

# Peninsula Office

## Market Forecast

Trends

Absorption



Vacancy



Rental Rate



New Construction



## Notable Lease Transactions

\*Facebook, Inc.  
162 Jefferson Dr, Menlo Park  
135,307 s.f.

\*Volkswagen  
500-600 Clipper Dr, Belmont  
53,508 s.f.

Confidential  
2765 Sand Hill Rd, Menlo Park  
28,162 s.f.

Karius Inc.  
975 Island Dr, Redwood City  
25,194 s.f.

\*sublease

## Notable Sale Transactions

Rubicon Point Partners LLC  
901 & 951 Mariners Island Blvd &  
999 Baker Way, San Mateo  
\$154.4 million | \$515/s.f.

Wafra Investment Advisory Group  
777 Mariners Island Blvd, San Mateo  
\$95 million | \$507/s.f.

Google, Inc.  
1150, 1200, & 1250 Bayhill Dr, San Bruno  
\$58 million | \$393/s.f.

HCA Management Company, LLC  
801 & 851 Traeger Ave, San Bruno  
\$42 million | \$363/s.f.

The Peninsula office real estate market sent mixed signals in the third quarter, as healthy investment activity met fluctuating lease activity that varied considerably between submarkets. Menlo Park's robust quarter single-handedly lowered the Peninsula's overall vacancy rate to 7.9%, but the 30,000-foot-high view may be somewhat deceptive, as inconsistent activity at the submarket level indicates that the leasing market may have reached its peak. Record-high rental rates have also led to a slight increase in the number of sublease listings, but good credit tenants have been quick to snag the larger availabilities, causing a decline in the volume of available sublet space, as larger-block listings come off the market faster than smaller startup spaces. Although leasing activity started to waver in the third quarter, strong large-scale tenant demand suggests a positive fourth quarter, with rental rates staying near their cycle highs.

Rental rates essentially held at their second-quarter levels, demonstrating that they are approaching their cycle peak, with the 0.3% third-quarter increase to \$4.45/s.f., fully serviced, representing a more incremental uptick in price tags than was seen in previous quarters. Increased leasing activity in the mid-Peninsula region placed the largest quarter-over-quarter rate increases in the San Mateo and Burlingame submarkets, where rents rose 0.5%. The majority of the mid-Peninsula's interest continues to come from north Peninsula companies looking to expand, but there are also a number of tenants in the heart of Silicon Valley exploring cheaper alternatives to the north. While most rental rates are expected to hold for the remainder of 2016, it's possible that the southern regions will see a minor correction, as declining rates in Silicon Valley could trickle upward from the Palo Alto and Mountain View submarkets.

Net absorption was positive 275,393 s.f. during the third quarter, making it the 10th positive period in the last three years. Menlo Park anchored the quarter's gains with a robust 251,030 s.f. of positive net absorption, which dropped that submarket's vacancy rate to 6.8%. Rising interest in the mid-Peninsula region made the San Mateo submarket this quarter's runner-up,

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# Area Review

## Submarket Statistics

Submarket	Number of Buildings	Total Inventory	Direct Vacancy	Sublease Vacancy	Net Absorption YTD	Direct Vacant Rate	Direct Avg Rate
Daly City	41	1,456,775	263,416	1,849	3,973	18.10%	\$3.55
Brisbane	14	993,809	278,214	8,863	(7,444)	28.00%	\$3.55
South San Francisco	89	4,951,405	333,346	9,855	38,736	6.70%	\$3.36
San Bruno/Millbrae	49	1,708,890	66,805	640	30,671	3.90%	\$2.76
Burlingame	83	2,812,070	147,150	25,706	(7,365)	5.20%	\$3.42
North County Totals	276	11,922,949	1,088,931	46,913	58,571	12.38%	\$3.33
San Mateo	167	7,451,696	640,636	88,456	40,566	8.60%	\$4.35
Foster City	34	2,500,256	320,568	52,038	11,116	12.80%	\$4.58
Central County Totals	201	9,951,952	961,204	140,494	51,682	10.70%	\$4.41
Redwood Shores	48	2,993,496	289,223	65,979	(72,930)	9.70%	\$4.67
Belmont/San Carlos	45	1,368,698	29,712	144,851	(2,472)	2.20%	\$4.58
Redwood City	163	5,400,806	187,552	25,580	(10,488)	3.50%	\$4.77
Menlo Park	179	5,413,053	365,749	22,118	251,030	6.80%	\$6.55
South County Totals	435	15,176,053	872,236	258,528	165,140	5.55%	\$5.37
<b>Total</b>	<b>912</b>	<b>37,050,954</b>	<b>2,922,371</b>	<b>445,935</b>	<b>275,393</b>	<b>7.90%</b>	<b>\$4.45</b>

with 40,566 s.f. of positive net absorption. While four submarkets experienced negligible negative net absorptions, the Redwood Shores submarket dropped a more notable 72,930 s.f. of occupied office space. As a result, Redwood Shores' direct vacancy rate increased to 9.7%, a 250-basis-point jump over the previous quarter.

While the amount of sublease listings increased, the total square footage of available sublet space declined from the previous quarter, signaling greater demand for larger spaces than for smaller offerings for earlier-stage startups. The volume of newly available subleases grew as tenants continued to feel the effects of record-high rental rates, which most heavily hit startups that stopped receiving early-stage funding and could no longer fulfill their lease obligations. However, good-credit companies are quick to secure these short-term spaces at discounted rates. Since the previous quarter, the total available sublet space declined by 5.6% to 916,382 s.f. Facebook led the charge by subleasing the entire 135,307 s.f. building at 162 Jefferson Drive in Menlo Park, which was being listed by EMC Corporation. Additionally, Volkswagen picked up 53,508 s.f. at 500-600 Clipper Drive in Belmont that was listed last quarter by SunEdison. The two major subleases listed in the third quarter that remain available are located in the Redwood City submarket, where XenoPort listed 34,329 s.f. at 2000 Seaport Boulevard and Rocket Fuel put up another 23,177 s.f. at 350 Marine Parkway.

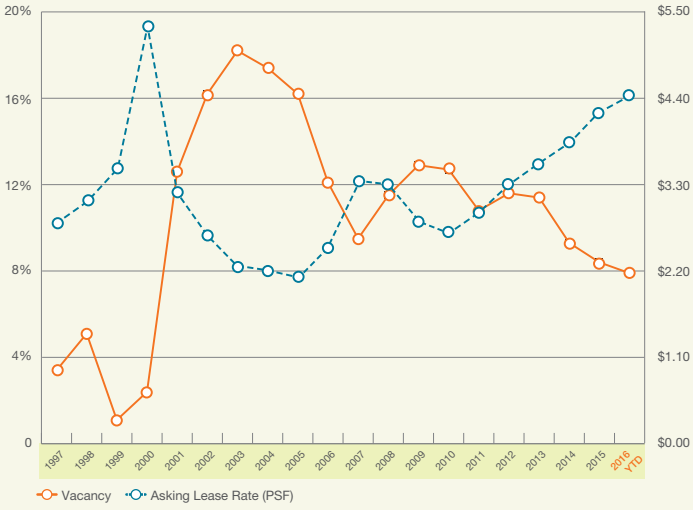
The Peninsula encountered significant investment activity this quarter, with six noteworthy sales. The majority of these transactions were portfolio sales, which led to a total of 12 buildings and nearly 1 million s.f. changing hands. Rubicon Point Partners conducted the largest transaction, purchasing the San Mateo BayCenter, a 300,000 s.f. three-building campus, for \$154.4 million (\$515/s.f.). This acquisition comes less than three months after Beacon Capital Partners acquired The Crossroads in San Mateo, a comparable

three-building campus, for \$440/s.f. New York-based Wafra Investment Advisory Group executed their first Peninsula investment with the \$95 million (\$507/s.f.) acquisition of 777 Mariners Island Boulevard in San Mateo. Google continued to build its San Bruno portfolio with the addition of 1150, 1200, and 1250 Bayhill Drive for \$58 million (\$393/s.f.). Google's subsidiary, YouTube, also obtained five neighboring buildings in San Bruno for \$396/s.f. back in January. In the last major sale transaction of the third quarter, The Carlyle Group acquired 6000 Shoreline Court in South San Francisco for \$34.1 million (\$240/s.f.). However, following in the footsteps of Phase 3 Properties' conversion of Genesis Towers (formerly known as Centennial Towers), The Carlyle Group plans to convert the building into life science space.

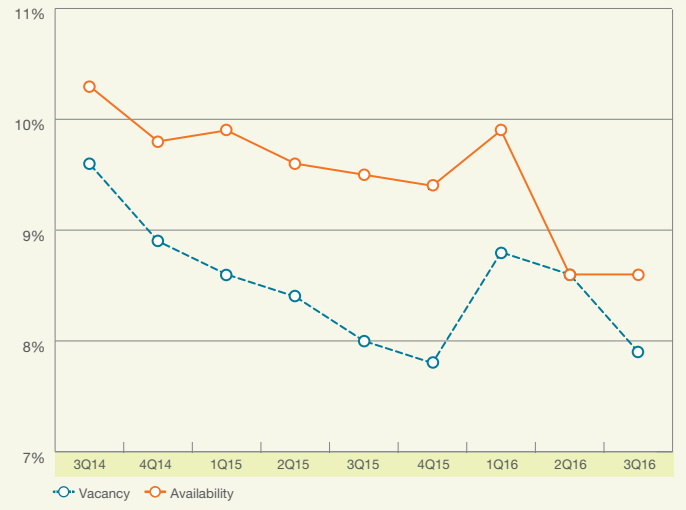
Construction activity remained unchanged as no buildings were delivered and no new projects broke ground. Roughly 1.25 million s.f. remains under construction along the Peninsula, but nearly half of that space has been pre-leased. The second phase of Bay Meadows remains on track for a fourth-quarter delivery, and while it has not secured a tenant yet, there is strong interest. There are no projects slated to begin construction in the fourth quarter, but Phase 3 Properties' Genesis North Tower is expected to break ground in early 2017, which will provide nearly 400,000 s.f. of life science and office space. In the continued effort to increase inventory within the Peninsula, Menlo Park's Planning Commission approved Facebook's 58-acre redevelopment at the site previously occupied by TE Connectivity. The redevelopment will consist of 962,400 s.f. of office space and a 200-room hotel. This major approval comes months after San Carlos green-lit the 560,000 s.f. Meridian25 project.

Source: CoStar

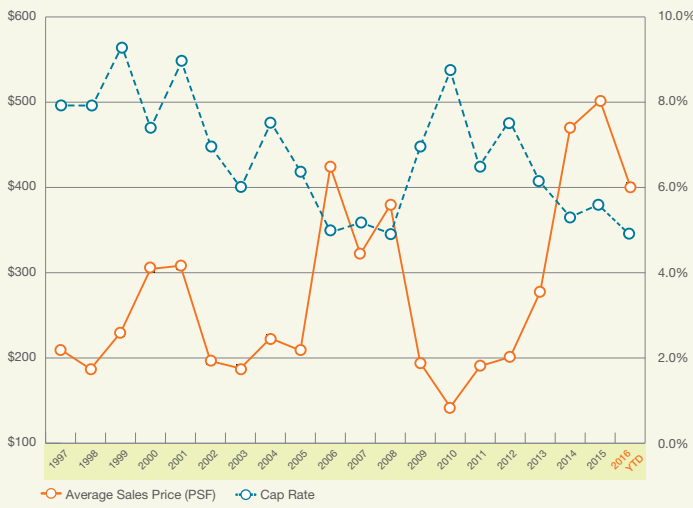
### VACANCY VS ASKING LEASE RATE



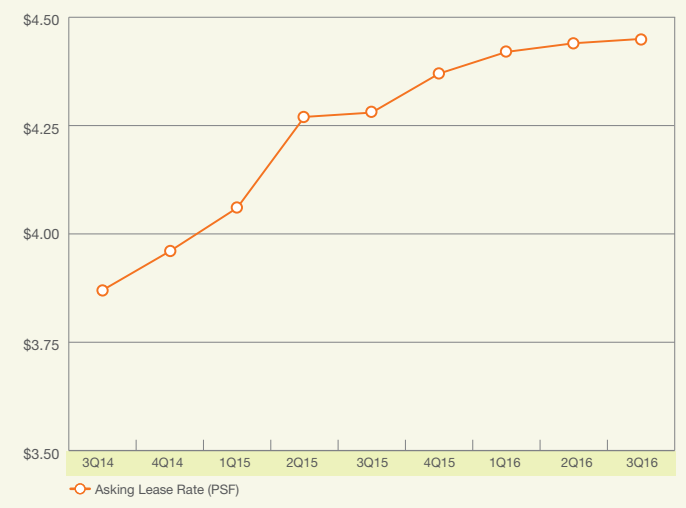
### VACANCY VS AVAILABILITY



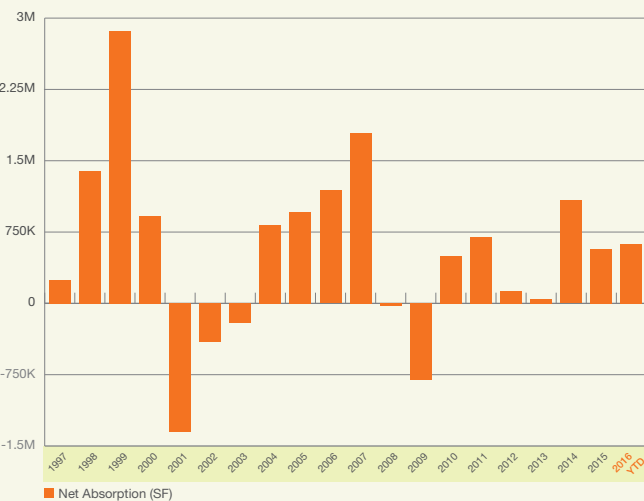
### AVERAGE SALES PRICE & CAPITALIZATION RATES



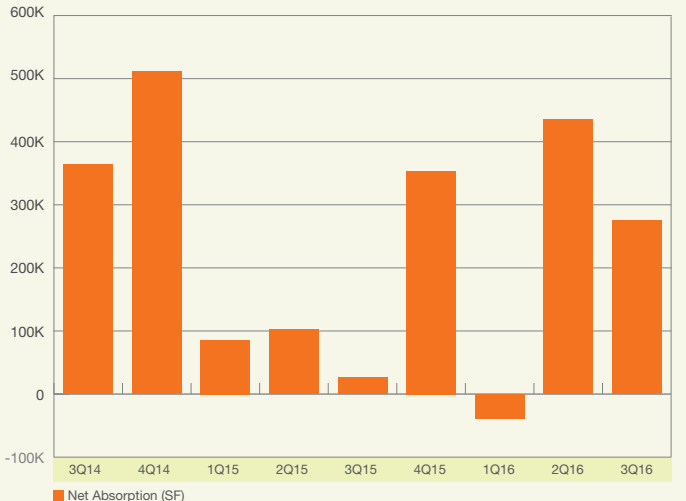
### DIRECT ASKING LEASE RATE



### NET ABSORPTION - HISTORICAL



### NET ABSORPTION - QUARTERLY



**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

Orange County  
949.557.5000

San Diego  
858.509.1200

Carlsbad  
760.430.1000

Reno  
775.301.1300

Phoenix  
602.513.5200

**Contact**

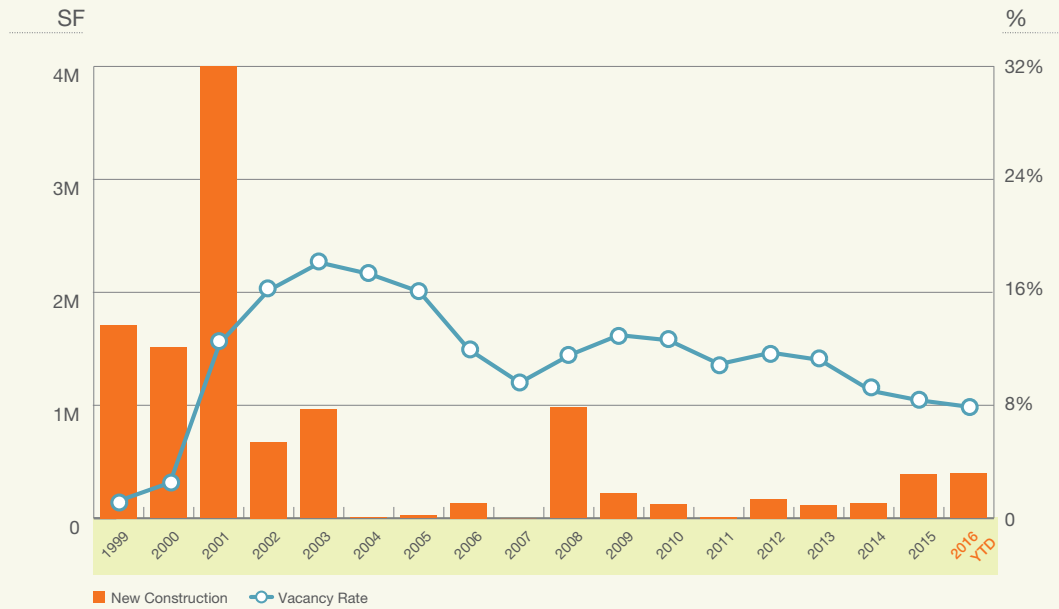
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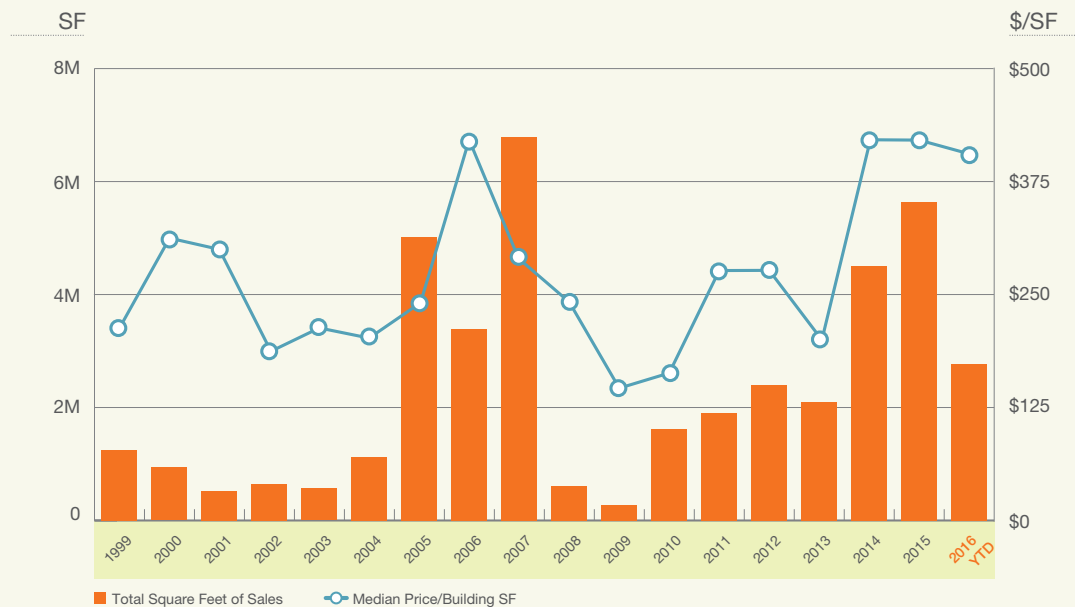
**Market Breakdown**

	3Q 2016	2Q 2016	3Q 2015	Annual % Change
Vacancy Rate	7.9%	8.6%	8.0%	-1.3%
Availability Rate	11.1%	11.2%	12.0%	-8.1%
Asking Lease Rate	\$4.45	\$4.44	\$4.28	3.8%
Sold SF	989,919	666,453	695,080	42.4%
Net Absorption	275,393	435,020	25,969	N/A

**HISTORICAL NEW CONSTRUCTION & VACANCY RATES**



**HISTORICAL SALES SF & MEDIAN SALE PRICE**



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