
1Q24

South Peninsula R&D 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.
- 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 took place in Mountain View, with Databricks leasing two buildings at 321 & 351 Evelyn Avenue for a total of ± 106,755 square feet. This deal represents a significant expansion by a tech company in the South Peninsula, which signals optimism for the local economy.
- Life science saw an infusion of availability this quarter, with Genomic Health vacating their ± 47,186 square foot space at 101 Galveston Drive in Redwood City, the completion of market-ready work at Palo Alto Labs at 1804 Embarcadero Road in Palo Alto added ±34,000 square feet of new lab space, and finally the completion of 3150 Bay Road in Redwood City, which added ± 31,170 square feet of newly converted life science space to the market.

Leasing Market Fundamentals

- Net absorption in the first quarter of 2024 was relatively flat, posting just ± 10,077 square feet of quarter of occupancy losses, causing the vacancy rate to rise to 15.7%. Comparatively, this is a relatively quiet quarter following a year when 1.4 million square feet was vacated in the South Peninsula R&D market, causing vacancy to rise from 9.9% to 15.5% in a single year.
- The construction pipeline totals ±1.1 million square feet following the completion of 3150 Bay Road in Redwood City, a ±31,170 square foot life science conversion.
- Rents fell 3.2% quarter over quarter from \$5.28 to \$5.11 after holding at the same level for the previous three quarters. Although R&D space in the region has always commanded high rents owing to the presence of high-quality R&D space and life science users, that number could fall as market fundamentals soften.

Outlook

- The relatively flat start to 2024 after a year that saw negative 1.4 million square feet of net absorption could indicate that the worst is over; though occupiers and investors alike will approach deals with greater caution, with interest rates remaining stable there will likely be a rebound to offset prior occupancy losses.
- Given the large amount of life science space entering the market, it’s possible to see a softening of rents in that sector after years of sustained rent growth specifically catering to high-end and specialized users.
- As economic conditions improves, expansion opportunities for existing tenants will become more viable, as well as opportunities for new tenants to enter the highly competitive South Peninsula R&D submarket.

1. Economy
2. Leasing Market Fundamentals
3. Appendix

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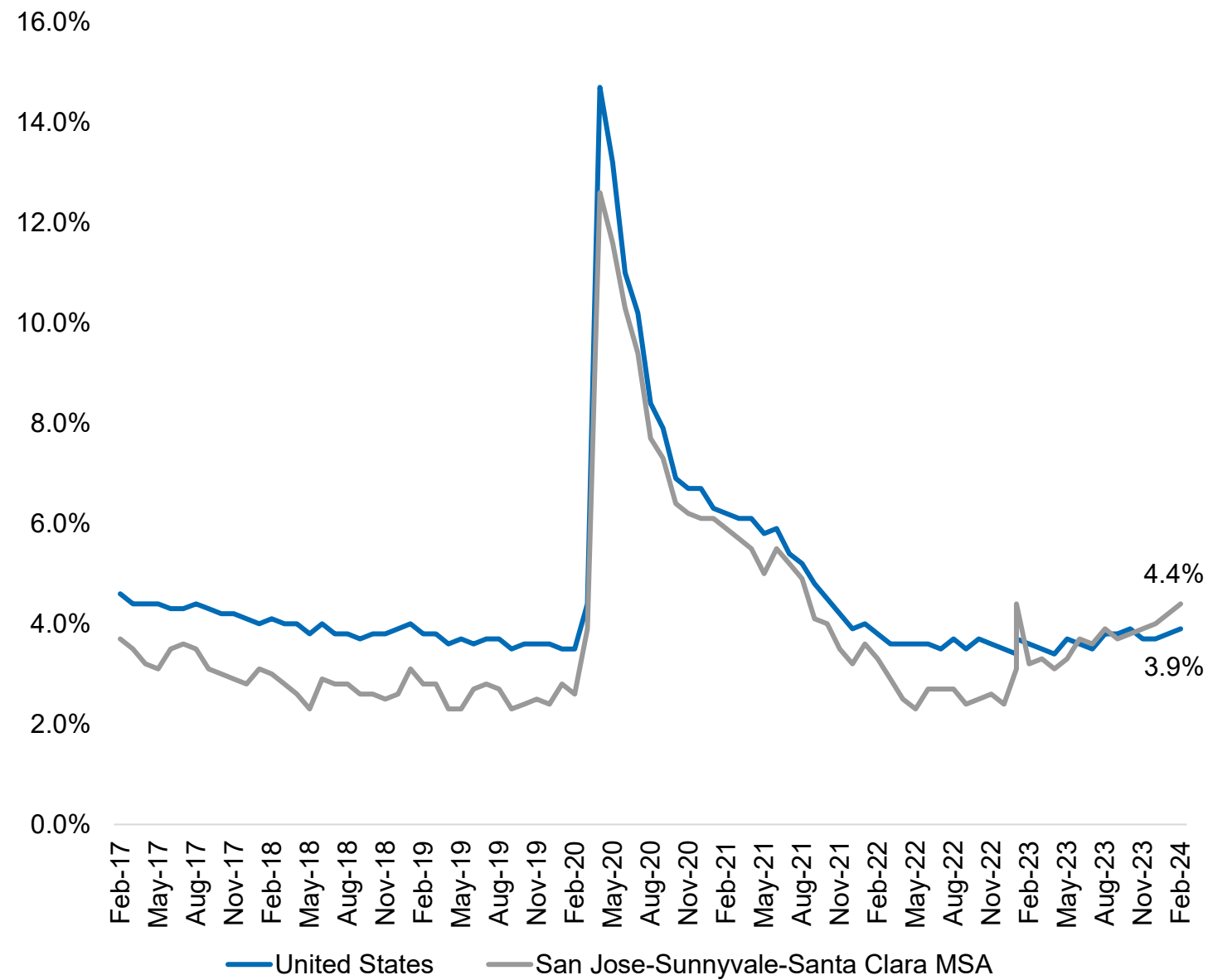
Economy



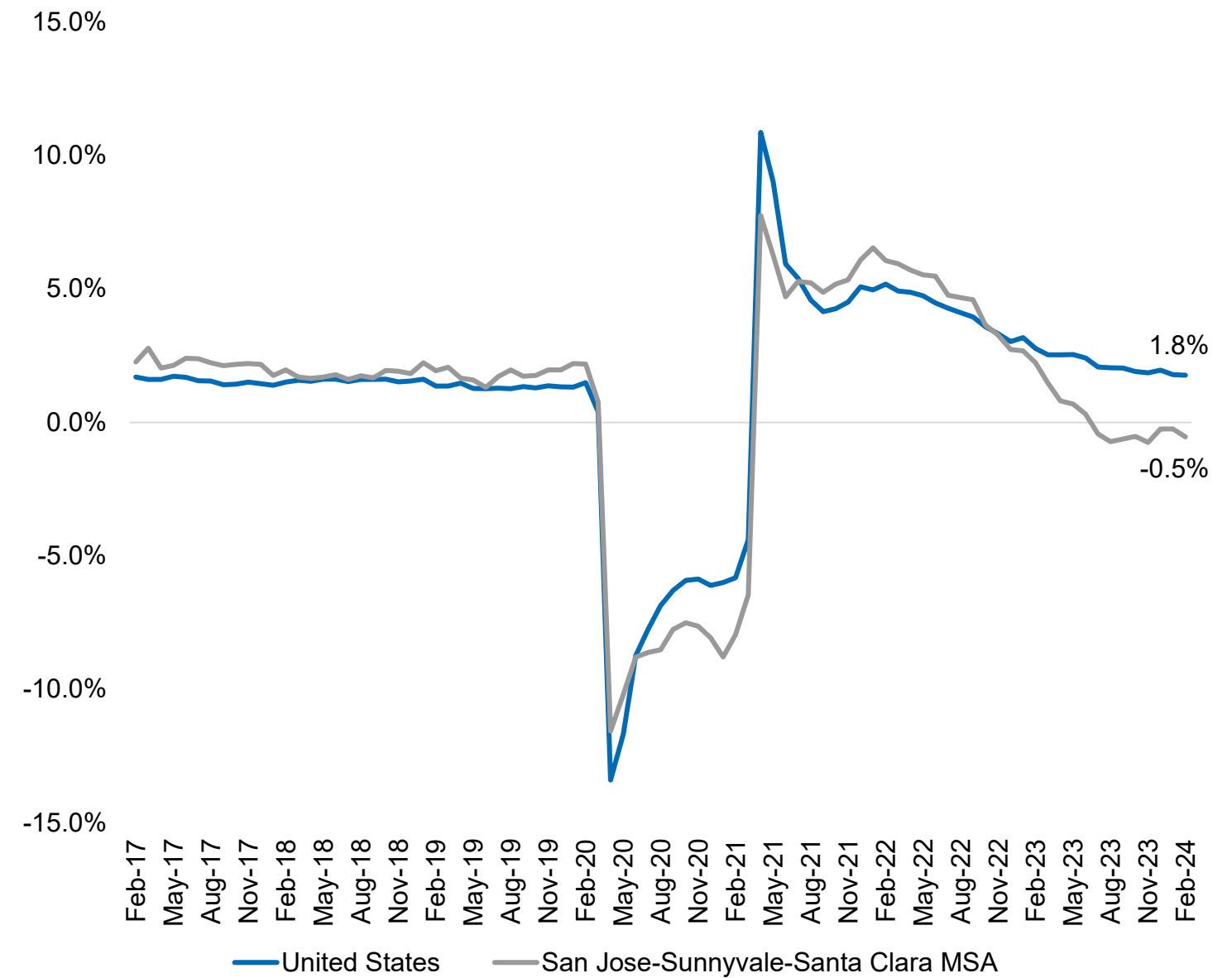
Overall Employment Falling Year-over-Year

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 since July 2023.

Unemployment Rate, Seasonally Adjusted



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



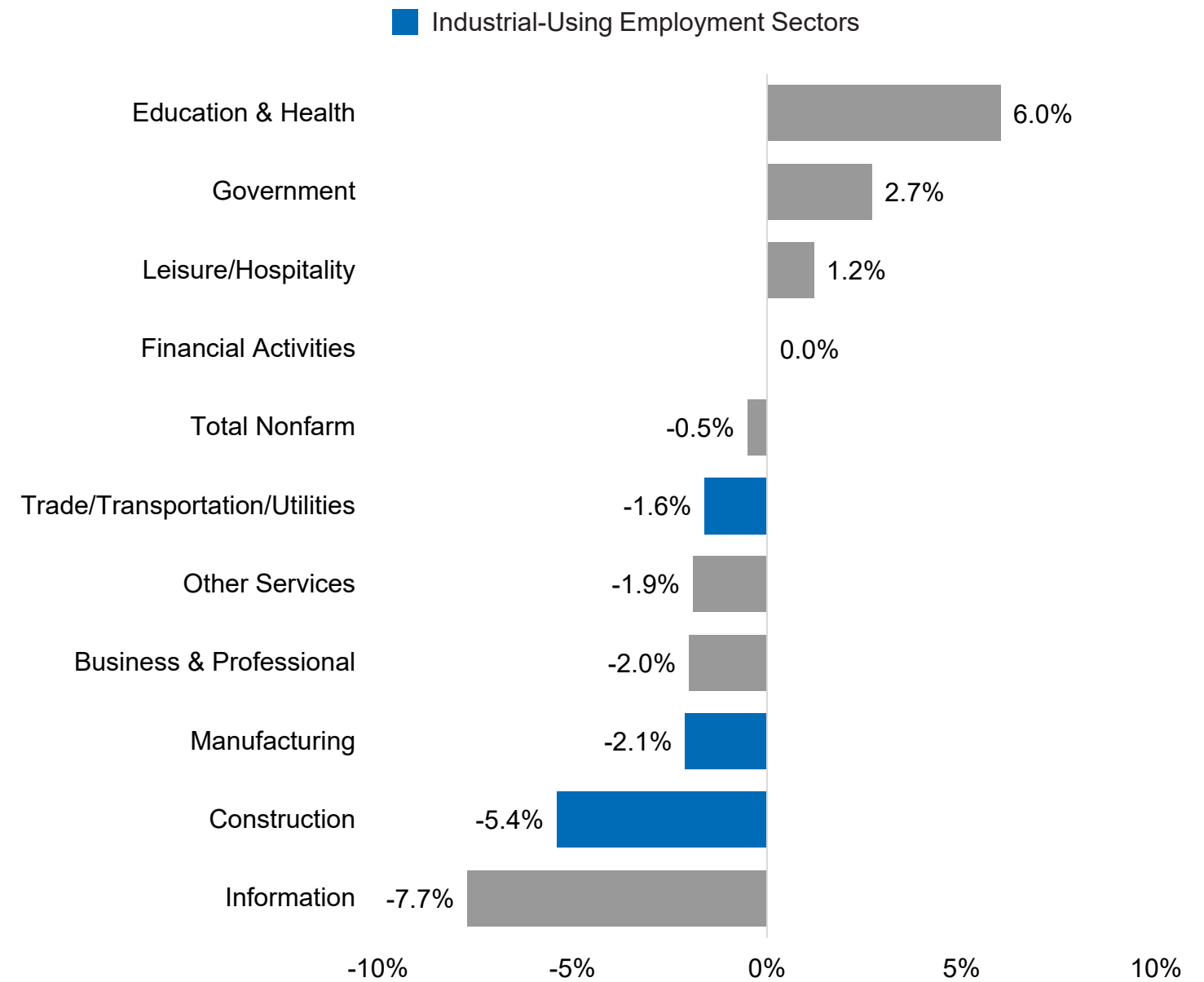
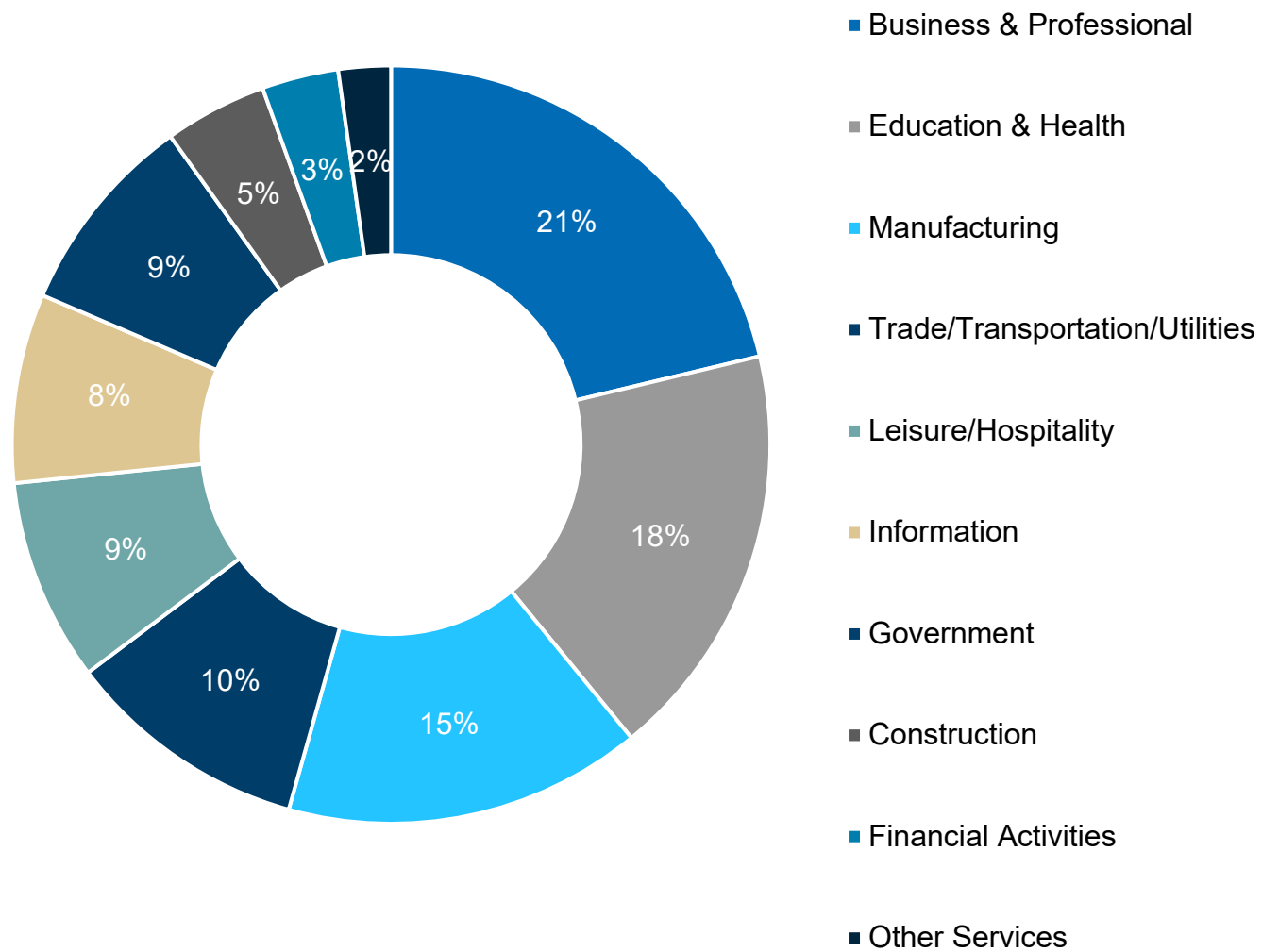
Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
 Note: February 2024 data is preliminary.

Industrial Growth Falters 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%. All three industrial-using employment sectors saw negative growth year-over-year, with the construction sector seeing total employment fall 5.4% compared to last year. This downward pressure is likely due to the tech sector pullback, which affects nearly all other industries in the region.

Employment by Industry, February 2024

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

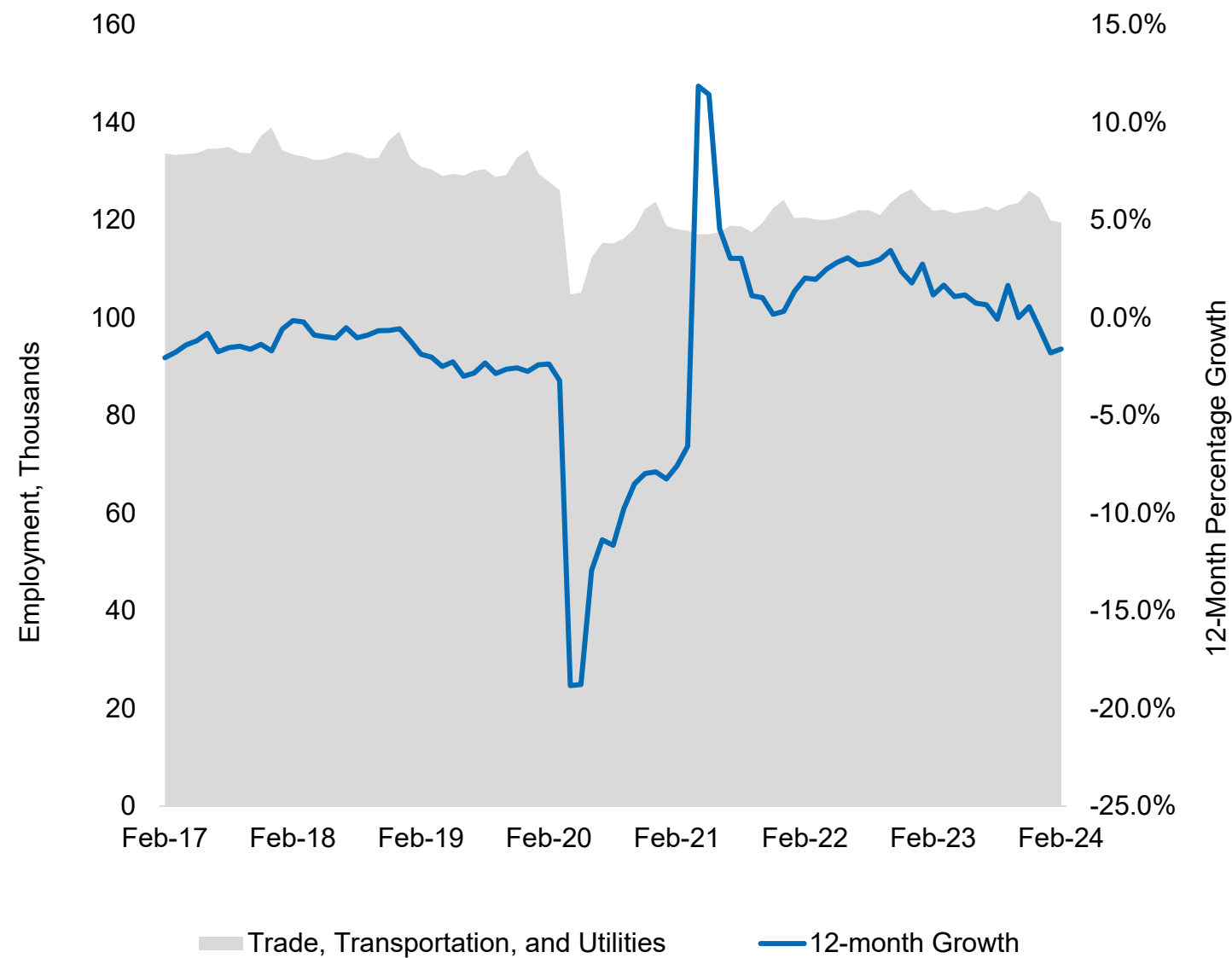


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale, layoffs.fyi
 Note: February 2024 data is preliminary.

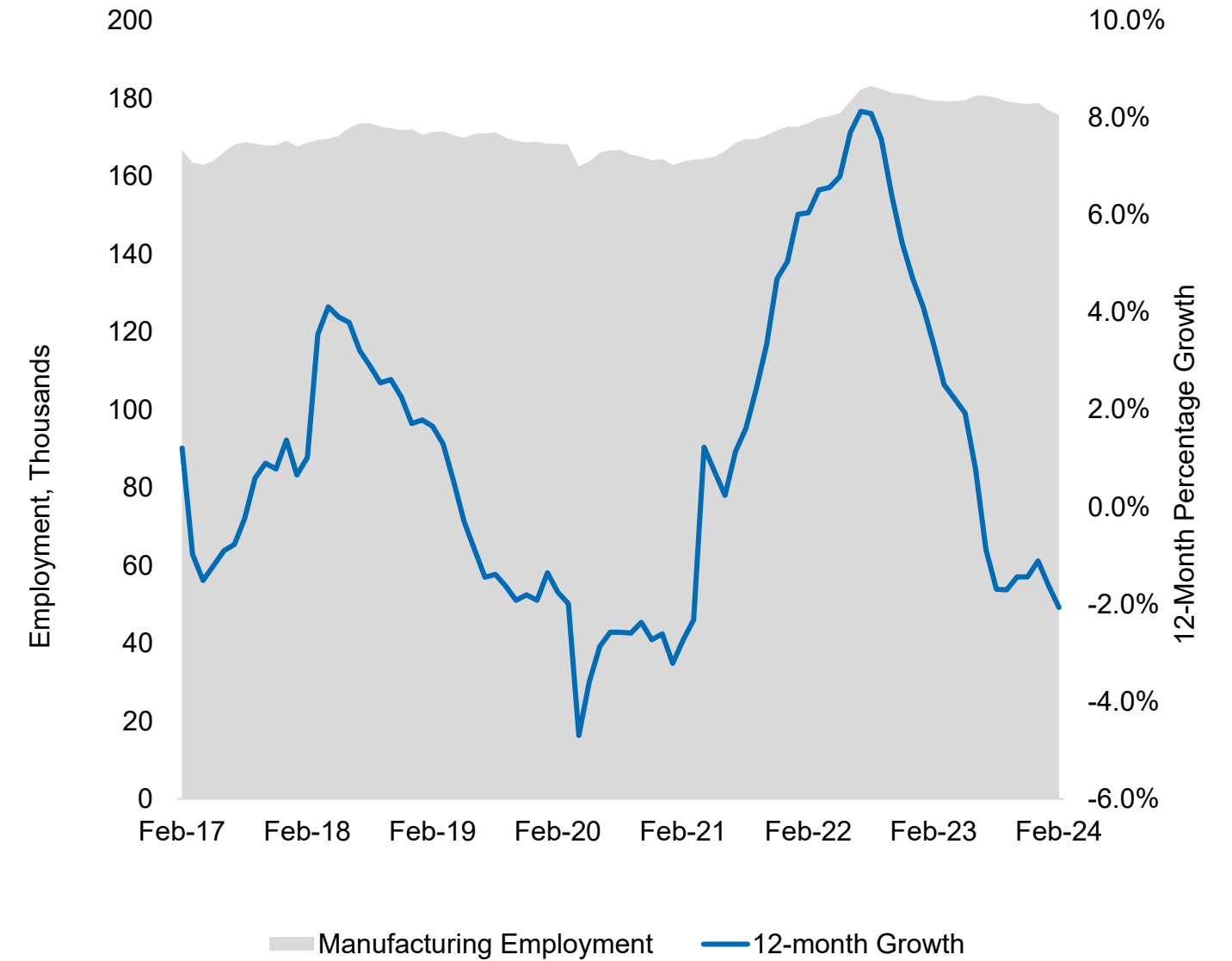
Trade, Manufacturing Sectors See Slight Correction in 2024

The trade/transportation/utilities sector saw a slight correction to start 2024 after holding firm throughout 2023. The manufacturing sector, which saw significant growth in 2022 and 2023 due to the AI boom, has also started to see corrections, posting a 2.1% decline in total employment year-over-year but overall at a higher level than it was in 2020. Both sectors' numbers can be seen as typical of a region that has persistent demand from the tech sector.

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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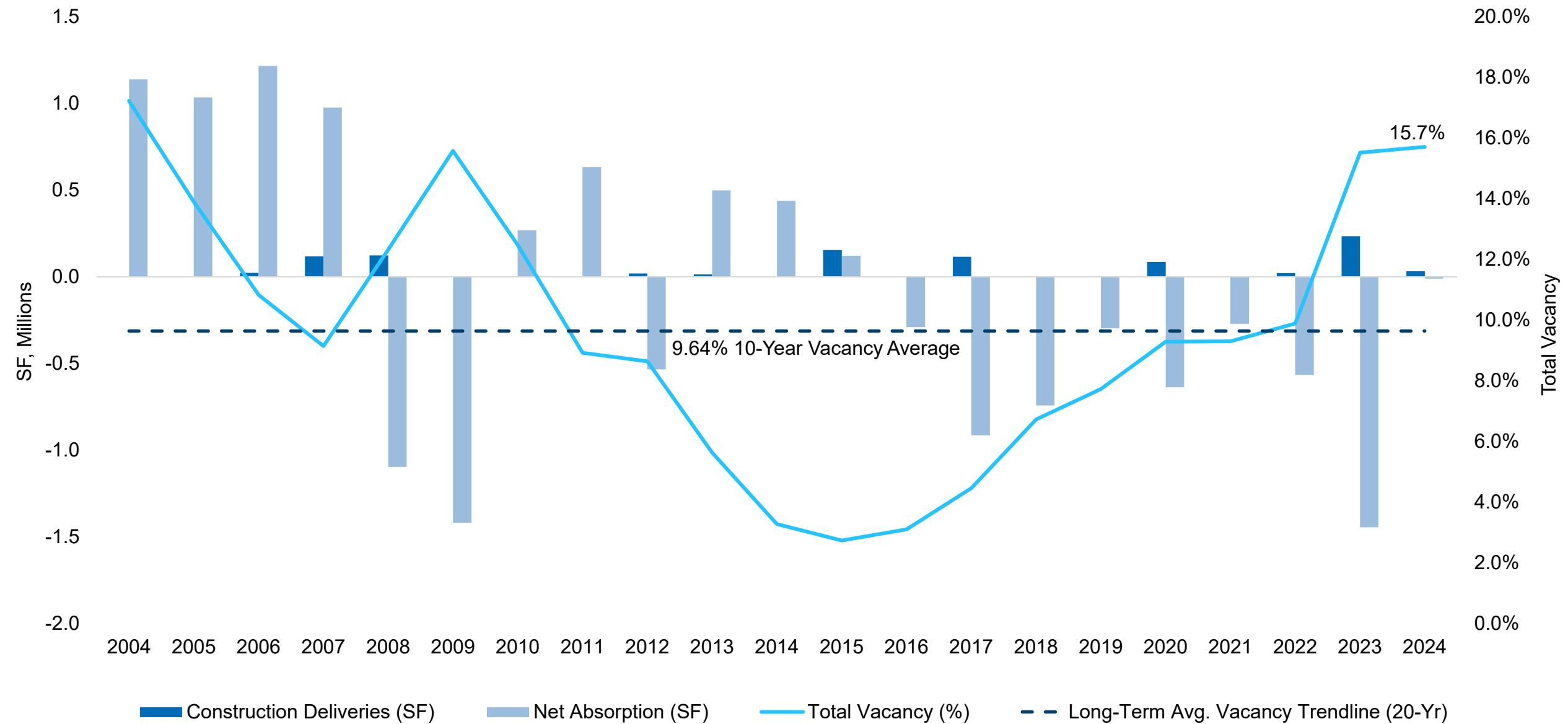
Leasing Market Fundamentals



Velocity of Increasing Vacancy Slows Starting 2024

Total vacancy for the first quarter of 2024 saw a two-basis point increase compared to the end of 2023. Net absorption for the quarter is measured at -10,077 SF, though still a negative value this is still above the average quarterly net absorption of -90,551 SF seen over the past 10 years. Vacancy also rose due to one project completion at 3170 Bay Road in Redwood City, adding 31,170 SF of vacant space to the market.

Historical Construction Deliveries, Net Absorption, and Vacancy

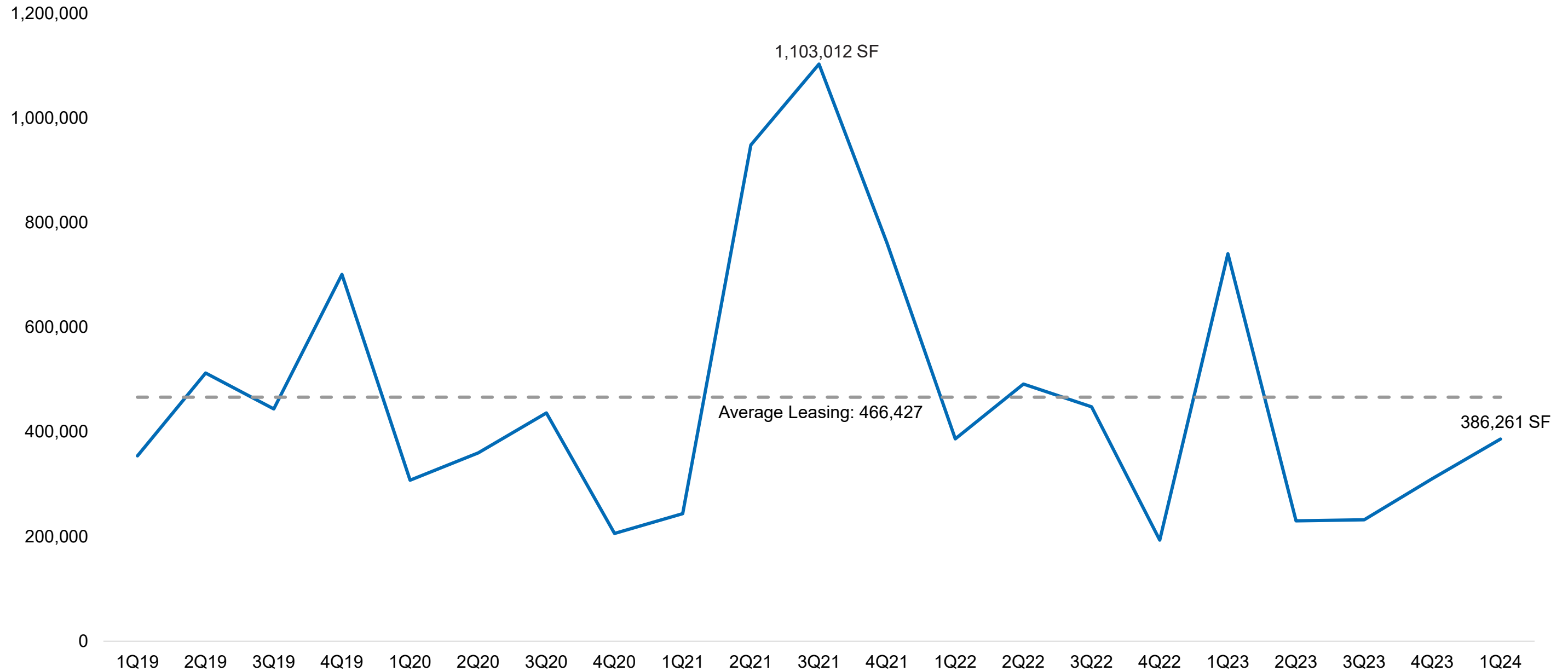


Source: Newmark Research

Leasing Activity Trends Toward Pre-Pandemic Average

Leasing activity continues its positive climb starting 2024 with gross absorption at 386,261 SF, growing 24% from the fourth quarter of 2023. Leasing activity has remained below the five-year quarterly average for four consecutive quarters, due to a simple lack of demand for R&D space currently as renewals by existing tenants contributed 42.3% of total square footage transacted in the first quarter of 2024. Leasing in the R&D sector will likely remain depressed until economic conditions improve.

Total Leasing Activity (SF)

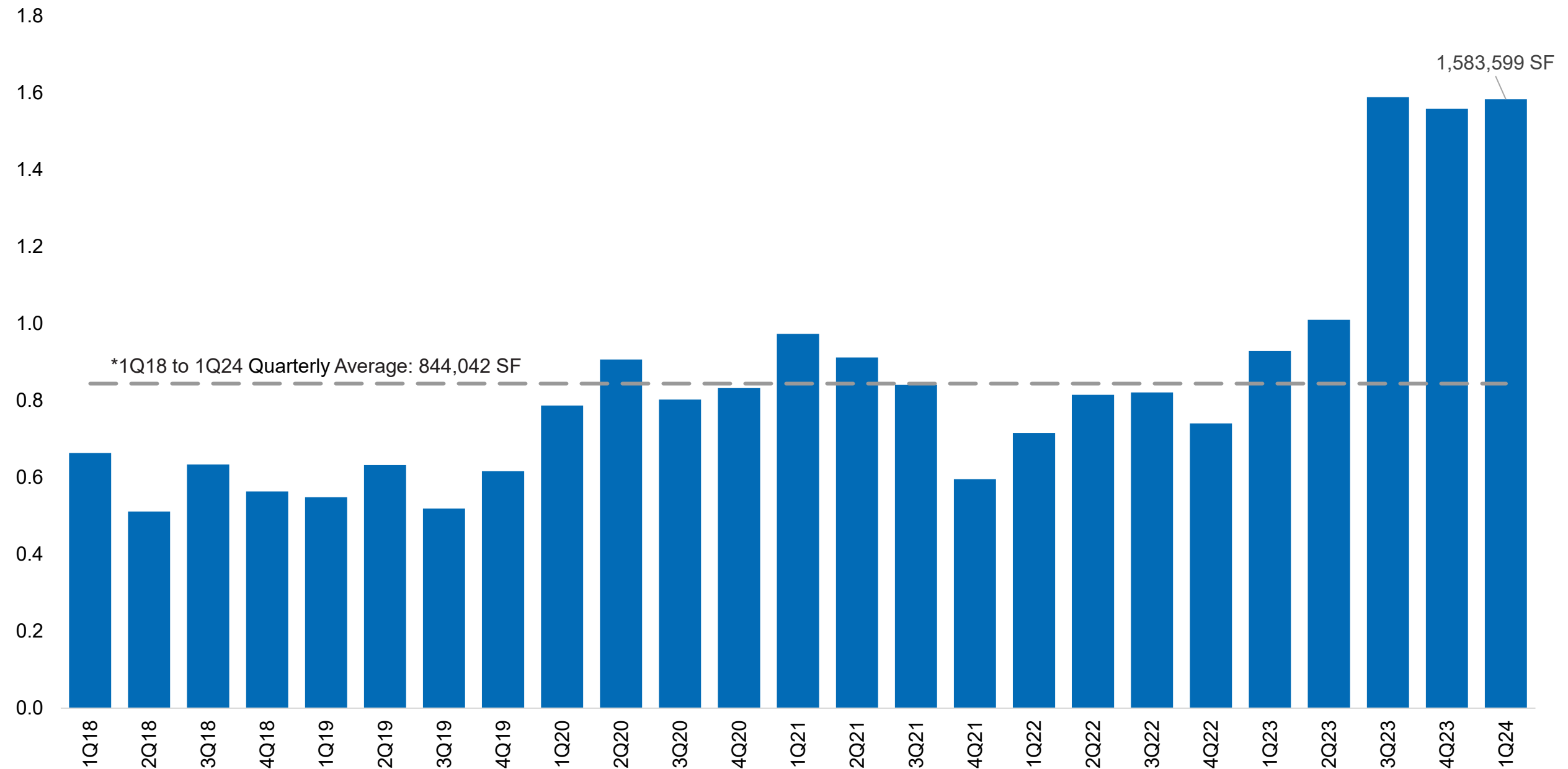


Source: Newmark Research, CoStar

R&D Sublease Vacancy Continues Upward Trend

Sublease space in the first quarter of 2024 remained at roughly the same level as the previous quarter increasing 1.6% from the fourth quarter of 2023, though year-over-year we see a 654,710 SF increase in sublease availability. 2023 saw a significant increase in sublease space due to large-block companies such as Google and Meta shedding their space, which alone contributes 631,810 SF to R&D sublease availability.

Available R&D Sublease Volume (msf)

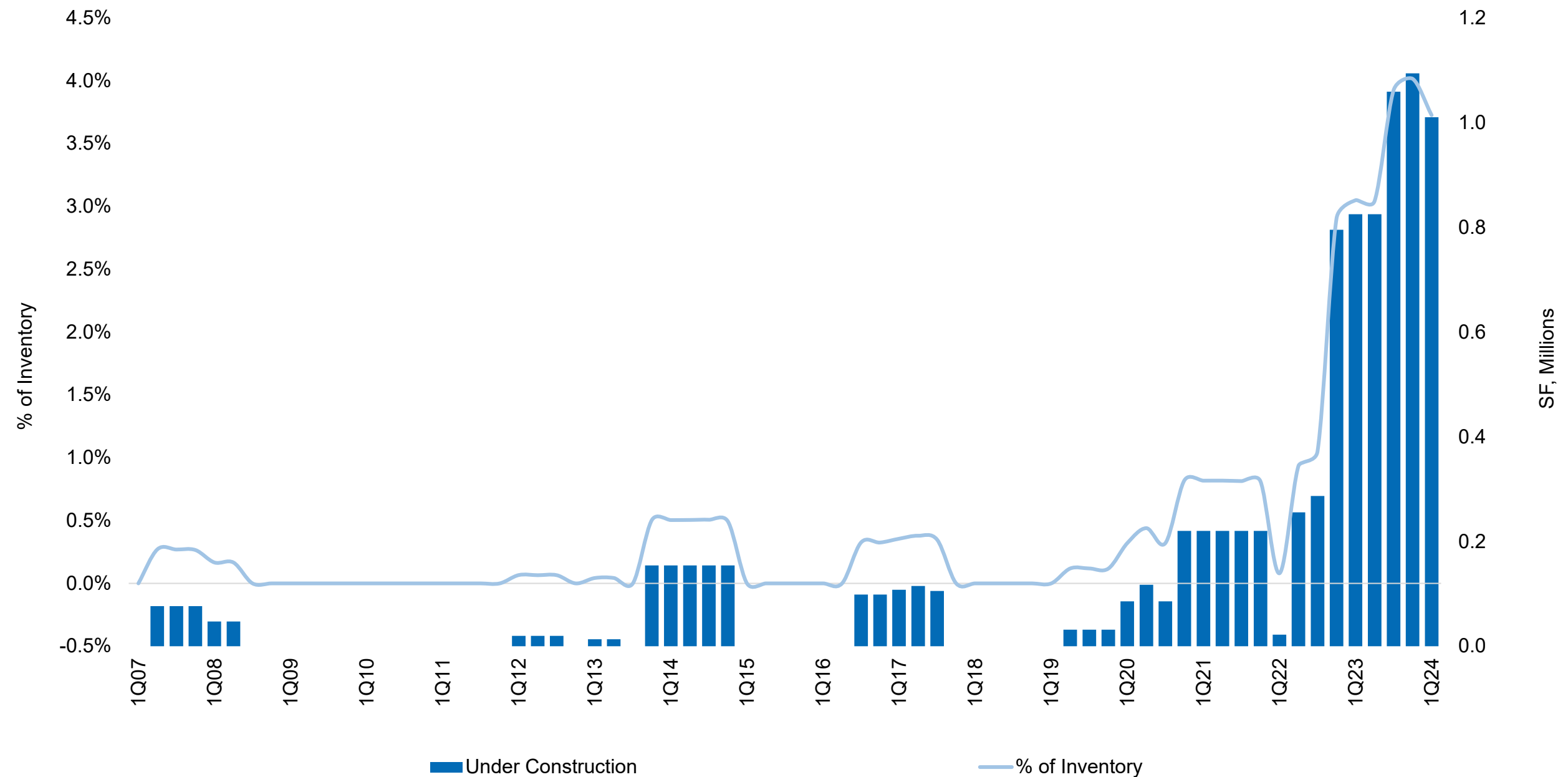


Source: Newmark Research, CoStar

R&D Construction Pipeline Decrease with First Quarter Delivery

The R&D construction pipeline saw a slight decrease in 2024 as no new projects broke ground, and a life science conversion project was completed, totaling 31,370 SF at 3150 Bay Road in Redwood City. The largest R&D development in the pipeline is Elco Yards in Downtown Redwood City with a project size of 530,000 SF. Despite some tenant pullback in the region, developer interest remains strong as developers hope to capture life science tenants in the region.

Industrial Under Construction and % of Inventory

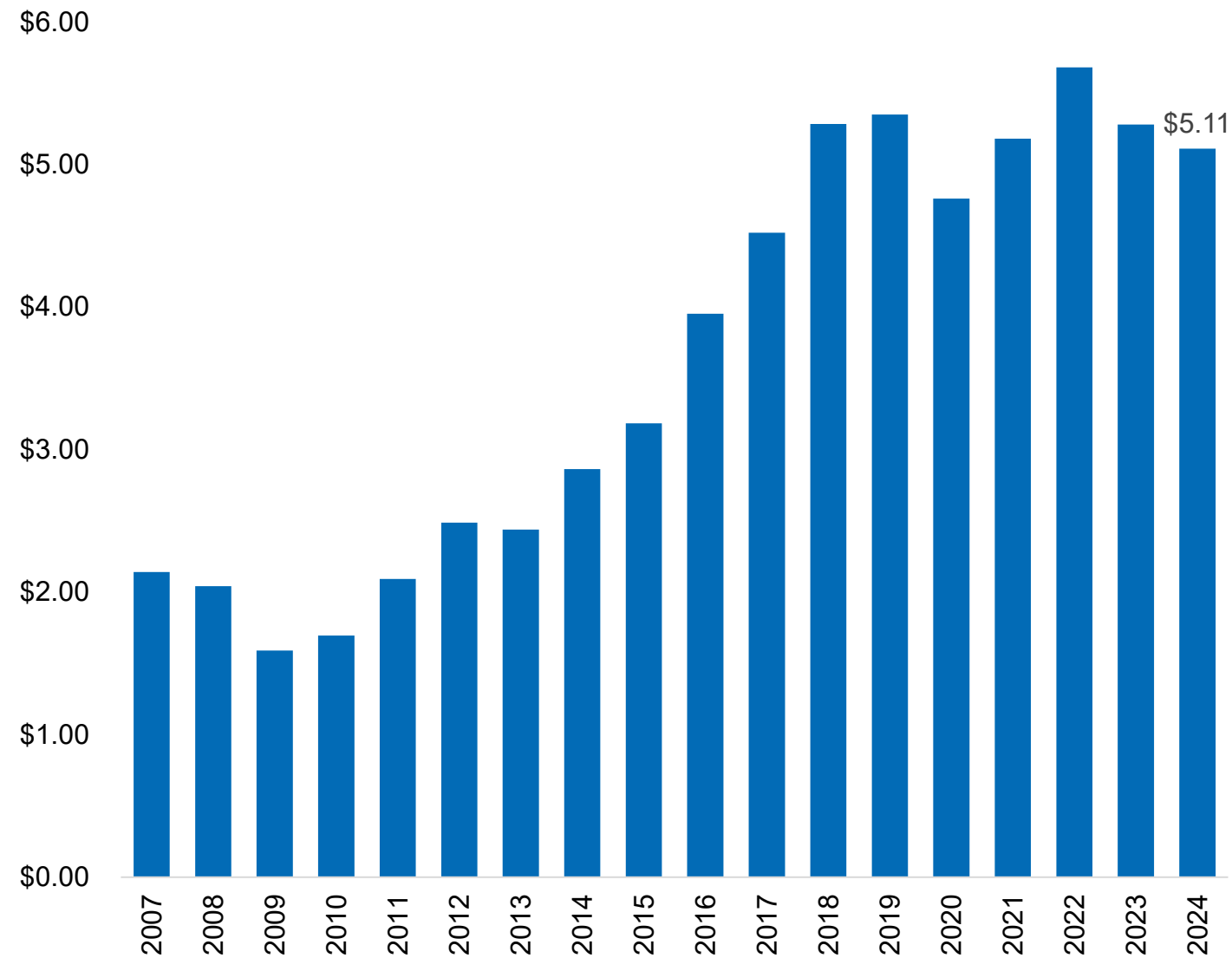


Source: Newmark Research, CoStar

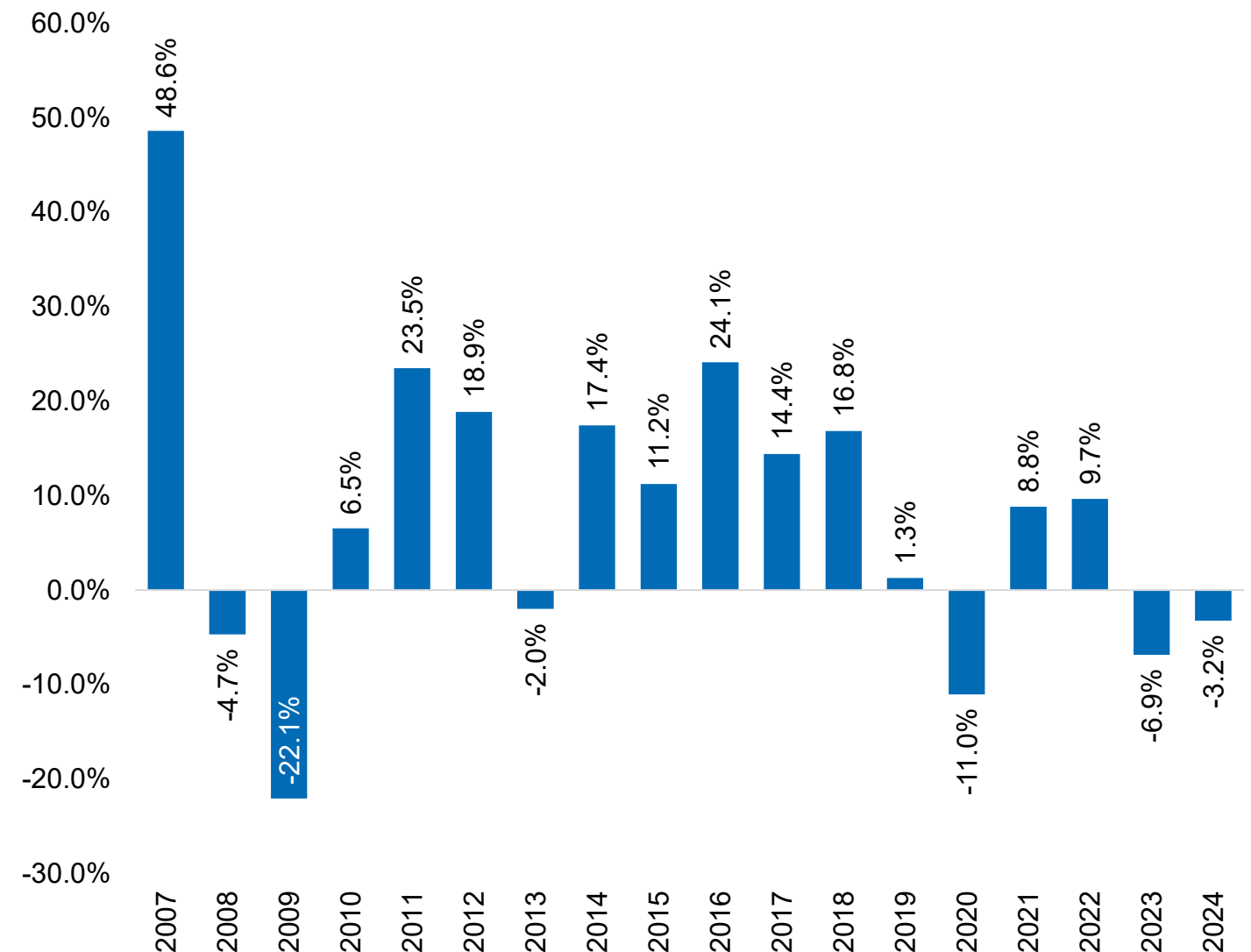
R&D Rents Continue to Decline

R&D asking rents for the first quarter are \$5.11/SF, the sixth consecutive quarter of declining asking rents from a peak of \$5.82/SF in the third quarter of 2022. This trend of falling rents can be attributed to increasing amounts of space added to the market quarter-over-quarter, as sublease space contributes 37.16% of total availability. With a -3.2% change in asking rent quarter-over-quarter, we expect the trend to continue as supply continues to rise.

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



Year-over-Year Asking Rent Growth Rate % Change



Source: Newmark Research



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Appendix / Tables





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