

# San Francisco Office

## Market Forecast

Trends

Absorption	↓
Vacancy	↑
Class A FiDi Rental Rate	↔
Under Construction	↑

## Notable 2017 Leases

- Slack  
500 Howard | 227,632 s.f.

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- Google  
121 Spear | 166,460 s.f.

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- Accenture  
415 Mission | 100,616 s.f.

## Notable 2017 Sales

- Blackstone Group  
211 Main Street (Charles Schwab Plaza)  
417,266 s.f. sold for \$312.9M or \$750/s.f.

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- Rockpoint Group  
100 Pine Street  
402,534 s.f. sold for \$287.5M or \$714/s.f.

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- Walnut Hill Capital  
150 Spear Street  
264,492 s.f. sold for \$185M or \$699/s.f.

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- Deka Immobilien GmbH  
114 Sansome Street  
193,750 s.f. sold for \$145M or \$748/s.f.

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- TIAA-CREF  
539 Bryant Street  
55,616 s.f. sold for \$46M or \$827/s.f.

The San Francisco office real estate market is positioned for substantial growth in the coming quarters, as tech sector giants aspire to attract elite industry talent by forming urban campuses in the city. While San Francisco properties saw 387,145 s.f. of negative net absorption during the first quarter, strong tenant demand should see the newly vacated spaces backfilled soon. At least a dozen firms were searching for 100,000 or more square feet at quarter's end. Asking rents have steadied over the past year, at averages of \$72.40 for Class A Financial District product, \$66.01 for Class B offerings, and \$67.44 for creative Class C spaces. The San Francisco market will see 3 million s.f. of new office inventory by the end of 2017, but recent leasing activity and the high volume of tenants in the market indicates that vacancies and rental rates will be robust against the increase in supply. Approximately 2.18 million s.f. came off the market in leases this quarter, including four transactions for more than 95,000 s.f. National and global investors continued to bet on San Francisco assets, as \$1.6 billion worth of office properties changed hands at an average price of \$742/s.f.

## Technology Sector

Well-established technology companies continued to lead the way in San Francisco's office real estate market, accounting for a substantial share of the area's tenant demand, signing many of the city's largest leases, and bolstering a dynamic local economy. In the past two quarters, technology firms headquartered in Silicon Valley have joined San Francisco's own in seeking urban campuses downtown or in Mission Bay, as part of an effort to attract employees who live in the city.

Google, which is headquartered in Mountain View, has gradually grown its San Francisco footprint to more than 700,000 s.f. and 1,500 workers. It tacked on another 166,460 s.f. to its holdings this quarter by leasing the second through sixth floors of Rincon Center II (121 Spear), a stone's throw from its other San Francisco offices at One Market, 345 Spear, and 188 Embarcadero. Google will take over spaces vacated by AIG and Dentons in the spring of 2018, bringing nearly 2,000 employees together around the eastern edge of the Financial District.

Among San Francisco's homegrown tech giants, Uber announced plans to concentrate its headquarters in Mission Bay while backing away from its commitment to the Uptown Station project in Oakland. The ride-hailing company bought a share of two future office buildings in the Golden State Warriors project, a block away from 1455 and 1515 Third, where Uber is developing its own

→ Continued, page 2

# Area Review

future headquarters complex. The Warriors purchase cements Uber's Mission Bay plans and is another example of a tech firm aiming to unify its operations within a city where opportunities to do so are rare.

Two other tech sector heavyweights, Amazon and Facebook, were reportedly in the market for large blocks of San Francisco office space at quarter's end, vying for leases in new developments such as 181 Fremont. Approximately 3 million s.f. of new office stock is expected to come on line in San Francisco by the end of the year, and technology tenants in the market are poised to have the first bites at the apple.

## Accenture

The Salesforce Tower, which features nearly half (1.42 million) of the office space set to open later this year, secured its largest non-Salesforce tenant to date when the global business consulting firm Accenture took 100,616 s.f. on the 31st-34th floors. Accenture was named the official "technology innovation partner" of the Golden State Warriors, as part of the team's outreach strategy to connect with technology firms before it moves into the Chase Center in 2019. Now, Dublin, Ireland-based Accenture has further raised its San Francisco profile by settling on the middle floors of the Salesforce Tower, bringing the 61-story skyscraper past two-thirds leased. It is not yet clear whether Accenture intends to consolidate its existing Bay Area workforce in the Salesforce Tower or if the new space is meant to accommodate a significant expansion. Developers Boston Properties and Hines now have about 450,000 s.f. left available some eight months before delivery.

## Office Leasing

Direct asking rental rates in downtown San Francisco have leveled off over the last year, after surging in the latter months of 2015 and the first quarter of 2016.

- Fully-serviced Class A spaces ranged from the mid-\$60s per s.f. at 555 Montgomery to the low-\$100s on the upper floors of choice properties such as 4 Embarcadero Center. Full-floor offerings on the lower floors of 345 California and the Transamerica Pyramid were asking in the high-\$60s to low-\$70s.
- Availabilities in new office developments such as Park Tower and 181 Fremont were marketed in the high-\$80s or low-\$90s, NNN; the NNN expenses are estimated at \$25, bringing the fully serviced equivalents above \$100/s.f.
- Full-floor Class B offerings varied widely, from the high-\$50s north of Market to the low-\$80s in SOMA's tech-oriented buildings. A creative space at 875 Battery was being marketed for \$58 while a high-end offering on the top floor of 795 Folsom was asking \$80.
- Class C SOMA product averages stayed in the mid-\$60s, spanning from the low-\$40s for non-creative listings to the mid-\$70s for spaces geared toward tech tenants, excluding South Park outliers over \$100. At 1269 Howard, a full-floor opportunity with exposed ceilings was listed for \$65 IG.

## Absorption

Several large givebacks led to 387,145 s.f. of negative net absorption in the first quarter.

- The South Financial District dropped a city-high 224,533 s.f., as Medivation vacated 114,816 s.f. at 525 Market, space that is now listed for sublease. Quantcast left 57,530 s.f. at 201 Third when it relocated to 795 Folsom.
- The North Financial District saw 131,474 s.f. of negative net absorption. In the largest single move-out, AECOM gave back 38,701 s.f. at One Montgomery as part of its Bay Area office consolidation plan. Wells Fargo vacated 37,123 s.f. at One Front.

## Spotlight: WeWork

The two most valuable American startups, Uber and Airbnb, operate platforms that connect those in need of a service with those offering it. For the most part, Uber doesn't own its cars and Airbnb doesn't own the rooms and homes in which its users stay. The same is true of the company that could soon rise to third on the United States' startup rankings, WeWork, a shared office space operator is riding the wave of tech sector growth worldwide, despite uncertainty about its fate in the event the tide turns.

Headquartered in New York, WeWork has rapidly expanded its global footprint to 36 cities last year and continued to do so this quarter, after earning \$3 billion in funding from Japan's SoftBank Group, pushing its valuation past \$20 billion. In San Francisco, WeWork signed on for two new locations, at 650 California at 201 Spear, its eighth and ninth offices in the city. Each offers both desks and private offices rented out by the month, a model that is well tailored to San Francisco's dynamic economy. WeWork reported nearly full occupancy at its existing San Francisco locations this quarter.

Ironically, though, the lease commitments that WeWork helps its users avoid are at the heart of skeptics' concerns about the future viability of the parent company's own model. WeWork's leases typically run for 10-15 years, heightening its risk if demand declines. The company has protected itself by registering each location as a separate LLC to insulate the parent, and SoftBank's investment indicates ample confidence in WeWork's sustainability. But the need for shared office space is likely to prove more volatile than the demand for rides and rooms, and only time will tell if WeWork can endure an economic decline.

- In Yerba Buena, the absorption gain from Quantcast's move-in was negated by a batch of move-outs. Carat gave up 33,291 s.f. at 875 Howard, Crunchyroll moved out of 30,000 s.f. at 835 Market, and Demandforce began downsizing at 22 4th.

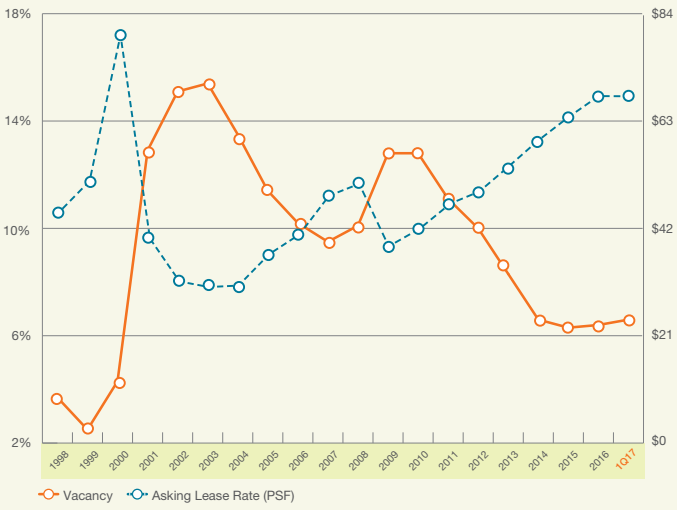
While the first quarter of 2017 marked the city's worst absorption period this cycle, the large leases signed this quarter, the ongoing construction activity, and the high volume of tenants in the market all foretell a return to positive absorption in the coming quarters.

## Investment

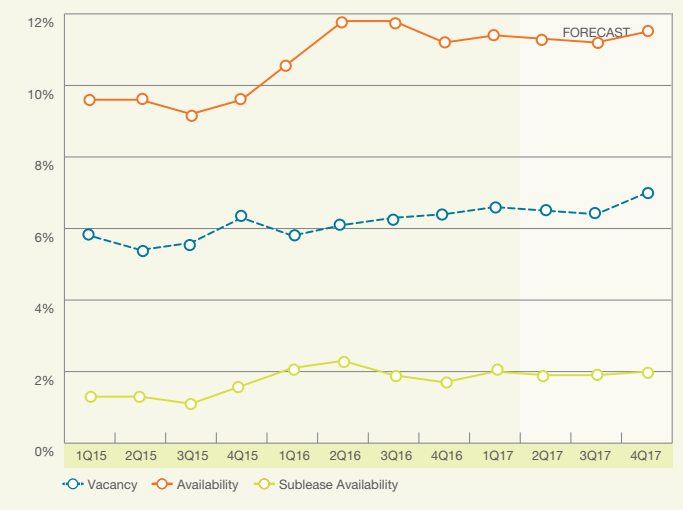
More than \$1 billion worth of San Francisco office real estate traded for the fourth consecutive quarter, continuing a trend of vigorous investment activity that began during the spring of 2016. This period's 11 sale transactions totaled 1.47 million s.f. and \$1.04 billion in dollar volume, for an average per-square-foot price tag of \$742 and an average cap rate of 4.6%. The Blackstone Group, a New York-based investor that last year purchased the Market Center buildings at 525 and 575 Market, added Charles Schwab Plaza to its San Francisco portfolio, the largest transaction by dollars spent over the past three months. Blackstone acquired the 417,266 s.f. asset from CIM for \$312.9 million or \$750/s.f., three months after Charles Schwab renewed its headquarters lease in the building through 2026. In the North Financial District, Boston's Rockpoint Group bought 100 Pine, a 402,534 s.f. Class A asset, from Alaska Permanent Fund Corporation for \$287.5 million or \$714/s.f. Deka Immobilien, out of Frankfurt, Germany, turned in the quarter's largest outlay by a foreign investor, spending \$145 million or \$748/s.f. on 114 Sansome, a 193,750 s.f. Class B building. The seller, Credit Suisse, purchased 114 Sansome for \$105 million in 2013, earning a 38% return on its purchase price in about 40 months.

Data Source: CoStar

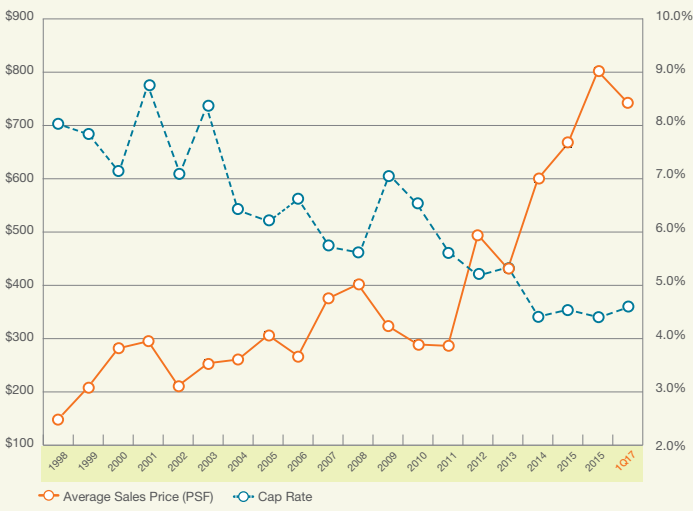
### VACANCY VS ASKING LEASE RATE



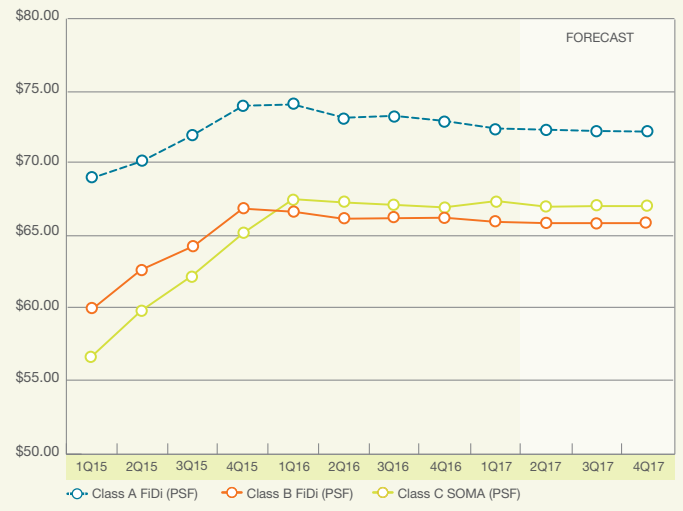
### VACANCY VS AVAILABILITY



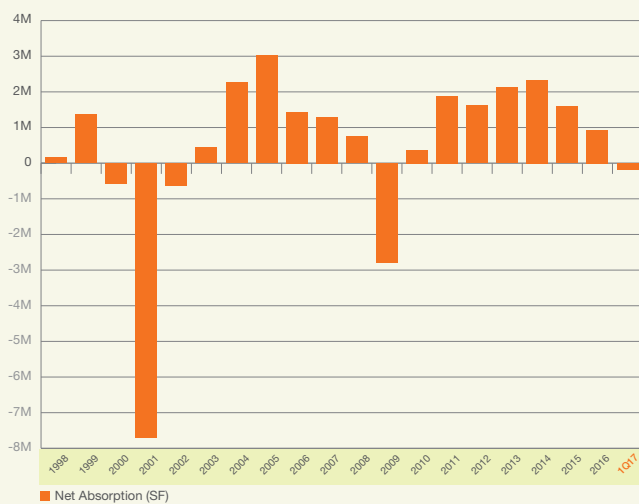
### AVERAGE SALES PRICE & CAPITALIZATION RATES



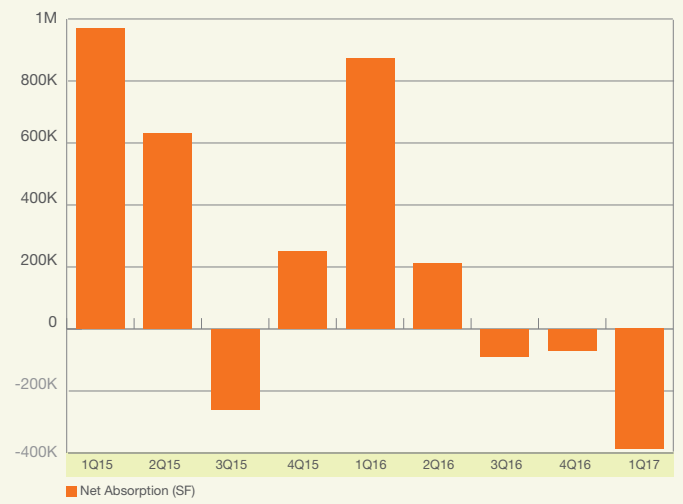
### ASKING LEASE RATE



### NET ABSORPTION - HISTORICAL



### NET ABSORPTION - QUARTERLY



**Offices**

Seattle  
206.296.9600

Bellevue  
425.454.7040

South Seattle  
206.248.7300

Tacoma  
253.722.1400

Olympia  
360.705.2800

Portland  
503.221.9900

San Francisco  
415.229.8888

Redwood Shores  
650.769.3600

Silicon Valley  
408.970.9400

Sacramento  
916.970.9700

Roseville  
916.751.3600

Los Angeles  
213.880.5250

Commerce  
323.727.1144

Long Beach  
562.472.0071

Orange County  
949.557.5000

Inland Empire  
909.764.6500

San Diego  
858.509.1200

Carlsbad  
760.430.1000

Reno  
775.301.1300

Phoenix  
602.513.5200

**Contact**

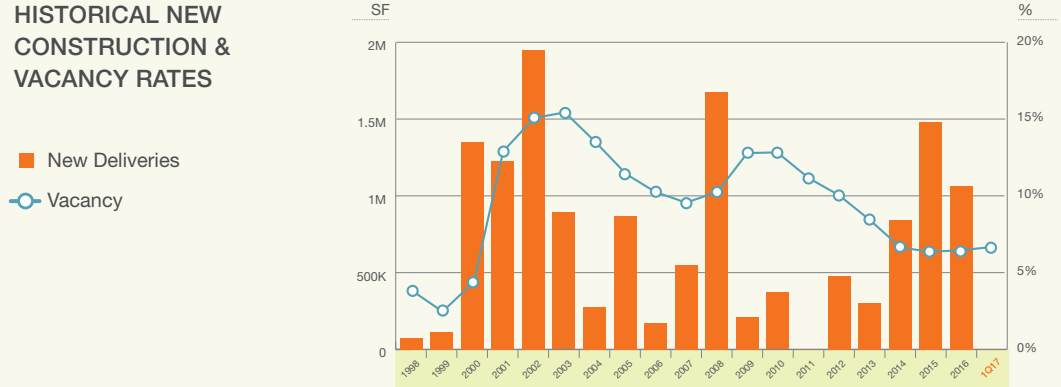
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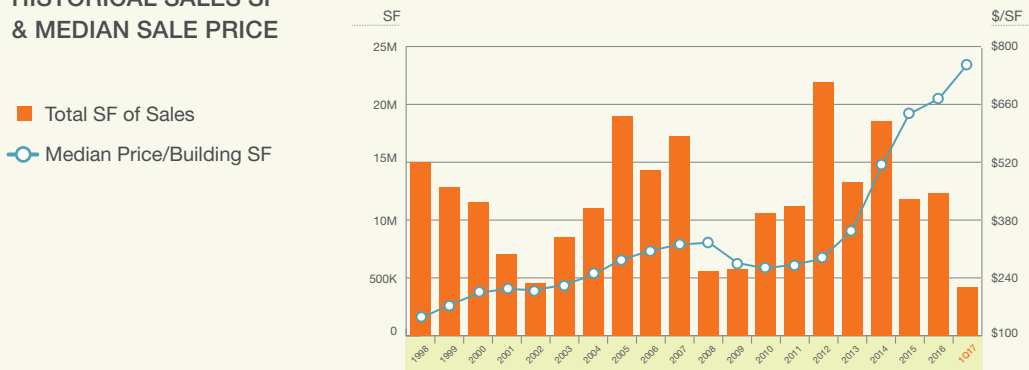
**Market Breakdown**

	2017 Q1	2016 Q4	2016 Q1	Annual % Change
Vacancy Rate	6.6%	6.4%	5.8%	13.4%
Availability Rate	11.4%	11.2%	10.7%	6.5%
Asking Lease Rate (Class A FiDi)	\$72.40	\$72.98	\$73.05	-0.9%
Leased SF	2,178,478	2,504,671	2,669,881	-18.4%
Sold SF	4,207,900	5,180,896	1,912,813	120.0%
Net Absorption	-387,145	-70,015	872,040	N/A

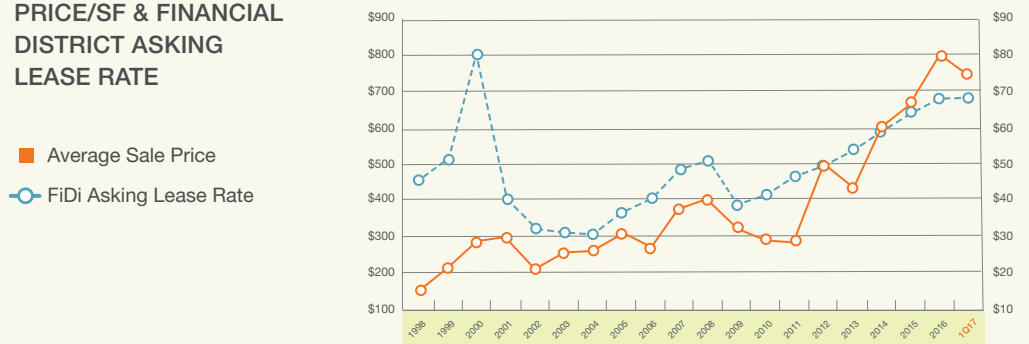
**HISTORICAL NEW CONSTRUCTION & VACANCY RATES**



**HISTORICAL SALES SF & MEDIAN SALE PRICE**



**AVERAGE SALE PRICE/SF & FINANCIAL DISTRICT ASKING LEASE RATE**



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