Silicon Valley 2022 Year-End Report

Though the volume of layoffs seems significant, the tech industry is the sector contracting the most. Tech workers, however, make up roughly 2% of the labor force, so losses thus far have not had a meaningful economic impact. Otherwise, the job market is still strong with the most growth in healthcare, hotel and leisure, and personal services, but office-using sector growth is increasing as well.

Tech companies that grew headcount significantly in the last two years are scaling back and evaluating office space needs. Traditional office-using companies are still building on the strategy that the office is a crucial part of the collaborative environment and focusing on creating intentional workplaces. The customized, hybrid workplace encourages employees to use the space in a meaningful and productive way. Additionally, coworking has become a cornerstone for many companies looking for maximum flexibility and growth opportunities.

RAISE

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Top Silicon Valley Trends

Reduced momentum in VC funding, sales and leasing activity compared with 2021; however, well-located and amenity-rich Class A assets are first pick for tenants.

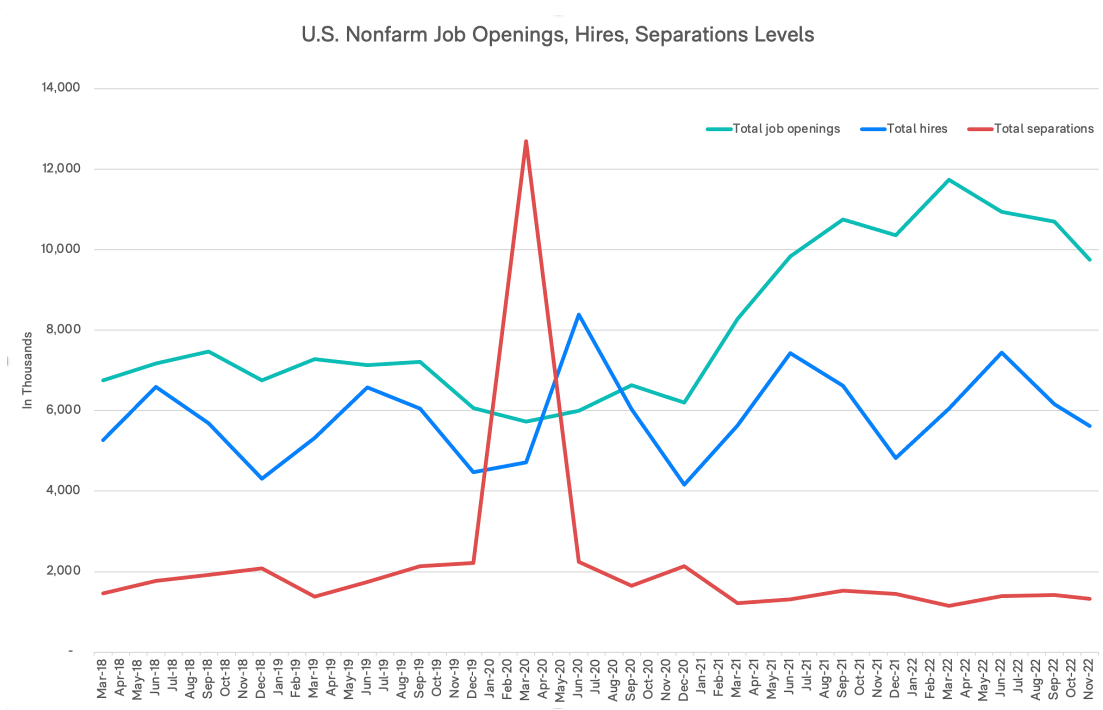
Tenant-favorable market with influx of quality direct and sublease options.

Rising interest rates will hinder Commercial Real Estate recovery.

Increased concession packages like free rents, tenant improvement dollars, and investment in amenities, will aid the path to recovery.

U.S. Job Openings, Hires, Separations

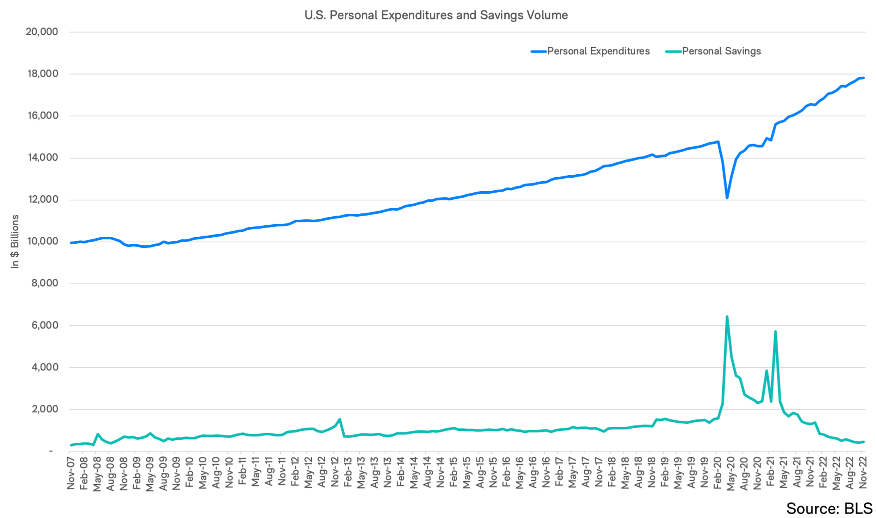
Since the dramatic spike (layoffs, quits, discharges) in March 2020, separation levels returned to normal. November 2022 totals were 29% and 33% below the ten-year and five-year averages, respectively. Job openings peaked in April 2022, but as of November 2022, were still 50% above the ten-year average. Hires have recurrently fluctuated, with a higher-than-usual spike in September 2020, and ended 2022 just 3% above the ten-year average.



Source: JOLTS

The Information sector accounted for just 3% of total nonfarm separations, as of November 2022, and was also 7% and 30% below ten-year and five-year averages, respectively. Job openings peaked in May 2020, but despite the subsequent decline, were still 60% and 29% above ten-year and five-year averages, respectively, as of November 2022. Hiring levels peaked in both October 2020 and 2021 and remained at higher-than-average levels for 21 of the past 26 months.

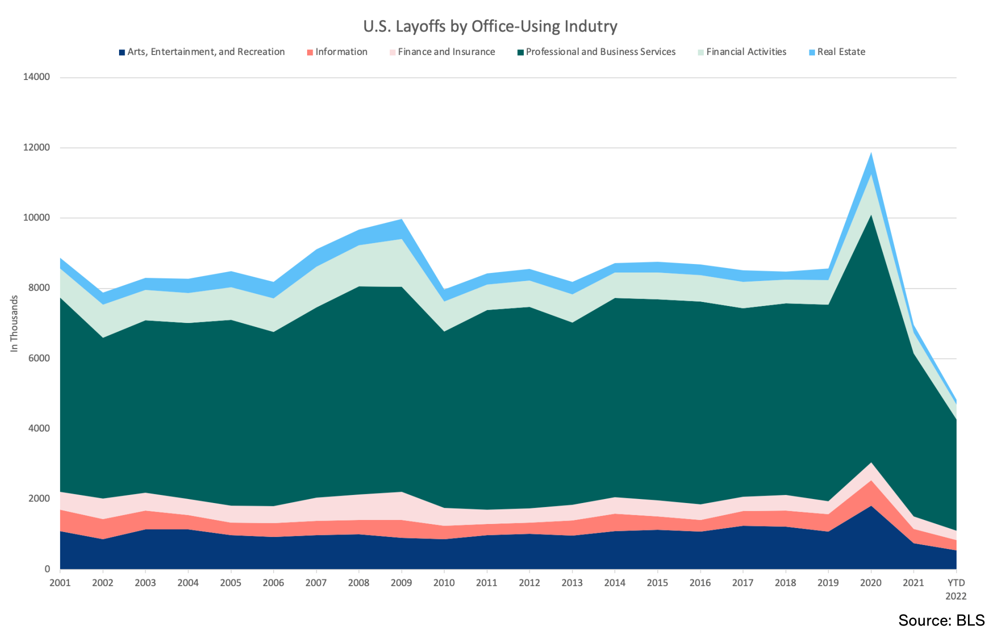
U.S. Savings And Expenditures



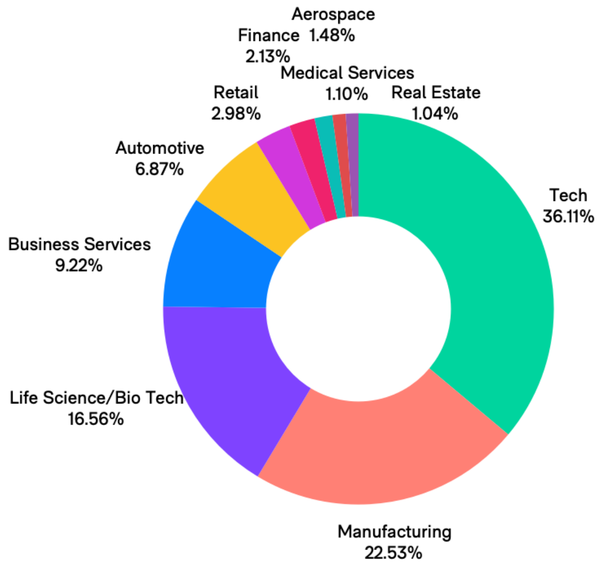
Historic personal savings levels in April 2020 and February 2021 were related to COVID-19 and the Omicron outbreaks, followed by sharp decreases as expenditures (goods, services, household) increased due to rising prices. Used vehicle prices, which had been a major contributor to the initial inflation burst, have steadily dropped over the past year. Food prices dropped for the first time after increasing at a constant rate of 0.9% the past few months. Gasoline prices also dropped after steady increases in 2021. If prices of goods and services keep falling as higher interest rates curb demand, the target rate can be attainable in the latter half of 2023.

U.S. Layoffs

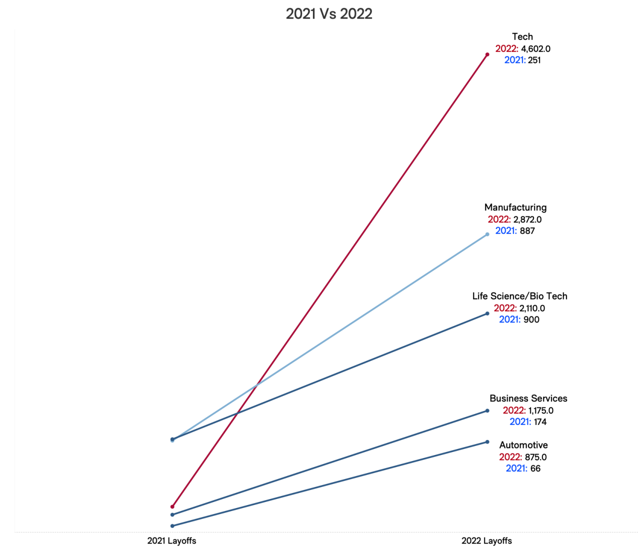
The volume of layoffs in the office-using sector decreased sharply since 2020 and is now below even 2008 levels. Professional and Business Services typically bear the brunt of layoffs when moving into a recession, and are the slowest to recover from that cycle.



Layoffs by Industry

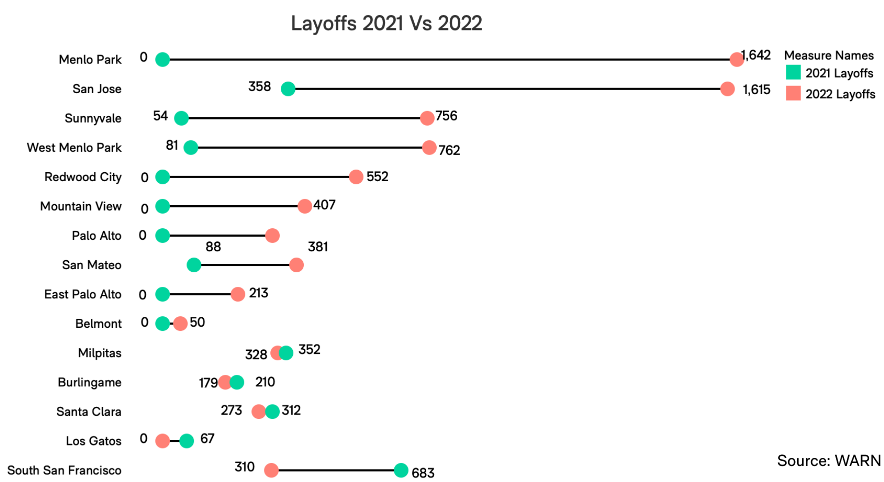


Source: WARN



Source: WARN

Layoffs by Submarket



Source: WARN

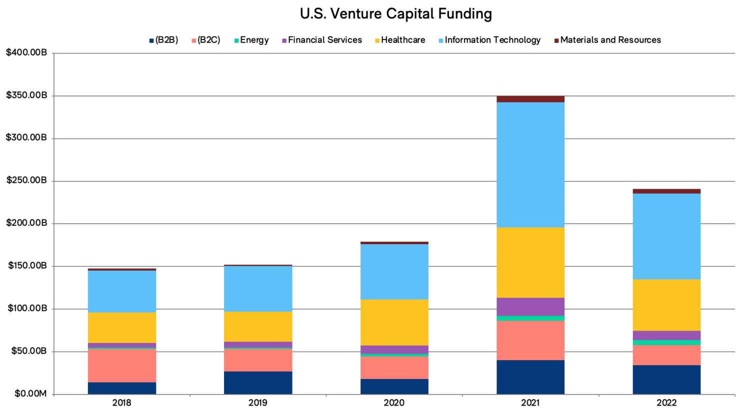
Silicon Valley, the heart of tech and life science innovation, was the first market impacted by the wave of white collar layoffs that began in 2022. Meta, Tesla, Amazon, Nuro, and Zymergen are some of the companies that let go hundreds of employees in the Bay Area. In 2022, 7,782 employees lost their jobs, which is 3.5 times the reduction in headcount in 2021. Meta platforms contributed to the most number of layoffs in Menlo Park. Cisco Systems, Paypal, and Twitter accounted for the 1,615 employees who were let go in San Jose.

Tech, Life Science, Manufacturing, Business Services, and Automotive sectors were hit hardest with layoffs in 2022. As big tech companies like Meta and Amazon grew astronomically during the pandemic, the retraction was imminent. In 2022, 4,602 Tech employees in Silicon Valley were let go compared with only 174 in 2021, according to a WARN filing notice from the state of California. The Manufacturing sector layoffs also increased dramatically compared with 2021 (2,872 in 2022 from 887), followed by Life Science where 2,110 jobs were lost compared with 900 in 2021.

Overall, in 2022 companies reevaluated balance sheets and headcount, which resulted in a decrease of 153,937 tech employees according to Layoffs.fyi. Most of these companies grew by similar scale over the last two years, therefore, there may be less impact on their commercial real estate footprint.

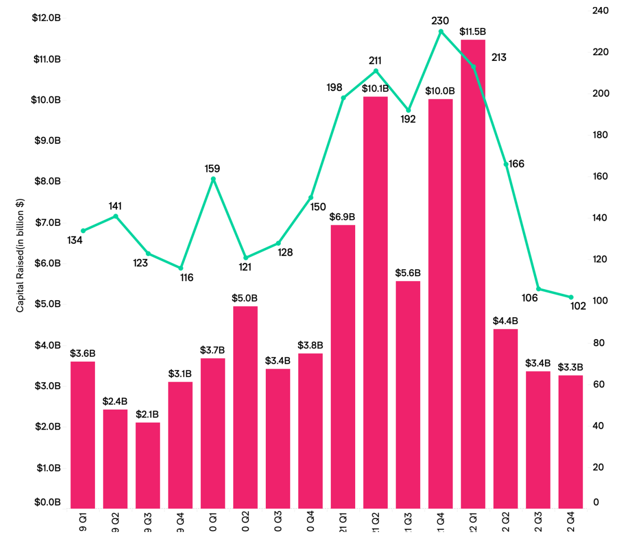
U.S. VC Funding

Investment activity of privately held VC backed companies with an office in the US.



Source: Pitchbook

Silicon Valley VC Funding

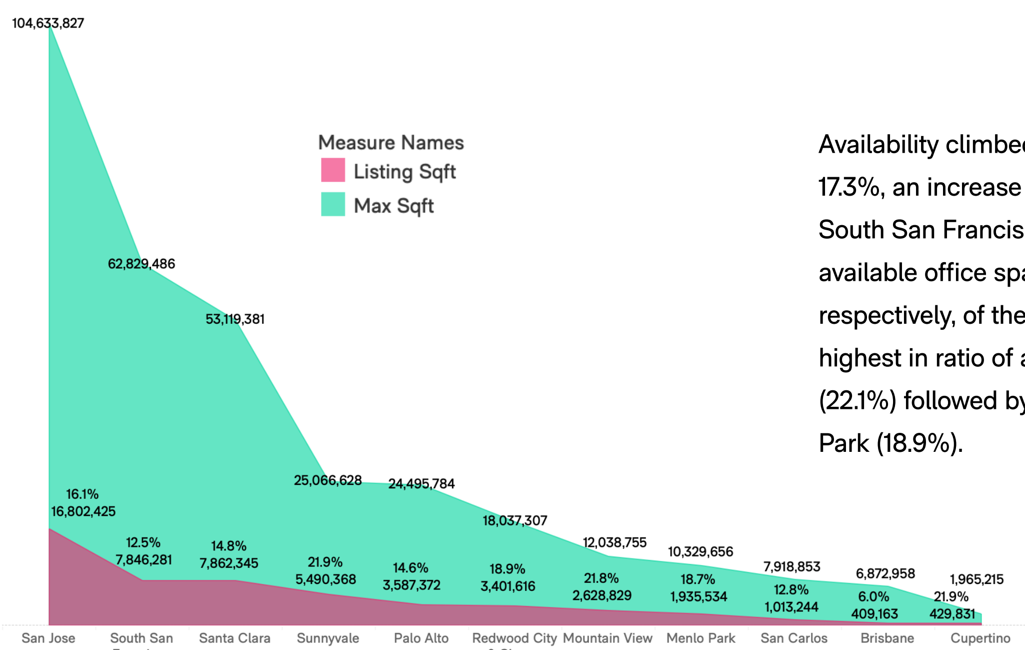


Source: Raise

After robust investment activity in 2021, VC funding in 2022 across the U.S. dropped by 27%. It is important to note, however, that deal volume in 2022 was still higher compared with the total amount of VC funding in 2019. Total capital across all deal types was impacted, both early and later stage VC deals reduced in deal volume and size. The Information Technology sector received a higher percentage of funding over the past five years totaling $414B, followed by Healthcare. In 2022, 14.5% of the VC deals were allocated to later-stage VC companies.

VC funding activity in Silicon Valley followed a similar trend as the rest of the country. Change in quarter-over-quarter (QoQ) investment volume was negligible ($3.3B in 2022 Q4 vs $3.4B in 2022 Q3). Year-over-year (YoY) investment volume, however, dropped by 67%. Total number of VC deals in Q4 2022 in Silicon Valley was the lowest since Q4 2019. As investors brace for turbulent economic conditions, fueled by higher interest rates, this phenomenon might linger in 2023.

Availability Trends



Source: Raise

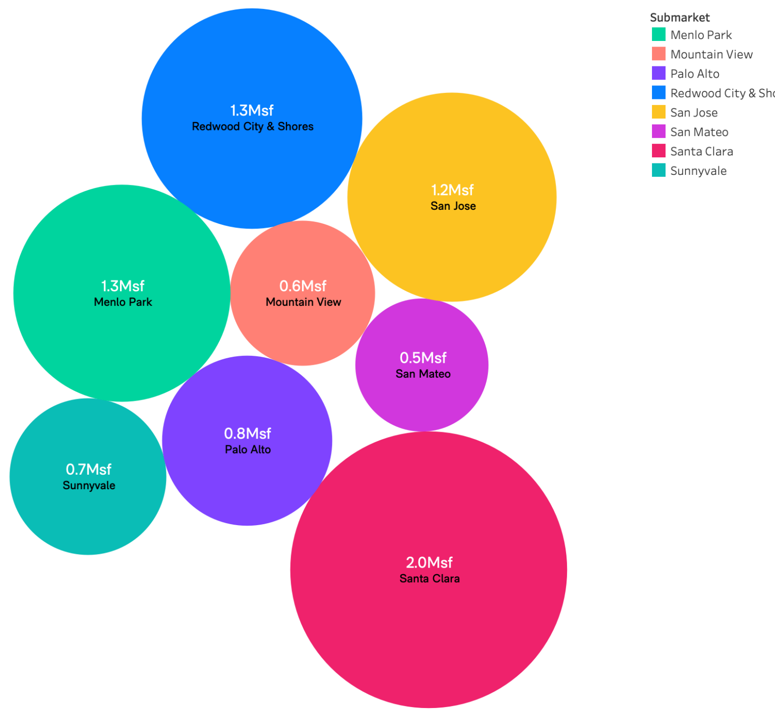
Availability climbed further upward in Silicon Valley to 17.3%, an increase of 8.8% since H1 2022. San Jose and South San Francisco, with the highest square feet of available office space, only represent 15.9% and 12.5%, respectively, of the total inventory. Sunnyvale ranked the highest in ratio of available space to inventory in the valley (22.1%) followed by Mountain View (21.8%) and Menlo Park (18.9%).

Silicon Valley Large Block Availabilities

STREET ADDRESS	SUBMARKET	AVAILABLE SF	TIME ON MARKET	FORMER TENANT
395 Page Mill Rd.	Palo Alto	243,572	332 Days	Cloudera
380 Ellis St. Bldgs C & D	Mountain View	235,466	496 Days	Symantec
401 San Antonio Rd.	Mountain View	204,000	354 Days	Meta
1900 & 2000 University Ave.	East Palo Alto	200,000	155 Days	DLA Piper
3655 Kifer Rd.	Sunnyvale	183,000	510 Days	Vacant Since Completion
221 N. Mathilda Ave.	Sunnyvale	155,000	785 Days	23&Me Downsize
600 W. California Ave.	Sunnyvale	70,850	156 Days	Walmart

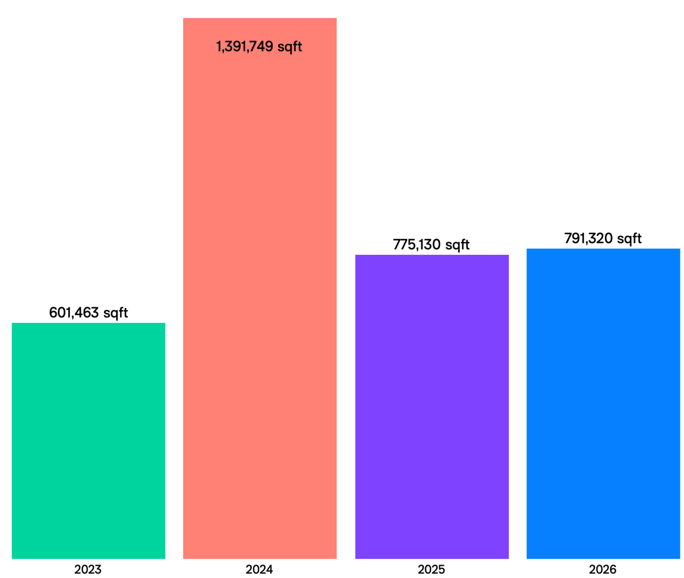
These large blocks supply unique opportunities for companies looking for options to move to higher-quality space and provide leverage to secure favorable lease terms.

Of the direct leases that will expire in the next five years, 13 msf of them could be added back to the Silicon Valley market. Big tech companies, like Google and Amazon, are rumored to conduct mass layoffs in 2023, making their decision to renew big block spaces uncertain.



Additionally, more space is anticipated to come to market from subleases. Course Hero, Survey Monkey, Lattice Semiconductor, and Cloudera are some of the sub-landlords currently marketing space for sublease. LinkedIn is also rumored to market 200,000 sf of its sublease space in the next few months.

In total over 3.6 msf of negative absorption is expected from subleases expiring between 2023 and 2026.

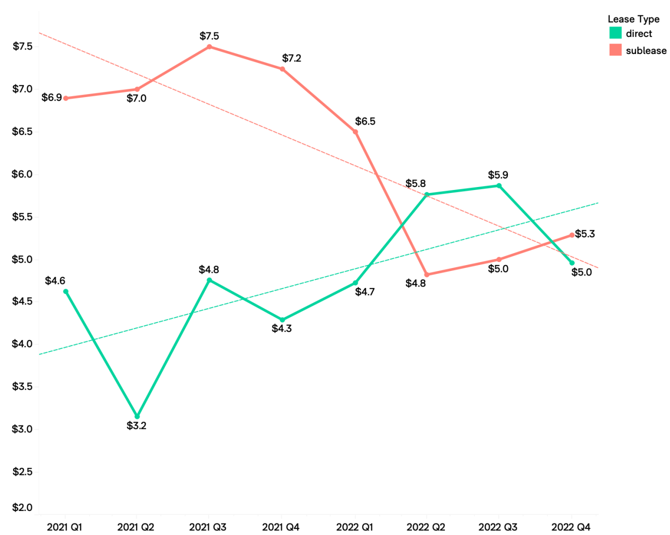


Source: Raise

Rent Trends

Asking Full Service Gross (FSG) rents in the Silicon Valley market remained dichotomous. Submarkets like Menlo Park, Palo Alto and Mountain View with more than 50% Class A inventory still command high asking rents starting from $5.00 per square foot per month (psf/mo) despite the double-digit availability rate. Submarkets with higher availability, like San Jose with 16 msf of available space, and Santa Clara, with close to 8 msf of available space, have lower asking FSG rents in the $3.00 to $3.50 psf/mo range.

Source: Raise

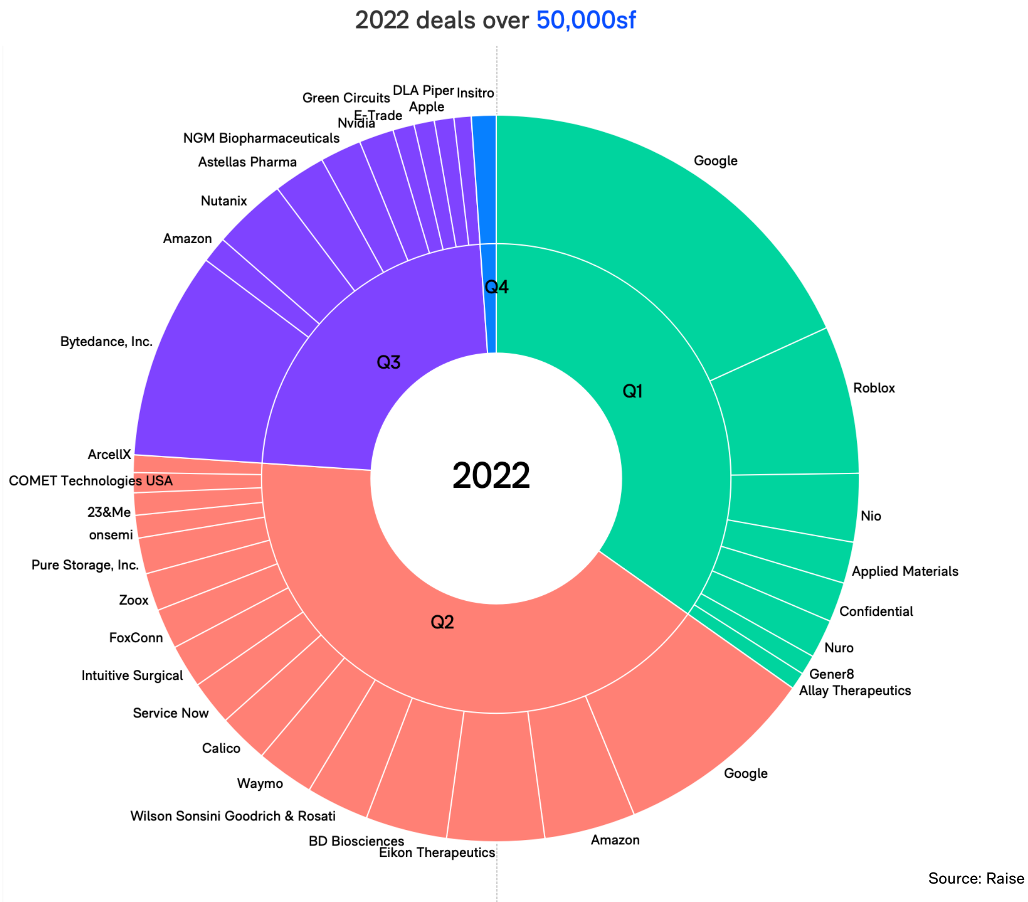


Sublease starting rents in 2022 declined due to an influx of availability and reduced demand. As QoQ deal volume and activity for direct spaces decreased in Q4 2022, so did Net Effective Rents.

Conversely, tenant improvements and free rent have trajected upward since Q1 2019. Landlords offered increased concession packages, which is expected until demand for office space returns to pre-pandemic levels.

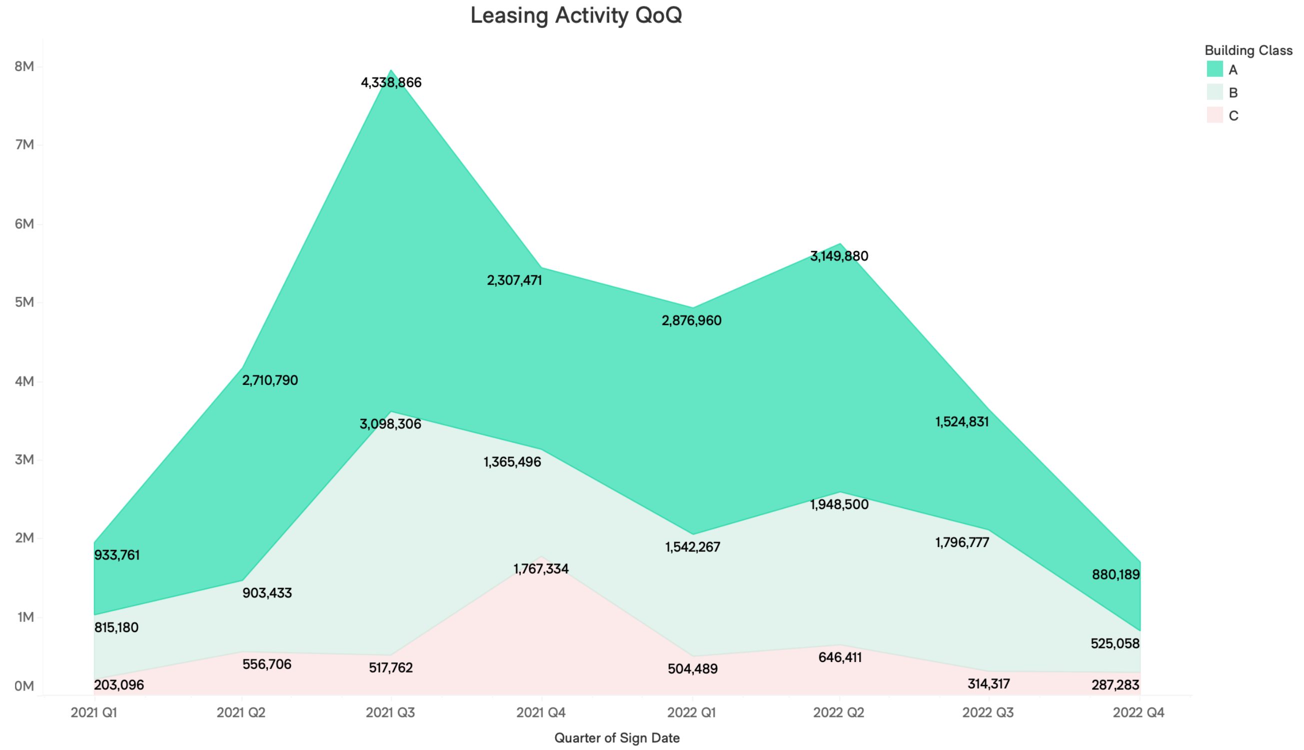
Source: Raise

Leasing Trends



In 2022, 73% of deals took place in H1 2022 with tech giants like Google, Apple, and Amazon taking large blocks of space. Leasing activity softened in H2 2022 amidst recessionary fears. Most companies pushed out their commercial real estate decisions until the macroeconomic climate stabilizes.

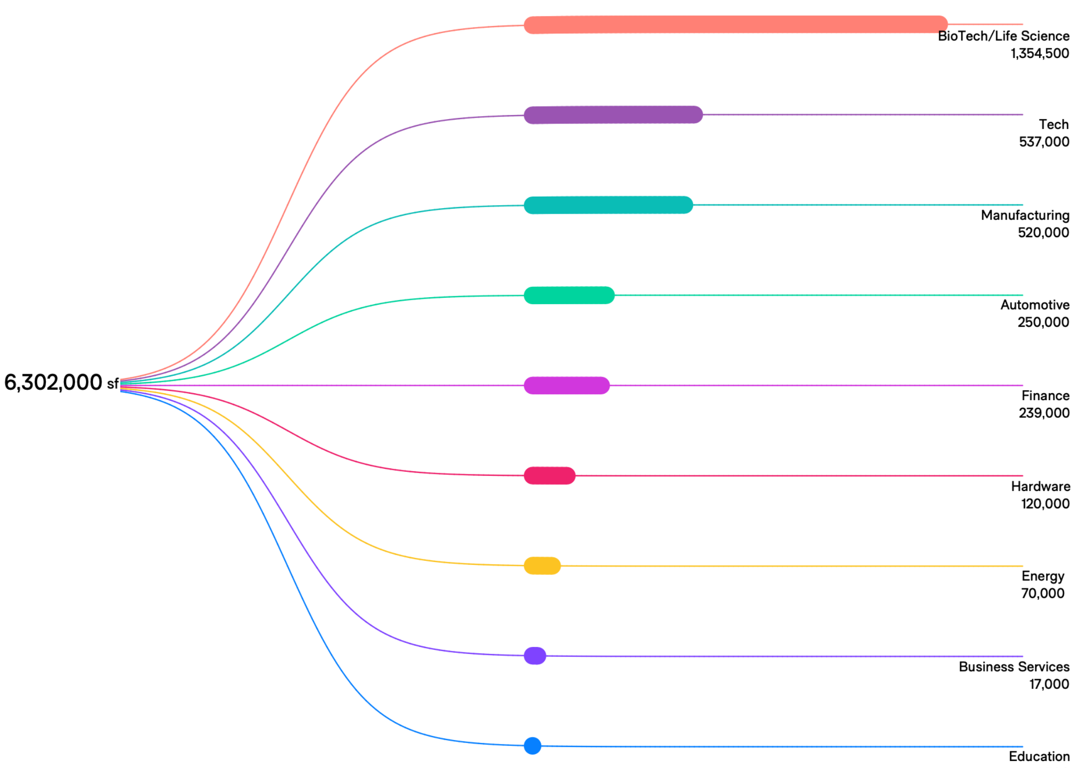
SIGN DATE	SUBMARKET	TENANT	LEASED SF
Q3 2022	San Jose	Bytedance	609,000
Q3 2022	San Jose	Nutanix	216,000
Q3 2022	Santa Clara	Nvidia	102,000
Q3 2022	Brisbane	Amazon	77,000
Q4 2022	South San Francisco	Insitro	72,000
Q3 2022	Sunnyvale	Apple	58,000
Q4 2022	Mountain View	Lacework	40,000



Source: Raise

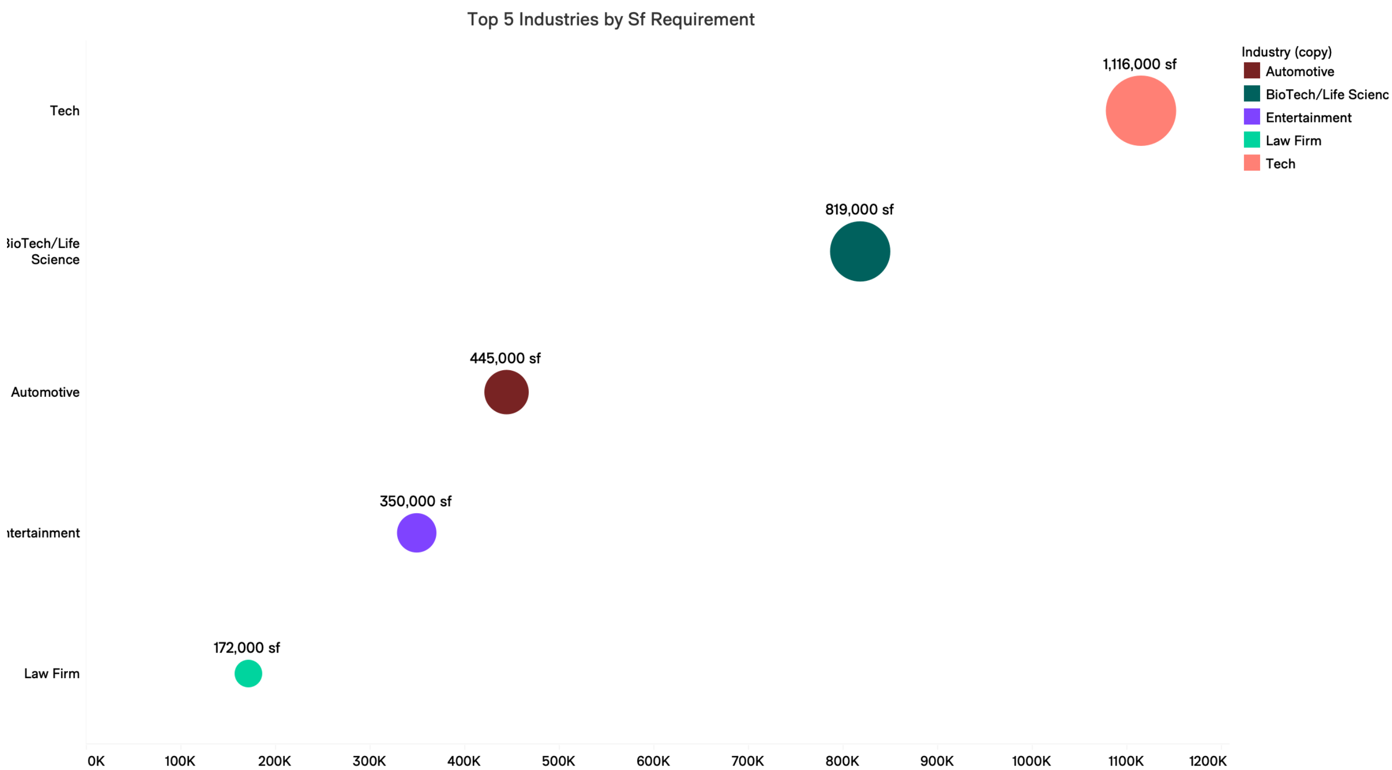
Though QoQ leasing volume across all asset classes dropped in Q4, tenants prioritized spaces in Class A buildings, totaling more than 50% of the deals. This trend will intensify as companies rethink the utility of office space. Newer and well-located buildings with quality amenities will also help incentivize employees to return to the office either full time or on a hybrid basis.

Office Demand



Compared with H1 2022, demand for office space by tenants in the Tech industry slashed by 50%, with active requirements for space totaling 557,000 sf compared with 1 msf in H1 2022. With an uptick in layoffs and a turbulent macroeconomic climate, which affected big and small tech companies, the requirements for office space were paused or delayed by many companies.

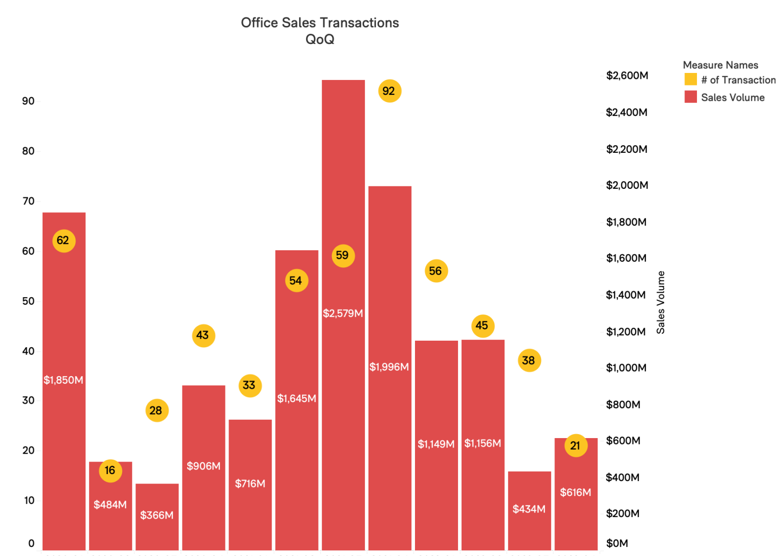
BioTech/Life Science tenants, on the other hand, have similar requirements compared with H1 2022. Currently, there are 18 tenants in the Life Science industry looking for 1.3 msf of space. Total demand for office space at the end of 2022 in Silicon Valley is 6.3 msf.



Source: Raise

Sales Activity

The total number of office buildings transacted in 2022 was 32% lower than 2021, due to the difference in interest rates affecting borrowing costs. Average price per square foot, however, was higher in 2022 at $1,014.91 in Q4. Tishman Speyer sold $1B worth of their portfolio in 2022. On the buyer side, companies like Commonwealth Partners ($433M), Blackstone ($391M) and Alexandria Real Estate ($268M) remained active in acquiring office portfolios in 2022.



Source: Costar

Summary

There is little doubt that the signs of a recession are accumulating and the effects of the pandemic recession are still present. On the brighter side, there is still an abundance of cash both on the investment side and personal savings. In order for inflation to stabilize, wage growth will need to level off, which will put downward pressure on demand, and subsequently, pricing on consumer goods.

In order to better weather this downturn and prepare for the next growth cycle, now is the time for companies to consider a financial strategy and review market fundamentals for flight-to-quality and repositioning opportunities. Though all eyes are on large companies to see what workplace strategy they are adopting, the large companies are also looking to the nimble startups that are test fitting hybrid models to which large companies can scale.

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