

Q₃ 2016 TRI Commercial Real Estate Services
SAN FRANCISCO TRENDS

First signs of negative absorption.....

OUTLOOK FOR 2016

The current market signals are a curious mixed bag. Sublease space has grown, nearly doubling over the last 12 months, from 1.4 million square feet a year ago to 2.3 million square feet at the end of this 3rd Quarter.

Although this situation can almost certainly be attributed to the tech sector slowing down, we are still seeing demand from tenants such as Nerd Wallet, Blend Labs, Fastly, Pivotal, Uber, Slack, Accenture and others--each seeking a minimum of 100,000 square feet of office space in a concentrated area of San Francisco.

This creates an interesting scenario, as both subleases and large space demands are occurring simultaneously. It is quite likely the market will continue to slow down, but the landing won't be as disruptive as witnessed previously in the Dot-com era.

MARKET OVERVIEW

Absorption continued its downward trend in the San Francisco office market. The 3rd Quarter ended with an overall absorption of negative 130,395 square feet, down from 204,966 positive square feet from the 2nd Quarter, and 795,351 positive square feet from the 1st Quarter. Leasing activity continued to be slow and rental rates remained relatively flat. Sublet office space hovered around 2.3 million square feet, compared to 1.4 million square feet a year ago. Citywide direct vacancy rate is at 4.4%, up slightly from 2nd Quarter's 4.1%.

3rd QUARTER ACTIVITY

In the Downtown Core, direct vacant available space is at 5.4%, up from the 2nd Quarter at 4.7%. Class A average direct asking rates reduced slightly from mid-to-high \$60's; Class B is in the mid-\$50's. The tech-heavy South of Market submarkets experienced its first negative absorption of 310,941 square feet. In contrast, North of Market submarkets turned in a positive absorption of 176,415 square feet.

Large lease transactions done in the 2nd Quarter included Twitch pre-leasing 177,826 square feet at 350 Bush, with an estimated delivery in the 1st Quarter of 2017. Price Waterhouse leased 78,285 square feet at 2 Embarcadero. McKinsey moved into 50,105 square feet at 555 California. OpenAI leased 37,104 square feet at 3180 Eighteenth. Manatt, Phelps & Philips renewed their 35,912 square feet lease at 1 Embarcadero and Capital One leased 29,498 square feet at 201 Third.

Foreign investors targeting San Francisco are in the spotlight once again. Israeli investor-backed KBS purchased 353 Sacramento for \$169 million, or \$596 per square foot. New York's Vanbarton Group closed its transaction at 100 Montgomery for \$284 million, or \$658 per square foot. The Chinese HNA Group paid \$255 million, or \$737 per square foot, for 180 Montgomery. More eye-popping sale prices included private London-based Phelan paying \$374 million, or \$1,256 per square foot, for 760 Market; ZARA's Amancio Ortega of Spain paid \$145 million, or \$1,496 per square foot, for the Tiffany office building at 350 Post; and UK's Grosvenor USA purchased 240 Stockton for \$80 million, for a whopping \$1,978 per square foot.

Downtown Core is North & South Financial Submarkets; Mid-Market is the area bordered by Civic Center to the north, Union Square to the east, Howard Street to the south and Van Ness to the west. SoMa is the area bordered by Market Street to the north, 6th Street to the east, Bryant Street to the south and 12th Street to the west.

In Summary:

- *Negative net absorption of 130,395 square feet in the 3rd-Quarter*
- *Class A direct asking rates in the mid-to-high \$60's*
- *Class B direct asking rates in the mid-\$50's*
- *Direct vacant available - Downtown Core at 5.4%; Citywide at 4.4%*

ABSORPTION - SAN FRANCISCO OFFICE MARKET





Q3 MAJOR LEASE TRANSACTIONS

Tenant	Address	Sq.Ft.
Twitch	350 Bush	177,826
Price Waterhouse	2 Embarcadero	78,285
McKinsey & Co.	555 California	50,105
OpenAI	3180 Eighteenth	37,104
Manatt, Phelps, & Philips	1 Embarcadero	35,912
Capital One	201 Third	29,498
Practice Fusion	731 Market	27,567
Switchfly	601 Montgomery	26,690
Zendesk	1033-1045 Market	17,663
Newmark Cornish & Carey	1 Bush	17,044
Showpad, Inc.	301 Howard	14,191
Circle CI	201 Spear	14,011
Talx	660 Third	11,864

Q3 LARGE SALE TRANSACTIONS

Buyer	Address	Price	Per Sq.Ft.
Phelan Building, LLC	760 Market	\$374.5 Million	\$1,256
Vanbarton Group	100 Montgomery	\$284.0 Million	\$ 685
HNA Group N.A, LLC	123 Mission	\$255.0 Million	\$ 737
KBS Strategic REIT	353 Sacramento	\$141.5 Million	\$ 595
Amancio Ortega	350 Post	\$145.0 Million	\$1,496
Grosvenor USA Ltd	240 Stockton	\$ 80.0 Million	\$1,978
Invesco	Pier 3	\$ 53.6 Million	\$1,351

DOWNTOWN CORE CLASS A VACANCY & RENTAL RATES



DOWNTOWN CORE CLASS B VACANCY & RENTAL RATES



Note: Rental rates based on COSTAR data on the above charts are lower than actual market rental rates due to averaging of undisclosed "negotiated rents." Graph is based on Vacant Direct space; Vacant Direct Available space is what is actually on the market for lease.

SUBMARKET STATISTICS

Submarket	Net Rentable Area (sq.ft.)	QTR Absorption (sq.ft.)	Total Avail. (%)	Vacant Direct * (%)	Vacant Dir.Avail. (%)
Financial District	29,902,877	171,320	13.0	11.3	6.5
South Financial District	27,984,451	(117,011)	16.9	6.2	5.4
Yerba Buena	3,582,994	9,605	9.8	5.2	5.1
Rincon/South Beach	6,569,761	63,596	8.6	8.0	4.0
Jackson Square	3,135,260	(31,485)	6.3	5.3	3.7
Union Square	5,406,043	(49,486)	8.4	5.7	5.3
Mid-Market	7,061,447	(194,173)	7.8	2.7	2.3
Civic Center	4,298,896	(1,150)	2.0	2.0	1.5
Van Ness Corridor	2,346,932	42,592	6.9	4.5	4.5
Waterfront/North Beach	4,361,218	36,580	9.4	5.5	5.1
South of Market	2,102,692	4,608	6.9	2.8	2.8
Showplace Square	3,172,091	(42,122)	14.4	9.6	4.9
Potrero East/West of 101 Fwy	2,152,6955	(126,646)	7.3	3.6	1.5
Mission Bay/China Basin	3,499,718	123,864	19.9	5.5	2.5

*Total direct available is not necessarily all vacant, as some of the space may be occupied and available on a 30 to 120-day notice or proposed space.

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