SAN FRANCISCO

EXECUTIVE SUMMARY

- San Francisco's economic boom is expected to continue throughout 2020, however the pace of growth is expected to moderate.
- As one of the most expensive places in the world to build, affordability issues will persist across all property types.
- Lack of space, high business cost, and regulations will impact companies' growth operations to relocate outside of San Francisco.
- There will be an increase in further pre-leasing of proposed sites as entitlements begin to move forward.

San Francisco has proven itself as an innovative leader demonstrated by its ability to withstand and recover from market corrections with more resiliency than others. This is most likely attributed to the booming tech industry that has seen enormous growth, which is likely to continue in 2020 albeit at a slower place. The city will continue to attract young professionals drawn to its cutting-edge technology, innovation, and robust economy adding to the thriving labor market. As of October, San Francisco measured an unemployment rate of 1.9%, one of the lowest in the country.

San Francisco's year-over-year increase in investment volume, job growth, and housing costs make it the epitome of the nation's strongest market. Companies continue to receive the lion's share of VC funding in the U.S. ending 2019 with a total valuation of $182.6 million. Despite worries of a potential economic slowdown, high-growth tech companies will continue to grow their footprint within the city and San Francisco is poised for another strong year in 2020.

By the end of 2019, the overall asking rate has climbed to a record-breaking $88.73 per square foot (psf), full service, quickly outpacing every major market in the U.S. Office rents have increased at an average rate of 3% per quarter during the prior 12-month period, however they have been showing recent signs of a minor slowing. Non-tech companies are realizing San Francisco's political and business climate is simply not feasible. In the past year, corporate titans such as Charles Schwab, McKesson, and Bechtel decided to relocate their headquarter locations outside of the city. Corporate departures are likely to continue in the coming year as space constraints limit tenant growth and put upward pressure on rents.

AVISON YOUNG

KEY MARKET METRICS – 2020 EXPECTATIONS

Annual growth rates, estimated for year-end 2020 vs year-end 2019.

	OFFICE	RETAIL
Rental Growth	↑	↓
Vacant Space	↓	↑
Construction Levels	→	↓
Leasing Volume	↑	↑
Investment Volume	→	→

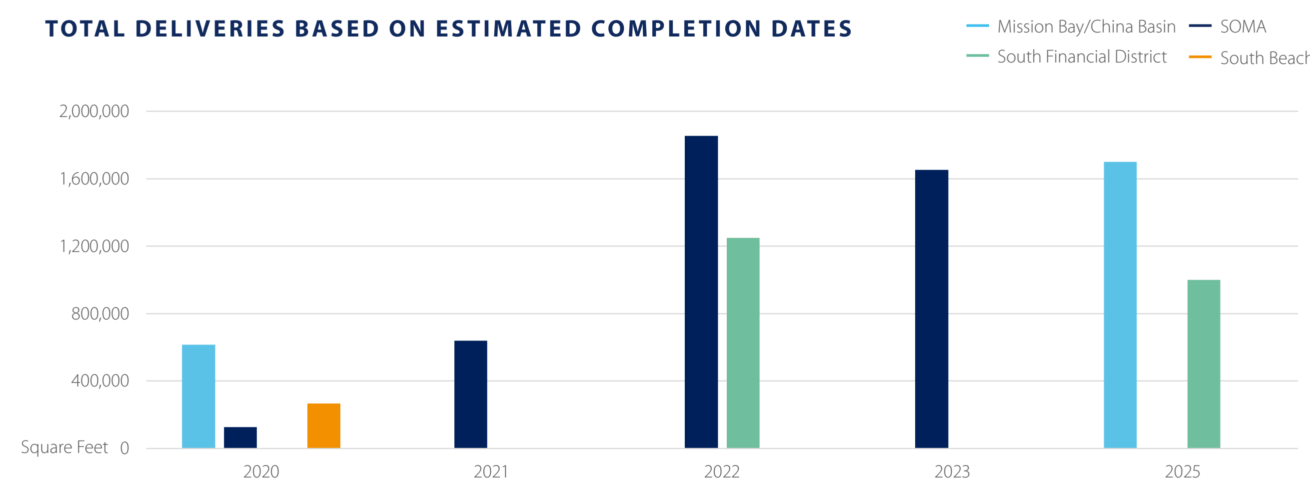
Expect a few large blocks of office space to hit the market in the coming year. Uber recently put their 730,000 square foot (sf) portfolio on the market for sublease as it begins to consolidate its workforce at their newly built Mission Bay campus. In addition, large corporations such as Sephora, Wells Fargo, and Levi's each looking to add an additional 100,000 sf to their already large footprint. However, it is likely these spaces will get leased quickly as demand continues to outpace supply in San Francisco. At the close of 2019, 25% of active tenant requirements in the market were for spaces greater than 100,000 sf.

In the coming year, expect to see demand continue to outpace supply in San Francisco. This grave imbalance is largely attributed to the city's many regulations and building restrictions. These include Prop M, which limits annual developments to 875,000 sf and the recent approval of a plan to raise development fees by 143% to fund homeless services. This will further impede improvements across all property types which are in desperate need of future supply growth. It is no surprise San Francisco was recently voted as the most expensive place to build in the world according to consulting firm Turner & Townsend.

Although the office market shows strong fundamentals, the retail sector is likely to see itself struggling in 2020. Due to changes in consumer spending, high rents, and permit fees, mom-and-pop shops particularly struggle to keep their business afloat. Empty storefronts are becoming more omnipresent throughout the city. As of the end of fourth quarter 2019, retail vacancy reached 4.5%, a slight increase from the figure measured one year ago. Notably, a vacancy tax is heading to the March 2020 ballot where voters will decide to tax retail landlords if spaces remain vacant for more than six months. This tax is intended to reprimand landlords who intentionally leave the spaces vacant in order to obtain higher rent.

Due to limited space in the Financial District, tech companies looking to expand are beginning to prelease projects in surrounding submarkets that have yet to receive entitlements. The Central SOMA Plan, which recently settled environmental lawsuits embattling the plan, finally allowed projects to break ground and provide some relief. Looking forward we should anticipate further pre-leasing of large proposed projects which will transform San Francisco's skyline.

TOTAL DELIVERIES BASED ON ESTIMATED COMPLETION DATES



Source: Avison Young and CoStar Realty Information, Inc.