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2009

TRI Commercial SAN FRANCISCO TRENDS

OFFICE MARKET REPORT 2nd Quarter 2009 San Francisco Market Overview

MARKET OVERVIEW

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VACANCY CONTINUING TO RISE—IT'S A TENANT'S MARKET

The uncertainty of our current economic climate is driving companies to be more conservative with expansion plans. However, for companies with more solid revenue projections, this tumultuous climate is being viewed as a tremendous opportunity to secure quality office space at affordable rates. Direct Leasing Activity slowed to one-half the normal pace. Even so, the Central Business District returned to the market 373,000 sf more than it leased for the quarter. Class A direct rents continued to fall in the CBD by 25%, compared to rents a year ago, down to \$35 from \$37 the previous quarter. Class B asking rents fell to roughly \$29 on a direct basis. (Class B rates typically trail Class A by 4-6 months). Actual deals are being negotiated at much lower rates. The sublease market continues to impact direct asking rents as landlords struggle to compete with these historically low sublease asking rents. Over the next two years, tenants will experience very favorable conditions not seen in over a decade.

The sublease market is a huge force in a tenant's decision-making process. As of June 30, 2009 there was 1,706,108 sf of sublease space (or 3.1%) in the CBD. Some of the larger available sublease spaces available in the market are: Macy's West at 22-4th Street, 150,000 sf for a 6-year sublease starting as low as \$20/sf; Charles Schwab at 120 Kearny for 376,000 sf, a short-term sublease offered at \$12/sf; Babcock and Brown at One Letterman Drive with close to 50,000 sf; DLA Piper at 153 Townsend with 28,788 sf; and Oracle Corporation at 475 Sansome with 21,391 sf. While a sublease can provide opportunity for lowering rents, the subtenant is unlikely to negotiate for tenant improvements and risks contractual exposures due to the possible instability of the sublessor.

Recently, news about a Class A building being sold (the note) at one-half of the Class A average 2009 sales comparables could portend increased landlord flexibility in setting rental rates. The referenced sale of 250 Montgomery for \$172/sf contrasts with the purchase of that same building at over \$400/sf in December of 2006. It is expected that more buildings will go back to their lenders. Deutsche Bank's Global Commercial Real Estate Group estimates that many buildings are now worth 50% of their 2007 values. We await confirmation of additional sales before pronouncing that such a significant decline is a reliable trend.

CENTRAL BUSINESS DISTRICT OFFICE LEASING MARKET

Office space activity in San Francisco's Central Business District (Financial and South Financial Districts) has declined, driven by a negative 373,000 square feet of absorption this quarter. Direct vacancies for Class A office space increased to 14.5 percent, and Class B space increased to 18.7 percent. The uncertainty of our current economic climate is driving companies to be more conservative with expansion plans. However, for companies with more solid revenue projections, this tumultuous climate is being viewed as a tremendous opportunity to secure quality office space at affordable rates. Just recently, for example, Reed Smith LLP signed a lease for 94,704 square feet of office space at 101 Second Street, a Class A South Financial District office building. This will be the largest lease deal closed so far this year. The tenant will be moving into 79,414 square feet of office space in October 2009, and 15,290 square feet of office space in January 2012.

As for submarkets, the Financial District felt the greatest impact this quarter from the economic downturn with an abundance of available Class A at 4.2 million sf. (or 20% - this included vacant space, direct space being marketed, and sublease space of 5.5%). Class B buildings also experienced available space of 20%, due to small businesses downsizing, closing their offices altogether, or upgrading to Class A. As for "done deal" rental rates, we are now seeing mid to high \$20's for Class A buildings; with view space in the mid to high \$30's. Sublease spaces, however, are as low as \$18-\$20/sf. In addition to reduced rental rates, landlords are offering concessions such as free rent, generous tenant improvement packages, relocation allowances, and expansion/renewal options.

Submarket Statistics Table* (from 6/17/2009 vacancy report)

Submarket	Net Rentable Area (sq.ft.)	Absorption (sq.ft.)	Total Available (%)	Direct Available (%)	Direct Asking Rent Class A	Direct Asking Rent Class B
Financial District	29,282,579	(85,378)	19.6	15.2	\$37.51	\$30.85
South Financial District	25,326,091	(18,109)	14.9	13.1	\$37.16	\$29.97
Jackson Square	2,773,984	(100,481)	18.3	16.6	\$41.05	\$26.88
Union Square	5,559,504	(81,697)	17.0	15.8	n.a	\$28.01
Civic Center	3,467,710	(2,748)	23.0	23.0	\$33.50	\$21.79
Van Ness Corridor	2,862,171	(49,457)	11.4	8.3	\$31.65	\$27.51
Waterfront/North Beach	4,651,699	(5,667)	12.4	9.0	\$27.00	\$29.40
South of Market	6,104,392	(13,487)	22.0	21.2	\$29.71	\$33.58

MAJOR LEASE TRANSACTIONS

Tenant	Address	Class	Submarket	Sq.ft.
Reed Smith LLP	101 Second Street	A	South Financial District	94,704
United BioSource Corp.	303 Second Street	A	Rincon/South Beach	30,000
CNA Insurance	555 Mission Street	A	South Financial District	30,000
Embarcadero Technologies	100 California Street	A	Financial District	20,173
Lumetra	1 Sansome Street	A	Financial District	16,792
Workshare	208 Utah Street	C	Showplace Square	15,812
My New Place ²	343 Sansome Street	A	Financial District	14,781
Federal Home Loan Bank San Francisco	580 California Street	A	Financial District	14,105
Chicago Title ¹	455 Market Street	A	South Financial District	12,397
HDR Engineering, Inc.	575 Market Street	A	South Financial District	12,110
Scribd	539 Bryant Street	B	Lower South of Market	10,956
Goodin MacBride	505 Sansome Street	B	Financial District	9,984
Birst	153 Kearny Street	B	Union Square	9,967
The Kipp Foundation ¹	345 Spear Street	A	Rincon/South Beach	9,928
Trulia	208 Utah Street	C	Showplace Square	9,695

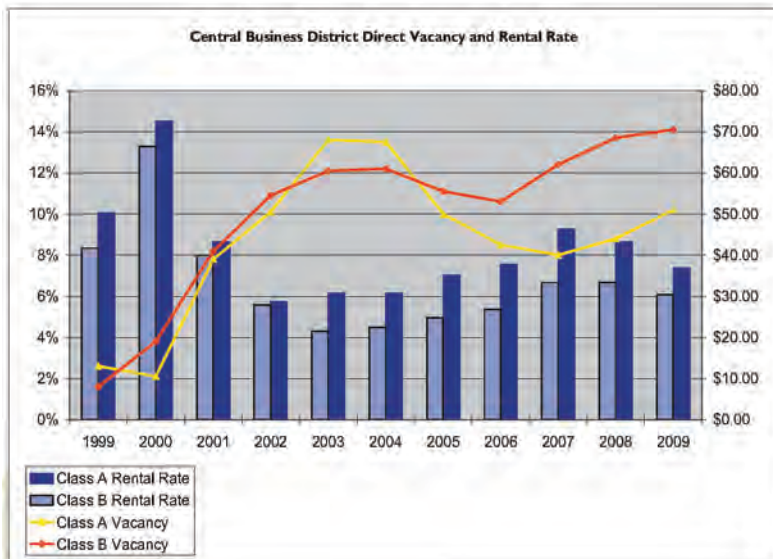
¹ Tenant Represented by TRI Commercial
² Sublease



HISTORICAL DATA

Class A							
Quarter	Total RBA	Direct Vacant SF	Sublet Vacant SF	Total Vacant SF	Direct Vacant %	Sublet Vacant %	Total Vacant %
QTD	46,785,353	4,476,199	850,092	5,326,291	9.6%	1.8%	11.4%
2009 1Q	46,785,353	4,435,853	637,672	5,073,525	9.5%	1.4%	10.8%
2008 4Q	46,785,353	3,915,615	729,265	4,644,880	8.4%	1.6%	9.9%
2008 3Q	46,785,353	3,715,448	577,208	4,292,656	7.9%	1.2%	9.2%
2008 2Q	46,229,034	3,249,993	342,433	3,592,426	7.0%	0.7%	7.8%
2008 1Q	45,894,034	3,334,154	350,897	3,685,051	7.3%	0.8%	8.0%

Class B							
Quarter	Total RBA	Direct Vacant SF	Sublet Vacant SF	Total Vacant SF	Direct Vacant %	Sublet Vacant %	Total Vacant %
QTD	41,092,640	5,418,459	322,194	5,740,653	13.2%	0.8%	14.0%
2009 1Q	41,054,108	5,201,689	278,258	5,479,947	12.7%	0.7%	13.3%
2008 4Q	41,054,108	4,772,080	240,185	5,012,265	11.6%	0.6%	12.2%
2008 3Q	41,054,108	4,528,510	257,402	4,785,912	11.0%	0.6%	11.7%
2008 2Q	41,054,108	4,633,283	238,663	4,871,946	11.3%	0.6%	11.9%
2008 1Q	41,054,108	4,720,092	278,734	4,998,826	11.5%	0.7%	12.2%



CBD Direct Vacancy and Rental Rate

Year	Direct Asking Rate Class A	Direct Asking Rate Class B	Direct Vacancy Class A	Direct Vacancy Class B
2009	\$36.85	\$30.42	10.2%	14.1%
2008	\$43.17	\$33.29	8.8%	13.7%
2007	\$46.25	\$33.26	8.0%	12.4%
2006	\$37.78	\$26.86	8.5%	10.6%
2005	\$35.12	\$24.73	10.0%	11.1%
2004	\$30.77	\$22.39	13.5%	12.2%
2003	\$30.75	\$21.45	13.6%	12.1%
2002	\$28.63	\$27.89	10.1%	10.9%
2001	\$43.22	\$39.97	7.8%	8.2%
2000	\$72.48	\$66.41	2.1%	3.8%
1999	\$50.22	\$41.69	2.6%	1.6%

INVESTMENT MARKET UPDATE

The Citywide investment activity continues to be fairly quiet for 2009, except for the note sale of 250 Montgomery Street. Due to the current downtrends in leasing rental rates, some owners of recently purchased properties could be facing financial difficulties in retaining their buildings. We could soon be seeing banks and property owners selling distressed properties at discount prices. This scenario will likely create new rock-bottom prices, as well as ample opportunities for potential buyers with cash who are waiting on the sidelines. However, the gap in understanding the current market is still a broad one between buyers and sellers; buyers are expecting bargains, while sellers are reluctant to recognize their property's new value.

2Q 2009 COMMERCIAL REAL ESTATE FORECAST

Unlike the residential market glut, the commercial real estate market is not overbuilt. Even so, it is not immune to the distressed economy and resultant market inertia. The trends discussed in this report will continue for some time, as bad assets need to be flushed out of the liquidity pipeline first before a new basement-pricing structure can reset the market. Investors and tenants who are looking to purchase or lease office space are more likely to hunt for, and expect, an economical deal with more concessions from the seller or landlord. The silver lining in these somewhat confusing times are the cash buyers, and relocating tenants (entering the market to look for long-term investments or office expansion) who will have much more leverage in negotiating deals that make fiscal sense.