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**THE SAN FRANCISCO ECONOMY:
A CASE STUDY OF THE MULTIMEDIA GULCH**

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San Francisco's Multimedia Gulch

The multimedia industry has become a vital component of San Francisco's economy. The concentration of multimedia activity in the Bay Area is two and one-half times the national average, and most of this activity is located in San Francisco. Between 1994 and 1998, the city's multimedia industry grew by 52%, or 6,000 jobs, and currently, there are over 35,000 people employed in the multimedia industry in San Francisco. This multimedia boom has not only created a robust economic base for the city, but has also changed the landscape of many of San Francisco's neighborhoods. The South of Market (SOMA) or Multimedia Gulch area, where 70% of multimedia activity in the Bay Area is concentrated, is the hotbed of activity and has experienced a dramatic transformation. Formerly an industrial area, old warehouses and manufacturing facilities in the Gulch are being rapidly converted into office space for multimedia firms. There are over three million square feet in office renovations underway in the submarket. Residential units to house the area's growing employment base are also springing up. As buildings are upgraded, leasing activity and rents have surged, creating one of the strongest office submarkets in San Francisco.

In the early years, comparatively lower rents and the larger, open floor plates offered by the older, low-rise industrial buildings in SOMA attracted multimedia companies to the area. There was already a core of traditional design activity around South Park within SOMA, and the "hip" aspect of this area was also a big draw. As a critical mass formed, the area within SOMA with the highest concentration of these firms became known as the Multimedia Gulch. This submarket is bounded by:

- Market Street to the North
- Embarcadero to the East
- Townsend Street to the South
- Division Street to the West

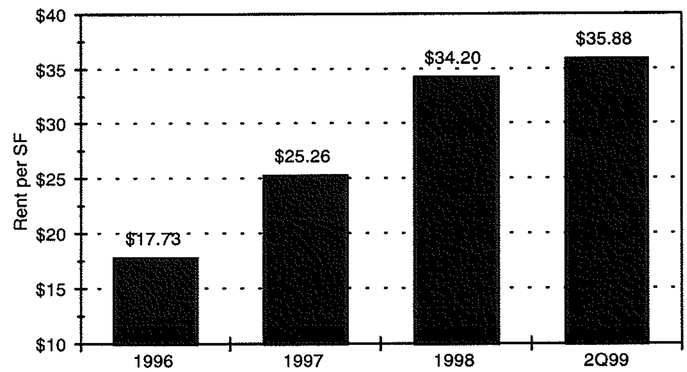
However, while the original Gulch area offered an abundance of space and lower rents early on, the boom in demand and acceleration in rent growth have pushed activity out to neighboring areas such as SOMA/ Inner Mission and the Showplace Square area near 8th and Townsend Streets. As the borders of the Gulch widen, the entire SOMA area is now being referred to as the Multimedia Gulch. For this reason, SOMA and Multimedia Gulch are used interchangeably herein.

Historical Overview and Current Conditions

San Francisco's evolution into a vital center for multimedia started in the early 1980s when the city's more traditional media providers such as printers, publishers and commercial artists began to experiment with emerging interactive technologies. During this first wave of multimedia activity, companies focused primarily on gaming and educational CD ROM applications. However, by 1985, 60% of these early companies went under. The multimedia firms that did survive were the ones that were able to develop a niche and create products for either the publishing, educational content or entertainment industries. As the industry became more established in the mid-1990s and the Internet started to take off, entrepreneurs began moving out of their "garages" into converted warehouses in the SOMA area. In 1995, for example, Mariposa Management Company acquired the former Best Foods facility for one of the first multimedia office renovations in the area. During this period, companies such as Macromedia began to experiment with product development for the Internet while still producing CD ROM applications.

In the last three and one-half years, as Internet use has become more widespread, multimedia industry growth has accelerated, with many local companies garnering substantial profits and going public, while new companies continue to start up. This boom has resulted in companies flocking into the Multimedia Gulch in search of office space, transforming the Gulch into San Francisco's hottest office market. During the second quarter of 1999 alone, about 823,000 square feet of office space were leased in the area, bringing the overall vacancy rate down to 8.2% at mid-year from 11.4% at the end of 1998.

Office Rental Rates
Multimedia Gulch (SOMA)



Cushman and Wakefield, RCG

For multimeida and other technology firms, the market feels even tighter because they are competing for very specific types of facilities (i.e. Class B and C warehouse conversions), which are in very high demand and short supply. In fact, five of the ten largest lease deals transacted in San Francisco during the second quarter were signed by Internet-related multimedia companies in SOMA. Demand is showing no signs of slowing and as of the end of the second quarter, high tech tenants were looking for about 1.5 million square feet of space in the area. This strong demand and the upgrading of space have also put upward pressure on rents, which have more than doubled since 1996. Rents currently range from $25 to $45 per square foot, with many $40+ leases transacted in the last few months.

Largest Office Lease Transactions in San Francisco: 2Q99

Building	Submarket	Tenant	Square Feet	Building Class
625 Second Street	**SOMA**	**LookSmart**	**134,000**	**C**
101 Second Street	Downtown	Thelan Reid & Preist	115,000	A
Marathon Plaza	SOMA	Northpoint Communications	98,000	A
640 Battery	Jackson Square	Goldberg, Moser, O'Neill	94,000	B
45 Fremont	Downtown	Wells Fargo/Barclay's	89,600	A
199 Fremont	Downtown	Fremont Group	80,000	A
410 Townsend Street	**SOMA**	**US Web/CKS**	**73,600**	**C**
475 Brannon	**SOMA**	**Netcentives**	**70,000**	**B**
2300 Harrison	**SOMA**	**Sapient**	**66,000**	**C**
One South Park	**SOMA**	**Advent Software**	**60,000**	**C**

Source: Cushman & Wakefield

Not only are media companies entering the area, but law firms and other service providers catering to multimedia firms are also relocating into the Gulch. Additionally, traditional companies are taking space for their web operations. For example, with the rapid growth in e-commerce, retailers are showing an interest in the submarket as they expand their on-line retailing businesses. In August, Williams Sonoma announced plans for a new corporate headquarters facility in SOMA, signaling the company's push into Internet sales.

The SOMA market currently has about seven million square feet of space, four million square feet of which are occupied by multimedia companies. Encouraged by this strong demand for office space, developers have started to step up the pace of new construction and renovation activity. In total there are over three million square feet of space underway or planned which will come to the market over the next few years. Major developers include SKS Investments, Wilson Cornerstone and the Rosenberg Company. The largest projects include Wilson's one million square-foot development at Howard and First and SKS Investment's 250,000 square-foot San Francisco Multimedia Center, which will be completed by the end of the year. Additionally, during the second quarter of 1999, Los Angeles-based William E. Simon & Sons Realty announced a joint venture with SKS Investments in which Simon will commit $100 million in equity to acquire or develop commercial properties in the Gulch area. SKS Investments will break ground in November on a 2-building 350,000 square-foot office project in Portero Hill, which will be the joint venture's largest project.

Investment sales have also been strong. Recent transactions include Mac-Cali's purchase of the AT&T building on Fourth and Folsom for about $185 per square foot. Beacon Capital Partners is also purchasing 215 Fremont for $124.50 per square foot from Equity Office Properties. As multimedia companies continue to develop new products catering to the ever-growing base of Internet users and create new ways of transferring information, the industry will continue to evolve, providing a dynamic economic driver to the San Francisco economy and real estate market.

Success Factors: What Led to the Emergence of the Multimedia Gulch?

As with the emergence of most industry clusters, several factors came together to give rise to San Francisco's multimedia concentration. The most cited attribute is the **existing base of skilled workers and entrepreneurs**. Silicon Valley to the south is the world's largest high tech agglomeration, allowing multimedia firms to tap into this existing skill base. Additionally, San Francisco's strength in the traditional media disciplines such as printing and publishing provide access to the editorial and artistic talent needed in multimedia. Related to the workforce is the **presence of world-renowned research and educational institutions** (Stanford, U.C. Berkeley and U.C. San Francisco) which produce the skilled workers and entrepreneurs.

A second factor is the **availability of suitable, affordable space** in San Francisco's old industrial neighborhoods, which made it possible for multimedia start-ups to establish themselves here, creating a critical mass. Without this non-traditional, affordable space which high tech companies tend to prefer, it would not have been feasible for the hundreds of multimedia start-ups to form such a large concentration in the Gulch. Other important success factors include San Francisco's **favorable quality of life amenities** and good access to existing **technological infrastructure**. San Francisco has a vast network of fiber-optic telecommunications lines that runs directly through SOMA.

With the area's growing popularity, some of the factors that led to the emergence of the multimedia cluster in the Gulch have disappeared. Specifically, rents have skyrocketed and space has become scarcer, making it more difficult for companies, especially new start-ups, to find affordable offices. While there is concern that this will cause companies to look to other parts of the Bay Area, activity is still going strong in spite of high rents and parking costs. The reason for this is the **quality of life** found in San Francisco that appeals to the predominantly young multimedia workforce and the importance of the **proximity to industry players** such as other multimedia firms, **venture capital,** research institutions and trade organizations. As with all successful clusters, the geographic proximity of the various players has created a certain synergy that facilitates the sharing of ideas and provides access to resources such as employees and capital that make rapid expansion possible; this dynamic continues to further strengthen the cluster.

Location Decision Factors: Multimedia Companies in San Francisco

	Importance	S.F. Meets Needs
Access to Qualified Labor Pool	4.65	4.22
Affordable Facilities	4.53	2.72
Overall Quality of Life	4.49	4.36
Technological Infrastructure	4.44	4.13
Employees Desire to Work in S.F.	4.38	4.31
Availability of Expansion Space	4.33	2.73
Proximity to Industry Participants	4.27	4.45
Suitable Facilities	4.27	3.55
Affordable Parking	4.23	1.97
Access to Strategic Partners	4.22	4.00
Access to Investors/Capital	3.77	3.93
Social Amenities	3.76	4.23
Related Educational Resources	3.68	4.04
Diversity/Multicultural	3.66	4.04

Importance: 1=Low Importance 5 = High Importance
San Francisco Meets Needs:
1=Strongly Disagree 2=Disagree 3=Neither 4=Agree 5=Strongly Agree

Source: Coopers and Lybrand and MGD.org

Illustrating this point is a survey of local multimedia firms in San Francisco conducted by Coopers and Lybrand and MDG.org, a local multimedia trade organization.* Companies were asked what the most important features were that they looked for in locating their business and to what extent San Francisco satisfied their requirements. While office space considerations were high on the list, in terms of satisfaction, quality of life indicators such as social amenities and diversity in the area along with proximity to various industry players received the highest satisfaction scores and surpassed expectations.

*The survey was conducted as part of a study released in 1998 by the San Francisco Redevelopment Agency, The San Francisco Partnership, Coopers and Lybrand and MGD.org entitled *A Survey of the Interactive Media Industry in San Francisco.*

Profile of Multimedia Gulch Tenants

Because the multimedia industry is still a relatively new industry, the majority of companies are fairly young. For example, in the survey conducted by Coopers and Lybrand, all respondents had begun business within the last fifteen years, with 64% starting up after 1993. Companies also tend to be small to mid-sized and privately-financed, many with revenues below $500,000. In 1996, the average revenue of multimedia firms surveyed by Coopers and Lybrand was $4.5 million, while 34% of companies had revenues below $300,000. However, while there is a high concentration of start-ups in the area, as the industry grows, many well-established companies with hundreds of employees have also emerged. While a few have gone public themselves, most of the companies which are not privately owned have been acquired by larger corporations. The largest multimedia company in the Gulch is Sapient Corporation with 500 local employees and $164 million in revenues.

Largest Multimedia Companies in San Francisco: 1998*

Rank	Company	Bay Area Employees	Company-wide Employees	1998 Revenue (Millions)
1	Sapient Corporation	500	1600+	$164
2	Macromedia	390	550	$113
3	Organic	170	500+	$30
4	Andromedia	102	102	---
5	Discreet	90	450	$174
6	Vivid Studios	80	80	---
7	Razorfish	50	500	$14
8	MetaDesign	50	200	---
9	Mondo Media	47	47	$4
10	Protozoa	40	40	---
11	Design Media	30	30	---
12	Interactive Bureau	14	55	$5
13	Planet 9 Studios	10	12	---

*Note: The universe of this survey is smaller than that used by city agencies, which includes multimedia divisions within companies whose primary business is not multimedia. This explains the high 35,000 multimedia employee count that city agencies report.

Source: San Francisco Business Journal

Profile of Space Needs for Multimedia Firms

As multimedia companies range from small privately-owned start-ups with one to two employees to large public corporations, the space needs of multimedia tenants are also diverse. The average company surveyed by Coopers and Lybrand rented 7,900 feet of space, although the range was quite large. As the multimedia industry matures and companies grow, many are looking for large blocks of space. For example, in one of the largest transactions in SOMA in 1998, Sega of America leased 160,000 square feet of office space at the Townsend Center and more recently LookSmart has agreed to occupy the 135,000 square-foot Southend Warehouse Building, representing the lagest lease transaction in the City of San Francisco during the second quarter of 1999. In the middle range, Platinum Technologies, Quokka Sports and Netcentives have all pre-leased space between 50,000 and 90,000 square feet in SKS' Multimedia Center. At the low end, young companies are looking for space between 3,000 and 10,000 square feet.

However, despite the large range in size needs, there are still quite a few commonalties. As discussed earlier, older, low-rise industrial buildings which are more **affordable** and have **larger, open floor plates and high ceilings** are generally preferred by multimedia companies. This of course, explains the attraction of the Multimedia Gulch area. A similar pattern can be found in other parts of the Bay Area. For example, Emeryville, which was historically an industrial area, is attracting a growing number of Internet companies as well as developers who are converting old industrial sites into high tech office space.

Top Office Space Requirements:

Rank	
1	Cost
2	Communication Infrastructure
3	Available Expansion Space
4	Flexibility of Space
5	Building Security

Source: Coopers and Lybrand, MGD.org

Another major issue is **room for expansion**. Because of such dynamic growth in the industry, companies are planning ahead and want to be in locales where they will be able to easily add space. Local brokers and developers report that many companies are outgrowing their space in less than a year, and scrambling to lease more space in the buildings where they are currently located. Single-year jumps to 100,000 square feet from under 10,000 square feet have occured and 25,000 to 50,000 square-foot jumps have become common. Getting expansion space in a timely manner is often an even more crucial consideration than rental rates because many expanding companies are trying to meet their launch dates. In response to tightening market conditions, companies have started renting large blocks of space in anticipation of future expansion and "warehousing" it in the short-term. The aforementioned LookSmart lease in the Gulch is a recent example of these trends. The company started out last year with 3,500 square feet and has expanded into a 134,000 square-foot space in less than a year following a $60 million private placement. LookSmart plans to lease out about 50,000 square feet of this space until it is ready to expand into the space itself.

Given these space requirements, a major concern for local companies is the ability of the SOMA area to continue to fulfill their space needs. The hot market has made larger blocks of contiguous space more expensive and more scarce. While demand for space is currently very strong, and has accelerated into 1999, over the long-term, tight market conditions will likely push tenants into other areas. Already, the borders of the Gulch are being pushed further and further out while some companies are also turning to the financial district and opting for Class A space. The fact that these firms are migratinag into the downtown, which does not have their ideal space type, instead of out of the area is a good indication of the desirability of San Francisco for multimedia companies. However, other parts of the Bay Area like Emeryville will also attract multimedia companies to a greater extent as space in the Gulch disappears and rents in the downtown, which have been fairly flat in 1999, begin to rise again. In the short-term, the substantial amount of renovated space coming to the market will continue to support company expansions and attract new entrants into the market, while new construction scheduled to come on line in a few years will also provide some releif for pent-up demand.