

INVESTMENT FORECAST

Office
San Jose

IPA
INSTITUTIONAL
PROPERTY
ADVISORS

2022

Large Investors Optimistic About Silicon Valley Market as Employees Trickle Back to Offices

New supply outpaces resumption of office demand. San Jose's office market is bolstered by the metro's anchor employers' commitment to bringing workers back into the office when concerns of COVID-19 transmission abate. Google, Apple and Facebook have resisted the idea of permanent remote work, which will help regenerate conditions closer to those observed prior to the health crisis. Facebook committed to more than 1 million square feet of space in the second half of last year, including 719,000 square feet in Sunnyvale, the largest lease signed in the U.S. in 2021. Many workers have already returned to the South Bay following shutdowns, evident by the drop in multifamily vacancy to pre-recession levels. Although the demand outlook is optimistic, supply growth will apply upward pressure to availability. Of the 7 million square feet scheduled for delivery in the next two years, approximately 75 percent is pre-leased. However, the new stock will compete with existing properties that are backfilling space abandoned during the downturn.

Buyers return ahead of many employers. Institutions are already active in Silicon Valley, a testament to their confidence in the area's prospects. This trend will persist this year, though more smaller buyers are anticipated to become active as fundamentals improve. Deal flow will be dictated by available supply that meets investor expectations. The average cap rate has been in the low-5 percent area since 2017, providing evidence of a return floor the metro will bear. Top-tier properties can trade well below that level, especially if the acquisition is for owner-user purposes. These transactions occur at the other end of the scale in suburban locations as some firms continue to opt for their own buildings as broader reopening approaches and existing leases begin to sunset. Sellers, meanwhile, are primarily motivated to move out of the office sector and execute 1031 exchanges into a less management-intensive asset class. Others are making arbitrage plays at a time when cash-heavy institutions, REITs and tech companies are willing to pay prices near peak levels.

2022 Market Forecast

- Employment**
up 3.4%

Employers add 38,000 positions this year, down from the 62,600 created in 2021.
- Construction**
4,400,000 sq. ft.

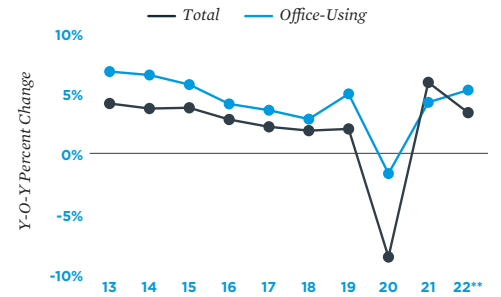
Stock increases 3.5 percent in 2022, building on the 2.5 percent gain in office space last year, when 3.1 million square feet was brought online.
- Vacancy**
up 120 bps

New supply will keep pressure on availability. Vacancy climbs to 17.5 percent by the fourth quarter, after a 300-basis-point rise in 2021.
- Rent**
up 1.2%

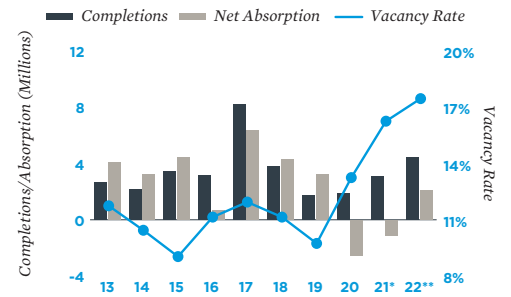
Only modest movement is projected in marketed rents as the presence of new space offsets discounting elsewhere. At year-end, the average asking rent will reach \$51.11 per square foot.
- Investment**

South Bay's investment market will begin the year bifurcated as institutions remain active at the top of the scale and private buyers and owner-users target suburban, lower-tier buildings.

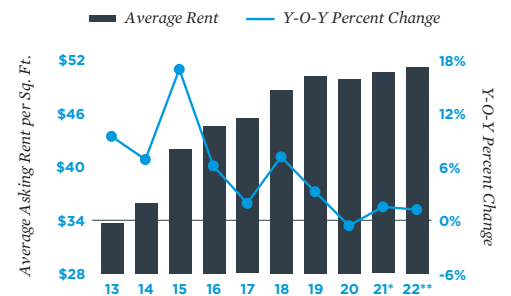
Employment Trends



Supply and Demand



Rent Trends



* Estimate; ** Forecast
Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

Al Pontius

Senior Vice President
Director IPA Office
Tel: (415) 963-3000 | apontius@ipausa.com

Metro-level employment, vacancy and effective rents are year-end figures and are based on the most up-to-date information available as of December 2021. Effective rent is equal to asking rent less concessions. Average prices and cap rates are a function of the age, class and geographic area of the properties trading and therefore may not be representative of the market as a whole. Sales data includes transactions valued at \$1,000,000 and greater unless otherwise noted. Forecasts for employment and apartment data are made during the fourth quarter and represent estimates of future performance. No representation, warranty or guarantee, express or implied may be made as to the accuracy or reliability of the information contained herein. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice.