The office market in San Francisco kicked off 2019 with over 770K square feet of construction deliveries. Even with the large scale of deliveries, the construction pipeline remains robust with over 4.1 million square feet yet to be delivered, 72.9% of which is already pre-leased. Sales volume hit its highest quarterly total in two years, while average sales price per square foot jumped over $100 quarter-over-quarter, and skyrocketed more than $400 year-over-year. 2018 was a historic year in terms of occupancy, net absorption, rent, and development. The first quarter of 2019 has mostly maintained much of those gains, despite the quarter being less active than previous years.

New Construction

In 2018, the South Financial District submarket led all others in office property deliveries, with 1,832,000 s.f. This trend continued into 2019 with the only delivery being Park Tower at Transbay on 250 Howard Street that added 772,961 s.f. to the South Financial District’s office inventory. The South Financial District also has the largest property in the development pipeline with the 1.25 million s.f. First Street Tower expected to deliver in 2023. Mission Bay/China Basin is expected to be a major destination for construction deliveries in the near future with over 1.7 million s.f. expected to be delivered either this or next year. With 100% of that space already pre-leased, the Mission Bay/China Basin submarket is quickly establishing itself as a premium destination for office tenants.

Asking Rental Rates

Direct asking lease rates ended the first quarter of 2019 higher quarter-over-quarter for the sixth straight time at $64.71 FS. This represented a 6.26% increase quarter-over-quarter, and a 9.59% increase year-over-year. Class A direct asking rents increased 9.78% on a year-over-year basis, while Class B buildings experienced a year-over-year rise of 5.72% in direct asking rents. Waterfront/North Beach had the steepest rise quarter-over-quarter with a 20.3% increase in direct asking lease rates. Year-over-year Mission Bay/China Basin saw the most dramatic rise, as direct asking rent grew 72.7% to $70.87 FS. After many years as an afterthought, Mission Bay/China Basin is commanding the second highest asking lease rates in the city. The roaring growth of...
Market Breakdown

<table>
<thead>
<tr>
<th></th>
<th>Q1 2019</th>
<th>Q4 2018</th>
<th>Q1 2018</th>
<th>Annual % Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Construction</td>
<td>772,961</td>
<td>0</td>
<td>1,867,682</td>
<td>N/A</td>
</tr>
<tr>
<td>Under Construction</td>
<td>4,111,652</td>
<td>4,758,076</td>
<td>3,901,409</td>
<td>5.39%</td>
</tr>
<tr>
<td>Direct Vacancy Rate</td>
<td>4.57%</td>
<td>4.30%</td>
<td>5.80%</td>
<td>-21.21%</td>
</tr>
<tr>
<td>Availability Rate</td>
<td>8.52%</td>
<td>8.60%</td>
<td>9.30%</td>
<td>-8.37%</td>
</tr>
<tr>
<td>FIDI Asking Lease Rate (A&amp;B)</td>
<td>$70.27</td>
<td>$68.51</td>
<td>$67.69</td>
<td>3.81%</td>
</tr>
<tr>
<td>Leased SF</td>
<td>2,199,853</td>
<td>3,399,859</td>
<td>3,493,239</td>
<td>-37.03%</td>
</tr>
<tr>
<td>Sold SF</td>
<td>1,399,531</td>
<td>1,288,266</td>
<td>775,477</td>
<td>80.47%</td>
</tr>
<tr>
<td>Net Absorption</td>
<td>459,501</td>
<td>715,599</td>
<td>1,703,050</td>
<td>N/A</td>
</tr>
</tbody>
</table>

San Francisco Office Charts

AVERAGE ASKING RENT/SF & VACANCY RATE

AVERAGE SALES PRICE & CAPITALIZATION RATES

NET ABSORPTION & NEW DELIVERIES

SALES VOLUME VS. LEASE VOLUME
Submarket Statistics

<table>
<thead>
<tr>
<th>Submarket</th>
<th>Total Inventory</th>
<th>SF Under Construction</th>
<th>Direct Vacancy Rate</th>
<th>Direct Net Absorption</th>
<th>Total Vacancy Rate</th>
<th>Total Available Rate</th>
<th>1Q Direct Net Absorption</th>
<th>2018 Direct Net Absorption</th>
<th>1Q Leasing Activity</th>
<th>2018 Leasing Activity</th>
<th>Avg Rental Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial District</td>
<td>30,365,397</td>
<td>0</td>
<td>6.2%</td>
<td>(147,021)</td>
<td>10.1%</td>
<td>6.8%</td>
<td>274,325</td>
<td>576,260</td>
<td>1,166,720</td>
<td>68.26</td>
<td></td>
</tr>
<tr>
<td>South Financial District</td>
<td>30,511,138</td>
<td>1,250,000</td>
<td>4.6%</td>
<td>784,056</td>
<td>9.8%</td>
<td>7.0%</td>
<td>(250,888)</td>
<td>682,724</td>
<td>809,121</td>
<td>71.84</td>
<td></td>
</tr>
<tr>
<td>Jackson Square</td>
<td>3,108,060</td>
<td>0</td>
<td>2.9%</td>
<td>(26,492)</td>
<td>5.5%</td>
<td>3.6%</td>
<td>82,778</td>
<td>64,625</td>
<td>111,936</td>
<td>58.68</td>
<td></td>
</tr>
<tr>
<td>Waterfront/North Beach</td>
<td>4,379,588</td>
<td>0</td>
<td>4.3%</td>
<td>62,479</td>
<td>7.1%</td>
<td>5.0%</td>
<td>(90,340)</td>
<td>39,593</td>
<td>168,118</td>
<td>58.88</td>
<td></td>
</tr>
<tr>
<td>Mid-Market</td>
<td>6,931,594</td>
<td>466,000</td>
<td>1.9%</td>
<td>16,114</td>
<td>6.3%</td>
<td>3.7%</td>
<td>133,828</td>
<td>162,932</td>
<td>81,781</td>
<td>47.49</td>
<td></td>
</tr>
<tr>
<td>SOMA</td>
<td>7,818,361</td>
<td>0</td>
<td>4.3%</td>
<td>(154,369)</td>
<td>6.1%</td>
<td>5.7%</td>
<td>43,028</td>
<td>86,970</td>
<td>221,181</td>
<td>64.10</td>
<td></td>
</tr>
<tr>
<td>Rincon/South Beach</td>
<td>6,619,700</td>
<td>268,000</td>
<td>3.7%</td>
<td>(55,819)</td>
<td>6.5%</td>
<td>4.7%</td>
<td>12,354</td>
<td>408,996</td>
<td>544,213</td>
<td>68.72</td>
<td></td>
</tr>
<tr>
<td>Showplace Square</td>
<td>3,601,985</td>
<td>126,537</td>
<td>2.4%</td>
<td>25,709</td>
<td>8.5%</td>
<td>2.5%</td>
<td>330,507</td>
<td>40,602</td>
<td>165,039</td>
<td>53.01</td>
<td></td>
</tr>
<tr>
<td>Civic Center</td>
<td>4,308,684</td>
<td>0</td>
<td>1.5%</td>
<td>(941)</td>
<td>1.6%</td>
<td>1.5%</td>
<td>-</td>
<td>-</td>
<td>3,866</td>
<td>37.48</td>
<td></td>
</tr>
<tr>
<td>Union Square</td>
<td>5,381,558</td>
<td>0</td>
<td>7.3%</td>
<td>21,057</td>
<td>13.4%</td>
<td>8.3%</td>
<td>1,080</td>
<td>105,570</td>
<td>102,986</td>
<td>62.82</td>
<td></td>
</tr>
<tr>
<td>Van Ness Corridor</td>
<td>2,105,573</td>
<td>234,000</td>
<td>8.5%</td>
<td>72,774</td>
<td>14.3%</td>
<td>9.0%</td>
<td>13,029</td>
<td>10,309</td>
<td>56.05</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mission Bay/China Basin</td>
<td>3,393,785</td>
<td>1,767,115</td>
<td>0.3%</td>
<td>1,827</td>
<td>0.3%</td>
<td>0.3%</td>
<td>108,491</td>
<td>-</td>
<td>-</td>
<td>70.87</td>
<td></td>
</tr>
<tr>
<td>Potrero</td>
<td>2,211,609</td>
<td>0</td>
<td>2.5%</td>
<td>(15,123)</td>
<td>6.8%</td>
<td>3.1%</td>
<td>(2,338)</td>
<td>18,552</td>
<td>14,589</td>
<td>57.34</td>
<td></td>
</tr>
</tbody>
</table>

San Francisco Total: 110,737,032 4,111,652 4.57% 5.78% 8.52% 459,501 715,599 2,199,853 3,399,859 64.71%

Class A: 59,283,339 3,143,652 3.60% 4.70% 8.60% 649,739 536,966 1,201,457 1,677,032 71.53%
Class B: 45,807,798 968,000 5.70% 7.10% 8.00% (212,242) 59,643 902,163 1,588,084 62.28%
Class C: 14,415,950 0 4.40% 5.00% 6.20% (4,854) 50,373 121,465 190,567 54.86%

Notable Lease Transactions

**PINTREST**
88 Bluxome Street
San Francisco
508,940 s.f.

**ASANA, INC.**
633 Folsom Street
San Francisco
268,000 s.f.

**SLACK**
45 Fremont Street
San Francisco
208,459 s.f.

Notable Under Construction

**FIRST STREET TOWER**
50 First Street
San Francisco
1,250,000 s.f.

**THE EXCHANGE ON SIXTEENTH**
1800 Owens Street
San Francisco
750,370 s.f.

**1500 MISSION STREET**
1500 Mission Street
San Francisco
466,000 s.f.
direct rental rates has continued, adding to an already stellar increase during this cycle.

Absorption & Vacancy

A quarter after one of the most active years in two decades, net absorption finished the quarter in positive territory for the sixth straight quarter. While this quarter’s net absorption is in strongly positive territory, an increase in move-ins in Q2 is expected to significantly boost net absorption further positive for the year. The Financial and South Financial Districts led all other submarkets in leasing activity once again, as the two submarkets still dominate the downtown core. Large tech firms that normally dominate the market signed on to a significant amount of space in the first quarter. Pinterest had the largest lease of the quarter, as they committed to lease over 500K s.f. of a 1 million s.f. proposed mixed use building that will replace the former San Francisco Tennis Club at 88 Bluxome. Asana, Inc. made the second largest commitment with their lease of the entire 268,000 s.f. building at 633 Folsom St. Slack took on the third largest lease of the quarter when they decided to sign on to occupy 11 floors at 45 Fremont St, just minutes away from their HQ at 500 Howard St.

Although overall net absorption ended the quarter positive, both total and direct vacancy rates for San Francisco were up slightly quarter-over-quarter. The total vacancy rate increased by 30 basis points quarter-over-quarter, while direct vacancy increased by 27 basis points in the same time frame. However, year-over-year both direct and total vacancy rates remain lower by 123 and 90 basis points, respectively. With direct rates at 4.57% and total rates at 5.6%, the market is still very tight.

Investment

San Francisco office property sales jumped significantly from last quarter, with total dollar volume reaching over $1.3 billion by the close of the first quarter. Average per square foot price also rose 12.32% quarter-over-quarter to $943.43. Year-over-year, the increases are even more staggering as dollar volume increased by over $1 billion and average per square foot sales price jumped 74.42%. The most significant sale of the quarter was Gap, Inc.’s February purchase of the Mission Bay/China Basin building they were previously leasing from Hines Global REIT, Inc. for $342,500,000 ($1,211.22/psf). Clarion Partners purchase of the Charles Schwab Building at 215 Fremont from Jack Resnick & Sons, Inc. for $335,500,000 ($898.56/psf) was a close second. Rounding out the top three largest sales of the first quarter was JLL Income Property Trust's sale of 11 Sutter to Harbor Group International, LLC for $227,000,000 ($774.74/psf). The slowdown on cross-border investments by the Chinese government has not had the lasting effect many thought it might, as REITs and other domestic investors have become very aggressive in obtaining assets in San Francisco’s robust office market. As predicted in the Q4 2018 market report, domestic investors were happy to fill the void left by Chinese buyers after the imposition of stricter capital controls from the ruling Chinese Communist Party. Furthermore, many Chinese investors remain unfazed by the capital controls, and continue to maintain a large presence in the U.S. market. Looking ahead, it is likely that this market will continue to be very popular among investors, as rental rates maintain all-time highs and recent sales have yielded remarkable returns on investment.

Source: CoStar, RCA, San Francisco Business Times, and The Registry

Contact

The information in this report was composed by the Kidder Mathews Research Group.

Jerry Holdner
Director of Research
949.557.5050
jholdner@kiddermathews.com

Eric Luhrs
Regional President, Brokerage
Northern California/Nevada
415.229.8888
eluhrs@kiddermathews.com

Designated Broker
Mark Read | LIC # 00572743

kiddermathews.com

This information supplied herein is from sources we deem reliable. It is provided without any representation, warranty or guarantee, expressed or implied as to its accuracy. Prospective Buyer or Tenant should conduct an independent investigation and verification of all matters deemed to be material, including, but not limited to, statements of income and expenses. CONSULT YOUR ATTORNEY, ACCOUNTANT, OR OTHER PROFESSIONAL ADVISOR.