

MARKETBEAT

Silicon Valley

Office Q2 2019



SILICON VALLEY OFFICE

Economics Indicators

	Q2 18	Q2 19*	12-Month Forecast
San Jose MSA Employment	1.12M	1.14M	▲
San Jose MSA Unemployment	2.7%	2.7%	▼
U.S. Unemployment	3.9%	3.6%	▼

*2019 Q2 data are based on latest available data.
Source: BLS, Moody's Analytics, C&W Research

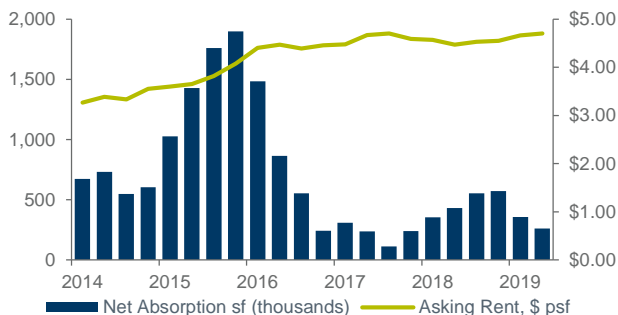
Market Indicators

	Q2 18	Q2 19	12-Month Forecast
Overall Vacancy	9.8%	10.0%	▼
Overall Net Absorption (SF)	-61K	-448K	▲
Under Construction (SF)	3.8M	5.3M	▲
Average Asking Rent*	\$4.47	\$4.70	▲

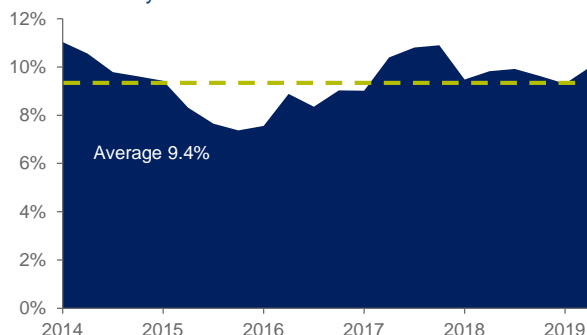
*Rental rates reflect full service asking \$PSF/month

Overall Net Absorption/Asking Rent (Full Service)

4-QTR TRAILING AVERAGE



Overall Vacancy



Second Quarter Gains Momentum

Job growth in the San Jose metropolitan statistical area (MSA) powered on with an increase of 2.3% or 25,700 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 remained consistent during the year, closing at 2.7% which compares to the higher national figure of 3.6%.

Silicon Valley's office vacancy rate climbed to 10.0% during the second quarter of 2019, an increase of 70 basis points (bps) from 9.3% in the first quarter. The current rate translates to 8.3 million square feet (msf) of vacancy, up from 7.6 msf in the first quarter. Although the vacancy increased, the percentage of vacant sublease space decreased slightly to 32.0% of all vacant space, down from a figure of 32.3% in the first quarter but still double the ten year average of 16.3%. 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 slow start in the first quarter of 2019, occupancy took a further step back in the second quarter as net absorption tumbled to negative 448,000 square feet (sf), down from the positive 288,000 sf recorded in the first quarter. But the future looks brighter as there was strong gross absorption (leasing) at 3.0 msf up from 1.7 msf in the first quarter. This was, in large part, due to significant preleasing with occupancy expected in the second half of 2019 and into 2020. Net absorption is based on occupancy date and doesn't yet reflect these preleased deals. Beyond the uptick in leasing activity, there remain expectations that several large deals will soon be signed.

In the second 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 four buildings totaling 728,000 sf in North San Jose. One of these buildings was shell complete and the other three are yet to be built. Another notable large deal was Uber's expansion into the Silicon Valley with a two-building lease of 290,000 sf in Downtown Sunnyvale. Roku expanded in the San Jose Airport with another lease of 162,000 sf which brings its total occupancy at Coleman Highline to 738,000 sf. Included in the top deals was the renewal of Netflix in Los Gatos (164,000 sf). Other significant leases in the second quarter included Zscaler (172,000 sf) and McAfee (84,000 sf) both in North San Jose, Shape Security (93,000 sf) in Santa Clara and Confluent Inc. (75,000 sf) in Downtown Mountain View.

The average asking rent increased in the second quarter to \$4.70 per square foot on a monthly full service basis (psf) from \$4.66 psf in the first 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 a high volume of leasing at more modest rents. With interest and activity on the rise, the Downtown San Jose submarket has seen the most significant change recently with a 15% YOY increase closing the second quarter with an average asking rent of \$4.32 psf.

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New product under construction across the region currently stands at approximately 5.3 msf. This is comprised of 4.4 msf of speculative product and 915,000 sf of build-to-suits. It's important to note that most of the 4.4 msf of "spec" is preleased. Only 1.2 msf under construction is currently available – 360,000 sf delivering in the second half of 2019 and 847,000 sf in 2020. As of mid-year, we are tracking 11.3 msf of active office/R&D tenant requirements and believe much of this demand will transition to activity in the next few quarters.

LEASING ACTIVITY SURGED IN THE SECOND QUARTER FINISHING AT 3.0 MSF, BOLSTERED BY PRELEASING

Capital markets activity in Silicon Valley continued to be healthy through the first half of 2019. Fundamentals remain strong throughout the Bay Area 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 have fallen significantly on benchmark treasuries since the beginning of the year. Historical pricing highs continue to rise 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.

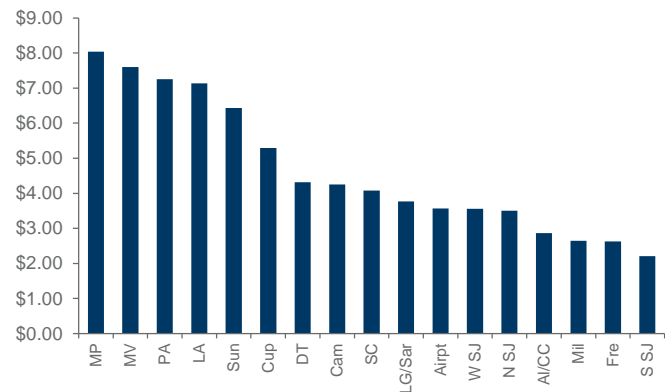
After finishing 2018 with the strongest leasing activity in five years, 2019 started cautiously. However the second quarter showed signs of increased deal velocity with preleasing that will contribute to second half 2019 positive absorption. Tenant demand is on the rise and we expect that will translate into leasing activity throughout the next two quarters of the year.

Outlook

- The current average asking rent of \$4.70 psf (full service) has increased from \$4.66 psf three months ago. We expect average rents to increase across the Valley as new construction picks up.
- Net absorption in Q2 was negative 448,000 sf, down from Q1's 288,000 sf. This follows the 2018 annual net of 2.2 msf which is double the 2017 and 2016 totals. We expect net to increase as the recently signed preleased deals occupy.
- Tenant demand is still hot and we expect that demand to translate into leasing throughout the remainder of the year.

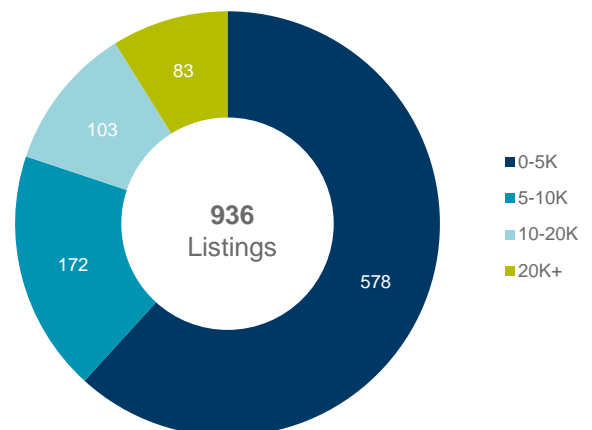
Average Asking Rate by Submarket (Full Service)

NORTHERN CITIES COMMANDING HIGHEST RENTS



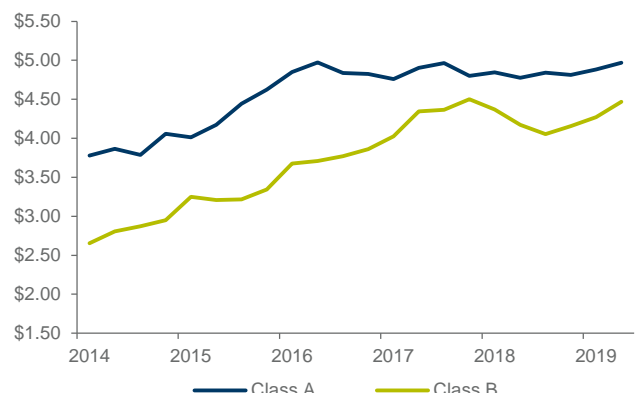
Availabilities by Size Segment

LACK OF SUPPLY FOR QUALITY LARGE BLOCK SPACE



Average Asking Rate by Class (FS)

CLASS A OVERALL RENTS INCREASED BY 32% 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	5,380,559	133,173	152,187	5.3%	(31,066)	(31,088)	798,794	\$8.05	\$9.03
Palo Alto	10,494,257	272,203	460,047	7.0%	(54,959)	(121,407)	200,616	\$7.25	\$8.62
Los Altos	1,136,329	11,888	62,290	6.5%	4,775	(25,833)	0	\$7.14	\$7.25
Mountain View	5,243,951	171,615	267,075	8.4%	(153,569)	(149,274)	411,974	\$7.60	\$8.10
Cupertino	4,420,625	44,743	104,685	3.4%	(70,642)	2,282	0	\$5.29	\$6.10
Campbell	2,619,982	57,162	485,079	20.7%	(6,244)	16,857	10,400	\$4.25	\$4.65
Los Gatos/Saratoga	2,402,360	53,837	48,870	4.3%	(21,879)	(1,504)	0	\$3.77	\$3.80
West San Jose	4,324,450	40,111	179,856	5.1%	(29,127)	(61,363)	301,000	\$3.56	\$5.15
Sunnyvale	11,189,969	97,491	329,856	3.8%	(95,391)	(68,848)	1,842,924	\$6.43	\$7.13
Santa Clara	9,933,165	1,085,194	996,828	21.0%	(109,458)	90,582	432,706	\$4.08	\$4.19
San Jose Airport	4,354,514	312,767	252,558	13.0%	116,012	42,874	359,179	\$3.57	\$3.64
North San Jose	5,735,602	200,289	975,244	20.5%	36,996	19,429	0	\$3.50	\$3.55
Alameda/Civic Center	2,029,039	0	96,088	4.7%	(7,365)	(2,714)	32,307	\$2.87	\$4.25
South San Jose	1,735,800	31,932	53,851	4.9%	13,697	18,027	0	\$2.21	\$2.93
Downtown San Jose	8,770,684	80,510	1,045,848	12.8%	(74,868)	69,428	929,000	\$4.32	\$4.79
Milpitas	979,437	9,075	36,143	4.6%	11,621	13,052	0	\$2.65	\$3.60
Fremont	2,038,924	44,193	83,212	6.2%	23,470	29,755	0	\$2.63	\$2.17
CLASS BREAKDOWN									
Class A	48,569,274	2,248,590	3,463,330	11.8%	(130,448)	55,043	5,318,900	N/A	\$4.97
Class B	19,433,247	295,879	1,315,443	8.3%	(152,476)	(29,896)	N/A	N/A	\$4.48
TOTAL	82,789,647	2,646,183	5,629,717	10.0%	(447,997)	(159,745)	5,318,900	\$4.70	

Asking rates converted to FS

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

Key Lease Transactions Q2 2019

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
First St, N. @ Brokaw	728,335	Google, Inc.	Peery Arrillaga	New Lease	North San Jose
Sunnyvale Cityline	290,926	Uber	SPF Mathilda, LLC	New Lease	Sunnyvale
120 Holger Way	172,405	Zscaler	Micron	Sublease	North San Jose
100-150 Winchester Circle	164,176	Netflix	Sobrato Companies	Renewal	Los Gatos
1143 Coleman Ave	162,557	Roku	Hunter Storm Properties	Expansion	San Jose Airport
2755 Augustine Dr	93,750	Shape Security	Irvine Company	New Lease	Santa Clara
6220 America Center Dr	84,273	McAfee	USAA Real Estate Company	New Lease	North San Jose
899 Evelyn Ave, W.	75,475	Confluent, Inc.	West Evelyn Development LLC	New Lease	Mountain View

Key Sale Transactions Q2 2019

PROPERTY	SF	BUYER	SELLER	SALE PRICE / \$PSF	MARKET
50 San Fernando St, W.	353,527	Jay Paul Company	DivcoWest/Rockpoint JV	\$238,000,000 / \$673	Downtown San Jose
Market Square	323,529	Rubicon Point Partners	Ridge Capital Investors LLC	\$141,250,000 / \$436	Downtown San Jose
2107 First St, N.	99,666	The Stanley Group, Inc.	TA Realty	\$35,500,000 / \$356	North San Jose
1190 Saratoga Ave	43,444	Dollinger Properties	Saratoga Avenue, LLC	\$15,250,000 / \$351	West San Jose

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Office Submarkets Silicon Valley



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