MARKETBEAT
Silicon Valley
R&D Q3 2019

CUSHMAN & WAKEFIELD

SILICON VALLEY R&D

Economics Indicators

	Q3 18	Q3 19*	12-Month Forecast
San Jose MSA Employment	1.13M	1.16M	▲
San Jose MSA Unemployment rate	2.5%	2.6 %	▲
U.S. Unemployment rate	3.8%	3.7%	▲

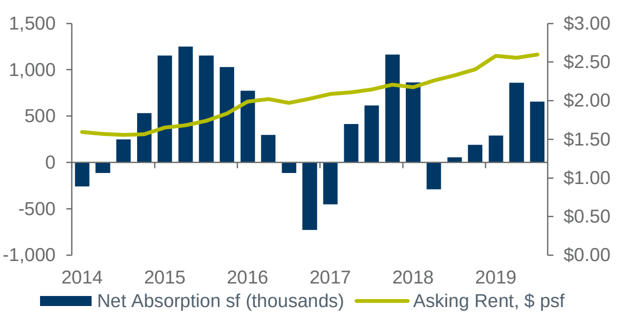
*Q3 19 data based on the latest data
Source: BLS, Moody's Analytics

Market Indicators

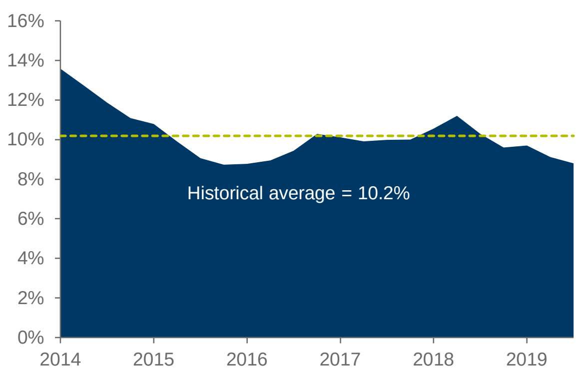
	Q3 18	Q3 19	12-Month Forecast
Overall Vacancy	10.3%	8.8%	▼
Overall Net Absorption (SF)	1.5M	451K	▲
Under Construction (SF)	1.9M	4.4M	▲
Average Asking Rent*	$2.33	$2.60	▲

*Rental rates reflect NNN asking $PSF/month

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



Overall Vacancy



How Low Can It Go?

Job growth in the San Jose metropolitan statistical area (MSA) continued on with an increase of 31,900 jobs (2.8%) added year-over-year (YOY). This brings regional employment to 1.2 million. Though that increase is impressive, particularly considering the market is at full employment, it has slowed from just a few years ago. The strongest driver to job growth remains, of course, the tech sector. The San Jose MSA unemployment rate remained consistent during the year, closing at 2.6% which compares to the higher national figure of 3.7%.

Silicon Valley's R&D vacancy rate dropped below 9.0% for the first time since 2016 at an impressive 8.8% in the third quarter of 2019, down from 9.1% in the second quarter. Despite the strong trend in vacancy, it should be noted that sublease as a component of vacancy increased for the second quarter in a row ending the quarter at 23.4% up from 19.9% in the second quarter. Large subleases that came on the market this quarter included Boston Scientific (226,000 sf) and Alta Devices (96,000 sf), both in North San Jose, plus Jabil Wolfe (110,000 sf) in South San Jose.

Like several market sectors, R&D in 2019 started slow with a negative net absorption. The second and third quarters have shown an impressive rebound with the year-to-date net absorption almost double the 2018 number in just three quarters. At a positive 450,000 sf occupancy, the third quarter continues to show a defiant consistency in not only net growth but also gross activity.

Leasing activity was consistent in the third quarter, registering 2.9 msf, following the 2.9 msf recorded in the second quarter. There were five transactions over 100,000 sf in the third quarter, however two of them were renewals. The largest deal was the Raytheon renewal of three buildings totaling 162,000 sf in Sunnyvale with the other major renewal being Equinix in North San Jose (103,000 sf). Other significant deals included Olympus (128,000 sf) in South San Jose, Aurora Innovation (111,000 sf) in Mountain View, and MKS Instruments (102,000 sf) in Milpitas. Additional noteworthy deals include NXP USA, Inc. (95,000 sf) in North San Jose, Infinera (82,000 sf) in South San Jose, and a confidential tenant who subleased two floors (80,000 sf) from EMC in Santa Clara. It should be noted that although some of the regional heavy weights like Google and Apple were absent from R&D leasing in the third quarter, there were major office transactions involving them including significant user sales. (See office report).

The average asking rent for R&D space in Silicon Valley increased slightly from $2.56 per square foot (psf) in the second quarter to $2.60 psf on a monthly triple net basis. This is an 11.6% increase from one year ago when the asking rent was

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$2.33 psf. The northern Silicon Valley cities continue to outperform the market averages posting the highest rents, with Palo Alto at $6.74 psf, Menlo Park at $4.58 psf and Mountain View at $4.43 psf.

New product under construction across the region consists of 4.4 msf which breaks down to 2.4 msf of build-to-suits and 2.0 msf of speculative product. However, almost 50% of the “spec” space is preleased, leaving only 1.1 msf that could enter vacancy once complete. The build-to-suits include Google, Nvidia, Intuitive Surgical and Fortinet who are all building on their own land. In one of the strongest market indicators, we are currently tracking 11.2 msf of active office/R&D tenant requirements and believe much of this demand will transition to activity in the next few quarters.

NET ABSORPTION FINISHES Q3 AT 450,000 SF BRINGING 2019 YEAR-TO-DATE NUMBER TO 1.2 MSF, ALMOST DOUBLE THE 2018 ANNUAL NUMBER

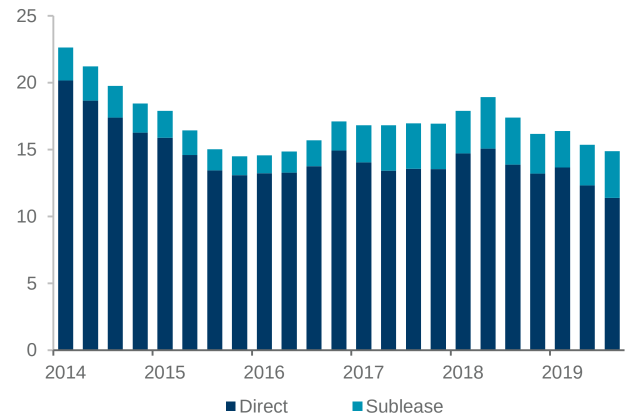
Capital markets activity in Silicon Valley continued to be healthy through year-to-date 2019. Fundamentals remain strong throughout the region, and investor optimism for tech-driven real estate is still in high demand. The Valley is one of the few suburban markets in the country to be attracting investor attention. Debt continues to remain low priced as rates on benchmark treasuries have fallen significantly since the beginning of the year. Historical pricing records continue to be set on the western side of the Valley and the Peninsula, particularly in areas that are served by Caltrain. Value-add opportunities continue to be scarce.

The third quarter saw a number of mixed signals. Gross absorption was steady and strong while net absorption was almost double the previous year. Vacancy is at a four year low, yet sublease space is on the rise. Approximately 75.0% of new construction is either build-to-suit or preleased, yet prudence prevails in speculative new starts. There continue to be more buyers than sellers in the capital markets and interest rates remain low. Technology tenants dominate the growth in both leasing activity and user purchases. With tenant tracking in excess of 11 msf, we expect 2019 to finish with lower vacancy, continued preleasing and modest upward pressure on rental rates.

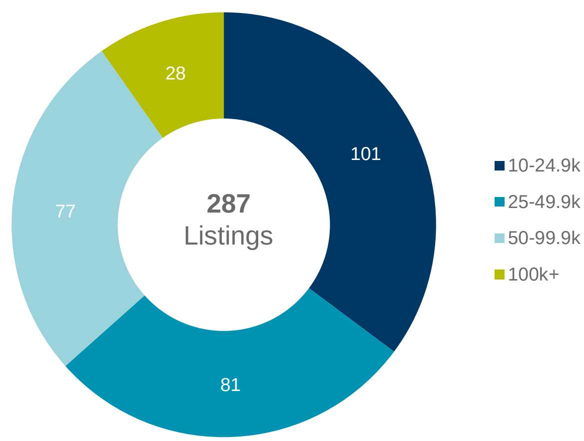
Outlook

- R&D vacancy now stands at 8.8%, down 150 bps from 10.3% one year ago. This is the first time in four years that vacancy has been below 9%.
- The current average asking rent for R&D space in Silicon Valley is $2.60 per square foot (on a monthly triple net basis), up 11.6% from $2.33 psf one year ago.
- We anticipate leasing activity to pick up through the remainder of 2019. There are currently 11.2 msf of active office/R&D tenant requirements in the Valley.

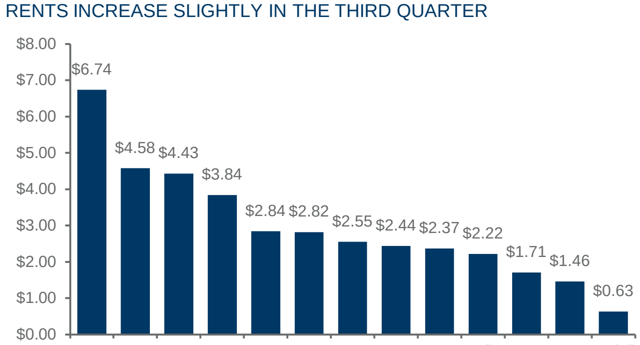
Direct & Sublease Available Space
VACANCY DECREASES SLIGHTLY BUT SUBLEASE % INCREASES



Availabilities by Size Segment
LACK OF SUPPLY FOR QUALITY LARGE BLOCK SPACE



Overall Average Asking Rate by Submarket (NNN)
RENTS INCREASE SLIGHTLY IN THE THIRD QUARTER



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SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	VACANCY RATE	CURRENT NET ABSORPTION* (SF)	YTD NET ABSORPTION* (SF)	UNDER CONST (SF)	OVERALL AVERAGE ASKING RATE
Menlo Park	3,951,867	0	64,632	1.3%	9,912	46,245	0	$4.58
Palo Alto	10,365,438	98,232	779,503	8.5%	236,124	(321,106)	116,774	$6.74
Mountain View	14,828,863	190,269	364,436	3.7%	219,596	378,629	1,195,000	$4.43
Cupertino	5,698,336	0	44,490	0.8%	(20,555)	(20,555)	0	$3.84
Westside	2,284,992	0	123,311	5.4%	830	6,502	0	$2.82
Sunnyvale	22,717,789	159,828	376,476	2.4%	(38,544)	372,160	2,357,556	$2.84
Santa Clara	21,863,457	616,026	1,637,481	10.3%	26,819	211,977	750,000	$2.55
North San Jose	36,133,442	1,447,488	3,660,138	14.1%	(131,624)	113,911	0	$2.37
South San Jose	10,618,177	116,302	790,556	8.5%	(106,976)	4,848	0	$1.46
Milpitas	12,727,679	195,956	2,187,572	18.7%	55,273	(139,886)	0	$2.22
Fremont	20,630,141	338,403	1,293,822	7.9%	128,675	131,189	0	$1.71
Newark	3,047,855	199,078	32,334	7.6%	11,064	328,840	0	$2.44
Morgan Hill/Gilroy	3,583,140	120,000	38,559	4.4%	60,018	66,988	0	$0.63
TOTAL	**168,451,176**	**3,481,582**	**11,393,310**	**8.8%**	**450,612**	**1,179,742**	**4,419,330**	**$2.60**

Asking rents converted to NNN

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

Key Lease Transactions Q3 2019

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
430-490 California Ave	162,550	Raytheon	Principal Global Investors	Renewal	Sunnyvale
5325 Hellyer Ave	128,250	Olympus	MWest	New Lease	South San Jose
250 Bernardo Ave	111,154	Aurora Innovation	Sand Hill Properties	New Lease	Mountain View
1735 Lundy Ave	103,420	Equinix	Sobrato Development	Renewal	North San Jose
1565 Barber Ln	102,668	MKS Instruments	Westport Capital Partners	New Lease	Milpitas
350 Holger Wy	96,502	NXP USA, Inc.	KBS REIT II	New Lease	North San Jose
6373 San Ignacio Ave	82,144	Infinera	Kennedy-Wilson Properties	New Lease	South San Jose
2841 Mission College Blvd	80,000	Confidential tenant	EMC	Sublease	Santa Clara

Key Sale Transactions Q3 2019

PROPERTY	SF	BUYER	SELLER	SALE PRICE / $PSF	MARKET
115-135 McCarthy Blvd	471,580	Embarcadero / PCCP	Hudson Pacific Properties	$70,250,000 / $149	Milpitas
Rose Orchard Technology Pk	314,455	Drawbridge Realty	Shorenstein Properties	$128,500,000 / $409	North San Jose
5853-5863 Rue Ferrari	286,330	Cannae Partners	Gibson Avenue Capital LLC	$30,750,000 / $107	South San Jose
3420 Hillview Ave	177,250	PSAI	EPRI	$64,000,000 / $361	Palo Alto
5300 & 5350 Hellyer Ave	160,000	Empire Square Group	Drawbridge Realty	$55,500,000 / $347	South San Jose
620 National Ave	151,998	Preylock	National Avenue Partners	$190,000,000 / $1,250	Mountain View
2300 Orchard Pkwy	116,381	BPM Real Estate Group	Han's Holdings	$61,000,000 / $524	North San Jose
3160 Porter	103,553	Alexandria Real Estate	Stanford Real Estate	$26,000,000 / $251	Palo Alto

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