

Savills Studley Report

San Francisco office sector

Q3 2017



SUMMARY

Market Highlights

LEASING STEADY

Quarterly leasing activity spiked in the third quarter, rising from 1.6 msf to 2.7 msf. Tenants have leased 7.0 msf in the four most recent quarters, roughly 10% below the long-term annual average of 7.7 msf.

AVAILABILITY DOWN SLIGHTLY

San Francisco's overall availability rate dipped by 50 basis points to 9.5%. The Class A availability rate posted a sharper decrease in the quarter, dropping by 110 basis points to 10.2%.

RENT INCH DOWN

The average Class A asking rent ticked down by 0.6% from \$68.92 to \$68.50, but has increased by 3.6% year-on-year. Class B rent averaged \$66.28 and has spiked by nearly 10.0% year-on-year.

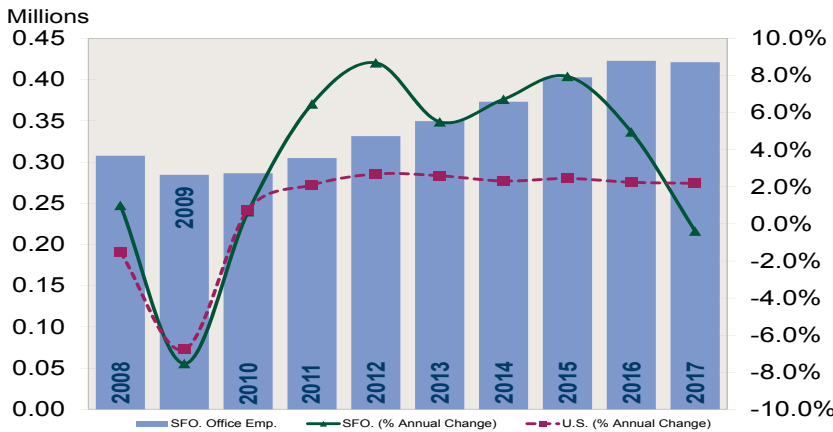
INVESTORS REMAIN BUSY

Year-to-date office property sales totaled \$2.66 billion – rising by 47% compared to the \$1.81 billion sold during the same period in 2016.

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"Another round of significant leases further depleted the supply of blocks of space greater than 75,000 sf. The dearth of options continues to be a challenge for very large requirements, but companies looking for full floors or less still have plenty of alternatives."

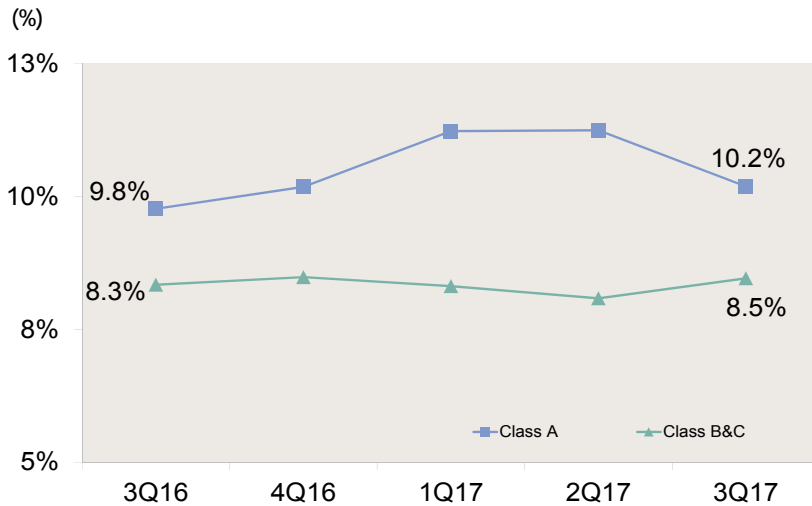
Colin Scanlon, Research Manager

Office-Using Employment Trends

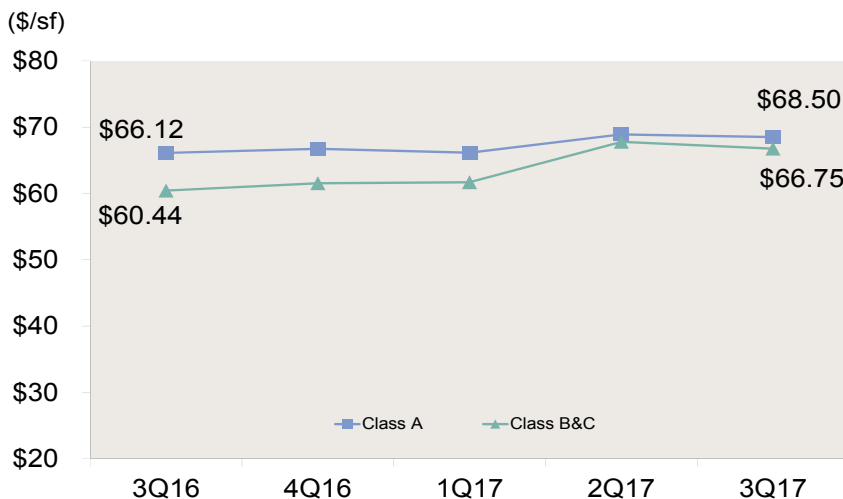


Source: Bureau of Labor Statistics

Availability Rate Trends



Asking Rent Trends



Two Sides to a Coin

San Francisco's chronic shortage of labor, housing and office space is a benefit for some and a curse for others. Limited labor and housing keeps rent, property values and wages elevated (most of the time). It also impedes the ability of companies to expand. The shortage of qualified employees has pushed some of the Bay Area's top employers to pursue talent in major metro areas, both domestic and global. A recent analysis of job openings on Indeed.com found that the Bay Area's share of tech job postings has fallen compared to a year ago. San Francisco had an 11 percent share of tech job listings, down by nearly 8%. Silicon Valley had a 19% share, a six percent decrease. Seattle appears to have gained at the Bay's area expense – it accounted for nearly 13% of the national total, spiking by 11.0%. Amazon's search for a second headquarters suggests that Seattle's labor pool is getting too depleted to meet the requirements of the rapidly expanding firm.

Big Deals Dominate Activity

Despite labor shortfalls and tight market conditions, deal volume has been sustained in 2017. Leasing volume totaled 2.7 msf in the quarter. Tenants have leased 7.0 msf in the last four quarters. Year-to-date, 19 leases over 50,000 sf have been signed, just shy of the 22 signed through the third quarter of 2016. Leasing activity has been quite top heavy in San Francisco in recent quarters, as the market's largest firms secure more space. During the third quarter Airbnb committed to 270,000 sf at 650 Townsend Street – signing a nine-year lease within the Zynga headquarters building in Showplace Square. The bookings firm has about 1,500 employees in San Francisco. They have expanded multiple times in the last few quarters, including the recent addition of space at 999 Brannan Street. Of note, Airbnb's listings recently surpassed 4.0 million, exceeding the number of hotel rooms listed by the top five hotel brands.

In mid-September, Jay Paul's new project at 181 Fremont Street hooked Facebook as its sole office tenant. The Menlo Park-based social media giant will take all 412,234 sf of the office space in the mixed-use tower, scheduled for completion in the first half of 2018. There were also a fair number of mid-sized leases in the quarter. Delta Dental of California signed a seven-year, 43,400 sf lease at 560 Mission Street. The healthcare insurance provider will relocate from 100 First Street, where it has been located for 30 years. They also recently leased 82,000 sf in Downtown Oakland, giving them a combined footprint of just over 125,000 sf

in the Bay Area – significantly less than the 188,000 sf they occupy at 100 First Street.

Smaller & Mid-Sized Firms Have More Options

The market's availability rate posted a 50 basis point decrease during the third quarter, sliding back under 10.0%. Sublet supply which has been on the increase through much of the year increased by 250,000 sf (15.8%) over the quarter, despite strong activity in the subleasing market. Athena Health was rumored to be placing 55,000-sf of space up for sublease at 55 Hawthorne, and within days several firms were reportedly circling the space. Tenants remain aggressive in their pursuit of built sublet space. Companies looking for sublet space need to be vigilant and willing to jump on these opportunities quickly.

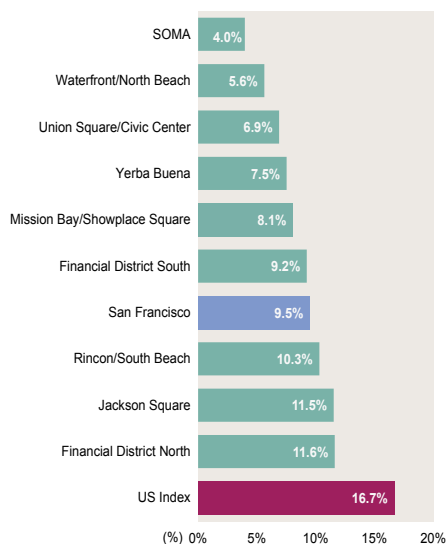
The current market presents tenants looking for 75,000 sf or more with very few options. Companies seeking full floors have ample choices, with 191 blocks between 10,000 sf and 30,000 sf - a jump from the 170 such blocks in the prior year.

Funding Spree

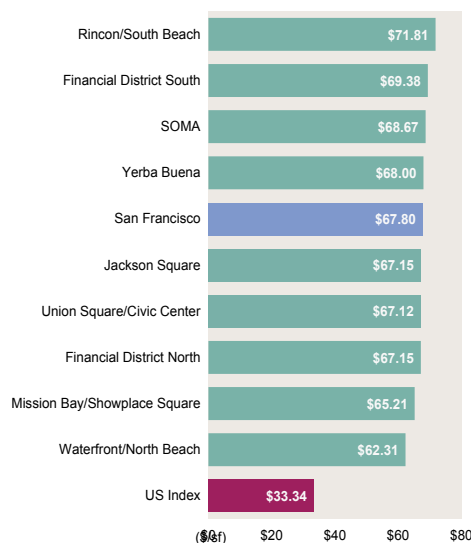
A moribund IPO market and several severe down-rounds during 2016 caused concern and prompted some firms to delay funding efforts. Funding conditions have improved in 2017. Some companies that were initially facing a hefty loss in valuation were able to arrange additional financing that minimized the extent of the devaluation. Japanese investor SoftBank Group, for example, reportedly offered a \$10-billion infusion for nearly 20% of Uber's stock that would have shaved about 30% off from its \$70 billion in valuation. Apparently trying to keep pace with its competitor, Lyft is in talks with Alphabet to secure an investment of roughly \$1 billion. Of note, Waymo, Alphabet's self-driving car initiative is entangled in a trade secret lawsuit with Uber. Lyft, valued at \$7 billion in April, recently announced a joint venture with Mountain View startup Drive.ai to start testing driverless cars.

SoftBank's Vision Fund is very active. Since launching in May with \$93 billion to place, Vision Fund has made investments in SoFi, WeWork and Snapdeal. It recently teamed up with Accel and several other investors in a quarter-billion dollar funding for business messaging app Slack, which values the firm at \$5.1 billion. Launched in 2013, the app has set the new record in terms of how quickly it attained unicorn status. As of September Slack has 9 million active users, up from 6.8 million in January. Stitch Fix is rumored to have filed confidentially

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
Facebook	412,234	181 Fremont St	Financial District South
AirBnB	270,000	650 Townsend St	Mission Bay/Showplace Square
Amazon	175,727	525 Market St	Financial District South
WeWork	98,357	44 Montgomery St	Financial District North
LendingHome	60,212	315 Montgomery St	Financial District North
First Republic Bank	43,449	1 Front St	Financial District North
Venable	38,317	101 California St	Financial District North
Mozilla	36,600	2 Harrison St	Financial District South
MasterClass	33,611	475 Brannan St	Rincon/South Beach
Holberton School	28,000	972 Mission St	Yerba Buena

for an IPO and is seeking a valuation of \$3 to \$4 billion. The five-year old firm uses algorithms and stylists to select clothing and accessories to send to customers. It would be the biggest e-commerce IPO since Etsy in 2015

Fintech Woes

Although conditions have improved in the tech sector and IPO markets as a whole, some areas of concern still prevail – particularly the increasingly crowded fintech space. This rapidly changing sector has seen a myriad of different competitors ranging from startups to newly created divisions at major banks. This space seems to be poised for some elimination of redundancy, though. Prosper Marketplace recently raised \$50 million. The funding represented a 70% cut from its 2015 valuation. The marketplace lender turned cash-flow positive in the second quarter, but only after cutting its workforce by nearly 30% and closing its Salt Lake City office.

Some analysts expect that 90% of marketplace lenders may be eliminated in the next recession, due to their reliance on hedge funds and Wall Street investors for funding.

Looking Forward

The cost of talent and lack of affordable housing go hand in hand in San Francisco. While the Valley has the luxury of land and former corporate campuses that can be converted to housing, San Francisco is more complicated. In addition to the challenges of exorbitant redevelopment costs and very extensive regulations, negotiations over affordable housing are very contentious. The city of San Francisco is introducing measures to encourage the development of affordable housing units, including HOME-SF which would give developers two additional stories of development rights in exchange for 30% affordable housing. Some of the solutions - and obstacles - to housing shortages ultimately rests in the hands of current residents and voters.

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	29,496	2,271	3,428	-6.7%	3,341	4,108	11.6%	-0.8%	10.0%	\$67.15	-2.8%	\$64.42
	Financial District North - Class A	20,695	1,697	2,433	-5.0%	2,541	3,290	11.8%	-0.6%	10.3%	\$66.86	-1.8%	\$65.54
2	Financial District South	23,338	2,413	2,158	-15.3%	1,671	2,702	9.2%	-1.7%	8.2%	\$69.38	-1.2%	\$65.51
	Financial District South - Class A	19,203	2,159	1,770	-17.9%	1,355	2,337	9.2%	-2.0%	8.6%	\$69.48	-1.4%	\$66.36
3	Rincon/South Beach	4,298	676	444	4.9%	255	283	10.3%	0.5%	6.0%	\$71.81	3.0%	\$67.80
	Rincon/South Beach - Class A	1,522	418	244	18.9%	217	156	16.0%	2.5%	9.6%	\$71.78	2.5%	\$69.73
4	Yerba Buena	3,100	433	233	-18.3%	126	787	7.5%	-1.7%	3.8%	\$68.00	-2.5%	\$66.45
	Yerba Buena - Class A	730	15	37	N/A	41	130	5.1%	-3.8%	0.8%	N/A	N/A	N/A
5	SOMA	4,529	315	180	-30.2%	75	599	4.0%	-1.7%	1.7%	\$68.67	-5.1%	\$63.46
	SOMA - Class A	1,859	N/A	94	-5.7%	79	64	5.0%	-0.3%	0.5%	\$66.03	-0.5%	\$70.00
6	Union Square/Civic Center	4,522	220	312	1.3%	354	539	6.9%	0.1%	7.1%	\$67.12	3.6%	\$57.23
	Union Square/Civic Center - Class A	505	12	22	-11.7%	24	93	4.3%	-0.6%	4.3%	\$69.06	0.7%	\$67.81
7	Jackson Square	2,039	170	235	-13.4%	232	203	11.5%	-1.8%	6.8%	\$67.15	7.8%	\$57.54
	Jackson Square - Class A	414	23	N/A	N/A	N/A	0	N/A	N/A	N/A	N/A	N/A	N/A
8	Waterfront/North Beach	3,472	103	196	-12.4%	179	344	5.6%	-0.8%	5.2%	\$62.31	8.6%	\$55.11
	Waterfront/North Beach - Class A	859	44	32	-6.0%	46	103	3.8%	-0.2%	3.4%	\$65.00	11.9%	\$55.46
9	Mission Bay/Showplace Square	4,954	387	399	32.2%	204	1,290	8.1%	2.0%	4.1%	\$65.21	-3.8%	\$66.07
	Mission Bay/Showplace Square - Class A	2,681	109	209	-6.1%	351	374	7.8%	0.0%	4.2%	\$69.48	0.6%	\$70.00
1-9	San Francisco Total	79,746	6,989	7,585	-8.5%	7,342	10,857	9.5%	-0.5%	9.2%	\$67.80	-1.0%	\$64.30
	San Francisco Total - Class A	48,468	4,478	4,939	-9.4%	4,734	6,546	10.2%	-1.1%	9.8%	\$68.50	-0.6%	\$66.12

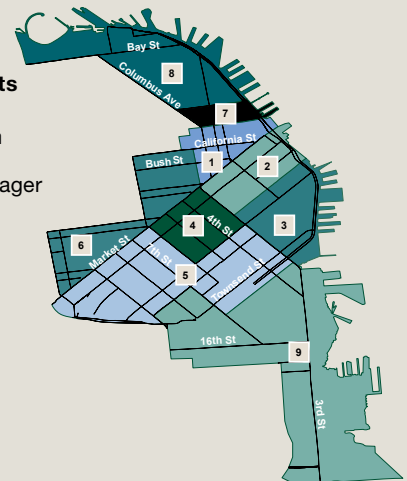
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(1) Percentage point change for availability rates.
 Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.
 Submarkets with limited inventory may be subject to larger changes in statistics.
 Statistics are calculated using both direct and sublease information.
 Short-term sublet spaces (terms under two years) were excluded.

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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