

Savills Studley Report San Francisco office sector

Q1 2018



SUMMARY

Market Highlights

LEASING PAUSES

Quarterly leasing activity totaled 1.8 million square feet (msf), declining 31.1% from the fourth quarter of 2017. Tenants have leased 8.8 msf in the four most recent quarters. However, this decline is partially due to a few large leases still pending execution. Leasing is expected push back to the trend line in the second quarter.

AVAILABILITY STABLE

San Francisco's overall availability inched up by 10 basis points to 10.7% in the first quarter of 2018. The Class A availability rate posted a decrease in the quarter, dropping by 70 basis points to 9.6%.

STABLE RENT

The average total asking rent ticked down by 0.8% to \$67.15, but has increased by 4.7% year-on-year. Class A rent averaged \$69.15, a 1.2% quarter-on-quarter decrease and has jumped by 7.1% year-on-year.

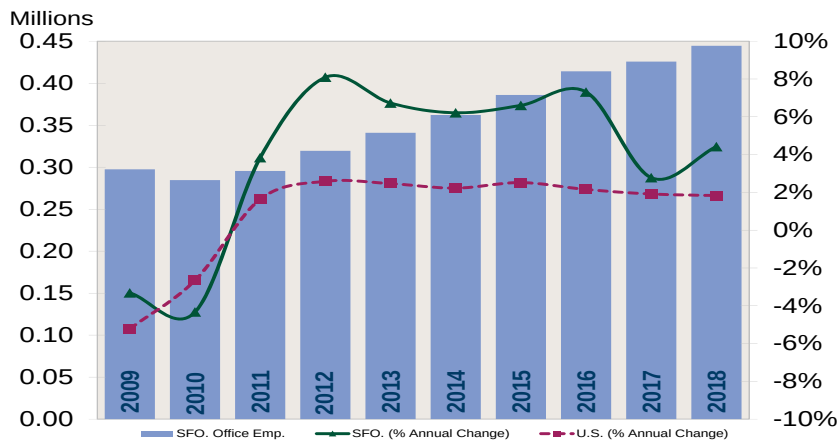
SALES DROP

Office property sales during the last six months (through February 2018) totaled \$1.1 billion, falling sharply compared to the previous six-month total of \$3.4 billion.

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"Leasing paused in the first quarter, with only one lease exceeding 100,000 sf signed. Nevertheless, space options remain very limited, particularly for the market's biggest tenants. Last year's scrum for space left the market's new development pipeline nearly stripped bare of big block options."

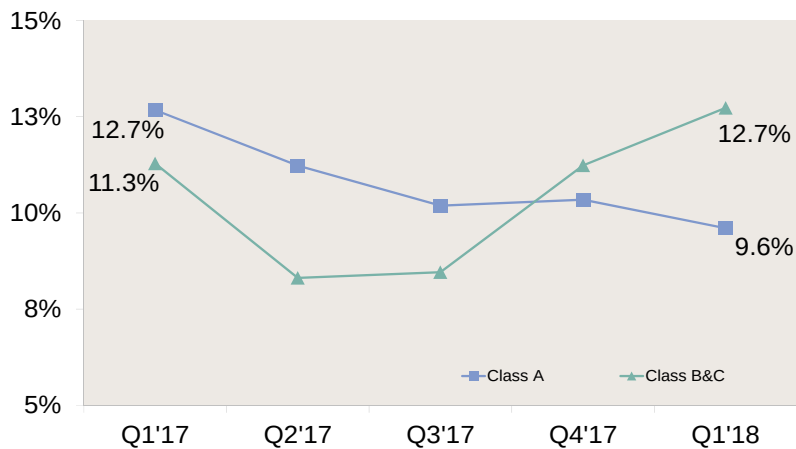
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Office-Using Employment Trends

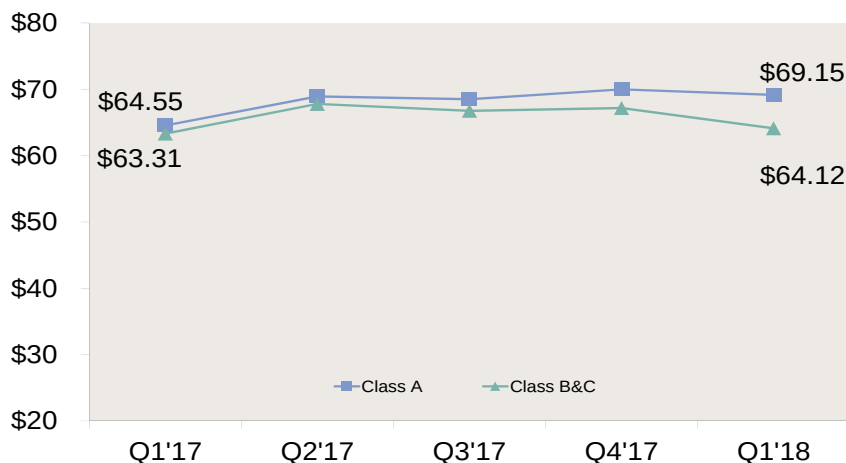


Source: Bureau of Labor Statistics^

Availability Rate Trends



Asking Rent Trends (\$/sf)



Labor and Space Shortages Prevail

San Francisco's office market enjoyed a stellar second half of 2017. Over the course of a few months, top area employers such as Dropbox, as well as relative newcomers (Facebook, Airbnb and Amazon) depleted the market's next crop of new development.

San Francisco's Class A availability rate fell to 9.6% at the end of the first quarter. In last year's scrum for space, cost was secondary to the goal of securing new hires. Tenants were willing to pay top dollar for prime space located in the heart of the most sought-after areas. Many top firms have added space, even though they are unsure whether they will be able to hit hiring goals as rapidly as they hope to.

It remains to be seen whether the recent pace of hiring and leasing is sustainable. A limited supply of skilled labor and space presents firms with soaring costs and obstacles to achieving expansion goals. The region's unemployment rate remains well under 4.0%. Nevertheless, many top employers are doubling down on their payroll expansion and space commitments. Additionally, startups are adding to the bidding war for talent. Office-using employment has jumped by 4.3% in the last 12 months, up from 2.8% in the prior 12 months and eclipsing the anemic 0.7% nationally.

Blind Eye to Cost

Wages and salaries are soaring. Some firms are looking for options elsewhere. Other tenants, flush with funding, remain indifferent to the cost when it comes to attracting the creative and engineering talent that San Francisco has to offer. The Bay Area is in the midst of another wave of investment, expansion and planned hiring. According to the latest PwC/CB Insights MoneyTree Report, San Francisco tallied \$6.33 billion in 233 fundings during the first quarter, well above the \$2.57 billion in 172 fundings in the New York Metro region, as well as Silicon Valley, with \$2.9 billion in 158 deals. Top deals included AI auto innovator Nuro, which raised \$92 million, and Sift Science (a cybersecurity startup) raising \$53 million. Software companies that have been around a bit longer such as Cloudera, Intelliswift Software and MuleSoft have also secured additional funding and are in expansion mode. Finally, heavyweights from the Valley such as Facebook are still pushing into San Francisco as they accept the reality that some talent simply will not make the trek to

the Valley.

As companies scramble for talent and space, leasing up 100,000-sf-plus blocks, it creates a sense of urgency among other firms still conducting their searches. Tech firms have the funds to act aggressively. On the other hand, many professional/business services and law firms continue to operate more cautiously. Considering the limited quality space options and spiraling rent, some tenants can not afford to sit on their heels.

Landlords pulled back on concessions as 2017 progressed. They have remained inflexible in early 2018. Smaller and mid-sized firms in existing properties ran into reduced concessions. Buildout costs continue to grow at a much faster pace than improvement allowances. Ample venture capital funding is also spurring some lavish build-outs.

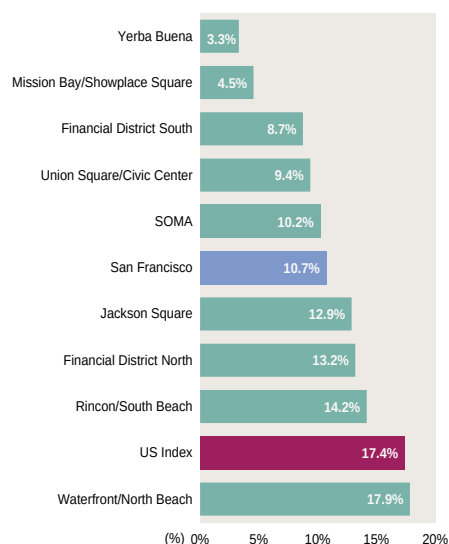
Larger companies requiring bigger blocks of space face the most challenges. At the close of the first quarter, there were only 20 buildings offering a block in excess of 50,000 sf. New construction will not alleviate the space crunch. Among the seven properties totaling 1.8 msf currently under way, Park Tower at Transbay— with 772,954 sf remaining — is the only building with any material availability not pre-leased. Multiple tenants were in negotiations for this space in the quarter, though. A few more proposed buildings are on the horizon. San Francisco currently has more pending development (just over 4 msf) than the 2.0 msf remaining in the Prop M large cap office allocation pool.

WeWork's Big Move

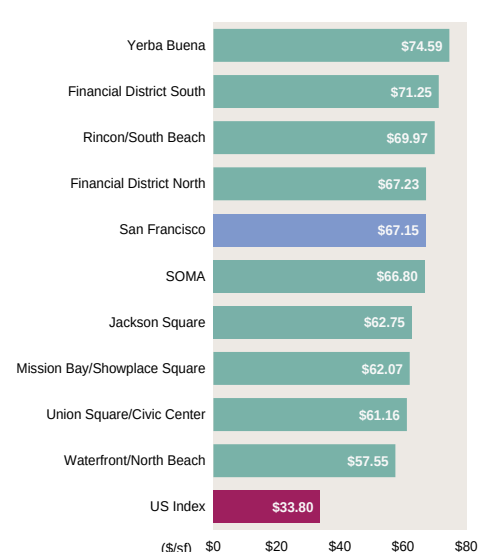
WeWork's prolific expansion is old news in most markets, but the coworking giant has had a tougher time pushing into San Francisco. WeWork has 13 locations in San Francisco, compared to 42 in Manhattan. This is both a testament to the tightness of the San Francisco office market and the proliferation of incubators and more local/regional co-working providers.

When they have found space, though, WeWork has not held back. In March, WeWork signed a massive 18-year lease for the entirety of 430 California Street in the North Financial District. The workplace innovator will lease all 20 floors of the 251,722-sf building. Kennedy Wilson and Takenaka Corporation acquired the property for \$135 million in 2016 and hope to complete renovations by early 2019. Given the tight market conditions and dearth of big

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
WeWork	251,722	430 California St	Financial District North
Covington & Burling, LLP	78,414	415 Mission St	Financial District South
New Relic	74,000	188 Spear St	Financial District South
Samsara Networks	71,000	350 Rhode Island St	Mission Bay/Showplace Square
Google	57,259	2 Harrison St	Rincon/South Beach
Meltwater	45,000	1 Ferry Building	Jackson Square
NBC Sports Bay Area	44,000	360 3rd St	Yerba Buena
Stitchfix	38,700	1 Montgomery St	Financial District North
MindSpace	36,111	575 Market St	Financial District South
Databricks Inc.	31,718	160 Spear St	Financial District South

block options, it would not be a surprise to see the space at WeWork go quickly, and to just one or two firms.

Leasing activity relented slightly in the first quarter with only a handful of bigger leases signed. WeWork's lease was the only one over 100,000 sf during the quarter. In other notable leases, New Relic renewed 74,000 sf at 188 Spear Street. Despite tight market conditions, tenants remain mobile with surprisingly few renewals. Samsara Networks inked a 71,000-sf lease at 350 Rhode Island in Showplace Square.

Other notable leases included Google's 57,000-sf expansion at Two Harrison Street; a 45,000-sf lease by Meltwater at The Ferry Building and a 38,700-sf lease by Stitchfix at One Montgomery Street. Of note, the Ferry Building, which is now fully leased, is now on the market. It is expected to sell for much more than the \$39.2 million it commanded in 2007.

Looking Forward

There is little short-term alleviation to the space and talent crunch. Available sublet space (3.6 msf) has not increased in the last five months. New product underway has negligible space remaining. In turn, most landlords will take a tougher stance on lease terms in the next several quarters.

Labor shortfalls are exacerbated by a renewed loss of businesses and households to other markets. Net migration is expected to turn into negative territory for the first time in a decade. Professional/business services and banks have accounted for much of the movement to other markets. A few more tech companies have decided to relocate. Maxar Technologies, for example, announced that it will move Digital Globe, its satellite imaging company, and 800 jobs to Westminster, Colorado.

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	27,915	2,558	3,686	9.9%	3,565	3,516	13.2%	1.2%	12.8%	\$67.23	1.3%	\$62.95
	Financial District North - Class A	20,475	1,746	2,542	7.0%	2,535	2,578	12.4%	0.8%	12.4%	\$67.48	-5.3%	\$65.48
2	Financial District South	23,675	2,903	2,071	-17.1%	3,116	2,540	8.7%	-1.8%	13.2%	\$71.25	0.9%	\$65.35
	Financial District South - Class A	20,087	2,583	1,614	-19.3%	2,728	2,036	8.0%	-1.9%	13.6%	\$71.73	4.3%	\$64.52
3	Rincon/South Beach	4,197	688	595	111.1%	437	499	14.2%	7.5%	10.4%	\$69.97	6.7%	\$66.12
	Rincon/South Beach - Class A	1,544	446	181	14.3%	201	148	11.7%	1.5%	13.0%	\$74.52	-2.3%	\$65.70
4	Yerba Buena	3,246	622	107	-47.2%	427	619	3.3%	-2.9%	13.1%	\$74.59	2.7%	\$68.62
	Yerba Buena - Class A	701	75	16	N/A	64	134	2.3%	-9.8%	9.1%	N/A	N/A	N/A
5	SOMA	3,808	166	389	-2.3%	301	1,235	10.2%	-0.2%	7.9%	\$66.80	2.4%	\$48.86
	SOMA - Class A	1,158	N/A	77	-25.3%	99	273	6.6%	-2.2%	8.6%	\$66.86	-0.5%	\$48.07
6	Union Square/Civic Center	3,627	316	340	-19.5%	440	378	9.4%	-2.3%	12.1%	\$61.16	-14.5%	\$67.15
	Union Square/Civic Center - Class A	503	0	18	0.0%	22	31	3.7%	0.0%	4.3%	\$66.00	0.0%	\$69.06
7	Jackson Square	1,916	135	247	-13.3%	280	199	12.9%	-2.0%	14.6%	\$62.75	-6.6%	\$58.19
	Jackson Square - Class A	414	63	N/A	N/A	N/A	0	N/A	N/A	N/A	N/A	N/A	N/A
8	Waterfront/North Beach	2,572	140	459	35.4%	248	458	17.9%	4.7%	9.6%	\$57.55	-22.9%	\$57.50
	Waterfront/North Beach - Class A	503	46	43	36.7%	62	207	8.5%	2.3%	12.3%	\$62.36	13.4%	\$64.92
9	Mission Bay/Showplace Square	4,439	1,296	202	-23.0%	363	846	4.5%	-1.4%	8.2%	\$62.07	12.6%	\$62.73
	Mission Bay/Showplace Square - Class A	2,676	1,093	74	-26.6%	268	285	2.8%	0.0%	10.0%	\$69.86	42.6%	\$64.93
1-9	San Francisco Total	75,395	8,824	8,095	0.7%	9,176	10,290	10.7%	0.1%	12.2%	\$67.15	-0.8%	\$64.11
	San Francisco Total - Class A	48,060	6,063	4,615	-7.2%	6,091	5,692	9.6%	-0.7%	12.7%	\$69.15	-1.2%	\$64.55

Please contact us for further information

Savills Studley

150 California Street
14th Floor
San Francisco, CA 94111
(415) 421-5900

Branch Manager

Steve Barker - Vice Chairman
sbarker@savills-studley.com

(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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