2Q24

South Peninsula Office Market Overview

NEWMARK

Market Observations

Economy

- 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. This possible stabilization translated directly into the overall unemployment rate steadily ticking down the last three months to 3.5% from 4.5% one year ago.
- 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.

Leasing Market Fundamentals

- While the construction pipeline has dramatically slowed, both direct and sublease space is still returning to the market. This increase in supply pushed the overall availability rate up to 25.7% in the second quarter from 24.5% at year-end 2023. Demand from tenant requirements steadily declined in the past four quarters to 4.2% of total inventory after peaking at 9.4% in the third quarter of 2023. With the economy possibly stabilizing, we expect to see an increase in tenant demand.
- Weak demand coupled with a glut of available space put downward pressure on asking rents this quarter. After peaking in 2022, asking rents fell 6.9% in the first half of the year to $5.70/SF. While asking rents are declining, concessions, including TIs and free rent, play a big part in lease negotiations. In addition, as companies continue to look for ways to bring people back to the office, amenities such as conference rooms, flexible workspace and up-to-date infrastructure, are important.

Major Transactions

- Leasing activity through the first half of the year is well below the 16-year historical average but if the pace set in the first two quarters continues in the second half of the year, then leasing activity will likely mirror levels from 2023.
- The largest lease in the second quarter was a lease renewal for 115,061 SF in Downtown Redwood City. The largest direct lease was by Tinder for 41,000 SF in Palo Alto.
- Palo Alto recorded the largest share of leasing activity with nearly 45% of all leases signed in that submarket followed by Menlo Park with a distant second with nearly 25% of all activity. Law firm Skadden, Arps, Slate, Meagher & Flom LLP renewed their lease in Palo Alto for nearly 60,000 SF.

Outlook

- As activity from AI companies continue to expand, the outlook for the Professional & Business Services sector is positive as these firms ramp up their staff and space needs in order to cluster near these AI companies. This bodes well for the office market, especially Class A buildings.
- While the short-term outlook is still weak, there are signs that the economy and office market are approaching an inflection point. A slight increase in sublease and direct space put on the market pushed the total vacancy rate up to 22.6% in the second quarter, its highest level in at least 20 years.
- However, there are signs that the market may be stabilizing as the clip at which the vacancy rate has increased has slowed. In addition, after posting a large decline in net absorption in 2023, net absorption contracted by a minimal amount so far in 2024. Lastly, the pace of new construction deliveries has fallen off dramatically. All of this bodes well for the market in the coming years.

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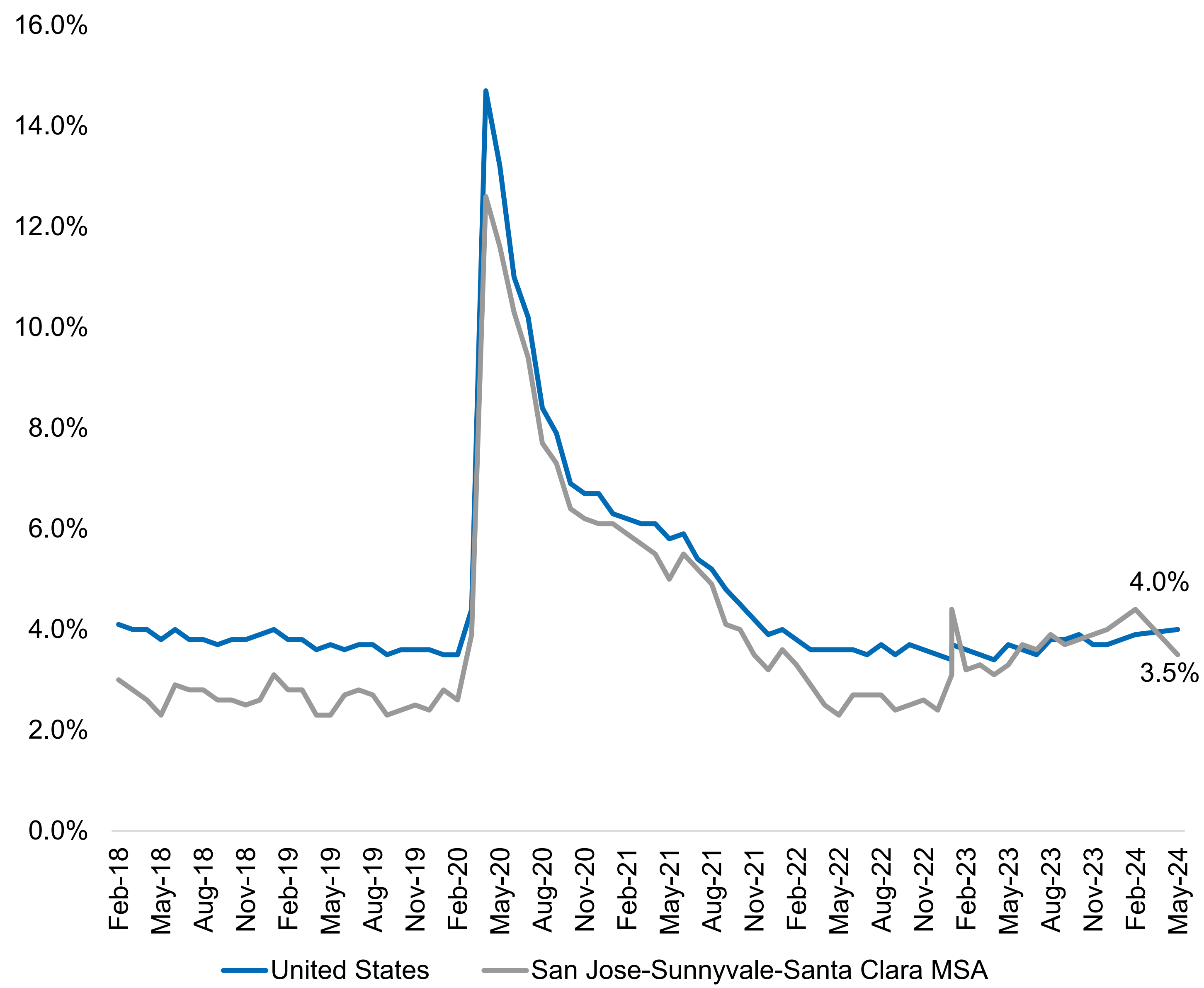
Economy

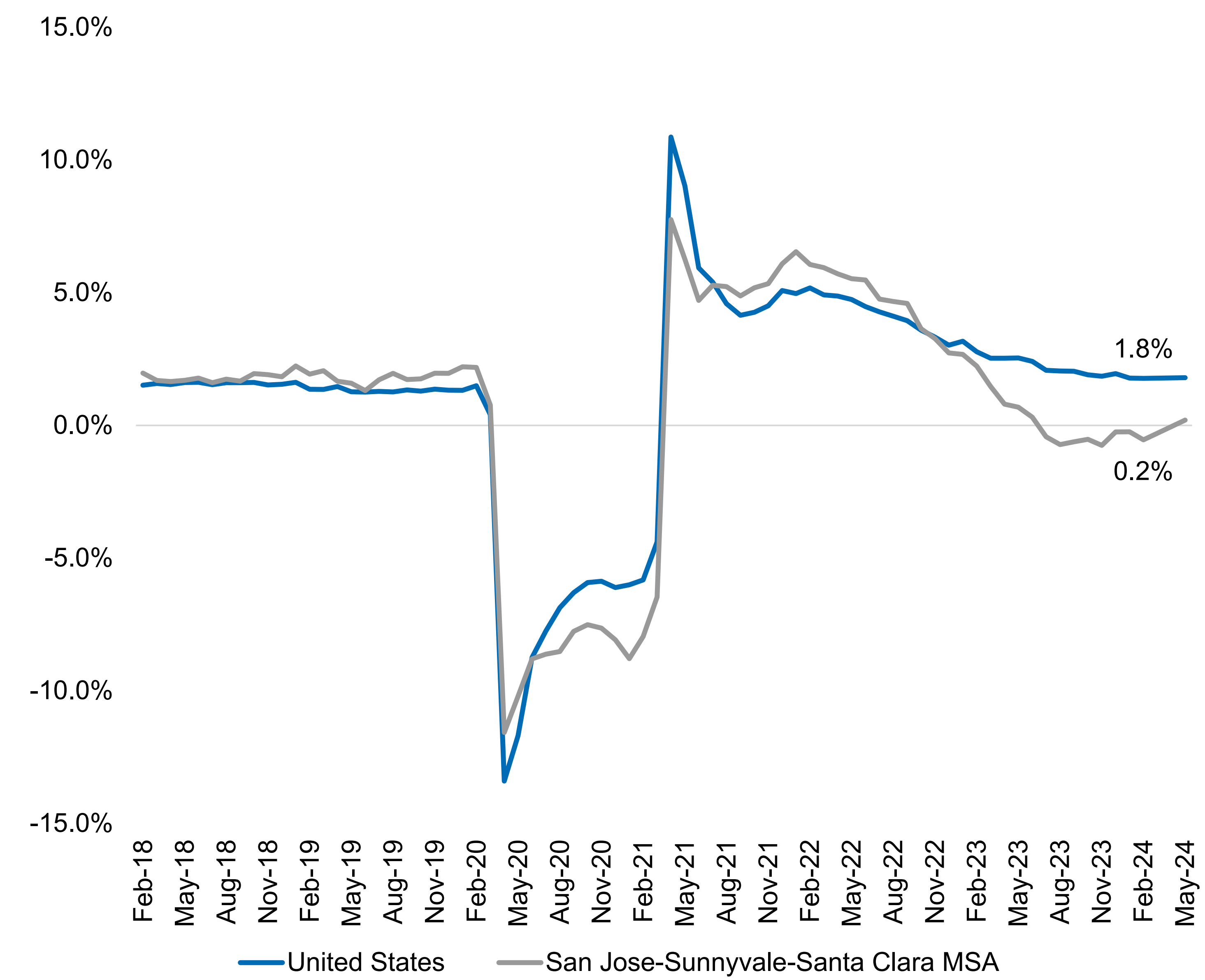
Employment Losses Appeared to be Stabilizing

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. This stabilizing has translated directly into the overall unemployment rate steadily ticking down the last three months to 3.5% from 4.5% one year ago. While employment growth has been slower in this market relative to the U.S., the unemployment has fallen more sharply, indicating a tighter labor pool.

Unemployment Rate, Seasonally Adjusted



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

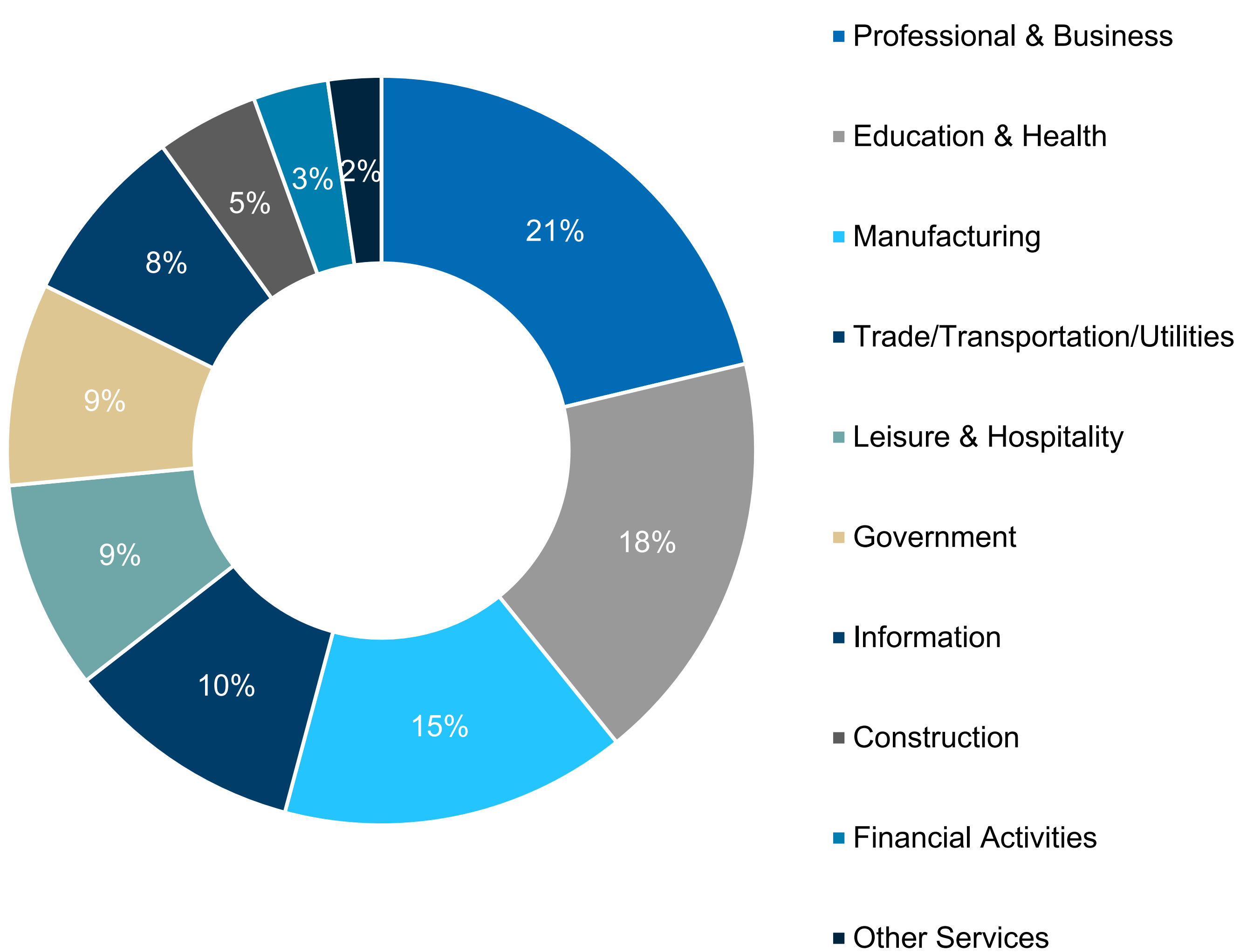


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
Note: May 2024 data is preliminary.

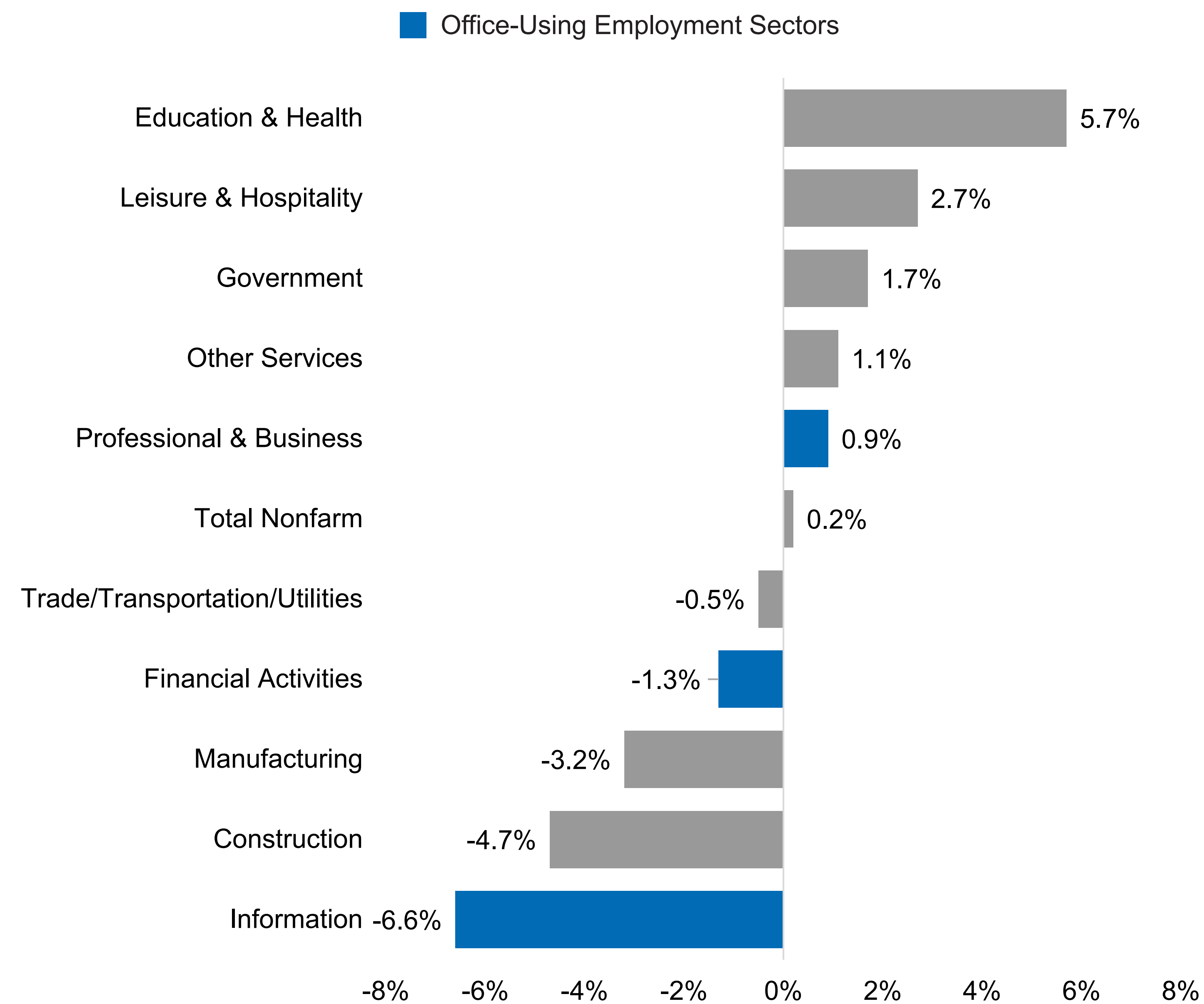
The Tech Sector Decline Continued to Drag on Overall Employment Growth

Despite strong employment growth in the Education & Health and Leisure & Hospitality sectors, job losses in the Information 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 & Business services, such as law and consulting firms, are staffing up to support AI.

Employment by Industry, May 2024



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

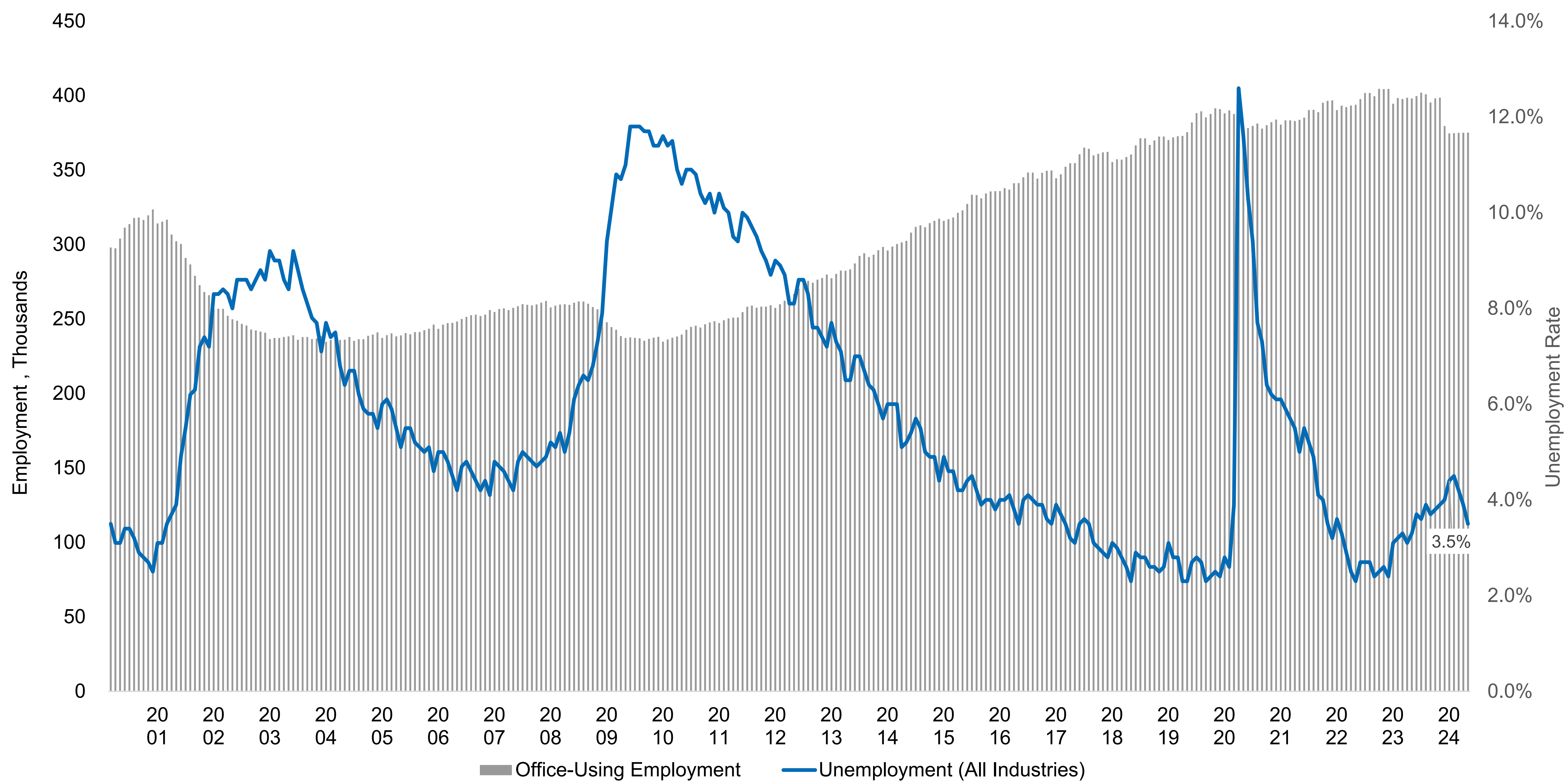


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale, layoffs.fyi
Note: May 2024 data is preliminary.

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. Job in the Professional & Business 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: May 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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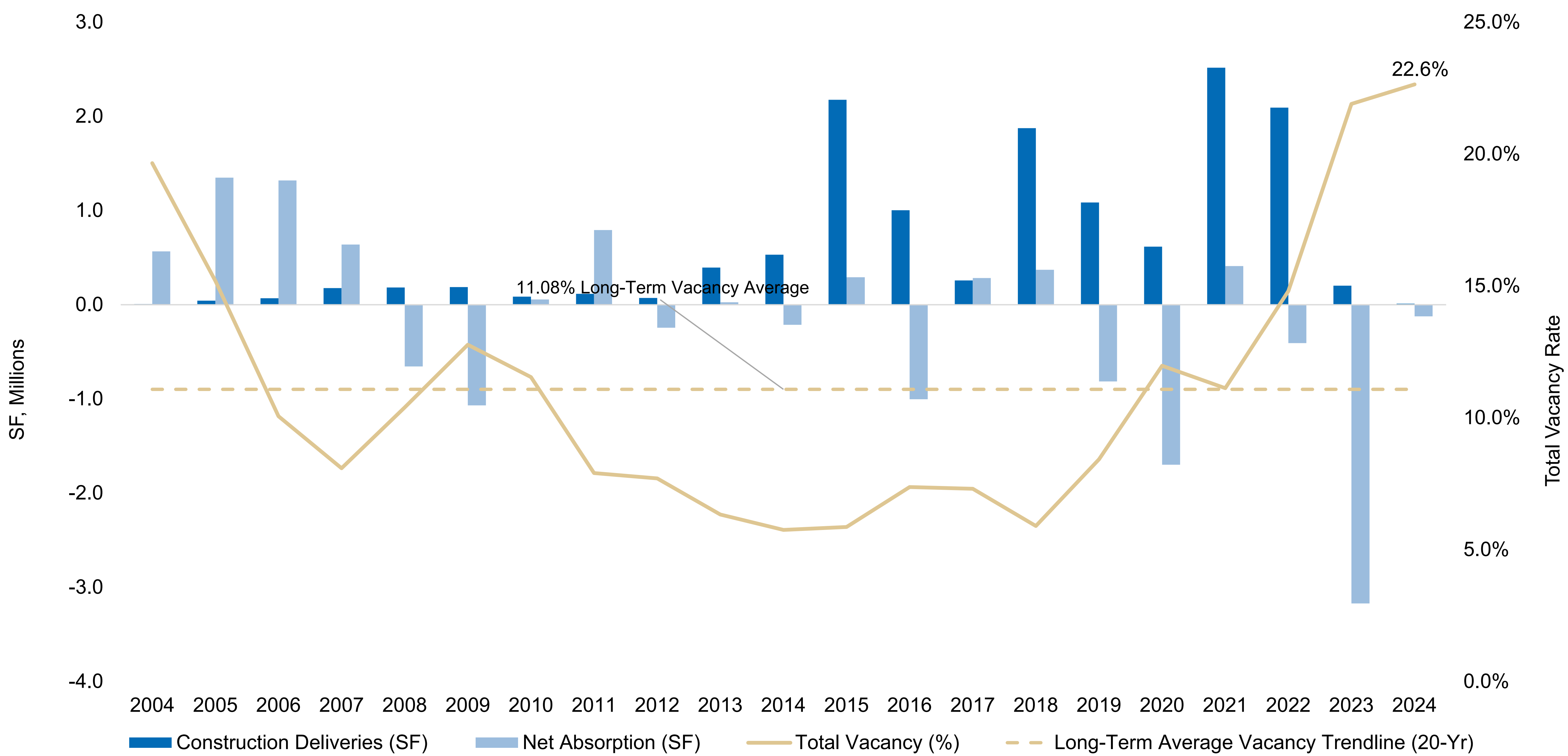
Leasing Market Fundamentals

Construction Pipeline Significantly Slowed, Which Should Help Stabilize the Market

A slight increase in sublease and direct space put on the market pushed the total vacancy rate up to 22.6% in the second quarter, its highest level in at least 20 years. However, there are signs that the market may be stabilizing as the clip at which the vacancy rate has increased has slowed. In addition, after posting a large decline in 2023, net absorption contracted by a minimal amount so far in 2024. Lastly, pace of new construction deliveries has fallen off dramatically. All of this bodes well for the market in the coming years.

Historical Construction Deliveries, Net Absorption, and Vacancy

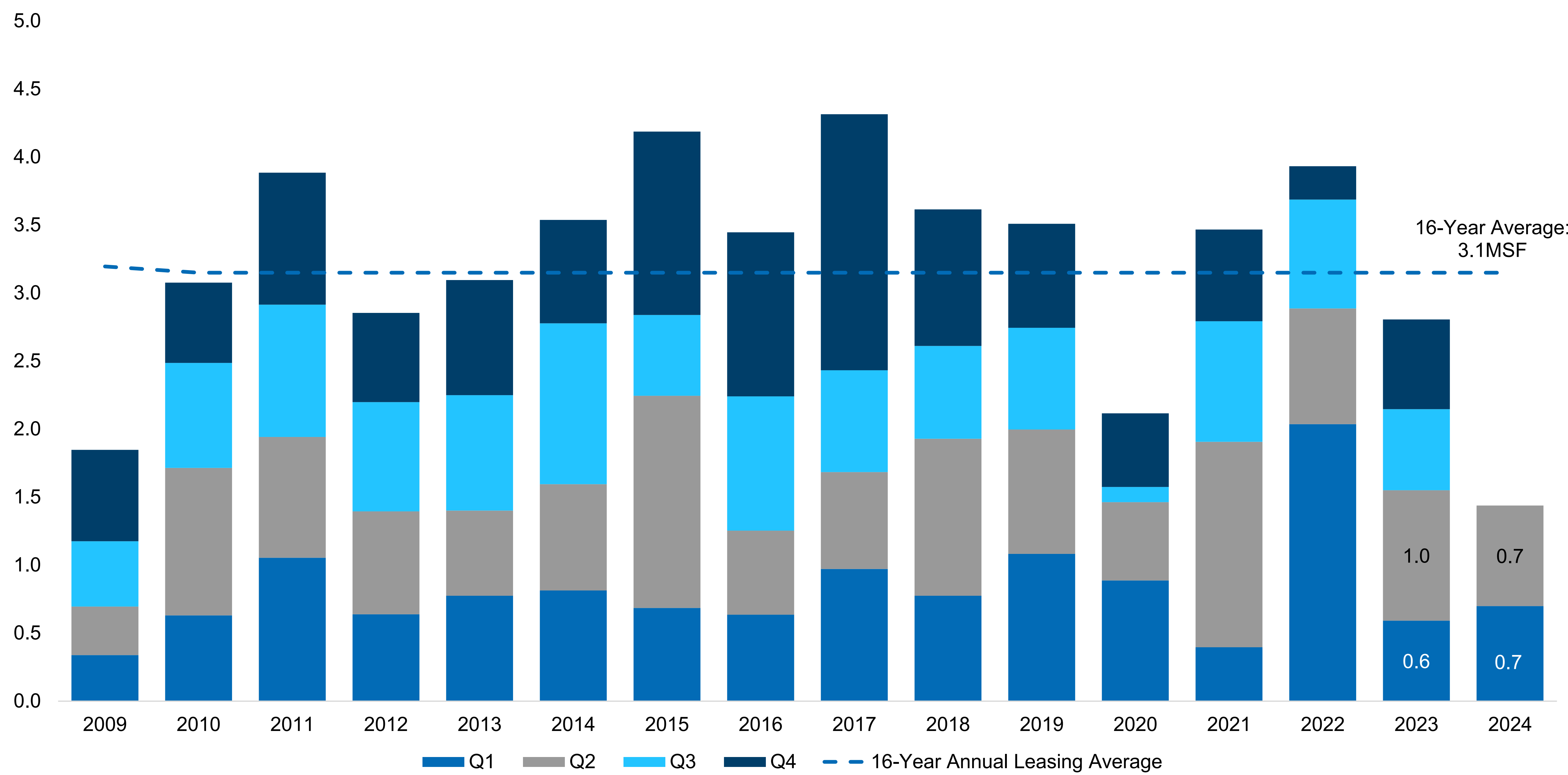


Source: Newmark Research

Leasing Activity on Par to Match 2023 Levels

Leasing activity through the first half of the year was well below the 16-year historical average but if the pace set in the first two quarters continues in the second half of the year, then leasing activity will mirror levels from 2023. More than 40% of all leases signed during the quarter were direct leases, another positive indicator for the market. Another 20% were tenants taking sublease space and nearly 19% were renewals. Also, fewer than 1.0% of the leases signed were tenants downsizing space.

Total Leasing Activity (msf)

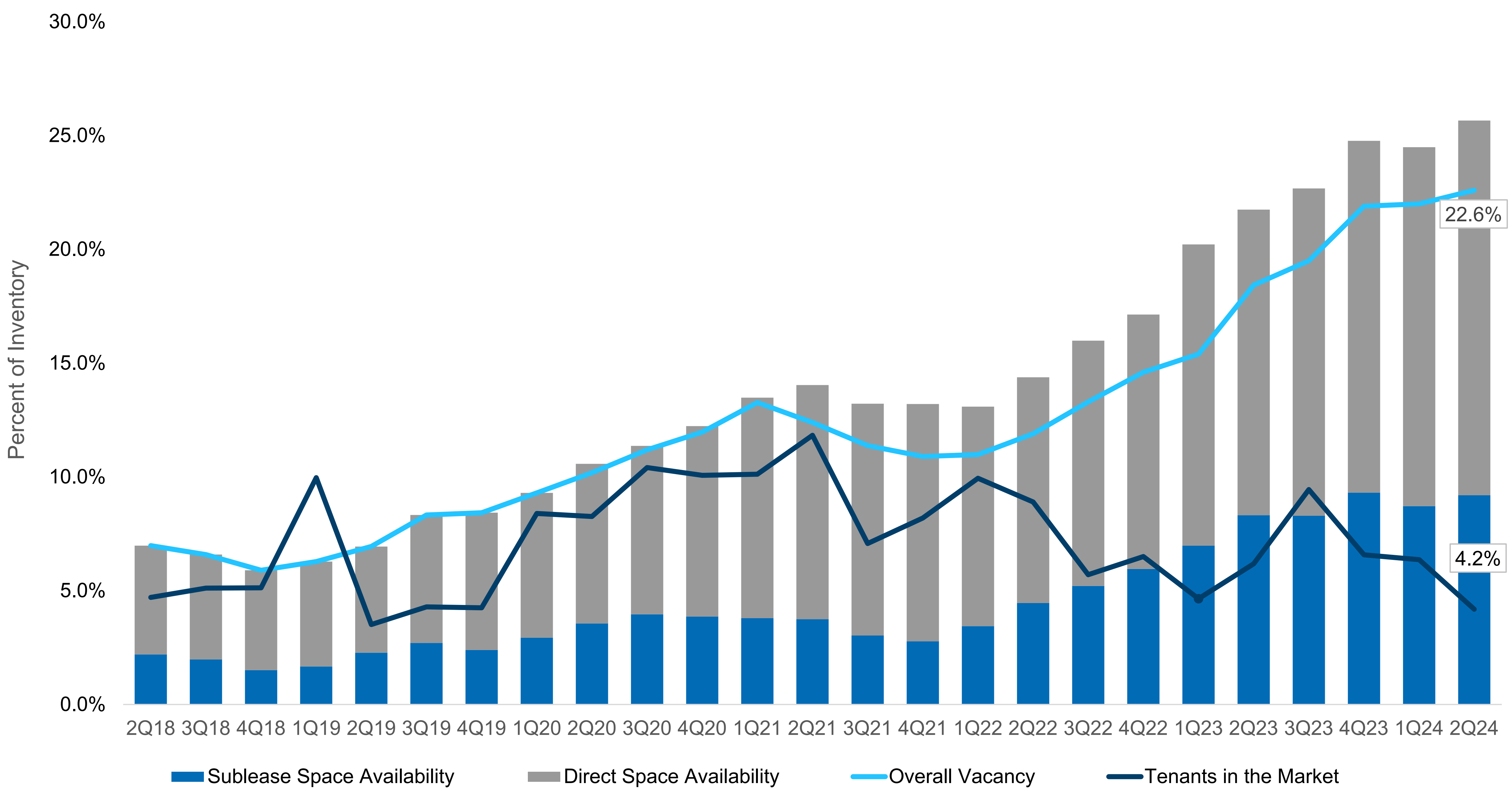


Source: Newmark Research, CoStar

Tenant Demand Ticked Down

While the construction spigot has been turned nearly off, both direct and sublease space continued to return to the market. With an increase in direct and sublease space back on the market, the overall availability rate inched up to 25.7% in the second quarter from 24.5% at year-end 2023. Demand from tenant requirements steadily declined in the past four quarters to 4.2% of total inventory after peaking at 9.4% in the third quarter of 2023. With the economy possibly stabilizing, we expect to see an increase in tenant demand.

Available Space and Tenant Demand as Percent of Overall Market

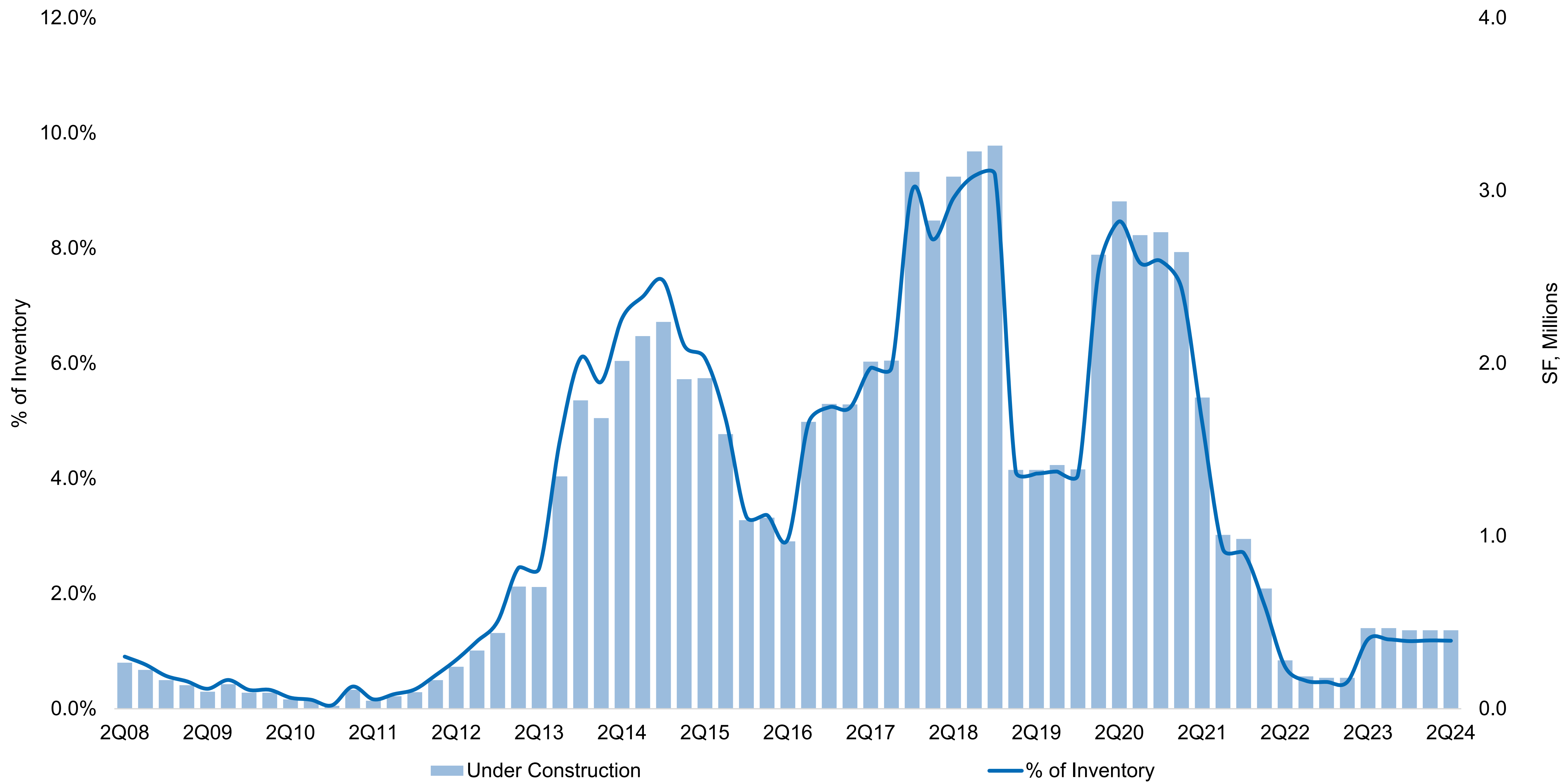


Source: Newmark Research

Construction Levels Have Dropped Considerably Which Bodes Well for the Market

The Combination of low demand, high interest rates and investor/developer trepidation has halted the construction pipeline. The 454,000 SF under construction in Q2 has fallen well below the ten-year average of 1.6 million square feet. With tenants reconsidering their space needs given the fact that the hybrid work/home model is most likely here to stay, developers are hesitant to start any new spec projects. We expect this reduced level of new supply will help a boost the market's recovery.

Office Under Construction and % of Inventory

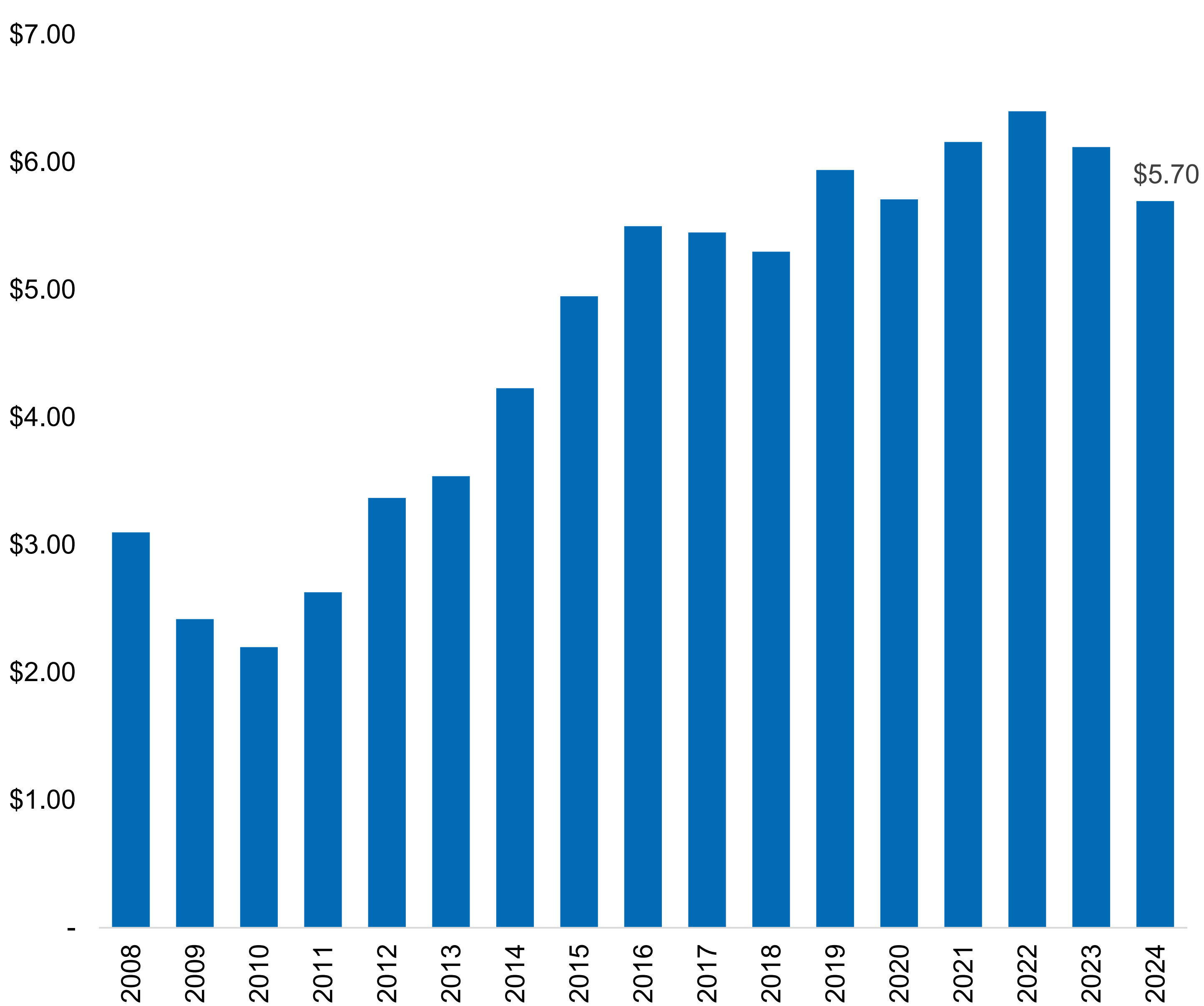


Source: Newmark Research, CoStar

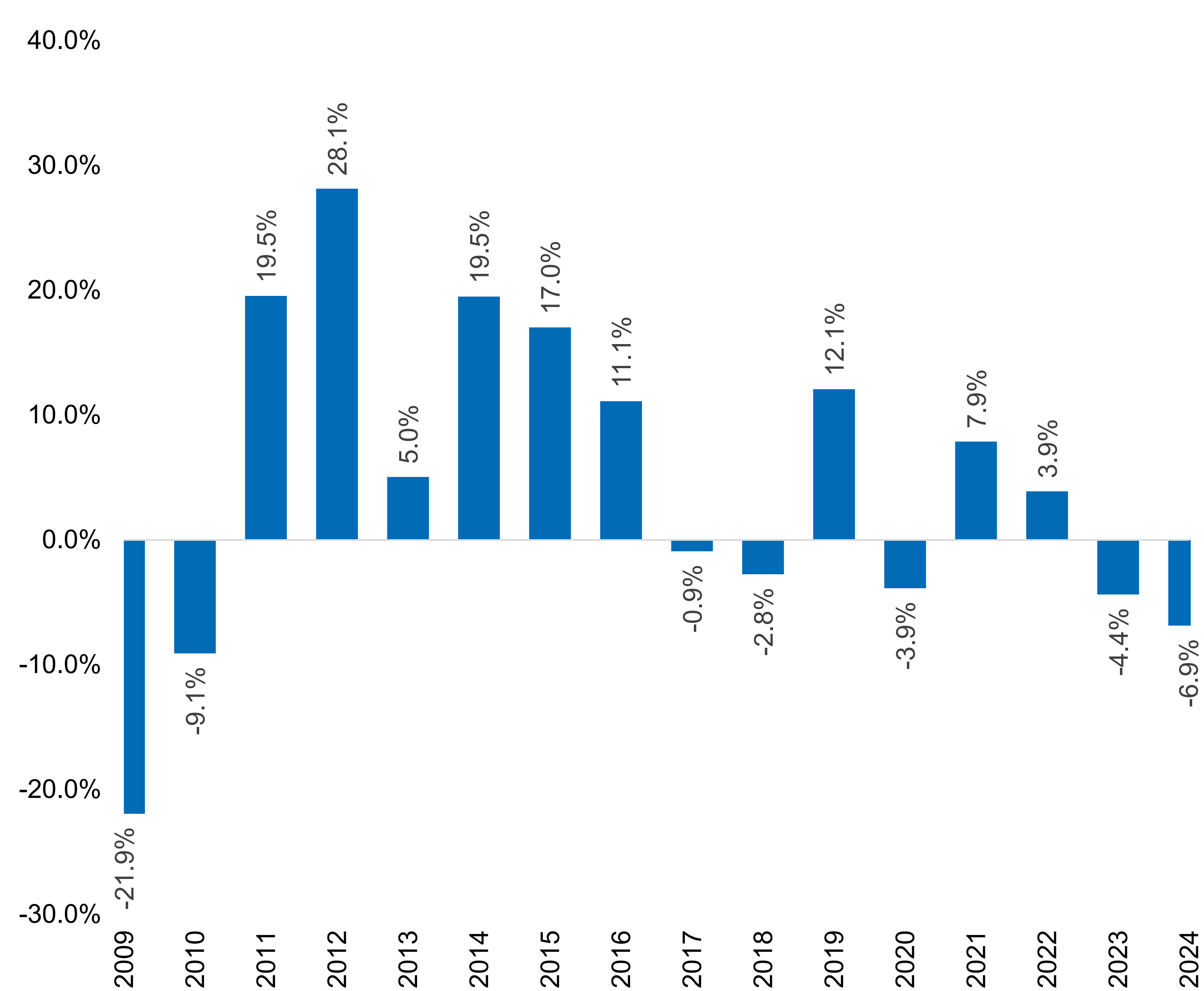
Asking Rents Continue to Drop Amid of Glut of Available Space

Weak demand coupled with a glut of available space put downward pressure on asking rents this quarter. After peaking in 2022, asking rents fell 6.9% in the first half of 2024 to $5.70/SF NNN. Concessions including TIs and free rent, are increasing and play a bigger role in lease negotiations. As companies continue to look for ways to bring people back to the office, amenities such as conference rooms, flexible workspace, more natural light and open spaces, and up-to-date infrastructure, are important as well.

Office Average Asking Rent, $/SF, NNN



Year-over-Year Asking Rent Growth Rate



Source: Newmark Research, CoStar

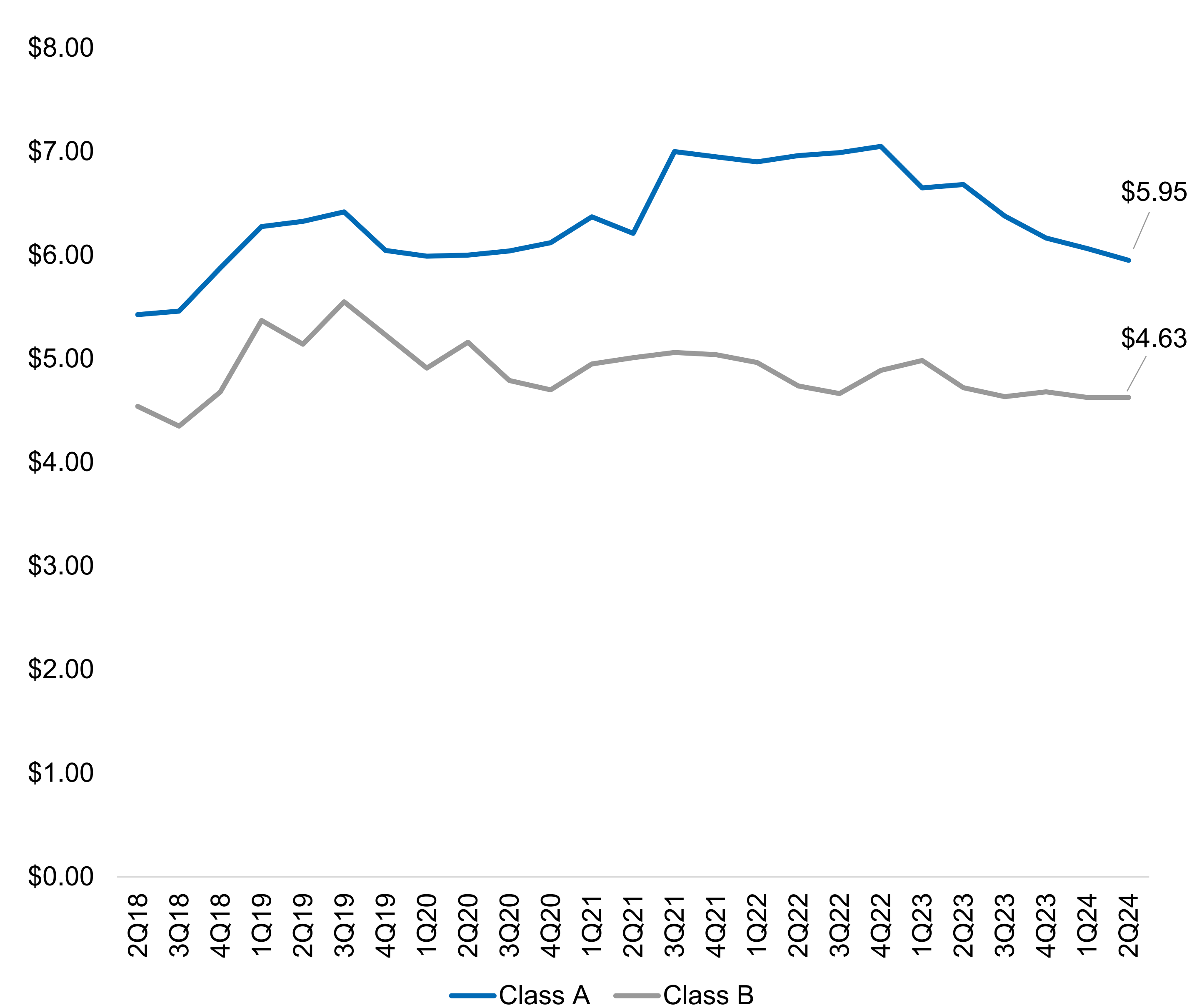
Add Trendline

Add Trendline

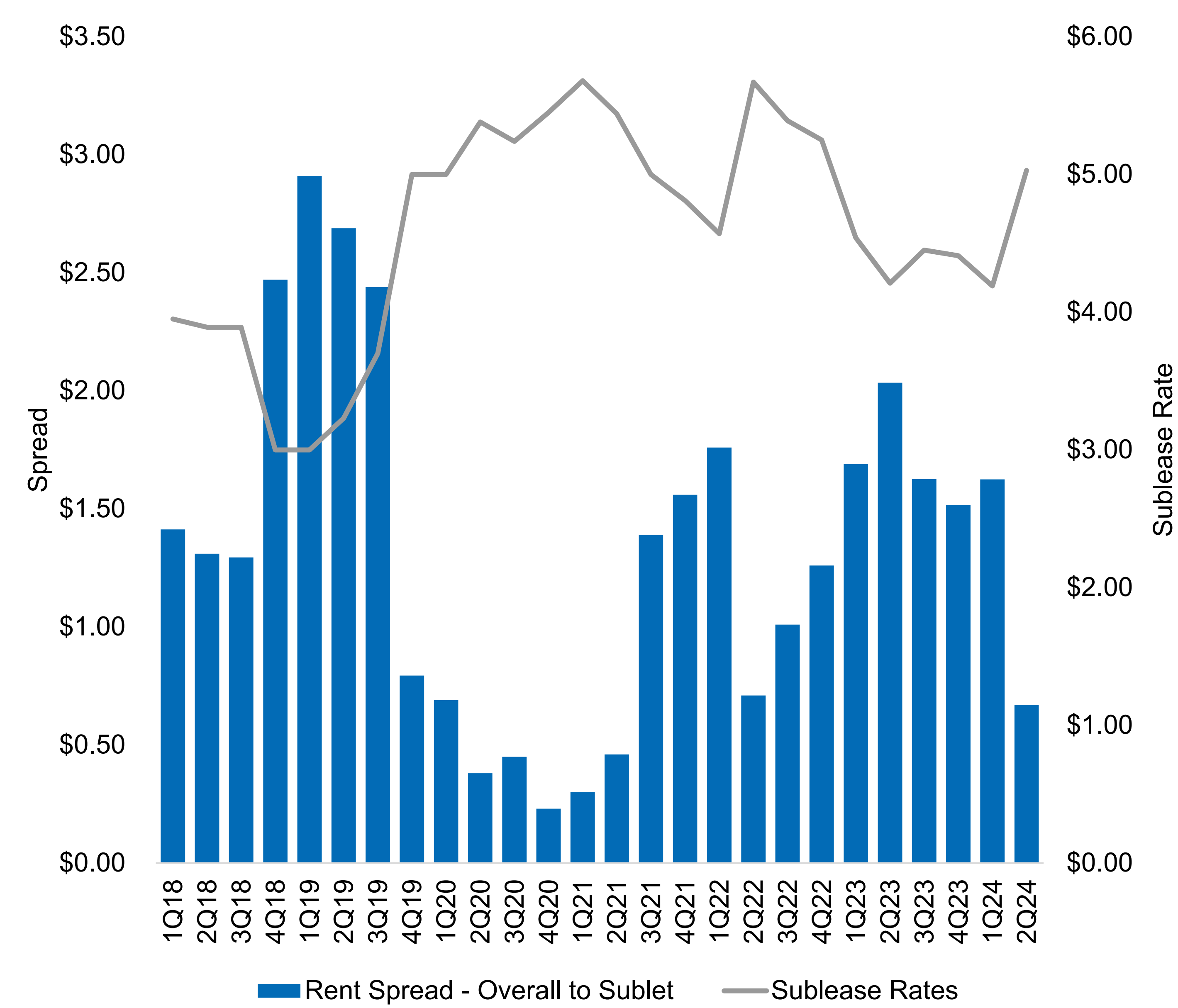
Sublease Asking Rents Rising Given Heightened Interest

The availability rate for Class A space was high at the second quarter (over 28%). This led to a slowdown in demand, causing landlords to reduce their asking rents. Asking rents fell 2.0% from last quarter and down 8.9% from a year ago. The average Class A asking price stood at $5.95 per square foot. Class B rents remained flat quarter-over-quarter at $4.63/SF. Rents for sublease space ticked up in the second quarter from an increase in activity that led to the tightening of the spread between the total asking rents to sublease rents.

Class A and Class B Asking Rents, $/SF, NNN



Sublease Rates



Source: Newmark Research, CoStar

Leasing Activity from a Variety of Industries

The largest direct lease was by Tinder for 41,000 SF in Palo Alto. Palo Alto recorded the largest share of leasing activity with nearly 45% of all leases signed in that submarket followed by Menlo Park with a distant second with nearly 25% of all activity. Law firm Skadden, Arps, Slate, Meagher & Flom LLP renewed its lease in Palo Alto for nearly 60,000 SF. Shortly after the end of the second quarter, Yahoo blended and extended its sublease in Mountain View for nearly 120,000 SF.

Notable 2Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Skadden, Arps, Slate, Meagher & Flom LLP	525 University Avenue	Palo Alto	Lease Renewal	58,671 SF
Renewal. Law firm Skadden, Arps, Slate Meagher & Flom LLP renewed their lease of 5 suites within 525 University Avenue.				
Corcept Therapeutics	149 Commonwealth Drive	Menlo Park	Lease Extension	50,777 SF
Sublease Extension. Short term extension for Corcept Therapeautics before the company relocates to 101 Redwood Shores Parkway.				
Corcept Therapeutics	101 Redwood Shores Parkway	Redwood Shores	Sublease	50,632 SF
Sublease. As seen above, Corcept Therapeutics is relocating to 101 Redwood Shore Parkway to sublease floors 3 & 4 from Zuora.				
Tinder, Inc	285 Hamilton Avenue	Palo Alto	Direct Lease	41,000 SF
Direct Lease. Tinder Inc has signed a new direct lease for floors 2-5 of 288 Hamilton Avenue, which the company had previously been subletting.				
Moloco	601 Marshall Street	Redwood City	Sublease Renewal	25,450 SF
Sublease Renewal. Moloco a machine learning company renewed their sublease at 601 Marshall with the Chan Zuckerberg Initiative as the lessor.				

Source: Newmark Research

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Appendix

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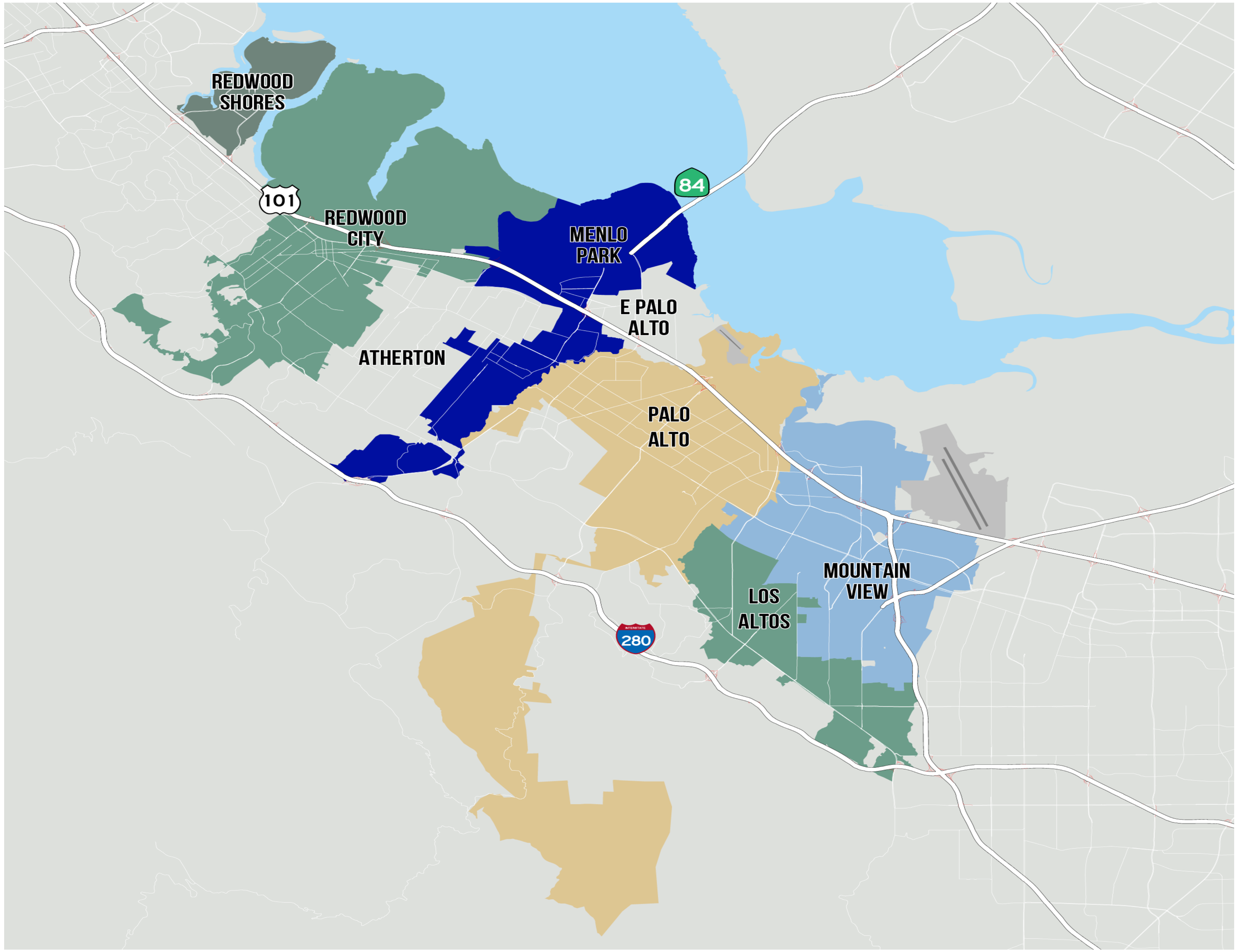
South Peninsula Submarket Map



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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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