

# OFFICE MARKET REPORT 4th Quarter 2006

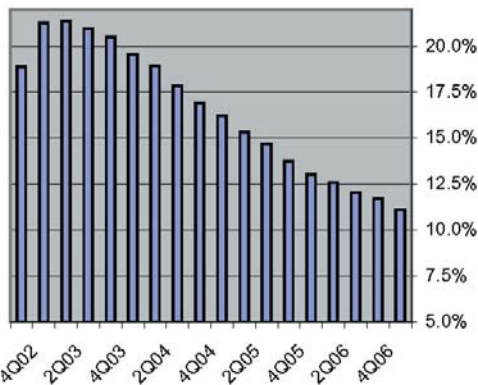
## San Francisco Market Overview

The technology sector, along with existing tenant expansions and renewals accounted for the majority of 4Q06's leasing activity. As a result, San Francisco's vacancy rate continued its steady decline, dropping from 11.7% to 10.98%. This represented the 7th consecutive quarter of declining vacancy.

San Francisco absorbed another 347,613 sq.ft. in 4Q06, for an annual total of 1,200,292 sq.ft in net absorption. Though down from the 2005 absorption total of 1,690,283 sq.ft., 2006's absorption total nonetheless represents a strong year for San Francisco's office leasing market.

Moreover, San Francisco's unemployment rate decreased from 4.5% to 3.8%, the city's lowest unemployment rate since the dot-com era. The resurgent tech sector, along with professional and business firms, accounted for the majority of the 2,800 new jobs. This demand created a tighter office market in the Bay Area and affected vacancy rates dramatically. Current asking rates for Class A space rose to \$39.37 per square foot, and Class B space climbed to asking rents at around \$30.97 per square foot.

San Francisco Vacancy 2002 - 2006



### CBD OFFICE LEASING MARKET

Class A view space commanded rents as high as the mid to high \$70's, and in the early part of the 1Q2007 there were a few deals inked in the low \$80's a foot. These numbers are interesting because these high rents were similar to the rent numbers achieved in the same buildings in 1999/2000, during the height of the dot-com era. With top tier view space scarce, the majority of the CBD leasing activity took place in Class A commodity space and in Class B buildings.

Consequently, the Class A average remained steady while Class B rates increased significantly as tenants sought less expensive options.

Large blocks of space citywide are getting harder to come by. Some notable deals along these lines are Pay By Touch's 93,000 sq. ft. and Accenture's 43,000 sq. ft deals at 560 Mission Street, effectively deleting 136,000 sq. ft of space, one of the largest South Financial District blocks, that were on the market. Another testament to the desirability of San Francisco is Santa Clara based Google Inc.'s lease for 210,000 sq. ft at Hills Plaza, which has not been signed yet, but is close to a deal. With several requirements still out in the marketplace, this should dramatically affect vacancy rates in 2007, as these requirements slowly eliminate big blocks of space as the year progresses.

### 4Q06 Significant Lease Transactions

Building	Tenant	Submarket	Sq. Ft.	Type
One Post St.	McKesson	Financial District	258,809	Direct lease
101 Spear St.	AIG	South Financial District	140,000	Renew/ Exp
560 Mission St.	Pay by Touch	South Financial District	93,000	Sublease
405 Howard St.	Barclays Global Investors	South Financial District	85,439	Direct lease
835 Market St.	Microsoft Corporation	Yerba Buena	71,614	Direct lease
199 Fremont St.	Riverbed Technology	South Financial District	58,000	Sublease
425 Market St.	Sephora	South Financial District	58,000	Direct lease
525 Market St.	DFS Group Ltd. - San Francisco	South Financial District	57,350	Expansion
45 Fremont St.	Wells Fargo	South Financial District	55,707	Expansion

## Investment Market Analysis

4Q06 capped off an exceedingly hot year for San Francisco office sales, with \$3.8 Billion in office property investment sales. Foreign and institutional investors continue to compete for a limited supply of San Francisco office properties. This bodes tough for tenants, as landlords will attempt to push rents higher in order to justify prices now in excess of \$400 per square foot for Class A buildings, as evidenced by recent sales of two buildings: 180 Montgomery St. and 250 Montgomery St.

A division of Principal Global Investors acquired 333 Market Street in San Francisco for \$370 million, which represents about \$587 per square foot. Another major Class A building deal with nearly 630,000 rsf, the MetLife's acquisition of 425 Market Street closed last year. They will now own the entire building.

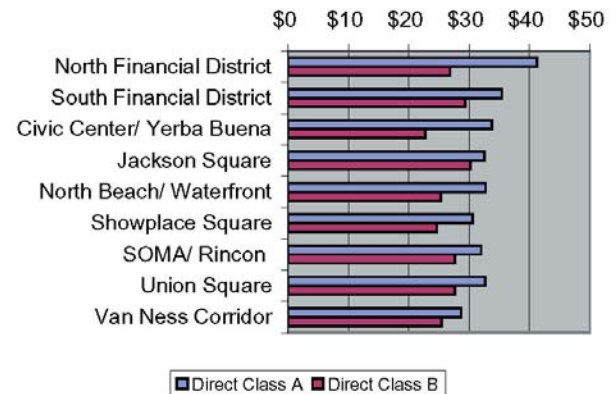
## 4Q06 Office Leasing Forecast

The year 2006 was a very good one; San Francisco ended with the lowest office vacancy rate throughout the country, a net absorption of 1.2 million sq. ft with 5% increase in overall San Francisco rental rates. With new office supply and strong activity level, the overall market is expected to continue to remain strong with more positive performance in 2007. However, it is important to consider that high tenant improvement costs may discourage large tenant relocations.

4Q06 Significant Sale Transactions

Building	Class	Buyer	Submarket	Sales Price	Price/ Sq.Ft
333 Market St.	A	Principal Global Investors	South Financial District	\$332,000,000	\$536
425 Market St.	A	MetLife Insurance Group	South Financial District	\$283,079,000	\$426
201 3rd St.	A	ADCO	South Financial District	\$86,150,208	\$268
250 Montgomery	A	Lincoln Properties	North Financial	\$47,000,000	\$420
760 Market St.	B	Westcore Properties	Union Square	\$74,737,000	\$279
795 Folsom St.	B	Westcore Properties	Yerba Buena	\$51,263,000	\$279
410 Townsend	B	PMI Properties	SOMA	\$17,200,000	\$233

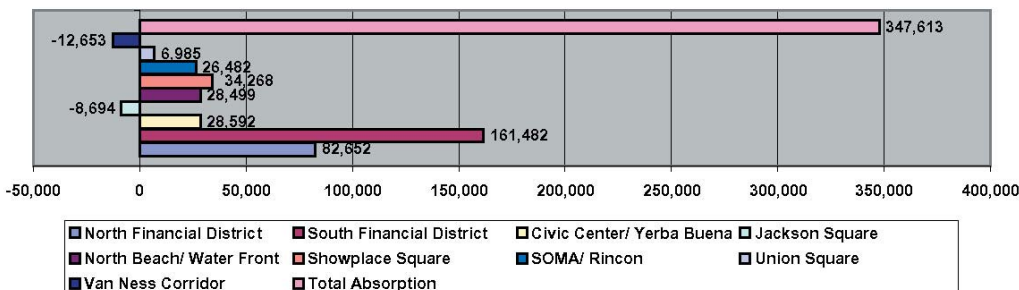
4Q06 Rental Rates by Submarket



## 1Q2007 Office Market Forecast

The continuing rise in rents and increased demand is producing a surge in new office construction. Tishman-Speyer has broken ground on 555 Mission St. without an anchor tenant, the first spec construction office building since the dot-com crash. In addition, several large developers are taking advantage of San Francisco's new LEED certification program— a policy that encourages “green” construction by fast-tracking the entitlement process. An entitlement process that once took 18 months can now be processed in a much shorter period of time.

Quarterly Absorption by Submarket (sq. ft.)



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