

YARDI[®] Matrix

San Francisco: Suburbs Rising

Multifamily Winter Report 2017

Rent Growth Slows to 2%

Development Pipeline Swells

Pricing Plateaus in Face of Low Yields

Market Analysis

Winter 2017

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Rent Growth Decelerates in The Bay

San Francisco has been the poster child for booming technology markets on the West Coast, but the effects of those surging years are coming back to haunt its multifamily market. Supply is lagging demand, pushing rents past any reasonable level of affordability, even for high-paid workers. Renters are moving into the suburbs, driving up rents there as a result. Meanwhile, demand for Bay Area assets has compressed acquisition yields to some of the lowest levels in the nation, sending investors toward the lower Peninsula and Alameda County.

Technology remains a key driver of growth, but other job segments—such as education and health services, and hospitality—are also surging. The Transbay Transit Center is one of the most significant multimodal transit hubs taking shape in the Western United States. Once completed, it will create an entire neighborhood, with 4,000 new units, more than a third of which will be designated for affordable housing. In addition, the development will contain 6 million square feet of office space.

Roughly 15,000 units are underway in the Bay Area, pointing toward an escalation in completions. However, demand is very high, due to employment and population growth. Rent gains have decelerated, improving affordability, but we expect growth to rebound to moderate levels in 2017.

Recent San Francisco Transactions

Woodland Park



City: East Palo Alto, Calif.
Buyer: Sand Hill Property Co.
Purchase Price: \$413 MM
Price per Unit: \$228,027

Indigo Apartment Homes



City: Redwood City, Calif.
Buyer: Aimco
Purchase Price: \$320 MM
Price per Unit: \$691,145

Franklin 299



City: Redwood City, Calif.
Buyer: TIAA
Purchase Price: \$213 MM
Price per Unit: \$699,507

The Marston by Windsor



City: Redwood City, Calif.
Buyer: GID
Purchase Price: \$153 MM
Price per Unit: \$780,612

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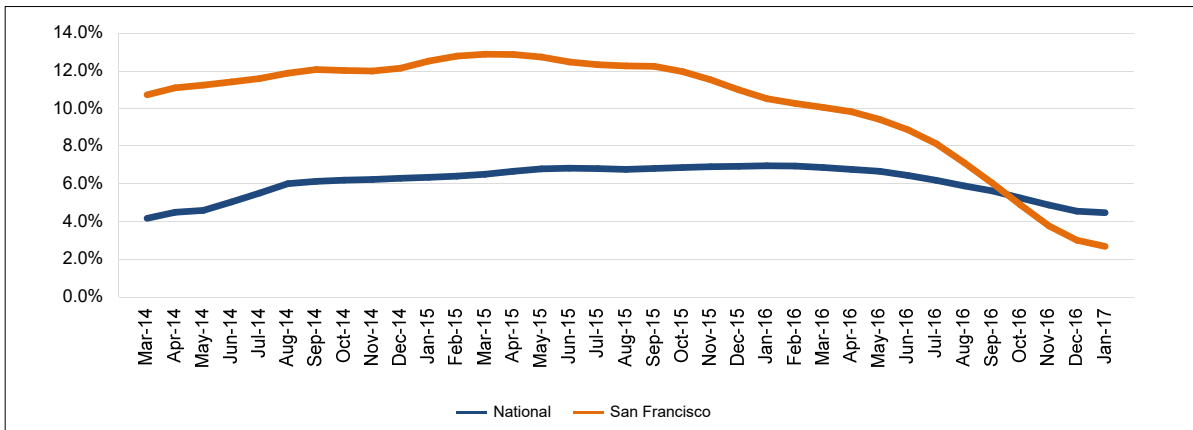
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Rent Trends

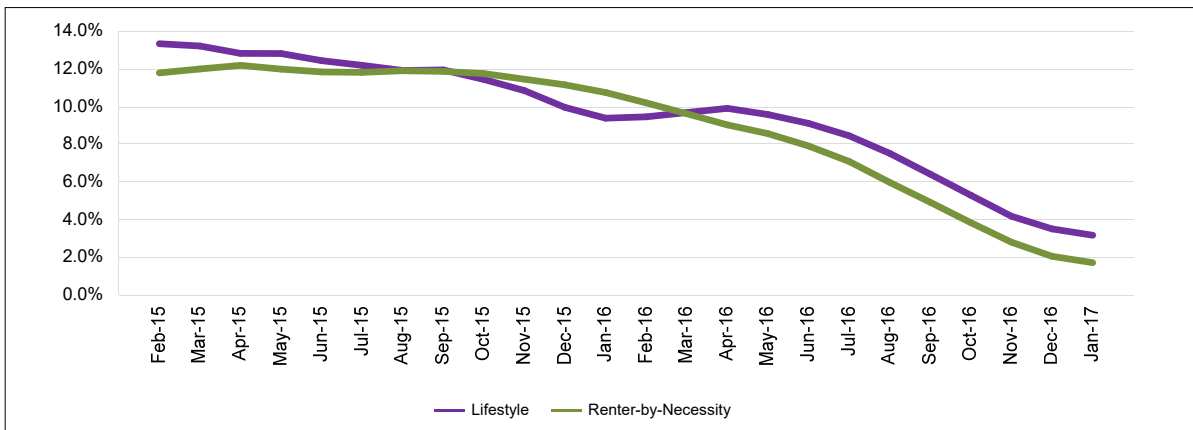
- San Francisco rents grew 2.7% year-over-year through January, 170 basis points below the national rate. Rents hit \$2,472 in January, more than \$1,000 above the national average, according to Yardi Matrix. After a prolonged period of above-trend increases, rent growth in San Francisco plunged in 2016, going from double digits at the start of the year to just over 2%.
- Rents in the upscale Lifestyle sector grew 3.2% year-over-year to \$2,963. Employment gains in the technology sector have continued fueling demand for higher-end units, but supply growth has not kept pace. Rents in the working-class Renter-by-Necessity properties rose 1.7% year-over-year to an average of \$2,238.
- Core submarkets are no longer leading rent growth, as problems with affordability have pushed renters to fringe submarkets in Contra Costa, Alameda and Solano counties. Fairfield (14.5%), San Lorenzo (12.2%), Antioch/Oakley (12%) and East Livermore/East Dublin (12%) led rent gains, since these areas have some of the lowest rates in the Bay Area.
- More than 4,500 units are underway in China Basin and Eastern San Francisco, where year-over-year rent growth was in the 4% range and average rents hovered around \$4,000.

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)

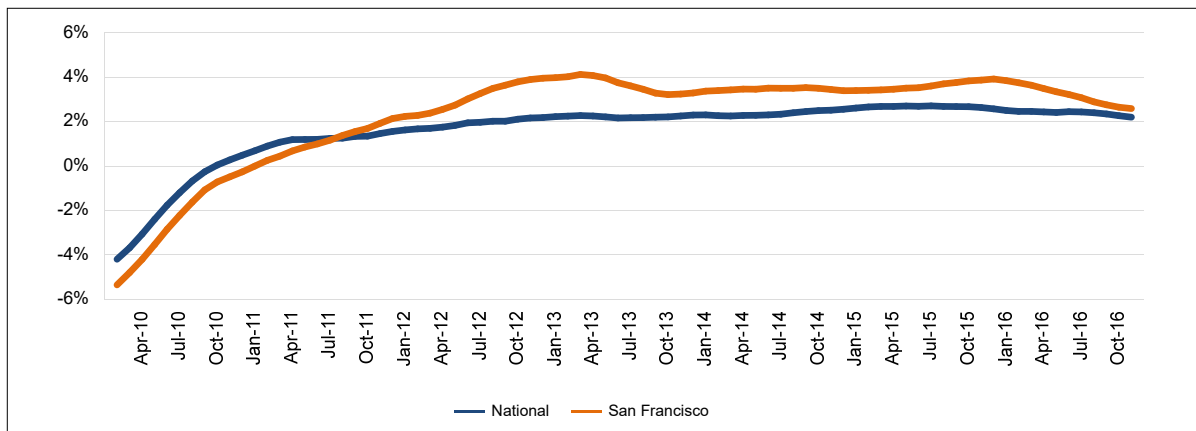


Source: YardiMatrix

Economic Snapshot

- San Francisco added 65,000 jobs in the 12 months ending in November, up 2.6%. Although the growth rate was 40 basis points above the national average, job creation has decelerated in recent months, as the technology sector is beginning to exhibit signs of cooling.
- Education and health services led employment growth—which was broad-based—with 14,200 new hires. Another direct consequence of population growth is visible in the construction sector, where 10,300 new jobs came online, due to the robust development pipeline in both housing and commercial projects.
- San Francisco’s office market is one of the nation’s strongest. The vacancy rate is low, as a result of high demand from the technology and finance industries. Roughly 5.5 million square feet of office space was leased in 2016. As a result, absorption was very high in 2016, more than keeping up with the rate of new inventory. Investor demand has pushed prices to near-record levels.
- Leisure and hospitality also performed well, adding 10,500 new jobs in the 12 months ending in November. Growth across all key industry metrics has also encouraged new hospitality development across the Bay Area. Hyatt is developing a new Grand Hyatt hotel near San Francisco International Airport, while plans are in the works for a Hyatt Place on Market Street.

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)

Code	Employment Sector	Current Employment		Year Change	
		(000)	% Share	Employment	%
65	Education and Health Services	418	15.0%	14,200	3.5%
60	Professional and Business Services	525	18.9%	13,000	2.5%
70	Leisure and Hospitality	322	11.6%	10,500	3.4%
15	Mining, Logging and Construction	152	5.5%	10,300	7.3%
40	Trade, Transportation and Utilities	465	16.7%	8,600	1.9%
90	Government	387	13.9%	4,800	1.3%
55	Financial Activities	147	5.3%	2,400	1.7%
30	Manufacturing	174	6.3%	700	0.4%
80	Other Services	97	3.5%	300	0.3%
50	Information	91	3.3%	200	0.2%

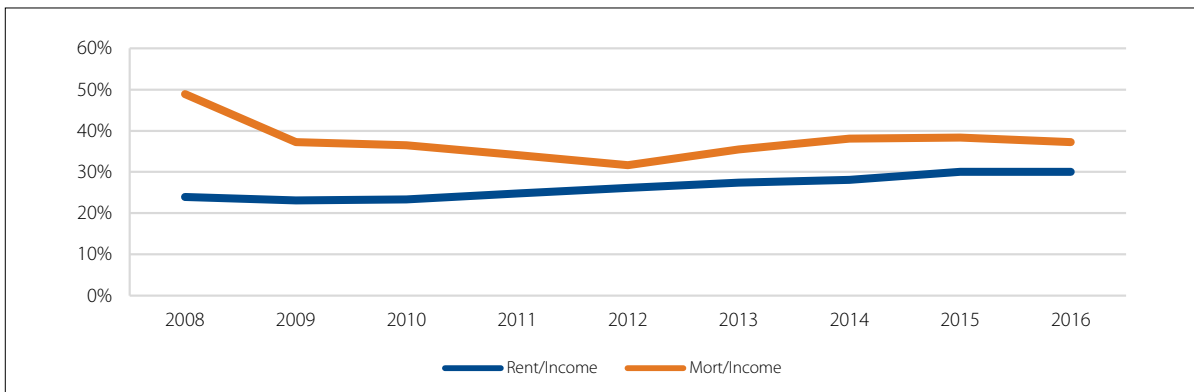
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

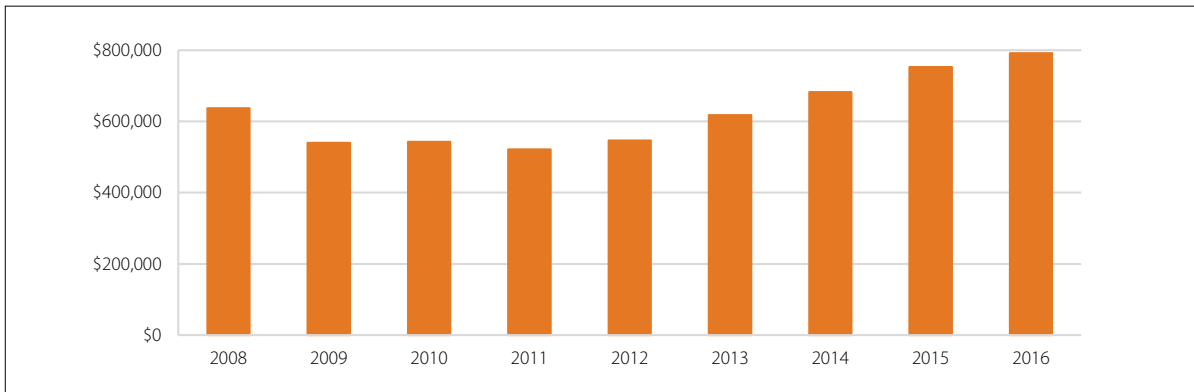
- Although San Francisco's household income is among the highest in the nation, the housing is so costly that affordability persists as a major issue for both renters and homeowners. The median home price in 2016 was \$792,072, the highest it's been during the current expansion.
- Meanwhile, rents have risen consistently, reaching \$2,472 in January and putting serious strain on area incomes. Due to gentrification, many trendy neighborhoods that were once affordable are now overpriced.

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

- Between 2011 and 2015, San Francisco expanded nearly twice as fast as the entire U.S., adding 255,375 residents.
- An improving entertainment scene and solid job market continue to drive growth.

San Francisco vs. National Population

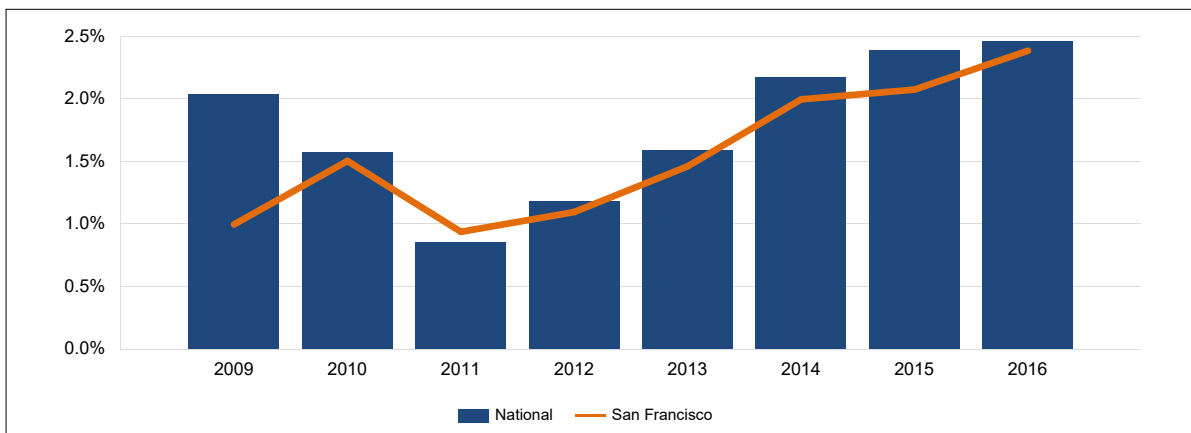
	2011	2012	2013	2014	2015
National	311,718,857	314,102,623	316,427,395	318,907,401	321,418,820
San Francisco, Calif. Metropolitan Statistical Area	4,400,757	4,462,425	4,529,180	4,595,980	4,656,132

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

Supply

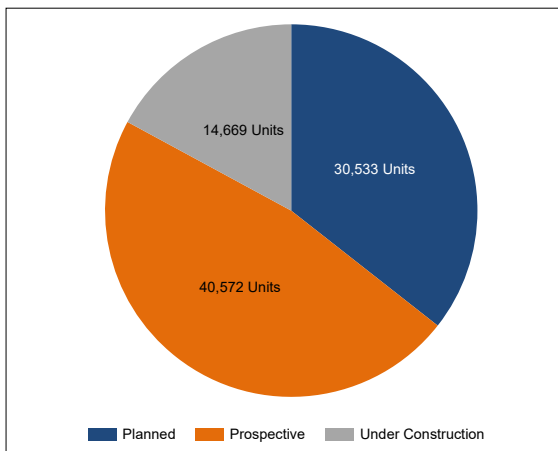
- San Francisco has consistently added units at about the same rate as the nation. Around 5,700 units came online in 2016, marking an increase of 2.4%. Rigid building restrictions have kept supply from catching up to demand, although that is starting to change, as officials recognize the severe housing shortage.
- More than 20,000 new units have hit the market since 2012, but solid demand has kept stabilized properties' occupancy high, reaching 96.2% in December.
- The total development pipeline in San Francisco comprises more than 85,000 units. Approximately 15,000 of those units are underway, with projects lined up on both sides of the Bay. The Eastern San Francisco and China Basin submarkets are home to 4,500 units in various development stages, while projects are also in progress in Pleasanton, San Mateo and East Oakland/Oakland Hills.
- The 599-unit Station Park Green in San Mateo is the largest project underway on the Peninsula. In 2015, Essex Property Trust, a REIT based in San Mateo, Calif., acquired it from EBL&S Development of Philadelphia for \$67 million.

San Francisco vs. National Completions as a Percentage of Total Stock (as of January 2017)



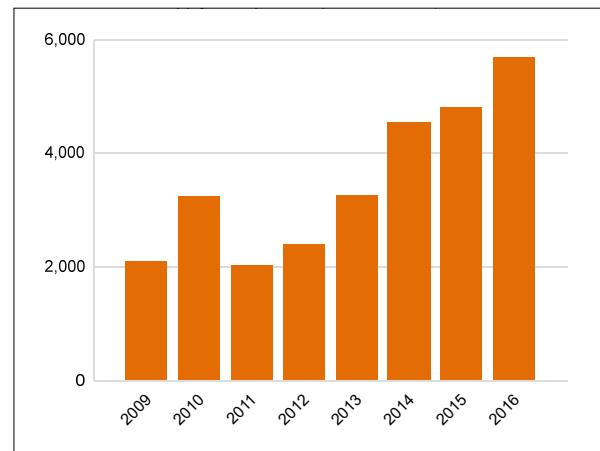
Source: YardiMatrix

Development Pipeline (as of January 2017)



Source: YardiMatrix

San Francisco Completions (as of January 2017)

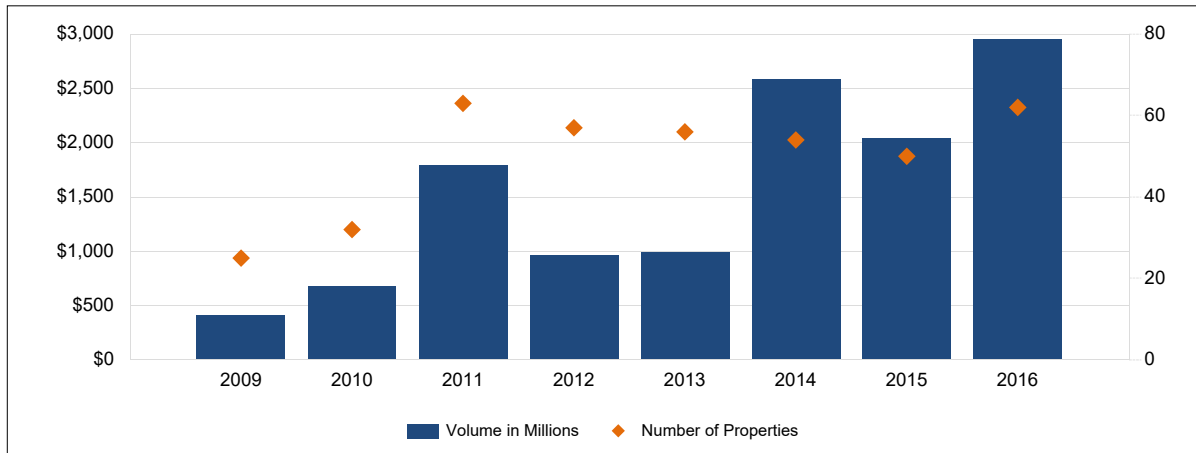


Source: YardiMatrix

Transactions

- Investment sales barely crested \$3 billion in 2016, a new cyclical high for the metro and a 45% increase over 2015. Demand for San Francisco assets is among the highest in the country, especially from Asia. The increase in pricing has plateaued, with investors concerned about low acquisition yields at a time when interest rates are expected to rise. Although demand is high, fewer investors are willing to accept yields in the 3 to 5% range, which might slow activity somewhat. Investors are also targeting value-add properties to boost yields.
- Redwood City, where more than \$700 million in real estate traded hands, led investment activity in the 12 months ending in January. Sand Hill Property Co. completed the largest multifamily deal of 2016: the \$413 million acquisition of the Woodland Park community in East Palo Alto. The value of the 1,809-unit community has more than tripled since trading for \$130 million in 2011.

San Francisco Sales Volume and Number of Properties Sold (as of January 2017)



Source: YardiMatrix

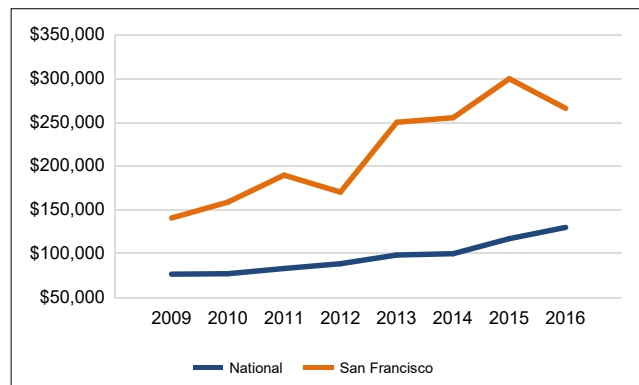
Top Submarkets for Transaction Volume¹

Submarket	Volume (\$MM)
Redwood City	704
Menlo Park/East Palo Alto	413
Petaluma	199
Santa Rosa	185
Union City	171
Pleasanton	153
Concord	136
Downtown Oakland	135

Source: YardiMatrix

¹ From December 2016 to January 2017

San Francisco vs. National Sales Price per Unit



Source: YardiMatrix

Read All About It!



LaSalle, Harvest JV Buys
\$35M Mixed-Use Asset



Napa Valley Hotel Sells
For \$1.2M per Key



Marcus & Millichap Announces
\$17M Sale of Atherton Court

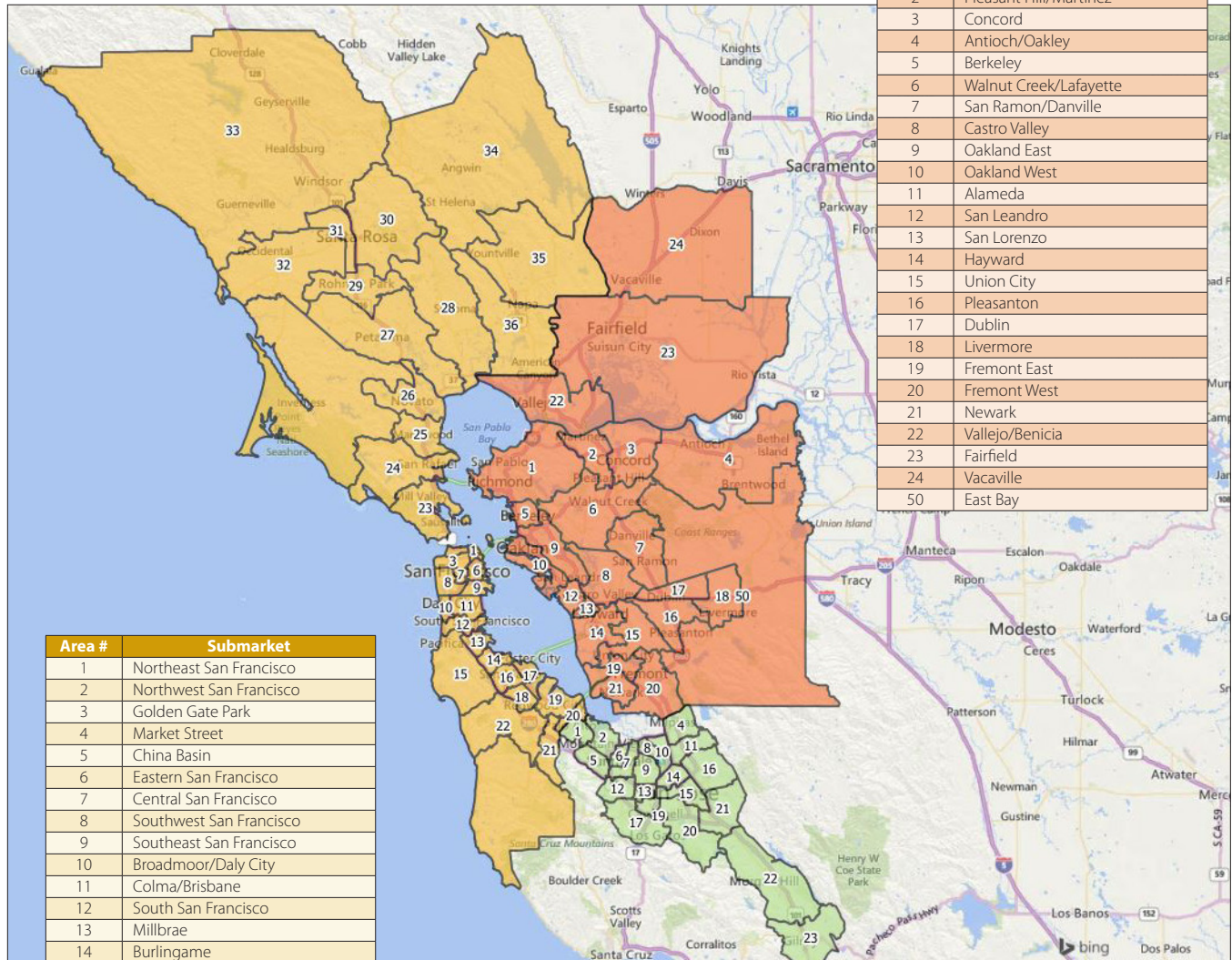


HFF Secures \$11M
Financing for 2
Walnut Creek Communities

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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

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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.

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