



TRANSWESTERN

SAN FRANCISCO OFFICE MARKET

Q4 2023



VACANCY RISES AS VC FUNDING INTO AI CONTINUES

Despite high borrowing costs for businesses and consumers, economic conditions in the San Francisco metropolitan area remain strong and stable. The unemployment rate was 3.4% in November, down from 3.5% three months ago and remains at historically low levels. The pace of job growth softened to 0.6% year over year as 7,800 jobs were added.

The local labor market remains strong, but hybrid work has led to more vacant space in the San Francisco office market. In the fourth quarter, the total amount of office space available for lease in downtown San Francisco climbed to a record high of 39.1 million square feet. The vacancy rate rose 310 basis points (bps) on a quarterly basis to an all-time high of 35.1%. Net absorption was negative with 2.6 million SF of space returned to the market. Despite these fundamentals, average starting rents rose 3.8% over the quarter to \$62.48. Class A rents rose 3.2% to \$69.54.

While supply and demand fundamentals look bleak, capital markets are recalibrating with several notable discounted sales over the last couple of quarters. Venture capital funding, a demand driver in San Francisco, remains active with \$19.7 billion in Q4 2023, up 17.7% over the year and just below the 2015 to 2019 quarterly average of \$19.9 billion. Artificial intelligence has emerged as a major tenant, accounting for 44.2% (\$8.7 billion) of VC funding.

TRENDLINES

	Q4 2023	Q4 2022	CHANGE	FIVE-YEAR AVERAGE
Nonfarm Jobs (Thous.)	1,213	1,205	0.6%	1,150
Office-Using Jobs (Thous.)	525	533	-1.6%	497
Kastle Barometer - Occupancy (%)	18.0	16.2	1.8%	--
Sublease Availability (%)	10.6	10.0	60 bps	7.6
Net Absorption (Thous. SF)	-2,259	-1,204	-87.7%	-1,185
Overall Vacancy Rate	35.1	26.4	870 bps	18.3
Class A Starting Rents (\$/SF)	69.54	74.68	-28.4%	77.26
Under Construction (Mil. SF)	0.1	0.7	-88.4%	1.1
12-Mo. Investment Volume (\$ Mil.)	647	355	82.2%	2,664
Venture Capital Funding (\$ Bil.)	19.7	16.8	17.7%	30.6

Source: Transwestern, CA EDD, Kastle Systems, MSCI Real Assets, Pitchbook, CoStar, CompStak, Q4 2023.
Note: Employment figures as of November 2023. Data not seasonally adjusted.



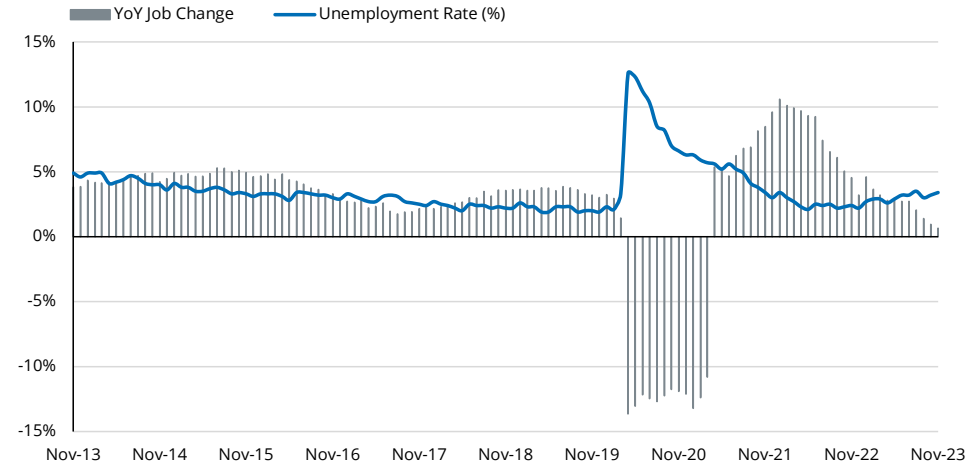
ECONOMY

Job Growth Softens to 0.6% YOY

- The November unemployment rate in the San Francisco metro area ticked down 10 bps from three months ago to 3.4%. Though up from 2.4% one year ago, it has been under 4% for over two years. It remains a tight labor market but with softening job gains as businesses and consumers facing high borrowing costs.
- With the rise of interest rates cutting back at profits, hiring has gradually slowed over the past two years. In Q4, employers added 7,800 jobs annually, a 0.6% gain over the year.
- Jobs gains were driven by a year-over-year increase of 6.0 in Education and Health Services employment (+9,500 jobs). Leisure and Hospitality also made a significant contribution, growing 6.1% and adding 7,400 jobs. Office-using industries lost 8,500 jobs, down 1.6% from last year.

UNEMPLOYMENT RATE AND OFFICE-USING JOBS

San Francisco-Redwood City-South San Francisco MD

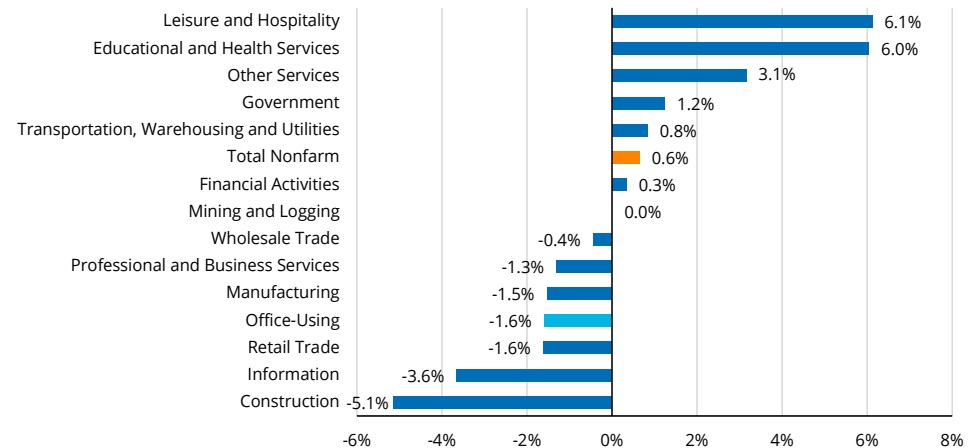


Source: Transwestern, CA EDD, November 2023.

Note: Data not seasonally adjusted.

YOY EMPLOYMENT CHANGE BY INDUSTRY

San Francisco-Redwood City-South San Francisco MD



Source: Transwestern, CA EDD, November 2023.

Note: Data not seasonally adjusted.

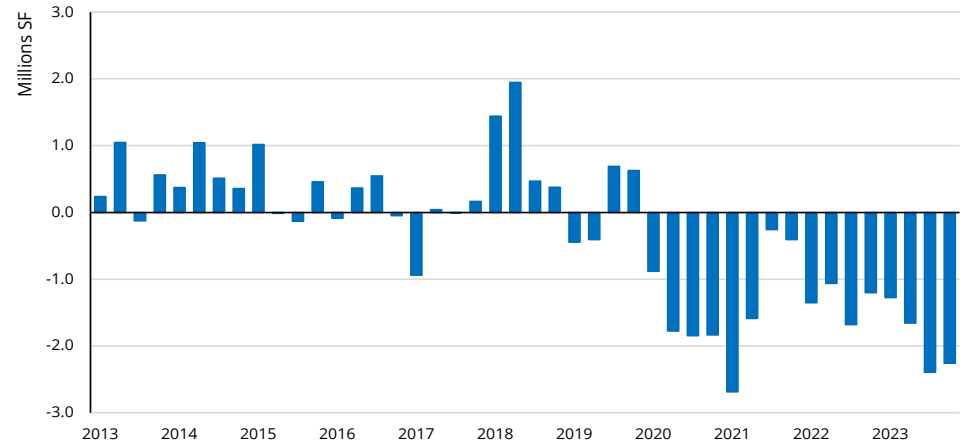


SUPPLY AND DEMAND FUNDAMENTALS

Negative Absorption Continues; Office Occupancy Remains Steady

- A shift to a hybrid-based work model has reduced occupancy levels in San Francisco. Net absorption was negative 2.3 million SF in the fourth quarter, marking it one of the weakest quarters on record as companies continued to downsize, relocate or give up space altogether.
- Uber's lease expiration at 1455 Market and WeWork's lease termination at 655 Montgomery accounted for over 1.1 MSF of the quarter's negative absorption. Six other buildings recorded negative absorption of at least 100,000 SF. Total net absorption since the beginning of 2020 stands at negative 24.2 million SF.
- Office occupancy was largely unchanged in Q4 according to data tracked by Kastle Systems, with San Francisco seeing an average of 46.7% of workers swiping into offices for the week of December 13, 2023. San Jose had the lowest of the major metros tracked with a rate of 41.2%, reflecting the Bay Area's large concentration of tech jobs.

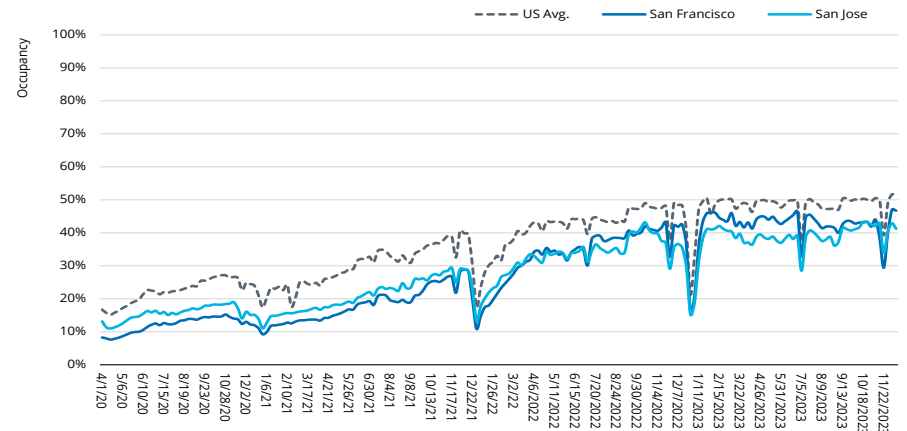
NET ABSORPTION



Source: Transwestern, CoStar, Q4 2023.

BACK TO WORK BAROMETER

Office Occupancy %



Source: Transwestern, Kastle Systems, December 2023.

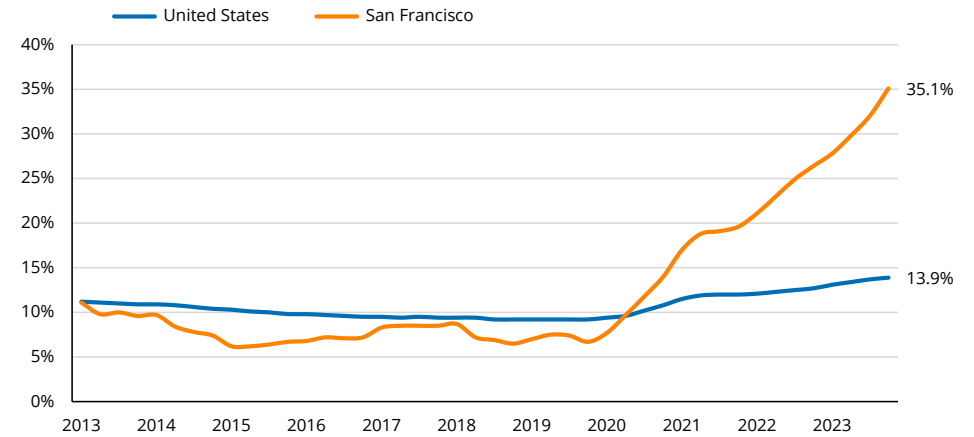


SUPPLY AND DEMAND FUNDAMENTALS

Market Continues to Shed Space as Vacancy Rises

- In Q4, the overall vacancy rate rose 310 bps on a quarterly basis to 35.1%, the highest level on record.
- Class A vacancy increased 260 bps to 32.3% in Q4 while Class B vacancy rose more sharply, by 360 bps to end the quarter at 39.7%.
- There was roughly 9.6 million SF of available sublet space, or 10.6% of total inventory. The sublease availability rate is up 60 bps from 10.0% one year ago as companies shed more space despite the market's deeply discounted sublet rates.
- In the fourth quarter, there was a total of 493,000 SF in subleases composed of 24 leases averaging 11,400 SF per transaction (when excluding Anthropic's 230,000 SF deal).

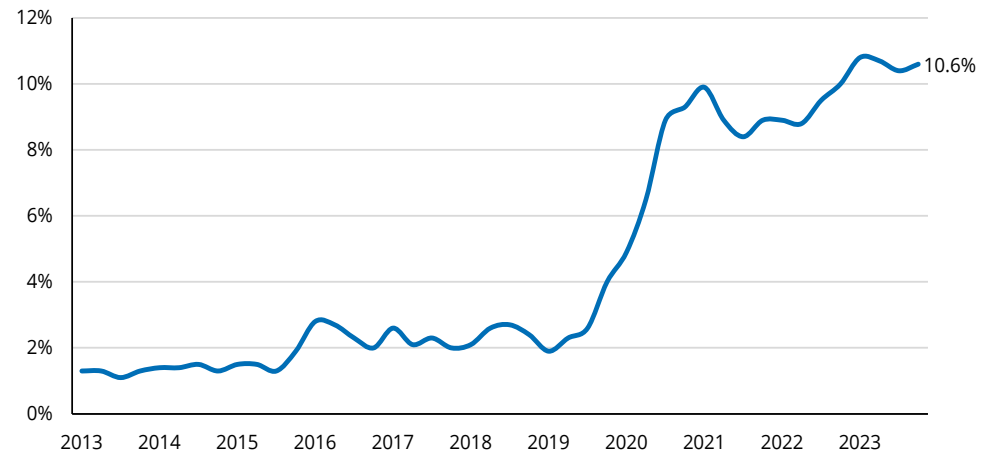
VACANCY RATE



Source: Transwestern, CoStar, Q4 2023.

SUBLEASE AVAILABILITY RATE

SF as % of Inventory



Source: Transwestern, CoStar, Q4 2023.

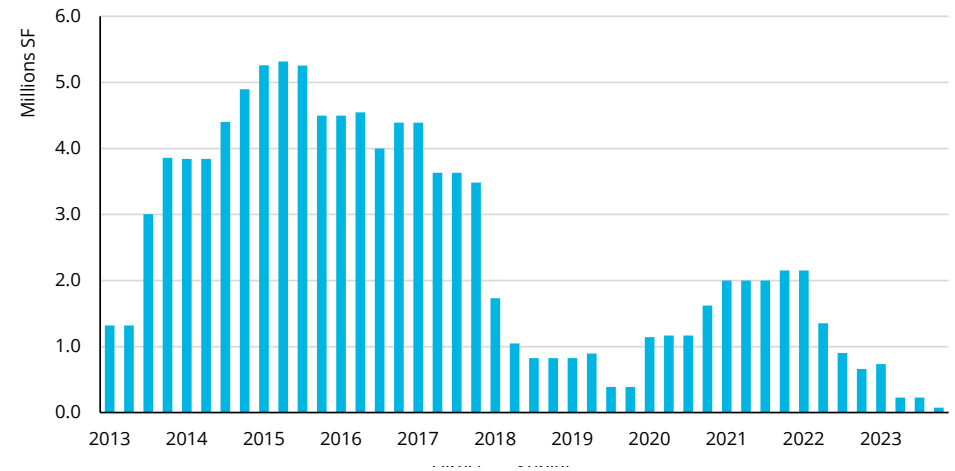


SUPPLY AND DEMAND FUNDAMENTALS

Class A Rents Edge Up Despite More Space on the Market

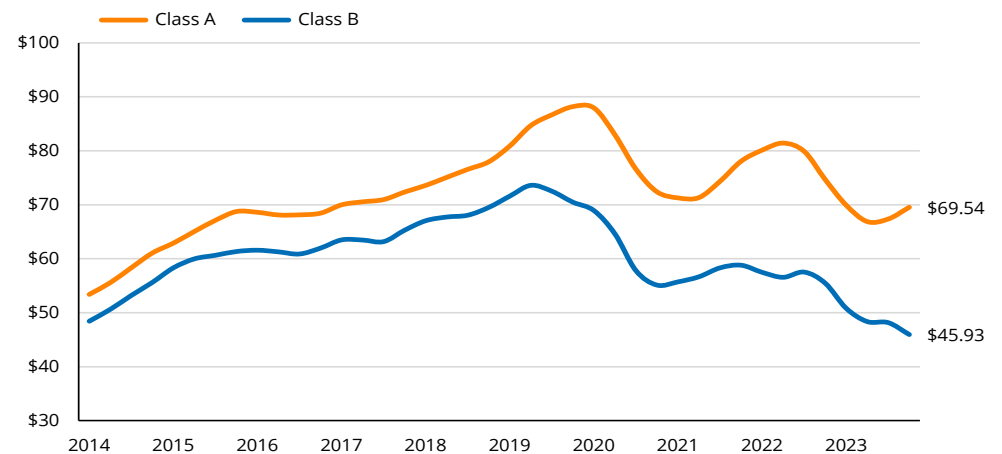
- Office construction totaled 80,000 SF in Q4, trending down since 2017. There are two buildings currently under construction. At 531 Bryant, Urban Land Development is building out a Class B office building that will reach roughly 51,000 SF. The S. Hekemian Group is also constructing 29,000 SF of Class B space at 828 Brannan.
- Average office starting rents rose 3.8% from the previous quarter to an average of \$62.48 PSF but was down 8.4% from one year ago. This compares with a pre-pandemic high of \$81.57 PSF.
- By class segment, Class A starting rents increased 3.2% from Q3 to end the quarter at \$69.54 PSF. Class B slowed by 4.6% to finish at \$45.93 PSF. Pre-pandemic peak rents were \$88.18 and \$73.60 for the two segments, respectively.

UNDER CONSTRUCTION



Source: Transwestern, CoStar, Q4 2023.

STARTING RENT, \$/SF



Source: Transwestern, CompStak, Q4 2023.



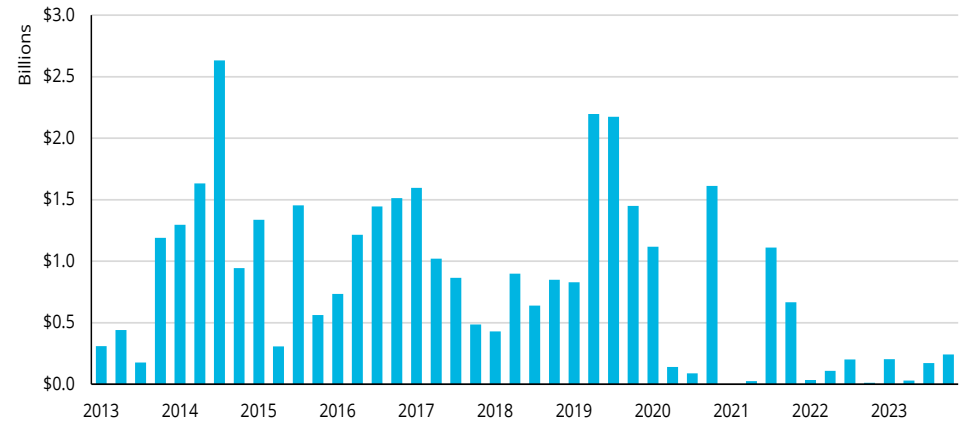
CAPITAL MARKETS

Investment Stalls; VC Funding Returns to Pre-Pandemic Levels

- The office sector recorded \$242 million in Q4 deal volume in a market that frequently experienced over \$1 billion in quarterly investment during pre-pandemic years. Though investment was comparatively weak, there were a few notable deals in which buyers and sellers agreed on reduced pricing.
- In Q4, Gaw Capital purchased 650 Davis for \$82 million. The next largest transaction was a deal inked by Rubicon Point Partners for 123 Townsend at \$72 million. Strada bought 201 Spear for approximately \$60 million.
- Venture capital funding, a driving source of office demand in the tech-heavy San Francisco Bay Area, reached \$19.7 billion during Q4, a minor decrease from last quarter's \$19.9 billion. While funding has fallen from pandemic-fueled highs, capital is active and just below the 2015 to 2019 quarterly average of \$19.9 billion.

INVESTMENT VOLUME

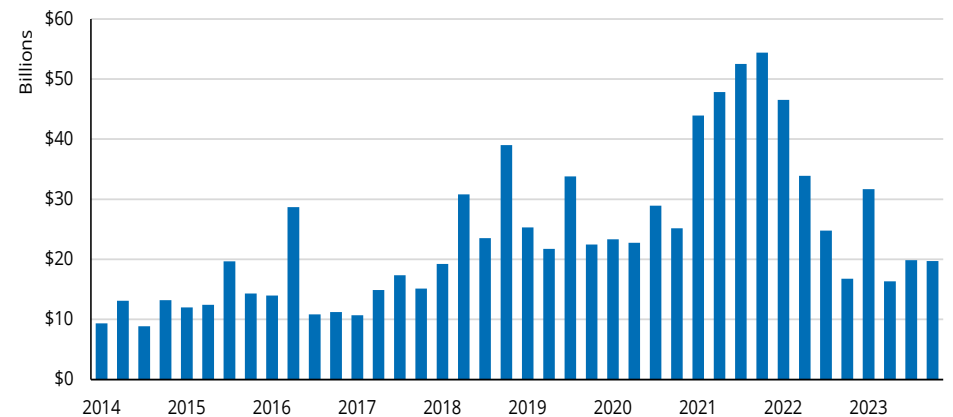
San Francisco CBD



Source: Transwestern, MSCI Real Assets, Q4 2023

VENTURE CAPITAL FUNDING

San Francisco Bay Area



Source: Transwestern, Pitchbook, Q4 2023.



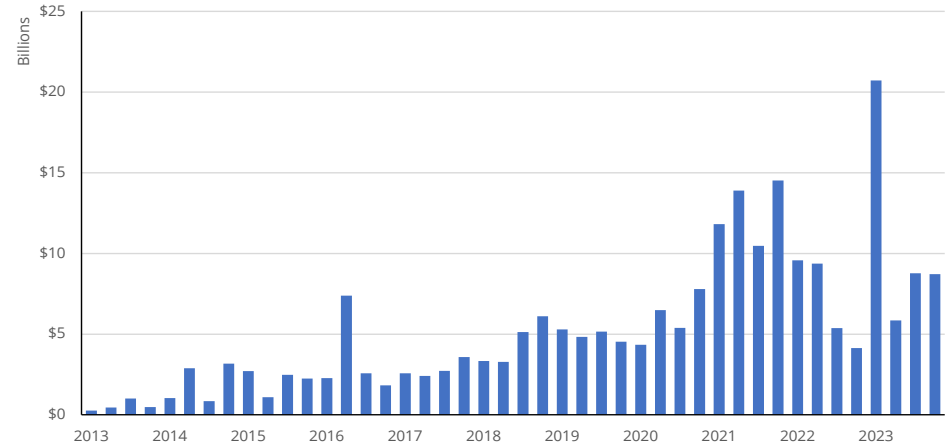
ARTIFICIAL INTELLIGENCE

AI Accounts for Nearly Half of VC Funding

- While overall venture capital funding has fallen from previously unsustainable levels, capital invested into artificial intelligence has offset some of that decline. Companies operating in the AI vertical accounted for \$8.7 billion of the quarterly total, or 44.2% for the second consecutive quarter.
- The largest deal of the quarter was Amazon's \$2 billion investment in AI company, Anthropic. Databricks closed on a \$685 million investment from Andreessen Horowitz and BlueVoyant secured \$140 million from ISTARI and Liberty Strategic Capital.

VENTURE CAPITAL FUNDING INTO AI

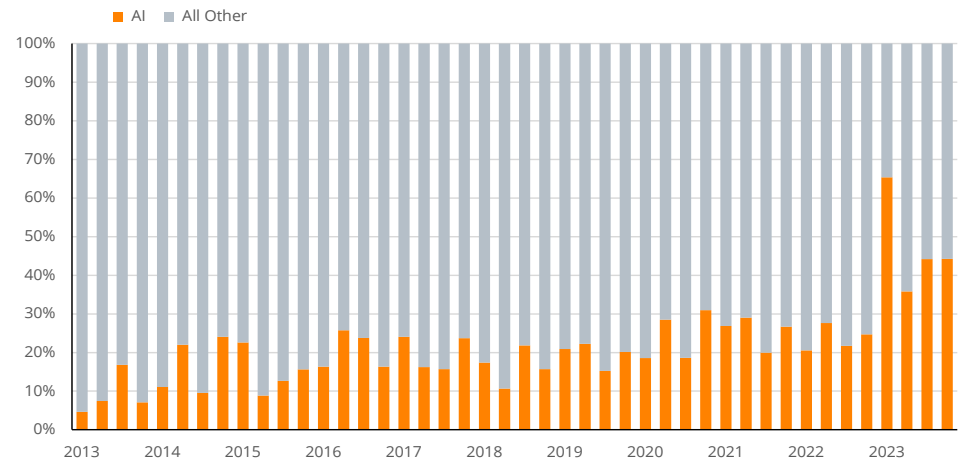
San Francisco Bay Area



Source: Transwestern, Pitchbook, Q4 2023

VENTURE CAPITAL FUNDING

San Francisco Bay Area



Source: Transwestern, Pitchbook, Q4 2023.



TOP LEASES

TENANT	DEAL TYPE	ADDRESS	SUBMARKET	SF LEASED	INDUSTRY
OPENAI	Direct	1455 & 1515 3rd St	Mission Bay/China Basin	486,600	Artificial Intelligence
ANTHROPIC	Sublease	500 Howard St	South Financial District	230,000	Artificial Intelligence
GITHUB	Renewal	275 Brannan	Rincon/South Beach	57,120	Software and IT Services
PATREON	Renewal	600 Townsend St	Financial District	41,403	Software and IT Services
SNAP, INC.	Direct	1160 Battery St	Yerba Buena	37,675	Software and IT Services

= Transwestern deal

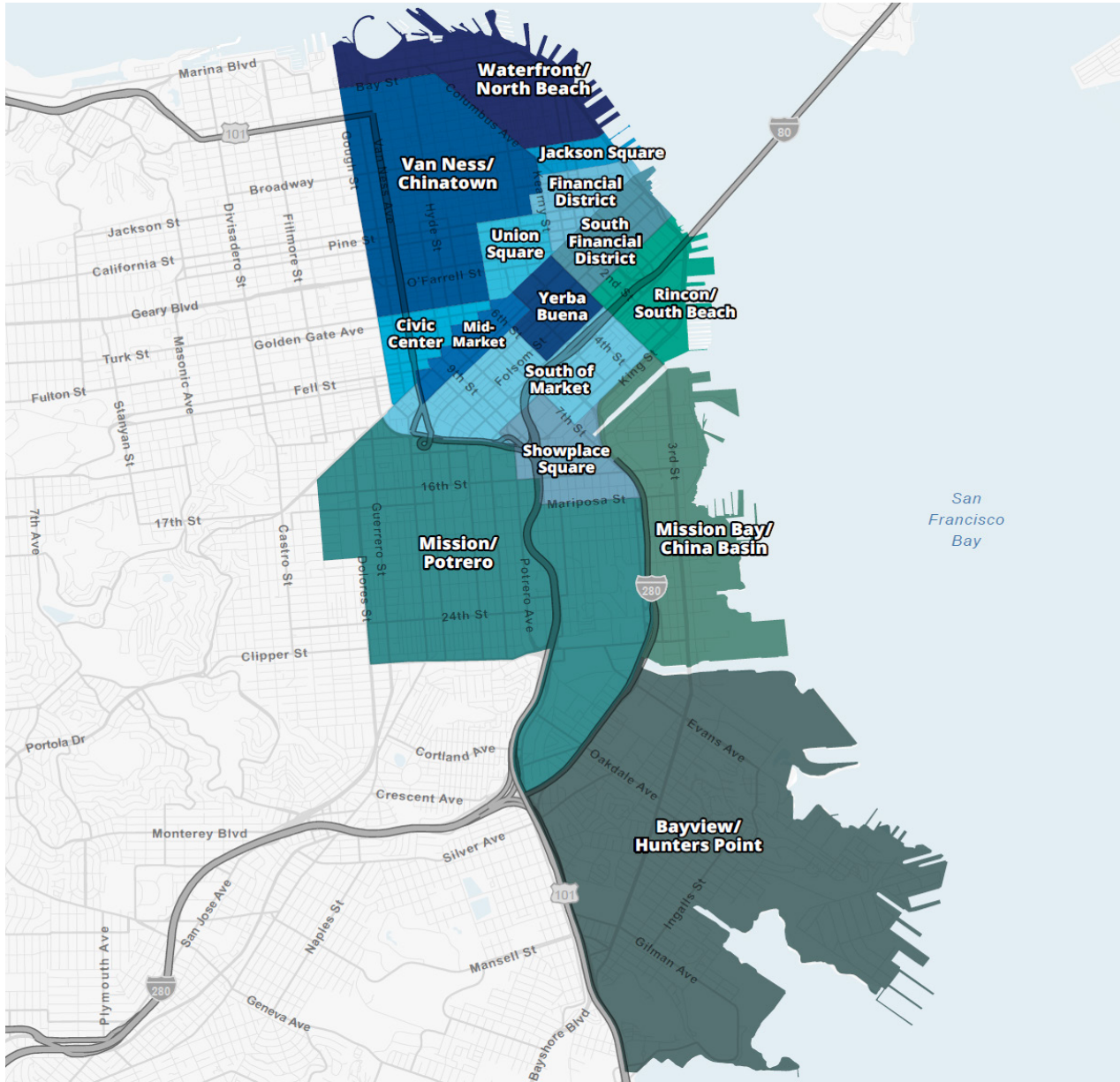
SUBMARKET FUNDAMENTALS

SUBMARKET	INVENTORY SF	LEASING ACTIVITY SF	VACANCY RATE %	QUARTERLY NET ABSORPTION SF	12-MO. NET ABSORPTION SF	UNDER CONSTRUCTION SF	FULL SERVICE RENT \$/SF
BAYVIEW/HUNTERS POINT	263,945	1,180	6.8%	-5,110	32,210	0	\$40.71
CIVIC CENTER	287,311	2,407	46.3%	2,033	5,618	0	N/A
FINANCIAL DISTRICT	29,302,516	286,203	31.7%	-973,487	-2,254,275	0	\$67.24
JACKSON SQUARE	1,677,774	43,247	31.7%	-29,999	-8,221	0	\$50.44
MID-MARKET	4,920,277	116,081	46.2%	-699,718	-1,179,986	0	\$60.98
MISSION BAY/CHINA BASIN	3,569,116	12,750	26.2%	179,069	129,504	0	\$84.28
MISSION/PORTRERO	1,873,264	59,891	29.7%	-85,295	-161,517	0	\$51.75
RINCON/SOUTH BEACH	5,075,541	25,815	41.2%	-40,716	-503,344	0	\$48.42
SHOWPLACE SQUARE	3,590,870	51,724	46.0%	-10,911	-255,262	24,956	\$76.72
SOUTH FINANCIAL DISTRICT	24,199,703	225,269	32.2%	-779,479	-2,388,822	0	\$78.44
SOUTH OF MARKET	2,536,853	17,705	47.5%	-41,238	-362,408	51,223	\$60.98
UNION SQUARE	4,467,128	51,245	33.0%	-42,747	-112,260	0	\$62.86
VAN NESS/CHINATOWN	1,369,244	12,059	22.4%	-11,078	-57,274	0	\$63.82
WATERFRONT/NORTH BEACH	2,835,626	49,075	44.1%	-32,498	-202,062	0	\$73.24
YERBA BUENA	3,942,381	9,628	50.8%	-50,250	-268,392	0	\$56.79
TOTAL	89,911,549	964,279	35.1%	-2,621,424	-5,818,007	76,179	\$62.48

Source: Transwestern, CoStar, CompStak, Q4 2023.



SUBMARKET MAP



FOR MORE INFORMATION

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RESEARCH METHODOLOGY

The information in this report is a compilation of single- and multi-tenant office properties 10,000 SF and larger in downtown San Francisco. Medical offices and government-owned buildings are excluded from analysis.

ABOUT TRANSWESTERN

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