San Francisco Mid-Year Office Market Report

The positives of the current economic landscape include robust construction, jobs, and travel, offset by the negatives of rising gas prices, supply chain issues, and scaled back investment from overseas and venture capital. A recession seems likely, but it's too soon to predict how drastic and how long it will last. This uncertainty could hinder companies that are working to establish a clear way forward with a hybrid workplace model and prolong a wait-and-see approach to leasing new office space.

News of more companies adopting the hybrid workplace model seems to be increasing, but the commercial real estate sector was already moving toward hybrid work, albeit at a very slow pace. The pandemic compressed that timeline. The office space rightsizing in 2008, as companies evaluated space usage and how people work, was a precursor to the hybrid workplace model.

RAISE

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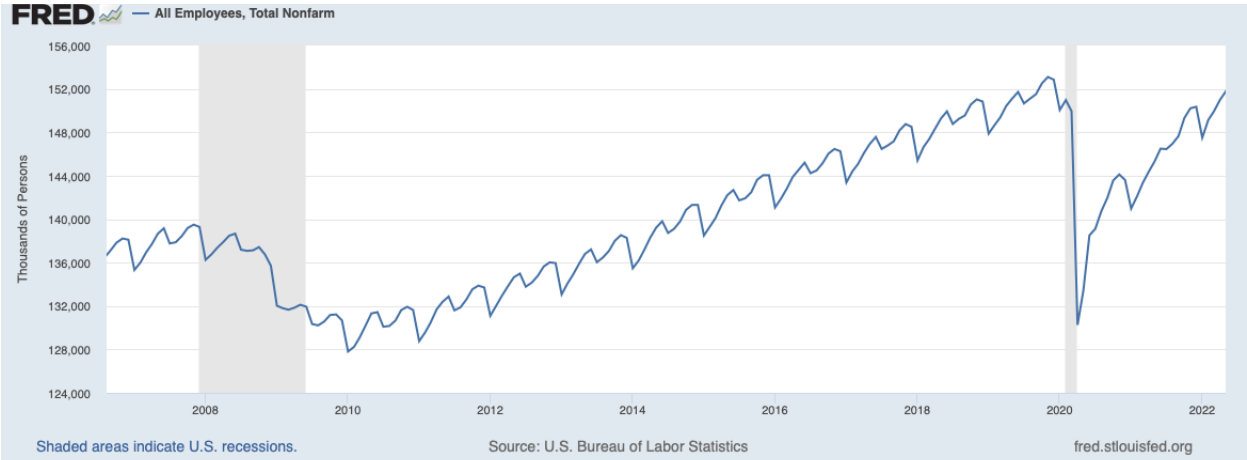
Employment

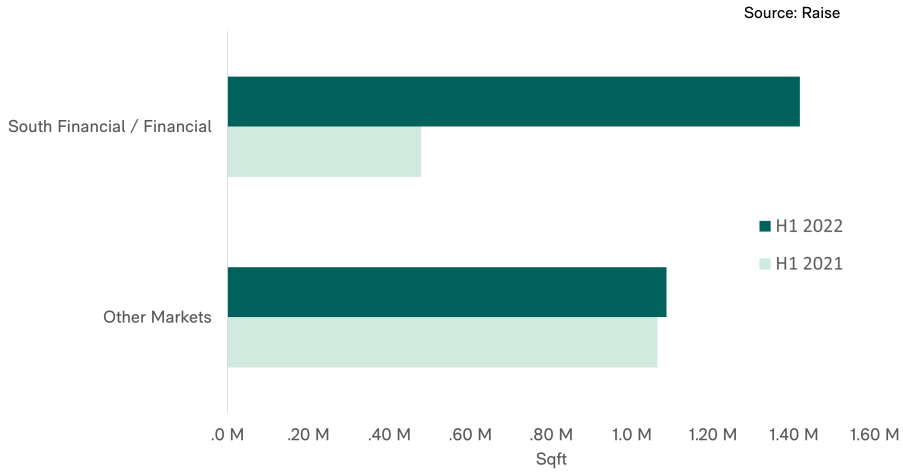
Additional job gains in June pushed up US employment to near pre-pandemic levels indicating hiring needs may outweigh recession concerns.



Availabilities/Asking Rent

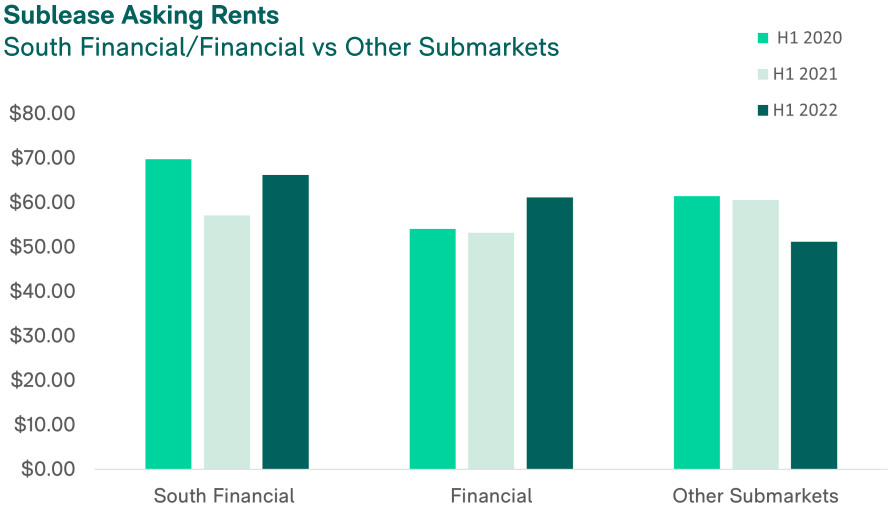
Just under 8.5 million square feet (msf) of space was added to the market in the first half of 2022 (H1), which was a 10.75% increase from the first half of 2021. Though direct space added to the market has not changed significantly compared with H1 2021, subleases increased over 60%, predominantly in the South Financial and Financial Districts. This increase is due in large part to many companies re-evaluating their real estate portfolio after leasing large amounts of space pre-Covid-19, and preparing for a new hybrid workplace model.

Sublease Brought onto the Market



Direct asking rents dropped almost 10% overall from H1 2021. On the other hand, there was an increase in the two largest submarkets (South Financial and Financial Districts) with increases between 15-16% in asking sublease rents from H1 2021. This growth was partly due to a number of factors including an increase of tenant demand for the South Financial and Financial District, continued path towards flight to quality, and lower priced subleases leased and/or withdrawn from the market.

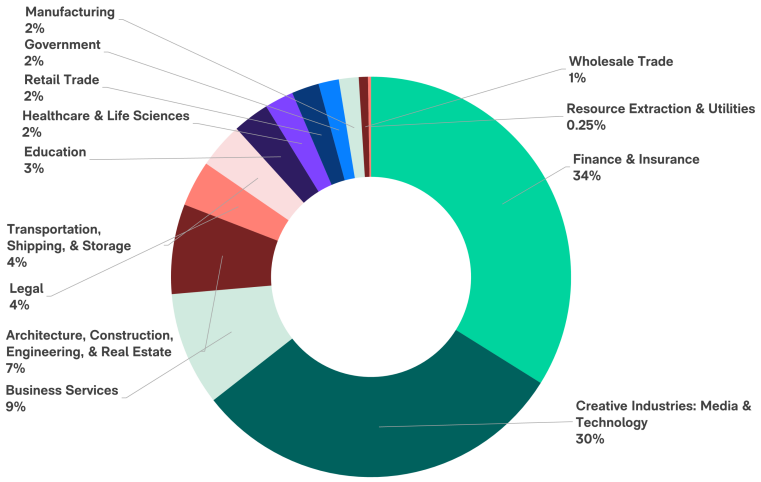
Sublease Asking Rents
South Financial/Financial vs Other Submarkets



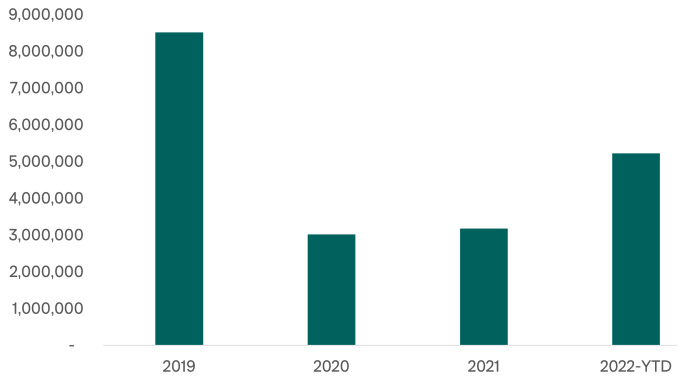
Tenants in the Market

As of H1 2022, there were over 4.8 million square feet of space in demand by tenants in San Francisco with over 60% of those tenants in the Media/Technology and Finance & Insurance industries. With many large companies in the process of consolidating their real estate footprint, smaller early-stage companies and professional service firms are able to take advantage of the increase of spaces added to the market along with more flexibility in negotiating favorable lease terms.

Industry Breakdown



Cumulative Tenants in Demand

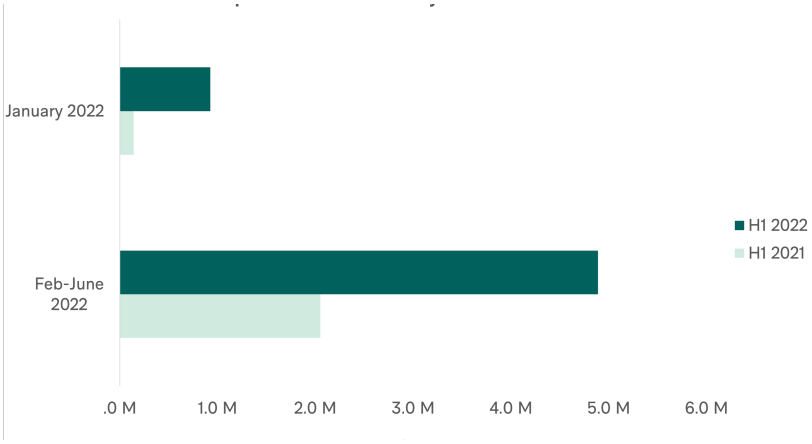


Source: Raise

Leasing

Though some markets have a noticeable increase of workers returning to the office, San Francisco's employee workforce has returned more gradually with an office occupancy of 33.8% compared with New York (38.3%), Los Angeles (41.1%), and Austin (59.9%) in the month of May according to Kastle Systems. January's leasing activity was the highest of any month during H1 2022, with over 400,000 square feet (sf) of sublease space and over 500,000 sf of direct space signed, until two large deals signed in late Q2 of 2022 (Wells Fargo and Google Cloud). In total, leases executed in January amounted to over 20% of all activity in the first half of 2022. With the emergence of Omicron and the following macroeconomic setbacks, leasing activity since January has stalled; however, San Francisco and San Mateo County's increase of nearly 3,000 jobs in the month of May according to the Employment Development Department suggests a bright future.

Space Leased in January vs Rest of Months

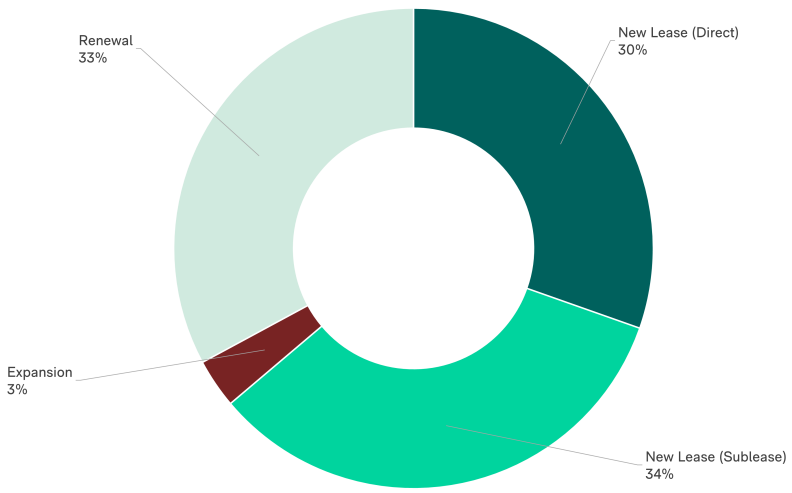


Source: Raise

Aside, from two large sublease transactions (Sephora's sublease in Q1 of 2022 and Google Cloud's sublease in late Q2 of 2022), the total square footage of sublease deals executed between H1 2021 and H1 2022 have not changed significantly. Though tenants previously looked at up-and-coming submarkets outside the Financial and South Financial Districts, tenants now are gravitating back toward the Financial and South Financial Districts due to its proximity to transportation, more neighborhood/building amenities, and its perceived safety and security for its workforce. The South Financial and Financial Districts combined make up a larger proportion of sublease space leased with 60% in H1 2022 compared with 45% in H1 2021. Companies are beginning to shift their flight to quality pursuits toward the well-established core downtown submarkets.

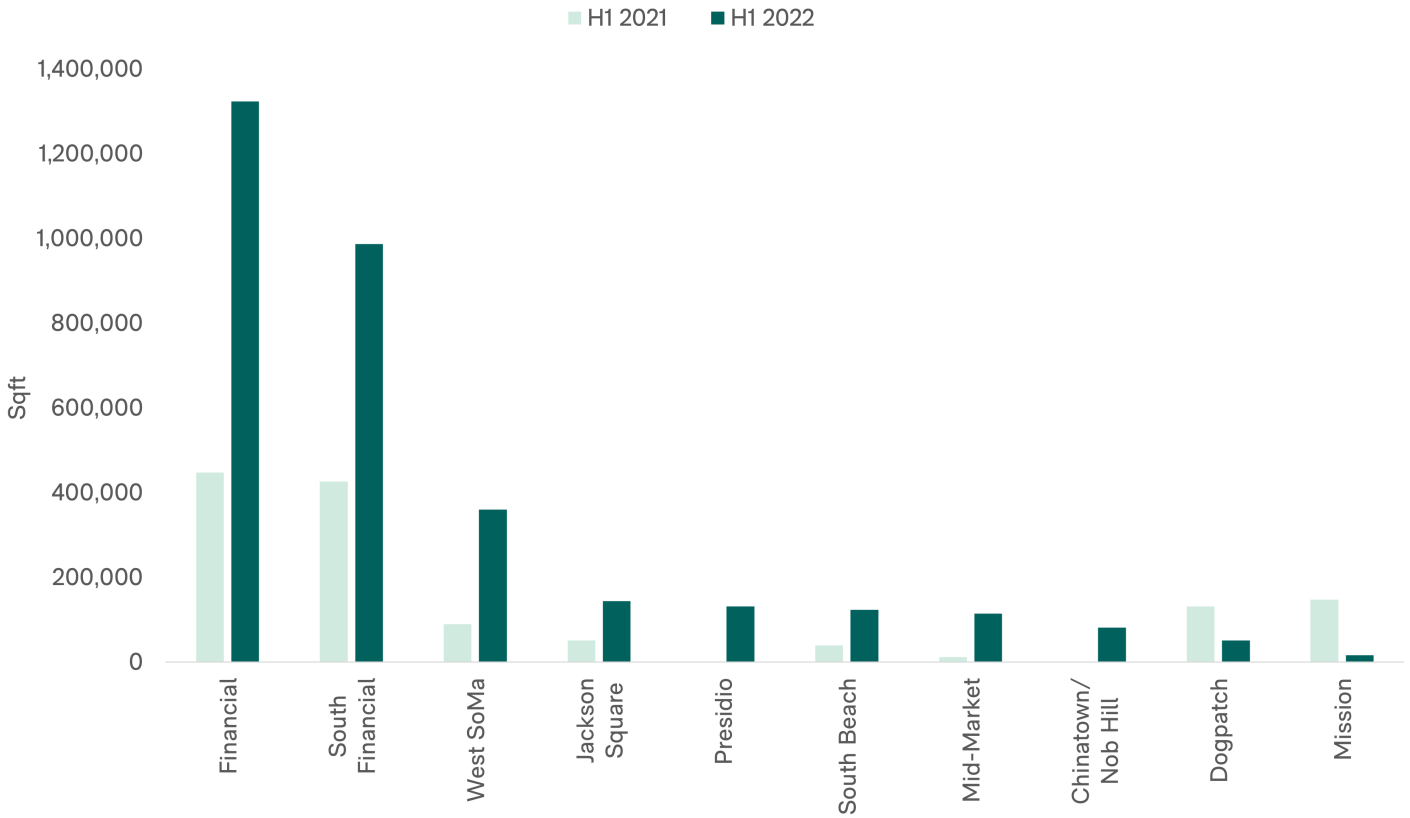
Transaction Type: H1 2022

Source: Raise



Though San Francisco's overall recovery has been slower than expected, the Financial and South Financial Districts offer a glimmer of light at the end of the tunnel. Just over 65% of the total square feet leased in the first half of 2022 occurred in the Financial and South Financial Districts. In both districts the number of deals and square footage leased increased over 2021 by over 55%, respectively. Traditional and early-stage tenants have been able to capitalize on the increase of available space and more favorable lease.

Top 10 Districts: Leasing Activity



Source: Raise

San Francisco Significant Direct Deals H1 2022

Source: Raise

Submarket	Tenant	Address	Leased SF	Space Type
Financial	Wells Fargo	333 Market St	656,353	Renewal
Jackson Square	Ripple Labs	600 Battery St	124,547	New Lease
Chinatown/Nob Hill	Goodby Silverstein & Partners	720 California St	81,065	Renewal
Mid-Market	Twitter	1355 Market St	80,000	Renewal
South Financial	Silicon Valley Bank	505 Howard St	71,515	New Lease
Presidio	Sixth Street Capital	1 Letterman Dr	60,000	New Lease
Financial	Upgrade	275 Battery St	52,000	Renewal
Financial	Lieff Cabraser	275 Battery St	47,564	Renewal
Financial	Farella Braun	1 Bush St	39,935	New Lease

San Francisco Significant Sublease Deals H1 2022

Submarket	Tenant	Address	Leased SF	Space Type
West SoMa	Google Cloud	510 Townsend St	295,333	New Lease
South Financial	Sephora	350 Mission St	232,942	New Lease
South Financial	CBS	680 Folsom St	90,000	New Lease
South Financial	Iconiq Capital	300 Mission St	88,600	New Lease
South Beach	Opendoor	303 2nd St	44,961	New Lease
South Financial	Loom	85 2nd St	33,426	New Lease
South Beach	Sofar Ocean Technologies	Pier 26	28,341	New Lease
Mission	Notion	2300 Harrison St	23,651	Expansion
Dogpatch	Astranis	Pier 70	23,017	Expansion

Outlook

If companies had surveyed employees in 2018 to gauge the desire of a hybrid schedule, and on-site employees were viewed the same as off-site employees, the results would likely be the same as they are now. Employees now expect flexibility and for that reason, 81% of companies are adopting a hybrid workplace model.

The workplace is changing and employees are no longer in the office 5 days a week. Office demand is changing as well as companies seek radically different space to support hybrid workplace solutions. There is still demand for office space but the equation is shifting away from fixed square footage per employee.

Despite reduced office space demand, companies are still eager to grow and strengthen culture, foster collaboration and ideation, and bring back a sense of community. The hybrid model is here to stay and can support both flexibility and the structure employees want to access mentors to grow their careers, which will positively impact office demand in the future.

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