

SAN FRANCISCO OFFICE MARKET

FIRST QUARTER 2016

Market Rebounds Sublease Space Increases

The 1st quarter of 2016 has brought the same questions of market depth and momentum that we had in 2015. The increasing amount of sublease space is becoming the focal point in predicting where we might be headed. Is this just “right sizing” by companies who were too aggressive in their growth projections but are otherwise healthy, or is it the beginning of an avalanche of space as the tech bubble bursts? For spaces 20,000 square feet or larger, there are currently more than 1.3 million square feet of sublease space on the market. 756,000 square feet of that total came on the market in the 1st quarter 2016. Of the 22 companies who are subleasing, 17 are technology related, and most are downsizing operations. The current 4.9 million square feet of vacant space would last less than three years at the five-year average annual net absorption of approximately 1.7 million square feet.

ECONOMY




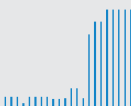


Employment flat in San Francisco

San Francisco unemployment stayed at 3.3% at the end of the 1st quarter, unchanged from the previous quarter. As some firms grow, others reduce headcount. The largest component of the labor force is professional and business services, accounting for 25% of all jobs. Silicon Valley also ended the first quarter with the same 3.9% unemployment rate it posted in the fourth quarter 2015. In Alameda County the unemployment rate was 4.3%, and 4.5% in Contra Costa County. The overall unemployment rate in California is 5.5%, and 5.0% nationally.

SUPPLY & DEVELOPMENT

New towers wait for tenants

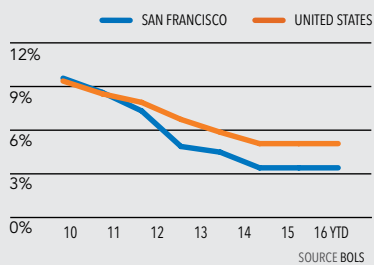
Two new buildings opened their doors in the first quarter – LinkedIn’s 450,000 square feet at 222 Second Street and Salesforce’s 450,000 square feet at 350 Mission Street. Three other office towers expecting to deliver in mid-2017 are still largely unleased. Salesforce Tower at 415 Mission Street is about 42% vacant, with over 593,000 square feet available on the upper floors. Deals for multiple floors are in the works, however. 350 Bush Street with 433,000 square feet and 181 Fremont Street with 413,000 square feet are in discussions with users but have yet to land any tenants.

TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	7.1% Sublease space increases
ABSORPTION 	221,609 SF Absorption levels rebound
RENTAL RATE 	\$68.07 PSF Rent reaches another all-time high
UNDER CONSTRUCTION 	3,620,125 SF Projects poised for delivery
PRICE PER SQUARE FOOT 	\$671 PSF Buildings trade at peak values
JOB GROWTH 	3.3% Unemployment

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UNEMPLOYMENT RATE

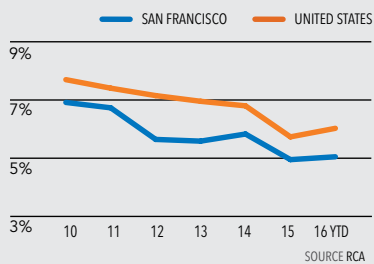


VACANCY

1st quarter vacancy declines

The overall vacancy rate for Class-A and Class-B office space in San Francisco declined forty basis points in the 1st quarter, from 7.5% to 7.1%. Out of the ten submarkets in the downtown area, six experienced negative absorption, with positive absorption in four. Two submarkets – South Financial District and SOMA/Rincon/Showplace Square - turned in positive net absorption of 448,276 square feet. Some of the large leases in these two submarkets were: Airbnb taking 150,000 square feet at Dolby's 999 Brannan Street, 94,889 square feet for Quantcast at 795 Folsom Street, and Twilio's lease for 92,000 square feet at 375 Beale Street.

CAP RATE



DEMAND

Leasing activity increases

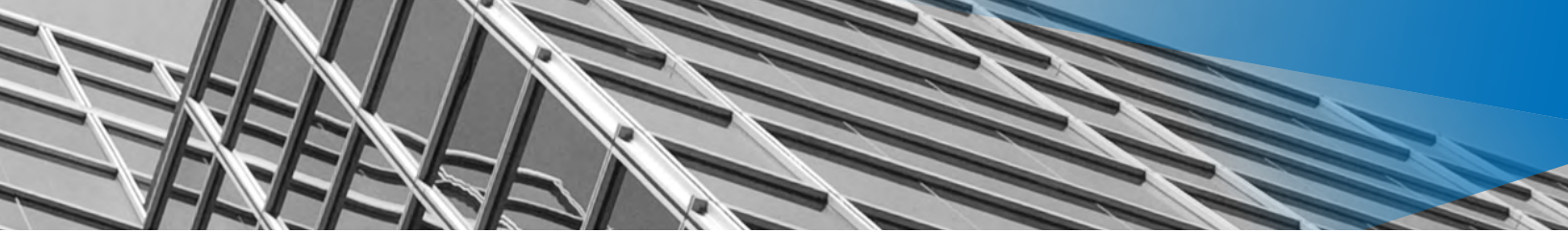
Net absorption was 221,609 square feet in the 1st quarter, which was a 33% improvement over the 166,219 square feet in the 4th quarter 2015. Even though this absorption is below the average absorption posted since 2011, it continues the trend of increasing occupancy levels. Since 2011, there have only been two quarters of negative absorption. Tech companies still account for most of the major lease requirements in the market, with Lyft, Fitbit and Google reportedly looking for 200,000-300,000 square feet each. Even though venture capital funding has dropped by approximately 30%, there remains enough business growth to keep demand and net absorption in positive territory.

San Francisco Office First Quarter Largest Lease Transactions

PROPERTY	TENANT	SF	TYPE	SUBMARKET
Airbnb	999 Brannan Street	150,000	Class B Direct	Showplace Square
Quantcast	795 Folsom Street	94,889	Class B Direct	Yerba Buena
Twilio	375 Beale Street	92,000	Class B Direct	Rincon/South Beach

San Francisco Office First Quarter Largest Sale Transactions

PROPERTY	BUYER	SF	PRICE	PRICE PSF	SUBMARKET
140 New Montgomery St	Pembroke	342,574	\$276.0 M	\$806.00	South Financial District
550 Kearny Street	Madison International	197,000	\$103.5 M	\$526.00	Financial District
995 Market Street	Bridgeton Holdings	91,000	\$62.0 M	\$681.00	MidMarket



RENTS

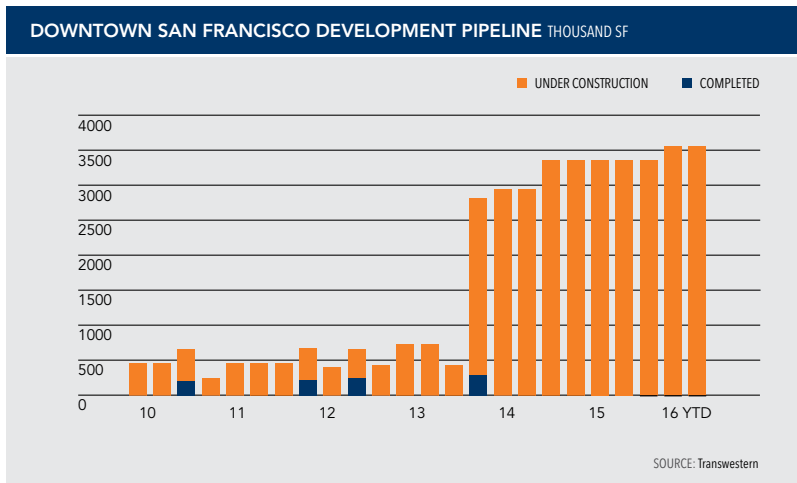
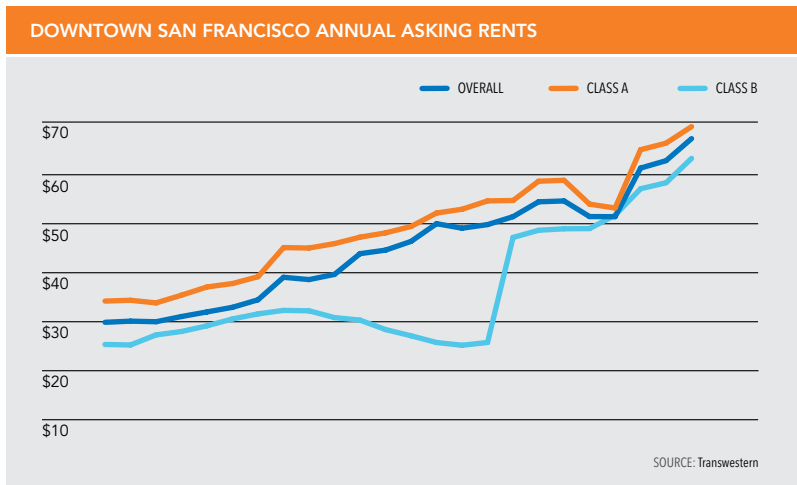
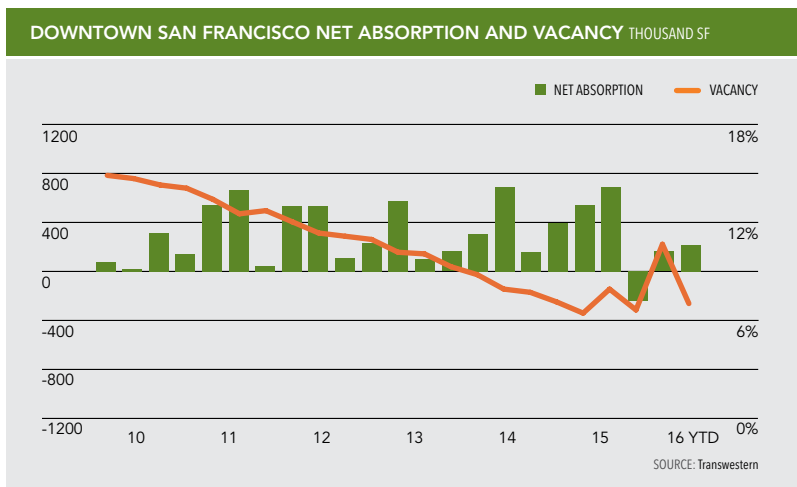
Lease rates hold steady

Average rental rates reached \$70.56 per square foot for Class-A space and \$63.96 per square foot for Class-B space in the 1st quarter. For Class-A office space, the highest rents are to be found in Mission Bay/China Basin \$77.14 per sf, followed by the South Financial District (\$71.66 per sf) and SOMA/Rincon (\$69.86 per sf). The Van Ness Corridor and North Waterfront have the lowest Class-A rents, which are in the mid-\$50's. Rent growth is expected to taper off in 2016 as demand slows down from the torrid pace of the last few years.

INVESTMENT

As prices increase, sales volume slows

There were only three major office building sales in the first quarter 2016, but they continued the trend of increasingly higher values for office buildings in San Francisco. 140 New Montgomery Street was sold by Wilson Meany Sullivan to Pembroke Properties for \$806 per square foot, which is in line with the \$813 per square foot paid for 116 New Montgomery Street in the 4th quarter 2015. A partial interest in 550 Kearny Street, a Class-B building on the northern edge of the Financial District was acquired by Madison International from Brickman Associates for \$526 per square foot. The building was 93% occupied at the time of sale. Another Class-B building, 995 Market Street was sold to Bridgeton Holdings from Long Market Properties for \$681 per square foot. Properties currently on the market for sale include 760 Market Street, 353 Sacramento Street and 1 Front Street.



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Metro San Francisco Office Market Indicators

SUBMARKET	INVENTORY	UNDER CONSTRUCTION	QTR NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	715,735	0	14,160	14,160	0.0%	0.0%	0.0%	\$-
Class B	2,404,725	0	28,945	28,945	3.7%	0.9%	4.5%	\$55.68
North Waterfront Subtotal	3,120,460	0	43,105	43,105	2.8%	0.7%	3.5%	
Class A	120,000	0	2,091	2,091	1.6%	0.0%	1.6%	\$55.00
Class B	983,741	0	-39,825	-39,825	15.0%	0.3%	15.3%	\$50.33
Van Ness Subtotal	1,103,741	0	-37,734	-37,734	13.6%	0.2%	13.8%	
Class A	444,347	0	-9,575	-9,575	8.9%	0.0%	8.9%	\$68.78
Class B	1,312,862	0	-24,466	-24,466	5.1%	0.7%	5.8%	\$63.21
Jackson Square Subtotal	1,757,209	0	-34,041	-34,041	6.1%	0.5%	6.6%	
Class A	21,563,224	72,000	-159,811	-159,811	7.4%	1.2%	8.7%	\$70.42
Class B	5,745,443	0	10,120	10,120	8.7%	0.4%	9.0%	\$67.39
North Financial District Subtotal	27,308,667	0	-149,691	-149,691	7.7%	1.1%	8.7%	
Class A	19,085,127	2,581,894	188,023	188,023	5.3%	0.8%	6.1%	\$71.66
Class B	3,577,382	0	11,240	11,240	3.1%	0.2%	3.4%	\$69.10
South Financial District Subtotal	22,662,509	2,581,894	199,263	199,263	4.9%	0.7%	5.7%	
Class A	213,125	0	26,166	26,166	0.0%	1.5%	1.5%	\$64.93
Class B	3,053,177	0	-51,304	-51,304	6.5%	0.1%	6.6%	\$62.84
Union Square Subtotal	3,266,302	0	-25,138	-25,138	6.1%	0.2%	6.3%	
Class A	553,917	0	38,748	38,748	0.0%	0.0%	0.0%	\$-
Class B	2,368,091	0	-56,218	-56,218	11.4%	0.0%	11.4%	\$62.29
Yerba Buena Subtotal	2,922,008	0	-17,470	-17,470	9.3%	0.0%	9.3%	
Class A	2,330,503	0	12,203	12,203	2.3%	2.3%	4.6%	\$57.70
Class B	1,585,093	0	8,599	8,599	1.2%	0.2%	1.4%	\$51.28
Mid Market Subtotal	3,915,596	0	20,802	20,802	1.9%	1.5%	3.3%	
Class A	1,704,945	0	25,895	25,895	3.6%	0.0%	3.6%	\$69.86
Class B	6,844,884	764,231	223,118	223,118	8.8%	0.8%	9.6%	\$66.35
SOMA Subtotal	8,549,829	764,231	249,013	249,013	7.8%	0.6%	8.4%	
Class A	2,508,788	202,000	-26,500	-26,500	4.2%	1.1%	5.2%	\$77.14
Class B	0	0	0	0	0.0%	0.0%	0.0%	\$-
Mission Bay Subtotal	2,508,788	202,000	-26,500	-26,500	4.2%	1.1%	5.2%	
Class A	49,239,711	2,855,894	111,400	111,400	5.8%	1.0%	6.9%	\$70.56
Class B	27,875,398	764,231	110,209	110,209	7.2%	0.4%	7.6%	\$63.96
San Francisco Market Total	77,115,109	3,620,125	221,609	221,609	6.3%	0.8%	7.1%	\$68.07

CONTACT

Michael Pitre
 Vice President, Tenant Advisory Services
 415.489.1824
 michael.pitre@transwestern.com

METHODOLOGY

The information in this report is the result of a compilation of information on office properties located in the Bay Area. Transwestern obtained the information from a variety of primary and secondary sources including CoStar. This report includes single-tenant and multi-tenant office properties 10,000 sq. ft. or larger, excluding office condominiums, medical office facilities, flex and owner-occupied properties.



101 Second Street, Suite 300
 San Francisco, CA 94105

CA BROKERAGE LIC 00875087
 T 415.489.1820