

MARKET REPORT

Office
San Francisco Metro Area

IPA
INSTITUTIONAL
PROPERTY
ADVISORS

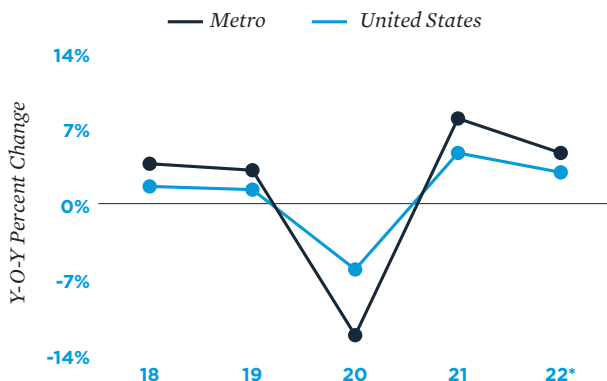
4Q/22

High-Profile Commitments and Robust Metro Pre-Leasing are Positive Signs for a Market Rebound

Large leases reveal companies are beginning to claim more space. At the end of June, Google Cloud signed a lease amounting to nearly 300,000 square feet in South of Market. This was the largest direct lease since the onset of the pandemic, after a 230,000-square-foot sublease inked by Sephora in January and a 200,000-plus-square-foot commitment signed by Roblox in March. While vacancy remains high in Greater San Francisco, the commitment by Google Cloud exhibits a potential trend toward larger leases and company willingness to sign long-term agreements in Downtown South. Space demand is also improving southeast of downtown, from Mission Bay down to Bayview, as availability here compressed 200 basis points on a quarterly basis to 17 percent. Positive net absorption here through midyear exists as a bright spot amid the prevailing uncertainty the pandemic has placed on the San Francisco office sector.

High pre-leasing is a potential tailwind. Of the 2.3 million square feet of office space currently underway in the metro with delivery dates extending into 2025, nearly half is expected in south San Mateo County. Most of these builds were completely pre-leased as of September. Similarly, projects in San Francisco proper were around 90 percent pre-leased. Sustained elevated vacancy in the overall market may stall some proposed projects, allowing the current construction pipeline to be integrated into the market with minimal negative impact on availability. Additionally, the lack of unoccupied builds is likely to guide expanding companies into existing space.

Employment Trends



* Forecast
Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook



54,000

JOBS

will be created

EMPLOYMENT:

After surpassing the pre-pandemic high at the end of 2021, the number of traditionally office-using jobs will expand by an additional 4.6 percent in 2022. About 23,000 new positions will be added in such fields.



1,700,000

SQ. FT.

will be completed

CONSTRUCTION:

Deliveries will taper this year, following the nearly 5 million square feet that came online in 2021. The current construction pipeline as of September included projects as large as 300,000 square feet.



180

BASIS POINT

increase in vacancy

VACANCY:

Vacancy will rise to 19.8 percent, as remote and hybrid firms evaluate their space needs once leases expire. This will mark the third year of availability decompression, though the rate will rise slower than the last two years.



2.2%

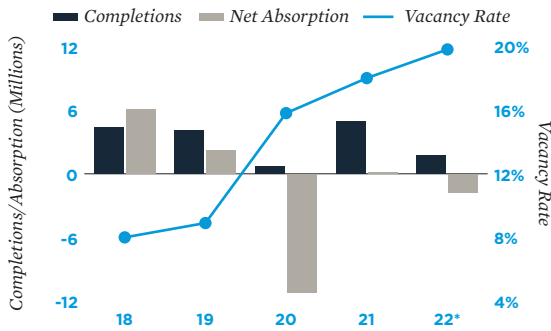
DECREASE

in asking rent

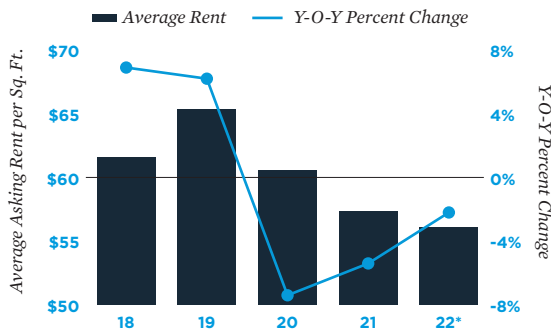
RENT:

After a 74 percent drop in 2020 and a 5.4 percent decrease in 2021, the average asking rent in San Francisco will end the year at \$56.05 per square foot. This is the lowest mean rate in the metro since 2016.

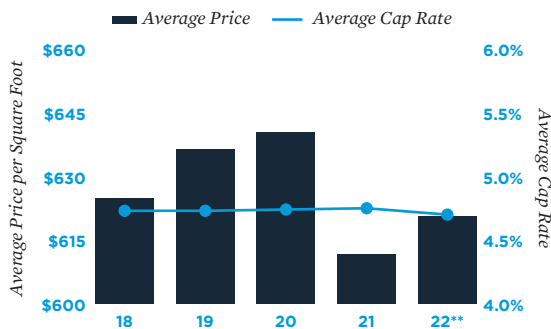
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 2Q

Sources: CoStar Group, Inc.; Real Capital Analytics

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2Q 2022 - 12-Month Period



CONSTRUCTION

2,523,000 sq. ft. completed

- Completions in the trailing 12 months ended in June expanded metro stock by 1.4 percent. Only around 530,000 square feet came online in the first half of this year, however.
- Deliveries were split between the CBD and the suburbs during this span. San Mateo County's inventory grew the fastest by 2.5 percent.



VACANCY

90 basis point increase in vacancy Y-O-Y

- Availability rose to 19.7 percent in the second quarter, driven by 1.1 million square feet coming back to the market in the core.
- The vacancy rate in suburban areas compressed by 170 basis points year-over-year in June to 12 percent, offsetting some of the negative net absorption in the Downtown South and Downtown Core submarkets.



RENT

3.4% decrease in the average asking rent Y-O-Y

- The average asking rent shrunk to \$56.28 per square foot in June. Rent slides in some submarkets were mitigated by a 22.2 percent rise in North San Mateo County.
- Rents in the western half of the city grew by an average of 12.6 percent, allowing the mean asking rent there to reach \$75.87 per square foot.

Investment Highlights

- As some signs of recovery emerged, the mean price per square foot fell at a slower pace than in 2021. The average price per square foot over the four-quarter period ended in June was \$620 per square foot, a 1 percent dip from the previous yearlong span. This price point landed only \$20 per square foot below the metro high recorded at year-end 2020. Meanwhile, the mean cap rate remained in the high-4 percent range.
- Transaction velocity rose by 55 percent in the yearlong period preceding July. A greater number of trades also involved properties over \$20 million, indicating a rise of institutional capital and multi-property sales compared to last period. The southern downtown area of San Francisco noted a climb in trades in 2022 compared to the last two years. Investors have made note of prices in the mid-\$600 to low-\$800 per square foot range for older Class B/C builds. In prior years, the price per square foot rarely fell below \$1,000.
- In the trailing 12-month period, medical office sales increased well above what was typical in 2018 and 2019, before the health crisis. Class B assets were typically traded in central and northern San Mateo County, as well as in outlying San Francisco, for around \$700 to \$800 per square foot.