

MARKETBEAT

San Francisco

Office Q3 2017



SAN FRANCISCO OFFICE

Economic Indicators*

	Q3 16	Q3 17	12-Month Forecast
San Francisco Metro Employment	1,099K	1,119K	▲
San Francisco Metro Unemployment	3.1%	3.0%	▼
U.S. Unemployment	4.9%	4.4%	▼

*Q3 17 data based on August values

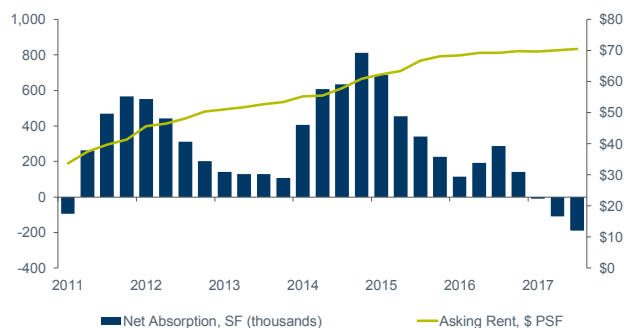
Market Indicators (Overall, All Classes)

	Q3 16	Q3 17	12-Month Forecast
Overall Vacancy	7.7%	8.5%	▲
Net Absorption (sf)	263K	-56K	▼
Under Construction (sf)	3.8M	5.1M	▼
Average Asking Rent*	\$69.21	\$70.51	▲

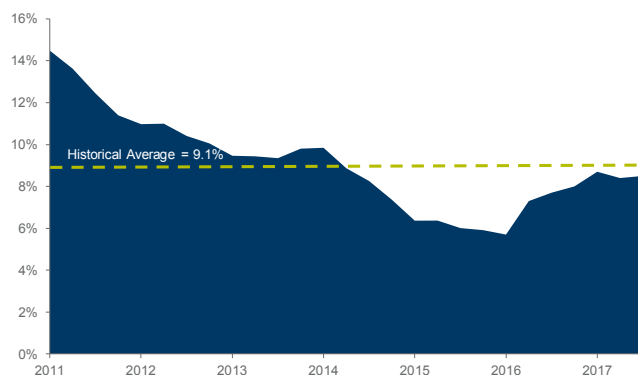
*Rental rates reflect full service asking \$psf/year

Overall Net Absorption/Overall Asking Rent

4-QTR TRAILING AVERAGE



Overall Vacancy



Another Wave of “Big Tech” Leasing

The unemployment rate for the San Francisco metropolitan division (San Francisco and San Mateo counties) was 3.3% in August, unchanged from the 3.3% reported one year ago as the market has reached full employment translating to hiring challenges across the spectrum. Total private sector jobs increased by +1.8% to 992,800 while office using positions were essentially flat year-over-year at 425,800.

- The San Francisco office market is undergoing another wave of very strong leasing activity – this time around not just start-ups but established technology companies taking down large blocks of space.
- The Citywide overall vacancy rate closed the second quarter at 8.5%, an increase of +10 basis points (bps) from the second quarter and a +80 bps increase from one year ago.
- The CBD saw direct Class A vacancy increase +40 bps to 7.7% in the third quarter. The North Financial District continues to carry the majority of vacancy in the CBD (9.1%) compared with the South Financial District (6.5%). That said, the North Financial District remained unchanged while South Financial direct vacancy increased +80 bps.
- The Citywide overall asking rent increased +\$0.35 per square foot (psf) or +0.5% to \$70.51 psf in the third quarter. The CBD Class A direct average asking rent decreased -\$0.38 psf or +0.5% in the third quarter to \$74.71 psf.

Construction & Development

A total of 5.1 million square feet (msf) was under construction at the end of the third quarter with 1.8 msf of new construction scheduled to deliver in the fourth quarter of this year including Salesforce Tower and 350 Bush Street. At the close of the quarter, 1.1 msf (63.7%) of this inventory was pre-leased. A number of large users are in negotiation for the remainder of this space and these buildings may very likely deliver at 100% occupancy.

As of August a total of 1.2 msf remained in San Francisco’s Prop M large cap office allocation pool with an additional 875,000 sf to be added on October 17th for a total of 2.1 msf. Two waterfront projects could put a serious dent in the remaining cap if and when they move forward. The San Francisco Giants just secured a round of approvals from the Planning Department that could tie-up 1.4 msf of the office allocation. Additionally, Forest City’s Pier 70 mixed use project was awarded approval in August which could take down any remaining balance. Neither of these projects has to go through the Prop M approval process. It is likely, however, that these sites will be built out over several years with office properties going forward in stages. Beyond these two mega-projects, there is another 3.8 msf in pending projects with 4.7 msf in the pre-application phase. All of this makes it very clear that San Francisco could easily be without any allocation left in 2018.

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With 5.5 msf of tenants in the market and with 16 of these tenants (most well financed big tech) looking for at least 100,000 sf, any remaining blocks are likely to be absorbed quickly. In fact, we count 15 blocks 100,000 sf or greater that are or will be available thru 2020 (in existing or under construction product). There is a real possibility that bidding wars for these spaces could lead to price spikes. That said, there remains a substantial amount of smaller so-called commodity space available in San Francisco for both start-up operations and non-tech companies.

AT THE CURRENT PACE, 2017 SHOULD BE THE MOST ACTIVE YEAR FOR LEASING ACTIVITY SINCE 2014'S TOTAL OF 9.8 MSF.

Leasing Activity & Absorption

New leasing closed the third quarter at 1.8 msf of activity with the year to date figure totaling 5.6 msf. At the current pace, 2017 should be the most active year since 2014's total of 9.8 msf. By far, the largest transaction of the quarter was Facebook's 423,000 sf at 181 Fremont Street. Facebook will occupy the entire office portion in the first half of 2018. The second largest lease in the third quarter totaled 176,000 sf at 525 Market Street and was leased to a technology company. Additionally, Dropbox is pending to take the entire 680,000 sf at The Exchange in Mission Bay.

Overall net absorption (the net change in occupied space) was essentially flat in third quarter, totaling -55,894 sf due to a lack of large block move-ins. C&W measures absorption at the time of move-in and with several construction completions delivering in the fourth quarter and into early 2018, positive absorption will return quickly to San Francisco.

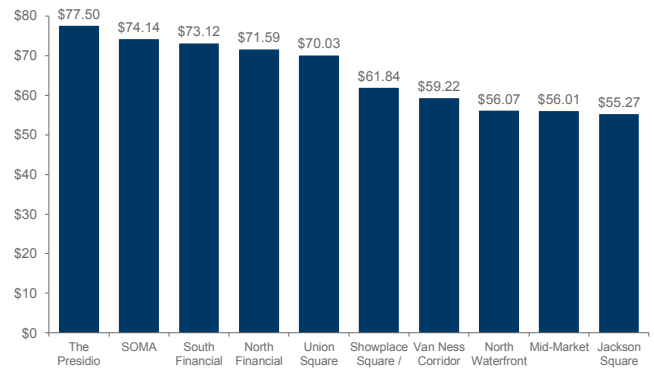
Investment Activity

There is a scarcity of inventory for sale in San Francisco. There were only three Class A sales in Q3 and two were partial interest sales. Tishman Speyer bought out JP Morgan 80% share in 222 Second Street occupied by LinkedIn. Additionally, Allianz Global Real Estate purchased a 22.5% ownership in 333 Market Street as a part of a portfolio sale by Columbia Property Trust. Activity should remain low for the remainder of the year.

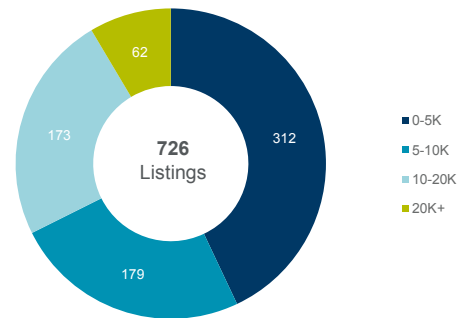
Outlook

- Continued office job growth throughout the remainder of 2017 though at a slower pace.
- Positive net absorption at year end as new construction delivers at or near fully leased.
- Average asking rents will continue upward trend.
- Demand fundamentals strong due to heavy in-bound demand from big tech.

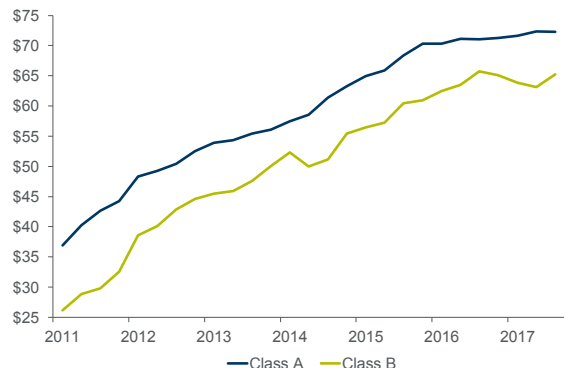
Average Asking Rate by Submarket (Full Service)
THE PRESIDIO AND SOMA CONTINUE TO OUTPRICE CBD



Availabilities by Size Segment
DECREASING SUPPLY FOR 20K+ SF SPACES



Average Asking Rate by Class (Full Service)
CLASS B RENTS ON THE RISE 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	495,652	2,362,701	11.0%	-52,165	-109,319	1,679,733	370,000	\$71.59	\$72.91
South Financial District	25,627,040	333,887	1,570,404	7.4%	46,213	-133,574	2,268,587	3,618,398	\$73.12	\$73.80
CBD	51,535,375	829,539	3,933,105	9.2%	-5,952	-242,893	3,948,320	3,988,398	\$72.17	\$73.30
Jackson Square	1,490,806	3,545	28,248	2.1%	16,849	40,973	70,176	0	\$55.27	\$59.00
North Waterfront	3,176,308	57,838	150,295	6.6%	-4,353	-57,151	137,118	0	\$56.07	\$58.58
SOMA	7,947,198	223,987	485,532	8.9%	71,785	-52,418	786,153	153,117	\$74.14	\$78.25
The Presidio	1,030,627	0	8,664	0.8%	0	5,330	8,563	0	\$77.50	\$77.50
Union Square	3,173,989	47,290	201,151	7.8%	-10,709	-54,208	133,715	0	\$70.03	\$73.89
Van Ness Corridor	878,956	4,674	111,816	13.3%	0	-7,019	5,358	0	\$59.22	\$57.09
Showplace Square / Potrero Hill	3,261,042	85,975	335,733	12.9%	-156,029	-140,373	472,188	314,000	\$61.84	\$61.76
Mission Bay	1,056,735	0	0	0.0%	43,625	0	43,625	680,000	N/A	N/A
Mid-Market	4,223,733	29,482	118,135	3.5%	-11,110	88,388	10,228	0	\$56.01	\$60.91
Third Street Corridor	349,465	0	0	0.0%	0	0	0	0	N/A	N/A
TOTAL	78,124,234	1,282,330	5,372,679	8.5%	-55,894	-419,371	5,615,444	5,135,515	\$70.51	\$72.29

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

OFFICE CLASS BREAKDOWN										
Class A	55,190,495	821,714	4,111,732	8.9%	-109,379	-375,203	4,380,926	4,982,398	\$72.29	
Class B	15,634,271	369,102	1,029,796	8.9%	53,158	-110,362	948,698	153,117	\$65.23	
Class C	7,299,468	91,514	231,151	4.4%	327	66,194	285,820	0	\$61.30	

Key Lease Transactions Q3 2017

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
181 Fremont Street	404,000	Facebook	Jay Paul Company	New Lease	South Financial
525 Market Street	176,000	Confidential	Knickerbocker Properties	Direct	South Financial
1 Sansome Street	107,000	Wish*	PGIM Real Estate / Barker Pacific Group	Renewal / Expansion	North Financial
44 Montgomery Street	84,000	WeWork	Beacon Capital Partners	Direct	North Financial
250 Brannan Street	62,000	Dropbox	Kilroy Realty Corporation	Direct	SOMA
185 Berry Street	58,000	Lyft	JPMorgan Chase & Co.	Expansion	SOMA
315 Montgomery Street	54,000	LendingHome	Vornado Realty Trust	Direct	North Financial

*Renewal 55,000 SF and expansion 52,000 SF

Key Sale Transactions Q3 2017

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
333 Market Street*	657,000	Allianz Real Estate	Columbia Property Trust	\$112,500,000 / \$761	South Financial
222 Second Street	452,000	Tishman Speyer	JPMorgan Chase & Co.	\$542,900,000 / \$1,200	South Financial
150 Post Street	106,000	PGIM Real Estate	Federal Realty Investment Trust	\$69,300,000 / \$655	Union Square

*Columbia Property Trust sold a 22.5% interest to Allianz Real Estate valuing the building at \$500 million

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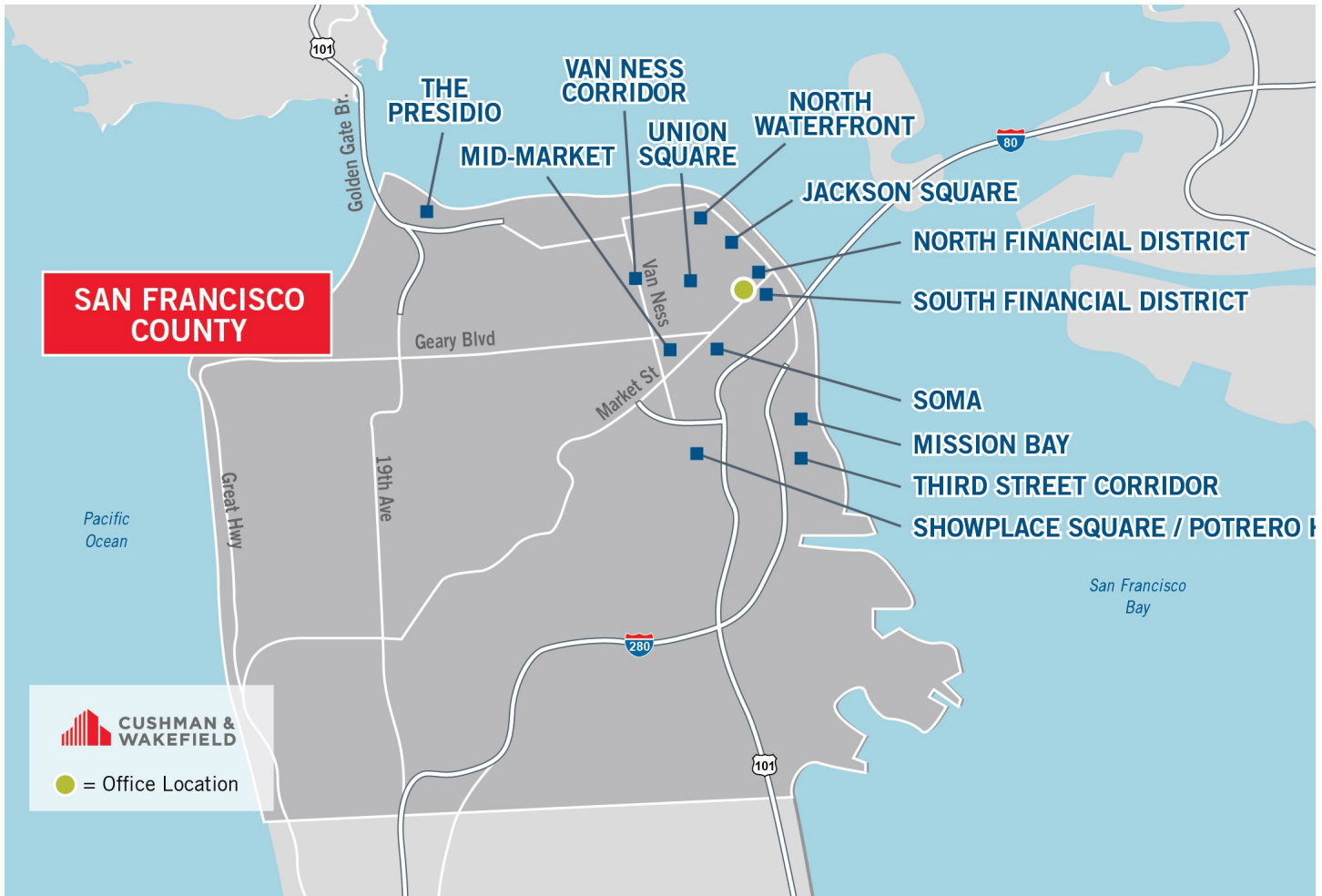
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Office Submarkets

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