

# CASE STUDY

The acquisition consisted of two buildings totaling ~290k SF, constructed in 1992 and located on a 17.4-acre parcel that fronted Highway 101 in South San Jose, CA. The Property was 100% leased to a credit tenant (Baa credit) who maintained a contractual expiration 18 months following the Property's acquisition. The tenant was anticipated to vacate the Property at the end of their lease term due to a broader market consolidation, providing a significant mark-to-market opportunity (~80% below market at expiration).

FLEX R&D / ADVANCED MANUFACTURING  
SOUTH SAN JOSE  
290,000 SF



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## BELOW MARKET RENT

The Property was 100% occupied by a credit tenant at a rental rate of \$0.75/SF NNN per month, which represented an 80% discount to the then current market rates. Additionally, CoStar projected market rents throughout South San Jose to increase by 7.5%, 6.00%, and 5.00% during the first three years of ownership, of which the partnership was receiving cash flow from the existing tenant for the first 18 months.

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## FLEXIBLE BUSINESS PLAN

The Property offered the ability to acquire a high-quality R&D office and advanced manufacturing project at an attractive basis with multiple opportunities to increase value. The zoning provided for a wide spectrum of development options, and the 17-acre parcel offered an ability to increase FAR.

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## SUBMARKET FUNDAMENTALS

South San Jose's vacancy rate at the end of 2018 stood at 7.7%, a 630 bps decrease from the end of 2017. Over 50% of the remaining vacant square footage in the submarket was attributable to one project. Excluding this project, the South San Jose R&D vacancy rate sat below 4%. Net absorption had been strong, posting 900K SF of occupancy gains during the two years prior.

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# CASE STUDY - CONTINUED

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## - INVESTMENT OVERVIEW -

The Property, which consisted of two buildings totaling 286,330 SF, was constructed in 1992 and was located on a 17.4-acre parcel that fronts Highway 101. The Property was 100% leased to a credit tenant (Baa credit; \$13.2 billion market cap) who maintained a contractual expiration of December 2020 and was anticipated to vacate the Property at the end of their lease term due to their broader market consolidation into their new corporate headquarters. The tenant was paying rent ~80% below market, providing the Venture stable, in-place cash flow from a credit tenant in the near term and the opportunity to re-lease the Property at materially higher, market rents post expiration. Given the length of time remaining on the tenant's lease, there existed the possibility for the Venture to market and execute a user-sale for one or both buildings, or a third-party sale to a developer looking to convert the site to a higher and better use.

The South San Jose market had undergone a fundamental shift during the two years prior, primarily due to robust tenant migration into the submarket. With companies relocating from Northern Silicon Valley submarkets due to a.) limited availabilities (fueled by demand, user sales and asset repositioning), b.) high cost of occupancy, as well as c.) San Jose's booming housing and hence, employee population, South San Jose had witnessed nearly 1.7 million SF of tenant migration during the five years prior. Together with a decreasing stock of advanced manufacturing/R&D assets, South San Jose's vacancy rate had plummeted from 21.6% to 7.7%, or excluding the vacancy of a large, non-competitive project of 384,000 SF (3403 Yerba Buena Rd), below 4%. The described migration looked to represent a wide variety of industries, including automobile, technology and advanced manufacturers, growing the potential tenant pool for the Property.

The Property offered a functional and flexible design and layout that allowed for a variety of users and tenancy types. Within the existing buildout existed a combination of open office, advanced manufacturing/production space, dry lab, clean lab (class 10 certified) and warehouse space. Each building offered dock and grade-level loading, and both maintained excellent power at 4,000 amps (at 277/480) for a total of 8,000 amps at the Property. The latter, according to local leasing brokers, was highly sought after by tenants. In addition, the Property had excellent freeway visibility, offering signage on Highway 101 and above-market parking for advanced manufacturing tenants. Given the two-building layout, it was possible that two different tenants would occupy the premises post-expiration. Therefore, it was the Venture's intent to speculatively complete demolition and buildouts to target the bell-curve of demand for each building's most probable tenant. The 18-months of cash-flow from the existing tenant would provide the Venture a greater understanding of tenant demand and what may/may-not be required by the time of their expiration.

## - RESULTS -

Having spent one year planning the renovations and marketing the property for lease, the venture was in negotiations to lease one of the buildings. In early March 2020, however, the Venture received an unsolicited offer from a large public industrial REIT to purchase the Property. The Buyer planned to tear down the buildings and develop a large industrial spec building on the site. Once Covid hit, the Buyer pulled out. The Venture then received a second unsolicited offer from a large, private developer. It was then that the first Buyer reengaged, and was ultimately selected (having provided the best economic and non-economic terms). Closing occurred in December 2020, only days after the existing tenant's expiration.