
1Q24

South Peninsula Office Market Overview



NEWMARK

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.
- The information sector saw a 7.7% annual decrease in employment year-over-year as tech sector layoffs continued throughout the region. Education and healthcare saw the greatest growth of all industries, posting a 6.0% increase year-over-year.
- Office-using employment saw another correction in the first quarter of 2024, with total employment falling from 398,000 to 375,000 jobs quarter-over-quarter. Although layoffs took a brief pause at the end of 2023, the start of 2024 saw an uptick in layoffs as companies continued to cut payroll to reduce costs.

Major Transactions

- The overall vacancy rate remained relatively flat this quarter, rising just 10 basis points quarter-over-quarter. The largest drivers of vacancy this quarter were both in Palo Alto, where two market-ready completions at 975 Page Mill Rd and 250 Cambridge Ave, adding ±53,915 and ±39,000 square feet of vacant space, respectively. The largest occupier this quarter was Coinbase, which extended its 42,217 SF lease at 391 San Antonio Rd in Mountain View.
- The largest deal of the quarter was signed in Redwood City, where Poshmark renewed on two floors totaling 50,327 SF, followed by Morgan Stanley, which renewed on 48,000 SF in Sand Hill Road. Although leasing activity remains low compared to the pre-pandemic area, these leases are evidence that tech and established financial companies are still willing to commit to the region.

Leasing Market Fundamentals

- Net absorption in the first quarter of 2024 measured negative 72,650 SF, the eighth consecutive quarter of negative net absorption. Following a year that saw a total of 3.1 million SF of occupancy losses, the quarterly net absorption figure is comparatively low and is the highest net absorption figure measured since the first quarter of 2022.
- The overall vacancy rate is currently 22.0% in the region, up from 15.4% in the first quarter of 2023 and at its highest level since the first quarter of 2004.
- Asking lease rates fell again this quarter to \$7.55/SF, and are down 1.2% quarter-over-quarter and 8.2% year-over-year. The lack of tech leasing and high levels of availability have caused asking lease rates to slowly fall over the past four quarters.

Outlook

- Federal interest rates are expected to decrease during 2024, though to what extent remains unknown. After months of investment pullback, the lessened cost of capital could encourage new startup activity and office expansions.
- AI companies seeking space could make a significant impact on office vacancies of all sizes, with more than 32 deals signed by AI companies in the South Peninsula in the last 12 months, primarily in Palo Alto and Mountain View.
- The increase of sublease offerings, especially in former tech campuses released during 2023, has caused a large rise in vacancy levels region-wide. This level will likely persist throughout 2024 as companies continue to reassess their space needs.

1. Economy
2. Leasing Market Fundamentals
3. Appendix

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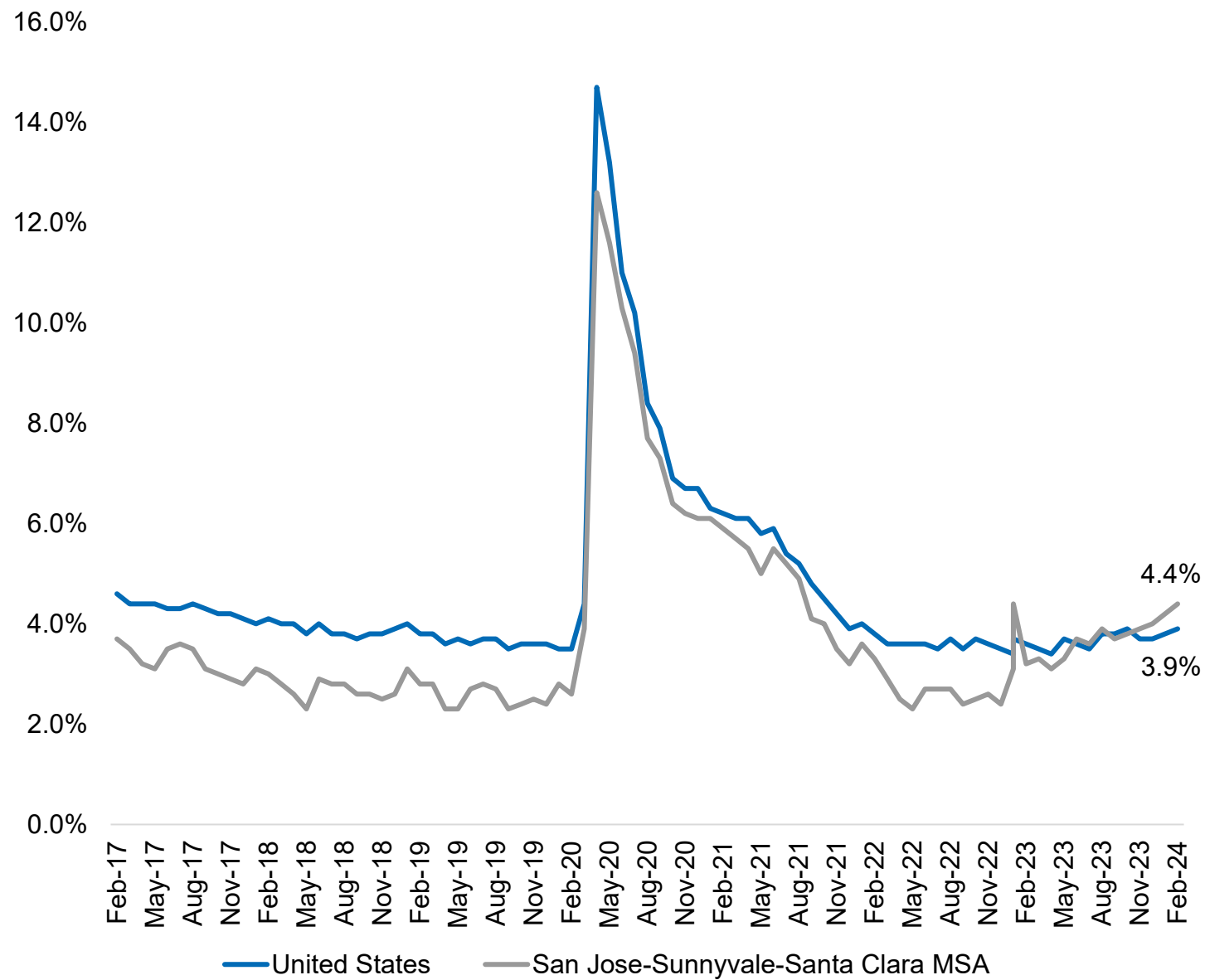
Economy



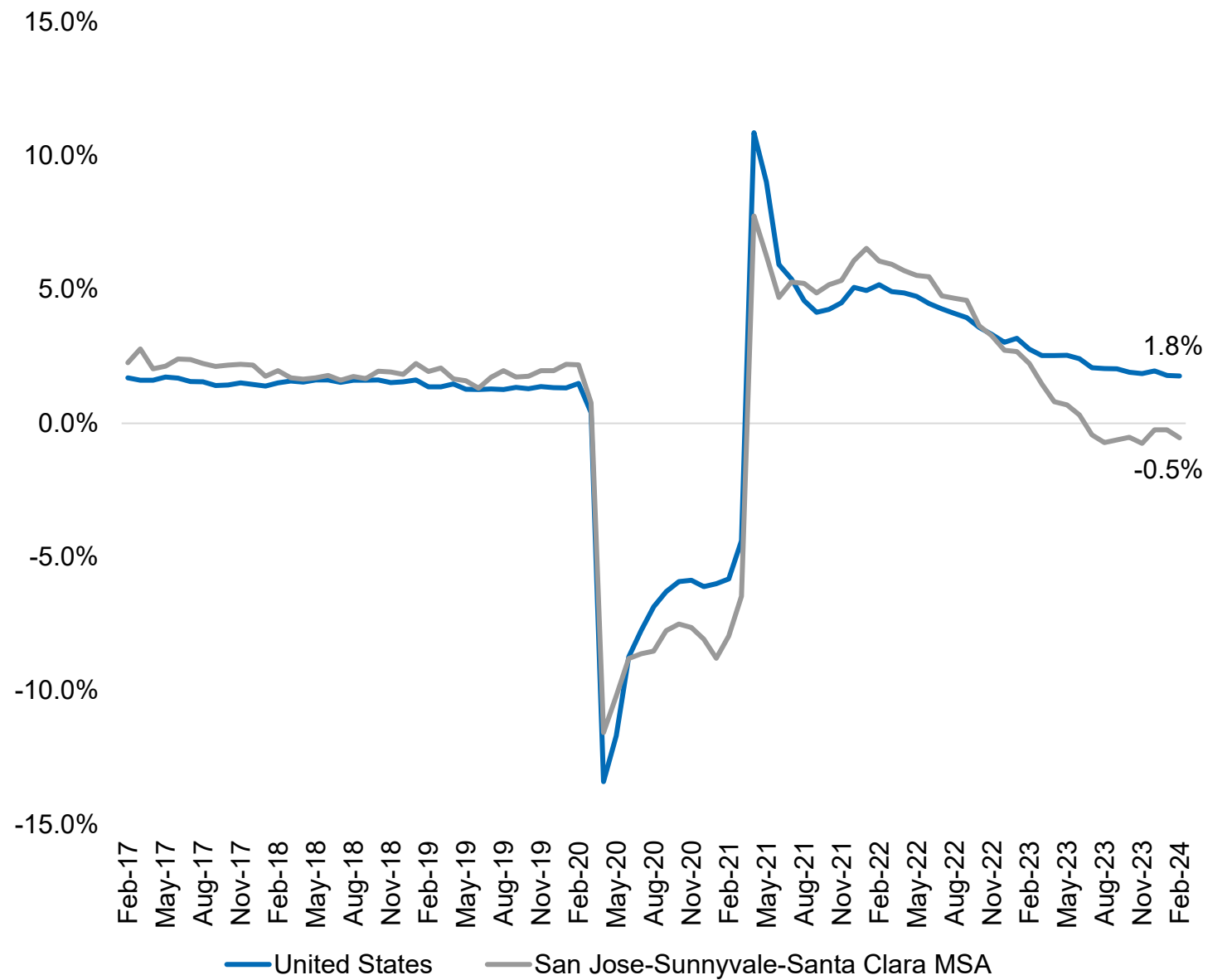
Overall Employment Falling Year-over-Year

The San Jose-Sunnyvale-Santa Clara MSA's overall unemployment rate rose for the fourth consecutive quarter to 4.4%, trending slightly higher than the national average of 3.9%, which remained at the same level as October 2023. Though Santa Clara County has historically outperformed the US average, tech sector layoffs have caused a ripple effect on the local economy, which has posted negative job growth every month since July 2023.

Unemployment Rate, Seasonally Adjusted



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

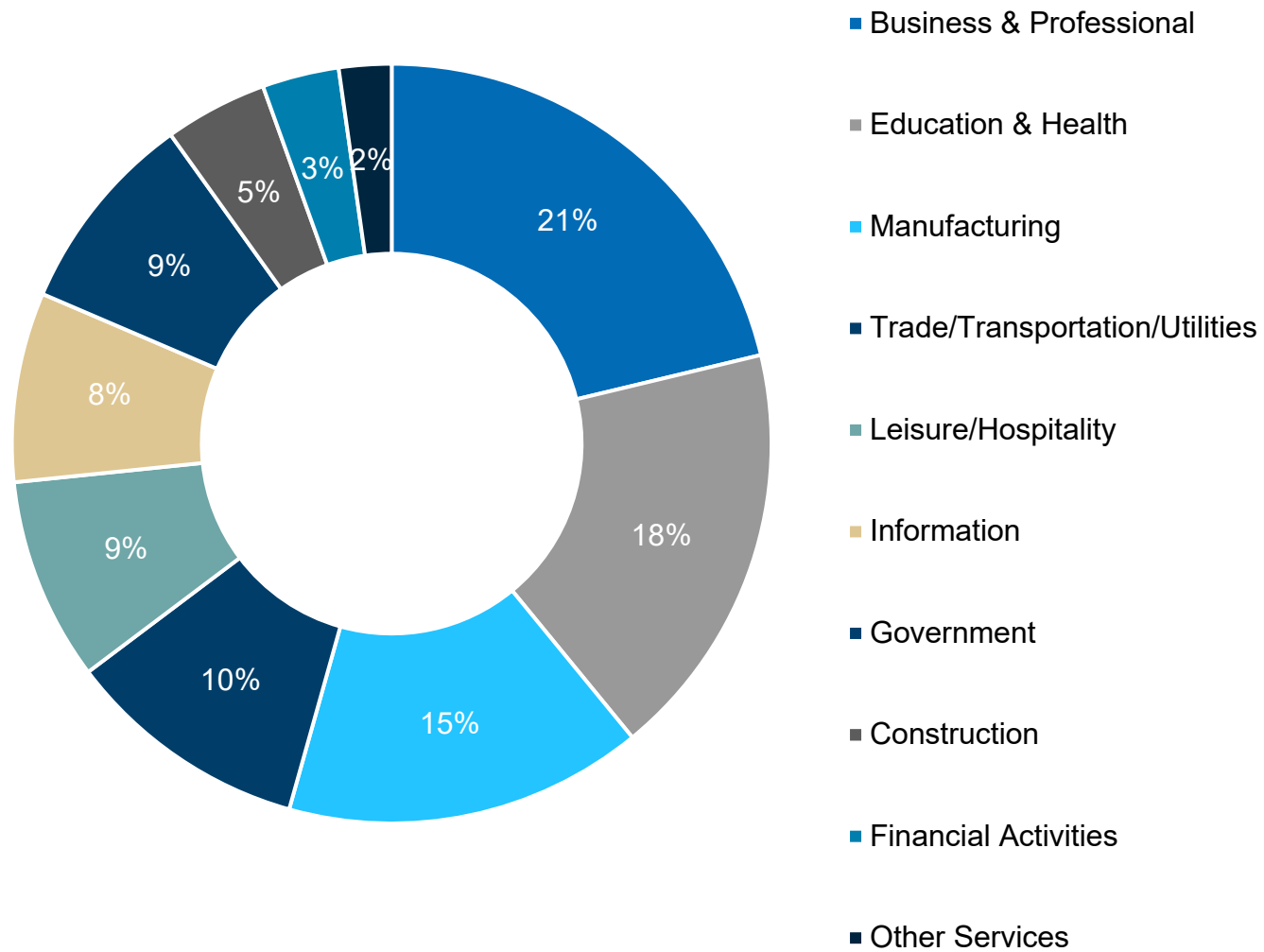


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
 Note: February 2024 data is preliminary.

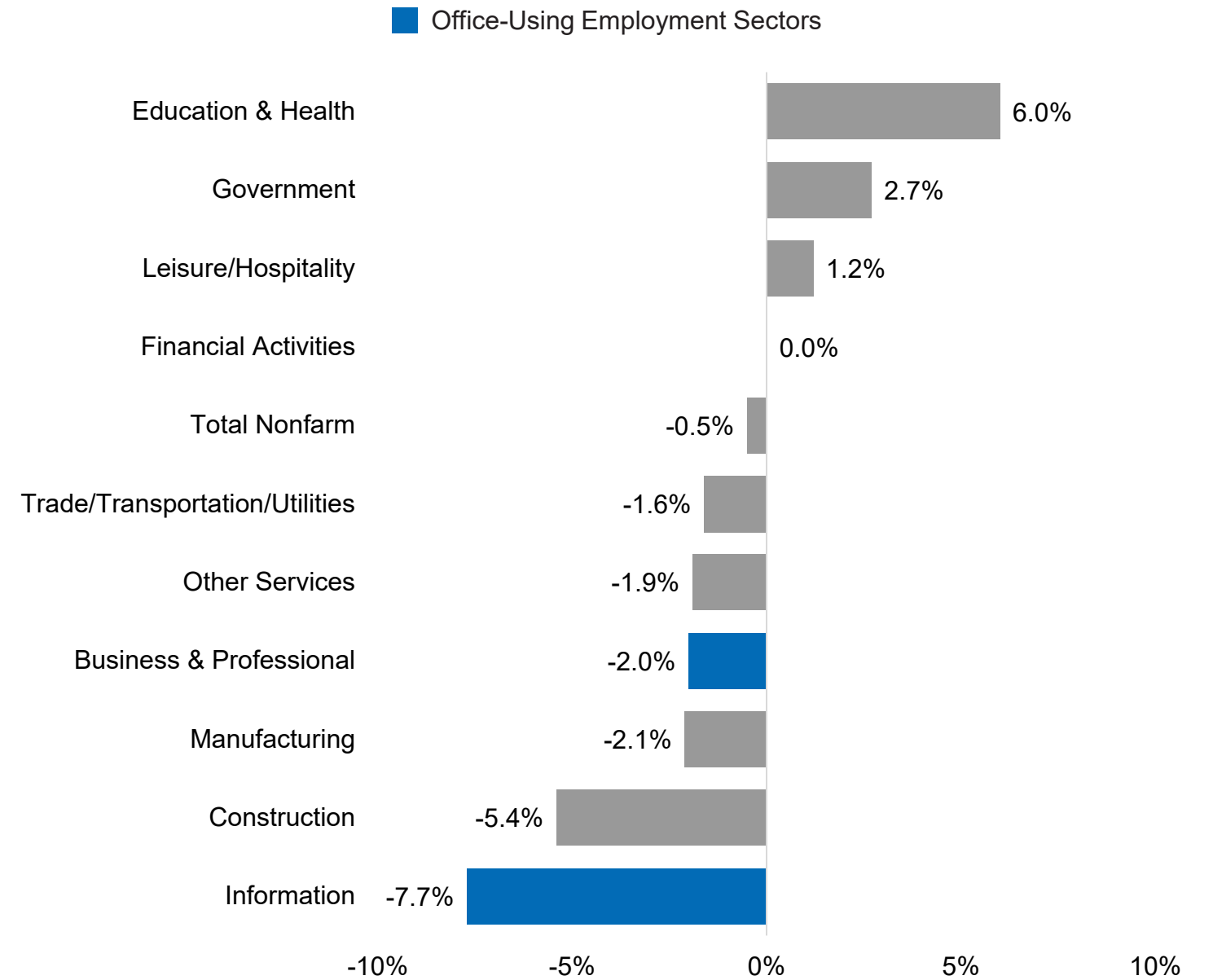
Information Sector Employment Falling at Start of 2024

In step with a rising unemployment rate and falling overall employment, most industries saw negative year-over-year growth, with total nonfarm employment falling by 0.5%. The information sector saw the largest loss of employment year-over-year, likely driven by the ±57,000 tech sector employee layoffs in the first quarter of 2024, as reported by layoff tracker website layoffs.fyi.

Employment by Industry, February 2024



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

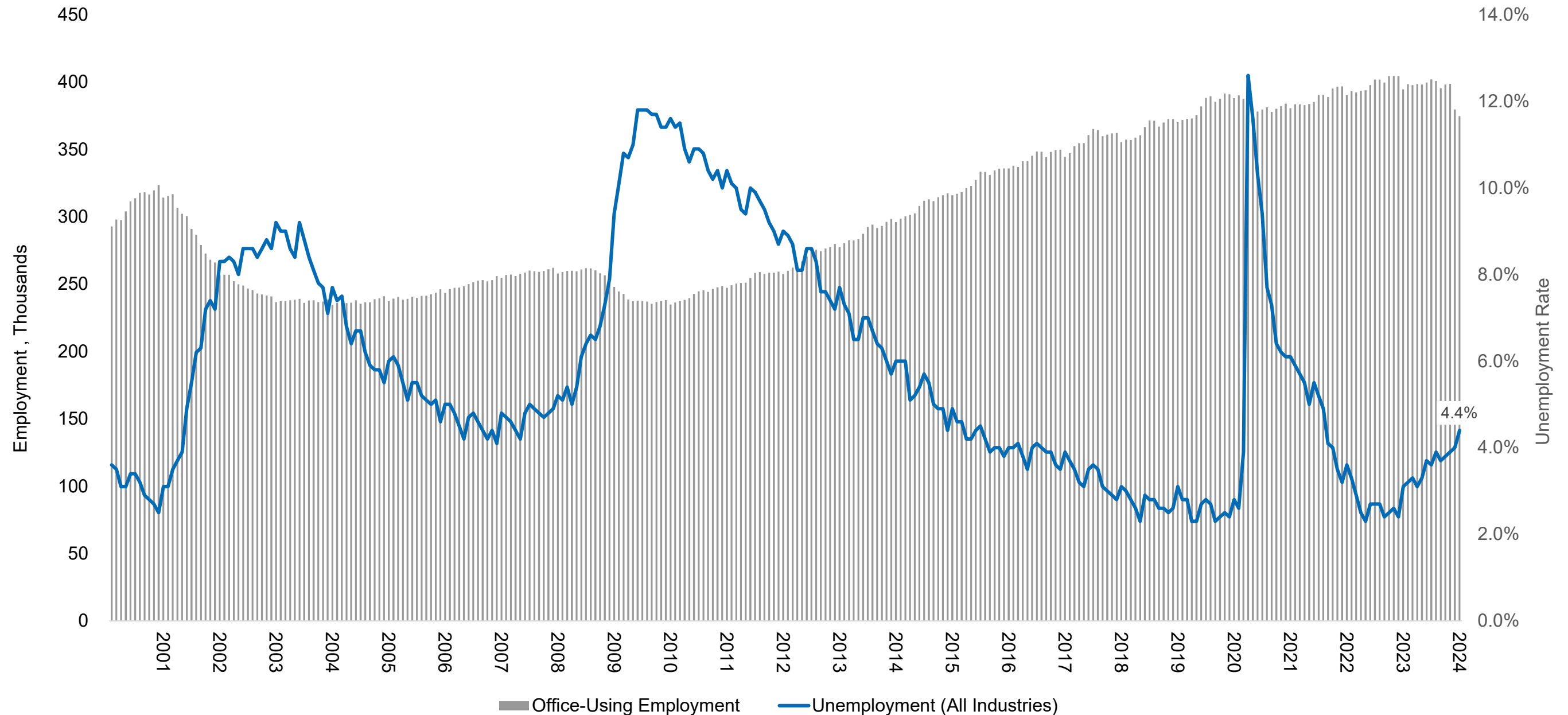


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale, layoffs.fyi
 Note: February 2024 data is preliminary.

Overall Office-Using Employment Falling in 2024

Specific office-using employment began to fall in the first quarter of 2024, falling from ±398,000 to ±375,000 since October 2023, a 5.7% decrease. Cost-cutting in the financial sectors and tech sector hiring freezes, which saw the largest loss among all industries, can be credited for this decrease. Despite this, advancements in the AI sector as well as upcoming national elections could offset this downward trend relatively quickly.

Office-Using Employment* and Unemployment Across All Industries



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

Note: February 2024 data is preliminary.

*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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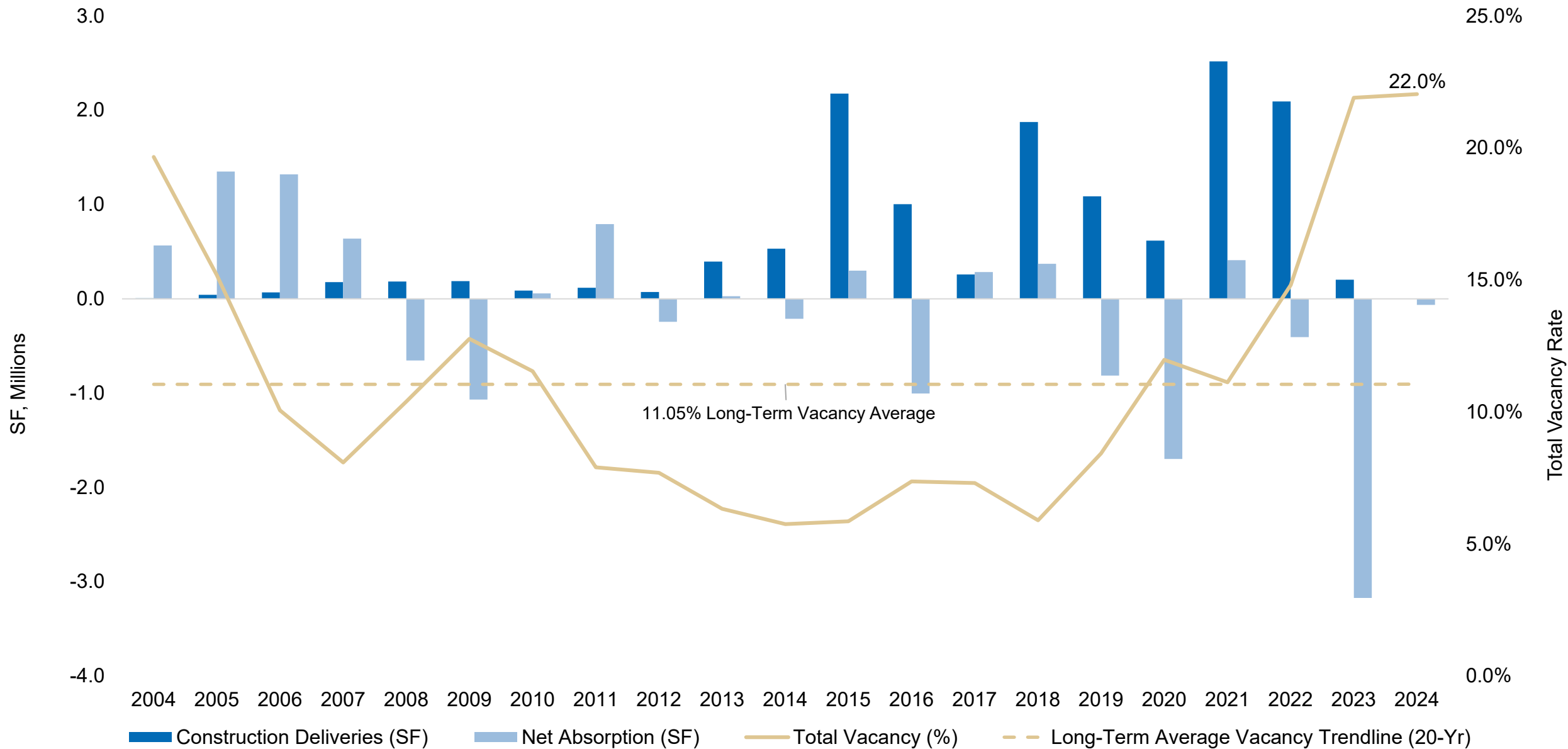
Leasing Market Fundamentals



Vacancy Shows Signs of Subsiding Growth as Construction Deliveries Decrease

Net absorption for the first quarter of 2024 measured negative 65,322 SF. Though still negative, this absorption number is also the largest recorded since the first quarter of 2022. This quarter also marks the eighth consecutive quarter of occupancy losses in the South Peninsula, though it is important to note the velocity of vacancy has declined since the large initial spike in the fourth quarter of 2018, rising only 14 basis points quarter-over-quarter in the first quarter of 2024.

Historical Construction Deliveries, Net Absorption, and Vacancy

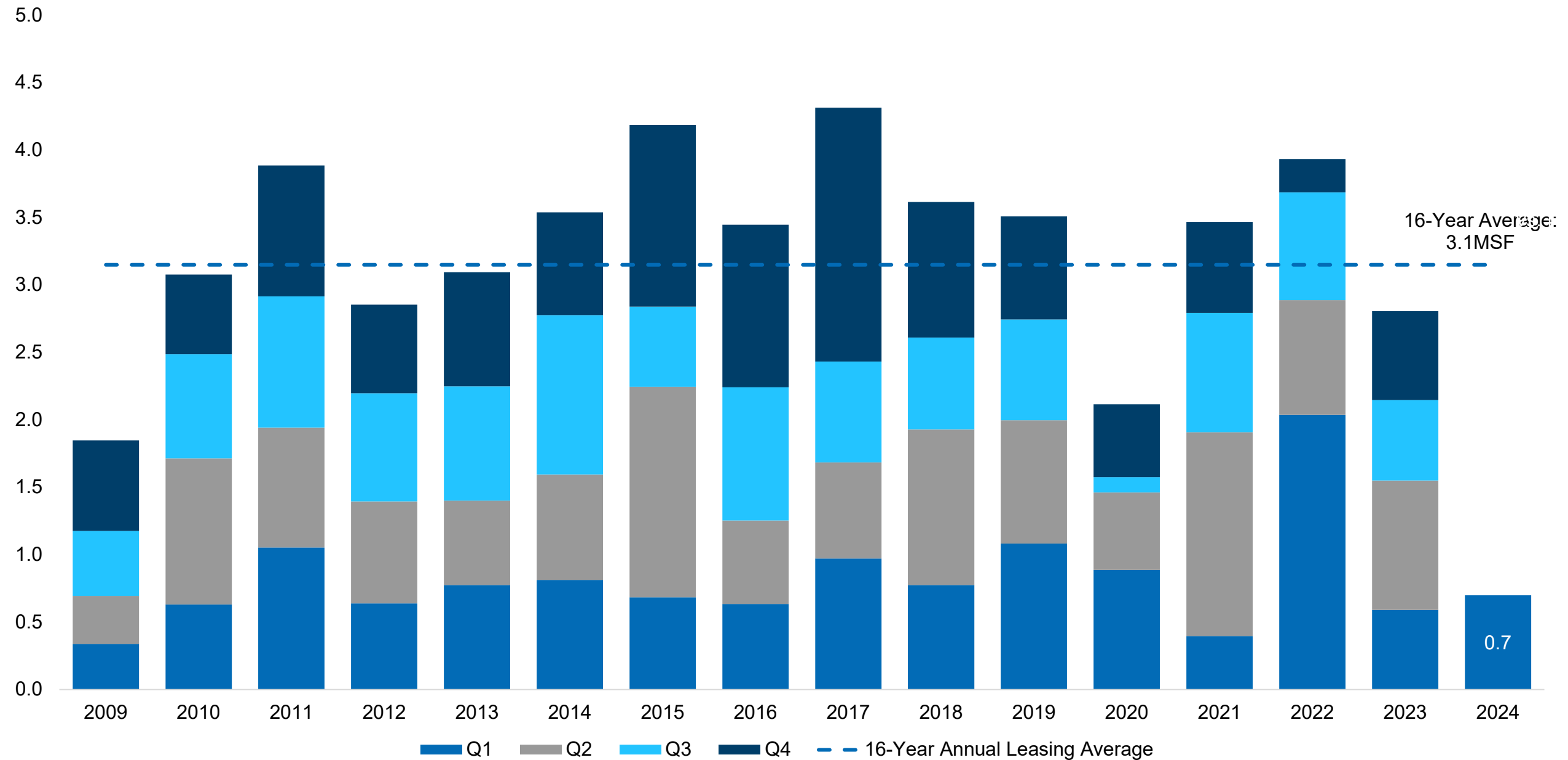


Source: Newmark Research

Leasing Activity for 2024 Starts below Historical First-Quarter Average

Activity in the first quarter of 2024 is off to a strong start compared to 2023, posting 699,393 square feet of gross absorption, though remains short of the historical quarterly average. With a lack of pre-leased projects in the construction pipeline, activity in the office market will heavily rely on leases in existing, market-ready spaces. With roughly 2.0 million SF of tracked office leases expiring in 2024, tenant decisions to renew, expand, or downsize will also have a large impact on absorption numbers in 2024.

Total Leasing Activity (msf)



Source: Newmark Research, CoStar

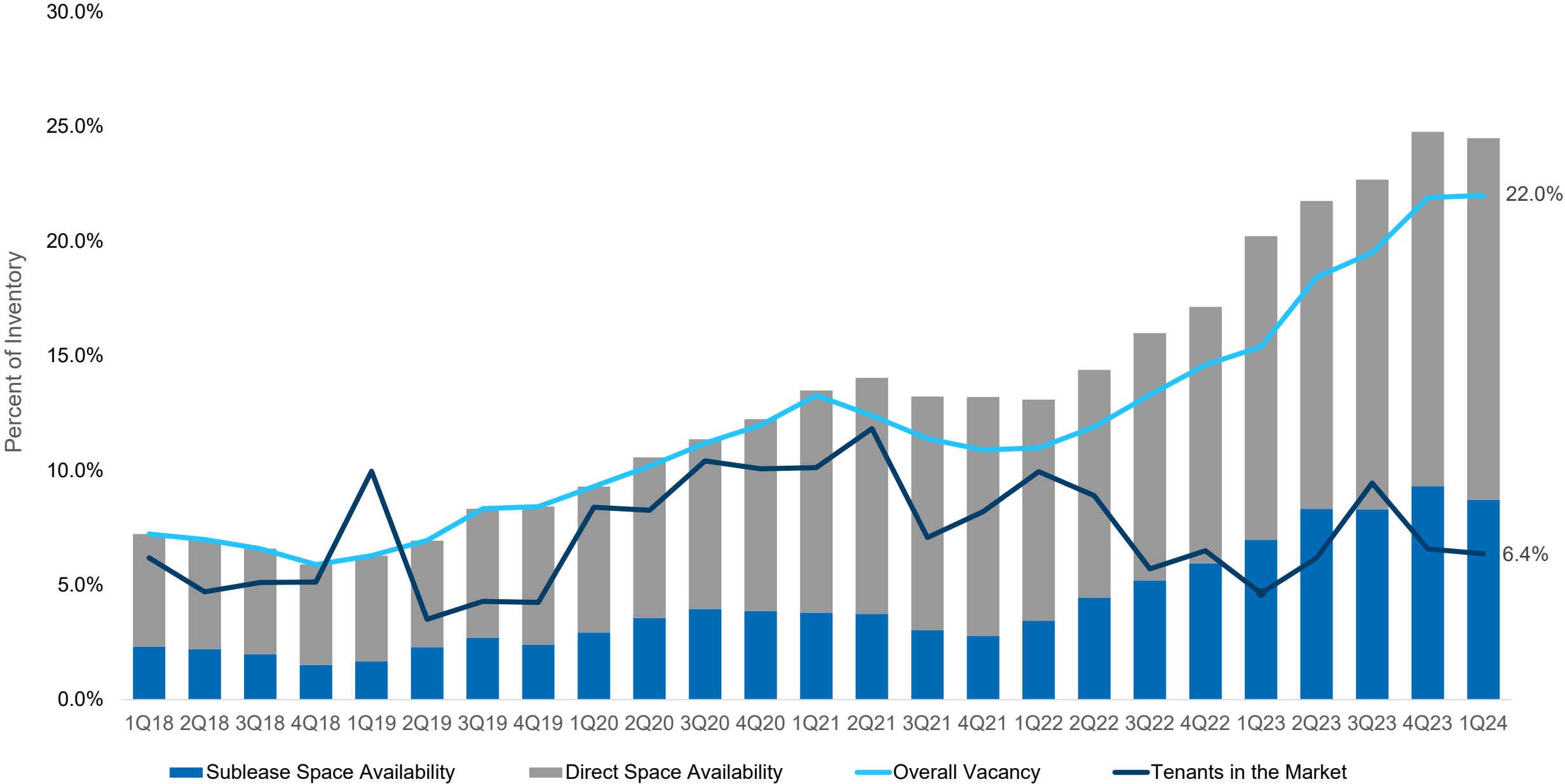


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Tenant Demand Remains Stable as Vacancy Continues to Climb

Tenant demand has remained at a stable level of roughly 2.4M SF in the South Peninsula, as existing tenants sign attractive renewals with concessions, and large-block tenant requirements are temporarily on hold due to internal reconfiguration and right-sizing initiatives. As availabilities continue to climb in the region, touring tenants are focused on high-class, highly-amenitized spaces to capitalize on lower rental rates in the current market.

Available Space and Tenant Demand as Percent of Overall Market

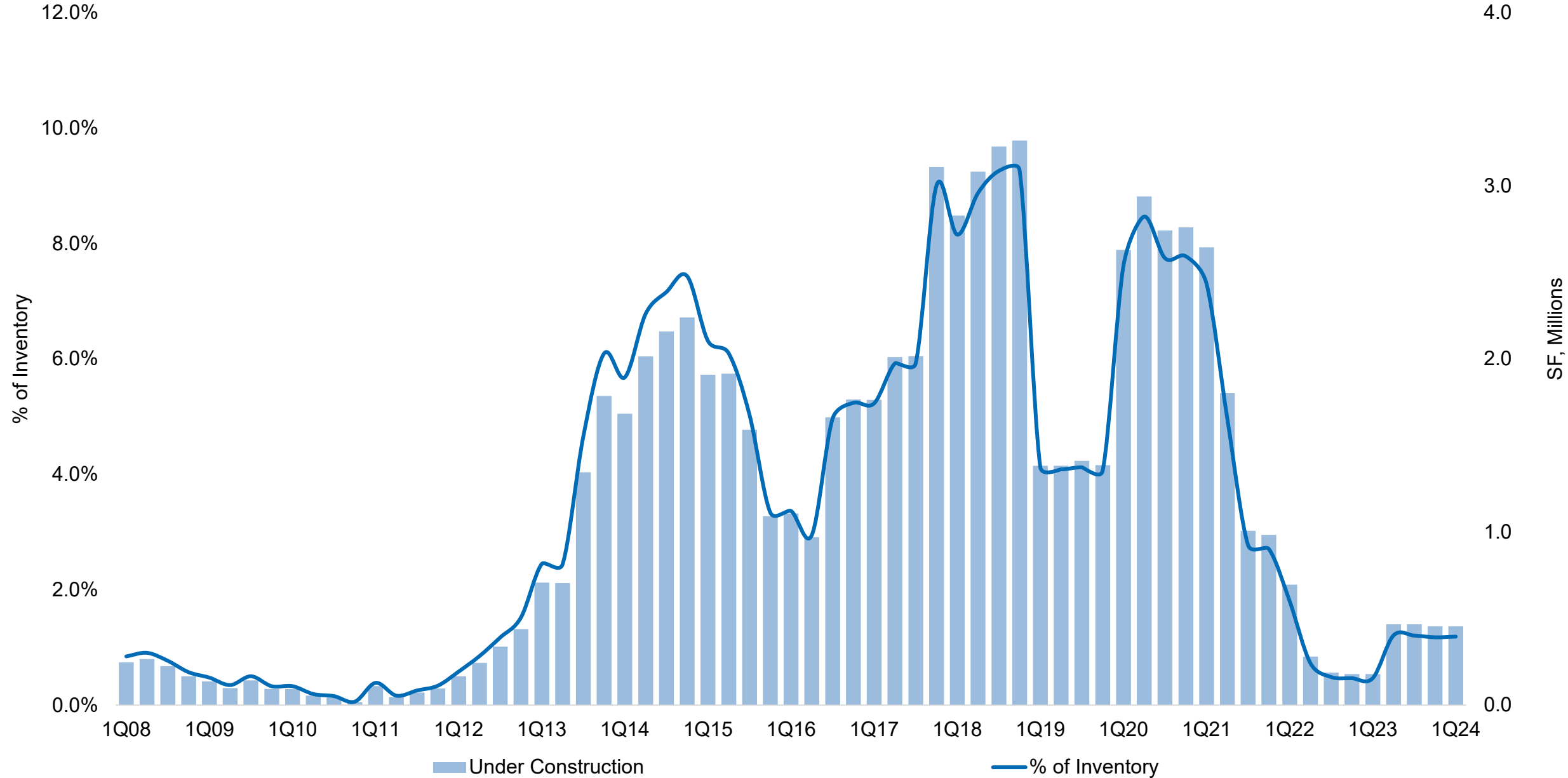


Source: Newmark Research

Construction Levels Remain Flat

Construction projects have remained level compared to the fourth quarter of 2023. Several proposed and entitled projects have not broken ground due to economic uncertainty in the market, along with rising availabilities at existing buildings in the area. Intentions from developers remain positive, however, as high-profile tenants continue to seek out trophy space, several entitled projects seeking permit extensions, and regular new commercial proposals submissions in the county.

Office Under Construction and % of Inventory

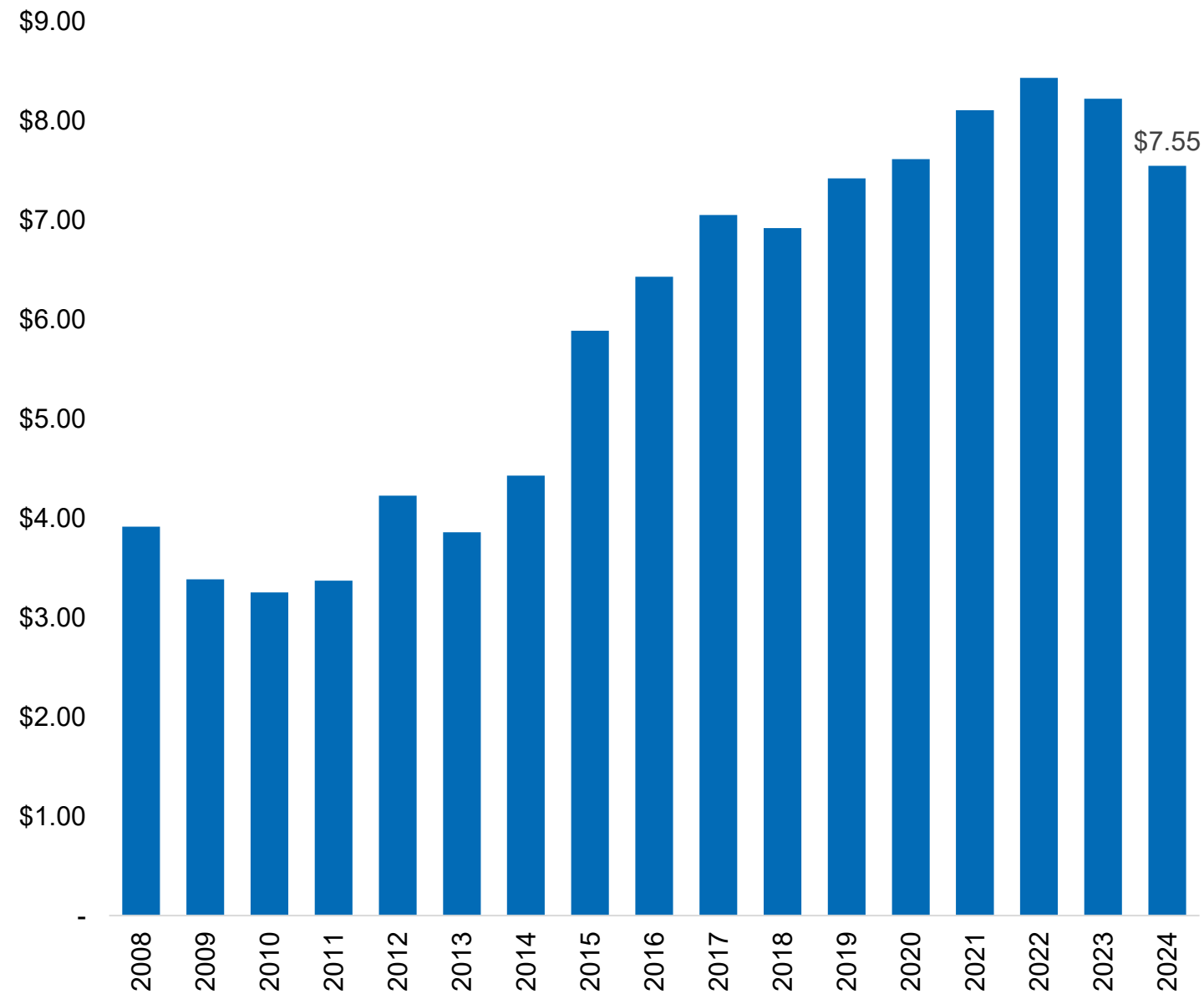


Source: Newmark Research, CoStar

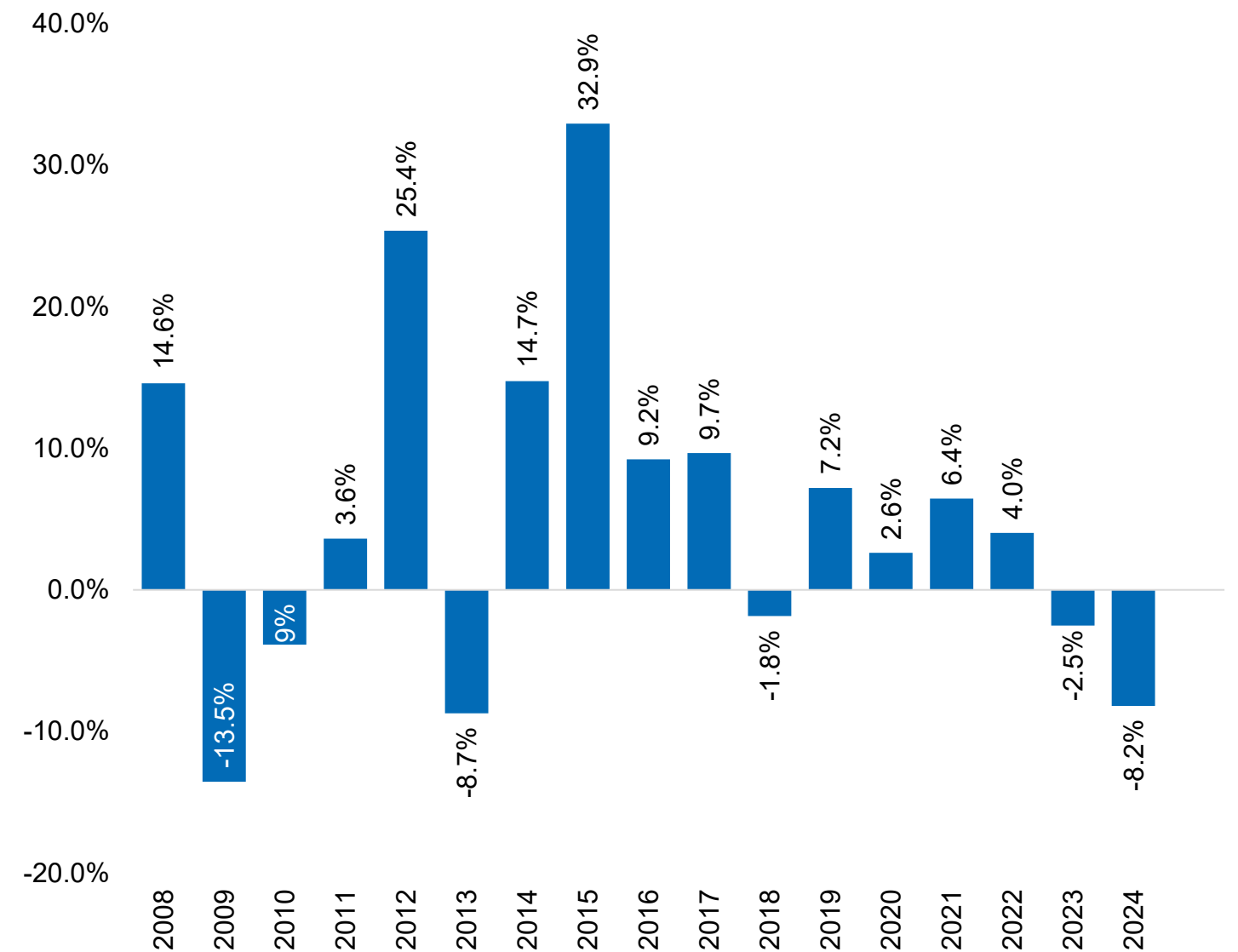
Rents Continue Downward in Response to Increase Space and Faltering Demand

Overall office asking rates at the start 2024 measured \$7.55/SF, decreasing consecutively since the second quarter of 2023. The asking rents for the first quarter of 2024 show an 8.2% decrease in asking rates year-over-year, a direct reaction to the consistent amount of space being shed by tech companies and other major firms. As supply continues its rise since 2019, continue to expect rents to react and fall in line with a diminished demand.

Office Average Asking Rent, \$/SF, FS



Year-over-Year Asking Rent Growth Rate

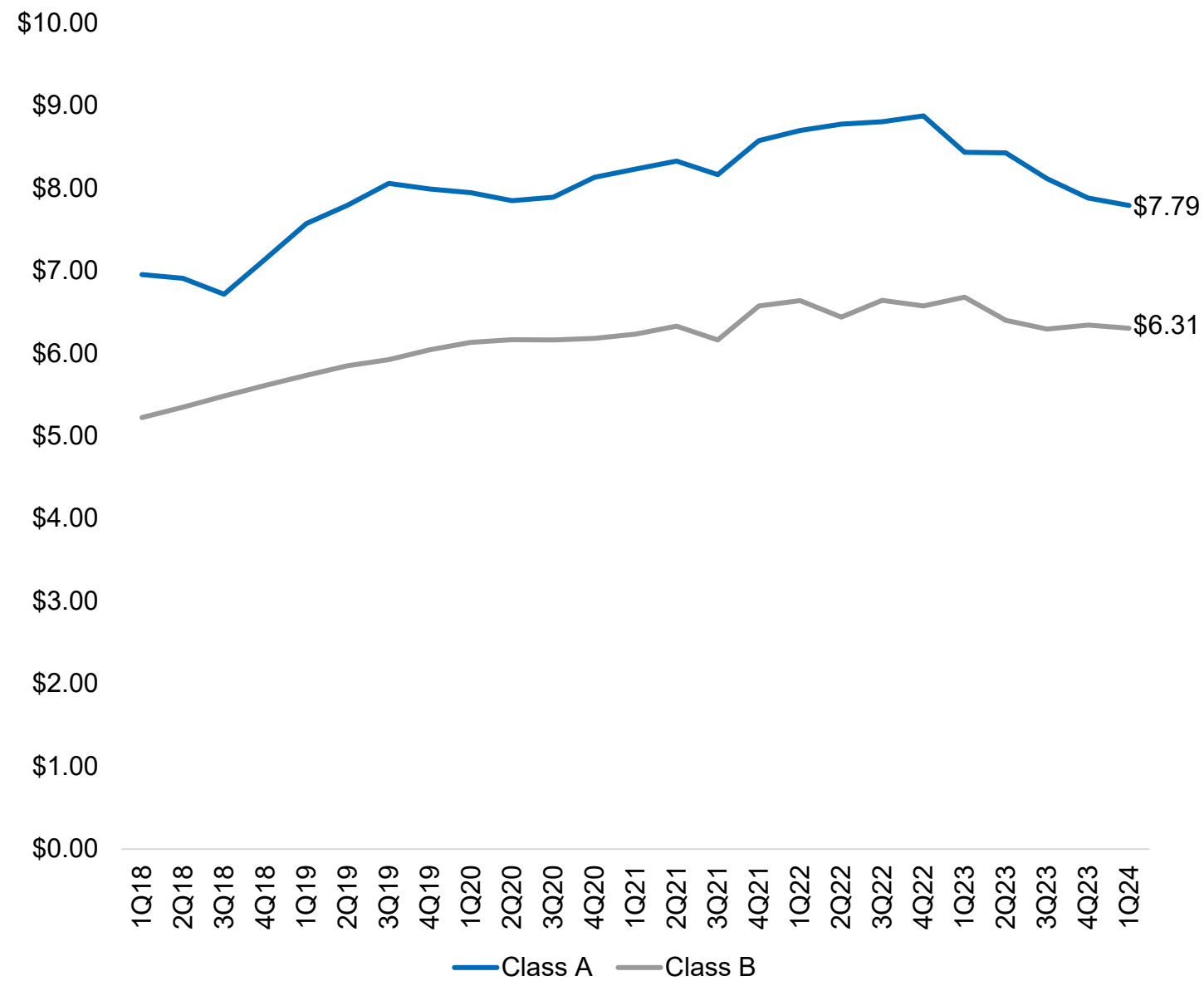


Source: Newmark Research, CoStar

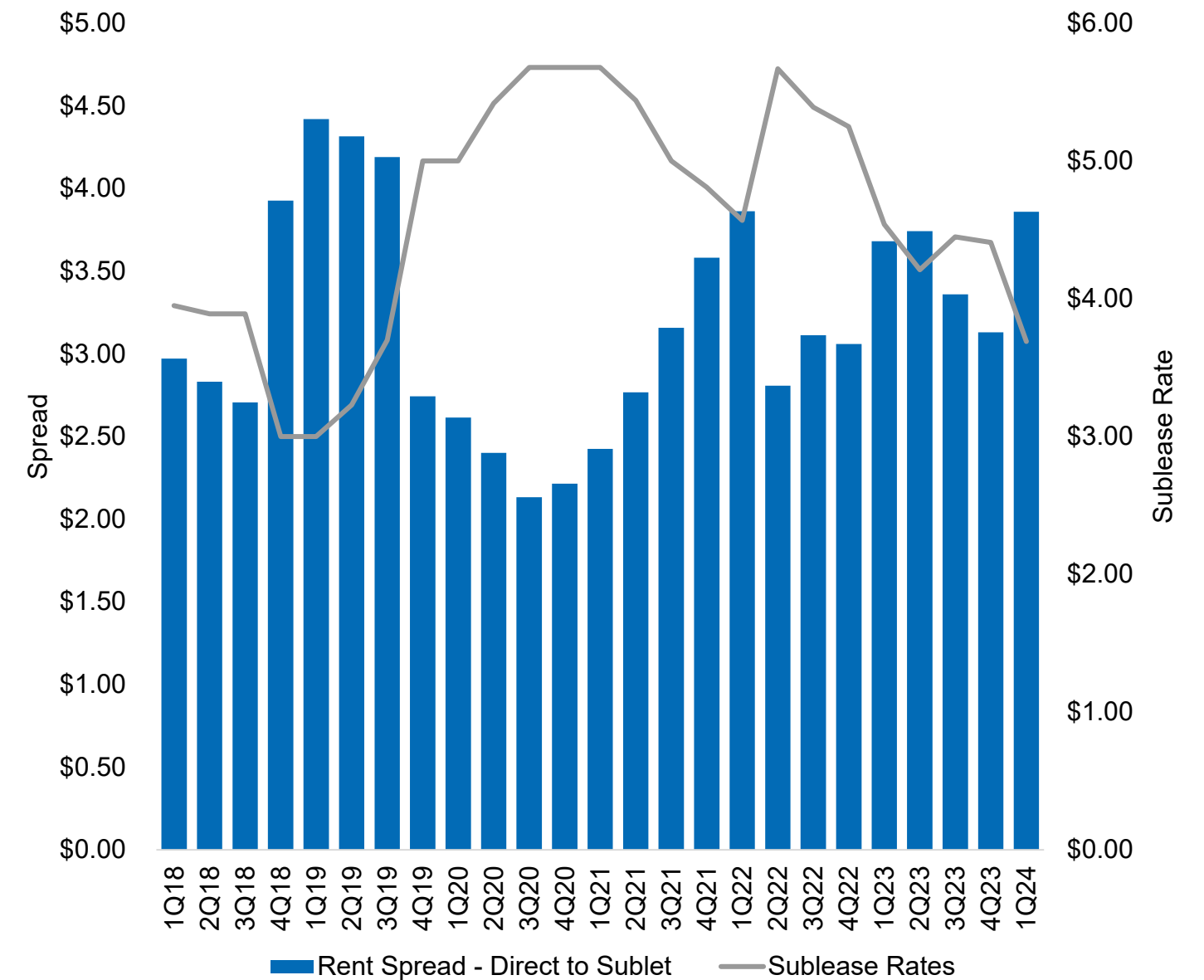
Asking Rents across All Office Classes Respond to High Vacancy Rates

For the third consecutive quarter, asking rents have decreased in the first quarter of 2024, affected heavily by the increase in office vacancies. Overall rents for both Class A and B space have decreased, as landlords across the market respond to a decreased demand for office space. The spread between direct and sublease space is \$3.86/SF, a 10.9% increase quarter-over-quarter as both direct and sublease space compete to find tenancy. Future rent adjustments are likely to continue as the economy recovers.

Class A and Class B Asking Rents, \$/SF, FS



Sublease Rates



Source: Newmark Research, CoStar

Leasing Activity Continues Upward Trend as Vacancy Spikes Subside

The first quarter of 2024 has a 15% uptick in gross absorption compared to the first quarter of 2023, totaling 699,393 SF. Submarkets in Palo Alto and Menlo Park showed the most leasing activity in the South Peninsula, while Redwood Shores also displayed a historical uptick in leasing activity, closing out the quarter with 107,885 SF of gross absorption, the highest square footage of leasing activity in the submarket since the second quarter of 2020.

Notable 1Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Poshmark	203 Redwood Shores Parkway	Redwood Shores	Lease Renewal	50,327
<i>Renewal. Directly leased in the fourth quarter of 2018, Poshmark extended their lease on the 7th & 8th floors of the building totaling 50,237 SF and gave back space on the 3rd floor.</i>				
Morgan Stanley	2725 Sand Hill Road	Menlo Park – Sand Hill Road	Lease Renewal	48,000
<i>Renewal. Morgan Stanley finalized a full building direct renewal after previously subleasing partial space in the building.</i>				
Coinbase, Inc.	391 San Antonio Road	Mountain View – El Camino Corridor	Sublease Extension	42,217
<i>Sublease Extension. Occupying the full 4th floor, Coinbase extended their short-term sublease from LinkedIn.</i>				
Augment Computing	395 Page Mill Road	Palo Alto – Stanford Research Park	Sublease	35,067
<i>Sublease. Augment Computing leased space on the first floor from sublessor Cloudera, and represents an AI company taking advantage of Class A availability within Stanford Research Park.</i>				
Character Technologies	68 Willow Road	Menlo Park - Middlefield	Sublease	27,500
<i>Sublease. Telecommunications company Character Technologies subleased the full building at 68 Willow Road through the sublease's expiration.</i>				

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Appendix





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