demand has not turned a corner, despite marked improvement in other segments of the economy. The labor market, which is the forerunner of tenant demand, was hit particularly hard by the recession and is lagging behind the nation's broader economic recovery. Although improvements in the labor market have generated positive headlines recently, a full recuperation of jobs lost throughout the recession lingers in the distant future according to even the most optimistic forecasts.

Employment has increased by more than 1% since bottoming in January 2010, but remains 6.2% below its pre-recession peak in San Francisco County and 7.9% below its pre-recession peak in the metropolitan area (San Francisco, San Mateo and Marin Counties), according to the California Employment Development Department. Local employment within traditional office space using industries is faring even worse; it has fallen by 9.9% since the recession began, with losses continuing through June's employment situation release of May data.

The titans of San Francisco's tenant base – the legal, banking and insurance industries – continue to reduce their footprint in 2010. Expansion and start-up activity has been largely driven by technology firms like Salesforce.com, and particularly "Web 2.0" social networking companies such as Yelp and Twitter, a bright spot in the local economy. One out of every five tenants seeking space in the market is technology-based, and their requirements total 1.5 msf. These innovative companies have been increasingly attracted to the young and creative labor force in San Francisco and the limited inventory of creative space buildings south of Market Street. Available space in the SOMA submarket is in short supply and in many cases asking rents have surpassed those in the financial district. However, despite green shoots from these technology firms and some healthcare companies, weak overall tenant demand prevails in the broad San Francisco marketplace.

Almost one-third of NYSE Euronext CEO Report 2010 respondents do not believe that a full job recovery is going to occur until 2014 or later. Similarly, economic research companies Moody's economy.com and Beacon Economics, as well as the Association of Bay Area Governments, are in

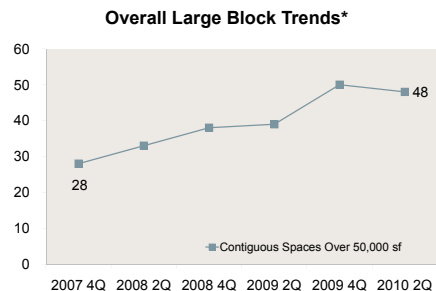
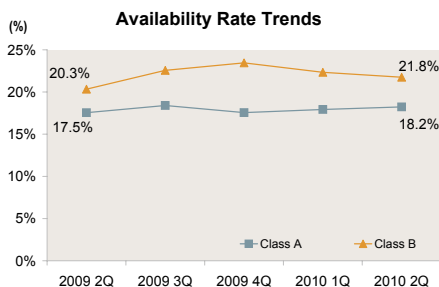
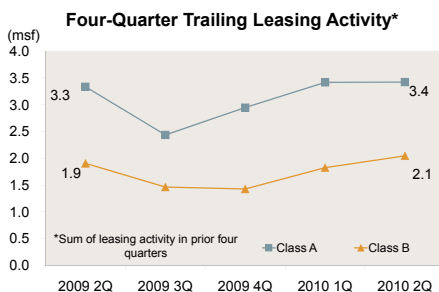
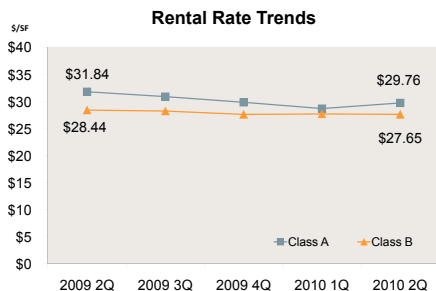
### SAN FRANCISCO CBD TRANSACTION BAROMETER

	Under 50,000 sf	One Qtr Change	Over 50,000 sf	One Qtr Change
<b>Average Term:</b>	5 years	◀▶	10 years	◀▶
<b>Concessions:</b>				
Free Rent	4 months	◀▶	10 months	◀▶
Tenant Improvements	\$35.00/sf	◀▶	\$60.00/sf	◀▶
Moving allowance	\$2.00/sf	◀▶	\$2.00/sf	◀▶
<b>Outlook:</b>	Until we see availability rates decrease significantly quarter after quarter, rents and landlord leverage should not increase.			

### EAST BAY TRANSACTION BAROMETER

	Under 50,000 sf	One Qtr Change	Over 50,000 sf	One Qtr Change
<b>Average Term:</b>	5 years	◀▶	7 years	◀▶
<b>Concessions:</b>				
Free Rent	7 months	◀▶	9 months	◀▶
Tenant Improvements	\$30.00/sf	◀▶	\$45.00/sf	◀▶
Parking/Other	some	◀▶	some	◀▶
<b>Outlook:</b>	Based on building supply additions and employment projections, the East Bay market is expected to recover later than San Francisco.			

▲ Up ▼ Down ◀▶ Unchanged



agreement that it will be four to five years before San Francisco reaches pre-recessionary levels of employment. Slow growth is the forecast for the next couple of years.

Without robust job growth, it is hard to imagine tenants absorbing the vast amount of available space in the market. Therefore, availability rates are not predicted to fall significantly in the near term. Until availability rates fall quarter after quarter, signifying the trend of a tightening market, landlords will have little justification to increase rental rates.

Availability, on a square footage and percentage of inventory basis, has essentially equaled that of the previous market downturn. Rents, however, have not retreated to their previous lows. In fact, current asking rents are approximately 20% higher than they were following the dot-com bust. As a benchmark, rent stabilized for approximately three years after freefalling in response to the dot-com bust and did not move higher again until market availability fell below 15%. Landlord attempts to raise rental rates at this juncture in the real estate cycle and ailing economy have little justification, but such attempts have occurred. Average asking rents rose by 2.3% in the second quarter to \$29.00. Specifically among Class A buildings, asking rent rose by 3.6% in the quarter to \$29.76, full service. This is the first asking rent increase since the recession began two years ago. Aggressive landlords are hyping up a market comeback that is not materializing. A few smaller-sized deals have achieved higher rents, but effective rents on the bulk of completed leases in the second quarter accurately reflect tenant-favorable market dynamics.

Landlords are structuring deals with high face rents in order to maintain loan payments and building values when re-capitalization or disposition plans are on the horizon. Heavy concession packages are being offered to offset higher face rates. Concessions have driven down net effective rents. Tenants are taking advantage of favorable market conditions by securing monetary allowances for space improvements and significant periods of free rent, or by moving up in space quality without incurring higher costs.

The recession's impact on commercial real estate has created a ripe opportunity for tenants. Business leaders are faced with opportunities to capitalize on the down market by securing markedly discounted rents, but must pay heed to the financial stability and vulnerability of new potential landlords. Many owners are in jeopardy of losing buildings. Banks are saddled with delinquent loans. The CMBS delinquency rate jumped 40 basis points in May to 8.4%, according to research firm Trepp, which does not expect the default rate on CMBS loans to peak until mid-2011. Trepp also expects the percentage of CMBS loans in special servicing to continue rising from 11.7% through May to as high as 20%.

It is paramount for tenants to research and analyze the ownership structure of buildings in today's environment, where building operational control is volatile. Understanding the landlord's cost basis, debt structure, debt service coverage ratio and payment history, as well as exposure to existing tenant rollover, can impart critical negotiating leverage to prospective tenants. Furthermore, tenants would be wise to steer clear of building owners at risk of non-performance, and to secure non-disturbance clauses when possible.

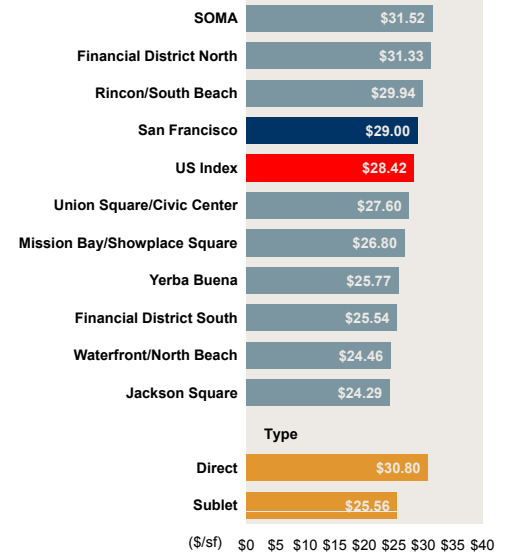
## MAJOR TRANSACTIONS

Tenant	Sq Feet	Address	Market Area
Morrison & Foerster LLP	275,000	425 Market St	Financial District South
Salesforce.com	226,000	The Landmark @ One Market	Financial District South
Latham & Watkins	117,133	505 Montgomery St	Financial District North
IRS	72,736	100 1st St	Financial District South
Goldman Sachs	67,000	555 California St	Financial District North
Woodruff Sawyer	56,613	50 California St	Financial District North
Bayer Healthcare	50,000	455 Mission Bay Blvd S	Mission Bay/Showplace Square
Conifer Securities	47,935	1 Ferry Building	Financial District North
US SEC	43,900	44 Montgomery St	Financial District North
Regus Business Centers	43,094	1 Market St - Spear Tower	Financial District South
Ubisoft	42,429	625 Third St	Rincon/South Beach
Baker & McKenzie LLP	40,597	2 Embarcadero Ctr	Financial District North
Schiff Hardin LLP	38,300	1 Market St - Spear Tower	Financial District South
The Trust for Public Land	33,119	101 Montgomery St	Financial District North
Trulia	31,748	116 New Montgomery St	Financial District South
<b>Sum of Top 15 Leases</b>	<b>1,185,604</b>		

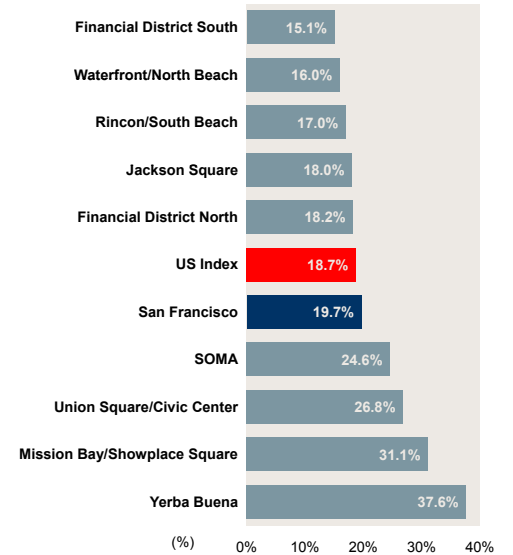
## Market Forecast

The economy is on a growth path, but one that is protracted and propped up by government spending. Businesses are expected to bolster work forces modestly as the economy recovers. However important, this positive employment trend will not translate into an immediate upswing for commercial real estate markets. Because by its very nature the office space market trails economic momentum, it still has a bit of deterioration to work through yet. For example, the trend of major tenants downsizing out of excess space has yet to conclude. Bank of America and Barclays unloaded several floors each in the second quarter, offering them for sublease. Additionally, Morrison & Foerster and Deloitte & Touche downsized significantly as part of their renewal transactions, giving up multiple floors each. Looking forward, leasing activity will stem from renewals and tenants playing musical chairs, with few expansions or new-to-market move-ins. Availability will remain high. Until we see three consecutive quarters of positive absorption, tenants will maintain the upper hand in San Francisco's office market, and particularly in the financial district.

## Overall Rental Rate Comparison



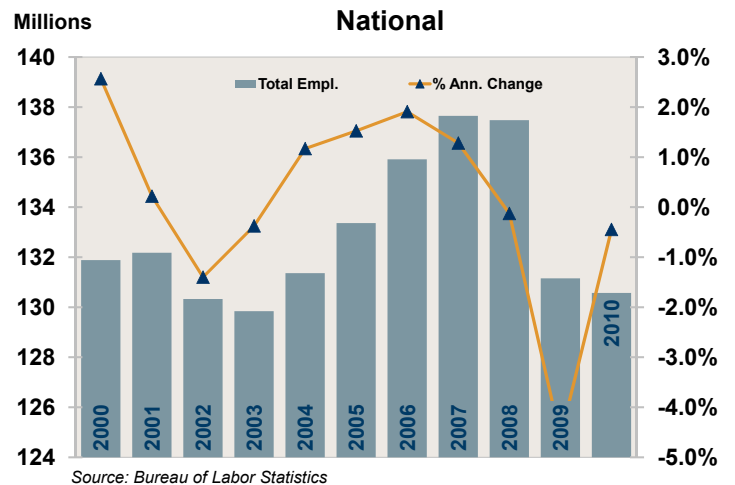
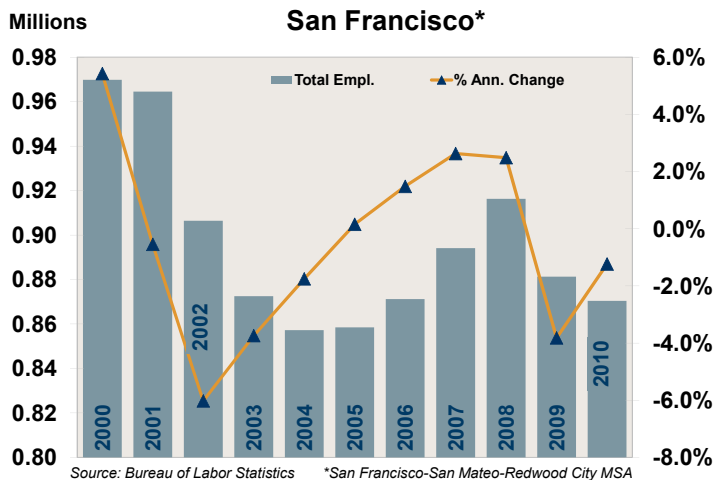
## Availability Rate Comparison



## ABOUT OUR FIRM

**Studley** is the only global tenant advisory firm with a pure tenant representative delivery platform. Founded in 1954, Studley pioneered this conflict-free business model. Today, with 19 offices nationwide and an international presence through its London office and AOS Studley throughout Europe, Studley provides strategic real estate consulting services to top-tier corporations, law firms, nonprofits, government agencies and institutions of higher education. Information about Studley is available at [www.studley.com](http://www.studley.com).

## EMPLOYMENT TRENDS

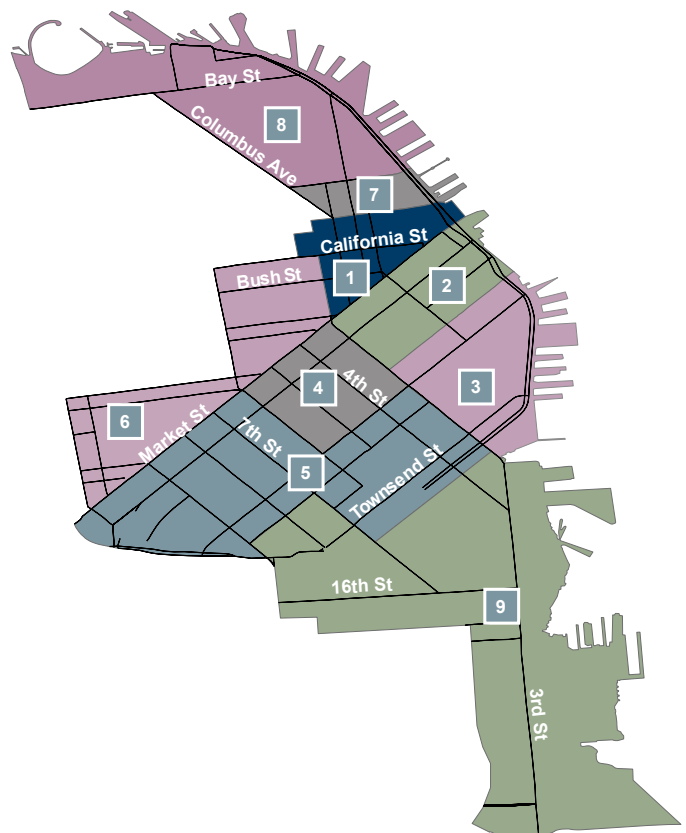


MARKET SNAPSHOT: 2Q 2010

MAP	SUBMARKET	TOTAL	LEASING	AVAILABLE SF			AVAILABILITY RATE			ASKING RENTS PER SF		
		Inventory SF (1,000's)	Last 12 Mos	This Qtr	% Change from Last Qtr	Yr Ago	This Qtr	pp Change from Last Qtr <sup>(1)</sup>	Yr Ago	This Qtr	% Change from Last Qtr	Yr Ago
1	<b>Financial District North</b>	29,118	2,339	5,307	3.1%	5,536	18.2%	0.5%	18.9%	\$31.33	8.7%	\$30.45
	Financial District North - Class A	20,379	1,659	3,940	3.6%	3,924	19.3%	0.6%	19.3%	\$32.15	9.2%	\$30.82
2	<b>Financial District South</b>	23,773	1,241	3,580	-3.6%	3,472	15.1%	-0.6%	14.3%	\$25.54	-4.8%	\$32.99
	Financial District South - Class A	19,055	1,022	2,624	-4.2%	2,551	13.8%	-0.6%	13.4%	\$26.01	-5.3%	\$34.00
3	<b>Rincon/South Beach</b>	4,142	297	704	3.0%	759	17.0%	0.8%	17.7%	\$29.94	10.5%	\$29.28
	Rincon/South Beach - Class A	1,544	164	254	26.9%	238	16.5%	3.5%	15.2%	\$30.56	-0.5%	N/A
4	<b>Yerba Buena</b>	3,333	300	1,254	-1.6%	989	37.6%	-0.6%	26.2%	\$25.77	-2.2%	\$24.57
	Yerba Buena - Class A	690	36	504	1.3%	526	73.0%	0.9%	76.1%	\$28.95	0.1%	N/A
5	<b>SOMA</b>	4,741	154	1,164	-3.5%	1,145	24.6%	-0.9%	23.3%	\$31.52	0.1%	\$31.50
	SOMA - Class A	1,855	0	23	0.0%	26	1.3%	0.0%	1.4%	\$33.00	3.5%	\$31.87
6	<b>Union Square/Civic Center</b>	4,924	175	1,319	-3.4%	1,265	26.8%	-0.5%	25.6%	\$27.60	1.0%	\$29.64
	Union Square/Civic Center - Class A	502	8	150	4.5%	130	29.8%	1.3%	25.8%	\$31.12	N/A	\$31.54
7	<b>Jackson Square</b>	2,032	224	366	12.3%	354	18.0%	2.2%	17.1%	\$24.29	-0.6%	\$25.69
	Jackson Square - Class A	326	0	0	N/A	0	0.0%	0.0%	5.9%	N/A	N/A	N/A
8	<b>Waterfront/North Beach</b>	3,649	595	583	3.8%	510	16.0%	0.6%	14.2%	\$24.46	6.1%	\$23.30
	Waterfront/North Beach - Class A	912	414	234	78.6%	103	25.6%	11.3%	14.3%	\$28.44	8.1%	\$26.22
9	<b>Mission Bay/Showplace Square</b>	5,385	146	1,672	-4.2%	1,421	31.1%	-1.4%	25.9%	\$26.80	12.3%	\$28.40
	Mission Bay/Showplace Square - Class A	2,863	39	1,046	-3.6%	876	36.5%	-1.4%	30.7%	\$35.00	0.0%	\$30.45
1-9	<b>SAN FRANCISCO TOTAL</b>	81,097	5,470	15,948	-0.5%	15,452	19.7%	-0.1%	18.7%	\$29.00	2.3%	\$30.53
	SAN FRANCISCO TOTAL - Class A	48,126	3,424	8,775	1.8%	8,392	18.2%	0.3%	17.5%	\$29.76	3.6%	\$31.84

(1) Percentage point change for availability rates. Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf. Statistics are calculated using both direct and sublease information. Recent inventory adjustments may have contributed to statistical fluctuations in some submarkets.

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SAN FRANCISCO CONTACTS

150 California Street, 14<sup>th</sup> Floor  
 San Francisco, CA 94111  
 (415) 421-5900

**Branch Manager**  
 Steve Barker - Executive Vice President  
 sbarker@studley.com  
 License 01165044

California Corporate License 00388260