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Savills World Research
US Residential


Spotlight **San Francisco and the Bay Area**

2016

WORLD CLASS

San Francisco's prime residential market
is a strong performer on the global stage

savills.com/research

A full-page photograph of the Golden Gate Bridge in San Francisco at night. The bridge's iconic red-orange towers and suspension cables are illuminated, with the top of the towers glowing with red lights. In the background, the city of San Francisco is visible, with numerous buildings lit up and the Transamerica Pyramid standing out prominently. The sky is a deep blue, suggesting twilight.

Notes about the publication

This document was published in April 2016. The data used in the charts and tables is the latest available at the time of going to press. Sources are included for all the charts.

Spotlight San Francisco and the Bay Area



The prime residential markets in San Francisco and the Bay Area are experiencing record highs

The story of San Francisco's real estate markets is the story of global city real estate. The attraction of the urban form has proved irresistible to residents and companies alike, attracting an influx of people that goes beyond urban renaissance. This means the city is once again a powerhouse of industry and commerce in the digital age.

Like so many burgeoning yet land-limited cities, San Francisco's prime real estate markets are at record highs having not only recovered from the recessionary lows of 2011, but also long since exceeded their former peak.

The fundamental strengths of San Francisco's markets are assisted by the even faster rise of rents than capital values. There is no investor-induced speculative bubble in San Francisco. At a time when many of the world's

core, prime city markets have seen yield compression due to investor demand, San Francisco's residential yields have moved out due to rental growth.

This means that the affordability issues plaguing many a world city are writ large in San Francisco's popular districts. Young people especially risk being priced out of the city. The likely outcome of this pressure is an 'urban dispersal': the colonization of new urban areas by creative millennials outside the city limits. Oakland is already benefiting from this.

We also anticipate the urbanisation of suburbs and a rise in the popularity of small towns and cities in outlying but accessible districts. Authentic places with heritage and local character have been increasingly popular with 'priced out' millennials across the globe. The trend is still urban but the next genesis of real estate in the Bay Area is likely to be increasingly 'small urban'. ■

▼ San Francisco Downtown



EXECUTIVE SUMMARY



San Francisco's residential market was the strongest performer of major world cities in 2015, driven by a growing domestic economy, low levels of inventory and demand for urban living. See page 04



With prime prices at \$1,150 per sqft, the market is still 32% less expensive than New York and 56% cheaper than London. See page 05



The Bay Area is home to the second highest concentration of billionaires in the world. Domestic wealth has driven prime sub-markets in San Francisco and the Mid-Peninsula to new highs. See page 05



Buyers seeking value in the Bay Area are turning to markets such as Oakland and Napa, but the price differential with the prime core is fast eroding as wealth dissipates throughout the region. See page 08



With limited land supply, the Bay Area faces affordability constraints and the challenge of meeting demand for homes. We anticipate further, but lower level, price growth in the near term. See page 10

▼ The Bay Area is among the wealthiest in the US



FIGURE 1
AT Kearney Global cities outlook ranking (future potential)

1	San Francisco
2	London
3	Boston
4	New York
5	Zurich
6	Houston
7	Munich
8	Stockholm
9	Amsterdam
10	Seoul

Source: AT Kearney

SAN FRANCISCO AND THE BAY AREA AT A GLANCE

Located in Northern California, the San Francisco Bay Area is home to 7.5 million people and covers an area of 7,000 square miles. San Francisco, its cultural and economic heart, is bound together with other urban areas including Oakland and Silicon Valley by a network of roads, commuter rail and metro services. The Bay Area is among the wealthiest in the US and its residential offer is as diverse as the region's climate and landscape. Vibrant cities and leafy suburbs are complemented by national parks, mountains and Pacific coastline.

Economy

The San Francisco and San Jose metro areas have a combined GDP of \$665 billion and are home to four of the world's top 10 most valuable companies by market cap, namely Alphabet (Google), Apple, Facebook and Wells Fargo. If the Bay Area were its own country it would have an economy larger than Switzerland.

The Bay Area's success is underpinned by San Francisco and Silicon Valley's position as a center of innovation and the global capital of tech. The roots of the industry lie in university research bases, the presence of venture capital and early on, US Department of Defense spending. Today, the region is a magnet for innovative, alternative-thinking talent which actively shapes the development of the online world.

The region is also a major center for sustainable energy, bio-tech and medical services. Oakland is home to the fifth largest container shipping port in the US. The Napa Valley is an important wine producer and led the organic farming movement. Tourism is another major economic driver; in 2014 San Francisco alone received 18 million visitors, contributing \$10.7 billion to the economy.

Innovation capital

San Francisco has ascended on the world stage and is now challenging the major world cities for global prowess. AT Kearney ranks San Francisco 22nd in its global cities index, but puts it number one globally for future potential due to its strength in innovation, economic prospects and its appeal as a place to live (see Figure 1).

The Bay Area's knowledge economy is closely linked to the strength of its higher education offer. Stanford University alumni are responsible for founding today's biggest tech names, including Google, Yahoo, LinkedIn, PayPal, Instagram and Snapchat. The University of California, Berkeley counts 29 Nobel Prize winners among its alumni, while the University of California, San Francisco runs a highly regarded medical center.

Wealth drivers

Rapid job growth in high-value industries is fueling demand for prime residential property by creating wealth and housing demand from new employees. This job growth has been led by the professional, scientific and technical services sector, incorporating many 'tech' related roles (Figure 2). Between 2000 (the 'dot com' peak) and 2015 Silicon Valley added 36,800 jobs in this sector, an increase of 31%. Meanwhile San Francisco added 81,500 jobs in the sector over the same period, a 77% increase.

These figures illustrate the increasing draw of San Francisco over neighboring Silicon Valley as an attractor of tech companies, start-ups, scale-ups and entrepreneurs. Young singles and couples with creative talent want to live and work in a vibrant, urban environment. For growing tech and creative businesses, human capital is the most important asset. It would seem that, in the digital age, cities are better attractors of footloose human talent than suburban campuses and business parks. This means San Francisco has an edge over the valley and job creation has therefore outpaced Silicon Valley since 2008.

Another major growth industry in the Bay Area has been healthcare and bio-medical services. Silicon Valley has added more jobs to the education and health services sector (73,600, +83%) than San Francisco did (44,200, +48%) in the last 15 years. Conversely, financial activities in San Francisco have contracted over the same period (down 27%), reflecting the relative decline of the financial services sector in the US as a whole.

Bay Area residential markets in a national and global context

The USA's housing market or, more specifically, its sub-prime mortgage market, was the source of the North Atlantic debt crisis of 2007/2008. It is therefore unsurprising that America's housing markets were among the hardest-hit in developed nations and remained suppressed for longest. With a return to economic growth, the housing market recovery is now well ingrained in first tier US cities.

City outperformance has been led by San Francisco, which recorded average price growth of 16.5% per annum between 2011 and 2015. Prime prices on a dollar per square foot basis in San Francisco have risen from \$760 per sqft in 2008, to \$1,150 per sqft in 2015. This represents an increase of 50% in the seven-year period but San Francisco still remains 32% less expensive than New York, 56% cheaper than London, and some 73% below the price per square foot of Hong Kong (Figure 3).

FIGURE 2
Sector employment trends (2000-2015)

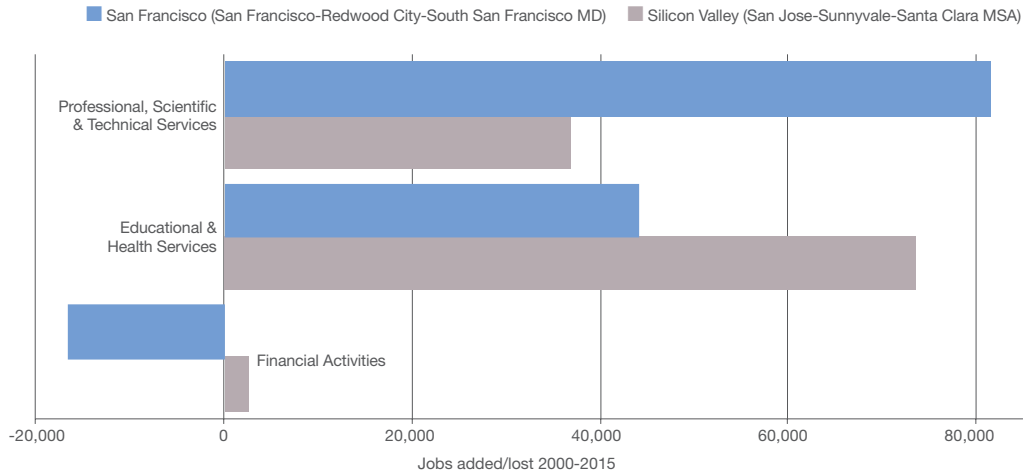
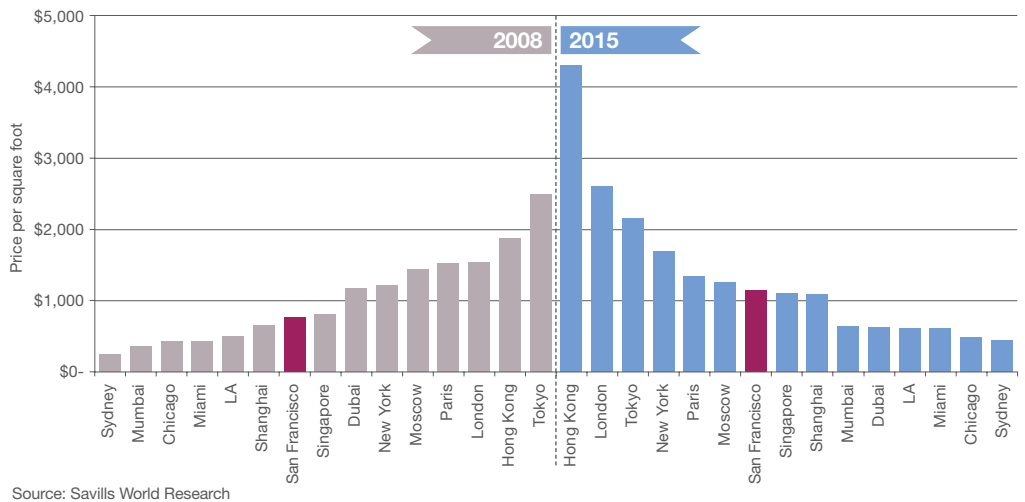


FIGURE 3
Global prime price league



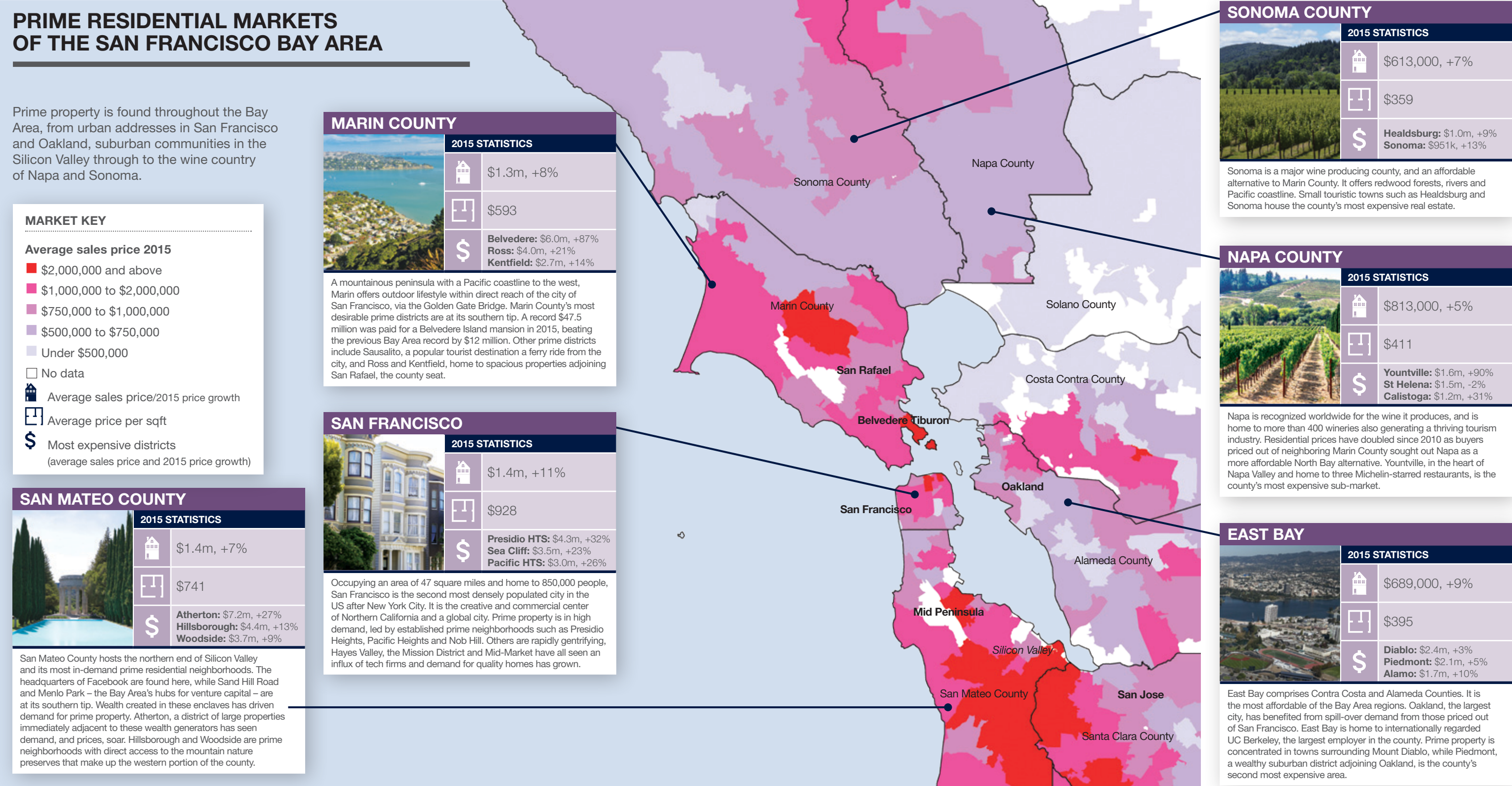
BAY AREA BILLIONAIRES

San Francisco and the Silicon Valley are home to 51 of Forbes' 400 wealthiest people in the US (70 billionaires in total), a density of one billionaire every 6.3 square miles, second only to New York. With a combined net worth of \$329bn, 55% of these billionaires made their money in tech industries (wealth of \$259bn). Billionaire enclaves are found in San Francisco, Palo Alto, Woodside and Atherton.

FIGURE 4
Concentrations of US-based billionaires

		B'naires in the US top 400	Square miles per billionaire
1	New York	56	5.4
2	San Francisco and Silicon Valley	51	6.3
3	Los Angeles Metro	28	18.0
4	Dallas	12	32.2
5	Palm Beach	11	0.9

Source: Forbes 400, Savills World Research



BAY AREA RESIDENTIAL MARKETS

The expansion of high-value employment in the Bay Area, driven by tech and healthcare sectors, is supporting demand for prime residential real estate. The Bay Area's population grew by 13% between 2005 and 2015. Wages are rising rapidly as companies in the region compete to attract talent.

Although there are some investors present in the Bay Area market, including those from overseas, the residential market story is one of domestic, end-user demand.

Savills data on prime residential real estate in San Francisco shows that capital values grew by 50% between 2005 and 2015 while rents increase by 108% over the same period (Figure 5). Strong rental markets are testament to the occupier-driven nature of the San Francisco markets; some 64% of stock in San Francisco is renter-occupied,

compared to 44% across the Bay Area. High rental demand means that rental growth has been even stronger than capital growth and yields have moved out as a consequence; from 3% in 2005 to 4.2% in 2015. This bucks the trend seen in many global cities where investment activity has pushed yields downwards over the same period. This suggests that San Francisco may still be considered a 'buy' for investors as there is no sign of higher rental supply choking off rental growth.

San Francisco and the Bay Area market trends

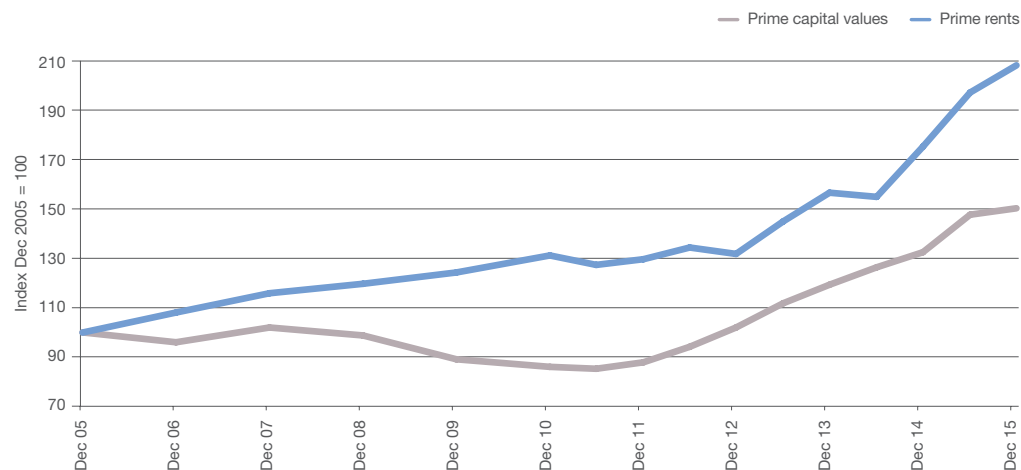
With San Francisco at its core, the Bay Area is characterized by distinct sub regions (see map on page 06). The distribution of high-value property sales in these sub-regions is shown in Figure 6.

The bulk of Bay Area prime property is found in San Francisco and the Mid Peninsula, where 79% and 75% of properties sold in 2015 were over the value of \$1m. This was an increase of 38.2% and 25.5% since 2009 respectively. In North Bay and East Bay, \$1m+ sales accounted for 48% and 33% of total deals, an increase of 19.7% and 20.0%, demonstrating the spread of wealth from San Francisco and Silicon Valley across the Bay Area.

Oakland, in East Bay, has been a major beneficiary of this trend. Prices grew by 183.7% between the market low of Q1 2009 and Q4 2015 as the city attracted those priced out of San Francisco. Oakland is just 15 minutes from San Francisco via the BART, making it closer to the city's key employment districts than much of San Francisco itself. The price differential is also drawing business occupiers into Oakland in its own right, which further supports residential demand. Residential values in Oakland stood at \$450 per sqft in 2015 which is 52% less than in San Francisco.

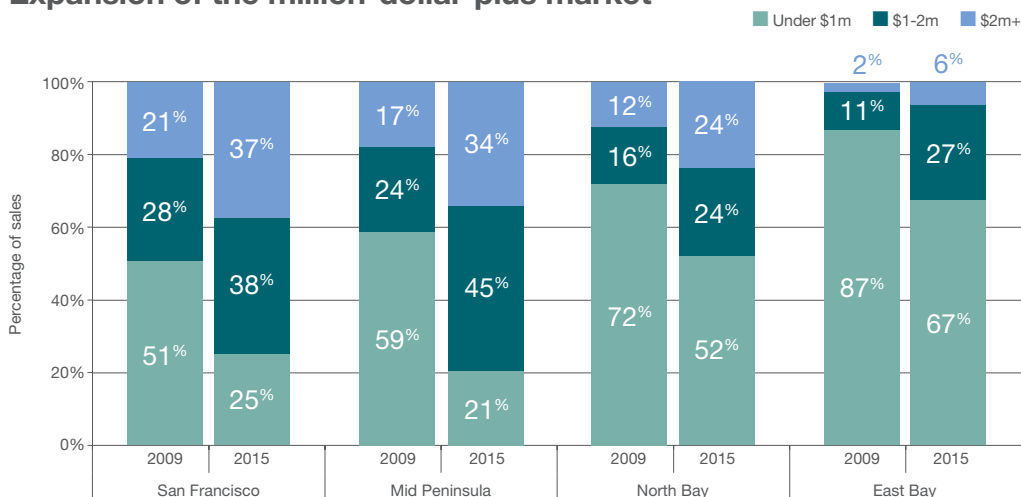
Outside the urban cores, Napa and Sonoma Counties had benefited from growing demand from those priced out of Marin County, but it was Marin County that was the star performer in 2015, recording price growth of 8%.

FIGURE 5
San Francisco: prime capital values vs rentals



Source: Savills World Research

FIGURE 6
Expansion of the million-dollar-plus market



Source: MLS

▼ Oakland Bay Bridge and port tower



In 2009 Napa County was 47% cheaper than Marin County, but by 2015 the discount had eroded to 37%. With the value gap narrowing, North Bay buyers may consider Sonoma County, which still trades at a 52% discount to Marin County.

San Francisco

The strongest performer in the Bay Area during 2015 was the city of San Francisco, where achieved prices increased by 11.1% in the year, according to MLS data (Figure 7). Figure 8, overleaf, shows achieved prices against listing prices and days on the market for San Francisco over the last two decades. Even at the depths of the Great Recession the average discount on asking prices dipped no lower than 2%, a testament to the strength of the San Francisco market. In 2015 properties spent an average of 63 days on the market, down from 94 days in 2009, and achieved an average 11.8% over listing price.

The renaissance of urban living in the US has fuelled demand for property in the Bay Area's urban enclaves. Existing run-down neighborhoods and districts have been colonized by artists and tech entrepreneurs and been reinvigorated. Established neighborhoods have also benefited and values have been pushed to new highs.

In San Francisco, Hayes Valley, the Mission District, Mid Market and SoMa have seen an influx of tech firms, pushing up commercial rents and in turn demand for residential property. Asking office rents stood at \$63.87 per sqft at the end of 2015, 14.1% year-on-year increase, outpacing residential price growth, up on average 6% across the same districts.

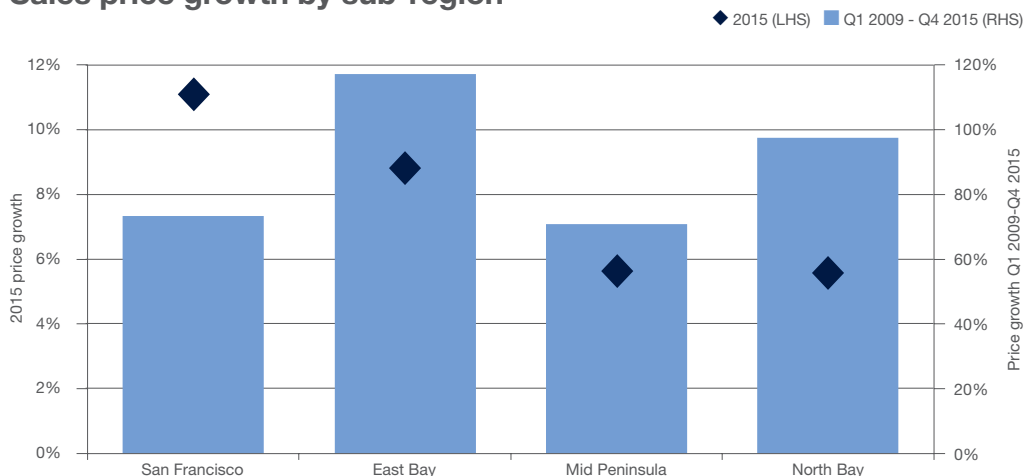
Development

Development and expansion of the Bay Area is limited by the national parks and bodies of water that surround it. As a

consequence, major new developments are typically the regeneration and renewal of existing urban areas.

In San Francisco, Mission Bay, a former industrial area, has emerged as a center for healthcare-led development complete with a UCSF medical and research center, biotech start-up incubators and major commercial occupiers. Hunters Point Shipyard is an 800-acre mixed-use development at the city's south-eastern point that will deliver 12,500 new homes. ➔

FIGURE 7
Sales price growth by sub-region



Source: MLS

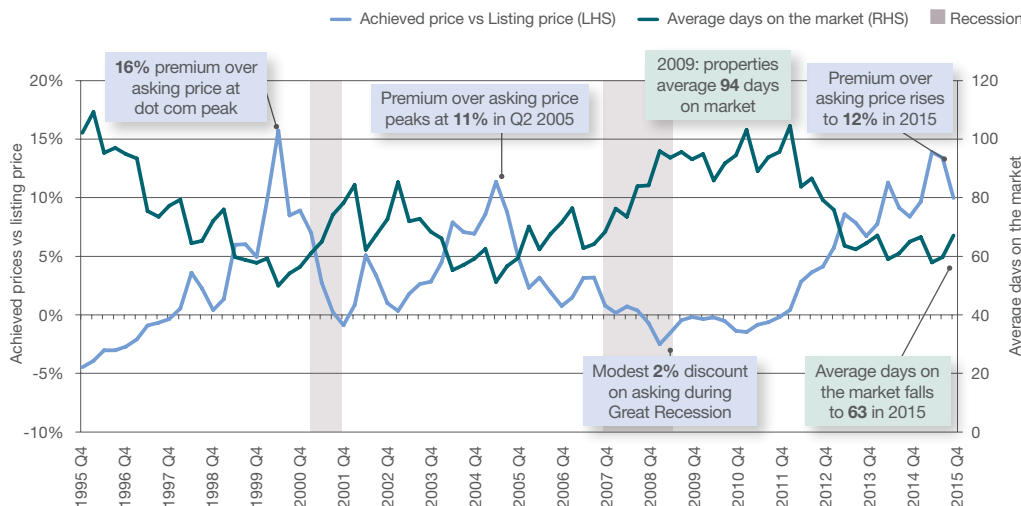
→ In Silicon Valley, suburban campus-style office developments and lower density housing means commuters are car-reliant and new development puts further pressure on roads. Apple's new campus in Cupertino, for example, will have space for 12,000 employees together with garages for 10,980 vehicles. New residential delivery is falling short of in-migration, with affordable housing being in exceptionally short supply. Densification is occurring in some suburban environments, with downtown San Jose seeing more high-rise condominium development.

In light of tight supply in both San Francisco and the Valley, East Bay is again emerging as the major beneficiary. Oakland is seeing its large stock of historic buildings converted into creative office and residential space. A former Sears department store, now Uptown Station, is to be the new headquarters for online taxi firm Uber, while a General Electric light plant in West Oakland has been converted to apartments, for example. New residential condominiums are being developed in the Broadway-Valdez corridor. ■

▼ San Francisco Coit Tower



FIGURE 8
San Francisco market strength indicators



Source: MLS

OUTLOOK

Strong demand to support further price growth

■ PROSPECTS FOR PRICES

Given the outperformance of prime rental markets, it would appear that capital values in the Bay Area may yet have further to run. Low levels of inventory coupled with a strong demand will support further price growth. With affordability increasingly squeezed, however, we expect to see lower levels of growth to that seen in the last four years.

■ THE PRICE OF WORLD CITY STATUS

World cities can become a victim of their own success when accommodation costs rise to the point where affordability becomes an issue. The challenge for San Francisco and the Bay Area is in supplying new business quarters and residential neighborhoods while capturing the characteristics that made it so attractive in the first place. The regeneration, renewal and gentrification of Oakland is likely to play a large part in the future of San Francisco as a successful urban area.

■ INFRASTRUCTURE IMPLICATIONS

A new high speed rail line will connect Los Angeles with San Francisco in 2 hours and 40 minutes. The first stretch, from San Jose to Bakersfield, is scheduled to open in 2025 and may open up new parts of California to a Bay Area commute. Conversely, it may encourage the spread of San Francisco and Silicon Valley firms to new, cheaper cities further down the line.

■ SLOWING TECH RALLY

Start-up valuations are down and sector salary expectations are reaching a tipping point. Some tech firms are already making savings. Lyft, for example is setting up its engineering hub in Seattle and moving customer support functions to Nashville. An exodus seems unlikely, however, thanks to the Bay Area's global reputation and established industry infrastructure. Any slowdown may also be offset by growth in other sectors, notably life sciences.

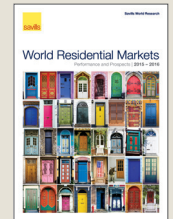
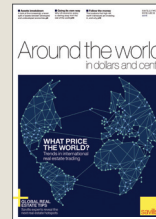
About McGuire Real Estate

As a local, luxury boutique that focuses on the San Francisco Bay Area's high-end niche markets, McGuire Real Estate is a privately held corporation that was founded in 1919. We are headquartered in San Francisco's Marina District with offices in Noe Valley and South Beach—as well as Mill Valley, Berkeley, Burlingame, and Wine Country. McGuire is proud to be the exclusive international associate of Savills. Our luxury, global, and industry affiliations allow us to connect our agents and clients to a world-wide marketplace with exclusive opportunities.



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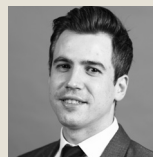
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