

Peninsula Industrial

Market Forecast

Industrial

Trends

Vacancy



Absorption



Rental Rate



New Construction



Notable Lease Transactions

Pitco Foods
385 Valley Dr, Brisbane
89,200 s.f. (renewal)

Pacific Produce
570-586 Eccles Ave, South San Francisco
54,299 s.f.

Confidential
1025 Rollins Rd, Burlingame
39,516 s.f.

Gruma
570-586 Eccles Ave, South San Francisco
39,141 s.f.

Notable Sales Transactions

Prologis
3745 & 3775-3785 Bayshore Blvd, Brisbane
345,270 s.f. | \$37,475,000

Eureka Ventures VI, LLC
220 Shaw Rd, South San Francisco
70,328 s.f. | \$7,950,000

***Sobrato Organization**
130 Constitution Dr, Menlo Park
47,000 s.f. | \$15,000,000

*R&D deals

The Peninsula industrial market continues to experience record low vacancy rates after another positive quarter. After 102,790 s.f. of positive net absorption, the vacancy rate dropped to 2.4%, a 40 basis point decline from the previous quarter. The healthy activity occurring in the first half of 2016 has led to a combined 513,384 s.f. of net absorption year to date, which already surpasses the net absorption from the entire previous year. Leasing activity is expected to persist throughout the second half of the year as tenant demand remains strong, but absorption will surely be hindered by the constricted supply.

Vacancy and Rental Rates

The majority of activity during the second quarter occurred in the northern region of San Mateo County, which played host to the four primary lease transactions. Logistics and distribution occupiers turned in the two largest transactions, as Pitco Foods renewed their lease for 89,200 s.f. in Brisbane, and Pacific Produce obtained 54,299 s.f. at 570-586 Eccles Avenue in South San Francisco. Gruma, the parent company of Mission Foods, also took 39,141 s.f. at 570-586 Eccles Avenue. Location and existing large warehouse properties continue to make the north county submarkets an attractive site for logistics and distribution users, a significant factor in that area's 3.2 percentage point drop in vacancy over the past three years. The largest transaction outside the northern region was carried out by Al's Roofing Supplies, who leased 24,500 s.f. at 266 Industrial Road in San Carlos.

Rental rates saw a minimal increase across the board. The average asking rate for the Peninsula increased less than 1% over the previous quarter to \$1.29/s.f., NNN. However, asking rates are up 11.6% year-over-year, and 18.6% since the end of 2014. Menlo Park continues to set the high water mark at \$2.39/s.f., NNN, while the Brisbane/Daly City submarket remains the most affordable at \$0.75/s.f., NNN. Despite continued activity and strong demand, caution among tenants and landlords grew as a consequence of economic volatility. Tenants are now being challenged with historically low vacancies and high rental rates. With no developments under construction or in planning, and more

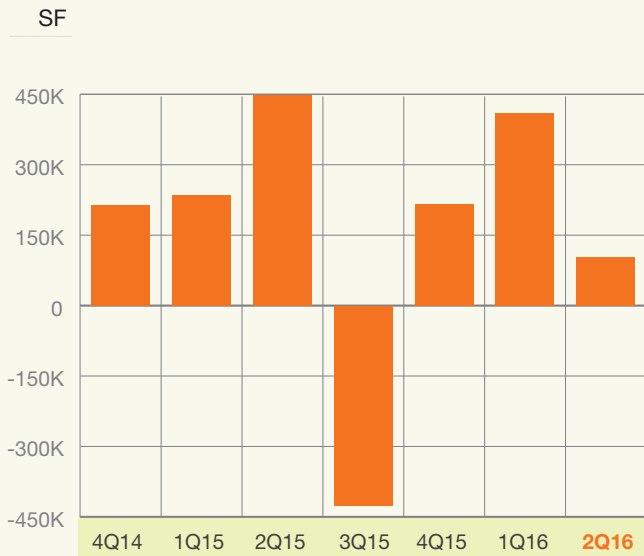
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Area Review

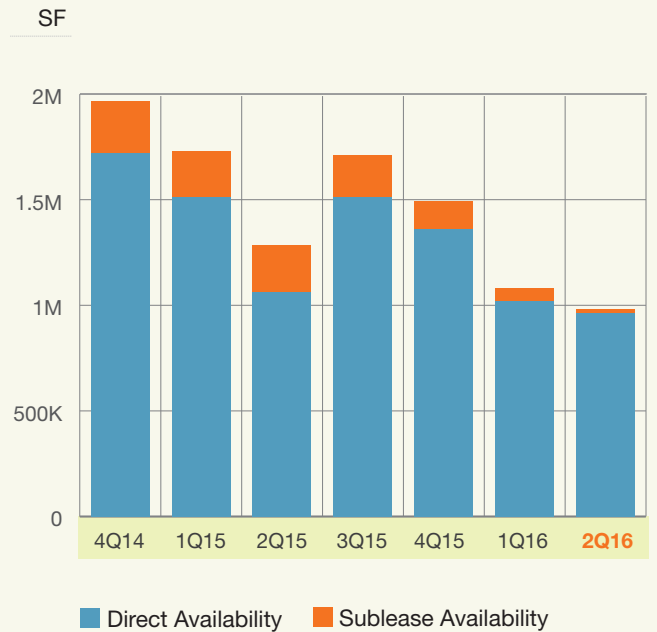
Industrial Submarket Statistics

Submarket	Number of Buildings	Total Inventory	Direct Available	Sublease Available	Total Available	Total Available Rate	Total Vacancy Rate	2Q Net Absorption
Brisbane/Daly City	85	4,738,021	20,680	106,895	127,575	2.7%	0.4%	1,010
South San Francisco	373	16,212,837	571,887	127,632	699,519	4.3%	3.0%	77,725
San Bruno/Millbrae	20	477,635	16,725	0	16,725	3.5%	2.9%	7,104
Burlingame	142	3,747,998	155,460	1,000	156,460	4.2%	3.4%	(21,360)
San Mateo	44	723,771	30,039	0	30,039	4.2%	4.5%	(3,955)
Foster City/Redwood Shores	33	914,825	48,482	0	48,482	5.3%	5.3%	(32,450)
Belmont	45	921,362	24,599	0	24,599	2.7%	2.5%	726
San Carlos	174	4,147,265	61,514	0	61,514	1.5%	2.1%	77,419
Redwood City	170	4,210,561	174,624	10,767	185,391	4.4%	1.9%	(18,364)
Menlo Park	133	5,241,693	78,762	10,000	88,762	1.7%	1.4%	20,935
Totals	1,219	41,335,968	1,182,772	256,294	1,439,066	3.5%	2.4%	102,790

Total Industrial Net Absorption



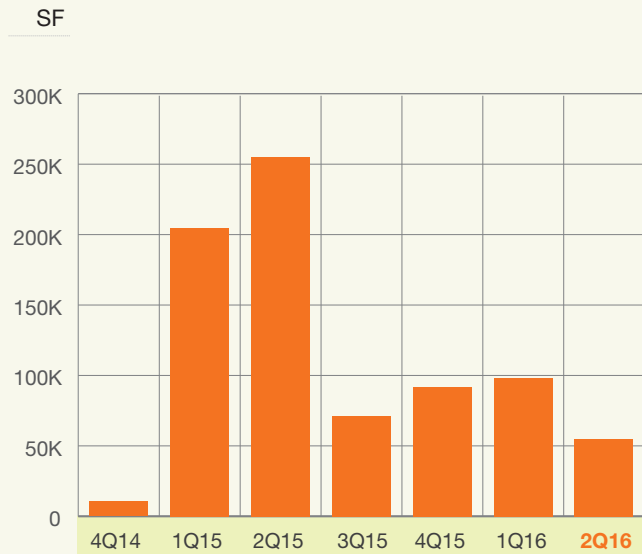
Available Industrial Space: Direct vs. Sublease



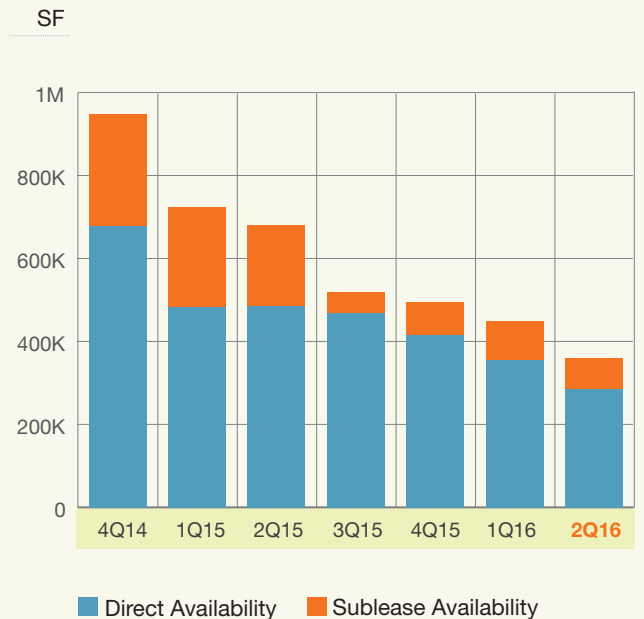
R&D Submarket Statistics

Submarket	Number of Buildings	Total Inventory	Direct Available	Sublease Available	Total Available	Total Available Rate	Total Vacancy Rate	2Q Net Absorption
Brisbane/Daly City	6	246,113	0	0	0	0.0%	0.0%	1,010
South San Francisco	73	3,691,377	20,004	58,793	78,797	2.1%	0.2%	60,974
San Bruno/Millbrae	6	231,212	16,725	0	16,725	7.2%	6.1%	7,104
Burlingame	36	1,026,014	31,230	1,000	32,230	3.1%	1.2%	16,872
San Mateo	11	259,902	0	0	0	0.0%	0.0%	0
Foster City/Redwood Shores	35	1,197,499	33,228	0	33,228	2.8%	2.8%	(32,450)
Belmont	13	376,652	0	0	0	0.0%	0.0%	1,210
San Carlos	45	1,461,158	15,526	0	15,526	1.1%	1.0%	(4,832)
Redwood City	49	1,837,527	90,231	4,267	94,498	5.1%	3.3%	(12,000)
Menlo Park	71	3,544,372	78,762	10,000	88,762	2.5%	2.1%	16,935
Totals	345	13,871,826	285,706	74,060	359,766	2.6%	1.6%	54,823

Total R&D Net Absorption



Available R&D Space: Direct vs. Sublease



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Offices

San Francisco
415.229.8888

Redwood Shores
650.769.3600

Silicon Valley
408.970.9400

Sacramento
916.751.3600

Reno
775.301.1300

San Diego
858.509.1200

Orange County
949.557.5000

Phoenix
602.513.5200

Seattle
206.296.9600

Bellevue
425.454.7040

South Seattle
206.248.7300

Tacoma
253.722.1400

Olympia
360.705.2800

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industrial buildings being demolished or converted into R&D space, relief is unlikely to come in the near future. In particular, the San Carlos City Council's approval of the Meridian25 project by Windy Hill Property Ventures—a Class A office development that will replace 134,000 s.f. of industrial and R&D space along Industrial Road—will further constrain the market's supply.

Current market conditions would ordinarily lead to increased rental rates from landlords, but owners have similarly been forced to act cautiously and hike rates incrementally. The number of investment sales also declined to six transactions, four less than in the previous quarter. Prologis carried out the largest investment by dollars spent, acquiring three buildings along Bayshore Boulevard in Brisbane for \$37.475 million, or \$109/s.f. Eureka Ventures VI LLC followed up with another north county investment, paying \$7.95 million (\$113/s.f.) for 220 Shaw Road. Overall, the average price per square foot plummeted roughly 250% from the previous quarter to \$116/s.f. The plunge is primarily attributable to the location of the sales, as the first quarter was heavily influenced by higher-valued investments located in central and south county, while the majority of second-quarter acquisitions occurred in north county. Steady investment activity is expected to continue in the second half of the year as demand in the market remains strong.

R&D

The R&D market continues to grow in the Peninsula after experiencing 54,823 s.f. of positive net absorption. This is the ninth consecutive quarter with positive net absorption, with a net total of 1.2 million s.f. of occupied space added in that same time. South San Francisco led the way with 60,974 s.f. of positive net absorption, but San Carlos saw the largest transaction as Stanford Health Care secured 35,000 s.f. at 867 American Street. Menlo Park finished with 16,935 s.f. of positive net absorption after a confidential tenant

obtained 21,519 s.f. at 1490 O'Brien Drive. The amount of lease transactions dropped 35% from the previous quarter to 20, but 19 of the leases were direct deals, which is a positive sign of the market's health.

The amount of lease transactions per quarter has declined since the beginning of 2016 as vacancy rates continue to fall to unprecedented levels. In fact, the vacancy rate has now declined in 10 consecutive quarters, plummeting from 9.8% at the beginning of 2014 to its current level of 1.6%. There is no sign of relief in sight, with zero projects under construction. The only R&D space currently being added to the Peninsula inventory is older industrial space that's converted to R&D.

Landlords continue to increase rental rates as the market tightens and demand remains healthy. During the second quarter, average asking rental rates increased 2.6% over the previous quarter to \$2.29/s.f., NNN, which is a 20% increase compared to the same time last year. Redwood City continues to set the high water mark, as the average asking rental rate there experienced an 8% bump over the previous quarter to \$2.85/s.f., NNN. Rental rates will progressively increase as demand remains very strong, but leasing activity will regress as available space becomes extremely limited.

Investment activity dropped to a single transaction during the second quarter, with the Sobrato Organization continuing to increase its presence in Menlo Park, procuring the 47,000 s.f. building at 130 Constitution Drive for \$15 million, or \$319/s.f. This marks the fifth building the Sobrato Organization has acquired in Menlo Park since the start of 2015, with its investments there totaling 145,000 s.f. Capitalization rates are expected to decline as the value of R&D space increases, but investors will continue to be proactive as the market remains healthy with strong demand from the tech and biotech industries.