

# THE POLETTI PERSPECTIVE

## Northern San Mateo County Industrial Market

The end of the first quarter of any calendar year is an excellent time to analyze the Northern San Mateo County industrial market's past fifteen months and predict future developments. The first few months of any year are typically good indicators of how the market will evolve through the remainder of the year. Below Karl Hansen with Poletti Realty analyzes the lease and sales segments of the market.

### Lease Market

Early 2004 was the turning point for vacancy rates in the Northern San Mateo County industrial leasing market. Over the course of the year, there was a steady decrease in the amount of available warehouse and industrial space on the market. The net result was a decrease in vacancy from approximately 11% at the end of 2003 to approximately 7% at the end of 2004. The drop in vacancy can be attributed to the improving outlook of the current and future business environment. A three to five year lease is a major, long-term business decision. For the first time in years, firms are demonstrating comfort with future business prospects by expanding into new geographic markets. Companies are experiencing needs to lease additional space, due to future business expansion projections.

2004 clearly demonstrated the lag effect between vacancy and lease rates. This dictates that vacancy will begin decreasing prior to any increase in lease rates. Vacancy decreased gradually throughout the year, but lease rates remained steady. 2005 will likely be the year when rental rates begin to rise. Some sub-markets, such as warehouse spaces under 5,000 square feet and high-quality dock facilities, have already experienced price appreciation. Freight companies in particular are experiencing difficulty finding viable real estate solutions.

Tenants with opportunities to relocate and requiring a different real estate situation should act quickly. Even with the improvements in the market over the past year, tenants still yield significant power in most lease negotiations. However, the market is gradually changing and momentum is in the landlords favor. Landlords should remain flexible in lease negotiations with tenants. Although the situation is no longer desperate, vacancy remains above historical norms and an eventual rise in rental rates will likely be slow.

### Sale Market

The continuing strong sales market is another factor contributing to the decreasing vacancy rate. In 2004 this included both industrial owner/user purchases and the reemergence of warehouse/biotech conversions. There were also a few significant investor purchases, although in most cases owner/users priced these buyers out of the market. Genentech was the most significant player in the Northern San Mateo County real estate market. During the last few months of 2004 the South San Francisco biotech behemoth purchased 6 warehouse buildings totaling over 500,000 square feet. This will permanently decrease the amount of warehouse space in South San Francisco and especially affect the amount of quality freight space, because a number of the buildings purchased by the company are among the highest quality freight facilities on the peninsula.

The sale of small stand-alone buildings and industrial condos between 1,500 and 4,000 square feet is the hottest segment of the market. These buildings typically sell quickly, with multiple offers and at terms very favorable to the sellers. The prices increased steadily throughout 2004; starting at under \$140 per square foot in January and increasing to between \$155 and \$165 by April of 2004. During the second half of 2004 numerous properties sold for around \$200 per square foot. Poletti Realty currently represents the seller of a 2,500 square foot freestanding building, which is in escrow for \$220 per square foot. The all-cash-buyer placed a \$30,000 non-refundable deposit into escrow upon execution of the purchase contract and after only a brief building walk through. This demonstrates the intense competition amongst buyers in the market.

Traditional building purchases by industrial owner-users remained brisk throughout the year. The demand, number of property sales, total square feet sold and price generated has remained fairly consistent over the past three years. Buyers were motivated by stubbornly low interest rates and the increased leasing activity did not significantly dissuade sellers, which in many cases were investment owners with vacant buildings. Smaller stand-alone property sales generated the most demand and highest prices. A couple months ago Poletti Realty placed a 13,000 square foot building on the market for the price it had appraised for two years ago. After an extensive marketing campaign the property had generated a dozen offers and eventually sold for 15% over the asking price. Sale prices for medium to large warehouse buildings over 15,000 square feet varied depending on the size and quality of building. In 2004 a few lower quality buildings sold for around \$90 per square foot, while the highest priced buildings generated \$140 per square foot.

2005 has started with strong sales activity, but the main factors driving the sales market will gradually disappear. With the continuing rise in interest rates and decrease in warehouse vacancy the pace of building sales will likely slow by the end of 2005. However, even with the drop off in demand, the limited supply of medium and large warehouse buildings will prevent a decrease in prices. After the extreme run-up in the prices of small freestanding buildings and condos in 2004, prices for these properties are likely to stabilize by the second half of 2005.

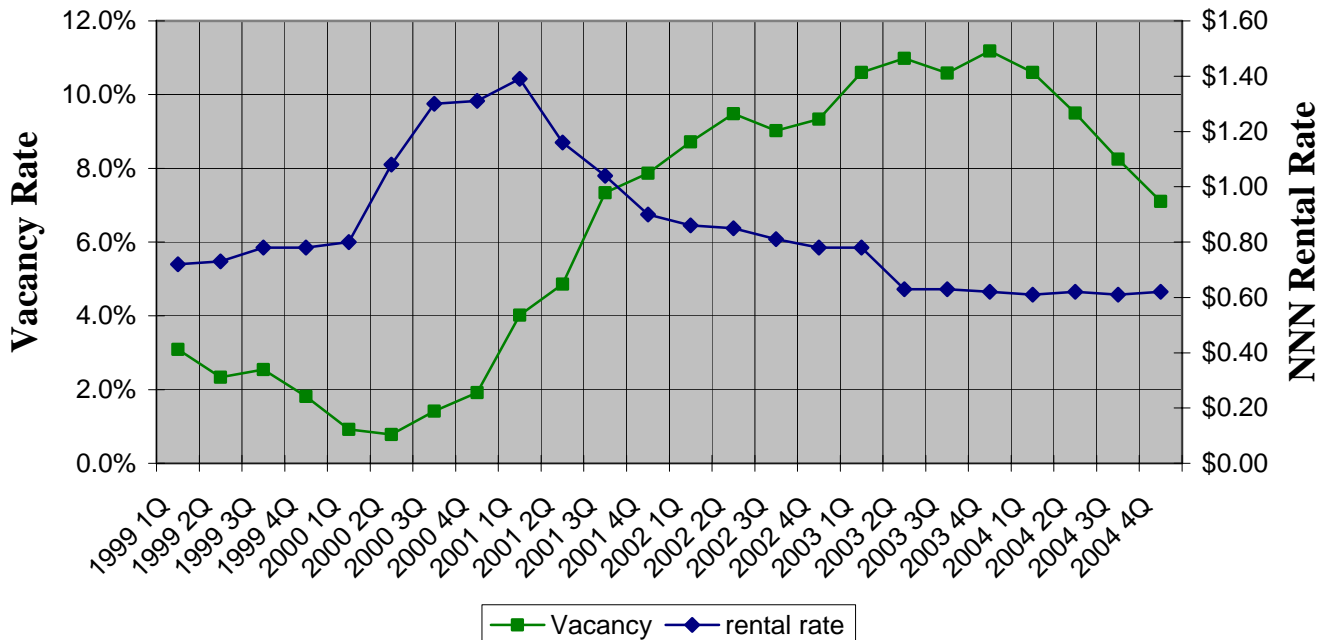
### Poletti Realty And Karl Hansen

Poletti Realty has been locally owned and operated in South San Francisco since 1956. Our successful history is due to our ongoing focus on long-term mutually beneficial relationships with our clients. We are the only major commercial real estate company located in South San Francisco. Operating in the heart of the San Mateo County industrial market on a daily basis gives our firm a unique advantage over the competition. Additionally, as a result of our long history of community involvement we have an excellent working relationship with city government. Our firm can leverage this local focus to help with zoning issues, use permits, and market tracking.

Karl Hansen specializes in the sale and leasing of warehouse and office buildings from Brisbane to San Mateo, with special focus on the South San Francisco market. In 2004, Karl closed transactions worth more than fifteen million dollars in total consideration. Twenty-seven of the transactions involved industrial/warehouse buildings while the other twelve were office deals. Some of his clients include France Telecom R&D, PS Business Parks Inc. (AMEX: PSB), FleetCor Technologies Inc., Panalpina World Transport Ltd., Reggie Jackson and The South San Francisco Classroom Teachers Association. Karl works closely with Richard Poletti, Lou Poletti and Ray Zapletal at Poletti Realty to form a dynamic team with nearly one hundred years of commercial real estate experience.

Poletti Realty currently exclusively represents numerous landlords and tenants in Northern San Mateo County. Furthermore, we are in contact with dozens of landlords and tenants who have leases expiring throughout the year. Please contact Poletti Realty to discuss how we can help you best fulfill all future real estate requirements or for detailed information on current market conditions. Additional information on Poletti Realty and our current listings can be viewed on our website at [www.polettirealty.com](http://www.polettirealty.com).

## Historical Vacancy & Rental Rates



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