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The San Francisco Bay Area's office markets have been experiencing boom conditions since the middle of 2010. This boom has been driven by some of the biggest names in the tech world; Google, Apple and Facebook just to name a few. The ongoing worldwide revolution in social media, smartphones and their applications was almost exclusively jumpstarted by San Francisco Bay Area firms and this has translated into a surge in demand for commercial real estate as these companies explode with growth. Over the past two years, the Bay Area's office market has absorbed nearly 12.4 million square feet of office space and over 6.1 million square feet of R&D space. To put this in perspective, this is the equivalent of more than 38 Transamerica Pyramids being fully leased out.

The amount of growth recorded over the past two years is perhaps an even more astounding feat when one considers that nearly all of it has come from properties located along the Highway 101 corridor between San Jose and San Francisco. In contrast, activity has remained relatively flat in both the East and North Bay. This has largely been attributed to the fact that tech companies have generally wished to remain close to their traditional bases in San Francisco, San Mateo and Santa Clara Counties. But this dynamic is rapidly changing.

While both the San Francisco and Silicon Valley office markets were continuing to experience fallout from the recession through the first quarter of 2010, conditions changed first in the San Mateo County market. After hemorrhaging nearly 1.7 million square feet of office occupancy from late 2007 to the midyear mark of 2009, San Mateo County saw growth numbers turn positive as early as the third quarter of 2009. Over the next two years, San Mateo would backfill nearly 1.6 million square feet of previously vacant office space. But in the twelve intervening months since then, the San Mateo County office market has posted only one quarter of growth. The market has actually slid backwards over the past year, losing roughly 182,000 square feet of occupancy in the process.

The slowdown of San Mateo's office market has prompted many market watchers to question as to whether the region's boom is about to go bust again. Certainly the recent stock market troubles of Zynga and Facebook haven't helped to quell the speculation, yet our tracking of current demand levels finds that there is currently over 20.2 million square feet of active space requirements for office and R&D space throughout the Bay Area. This equates to 21.3 million square feet of active requirements in the marketplace one year ago, or a drop of just 5%.

Meanwhile, both the San Francisco and Silicon Valley markets have remained white hot. The San Francisco office market has recorded over 1.6 million square feet of growth in just the first six months of this year. The Silicon Valley office market has posted just 301,000 square feet of growth so far this year, but this follows a record 2011 in which the market absorbed nearly 2.7 million square feet of previously vacant office space. Meanwhile, deals already completed during July and August, plus a number of transactions that are currently in the works should ensure that third quarter growth numbers increase substantially in the South Bay.

All of these trends leave the question, if the boom is not over, then what exactly is happening with the San Mateo market? We see two factors behind the slowdown on the Peninsula. One has to do with supply and the other with demand. Let's start first with supply.

Tech companies have been responsible for the overwhelming majority of occupancy growth that has occurred over the past two years. Of the 18.5 million square feet of total net absorption posted over the past 24 months throughout the Bay Area, we estimate that about 85% of that total, or over 15.7 million square feet, came from tech companies. As much as tech companies have driven Bay Area growth, they have also been driving radical changes in office space itself.

The cubicle-heavy layouts of "commodity" office space have largely been eschewed by tech users. Instead, we are seeing the rise of a new type of Class A office space, one that tends to allow for large, wide-open areas and space that allows for more collaboration. Some of the traits of this new type of space include informal meeting areas for small teams, more open spaces for collaboration, lower height walls for workstations, fewer small enclosed spaces (but some) for privacy and a focus on green-conscious space. The goal of the new tech office is twofold; to increase creativity (innovation through collaboration) and productivity (smaller and more efficient office space). The new tech office is geared towards the mobile worker, with some spaces short on wall connections for phones and computers but heavy on wireless access and charging stations. Collaboration space is more common than private offices, enough so that CoreNet (a corporate real estate association that focuses on technology) is predicting that the average allocation of office space per employee will fall to 100 square feet by 2017. Ten years ago, the average amount of office space per employee was about 250 square feet.

There is only one problem in this shifting paradigm and that is that many older office buildings are simply not equipped to accommodate these types of users, without significant remodels or upgrades. This holds true even for Class A office space, where most older product in particular, remains geared towards the kind of cubicle-heavy users we still mostly see in the financial or business services realm. And this is one of San Mateo County's problems.

We currently track 214 Class A office buildings in the San Mateo County office market. Yet, only 17 of these buildings were built in the last ten years. We know of two more that have had significant remodels during that time. In other words, only 19 (or less than 9%) buildings in this market are effectively less than ten years old. The average age of Class A space in San Mateo County is 20 years old.

By comparison, we track 206 Class A office buildings in San Francisco. Though the average age of the inventory here is 33 years old, we are aware of 25 buildings that were built over the past ten years. Add nine buildings which have had extensive remodels since 2002, and there is a total of 34 Class A office buildings in San Francisco with an effective age of ten or less (or roughly 17% of the inventory). Meanwhile, the Santa Clara County office market has 250 Class A structures, 54 of which were built since 2002. Adding two that were remodeled since then, and this market effectively has 56 Class A office projects that are less than ten years old, or 22% of its inventory.

But the lack of new tech-friendly Class A+ space is not the only reason why we are seeing the tech boom narrow its focus to just the San Francisco and San Jose markets. On the demand side of the equation, a very simple trend has emerged from tech space users; they want to be where their employees want to live.

A recent survey from research firm, PayScale, found that the average age of a Facebook employee is 26, the average age at Google is 31 while this metric increases to 33 at Apple. Contrast this with the average age at HP and IBM of 44 and you start to see a pattern emerging. Tech innovation is being driven by younger workers and the new tech growth in social media, smartphones and their applications, gaming, virtual reality and search engines is being dominated by the young. And these young workers—still unencumbered by children and the demands of raising a family—much prefer the excitement of urban living in both San Francisco and San Jose over the more sedate suburban environs of San Mateo County. And their employers are following…

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