Yardi® Matrix

Technology Still Rules San Jose

Multifamily Report Spring 2018

Affordability Issues Deepen

Per-Unit Price Reaches New Peak

Lifestyle Outpaces Renter-by-Necessity

Market Analysis

Spring 2018

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Upscale Units Drive Rent Growth

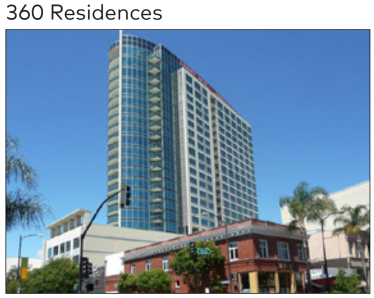
A top-heavy job market, strong technology sector and solid population growth are upholding San Jose as one of the most economically vibrant metros in the U.S. Although 2018 is expected to be a banner year for completions, policy changes may lead to ballooning construction costs for multifamily properties. Until then, it is growth in the Lifestyle segment that's driving improvement in the local rental market.

At 2.7% as of November, San Jose's unemployment rate is among the lowest it's been in the current cycle. The metro's education and health services sector led growth, with the addition of 9,100 jobs in 2017. Due to the metro's position as the world's most high-profile technology hub, major companies are continuing their expansion—Google, LinkedIn and Apple still have projects lined up. The office development pipeline is expected to remain robust, as 3.3 million square feet is scheduled for delivery this year.

The metro's affordability issues are likely to continue, since developers are focusing on upscale assets, which are more profitable than working-class units. This trend is in fact predominant in most of the nation's major metros. As of February, 8,000 units were underway in San Jose, mostly concentrated in core submarkets. We expect 3,800 units to be added this year. As a result, rent growth will likely reach 2.4% in 2018.

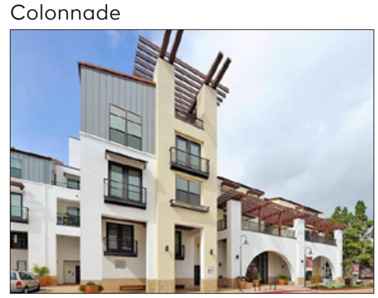
Recent San Jose Transactions

360 Residences



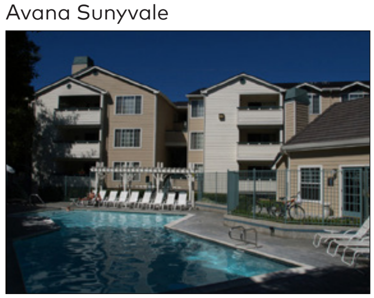
City: San Jose, Calif.
Buyer: Essex Property Trust
Purchase Price: $134 MM
Price per Unit: $626,760

Colonnade



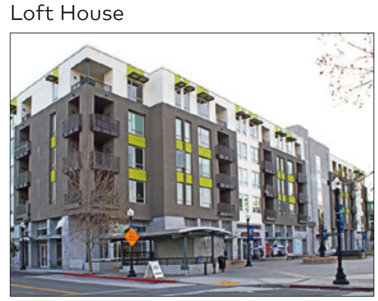
City: Los Altos, Calif.
Buyer: Stanford University
Purchase Price: $131 MM
Price per Unit: $781,437

Avana Sunyvale



City: Sunnyvale, Calif.
Buyer: Greystar
Purchase Price: $107 MM
Price per Unit: $557,291

Loft House



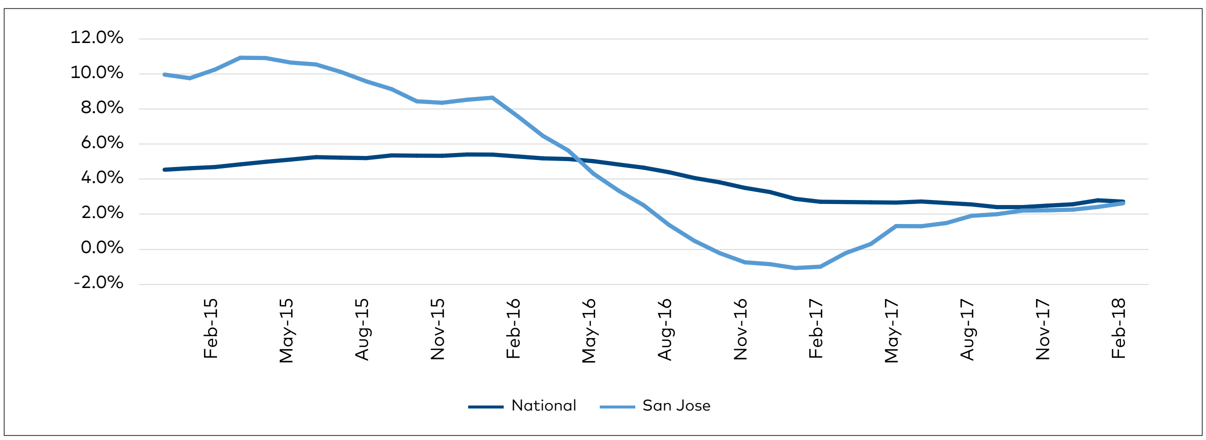
City: Sunnyvale, Calif.
Buyer: Shorenstein
Purchase Price: $104 MM
Price per Unit: $781,954

On the cover: Photo by NNehring/iStockphoto.com

Rent Trends

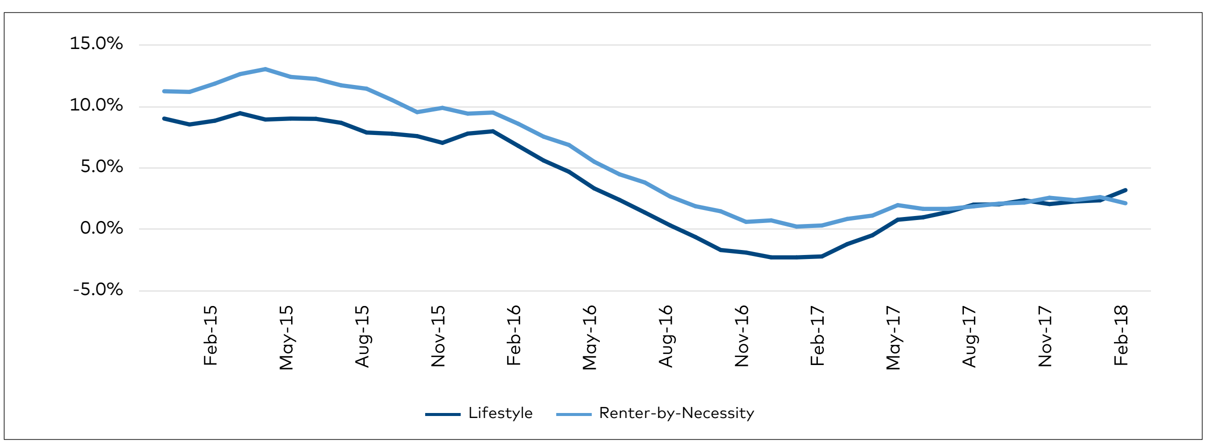
- Rents were up 2.6% in the year ending in February, only 10 basis points below the national average. At $2,739, the average overall rent was roughly $1,300 above the U.S. average. San Jose rents are some of the highest in the country.
- The Lifestyle segment continued to lead growth in the metro, rising 3.2% year-over-year through February, to $2,997, furthering Silicon Valley's affordability issues. Demand for working-class units continues to outstrip supply, as developers are concentrating on delivering upscale projects. The working-class Renter-by-Necessity segment rose 2.1% to $2,486.
- Tech hubs Palo Alto–Stanford, Cupertino and Mountain View–Los Altos were the only submarkets that had average rents above the $3,000-mark. As a result of an increase in rents, residents are moving toward suburban regions such as Morgan Hill (7.5%) and San Benito County (4.7%), which saw the largest year-over-year growth rates.
- Strong demographics and a solid job market will likely continue to fuel demand for housing. Demand for apartments should get a marginal boost from the new tax law, so it's possible that rent growth will continue. We expect rents to grow 2.4% by year's end.

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

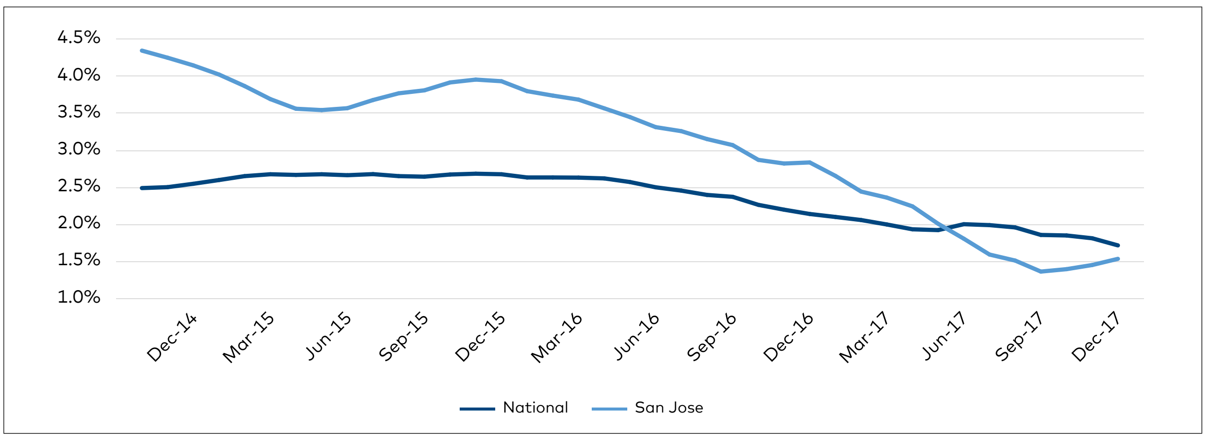
Economic Snapshot

- Silicon Valley added 24,200 jobs in 2017, up 1.5% year-over-year, below the 1.7% national average. The metro continues to have a strong economy, keeping the unemployment rate at the lowest value in the current cycle, 2.7% as of November, well below the 4.1% U.S. rate.

- Although the leisure and hospitality sector saw the biggest year-over-year change—7.6%—the education and health services sector is leading gains in the metro, having added 9,100 jobs in 2017. San Jose's universities and colleges are feeding the technology companies with a stream of young, highly skilled workers, which is expected to further produce demand for housing.

- Although San Jose is known as a tech hub, the professional and business services sector added only 2,400 jobs; however, that is expected to increase as major tech companies expand in the area. Owned by Microsoft, LinkedIn is building a new headquarters in Mountain View totaling 300,000 square feet, while Google is in the early stages of developing a new corporate campus adjacent to Diridon Station, which will house as many as 20,000 employees. In 2017, roughly 3.9 million square feet of office space were delivered (1.8 million square feet in the last quarter alone), CBRE data shows. The metro's development pipeline is set to stay robust, as approximately 3.3 million square feet are slated for completion this year, 1.9 million square feet of which are already preleased.

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	%
65	Education and Health Services	174	15.6%	9,100	5.5%
70	Leisure and Hospitality	109	9.8%	7,700	7.6%
30	Manufacturing	169	15.1%	5,300	3.2%
50	Information	80	7.2%	3,700	4.8%
60	Professional and Business Services	230	20.6%	2,400	1.1%
90	Government	99	8.9%	1,800	1.8%
15	Mining, Logging and Construction	50	4.5%	800	1.6%
80	Other Services	27	2.4%	-500	-1.8%
55	Financial Activities	35	3.1%	-700	-1.9%
40	Trade, Transportation and Utilities	142	12.7%	-5,400	-3.7%

Sources: YardiMatrix, Bureau of Labor Statistics

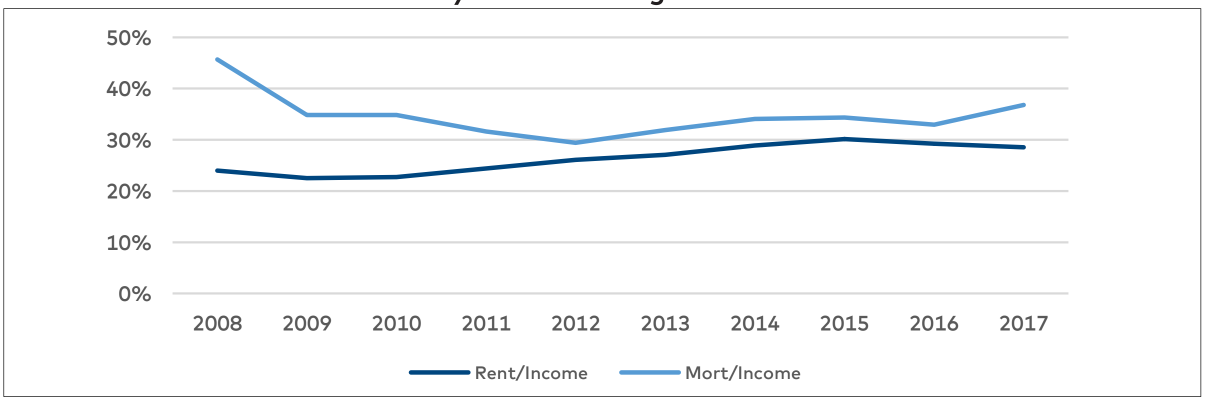
Demographics

Affordability

- Since 2012, the median home price has risen 54.4%, to a cycle peak of $917,139 in 2017. Although rents in the metro are among the highest in the country, at $2,739 as of February, renting accounts for only 29% of the area's median income, while the average mortgage payment equates to 37%.

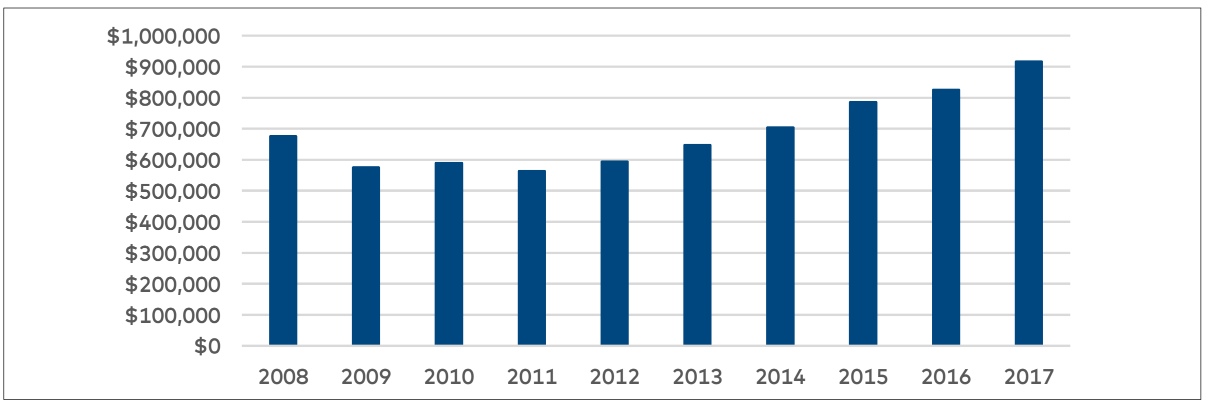
- San Jose's affordability problems for lower-income residents are not expected to soften soon. The construction sector is likely to face uncertain times due to newly imposed steel tariffs, as rental development is closely tied to building costs, which are expected to inflate as a result of policies. With developers opting to build Lifestyle properties to recuperate costs, more pressure to do so may follow.

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

- The metro added more than 10,000 residents in 2016, a 0.5% increase, 20 basis points below the national average.
- Driven by a strong employment market, San Jose is likely to keep growing in the coming years.

San Jose vs. National Population

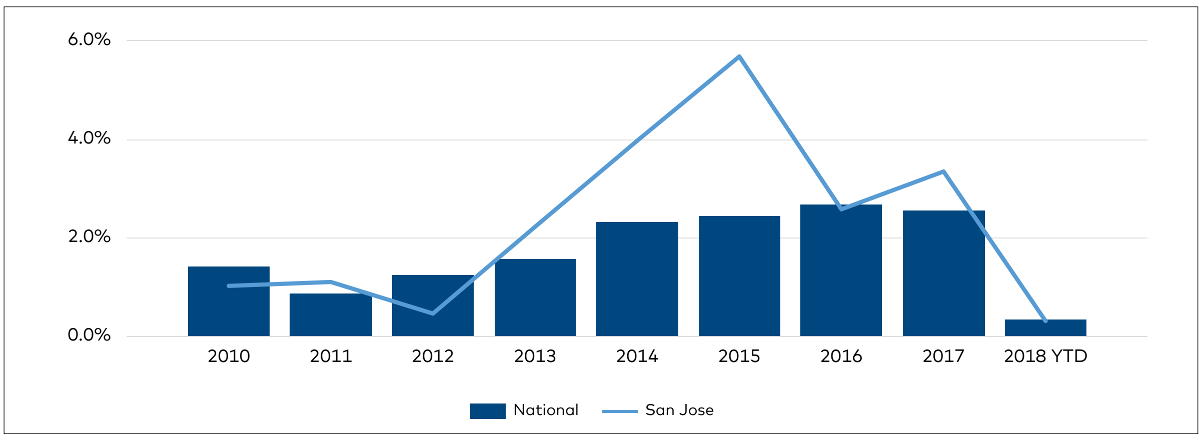
	2012	2013	2014	2015	2016
National	313,998,379	316,204,908	318,563,456	320,896,618	323,127,513
San Jose Metro	1,895,787	1,924,432	1,947,922	1,968,578	1,978,816

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

Supply

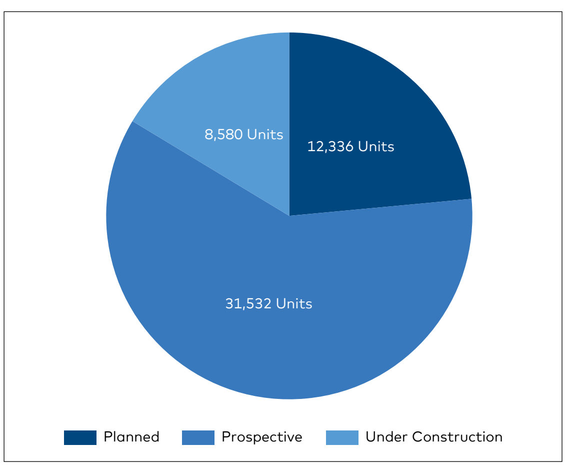
- Nearly 400 units were delivered year-to-date through February, all of them in the Far South San Jose submarket. Nearly 4,100 units came online in 2017, 3.4% of total stock and 80 basis points above the U.S. rate. The administration's steel tariffs may put a damper on deliveries, as construction costs for multifamily properties skyrocket. We expect 3,800 units to be delivered this year.
- Roughly 8,500 units were underway and more than 43,800 units were in the planning and permitting stages. Most of the units under construction are concentrated in Central San Jose and Central San Jose West (totaling 1,957 units) and Santa Clara (1,778). The continued expansion of major tech companies such as Google, Facebook and LinkedIn is attracting talent, further solidifying the need for housing. As a result, Google received approval to build nearly 10,000 units near its future campus in Mountain View. Occupancy in stabilized properties was 95.5%, down 60 basis points since 2016.
- The largest project currently under construction is Irvine Co.'s Santa Clara Square, a mixed-use development. Upon its planned August 2018 completion, the building will include office and retail space, as well as 1,778 units.

San Jose vs. National Completions as a Percentage of Total Stock (as of February 2018)



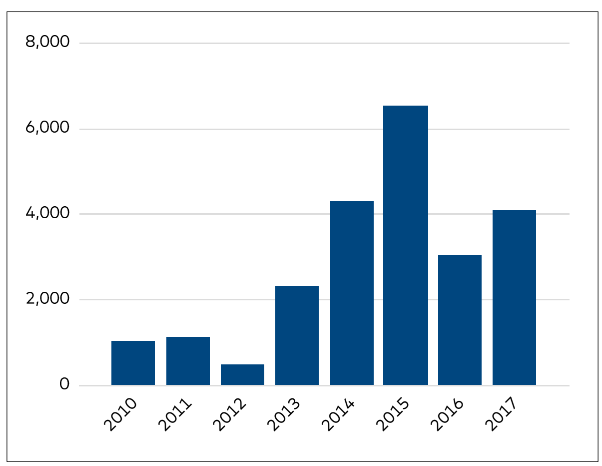
Source: YardiMatrix

Development Pipeline (as of February 2018)



Source: YardiMatrix

San Jose Completions (as of February 2018)

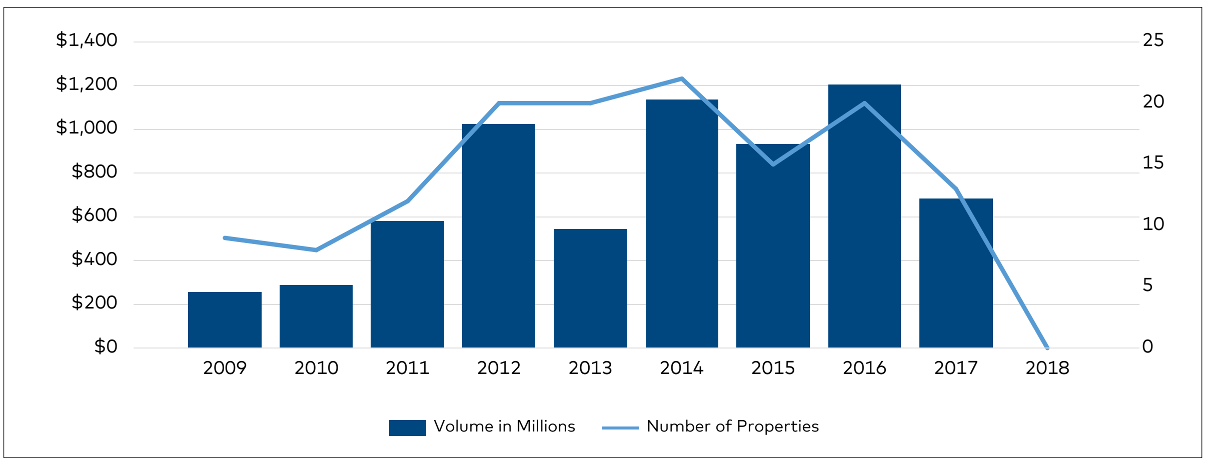


Source: YardiMatrix

Transactions

- Some $685 million in multifamily assets traded in 2017. Although transaction volumes were down compared to 2016's cycle peak of $1.2 billion, consistent job growth coupled with low interest rates have kept investors motivated to continue to deploy capital throughout Silicon Valley. The thriving economy, led mostly by corporate companies expanding or relocating to the metro, is also reflected in increasing property values, with the average price per unit peaking at $439,866 in 2017.
- In the 12 months ending in February, investor appetite was mostly focused in or near submarkets where big tech hubs are located such as Sunnyvale ($237 million), Central San Jose ($208 million) and Mountain View–Los Altos ($131 million). 360 Residences was the most expensive property to be transacted in 2017. Essex Property Trust acquired the asset from Capri Capital Partners for $134 million ($626,760 per unit), $16 million more than what it had traded for in 2014.

San Jose Sales Volume and Number of Properties Sold (as of February 2018)



Source: YardiMatrix

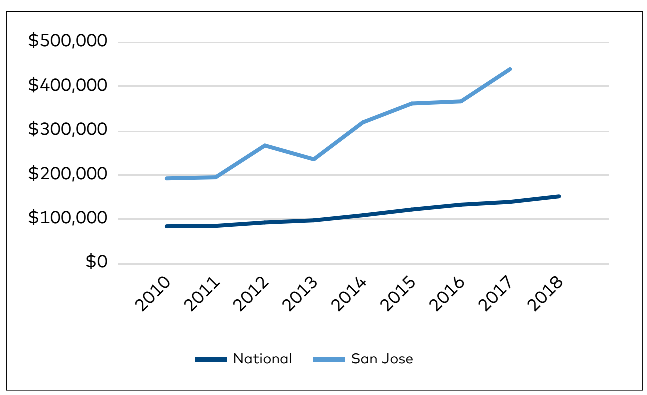
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Sunnyvale	237
Central San Jose	208
Mountain View–Los Altos	131
West San Jose	96
Santa Clara	14

Source: YardiMatrix

[1] From March 2017 to February 2018

San Jose vs. National Sales Price per Unit



Source: YardiMatrix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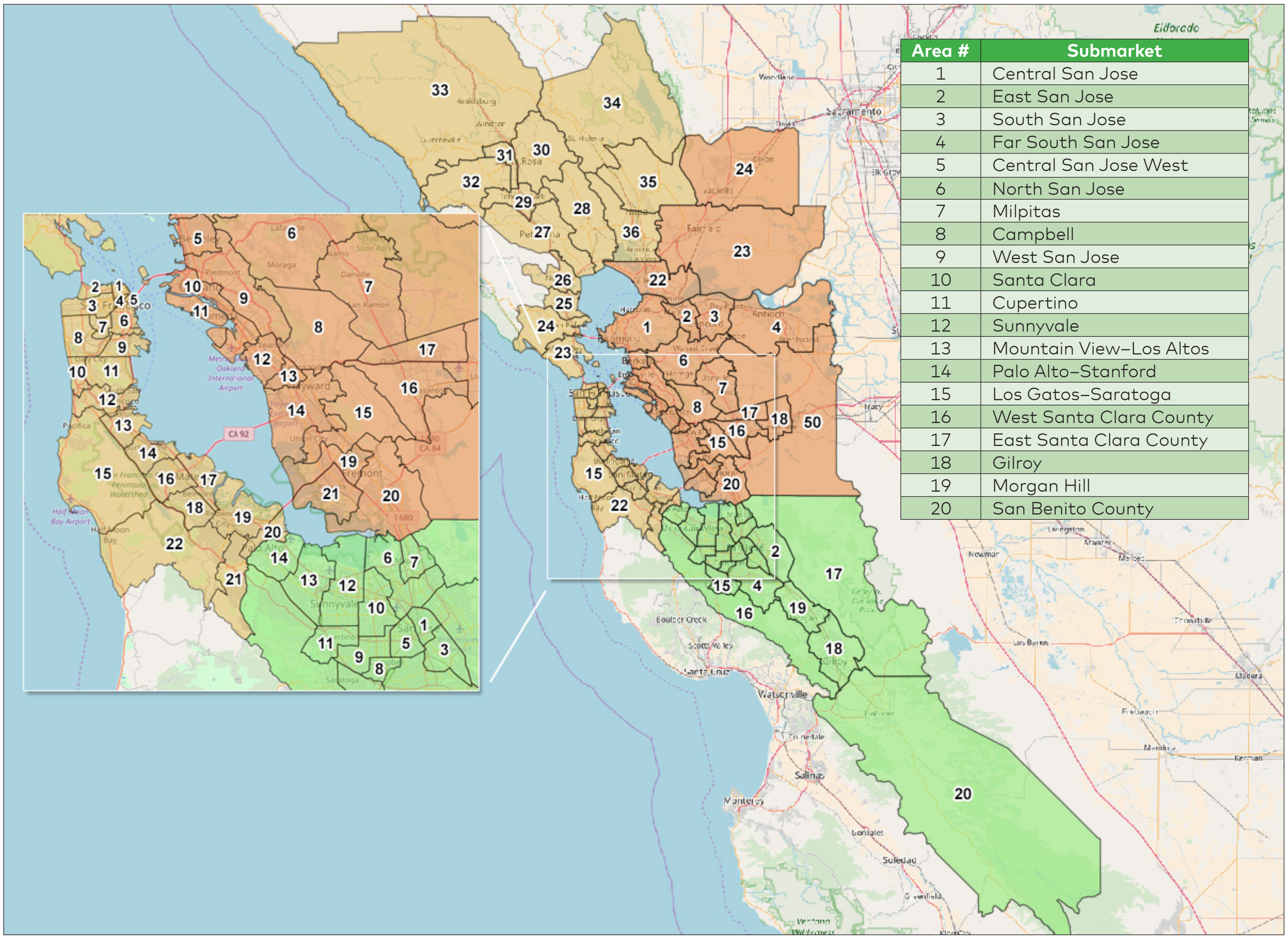
San Jose Submarkets



Area #	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

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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
25	East Livermore/ East Dublin

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.