



The Axiant Group

COMMERCIAL REAL ESTATE SERVICES



# Market Overview

A quarterly publication of the San Francisco office market by The Axiant Group

1st Quarter 2009

## Space Continues to Deluge Market

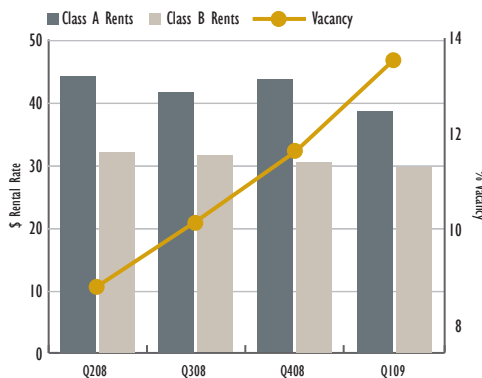
In the 1st quarter, new blocks of space continued to come on the market. Negative absorption continues to increase. Subleases are being marketed very aggressively as sublessors try to lead the market, instead of follow it. A lack of activity in the market has pushed building owners to drop rates and increase incentives for potential Tenants.

## Negative Absorption Increases From 4th Quarter

Office vacancy in San Francisco's Financial Core increased from 11.6% in the 4th quarter 2008 to 13.6 % in the 1st quarter 2009. Gross leasing activity was down to 629,697 square feet in the 1st quarter from 706,861 square feet in the 4th quarter. Net absorption was negative, more than doubling to over 919,943 square feet, compared to 400,293 square feet of negative absorption in the 4th quarter.

Class A asking rental rates declined significantly. Rates decreased from \$42.37 in the 4th quarter to \$39.38 in the 1st quarter, a drop of more than 7%. Class B financial core rental rates also moved downward, with asking rates decreasing from \$32.41 to \$31.57.

SAN FRANCISCO FINANCIAL CORE



## Large Blocks Of Sublet Space Available

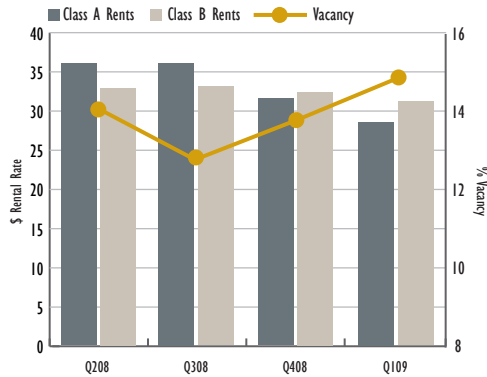
Large blocks of sublease space continued to pour into market in the first quarter. Charles Schwab is subleasing over 400,000 square feet at 120 Kearny Street, also known as One Montgomery Street. The financial service firms are

suffering in this economy, but the retail companies have been hit even harder, with consumers holding back on purchases. Macy's, a major retail force in San Francisco, and nationally, closed their west coast offices. The layoffs affected over 7,000 employees, adding over 160,000 square feet of sublet space to the San Francisco market at 22 Fourth Street. We are also seeing space come back from the legal community, Thelen LLP a firm with over 80 years of history in San Francisco and Heller Erhman, the oldest firm in San Francisco dissolved after residing in San Francisco for 118 years. Combined, these two firms put over 500,000 square feet of additional direct space on the market. The space came back on as direct space because both firms handed the keys back to their respective landlords, walking away from their leases. Neither firm had personally guaranteed the lease. Heller Ehrman occupied 333 Bush Street, which is owned by Hines and Sterling American Property and is rumored to be close to foreclosure as a result of the firm vacating the building.

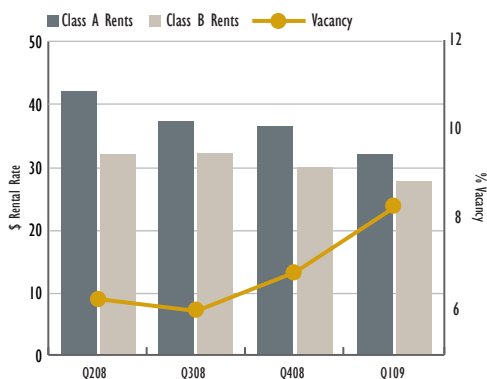
## Supply And Demand

Traditional real estate cycles demonstrate that when supply goes up rental rates come down. The first real estate market to be affected in a down economic cycle is sublet space. Sub-Landlords have less flexibility in what they can offer tenants, in length of term and available capital for improvements. This lack of flexibility forces them to discount the value of the space to compete with space being offered by landlords on a direct basis. We are currently seeing rental rates decline rapidly for sublet space all across the market, due to large blocks sublease space coming available and a lack of tenant demand. Vacancy rates for direct space have been increasing and rental rates dropping as well, although on percentage basis rental rates have not dropped as quickly as the sublet market. While it is typical for the direct market to lag somewhat behind the sublet market, for the reasons mentioned above, there may be some additional reasons. Seventy-five percent of the office buildings in downtown San Francisco have traded hands over the past five years. Because these sales were at the top of the market, many new landlords are unwilling to sign deals at rental rates which are in many cases half of what they originally promised their investors. We are now seeing buildings of similar quality quote dramatically different rental rates as some landlords refuse to face market realities.

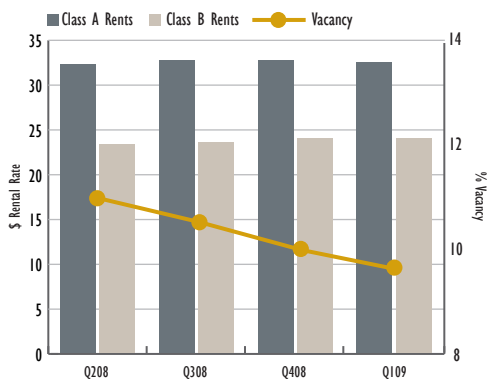
**SAN FRANCISCO SOMA**



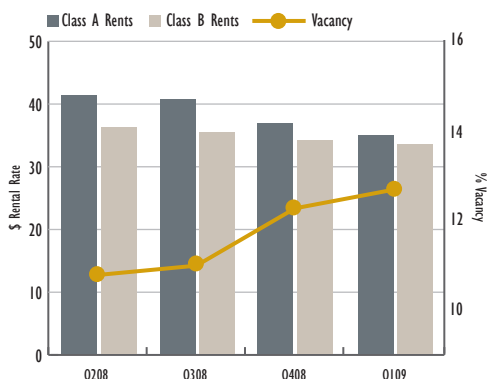
**SAN FRANCISCO NORTH WATERFRONT**



**OAKLAND**



**PENINSULA**



**Where's the Space?**

Submarket	Direct SF	Vacancy (direct)	Sublet SF	Vacancy (sublet)	Total SF	Vacancy (Total)
Top 10 Buildings	685,663	7.50%	170,808	1.90%	856,471	9.40%
Fin. Dist. A	3,904,496	9.90%	917,912	2.40%	4,822,408	12.30%
Fin. Dist. B	2,025,275	14.10%	92,843	0.60%	2,118,118	14.80%
SOMA A	248,687	5.10%	76,014	1.60%	324,701	6.70%
SOMA B	2,168,018	17.60%	65,479	0.50%	2,233,497	18.10%

**Large Tenants in the Market**

Tenant	Sq. Ft.
EPA	290,000
Latham Watkins	150,000
Reed Smith LLP	100,000
Bay Area Air Quality Mgmt District	70,000
Foley & Lardner LLP	50,000

**Significant Leases Completed Second Quarter 2008**

Tenant	Sq. Ft.	Address
Fox Interactive Media	70,000	625 Second Street
Duane Morris LLP (R)	50,000	One Market Plaza
Art Institute of California	37,102	1170 Market Street
Textainer (R)	23,111	650 California Street
Horsley Bridge (R)	21,000	505 Montgomery Street
Archimedes	15,744	201 Mission Street



**The Axiant Group Can Help You**

Do you want information about rents and space available in your building? Are you interested in subleasing or terminating your lease? Is your lease expiring in the next three years?

Contact The Axiant Group. We have handled transactions from 1,000 to 1,000,000 sq.ft. in the Bay Area and throughout the U.S. The average tenure of our brokers is over 20 years. We have handled assignments for clients including Chevron U.S.A., Coblenz, Patch, Duffy & Bass, Oracle Corporation, PG&E, Sutro & Company, Zurich Scudder Investments, Charles Schwab, Texas Pacific Group, Club One, Moss Adams, and many others.