

Savills Studley Report

Silicon Valley office sector

Q2 2018



SUMMARY

Market Highlights

LEASING STEADY

Deal volume totaled over 2.6 million square feet (msf), as several significant leases were signed. Tenants have leased 5.8 msf in the four most recent quarters.

AVAILABILITY DECREASES

The region's overall availability rate declined by 200 basis points to 15.8%, and has decreased by 130 basis points compared to mid-year 2017. Availability remains negligible in Menlo Park, Palo Alto and Sunnyvale/Cupertino with single-digit availability in these core locations.

RENTAL RATE PUSHER HIGHER

Regional overall asking rent rose by 4.0% to \$50.94 (\$4.25 monthly) during the second quarter. Class A rent increased by 1.7% to \$52.51 (\$4.38 monthly).

SALES DROP

Office property sales during the last six months (through May 2018) totaled \$1.6 billion, a 33% decrease compared to the previous six-month total of \$2.5 billion.

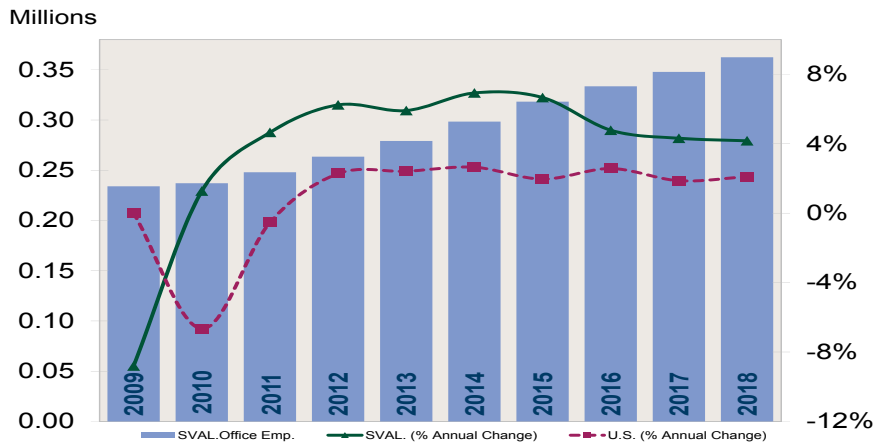
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"Developers seemingly only have to conjure up a new project and one of the Valley's top employers magically appears to take it. Realistically, though, securing financing and approvals for new development remains challenging. Landing a tenant in this current market may be the least difficult part of the equation - at least for the time being."

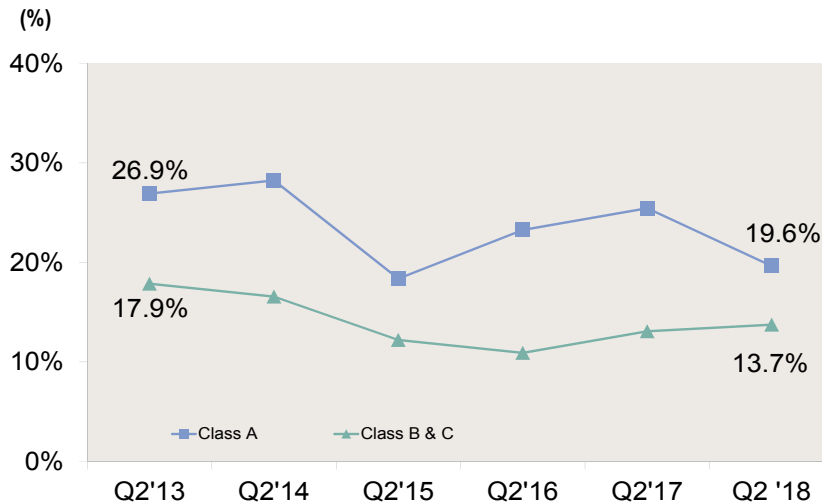
John Brady,
Vice Chairman

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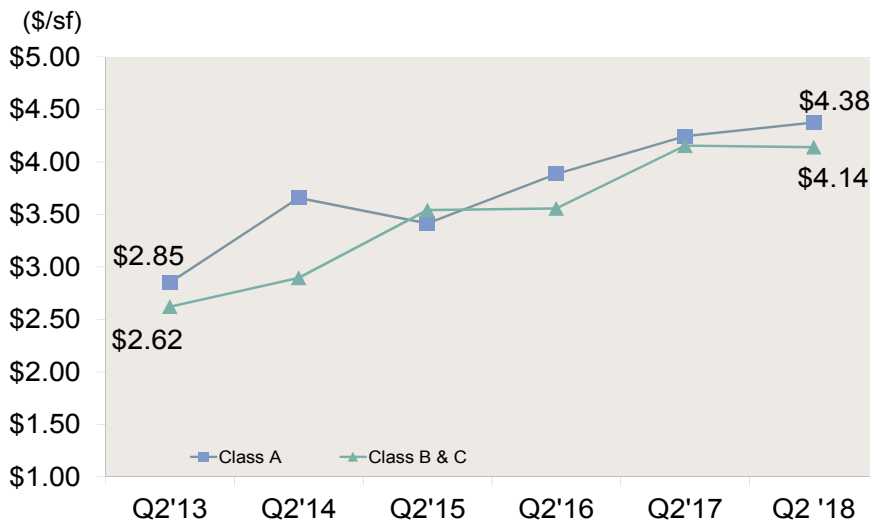
Office-Using Employment Trends

Source: Bureau of Labor Statistics[^]

Vacant Availability Rate Trends



Asking Rent Trends



Leasing up Blueprints

In Silicon Valley, as in San Francisco, it seems as though a developer has merely to conjure up a project and one of the region's top tech firms will magically appear to take it. Realistically, it takes much more than that – owners must secure approvals for developments, as well as financing – but that may be the most difficult part in this market.

Facebook, much like Google, has been right there of late, to lease up new projects even before they get underway. Its massive 1.0-msf lease at Moffett Towers II earlier this year made the social media giant's push into Sunnyvale official. Jay Paul has pre-leased all of the 1.8 msf of office space in five buildings at the second phase in Moffett Towers. Facebook is taking three of the five buildings. Amazon has leased most of the balance of the project, including 350,000 sf at 1111 Lockheed Martin Way. Amazon also leases 581,000 sf for its Lab126 group at the first phase of Moffett Towers (905 and 925 11th Avenue).

Facebook also recently swooped in to take all of WeWork's space at The Village at San Antonio Center in Mountain View (391 and 401 San Antonio Road). The two eight-story buildings, with a combined 450,000 sf of space, give Facebook another outpost with proximity to its headquarters in Menlo Park.

Negligible Big Blocks

Conditions for larger tenants over 100,000 sf in the Valley are very challenging. Businesses that are open to any geography in the region can find a lot more options. There are nearly 40 existing buildings offering a contiguous block of 100,000 sf or more – 16 of them are in North San Jose and Santa Clara accounts for another 15. Mountain View only has two such buildings. Smaller and even mid-sized tenants with geographical flexibility have more options, as long as they steer clear of Menlo Park, Mountain View, Palo Alto or Sunnyvale/Cupertino – these core towns have vacancy rates under 5%.

Many tech firms, particularly startups, view Palo Alto as a must-have location. When rare opportunities pop up they are quickly grabbed. The Stanford School of Medicine, for example, quickly snared the former Theranos headquarters in Palo Alto. The 116,000-sf building in the Stanford Research Park has been vacant ever since Theranos pulled its operations to Newark.

Life Science Firms Cast a Wide Net

Conditions are also extremely tight in Menlo Park, both in its office and R&D buildings. Life science firms are struggling to find any space. Tarlton Properties plans to add a new building at Menlo Park Labs for the first time in 30 years. The new 260,000-sf R&D building at 1350 Adams Court is just the first phase of what will eventually be one of the region's largest new life science development in the Valley. Securing land and permits in Menlo Park and Palo Alto is often a daunting process. Fortunately the City of Menlo Park granted Tarlton's 11.2-acre site expanded development rights in 2017. The parcel was previously a warehouse for Office Depot/Office Max.

The life sciences sector is in desperate need of new development. Vacancy in San Francisco's Mission Bay district is well under 1.0%. San Mateo and Santa Clara have a bit more availability but vacancy is below 3.0%. Much of the new construction is in the Peninsula. Illumina, based in San Diego is working on 500,000 sf of lab space in Foster City and Merck & Co. is building a 290,000 sf facility in South San Francisco.

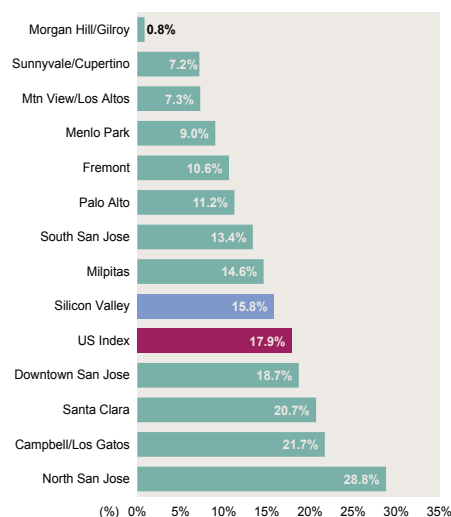
Demand from Far and Wide

In addition to continued activity from top firms such as Facebook, Google and Amazon, many mid-sized firms are also active. This includes some foreign competitors trying to establish a foothold. Amazon competitor Tencent, for example, signed a 36,120-sf lease for the entirety of 2747 Park Boulevard in Palo Alto. The popular Chinese messaging and payments app is one of the most profitable companies in the world. It also owns stakes in top gaming companies, including North Carolina-based Epic Games. Many of the positions Tencent is recruiting for in the Valley are related to gaming. Tencent currently occupies 13,300-sf at 661 Bryant Street, but the lease does not expire until 2023.

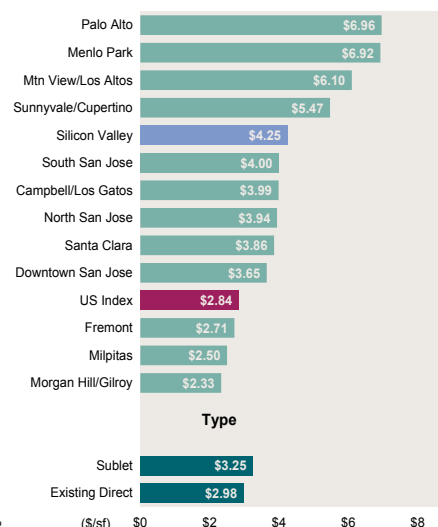
Demand from long-standing local firms has also been steady. Achronix Semiconductor Corporation recently opened its new corporate headquarters at 2093 Bunker Hill in Santa Clara. The semiconductor plans to add more employees as part of its growth in its high-performance and high-density FPGA technology for hardware acceleration applications in data centers.

Investors are still paying top dollar for buildings across the region. A partnership between Lincoln Property and PCCP paid

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
Micron Technology	463,623	120 & 130 Holger Way	San Jose
Facebook	450,000	391 & 401 San Antonio Rd	Mountain View/Los Altos
Amazon	350,663	1100 Discovery Way	Sunnyvale/Cupertino
Hewlett-Packard Company	225,000	6280 America Center Dr	North San Jose
Hortonworks Inc	66,137	5470 Great America Pky	Santa Clara
Netskope	61,753	2445 Augustine Dr	Santa Clara
Regus	40,022	2445 Augustine Dr	Santa Clara
Tencent	36,120	2747 Park Blvd	Palo Alto
Rockwell Automation, Inc.	20,114	111 N Market St	Downtown San Jose
Ondot Systems	11,500	2811 Mission College Blvd	Santa Clara

\$144.5 million for Valley Technology Centre in North San Jose. The seven-building office park totaling 464,000 sf sold for \$311/sf. The site consists largely of two-story buildings constructed in 1999. The 28.5-acre site is seen as a future redevelopment play, remarkable considering that all of the buildings are less than two decades old.

Pay as You Hire

In addition to their pitched battle for talent many of the top tech towns in Northern California are in the midst of efforts to control growth. Payroll taxes have been proposed in multiple tech markets up and down the West Coast in recent months. Seattle, for example, considered a payroll tax that would have hit Amazon the hardest but ultimately withdrew the proposal. Similarly, Cupertino pulled back from a ballot measure that would have taxed Apple up to \$31.6 million per year.

Mountain View is proposing what some are calling the "Google tax." The November ballot issue calls for an update to the business license fee for the first time in 30 years. The current \$30 flat tax rate is one of the lowest in the Bay Area. The head tax would raise a hefty levy on Google — it is estimated that the company would pay \$3.3 million per year.

It is ultimately up to the voters to decide whether the tax will go forward, but one use for tax revenues being considered is congestion alleviation efforts. Of note, Sunnyvale, San Jose and Redwood City all have per-employee taxes. If enacted, the tax measure coupled with negligible space options could give added cause for businesses to consider operations in other towns across the Valley.

Map	Submarket	Total	Leasing Activity		Available SF		Availability Rate			Asking Rents Per SF		
			Last 12 Months	This Quarter	% Change from Last Qtr.	Year Ago	This Quarter	pp Change from Last Qtr. ⁽¹⁾	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
1	Campbell/Los Gatos	3,359	106	730	22.3%	457	21.7%	4.0%	13.6%	\$3.99	5.7%	\$3.69
	Campbell/Los Gatos - Class A	1,009	39	264	15.1%	203	26.1%	3.4%	20.2%	\$4.49	11.1%	\$3.96
2	Downtown San Jose	8,708	455	1,629	7.9%	1,454	18.7%	1.4%	16.7%	\$3.65	1.9%	\$3.53
	Downtown San Jose - Class A	3,590	243	722	21.8%	592	20.1%	3.6%	16.5%	\$4.08	-0.9%	\$3.82
3	Milpitas	2,778	155	407	11.3%	597	14.6%	1.5%	21.5%	\$2.50	0.5%	\$2.48
	Milpitas - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
4	Morgan Hill/Gilroy	723	9	6	0.0%	8	0.8%	0.0%	1.1%	\$2.33	0.0%	\$2.03
	Morgan Hill/Gilroy - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$0.00	N/A	\$0.00
5	Mountain View/Los Altos	7,583	1,150	553	36.7%	993	7.3%	2.0%	13.1%	\$6.10	0.5%	\$6.45
	Mountain View/Los Altos - Class A	1,232	2	207	22.2%	173	16.8%	3.0%	14.0%	\$6.47	4.6%	\$5.98
6	North San Jose	12,786	1,475	3,685	-15.5%	3,658	28.8%	-5.3%	28.6%	\$3.94	10.4%	\$3.46
	North San Jose - Class A	5,613	1,118	1,843	-9.8%	1,777	32.8%	-3.6%	31.7%	\$3.91	9.0%	\$3.53
7	Palo Alto	6,643	289	747	20.5%	558	11.2%	1.9%	8.4%	\$6.96	0.6%	\$7.07
	Palo Alto - Class A	273	116	N/A	235.2%	78	18.0%	12.6%	28.6%	\$7.95	N/A	\$0.00
8	Santa Clara	14,870	968	3,080	-22.0%	4,132	20.7%	-5.9%	27.8%	\$3.86	-0.2%	\$3.88
	Santa Clara - Class A	7,000	545	1,888	-29.3%	3,020	27.0%	-11.2%	43.1%	\$4.16	-1.3%	\$4.47
9	South San Jose	4,184	265	560	7.5%	487	13.4%	0.9%	11.6%	\$4.00	21.5%	\$4.39
	South San Jose - Class A	844	91	317	1.5%	389	37.6%	0.5%	46.1%	N/A	N/A	\$5.17
10	Sunnyvale/Cupertino	13,972	579	1,005	-28.2%	868	7.2%	-2.8%	6.2%	\$5.47	8.7%	\$4.66
	Sunnyvale/Cupertino - Class A	8,009	414	360	-48.2%	426	4.5%	-4.2%	5.3%	\$6.27	0.7%	\$5.15
11	Menlo Park	5,005	193	452	25.7%	411	9.0%	1.8%	8.2%	\$6.92	-5.6%	\$7.91
	Menlo Park - Class A	1,502	128	58	126.8%	45	3.8%	2.1%	3.0%	\$11.77	8.2%	\$8.66
12	Fremont	2,009	185	213	-31.8%	242	10.6%	-5.0%	12.0%	\$2.71	19.4%	\$2.15
	Fremont - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1-12	Silicon Valley Total	82,620	5,829	13,067	-9.3%	13,864	15.8%	-2.0%	17.1%	\$4.25	4.0%	\$4.19
	Silicon Valley Total - Class A	29,071	2,696	5,707	-15.5%	6,703	19.6%	-6.0%	25.4%	\$4.38	1.7%	\$4.25

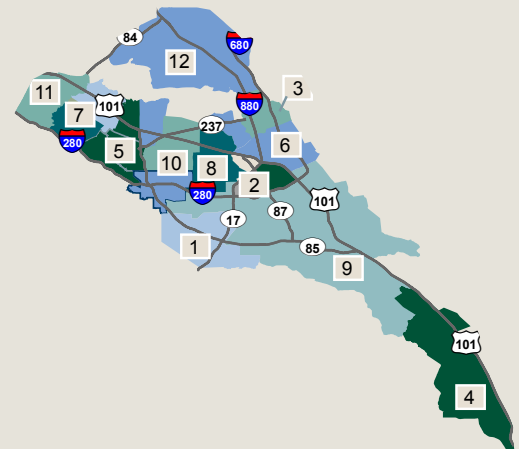
Please contact us for further information

Savills Studley
550 S. Winchester Blvd., Suite 600
San Jose, CA 95128
408-554-8855

Vice Chairman
John Brady
jbrady@savills-studley.com
License 00580537

Savills Studley
705 High Street
Palo Alto, CA 94301
650-812-9800

Executive Managing Director
Mark Pearson
mpearson@savills-studley.com
License 00891920



(1) Percentage point change for availability rates.
Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.
Statistics are calculated using both direct and sublease information.
Short-term sublet spaces (terms under two years) were excluded.
^Unless otherwise noted, source for data is Savills Studley.
The information in this report is obtained from sources deemed reliable, but no representation is made as to the accuracy thereof. Statistics compiled with the support of The CoStar Group.
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