

INVESTMENT FORECAST

OFFICE
San Francisco Metro Area

IPA
INSTITUTIONAL
PROPERTY
ADVISORS


2020


Large, Contiguous Blocks of Space Remain in High Demand; Low Supply Supporting New Construction


Awash with capital, tech firms target premier office space in San Francisco. Despite rent doubling over the past decade, technology companies appear unfettered when leasing premium office space in the metro, a trend that will persist this year. Pinterest, Google and Asana committed to large blocks of space in the past 12 months, while Facebook committed to all 800,000 square feet at Burlingame Point when the campus comes online around midyear. A lack of large blocks of available space encourages tenants to ink new leases months ahead of availability, which has pushed pre-leasing to nearly 70 percent across the metro. More than half of the unleased space under construction is in the First Street Tower. Currently the largest project underway, the 1.25 million-square-foot development finishes in 2023. Smaller, traditional office users are feeling the pressure from the heated market. Year-over-year rent gains in the Class B/C sector accelerated to more than 7 percent due to tight vacancy.


Institutional investors dominate local office market. The average cap rate compressed to 5 percent last year, the lowest level of the current cycle. However, fewer Class C deals were among the mix of properties that transacted, indicating that first-year returns have shown resistance to further compression. Buyer demand is strong across all property types, though few Class C properties are moving as owners enjoy robust rent growth amid healthy vacancy. That trend could reverse course this year as investors searching for repositioning plays make aggressive bids. Additionally, some owners may take advantage of current pricing to upgrade or enlarge their portfolios through a 1031 exchange. The average cap rate in San Francisco is approximately 200 basis points lower than the national average. Institutional capital is drawn to Class A properties, where sales doubled in the past 12 months. Nonetheless, a single buyer accounted for nearly the entire increase in top-tier transactions last year.


2020 Market Forecast

- Employment**  Employers increase payrolls by 30,000 positions in 2020. Approximately 12,000 new spots will be in traditional office-using sectors. Last year, the employment base grew by 2.6 percent.

up 2.5%
- Construction**  Development remains near the cyclical peak, though strong pre-leasing should limit any impact on fundamentals arising from new stock.

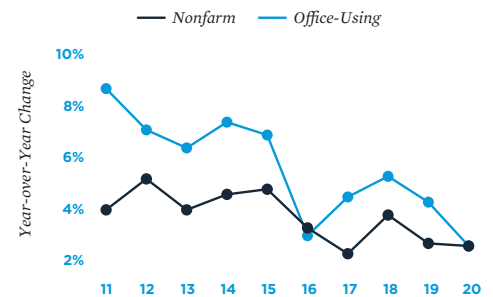
3.8 million sq. ft.
- Vacancy**  Vacancy dips to 8.1 percent this year. Last year, vacancy increased 60 basis points.

down 60 bps
- Rent**  The average asking rent builds on last year's robust gain of 10.7 percent. By year-end 2020, the average rent is projected to reach \$73.43 per square foot.

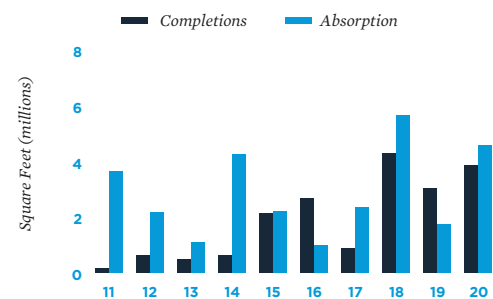
up 7.1%
- Investment**  Despite highly favorable asking prices, available inventory will determine deal flow this year. Owners of smaller properties will consider taking advantage of demand and move capital out of the market.

up 7.1%

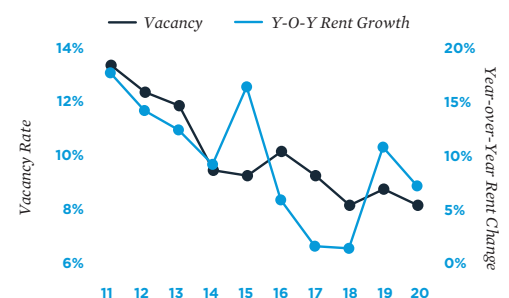
Employment Trends



Office Supply and Demand



Vacancy and Rent Trends



* Forecast
Sources: CoStar Group, Inc.; Real Capital Analytics

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Metro-level employment, vacancy and asking rents are year-end figures and are based on the most up-to-date information available as of December 2020. Asking rent is based on the full-service marketed rental rate. Average prices and cap rates are a function of the age, class and geographic area of the properties trading and therefore may not be representative of the market as a whole. Sales data includes transactions valued at \$1,000,000 and greater unless otherwise noted. Forecasts for employment and office data are made during the fourth quarter and represent estimates of future performance. No representation, warranty or guaranty, express or implied may be made as to the accuracy or reliability of the information contained herein. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice.