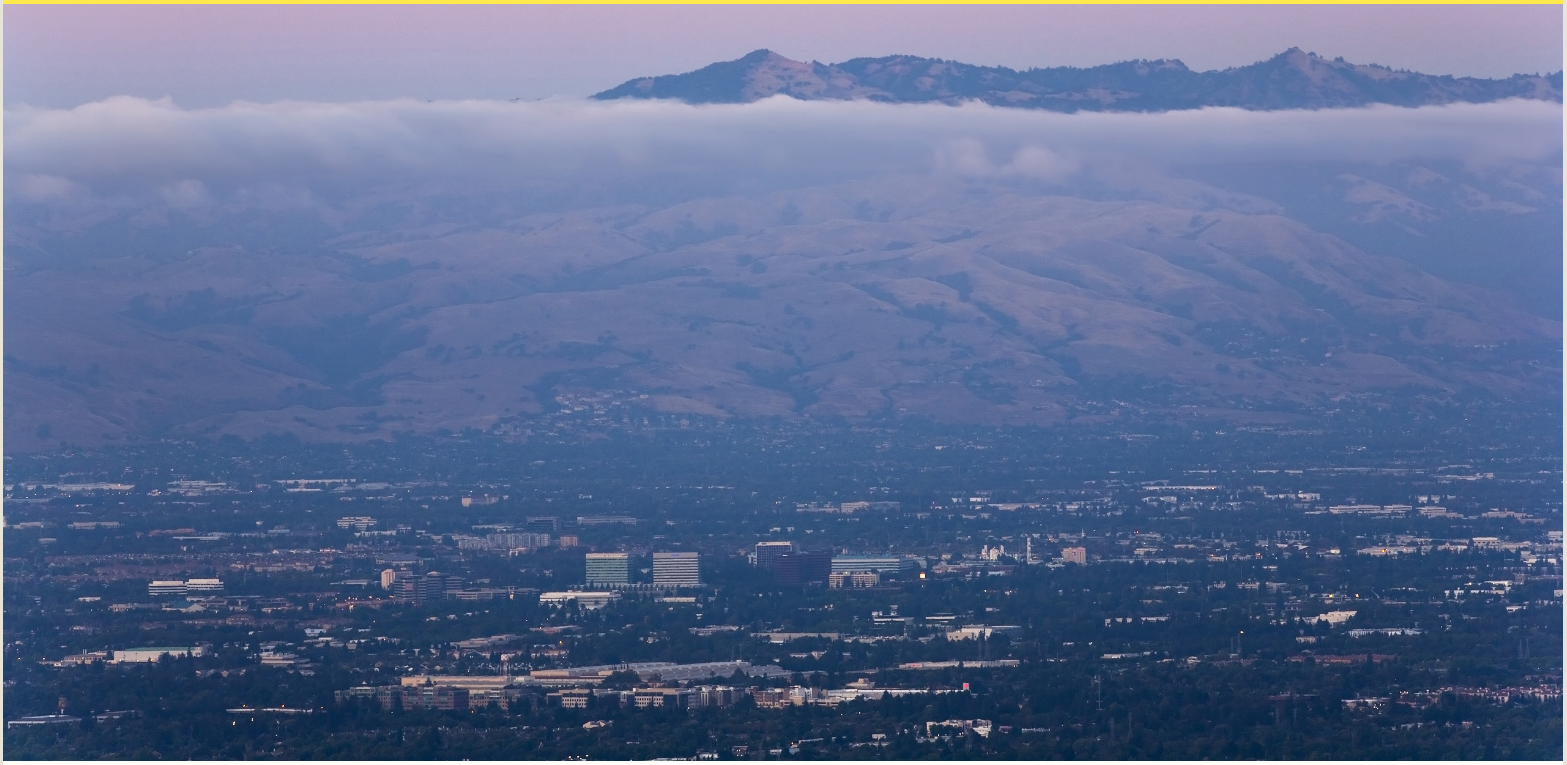
Savills Studley Report
Silicon Valley office sector

Q4 2016



SUMMARY

Market Highlights

LEASING SLOWS

Since hitting a peak of 11.6 msf in mid-year 2015, four-quarter trailing leasing has steadily declined, and fell below 6.0 msf in the final quarter of 2016.

CLASS A AVAILABILITY RATE UP YEAR-ON-YEAR

Following an increase in the third quarter, the region's overall vacant availability rate fell by 50 basis points to 8.6%. The Class A rate (8.9%) was unchanged from the third quarter, but has spiked by 130 basis points from year-end 2015.

RENTAL RATE JUMPS

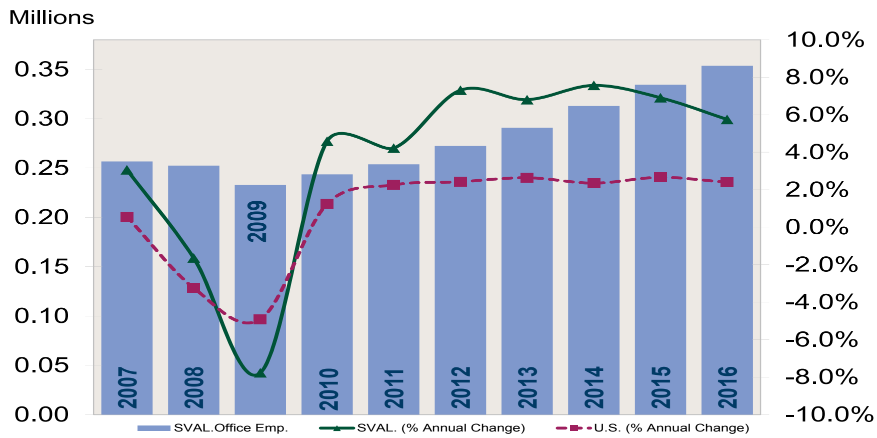
Regional overall asking rent, $3.73, rose by 1.4% during the fourth quarter, and has increased by 4.7% year-on-year. Class A rent posted a sharper 9.8% quarter-on-quarter increase and has spiked by 11.0% from year-end 2015.

SHARP DROP IN SALES

Office property sales have dipped from $6.1 billion in the first 11 months of 2015, to $3.4 billion through November of 2016 - a 44.5% decline.

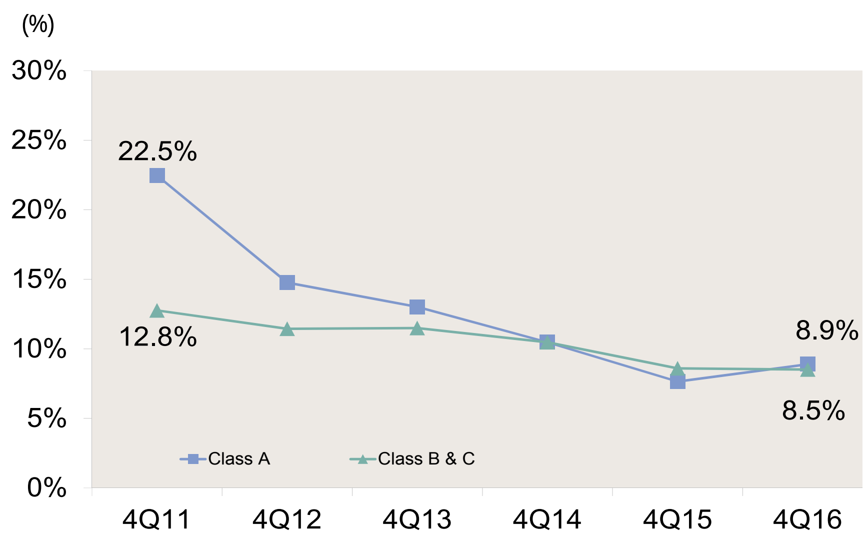
" The Valley's economy and office market got a taste of reality during 2016. Hiring and leasing activity moderated just as the latest wave of new properties in North San Jose, Downtown San Jose and Santa Clara looms on the horizon. Tenants can expect a moderation in rental rate growth in 2017." Peter Hamann,

Office-Using Employment Trends

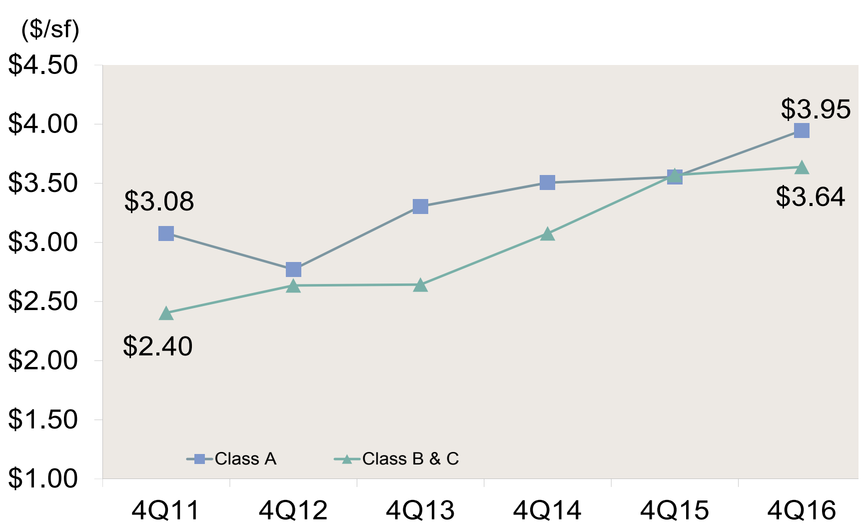


Source: Bureau of Labor Statistics

Vacant Availability Rate Trends



Asking Rent Trends



Market Coming Back Down to Earth

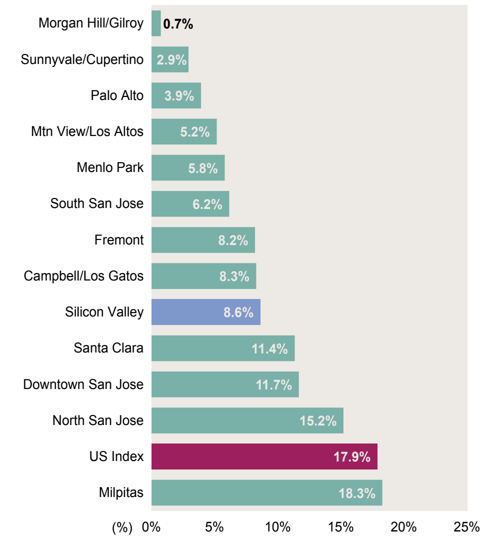
The Valley's economy and office market got a taste of reality in the past 12 months. The dose was not as harsh as in San Francisco, but it still gave businesses and landlords cause to pull back on their expectations a bit heading into 2017. Tougher financing requirements and a chilly IPO market negatively impacted the value of smaller and larger firms alike, forcing some to rein in growth plans and spending. Landlords are accepting that this amazing rally has to wind down at some point – perhaps sooner rather than later. Tenants can expect a bit more rental rate growth in 2017 in hotter submarkets, but it will not be as severe as in the last few years. Rents have already begun to dip in weaker submarkets such as Santa Clara and North San Jose, where landlords have been more willing of late to strike a deal.

Dealing with a Reality Check

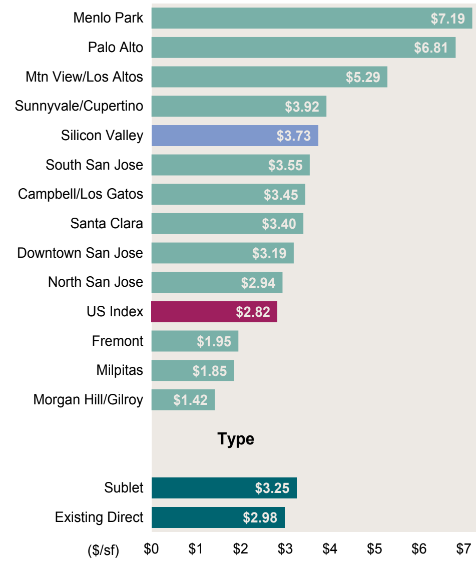
Excluding a handful of firms, the "growth first, profitability later" phase has seen its heyday. More businesses are trying to balance growth with expenditures. This still leaves a lot of room for expansion and hiring activity, particularly by the likes of Apple and Google, but there has been a moderation in the most aggressive leasing patterns. Leasing activity has not dropped off a cliff, but it has calmed. During the second half of the year the number of leases over 100,000 sf has slowed. Just a few quarters ago, companies were grabbing every building and complex almost as soon as plans were unveiled. In addition to a decrease in the number of pre-emptive discretionary leases, there is a related reduction in the warehousing of space. As more tenants adhere by their business plans, fewer leases are being based on fear factor – the worry that space must be hoarded to prevent overpaying or worse yet lack of space.

This pre-emptive strike approach to expanding in the Bay Area has now shifted to secondary markets such as Seattle and Austin – employers based in the Valley who cannot find adequate talent locally are contributing to the rallies in these markets. This search for labor in other markets is in some ways a form of price resistance. Locally, many of the remaining options are found in North San Jose, Santa Clara or Downtown San Jose. Some companies have leased in these submarkets, but the heavyweights, such as Facebook, Google and LinkedIn, have staked their claim elsewhere - at least for now.

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
Microsoft	92,500	3210 Porter Dr	Palo Alto
Concentric Medical	61,997	301 E Evelyn Ave	Mountain View
Labcyte	60,002	170 Rose Orchard Way	North San Jose
Palantir Technologies	59,914	100 Hamilton Ave	Palo Alto
FICO	54,528	181 Metro Dr	North San Jose
Corning	39,311	674 W Maude Ave	Sunnyvale
Okta	38,750	300 Park Ave	Downtown San Jose
VIPtela	28,924	1730 N 1st St	North San Jose
Red Hat Inc	28,389	150 Mathilda Pl	Sunnyvale
Elo Touch Solutions	26,642	670 N McCarthy Blvd	Milpitas

Demand Moderating as Next Phase of Product Looms

The past year took a little wind out of the sails of the rally, but conditions are still very tight in submarkets such as Palo Alto, Mountain View and Menlo Park. These areas continue to provide little breathing room to tenants. Outside of these areas, though, the market as a whole is seeing a moderation in the optimal landlord-favorable conditions that have prevailed for the last two to three years. Larger concession packages and more favorable terms are being offered to tenants and rent is starting to shift in the outlying submarkets.

Tenants that must sign a lease in the next few quarters will still face challenging conditions, but their range of options is increasing - an improvement from several quarters ago when space was evaporating. Landlords in Santa Clara, North San Jose and Downtown San Jose are sitting on the biggest blocks of space left for lease in the market. New construction has been ramping up. The largest projects coming online are located in Mountain View, Santa Clara, and North San Jose. North San Jose has the most available new product, with 85% of the 5.5 msf of new space available for lease. Both Boston Properties' 1.2 msf project, The Station on North First, and Hunter Properties' 1.5 msf project, Coleman Highline, are set to break ground in North San Jose in early 2017. Neither project has an anchor tenant in hand.

As long as demand stays robust these landlords stand to capture the lion's share of leasing next year. More than 6.0 msf of new construction is scheduled to deliver in the next two years. New construction should hopefully put some tenants in the position to gain leverage as the supply pools deepens and more options open up. As time goes by and space goes unleased, landlords will display more flexibility and more aggressiveness in their efforts to lock in established companies that will commit to term.

Elevated Concessions Signal Shift

Landlords are already starting to pad concessions a bit, particularly in those areas that have not shared as fully in the frenetic leasing of several quarters ago. As the time to lease up newly constructed space increases, a few owners are realizing that they need to raise tenant improvement allowances to induce tenants to move. Some owners are being more aggressive than others – a few are increasing rent abatements to fill big blocks of space now before market conditions change any more. Relocating tenants face the added costs associated with relocation and build-out. Construction costs have jumped by 15% over the last three years. Some landlords have increased tenant improvement allowances slightly but these adjustment do not go far enough to cover all of the construction costs, which routinely exceed $100/sf and higher. Some tenants will ultimately opt for renovating their existing facility. Companies such as Google and Facebook have the capacity to lease or "bank" extra space and lock in contractors while they renovate or build facilities, but most companies do not have this luxury.

Looking Forward

Barring a shock to the economy, or a major geopolitical event, conditions are not expected to change dramatically during 2017. Tenants can see some relief, though, as the competition for talent and space to house them will moderate a bit. The burst of development activity could very well coincide with a slowdown in the broader economy, despite excitement growing about potentially beneficial measures being considered by the new Trump Administration.

There seems to be sentiment that the next correction will be more of a soft landing, less of a sharp correction and more of a soft landing. Some see this year's moderation as healthy medicine that will help avert the development of a bubble – companies have been forced to make controlled adjustments to their expenditures. Of course, the phrase "this time will be different" brings back painful memories of how badly prognosticators miscalculated the last two corrections.

Map	Submarket	Total	Leasing Activity		Available SF			Availability Rate			Asking Rents Per SF		
		SF (1000's)	Last 12 Months	Net Absorp Last 12 Mos.	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**	2,934	114	17	243	7.5%	121	8.3%	1.4%	4.3%	$3.45	1.3%	$3.40
	Campbell/Los Gatos - Class A	509	2	9	18	30.7%	13	3.5%	0.8%	2.6%	$3.63	0.1%	$3.64
2	**Downtown San Jose**	9,030	619	306	1,054	3.1%	1,437	11.7%	0.3%	16.0%	$3.19	1.5%	$2.83
	Downtown San Jose - Class A	3,425	262	125	345	-8.7%	508	10.1%	-1.0%	14.8%	$3.34	4.0%	$3.05
3	**Milpitas**	2,765	487	-251	506	0.7%	500	18.3%	0.1%	17.9%	$1.85	-3.4%	$1.89
	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	N/A
4	**Morgan Hill/Gilroy**	691	39	4	5	-83.9%	35	0.7%	-3.8%	4.8%	$1.42	1.7%	$1.34
	Morgan Hill/Gilroy - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
5	**Mountain View/Los Altos**	7,027	468	-10	363	1.9%	134	5.2%	0.1%	1.9%	$5.29	-1.5%	$5.44
	Mountain View/Los Altos - Class A	1,123	122	5	152	N/A	0	13.5%	13.5%	0.0%	$5.06	19.1%	$5.62
6	**North San Jose**	11,290	1,050	-41	1,717	10.2%	1,884	15.2%	1.4%	17.2%	$2.94	-0.3%	$2.55
	North San Jose - Class A	4,607	623	70	761	1.2%	580	16.5%	0.2%	13.5%	$3.07	-1.5%	$2.95
7	**Palo Alto**	6,562	384	-63	258	37.5%	101	3.9%	1.0%	1.6%	$6.81	0.5%	$5.88
	Palo Alto - Class A	207	3	2	0	N/A	2	N/A	N/A	1.2%	N/A	N/A	$4.70
8	**Santa Clara**	12,536	773	284	1,423	2.3%	905	11.4%	0.3%	7.6%	$3.40	3.6%	$3.03
	Santa Clara - Class A	4,277	487	195	596	5.2%	242	13.9%	0.7%	6.3%	$3.76	1.6%	$3.58
9	**South San Jose**	3,715	218	238	229	-8.9%	275	6.2%	-0.8%	7.9%	$3.55	7.0%	$2.91
	South San Jose - Class A	282	18	0	51	N/A	51	18.2%	0.0%	18.3%	$4.39	0.6%	$4.00
10	**Sunnyvale/Cupertino**	13,701	1,051	1,520	402	2.7%	447	2.9%	0.0%	3.6%	$3.92	3.3%	$3.49
	Sunnyvale/Cupertino - Class A	7,312	766	982	71	N/A	166	1.0%	-0.1%	2.7%	$4.15	7.9%	$3.52
11	**Menlo Park**	4,795	228	216	278	-23.6%	215	5.8%	-1.8%	4.0%	$7.19	-0.8%	$4.76
	Menlo Park - Class A	1,288	150	236	52	-70.9%	19	4.0%	-9.8%	2.1%	$7.32	2.2%	$4.94
12	**Fremont**	2,122	129	-22	174	-15.3%	157	8.2%	-0.5%	7.9%	$1.95	14.9%	$1.54
	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	N/A
1-12	**Silicon Valley Total**	**77,168**	**5,588**	**2,199**	**6,652**	**-5.1%**	**6,225**	**8.6%**	**-0.5%**	**8.3%**	**$3.73**	**1.4%**	**$3.57**
	Silicon Valley Total - Class A	**23,028**	**2,561**	**1,624**	**2,047**	**1.6%**	**1,582**	**8.9%**	**0.0%**	**7.6%**	**$3.95**	**9.8%**	**$2.58**

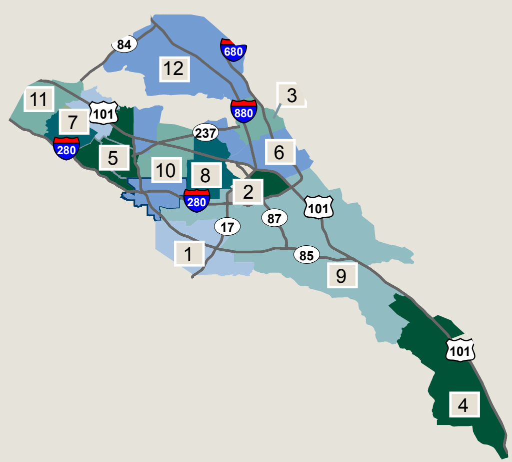
Please contact us for further information

Savills Studley
550 S. Winchester Blvd., Suite 600
San Jose, CA 95128
408-554-8855

Executive Managing Director
John Brady
jbrady@savills-studley.com
License 00580537

Savills Studley
705 High Street
Palo Alto, CA 94301
650-812-9800

Executive Managing Director
Mark Pearson
mpearson@savills-studley.com
License 00891920



(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.