

Tech firms begin to shift from Silicon Valley to San Francisco

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Webster's defines a valley as "a stretch of low lands between hills or mountains." But for a growing number of tech entrepreneurs and workers, "Silicon Valley" is a squared-off patch surrounded by water, not mountain ranges.

Consider this: San Francisco has led the world in [venture capital funding](#) for three years running, and the city has more than 4,000 startups in the South of Market area alone, according to San Francisco tech incubator the [Hatchery](#).

Of course, the South Bay remains the home of [Silicon Valley](#)'s dominant companies: Apple, [Google](#), Oracle and Hewlett-Packard. And the venture capital industry is still all but run from Sand Hill Road.

But the rise of social media, with fast-growing companies like Twitter, Zynga and [Yelp](#) setting up shop in San Francisco, has led to a northward shift in Silicon Valley's center of gravity.

"Silicon Valley is starting to migrate to San Francisco," said Chris Foley, co-founder of real estate analysis firm Polaris Group.

The two regions' vibes are, of course, quite distinct.

In the Peninsula and South Bay, Silicon Valley's traditional geography, "you're driving from one business park to the next," Foley said. "In San Francisco, everything's happening in a 1-mile radius."

And that, he and others argue, plays an even bigger role than chic urban restaurants and coffee bars in the city's climb to the top of the technology heap.

"It's about running into people and building relationships, because people want to work with and invest in people they know and trust," said Bill Maris, managing partner of Google Ventures, which is seeding an average of two new startups a week - roughly half of them in the city.

With so many techies in such a small place all thinking about the next big thing, Foley added, "You're seeing an explosion of new ideas."

And an explosion in real estate costs: Foley notes that units in a new Mission district condominium project just sold for a record \$900 per square foot. Things are equally superheated when it comes to office rents.

Mount Hamilton in San Jose, Calif. - the San Francisco Bay Area's tallest peak, at more than 4,300 feet - helped spark the region's appeal for technology geeks when Lick Observatory was established at its summit in 1888, drawing the scientifically minded here. But three years later, Stanford University opened its doors, beginning a long-term, northward shift of Silicon Valley's innovation culture.

"Looking at the history of Silicon Valley, the mother lode is Stanford and Palo Alto, and the rest flowed out into the alluvial plain," quipped San Jose Mayor Chuck Reed. "Eventually, we get some gold nuggets, too."

His city's efforts to court startups got more challenging this year when the state killed redevelopment agencies; San Jose underwrote office space for a number of tech incubators. Now city officials are looking for new ways to join with those incubators, while preparing to open an

Environmental Innovation Center to let young clean-tech companies develop and demonstrate their wares.

But Reed said San Jose's real bread and butter is in luring tech companies from the pricier north once they begin to grow. "We have millions of square feet of space that's been vacant since the (dot-com) bust, and that's a huge asset," he said.

His office trots out numbers showing that from 2007 to 2011, dozens of tech companies relocated to or expanded in San Jose, adding nearly 9,000 jobs. They include names like Palo Alto's Nanosolar and Redwood City's Zazzle.

Mindful of that trend, Reed's San Francisco counterpart, Ed Lee, has worked to woo the [startup](#) crowd. Together with influential investor Ron Conway, Lee in January launched a nonprofit that aims to lure more tech outfits to town and forge new policies to keep them there.

Under Lee's watch, Twitter last year cut a deal to avoid paying a 1.5 percent city payroll tax on new hires for the next six years. As part of the controversial pact - which reportedly will save the social media powerhouse \$22 million - Twitter and other startups looking to avoid the tax have to base themselves in dodgier pockets of the city's downtown, including the Tenderloin.

Lee recently persuaded the board of supervisors to go even further and place on the fall ballot a measure that would replace the payroll tax - which the mayor said "punishes companies for creating new jobs" - with a more broadly based tax on receipts that won't increase as fast when companies grow.

While San Francisco's liberal wing has questioned Lee's devotion to the business community, the city's economic development department points

up CBRE's figures as proof the tech-friendly approach is paying dividends.

To be sure, San Francisco still faces a bragging-rights competition for the Startup Central title from Mountain View, Calif., which, though much smaller, is home to Google, top incubators like Y Combinator and Microsoft's diplomatic mission to Silicon Valley.

Yet ironically, many say Google kicked off the current craze toward San Francisco.

Santosh Jayaram was a senior manager at the search giant five years ago when it began running free, Wi-Fi-equipped employee buses between San Francisco and Mountain View. "They were busing 3,000 people every day," he recalled. "Then Yahoo started doing it, and it became this arms race."

Freed from the hassles of commuting, techies could live in their neighborhoods of choice, and San Francisco's cultural riches made it a natural pick. And because, unlike earlier generations of startups, today's Internet newbies don't need pricey wet labs or clean rooms, those bus-riding techies could later launch new companies in their own backyards.

Derek Anderson, founder of entrepreneur networking group Startup Grind, argues there's yet another reason San Francisco has snatched Silicon Valley's mojo. With vacancy rates in Palo Alto and Mountain View barely above 2 percent, he said, hot startups like Pinterest are finding themselves practically forced to relocate. "There's no room in the freaking inn," he said.

Not that there's much in San Francisco. CBRE notes that tech companies signed more than 2 million square feet of office space - roughly equal to four Transamerica Pyramids - in town during the first five months of

this year. That puts the city well on pace to shatter the 3 million square feet leased during all of 2011.

And, according to the firm's research, there are still hundreds of companies seeking 4.5 million more square feet in San Francisco.

Jayaram - who's now co-founder of mobile-app-maker Daemonics Labs - believes rising office and housing costs are dual threats to the city's digital domination. While his startup is based in San Francisco's trendy South Park neighborhood, about half its 14 employees are based in Argentina, where Jayaram describes personnel costs as "30 cents on the dollar."

But real estate expert Foley isn't concerned. "Compared to New York and London," he said, "we're still cheap."

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