MARKET REPORT

RETAIL

San Jose Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

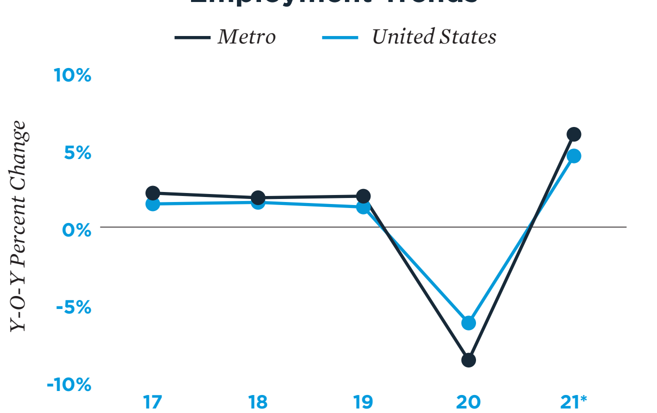
3Q/21

Reopening of Technology Campuses in the First Half Of 2022 Key to Retail Outlook

Silicon Valley retail awaits return of tech giants. The long-term outlook remains bright, though the migration of many highly paid workers is delaying a stronger recovery in the retail arena. Furthermore, the emergence of the COVID-19 variants is giving pause to some to the local economy's anchors. Google, Apple and Facebook have all pushed reopening into early 2022 as the current wave of positive cases needs to pass. Nonetheless, tech companies in the South Bay do plan on bringing all or a majority of their workers back to their expansive campuses, which will boost retail spending next year and into the future. New retailers will follow workers into the metro in 2022, filling up space that was left dark by other tenants that were unable to survive the recession.

San Jose fundamentals ahead of the economy. Despite significant stress on local retailers due to remote work and relatively strict COVID-19 measures, overall metrics are still healthy. Largely due to the exceptional tightness prior to the downturn, vacancy has only ticked up to slightly south of 5 percent. Compared with the previous recession in 2008-2009, availability remains low and the path to a strong retail market is not a long one as high household incomes will attract new retailers. With limited options coming from a minimal supply pipeline, operators are unlikely to offer significant discounts on asking rents unless the health crisis drags on for several more months. Retail fundamentals should begin to improve in the first half of next year as business as usual resumes.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Retail 2021 Outlook

64,000 JOBS *will be created*

EMPLOYMENT:

Payrolls grow by 6.0 percent this year, bringing total employment to within 36,100 of the previous peak in the fourth quarter of 2019. Job gains hinge on the speed that major firms are able to bring workers back.

160,000 SQ. FT. *will be completed*

CONSTRUCTION:

Few deliveries are anticipated this year, reducing pressure on existing properties. Last year, builders completed approximately 850,000 square feet in the South Bay.

30 BASIS POINT *increase in vacancy*

VACANCY:

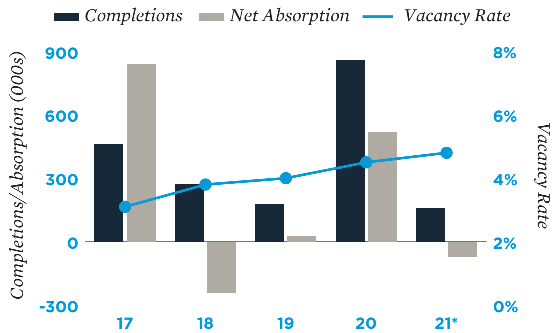
Vacancy will inch lower in the second half of the year, though the rate will be up on an annual basis. At year-end, the rate is projected to lay at 4.8 percent, approximately 60 basis points above the pre-pandemic rate.

1.3% INCREASE *in asking rent*

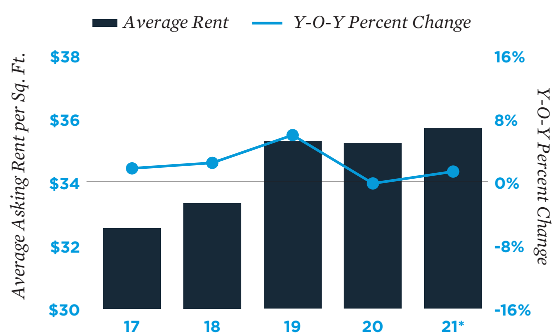
RENT:

Asking rents inch up this year to \$35.70 per square foot. Operators may need to be aggressive with concessions and tenant improvements in the short term to capture the initial demand that emerges post recession.

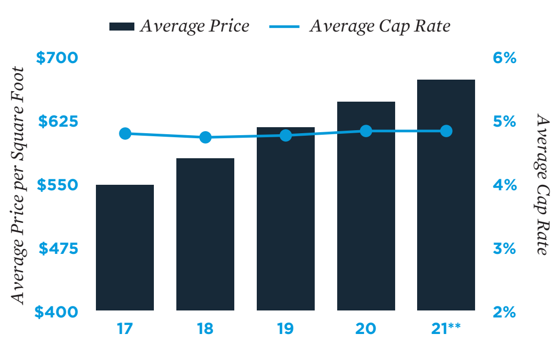
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

IPA Retail

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Price: $250

2Q21 — 12-Month Period

CONSTRUCTION

430,000 square feet completed

- Builders are relatively inactive in the market as they wait to see the long-term impact of the health crisis and grapple with the substantial rise in construction costs.
- Less than 100,000 square feet of space is underway across the metro, and 75 percent of the pipeline currently has leasing commitments.

VACANCY

70 basis point increase in vacancy Y-O-Y

- Vacancy ticked up 20 basis points in the second quarter to 4.9 percent, a recessionary peak thus far and the highest level since 2013.
- Single-tenant vacancy climbed 100 basis points over the past year to 5.1 percent in June. During the same period, multi-tenant vacancy tightened 50 basis points to 4.1 percent.

RENT

0.4% decrease in the average asking rent Y-O-Y

- Retail rent reversed course in the second quarter, increasing 3.0 percent in the spring period. However, asking rates dipped modestly over the past year to $35.77 per square foot.
- Multi-tenant operators cut rents 2.8 percent in the yearlong period while single-tenant average asking rent ticked up 0.1 percent.

Investment Highlights

- Investors stepped back during the 12-month period ending at midyear as buyers awaited more clarity regarding the work-from-home model. Single-tenant deal flow dipped about 30 percent during that time as acquisitions fell across all product types except convenience stores.
- Buyers paid an average of $743 per square for single-tenant properties in the yearlong period ending in the second quarter. Prices were 8 percent above the prior year rate as investors retrenched and targeted high-credit tenants. The average cap rate remained steady at 4.7 percent year over year.
- Multi-tenant properties faced increased due diligence during the health crisis as operators weighed the possibility of having to refill in-line space following the downturn. The average price climbed 4 percent to $593 per square foot during the yearlong period ending at midyear. Nonetheless, first-year returns inched up 10 basis points to 5.0 percent as buyers priced in more risk.