

MARKET TRENDS

SAN FRANCISCO OFFICE

MARKET DRIVERS

The San Francisco office market is reporting its ninth consecutive quarter of negative net absorption, approximately negative 7.3 million SF year-to-date, with this quarter accounting for over negative 2.2 million SF, greater than any quarter in 2023. Total office vacancy continues to rise and currently sits at 30.8% - up 230 basis points (bps) quarter-over-quarter. The continued popularity of subleases for companies wary of long-term commitments outpaced supply this quarter with the sublease vacancy rate decreasing 30 bps to 5.8%. However, sublease vacancies have increased by 60 bps year-over-year, cautioning against attributing this drop to a fundamental change in long-term sublease supply and demand dynamics.

Leasing activity throughout the quarter grew year-over-year by 31.5% to 2,106,599 SF. Class A and B office buildings led leasing activity, accounting for approximately 72.8% (1,534,343 SF) and 24.1% (508,273 SF) of total leasing activity, respectively. Throughout the market, rental rates continue to decline as average direct rental asking rates fell to \$53.26/sf. Within the Financial District, direct rental rates for Class A and Class B spaces have fallen to \$56.14 /SF and \$52.28 /SF respectively. Despite the dip in rental rates, there is a large discrepancy in pricing with very limited compression. Overall, the office market continues to bifurcate as premier Class A offices with desirable amenities regularly rent for above \$80 /sf full service and average direct rental asking rates for Class B and C offices have fallen to \$46.96/ sf and \$39.72 /SF full service respectfully.

813,924 SF of office properties traded hands for \$186 million throughout the quarter. This represents the second highest quarterly square foot total since Q2 of 2022 and the second highest quarterly sales volume (in dollars) of 2023. Two large transactions occurred this quarter which together account for over 67% of the sales volume (in dollars) during this period. 123 Townsend Street sold for \$72 million (\$525.74/SF) and 180-182 Howard Street sold for \$54 million (\$221.84/SF). The investment sales market remains depressed with 2023 showing a 36% year-over-year dollar sales volume decline from 2022 figures and over a 90% decline from pre-pandemic figures. High interest rates continue to exert downward pressure on the market, though recent Federal Reserve projections of one or more rate cuts in 2024 may signal future relief.

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Market Summary

| | 4Q23 | 3Q23 | 4Q22 | Annual Change |
|------------------------------|-------------|-------------|-------------|---------------|
| New Construction | 151,777 | 310,971 | 0 | N/A |
| Under Construction | 700,015 | 873,881 | 1,155,503 | -39.4% |
| Direct Vacancy Rate | 24.9% | 22.3% | 18.2% | 36.8% |
| Sublease Vacancy Rate | 5.8% | 6.1% | 5.2% | 11.5% |
| Overall Vacancy Rate | 30.8% | 28.5% | 23.4% | 31.6% |
| FIDI Direct Lease Rate (A&B) | \$55.39 | \$56.83 | \$60.63 | -8.6% |
| Leased SF | 2,106,599 | 776,256 | 1,602,087 | 31.5% |
| Sold SF | 813,924 | 1,193,329 | 509,549 | 59.7% |
| Total Net Absorption | (2,272,879) | (2,016,059) | (1,250,080) | N/A |

↑ **2.1M SF**
LEASING ACTIVITY

↓ **-2.3M SF**
NET ABSORPTION

↑ **24.9%**
VACANCY RATE

↓ **\$55.39**
ASKING RENT (AVG)

↑ **151K SF**
NEW DELIVERIES

Year-Over-Year Trend

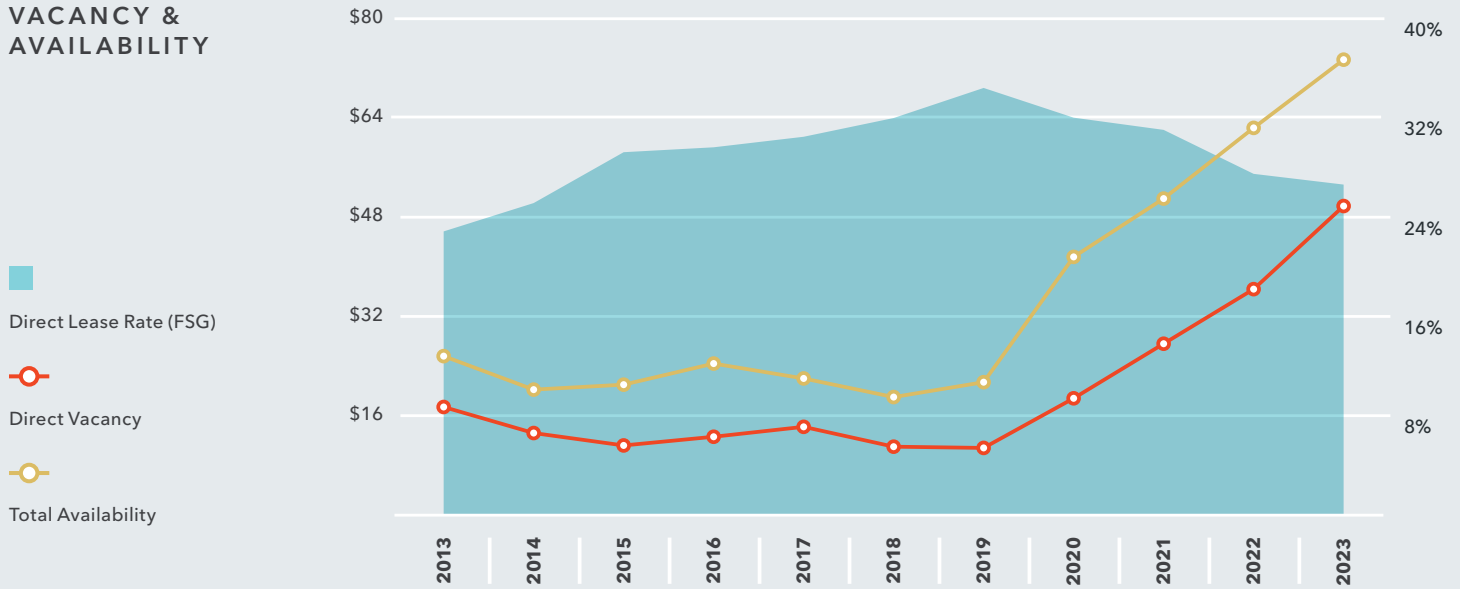
Market Highlights

TOTAL VACANCY continues to rise, currently 30.8%

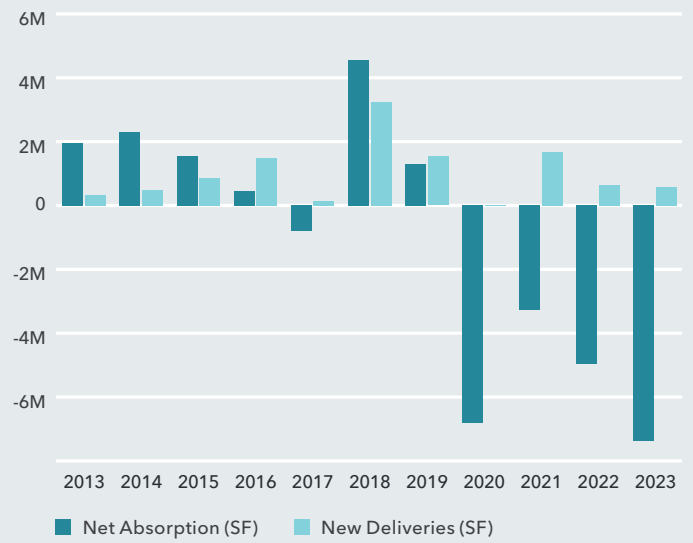
MARKET RENTAL RATES continue to decline, standing at \$55.39/SF full service

OFFICE INVESTMENT SALES activity grew, totaling 813,924 SF or \$186 million

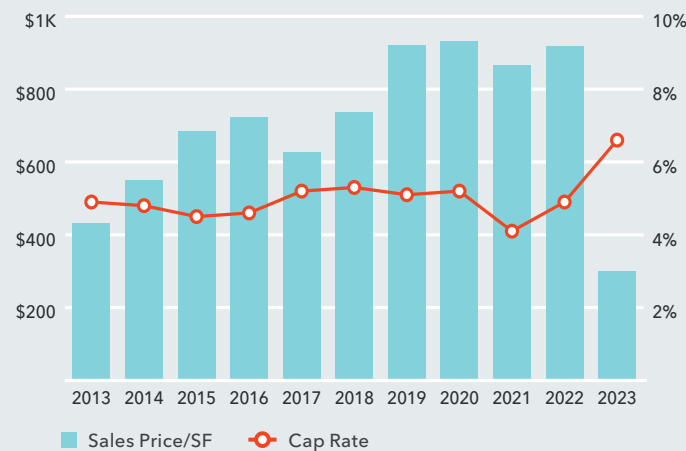
LEASE RATE, VACANCY & AVAILABILITY



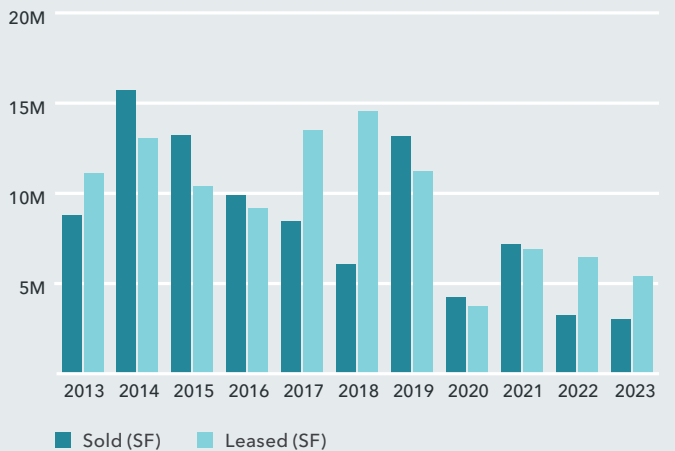
NET ABSORPTION & NEW DELIVERIES



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 Availability Rate | 4Q23 Total Net Absorption | 2023 Total Net Absorption | 4Q23 Leasing Activity | 2023 Leasing Activity | Average Rental Rate (FS) |
|-----------------------------|--------------------|--------------------|---------------------|---------------------|--------------------|-------------------------|---------------------------|---------------------------|-----------------------|-----------------------|--------------------------|
| Civic Center | 616,967 | 0 | 21.6% | 0.0% | 21.6% | 23.0% | 4,533 | 25,335 | 2,407 | 40,557 | \$36.86 |
| Financial District | 26,919,354 | 0 | 30.2% | 3.7% | 33.8% | 39.5% | -994,476 | -2,157,106 | 489,162 | 1,484,688 | \$54.55 |
| Jackson Square | 2,369,488 | 0 | 15.9% | 2.8% | 18.7% | 24.5% | -11,622 | 21,826 | 50,482 | 213,420 | \$45.70 |
| Mid Market | 4,968,155 | 0 | 34.6% | 6.6% | 41.3% | 59.4% | -701,109 | -1,039,300 | 100,221 | 172,272 | \$49.96 |
| Mission Bay/China Basin | 5,431,909 | 594,546 | 14.8% | 10.6% | 25.4% | 33.2% | 156,696 | -378,986 | 500,494 | 775,308 | \$60.10 |
| Mission/Potrero | 3,163,957 | 0 | 19.7% | 4.0% | 23.7% | 26.8% | -15,003 | 90,112 | 81,912 | 284,285 | \$45.35 |
| Rincon/South Beach | 6,061,030 | 0 | 22.7% | 8.4% | 31.1% | 39.9% | -2,976 | -445,934 | 24,135 | 146,777 | \$51.75 |
| Showplace Square | 3,736,388 | 24,956 | 18.6% | 14.8% | 33.4% | 48.7% | -16,139 | -242,486 | 51,724 | 120,045 | \$47.12 |
| South Financial District | 30,221,183 | 0 | 19.1% | 6.5% | 25.7% | 32.7% | -496,238 | -2,341,977 | 642,514 | 1,533,346 | \$56.18 |
| SOMA | 6,184,055 | 80,513 | 24.9% | 5.0% | 29.9% | 36.3% | -140,197 | -458,897 | 29,119 | 152,517 | \$46.94 |
| Union Square | 4,335,405 | 0 | 24.7% | 3.3% | 28.1% | 34.6% | 14,206 | -31,418 | 51,245 | 207,954 | \$51.01 |
| Van Ness Corridor/Chinatown | 1,340,853 | 0 | 17.5% | 0.7% | 18.2% | 30.8% | -14,924 | -28,111 | 9,707 | 27,822 | \$47.52 |
| Waterfront/North Beach | 3,931,549 | 0 | 26.4% | 4.5% | 30.9% | 37.0% | -40,885 | -225,917 | 60,209 | 159,447 | \$46.95 |
| Yerba Buena | 4,027,730 | 0 | 41.3% | 5.9% | 47.2% | 51.3% | -14,745 | -147,409 | 13,268 | 109,979 | \$46.17 |
| San Francisco Totals | 103,308,023 | 700,015 | 24.9% | 5.8% | 30.8% | 37.6% | -2,272,879 | -7,360,268 | 2,106,599 | 5,428,417 | \$53.26 |
| Class A | 57,787,888 | 594,546 | 24.3% | 6.4% | 30.8% | 37.8% | -1,140,506 | -4,707,548 | 1,534,343 | 3,325,648 | \$58.32 |
| Class B | 37,655,794 | 105,469 | 26.4% | 5.8% | 32.2% | 39.5% | -1,036,331 | -2,376,149 | 508,273 | 1,694,594 | \$46.96 |
| Class C | 7,864,341 | 0 | 22.4% | 1.5% | 23.9% | 27.5% | -96,042 | -276,571 | 63,983 | 408,175 | \$39.72 |

ECONOMIC REVIEW

The unemployment rate throughout San Francisco continued to tick up slightly, reaching 3.5% in November, 30 bps higher than the 3.2% in July. Throughout 2023, the unemployment rate in the city has grown from 2.7% to 3.5% indicating a gradual deterioration in the labor market. Tech/Information industry layoffs constitute a large portion of lost jobs in 2023 but have slowly been surpassed by layoffs in the professional / business services sector according to data from California Employment Development Department.

Inflation has exhibited an above-expected decline in recent months, though it remains above the Fed's long-term target. This said, the decline has been enough to avoid any further rate hikes in Q4. Despite this decline, inflation remains high, and the effects of two years of robust price increases continue to contribute to layoffs, supply chain strain, and high raw material costs used in construction, the latter of which is delaying delivery times and tenant improvement projects.

NEAR-TERM OUTLOOK

Office occupancy in San Francisco for the week of December 13th was measured at 46.7% according to data from Kastle Systems, a company that tracks building occupancy through its access card systems. While occupancy has varied throughout 2023, it is mostly flat compared to the 42% reported in December of 2022 and appears to have leveled out in the mid 40% range, significantly below pre-pandemic levels.

Amidst ongoing office space optimization, demand for sub-10,000 SF spaces remains competitive, especially for suites under 5,000 SF. Limited tenant movement persists, with renewals and downsizing prevalent, but the growing presence of new Artificial Intelligence companies brings optimism. One such company, OpenAI, recently signed a 486,600 SF sublease from Uber in Mission Bay, resulting in one of the largest office leases the city has seen since 2018. Additionally, Anthropic, another AI company, recently leased 230,325 SF at 500 Howard. That said, despite these two large leases, vacancy continues to rise and absorption remains negative.

TOP SALE TRANSACTIONS 4Q 2023

| Property | Submarket | Square Feet | Sale Price | \$/SF | Buyer | Seller |
|-------------------|--------------------------|-------------|--------------|----------|-------------------------|-----------------------------|
| 123 Townsend St | Rincon/South Beach | 136,950 | \$72,000,000 | \$525.74 | Rubicon Point Partners | CPUS 123 Townsend, LP |
| 180-182 Howard St | South Financial District | 243,418 | \$54,000,000 | \$221.84 | Ridge Capital Investors | The State Bar of California |
| 150 Green St | Waterfront/North Beach | 25,052 | \$11,150,000 | \$445.07 | BZBM | 150 Green Street Associates |

TOP LEASE TRANSACTIONS 4Q 2023

| Property | Submarket | SF | Transaction Date | Landlord | Tenant |
|---------------|--------------------------|---------|------------------|------------------------|-----------|
| 1455-1515 3rd | Mission Bay/ China Basin | 486,600 | October 2023 | Alexandria Real Estate | OpenAI |
| 500 Howard | South Financial District | 230,325 | November 2023 | Heitman | Anthropic |
| 600 Townsend | Showplace Square | 41,403 | October 2023 | Toda America, Inc. | Patreon |

TOP UNDER CONSTRUCTION

| Property | Address | Submarket | SF | Owner | Delivery |
|--------------------|-------------------|-------------------------|---------|------------------------|----------|
| Block 15 Station A | 420 23rd St | Mission Bay/China Basin | 381,750 | Associate Capital | 2Q 2025 |
| 531 Bryant | 531 Byrant St | South of Market | 51,223 | Urban Land Development | 2Q 2024 |
| 952-960 Howard St | 952-960 Howard St | South of Market | 29,290 | oWOW | 1Q 2024 |

Data Source: KM Research, CoStar, United States Bureau of Labor Statistics, Kastle Systems



Kidder Mathews is the largest, independent commercial real estate firm on the West Coast, with 900 real estate professionals and staff in 20 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.

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|-----------------------------|---|--|---------------------------------------|
| COMMERCIAL BROKERAGE | <i>\$12B</i> TRANSACTION VOLUME ANNUALLY | <i>32.1M</i> ANNUAL SALES SF | <i>41.2M</i> ANNUAL LEASING SF |
| ASSET SERVICES | <i>53M</i> MANAGEMENT PORTFOLIO SF | <i>771+</i> ASSETS UNDER MANAGEMENT | <i>250+</i> ASSET SERVICES CLIENTS |
| VALUATION ADVISORY | <i>2,800+</i> ASSIGNMENTS ANNUALLY | <i>42</i> TOTAL APPRAISERS | <i>23</i> WITH MAI DESIGNATIONS |

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