San Francisco Office
MarketView

Q3 2014

CBRE Global Research and Consulting

VACANCY RATE	LEASE RATE	NET ABSORPTION	UNDER CONSTRUCTION
6.7%, down 30 basis points	$61.69, up 4.1%	293K SF, down 494K SF	4.6 MSF, up 244K SF

*Change from last quarter

WILL DEMAND EXCEED MAXIMUM ALLOWED NEW SUPPLY?

Top Transactions

Lease	
Uber 1455/1515 3rd St	422,980 SF
Confidential 1 Market St	240,000 SF
SF Dept. of Human Services 1235 Mission St	117,826 SF
Dodge & Cox 555 California St	111,388 SF

Sale	
50 Beale St Paramount	662,060 SF
405 Howard St TIAA-CREF	521,555 SF
650 California St Columbia Property Trust	478,392 SF
100 California St Pembroke Real Estate	288,431 SF

Hot Topics

Sustained demand levels drive market fundamentals

- Asking rents surpassed $60 per sq. ft. for the first time since 2000
- Year-to-date net absorption is 1.7 million sq. ft., expected to reach 2.0 million sq. ft. by year-end
- Four deals over 100,000 sq. ft. signed in Q3 2014, bringing the year-to-date total to 13 for 3.2 million sq. ft.
- No new construction deliveries; 270 Brannan commenced construction

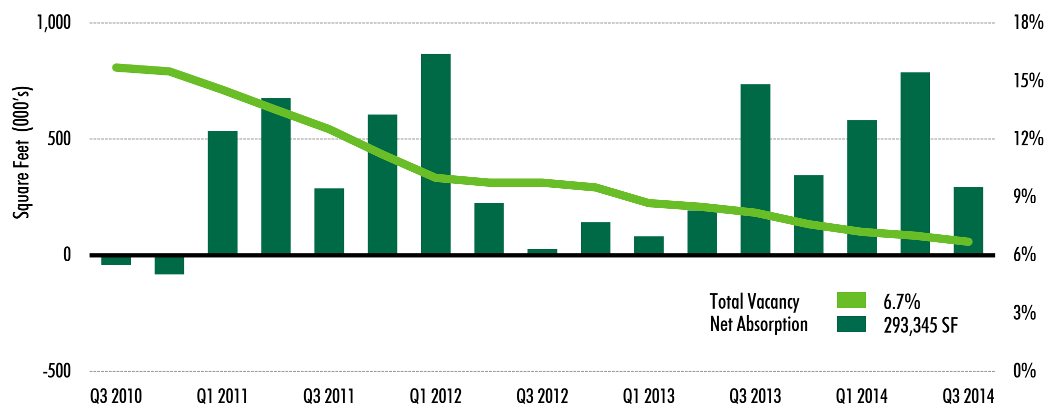
Dwindling availability of existing space has placed even more emphasis on new construction to ease supply constraints and support consistently strong demand from fast-growing high-tech users. The fact that third quarter vacancy fell by 30 basis points to 6.7% and market-wide asking rates have increased by another 4.1% to $61.69 per sq. ft. shows the supply side falling further behind demand, potentially stifling growth and creating more difficult market conditions for tenants.

Large transactions continue to dominate leasing activity in 2014 and net absorption has already reached nearly 1.7 million sq. ft. year-to-date. Four deals over 100,000 sq. ft. signed during the third quarter, bringing the 2014 total to 13 deals for 3.2 million sq. ft. leased. The previous high was 16 deals for 3.5 million sq. ft. in 2000 and, given the number of large tenants currently in the market, the deal count and total space leased could set a new record by year-end. Office building sales are also on pace to close out the year with record average Class A pricing and $6.7 billion in volume, its second highest total since 2007. Through the third quarter, $4.5 billion has closed and Class A pricing has averaged $650 per sq. ft.

The biggest concern is the impending impact of Prop M. While current known demand for Prop M approvals outstrips the maximum availability through 2015 by 3 to 1, a substantial amount of new supply will hit the market within the next four years. The current large project Prop M availability allows for 2.1 million sq. ft. of new approvals, with 875,000 added every October 17th, totaling 3.9 million sq. ft. by 2015. Taking into account projects that are currently under construction, approved for construction, or scheduled to be approved under Prop M by the end of 2015, a maximum total of 9.8 million sq. ft. of new supply could be delivered between 2015 and 2018, the first year Prop M impacts supply deliveries. Of that total, 6.7 million sq. ft. has not been pre-committed. If net absorption maintains its 1.7 million sq. ft. annualized average since 2011, there will be 6.8 million sq. ft. of new demand between 2015 and 2018. That's 3.0 million sq. ft. less than supply, which would raise vacancy to 9.0% by year-end 2018, still short of the 10% long-term average representative of balanced market conditions. If this scenario plays out, only 875,000 sq. ft. could be delivered each year starting in 2019.

Given the limits of Prop M, the outlook is for further rent and occupancy gains in the next two years, as new supply will have limited impact on landlord-favorable market conditions. The demand side of the equation could change if the pace of relocations out of and downsizing within San Francisco, mostly on the part of non-tech firms, accelerates and tech demand moderates. Even then, market conditions are likely to remain tight, especially if demand were to exceed its historical average.

Figure 1: Total Vacancy vs. Absorption



Source: CBRE Research, Q3 2014.

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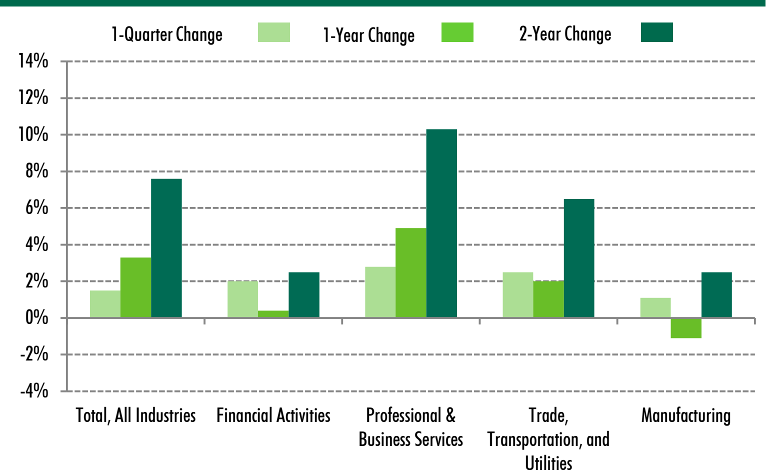
Figure 2: Total Office Market Statistics

Submarket	Net Rentable Area	Total Vacancy %	Total Availability %	Average Asking Rate*	Q3 Net Absorption	YTD Net Absorption
Financial District	26,193,031	7.6%	12.0%	$63.35	(22,374)	6,282
Class A	19,654,154	7.5%	11.4%	$65.37	(17,232)	(15,741)
South Financial District	21,594,343	7.2%	10.2%	$67.02	232,140	804,794
Class A	17,871,101	6.4%	9.3%	$68.31	263,842	809,813
N. Waterfront & Jackson Sq.	5,271,839	7.2%	8.9%	$54.21	13,957	10,157
Class A	1,928,125	5.4%	8.6%	$57.56	11,811	(8,969)
South of Market	6,677,205	7.0%	15.8%	$61.61	(39,867)	95,057
Class A	2,633,196	6.8%	21.1%	$64.20	(21,984)	7,679
Yerba Buena	3,355,100	5.1%	8.0%	$58.15	13,517	394,575
Class A	1,279,859	2.9%	10.7%	$63.72	(9,786)	358,926
South of Market West	3,125,736	2.3%	3.5%	$48.83	33,895	118,741
Class A	1,296,043	1.3%	1.3%	$53.27	39,332	149,784
Mission Bay / China Basin	2,510,383	0.7%	1.0%	$68.29	19,943	100,976
Class A	2,510,383	0.7%	1.0%	$68.29	19,943	100,976
Potrero Hill	1,939,358	5.3%	9.6%	$51.40	74,380	184,688
Class A	257,109	7.0%	34.1%	$55.30	-	17,063
Civic Center & Van Ness	1,886,302	9.6%	10.9%	$41.87	(20,105)	(41,657)
Class A	609,236	10.7%	13.1%	$48.67	(14,665)	(43,415)
Union Square	3,694,923	5.0%	6.8%	$54.80	(12,141)	(10,626)
Class A	335,200	0.5%	3.4%	$57.68	-	-
San Francisco Office Market	76,248,220	6.7%	10.4%	$61.69	293,345	1,662,987
Class A	48,374,406	6.3%	10.3%	$65.55	271,261	1,376,116

* Direct Annual Lease Rates, Full Service Gross

Source: CBRE Research, Q3 2014.

Figure 3: San Francisco Employment*



*San Francisco MD (Marin-San Francisco-San Mateo counties), September 2014
Source: CA EDD , CBRE Research, Q3 2014.

In August of 2014 the unemployment rate for the San Francisco Metropolitan Division (MD) was 4.5%, considerably lower than that of California at 7.4% or the national unemployment rate of 6.1%. This translates to a 35,500 net gain in jobs, or a 3.3% increase, over a 12-month period since August of 2013 with the strongest growth in the Professional Business Services sector (which saw a 10.3% increase over the past 2 years). The Financial Activities and Manufacturing sectors, while also increasing, have grown at slower rate of 2.5% over the same time period.

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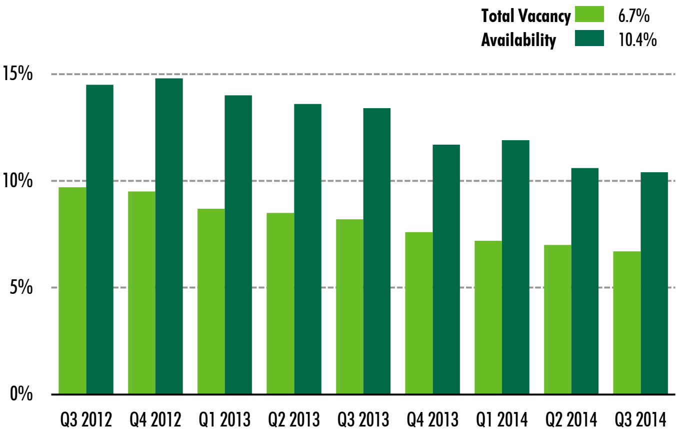
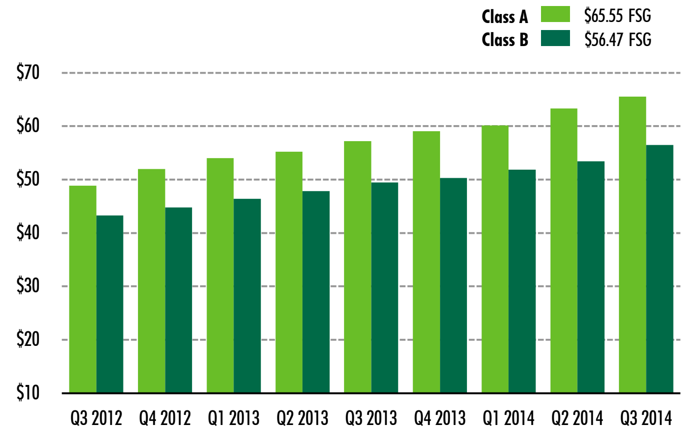
Figure 4: Vacancy & Availability



Source: CBRE Research, Q3 2014.

Market wide vacancy dipped to 6.7% during the third quarter, declining by 30 basis points quarter-over-quarter and 160 basis points year-over-year. Availability fell by 20 basis points to 10.4%. The sharpest declines in availability were in Potrero Hill and the South Financial District, mostly due to a number of large leases in those submarkets. Sublease space saw a slight increase from last quarter and now accounts for 1.4 of the 7.9 million sq. ft. available. Vacancy is expected to continue to trend slightly down in the fourth quarter, since any dramatic drops should be mitigated when construction delivers new vacant space to the market.

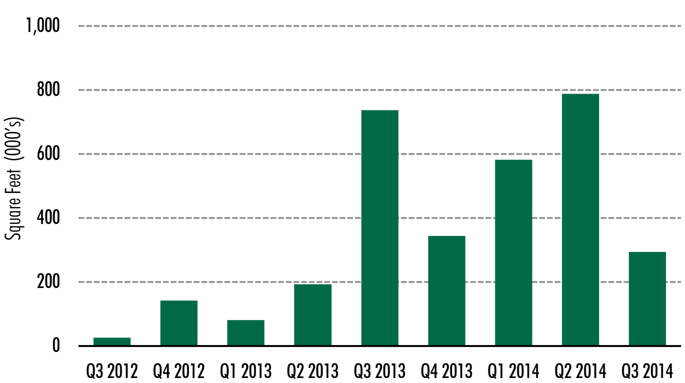
Figure 5: Lease Rates



Source: CBRE Research, Q3 2014.

Asking rates continued their upward trend as a result of declining availability, hitting a market-wide average of $61.69 during the third quarter. This is an increase of 4.1% over last quarter and a year-over-year increase of 14.6%. Class A asking rates are now over $65.00. The South Financial District has seen a 20.3% increase since this time last year, and at an average of $67.02, is just slightly behind Mission Bay/China Basin as the priciest submarket. Civic Center/Van Ness remains the least expensive submarket. If rents continue to rise at this rate, the market-wide average could hit as high as $65.00 by the end of the year.

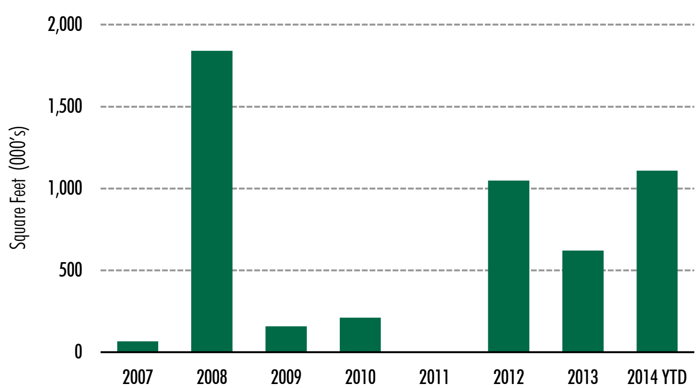
Figure 6: Net Absorption



Source: CBRE Research, Q3 2014.

Net absorption for the third quarter was 293,345 sq. ft., which is more moderate compared to the strong absorption seen during the first half of the year. Most of this reduction is attributable to the absence of new construction deliveries this quarter adding occupied space to the market. Nearly all of the absorption came from the South Financial District, which saw a number of the largest leases of the quarter. Occupancy gains were much more modest in other areas, with tenants actually giving up space in certain submarkets, including the Financial District and South of Market among others. Total net absorption year-to-date is now at 1.7 million sq. ft. and given expected construction completions and sustained demand in the fourth quarter, this number is expected to surpass 2.0 million sq. ft. by the end of the year.

Figure 7: Construction Completions



Source: CBRE Research, Q3 2014.

There is a total of 4.6 million sq. ft. currently under construction and another 1.6 million sq. ft. pending construction, with no new construction completions during the third quarter. Three additional construction projects at 1 Tenth, 535 Mission and 340 Bryant are scheduled to complete during the fourth quarter, which will deliver another significant amount of absorption (as well as new vacant space) to the market. Beyond this, another 2.1 million sq. ft. of construction is expected to deliver in 2015, but at 93% pre-leased, this will not produce much in the way of available supply. The new project at 270 Brannan commenced construction during the third quarter and two additional projects are expected to break ground before year-end.

Figure 8: San Francisco Office Submarkets

Submarket	Size (SF)
Financial District	26,193,031
South Financial District	21,594,343
North Waterfront & Jackson Square	5,271,839
South of Market	6,677,205
Yerba Buena	3,355,100
South of Market West	3,125,736
Mission Bay / China Basin	2,510,383
Potrero Hill	1,939,358
Civic Center & Van Ness Corridor	1,886,302
Union Square	3,694,923
San Francisco	**76,248,220**

Source: CBRE Research, Q3 2014.

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