

SAN FRANCISCO | OFFICE MARKET

Q3 | 2018

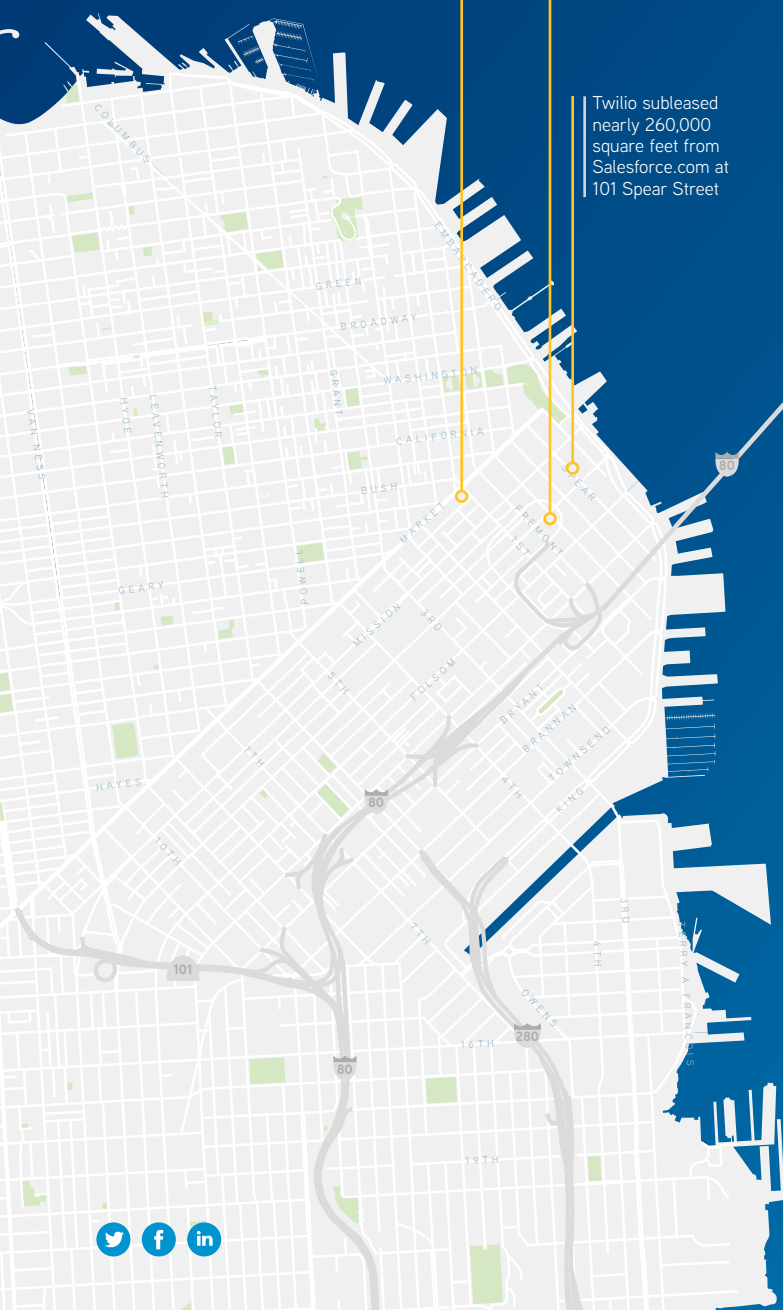
Accelerating success.

Technology Companies Continue to Fuel Tenant Demand

Amazon is expanding its footprint at 525 Market Street by 143,000 square feet

DivcoWest/CalSTRS acquired 301 Howard Street for nearly \$293 million (\$942 psf)

Twilio subleased nearly 260,000 square feet from Salesforce.com at 101 Spear Street



> VACANCY San Francisco's overall vacancy rate edged down 30 basis points to 5.8 percent. The vacant sublease rate was flat this quarter at 0.8 percent and continues to be well below the high-water market of 5.1 percent reached in 2002, meanwhile the City's direct vacancy rate shrunk 30 basis points to 5.0 percent. Class A and B assets drove market absorption in the City posting 3.0 million and over 630,000 square feet year-to-date. The positive net absorption for Class B assets translated into the vacancy rate dropping 110 basis points since the end of 2017. There's nearly 946,000 square feet scheduled for delivery by year-end, while over 93 percent has been preleased this may translate into a temporary increase in vacancy until tenants move into their new spaces.

> LEASING VOLUME San Francisco experienced strong leasing activity during the third quarter, which translated into nearly 2.3 million square feet of transactions closing. This volume of leasing activity is well above the quarterly 18-year average of 1.8 million square feet. Tenant demand for space in San Francisco continued to grow over the past three months with technology tenants accounting for over 50 percent of that demand in the market. There were four deals signed over 100,000 square feet, the sublease at 101 Spear Street in which Twilio took over 259,000 square feet, SoFi leased nearly 101,000 square feet at 246 1st Street and Amazon took an additional 143,000 square feet at 525 Market Street.

> ABSORPTION At the end of the third quarter, San Francisco posted over 341,000 square feet of positive net absorption. Year-to-date absorption hit over 3.6 million square feet in the core CBD submarkets. The North Financial District was the key contributor for the positive net absorption for the City posting over 374,000 square feet. A primary driver for this positive net absorption was Atlassian moving into over 145,000 square feet at 350 Bush Street. Tenant demand continued to grow throughout the past quarter, there's currently 7.2 million square feet of requirements from 180 tenants and 18 requirements that are over 100,000 square feet. Technology companies continue to be the primary driver for the demand in the market, fast growing demand from coworking tenants puts this industry as the second largest sector in the market accounting for nearly 22 percent of total market requirements. At the close of the second quarter, space requirements from coworking tenants represented 8 percent of the total demand in the market. The third largest requirement comes from the legal service industry which accounts for almost 8 percent of the total demand.

> RENTS After reaching an all-time high effective weighted rent during the second quarter, overall weighted rents softened this quarter by nearly 10 percent to \$82.17 per square foot. The drop in the overall weighted rents can be attributed to multiple large leases with effective rents of \$95 or higher that closed in the second quarter. Meanwhile overall non-weighted rents inched up 1.1 percent to \$78.39. One of the largest decreases experienced in the market was with Class A rents in the Financial District. Weighted rents in this submarket fell 16.2 percent to \$81.84 per square foot, meanwhile non-weighted rents in the Financial District rose by 1.1 percent to \$78.39.

Market Indicators

Relative to prior period	Q3 2018	2018 Forecast
VACANCY	↓	↑
NET ABSORPTION	↑	↑
CONSTRUCTION	↔	↑
WEIGHTED RENTAL RATE	↓	↑
NON-WEIGHTED RENTAL RATE	↑	↑
SALES VOLUME	↑	↑
SALES PRICES	↑	↑

San Francisco – Office Rents - Q3 2018

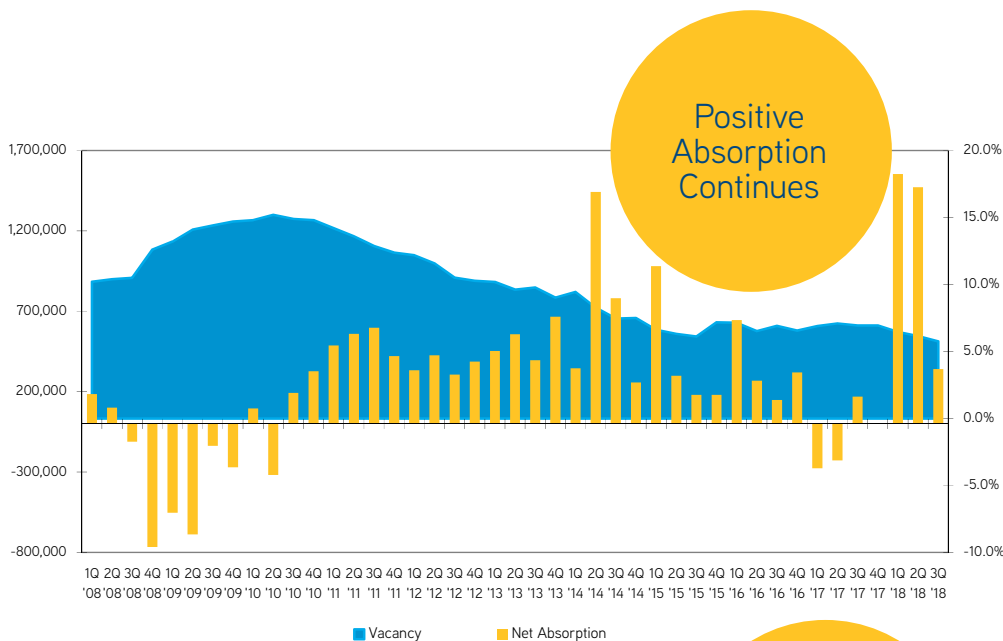
MARKET	3Q '18 OVERALL	3Q '18 DIRECT	3Q '18 SUBLEASE	2Q '18 OVERALL	% OVERALL QUARTERLY CHANGE
All Markets	\$82.17	\$83.65	\$74.02	\$91.25	-9.9%
All Markets: Class A	\$83.81	\$84.91	\$74.72	\$97.07	-13.7%
All Markets: Class B	\$78.70	\$80.25	\$74.61	\$77.80	1.2%
Financial District: Class A	\$81.84	\$82.55	\$73.90	\$97.65	-16.2%
Financial District: Class B	\$85.11	\$88.34	\$66.68	\$84.77	0.4%
SOMA Overall	\$86.00	\$86.67	\$82.30	\$86.95	-1.1%

Source: Colliers International

Note: Weighted Average Rents

Rental Rates

Although overall effective weighted rents soften during the quarter, the North Financial District experienced effective rent growth for both weighted and non-weighted rents this quarter. The North Financial District experienced overall weighted rent growth of 3.5 percent to \$80.49 and non-weighted rent growth of 0.3 percent to \$74.74. The SOMA submarket experienced a slight decrease of 1.1 percent in overall weighted rents to \$86.00 and growth in its overall non-weighted rents of 3.4 percent to \$78.60. Meanwhile overall weighted starting rents fall 5.1 percent below the overall effective weighted rents at \$78.02 in San Francisco.



Source: Colliers International



Source: Colliers International

Absorption & Vacancy

The driving force for this quarter's positive net absorption was from the North Financial District with occupancy gains of over 374,000 square feet. A few of the largest move ins for the quarter were Atlassian occupying over 145,000 square feet at 350 Bush Street, On Lok moving into a sublease at 600 Montgomery Street on the 12-13th floors, Alpine Management Services occupied nearly 17,000 square feet at 1 California Street, Discovia moved into their approximately 16,000 square foot sublease space at 465 California Street and First Republic Bank moved into 16,700 square feet at 201 California Street. The vacancy rate for the North Financial District fell 130 basis points to 7.7 percent. The vacancy rate for the North Financial District hasn't been this low since 2000.

Investment Volume

Fueled by robust leasing activity and a limited supply of available office space, the San Francisco investment market continues to command phenomenal investor interest. During the third quarter of 2018, San Francisco experienced nearly \$430 million in transaction volume with a total of six closed transactions. Half of the buildings sold during the quarter are in the Financial District achieving average pricing of \$932 per square foot and average cap rates of approximately five percent. Notable transactions included the sale of 301 Howard Street for \$293 million (\$942 per square foot) to DivoWest/CalSTRS, 1130 Market Street for \$49 million (\$575 per square foot) to Rubicon Point Partners and 660 Market Street for \$40 million (\$1,058 per square foot) to Jamestown. In the fourth quarter of 2018, look for continued sales activity at robust pricing levels.

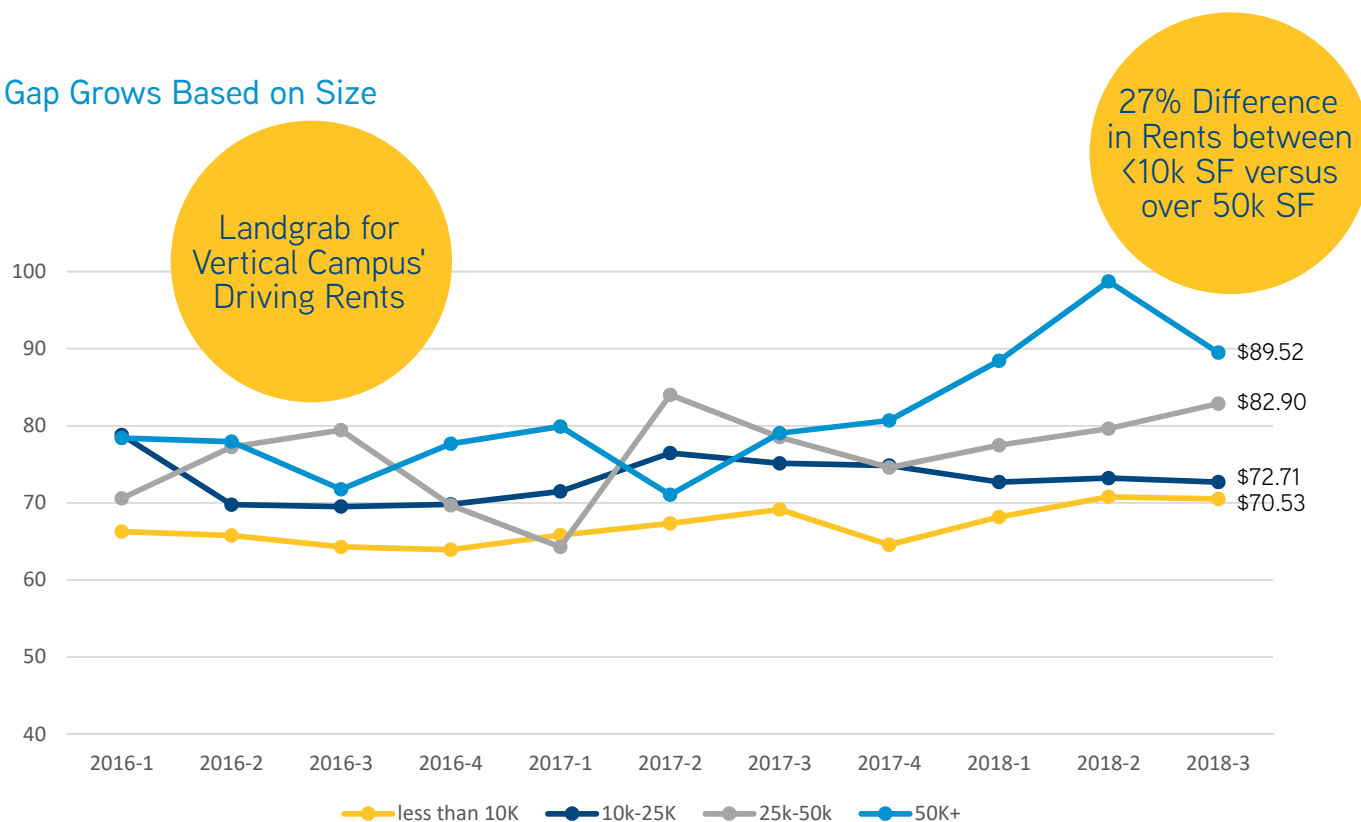
Major Office Lease Transactions - Q3 2018

ADDRESS	TENANT	SIZE	TYPE	SIGNED DATE	CLASS
101 Spear Street	Twilio	259,416	Sublease	Sep-18	B
525 Market Street	Amazon	143,000	Expansion	Aug-18	A
246 1st Street	SoFi	100,800	Lease	Aug-18	B
657 & 667 Mission Street	Unity Technologies	144,924	Lease	Aug-18	C
345 Montgomery Street	Regus (Spaces)	77,999	Lease	Jul-18	A
55 2nd Street	Intercom	58,847	Renewal/Expansion	Sep-18	A
1 Embarcadero Center	Nixon Peabody	53,904	Renewal/Downsize	Aug-18	A
634 2nd Street	Cloudflare, Inc	45,032	Sublease	Jul-18	B
840-848 Battery Street	OneLogin	40,125	Lease	Aug-18	B
1255 Battery Street	Vungle, Inc	34,037	Sublease	Jul-18	A
795 Folsom Street	NGINX, Inc	32,588	Lease	Jul-18	B
Note: WeWork Deal, 430 California Street		Coinbase	271,720	Sep-18	B

Major Office Sale Transactions - Q3 2018

ADDRESS	SELLER	BUYER	SQ.FT.	SALES DATE	CLASS	SALE PRICE	PRICE/SQ.FT.
301 Howard Street	Vanbarton Group	DivcoWest / CalSTRS	310,418	Aug-18	A	\$292,500,000	\$942
1130 Market Street (10 UN Plaza)	The Kivelstadt Group	Rubicon Point Patners	85,180	Aug-18	B	\$49,000,000	\$575
660 Market Street	Bentall Kennedy	Jamestown	37,822	Aug-18	B	\$40,000,000	\$1,058
831-835 Montgomery Street	Milford Holdings LLC	Private Investor	4,990	Aug-18	B	\$4,000,000	\$802
332 Pine Street	Polidev Investments	Lincoln Property Company / Rockwood Capital LLC	47,733	Jul-18	B	\$38,000,000	\$796
122-132 9th Street	BLK Properties, Inc.	Sunhill Corporation	27,800	Apr-18	B	\$13,300,000	\$478

Rent Gap Grows Based on Size



Development Pipeline

Year-to-date there's been nearly 2.9 million square feet of new office deliveries in San Francisco and 99 percent of that product has been preleased. Currently there's a total of over 5 million square feet of new development and renovation being built in the City. There's nearly 946,000 square feet scheduled to be completed during the last quarter of the year. The largest schedule project to hit the market is The Exchange at 1800 Owens Street for nearly 737,000 square feet and this project has been entirely preleased from Dropbox. Additionally, two renovations projects, 700 Mission Street for over 108,000 square feet and 246 1st Street for nearly 101,000 square feet, are scheduled to be delivered as well. The market has over 10 million square feet of development in either proposed and pending stages with only 3.6 million square feet of that development with Prop M large allocations.

San Francisco currently has approximately 918,000 square feet of Prop M large allocations and will add an additional 875,000 square feet by the end of October this year.

Leasing Activity

At the close of 2017, San Francisco enjoyed historic gross leasing activity to the likes that had not been experienced since the dot com boom posting nearly 9.5 million square feet of closed deals. As the third quarter ends, the market is on pace to hit similar gross leasing activity for 2018. Year-to-date 13 deals over 100,000 square feet have closed and as leasing activity continues to be robust watch for a strong fourth quarter.

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	187	61,666,259	3,078,520	5.0%	483,606	0.8%	3,562,126	58,104,133	5.8%	6.0%	149,634	2,991,701	-	2,469,258	3,836,115	9,687,709
B	292	25,443,387	1,298,643	5.1%	192,287	0.8%	1,490,930	23,952,457	5.9%	6.6%	172,981	630,142	-	419,063	1,179,454	348,722
C	124	6,396,485	267,071	4.2%	59,944	0.9%	327,015	6,069,470	5.1%	5.4%	18,786	12,759	-	-	-	-
Total	603	93,506,131	4,644,234	5.0%	735,837	0.8%	5,380,071	88,126,060	5.8%	6.1%	341,401	3,634,602	-	2,888,321	5,015,569	10,036,431
FINANCIAL DISTRICT:																
A	111	46,506,518	2,376,755	5.1%	304,633	0.7%	2,681,388	43,825,130	5.8%	6.2%	221,855	2,933,513	-	2,154,811	1,786,467	288,677
B	73	8,126,568	677,601	8.3%	61,598	0.8%	739,199	7,387,369	9.1%	9.9%	69,304	49,718	-	-	100,800	-
C	34	1,476,936	114,710	7.8%	2,622	0.2%	117,332	1,359,604	7.9%	9.3%	19,448	19,850	-	-	-	-
Total	218	56,110,022	3,169,066	5.6%	368,853	0.7%	3,537,919	52,572,103	6.3%	6.9%	310,607	3,003,081	-	2,154,811	1,887,267	288,677
SUBMARKETS:																
North Financial	117	28,777,524	1,997,688	6.9%	216,338	0.8%	2,214,026	26,563,498	7.7%	9.0%	374,009	778,769	-	372,000	77,999	-
South Financial	101	27,332,498	1,171,378	4.3%	152,515	0.6%	1,323,893	26,008,605	4.8%	4.6%	(63,402)	2,224,312	-	1,782,811	1,809,268	288,677
Total	218	56,110,022	3,169,066	5.6%	368,853	0.7%	3,537,919	52,572,103	6.3%	6.9%	310,607	3,003,081	-	2,154,811	1,887,267	288,677
Union Square	58	4,063,190	263,887	6.5%	7,956	0.2%	271,843	3,791,347	6.7%	6.2%	(18,352)	(11,687)	-	-	-	-
Yerba Buena	31	4,663,528	61,956	1.3%	84,616	1.8%	146,572	4,516,956	3.1%	3.7%	26,281	13,767	-	-	108,500	1,611,600
SOMA West	40	3,774,330	53,870	1.4%	41,141	1.1%	95,011	3,679,319	2.5%	2.6%	(18,352)	(11,687)	-	419,063	-	2,939,250
SOMA East	61	6,337,586	150,955	2.4%	123,681	2.0%	274,636	6,062,950	4.3%	4.1%	(3,434)	424,407	-	-	266,053	1,006,015
Civic Center/Mid-Market	45	6,385,741	141,568	2.2%	15,617	0.2%	157,185	6,228,556	2.5%	2.5%	1,290	34,432	-	-	460,000	-
Jackson Square	40	2,330,330	105,888	4.5%	35,167	1.5%	141,055	2,189,275	6.1%	4.5%	(35,560)	(15,694)	-	-	-	-
North Waterfront	48	3,633,826	152,321	4.2%	31,934	0.9%	184,255	3,449,571	5.1%	6.5%	51,320	(17,827)	-	-	-	-
Van Ness Corridor	18	1,063,442	105,334	9.9%	950	0.1%	106,284	957,158	10.0%	15.0%	53,388	30,149	-	-	-	-
Potrero West	17	1,258,348	94,841	7.5%	24,092	1.9%	118,933	1,139,415	9.5%	6.3%	(39,431)	1,555	-	-	244,101	187,416
Potrero East	11	1,088,053	344,548	31.7%	1,830	0.2%	346,378	741,675	31.8%	32.5%	7,370	(15,042)	-	314,447	-	126,537
Mission Bay	16	2,797,735	-	0.0%	-	0.0%	-	2,797,735	0.0%	0.0%	0	40,490	-	-	2,049,648	3,876,936
Total	603	93,506,131	4,644,234	5.0%	735,837	0.8%	5,380,071	88,126,060	5.8%	6.1%	335,127	3,475,944	-	2,888,321	5,015,569	10,036,431
QUARTERLY COMPARISON/TOTALS																
Q2-18	603	93,506,131	4,948,469	5.2%	776,003	0.8%	5,721,472	87,784,689	6.1%	6.5%	1,740,092	3,293,201	1,517,744	2,888,321	4,614,234	11,064,597
Q1-18	598	91,988,387	5,212,864	5.7%	730,986	0.8%	5,943,820	86,044,567	6.5%	6.9%	1,553,109	1,553,109	1,370,577	1,370,577	5,065,925	10,463,581
Q4-17	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
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

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