

SAN FRANCISCO | OFFICE MARKET

Q2 | 2015

Accelerating success.

Office Vacancy Falls Dramatically

5.2 million square feet of new construction (6 percent added to existing inventory) will increase vacancy in 2016

888 Brannan Street, which is currently the largest Class A asset for sale in the city.

143 Second Street sold for \$816/SF – This is an all-time record price for a Class B office building

Stripe inked the largest lease YTD in 2015, taking 300,000 SF at 510 Townsend Street with a scheduled 2017 occupancy

FitBit leased nearly 164,000 SF at 199 Fremont, the second largest lease of the quarter



► **VACANCY** San Francisco’s overall office vacancy rate fell to 6.3 percent in the quarter, a 6 percent decrease from 6.7 percent in the first quarter. The Financial District experienced the largest decrease in vacancy, with tenants attracted by public transportation and proximity to Market Street.

► **CONSTRUCTION** 5.2 million square feet is under construction adding an unprecedented 5.8 percent to the city’s total. This may result in increased vacancy and flat rents in 2016, unless demand doubles from current levels (already 2.5 million annually).

► **LEASING VOLUME** Strong employment in the city continues to drive leasing activity with nearly 1.9 million square feet of transactions in the second quarter. Eight leases over 100,000 square feet were signed in the first half of 2015, with 3 being renewing leases and five representing tenants expanding their footprint in the city.

► **ABSORPTION** San Francisco posted its twentieth consecutive quarter of positive absorption, netting nearly 300,000 square feet, almost 92 percent of which occurred in the Financial District. Year-to-date absorption is currently at 1,209,000 square feet. Driven by rapid tech grow, the race for space is forcing some tenants to lease more space than their immediate needs require in order to secure space for future planned growth.

► **RENTS** Overall market weighted rental rates reflected an increase of 3.2 percent for the second quarter and weighted Class A rents rose 2.5 percent. Meanwhile, weighted Class B rents continued to climb and finished the quarter up 5.2 percent. This is a continued trend from the previous year and the first quarter resuming its normal pattern of rental increases that had only been interrupted in the fourth quarter of 2014 when weighted Class B rents briefly paused their growth.

Market Indicators

Relative to prior period	Q2 2015	2015 Forecast
VACANCY	↓	↔
NET ABSORPTION	↑	↑
CONSTRUCTION	↑	↑
WEIGHTED RENTAL RATE	↑	↑
NON-WEIGHTED RENTAL RATE	↑	↑
SALES VOLUME	↓	↓
SALES PRICES	↓	↑

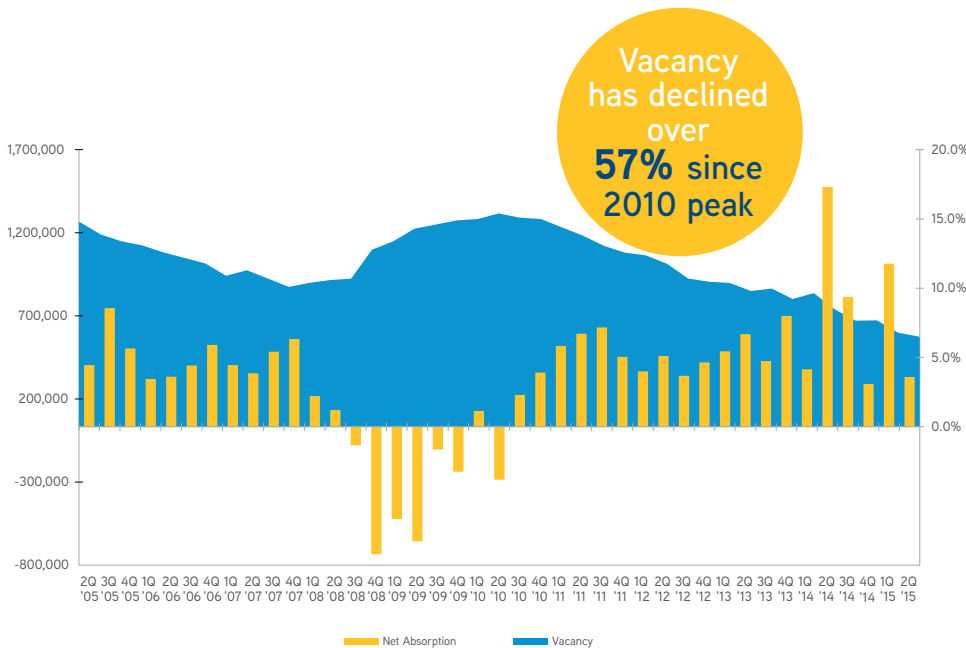
San Francisco – Office Rents - Q2 2015					
MARKET	2Q '15 OVERALL	2Q '15 DIRECT	2Q '15 SUBLEASE	1Q '15 OVERALL	% OVERALL QUARTERLY CHANGE
All Markets	\$67.13	\$67.99	\$56.76	\$65.05	3.2%
All Markets: Class A	\$67.66	\$68.97	\$56.76	\$66.04	2.5%
All Markets: Class B	\$66.47	\$66.47	-	\$63.17	5.2%
Financial District: Class A	\$68.07	\$69.21	\$52.61	\$67.33	1.1%
Financial District: Class B	\$65.52	\$65.52	-	\$61.84	6.0%
SOMA Overall	\$69.22	\$69.22	-	\$65.25	6.1%

Source: Colliers International

Note: Weighted Average Rents

Rental Rates

Strong leasing activity in the market continued to drive rents up, but the rate of growth has waned in comparison to the previous two years. Class B rents experienced the strongest growth as many tenants have hit a rent threshold and are looking for more affordable options. In the South Financial District weighted Class B rents increased 15.6 percent in the second quarter alone, to \$73.04 per square foot.



Source: Colliers International

Absorption & Vacancy

The Financial District experienced the largest occupancy gains for the quarter with approximately 275,000 square feet of positive net absorption. A significant amount of these gains in the Financial District can be attributed to Mixpanel moving into nearly 61,000 square feet at 405 Howard Street and WeWork's occupancy of 91,000 square feet at 535 Mission Street. This positive net absorption helped to shrink the vacancy rate for the Financial District by 50 basis points to 6.7 percent.



Source: Colliers International

Investment Volume

2014 was a peak investment year with over \$5 billion in sales volume. Investment sales have since tapered off during the first half of 2015, but are anticipated to finish the year strong. As it did in the first quarter, the Financial District continued to dominate investment sales activity with three major office properties changing hands. The largest sale for the quarter was 160 Spear Street for \$197.7 million (\$683 per square foot). Trading at the highest price per square foot during the quarter was 143 Second Street, which sold to a private investment group for \$816 per square foot, or \$16.1 million. Additionally, 580 Market Street sold to Paragon Real Estate Fund for \$24.2 million (\$716 per square foot).

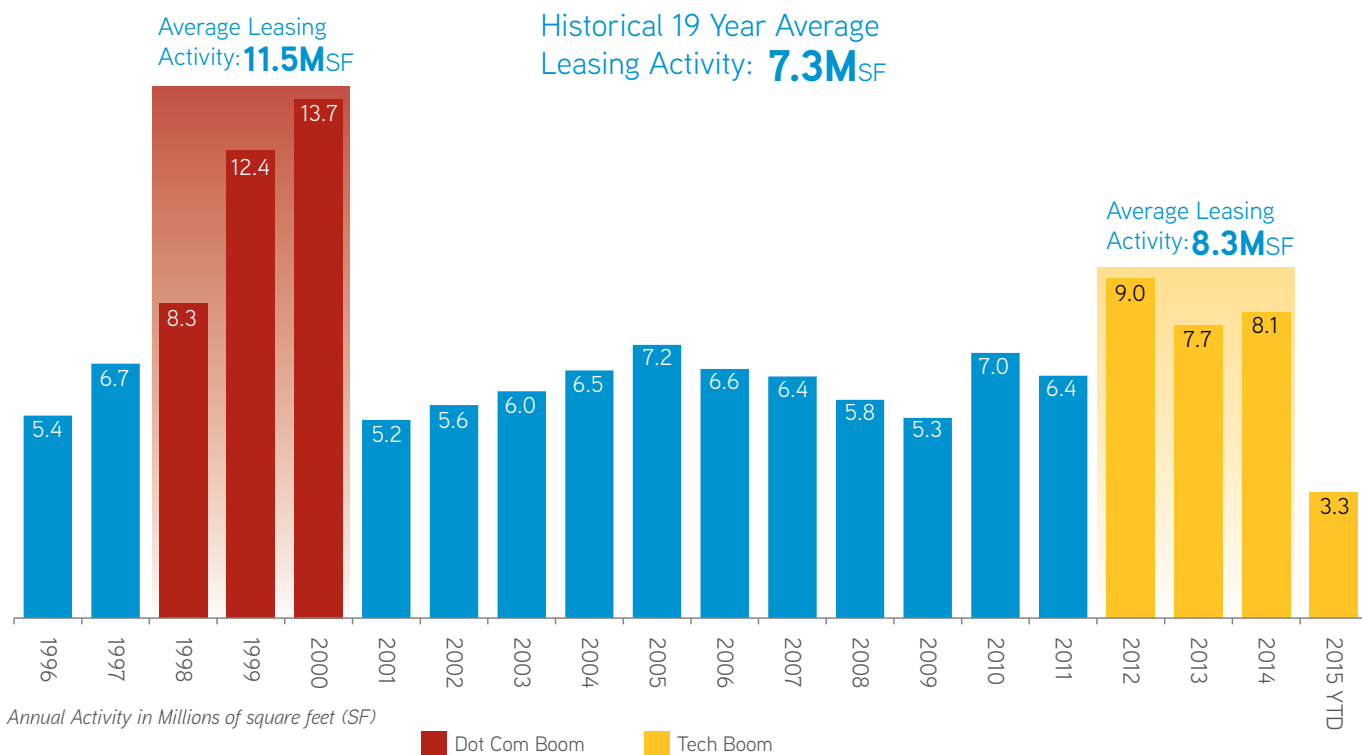
Major Office Lease Transactions - Q2 2015

ADDRESS	TENANT	SIZE	TYPE	SIGNED DATE	CLASS
SIGNIFICANT LEASES Q2 2015					
510 Townsend Street	Stripe	300,000	New	Apr - 15	A
199 Fremont Street	Fitbit	163,628	New	Jun - 15	A
595 Market Street	Lending Club	122,330	New	Apr - 15	A
4 Embarcadero Center	Sheppard, Mullin, Richter & Hampton	72,000	Renewal	Apr - 15	A
400 2nd Street	Sony	63,000	Renewal/Expansion	Jun - 15	B
50 Beale Street	Instacart	56,288	New	May - 15	A
100 California Street	NRG Energy	51,530	New	May - 15	A

Major Office Sale Transactions - Q2 2015

ADDRESS	SELLER	BUYER	SQ.FT.	SALES DATE	CLASS	SALE PRICE	PRICE/SQ.FT.
SIGNIFICANT SALES Q2 2015							
160 Spear Street	Legacy Partners	Tishman Speyer	289,253	May - 15	A	\$197,700,000	\$683
580 Market Street	Market Street Real Estate Partners	Paragon Real Estate Fund, LLC	33,656	May - 15	B	\$24,150,000	\$716
143 2nd Street	Market Street Real Estate Partners	143 SF Investors LLC	19,741	Apr - 15	B	\$16,100,000	\$816

Historical Annual Leasing Chart



Development Pipeline

340 Bryant Street completed construction this quarter, adding an additional 62,050 square feet to the market. The San Francisco market has approximately 5.2 million square feet currently under construction increasing the city's office space by a massive 5.8 percent with 1.4 million square feet scheduled to be delivered this year alone. 88 percent of that 2015 space has been pre-leased.

Leasing Activity

The San Francisco market's leasing activity continues to be one of the healthiest in the country. During this current tech boom, leasing activity has surpassed the historical annual average of 7.3 million square feet, though it still remains well below the 11.5 million square foot annual average during the 2000 dot com boom. Adding to the leasing activity volume, the market closed three new transactions over 100,000 square feet this quarter, including the largest transaction year-to-date with Stripe leasing 300,000 square feet at 510 Townsend Street.

Existing Properties											Absorption		New Supply		U/C & Proposed	
Class	# of Buildings	Total Inventory (square feet)	Direct Vacant (square feet)	Direct Vacancy Rate	Sublease Vacant (square feet)	Sublease Vacancy Rate	Total Vacant (square feet)	Occupied Space (square feet)	Vacancy Rate Current Period	Vacancy Rate Prior Period	Current Net Absorption	YTD Net Absorption	Net New Supply Current (square feet)	Net New Supply YTD	Under Construction (square feet)	Proposed (square feet)
DOWNTOWN MARKET:																
A	177	57,516,593	3,422,360	6.0%	412,000	0.7%	3,834,360	53,682,233	6.7%	7.1%	217,911	1,106,842	-	151,360	4,529,372	12,142,765
B	293	24,687,717	1,359,659	5.5%	71,704	0.3%	1,431,363	23,256,354	5.8%	6.4%	147,909	167,139	62,050	95,630	670,215	49,730
C	130	6,739,967	349,921	5.2%	4,802	0.1%	354,723	6,385,244	5.3%	4.3%	(66,301)	(65,176)	-	-	-	-
Total	600	88,944,277	5,131,940	5.8%	488,506	0.5%	5,620,446	83,323,831	6.3%	6.7%	299,519	1,208,805	62,050	246,990	5,199,587	12,192,495
FINANCIAL DISTRICT:																
A	106	43,448,284	2,702,784	6.2%	298,016	0.7%	3,000,800	40,447,484	6.9%	7.5%	223,450	527,042	-	-	3,048,224	2,533,820
B	73	8,145,794	401,580	4.9%	8,023	0.1%	409,603	7,736,191	5.0%	5.7%	54,670	142,494	-	-	-	-
C	36	1,640,936	129,731	7.9%	-	0.0%	129,731	1,511,205	7.9%	7.7%	(3,435)	(7,453)	-	-	-	-
Total	215	53,235,014	3,234,095	6.1%	306,039	0.6%	3,540,134	49,694,880	6.7%	7.2%	274,685	662,083	-	-	3,048,224	2,533,820
SUBMARKETS:																
North Financial	116	28,405,524	1,929,894	6.8%	184,114	0.6%	2,114,008	26,291,516	7.4%	7.8%	105,744	183,724	-	-	372,000	-
South Financial	99	24,829,490	1,304,201	5.3%	121,925	0.5%	1,426,126	23,403,364	5.7%	6.5%	168,941	478,359	-	-	2,676,224	2,533,820
Total	215	53,235,014	3,234,095	6.1%	306,039	0.6%	3,540,134	49,694,880	6.7%	7.2%	274,685	662,083	-	-	3,048,224	2,533,820
Union Square	60	4,150,158	159,329	3.8%	9,759	0.2%	169,088	3,981,070	4.1%	3.5%	(24,299)	4,571	-	-	-	-
Yerba Buena	31	4,623,673	166,205	3.6%	47,990	1.0%	214,195	4,409,478	4.6%	6.1%	67,712	79,107	-	-	53,016	1,534,240
SOMA West	41	3,468,914	123,544	3.6%	10,000	0.3%	133,544	3,335,370	3.8%	4.1%	10,213	51,109	-	-	55,000	3,695,673
SOMA East	56	5,270,348	359,558	6.8%	42,565	0.8%	402,123	4,868,225	7.6%	7.6%	(6,389)	(52,196)	62,050	95,630	1,035,519	49,730
Civic Center/Mid-Market	45	6,371,304	496,189	7.8%	-	0.0%	496,189	5,875,115	7.8%	7.9%	8,525	469,346	-	-	-	-
Jackson Square	40	2,330,330	75,545	3.2%	8,649	0.4%	84,194	2,246,136	3.6%	3.9%	7,746	(453)	-	-	-	-
North Waterfront	47	3,557,849	259,270	7.3%	15,678	0.4%	274,948	3,282,901	7.7%	8.2%	22,323	(29,024)	-	-	61,680	-
Van Ness Corridor	21	1,233,094	163,095	13.2%	-	0.0%	163,095	1,069,999	13.2%	13.7%	5,277	(78,657)	-	-	-	-
Potrero West	18	1,339,348	42,614	3.2%	-	0.0%	42,614	1,296,734	3.2%	2.4%	(10,045)	(13,380)	-	-	-	-
Potrero East	11	864,650	30,151	3.5%	47,826	5.5%	77,977	786,673	9.0%	4.0%	(43,593)	(24,825)	-	-	-	284,471
Mission Bay	15	2,499,595	22,345	0.9%	-	0.0%	22,345	2,477,250	0.9%	0.4%	(12,636)	141,124	-	151,360	946,148	4,094,561
Total	600	88,944,277	5,131,940	5.8%	488,506	0.5%	5,620,446	83,323,831	6.3%	6.7%	299,519	1,208,805	62,050	246,990	5,199,587	12,192,495
QUARTERLY COMPARISON AND TOTALS																
Q1-15	600	88,943,907	5,424,199	6.1%	525,301	0.6%	5,949,500	82,994,407	6.7%	7.5%	909,286	909,286	184,940	184,940	5,029,975	10,898,043
Q4-14	606	89,580,305	6,298,905	7.0%	411,308	0.5%	6,710,213	82,870,092	7.5%	7.5%	257,443	2,800,269	307,235	1,557,396	5,161,899	12,643,043
Q3-14	606	89,303,236	5,997,997	6.7%	662,424	0.7%	6,660,421	82,642,815	7.5%	8.3%	781,565	2,554,546	55,756	1,250,161	4,965,035	13,070,043
Q2-14	605	89,213,545	6,771,446	7.6%	614,784	0.7%	7,386,230	81,827,315	8.3%	9.4%	1,442,981	1,772,981	425,993	1,194,405	4,990,366	11,119,347

FOR MORE INFORMATION

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