Forecast 2021

San Francisco, CA

AVISON YOUNG

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Executive Summary

- Institutional owners of Class A buildings will likely offer additional free rent, improvement allowances and other tenant concessions in order to hold rental rates steady.
- With tech giants and others putting a myriad of subleases on the market, there will be greater optionality for tenants in what was once a very tight offering of options.
- In the race for a vaccine, the booming health and life science industries will help San Francisco's tech-driven economy rebound.

COVID-19 has fundamentally brought structural changes in the way we work. The impacts on the office market, whether they are short or long-term, will manifest itself in many ways. The uncertainty regarding the severity of these changes however will persist in the coming year. As 2021 unfolds, opportunities to have options will be a determining factor in how quickly San Francisco's office market will rebound.

The pandemic induced downturn is unlike any the San Francisco market has seen before. As the world navigates through unchartered territory, San Francisco's economic fundamentals give it a drastic advantage. Due to its high concentration of technology companies and venture capitalists, the life sciences industry will likely put San Francisco on a path back to economic recovery faster than most markets.

By the end of 2020, the overall asking rate dipped approximately 10% to $80.17 per square foot (psf), full service. Overall vacancy has climbed to 11% as large tech occupiers such Uber, Pinterest, Zendesk, and Credit Karma forego their space commitments or right size. As a result, approximately 9.0 million square feet of sublease space has hit the market, creating several opportunistic scenarios for both institutional landlords and tenants.

While remote work has proliferated during the pandemic, the market is noticing conflicting scenarios, particularly in the coming year. Working from home can be effective in the short-term; however, there has not been a clear narrative yet on its long-term detrimental impacts. As the market softens and demand decreases, companies will have more leverage in their leasing decisions. Whether this translates into businesses leasing less space is not clear long-term. Mentorship and culture are pervasive to every tech company's success, thus making remote work difficult to continue in a post pandemic world. Some companies, such as Facebook, Dropbox and Twitter, made headlines for announcing a permanent

Amid efforts to contain COVID-19, San Francisco will face hiring slowdowns in the coming year. However, historic recessions, such as the 2001 Dot.com bust, have shown the tech industry's resilience to such punches. Despite drops in rental rates and vacancies rising, these short-lived periods are rather minor. As technology has become more pervasive in society, San Francisco's economic infrastructure will shift its office market to a promising future.

Trend watch

Portfolio Flexibility: Carpe Diem

In order to attract top talent, tech companies will offer a hybrid work model as a supplement rather than as a substitute to collaborating in the office.

Alternative Investing: "Building Recovery"

An increase in PDR-flex space as the life sciences sector booms in the race for a vaccine.

work from home model over the next ten years. However, this may not necessarily reflect long-term strategic shifts in all companies. Instead it may act more as a supplement rather than a substitute to the office setting.

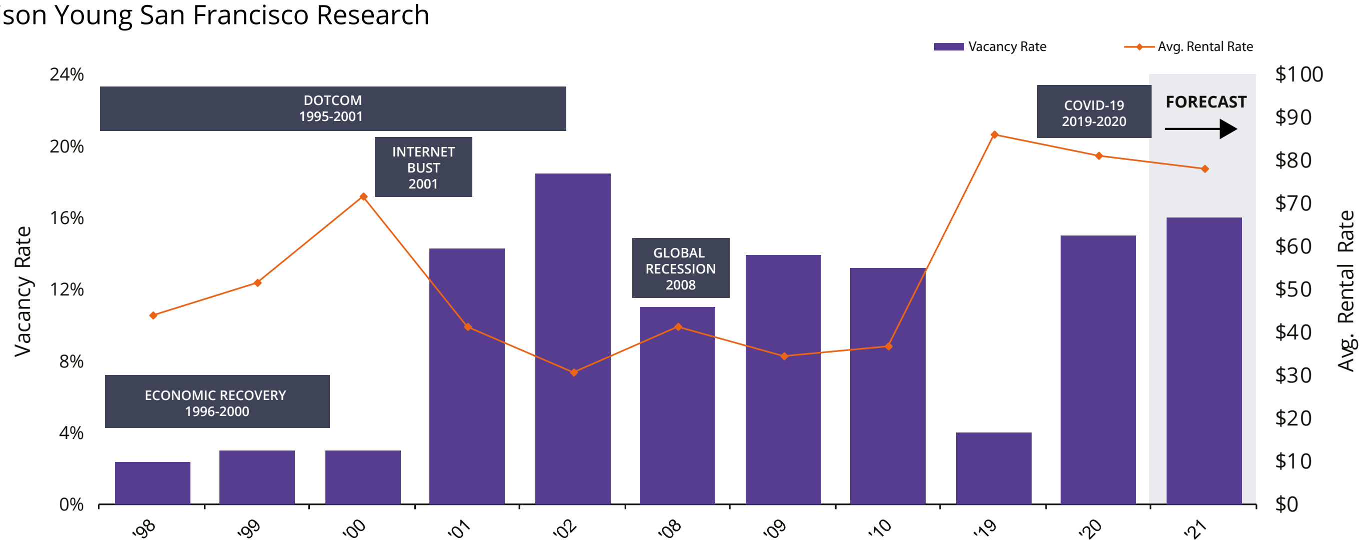
Landlords will respond to this market shift by adding amenities to their properties to attract the best tenants, who in turn pay higher rents to attract the best talent. Class A assets are positioned to fare better than Class B buildings as institutional owners in urban core centers may keep their face rates high with turnkey buildouts. Although leasing volume was subdued in 2020, there will be opportunities for tenants, particularly non-tech to move from Class B buildings to a Class A creative sublease space at a discount.

Although the office market is poised to bounce back, San Francisco's retail will continue to face challenges in 2021. With an uptick in overall vacancy to 4.3%, restaurants, retail, hospitality, and entertainment venues will continue to see the trickle-down impacts of social distancing measures. Low foot traffic, high cost of conducting business, and lost wages has been difficult for retail to stay afloat. Tourism, one of the primary drivers of income for San Francisco, has declined 90% since March 2020. The degree of economic destruction to retail remains uncertain, and until a vaccine is developed, the path to recovery looks bleak.

Despite the exodus of talent from offices to work from home scenarios in various geographies, the Bay Area is still home to leading universities such as University of California, Berkeley, Stanford, UCSF, USF, San Francisco State, University of Santa Clara, San Jose State. These schools are not relocating and will continue to attract young and innovative minds, fueling a highly educated workforce in the region for the unforeseeable future. Any outward migration of tenants or employees only creates an opportunity for new talent and employers to set their roots in San Francisco, which has historically been one of the most sought after and competitive markets in the world.

San Francisco Vacancy vs. Rental Rates Class A Office

Avison Young San Francisco Research



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