

**MARKET SUMMARY**

Leasing and sales transaction velocity in the San Francisco office market continued to climb in the third quarter. Office vacancy rates declined more than 2.5% to 14.2%. This is the lowest vacancy rate since Q1-01. Market absorption was 1,982,644 feet city wide for the quarter, with the average rental rate across all office classes citywide running about \$25. This is a 10% rise since the beginning of the year.

**ABSORPTION**

Net absorption in the CBD for the third quarter was a positive 720,000 feet. This brings the year-to-date net absorption to approximately 1,228,234 feet, which compares favorably to 1,200,000 feet for all of 2004. Lucas Arts, Macromedia, and Genentech are among the largest leases year to date. Most of the absorption was in the CBD, with class A buildings taking the lion's share resulting in sharp rental increases.

**Largest Q3 Leasing Deals**

Address	Tenant	Size
303 2 <sup>nd</sup> St.	State Compensation	95,128
525 Market St.	Sonnenschein Nath Rosenthal	69,730
345 California St.	Texas Pacific Group	69,000
795 Folsom St.	SBC Communication	63,000
303 2 <sup>nd</sup> St.	WPP Group	54,626
500 Sansome St.	Plumtree Software	50,890
1160 Battery St.	Mindjet LLC	47,000

**VACANCY RATES**

Asking rents in the CBD climbed to \$28.86 per square foot, and the vacancy rate was 13.1%, according to a report from Co-Star; that is up 16 % from the same time last year. Our analysis indicates that the office vacancy rate could drop to 11% by the end of 2006 if job growth and the conversion of commercial properties to residential use continue. (Last year more than 4 million feet of office space were converted from office to residential.) The average asking rents for class A CBD space at the end of the third quarter was \$33 per square foot, as compared with about \$31 at the end of the second quarter.

The market seems to be at or close to equilibrium: There is not an excess or a shortage of space. In other words, there is enough office space available for companies that need it, but not so much that the city is suffering from a glut.

**LEASE RATES - CITYWIDE**

Property Class	Average Lease Rates Q3-05
Class A	\$30.90
Class B	\$24.75
Class C	\$22.70

**SALES VOLUME**

The volume and pace of commercial sales transactions have been hot. \$500 million in office sales were recorded during the third quarter, bringing total volume for the year to \$2.7 billion. This equals sales for all of 2004.

Remarkably strong capital markets continue to power investment sales to new heights. Cap rates have continued to compress and are now below 7%. The key reasons are lack of alternative investments in stocks and bonds; continued low mortgage rates; and the pursuit of stable or high real estate returns by nearly every real estate investment vehicle. Signs of activity during the quarter included the BankAmerica Building entering a contract with an investor for \$1.05 billion and Shorenstein Company's purchase of a Mission Bay land parcel on Illinois Street for \$32 million. The 3.8-acre site has been cleared by the city for 450,000 square feet of office or laboratory space. We expect to reach \$4.9 billion in sales for 2005.

**FORECAST**

Office rents will continue to rise in San Francisco as the bull market continues. Much of the 5 million square feet of gross leasing activity year to date was concentrated in the financial district; SOMA is making a comeback. If venture capital continues to flow, job creation will continue and SOMA rentals may soon be back to dot-com levels. Further contributing to this is the fact that no new product is coming on the market in the next few years.

With the balance continuing to shift in favor of landlords, tenants should seek to take advantage of current conditions. Rents are still very attractive in high-vacancy buildings. Incentives offered by landlords are diminishing quickly, although some are still available. *The key is for tenants to move quickly and decisively. In addition we are suggesting tenants make multiple back up offers to avoid disappointment.* Landlords have a great opportunity to test the limits of the markets in high-demand areas by pushing rents up, moving toward 5-versus 10-year terms, and seeking annual rent increases. With more than 11 million feet of vacant space on the market, neither side has the upper hand, though this is changing quickly.

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Peter Rosenthal  
**Title:** Leasing & Sales  
**Phone:** 415.816.4410  
**Email:** Peter@starboardnet.com

#### BIO

Peter Rosenthal has worked on numerous development projects in New York and San Francisco. He has spent much of his career heading up the real estate activities of actor Robert DeNiro's real estate holdings company Tribeca Film Center.

#### Specialization

Peter specializes in tenant representation and advocacy services in San Francisco CBD. In addition to his work at Starboard, he is a partner in a small real estate investment fund focused on stable assets, which generate above-average current returns.

#### Highlights

- Fifteen years of experience in lease management, negotiation, development, and capital structure analysis.
- Total transaction closings in excess of \$15 million in 2004.
- Earned Starboard's Goal Maker of the Year award in 2003 and 2004.
- Evaluated buy/sell options on behalf of ownership entities.
- Underwrote JV debt structure at Appian Ventures.

#### Past Clients

- Grovseiner
- Venture Corp
- SEIU 250
- Bank of Stockton
- Blue Shirt Group
- Film Arts Foundation
- Leadership Public Schools
- Breast Cancer Fund
- *Mother Jones* magazine



Stephen Newhauser  
**Title:** Leasing & Investment  
**Phone:** 415.477.8499  
**Email:** Steve@starboardnet.com

#### BIO

Throughout his career, Stephen Newhauser has consistently been ranked as a top agent and salesperson. He has worked on numerous complex transactions and brings the highest level of integrated to each deal.

#### Specialization

Stephen's primary focus is tenant representation and project leasing in San Francisco's submarkets and investment sales across the United States. He is the managing partner of Newhauser & Associates, a small real estate fund with assets over \$3 million focused on all product types with solid double-digit returns.

#### Highlights

- Starboard TCN Worldwide total transaction value in excess of \$30 million and Goal Maker of the Year in 2004.
- As an Exodus Communications senior account executive, managed 80 clients with annual billings over \$5 million with an average revenue per square foot of \$180.
- At MCI was one of the top 5 account executives in 2000 and helped "light" many of San Francisco's downtown buildings with fiber optics.

#### Past Clients

- Brite Vision Media
- Canyon Pacific Management
- Knk Builders
- Melting Pot
- Rose Pistola
- SEIU Local 250
- Solid Gold Financial

#### **TEAM SKYLINE**

Peter Rosenthal  
Steve Newhauser

Starboard Commercial Real Estate  
26 O'Farrell Street, 10th Floor  
San Francisco, CA 94108  
415.816.4410  
<http://www.skylineleasing.com>

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