MARKET REPORT

Office

San Francisco Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

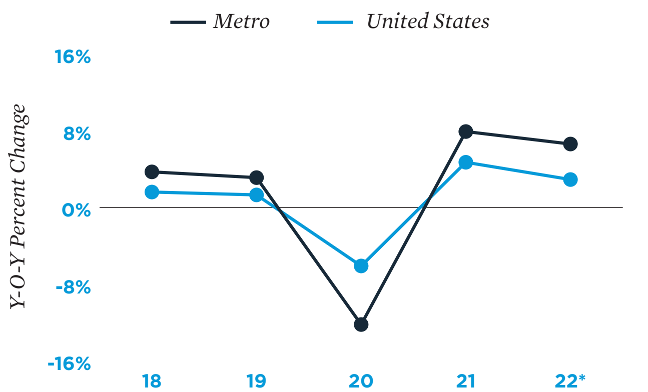
2Q/22

San Mateo Offices Return to Positive Path as San Francisco Waits on Demand Recovery

San Mateo posts initial gains. Office fundamentals across the San Francisco metro are starting to turn the corner following a challenging two years. Vacancy and rent metrics, while still moving in the wrong directions, are beginning to shift, largely due to renewed demand in San Mateo County. Space absorption here has been net positive since April 2021, lowering availability and fostering mild rent growth over the subsequent 12 months. This inclination will continue, with new leases recently signed for 2023 move-ins. Among firms expanding in the area is video game developer Roblox. While employees of the company can choose to work mostly from home, new graduate hires are required to be in the office. These and other hybrid policies from employers will buttress space needs, even as marketwide office utilization lags 2019 levels by over 60 percent.

City of San Francisco still challenged. Absorption in San Francisco proper has yet to turn net positive, but new lease signings could foretell a change. Cryptocurrency firm Ripple Labs recently signed on for 124,000 square feet on Battery Street. Ample space must be backfilled, however, before demand can start to reverse the course of vacancies and rents. The most prominent recent sublease was from Sephora, which will be taking 233,000 square feet from Salesforce next year as the beauty products firm consolidates offices into one, larger location. Compounding subleasing availability is new supply pressure. While the 270,000 square feet expected here in 2022 is modest, 85 percent of the space was unclaimed as of June.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

75,000 JOBS *will be created*

EMPLOYMENT:

The creation of 24,900 jobs through the first four months of the year puts metro employers on track to expand staff counts by 6.6 percent in 2022. About 26,000 of the new positions will be in traditionally office-using fields, a 5.2 percent year-over-year gain.

1,700,000 SQ. FT. *will be completed*

CONSTRUCTION:

Two buildings in a life science hub lead a San Mateo County-heavy pipeline that will grow market inventory by 1 percent in 2022. A slowdown in deliveries from last year's 2.9 percent expansion, a decade-plus high, should aid vacancy.

130 BASIS POINT *increase in vacancy*

VACANCY:

After climbing 920 basis points in 2020 and 2021, the metro's vacancy rate will advance by less than one-seventh of that magnitude in 2022 to 19.4 percent. Declining availability in San Mateo County is beginning to help the overall market change course.

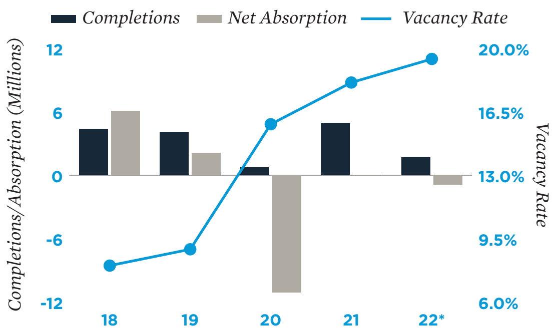
1.1% DECREASE *in asking rent*

RENT:

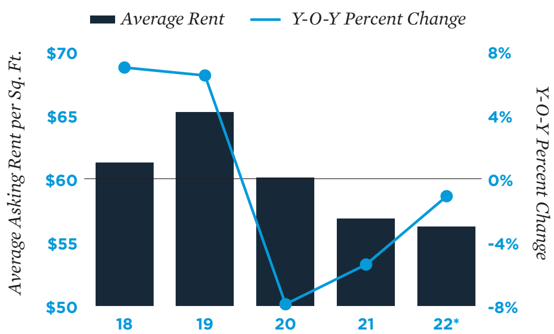
Asking rents will dip by a much more moderate pace in 2022 following last year's 5.4 percent decline, the steepest drop of any major metro at the time. In 2022, the average marketed rate will adjust to $56.25 per square foot.

IPA INSTITUTIONAL PROPERTY ADVISORS

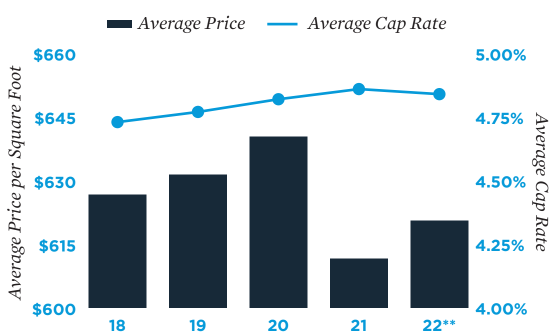
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

San Francisco Office:

David Nelson

Regional Manager

Tel: (510) 379-1200 | david.nelson@marcusmillichap.com

For information on national office trends, contact:

John Chang

Senior Vice President, Director | Research & Advisory Services

Tel: (602) 707-9700 | jchang@ipausa.com

Price: $250

1Q 2022 - 12-Month Period

CONSTRUCTION

4,713,000 sq. ft. completed

- The pace of deliveries quadrupled over the past four quarters compared to the previous 12-month span, led by the June 2021 arrivals of Uber's Mission Bay headquarters and Facebook's Burlingame Point campus.
- Future supply pressure is dependent on how much of the ample 23 million square feet of projects under proposal ultimately come to fruition.

VACANCY

50 basis point increase in vacancy Y-O-Y

- The metro's overall vacancy rate climbed to 18.7 percent in March, driven entirely by a 170-basis-point year-over-year rise within the city of San Francisco to 22.3 percent. Availability is highest in Downtown South.
- In stark contrast to San Francisco proper, across San Mateo County, vacancy fell 200 basis points to 10.5 percent over the 12 months ended in March.

RENT

2.8% decrease in the average asking rent Y-O-Y

- While the overall average asking rent slid further to $57.13 per square foot in the first quarter, annual growth did occur in Central and North San Mateo County, where positive net absorption has been most prevalent.
- Comparatively tighter availability has contributed to slower rent declines among Class A space than in the Class B and C tiers.

Investment Highlights

- Investment activity kept consistent levels between 2020 and 2021, although about 40 percent fewer assets changed hands last year than in 2019, given substantial pressure on property fundamentals. The impact to operations has also had an effect on pricing. The average sale price for trades completed in the 12-month period ended in March was $620 per square foot, down 2 percent from the previous annual span.
- The metro's mean cap rate continues to hold within the 4.7 percent to 4.9 percent band, where it has rested since 2016. Only San Jose and Los Angeles have tighter first-year yields, and as climbing interest rates put pressure on investors' margins, transaction velocity could temper.
- As in past years, about half of all trades involved San Mateo properties, with the Central County submarket posting the most activity. Entry costs were frequently below market, with cap rates that could rise above 6 percent for older Class C assets. Several transactions were for redevelopment purposes, including office parks in Redwood City and Burlingame.
- Sales velocity in medical offices has slowed since 2018, with recent trades involving assets built before 1970. Buyers may be factoring in age for higher yield, as medical office cap rates here trend under mid-4 percent.