

### PAYROLL JOB SUMMARY

Average Payrolls	1,074.3m
Annual Change 1Q17	21.5m (2.0%)
RCR 2017 Forecast	33.3m (3.1%)
RCR 2018 Forecast	50.6m (4.6%)
RCR 2019 Forecast	22.1m (1.9%)
RCR 2020 Forecast	15.2m (1.3%)
RCR 2021 Forecast	20.1m (1.7%)
Unemployment (NSA)	3.2% (4/17)

### 1Q17 PAYROLL TRENDS AND FORECAST

Santa Clara Co. employment growth decelerated to its slowest rate since 4Q10, as establishments added workers to payrolls at a 21,500-job 2.0% year-on-year pace, down from 4Q16's 28,400-job, 2.7% performance. Weaker growth in the construction, retail trade and education services industries was primarily responsible: the sectors collectively shed workers at a 300-job, -0.1% rate in 1Q, compared to last summer's 6,400-job, 3.7% advance. Distinctly slower expansion also was evident in the information and financial services sectors, most likely attributable to the development of comparatively lackluster conditions in the tech start-up and VC spaces. On the brighter side, the professional and technical (4.0%) and health care (3.6%) services sectors maintained full heads of steam.

Seasonally-adjusted data also hinted at slower expansion. This series recorded a -5,000-job net loss in 1Q17, the first quarterly setback since 3Q11. Payrolls also declined sequentially in April, falling by -2,900 jobs from March.

RED Capital Research's San Jose payroll model suggests that early 2017 results are not more than a temporary lull. Our 98.5% adjusted-R<sup>2</sup> (SE=0.5%) model relies on US payroll and personal consumption expenditure growth, San Jose income growth and S&P500 returns as independent variables. We expect 10%+ y-o-y equity returns to continue through 1Q18, producing double digit PI growth and abundant capital for Silicon Valley firms. This should rekindle an 18-month spurt along 2014 lines before cooling in 2019.

### OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	95.8%
RED 51 Rank	23 <sup>rd</sup>
Annual Chg. (Reis)	+0.0%
RCR YE17 Forecast	95.9%
RCR YE18 Forecast	96.2%
RCR YE19 Forecast	95.8%
RCR YE20 Forecast	96.0%
RCR YE21 Forecast	96.2%

### 1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Renters expressed moderate space demand during the winter quarter, absorbing a net of 295 units, according to Reis, up from 4Q16's seasonally soft 151-unit tally but down materially from a solid 771-unit performance in the year-earlier period. Supply also was thin: developers completed only 232 new units. Consequently, San Jose occupancy inched up 5 basis points sequentially to 95.84%.

rise buildings posted a 95.4% rate. Among submarkets, Sunnyvale (96.4%) and East (95.9%) and Northeast (95.7%) San Jose posted the highest rates. Conditions in Campbell/Los Gatos (91.3%/-3.3% y-o-y) were weakest.

Axiometrics surveys of 287 stabilized same-store properties recorded at 95.3% occupancy rate, down 10 bps year-on-year. Including buildings in lease-up, the rate was 95.0%. Class-C (96.0%) recorded highest occupancy, followed by classes-A (95.3%) and -B (95.1%). Mid- and high-

Elevated supply will challenge the market for the next 30 months or longer. But RCR's absorption model suggests that job growth and pent-up demand for new space will create sufficient demand to absorb most of the new units. The 92.3% ARS (SE=0.3%) equation projects that renters are likely to net lease over 90% of the 9,840 units expected to be delivered by YE19. As a result, San Jose occupancy should hover near 96% for the duration of the forecast.

### EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	\$2,404
Annual Change	1.6%
RED 51 Rent Change Rank	46 <sup>th</sup>
RCR YE17 Forecast	5.3%
RCR YE18 Forecast	6.8%
RCR YE19 Forecast	1.6%
RCR YE20 Forecast	2.5%
RCR YE21 Forecast	4.9%

### 1Q17 EFFECTIVE RENT TRENDS

Reis report that San Jose rent trends rebounded from 4Q16's uncharacteristic \$24 (-1.0%) sequential decrease with a solid \$20 (0.8%) advance in 1Q17. Gains were observed across classes as both "A" (0.8%) and "B&C" (0.6%) segment asking rents posted robust recoveries. Expressed on a year-on-year basis, effective rents increased 1.6%, marginally slower than 4Q16's 1.8% advance.

rents were essentially unchanged y-o-y, while classes-A and -C declined -0.4%. Four submarkets notched rent increases - Central (0.7%), Northeast (1.2%) and South (2.8%) SJ and Campbell (0.9%) - while East SJ (-3.5%) and Santa Clara (-2.2%) suffered the worst bruising.

Axiometrics same-store data revealed similar trends in the larger, professionally-managed segment. Sample rents also recorded a significant sequential quarter increase. But y-o-y rent growth remained in the red, falling -0.1% in 1Q17, up from 4Q16's sharp -2.2% retreat. Class-B (0.0%)

RCR's SJ rent model suggests that the rally will continue. The 97.9% ARS (SE=1.5%) model employs two lags of the dependent variable, occupancy (+) and San Jose income (+) as equation variables. We expect occupancy to be high and stable and income growth to rise as equity options are exercised and high wage jobs are created. This should propel rents up about 4.1% annually through 2021.

### TRADE & RETURN SUMMARY

\$5mm+ / 60-unit+ Sales	6
Approximate Proceeds	\$257.0mm
Average Cap Rate (FNM)	4.7%
Average Price / Unit	\$168,051
Expected Total Return	7.1%
RED 49 ETR Rank	24 <sup>th</sup>
Risk-adjusted Index	1.95
RED 49 RAI Rank	46 <sup>th</sup>

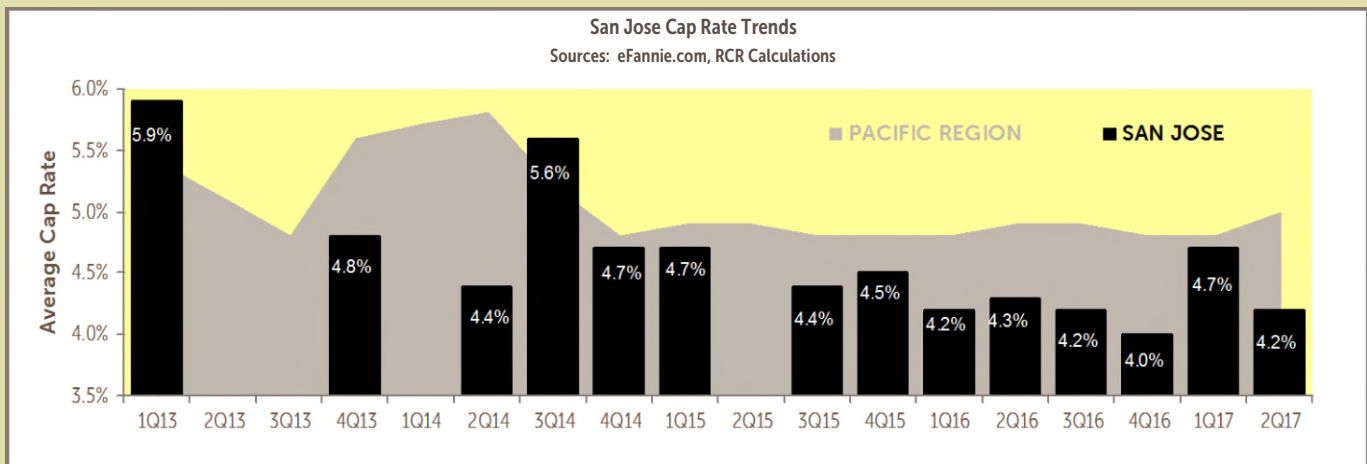
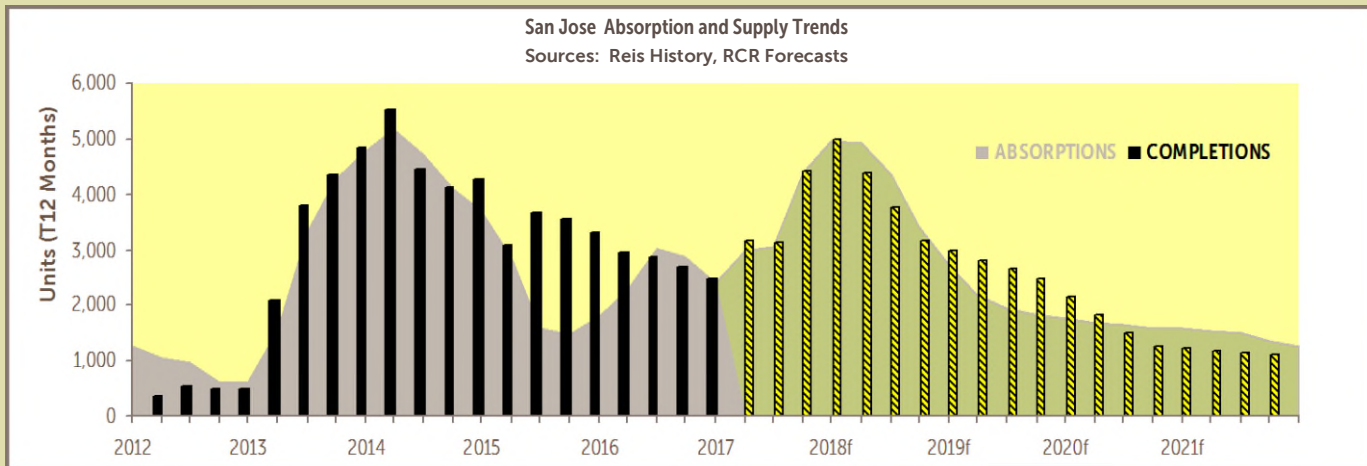
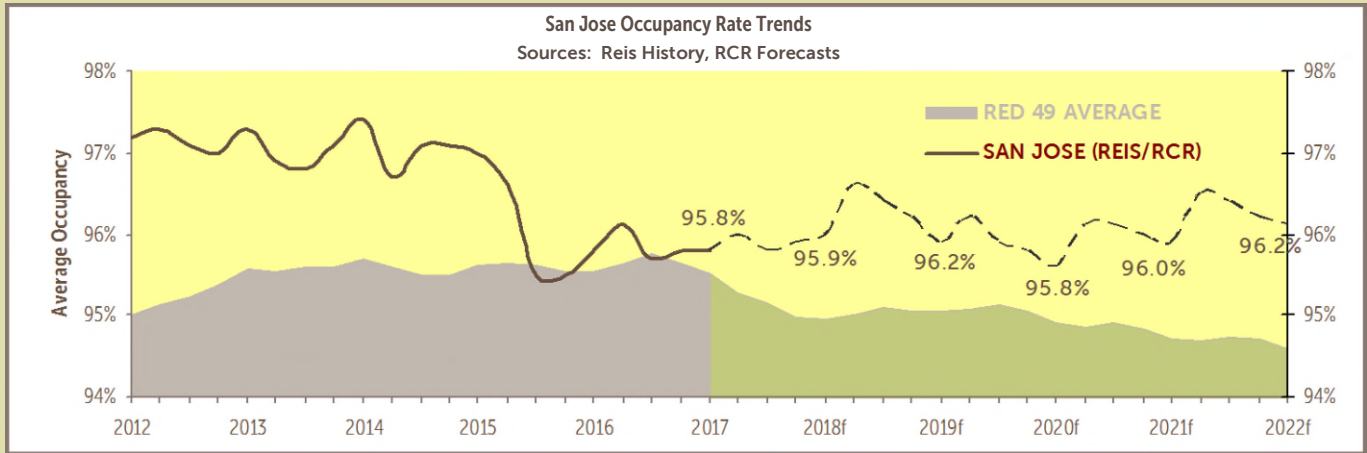
### 1Q17 PROPERTY MARKETS AND TOTAL RETURNS

Santa Clara Co. property market activity continued at a leisurely pace as current owners found little reason to divest valuable core holdings. CoStar reported six transactions valued at \$5 million or more were closed during the first quarter, matching the totals observed in the prior and year-earlier periods. Sales proceeds totaled \$256.9mm, comparing unfavorably to \$469.6mm and \$394.1mm metrics recorded in 4Q16 and 1Q17, respectively. The average price of units sold was \$168,051, low for San Jose, down -35% sequentially and -56% year-on-year.

corporate housing project located in Los Altos.

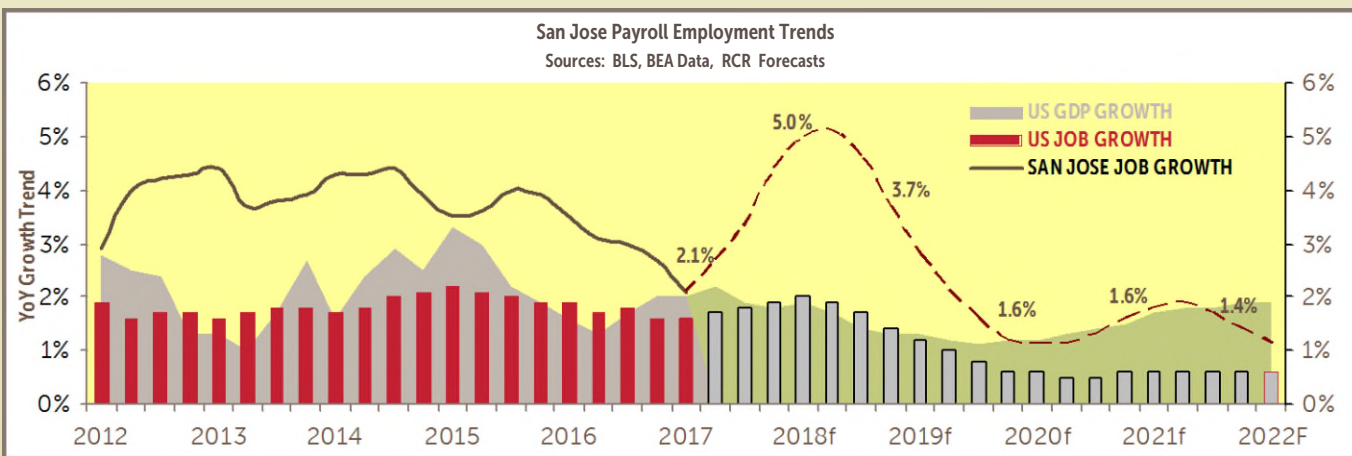
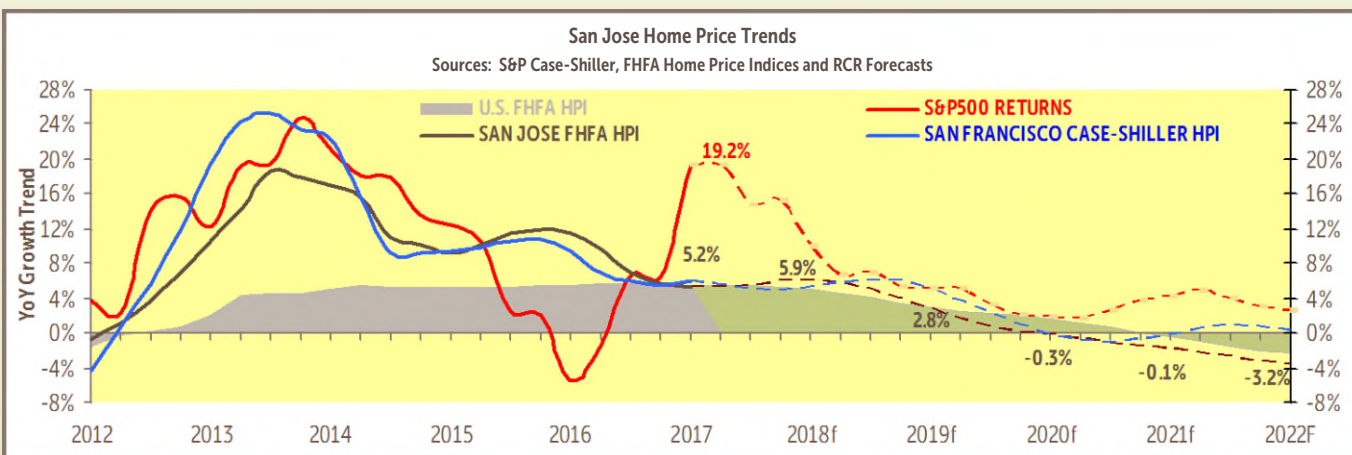
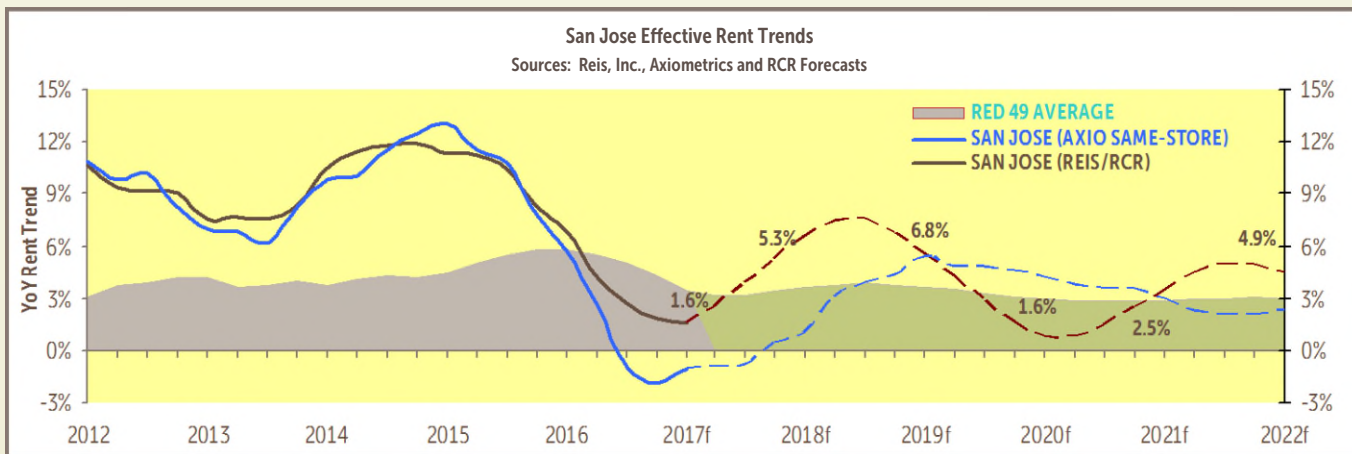
Early 2Q17 trade velocity was more of the same. Only one property of substance traded through May, a new high-end

Soft rent trends in 2H16 notwithstanding, San Jose cap rates remain among the lowest in the country. RCR elected to cut our B/B+ purchase cap rate proxy 5 basis points to 4.25% to reflect the intensifying "sellers" market conditions in the Valley. With a projected 2022 terminal cap of 4.78% and model derived rent and occupancy point estimates, we calculate an investor would expect to earn a 7.1% annual total return on a 5-year hold. This ranks 24<sup>th</sup> among the RED 49. High rent model standard error and high rent volatility hamper risk-adjusted returns, however; the metro ranks 46<sup>th</sup> among the peer group on this basis.



## NOTABLE TRANSACTIONS

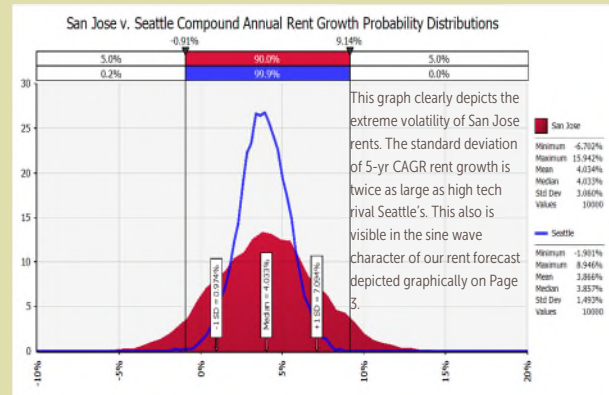
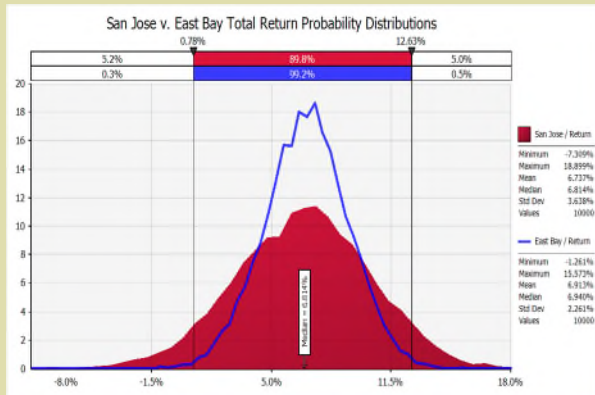
Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
The Grove (Central San Jose / Fruitdale / Rexford)	C / GLR (1970)	2-Dec-2016	\$96.0	\$290,030	4.4%
The Vineyards (Santa Clara Co. / Gilroy)	B / GLR (2006)	17-Dec-2016	\$53.5	\$314,706	5.2%
Santa Palma (South San Jose / Oak Ridge)	B+ / WF MR (2003)	6-Jan-2017	\$140.3 (allocated)	\$343,142	6.1% (Int. Trans.)
Villa Veneto (South San Jose / Oak Ridge)	B / WF MR (1999)	6-Jan-2017	\$75.0 (allocated)	\$331,858	6.1% (Int. Trans.)
Villa Veneto Palm Valley (South SJ / Oak Ridge)	B+ / WF MR (2008)	6-Jan-2017	\$58.5 (allocated)	\$309,524	6.1% (Int. Trans.)
Sage at Cupertino (Cupertino / Central / Loma Linda)	B / LR (1971)	31-Mar-2014	\$90.0	\$391,304	5.0% (Int. Trans.)



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## SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory		Effective Rent			Physical Vacancy		Basis Point Change
	Percent Change	4Q16	1Q17	Change	4Q16	1Q17		
Campbell/Los Gatos	0.0%	\$2,236	\$2,294	2.6%	1.7%	3.1%	140 bps	
Central San Jose	0.0%	\$1,772	\$1,839	3.8%	4.3%	4.3%	0 bps	
Cupertino/Saratoga	0.0%	\$2,820	\$2,993	6.1%	4.4%	3.9%	-50 bps	
East San Jose	3.9%	\$2,144	\$2,241	4.5%	4.6%	4.9%	30 bps	
Mountain View	1.3%	\$2,867	\$3,060	6.7%	4.5%	4.0%	-50 bps	
Northeast San Jose	13.6%	\$2,364	\$2,494	5.5%	3.7%	4.3%	60 bps	
Santa Clara	4.7%	\$2,448	\$2,638	7.8%	4.1%	4.4%	30 bps	
South San Jose	5.1%	\$2,057	\$2,153	4.7%	5.2%	4.9%	-30 bps	
Sunnyvale	1.1%	\$2,565	\$2,626	2.4%	2.5%	3.6%	110 bps	
Metro	2.0%	\$2,384	\$2,404	0.8%	4.2%	4.2%	0 bps	



This graph clearly depicts the extreme volatility of San Jose rents. The standard deviation of 5-yr CAGR rent growth is twice as large as high tech rival Seattle's. This is also visible in the sine wave character of our rent forecast depicted graphically on Page 5.

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