TRANSWESTERN

SAN FRANCISCO OFFICE MARKET

Q1 2024

RISE IN VACANCY RATE SLOWS; RECORD VC FUNDING INTO AI

Despite high borrowing costs for businesses and consumers, economic conditions in the San Francisco metropolitan area remain stable. The unemployment rate was 3.8% in February, up from 3.4% three months ago and remains near historically low levels. The pace of job growth was negative 1.4% year over year driven largely by layoffs in tech-related employment.

The local labor market remains tight, but hybrid work has led to more vacant space in the San Francisco office market, though at a slowing pace. In the first quarter, the total amount of office space available for lease climbed to a record high of 37.8 million square feet. The vacancy rate rose 50 basis points (bps) on a quarterly basis to 35.2%. Net absorption was negative with 455,420 SF of space returned to the market. Consequently, average rents declined 1.2% over the quarter to $61.73 PSF. Class A rents fell 0.8% to $68.98 PSF.

While supply and demand fundamentals are strained, capital markets are recalibrating with several notable discounted sales over the last few quarters. Venture capital funding, a demand driver in San Francisco, accelerated with $28.0 billion in Q1 2024, up 9.7% over the year and well above the 2015 to 2019 quarterly average of $19.9 billion. Artificial intelligence has emerged as a major tenant, accounting for 61.3% ($17.1 billion) of VC funding.

TRENDLINES

	Q1 2024	Q1 2023	CHANGE	FIVE-YEAR AVERAGE
Nonfarm Jobs (Thous.)	1,153	1,170	-1.4%	1,141
Office-Using Jobs (Thous.)	462	490	-5.8%	471
Kastle Barometer - Occupancy (%)	46.4	41.6	4.8%	--
Sublease Availability (%)	10.6	11.0	-40 bps	8.1
Net Absorption (Thous. SF)	-455	-1,166	60.9%	-1,135
Overall Vacancy Rate	35.2	27.5	780 bps	19.5
Class A Starting Rents ($/SF)	68.64	69.92	-1.8%	76.65
Under Construction (Mil. SF)	0.1	0.4	-78.5%	0.6
12-Mo. Investment Volume ($ Mil.)	572	1,947	-70.6%	4,894
Venture Capital Funding ($ Bil.)	28.0	25.5	9.7%	24.2

Source: Transwestern, CA EDD, Kastle Systems, MSCI Real Assets, Pitchbook, CoStar, CompStak, Q1 2024.
Note: Employment figures as of February 2024. Data not seasonally adjusted.

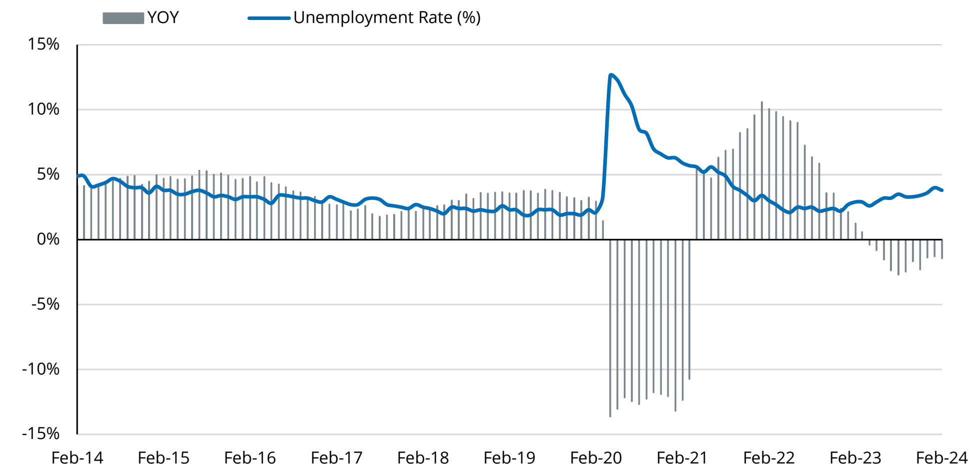
ECONOMY

Job Growth Declines by 1.4% YOY

- The February unemployment rate in the San Francisco metro area edged up 40 bps from three months ago to 3.8%. Though up from 2.9% one year ago, it has been under 4% for over two years. Overall it remains a tight labor market, though it is losing jobs on net due to layoffs in the tech sector. In Q1, the local labor market contracted by 16,900 jobs, or 1.4%.
- Jobs losses were driven by a year-over-year decrease of 11.5 in Information employment (-19,500 jobs). Office-using industries lost 43,900 jobs altogether, down 5.8% from last year. Educational and Health Services as well as Leisure and Hospitality offset some of those losses, growing by 4.3% and 4.2%, respectively.

UNEMPLOYMENT RATE AND OFFICE-USING JOBS

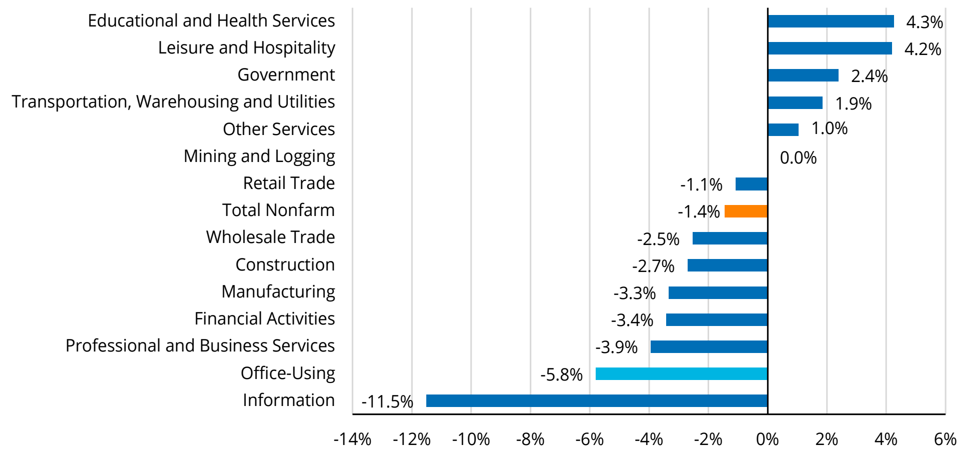
San Francisco-Redwood City-South San Francisco MD



Source: Transwestern, CA EDD, February 2024.
Note: Data not seasonally adjusted.

YOY EMPLOYMENT CHANGE BY INDUSTRY

San Francisco-Redwood City-South San Francisco MD



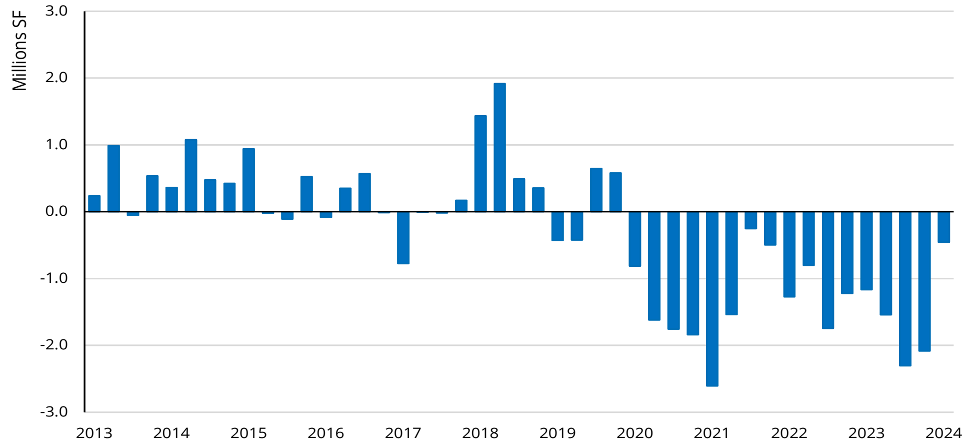
Source: Transwestern, CA EDD, February 2024.
Note: Data not seasonally adjusted.

SUPPLY AND DEMAND FUNDAMENTALS

Negative Absorption Continues; Office Occupancy Remains Steady

- A shift to a hybrid-based work model has reduced occupancy levels in San Francisco. Net absorption was negative 455,424 SF in the first quarter, making it the strongest quarter since Q3 2021, though companies continued to downsize, relocate or give up space altogether.
- Office occupancy was largely unchanged in Q1 according to data tracked by Kastle Systems, with San Francisco seeing an average of 46.4% of workers swiping into offices for the week of March 27, 2024. San Jose had the lowest of the major metros tracked with a rate of 43.4%, reflecting the Bay Area's large concentration of tech jobs.

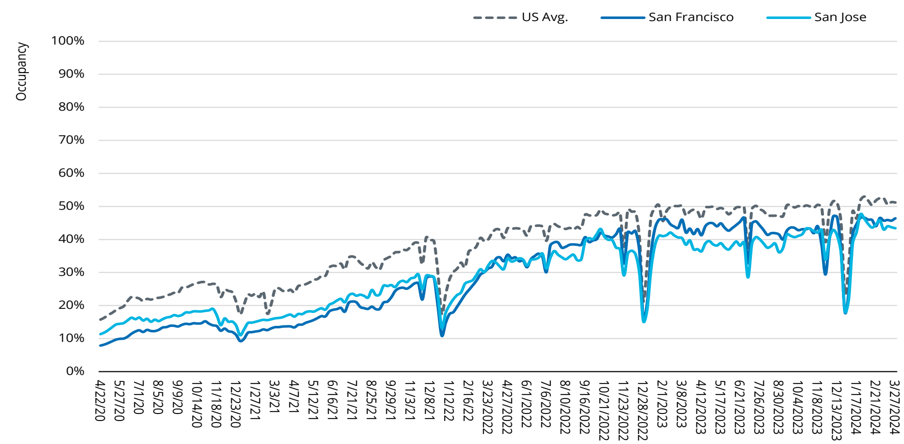
NET ABSORPTION



Source: Transwestern, CoStar, Q1 2024.

BACK TO WORK BAROMETER

Office Occupancy %



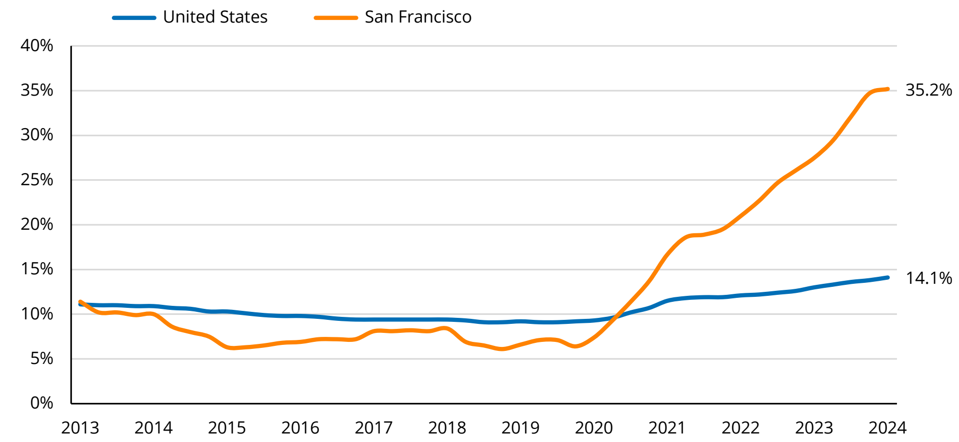
Source: Transwestern, Kastle Systems, March 2024.

SUPPLY AND DEMAND FUNDAMENTALS

Market Continues to Shed Space as Vacancy Rises

- In Q1, the overall vacancy rate rose 50 bps on a quarterly basis to 35.2%, the highest level on record. However, the pace of the rise is the slowest in nearly three years.
- Class A vacancy remained unchanged at 31.8% in Q1 while Class B vacancy rose by 100 bps to end the quarter at 41.3%.
- There was roughly 9.1 million SF of available sublet space, or 10.6% of total inventory. The sublease availability rate is down 30 bps from 10.9% one year ago as companies respond to the market's deeply discounted sublet rates. More importantly, tenants are taking subleases because they are newly built-out, fully furnished and well-located.
- In the first quarter, there was a total of 268,400 SF in subleases composed of 15 leases averaging 7,900 SF per transaction.

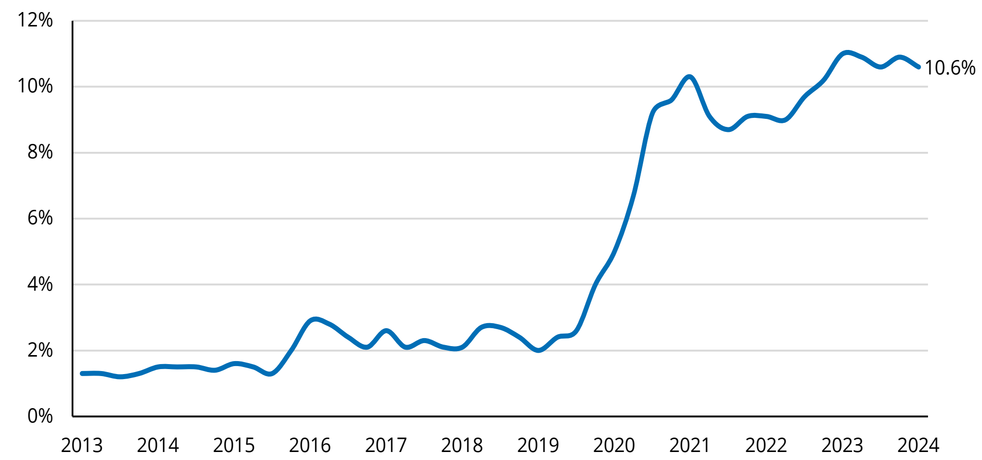
VACANCY RATE



Source: Transwestern, CoStar, Q1 2024.

SUBLEASE AVAILABILITY RATE

SF as % of Inventory



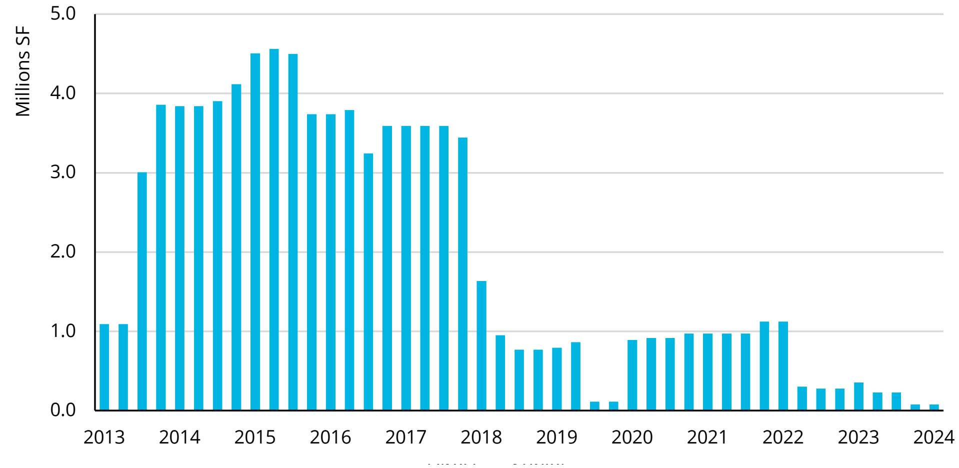
Source: Transwestern, CoStar, Q1 2024.

SUPPLY AND DEMAND FUNDAMENTALS

Rent Growth Slows as Vacancy Rises

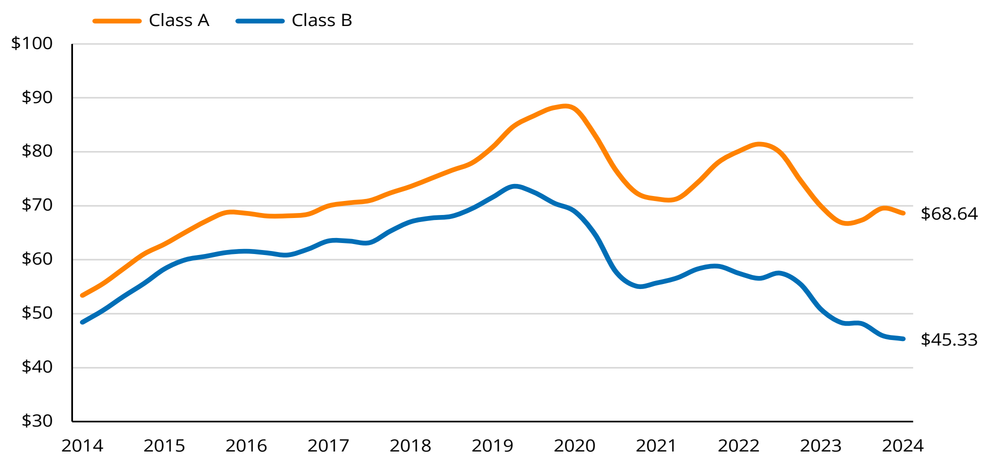
- Office construction totaled 76,200 SF in Q1, trending down since 2017. There are two buildings currently under construction. At 531 Bryant, Urban Land Development is building out a Class B office building that will reach roughly 51,000 SF. The S. Hekemian Group is also constructing 29,000 SF of Class B space at 828 Brannan.
- Average office starting rents edged down 1.2% from the previous quarter to an average of $61.73 PSF and was down 2.3% from one year ago. This compares with a pre-pandemic high of $81.57 PSF.
- By class segment, Class A starting rents fell 0.8% from Q4 to end the quarter at $68.98 PSF. Class B slowed by 1.8% to finish at $45.38 PSF. Pre-pandemic peak rents were $88.18 and $73.60 for the two segments, respectively.

UNDER CONSTRUCTION



Source: Transwestern, CoStar, Q1 2024.

STARTING RENT, $/SF



Source: Transwestern, CompStak, Q1 2024.

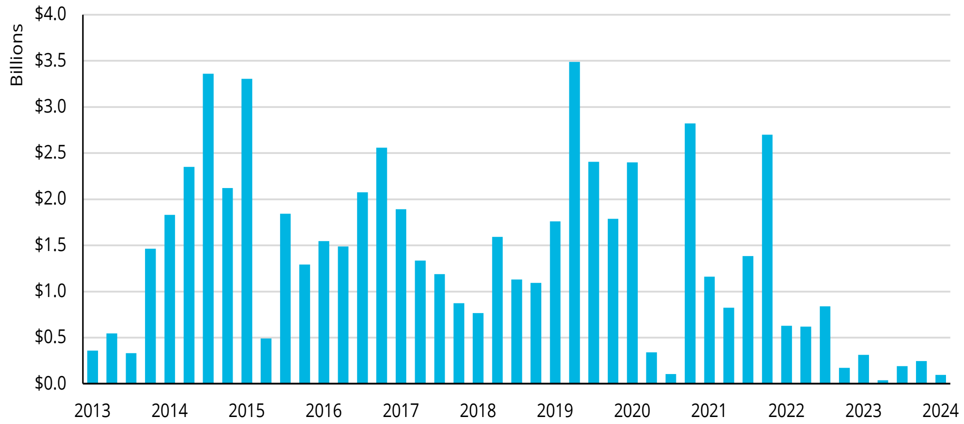
CAPITAL MARKETS

Investment Stalls; VC Funding Returns to Pre-Pandemic Levels

- The office sector recorded $96 million in Q1 deal volume in a market that frequently experienced over $1 billion in quarterly investment during pre-pandemic years.
- In Q1, the only transaction in excess of $10 million was Strada's purchase of 201 Spear St. from KBS REIT III for $67.2 million (255,000 SF at $264 PSF).
- Last quarter, Gaw Capital purchased 650 Davis for $82 million. The next largest transaction was a deal inked by Rubicon Point Partners for 123 Townsend at $72 million. These transactions have added to certainty in asset pricing, implying that going forward, new owners will have a reset on a lower basis.
- Venture capital funding, a driving source of office demand in the tech-heavy San Francisco Bay Area, reached $28.0 billion during Q1, a 37.6% jump from last quarter's $20.3billion. While funding has fallen from pandemic-fueled highs, capital is active and well above the 2015 to 2019 quarterly average of $19.9 billion.

INVESTMENT VOLUME

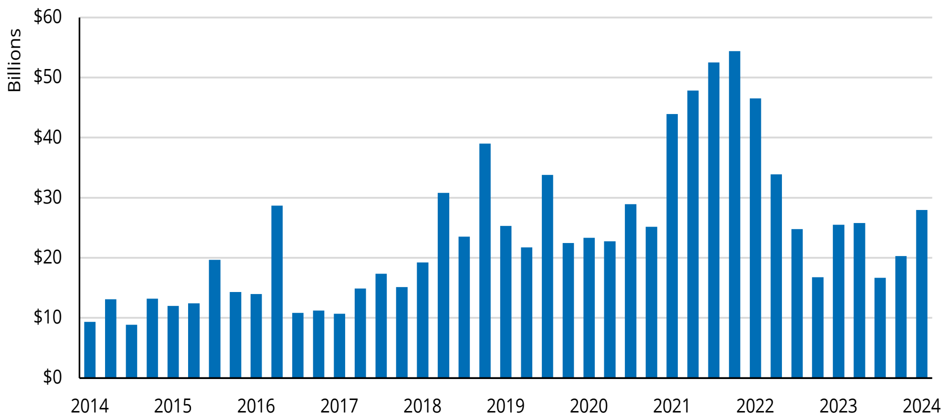
San Francisco CBD



Source: Transwestern, MSCI Real Assets, Q1 2024.

VENTURE CAPITAL FUNDING

San Francisco Bay Area



Source: Transwestern, Pitchbook, Q1 2024.

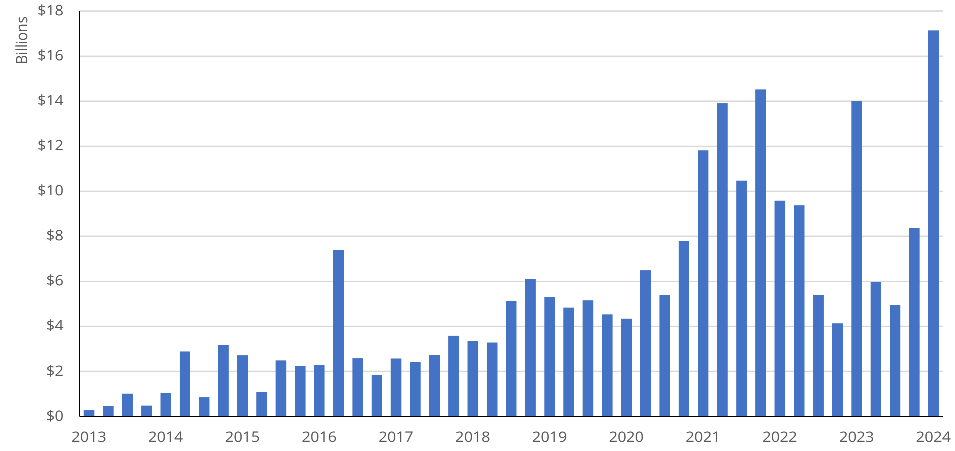
ARTIFICIAL INTELLIGENCE

AI Accounts for Nearly Half of VC Funding

- While overall venture capital funding has fallen from previously unsustainable levels, capital invested into artificial intelligence has offset some of that decline, especially in Q1. Companies operating in the AI vertical accounted for $17.1 billion of the quarterly total, or 61.3% - a record level.
- The largest deal of the quarter was Amazon's $4 billion investment in Anthropic. Figure AI closed on a $675 million investment from a group of investors and Lambda secured $320 million.

VENTURE CAPITAL FUNDING INTO AI

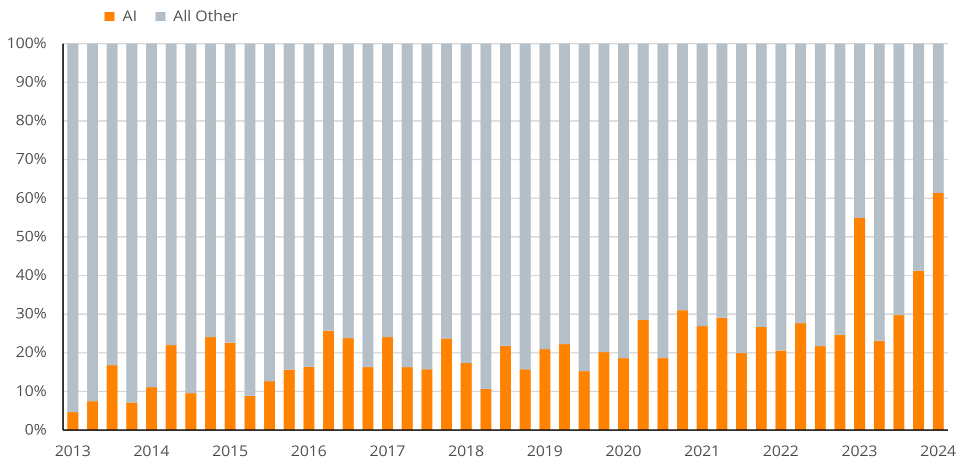
San Francisco Bay Area



Source: Transwestern, Pitchbook, Q1 2024.

VENTURE CAPITAL FUNDING

San Francisco Bay Area



Source: Transwestern, Pitchbook, Q1 2024.

TOP LEASES

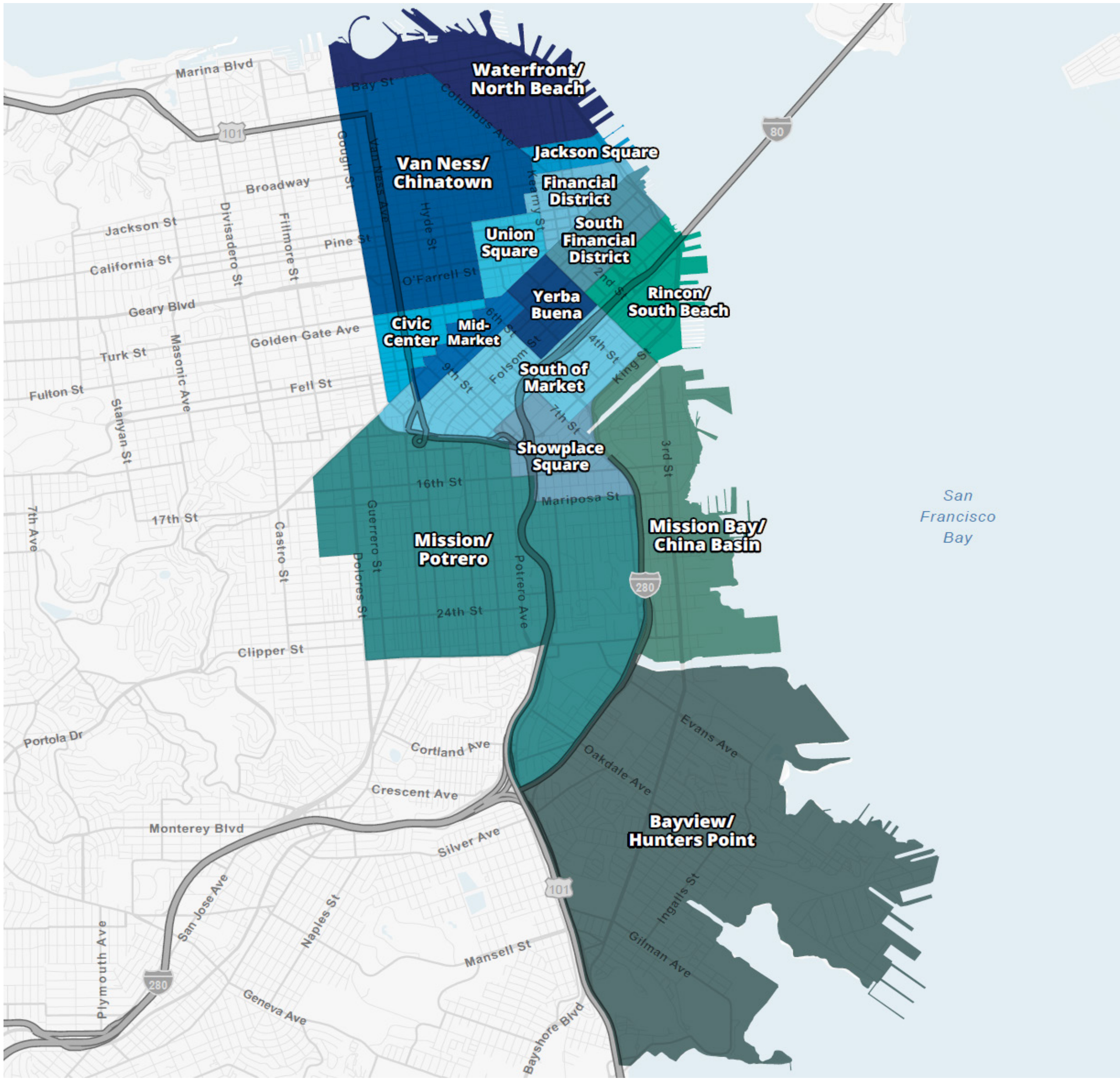
TENANT	DEAL TYPE	ADDRESS	SUBMARKET	SF LEASED	INDUSTRY
ADYEN	Sublease	505 Brannan St	South of Market	150,000	Financial Services
KPMG	Renewal	55 2nd St	South Financial District	142,785	Financial Services
RIPPLING	New Lease	400-430 California St	Financial District	123,320	Software and IT Services
FIGMA	Renewal	760 Market St	Union Square	97,606	Software and IT Services
GOODWIN PROCTER	New Lease	525 Market St	South Financial District	58,992	Legal Services

SUBMARKET FUNDAMENTALS

SUBMARKET	INVENTORY SF	LEASING ACTIVITY SF	VACANCY RATE %	QUARTERLY NET ABSORPTION SF	12-MO. NET ABSORPTION SF	UNDER CONSTRUCTION SF	FULL SERVICE RENT $/SF
BAYVIEW/HUNTERS POINT	345,991	1,660	24.1%	-38,361	-38,317	0	$40.71
CIVIC CENTER	431,400	885	47.0%	-14,091	-14,708	0	N/A
FINANCIAL DISTRICT	29,754,516	396,140	31.1%	46,489	-1,643,305	0	$67.24
JACKSON SQUARE	1,549,076	18,937	30.3%	21,731	40,411	0	$50.44
MID-MARKET	4,554,260	6,226	42.5%	48,284	-1,154,546	0	$60.98
MISSION BAY/CHINA BASIN	3,122,227	4,139	30.3%	-78,882	192,249	0	$84.28
MISSION/PORTRERO	1,103,615	20,421	43.9%	-55,526	-188,314	0	$51.75
RINCON/SOUTH BEACH	4,660,950	54,814	38.8%	96,883	-328,397	0	$48.42
SHOWPLACE SQUARE	3,073,567	6,179	43.9%	17,343	-179,173	24,956	$76.72
SOUTH FINANCIAL DISTRICT	23,571,848	366,753	32.8%	-31,025	-2,061,409	0	$78.44
SOUTH OF MARKET	2,148,051	39,360	49.4%	-61,249	-224,243	51,223	$60.98
UNION SQUARE	3,909,358	12,727	32.2%	-97,542	-167,900	0	$62.86
VAN NESS/CHINATOWN	1,169,131	3,840	24.2%	-5,662	-58,597	0	$63.82
WATERFRONT/NORTH BEACH	2,659,359	16,220	49.0%	-169,519	-336,580	0	$73.24
YERBA BUENA	3,611,837	3,981	54.8%	-134,297	-221,560	0	$56.79
TOTAL	**85,665,186**	**952,282**	**35.2%**	**-455,424**	**-6,384,389**	**76,179**	**$61.67**

Source: Transwestern, CoStar, Q1 2024.

SUBMARKET MAP



FOR MORE INFORMATION

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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.

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