

CALIFORNIA'S NEW

GOLD RUSH

\$3.8 M

\$4.5 M

\$6.2 M

\$5.8 M

\$1,450/
SQ.FT.

\$1.6 M

\$2.3 M

\$1.0 M

\$1,300/
SQ. FT.

\$5.5 M

\$6.7 M

\$4.9 M

\$5.2 M

\$10 M

\$1,500/
SQ.FT.

\$3.5 M

\$1,200/
SQ.FT.

\$2.6 M

Can one of the nation's hottest real estate markets stay that way?

By **DEBORAH R. HUSO**

What would it cost to live next door to Facebook founder Mark Zuckerberg? Well, right now it's not even possible. That's because Zuckerberg, like many of the reigning elite in Silicon Valley, has bought out all his neighbors to create a "buffer zone" around his Palo Alto residence. Now he rents their houses back to them.

To those of us who live in the real world (i.e., not California's over-the-top prosperous tech corridor between San Francisco and San Jose), the idea of spending tens of millions

of dollars to buy not just a house but maybe a whole neighborhood for one's own use sounds pretty unbelievable.

But this, after all, is Disney World for geeks.

\$4.3 M

"Technology is the driving force in real estate values in this area," says Yvonne Broszus, MAI, director at Valbridge Property Advisors in San Jose, California. "Companies here are growing rapidly. And they are bringing in a highly educated, highly paid workforce."

A workforce with stock options.

And what happens when these companies go public, as many recently have? You've got it. Even more wealth to spread around.

In fact, Kurt Reitman, MAI, SRA, principal at The Reitman Group in Menlo Park, California, says he believes the increase in IPOs actually is driving residential values in Silicon Valley. A lot of newly rich professionals who have cashed out their stock options are buying homes with cash or with minimal financing because their actual salaries are not commensurate with the cost to traditionally finance a home purchase, at least not a home purchase in Silicon Valley.

"We're finding prices at asking or above asking," Reitman adds. "Current average time on market is less than 30 days."

"Companies are so cash-rich, which was not the case in the dot-com era (1997–2000). The downside is the infrastructure. We can only support so many people here."

—GENE WILLIAMS, MAI



Plaque at the Hewlett Packard Garage—the birthplace of the world's first high-technology region, "Silicon Valley." Two Stanford University students, William R. Hewlett and David Packard, began developing their first product in this garage in 1938.

Venture Capital Sparks a Housing Boom

Gene Williams, MAI, vice president at real estate services firm CBRE in San Jose, points out that while Silicon Valley has traditionally garnered about a third of the nation's venture capital, it's now reeling in about 50 percent, and half of that is in software development.

"Companies are so cash-rich, which was not the case in the dot-com era (1997–2000)," he says. "The downside is the infrastructure. We can only support so many people here."

The market really started to boom in 2011 and 2012, Broszus notes. Between then and early 2014, she says single-family home prices in Santa Clara County (the heart of Silicon Valley) have jumped 36 percent. Meanwhile multifamily properties have seen a 50 percent increase.

Builder magazine reported in February that the San Jose-Sunnyvale-Santa Clara regions of California ranked eighth among the nation's healthiest markets for new home construction and sales.

The highest growth areas, Broszus says, have been near public transportation hubs or proposed hubs now that the Bay Area Rapid Transit is in full expansion mode with plans finally on the board to extend rail service all the way to downtown San Jose.

"Over the last five years, there has been a lot of focus on office space near the rail corridor because a lot of young professionals prefer to live in San Francisco," Reitman explains. They want to use rail to get to their jobs in a region rife with traffic issues. To cope with traffic problems in the absence of rail, many large corporations use private (and often controversial) buses to transport their employees from home to work and back again.

Broszus says that while all the growth and wealth in Silicon Valley is exciting, it's also disruptive. "There has been a large shift in values in an upward direction across the entire real estate market here," she says. With so much new money flowing into the area and the exit of the unskilled labor force that worked in the region's once dominant manufacturing industry, "there is now an imbalance in the economy," she says.

Not only is there an overall housing shortage, but there's an even steeper shortage in affordable housing. "It's becoming a crisis," Broszus says. The result is that local governments are now requiring new development or redevelopment projects to include affordable housing options in order for the developer to obtain project approvals. In Fremont, for example, home-builder Lennar is planning a new development that would result in more than 2,200 new housing units and 1.4 million square feet of commercial space. To gain approval, Lennar's project must include 286 "affordable" housing units, according to the *Silicon Valley Business Journal*.

Reitman is quick to point out that "affordable housing" does not mean "low-cost" housing in Silicon Valley. He says a lower-priced, single-family home in Menlo Park would come in at around \$1.25 million, and in San Jose, one can probably get a single-family residence in a desirable neighborhood for \$700,000 to \$800,000. "As a single person," he notes, "it's very hard to live here."

DO YOU KNOW WHO PAYS IN SAN JOSE?



The major players in Northern California's tech industry can be found in a relatively small strip of real estate between San Francisco and San Jose.



Multimedia; software



Electronics; software; online services



Networking equipment



E-commerce



Video game developer



Social networking



Biotechnology



Online services and products; search



Electronics; software



Microprocessors; hardware



Software



Venture capital



Social networking



Media; entertainment



Hardware; software



Customer relations management; cloud services



Automotive



Social media



Search; social media



Venture capital



Social media game developer



Google plans to build a futuristic-looking headquarters in Mountain View, Calif., for 20,000 employees. It would be the first time Google has designed and built offices from scratch.

Williams agrees, noting that Silicon Valley home prices are among the highest in the nation with two-bedroom townhomes selling for as much as \$600,000 to \$700,000. “Meanwhile,” he adds, “the average salary at Google is \$180,000.”

Broszus won’t go so far as to say Silicon Valley is filled with “one-percenters,” but she does note, “as far as who is owning in the valley, I would say ‘yes,’ it’s definitely the one-percenters.” She adds, “The extremely wealthy still need service-industry workers.” Where are those workers going to live? It’s anybody’s guess.

“The housing imbalance we have isn’t just due to housing not being affordable,” Broszus explains. “It’s not available either.” She says for every three workers in the city of Palo Alto, there is only one residence.

Williams says there are few examples of traditional residential subdivision development in Silicon Valley. “There’s no more land here,” he notes. “Vacancy rates in apartments now stand at 3 percent.” And Broszus notes, “Cities are starting to require that new residential development have at least 50 to 60 units per acre.

The result is that companies are pre-leasing new developments, before they’re even complete, to reserve residential space for their workers.

Demand Far Outpaces Supply

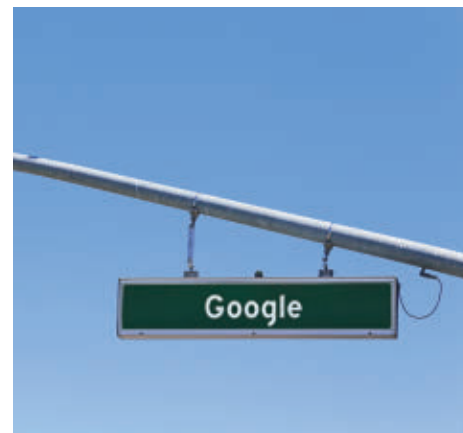
And demand is well in excess of supply, both on the residential and commercial side. Broszus notes that the city of Mountain View recently authorized construction of an additional 2.5 million square feet of commercial space, yet the city has proposals from companies, including Google, totaling more than 6 million square feet.

Williams says that in Santa Clara County alone, there is 7 million square feet of office space currently in development. “Four years ago, rents were so low, no one would have conceived of constructing an office building,” he says. “Now we’re seeing a giant influx of office demand.”

The highest demand in the commercial arena is for Class A office space for high-tech companies, mainly in areas like Palo Alto, Mountain View and Sunnyvale, where rents have skyrocketed. The further south or north from these areas one goes, the lower the rents. Yet vacancy rates have dropped across the whole market, according to Broszus.

According to Reitman, Class A office space in the hottest areas, like Palo Alto and Menlo Park, can cost \$1,200 to \$1,600 per square foot. “The domino effect is forcing up office demand in adjacent areas,” he adds. For example, Apple is now building its new headquarters in Cupertino. The growth isn’t restricted to IT, however. Bioscience also is big

Where the Streets Have Weird Names



Silicon Valley’s tech giants haven’t just taken over the map of Northern California—they’ve rewritten it with vanity addresses. At Apple’s campus, visitors will find themselves on Infinite Loop, a reference to a bit of programming jargon, with Apple’s main building located at One Infinite Loop. And when Facebook moved into its headquarters in 2011, it christened its main access road “Hacker Way,” a tribute to CEO Mark Zuckerberg’s misspent youth as well as Facebook’s internal ethos: “Move fast and break things.”

HOT POCKETS

Even in Silicon Valley, some neighborhoods are hotter than others. Where's the most coveted and expensive residential real estate, according to real estate firm Trulia? Here's the scoop....

CITY	MEDIAN HOME PRICE
Atherton	\$4.29 million
Burlingame	\$1.35 million
Los Altos Hills	\$3.7 million
Menlo Park	\$1.9 million
Mountain View	\$1.05 million
Palo Alto	\$2.2 million
Sunnyvale	\$950,000
Woodside	\$1.86 million



in the areas around Stanford University and University of California–Berkeley.

“In Palo Alto, values have always been big because Stanford is there,” Broszus says. “Values tend to filter out from that region because so many high-tech companies develop out of Stanford.”

But with no more room in Palo Alto and other hot areas, values are spiking everywhere. “There just isn’t sufficient space,” Reitman remarks. “Adjacent communities are experiencing the benefit of hyper-inflated values.” Mountain View and Sunnyvale are prime examples. In March, real estate investment firm Divco West acquired 210,000 square feet of office space in San Mateo for \$130.6 million (\$621/square foot). Owner JPMorgan originally acquired the property in 2007 for \$100.5 million. Meanwhile, in Sunnyvale, Divco sold an office complex to CBRE Global Investors for \$29.5 million after having purchased the property only two years earlier for \$18.8 million, according to the *San Jose Business Journal*.

Reitman says that the extreme upward movement in rental rates from San Francisco to San Jose has resulted in cap rate compression. “But it’s difficult to document cap rates due to the lack of transactions,” he adds. “There is a definite lack of supply, and when transactions do occur, they reflect significantly higher per-unit values.”

In San Francisco, office investment sales volume jumped 400 percent year-over-year in the first six months of 2014, according to the 2015 “Expectations & Market Realities in

Real Estate” report sponsored in part by the National Association of Realtors. Meanwhile, rental rates during the same period jumped 3.5 percent in San Francisco and 4.2 percent in San Jose.

Williams says the result is that cap rates have dropped as much as 300 to 400 basis points in some areas. “That gave huge property value jumps,” he adds.

Office vacancy rates stood at 8.27 percent on the San Francisco peninsula at the close of 2014, according to a market report from real estate services firm Colliers International. The rate was 10.44 percent for San Mateo County. Both represent the lowest vacancy rates since the dot-com era. Vacancy rates near commuter rails are even lower.

“A bubble is always a potential risk, but at the same time, there is nothing on the horizon right now indicating to me that we’re about to pop a bubble.”

—YVONNE BROSZUS, MAI

And the net absorption rate for office space in Silicon Valley is outpaced only by New York and Houston, according to data from real estate services firm DTZ (formerly Cassidy Turley). And San Francisco’s office rental rates are exceeded only by New York City, having increased nearly 17 percent year-over-year between the end of 2013 and the end of 2014. The average office rental rate in San Francisco at year’s end was \$62.26 per square foot. In San Mateo County, the average was \$46.08. The national average was \$22.63.

Will the Bubble Burst?

One would think the cycle of high-demand and short supply eventually would end, leading to a localized bubble in Silicon Valley in the future. “A bubble is always a potential risk,” Broszus says, “but at the same time, there is nothing on the horizon right now indicating to me that we’re about to pop a bubble.”

A March report from analytics firm Clear Capital indicates Marin, San Francisco, San Mateo and Santa Clara counties are approaching, if not exceeding, their peak price gains pre-recession. San Francisco prices were 16 percent above peak as of January, while San Mateo’s gain stood at 8 percent, Santa Clara at 3 percent and Marin at 2 percent. But quarterly growth rates have consistently slowed since mid-2013.

Williams says he expects increasing redevelopment of older properties and higher density projects due to high demand and lack of space throughout the region, which should mean a stable outlook at least through 2016. Williams expects the expansion of BART to eventually turn downtown San Jose into a 24-hour city and lead to increased residential development there.

Reitman is more cautious, saying he expects accelerated growth to persist for at least another two years. After that, however, he says he would not be surprised to see a bubble burst. “It’s the normal cycle of things,” he notes. ■

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