



Memorandum

TO: COMMUNITY AND ECONOMIC
DEVELOPMENT COMMITTEE

FROM: Chris Burton

SUBJECT: San Jose's Manufacturing
Real Estate Landscape

DATE: August 10, 2020

Approved /s/
Kim Welsh

Date 8/10/20

COUNCIL: CITY-WIDE

RECOMMENDATION

Accept a report on San Jose's manufacturing real estate landscape, which presents findings on the City's manufacturing sector, information on the City's industrial real estate market, and recommendations for maintaining and modernizing the City's industrial real estate stock.

BACKGROUND

Manufacturing represents San Jose's largest employment sector, responsible for employing more than 50,000 people, or roughly 12 percent of all jobs in the City. While the City hosts several very large manufacturers, this ecosystem also extends down to smaller, family owned suppliers as well as artisan makers. The local manufacturing sector not only contributes to the number of quality jobs locally but also has the largest economic multiplier of any sector in the U.S. economy, supporting 2.5 jobs for every one in manufacturing.

In 2019, the Office of Economic Development commissioned SFMade Inc. to examine the City's manufacturing economy and the state of the City's industrial real estate market. The goal was to understand the current status of the sector, its geographic distribution, and how well its' needs were being supported by available real estate inventory. Staff also sought recommendations to maintain and modernize the City's industrial stock.

SFMade is a 501(c)(3) nonprofit organization that supports San Francisco-area manufacturers who create jobs and career pathways for local residents who have overcome barriers to employment for a more vibrant, equitable, and resilient economy. In 2018, SF Made launched Manufacture: San Jose as a public-private initiative, with the goal to drive resources, knowledge, and visibility to San Jose's manufacturing ecosystem. SFMade joined with BAE Urban Economics for the report, which was completed in early 2020.

Recent events have put American manufacturing and supply chains front and center. During the pandemic, frontline medical workers have faced shortages in key medical supplies including personal protective equipment (PPE), highlighting weaknesses in the supply chain as most production is overseas. San Jose is fortunate to host several manufacturers working on production of critical medical supplies related to COVID-19 including large firms BD Biosciences and Boston Scientific, and numerous small to midsize contract manufacturers who are contributing parts for machines such as ventilators.

For all the reasons cited earlier, San Jose has a long history supporting the sector. Planning, Building and Code Enforcement's Special Tenant Improvement (STI) permitting program was designed to support the unique needs of manufacturers and has been critical to the City's ability to retain these companies. In addition, staff focuses on the sector in business outreach and workforce training program development. From a land use perspective, the City's industrial preservation policies are designed to ensure adequate capacity to maintain and grow manufacturing businesses within the City's business parks. Still, in recent years, the sector has experienced rising rents and the greater competition for space from office users, as developers have converted former manufacturing spaces into higher-end workspaces for office workers. While the report pre-dates the pandemic, its findings remain useful for understanding the industry's recent trendlines in San Jose and issues affecting the sector now and in the future. Key takeaways from the report include the following:

- Employment in manufacturing has been relatively stable to slightly down in recent years, with job estimates in the range of 50,000-65,000, or about 12% of total jobs in the City.
- Higher-wage manufacturing employment is concentrated in "advanced manufacturing" subsectors such as semiconductors, networking, storage, and medical devices. These jobs (which the report classifies as paying \$75,000-and-above) also represent most jobs in the sector.
- Lower-wage manufacturing (which still may be substantially higher than minimum wage) employment is concentrated in "legacy" subsectors such as building-materials manufacturing and machine shops.
- Manufacturing jobs at these legacy or traditional longtime manufacturers offer lower-skilled workers the opportunity for economic advancement. Legacy manufacturers also include a strong representation of multi-generational family-owned businesses with rich ties into San Jose's ethnic minority communities.
- Manufacturing employment density is concentrated in North San Jose (including the International Business Park), Monterey Corridor and Edenvale. Most of the higher-wage jobs are concentrated in North San Jose. Monterey Corridor has a relatively high density of *establishments* of smaller manufacturing businesses.
- San Jose's traditional industrial real estate inventory has been mostly stable for the past 10 years, with a net increase of about 700,000 square feet. That's an increase of about four percent. However, many of these facilities, especially in North San Jose, have transitioned to more office-oriented uses over the last 10 years.

- Similarly, San Jose's warehouse inventory has only added a net 700,000 square feet over the last decade. That's an increase of about five percent.
- San Jose's industrial space is ageing. Over 90 percent of the leased industrial space in San Jose was built 30 or more years ago; over 60 percent was built 40 or more years ago.

The study's recommendations to retain and modernize San Jose's industrial stock include the following:

- Strengthen existing industrial zoning controls to keep industrial areas truly industrial. Other commercial use types can typically pay higher rents, squeezing out manufacturing.
- Implement a moratorium on self-storage in industrial areas. These uses serve an important market need, but create few jobs and can often displace significant job-generators.
- Pay attention to competing uses *within* industrial sectors (such as warehouse/distribution).
- Support the modernization of older industrial buildings to preserve their useful life.
- Consider multi-story industrial near transit hubs, which can pack more jobs into the same space and create a driver for nearby transit stations. The area south of Berryessa BART is particularly promising for this.

COVID-19 Impact on Manufacturing

Manufacturing and other industrial-occupying industries have not been spared from job losses during the pandemic. From January to June, the San Jose-Santa Clara-Sunnyvale metro area shed about 5.3 percent of manufacturing jobs, compared to 7.75% for nonfarm payrolls overall. That equals roughly 9,300 manufacturing-related positions. Work2future staff have been outreaching to workers experiencing layoffs to offer them assistance in signing up for benefits and finding other jobs.

Manufacture: San Jose recently surveyed local manufacturers to learn more about the state of their businesses. The results underscore the reality that the economic impact of the crisis is not spread evenly. Of respondents, 19 percent said their business was declining; 50 percent said it was holding steady; 23 percent said it was improving and 8 percent said it was "booming."

There are additional signs of the sector's resilience. Since the pandemic, commercial real activity in general has taken a major hit, but demand for industrial real estate has held relatively steady, according to Cushman & Wakefield. To a large extent, this reflects the reality that these businesses cannot simply transition to work from home. Still, the industrial market has seen an increase in available space, including sublease space, which could be a sign of coming business closures or relocations out of the area.

In a second-quarter report, the brokerage notes that, “It is still uncertain how much COVID has contributed to the uptick in space on the market. However, a majority of currently vacant product lacks the desired attributes modern users are looking for such as height clearance, electrical requirements, and sprinkler capacity.” E-commerce companies have continued to be active in the market, as more and more retail activity moves online. This trend is likely to accelerate the pressure on traditional manufacturing employers as they face additional competition for space.

CONCLUSION

San Jose’s industrial building stock is critical for supporting thousands of jobs, including middle-income jobs for residents without four-year degrees. It also plays a vital role in our innovation economy and national self-sufficiency. As the City transitions, it will be important to maintain a place for this sector in a way that can co-exist with and complement new growth. The pandemic is also likely to intensify some existing trends that were already threatening to push manufacturers out of the City and the region. Providing technical assistance, access to resources, workforce development pathways and partnerships with organizations like Manufacture: San Jose and work2future are critical to supporting the sector’s survival long term.

/s/
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