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U.S.

Fire Sale: $300 Million San Francisco Office Tower, Mostly Empty. Open to Offers.

350 California Street was worth $300 million four years ago. It might sell for 80% less now, brokers say, in a market where office vacancy rates have soared.

By Peter Grant Follow *and Jim Carlton* Follow

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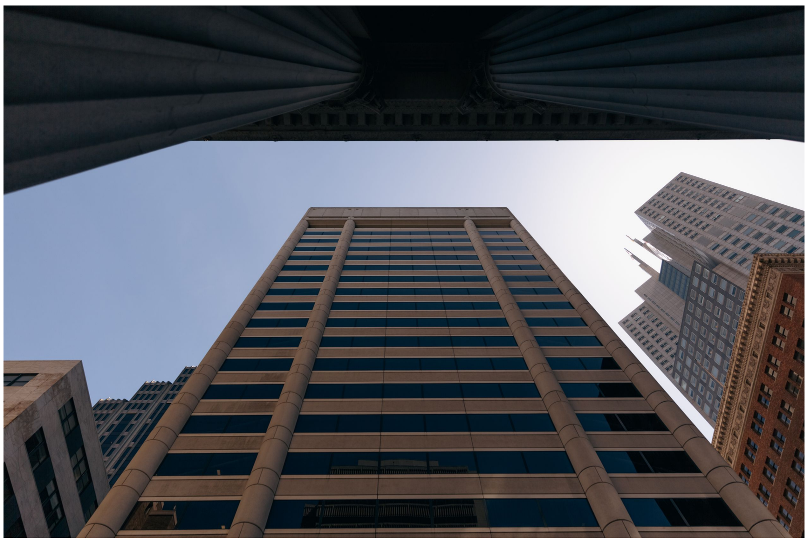
Before the pandemic, San Francisco's California Street was home to some of the world's most valuable commercial real estate. The corridor runs through the heart of the city's financial district and is lined with offices for banks and other companies that help fuel the global tech economy.

One building, a 22-story glass and stone tower at 350 California Street, was worth around $300 million in 2019, according to office broker estimates.

That building now is for sale, with bids due soon. They are expected to come in at about $60 million, commercial real-estate brokers say. That's an 80% decline in value in just four years.

This is how dire things have become in San Francisco, an extreme form of a challenge nationwide. Nearly every large U.S. city is struggling, to some degree, with reduced office-worker turnout since the pandemic spurred remote work. No market was hit harder than San Francisco, for reasons including its high costs, reliance on a tech industry quick to embrace hybrid work, and quality-of-life issues such as crime and homelessness.

Many of the city's most prominent corporate tenants, from Salesforce Inc. to Facebook parent Meta Platforms Inc., are flooding the office market with space for sublet rather than waiting for their leases to expire. The lack of office workers is rippling throughout the financial district, leading restaurants, retailers and other small businesses to lay off employees or close.



350 California Street in downtown San Francisco's financial district. PHOTO: SHELBY KNOWLES FOR THE WALL STREET JOURNAL (2)

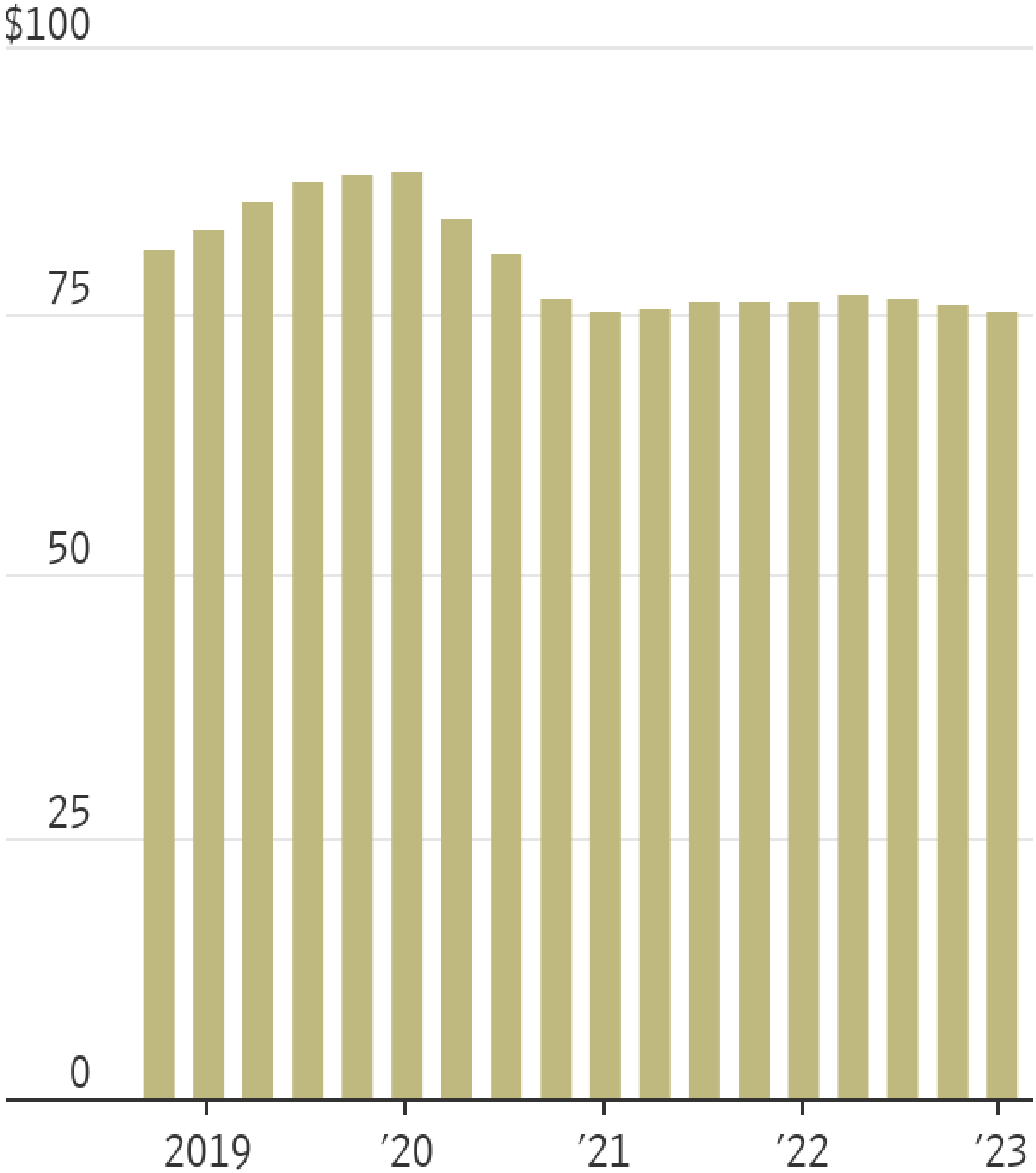
Nearly 30% of San Francisco's office space is vacant, which is more than seven times the rate before the pandemic hit, and the biggest increase of any major U.S. city, according to commercial real estate services firm CBRE Group Inc.

Today it is hard to know just what office buildings in San Francisco's financial district are worth, because transactions have practically dried up. A sale of 350 California promises to establish new pricing.

"We're all really on the edge of our seats to see the first office trade in San Francisco," said J.D. Lumpkin, executive managing director at real estate services firm Cushman & Wakefield.

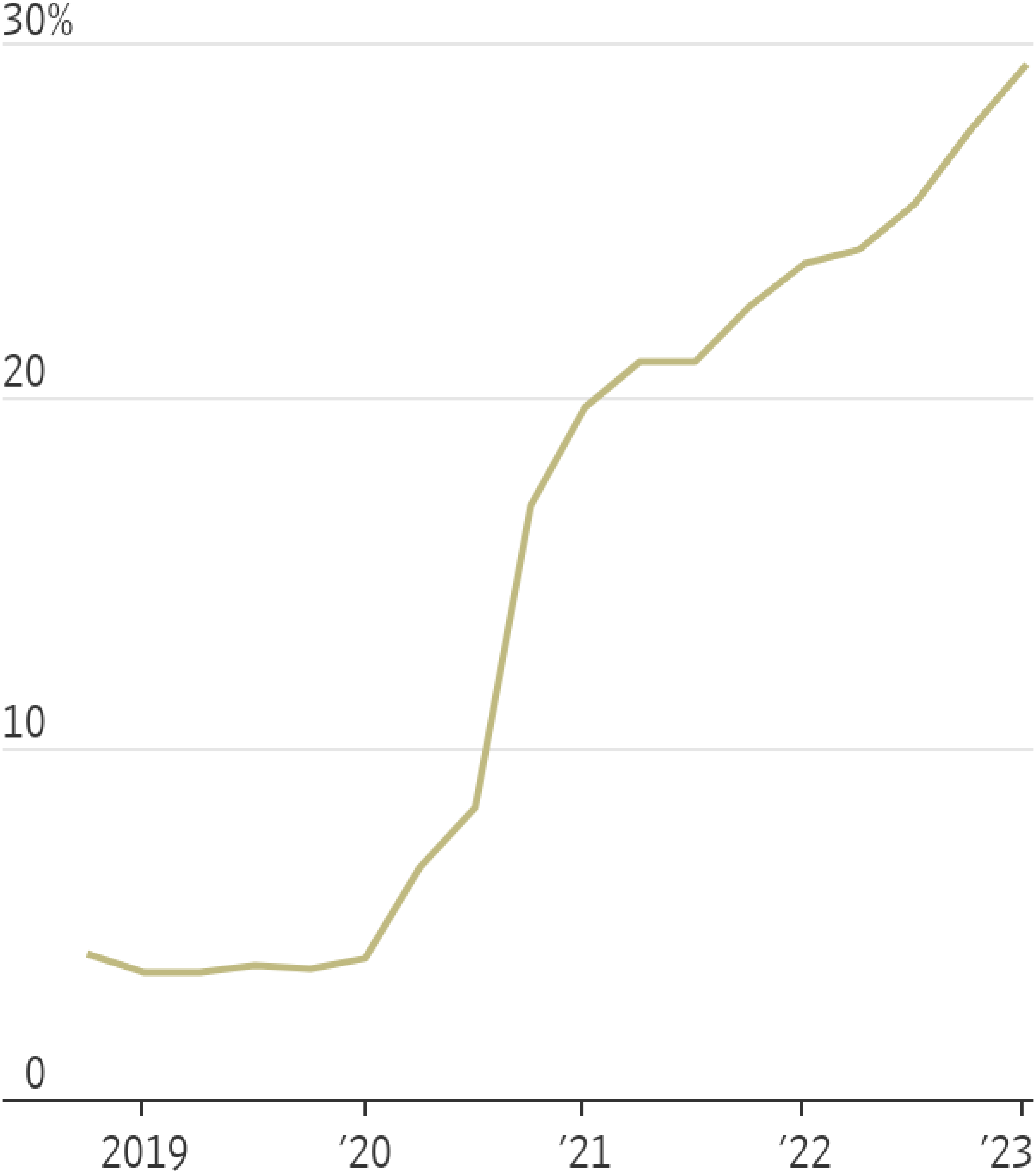
Stress on the office-building market across the U.S. is not an isolated problem, because of the effect on tax levies and nearby shops and the potential impact on the financial sector, especially regional banks that are big lenders on commercial real estate.

Asking rent for San Francisco office space



Source: CBRE

San Francisco office space vacancy rate



Source: CBRE

About $80 billion worth of loans backed by U.S. office buildings come due this year, according to data firm Trepp Inc. Most will need to be refinanced, at a time of higher interest rates and lower occupancy, threatening lenders with losses.

Wells Fargo & Co. recently said the volume of its office-building-backed loans that are classified as "nonaccrual"—meaning the bank no longer expects full interest and principal payment—jumped to $725 million in the first quarter from $186 million in the 2022 fourth quarter.

The office tower at 350 California, which CBRE is marketing, faces some specific challenges. The tower is about 75% vacant because the primary tenant, Union Bank, has mostly vacated it. Unfilled space is a big liability these days, in contrast to before the pandemic, when investors would often pay a premium for empty space because it meant a chance to raise rents.

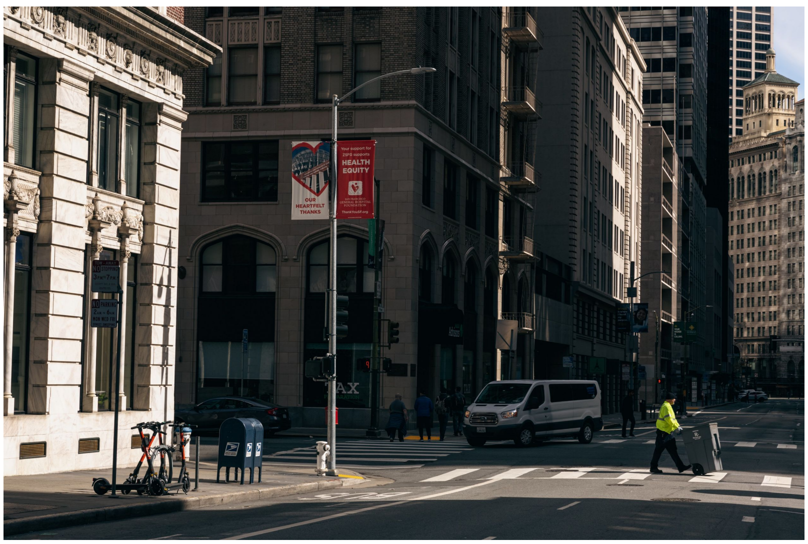
Any buyer of 350 California—built in the 1970s and owned by Mitsubishi UFJ Financial Group's MUFG Americas unit—is expected to have to spend another $50 million or so on interior spaces and other changes to lure new tenants. Amenities such as rooftop decks and spa-quality fitness centers now are standard in top-quality buildings that can charge the highest rents.

Regardless of the building's specific issues, a sale as low as the bids some brokers expect would be bad news for office owners in other U.S. cities too, said Mark Fawer, a partner in the real estate practice group at law firm Greenspoon Marder.

"This could be seen as a bellwether for the value destruction in the urban office market nationally," he said, "especially those markets that are more technology and financial services-centric."

California Street, stretching a 5.2 miles from the financial district to Lincoln Park, is one of San Francisco's longest and most celebrated boulevards. The corridor runs through Chinatown and is traversed by the city's famed cable cars. It intersects Montgomery Street, where traders swapped stocks at the Pacific Exchange on nearby Pine Street until 2006.

Though business activity in the district was upended by the dot-com bust in 2000 and the 2008 financial crisis, its office towers refilled not long after both of those downturns. "There always used to be people waiting at the elevator," said Paul Bleeg, a tax partner at accounting firm EisnerAmper LLP on California Street. "I could never get a seat on BART," the public transit system.



A quiet BART station in downtown San Francisco. PHOTO: SHELBY KNOWLES FOR THE WALL STREET JOURNAL (2)

On a recent afternoon, Robbie Silver strolled a California Street sidewalk next to empty stores and “for lease” signs. As executive director of Downtown SF Partnership, a nonprofit business advocacy group, he is lobbying for public-private partnerships to convert unused office space into apartments and help attract new stores, restaurants and other shops to replace those that have closed.

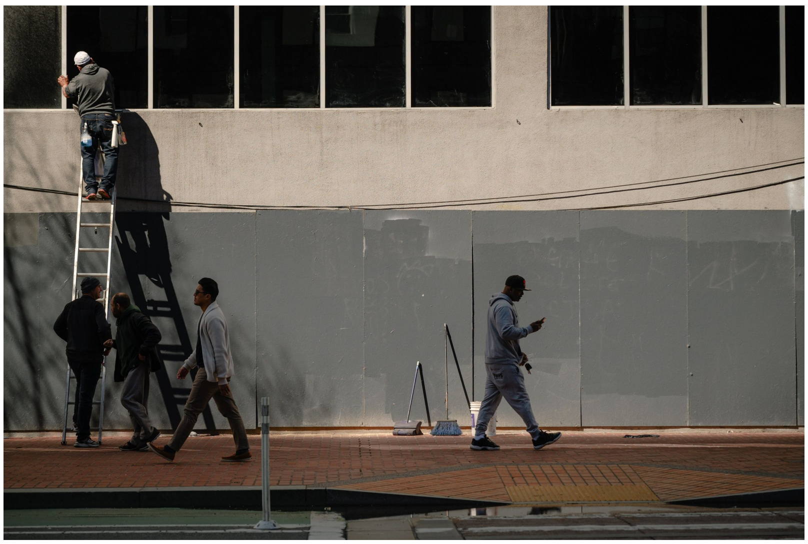
In February, San Francisco Mayor London Breed rolled out her plan to revitalize the downtown office market, the latest U.S. city to announce steps to recover from the office-worker exodus. Her proposal includes a mix of tax incentives.

Any financial solution to the city’s problems is made harder because property owners are among the city’s biggest taxpayers and now are earning considerably less income. The San Francisco controller’s office forecasts up to $1 billion in lost property taxes for local agencies from commercial buildings alone through 2028. Retail sales have fallen steeply in San Francisco.

Ms. Breed asked city department heads to prepare for cuts of up to 13% over the next two years to cope with a projected budget shortfall over that time of $780 million, or 6% of the total general-fund revenue, amid overall economic risks.

As recently as 2021, San Francisco office-building owners were still hopeful the financial district would emerge with renewed vigor, as after the previous downturns. That year, the owner tried to sell the office tower. It pulled the listing after bids failed to exceed $180 million, or 60% of the estimated 2019 value, according to people familiar with the matter.

The tepid interest was an early sign that this crisis was different, and that a deteriorating quality of life in the city was contributing to the reduced office turnout.



Workers clean a building on Market Street. A cable car passes 650 California Street. PHOTO: KORI SUZUKI FOR THE WALL STREET JOURNAL, SHELBY KNOWLES FOR THE WALL STREET JOURNAL

“There was a lot of hate crime on Asian Americans, and we had many Asians on our team who refused to come to the office,” said Anthemos Georgiades, CEO of Zumper, an online real-estate firm. By early this year, only about half of Zumper's San Francisco-based workers had returned to their office at the Transamerica Pyramid near California Street.

San Francisco's dependence on the tech industry, for years a strength, has become a weakness. With young workforces and break-the-mold corporate cultures, tech companies like Dropbox Inc. and Yelp Inc. announced shifts toward more remote work and needing less office space.

One company's policy on returning to work has particularly stung—that of Salesforce. CEO and co-founder Marc Benioff, a fourth-generation San Franciscan whose grandfather served on the city Board of Supervisors, was a public advocate for a special tax to assist the homeless that many other businesses opposed. In the years leading up to the pandemic, Salesforce became San Francisco's biggest employer, occupying two new towers in the South-of-Market district.

When it came to a full return to offices, Mr. Benioff wasn't a fan. "We're not all going back," he said at an industry event in 2021. "People's consciousness and lives and ability to work has changed." That put him in conflict with Mayor Breed, who in an interview earlier this year said that "for this city to be thriving, we need people back in the office."

Salesforce this year began adopting a stricter return-to-office policy, asking some workers back as many as four days per week. In his public remarks, Mr. Benioff has continued to say that his earlier comment about the workplace being changed has been validated.

There has been a slight increase in activity on California Street this year, say landlords and small businesses. JPMorgan Chase & Co., a tenant of a 52-story skyscraper at 555 California, has instructed managing directors to be back in the office five days a week. Other parts of the city also are seeing more activity now that tech giants like Alphabet Inc.'s Google and Uber Technologies Inc. have called employees back to the office some days.

Brokers say venture-capital firms investing in the fast-growing AI sector are making inquiries about office space. "If I wasn't bullish on San Francisco, I wouldn't be here," said Chris Roeder, lead broker for the San Francisco office of commercial real estate services firm Jones Lang LaSalle.

555 California Street rises over the Nob Hill neighborhood of San Francisco, California. PHOTO: KORI SUZUKI FOR THE WALL STREET JOURNAL (2)

Some landlords are getting new leases signed, though with steep concessions. In 2019, tenants signing 10-year leases would typically get three months of free rent. Today it can be as much as 18 months, brokers say.

Average asking office rent was $75.25 a square foot in the first quarter of this year, compared with $88.40 the first quarter of 2020, according to CBRE. Meanwhile, tenants are getting sublease space for as low as $25 a square foot. That is just enough to pay the electricity, heat and other costs to operate a building, said Elizabeth Hart, president of North American leasing for commercial property services firm Newmark Group Inc.

For the building at 350 California Street, some brokers say even an 80% markdown from the 2019 value might not attract an abundance of bids. Few conventional lenders will provide debt financing for a near-empty tower nowadays, brokers and landlords say, which means the winning bid will likely have to be all-cash. They say it's even possible no deal will be done.

Matthew Anderson, managing director at Trepp, the data firm, said that selling the office building at a deeply discounted price would be a sad moment for the office market sector.

"I want to cry," he said. "I'm getting emotional just thinking about that."

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