

Savills Studley Report Silicon Valley office sector

Q1 2018



SUMMARY

Market Highlights

LEASING DECLINES

Deal volume totaled 1 million square feet (msf), a 27.8% decline from last quarter's 1.5 msf and well short of the historical average of 1.8 msf.

AVAILABILITY UP

The region's overall availability rate increased by 20 basis points to 15.2% in the first quarter of the 2018. The Class A rate fell by 50 basis points to 18.1%, its lowest mark since late 2016, and has dropped by 50 basis points from year end 2016.

RENTAL RATE INCREASES

Regional overall asking rent (\$4.08) rose by 2.3% during the first quarter and jumped by 3.0% year-on-year. Class A rent (\$4.30) increased by 2.5% during the quarter, but has fallen by 1.2% from the first quarter of 2017.

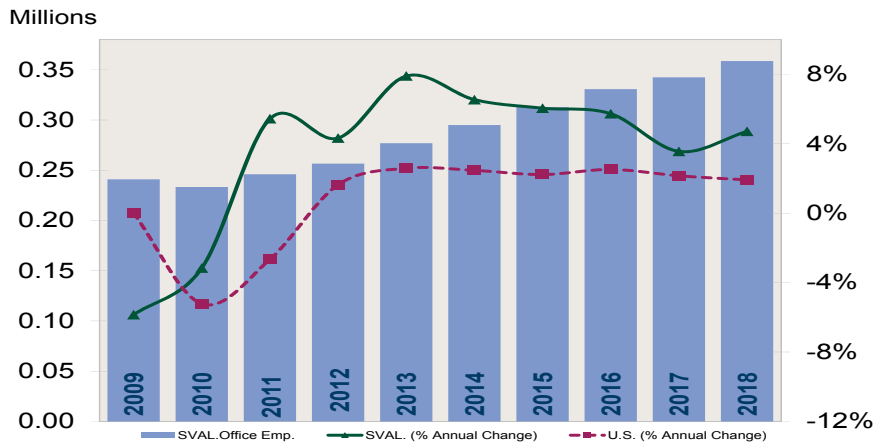
INVESTORS TARGET THE VALLEY

Office property sales during the last six months (through February 2018) totaled \$3.1 billion, a 62% increase compared to the previous six-month total of \$1.9 billion.

.....
"The Valley is in many ways a collection of company towns. Google, Apple and Facebook dominate demand for talent and space in their own domains. Downtown San Jose has largely been an island operating in a much calmer leasing environment -- Google's massive transit village promises to end this isolation, pushing more firms South."

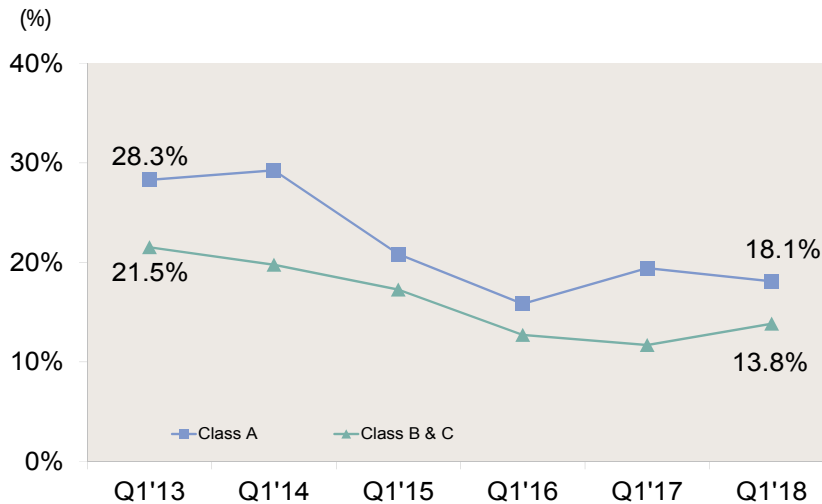
Nathan Currie,
Corporate Managing Director
.....

Office-Using Employment Trends

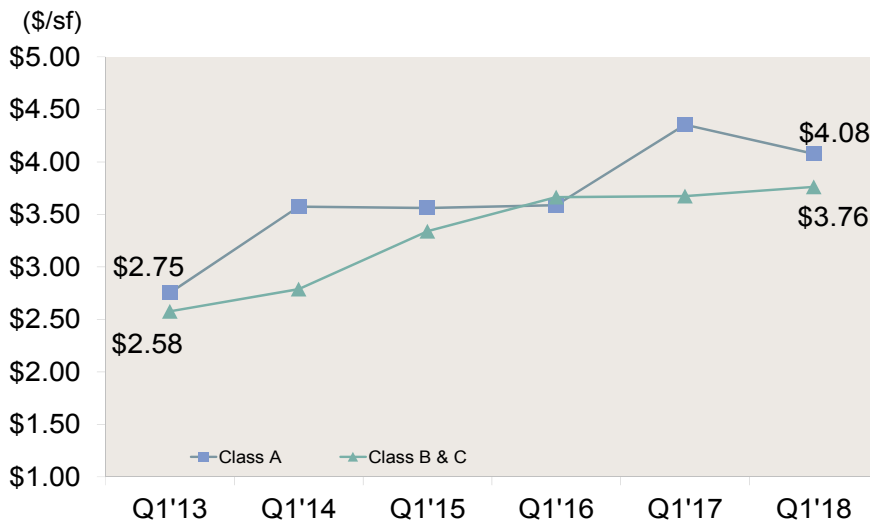


Source: Bureau of Labor Statistics^

Vacant Availability Rate Trends



Asking Rent Trends



Challenging for All, Some More So than Others

Silicon Valley has a unique propensity for dramatic rallies and epic busts. It remains one of the most challenging - but rewarding - economies for those firms that can survive the constant pressure to innovate. Fierce competition as well as a commitment to collaboration may be why the region is home to three global tech leaders -- Apple, Google and Facebook.

Conditions vary from one town to the next. After all, the Valley is in many ways largely a collection of company towns — Apple in Sunnyvale/Cupertino, Facebook in Menlo Park and Google seemingly almost everywhere. The walls between different domains have broken down in this cycle, though. Facebook is pushing into Sunnyvale. Google's mother ship may be in Mountain View, but they sprawled out across the Valley and are now poised to transform Downtown San Jose. This submarket has been on the periphery of the market and operated under atypical conditions, with limited demand from a smaller subset of firms. This isolation seems to be coming to an end. Google's massive transit village adjacent to Diridon Station will change all that, and could push the Valley's center center of gravity South.

Pre-Emptive Strikes

The big three — Apple, Google and Facebook — are in a different category. They steer and brake markets in their backyard as they need talent and space. The threat that one of the big three may swoop in to take down a few more buildings, even before development starts, creates abnormal leasing conditions. The rest of the market have to be extremely aggressive. If a company can not be geographically flexible, it must either blow its competition out of the water in their bid for space or decide to stay put.

This reality was apparent yet again in the first quarter. Facebook agreed in principle to more than 1.5 msf in new leases. This includes the last three towers to be constructed in Jay Paul's Moffett Towers in Apple's Sunnyvale backyard, and 494,800 sf at Menlo Gateway. Similarly, Analog Devices leased two entire buildings (2555 Augustine and 2565 Augustine) totaling 440,000 sf at Irvine Company's Santa Clara Square project. The two buildings, which will house more than 900 employees of the semiconductor company, are scheduled to be completed in... Just a few earlier Hitachi leased 225,000 sf at the same facility. Massachusetts-based Analog bought

Milpitas-based Linear Technology for \$14.8 billion in March of 2017 and will move its 930 employees from San Jose and Milpitas. Meanwhile, Irvine Company is making headway at Pathline Park, its 1.5 msf mixed-use project in Sunnyvale. Synopsys inked a 360,000-sf lease.

Rent Rising from Top to Bottom

The Valley is also characterized by a remarkable rental rate differentiation. Private equity and tech are paying \$100/sf-plus in Menlo Park's Sand Hill. Rent in Palo Alto routinely exceeds \$80/sf and it is approaching these levels in Sunnyvale/Cupertino. Tenants seeking much more affordable quality office space must go to the edges to North San Jose, Fremont or Milpitas or an isolated island such as Downtown San Jose. Rent in Downtown San Jose is in the mid-\$30/sf to mid \$40/sf range, with slightly lower rent in North San Jose. Firms with the flexibility to consider these locations or farther afield to San Mateo have more options and will save a great deal on real estate. Even in these areas, though, rent growth has been impressive.

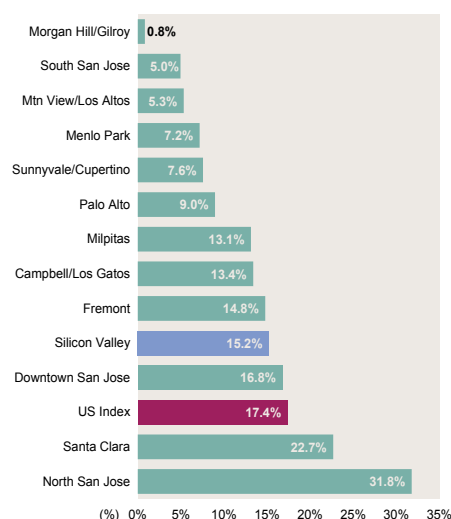
Descending on Diridon

Negligible space options and spiking rent in Mountain View, Sunnyvale and Menlo Park have pushed some tenants to consider Downtown San Jose. Plans for mass transit and Google's massive campus have changed the market's view of Downtown San Jose - from an afterthought to a serious part of the discussion.

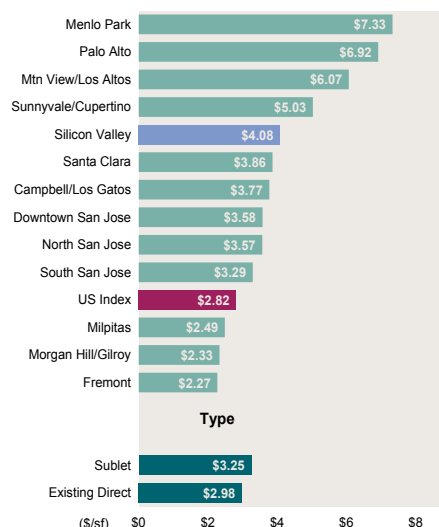
For the time being, Downtown San Jose remains a value play, but perhaps not for much longer. Google's new complex will draw more tenants, putting some landlords in position to significantly boost their rent. Transformation will come only through new development. Although Zoom Communications, Cohesity and Adobe have all expanded recently, Downtown San Jose's existing office product does not suit the needs of most top tech firms. Developers are scrambling to assemble land around Diridon Station in Downtown San Jose. A joint venture between TMG and Valley Oak Partners filed applications for a 1 msf office development at 440 West Julian Street. In December, the City Council approved the site's rezoning from industrial to a transit employment center. The proposal for the 4.4-acre site calls for the construction of three buildings with a combined totaled of just over 1.0 msf.

Landlords in Downtown San Jose are already feeling more confident about their

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
Facebook	1,050,200	Moffett Towers II	Sunnyvale/Cupertino
Facebook	494,800	Menlo Gateway	Menlo Park
Analog Devices	440,000	2555 & 2565 Augustine Dr	Santa Clara
Synopsys	360,000	Pathline Park	Sunnyvale/Cupertino
HPE	229,000	6280 America Center	San Jose
County of Santa Clara	204,000	353 Julian St	San Jose
8X8	162,557	Coleman Highline	San Jose
InvenSense	139,336	1745 Technology Dr	San Jose
Siliconix	56,359	2585 Junction Ave	North San Jose
Spaces	45,448	4353 First St	San Jose

prospects. Rent has jumped in the last few quarters and landlords have pulled back slightly on concessions during the last few quarters. Rent rising even though leasing has not picked up much in recent quarters and several buildings still have quite a bit of space to fill. Downtown San Jose still has 1.5 msf of overall available space for lease – second only to Santa Clara (1.9 msf) and even with North San Jose. Several significant leases were completed in the first quarter.

Legacy Firms Struggling A Bit

Top employers and startups are still vying with each other for talent and the space to house them. Heavyweights such as Apple, Google and Facebook have set the tone for the frenetic absorption of talent and space in the last few years. Local startups are also adding to the fierce competition for talent and space. Many companies are flush with cash. These firms can bid up salaries and what they will pay for space. Some of

the vintage tech firms continue to struggle to shift gears and adjust to innovation and disruption at the heart of the Valley's economy. Following 250 layoffs in 2017, Cisco recently cut another 310 jobs at its headquarters. Santa Clara-based Gigamon announced that it will lay off about one-fifth (74 employees) in its headquarters. The layoffs are part of a company restructuring.

These instances of continued workforce adjustments aside, the Valley remains one of the strongest markets nationally. Based on first-quarter leasing it is difficult to spot any signs of cooling in the office market. Tenants are likely to encounter additional decreases in concession packages next year. While landlords in many areas such as Menlo Park and Sunnyvale want the rally to keep running, their counterparts in Downtown San Jose and Fremont hope they will get a true taste of the tech rally for the first time in years.

Map	Submarket	Total	Leasing Activity		Available SF		Availability Rate			Asking Rents Per SF		
		SF (1000's)	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	3,181	98	426	17.5%	336	13.4%	2.0%	10.5%	\$3.77	3.8%	\$3.72
	Campbell/Los Gatos - Class A	831	22	59	17.0%	49	7.1%	1.0%	5.9%	\$4.04	2.2%	\$4.08
2	Downtown San Jose	8,985	540	1,510	8.8%	1,407	16.8%	1.4%	15.7%	\$3.58	1.4%	\$3.27
	Downtown San Jose - Class A	3,418	376	593	13.3%	527	17.3%	2.0%	15.4%	\$4.11	-0.4%	\$3.65
3	Milpitas	2,778	250	365	-6.2%	577	13.1%	-0.9%	20.8%	\$2.49	5.4%	\$2.41
	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	12	6	57.4%	9	0.8%	0.3%	1.2%	\$2.33	29.5%	\$2.11
	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	7,575	644	405	-15.8%	447	5.3%	-1.0%	5.9%	\$6.07	1.8%	\$5.88
	Mountain View/Los Altos - Class A	1,232	2	169	9.7%	194	13.7%	1.2%	15.8%	\$6.18	4.7%	\$5.75
6	North San Jose	12,264	528	3,899	-2.5%	3,284	31.8%	-0.8%	26.8%	\$3.57	5.4%	\$3.37
	North San Jose - Class A	4,789	323	1,579	-11.3%	1,699	33.0%	-4.2%	35.5%	\$3.58	2.4%	\$3.67
7	Palo Alto	6,563	221	589	-18.5%	351	9.0%	-2.0%	5.4%	\$6.92	5.5%	\$7.66
	Palo Alto - Class A	273	78	N/A	-83.6%	0	5.4%	-27.3%	0.0%	\$0.00	N/A	\$0.00
8	Santa Clara	14,291	660	3,242	3.6%	2,652	22.7%	0.8%	18.6%	\$3.86	7.5%	\$3.72
	Santa Clara - Class A	6,013	306	1,962	5.1%	1,464	32.6%	1.6%	24.3%	\$4.22	5.2%	\$4.44
9	South San Jose	3,776	252	187	31.5%	296	5.0%	1.2%	7.8%	\$3.29	-5.6%	\$3.97
	South San Jose - Class A	522	91	24	-25.7%	150	4.5%	-1.6%	28.7%	N/A	N/A	\$5.17
10	Sunnyvale/Cupertino	13,850	172	1,050	6.6%	1,376	7.6%	0.5%	9.9%	\$5.03	5.9%	\$4.69
	Sunnyvale/Cupertino - Class A	7,764	59	343	-12.2%	778	4.4%	-0.6%	10.0%	\$6.23	12.6%	\$5.44
11	Menlo Park	5,005	183	360	-2.8%	574	7.2%	-0.2%	11.5%	\$7.33	0.8%	\$7.57
	Menlo Park - Class A	1,502	128	25	0.0%	250	1.7%	0.0%	16.6%	\$10.87	0.0%	\$10.17
12	Fremont	2,113	159	313	48.7%	229	14.8%	4.9%	10.9%	\$2.27	2.3%	\$2.14
	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	81,104	3,719	12,351	1.4%	11,539	15.2%	0.2%	14.2%	\$4.08	2.3%	\$3.96
	Silicon Valley Total - Class A	26,345	1,385	4,769	-2.9%	5,111	18.1%	-0.5%	19.4%	\$4.30	2.5%	\$4.35

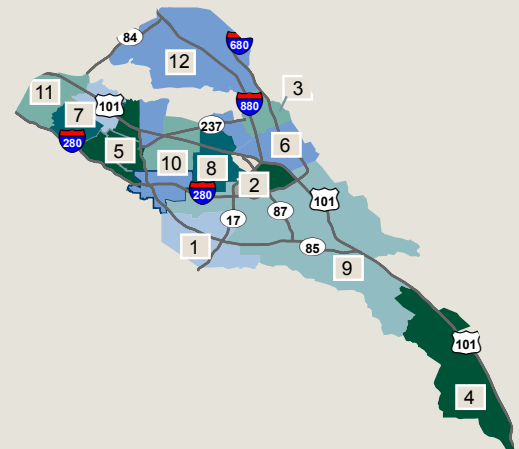
Please contact us for further information

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.
Copyright © 2018 Savills Studley