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3Q24

# South Peninsula Office Market Overview



**NEWMARK**

# Market Observations

## Economy

- The region’s labor market showed signs of stabilizing. After two months of declines in the beginning of 2024, we have now tracked five months of modest growth, a welcome sign. While employment growth has been slower in this market relative to the U.S., the unemployment rate has remained steady indicating an equilibrium between labor supply and demand.
- Following the Federal Reserve's 0.50 percentage point reduction in September, lenders are optimistic about additional rate decreases anticipated in Q4 2024 and throughout 2025. This adjustment signifies the commencement of a strategic shift by the central bank from a restrictive to an accommodative monetary policy, marking its first rate cut since July 2023. Analysts forecast the possibility of an additional rate reduction in 2024, along with further cuts in 2025.

## Major Transactions

- The South Peninsula experienced a robust quarter in leasing activity, with total leased space of 961,177 square feet—marking the strongest performance of 2024 to date.
- The third quarter's largest transaction was Yahoo's 119,884-square-foot sublease renewal in Mountain View. The largest direct lease was secured by Omnisia, a former division of VMware that is now operating independently, for 74,691 square feet, also in the Mountain View submarket.
- The city of Mountain View led in leasing activity, representing 31% of the total square footage leased within the South Peninsula Market. Redwood City closely trailed, constituting nearly 26% of the leasing activity. The revitalization of leasing activity in Mountain View is further evident in Downtown Mountain View, where the number of transactions has doubled compared to the second quarter.

## Leasing Market Fundamentals

- Strong leasing activity in the first three quarters of this year, signals that the market is recovering from previous lows. Along with a positive 150,000 SF of positive net absorption could be forecasting an upward trend in following quarters.
- The South Peninsula leasing market has exhibited a continuous downward trend in asking rates, encompassing all property classes and transaction modalities. Notably, sublease rental rates have mirrored this broader market trajectory, registering a marginal reduction in sublease rents in Q3.
- Free rent, TI’s, and mixtures of each are continuing to be important tools to be able to make deals happen given the current market conditions. In addition, as companies continue to look for ways to bring employees back to the office, amenities including flexible workspaces, more conference rooms, and up-to-date infrastructure also play a big role.

## Outlook

- Reports that major corporations such as Amazon, Dell, Disney, and JPMorgan are transitioning back to require in-person work signals a broader shift away from the remote work policies that have been widely adopted since the pandemic. This shift in workplace dynamics has the potential to significantly benefit the commercial real estate market.
- Vacancy rates will likely hover around their current levels while any real growth in asking rents will remain muted in the short term. As the economy improves in the medium term, we expect market conditions will once again improve.
- The expansion of artificial intelligence (AI) companies is driving a positive outlook for the Professional & Business Services sector, as firms increase their staffing and space requirements to support AI-focused operations. This trend is particularly favorable for the office market, especially Class A properties.

1. Economy
2. Leasing Market Fundamentals
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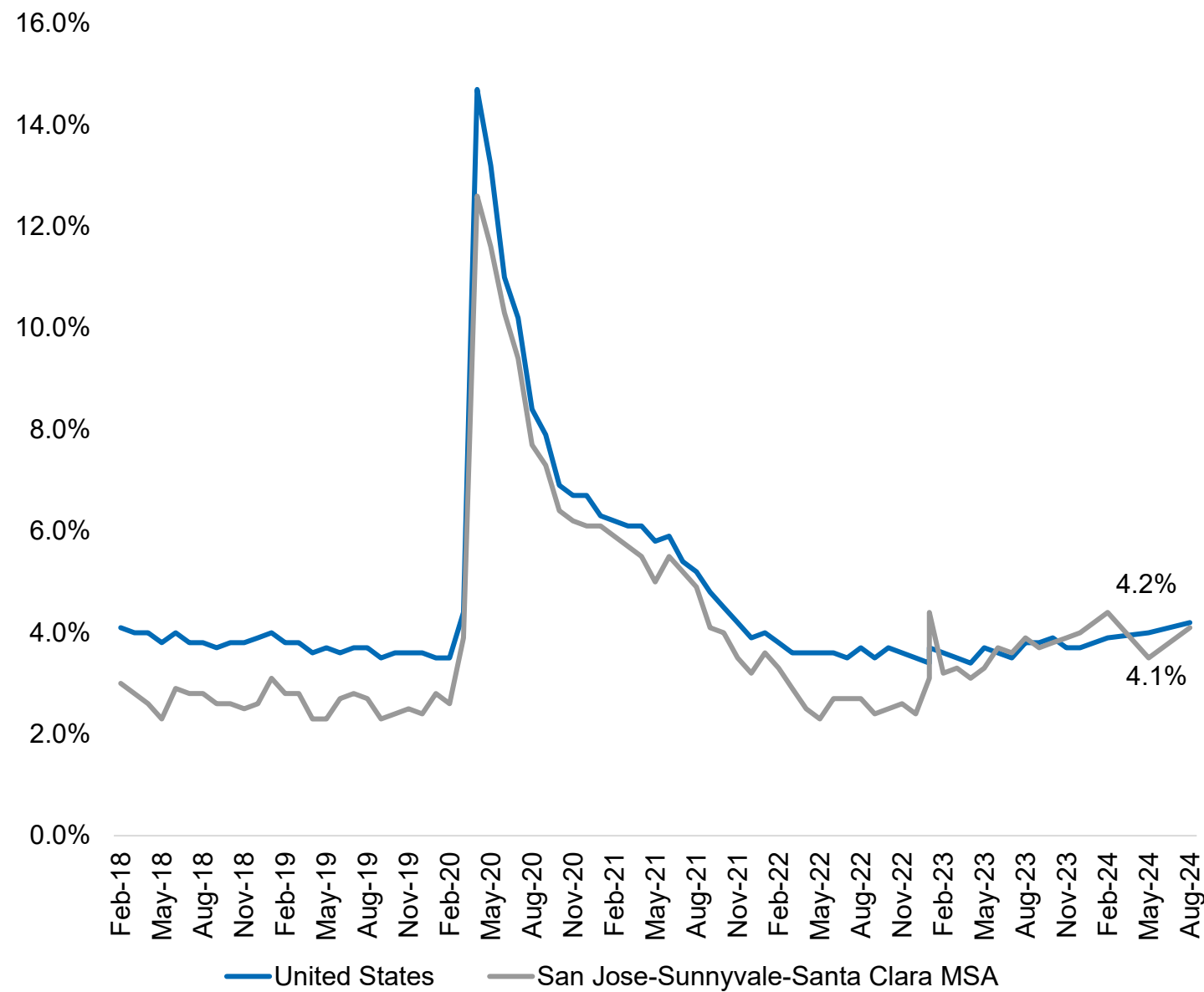
# Economy



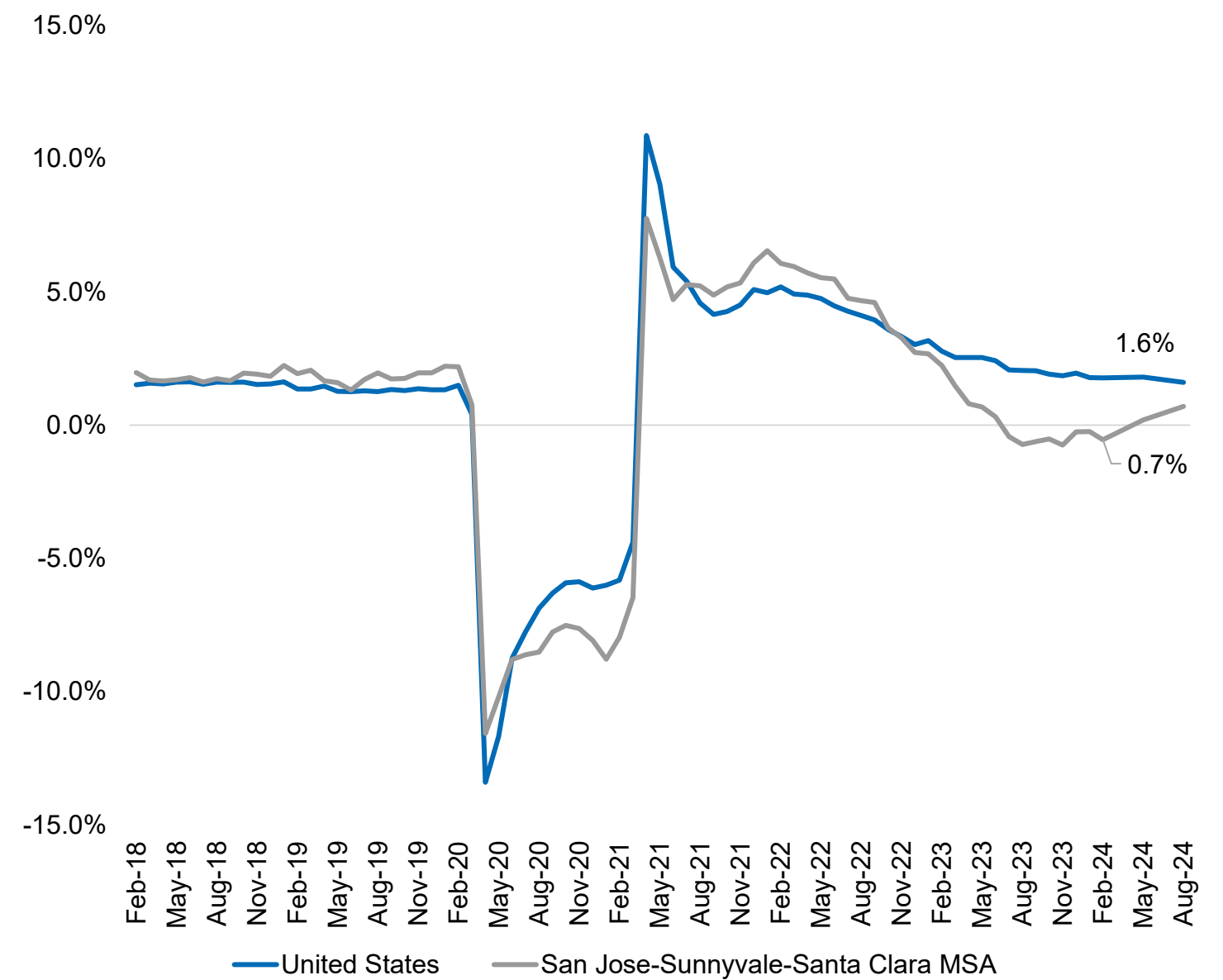
# Silicon Valley's Economy Shows Signs of Stabilizing After Job Losses

Modest job growth returned to the San Jose-Sunnyvale-Santa Clara's economy through August 2024 with employment inching up 0.7% year-over-year. This marks the fifth consecutive month of employment gains after eight months of losses. The overall unemployment rate held relatively steady through August, dropping below the U.S. average within the past two months. Professional & Business and Education & Health recorded the largest gains whereas Information Technology, Construction, and Manufacturing shed jobs.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change

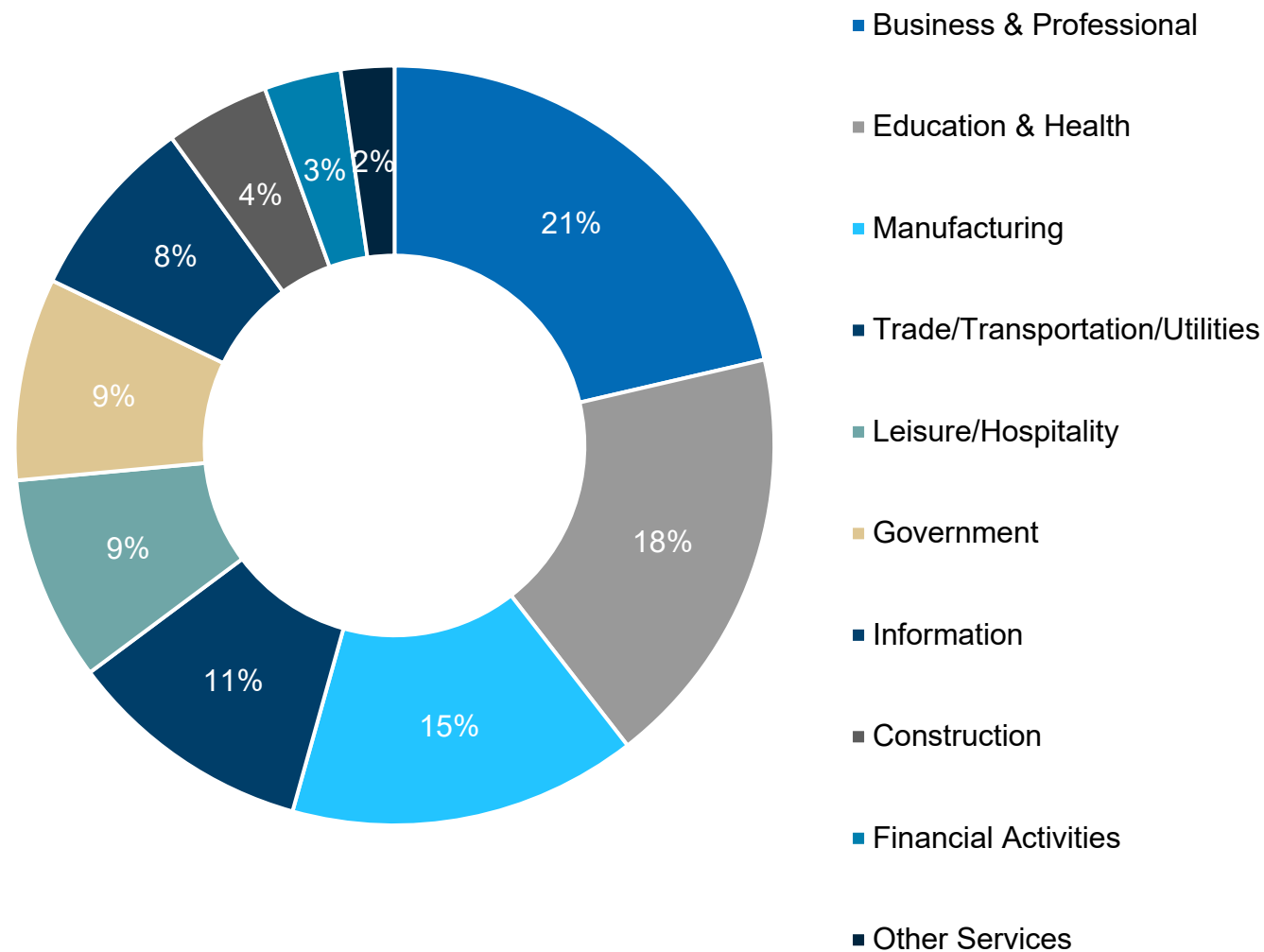


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale  
 Note: August 2024 data is preliminary.

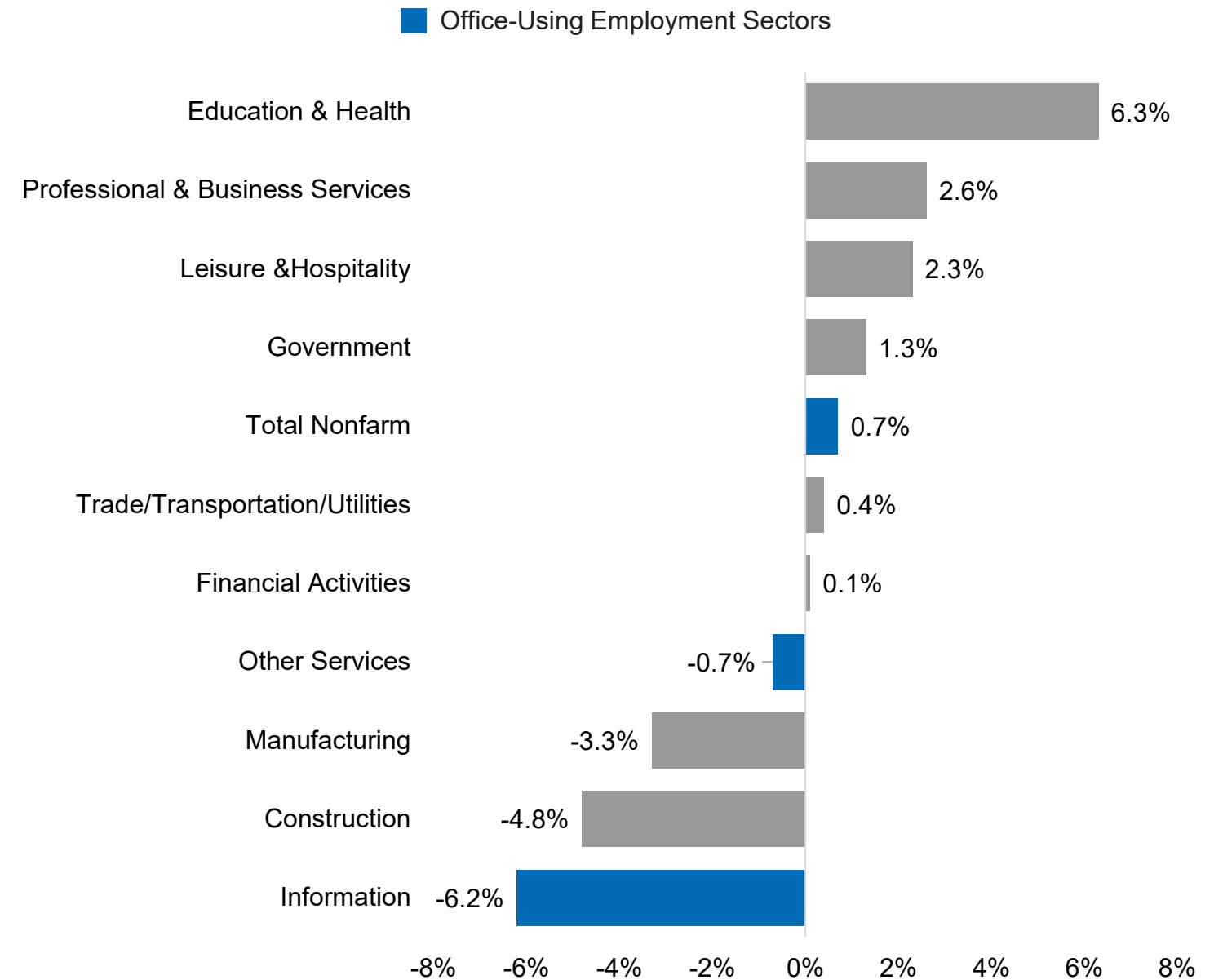
# Professional & Business Services Added Jobs While the Tech Sector Continued to Shed

Job gains in the Professional & Business Services, Education & Health, Leisure & Hospitality and Government outpaced losses in the Tech (Information Technology), Construction, and Manufacturing sectors. Fortunately, Professional & Business Services – a key driver of the local office market - remains Silicon Valley’s largest employment sector and is expanding once again, which bodes well for the office market, despite the Valley’s reputation as a tech-only hub.

Employment by Industry, August 2024



Employment Growth by Industry, 12-Month % Change, August 2024

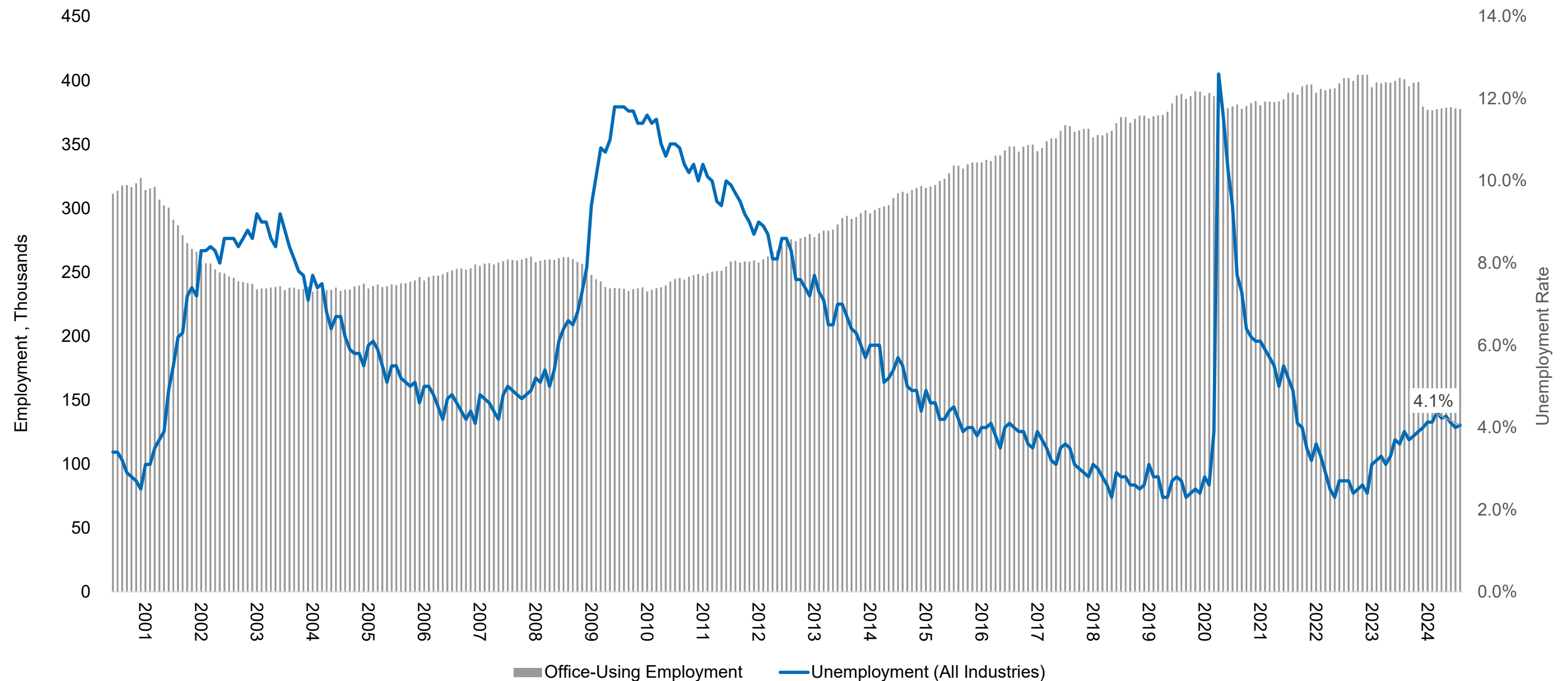


Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale, layoffs.fyi  
 Note: August 2024 data is preliminary.

# Office-Using Employment Expected to Trend Upward

Office-using employment has recently declined from its peak as the tech sector undergoes readjustment. Between 2020 and 2022, tech companies rapidly expanded their workforces in response to the shift to remote work. By early 2023, many began layoffs as the world returned to 'normal'. We believe the market has bottomed out and is now trending upward, driven by growing economic confidence and strong local demand from the rapid growth of AI companies.

Office-Using Employment\* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, San Jose-Santa Clara-Sunnyvale

Note: August 2024 data is preliminary.

\*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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# Leasing Market Fundamentals

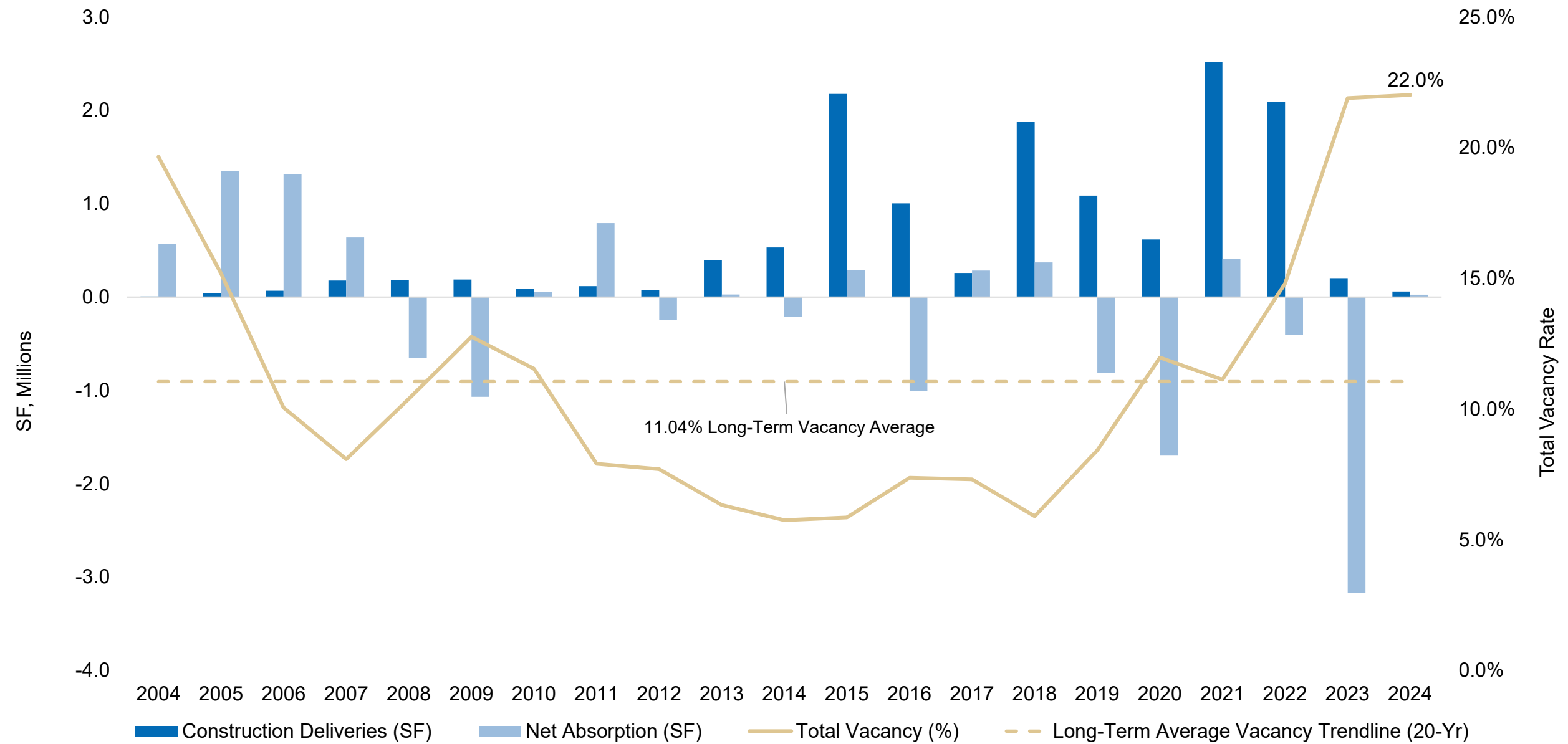




# Vacancy Climb Stabilizes in Third Quarter 2024

In the third quarter of 2024, significant leasing activity contributed to a reduction in the total vacancy rate, which now stands at 22.0%. This marks a stabilization of the vacancy rate over the last three quarters following two consecutive years of increases. Furthermore, the South Peninsula has shown improvement, with a positive net absorption of 149,122 square feet observed in the South Peninsula market.

## Historical Construction Deliveries, Net Absorption, and Vacancy

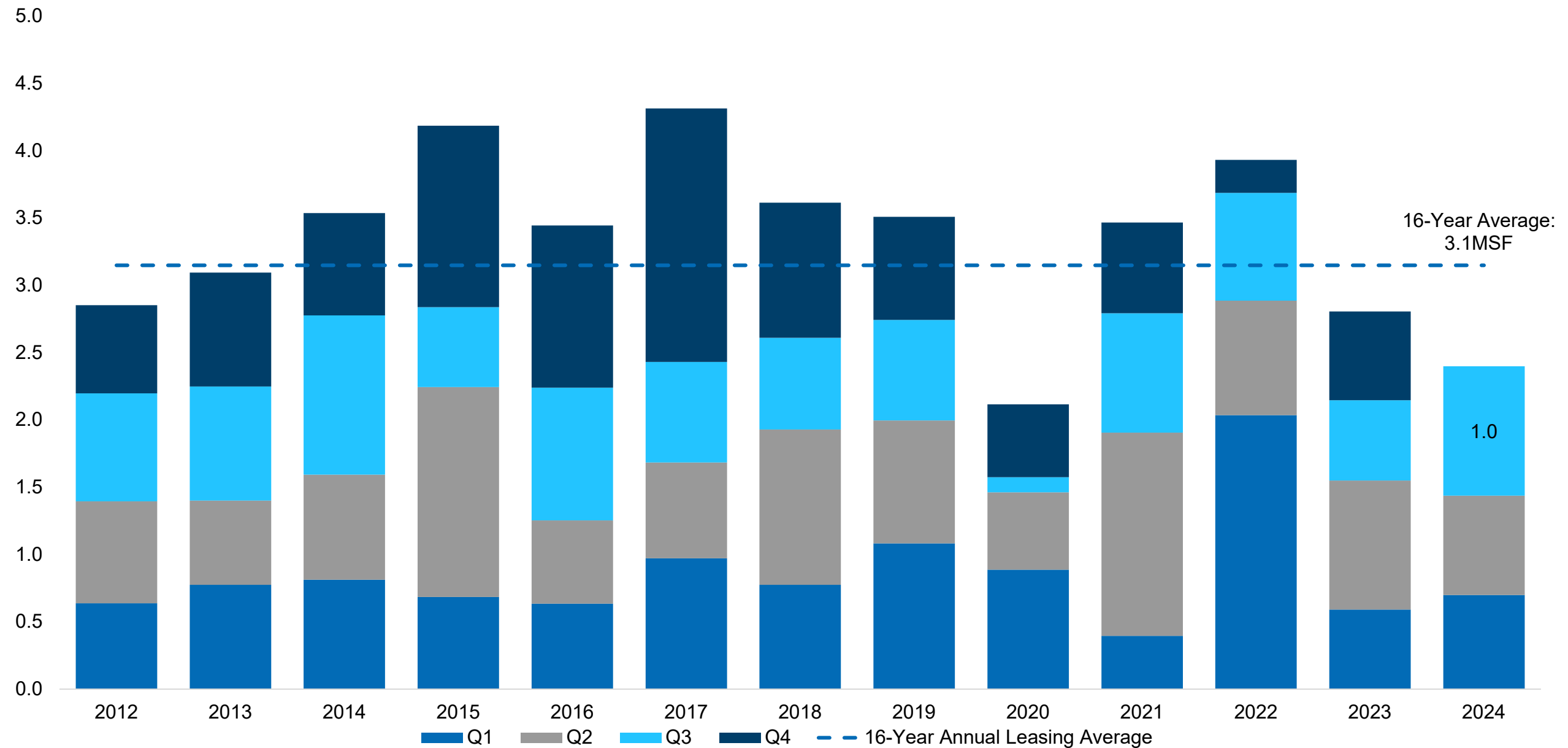


Source: Newmark Research

# Strong 3<sup>rd</sup> Quarter 2024 Leasing Surpasses Previous Year Total

A robust third quarter, with 961,777 square feet of space leased, has positioned the South Peninsula to potentially exceed the 16-year historical average. In addition, over 60% of the leases signed during this period were direct leases, highlighting a favorable trend for the market. Conversely, sublease transactions comprised only 9% of deals in the third quarter of 2024, reflecting a departure from the surge in sublease transactions that arose immediately the pandemic.

**Total Leasing Activity (msf)**

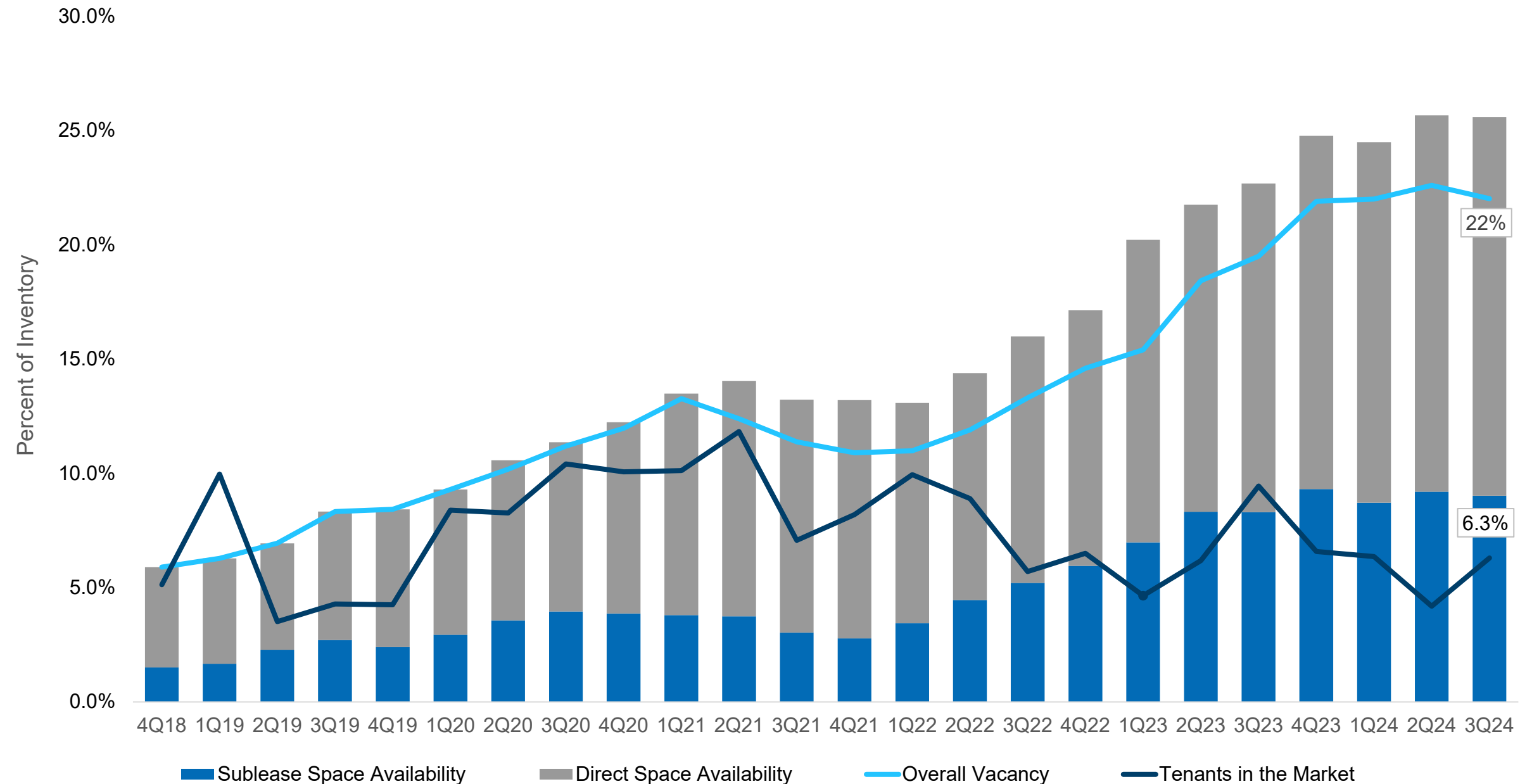


Source: Newmark Research, CoStar

# Tenant Demand Rises While Vacancy Sees Slight Decrease

Tenant demand has experienced an increase after three consecutive quarters of decline. This surge is largely attributed to the in-office mandates enforced by prominent Bay Area companies, including Amazon, Dell, and notably Zoom. Additionally, the Bay Area's investment in the AI industry has further stimulated tenant demand, with companies such as AiDash, SaltoAI, and Datalogy AI Inc. entering into lease agreements across the South Peninsula market in Q3 2024.

Available Space and Tenant Demand as Percent of Overall Market

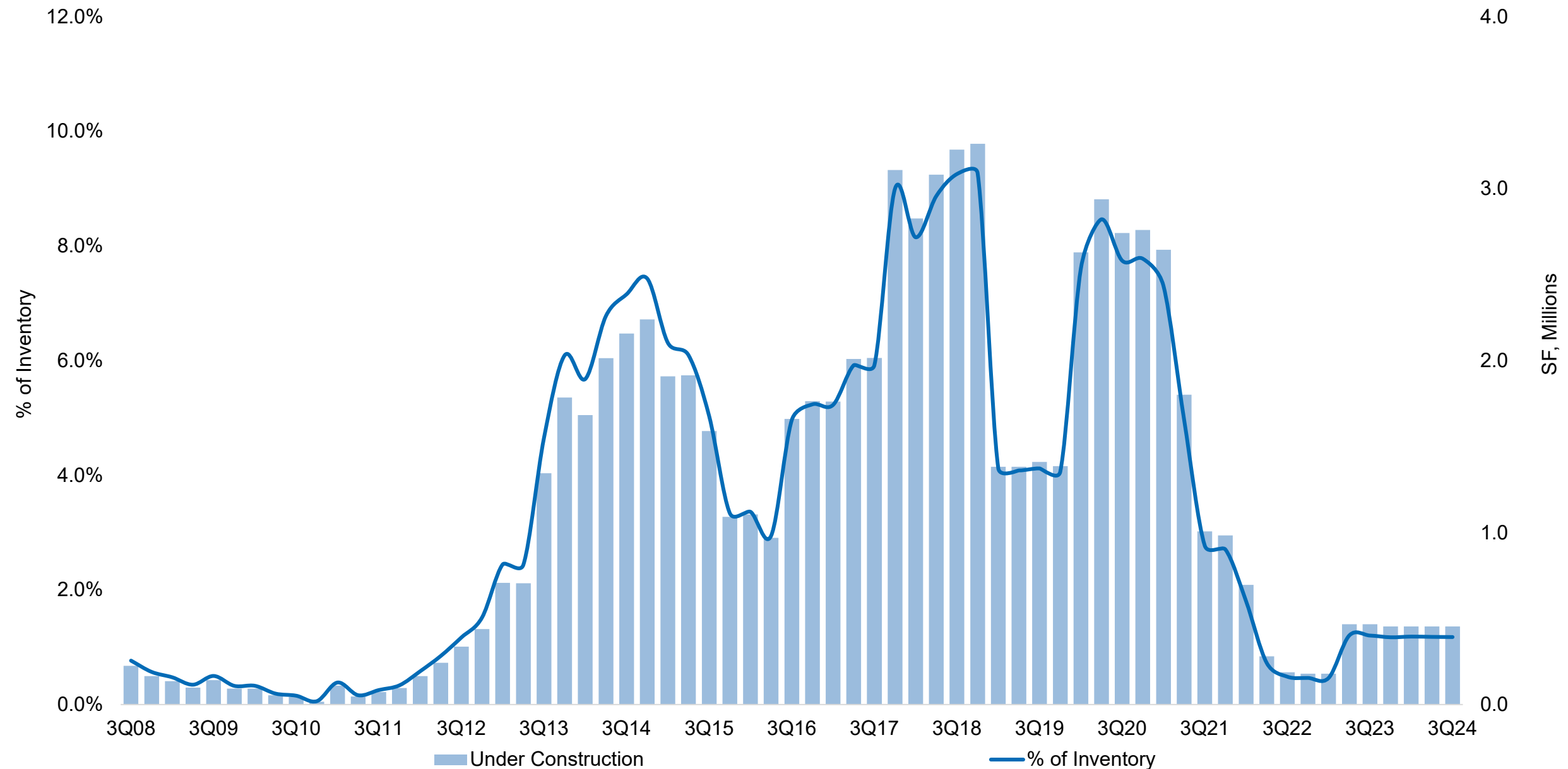


Source: Newmark Research

# New Construction Levels at a Standstill

Due to a combination of weaker demand, high construction costs, elevated interest rates, and cautiousness among investors and developers, the construction pipeline has come to a standstill. At the end of the third quarter, only 454,000 square feet are under construction, significantly below the ten-year quarterly average of 1.6 million square feet. We anticipate that this limited influx of new supply could aid in accelerating the market's recovery process. This cautious approach might also prompt developers to focus on revitalizing existing spaces to meet changing market needs.

## Office Under Construction and % of Inventory

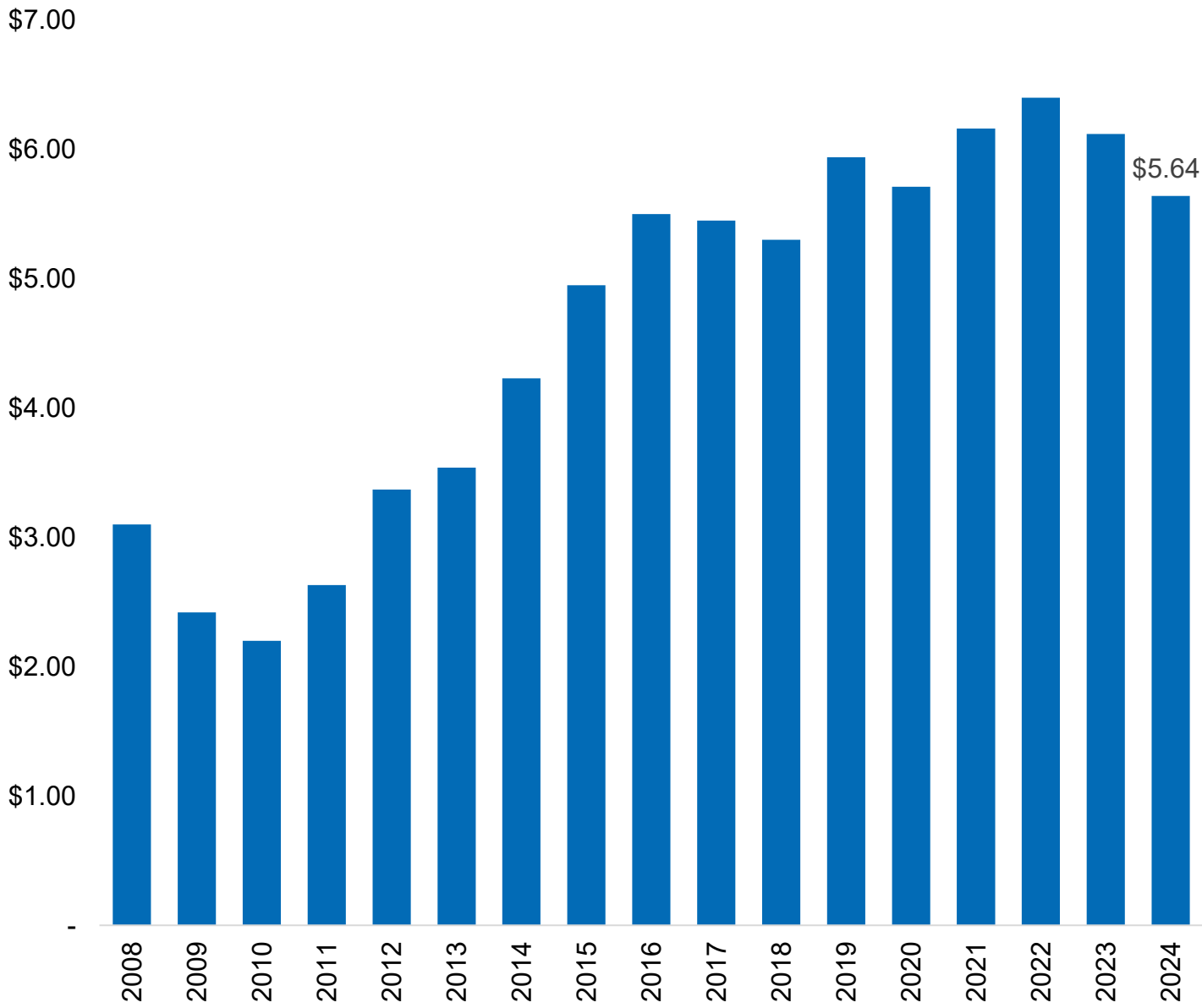


Source: Newmark Research, CoStar

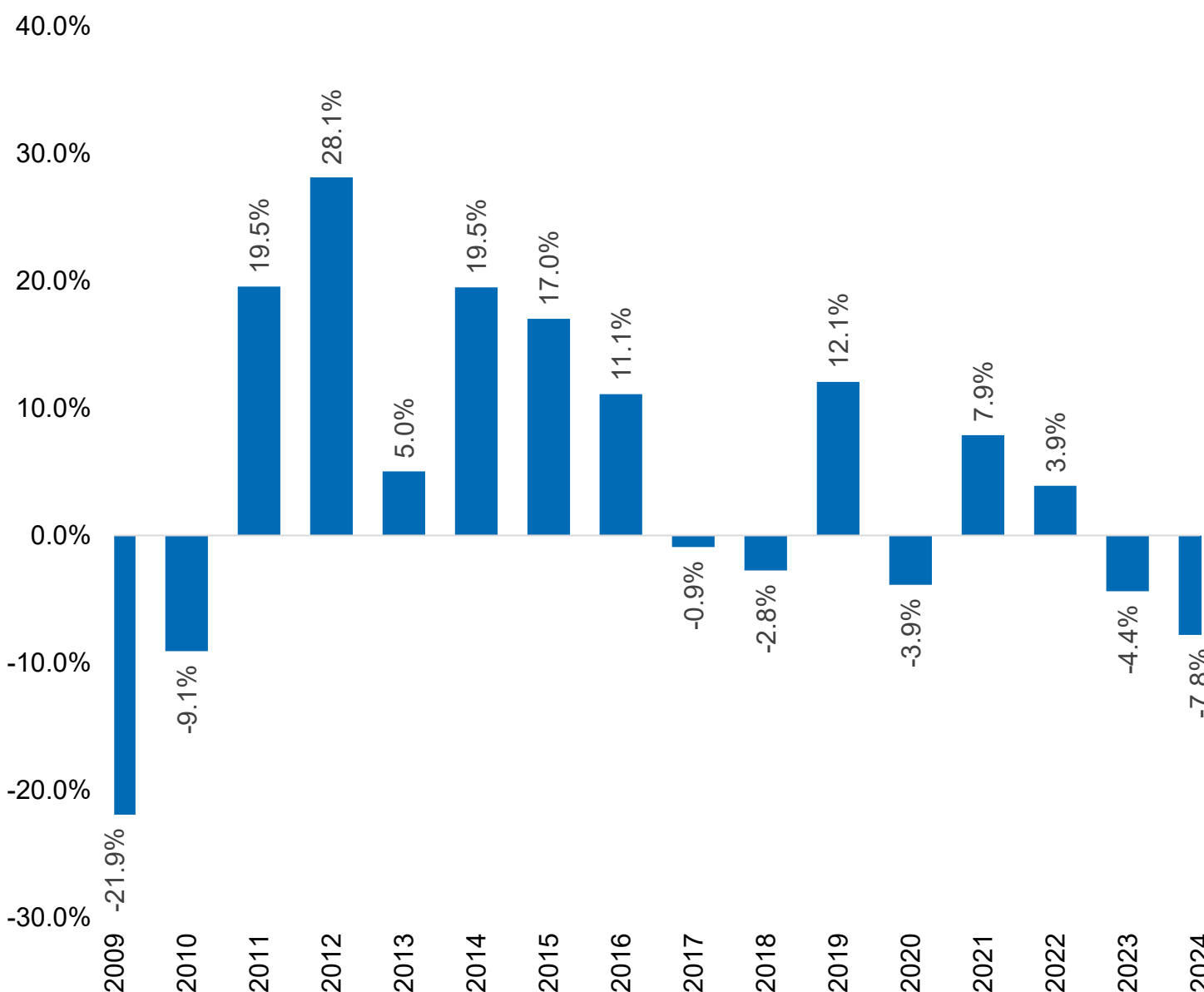
# Asking Rents Continue to Drop Across All Classes

The substantial amount of available space in the South Peninsula market continues to exert downward pressure on asking rents. Following their peak in 2022, asking rents have declined 7.8% year-to-date in 2024 to \$5.64 per square foot (NNN). Properties featuring premium amenities—such as conference facilities, flexible workspaces, abundant natural light, open floor plans, and modern infrastructure—have allowed landlords to maintain asking rates as companies focus on improving their spaces to encourage employee return.

Office Average Asking Rent, \$/SF, NNN



Year-over-Year Asking Rent Growth Rate

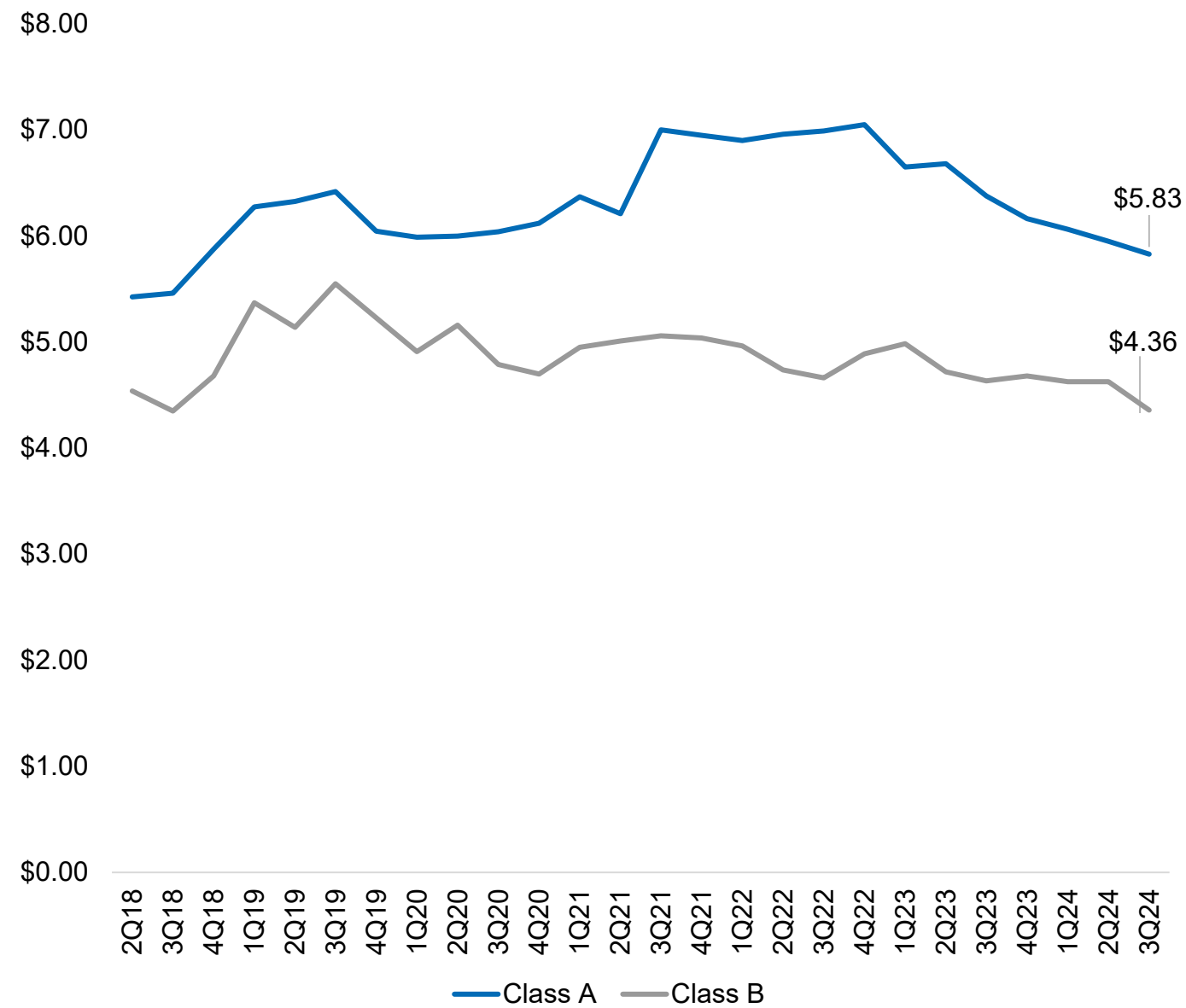


Source: Newmark Research, CoStar

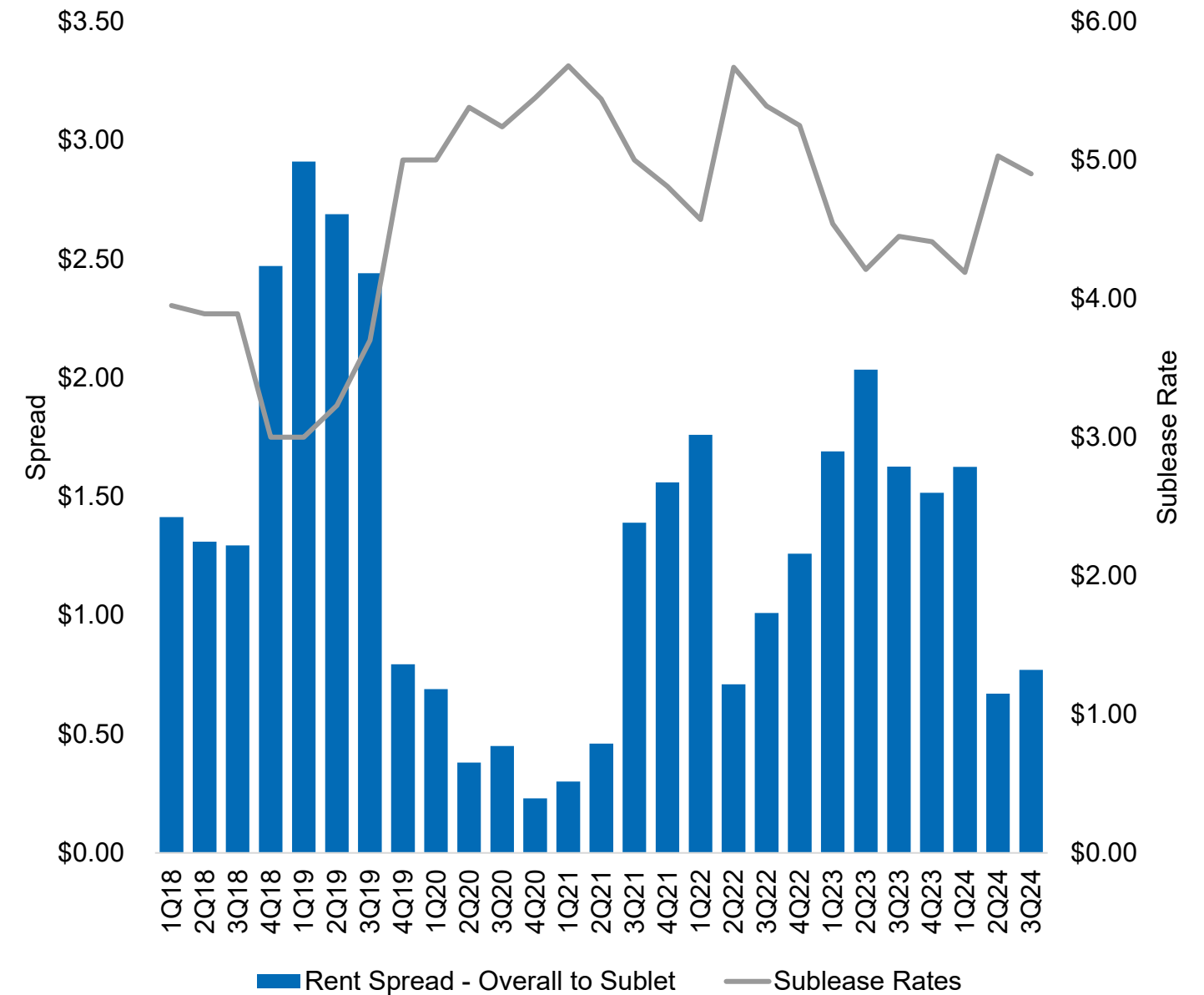
# Asking Rates Lowered Across the Board

Across all property and transaction types, a reduction in asking rates has been observed. Sublease rents have paralleled the general market trend, experiencing a modest decline in the third quarter. With the deceleration of construction and restricted supply, it is anticipated that asking rates may recover. Notably, large Class A buildings, particularly those with amenities such as those in the Sand Hill Road submarket, have demonstrated slightly greater resilience in maintaining their rent levels amid these downward pressures.

**Class A and Class B Asking Rents, \$/SF, NNN**



**Sublease Rates**



Source: Newmark Research, CoStar

# Strong Q3 Leasing Across South Peninsula

The third quarter's largest transaction was Yahoo's 119,884-square-foot sublease expansion in Mountain View, which included the extension of their existing sublease and expansion to occupy the entire second floor. Mountain View demonstrated strong performance with 290,029 square feet of gross absorption, reducing overall availability by more than 6% compared to the second quarter. Redwood City also experienced positive net absorption, notably driven by major tenants reoccupying space, including Box at 900 Middlefield Road and Zuora in Redwood Shores.

## Notable 3Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Yahoo	391 San Antonio Road	Mountain View	Sublease Expansion	119,884 SF
<i>"Yahoo has extended its existing sublease from LinkedIn and expanded the agreement to encompass the entire second floor, increasing its total footprint within the building."</i>				
Omnissa (formerly VMware)	590 Middlefield Road	Mountain View	Direct Lease	74,691
<i>After their official split from VMware, Omnissa a now independent software development company has leased floors 1-3 in 590 Middlefield on a direct basis.</i>				
Confidential	550 Allerton Street	Redwood City	Lease Renewal	61,760
<i>Sublease renewal. A confidential client renewed their lease at 550 Allerton Street.</i>				
Course Hero, Inc.	2000 Seaport	Redwood City	Lease Renewal	40,209 SF
<i>Lease renewal. Short-term extension, as Course Hero was previously subleasing the 3<sup>rd</sup> and 4<sup>th</sup> floors but only kept the 3<sup>rd</sup> floor.</i>				
Workato, Inc.	1530 Page Mill Road	Palo Alto	Direct Lease	23,915 SF
<i>Direct lease. Workato, a software development and AI company, is leasing 23,915 SF at 1530 Page Mill Road.</i>				

Source: Newmark Research

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# Appendix





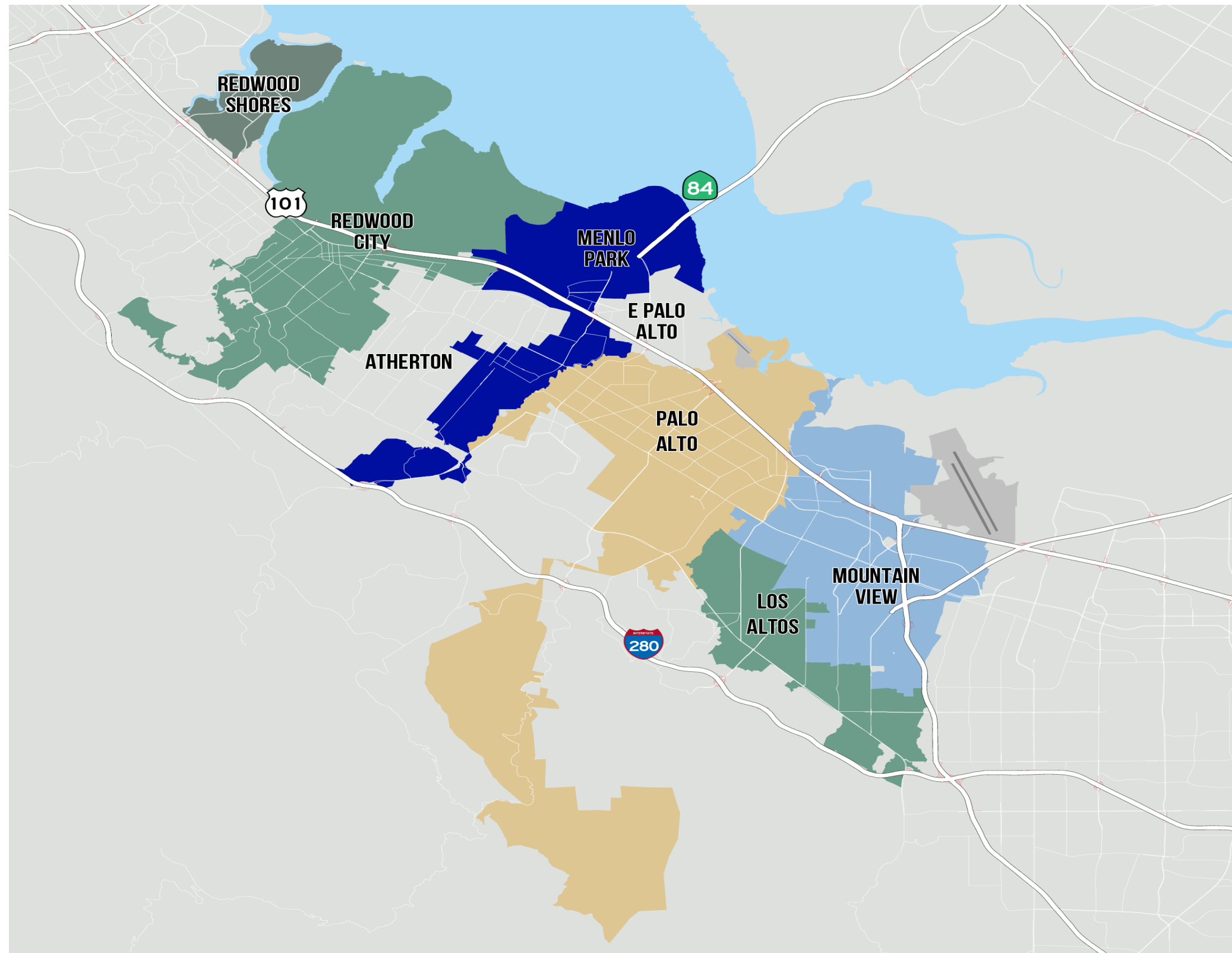


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# South Peninsula Submarket Map



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*For more information:*

**Zachary Faris**

*Research Analyst*

*Palo Alto Research*

[zach.faris@nmrk.com](mailto:zach.faris@nmrk.com)

**Palo Alto Office**

258 High Street

Palo Alto, CA 94301

t 650-322-2600

**New York Headquarters**

125 Park Ave.

New York, NY 10017

t 212-372-2000

**[nmrk.com](http://nmrk.com)**

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