U.S. Research

"NEW TECH" SPOTLIGHT REPORT

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Colliers INTERNATIONAL

Accelerating success.

IMPACT OF "NEW TECH" TENANTS ON U.S. OFFICE LEASING

"New Tech" Tenants Driving U.S. Office Absorption

Technology and e-commerce sales and marketing companies founded within the past 20 years ("New Tech") are having an outsized impact on our nation's office leasing. The markets where these companies locate have higher rents, lower vacancy and the greatest net absorption.

Key Takeaways

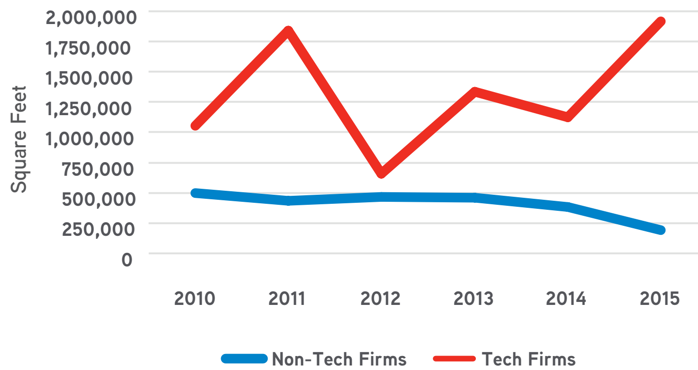
- Net new space absorption in many of the nation's leading office markets is largely being driven by New Tech firms, while the sectors that have traditionally dominated office leasing, such as finance, legal and publishing, are generally contracting.
- New Tech firms are increasingly dominating leasing activity for deals of at least 50,000 SF.
- New Tech firms are expanding at a pace rarely seen before in other sectors, with many tenants growing from a 5,000 SF start-up to a 100,000+ SF market mover in the matter of a few years. TripAdvisor, Brainshark, Care.com, Indeed and Invensys (now Schneider Electric), once just relatively unknown start-ups, are now major multi-market tenants.
- A number of large tech firms own their office space. Millions of square feet occupied by Google, Amazon and Salesforce are owned, and therefore not reflected in net new space absorption; therefore as a result, traditional methods of tracking absorption, i.e., leasing statistics are missing a big driver in office demand.
- The expansion of West Coast New Tech firms extending their footprint across the country presents an ongoing opportunity for landlords based in New York, Boston and Chicago, plus secondary cities..
- The impact of New Tech tenants is understated to the extent that most leasing statistics track total absorption, not net absorption. For example, even if a major i-bank renews their lease for 800,000 SF, which is 200,000 SF less than they had before, the entire 800,000 SF shows up in research statistics. The New Tech tenants represent positive net absorption!

New Tech Firms Outpacing Traditional Sectors in Expansion

While the rise of New Tech is no longer a new trend, its impact on our nation's office markets is still dramatic. LinkedIn and Salesforce, founded in 2002 and 1999 respectively, combine to occupy over 2.7 million square feet in San Francisco alone.

To better understand the impact of tech firms on absorption, we studied the top 20 deals by square footage annually from 2010–2015 for six key tech markets—New York, Boston, Chicago, Seattle, San Francisco and Silicon Valley—focusing on whether each lease represented a net increase or decrease from their previous footprint. In general, we found that tenants from traditional sectors such as finance, law and government have been either contracting or remaining stable while the deals by New Tech firms show they are generally expanding. As a result, New Tech has consistently outperformed all other sectors. To cite one extreme example, New Tech firms in Seattle last year absorbed 10 times the space among the big deals as all other industries combined. To be sure, this ratio has varied year to year since 2010, but over this period, New Tech has never failed to exceed all leasing by non-tech firms combined.

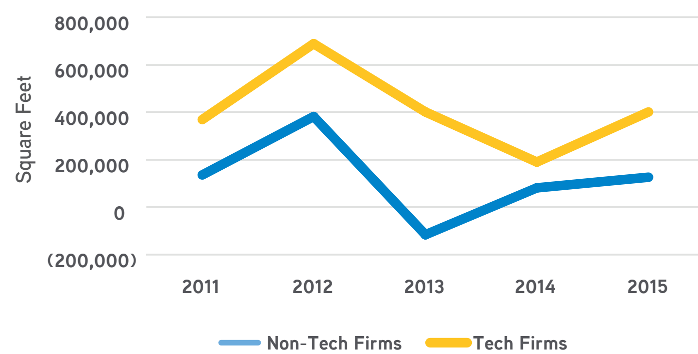
Annual Net Absorption Impact for Top 20 Deals in the Seattle CBD Market



Sources: CoStar, Colliers International

Though less extreme, we see similar trends in all the top markets we studied. The Chicago CBD market has seen a substantial, growing New Tech presence from both out-of-state firms (Google and Yelp), as well as home-grown companies, such as Groupon, which has grown to occupy roughly 500,000 SF, Avant which has ballooned from 5,000 SF to 123,000 SF, and Grubhub which has grown from 19,000 SF to 131,000 SF.

Annual Net Absorption Impact for Top 20 Deals in the Chicago CBD Market



Sources: CoStar, Colliers International

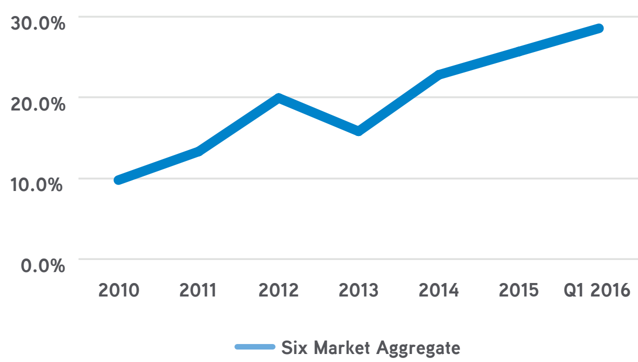
In the traditional tech hubs of San Francisco and Silicon Valley, the vast majority of major New Tech leases represent an expansion from their existing footprint. Of the 36 tech deals of more than 50,000 SF signed in Silicon Valley over the prior five quarters, only six were not expansions. San Francisco shows a similar story. In Q1 2016, of the top five New Tech leases, only one (a renewal) did not represent a net positive absorption in the market. In 2015, nine of the top 10 tech deals were net space additions, while only one deal was a contraction. These tenants included Apcera, Autodesk, Beckon, Digital Garage, MakeMeReach, Manage and Pivotlink—all of which were represented by Colliers.

New Tech Firms Responsible for Increased Share of Large Leases

While tech firms overall have a disproportionate impact on our leading office markets, it is New Tech that is increasingly dominating the deal flow of larger leases (50,000 SF and up). Specifically, the share of the total square footage of large deals in our six-city sample has been increasing steadily, from under 10% in 2010 to nearly 30% in Q1 2016. This increase does not even include net absorption. It is 30% of total absorption, but significantly higher of net absorption.

"If you look at this cycle, virtually all of the net absorption of office space in the country has been through the activity of firms strongly associated with millennials, such as those focused on creative or high-tech," says Owen Thomas, CEO of Boston Properties, as quoted in GlobeSt.com.

Percentage of Total Leasing (by SF) by New Tech Tenants - Known Leases over 50,000 SF



Sources: Colliers International

San Francisco and Silicon Valley, historical bastions of innovation and incubators of technology, have among the highest shares of space signed by New Tech firms. San Francisco leads overall, with almost 60% of large leases signed by these younger firms, just edging out Chicago with 54%.

In New York City and Boston, the impact that New Tech firms have on office leasing is understated in the general statistics. In these huge markets with 50% of total absorption historically attributed to FIRE (Finance, Insurance and Real Estate), New Tech is having a significant impact. "If landlords ask us what is driving tenant growth in Manhattan, we would say New Tech is a major factor," says Cynthia Foster, President, National Office Services, USA at Colliers. Of note in Manhattan: Salesforce's 202,678-SF expansion at 1095 Avenue of the Americas, Facebook's 200,000-SF expansion on Park Avenue South and Google's 250,000-SF expansion as the anchor tenant for Pier 57. This stands in contrast to significant traditional tenant in-place renewals or contractions, including McGraw Hill's 900,027-SF renewal, D.E. Shaw's 195,375-SF renewal, the UBS 900,000-SF renewal and ING's 132,400-SF new direct lease.

In Boston, the strength of the tech and cutting-edge biotech presence in East Cambridge is now spreading to other submarkets as the limited space options and corresponding rent increases have forced firms to expand their search horizons. Many firms are finding that the old warehouse-style exposed brick and beam buildings of the Seaport area are a good fit for their employees. Recent deals in Boston reflecting New Tech velocity include DigitasLBi for 200,000 SF, HubSpot for 185,000 SF and EZE Castle Integration for 125,000 SF. Migration from the suburbs to the CBD has been bolstered by LogMeIn's recent 227,000-SF lease and SONOS' completed move for 169,000 SF. In addition, New Tech tenant Akamai is in the market for 600,000 SF.

New Tech Growth Continues to Drive Office Demand

As impressive as the New Tech growth story seems, this analysis understates the full impact of these firms on office leasing. By examining only leases of at least 50,000 SF to assess the most market-moving tenants, we are implicitly focusing on the more mature firms within this universe. Excluded are the numerous companies that have not yet reached the 50,000 SF threshold. The pace of expansion of these newer firms (Curaspan, GuideSpark, Nanigans, RAGE Frameworks, SiteSpect to name a few) often far exceeds that of more traditional office users, with explosive growth that can see firms expand from 2,000 SF to 15,000 SF to 75,000 SF over a couple of years. Such growth is rare for more traditional office tenants or even more mature tech firms. Also excluded is the millions of square feet occupied by co-working providers such as WeWork and Regus (defined within the real estate sector rather than tech.).

Moreover, while we have focused on six major tech markets, tech companies are expanding nationwide at a scale and pace that we have rarely experienced in traditional industries. Their voracious appetite for space has spread outside of Silicon Valley into other primary markets as well as secondary metros and tertiary suburbs to house both back-office and frontline engineering jobs. The fierce competition for talent and rising cost of living as millennials start families have been factors in this expansion outside of the traditional tech hubs. Many secondary markets offer lower real estate costs and well-educated workforces.

What Does the Future Hold?

One key will be the millennial employees that comprise much of the staff of these tech firms. We must look at some of the relevant demographic and market trends, as well as the effect of venture capital funding on the New Tech sector. Will New Tech continue to be mostly attracted to office space in the highest priced CBDs? Will the millennial population begin to relocate from urban areas to the suburbs? Where are the New Tech back-office locations? Will all these New Tech firms survive? Will new ones continue to arrive on the scene?

Stay tuned!

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