YARDI® Matrix

An End to San Francisco's Bull Run?

Multifamily Fall Report 2016

Rent Growth Deceleration Reaches 1.6%

Investment Volume Slows, as Price Level Tops Cycle

Building Boom Endures, Promising to Boost Supply

Market Analysis

Fall 2016

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

Ioana Neamt

Senior Associate Editor

Rent Growth Chills Fog City

A Millennial hotspot and an economic juggernaut, home to more than 30 international financial institutions and a plethora of iconic tech brands, San Francisco continues to be a key city for multifamily investors. However, rent growth has finally ended its bull run after years of double-digit increases, as properties are bumping up against the limits of affordability.

Broad-based job growth and an influx of skilled young professionals have propelled rental rates to extreme highs, reaching a record average of $2,216 in 2015. Homeownership is out of reach for most San Franciscans, and the lack of affordable housing options is pushing workers toward commuter towns in the East Bay, where home prices are slightly lower. Future supply is robust, with more than 15,000 units underway and over 66,000 in the planning stages. Major projects, such as the $4.5 billion Transbay Transit Center, which will accommodate more than 100,000 passengers each weekday and as many as 45 million people per year, are likely to spur on further investment and attract renters looking for transit-friendly apartments.

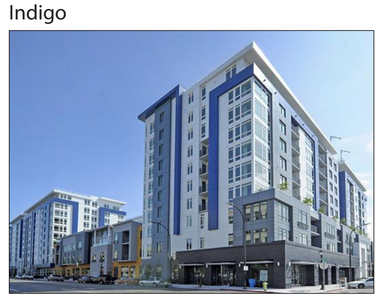
Job growth remains strong, and supply is increasing—though not more than demand. But the drop-off in rents is primarily a function of their surpassing what tenants can bear to pay. That's not a short-term issue, and we see rents moderating for the rest of the year and even beyond.

Recent San Francisco Transactions

Woodland Park

City: East Palo Alto
Buyer: Sand Hill Property Co.
Purchase Price: $413 MM
Price per Unit: $228,026

Indigo

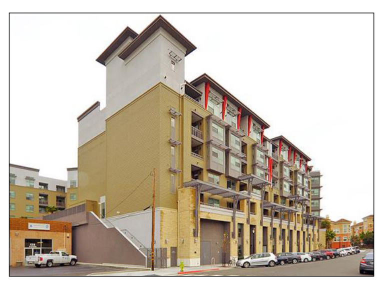


City: Redwood City
Buyer: Aimco
Purchase Price: $320 MM
Price per Unit: $691,144

Sharon Green

City: Menlo Park
Buyer: Maximus Real Estate Partners
Purchase Price: $245 MM
Price per Unit: $827,702

Franklin 299



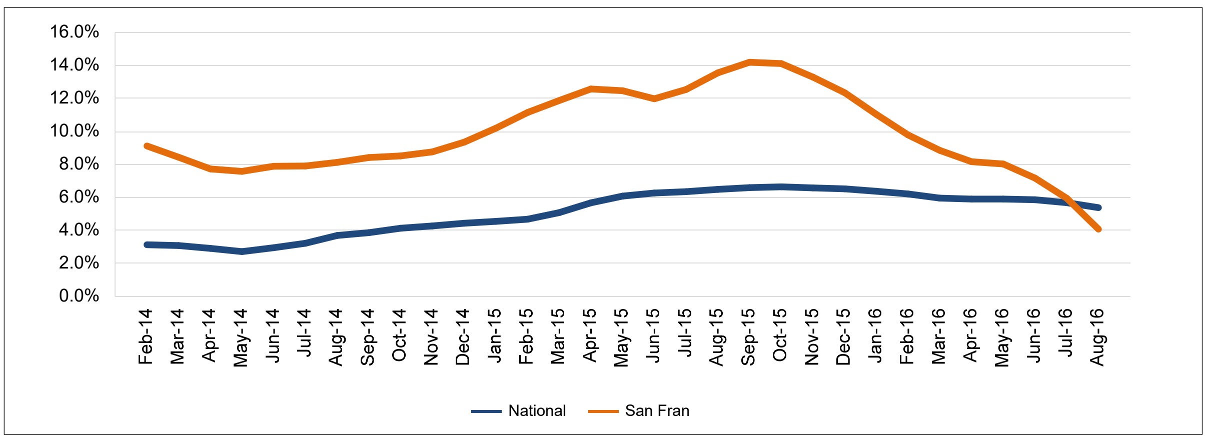
City: Redwood City
Buyer: TIAA
Purchase Price: $213 MM
Price per Unit: $699,506

On the cover: Photo by Phoenix Wang/iStockphoto.com

Rent Trends

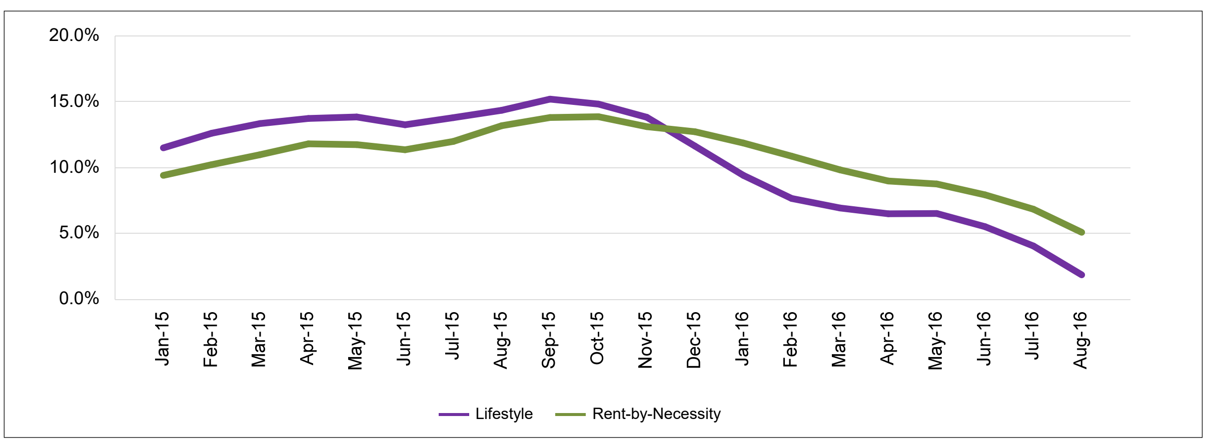
- After reaching the 12% range late last year, San Francisco's rent growth has experienced a cool-down this year, decelerating to 1.6% year-over-year in August, well below the 5% national rate. Rising affordability issues and growing supply are pushing rents down to a more sustainable level, though market fundamentals are still strong in the area.
- Rent growth in the San Francisco Peninsula may have peaked, dropping to -0.7% in August, while rents in the East Bay grew 4.2% year-over-year, to $2,118. Pushed by spreading gentrification and the high cost of living, tenants are flocking to smaller commuter towns on the East Bay, where rents are slightly more affordable. Most of the submarkets with the highest rent gains are located in eastern bedroom communities: Fairfield (13.1%), Concord (12.1%) and Castro Valley (11.3%). The exception is Central San Francisco, where rents continue to skyrocket, having risen 27.8% over the past year.
- Even though rent growth has tapered off in the region, occupancy rates remain extremely high and job creation is robust. But rents have simply risen too high too fast to continue growing. Although parts of the metro should continue to see moderate rent growth, overall growth is likely to flatten until the next spate of new supply is absorbed.

San Francisco vs. National Rent Growth (Sequential 3 Month, Year-Over-Year)



Source: YardiMatrix

San Francisco Rent Growth by Asset Class (Sequential 3 Month, Year-Over-Year)

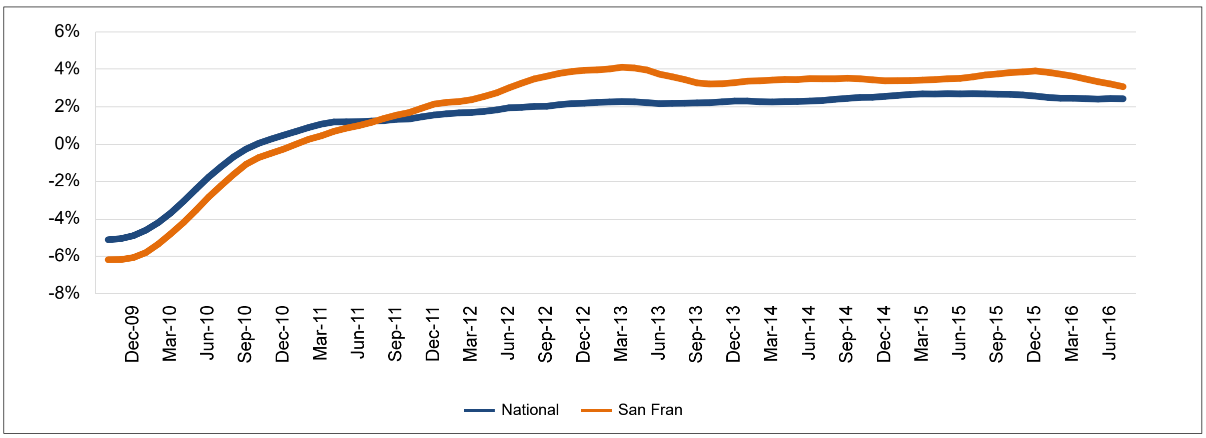


Source: YardiMatrix

Economic Snapshot

- San Francisco added nearly 73,000 jobs during the 12 months ending in August 2016, a 3.4% change year-over-year and above the 2.4% national average. Job growth was broad-based and led by core employment sectors such as professional and business services, education and healthcare, and leisure and hospitality. Companies continue to be drawn to the metro, due to its appeal as a tech haven with a growing and educated workforce.
- Job growth was led by the professional and business services sector, which added 18,200 jobs in the past year—a 3.6% increase. The booming San Francisco office market continues to attract investment, though demand is cooling down as new deliveries get absorbed. Tech companies also continue to expand in the area, including Fitbit, which recently signed a 306,000-square-foot lease expansion at 215 Fremont St. in San Francisco, and Lyft, which took over 204,000 square feet at 185 Berry St.
- The education and health services sector added 14,600 new jobs, up 3.7% year-over-year. Major projects, such as the $1 billion office and R&D project planned for the Landing at Oyster Point in South San Francisco, are likely to solidify the metro's reputation as a leading biotechnology innovation cluster. The University of California, Berkeley also has a number of projects in the works, including the 325,000-square-foot Berkeley Way West, which will house the School of Education and the Department of Psychology.

San Francisco vs. National Employment Growth (Year-Over-Year)



Sources: YardiMatrix, Bureau of Labor Statistics (not seasonally adjusted)

San Francisco Employment Growth by Sector (Year-Over-Year)

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
60	Professional and Business Services	523	19.1%	18,200	3.6%
65	Education and Health Services	407	14.9%	14,600	3.7%
70	Leisure and Hospitality	327	11.9%	11,200	3.5%
15	Mining, Logging and Construction	150	5.5%	9,700	6.9%
40	Trade, Transportation and Utilities	449	16.4%	8,600	2.0%
90	Government	368	13.4%	6,400	1.8%
30	Manufacturing	177	6.5%	3,100	1.8%
50	Information	92	3.4%	800	0.9%
80	Other Services	99	3.6%	300	0.3%
55	Financial Activities	147	5.4%	-300	-0.2%

Sources: YardiMatrix, Bureau of Labor Statistics

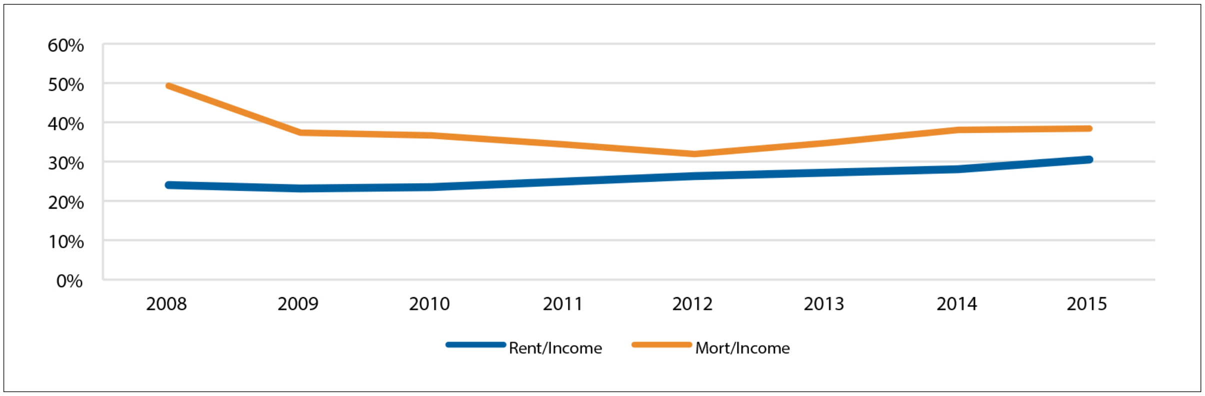
Demographics

Affordability

- As housing costs continue to skyrocket, affordability has become a problem for San Franciscans. Average rental rates climbed to an all-time high of $2,216, making up 31% of income. Though wages are on an upward path in the metro, homeownership is still out of reach for most residents, as the median home value rose to a record $751,246, comprising 38% of income.

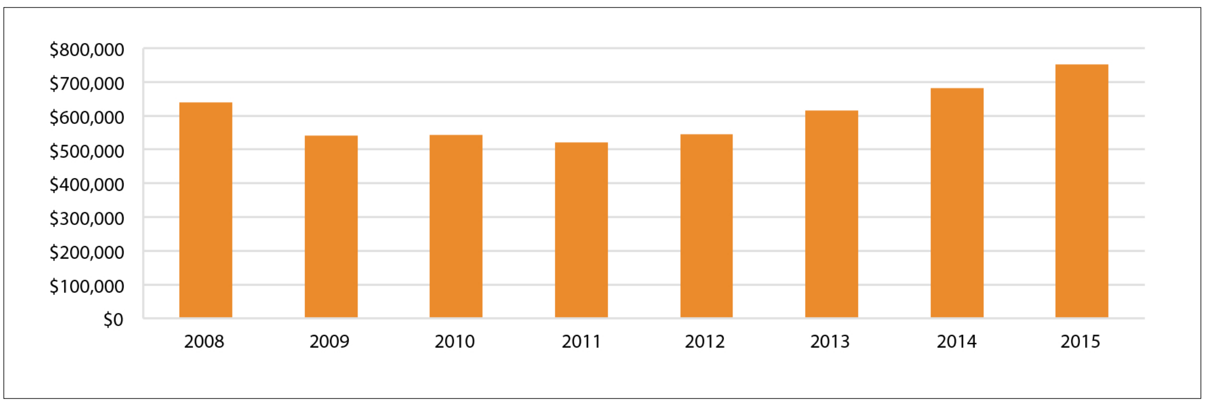
- City officials are working to battle the affordability crisis with policy measures that include Proposition C, which requires new projects to have 20% of units at below-market rates. The affordable housing requirement would be raised 0.5% each year, up to 25.5% for rentals and 27.5% for condos.

San Francisco Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

San Francisco Median Home Price



Source: Moody's Analytics

Population

- The metro added 60,152 residents in 2015, a 1.3% increase, higher than the 0.8% national average.

- The metro's population has risen by more than 255,375 residents since 2011.

San Francisco vs. National Population

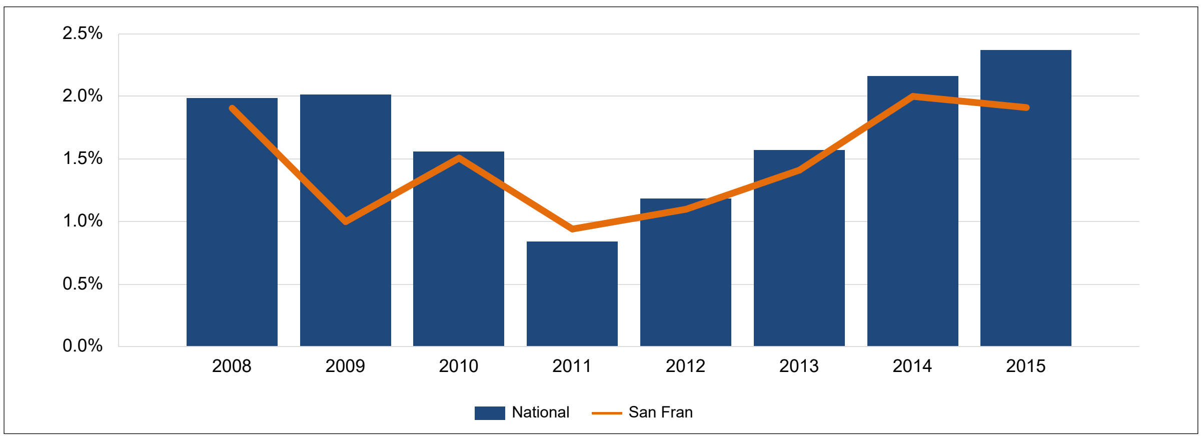
	2011	2012	2013	2014	2015
National	311,718,857	314,102,623	316,427,395	318,907,401	321,418,820
San Francisco-Oakland-Hayward, CA Metro Statistical Area	4,400,757	4,462,425	4,529,180	4,595,980	4,656,132

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

Supply

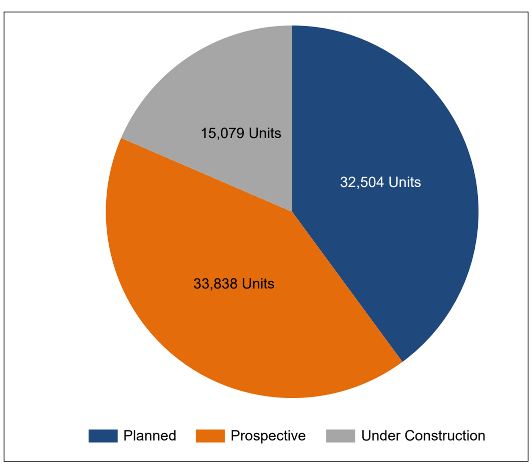
- Only 4,400 units came online in the San Francisco Peninsula-East Bay region during the past year. That represents a 1.9% year-over-year increase in the total inventory across the metro, slightly below the 2.4% national average. San Francisco's planning process is notoriously difficult.
- However, there is a building boom in the works, as more than 81,400 units are in the pipeline. Some 15,079 units are already underway and 66,342 are in the planning stages. The boost in construction is fueled by strong demand for apartments across the metro and a 96.4% occupancy rate for stabilized properties.
- Multifamily development is concentrated on the Peninsula, in submarkets such as Eastern San Francisco (3,394 units) and Redwood City (2,061), areas offering easy access to major employment centers, as well as a plethora of entertainment and leisure destinations. However, rising housing costs are influencing renters to move eastward, to slightly more affordable submarkets such as China Basin (2,033), Pleasanton (1,061) or East Oakland/Oakland Hills (798).
- The largest project currently underway in the region is the 545-unit Transbay Block 9 in China Basin, scheduled for completion in 2019. Essex Property Trust's 43-story tower will include 109 affordable units.

San Francisco vs. National Completions as a Percentage of Total Stock (as of August 2016)



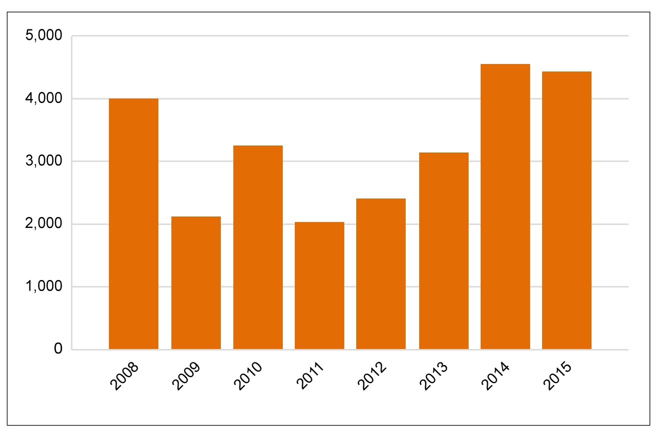
Source: YardiMatrix

Development Pipeline (as of August 2016)



Source: YardiMatrix

San Francisco City Completions (as of August 2016)

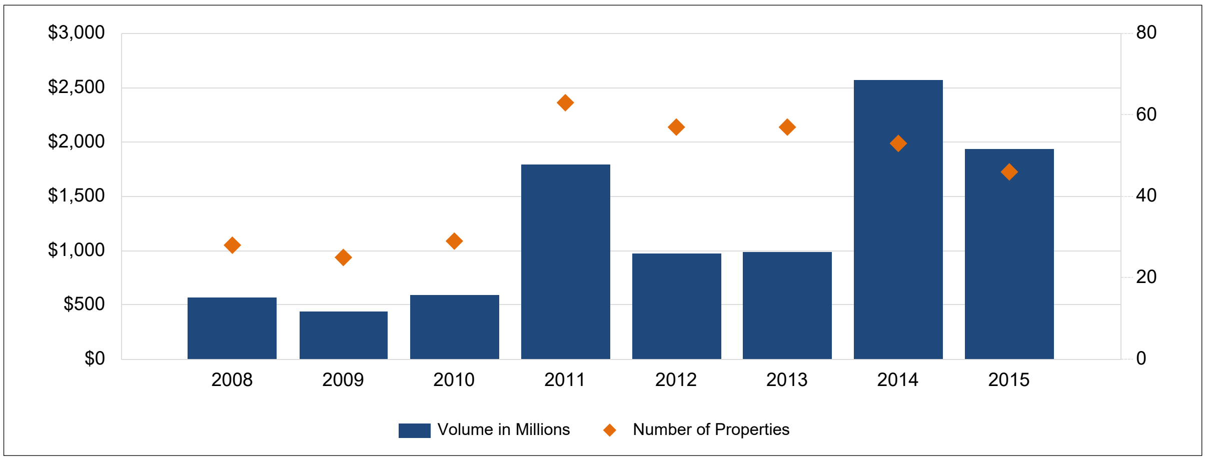


Source: YardiMatrix

Transactions

- Demand has slowed for San Francisco multifamily assets, with $1.9 billion worth of properties changing hands last year, well below 2014's boom-year total of $2.6 billion. But investors continue to flock to the metro, drawn in by its growth potential, appeal to Millennials and thriving tech sector.
- The average price per unit reached $300,568 throughout the year, the highest number in the current cycle and more than double the $117,000 national average. Strong investor demand has also helped yields constrict to 4.7% for stabilized properties in the East Bay, while Oakland emerges as a new haven for tech companies and Millennials.
- The largest transaction of the past year was Sand Hill Property Co.'s $413 million acquisition of Woodland Park, a 1,809-unit community in East Palo Alto. The sale price was 217% higher than the last time the asset traded, back in 2011. The most active submarkets have been Redwood City ($533 million) and Menlo Park/ East Palo Alto ($413 million).

San Francisco Sales Volume and Number of Properties Sold (as of August 2016)



Source: YardiMatrix

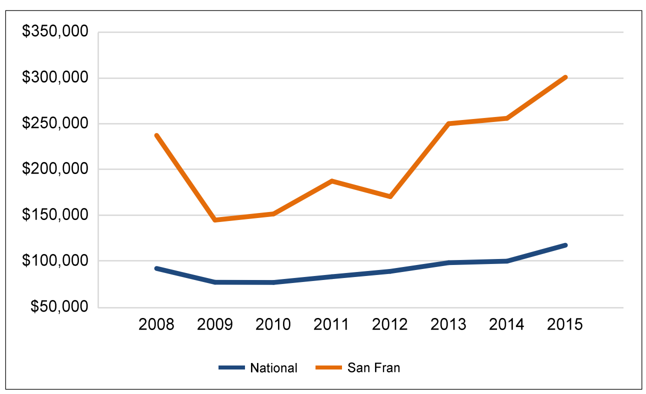
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Redwood City	533
Menlo Park/East Palo Alto	413
Atherton/Portola	245
Petaluma	218
Antioch/Oakley	120
Union City	109
Hayward	106
Santa Rosa	98

Source: YardiMatrix

[1] From September 2015 to August 2016

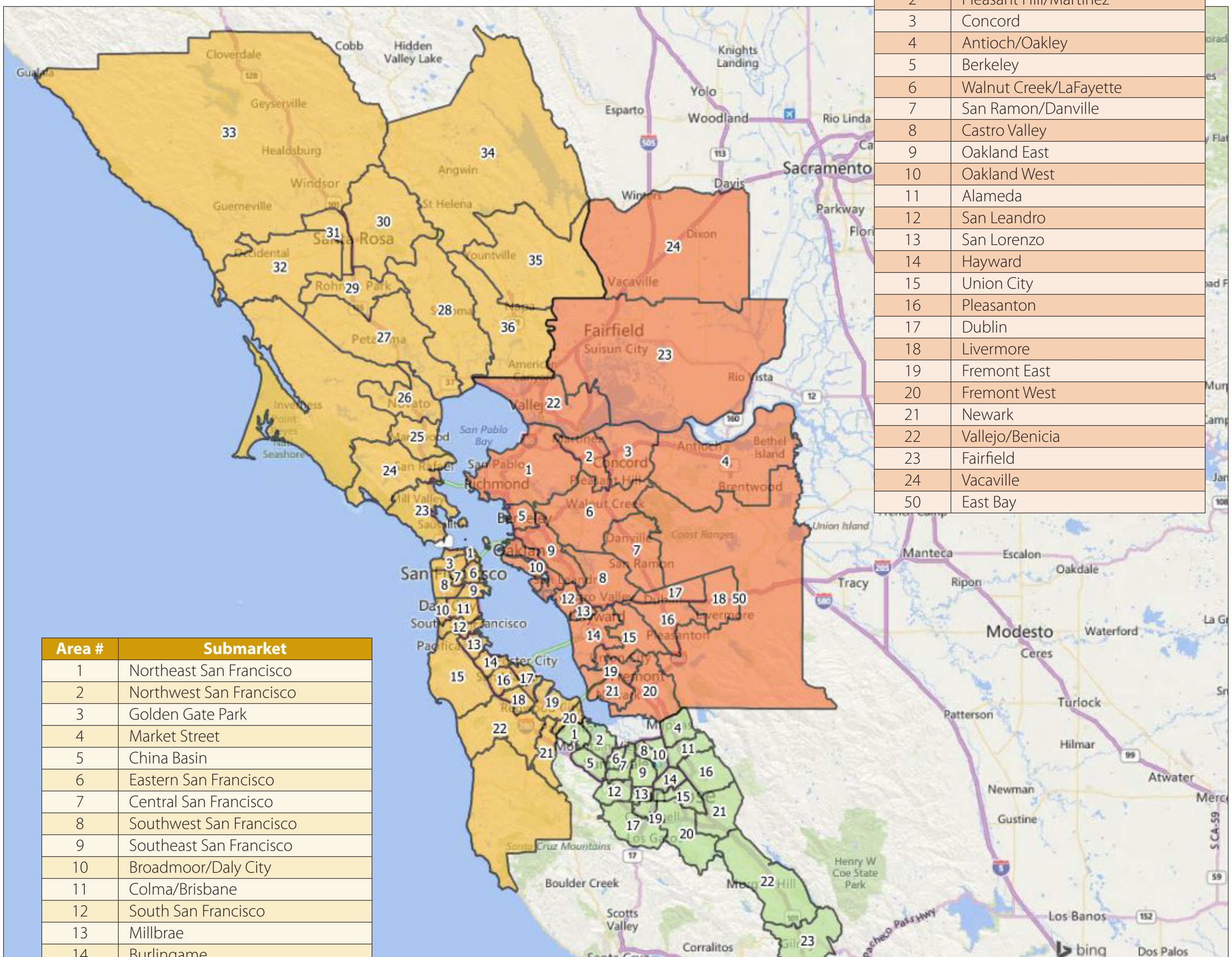
San Francisco vs. National Sales Price per Unit



Source: YardiMatrix

San Francisco photo by Glenn Nagel/iStockphoto.com

San Francisco Submarkets



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
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

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
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

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

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

Area #	Submarket
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

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.