MARKET REPORT

OFFICE

San Francisco Metro Area

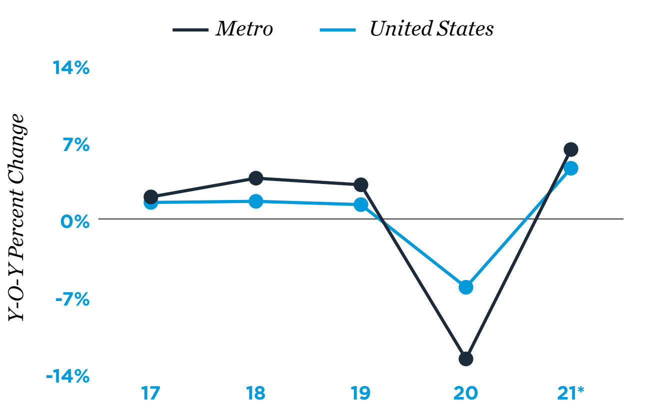
2Q/21

Flex Work Adoption Creates Near-Term Challenges; Long-Term Optimism Prevalent

Local economy shows signs of life. Businesses are beginning to bring employees back into offices and indoor dining resumed in January. However, the state remains under relatively stringent restrictions, preventing a more robust recovery in the service sector. Only 5,200 leisure and hospitality jobs were added in the first quarter and the sector remains approximately half the pre-recession size. Nonetheless, new positive COVID-19 cases have fallen significantly, and the state government has announced that all restrictions are expected to be lifted on June 15. Although a fully open economy will accelerate growth, international travel will need to return to previous levels to help the job market recover.

Office market faces mixed short-term outlook. San Francisco's tech companies have adopted flex work schedules more readily than traditional industries, such as finance. Salesforce, for example, announced earlier this year that some employees will be allowed to continue to work remotely even after COVID-19 restrictions are lifted. Other firms, including Twitter and Square, are also letting workers permanently stay away from the office. The short-term impact has been a surge in sublease space and canceled commitments. For instance, Salesforce has relinquished 550,000 square feet this year. However, the long-term outlook for the office market remains optimistic due to the solid core of both tech firms and talent. Over time, expanding firms eager to operate near their clients will backfill available spaces, particularly at today's reduced rates.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook

65,500 JOBS
will be created

EMPLOYMENT:

Vaccine distribution will begin to help the local tourism sector recover, generating both leisure and hospitality and retail jobs. Overall, payrolls will expand by 6.3 percent this year, including a 3.8 percent rise in traditionally office-using jobs.

4,480,000 SQ. FT.
will be completed

CONSTRUCTION:

Office stock increases 2.6 percent in 2021 as several large projects come online in the second half of the year. Pre-leasing remains healthy at more than 70 percent of the scheduled inventory owning commitments.

490 BASIS POINT
increase in vacancy

VACANCY:

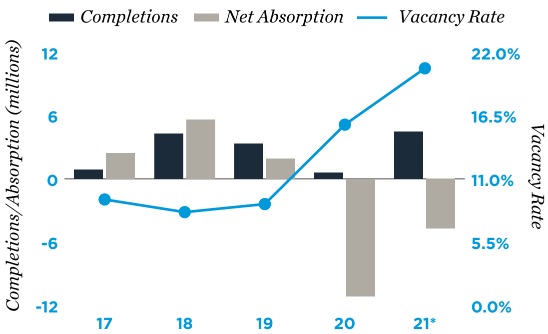
The availability rate surges to 20.6 percent by year end as office users lessen their footprints as leases expire and remote work plans are solidified. High-rent office towers could be particularly susceptible as firms impacted by the pandemic cut costs.

9.0% DECREASE
in asking rent

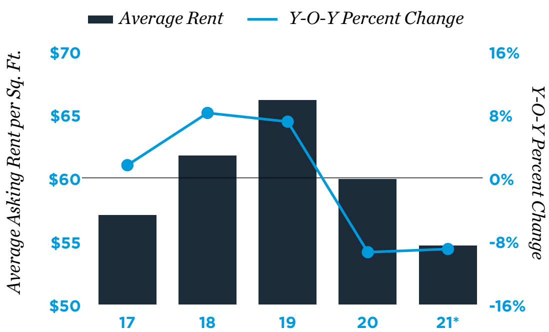
RENT:

The average asking rent will adjust lower as owners compete with vacant and sublease space on the market. By year-end, the average asking rent is projected to fall to $54.64 per square foot, the lowest level since 2015.

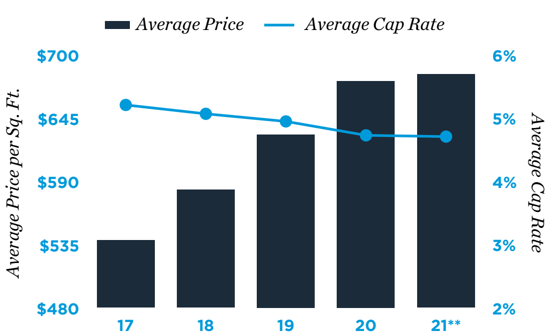
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

IPA Office

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1Q21 — 12-Month Period

CONSTRUCTION

745,000 square feet completed

- Office inventory increased by 0.4 percent during the 12-month period ending in the first quarter. In this year's opening three months, approximately 210,000 spare feet was completed.
- The largest project underway is 415 Natoma, which will add nearly 600,000 square feet to stock later this year.

VACANCY

840 basis point increase in vacancy Y-O-Y

- In this year's opening period, vacancy climbed 270 basis points to 18.4 percent. Following the previous recession, the peak was 16.8 percent.
- Class A vacancy rose 880 basis points in the past 12 months to 18.1 percent. The rise was less pronounced in the Class B/C segment, where the rate increased 790 basis points to 18.6 percent.

RENT

9.9% decrease in the average asking rent Y-O-Y

- Rapidly rising availability pushed the average asking rent down 9.9 percent to $58.83 per square foot in the first quarter. Asking rents have retreated back to a level last recorded at the end of 2017.
- Top-tier rent eroded 8.6 percent year over year, while Class B/C rent decreased 11.4 percent.

Investment Highlights

- Following a strong year in 2019, deal flow fell 65 percent in 2020 due to uncertainty created by the health crisis. In the early months of this year, the pace of transactions appears to be accelerating as buyers seek opportunities to purchase discounted properties. Class A assets have garnered the most interest relative to last year.
- Year over year through the first quarter, the average price advanced 6 percent to $683 per square foot. The average cap rate compressed 20 basis points to 4.7 percent. Although prices climbed, the increase can be attributed to higher-quality assets changing hands rather than property appreciation during the period.
- Buyers that remained active last year moved to the suburbs but took a defensive position as the near-term future of San Francisco's office market was among the most cloudy in the country. Class B and Class C properties in San Mateo County that are proximate to San Francisco or Silicon Valley continue to present opportunities for buyers awaiting more clarity on the future of the dense urban core.