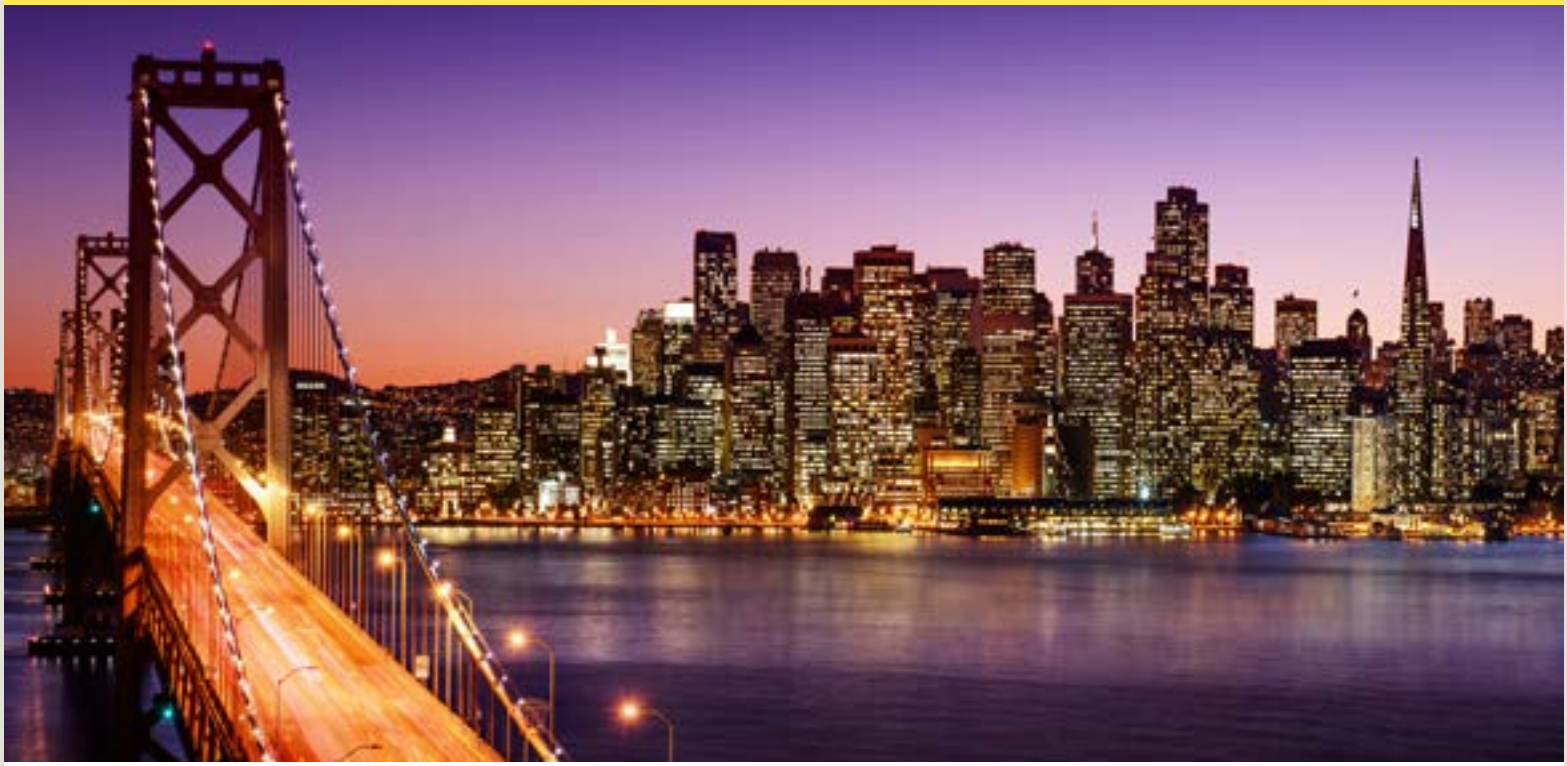
Savills Studley Research
San Francisco

Savills Studley Report
San Francisco office sector

Q2 2016



SUMMARY

Market Highlights

VACANCY INCREASES AGAIN

San Francisco's overall vacant availability rose for the second time in the last three quarters, jumping by 0.6 pp to 8.3%. The Class A rate posted a quarter-on-quarter increase of 0.8 pp to 9.2%, spurred in large part by a 1.2 pp spike in Financial District South to 9.8%. Of note, SOMA's overall availability rate was flat, remaining at 1.7%.

RENTS EDGE UP SLIGHTLY

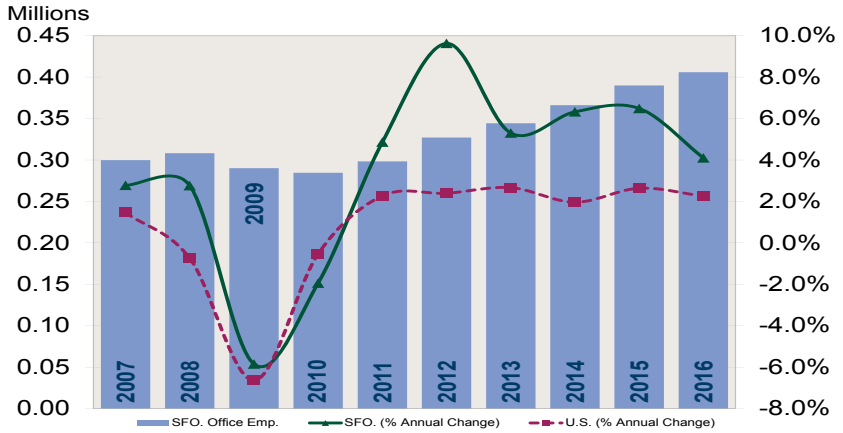
Overall asking rent ($64.30) increased by 0.4% in the quarter and was up by 5.2% year-on-year. Class A asking rent ($66.12) posted an 0.9% increase for the quarter and a 5.1% increase for the year.

LEASING IMPROVES

Following a very weak first quarter, deal volume rebounded in the second quarter as several larger subleases boosted activity. Even so, the tenants have leased only 5.9 msf in the four most recent quarters, well below the pace of the last few years which averaged 8.6 msf between 2011 and 2015.

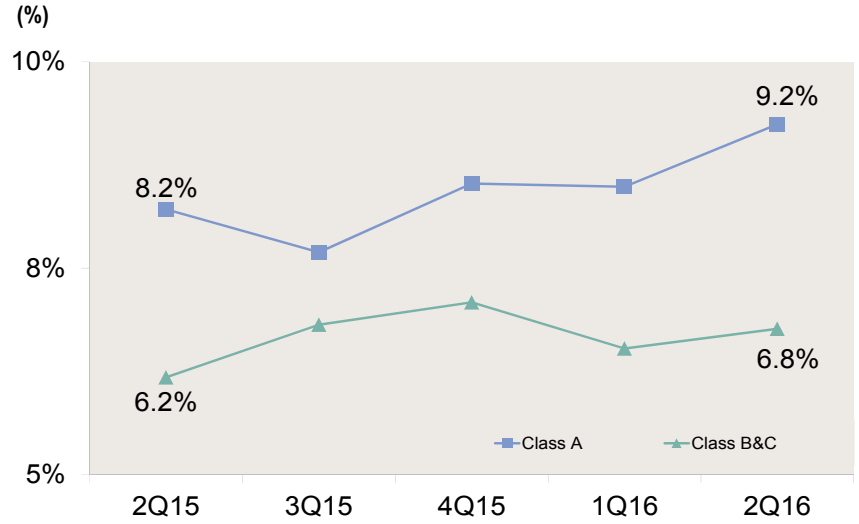
"San Francisco's office market and tech sector showed some resiliency in the second quarter as pent-up demand for quality blocks of sublet space was fulfilled. Leasing activity still fell short of historical trends as caution prevailed, and more firms coped with funding shortfalls by cutting back or considering relocations to other markets."
Colin Scanlon, Research Manager

Office-Using Employment Trends

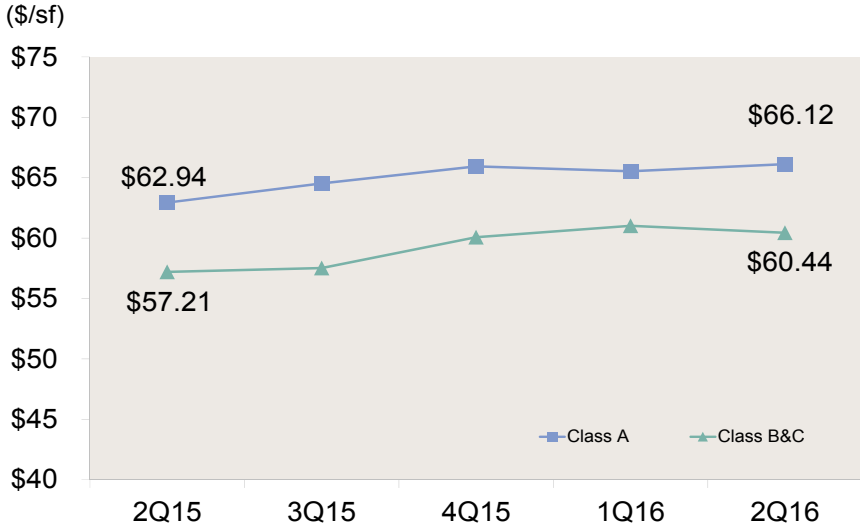


Source: Bureau of Labor Statistics

Availability Rate Trends



Asking Rent Trends



Quarter with Many Ups and Downs

The second quarter brought mixed signals in San Francisco's economy and office market. The tech sector clearly still has some pent up demand, particularly for highly improved space. The top three leases of the quarter were subleases. Fitbit signed an agreement for a total of 311,116 sf at 215 Fremont and will take occupancy of the former Charles Schwab space over the next three years. Lyft subleased 110,654 sf from Dropbox and took 93,713 sf direct at 185 Berry Street for a total of 204,367 sf. This gives the Uber competitor more than triple the amount of space they currently lease at 2300 Harrison St, which is now being marketed for sublease. Stripe subleased the remainder of Dropbox's space at 185 Berry Street, taking 102,392 sf. In the continuing game of musical chairs Stripe is in talks to sublease its 31,700 sf former headquarters at 3180 18th St to another startup. These leases suggest that there are still a few late stage tech firms in San Francisco with aggressive expansion plans.

Bay Area companies are still encountering obstacles to growth. Lyft continues to hit some regulatory hurdles that could curb its aggressive expansion plans in some markets. On the other hand, GM invested $500 million in the startup earlier this year, to partner on the construction of an on-demand network of self-driving cars. Lyft has now raised more than $2 billion in capital. Lyft's ups and downs match the recent trajectory of San Francisco's tech sector – it has experienced both high notes and lows. Twilio had a very successful IPO, offsetting notions that the IPO market was dead early in the year. More recently, Microsoft's mammoth $26-billion acquisition of LinkedIn boosted optimism. Then along came Brexit — the value of tech companies has little if anything to do with the UK's vote to leave the EU, but in the short term the vote has clearly rattled investor confidence and shaken up the equity markets.

A "Post-Unicorn" World

Even before the vote, leasing was on a slower track for most of the quarter as tech firms proceeded cautiously. Dropbox CEO Drew Houston described the new reality as a "post-unicorn" world, saying: "you really get disconnected from the fundamentals" but then as a "post-unicorn" you have to get back to fundamentals. "Things correct, and then it's back to basics and a focus on profitability, and the scorecard changes." Dropbox has unloaded some of its space

in China Basin and it has cut perks such as its shuttle for employees that live in San Francisco, free gym memberships and laundry service. More tech companies are either having to put expansion plans on hold, or in some cases roll back payroll. Venture capital funds are picking their horses, particularly in niches such as food delivery and laundry apps, where the field of competitors is getting too saturated.

Banks and Law Firms Shed More Space

The size of leases dropped off quite dramatically from the trio of subleases. Direct leasing was led by financial services and law firms, but many shed space. Ernst & Young signed an early renewal/contraction for 64,696 sf at 560 Mission Street—their lease was set to expire next September—they are consolidating down from 108,000 sf. Law firm Paul Hastings signed a lease to move into 40,422 sf at 101 California St, downsizing from 60,000 sf at 55 2nd Street. The firm originally had 82,600 sf on 2nd Street before subleasing two floors to Arent Fox. At the close of the first quarter, Squire Patton Boggs announced its acquisition of Carroll Burdick & McDonough. The firms are consolidating space at Squire Patton's facility at 275 Battery Street, shedding Carroll Burdick's 42,000 sf at 44 Montgomery St.

Even with the flurry of larger subleases and these direct deals, leasing volume for the quarter fell short of long term averages. Leasing activity was roughly 1.6 msf for the quarter—40% of that was subleases—the lowest quarterly leasing volume since 2009. Another telling sign is the lack of activity in the new Transbay towers – 181 Fremont and Park Tower have not signed any tenants yet. Tenants are showing an understandable preference for pre-built space with immediate occupancy.

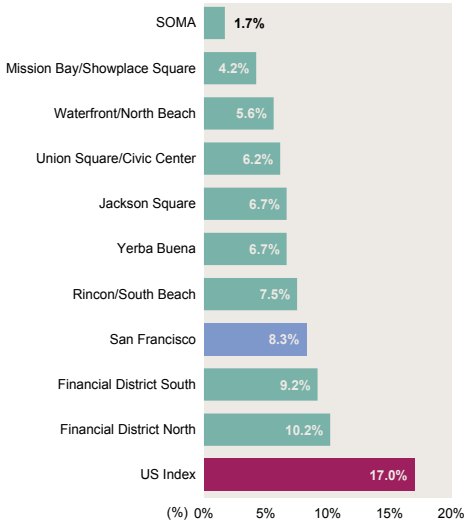
Little Letup in Operating Costs

For now, the moderation in demand is by no means translating into reduced real estate costs or costs of doing business. Tenants with upcoming lease rollovers in the next few quarters who last signed a lease in 2011 or even in 2006 are still in for a shock. Additionally, the cost to compete for top tech talent in this market remains very high. Several recent reports from area recruiters underscore the elevated expectations for wages, salaries and benefits. Hired for example, recently reported that the average tech salary rose to $134,000 in the first quarter of 2016, up from $129,000 in the initial quarter of 2015. Hired also notes that Series B companies are still hiring aggressively, with interview requests up by 30% year-on-year. In contrast Series A companies, those just starting to get on their feet on the ground, are wobbling and have decreased the number of interviews. While interviews may be up for Series B companies, large expansions of the kind we saw in 2013-2015 have slowed dramatically, indicating these younger firms are filling space. Large expansionary leases in 2016 have been limited to firms that have Series C or later rounds of funding.

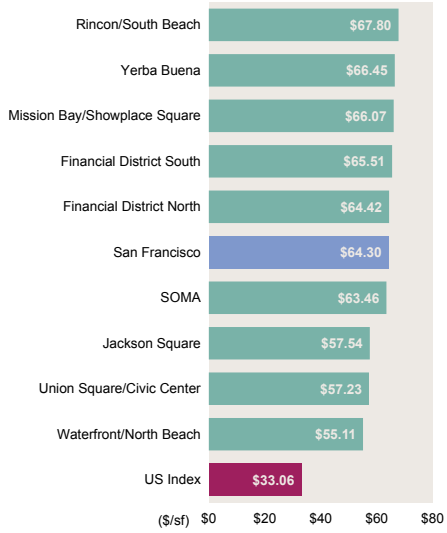
Looking Forward

A couple of years ago San Francisco was seen as the place that you simply had to be if you were a startup or a young tech employee. According to a recent survey by the Bay Area Council, more than one-third of residents said they plan to eventually move elsewhere citing "skyrocketing housing costs, terrible commutes and an increasingly high cost of living." Bay Area council president Jim Wunderman commented – "our housing shortage is pricing workers, families and others out of their homes and out of the region." Other recent reports have cited an emerging glut in the condo market, with for sale inventory up 50% compared to last year, and even larger spikes in higher priced neighborhoods. This has led many to conclude it is a not a shortage of housing that the City faces, rather a shortage of housing that most working families can afford. It is far from clear how many disgruntled residents will actually go elsewhere, but an exodus of skilled employees would exacerbate a labor shortage issue that is quite acute. There are still rapidly expanding companies based in San Francisco who have extensive talent and space requirements; but a growing number are already directing their search for talent and office space to other markets where they will have less competition and lower costs.

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
Fitbit	311,116	215 Fremont St	Financial District South
Lyft	110,654	185 Berry St	Mission Bay Showplace Square
Stripe	102,392	185 Berry St	Mission Bay Showplace Square
Lyft	93,713	185 Berry St	Mission Bay Showplace Square
UCSF	97,702	499 Illinois St	Mission Bay Showplace Square
Paul Hastings LLP	40,422	101 California St	Financial District North
Ernst & Young	64,696	560 Mission St	Financial District South
Pattern Energy	46,487	Pier One	Jackson Square
Travana	43,988	600 Townsend St	Showplace Square
Slack	35,556	22 4th St	Financial District North

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**	30,155	2,020	3,078	2.5%	2,945	2,206	10.2%	0.3%	9.8%	$64.42	0.0%	$61.40
	Financial District North - Class A	21,343	1,433	2,288	4.1%	2,229	1,694	10.7%	0.4%	10.4%	$65.54	1.1%	$62.29
2	**Financial District South**	23,700	2,236	2,176	12.3%	1,626	1,459	9.2%	1.0%	6.9%	$65.51	-0.8%	$64.09
	Financial District South - Class A	19,252	1,984	1,888	14.5%	1,354	1,202	9.8%	1.2%	7.0%	$66.36	-0.1%	$64.48
3	**Rincon/South Beach**	4,266	386	321	25.8%	250	578	7.5%	1.5%	5.9%	$67.80	-0.1%	$61.51
	Rincon/South Beach - Class A	1,544	75	180	22.0%	176	298	11.7%	2.1%	11.4%	$69.73	0.6%	$60.09
4	**Yerba Buena**	3,320	196	222	75.8%	201	190	6.7%	2.9%	6.1%	$66.45	-0.3%	$66.80
	Yerba Buena - Class A	730	0	6	N/A	0	70	0.8%	0.0%	0.0%	N/A	N/A	N/A
5	**SOMA**	4,475	52	76	0.7%	48	236	1.7%	0.0%	1.1%	$63.46	-5.5%	$64.80
	SOMA - Class A	1,845	N/A	9	0.0%	16	0	0.5%	0.0%	0.8%	N/A	N/A	$66.67
6	**Union Square/Civic Center**	4,999	255	308	-12.9%	316	169	6.2%	-0.9%	6.3%	$57.23	6.6%	$49.97
	Union Square/Civic Center - Class A	503	13	22	0.0%	17	6	4.3%	0.0%	3.3%	N/A	N/A	$58.50
7	**Jackson Square**	2,085	150	139	-1.9%	106	212	6.7%	-0.1%	5.1%	$57.54	1.0%	$52.16
	Jackson Square - Class A	414	0	N/A	N/A	N/A	77	N/A	N/A	N/A	N/A	N/A	N/A
8	**Waterfront/North Beach**	3,455	224	195	8.6%	221	278	5.6%	0.4%	6.4%	$55.11	7.3%	$47.06
	Waterfront/North Beach - Class A	859	58	28	-5.8%	54	71	3.2%	-0.2%	6.3%	N/A	N/A	$50.00
9	**Mission Bay/Showplace Square**	4,947	423	209	2.4%	316	165	4.2%	0.1%	6.4%	$66.07	2.3%	$63.00
	Mission Bay/Showplace Square - Class A	2,688	246	125	11.5%	193	46	4.6%	0.0%	7.2%	N/A	0.0%	$65.92
1-9	**San Francisco Total**	**81,401**	**5,942**	**6,725**	**7.2%**	**6,029**	**5,494**	**8.3%**	**0.6%**	**7.4%**	**$64.30**	**0.4%**	**$61.12**
	San Francisco Total - Class A	**49,179**	**3,812**	**4,545**	**8.9%**	**4,038**	**3,463**	**9.2%**	**0.8%**	**8.2%**	**$66.12**	**0.9%**	**$62.94**

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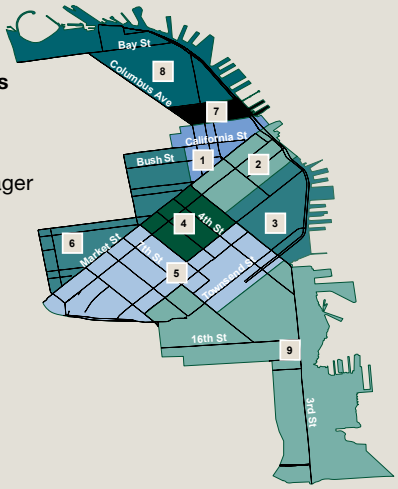

(1) Percentage point change for availability rates.
Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.
Statistics are calculated using both direct and sublease information.
Short-term sublet spaces (terms under two years) were excluded.

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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