Silicon Valley Mid-Year Office Market Report

The positives of the current economic landscape include robust construction, jobs, and travel, offset by the negatives of rising gas prices, supply chain issues, and scaled back investment from overseas and venture capital. A recession seems likely, but it's too soon to predict how drastic and how long it will last. This uncertainty could hinder companies that are working to establish a clear way forward with a hybrid workplace model and prolong a wait-and-see approach to leasing new office space.

News of more companies adopting the hybrid workplace model seems to be increasing, but the commercial real estate sector was already moving toward hybrid work, albeit at a very slow pace. The pandemic compressed that timeline. The office space rightsizing in 2008, as companies evaluated space usage and how people work, was a precursor to the hybrid workplace model.

RAISE

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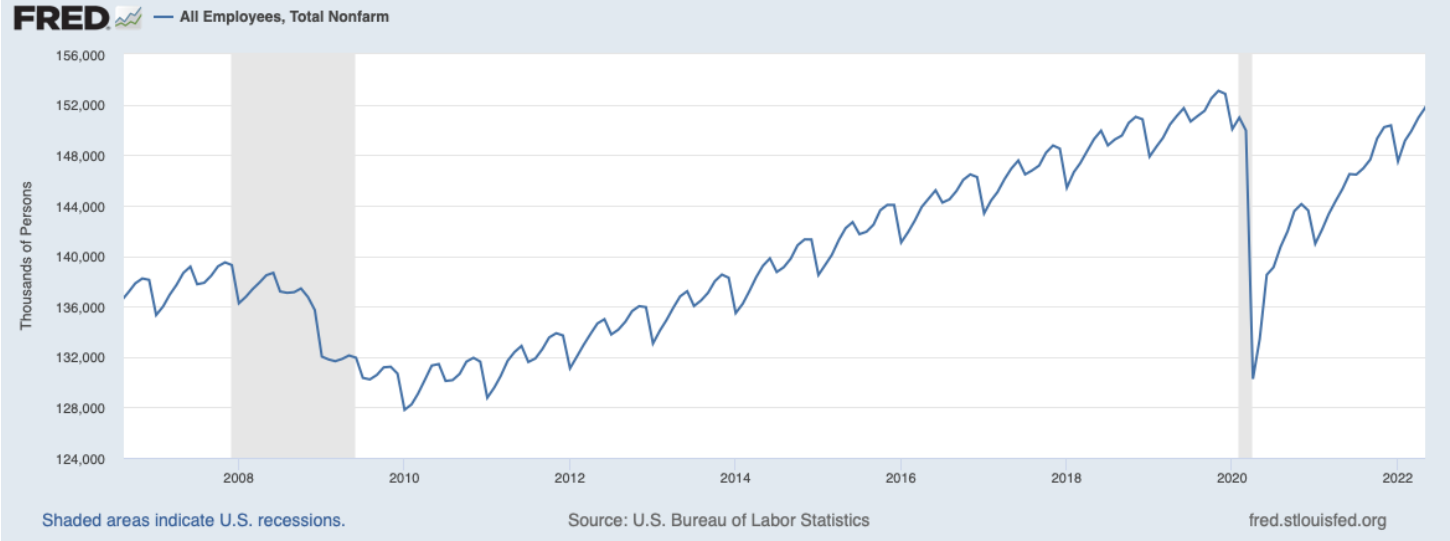
Employment

Additional job gains in June pushed up US employment to near pre-pandemic levels indicating hiring needs may outweigh recession concerns.



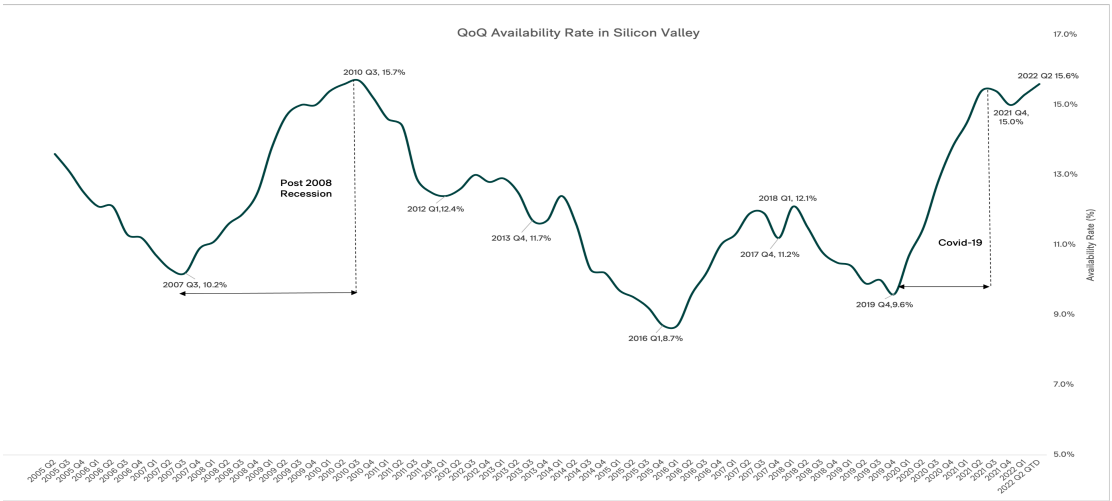
Total Availability In Silicon Valley

Though 2022 was off to a relatively mediocre start, rising inflation, interest rates hikes, remote vs. hybrid debate, and a worrisome sentiment of the economy pushed the market availability rate to 15.6%.

The after effects of Covid-19 on the commercial real estate (CRE) market were drastic and severe in 2020. As the market availabilities reached an inflection point in Q3 of 2021 of 15.4%, the availability rate shifted gears and was on a downward trajectory since then as leasing and touring activity picked up. The market sentiment has changed since then, however, and the availability rate started ticking up again from Q1 of 2022. For the second consecutive quarter, the availability rate increased by 2% to 15.6%.

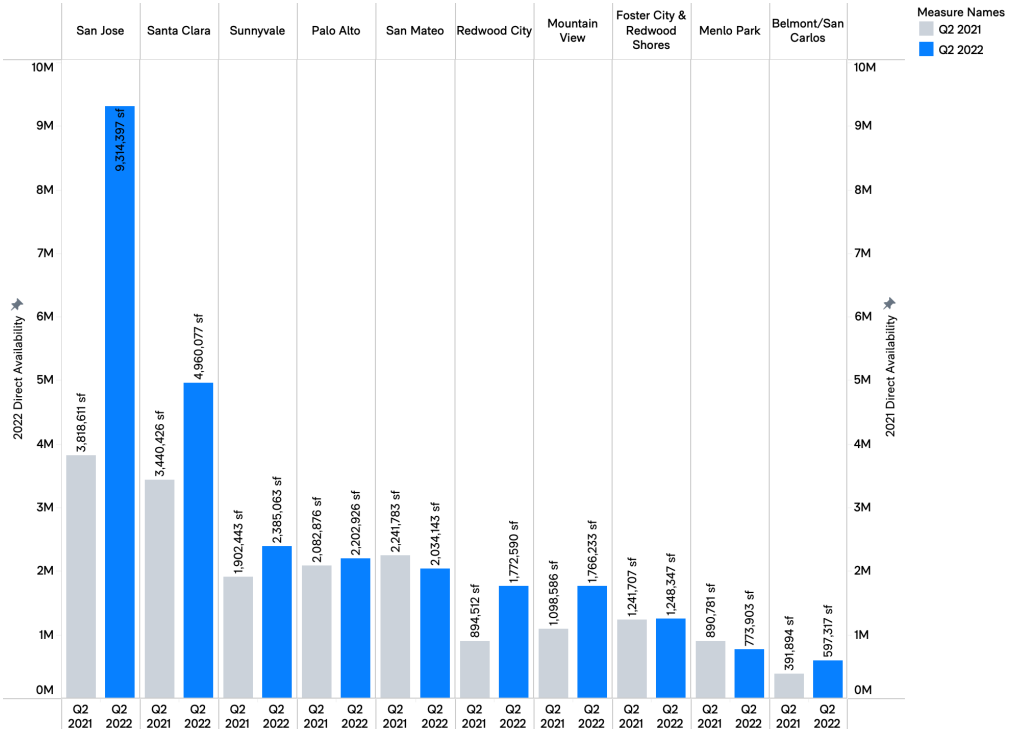
With the anticipated tighter monetary policies from the Federal bank, the availability rate is projected to surpass the historical high of 15.7% (post 2008 recession). Although higher availability translates to ample opportunities for tenants to shop for their desired space, economic uncertainties could also negatively impact confidence.

Silicon Valley Historical Total Availability



Source: Raise

Submarkets With Highest Direct Availability

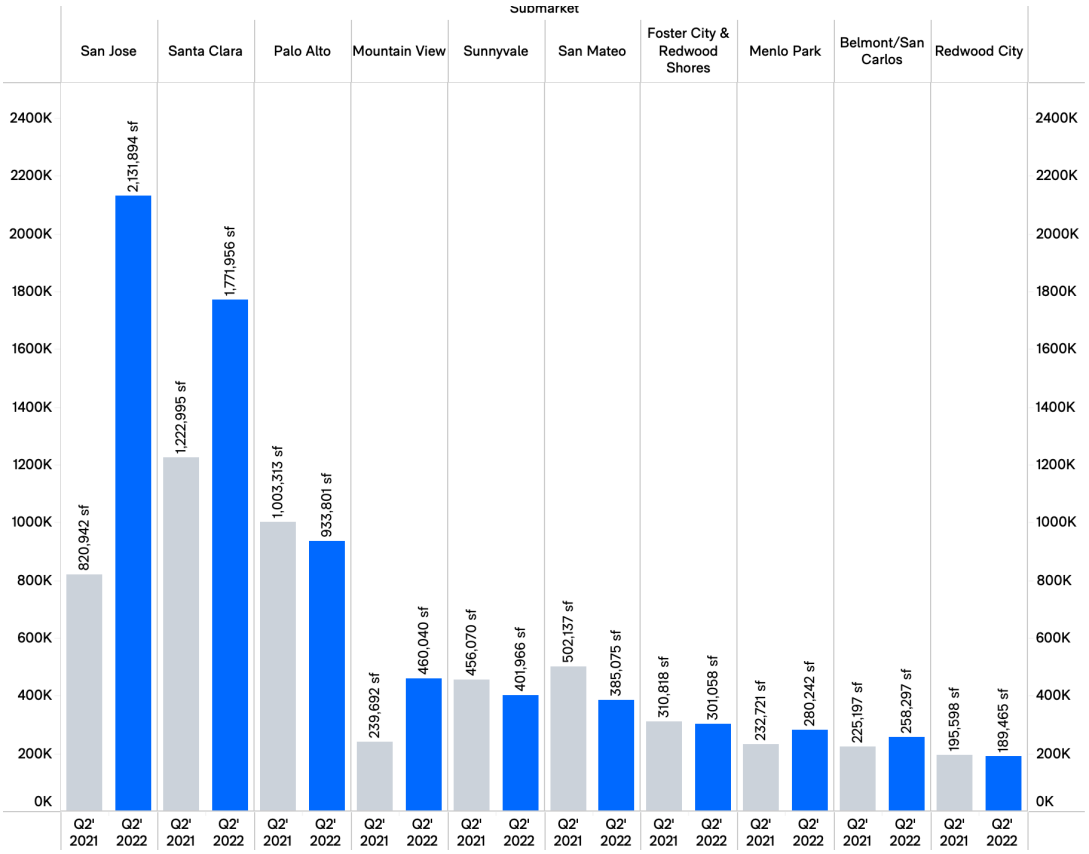


Source: Raise

Direct available space in the San Jose submarket more than doubled year over year (YoY) to 9 million square feet (msf). Direct space in the North San Jose node alone increased by more than 5 msf, mostly due to new inventory like The Station on North First, which is currently under construction. Another 400,000 square feet (sf) of available space in this submarket was added when Qualcomm vacated their campus. Vacancy in this node is now 14.9%.

Redwood City availability ticked up when Course Hero added 85,000 sf to the market. Mountain View availability was driven up by the 258,794-sf proposed development by The Sobrato Organization at 600 Ellis St.

Submarkets With Highest Sublease Availability



Source: Raise

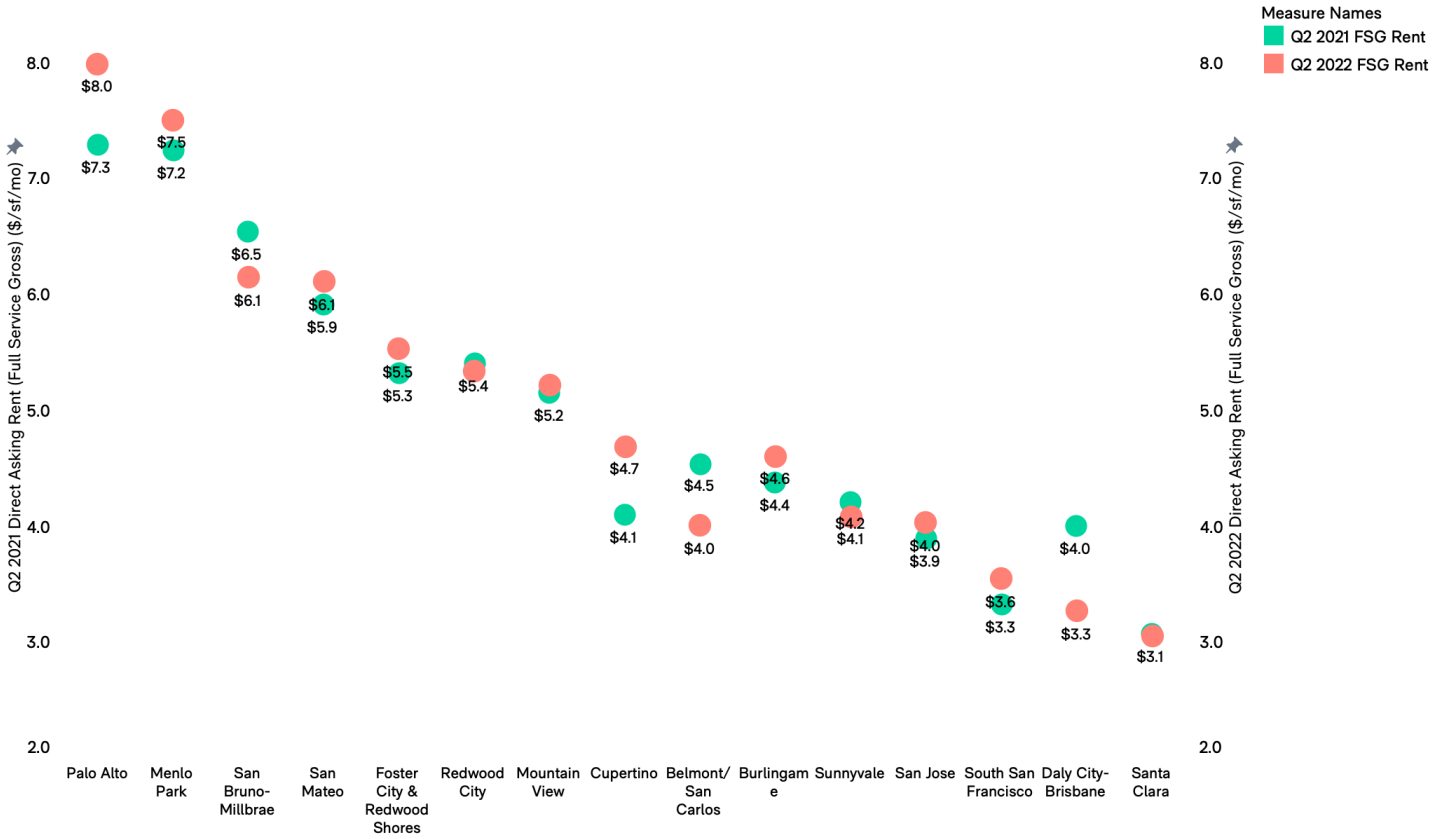
On the sublease side, available space in San Jose grew by 160%, mostly in class B inventory. Driving this increase was Yahoo subleasing their global HQ at 1199 Coleman Ave (665,000 sf) and A10 networks subleasing their HQ at 2300 Orchard Pkwy (116,382 sf). Mountain View's sublease options grew by 92% as a result of Pure Storage adding 77,402 sf of sublease space in April at 599 Castro St. (The Sobrato building).

Palo Alto bounced back impressively from Q1 of 2022. Sublease availability contracted by 7% mostly due to demand driven by VCs and emerging tech companies that prefer to set up shop in the heart of all the action. Sublease options in San Mateo and Redwood City also shrank YoY. Roblox's 122,630-sf deal at 1 Franklin Pkwy, Upstart's 100,000-sf lease at 2950 S Delware St., and Sullivan & Cromwell's 43,475-sf deal at 550 Hamilton were some of the notable deals in these submarkets in the past year.

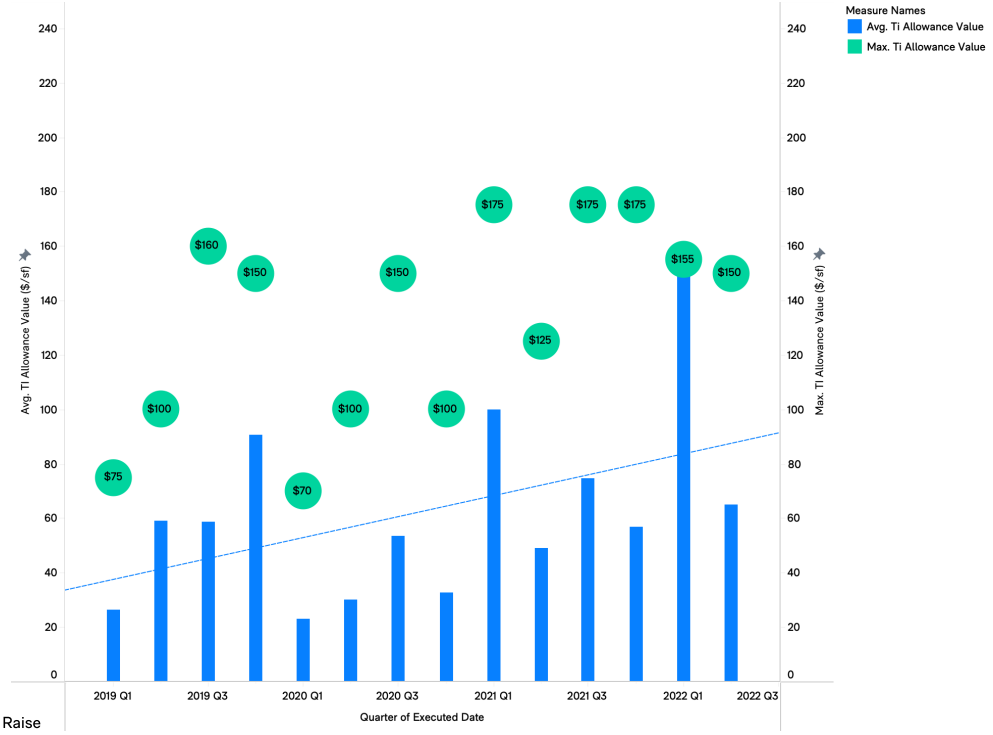
Asking Rates And Incentives

Direct asking rents in most submarkets remained unchanged in Q2 of 2022 compared with Q2 of 2021. Palo Alto and Menlo Park ranked as the two most expensive submarkets in the Bay Area. Asking rents in these two submarkets increased YoY as direct availability dropped by 50% YoY. Asking rents in Belmont/San Carlos, Daly City-Brisbane and San Bruno decreased YoY.

Though asking rents remained stable in most neighborhoods, there was a significant increase in tenant improvements. Landlords maintained steady asking rents, despite an uptick in availability, by offering enhanced concession packages in hopes of offsetting inflationary pressures. By helping keep leasing activity at a somewhat decent pace, these efforts could result in a recovery of CRE demand.



Source: Raise

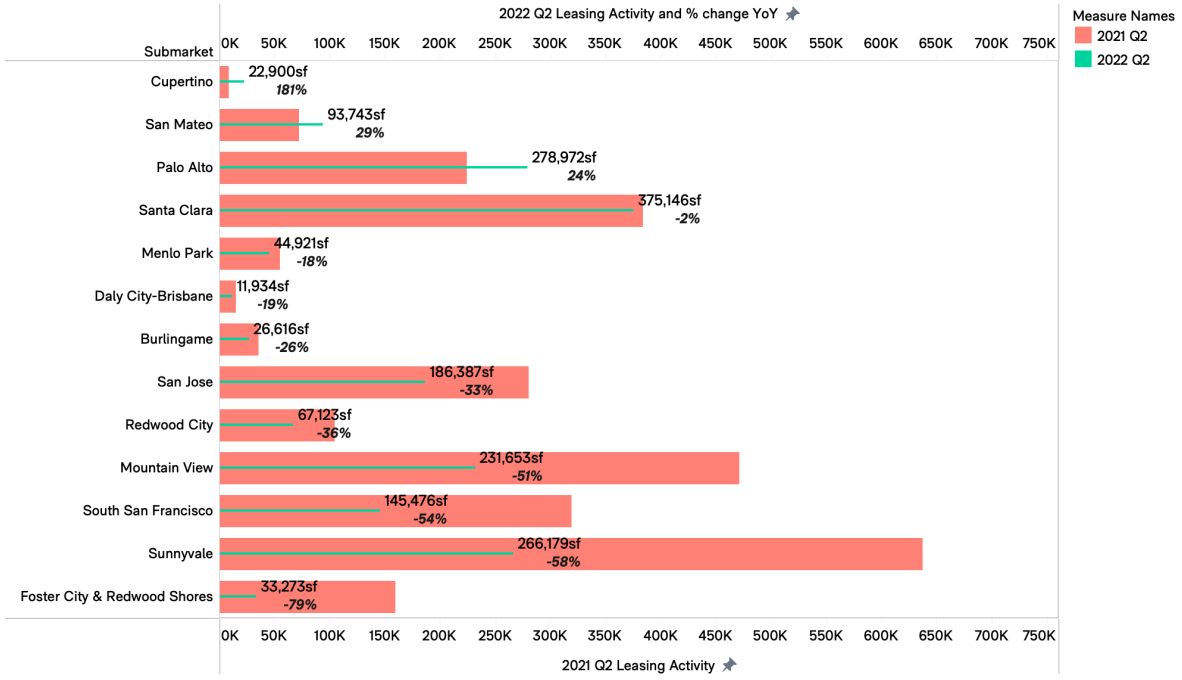


Source: Raise

Prior to Covid-19, maximum concessions hovered around $50 to 80 per square foot (psf), with the highest reaching $100 psf. Since Q2 of 2020, however, landlords have pushed the bar in an attempt to lure tenants and are offering TIs that range from $150 psf to as high as $175 psf. There have also been several anecdotal examples of landlords offering furniture in addition to TIs. This trend is projected to continue as landlords struggle to attract and incentivize creditworthy tenants.

Leasing Activity

Santa Clara submarket's leasing volume reached the highest level Quarter To Date (QTD) with 375,146 sf. Leasing activity in Santa Clara and San Mateo in Q2 of 2022 remained on par with leasing volume in Q1 of 2022, while momentum dipped in other submarkets. Leasing volume in Sunnyvale, Mountainview, and San Jose decreased by almost 50%, despite some big tech names making headlines for taking up space.



Source: Raise

Some notable deals of Q2 include:

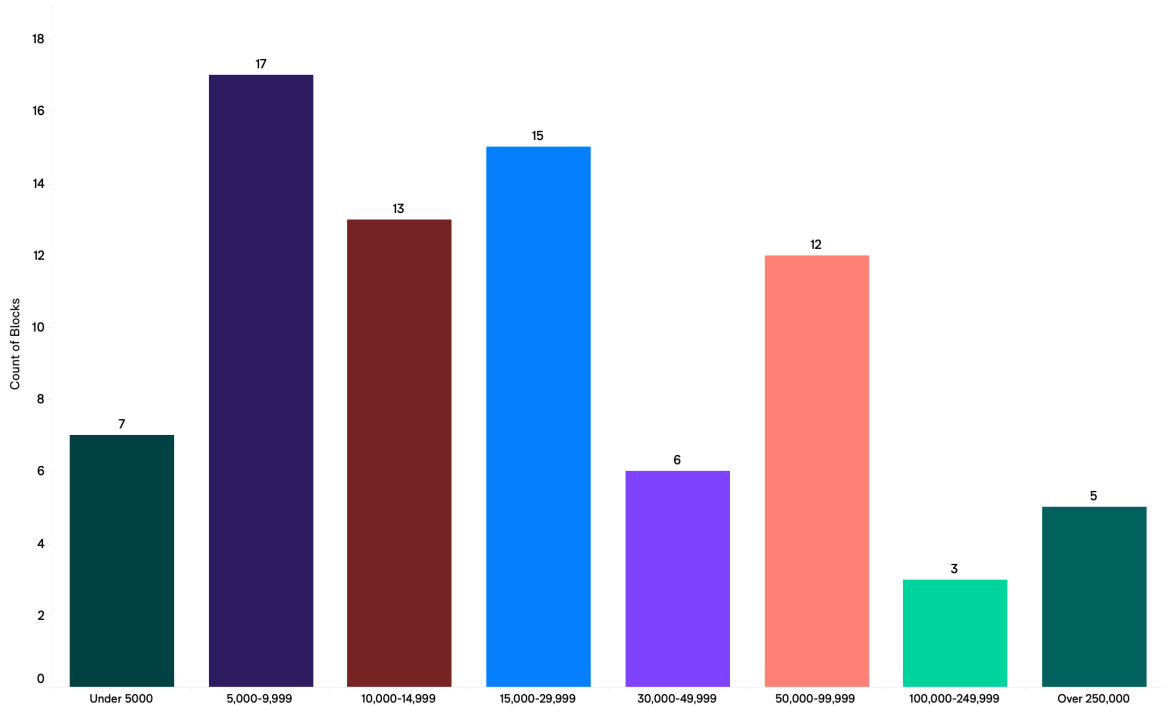
City	Street Address	Transaction Type	Lease Type	Tenant Name	Square Feet
Sunnyvale	625-655 N Mathilda Ave	New	Direct	Apple	358,800
Santa Clara	3333 Scott Blvd	New	Sublease	Applied Materials	245,830
Palo Alto	650 Page Mill Rd	Renewal	Direct	Wilson Sonsini Goodrich & Rosati	190,000
Mountain View	690 E Middlefield Rd	New	Sublease	Waymo	170,000
Sunnyvale	675 Alamnor Ave	New	Direct	Synopsis	150,579
South San Francisco	499 Forbes Blvd	New	Direct	InterVenn Biosciences	142,500
Santa Clara	2251 Lawson Lane	New	Direct	Service Now	130,400
San Jose	1768 Automation Pkwy	New	Direct	FoxConn	118,500
Santa Clara	3655 Kifer Rd	New	Direct	Zoox	110,600
Mountain View	351 East Evelyn Ave	New	Sublease	Databricks	47,053
Menlo Park	1300 El Camino Real	New	Direct	Norwest Venture Partners	36,229

Source: Raise

Demand And Tenants In The Market

Silicon Valley CRE demand was further driven by Tech and BioTech/LifeScience tenants. Currently, 18 tech companies are in the market looking for more than 1 msf of space, BioTech/LifeScience companies are actively looking for 819,000 sf. Demand is strong for blocks in the 5,000 to 30,000-sf range, mostly due to many companies re-evaluating their footprint with hybrid working options on the rise.

Although a large number of companies are actively looking for options and making the most of ample opportunities on the market, leasing decisions are being made at a much slower pace than before. With uncertainty surrounding the economy, this trend will last for the foreseeable future.



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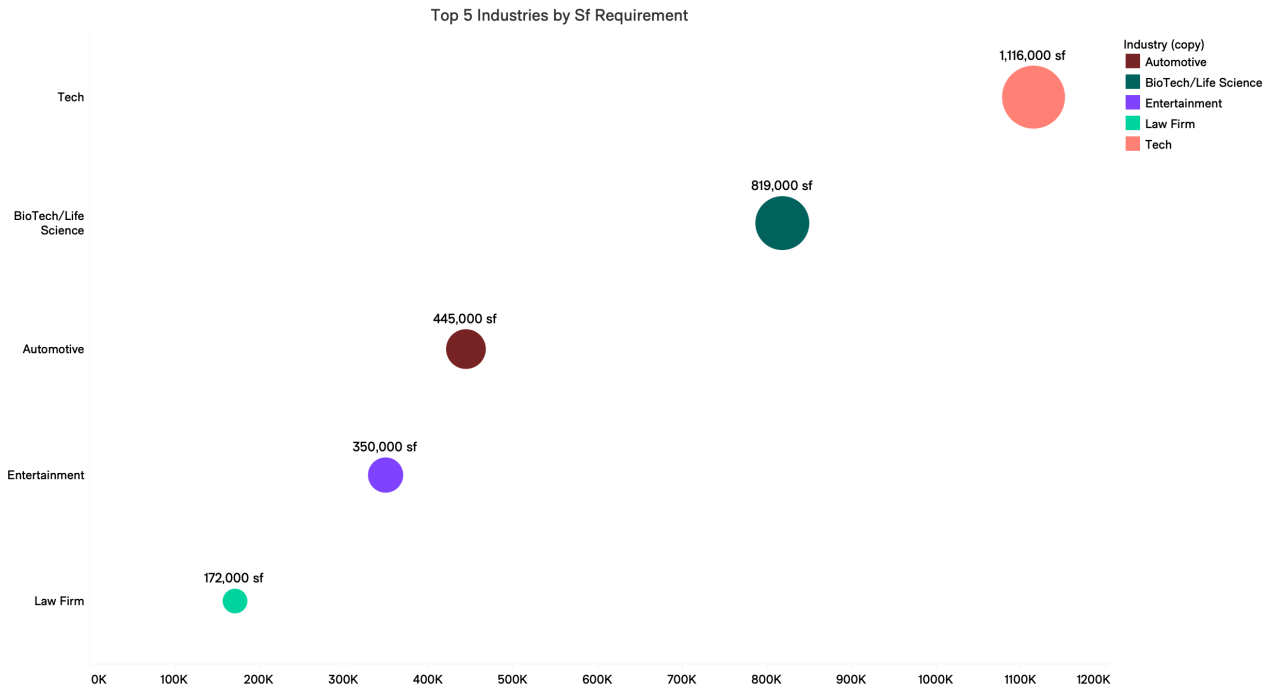
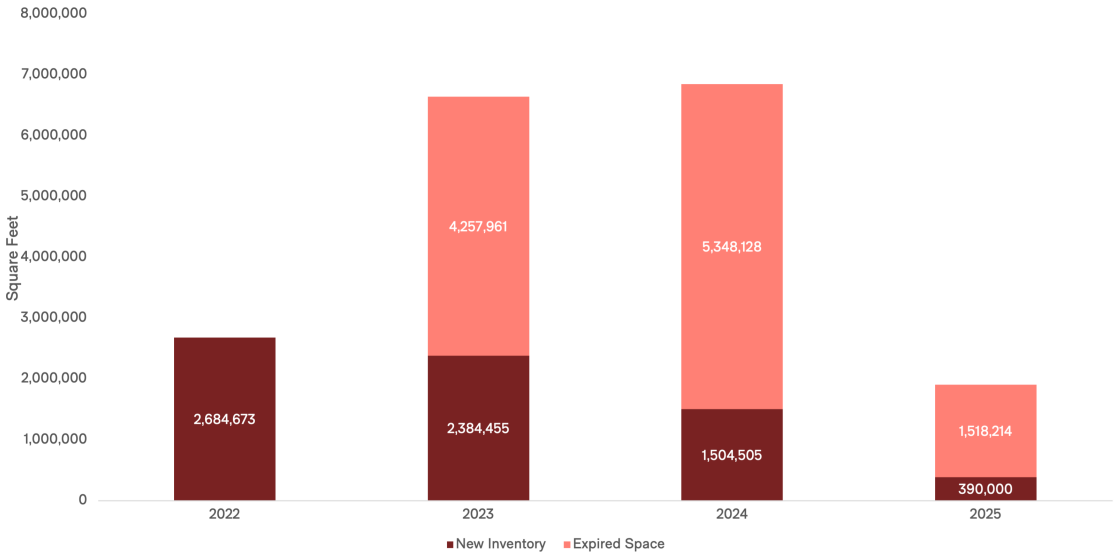


Source: Raise

Lease Expirations And New Inventory (2023-2025)

Looking ahead, close to 18 msf of office space is expected to be added to the Silicon Valley market. Though the majority of it will be high-quality, Class A space, coming from new construction projects in the pipeline, 11 msf of existing space is set to expire in 2023 to 2025, which could result in additional space coming back online as companies adjust to more flexible space.

Companies like Airbnb, Robinhood, Arista Networks, State Farm, and American Express with active leases in Silicon Valley have already announced plans to become 100% remote. Small- to medium-sized tech companies are weighing the options of hybrid versus remote work options and re-evaluating their footprint. Big tech companies, however, are leasing big block spaces and continue to inject confidence in the market.

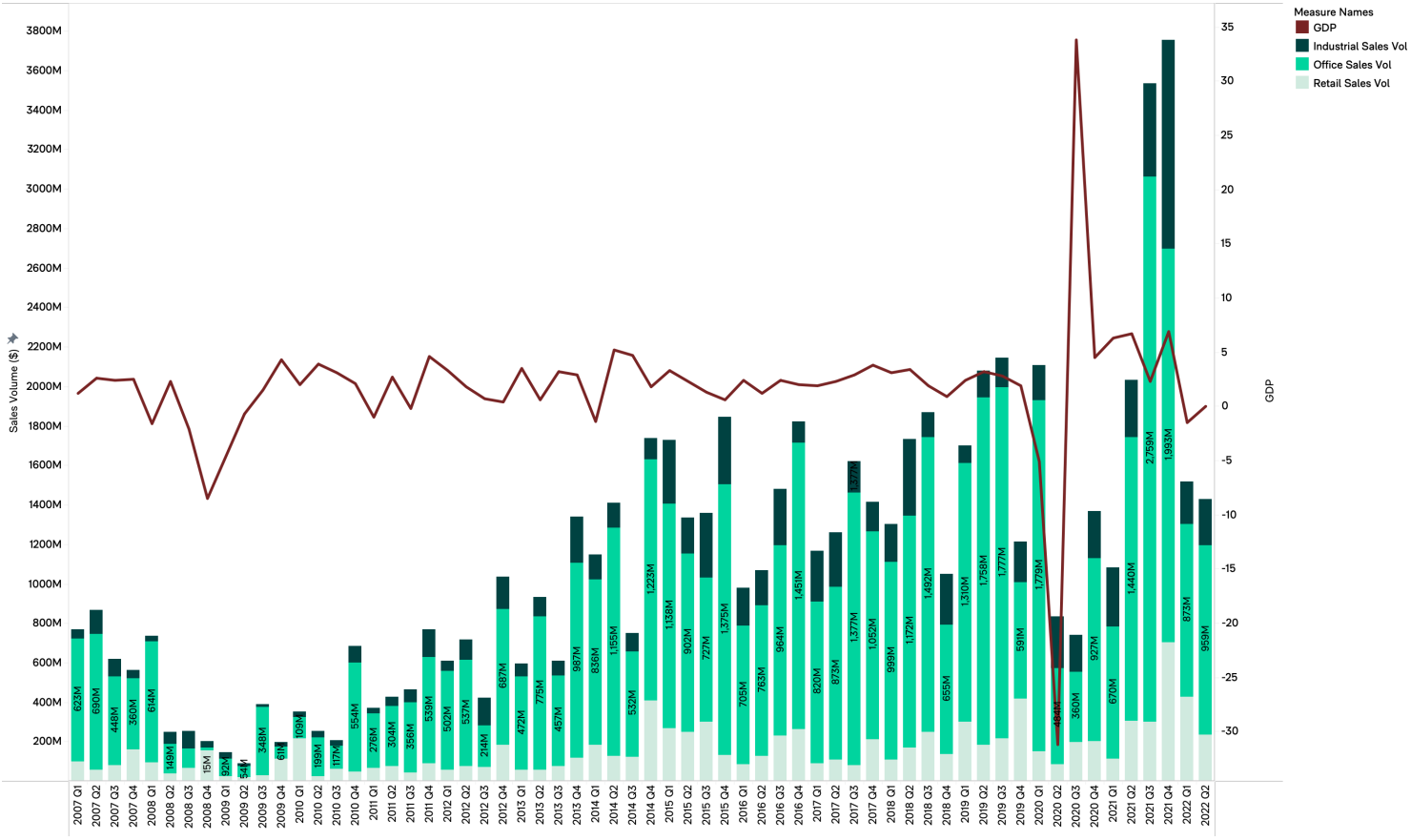


Source: CoStar

Correlation Between GDP And Total Sales & Investment Activity

CRE investment activity post-Covid has held strong relative to the economic slowdown of 2008. Office sales volume took a significant hit after the 2008 recession, when sales volume dropped to as low as $15M per quarter in Q4 of 2008. Though the volume of sale transactions across all asset classes decreased after reaching a decade high in Q4 2021, the market seems to be reacting better to a reduction in GDP than it did in 2008. Total number of office sales transactions increased by 17% QoQ in 2022. Total office sales volume in 2022 is $959M, 97% of which was investment sales. The most notable transaction of the quarter was the sale of a Meta-occupied, four-property portfolio, at 1275 Crossman Ave for $707M.

Looking ahead, the two-year long investment frenzy catalyzed by low interest rates is expected to slow down as the Federal bank implements further rate hikes. For CRE, however, mostly office assets continue to make up a big part of investors' appetite in 2022. It is expected to remain that way; CRE investment is deemed an inflationary protection measure by investors.



Source: CoStar and BEA

Outlook

If companies had surveyed employees in 2018 to gauge the desire of a hybrid schedule, and on-site employees were viewed the same as off-site employees, the results would likely be the same as they are now. Employees now expect flexibility and for that reason, 81% of companies are adopting a hybrid workplace model.

The workplace is changing and employees are no longer in the office 5 days a week. Office demand is changing as well as companies seek radically different space to support hybrid workplace solutions. There is still demand for office space but the equation is shifting away from fixed square footage per employee.

Despite reduced office space demand, companies are still eager to grow and strengthen culture, foster collaboration and ideation, and bring back a sense of community. The hybrid model is here to stay and can support both flexibility and the structure employees want to access mentors to grow their careers, which will positively impact office demand in the future.

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