

# SAN FRANCISCO | OFFICE MARKET

Q4 | 2016

Accelerating success.

## Market Leasing Activity Increases and Sales Volumes Close the Year Strong



**> VACANCY** Overall vacancy rate fell 30 basis points to 6.6 percent during the last quarter of 2016. The City continues to have record low vacancy rates with the vacancy rate below seven percent for nearly two years. Meanwhile, the amount of vacant sublease space has been experiencing slow, but steady increases over the past three years and hit 1.0 percent vacant sublease space, something the market hasn't seen since 2010. San Francisco experienced a full percentage point decline from 7.5 percent to 6.5 percent for Class B product with a few large moves such as AirBnB occupying the entire building at 999 Brannan Street.

**> LEASING VOLUME** New leasing activity increased during the last quarter of the year to 1.6 million square feet of transactions recorded in the City and bringing the total leasing activity for the year to 5.7 million square feet. Although this quarter experienced an increase in leasing activity, it falls below the ten-year annual average of 6.75 million square feet. There were a significant number of large leases completed during the last quarter of the year with five leases over 100,000 square feet. Adobe is taking nearly 207,000 square feet at 100 Hooper Street, Slack secured approximately 229,000 square feet at 500 Howard Street and NerdWallet subleased 105,000 square feet at One Tenth Street.

**> ABSORPTION** Absorption for the quarter tallied over 320,000 square feet and brings San Francisco to a record 26th consecutive quarter of positive net absorption and helped to bring the year-to-date total absorption to over 1.5 million square feet. The SOMA East and SOMA West submarkets fueled large net absorption gains by posting over 350,000 square feet of positive net absorption for the quarter. Tenant demand continues to be solid with approximately 4.6 million square feet of tenant requirements, although this is slightly less than the six-year average of 4.8 million square feet. Additionally, of the current 141 tenant requirements in the market, seven of those requirements are for over 100,000 square feet. If all the current market requirements were to be completed, it could translate into over 2.5 million square of net absorption.

**> RENTS** Citywide overall effective rents softened slightly during the fourth quarter. This is mostly attributed to lower sublease rents bringing down the overall effective rents. Year-over-year overall weighted rents were flat at \$72.41; meanwhile annual direct weighted rents experienced a 3 percent increase to \$75.24. As mentioned, year-over-year weighted sublease rents experienced a decrease of nearly 7 percent to \$63.60.

### Market Indicators

Relative to prior period	Q4 2016	2017 Forecast
VACANCY	↓	↑
NET ABSORPTION	↑	↓
CONSTRUCTION	↑	↔
WEIGHTED RENTAL RATE	↔	↔
NON-WEIGHTED RENTAL RATE	↔	↔
SALES VOLUME	↑	↓
SALES PRICES	↑	↓

## San Francisco – Office Rents - Q4 2016

MARKET	4Q '16 OVERALL	4Q '16 DIRECT	4Q '16 SUBLEASE	3Q '16 OVERALL	% OVERALL QUARTERLY CHANGE
All Markets	\$72.41	\$75.24	\$63.91	\$73.81	-1.9%
All Markets: Class A	\$74.62	\$76.98	\$63.60	\$77.54	-3.8%
All Markets: Class B	\$66.45	\$68.50	\$64.15	\$69.85	-4.9%
Financial District: Class A	\$69.97	\$71.30	\$64.45	\$77.62	-9.9%
Financial District: Class B	\$64.66	\$64.65	\$65.00	\$60.72	6.5%
SOMA Overall	\$67.60	\$74.14	\$48.91	\$71.55	-5.5%

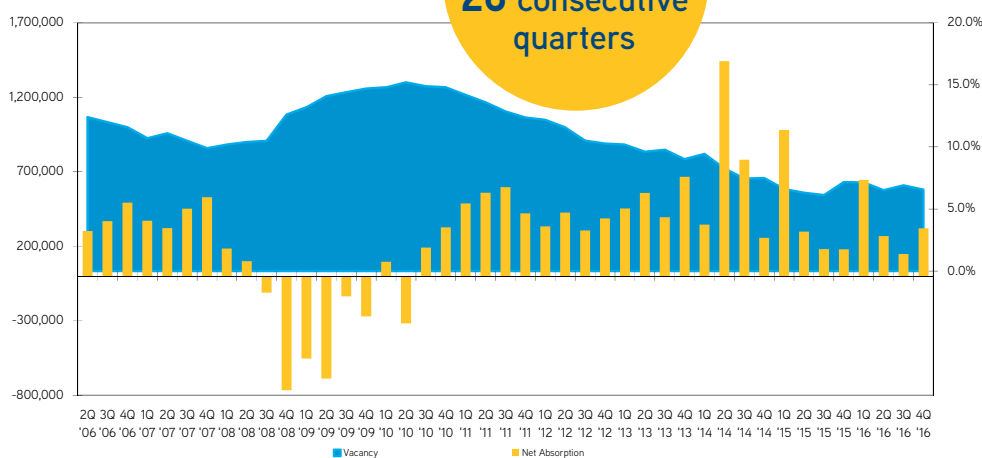
Source: Colliers International

Note: Weighted Average Rents

## Rental Rates

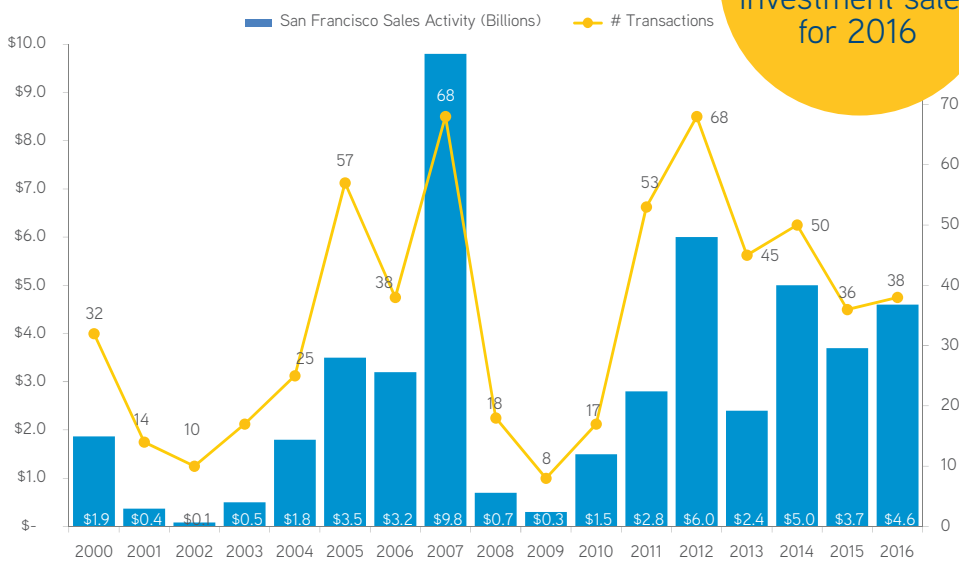
The City saw effective rents soften for all Classes during the last quarter of 2016. One of the only submarkets to experience rent growth this quarter was Class B weighted effective rents in the Financial District. They rose 6.5 percent to \$64.66 from \$64.65. Additionally, year-over-year overall Class C weighted effective rents in the Financial District grew by 13.1 percent to bring the rents up to \$71.13 from \$62.90 at this time last quarter. Watch for rents to remain relatively flat in the beginning of 2017.

Positive Net Absorption for **26 consecutive quarters**



Source: Colliers International

**\$4.6B** in office investment sales for 2016



Source: Colliers International

## Absorption & Vacancy

The SOMA West submarket experienced the largest occupancy gains this quarter with nearly 208,000 square feet of net absorption. Two of this quarter's large occupancies are primarily responsible for this absorption with AirBnB occupying the entire building for 150,000 square feet at 999 Brannan Street and iRhythm moving into nearly 60,864 square feet at 650 Townsend Street. The second largest occupancy growth was in SOMA East, which posted nearly 143,000 square feet of net absorption when Twilio moved into almost 87,000 square feet at 375 Beale Street, GitHub occupied over 35,000 square feet at 625 Second Street and Pinterest moved into the Fastly sublease space for nearly 15,000 square feet at 475 Brannan Street.

## Investment Volume

The San Francisco investment market continues to reign as one of the strongest markets in the country. Investment sales volume continued at a solid pace during the fourth quarter with 13 office sales transactions closing for a combined value of over \$1.5 billion. In 2016 the market experienced a few more investments with 38 transactions closing during the year in comparison with 2015; the totals sales value was 24 percent higher at \$4.6 billion. The largest sale during the fourth quarter was in the North Financial District with Paramount Group, Inc.'s purchase of 1 Front Street from the Florida State Board of Administration for \$521 million dollars (\$800 per square foot). Another record per square foot sale was American Realty Advisors' purchase of Foundry III (505 Howard Street) for \$350 million dollars (\$1,203 per square foot) from Tishman Speyer. An additional significant sale for the quarter was Kennedy-Wilson Properties purchase of 400 California Street from MUFG Union Bank for \$135 million dollars (\$511 per square foot). Watch for the investment market in San Francisco to remain hot well into 2017.

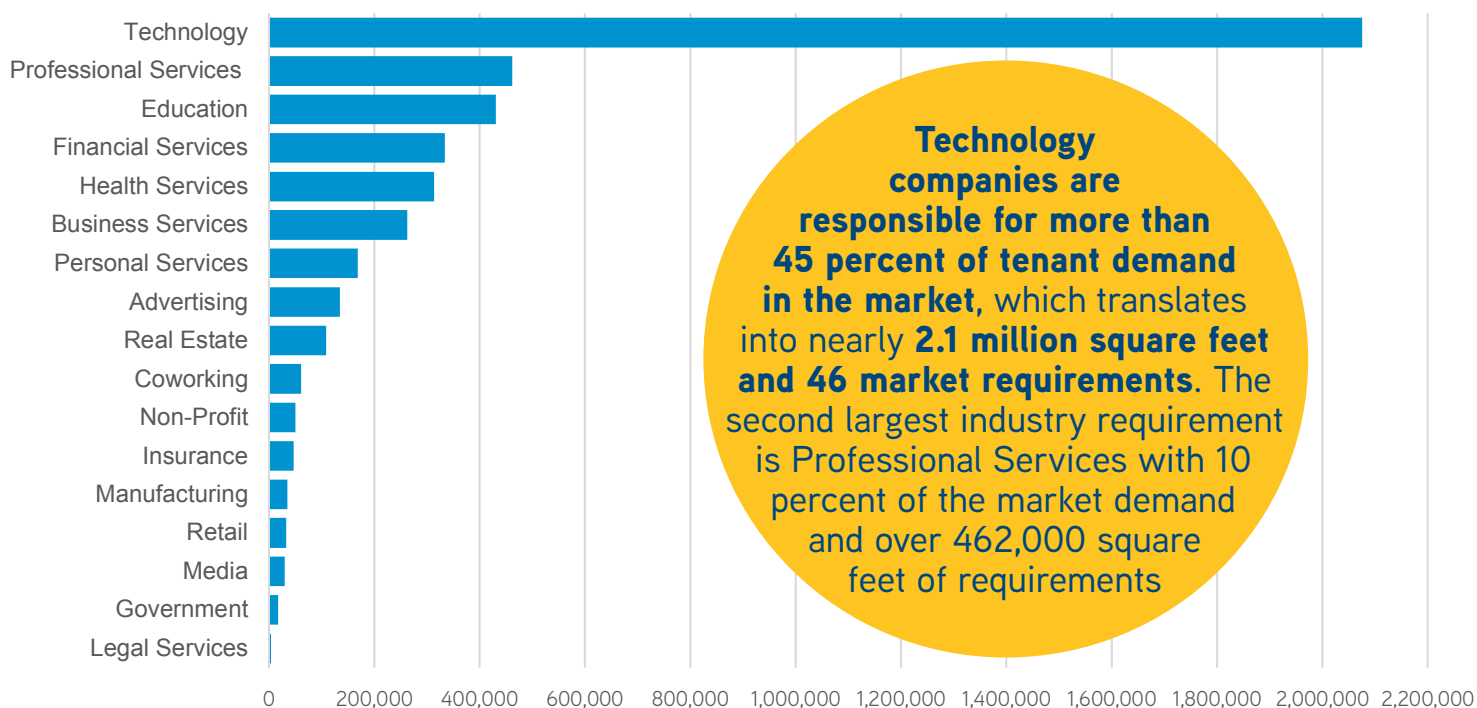
## Major Office Lease Transactions - Q4 2016

ADDRESS	TENANT	SIZE	TYPE	SIGNED DATE	CLASS
211 Main Street	Charles Schwab	394,704	Renewal	Oct-16	A
500 Howard Street	Slack Technologies	228,998	New	Dec-16	A
100 Hooper Street	Adobe	206,944	New	Oct-16	A
185 Berry Street	UCSF	125,000	Renewal	Dec-16	A
One Tenth Street	Nerdwallet	104,850	Sublease	Dec-16	B
101 California Street	Morgan Stanley	91,000	Renewal	Oct-16	A
71 Stevenson Street	Gymboree	79,678	Sublease	Dec-16	A
1355 Market Street	Thumbtack	78,792	New	Dec-16	A
2300 Harrison Street	Adroll	65,494	Sublease	Nov-16	B
185 Berry Street	Synopsys, Inc	53,025	Renewal	Oct-16	A

## Major Office Sale Transactions - Q4 2016

ADDRESS	SELLER	BUYER	SQ.FT.	SALES DATE	CLASS	SALE PRICE	PRICE/SQ.FT.
1 Front Street	Florida State Board of Administration	Paramount Group, Inc.	651,000	Dec-16	A	\$521,000,000	\$800
Foundry III - 505 Howard Street	Tishman Speyer	American Realty Advisors	291,032	Dec-16	A	\$350,000,000	\$1,203
400 California Street	MUFG Union Bank	Kennedy-Wilson Properties	264,000	Dec-16	B	\$135,000,000	\$511
55 Hawthorne Street	Harvest Properties	CIM Group	143,000	Dec-16	B	\$123,000,000	\$860
55 Francisco Street	Lincoln Property Company	Jamestown	145,172	Dec-16	B	\$91,000,000	\$627
115 Sansome Street	TA Realty	Vanbarton Group LLC	126,716	Nov-16	B	\$83,000,000	\$655
600 Townsend Street - East	Alecta Real Estate Investment LLC	Blackstone	82,862	Dec-16	B	\$50,470,000	\$609
400 Montgomery Street	The Hearst Corporation	Harvest Properties / TIAA-CREF	82,469	Oct-16	B	\$49,780,000	\$604

## Tenants in the Market by Industry



## Development Pipeline

There were no new office deliveries this quarter for the San Francisco market, but there's almost 5.4 million square feet currently in the development pipeline for the City and over 3.2 million square feet scheduled for delivery in 2017. Of the entire product that will be delivered in 2017, 44 percent has been pre-leased. Two significant projects started construction with a over 284,000 million square foot project at 100 Hooper Street and the second largest building in San Francisco at 50 1st Street for 1.05 million square feet breaking ground this quarter.

## Leasing Activity

While the San Francisco market experienced a softening in leasing activity during the third quarter, the fourth quarter experienced strong leasing activity to post 1.6 million square feet. At the close of the year, the City had experienced nearly 5.7 million square feet of leasing activity. While not on par to hit the historical 20-year annual average of 7.2 million square feet, leasing volume is expected to be healthy in 2017. Demand continues to remain strong for the City with over 4.6 million square feet of requirements in the market. There are concerns about the amount of unleased speculative construction set to hit the market over the next few years, but this will likely translate into a more balanced office market in the City.

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)	
<b>DOWNTOWN MARKET:</b>																	
A	183	64.9%	59,122,564	3,217,712	5.4%	719,004	1.2%	3,936,716	55,185,848	6.7%	6.7%	53,988	1,022,367	-	454,999	5,361,182	9,366,059
B	295	27.8%	25,357,199	1,523,595	6.0%	136,526	0.5%	1,660,121	23,697,078	6.5%	7.5%	232,433	569,251	-	692,097	-	958,186
C	127	7.2%	6,600,596	321,183	4.9%	52,671	0.8%	373,854	6,226,742	5.7%	6.2%	33,594	(63,275)	-	-	-	-
<b>Total</b>	<b>605</b>	<b>100.0%</b>	<b>91,080,359</b>	<b>5,062,490</b>	<b>5.6%</b>	<b>908,201</b>	<b>1.0%</b>	<b>5,970,691</b>	<b>85,109,668</b>	<b>6.6%</b>	<b>6.9%</b>	<b>320,015</b>	<b>1,528,343</b>	<b>-</b>	<b>1,147,096</b>	<b>5,361,182</b>	<b>10,324,248</b>
<b>FINANCIAL DISTRICT:</b>																	
A	108	81.9%	44,351,707	2,805,662	6.3%	320,973	0.7%	3,126,635	41,225,072	7.0%	7.1%	28,872	653,774	-	-	3,958,077	-
B	73	15.0%	8,145,794	595,102	7.3%	6,774	0.1%	601,876	7,543,918	7.4%	6.9%	(38,815)	(36,626)	-	-	-	-
C	36	3.0%	1,640,936	151,364	9.2%	230	0.0%	151,594	1,489,342	9.2%	11.5%	36,837	11,720	-	-	-	-
<b>Total</b>	<b>217</b>	<b>100.0%</b>	<b>54,138,437</b>	<b>3,552,128</b>	<b>6.6%</b>	<b>327,977</b>	<b>0.6%</b>	<b>3,880,105</b>	<b>50,258,332</b>	<b>7.2%</b>	<b>7.2%</b>	<b>26,894</b>	<b>628,868</b>	<b>-</b>	<b>-</b>	<b>3,958,077</b>	<b>-</b>
<b>SUBMARKETS:</b>																	
North Financial	116	31.2%	28,405,524	2,202,301	7.8%	238,788	0.8%	2,441,089	25,964,435	8.6%	8.8%	72,840	(154,275)	-	-	372,000	-
South Financial	101	28.3%	25,732,913	1,349,827	5.2%	89,189	0.3%	1,439,016	24,293,897	5.6%	5.4%	(45,946)	783,143	-	-	3,586,077	-
<b>Total</b>	<b>217</b>	<b>59.4%</b>	<b>54,138,437</b>	<b>3,552,128</b>	<b>6.6%</b>	<b>327,977</b>	<b>0.6%</b>	<b>3,880,105</b>	<b>50,258,332</b>	<b>7.2%</b>	<b>7.2%</b>	<b>26,894</b>	<b>628,868</b>	<b>-</b>	<b>-</b>	<b>3,958,077</b>	<b>-</b>
Union Square	58	4.5%	4,063,190	190,206	4.7%	500	0.0%	190,706	3,872,484	4.7%	4.0%	(29,152)	(26,800)	-	-	-	-
Yerba Buena	31	5.1%	4,642,139	199,035	4.3%	3,400	0.1%	202,435	4,439,704	4.4%	4.3%	(4,068)	29,076	-	57,666	-	1,710,210
SOMA West	41	1.5%	3,509,267	61,376	1.7%	13,637	0.4%	75,013	3,434,254	2.1%	8.1%	207,925	224,431	-	52,999	418,634	3,318,728
SOMA East	61	6.9%	6,325,647	423,828	6.7%	127,777	2.0%	551,605	5,774,042	8.7%	11.0%	142,564	810,572	-	754,751	-	599,148
Civic Center/Mid-Market	44	6.9%	6,311,133	84,668	1.3%	289,933	4.6%	374,601	5,936,532	5.9%	5.9%	(933)	(226,624)	-	-	-	432,000
Jackson Square	40	2.6%	2,330,330	84,870	3.6%	2,676	0.1%	87,546	2,242,784	3.8%	3.9%	2,321	2,675	-	-	-	-
North Waterfront	48	4.0%	3,619,529	137,937	3.8%	14,606	0.4%	152,543	3,466,986	4.2%	3.9%	(12,623)	82,848	-	61,680	-	-
Van Ness Corridor	20	1.3%	1,217,094	216,658	17.8%	2,553	0.2%	219,211	997,883	18.0%	18.0%	-	(65,150)	-	-	-	-
Potrero West	18	1.5%	1,339,348	76,205	5.7%	88,223	6.6%	164,428	1,174,920	12.3%	11.9%	(4,838)	(133,805)	-	-	-	169,598
Potrero East	11	0.9%	864,650	7,779	0.9%	36,919	4.3%	44,698	819,952	5.2%	4.4%	(6,375)	1,552	-	-	284,471	-
Mission Bay	16	3.0%	2,719,595	27,800	1.0%	-	0.0%	27,800	2,691,795	1.0%	1.0%	(1,700)	200,700	-	220,000	700,000	4,094,561
<b>Total</b>	<b>605</b>	<b>97.6%</b>	<b>91,080,359</b>	<b>5,062,490</b>	<b>5.6%</b>	<b>908,201</b>	<b>1.0%</b>	<b>5,970,691</b>	<b>85,109,668</b>	<b>6.6%</b>	<b>6.9%</b>	<b>320,015</b>	<b>1,528,343</b>	<b>-</b>	<b>1,147,096</b>	<b>5,361,182</b>	<b>10,324,248</b>
<b>QUARTERLY COMPARISON/TOTALS</b>																	
Q3-16	605	97.6%	91,083,359	5,186,232	5.7%	1,104,474	1.2%	6,290,706	84,792,653	6.9%	6.9%	148,612	1,208,328	529,232	1,147,096	3,876,711	12,379,561
Q2-16	604	97.6%	90,551,127	5,096,397	5.6%	813,689	0.9%	5,910,086	84,641,041	6.5%	6.5%	268,244	1,059,716	112,666	619,865	4,120,077	12,648,215
Q1-16	603	100.0%	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	100.0%	90,148,248	5,790,031	6.4%	673,689	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

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