

MARKET TRENDS | SAN FRANCISCO

OFFICE

MARKET DRIVERS

THE SAN FRANCISCO OFFICE MARKET is still turning the corner with a slow, but steady recovery. In 2021 we reported 5.5M SF of leasing activity which was on track to pre-pandemic levels. This quarter we are seeing leasing activity of almost 1.3M SF which is more than double the amount reported in Q1 of last year. Year-over-year there has been an improvement, though activity seems to have slowed when compared to Q4 2021, which recorded 2.1M SF of leasing activity.

Q4 2021 seemed to be a turning point for the market, but we aren't seeing the uptick in activity that was expected. Total vacancy rates are still high at 20.2%, 100 basis points (bps) up from Q4 2021, while sublease vacancy rates remained steady at 4.4%. Kidder Mathews is seeing an uptick in tenant prospects, yet it seems they are not quite ready to make the jump to return to the office.

MUCH OF THE VACANCY in the office market is still coming from class B and C buildings, currently reporting 22.5% and 20.6% respectively. The "flight to quality" trend continues, with class A office enjoying a lower 18.4% total vacancy rate.

SUBLEASE VACANCY has remained steady and only dipped by 10 bps since the last quarter. Direct leasing activity dropped significantly to only 704,845 SF compared to last quarter's 1.7M SF. That said, subleasing activity rose to 562,885 SF as compared to last quarter's 344,823 SF. The sublease market is approaching pre-pandemic levels, which indicates some level of demand. Our read is that prospective tenants may still be wary of long-term leases due to the latest Omicron surge but would still like to have office space in the city.

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Market Summary

	1Q2022	4Q21	1Q21	Annual Change
New Construction	145,000	921,900	115,766	25.3%
Under Construction	843,684	1,024,257	2,238,253	-62.3%
Direct Vacancy Rate	15.7%	14.7%	11.4%	37.7%
Sublease Vacancy Rate	4.4%	4.5%	5.3%	-17.0%
Overall Vacancy Rate	20.2%	19.2%	16.7%	21.0%
FIDI Direct Asking Lease Rate (A&B)	\$66.55	\$66.34	\$66.92	-0.6%
Leased SF	1,267,730	2,120,557	548,614	131.1%
Sold SF	303,997	2,701,943	814,758	-62.7%
Total Net Absorption	(977,988)	(168,832)	(2,634,043)	N/A

▲ **1.3M**
LEASING ACTIVITY (SF)

▼ **-977K**
NET ABSORPTION (SF)

▲ **20.2%**
OVERALL VACANCY RATE

▼ **\$66.55**
AVERAGE ASKING RENT

▲ **145K**
NEW DELIVERIES (SF)

CHANGE FROM PRIOR YEAR

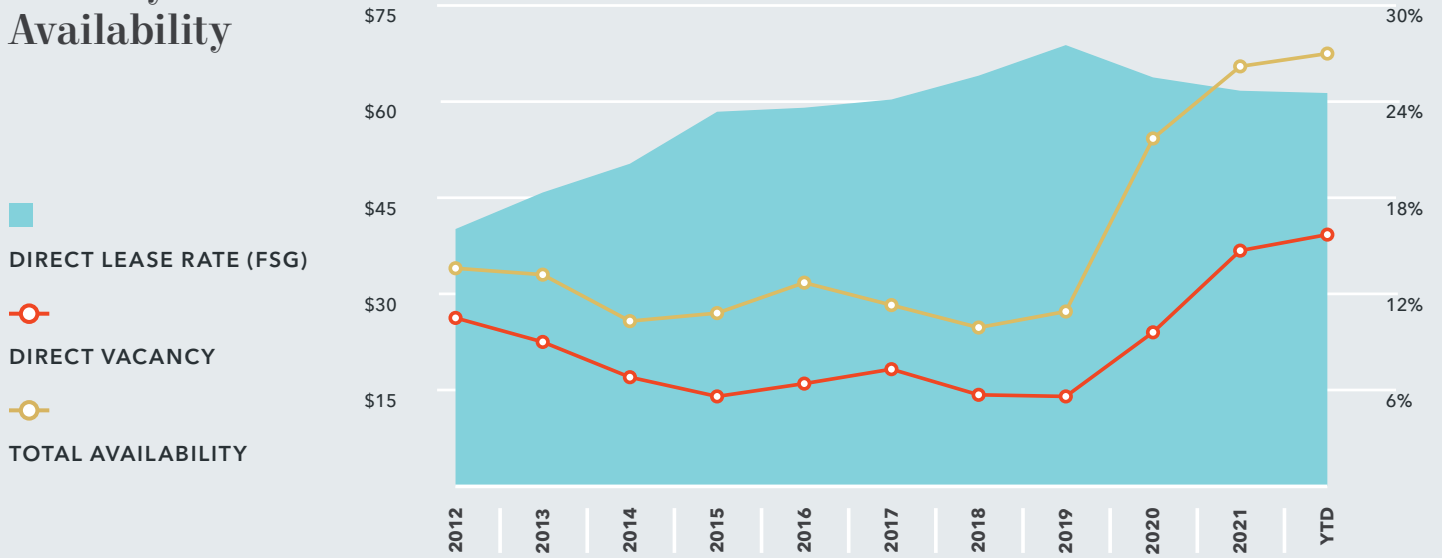
Market Highlights

SUB-10K SF tenant activity on the rise

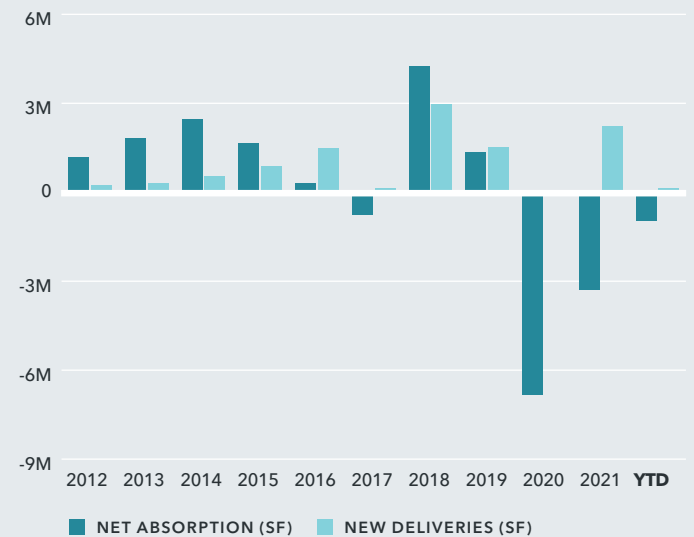
COMPANIES still figuring out hybrid work models

FLIGHT to quality continues and some landlords are investing in their buildings to capture that demand

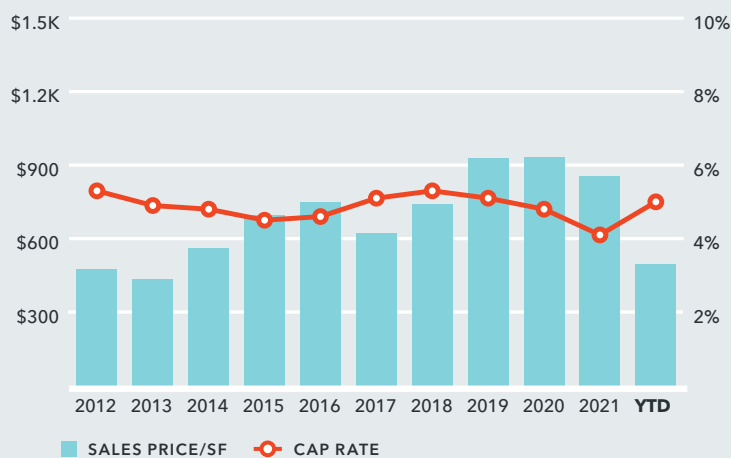
Lease Rate, Vacancy & Availability



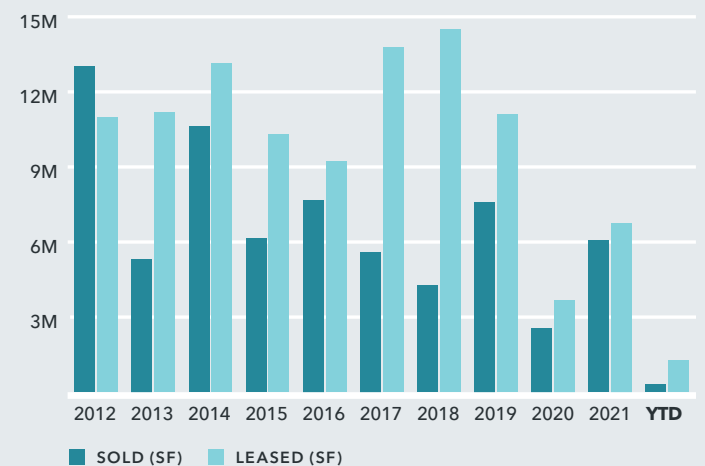
Net Absorption & New Deliveries



Average Sales Price/SF & Cap Rate



Sale Volume & Leasing Activity



SUBMARKET STATISTICS

Submarket	Total Inventory	Under Construction	Direct Vacancy Rate	Sublet Vacancy Rate	Total Vacancy Rate	Total Available Rate	1Q22 Total Net Absorption	YTD Total Net Absorption	1Q22 Leasing Activity	YTD Leasing Activity	Average Rental Rate (FS)
Civic Center	615,732	0	22.3%	2.3%	24.5%	27.2%	-20,170	-20,170	5,308	5,308	\$24.58
Financial District	26,169,949	0	18.8%	2.9%	21.6%	28.1%	-522,927	-522,927	295,399	295,399	\$62.73
Jackson Square	2,343,479	0	20.2%	1.6%	21.8%	26.7%	-413	-413	22,090	22,090	\$61.12
Mid Market	4,702,660	0	11.8%	5.8%	17.6%	32.1%	-51,309	-51,309	35,554	35,554	\$27.60
Mission Bay/China Basin	5,090,070	600,000	4.1%	10.9%	14.9%	21.8%	-110,784	-110,784	56,474	56,474	\$39.00
Mission/Potrero	3,270,252	0	21.7%	3.0%	24.7%	28.0%	186,267	186,267	37,204	37,204	\$50.00
Rincon/South Beach	5,973,528	0	12.5%	8.2%	20.7%	29.4%	-84,937	-84,937	71,649	71,649	\$59.71
Showplace Square	3,567,166	101,782	6.1%	9.6%	15.7%	38.7%	-55,117	-55,117	8,609	8,609	\$47.21
South Financial District	28,611,144	0	10.4%	4.4%	14.7%	21.4%	-144,394	-144,394	517,619	517,619	\$69.24
SOMA	5,672,448	141,902	24.9%	2.3%	27.3%	27.6%	-56,465	-56,465	86,485	86,485	\$62.00
Union Square	4,373,963	0	20.3%	2.2%	22.5%	29.7%	-68,753	-68,753	100,067	100,067	\$50.74
Van Ness Corridor/Chinatown	1,341,329	0	16.5%	0.8%	17.2%	28.1%	-13,927	-13,927	3,701	3,701	\$53.83
Waterfront/North Beach	3,823,724	0	19.7%	2.5%	22.2%	26.1%	-65,599	-65,599	19,018	19,018	\$30.92
Yerba Buena	3,941,440	0	33.7%	6.5%	40.2%	46.5%	30,540	30,540	8,553	8,553	\$55.73
San Francisco Totals	99,496,884	843,684	15.7%	4.4%	20.2%	27.2%	-977,988	-977,988	1,267,730	1,267,730	\$61.34
Class A	53,589,962	725,546	13.8%	4.7%	18.4%	24.6%	-739,178	-739,178	783,692	783,692	\$71.88
Class B	38,550,096	118,138	18.1%	4.4%	22.5%	30.8%	-171,331	-171,331	366,773	366,773	\$55.73
Class C	7,356,826	0	17.9%	2.8%	20.6%	26.7%	-67,479	-67,479	117,265	117,265	\$44.42

ECONOMIC REVIEW

IN JANUARY OF 2022 the unemployment rate rose slightly to only 3.4% in San Francisco, 10bps higher than last quarter. The Bay Area's labor market remains strong.

HYBRID WORK MODELS are here as Salesforce, Google, Meta, and many more notable companies have announced their plans to return to the office. Most companies are opting to "phase-in" hybrid work in the coming months until both employees and employers are ready to return to full time offices. Some companies may be thinking of a full-time hybrid model moving forward, however they are still in the planning phase to straighten out the logistics of how much office space they will actually need.

INFLATION REMAINS on the rise-which is putting even more pressure on our supply chain. This is directly causing the cost of raw materials used in construction to increase which may delay delivery times and build outs.

NEAR TERM OUTLOOK

SOME LANDLORDS are starting to propose greater than 3% annual rent increases, which we expect to become a larger trend as the year progresses due to their inflation expectations.

TENANT PROSPECT OUTREACH has been increasing which is a positive sign for future market growth. Kidder Mathews is seeing many smaller tenants actively searching for space under 10,000 SF. Quarter-over-quarter we have tracked a 23% increase of tenants in the market that are looking for office space under 10,000 SF. This could be indicative of new company formation increasing as venture capital funding soared last year specifically in the Bay Area. According to data from CB Insights, the SF Bay Area reported 101% growth year-over-year in venture capital funding.

DUE TO INFLATION and the strain on the supply chain, delivery times may be delayed further.

SOURCES: STATE OF CALIFORNIA EMPLOYMENT DEVELOPMENT DEPARTMENT, U.S. BUREAU OF LABOR STATISTICS, COSTAR, KIDDER MATHEWS RESEARCH

TOP SALE TRANSACTIONS FOR 1Q22

Property	Submarket	Square Feet	Sale Price	\$/SF	Buyer	Seller
350 Rhode Island St- N Bldg.	Showplace Square	127,100	\$118,000,000	\$928.40	Lincoln Property Company	PRP Real Estate Investment Mgmt.
1525-1535 Mission St	South of Market	30,000	\$20,340,000	\$678.00	Consulate General of Switzerland	Paige Family Trust
70 Oak Grove St	South of Market	10,000	\$7,350,000	\$735.00	1DS LLC	Mellinger Family Trust

TOP LEASE TRANSACTIONS FOR 1Q22

Property	Submarket	Square Feet	Transaction Date	Landlord	Tenant
350 Mission St	South Financial District	232,942	January 2022	Salesforce	Sephora
600 Montgomery St.	Financial District	43,335	January 2022	Deutsche Finance International LLP	Core Club
631 Howard	South Financial District	42,349	February 2022	Harvest Properties	Finix Payments, Inc.

TOP UNDER CONSTRUCTION

Property	Address	Submarket	Square Feet	Owner	Delivery Date
Mission Rock (Bldg G)	1051 3rd St	Mission Bay/China Basin	300,000	Port of San Francisco	Q3 2022
Mission Rock (Bldg B)	1051 3rd St	Mission Bay/China Basin	300,000	Port of San Francisco	Q3 2022
1035 Howard St	1035 Howard St	South Of Market	93,138	Embarcadero Capital Partners	Q3 2022

DATA SOURCE: COSTAR

Kidder Mathews is the largest, independent commercial real estate firm on the West Coast, with 900 real estate professionals and staff in 21 offices in Washington, Oregon, California, Nevada, and Arizona. We offer a complete range of brokerage, appraisal, asset services, consulting, project and construction management, and debt equity finance services for all property types.

The information in this report was composed by the Kidder Mathews Research Group.

**Commercial
Brokerage**

\$10.9B
TRANSACTION
VOLUME (ANNUAL)

49.7M **43.7M**
SALES SF
(ANNUAL) LEASING SF
(ANNUAL)

**Valuation
Advisory**

2,600+
ASSIGNMENTS
ANNUALLY

51/24
TOTAL NO.
APPRAISERS/MAI'S

**Asset
Services**

62M
MANAGEMENT
PORTFOLIO SF

\$11B
IN ASSETS UNDER
MANAGEMENT

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