Yardi® Matrix

San Francisco Cools Off

Multifamily Report Summer 2017

Rents Down 0.5% Year-Over-Year

Supply-Demand Mismatch Persists

Transaction Volume Tapers

Market Analysis

Summer 2017

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Rents Moderate in the Bay

After several years of heightened growth, multifamily rents in San Francisco have tempered. Just one year after double-digit increases had bumped the average to $2,480—among the highest in the country—rents decreased by 0.5% year-over-year through May. Rents have reached a point where even highly paid workers can't afford the premium prices, despite the metro's consistent job expansion, robust tenant demand and high home prices. The lack of affordability is a prime suspect in the slowdown.

San Francisco's economy continues to attract investment and development. The University of California, Berkeley, anticipates that the 325,000-square-foot Berkeley Way West will be completed by December 2017, boosting the education sector. The Chinese investor behind the 42-acre waterfront Landing at Oyster Point in South San Francisco plans to add a residential component with roughly 1,200 units to prepare the area for the life sciences industry, which is expected to add 18,000 jobs in the next three years.

Transaction activity has slowed in 2017, with only $300 million in properties trading in the first five months of the year. This comes after last year's cycle high, when more than $3 billion in assets changed hands, reflecting investor caution amid escalating prices and macroeconomic uncertainty. With more than 15,000 units under construction, Yardi Matrix forecasts rents will remain flat in 2017.

Recent San Francisco Transactions

Indigo Apartment Homes

City: Redwood City, Calif.
Buyer: Aimco
Purchase Price: $320 MM
Price per Unit: $691,145

Franklin 299

City: Redwood City, Calif.
Buyer: TIAA
Purchase Price: $213 MM
Price per Unit: $699,507

The Marston by Windsor

City: Redwood City, Calif.
Buyer: GID
Purchase Price: $153 MM
Price per Unit: $780,612

The Enclave at Adobe Creek

City: Petaluma, Calif.
Buyer: JRK Property Holdings
Purchase Price: $145 MM
Price per Unit: $293,699

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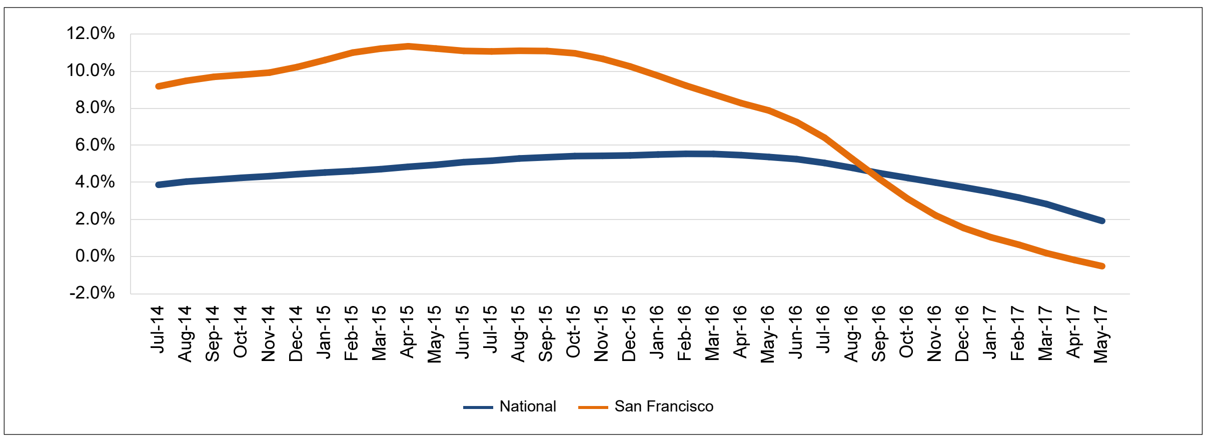
Rent Trends

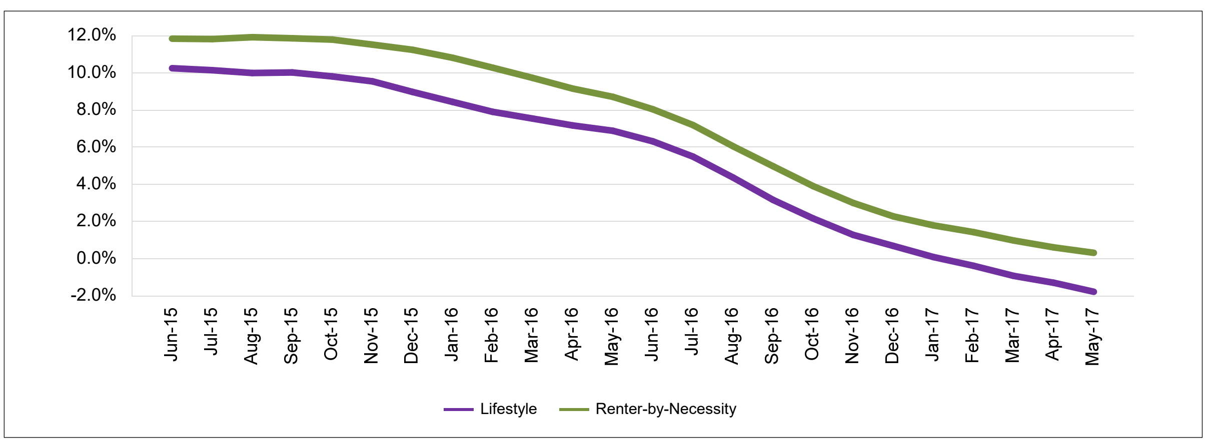
- After an extended period of double-digit increases, rents in San Francisco have softened, falling by 0.5% year-over-year through May, to $2,480—$1,000 more than the national average.
- Rent in the upscale Lifestyle segment has been most subject to the cooling trend, falling 1.8% year-over-year through May to an average of $2,969. Most of the metro's new supply is in this category, while the demand is concentrated in less expensive stock. Average rent in the working-class Renter-by-Necessity group grew by a mere 0.3% year-over-year to $2,242.
- Rent growth has been uneven, with one-third of San Francisco's submarkets contracting during the past year. The greatest gains occurred in San Rafael (7.9%), Roseland (7.9%) and Santa Rosa (7.8%), while the biggest decreases emerged in Moss Beach (-11.2%), Southwest San Francisco (-8.5%) and Central San Francisco (-5.5%).
- The occupancy rate for stabilized properties was 96.0% as of April, down 10 basis points from March, a sign that new supply has finally caught up with demand. Yardi Matrix forecasts rents will remain flat in 2017.

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



Source: YardiMatrix

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

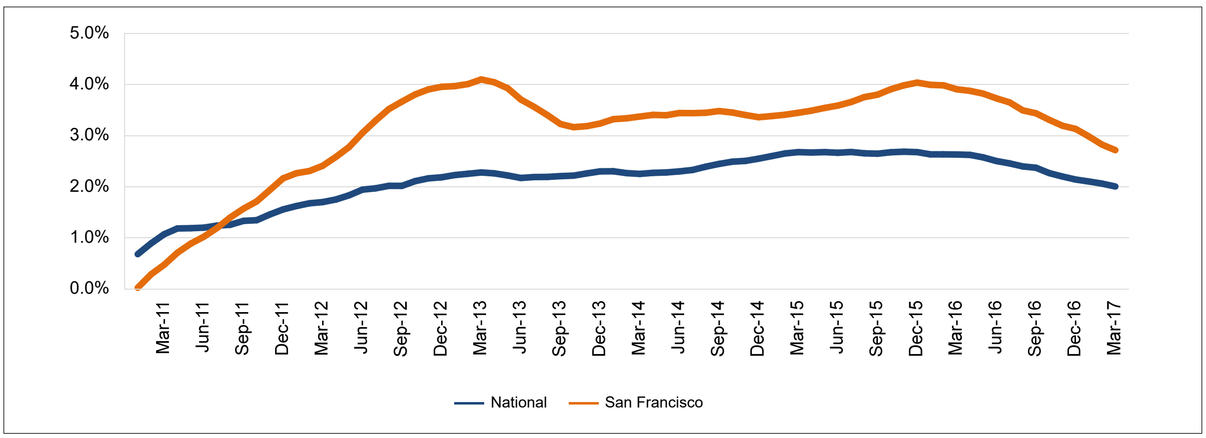


Source: YardiMatrix

Economic Snapshot

- San Francisco added 69,900 new jobs year-over-year through March, up 2.7%. Although job expansion is slower than in the prior 12 months, it still exceeds the national average of 2.0%. The growth rate in the metro decelerated in recent months in part due to a slowdown in the technology industry.
- Employment growth was strongest in education and health services, which added 13,900 jobs, a 3.4% uptick. The University of California, Berkeley, is completing the 320,000-square-foot Berkeley Way West, which will house the School of Education, School of Public Health and Department of Psychology. Projects underway include the $1 billion Oyster Point in South San Francisco—a mixed-use project with research and development, office and residential components—which will strengthen the metro's position in the biotechnology industry.
- Leisure and hospitality (8,900) is expected to expand further, thanks to 10 new hotels that are anticipated to open this year and bring 1,774 new rooms to the market.
- Demand for office space is positive but moderating. Little new office space was delivered in 2016. However, more than 3.3 million square feet of new supply is expected to come online in 2017, which will push vacancy above its current 8.3%.

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



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

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

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
65	Education and Health Services	420	15.1%	13,900	3.4%
60	Professional and Business Services	511	18.4%	10,500	2.1%
90	Government	396	14.2%	10,000	2.6%
15	Mining, Logging and Construction	144	5.2%	9,200	6.8%
70	Leisure and Hospitality	321	11.5%	8,200	2.6%
40	Trade, Transportation and Utilities	448	16.1%	6,100	1.4%
55	Financial Activities	162	5.8%	6,000	3.9%
80	Other Services	101	3.6%	3,600	3.7%
50	Information	104	3.7%	2,300	2.3%
30	Manufacturing	176	6.3%	100	0.1%

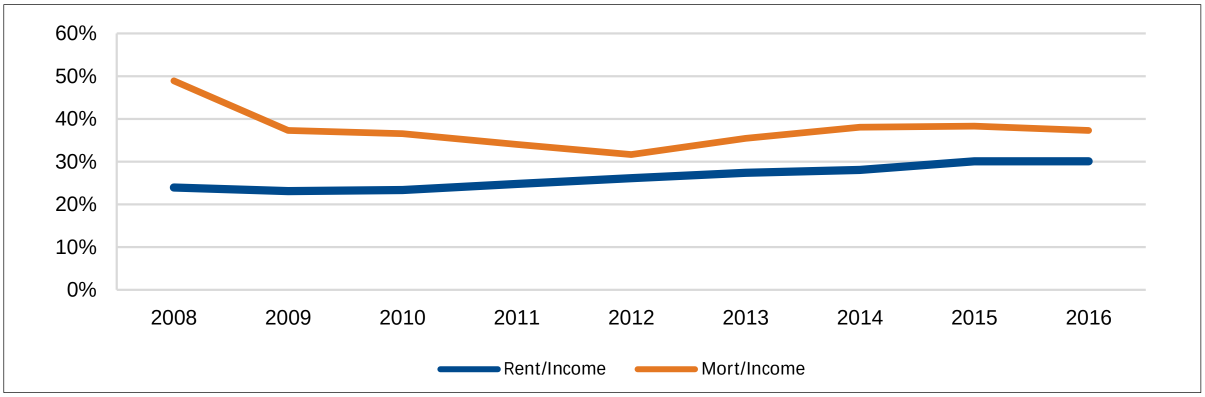
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

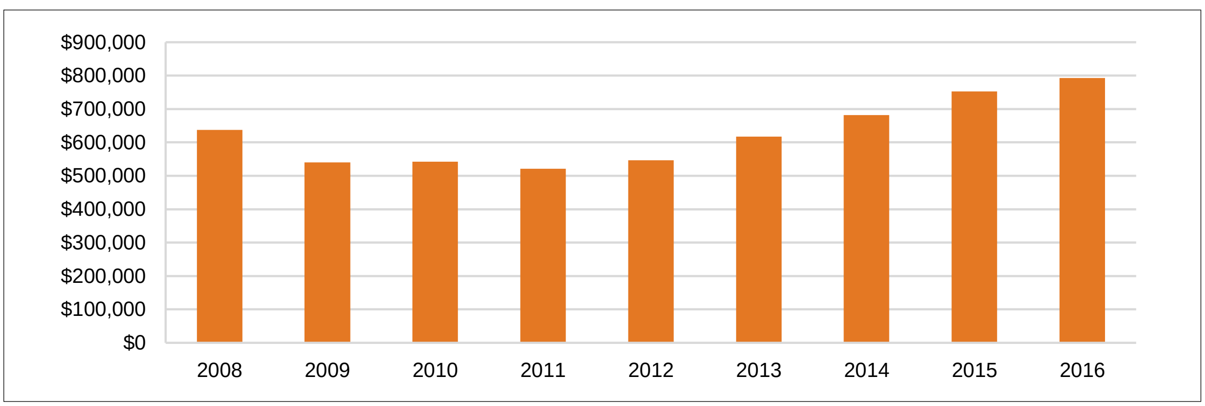
- Housing affordability in San Francisco has reached a critical point. Average rental rates have climbed to $2,480, comprising 30% of the metro's median income. Even though the area has some of the highest wages in the country, homeownership is a distant dream for most residents, as the median home value climbed to $793,251 in 2016, representing 37% of income.
- In an attempt to address the affordability crisis, city officials reached an agreement that targets new market-rate housing developments. Under the agreement, beginning in 2018, developments must reserve 19% of units for low-income tenants. The portion of units reserved for affordable residents will increase to 24% by 2027.

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



Sources: YardiMatrix, Moody's Analytics

San Francisco Median Home Price



Source: Moody's Analytics

Population

- San Francisco added some 40,000 residents in 2016, marking a 0.8% increase.
- Since 2012, the metro's population has grown by almost 5%, far exceeding the 3% national average.

San Francisco vs. National Population

	2012	2013	2014	2015	2016
National	313,998,379	316,204,908	318,563,456	320,896,618	323,127,513
San Francisco Metro	4,458,646	4,521,994	4,585,623	4,642,227	4,679,166

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

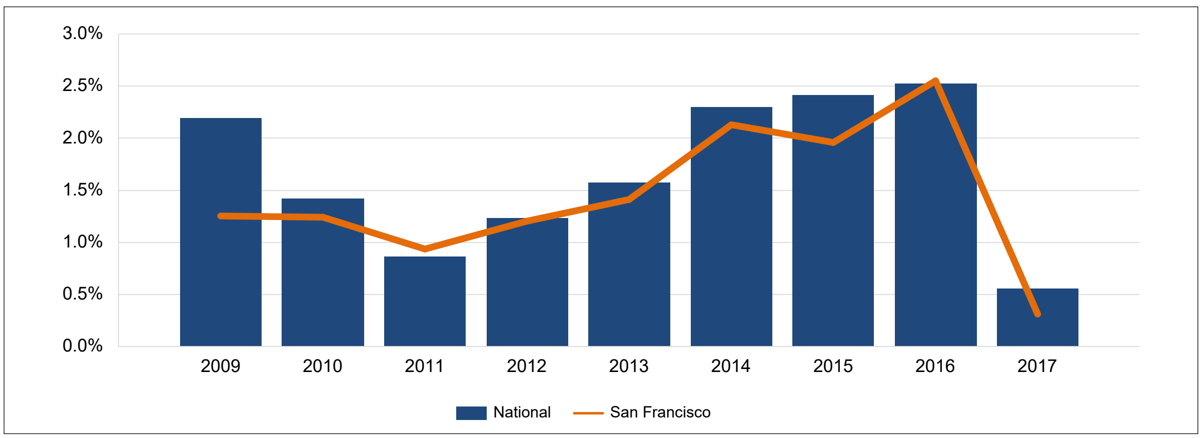
Supply

- In the first five months of 2017, only 625 units came online in San Francisco, representing a mere 0.2% increase, slightly below the 0.4% national average. Despite local building restrictions and high development costs, Yardi Matrix forecasts development to accelerate during the second half of the year and produce 5,600 new units.

- Currently there are 15,300 units under construction, with the majority of the new apartments in Eastern San Francisco (2,945 units), East Oakland/Oakland Hills (2,062), Redwood City (1,879) and China Basin (1,506). The development pipeline in San Francisco comprises 92,258 units in various stages of development, more than 38,000 of which are planned. Colma/Brisbane will add the fewest new apartments, delivering only 52 units at the fully affordable Sweeney Lane project in 2017.

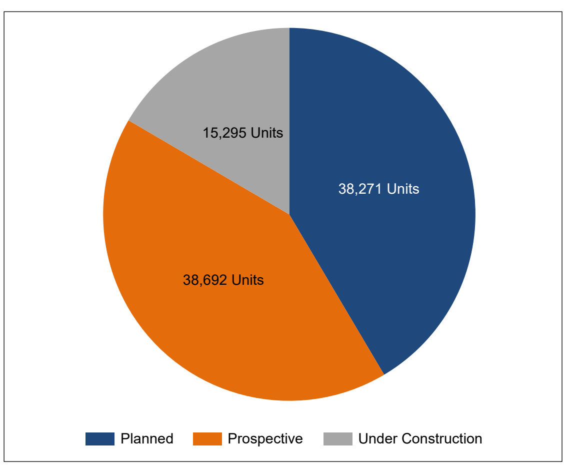
- The largest development currently underway in San Francisco is the 599-unit Station Park Green, which is scheduled for completion in 2017. Owned by Essex Property Trust, 10% of the community's units will be affordable. Other notable developments include the 545-unit 500 Folsom in China Basin, the 540-unit 22 8th Street at Trinity Place in Eastern San Francisco and the 463-unit Indigo Apartment Homes in Redwood City.

San Francisco vs. National Completions as a Percentage of Total Stock (as of May 2017)



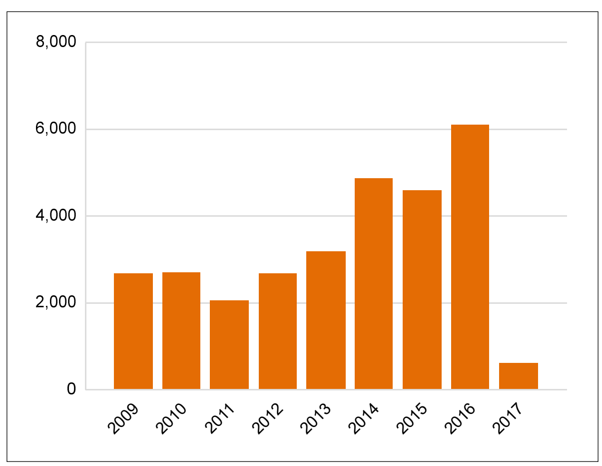
Source: YardiMatrix

Development Pipeline (as of May 2017)



Source: YardiMatrix

San Francisco Completions (as of May 2017)

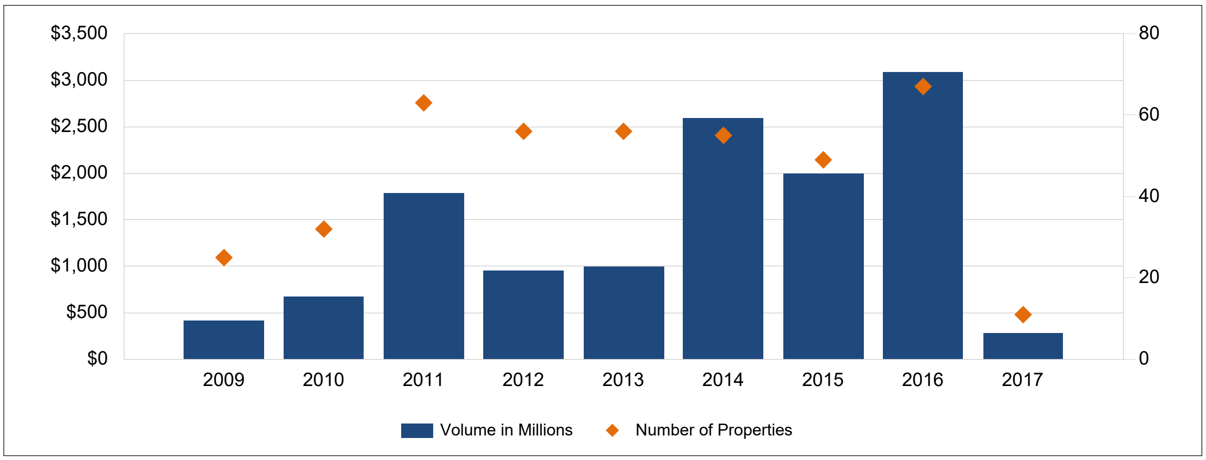


Source: YardiMatrix

Transactions

- After several years of extreme apartment price appreciation, transactions have slowed, with only $300 million in properties trading year-to-date through May. One reason is that buyers and sellers have moved apart in pricing: Buyers in general are exercising more caution with prices at peak levels, and many sellers still want record-low transaction yields. The slowdown also reflects a national trend.
- Transaction volume in the metro hit a cycle high last year, when more than $3 billion in apartment assets changed hands. The per-unit price slid to $239,887 in 2017 after last year's record $273,443, reflecting a shift in investor focus from high-end assets to older, value-add properties. The largest transactions during the past year occurred in Redwood City, where Aimco acquired the 463-unit Indigo Apartment Homes last August for $320 million—or $691,145 per unit—and TIAA purchased the 304-unit Franklin 299 last June for $213 million, or $699,507 per unit.

San Francisco Sales Volume and Number of Properties Sold (as of May 2017)



Source: YardiMatrix

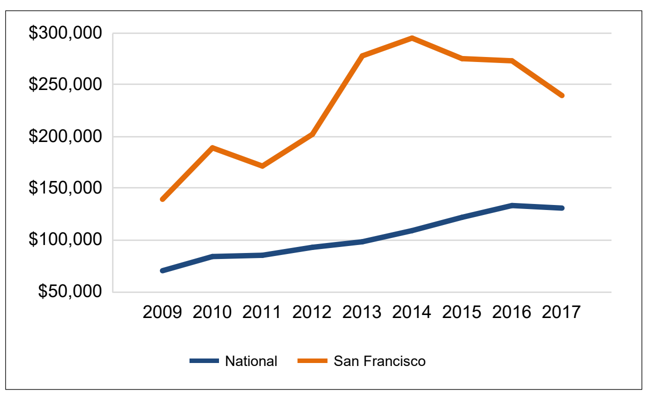
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Redwood City	721
Petaluma	199
Hayward	170
Pleasanton	153
Fairfield	94
Santa Rosa	88
Concord	81
Richmond	76

Source: YardiMatrix

[1] From June 2016 to May 2017

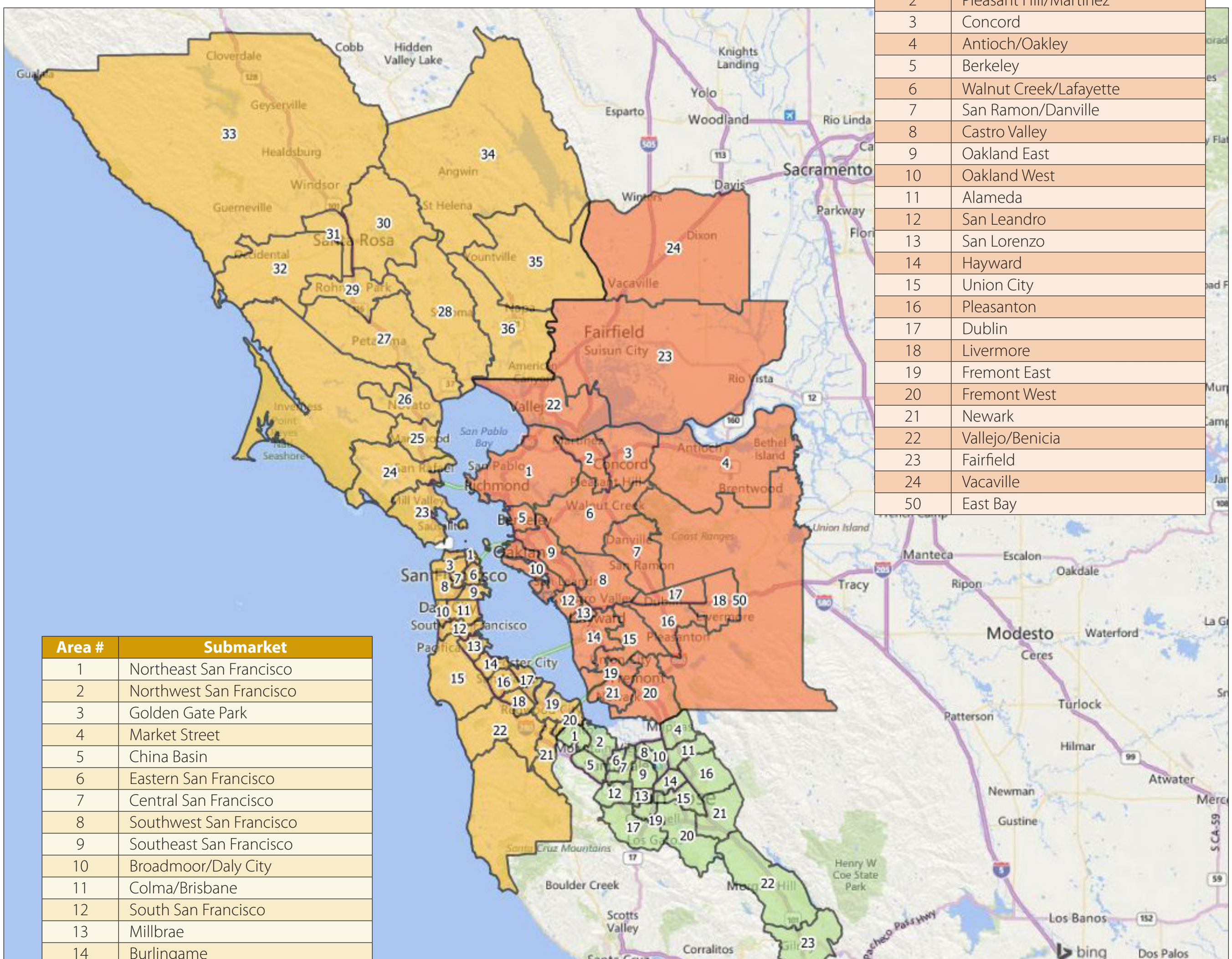
San Francisco vs. National Sales Price per Unit



Source: YardiMatrix

Photo by Jason Finn/iStockphoto.com

San Francisco Submarkets



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
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

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
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

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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

Area #	Submarket
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

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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