

SAN FRANCISCO | OFFICE MARKET

Q2 | 2016

Accelerating success.

Market Remains Strong, but Slight Cooling of Demand from the City's Record High Levels



> VACANCY The vacancy rate decreased 20 basis points this quarter to 6.5 percent and continues to reflect record low vacancy rates for the City. The gap between the North and South Financial Districts continued to widen this quarter to 9.2 percent and 4.8 percent, respectively. In fact, the North Financial District now has the second highest vacancy in the City after the Van Ness Corridor submarket. Vacant sublease space increased 9.8 percent this quarter to 813,689 square feet and has increased 20.7 percent year-to-date. More sublease space looms as notable large technology companies, such as Zenefits; Lending Club and Prosper have announced job cuts which will result in more sublease space coming to the market over the second half of the year.

> LEASING VOLUME Leasing activity in the City rose during the second quarter of 2016 to nearly 1.6 million square feet of transactions recorded. Despite the increase in leasing activity for the quarter, it still falls short of the 15-year historical quarterly average of 1.8 million square feet. There were three leases signed over 100,000 square feet this quarter, the largest was Fitbit taking approximately 306,000 square feet at 215 Fremont Street and at 185 Berry Street Lyft took over 204,000 square feet and Stripe subleased nearly 103,000 square feet.

> ABSORPTION Absorption for the quarter tallied over 268,000 square feet making a record 24th consecutive quarter of positive absorption and bringing the year-to-date total to approximately 1.06 million square feet. The South Financial District and SOMA East submarkets fueled large net absorption gains, collectively posting over 515,000 square feet of positive net absorption for the quarter. Tenant requirements for office space in San Francisco remains healthy with nearly 4.6 million square feet of tenant demand of which there are 12 separate requirements over 100,000 square feet for a total of over 1.8 million square feet of demand. While all of this tenant demand won't likely be fulfilled, this could translate into 2.4 million square feet of positive net absorption.

> RENTS Overall citywide rents increased this quarter, mostly attributable to the four large leases which all had effective rental rates in the \$80's or higher, pulling the overall weighted rent average up 9.4 percent to \$77.37 per square foot and the overall non-weighted up 1.8 percent to \$70.22 per square foot. Overall Class A weighted rents rose 9.5 percent to \$80.42 and non-weighted Class A rents increased 2.6 percent to \$73.38 this quarter. The Financial District Class A weighted rents rose 3.1 percent to \$77.25 during the second quarter.

Market Indicators

Relative to prior period	Q2 2016	2016 Forecast
VACANCY	↓	↓
NET ABSORPTION	↑	↑
CONSTRUCTION	↔	↑
WEIGHTED RENTAL RATE	↑	↑
NON-WEIGHTED RENTAL RATE	↔	↑
SALES VOLUME	↑	↑
SALES PRICES	↑	↑

San Francisco – Office Rents - Q2 2016

MARKET	2Q '16 OVERALL	2Q '16 DIRECT	2Q '16 SUBLEASE	1Q '16 OVERALL	% OVERALL QUARTERLY CHANGE
All Markets	\$77.37	\$77.46	\$77.21	\$70.72	9.4%
All Markets: Class A	\$80.42	\$81.24	\$79.22	\$73.41	9.5%
All Markets: Class B	\$70.52	\$71.46	\$68.42	\$65.11	8.3%
Financial District: Class A	\$77.25	\$78.57	\$74.55	\$74.90	3.1%
Financial District: Class B	\$69.33	\$66.84	\$73.65	\$56.55	22.6%
SOMA Overall	\$82.57	\$83.82	\$81.89	\$68.69	20.2%

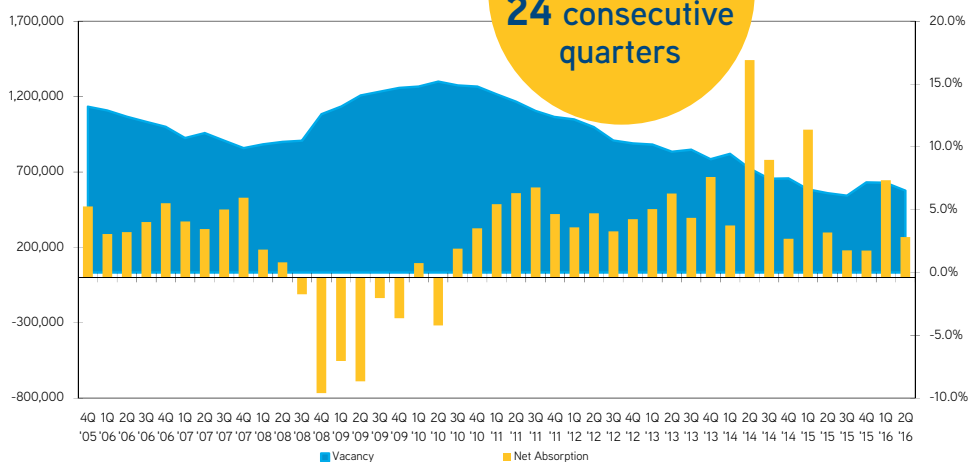
Source: Colliers International

Note: Weighted Average Rents

Rental Rates

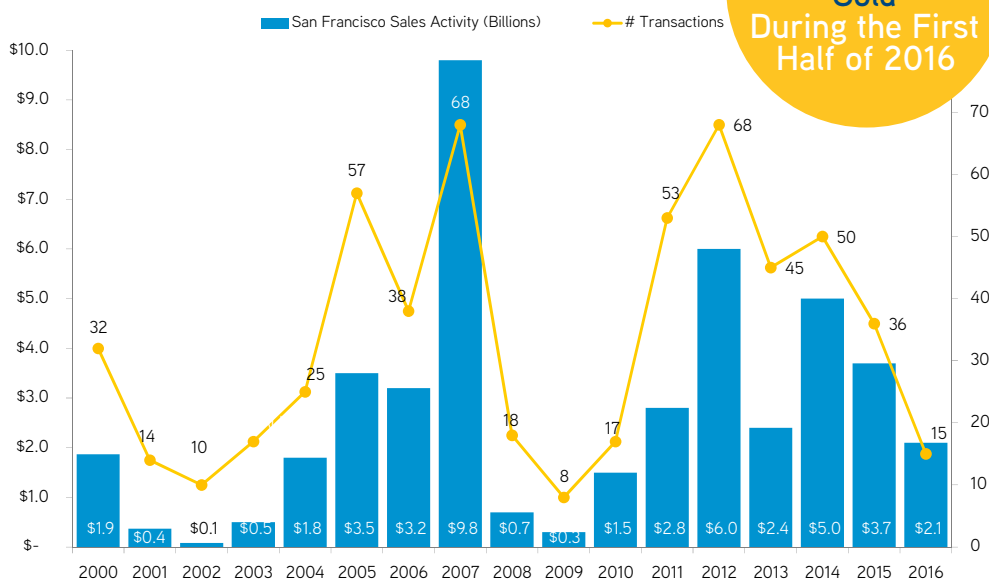
Weighted effective rents increased across all asset Classes during the second quarter, with Class A weighted rents rising 9.5 percent to \$80.42, Class B rose 8.3 percent to \$70.52 and Class C increasing 3.6 percent to \$65.17. The overall weighted Class B rents in the Financial District experienced the largest increase of the quarter jumping up 22.6 percent to \$69.33. Meanwhile, non-weighted rents remained relatively flat for the quarter.

Positive Net Absorption for 24 consecutive quarters



Source: Colliers International

15 Office Properties Sold During the First Half of 2016



Source: Colliers International

Absorption & Vacancy

For the second consecutive quarter in 2016 the South Financial District experienced the strongest occupancy gains with nearly 267,000 square feet of absorption for the quarter and posting approximately 977,000 square feet of absorption year-to-date. This quarter's absorption was a result of a couple of large expansions: Fitbit expanded into over 218,000 square feet combined at 199 Fremont Street and 215 Fremont Street. The second largest occupancy growth was experienced in the SOMA East submarket with over 248,000 square feet of absorption. A key contributor for this absorption is Splunk moving into their new 182,000 square foot building at 270 Brannan Street. Also, a flight to quality continues to persist as Class A space accounted for nearly 424,000 square feet of absorption in the second quarter and approximately 1.3 million square feet year-to-date.

Investment Volume

Increasing sales activity continues to be the lead story as more investors look to sell their assets to capitalize on the apex of the market. The largest sale during the second quarter was in the South Financial District with The Blackstone Group's purchase of 555-575 Market Street from John Hancock Life Insurance Company for nearly \$512 million dollars (\$680 per square foot). Additional significant sales for the quarter were Joseph Hotung/AIG purchasing 760 Market Street from Thor Equities for \$370 million dollars (\$1,241 per square foot), and Pembroke Real Estate acquired 140 New Montgomery from Stockbridge Capital Group for \$284 million dollars (\$962 per square foot). Year-to-date there has been over \$2.1 billion in sales volume and there is another \$4.0 billion listed for sale. There are many Class A & B office properties on the market which could result in very strong sales volume for 2016.

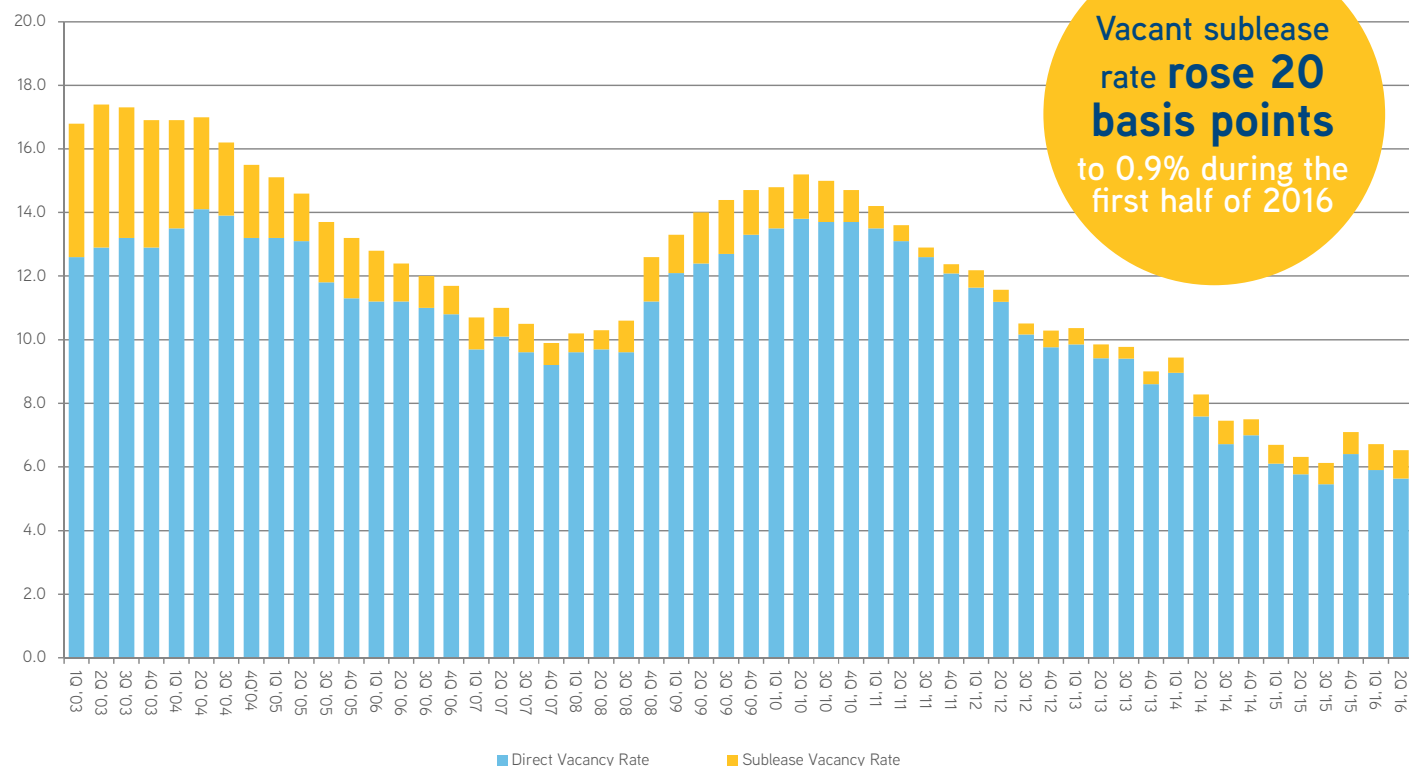
Major Office Lease Transactions - Q2 2016

ADDRESS	TENANT	SIZE	TYPE	SIGNED DATE	CLASS
215 Fremont Street	Fitbit	305,502	New	Apr-16	A
185 Berry Street	Lyft	204,367	New/Sublease	Apr-16	A
185 Berry Street	Stripe	102,392	Sublease	Apr-16	A
499 Illinois Street	UCSF	97,702	New	Apr-16	A
420 Taylor Street	Reddit	50,000	New	May-16	B
85 2nd Street	Chartboost	41,669	New	Jun-16	C
101 California Street	Paul Hastings, LLC	40,422	New	Jun-16	A

Major Office Sale Transactions - Q2 2016

ADDRESS	SELLER	BUYER	SQ.FT.	SALES DATE	CLASS	SALE PRICE	PRICE/SQ.FT.
Market Center - 555 & 575 Market Street	John Hancock Life Insurance Company	Blackstone	752,738	Jun-16	A	\$511,861,840	\$680
760 Market Street	Thor Equities	Joseph Hotung / AIG	298,124	Jun-16	B	\$370,000,000	\$1,241
140 New Montgomery	Stockbridge Capital Group, LLC	Pembroke Real Estate	295,177	Apr-16	B	\$284,000,000	\$962
180 Montgomery Street	CBRE Global Investors	Sidra Capital	304,162	May-16	A	\$185,000,000	\$608
799 Market Street	Jamestown	ASB Real Estate Investments	145,423	Jun-16	B	\$141,500,000	\$973
274 Brannan Street	The Swig Company	CIM Group	105,325	Apr-16	B	\$71,000,000	\$674
755 Sansome Street	Market Street Real Estate Partners	Lingang Investment, LLC	68,000	Jun-16	B	\$42,650,000	\$627
944 Market Street	New Urban Properties, LLC	Synapse Development Group LLC	49,000	Jun-16	B	\$33,050,000	\$674
2233 Post Street	2233 Post Street Associates, LP	York Enterprises, Inc.	18,592	Apr-16	B	\$11,400,000	\$613
701 Sutter Street	John Lee	Private Investor	18,800	Apr-16	B	\$9,000,000	\$479

Direct Vs. Sublease Vacancy Rates



Development Pipeline

There were two deliveries during the second quarter of 2016, with those projects completely preleased, Unity Technologies' nearly 58,000 square foot office space in Yerba Buena at 26-34 3rd Street and Collective Health's nearly 53,000 square foot office building in SOMA West at 81-85 Bluxome Street. The sparsely pre-leased development pipeline persists to hang over the City as a main concern. Currently there is 4.1 million square feet under construction of which only 32 percent is preleased. Of note, Salesforce Tower is 60 percent preleased and 250 Howard Street, 1800 Owens Street, 350 Bush Street, and 181 Fremont Street, which account for 2.2 million square feet, remain without any preleasing commitments. In addition, the City has 12.6 million square feet of office developments

that are either proposed or in various stages of planning with over 9 million square feet of those projects still competing for Prop M allocations

Leasing Activity

The San Francisco office market continued to post positive results during the second quarter of 2016, however, the market expects to experience a slight cooling in demand during the second half of the year. Absorption, vacancy and rental rate statistics are heavily influenced by a few large transactions, which have translated into decreased vacancy rates, positive absorption and skewed weight rents upward. Additional concerns are the growing amount of available sublease space and unleased speculative construction set to hit the market over the next couple of years. These factors will likely translate into a more balanced office market.

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)
DOWNTOWN MARKET:																
A	183	59,122,564	3,096,945	5.2%	591,382	1.0%	3,688,327	55,434,237	6.2%	7.0%	423,977	1,270,756	55,000	457,000	3,608,077	11,690,029
B	294	24,827,967	1,683,295	6.8%	207,609	0.8%	1,890,904	22,937,063	7.6%	6.8%	(111,618)	(190,764)	57,666	162,865	512,000	958,186
C	127	6,600,596	316,157	4.8%	14,698	0.2%	330,855	6,269,741	5.0%	4.3%	(44,115)	(20,276)	-	-	-	-
Total	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
FINANCIAL DISTRICT:																
A	108	44,351,707	2,634,324	5.9%	375,426	0.8%	3,009,750	41,341,957	6.8%	7.2%	169,118	770,659	-	-	2,908,077	1,050,000
B	73	8,145,794	558,309	6.9%	80,534	1.0%	638,843	7,506,951	7.8%	6.7%	(93,431)	(73,593)	-	-	-	-
C	36	1,640,936	191,897	11.7%	4,541	0.3%	196,438	1,444,498	12.0%	8.5%	(57,513)	(33,124)	-	-	-	-
Total	217	54,138,437	3,384,530	6.3%	460,501	0.9%	3,845,031	50,293,406	7.1%	7.1%	18,174	663,942	-	-	2,908,077	1,050,000
SUBMARKETS:																
North Financial	116	28,405,524	2,285,328	8.0%	314,421	1.1%	2,599,749	25,805,775	9.2%	8.3%	(248,600)	(312,935)	-	-	372,000	-
South Financial	101	25,732,913	1,099,202	4.3%	146,080	0.6%	1,245,282	24,487,631	4.8%	5.9%	266,774	976,877	-	-	2,536,077	1,050,000
Total	217	54,138,437	3,384,530	6.3%	460,501	0.9%	3,845,031	50,293,406	7.1%	7.1%	18,174	663,942	-	-	2,908,077	1,050,000
Union Square	58	4,063,190	146,763	3.6%	2,050	0.1%	148,813	3,914,377	3.7%	4.5%	34,569	15,093	-	-	-	-
Yerba Buena	31	4,642,139	308,647	6.6%	13,570	0.3%	322,217	4,319,922	6.9%	5.4%	(17,694)	(90,706)	57,666	57,666	-	1,710,210
SOMA West	41	3,509,267	232,288	6.6%	-	0.0%	232,288	3,276,979	6.6%	7.6%	85,059	67,156	55,000	55,000	-	4,308,227
SOMA East	60	5,796,415	335,962	5.8%	102,246	1.8%	438,208	5,358,207	7.6%	11.8%	248,426	394,737	-	225,519	512,000	599,148
Civic Center/Mid-Market	44	6,311,133	120,223	1.9%	130,904	2.1%	251,127	6,060,006	4.0%	3.7%	(20,315)	(103,150)	-	-	-	432,000
Jackson Square	40	2,330,330	98,960	4.2%	4,876	0.2%	103,836	2,226,494	4.5%	5.2%	18,236	(13,615)	-	-	-	-
North Waterfront	48	3,619,529	191,044	5.3%	-	0.0%	191,044	3,428,485	5.3%	7.2%	70,860	44,347	-	61,680	-	-
Van Ness Corridor	20	1,217,094	215,190	17.7%	2,553	0.2%	217,743	999,351	17.9%	10.1%	(94,827)	(63,682)	-	-	-	-
Potrero West	18	1,339,348	47,826	3.6%	73,600	5.5%	121,426	1,217,922	9.1%	3.8%	(70,902)	(90,803)	-	-	-	169,598
Potrero East	11	864,650	7,964	0.9%	23,389	2.7%	31,353	833,297	3.6%	4.4%	(3,342)	14,897	-	-	-	284,471
Mission Bay	16	2,719,595	7,000	0.3%	-	0.0%	7,000	2,712,595	0.3%	0.3%	-	221,500	-	220,000	700,000	4,094,561
Total	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
QUARTERLY COMPARISON AND TOTALS																
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
Q2-15	600	88,944,277	5,131,940	5.8%	488,506	0.5%	5,620,446	83,323,831	6.3%	6.3%	299,519	1,208,805	62,050	246,990	5,199,587	12,192,495

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