

EISNERAMPER

California Real Estate: The Battle of the Bay



In partnership with



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ABOUT EISNERAMPER

EisnerAmper LLP's dedicated Real Estate Fund practice supports real estate private equity, Qualified Opportunity Funds, private REITs and property-level JV funds. Our advisors address complex matters, such as navigating operating agreements, waterfall provisions and specific investor-ownership issues.

EisnerAmper LLP, one of the largest professional services firms in the world, is a premier accounting and business advisory services firm with 180 partners and principals and 1,500 professionals. The firm provides audit, accounting and tax services; valuation, due diligence, internal audit and risk management, litigation consulting and forensic accounting; as well as technology, compliance and regulatory, operational consulting and other professional services to a broad range of clients.

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CALIFORNIA: THE BATTLE OF THE BAY

Home to some of the world's largest and most active fund managers, California has long represented a crucial market for real estate investment. The state alone constitutes 19% of the private equity real estate (PERE) market in the US, and 12% of global PERE assets under management. With property prices rising exponentially, California is also increasingly attractive as a destination for private investment in property. The total value of PERE deals in California reached an annual record of \$40bn in 2018 (Fig. 1), and the average size of deals completed in Q1 2019 surpassed the \$50mn mark.

The Bay Area of California is, famously, a major global technology hub, home to Silicon Valley and many of the biggest names in technology. As the technology industry thrives and expands, the demand for property in the Bay Area is rising fast,

and the traditionally dominant PERE hubs of San Francisco and Los Angeles are beginning to jostle for position with up-and-coming property markets across the bay in both San Jose and Oakland.

As the most active markets, San Francisco and Los Angeles together represent 30% of the aggregate value of PERE deals completed in California since 2014. Yet, as increasing demand exposes the property limitations of San Francisco, their share of total Californian PERE deal value since the start of 2018 has waned to only 25%. Deal activity in Oakland and San Jose, meanwhile, has increased considerably over the past two years.

As tech companies evaluate the most valuable and business-appropriate location for their offices in the Bay Area, it seems that this 'Battle of the Bay' will only intensify.

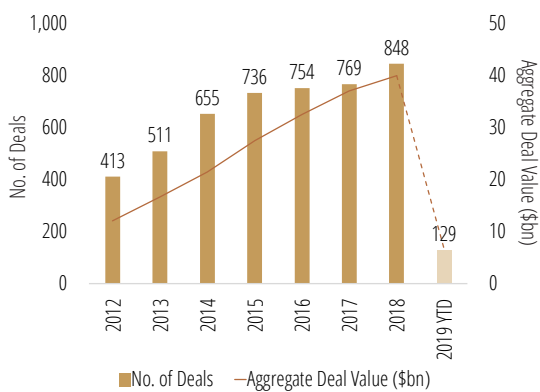
We invest in multi-family projects, primarily in the East Bay. One of the great benefits we see for this real estate market is a strong job market that supports all of the Bay Area. The job market has been strong for a number of years, and these are generally high-paying jobs.

Happy EMPLOYED tenants, paying rent is a wonderful combination.

Gary V. Guarisco, CEO, PTLA Real Estate Group

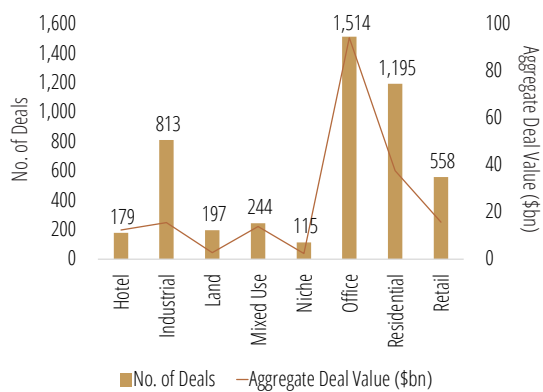


Fig. 1: Single-Asset PERE Deals in California, 2012 - 2019 YTD



Source: Preqin Pro. Data as of March 2019

Fig. 2: PERE Deals in California by Property Type, 2012 - 2019 YTD



Source: Preqin Pro. Data as of March 2019

SAN FRANCISCO

We invest in SF Bay Area real estate due to its inherently limited supply, ever increasing workforce, high wages and vibrant communities. I moved to San Francisco 20 years ago and the growth has been staggering! Today, seven of the top 15 companies in S&P 500 are from the Bay Area, compared to only one company two decades ago!

Bora Ozturk, Co-Founder, March Capital Funds



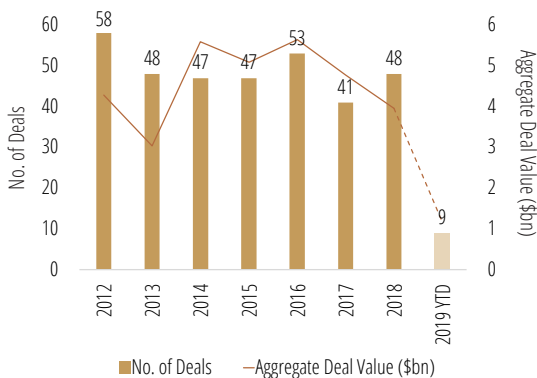
Fund managers continue to see value in San Francisco office property, collectively investing \$10bn in its office market since the beginning of 2016. In a year in which tech giants including Facebook and Uber signed pre-leases in the city, \$3.2bn of PERE deals were completed for San Francisco office property in 2018, up from \$2.2bn in 2017. This included the \$413mn purchase of Embarcadero Center West by Northern Mutual Real Estate, the largest PERE transaction of the year in San Francisco.

Over \$1bn has already been invested in San Francisco office property in 2019 (Fig. 3), led by the \$334mn joint venture between Clarion Partners and

Lincoln Property Company for 215 Fremont Street in the South Financial District.

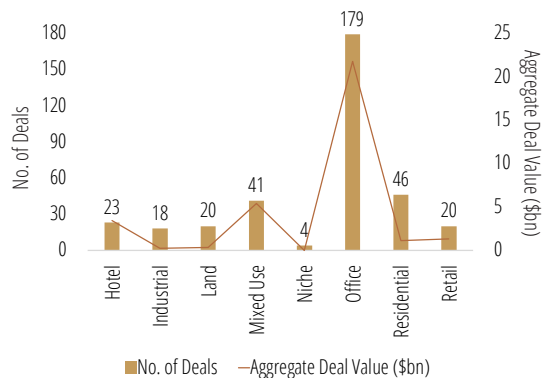
While the overall total value of PERE deals in San Francisco in 2018 (\$4.0bn) dropped slightly from 2017 (\$4.8bn) and 2016 (\$5.6bn), this was due to a drop-off in the number of large mixed-use transactions compared with recent years. The core of San Francisco PERE investment, however, remains the office market (Fig. 4). With strong activity already seen in 2019, and technology giants continuing to expand their San Francisco footprint, we will likely see continued demand for assets in the city throughout 2019.

Fig. 3: Single-Asset PERE Deals in San Francisco, 2012 - 2019 YTD



Source: Preqin Pro. Data as of March 2019

Fig. 4: PERE Deals in San Francisco by Property Type, 2012 - 2019 YTD



Source: Preqin Pro. Data as of March 2019

SAN JOSE

The seven counties of the Bay Area are like a giant biodynamic garden for new ideas, new businesses and innovation. The explosive growth in jobs mimics the explosive growth of technology of all types: AI, autonomous cars, biotech, virtual reality – you name it. In consequence, there is no better place to be a housing developer – even though this is probably the hardest place to develop outside of the Kremlin.



Patrick Kennedy, Owner, Panoramic Interest

Property in Silicon Valley unsurprisingly drives much of the activity within San Jose; as a global hub for the technology industry, property in the Valley can command some of the greatest premiums within the Bay Area. As with the other Bay cities, the office market traditionally accounts for the majority of PERE activity in San Jose (Fig. 6). While San Francisco represents the largest market for Bay Area office transactions, San Jose can be considered the growth market.

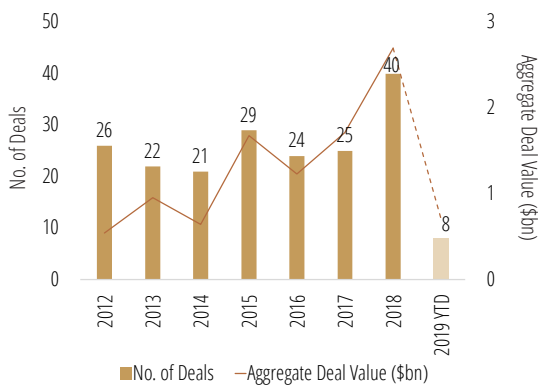
A record \$1.2bn of PERE office deal activity was recorded in San Jose in 2018, marking the second consecutive year in which the value of office deals in the city has reached the \$1bn mark (\$1.0bn in 2017). As we progress through 2019, the prospects for further growth in the San Jose office market are

strong: \$500mn of PERE deal value was recorded in Q1 2019, bolstered by Mori Trust Group’s acquisition of HQ @ First for \$429mn.

While the retail market has come under scrutiny in recent years amid the continued growth of e-commerce, 2019 has seen one of the largest PERE retail deals recorded in the Bay Area: Sand Hill Property Company’s \$147mn purchase of El Paseo de Saratoga.

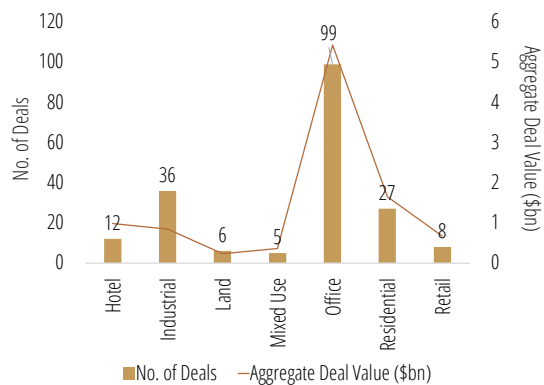
With a record \$2.7bn of PERE deals in 2018, up nearly 60% from 2017’s \$1.7bn (Fig. 5), San Jose represents a city of significant growth. For as long as the property market in San Francisco faces physical limitations, more and more investors will turn to San Jose to gain exposure to the Bay Area of California.

Fig. 5: Single-Asset PERE Deals in San Jose, 2012 - 2019 YTD



Source: Preqin Pro. Data as of March 2019

Fig. 6: PERE Deals in San Jose by Property Type, 2012 - 2019 YTD



Source: Preqin Pro. Data as of March 2019

OAKLAND

Oakland/East Bay presents the greatest growth driver for the Bay Area with superior transportation infrastructure, affordability and land availability. Oakland has also surpassed San Francisco as the 'cool' capital of the Bay Area.

Roger Snell, Chief Investment Officer, Veritas Investments



As a smaller city, Oakland is more of an emerging market for PERE activity in relation to the other cities in the Bay Area, and has the greatest growth potential. PERE deal activity in Oakland amounted to \$646mn in 2015, increasing to \$870mn in both 2017 and 2018; it could well be that aggregate PERE deal value in Oakland reaches the \$1bn landmark in 2019, having recorded \$560mn of activity in Q1 2019.

As industry participants catch on to Oakland's potential, investment has begun to flow into the city. The office market is again the driving force behind this growth (Fig. 7): Starwood Capital Group has completed two transactions worth a combined \$493mn. The Connecticut-based real estate firm purchased Center 21 for \$347mn and 1900 Harrison

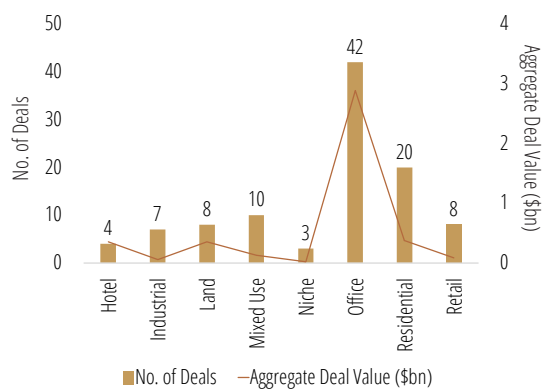
Street for \$147mn – a vote of confidence in the investment credentials of downtown Oakland.

While San Francisco has traditionally been the dominant property market in the Bay Area and San Jose is observing strong growth as well as high-value deals, Oakland looks to be on the start of an upward trend. Providing tenants a viable alternative across the bay from San Francisco, Oakland may start to benefit from the lack of available real estate in the more established city. Indeed, digital payments company Square Inc.'s December 2018 announcement to move 2,000 employees into Oakland office space could well signal Oakland's emergence as a rival to San Francisco and San Jose in the Battle of the Bay.

The attraction of investment in Oakland stems from the geographic advantage that the city provides being located in the centre of the Bay Area. That being said, we have also seen growth driven by innovation in new and existing companies as well as its diverse, distinct and edgy culture. As investment in Oakland increases, the city is quickly becoming a 24-hour destination.

John Protopappas, President & CEO, Madison Park Financial Corporation

Fig. 7: PERE Deals in Oakland by Property Type, 2012 - 2019 YTD



Source: Preqin Pro. Data as of March 2019

QOFs IN THE BAY

The 2017 Tax Cuts and Jobs Act brought about significant changes to the tax laws across the US, its primary aim being to encourage investment in predominantly low-income communities. Within California, there are 879 communities that are designated Opportunity Zones, with 57 counties that include at least one Opportunity Zone and three million Californians living within them.

A Qualified Opportunity Fund (QOF) is a vehicle for investing in eligible properties located within an Opportunity Zone. As per the Opportunity Zone program, investors can only benefit by investing in a QOF within 180 days of the sale or exchange of a capital asset. As the largest market in the Bay Area, San Francisco contains a large proportion of Opportunity Zones, representing an untapped wealth of investment opportunity. The affluence that covers much of Silicon Valley means San Jose's zones are located outside the technology hub. Oakland has

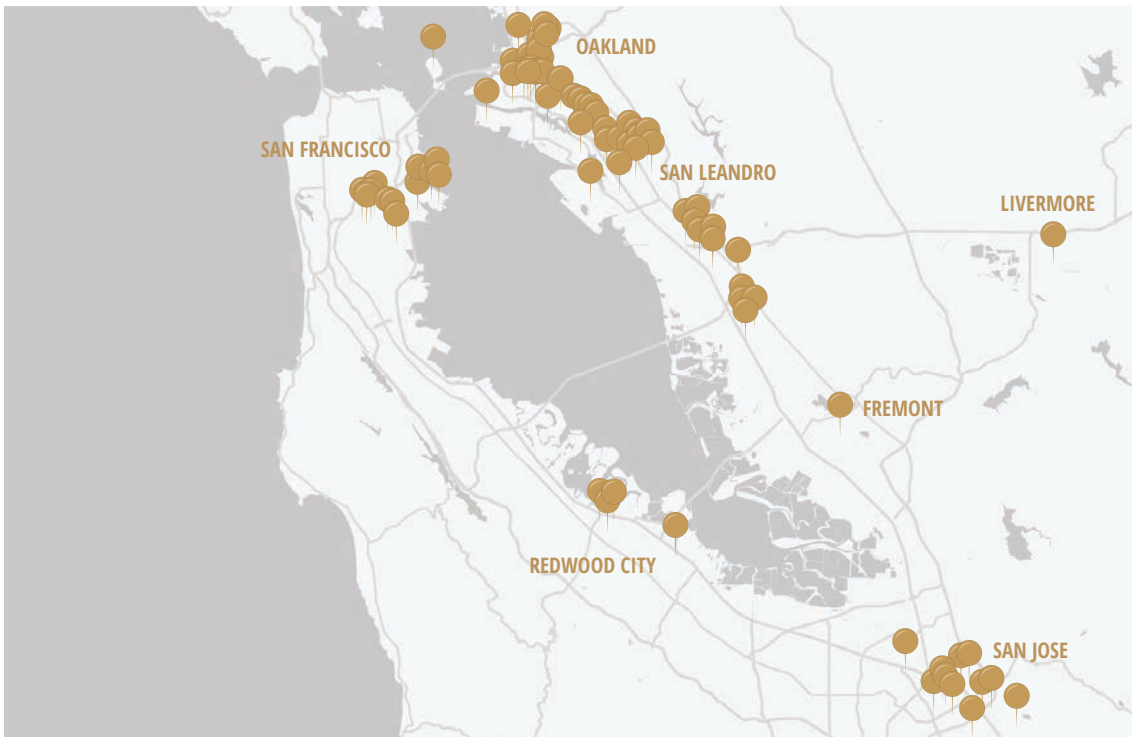
more Opportunity Zones than anywhere else in the Bay Area, where locations outside the larger, more wealthy areas of the Bay can reap the benefits of increased investment via QOFs.

As a group that is focused on long-term value for our investors, we believe the SF Bay Area is unmatched in its ability to provide stability and growth through multiple market cycles because of its diverse demand generators and unique barriers to entry. And when Opportunity Zone tax incentives are coupled with the inherent value found in certain Bay Area markets such as San Jose and Oakland, we find that investing in our back yard becomes even more compelling.

”

Matthew Love, President, Epoch Realty Capital

Fig. 8: Opportunity Zones in the Bay Area



Map data ©2019 Google



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