

Quarterly Report

SILICON VALLEY COMMERCIAL SPACE

Status of Commercial Space Pre-Pandemic and Early Impacts

Q1 2020



This report is released on a quarterly basis by the Silicon Valley Institute for Regional Studies, in partnership with JLL Silicon Valley. It covers trends in commercial space within Silicon Valley, encompassing San Mateo and Santa Clara Counties and the Cities of Fremont and Newark.

JLL's COVID-19 Research Statement

Given the health, policy, economic and financial disruption unfolding from the COVID-19 outbreak, resulting real estate market shifts will not be fully reflected in Q1 2020 statistical indicators. It is too early to provide a quantitative assessment or forecast of the ultimate market impact of COVID-19. Our analysis focuses on Q1 market activity and how the market is positioned moving forward. We will be continually monitoring market movements as the situation evolves. Please feel free to contact us if we can assist.

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Summary

With the significant economic impacts expected due to the COVID-19 pandemic, the Q1 data provided here is intended to represent the status of pre-pandemic Silicon Valley commercial space, with some potential early impacts in mid- to late-March, 2020.

The most immediate impacts of the pandemic on Silicon Valley commercial real estate were directly associated with the shelter-in-place orders, which limited touring activity, construction progress, and building inspections. Until the crisis subsides, it will be impossible to understand the full impact of the COVID-19 pandemic.

Office and R&D vacancy rates remained relatively stable into Q1, as did rental rates. A significant amount of new space is under construction, despite some pandemic-related delays. Major projects underway are spread among cities throughout the region, with large projects in cities such as San Jose, Santa Clara, Mountain View, and South San Francisco.

Due to the ability of many Silicon Valley tech companies to relatively easily migrate to telework and maintain significant revenues, as well as the increased demand for e-commerce, the region's commercial real estate market will likely be more resilient to the effects of the pandemic than other less tech-centric regions.¹

1. Institute interpretation from JLL's *Silicon Valley Office Insight Report, Q1 2020*. "Many major corporate campuses preemptively migrated to an online workplace ahead of the shelter-in-place order in the state. Given that the top 10 local technology employers have an aggregate cash runway of about \$600 billion, our local economy is likely more resilient to the immediate impact of COVID-19 than less tech-centric markets." www.us.jll.com/en/trends-and-insights/research/silicon-valley-office-insight

Key Findings

- Office and R&D vacancy rates remained relatively steady in Q1 due to the significant amount of leasing activity that was already in the pipeline before the COVID-19 shelter-in-place orders, which went forward as planned. These leases included Zuora’s space in Redwood Shores and Exabeam’s lease in Foster City, resulting in a slight dip in San Mateo County office vacancy rates in Q1. In contrast, office vacancy rates in Santa Clara County increased slightly in Q1.
- Office space vacancy rates regionally remained steady into Q1, with a slight decline in San Mateo County counteracted by a slight increase in Santa Clara County (plus Fremont). Moving forward, office vacancy may be affected by pandemic-related disruption of leasing activity, and uncertainties about the duration of the disruption.²
- Tenants such as Rambus and Harmonic were unable to move into their spaces in Q1 due to stalls in building inspections caused by the shelter-in-place; thus, any expected absorption (and associated decline in vacancy rates) will be deferred until at least Q2.³
- The shelter-in-place order limited touring activity at the end of the quarter, so some delays in new leasing activity are expected moving forward. Additionally, FAANG (Facebook, Apple, Amazon, Netflix, and Google) companies have slowed leasing as they have already secured the space they need for the near (2-3 year) future.
- Rental rates remained relatively steady in Q1, but may be vulnerable to the duration of the COVID-19 crisis.⁴
- While permitting and building delays are inevitable given the shelter-in-place orders, there remains a significant amount (15.8 million square feet) under construction. Major projects underway include two 600,000-square-foot built-to-suit developments in San Jose – one for Verizon Media and another for Google.
- While current projects are likely to continue, with delays, speculative development (which has been seen recently, particularly for industrial and office space) will likely be put on hold until there is more certainty regarding the COVID-19 pandemic and overall economic health.

2. Institute interpretation from JLL's *SF Mid-Peninsula Office Insight Report, Q1 2020*. "...we expect new leasing activity to pause as businesses focus on their operational continuity." (www.us.jll.com/en/trends-and-insights/research/san-francisco-mid-peninsula-office-insight)

3. Institute interpretation from JLL's *Silicon Valley Office Insight Report, Q1 2020*. "Though some tenants were expected to move (e.g. Rambus and Harmonic), stalled building inspections has deferred some absorption into at least the next quarter as a direct result of the shelter in place order." (www.us.jll.com/en/trends-and-insights/research/silicon-valley-office-insight)

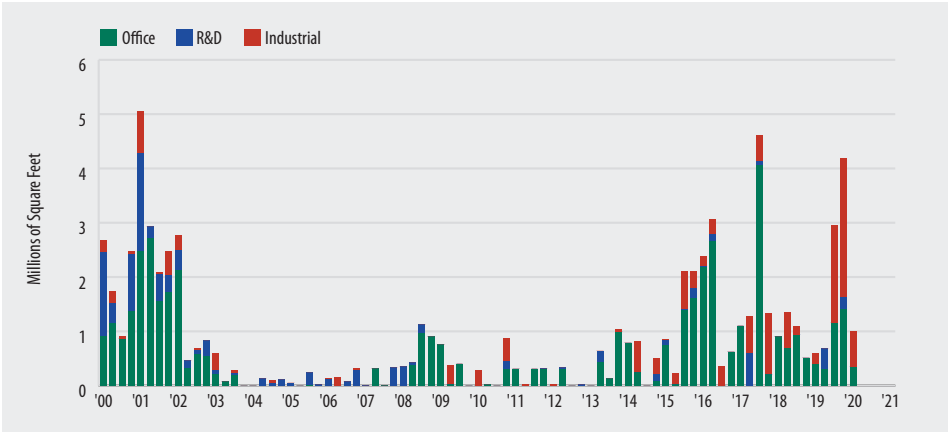
4. Institute interpretation from JLL's *SF Mid-Peninsula Office Insight Report, Q1 2020*. "The extent of the impact in rents in the near term is largely dependent upon the longevity of the crisis and the area's economic diversity." (www.us.jll.com/en/trends-and-insights/research/san-francisco-mid-peninsula-office-insight)

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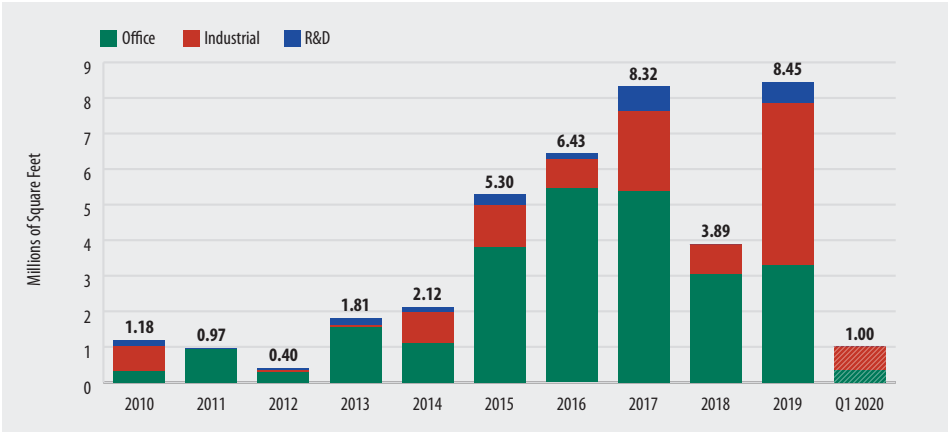
A. New Commercial Development

A1. Quarterly Commercial Space Completions by Sector, Silicon Valley, 2000 – Q1 2020



Q1 commercial space completions totaled one million square feet – nearly twice as much as was completed during the first quarter of the prior year – consisting of 35% office space and 65% industrial. This mix of completions has a higher share of industrial space compared to the average quarterly mix (64% office, 6% R&D, and 30% industrial since the start of the economic recovery period in 2010). The industrial space completed in Q1 included the remainder of Morton Commerce Center, and Gateway 84 in Newark.

A2. Annual and Year-to-Date Commercial Space Completions by Sector, Silicon Valley, 2010 – Q1 2020



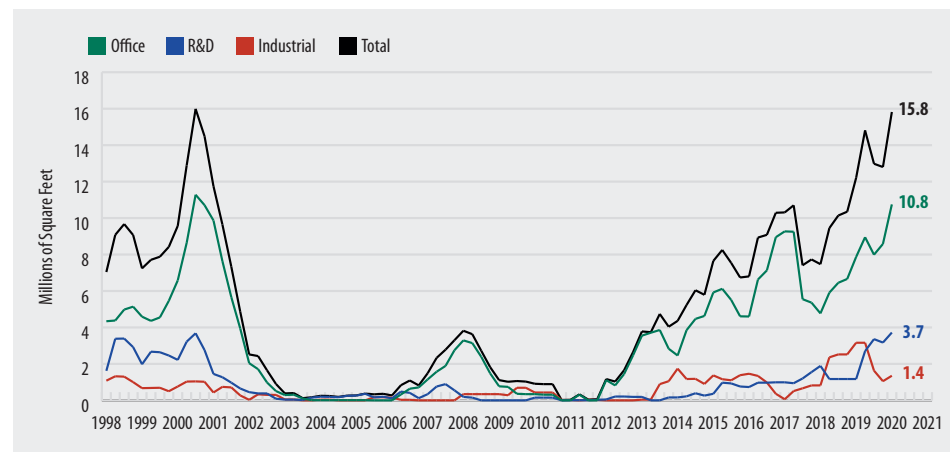
There was a total of one million square feet of Silicon Valley commercial space completed in the first quarter of 2020, none of which was R&D space. If the region were to continue at this pace of new construction through the end of the year, it will only produce half of the 2019 total (8.45 million square feet); given the state of the COVID-19 pandemic and subsequent construction delays, the region will likely complete less than expected in the second quarter of the year.

A3. Large Commercial Space Completions, Silicon Valley, Q1 2020

Street Address	City	Owner/ Developer	Rentable Building Area (square feet)	Percent Leased at Time of Delivery	Class & Type of Space
700 Santana Row	San Jose	Federal Realty	289,645	100%	Class A Office
2600 El Camino Real	Palo Alto	Sand Hill Property Company	62,616	75%	Class A Office
2061 Oakland Road	San Jose	Panattoni Development	84,648	100%	Class A Warehouse
7200 Gateway Boulevard	Newark	Panattoni Development / Clarion Partners	66,239	0%	Class A Warehouse
7400 Gateway Boulevard	Newark	Panattoni Development / Clarion Partners	117,889	100%	Class A Warehouse
7355 Morton Avenue	Newark	Overton Moore Properties	76,162	0%	Class A Warehouse
7375 Morton Avenue	Newark	Overton Moore Properties	141,275	0%	Class A Warehouse
7395 Morton Avenue	Newark	Overton Moore Properties	161,680	0%	Class A Warehouse

Eight large commercial space developments were completed during the first quarter, including two Class A Office projects (one on El Camino in Palo Alto, 75% of which was preleased to Wilmer Hale, and one at Santana Row in San Jose, 100% preleased to Splunk). Of the six Class A Warehouse completions in Q1, five were in Newark (two totaling 184,000 square feet on Gateway Boulevard, and three totaling 379,000 square feet on Morton Avenue); of those warehouse developments, two were preleased at the time of delivery (Oakland Road in San Jose to the County of Santa Clara, and 7400 Gateway Boulevard in Newark to a biotech company, Allogene, to accommodate post-2018-IPO expansion beyond its South San Francisco headquarters).

A4. Quarterly In-Progress Commercial Space Developments by Sector, Silicon Valley, 2000 – Q1 2020

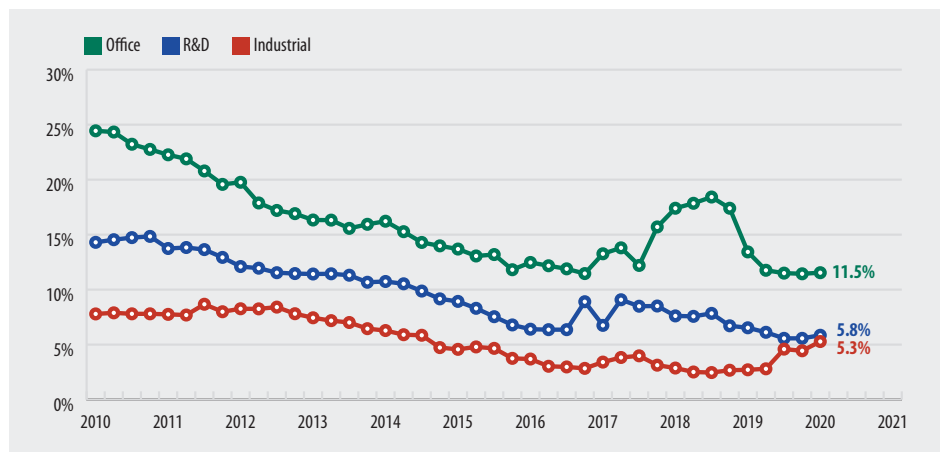


Silicon Valley had more commercial space under construction in Q1 2020 (15.8 million square feet) than any other quarter since Q4 2000. The majority of the space (68%) is office, with 9% industrial, and 23% R&D. Major office projects include the 600,000 square foot development for Verizon Media near the San Jose airport, and another

600,000 square foot development built-to-suit for Google at the former Bay 101 site, also in San Jose. Major industrial projects include the 477,000 square-foot second phase of Pacific Commons South in Fremont and the nearly 400,000 square-foot Bridge Point Building 2 in Milpitas, as well as more than 300,000 square feet of manufacturing space (82,000 of which is in San Jose). While the timing of these projects is likely to be delayed due to the pandemic, the total in-progress represents a significant amount for the region.

B. Commercial Vacancy Rates

B1. Quarterly Vacancy Rates, Silicon Valley, 2010 – Q1 2020

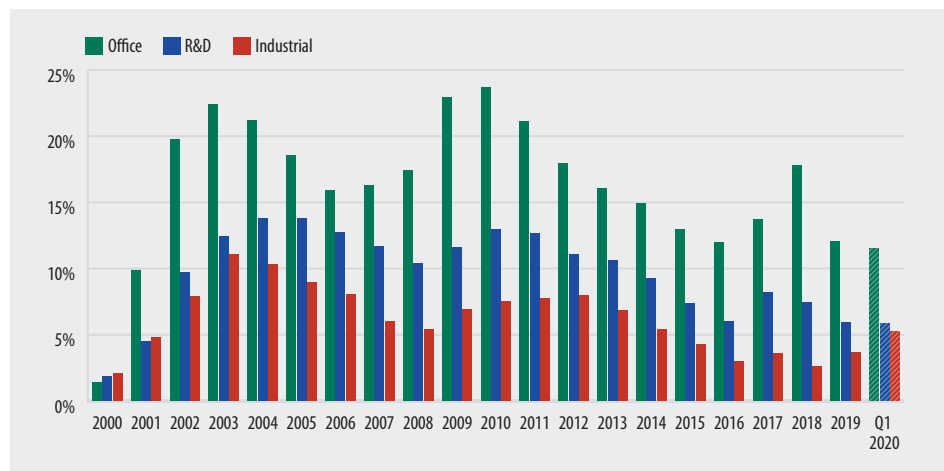


Industrial space vacancy rates have hovered around 5% since mid-2019 due to stability in the market over that period (with move-ins balancing out new space hitting the market). Meanwhile, office and R&D vacancy rates have remained relatively stable, and in Q1 were at 11.5% and 5.8%, respectively. There was a slight Q1 decline in San Mateo County office vacancy rates (a half of a percentage point) due to leasing activity that was already in the pipeline before the COVID-19 shelter-in-place orders (e.g., enterprise software company Zuora’s space in Redwood Shores, and security management platform Exabeam’s lease in Foster City). In contrast, office vacancy rates in the Santa Clara County (plus Fremont) market increased slightly in Q1, despite a notable 300,000-square-foot sublease by Airbnb in Santa Clara.⁵ Office space vacancy rates may be affected by pandemic-related disruption of leasing activity, and uncertainties about the duration of the disruption.⁶

5. Mercury News. Airbnb signs big lease in Santa Clara, sets stage for major Silicon Valley job hub. January 9, 2020. (www.mercurynews.com/2020/01/09/airbnb-signs-big-lease-santa-clara-major-silicon-valley-outpost-tech-real-estate)

6. Institute interpretation from JLL’s *SF Mid-Peninsula Office Insight Report, Q1 2020*. “...we expect new leasing activity to pause as businesses focus on their operational continuity.” (www.us.jll.com/en/trends-and-insights/research/san-francisco-mid-peninsula-office-insight)

B2. Annual Rate of Commercial Vacancy by Sector, Silicon Valley, 2000 – Q1 2020



Silicon Valley’s Q1 office space vacancy rates (11.5%) are much lower than the recent peak of 2018 (17.8% on average over that year) reflecting elevated tenant demand with strong absorption and leasing activity. Tenants such as Rambus and Harmonic were unable to move into their spaces in Q1 due to stalls in building inspections caused by the shelter-in-place; thus, any expected absorption (and associated decline in vacancy rates) will be deferred until at least Q2.⁷ Industrial space vacancy rates in Q1 (5.3%) were higher than the 2019 average (3.6%), however, demand for industrial/warehouse space is expected to remain elevated due to increased e-commerce during the pandemic.

B3. Average Office Space Vacancy Rates by Proximity to Transit, Q1 2020

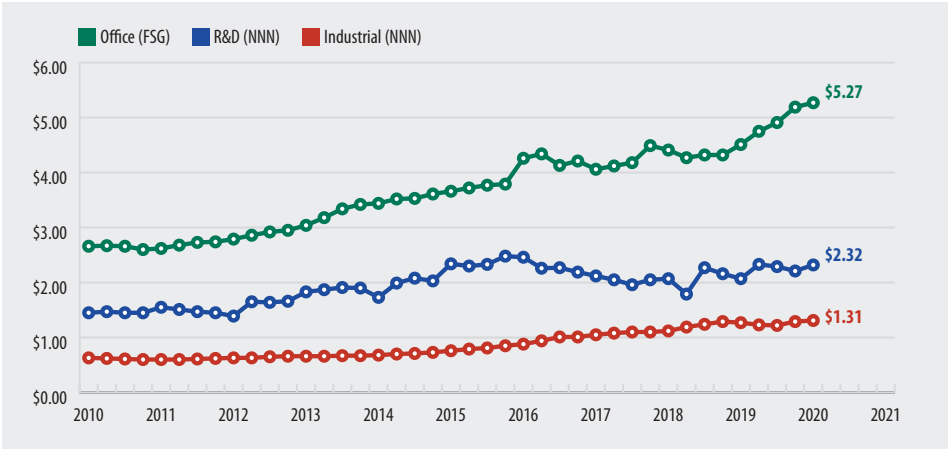
Near Transit	6.0%
Not Near Transit	8.4%

Silicon Valley office space vacancy rates remain lower at locations within a ten-minute walk from public transit, impacted by elevated tenant demand due to the ease of employee commutes.

7. Institute interpretation from JLL’s *Silicon Valley Office Insight Report, Q1 2020*. “Though some tenants were expected to move (e.g. Rambus and Harmonic), stalled building inspections has deferred some absorption into at least the next quarter as a direct result of the shelter in place order.” (www.us.jll.com/en/trends-and-insights/research/silicon-valley-office-insight)

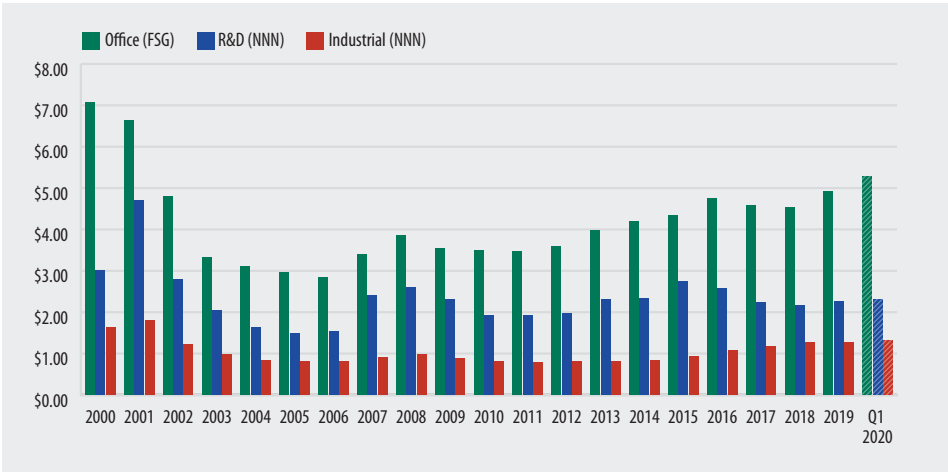
C. Commercial Rents

C1. Nominal Quarterly Asking Rents by Sector, Silicon Valley, 2010 – Q1 2020



Silicon Valley asking rents for office and R&D space increased very slightly in Q1 (reaching \$5.27 and \$2.32 per square foot, respectively), while industrial space asking rents remained steady at \$1.31 per square foot.

C2. Inflation-Adjusted Annual Average Asking Rents by Sector, Silicon Valley, 2000 – Q1 2020



Inflation-adjusted asking rents for industrial and R&D space remained steady into Q1, while office space asking rents in Q1 were 7% higher than the 2019 average after inflation-adjustment. Rental rates in the latter part of the year will likely be vulnerable to the duration of the COVID-19 crisis,⁸ which is uncertain at present.

8. Institute interpretation from JLL's *SF Mid-Peninsula Office Insight Report, Q1 2020*. "The extent of the impact in rents in the near term is largely dependent upon the longevity of the crisis and the area's economic diversity." (www.us.jll.com/en/trends-and-insights/research/san-francisco-mid-peninsula-office-insight)

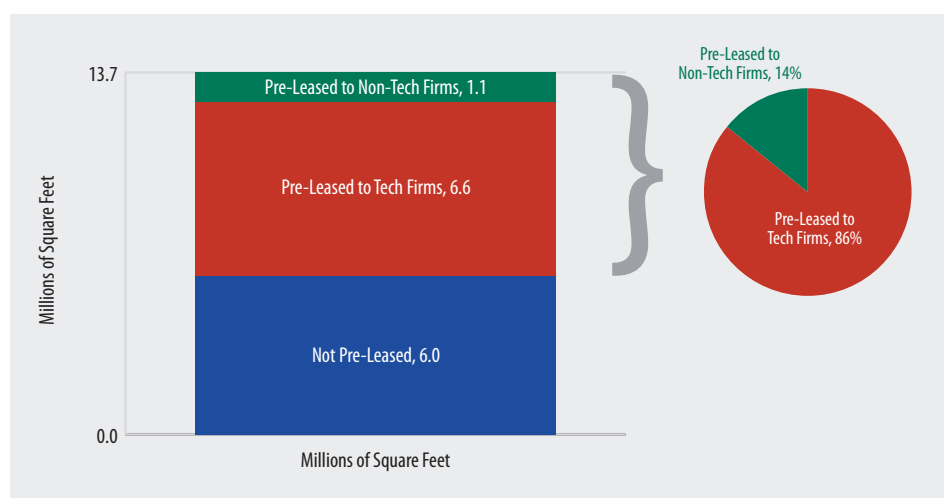
C3. Average Office Space Asking Rents by Proximity to Transit, Q1 2020

Near Transit	\$9.63
Not Near Transit	\$6.14

Silicon Valley office space asking rents were 57% higher at locations near public transit (within a ten-minute walk of a Caltrain, BART, or VTA station) in Q1 2020.

D. Tech Occupancy

D1. Commercial Office Space Under Construction and Share Pre-Leased to Tech Firms, Bay Area, Q1 2020



A total of 13.7 million square feet of new commercial office space was under construction throughout the Bay Area in Q1 2020 (78% of which was in Silicon Valley). Of that total, 7.7 million square feet has been preleased, primarily (86%) to tech companies.

Annotations

Data Source: JLL

Analysis: Silicon Valley Institute for Regional Studies; JLL

Notes: Data represents the end of each annual period unless otherwise noted. Commercial space includes Office, Industrial, and R&D. The JLL inventory includes all development above 35,000 square feet, with the exception of Downtown Palo Alto and Downtown Mountain View, and all R&D development above 10,000 square feet. The data included in this report does not include owner/user developments. Silicon Valley data includes San Mateo County, Santa Clara County, and the Cities of Fremont and Newark. Bay Area data includes all San Francisco Bay Area Submarkets, including Silicon Valley, North Bay, Mid-Peninsula, Oakland, and East Bay Suburbs. Average office space asking rents are “Full Service Gross” (FSG), which is the monthly rental rate and includes common area maintenance fees, utility fees, and taxes/insurance fees. Industrial and R&D asking rents are quoted “triple net” (NNN), which is the monthly base rental rate in which common area maintenance fees, utility fees, and taxes/insurance fees are excluded. The vacancy rate is the amount of unoccupied space, and is calculated by dividing the direct and sublease vacant space by the building base. The vacancy rate does not include occupied spaces presently being offered on the market for sale or lease. Average asking rents, where not noted as nominal, have been inflation-adjusted and are reported in 2020 dollars using the Bay Area consumer price index for all urban consumers from the Bureau of Labor Statistics, estimate for February 2020. Near transit is defined as located within a 10-minute walk of a Caltrain, BART, or VTA station.

Resources

- For questions regarding this report, contact Rachel Massaro (massaro@jointventure.org).
- For more information about Silicon Valley’s commercial real estate market, contact Heather Belfor (Heather.Belfor@am.jll.com) or visit www.jll.com/silicon-valley/en-us/research.
- To access Silicon Valley’s online data hub, visit www.SiliconValleyIndicators.org.

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Silicon Valley Institute for Regional Studies

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