

# MARKET REPORT

INDUSTRIAL

San Francisco Metro Area

IPA

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PROPERTY  
ADVISORS

2H/19

## Limited Construction Activity Heightens Competition Among Tenants and Investors for Existing Assets

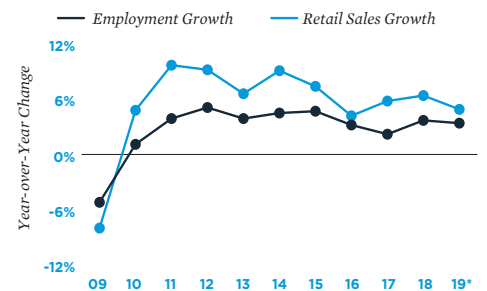
An expanding local economy and limited industrial space keep operations tight with the ability to raise rental revenues with new leases. A booming technology industry has produced robust employment and household income gains in recent years. Job opportunities are abundant, outnumbering the metro's qualified job seekers, as companies continue to expand. These factors have helped to push the median household income to nearly twice the national level. Though the cost of housing is five times greater than the national rate, demand for rentals within the city remains robust, supporting a growing consumer base who desire last-minute mile deliveries. Biotech firms are also seeking research and development space to be near clients. San Francisco's industrial market is thus localized, and many industrial/flex tenants are here primarily to be close to their delivery points within the city. Due to expensive land, few industrial properties have been built in San Francisco over the past decade, keeping vacancy rates tight and allowing marketed rents for available space to rise annually the past four years.

The market's low vacancies and strong rent growth are appealing to investors, but the relatively limited and aged inventory mute sales volume. Pricing is still well above the national average and cap rates remain among the lowest in the U.S. The lack of inventory trading is partially due to San Francisco being a small industrial market, which is compounded by the fact that many investors here prefer to buy and hold long term. The trend triggers competitive bidding when industrial assets are brought to market. Although average first-year yields are low compared with most other metros, the significant increase in appreciative value lures investors seeking a relatively secure investment option. Values can be impacted by an economic downturn; however, the average price per square foot for industrial assets has risen annually since 2011. Comparing the past trailing 12 months though second quarter with the previous period, the average price jumped 15.8 percent to \$482 per square foot, while the average cap rate compressed 30 basis point to 4.6 percent over the same span of time.

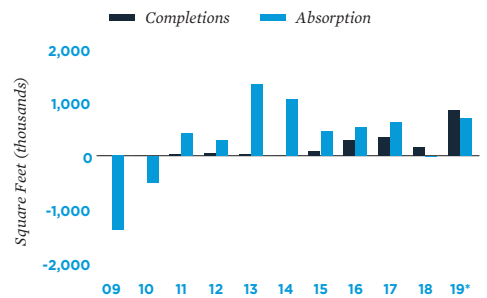
## 2019 Market Forecast

- Employment** up 3.4%  
A tight labor market will slow job growth from 3.7 percent last year with the projected creation of 40,000 positions in 2019.
- Construction** 850,100 sq. ft.  
The majority of space under construction is located in South San Francisco in the Oyster Point area. The buildings are largely flex and research and development projects that are geared toward biotech tenants.
- Vacancy** up 20 bps  
Half of the inventory completed in 2019 is pre-leased. The remaining is anticipated to lease up quickly but leasing may push into 2020. As a result, this year's vacancy rate will lift to a tight 3 percent.
- Rent** up 9.0%  
With the high price of land and limited new construction, the average asking rent in 2019 will rise to \$23.25 per square foot.
- Investment**  
Minimal development activity hinders tenants from departing for speculative construction, keeping vacancy tight. The majority of new projects to break ground in the near future will likely be built-to-suit.

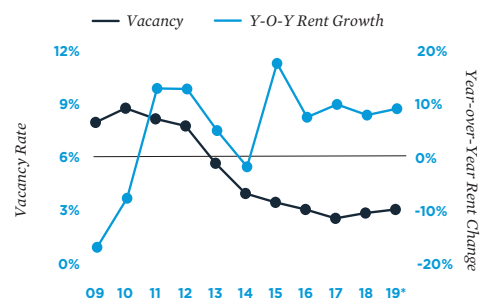
## Employment vs. Retail Sales Trends



## Industrial Completions



## Asking Rent and Vacancy Trends



\* Forecast

Sources: CoStar Group, Inc.; Real Capital Analytics; Moody's Analytics

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Metro-level employment, vacancy and asking rents are year-end figures and are based on the most up-to-date information available as of September 2019. 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. Sales data includes transactions valued at \$1,000,000 and greater unless otherwise noted. Forecasts for employment and industrial data are made during the third 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.