

San Francisco Industrial

Market Forecast

Trends

Absorption



Vacancy



Rental Rate



New Construction



Notable Lease Transactions

Unknown Tenant
737-743 Harrison, San Francisco
37,000 s.f.

Unknown Tenant
955-975 Bryant Street, San Francisco
35,000 s.f.

Honda
1960 Folsom Street, San Francisco
30,993 s.f.

The San Francisco industrial market contracted modestly in the second quarter of 2016, with 141,800 square feet of negative net absorption raising the vacancy rate to 3.7%. Asking rental rates inched up to an average of \$15.67 per square foot, reaching price tags unseen since before the recession. The region’s largest industrial leases continue to be consummated in San Mateo County and in 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 14 deals covering 113,961 square feet this quarter, reflecting the lack of functionally viable space on the market. Earlier this year, the San Francisco Planning Department began to engage in stricter enforcement of its Production, Distribution, and Repair (PDR) zoning, as part of a bid to reinvigorate the manufacturing sector of the city’s economy.

Net absorption, a measure of market strength, was negative 141,800 square feet in the second quarter of 2016, the biggest quarterly loss of occupied industrial space since the second quarter of last year. Potrero-East of 101 was the only submarket to record positive net absorption this quarter, adding 20,904 square feet. All other submarkets finished in the red, exemplified by Showplace Square, which lost 50,000 square feet due to a combination of move-outs and redevelopments.

Leasing activity remained cool in the second quarter; only 113,961 square feet of industrial space came off the market citywide, the slowest three months since the first quarter of 2013. With industrial product disappearing in San Francisco to make way for residential and office developments, the ongoing leasing lull is likely to continue for the foreseeable future. This quarter’s largest lease transaction was signed by an unknown tenant for the full 37,000 square foot building at 737-743 Harrison Street in Lower SOMA. In Potrero Hill, Honda signed on for the entirety of a 30,993 square foot warehouse facility at 1960 Folsom.

The San Francisco industrial market vacancy rate increased from 3.4% to 3.7% during the second quarter, but that equates to only 739,294 square feet of vacant space. The Southern City, India Basin, and Rincon/South Beach submarkets all have vacancy rates below 1%,

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and Bayview/Hunters Point, Lower SOMA, and Potrero-West of 101 are below 3%. Mission Bay/China Basin and Showplace Square are the only submarkets above 5% vacancy this quarter.

The average asking rental rate in the second quarter was \$15.67 per square foot on a triple-net basis, reflecting a 10% year-over-year increase. 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 asking-rent figure 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 has now virtually caught up to the market rate of \$16/s.f., 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 the dearth of 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 increased slightly to 29 transactions covering about 375,000 square feet of industrial space, and dollar volume grew to approximately \$127 million. Nonetheless, industrial investments and owner/user buys remain in a two-year-long slumber, largely because of the city's limited supply. The quarter's largest sale transaction involved a two-parcel portfolio at 610-620 Brannan Street, which Kilroy purchased from Zappettini Properties for about \$87 million, as the developer assembles the lots necessary to begin construction on its expansive Flower Mart project. The 10,000 square foot warehouse at 901 Tennessee Street traded for \$8.5 million in April, and its former tenant, Furniture Innovation, has vacated to allow for demolition and

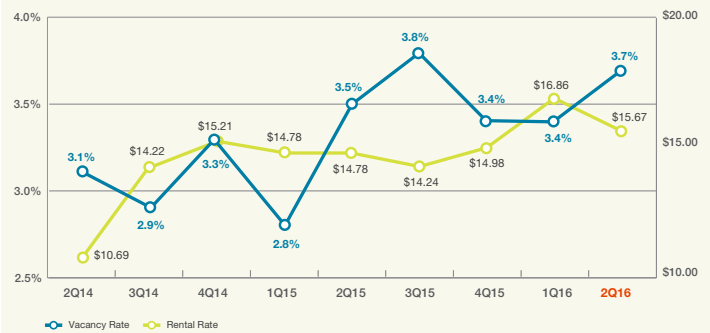
subsequent mixed-use development. Excluding outliers, the median sale price per square foot decreased by 2.3% from last quarter, to \$461.

PDR Enforcement

In January, the San Francisco Planning Department ramped up enforcement of the city's PDR zoning, which disallows building use by firms that do not produce tangible goods. The majority of the city's PDR-zoned parcels lie in the SOMA, Potrero, and Bayview/Hunters Point submarkets. By evicting non-conforming tenants, the city aims to preserve or create space for local makers and supporting businesses. This should also result in a modest boost to the city's industrial building inventory and may help to loosen a severely constrained market, opening the door for more manufacturers and distributors to set up shop in the city in the coming years.

**Figures and information for this report look only at industrial buildings larger than 15,000 s.f. Source: CoStar*

Vacancy Rates vs. Rental Rates



Submarket Statistics

Submarket	Number of Buildings	Total Inventory	Direct Available	Sublease Available	Total Available	Total Vacancy	Total Available Rate	Total Vacancy Rate	2Q Net Absorption
Showplace Square	29	1,083,178	120,245	25,987	124,606	60,121	11.5%	5.6%	(20,751)
Southern City	12	407,505	0	0	0	0	0.0%	0.0%	0
Bay View/Hunters Point	89	3,664,009	122,110	36,000	158,110	104,700	4.3%	2.9%	(50,000)
South of Market	32	959,472	31,380	11,000	42,380	43,599	4.4%	4.5%	(27,680)
Lower South of Market	28	709,058	24,419	9,000	33,419	9,000	4.7%	1.3%	0
Yerba Buena	32	959,472	31,380	11,000	42,380	43,599	4.4%	4.5%	(27,680)
Rincon/South Beach	9	220,527	0	0	0	0	0.0%	0.0%	0
Mission Bay/China Basin	64	2,872,966	250,270	0	250,270	253,989	8.7%	8.8%	(2,600)
India Basin	25	1,190,437	0	0	0	1,250	0.0%	0.1%	0
Potrero Hill	154	6,936,615	185,181	28,770	213,951	221,699	3.1%	3.2%	(13,089)
All Other Areas SF	37	1,515,984	100,829	0	100,829	19,936	6.7%	1.3%	0
Total	511	20,519,223	865,814	121,757	965,945	757,893	4.7%	3.7%	(141,800)

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