THE CORPORATE REAL ESTATE LETTER
BY FRANK FUDEM

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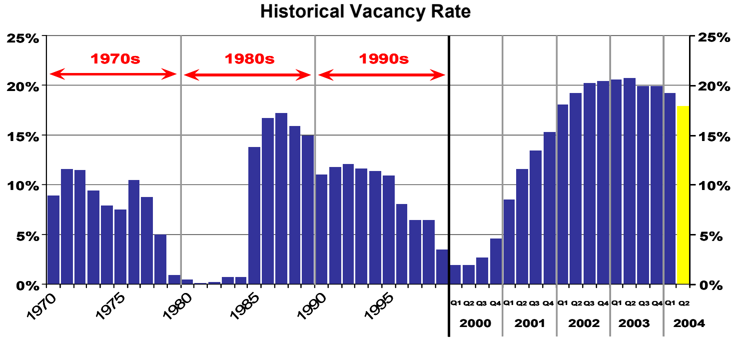
San Francisco office tenants still have an opportunity to consummate an advantageous real estate transaction. However, conditions are changing. Vacancies have dropped to 17.9% from last year's peak of 20.7%. **There are now 2.4 Million *fewer* feet available for lease than in 2003.** Occupancy increased by 469,000 s.f. in the second quarter of 2004. San Francisco has had 750,000 s.f. of positive absorption during the first half of the year. Declining vacancy/increasing occupancy have caused rents to increase, particularly for Class A space in the Financial District.

Historical Vacancy Rate



Another development that is likely to reinforce the trend to higher rents in coming years is the unprecedented number of office buildings for sale, or recently sold, at prices that bear no relation to today's rents.

	Property	Sq. Ft. per Building
Sold in 2004:	475 Brannan Street (partial interest)	255,000
	22 Fourth Street	224,000
	215 Fremont Street	240,131
	75 Hawthorne Street	334,423
	95 Hawthorne Street	75,000
	Hills Plaza I and II	561,326
	425 Market Street (67% interest)	996,760
	90 New Montgomery Street	125,000
	114 Sansome Street	255,000
	One South Van Ness Avenue	656,844
	601 Townsend Street	275,550
For Sale:	One Bush Street (51% interest)	298,080
	250 Brannan Street	104,351
	550 California Street	340,000
	555 California Street (50% interest)	1,352,000
	601 California Street	246,456
	50 Fremont Street	817,412
	160 King Street	158,000
	333 Market Street	596,000
	595 Market Street (51% interest)	428,420
	315 Montgomery Street (50% interest)	275,000
	505 Montgomery Street	329,732
	450 Sansome Street	137,011
	55 Second Street	379,000
	101 Second Street	396,300
	160 Spear Street	274,795
	71 Stevenson Street (50% interest)	315,800
	Total:	10,447,391

Some of these high purchase prices partly reflect income from existing leases with high rents that were put in place during the rent spike that occurred a few years ago. But there is a huge disconnect between the high purchase prices now being paid for San Francisco office buildings, and the low rents available in today's leasing market.

Rents fell for three years after the rent spike to levels comparable to 20 years ago. The fact that rents have now stopped falling and have started to tick up enables both buyers and sellers to justify high purchase prices. This trend allows for plausible projections of still higher rents over the next few years, thus rationalizing a substantial premium over a price that would otherwise be based on today's low rents. The indications are clear – buyers expect, and will strive to achieve, higher rents in the coming years to justify the prices paid and cause their investments to succeed.

Full-service rental rates have three components: "net" rent; operating expenses; and real estate taxes. A sale directly impacts two of these three components.

When a seller's low cost basis is replaced by a buyer's higher cost basis, the new owner requires higher "net" rents to generate a return on investment. Additionally, real estate taxes are reassessed on the basis of the new purchase price, and the resulting tax obligation is often significantly increased.

The need for higher net rents for a return on investment, coupled with higher taxes, could raise the "floor" for the full-service rents landlords are prepared to accept.

Operating expenses, the third component of full-service rents, have increased dramatically in recent years, placing additional upward pressure on rental rates.

Whether or not job growth in San Francisco's office market will support these higher valuations and expectations remains to be seen, but landlords will certainly strive to achieve the higher rents needed for profitable investments.

Today's market is still advantageous for tenants, but the trends are turning, and the window to lock in lower rents is closing. Tenants with upcoming real estate requirements are well advised to act now and secure their real estate future. Please call, write or e-mail for information on how to take maximum advantage of today's favorable market conditions.

The Corporate Real Estate Letter by Frank Fudem is a complimentary periodic commentary on the San Francisco office market. If you foresee a real estate need or if others in your organization would like to receive future editions of this letter at no charge, please call, write or email: Frank Fudem, Senior Vice President, (415) 677-0455
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The Corporate Real Estate Letter by Frank Fudem

San Francisco Central Business District

Office Market Conditions

Second Quarter 2004

		Office Vacancy						Change in Total Vacancy				Net Absorption [Change in Occupancy]	
		Direct Vacancy		Sublease Vacancy		Total Vacancy		From Last Quarter		From One Year Ago		From Last Quarter	2004 YTD
Submarket		Sq. Ft.	%	Sq. Ft.	%	Sq. Ft.	%	Sq. Ft.	%	Sq. Ft.	%	Sq.Ft.	Sq.Ft
North Financial District													
Class A	21,202,395 *s.f.*	2,841,841	13.4%	934,238	4.4%	3,776,079	17.8%	dn (57,868)	-0.3%	dn (831,899)	-3.9%	pos 2,157	pos 196,218
Class B	6,163,969 *s.f.*	835,727	13.6%	297,442	4.8%	1,133,169	18.4%	up 86,770	1.4%	dn (85,598)	-1.4%	neg (103,779)	neg (3,888)
Subtotal	27,366,364 *s.f.*	3,677,568	13.4%	1,231,680	4.5%	4,909,248	17.9%	up 28,902	0.1%	dn (917,497)	-5.3%	neg (101,622)	pos 192,330
South Financial District													
Class A	18,822,816 *s.f.*	2,626,193	14.0%	563,794	3.0%	3,189,987	16.9%	dn (369,720)	-2.0%	dn (542,994)	-2.9%	pos 309,444	pos 311,225
Class B	3,504,579 *s.f.*	352,341	10.1%	46,319	1.3%	398,660	11.4%	dn (64,769)	-1.8%	dn (97,031)	-2.8%	pos 54,325	pos 58,324
Subtotal	22,327,395 *s.f.*	2,978,534	13.3%	610,113	2.7%	3,588,647	16.1%	dn (434,489)	-1.9%	dn (640,025)	-5.7%	pos 363,769	pos 369,549
Jackson Square/No. Waterfront													
Subtotal	6,736,609 *s.f.*	815,546	12.1%	203,177	3.0%	1,018,723	15.1%	dn (151,570)	-2.2%	dn (282,117)	-4.2%	pos 126,501	pos 130,402
Union Square													
Subtotal	4,824,607 *s.f.*	419,546	8.7%	60,171	1.2%	479,717	9.9%	dn (80,252)	-1.4%	dn (134,610)	-2.5%	neg (53,279)	neg (24,896)
Yerba Buena													
Subtotal	3,794,953 *s.f.*	640,311	16.9%	109,112	2.9%	749,423	19.7%	dn (49,576)	-1.3%	dn (93,133)	-2.5%	pos 9,376	neg (36,402)
South Beach/Rincon Hill/SOMA													
Subtotal	19,086,635 *s.f.*	3,480,657	18.2%	801,393	4.2%	4,282,050	22.4%	dn (439,513)	-2.3%	dn (298,518)	-1.7%	pos 124,040	pos 121,112
All San Francisco CBD Markets													
Total	84,136,563 *s.f.*	12,012,162	14.3%	3,015,646	3.6%	15,027,808	17.9%	dn (1,126,498)	-1.3%	dn (2,365,900)	-2.8%	pos 468,785	pos 752,095

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 through real estate expertise.

BT Commercial Real Estate is the largest brokerage focusing exclusively on Northern California. BT Commercial has 130 agents in ten offices serving San Francisco, the Peninsula, Marin, and the East Bay. BT has consummated more than $18 Billion of real estate transactions

If you foresee a real estate need, or if you would like more information on San Francisco or Bay Area commercial real estate, please call, write, or email:

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