MARKET REPORT

Multifamily

San Jose Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

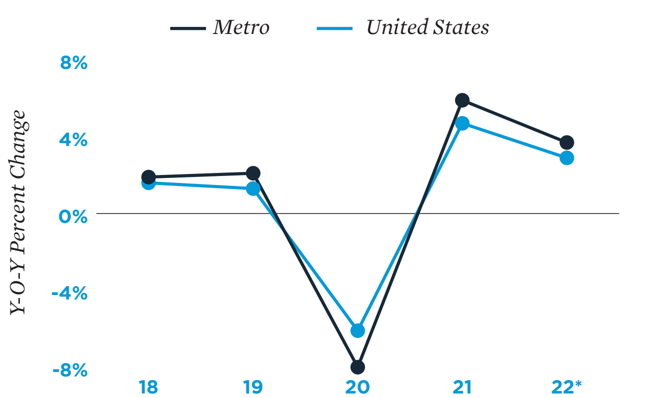
3Q/22

Apartments Return to Pre-Pandemic Path as Tech Office Return May be on the Horizon

Renters are moving back to central areas, ahead of office plans. Apple's aim to have most employees in the office at least three days per week starting in September may be a catalyst for a broader workplace return among South Bay technology companies, but for the metro's apartments, demand has already come back. Vacancy in the Mountain View-Palo Alto-Los Altos submarket dropped to 3.1 percent in June, 100 basis points below the year-end 2019 level and a fraction of the 9.3 percent pandemic high. Availability is even tighter in North Sunnyvale, despite rapid local supply gains, with high renter demand reflected in 20 percent rent growth year-over-year. Monthly rates are climbing nearly as quickly in Cupertino and Central San Jose. Renters are returning to many of the market's major employment hubs, either for lifestyle preferences or in anticipation of a broader adoption of in-workplace routines.

Demand strong across quality tiers. Reflecting the general rental recovery of the past year, vacancies and rents have improved across all three apartment classes. Expanded construction may put upward pressure on Class A fundamentals in the second half of the year, however. The resumption of eviction proceedings in July may also impact Class C operations. Employment at retail shops, restaurants and bars continues to trail the pre-pandemic high, affecting payrolls for some budget-conscious renters. A broader return to offices could restore some of those jobs in major workplace hubs, though. Amid these possible headwinds, the Class B outlook is stable.

Employment Trends



* Forecast

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

Multifamily 2022 Outlook

42,000 JOBS *will be created*

EMPLOYMENT:

The addition of over 26,000 jobs through the first six months of the year places metro employers on track to expand staff counts by 3.7 percent this year. The total employment base is set to recover to the pre-pandemic level by the end of 2022.

4,300 UNITS *will be completed*

CONSTRUCTION:

Openings pick up notably in the Mountain View-Palo Alto-Los Altos area, joining Central San Jose as the two submarkets slated to welcome the most new units in 2022. The 2.3 percent inventory expansion matches the pace from 2020.

50 BASIS POINT *increase in vacancy*

VACANCY:

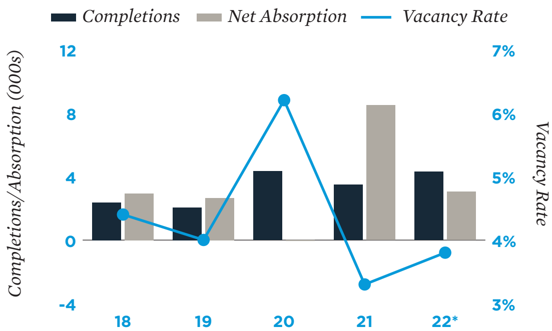
Elevated supply growth, paired with stabilizing renter demand following last year's absorption surge, will place metro vacancy at 3.8 percent this year. Availability will still trail the year-end 2019 mark by 20 basis points.

10.7% INCREASE *in effective rent*

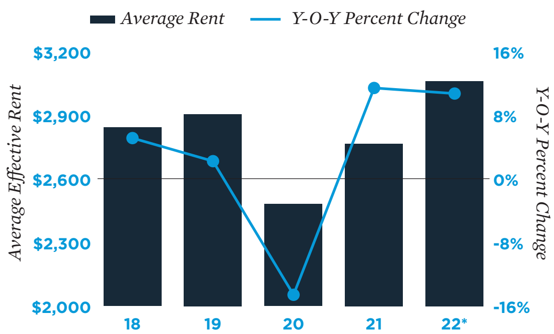
RENT:

After declining 14.6 percent in 2020, the average effective rent will have posted a combined 2021-2022 growth rate of 23.3 percent. The mean monthly rate for the metro will reach $3,060 by year-end, a new high point.

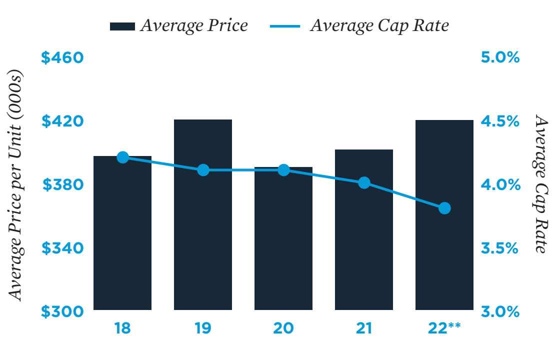
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

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

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Price: $250

2Q 2022 - 12-Month Period

CONSTRUCTION

3,008 units completed

- Roughly 1,400 fewer units were completed over the 12-month period ended in June compared to the prior yearlong span, equating to the lowest four-quarter total since March 2020.
- Development was heaviest in Central San Jose and Santa Clara, as each submarket welcomed over 700 doors over the past year.

VACANCY

220 basis point decrease in vacancy Y-O-Y

- The net absorption of over 6,600 rentals between July 2021 and June 2022, more than double the preceding decade average, tightened vacancy to 3.1 percent — the lowest summer rate since 2011.
- All three apartment tiers recorded vacancy rate drops of at least 200 basis points year-over-year, led by the Class A segment at 280 basis points.

RENT

16.8% increase in the average effective rent Y-O-Y

- Greater leasing supported the fastest rent growth in two decades over the past year ended in the second quarter, with the metro's average effective rate advancing to $2,978 per month, just short of the pre-pandemic high.
- Reflective of broad renter demand, effective rents climbed by double-digit percentages across the Class A, B and C levels.

Investment Highlights

- A favorable turnaround in property fundamentals has encouraged investment activity, as transaction velocity over the 12-month period ended in June improved about 30 percent from the preceding yearlong period. Competition for listings helped lift the average sale price in the most recent four-quarter period to $419,300 per unit, up 6 percent over the previous span. While posting the greatest pricing increase of any Bay Area metro, entry costs in San Jose still modestly trail the 2019 high.
- Sales velocity through the first six months of 2022 exceeded the second half of 2021, even as rising interest rates impacted investment and financing. Those factors may come into play through the rest of this year, as San Jose boasts the tightest cap rate in the Bay Area at an average of 3.8 percent.
- Transactions notably picked up in Downtown and Midtown San Jose, as well as Sunnyvale, Campbell-Los Gatos and Mountain View-Los Altos, as some institutions regained confidence in central areas and neighborhoods near major tech employers. Among these submarkets, Class A vacancy is the tightest in North Sunnyvale at just 2.5 percent, while Mountain View-Palo Alto-Los Altos claims the lowest Class B availability at 2.1 percent.