

YARDI[®] Matrix

San Jose: Peak Market, Weak Appreciation

Multifamily Winter Report 2017

**Rent Growth
Decelerates**

**Affordability
Under Pressure**

**Tech Sector
Sustains Appeal**

Market Analysis

Winter 2017

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Affordability Cuts Into Rent Growth

Silicon Valley remains the largest technology hub in the nation and the anchor of the Bay Area. The area continues to thrive as one of the nation's most attractive markets for businesses to operate and as a destination for Millennials. However, after a huge run-up from 2014-15, rent growth is taking a time out, as the market is becoming unaffordable for its target demographic.

A diverse range of industries are fueling employment growth—among them professional and business services; education and health; and construction. The professional and business services segment continues to dominate the job growth in the metro, having made 14,500 new hires during the 12 months ending in November 2016. With large companies such as Google, Samsung, Toshiba, Apple and Facebook expanding their footprints and adding jobs, developers are keeping themselves busy, due to strong demand for multifamily units. Related Cos. received approval for City Place, at \$6.5 billion the largest development plan in Silicon Valley's history.

Multifamily development will stay robust in 2017. Approximately 40,000 units are in the pipeline, about 6,600 of which are expected to come online in 2017. Despite strong demand, the metro needs to tackle its affordability problem, a feat which may not be possible until strict construction guidelines begin to ease. Therefore, Yardi Matrix expects moderate rent growth in 2017.

Recent San Jose Transactions

Avana Almaden



City: San Jose, Calif.
Buyer: Greystar
Purchase Price: \$150.5 MM
Price per Unit: \$380,051

The Grove



City: San Jose, Calif.
Buyer: TIAA
Purchase Price: \$95.5 MM
Price per Unit: \$288,520

Domus on the Boulevard



City: Mountain View, Calif.
Buyer: Pacific Urban Residential
Purchase Price: \$76.82 MM
Price per Unit: \$398,052

Sofi Berryessa



City: San Jose, Calif.
Buyer: Pacific Urban Residential
Purchase Price: \$55.5 MM
Price per Unit: \$330,357

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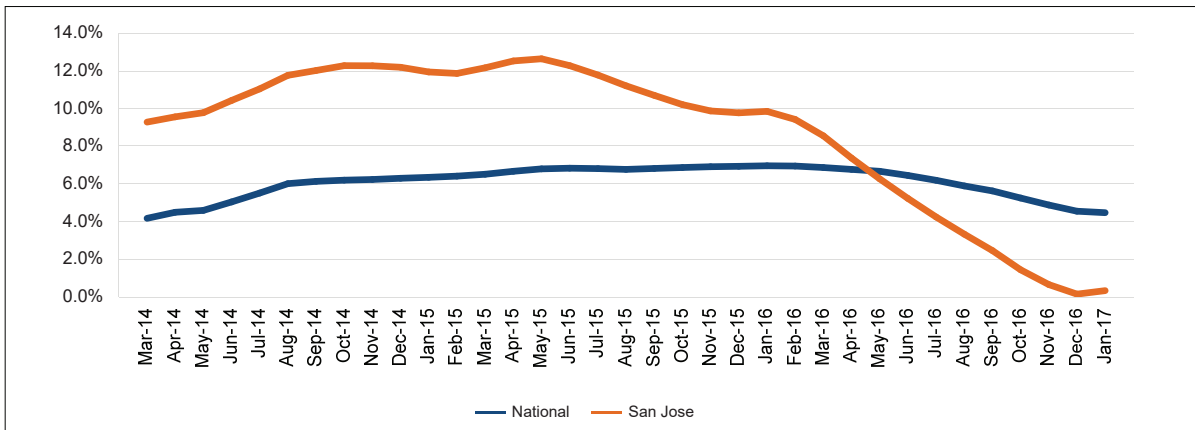
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Rent Trends

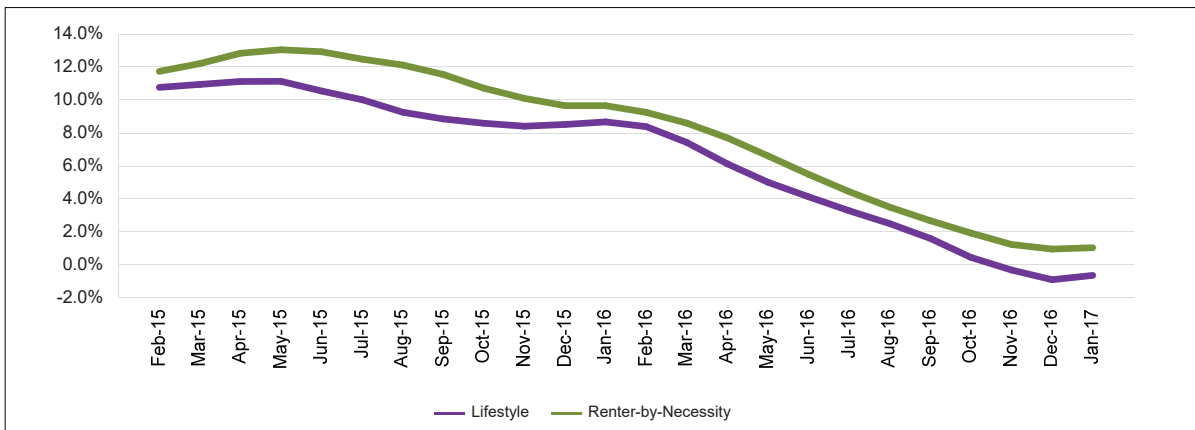
- Rents in San Jose have decelerated drastically in the past year, with the growth rate dropping from 9.9% year-over-year in January 2016 to 0.3% a year later. The metro went from being among the hottest markets in the country to one of the most feeble, its rent increase far below the 4.5% national average. The main reason is affordability: San Jose's average rent of \$2,680 is double the \$1,315 national figure.
- Occupancy in stabilized properties was 95.7% as of December 2016. Although it could decline as a wave of new supply comes online over the next couple of years, the long-term demand outlook remains positive.
- Rents in the Lifestyle segment fell by -0.7% year-over-year, largely due to the increase in high-end supply, as the majority of new developments were luxury apartments. Most of the demand, on the other hand, was for more affordable product. Rents for the working-class Renter-by-Necessity segment rose, but only slightly at 1% year-over-year through January. Submarkets with the highest rent growth included Palo Alto (6.9%), Morgan Hill (8.8%) and East San Jose (10.1%).
- Although rent growth has hit a speed bump, demand is likely to remain strong as the technology segment attracts highly paid young workers. Yardi Matrix expects 6% rent growth in 2017.

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)

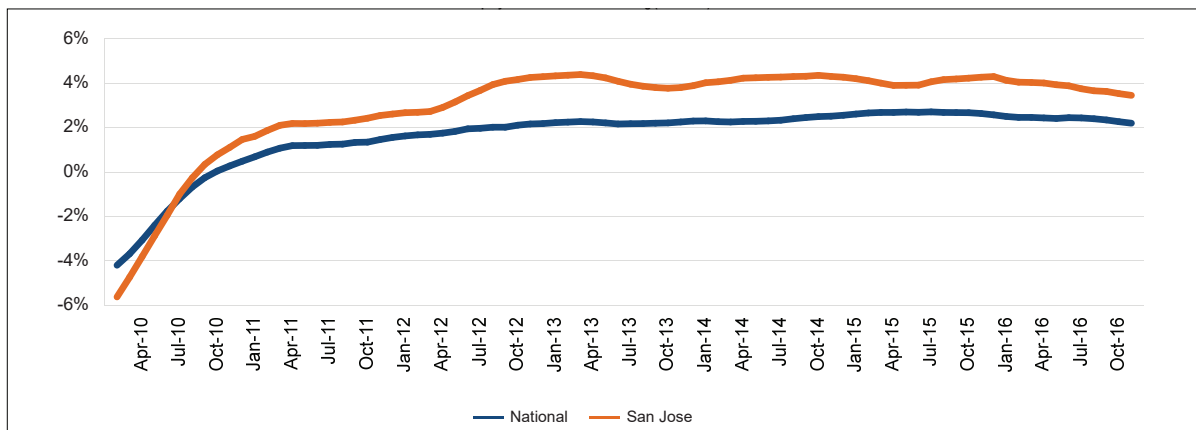


Source: YardiMatrix

Economic Snapshot

- San Jose’s job market is strong, expanding by 35,300 jobs in the 12 months ending in November and increasing the employment rate by 3.4%—a full 125 basis points above the national average. Since 2010, the metro’s job growth has exceeded the national rate.
- Major tech companies continue to grow, with the professional and business services and information segments adding a combined 18,800 jobs. Education and health services contributed 8,700 new positions. The construction industry responded to high demand for housing and high-tech companies’ expansion by making 4,600 new hires.
- Related Cos. received approval for City Place, a \$6.5 billion mixed-use project in Santa Clara that will surround a 35-acre park and encompass as many as 1,680 apartments, 5.7 million square feet of office, 1.1 million square feet of retail and 700 hotel rooms.
- A wave of tech firms—including Google, Palo Alto Networks, Advanced Micro Devices, Toshiba and Facebook—are planning to occupy more than 2 million square feet of pre-leased office construction projects over the next year. Apple’s new Campus 2, a 3.3 million-square-foot office complex, will house as many as 16,000 employees.

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)

Code	Employment Sector	Current Employment		Year Change	
		(000)	% Share	Employment	%
60	Professional and Business Services	238	21.6%	14,500	6.5%
65	Education and Health Services	170	15.4%	8,700	5.4%
15	Mining, Logging and Construction	49	4.4%	4,600	10.3%
50	Information	80	7.3%	4,300	5.7%
90	Government	97	8.8%	2,300	2.4%
70	Leisure and Hospitality	99	9.0%	1,900	2.0%
55	Financial Activities	36	3.3%	500	1.4%
30	Manufacturing	162	14.7%	-400	-0.2%
80	Other Services	27	2.5%	-500	-1.8%
40	Trade, Transportation and Utilities	143	13.0%	-600	-0.4%

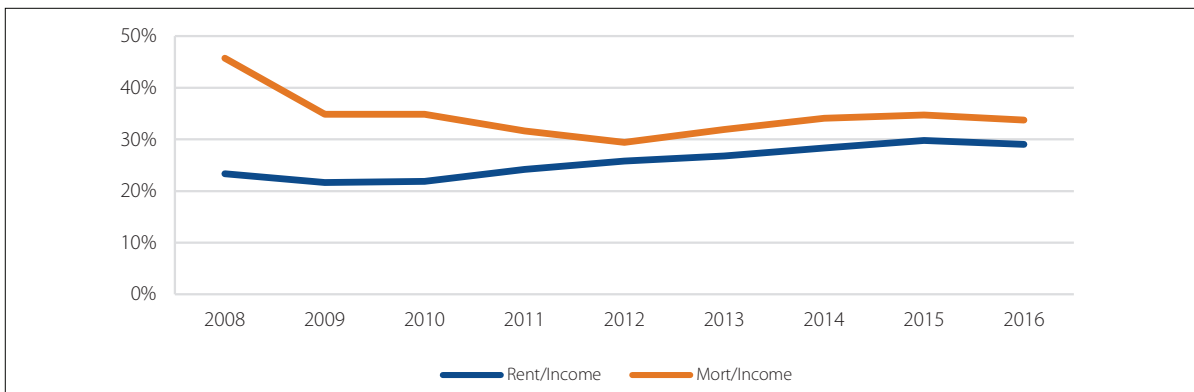
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

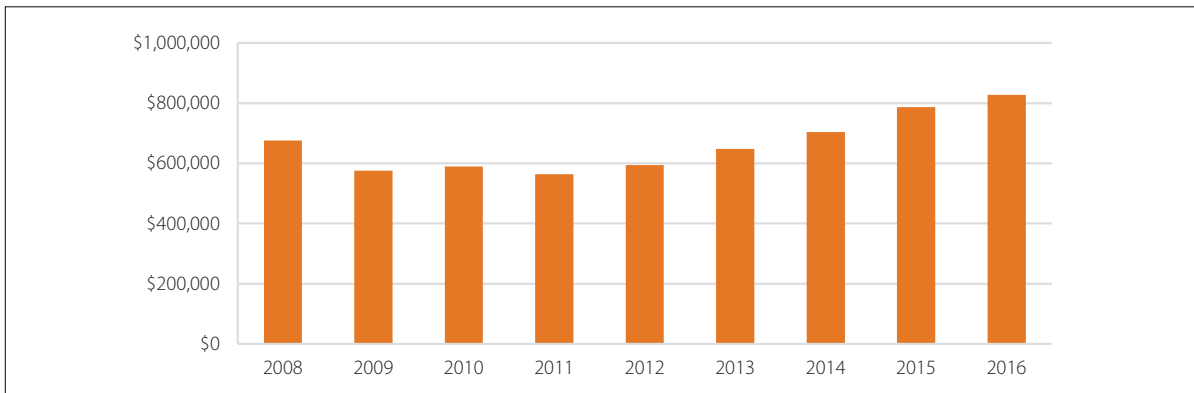
- San Jose's median home price surpassed \$827,538 in 2016, a new cycle high. Renting remains slightly more affordable than owning, with rent accounting for 29% of median income while the average mortgage payment comprises 34%.
- Acknowledging San Jose's high cost of living, the city council implemented a plan to build 20,000 affordable units by 2022. Also, the city council partnered with Facebook to make affordable housing a part of the firm's expansion development agreement. However, the number of lots zoned for market-rate residential development is limited.

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 grew by 22,488 in 2015—up 1.2%—topping the 0.8% national average.
- In-migration remains high, despite the lack of affordable housing.

San Jose vs. National Population

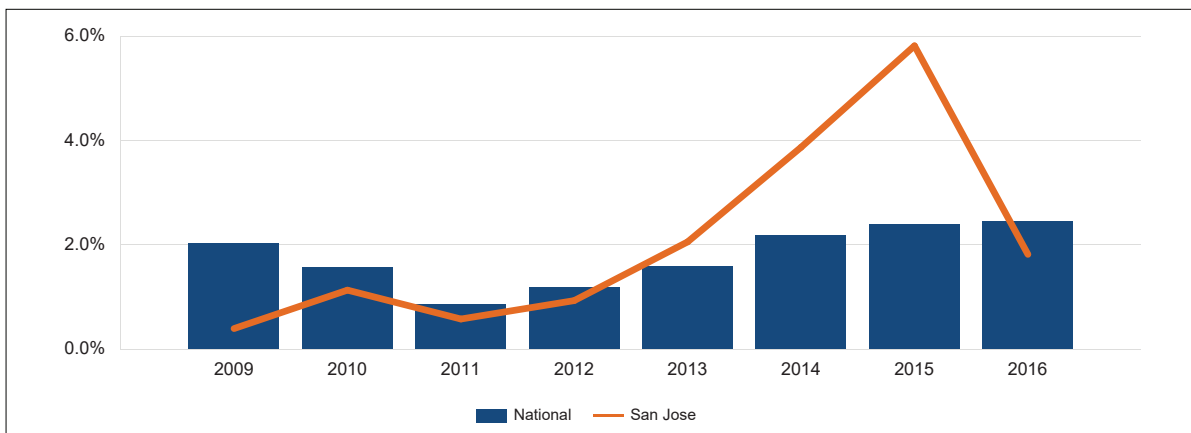
	2011	2012	2013	2014	2015
National	311,718,857	314,102,623	316,427,395	318,907,401	321,418,820
San Jose-Sunnyvale-Santa Clara, Calif., Metropolitan Statistical Area	1,870,402	1,898,203	1,928,745	1,954,348	1,976,836

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

Supply

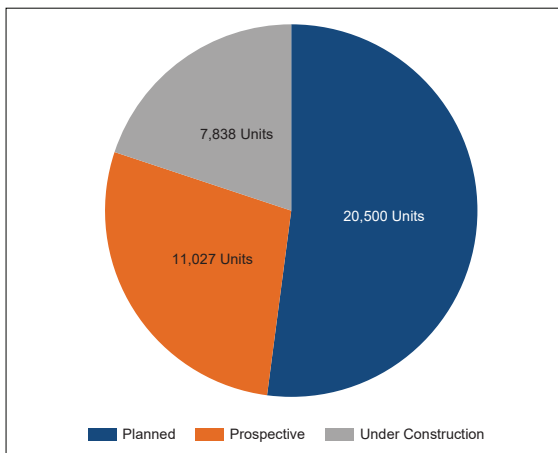
- Completions dropped precipitously in 2016, with only 2,122 units completed, about one-third of the new supply in 2015. Only 1.8% was added to stock. However, that was largely due to the delayed completion of a number of projects. The pipeline is expected to pick up again in 2017, with about the same number of completions as in 2015.
- Yardi Matrix forecasts 6,600 units coming online in 2017. All told, some 7,838 are under construction and 40,000 are in planning stages. About 20,000 units are slated to target the Central San Jose and North San Jose/Milpitas submarkets.
- The inability of most residents to afford a single-family home helps feed demand for apartments, particularly those in well-located neighborhoods near corporate campuses.
- The Irvine Co. has several projects in the works, including Monticello, an 825-unit project in Santa Clara, set to be completed in June. Other submarkets with more than 2,000 units underway are Far South San Jose (1,171) and Sunnyvale (1,115).

San Jose vs. National Completions as a Percentage of Total Stock (as of January 2017)



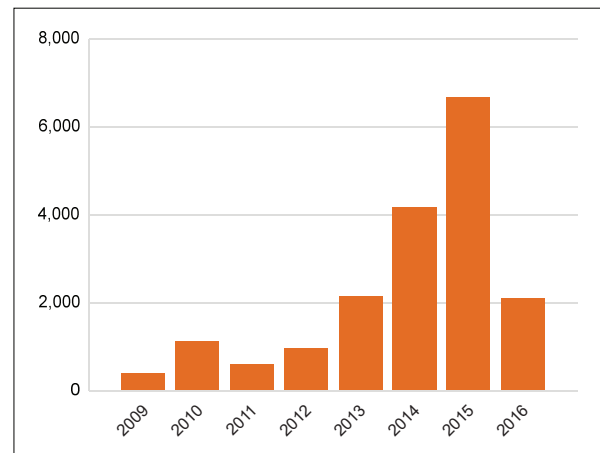
Source: YardiMatrix

Development Pipeline (as of January 2017)



Source: YardiMatrix

San Jose Completions (as of January 2017)

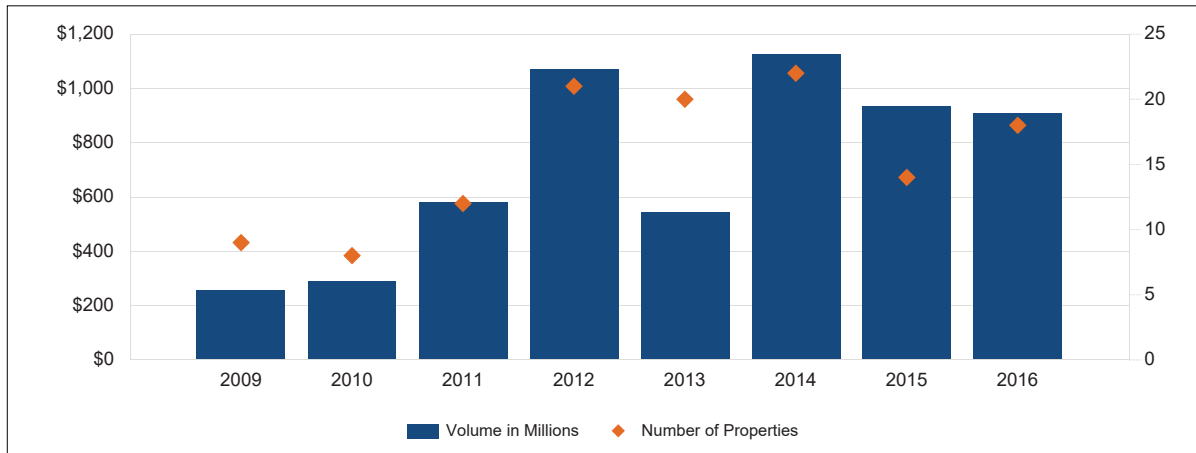


Source: YardiMatrix

Transactions

- The Bay Area is one of the most sought-after markets by investors, enjoying capital inflows from Asia, North American institutions, REITs and others. Acquisition yields for stable assets in San Jose are in the 4% range, and investors are scouring the suburbs for value-add opportunities.
- More than \$900 million worth of multifamily assets changed hands in 2016. The average price per unit was \$370,796, a new cycle high and well above the national average of \$134,999.
- Central San Jose West was the busiest submarket in transactions, with \$208 million in acquisitions, followed by Far South San Jose (\$150 million) and Mountain View (\$109 million). The most active buyer was Greystar, which acquired Avana Almaden in Far South San Jose for \$150.5 million. Klingbeil Capital sold the asset for a per-unit price of \$380,051.

San Jose Sales Volume and Number of Properties Sold (as of January 2017)



Source: YardiMatrix

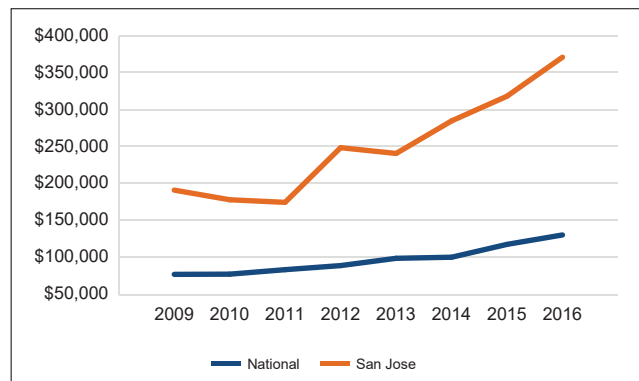
Top Submarkets for Transaction Volume¹

Submarket	Volume (\$MM)
Central San Jose West	209
Far South San Jose	151
Mountain View–Los Altos	109
East San Jose	71
Gilroy	55
Milpitas	46
Campbell	45
Sunnyvale	29

Source: YardiMatrix

¹ From February 2016 to January 2017

San Jose vs. National Sales Price per Unit



Source: YardiMatrix

Read All About It!



San Jose Marriott
Changes Hands



Affordable Housing Project
Completed in San Jose



TMG Partners Bets
On San Jose Tech Scene

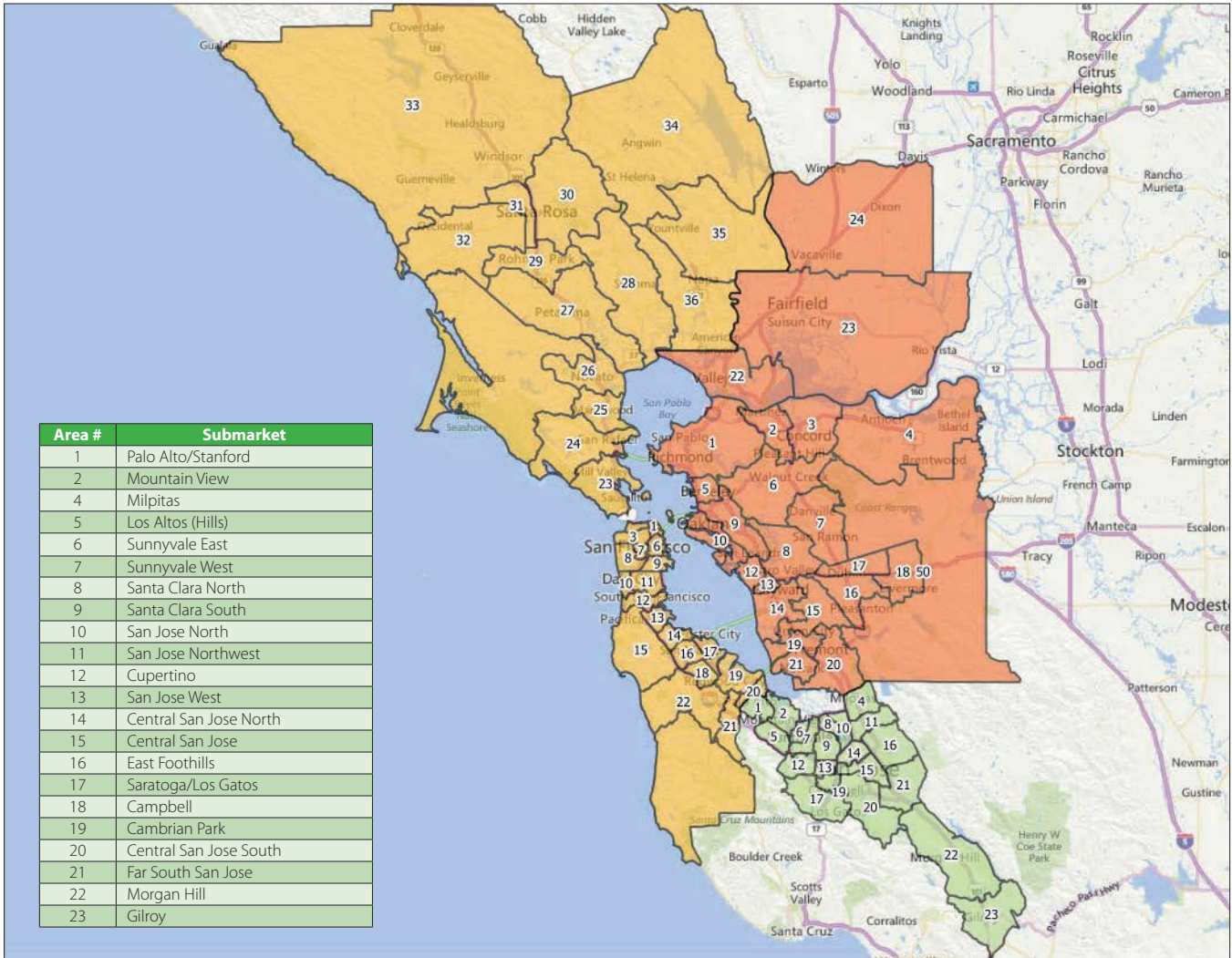


San Jose Apartments
Command \$96M

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San Jose City Submarkets



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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.

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