

MARKETBEAT

San Francisco

Office Q3 2016



SAN FRANCISCO OFFICE

Economic Indicators*

	Q3 15	Q3 16	12-Month Forecast
San Francisco Employment	1,060K	1,088K	▼
San Francisco Unemployment	3.5%	3.3%	▲
U.S. Unemployment	5.2%	4.9%	■

*Q3 16 data based on August values

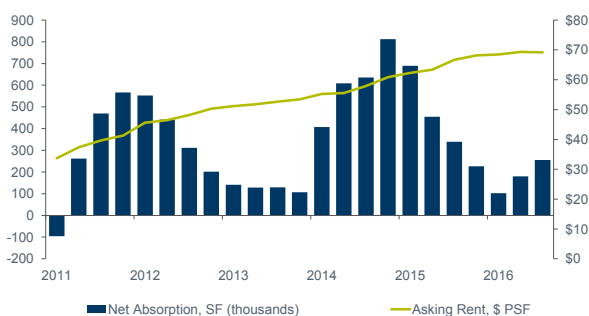
Market Indicators (Overall, All Classes)

	Q3 15	Q3 16	12-Month Forecast
Overall Vacancy	6.0%	7.7%	▲
Net Absorption (sf)	-117K	185K	▼
Under Construction (sf)	4.3M	3.8M	▼
Average Asking Rent*	\$66.71	\$69.21	▼

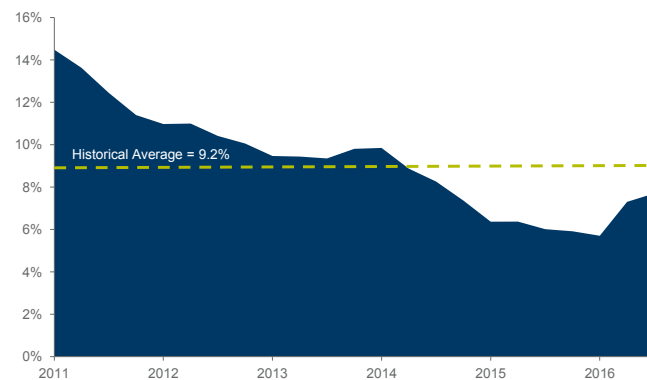
*Rental rates reflect full service asking \$psf/year

Overall Net Absorption/Overall Asking Rent

4-QTR TRAILING AVERAGE



Overall Vacancy



Market Rebalancing

The unemployment rate in the San Francisco market (San Francisco-Redwood City-South San Francisco metropolitan division) was 3.4% in August, down from a revised 3.6% in July, and below the 3.5% reported one year ago. Total private sector jobs reached a record high in August (961,800 positions) with +2.4% growth year-over-year. Total office using positions increased +2.5% annually to its own new record figure of 414,400.

After the longest economic expansion in recent history, the San Francisco commercial real estate market was relatively flat in the third quarter with a hint of stabilization.

Citywide overall vacancy closed the quarter at 7.7%, a 40 basis point (BPS) increase from the second quarter. Overall asking rents dipped -\$0.09 per square foot (PSF) to \$69.21 PSF. Overall vacancy is at the highest rate since the third quarter of 2014 and asking rents are down for the first time since the second quarter of 2010. The overall availability rate, which measures all space actively marketed, whether vacant or occupied, now stands at 11.2%.

CBD Class A direct vacancy was up 60 BPS over the quarter, rising to 6.4%. Rents were relatively flat, dipping -\$0.10 PSF to \$74.39 PSF. Civic Center/Mid-Market saw the largest increase in vacancy as Twitter put a 180,000-square-foot (SF) block on the market for sublease. The South Financial District of the CBD accounted for the second largest jump in vacancy; there wasn't one single space that caused the increase, however, the largest new blocks were located at 525 Market Street and 201 Mission Street.

Construction & Development

New construction completions reached 1.5 million square feet (MSF) in 2016, the biggest year for completions since 2008. The new inventory was 96.0% leased at the time of delivery. The only new building to deliver in the third quarter was 500 Pine Street in the North Financial District with 55,000 SF currently 100% vacant. In the South Financial District, the fully leased MTC building at 375 Beale Street completed a major renovation, adding 530,000 SF of inventory to the market. There will be no more building deliveries in 2016.

Significant deliveries are expected in 2017 as 3.0 MSF is scheduled to be delivered with 40.0% currently pre-leased. The majority of new deliveries will be concentrated in the CBD with a total of 2.2 MSF delivering at Salesforce Tower, 181 Fremont Street, and 350 Bush Street (a combined 46.0% pre-leased at the time of writing). Additionally, there are five potential deliveries scheduled for 2018 totaling 1.8 MSF.

Leasing Activity & Absorption

Leasing activity totaled 875,000 SF in the third quarter; the weakest third quarter since 2001. Large deal activity was practically non-existent, with only one lease greater than 100,000 SF signed during the quarter (Twitch at 350 Bush Street for 180,000 SF). Year-to-date leasing activity stands at 4.4 MSF, the lowest level since 2010.

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There is light at the end of the tunnel though, as a number of large leases are on pace to close by year-end.

Overall net absorption totaled 185,000 SF in the third quarter, bringing the year-to-date total to 770,000 SF. Positive absorption for the year was fueled by the previously mentioned 1.5 MSF of fully leased construction completions. Blocks of space that were left behind by those tenants include: 135,000 SF at One Montgomery Street (LinkedIn) and 195,000 SF at 185 Berry Street (Dropbox; which was backfilled in the second quarter). The fourth quarter may pick up the slack as tenants are expected to occupy an additional 500,000 SF.

Sublease Activity

Sublease vacancy remained relatively flat for the quarter after a big jump last quarter. Sublease vacancy increased +2.1% quarterly to 1.5 MSF. On a positive note, sublease availability, a leading indicator of the overall health of the market, pulled back in the third quarter both in absolute terms and as a percentage of overall availability falling -8.5% and now totaling 2.4 MSF. In total, sublease space from tech firms now accounts for roughly half of all available sublease inventory (including the aforementioned Twitter block).

The market was relatively flat in the third quarter and appeared to be stabilizing.

Sales

Cushman & Wakefield tracked seven sales in the third quarter totaling \$1.6 billion and we expect five more sales totaling \$1.4 billion to close by the end of October. The expected transaction activity for the second half of the year will be the highest volume the city has experienced in its history.

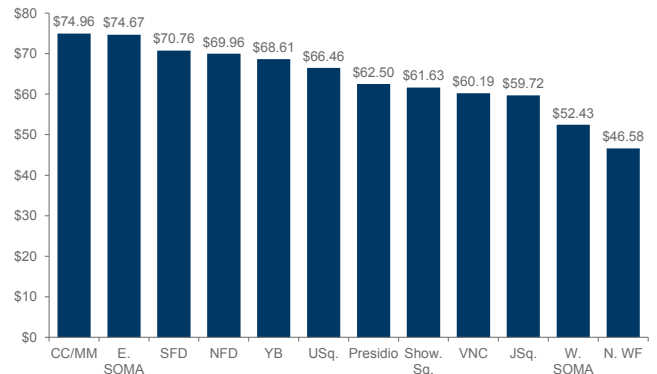
Some of the more notable third quarter transactions included a high-net worth individual's acquisition of the landmark Phelan building at 760 Market Street in Union Square and HNA EcoTech Group's purchase of 123 Mission in the South Financial District. Both purchasers were new entrants to the market and underscored the belief among global investors that San Francisco continues to be an attractive long-term option.

Outlook

- Cushman & Wakefield forecasts that over the next two years rents will flatten and vacancy will increase as major new construction comes on-line and job growth slows.
- Tenant touring activity totals 4.0 MSF and tenant requirements larger than 100,000 SF are in the double digits, although this is lower than the last two years at this time. A number of large transactions are near the finish line and may close by year-end.

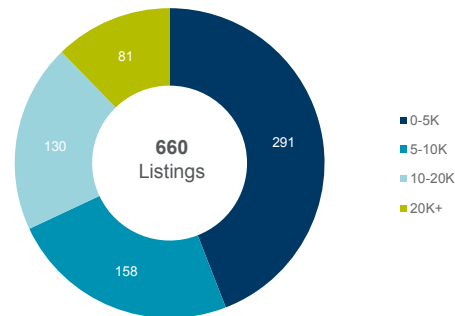
Average Asking Rate by Submarket (Full Service)

CC/MM AND E. SOMA SURPASSES CBD SUBMARKETS



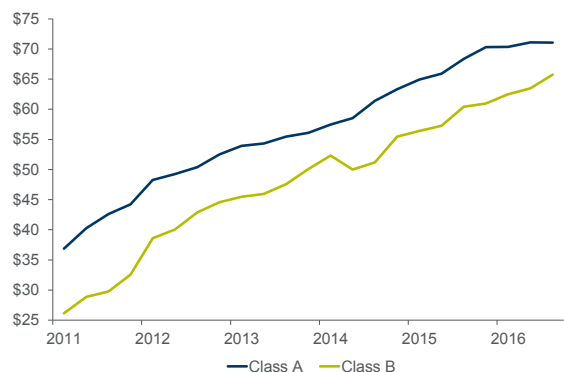
Availabilities by Size Segment

INCREASING SUPPLY OF 10-20K SF SPACE



Average Asking Rate by Class (Full Service)

CLASS A RENTS FLATTEN IN THIRD QUARTER



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SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL VACANCY RATE	CURRENT QTR OVERALL NET ABSORPTION (SF)	YTD OVERALL NET ABSORPTION (SF)	YTD LEASING ACTIVITY (SF)	UNDER CNSTC (SF)	OVERALL AVERAGE ASKING RENT (ALL CLASSES)*	OVERALL AVERAGE ASKING RENT (CLASS A)*
North Financial District	25,908,335	440,284	2,245,296	10.4%	36,713	-558,933	1,565,165	370,000	\$69.96	\$71.64
South Financial District	25,724,588	479,564	1,166,063	6.4%	373,535	1,377,107	1,308,855	2,568,398	\$70.76	\$71.88
CBD	51,632,923	919,848	3,411,359	8.4%	410,248	818,174	2,874,020	2,938,398	\$70.23	\$71.73
Jackson Square	1,490,806	24,544	41,961	4.5%	4,280	-28,187	33,170	0	\$59.72	\$59.00
North Waterfront	3,176,308	19,838	124,411	4.5%	-3,734	62,875	162,586	0	\$46.58	\$49.42
East SOMA	4,838,815	114,371	329,552	9.2%	27,770	483,419	461,476	153,117	\$74.67	\$79.93
West SOMA	851,672	13,637	3,500	2.0%	-13,637	-13,637	0	0	\$52.43	N/A
The Presidio	1,030,627	0	4,384	0.4%	-4,384	-4,384	0	0	\$62.50	\$62.50
Union Square	3,173,989	30,672	144,263	5.5%	-18,329	-62,073	184,627	0	\$66.46	\$71.07
Van Ness Corridor	785,956	2,553	16,918	2.5%	-304	-6,258	4,051	0	\$60.19	\$60.19
Showplace Square / Potrero Hill	3,111,042	128,748	235,522	11.7%	-128,308	-247,969	200,368	0	\$61.63	\$63.77
Mission Bay	1,056,735	0	0	0.0%	0	0	97,700	680,000	N/A	N/A
Yerba Buena	3,108,383	8,776	154,371	5.2%	78,787	3,026	260,913	0	\$68.61	\$52.00
Civic Center / Mid-Market	3,159,668	251,308	40,712	9.2%	-167,779	-237,494	89,033	0	\$74.96	\$57.36
Third Street Corridor	349,465	N/A	N/A	N/A	N/A	N/A	N/A	0	N/A	N/A
TOTAL	77,766,389	1,514,294	4,506,953	7.7%	184,610	767,492	4,367,944	3,771,515	\$69.21	\$71.04

*Rental rates reflect full service asking \$psf/year

OFFICE CLASS BREAKDOWN										
Class A	53,575,381	994,344	3,230,910	7.9%	-136,846	978,680	3,142,453	3,771,515	\$71.04	
Class B	16,573,440	436,904	891,469	8.0%	308,342	-139,138	889,322	0	\$65.74	
Class C	7,617,568	83,047	384,574	6.1%	13,114	-72,050	336,169	0	\$60.07	

Key Lease Transactions Q3 2016

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
350 Bush Street	178,000	Twitch	Lincoln Property / Gemdale USA	Direct	North Financial District
650 Townsend Street	60,864	iRythm	Zynga	Direct	Showplace Square
505 Howard Street	54,698	Silicon Valley Bank	Tishman Speyer	Sublease	South Financial
3180 18th Street	34,000	OpenAI	Bridgeton Holdings	Direct	Potrero Hill

Key Sale Transactions Q3 2016

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
100 First Street*	465,363	Norges Bank Investment Mgmt.	Kilroy Realty	\$435,000,000 / \$935	South Financial District
100 Montgomery Street	431,407	Vanbarton Group	The Blackstone Group	\$284,000,000 / \$658	North Financial District
123 Mission Street	345,595	HNA Group North America	Pacific Eagle	\$255,000,000 / \$738	South Financial District
760 Market Street	298,124	Phelan Building LLC	Thor Equities	\$374,000,000 / \$1,255	Union Square
353 Sacramento Street	284,751	KBS Strategic Opportunity REIT	Pacific Eagle	\$169,500,000 / \$595	North Financial District

*Partial interest sale

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