Kidder Mathews

Real Estate Market Review

NORTHERN CALIFORNIA | Oakland/East Bay

1st Quarter
2016

East Bay Office

Market Forecast

	Trends
Absorption	↓
Vacancy	↑
Rental Rate	↑
New Construction	↔

Notable Lease Transactions

Cost Plus
1201 Marina Village Parkway, Alameda
88,110 s.f.

Unknown Tenant
2100 Powell, Emeryville
24,364 s.f.

Merrill Lynch
1111 Broadway, Oakland
23,237 s.f.

Notable Sale Transactions

Rockpoint Group
300 Lakeside Drive, Oakland
(Kaiser Center)
811,000 s.f. | $197M or $243/s.f.

The California Endowment
2000 Franklin Street, Oakland
33,241 s.f. | $13.9M or $418/s.f.

Graham Street Realty
1936 University Avenue, Berkeley
(The Promenade)
42,665 s.f. | $13.4M or $315/s.f.

The East Bay office market relaxed in the first quarter of 2016, as negative 111,524 square feet of net absorption upped the vacancy rate to 8.2%, up 0.3 percentage points from the fourth quarter but still down 2.3 percentage points year-over-year. Leasing activity tapered from the previous quarter, to 161 deals covering 505,650 square feet, the lowest quarterly space volume since the fourth quarter of 2011. Market-wide rental rates climbed to $2.20 per square foot—a 7.4% increase over the past year—and rents in the Oakland CBD were up 19.3% since the first quarter of 2015, clearing $3.09 per square foot, fully serviced, for the first time. Nonetheless, the East Bay remains much more affordable than San Francisco, and its lower rents, larger spaces, and BART accessibility continue to attract office tenants squeezed out from across the Bay. However, as a result of this demand pressure and a lack of new construction, the vacancy rate in the Oakland CBD is now lower than that reported in San Francisco, and rental rates in key submarkets such as downtown Oakland and Emeryville continue to rise.

The East Bay office market gave back a modest share of its cycle-high absorption gain from the previous quarter, shedding 111,524 square feet in the first quarter of 2016. Absorption losses were largely concentrated in Class B properties (-140,607 s.f.), and in the cities of Alameda (-87,086 s.f.) and Oakland (-50,770 s.f.). By contrast, Hayward/Castro Valley (+35,528 s.f.) and Emeryville (+8,482 s.f.) both reported positive net absorption for the third consecutive quarter. While Class B assets dipped into the red, the East Bay market showed a 25,798 square foot gain in occupied Class A space, which is up 551,134 square feet since the second quarter of 2014 to a cycle-high occupancy of 10,117,427 square feet.

Consequently, the Class A market tightened further this quarter, with vacancies dropping to 6.1%, lower than the rate reported in San Francisco for the second consecutive period. While more and more companies are being priced out of the San Francisco market, the static supply of Class A space in the East Bay is gradually complicating the move. Only one new office building—the 20,000 square foot 1630 San Pablo Avenue—was under construction in downtown Oakland at quarter's end, and the Oakland CBD submarket has not seen a new office delivery since 2010. Asking rental rates for Class A spaces market-wide jumped 8.0%, to $3.84 per square foot, fully serviced, and price tags on Class A availabilities in Oakland CBD now comfortably exceed $4.00 per square foot. Even though Class A vacancies dropped 0.2 percentage points from the previous quarter and are down 5.1 percentage points year-over-year, there is still ample Class A space to accommodate companies moving

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out of San Francisco. Comparable rents in Oakland remain at least 30 percent lower than they are across the Bay Bridge, and other inner East Bay cities are enjoying spillover benefits from companies seeking more space than downtown Oakland landlords can provide.

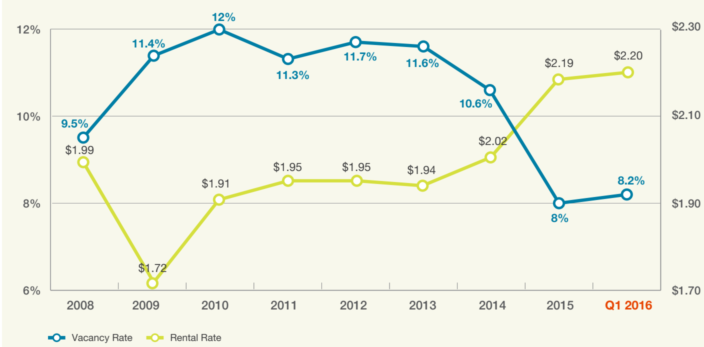
Unemployment in the East Bay continued to drop this quarter, to 4.3%, down 0.8 percentage points year-over-year, with some submarkets registering lows unseen since the dot-com boom. Total employment is up about 30,000 jobs from the first quarter of 2015. The Educational and Health Services sector showed the biggest gain, growing by 8,600 jobs, followed by Trade, Transportation, and Utilities, which added 7,400 jobs. Continued employment growth in office-based sectors, such as Professional and Business Services—which was up 1,400 jobs year-over-year—will lead to increasing demand for office space in the coming quarters. Without a corresponding increase in supply, this will place upward pressure on rental rates, which have trended upward for nine consecutive quarters and hiked by 7.4% market-wide year-over-year.

Leasing activity slipped to 161 transactions totaling 505,650 square feet during the first quarter, the slowest by either measure since the second quarter of 2012. Average deal size continues to trend downward, to a mean of 3,141 square feet this quarter, compared to 3,549 in the fourth quarter of 2015 and well below the 5,276 square foot mean recorded in 2014. The lower average stems in part from a dearth of large-scale leases—only two downtown Oakland deals exceeded 10,000 square feet this quarter—but is mainly attributable to the types of companies coming from across the Bay. Startups, smaller tech companies, and nonprofits comprise the bulk of the exodus from San Francisco, escaping the city's skyrocketing rents while still enjoying the agglomeration of benefits of working alongside other fledgling firms in the Oakland CBD. The per-lease average in the downtown Oakland submarket was approximately 2,900 s.f., compared to 5,000-6,000 s.f. in nearby Alameda, Berkeley, and Emeryville.

The quarter's largest lease deal was struck by Cost Plus, which is relocating its headquarters to 1201 Marina Village Parkway in Alameda, where it grabbed 88,110 square feet. Previously based in Oakland's Jack London Square, the retailer is among several companies that have recently looked to other parts of the inner East Bay for larger spaces to accommodate their workforce needs. The largest transaction in the Oakland CBD was Merrill Lynch's 23,237 square foot pact at 1111 Broadway. Demand in downtown Oakland is increasingly concentrated on buildings in the Uptown neighborhood, near Uber's future East Bay headquarters and within easy walking distance of BART. The overall Oakland CBD vacancy rate was 4.9% at quarter's end, down from 7.8% a year ago, and space was even harder to come by in the most desirable pockets of the city's downtown area.

Source: CoStar

Vacancy Rates vs. Rental Rates



Submarket Statistics

Submarket	Number of Buildings	Total Inventory	Direct Available	Sublease Available	Total Vacancy	Direct Availability Rate	Sublease Availability Rate	Total Vacancy Rate	Net Absorption YTD
West Contra Costa	124	2,457,673	207,108	0	142,112	8.40%	0.00%	5.80%	645
Berkeley	211	5,167,872	124,568	22,093	223,975	2.40%	0.40%	4.30%	(11,461)
Emeryville	64	4,755,073	510,893	91,898	419,228	10.70%	1.90%	8.80%	8,482
Oakland CBD	235	17,045,221	1,200,820	71,033	837,310	7.00%	0.40%	4.90%	(24,776)
Greater Oakland	379	9,285,767	891,685	19,405	837,304	9.60%	0.20%	9.00%	(25,994)
Alameda	123	3,821,636	643,107	112,312	714,011	16.80%	2.90%	18.70%	(87,086)
San Leandro/San Lorenzo	99	1,920,200	190,301	1,200	118,531	9.90%	0.10%	6.20%	(5,374)
Hayward/Castro Valley	155	3,525,113	707,722	0	659,125	20.10%	0.00%	18.70%	35,528
Union City	29	607,898	12,922	0	12,922	2.10%	0.00%	2.10%	(1,488)
Total	**1,419**	**48,586,453**	**4,489,126**	**317,941**	**3,964,518**	**9.20%**	**0.70%**	**8.20%**	**(111,524)**

Contact

Reed Payne
Executive Vice President, Brokerage
Northern California
415.229.8888 | rpayne@kiddermathews.com

Designated Broker: Reed Payne | LIC #00818935

Offices

San Francisco
415.229.8888

Silicon Valley
408.970.9400

San Diego
858.509.1200

Seattle
206.296.9600

Phoenix
602.513.5200

Peninsula
650.769.3600

Sacramento
916.751.3600

Orange County
949.557.5000

Portland
503.221.9900

Reno
775.301.1300