Yardi® Matrix

Rents on the Rise

Multifamily Report Summer 2018

Information Sector Leads Economic Growth

Developers Focus on Lifestyle Assets

Home Prices Reach New Peak

Market Analysis

Summer 2018

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Silicon Valley Prices Everyone Out

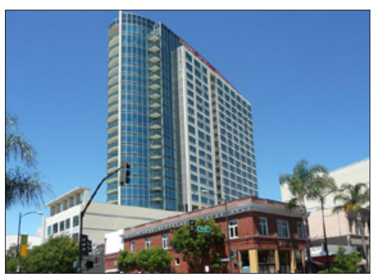
San Jose's multifamily market continues to be strong, driven by a technology-dominant economy. Developers are focusing on upscale assets in the vicinity of corporate campuses, further increasing the need for housing, especially for low- and median-income residents. The metro's affordability issues continue to be a major headwind for population growth, as Silicon Valley's residential market has some of the highest rents in the nation, as well as median home prices just under the $1 million mark.

The information sector led employment growth in the metro, having added 9,700 jobs in the 12 months ending in April, up 11.9% year-over-year. The construction sector also continued gaining momentum, with major commercial projects taking shape in the metro, including Moffett Towers II, a 1.8 million-square-foot office building that's already fully pre-leased to tech giants Facebook and Amazon.

Development activity remains robust, with 9,800 units under construction as of June and another 46,000 in the planning and permitting stages. The overall high business and living costs, in addition to the prohibitive cost of homeownership, will continue to keep would-be homebuyers in the rental market. As a result, Yardi Matrix expects that metro rents will rise 3.1% in 2018.

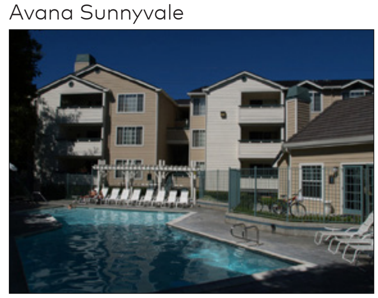
Recent San Jose Transactions

360 Residences



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

Avana Sunnyvale



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

The Franciscan

City: Campbell, Calif.
Buyer: Raintree Partners
Purchase Price: $67 MM
Price per Unit: $370,556

President Hotel

City: Palo Alto, Calif.
Buyer: AJ Capital Partners
Purchase Price: $65 MM
Price per Unit: $866,666

On the cover: Photo by SpVVK/iStockphoto.com

Rent Trends

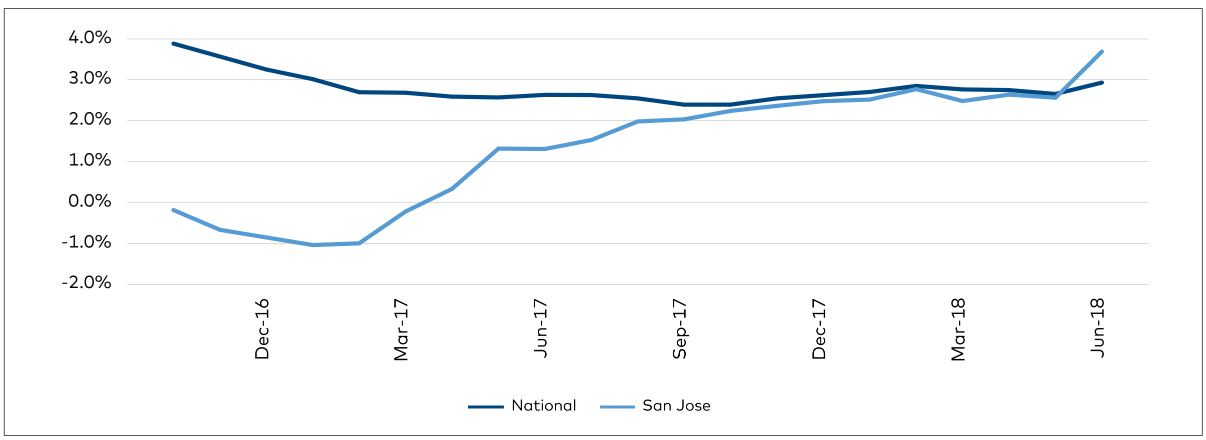
- Monthly rents in San Jose are among the highest in the U.S., only trailing major gateway markets such as Manhattan ($4,110) and San Francisco ($3,070). Rents rose 3.7% year-over-year as of June to an overall $2,894 average, 80 basis points higher than the national rate.

- Silicon Valley's affordability issues are deepened by the growth of rents in the Lifestyle segment, up to $3,170 per month, 4.0% year-over-year. The working-class Renter-by-Necessity segment grew 3.3%, to $2,620. Low- and middle-income renters are being priced out of submarkets close to major tech hubs where developers are focusing on more upscale projects. Affordability issues are pushing residents into the East Bay, where rents are considerably lower.

- Demand for rental housing is expected to remain strong, due in part to home values reaching new peaks and being out-of-reach for most residents. Rent growth was fastest in Santa Clara (up 5.8% year-over-year), North San Jose (4.9%), Sunnyvale (4.7%) and Mountain View–Los Altos (4.2%).

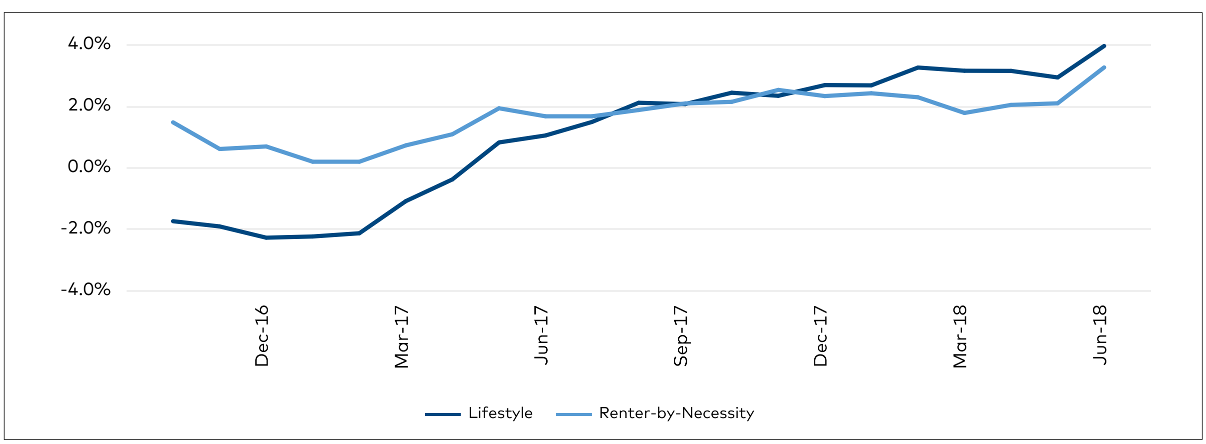
- Since the beginning of the year, rent growth has picked up more substantially in the metro. As a result, we expect the local rental market to continue its improvement, with rents slated to gain 3.1% in 2018.

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

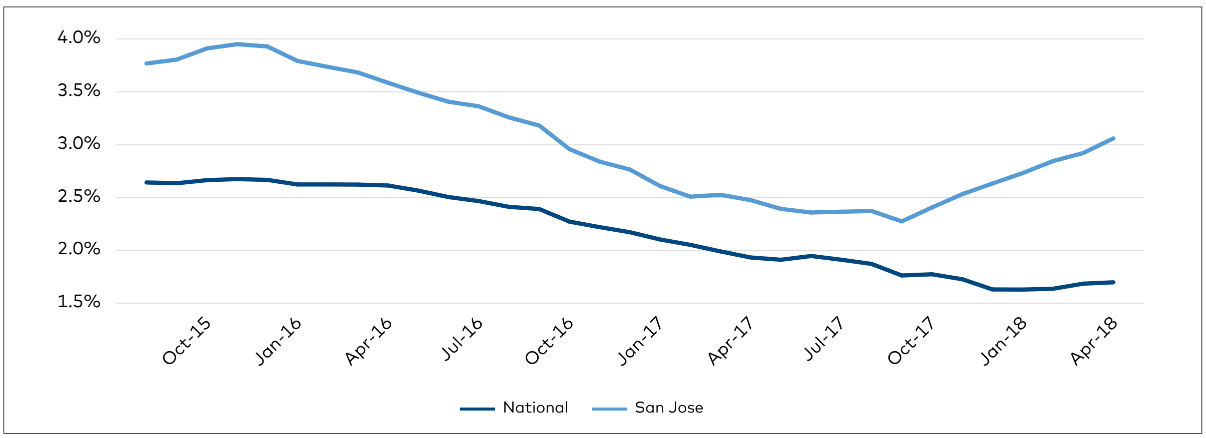
Economic Snapshot

- The metro added 38,500 jobs in the 12 months ending in April, while the unemployment rate dropped below the 2.4% average. Employment growth continues to be among the strongest in the country, up 3.1% year-over-year, well above the 1.7% national average. Fueled by its technology companies and startups, Silicon Valley continues to anchor the Bay Area's thriving economy.

- The information sector saw the largest year-over-year change—11.9%—having added 9,700 jobs. The construction sector added 3,000 new jobs through that interval, boosted by large-scale office projects such as Jay Paul Co.'s 1.8 million-square-foot Moffett Towers II in Sunnyvale and The Irvine Co.'s 1.1 million-square-foot Pathline Peery Park, also in Sunnyvale. Both assets are already fully leased to Facebook, Amazon and Synopsys.

- More than 9 million square feet of office space was underway in Silicon Valley as of July, mostly concentrated in submarkets closer to the shoreline such as Mountain View, Palo Alto and Sunnyvale, Yardi Matrix data shows. More than 1 million square feet of pre-leased Class A space will be occupied this year by tech tenants such as Veritas, 8x8 and Google. One of the largest deals was Analog Devices' lease of the 445,000-square-foot office space at The Irvine Co.'s Santa Clara Square, the largest office project in the metro.

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	%
50	Information	91	8.1%	9,700	11.9%
30	Manufacturing	171	15.2%	7,800	4.8%
65	Education and Health Services	175	15.6%	6,800	4.0%
60	Professional and Business Services	232	20.6%	6,000	2.7%
70	Leisure and Hospitality	105	9.3%	3,300	3.3%
15	Mining, Logging and Construction	52	4.6%	3,000	6.1%
40	Trade, Transportation and Utilities	136	12.1%	900	0.7%
90	Government	98	8.7%	900	0.9%
55	Financial Activities	37	3.3%	300	0.8%
80	Other Services	29	2.6%	-200	-0.7%

Sources: YardiMatrix, Bureau of Labor Statistics

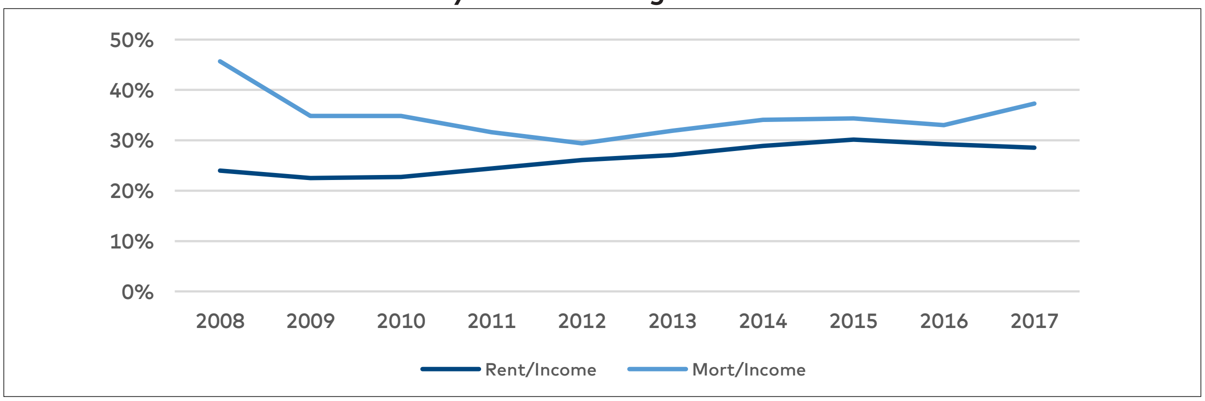
Demographics

Affordability

- The median home value in the Bay Area reached a cycle peak of $929,877 in 2017, up 12% over 2016's value. Mortgage payments now account for 37% of median incomes. While the area has one of the most expensive rents in the country ($2,894 as of June), renting remains the more affordable option for residents, comprising 29% of the metro's median income.

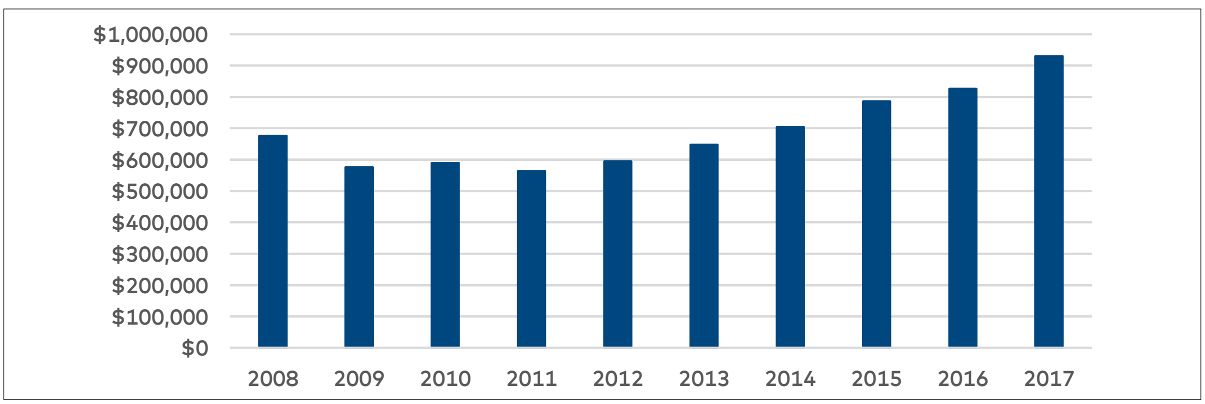
- According to the 2017 Demographia International Housing Affordability Survey, San Jose has the most expensive housing market in the country and the fifth most expensive housing market in the world, overpowering other California markets such as Los Angeles and San Francisco.

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 more than 7,500 residents, a 0.4% increase in 2017, below the 0.7% national rate.
- Over the past five years, nearly 100,000 residents came to the metro, driven by a healthy job market.

San Jose vs. National Population

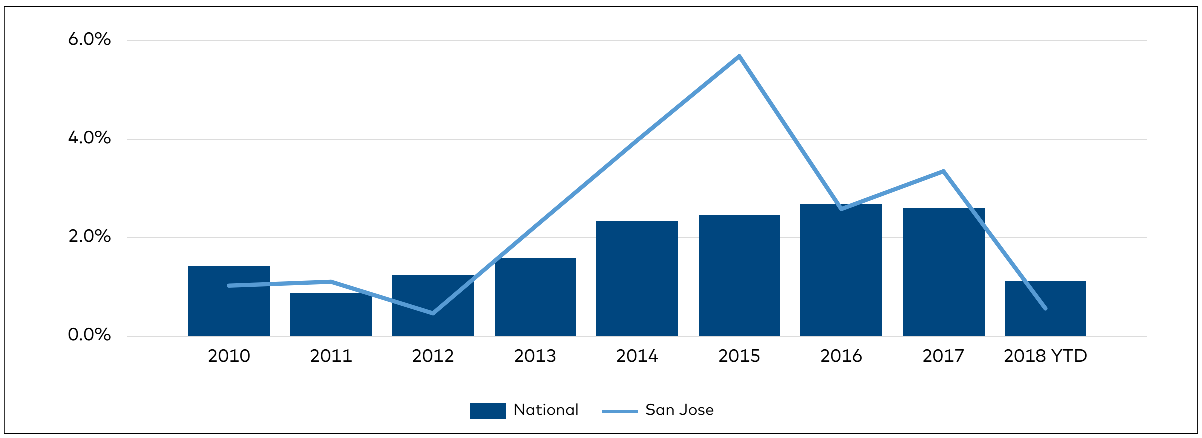
	2013	2014	2015	2016	2017
National	316,234,505	318,622,525	321,039,839	323,405,935	325,719,178
San Jose Metro	1,928,305	1,954,220	1,977,584	1,990,910	1,998,463

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

Supply

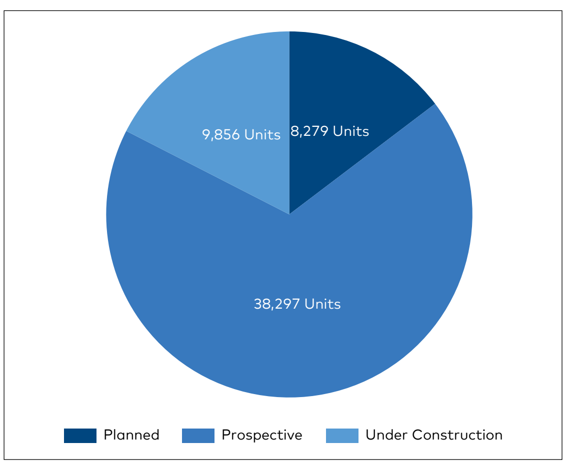
- Nearly 700 units came online this year through June, a slowdown compared to 2017's completions when 4,090 units were delivered. San Jose's strong employment industry led by tech firms is driving housing demand. As a result, we expect that deliveries will likely pick up considerably by the end of the year.
- The metro's growing population and penchant for adding highly skilled young professionals, coupled with a strong job market driven by major tech companies expanding or relocating in the area, is fueling demand for housing, lending to strong absorption of new units. As of June, roughly 9,800 units were underway, with another 46,500 units in the planning and permitting stages. Occupancy in stabilized properties was at 96.3% as of May, down only 10 basis points compared to last year.
- Development activity is concentrated in core submarkets such as Santa Clara (1,840 units), Milpitas (1,682 units), Mountain View–Los Altos (1,468 units) and Central San Jose West (997 units). The Irvine Co.'s Santa Clara Square, a 1,840-unit community, is the largest property currently underway. According to Yardi Matrix, the community started pre-leasing units in May.

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



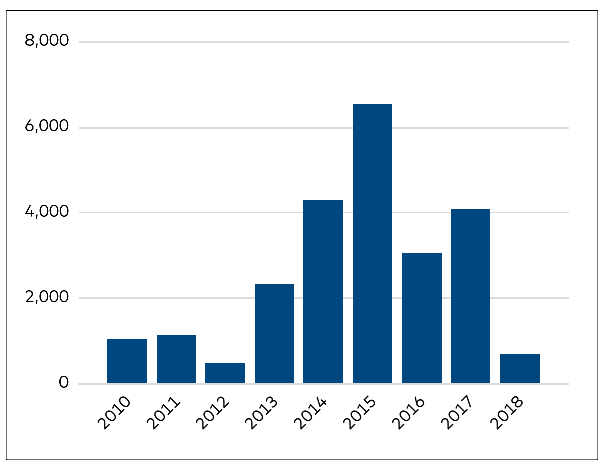
Source: YardiMatrix

Development Pipeline (as of June 2018)



Source: YardiMatrix

San Jose Completions (as of June 2018)

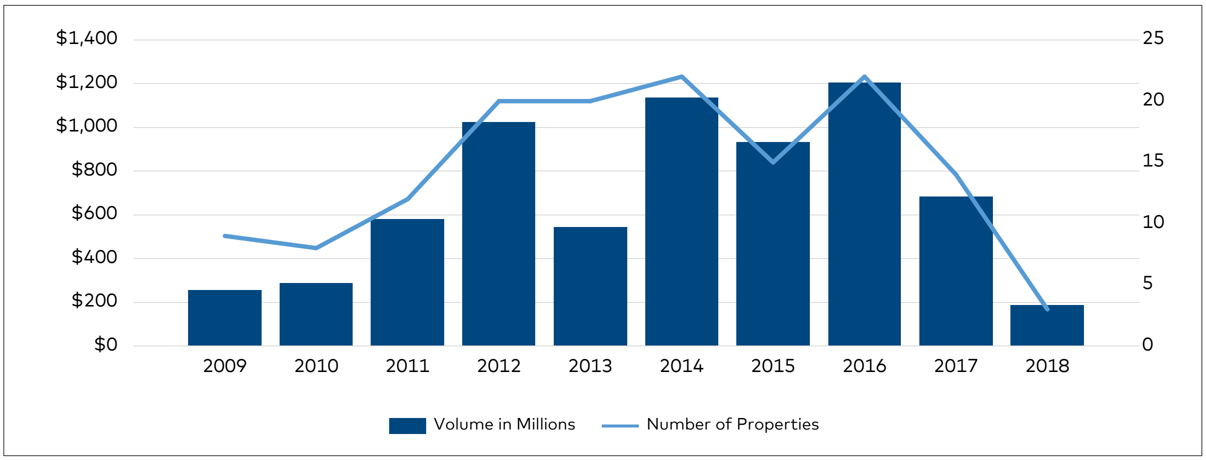


Source: YardiMatrix

Transactions

- Although transaction volume dropped significantly this year, San Jose's tech scene continues to prove attractive to both foreign and domestic investors. Roughly $186 million in multifamily assets traded through the year's midpoint, less than a third of total investment sales in 2017. High competition for assets continued to push per-unit prices, which reached a new cycle high of $587,539.
- The most sought-after submarkets were located in the metro's core area: Central San Jose ($185 million), Sunnyvale ($133 million) and Santa Clara ($121 million). AJ Capital Partners' President Hotel, a 75-unit community in Palo Alto, was the most recent transaction completed in the metro. Flynn Investments sold the asset for $65 million, or $866,667 per unit. Low interest rates and consistent job growth are expected to keep investors motivated to deploy capital in the Bay Area, scouring for value-add opportunities to capture potentially higher returns. Metrowide, acquisition yields start in the low 4% range and reach the high 4% range on average.

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



Source: YardiMatrix

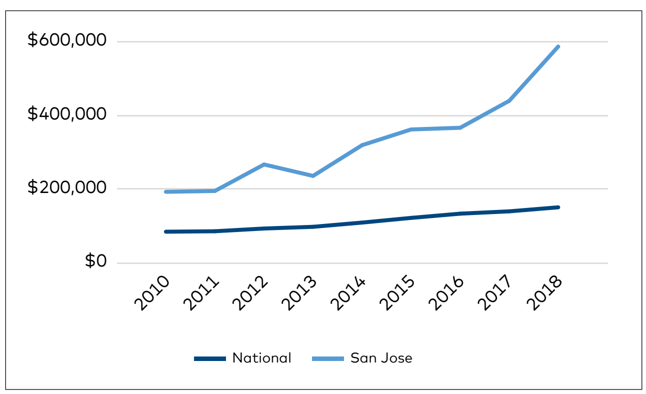
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Central San Jose	185
Sunnyvale	133
Santa Clara	121
West San Jose	67
Palo Alto–Stanford	65

Source: YardiMatrix

[1] From July 2017 to June 2018

San Jose vs. National Sales Price per Unit



Source: YardiMatrix

News in The Metro

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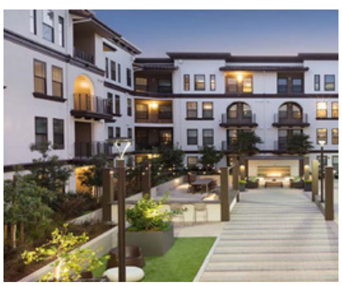
MULTI-HOUSING NEWS

Greystone Provides $71M for San Jose Community

The company facilitated a Fannie Mae DUS loan for 251 Brandon St. The mortgage includes a 10-year fixed-rate, eight years of interest-only and a 30-year amortization period.

Downtown San Jose Property Sells For $13M

Levin Johnston brokered the sale of First Street Manor, a property located in downtown San Jose and within two miles of the city's future Google Village.



South Bay Luxury Asset Trades For $107M

TH Real Estate acquired a newly constructed, 186-unit asset located in Santa Clara, Calif. Designed by KTGY Architecture + Planning, the property came online in the spring of 2017.

Palo Alto Community Changes Hands

Levin Johnston arranged the $8.5 million sale of Villa Sierra Apartments on behalf of the seller—an international owner—and represented the buyer, a local investor.

JEMCOR Breaks Ground on $60M CA Property

The 171-unit Ageno Apartments is part of the larger Vineyard Crossing, a 34.5-acre master-planned community comprising 465 single-family homes, townhomes and apartments.

Affirmed Housing Kicks Off San Jose Community

The project is meant for formerly homeless individuals and will include a temporary housing section, slated to accommodate 20 people waiting for permanent housing.

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The Story of MIRO: San Jose's Tallest Development

High demand for rental units, population growth and a strong employment market have led to a housing shortage in San Jose. In response, developers are reaching new heights with residential projects for the tech talent moving in.

MIRO, a 28-story community located on East Santa Clara Street, broke ground in November 2017 and is San Jose's tallest development. Although the project won't fix the city's housing crisis, it will impact the downtown area by adding 630 units to existing supply. Ted McMahon, chief investment officer of developer Bayview Development Group, and Mike DiNapoli, general manager at contractor Suffolk, discussed the evolution of the project with Associate Editor Evelyn Jozsa.

What is the current status of construction work at MIRO?

DiNapoli: Suffolk is currently shoring and excavating for the three-level below-grade parking garage, and we're continuously dewatering the site as we work down to the bottom of the hole. We are set to pour foundations and erect the tower crane in advance of vertical construction.

What challenges have you come across so far in developing MIRO?

McMahon: We've had a variety of challenges but continue to make progress. The cost of construction remains the biggest impediment to building in the Bay Area, and MIRO is no exception. The rate at which costs are escalating makes getting clarity as early as possible from our design partners and the municipality critical.

MIRO is part of an ongoing wave of luxury residential development in San Jose's downtown area. What is unique about this project?

MIRO will break new ground with the scale and quality of amenities offered. One example of this is the significant rooftop lounge space with chef's kitchens and dining space that can be reserved by residents for events and will offer cooking classes and wine tastings.

Another example is music practice spaces for residents to either practice alone or have jam sessions in sound-attenuated rooms.

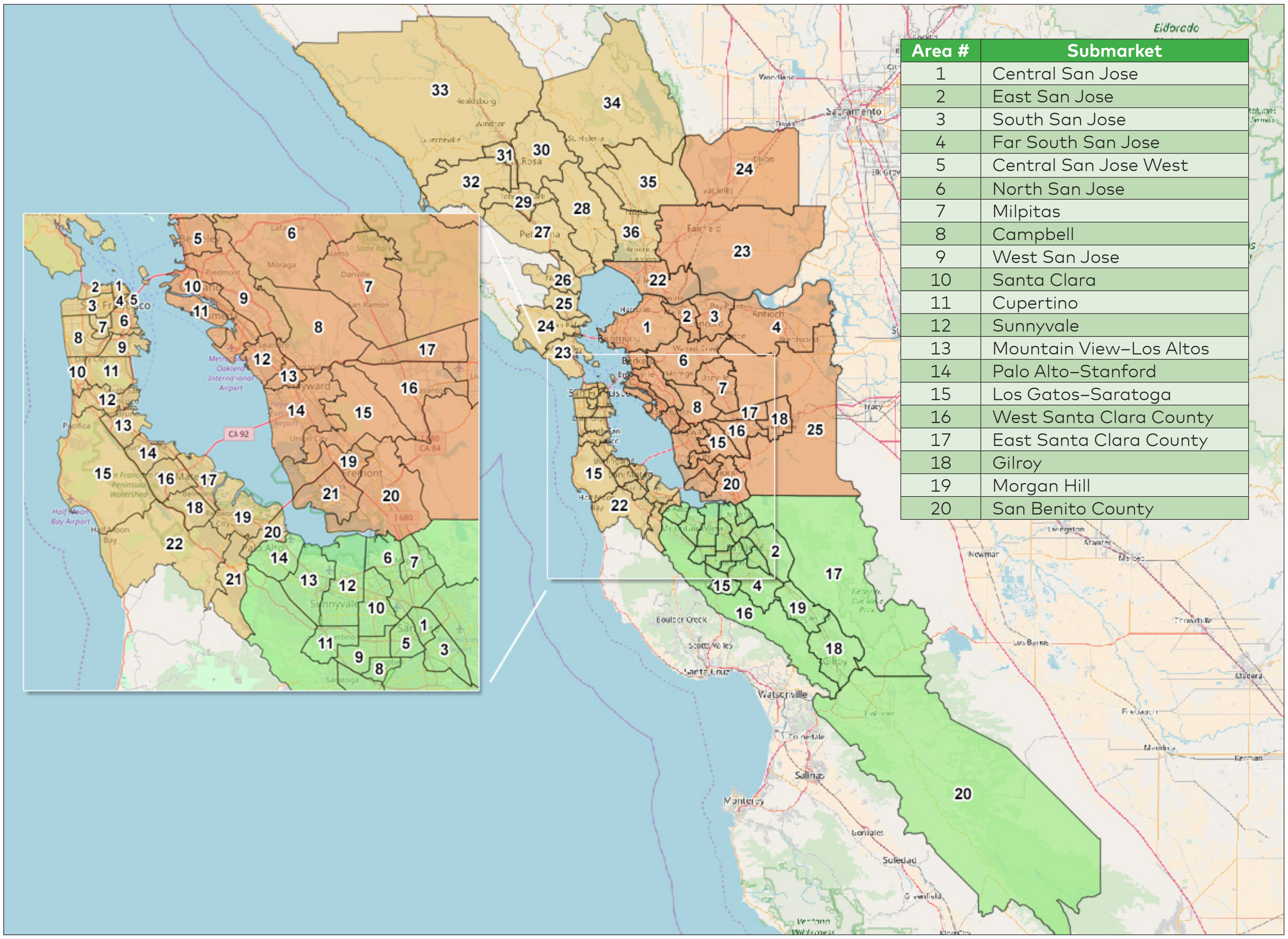
How will this new development impact San Jose's multifamily market?

McMahon: San Jose, like the rest of the Bay Area, is so short on housing that 630 units will be a drop in the bucket within the whole city. For downtown, though, MIRO will help to stretch the trend of high-density, well-appointed buildings a few blocks farther east than the current offerings. We believe there is great potential for growth in this transitional neighborhood, and MIRO will be a positive catalyst.

How do you see multifamily demand in San Jose going forward?

McMahon: We still love the fundamentals of the new job/housing starts ratio, and the backlog of demand for quality housing should contribute to continued growth. The city of San Jose is very supportive of finding ways to fill that demand in thoughtful ways that encourage density where infrastructure can support it, meaning less impact on traffic and sprawl, concerns we all share as Bay Area residents. Infill development in strategic areas with existing and planned infrastructure makes good sense.

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.