MARKET REPORT

Retail

San Francisco Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

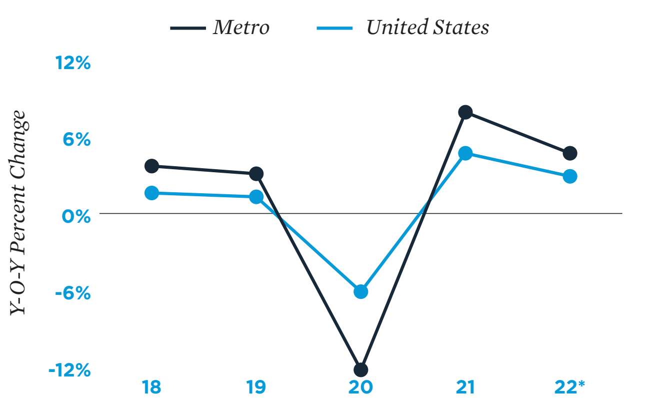
3Q/22

Retail Sales Continue to Rise Amid Widespread Inflation, Suggesting Strong Consumer Demand

Economic growth underpins consumer spending. The addition of roughly 71,000 new jobs over the trailing 12-month period ending in August lowered unemployment to 2.1 percent, the second-lowest rate among major U.S. markets. Additionally, the median household income increased by 3.0 percent in the past year, ranking San Francisco among the top three metros in the nation for that metric. The strength of the economy supported a rise in retail sales that is outpacing inflation, indicating consumer demand for goods and services is robust, even though prices are higher. Grocery stores, fitness centers, restaurants and experiential retailers are among tenants actively taking space off the market in the metro. The western half of the city of San Francisco, along with suburban locales — such as San Mateo, Belmont-San Carlos, Burlingame, Redwood City and Menlo Park — have recorded the most leasing activity as of late.

CBD headwinds persist. The prevalence of hybrid and remote work schedules has fewer workers commuting downtown. Additionally, hotel occupancy rates measured on a trailing 12-month average are still 20 percent below pre-pandemic levels, indicating a slow recovery in business travel. These factors have hamstrung midweek foot traffic in the CBD, creating uncertainty for retailers. As a result, tenants are relinquishing space in areas like Mid-Market, Rincon-South Beach, Showplace Square and Yerba Buena. Moveouts here are expected to offset the momentum building in the suburbs, resulting in a slight vacancy increase metrowide in 2022.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Retail 2022 Outlook

54,000 JOBS
will be created

EMPLOYMENT:

Firms are on pace to expand headcounts by 4.7 percent, following the addition of 42,000 jobs through the first eight months of 2022. However, the pace of hiring is expected to slow in the remaining months of this year, due to record-low unemployment.

255,000 SQ. FT.
will be completed

CONSTRUCTION:

Elevated costs for raw materials, coupled with supply chain constraints, contribute to development activity declining from last year's pace. Inventory will increase by 0.4 percent this year, with Union Square slated to receive the bulk of new supply.

30 BASIS POINT
increase in vacancy

VACANCY:

Availability increases on an annual basis for the seventh consecutive year, as new supply outpaces net absorption in 2022. At 5.8 percent, the metro's vacancy rate will be at the highest level in more than 15 years.

0.4% DECREASE
in asking rent

RENT:

The average asking rent declines this year, following the 2.6 percent gain recorded in 2021, as operators lower rates to attract new tenants. By year-end, the average asking rent will fall to $38.40 per square foot, nearly 6.0 percent lower than the 2019 level.

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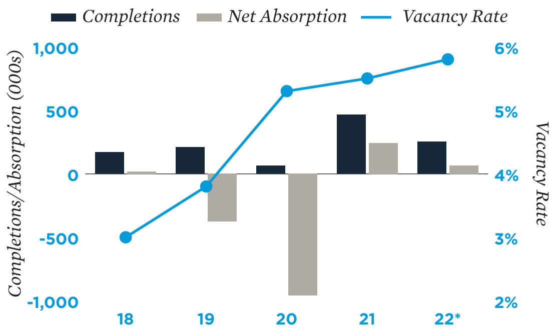
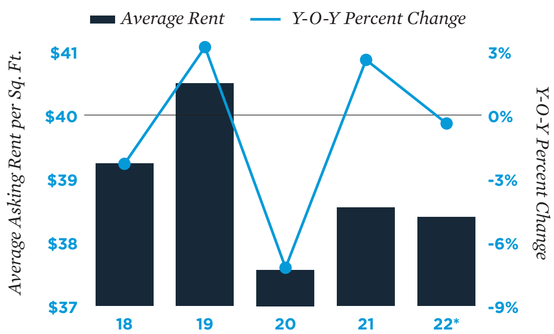
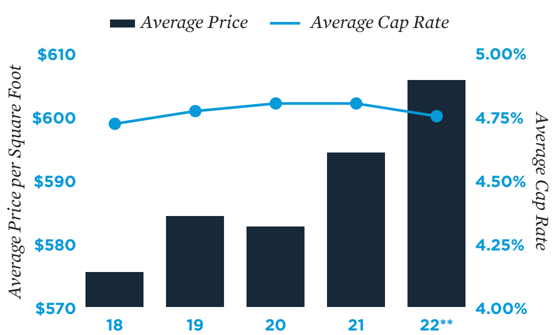
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

IPA Retail

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Price: $250

2Q 2022 - 12-Month Period

CONSTRUCTION

139,000 sq. ft. completed

- Supply additions slowed significantly since the onset of this year, with only 8,400 square feet delivering over the first half. Overall, developers increased retail space by 0.2 percent in the past 12 months ending in June.
- The largest project in the active pipeline is a mixed-use building delivering in Union Square that contains around 60,000 square feet of retail space.

VACANCY

10 basis point decrease in vacancy Y-O-Y

- More than 200,000 square feet of positive net absorption over the past four quarters ending in June lowered metro vacancy to 5.7 percent.
- Submarkets like Civic Center, Union Square and Van Ness-Chinatown are outperforming other downtown neighborhoods, with local vacancy roughly 750 basis points less than the north and south areas of the CBD.

RENT

4.3% decrease in the average asking rent Y-O-Y

- During the trailing 12-month period ending in June, the average asking rent in San Francisco fell to $37.96 per square foot.
- The mean asking rent in the single-tenant segment decreased by 4.8 percent to $38.36 per square foot. Meanwhile, the average rate in multi-tenant properties fell 0.5 percent to $34.69 per square foot.

Investment Highlights

- Transaction velocity for single-tenant assets increased by 26 percent over the past year ending in June relative to the previous yearlong span. Entry costs for properties in this segment remained relatively steady during this span, averaging $655 per square foot, with first-year returns that average in the mid-4 percent range.
- Investors targeting single-tenant properties were most active in the western half of the city of San Francisco. Leasing activity has been most pronounced here as of late, and the local vacancy rate is the lowest in the metro at 2.5 percent. Restaurants, auto parts shops and department stores are highly coveted in this segment. Buyers are also finding similar opportunities in western downtown neighborhoods, such as Civic Center, Union Square and Van Ness-Chinatown, as well as San Mateo County.
- Deal flow for multi-tenant properties rose by 18 percent over the past four quarters ending in June. Pricing increased nearly 5 percent during this span to $575 per square foot on average, while the mean cap rate remained in the high-4 percent span. Neighborhood and community centers with grocery-anchor tenants are changing hands in areas like Belmont-San Carlos, Menlo Park, Redwood City and the western half of San Francisco.