INVESTMENT FORECAST

IPA INSTITUTIONAL PROPERTY ADVISORS

Retail

San Jose

2022

Local Economy and Retail Market on Path to Recovery; Return of Tech Workers Presents Potential Tailwinds

Elevated incomes help push retail fundamentals closer to pre-pandemic levels. At $129,800 annually, the median household income in the San Jose market trails only San Francisco entering this year. Although the elevated cost of living in the South Bay erodes some of the spending power among local residents, most households have sufficient discretionary funds to drive retail sales higher. Consumer spending is expected to finish this year at 23 percent above the year-end 2019 level. Achieving that feat partially hinges on the return of employees to offices on a permanent basis. Both Google and Apple, along with many smaller firms headquartered in the South Bay, have indefinitely delayed a return to offices. Regardless, the Silicon Valley giants have shown little impetus to transition away from in-person work, unlike many of their San Francisco counterparts. Furthermore, the spread-out nature of the area is attractive to employees that can work a hybrid model, raising the number of consumers. Combined with low development, both vacancy and rent will improve this year.

Sales market expected to find footing this year. Buyers remained selective in 2021 as the pace of recovery remained cloudy and investors sought opportunities elsewhere. That trend should abate in the coming months as property performance improves and institutional capital searches for opportunities. Creditworthy single-tenant properties remain on top of investors' wish lists, but locally-based buyers are anticipated to shift search criteria to include more franchises and other retailers with a proven track record. Single-tenant cap rates increased modestly in 2021, bucking the national trend. In the high-4 percent area, the mean first-year return entering 2022 is at the highest level since 2018. Multi-tenant sales continue to attract the large institutional and REIT buyers, though smaller players should emerge in the coming months. Local operators may find opportunities targeting strip centers or secondary-anchored centers. The average multi-tenant cap rate is slightly under 5 percent.

2022 Market Forecast

Employment up 3.4% — With the addition of 38,000 jobs this year, overall employment will surpass the year-end 2019 level.

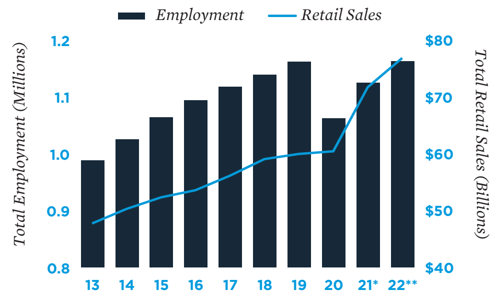
Construction 100,000 sq. ft. — Just a handful of properties are scheduled to come online in the South Bay, lifting inventory an inconsequential 0.1 percent. Last year, only 175,000 square feet was completed.

Vacancy down 40 bps — Vacancy falls to 4.2 percent this year, a level last achieved during the second quarter of 2020. The availability rate ticked up 10 basis points in 2021 as the retail market began to heal.

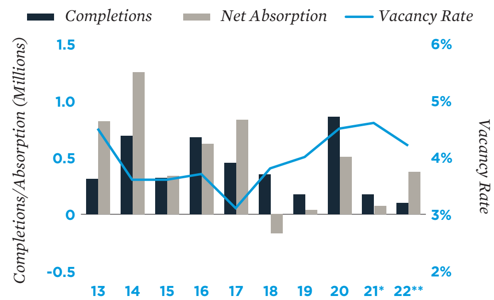
Rent up 3.2% — Although the year-end projection of $34.87 per square foot is below the pre-recession level, rent growth in 2022 will cut into the 4.5 percent decline registered last year.

Investment — Buyers with a penchant for risk may begin to target multi-tenant locations with traditionally high foot traffic, in anticipation of a movement toward pre-pandemic conditions.

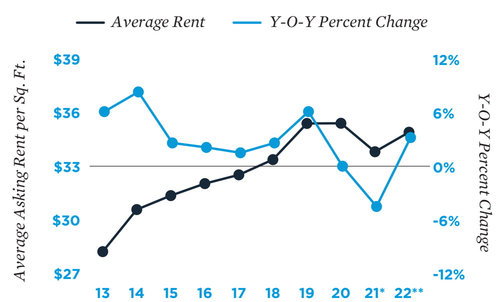
Economic Trends



Supply and Demand



Rent Trends



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

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