MARKET REPORT

Multifamily

San Jose Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

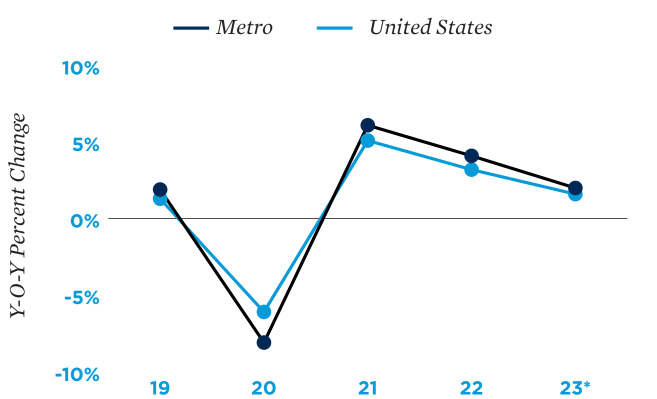
3Q/23

Recovering Demographics and Easing Supply Result in Greater Near-Term Multifamily Stability

First-half demand topped all other major California metros. After having a net of more than 80,000 residents move out of the metro from 2020 to 2022, San Jose is back on track to regain an overall positive count of transplants this year. Lower levels of urban malaise than nearby Bay Area counterparts, as well as a relatively steady job market, are positioning the metro to record household growth above the long-term pace of 0.5 percent in 2023. At the same time, transplants' options for housing remain limited. The difference between a typical monthly mortgage payment on a median priced house and the mean effective Class A rent was the second-highest among U.S. markets, at $7,150 in June. Top-tier options will likely see stronger demand, both from relocating households and locals that remain in the renter pool. Already in the first half, San Jose's net absorption of 1,380 units was the highest among major California metros.

Metro's construction is lowest on the West Coast. San Jose will note its smallest annual inventory growth since 2011, as it adds fewer units than any other major Pacific coast market this year. The downshift will limit the impact of new builds on vacancy by steering renters toward existing units. Santa Clara and West San Jose are already seeing this trend take shape. Recently, scant completions facilitated drops in both local vacancy rates over the first half of 2023. Likewise, metrics in South Sunnyvale-Cupertino and South San Jose are likely to remain at similar levels, as they welcome nominal development.

Employment Trends



** Forecast*

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

Multifamily 2023 Outlook

23,000 JOBS
will be created

EMPLOYMENT:

Despite headlines of tech sector layoffs, San Jose has not recorded overall job losses since January 2021. Roughly 12,300 personnel were added over the first seven months, contributing to 2.0 percent job growth this year.

2,100 UNITS
will be completed

CONSTRUCTION:

Development slows meaningfully in 2023, facilitating a marketwide stock expansion of 1.1 percent. Near-term deliveries are slated to be highest in Mountain View-Palo Alto-Los Altos, at approximately 590 units this year.

10 BASIS POINT
increase in vacancy

VACANCY:

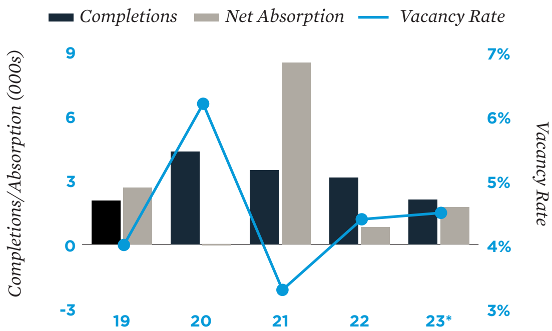
Marketwide vacancy increases will crest in 2023, placing the metric at 4.5 percent at year-end. With some supply still entering the market, Class A vacancy is likely to remain the highest, after noting a 5.0 percent rate in June.

1.3% INCREASE
in effective rent

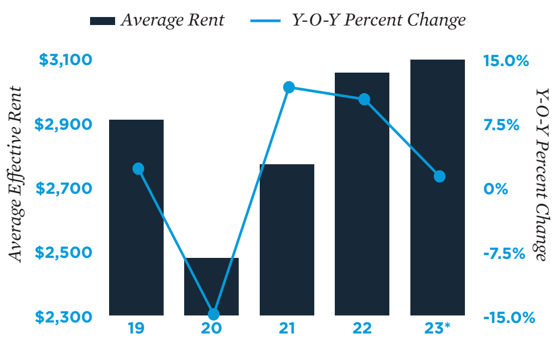
RENT:

Outside of past declines, San Jose is expected to note its slowest rent growth since 2008. However, at $3,095 per month, the average effective rate will be $260 above San Fransisco, which is the largest margin on record.

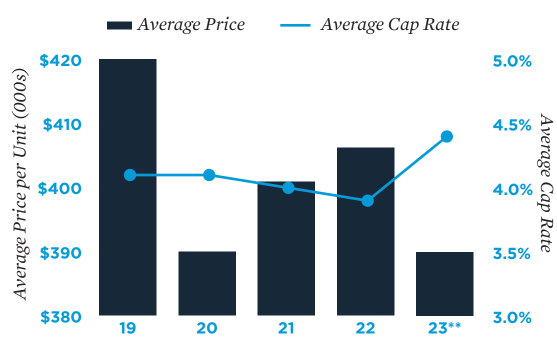
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

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

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Price: $250

2Q 2023 - 12-Month Period

CONSTRUCTION

2,964 units completed

- Marketwide, stock expanded by 1.6 percent during the 12-month span ended in June. Mountain View-Palo Alto-Los Altos, Central San Jose and North Sunnyvale received the bulk of new builds.
- In Mountain View-Palo Alto-Los Altos, about 1,220 units were completed over the past year. This drove record inventory growth here, at 4.1 percent.

VACANCY

110 basis point increase in vacancy Y-O-Y

- Despite climbing year-over-year, San Jose's vacancy rate of 4.2 percent in June was 20 basis points lower than the metric from the start of 2023.
- Five out of the metro's nine submarkets noted vacancy decreases over the first half. North San Jose-Milpitas had the largest reduction, as its local rate fell 90 basis points to a metro-low of 3.2 percent in June.

RENT

3.8% increase in the average effective rent Y-O-Y

- The average effective rent rose on an annual basis to $3,096 per month in June, but was 1.0 percent lower than the peak recorded last September.
- While rents increased across each sector during the last year, Class A properties registered a gain lower than the marketwide rate. In this segment, the average effective rent grew by 3.5 percent to $3,683 per month.

Investment Highlights

- Rising insurance premiums and a higher cost of borrowing are leading many operators to acquire existing assets, rather than propose new builds. This has been most apparent in South San Jose, where trading activity over the first six months surpassed the entirety of 2022. Here, construction through the end of 2025 is projected to comprise just 2.7 percent of current inventory, limiting additional supply-side pressures and stoking investor interest. However, amid rising operational costs, buyers who continue to target the area are generally accepting higher yields than in recent years. In 2022, many deals here had cap rates under 4.5 percent, whereas in 2023, most trades are being completed in the mid-5 percent band.
- Deal flow generally sustained in Palo Alto, with local assets still commanding premium pricing despite the area's major employers, such as Google, recently listing local space for sublease. In Old Town Palo Alto and College Terrace, complexes have traded for over $1 million per unit this year.
- Amid higher vacancy, Santa Clara University has become a greater draw for buyers due to its potential recession resistance. Pricing for nearby assets has been fairly stable since 2022, remaining around $390,000 per unit.