MARKET REPORT

Multifamily

San Jose Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

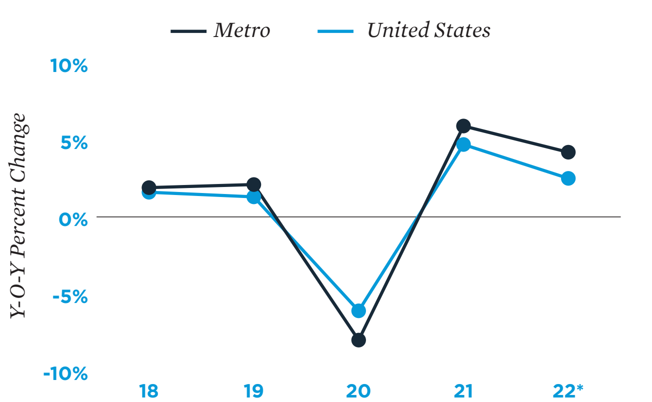
2Q/22

Local Vacancy Falling Faster than Other Bay Area Metros, Rents to Fully Recover

First quarter caps strongest yearlong absorption on record. San Jose's rental market has bounced back in a big way, with more than 9,300 units of net absorption logged from April 2021 though March 2022. The next highest 12-month total during the two decades leading up to the health crisis was about 3,000 units below that measure. Surging demand allowed San Jose's vacancy contraction to beat Oakland and San Francisco by 100-plus basis points year-over-year in March. This should allow operators to push up rents in the near term, as availability reaches the sub-3 percent threshold for the first time since mid-2011. The average effective rent was about 5 percent shy of the pre-pandemic peak entering April, but projected gains over the coming quarters will produce a new year-end high.

Improvement is widespread. All nine submarkets recorded vacancy contractions of at least 100 basis points over the past four quarters ended in March. Each area posted an annual effective rent gain exceeding 12 percent as well. Availability is falling the fastest in Mountain View-Palo Alto-Los Altos and North Sunnyvale, some of the metro's highest cost areas with clusters of tech employers. This is a welcomed signal, given initial questions regarding the impact of remote work among tech firms on rental demand. Nonetheless, supply pressure could stunt momentum in Mountain View-Palo Alto-Los Altos this year, as it will lead the market with over 1,400 units delivered.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.; RealPage, Inc.

Multifamily 2022 Outlook

48,000 JOBS
will be created

EMPLOYMENT:

San Jose's personnel count expands by 4.2 percent, which is slower than last year's 5.9 percent lift, as the bulk of pandemic-related job losses are already recovered. By year-end, the employment total will surpass the 2019 level by about 18,500 positions.

4,300 UNITS
will be completed

CONSTRUCTION:

Delivery volume is expected to be roughly 750 units higher in 2022 than what was recorded in 2021. Inventory growth of 2.4 percent in San Jose will be the biggest jump among the three Bay Area metros this year, but new supply is necessary amid low vacancy.

40 BASIS POINT
decrease in vacancy

VACANCY:

A 290-basis-point vacancy descent in 2021 undid the previous year's 230-basis-point rise, and availability will remain on a downward trajectory, despite new construction. At 2.9 percent, vacancy will be lower at year-end than in any period since 2000.

8.9% INCREASE
in effective rent

RENT:

The market's average effective monthly rent plummeted by about $400 in 2020, but has since steadily advanced as conditions improve. Gains in 2022 will bring the mean rate to $3,011 per month, which is 1 percent above the pre-pandemic peak.

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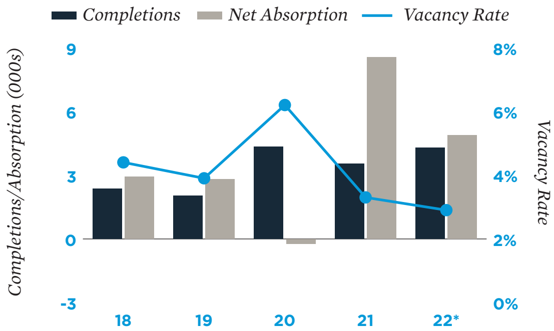
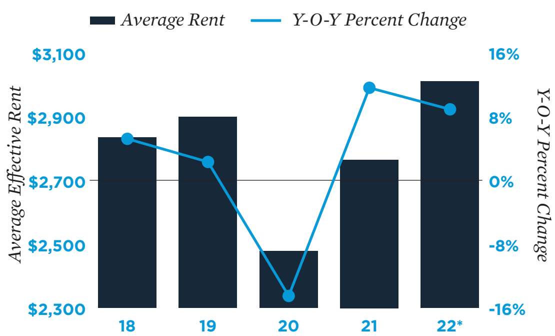
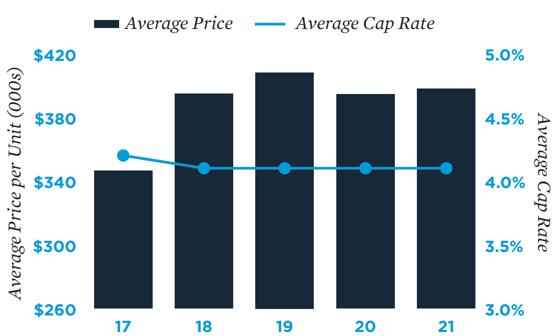
Supply and Demand



Rent Trends



Sales Trends



** Forecast*

Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

IPA Multifamily

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Price: $250

1Q 2022 - 12-Month Period

CONSTRUCTION

3,363 units completed

- Development faded during the past four quarters amid high material costs and labor shortages; however, it will be a brief slowdown, with 7,200 units underway and expected to finalize by the end of 2023.
- North Sunnyvale has a very small pipeline, boding well for existing properties in an area where absorption doubled completions over the past year.

VACANCY

340 basis point decrease in vacancy Y-O-Y

- All three classes of apartments had vacancy rates in the mid-2 percent to mid-3 percent range entering April. Relative to 2019, Class A and B availability is down at least 140 basis points, while the Class C rate is up.
- Each of the nine submarkets entered April with a vacancy rate below 4 percent, with four different areas noting sub-3 percent availability.

RENT

14.8% increase in the average effective rent Y-O-Y

- While the average effective rent is 2.6 percent shy of 2019, the mean monthly rate surged by a quarterly average of $91 during the past year.
- The spread between Class B and Class C mean rents widened from $280 per month in 2020 to $530 per month in March 2022. Soaring home costs may push residents to mid-tier rentals and stretch the gap again.

Investment Highlights

- Deal flow last year was stronger than the 2020 total, but just below the 2019 figure. Nonetheless, investors are ramping up activity as metrics improve, with more trades completed in the second half of last year than during the same six months in 2018 or 2019. Transactions featuring assets priced above $10 million have been slower to return, but roughly 30 percent more properties in the $1 million to $10 million price tranche changed hands last year than in 2020.
- The average sale price held relatively steady last year, growing by less than 1 percent to $397,900 per unit. First-year returns also remained consistent at 4.1 percent on average, unchanged since 2018. Buyers searching for entry costs below the metro average are most active in Downtown San Jose, particularly the SUN neighborhood adjacent to the university. Class C assets here and elsewhere in the urban core typically trade at cap rates in the low-3 percent to high-4 percent band.
- Investors accept minimum returns in the low-2 percent range in the Palo Alto and Campbell-Los Gatos areas. Class C buildings with fewer than 20 units comprise the bulk of deal flow in these cities, often commanding prices above $450,000 per unit.