MARKET REPORT

OFFICE

San Francisco Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

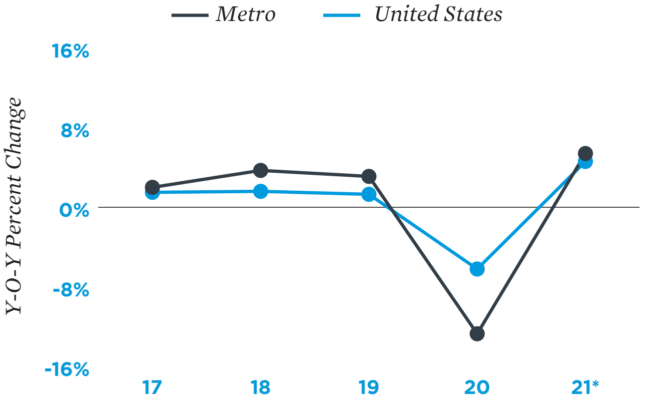
4Q/21

Despite Concerns Spurred by Health Crisis, San Francisco Office Market Will Recover

Short-term headwinds challenge office market. San Francisco is facing a temporary confluence of soft demand and increasing supply. The emergence of variants of COVID-19 has pushed reopening plans for several local employers into next year, which will keep many office buildings sparsely occupied through the end of the year. The return of anchor tech companies will precede smaller firms resuming in-person operations early next year. Still, some major San Francisco employers are not expected to occupy as much space as they did prior to the health crisis. Salesforce, for example, has backed out of a lease at 550 Howard St. and is subleasing hundreds of thousands of square feet. Pinterest paid $90 million to terminate its lease for 490,000 square feet and Twitter is subleasing 100,000 square feet. Overall, it will take several quarters for the supply overhang to be eroded.

Long-term outlook bright. San Francisco has a world-class office market and tech companies will take advantage of discounting over time. Along with New York, the metro has a long road ahead to return to pre-COVID-19 performance. However, the pace of that recovery could be hastened due to the in-place infrastructure. Most of the office buildings are equipped for tech firms, conditions not present in many areas of the country. Furthermore, major employers are not leaving the area, despite narrowing their office footprints. These companies will attract workers as full occupancy becomes safer and the need for in-person collaboration rises.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook

56,000 JOBS
will be created

EMPLOYMENT:

Headcounts expand 5.4 percent this year as the local economy continues a measured opening. Traditionally office-using sectors are anticipated to increase 4.5 percent as 21,000 positions are generated.

5,700,000 SQ. FT.
will be completed

CONSTRUCTION:

Projects that were delayed during strict lockdowns are being completed this year, along with the regularly anticipated deliveries. The surge in finalizations will lift inventory 3.3 percent in 2021.

510 BASIS POINT
increase in vacancy

VACANCY:

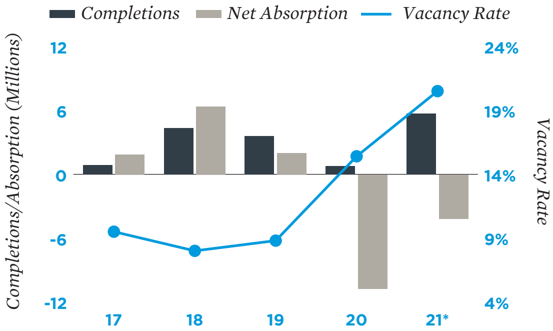
The peaking construction cycle will push the vacancy rate up to 20.5 percent by year-end. Last year, the rate climbed 660 basis points when nearly 10.8 million square feet of space was vacated in the metro.

9.0% DECREASE
in asking rent

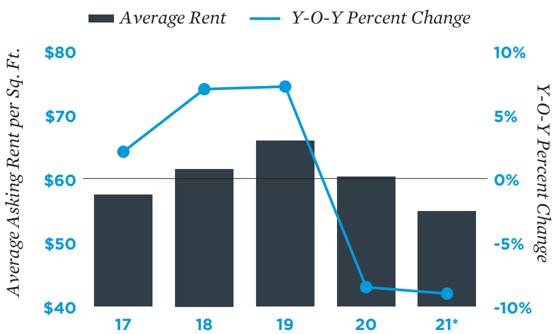
RENT:

Existing office properties will compete with the deluge of new stock, pulling down the average asking rent to $54.90 per square foot. In 2020, the mean rate contracted 8.5 percent.

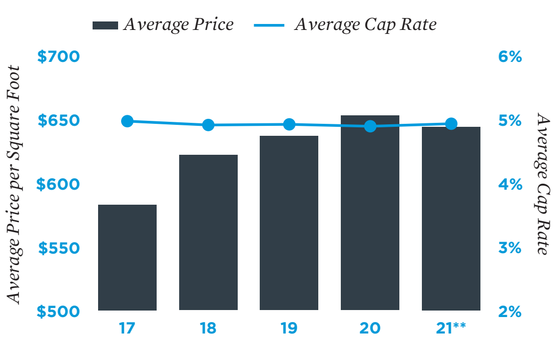
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

IPA Office

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2Q21 — 12-Month Period

CONSTRUCTION

3,405,000 sq. ft. completed

- Office inventory has grown 2 percent during the past year as projects that were started well before the health crisis were finished.
- The pace of construction is expected to ease as developers tap the brakes in light of current conditions. Approximately 3.4 million square feet is underway across the market.

VACANCY

710 basis point increase in vacancy Y-O-Y

- Vacancy climbed to 18.8 percent at midyear after office tenants returned 9.2 million square feet to the market during the past year.
- Over the yearlong period ending in June, Class A vacancy increased 800 basis points to 18.7 percent. Class B/C vacancy rose 600 basis points to 18.8 percent during that time.

RENT

10.7% decrease in the average asking rent Y-O-Y

- The average asking rent was $57.58 per square foot in the spring period. Contraction slowed moderately in the first half of this year as the average rate declined 4.6 percent.
- Class A and Class B/C asking rent declined 11.1 percent and 10.3 percent, respectively, over the 12-month period ending in June.

Investment Highlights

- Buyers continued to await more clarity on the pace of the local office recovery. Year over year, transaction velocity declined by approximately 50 percent, led by a decrease in Class B sales of 65 percent. Class C deals showed the most resiliency during the period, falling a more modest 33 percent.
- The average price for office properties remained stable during the 12-month period ending in June relative to the prior year. Investors paid an average of $644 per square foot during that time. Class A and B buyers targeted assets with established tenants secured under long-term leases that could surpass the local challenges. Class C investors took advantage of some discounting to acquire properties.
- Since 2018, the average cap rate has held firm at 4.9 percent, indicative of an ROI floor desired by local office buyers. The spread between average first-year returns for Class A and Class C deals widened during the 12-month period ending in June as the short-term risk profile for lower-tier properties increased.