

MARKET REPORT

Office
San Jose Metro Area

IPA
INSTITUTIONAL
PROPERTY
ADVISORS

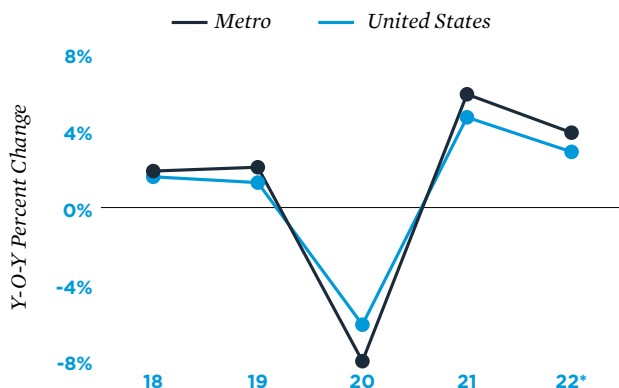
2Q/22

Demand From Tech Firms Pulling in Ancillary Companies as Market Begins to Turn Corner

Smart device industry aids offices. After getting off to a slow start in the opening quarter of 2022, when omicron concerns dragged down absorption, recent new lease signings signal improvements ahead. Apple is committing to more space in Sunnyvale, drawing companies in related industries to the surrounding areas. While the technology giant is still maintaining a flexible remote work policy, firms integral to the development of smart phones and other devices are demonstrating a clear value in having a close physical presence. Semiconductor provider Applied Materials is moving into 246,000 square feet in Santa Clara later this year, with flash memory hardware developer Pure Storage, Inc. leasing 223,000 square feet nearby. Silicon design firm Synopsys will also occupy 152,000 square feet in Sunnyvale in the winter. These decisions add further momentum to some of the metro's better performing submarkets.

Subleasing plans critical to metro's future. The continued expansion of several well-established technology companies is underpinning core demand. Yet, many of these firms have existing leases coming due within the next five years, and it is unclear how many organizations will keep these footprints or shift to the new offices they are obtaining now. The tight labor market is placing an emphasis on the most modern amenities and proximity to residential hubs. Any additional space becoming available for sublease would add to already elevated levels, which are up over 80 percent since 2019. That increase had added 190 basis points to vacancy.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook



**44,000
JOBS**
will be created

EMPLOYMENT:

Led by hiring in professional and business services, as well as leisure and hospitality, staff counts are on pace to surpass the pre-pandemic high by the end of the year. Approximately 11,000 of the new jobs this year will be in traditionally office-using fields.



**4,000,000
SQ. FT.**
will be completed

CONSTRUCTION:

Development activity climbs to its highest rate in five years as Google's Moffett Park and Mountain View buildings account for just over half of 2022 deliveries. The focus on built-to-suit projects will lessen the impact on an otherwise challenged vacancy rate.



**120
BASIS POINT**
increase in vacancy

VACANCY:

Vacancy will climb by about one-third of the 2020 jump as the metrowide measure rises to 16.6 percent. The decelerating pace will help keep availability 140 basis points below the previous year-end high achieved in 2009 during the financial crisis.

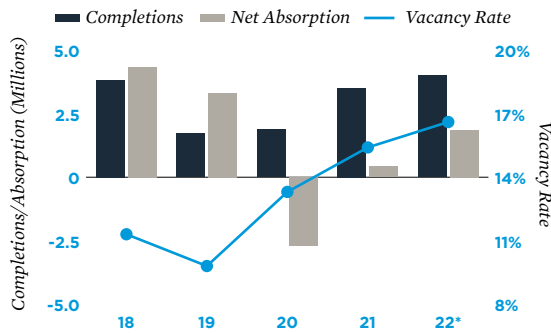


**1.8%
INCREASE**
in asking rent

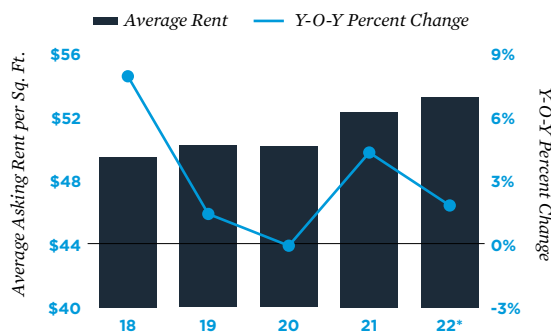
RENT:

Rent growth will moderate this year as some high-quality office space is taken off the market. The projected year-end average asking rate of \$53.23 per square foot will nevertheless mark a new high, about 6 percent above the pre-pandemic mean.

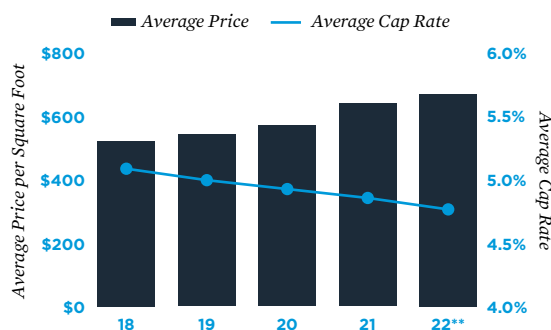
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 1Q

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: \$250

1Q 2022 - 12-Month Period



CONSTRUCTION

3,881,000 sq. ft. completed

- About double the amount of space was delivered over the 12-month period ended in March compared to the prior yearlong span, led by over 1 million square feet of additions in the Sunnyvale-Cupertino submarket.
- Yahoo's new 665,000-square-foot global headquarters in North San Jose was the largest single completion of the past four quarters.



VACANCY

160 basis point increase in vacancy Y-O-Y

- Year-over-year vacancy decreases in Palo Alto, Sunnyvale-Cupertino and Campbell-Los Gatos of more than 200 basis points helped ease the upward momentum on the metrowide rate, which rose to 15.9 percent in March.
- Possibly reflecting a slight flight-to-quality, Class A availability has risen 90 basis points less than in Class B/C buildings since the end of 2019.



RENT

3.5% increase in the average asking rent Y-O-Y

- Asking rent growth accelerated over the past four quarters relative to the previous yearlong period, climbing to an average of \$53.03 per square foot.
- For submarkets with more than 10 million square feet of inventory, rents increased the fastest in North San Jose and Santa Clara. Comparatively lower asking rates may have appealed to more budget-conscious tenants.

Investment Highlights

- Driven in part by an active fourth quarter of 2021, transaction velocity for the 12-month period in March was up over 50 percent from the previous yearlong span. While still trailing high marks set in 2016 and 2017, the improved sales activity reflects a positive long-term perspective from investors. Additional buyer competition helped lift prices by 14 percent year-over-year in March, arriving at a new average of \$667 per square foot. The mean cap rate held comparable to San Francisco at just under 5 percent.
- Sales pricing is being influenced by a shift to submarkets more closely tied to prominent technology firms. Several institutions have exchanged portfolios based in Palo Alto, Mountain View and Sunnyvale-Cupertino, where entry costs are some of the highest in the market. These properties were highly leased to tech leaders, such as Facebook parent company Meta, which has continued to show a commitment to physical offices.
- Trading of individual assets in the \$1 million to \$10 million price tranche was focused more on lower entry cost submarkets, including Morgan Hill, Campbell and Los Gatos. About one quarter of these transactions were for medical office properties, reflecting demographic-driven needs for such spaces that are separate from other office-based labor trends.

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Metro-level employment growth is calculated based on the last month of the quarter/year. Sales data includes transactions sold for \$1 million or greater unless otherwise noted. 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. Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics

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