

What are San Francisco Office Market Conditions?

- Vacancy Rates: Over 20%, more than 17 million square feet.
- Rental Rates: Below half of their peak reached in 2000. Good space in good buildings can be had for rents in the \$20's per square foot; premium space in the \$30's; and super-premium space in the \$40's.
- Absorption: Occupancy declined sharply during each of the last eight quarters, and dropped by another 500,000 square feet in the third quarter of 2002.

What Caused these Market Conditions?

A steep decline in employment in San Francisco. While the exact number is unknown, San Francisco may have lost as many as 40,000 jobs in the last two years.

Is This Fall-out from the "dot com" Bubble?

We are long past the dot com bubble for the most part. At the end of 1998, 74.4 million feet of office space were occupied. The dot com bubble then caused occupancy to surge more than 5 million feet; occupancy peaked in Q1 2000 at 79 million feet. 12 million feet have been put back on the market since that peak; occupancy now stands at about 66.8 million feet. Put another way, San Francisco businesses now occupy 7.6 million fewer feet than at the end of 1998, before the bubble.

The demise of Arthur Andersen & Co. and Robertson, Stephens & Co. contributed to the 500,000 s.f. negative absorption sustained in Q3 2002. Many other non-dot com companies have also reduced their San Francisco headcounts, including Schwab and Bank of America.

What is the Rental Rate Trend?

After falling by more than half, rents are still declining, but more slowly. Rents appear to be approaching a leveling-off point.

With an Unprecedented 17 Million Feet Available, Why are Rents Starting to Level Off?

There are several theories attempting to explain this phenomenon: increased transaction volume of late; relatively low (10-13%) vacancy for direct (not sublease) space in Class "A" buildings in the Financial District; willingness of some landlords to let space sit vacant rather than lock in a long-term lease at today's low rates; and the fact that when today's higher expenses and taxes are backed out of gross rents, the remaining "net" rents are nearly comparable to the net rents experienced at the depths of the early 1990's real estate recession.

While I acknowledge the leveling off, I am not fully convinced that this trend is here to stay. I expect rents to keep drifting lower, at least until San Francisco's job base stops shrinking.

Is This a Good Time to Buy a Building?

Perhaps soon. There have been very few distress sales in San Francisco so far this cycle; that may change next year, particularly outside of the Central Business District. Purchase prices have not fallen nearly as much as rental rates, so today's purchase prices are not supported by today's rents. Prices have been propped up by a scarcity of product for sale, coupled with great demand on the part of would-be buyers, including some seeking to diversity out of the stock market.



**SAN FRANCISCO CENTRAL BUSINESS DISTRICT
3rd QUARTER, 2002**

Submarket:	Direct Vacancy		Sublease Vacancy		Total Vacancy		Change in Total Vacancy Since Last Qtr (Q2 2002):		Change in Total Vacancy Since One Year Ago (Q3 2001):		Net Absorption (Change in Occupancy) Q3 2002:
	Sq. Ft.	%	Sq. Ft.	%	Sq. Ft.	%	Sq. Ft.	%	Sq. Ft.	%	Sq. Ft.
North Financial District											
Class A 21,027,395 s.f.	2,247,947	10.7%	2,016,028	9.6%	4,263,975	20.3%	up 383,630	+ 1.8%	up 1,763,084	+ 8.4%	Neg -383,630
Class B 6,163,969 s.f.	826,646	13.4%	468,400	7.6%	1,295,046	21.0%	up 63,912	+ 1.0%	up 327,442	+ 5.3%	Neg -63,912
Subtotal: 27,191,364 s.f.	3,074,593	11.3%	2,484,428	9.1%	5,559,021	20.4%	up 447,542	+ 1.6%	up 2,090,526	+ 7.6%	Neg -447,542
South Financial District											
Class A 18,822,816 s.f.	2,385,681	12.7%	1,359,000	7.2%	3,744,681	19.9%	up 569,879	+ 2.6%	up 1,725,392	+ 8.9%	Neg -86,979
Class B 3,504,579 s.f.	408,668	11.7%	101,582	2.9%	510,250	14.6%	up 101,325	+ 2.9%	up 195,066	+ 5.6%	Neg -101,325
Subtotal: 22,327,395 s.f.	2,794,349	12.5%	1,460,582	6.5%	4,254,931	19.1%	up 671,204	+ 2.7%	up 1,920,458	+ 8.4%	Neg -188,304
Jackson Square/North Waterfront											
Subtotal: 6,736,609 s.f.	884,407	13.1%	308,366	4.6%	1,192,773	17.7%	dn 108,754	- 1.6%	up 304,597	+ 4.5%	Pos +108,754
Union Square											
Subtotal: 4,917,807 s.f.	489,478	10.0%	92,117	1.9%	581,595	11.8%	up 31,515	+ 0.6%	up 140,553	+2.8%	Neg -31,515
Yerba Buena											
Subtotal: 3,794,953 s.f.	624,254	16.4%	263,289	6.9%	887,543	23.4%	up 11,939	+ 0.3%	up 249,687	+ 6.6%	Neg -11,939
South Beach/Rincon Hill/SOMA											
Subtotal: 9,145,937 s.f.	3,430,676	17.9%	1,443,109	7.5%	4,873,785	25.5%	dn 5,419	0.0%	up 1,334,282	+ 6.6%	Pos + 5,419
All San Francisco CBD Markets											
Total: 84,114,065 s.f.	11,297,757	13.4%	6,051,891	7.2%	17,349,648	20.6%	up 1,048,027	+ 1.1%	up 6,040,103	+ 7.0%	Neg -565,127

Frank Fudem specializes in representing corporate tenants in office space transactions including relocations, lease renewals, and consulting. One of San Francisco's top brokers since 1984, he has represented local and national tenants in millions of square feet of successful negotiations.

Personal Mission Statement: Increase my clients' success via real estate expertise.

BT Commercial Real Estate is the largest brokerage focusing exclusively on Northern California: BT Commercial has 130 agents in nine offices serving San Francisco, the Peninsula, Marin, and the East Bay. BT has consummated more than \$18 Billion of real estate transactions.

If you foresee a real estate need, or if you would like more information on Bay Area or San Francisco commercial real estate, please call, write, or email:

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