

Silicon Valley R&D Market Overview

Market Observations

Economy

- The region’s labor market saw signs of weakening in the first quarter of 2024, with the unemployment rate rising to 4.4%, slightly above the 10-year average of 4.3%. Although not much higher than the national average of 3.9%, nonfarm enrollment also saw annual losses of 0.5% year-over-year, suggesting that the local economy has yet to rebound from the tech layoffs of 2023.
- All industrial-using sectors in the San Jose-Santa Clara-Sunnyvale MSA saw negative job growth year-over-year, with the construction sector seeing total employment fall 5.4% compared to last year, likely owing to a delayed effect from tech sector pullback.
- The manufacturing sector corrected this quarter, posting -0.5% job growth year-over-year following a run since 2022 that saw the creation of an additional 18,700 jobs.

Major Transactions

- The largest deal this quarter was Fortinet’s purchase of the Texas Instruments buildings at 2900 Semiconductor & 3875/3833 Kifer Road in Santa Clara totaling ±753,440 square feet, followed by a ±146,159 square foot renewal by Intermolecular at 3011 N First Street. These deals illustrate that although deal volume is down, tenants are still willing to commit firmly to the region.
- North San Jose saw a significant amount of vacancies this quarter, with Google vacating ±173,992 square feet at 75 Trimble Road and 2600 N First Street and Ciena Corporation vacating ±64,336 square feet at 3939 N First Street. Although vacancies were primarily centered in office space in the previous year, it seems like retrofitted R&D space is not immune to downsizing strategies.

Leasing Market Fundamentals

- Net absorption in the first quarter of 2024 totaled negative ±517,135 square feet, the eighth consecutive quarter of occupancy losses, translating to an increase in the overall vacancy rate from 11.3% to 11.7% quarter-over-quarter. Gross absorption saw a bump this quarter, posting ±2.8 million square feet of activity, however, much of this figure came from off-market sale activity that did not influence the vacancy rate.
- R&D rents fell slightly to start the year, decreasing from \$2.96 to \$2.93/SF quarter-over-quarter. Although life sciences rent continue to prop up the market, diminished demand from the life science sector have caused rent growth to stagnate.
- One project broke ground this quarter, the ±55,000 square foot “The Barn” in Morgan Hill to be used as Techcon’s headquarters. As R&D space becomes increasingly specialized, more users are opting for build-to-suit construction over renting.

Outlook

- Although deal volume was significantly higher this quarter compared to previous quarters, demand for R&D space remains below historical levels, causing the vacancy rate to continue to climb. A cut to interest rates, expected this year, may reverse this trend in the upcoming year.
- Rents are expected to soften this year as the market responds to diminished demand combined with an increasing amount of space on the market. This trend, already observed in the office market, will likely manifest itself in the R&D sector in upcoming months.
- Given the movement towards smaller space and consolidation, the R&D sector is likely to continue to see occupancy losses in the immediate future.

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2. Leasing Market Fundamentals
3. Appendix

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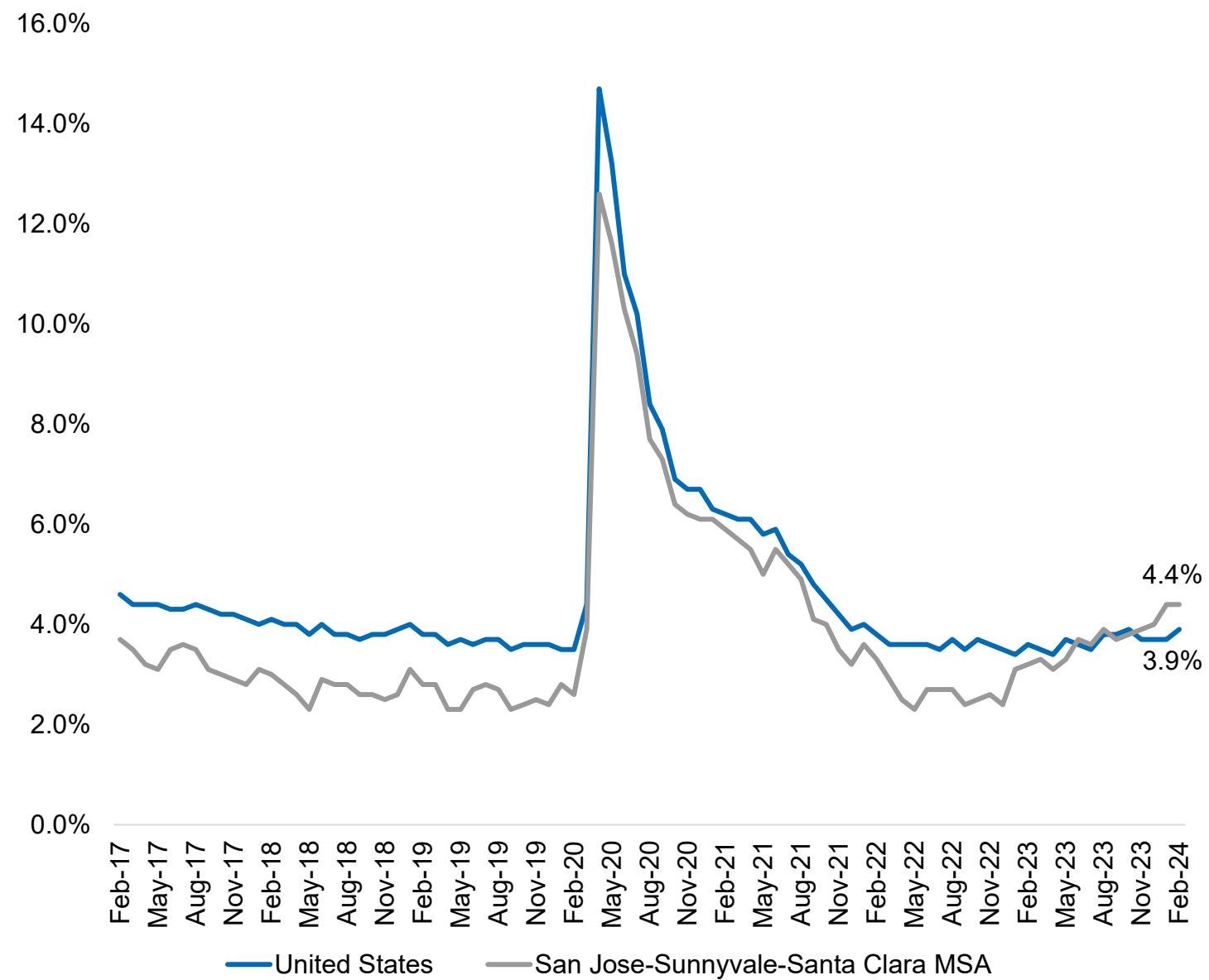
Economy



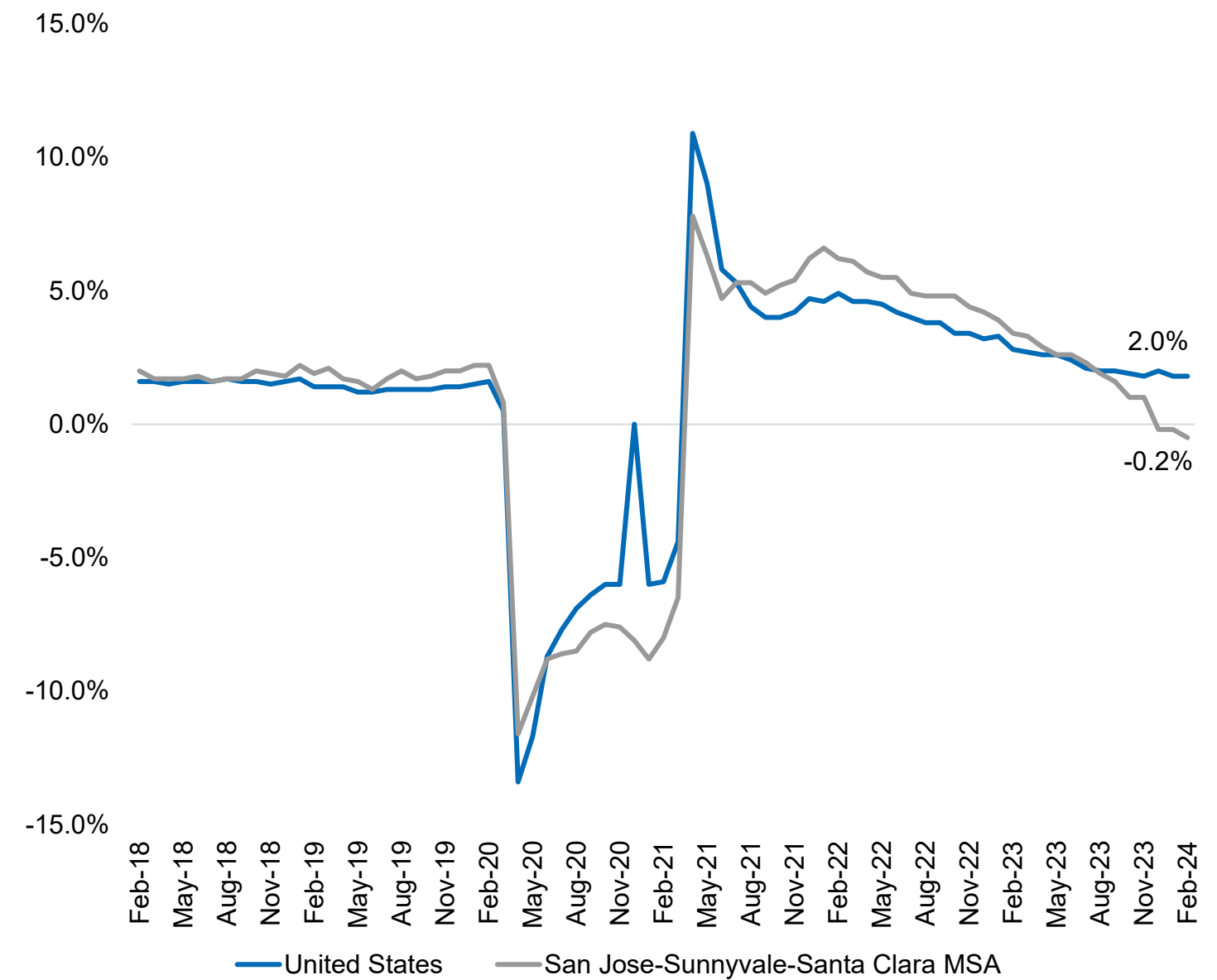
Metro Employment Trends Indicate a Slower Recovery Compared Nationally

The San Jose-Sunnyvale-Santa Clara MSA's overall unemployment rate rose for the third consecutive quarter to 3.9%, trending slightly higher than the national average of 3.7%. Though Santa Clara County has historically outperformed the US average, tech sector layoffs have caused companies to hit pause on hiring, tapering growth at the end of 2023.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change

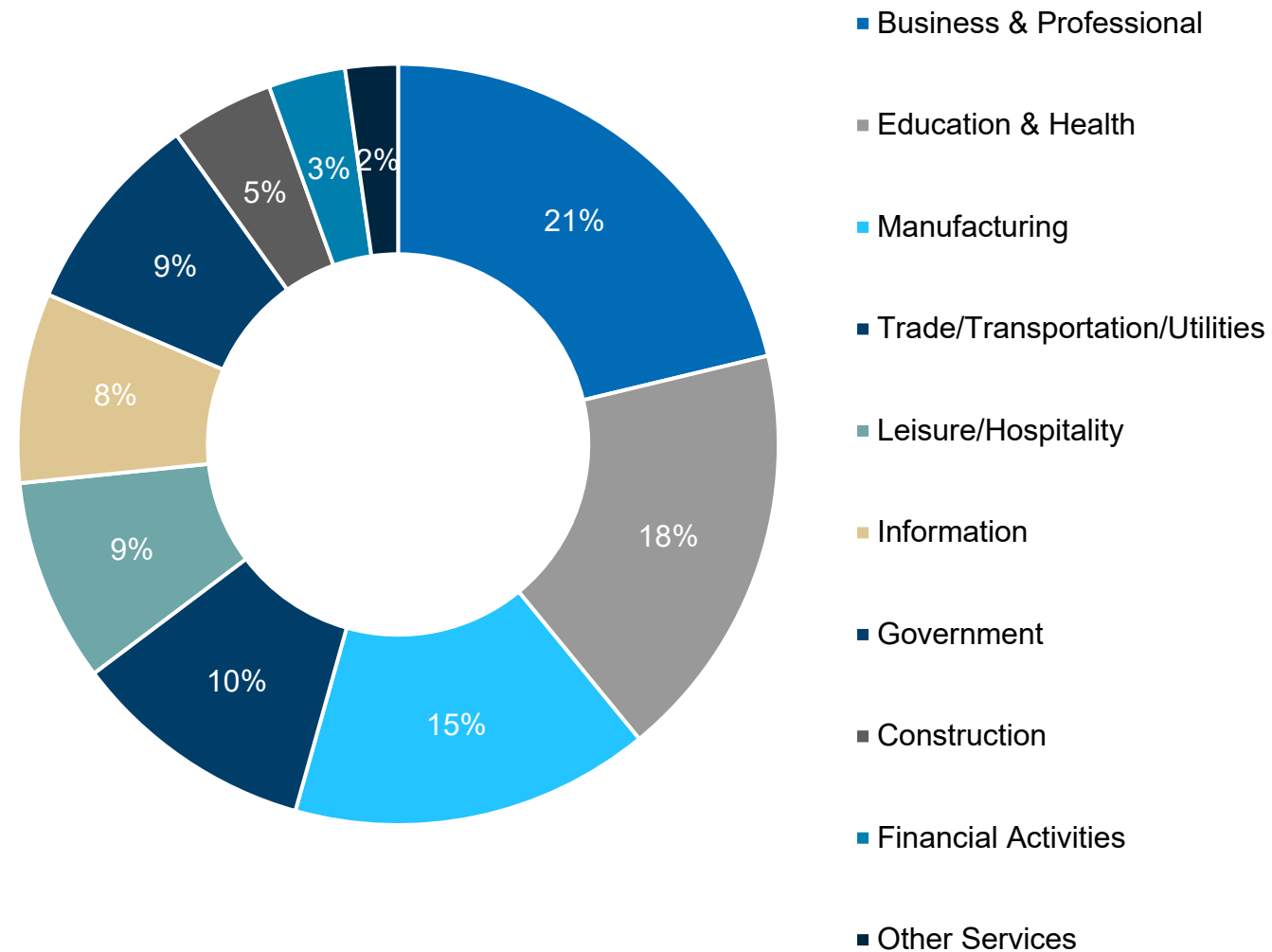


Source: U.S. Bureau of Labor Statistics, San Jose-Sunnyvale-Santa Clara MSA
 Note: November 2023 data is preliminary.

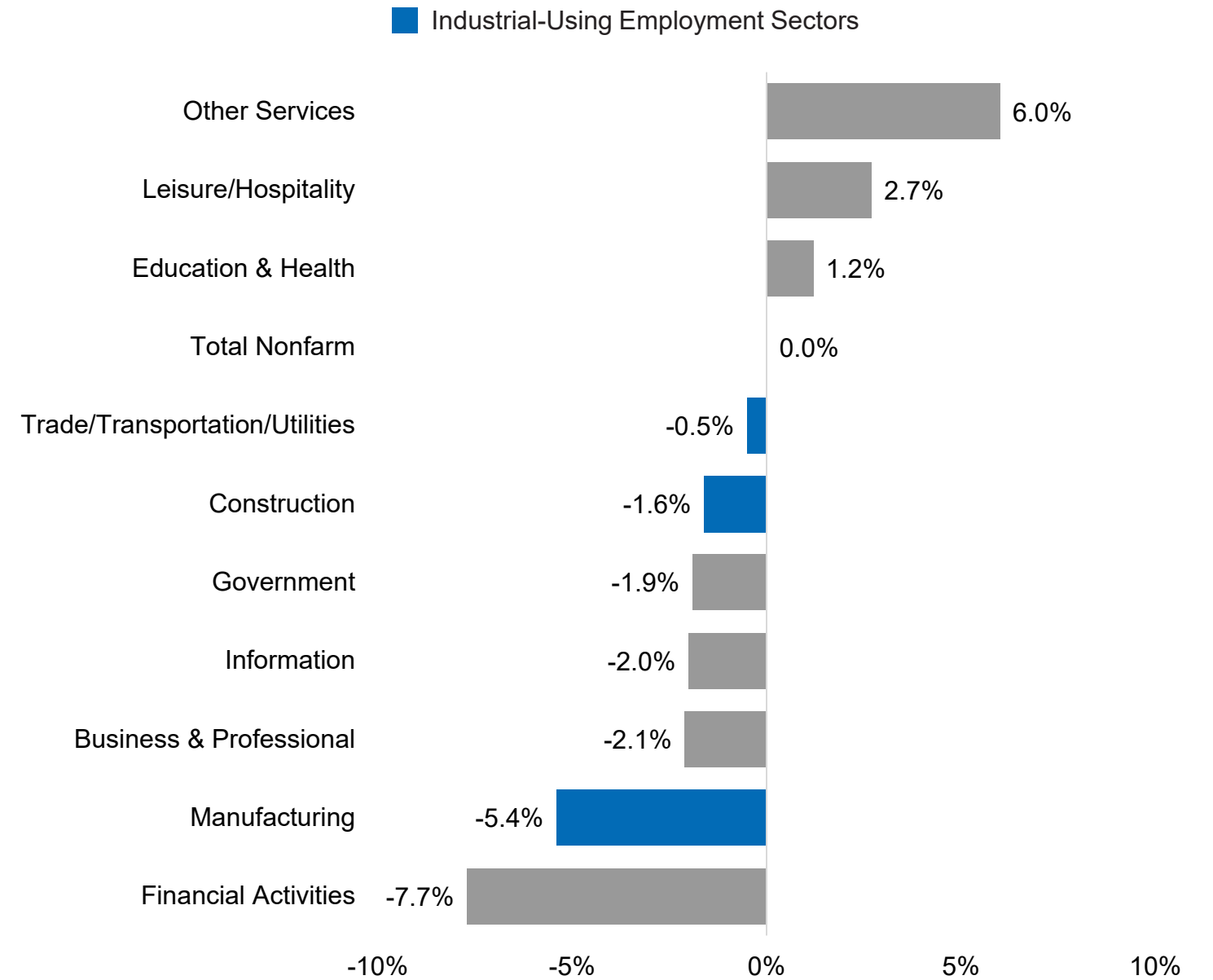
Job Growth Driven in Large Part by Services Still Making Up for Pandemic Losses

In step with a rising overall unemployment rate, several industries this quarter saw negative year-over-year growth, with the financial sector seeing the largest loss of employment year-over-year. The leisure/hospitality sector, however, consistently saw growth throughout 2023 and continues to grow, as in-person dining and retail gradually returns to the region following the pandemic.

Employment by Industry, February 2024



Employment Growth by Industry, 12-Month % Change, February 2024

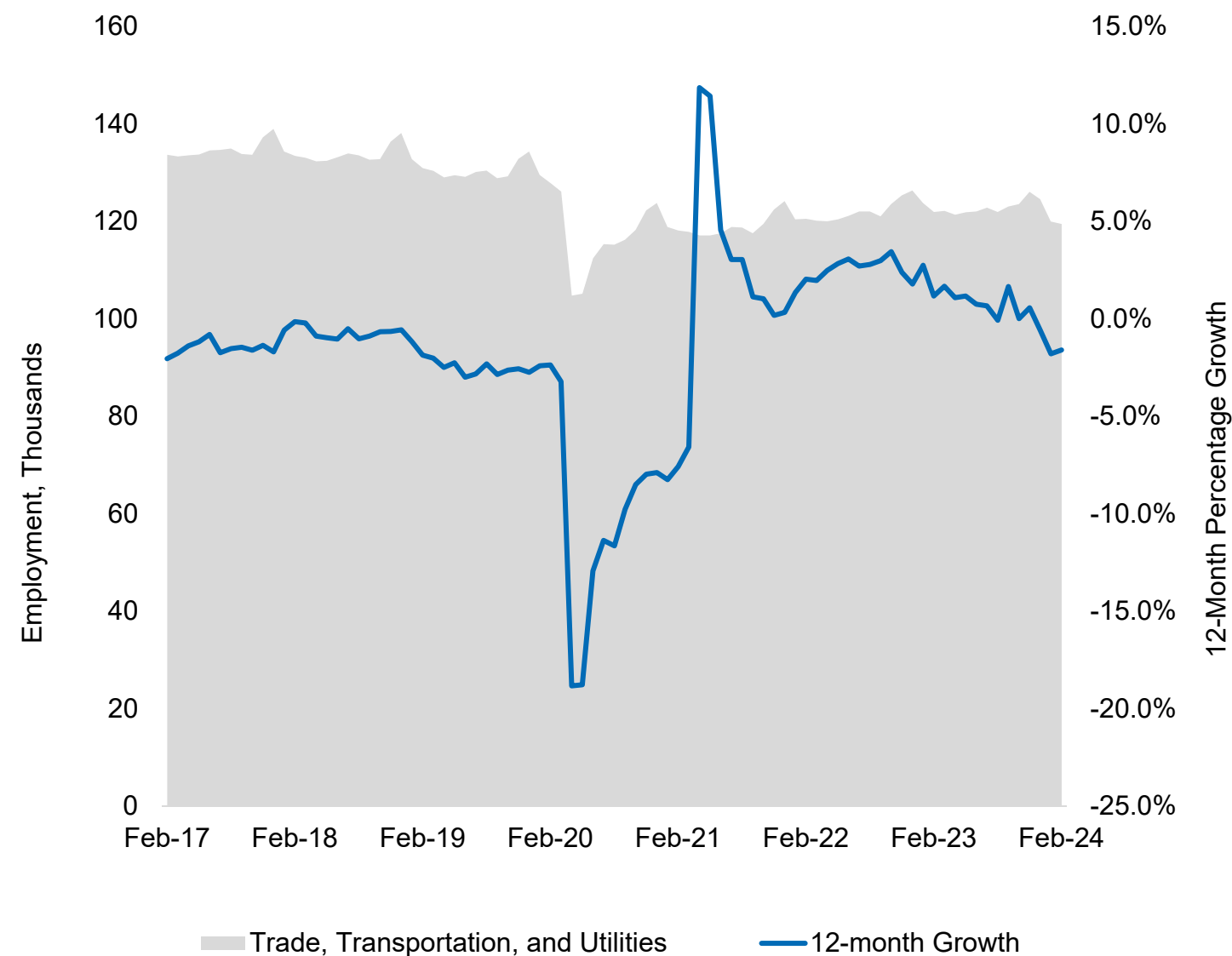


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
 Note: November 2023 data is preliminary.

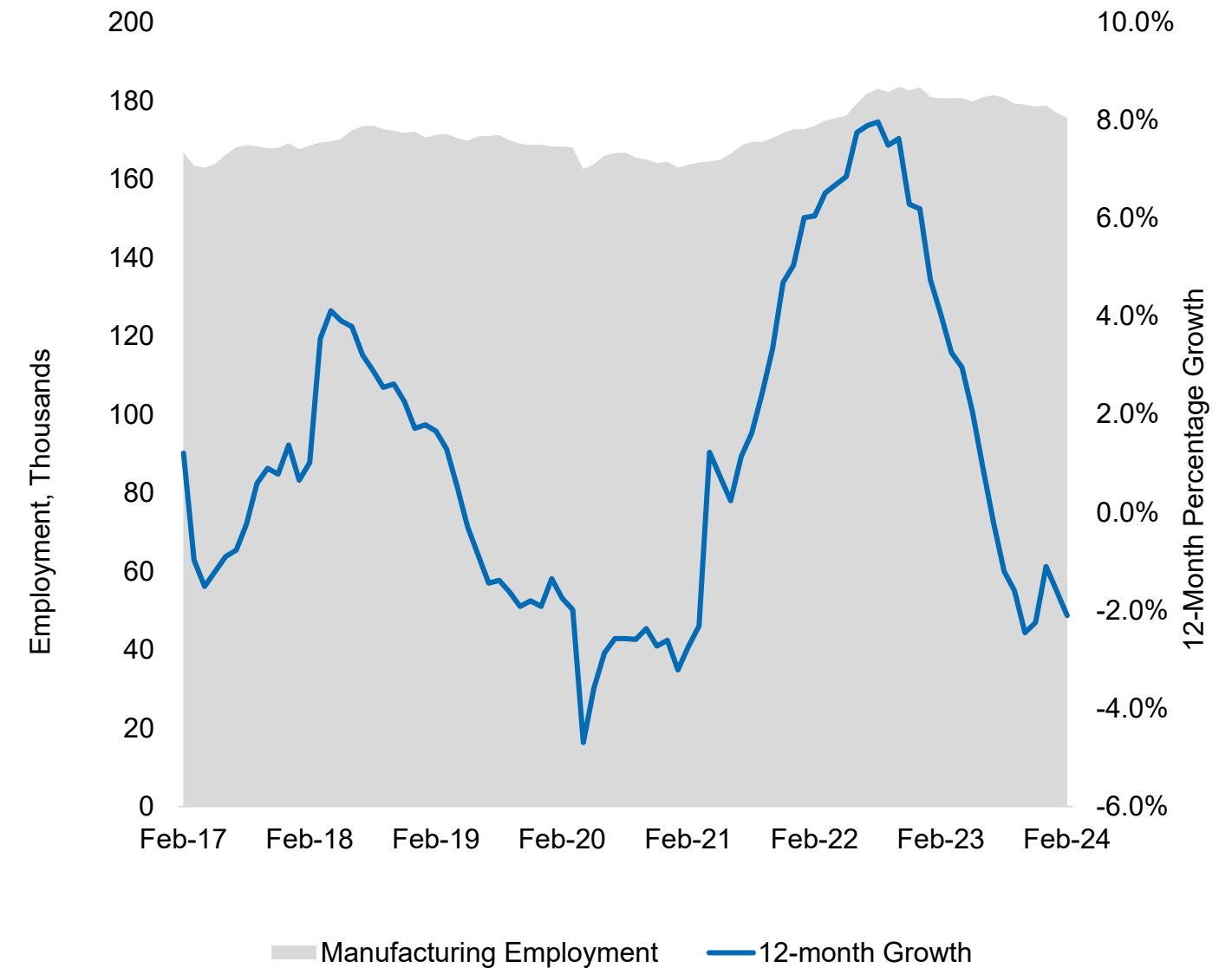
Manufacturing Sector Sees Slight Correction to 2022 Levels

Although the manufacturing sector saw impressive gains in 2022 from an increased demand for chips due to the AI boom, total employment in that sector saw a slight correction at the end of 2023, ending the year with a 2.2% decline in total employment year-over-year. Meanwhile, the trade/transportation/utilities sector saw slight growth year-over-year, with a 0.6% increase in total employment year-over-year. Given the persistent demand from the tech industry for both sectors, it's likely very little ground will be lost in the upcoming months.

Total Employment and 12-Month Growth Rate, Trade/Transportation/Utilities



Total Employment and 12-Month Growth Rate, Manufacturing



Source: U.S. Bureau of Labor Statistics, San Jose-Sunnyvale-Santa Clara MSA

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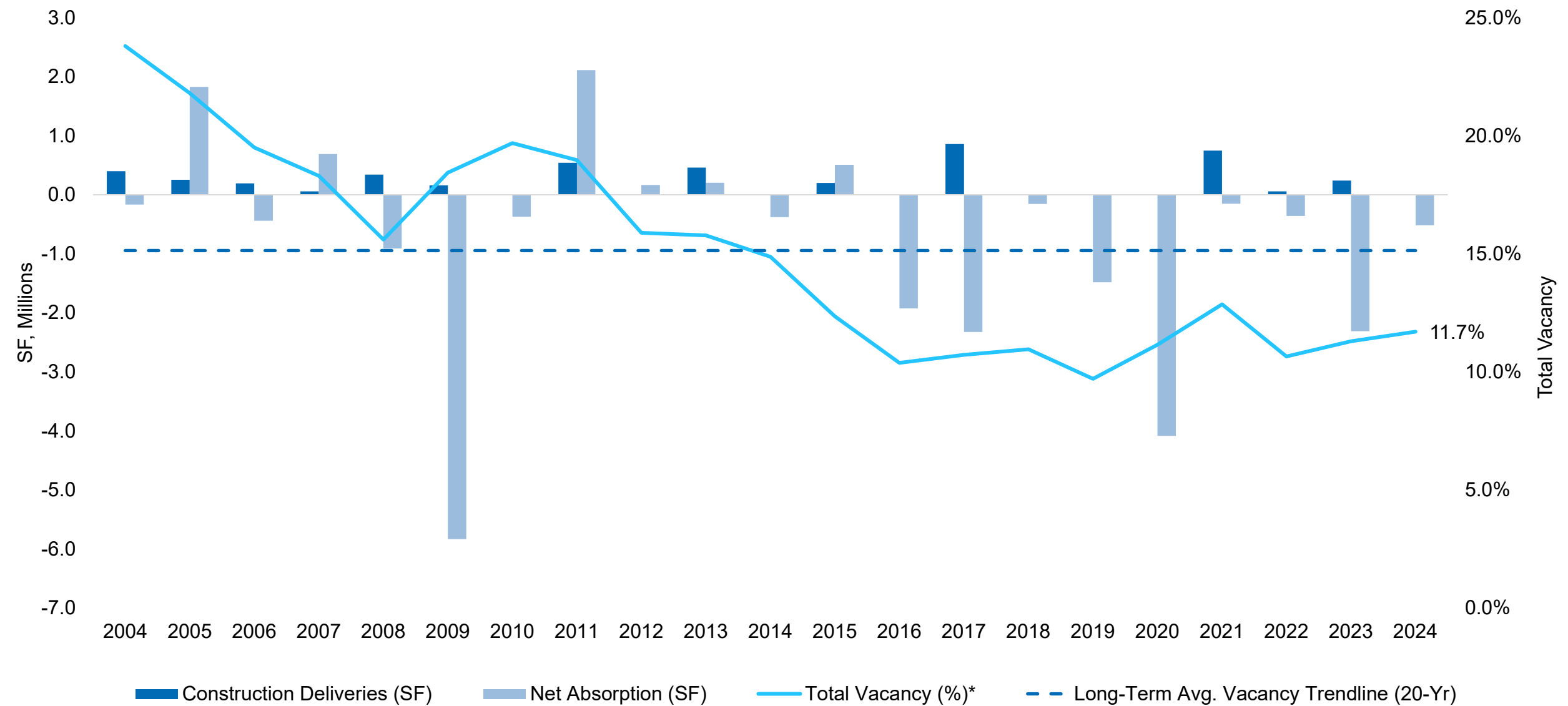
Leasing Market Fundamentals



Vacancy Increases Amid Ongoing Challenges

The overall vacancy rate increased to 11.7% in the first quarter of 2024 after posting negative 517,135 square feet of net absorption. The Silicon Valley R&D market has posted eight consecutive quarters of negative absorption, during which time vacancy has increased from 10.3% to 11.7%. Although established tech tenants such as NVIDIA and Fortinet that have done well in recent years have expanded, most tenants are seeking to consolidate operations, causing supply to increase over the past few years.

Historical Construction Deliveries, Net Absorption, and Vacancy

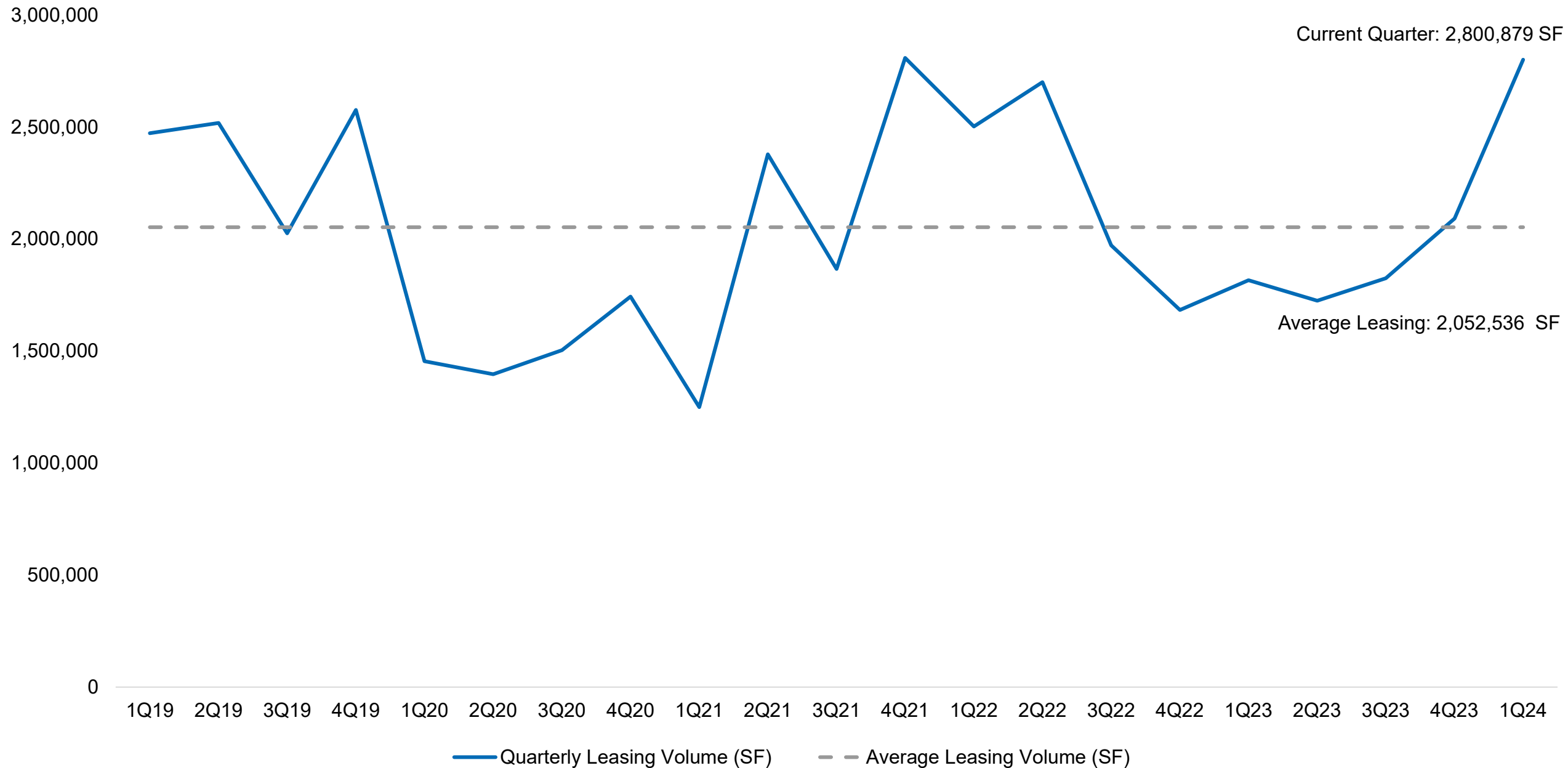


*Vacancy was only tracked starting in 2023; prior figures refer to availability.

Surge in R&D Leasing Activity

Activity in the R&D sector surged in the first quarter of 2024, posting 2.8 million square feet of gross absorption, bolstered by the ±753,440 square feet purchase of the Texas Instruments campus by Fortinet. Although it was a user sale, the fact that large transactions in tech campus settings are still taking place, suggest that large blocks of space can still be considered viable by tenants even in the current economy.

Total Leasing Activity (SF)

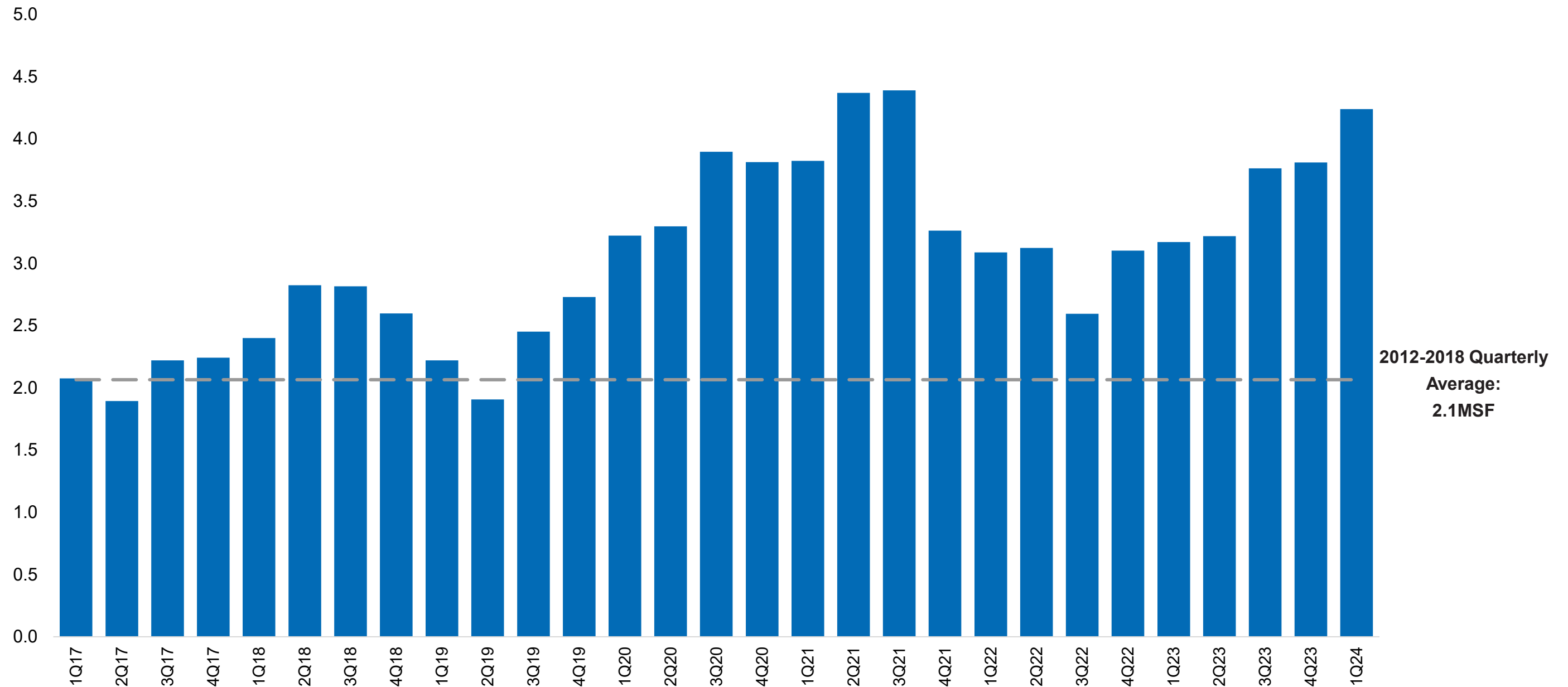


Source: Newmark Research, CoStar

Sublease Space on the Rise

Sublease availability space rose slightly significantly from the previous quarter, increasing by 11.2% quarter-over-quarter from ±3.8 million square feet to ±4.2 million square feet. Much of this space was in the San Jose – North submarket, which added ±408,695 square feet of sublease space this quarter. Since 2020, sublease space has not returned to pre-pandemic levels, and, given the propensity of tenants in the current market to downsize, sublease space will likely continue to rise throughout the year.

Available Industrial Sublease Volume (msf)

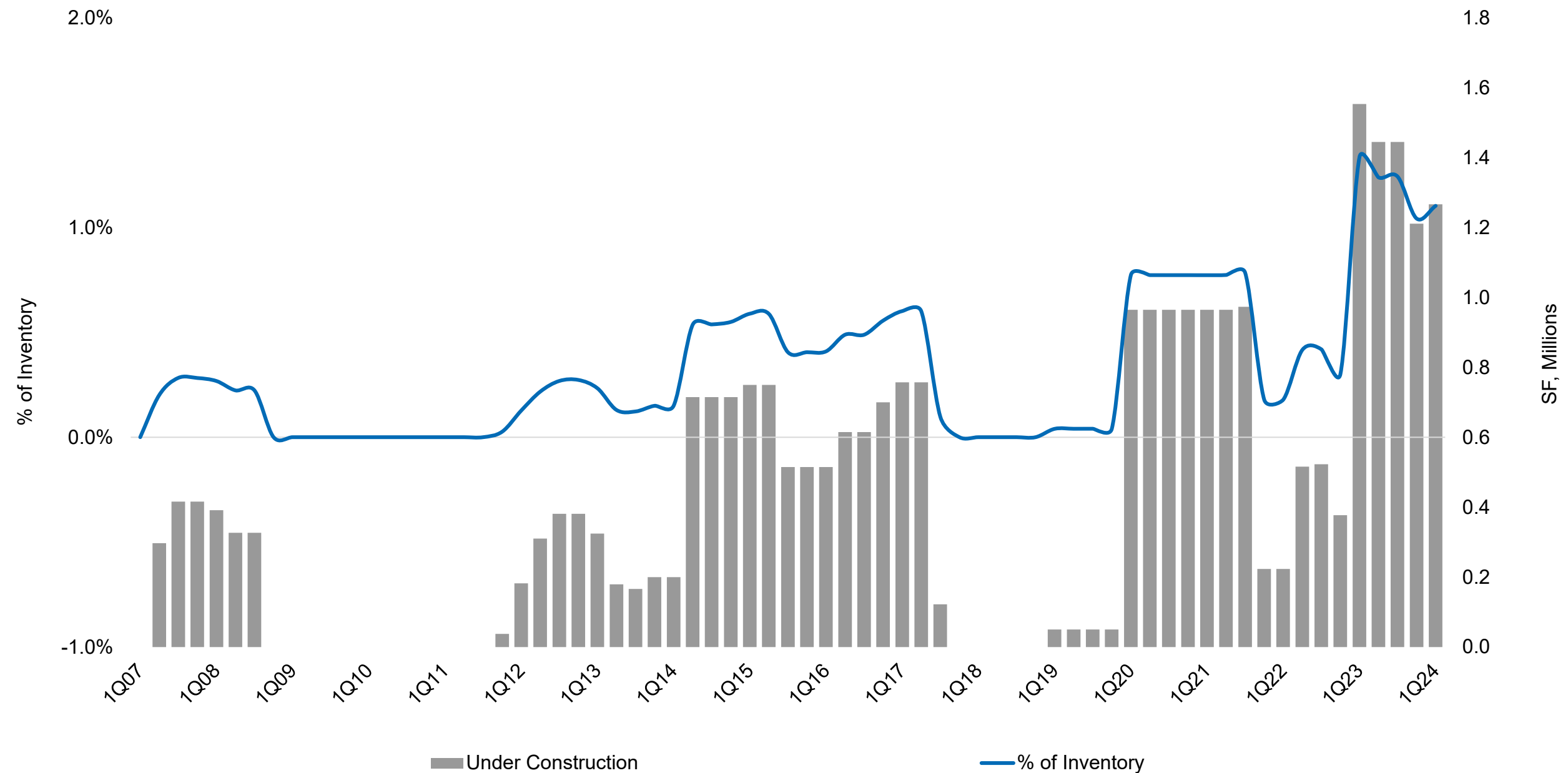


Source: Newmark Research, CoStar

Construction Pipeline Expands due to Owner-Users

The R&D pipeline grew slightly with the breaking ground of the 55,000 square foot project “The Barn” in Morgan Hill, to be used as Techcon’s headquarters. It joins the only other project in the pipeline, the 1.21 million square foot Intuitive Surgical campus being constructed in Sunnyvale. Although the scale of these two projects differ vastly, it highlights a trend in the R&D sector that, as tenants seek out increasingly specialized space, some are opting to simply build their own facilities rather than rent.

R&D Under Construction and % of Inventory

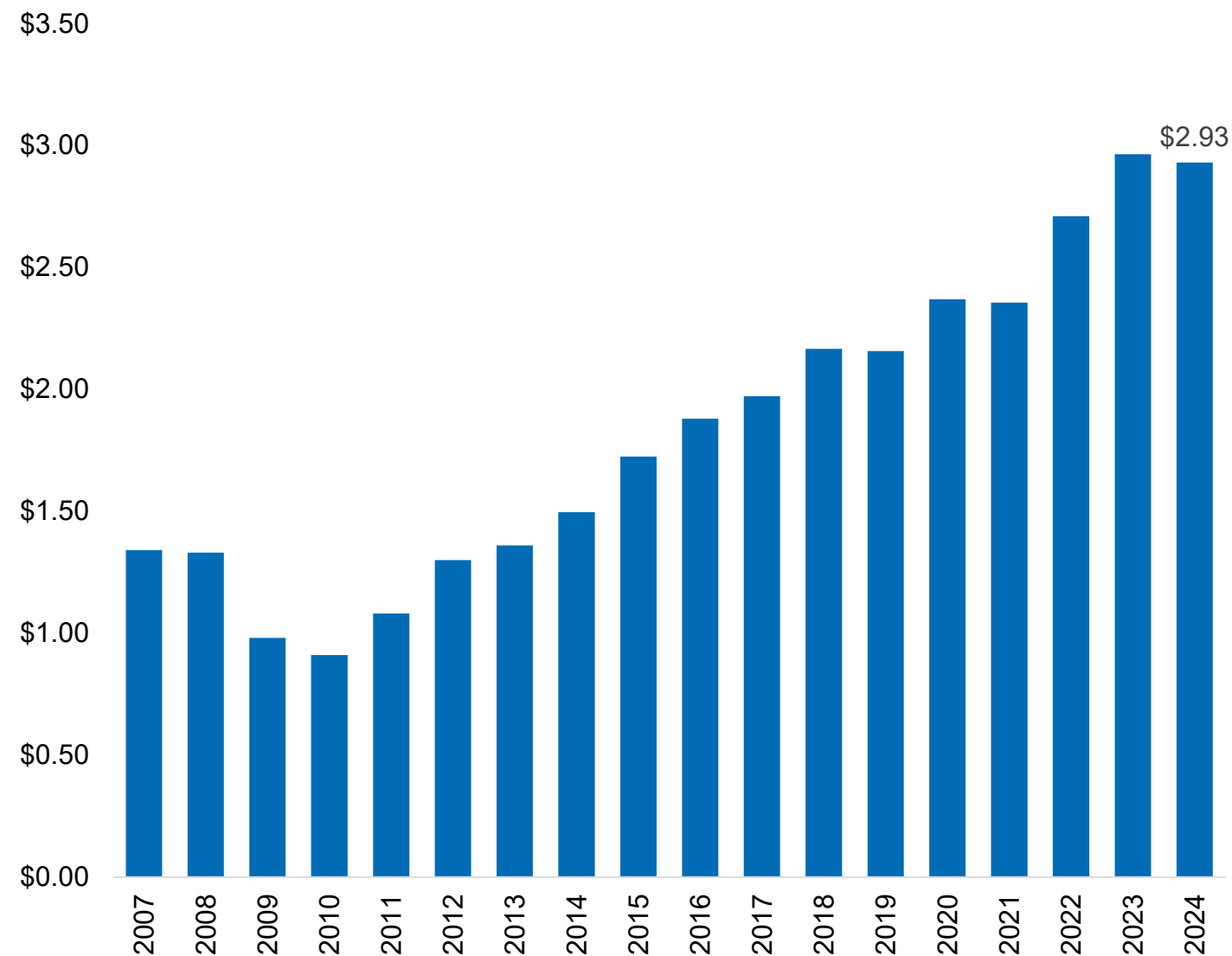


Source: Newmark Research, CoStar

Slight Drop in Asking Rents Amidst Growing Availability

R&D asking rents fell slightly this quarter to \$2.93/SF, down from \$2.96 in the previous quarter. Although one quarter is too early to tell if the trend will continue, especially as R&D rents have increased significantly year-over-year, given the rising amount of availability, it's possible that rents will soften as the year continues.

R&D Average Asking Rent, \$/SF, NNN



Year-over-Year Asking Rent Growth Rate % Change



Source: Newmark Research, CoStar



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R&D Sector Booms with New Tech Leases

The R&D sector saw a bump in activity this quarter, posting 2,800,879 square feet of gross absorption, with several new deals transacting instead of the typical mix of renewals – these new deals came from tech tenants, such as Databricks which expanded into an additional 59,702 square feet in Mountain View, alphaEMS, which, though traditionally a manufacturer, has pivoted to building parts for autonomous vehicles, and finally Fortinet’s purchase of the ±753,400 square foot Texas Instrument’s campus.

1Q24 Top Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
Intermolecular Merck <i>Lease renewal. Intermolecular (parent company is Merck Group) is a life science tenant that signed a long-term lease extension for the entire building. They have been in the space since 2010.</i>	3011 N First Street	San Jose – North	Renewal	146,159
alphaEMS <i>New Lease. alphaEMS is a specialized manufacturer of parts, and more recently parts for autonomous vehicles. They represent a tenant that has been able to expand on the latest autonomous vehicle/AI boom.</i>	4211 Starboard Drive	Fremont – Bayside	Direct Lease	129,808
Databricks <i>New Lease. Databricks leased two buildings, 59,702 SF from Atlassian at 321 E Evelyn, and 47,053 SF directly at their current location at 351 E Evelyn, where they had been subleasing the space from Coursera.</i>	321 & 351 E Evelyn Avenue	Mountain View – South Middlefield	Direct & Sublease	106,755
Intevac <i>Lease renewal. Intevac, a manufacturer of thinfilm products and hard drives, have been in this space since 2011.</i>	3560 Bassett Street	Santa Clara – 101 North	Renewal	75,376
Tesla <i>New lease. Tesla, a major occupier in Fremont, expanded its footprint by leasing an additional 58,424 square feet just south of their factory at 45500 Fremont Boulevard.</i>	47300 Kato Road	Fremont – Mission South	New Lease	58,424

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Appendix/Tables





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