

MARKETBEAT

Silicon Valley

Office Q1 2019



SILICON VALLEY OFFICE

Economics Indicators*

	Q1 18	Q1 19	12-Month Forecast
Santa Clara Co. Employment	1.12M	1.14M	▲
Santa Clara Co. Unemployment	2.9%	2.5%	▼
U.S. Unemployment	4.1%	3.8%	▼

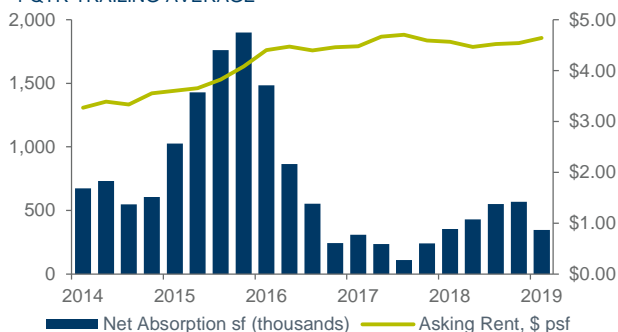
*Q1 19 data based on the average of January and February values

Market Indicators

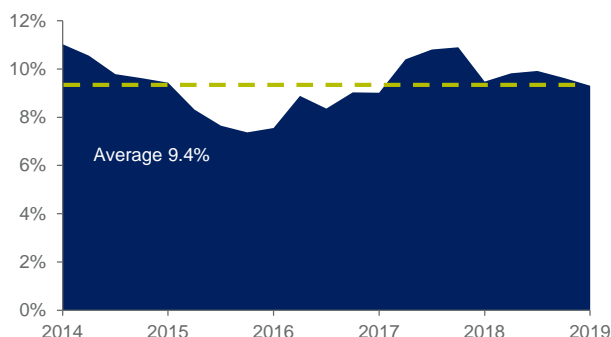
	Q1 18	Q1 19	12-Month Forecast
Overall Vacancy	9.5%	9.3%	▼
Overall Net Absorption (SF)	1.2M	269K	▲
Under Construction (SF)	3.2M	4.4M	▲
Average Asking Rent*	\$4.57	\$4.64	▲

*Rental rates reflect full service asking \$PSF/month

Overall Net Absorption/Asking Rent (Full Service) 4-QTR TRAILING AVERAGE



Overall Vacancy



Slow Start Though Momentum Expected to Build

Job growth in the San Jose metropolitan statistical area (MSA) powered on with an increase of 2.2% or 24,200 non-farm jobs year-over-year (YoY). Though that increase is impressive, particularly considering the market is at full employment, it is still slower than just a few years ago. The strongest driver to job growth remains, of course, the tech sector. The San Jose MSA unemployment rate tumbled further during the year, closing at 2.5% from 2.9%, which compares to the higher national figure of 3.8%.

Silicon Valley's office vacancy rate decreased to 9.3% during the first quarter of 2019, down 30 basis points (bps) from 9.6% in the fourth quarter. The current rate translates to 7.7 million square feet (msf) of vacancy, a slight decrease from 8.0 msf in the fourth quarter. Although the vacancy decreased, the percentage of vacant sublease space increased yet again to 32.4% of all vacant space, up from a figure of 30.4% in the fourth quarter and well above the ten year average of 15.9%. The most significant new sublease on the market was a block of 162,000 square feet (sf) from 8X8 at Coleman Highline. Though not yet included in our vacancy statistics, another sublease block now being marketed is Splunk in West San Jose (150,000 sf). The Santana Row building is still under construction and will be ready for occupancy in November 2019. It should be noted that most sublease space is typically offered in an "as-is" condition, where most of the demand is from tenants looking for customized tenant improvements.

After a solid performance in 2018, the first quarter finished at more of a modest pace. Net absorption decreased in the first quarter to (a still positive) 269,000 sf after a strong 556,000 sf in the fourth quarter. The total annual net absorption finished 2018 at 2.3 msf which is significantly above the 10-year average of 1.3 msf. Where net absorption typically indicates the true growth of the market, gross absorption (or leasing) represents the activity within the market. For the second quarter in a row, leasing activity declined significantly in the first quarter, to 1.7 msf from 2.2 msf. Typically the first quarter of a year can be on the slower side with activity picking up in the second and third quarters. There are, in fact, expectations that several large deals are about to be signed. In the fourth quarter, five of the top eight transactions were over 100,000 sf compared to the first quarter with just two deals over 100,000 sf. The largest deal of the quarter was Google's prelease of an 189,000 sf planned building in Mountain View. A confidential tenant also made our top transaction list, renewing on 121,000 sf in Cupertino. Meanwhile, Blue Jean Networks subleased a block from Splunk in West San Jose (40,000 sf). Other noteworthy transactions include WeWork (40,000 sf) and Wealthfront (38,000 sf) both in Palo Alto along with Target (38,000 sf) and Indeed (also 38,000 sf) both in Downtown Sunnyvale.

The average asking rent increased in the first quarter to \$4.64 per square foot on a monthly full service basis (psf) from \$4.54 psf in the fourth quarter. Despite strong activity, rents have remained relatively flat with slight upticks in select markets. This is largely due to the fact that sublease space has continued to represent such a significant portion of the total availability which forces direct space to compete with those lower priced aggressive rents. The end result is high volumes of leasing at more modest rent growth.

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Capital markets activity in Silicon Valley remained strong through the first quarter of 2019. Interestingly all of the top sales of the quarter were in North San Jose with sales prices ranging from \$334 per square foot (psf) to \$710 psf. With a backdrop of strong fundamentals throughout the Bay Area, investor optimism for tech-driven real estate has been strong. Treasury rates have settled significantly lower at the end of the quarter versus their peak in late 2018, and accordingly real estate debt has remained low priced and plentiful. Historical pricing highs have been shattered on the western side of the Valley and the Peninsula, particularly in areas that are served by Caltrain. Value-add opportunities have been scarce. The in-fill suburban markets have been notable for transactions with mixed profiles - partially value-add with a component of stability and in-place income. As downtown San Jose has emerged as a transit and tech hub, investors have focused on the developing transit corridor along the eastern Bayshore (San Jose through Oakland).

THE FIRST QUARTER IS OFF TO A SLOW START HOWEVER DEMAND IS HOT AND PRELEASING HAS CONTINUED TO INCREASE.

New product under construction across the region currently stands at approximately 4.4 msf. Although this is comprised of all speculative product, 3.2 msf has been preleased. The balance of 1.2 msf under construction will enter the vacancy if not preleased prior to completion – 513,000 sf in 2019 and 645,000 sf in 2020. We are currently tracking 11.8 msf of active office/R&D tenant requirements which is up from the 10.5 msf last quarter. We feel this increase in demand will transition to activity in the next few quarters.

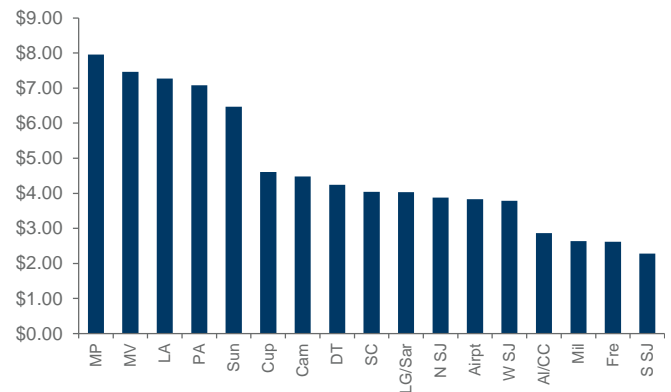
After closing out 2018 with one of the strongest leasing activity years on record along with net absorption double the 2017 level, the first quarter performance was certainly lackluster by comparison. That said, tenant demand is up and preleasing has continued to increase. We expect that activity will translate into leasing and the market will pick up speed throughout the next two quarters of this year.

Outlook

- The current average asking rent of \$4.64 psf (full service) has increased from \$4.54 psf three months ago. We expect average rents to flatten across the Valley as new construction slows.
- Net absorption in Q1 was 269,000 sf, down from Q4's 556,000 sf. This follows the 2018 annual net of 2.3 msf which is double the 2017 and 2016 totals.
- We anticipate that leasing will pick up in the next few quarters. Tenant demand increased this quarter and we are now tracking 11.8 msf of active office/R&D requirements in the Silicon Valley.

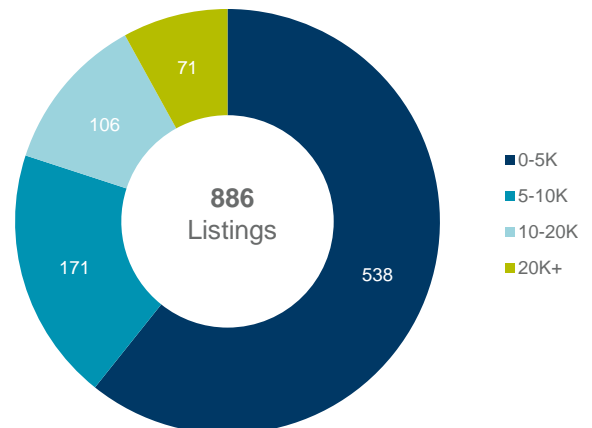
Average Asking Rate by Submarket (Full Service)

NORTHERN CITIES COMMANDING HIGHEST RENTS



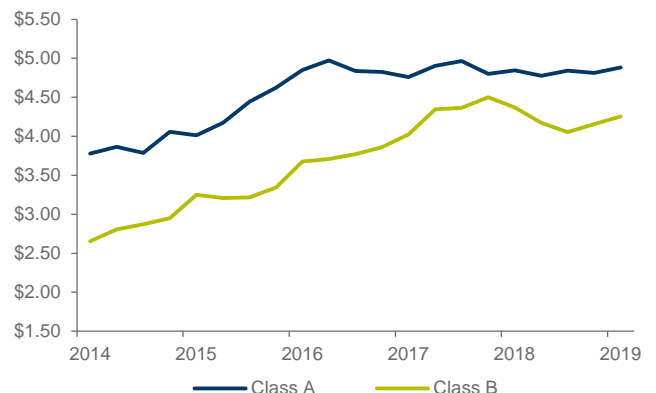
Availabilities by Size Segment

LACK OF SUPPLY FOR QUALITY LARGE BLOCK SPACE



Average Direct Asking Rate by Class (FS)

CLASS A OVERALL RENTS INCREASED BY 29% SINCE 2014



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SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	VACANCY RATE	CURRENT NET ABSORP* (SF)	YTD NET ABSORPTION* (SF)	UNDER CONST (SF)	OVERALL AVERAGE ASKING RENT (ALL Classes)	OVERALL AVERAGE ASKING RENT (CLASS A)
Menlo Park	5,454,311	111,306	143,246	4.7%	(22)	(22)	732,294	\$7.96	\$9.10
Palo Alto	10,490,940	245,371	430,681	6.4%	(62,793)	(62,793)	200,616	\$7.08	\$7.98
Los Altos	1,136,329	13,922	68,448	7.2%	(30,968)	(30,968)	0	\$7.27	\$7.34
Mountain View	5,296,159	59,246	222,276	5.3%	10,474	10,474	222,000	\$7.46	\$8.06
Cupertino	4,460,866	0	76,222	1.7%	75,488	75,488	0	\$4.61	\$5.26
Campbell	2,625,912	75,627	466,872	20.7%	21,835	21,835	0	\$4.48	\$4.70
Los Gatos/Saratoga	2,385,504	56,335	24,493	3.4%	20,375	20,375	0	\$4.03	\$4.13
West San Jose	4,324,450	39,534	158,128	4.6%	(32,236)	(32,236)	301,000	\$3.79	\$5.15
Sunnyvale	11,184,694	97,773	240,671	3.0%	20,055	20,055	1,717,924	\$6.47	\$7.37
Santa Clara	10,202,811	1,048,614	923,713	19.3%	204,296	204,296	432,706	\$4.04	\$4.14
San Jose Airport	4,354,514	355,587	332,392	15.8%	(79,801)	(79,801)	359,179	\$3.83	\$3.88
North San Jose	5,545,608	216,465	830,277	18.9%	(36,131)	(36,131)	184,351	\$3.88	\$4.07
Alameda/Civic Center	2,029,039	0	88,723	4.4%	4,651	4,651	0	\$2.87	\$4.25
South San Jose	1,815,800	38,705	60,775	5.5%	4,330	4,330	0	\$2.28	\$3.32
Downtown San Jose	8,770,684	74,966	1,024,845	12.5%	141,897	141,897	204,000	\$4.24	\$4.54
Milpitas	979,437	18,103	38,736	5.8%	1,431	1,431	0	\$2.64	\$3.60
Fremont	2,039,002	57,584	93,291	7.4%	6,285	6,285	0	\$2.62	\$2.17
CLASS BREAKDOWN									
Class A	48,767,149	2,112,979	3,292,552	11.1%	178,420	178,420	4,354,070	N/A	\$4.88
Class B	19,498,682	273,485	1,213,172	7.6%	111,397	111,397	N/A	N/A	\$4.26
TOTAL	83,096,060	2,509,138	5,223,789	9.3%	269,166	269,166	4,354,070	\$4.64	

Asking rates converted to FS

- Net Absorption is by occupancy date.
- Market Indicators are not reflective of U.S. MarketBeat Tables

Key Lease Transactions Q1 2019

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
600 Clyde Ave	189,974	Google, Inc.	Renault & Handley	New Lease	Mountain View
20450 Stevens Creek Blvd	121,780	Confidential	Prometheus Real Estate	Renewal	Cupertino
500 Santana Row, 2 nd Flr	40,220	Blue Jean Networks	Splunk	Sublease	West San Jose
3101 Park Blvd	40,000	WeWork	Park Place Associates	New Lease	Palo Alto
100 Mathilda Ave, 3 rd Flr	38,525	Target	SPF Mathilda, LLC	New Lease	Sunnyvale
100 Mathilda Ave, 4 th Flr	38,525	Indeed	SPF Mathilda, LLC	New Lease	Sunnyvale
261 Hamilton Ave	36,700	Wealthfront	Hamilton Ramona LLC	New Lease	Palo Alto
2625 Augustine Dr	32,492	Upwork	Veritas	Sublease	Santa Clara

Key Sale Transactions Q1 2019

PROPERTY	SF	BUYER	SELLER	SALE PRICE / \$PSF	MARKET
110-130 Holger Wy	603,666	Mori Partners	Lane Partners / PIMCO	\$429,000,000 / \$710	North San Jose
2460-2480 First St, N.	147,774	Toeniskoetter Development Inc.	TMG Partners	\$54,100,000 / \$366	North San Jose
2150 First St, N.	123,699	Novel Coworking	2150 North First Street, LLC	\$42,000,000 / \$349	North San Jose
2665 First St, N.	122,619	GZI North First LLC	Seagate 2665 N First LLC	\$41,000,000 / \$334	North San Jose

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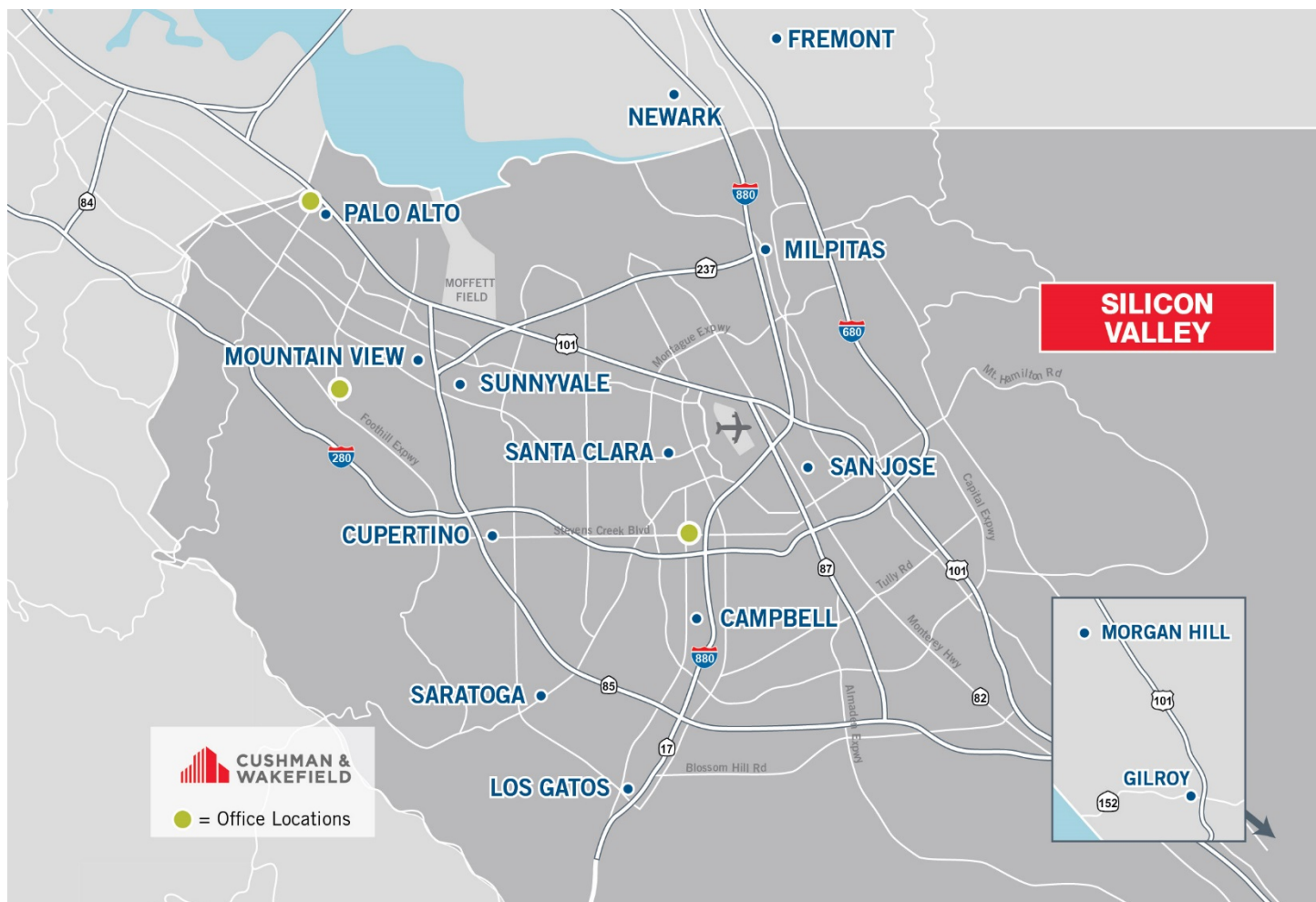
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Office Submarkets

Silicon Valley



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