Yardi® Matrix

# Silicon Valley Takes Steady Path

## Multifamily Report Fall 2017

Rent Growth Picks Up

Property Values Top Nation

Major Affordability Issues Linger

## Market Analysis
Fall 2017

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# Jobs, Population Growth Sustain Demand

Silicon Valley remains the nation's top tech hub, as well as a strong multifamily market, although rent growth has been on a roller coaster ride. The market saw two quarters of double-digit growth in 2014. Then, at the beginning of 2016, rents rose 8%, before hitting seven consecutive months of negative growth. San Jose rents are now stabilizing, up 2.9% year-over-year through September.

A competitive economy is keeping San Jose's unemployment rate down, at 3.8% as of July. The leisure and hospitality sector is leading employment growth, having added 7,400 jobs, a 7.3% year-over-year increase. Apart from corporate clients, this is due to companies such as Google, Tesla and Facebook attracting an increasing number of tourists to their headquarters. The technology sector, a Silicon Valley staple, continues to be the area's main economic driver. And as major companies are relocating or expanding their footprint, the metro had more than 4 million square feet of office space under development as of the third quarter.

The multifamily pipeline is also strong, with 5,500 units under construction as of September, most of which are slated for completion in 2018. Transaction activity slightly softened this year, compared to 2016's cycle high of $1.2 billion, as San Jose offers both the highest per-unit prices and the lowest acquisition yields of any U.S. metro. With Silicon Valley continuing to expand, demand for rentals is likely to remain healthy, albeit less frothy. Yardi Matrix expects a 1.2% rent growth in 2017.

### Recent San Jose Transactions

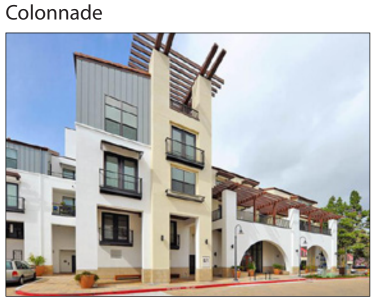
Bella Vista

City: Santa Clara, Calif.
Buyer: Acacia Capital
Purchase Price: $295 MM
Price per Unit: $465,300

360 Residences

City: San Jose, Calif.
Buyer: Essex Property Trust
Purchase Price: $134 MM
Price per Unit: $626,761

Colonnade



City: Los Altos, Calif.
Buyer: Stanford University
Purchase Price: $131 MM
Price per Unit: $781,437

Avana Sunnyvale

City: Sunnyvale, Calif.
Buyer: Greystar
Purchase Price: $107 MM
Price per Unit: $557,292

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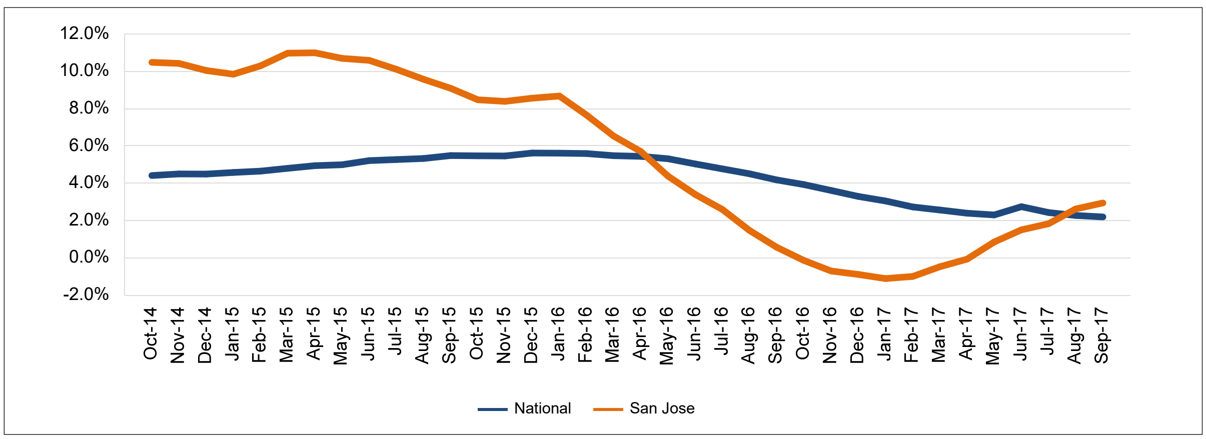
On the cover: Photo by Derek Neumann/iStockphoto.com

## Rent Trends

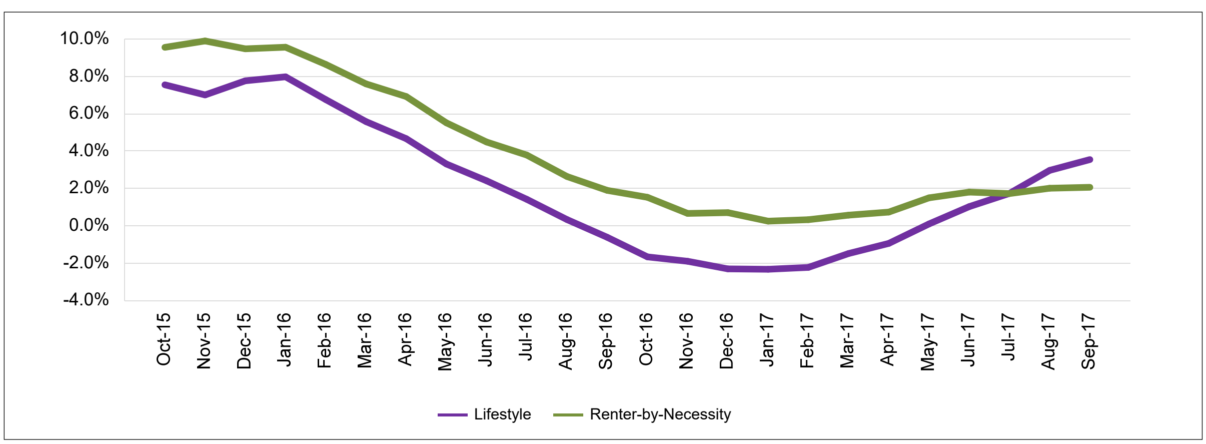
- San Jose rents were up 2.9% year-over-year through September, 70 basis points above the national rate. This marks a stabilization after two quarters of rent contraction, which was itself preceded by strong, above-trend growth due to overgrown demand. At $2,774, the average rent was more than double the $1,354 U.S. figure.
- Rents in the Lifestyle segment—mainly driven by high-earning tech workers—grew 3.5% year-over-year, to $3,035. At the same time, the working-class Renter-by-Necessity (RBN) class was up 2.1%, to $2,522, the first time since 2010 that Lifestyle outperformed the RBN segment.
- Growth was led by Milpitas (3.7%), Cupertino (3.5%), East San Jose (3.3%) and North San Jose (3.0%). At the same time, Los Gatos–Saratoga (-6.0%), Gilroy (-1.2%) and Central San Jose West (-0.9%) were the only submarkets where rents dropped. There are three Silicon Valley submarkets with rents surpassing the $3,000 mark: Palo Alto–Stanford ($3,651), Cupertino ($3,234) and Mountain View–Los Altos ($3,082).
- Affordability issues continue to have a significant impact on Silicon Valley's multifamily market—a prevalent problem across many Bay Area metros—and this is likely to continue dampening rent growth, while many residents continue to be priced out of the area. Yardi Matrix forecasts a 1.2% rent growth for 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)

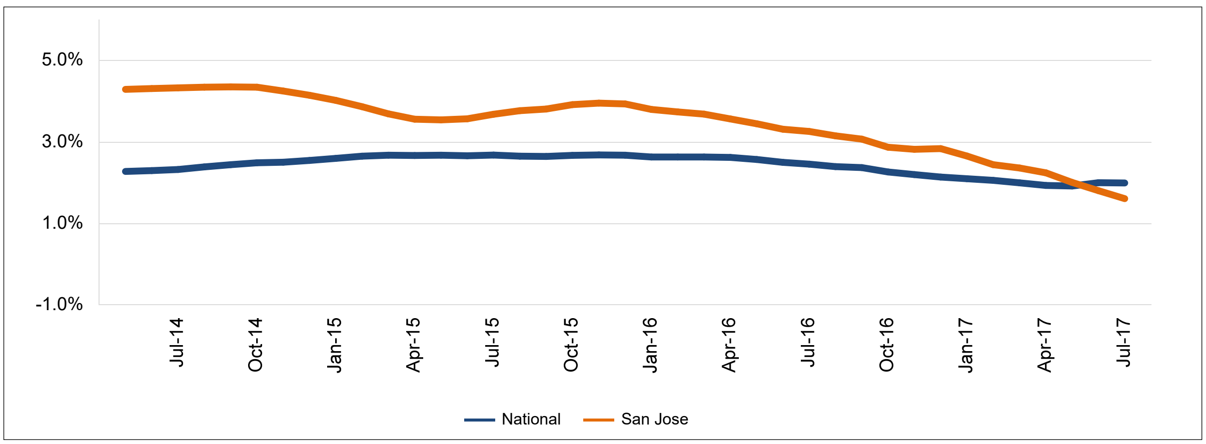



Source: YardiMatrix

## Economic Snapshot

- The metro added 10,500 jobs in the year ending in July, marking a 1.6% increase, 40 basis points below the national rate. After outperforming the U.S. average for the better part of this cycle, Silicon Valley's job market is shifting down a gear, as young workers—both highly skilled and lower-paid—are facing affordability issues.
- Leisure and hospitality took the wheel on employment growth, with 7,400 jobs added in the 12 months ending in July. Large and expanding tech employers in the area are pushing up hotel demand, due to corporate transient guests, the number one factor behind the hospitality sector's surge. According to HVS Global Hospitality Services, Silicon Valley is slated to add more than 2,700 guestrooms in 2017 and 2018.
- Information and professional and business services, the metro's main economic anchors, added 4,200 jobs. This is also reflected in the office market's pipeline: According to Colliers International, some 5.3 million square feet of office space came online in Silicon Valley in the first three quarters of 2017, while more than 4 million square feet were under construction, as major companies are expanding in the area, creating a ripple effect. Apple's new 2.8 million-square-foot campus opened in April. Meanwhile, Google is moving forward with plans to increase its Silicon Valley footprint by roughly 6 million square feet of space near downtown San Jose's Diridon train station. The new campus is expected to generate as many as 20,000 full-time Google jobs.

**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 | % |
| 70 | Leisure and Hospitality | 109 | 10.0% | 7,400 | 7.3% |
| 65 | Education and Health Services | 164 | 15.1% | 3,800 | 2.4% |
| 50 | Information | 80 | 7.4% | 2,700 | 3.5% |
| 60 | Professional and Business Services | 230 | 21.2% | 1,500 | 0.7% |
| 30 | Manufacturing | 167 | 15.4% | 900 | 0.5% |
| 90 | Government | 86 | 7.9% | 800 | 0.9% |
| 55 | Financial Activities | 35 | 3.2% | -1,000 | -2.8% |
| 80 | Other Services | 27 | 2.5% | -1,100 | -3.9% |
| 15 | Mining, Logging and Construction | 49 | 4.5% | -2,000 | -3.9% |
| 40 | Trade, Transportation and Utilities | 138 | 12.7% | -2,500 | -1.8% |

Sources: YardiMatrix, Bureau of Labor Statistics

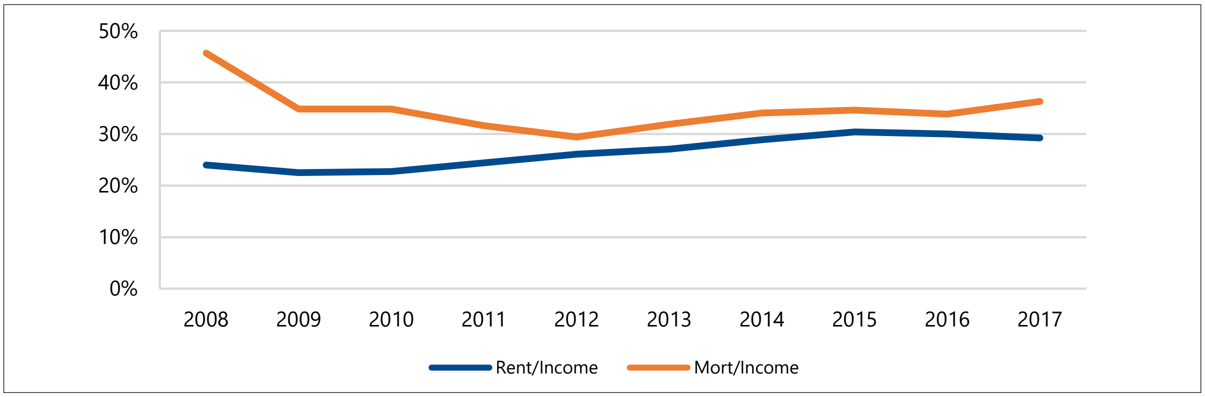
## Demographics

### Affordability

- The median home price in San Jose reached $883,385 in the first half of 2017, four times the U.S. figure and up 57% since 2011. The average mortgage payment accounted for 36% of the area's median income. Although San Jose rents are among the highest in the U.S.—$2,774 as of September—renting remains a more affordable option than owning, taking up 29% of the area's median income.

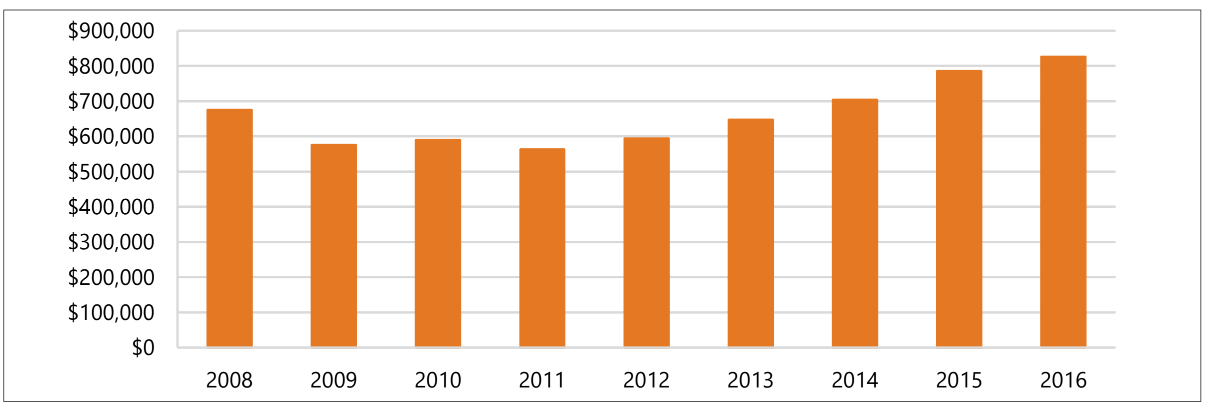
- In order to address the metro's deeply rooted affordability issues, San Jose Mayor Sam Liccardo recently launched a plan aiming to generate 25,000 new residential units over the next five years. The plan calls for 10,000 affordable units set aside for low- and middle-income residents.

**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 expanded by 4.4% since 2012, outperforming the nation by 150 basis points.

- The metro added more than 10,000 residents in 2016 for a 0.5% increase, 20 basis points below the U.S. rate.

**San Jose vs. National Population**

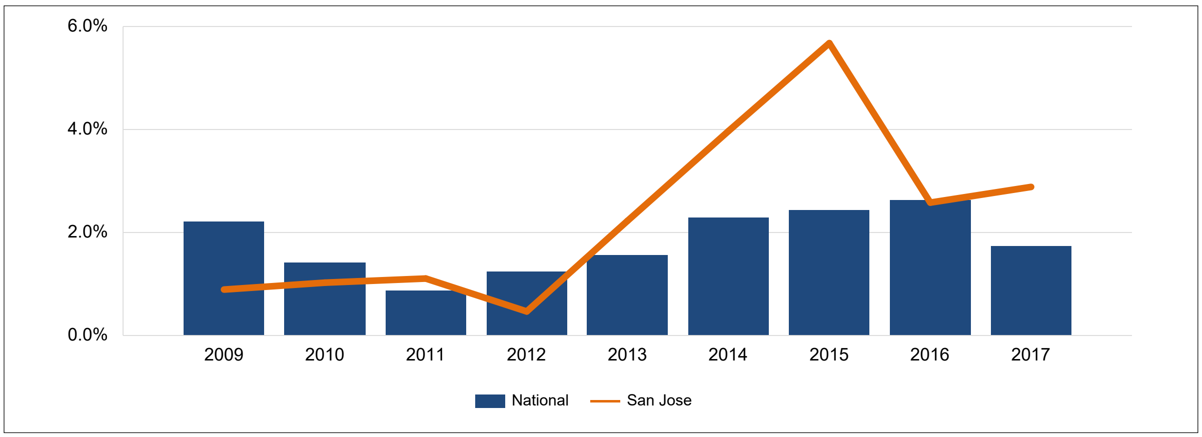
| | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| National | 313,998,379 | 316,204,908 | 318,563,456 | 320,896,618 | 323,127,513 |
| San Jose Metro | 1,895,787 | 1,924,432 | 1,947,922 | 1,968,578 | 1,978,816 |

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

## Supply

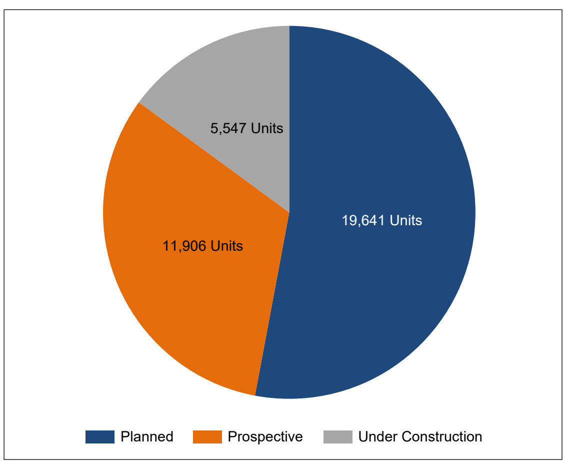
- Some 3,100 units came online in 2017 through September, surpassing the 3,050 units delivered last year. An additional 150 units are expected to come online by the end of the year. This comes after 2015's cycle high of more than 6,500 new units, a development boom that was partially responsible for last year's rent growth deceleration.
- More than 5,500 units were under construction as of September, with an additional 31,500 planned and prospective units. The pipeline is fairly concentrated, with three core submarkets accounting for two thirds of the number of units underway. As developers are responding to demand in areas close to large office clusters, Milpitas led the list (1,334 units), followed by Central San Jose West (941) and Central San Jose (733).
- The largest project underway as of September was Anton Development Co.'s Anton Milpitas, a 582-unit market-rate community. The property is located across the street from the Milpitas BART/VTA station, which is slated to open in mid-2018 as part of Valley Transportation Authority's expansion into Santa Clara County. The second phase of VTA's project, which also includes a station in Berryessa, is expected to attract new transit-oriented developments.

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



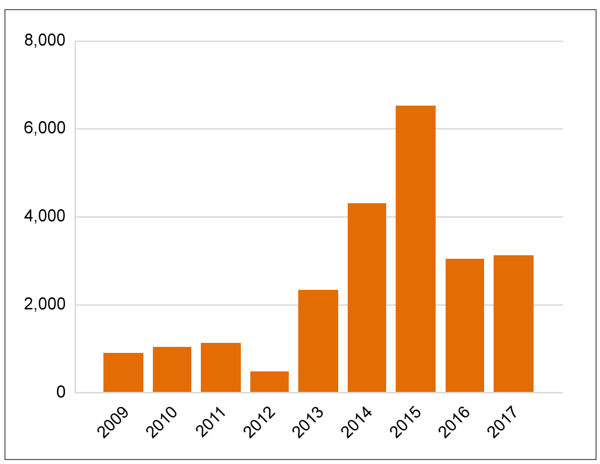

Source: YardiMatrix

**Development Pipeline** (as of September 2017)




Source: YardiMatrix

**San Jose Completions** (as of September 2017)

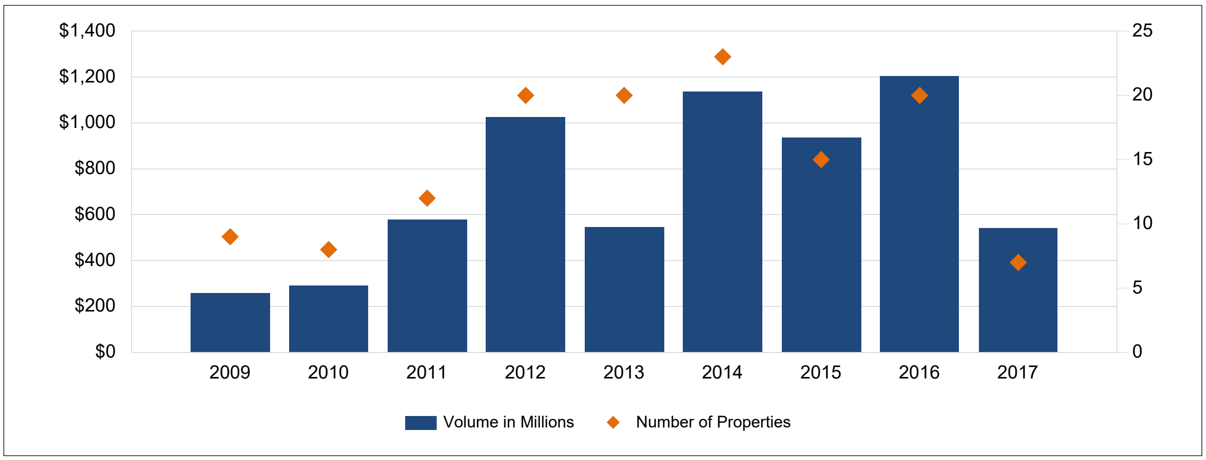



Source: YardiMatrix

## Transactions

- Investor appetite softened in San Jose as roughly $542 million in multifamily assets traded in 2017 through August. This marks a slight slowdown compared to 2016's cycle high of $1.2 billion.
- Per-unit prices reached the $500,000 mark this year through August, up 36% since 2016. Silicon Valley commands some of the highest per-unit prices in the country, including Bay Area metros and New York boroughs. The price surge is one of the reasons transaction activity is decelerating, with investors concerned about buying at the top of the market. According to CBRE, acquisition yields in San Jose were in the 3.75%-4.75% range during the first half of 2017, the lowest nationwide, alongside San Francisco.
- The busiest submarkets in the 12 months ending in August were Santa Clara ($295 million), Sunnyvale ($211 million), as well as Central San Jose and Central San Jose West (totaling $309 million).

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




Source: YardiMatrix

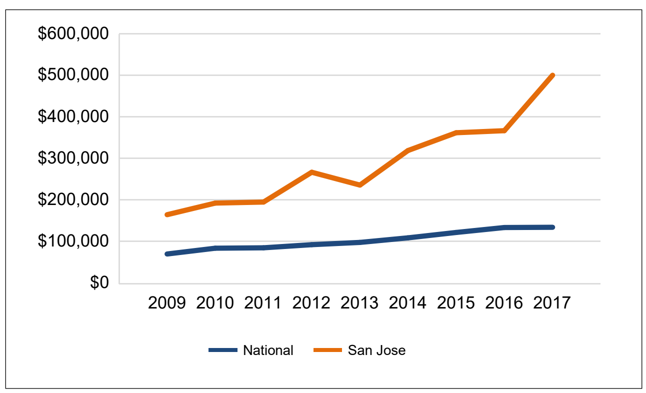
**Top Submarkets for Transaction Volume**[1]

| Submarket | Volume ($MM) |
|---|---|
| Santa Clara | 295 |
| Sunnyvale | 211 |
| Central San Jose | 171 |
| Central San Jose West | 138 |
| Mountain View–Los Altos | 131 |
| West San Jose | 58 |
| East San Jose | 56 |
| Gilroy | 54 |

Source: YardiMatrix

[1] From September 2016 to August 2017

**San Jose vs. National Sales Price per Unit**




Source: YardiMatrix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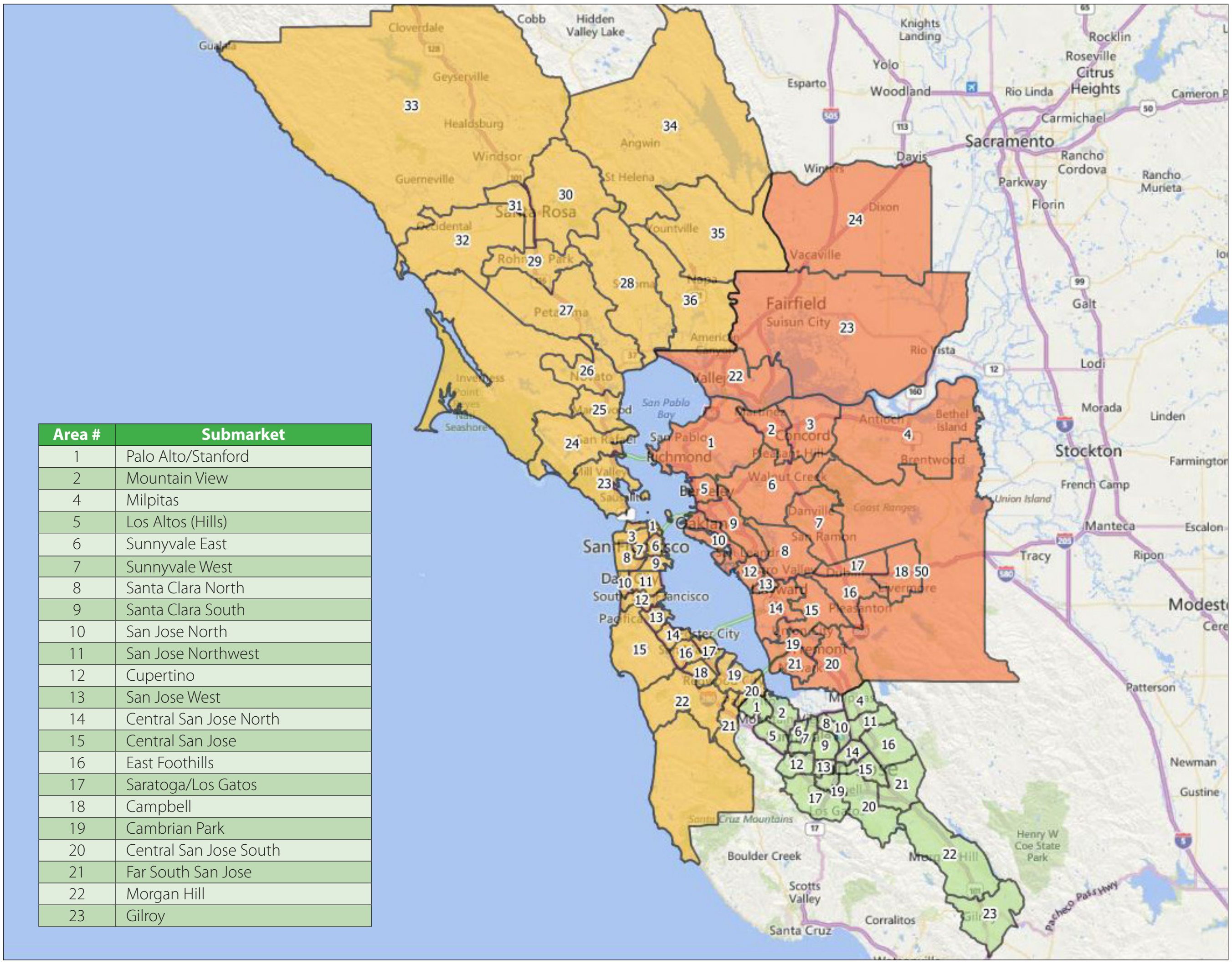
## San Jose Submarkets




| 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 |

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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 |

| Area # | Submarket |
|---|---|
| 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 |

## 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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