What's Ahead for the South Bay Apartment Market?
By Hendricks & Partners

Second Quarter 2006

General economic conditions in the South Bay, as noted previously were starting to recover, and with strong local performance by South Bay based companies, the region has shifted from stabilization to expansion. It should be noted that the South Bay region seems to be in a bi-modal recovery. The North/Northeast Valley and Central San Jose submarkets are lagging via a variety of indicators but the northern submarkets such as the Northwest Valley and San Mateo County are experiencing generally lower office vacancy, better job growth, and more investment. Genentech provides a good example of what is happening.
Genentech, based in the San Mateo County submarket is planning on adding 2.5 million square feet of building space in the city of South San Francisco. This expansion will enable Genentech to create room for up to 16,000 additional employees over the next 10 years, tripling the number of workers that Genentech employs in South San Francisco. Significantly, San Mateo County is home to the biotech cluster, of which Genentech is a large piece of the foundation. The agglomeration of biotech firms in San Mateo County and to a lesser extent in the Northwest Valley, versus the agglomeration of traditional technology firms in Central San Jose and the North/Northeast Valley, explains why there is a bi-modal recovery. San Mateo County did not grow as fast as the traditional heart of Silicon Valley did during the 1990's. As a result, it developed a different span of industries that have positioned it as the current growth within the South Bay region. Anecdotal reports indicate that after several years of retrenchment, traditional tech companies are beginning to add employees in Central San Jose and the North/Northeast Valley submarkets.

- Demand for the second quarter measured 303 apartment units. The second quarter was the sixth straight quarter of positive absorption. The 12-month absorption total was 1,101 apartment units.
- In the second quarter of 2006, 342 new apartment units were completed. Over the last four quarters, only 418 new apartment units reached lease-up. In contrast, the five-year average for new apartment construction is 1,748 units every 12 months or 437 new apartment units every quarter.
- A total of 536 multifamily units were permitted for the quarter; 1,545 multifamily units have been permitted in the first two quarters of 2006, which was down 20.0% from the first two quarters of 2005. Belying the South Bay's image as a suburban region, nearly 59% of all housing units permitted were for multifamily.
- The South Bay's average apartment vacancy rate held steady at 4.3% in the second quarter. That was down from 5.0% in the second quarter of 2006. The Northwest Valley submarket again had the lowest vacancy rate of 2.6%. The North/Northeast Valley submarket had the highest measured vacancy rate of 6.3%
- Average year-over-year rent growth for the South Bay region continued to surge, and measured 6.5% in the second quarter of 2006. The high-end markets of the West

Valley and San Mateo County continued to lead the pack with rent growth measuring 9.5% and 8.5%, respectively.

The South Bay's rebound in employment growth is focused on higher paying jobs. Employers are shifting many low-wage, low-skill jobs to lower-cost regions. This is a boon for current apartment owners, as the income demographic shifts upward, buoyed by biotech and other technology oriented jobs, which on average pay significantly more than the jobs they displaced. Strict development restrictions also prevent significantly increased competition by raising the cost of the permitting process and of available land parcels.

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