
2Q24

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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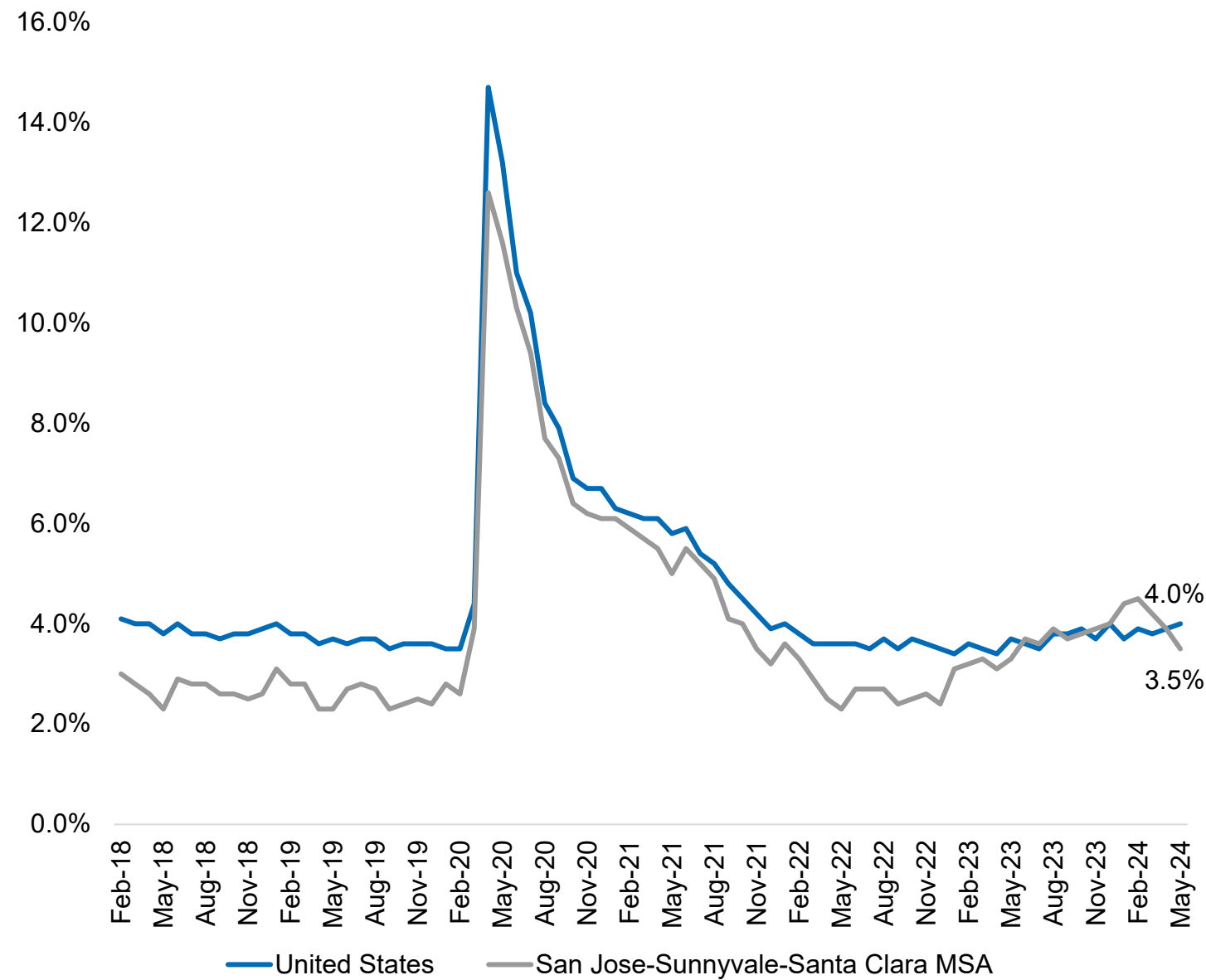
Economy



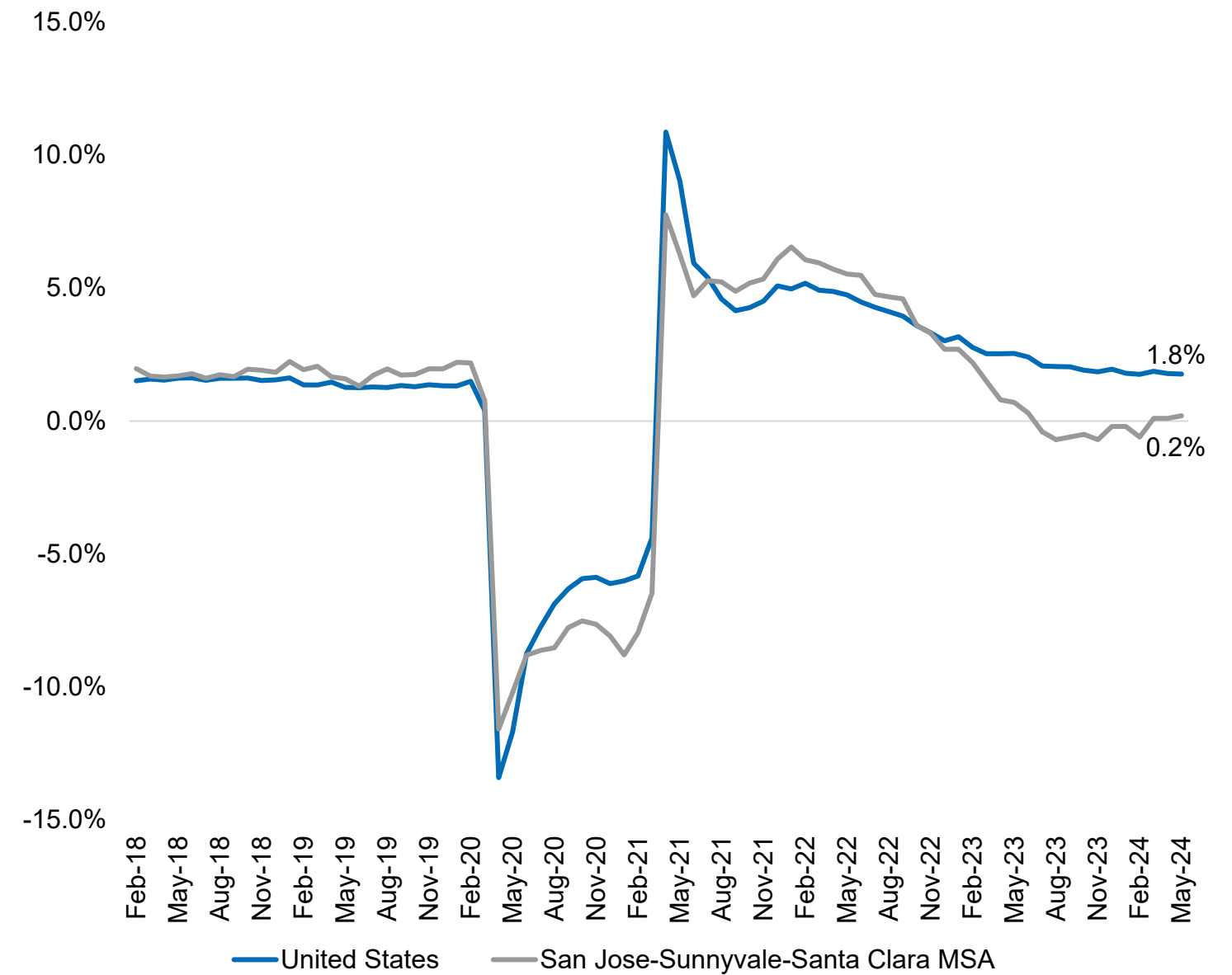
Job Growth Turned Positive, Indicating a Possible Turning Point in the Economy

Employment growth in the San Jose-Sunnyvale-Santa Clara MSA turned positive the past three months through May 2024 after eight months of decline. While still very low at only 0.2% year-over-year, it indicates that the local economy may be stabilizing. The unemployment rate ticked down to 3.5% from 4.5% one year ago, whereas the U.S.'s unemployment rate has stayed in the high -3.0% to 4.0% during this same period. The sharper rate of decline in the MSA indicates a tight labor market.

Unemployment Rate, Seasonally Adjusted



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

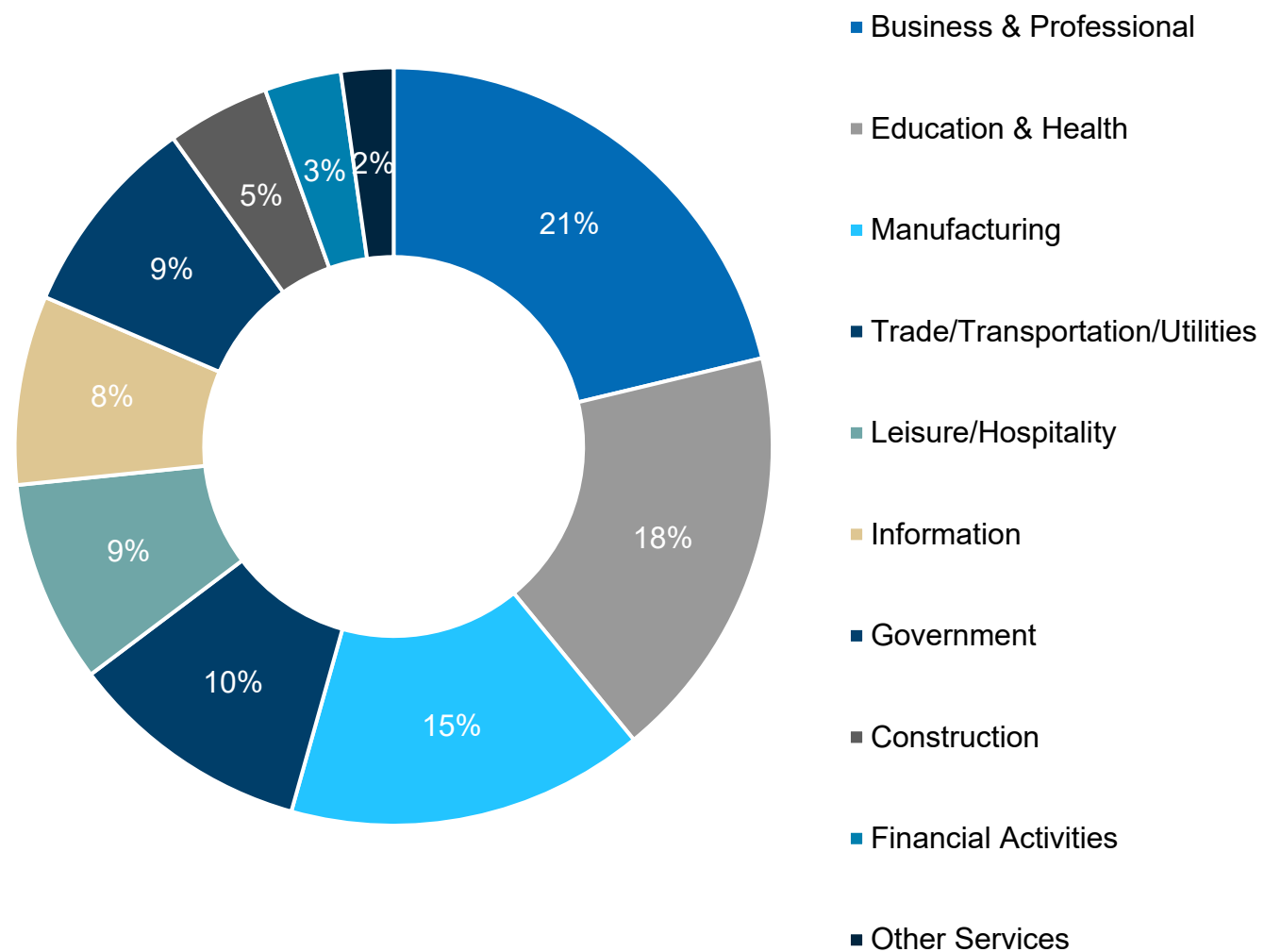


Source: U.S. Bureau of Labor Statistics, San Jose-Sunnyvale-Santa Clara MSA

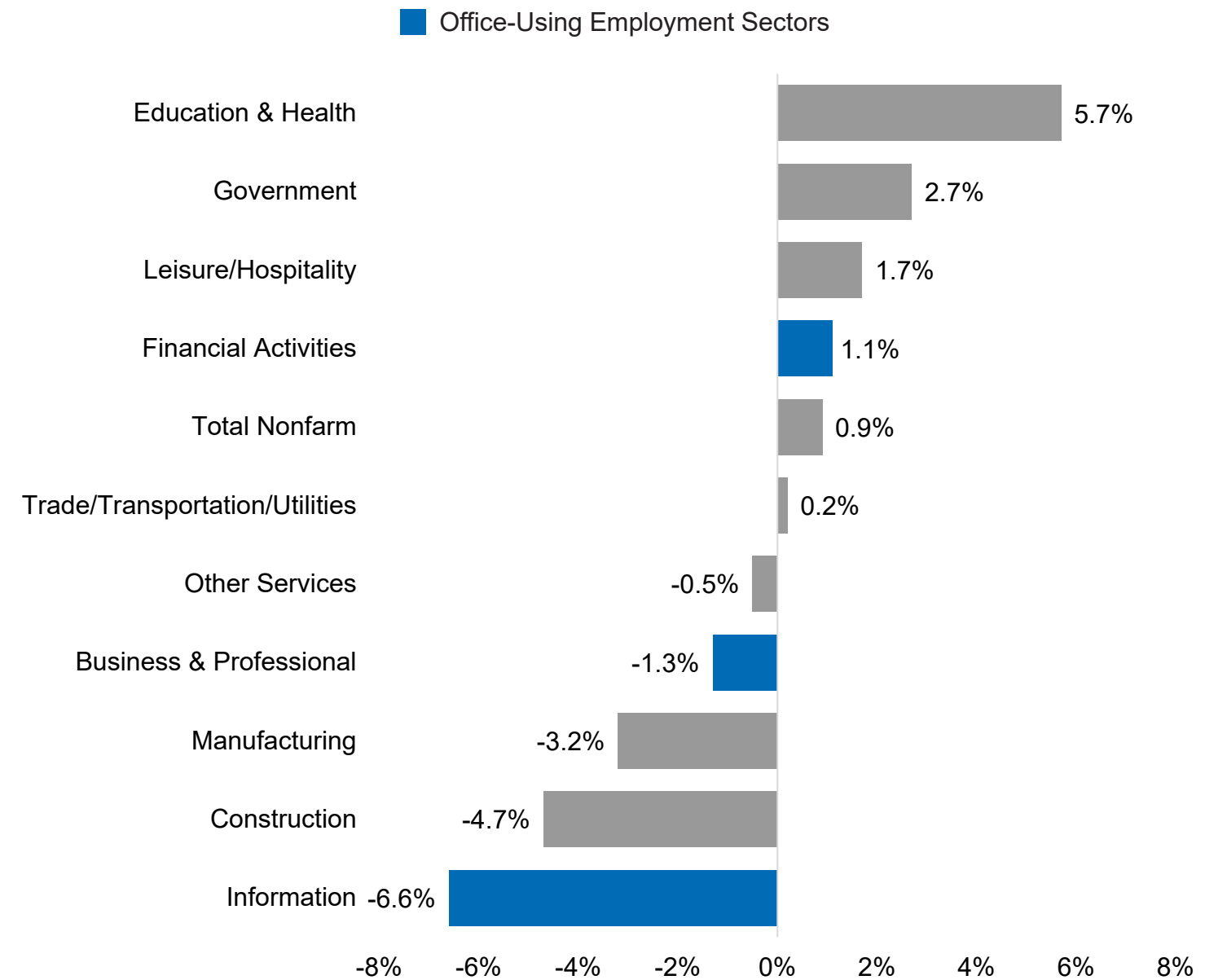
Tech Sector Layoffs Impacting Job Growth in 2024

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%. The information sector saw the largest loss of employment year-over-year.

Employment by Industry, May 2024



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

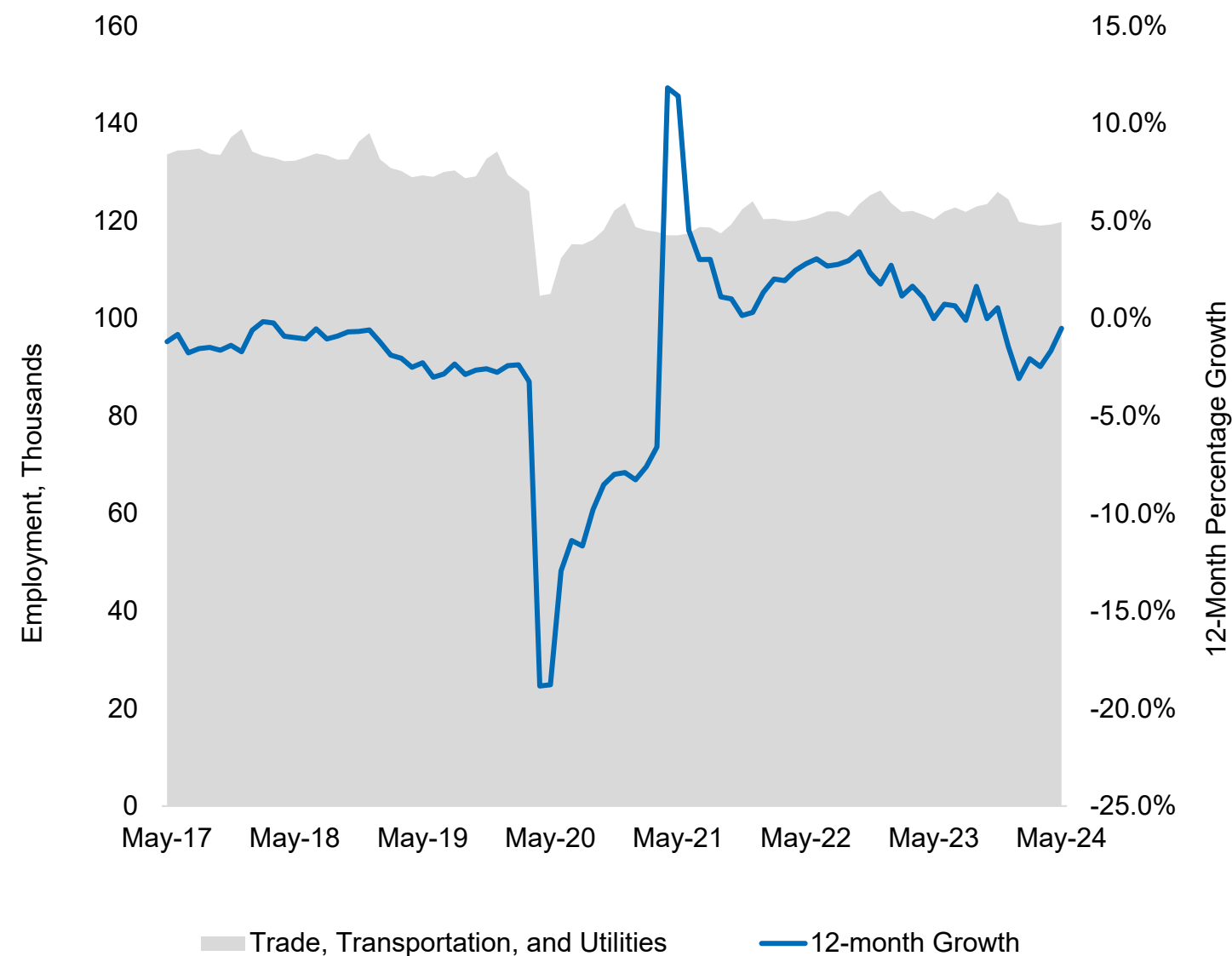


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale
 Note: May 2024 data is preliminary.

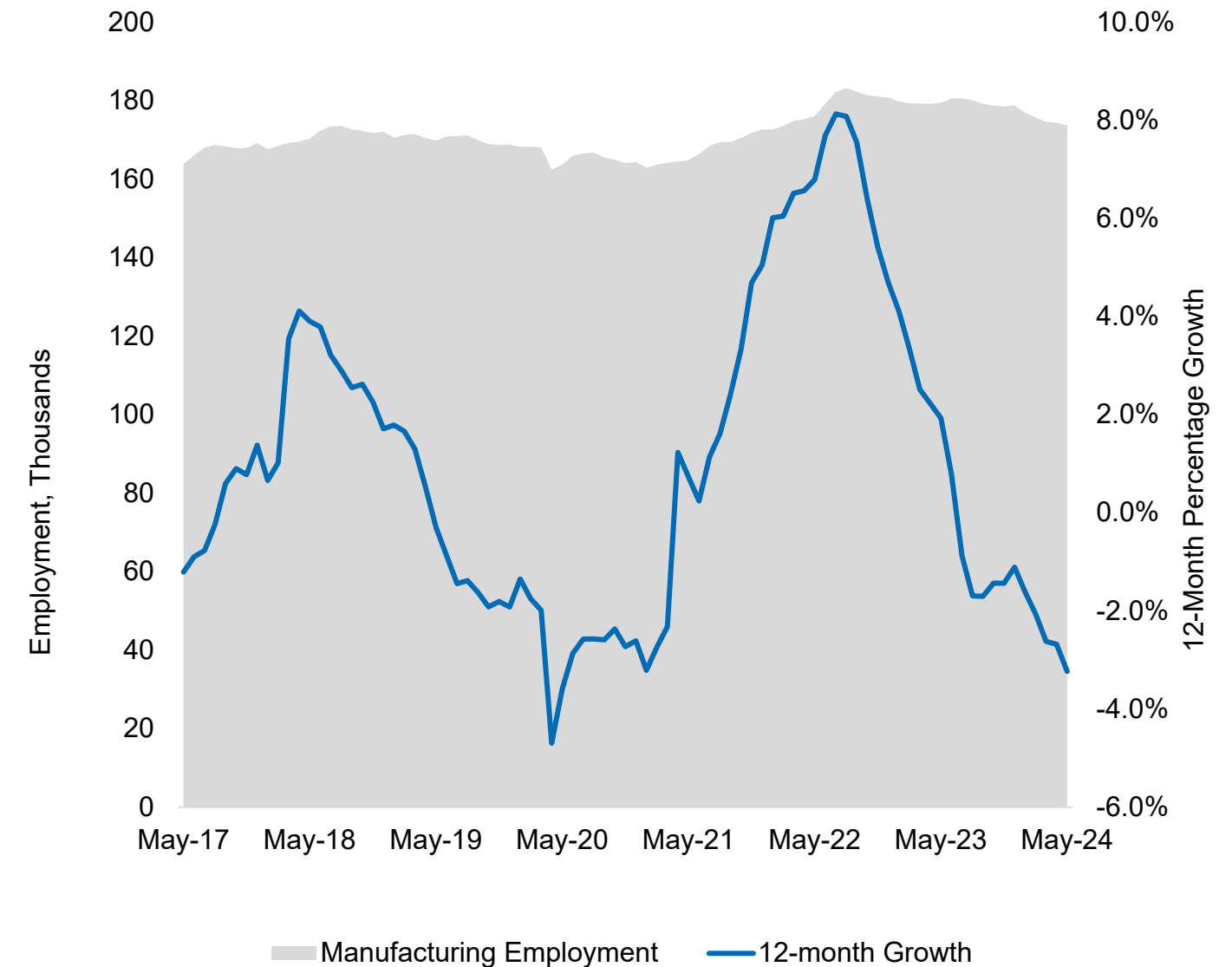
Mixed Signals for Industrial/R&D Demand Drivers

After peaking in the summer of 2022 as demand for AI hardware exploded, employment in the manufacturing sector shed jobs. Employment in this sector contracted by 3.2% year-over-year through May 2024. Meanwhile, the trade/transportation/utilities sector posted two months of subdued job growth after shedding jobs at the end of 2023 and into the first three months of 2024. As the economy hits bottom and then starts improving, we expect these two sectors will quickly rebound.

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
 Note: May 2024 data is preliminary.

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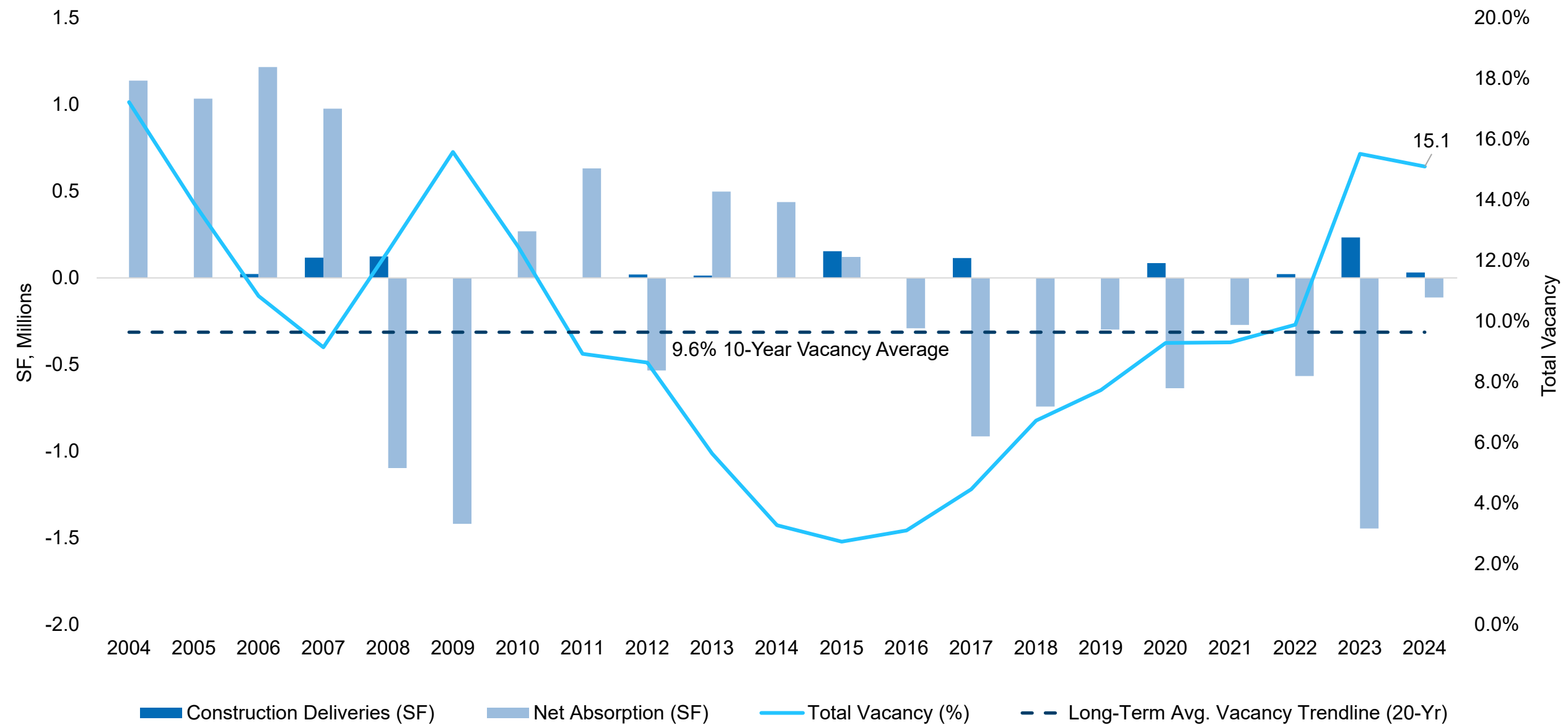
Leasing Market Fundamentals



Vacancy Rate Decrease Signals a Plateau of High Vacancy Rates

The South Peninsula's Research and Development (R&D) real estate landscape is showcasing optimistic signs of recovery, with vacancy rates experiencing their first decrease since 2021. This downward trend in vacancies, signals a potential revival for the market. Despite the negative net absorption of -83,365 square feet reported in Q2 2024, this figure reflects a tough oversupplied market. The statistics signify a creeping stabilization, laying a foundational promise for recovery.

Historical Construction Deliveries, Net Absorption, and Vacancy

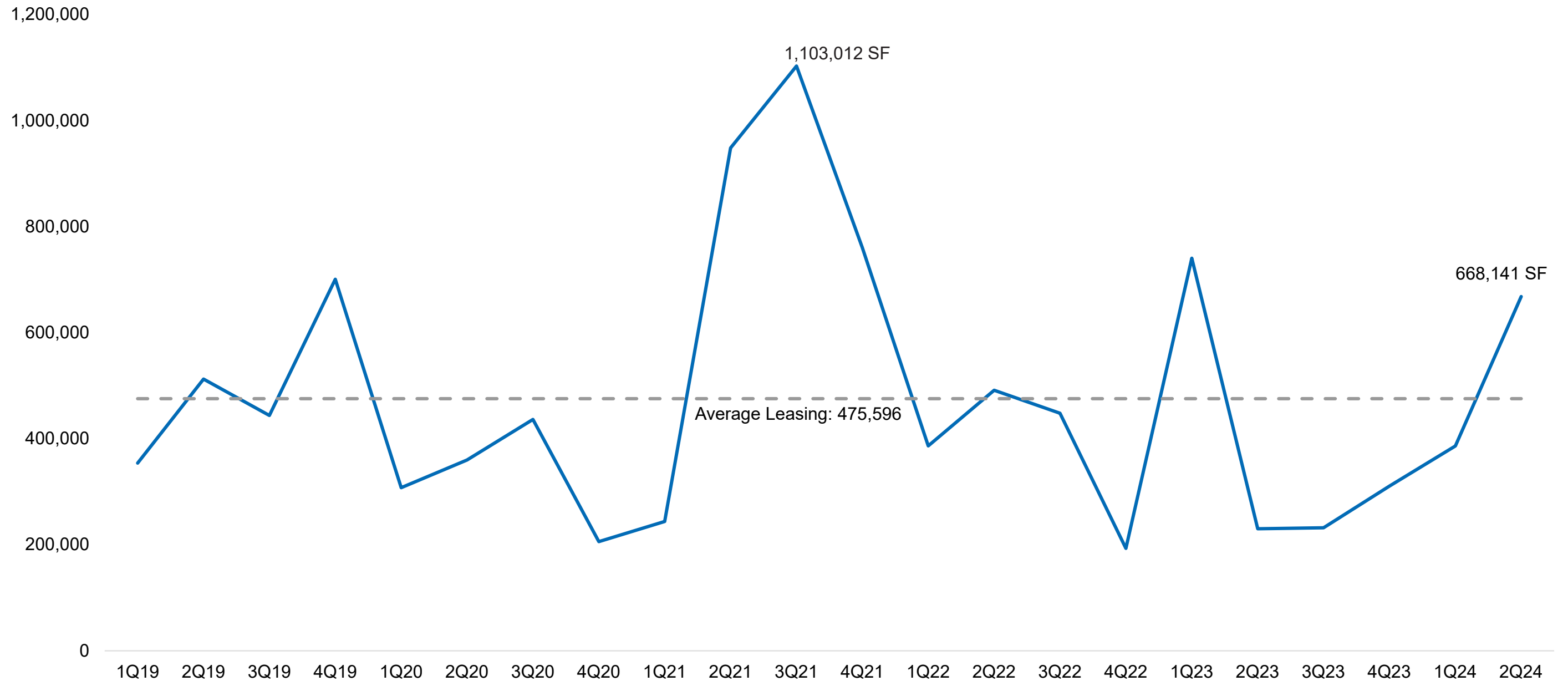


Source: Newmark Research

Leasing Activity Increased

Leasing activity continues its positive climb in Q2 2024 with gross absorption at 668,141, growing 73% from the first quarter of 2024. This marks the first time that leasing activity has outperformed the five-year quarterly average in 6 consecutive quarters. Leasing in the R&D sector will likely level off in the upcoming quarters, arriving closer to the average leasing amount shown below.

Total Leasing Activity (SF)

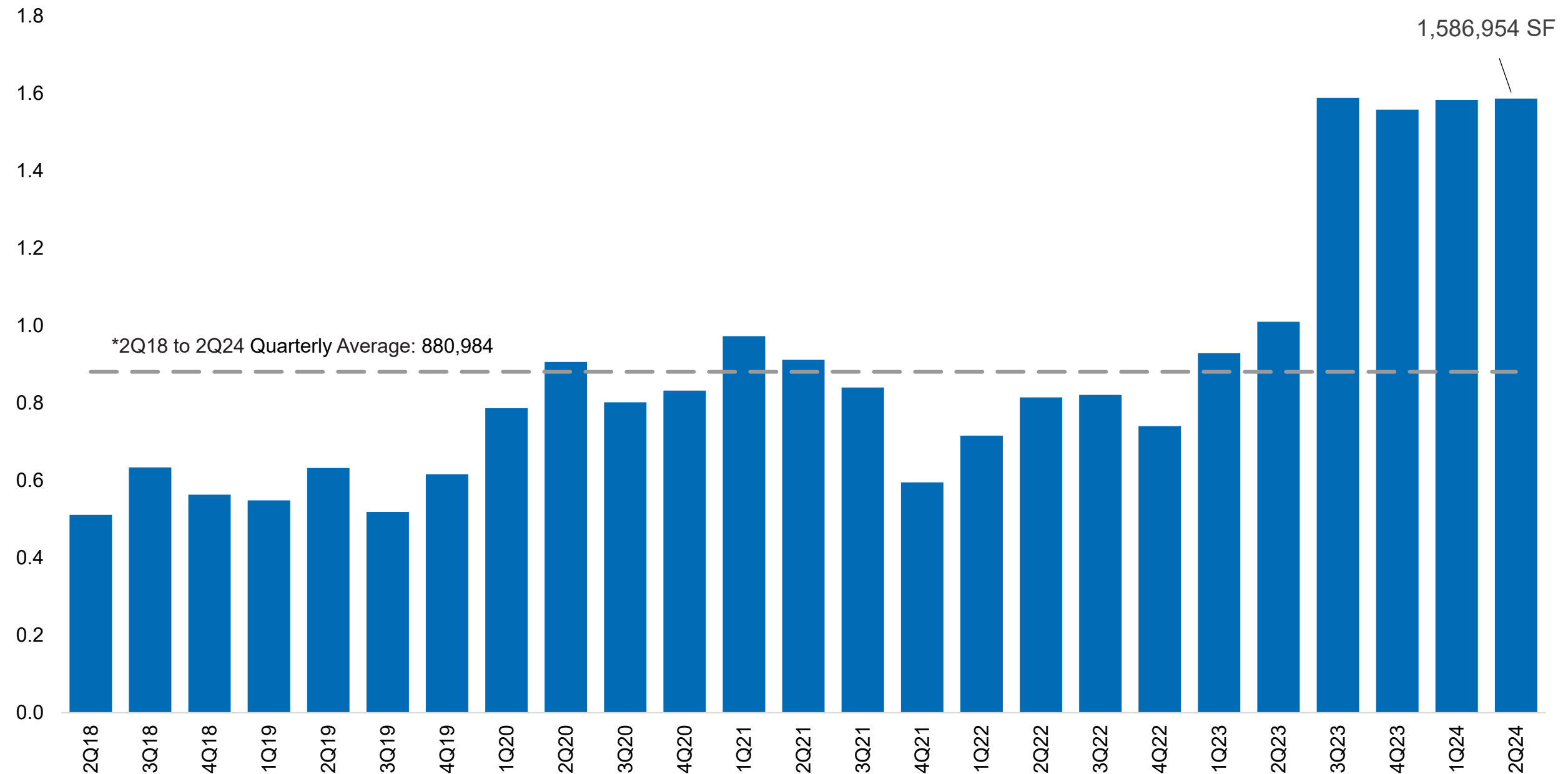


Source: Newmark Research, CoStar

R&D Sublease Availability Levelled Off as Meta Buildings Stay Vacant

Sublease space in the second quarter of 2024 remained at the same level as the previous quarter, increasing by just over 3,000 SF over the quarter. Throughout 2024 the South Peninsula market has maintained an increased amount of sublease availability due to large-block companies such as Google and Meta shedding their space in 2023, which alone contributes 631,810 SF to overall R&D sublease availability.

Available R&D Sublease Volume (msf)

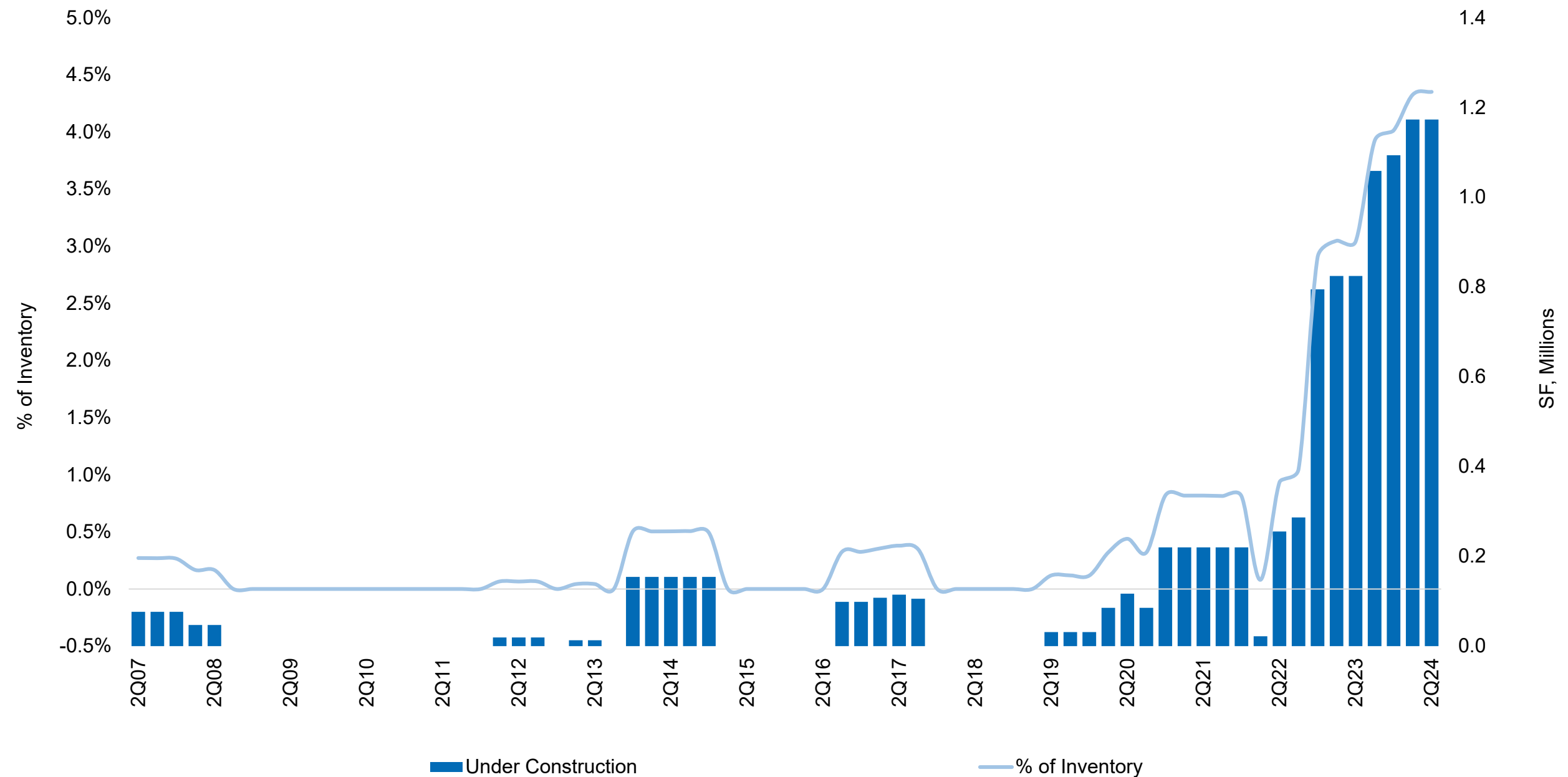


Source: Newmark Research, CoStar

R&D Construction Pipeline Decreased with First Quarter Delivery

The R&D construction pipeline saw no change in the 2nd Quarter of 2024 as no new projects broke ground. The largest R&D development in the pipeline is Elco Yards in Downtown Redwood City with a project size of 670,000 SF. Despite some tenant pullback in the region, developer interest remains strong as developers hope to capture life science tenants in the region. The first of the 4 buildings is expected to be delivered in the 4th quarter of 2024.

Industrial Under Construction and % of Inventory

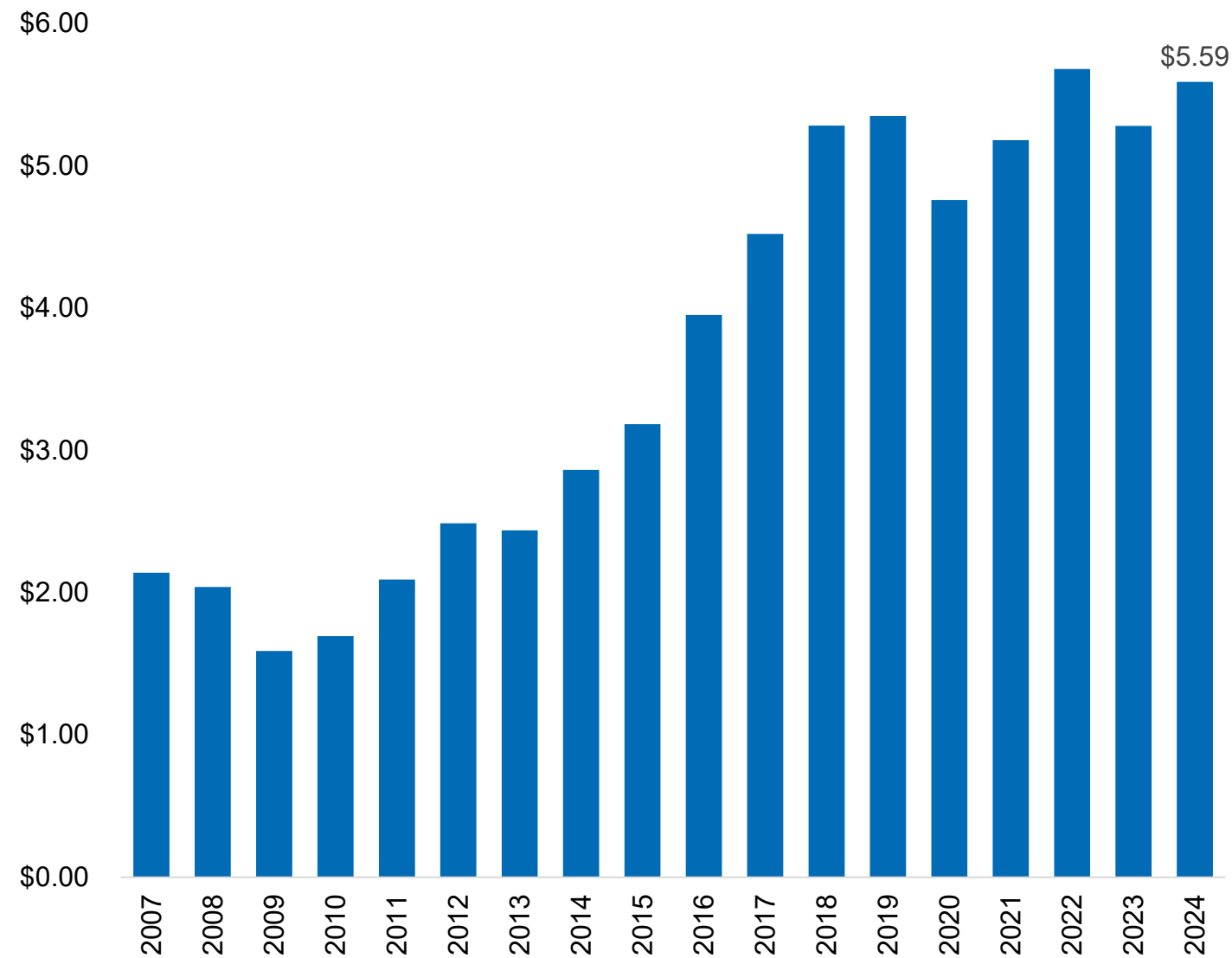


Source: Newmark Research, CoStar

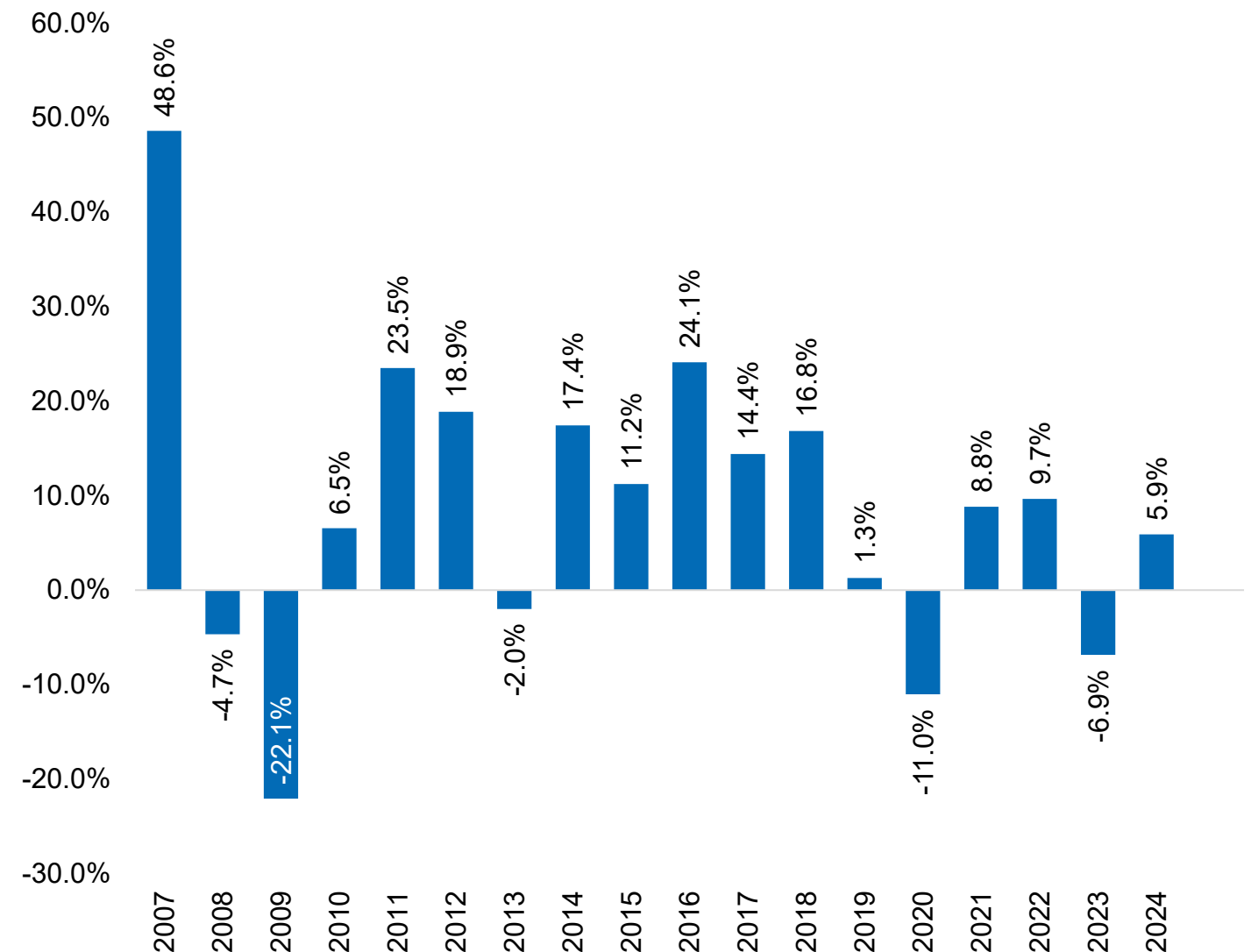
R&D Rents Show Signs of Improvement

R&D asking rents were at \$5.59 at the end of the second quarter, a sizable growth compared to first quarter's average of \$5.11/SF. This rent increase marked the end of the six consecutive quarters of declining asking rents from a peak of \$5.82/SF in the third quarter of 2022.

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



Year-over-Year Asking Rent Growth Rate % Change



Source: Newmark Research

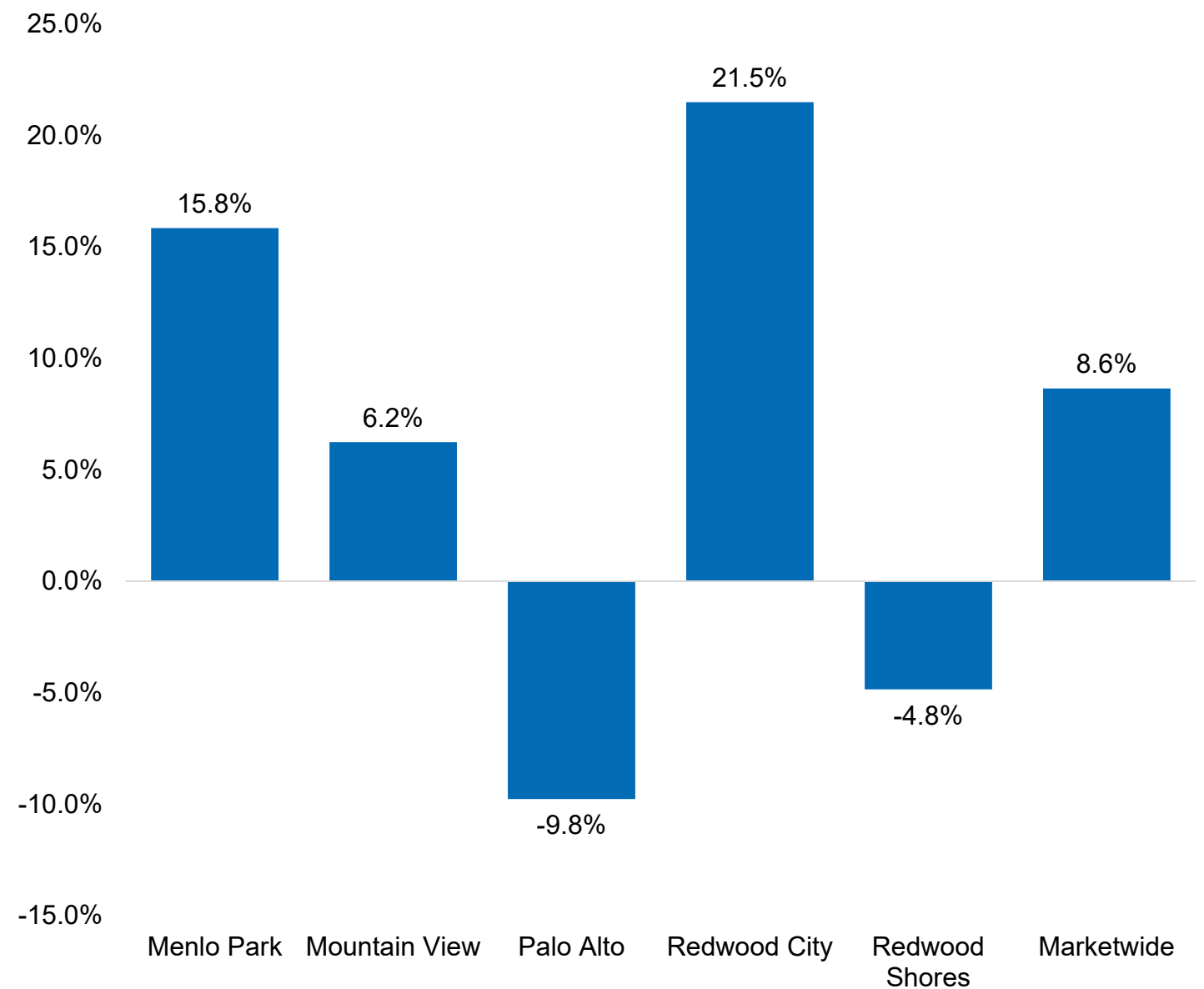
Market Wide Rents Climb, but Highly Variable by Submarket

Although rents have increased market-wide, performance among submarkets varies significantly based on the space offering available in each submarket. Year-over-year, Palo Alto saw the largest decrease in asking rents with a 9.8% decline, while Redwood City saw a significant increase in its average asking with a 21.5% growth, largely due to an increase in vacant life science space in that submarket. Redwood Shores, with its high concentration of life science tenants and spaces, continues to lead the region in asking rents.

Asking Rent by Submarket



Year-over-year Percent Change in Asking Rate



Source: Newmark Research

Leasing Activity Increases for the Third Consecutive Quarter

Leasing volume in the second quarter of 2024 measured 668,141 SF, showing a significant increase in activity quarter over quarter since the second quarter of 2023. This is also the first time in 4 quarters that the leasing average has been larger than the 10-year average of 475,596. We are still seeing a majority of gross absorption contributors being from lease renewals, although there were a few significant direct lease deals in the market.

Select Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
Elco Yards <i>New Direct lease for a confidential life science tenant.</i>	1300 Main Street	Redwood City – Downtown	Direct Lease	115,061
Nevro <i>Lease Renewal for a R&D/office space in Redwood Shores. Tenant renewed in lease at 1600 Bridge Parkway and 1800 Bridge Parkway for a total of 77,616 SF.</i>	1600 Bridge Parkway	Redwood Shores	Lease Renewal	77,616
Panasonic Corporation of North America <i>Lease Renewal. Panasonic Corporation renewed their existing lease for the full building at 3460 Hillview Glen from 2020.</i>	3460 Hillview Avenue	Palo Alto – Stanford Research Park	Lease Renewal	34,611
Retro Biosciences, Inc <i>Direct Lease. Biotechnology company Retro Biosciences has signed a direct lease lease at 3150 Bay Road which will last until 2029.</i>	3150 Bay Road	Redwood City – Other	Direct Lease	31,370
Verily <i>Sublease. Verily is set to sublease 30,000 SF from 100 Mayfield from Google.</i>	100 Mayfield Avenue	Mountain View – Central Expressway	Sublease	30,000

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Appendix / Tables





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