

MARKETBEAT

Silicon Valley

Office Q3 2019



SILICON VALLEY OFFICE

Economics Indicators

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

*2019 Q3 data are based on latest available data.
Source: BLS, Moody's Analytics

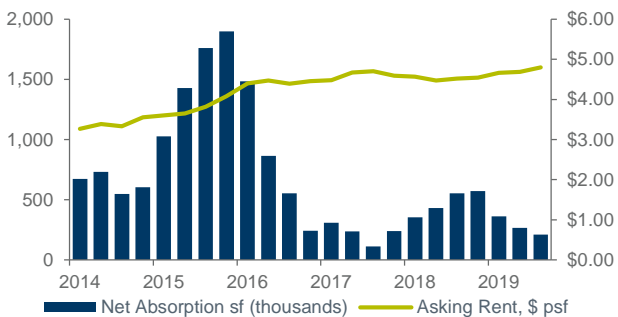
Market Indicators

	Q3 18	Q3 19	12-Month Forecast
Overall Vacancy	9.9%	9.8%	▼
Overall Net Absorption (SF)	632K	412K	▲
Under Construction (SF)	3.8M	5.7M	▲
Average Asking Rent*	\$4.52	\$4.80	▲

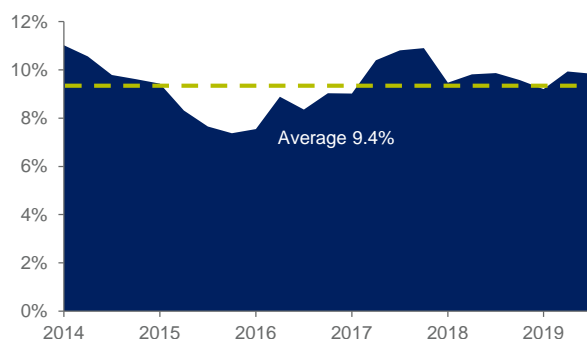
*Rental rates reflect full service asking \$PSF/month

Overall Net Absorption/Asking Rent (Full Service)

4-QTR TRAILING AVERAGE



Overall Vacancy



Preleasing is the Name of the Game

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 office vacancy rate decreased marginally to 9.8% during the third quarter of 2019, a decrease of just 10 basis points (bps) from 9.9% in the second quarter. For the last five quarters vacancy has stayed pretty consistent hovering near 10.0%. The current rate translates to 8.2 million square feet (msf) of vacancy. With this figure in a slight decline, the percentage of vacant sublease space also edged lower slightly to 31.5% of all vacant space, down from a figure of 32.0% in the second quarter. However this is almost double the ten year average of 16.3%. Large subleases on the market include Palo Alto Networks, Citrix, and Global Foundries, all located in Santa Clara.

After a step backward in the second quarter of 2019, occupancy rebounded in the third quarter as net absorption recorded a positive 412,000 square feet (sf), almost negating the loss of negative 440,000 sf last quarter. Gross absorption (leasing) also increased finishing the third quarter at 3.4 msf up from 3.1 msf in the second quarter. This was, in large part, due to a significant owner/user sale. Google purchased the 7-building Yahoo/Verizon campus totaling 1 msf in Sunnyvale. Verizon will continue to lease the property for two years while its new campus is being built. Another significant owner/user sale was the Apple purchase of two buildings totaling 313,000 sf in Cupertino. This will not result in a change in occupancy as Apple had been in these buildings for the last 10 years. The increased gross absorption in the third quarter brings the year-to-date figure to 8.2 msf. Although this doesn't come close to the near record setting level in 2018 of 13.4 msf, it is on track to surpass both 2016 and 2017 levels which came in at 8.4 and 8.6 msf respectively.

In the third quarter, only one of the top eight transactions was a renewal. The largest deal of the quarter was Verizon's prelease of two buildings totaling 643,000 sf in the San Jose Airport. Another prelease transaction was Softbank's lease of 154,000 sf in Menlo Park. Other notable deals include 8X8 (177,000 sf) in Campbell, Rambus (89,000 sf) in North San Jose and Heritage Bank of Commerce (54,000 sf) in the San Jose Airport. A significant renewal/expansion deal was Intacct Corp/Sage's lease of 118,000 sf in Downtown San Jose. They had been occupying five floors and expanded into a sixth floor. There was one noteworthy sublease deal with Bytedance taking 78,000 sf from WhatsApp in Downtown Mountain View.

The average asking rent increased in the third quarter to \$4.80 per square foot on a monthly full service basis (psf) from \$4.69 psf in the second 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 an 18% YOY increase closing the third quarter with an average asking rent of \$4.53 psf.

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New product under construction across the region currently stands at approximately 5.7 msf. This is comprised of 4.7 msf of speculative product and 1.0 msf of build-to-suits. It's important to note that most of the 4.7 msf of "spec" is preleased. Only 1.4 msf under construction is currently available – 340,000 sf delivering in the balance of 2019 and 1.1 msf in 2020. 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.

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.

LEASING ACTIVITY ON TRACK TO SURPASS THE 10-YEAR AVERAGE BY 20-25%

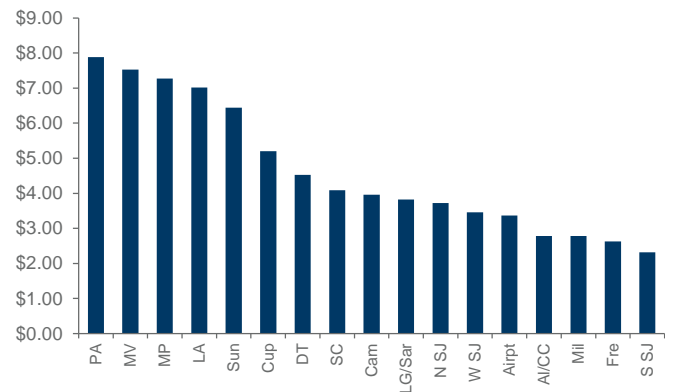
After 2018 finished with the strongest leasing activity in five years, 2019 began with a whimper amidst caution of a market slowdown. Both tenants and developers hit the pause button in a "wait and see approach to growth", however after a modest start in the first quarter, deal velocity began to gain momentum. In just three months rents rose 3% and the second quarter saw gross activity double from the first quarter. The third quarter gained further momentum with the highest quarterly gross and net absorption in the year. Despite the cautionary start, 2019 is on pace to surpass the ten-year average gross absorption by 20-25%. With the preleased deals from earlier this year we expect to see an increase in net absorption as those tenants occupy into 2020. Tenant demand is still strong and we expect that will translate into leasing activity throughout the remainder of the year though deals are taking longer to consummate.

Outlook

- The current average asking rent of \$4.80 psf (full service) has increased from \$4.69 psf three months ago. We expect average rents to increase across the Valley as new construction picks up.
- Net absorption in Q3 was 412,000 sf, almost negating Q2's loss. We expect net to increase as the recently signed preleased deals occupy this year and into 2020.
- Tenant demand is still hot and we expect that demand to translate into leasing throughout the remainder of the year.

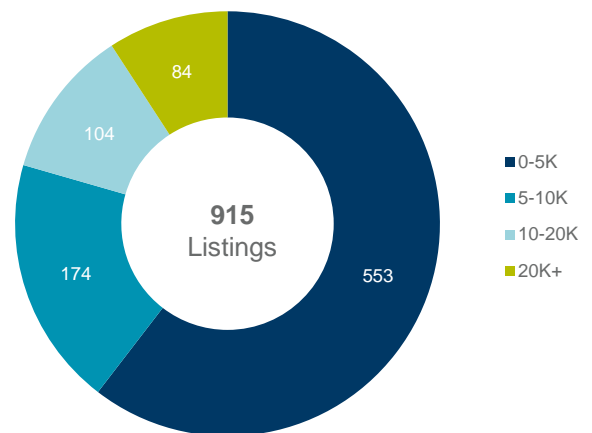
Average Asking Rate by Submarket (Full Service)

NORTHERN CITIES COMMANDING HIGHEST RENTS



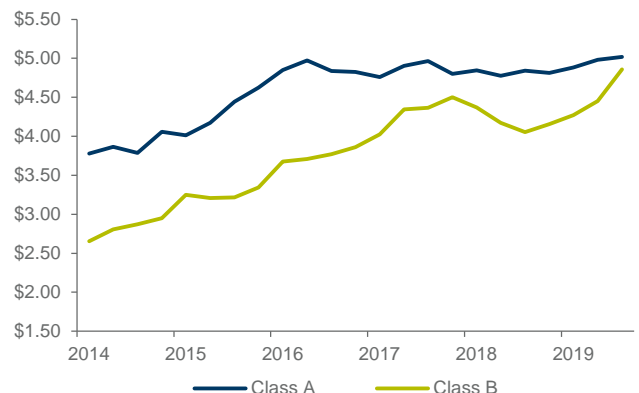
Availabilities by Size Segment

LACK OF SUPPLY FOR QUALITY LARGE BLOCK SPACE



Average Asking Rate by Class (FS)

CLASS A OVERALL RENTS INCREASED BY 33% 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	157,532	157,031	5.8%	(37,396)	(66,291)	952,794	\$7.27	\$8.65
Palo Alto	10,505,042	301,308	452,551	7.2%	(12,994)	(125,016)	182,700	\$7.88	\$8.66
Los Altos	1,136,329	11,049	71,837	7.3%	(8,708)	(34,541)	0	\$7.02	\$7.44
Mountain View	5,249,194	197,241	248,738	8.5%	(7,289)	(156,563)	411,974	\$7.53	\$7.82
Cupertino	4,434,532	54,716	118,006	3.9%	(23,294)	(21,012)	0	\$5.20	\$5.69
Campbell	2,619,982	69,874	461,688	20.3%	10,679	24,602	10,400	\$3.96	\$4.38
Los Gatos/Saratoga	2,408,616	21,991	39,375	2.5%	41,341	39,837	0	\$3.82	\$3.86
West San Jose	4,324,450	38,908	133,088	4.0%	47,971	(13,392)	676,000	\$3.46	\$4.90
Sunnyvale	11,703,951	104,659	325,336	3.7%	348,015	279,167	1,367,261	\$6.44	\$7.28
Santa Clara	9,929,853	1,006,989	1,013,515	20.3%	48,900	152,100	580,206	\$4.09	\$4.16
San Jose Airport	4,354,514	302,846	257,225	12.9%	2,546	48,128	359,179	\$3.37	\$3.39
North San Jose	5,734,972	215,885	976,220	20.8%	(24,780)	2,227	242,320	\$3.72	\$3.96
Alameda/Civic Center	2,029,039	0	83,358	4.1%	12,730	10,016	32,307	\$2.78	\$4.25
South San Jose	1,735,800	24,305	55,826	4.6%	5,652	23,679	0	\$2.32	\$3.29
Downtown San Jose	8,761,129	46,699	1,103,255	13.1%	(17,585)	45,832	929,000	\$4.53	\$4.98
Milpitas	979,437	1,206	42,690	4.5%	1,322	14,374	0	\$2.78	\$3.60
Fremont	2,038,924	28,763	74,126	5.0%	24,516	54,271	0	\$2.63	\$2.17
CLASS BREAKDOWN									
Class A	48,815,058	2,182,107	3,499,920	11.6%	310,714	392,431	5,744,141	N/A	\$5.02
Class B	20,088,670	332,256	1,243,678	7.8%	91,977	60,030	N/A	N/A	\$4.86
TOTAL	83,326,323	2,583,971	5,613,865	9.8%	411,626	277,418	5,744,141	\$4.80	\$5.02

Asking rates converted to FS

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

Key Lease Transactions Q3 2019

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
Coleman Highline	643,990	Verizon	Hunter Storm Properties	Prelease	San Jose Airport
675 Creekside Way	177,815	8X8	South Bay Development	New Lease	Campbell
500 El Camino Real	154,000	Softbank	Stanford University / Peery Arrillaga	Prelease	Menlo Park
300 Park Ave	118,410	Intacct Corp / Sage	Divco / Rockpoint Group	Expan/Renewal	Downtown San Jose
4453 First St, N.	89,425	Rambus	South Bay Development	New Lease	North San Jose
250 Bryant St	78,256	Bytedance	WhatsApp / Facebook	Sublease	Mountain View
224 Airport Pkwy	54,910	Heritage Bank of Commerce	Hudson Pacific Properties	New Lease	San Jose Airport
3950 Fabian Wy	34,173	Confidential tenant	Calif Pacific Comm Corp.	New Lease	Palo Alto

Key Sale Transactions Q3 2019

PROPERTY	SF	BUYER	SELLER	SALE PRICE / \$PSF	MARKET
700 First Ave	1,035,337	Google, Inc.	Yahoo / Verizon	\$1,000,000,000 / \$966	Sunnyvale
20300-20330 Stevens Creek	313,948	Apple, Inc.	American Realty Advisors	\$290,000,000 / \$924	Cupertino
Palo Alto Technology Ctr	259,586	Longfellow Real Estate	KBS Realty Advisors	\$205,000,000 / \$790	Palo Alto
10200 De Anza Blvd	142,651	Rubicon Point Partners	Seagate Technologies LLC	\$107,500,000 / \$754	Cupertino

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Office Submarkets Silicon Valley



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