2Q24

Silicon Valley Office Market Overview

NEWMARK

Market Observations

Economy

– The region's labor market showed signs of stabilizing. After eight months of declines, we have now tracked three months of modest growth, a welcome sign. While employment growth has been slower in this market relative to the U.S., the unemployment rate has fallen more sharply indicating a tighter labor pool.

– Layoffs in the large tech companies outpaced employment gains in the AI space, something that we are closely monitoring. Professional and business services, such as law and consulting firms, are staffing up in anticipation of an increase in work which bodes well for the office market, especially Class A buildings.

– Following along with the overall employment showing signs of stabilizing, office-using employment ticked up in the first five months of 2024 after sharp declines in the previous few months. However, the level of office-using employment is still below the peak from one year ago. Small job growth in the AI sector was not enough to counter the overall decline in the information services sector.

Leasing Market Fundamentals

– Given the leasing activity in the first half of the year, we might be at an inflection point in the office market. Net absorption was positive through the second quarter as the combination of sublease space and new construction that has been delivered to the market slowed.

– Despite the shrinking supply of sublease space, more direct available space came back on the market in the first half of 2024 pushing the overall vacancy rate up to 19.4% in the second quarter from 18.8% at year-end 2023.

– Asking rents in Silicon Valley rose to $5.10/SF full service in 2023 and have remained relatively steady at $5.12/SF full service so far in 2024. While full service asking rents are flat, concessions, including TIs and free rent, still play a big part in lease negotiations. In addition, as companies continue to look for ways to bring employees back to the office, amenities including flexible workspaces, more conference rooms, and up-to-date infrastructure also play a big role.

Major Transactions

– A semiconductor company accounted for the largest lease in the second quarter in the Santa Clara submarket, which was slightly larger than the largest lease in the first quarter.

– One noteworthy trend for the first half of 2024 is that the bulk of the leases signed, nearly 50%, were for new deals whereas this past two years renewals comprised most of the activity.

– We tracked at least 154 office transaction in the second quarter alone, bringing the total for the first half of the year to more than 300 deals. We are currently tracking 4.6 million square feet of active tenants in the market, which is far below the 16-year market average of 8.2 million square feet.

Outlook

– Positive signs suggest an inflection point in the economy, but headwinds like the amount of available space, higher interest rates, election jitters, and ongoing tech right-sizing could cause further demand/supply imbalances.

– We are closely watching the AI space, tracking the investments and also leasing activity. As AI companies expand, law firms and professional and business services firms are growing as well to be located near these AI companies.

– We believe vacancy rates will likely hover around or even slightly above their current levels while any real growth in asking rents will remain muted in the short term. As the economy improves in the medium term, we expect market conditions will once again improve.

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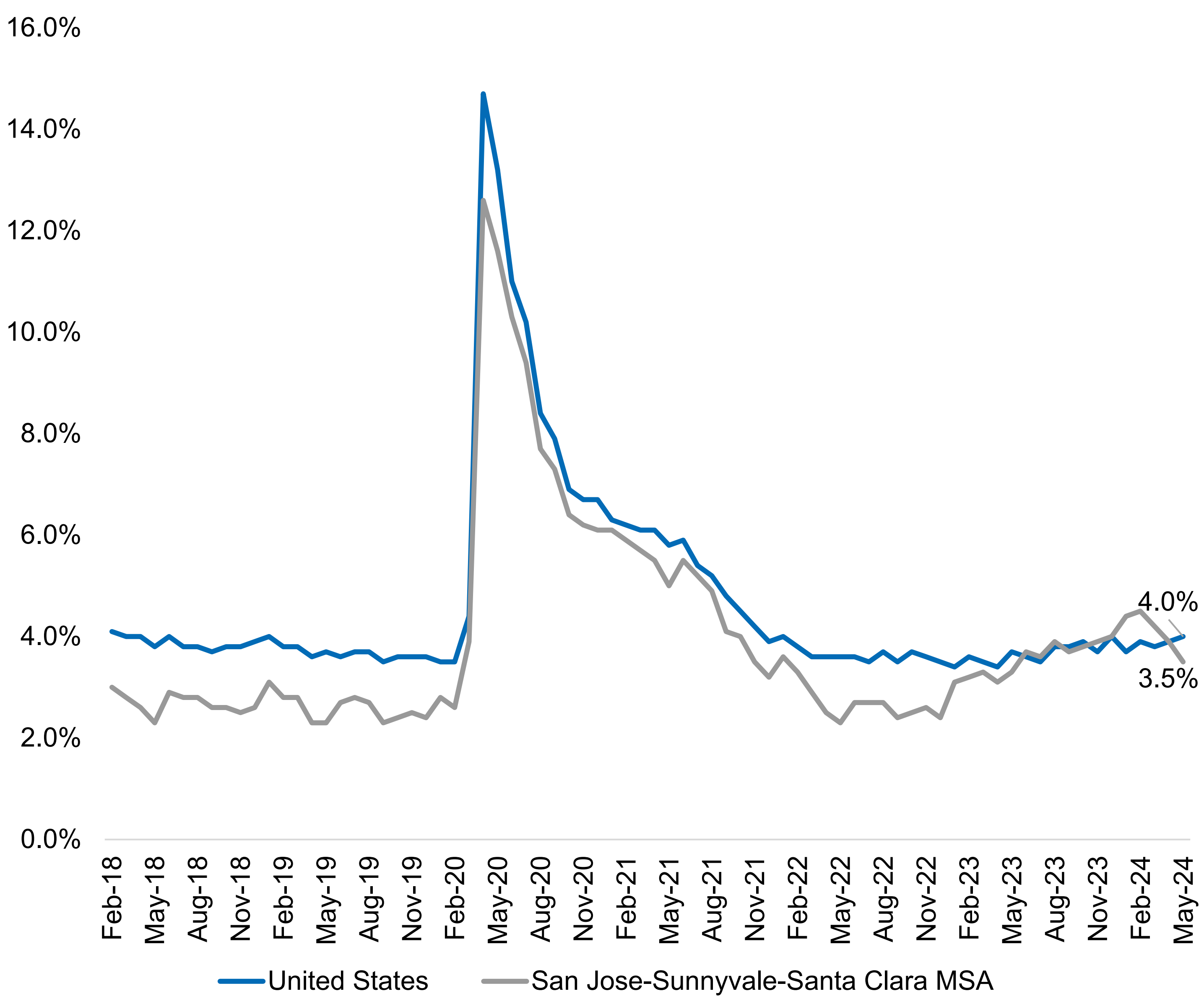
Economy

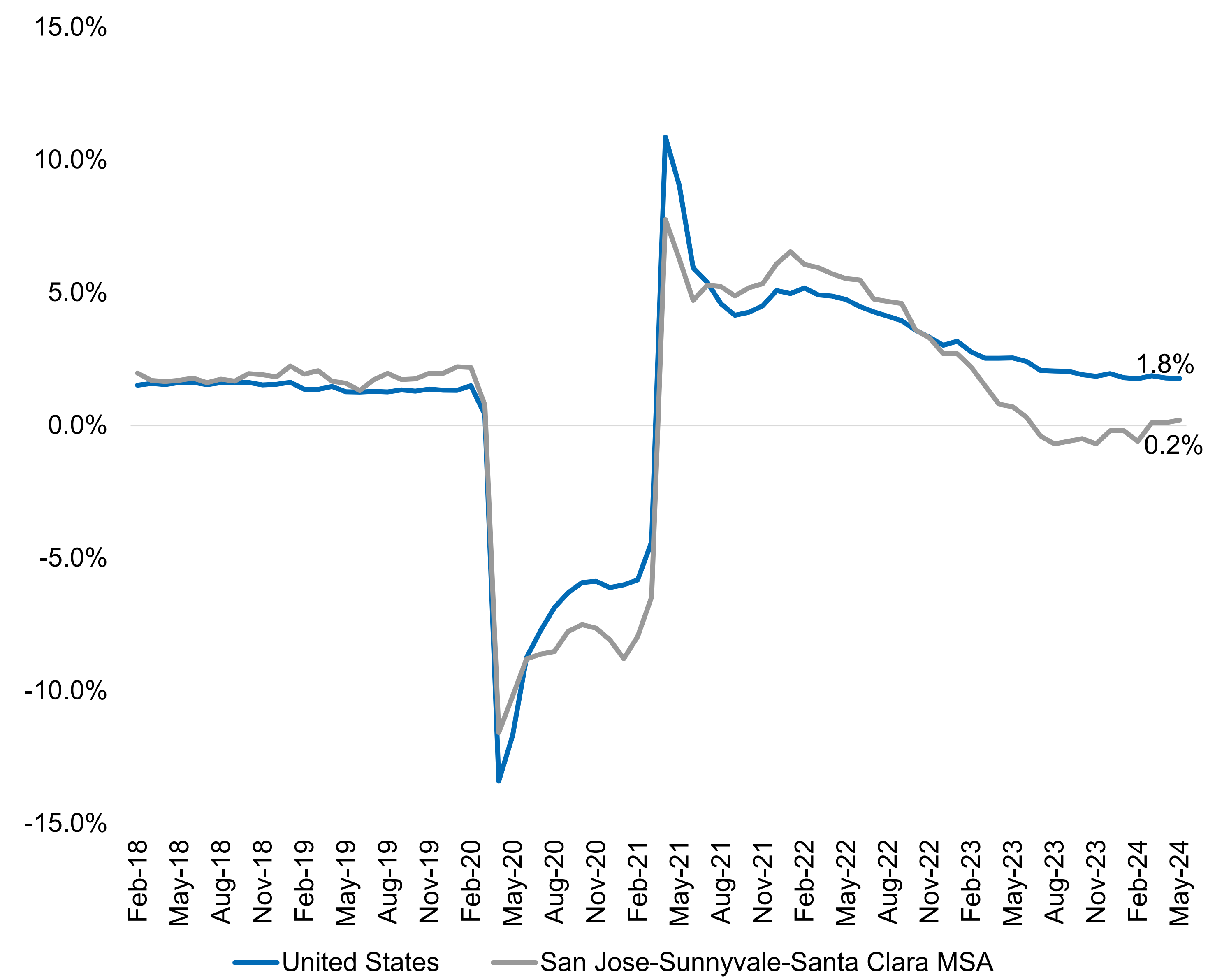
Employment Growth Appears to Be Stabilizing

The San Jose-Sunnyvale-Santa Clara MSA's economy showed signs of stabilizing, adding a modest 0.2% job growth year-over-year. This is the third month in a row with year-over-year growth, a welcome change from eight months of declines. The overall unemployment rate has steadily ticked down the last three months to 3.5%, a 100 bps drop during the period. While employment growth has been slower in this market relative to the U.S., the unemployment rate has fallen more sharply indicating a tighter labor pool.

Unemployment Rate, Seasonally Adjusted



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

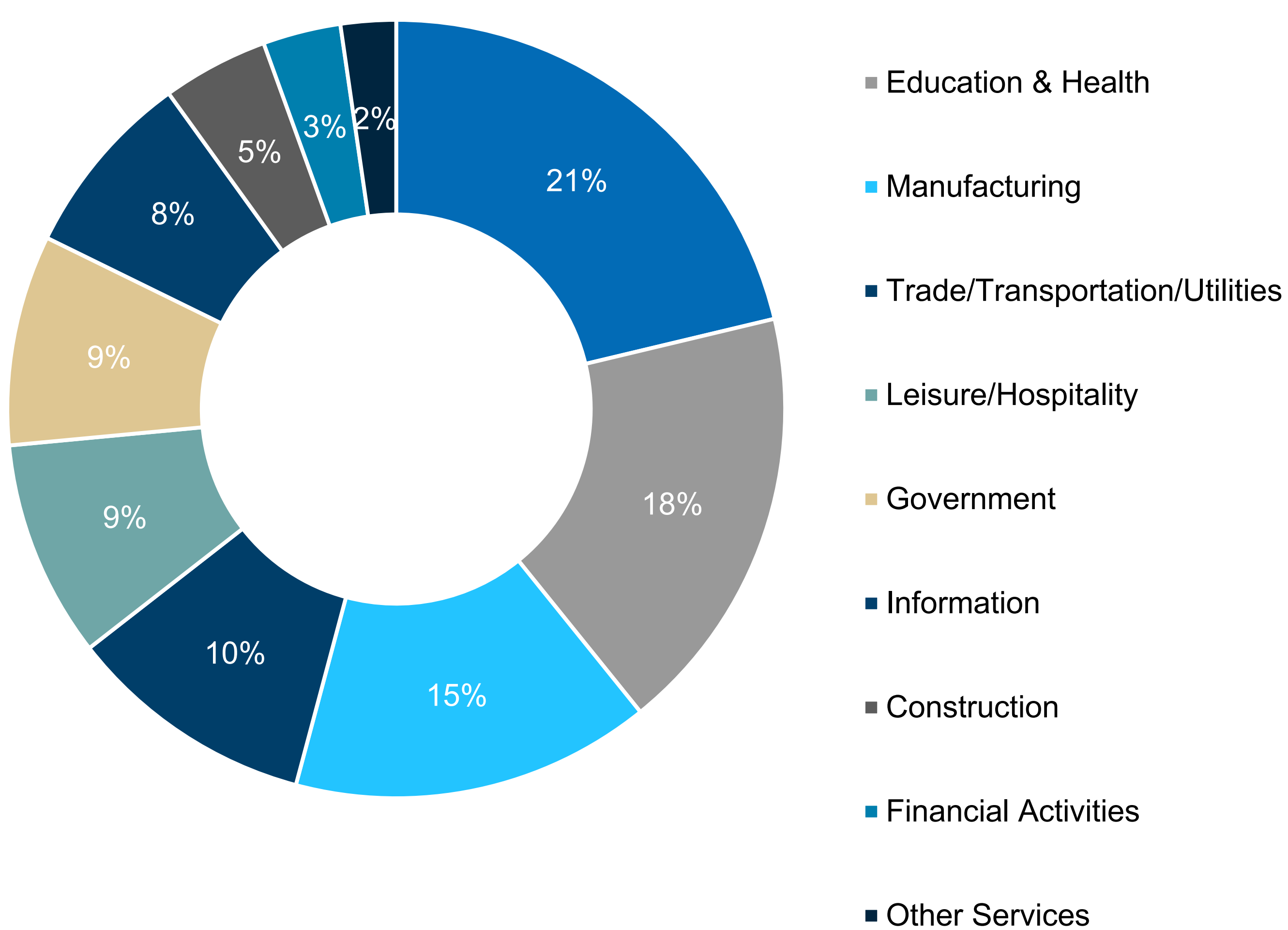


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale

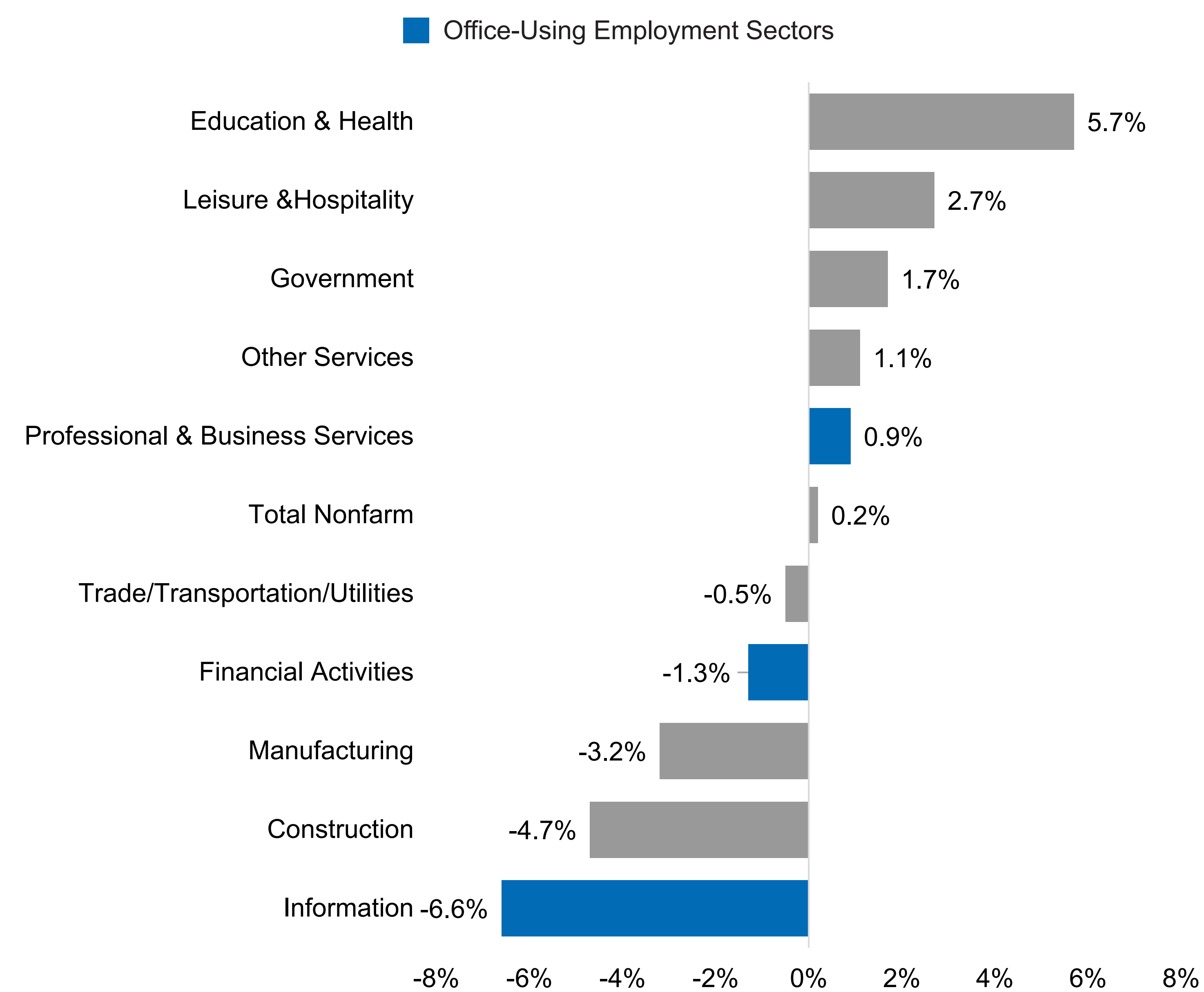
The Tech Sector Decline Continued to Drag On Overall Employment

Despite strong employment growth in the Education & Health and Leisure & Hospitality sectors, job losses in the Tech sector dragged down overall employment growth to a mere 0.2% from the same time last year. Layoffs in the large tech companies that occupy large blocks of space in Silicon Valley outpaced employment gains in the AI space, something that we are closely monitoring. As a result of growth in the AI sector, professional and business services, such as law and consulting firms, are staffing up in anticipation of an increase in work.

Employment by Industry, May 2024



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

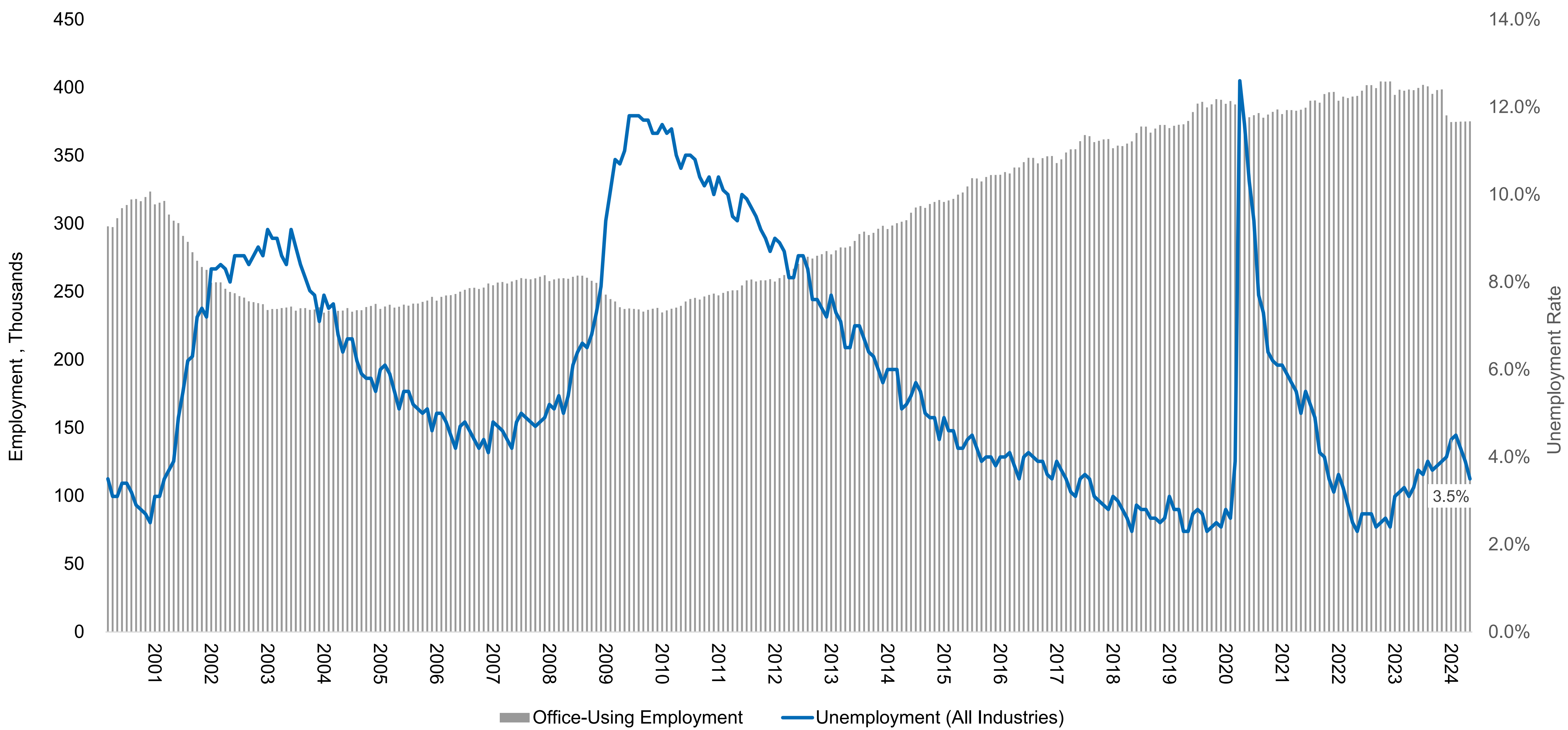


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale, layoffs.fyi
Note: May 2024 data is preliminary.

Office-Using Employment Showed Signs of Improving

Following along with the overall employment showing signs of stabilizing, office-using employment ticked up in the first five months of 2024 after sharp declines in the previous few months. However, the level of office-using employment is still below the peak from one year ago. Small job growth in the AI sector was not enough to counter the overall decline in the information services sector. However, job in the professional services sector is starting to show signs of life, which bodes well for the office market, especially Class A buildings.

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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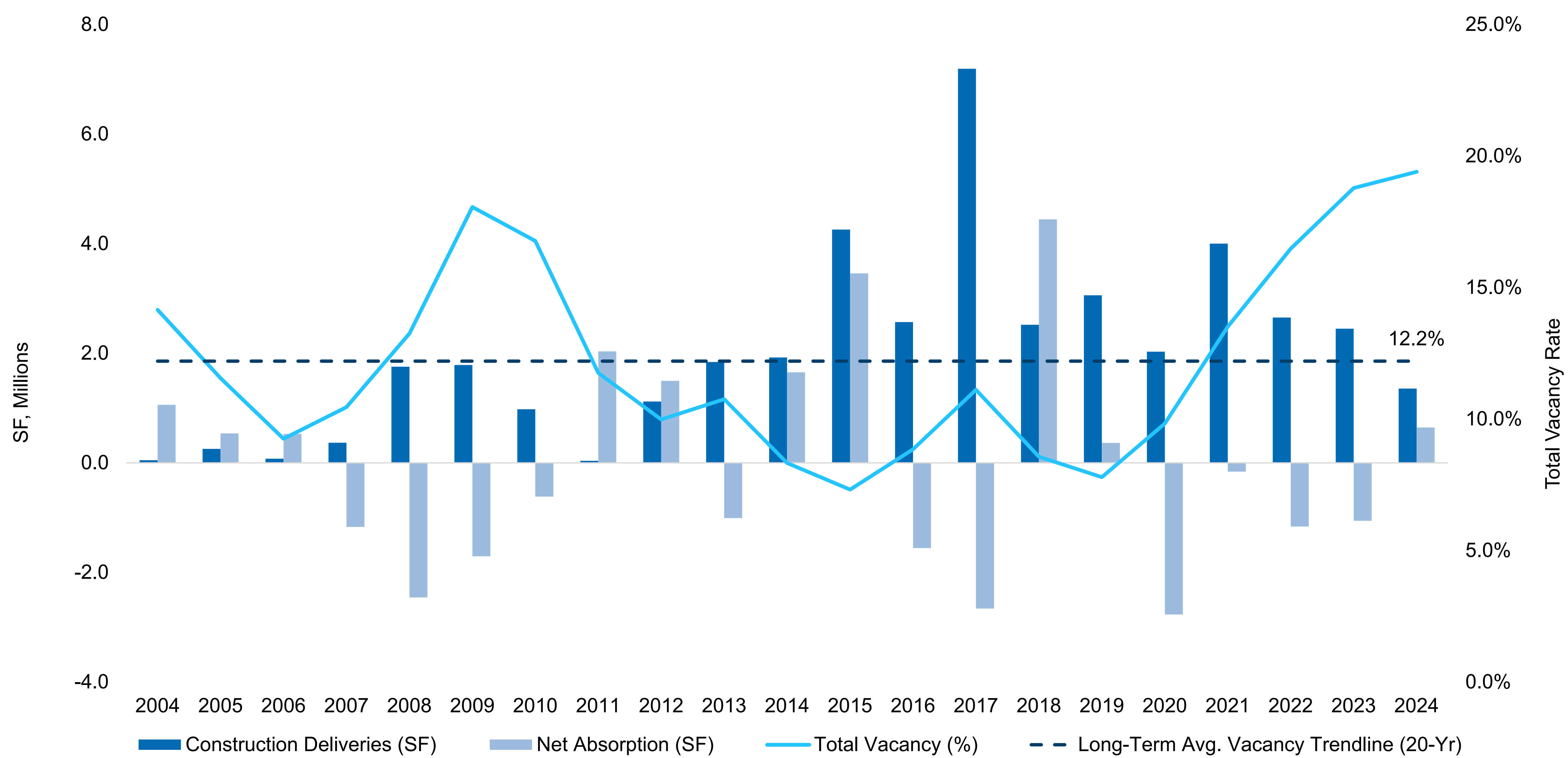
Leasing Market Fundamentals

Despite Slower Construction and Positive Net Absorption, Vacancy Rate Inched Up

The large blocks of both direct and sublease space that have been returned to the market, especially from some of the big tech names, pushed the overall vacancy rate up to 19.4% in the second quarter, 60 basis point increase from year-end 2023. Despite this increased in space, net absorption was positive in the first half of the year as the new construction pipeline slowed down to only 1.3 million square feet, well below its ten-year historic average.

Historical Construction Deliveries, Net Absorption, and Vacancy

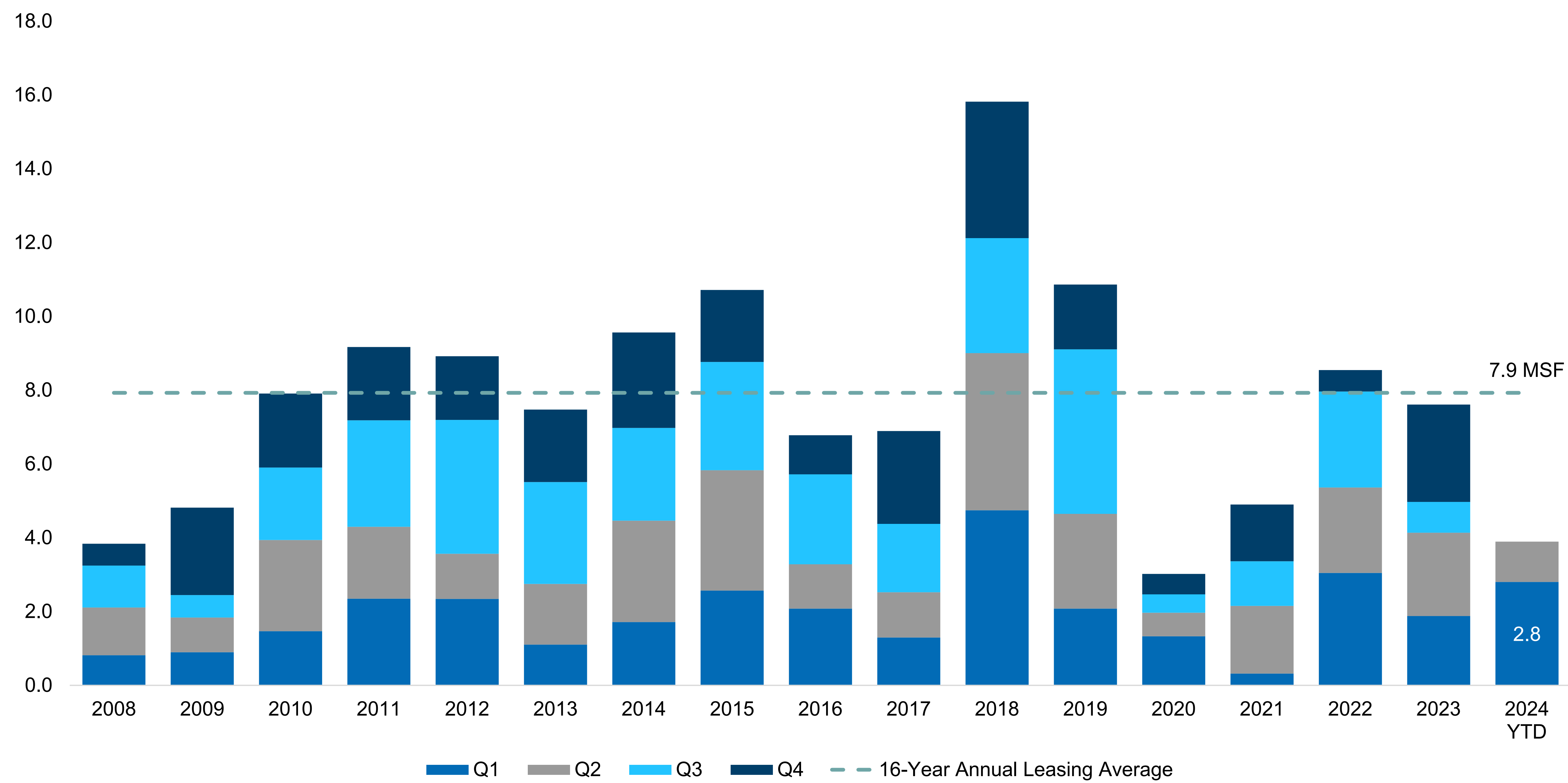


Source: Newmark Research

Leasing Activity in First Half of the Year Showed a Possible Inflection Point

The strong pace of leasing activity in the first quarter, combined with a lower levels in the second quarter, might be enough is to push the total leasing activity for this year close to the 16-year leasing average of 7.9 million square feet. Google leased 1.4 million square feet in Moffett Park that led to the company leasing all six buildings in Moffett Park and Moffett Gateway. While tenant demand is still weak, we are currently tracking at least 15 requirements over 50,000 square feet, of which nine are 100,000 square feet or greater.

Total Leasing Activity (msf)

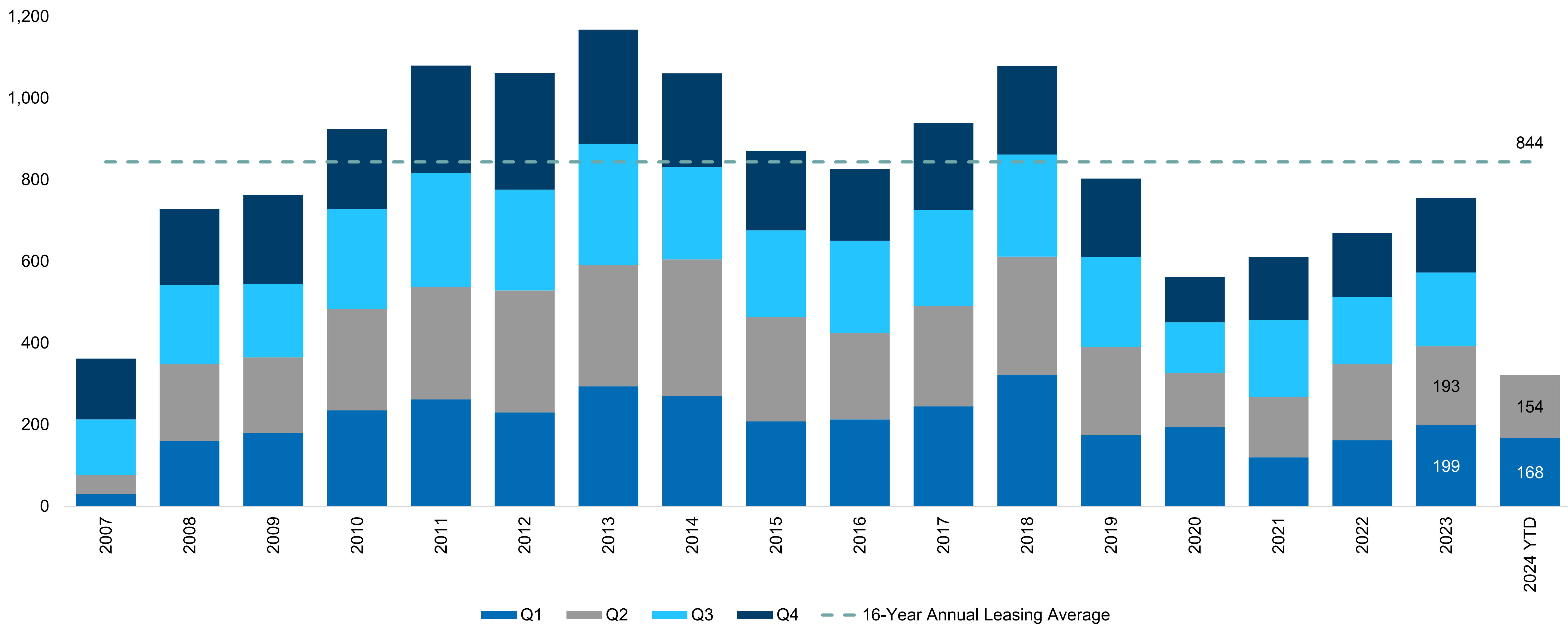


Source: Newmark Research, CoStar

Transaction Counts Remain Below Historical Average

We tracked at least 154 office transaction in the second quarter alone, bringing the total for the first half of the year to more than 300 deals. While there are positive signs in the market that we are at an inflection point, if the pace of activity continued through the second half of the year, leasing activity will still be slightly lower than the 16-year average of nearly 844 deals. In addition, we are currently tracking 4.6 million square feet of active tenants in the market, which is far below the 16-year market average of 8.2 million square feet.

Number of Leases Signed



Source: Newmark Research, CoStar

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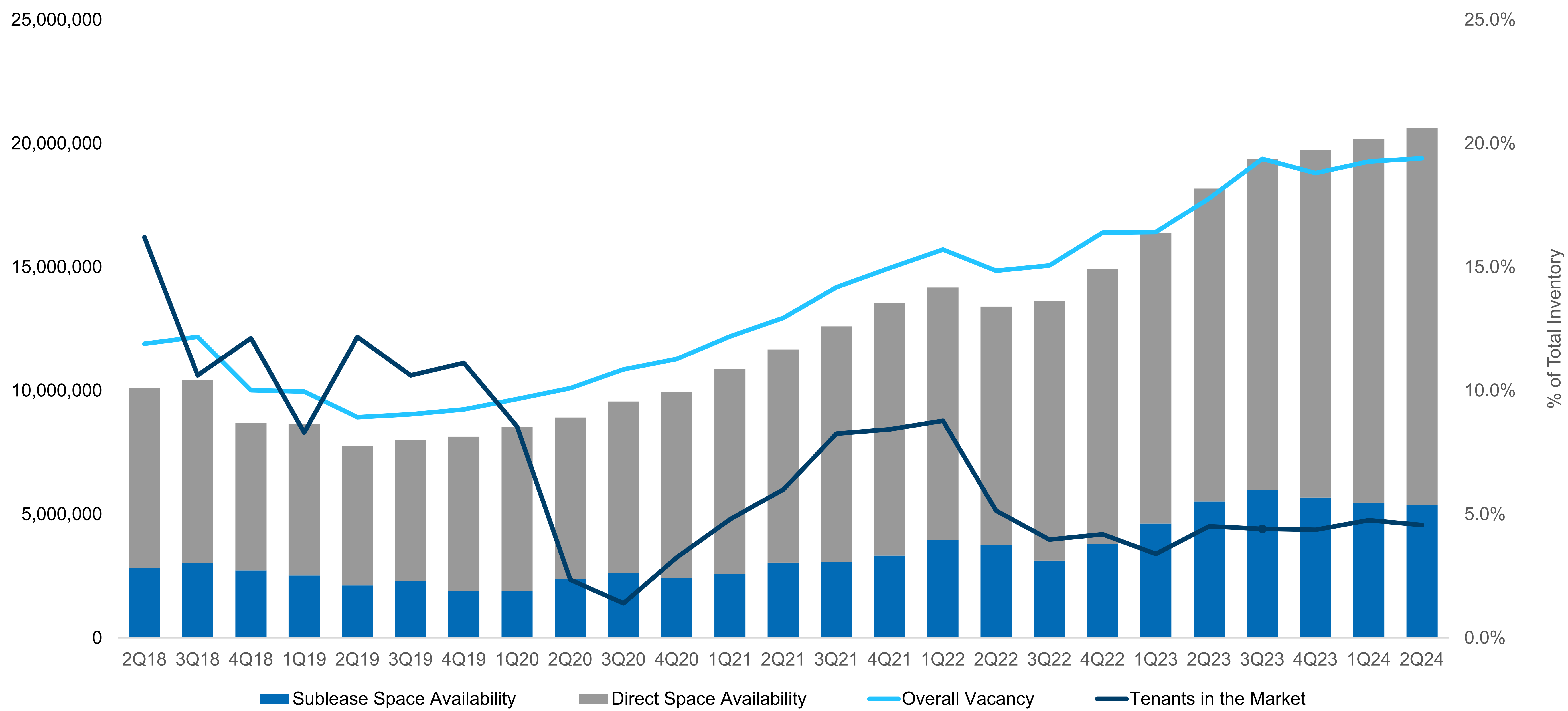
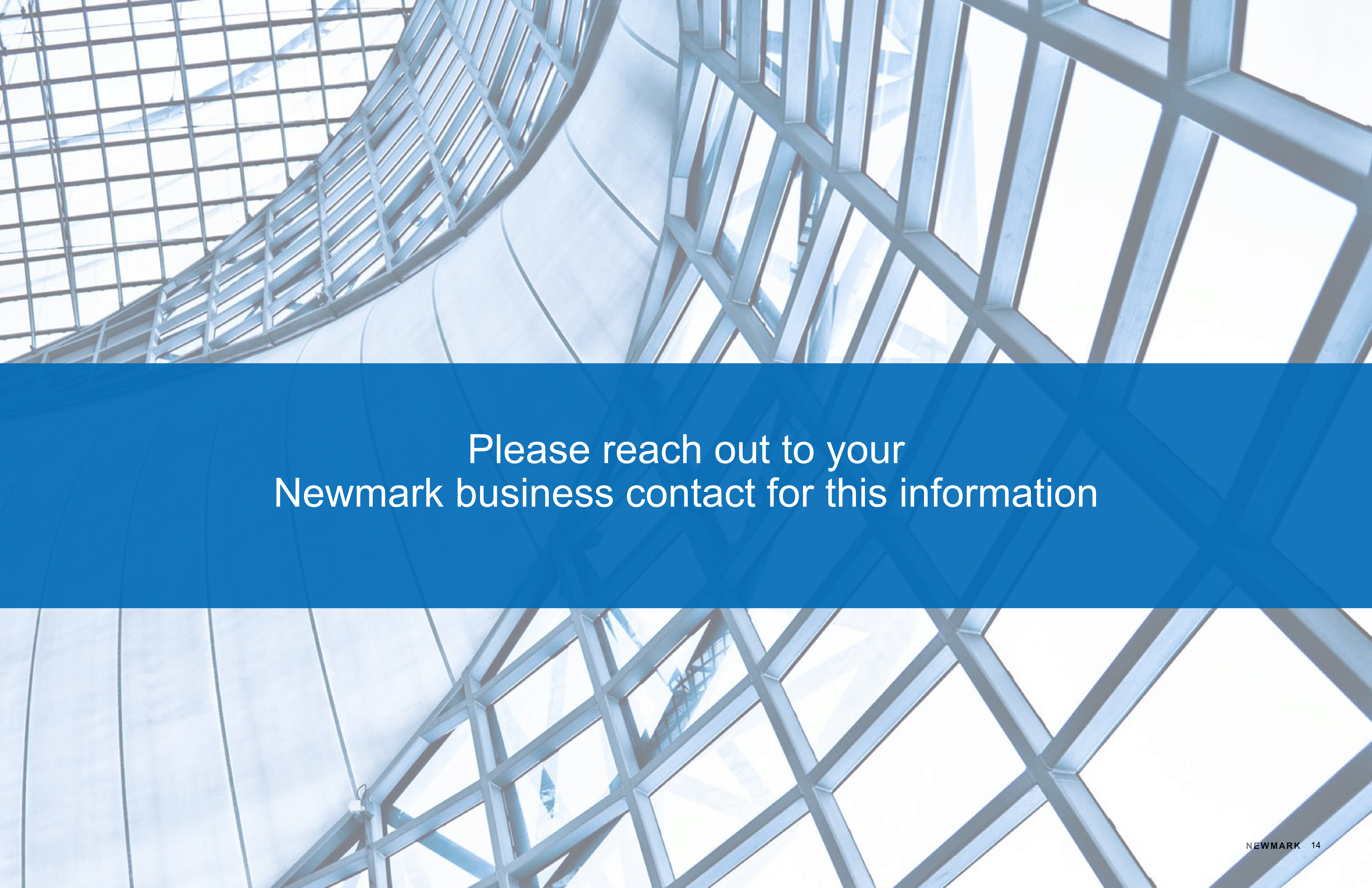
Amount of Sublease Space Shrinking

With an increase in direct available space returned to the market in the second quarter, the overall availability rate inched up to 19.4% from 18.8% at year-end 2023. Demand from tenant requirements currently stands of 4.8% of total inventory, basically flat from the first quarter. One positive sign for the market is that the amount of sublease space is dwindling as some tenants in the market are still price sensitive and are snapping up sublease space.

Available Space and Tenant Demand as Percent of Overall Market



Source: Newmark Research



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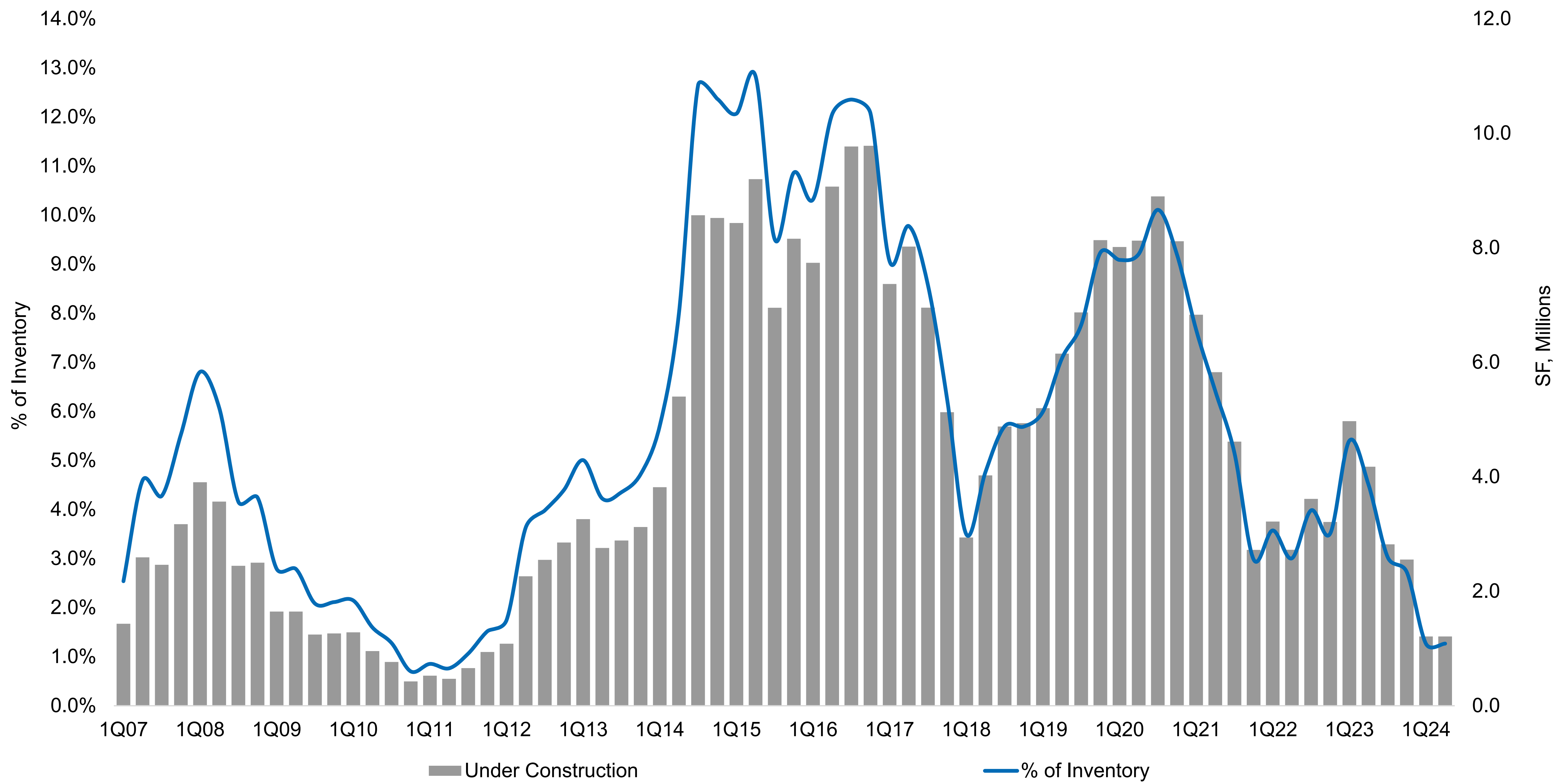
Construction Pipeline Tempered Down, Which Bodes Well for the Market

One positive sign for the market is that the new construction spigot has nearly been turned off, with the amount under construction at the lowest level it has been at for more than ten years. In addition to developers holding off on starting new projects until tenant demand returns, the tight capital market with high borrowing costs are also dampening the construction starts. Given the glut of available office space and the move to hybrid-work/office model, some developers have proposed converting older office buildings into residential buildings.

Office Under Construction and % of Inventory

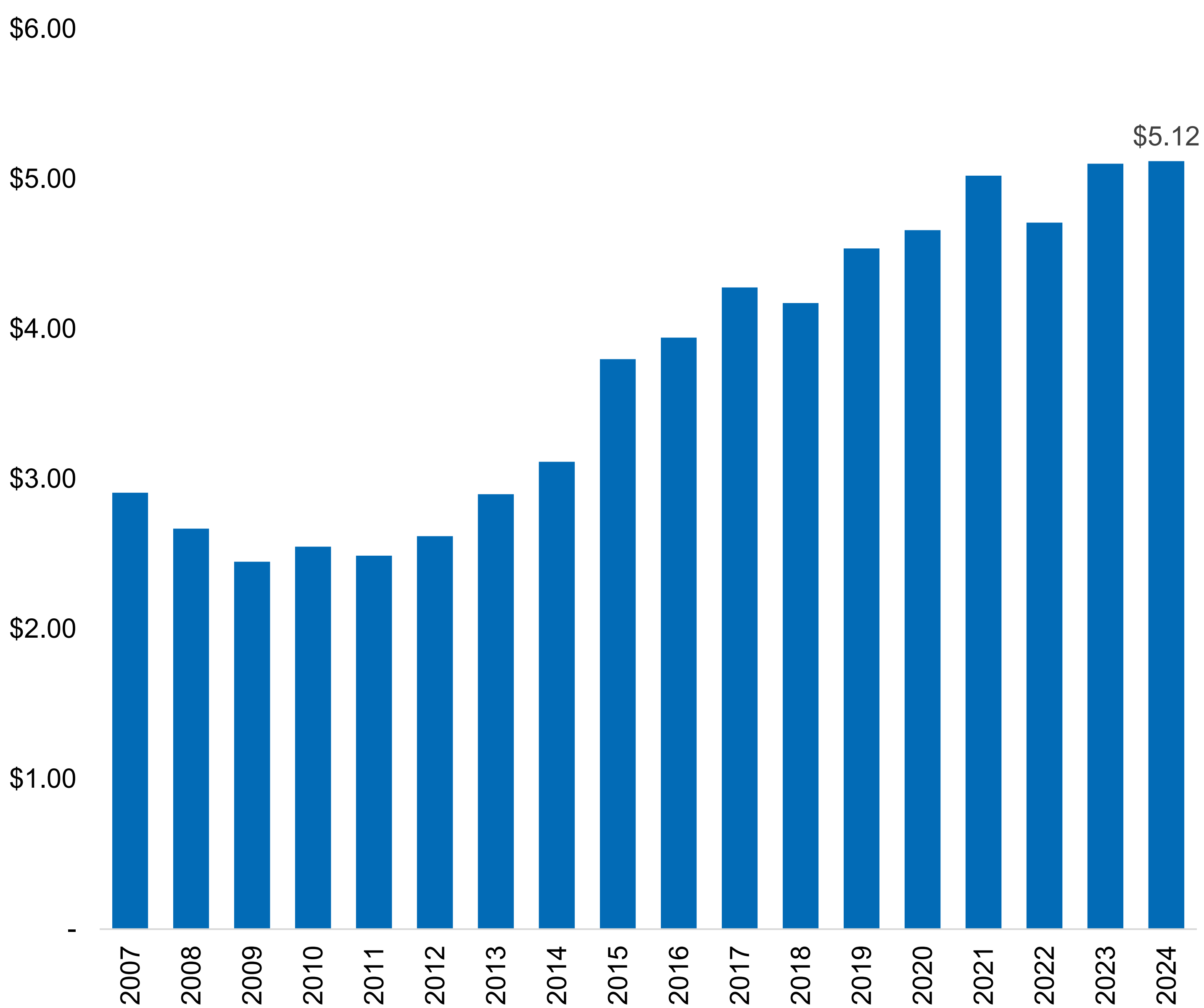


Source: Newmark Research, CoStar, San Jose-Santa Clara-Sunnyvale MSA

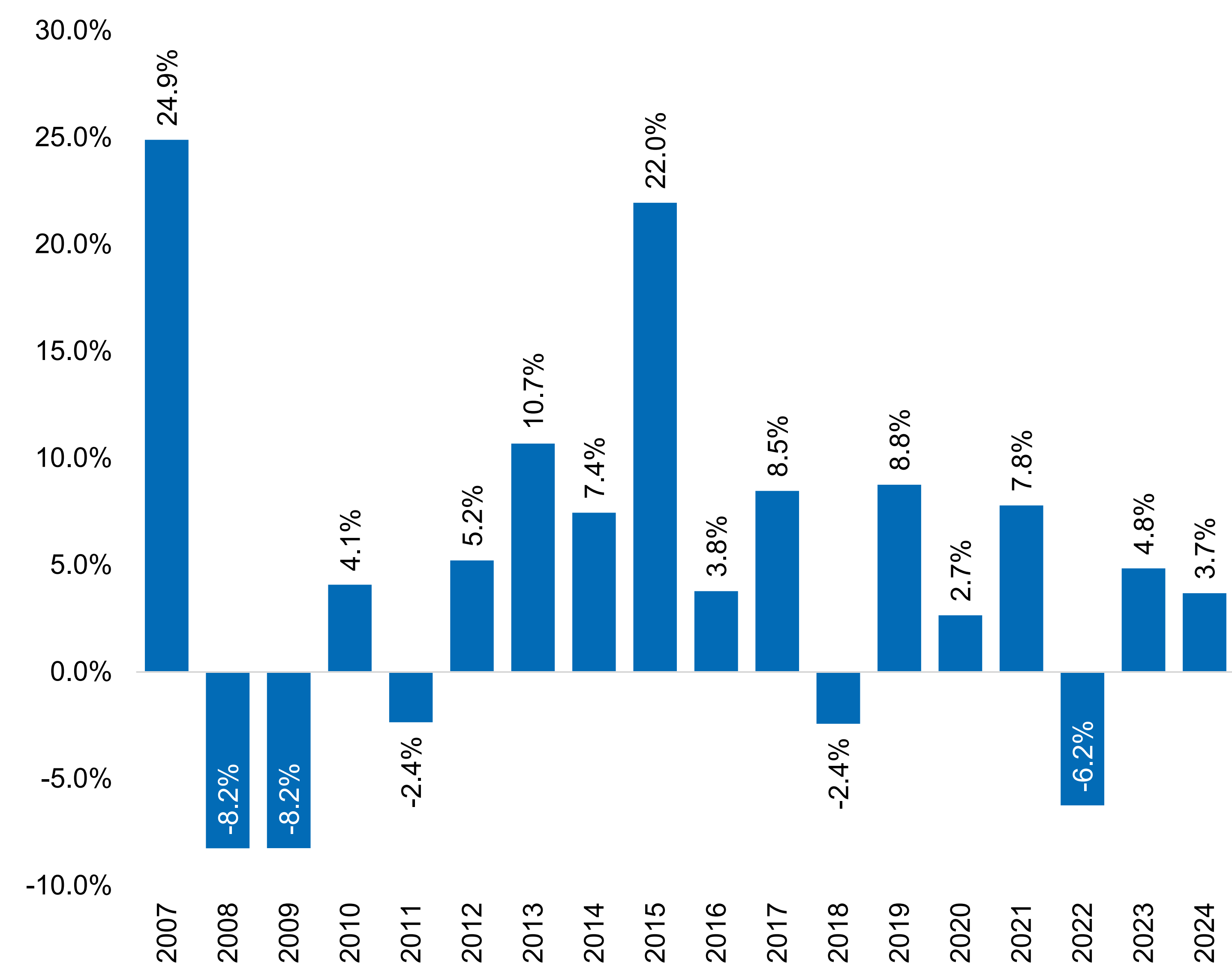
Asking Rents Have Held Relatively Stable so Far This Year

After springing up in 2023 to $5.10/SF full service, asking rents have basically held steady in the second quarter of 2024 at $5.12/SF full service. Concessions, including Tis and free rent, still play a big part in lease negotiations. In addition, as companies continue to look for ways to bring employees back to the office, amenities continue to also play a big role in attracting people back. These amenities include flexible workspaces, more conference rooms, natural light and open spaces, and advanced infrastructure.

Office Average Asking Rent, $/SF, FS



Year-over-Year Asking Rent Growth Rate



Source: Newmark Research, CoStar

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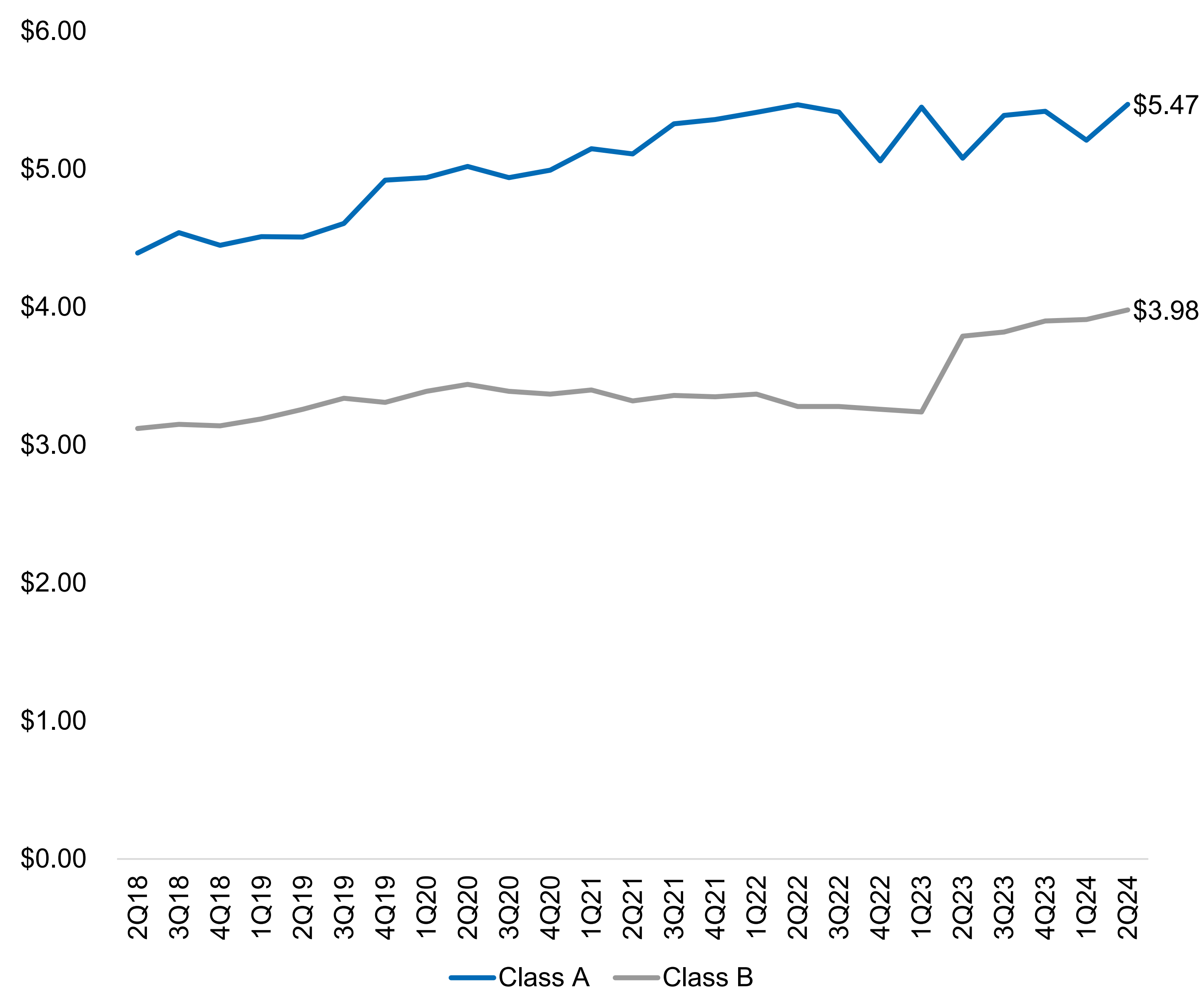
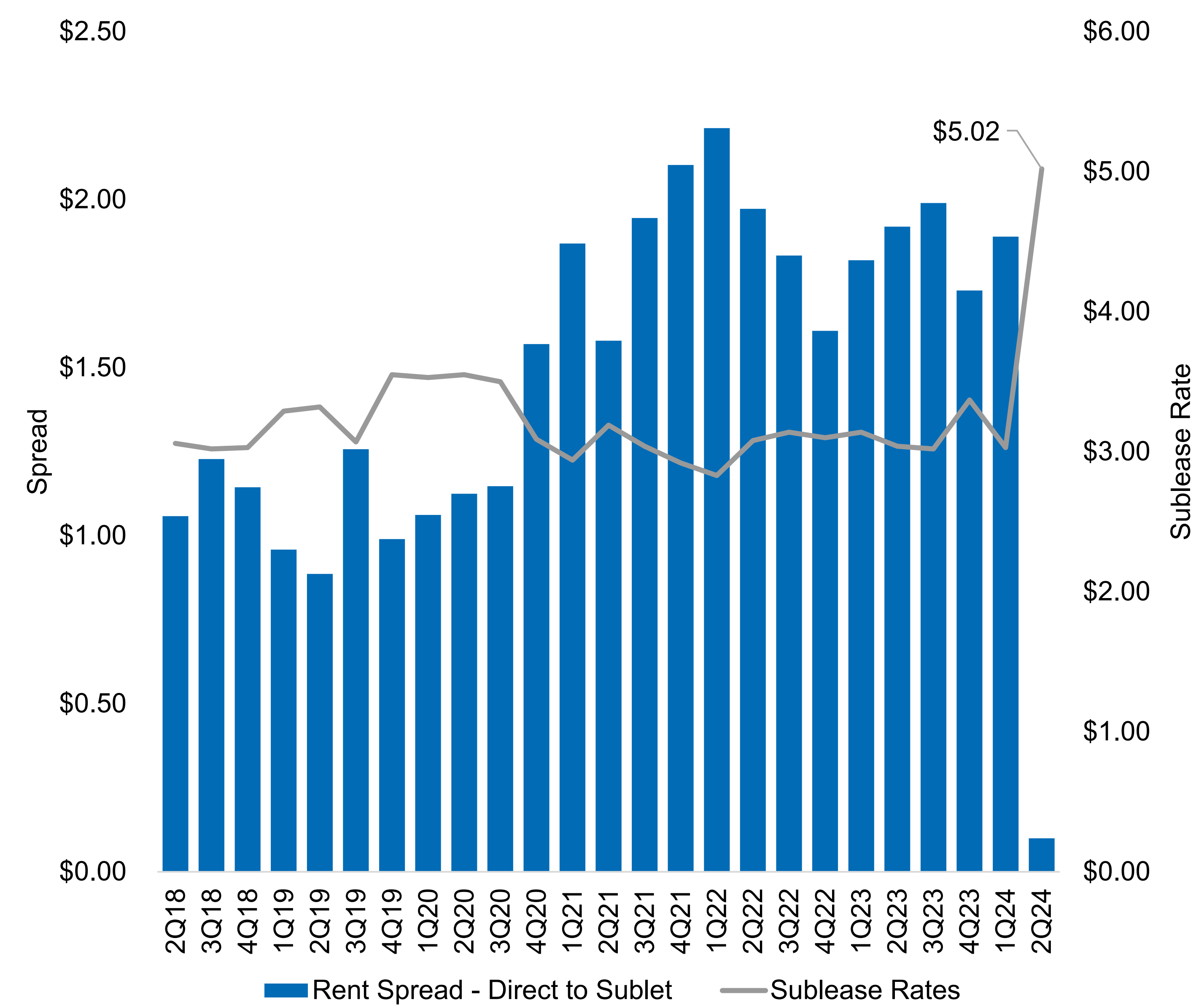
Class A Rents Actually Inched Up

Overall class A rents reached their highest level in more than ten years to $5.48/SF, a 5.3% increase from the previous quarter and nearly 3.0% from the same time last year. Leading the growth was the Sunnyvale submarket that had the largest increase of all the submarkets with a 7.0% increase from the first quarter. Santa Clara and Mountain View also posted healthy rental rate growth in the second quarter as demand picked up for class A space in these submarkets. Asking rent growth for class B space was still positive.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

A Few Large Direct Deals Were Inked in the Second Quarter

A semiconductor company accounted for the largest lease in the second quarter in the Santa Clara submarket, which was slightly larger than the largest lease in the first quarter. One noteworthy trend for the first half of 2024 is that the bulk of the leases signed, nearly 50%, were for direct space whereas this past two years renewals comprised most of the activity. Subleases continue to play a role in this market with a glut of sublease space returned to the market over the past few years after tech firms in the area are shrinking their footprint.

Notable 2Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Applied Materials	3325 Scott Boulevard	Santa Clara – Central Expressway North	Lease Renewal	154,841
Lease Renewal. Applied Materials occupied 4 floors (Floor 1-4)				
Indie Semiconductor Inc	181 Metro Drive	San Jose – Airport	Direct Lease	23,135
New Lease. Indie Semiconductor's first location in the Bay Area, making this their second location in California and the fifth in the United States.				
Confidential	2160 Lundy Avenue	San Jose – International Bus Park	Lease Expansion	22,629
Lease Expansion. Occupied by confidential tenant.				
Sutter Health	6399 San Ignacio Avenue	San Jose – South	Lease Renewal	20,509
Lease Renewal. Sutter Health, one of the nation's leading healthcare with a presence in the Valley, renewed in their facility in San Jose.				
AESC	2350 Mission College Boulevard	Santa Clara – Marriott Park	Direct Lease	20,133
New Lease. AESC leased a ±20,133 SF space in the same building it was subleasing before.				

Source: Newmark Research

Appendix

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Newmark has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Research Reports are available at nmrk.com/insights.

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