

# SAN FRANCISCO | OFFICE MARKET

Q3 | 2016

Accelerating success.

## Market Leasing Volume Wanes, but Market Remains Solid.



**> VACANCY** The overall vacancy rate rose 40 basis points from the second quarter to 6.9 percent. While the City experienced an increase in vacancy the current vacancy rate remains extremely low, which reflects the health of the San Francisco market. The direct vacancy rate inched up only 10 basis points to 5.7 percent. Meanwhile this quarter vacant sublease space is up 30 basis points to 1.2 percent. While this is the first time vacant sublease rate hit over 1 percent in the past five years, the vacant sublease rate remains well below the high water market of 5.1 percent experienced in 2002.

**> LEASING VOLUME** Leasing activity slowed during the third quarter of 2016 to over 1.1 million square feet of transactions recorded. Leasing activity in the City continues to fall short of the 10-year historical average of 1.7 million square feet. The market has experienced a cooling in leasing activity in comparison to the furious pace in activity over the past three years, but there is still big demand for well located and ready to go space in the market. Additionally, there are numerous large deals in progress that are due to close next quarter. Another positive sign is despite a slowdown in activity rents have remained stable and the market is seeing sublease rents trading higher than the master lease rents.

**> ABSORPTION** The San Francisco office market posted a record 25th consecutive quarter of positive absorption and brought the year-to-date total to 1.2 million square feet. The primary driver for posting nearly 150,000 square feet this quarter was due to the newly renovated building at 375 Beale Street. Additionally, the SOMA East and Yerba Buena submarkets experienced large net absorption gains, posting over 273,000 and nearly 124,000 square feet of positive net absorption, respectively. Tenant demand remains solid for space in San Francisco with over 4.5 million square feet of office space requirements involving 129 tenants in the market and fourteen of those tenant requirements are looking for over 100,000 square feet.

**> RENTS** Overall citywide rents softened slightly this quarter, this can be mostly attributable to the four large leases signed in the second quarter which had effective rental rates in the \$80's or higher and pushed overall weighted rents to \$77.37 per square foot. Year-over-year citywide rents have increased nearly 5 percent to \$73.81 per square foot. Annually, Class A weighted rents have rose 8.4 percent to \$77.54 and the non-weighted Class A rents increased 1.9 percent to \$73.02 per square foot.

### Market Indicators

Relative to prior period	Q3 2016	2016 Forecast
VACANCY	↑	↓
NET ABSORPTION	↑	↑
CONSTRUCTION	↔	↑
WEIGHTED RENTAL RATE	↓	↑
NON-WEIGHTED RENTAL RATE	↓	↑
SALES VOLUME	↔	↑
SALES PRICES	↔	↑

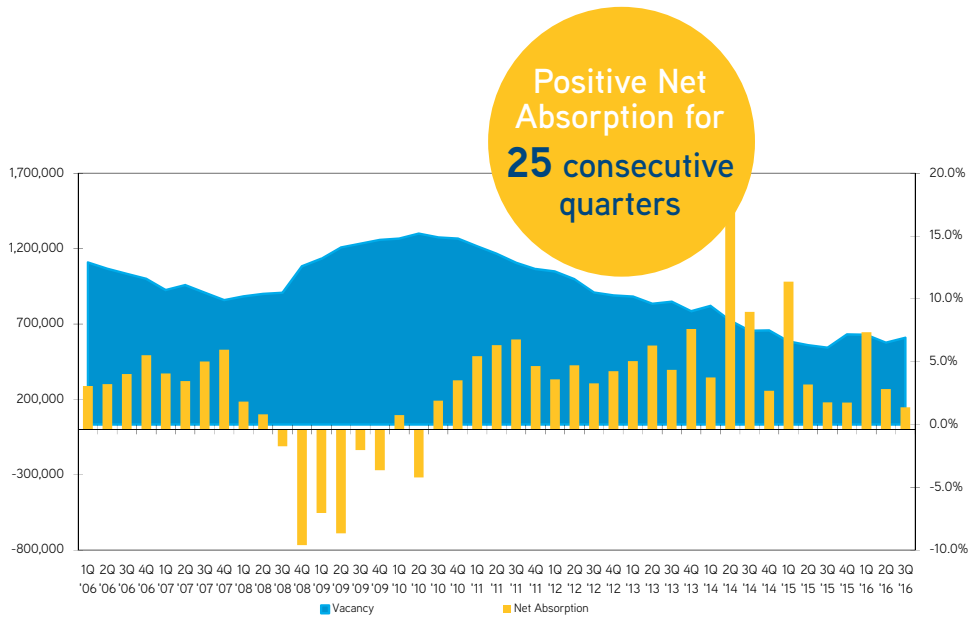
San Francisco – Office Rents - Q3 2016					
MARKET	3Q '16 OVERALL	3Q '16 DIRECT	3Q '16 SUBLEASE	2Q '16 OVERALL	% OVERALL QUARTERLY CHANGE
All Markets	\$73.81	\$73.39	\$76.24	\$77.37	-4.6%
All Markets: Class A	\$77.54	\$77.54	-	\$80.42	-3.6%
All Markets: Class B	\$69.85	\$69.21	\$76.24	\$70.52	-1.0%
Financial District: Class A	\$77.62	\$77.62	-	\$77.25	0.5%
Financial District: Class B	\$60.72	\$60.72	\$73.65	\$69.33	-12.4%
SOMA Overall	\$71.55	\$70.77	\$76.24	\$82.57	-13.3%

Source: Colliers International

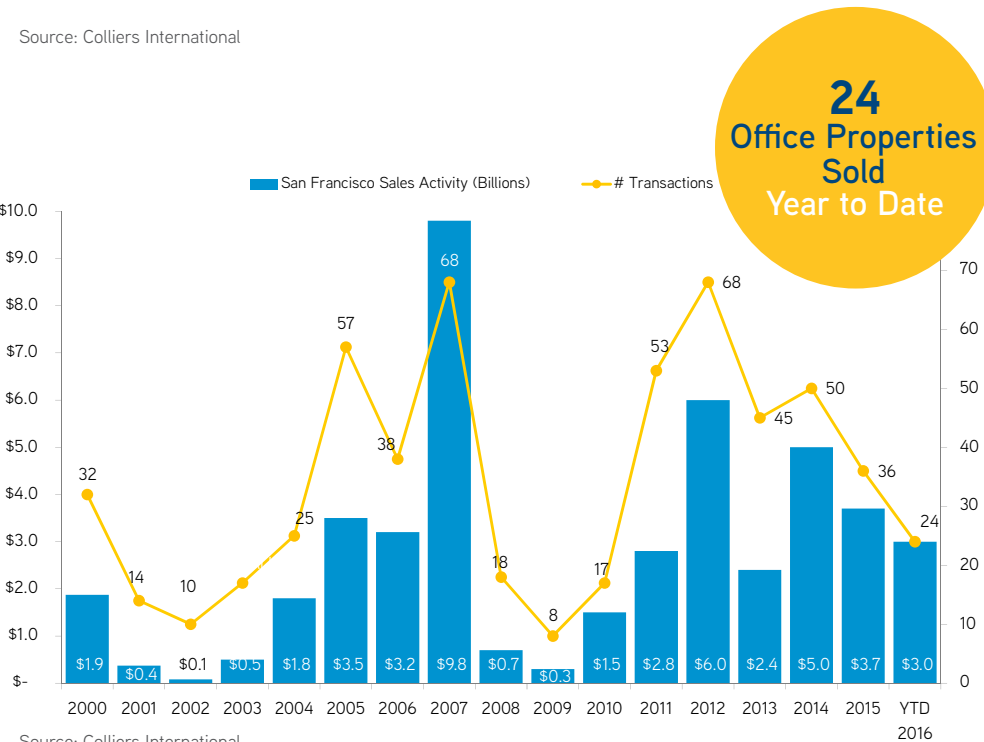
Note: Weighted Average Rents

## Rental Rates

While effective rents softened slightly across all Classes during the third quarter, semi-annually rents rose across all Classes. Over the past six months Class A weighted rents rose 5.6 percent to \$77.54, Class B weighted rents increased 7.3 percent to \$69.85 and Class C weighted rents increased 3.3 percent to \$64.96. The overall weighted Class B rents in the North Financial District experienced the largest increase for the quarter rising 9.2 percent to \$58.45. Additionally, Civic Center/Mid-Market weighted rents experienced a year-over-year increase of 6.7 percent this quarter.



Source: Colliers International



Source: Colliers International

## Absorption & Vacancy

The SOMA East submarket experienced the largest occupancy gains with over 273,000 square feet of absorption for the quarter and posting over 668,000 square feet of absorption year-to-date. The absorption for the third quarter is primarily due to delivery of the newly renovated Metropolitan Transportation Commission (MTC) building at 375 Beale Street and MTC moved into over 130,000 square feet and Twilio has leased an additional nearly 98,000 square feet which they are scheduled to occupy during the fourth quarter. The second largest occupancy growth was experienced in the Yerba Buena submarket with nearly 124,000 square feet of absorption. Key contributors for this growth in occupancy was Quantcast occupying nearly 95,000 square feet at 795 Folsom Street, Practice Fusion moving into nearly 28,000 square feet at 731 Market Street and Flexport occupying over 27,000 square feet at 731 Market Street.

## Investment Volume

Sales volumes for 2016 are poised to result in one of the strongest years for investment sales in San Francisco. Year-to-date there have been 24 office transactions for a combined value of approximately \$3 billion. During the last three months of the year, there were 8 office transactions for a total of over \$930 million. The largest sale for the quarter was in the North Financial District with Vanbarton Group's purchase of 100 Montgomery Street from the Blackstone EOP for \$285 million dollars (\$661 per square foot). Additional significant sales were HNA purchasing 123 Mission Street from Pacific Eagle for \$255 million (\$738 per square foot), Invesco acquired The Piers from Pacific Waterfront Partners for \$103 million (\$1,248 per square foot) and KBS Realty's purchase of 353 Sacramento Street from Pacific Eagle for \$255 million (\$600 per square foot). There are many investors that find San Francisco a desired long-term option for their investments.

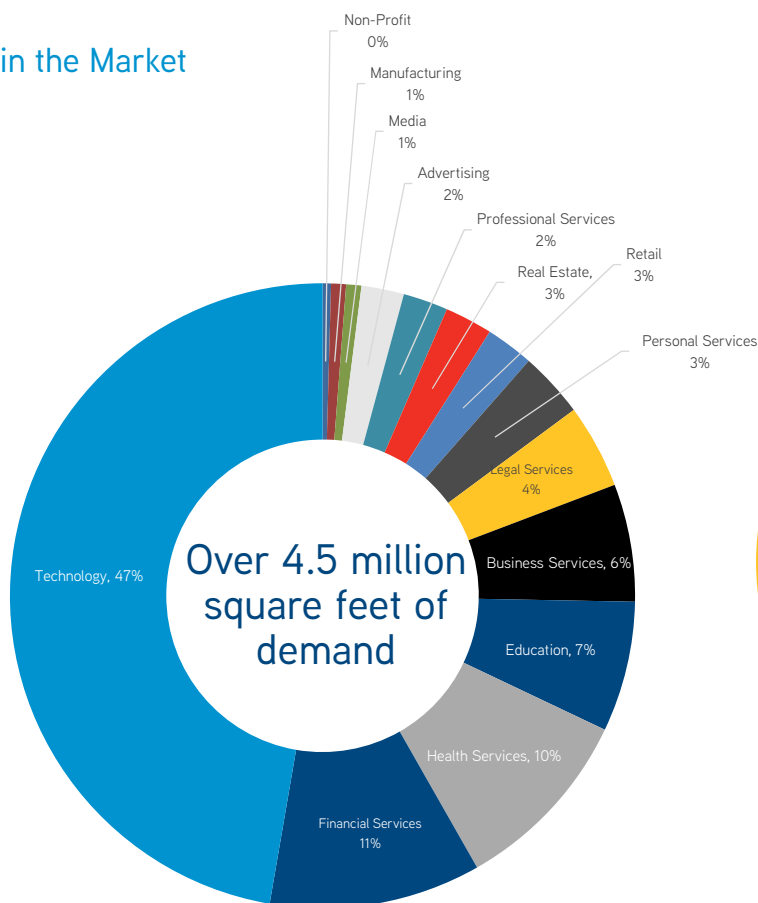
## Major Office Lease Transactions - Q3 2016

ADDRESS	TENANT	SIZE	TYPE	SIGNED DATE	CLASS
350 Bush Street	Twitch	185,000	New	Jul-16	A
Two Embarcadero Center	WeWork	78,000	New	Jul-16	A
650 Townsend Street	iRhythm Technologies	60,864	New	Aug-16	B
50 Fremont Street	BNY Mellon	60,000	Renewal	Aug-16	A
505 Howard Street	Silicon Valley Bank	54,698	Sublease	Sep-16	A
625 Second Street	GitHub, Inc.	35,330	New	Jul-16	B
One Embarcadero Center	Manatt, Phelps, & Phillips	35,912	Renewal	Aug-16	A
3180 18th Street	OpenAI	34,000	New	Jul-16	B

## Major Office Sale Transactions - Q3 2016

ADDRESS	SELLER	BUYER	SQ.FT.	SALES DATE	CLASS	SALE PRICE	PRICE/SQ.FT.
100 Montgomery Street	Blackstone EOP	Vanbarton Group LLC	431,407	Jul-16	A	\$285,000,000	\$661
123 Mission Street	Pacific Eagle	HNA	345,595	Aug-16	A	\$255,000,000	\$738
353 Sacramento Street	Pacific Eagle	KBS Realty	295,142	Jul-16	A	\$177,000,000	\$600
The Piers / Piers 1, 1.5, 3 & 5	Pacific Waterfront Partners LLC	Invesco	82,526	Aug-16	B	\$103,000,000	\$1,248
394 Pacific Avenue	PMI Properties	Grosvenor	54,700	Jul-16	B	\$32,340,000	\$591
420 Taylor Street	PRES Companies	Seven Equity	46,024	Sep-16	B	\$45,000,000	\$978
244-252 California Street	Montgomery Capital Corporation	250 Cal LP	34,026	Aug-16	B	\$21,750,000	\$639
855 Front Street	LaSalle Investment Management	855 Front Street, LLC	19,650	Jul-16	C	\$11,250,000	\$573

## Tenants in the Market



Over 4.5 million square feet of demand

If all of these stated tenant demands were fulfilled, this would equate to a **net absorption of approximately 2.3 million square feet**

## Development Pipeline

There was only one delivery during the third quarter of 2016, while nearly 95 percent had been pre-leased only the Metropolitan Transportation Commission occupied this quarter with most of the remaining space being occupied during the fourth quarter by Twilio. There aren't any additional deliveries expected for this year, but there are nearly 2.9 million square feet expected for delivery in 2017 with only 35 percent that has been pre-leased. Currently the City has nearly 12.4 million square feet of office developments that are either proposed or in various stages of planning with over 9 million square feet of those developments still vying for Prop M allocations.

## Leasing Activity

Leasing activity softened during the third quarter of 2016, but solid demand still remains for the San Francisco office market. Year-to-date the City has experienced approximately 4 million square feet of leasing activity. While not on par to hit the historical annual average of 7.3 million square feet for the year, leasing volume for 2016 is still likely to be healthy just not up to the scorching levels experienced over the past three years.

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)
<b>DOWNTOWN MARKET:</b>																
A	183	59,122,564	3,208,057	5.4%	781,847	1.3%	3,990,704	55,131,860	6.7%	6.2%	(302,377)	988,379	-	454,999	3,876,711	11,421,395
B	295	25,357,199	1,658,938	6.5%	233,616	0.9%	1,892,554	23,464,645	7.5%	7.6%	527,582	336,818	529,232	692,097	-	958,186
C	127	6,600,596	318,237	4.8%	89,211	1.4%	407,448	6,193,148	6.2%	5.0%	(76,593)	(96,869)	-	-	-	-
<b>Total</b>	<b>605</b>	<b>91,080,359</b>	<b>5,186,232</b>	<b>5.7%</b>	<b>1,104,474</b>	<b>1.2%</b>	<b>6,290,706</b>	<b>84,789,653</b>	<b>6.9%</b>	<b>6.5%</b>	<b>148,612</b>	<b>1,208,328</b>	<b>529,232</b>	<b>1,147,096</b>	<b>3,876,711</b>	<b>12,379,581</b>
<b>FINANCIAL DISTRICT:</b>																
A	108	44,351,707	2,763,327	6.2%	392,180	0.9%	3,155,507	41,196,200	7.1%	6.8%	(145,757)	624,902	-	-	2,908,077	1,050,000
B	73	8,145,794	521,354	6.4%	41,707	0.5%	563,061	7,582,733	6.9%	7.8%	75,782	2,189	-	-	-	-
C	36	1,640,936	185,733	11.3%	2,698	0.2%	188,431	1,452,505	11.5%	12.0%	8,007	(25,117)	-	-	-	-
<b>Total</b>	<b>217</b>	<b>54,138,437</b>	<b>3,470,414</b>	<b>6.4%</b>	<b>436,585</b>	<b>0.8%</b>	<b>3,906,999</b>	<b>50,231,438</b>	<b>7.2%</b>	<b>7.1%</b>	<b>61,968</b>	<b>601,974</b>	<b>-</b>	<b>-</b>	<b>2,908,077</b>	<b>1,050,000</b>
<b>SUBMARKETS:</b>																
North Financial	116	28,408,524	2,206,663	7.8%	307,266	1.1%	2,513,929	25,894,595	8.8%	9.2%	85,820	(227,115)	-	-	372,000	-
South Financial	101	25,732,913	1,263,751	4.9%	129,319	0.5%	1,393,070	24,339,843	5.4%	4.8%	(147,788)	829,089	-	-	2,536,077	1,050,000
<b>Total</b>	<b>217</b>	<b>54,141,437</b>	<b>3,470,414</b>	<b>6.4%</b>	<b>436,585</b>	<b>0.8%</b>	<b>3,906,999</b>	<b>50,234,438</b>	<b>7.2%</b>	<b>7.1%</b>	<b>(61,968)</b>	<b>601,974</b>	<b>-</b>	<b>-</b>	<b>2,908,077</b>	<b>1,050,000</b>
Union Square	58	4,063,190	157,896	3.9%	3,658	0.1%	161,554	3,901,636	4.0%	3.7%	(12,741)	2,352	-	-	-	-
Yerba Buena	31	4,642,139	162,781	3.5%	35,586	0.8%	198,367	4,443,772	4.3%	6.9%	123,850	33,144	-	57,666	-	1,710,210
SOMA West	41	3,509,267	282,938	8.1%	-	0.0%	282,938	3,226,329	8.1%	6.6%	(50,650)	16,506	-	52,999	268,634	4,039,593
SOMA East	61	6,325,647	518,728	8.2%	175,441	2.8%	694,169	5,631,478	11.0%	7.6%	273,271	668,008	529,232	754,751	-	599,148
Civic Center/Mid-Market	44	6,311,133	94,373	1.5%	279,295	4.4%	373,668	5,937,465	5.9%	4.0%	(122,541)	(225,691)	-	-	-	432,000
Jackson Square	40	2,330,330	83,067	3.6%	6,800	0.3%	89,867	2,240,463	3.9%	4.5%	13,969	354	-	-	-	-
North Waterfront	48	3,619,529	136,898	3.8%	3,022	0.1%	139,920	3,479,609	3.9%	5.3%	51,124	95,471	-	61,680	-	-
Van Ness Corridor	20	1,217,094	216,658	17.8%	2,553	0.2%	219,211	997,883	18.0%	17.9%	(1,468)	(65,150)	-	-	-	-
Potrero West	18	1,339,348	56,165	4.2%	103,425	7.7%	159,590	1,179,758	11.9%	9.1%	(38,164)	(128,967)	-	-	-	169,598
Potrero East	11	864,650	6,314	0.7%	32,009	3.7%	38,323	826,327	4.4%	3.6%	(6,970)	7,927	-	-	-	284,471
Mission Bay	16	2,719,595	-	0.0%	26,100	1.0%	26,100	2,693,495	1.0%	0.3%	(19,100)	202,400	-	220,000	700,000	4,094,561
<b>Total</b>	<b>605</b>	<b>91,083,359</b>	<b>5,186,232</b>	<b>5.7%</b>	<b>1,104,474</b>	<b>1.2%</b>	<b>6,290,706</b>	<b>84,792,653</b>	<b>6.9%</b>	<b>6.5%</b>	<b>148,612</b>	<b>1,208,328</b>	<b>529,232</b>	<b>1,147,096</b>	<b>3,876,711</b>	<b>12,379,581</b>
<b>QUARTERLY COMPARISON AND TOTALS</b>																
Q2-16	604	90,551,127	5,096,397	5.6%	813,689	0.9%	5,910,086	84,641,041	6.5%	6.7%	268,244	1,059,716	112,666	619,865	4,120,077	12,648,215
Q1-16	603	90,468,108	5,339,674	5.9%	740,778	0.8%	6,080,452	84,387,656	6.7%	6.7%	776,472	776,472	507,199	507,199	4,232,743	12,635,661
Q4-15	604	90,148,248	5,790,031	6.4%	673,659	0.7%	6,463,690	83,684,558	7.2%	7.2%	179,736	1,569,532	1,203,971	1,450,961	4,761,440	12,035,661
Q3-15	600	88,944,277	4,852,323	5.5%	587,132	0.7%	5,439,455	83,504,822	6.1%	6.1%	180,991	1,389,796	-	246,990	5,199,587	12,627,175

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