

Big Race for Space in SoMa

For a taste of how heated San Francisco's South of Market neighborhood has become, consider the eventful year that the four-story building at 642 Harrison Street just went through.

The 50,580-square-foot property went up for sale last year and attracted around a dozen interested buyers, including publicly traded real-estate investment trusts, or REITs, according to investors and real-estate executives. Los Angeles-based private investment firm PMI Properties ultimately snagged the building for \$13.3 million, just as the area's property prices soared.

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Annie Tritt for The Wall Street Journal

642 Harrison Street

Within days of closing the purchase in August, PMI had numerous technology start-ups interested in leasing the building's empty 12,710-square-foot second floor. Around a half-dozen start-ups submitted offers, driving the rent up to an average \$39 a square foot, exceeding PMI's expected \$35 a square foot.

By this month, 642 Harrison Street's second floor was leased to energy-software start-up Opower Inc., which had been searching since last May for more space. "Looking for space here can be really demoralizing" because of competition for offices, says Ling Ling Yee, Opower's manager of West Coast operations. "It's really a huge relief" to be done with the search, she says.

The activity at 642 Harrison Street underscores the ascendancy of the SoMa neighborhood amid the resurgent local tech economy. Filled with funky office buildings that were formerly warehouses, SoMa was a destination for young tech firms during the late-1990s dot-com boom, but tanked after the dot-com bust. In the past two years, the neighborhood has once again become one of the Bay Area's hottest, populated with fast-growing companies such as social-games maker Zynga Inc.

SoMa's office vacancy rate has dropped to 11.9% from 18.7% two years ago, putting it at its lowest level since early 2001, according to real-estate firm Cassidy Turley. Meanwhile, rents for top-tier SoMa office buildings now average \$50 a square foot, up from the mid-\$30s a year earlier, according to Cornish & Carey Commercial Newmark Knight Frank. Those rents exceed San Francisco's Financial District, where rents for comparable space hover around \$42 to \$43.50 a square foot.

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Opower's Ling Ling Yee at 642 Harrison Street, where the energy-software company has leased the second floor at an average \$39 a square foot for three years, more than the building's owners had expected to get.

The demand for SoMa space has in turn drawn numerous property buyers, who are renovating buildings to create more office space. REITs such as Kilroy Realty Corp. bought four SoMa office buildings in 2011 for around \$258 million, while Hudson Pacific Properties Inc. acquired two properties in the neighborhood last year for around \$68 million.

SoMa is "one of the very few bright spots" in the commercial real-estate world, says Frank Fudem, a senior vice president at Cassidy Turley. "It's like we're defying gravity."

The building at 642 Harrison Street, constructed in 1925, went through phases as a coffee factory and condo project, says Daniel Cressman, a Grubb & Ellis Co. executive vice president who has sold the property three times over 30 years, including to PMI last August. The previous owner, a group of individuals, decided to sell last year after unsuccessfully trying to turn the building into condos, he says.

Jeff Palmer, a managing partner at PMI, which owns three other SoMa buildings that are mostly filled with tech start-ups, says he wanted to buy more SoMa properties because of the demand and relative value in the area. "We knew there was a good market because most of our tenants [in other SoMa buildings] were expanding," he says.



Prices have risen since August, when PMI bought 642 Harrison Street for \$13.3 million, or around \$265 a square foot. In September Kilroy Realty purchased 201 Third Street for around \$330 a square foot, and in November acquired 301 Brannan Street for about \$423 a square foot.

SoMa "is leading the nation in attracting the young, mobile and growing work force driving today's tech-enabled creative industries," says Tyler Rose, a Kilroy spokesman. "We continue to evaluate new opportunities to grow in San Francisco and as always will be disciplined in our approach."

While most real-estate experts and investors believe SoMa's boom will continue for the near future, the start-up financing boom has shown signs of cooling off somewhat from the heights of early last year. That could eventually trickle down to the neighborhood just as a supply of new office inventory through renovations of buildings and new construction comes onto the market.

To attract new tech tenants to 642 Harrison Street's empty second floor (the other floors have existing tenants), PMI hung banners outside proclaiming the building was "for tech and digital media companies" and put up vintage Time magazine posters of a young Bill Gates and Steve Jobs in the foyer. It also renovated the second floor.

But even without those changes, would-be tenants were clamoring for the space. Among those in the hunt: Ms. Yee at Opower, which was growing out of its 10,000-square-foot sublease a few blocks away. The start-up, based in Arlington, Va., expects to expand its San Francisco office from nearly 40 people today to about 85 people in the future.

"My first impression of 642 Harrison was, this is it," says Ms. Yee. "It hit all the right things and was well located and the right size."

To win the space, Ms. Yee knew she would have to fork over higher rent. While Opower was paying in the mid-\$20s a square foot for its old office, Ms. Yee and her brokers courted PMI with an initial offer of \$35 a square foot. They slowly moved up the price to an average of \$39 a square foot for a three-year lease. Opower's brokers also sent PMI press clippings about the start-up and showed PMI the company's financials.

Choosing a second-floor tenant ultimately boiled down to Opower and a daily-deals site, says Mr. Palmer, who declined to name the daily-deals company.

"I thought it would be more difficult to sell a daily-deals site to our lenders," he says, so PMI went with Opower. "We got a higher rent than we forecast, so it was a good outcome."

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