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News Release

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San Francisco Skyline Office Buildings Show Highest Gains in Asking Rents in 2010

Jones Lang LaSalle's first North American Skyline Review shows increased occupancy in high-profile office buildings, leading to market tightening and rent growth this year in most markets

SAN FRANCISCO, March 9, 2011– After two years of steady new development deliveries and increasing sublease options, supply dynamics have stabilized, rents have bottomed out and landlords have begun to scale back tenant improvement allowances at top office properties across the U.S. and Canada, according to the first-ever North American Skyline Review from Jones Lang LaSalle. As a result of these supply-demand dynamics, investor interest for this type of product has heated up, causing activity and pricing to jump and yields to compress.

In San Francisco, average asking rents at Skyline buildings (49 Class A office buildings totaling more than 26 million square feet of downtown space) were $43.63 per square foot, a 6 percent increase over the prior 12 month period and the highest gain of any market in Jones Lang LaSalle's North American Skyline Review. Downtown landlords have seen resilience in their buildings through the downturn and total Skyline vacancy of 15 percent is two percentage points less than the citywide rate. During the last quarter of 2010, Skyline buildings dominated net absorption and accounted for almost 40 percent of the 533,000 square feet newly occupied space by local businesses. Further, the Skyline illustration clearly shows upper floor bank space being less available than lower floor bank space.

"The outlook moving into 2011 is promising, as tenants are confident that business is back on track and ready for new growth. Leasing fundamentals still have plenty of upside ahead and that's sure to bring higher property values in the years ahead," said Colin Yasukochi, Vice President Northwest Research at Jones Lang LaSalle.

Jones Lang LaSalle Skyline markets

Jones Lang LaSalle's Skyline reports—known as Trophy, AAA or Tower Market reports in some cities—provide a unique perspective of office market trends across a selective group of Class A buildings in urban areas. This top tier of buildings, representing 30 percent of total CBD office space, historically has been the market-moving segment of the office sector, leading the overall market through downturns and expansions. The North American Skyline Review combines data from 21 U.S. and Canadian markets to gain a broader insight into near-term market trends.

"Rents have stabilized and even started to grow in many Skyline segments of the market, while overall market rents across non-Skyline buildings likely have about six months until bottoming out,"

said John Sikaitis, Senior Vice President of Research at Jones Lang LaSalle. In many markets, there are few large block space options in Skyline buildings. “Due to space limits in this segment of the market, we will see rent growth in the near term and potentially rent spikes over the next 24 months as new construction could be the only viable alternative for larger tenants in some of these markets,” said Sikaitis.

Leasing dynamics

Of the 21 markets studied, 15 experienced positive net absorption in 2010, with four markets—Charlotte, New York City, Toronto and Denver—absorbing more than 1 million square feet each. Despite accounting for approximately 30 percent of the CBD markets and less than 15 percent of the overall metro markets, on average, numerous markets such as Atlanta, Boston, Charlotte, Denver, Fort Lauderdale, Miami, Philadelphia, and Stamford, saw Skyline buildings account for all of the positive absorption metro wide, and then some.

“We typically see demand levels in this product type lead demand levels of the overall market by 12 to 15 months. The tenants that migrate to this type of product are industry leaders for the most part and see their profit margins and business grow before the overall macro economy demonstrates signs of universal growth,” Sikaitis said.

Fifteen of the markets experienced a drop in average asking rents during 2010, but the decline was less than 2 percent in four of the 15 cities, and only one market—Stamford—saw rents in Trophy buildings drop by more than 10 percent. Rent declines occurred mainly in the first half of 2010; as demand levels picked up, rents stabilized in the second half of the year.

Investment dynamics

After 2009 saw only 11 investment trades across Skyline buildings, generating less than $3 billion in volume, investment activity in 2010 totaled 33 different sales, fueling more than $10.1 billion in Skyline volume in 2010. “Investors returned to the market in 2010 and allocated the majority of their investment allocation into core properties across Skyline buildings,” said Sikaitis. Skyline buildings registered a 169.0 percent increase in total square feet of office product sold, while pricing increased 7.2 percent on a per square foot basis and yields declined 110 basis points to average 6.1 percent.

“We only saw three transactions involving San Francisco Skyline buildings in 2010, but with a total square footage of almost two million square feet and an average price of $422 per square foot, these buildings commanded sub 6 percent cap rates last year and the expectation is that improved property-level financial performance will likely result in many more transactions surfacing in 2011,” said Yasukochi.

Nationally, 2011 has already seen the trades of several buildings, including 3344 Peachtree in Atlanta, 1800 Larimer in Denver, Market Square in Washington, DC, signaling that investor interest for this type of product will continue to be strong in 2011. “Due to intense competition in the leading Gateway markets of New York City, Boston, Washington, DC and San Francisco, we believe

investment allocation will widen to incorporate more geographies in 2011 and 2012, as we saw with the 1800 Larimer trade drawing intense competition, " said Sikaitis.

Outlook across some local Skylines

Chicago: "In the coming year, deal velocity will increase as the decision-making process accelerates; however, space needs should remain flat. Continuing the trend from 2010, activity will include a variety of relocations, renewals and subleases, but overall shifts in size, positive or negative, should average out," said Rena Christofidis, Vice President Midwest Research at Jones Lang LaSalle. It is also highly unlikely that a new building will be kicked off in 2011, thus supply dynamics will remain constant for a few more years.

New York: Recovery in the Trophy sector will continue to outpace the larger Manhattan market. "Landlords in Trophy properties appear eager to raise asking rents, and evidence shows that some tenants are again willing to pay top dollar for the best space. Whether there will be sufficient demand to push average Trophy rents significantly higher in the near-term is less clear," said Jim Delmonte, Vice President Tristate Research at Jones Lang LaSalle. While high-end financial services: hedge funds, private equity are responsible for driving prices at the very top, several large-plate Trophy properties depend on more typical financial activities, such as traditional banking and trading operations, for occupancy in the base and middle floors of their buildings. Mid-size and large blocks of space, here, are still not in great demand

Toronto: Diminishing large block availabilities, coupled with an emerging landlord's market, will drive occupancy costs higher in the Trophy market asset class through 2011. "Limited opportunity for new construction will push vacancy down forcing tenants to look at new construction options or face a move to the fringe or suburbs," said Kristian Halkias, Senior Research Analyst at Jones Lang LaSalle.

Washington, DC: Occupancy gains will persist in 2011 as law firms resume hiring and government affairs groups continue to grow their presence. "Tenants' willingness to pay a premium for views, location and amenities will continue to drive prices and leasing activity in the market, with net effective rent growth forecasted to reach double digits over the next two years as conditions tighten," said Scott Homa, DC Research Manager at Jones Lang LaSalle.

About Jones Lang LaSalle

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