Yardi® Matrix

Technology Propels San Jose

Multifamily Report Winter 2019

Job Growth Rate Outpaces Nation

Deliveries Taper Off

Sliding Supply Powers Rent Growth

Market Analysis
Winter 2019

Contacts
Paul Fiorilla
Associate Director of Research
Paul.Fiorilla@Yardi.com
(800) 866-1124 x5764

Jack Kern
Director of Research and Publications
Jack.Kern@Yardi.com
(800) 866-1124 x2444

Author
Anca Gagiuc
Associate Editor

Demand Pressured by Lagging Supply

San Jose's tech sector propelled the metro to a position among the world's fastest-growing economies. The ranking is reflected in the multifamily sector, where demand for housing has increased rents by 5.0% year-over-year through November to $2,862, more than double the national average.

Employment growth has been solid, hovering around the 3.0% mark all year long, hitting 3.3% in September, above the 2.0% national rate. San Jose added 36,500 jobs in the year ending in September, with all but one sector seeing net positives. Consequently, the unemployment rate clocked in at 2.5% as of September. Education and health services led growth with the addition of 9,600 jobs and is expected to sustain its performance. In early 2019, Stanford's new 35-acre Redwood City campus is anticipated to open and add 2,700 jobs. Other notable developments estimated to boost the area's economy are JPMorgan Chase's 195,000-square-foot fintech campus in Palo Alto's Stanford Research Park and Google's plan to build a mixed-use campus that will accommodate some 20,000 employees by 2035.

Deliveries fell in 2018, as only 1,370 units were added through November, about 1.1% of total stock. The transaction volume hit $935 million through the first 10 months of the year, with an overall per-unit price of $503,827, as assets continued to rise in value in an undersupplied market.

Recent San Jose Transactions

El Rancho Verde

City: San Jose, Calif.
Buyer: WNC & Associates
Purchase Price: $370 MM
Price per Unit: $528,571

Meridian at Midtown

City: San Jose, Calif.
Buyer: Essex Property Trust
Purchase Price: $104 MM
Price per Unit: $477,064

The Verandas at Cupertino

City: Cupertino, Calif.
Buyer: Prometheus Real Estate Group
Purchase Price: $74 MM
Price per Unit: $614,583

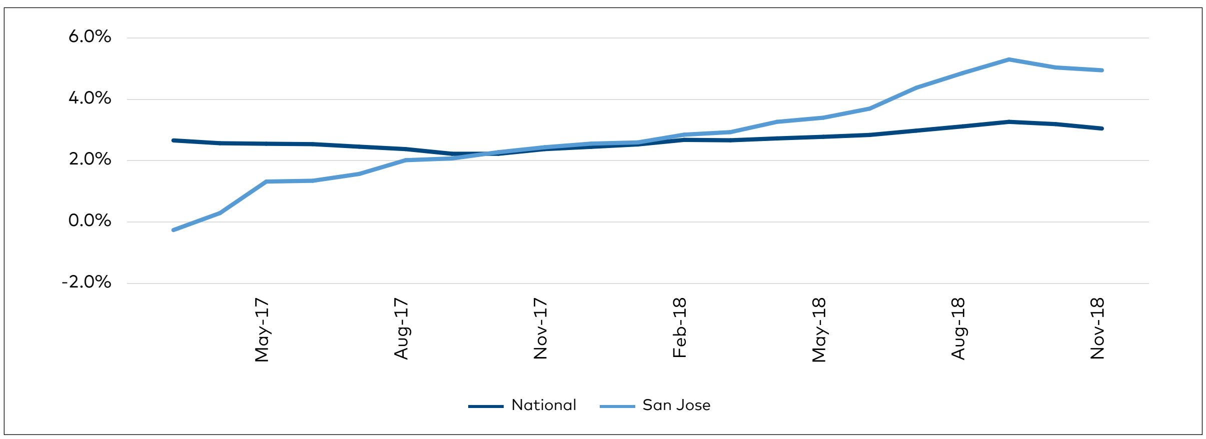
The Crossing

City: Sunnyvale, Calif.
Buyer: Interstate Equities Corp.
Purchase Price: $64 MM
Price per Unit: $429,054

Rent Trends

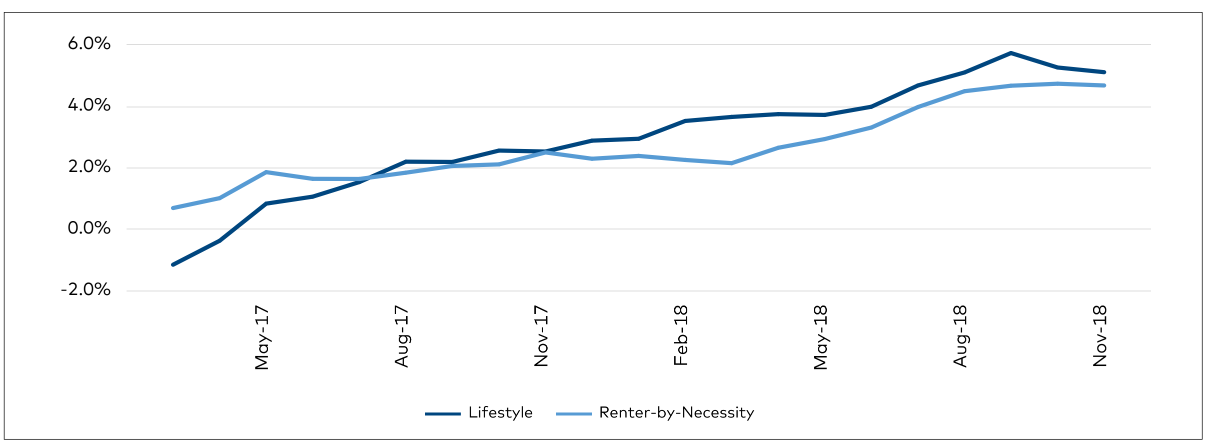
- Rents were up 5.0% year-over-year through November, as growth surged during the year's second half. That was 190 basis points above the national growth rate, with the average overall rent climbing to $2,862, leading the national figure by $1,443. Last year's consistent deliveries in rental units didn't tame rent growth in San Jose, as housing needs are still pressing. The metro was one of the fastest-growing rental markets in 2018, and as deliveries still lag, it will likely continue to become more expensive.
- Upscale Lifestyle units led growth over the 12 months ending in November, with rents increasing 5.1% to $3,105. Renter-by-Necessity assets rose 4.7% to $2,618, nearly double the national average. The low spread between segments highlights healthy demand across the quality spectrum.
- The average rent climbed above the $3,000 mark in four submarkets: Palo Alto–Stanford holds the metro's most expensive units, up 5.2% to $3,699, followed by Mountain View–Los Altos, where rents registered the largest increase, up 6.6% to $3,234. Cupertino (up 4.3% to $3,215) and Los Gatos–Saratoga (up 5.2% to $3,028) round out the metro's top submarkets. Only one submarket posted rents below the $2,000 mark, claiming the label of most affordable in San Jose: San Benito County, where rents rose 5.7% to $1,217.

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)

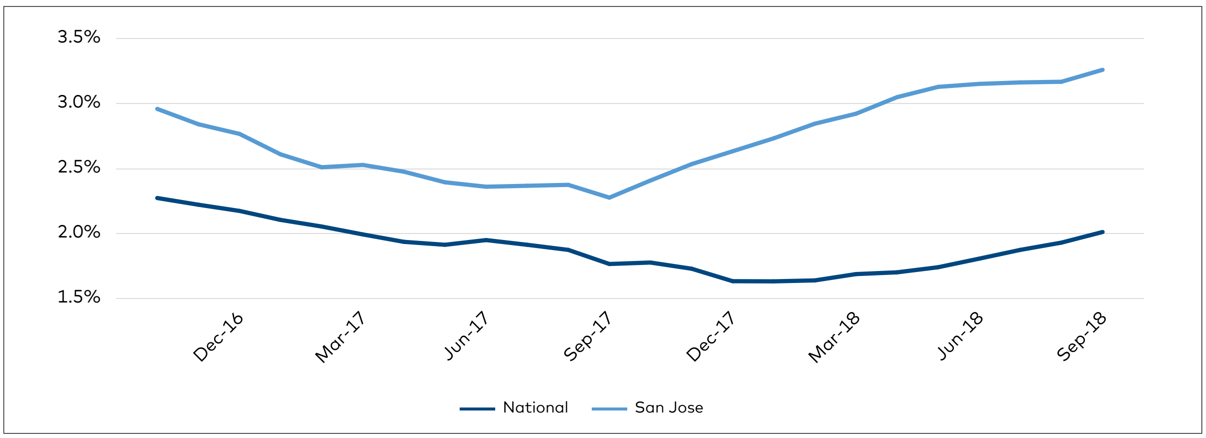


Source: YardiMatrix

Economic Snapshot

- San Jose added 36,500 jobs in the 12 months ending in September, up 3.3% year-over-year, well above the 2.0% national average. San Jose has experienced consistent job creation and income growth due to its strong technology sector. The metro's robust economy earned the second spot in Brookings' Global Metro Monitor report, which ranks the world's fastest-growing economies. The unemployment rate dropped to 2.5%, leading the 4.1% national average.
- The biggest change was registered in education and health services, which added 9,600 jobs. Stanford University's new Redwood City campus—spreading across 35 acres and slated to open in early 2019—will likely maintain the trend, as some 2,700 Stanford employees are expected to work there. Professional and business services added 7,300 jobs and will continue to expand, thanks to various projects underway, including JPMorgan Chase's 195,000-square-foot fintech campus in Palo Alto's Stanford Research Park that will house 1,000 employees upon completion in 2020. Google's plan to build a mixed-use campus with about 20,000 employees will add to the city's flourishing economy.
- Phase II of the Bay Area Rapid Transit (BART) expansion into Berryessa/North San Jose has been pushed toward the end of 2019. The additional station will offer easy transit farther East into the metro and provide additional incentive for transit-oriented development in the Berryessa District.

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	175	15.4%	9,600	5.8%
60	Professional and Business Services	236	20.8%	7,300	3.2%
50	Information	94	8.3%	6,900	7.9%
30	Manufacturing	174	15.3%	6,000	3.6%
15	Mining, Logging and Construction	53	4.7%	2,800	5.5%
90	Government	96	8.5%	2,200	2.3%
70	Leisure and Hospitality	105	9.2%	2,000	1.9%
55	Financial Activities	37	3.3%	1,100	3.1%
80	Other Services	29	2.6%	300	1.0%
40	Trade, Transportation and Utilities	136	12.0%	-1,700	-1.2%

Sources: YardiMatrix, Bureau of Labor Statistics

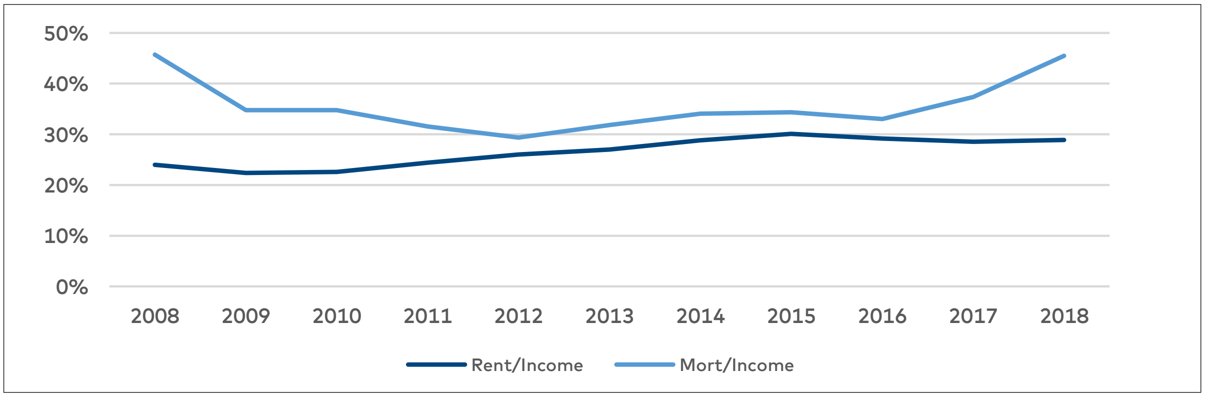
Demographics

Affordability

- The median home price in San Jose rose another 19.4% year-over-year, crossing the $1 million mark for the first time. At $1,110,105, the amount represents a 97.4% increase over the 2011 trough. Mortgage payments now account for 45% of median incomes. At $2,862 in November, rents claimed about 29% of the metro's median income. In 2018, two fully affordable projects were delivered, totaling 165 units.

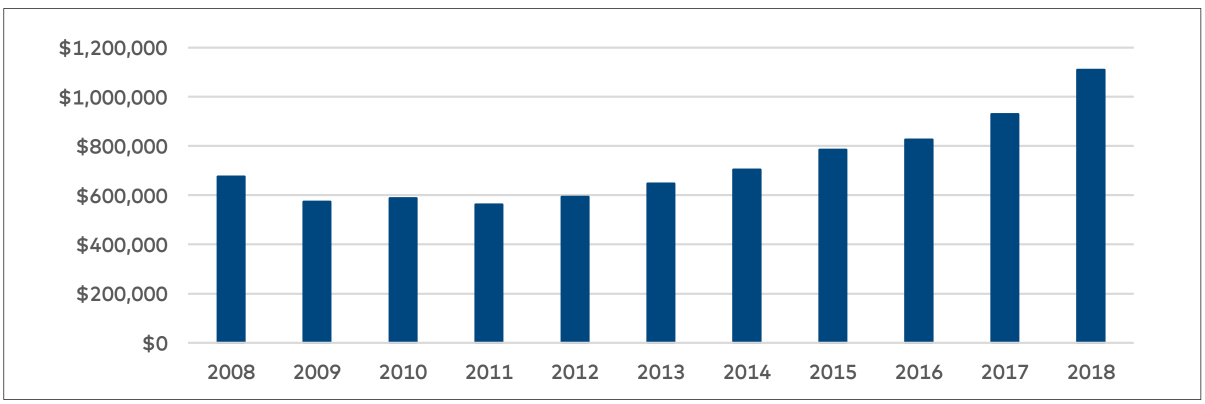
- Affordability is under debate following Google's $110 million acquisition of public land where it plans to build a 50-acre campus that would employ 20,000 people by 2035. Following the announcement, Mayor Licarrdo has pushed for 25% of overall housing built around Diridon Station to be affordable.

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 added some 7,500 residents in 2017. The bulk of that demographic growth is due to immigrants.

- Meanwhile, those who left the metro chose other parts of the U.S., as the area continues to price out its residents.

San Jose vs. National Population

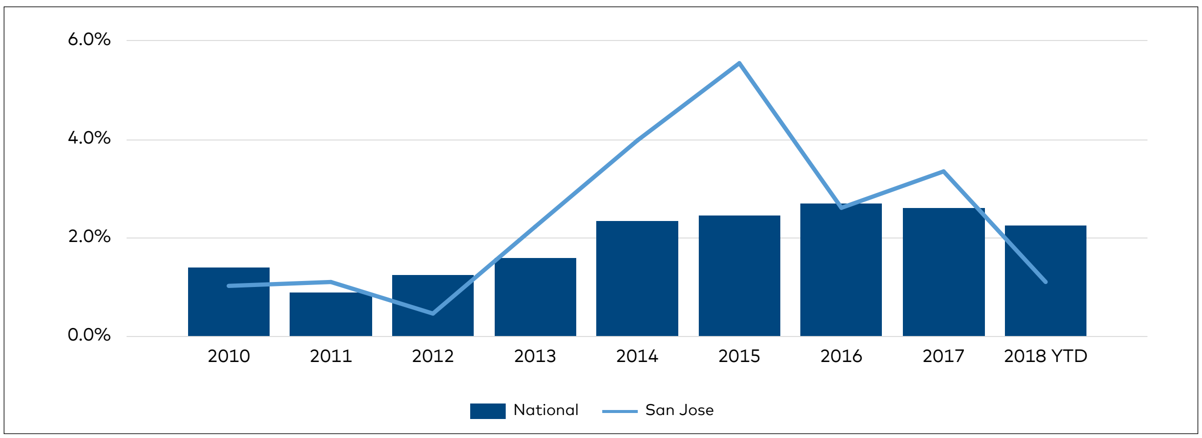
	2013	2014	2015	2016	2017
National	316,234,505	318,622,525	321,039,839	323,405,935	325,719,178
San Jose Metro	1,928,305	1,954,220	1,977,584	1,990,910	1,998,463

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

Supply

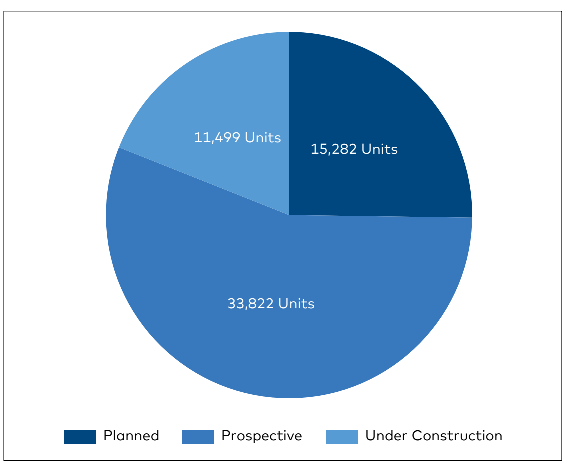
- Deliveries cooled in San Jose, mirroring the slowing population growth, with only 1,370 units in seven properties coming online in the first 11 months of 2018. Of those, the bulk was in Lifestyle-rated assets. Despite the metro's shortage of market-rate housing, the occupancy rate in stabilized properties slid 10 basis points year-over-year through October, to 95.8%.
- Nearly 11,500 units were underway as of November, and more than 49,000 units were in the planning and permitting stages. The inventory composition is also favoring Lifestyle assets, as nearly 6,000 units under construction are geared toward the upscale segment. Although San Jose is a strong market due to its well-educated workforce and tech industry, further burdens are anticipated for renters looking for Renter-by-Necessity properties.
- Development activity is spotty, with a focus on the core areas. The top six submarkets comprise more than 9,000 units under construction, with nearly 5,500 targeting Lifestyle renters. The largest project underway is The Irvine Co.'s 1,840-unit Santa Clara Square, a development that includes 40,000 square feet of retail and is slated for completion by February 2021.

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



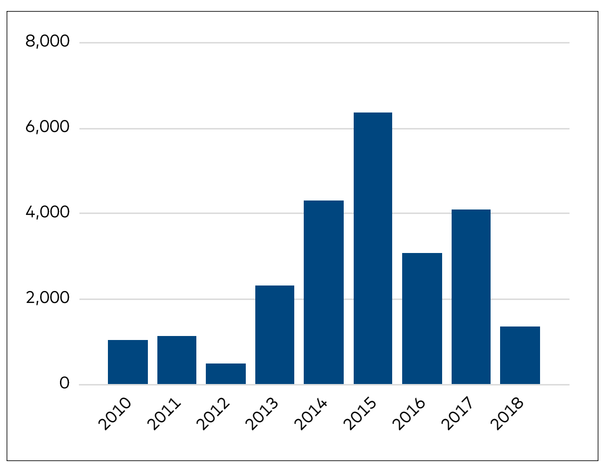
Source: YardiMatrix

Development Pipeline (as of November 2018)



Source: YardiMatrix

San Jose Completions (as of November 2018)

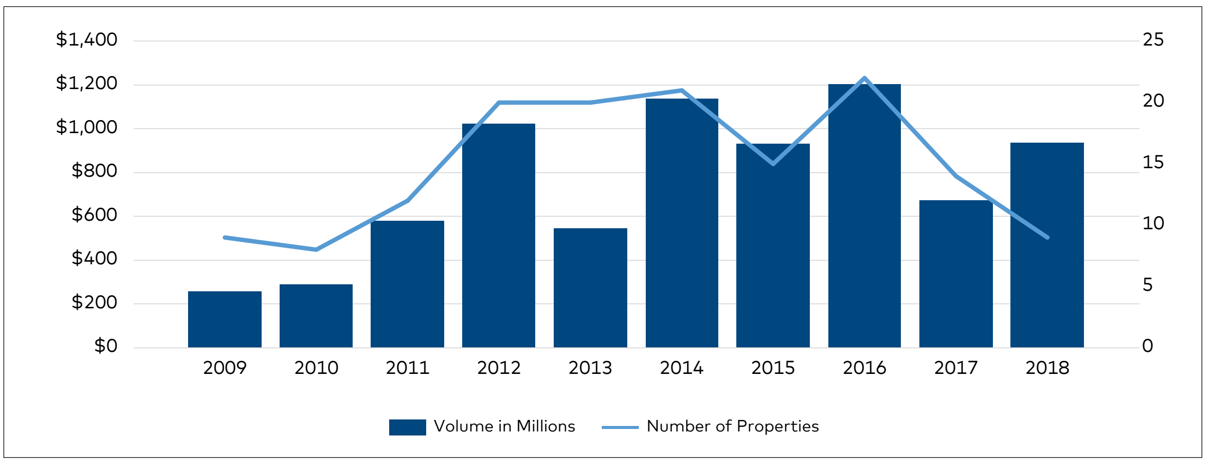


Source: YardiMatrix

Transactions

- Investment sales hit $935 million through October, nearly 39% above last year's total. The overall price per unit rose 16.6% to $503,827, a new cycle peak and well above the national figure. San Jose is a seller's market, as prices have inflated even though that rise has yielded a lower number of transactions in the metro of late.
- Two-thirds of the properties that changed hands were in the Renter-by-Necessity segment, trading at an average per-unit price of $513,274, thanks to their premium location. Counterintuitively, Lifestyle assets traded at a lower per-unit price, at $481,295—a result of their placement in fringe submarkets.
- East San Jose topped the list of the most active submarkets in the 12 months ending in November, due to the $370 million sale of the 700-unit El Rancho Verde. WNC & Associates acquired the asset.

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



Source: YardiMatrix

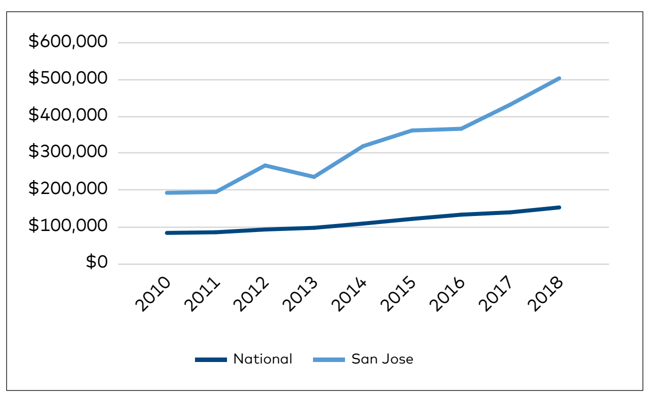
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
East San Jose	370
Santa Clara	121
Campbell	119
Central San Jose West	104
Sunnyvale	90
Cupertino	74
Palo Alto–Stanford	65
South San Jose	53

Source: YardiMatrix

[1] From November 2017 to October 2018

San Jose vs. National Sales Price per Unit



Source: YardiMatrix

News in the Metro

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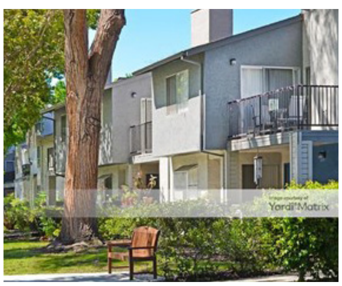
Bank of America Provides $25M For Bay-Area Refi

The loan retires a prior $30 million CMBS mortgage from late 2008. It had been set to mature in January.

Luxury Community Trades for $104M

Republic Urban Properties sold the 2015-built, 218-unit asset located within a mile of downtown. HFF represented the seller and procured the buyer.



Decron Properties Buys San Jose Apartments

The partially affordable property last changed hands in 2012, when Greystar purchased it from Invesco for nearly $60 million.

Standard Communities Upgrades Senior Housing Asset

The affordable housing division of Standard Cos. renovated Villa de Guadalupe Apartments, preserving the property's affordability.

Silicon Valley Community Sells For $17M

A Northern California-based development company sold the property to a private investor. The 32-unit community is situated in Palo Alto, Calif.

Tech CU Funds Luxury Development

Cypress Group received $20.5 million in financing for the construction of the apartment building located in the Willow Glen neighborhood.

Executive Insight

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MULTI-HOUSING NEWS

The Story of MIRO: San Jose's Tallest Development

By Evelyn Jozsa

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 San Jose's housing crisis, it will impact the downtown area by adding 630 units to existing supply.

Multi-Housing News reached out to Ted McMahon, chief investment officer of Bayview Development Group, to find out more about MIRO and the challenges it brought on.

What challenges have you come across so far in developing MIRO? How did you overcome them?

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.

San Jose has the best weather in the Bay Area, and the architecture takes full advantage of that fact. That's

also why we offer huge verandas and balconies on our upper floor units. Another example is music practice spaces for residents to either practice alone or have jam sessions in sound-attenuated rooms. The overall offering is geared to be competitive with the best apartment buildings up and down the peninsula.

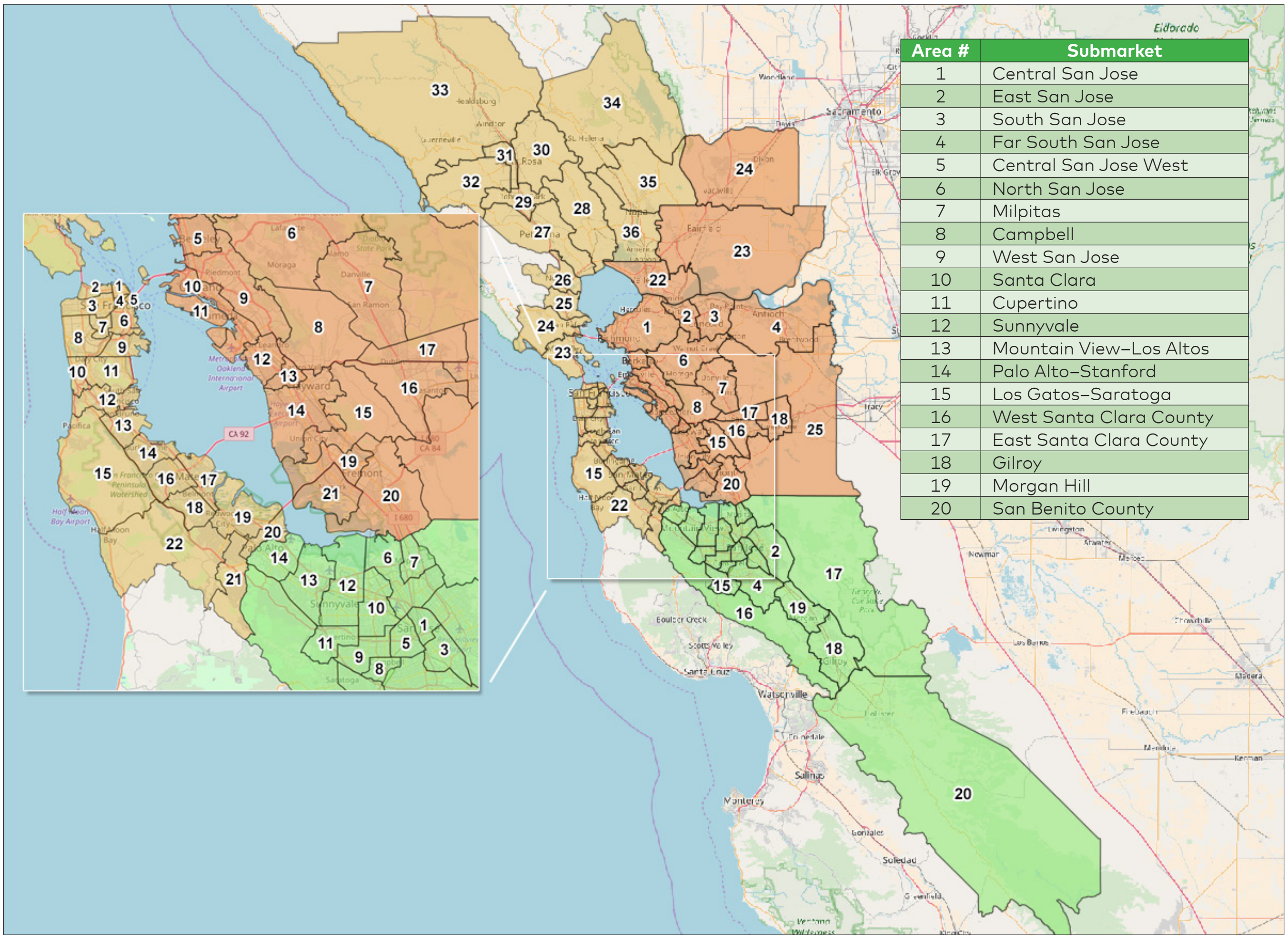
How will this new development impact San Jose's multifamily market?

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 are close to San Jose State University, which is the largest employer in downtown and a huge economic driver. 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?

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. With BART on the horizon for downtown, we expect long-term demand in the core of the city able to weather likely macroeconomic fluctuations.

San Jose Submarkets



Learn the latest about the state of these markets. Download our San Francisco Report.

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.