

MARKET TRENDS | **SAN FRANCISCO**

# OFFICE

**MARKET DRIVERS**

**THE SAN FRANCISCO OFFICE MARKET** saw premier Class A space continue to be in high demand in the second quarter, while most of the rest of the market remained stagnant. Quarter to date leasing activity totals 1.1M SF—roughly half the leasing activity year-over-year. Sales activity grew 275.2% year-over-year to 409,504 SF which indicates some level of demand despite the slowdown in recent leasing activity.

**MANY FIRMS** are continuing to rebalance their office footprint amidst the rise in hybrid work models. Typical tenants are looking to right-size while taking, at most, as much square footage as they had pre-COVID, with many leasing less space than before—anywhere from 20-30% less space on average as compared to 2 years ago. This is resulting in another quarter of negative net absorption of 809,714 SF. Quarter-over-quarter the total net absorption dropped slightly from negative 984,616 SF, while year-over-year negative net absorption roughly doubled.

**“RIGHT-SIZING”** of space has resulted in an uptick of 80 basis points (bps) in the overall vacancy rate to 20.9%. Most of the vacancies are in Class B and C buildings reporting a direct vacancy rate of 18.7% and 17.8% respectively. The direct vacancy rate for Class A offices is only 14.8% supporting the continuing trend of flight to quality. Availability of premier Class A offices with water views remains tight, reporting asking rates above \$100/SF for some of the best suites in the city. Commodity, middle of the road spaces in Class A offices are struggling to find tenants, even with rates in the mid \$50s to \$70s per square foot. Class A buildings are reporting an average direct asking lease rate of \$68.74 per square foot full service and Class B buildings are reporting \$54.55

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## Market Summary

	2Q2022	1Q22	2Q21	Annual Change
New Construction	23,764	145,000	1,064,271	<b>-97.8%</b>
Under Construction	819,920	843,684	1,173,982	<b>-30.2%</b>
Direct Vacancy Rate	16.5%	15.7%	12.7%	<b>29.9%</b>
Sublease Vacancy Rate	4.4%	4.4%	5.3%	<b>-17.0%</b>
Overall Vacancy Rate	20.9%	20.1%	18.0%	<b>16.1%</b>
FIDI Direct Asking Lease Rate (A&B)	\$63.63	\$66.43	\$67.27	<b>-5.4%</b>
Leased SF	1,100,336	1,522,592	2,014,402	<b>-45.4%</b>
Sold SF	409,504	324,520	109,131	<b>275.2%</b>
Total Net Absorption	(809,714)	(984,616)	(481,237)	<b>N/A</b>

▼ **1.1M**  
LEASING ACTIVITY (SF)

▼ **-809K**  
NET ABSORPTION (SF)

▲ **20.9%**  
OVERALL VACANCY RATE

▼ **\$63.63**  
AVERAGE ASKING RENT

▼ **23.8K**  
NEW DELIVERIES (SF)

CHANGE FROM PRIOR YEAR

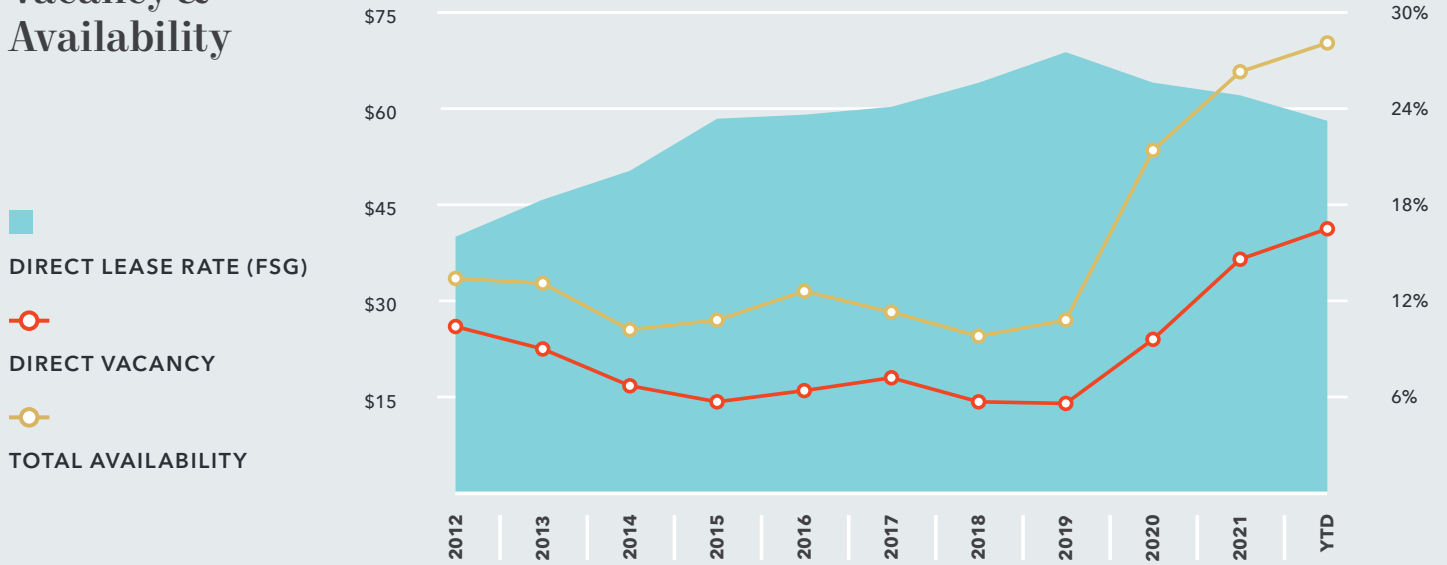
## Market Highlights

**MANY FIRMS** are “right-sizing”, taking less space than they previously occupied.

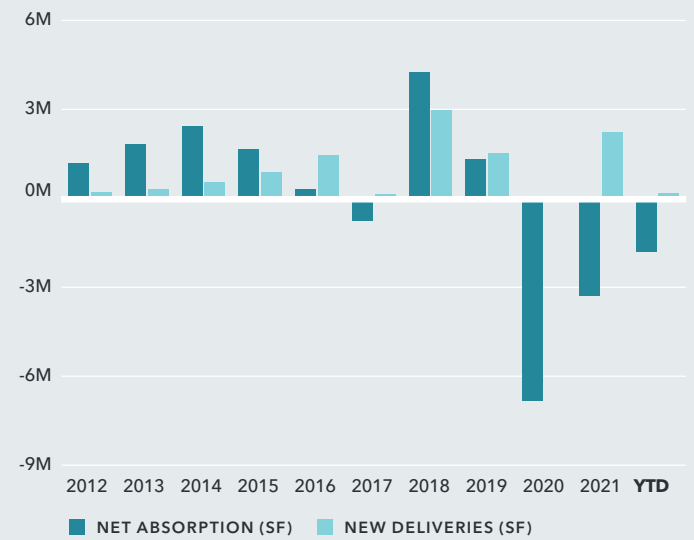
**FLIGHT** to quality continues, creating an uptick in demand for premier Class A office spaces.

**SAN FRANCISCO** has a low unemployment rate of 2.2%.

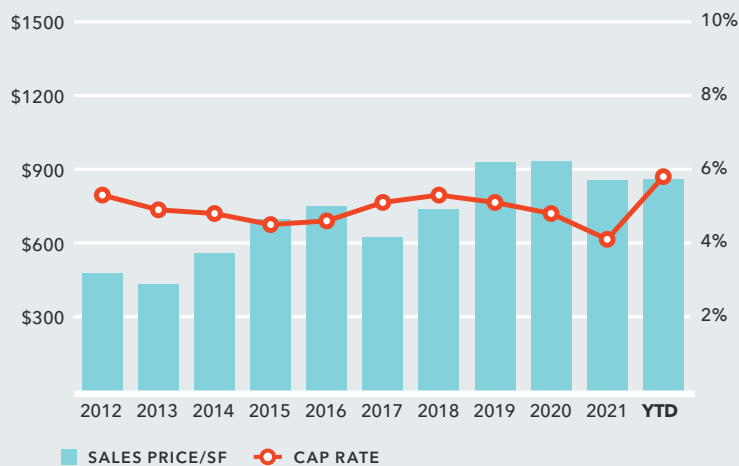
# Lease Rate, Vacancy & Availability



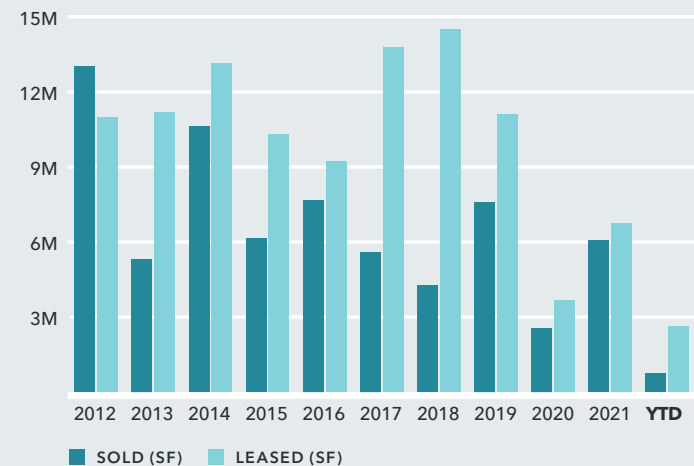
# Net Absorption & New Deliveries



# 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	2Q22 Total Net Absorption	YTD Total Net Absorption	2Q22 Leasing Activity	YTD Leasing Activity	Average Rental Rate (FS)
Civic Center	615,732	0	23.2%	0.0%	23.2%	25.9%	-276	-6,272	2,064	7,372	\$41.81
Financial District	26,121,200	0	19.9%	3.3%	23.3%	30.0%	-387,821	-938,041	375,872	710,843	\$61.50
Jackson Square	2,343,479	0	16.5%	1.3%	17.8%	22.0%	-38,918	-39,331	140,276	162,366	\$60.07
Mid Market	4,500,814	0	16.3%	4.9%	21.2%	35.1%	-163,496	-203,363	18,255	53,809	\$30.56
Mission Bay/China Basin	5,414,896	600,000	3.8%	9.4%	13.2%	22.4%	57,636	-63,148	8,618	66,961	\$39.00
Mission/Potrero	3,271,570	0	20.6%	1.8%	22.4%	26.6%	35,945	230,712	47,091	79,628	\$50.00
Rincon/South Beach	6,006,902	0	12.2%	6.5%	18.8%	31.0%	32,233	-6,543	55,164	171,774	\$49.03
Showplace Square	3,593,708	101,782	6.0%	11.7%	17.7%	40.6%	-78,565	-133,682	1,100	9,709	\$43.05
South Financial District	28,738,515	0	10.9%	4.1%	15.0%	21.6%	-127,694	-253,574	362,505	915,684	\$65.17
SOMA	5,719,597	118,138	24.1%	1.6%	25.7%	27.8%	102,182	47,446	54,746	167,631	\$62.00
Union Square	4,412,937	0	22.8%	2.9%	25.8%	31.9%	-111,726	-189,181	25,786	135,655	\$51.66
Van Ness Corridor/Chinatown	1,340,028	0	15.9%	0.4%	16.3%	30.9%	12,523	-1,404	3,733	88,499	\$53.97
Waterfront/North Beach	3,858,976	0	19.8%	3.4%	23.2%	30.7%	-36,266	-106,287	2,099	21,117	\$30.92
Yerba Buena	3,941,440	0	35.3%	9.0%	44.3%	49.5%	-105,471	-131,662	3,027	31,880	\$56.02
<b>San Francisco Totals</b>	<b>99,879,794</b>	<b>819,920</b>	<b>16.5%</b>	<b>4.4%</b>	<b>20.9%</b>	<b>28.4%</b>	<b>-809,714</b>	<b>-1,794,330</b>	<b>1,100,336</b>	<b>2,622,928</b>	<b>\$58.10</b>
Class A	54,645,497	701,782	14.8%	4.4%	19.2%	25.3%	-533,079	-1,281,211	636,860	1,530,201	\$68.74
Class B	37,808,698	118,138	18.7%	4.6%	23.3%	33.0%	-246,333	-434,223	414,768	816,789	\$54.55
Class C	7,425,599	0	17.8%	3.0%	20.8%	28.2%	-30,302	-78,896	48,708	275,938	\$44.30

per square foot full service. Sublease vacancy rates are 4.4%, 90 bps lower year-over-year and steady quarter-over-quarter, demonstrating the continuing relative attractiveness of shorter term, typically plug & play suites.

**THERE IS 819,920 SF OF OFFICE SPACE** currently under construction. The largest project is Mission Rock buildings B and G totaling 613,952 SF slated for delivery in Q3 2022. Due to continuing supply chain issues and rising inflation, construction costs have increased, delaying projects even further.

## ECONOMIC REVIEW

**THIS APRIL**, San Francisco's unemployment rate dropped to 2.2%, 130 bps lower than the start of the year. Despite the recent news of some San Francisco based companies laying off their staff, the labor market remains very strong.

**THE ONGOING COVID PANDEMIC AND RISE IN INFLATION** has continued to strain the supply chain directly causing the cost of raw materials used in construction to increase, further delaying delivery times and tenant improvement projects. Landlords that can provide significant TI dollars will be able to charge rents much closer to their initial asking rate to offset the cost of construction.

## NEAR TERM OUTLOOK

**SAN FRANCISCO** is showing some flickers of life, as Bay Area Rapid Transit has reported a steady increase in ridership since the start of 2022. BART reported a monthly ridership of 3,543,655 in May of 2022, up 5% from April. Even though this is only 36% of expected monthly ridership from pre-COVID, the increase in ridership is promising for the future of San Francisco.

**DESPITE THE 20.9% VACANCY RATE**, companies that are rightsizing are driving the demand for top-shelf Class A offices, creating a competitive market for these premier spaces. With COVID's impact diminishing (at least for now), touring activity has picked up as many prospective tenants are looking at more open-office creative spaces instead of the more traditional office floor plans.

**RECENTLY** UBS Asset Management's 455 Market St, a 374,200 Class A Office building came to the market for the first time. When the sale of this property occurs, the pricing should gauge demand for office building investment sales in this new post-COVID market.

## TOP SALE TRANSACTIONS FOR 2Q22

Property	Submarket	Square Feet	Sale Price	\$/SF	Buyer	Seller
550 Terry A Francois Blvd	Mission Bay	314,826	\$356,000,000	\$1,130.78	Divco West Services, LLC	The Gap, Inc.
180 Townsend St	Rincon/South Beach	41,125	\$71,000,000	\$1,726.44	The Sobrato Organization	Divco West Services, LLC
350 Brannan St	Rincon/South Beach	18,055	\$11,590,000	\$641.93	Global Asset Capital	350 Brannan Co.

## TOP LEASE TRANSACTIONS FOR 2Q22

Property	Submarket	Square Feet	Transaction Date	Landlord	Tenant
600 Battery St	Jackson Square	124,547	May 2022	TMG Partners	Ripple Labs
50 Beale St	South Financial District	88,600	April 2022	Autodesk	ICONIQ Capital
303 2nd St	Rincon/South Beach	28,885	May 2022	Kilroy Realty Corporation	Banyan

## TOP UNDER CONSTRUCTION

Property	Address	Submarket	Square Feet	Owner	Delivery Date
Mission Rock (Bldg B)	1051 3rd St	Mission Bay/China Basin	313,952	Port of San Francisco	Q3 2022
Mission Rock (Bldg G)	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

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

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**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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