

Peninsula Office

Market Forecast

Trends

Absorption	↓
Vacancy	↑
Rental Rate	↑
New Construction	↑

Notable Lease Transactions

Verily (Google Life Science)*
249-269 E Grand Ave, So San Francisco
404,109 s.f. (3 bldgs)

Medallia
450 Concar Dr, San Mateo
210,000 s.f.

GoPro, Inc.
3025 Clearview Way, San Mateo
110,874 s.f.

Avinger, Inc.
400-600 Chesapeake Dr, Redwood City
44,200 s.f. (2 bldgs)

*sublease

Notable Sales Transactions

YouTube
999-1111 Bayhill Dr, 1100 Grundy Ln &
950 Elm Ave, San Bruno
542,520 s.f. | \$215M (5 bldgs)

Facebook
1-19 Hacker Way, Menlo Park
1,078,227 s.f. | \$202M (10 bldgs)
(renting to owning)

Seagate Properties
1900 S Norfolk St, San Mateo
163,791 s.f. | \$61.6M

The San Francisco Peninsula office market experienced its first quarter with negative net absorption in over two years. Growing uncertainty in the economy and increasing rental rates have created concern among undersized companies with limited funding. This correction has led to 126,864 s.f. of negative net absorption. The vacancy rate increased 1.4 percentage points to 9.5%, however many investors still view the Peninsula as a healthy market.

Market Drivers

After its first negative posting in 11 quarters, the market remains stable as tenant demand remains healthy. One quarter's outcome isn't cause for concern, nor does it signal a trend. According to the Silicon Valley Business Journal, two-thirds of tech and life science executives believe business conditions will be better than 2015. This confidence remains most prevalent among the life science sector as it continues to be one of the primary industries acquiring office space on the Peninsula. The largest transaction of the quarter was completed by Google's life science company, Verily, who subleased Onyx's old 404,109 s.f. campus located at 249-269 E Grand Avenue in South San Francisco. Avinger, Inc. also acquired 44,200 s.f. at 400-600 Chesapeake Drive in Redwood City, the counties third largest transaction.

Sizeable spaces between 15,000-25,000 s.f. continue to be available, however office space under 5,000 s.f. continues to be in high demand. This smaller size demand remains healthy, even with a 25% reduction in venture funding over the previous quarter. Established companies continue to be active as they remain profitable and receive additional funding. Average rental rates for the Peninsula grew 1% over the previous quarter, which currently stands at \$4.42/s.f. fully serviced. The submarket of Menlo Park remains the high water mark with an average rental rate of \$6.65/s.f. fully serviced.

Developers and investors recognize Silicon Valley will continue to be the hub of innovation, and as a result there are many new buildings in the pipeline. The lone project to be delivered in the first quarter was at 151 Commonwealth Drive in Menlo Park, however the 260,000 s.f. project was already pre-leased by EMC Corporation. The only project to begin construction during the first quarter was the 25,077 s.f. mixed-use development at 2 East 3rd Avenue in San Mateo, which has also been pre-leased. Another 675,000 s.f. is set to be delivered throughout 2016, but significant pre-leasing from SurveyMonkey, GoPro, and Medallia has limited the direct availability to nearly 100,000 s.f., which can be found at the 400 Concar Drive development in San Mateo.

Sublease Space

The amount of available sublease space has grown 0.4% over the previous quarter, which remains insignificant at this point. Companies that pre-leased "big-block" spaces are responsible for a

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significant portion placed back on the market while they bank space for future growth. SurveyMonkey listed 96,873 s.f. at their new Bay Meadows location in San Mateo, which will be delivered during the third quarter. EMC Corporation also listed an entire 135,207 s.f. building at its new Menlo Park location. While available sublet space has increased, some generously funded companies are seizing the opportunity to acquire discounted space, as indicated by Verily's subleasing at 249-269 E Grand Ave in South San Francisco.

Employment

Employment among the tech industry remains very strong in the Bay Area, but the competition for talent has progressively increased as cities nationwide develop into legitimate players for tech workers. Affordability and quality of life have become attractive elements for the emerging tech markets of Seattle, Denver, Austin, and New York City. According to a study performed by Woo, a tech hiring research firm, Bay Area salary expectations dipped 4.1% during the first quarter to \$143,797, while the national salary expectation declined 12.6% to \$124,285. Despite the growing margin between expected salaries, the employees' desire to relocate increased 6.9% over the previous quarter, with the quality of life being the primary reason. Although some growth will occur in outlying areas, the innovation think tank still resides in Silicon Valley. As a result, existing companies and emerging companies will continue to make the Peninsula their home.

Investment

The first quarter witnessed building sales slow down, however new funds are becoming available for acquisitions, and we expect to see several major properties come to market over the next few quarters. YouTube carried out the most notable investment as they spent \$215 million (\$396.30/s.f.) for a five building portfolio acquisition in San Bruno. The 542,520 s.f. campus is

SPOTLIGHT: VC Funding

The stabilizing market has forced VC's to proceed cautiously. Funding suffered a 25% reduction over the previous quarter, making this quarter the lowest amount of capital infusion since the third quarter of 2014. It was also the first quarter in over 20 years there wasn't a single non-healthcare IPO. Reputable private corporations realized they can survive off current profits and additional funding while waiting for a more opportune time to go public. As for smaller startups dealing with dwindling levels of capital, down rounds (companies raising additional rounds of capital at lower valuations) increased 25% over the previous quarter. Despite the overall decline, six of the Bay Area cities that attracted the most funding during the first quarter actually saw year-over-year increases. San Mateo increased 79% and Menlo Park was up 26%. Redwood City also made the list of highest funded cities, but total funding was down 33% compared to their first quarter of 2015. Overall, the Bay Area remains a hotbed for startups as it snagged 47% of all U.S. venture funding in 2015. The software and life science industries continue to be the primary benefactors as they combined to attract nearly two-thirds of all Bay Area funding during the first quarter.

set to become YouTube's new headquarter location. Facebook went from renters to owners as they shelled out \$202 million for the 1,078,227 s.f. (\$187.35/s.f.) campus at 1-19 Hacker Way in Menlo Park. The third and final noteworthy investment was Seagate Properties' as they acquired 1900 S Norfolk Street in San Mateo for \$61.6 million (\$376.09/s.f.).

Source: CoStar

Submarket Statistics

Submarket	Number of Buildings	Total Inventory	Direct Vacancy	Sublease Vacancy	Direct Vacant Rate	1Q Net Absorption
Daly City	41	1,452,059	275,915	0	19.00%	(8,994)
Brisbane	14	993,809	328,092	29,805	33.00%	(6,293)
South San Francisco	90	5,276,045	541,971	251,855	10.30%	(177,946)
San Bruno/Millbrae	49	1,714,582	117,791	640	6.90%	(5,508)
Burlingame	83	2,793,420	166,101	5,009	5.90%	13,903
North County Totals	277	12,229,915	1,429,870	287,309	15.02%	(184,838)
San Mateo	167	7,441,891	567,281	68,557	7.60%	(24,275)
Foster City	34	2,500,256	362,853	76,644	14.50%	(3,675)
Central County Totals	201	9,942,147	930,134	145,201	11.05%	(27,950)
Redwood Shores	48	3,008,797	309,570	18,077	10.30%	21,570
Belmont/San Carlos	47	1,424,934	106,653	88,392	7.50%	16,680
Redwood City	161	5,389,279	214,161	97,583	4.00%	34,012
Menlo Park	178	5,272,989	570,603	53,302	10.80%	13,662
South County Totals	434	15,095,999	1,200,987	257,354	8.15%	85,924
Totals	912	37,268,061	3,560,991	689,864	9.50%	(126,864)

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