INVESTMENT FORECAST

IPA INSTITUTIONAL PROPERTY ADVISORS

Retail

San Francisco

2022

Retail to Make a Slow but Clear Comeback this Year; Buyers Target Storefronts in Residential Areas

San Francisco retail market begins to turn corner. After the metro was hard hit by the health crisis, a broader reopening and the return of the retail spending base will support a modest improvement in operations this year. A rapid bounce back is not anticipated, as the pace of businesses returning to offices is relatively pedestrian in the face of the ongoing pandemic. Furthermore, local retailers are highly dependent on tourism, which has not returned in a significant way due to restrictions both in the United States and abroad. Last year, the number of tourists that visited the city was down 39 percent from pre-pandemic levels, and a full recovery in the number of visitors is not expected until 2025. Furthermore, only two-thirds of Californians meet the minimum requirement to visit most retailers in the metro, which is hamstringing local tourism. In the long run, the outlook is much brighter. The density of the metro limits overbuilding at a time when more residential units are added vertically, supporting more shoppers per square foot.

Investors remain optimistic. Despite the metro being impacted more than most from the pandemic, sentiment among retail owners remains positive. Discounting on a large scale has not occurred, and valuations have stabilized for most of the retail inventory. Both single and multi-tenant prices dipped modestly last year, but the decline was less than 2 percent in both property classes. In the city, storefronts under residential units are the most sought-after properties, though a return of office workers will elevate buyer enthusiasm for similar spaces in those towers. The peninsula is also a favored location, as many of the less dense areas were able to recall workers earlier. Entering the year, single-tenant average cap rates were approximately 4.8 percent, slightly higher than the pre-recession low and relatively attractive at current interest rates. Meanwhile, multi-tenant properties saw a 10 basis point rise in the average first-year return last year.

2022 Market Forecast

Employment up 5.8% — The metro recovers more of its employment base this year, as 65,500 spots are created, building on 84,900 jobs in 2021.

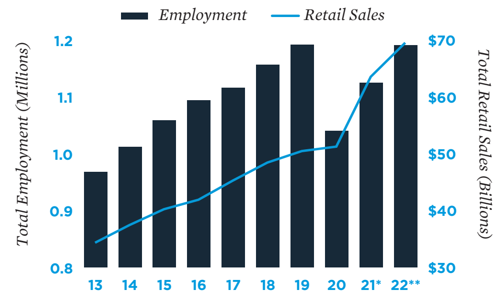
Construction 550,000 sq. ft. — Development will be limited as stock increases by a modest 0.8 percent, slightly above the 0.6 percent rise in inventory last year when 450,000 square feet was completed.

Vacancy down 20 bps — For the first time since 2014, vacancy will decrease on an annual basis, slipping to 5.4 percent. In 2021, the average availability rate climbed 50 basis points.

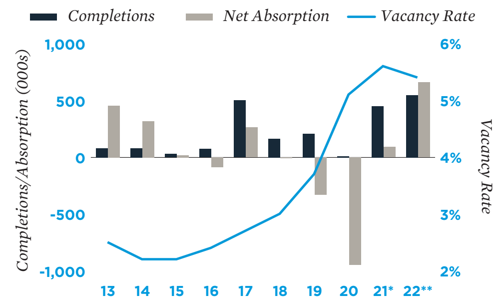
Rent up 1.7% — Following two consecutive years of declines, including a 2.6 percent decrease last year, the average marketed rate is projected to rise to $37.44 per square foot.

Investment — Investment activity should hasten in the first half of this year, as buyers seek to increase their portfolios on the peninsula ahead of an anticipated rise in interest rates.

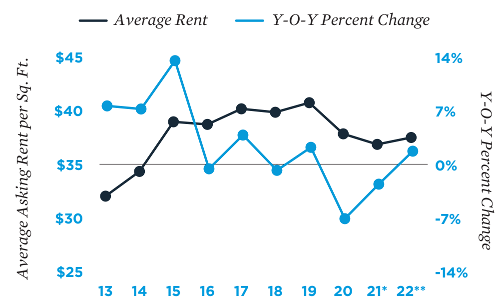
Economic Trends



Supply and Demand



Rent Trends



* Estimate; ** Forecast

Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

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Metro-level employment, vacancy and effective rents are year-end figures and are based on the most up-to-date information available as of February 2022. Average prices and cap rates are a function of the age, class and geographic area of the properties trading and therefore may not be representative of the market as a whole. Forecasts for employment and retail data are made during the first quarter and represent estimates of future performance. No representation, warranty or guarantee, express or implied may be made as to the accuracy or reliability of the information contained herein. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice.

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