PACIFIC UNION

Real Estate
Economic Forecast
San Francisco Bay Area to 2019

White Paper

Santa Clara & San Benito Counties Housing and Economic Outlook

Bay Area Economic Forecast Summary

Presented by Pacific Union International, Inc. and John Burns Real Estate Consulting, LLC

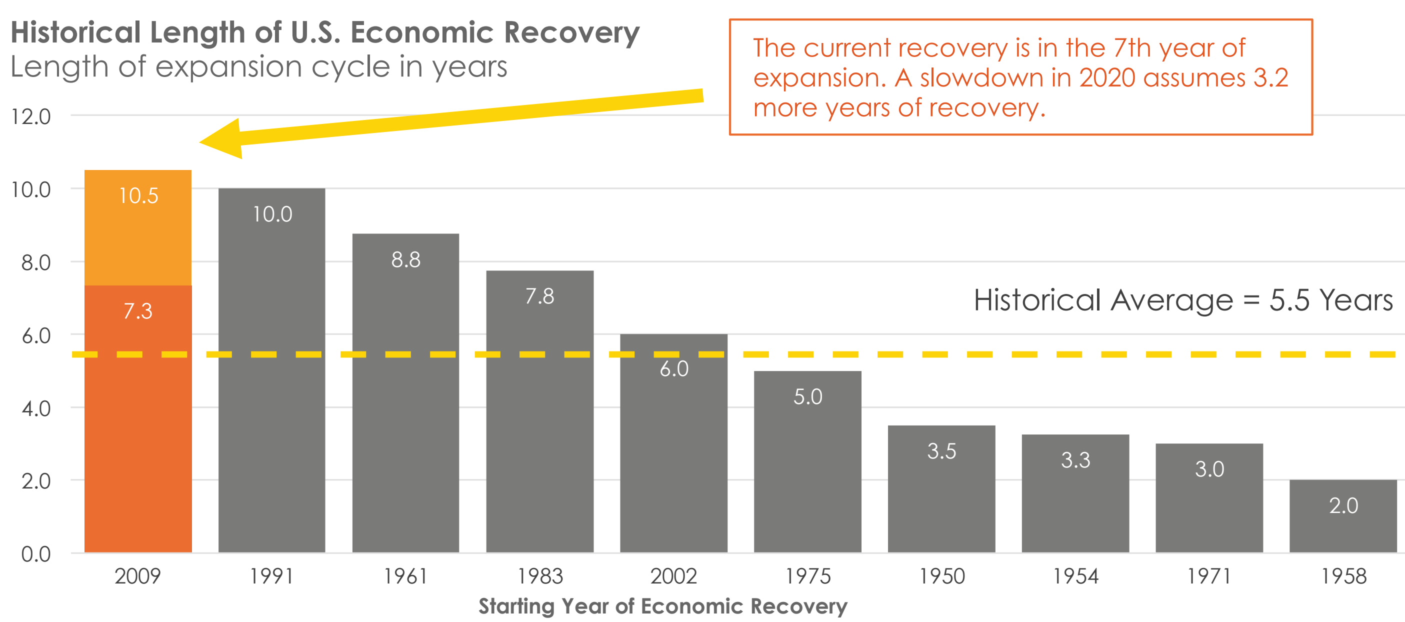
On Nov. 16, 2016, Pacific Union CEO Mark A. McLaughlin and esteemed housing experts John Burns, Dean Wehrli, and Selma Hepp teamed up to present the third in a series of live economic forecasts, providing proprietary research findings that give investors, buyers, and sellers the knowledge they'll need for success in their Bay Area real estate investments. This report is a summary of their key findings and conclusions, in addition to supplemental market knowledge provided by John Burns Real Estate Consulting ("JBREC").

Macroeconomics and Demographic Shifts

JOHN BURNS
REAL ESTATE CONSULTING

John Burns

Chief Executive Officer



This Economic Expansion is Historically Long: Since the Korean War (1950), the United States has experienced 10 economic expansions, with the average cycle lasting five and a half years. The current recovery has endured for over seven years, almost two years past the typical time frame. However, as the Great Recession was one of the worst economic downturns in history and recent growth has been relatively conservative, John Burns forecasts another three years of expansion (through 2019) before the current cycle comes to an end.

Bay Area Thrives in Diversity: Though nationally about 13 percent of residents in the United States were born in a foreign country, in the Bay Area that proportion jumps to 32 percent (2.5 times higher). Among Bay Area residents born in the 1970s – a vital homebuyer demographic – 50 percent are foreign born. Real estate brokers and builders need to have a deep understanding now more than ever of their target buyer's culture, including their home preferences and living arrangements (for example, multigenerational living).

Surban Living on the Rise: "Surban" is a term coined by John Burns Real Estate Consulting to help identify a nationwide trend of "bringing the best of urban living to a more affordable suburban environment." Surban communities are characterized by smaller homes with little or no yards in high-population areas that can meet the demand to commute less and live closer to restaurants and entertainment. As homebuyer priorities shift and Bay Area affordability worsens, Surban communities will become increasingly prevalent throughout the Bay Area.

Bay Area Housing Snapshot

PACIFIC UNION

Selma Hepp

Chief Economist

Bay Area Homes Appreciated by 7 Percent Over the Past Year: Overall, the counties that comprise the Bay Area have experienced a price increase of 7 percent in 2016 (year to date through October) from 2015 YTD. There is tremendous variability. Some of the highest appreciating cities, including East Palo Alto (up 19 percent), Oakland (up 14 percent), and Richmond (up 13 percent), have historically been perceived as less desirable addresses. Affordability concerns and proximity to employment and mass transit, however, have translated into large gains. Conversely, the few cities that have experienced depreciation over the past year include some of the highest-priced areas. Places like Palo Alto (-6 percent), Tiburon (-5 percent), and Menlo Park (-5 percent) have already achieved huge price gains in years prior.

LUXURY SALES

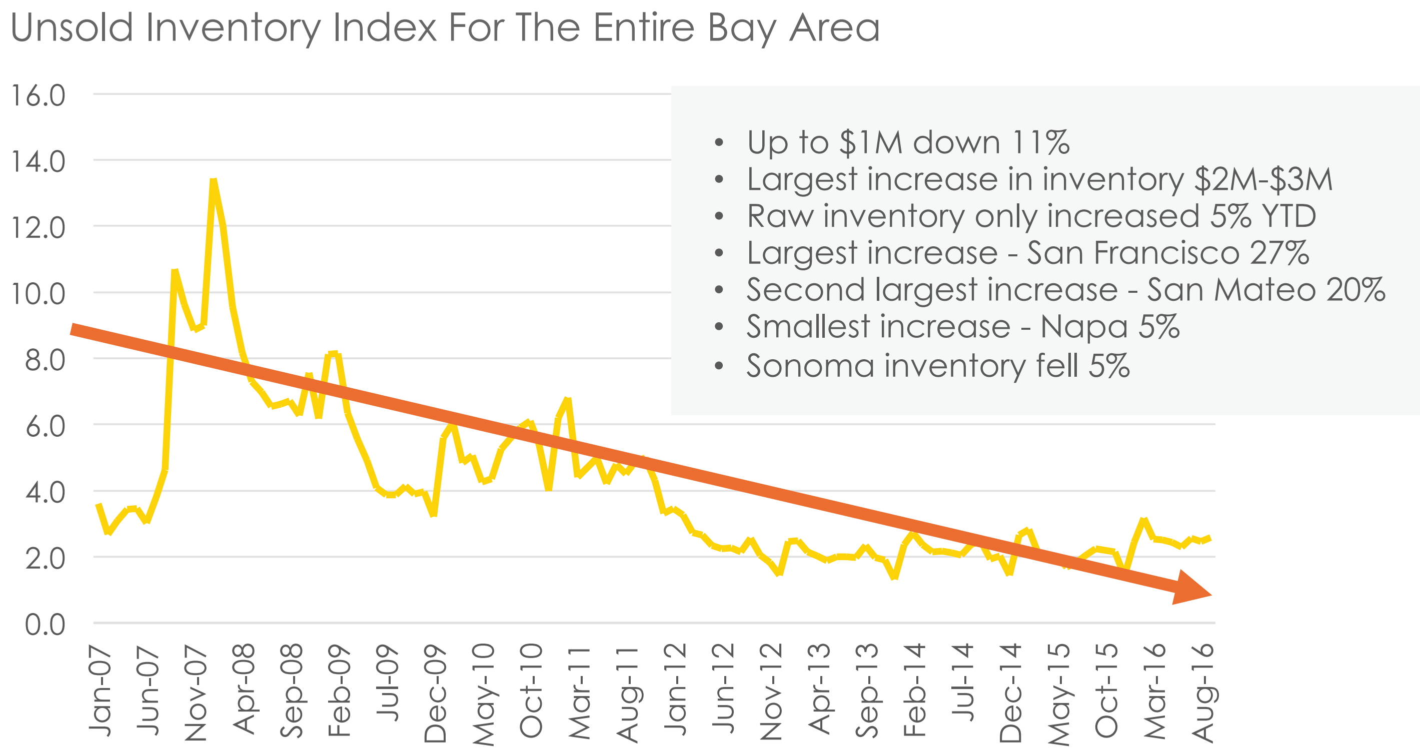
	2015	2016
Marin	5	2
Napa	3	2
Sonoma	2	2
Alameda	0	1
San Francisco	11	14
San Mateo	24	26
Santa Clara	6	11

Ultraluxury Home Sales Are Up: Bay Area homes priced $10 million and above rose from 51 sales in 2015 YTD to 58 sales in 2016 YTD. This includes increases in key markets including San Francisco, San Mateo, and Santa Clara Counties, while Marin and Napa Counties are slightly down.

Buyer Frenzy Cools: The percentage of listings selling over the original asking price has decreased in nearly all Bay Area markets, but particularly in San Francisco, San Mateo and Santa Clara counties. Likewise, the premium buyers are willing to pay over asking price has diminished by approximately 3 to 4 percent in these key markets.

Inventory Trending in the Right Direction, Though Remains Low: Total inventory is up about 5 percent in 2016 YTD, bolstered by significant increases in San Francisco (up 27 percent) and San Mateo (up 20 percent) counties. From a historical perspective, however, inventory throughout the Bay Area remains relatively low, with just over two months of supply. The inventory that is coming available to the market is primarily at the higher end, as the inventory of homes priced under $1 million is down 11 percent in 2016 YTD.

The Big Question Inventory?

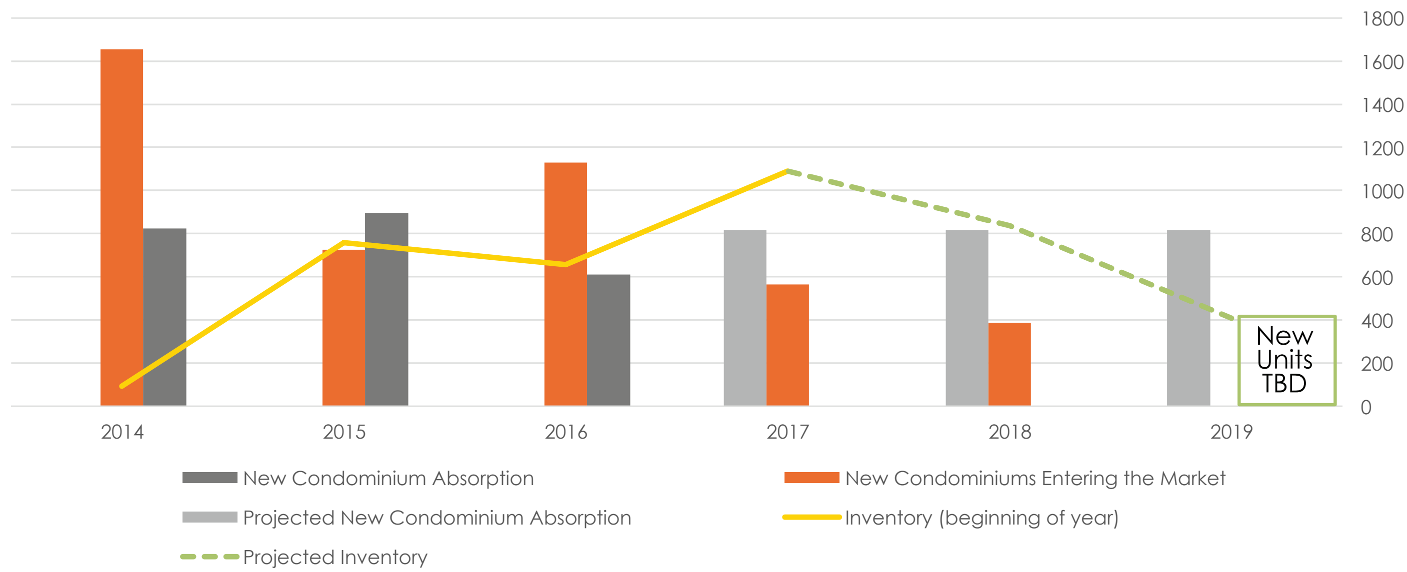


San Francisco Supply and Mortgage Rates Impact

PACIFIC UNION

Mark A. McLaughlin
Chief Executive Officer

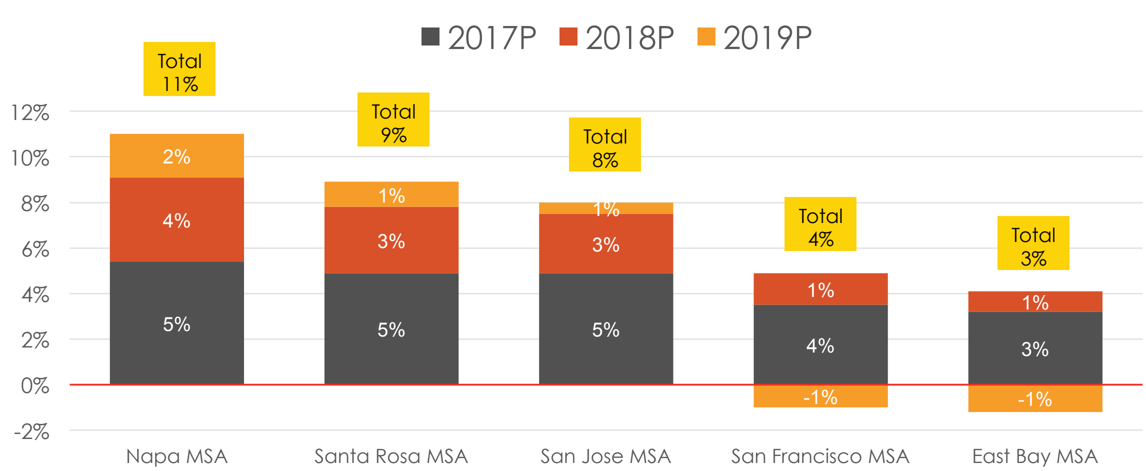
San Francisco Condo Market in Healthy Equilibrium: While the Bay Area as a whole is generally a supply-constrained environment, the city of San Francisco currently has a healthy level of inventory in its pipeline. There is roughly a year's supply in the city, with 1,090 condominium units currently selling, as well as 950 units under construction (and three times as many rental units!). Condominiums that are approved for construction total over 3,000 units with an additional +/- 30,000 units yet to be determined as for-sale or rental. San Francisco condominium inventory is just above the historical norm, though not considered oversupplied and will need additional construction going forward to satisfy demand.



Increasing Interest Rates Will Undoubtedly Shrink the Buyer Pool: Interest rates are on the rise, and it's going to directly impact the proportion of those who can qualify for homes. On a 30-year fixed mortgage at 4.0 percent, roughly one-quarter of Bay Area households can qualify for a $1 million mortgage. When the mortgage rate increases to 5.0 percent, as John Burns projects for the year 2020, the proportion of households that can qualify drops to 20 percent. A 6.0 percent rate would lead to 16 percent qualified households. A 5 percent rate translates into a 20 percent decrease in the buyer pool of qualified buyers for a $1 million mortgage over the next four to five years.

Growth Still Remains at Decelerating Rates: The Bay Area has generally experienced rapid pricing appreciation from 2011 through 2015. This surge in pricing following the Great Recession was not sustainable for the long term, though there is still growth ahead at more modest increases. The Burns Home Value Index projects pricing appreciation at the MSA level (shown to the right). Prices in 2017 and 2018 are up 1 percent to 5 percent annually across all five Bay Area markets, with the initial signs of a declining market occurring in San Francisco and the East Bay by 2019.

JBREC Burns Home Value Index -
Price Projections Through 2019



**Note the term Bay Area throughout this report is defined as the aggregate of the five metropolitan statistical areas comprised of the East Bay, Napa, San Francisco, San Jose, and Santa Rosa.*

SUBMARKET COLOR

JOHN BURNS
REAL ESTATE CONSULTING

Dean Wehrli
Senior Vice President

San Jose MSA (Santa Clara and San Benito Counties)

2017 JBREC PROJECTIONS

	Volume	Units	Pricing
Existing Home	4%	**18.4K**	5%
New Home	5%	**2.2K**	5%

Fundamentals Remain "Strong-ish": Price appreciation remains positive, housing inventory is low, and employment is still solid. Near term this market should remain stable, but conditions are clearly easing from the rampant growth of recent years. Employment growth is projected (in December) at 3.5 percent for 2016. Though a solid rate, it is the lowest increase the San Jose MSA job market has experienced in the past five years. Existing home prices were up 5 percent in 2016 and are projected to increase an additional 5 percent in 2017, well below the 9 percent to 17 percent annual appreciation that occurred from 2012 through 2015. We anticipate modest growth in sales volumes for both new and existing homes in 2017.

Can Now Make a Mistake: In recent years, home builders and brokers were sometimes able to escape the consequences of mistakes due to strong market conditions. That's no longer true. The wrong location or product or pricing will cost them. It is increasingly important for sellers to be realistic with their expectations and do their homework prior to entering the market, as poor execution will no longer be rescued by a rising market.

Push to Outlying Markets: Home prices in the San Jose MSA have reached historical highs, with a median resale price of $915,000. Buyers are increasingly forced into more outlying markets outside of the core Silicon Valley locales in search of affordability. This has resulted in increased demand in markets south of San Jose, including Morgan Hill, Gilroy, and Hollister. Buyers are increasingly displaying a willingness to commute in order to purchase the product (single-family homes on conventional lots rather attached product) or price points that are attainable.