

# The Corporate Real Estate Letter

By Frank Fudem | May 2007

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**Vacancies:** San Francisco's office vacancy rate declined to 10.1% in Q1 (down from 10.6% at the end of 2006).

**Net Absorption:** San Francisco office occupancy increased 291,709 square feet in Q1 2007.

**Rental Rates:** After increasing gradually quarter by quarter for the past three years, rents are now surging. This newsletter has been warning about the possibility of a rent spike since 2005. That day has now arrived.

The big story in Q1 was the purchase of Equity Office Properties (EOP), the largest office REIT in the U.S. and San Francisco's largest landlord. Private equity firm Blackstone bought the entire REIT, but not before a bidding war drove the price sky-high. Blackstone immediately sold large portions of the EOP portfolio to pay down debt associated with the deal, including 10 of EOP's 11 San Francisco buildings to Morgan Stanley.

The shocker is the price: Morgan is paying about \$2.61 billion for a 100% interest in seven buildings plus a partial interest in another three buildings, the equivalent of \$680 per square foot for the entire portfolio.

What does that mean? Get ready for serious sticker shock! Morgan Stanley will need to average rents in the \$60s/sq. ft. throughout the portfolio to realize a return on their investment. Space that recently rented in the \$20s or low \$30s per sq. ft. will have to be priced in the \$40s, and premium space that was in the \$50s will probably be priced in the \$90s or higher. Other landlords are also ratcheting up their rents.

Will tenant demand support such a dramatic spike in rents? No one knows, but Morgan Stanley and other institutional buyers are betting billions of dollars that it will. This may take some time to sort itself out, during which there could be a big spread between the "bid" from tenants and the "ask" from landlords. This could be a challenging period for many tenants. Quality representation is more important than ever. Please let me know if I can be of assistance.

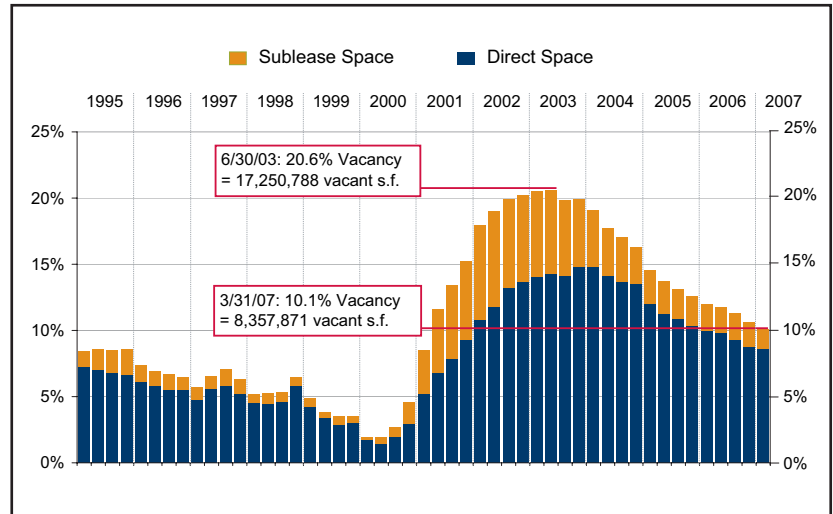
Frank Fudem represents corporate tenants in office space transactions. He has represented office tenants in millions of square feet of successful transactions since 1984. He plans and executes strategies to help his clients obtain the most advantageous transactions possible. When you foresee a real estate need please contact:

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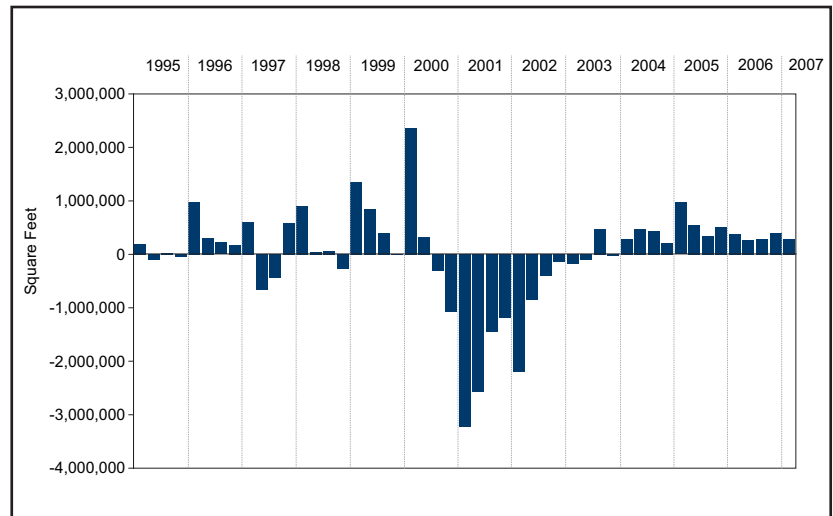
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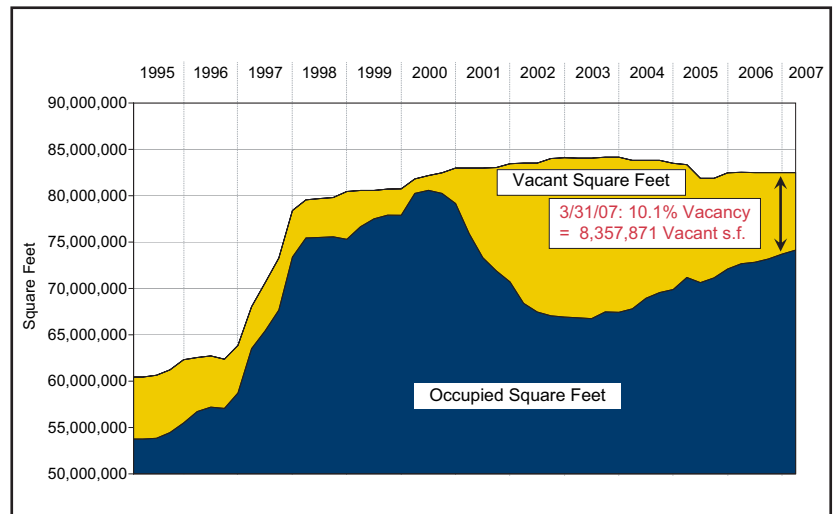
## San Francisco Office Vacancy



## Net Absorption



## San Francisco Office Space



# Vacancy and Net Absorption by Submarket

Net Absorption = Change in Occupancy

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