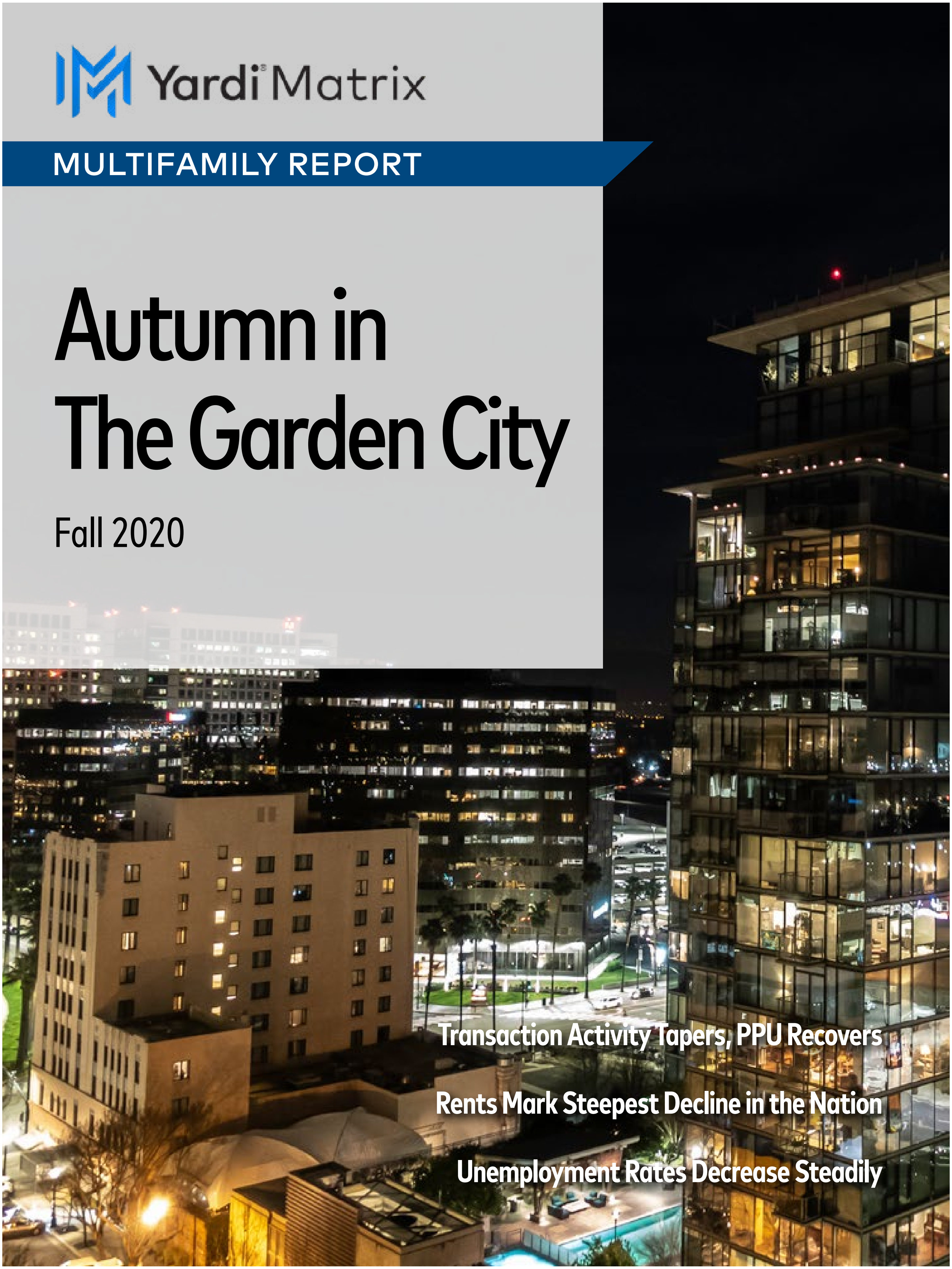
Yardi Matrix

MULTIFAMILY REPORT

Autumn in The Garden City

Fall 2020



Transaction Activity Tapers, PPU Recovers

Rents Mark Steepest Decline in the Nation

Unemployment Rates Decrease Steadily

Yardi Matrix

Resetting the Rental Market

While fueled by one of the strongest economies, the recovery of San Jose's multifamily industry has stalled. The California city posted the steepest rent drop among major U.S. metros, down 1.1% to $2,737 on a trailing three-month basis through September, while the U.S. average rose for the second-consecutive month to $1,463. The occupancy rate in stabilized properties reflected lackluster demand, down 160 basis points to 94.2% year-over-year as of August.

The unemployment rate dropped to 9.5% in July from 12.0% in April, with preliminary data for August pointing to 7.6%. Unemployment claims filed across the state surpassed 8.8 million between mid-March and early October. Meanwhile, the employment market marked its fourth-consecutive month of contractions, declining 6.3% year-over-year through July. Its main economic driver—professional and business services—shrunk by only 3.2%. Despite elevated uncertainty about employees' return to the office, projects remain underway or in the planning stages, including the Adobe North Tower and Google's Downtown West development.

Developers had brought 1,515 units online by September and had another 11,333 underway. Meanwhile, transaction activity dwindled to a total of $554 million, for a price per unit that rose 11.9% to $535,977. Accounting for current circumstances, Yardi Matrix expects rents to depreciate 6.9% in 2020.

Market Analysis | Fall 2020

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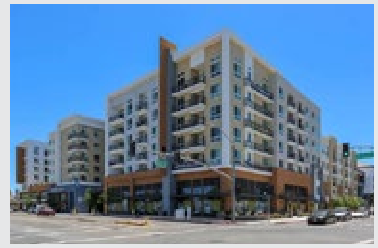
Recent San Jose Transactions

808 West

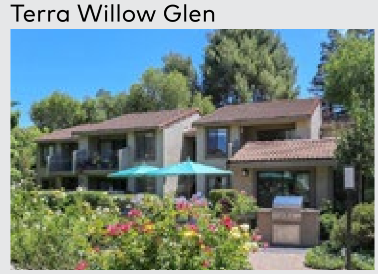


City: San Jose, Calif.
Buyer: Northwestern Mutual Real Estate Investors
Purchase Price: $184 MM
Price per Unit: $584,127

Gardens of Fountainbleu

City: Cupertino, Calif.
Buyer: Prometheus Real Estate Group
Purchase Price: $70 MM
Price per Unit: $569,106

Terra Willow Glen



City: San Jose, Calif.
Buyer: Stanford Properties
Purchase Price: $51 MM
Price per Unit: $455,357

Willow Pond

City: Sunnyvale, Calif.
Buyer: Prometheus Real Estate Group
Purchase Price: $17 MM
Price per Unit: $312,727

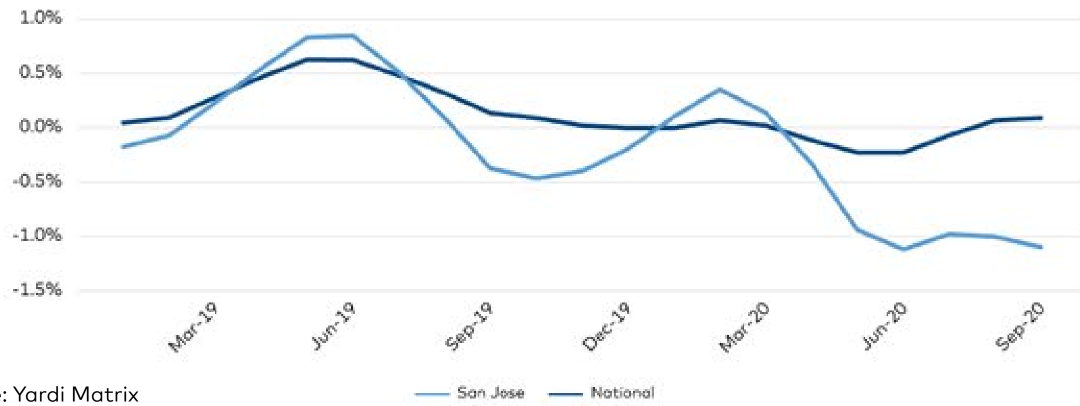
RENT TRENDS

- The average rent decreased 1.1% to $2,737 on a trailing three-month basis through September, while the national average appreciated 0.1% to $1,463. San Jose rents posted the largest decline among major metros at the end of the third quarter. In recent years, rent growth in the metro has followed a seasonal pattern by recording a negative change at the end of the third or beginning of the fourth quarter, and rebounding by the middle of the first quarter of the following year.

- Rent deceleration was even across the quality spectrum, with both working-class Renter-by-Necessity and Lifestyle rents contracting by 1.1% on a trailing three-month basis through September to $2,529 and $2,939, respectively. Weakening demand for housing was also reflected in the occupancy rate in stabilized properties–the metric was down 160 basis points year-over-year through August, to 94.2%.

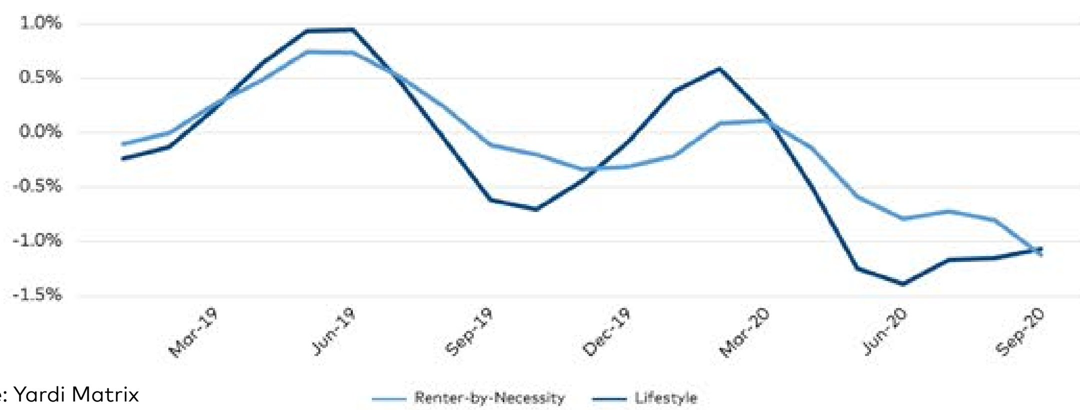
- The submarkets with the highest average rents were also those that marked the steepest declines–Palo Alto-Stanford (down 10.2% to $3,443), Cupertino (down 9.6% to $3,014) and Mountain View-Los Altos (down 9.1% to $3,021). Only three submarkets posted increases, with all three located along South Valley Freeway-Gilroy ($2,219), Morgan Hill ($2,496) and San Benito County ($1,511).

San Jose vs. National Rent Growth (Trailing 3 Months)



Source: Yardi Matrix

San Jose Rent Growth by Asset Class (Trailing 3 Months)



Source: Yardi Matrix

ECONOMIC SNAPSHOT

- The unemployment rate in San Jose decreased steadily to 9.5% in July, down from its all-time high of 12.0% registered in April. August preliminary data—posted at 7.6%—pointed to sustained recovery. The number of unemployment claims rose substantially, surpassing 8.8 million between mid-March and early October. This prompted officials on Sept. 20 to take a two-week pause from processing new applications.

- Employment growth entered its fourth-consecutive month of year-over-year contraction in July, down 6.3% and faring slightly better than the -6.6% U.S. rate. The job market has some caveats, as less than one-fifth of San Jose's employment is made up of high-risk sectors. Its main economic driver—professional and business services—shrunk by 3.2% in the year ending in July. everal projects are underway or in the planning stages, including the Adobe North Tower, Boston Properties' Platform 16, Google's Downtown West development and Woz Way Offices. The transportation sector lost 9.1% of jobs, but the newly opened BART stations will likely add to the long-term benefits of the metro.

- In Gov. Gavin Newsom's reopening plan, which groups counties in four tiers based on the level of risk, San Jose falls in the second tier, with some nonessential indoor businesses still closed.

San Jose Employment Share by Sector

		Current Employment	
Code	Employment Sector	(000)	% Share
55	Financial Activities	37	3.5%
15	Mining, Logging and Construction	51	4.8%
90	Government	86	8.2%
80	Other Services	24	2.3%
65	Education and Health Services	166	15.7%
30	Manufacturing	166	15.7%
60	Professional and Business Services	238	22.6%
50	Information	93	8.8%
40	Trade, Transportation and Utilities	119	11.3%
70	Leisure and Hospitality	75	7.1%

Sources: Yardi Matrix, Bureau of Labor Statistics

Population

- San Jose's population dwindled by 0.4%, or 8,447 residents, in 2019. In 2018, the metro added 5,525 residents.

- Nationally, the rate of population growth stood at 0.3% last year.

San Jose vs. National Population

	2016	2017	2018	2019
National	323,071,342	325,147,121	327,167,434	328,239,523
San Jose Metro	1,988,816	1,993,582	1,999,107	1,990,660

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

SUPPLY

- The development pipeline counted some 11,333 units underway as of September, more than 4,500 of which were slated for completion by the end of the year. Another 59,500 units were in the planning and permitting stages. While its tech-heavy economy keeps the construction sector up and running, timeline delays are expected across projects due to ongoing economic volatility.

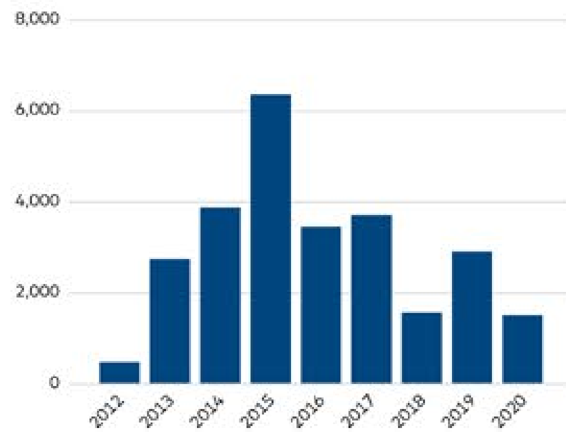
- The first three quarters of the year brought 1,515 new rental units in 10 properties to San Jose's inventory, all in the Lifestyle segment. Deliveries represented 1.2% of total stock, registering 40 basis points below the U.S. rate.

- Developers remained focused on upscale projects, as the pipeline–which consists of 36 properties–includes 32 Lifestyle developments. The remaining four are fully affordable communities that amount to 332 units.

- Attention to affordable housing is rising, with local officials recently introducing a strategy meant to protect low-income residents from displacement. A recent study released by the Law Foundation of Silicon Valley and Working Partnerships USA estimated that 43,000 renter households in Santa Clara County were at risk of eviction.

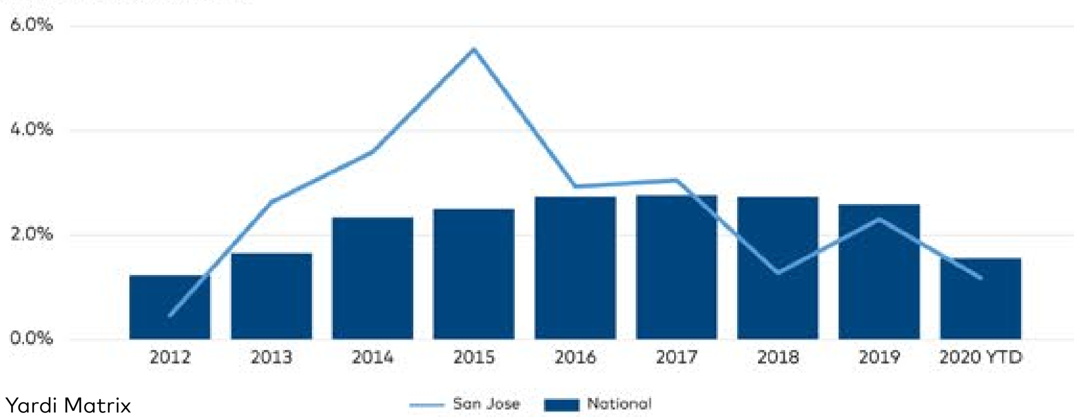
- Development activity was most intense in four submarkets, which accounted for nearly three-quarters of the pipeline. The top two had more than 2,000 units underway as of September–Central San Jose (2,390 units) and Santa Clara (2,202 units).

San Jose Completions (as of September 2020)



Source: Yardi Matrix

San Jose vs. National Completions as a Percentage of Total Stock (as of September 2020)

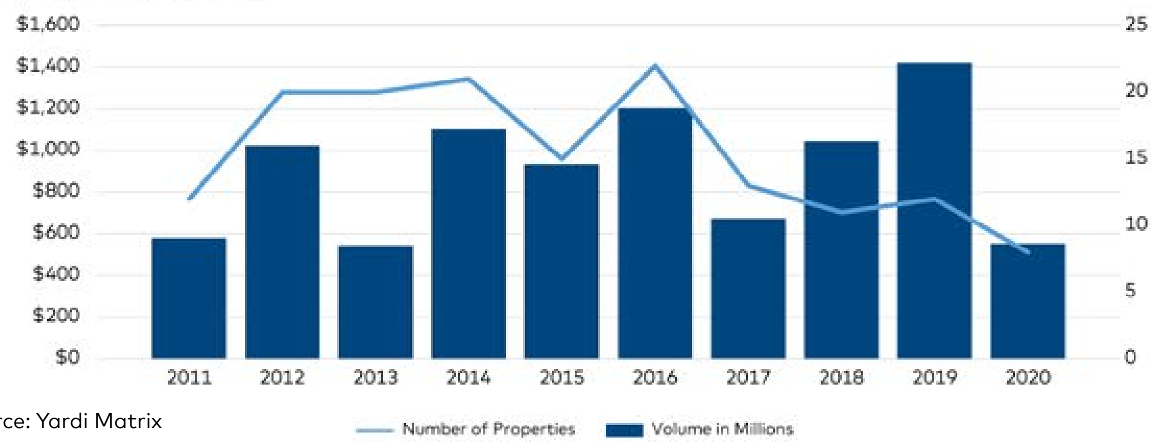


Source: Yardi Matrix

TRANSACTIONS

- Through September, $554 million in multifamily assets traded in the metro, 11.2% below the volume registered last year during the first three quarters. In the fourth quarter of 2019, deals spiked and transactions surpassed the total of the first three quarters combined, but a similar move is unlikely to be replicated this year, as economic uncertainty persists.
- Even though five of the eight properties that changed ownership were in the Renter-by-Necessity segment, the price per unit increased 11.9% to $535,977. Meanwhile, the national average slid 3.0% to $163,150.
- One of the most active investors in the metro was Prometheus Real Estate Group. The local company spent $87 million on two assets–Gardens of Fountainbleau in March for $569,106 per unit, and Willow Pond in September for $312,727 per unit.

San Jose Sales Volume and Number of Properties Sold (as of September 2020)



Source: Yardi Matrix

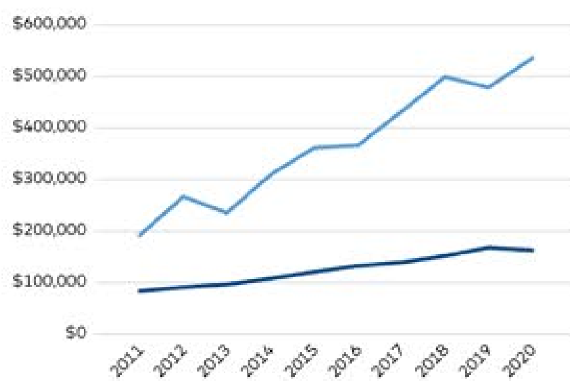
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Far South San Jose	339
Mountain View-Los Altos	292
Central San Jose West	292
Central San Jose	175
East San Jose	104
Cupertino	70
Milpitas	62

Source: Yardi Matrix

[1] From October 2019 to September 2020

San Jose vs. National Sales Price per Unit



Source: Yardi Matrix

EXECUTIVE INSIGHTS

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MULTI-HOUSING NEWS

What San Jose Investors Are Looking for Now

By Evelyn Jozsa

San Jose's multifamily market has been fueled by one of the strongest economies in the country. Nonetheless, the COVID-19 crisis has pushed residents to look for more affordable housing options, shifting buyer interest from luxury apartments toward value-add properties. Levin Johnston's Adam Levin and Robert Johnston examine how investor sentiment and market fundamentals have changed since the onset of the pandemic.

Which aspect of San Jose's multifamily sector has been most affected by the health crisis?

Johnston: The health and economic crisis caused by COVID-19 has affected the luxury apartment sector far more than the value-add sector in San Jose. We have seen that spacious, garden-style, Class B and C properties—where value creation is possible—have maintained some of the highest occupancies.

What type of properties are buyers looking for now?

Levin: Astute and seasoned investors recognize that this period of slowed activity and record-low interest rates provides numerous new opportunities for growth for those who know where to look and have trusted advisers on their side. The opportunity to acquire solid properties at a discount is greater when there is economic uncertainty, and smart investors use times like these to fill out their portfolios with potentially high-performing assets in growth markets like San Jose.

Adam Levin *(left)* and Robert Johnston *(right)*

To what extent is San Jose's tech-anchored economy providing insulation for the metro's multifamily market?

Johnston: Tech markets like San Jose have traditionally fared well in our increasingly tech-oriented society. While some tech companies did experience layoffs as a result of COVID-19, others—like Amazon—added to their teams.

During the pandemic, our collective reliance on digital communication and online shopping have benefited businesses that specialize in those areas, and this has held true in San Jose as in other tech markets throughout the country.

How does the San Jose multifamily investment environment compare to other markets in the Bay Area?

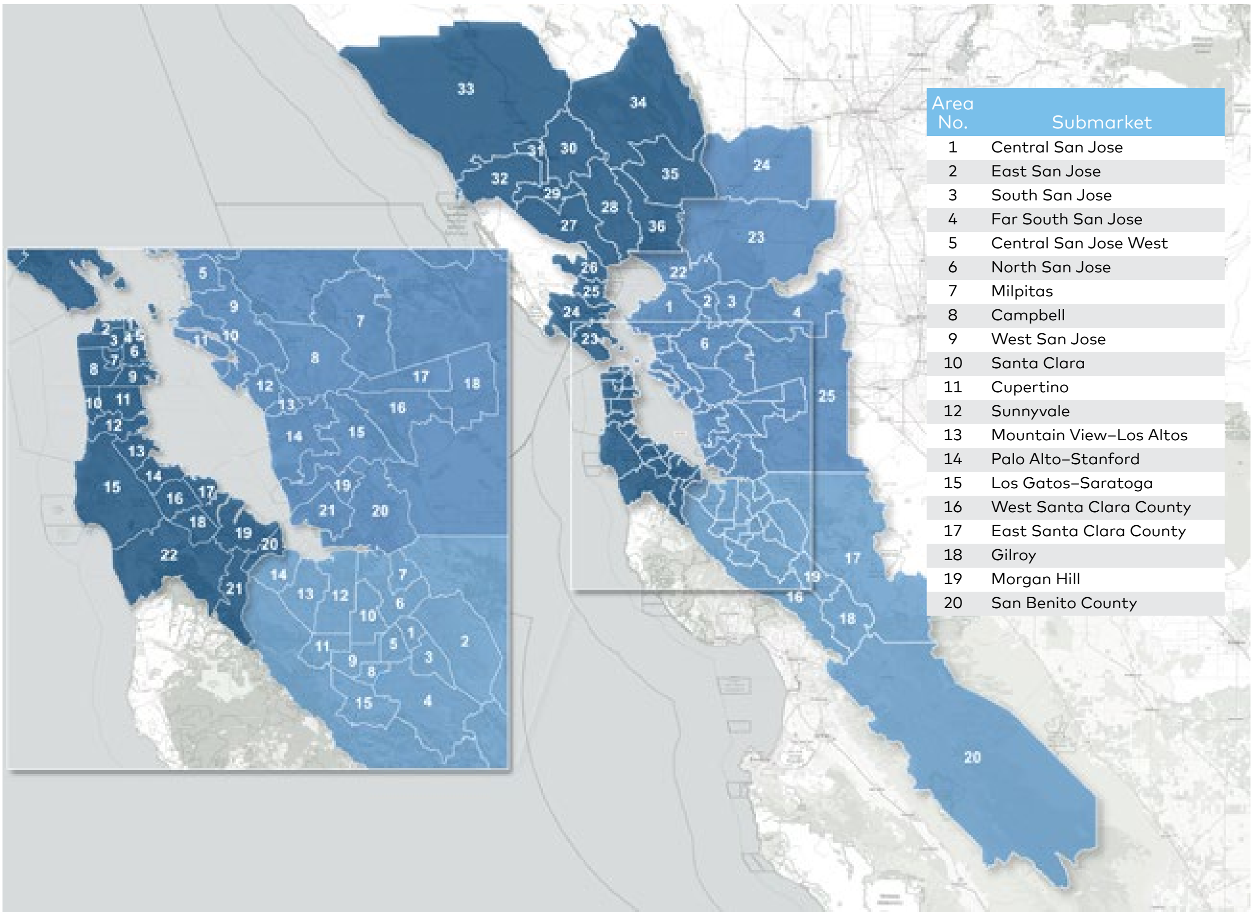
Levin: San Jose enjoys spillover from San Francisco and other Bay Area markets in both multifamily renters and investors. Buyers seek out opportunities to own or invest in apartment communities in San Jose where—like other parts of the South and East bay areas—rents have remained relatively stable, and leasing concerns caused by COVID-19 are more short-lived.

What types of properties would you consider risky investments in upcoming quarters?

Levin: Luxury communities are facing the greatest challenges. This is likely because luxury renters were better equipped financially than middle-income renters to relocate elsewhere or downgrade if necessary, during the pandemic. COVID-19 will pass and as business returns to normal, fundamentals will continue to improve.

(Read the complete interview on multihousingnews.com.)

SAN JOSE SUBMARKETS



Area No.	Submarket
1	Central San Jose
2	East San Jose
3	South San Jose
4	Far South San Jose
5	Central San Jose West
6	North San Jose
7	Milpitas
8	Campbell
9	West San Jose
10	Santa Clara
11	Cupertino
12	Sunnyvale
13	Mountain View–Los Altos
14	Palo Alto–Stanford
15	Los Gatos–Saratoga
16	West Santa Clara County
17	East Santa Clara County
18	Gilroy
19	Morgan Hill
20	San Benito County

Area No.	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/Airport
14	Burlingame
15	Moss Beach
16	San Mateo
17	Foster City
18	Belmont/San Carlos

Area No.	Submarket
19	Redwood City
20	Menlo Park/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	Sebastopol
33	Northern Sonoma County
34	Deer Park/St. Helena
35	Napa North
36	Napa South

Area No.	Submarket
1	Richmond
2	Pleasant Hill/Martinez
3	Concord
4	Antioch/Oakley
5	Berkeley
6	Walnut Creek/Lafayette
7	San Ramon–West/Danville
8	Castro Valley
9	Oakland East/Oakland Hills
10	Downtown Oakland
11	Alameda
12	San Leandro
13	San Lorenzo

Area No.	Submarket
14	Hayward
15	Union City
16	Pleasanton
17	Dublin
18	Livermore
19	West Fremont
20	East Fremont
21	Newark
22	Vallejo/Benicia
23	Fairfield
24	Vacaville
25	San Ramon–East

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 September 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 September 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, September 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.