

3Q23

Silicon Valley Office Market Overview



NEWMARK

Market Observations

Economy

- The region’s labor market has begun to show cracks, with unemployment rising to 3.9% compared with 3.8% nationally. August’s 3.9% unemployment rate remained lower than the 4.3% 10-year historical average.
- Year over year, job gains have been most pronounced in the leisure/hospitality industry, which is still making up for lost ground during the pandemic. Leisure/hospitality led all sectors in job gains during the past 12 months and has done so in the past two quarters.
- Office-using employment fell slightly this quarter, with financial and business & professional sectors seeing negative growth year over year. Civilian labor force numbers remain mostly stable, with 0.4% growth year over year.

Major Transactions

- As with the previous quarter, large block sublease space continued to push vacancy higher, with Roku putting $\pm 350,000$ SF on the sublease market, half of which is vacant.
- Although the tech sector has been mostly quiet in 2023, the largest deal this quarter was a $\pm 80,000$ SF lease extension from Sony at 1730 North First Street in San Jose, followed by a $\pm 30,000$ SF new lease by Workday in Santa Clara.
- The recent completion of 200 Park Avenue adds $\pm 965,000$ SF of Class A New Shell to the Downtown San Jose submarket, causing vacancy to increase from 20.7% to 27.9% quarter over quarter.

Leasing Market Fundamentals

- Absorption in the third quarter of 2023 totaled negative -677,481 SF. This is the sixth consecutive quarter of negative absorption, during which time the vacancy rate has risen to 19.4%. Sublease space continues to push this figure higher, with large block space entering the market in the San Jose and Sunnyvale submarkets. Year to date, there has been 1.8 million SF of net occupancy losses.
- The construction pipeline fell to 3.0 million SF this quarter, owing to the completion of 200 Park as well as Boston Properties’ Platform 16 project being put on hold.
- Sublease space in the Valley has risen greatly in recent years, reaching 6.0 million SF this quarter – a 219% increase since its lowest point in Q1 2020. This in turn has put downward pressure on rents, which have increased just 0.8% year over year to \$5.01/SF.

Outlook

- Rising interest rates and the accompanying investment pullback has caused uncertainty among occupiers that is unlikely to abate in the immediate future.
- Despite the hope for an “AI boom”, vacancy is still increasing throughout the Valley. With many tech tenants putting a pause on their leasing strategy, it’s likely that vacancy will continue to rise in coming quarters.
- After a small bump in 2022 when economic optimism was high, rents have mostly stabilized with many landlords refusing to budge on rents. Investor interest in the region has similarly paused due to ongoing economic uncertainty, though buildings with credit tenants will always remain a popular option.

1. Economy
2. Leasing Market Fundamentals
3. Appendix

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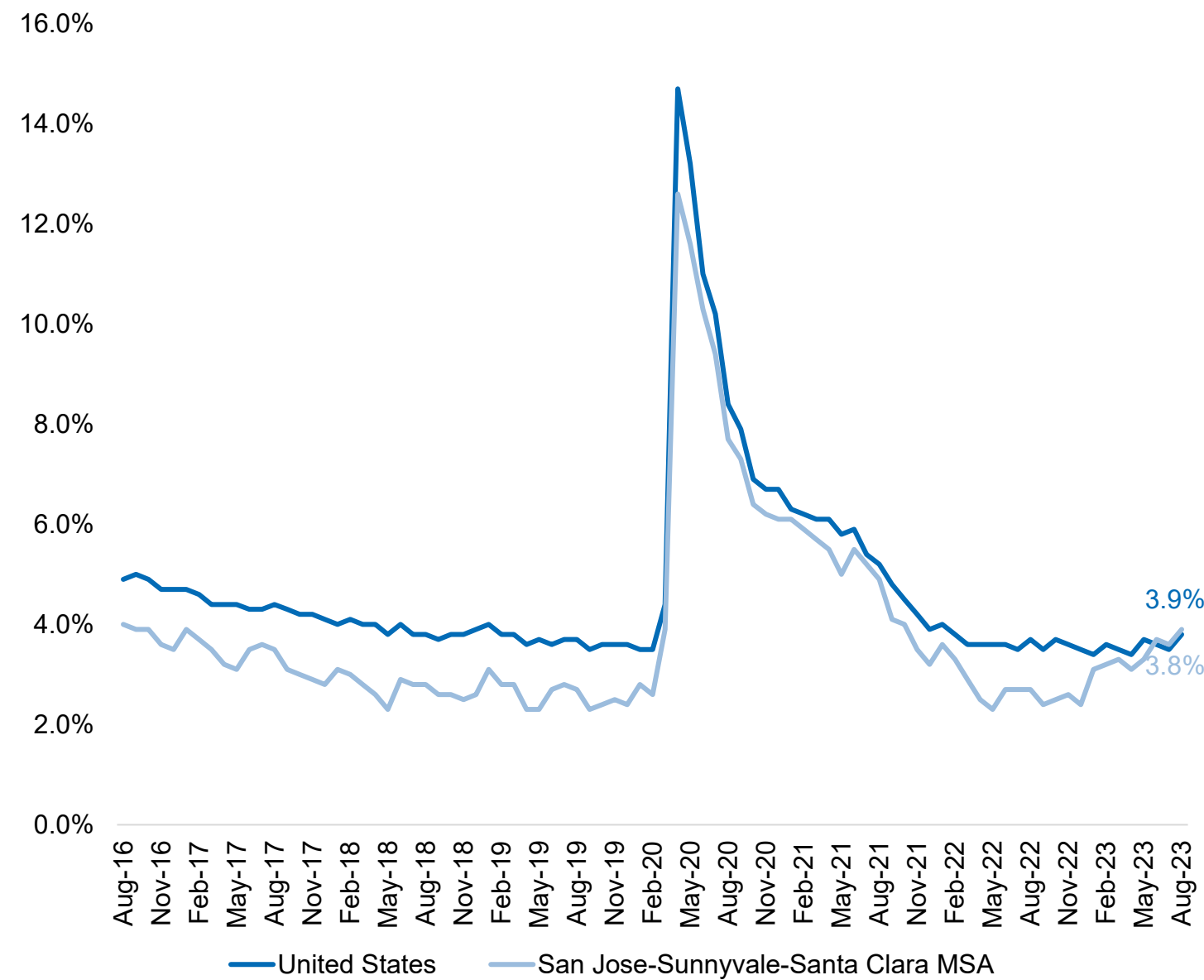
Economy



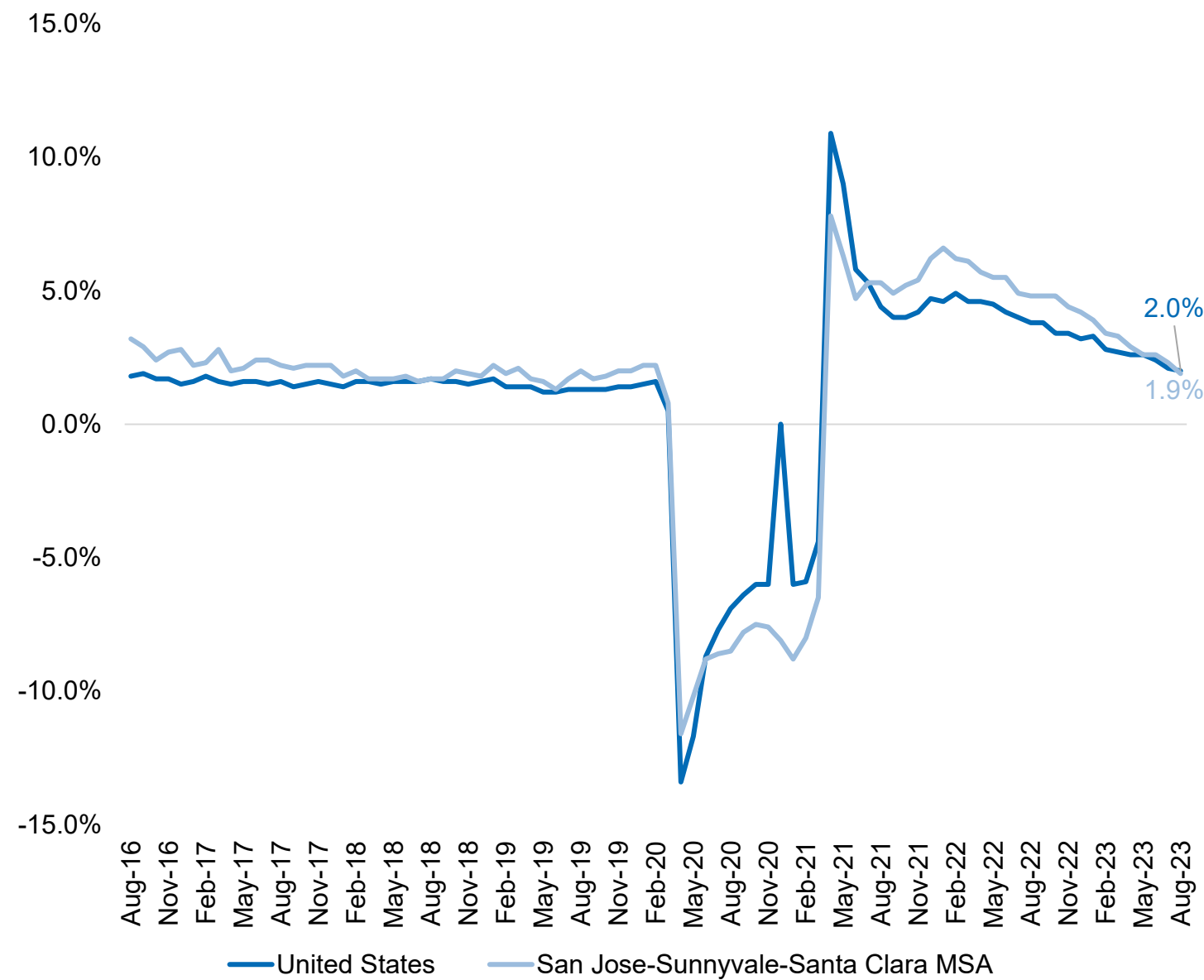
Metro Employment Trends Indicate a Slower Recovery Compared Nationally

The San Jose-Sunnyvale-Santa Clara MSA's overall unemployment rate rose for the second time in two quarters and is trending above the national average, indicating a slower recovery compared with the rest of the country as the impact of tech sector labor reductions has yet to be fully realized.

Unemployment Rate, Seasonally Adjusted



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



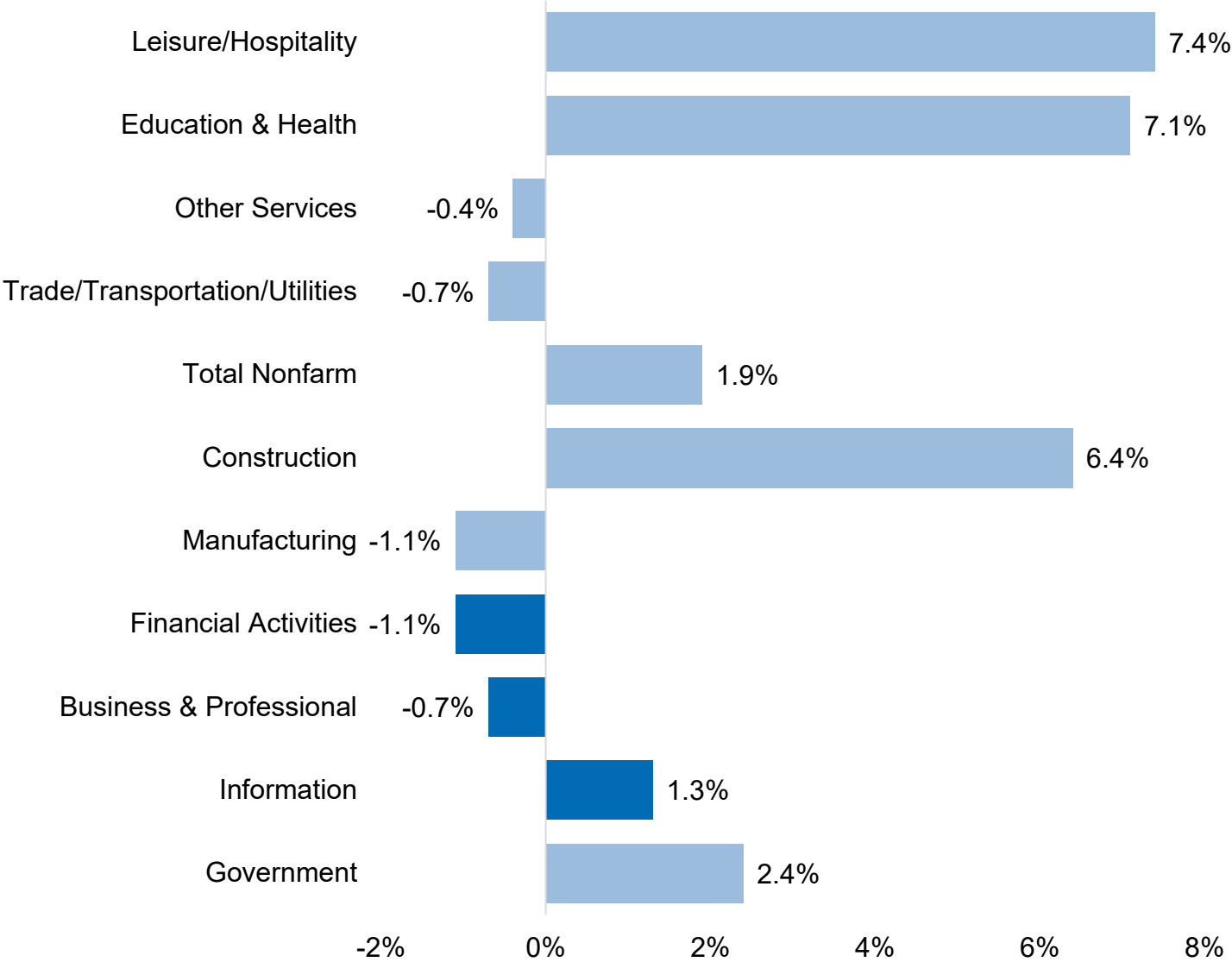
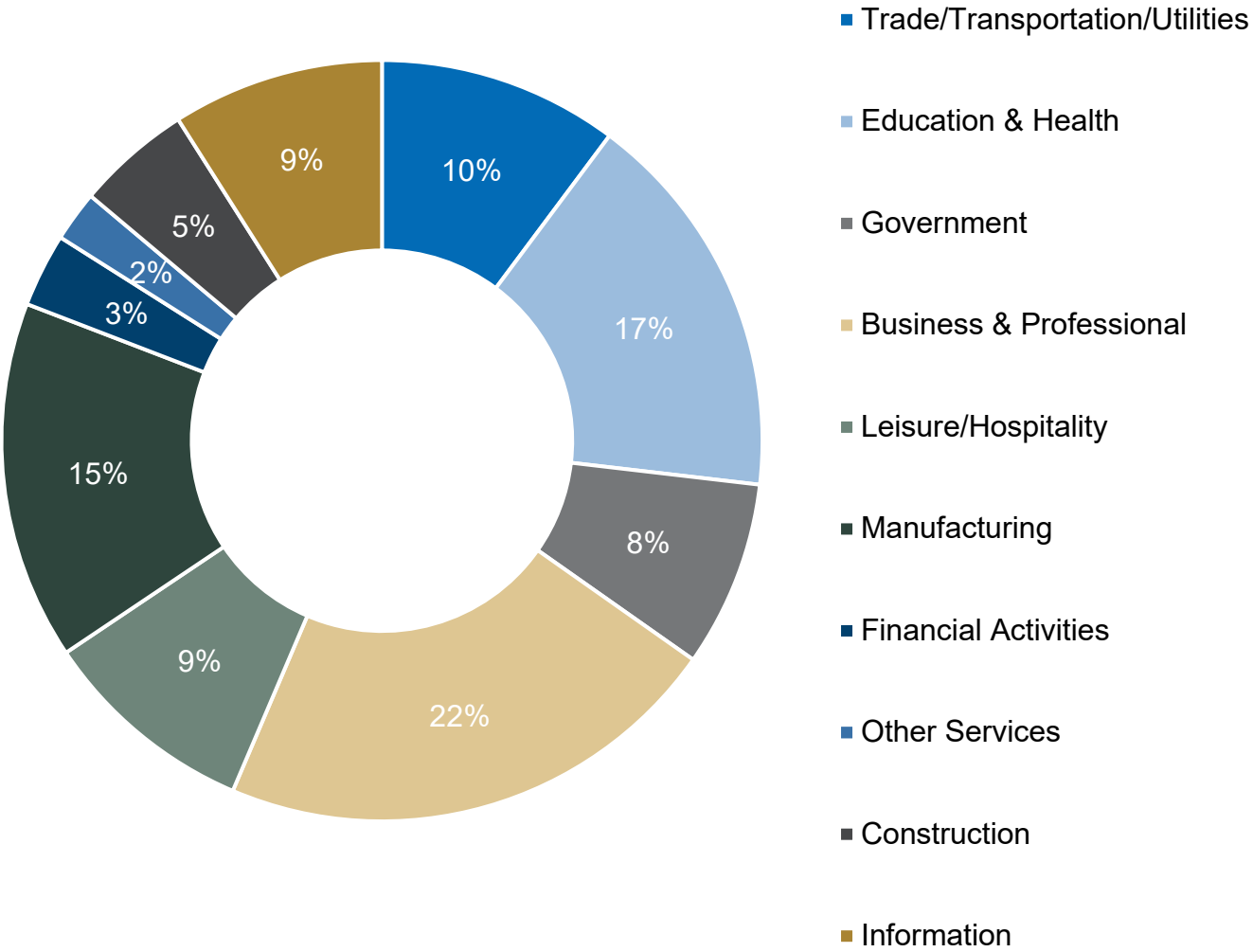
Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
Note: August 2023 data is preliminary.

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 Manufacturing and Financial Services sector hit the hardest. The leisure/hospitality sector continued to lead all industries in annual job growth, as expected of an industry hit hardest by the pandemic. Although the construction sector jobs also saw significant growth, this is likely not due to commercial real estate projects, many of which were put on hold in 2023.

Employment by Industry, August 2023

Employment Growth by Industry, 12-Month % Change, August 2023

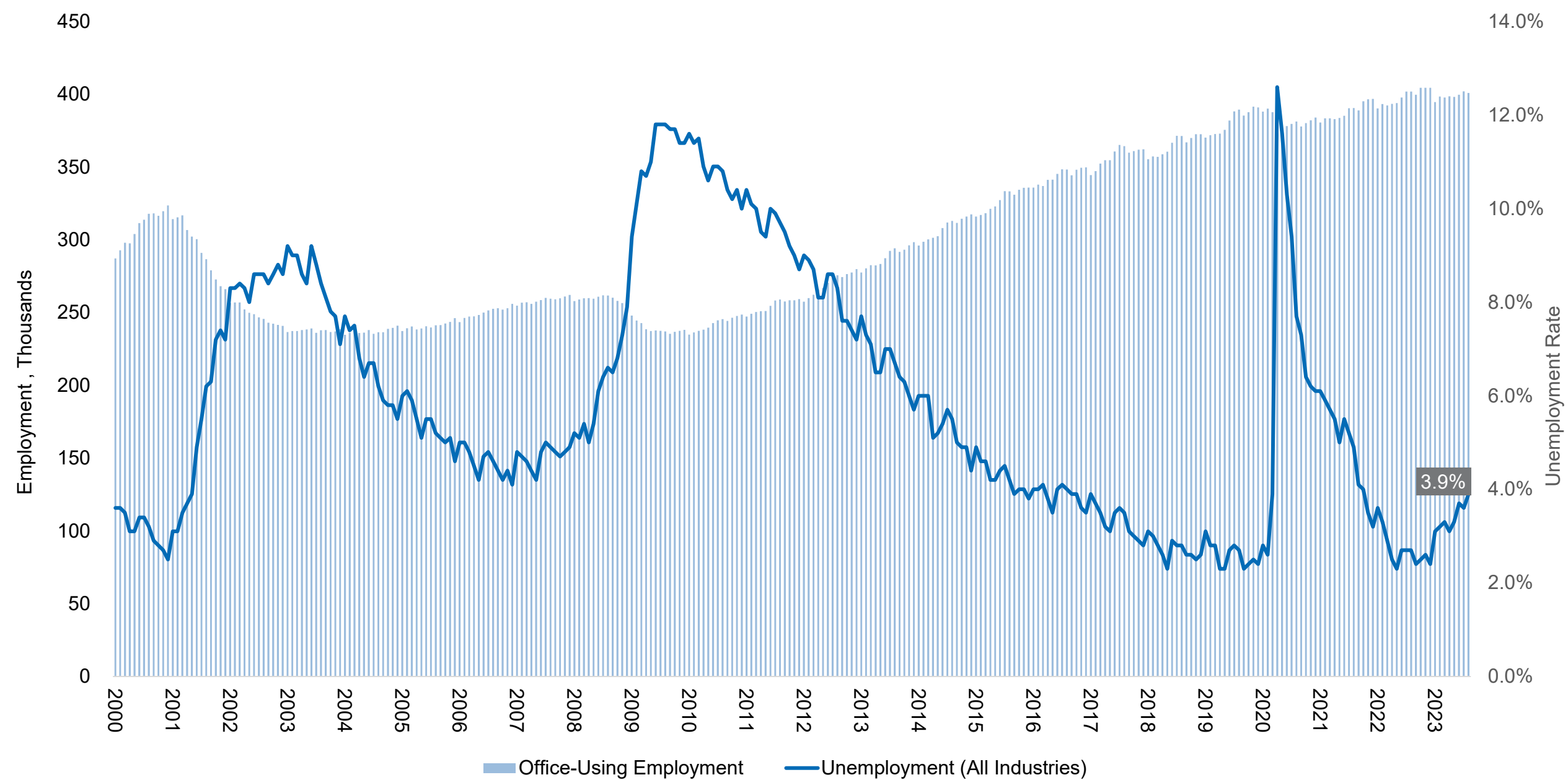


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
Note: August 2023 data is preliminary.

Overall Office-Using Employment Falling

Following an impressive rebound back to pre-pandemic levels, office-using employment rose this quarter up to 3.9%, slightly above the national average. This bump in the unemployment rate can be attributed to tech sector pullbacks as well as cost cutting in the financial sector in the face of economic uncertainty. With no further news of additional layoffs, this number is expected to hover around the same level as the economy stabilizes.

Office-Using Employment* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
Note: August 2023 data is preliminary.
*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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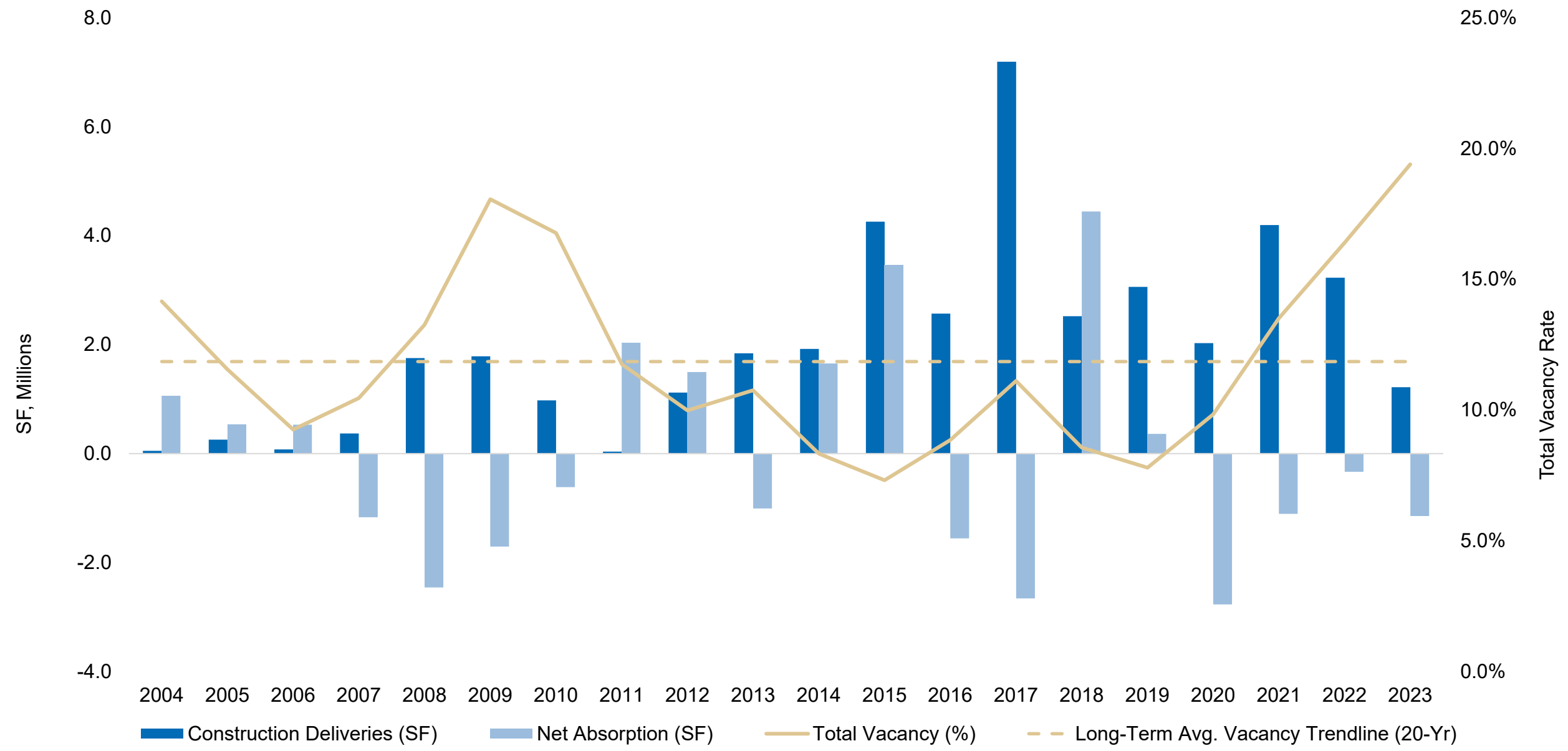
Leasing Market Fundamentals



Vacancy Rises as Construction Deliveries Outpace Net Absorption

The vacancy rate increased to 19.4% in the third quarter of 2023, up from 17.8% in the previous quarter. The delivery of 200 Park Avenue in San Jose, as well as several large sublease spaces, is the biggest contributor to this increase, however, vacancy is expected to climb even further as the economy remains sluggish. The current level of vacancy is significantly higher than the long-term average of 11.9%.

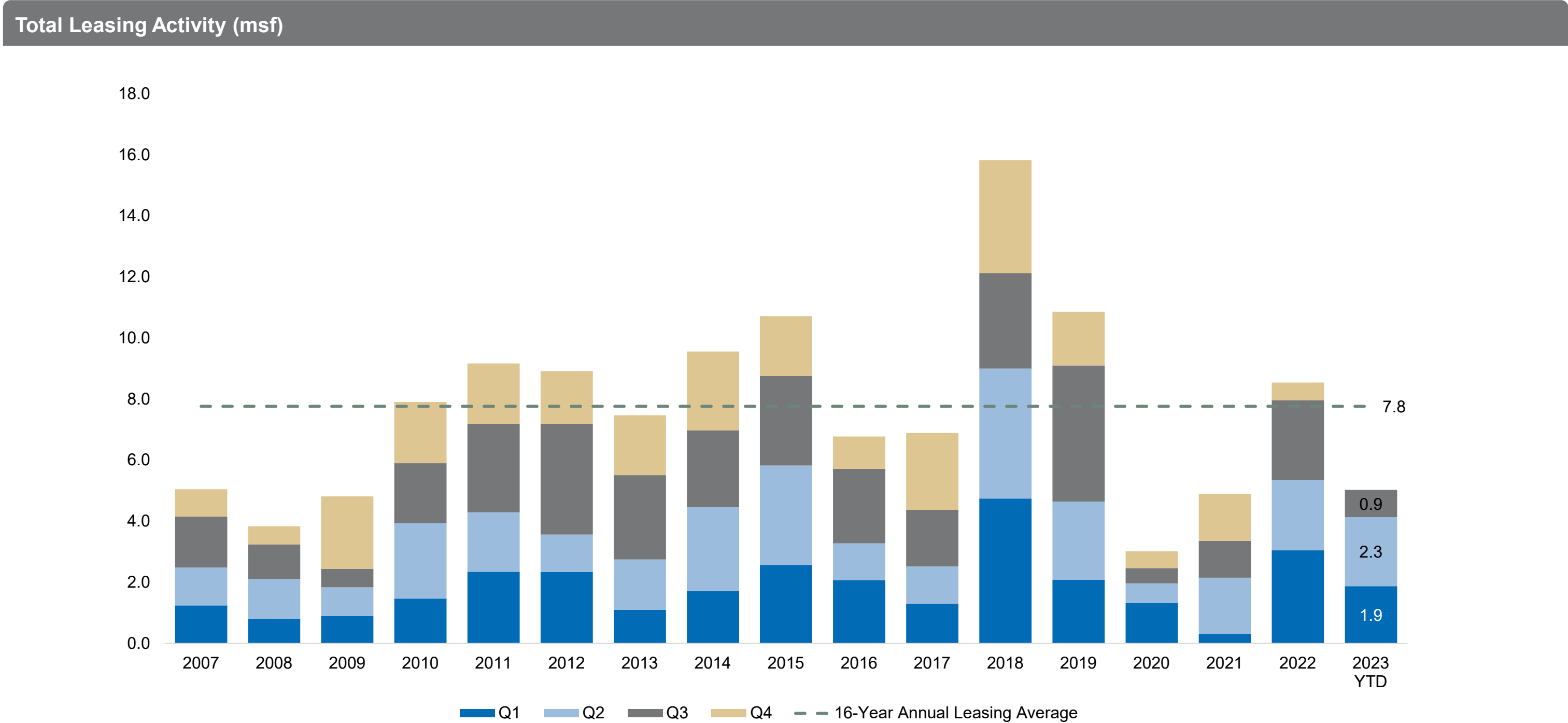
Historical Construction Deliveries, Net Absorption, and Vacancy



Source: Newmark Research

Leasing Activity Pace Has Slowed

Leasing volume in the third quarter of 2023 was its lowest since 2020, primarily due to diminished demand for large block space, with a few exceptions. Large deals are primarily renewals, with new leases or expansions rare. Given that the current economic outlook and the higher cost of capital, its likely that this trend will continue for several quarters.

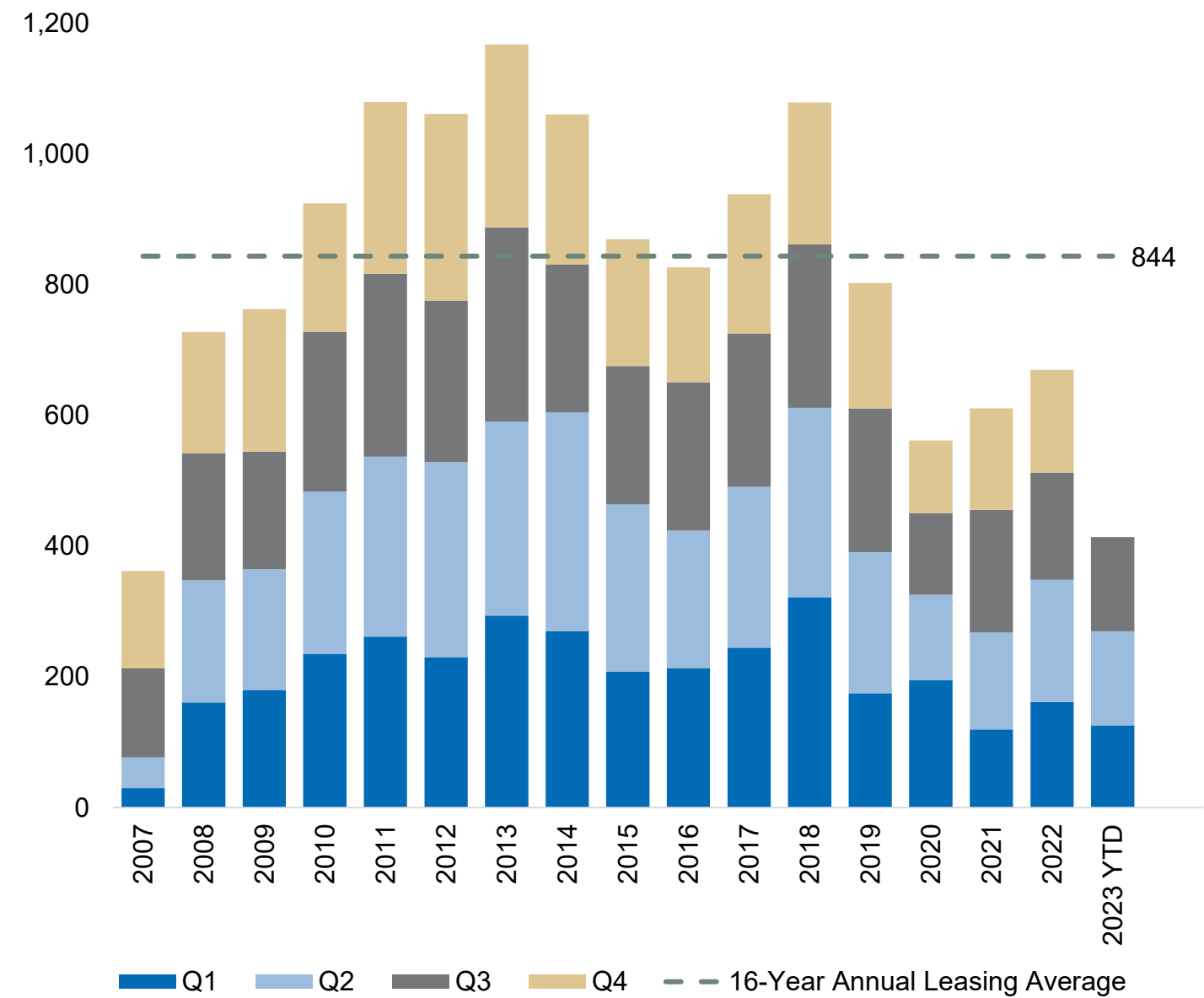


Source: Newmark Research, CoStar

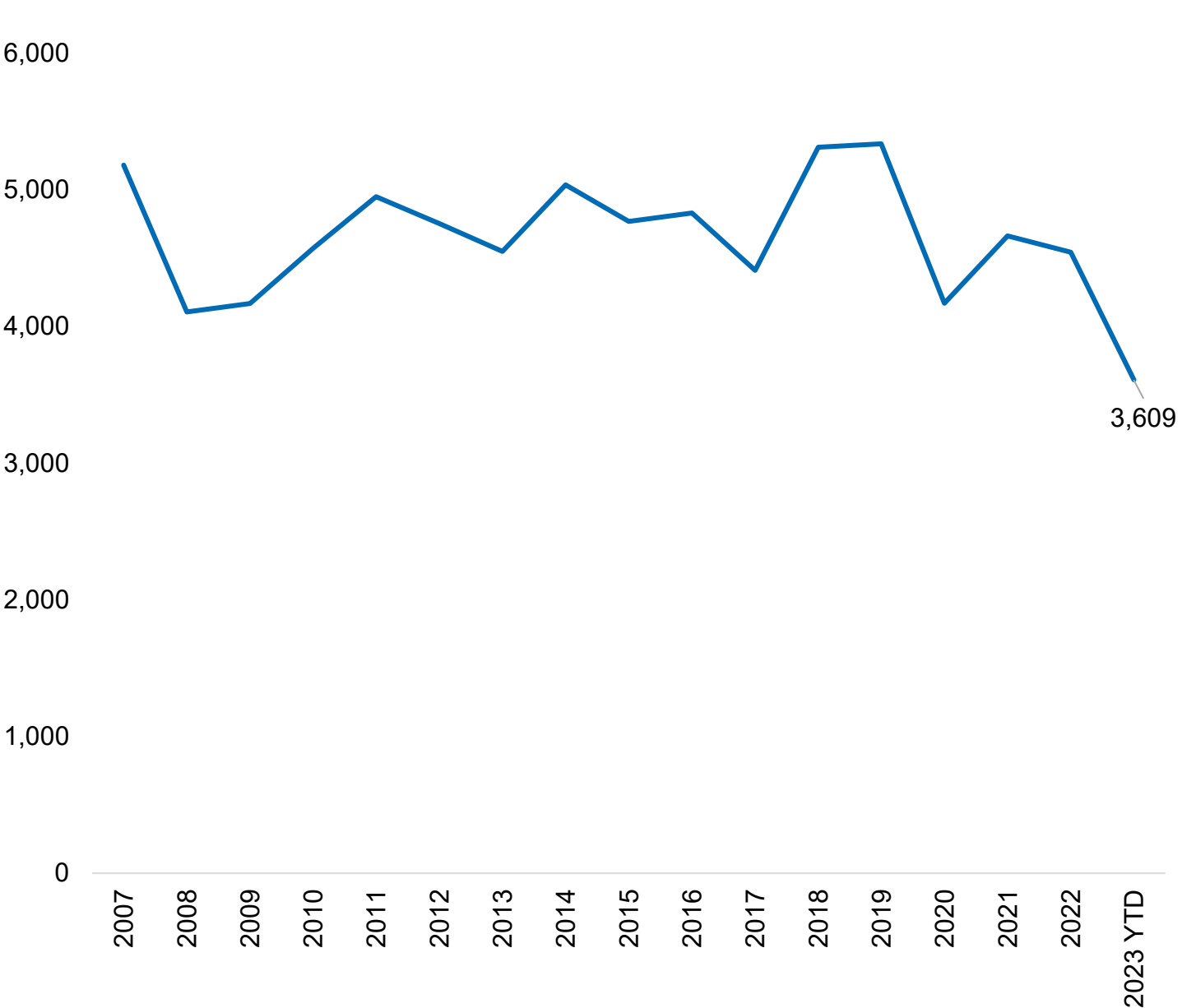
Leases Are Smaller, and Fewer Are Being Signed

The overall total space lease has been impacted by both a fewer number of leases signed as well as a smaller size for each lease – at a mere 414 deals, year to date totals are less than half of the historical annual average of 844 after 3 quarters..

Number of Leases Signed



Average Lease Size (sf)



Source: Newmark Research, CoStar

Many Submarkets Continue to Underperform

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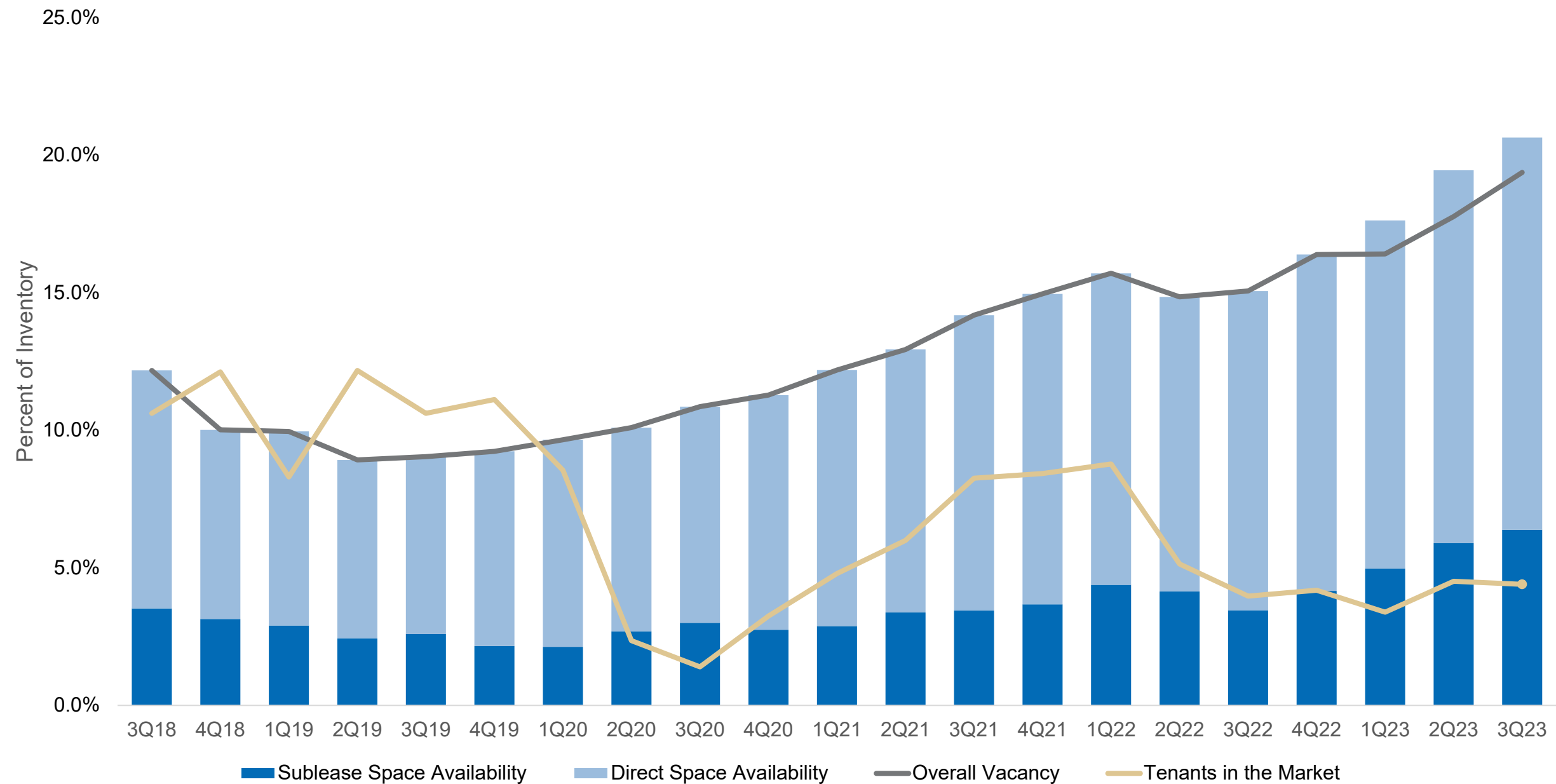
Technology Companies Are Driving the Slowdown in Leasing

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Availability Continues to Increase While Tenant Demand Drops

Tenant demand remained mostly flat quarter-to-quarter as many tenant requirements are put on hold given current economic uncertainty. While vacancy continues to rise, there are very few tenant requirements that are large enough to fulfill these spaces coming onto the market.

Available Space and Tenant Demand as Percent of Overall Market



Source: Newmark Research

The Highest Availability Rate Is in Santa Clara

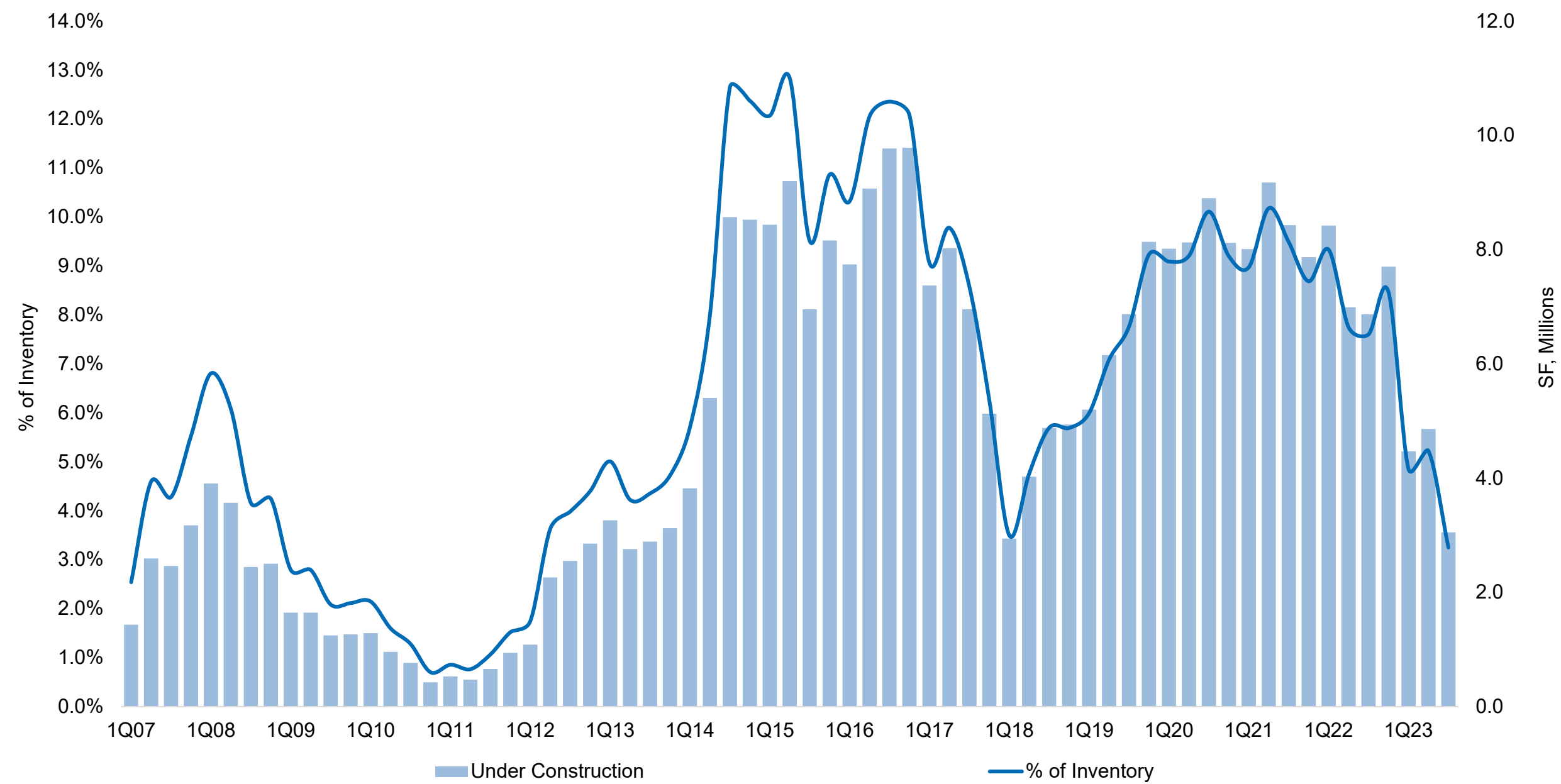


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Deliveries Continue While New Construction Slows

The office construction pipeline has slowed in 2023, with total construction measuring just 3.0 million SF this quarter, down 37.2% quarter over quarter. This reason for this decline is due to the completion of 200 Park, as well as Platform 16 being put on hold – both projects in San Jose. It is likely that few projects will break ground soon until economic conditions improve.

Office Under Construction and % of Inventory



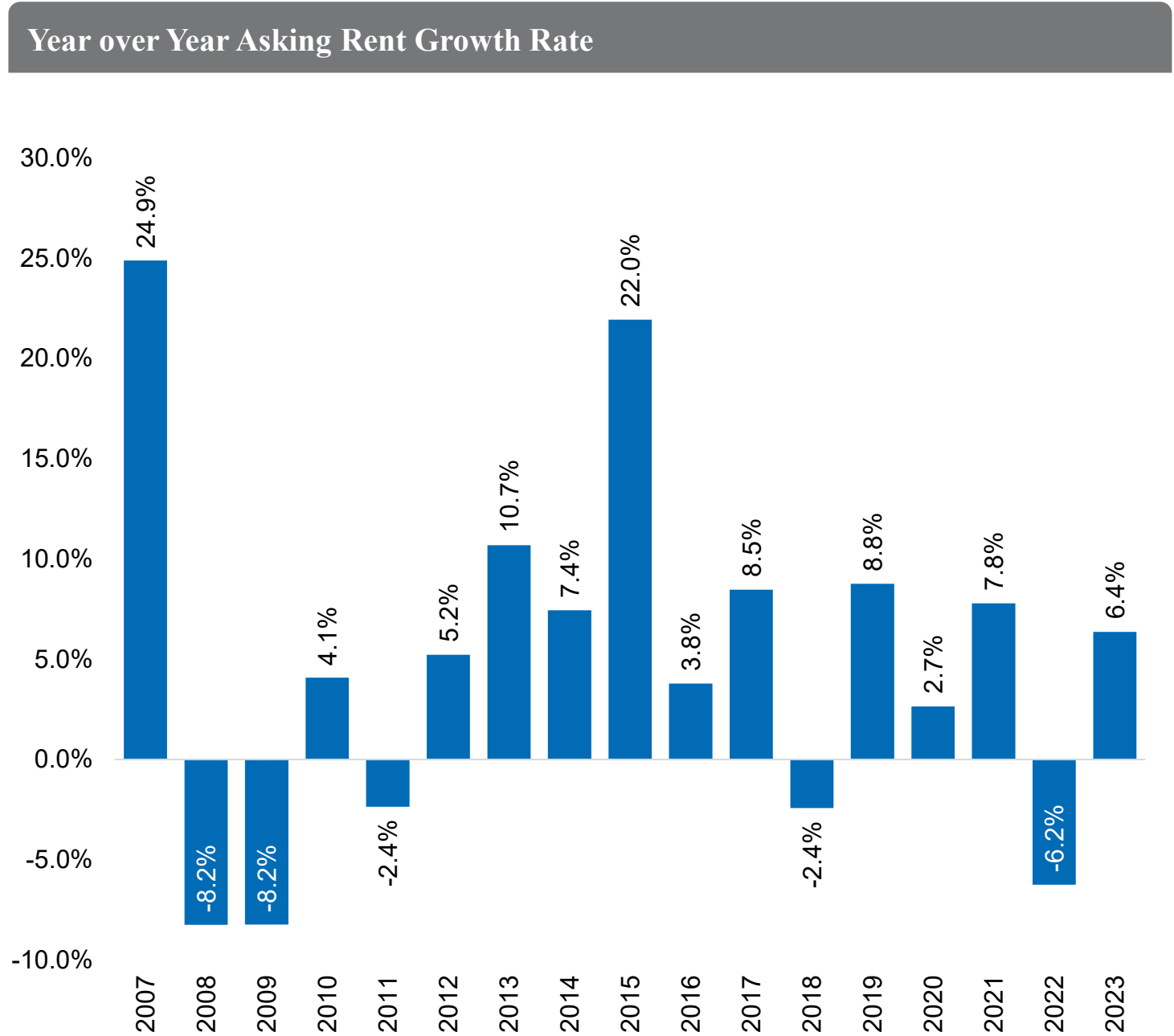
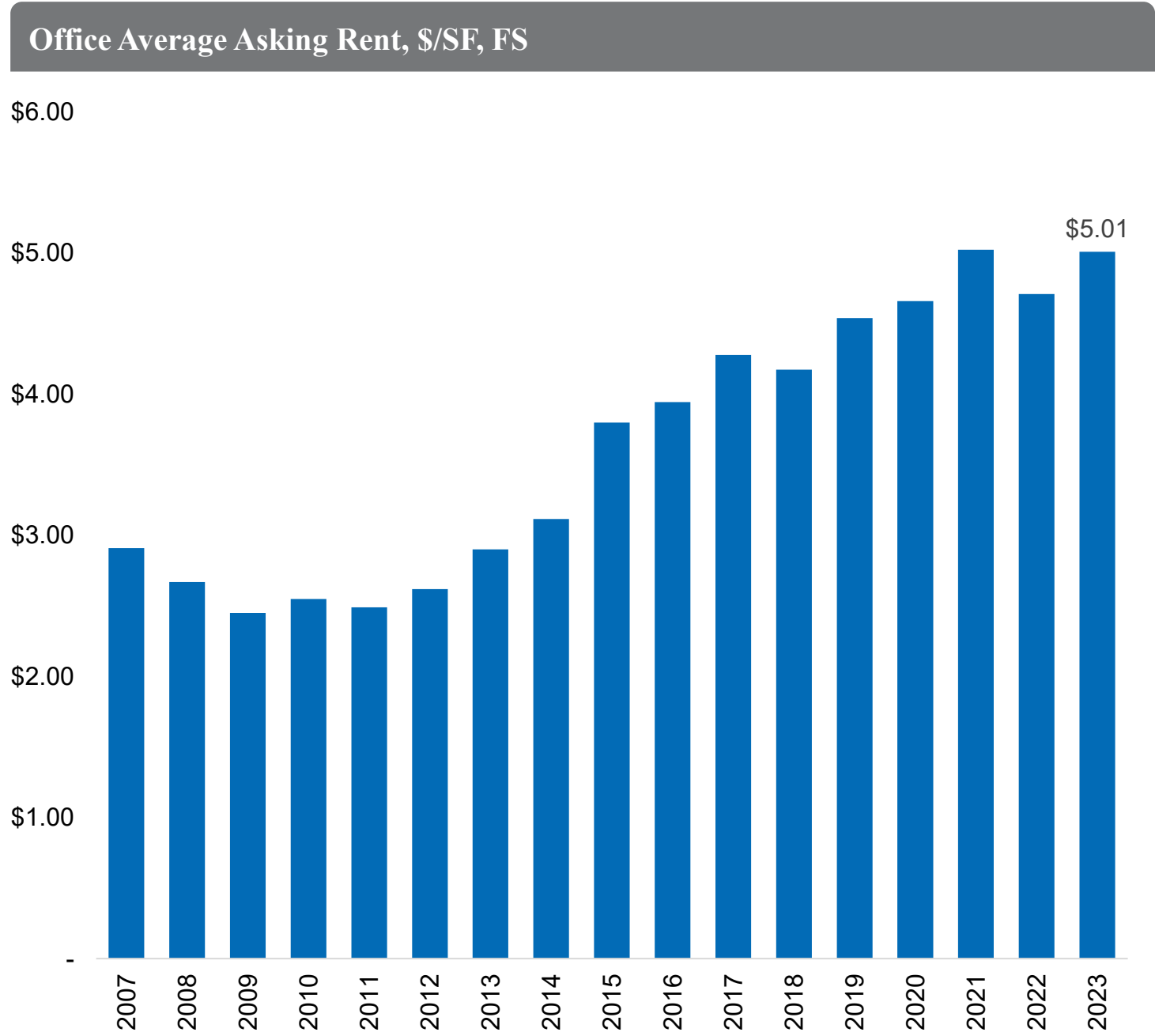
Source: Newmark Research, CoStar, San Jose-Santa Clara-Sunnyvale MSA

New Deliveries Will Impact Downtown Santa Clara and Downtown Sunnyvale

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Rents Stabilize Despite Rising Availability

Overall asking rates increased slightly to \$5.01/SF, a 1.4% increase quarter over quarter, and a return to rates seen at the end of 2021. Rents have held mostly firm despite the rising vacancy rate. Compared to the end of 2022, rent growth seems strong, however, given the high amounts of availability, it's likely that deals are not taking place at this level without landlord concessions.



Source: Newmark Research, CoStar

Rents Continue to Fall in Mountain View

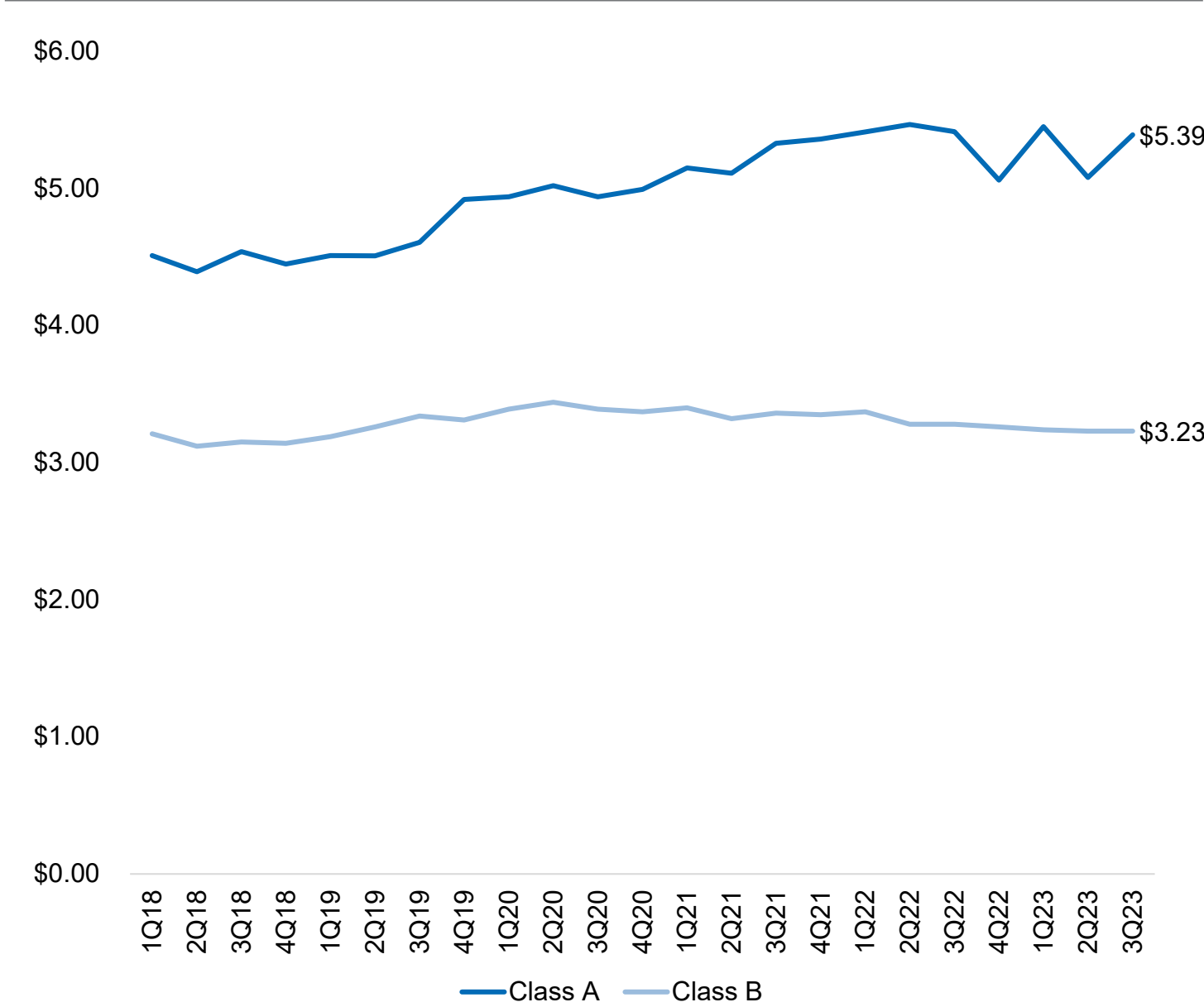


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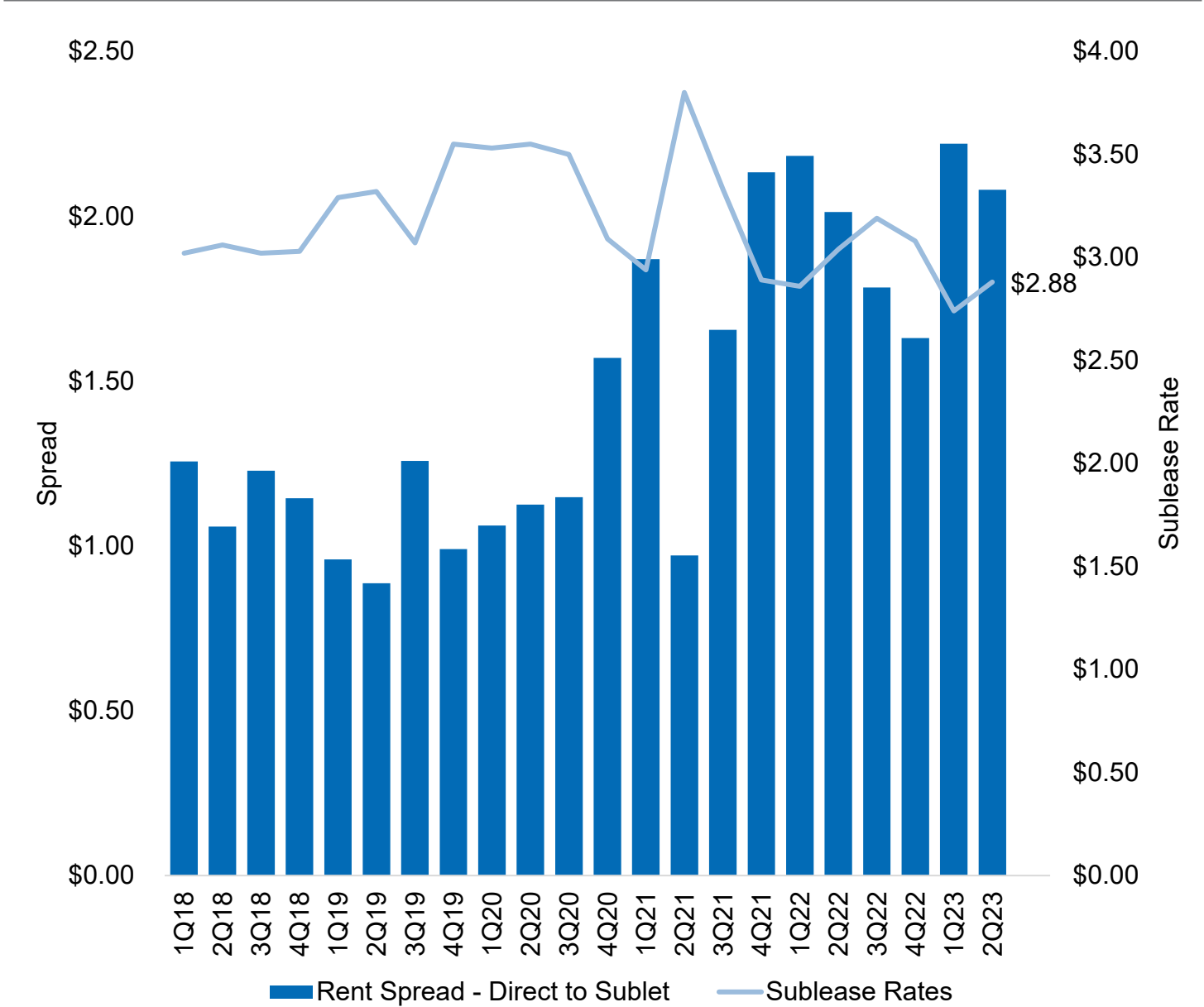
Asking Rents Remain High, but Falling

Given the sharp increase in availability in the past years, the correction of lease rates in the Valley seems almost overdue. Historically, landlords have resisted asking rate adjustments in favor of concessions, however, that no longer seems to be the case going forward, and landlords have begun to bend on rates and have even shown a willingness to take a haircut on sale prices. Future rent adjustments are likely until the economy begins to recover.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Leasing Activity Slows

Continuing the trend seen in recent quarters, leasing activity has slowed and is primarily comprised of renewals or subleases. The largest deals have typically been renewals, as tenants occupying large block spaces typically find it more expensive to move, or because landlords are offering premium concessions to retain tenants.

Notable 3Q23 Lease Transactions				
Tenant	Building(s)	Submarket	Type	Square Feet
Sony Electronics, Inc	1730 N First Street	San Jose – Airport	Lease Extension	79,874
Lease extension. Sony has been in this location since 2006 and is one of the major tenants in the San Jose Airport submarket.				
Workday	5451 Great America Parkway	Santa Clara – Marriott Park	Direct Lease	30,279
New lease. This deal brings occupancy in 5451 Great America (part of Santa Clara Gateway) to 100% and represents on the deals that has driven falling the vacancy rate in the Santa Clara submarket.				
Juniper Networks	1601 S De Anza Boulevard	Cupertino	Lease Renewal	14,036
Lease renewal. Mist Systems (acquired by Juniper Networks in 2019) has been in this space since 2018.				
Treasure Data	2440 W El Camino Real	Mountain View – El Camino Corridor	Sublease	12,717
Sublease. Subleased from Udacity.				
Sutter Visiting Nurses Association	12930 Saratoga Avenue	Saratoga	Direct Lease	10,708
New lease. Sutter Health signed a separate lease within the same building for 2,427 SF.				

Source: Newmark Research

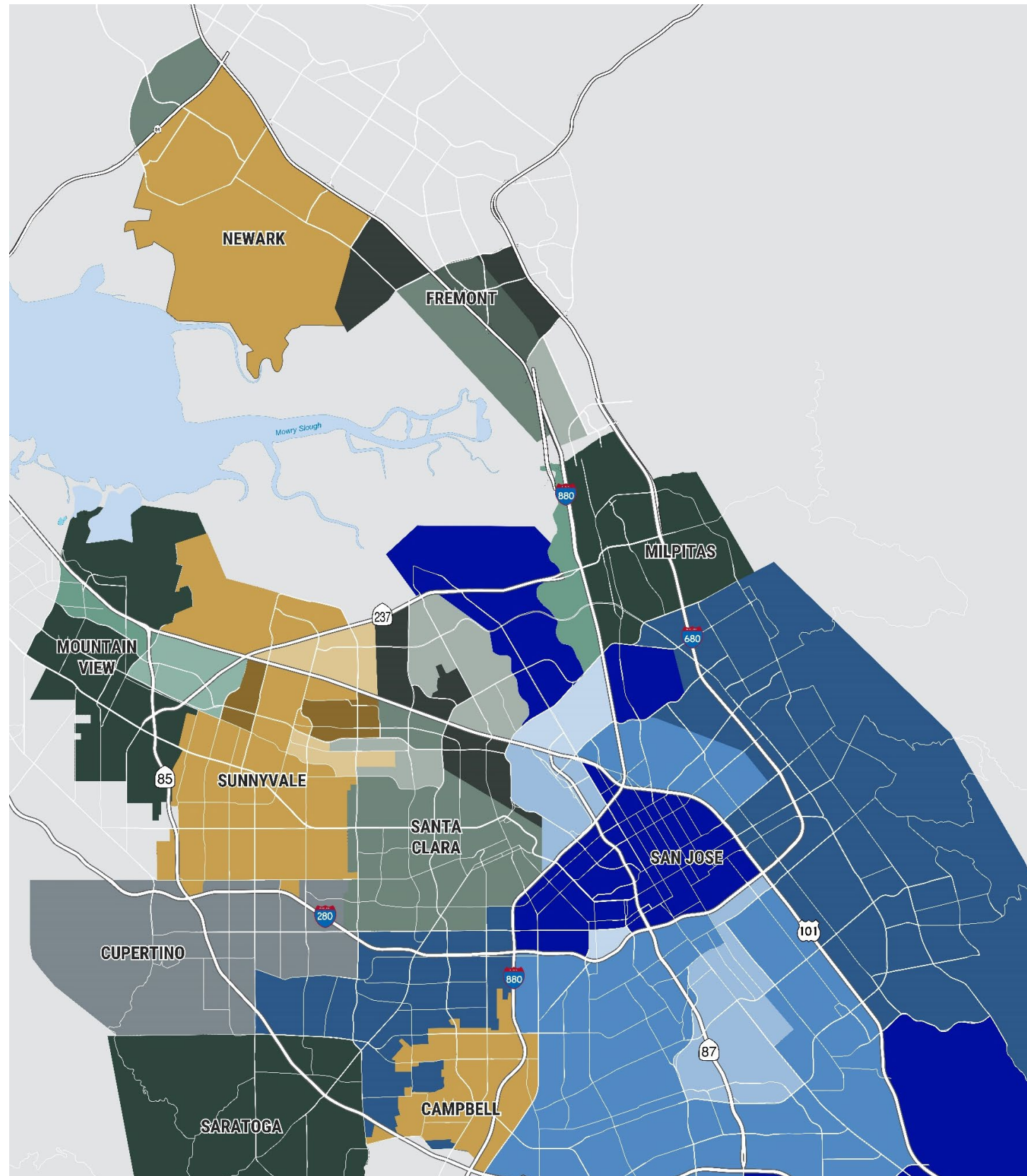
Appendix



Silicon Valley Stats Overview

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Silicon Valley - Submarket Map



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