

MARKETBEAT

East Bay Walnut Creek

Office Q3 2019



EAST BAY WALNUT CREEK OFFICE

Economic Indicators*

	Q3 18	Q3 19	12-Month Forecast
East Bay Employment	1.18M	1.20M	▲
East Bay Unemployment	2.9%	3.0%	▲
U.S. Unemployment	3.8%	3.7%	▲

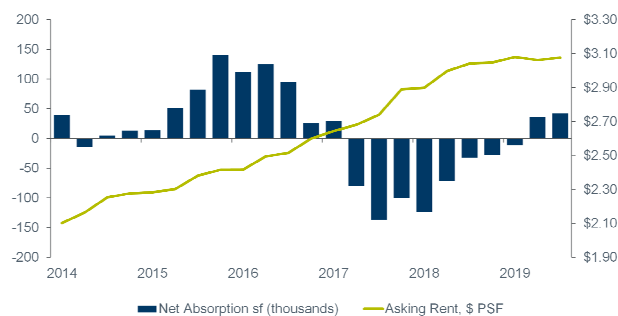
*2019 Q3 data are based on latest available data
Source: BLS, Moody's Analytics, C&W Research

Market Indicators (Overall, All Classes)

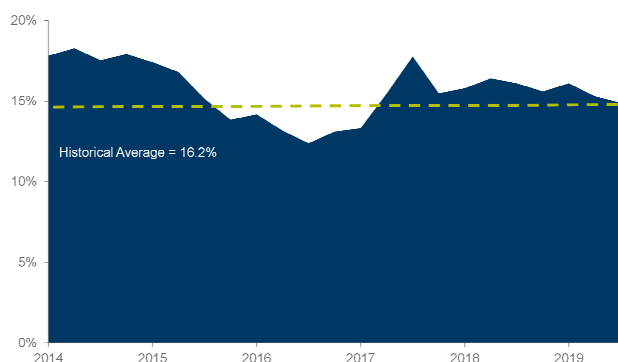
	Q3 18	Q3 19	12-Month Forecast
Overall Vacancy	16.1%	14.9%	■
Net Absorption (sf)	37K	60K	■
Under Construction (sf)	0	0	■
Average Asking Rent*	\$3.05	\$3.08	■

*Rental rates reflect full service asking \$psf/mo

Overall Net Absorption/Asking Rent 4-QTR TRAILING AVERAGE



Overall Vacancy



Summer Soaks Up Vacancy

Alameda and Contra Costa counties, collectively known as the East Bay, continued their positive employment growth adding 22,000 non-farm payroll positions (+1.8%) year-over-year (YOY), bringing total employment to 1,203,000 jobs. Despite this increase in jobs, the unemployment rate ticked up slightly YOY to 3.0% but even with an increase, unemployment for the region was 70 basis points (bps) below the national average. The underlying cause for this increase in jobs in the East Bay is its proximity to San Francisco's thriving labor market, one of the tightest in the country, with unemployment at a scant 2.2%. As companies compete for talent in San Francisco, office space becomes a key differentiator, creating an extremely tight market for all, but particularly, quality space. Consequently, the East Bay is steadily experiencing migration or secondary locations due to its ease of transportation, lower rents, and expanding talent pool. The East Bay Walnut Creek office market specifically appeals to small and medium sized professional services firms that find refuge in its more affordable pricing and relaxed vibe.

Vacancy in the third quarter of 2019 continued the downward trend seen in the second quarter, closing at 14.9%, a decline of 40 bps from the previous quarter and 120 bps YOY. This sharp drop in vacancy was a welcome change in momentum for the market. Vacancy had stagnated between 15-17% for the past two years, and this quarter is the first since 2017 to record vacancy below 15%. Large blocks of space make up a small percentage of availabilities but represent a large portion of vacancy. With vacant spaces over 10,000 square feet (sf) making up just 13% of availabilities, the only thing less common are the large-scale occupiers to fill them. The result is that these big blocks of space sit vacant for long periods of time. The East Bay Walnut Creek office market tends to cater to professional services firms looking for spaces ranging between 5,000 sf and 7,000 sf. Strong demand in this size range often makes it difficult for tenants to find the high-quality spaces they want, creating a market that is much more competitive than the vacancy rate suggests. Historically, the East Bay Walnut Creek has had some of the highest vacancy rates in the Bay Area, despite providing a steep discount to nearby markets. However, the recent positive net absorption is a sign that tenants are beginning to recognize the value available outside of major hubs like San Francisco and increasingly, Oakland.

The East Bay Walnut Creek market recorded 59,910 sf of positive net absorption in the third quarter, building upon the positive net absorption seen in the second quarter. Despite beginning the year in the red, year to date (YTD) net absorption is a positive 104,233 sf. Occupancy this quarter was driven by larger tenants who had signed leases earlier in the year, taking delivery of their space. Overall leasing activity was low for the quarter with Liberty Mutual Insurance signing the largest new lease of the quarter for 14,797 sf at 1340 Treat Boulevard. Aetna and San Francisco Fire Credit Union each occupied more than 20,000 sf this quarter. Tenants are slowly beginning

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to take large block spaces that have long plagued vacancy, off the market. The number of availabilities over 20,000 sf has declined by 27% YOY. The past two quarters have been particularly positive in shifting the market's momentum, but a concern is that a lack of large leases this quarter could negatively affect net absorption in the quarters to come.

SPACES ARE BEGINNING TO TRANSACT CONSISTENTLY OVER \$4.00 PSF...

After a strong second quarter of sales activity, the third quarter saw a distinct slow down. The largest sale was a 30,160 sf office building in Antioch that sold for \$4,000,000. No other office properties over 10,000 sf sold, with only a few small owner-user properties changing hands. There are however several properties under contract and we anticipate investment activity to pick back up in the fourth quarter.

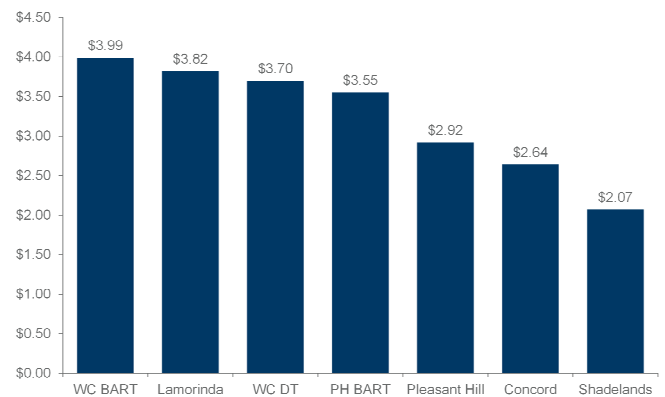
The overall average asking rent ticked up slightly from \$3.06 per square foot (psf) on a monthly full service basis in the second quarter of 2019 to \$3.08 psf in the third quarter. Over the past two years, asking rents in the East Bay Walnut Creek have somewhat defied expectations, as the figure has trended higher alongside rising vacancy. There is, however, an explanation. The market has had many large, Class A buildings change hands in the past two years and these investors are seeking return on their investment. Some larger investment firms appear to be pricing consistently with Class A assets in surrounding markets with less vacancy, with some asking over \$5.00 psf. While tenants have not yet shown an appetite for this pricing, spaces are beginning to transact consistently over \$4.00 psf. This is historically high for the market but for the right space, it represents a steep discount over equivalent space in some nearby markets. There are also some benefits to tenants that stem from these higher asking rents. It allows landlords to provide larger tenant improvement packages and expend more capital on upgrades to the common spaces and building amenities. The positive net absorption seen recently demonstrates that tenants are becoming less price sensitive in this market, and are recognizing the value of even the best product in the East Bay Walnut Creek.

Outlook

- Vacancy is expected to hold amidst inflow from surrounding markets
- We anticipate sales volume to increase in the fourth quarter of 2019
- Asking rents will remain flat until tenants show a declining sensitivity to price

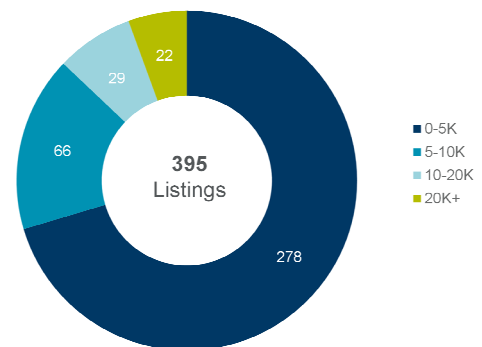
Average Asking Rate by Submarket (Full Service)

ASKING RATES VARY BY SUBMARKET



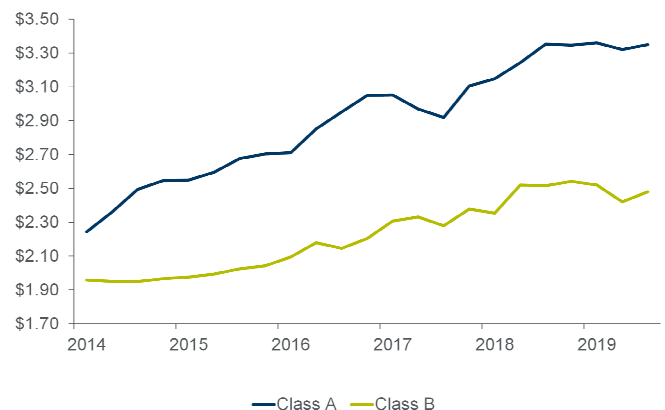
Availabilities by Size Segment

BIG BLOCKS OF SPACE SCARCE



Average Asking Rate by Class (Full Service)

ASKING RATES UP IN THIRD QUARTER



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SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	VACANCY RATE	CURRENT OVERALL NET ABSORPTION (SF)	YTD OVERALL NET ABSORPTION (SF)	UNDER CONSTRUCTION (SF)	OVERALL AVERAGE ASKING RENT* (ALL CLASSES)	OVERALL AVERAGE ASKING RENT* (CLASS A)
Concord	4,518,312	108,294	595,523	15.6%	73,063	40,125	0	\$2.71	\$2.74
Pleasant Hill	553,572	0	39,444	7.1%	529	3,424	0	\$2.92	\$3.25
Lamorinda	1,121,196	0	76,004	6.8%	-16,588	-17,795	0	\$3.82	\$4.50
WC Downtown	1,904,293	11,983	204,655	10.7%	6,160	73,531	0	\$3.70	\$4.98
WC Pleasant Hill BART	1,673,423	116,865	182,772	17.9%	-43,931	-49,990	0	\$3.55	\$3.71
WC BART Area	2,311,234	9,493	366,015	16.2%	31	28,978	0	\$3.99	\$4.05
WC Shadelands	1,741,328	0	356,724	20.5%	40,646	25,960	0	\$2.07	\$2.05
Walnut Creek Totals	7,630,278	138,341	1,098,183	16.2%	2,906	78,479	0	\$3.28	\$3.90
CLASS BREAKDOWN									
Class A	8,187,778	229,238	1,193,754	17.4%	50,749	-17,518	0	\$3.35	
Class B	5,635,580	17,397	615,400	11.2%	9,161	121,751	0	\$2.48	
TOTAL	13,823,358	246,635	1,809,154	14.9%	59,910	104,233	0	\$3.08	\$3.35

Key Lease Transactions Q3 2019

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
1340 Treat Boulevard	14,797	Liberty Mutual Insurance	CalSTRS	New Lease	Walnut Creek - Pleasant Hill BART

Key Sale Transactions Q3 2019

PROPERTY	SF	BUYER	SELLER	SALE PRICE / \$PSF	SUBMARKET
2157 Country Hills Drive	30,160	CCARC	Reynolds & Brown	\$4,000,000 / \$133	Antioch

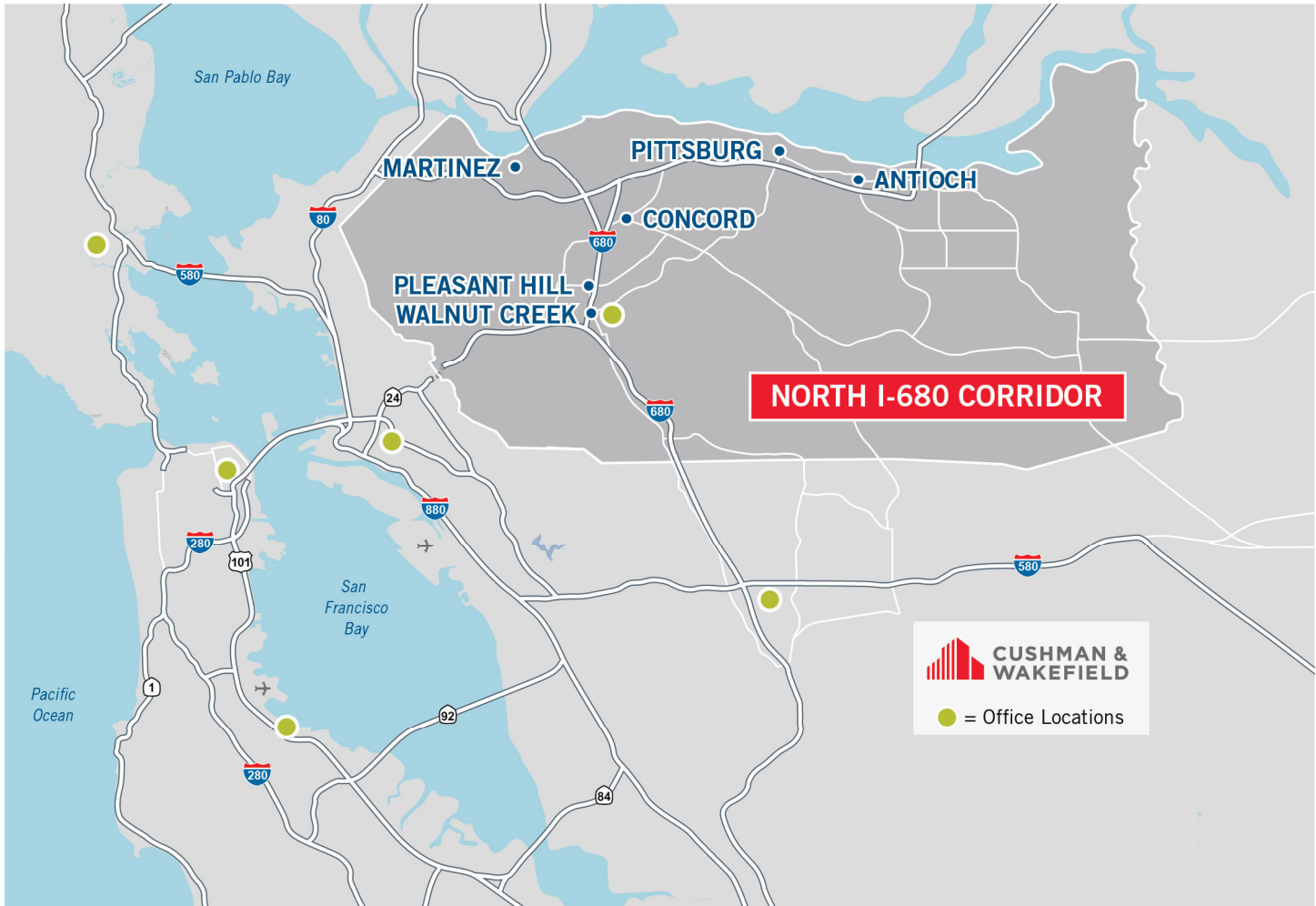
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Office Submarkets East Bay Walnut Creek



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