



**San Francisco**  
**Office Demand Analysis**

The conclusion of this analysis as of May 9<sup>th</sup>, 2012 is that there is substantial city wide corporate leasing demand at this time with positive absorption sustainable in the near to mid-term and a local employment base that continues to remain reasonably diversified. Based upon the attached summary of San Francisco new office leases executed in 2011-2012 to date, 37% of all square footage was leased to tech tenants who comprised 52% of all demand (one of every two tenants; See exhibit #1 attached). This trend of office demand should persist for the next year and one half through 2013 with net absorption anticipated with considerable certainty, between \$1,400,000 to \$1,800,000 square feet in 2012 and \$1,100,000 to \$1,300,000 in 2013. The results and effects of these projections follow.

As a collateral finding for this mid-year evaluation, it is established that current San Francisco technology company employment equals 51,706 workers out of a city workforce of 432,600. That is 12%, with only 1 in 8 workers tied directly into the fast growing technology-information sectors, thereby establishing that there is ample city work force diversification this time around. We are not yet top heavy in tech employment. Nevertheless, there is a much higher percentage of past, current, and anticipated upcoming office leasing activity that is weighted to the tech sector and they are gradually becoming disproportionate to the percentage to all worker occupations in the city workforce. Thus, these new upcoming commercial leases do confer additional risk exposure as to the diversity of the employment sector and should be closely monitored going forward as we are doing here.

Tech sector overexposure and factors to watch and evaluate are as follows:

Check Here to Gauge

*Bubble*

- Extravagant Parties-Exuberance \_\_\_\_\_
- Company valuations exceedingly high in relation to their earnings. \_\_\_\_\_
- Hoarding tenant space that may never get filled. Increases overhead \_\_\_\_\_
- Traditional S.F. businesses begin leaving town for cheaper digs \_\_\_\_\_
- City gross receipts tax scares businesses off \_\_\_\_\_
- City housing costs too high. Current local rents up 13% in 1 year \_\_\_\_\_
- Tech business models start attracting harsh scrutiny from new investors. \_\_\_\_\_
- Limits to how many ad platforms, location sharing apps, 70s photo filters and niche social networking software can be absorbed into this market. \_\_\_\_\_

*No Bubble*

- More realistic valuation of companies this time around \_\_\_\_\_
- Solid business models that are actually making money now \_\_\_\_\_

- 28 more tech job slots now than before promote future flexibility \_\_\_\_\_
- New City Taxing system favors employee heavy businesses \_\_\_\_\_
- Housing costs in line with payroll. Counter rent controls. \_\_\_\_\_
- Urban setting best compliments tech products being produced \_\_\_\_\_
- More restrictive and expensive to go public. Staying private cheaper \_\_\_\_\_
- Profitable businesses can still be profitable after a correction \_\_\_\_\_
- Venture Capital only 35% of what it was in 1999 (\$5B vs. \$14B) \_\_\_\_\_

In the future, upcoming City Tax Policy on employers will have a substantial effect, either positive or negative, on future leasing activity. That is to say the effects of their policy will mostly fall upon and impact tenant employers that are heavily dependant on a high level of employees for their existence. Alternatively, if city taxation policy refocuses on gross business revenues, it will then adversely affect large companies with heavy reliance in local sales and also on fee based consulting firms. This looming issue could become our best asset or our worst liability directly affecting local real estate developments and the supply and demand of local office space.

Subject to the above, the current San Francisco leasing renaissance should be with us for 2 to 3 years-(til 2014 to 2015). However, the Bay Area tech and information industry is now in an extrapolative state with a focus on expanding it's capacity in finding new applications for what is now, old and pre-established technology. There are no "White Swans" or innovations for the better that are game changers in close sight. We are simply rearranging the furniture. Until technology creates that game changer, (i.e. robotics; the repowering of technical innovations; space based solar power etc.), the profitability of the San Francisco tech and information industry will stagnate or even evaporate in its present state over time. With no new innovations, this could happen by late 2015 or 2016.

In addition to forecasting a tech bubble (or not) as evaluated above, a parallel focal point is the commercial office leasing market itself, its "net absorption" and the quantity and quality of remaining "available" space (See exhibit #2 attached).

Net absorption is a quantification of:

#### Existing Office Inventory

##### Plus:

- Newly constructed space made available to lease
- Space converted to offices made available to lease
- Existing space put on market to lease

##### Minus:

- Existing space demolished or taken off market
- Existing and newly constructed space leased to new tenants

To the extent the pluses above are greater than the minuses, you have negative absorption and an increase in office availability and a vacancy increase. If, more space is leased and/or demolished than put on market, this then is positive absorption and office availability is then decreased. Of course, for a landlord, the latter is a good thing.

“Available space” is the summation of “direct leases” which is space that is on the public market for lease plus space that is not formally on the market but is for sub-lease by a tenant (not landlord) called “Shadow Space”. In the San Francisco market place, if quoted vacancy is 10%, add 2% to 3% more to cover all space for lease or sublease (i.e. “Available Space”). This is a superior evaluation barometer to quantify and qualify office space supply and demand going forward and is used herein.


Attached is a summary of the above (see exhibit #2). Note that total office inventory in 1<sup>st</sup> quarter 2011 was 68,227,634 SF and “availability” was 16.4% of this inventory in our specific market areas of interest (North and South Financial District, Jackson Square and SOMA). Note that a year later, inventory was up to 70,139,262 (about 3%), yet total “availability” went down from 11,175,210 to 8,943,074 or 20% (16.4% to 11.9% total office space availability). This was huge.

If absorption continues as projected even at 75% of the past year’s rate, total office availability will be 8.9% with vacancy down to 6-6.5% in 2013. Rents could very well exceed that of Baner’s January 2012 market predictions of \$46-\$50 and could exceed \$60-\$70 for “A” class property in 2013. Class AA property such as Embarcadero Center, Foundry Square, and One Market could exceed \$85-\$90. As mentioned in our January 2012 report, Modified Gross (Single Net) versus Fully Serviced Gross will be the rule, not exception. As the market strengthens further, Double to Triple Net leases will start to come into play.

Starting in mid to late 2014, new construction projects starts should be coming on line. This will add to the 70,175,2100 square foot inventory by 400,000 to 550,000 square feet in 2014. This could cut net absorption down to 900,000 square feet in 2014 and raise availability to 9.5-10%. This is ok. In 2015 to 2016 numerous projects will be coming on line which could raise inventory to 72,000,000-73,000,000 square feet and bring availability backup to 12-15% and rents leveling off (not falling off). Again, future city tax policy to employers will dictate tenant demand and lease terms. Also systemic Technical and Informational corporate development trends, their limitations and/or White Swan events can also prevail and influence as outlined discussed earlier.

2012, 2013 and 2014 will be good years. 2015 and 2016 trends should be monitored closely and leasing strategies adjusted accordingly well in advance.

Baner Financial Interests, LLC



William B. Baner  
Managing Member  
May 2012

# **Exhibit 1**

**Office Leasing Activity 2011-2012  
(15 Months)**

<u>Tenant Name</u>	<u>Location</u>	<u>SF</u>	<u>Rent</u>	<u>Business Type</u>	<u>Year/OTR</u>
Sephora	Market Street-525	110,588		Retail Cosmetics	2011-1st
Keker and Van Nest,LLP	Battery Street-633	90,000		Law	2011-1st
Sedgwick, Detert,LLP	Bush Street-333	89,076		Law	2011-1st
Salesforce.com	Mission Street-123	55,977		Tech	2011-1st
Inklings	Kearny Street-153	10,343		Tech	2011-1st
Catholic Healthcare	Berry Street-185	55,000		Health Care	2011-1st
Idle Games	Howard Street-875	33,252		Tech	2011-1st
ABM Industries	Harrison Street	31,179		Building Services	2011-1st
Airbnb.com	Rhode Island	20,000		Tech	2011-1st
Bit Torrent	2nd Street-303	17,522		Tech	2011-1st
U.S. Environmental Protection	Hawthorne-75	320,000		Govt.	2011-2nd
Twitter, Inc	Market Street-1355	205,903		Tech	2011-2nd
Farallon Capital, Hellman and Freidman, Foundation and Hall Capital	Maritime Plaza-1	175,000		Financial	2011-2nd
Bank of the West	Montgomery-180	150,000		Financial	2011-2nd
Farella, Braun and Martel	Montgomery-235	122,000		Law	2011-2nd
Zynga, Inc	Townsend Street	80,000		Tech	2011-2nd
PG&E	One Market	74,538		Utility	2011-2nd
Ancestry.com	Townsend Street-153	59,963		Tech	2011-2nd
Modcloth.com	Brannan-651	31,671		Tech	2011-2nd
Moss Adams, LLP	2nd Street-101	28,577		Law	2011-2nd
Vertical Response, Inc	Beale	28,121		Tech	2011-2nd
WeWork	2nd Street-156	25,998		Tech	2011-2nd
Miller Law Group	Sutter Street	25,531		Law	2011-2nd
Splunk, Inc	Brannan Street	23,362		Tech	2011-2nd
Stockbridge Capital	Embarcadero Center 4	22,313		Financial	2011-2nd
Zoosk	Sansome Street	21,391		Tech	2011-2nd

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(15 Months)**

<u>Tenant Name</u>	<u>Location</u>	<u>SF</u>	<u>Rent</u>	<u>Business Type</u>	<u>Year/QTR</u>
America's Cup Authority	Broadway-75	17,050		Entertainment	2011-2nd
Birst, Inc	Kearny Street-153	10,326		Tech	2011-2nd
Dropbox	Berry Street-185	85,591		Tech	2011-3rd
Wells Fargo	Sansome Street-343	69,824		Financial	2011-3rd
Symantec Corp.	2nd Street-303	67,000		Tech	2011-3rd
AE Com Tech Co.	California-300	54,266		Tech	2011-3rd
Practice Fusion	Taylor-420	46,024		Tech	2011-3rd
Cornerstone Research	Embarcadero Center 2	42,291		Consulting	2011-3rd
Atlassian	Harrison Street-1098	42,039		Tech	2011-3rd
Tagged, Inc	Battery Street-848	39,922		Tech	2011-3rd
Autodesk, Inc	One Market	36,436		Tech	2011-3rd
Pivotal Labs	Howard Street-875	33,258		?	2011-3rd
Pier 38 Maritime	One Market	33,180		Transportation	2011-3rd
Jones, Clifford LLP	Market Street-1390	10,547		Law	2011-3rd
Citigroup, Inc	Sansome-1	121,754		Financial	2011-4th
Pillsbury, Winthrop LLP	Embarcadero Center 4	108,000		Law	2011-4th
Covington and Burling, LLP	Front-1	104,998		Law	2011-4th
Academy of Art	Polk-625	78,116		Business	2011-4th
Pac-12	3rd Street-370	70,000		Entertainment	2011-4th
StumbleUpon	Brannan-301	62,852		Tech	2011-4th
First Republic Bank	Front-1	54,882		Financial	2011-4th
Covertly, Inc	Berry Street-185	53,025		Tech	2011-4th
Solution Set	Montgomery-120	50,874		Tech	2011-4th
Digital Realty Trust	Embarcadero Center 4	50,000		Financial	2011-4th
Zynga Inc	Townsend-650	50,000		Tech	2011-4th
McKesson Corp.	Mission Street-123	41,646		Pharmaceutical	2011-4th
Giant Creative Strategy	Montgomery-1700	19,655		Tech	2011-4th
Tightrope Interactive	Bush Street-425	6,444		Tech	2011-4th
Salesforce.com	Fremont-50	407,186		Tech	2012-1st
Macy's.com	Folsom-680	238,000		Retail	2012-1st
Riverbed Tech	Folsom-680	167,788		Tech	2012-1st
Bank of America	California-101	121,986		Finance	2012-1st
Kabam	Folsom-795	63,222		Tech	2012-1st
Fremont Group	Fremont-199	60,337		Financial	2012-1st

**Office Leasing Activity 2011-2012  
(15 Months)**

<u>Tenant Name</u>	<u>Location</u>	<u>SF</u>	<u>Rent</u>	<u>Business Type</u>	<u>Year/QTR</u>
RPX Corporation	One Market	59,837		?	2012-1st
Linkedin Corp	Montgomery-1	57,123		Tech	2012-1st
Kixeye	Bush-333	52,593		Tech	2012-1st
Lewis, Brisbois, LLP	Bush-333	52,000		Law	2012-1st
Samsung	Battery-735	25,000		Tech	2012-1st
One Kings Lane	Market-1355	51,821		Tech	2012-1st
Appirio, Inc	Market-760	25,000		Tech	2012-1st
Opower, Inc	Harrison-642	12,710		Tech	2012-1st
Buchalter, Nermer, LLP	2nd Street-55	29,950		Law	2012-1st
Grass Valley	Brannan-475	14,000		?	2012-1st
Cloudera	California-433	10,000		Tech	2012-1st
Meebo	Montgomery-101	10,000		Tech	2012-1st
Korn/Ferry Intl.	Sansome-1	17,440		?	2012-1st
Industry Capital	Sansome-1	9,400			2012-1st
Beacon Ins.	Sansome-1	6,401			2012-1st
Pocket Gems	Montgomery-220	39,000		Tech	2012-1st
JP Morgan	Harrison-600	35,000		Finance	2012-1st
Idle Games	Howard Street-875	33,000		Tech	2012-1st
Federated Media	Townsend-72	29,000		Business	2012-1st
EventBrite	Townsend-410	27,500		?	2012-1st
Steelcase	Brannan-475	27,000		Tech	2012-1st
Outcast.com	Townsend-123	21,000		Tech	2012-1st
Zynga (Expansion)	8th Street-699	19,000		Tech	2012-1st
Granicus Corp.	Harrison-600	15,000		Tech	2012-1st
Rackspace Hosting	Folsom-620	15,000		Tech	2012-1st
RDIO	Bryant-1550	15,000		Tech	2012-1st
Responsys, Inc	Bush-225	26,000		Tech	2012-1st

*Note #1: Smaller spaces not included here. Could be another 1M-SF*

*Note #2: Square Footage leased thru March 2012 (15 months)*

*Estimate of small office leasing (8,000SF and below)*

5,260,000  
1,000,000  
 6,260,000

*Total leased:*

## **Exhibit 2**



East San Francisco Office Market  
(2011-2012)

Supply, Demand, Absorption Analysis

<u>1st Quarter 2011</u>	<u>SF Inventory</u>	<u>Gross % Availability</u>	<u>Direct and Shadow Availability</u>	<u>Absorption</u>
North Financial	26,530,271	18.28%	4,849,733	4,394
South Financial	24,705,411	13.17%	3,253,702	155,136
Jackson Square	6,559,081	13.43%	880,873	-6,839
SOMA	10,432,871	21.00%	2,190,902	71,579
Total:	68,227,634	16.4%	11,175,210	224,270

End of 1st Quarter Availability: 10,950,940 16%

<u>2nd Quarter 2011</u>	<u>SF Inventory</u>	<u>Gross % Availability</u>	<u>Direct and Shadow Availability</u>	<u>Absorption</u>
North Financial	28,543,630	17%	4,852,417	85,619
South Financial	24,784,071	10.9%	2,701,463	-51,554
Jackson Square	6,756,207	12.8%	864,794	23,290
SOMA	10,881,768	23.3%	2,535,451	174,885
Total:	70,965,676	15.4%	10,954,125	232,240

End of 2nd Quarter Availability: 10,721,885 15.1%

<u>3rd Quarter 2011</u>	<u>SF Inventory</u>	<u>Gross % Availability</u>	<u>Direct and Shadow Availability</u>	<u>Absorption</u>
North Financial	28,523,316	14.8%	4,221,450	164,412
South Financial	24,737,394	10.5%	2,597,426	-188,771
Jackson Square	5,952,922	12.3%	732,209	-12,113
SOMA	10,679,172	21.2%	2,263,984	252,034
Total:	69,892,804	14%	9,815,069	215,562

End of 3rd Quarter Availability: 9,599,507 13.7%

East San Francisco Office Market  
(2011-2012)

Supply, Demand, Absorption Analysis

<u>4th Quarter 2011</u>	<u>SF Inventory</u>	<u>Gross % Availability</u>	<u>Direct and Shadow Availability</u>	<u>Absorption</u>
North Financial	28,523,316	13.2%	3,765,077	350,633
South Financial	24,797,364	10.9%	2,696,372	214,212
Jackson Square	5,959,172	13.4%	798,529	-29,686
SOMA	10,679,172	19.9%	2,125,155	149,776
Total:	69,959,024	13.4%	9,385,133	684,935

End of 4th Quarter Availability: 8,700,198 12.4%

<u>1st Quarter 2012</u>	<u>SF Inventory</u>	<u>Gross % Availability</u>	<u>Direct and Shadow Availability</u>	<u>Absorption</u>
North Financial	28,482,631	12.1%	3,446,398	288,520
South Financial	25,008,173	9.8%	2,450,800	358,936
Jackson Square	5,959,986	14.7%	876,117	-15,987
SOMA	10,688,472	20.3%	2,169,759	-55,619
Total:	70,139,262	12.7%	8,943,074	575,850

End of 1st Quarter Availability: 8,367,524 11.9%

*New Construction - Tishman Speyer 222 Second and Foundry Sq. III and 350 Mission*

<u>1st Quarter 2012</u>	<u>SF Inventory</u>	<u>Gross % Availability</u>	<u>Direct and Shadow Availability</u>	<u>Absorption</u>
Newmark-No. Financial	28,482,631	12.1%	3,446,398	288,520
Kidder-No. Financial	29,369,476	13%	3,818,031	-39,201
Newmark-So. Financial	25,008,173	9.8%	2,450,800	358,936
Kidder-So. Financial	26,341,905	12.1%	3,194,130	76,941
Newmark-Jackson Square	5,959,986	14.7%	876,117	-55,619
Kidder-Jackson Square	7,325,345	12.7%	327,600	169,438
Newmark-SOMA	10,688,472	20.3%	2,169,759	-15,987
Kidder-SOMA	21,130,251	23.3%	4,923,348	13,906
Newmark	70,139,262		8,943,074	575,850
Kidder	84,166,977		12,263,109	221,084

Newmark: End of 1st Quarter Availability: 8,367,524 11.9%  
Kidder: End of 1st Quarter Availability: 12,042,020 14.3%