YARDI® Matrix

Priced Out in San Jose?

Multifamily Fall Report 2016

Vacancies Low but Rent Growth Slows

Investors Seek Value-Add Opportunities

Developers Achieve Cyclical High

Market Analysis

Fall 2016

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Silicon Valley's Supercharged Demand

San Jose is at the heart of the most dynamic tech market in the world, and its real estate market lives and dies with the IT world. Solid employment over the past half decade has pushed the area's multifamily market to new highs, as rents have increased to the point where they are pricing out even the well-paid, highly skilled workforce that is the multifamily industry's prime target.

The information and professional and business services sectors are attracting workers to the area, prompting the need for a very dynamic market. Most major companies are in the process of full expansion, with Facebook recently completing a new campus, Apple edging closer to finishing its futuristic Apple Campus 2, and Google continuing to expand in Moutain View. Meanwhile, the upcoming expansion of the Bay Area Rapid Transit system has prompted investors and developers to direct attention to Milpitas.

With rents above the $2,600 mark and new inventory focused on the luxury segment, residents are being priced out of Silicon Valley. However, consistent employment growth and the ability to attract some of the strongest intellectual capital in the world are keeping demand at very high levels and vacancy rates below 4%. A 37,000-unit development pipeline is likely to moderate rent growth in the coming years, although absorption will remain very high. We expect rent growth to continue to decelerate throughout the year.

Recent San Jose Transactions

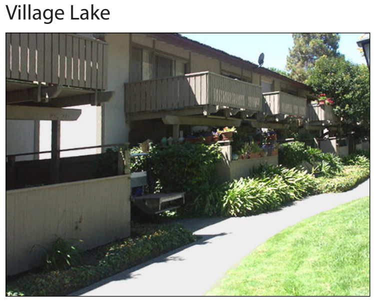
Waterstone

City: San Jose
Buyer: Grosvenor
Purchase Price: $160 MM
Price per Unit: $370,370

Avana Almaden

City: San Jose
Buyer: Greystar
Purchase Price: $151 MM
Price per Unit: $380,050

Village Lake



City: Moutain View, Calif.
Buyer: Tate, Ronald
Purchase Price: $145 MM
Price per Unit: $697,115

Avana Skyway

City: San Jose
Buyer: LivCor
Purchase Price: $124 MM
Price per Unit: $355,652

On the cover: Photo by Gerardo Brucker/iStockphoto.com

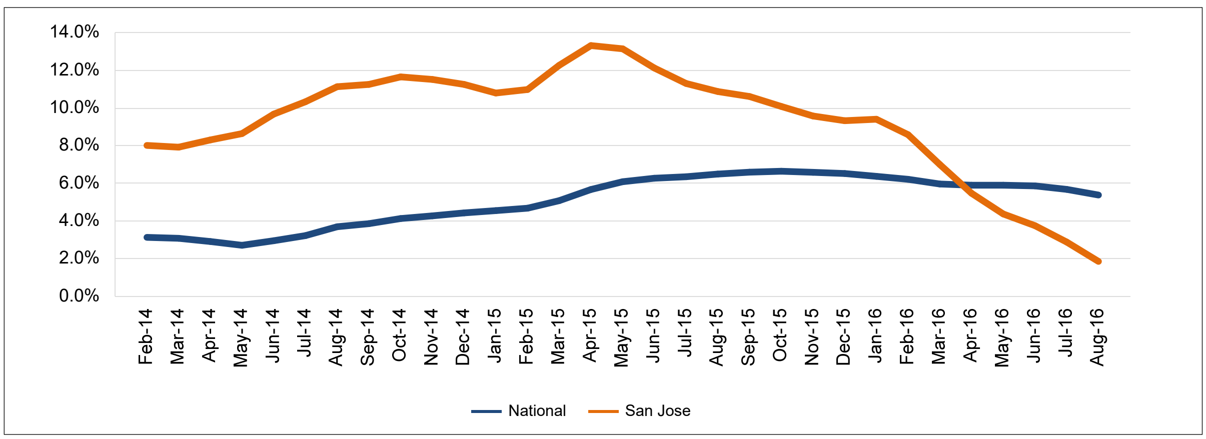
Rent Trends

- Rents in the South Bay rose by just 0.2% year-over-year through August, trailing the nation's 5% rate of growth. Average rents stood at $2,627 at the end of the summer, more than double the $1,220 national average. The rate of appreciation has dropped sharply since peaking near 14% in the spring of 2015, a sign that the market was overheated and tenants have been finding it difficult to pay ever-higher rents. Affordability is increasingly apparent, putting a damper on rent growth in Silicon Valley and the entire Bay Area.

- Rents in the Lifestyle segment contracted by 0.8% year-over-year to an average of $2,820. The downward trend is indicative of the state in which tech-driven rental markets find themselves. Upscale assets are losing momentum due to continued growth in supply during the current cycle, while pricing is still prohibitive for the majority of renters. Renter-by-Necessity assets claimed 1% higher rents for an average of $2,511, meaning that the gap between asset classes is closing rapidly. Although demand remains very high in San Jose, a slew of record-breaking years in terms of completions, as well as a 37,000-unit pipeline, will continue to moderate rent growth.

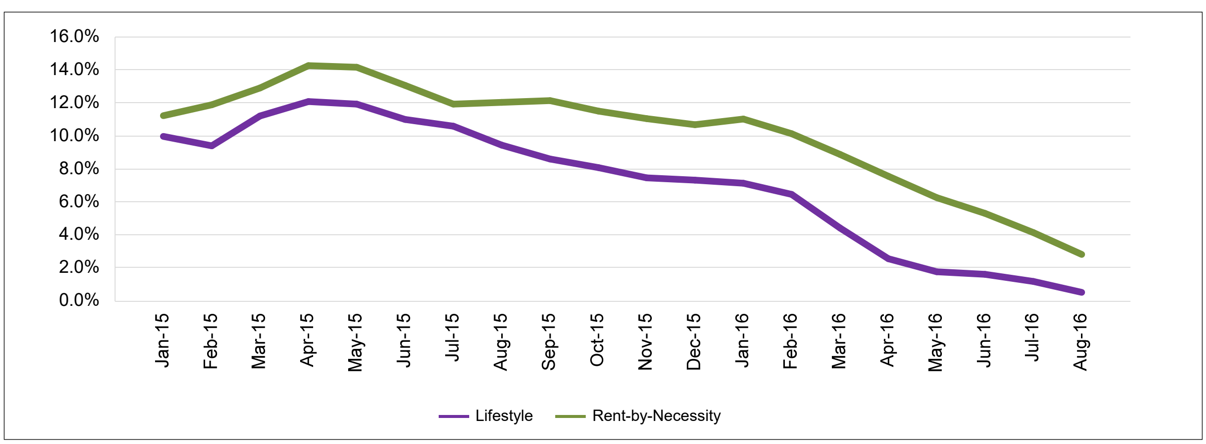
- Submarkets that led the way in rent growth were Palto Alto-Stanford (11.1%), East San Jose (8.9%), Morgan Hill (7.4%) and Sunnyvale (4.9%). During the past year, Palo Alto-Stanford's average rent crossed the $4,000 mark, ending August at $4,350, $433 more than it was at the same point in 2015.

San Jose vs. National Rent Growth (Sequential 3 Month, Year-Over-Year)



Source: YardiMatrix

San Jose Rent Growth by Asset Class (Sequential 3 Month, Year-Over-Year)

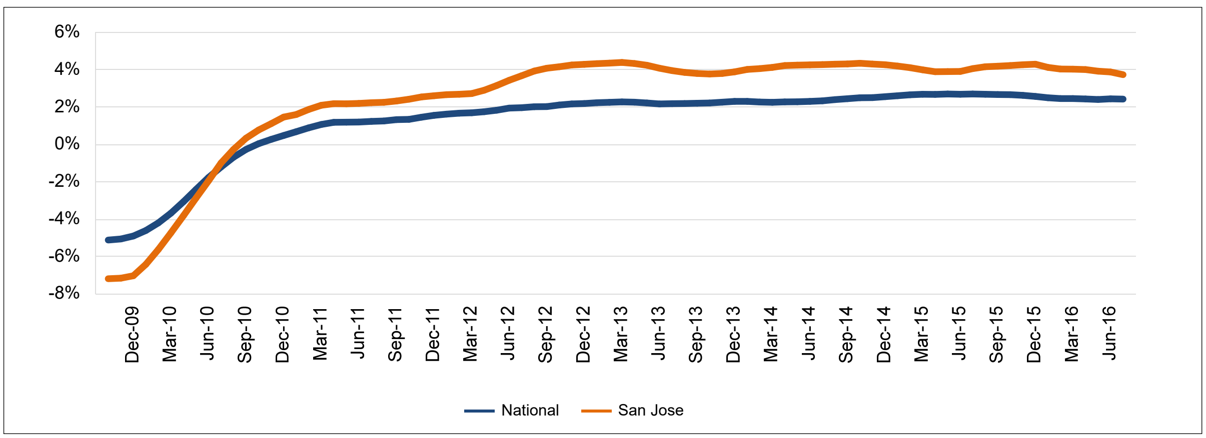


Source: YardiMatrix

Economic Snapshot

- San Jose added 31,500 jobs during the 12 months ending in July 2016, a 3% increase and 60 basis points above the national average. Capital continues to flock to Silicon Valley, leading employment to grow in most economic sectors. Activity in the South Bay is mostly centered in the upper tier of the economy, with incomes growing at a consistent pace and unemployment trending toward 4%.
- Information and professional and business services added more than 15,000 jobs as major tech companies continued to expand. Education and health services also improved, rising by 8,700 jobs, or 5.6% year-over-year. Stanford University, an institution that had a $22.2 billion endowment as of 2015, continues to provide a solid yearly influx of highly skilled professionals and startup growth.
- Due to historic highs in completions and a bustling development pipeline, construction jobs are up by 2,900 jobs, a 6.5% growth rate year-over-year. Although housing stock is expanding at unprecented levels, the strong employment market has kept demand high, and will keep pushing construction jobs further.
- The continued expansion of the tech sector has increased absorption in the office market, pushing the vacancy rate below 6%, which is among the lowest in the nation, according to Colliers. The high concentration of startups and IT companies has led venture capitalists to ramp up activity in the area, resulting in over $13 billion being raised during 1Q16 alone.

San Jose vs. National Employment Growth (Year-Over-Year)



Sources: YardiMatrix, Bureau of Labor Statistics (not seasonally adjusted)

San Jose Employment Growth by Sector (Year-Over-Year)

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
60	Professional and Business Services	232	21.6%	12,300	5.6%
65	Education and Health Services	164	15.2%	8,700	5.6%
70	Leisure and Hospitality	103	9.6%	5,600	5.7%
15	Mining, Logging and Construction	48	4.5%	2,900	6.5%
50	Information	81	7.5%	2,900	3.7%
40	Trade, Transportation and Utilities	140	13%	1,200	0.9%
80	Other Services	28	2.6%	100	0.4%
55	Financial Activities	35	3.3%	-500	-1.4%
90	Government	83	7.7%	-500	-0.6%
30	Manufacturing	163	15.1%	-1,200	-0.7%

Sources: YardiMatrix, Bureau of Labor Statistics

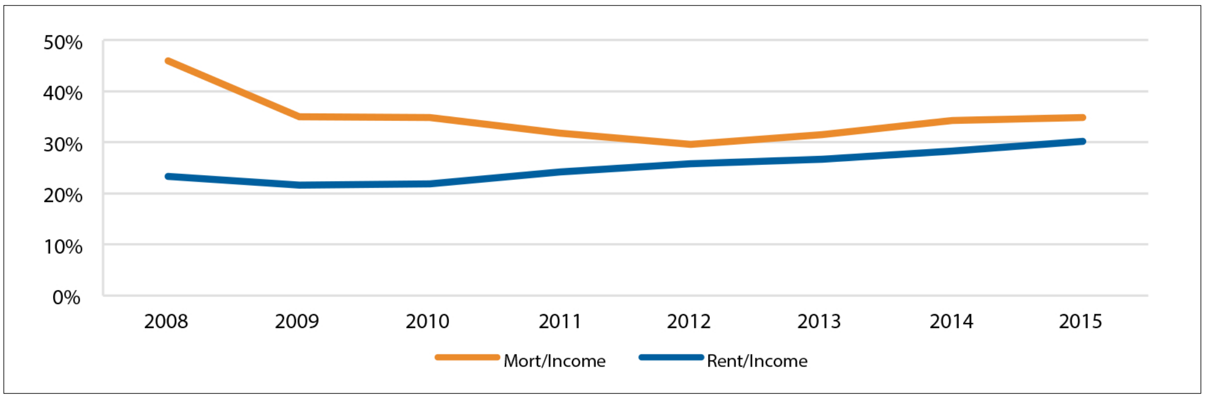
Demographics

Affordability

- San Jose's tech-dominant economic profile means that a large part of the workforce opts to rent rather than own. This trend has pushed rental rates to $2,627 at the end of August, 31% higher than they were at the same point in 2012. Although wages are among the highest in the nation, rents still comprise more than a third of incomes, making renting the costlier, albeit more common, option. Meanwhile, mortgages cost roughly 30% of incomes, with median home values skyrocketing to $786,652 in 2015.

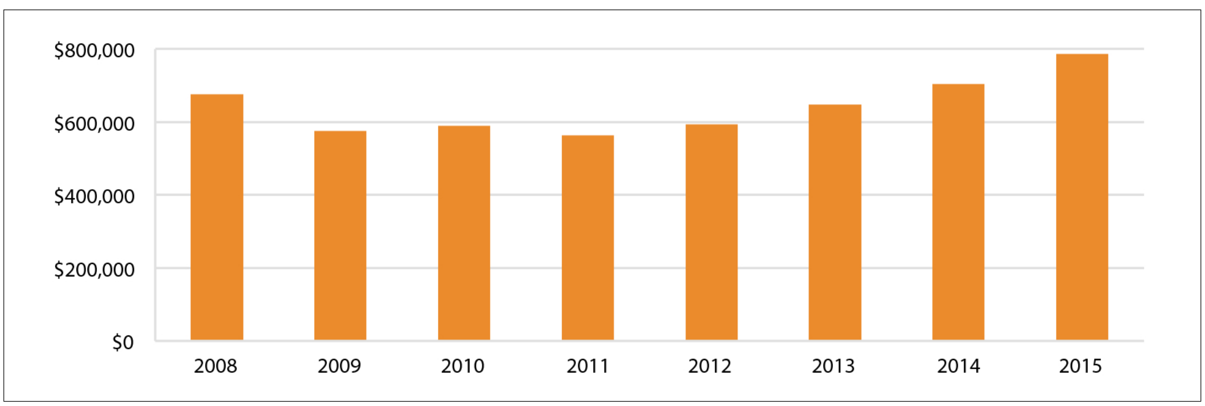
- Lack of affordability is a well-documented issue in the South Bay, and with only 500 affordable units set to come online in 2016, the issue doesn't seem set to change. Developers continue to focus on the top tier of the housing market.

San Jose Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

San Jose Median Home Price



Source: Moody's Analytics

Population

- San Jose's population has grown by 5.7% since 2011, prompting accelerated development and rising rents.

- High demand for a very skilled workforce continues to drive population growth.

San Jose vs. National Population

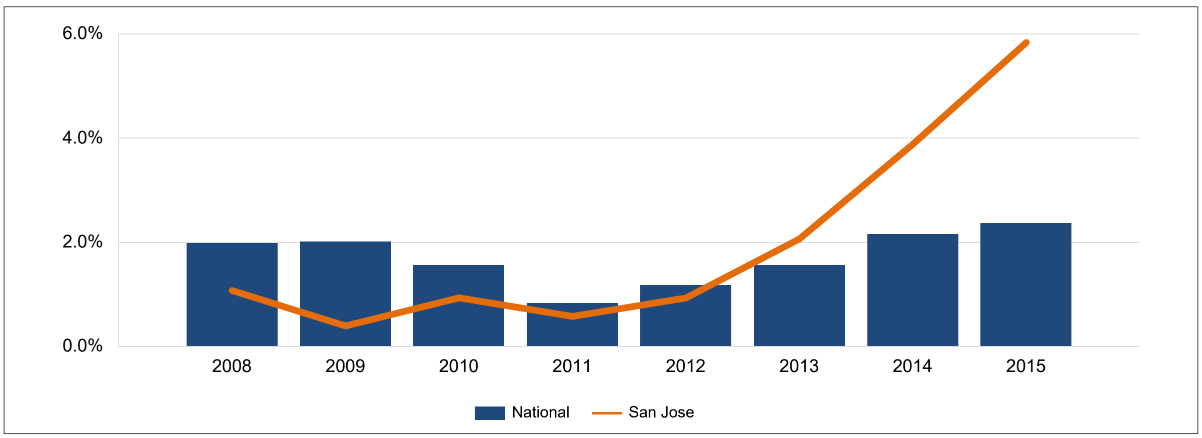
	2011	2012	2013	2014	2015
National	311,718,857	314,102,623	316,427,395	318,907,401	321,418,820
San Jose-Sunnyvale-Santa Clara, CA Metropolitan Statistical Area	1,870,402	1,898,203	1,928,745	1,954,348	1,976,836

Sources: U.S. Census, Moody's Analytics

Supply

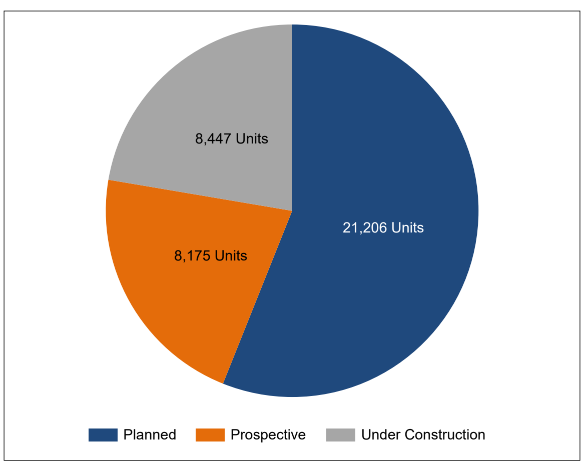
- San Jose reached a new cyclical high for inventory expansion in 2015, with the 6,665 additional units increasing housing stock by 5.8%, 340 basis points higher than the 2.4% national rate. The pace of development has quickened since 2012, when the rate hovered around the 1% mark, and vacancy rates remain high. But demand is strong, making developers increasingly bullish on the market during the second half of the cycle.
- A robust development pipeline totaling more than 37,000 units is meant to serve some of the accelerated demand. Of those units, roughly a quarter are under construction and more than half are already through the permitting stage. As a large segment of the area's workforce is prone to rent, developers continue to set up new projects to satisfy demand. Increased development activity in San Jose is likely to attract residents to submarkets along the metro's fringes. With a BART expansion set for Milpitas, developer interest may shift to the area as it becomes part of the Bay Area's commuting circuit.
- Developers are focusing their attention on the city of San Jose, where roughly 2,800 units are now under construction, while 2,400 are underway in Santa Clara and Sunnyvale.

San Jose vs. National Completions as a Percentage of Total Stock (as of August 2016)



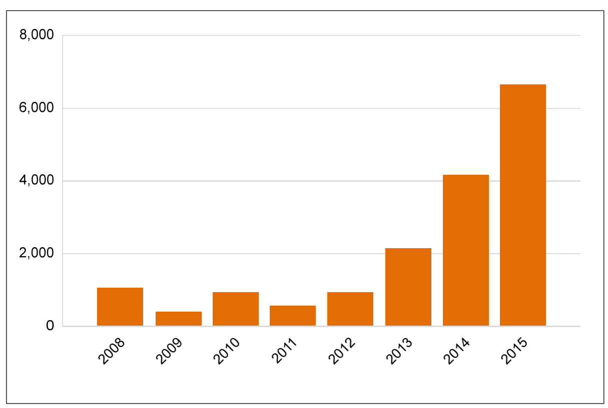
Source: YardiMatrix

Development Pipeline (as of August 2016)



Source: YardiMatrix

San Jose Completions (as of August 2016)

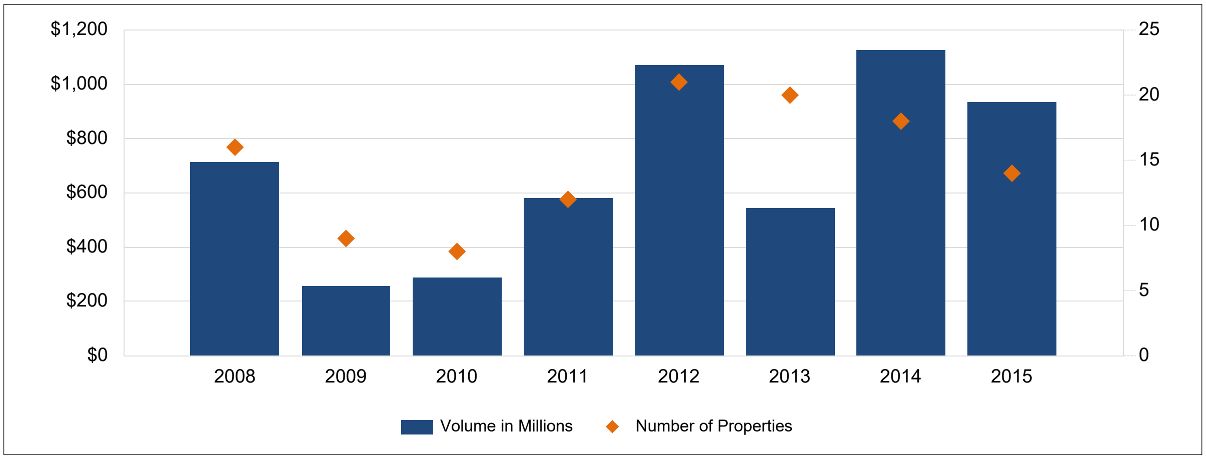


Source: YardiMatrix

Transactions

- San Jose and Silicon Valley have had a considerable amount of investor interest during the past few years, as more than $3.6 billion worth of multifamily assets have changed hands between 2012 and 2015. Through August, total investment volume in 2016 was at $540 million. Many investors are looking for value-add opportunities.
- Per-unit prices ended 2015 at $319,641, more than double the national average of $117,358. Year-to-date, the per-unit price has climbed to $352,445 leading the cost of entry to unprecedented levels.
- In the 12 months ending in August, the most sought-after submarkets were Far South San Jose ($434 million), Mountain View - Los Altos ($254 million) and Milpitas ($148 million). The most substantial transaction completed was Grosvenor's $160 million purchase of the Waterstone community in Far South San Jose.

San Jose Sales Volume and Number of Properties Sold (as of August 2016)



Source: YardiMatrix

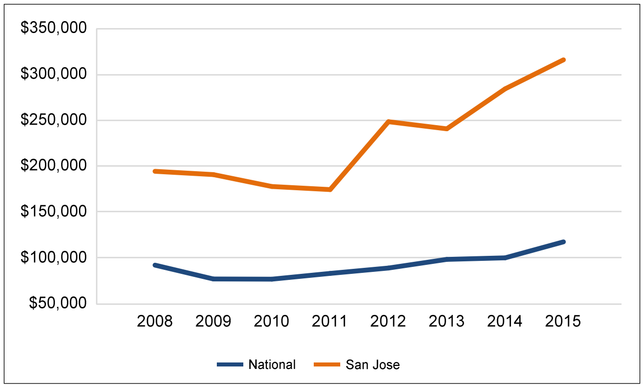
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Far South San Jose	434
Mountain View-Los Altos	254
Milpitas	148
Campbell	100
North San Jose	93
Central San Jose	81
Sunnyvale	46
Central San Jose West	22

Source: YardiMatrix

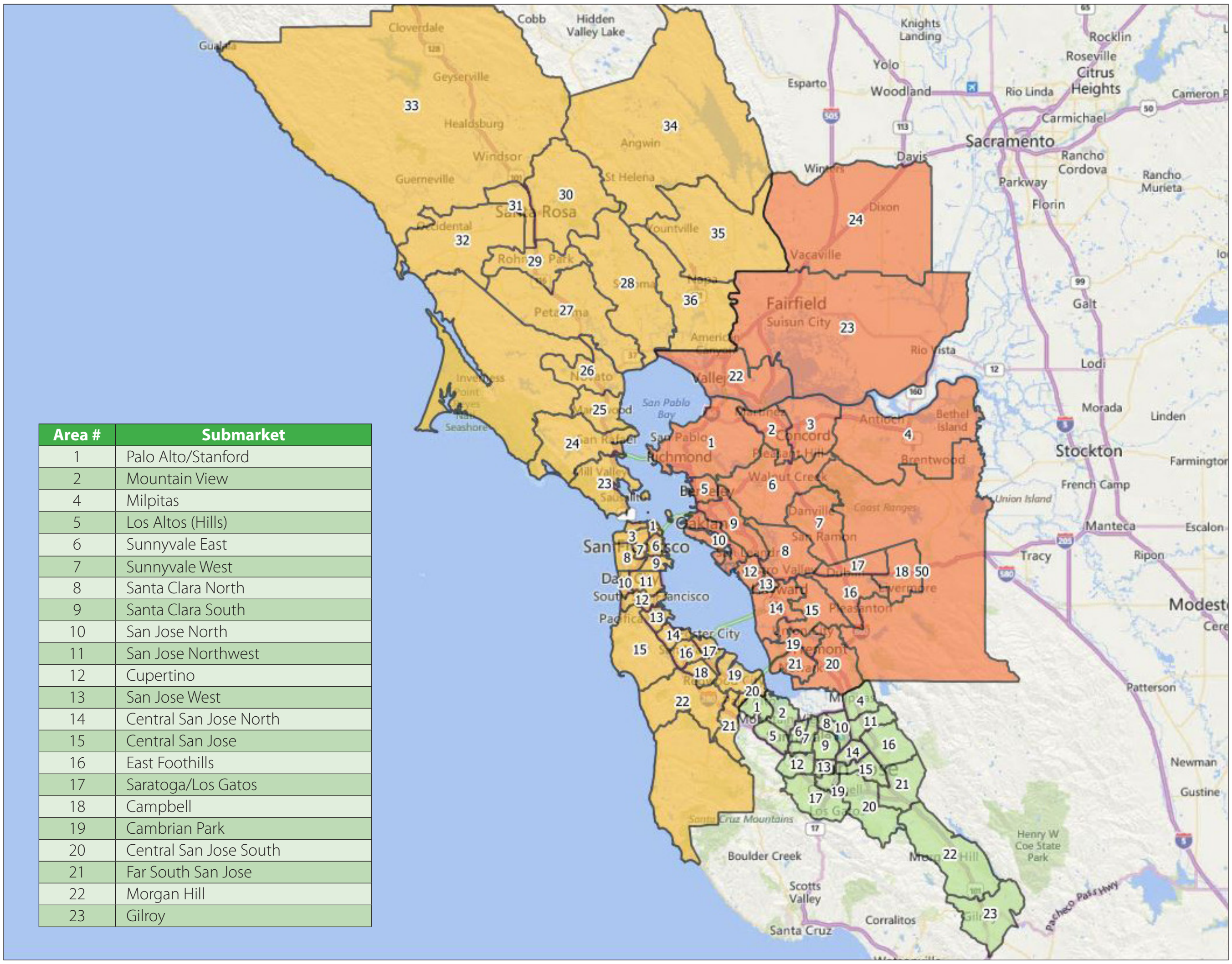
[1] From September 2015 to August 2016

San Jose vs. National Sales Price per Unit



Source: YardiMatrix

San Jose City Submarkets



Area #	Submarket
1	Palo Alto/Stanford
2	Mountain View
4	Milpitas
5	Los Altos (Hills)
6	Sunnyvale East
7	Sunnyvale West
8	Santa Clara North
9	Santa Clara South
10	San Jose North
11	San Jose Northwest
12	Cupertino
13	San Jose West
14	Central San Jose North
15	Central San Jose
16	East Foothills
17	Saratoga/Los Gatos
18	Campbell
19	Cambrian Park
20	Central San Jose South
21	Far South San Jose
22	Morgan Hill
23	Gilroy

Learn the latest about the state of these markets. Download our San Francisco Report.

Area #	Submarket
1	Northeast San Francisco
2	Northwest San Francisco
3	Golden Gate Park
4	Market Street
5	China Basin
6	Eastern San Francisco
7	Central San Francisco
8	Southwest San Francisco
9	Southeast San Francisco
10	Broadmoor/Daly City
11	Colma/Brisbane
12	South San Francisco
13	Millbrae
14	Burlingame
15	Moss Beach
16	San Mateo
17	Foster City
18	Belmont/San Carlos

Area #	Submarket
19	Redwood City
20	East Palo Alto
21	Atherton/Portola
22	Woodside
23	Tiburon/Sausalito
24	San Rafael
25	Lucas Valley
26	Novato
27	Petaluma
28	Sonoma
29	Rohnert Park
30	Santa Rosa
31	Roseland
32	Sebastapol
33	Northern Marin County
34	Deer Park/St. Helena
35	Napa North
36	Napa South

Area #	Submarket
1	NW Contra Costa (Richmond)
2	Pleasant Hill/Martinez
3	Concord
4	Antioch/Oakley
5	Berkeley
6	Walnut Creek/LaFayette
7	San Ramon/Danville
8	Castro Valley
9	Oakland East
10	Oakland West
11	Alameda
12	San Leandro
13	San Lorenzo

Area #	Submarket
14	Hayward
15	Union City
16	Pleasanton
17	Dublin
18	Livermore
19	Fremont East
20	Fremont West
21	Newark
22	Vallejo/Benicia
23	Fairfield
24	Vacaville
50	East Bay

Definitions

Lifestyle households (renters by choice) have wealth sufficient to own but have chosen to rent. Discretionary households, most typically a retired couple or single professional, have chosen the flexibility associated with renting over the obligations of ownership.

Renter by Necessity households span a range. In descending order, household types can be:

- *A young-professional, double-income-no-kids household* with substantial income but without wealth needed to acquire a home or condominium;
- *Students*, who also may span a range of income capability, extending from affluent to barely getting by;
- *Lower-middle-income ("gray collar") households,* composed of office workers, policemen, firemen, technical workers, teachers, etc.;
- *Blue-collar households*, which may barely meet rent demands each month and likely pay a disproportionate share of their income toward rent;
- *Subsidized households*, which pay a percentage of household income in rent, with the balance of rent paid through a governmental agency subsidy. Subsidized households, while typically low income, may extend to middle-income households in some high-cost markets, such as New York City;
- *Military households*, subject to frequency of relocation.

These differences can weigh heavily in determining a property's ability to attract specific renter market segments. The five-star resort serves a very different market than the down-and-outer motel. Apartments are distinguished similarly, but distinctions are often not clearly definitive without investigation. The Yardi® Matrix Context rating eliminates that requirement, designating property market positions as:

Market Position	Improvements Ratings
Discretionary	A+ / A
High Mid-Range	A- / B+
Low Mid-Range	B / B-
Workforce	C+ / C / C- / D

The value in application of the Yardi® Matrix Context rating is that standardized data provides consistency; information is more meaningful because there is less uncertainty. The user can move faster and more efficiently, with more accurate end results.

The Yardi® Matrix Context rating is not intended as a final word concerning a property's status—either improvements or location. Rather, the result provides reasonable consistency for comparing one property with another through reference to a consistently applied standard.

To learn more about Yardi® Matrix and subscribing, please visit www.yardimatrix.com or call Ron Brock, Jr., at 480-663-1149 x2404.