INVESTMENT FORECAST

RETAIL

San Francisco Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

2019

Development Moderates for Third Straight Year; Investors Remain Active in San Francisco

Construction contracts for third straight year; performance most robust in San Mateo County. Fueled by the lowest unemployment rate since the Dot Com era, San Francisco retail assets have undergone a dramatic upswing. Rising incomes and wages have supported a broad scope of retail assets, underpinning a metro vacancy rate below 3.5 percent since 2011. Meanwhile, development has been mostly nonexistent this cycle, with annual deliveries averaging less than 130,000 square feet per annum since the cycle lows in 2010. This year, overall supply growth will fall once more, with minimal space injections outside of the planned repairs and the eventual opening of the Salesforce Transit Center in downtown San Francisco. As a result, average asking rents have pushed higher, particularly in San Mateo County, where extremely limited availability and more affordable prices than the urban core have sponsored dramatic gains that reached the double digits in 2018. Similar conditions will remain in place this year, prompting additional growth, albeit with more dispersion than previous years exhibited.

National and regional capital sources dominate investment landscape amid rapid appreciation in asset prices. A combination of rising rental rates and limited competition from new developments is spurring robust competition among investors for the few attractive listings in the market. Due to the size of the majority of the floor space in the metro, institutional buyers have largely focused on massive mixed-use projects with retail on the ground floor. Meanwhile, private investors have been primarily bidding for properties in Marin and San Mateo counties, where lower price points and smaller asset sizes allow them to use local knowledge to outmaneuver more well-capitalized peers. As little new construction comes online, opportunities for increased density through redevelopment are becoming more popular as cap rates sink to the low-4 percent range and prices per square foot begin to support more ambitious plans for greater scale.

2019 Market Forecast

Employment up 1.9% — Job growth in San Francisco remains elevated as 22,000 positions are created, slightly below the 23,000 added in 2018.

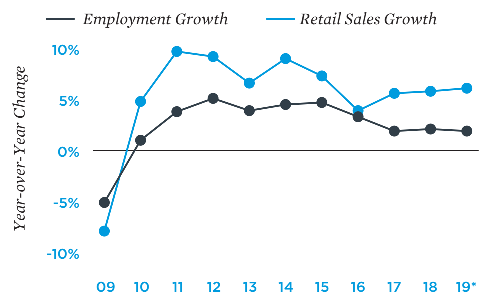
Construction 120,000 sq. ft. — Development will slide to a three-year low following the delivery of 140,000 square feet in 2018.

Vacancy up 10 bps — Tenant outflows will push vacancy up to 3.1 percent. Last year, vacancy rose 20 basis points.

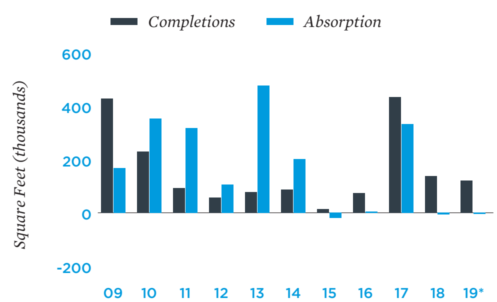
Rent up 2.1% — Following a 2.7 percent gain in 2018, the average asking rent will rise to $40.75 per square foot, with considerable dispersion between urban and suburban locations.

Investment — Locations between I-280 and Highway 101 will be highly sought out by investors seeking cap rates up to 50 basis points above the metro average as values continue to move upward due to corporate development in the area.

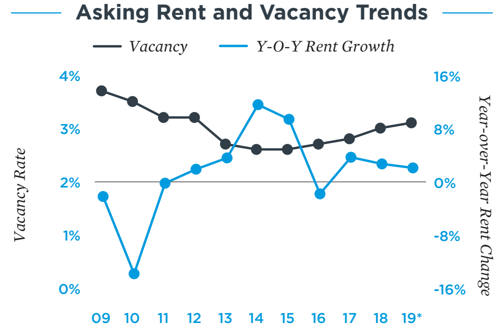
Employment vs. Retail Sales Trends



Retail Completions



Asking Rent and Vacancy Trends



* Forecast

Sources: CoStar Group, Inc.; Real Capital Analytics

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