

Market Bifurcation:

A New York investment banker who specializes in real estate recently called to ask, "What's going on in San Francisco? We're hearing two completely different stories here in New York." That's because there are two different stories: The market has become bifurcated as illustrated by the following two surveys of office space currently available in San Francisco:

	SURVEY #1	SURVEY #2
<i>GEOGRAPHICAL AREA:</i>	Central Business District (CBD), comprising 82 million square feet	Financial District Only, comprising 25.7 Million Square Feet (Financial District is part of CBD)
<i>TYPE OF SPACE SURVEYED:</i>	Class A, B + C Buildings; Direct leases and Subleases	Class A Buildings only; Direct leases only (no subleases)
<i>SQUARE FEET AVAILABLE:</i>	9.9 Million Square Feet	1.4 Million Square Feet
<i>VACANCY RATE:</i>	12.1%	5.2%

Depending on how one looks at this market, vacancies could be 5.2% or 12.1%. San Francisco has two very different kinds of landlords, with very different levels of motivation. Consequently, the rent differential between properties in Survey #1 and those in Survey #2 could be \$25/square foot or more!

Many landlords and sublandlords in Survey #1 are extremely motivated to generate income on vacant space, and rental rates have dropped sharply.

Rents have dropped in Survey #2 properties as well, but nowhere near as sharply as in Survey #1. Some Survey #2 landlords accurately point out that some of the 9 million feet available in Survey #1 is comprised of short-term (2 to 4 year) sublease space, or is in Class B or C space, or is outside of the traditional business district, and is therefore not fully comparable to Class A direct space. Some of these landlords hope the sublease space will soon be absorbed after which they can resume leasing space at premium rates. Furthermore, some of the relatively few lease transactions which were consummated during the first half of 2001

carried astonishingly high rental rates. (Some of these were the result of tenants exercising options to renew- please see enclosed).

Some Survey #2 landlords have, at least so far, maintained high rates and in some cases have elected to forego leasing vacant space in order to continue to refrain from lowering rents too far.

This market reminds me of 1996, when the market was similarly bifurcated. For example, one of San Francisco's largest law firms occupied space at 345 California Street, a trophy building in the heart of the Financial District which commanded premium rates. The landlord of 425 Market (a good building in a good location- not quite as prestigious as 345 Cal, but still good) offered the law firm a much better deal to relocate. The difference in rent was so compelling that the law firm moved.

For the first time in five years, market conditions make it worthwhile for some tenants to relocate within San Francisco, purely on the basis of the rent savings to be had in buildings with highly motivated landlords.

San Francisco

2nd Quarter 2001

Vacancy Rates and Asking Rental Rates

Submarkets	Vacancy Rates			Asking Rental Rates		
	2Q 2001	last 90 days	last 12 months	2Q 2001	last 90 days	last 12 months
North Financial						
<i>Direct</i>	5.3%	up 1.4%	up 3.3%			
<i>Sublease</i>	4.4%	up 1.2%	up 4.0%			
<i>Subtotal</i>	9.7%	up 2.6%	up 7.3%	\$45.43	down \$11.75	down \$26.23
South Financial						
<i>Direct</i>	5.3%	up 0.9%	up 4.3%			
<i>Sublease</i>	5.3%	up 1.8%	up 4.3%			
<i>Subtotal</i>	10.6%	up 2.7%	up 8.6%	\$43.22	down \$9.74	down \$30.80
Jackson Sq./ N. Waterfront						
<i>Direct</i>	5.9%	up 0.5%	up 5.2%			
<i>Sublease</i>	4.3%	up 0.8%	up 4.1%			
<i>Subtotal</i>	10.2%	up 1.3%	up 9.3%	\$40.78	down \$14.72	down \$27.19
S.Beach/Rincon/SOMA						
<i>Direct</i>	8.4%	up 2.8%	up 4.9%			
<i>Sublease</i>	4.7%	up 1.0%	up 4.0%			
<i>Subtotal</i>	13.1%	up 3.8%	up 8.9%	\$28.99	down \$8.92	down \$32.91
Union Square						
<i>Direct</i>	9.8%	up 2.1%	up 7.0%			
<i>Sublease</i>	2.3%	down 1.1%	up 2.0%			
<i>Subtotal</i>	12.1%	up 1.0%	up 9.0%	\$35.87	down \$11.44	down \$20.32
Yerba Buena						
<i>Direct</i>	9.9%	up 2.5%	up 6.0%			
<i>Sublease</i>	5.4%	up 2.8%	up 4.6%			
<i>Subtotal</i>	15.3%	up 5.3%	up 10.6%	\$29.28	down \$13.64	down \$23.26
San Francisco CBD Totals						
<i>Direct</i>	7.4%	up 1.4%	up 5.3%			
<i>Sublease</i>	4.7%	up 1.4%	up 4.1%			
Total	12.1%	up 2.8%	up 9.4%	\$37.87	down \$9.62	down \$28.39

Frank Fudem's Corporate Real Estate Letter is a complimentary periodic commentary on the San Francisco office market. If anyone else in your organization would like to receive future editions of this letter at no charge, please call, write, or email their names and addresses to: Frank Fudem.

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 by real estate expertise.

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