Yardi® Matrix

Sun Shines Bright on the Valley

Multifamily Report Spring 2019

Deliveries, Acquisitions Slow Out of the Gate

Investors Target Core Submarkets

Rent Growth Stays Strong

Market Analysis
Spring 2019

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Tech Industry Powers Rent Growth

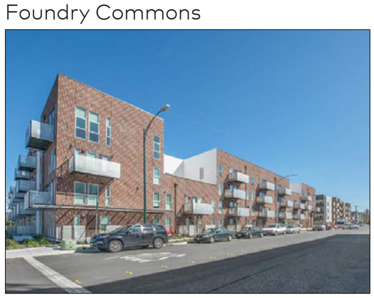
Fueled by a strong economy led by its technology industry, San Jose's multifamily sector remains healthy. Although it ranks among the most rent-burdened metros in the country, the market benefits from a strong, highly skilled renter cohort that can largely accommodate the market's high rents.

San Jose's economy has continued to be strong, adding 25,600 jobs in the 12 months ending in February, a 2.0% growth in rate of employment year-over-year. The information sector led growth in the metro with the addition of 8,500 jobs. The industry also saw the largest year-over-year change (9.7% as of March) and is expected to continue to increase as tech companies like Facebook, Google, Amazon and Apple expand local operations. Contributing to the bulk of office projects coming to the metro, Google's mixed-use campus is set to include roughly 3 million square feet of office space, 400,000 square feet of retail and 8,000 residential units.

Transaction activity slowed during the first quarter, following a $1 billion year in 2018, with two assets trading for a total of $101 million. Core submarkets close to corporate campuses remained in high demand. Despite a sluggish start to the year for deliveries, nearly 11,958 units were underway as of March. With strong fundamentals driving the housing market, we expect rents to continue to grow—by 2.4% in 2019.

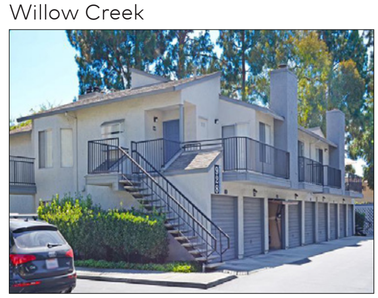
Recent San Jose Transactions

Foundry Commons



City: San Jose
Buyer: Tilden Properties
Purchase Price: $110 MM
Price per Unit: $463,235

Willow Creek



City: San Jose
Buyer: Decron Properties
Purchase Price: $85 MM
Price per Unit: $406,731

Avana San Jose

City: San Jose
Buyer: Greystar
Purchase Price: $80 MM
Price per Unit: $636,636

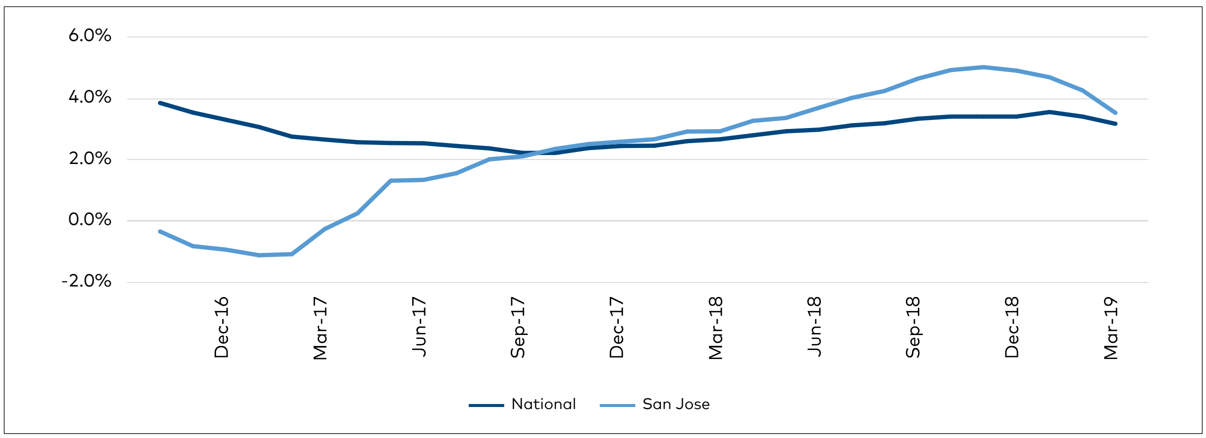
Lenzen Square

City: San Jose
Buyer: WNC & Associates
Purchase Price: $21 MM
Price per Unit: $238,636

Rent Trends

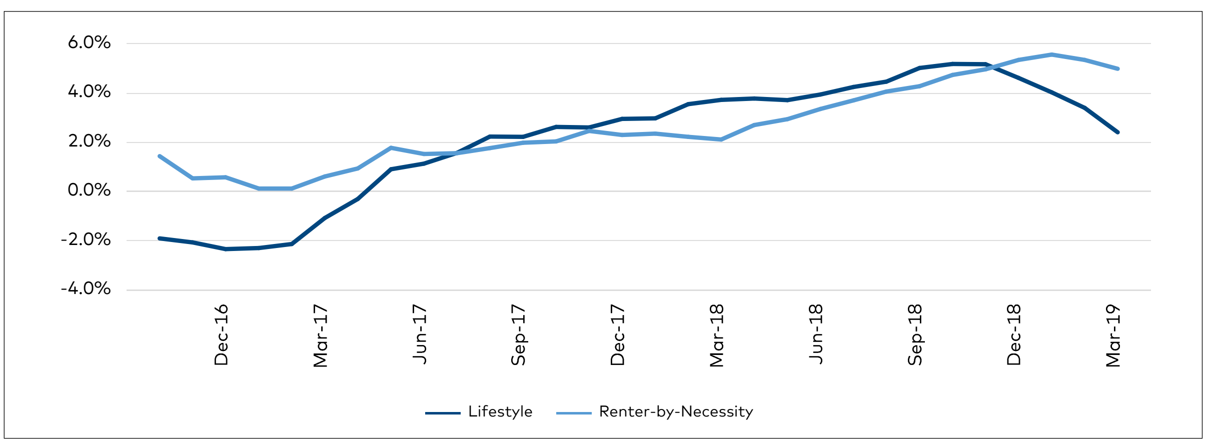
- Rents in San Jose rose 3.5% year-over-year through March, outpacing the national average by 30 basis points. The average rent stood at $2,872, roughly double the $1,430 national figure. Average occupancy in stabilized properties remained high, at 95.7% as of February, down only 10 basis points year-over-year, which points to solid absorption.
- Gains were led by the working-class Renter-by-Necessity segment, with rates up 5.0%, to an average of $2,633. Lifestyle rents reached $3,110 on average, a 2.4% year-over-year increase. Strong employment gains in high-paying sectors have maintained robust demand for upscale rentals.
- Palo Alto–Stanford ($3,737), Cupertino ($3,282), Mountain View–Los Altos ($3,237) and Los Gatos–Saratoga ($3,149) were the priciest submarkets, with rents above the $3,000 mark. Los Gatos–Saratoga (10.8%) and Palo Alto–Stanford (6.4%) also saw the largest year-over-year increases, followed by West San Jose (6.1%) and Gilroy (5.6%).
- As supply has generally been limited over the past five quarters, rents are poised to continue to rise, with demand staying consistent. We expect rents to grow 2.4% in 2019.

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)

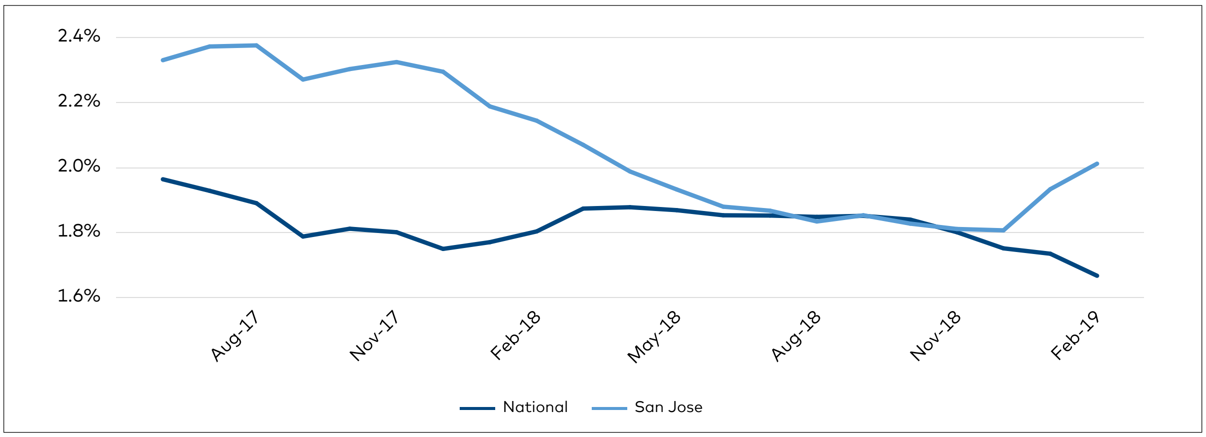


Source: YardiMatrix

Economic Snapshot

- The metro added 25,600 jobs in the 12 months ending in February, a 2.0% year-over-year increase, outperforming the national average by 30 basis points. The unemployment rate has reached historically low levels—3.0% as of January, significantly lower than it was 10 years ago, when it peaked at 11.3%.
- The information sector saw the largest year-over year increase—9.7% as of March—having added 8,500 jobs through that interval. Despite the high costs of developing office space in the area, Silicon Valley's position as the world's leading tech market means that companies continue to maintain a presence or expand in the metro. Roughly 4.3 million square feet of office space came online last year, almost double the space delivered in 2016. The bulk of activity was concentrated in Sunnyvale, where Facebook rented 1.1. million square feet of space in the under-construction Moffett Towers 2, and Mountain View, where Google announced plans to develop more than 3 million square feet of office, 400,000 square feet of retail space and roughly 8,000 residential units.
- Despite strong overall development activity in the area's commercial and residential sectors, the construction industry lost 2,600 jobs year-over-year through March. With development booming in other parts of the country where living costs are significantly lower, construction laborers are looking outside the Bay Area for opportunities.

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	96	8.5%	8,500	9.7%
30	Manufacturing	176	15.5%	7,400	4.4%
60	Professional and Business Services	239	21.0%	3,900	1.7%
65	Education and Health Services	176	15.5%	3,400	2.0%
70	Leisure and Hospitality	105	9.2%	2,700	2.6%
55	Financial Activities	38	3.3%	1,500	4.1%
90	Government	98	8.6%	1,200	1.2%
40	Trade, Transportation and Utilities	133	11.7%	500	0.4%
80	Other Services	28	2.5%	-900	-3.1%
15	Mining, Logging and Construction	47	4.1%	-2,600	-5.3%

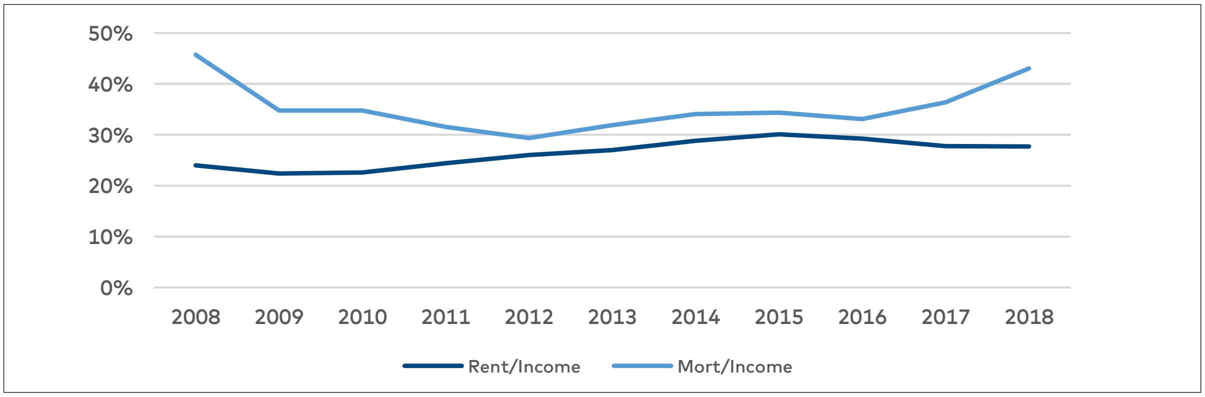
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

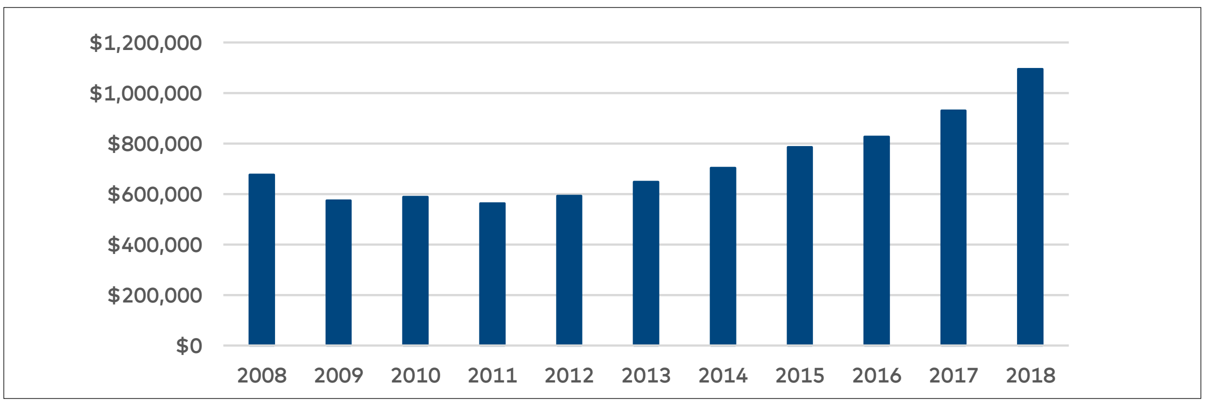
- Cost of living continues to be a major problem in the metro, as the median home price crossed the $1 million mark in 2018 ($1,094,432), an 18% increase over 2017 levels. Owning was significantly more expensive than renting, accounting for 43% of the area's median income, while rents—at $2,872 as of March—equated to 28%.
- Although San Jose residents have one of the highest median incomes in the country, the market continues to struggle with a shortage of available units at lower affordability levels, further pressuring lower-wage earners in the South Bay.

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 7,553 residents in 2017, a 0.4% increase, below the 0.7% national rate.
- Since 2012, San Jose has added nearly 100,000 residents, driven by strong employment.

San Jose vs. National Population

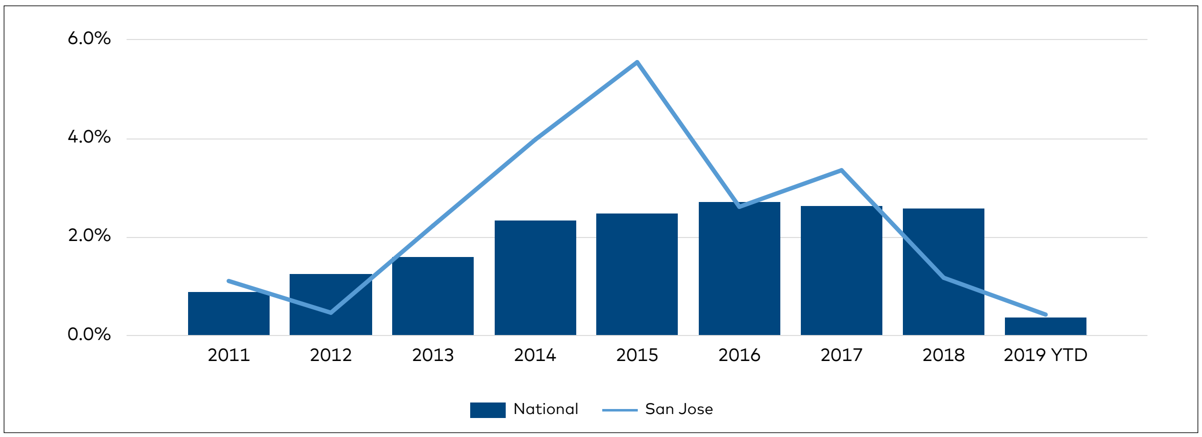
	2013	2014	2015	2016	2017
National	316,234,505	318,622,525	321,039,839	323,405,935	325,719,178
San Jose Metro	1,928,305	1,954,220	1,977,584	1,990,910	1,998,463

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

Supply

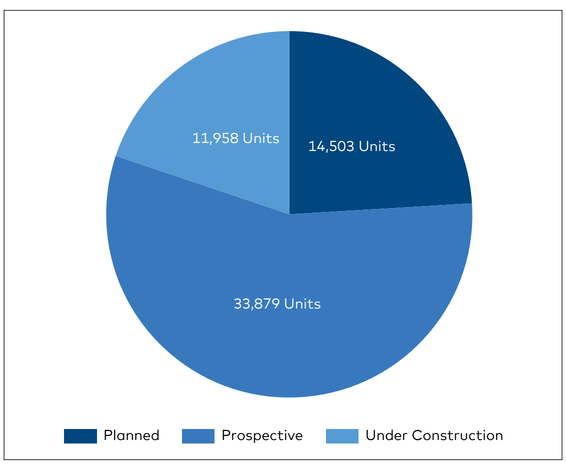
- Developers had 11,958 units under construction as of March, with 5,800 slated for delivery by year's end. Despite the slow start to the year—only 414 units came online during the first quarter—developers remained committed to building in the area due to the metro's opportunity for very high rent rates.
- Due to the Bay Area's high labor costs, soaring land prices and tight zoning laws, deliveries contracted dramatically in 2018, when 1,450 units were delivered, nearly a third of 2017's total completions (4,090 units). Although demand is high, these factors are likely to continue to keep deliveries tight overall.
- Milpitas (2,379 units under construction), Santa Clara (1,932), Sunnyvale (1,731) and Mountain View–Los Altos (1,508) are seeing the most development activity. Tech companies expanding or relocating in these markets have further increased the need for housing. Santa Clara Square, a 1,840-unit community in Santa Clara, was the largest development underway as of April. The mixed-use property will include offices, dining and retail space once completed.

San Jose vs. National Completions as a Percentage of Total Stock (as of March 2019)



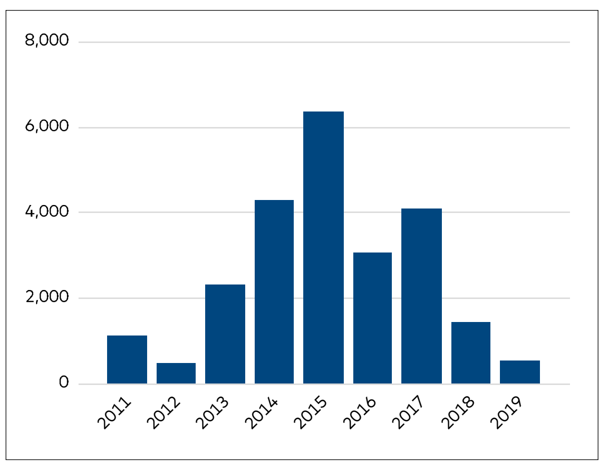
Source: YardiMatrix

Development Pipeline (as of March 2019)



Source: YardiMatrix

San Jose Completions (as of March 2019)

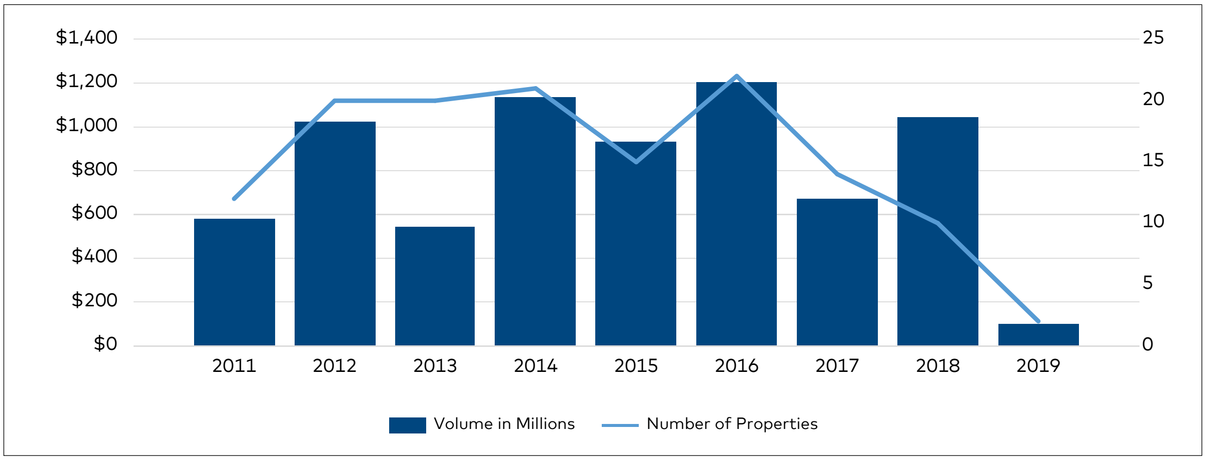


Source: YardiMatrix

Transactions

- Two multifamily assets traded for a total of $101 million during the year's first quarter. The average price per unit was $327,922, well above the $153,504 national rate, albeit on a very limited sample size. Transaction volume has been inconsistent for the better part of the cycle, with $674 million in multifamily properties sold in 2017, then bouncing to more than $1 billion last year.
- Metrowide, acquisition yields were in the mid-4% range, and value-add opportunities continued to be the most sought-after investments. In the 12 months ending in March, investors' focus was concentrated on the East San Jose ($370 million), Central San Jose West ($210 million), South San Jose ($133 million) and Central San Jose ($110 million) submarkets. These areas drew multifamily investment activity due to the presence of tech companies like Google, Facebook and Apple, which all continue to expand and drive demand for upscale housing in the South Bay.

San Jose Sales Volume and Number of Properties Sold (as of March 2019)



Source: YardiMatrix

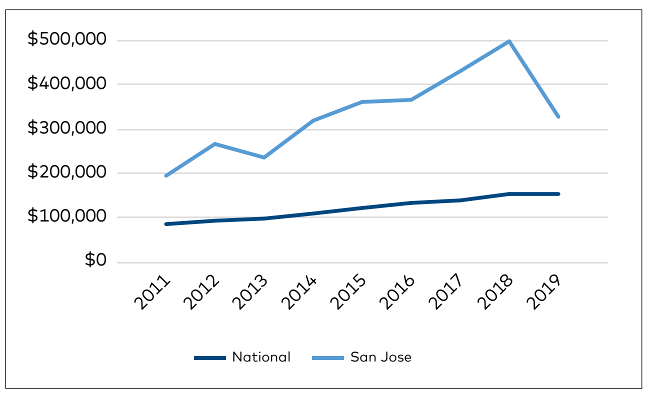
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
East San Jose	370
Central San Jose West	210
South San Jose	133
Central San Jose	110
Cupertino	74
Palo Alto - Stanford	65
Sunnyvale	64

Source: YardiMatrix

[1] From April 2018 to March 2019

San Jose vs. National Sales Price per Unit



Source: YardiMatrix

Executive Insight

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MULTI-HOUSING NEWS

The Answer to the Bay Area's Affordable Housing Crisis

By Laura Calugar

Enterprise Community Partners and Kaiser Permanente together launched a $100 million national loan fund to create and preserve multifamily rentals.

Enterprise Vice President Rich Gross and Kaiser Permanente Senior Vice President Bechara Choucair share their thoughts on the challenges the Bay Area faces today, suggest solutions to alleviate the affordability crunch and touch on their involvement in the creation of more affordable housing options.

How serious is the affordable housing crisis in the Bay Area today?

Gross: The Bay Area is home to the most expensive housing market in the country. In dollars and cents, San Francisco provides a perfect example. An individual would need to earn $58 per hour, or $120,000 per year, to afford a typical two-bedroom apartment. To find affordability, people are moving farther and farther away from their jobs, sacrificing the time they spend connected to family and community for long commutes. These affordable housing challenges facing the Bay Area create serious gentrification and displacement pressures and deny hundreds of thousands of families, seniors, veterans and people with special needs a fair opportunity to thrive, threatening the health, education and economies of our communities.

How difficult is it for you to obtain the necessary funds for affordable housing projects in the Bay Area?

Bechara Choucair *(left)*, Rich Gross
Images courtesy of Kaiser Permanente and Enterprise Community Partners

Gross: It's getting easier. Public recognition and private-sector engagement around affordable housing have created positive change and impact. Our work with Kaiser Permanente on the Housing for Health Fund represents a step into new and significant funding arenas—it is the first time that a health-care organization has put equity at this scale into a fund for affordable housing, and hopefully private sector businesses will follow.

The fact that we're working with a below-market return on an equity investment creates a valuable resource for affordable housing developers.

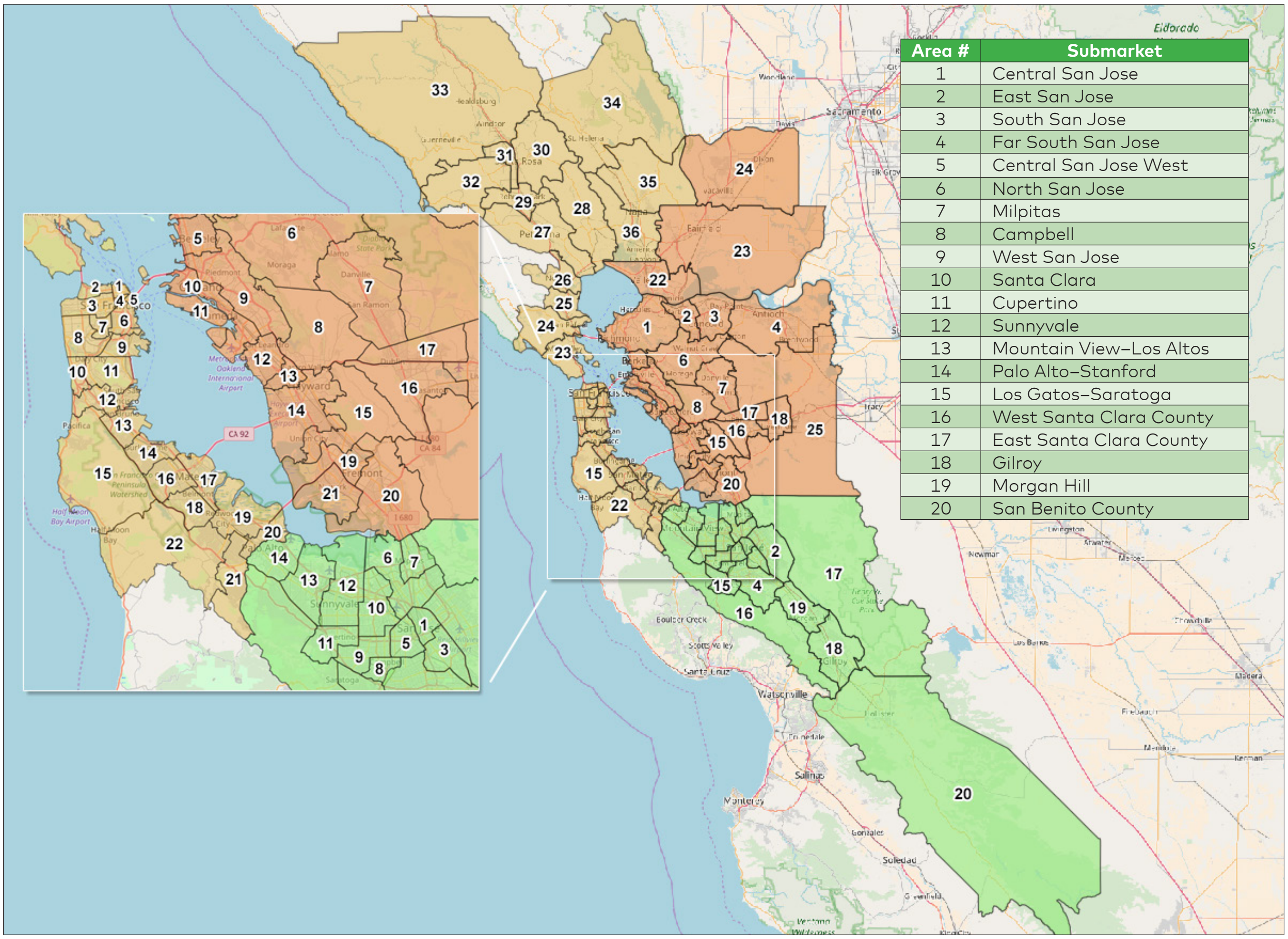
What projects do you have in mind for the $100 million loan fund?

Gross: We project financing the preservation or new construction of 3,250 affordable homes that will increase access to stable, quality housing for low- and moderate-income individuals, families and people who are either homeless or at risk of homelessness across Kaiser Permanente's served communities in California, Colorado, Georgia, Hawaii, the Mid-Atlantic—Maryland, Virginia and the District of Columbia—Oregon and Washington.

Do you expect your example to engage other entities in your fight against homelessness in the area?

Choucair: We know that public officials and organizations from several industries are using their expertise and resources to address the housing crisis and encourage others to continue to join the effort to increase affordable housing and decrease homelessness.

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

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.

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Market Data & Analysis

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