

San Francisco Industrial

Market Forecast

Trends

Absorption



Vacancy



Rental Rate



New Construction



Notable Lease Transactions

Unknown Tenant
450 Toland | 45,000 s.f.

Wagly
1400 17th | 16,000 s.f.

Hertz
1398 Bryant | 10,200 s.f.

The San Francisco industrial market continued to tighten in the first quarter of 2016, with 30,574 square feet of positive net absorption reducing the vacancy rate to 3.7% and further diminishing the limited stock of available space. Asking rental rates rose to an average of \$15.63 per square foot, the highest they've been since the recession. The region's largest industrial leases continue to be consummated in San Mateo County and the southern reaches of the East Bay, where available space and expansive facilities are in much greater supply, as tenants trade the appeal of a central location for adequate square footage. Leasing activity in San Francisco dipped to 16 deals covering 124,214 square feet this quarter, reflecting the paucity of functionally viable space on the market. The San Francisco Planning Department recently signaled plans to more strictly enforce its Production, Distribution, and Repair (PDR) zoning in the coming quarters, as part of a bid to reinvigorate the manufacturing sector of the city's economy.

Net absorption, a measure of market strength, was positive 30,574 square feet in the first quarter of 2016, giving San Francisco its first back-to-back quarters in the black since the middle of 2014. Two submarkets—Mission Bay/China Basin, which added 53,992 square feet of occupied space, and Potrero-West of 101, which contributed 35,400 square feet—accounted for virtually all of the positive absorption in the city this quarter.

Very little leasing activity occurred in the first quarter, with the 121,714 square feet that came off the market representing the slowest three months since the second quarter of 2014. With industrial product disappearing in San Francisco to make way for residential and office developments, the city is unlikely to awaken from its recent leasing slumber anytime soon. The quarter's largest deal was a 45,000 square foot lease by an unknown tenant at 450 Toland in the Potrero-East of 101 submarket; this deal alone accounted for 36% of the space taken in the city over the past three months.

The San Francisco industrial market vacancy rate ticked down from 3.8% to 3.7% during the first quarter, which equates to only 745,274 square feet of vacant industrial space citywide.

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The Southern City, India Basin, Rincon/South Beach, and Potrero-West of 101 submarkets all have vacancy rates below 1%, and both SOMA and Lower SOMA are below 2%. Mission Bay/China Basin and Showplace Square were the only submarkets above 5% vacancy this quarter, and the former registered a 1.6-percentage-point decline in vacant space.

The average asking rental rate in the third quarter was \$15.63 per square foot on a triple net basis. This is up 3% from the fourth quarter and nearly 6% year-over-year. In a trend that first emerged in 2014, many industrial spaces are entering the market unpriced, with landlords letting the market set the going rate. The numbers above can thus be swayed drastically by a few low or high price tags. Nonetheless, the asking rate for high quality industrial space in San Francisco is finally catching up to the market rate of around \$16.00, NNN.

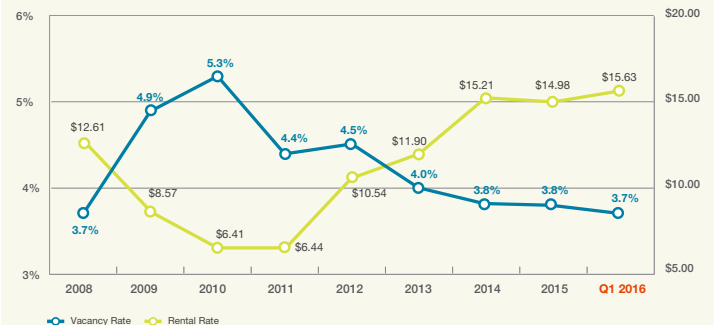
Sales Activity

The San Francisco industrial investment market remains relatively quiet, mostly because much of the high quality industrial product that sellers were looking to move sold in 2012 before the increase in the capital gains tax went into effect in January 2013. Another driving factor is simply that there is not much high quality industrial product left in San Francisco proper. Most of the industrial properties that are purchased are viewed as redevelopment opportunities, slated for demolition or refurbishment into creative space.

Sales activity held at 25 transactions, but dollar volume declined to approximately \$120 million, as industrial investment remains in a two-

year-long lull. Industrial buys this quarter ranged from a commercial redevelopment play to a large-scale sale-leaseback. The former occurred at 620 Brannan, where Kilroy executed a \$31 million cash purchase of a 33,880 square foot warehouse on 1.75 acres from Zappettini Trust; it intends to demolish the building to expand its mixed-use San Francisco Flower Mart project, for which it has now assembled 7 acres of land. The latter involved the 105,178 square foot McGuire Furniture building at 530 10th Street, which went from Kohler Company to SKS Investments for \$47 million (\$447 per square foot) and will soon undergo renovation. Excluding outliers, the median sale price per square foot in the third quarter was virtually unchanged, increasing by \$4 over last quarter to \$472.

Vacancy Rates vs. Rental Rates



*Figures and information for this report look only at industrial buildings larger than 15,000 s.f. and were obtained using 3/15/2016 as the cutoff date for the first quarter. Source: CoStar

Submarket Statistics

Submarket	Number of Buildings	Total Inventory	Direct Available	Sublease Available	Total Available	Total Vacancy	Total Available Rate	Total Vacancy Rate	1Q Net Absorption
Bay View/Hunters Point	30	1,100,798	142,744	1,100	143,844	74,370	13.1%	6.8%	(35,000)
Southern City	12	407,505	0	0	0	0	0.0%	0.0%	0
Showplace Square	90	3,744,352	164,210	0	164,210	134,800	4.4%	3.6%	0
South of Market	32	959,472	37,699	0	37,699	15,919	3.9%	1.7%	(3,300)
Lower South of Market	28	709,058	61,419	9,000	70,419	9,000	9.9%	1.3%	300
Yerba Buena	4	102,200	0	0	0	2,500	0.0%	2.4%	(2,500)
Rincon/South Beach	9	220,527	0	0	0	0	0.0%	0.0%	0
Mission Bay/China Basin	64	2,872,966	271,389	0	271,389	251,389	9.4%	8.8%	53,992
India Basin	25	1,190,437	0	0	0	1,250	0.0%	0.1%	(1,250)
Potrero Hill	154	6,936,615	287,838	28,770	316,608	156,110	4.6%	2.3%	18,332
All Other Areas SF	37	1,515,984	100,829	0	100,829	19,936	6.7%	1.3%	0
Total	485	19,759,914	1,066,128	38,870	1,104,998	665,274	5.6%	3.4%	30,574

Contact

Reed Payne
Executive Vice President, Brokerage
Northern California
415.229.8888 | rpayne@kiddermathews.com

Designated Broker: Reed Payne | LIC #00818935

Offices

San Francisco
415.229.8888
Peninsula
650.769.3600

Silicon Valley
408.970.9400
Sacramento
916.751.3600

San Diego
858.509.1200
Orange County
949.557.5000

Seattle
206.296.9600
Portland
503.221.9900

Phoenix
602.513.5200
Reno
775.301.1300

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