San Francisco office market report

Q1 2024

AVISON YOUNG

San Francisco office market trends

$132M

Low sales volume outlines continued pricing disparity

The increasing cost of capital due to mounting debt, high interest rates, and increasing vacancy have continued to weigh down asset pricing in San Francisco. While some potential sellers are trying to cut their losses, the appetite for acquisitions has seemingly increased, with a new generation of investors looking to capitalize on favorable pricing. The tepid total investment volume indicates that there continues to be a significant disparity between potential buyers and sellers.

0.97 msf

Q1 leasing activity points to positive trends for 2024

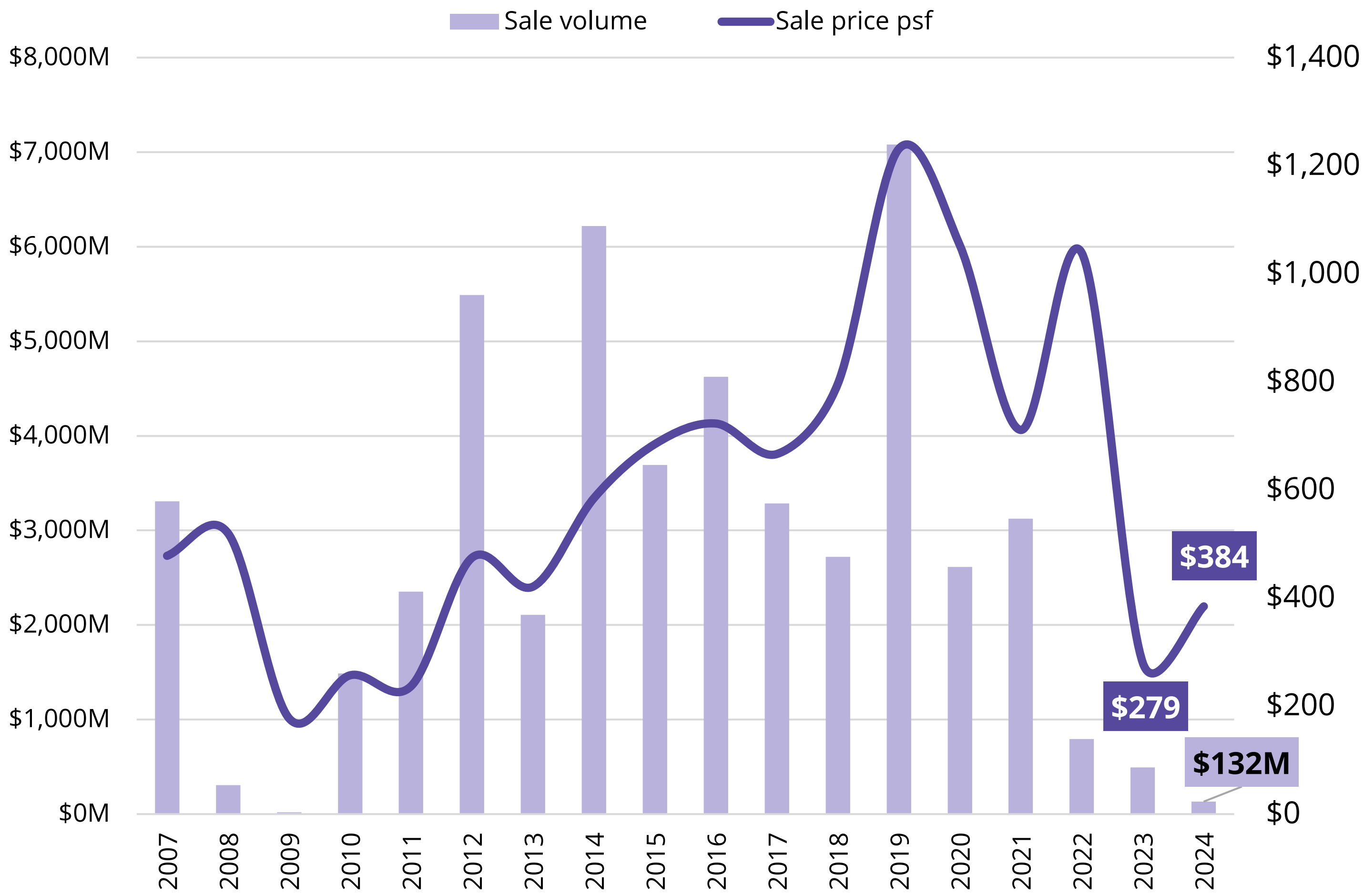
Leasing activity in Q1 2024 totaled 0.97 msf, falling 63.3% below the 5-year pre-Covid leasing average. However, there were encouraging signs as Adyen more than tripled its footprint after taking the Pinterest sublease at 505 Brannan St. Additionally, KPMG's decision to renew its lease at 55 2nd St has further bolstered optimism, with the combined square footage of both leases nearing 300k sf. Looking ahead, positive leasing momentum is slated to continue due to almost 5.5 msf of tenant requirements in the market, with more than 600,000 sf of office demand coming from AI companies.

22.2%

Remote job postings continue to decrease

Following seven consecutive quarters of decline, total job postings in San Francisco experienced a notable uptick of 22.7%. Despite this increase in overall job postings, the percentage share of remote job postings has decreased from the recent Q4 2022 peak of 27.5% to 22.2%, pointing to a continued trend of return-to-office. As the national ratio of office quits-to-layoffs continues to trend downwards, there are signs that the market is becoming more employer-favorable.

Investment sales



Source: AVANT by Avison Young, CoStar

The increasing cost of capital due to mounting debt, high interest rates, and increasing vacancy have continued to weigh down asset pricing in San Francisco. While some potential sellers are trying to cut their losses, the appetite for acquisitions has seemingly increased, with a new generation of investors looking to capitalize on favorable pricing. However, there continues to be a notable disparity between buyer and seller expectations.

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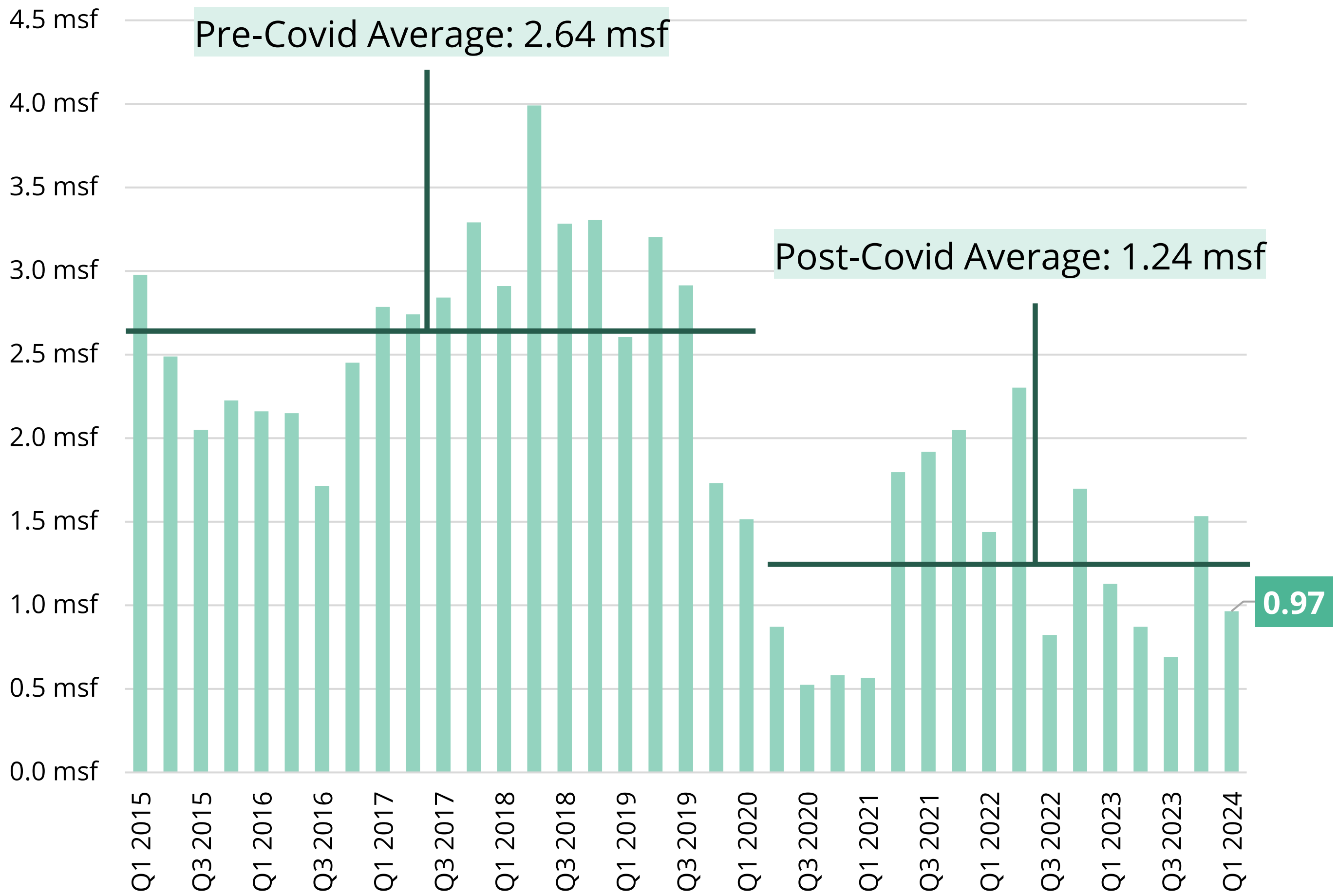
Leasing activity



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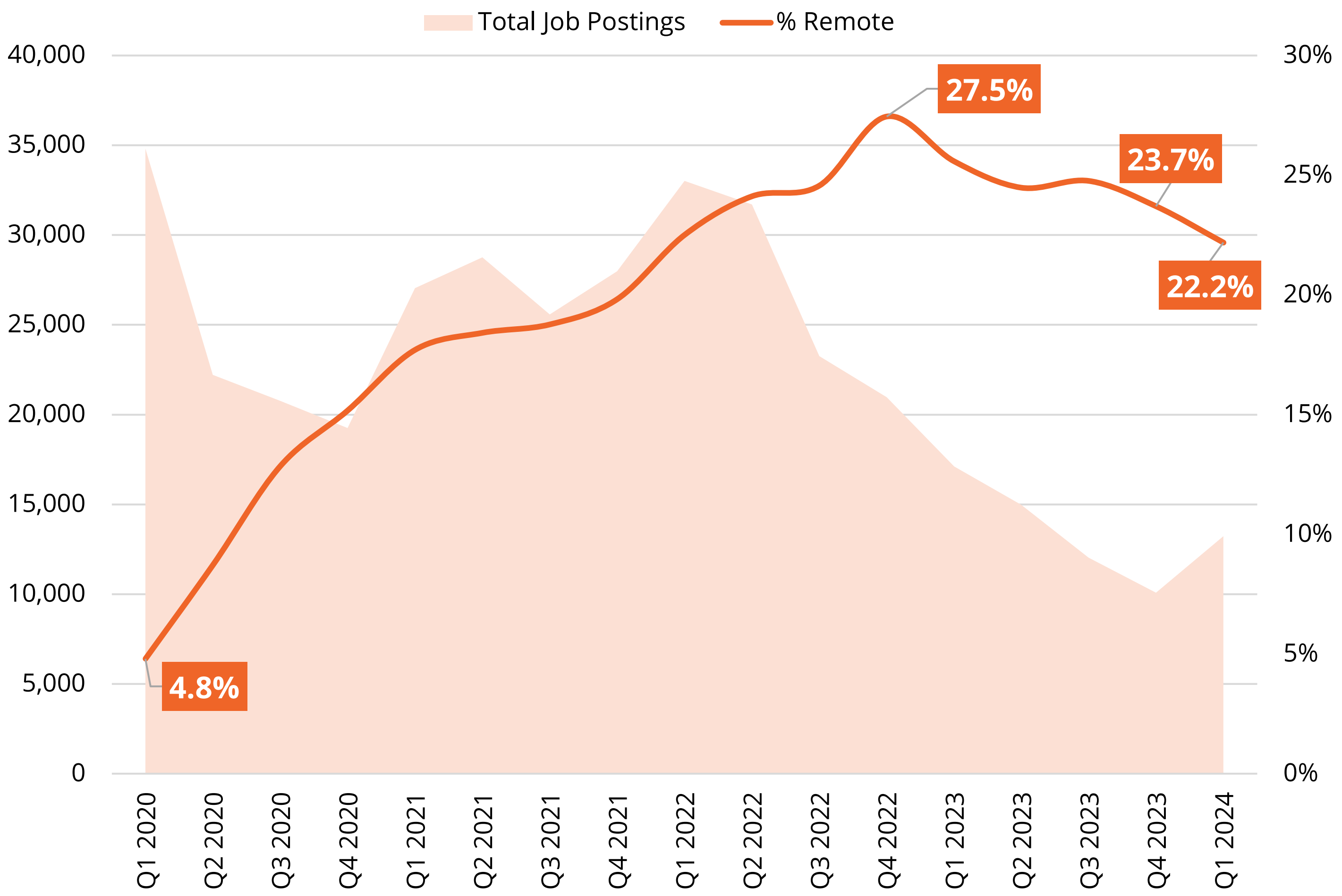
Remote job postings



Note: Office-using industries
Source: AVANT by Avison Young, Lightcast

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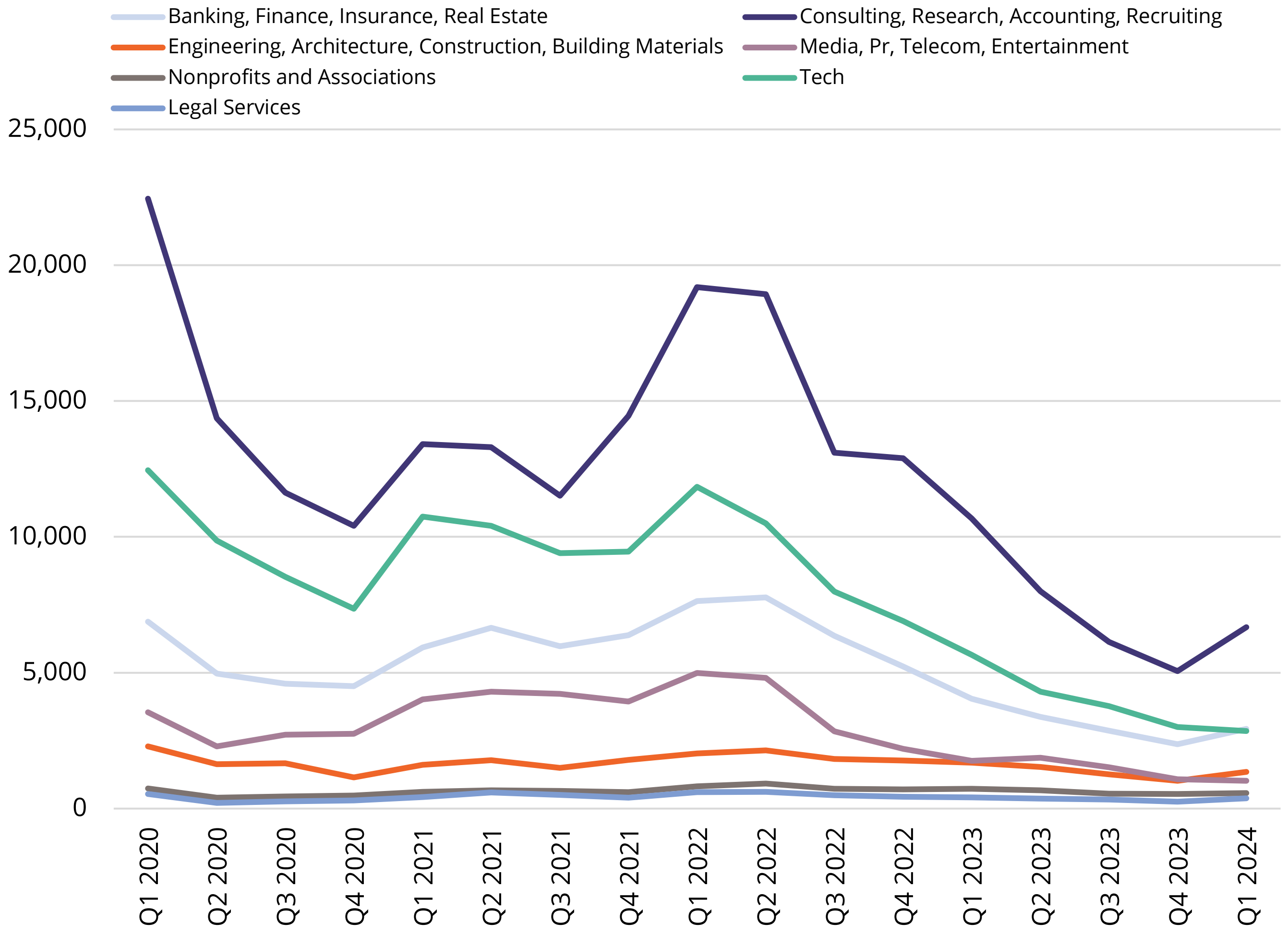
Economic trends

Office job postings by industry type



Note: Office-using industries
Source: AVANT by Avison Young, Lightcast

Overall job postings saw a 22.7% increase from the previous quarter, with only the media and tech industries seeing declines. Consulting, research, accounting and recruiting companies had the biggest increase in volume with over 1,600 jobs created from the previous quarter. Legal services and engineering both saw 52.8% and 33.3% increases, respectively.

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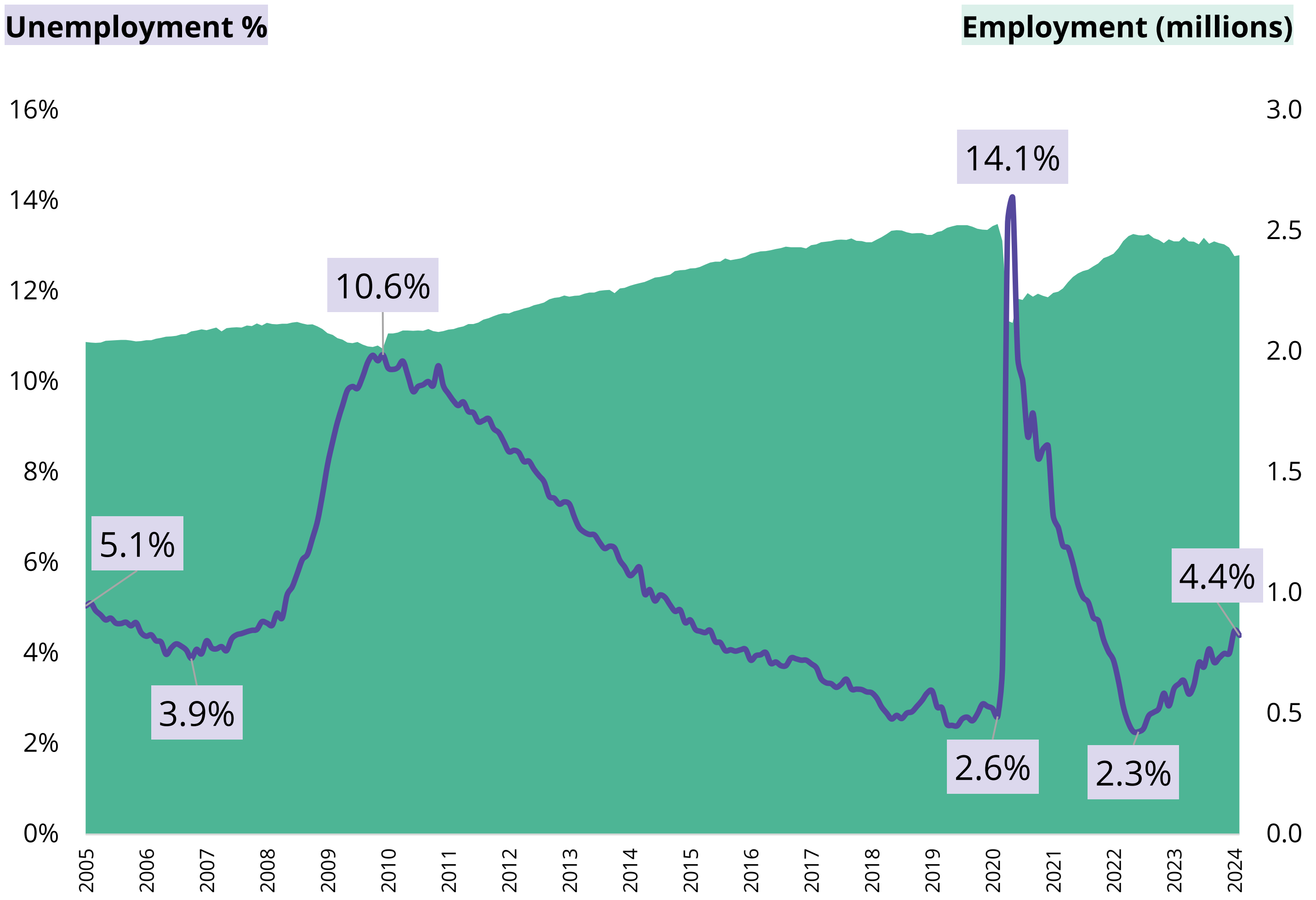
Employment and unemployment rate



Note: San Francisco-Oakland-Hayward MSA
Source: Bureau of Labor Statistics

San Francisco's unemployment has crept up to 4.4% this quarter after bottoming out in June 2022 at 2.3%. This follows the latest rate hikes in July, as the Federal Reserve continues to combat rising inflation. Market conditions are expected to improve, with the Fed hoping to cut rates by the end of the year.

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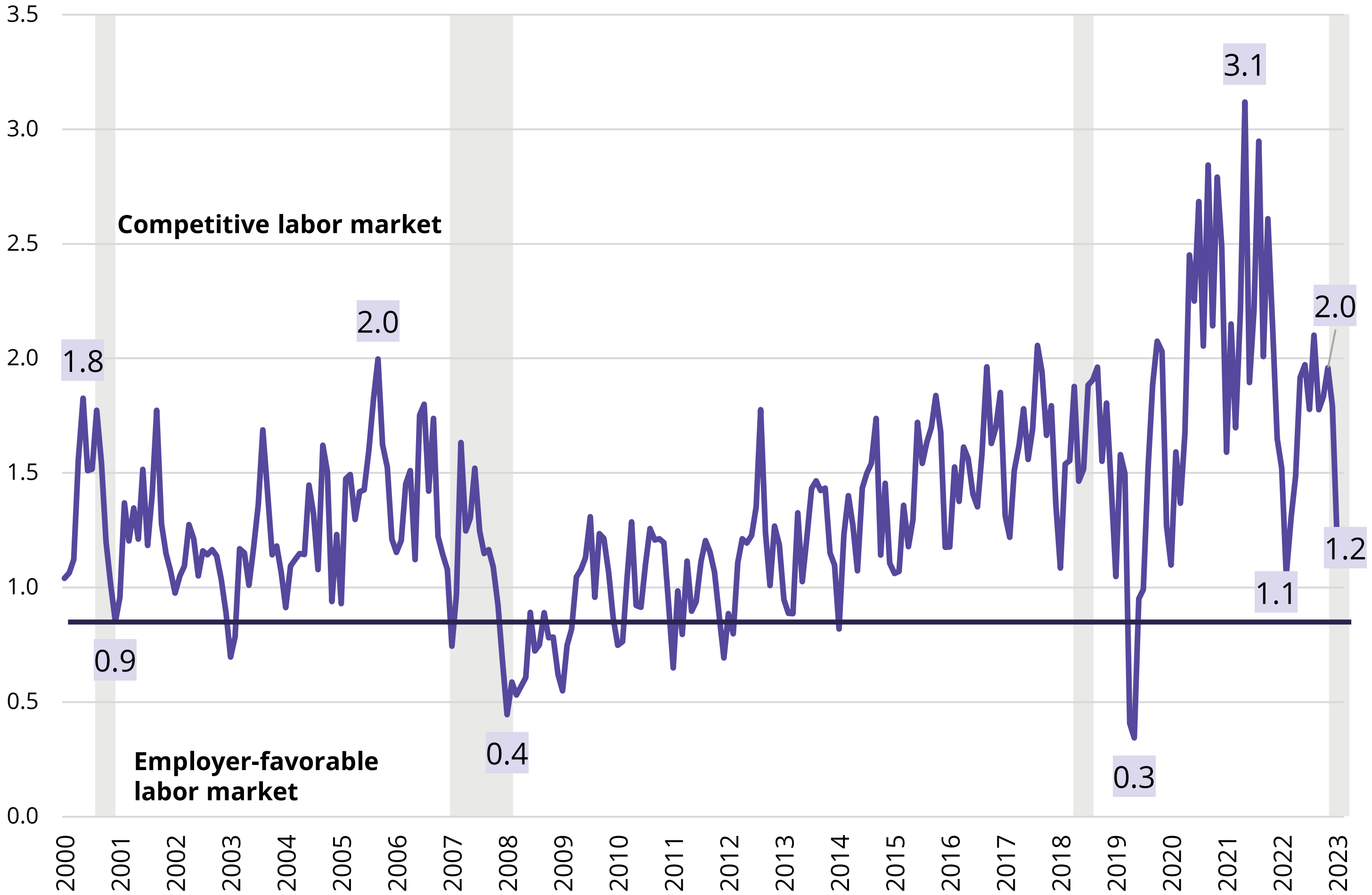
Office quits-to-layoffs and discharges ratio



The "quits-to-layoffs" ratio measures the tightness of the office labor market.

Employee leverage has all but vanished in recent months, with the ratio dropping to its lowest value since January 2023 – potentially due to increased return to office efforts across the U.S.

Note: Nationwide statistics
Source: Bureau of Labor Statistics

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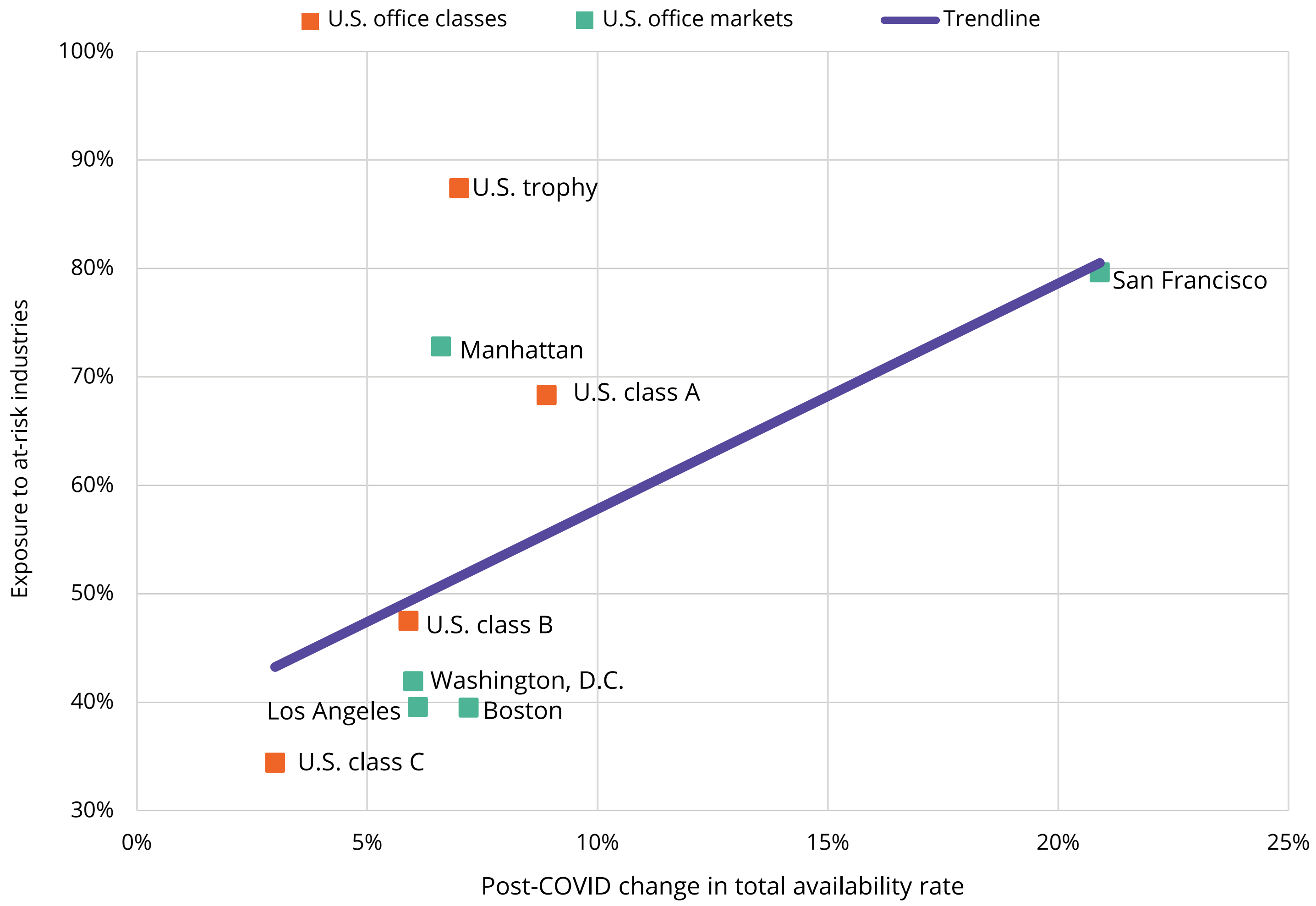
Office market trends

At-risk markets vs. post-COVID new supply



San Francisco's significant exposure to at-risk industries, namely tech, has propelled the city's availability rates to all-time highs. Markets with a more diverse tenant mix have been partially insulated from potential market distress.

Note: Central business districts and private office industries only. Includes sublet and direct availability rates.
Source: AVANT by Avison Young, CoStar

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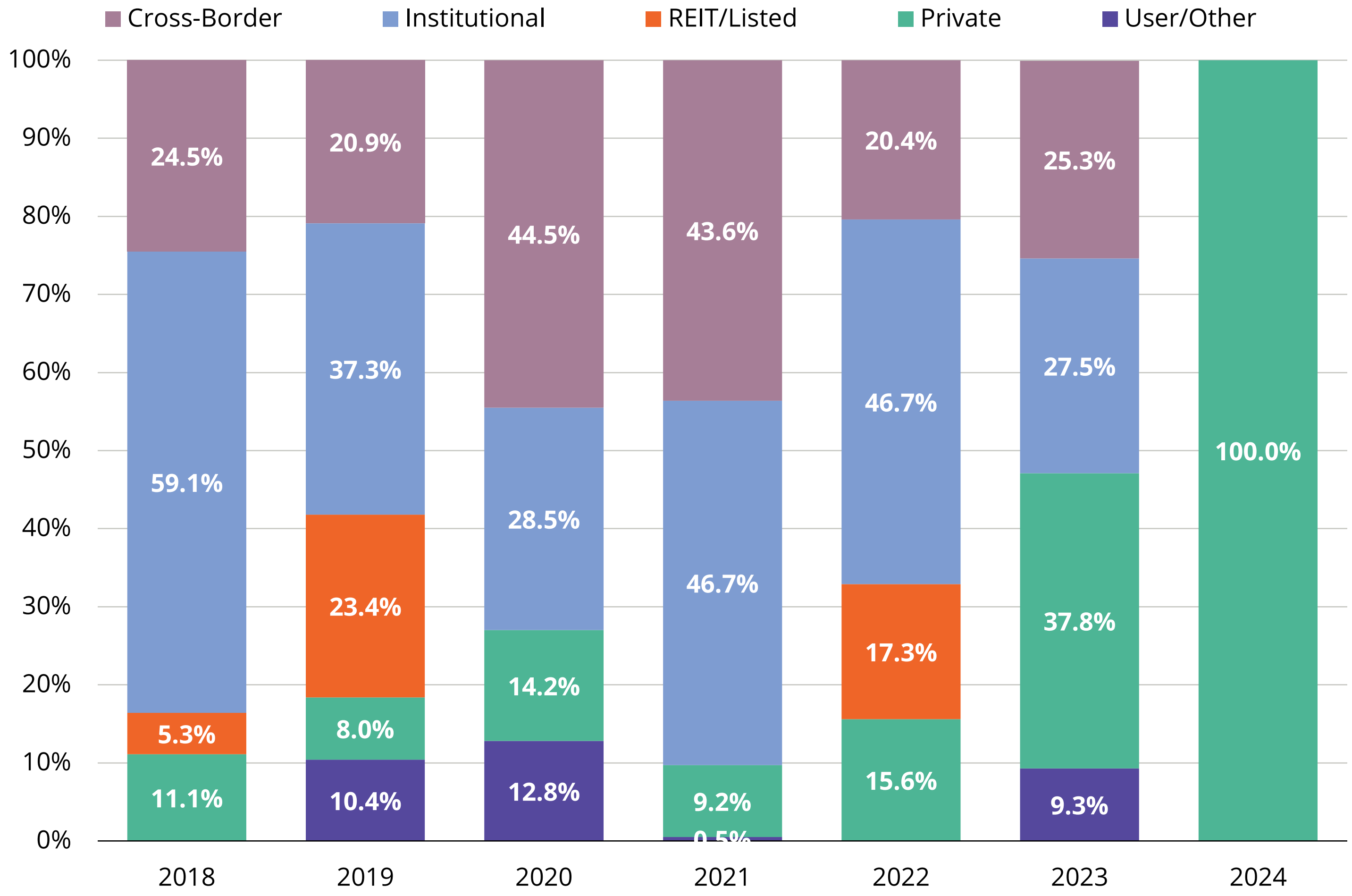
Buyer profiles



Due to decreased pricing and a rise in distressed assets within the market, private buyers have become more active, while institutional capital has scaled back. Although cross-border buyers typically participate during economic distress abroad, the continued lack of core investments has hindered this trend.

Source: AVANT by Avison Young, RCA

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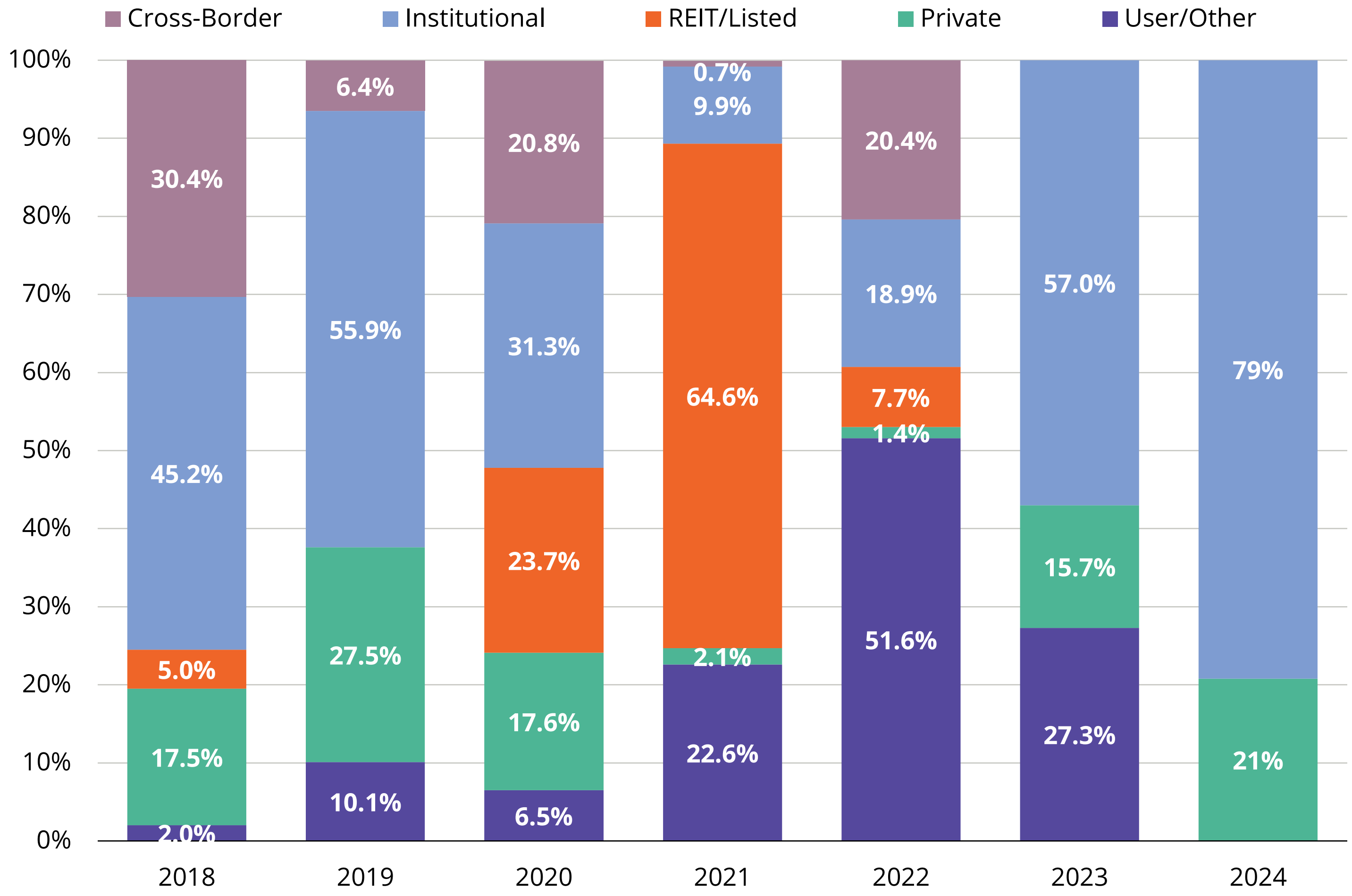
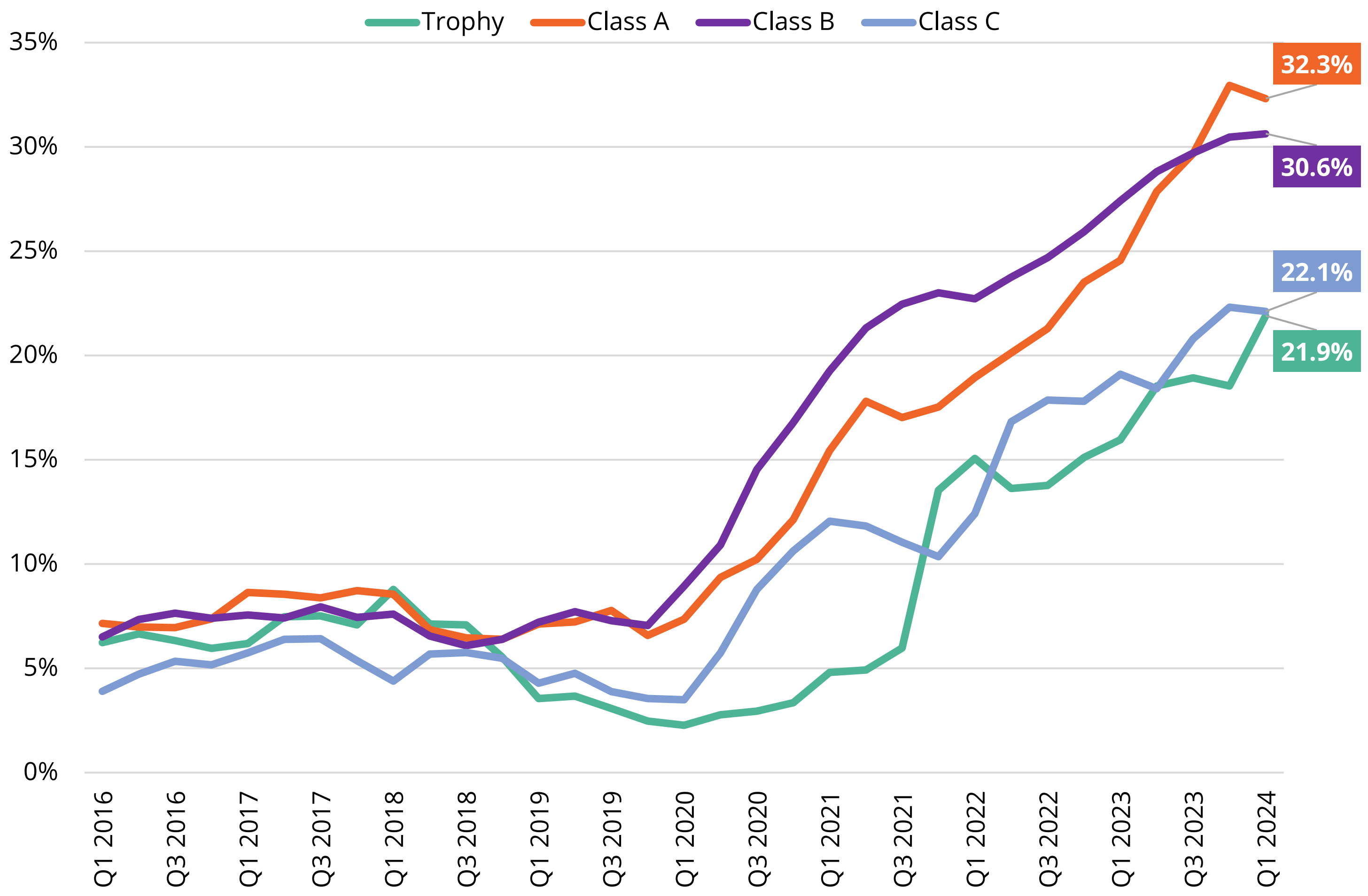
Seller profiles



Private investors are now facing a notably higher rate of asset sales compared to prior years, primarily driven by the difficult conditions prevailing in the debt markets. Refinancing assets has become progressively more challenging, with a growing risk of defaults looming.

Source: AVANT by Avison Young, RCA

Total vacancy by class



Source: AVANT by Avison Young, CoStar

A flurry of deals saw the vacancy rate for Class A assets decrease for the first time since Q3 2021. However, the Trophy vacancy rate increased due to tenants vacating space at 1 Market St. and 600 Montgomery St., as well as an overall lack of new deals. Class A commodity space continues to face challenges, as cash-constrained landlords struggle to attract tenants.

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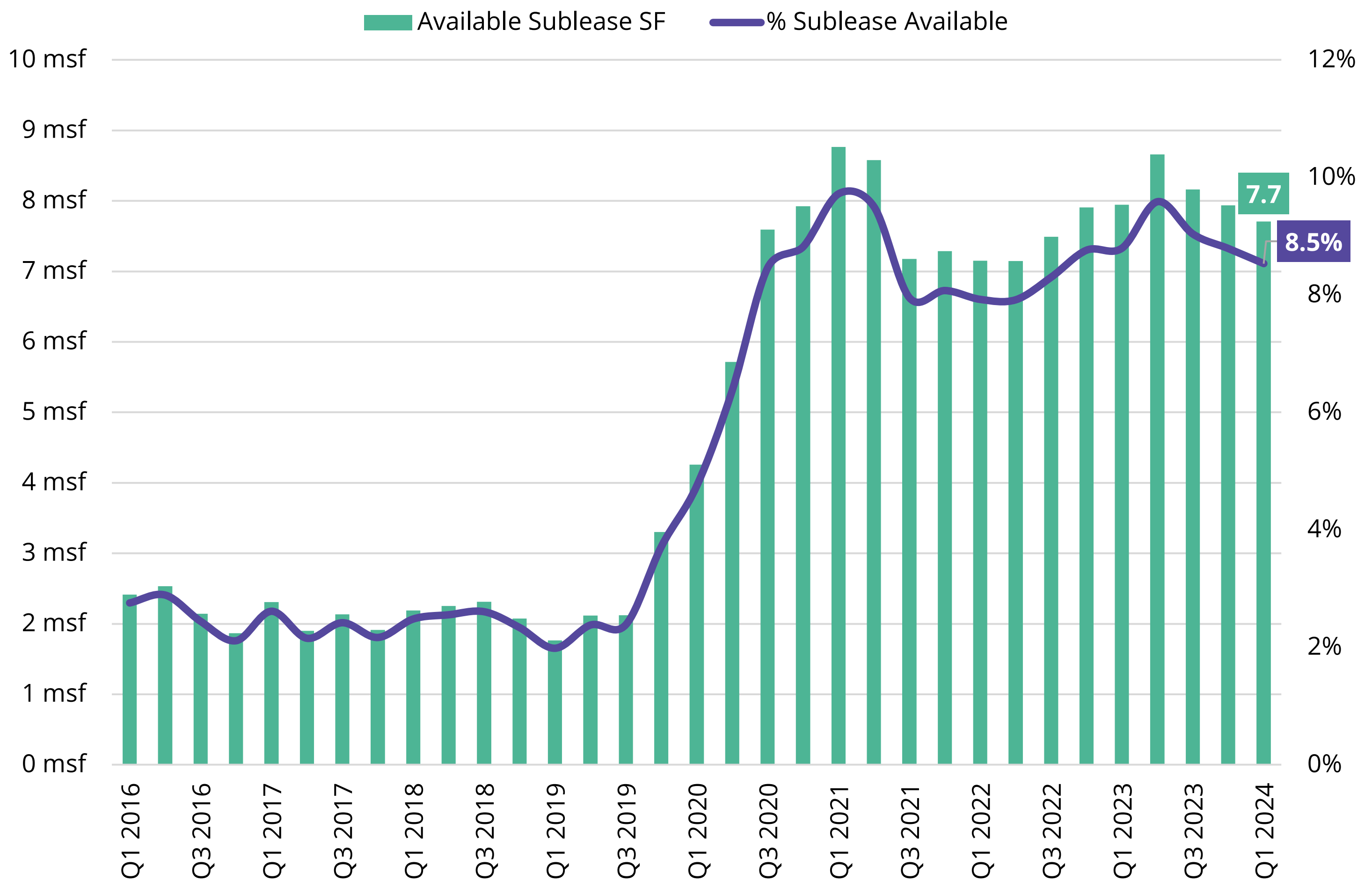
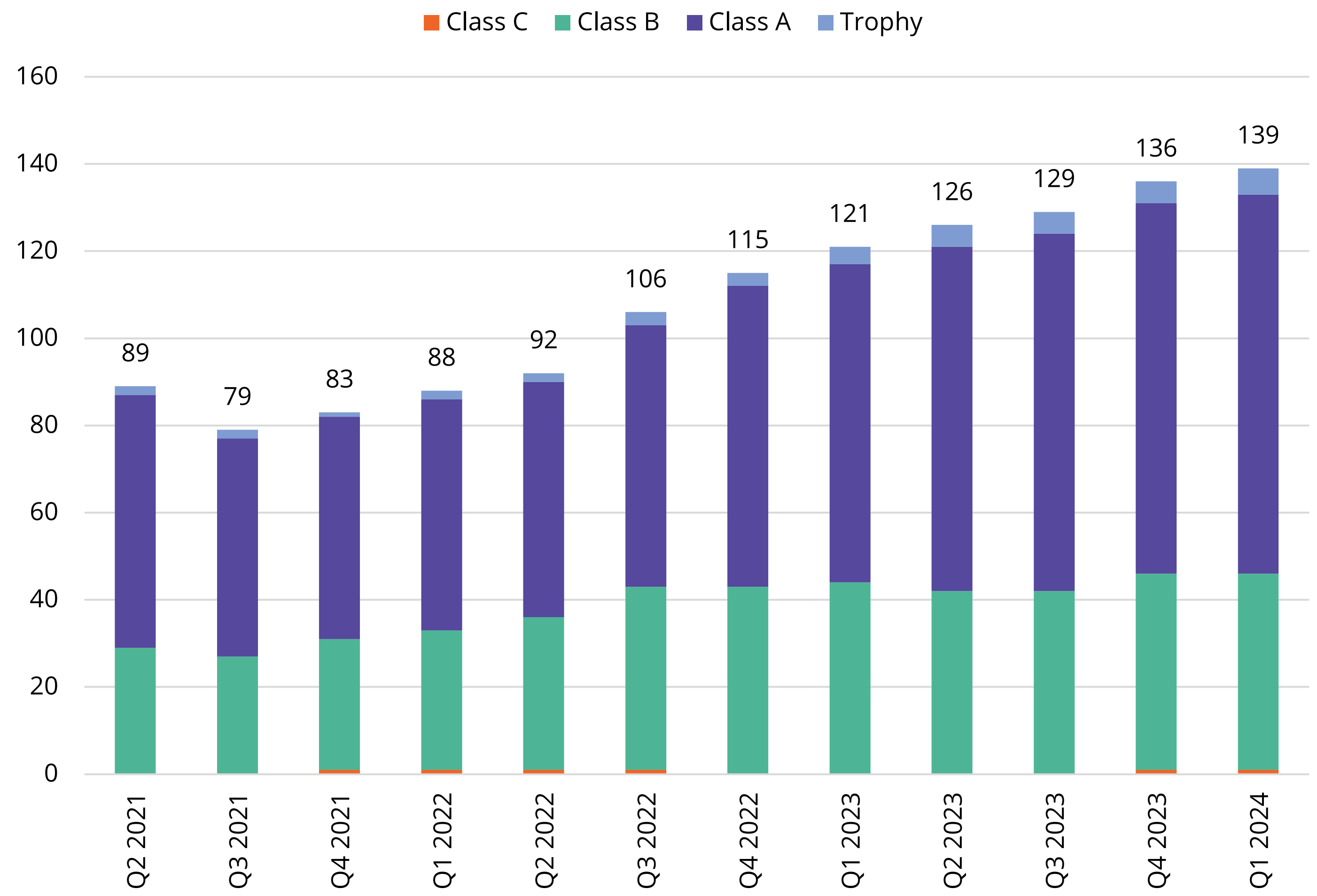
Sublease availability



Source: AVANT by Avison Young, CoStar

Adyen's 150k sf sublease of Pinterest's space at 505 Brannan, along with expiring leases on the sublease market contributed to a 3rd consecutive quarter of decline for sublease availability.

Historical office large block availability



Note: Large blocks over 50k RSF
Source: AVANT by Avison Young, CoStar

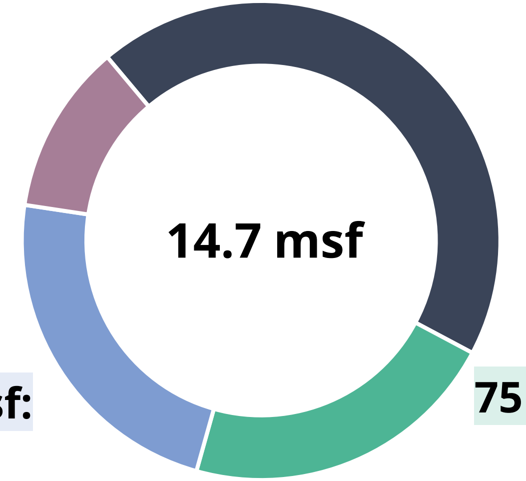
Once limited in supply, large blocks are now becoming saturated in both size and quantity due to tenants downsizing office requirements.

Office large block availability – 50,000+

Number of blocks by size:

>200K sf: 11%
15 blocks

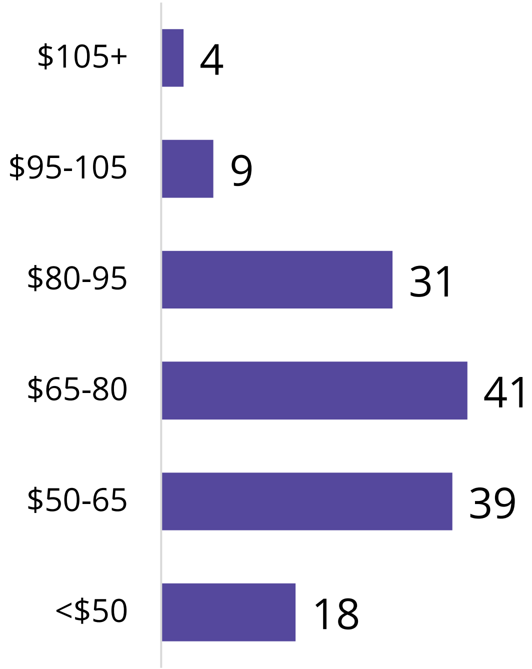
50K sf - 75K sf: 44%
52 blocks



100K sf - 200K sf: 23%
34 blocks

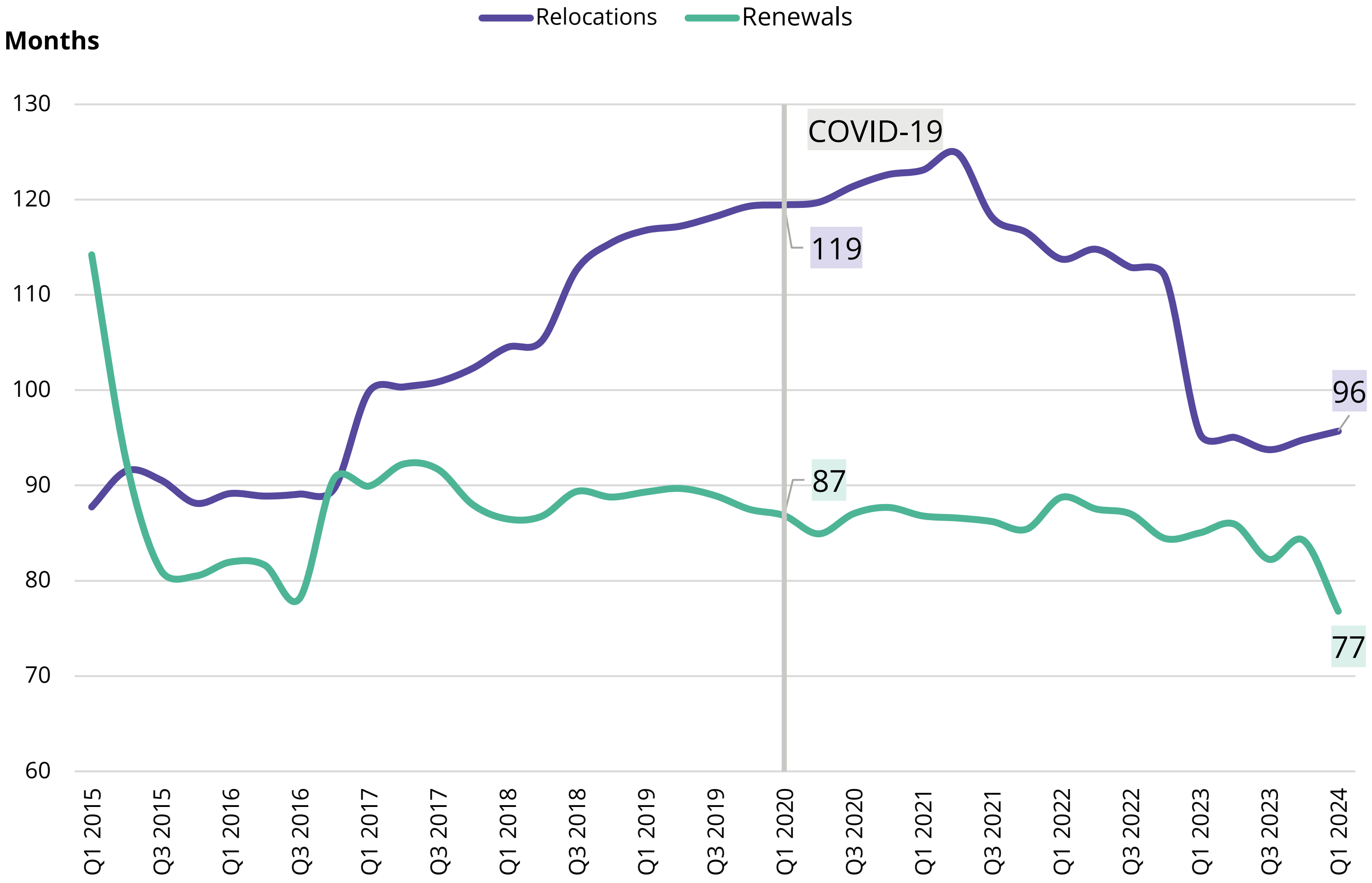
75K sf - 100K sf: 22%
34 blocks

Asking rents FS:



Source: AVANT by Avison Young, CoStar

Office lease term lengths



Lease term lengths for both relocations and renewals among trophy and class A properties have decreased since last quarter. Interestingly, average term lengths for relocations have decreased significantly from Q4 2022, showing that tenants want to maintain flexibility in the current market.

Note: 12-month moving averages, direct leases only. Trophy and Class A properties.
Source: AVANT by Avison Young

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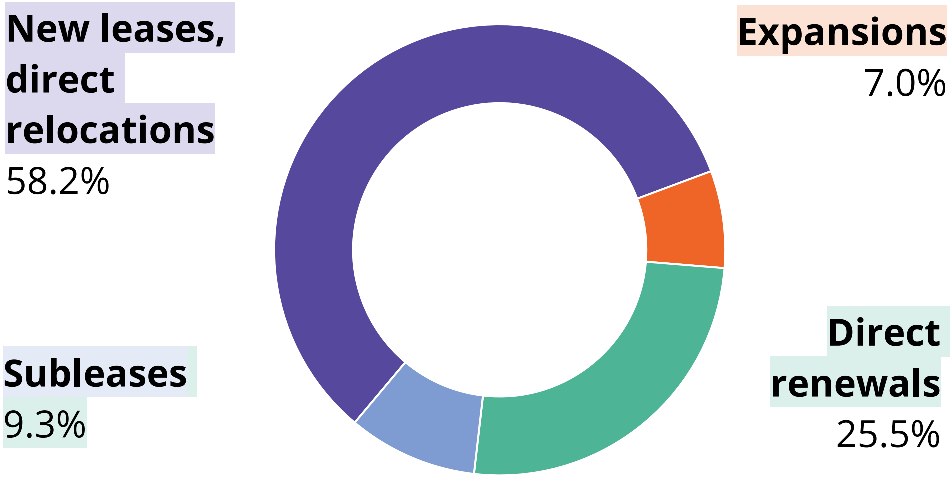
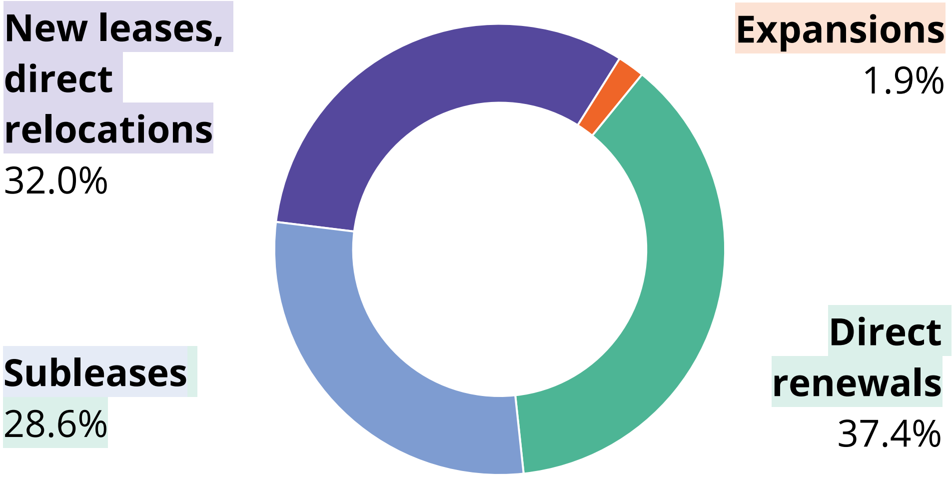
Leasing trends pre versus post-COVID

From 2018 through March 2020



Leasing activity post-COVID



Tenants have become increasingly selective, forcing landlords to offer lucrative concession packages for new leases and renewals. In addition, there has been a shift towards subleases, with many tenants seeking discounted high-end space and flexible leasing terms.

Source: AVANT by Avison Young

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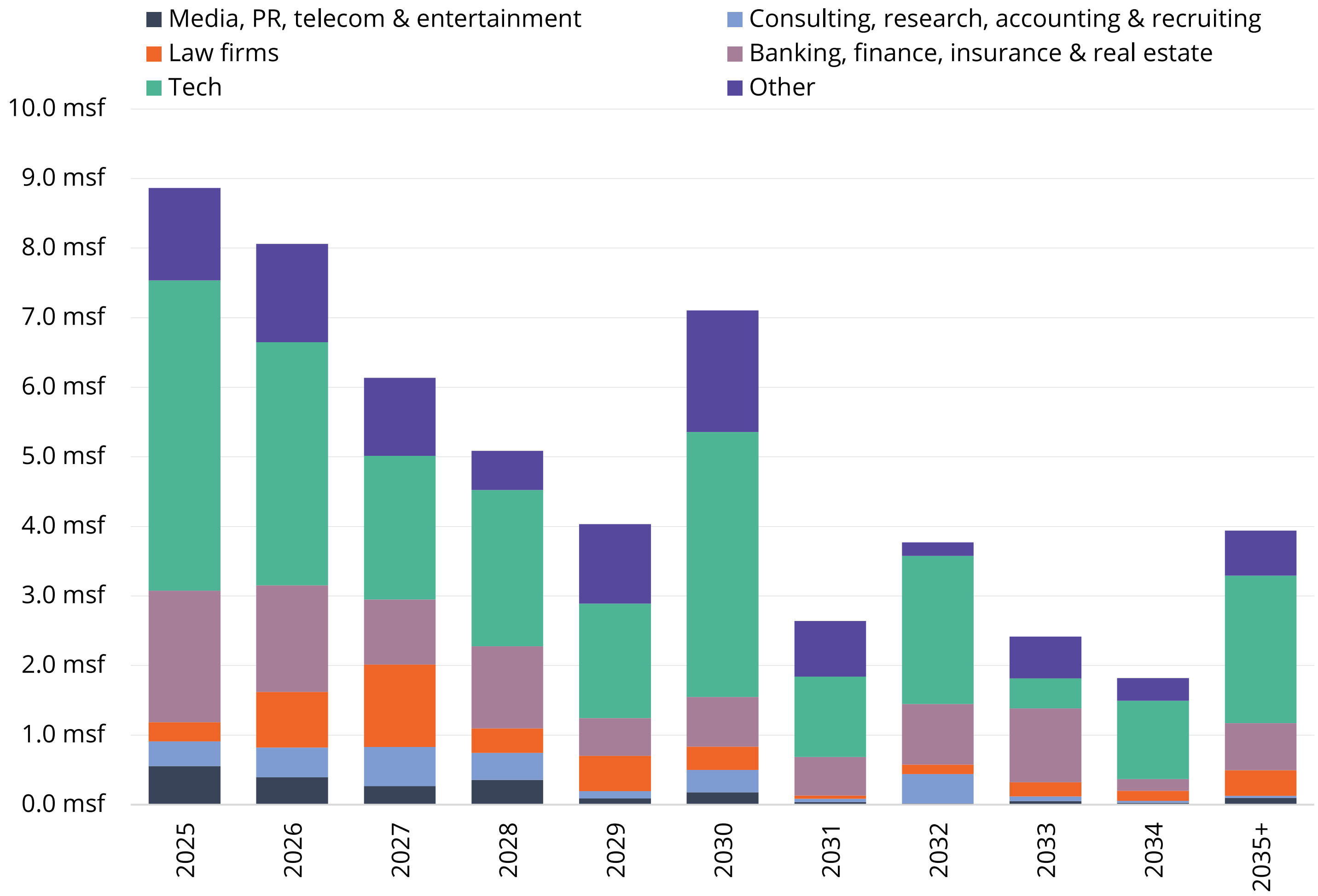
Future lease expirations by industry



Tech companies account for 45.8% of upcoming lease expirations among major industries, with financial services trailing behind at 18.8%. Over half of the market's currently occupied space is set to expire before 2030, representing a pivotal next five years for San Francisco.

Source: AVANT by Avison Young

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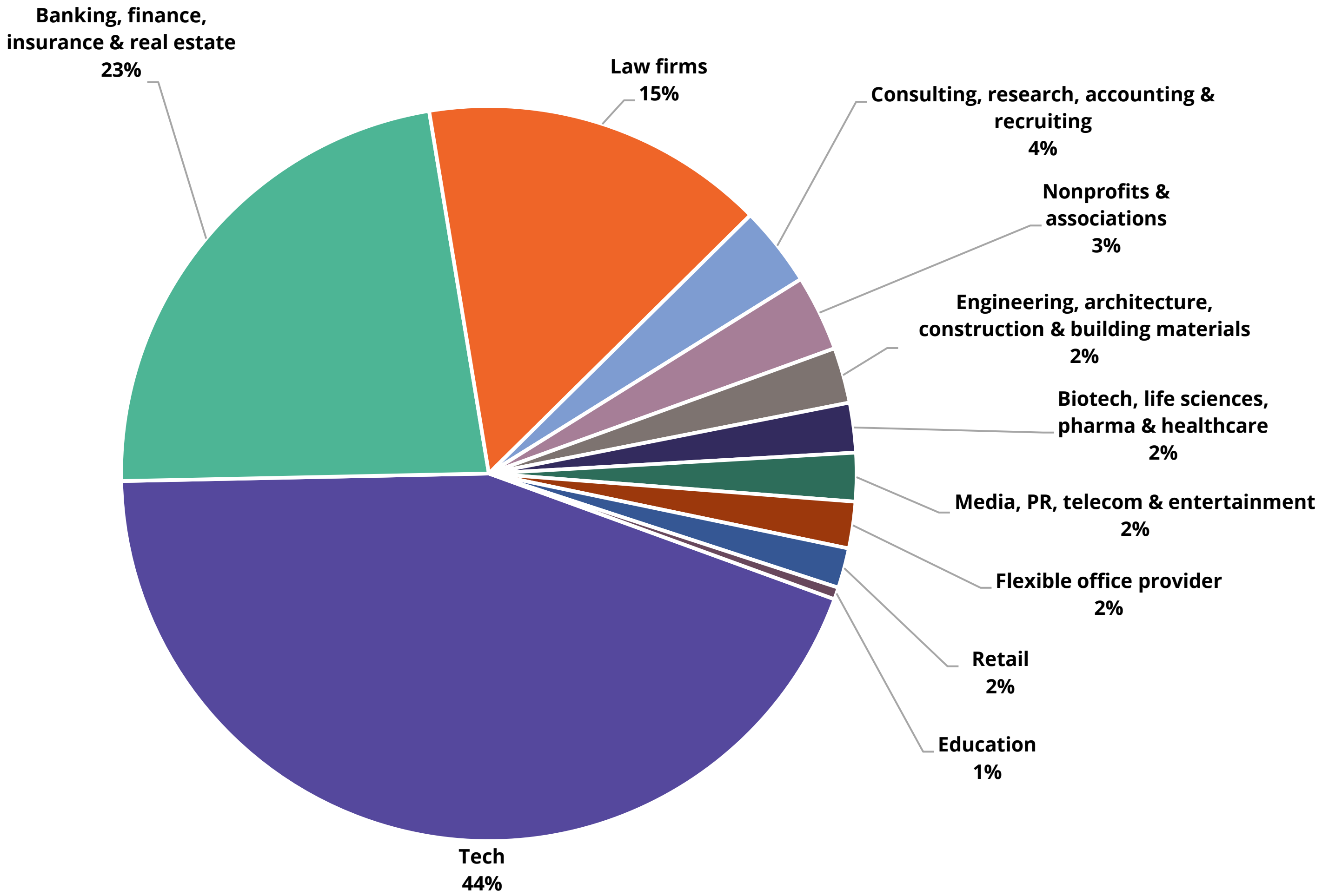
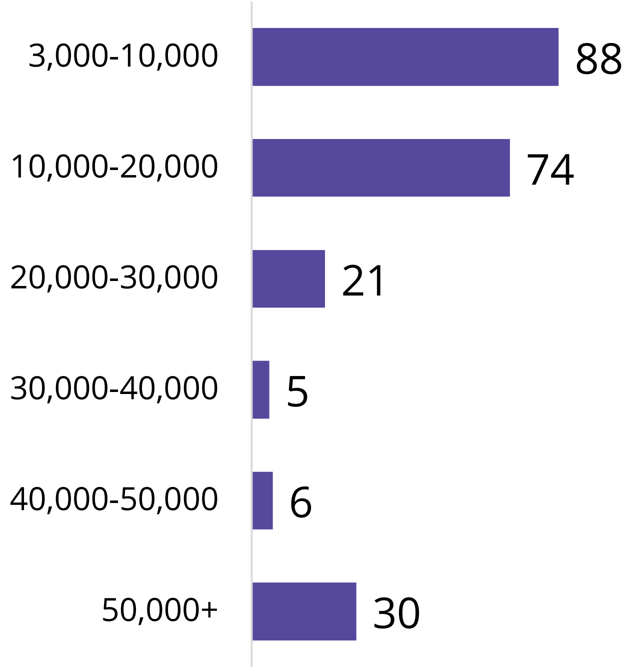
Current San Francisco tenants in the market



Total requirements by size



Source: AVANT by Avison Young

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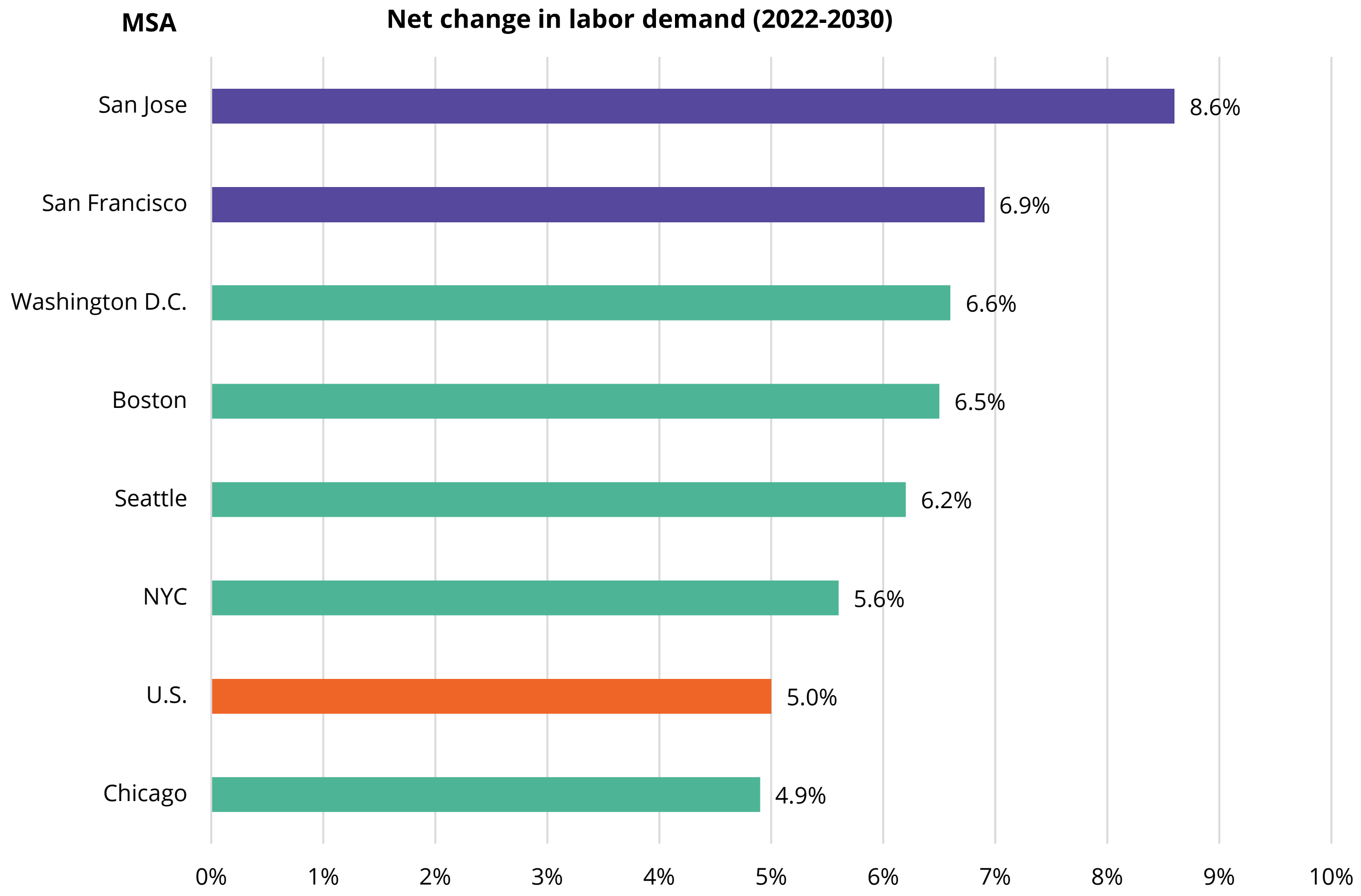
AI trends

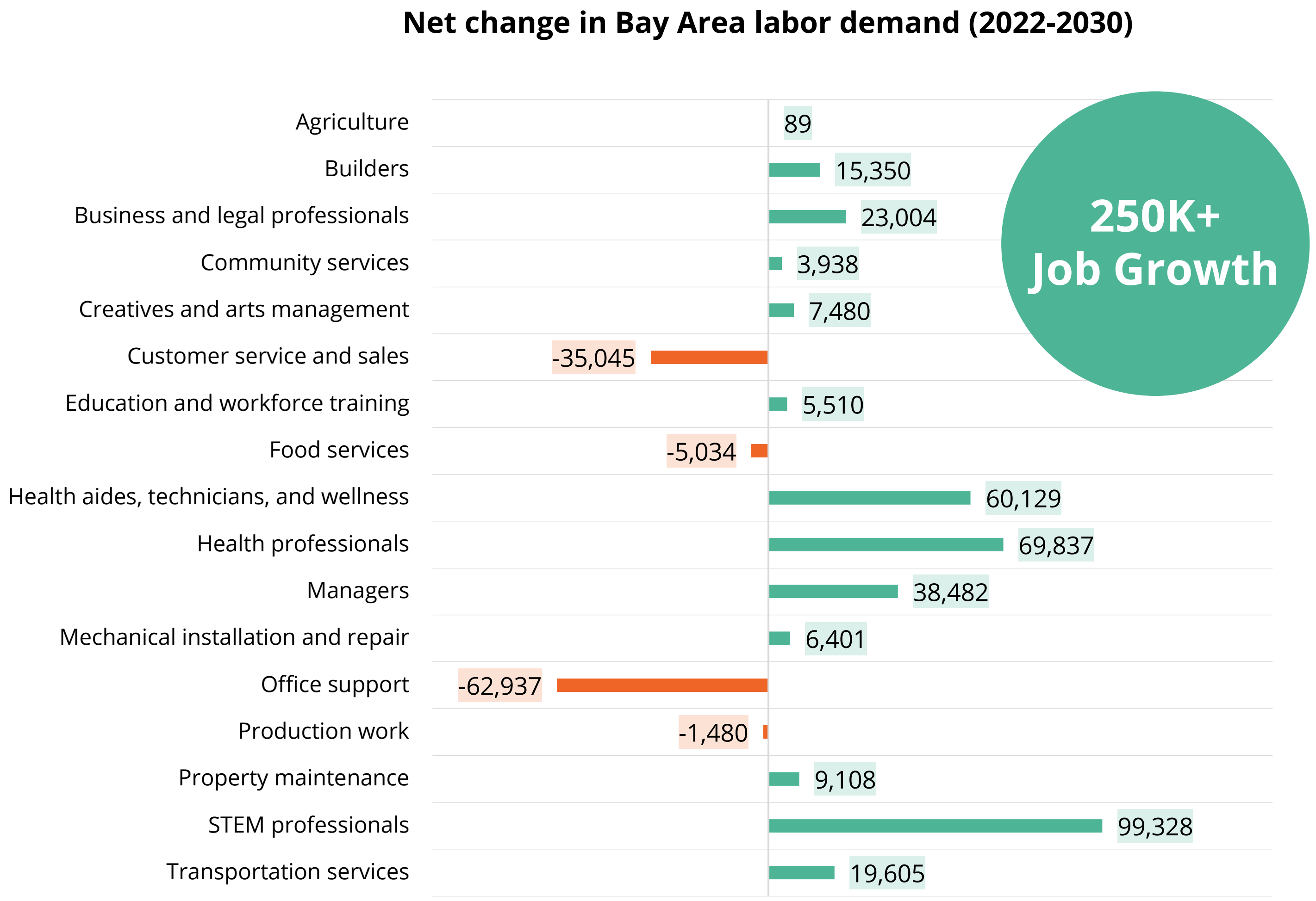
AI-driven labor demand by MSA



The two markets at the center of AI, San Francisco and San Jose, could unsurprisingly benefit the most from AI-driven changes in labor demand. MSAs with a lower concentration of college-educated workers could be the most negatively affected.

Source: McKinsey, Bureau of Labor Statistics

AI-driven labor demand by occupation



San Francisco and San Jose represent the two major MSAs that could benefit the most from AI in terms of labor demand. The implementation of automated systems would drastically reduce the need for office support and customer service, while driving demand for STEM and healthcare occupations.

Source: McKinsey, Bureau of Labor Statistics

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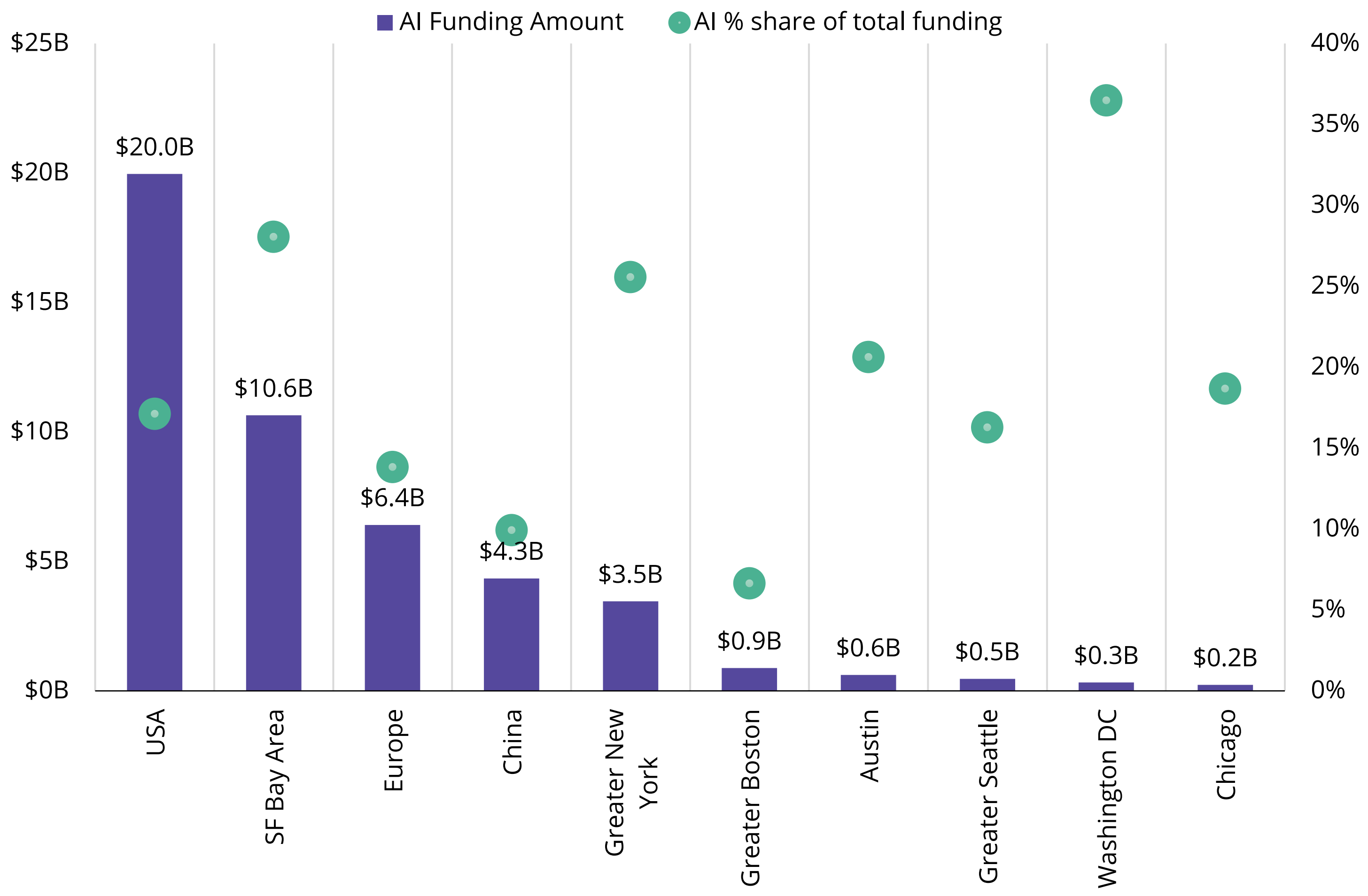
AI VC funding by region



Total AI VC funding from 2023 to present in the San Francisco Bay Area has eclipsed funding numbers for both Europe and China. Additionally, the Bay Area accounts for 53.3% of total AI funding in the U.S.

Note: VC Funding only, 2023 to present.
Source: Crunchbase

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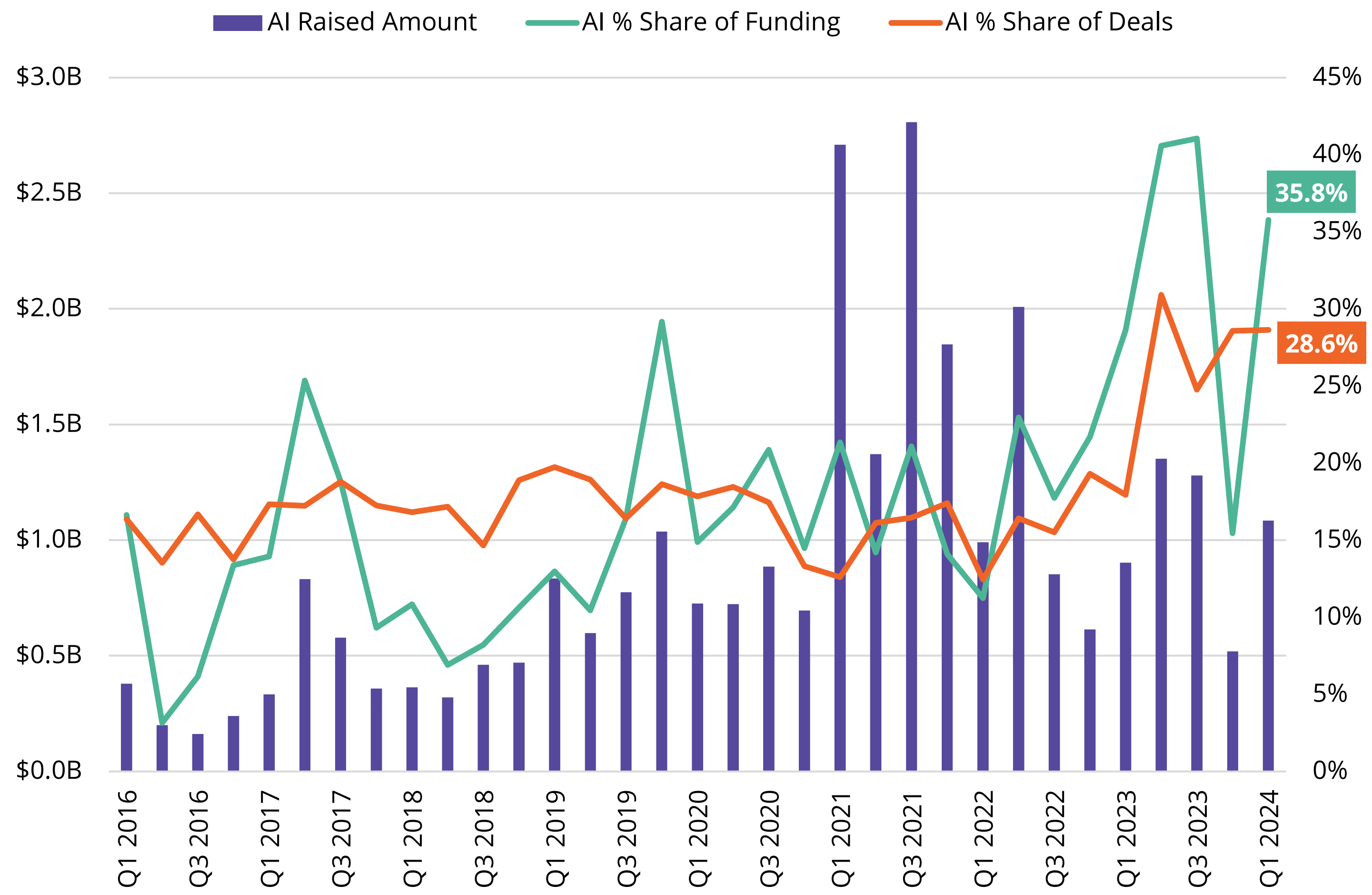
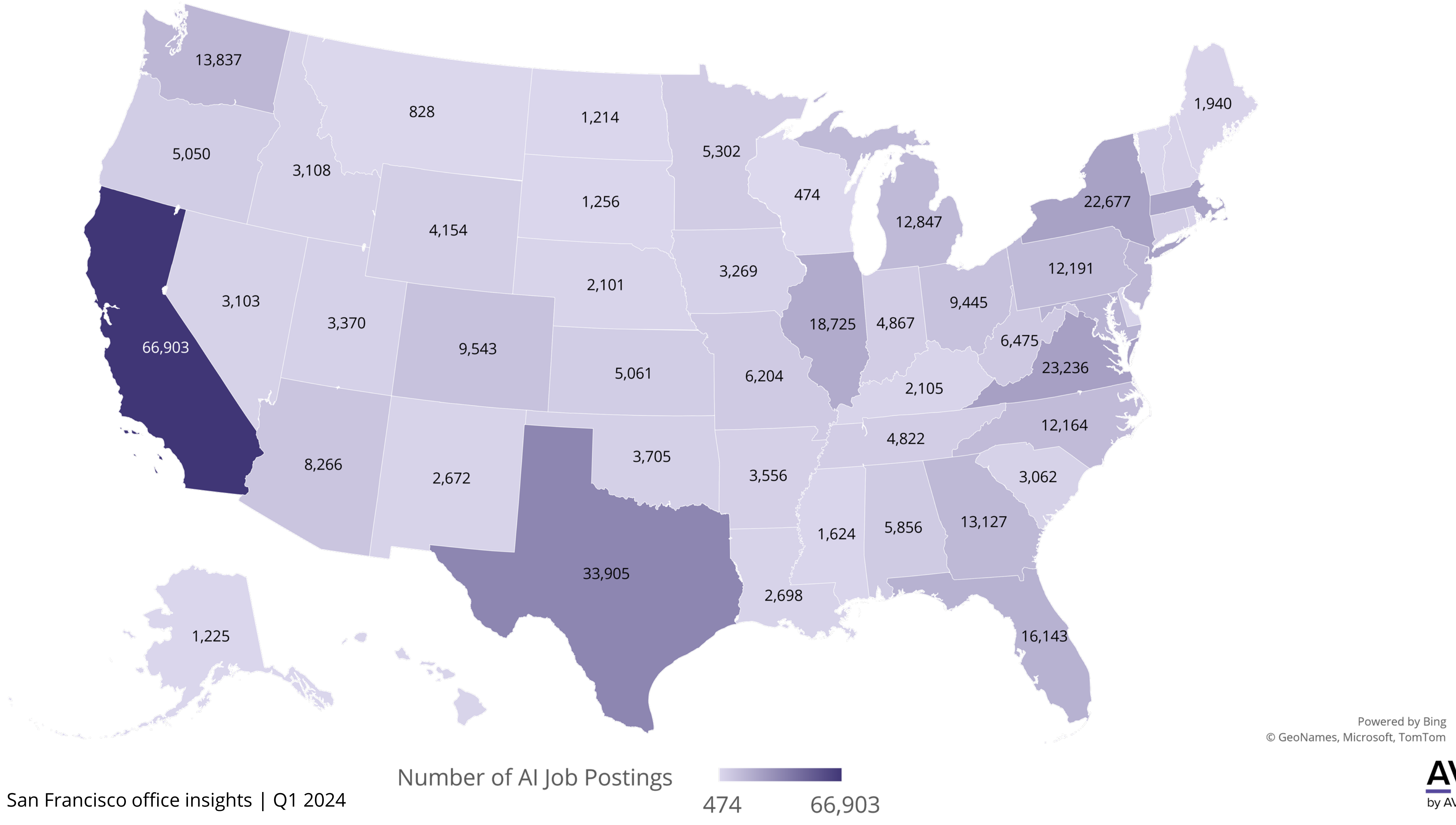
San Francisco AI VC funding



Source: Crunchbase

San Francisco's AI boom saw almost $1.1B in funding in Q1 2024, accounting for 35.8% of the market's total funding. While the percentage share of deals remained the same as the previous quarter, the overall raised amount increased by 109.1%. With only 9 more deals done than Q4 2023, investors seemed more willing to deploy larger amounts of capital.

Number of AI Job Postings in the United States by State, 2023



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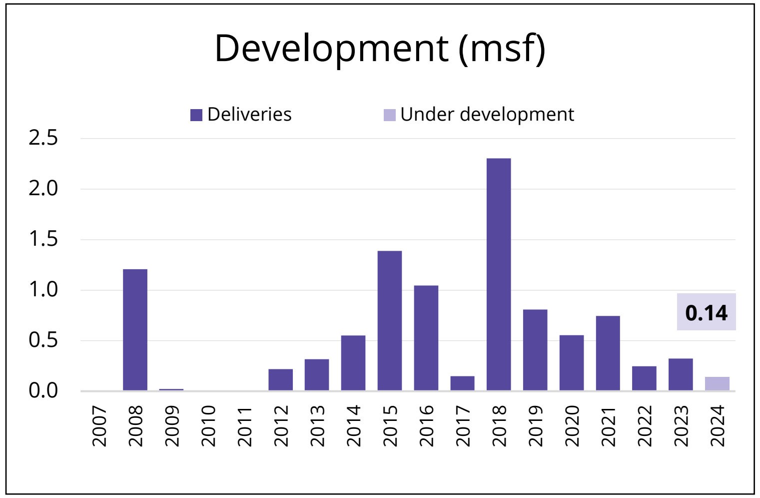
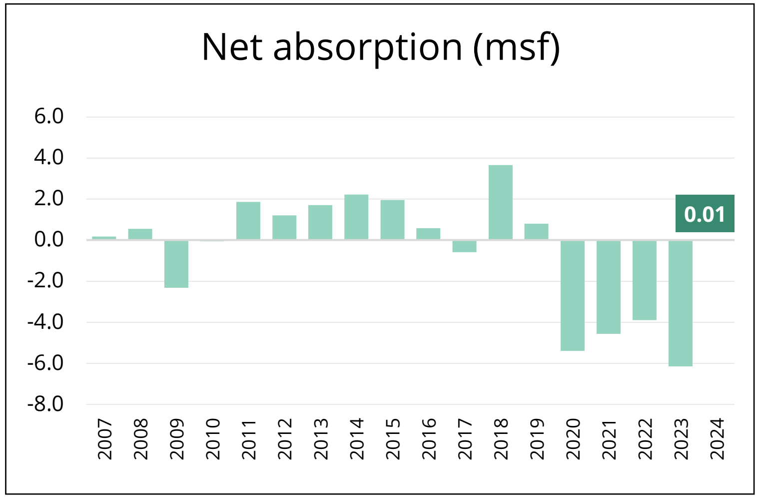
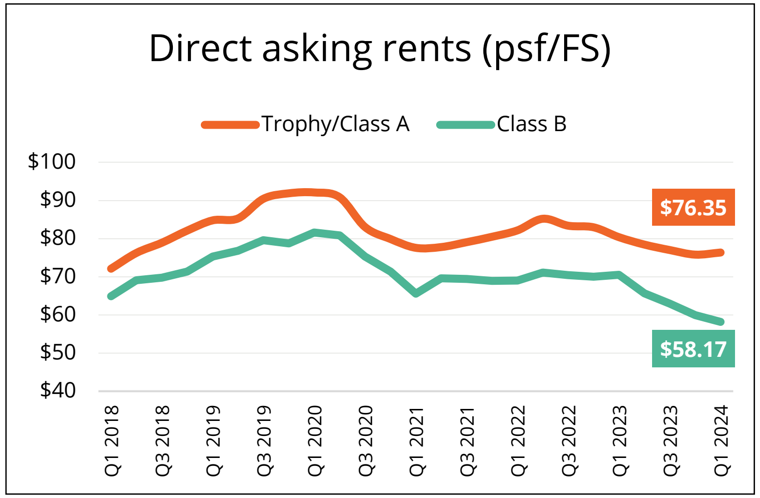
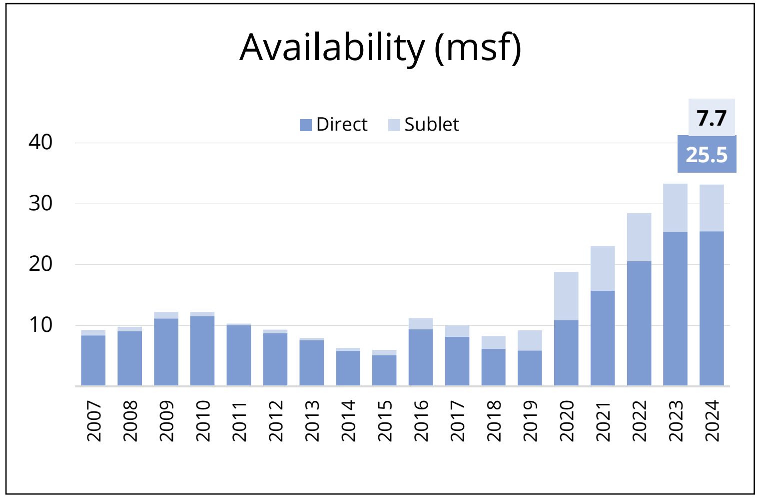
Appendix

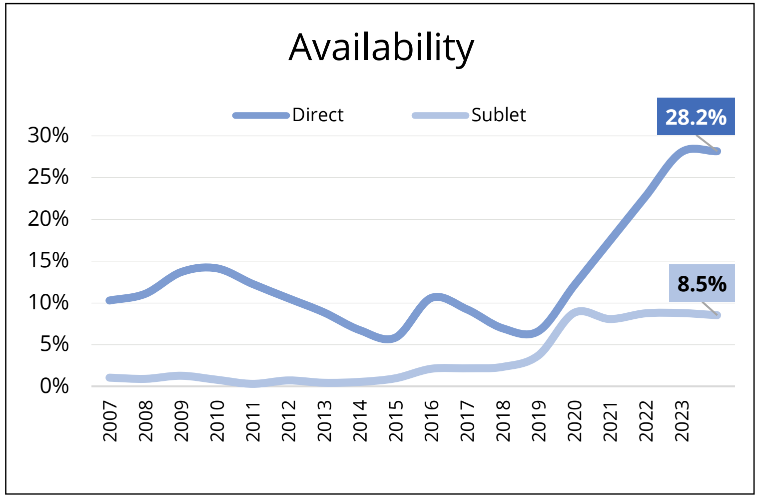
San Francisco office market indicators

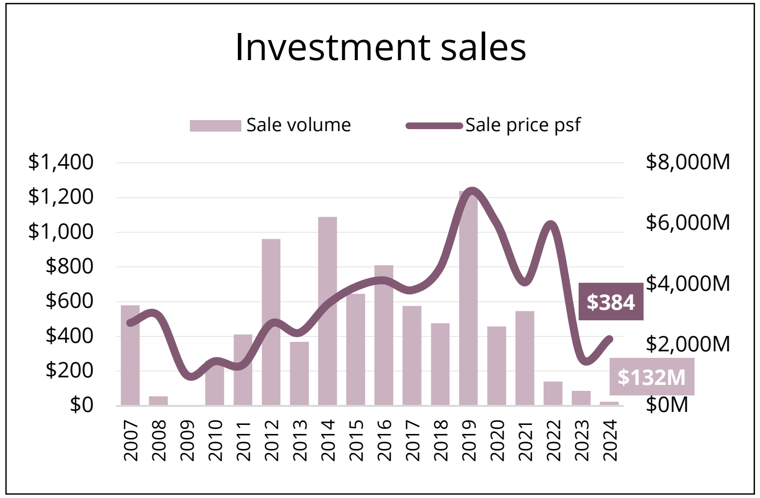












Source: AVANT by Avison Young, CoStar

San Francisco office market stats

	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Sublet vacancy	Total vacancy	Net absorption sf (Q1 2024)	Net absorption sf (YTD)	Direct asking rent FS
Financial District	28,571,226	0	0	27.1%	3.4%	30.5%	15,117	15,117	$72.54
South Financial District	27,304,571	0	0	21.2%	5.7%	27.0%	57,582	57,582	$73.55
CBD Total	**55,875,797**	**0**	**0**	**24.2%**	**4.5%**	**28.8%**	**72,699**	**72,699**	**$72.98**
Chinatown/Nob Hill/Russian Hill	105,570	0	0	17.4%	5.7%	23.1%	0	0	n/a
Jackson Square	1,909,445	0	0	21.4%	0.6%	22.0%	33,525	33,525	$51.94
MidMarket	4,482,036	0	0	29.3%	8.9%	38.2%	67,242	67,242	$60.39
Mission	922,047	0	0	30.3%	0.0%	30.3%	14,263	14,263	$71.00
Mission Bay	1,853,239	0	0	30.6%	1.3%	31.9%	(18,908)	(18,908)	$95.00
Outer San Francisco	1,212,250	0	0	6.8%	0.2%	7.0%	(11,431)	(11,431)	n/a
Potrero Hill	1,095,605	0	0	27.3%	7.7%	35.0%	0	0	$45.00
Rincon Hill/South Beach	5,730,641	0	0	21.4%	8.7%	30.2%	119,711	119,711	$53.14
Showplace Square	3,530,312	0	51,223	23.4%	12.7%	36.1%	6,127	6,127	$59.76
South of Market	874,596	0	93,138	26.7%	7.4%	34.0%	16,052	16,052	$34.82
Union Square	4,015,776	0	0	24.6%	5.3%	29.8%	(52,772)	(52,772)	$53.75
Van Ness Corridor	1,628,858	0	0	16.3%	0.2%	16.5%	(28,363)	(28,363)	$40.73
Waterfront/North Beach	3,243,220	0	0	29.4%	4.8%	34.2%	(96,774)	(96,774)	$75.18
Yerba Buena	3,718,149	0	0	42.4%	9.6%	51.9%	(115,586)	(115,586)	$86.46
Non-CBD Total	**34,321,744**	**0**	**144,361**	**26.3%**	**6.6%**	**32.9%**	**(66,914)**	**(66,914)**	**$67.98**
Market total	**90,197,541**	**0**	**144,361**	**25.0%**	**5.3%**	**30.4%**	**5,785**	**5,785**	**$71.49**

The charts and statistics in this report are composed by Class A, B, and C, non-owner-occupied office buildings 20,000 sf and above in the submarkets listed above.

Source: AVANT by Avison Young, CoStar

San Francisco office market stats by class

	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Sublet vacancy	Total vacancy	Net absorption sf (Q1 2024)	Net absorption sf (YTD)	Direct asking rent FS
Trophy	8,630,431	0	0	16.3%	5.6%	21.9%	(289,893)	(289,893)	$100.41
Class A	47,801,505	0	0	27.2%	5.2%	32.4%	320,714	320,714	$72.27
Class B	29,908,666	0	144,361	25.1%	5.6%	30.8%	(32,616)	(32,616)	$58.17
Class C	3,856,939	0	0	17.2%	3.4%	20.6%	7,580	7,580	$49.35
Market total	**90,197,541**	**0**	**144,361**	**25.0%**	**5.3%**	**30.4%**	**5,785**	**5,785**	**$71.49**

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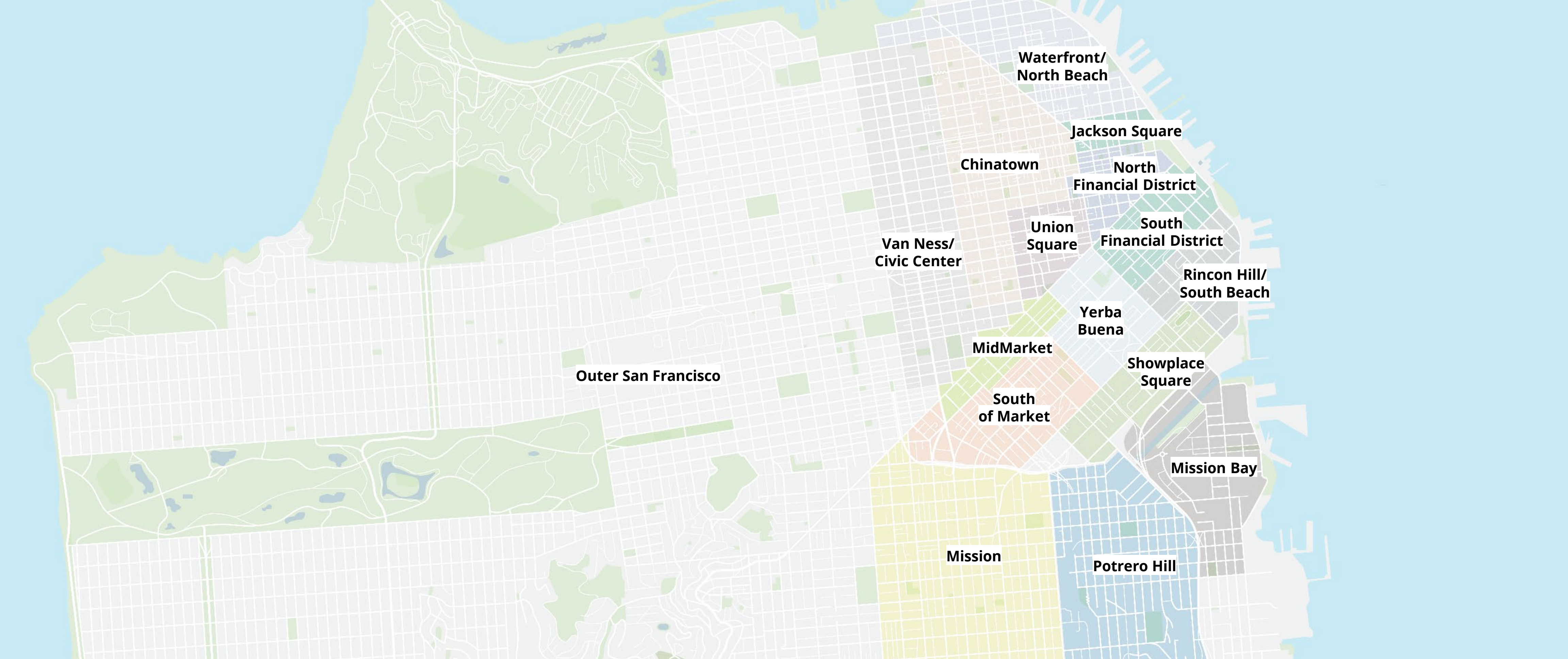
Source: AVANT by Avison Young, CoStar

San Francisco submarket map



Source: AVANT by Avison Young

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Office insights glossary of terms

Demand

- **Leasing activity:** total square footage of relocations, renewals, expansions and subleases expressed when the leases are signed, not when tenants take physical occupancy of the space
- **Absorption:** period-over-period change in occupied square footage

Supply

- **Direct vacancy rate:** space operated by landlords that is ready for immediate occupancy
- **Sublease vacancy rate:** space operated by sublandlords that is ready for immediate occupancy
- **Total vacancy rate:** sum of direct vacancy rate and sublease vacancy rate
- **Availability rate:** space that is vacant plus space that will become vacant over an indefinite time horizon, including spaces that are occupied by vacating tenants and under-construction properties

Office rents and concessions

- **Asking rents:** pricing guidance provided by landlords to tenants for available space expressed as full service (FS)
- **Base rents:** fair market value of market-level lease pricing based on representative executed leases, expressed as full service (FS)
- **Free rent period:** months of free rent that are typically provided upfront by landlords to tenants as a concession to offset the total cost of a lease and/or the construction timeline of an office suite
- **Tenant improvement allowance:** an allowance expressed in dollars per square foot provided from landlords to tenants to offset build-out, engineering, space planning and related permit costs
- **Net effective rent:** base rents discounted by the dollar values of tenant improvement allowance and free rent concessions expressed as full service (FS)

Capital markets

- **Investment volume:** office sales dollars expressed when the transactions close and based on inventory thresholds; partial-interest sale dollar amounts are not grossed-up to reflect the 100% value of the sale
- **Asset pricing:** unweighted average per-square-foot asset pricing of market-level closed sales
- **Cap rate:** net operating income divided by sale price; this measurement of market-level investment returns is calculated as an unweighted average based on closed investment sales

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For more market insights and information visit **avisonyoung.com**

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