

3Q23

# San Francisco Office Market Overview



NEWMARK

# Market Observations

## Economy

- The region’s labor market remained strong amid shifting macroeconomic conditions. August’s 3.5% unemployment rate was significantly lower than the 4.5% 10-year historical average.
- Year-over-year, job gains have been most pronounced in the services industry, which is still making up for lost ground during the pandemic. Leisure/hospitality led all sectors in job gains during the past 12 months.
- Technology firms are continuing to adjust labor needs. Locally, the information sector was the only office-using sector to see negative employment growth over the past 12 months.

## Major Transactions

- The largest lease transaction of the quarter was the Department of Housing and Urban Development’s renewal of 55,742 SF at One Sansome Street.
- The two largest subleases to hit the market during the quarter were both life science companies. Nektar Therapeutics listed their 126,283 SF space at 455 Mission Bay Blvd. and VIR Biotechnology listed their 43,635 SF space at 499 Illinois St..
- Two major sales were finalized during the quarter. 60 Spear Street was purchased by Presidio Bay Ventures for \$260/SF – a 62% drop in value from its previous purchase price. 600 Townsend Street East was also purchased during the quarter for \$290/SF by LBA Realty – a 50% drop in value from its previous purchase price.

## Leasing Market Fundamentals

- Net absorption for the third quarter of 2023 totaled negative 1.6 MSF. In the 15 quarters since the start of 2020, quarterly net absorption has averaged negative 1.3 MSF. In the 15 quarters prior to 2020, quarterly net absorption averaged positive 448,000 SF.
- Overall vacancy increased 170 basis points to 27.3% during the third quarter of 2023 while asking rents declined by \$0.89/SF to \$71.85/SF. This is the lowest average asking rate since the second quarter of 2017.
- During the third quarter of 2023, just over 600,000 SF was leased. This is the lowest level of leasing since the third quarter of 2020 and is down 21% compared to the third quarter of 2022.

## Outlook

- Uncertainty reigns in the macroeconomic outlook. Occupiers and investors alike will likely approach deals with greater caution as a result, impacting leasing and investment activity.
- Several artificial intelligence companies are in the process of expanding into large blocks of space as they take advantage of market conditions.
- Asking rates are expected to keep declining as assets begin to trade hands and reprice.

1. Economy
2. Leasing Market Fundamentals
3. Appendix



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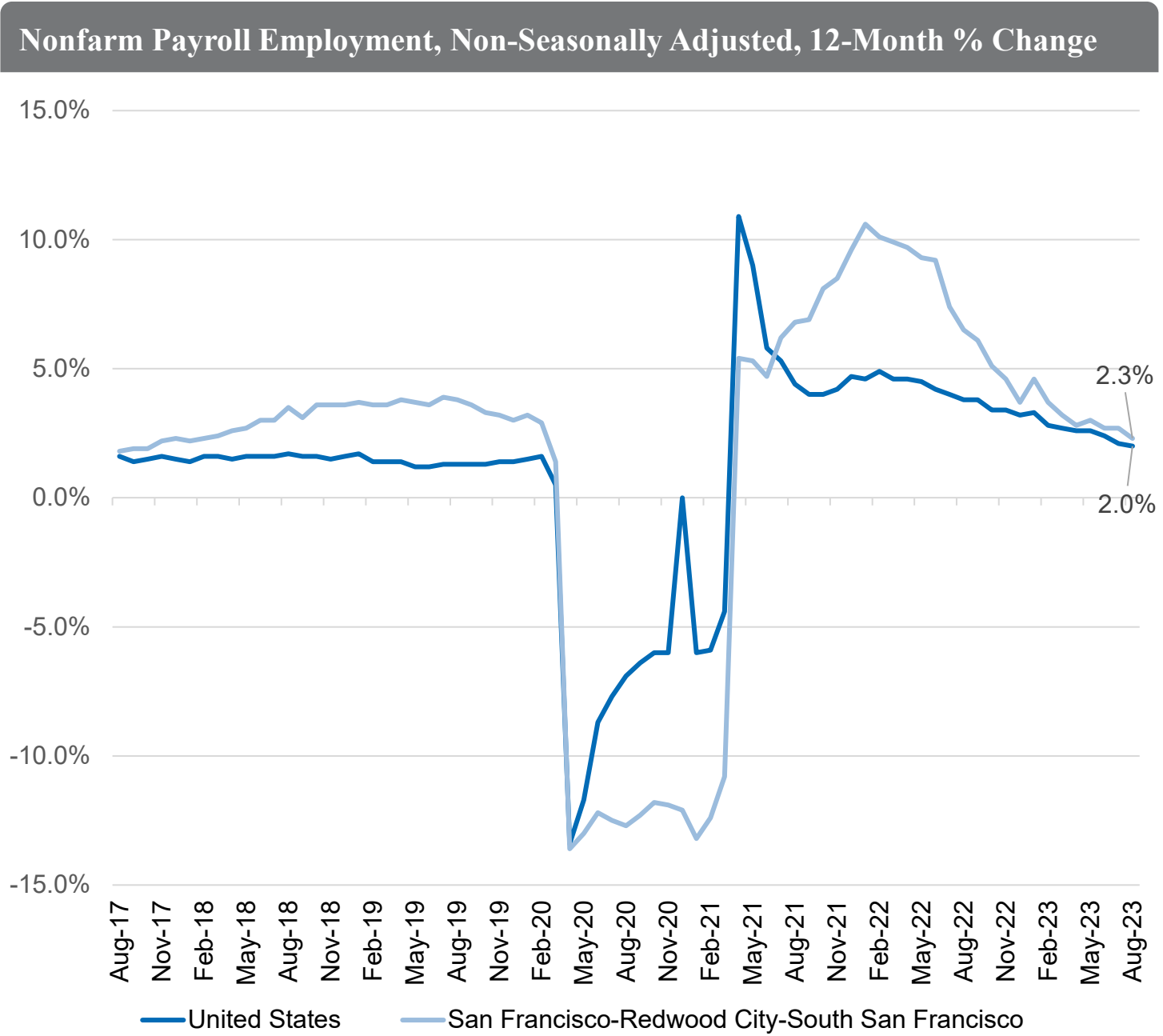
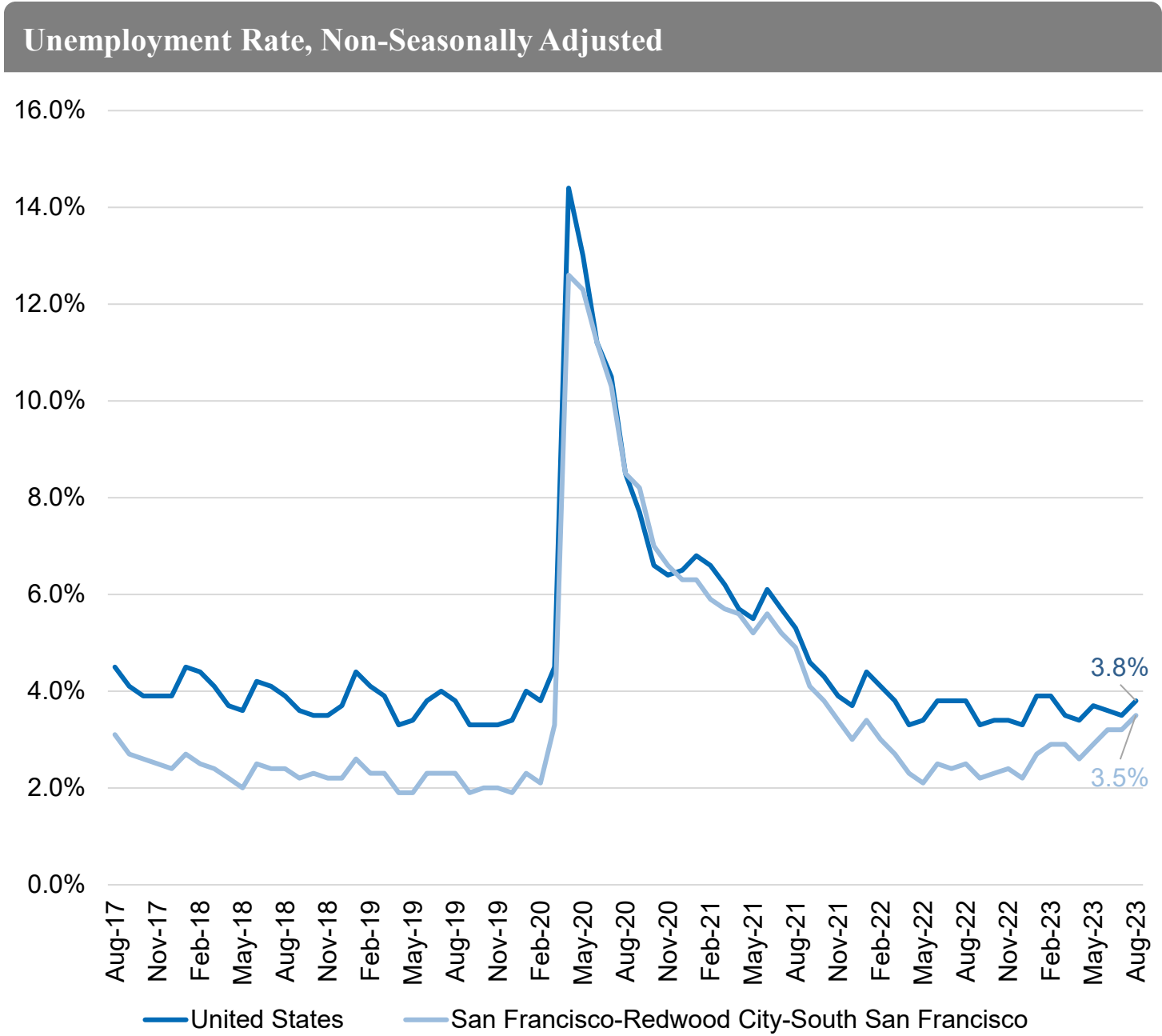
# Economy





# Metro Employment Trends Signal a Slowing, Tighter Economy

The region's labor market remains on relatively solid footing, while the annual job growth rate has slowed to near the national average.

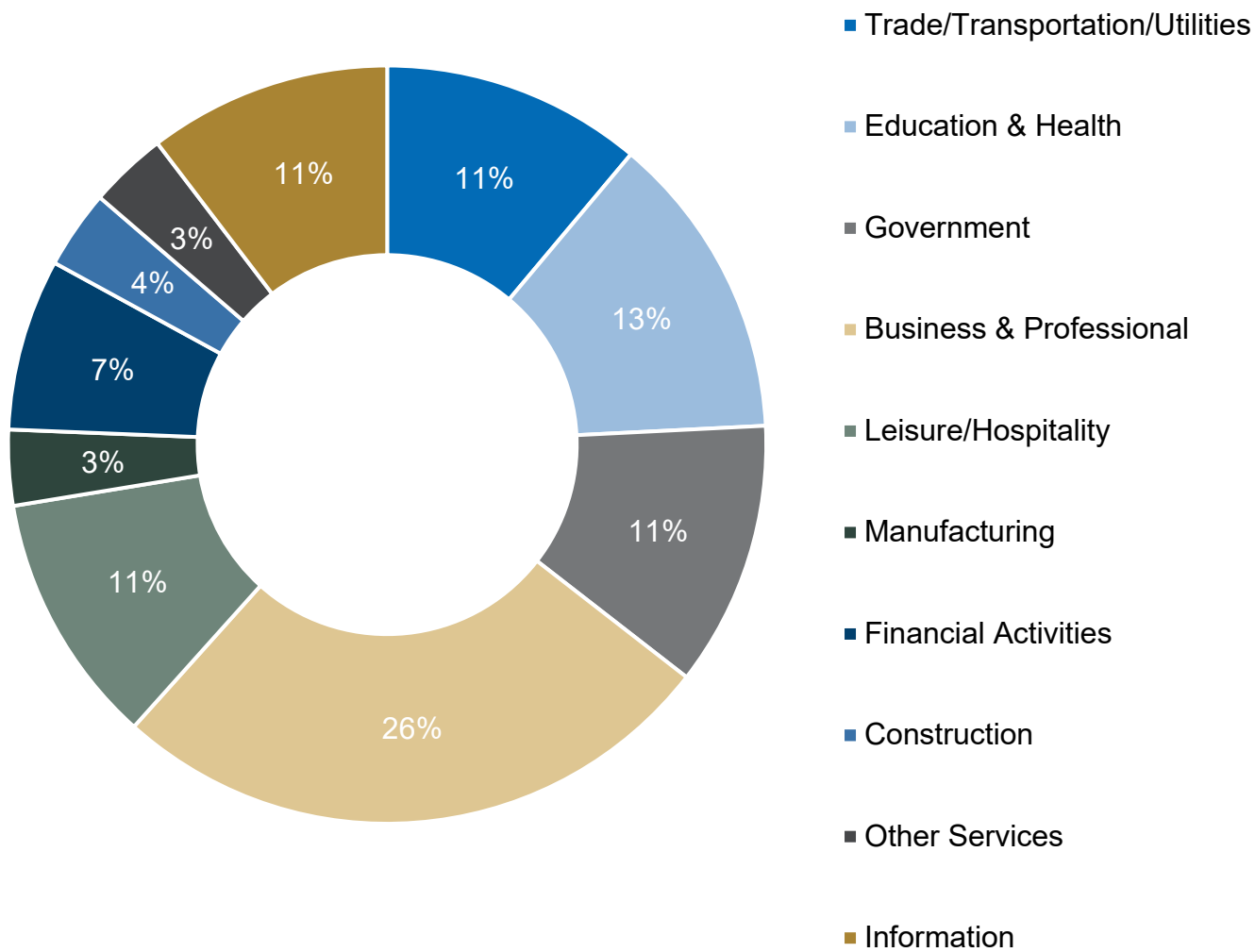


Source: U.S. Bureau of Labor Statistics, San Francisco-Redwood City-South San Francisco

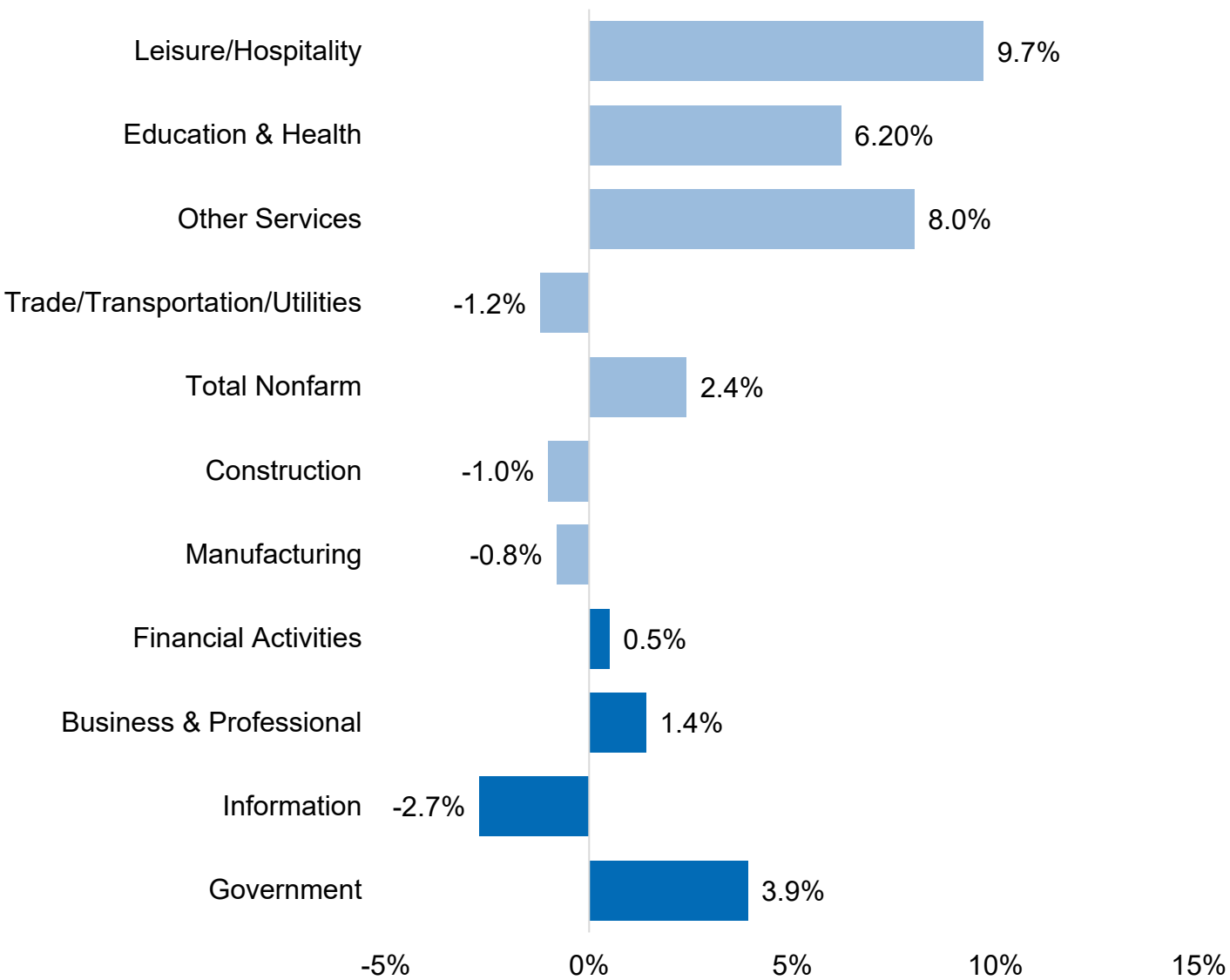
# Job Growth Driven in Large Part by Services Still Making Up for Pandemic Losses

The leisure/hospitality sector led all industries in regional annual job growth, underlining an industry still grappling with making up for pandemic losses amid a greater shift in spending from goods in favor of services. Office-occupying or adjacent industries all saw annual job gains except for the information sector.

Employment by Industry, August 2023



Employment Growth by Industry, 12-Month % Change, August 2023

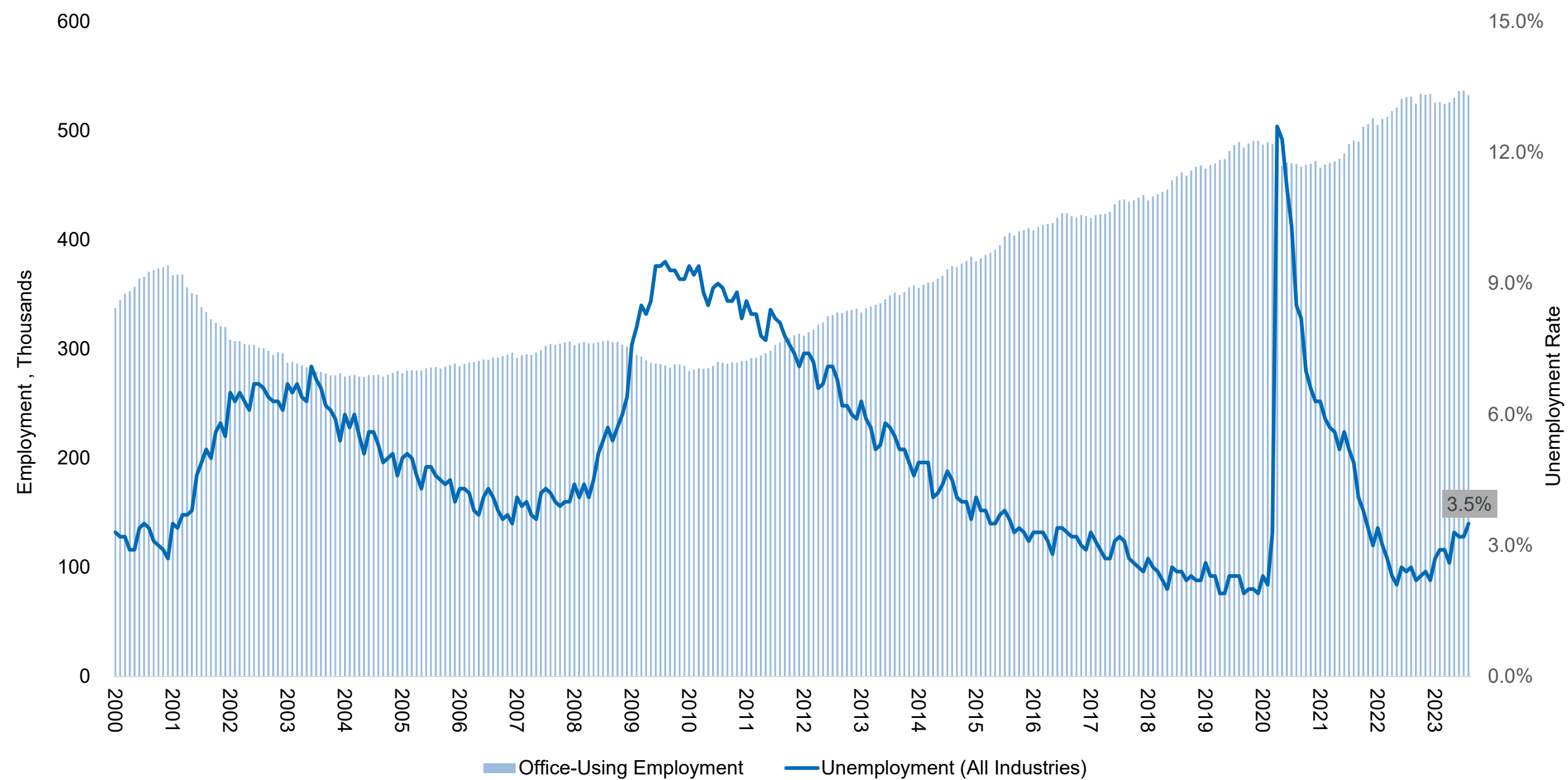


Source: U.S. Bureau of Labor Statistics, San Francisco-Redwood City-South San Francisco

# Overall Office-Using Employment Has Rebounded

The number of office jobs has rebounded to above pre-pandemic levels while the overall unemployment rate remains just above the pre-pandemic mark. It's a sign that the office-using sector is stronger than ever; however, workers are in the office only a fraction of the time they were pre-pandemic.

Office-Using Employment\* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, San Francisco-Redwood City-South San Francisco  
Note: August 2023 data is preliminary.  
\*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.



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# Leasing Market Fundamentals

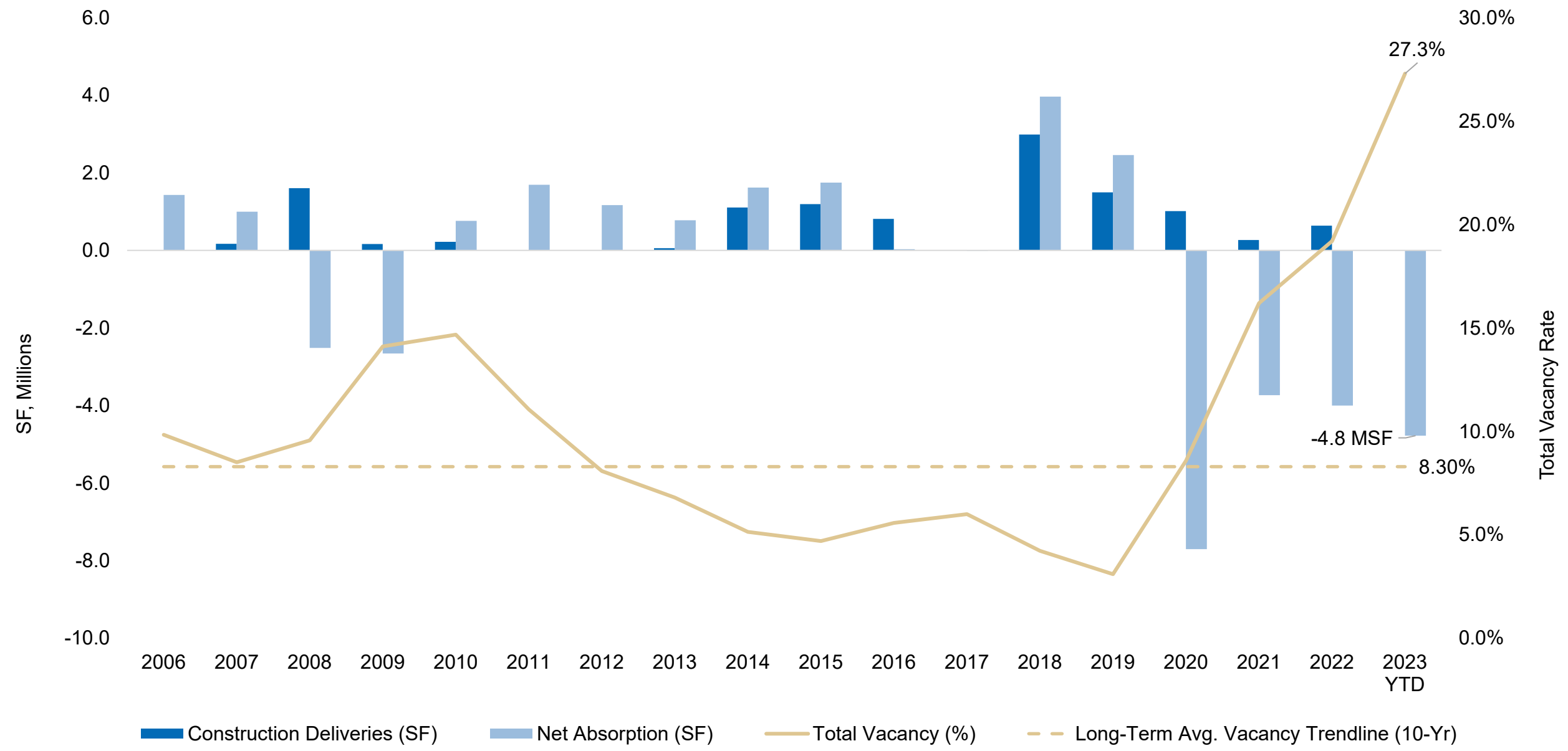




# Vacancy Rises as Net Absorption Remains Negative

The vacancy rate increased to 27.3% in the third quarter of 2023 from 25.6% in the second quarter of 2023. Vacancy is expected to continue to increase as more companies let their current leases expire and right-size their footprints.

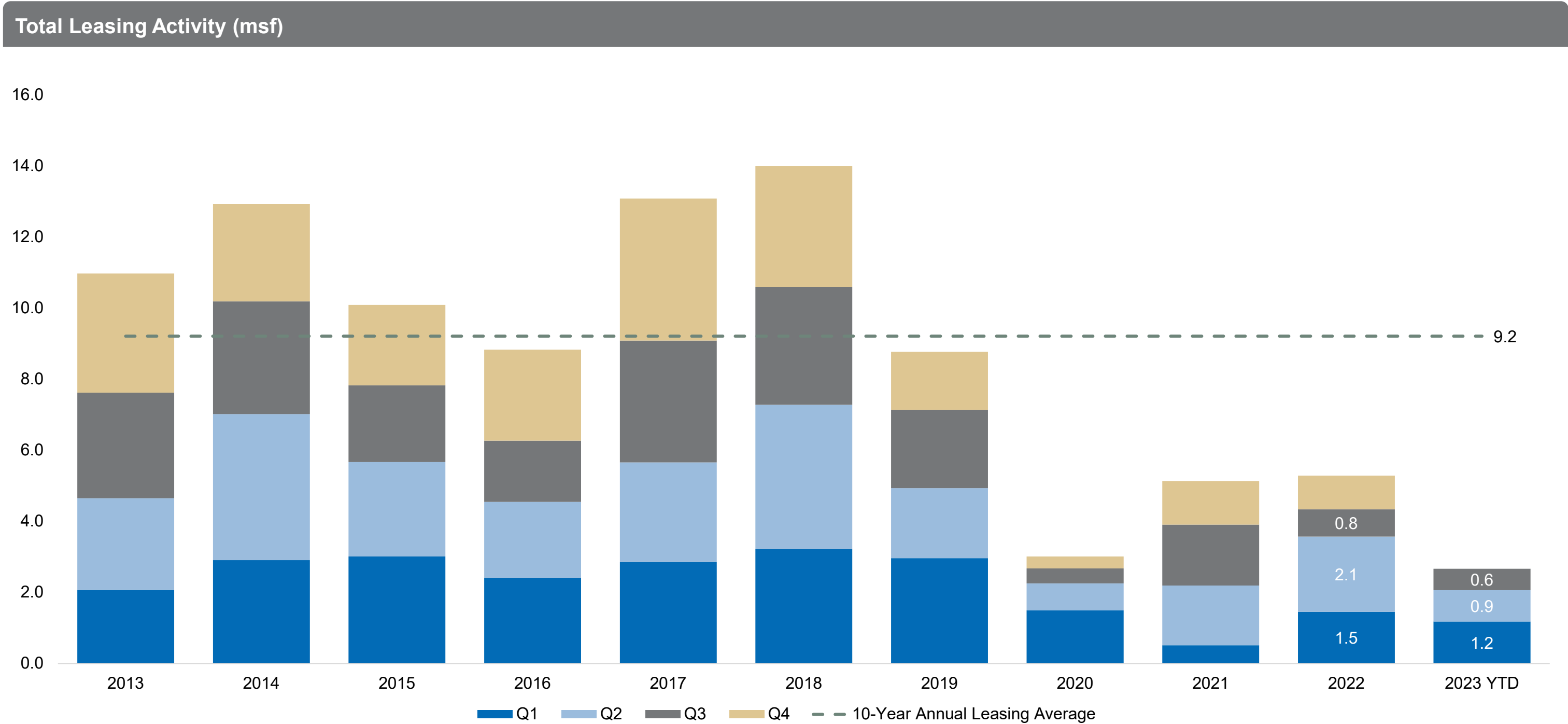
Historical Construction Deliveries, Net Absorption, and Vacancy



Source: Newmark Research, CoStar

# Leasing Activity Pace Has Slowed

A cloudy economic outlook and the higher cost of capital has prompted many companies to pause, assess current conditions and enact cost-cutting measures where applicable.



Source: Newmark Research, CoStar



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## Leases Are Smaller, and Fewer Are Being Signed

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# Traditional Companies Are Returning to the Market

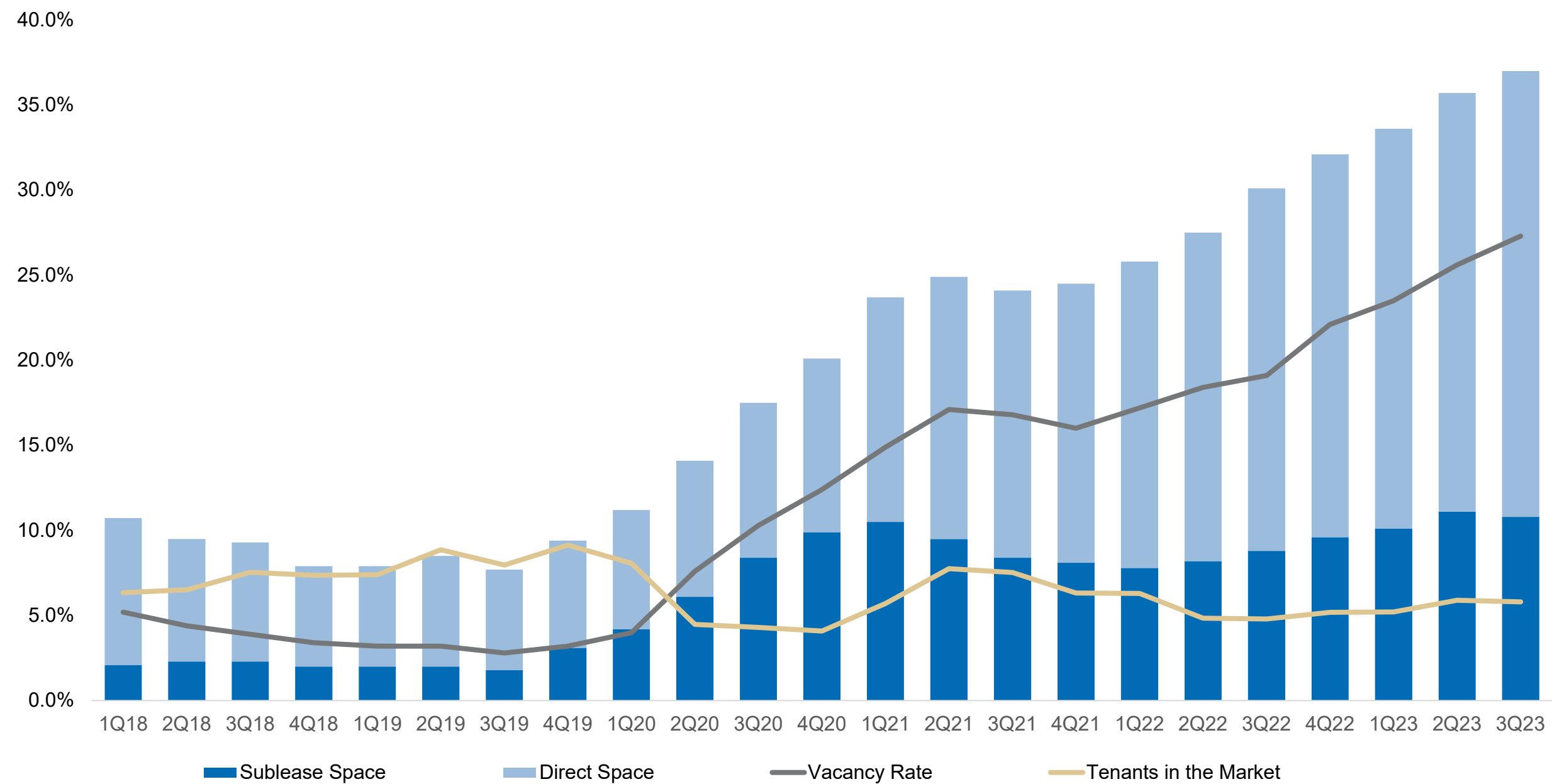
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# Availability Continues to Increase, While Tenant Demand Remains Largely Static

In the years leading to the pandemic, many tech companies leased space based on expected future employment growth as a hedge against diminishing supply and increasing rents. More sublease space is anticipated to become available as tech contracts.

Available Space and Tenant Demand as Percent of Overall Market



Source: Newmark Research, CoStar

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## The Highest Availability Rate Is in SOMA

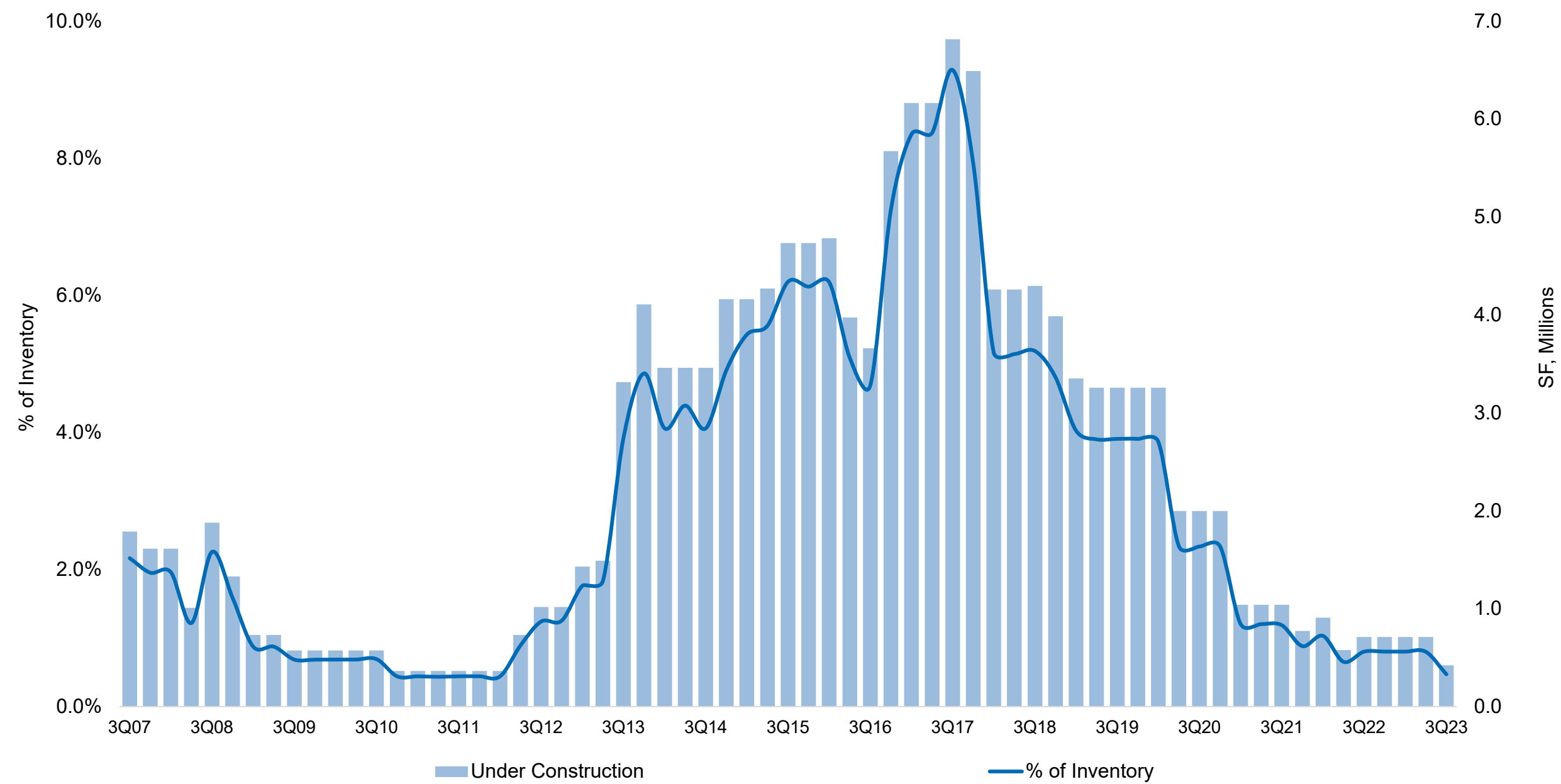
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# New Construction Slows

Rising construction costs and an uncertain economic outlook has halted new office construction for several quarters. In the third quarter of 2023, construction on 30 Van Ness was halted – reducing the square feet currently under construction by 275,000.

Office Under Construction and % of Inventory



Source: Newmark Research, CoStar, City and County of San Francisco

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## Rents Continue to Drop Slowly in Every Submarket

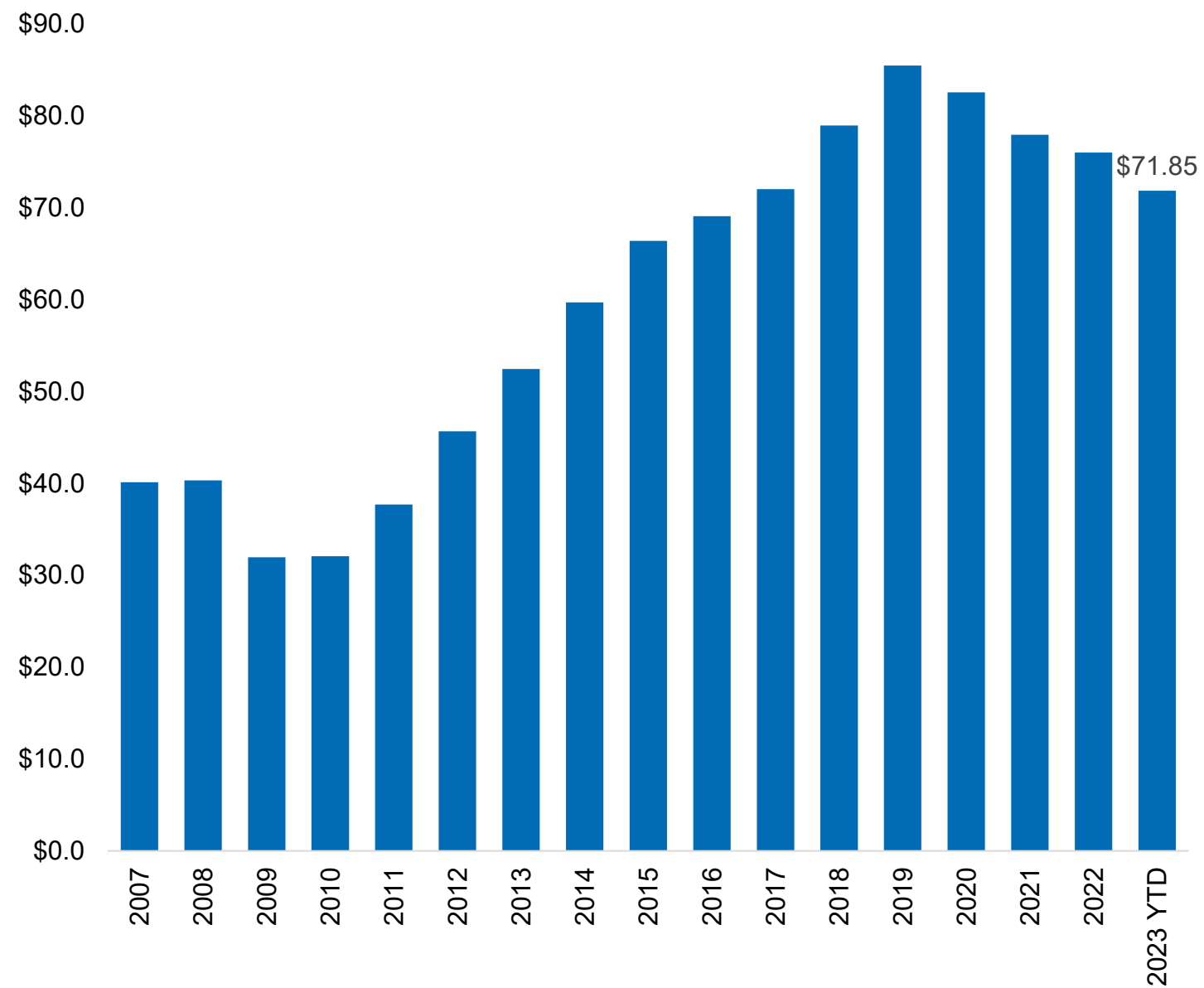
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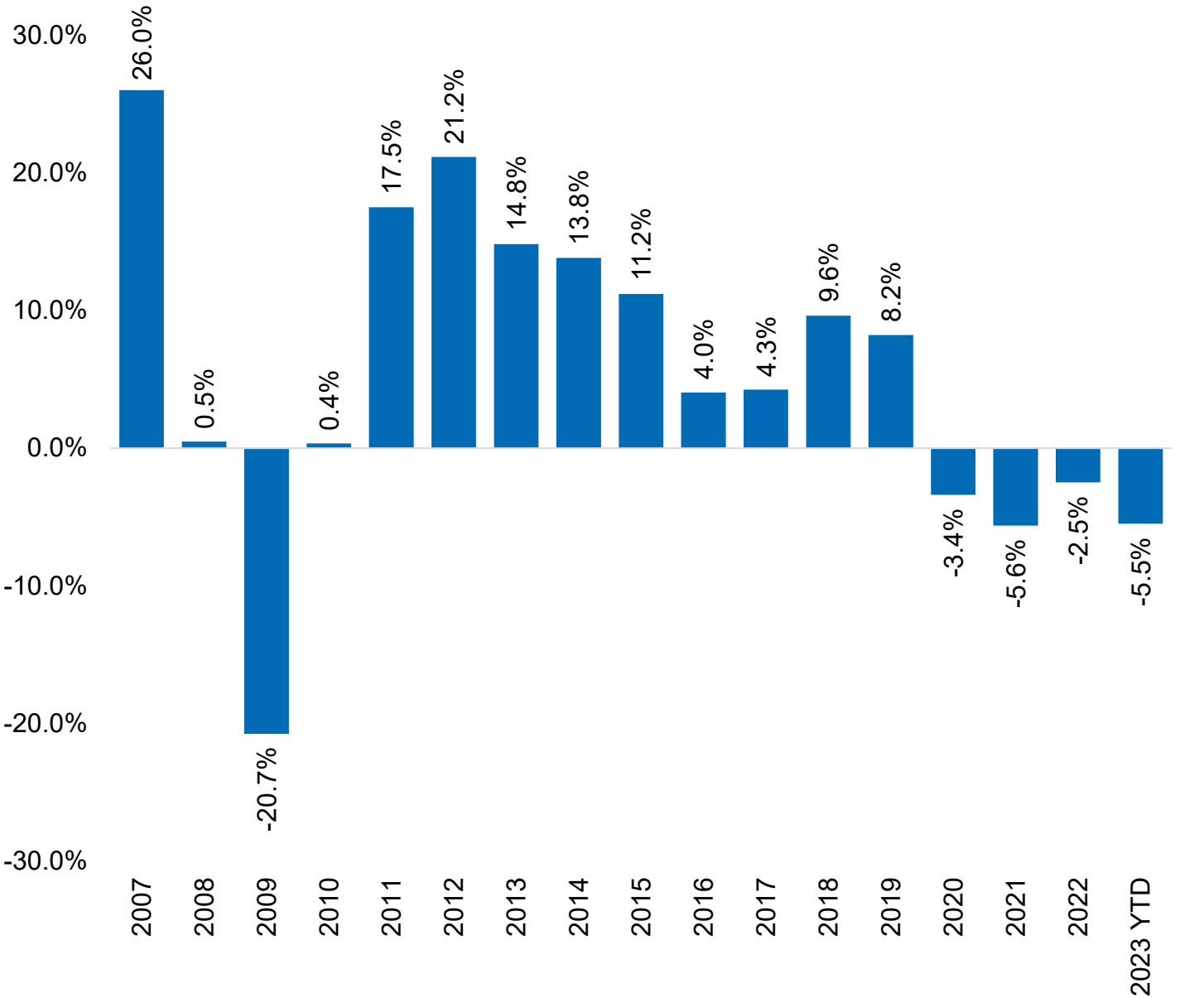
# Rents Continue to Slide

Rents have steadily declined since the start of the pandemic. Most recently, overall asking rates declined to \$71.85/SF. Asking rates are expected to keep declining as assets are beginning to trade hands and reprice.

Office Average Asking Rent, \$/SF, FS



Year-over-Year Asking Rent Growth Rate

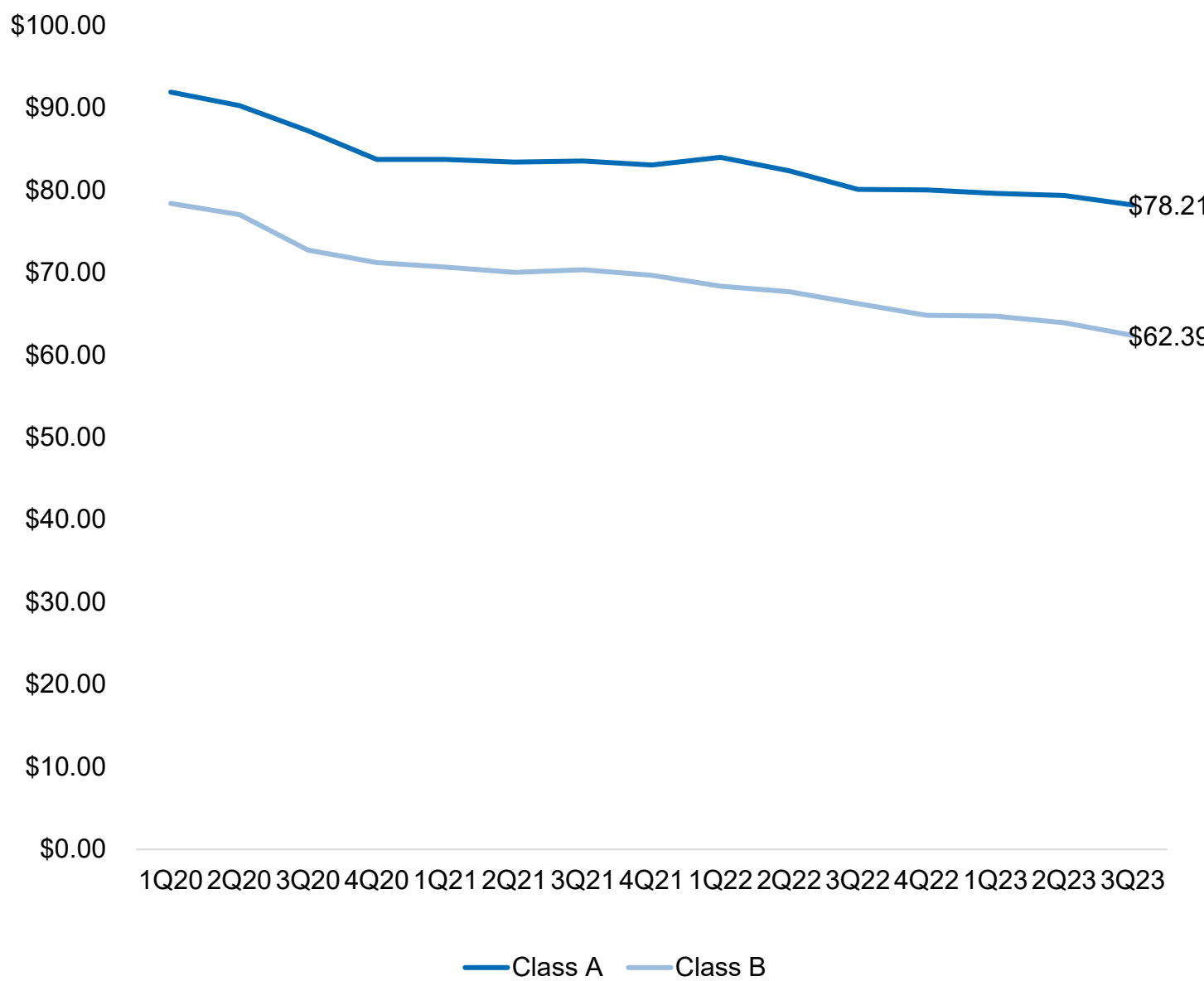


Source: Newmark Research, CoStar

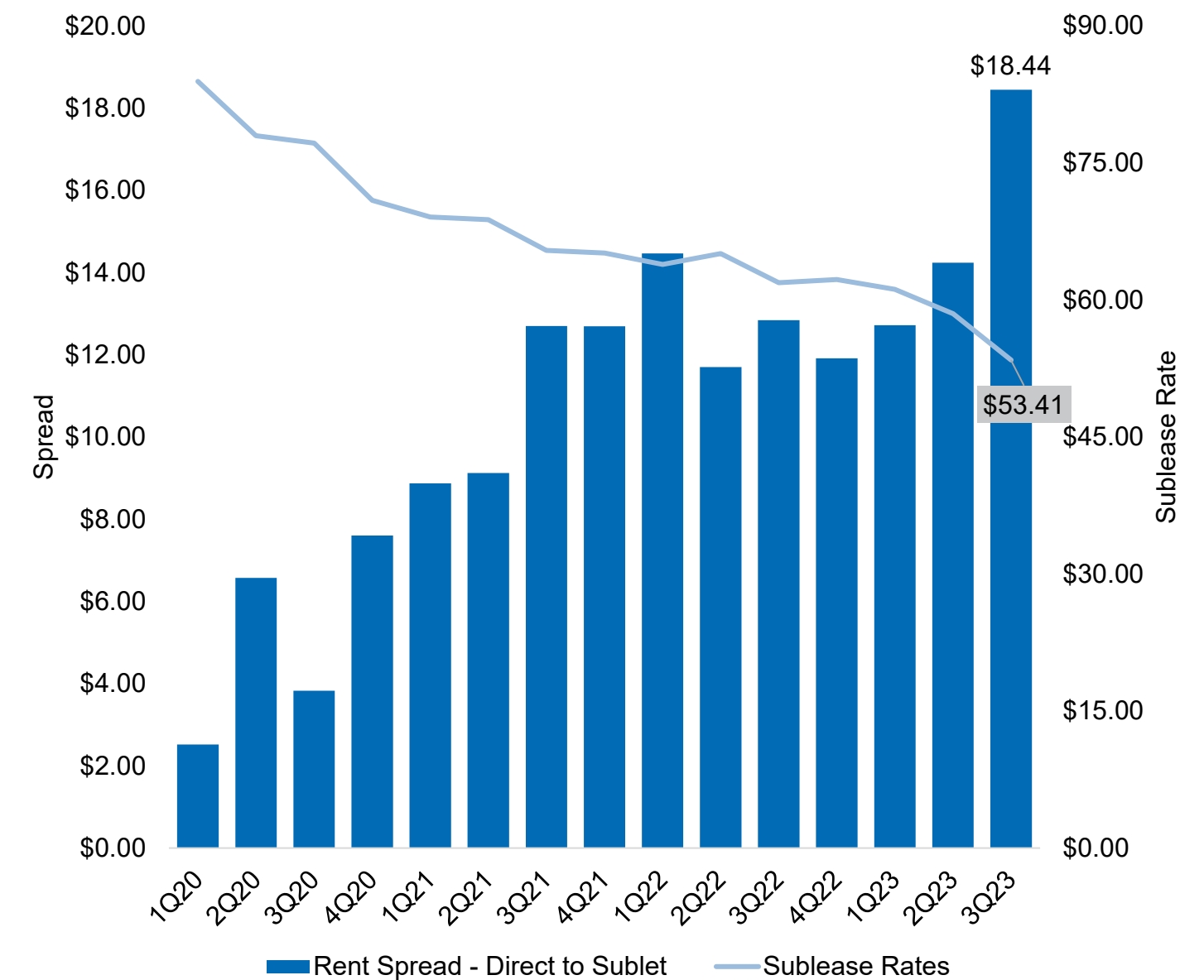
# Asking Rent Spread Between Direct and Sublease Space Climbs

Since the start of the pandemic, Class A asking rates declined by 15%, while Class B rates have declined by nearly 20%. Similarly, sublease asking rates declined by just over 35%. As a result, the spread between sublease space and direct space has widened by roughly 630%, to near all-time highs.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

# Leasing Activity

Representative of the current market, for the second quarter in a row the largest and most notable lease transactions during the quarter were subleases and renewals as tenants take advantage of market leverage.

Notable 3Q23 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
HUD	One Sansome Street	North Financial District	Lease Renewal	55,742
Renewed on floors 9,10, 11 and 12.				
Quantcast	795 Folsom Street	SOMA – Central Yerba Buena	Lease Renewal	45,000
Renewed on the 4 <sup>th</sup> and 5 <sup>th</sup> floors.				
Hayden.AI	460 Bryant Street	SOMA - East	Sublease	41,976
Subleased the first floor and mezzanine from Scribd.				
Adept.AI	350 Rhode Island Street	SOMA – Showplace/Potrero	Sublease	35,648
Subleased the fourth floor of the Samsara space.				
Yahoo	680 Folsom Street	South Financial District	Sublease	35,385
Subleased the top floor of the Asana space.				

Source: Newmark Research, CoStar



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# Appendix





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## Submarket Overview



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