Savills Studley Report
Silicon Valley office sector

Q2 2017

SUMMARY

Market Highlights

LEASING UP SLIGHTLY

Deal volume jumped by nearly 50% in the second quarter as several large leases were completed in the quarter. Tenants have leased 4.5 msf in the four most recent quarters.

OVERALL AVAILABILITY UNCHANGED

The region's overall availability rate remained at 15.7% for the second straight quarter. The Class A availability rate jumped by 150 basis points to 21.1%, but this was offset by a 80 basis point decrease in Class B and C availability to 13.1%.

RENTAL RATE PUSHES HIGHER

Regional overall asking rent, $4.19 rose by 5.7% during the second quarter, and has increased by 13.9% year-on-year. Class A rent has spiked by 9.3% from second quarter of 2016 to $4.25.

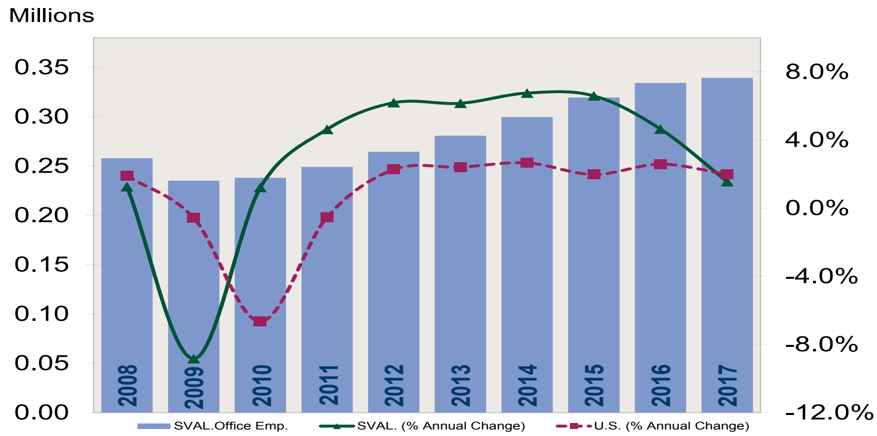
SALES INCREASED

Year-to-date office property sales totaled $1.56 billion – rising by 72.6% compared to the $909 million sold during the same period in 2016.

"*Demand is falling short of the market peak seen in 2014 and 2015. Some semblance of balance is emerging as landlords are no longer enjoying a bidding environment and tenants are slowing the leasing process down.*"

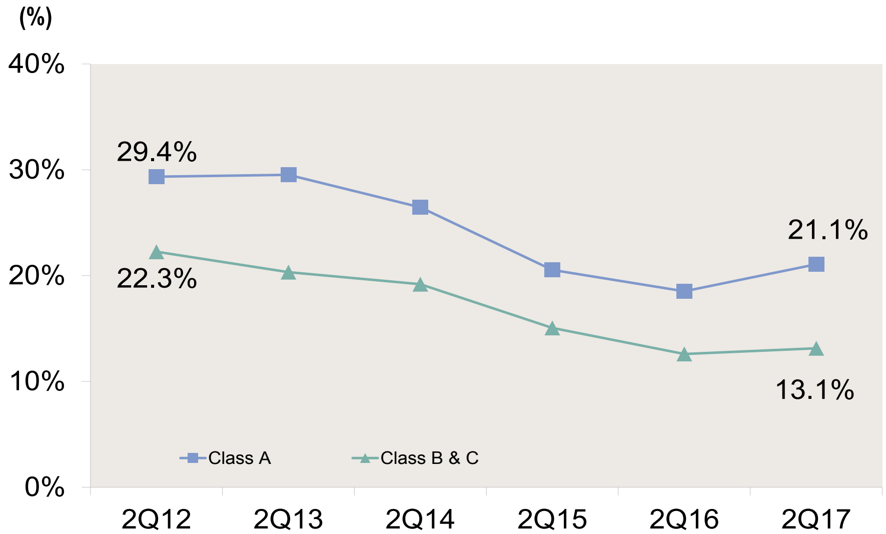
Savills Studley Research

Office-Using Employment Trends

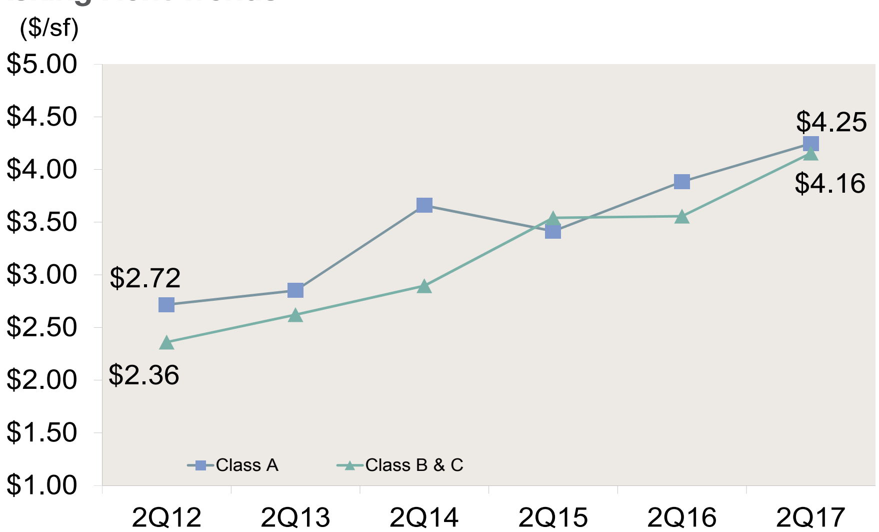


Source: Bureau of Labor Statistics

Vacant Availability Rate Trends



Asking Rent Trends



Semblance of Balance

Silicon Valley's tech sector has remained relatively active in the last few months. The most aggressive hiring and investment activity is concentrated in a handful of sectors, though. The top players – Facebook, Google, Amazon, Apple and Microsoft – are investing billions of dollars on disruptive technologies such as autonomous vehicles, cloud-based services and artificial intelligence. Startups related to these sectors are flush with cash. Others are being absorbed by regional heavyweights.

Conditions are very different for most other firms. Mid-stage companies are struggling to raise B/C rounds. Many late-stage firms are delaying IPOs and some are taking on debt from private equity rather than face a down round. According to VentureBeat, investors placed $16.5 billion into 1,797 startups during the first quarter of this year, below the $18.7 billion placed in 2,366 startups in the first quarter of 2016. Companies that cannot raise funds are delaying expansion plans. Tenants continue to slow the leasing process down as well. Most companies do not want to commit to space in a market that is showing some signs of softening.

Options Rising in Spots

In turn, demand is falling short of the market peak of 2014 and 2015. Areas that were highly challenging a year ago, such as Palo Alto and Mountain View, now have more space. Some semblance of balance is emerging as landlords are no longer enjoying a bidding environment. A year ago, knowing about a block of 10,000-sf space or a full floor was akin to getting inside information. There are currently 49 full-floor spaces of 10,000 sf or more available in Mountain View.

Tenants are able to find more space for a variety of reasons. Expanding firms that were priced or sized out of Mountain View, Sunnyvale or Menlo Park moved to North San Jose, San Mateo or the East Bay, leaving behind some substantial vacancies. Additionally, sublet space is registering some discernible increase – a few quarters ago such space was snared before it even hit the market. As of mid-year 2017, Silicon Valley had 6.0 msf of sublet space available for lease, up from 3.0 msf in mid-year 2016.

Market Attrition

A few established firms are cutting staff dedicated to increasingly obsolescent technology such as hardware, storage and networking. Cisco Systems disclosed another round of layoffs – this time totaling

1,100 workers. Last August it cut 5,500 jobs (7.0% of its workforce at the time.) The company is acquiring companies that will expedite their shift to in-demand sectors such as cloud computing, artificial intelligence and analytics. Avnet is shutting down two of its three Silicon Valley locations (326 Charcot Avenue and 2110 Zanker Road) and laying off 94 people. The electronics distributor is shifting its volume manufacturing from San Jose to Chandler, Arizona. Finally, Hitachi Data Systems laid off 48 employees in Santa Clara as it shifts it focus to its "smart city" initiative and IoT projects. This is the second round of layoffs, in April they cut 118 employees in Santa Clara.

Some segments of the office and R&D market remain extremely challenging. New or converted low-rise properties with large floor plates are particularly competitive. Major employers continue to account for much of the market activity. Appetite for space among the region's top employers continues to expand. Facebook is about to occupy 200,000 sf at the Menlo Gateway building and is reportedly nearing completion of leases for 500,000 sf in a second phase of the project that is expected to be finished in late 2019.

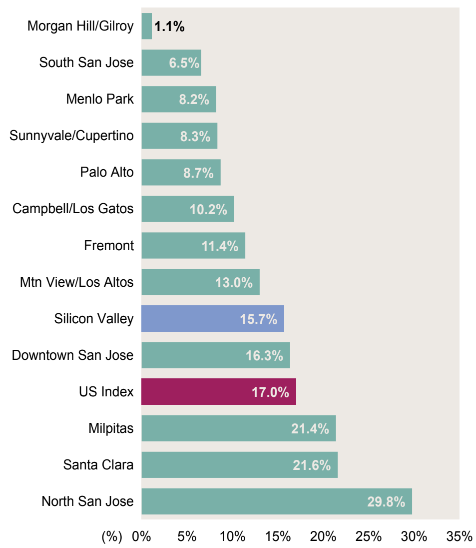
In the prime submarkets, such as Mountain View and Palo Alto, landlords are still acting as though demand is as strong as ever. Asking rent certainly has not budged, but they are extending more concessions to larger creditworthy tenants that will commit long-term. New developments in more peripheral areas such as Santa Clara have had a tougher time gaining traction in leasing.

Irvine Companies' Coronado Park office campus in Santa Clara Square, for example, secured its first lease. Duarte Inc signed a 25,000-sf lease at 3200 Coronado Park. The business communications company will move from 755 North Mary Avenue in Sunnyvale – another Irvine Company property. The seven-building low-rise office complex is across Highway 101 from Irvine Company's larger project The Campus. Irvine has had more success at the complex -- the first three buildings which total 220,000 sf have been almost fully leased. The second phase, currently underway, will have more than 1.0 msf in five buildings.

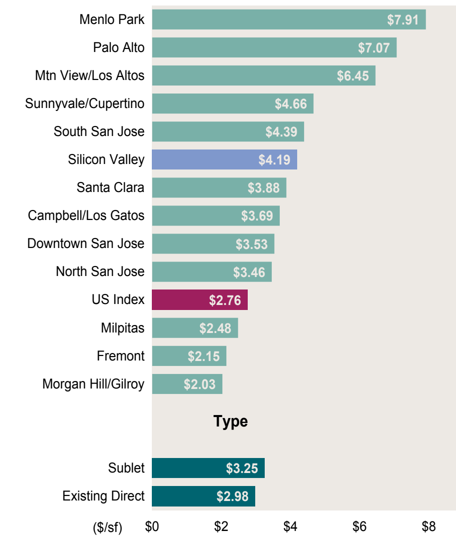
Housing & Transit, Key Concerns

As tenants realize that they have more options to consider, and leasing activity starts to slow, it puts companies n a position to assess their options more

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
Amazon	214,052	2100 University Ave	Menlo Park (San Mateo South)
San Andreas Regional Ctr	73,610	6203 San Ignacio Ave	South San Jose
ABB Power Systems Control	40,264	451 El Camino Real	Santa Clara
Versartis, Inc.	34,464	1020 Marsh Rd	Menlo Park (San Mateo South)
Versartis, Inc.	17,432	1060 Marsh Rd	Menlo Park (San Mateo South)
Outward, Inc.	15,626	1980-1982 Zanker Rd	North San Jose
CrowdStrike	10,893	150 Mathilda Pl	Sunnyvale/Cupertino
Broker Solutions	3,750	55 S Market St	Downtown San Jose
Transpacific Financial Inc	3,080	4340 Stevens Creek Blvd	South San Jose
D&J Michelleti, Inc.	2,668	111 N Market St	Downtown San Jose

critically. Properties and new developments that have ample housing nearby are getting ranked higher by businesses with extensive hiring plans. The lack of affordable housing options for younger talent is a core problem for the region. The movement of people and some employers to lower-cost markets such as Seattle, Phoenix and Austin can be attributed in part to the higher living costs.

Besides proximity to ample housing, walking distance to CalTrain or BART is a key differentiator. Downtown San Jose has long been a testament to how particular and disjointed tenant demand can be in the Valley – during the last two lengthy and record-setting cycles demand has largely bypassed Downtown San Jose. The last major tech firm to commit to Downtown was Adobe in 1996. Downtown's ship may be coming in, though, via major transit investments – plans call for a $8 billion BART subway stop and Caltrain extension near Diridon Station that will eventually bring 140,000 riders to Downtown San Jose on a daily basis. Google is forging ahead with its plans for a massive mixed-use campus near Diridon Station that could eventually accommodate 15,000 to 20,000 employees. Once considered a potential stadium site for the Oakland A's baseball stadium, the site now instead appears likely to go the route of a Hudson Yards or Candlestick Park with an urban village in the making.

There is still a long road to travel before the first steps of development in Downtown San Jose occur. The BART extension is not scheduled for completion for another decade, but activity should heat up once the Valley Transportation Authority starts auctioning off vacant land above and around the station and approvals of Google's development plans become official. A few developers are already circling. A partnership between TMG Partners and Valley Oak Partners unveiled plans for a 1.0 msf office project at 440 West Julian Street that would include three six-story buildings with 30,000 sf to 90,000 sf floorplates.

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**	2,967	146	302	-10.0%	239	10.2%	-1.1%	7.9%	$3.69	-0.8%	$3.38
	Campbell/Los Gatos - Class A	614	19	33	-31.7%	35	5.4%	-2.5%	5.7%	$3.96	-2.9%	$4.21
2	**Downtown San Jose**	9,030	369	1,475	4.8%	1,515	16.3%	0.8%	16.9%	$3.53	8.2%	$3.00
	Downtown San Jose - Class A	3,425	130	592	12.4%	625	17.3%	1.9%	18.2%	$3.82	4.9%	$3.23
3	**Milpitas**	2,790	351	597	3.4%	756	21.4%	0.7%	27.1%	$2.48	3.0%	$1.80
	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**	713	38	8	-10.7%	36	1.1%	-0.1%	5.0%	$2.03	-3.6%	$1.46
	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**	7,597	201	987	121.0%	602	13.0%	7.1%	7.9%	$6.45	9.8%	$5.27
	Mountain View/Los Altos - Class A	1,234	5	173	-10.9%	183	14.0%	-1.7%	14.9%	$5.98	4.0%	$5.60
6	**North San Jose**	12,289	446	3,658	11.4%	3,153	29.8%	3.0%	25.7%	$3.46	2.5%	$2.85
	North San Jose - Class A	4,827	221	1,777	4.6%	1,366	36.8%	1.6%	28.2%	$3.53	-3.7%	$3.17
7	**Palo Alto**	6,644	359	577	64.2%	438	8.7%	3.4%	6.6%	$7.07	-7.7%	$6.76
	Palo Alto - Class A	285	1	N/A	N/A	0	27.5%	27.5%	0.0%	$0.00	N/A	$0.00
8	**Santa Clara**	14,264	1,007	3,077	16.0%	2,400	21.6%	3.0%	16.8%	$3.88	4.1%	$3.24
	Santa Clara - Class A	5,977	562	1,965	34.2%	1,131	32.9%	8.4%	18.8%	$4.47	0.6%	$3.67
9	**South San Jose**	3,853	276	252	-14.7%	369	6.5%	-1.1%	9.6%	$4.39	10.8%	$3.62
	South San Jose - Class A	517	3	154	2.5%	138	29.8%	0.7%	26.8%	$5.17	-0.1%	$4.00
10	**Sunnyvale/Cupertino**	13,859	701	1,155	-16.0%	1,400	8.3%	-1.6%	10.0%	$4.66	-0.6%	$3.74
	Sunnyvale/Cupertino - Class A	7,857	621	714	-8.3%	997	9.1%	-0.8%	12.6%	$5.15	-5.5%	$3.87
11	**Menlo Park**	5,007	435	411	-28.5%	648	8.2%	-3.3%	12.9%	$7.91	4.5%	$7.01
	Menlo Park - Class A	1,502	359	45	-82.1%	401	3.0%	-13.7%	26.7%	$8.66	-14.8%	$7.33
12	**Fremont**	2,122	96	242	5.6%	240	11.4%	0.6%	11.3%	$2.15	0.2%	$1.73
	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**	**81,135**	**4,474**	**12,741**	**10.4%**	**11,796**	**15.7%**	**1.5%**	**14.5%**	**$4.19**	**5.7%**	**$3.68**
	Silicon Valley Total - Class A	**26,237**	**1,996**	**5,530**	**8.2%**	**4,877**	**21.1%**	**1.6%**	**18.5%**	**$4.25**	**-2.5%**	**$3.88**

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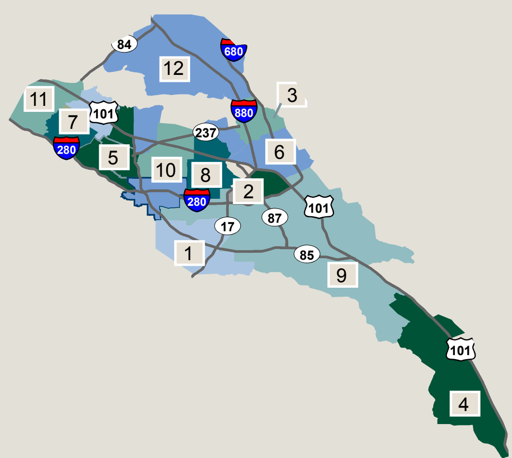

(1) Percentage point change for availability rates.
Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.
Statistics are calculated using both direct and sublease information.
Short-term sublet spaces (terms under two years) were excluded.

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.
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