

San Francisco Industrial

Market Summary

	FORECAST
Absorption	↑
Vacancy	↓
Rental Rate	↑
New Construction	↔

Notable Leases

Google
201 Toland Street
32,580 s.f. Leased (Renewal)

Lady M Confections
2025-2045 McKinnon Avenue
25,521 s.f. Leased

San Francisco Public Library
750 Brannan Street
24,419 s.f. Leased

Notable Sales

Spokane Culvert & Fabrication Company
2177 Jerrold Avenue
29,578 s.f.
Purchased for \$9.7M or \$327.95/s.f.
(Owner/User)

Farallon Capital Management
1250 Van Dyke Avenue
20,500 s.f.
Purchased for \$4M or \$195.12/s.f.
(Investment)

The San Francisco industrial market held its own in the third quarter of 2016, recording 34,035 s.f. of positive net absorption that reduced the vacancy rate to 3.5%. Asking rental rates increased to \$17.87 per s.f., triple-net, a post-recession high, and availabilities jumped to 5.8%. A slowdown in redevelopment sales and demolitions stabilized the city’s industrial stock, and most landlords marketing newly vacated spaces quickly secured replacement tenants, as leasing activity rose to 171,532 s.f. Nonetheless, 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. 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 and retain the city’s dwindling industrial supply.

Net absorption, a measure of market strength, was positive 34,035 s.f. in the third quarter of 2016, after beginning the year with consecutive quarters in the red. The year-to-date change in occupied industrial space stands at negative 116,499 s.f., primarily in the Lower SOMA submarket, which lost a city-high 47,168 s.f. in the quarter. Potrero Hill paced the San Francisco market in positive net absorption this period, adding a combined 89,625 s.f. on both sides of U.S.-101, after Honda moved into the 30,993 s.f. warehouse building at 1960 Folsom Street, previously home to Lumberman Supply.

Leasing perked up during the third quarter, to 15 transactions covering 171,532 s.f., the most active period in the year to date. Lady M Confections, a handmade cake company with boutiques in the United States, Hong Kong, and Singapore, leased 25,521 s.f. at the warehouse property at 2025-2045 McKinnon Avenue, its first foray into the San Francisco market. The San Francisco Public Library signed on for 24,419 s.f. at 750 Brannan in Lower SOMA, potentially for storage and retail uses associated with its Friends of the Library program. Both of those users are expected to move in during the first two months of next year.

Vacancies ticked down from 3.6% to 3.5% during the third quarter, up 20 basis points from this time last year. Lower SOMA experienced the largest increase in vacancy, jumping from 6.4% to a cycle-high 13%. California Saw and Knife Works, an owner/user, left the manufacturing space at 721 Brannan Street and relocated to Oregon, putting its 22,170 s.f. building up for sale for \$10.98 million or \$495

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per s.f. The Potrero submarkets saw the quarter's most substantial vacancy declines, with the portion east of 101 tumbling from 3.7% to 2.6% and the western segment tumbling from 2.0% to 0.3%. The Potrero West of 101 submarket, San Francisco's third-largest, had just 7,482 s.f. of vacant industrial space at quarter's end.

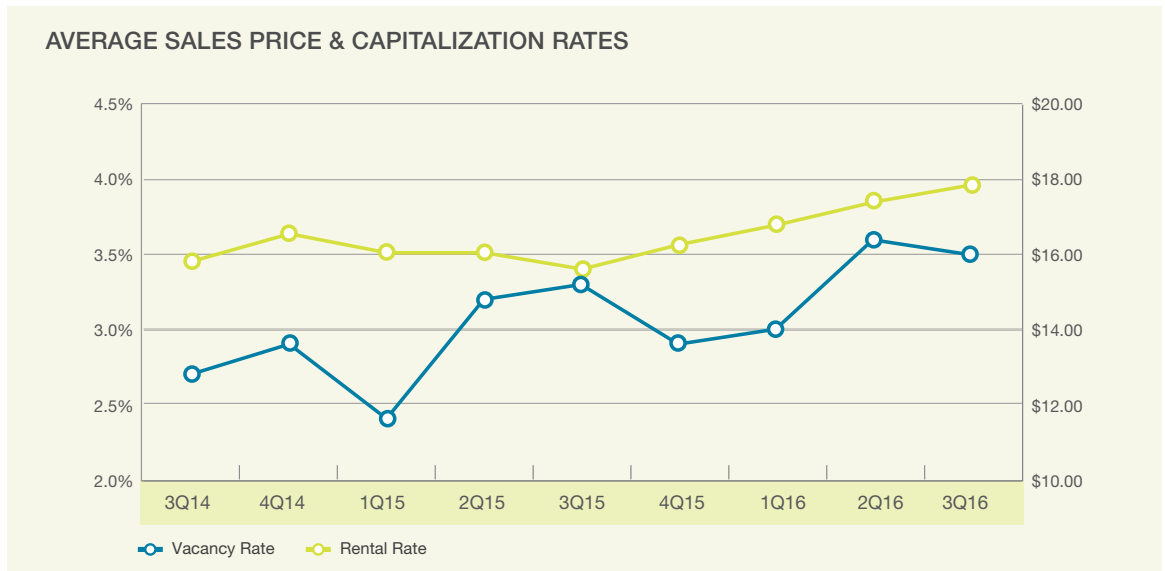
The average asking rental rate in the third quarter was \$17.87 per s.f. on a triple-net basis, reflecting a 14.6% year-over-year hike. In a trend that first emerged in 2014, many industrial spaces are entering the market unpriced, with landlords letting the market set the going rate. The asking-rent figure above can thus be swayed drastically by a few low or high price tags, particularly as industrial spaces are retrofitted for creative or non-traditional manufacturing uses.

Sales Activity

The San Francisco industrial investment market remains relatively quiet, in part because of the lack of functionally superior industrial product left within the city limits.

In recent quarters, most of the industrial properties purchased were viewed as redevelopment opportunities, slated for demolition or refurbishment into creative space. In the quarter's only major redevelopment play, Hines acquired the Factory Club building at 535 Harrison Street for \$8.5 million. Plans submitted in 2014 called for 184 residential units and 2,500 s.f. of ground-floor retail on the site at the corner of Harrison and Essex Streets, adjacent to the Interstate-80 onramp. The largest owner/user buy was struck at 2177 Jerrold Avenue in Potrero East of 101, where Spokane Culvert & Fabrication Company (SCAFCO) bought Clementina Clemco Holdings' 29,578-square-foot warehouse for \$9.7 million or \$328 per s.f. Finally, the biggest investment-oriented buy involved 1250 Van Dyke Avenue in Bayview/Hunters Point, which went from Charles and Karen Cunningham to Murphy Trust for \$4 million or \$195 per s.f. Excluding redevelopments, the median sale price per s.f. was \$328.14.

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



Submarket Statistics

Submarket	Total Inventory	Direct Vacancy Rate	Total Vacancy Rate	Total Available Rate	Q3 Net Absorption	YTD Net Absorption	Quarterly Leasing Activity	YTD Leasing Activity	Rental Rate
Bayview/Hunters Point	3,782,089	2.30%	3.30%	5.40%	(400)	(77,900)	35,596	64,420	\$13.20
India Basin	1,190,437	0.10%	0.10%	0.00%	0	(1,250)	0	585	N/A
Lower SOMA	714,228	10.40%	13.00%	7.50%	(47,168)	(83,868)	29,419	66,419	N/A
Mission Bay/China Basin	2,887,762	8.50%	8.50%	7.80%	8,519	59,911	29,200	43,519	\$18.19
Potrero East of 101	4,524,328	2.00%	2.60%	5.50%	51,622	(14,210)	58,317	133,706	\$15.38
Potrero West of 101	2,257,437	0.30%	0.30%	3.30%	37,993	39,400	0	48,193	\$16.20
Rincon/South Beach	222,527	0.00%	0.00%	10.80%	0	0	0	2,500	N/A
Showplace Square	1,069,278	5.20%	5.20%	17.20%	(10,831)	(16,582)	5,000	31,730	\$26.18
SOMA	754,666	2.20%	3.70%	4.30%	(5,700)	(22,000)	9,000	14,700	\$27.00
Southern City	407,505	0.00%	0.00%	0.00%	0	0	0	0	N/A
Yerba Buena	102,200	0.00%	0.00%	3.10%	0	0	0	2,500	N/A
All Others	1,479,364	0.00%	0.00%	5.50%	0	0	0	19,260	N/A
Total	19,391,821	3.00%	3.50%	5.80%	34,035	(116,499)	171,532	432,532	\$17.87

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