

Savills Studley Report San Francisco office sector

Q3 2018



SUMMARY

Market Highlights

LEASING DOWN SLIGHTLY

Following a record second quarter, leasing volume dipped slightly in the third quarter, totaling 2.5 million square feet (msf). Larger tenants remained active though, with several additional 100,000-plus-sf leases completed. Tenants have leased more than 10 msf in the four most recent quarters.

AVAILABILITY FALLS SHARPLY

San Francisco's overall availability fell sharply for the second straight quarter, declining by 190 basis points overall to 9.0%. The Class A rate decreased by 220 basis points to 8.4%.

RENT JUMPS

The average total asking rent rose by 2.5% to \$68.53. Class A rent averaged \$72.42, a 4.5% quarter-on-quarter increase.

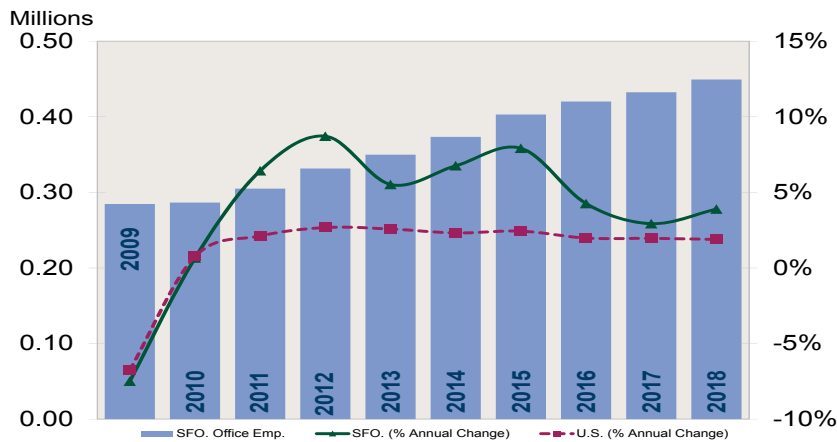
SALES DROP

Office property sales during the first seven months of the year totaled \$2.7 billion, a 25.4% decrease compared to the first seven months of 2017.

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"With few larger blocks of prime Class A space remaining for lease, deal volume dropped slightly from the strong second-quarter volume. Availability still posted a sharp decrease. Smaller startups continue to seek out alternatives to the market, though, raising concerns about the depletion of San Francisco's entrepreneurial base."

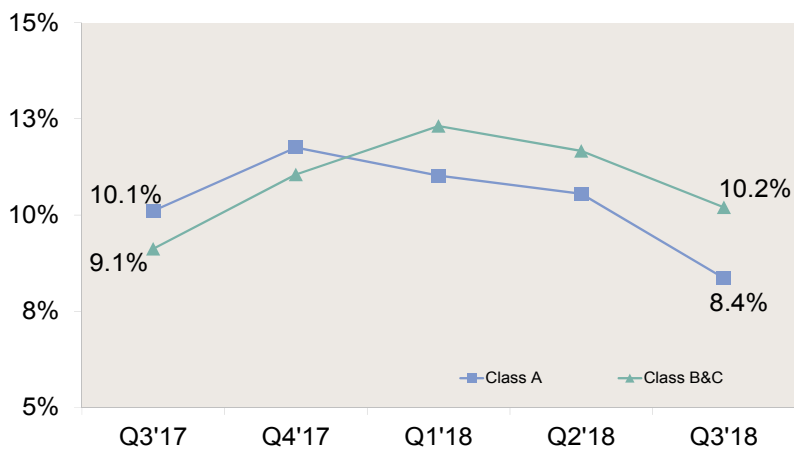
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Office-Using Employment Trends

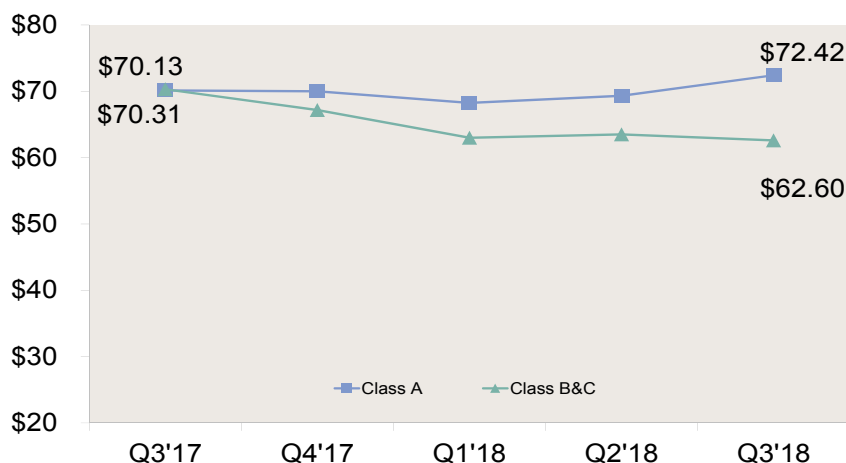


Source: Bureau of Labor Statistics^

Availability Rate Trends



Asking Rent Trends (\$/sf)



The Big Picture

Seeing the forest through the trees is sometimes difficult. Of late, there have been so many large leases signed in San Francisco's office market that it is easy to miss the relocation of mid-sized and smaller firms. In recent months, companies such as The North Face and Hewlett Packard have announced plans to move some or all of their operations to another market. It is not just fledgling startups or companies in the throes of restructuring that are relocating. Blue Shield of California recently announced that it will decamp more than 1,000 employees to Oakland.

So far, it is hard to see any evidence that the flow of businesses to Oakland, Denver and points beyond is negatively impacting employment. Office-using employment is levelling off – but at a level that is well above most markets around the country. During the last 12 months, the region has added nearly 16,000 office-using jobs, a 3.7% increase, eclipsing the 1.9% growth in national office-using employment.

Top Tech Firms Making Preemptive Strikes

The largest firms are still dominating quarterly activity. Steady leasing is taking place up and down the Peninsula from San Francisco to San Jose. Facebook has been at the forefront, grabbing entire projects across the region – Transbay Tower in San Francisco, WeWork's The Village at San Antonio Center in Mountain View, and most recently Burlingame Point in South San Francisco. As the quarter was closing, Facebook was reportedly close to taking another 200,000 sf at 215 Fremont, a former Charles Schwab building.

Tech tenants continue to aggressively lease space, sometimes even before it is ever marketed. Fintech firm SoFi plans to move from Presidio to 246 1st Street in SoMa and will lease the entirety of the building. SoFi will nearly triple the size of its lease from the 33,000 sf it currently occupies at One Letterman Drive. Additionally, Amazon leased nearly 150,000 sf of space at 525 Market Street.

Other Sectors Add to Space Demand

Tech firms are still driving this market, but a few professional and business services companies are also aggressively expanding payroll and space. PwC leased 196,356 sf at 405 Howard Street in the Transbay district, increasing from the 165,000 sf it

leases at Three Embarcadero. The move will accommodate the professional services firm's plan to expand its local payroll by about 20%.

Coworking space providers are also adding to the competition for larger blocks of space. Spaces, Regus' coworking division, leased 77,999 sf at the Bank of America complex (345 Montgomery Street). Regus is struggling to keep up with WeWork's expansion. WeWork recently introduced HQ by WeWork, its new division for mid-sized companies, that focuses on providing options for companies with 11 to 250 employees. The new division leased 17,500 sf at 800 Market Street (the California Savings Building). WeWork is negotiating for more space for HQ by WeWork in both San Francisco and New York City. Coworking is expected to continue its dramatic growth in San Francisco.

Dearth of Big Blocks

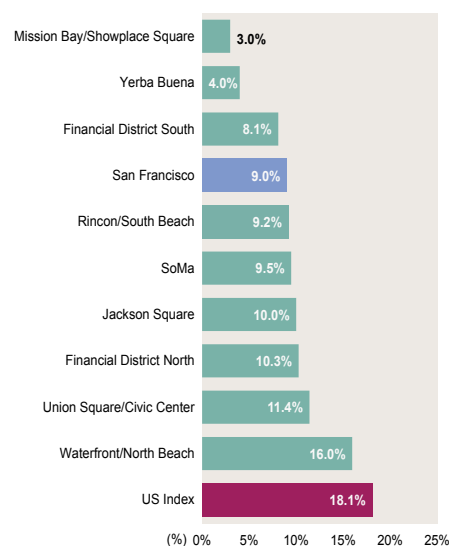
The office market remains most challenging for the largest firms. New construction does not offer a lot of relief. Although the region has 2.9 msf of speculative office space underway, about 90% of it is pre-leased. There are only six existing buildings offering a contiguous block in excess of 100,000 sf. The supply of big blocks was further depleted in the third quarter. Square Inc. leased 104,135 sf adding to its existing lease at 1455 Market Street and bringing its occupancy at the building to just under 470,000 sf. Square is the classic definition of a gazelle – skyrocketing from only 10 employees in 2009 to approximately 2,300 employees globally today.

Splunk signed a 100,850-sf, 12-year renewal and expansion at the Gallo Building (250 Brannan Street). The big data software firm is currently subleasing the block to human resources software firm Zenefits and Dropbox. Like Facebook, Splunk is expanding its presence in the Valley as well. It pre-leased the entire 301,000 sf at 700 Santana Row in Downtown San Jose, adding to the 234,000 sf they already lease at 500 Santana.

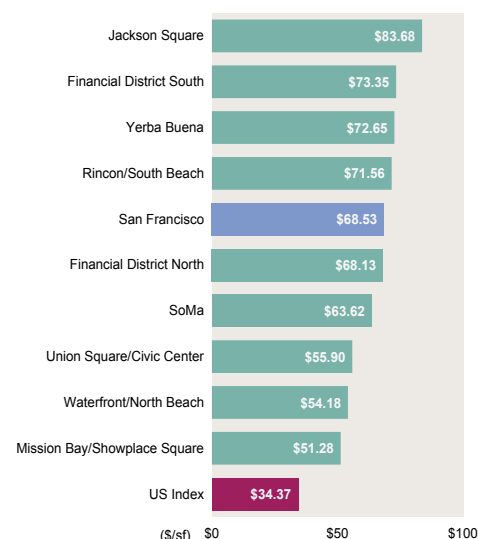
Central SoMa & Waterfront Plans on the Horizon

Kilroy Realty continues to expand its portfolio in Central SOMA. It is under contract to pay \$146 million (\$1,327/sf) for 345 Brannan Street, surpassing the prior record mark of \$1,250/sf paid by Tishman Speyer in 2017 for 222 Second Street. Dropbox leases the entire building. With its

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
PricewaterhouseCoopers	196,356	405 Howard St	Financial District South
Amazon	143,168	525 Market St	Financial District South
Ancestry	127,097	153 Townsend St	Rincon/South Beach
Splunk	100,850	250 Brannan St	Rincon/South Beach
Unity Technologies	98,553	657 Mission St	Financial District South
SoFi	98,566	246 1st St	Financial District South
Lyft	85,591	185 Berry St	Mission Bay/Showplace Square
Regus Spaces	77,999	345 Montgomery St	Financial District North
CloudFlare	43,310	634 2nd St	Rincon/South Beach
OneLogin	40,124	840-848 Battery St	Waterfront/North Beach

success in Central SoMa clearly established, Kilroy Realty is eager to move ahead with the Flower Mart project. The 2.0-msf project will push development in Central SoMa to another level. There are still a lot of moving parts to the project. It will be late next year before the current vendors shift to an interim location.

Tishman Speyer's Mission Rock development in the Central Waterfront neighborhood, located near AT&T Park, is also unlikely to get underway for quite some time. Mission Rock will be the centerpiece of the 28-acre Central Waterfront development. Plans call for up to 1,400 rental units, 250,000 sf of retail and manufacturing and as much as 1.4 msf of office space. As part of the redevelopment, Pier 48 will be rehabilitated.

The development pipeline is heating up, but most of the buildings in the next set of properties will not deliver until 2020 or later. In the meantime, this clears the way for

adaptive reuse projects to make a bid for tenants. The California College of the Arts is unifying its campus in San Francisco. The arts college wants to monetize and redevelop its original campus, which contains several historic buildings.

Looking Forward

The number of big blocks over 50,000 sf is negligible; however, smaller and mid-sized tenants have a few more options. Smaller tenants are increasingly being priced out of some submarkets, though. Activity has dropped off among smaller firms under 10,000 sf and many continue to seek out options in other markets. San Francisco, like other top tech centers – Boston, Silicon Valley and Seattle – will need to closely monitor the loss of smaller and mid-sized tenants to other cities.

Map	Submarket	Total	Leasing Activity	Available SF				Availability Rate			Asking Rents Per SF		
		SF (1000's)	Last 12 Months	This Quarter	% Change from Last Qtr.	Year Ago	5 Yrs Ago	This Quarter	pp Change from Last Qtr. ⁽¹⁾	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
1	Financial District North	27,910	2,756	2,866	-6.8%	3,428	2,971	10.3%	-0.7%	12.3%	\$68.13	2.6%	\$70.83
	Financial District North - Class A	20,475	1,733	2,080	-5.8%	2,433	1,996	10.2%	-0.6%	11.9%	\$69.01	3.5%	\$69.73
2	Financial District South	24,446	3,410	1,980	-35.9%	2,081	2,544	8.1%	-4.5%	8.5%	\$73.35	1.9%	\$72.16
	Financial District South - Class A	20,940	2,973	1,483	-37.8%	1,770	1,729	7.1%	-4.3%	8.5%	\$74.08	1.9%	\$72.16
3	Rincon/South Beach	4,530	1,020	416	-6.4%	421	508	9.2%	-0.6%	9.3%	\$71.56	0.2%	\$76.17
	Rincon/South Beach - Class A	1,544	286	229	-15.1%	244	143	14.8%	-2.6%	15.8%	\$74.84	-0.8%	\$73.00
4	Yerba Buena	3,180	602	127	-22.8%	233	696	4.0%	-1.2%	7.3%	\$72.65	-2.9%	\$69.68
	Yerba Buena - Class A	701	363	0	N/A	37	218	0.0%	0.0%	5.3%	N/A	N/A	N/A
5	SOMA	4,022	213	381	15.1%	180	1,280	9.5%	1.2%	4.5%	\$63.62	-4.1%	\$68.67
	SOMA - Class A	1,158	N/A	74	-31.0%	94	355	6.4%	-2.9%	8.1%	\$69.41	2.3%	\$66.03
6	Union Square/Civic Center	3,788	337	432	54.4%	300	455	11.4%	4.0%	7.9%	\$55.90	-7.7%	\$70.48
	Union Square/Civic Center - Class A	503	0	94	664.4%	22	34	18.7%	16.2%	4.3%	\$66.00	0.0%	\$0.00
7	Jackson Square	1,942	192	194	-29.9%	235	171	10.0%	-4.3%	12.1%	\$83.68	41.1%	\$66.31
	Jackson Square - Class A	414	83	N/A	N/A	N/A	0	N/A	N/A	N/A	N/A	N/A	N/A
8	Waterfront/North Beach	2,441	156	390	-34.7%	196	504	16.0%	-8.5%	8.0%	\$54.18	-5.5%	\$63.40
	Waterfront/North Beach - Class A	503	23	59	-33.2%	32	248	11.7%	-5.8%	6.4%	\$54.50	-11.3%	\$65.00
9	Mission Bay/Showplace Square	4,387	1,321	131	-6.3%	399	749	3.0%	-0.2%	9.1%	\$51.28	-18.8%	\$68.22
	Mission Bay/Showplace Square - Class A	2,620	1,098	6	-77.1%	209	202	0.2%	0.0%	8.0%	\$0.00	-100.0%	\$68.81
1-9	San Francisco Total	76,646	10,006	6,918	-17.6%	7,474	9,878	9.0%	-1.9%	9.8%	\$68.53	2.5%	\$70.19
	San Francisco Total - Class A	48,857	6,597	4,084	-20.8%	4,939	4,924	8.4%	-2.2%	10.1%	\$72.42	4.5%	\$70.13

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(1) Percentage point change for availability rates.

Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.

Submarkets with limited inventory may be subject to larger changes in statistics.

Statistics are calculated using both direct and sublease information.

Short-term sublet spaces (terms under two years) were excluded.

^Unless otherwise noted, source for data is Savills Studley.

The information in this report is obtained from sources deemed reliable, but no representation is made as to the accuracy thereof. Statistics compiled with the support of The CoStar Group.

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