INVESTMENT FORECAST

RETAIL

San Jose Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

2019

Revitalizing Mixed-Use Projects Highlight Booming Silicon Valley Economy

Massive jump in development pushes supply growth to cycle high amid extremely tight environment. Underpinned by some of the world's largest companies, the San Jose metro holds the highest median household income in the nation. The resulting strength has sponsored extremely robust retail demand, supporting a metrowide vacancy rate well below 5 percent. Tight conditions are beginning to filter into an elevated completions schedule, with construction set to reach a new cycle high in 2018 as developers focus on transformative, mixed-use projects. A $1.1 billion expansion to the Valley Fair mall in Santa Clara will add a new wing and outdoor spaces, while the retail portion of the 36-acre Sunnyvale Town Center will come online in central Sunnyvale. Meanwhile, the Village at San Antonio Center in Mountain View will be redeveloped into a modern mixed-use hub offering essential retail, office and apartments with a community park. The resulting rise in development will likely cause intermittent upticks in vacancy as the new space is leased, yet rent growth will remain elevated as retailers vie for the new high-quality space.

Buyers seek value near large-scale developments. A virtuous cycle of higher prices has continually compelled investors to deploy capital into the San Jose metro. Amid cap rates that will typically begin in the mid-4 percent range, buyers have focused primarily on how they can realize outsized returns by locating near new mixed-use projects where traffic counts will rapidly increase following completion. Seeking out these assets has led investment activity to be concentrated in Downtown and South San Jose and the Sunnyvale/Cupertino stretch to the west. Higher initial cap rates of up to 50 basis points can be achieved by seeking assets farther away from the metro core such as North San Jose and Los Gatos, where higher incomes are raising consumer preferences to levels more in line with the broader metro.

2019 Market Forecast

Employment up 3.5% — San Jose firms hire 40,000 people this year, slightly above the 36,300 positions created in 2018 as economic growth remains exceptional throughout the Bay Area.

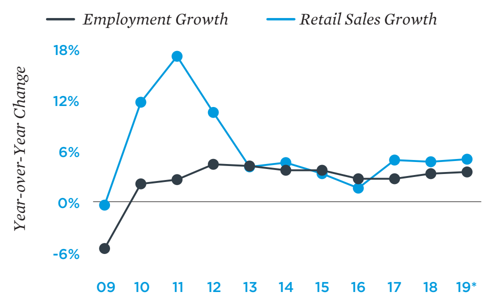
Construction 1.1 million sq. ft. — This year, development more than quadruples from the 190,000 square feet delivered in the previous year.

Vacancy up 20 bps — A cycle high in supply growth will push up the vacancy rate to 3.2 percent. Last year, vacancy increased 10 basis points.

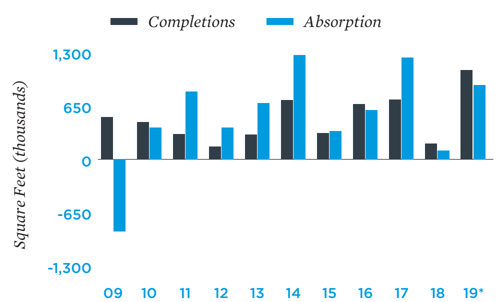
Rent up 2.0% — Following a 3.1 percent gain in 2018, the average asking rent will climb to $34.50 per square foot this year as high-quality space translates into elevated pricing.

Investment — As housing and office development rises inside the city limits of San Jose, retail assets will follow suit. The redevelopment of older mixed-use buildings in this area will be highly sought after.

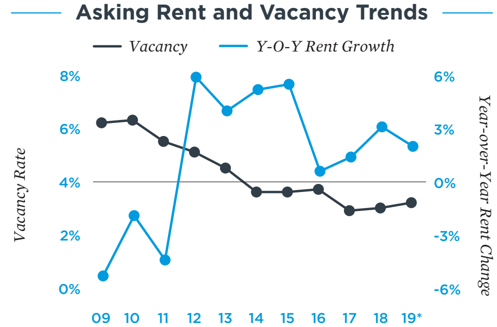
Employment vs. Retail Sales Trends



Retail Completions



Asking Rent and Vacancy Trends



* Forecast

Sources: CoStar Group, Inc.; Real Capital Analytics

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