

# Peninsula Industrial

## Market Forecast

| Industrial       | Trends |
|------------------|--------|
| Vacancy          | ↑      |
| Absorption       | ↓      |
| Rental Rate      | ↑      |
| New Construction | ↔      |

## Notable Lease Transactions

**Zoox Inc.**  
1149 Chess Dr, Foster City  
126,345 s.f.

**General Motors**  
175 Sylvester Rd, S. San Francisco  
74,562 s.f.

**Hydra Ventures**  
3785 Bayshore Blvd, Brisbane  
35,658 s.f.

**Sunbelt Rentals**  
105 Associated Rd, S. San Francisco  
29,897 s.f.

**Harvest Holiday**  
1320 San Mateo Ave, S. San Francisco  
20,060 s.f.

## Notable Sales Transactions

**LaSalle Investment Mgmt./  
Harvest Properties**  
1149 Chess Drive, Foster City  
\$35.3M - \$279/s.f.

The Peninsula industrial market cooled off during the first quarter of 2017 after experiencing five consecutive quarters with positive absorption. A decrease in transaction volume led to 255,781 s.f. of negative net absorption, which was primarily felt in the north county region. Record-setting rental rates were likely a contributing factor to the first quarter's slowdown, but asking rents started to plateau after the dip in activity. As rates begin to soften, leasing activity will likely resume as the north county region remains a highly desirable location for warehouse and distribution users. Nonetheless, limited availabilities will continue to make it difficult for users to find suitable space to fit their requirements.

The first quarter's most significant deal was completed by Zoox, which took 126,345 s.f. at 1149 Chess Drive in Foster City. The property consists of office, warehouse, and R&D space, which was secured by the robotics and artificial intelligence company immediately following the building's sale. The building will also be renovated before it becomes the company's new global headquarters. General Motors procured 74,562 s.f. of recently renovated warehouse space at 175 Sylvester Road in South San Francisco, while Hydra Ventures obtained 36,658 s.f. at 3785 Bayshore Boulevard in Brisbane. Although Brisbane and South San Francisco hosted three of the four largest transactions, the two submarkets combined to account for nearly all of the first quarter's losses, totaling 248,650 s.f. of negative net absorption. Burlingame finished the quarter as the leading submarket with 27,596 s.f. of positive absorption, led by an 11,778 s.f. transaction at 818 Mitten Road.

A five-quarter-long trend of growing leasing activity came to an end during the first quarter, which resulted in a 61 basis point increase in the county's vacancy rate, to 2.61%. The vacancy rate remains well below the five-year average of 5.64%, and the

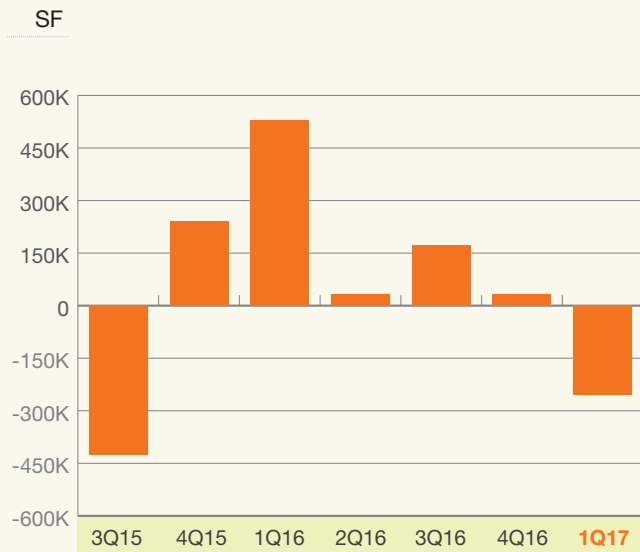
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# Area Review

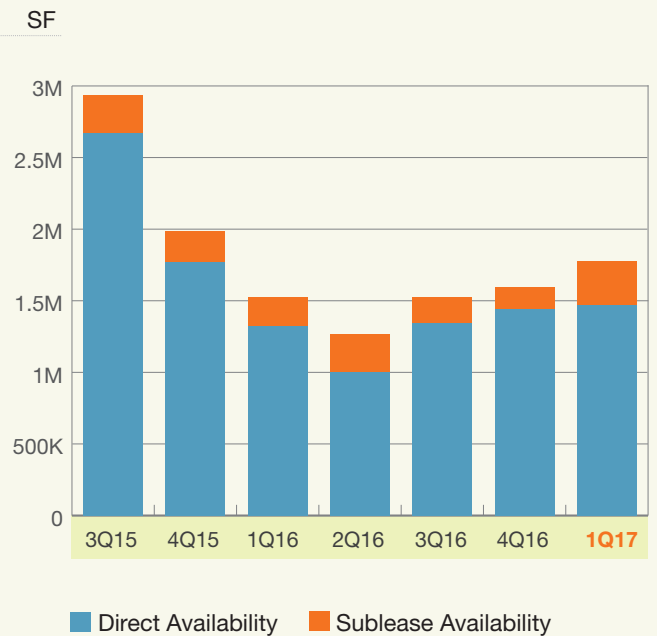
## Industrial Submarket Statistics

| Submarket                  | Number of Buildings | Total Inventory   | Direct Available | Sublease Available | Total Available  | Total Available Rate | Total Vacancy Rate | 1Q Net Absorption |
|----------------------------|---------------------|-------------------|------------------|--------------------|------------------|----------------------|--------------------|-------------------|
| Brisbane/Daly City         | 85                  | 4,738,021         | 160,237          | 28,170             | 188,407          | 4.0%                 | 2.2%               | (105,170)         |
| South San Francisco        | 374                 | 16,246,094        | 709,200          | 96,493             | 805,693          | 5.0%                 | 3.2%               | (143,480)         |
| San Bruno/Millbrae         | 19                  | 452,873           | 45,398           | 0                  | 45,398           | 10.0%                | 0.0%               | 7,680             |
| Burlingame                 | 144                 | 3,774,378         | 95,132           | 0                  | 95,132           | 2.5%                 | 1.1%               | 27,596            |
| San Mateo                  | 43                  | 707,204           | 19,534           | 0                  | 19,534           | 2.8%                 | 2.8%               | 1,400             |
| Foster City/Redwood Shores | 32                  | 794,365           | 15,254           | 0                  | 15,254           | 1.9%                 | 4.5%               | 0                 |
| Belmont                    | 44                  | 899,007           | 14,278           | 10,500             | 24,778           | 2.8%                 | 1.5%               | (2,522)           |
| San Carlos                 | 174                 | 4,215,367         | 104,648          | 50,085             | 154,733          | 3.7%                 | 2.0%               | 5,773             |
| Redwood City               | 164                 | 4,100,442         | 159,302          | 68,515             | 227,817          | 5.6%                 | 3.9%               | (37,457)          |
| Menlo Park                 | 133                 | 5,259,465         | 163,920          | 48,385             | 212,305          | 4.0%                 | 2.0%               | (9,601)           |
| <b>Totals</b>              | <b>1,212</b>        | <b>41,187,216</b> | <b>1,486,903</b> | <b>302,148</b>     | <b>1,789,051</b> | <b>4.3%</b>          | <b>2.6%</b>        | <b>(255,781)</b>  |

### Total Industrial Net Absorption



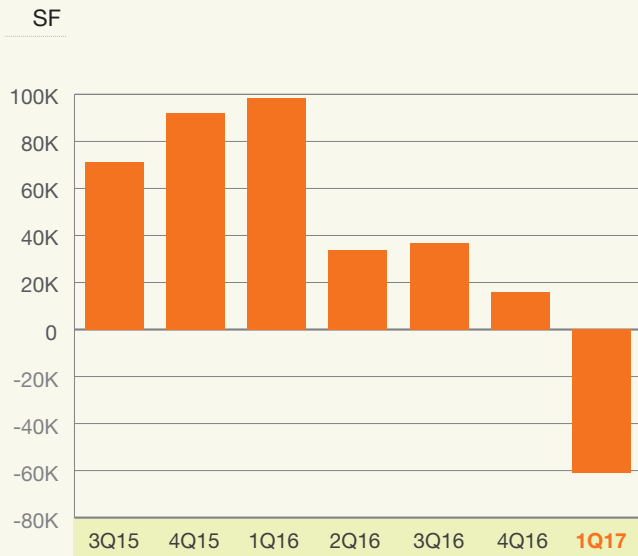
### Available Industrial Space: Direct vs. Sublease



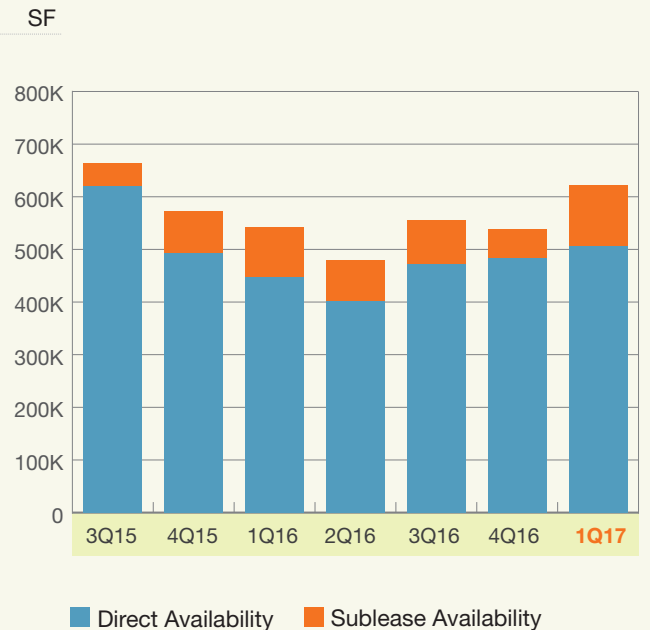
## R&D Submarket Statistics

| Submarket                  | Number of Buildings | Total Inventory   | Direct Available | Sublease Available | Total Available | Total Available Rate | Total Vacancy Rate | 1Q Net Absorption |
|----------------------------|---------------------|-------------------|------------------|--------------------|-----------------|----------------------|--------------------|-------------------|
| Brisbane/Daly City         | 6                   | 246,113           | 0                | 0                  | 0               | 0.0%                 | 0.0%               | 0                 |
| South San Francisco        | 73                  | 3,709,650         | 126,948          | 10,088             | 137,036         | 3.7%                 | 1.7%               | (217)             |
| San Bruno/Millbrae         | 6                   | 231,212           | 12,605           | 0                  | 12,605          | 5.5%                 | 0.0%               | 7,680             |
| Burlingame                 | 37                  | 1,037,581         | 50,372           | 0                  | 50,372          | 4.9%                 | 3.4%               | 2,452             |
| San Mateo                  | 11                  | 259,902           | 0                | 0                  | 0               | 0.0%                 | 0.0%               | 0                 |
| Foster City/Redwood Shores | 34                  | 1,077,039         | 0                | 0                  | 0               | 0.0%                 | 1.9%               | 0                 |
| Belmont                    | 13                  | 376,652           | 7,500            | 0                  | 7,500           | 2.0%                 | 4.8%               | (10,500)          |
| San Carlos                 | 47                  | 1,498,341         | 63,687           | 20,019             | 83,706          | 5.6%                 | 4.0%               | (15,455)          |
| Redwood City               | 49                  | 1,837,566         | 100,582          | 50,515             | 151,097         | 8.2%                 | 6.3%               | (26,067)          |
| Menlo Park                 | 71                  | 3,544,341         | 143,920          | 36,385             | 180,305         | 5.1%                 | 2.4%               | (19,083)          |
| <b>Totals</b>              | <b>342</b>          | <b>13,666,286</b> | <b>505,614</b>   | <b>117,007</b>     | <b>622,621</b>  | <b>4.6%</b>          | <b>2.9%</b>        | <b>(61,190)</b>   |

### Total R&D Net Absorption



### Available R&D Space: Direct vs. Sublease



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## Offices

Seattle  
206.296.9600

Bellevue  
425.454.7040

South Seattle  
206.248.7300

Tacoma  
253.722.1400

Olympia  
360.705.2800

Portland  
503.221.9900

San Francisco  
415.229.8888

Redwood Shores  
650.769.3600

Silicon Valley  
408.970.9400

Sacramento  
916.970.9700

Roseville  
916.751.3600

Los Angeles  
213.880.5250

Long Beach  
562.472.0071

Commerce  
323.727.1144

Orange County  
949.557.5000

Inland Empire  
909.764.6500

San Diego  
858.509.1200

Carlsbad  
760.430.1000

Reno  
775.301.1300

Phoenix  
602.513.5200

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northern region in particular remains constrained by a vacancy rate of 1.6%.

Limited leasing activity tempered rent increases across the market. The Peninsula's average rate increased just 1.9% over the previous quarter to \$1.59/s.f., NNN, marking the lowest quarter-over-quarter increase on a percentage basis since the second and third quarters of 2014. The submarkets of Foster City/Redwood Shores and Menlo Park set the high water mark at \$2.72/s.f., NNN, while Brisbane continues to be a bargain at \$1.05/s.f., NNN.

There is still no new construction in the Peninsula pipeline, and existing inventory will continue to be lost to conversions and redevelopments, maintaining a downward trend in the area's supply. The first quarter's lone sale transaction, in which LaSalle Investment Management and Harvest Properties jointly purchased 1149 Chess Drive in Foster City, could have a minor effect on the overall base inventory. The formerly vacant property was acquired for \$35.3 million, or \$279/s.f., and will be renovated prior to Zoox's occupancy. The property is not a fully dedicated industrial site but previous renovation plans for the 126,345 s.f. building call for 41,000 s.f. of warehouse space and 18,000 s.f. of R&D space. It remains to be seen whether those plans will be altered now that a long-term single tenant has been secured.

## R&D

The Peninsula's torrid R&D market finally hit a slump during the first quarter, witnessing its first negative period in nearly three years. No submarket experienced a major loss in absorption, but nearly every submarket finished in the red as activity went silent. Redwood City took the biggest hit, with 26,067 s.f. of negative net absorption, while Belmont, San Carlos, and Menlo Park faced more than 10,000 s.f. of negative net absorption apiece. The uneventful quarter finished with 61,190 s.f. of negative net absorption in all, which bumped the county's

vacancy rate by 42 basis points, to 2.92%. Despite the spike in vacancy, the Peninsula's rate remains lower than it was in the third quarter of 2015 and well below the five-year average of 6.75%.

Tenant demand remains stable within the Peninsula market, but limited availabilities and record-high rental rates have caused tenants to proceed cautiously. Transaction volume over the past two quarters has fallen to a five-year low. Reduced activity is partially attributable to the lack of available product, but landlords have started to soften their asking rates as tenants are increasingly patient in their searches. The average rental rate dipped 5.95% from the previous quarter, to \$2.52/s.f., NNN, which marks the first quarter-over-quarter decline since the fourth quarter of 2014. Nonetheless, rates are 13.5% higher than they were a year ago. South San Francisco, where the average asking rate held firm at \$3.35/s.f., NNN, continued to lead the way in the Peninsula. Menlo Park's average rate declined by 8.8%, to \$2.61/s.f., NNN, while the Foster City/Redwood Shores submarket remained stable at \$2.55/s.f., NNN. Despite the first quarter dip, rental rates will likely hold firm throughout the year as the market remains constricted. Successful funding rounds carried out by life science and medical device companies have also helped sustain healthy demand for Peninsula R&D product.

There were no acquisitions of fully dedicated R&D properties this quarter, with only the sale of 1149 Chess Drive containing a significant share of R&D space. Landlords have recently held on to their R&D properties as the Peninsula's limited inventory boosts their value, a trend indicated by the six acquisitions seen in all of 2016. However, some investment activity is expected to occur throughout 2017 as landlords look to capitalize on the current market conditions, which have seen property values increase in correlation to the limited inventory, low vacancies, and steady tenant demand.