TRANSWESTERN

SAN FRANCISCO OFFICE MARKET

Q1 2023

OFFICE MARKET DEMAND REMAINS DIM BUT VC FUNDING IMPROVES

Overall economic conditions in the San Francisco metropolitan area are strong but softening. The unemployment rate rose modestly to 2.8% in February, though it remained below 3.0% from one year ago and well below the long-term average. While the pace of job growth gradually slowed throughout 2022, the San Francisco economy still expanded by 52,800 jobs – a 4.6% annual growth rate, which exceeds pre-pandemic levels and compares with a national rate of 2.9%. Office-using jobs fared even better, growing by 27,700 jobs over the year, or 5.6%.

Hybrid work, tech layoffs and higher interest rates have led to more vacant space in an already struggling San Francisco office market. In the first quarter, vacancy climbed to a record high 24.9%, a 100-basis point jump from the prior quarter. Net absorption was negative with 904,400 SF of space returned to the market and a deep pool of sublet space continued to grow. Venture capital funding, which feeds office demand in the tech-heavy San Francisco market, rose on a quarterly basis for the first time in six quarters despite volalitlity in capital markets.

While supply and demand fundamentals look bleak, there are winners and losers. As tenants adjust to new working patterns and get rid of underutilized space, the supply of available space will continue to grow, presenting opportunities in 2023 for tenants looking for higher-quality spaces that align with their cost containment goals. Older buildings with fewer amenities, however, will have a challenging time attracting new tenants. Office properties that become obsolete will provide opportunities for demolition or conversions.

TRENDLINES

	Q1 2023	Q1 2022	CHANGE	FIVE-YEAR AVERAGE
Nonfarm Jobs (Thous.)	1,194	1,141	4.6%	1,138
Office-Using Jobs (Thous.)	525	498	5.6%	482
Kastle Barometer - Occupancy (%)	43.3	31.2	12.1%	--
Sublease Availability (%)	9.9	8.4	150 bps	6.3
Net Absorption (Thous. SF)	-904	-1,001	9.6%	-520
Overall Vacancy Rate	24.9	18.9	600 bps	12.4
Class A Direct Rents ($/SF)	64.02	71.71	-10.7%	74.44
Under Construction (Mil. SF)	1.7	1.6	7.2%	2.0
Investment Volume ($ Mil.)	192	34	470.8%	717
Venture Capital Funding ($ Bil.)	21.5	48.2	-55.3%	31.6

Source: Transwestern, CA EDD, Kastle Systems, RealPage, Real Capital Analytics, Pitchbook, Q1 2023.
Note: Employment figures as of February 2023. Data not seasonally adjusted.

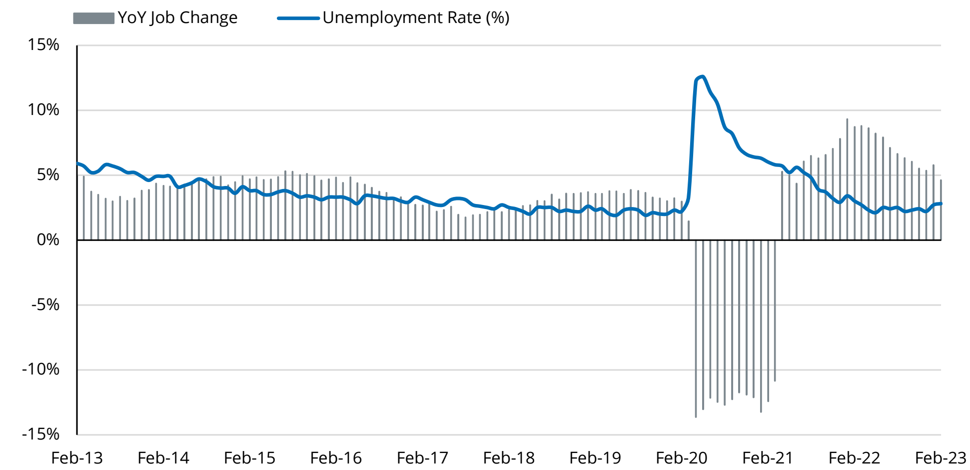
ECONOMY

Annual Job Growth Moderates to 4.6%

- The unemployment rate in the San Francisco metropolitan area edged up to 2.8% in February from one of the lowest rates in history, but was down from 3.0% one year ago and 12.6% at the onset of the pandemic.
- The regional labor market has showed signs of strength despite cooling from a blistering pace in 2022. Employers added 52,800 jobs annually, or 4.6% year over year, outpacing the national rate of 2.9%.
- Jobs gains were driven by a 12.2% increase in Leisure and Hospitality employment, the hardest hit sector during the pandemic. Professional and Business Services, the region's largest sector, rose by 5.2% from one year ago.
- Office-using industries added 27,700 jobs, jumping 5.6% from last year and exceeding pre-pandemic levels by 8.0%.

UNEMPLOYMENT RATE AND OFFICE-USING JOBS

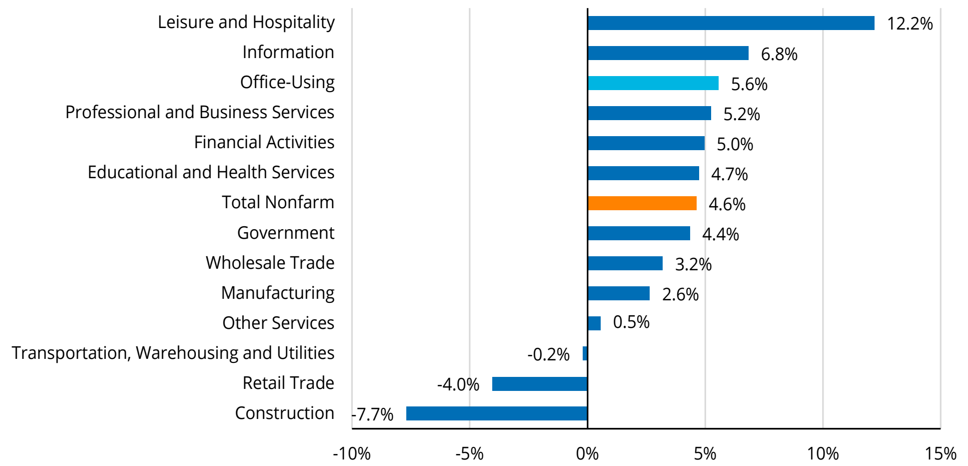
San Francisco MSA



Source: Transwestern Research, CA EDD, February 2023.
Note: Data not seasonally adjusted.

YOY EMPLOYMENT CHANGE BY INDUSTRY

San Francisco MSA



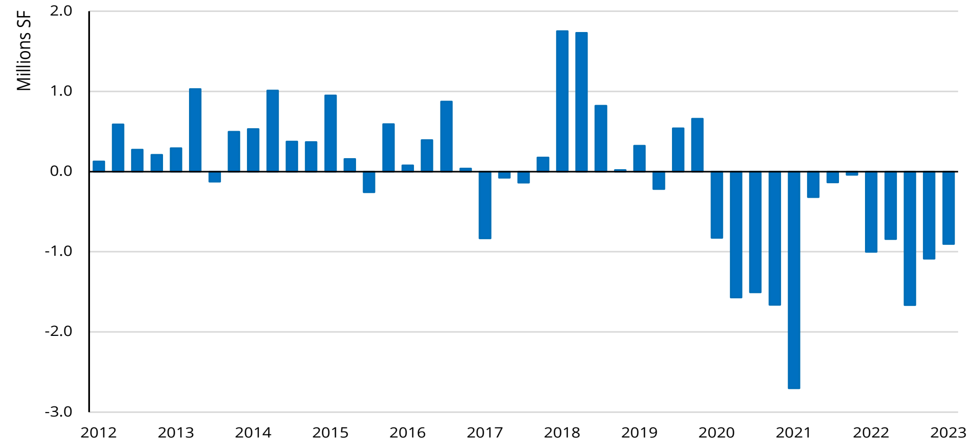
Source: Transwestern, CA EDD, February 2023.
Note: Data not seasonally adjusted.

SUPPLY AND DEMAND FUNDAMENTALS

Companies Continue to Reduce Real Estate Footprints

- Net absorption was negative 904,400 SF in the first quarter, a marginal improvement from negative 1.1 million SF last quarter as companies continued to downsize, relocate or give up space altogether. Total net absorption since the start of 2020 stands at negative 14.3 million SF.
- A shift to a hybrid-based work model combined with growing tech layoffs has taken a large bite out of occupancy levels in the San Francisco. In Q1, Meta added 435k SF of space to the sublease market, Salesforce shed 125k SF at the Salesforce Tower, Pinterest announced a downsizing of 150k SF in SOMA, and Trulia and Autodesk reduced their footprints as well.
- Office occupancy was steady in Q1 according to data tracked by Kastle Systems, a security company, with San Francisco seeing an average of 43.3% of workers swiping into offices for the week of March 22, up from 31.2% one year ago.

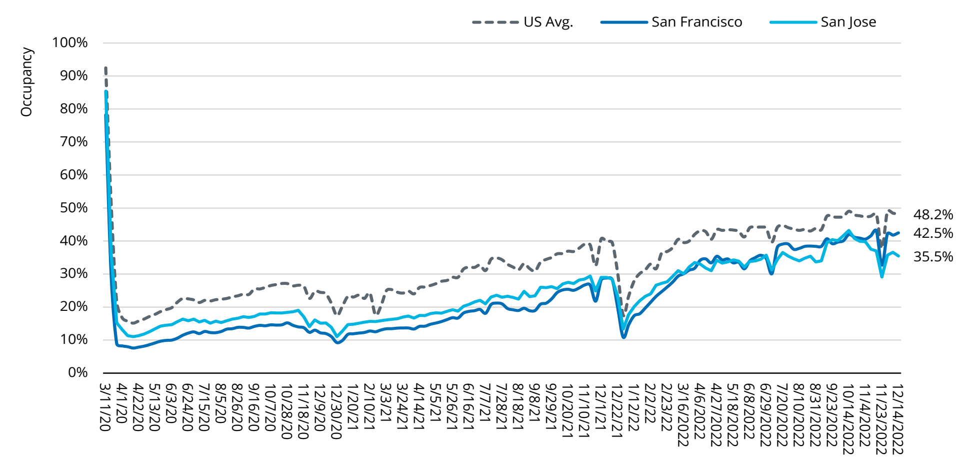
NET ABSORPTION



Source: Transwestern, CoStar, Q1 2023.

BACK TO WORK BAROMETER

Office Occupancy %



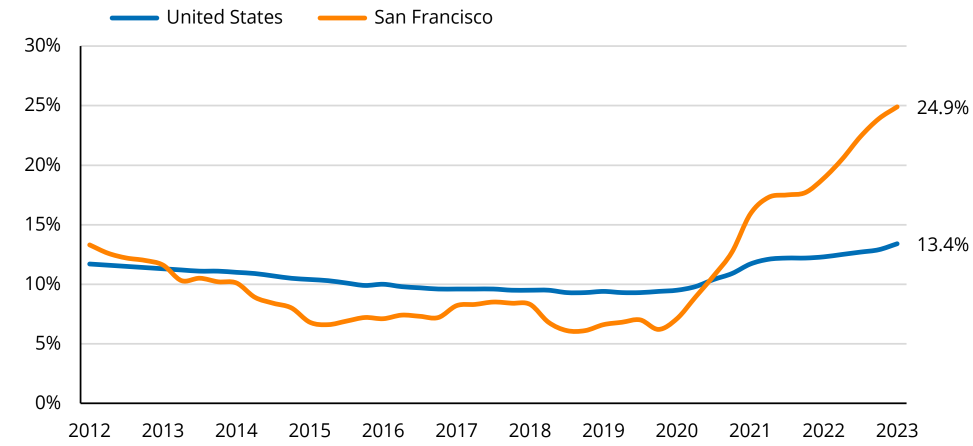
Source: Transwestern, Kastle Systems, March 2023.

SUPPLY AND DEMAND FUNDAMENTALS

Vacancy Rate Stubbornly Marches Up

- In Q1, the overall vacancy rate climbed 100 bps on a quarterly basis to 24.9%, the highest level on record, though the pace of growth has moderated for the second quarter in a row.
- Class A vacancy increased 120 bps to 23.7% in Q1 while Class B vacancy rose less sharply, by 70 bps to end the quarter at a higher rate of 27.1%. As leasing activity continues to trail behind pre-pandemic activity, companies are being strategic in securing high-quality spaces that will attract workers to the office.
- In Q1, there was almost 9.2 million SF of available sublet space, or 9.9% of total inventory. The sublease availability rate is up 150 bps from 8.4% one year ago as companies shed more space despite the market's deeply discounted sublet rates.

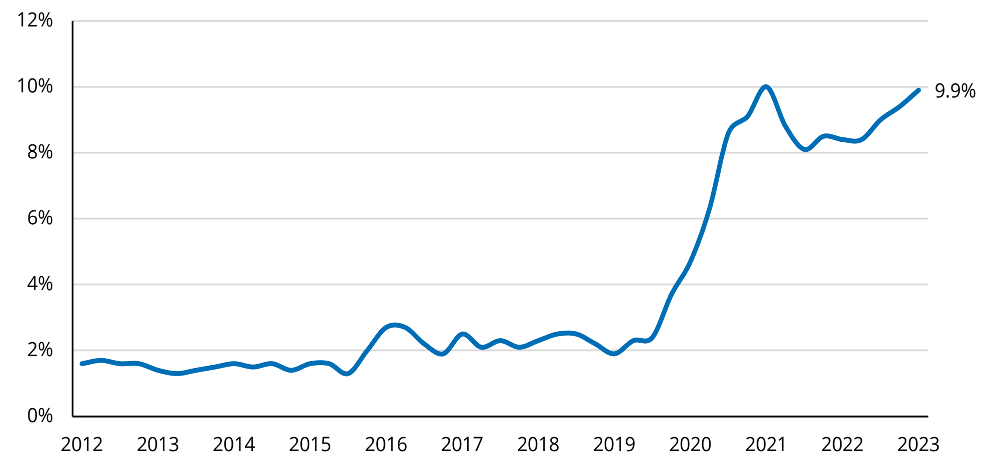
VACANCY RATE



Source: Transwestern, CoStar, Q1 2023.

SUBLEASE AVAILABILITY RATE

SF as % of Inventory



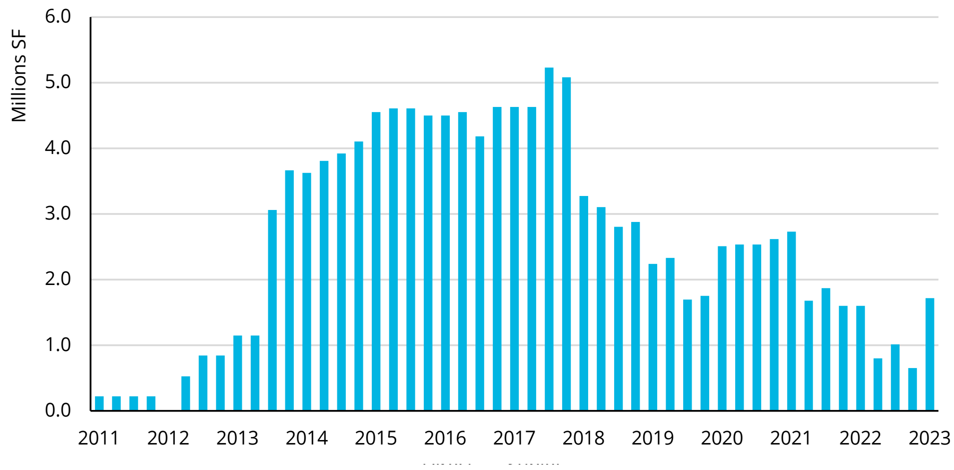
Source: Transwestern, CoStar, Q1 2023.

SUPPLY AND DEMAND FUNDAMENTALS

Rent Growth Slows as More Space Hits the Market

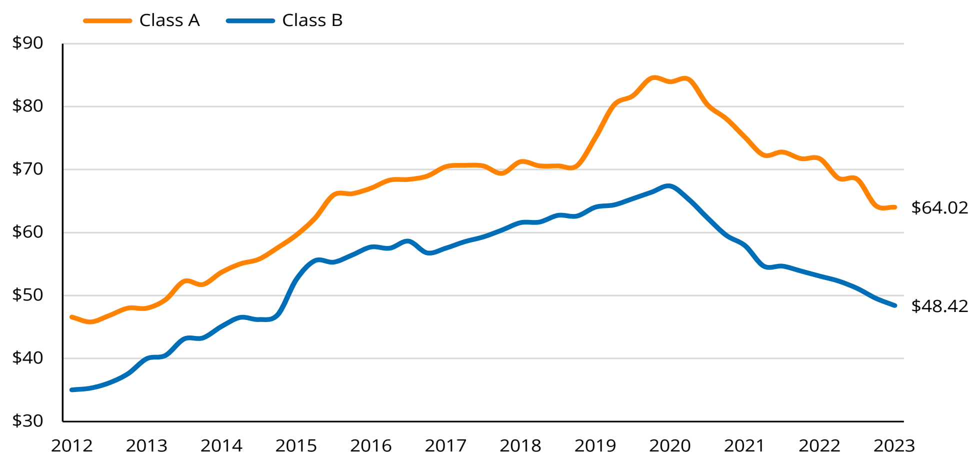
- Office construction totaled 1.7 million SF in Q1, up from last quarter but trending down since 2017. New construction typically slows when supply exceeds demand. As the market becomes increasingly saturated with vacant space, development will continue to be muted in 2023.
- With office demand waning, especially for traditional office spaces, asking rents continued to decline from their pre-pandemic peaks. Overall direct rents edged down 2.0% from Q4 to end the quarter at $53.13. Class A rents budged down by 0.4% to end the quarter at $64.02 PSF. Class B rents decelerated 2.3% to $48.42 PSF, reflecting the flight to quality. Companies are being strategic about about securing high-quality spaces that will encourage a return to the office as occupancy levels remain stagnant.

UNDER CONSTRUCTION



Source: Transwestern, CoStar, Q1 2023.

DIRECT RENTS, $/SF



Source: Transwestern, CoStar, Q1 2023.

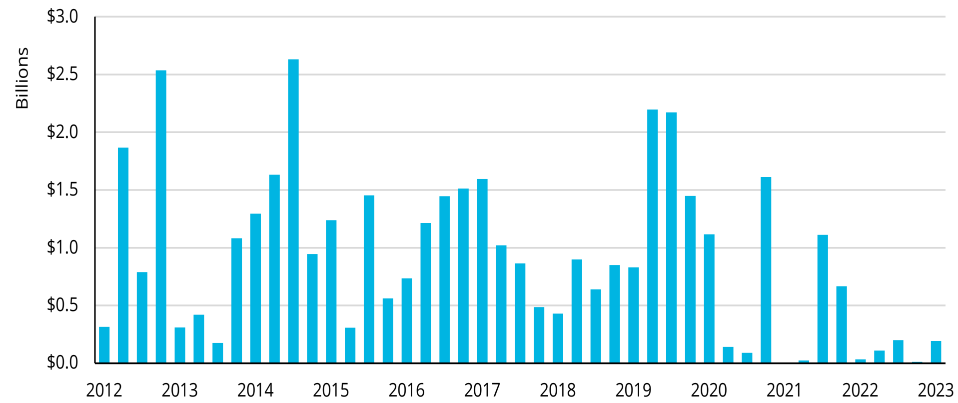
CAPITAL MARKETS

Investment Volume Subdued but Venture Capital Funding Improves

- Office deal volume remained subdued in Q1 with roughly $192 million trading hands. The four-quarter total fell year-over-year by 72.0% to $513 million. Financing acquisitions became difficult due to rising interest rates. Concerns over future demand of office space also slowed deal activity, and concerns over turmoil in the banking industry. The majority of commercial mortgages are held by smaller banks (less than $250 billion) and a record amount of commercial mortgages are expiring this year.
- Venture capital funding, an important source of office demand in the tech-heavy San Francisco Bay Area, reached $21.5 billion during Q1, a quarterly rise of 29.1% and a return back to pre-pandemic levels. The four-quarter total of $97.6 billion in capital invested was also back in line with pre-pandemic levels.
- VC funding in the first quarter was slightly skewed upward due to a megadeal in which Stripe, a financial software firm, raised $6.5 billion.
- Artificial intelligence-related companies accounted for $3.1 billion of the quarterly total, or 14.5%. While AI accounted for some of the larger deals (i.e. Adept raised $350 million and Anthropic raised $300 million), the share of VC funding last quarter was higher -- at 19.7%

INVESTMENT VOLUME

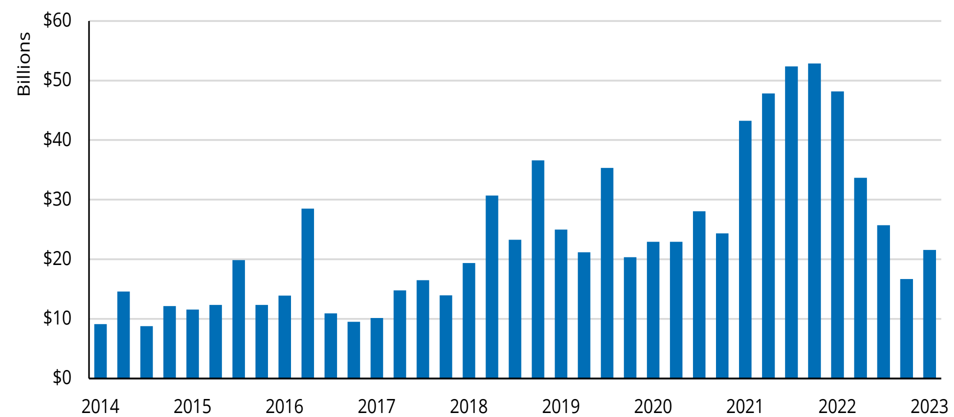
San Francisco CBD



Source: Transwestern, Real Capital Analytics, Q1 2023

VENTURE CAPITAL FUNDING

San Francisco Bay Area



Source: Transwestern, Pitchbook, Q1 2023.

TOP LEASES

TENANT	ADDRESS	SUBMARKET	SF LEASED	INDUSTRY
WAYMO	555 Market St		78,000	Information/Software
GIBSON, DUNN & CRUTCHER	1 Embarcadero Ctr	Financial District	41,551	Legal Services
UNKNOWN	505 Howard St	South Financial District	35,852	--
SHARTSIS FRIESE LLP	425 Market St		26,158	Legal Services
ENVOY	410 Townsend St		20,638	Information/Software

TOP SALES

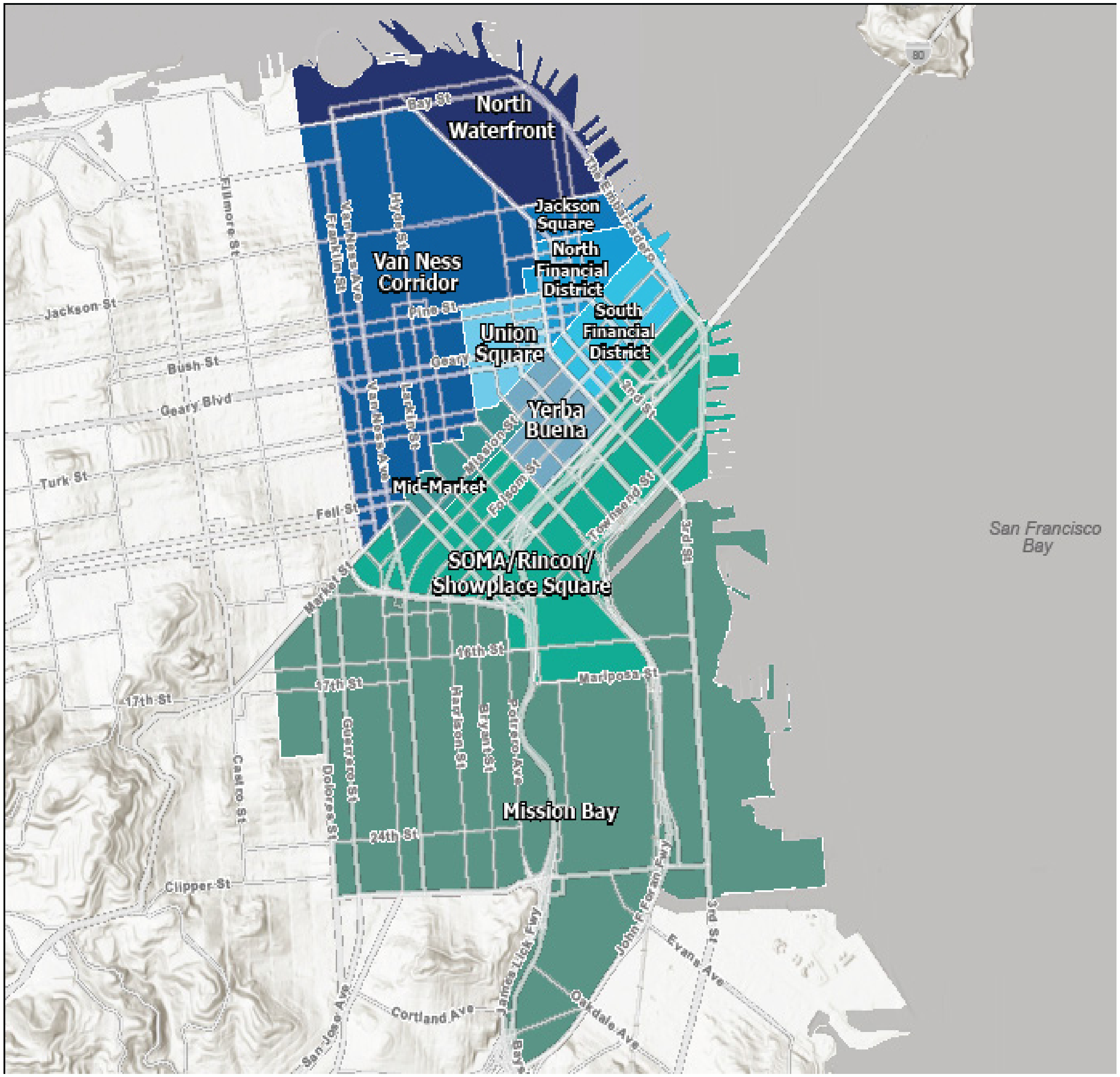
ADDRESS	CITY	PRICE ($ MIL.)	BUILDING SF	BUYER	SELLER
405 SPEAR ST	San Francisco	$82.5	161,650	Sobrato Development	Gap Inc
345 4TH ST	San Francisco	$52.8	49,580	Taipei Economic & Cultural Office	T2 Hospitality
807 MONTGOMERY ST	San Francisco	$38.0	10,397	807 Montgomery Street LLC	Daniel L Sabah; Joshua E Sabah
82-84 1ST ST	San Francisco	$12.0	30,872	Winhall 7 LLC	PLM Loan Mgmt Svcs Inc, 88 First Street SF LLC
131 FRANKLIN ST	San Francisco	$6.3	7,185	Sharyn R Grayson	iBorrow

SUBMARKET FUNDAMENTALS

SUBMARKET	INVENTORY SF	LEASING ACTIVITY SF	TOTAL VACANCY RATE	SUBLEASE AVAILABILITY RATE	QUARTERLY NET ABSORPTION SF	12-MO. NET ABSORPTION SF	UNDER CONSTRUCTION SF	ASKING RENT $/SF, CLASS A
NORTH WATERFRONT	3,084,618	30,073	26.1%	12.6%	-10,894	-118,649	0	$53.82
VAN NESS CORRIDOR	1,127,274	7,793	20.6%	0.5%	5,335	2,626	0	$50.06
JACKSON SQUARE	2,123,433	37,331	27.5%	5.9%	-53,792	-65,913	0	$45.05
NORTH FINANCIAL DISTRICT	29,528,268	265,103	26.2%	6.0%	-534,546	-1,710,939	0	$60.20
SOUTH FINANCIAL DISTRICT	27,234,886	281,042	19.3%	10.2%	-105,302	-1,330,918	0	$57.85
UNION SQUARE	3,799,351	26,605	25.9%	4.5%	-34,346	-107,320	0	$46.47
YERBA BUENA	3,607,825	5,828	48.4%	12.8%	-75,151	-131,080	0	$49.67
MID-MARKET	4,150,140	-	17.1%	13.6%	146,786	-39,587	235,071	$39.71
SOMA/RINCON/SHOWPLACE SQ.	10,358,878	59,445	27.6%	20.0%	-158,378	-705,485	202,961	$40.87
MISSION BAY	5,258,562	27,034	29.8%	11.2%	-84,080	-293,089	1,276,748	-
TOTAL	**90,303,235**	**740,254**	**24.9%**	**9.9%**	**-904,368**	**-4,502,392**	**1,714,780**	**$53.13**

Source: Transwestern, CoStar, Real Capital Analytics, Q1 2023.

SUBMARKET MAP



FOR MORE INFORMATION

George Entis

Senior Research Manager
george.entis@transwestern.com
415 489 1759

RESEARCH METHODOLOGY

The information in this report is a compilation of single- and multi-tenant office properties 10,000 SF and larger in downtown San Francisco. Medical offices and government-owned buildings are excluded from analysis.

ABOUT TRANSWESTERN

The privately held Transwestern companies have been delivering a higher level of personalized service and innovative real estate solutions since 1978. Through an integrated, customized approach that begins with fresh ideas, the firm drives value for clients across commercial real estate services, development, and investment management. Operating from 33 U.S. office, Transwestern extends its platform capabilities globally through strategic alliance partners whose unique geographic, cultural, and business expertise fuels creative solutions. Learn more at transwestern.com.