

SAN FRANCISCO | OFFICE MARKET

Q4 | 2017

Accelerating success.

San Francisco's Strongest Leasing Activity Since 2000



> VACANCY The overall vacancy rate in San Francisco remained flat at 6.9 percent for the quarter, but due to negative net absorption year to date the vacancy rate inched up 30 basis points for the year. Despite the slight increase in vacancy, San Francisco's vacancy rate remains low and the vacancy rate has been below eight percent for the past four years. There's almost 4.2 million square feet of new inventory scheduled to be added to the supply by the close of 2018 and this is likely to increase the vacancy rate in the City. Vacant sublease space has been experiencing slow, but steady increases over the past three years, but remained flat this quarter at 0.9 percent.

> LEASING VOLUME Technology companies continued their voracious appetite for premium office space during the last three months of the year with approximately 3.4 million square feet of transactions closing. The San Francisco market has hit near historic high leasing volumes posting nearly 9.5 million square feet of transactions in 2017. This well surpasses the annual 20-year historical annual average of 7.4 million square feet. Six deals over 100,000 square feet were signed in the City in the fourth quarter. The most notable leases were Okta taking over 207,000 square feet at 100 First Street, Nektar Therapeutics leasing nearly 129,000 square feet at 455 Mission Street and Dropbox leasing a record 737,000 square feet at 1800 Owens Street.

> ABSORPTION After experiencing seven straight years of positive net absorption, San Francisco posted over 333,000 square feet of negative net absorption in 2017. While the market experienced positive net absorption during the second half of the year, only a nominal 1,504 square feet of positive net absorption was posted in the fourth quarter. This can be attributed to some large occupancies being pushed into the first quarter of 2018 and 2.2 million square feet of new deliveries, which are 95 percent preleased, being pushed back to the first quarter as well. Watch for some significant positive net absorption during the first half of 2018. Currently there are nearly 4.6 million square feet of requirements in the market and nine of those are over 100,000 square feet. This is slightly down from the 7-year quarterly average of 4.9 million square feet. Not surprising since the City experienced over 5.8 million square feet of gross leasing activity during the second half of 2017.

> RENTS Citywide overall weighted rents grew 1.0 percent to \$81.42 per square foot during this quarter. A combination of preleased large blocks of space and numerous deals that closed over \$85 per square foot contributed to the increase for overall weighted rents. Meanwhile, overall non-weighted rents softened 3.3 percent to \$71.47 per square foot during the fourth quarter, but enjoyed a year over year increase of 4.8 percent. Overall weighted Class A rents citywide were relatively flat this quarter at \$84.51 per square foot, but grew 13.3 percent for the year.

Market Indicators

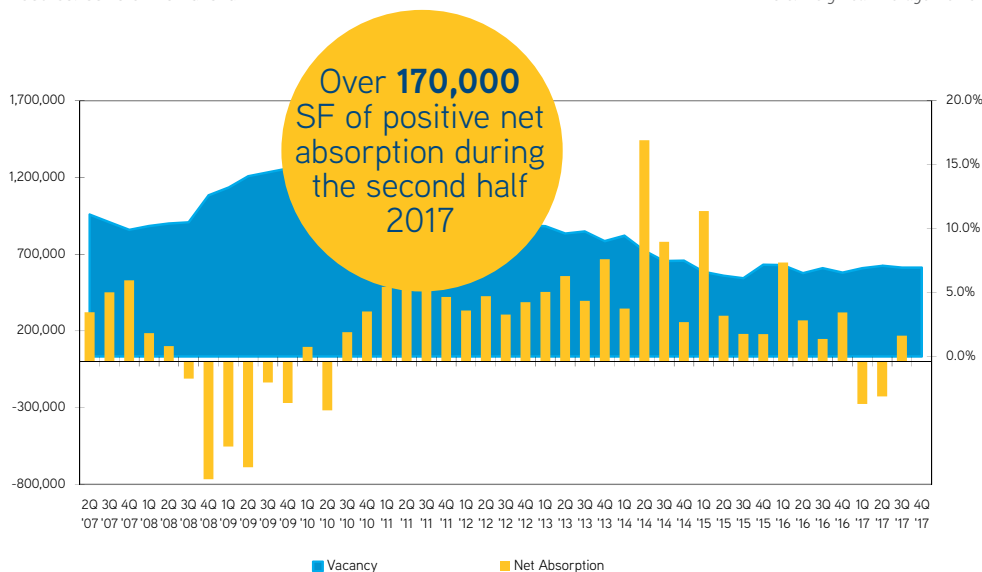
Relative to prior period	Q4 2017	2018 Forecast
VACANCY	↔↔	↑
NET ABSORPTION	↔↔	↑
CONSTRUCTION	↔↔	↑
WEIGHTED RENTAL RATE	↑	↔↔
NON-WEIGHTED RENTAL RATE	↓	↔↔
SALES VOLUME	↓	↔↔
SALES PRICES	↓	↔↔

San Francisco – Office Rents - Q4 2017

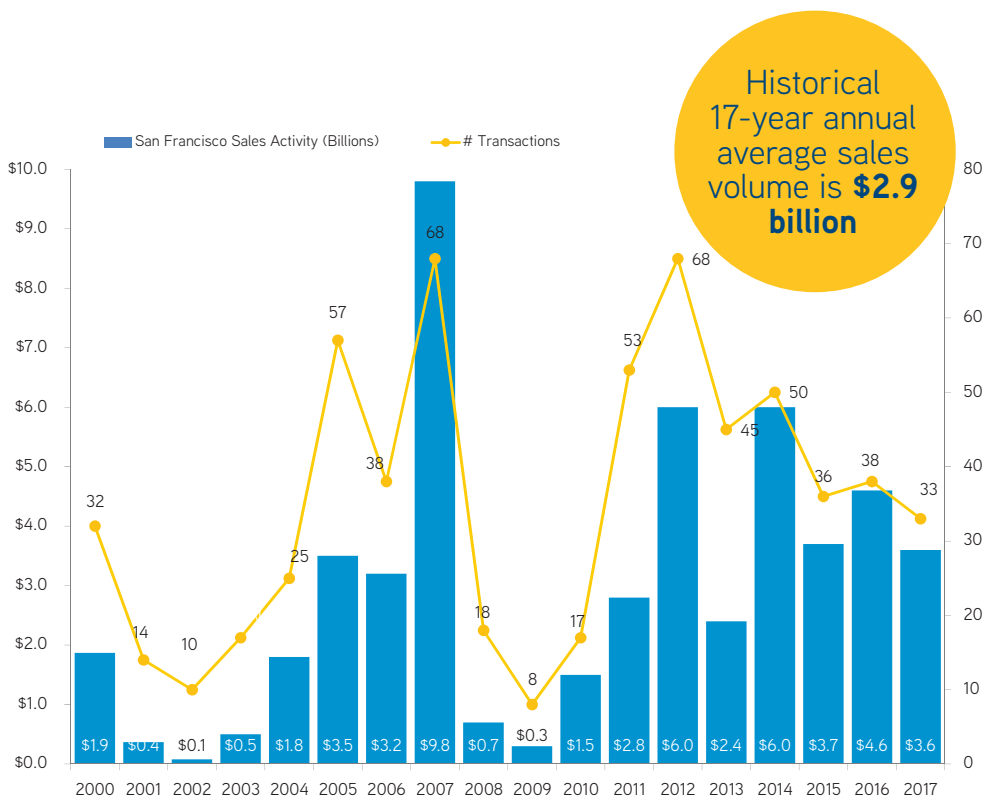
MARKET	4Q '17 OVERALL	4Q '17 DIRECT	4Q '17 SUBLEASE	3Q '17 OVERALL	% OVERALL QUARTERLY CHANGE
All Markets	\$81.42	\$82.85	\$71.98	\$80.59	1.0%
All Markets: Class A	\$84.51	\$84.81	\$73.74	\$84.34	0.2%
All Markets: Class B	\$74.89	\$75.72	\$73.43	\$75.83	-1.2%
Financial District: Class A	\$75.34	\$75.56	\$75.49	\$85.04	-11.4%
Financial District: Class B	\$79.03	\$73.99	\$85.75	\$84.13	-6.1%
SOMA Overall	\$79.23	\$86.30	\$66.67	\$78.88	0.4%

Source: Colliers International

Note: Weighted Average Rents



Source: Colliers International



Source: Colliers International

Rental Rates

Overall weighted rents for SOMA were relatively flat for the quarter inching up 0.4 percent to \$79.23 per square foot, but this submarket experienced a 17.2 percent rent growth year over year. Deals such as Cloudflare at 111 Townsend Street and the Earnest sublease at 303 Second Street contributed to this annual rent growth. Meanwhile, overall weighted rents for the Financial District experience softening during the quarter from \$84.65 to \$76.11, but posted rent gains of 9.5 percent for the year. This can be attributed to leases signed by Facebook at 181 Fremont Street, Google at Rincon Center II and Accenture signing at Salesforce Tower.

Absorption & Vacancy

The Yerba Buena and SOMA East submarkets enjoyed occupancy gains posting over 154,000 and nearly 104,000 square feet of positive net absorption, respectively. The two largest move ins in Yerba Buena was Postmates occupying nearly 58,000 square feet at 201 Third Street and Snap moving into over 33,000 square feet at 875 Howard Street. The key contributors to the positive net absorption in SOMA East was Dropbox moving into its 62,000 square foot sublease at 250 Brannan Street, Apartment Lists occupying nearly 25,000 square feet at 475 Brannan Street, and Kaiser moving into approximately 27,000 square feet at 185 Berry Street (Wharf). This positive net absorption for SOMA East help shrink the vacancy rate 160 basis points to 6.7 percent.

Investment Volume

San Francisco's investment market continues to be one of the most sought-after markets both nationally and internationally. Following a large investment year in 2016, 2017 posted slightly lower aggregate activity totaling \$3.6 billion in transaction volume with over 33 closed transactions. While 2017 was still a strong year for the investment market, the lower aggregate numbers are primarily due to the large amount of product that has traded in the prior 5 years. Notable fourth quarter 2017 sales transactions included Ponte Gadeo USA's purchase of Pacific Place (Office, Hotel & Retail) for \$469.5million dollars (\$1,068 per square foot), as well as Beacon Capital Partners purchase of 201 California Street for \$179.25 million dollars (\$737 per square foot). Investment activity is expected to remain strong going into 2018.

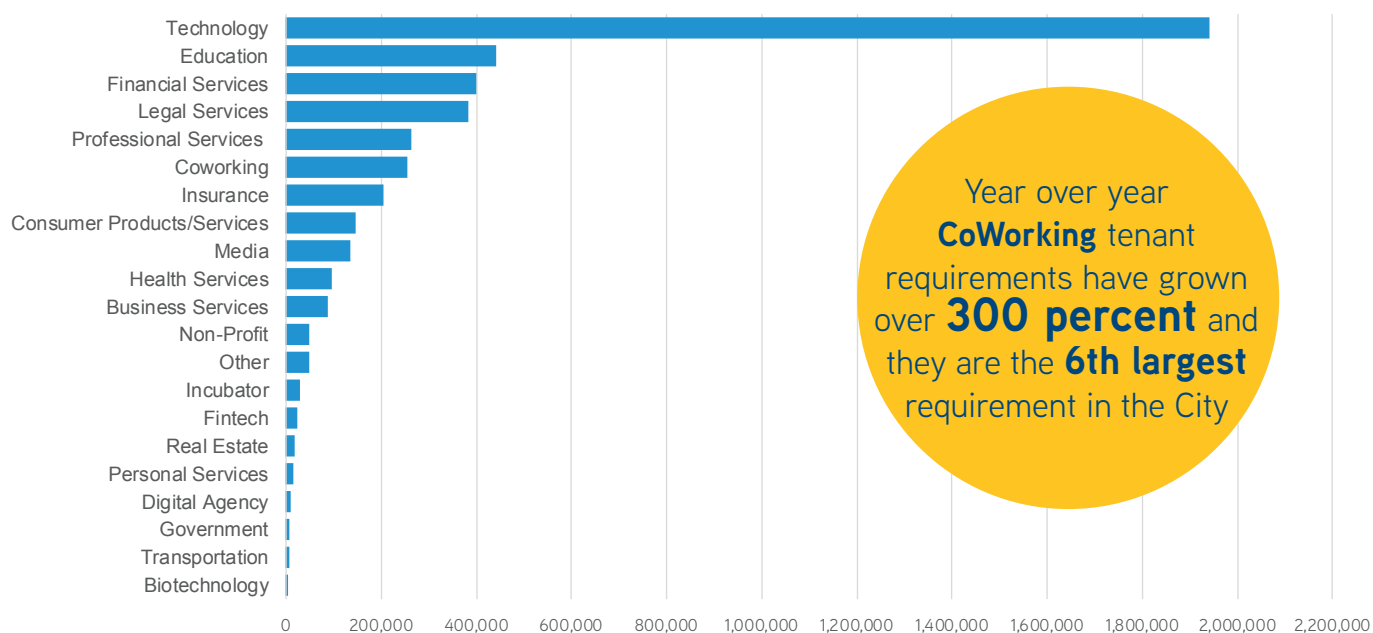
Major Office Lease Transactions - Q4 2017

ADDRESS	TENANT	SIZE	TYPE	SIGNED DATE	CLASS
1800 Owens Street/The Exchange	Dropbox	735,550	New	Oct-17	A
1355 Market Street	Twitter	215,000	Renewal	Dec-17	A
100 First Street	Okta	207,066	Lease	Dec-17	A
350 Bush Street	Atlassian	126,888	Lease	Dec-17	A
350 Rhode Island - North	City of San Francisco	125,122	Lease	Nov-17	A
1 Sansome Street	Citicorp North America	104,368	Renewal	Oct-17	B
650 7th Street	Airbnb	82,862	Sublease	Nov-17	B
350 Rhode Island - South	Samsara	80,000	Lease	Dec-17	A
100 Montgomery Street	Gibson, Dunn & Crutcher	70,789	Lease	Nov-17	B
1550 Bryant Street	Asana, Inc	62,549	Renewal	Nov-17	B
250 Brannan Street	Dropbox	62,015	Sublease	Oct-17	B
201 Third Street	Postmates	57,530	Lease	Dec-17	A

Major Office Sale Transactions - Q4 2017

ADDRESS	SELLER	BUYER	SQ.FT.	SALES DATE	CLASS	SALE PRICE	PRICE/SQ.FT.
Pacific Place - 22 Fourth Street	JP Morgan Chase	Ponte Gadeo USA, Inc.	439,740	Nov-17	A	\$469,500,000	\$1,068
201 California Street	Barings Real Estate Advisors LLC	Beacon Capital Partners	243,213	Dec-17	A	\$179,250,000	\$737
945 Bryant Street	Brickman	Bridgeton Holdings	37,848	Nov-17	B	\$27,000,000	\$713
407-411 Sansome Street	407 Sansome Street LLC	Wsingsky, LLC	17,178	Oct-17	C	\$12,970,000	\$755
401 Washington Street	PMI Properties	Century Urban	16,243	Dec-17	B	\$13,900,000	\$856

Tenants in the Market By Industry



Development Pipeline

There was no new construction delivered to the market in 2017. At the close of the year, there's over 6.4 million square feet under construction throughout San Francisco and nearly 2.2 million of that construction will hit the market during the first quarter of 2018. The three deliveries scheduled for completion include Salesforce Tower at 415 Mission Street, 181 Fremont Street and 350 Bush Street. Tenants have already preleased 94 percent of the availability in these three projects. Watch for another 2.2 million square feet, a total of five new office deliveries, to hit the market during the second half of 2018. Tenants have preleased these new deliveries in the second half of 2018 except for Park Tower at 250 Howard Street.

Leasing Activity

San Francisco experienced historic gross leasing activity in 2017 the likes that haven't been seen since 2000. There were 17 deals over 100,000 square feet that closed this year and six of those deals were signed during the fourth quarter. During the second half of the year two of the five largest deals in the market were recorded, Dropbox took nearly 737,000 square feet at 1800 Owens Street and Facebook leased all the office space, over 412,000 square feet, at 181 Fremont Street. Adding to the strength of the market, twelve of the top leases completed in 2017 were from tenants expanding their future occupancy in San Francisco.

Class	Existing Properties										Absorption		New Supply		U/C & Proposed	
	# 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	183	59,122,564	3,595,720	6.1%	488,849	0.8%	4,084,569	55,037,995	6.9%	6.8%	(69,849)	(147,853)	-	-	6,017,439	9,604,959
B	291	25,081,155	1,448,276	5.8%	314,560	1.3%	1,762,836	23,318,319	7.0%	7.3%	64,813	(102,715)	-	-	419,063	939,485
C	125	6,523,596	436,728	6.7%	19,707	0.3%	456,435	6,067,161	7.0%	7.1%	6,540	(82,581)	-	-	-	-
Total	599	90,727,315	5,480,724	6.0%	823,116	0.9%	6,303,840	84,423,475	6.9%	6.9%	1,504	(333,149)	-	-	6,436,502	10,544,444
FINANCIAL DISTRICT:																
A	108	44,351,707	3,135,682	7.1%	324,408	0.7%	3,460,090	40,891,617	7.8%	7.5%	(141,490)	(333,455)	-	-	3,963,860	-
B	73	8,145,794	669,838	8.2%	95,222	1.2%	765,060	7,380,734	9.4%	9.4%	1,280	(163,184)	-	-	-	-
C	36	1,658,936	256,183	15.4%	7,160	0.4%	263,343	1,395,593	15.9%	16.9%	17,715	(111,749)	-	-	-	-
Total	217	54,156,437	4,061,703	7.5%	426,790	0.8%	4,488,493	49,667,944	8.3%	8.1%	(122,495)	(608,388)	-	-	3,963,860	-
SUBMARKETS:																
North Financial	116	28,405,524	2,272,926	8.0%	347,869	1.2%	2,620,795	25,784,729	9.2%	9.3%	19,088	(179,706)	-	-	372,000	-
South Financial	101	25,750,913	1,788,777	6.9%	78,921	0.3%	1,867,698	23,883,215	7.3%	6.7%	(141,583)	(428,682)	-	-	3,591,860	-
Total	217	54,156,437	4,061,703	7.5%	426,790	0.8%	4,488,493	49,667,944	8.3%	8.1%	(122,495)	(608,388)	-	-	3,963,860	-
Union Square	58	4,063,190	238,271	5.9%	21,885	0.5%	260,156	3,803,034	6.4%	6.1%	(13,759)	(69,450)	-	-	-	-
Yerba Buena	31	4,642,139	62,459	1.3%	112,869	2.4%	175,328	4,466,811	3.8%	7.1%	154,246	27,107	-	-	-	1,886,868
SOMA West	38	3,355,267	63,353	1.9%	37,002	1.1%	100,355	3,254,912	3.0%	2.5%	(16,120)	(25,342)	-	-	419,063	3,796,728
SOMA East	61	6,325,647	341,997	5.4%	79,610	1.3%	421,607	5,904,040	6.7%	8.3%	103,894	129,998	-	-	-	549,168
Civic Center/Mid-Market	44	6,311,133	139,839	2.2%	36,150	0.6%	175,989	6,135,144	2.8%	2.8%	(2,025)	198,612	-	-	-	463,000
Jackson Square	40	2,330,330	116,699	5.0%	8,662	0.4%	125,361	2,204,969	5.4%	2.7%	(61,491)	(37,815)	-	-	-	-
North Waterfront	48	3,619,529	127,981	3.5%	38,447	1.1%	166,428	3,453,101	4.6%	5.1%	16,410	(13,885)	-	-	-	-
Van Ness Corridor	19	1,172,094	219,635	18.7%	2,121	0.2%	221,756	950,338	18.9%	19.2%	3,261	(2,545)	-	-	-	-
Potrero West	17	1,258,348	68,620	5.5%	51,868	4.1%	120,488	1,137,860	9.6%	3.6%	(75,390)	43,940	-	-	-	119,599
Potrero East	10	773,606	12,167	1.6%	4,722	0.6%	16,889	756,717	2.2%	3.0%	6,018	27,809	-	-	314,447	-
Mission Bay	16	2,719,595	28,000	1.0%	2,990	0.1%	30,990	2,688,605	1.1%	1.5%	8,955	(3,190)	-	-	1,739,132	3,729,081
Total	599	90,727,315	5,480,724	6.0%	823,116	0.9%	6,303,840	84,423,475	6.9%	6.9%	1,504	(333,149)	-	-	2,472,642	10,544,444
QUARTERLY COMPARISON/TOTALS																
Q3-17	599	90,727,315	5,487,833	6.0%	817,511	0.9%	6,305,344	84,421,971	6.9%	7.1%	168,981	(334,653)	-	-	6,446,900	10,501,944
Q2-17	599	90,727,315	5,778,994	6.4%	695,331	0.8%	6,474,325	84,252,990	7.1%	6.9%	(226,774)	(803,634)	-	-	6,462,104	10,023,944
Q1-17	599	90,727,315	5,374,857	5.9%	883,194	1.0%	6,258,051	84,469,264	6.9%	6.6%	(287,360)	(287,360)	-	-	6,392,162	10,023,944
Q4-16	605	91,083,359	5,062,490	5.6%	908,201	1.0%	5,970,691	85,109,668	6.6%	6.9%	32,015	1,528,343	-	1,147,096	5,361,182	10,324,245

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