

SAN FRANCISCO OFFICE MARKET

FOURTH QUARTER 2016







Market ends Year on Upswing

San Francisco's office leasing market ended Q4 with a fever pitch after 3 consecutive quarters of nominal average rent rate shifts and an uptick in vacancy rates. This brought a close to the year with strong leasing activity and record-setting investment sales. Numerous factors in 2017 could decide whether these trends continue, including a 'new normal' venture capital funding environment and interest rate hikes. The local, national and global economy is growing, albeit slowly, which will benefit businesses in the Bay Area. The wave of downsizing and subleasing that San Francisco experienced early in 2016 has tapered off, and returned to robust levels. Venture funding, however, has fallen for six straight quarters and startup creation and expansion will be less pronounced than in the recent past. The delivery in 2017 of several million square feet of vacant Class-A office space in buildings under construction may temper rent growth over the next year or two, depending upon the rate at which this newly available office space leases. For now, much of that space is at the high end of the rent spectrum.

ECONOMY

Jobs Follow the Talent: Job gains in San Francisco and Bay Area

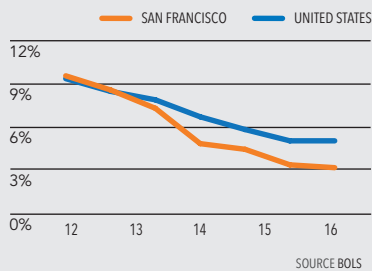
San Francisco's economy and work force talent draws companies to lease here because some of the best talent in the world is located here. Employers still look for the right recipe of Live, Work, Play when considering new and expanding operations, and it is no surprise that the unemployment rate continues to fall in San Francisco and the overall Bay Area. The close of the 4th quarter saw an unemployment rate of 3.1% in San Francisco, a decrease from 3.5% the previous quarter, and nearly a full percentage point since January 2015. In the surrounding Bay Area markets, Retail trade led expansion as retailers ramped up for the holiday season. San Mateo County continues to outperform other Bay Area markets with a 2.6% unemployment rate, down from 3.2% in the 3rd quarter. Santa Clara County ended 2016 with a 3.5% unemployment rate, dropping from 4.0% in the 3rd quarter. In Alameda County the unemployment rate fell to 4.0%, down from 4.6% in the 3rd quarter, and Contra Costa, where companies will look for more economical space, the unemployment rate ended the quarter at 4.1%, falling from 4.7% in the 3rd quarter. The overall unemployment rate is 5.0% in California and 5.0% nationally.

TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	7.3% Vacancy falls 40 basis points from Q3
ABSORPTION 	131,436 SF Absorption levels rebound
RENTAL RATE 	\$67.90 PSF Stabilizing in core areas
UNDER CONSTRUCTION 	4,979,689 SF
PRICE PER SQUARE FOOT 	\$764 PSF Overall prices increase
JOB GROWTH 	1% Less than 1% job growth

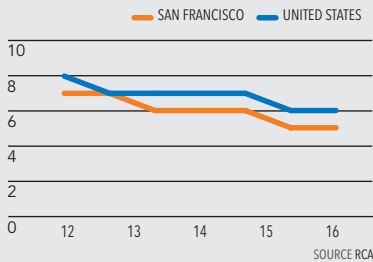
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UNEMPLOYMENT RATE



CAP RATE



SUPPLY & DEVELOPMENT

Most new development still unleased

Despite some high profile expansions in the 3rd and 4th quarters, some of the newly developed, marquis office space currently under construction still remains unleased, nearly a 70% vacancy rate in those projects. In the North Financial District, Blend Labs leased 500 Pine, a 56,000 square foot building completed in Q4 of 2016. In addition, Twitch/Amazon leased 236,942 square feet at 350 Bush Street, which should deliver in early 2017. However, 44% of the building is still vacant with asking rents in the mid to upper \$80s to low \$90s psf. In the South Financial District, over 100,000 square feet was leased in Salesforce Tower throughout 2016, but 543,000 square feet are still available – 38% of the building. Both 181 Fremont Street (413,000 sf) and 250 Howard Street (751,000 sf) have not signed any leases through Q4 2016. In SOMA, Adobe took 190,000 square feet of office/PDR space at 100 Hooper Street, a 380,000 square foot development currently under construction by Kilroy Realty. Another 190,000 square feet is available in two buildings.

VACANCY

Vacancy falls in the 4th quarter

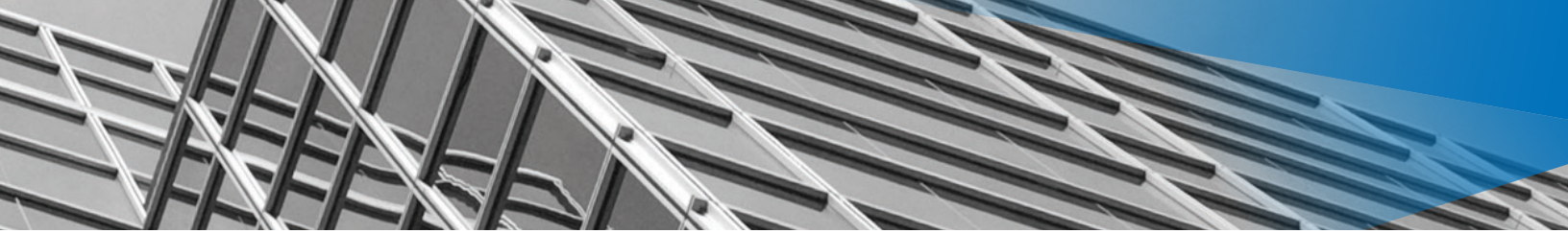
San Francisco's office vacancy rate for Class-A and Class-B space negated its 3rd quarter increase and fell forty basis points, from 8.0% to 7.6%. Of the ten submarkets in the downtown area, four experienced positive absorption, while six of the submarkets experienced negative absorption. The SOMA/Rincon/Showplace Square submarket was the highlight of the quarter with net gains of

San Francisco Office Fourth Quarter Largest Lease Transactions

PROPERTY	TENANT	SF	TYPE	SUBMARKET
211 Main Street	Charles Schwabb	394,704	Class A Direct	South Financial District
500 Howard Street	Slack	247,238	Class A Direct	South Financial District
185 Berry Street	Lyft	204,367	Class A Sublease	Mission Bay/China Basin
100 Hooper Street	Adobe	190,000	Class A Sublease	SOMA/Rincon/Showplace Square
1 Tenth Street	Nerd Wallet	104,850	Class A Sublease	Mid Market
1355 Market Street	Thumbtack	78,792	Class A Sublease	Mid Market

San Francisco Office Fourth Quarter Largest Sale Transactions

PROPERTY	BUYER	SF	PRICE	PRICE PSF	SUBMARKET
1 Front Street	Paramount Group	651,732	\$520M	\$799	Financial District
500 Howard Street	American Realty Advisors	291,083	\$350M	\$1202	South Financial District
55 Hawthorne Street	CIM Group	134,402	\$123M	\$915	South Financial District
430 California Street	Takenaka, Kennedy Wilson	295,783	\$121M	\$410	Financial District
55 Francisco Street	Jamestown	143,695	\$91M	\$633	North Waterfront
115 Sansome Street	Vanbarton Group	128,838	\$83M	\$644	Financial District
600 Townsend Street E	Blackstone	82,862	\$81M	\$978	Showplace Square



437,000 square feet of positive absorption. In the CBD, the North Financial District continued to see positive absorption, adding another 20,000 square feet. However, the South Financial District experienced a large increase in vacancy, with negative absorption of 252,000 square feet in the final quarter of the year. After an uptick in Q2 and Q3, Sublease space has continued to come off the market, dropping from approximately 20% to 14% of all vacancies this quarter.

DEMAND

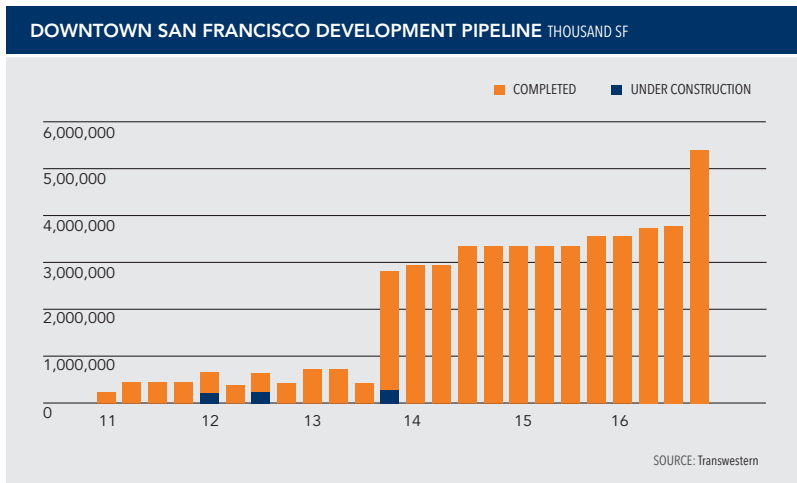
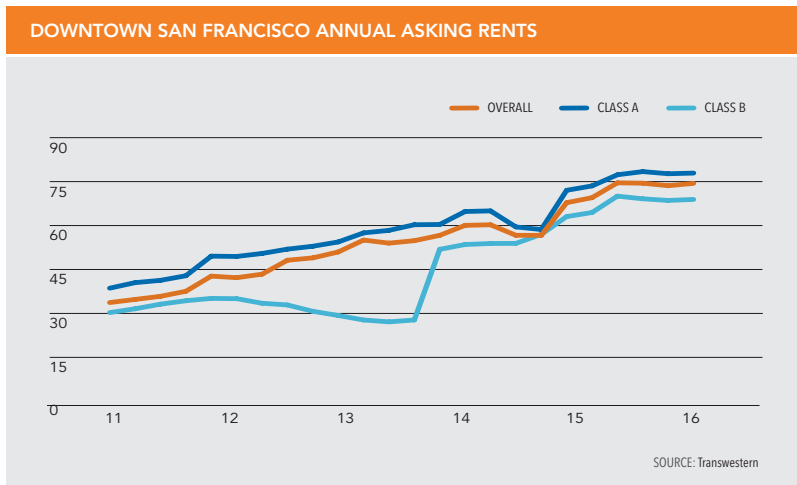
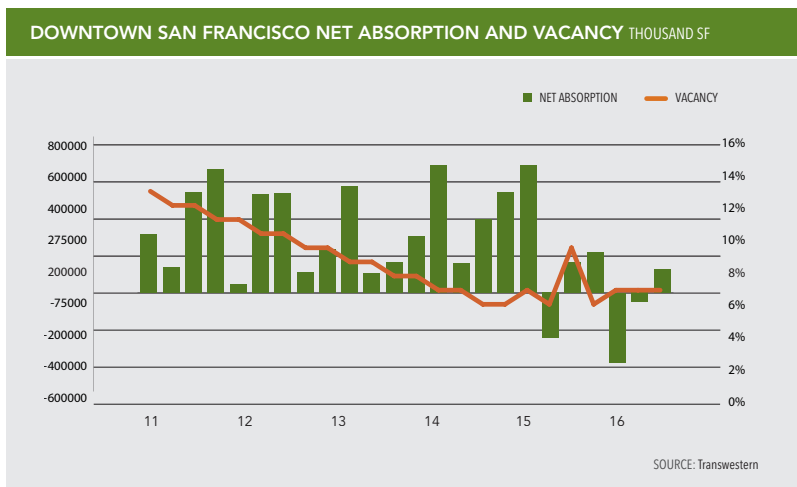
Net absorption increases in 4th Quarter

Net absorption was positive in the final quarter of the year as available space decreased by 131,436 square feet. SOMA had 437,333 square feet of positive absorption, again, thanks in large part to Adobe’s lease at 100 Hooper Street. Despite strong leasing activity in the South Financial District, the market had negative absorption of 252,312 square feet, the most of any submarket in the city. The largest lease in the quarter belonged to Charles Schwab, who renewed for 349,704 square feet at 211 Main Street, which helped lead the market to finish the year on a positive note with 4 leases over 100,000 square feet being executed.

RENTS

2nd consecutive quarter of rent decreases

Average rental rates declined slightly by about one percent, to \$70.88 per square foot for Class-A space and declined a little less than one percent to \$62.63 per square foot for Class-B space in the 3rd quarter. Average office rents fell from \$67.96 per square foot in the 2nd quarter to \$67.18 in the 3rd quarter. For Class-A office space, the highest rental rates are found in Mission Bay/China Basin (\$75.73 per sf), followed by the North Financial District (\$72.12 per sf) and the South Financial District (\$71.83 per sf). Asking rates have been slowly declining for several quarters in a row, but the shortage of available space and relatively consistent demand has kept rates stable in core submarkets.



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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	(11,584)	38,583	2.0%	2.0%	4.0%	\$61.59
Class B	2,407,735	0	(1,553)	(61,271)	6.4%	0.0%	6.4%	\$45.48
North Waterfront Subtotal	3,123,470	0	(13,137)	(22,688)	5.4%	0.5%	5.8%	
Class A	120,000	0	0	2,555	2.0%	0.0%	2.0%	\$51.00
Class B	981,692	0	1,630	(59,141)	17.0%	0.0%	17.0%	\$49.53
Van Ness Subtotal	1,101,692	0	1,630	(56,586)	15.4%	0.0%	15.4%	
Class A	444,347	0	(11,102)	149	6.7%	0.0%	6.7%	\$67.01
Class B	1,284,550	0	11,549	(15,246)	5.0%	0.2%	5.2%	\$64.53
Jackson Square Subtotal	1,728,897	0	447	(15,097)	5.5%	0.2%	5.6%	
Class A	21,218,933	447,000	50,853	(255,935)	7.6%	1.1%	8.6%	\$71.98
Class B	6,216,618	0	(30,982)	(70,166)	11.4%	0.2%	11.6%	\$67.14
North Financial District Subtotal	27,435,551	447,000	19,871	(326,101)	8.4%	0.9%	9.3%	
Class A	19,155,595	2,581,894	(199,179)	196,209	5.2%	0.8%	6.0%	\$72.26
Class B	3,493,916	159,740	(53,133)	(176,302)	5.8%	0.1%	5.9%	\$69.54
South Financial District Subtotal	22,649,511	2,741,634	(252,312)	19,907	5.3%	0.7%	6.0%	
Class A	213,125	0	0	29,330	0.0%	0.0%	0.0%	
Class B	3,038,027	0	(10,241)	(48,136)	7.4%	0.0%	7.4%	\$66.31
Union Square Subtotal	3,251,152	0	(10,241)	(18,806)	6.9%	0.0%	6.9%	
Class A	531,214	0	0	97,359	1.1%	0.0%	1.1%	\$62.00
Class B	2,398,719	0	(24,059)	(259)	7.9%	0.1%	8.0%	\$68.45
Yerba Buena Subtotal	2,929,933	0	(24,059)	97,100	6.6%	0.1%	6.8%	
Class A	2,330,503	0	(3,443)	(77,795)	0.9%	7.5%	8.4%	\$60.74
Class B	1,440,922	0	(12,065)	(111,097)	4.6%	7.6%	12.2%	\$54.80
Mid Market Subtotal	3,771,425	0	(15,508)	(188,892)	2.3%	7.6%	9.9%	
Class A	1,916,434	394,000	(18,605)	(136,312)	8.5%	3.3%	11.7%	\$66.38
Class B	6,898,381	657,055	455,938	455,719	4.9%	0.9%	5.7%	\$63.07
SOMA Subtotal	8,814,815	1,051,055	437,333	319,407	5.6%	1.4%	7.0%	
Class A	2,508,788	740,000	(12,588)	227,782	3.9%	0.6%	4.5%	\$76.39
Class B	0	0	0	0	0.0%	0.0%	0.0%	
Mission Bay Subtotal	2,508,788	740,000	(12,588)	227,782	3.9%	0.6%	4.5%	
Class A	49,154,674	4,162,894	(205,648)	121,925	6.0%	1.3%	7.3%	\$71.08
Class B	28,160,560	816,795	337,084	(85,899)	7.5%	0.7%	8.2%	\$62.94
San Francisco Market Total	77,315,234	4,979,689	131,436	36,026	6.5%	1.1%	7.6%	\$67.90

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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.



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