

Silicon Valley R&D Market Overview

Market Observations

Economy

- The region's labor market remained stable in the fourth quarter of 2023, holding at 3.9% quarter-over-quarter while the national unemployment rate fell 10 basis points to 3.7%. Though trailing the national average, local unemployment remains below the 10-year average of 4.3%.
- 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 three quarters.
- The manufacturing industry saw a correction at the end of 2023, ending the year with a 2.0% decline in total employment following a surge of hiring in 2022. Other industrial-using sectors saw modest gains year-over-year.

Major Transactions

- The largest lease this quarter was a 344,512 SF renewal by Flextronics in their Milpitas campus, continuing the trend of tenants mostly remaining in space. Four of the five top deals this quarter were all renewals.
- Tech tenants shed even more space this quarter, with Meta fully vacating 115,945 SF at 6900 Dumbarton Circle in the Fremont – Ardenwood submarket, and Sakku, a lithium battery manufacturer, vacating 78,794 SF in South San Jose.
- The R&D/office project Pear Village in Mountain View delivered this quarter, leaving just 1.21 million SF of construction pipeline in the Valley, all of it contained in one project, Intuitive Surgical's Sunnyvale campus expansion.

Leasing Market Fundamentals

- Net absorption in the fourth quarter of 2023 totaled negative 282,140 SF, with year-to-date net absorption measuring negative 2.31 million SF. This is the seventh consecutive quarter of occupancy losses in the R&D sector, during which time the vacancy rate has increased from 10.3% in the second quarter of 2022 to 13.5% at the end of the year.
- Despite occupancy losses, R&D rents have continued to climb in the Valley, increasing to \$2.96/SF, a 3.7% increase quarter-over-quarter. Life science rents continue to push this level higher despite making up a small percentage of the total inventory, such as in Fremont, which averages \$2.88/SF asking rent.
- Annual leasing volume fell in 2023, with 7.30 million SF of gross absorption compared to 8.86 million SF in 2022, a 17.6% decrease year-over-year.

Outlook

- Deal volume remains low compared to pre-pandemic levels, with most large deals manifesting as renewals instead of new leases or expansions. This trend is expected to continue due to rising interest rates, tightening lines of potential credit for tenants and their investors alike.
- Despite several quarters of occupancy losses and rising vacancy, rents among the region continue to climb, bolstered by life science conversions and a trend towards higher-end R&D space.
- Given the movement towards smaller space and consolidation, the R&D sector is likely to continue to see occupancy losses in the immediate future.

1. Economy
2. Leasing Market Fundamentals
3. Appendix

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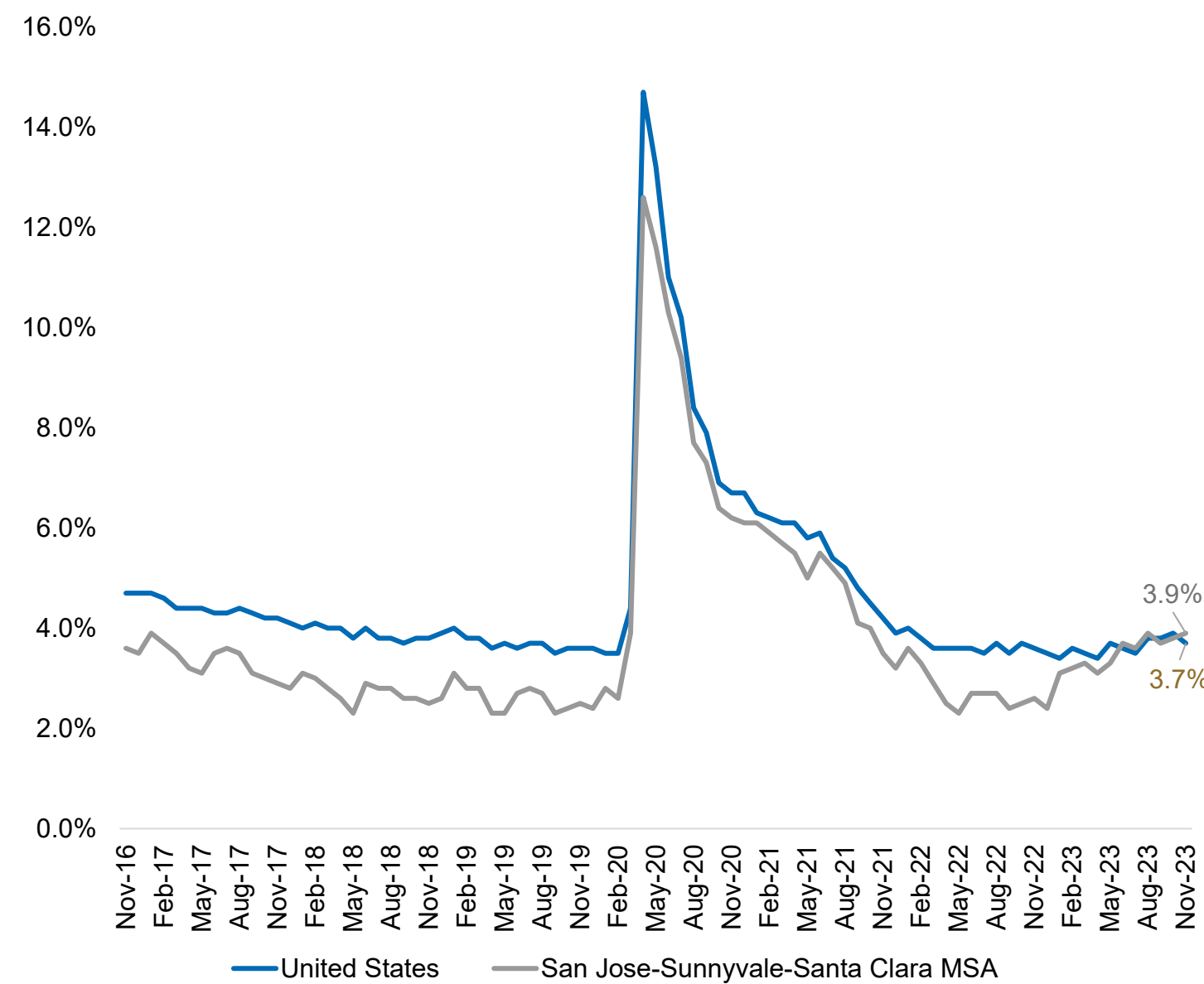
Economy



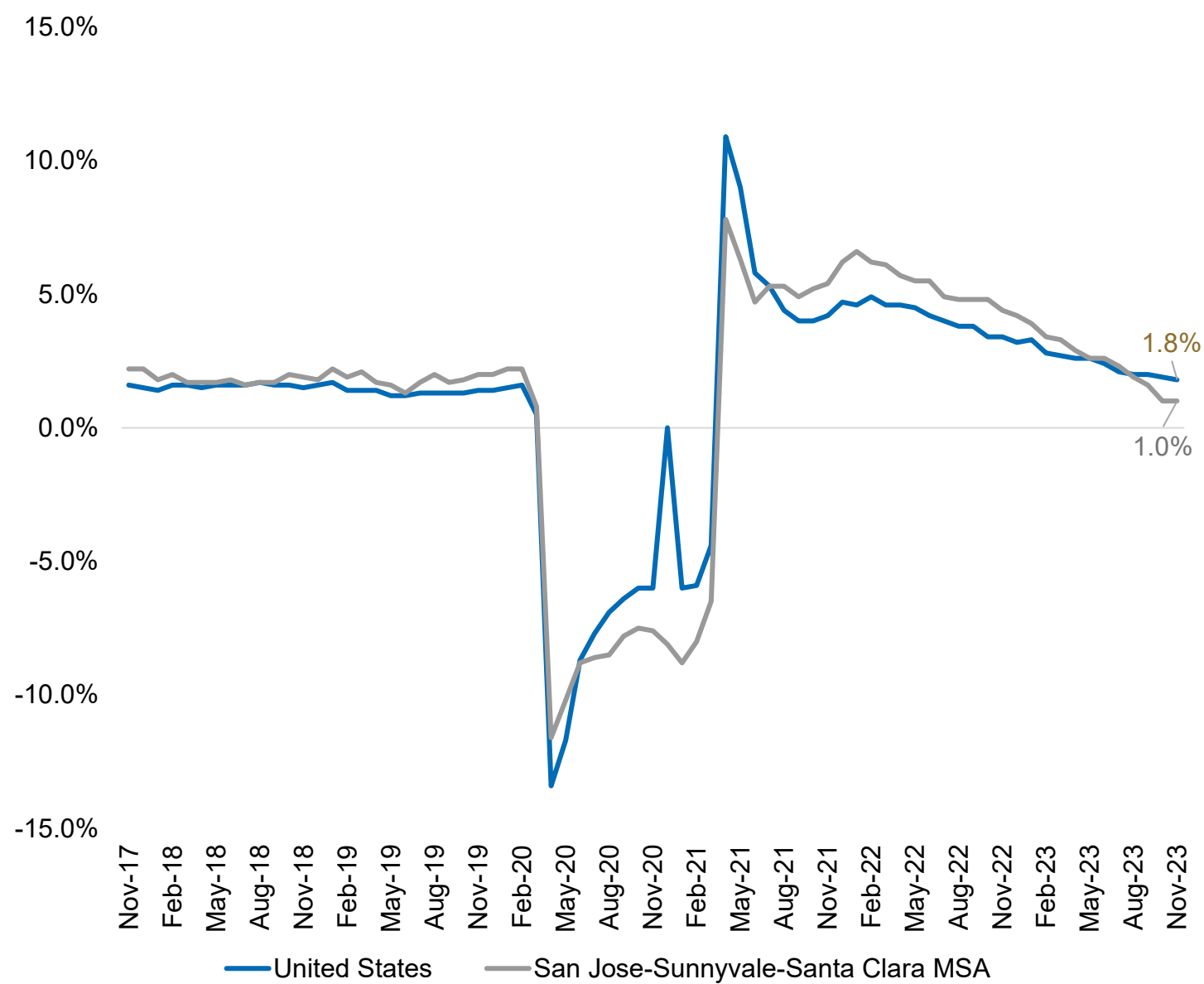
Metro Employment Trends Indicate a Slower Recovery Compared Nationally

The San Jose-Sunnyvale-Santa Clara MSA's overall unemployment rate rose for the 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



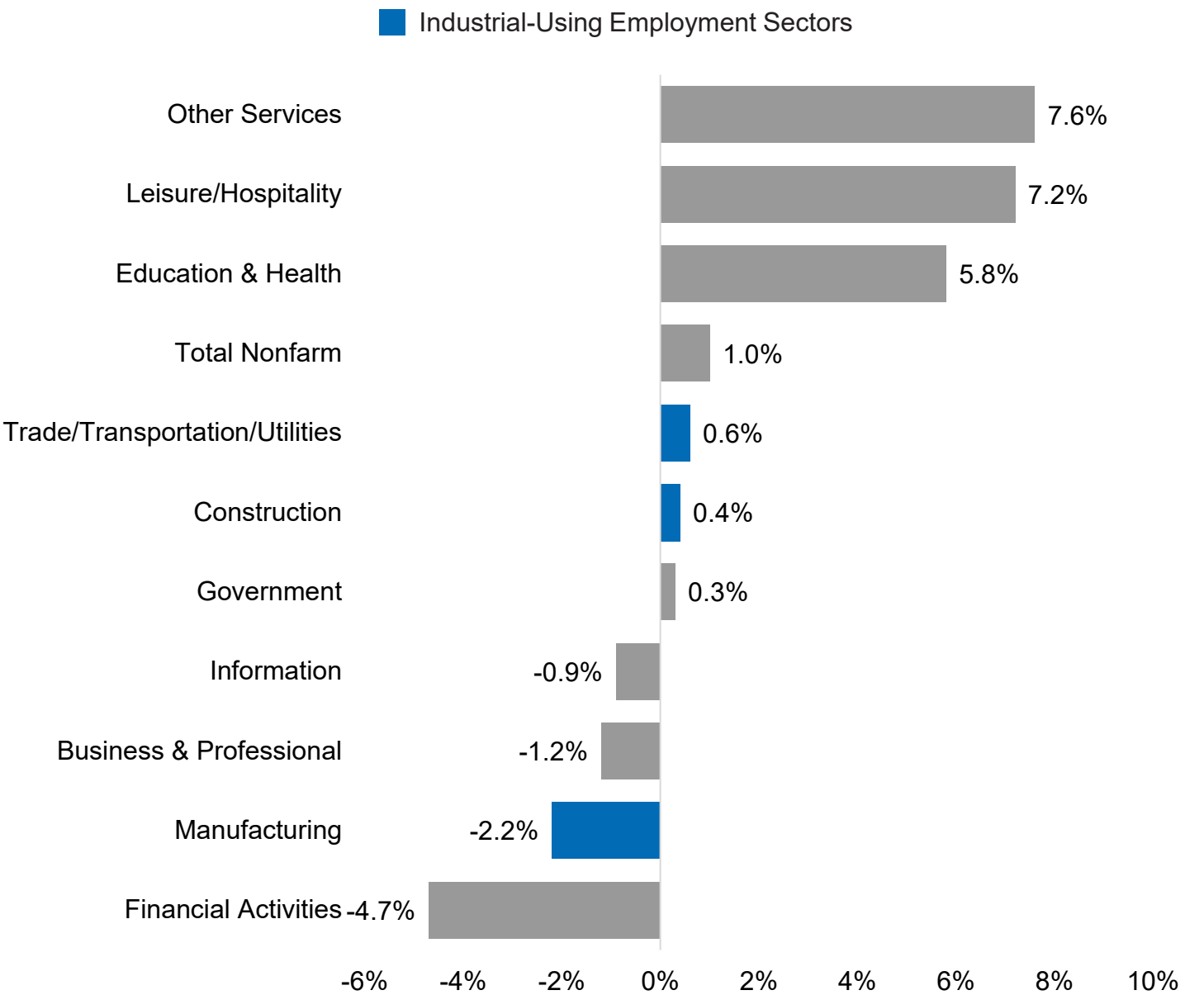
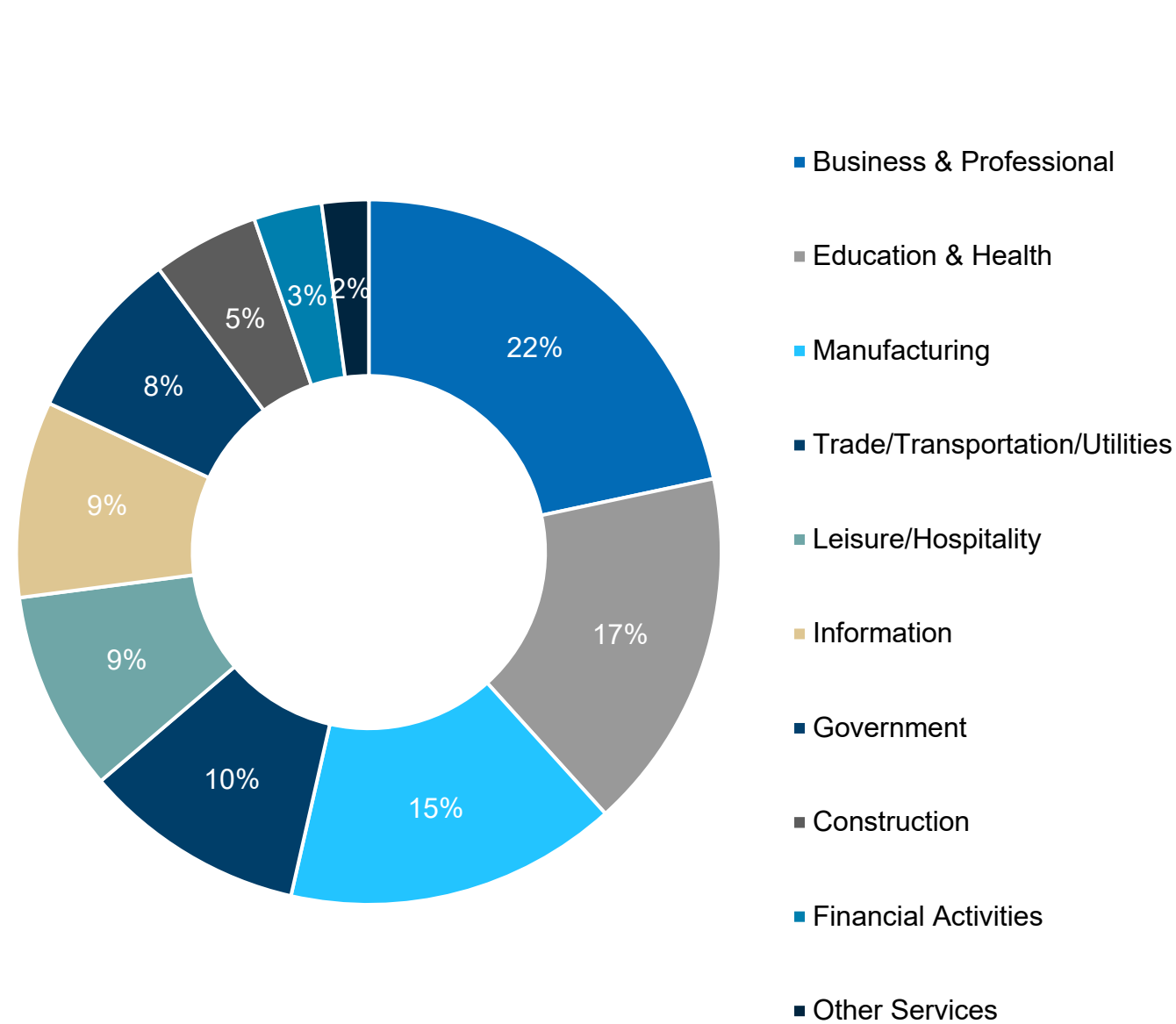
Source: U.S. Bureau of Labor Statistics, San Jose-Sunnyvale-Santa Clara MSA
Note: November 2023 data is preliminary.

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, as in-person dining and retail gradually returns to the region following the pandemic.

Employment by Industry, November 2023

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

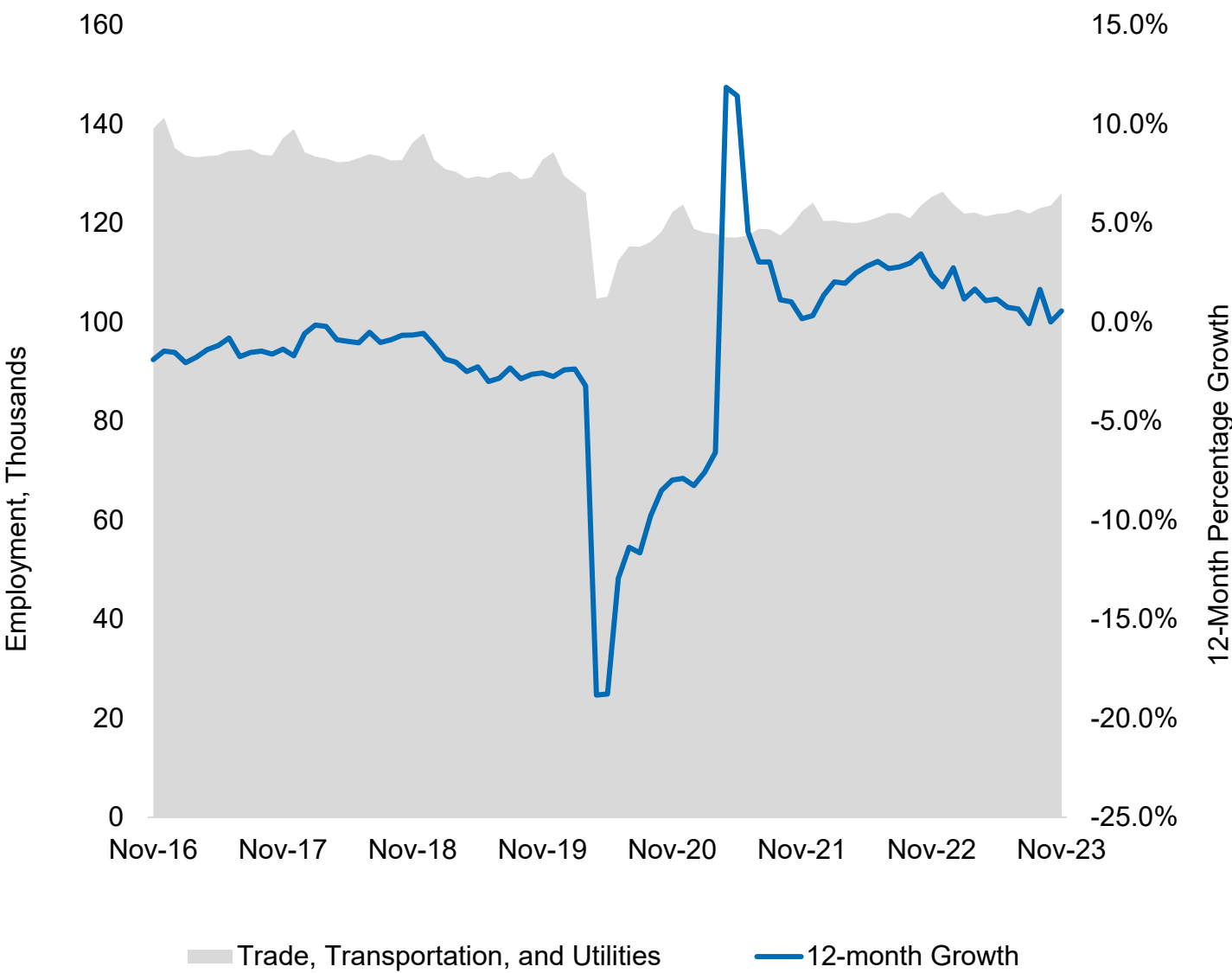


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
Note: November 2023 data is preliminary.

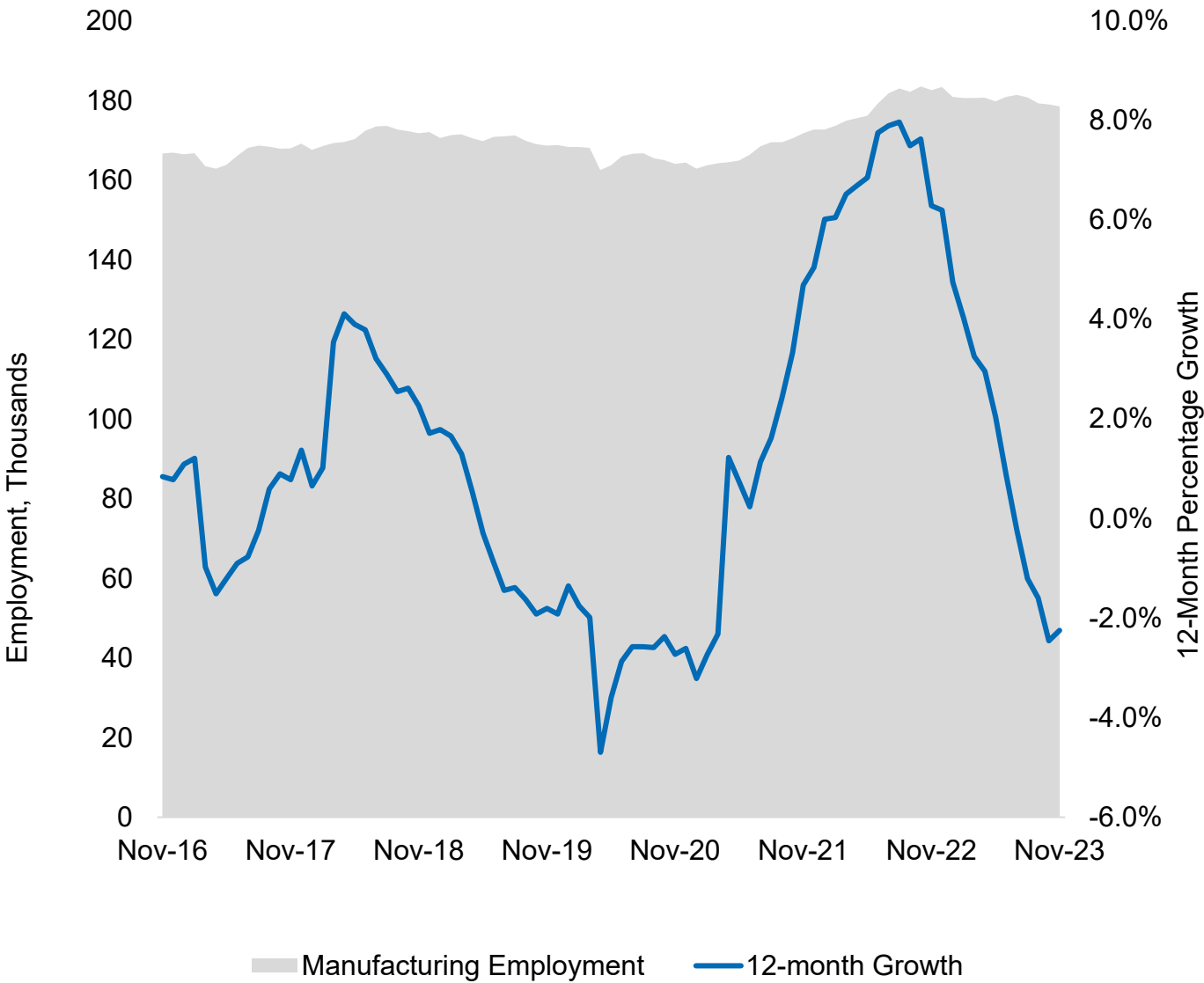
Manufacturing Sector Sees Slight Correction to 2022 Levels

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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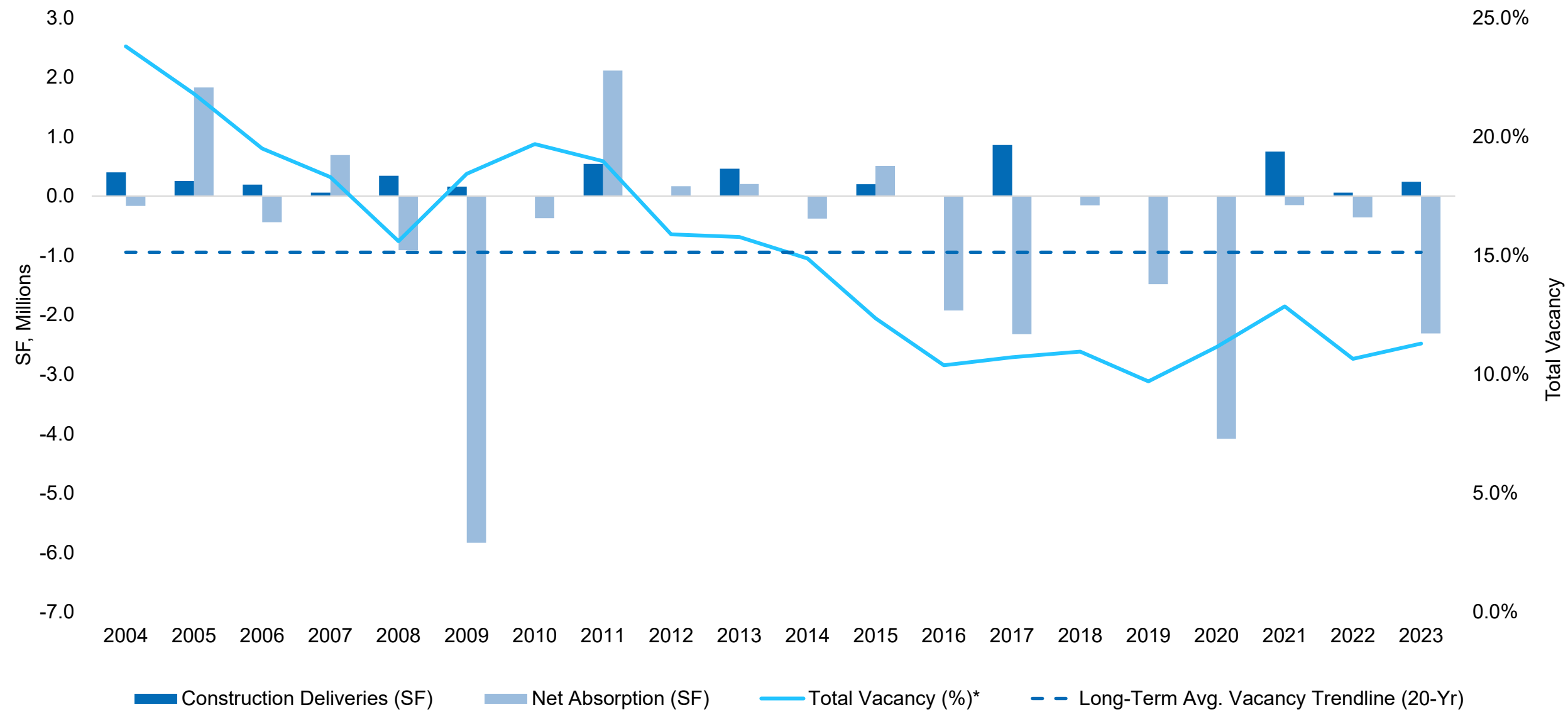
Leasing Market Fundamentals



Vacancy Increases After Levels Out as Demand Remains Low

The vacancy rate increased to 11.3% at the end of 2023, increasing from 10.6% year-over-year following a year that measured negative 2.3 million SF of net absorption. Overall vacancy rose this year primarily due to technology tenants consolidating their space, not new construction. The Mountain View submarket was the biggest contributor to this movement, posting -945,000 SF of occupancy losses this year, on top of delivering 233,000 SF of new shell space at Pear Village.

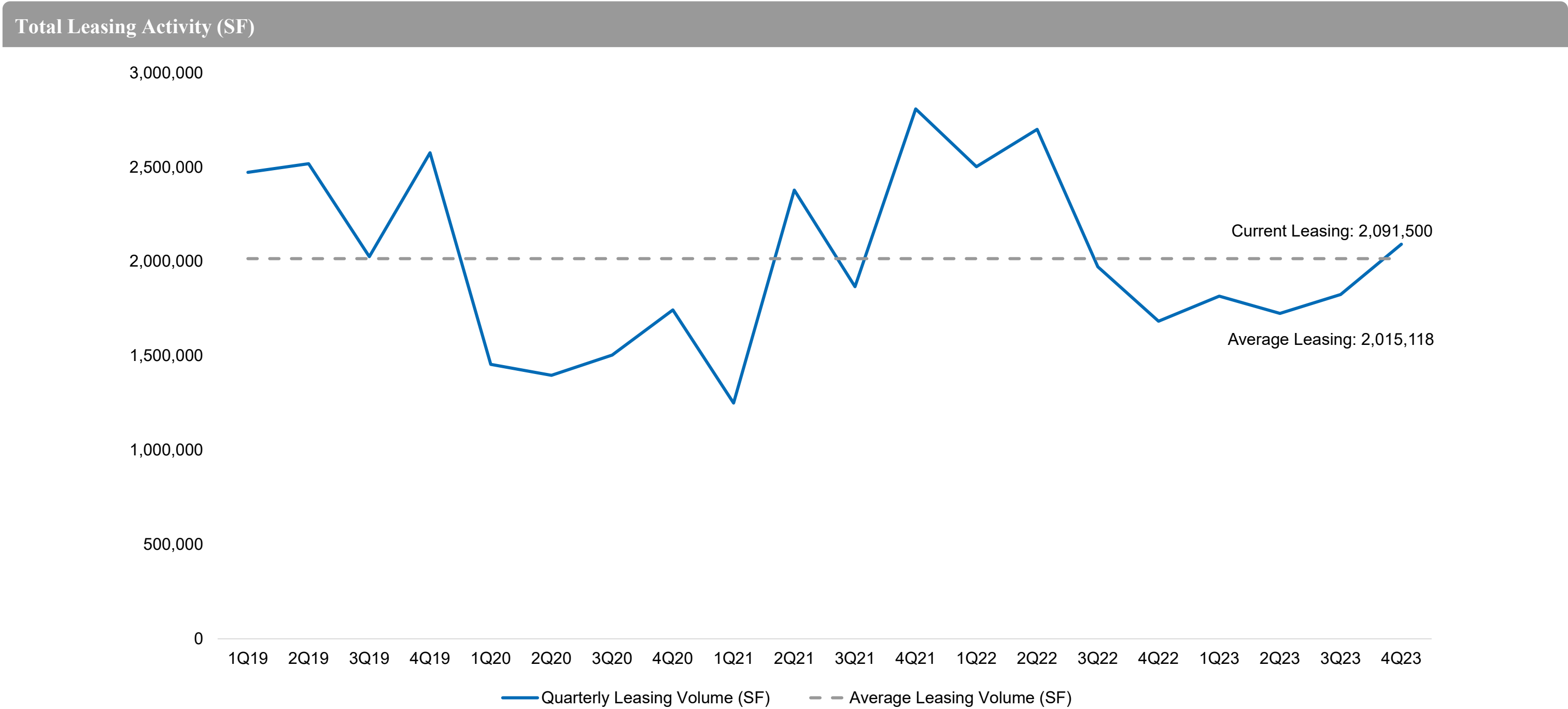
Historical Construction Deliveries, Net Absorption, and Vacancy



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

R&D Leasing Surpasses Historical Average For First Time in a Year

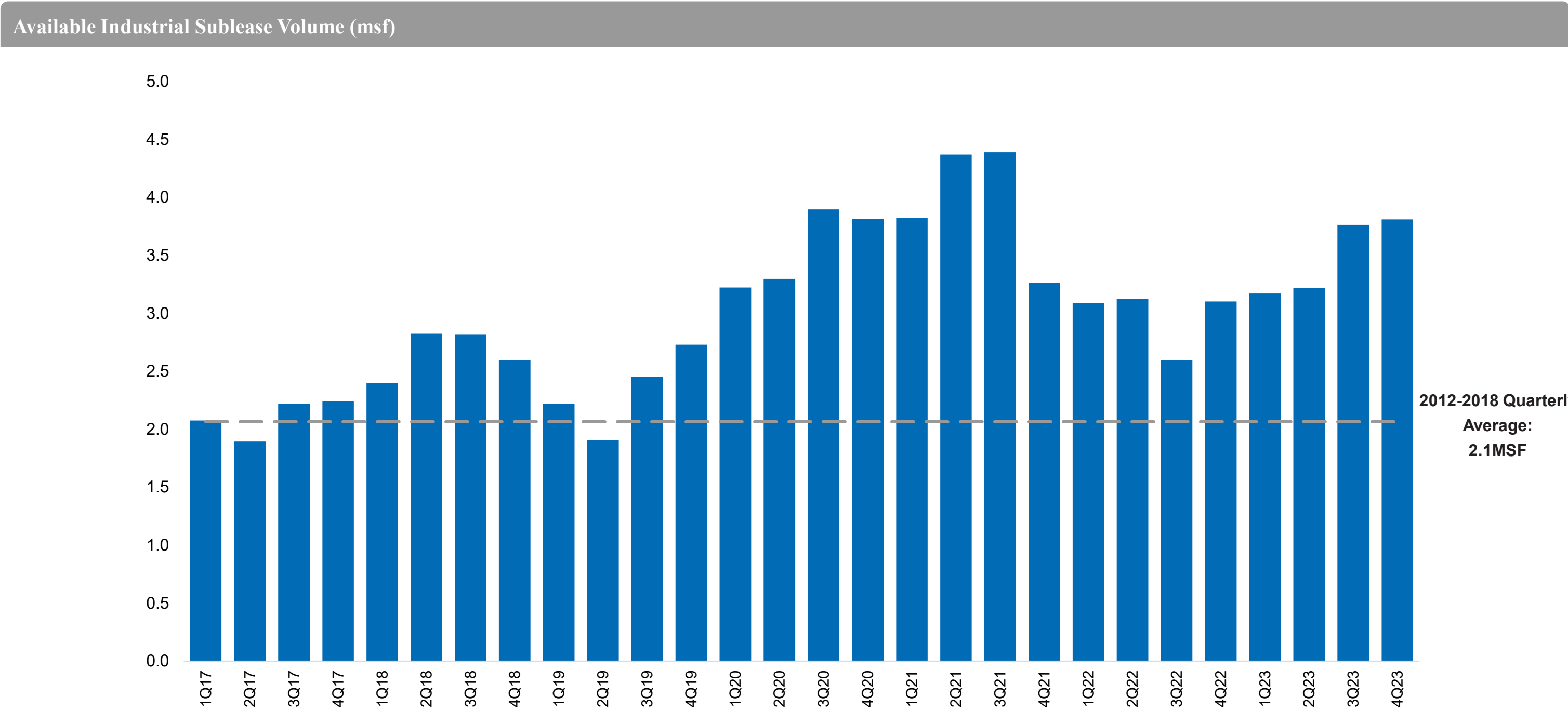
Leasing activity in the R&D sector picked up slightly this quarter with 2.1 million square feet of gross absorption, surpassing the historical average for the first time since the second quarter of 2022. Leasing volume was bolstered by several large renewals, such as the 344,512 SF renewal by Flextronics on their campus in Milpitas. Although activity in 2023 has dwindled compared to 2022, tenants in large block space can still take advantage of the current market.



Source: Newmark Research, CoStar

Sublease Availability Spikes above Pre-Pandemic Levels

Sublease availability rose slightly from the previous quarter, increasing 1.2% quarter-over-quarter. On the year, sublease space has increased by 22.8%, in large part due to tech tenants giving back space, such as the ±477,000 square foot Quad Campus in Mountain View. Since 2020, sublease space has not returned to pre-pandemic levels, and, given the decrease in demand this year, sublease space is likely to remain at this level for some time.

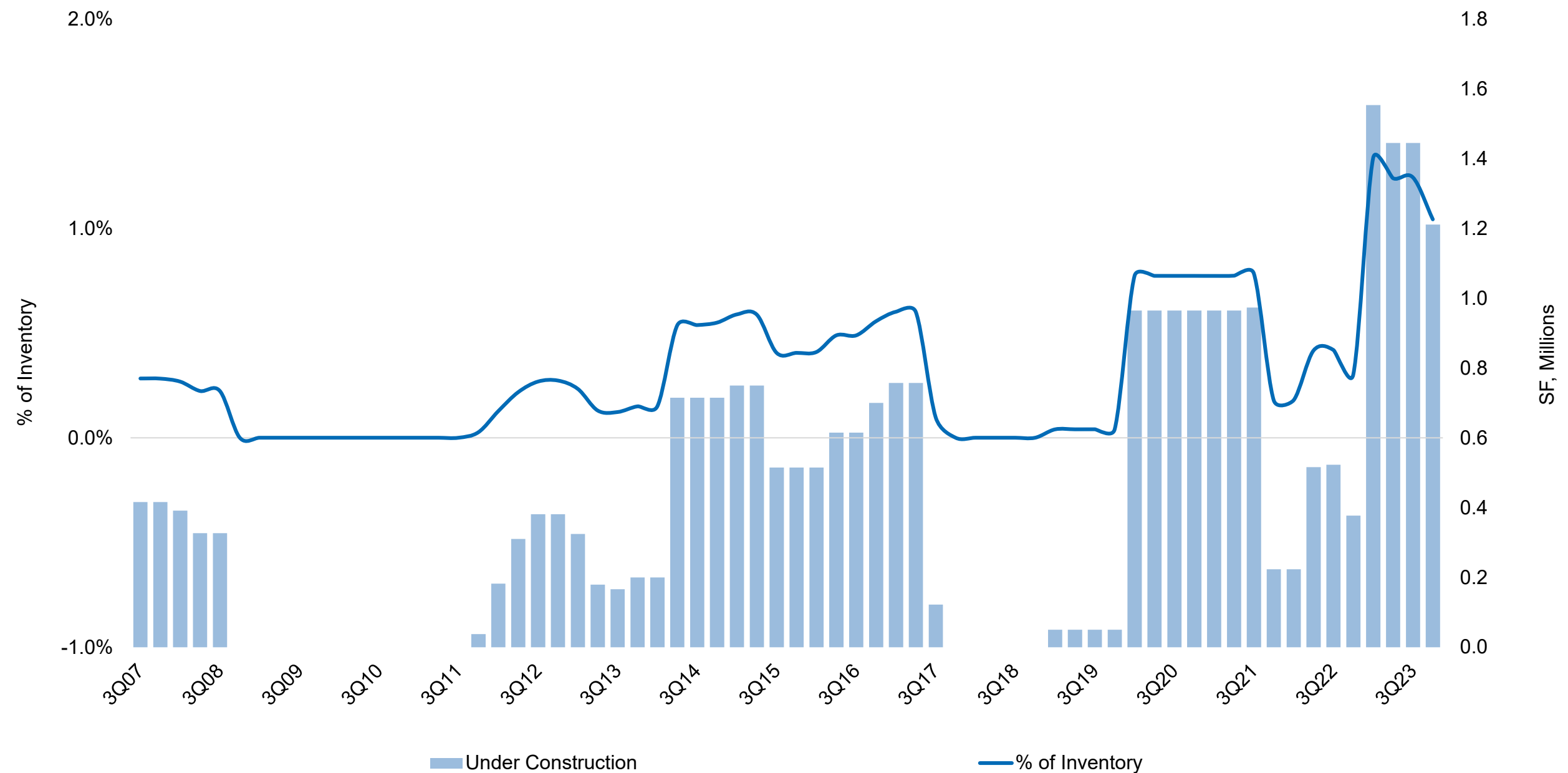


Source: Newmark Research, CoStar

R&D Construction Remains High Thanks to Owner-Users

Following the delivery of the 233,543 SF Pear Village in Mountain View, the R&D pipeline dropped to just one project: the 1.2 million SF Intuitive Surgical campus expansion in Sunnyvale. Although previously neglected in favor of office, hybrid office/R&D space is a popular choice among tech and medical device occupiers in the Valley, with several recent R&D build-to-suits delivering in the past few years.

R&D Under Construction and % of Inventory

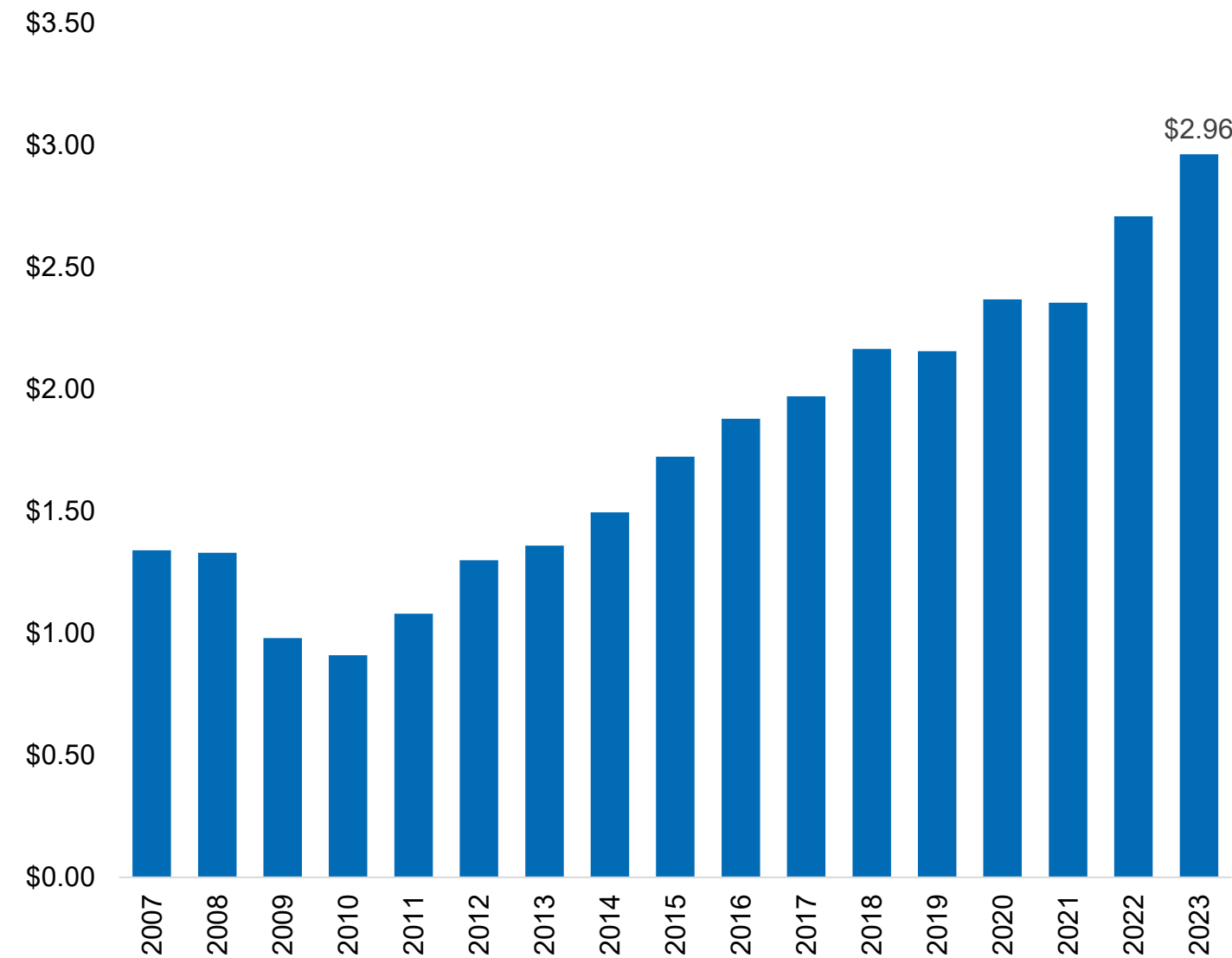


Source: Newmark Research, CoStar

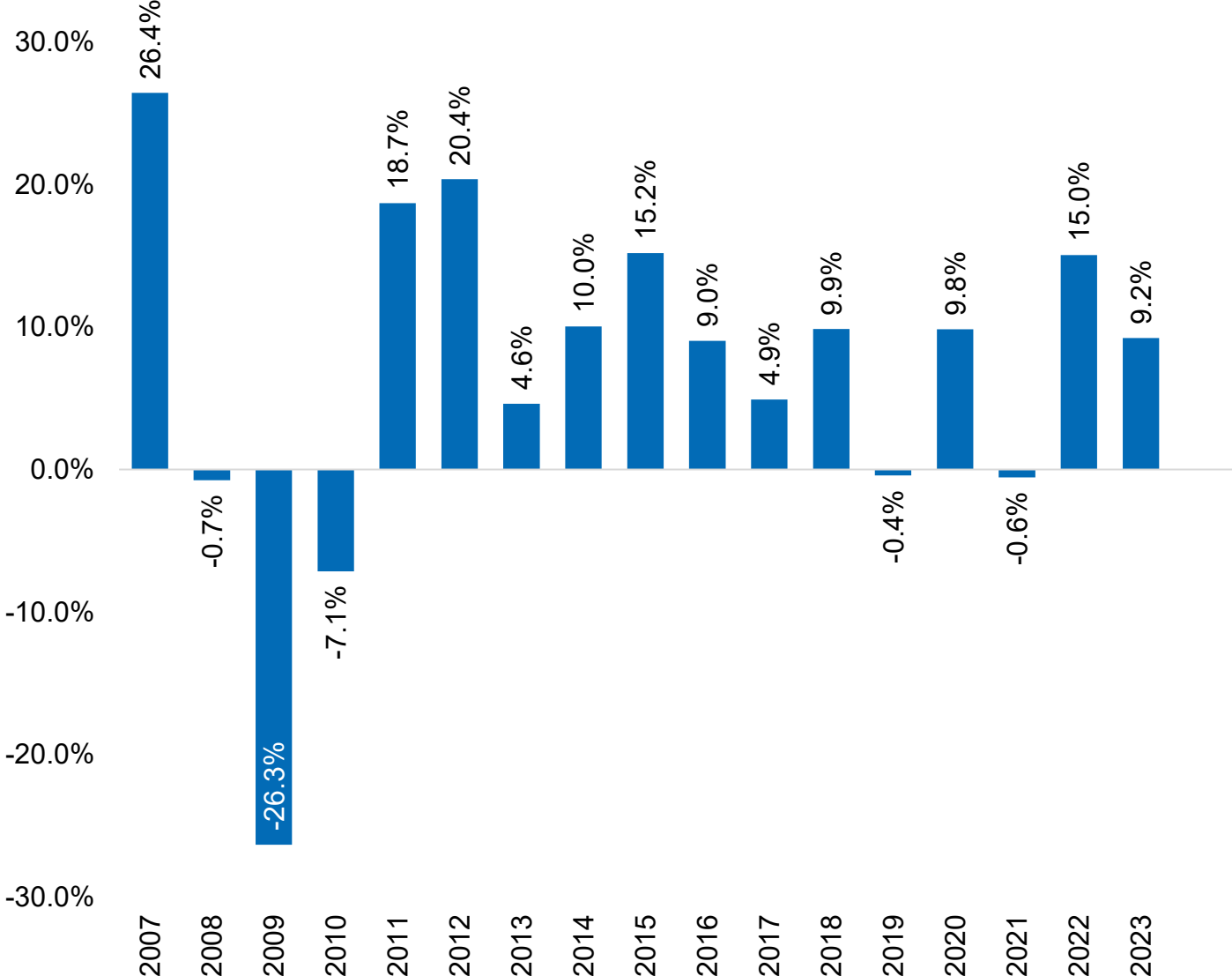
R&D Asking Rents Continue to Rise

R&D asking rents continued to grow, increasing to \$2.96/SF at the end of 2023, a 3.5% increase since the previous quarter and a 9.2% increase year over year. Despite rising availability, rents continue to climb due to life science conversions as well higher end R&D spaces being put back onto the market from tech vacancies.

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



Year-over-Year Asking Rent Growth Rate % Change



Source: Newmark Research, CoStar



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Renewals Continue to Drive Leasing Activity

Four of the top five largest transactions this quarter did not involve any tenant movement, indicating that current tenants are not currently compelled to expand or relocate. Due to current economic conditions, financing has become increasingly expensive, making expansion or new leases riskier. Although the R&D sector has a lower vacancy rate compared to the office sector, demand for both product types remains low.

4Q23 Top Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
Flextronics	1077-1177 Gibraltar Drive	Milpitas – East 880	Renewal	344,512
Lease renewal. This six-building campus has served as Flextronics's primary hub in Silicon Valley, with some buildings occupied by the former Solelectron.				
Intevac	3560 Bassett Street	Santa Clara – 101 North	Renewal	72,000
Lease renewal. Intevac, a manufacturer of fiber optics, has been headquartered in this location since 2011.				
Adeia	3025 Orchard Parkway	San Jose – North	Renewal	61,165
Lease renewal. Adeia has been in this location since 2008 and specializes in developing new technologies on behalf of other companies.				
Infinera Corporation	217 Humboldt Court	Sunnyvale – Moffett Park	Renewal	60,448
Lease renewal. Infinera has been in this location since 2016, however it has subleased the space to Bloom Energy since 2018. They have elected to continue to occupy the space.				
Neotech	48113 Warm Springs Boulevard	Fremont – Mission South	Sublease	56,500
Sublease. Neotech subleased this space from Netflix – this space was a former production site for the now-streaming service.				

Source: Newmark Research

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Appendix/Tables





Please reach out to your
Newmark business contact for this information



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Newmark business contact for this information

For more information:

Mike Pham
Associate Research Director
Silicon Valley Research
Mike.Pham@nmrk.com

Nu Nandar Aung
Research Analyst
Silicon Valley Research
NuNandar.Aung@nmrk.com

Silicon Valley Office
3055 Olin Ave, Ste 2200
San Jose, CA 95128
t 408-727-9600

New York Headquarters
125 Park Ave.
New York, NY 10017
t 212-372-2000

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