



San Francisco office market report

Q3 2023

**AVISON
YOUNG**

San Francisco office market trends

\$389 psf

Low investment volume drives down average psf pricing

The reduced level of investment activity in 2023 reflects a growing reluctance among investors. This hesitancy is primarily due to elevated interest rates and record vacancy levels, which have significantly driven down office pricing. Investors are grappling with limited available capital, particularly as distressed assets become more prevalent in the market. In contrast to 2022, prices have experienced a substantial decline of 62.5% to an average of \$389 psf, while 2023's total annualized investment volume could see a potential 42.0% decrease.

0.67 msf

Q3 leasing activity shows slowing momentum

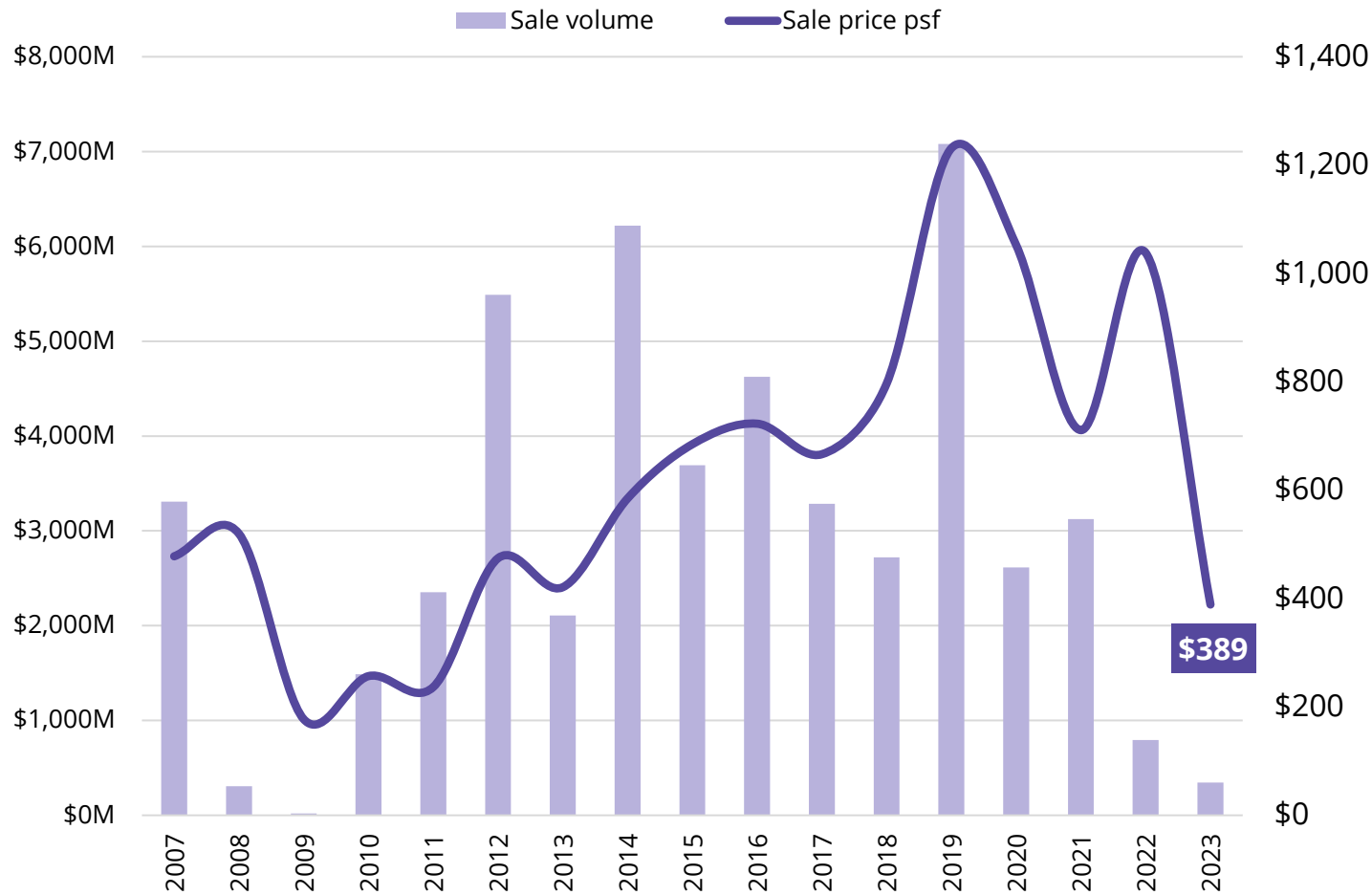
Leasing activity remains below the pre-Covid 5-year average as companies, constrained by limited capital, opt for short-term solutions. Year-to-date leasing figures indicate a 41.5% decrease compared to the same period in 2022. When annualizing leasing activity in 2023 to 3.56 msf, this represents only a marginal increase compared to the recent low of 3.50 msf in 2020. Despite this trend, the presence of several larger tenants in the market and pending transactions could very well lead to a substantial shift in gross leasing activity in Q4.

24.7%

Remote job postings still prevalent

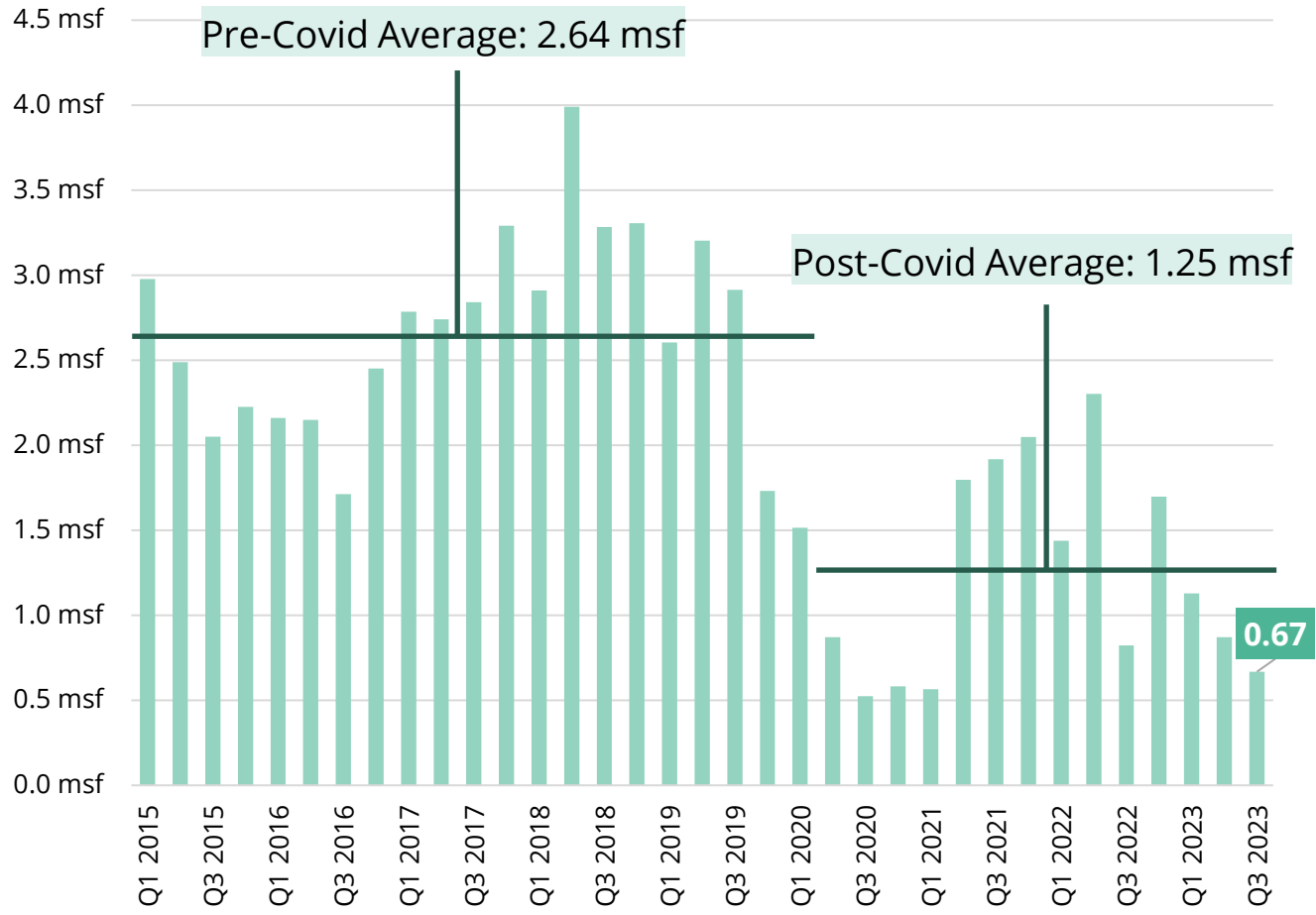
The total percentage of remote job postings in Q3 2023 averaged 24.7%, a slight increase from the previous quarter. As the job market continues to soften, remote work remains prevalent with many companies continuing efforts to conserve capital. Despite the trend of larger companies like Amazon, Meta, and Apple requiring employees to come back to the office, mid-sized companies have decided to buy their time in the market and wait for economic conditions to ameliorate.

Investment volume



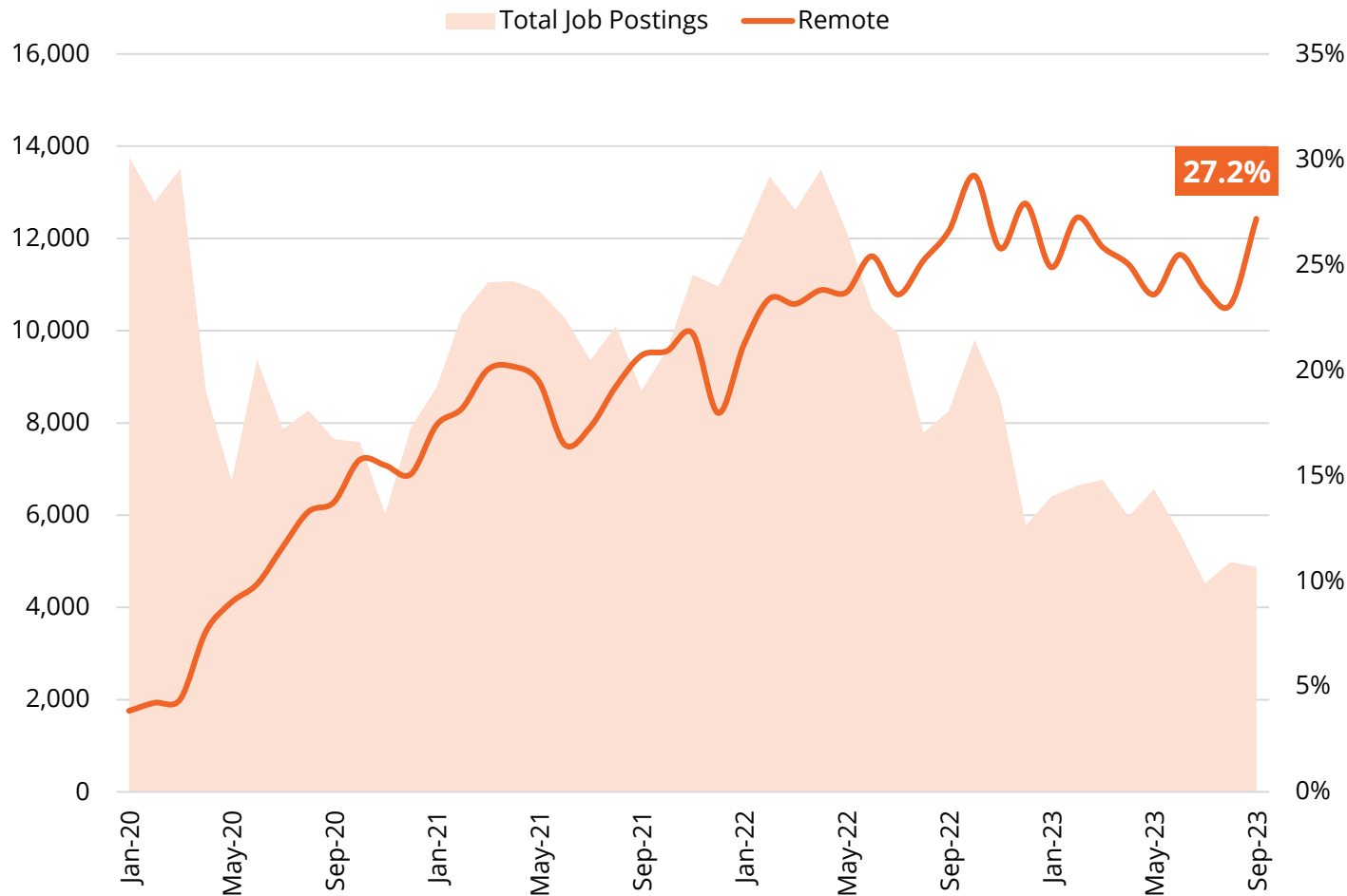
The amalgamation of high interest rates and vacancy have continued to suppress investment in commercial real estate, leading to softened pricing across the board.

Leasing activity



Leasing activity continues to fall short of the 5-year pre-Covid leasing average. Total 2023 leasing activity will struggle to surpass 2020 figures.

Remote job postings

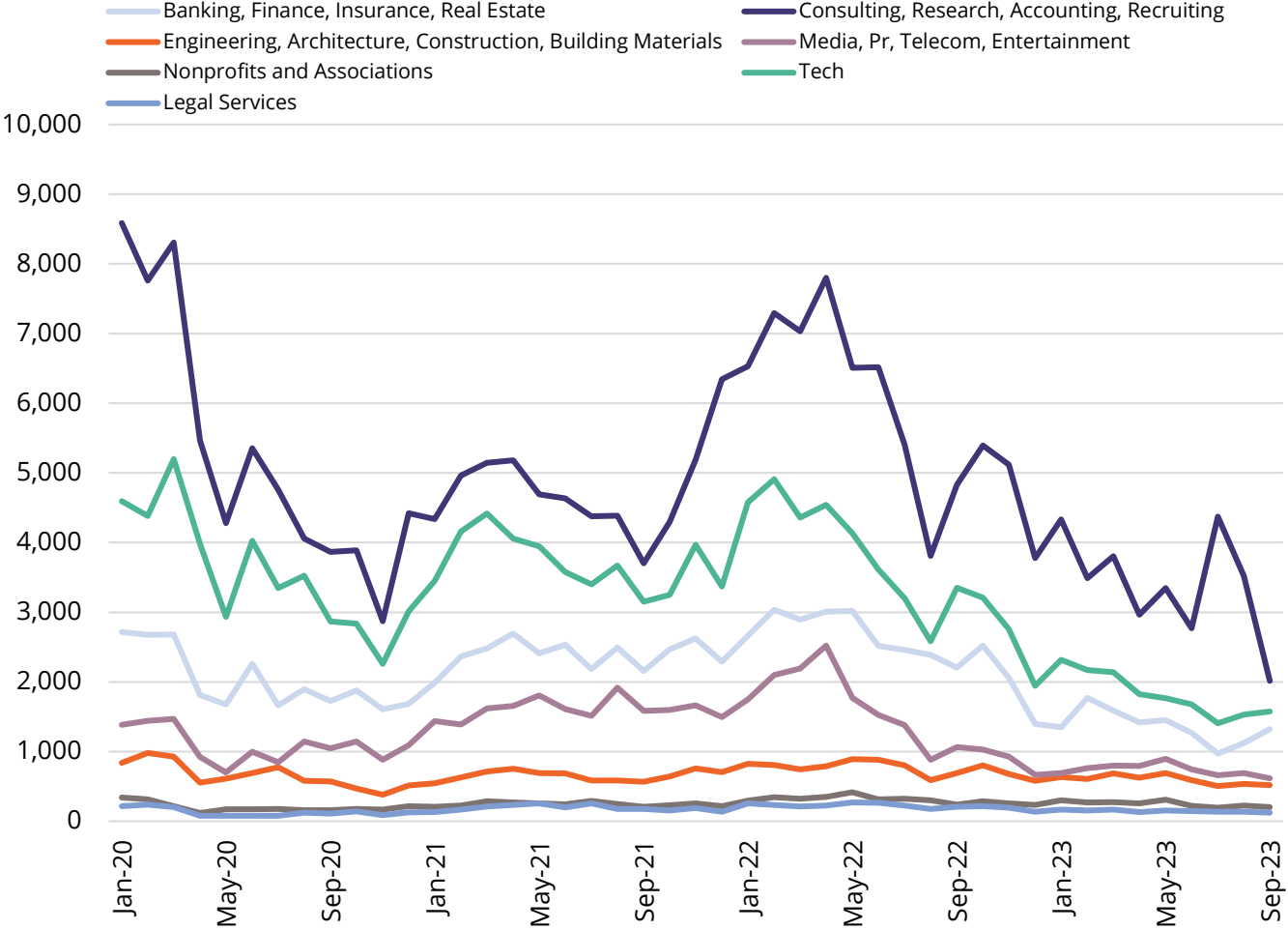


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Economic trends

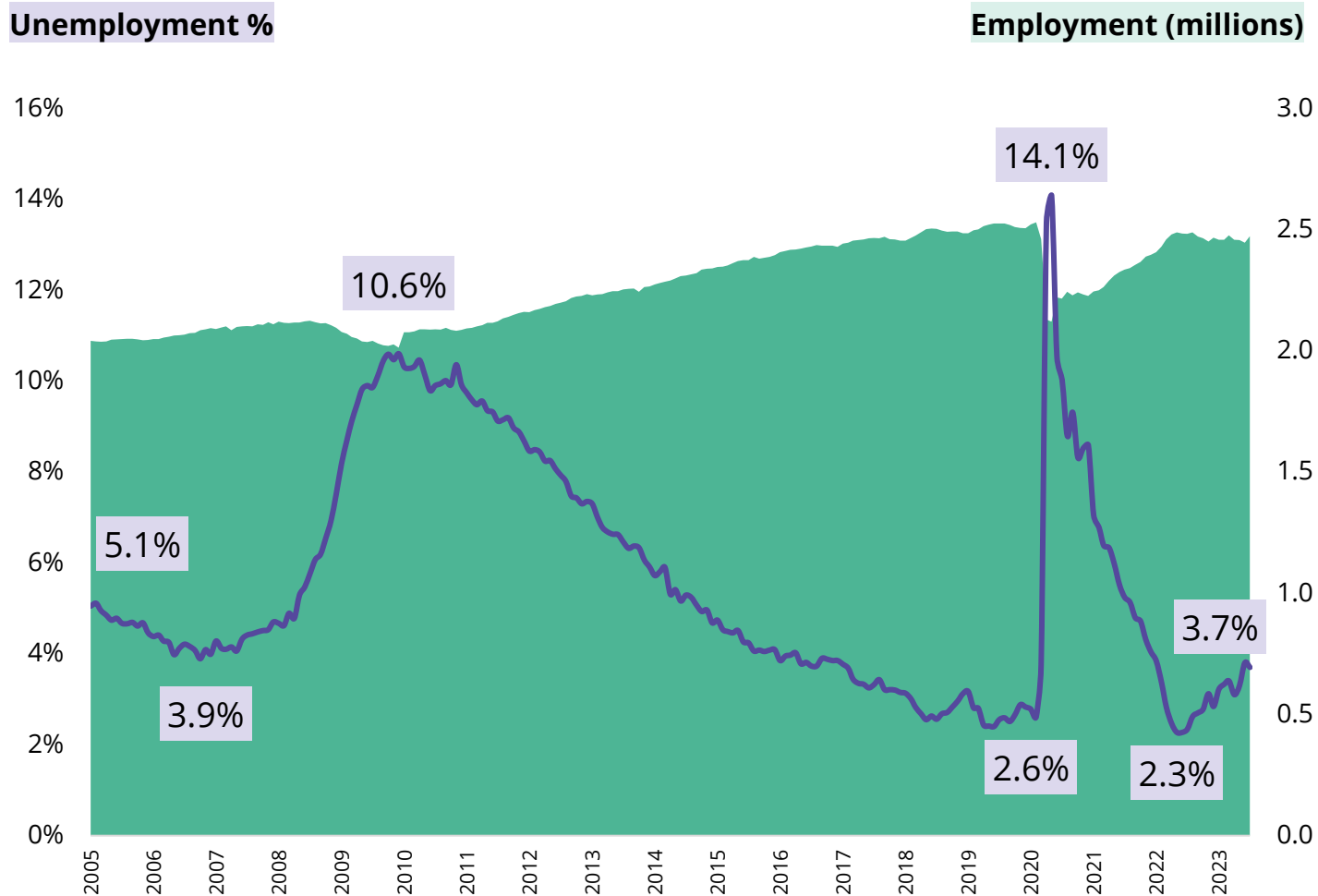


Job postings by industry type



Overall job postings saw a 6.9% decrease from the previous quarter. Consulting, research and accounting firms saw the only increase at 9.1%, while nonprofits slid downwards by 21.6%.

Employment and unemployment rate

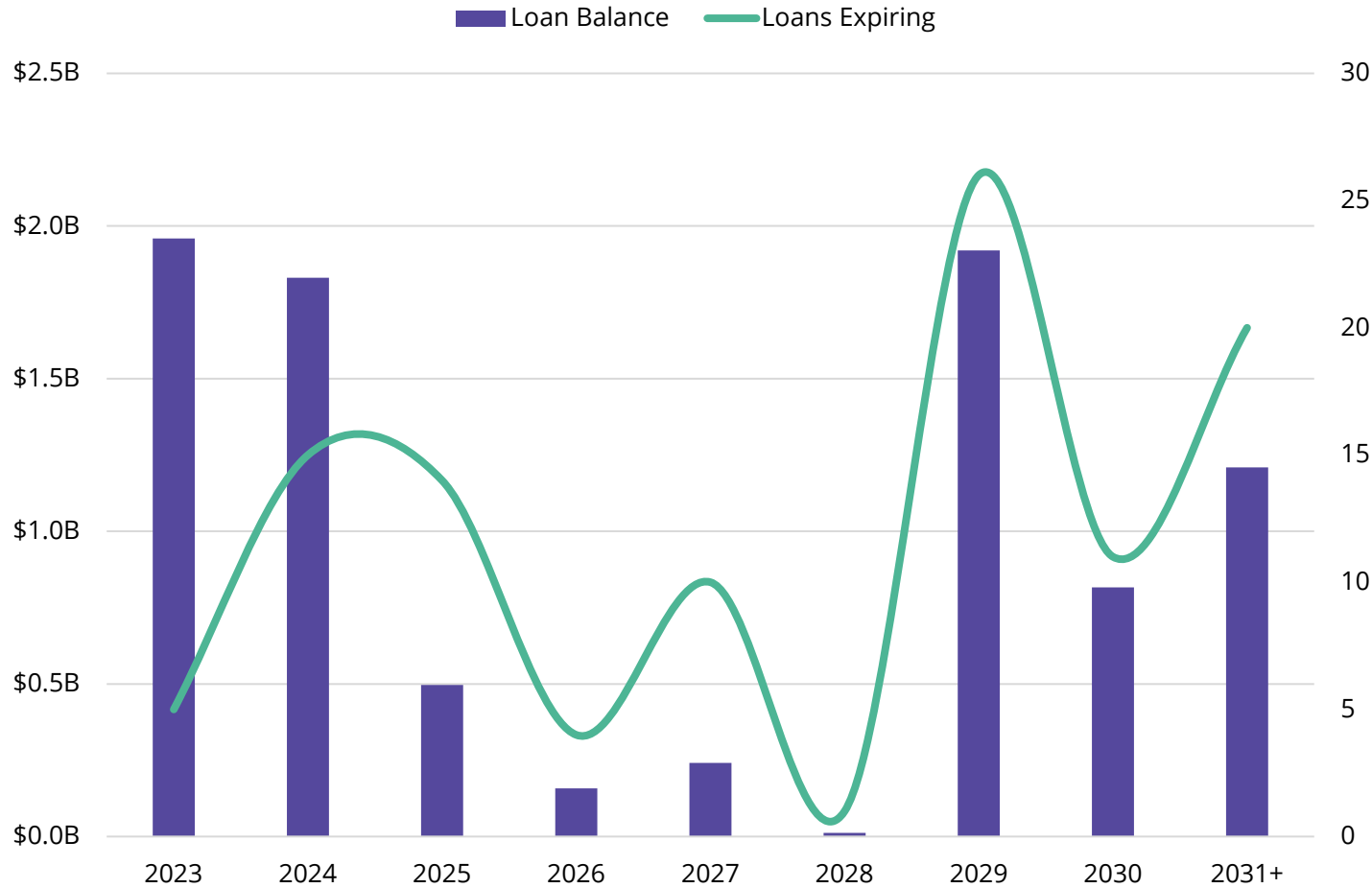


San Francisco's unemployment has steadily crept up to 3.7% this quarter after bottoming out in June 2022 at 2.3%. This follows the latest rate hikes in July, as the Federal Reserve continues to combat rising inflation.

Office market trends

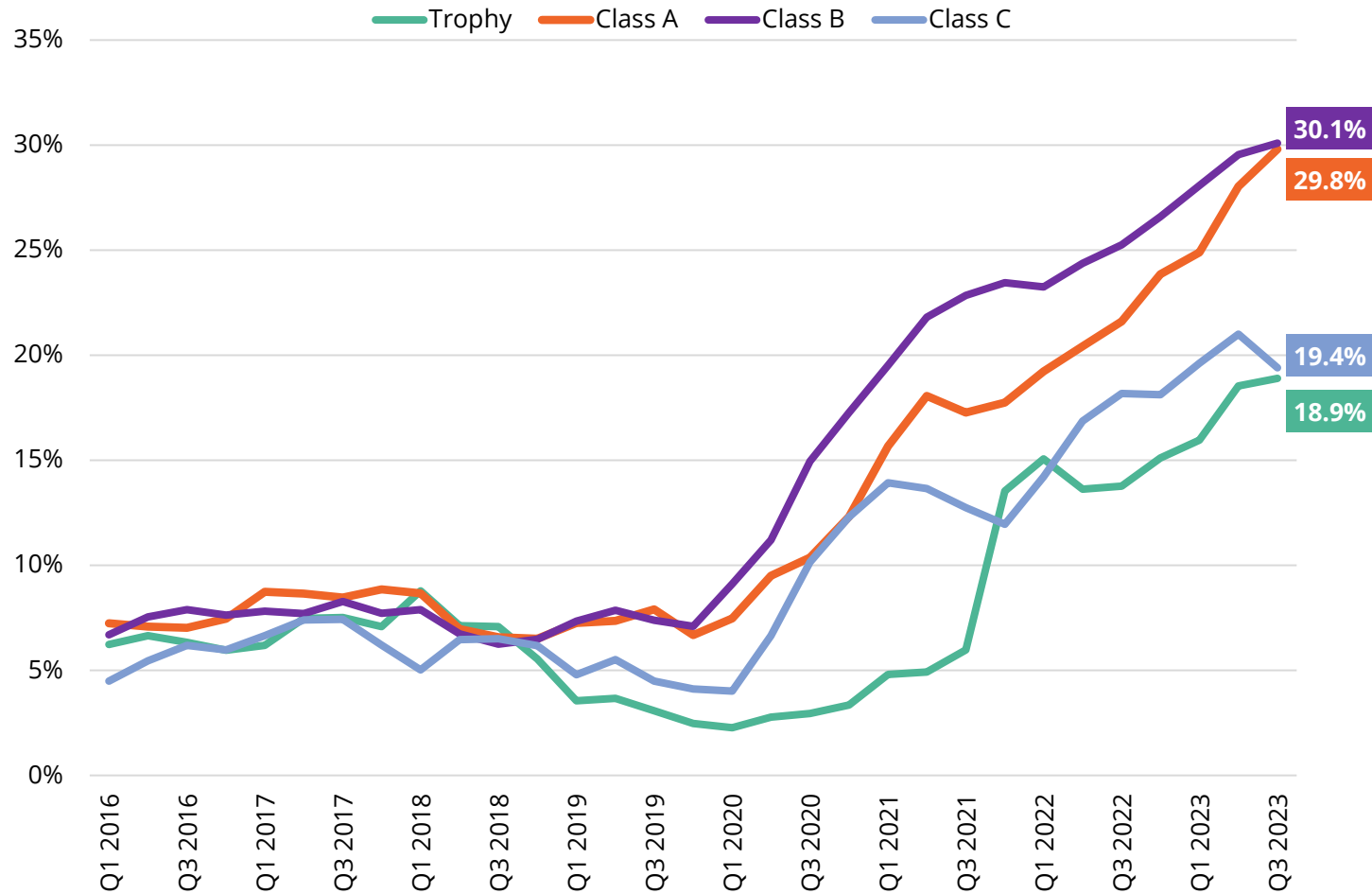


Current CMBS office loan maturities



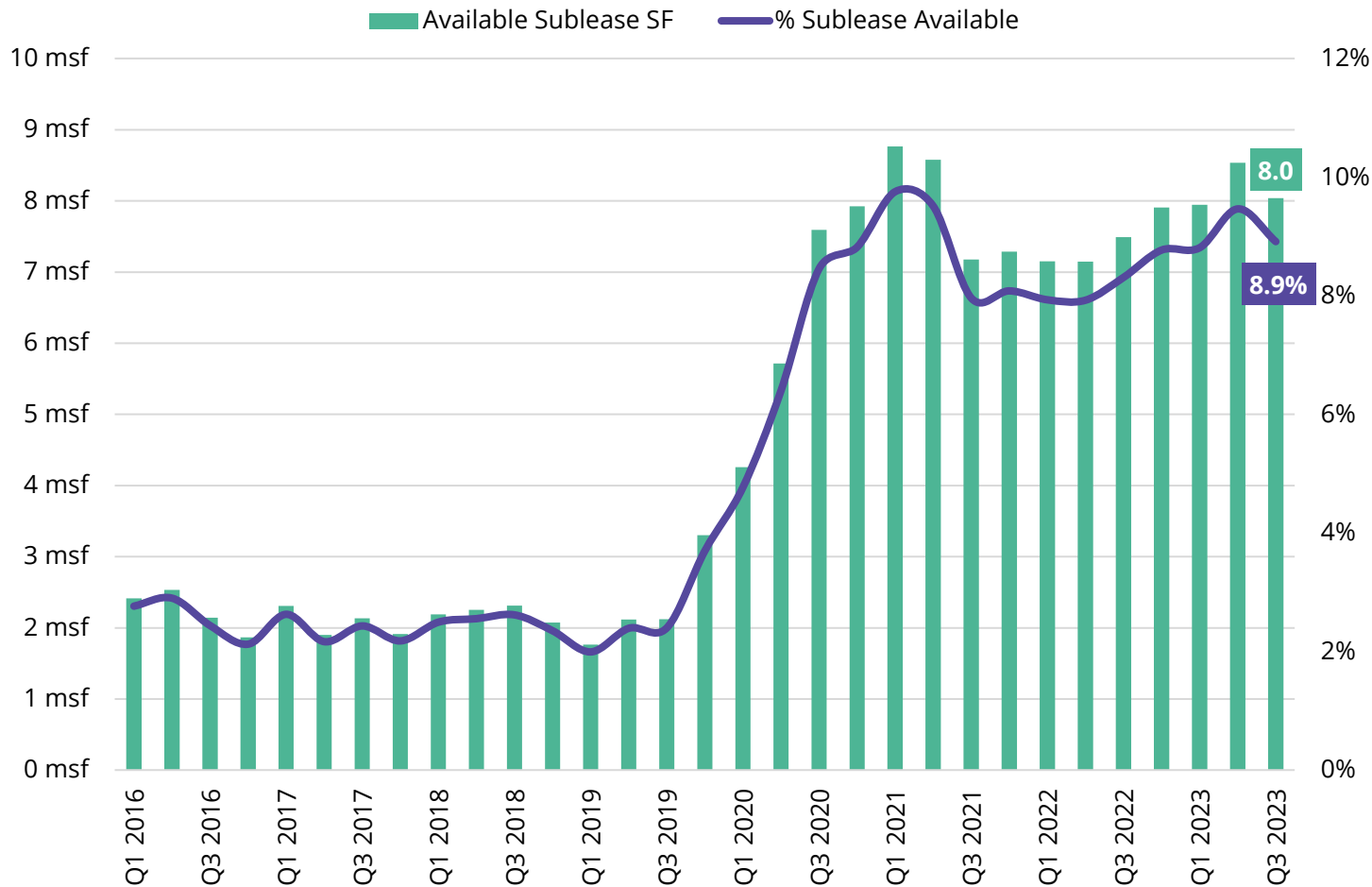
San Francisco's office market is the 2nd highest nationally with loans set to expire before the end of 2024. This includes \$3.8B of loan maturities spread across 20 properties.

Total vacancy by class



Premium view-spaces continue to be coveted assets, fetching premium rents. Class A commodity space vacancy continues to increase as a result of tech retrenching and flight to quality.

Sublease availability



Although the sublease market remains saturated, there has been a 5.8% reduction of availability compared to the previous quarter. This trend can be attributed to subleases from several prominent tenants and is expected to continue into next quarter.

Office large block availability - 50,000+

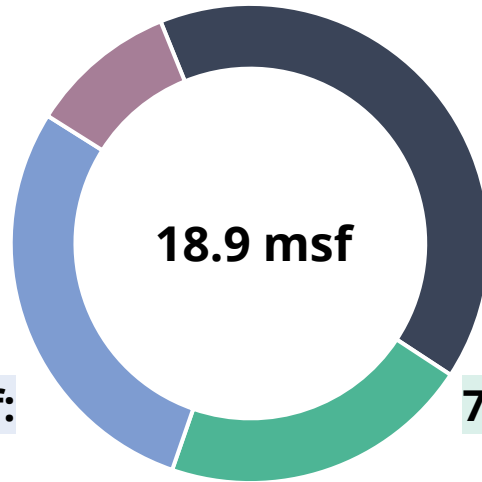
Number of blocks by size:

>200K sf: 10%
17 blocks

50K sf - 75K sf: 40%
69 blocks

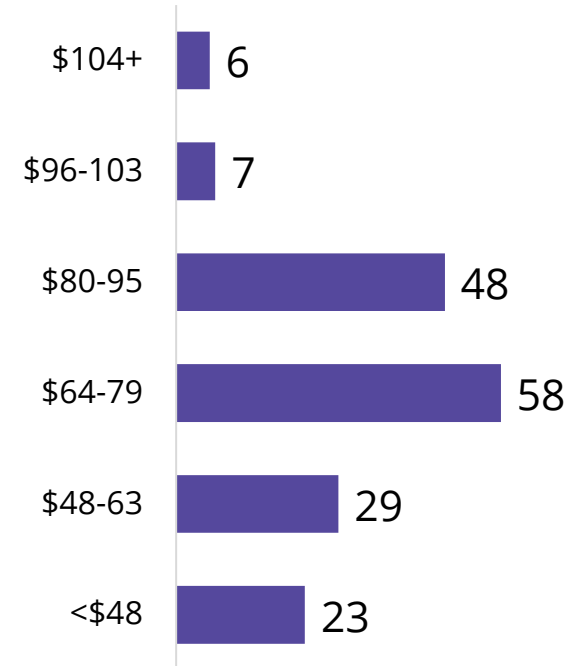
100K sf - 200K sf: 29%
49 blocks

75K sf - 100K sf: 21%
36 blocks

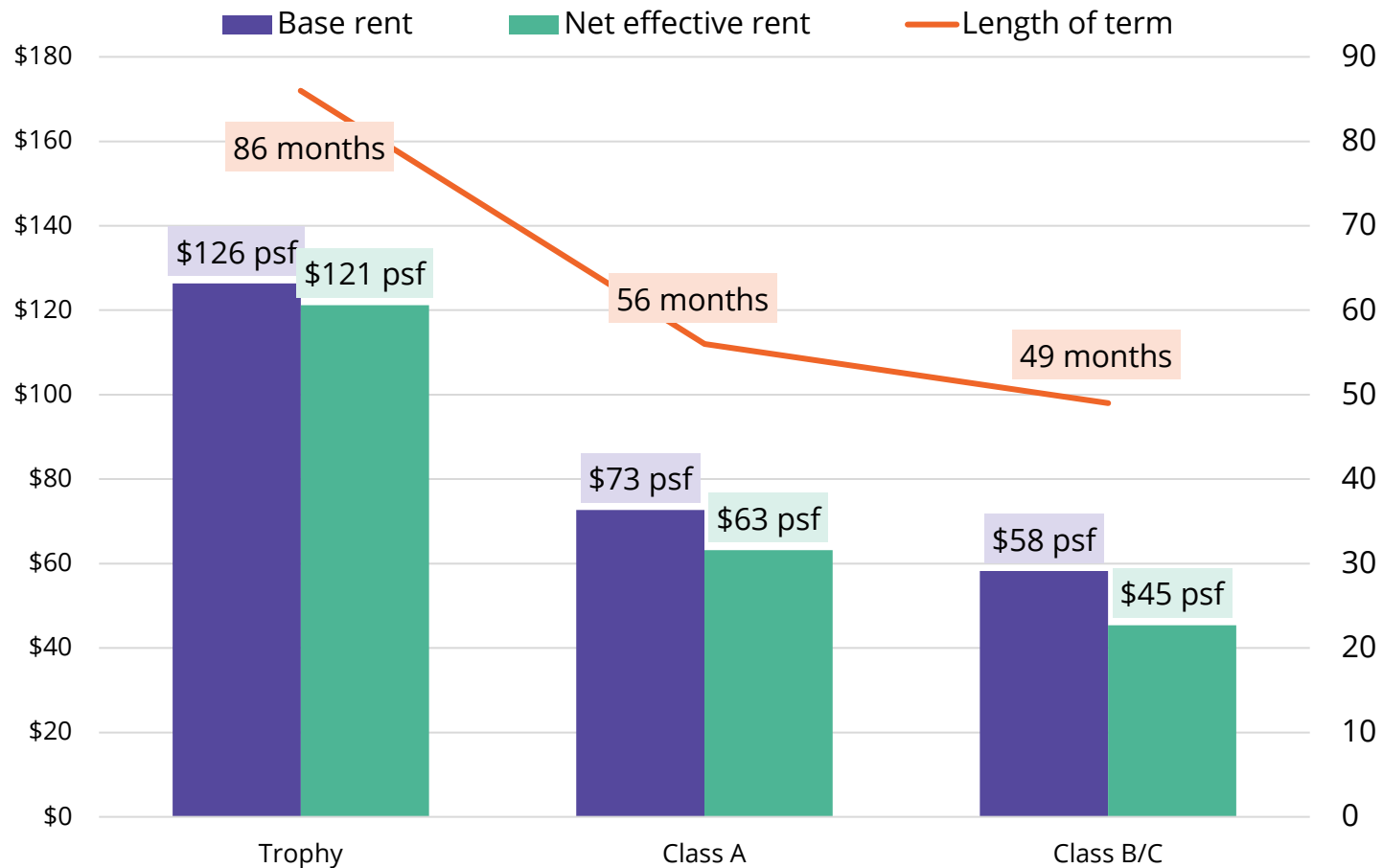


18.9 msf

Asking rents FS:



Lease economics by class

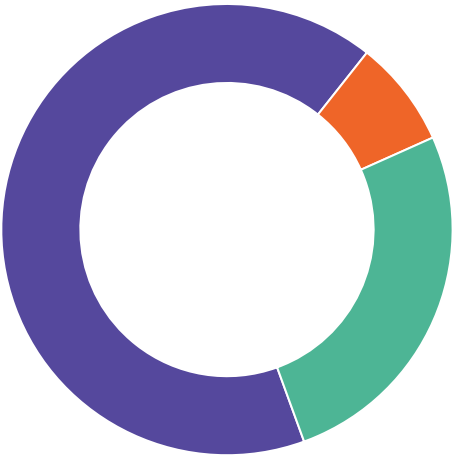


Higher-quality assets are experiencing longer lease terms and a smaller gap between base and net effective rents. The correlation between premium rents and the flight to quality continues.

Leasing trends pre versus post-COVID

From 2018 through March 2020

New leases, direct relocations
66.2%

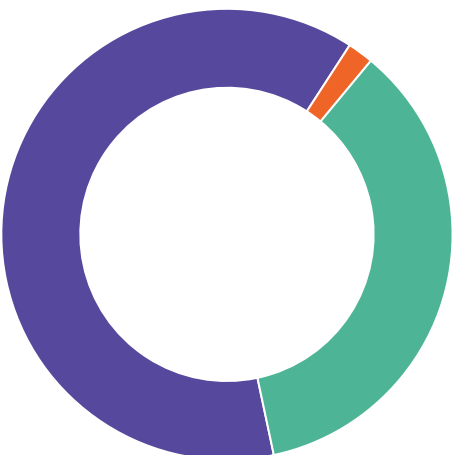


Expansions
7.7%

Direct renewals
26.1%

Leasing activity post-COVID

New leases, direct relocations
62.5%

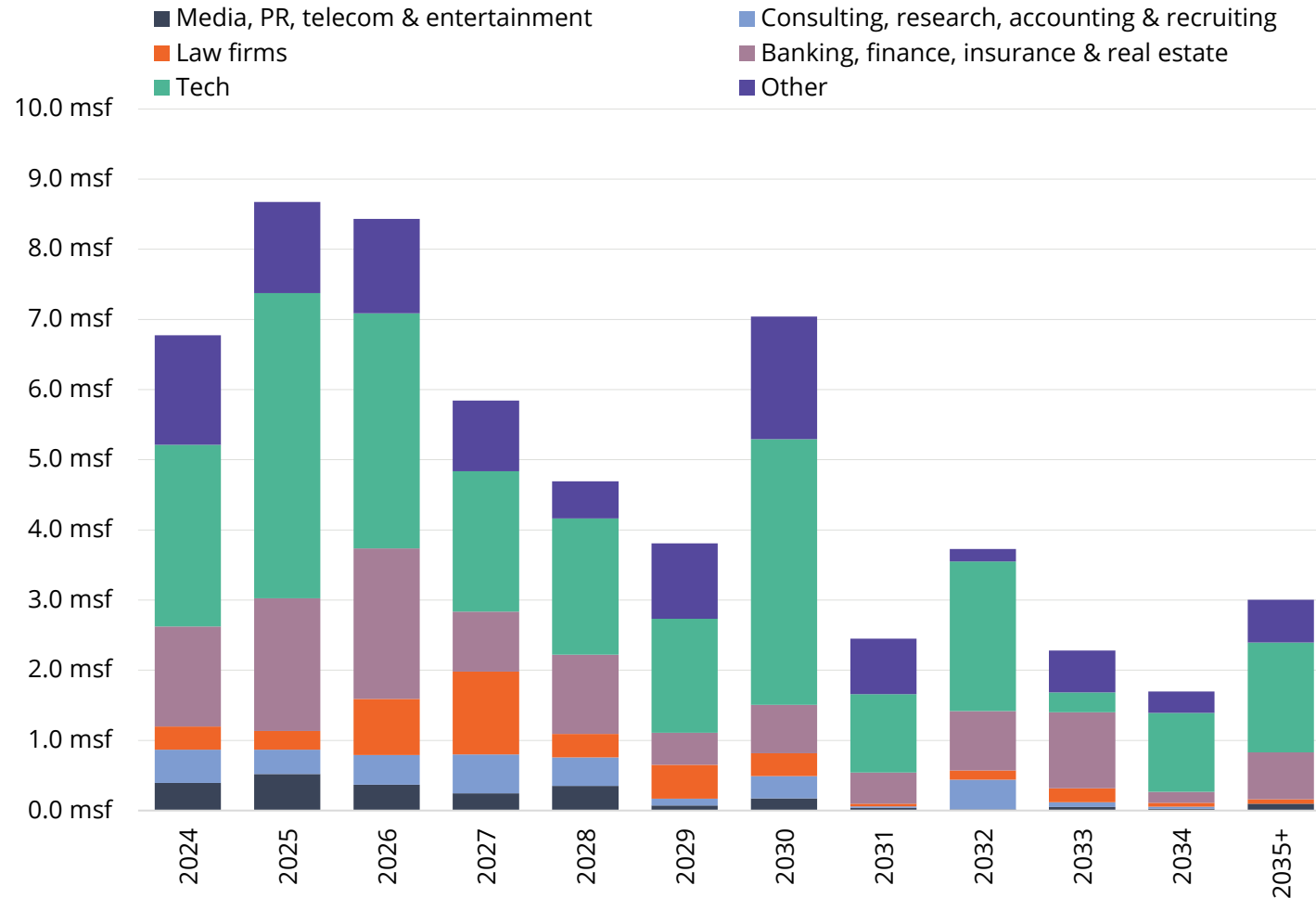


Expansions
1.9%

Direct renewals
35.7%

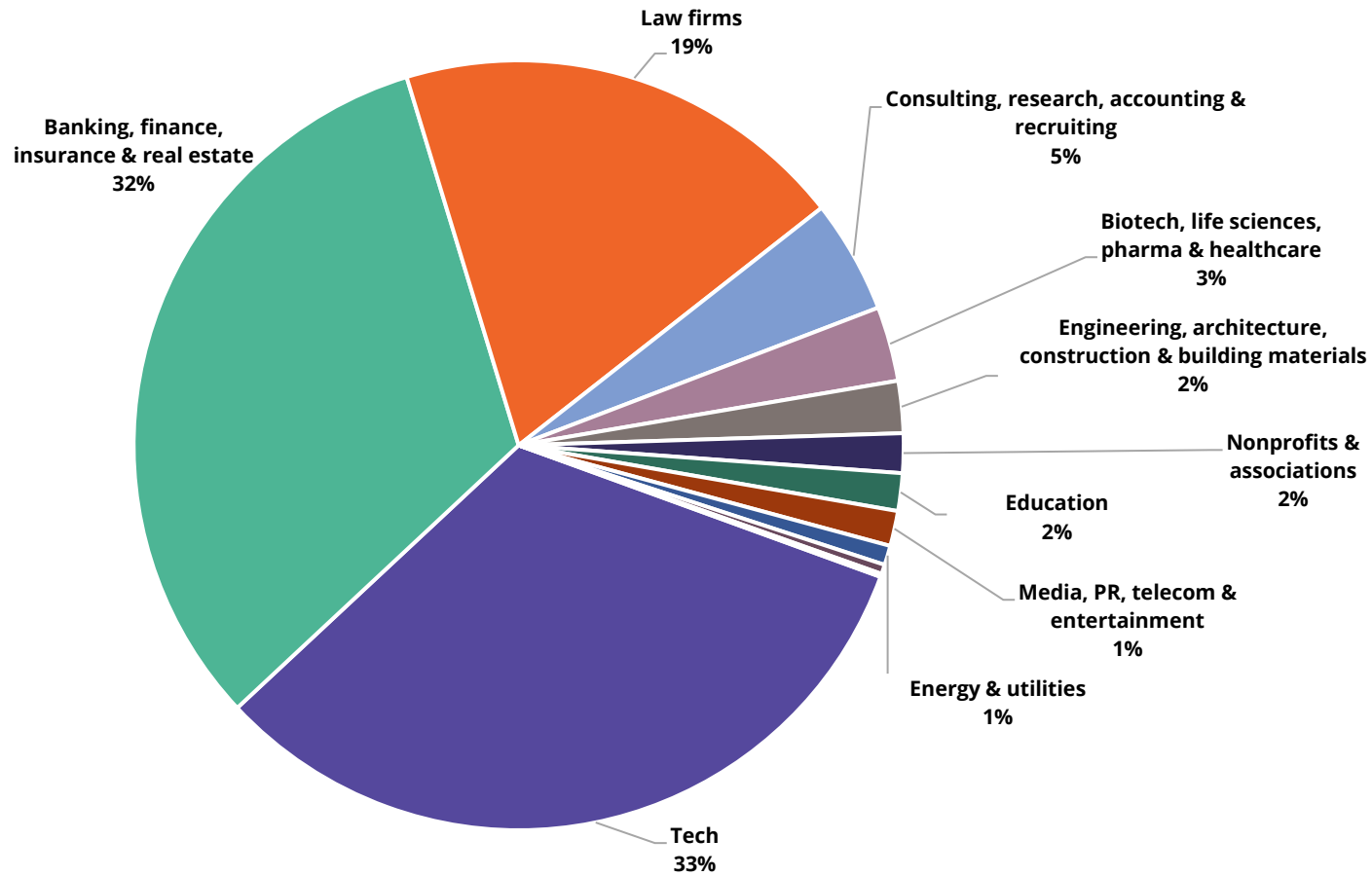
Tenants have shifted focus in leasing strategy taking advantage of landlords offering lucrative concession packages for new leases and renewals.

Future lease expirations by industry

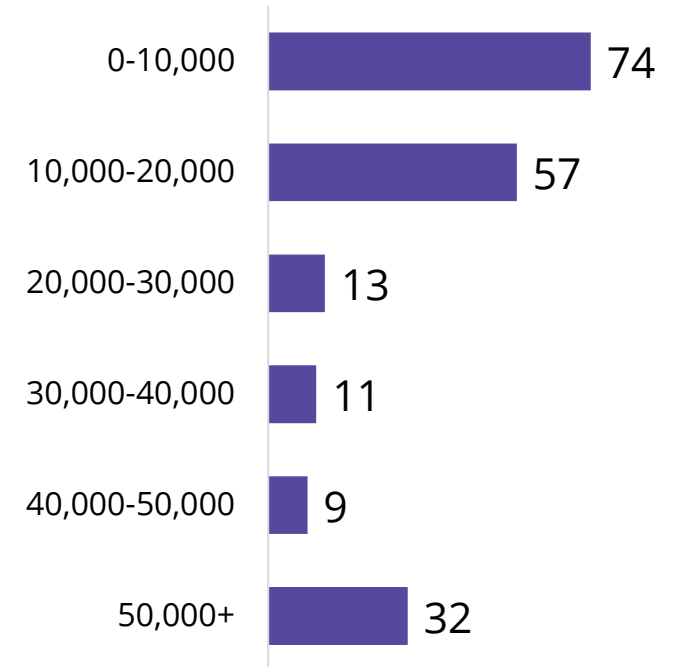


Tech companies account for 44.3% of upcoming lease expirations among major industries, with financial services trailing behind at 20.2%.

Current San Francisco tenants in the market



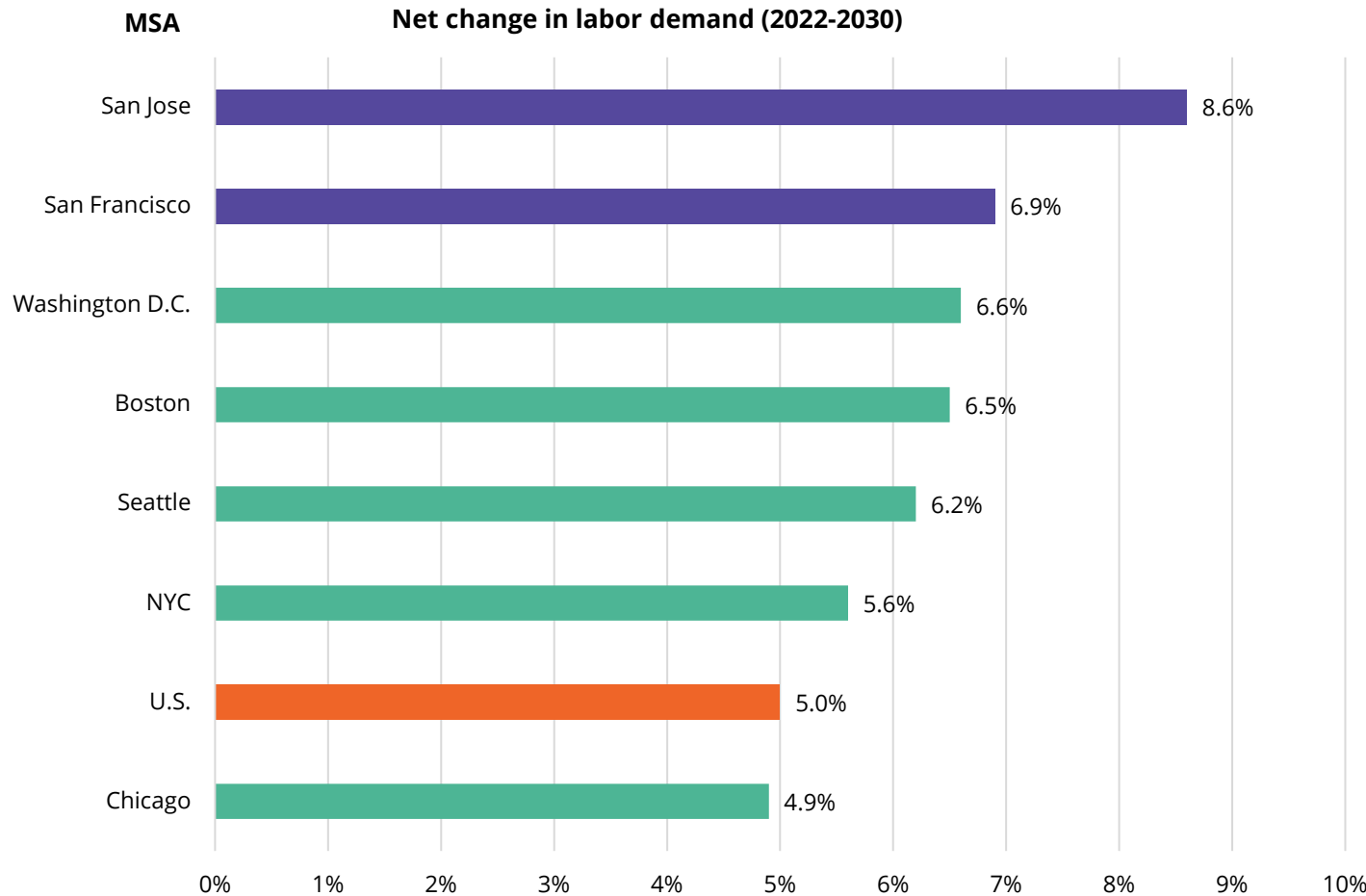
Total requirements by size



AI trends



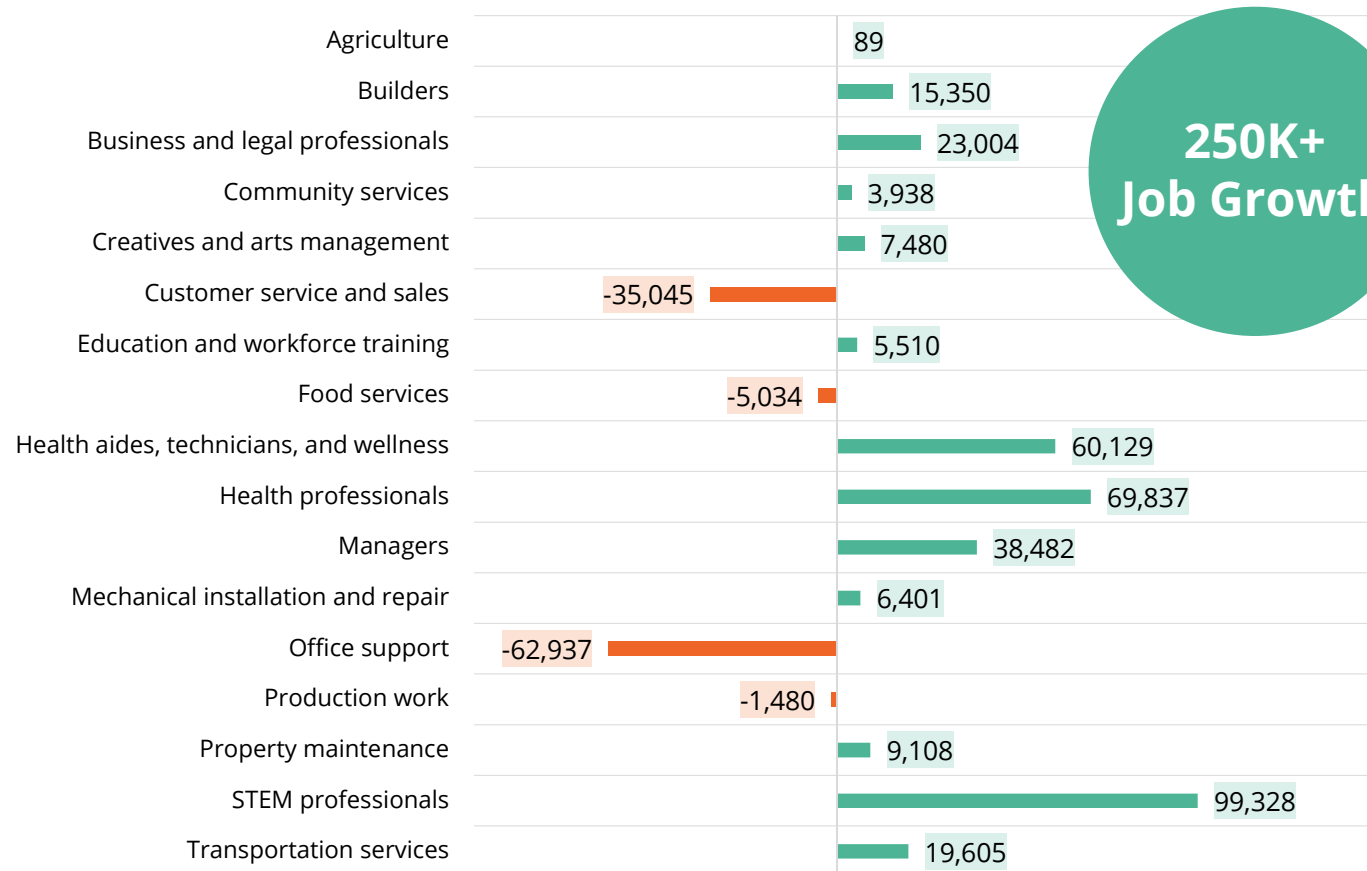
AI-driven labor demand by MSA



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.

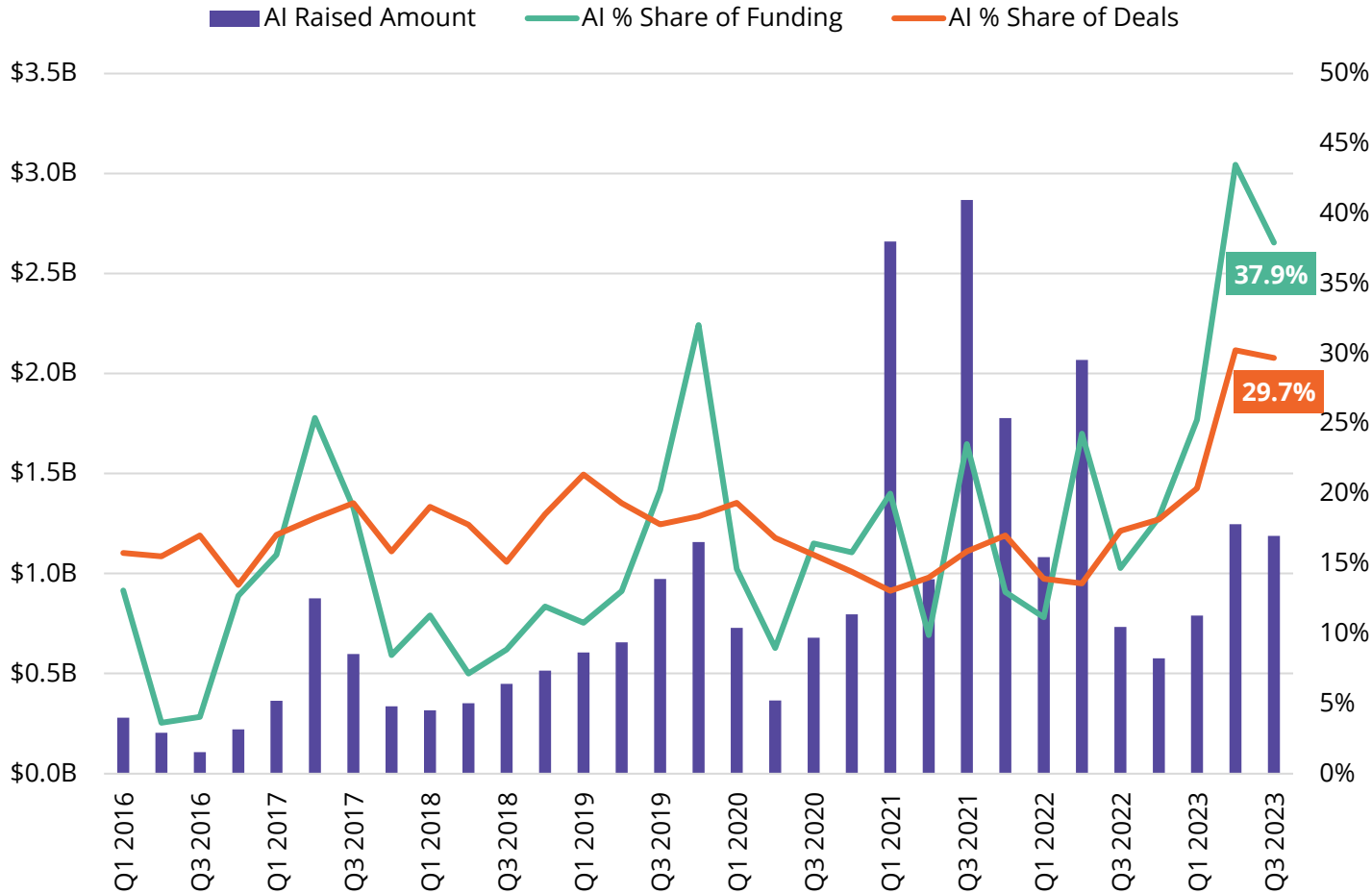
AI-driven labor demand by occupation

Net change in Bay Area labor demand (2022-2030)



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.

San Francisco VC funding for AI dominates

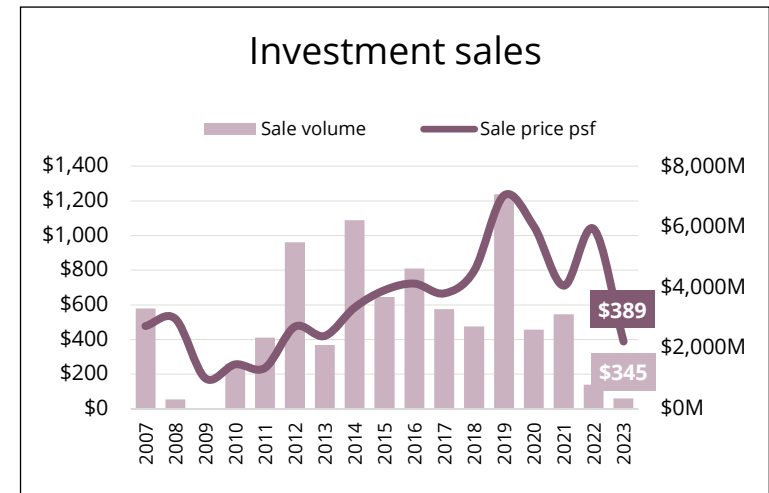
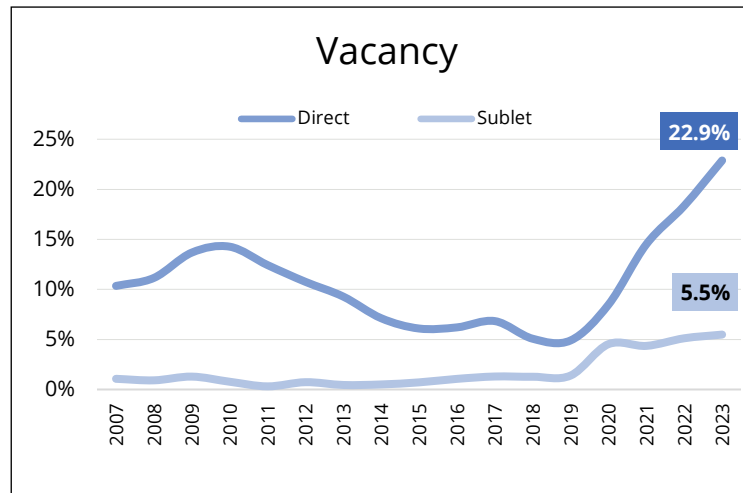
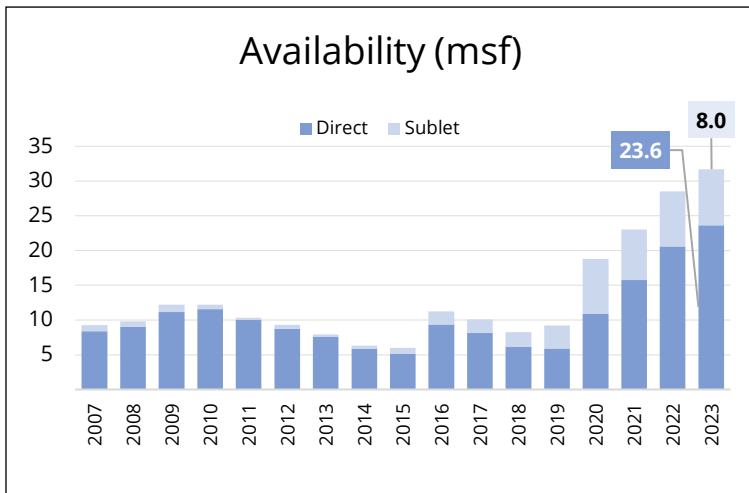
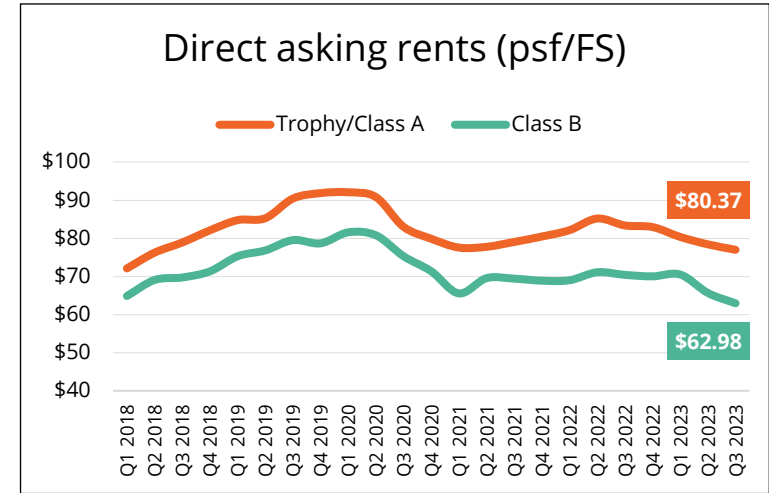
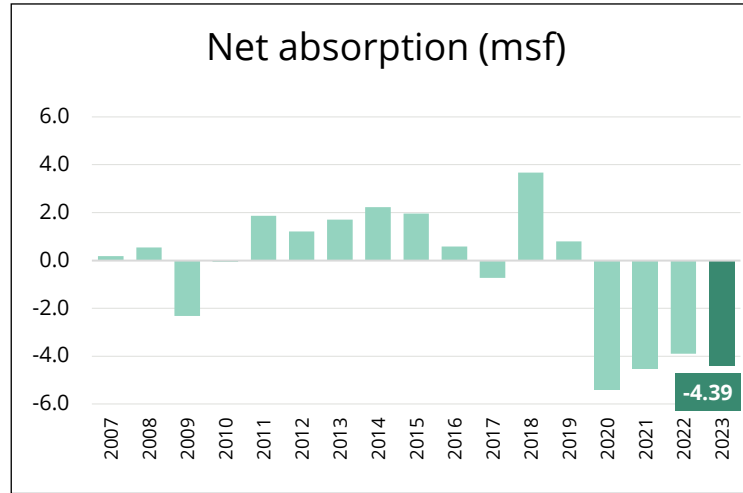
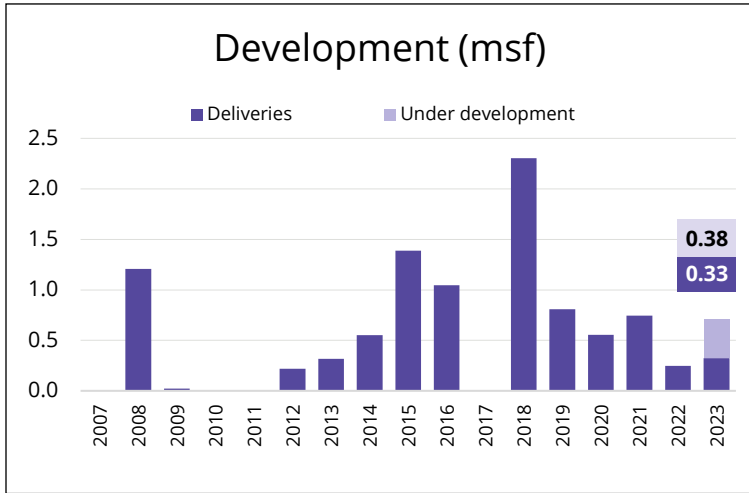


San Francisco's AI boom has seen over \$1B in funding through the first two quarters of 2023, accounting for 22.8% of the market's total funding compared to 10.3% from the same period in 2022. The appetite for VC funding has increased in Q3, with AI representing 40.9% of total funding in San Francisco.

Appendix



San Francisco office market indicators



San Francisco office market stats

	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Sublet vacancy	Total vacancy	Net absorption sf (Q3 2023)	Net absorption sf (YTD)	Direct asking rent FS
Financial District	28,205,186	0	0	25.1%	4.0%	29.2%	(509,621)	(1,298,625)	\$72.85
South Financial District	27,246,906	0	0	19.1%	6.5%	25.6%	(539,710)	(1,827,565)	\$73.29
CBD Total	55,452,092	0	0	22.2%	5.2%	27.4%	(1,049,331)	(3,126,190)	\$73.03
Chinatown/Nob Hill/Russian Hill	105,570	0	0	6.0%	0.0%	6.0%	(6,359)	(6,359)	-
Jackson Square	1,907,992	0	0	21.0%	4.5%	25.6%	21,112	29,436	\$61.18
MidMarket	4,476,386	0	235,071	17.2%	8.9%	26.1%	(59,754)	(275,460)	\$63.76
Mission	910,492	0	0	25.6%	2.0%	27.6%	3,682	(46,663)	\$71.00
Mission Bay	1,853,239	300,000	0	29.7%	2.8%	32.5%	8,456	20,989	-
Outer San Francisco	1,212,250	0	0	7.2%	0.0%	7.2%	21,204	24,205	-
Potrero Hill	1,095,605	0	0	28.2%	11.0%	39.3%	(38,882)	(280,639)	\$48.00
Rincon Hill/South Beach	5,703,401	0	0	23.1%	8.1%	31.2%	(187,461)	(421,564)	\$67.18
Showplace Square	3,322,654	0	51,409	23.2%	11.5%	34.6%	(12,837)	(152,943)	\$57.79
South of Market	874,596	25,000	93,138	26.9%	2.9%	29.8%	(7,794)	(6,727)	\$60.94
Union Square	4,015,711	0	0	24.1%	3.0%	27.1%	39,775	(7,649)	\$58.15
Van Ness Corridor	1,628,858	0	0	14.8%	0.1%	14.9%	(1,755)	25,613	\$37.35
Waterfront/North Beach	3,240,626	0	0	22.5%	4.6%	27.1%	(91,806)	(51,507)	\$81.52
Yerba Buena	3,623,466	0	0	42.1%	7.5%	49.6%	(32,358)	(115,144)	\$86.39
Non-CBD Total	33,970,846	325,000	379,618	24.0%	6.1%	30.1%	(344,777)	(1,264,412)	\$72.41
Market total	89,422,938	325,000	379,618	22.9%	5.6%	28.4%	(1,394,108)	(4,390,602)	\$72.83

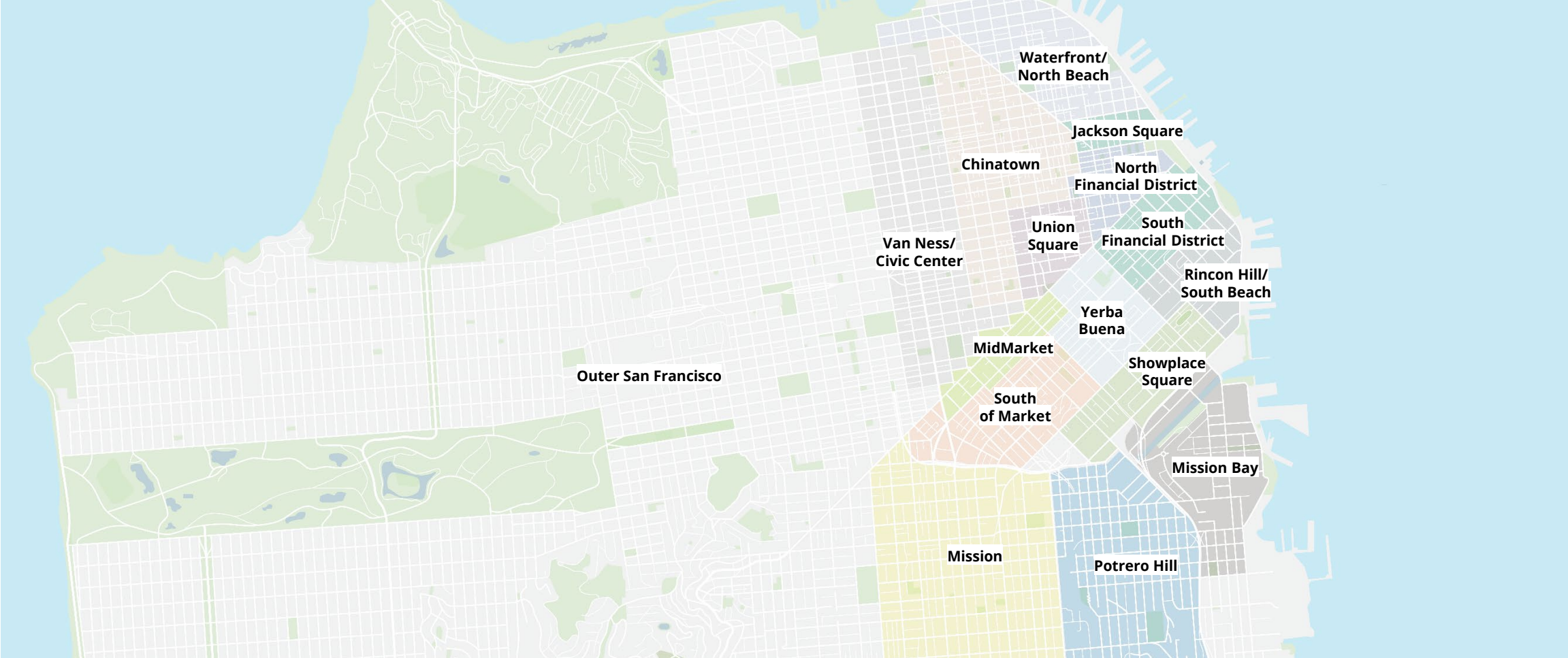
The charts and statistics in this report are composed by Class A, B, and C, non-owner-occupied office buildings 20,000 sf and above in the submarkets listed above.

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 (Q3 2023)	Net absorption sf (YTD)	Direct asking rent FS
Trophy	8,630,431	0	0	14.0%	4.9%	18.9%	(33,533)	(329,870)	\$98.48
Class A	47,337,010	300,000	235,071	24.0%	5.9%	29.8%	(1,051,706)	(2,789,800)	\$73.59
Class B	29,630,741	25,000	144,547	24.3%	5.8%	30.1%	(281,797)	(1,147,210)	\$62.98
Class C	3,824,756	0	0	17.9%	1.5%	19.4%	(27,072)	(123,722)	\$55.04
Market total	89,422,938	325,000	379,618	22.9%	5.6%	28.4%	(1,394,108)	(4,390,602)	\$72.83

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.

San Francisco submarket map



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

For more market insights and
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