Multifamily Research
Market Report

Fourth Quarter 2017

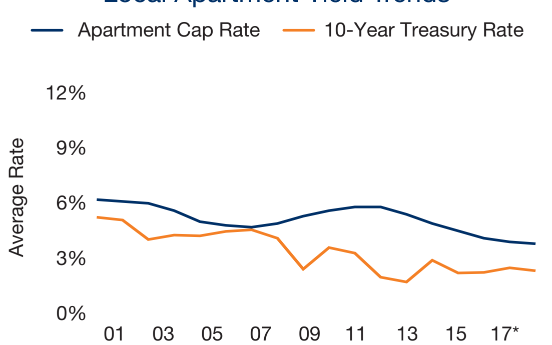
Bay Area Metros

Incredibly Tight Labor Markets Encouraging Renter Demand; Peak Supply Coming Online

Lowest unemployment rate in nearly 20 years spurring housing demand; lack of single-family homes encourages renting. The robust demand for technology workers and other professional employment has pushed the broad region's employment rate to a multidecade low, prompting surging demand for the limited housing stock that exists in the marketplace. Due to the high price of single-family homes, a continual flow of renters have kept rental demand elevated. In order to meet this demand, builders have pushed deliveries to the highest point in more than a decade. Although vacancy remains extremely depressed, the peak in deliveries in 2017 has begun to weigh on overall vacancy, particularly in the submarkets receiving the bulk of the injections. As a result, a modest uptick in vacancy is expected, while rent growth continues to reflect extremely tight conditions overall.

Sites in SoMa dominate elevated completions schedule. Following several years of moderate supply growth, 2017 represents the peak in new units, with more than 13,100 slated for delivery this year. More than 5,100 will come online in the fourth quarter, with nearly half of these units underway in the SoMa submarket. Elsewhere, construction remains widespread, reflecting the broad scope of development underway. Looking forward to 2018, completions will fall by more than 30 percent and will be evenly distributed between the three Bay Area metros.

Local Apartment Yield Trends



* Cap rates trailing 12 months through 3Q17; 10-year Treasury rate through Oct. 20.
Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2017 Outlook

Metro	Vacancy	Y-O-Y Basis Point Change	Effective Rent	Y-O-Y Change
San Francisco	3.5%	-20	$3,150	5.6%
San Jose	3.4%	-40	$2,650	8.4%
Oakland	3.0%	-30	$2,210	7.0%

Investment Trends

San Francisco

- San Mateo County assets remain in focus amid a surge in development on the peninsula. Buyers inside the city have focused on Financial District properties.
- Cap rates have sunk to the high-3 percent band over the last few years. Appreciation has begun to slow considerably, with prices nearly unchanged during the last 12 months.

San Jose

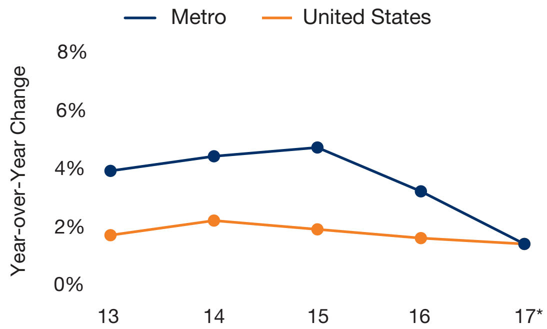
- Properties near corporate campuses or transportation routes remain attractive to buyers, drawing cap rates in the mid-4 percent range.
- Listings and trading activity have slowed dramatically, while prices were largely unchanged over the past year.

Oakland

- Relatively higher yields are drawing investors from both San Jose and San Francisco. Cap rates can be up to 50 basis points higher on average.
- Suburban assets with little competition from other complexes are in high demand due to greater pricing power. Rent growth in these areas can far exceed the metro average.

3Q17 – 12-MONTH PERIOD

Employment Trends

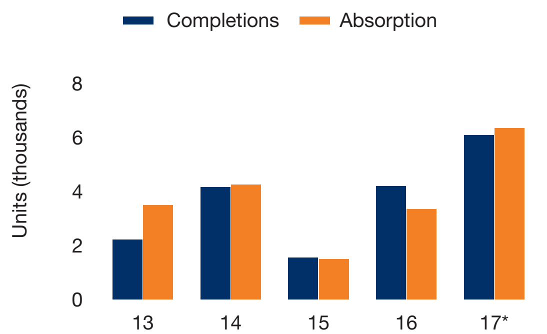


EMPLOYMENT:

1.4% increase in total employment Y-O-Y

- During the last year, San Francisco organizations created 15,600 positions, increasing total employment by 1.4 percent. The leisure and hospitality sector led the metro with more than 5,500 new workers.
- The extreme strength in the market has pushed the unemployment rate to the lowest point since the fourth quarter of 2000, ending the second quarter at 2.8 percent.

Completions and Absorption

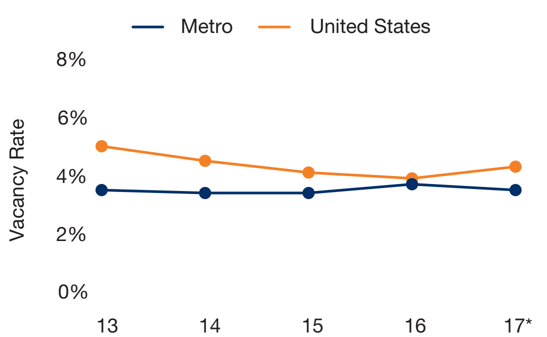


CONSTRUCTION:

4,100 units completed Y-O-Y

- Completions slowed marginally over the past year, sliding to 4,100 from 4,120 rentals in the previous year. Development remained concentrated in the SoMa submarket, where 2,970 units were brought online.
- The pace of development will accelerate through year end, with more than 2,900 apartments set for completion, led by 2,030 rentals in the SoMa submarket.

Vacancy Rate Trends

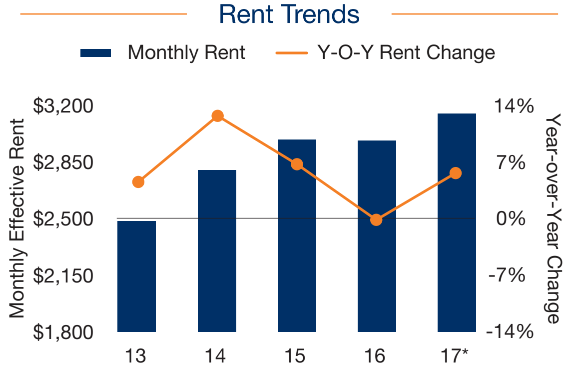


VACANCY:

50 basis point increase in vacancy Y-O-Y

- Over the past year, vacancy rose 50 basis points to 3.8 percent as net absorption turned negative in the third quarter of this year.
- Elevated development weighed on vacancy in the SoMa submarket, rising 80 basis points to 4.1 percent. Limited supply in the Downtown San Francisco submarket pushed vacancy 200 basis points lower to 2.1 percent.

Rent Trends



RENTS:

1.5% increase in effective rents Y-O-Y

- The average effective rent advanced 1.5 percent during the past 12 months to $3,071 per month, reflecting a broad advancement in rental rates.
- Rent growth was led by the South San Mateo County submarket, where the average effective rent climbed 5.4 percent to $3,020 per month. The SoMa submarket posted a 4.0 percent decline to $3,622 per month.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*

59,400

FIVE-YEAR HOUSEHOLD GROWTH*

44,000

* 2017-2022

3Q17 POPULATION AGE 20-34
(Percent of total population)

Metro 25%

U.S. 21%

POPULATION OF AGE 25+
PERCENT WITH BACHELOR DEGREE+**

Metro 50%

U.S. Average 29%

**2016

3Q17 MEDIAN HOUSEHOLD INCOME

Metro $107,213

U.S. Median $58,218

2Q17 TOTAL HOUSEHOLDS*

45% Rent

55% Own

*San Francisco-Oakland-Hayward, CA Metropolitan Statistical Area

SUBMARKET TRENDS

Lowest Vacancy Rates 3Q17

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Downtown San Francisco	2.1%	-200	$3,442	3.9%
West San Francisco	2.3%	-140	$2,980	0.1%
Marin County	3.2%	130	$2,555	2.5%
South San Mateo County	3.3%	20	$3,020	5.4%
SoMa	4.1%	80	$3,622	-4.0%
Central San Mateo County	4.2%	80	$3,042	3.6%
North San Mateo County	6.3%	280	$2,554	-1.0%
Overall Metro	**3.8%**	**50**	**$3,071**	**1.5%**

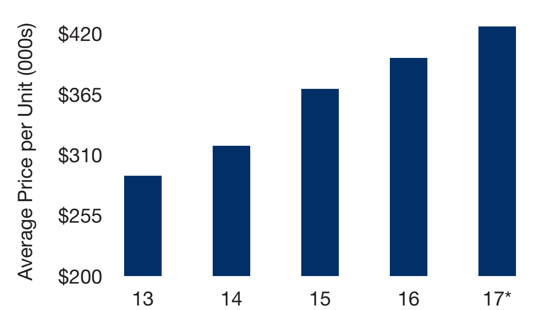
SALES TRENDS

Smaller Deals in San Mateo Lead Transactions Higher

- Transactions vaulted roughly 20 percent higher as buyers pursued deals throughout the metro, with properties in San Mateo County leading the way. Deal flow on the peninsula centered in the Financial District.
- Prices remain elevated, reaching the low-$440,000 per unit range. Cap rates average in the high-3 percent area for properties inside the city limits.

Outlook: Tight vacancy and continued rent growth are encouraging buyers to stay active. Deal flow in SoMa has become constrained due to the considerable new supply.

Pricing Trends

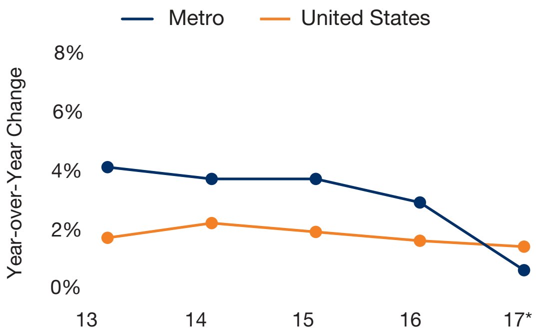


* Trailing 12 months through 3Q17
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

Marcus & Millichap

3Q17 – 12-MONTH PERIOD

Employment Trends

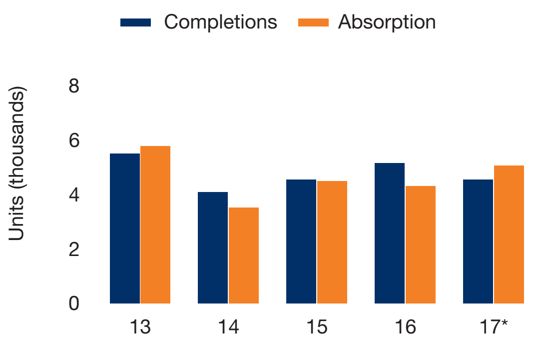


EMPLOYMENT:

1.4% increase in total employment Y-O-Y

- Over the past year, San Jose organizations created 14,700 positions, driven primarily by gains in the leisure and hospitality sector, where 6,700 workers were hired. Office-using jobs accounted for 3,750 places.
- Labor market strength is fostering an extremely low unemployment rate, reaching 3.6 percent by the end of the second quarter.

Completions and Absorption

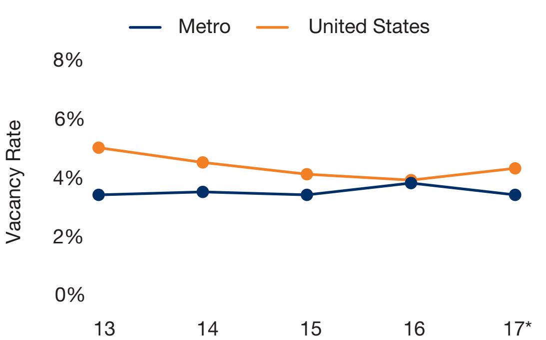


CONSTRUCTION:

5,440 units completed Y-O-Y

- Development accelerated moderately during the last four quarters, rising from nearly 4,600 units to more than 5,440, with the highest concentration in Santa Clara.
- Roughly 930 apartments will come online in the fourth quarter, pushing injections for 2017 to nearly 3,950 rentals. The largest project, Encasa, contains 465 units and is located in the North Sunnyvale submarket.

Vacancy Rate Trends

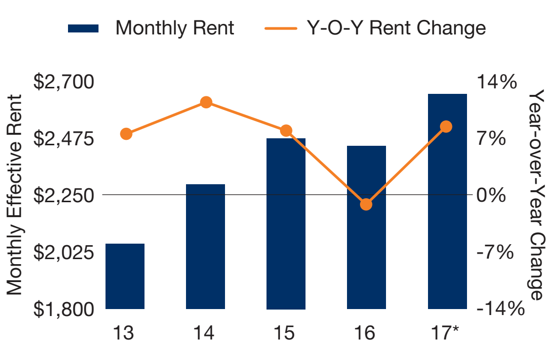


VACANCY:

20 basis point increase in vacancy Y-O-Y

- The metro vacancy rate ended the third quarter at 3.6 percent, 20 basis points higher than the same point last year. The Santa Clara submarket underperformed, with vacancy rising 120 basis points to 5.1 percent.
- Vacancy remains tightest in the East San Jose submarket at 1.4 percent, unchanged over the past year.

Rent Trends



RENTS:

5.3% increase in effective rents Y-O-Y

- The average effective rent surged 5.3 percent to $2,619 per square foot as tight conditions prompted sharp acceleration over the past year. The Mountain View/Palo Alto/Los Altos submarket led the growth, rising 10.1 percent to $3,211 per square foot.
- Central San Jose was the only submarket to contract, sliding 0.2 percent to $2,458 per square foot.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*
66,800

3Q17 POPULATION AGE 20-34
(Percent of total population)
Metro **22%**
U.S. 21%

3Q17 MEDIAN HOUSEHOLD INCOME
Metro **$110,772**
U.S. Median $58,218

FIVE-YEAR HOUSEHOLD GROWTH*
34,000

POPULATION OF AGE 25+
PERCENT WITH BACHELOR DEGREE+**
Metro **46%**
U.S. Average 29%

2Q17 TOTAL HOUSEHOLDS
45% Rent
55% Own

* 2017-2022

**2016

SUBMARKET TRENDS

Lowest Vacancy Rates 3Q17

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
East San Jose	1.4%	0	$1,727	4.5%
West San Jose/Campbell	2.9%	60	$2,454	4.3%
South San Jose	3.1%	50	$2,326	2.1%
North San Jose/Milpitas	3.2%	20	$2,717	4.1%
North Sunnyvale	3.3%	10	$2,708	3.4%
South Sunnyvale/Cupertino	3.6%	-90	$3,036	7.4%
Central San Jose	4.3%	-40	$2,458	-0.2%
Mountain View/Palo Alto/ Los Altos	5.0%	-10	$3,211	10.1%
Santa Clara	5.1%	120	$2,798	6.1%
Overall Metro	**3.6%**	**20**	**$2,619**	**5.3%**

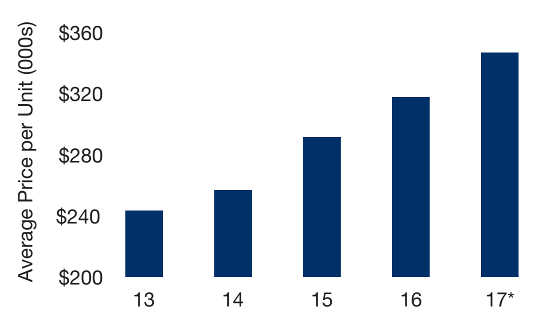
SALES TRENDS

Transactions Slowing as Stable Environment Encourages Buy and Hold Strategy

- Over the past year, transactions slipped nearly 25 percent, while the average price per unit rose steadily into the mid-$340,000 per door range as investors remained focused on executing buy and hold strategies.
- Cap rates remain in the low-4 percent range, reflecting the incredibly tight conditions currently in place in the metro. Premier assets in Palo Alto and Mountain View will price well above the metro average.

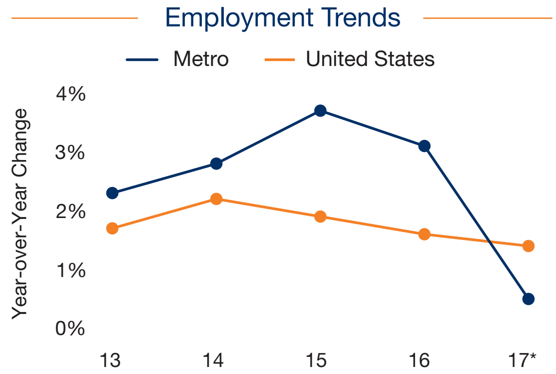
Outlook: Well-located properties remain extremely desirable, although a lack of availability is prompting buyers to venture into non-core neighborhoods for higher returns.

Pricing Trends



* Trailing 12 months through 3Q17
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

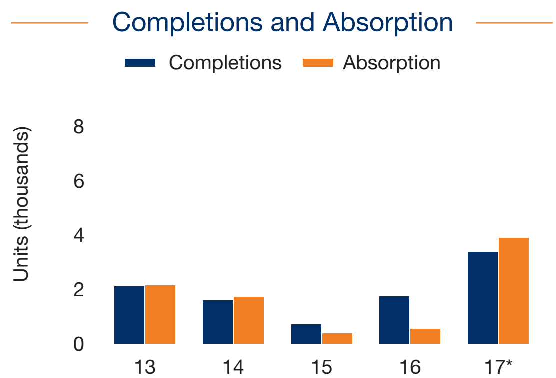
3Q17 – 12-MONTH PERIOD



EMPLOYMENT:

1.2% increase in total employment Y-O-Y

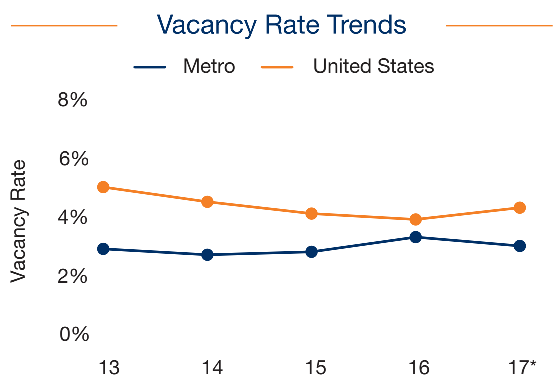
- Payroll additions, led by education and healthcare, generated the creation of 13,900 jobs over the past year. More than 5,500 people were hired in the education and healthcare sector, followed by 3,000 new employees in the leisure and hospitality sector.
- Unemployment fell below 4 percent in the third quarter, triggering a slowdown in overall hiring.



CONSTRUCTION:

2,200 units completed Y-O-Y

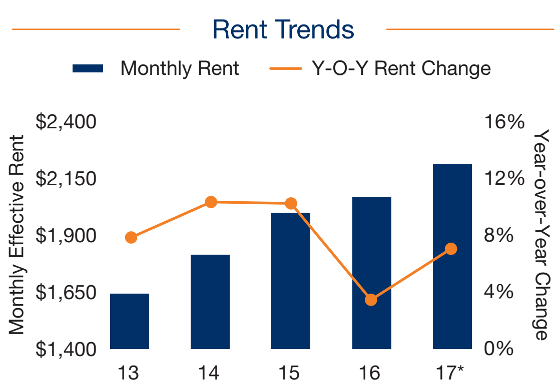
- Construction activity rose considerably over the past year, climbing from more than 1,500 rentals to above 2,200 units. Nearly half of all completions were in the Oakland/Berkeley submarket.
- Nearly 1,300 apartments are slated for delivery before year end, with builders focusing on the San Ramon/Dublin and Oakland/Berkeley submarkets.



VACANCY:

100 basis point increase in vacancy Y-O-Y

- Negative net absorption of more than 1,500 units in the third quarter of 2017 pushed up the metro vacancy rate by 100 basis points to 3.6 percent.
- A sharp increase in Class A unit vacancy in the Livermore/Pleasanton submarket prompted a 390-basis-point rise overall, ending the third quarter at 6.7 percent.



RENTS:

4.4% increase in effective rents Y-O-Y

- Average effective rent growth ascended over the past year, rising to $2,181 per month. Rent in properties in Northeast Contra Costa Country vaulted 5.6 percent higher to $1,610 per month, yet they remain the most affordable.
- The Oakland/Berkeley submarket tacked on 2.6 percent to $2,618 per month, remaining the most expensive in the submarket.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*

107,400

3Q17 POPULATION AGE 20-34
(Percent of total population)

Metro 21%

U.S. 21%

3Q17 MEDIAN HOUSEHOLD INCOME

Metro $88,424

U.S. Median $58,218

FIVE-YEAR HOUSEHOLD GROWTH*

60,000

POPULATION OF AGE 25+
PERCENT WITH BACHELOR DEGREE+**

Metro 40%

U.S. Average 29%

2Q17 TOTAL HOUSEHOLDS*

45% Rent

55% Own

* 2017-2022

**2016

*San Francisco-Oakland-Hayward, CA Metropolitan Statistical Area

SUBMARKET TRENDS

Lowest Vacancy Rates 3Q17

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
NE Contra Costa County	2.4%	-20	$1,610	5.6%
Concord/Martinez	2.7%	20	$1,883	1.1%
Walnut Creek/Lafayette	2.7%	-40	$2,346	5.5%
Fremont	3.3%	90	$2,334	2.5%
NW Contra Costa County	3.3%	100	$1,732	7.1%
San Ramon/Dublin	3.3%	0	$2,358	3.1%
Oakland/Berkeley	3.7%	70	$2,618	2.6%
Hayward/San Leandro/ Union City	4.3%	260	$1,995	5.7%
Livermore/Pleasanton	6.7%	390	$2,387	7.2%
Overall Metro	**3.6%**	**100**	**$2,181**	**4.4%**

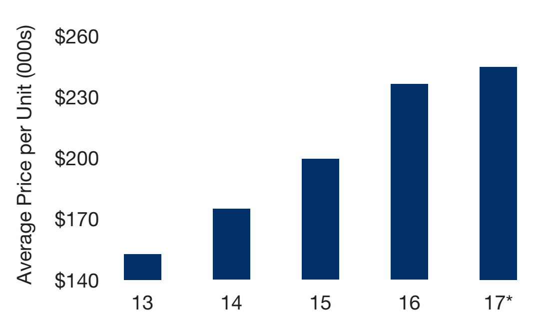
SALES TRENDS

Transaction Volume Remains Elevated As Buyers Pursue Suburban Class C Assets

- Prices inched modestly higher to more than $240,000 per unit as buyers remained active in East Oakland and the Fremont. Dollar volume slumped nearly 40 percent as transactions focused on transitioning neighborhoods and assets in order to achieve higher returns.
- Investors are pursuing cap rates that are averaging in the low-5 percent band, encouraging capital flows from other Bay Area metros. Properties in the core will transact in the high-4 percent range.

Outlook: Assets in commuter neighborhoods along major freeways remain the main target for investor capital.

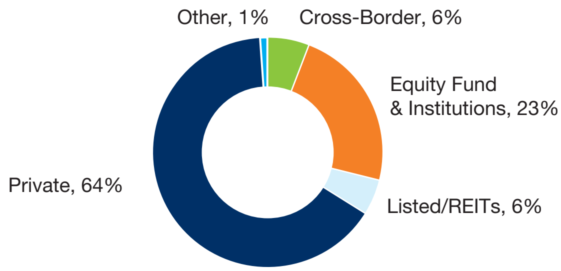
Pricing Trends



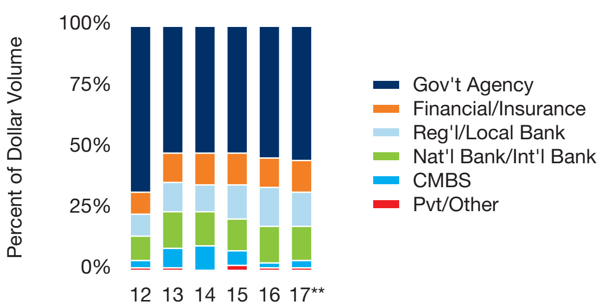
* Trailing 12 months through 3Q17

Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

Apartment Acquisitions By Buyer Type*



Apartment Mortgage Originations By Lender



* Trailing 12 months through 2Q17
** Through first half 2017
Include sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- **Monetary policy in transition.** Despite the Fed raising its benchmark short-term rate three times in seven months and signaling another rise before the end of the year, long-term rates have remained stable. The yield on the 10-year U.S. Treasury bond remained in the low- to mid-2 percent range throughout the third quarter of 2017. The Federal Reserve wants to normalize monetary policy and, in addition to raising its funds (or overnight lending) rate, has announced it will begin to taper its balance sheet by allowing an initial $10 billion in securities to mature without reinvestment. By reducing its acquisitions of securities, 10-year Treasury rates should drift upward, thereby widening the spread between short- and long-term rates.

- **Increase in interest rates over the course of the year, pushing up the cost of capital.** While commercial real estate fundamentals remain strong, rising costs associated with debt financing will tighten the spread between cap rates and lending benchmarks. This environment could weigh on transaction activity as investors evaluate their yield options. Cap rates have remained relatively stable over the last year, but upward movement in Treasury rates has amplified the expectation gap between buyers and sellers.

- **The capital markets environment continues to be highly competitive.** Government agencies continue to consume the lion's share, just slightly over 50 percent, of the apartment lending market. National and regional banks control approximately a quarter of the market. Growing uncertainty about federal policy and global geopolitical concerns are keeping long-term interest rates down with pricing residing in the 4 percent realm with maximum leverage of 80 percent. Portfolio lenders will typically require loan-to-value ratios closer to 75 percent with interest rates in the high-3 to mid-4 percent range. As uncertainty remains regarding the possibility of tax policy revision, rental demand remains strong with the national apartment vacancy at 4.5 percent.

National Multi Housing Group

Visit www.NationalMultiHousingGroup.com

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; National Association of Realtors; Moody's Analytics; Real Capital Analytics; MPF Research; TWR/Dodge Pipeline; U.S. Census Bureau