May 06, 2014

Economics Group

Special Commentary

Mark Vitner, Senior Economist
mark.vitner@wellsfargo.com • (704) 410-3277
Michael T. Wolf, Economist
michael.t.wolf@wellsfargo.com • (704) 410-3286
Mackenzie Miller, Economic Analyst
mackenzie.miller@wellsfargo.com • (704) 410-3358

San Francisco Bay Area Real Estate Outlook

Executive Summary

Going into 2014, a wide variety of publications ranked the San Francisco Bay Area as the top market for commercial real estate investment, a position it also held in 2013. Given the region's strong job growth, increased population growth and tightening real estate market, the top ranking seems appropriate. The San Francisco Bay Area remains the epicenter of many of the most rapidly growing technology sectors, including mobile devices, social media, cloud computing, data analytics and life sciences. Rapid job growth in these industries has helped fuel hiring in supporting services. Overall job and income growth have significantly outpaced the nation in recent years and the unemployment rate has fallen to its lowest level in nearly six years.

Strong economic growth has helped fuel in-migration and set off a real estate boom. Vacancy rates have tumbled for office, industrial and retail space over the past few years, and the Bay Area's perennially tight housing market has gotten even tighter, pushing rents and home prices up to some of the fastest rates in the nation. While conditions have improved throughout the Bay Area, the bulk of recent strength has been in the South of Market (SoMa) and Mid-Market areas of downtown San Francisco and a whole host of cities along the San Francisco Peninsula, stretching from San Mateo and Redwood City just south of the San Francisco International Airport, to Palo Alto, Mountain View, Sunnyvale, Santa Clara and San Jose, right in the heart of Silicon Valley.

One widely cited emerging trend is the increased preference by younger tech workers to work and/or live in and around downtown San Francisco. The trend has pulled in a whole host of major tech employers. Twitter, Dropbox, Square, Trulia and SalesForce.com are all headquartered in downtown San Francisco. All are growing rapidly and hurriedly securing large blocks of office space. The growth has set off a wave of new construction that is barely keeping pace with demand. The surge in office construction is being accompanied by a wave of apartment development.

The Bay Area's perennially tight housing market has gotten even tighter.

One widely cited emerging trend is the increased preference by younger tech workers to work and/or live in and around downtown San Francisco.

Figure 1

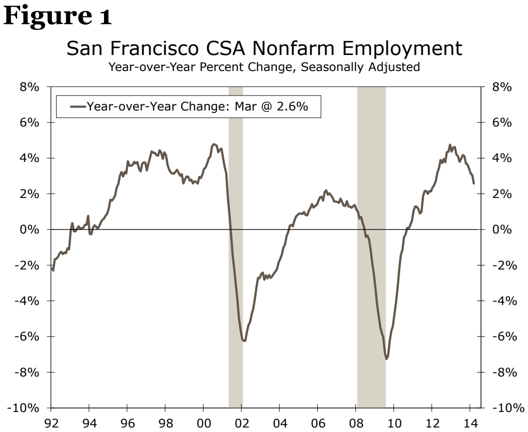
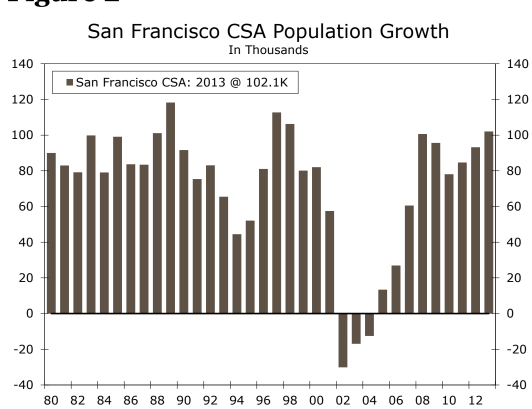


Figure 2



Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities, LLC

One of the Strongest Office Markets in the Country

While construction cranes are highly visible as you exit the Bay Bridge into San Francisco, the volume of office space currently under construction is barely keeping pace with demand. The most recent REIS survey shows a total of almost 3.3 million square feet of office space currently underway in San Francisco County, with around 2.6 million square feet underway in the South Financial district. The Transbay Tower accounts for the bulk of that space. The 61-story, 1.4-million-square-foot tower is currently slated to be completed in early 2017. Salesforce.com recently signed a lease for the lower 30 floors of the building, as well as the 61st floor at the top. The building, which will be the tallest on the West Coast, has recently been renamed the Salesforce Tower. Other notable projects include 181 Freemont, a 51-story mixed-use tower, which broke ground late last year and the second tower of One Rincon, a 50-story tower that should be completed by year-end, both in the SoMa district.

The rapid growth of the tech sector appears to be crowding out growth in some other areas.

Overall office employment in the San Francisco metro division has risen 3.4 percent over the past year, netting nearly 12,500 new jobs. The tech sector has accounted for the bulk of the gain, and in September, tech-related employment was up 6.9 percent from a year earlier. The rapid growth of the tech sector appears to be crowding out growth in some other areas. Employment in San Francisco's financial and legal sectors declined 0.7 percent over the past year. The trend is only slightly more positive when looking at the past three years, which saw employment in San Francisco's financial and legal sectors rise just 3.0 percent. In terms of jobs, San Francisco's financial and legal sectors will likely be hard pressed for some time. Several large financial institutions have reduced their downtown footprint, with the freed up space going to rapidly growing tech companies. More reductions are on the way. San Francisco-based Charles Schwab & Company announced that they would relocate 1,000 positions out of San Francisco to other areas of the country, including Colorado and Texas, where the firm maintains sizable operations.

Fortunately, the technology sector is growing much faster than other sectors are retreating. Office demand picked up in a major way toward the end of the first quarter, when several large leases were announced. Dropbox leased just over 400,000 square feet of space in three separate leases, and Twitter agreed to lease an additional 310,000 square feet of additional space. Other notable large leases include Trulia, which signed on for 79,277 square feet of space in a new tower being developed on Mission Street in SoMa, and Microsoft, which took 50,000 square feet at 555 California Street, right in the heart of the financial district.

Figure 3

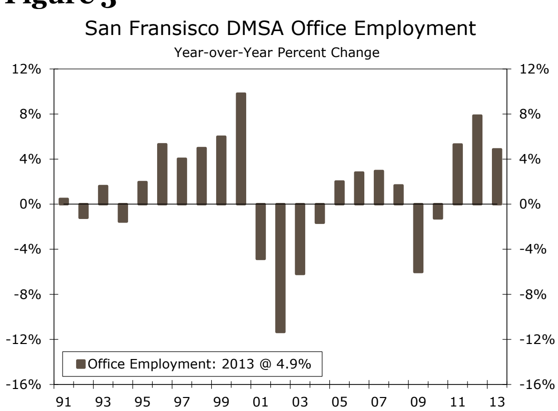
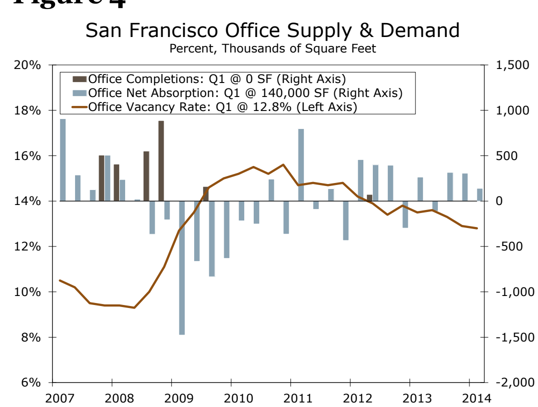


Figure 4



Source: U.S. Department of Labor, REIS and Wells Fargo Securities, LLC

The second quarter got off to a roaring start, as Salesforce.com signed the largest lease deal in San Francisco's history. The cloud computing firm agreed to lease 700,000 square feet, or roughly half the office space, in what will now be the Salesforce Tower. More recently, Mountain View-based career networking giant LinkedIn agreed to take all of the space in a new 26-story, 450,000-square-foot building being developed by Tishman Speyer on Second Street in SoMa. Many of these large deals are pre-leasing for buildings that will deliver later this year, in 2015, or later. As a result, San Francisco's office vacancy rate declined only marginally in the first quarter, falling 10 basis points to 12.8 percent, according to preliminary data from REIS. Effective rent rose 1.9 percent during the quarter to $44.68 per square foot and is up 4.8 percent over the past year, a pace that ranks only behind the neighboring San Jose market.

Silicon Valley Still Accounts for the Lion's Share of Tech Employment

With two monster-sized lease announcements already on the books, San Francisco's tech boom continues to grab most of the headlines. The growth of technology jobs in downtown San Francisco is a major transformative force for the region and reflects changing demographics, a growing preference for urban living, and the interactive nature of many new emerging tech businesses. While this trend still has considerable legs, technology firms have not abandoned the suburbs. Job growth in Silicon Valley remains exceptionally strong. Nonfarm employment has risen 4.3 percent over the past year, as the region has added 40,700 jobs. Growth in the region's tech sector, which accounted for 27.8 percent of nonfarm employment in September and was up 4.7 percent over the past year, produced a net gain of 8,235 new jobs. Technology firms employ about 270,000 workers in the San Jose metropolitan area, which includes Santa Clara and San Benito counties. Total tech employment in the San Jose metropolitan area is 73.4 percent higher than the number employed in the San Francisco metropolitan division. Household employment growth has risen more slowly in South Bay, however, climbing just 3.3 percent over the past year, which implies a significant number of workers are commuting into Silicon Valley from San Francisco, Oakland and other neighboring areas.

The growth of technology jobs in downtown San Francisco reflects changing demographics and a growing preference for urban living.

Technology firms employ 300,000 workers in the San Jose metropolitan area.

Figure 5

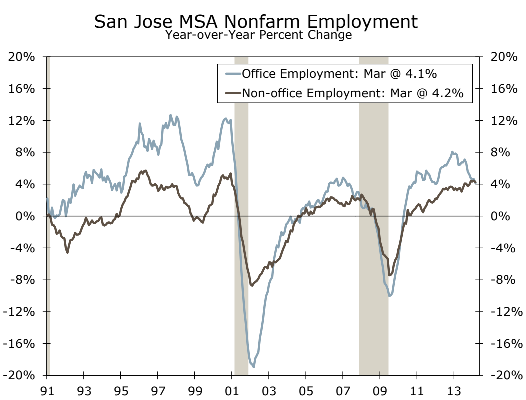
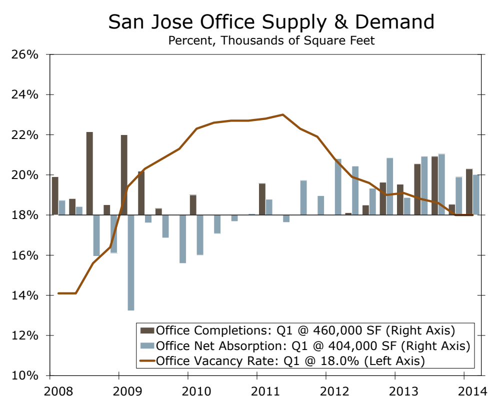


Figure 6



Source: U.S. Department of Labor, REIS and Wells Fargo Securities, LLC

The rapid growth in the tech sector is fueling demand for office space, and new development is having trouble keeping pace with demand. REIS reports that 1.5 million square feet of new office space were completed in the San Jose metro area during 2013, while 1.7 million square feet were absorbed. Just under half a million square feet of space were completed during the first quarter of this year, including the second phase of Irvine Company's Santa Clara Gateway, where Global Foundries occupied 165,000 square feet of office space. Peery-Arillaga also recently completed a 125,000-square-foot building in Sunnyvale, which LinkedIn agreed to completely occupy last fall. The metro area office vacancy rate has fallen 1.1 percentage points over the past year to 18.0 percent. The vacancy rate for Class A space has fallen faster than that, however, and is currently 3.4 percentage points lower than the overall rate. Office rents rose 6.2 percent over the past year, which was the strongest gain in the country.

Santa Clara is in the midst of a building boom. Recently announced projects include a new 226,000-square-foot speculative office building being developed by Spear Street Capital at Great American Parkway and Highway 237. In addition, Irvine Company is proceeding with its plans to build Santa Clara Square, at Bowers Avenue and Highway 101. The first phase of the project is now underway and will contain 600,000 square feet of office space. Santa Clara has enjoyed strong demand for office space over the past year, which is spurring interest in a number of projects. In addition, several transportation improvements are under way to support the new $1.3 billion Levi's Stadium, which will open this summer as the home of the San Francisco 49ers.

Other major deals completed in the first quarter include a major lease by Citrix, which agreed to lease 179,000 square feet in a new building set to begin construction this summer in Santa Clara, and Virident Systems, which occupies 68,000 square feet of space near the San Jose International Airport. Overall leasing was a bit slow during the first quarter, with REIS showing just 404,000-square feet of net absorption. Several mega projects are in the works, however, and the market still has a boom feel to it. Apple is making progress toward building its mega-campus in Cupertino. Demolition work has been under way for some time, removing 1.8 million square feet of office and R&D space to make room for a 2.8-million-square-foot headquarters, which is expected to be completed in mid-2016. Facebook broke ground on the West Campus of its headquarters in Menlo Park. The 433,555-square-foot building is slated to be completed in mid-2015. In nearby Mountain View, Google continues to build out space in a variety of buildings and Samsung is well on its way to completing its 385,000-square-foot R&D Center, scheduled to open in December. Samsung is also building two 10-story towers in North San Jose, totaling 680,000-square-feet of space, where it hopes to house 2,000 workers once it is completed in 2015.

Development Is Following the Rails from SoMa to San Jose

Average weekly ridership on Caltrain rose 11.8 percent this past year and has risen 39.3 percent since 2011.

Caltrain, which operates a 51-mile commuter rail service from downtown San Francisco to Gilroy, at the extreme southern end of Santa Clara County has seen ridership soar in recent years as the tech boom has steadily gained momentum. Average weekly ridership on Caltrain rose 11.8 percent this past year and has risen 39.3 percent since 2011. A major modernization program is now under way, which will extend service to the Transbay Transit Center being developed in San Francisco's booming SoMa area and move from diesel-electric locomotives to overhead-electric powered trains by 2019. The growth of the system, which will more firmly connect the major hubs of the Bay's tech sector, the San Francisco and San Jose airports, and many of the region's key sports and cultural venues, has become a major driver of residential and commercial development.

Figure 7

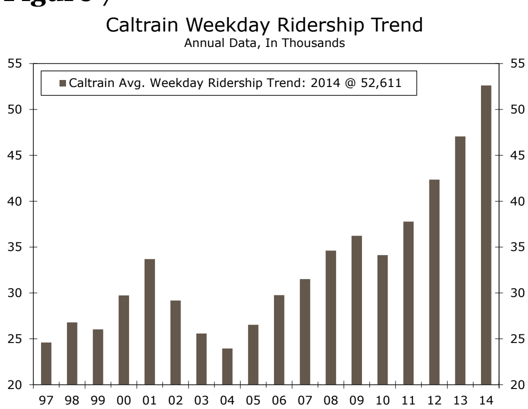
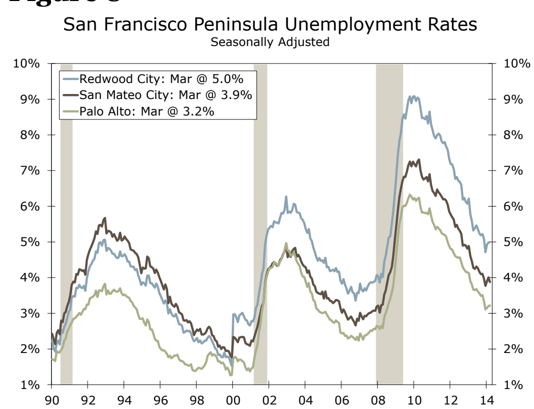


Figure 8



Source: Caltrain.Com, U.S. Department of Labor and Wells Fargo Securities, LLC

Redwood City is seeing a bit of a building boom since enacting a plan for downtown redevelopment back in 2011.

Several large residential and commercial projects are currently underway, or in the planning stages, near many of the Caltrain stations, stretching from San Francisco down to San Jose. In addition to the entire development taking place around the Transbay Transit Center, most of the cities along the Peninsula are seeing intense redevelopment interest near Caltrain stations. Redwood City is seeing a bit of a building boom since enacting a plan for downtown redevelopment back in 2011. More than 1,200 apartments have been approved for downtown Redwood City and another 400 are being developed just outside the city center. Construction is also underway for Crossing 900, a new 300,000-square-foot building that broke ground late last year adjacent to the Redwood City Caltrain station. Plans are in the works for much more development. Stanford University has received approvals to redevelop 35 acres of an industrial site into a medical and technology park that could ultimately contain up to 13 buildings and

1.5 million square feet of space. The project is expected to gradually build out over the next 30 years.

The same story is being repeated throughout towns dotting the San Francisco Peninsula. Caltrain and light rail are proving to be powerful draws to rapidly growing tech firms and expansions and improvements to these systems is expected to further this trend. The second phase of the redevelopment of the former Bay Meadows horse track, near the Hillsdale Caltrain station in San Mateo, continues its build out. When it is completed in 2018, the 83-acre development will include 1,100 new homes, 1.5-million square feet of office space, 90,000 square feet of retail space, a 15-acre park and a new private high school. Plans are also in the works for new office space and apartments near the Caltrain stations in Menlo Park and Palo Alto and the BART extension into the southern end of the county is helping drive development in Milpitas and San Jose.

Momentum Is Quietly Building in East Bay

Compared to San Francisco and South Bay, economic development in Oakland has followed a more measured pace. Nonfarm employment has increased by a solid 1.9 percent over the past year, producing a net gain of around 20,000 jobs. Office employment is rising much more slowly, climbing just 0.9 percent over the past year. Despite the modest employment gains, the region's unemployment rate has come down sharply, reflecting stronger job growth in adjoining areas. Moreover, with little new commercial space coming on line, vacancy rates have steadily fallen and interest in new development is increasing. A number of buildings have also changed hands recently at higher prices, as expectations of an influx of tenants priced out of the red-hot San Francisco and South Bay markets have increased. Actual progress on that front, however, has been slow.

There were a smattering of relatively small leases completed during the first quarter. The largest deals, however, were renewals, and net absorption was negative. Notable new leases include gourmet chocolate manufacturer TCHO, which announced plans to relocate from San Francisco's Pier 17 to a location in Berkeley. The firm will occupy 40,601 square feet of space, housing offices, production and retail space. In addition, Performance Contracting agreed to lease 18,000 square feet of office space in Alameda. Net absorption of office space for the Oakland metro division was -89,000 square feet during the first quarter and the vacancy rate rose by 20 basis points to 18.1 percent, based on data from REIS. Oakland's office vacancy rate has fallen just 20 basis points over the past year, reflecting net absorption of 145,000 square feet of space.

Net absorption of office space for the Oakland metro division was -89,000 square feet during Q1 and the vacancy rate rose by 20 basis points to 18.1 percent.

Oakland is also a major industrial market and has seen solid growth in its manufacturing and distribution sectors. Manufacturing employment has increased 2.7 percent over the past year, producing a net gain of 2,100 jobs, while growth in transportation and warehousing has jumped 5.3 percent, adding 1,500 jobs. Lower land cost and access to key transportation links, including the Port of Oakland, are the key drivers of the region's industrial sector. Port traffic has risen steadily, with the volume of loaded container exports climbing 2.8 percent in 2013 and loaded in-bound containers rising 1.5 percent. Proximity to Silicon Valley also helps. Fremont is home to Tesla's manufacturing plant, as well as numerous contract manufacturers serving the electronics industry. Other thriving industrial sectors include alternative energy, industrial products, life sciences and additive manufacturing.

Even with New Supply, the Apartment Market Remains Tight

Strong job growth has encouraged a wave of in-migration. The Bay Area has added nearly 300,000 new residents since 2010, including more than 100,000 in 2013. Population growth will likely exceed that figure this year. The influx has sent Bay Area home prices and rents soaring in the region's notoriously tight housing market. The California Association of Realtors reports that the median price of existing single-family homes in the Bay Area has surged 13.9 percent over the past year, with some of the largest gains occurring in San Mateo (+27.7 percent) and Marin (+17.0 percent) counties. The median selling price of a single-family home tops $1 million in both counties. Home prices in Santa Clara County have increased 16.7 percent, with the median price of a home sold in March reaching $852,000.

The Bay area has added nearly 300,000 new residents since 2010, including 105,295 in 2013.

Figure 9

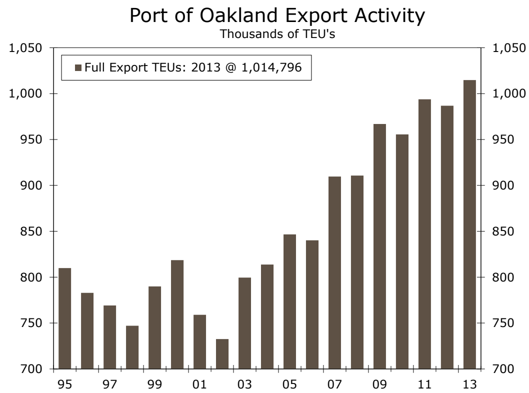
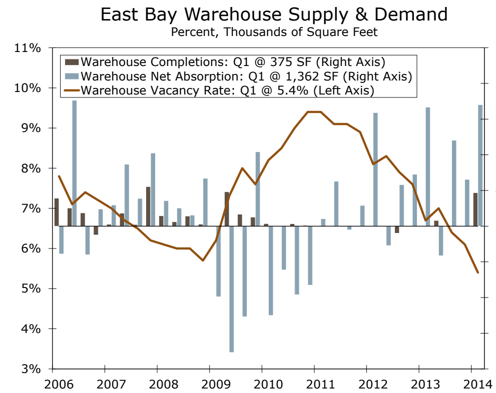


Figure 10



Source: Port of Oakland, PPR and Wells Fargo Securities, LLC

Price increases have been somewhat more restrained in East Bay. The median selling price for an existing home in Alameda County increased 14.2 percent over the past year to $660,610, while prices in Contra-Costa County fell 2.5 percent to $703,490. Rents for apartments and rental homes have also spiked. The latest figures from REIS show effective apartment rents surging 6.6 percent over the past year in San Jose and 6.3 percent in San Francisco, marking the two largest gains in the country. Apartment rents in Oakland-East Bay have risen 5.0 percent, which is still well ahead of the 3.2 percent rise in apartment rents seen nationwide.

The supply of homes and apartment available for sale or rent remains exceptionally tight.

The supply of homes and apartments available for sale or rent remains exceptionally tight. Santa Clara County, which added 27,663 residents in 2013, using State Department of Finance numbers, currently has just a 2.2-month supply of homes on the market. San Mateo County, which added 8,546 residents in 2013, is only a touch higher at 2.3 months. San Francisco has a 2.8-month supply of homes on the market, down from 4.0 months one year ago. Available supply in East Bay, which has seen the largest population gains in the Bay Area in 2013, is equally tight, with just a 2.4-month supply of homes available for sale in Alameda County and 3.0-month supply available in Contra-Costa County.

The available inventory of rental homes is also exceptionally tight. The latest Census estimates show rental vacancy rates at just 2.4 percent in the San Jose metro area and at 4.5 percent in the combined San Francisco-Oakland area. Looking solely at the apartment market, the market is even tighter, with vacancy rates at just 2.5 percent in San Jose, 2.9 percent in San Francisco and 2.7 percent in Oakland-East Bay. Effective rents increased 6.6 percent in San Jose, 6.3 percent in San Francisco and 5.0 percent in Oakland from a year earlier.

The combination of soaring rents and tight inventories has led to a surge in new apartment construction.

The combination of soaring rents and tight inventories has led to a surge in new apartment construction, but so far, new supply is just barely keeping pace with demand. Data for the first quarter show that just 1,641 apartments were added in San Francisco over the past year, while 1,952 were absorbed. The latest data available show 4,166 apartments currently under construction and another 17,555 units in the development pipeline. More than half of that new construction is taking place in downtown San Francisco, primarily in the South of Market and Mid-Market, which are rapidly redeveloping former industrial areas. Apartment development has also picked up considerably along the San Francisco Peninsula, with new projects underway in San Mateo, Redwood City and Menlo Park.

Figure 11

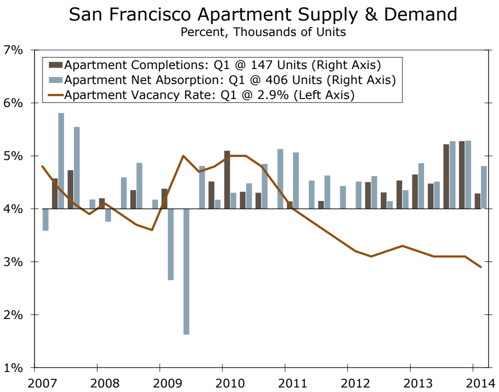
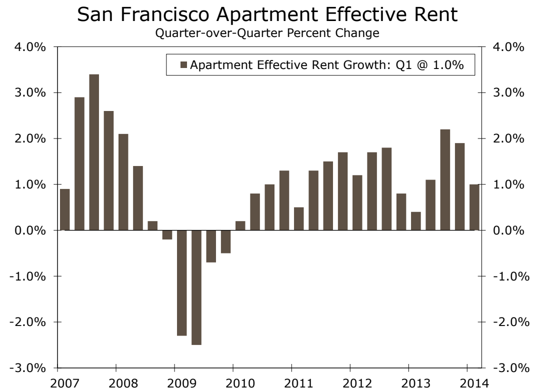


Figure 12



Source: REIS and Wells Fargo Securities, LLC

Apartment development in the San Jose market has truly taken off over the past couple of years.

Apartment development in the San Jose market has truly taken off over the past couple of years. The North San Jose market is one of the most active areas for expanding tech companies and downtown San Jose is receiving increased attention from tech firms looking to lock down more affordable office space. Stronger job growth has boosted in-migration. The City of San Jose, which is California's third-largest, saw its population increase 1.7 percent in 2013. The increase helped push the City of San Jose's population over the 1 million mark.

Strong population is fueling a building boom. Multi-family permits, which include both apartments and condominiums, surged 30.4 percent in Santa Clara County during 2013 and have eclipsed previous highs for this market. Most of these units are apartments and many are being built in or are planned for midrise developments in Palo Alto, Mountain View, Santa Clara Sunnyvale and Milpitas. A number of high-rise developments are also under way in downtown San Jose. Properties near Caltrain or existing or planned light rail and BART stations are in particularly high demand. Notable new projects include Centerra Towers, a 21-story, 347-unit tower, and One Market South, a 23-story, 312-unit tower, both under way in downtown San Jose.

Four more projects are actively being planned, which would ultimately bring 2,700 apartments to downtown San Jose by 2017. The new apartment towers are taking advantage of the proximity of these new jobs, as well as the convenient Caltrain connection to neighboring cities. Other notable projects include Tasman Apartments, a 554-unit project being developed by Equity Residential, which broke ground in March; Ascent, a 650-unit project being built in South San Jose, and Ilara Apartments, which is a 200-unit project expected to be completed this fall in Milpitas. Many more projects remain in the planning stages. In total, 17,580 apartments are under way or actively in the approval process throughout Santa Clara and southern San Mateo counties. While only a portion of these units may ultimately be built, construction activity appears set to remain at a high level for years to come.

Figure 13

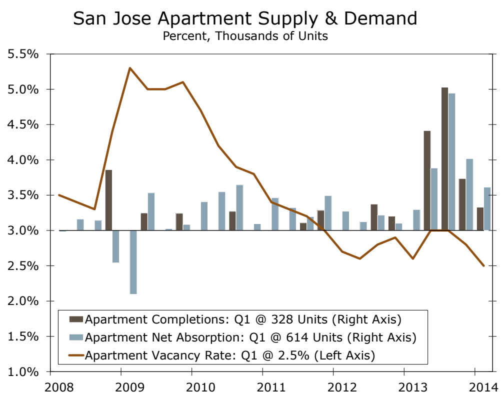
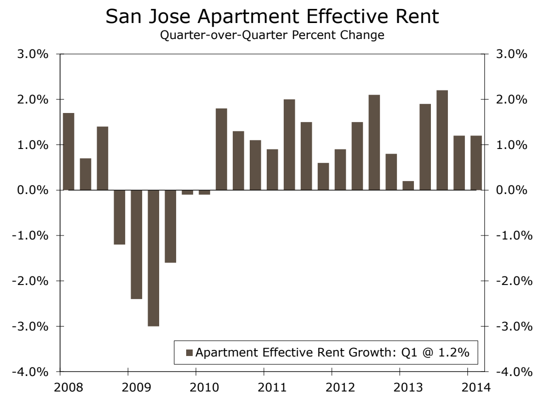


Figure 14



Source: REIS and Wells Fargo Securities, LLC

Oakland's apartment market differs from that of San Francisco and San Jose in a number of ways.

Oakland's apartment market differs from that of San Francisco and San Jose in a number of ways. While the existing stock of apartments is relatively large at 147,343 units, a large portion of the stock is relatively old. Class A apartments account for less than one-third of the market. The supply of apartments is not growing as quickly in Oakland-East Bay, even though Alameda County has seen population growth accelerate in recent years.

After delivering 998 units in 2013, only 1,099 apartments are currently under construction throughout the East Bay. The vacancy rate fell to 2.7 percent in the first quarter, down from 2.9 percent one year ago, and should remain low in the near term. Effective rents increased just 0.5 percent in the first quarter but are up 5.0 percent over the past year. Rising rents throughout the Bay area may also be boosting demand for condominiums. A number of apartments have been converted to condos throughout the East Bay and the number of condos under construction currently exceeds the number of apartments under construction.

Figure 15

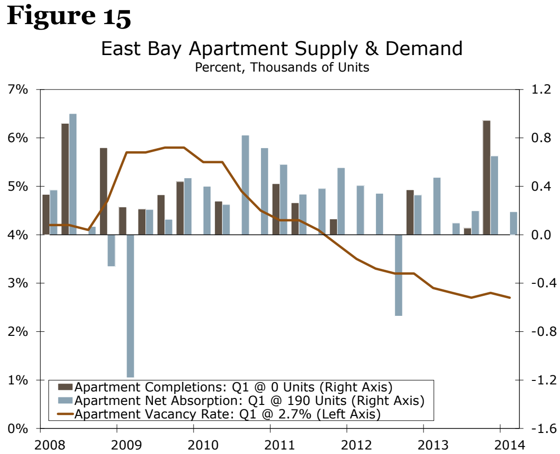
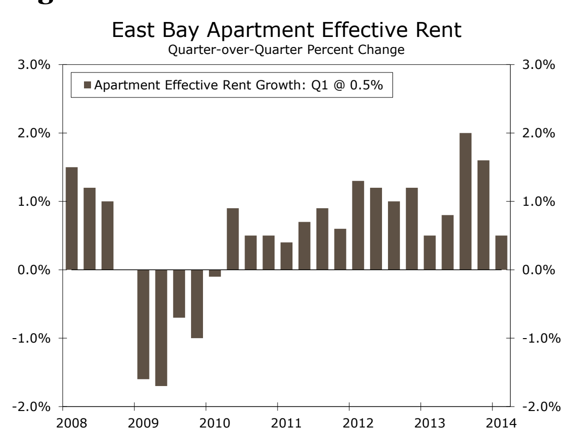


Figure 16



Source: REIS and Wells Fargo Securities, LLC

Summary & Outlook

The San Francisco Bay Area is enjoying its strongest run of economic growth since the heady days of the dot com boom in the late 1990s. Nonfarm employment growth has surged 2.6 percent over the past year, led by gains in the tech sector. The unemployment rate has plummeted to just 6.4 percent, its lowest level in almost six years. The resurgence in employment growth has encouraged a wave of in-migration which has overwhelmed the region's perennially tight housing market and sent home prices, apartment rents and apartment construction soaring. Single-family homebuilding is also rebounding but only slowly and off exceptionally low levels. Bay Area office markets have tightened, particularly in downtown San Francisco and in Silicon Valley, which is fueling new office development. Some 3.3 million square feet of space are currently under development in downtown San Francisco and another 3.4 million is being built in South Bay, largely in huge new corporate campuses for Apple, Facebook, Samsung, Google and others.

With employment and population growth exceeding expectations, worries are beginning to surface that the latest boom is showing signs of overheating. Explosive growth in the Bay Area's creative industries is beginning to crowd out activity in parts of the financial and professional services sector. The boom has also sparked a backlash by some individuals tied to slower growing and lower paying parts of the economy. Home prices, apartment rents and office rents have also increased dramatically, which has significantly increased the cost of living and doing business in the Bay Area. Despite these developments, we still expect the Bay Area to outperform the nation. While costs have increased dramatically over the past year, so has the quality of life. The opening of the long-awaited new Bay Bridge has eased the commute to East Bay and improvements to mass transit systems are sparking a wave of development in San Francisco, along the Peninsula and Silicon Valley that will strengthen and deepen the region's urbanizing culture.

There is little doubt that San Francisco's near-term economic fortunes ride with prospects for the tech sector.

There is little doubt that San Francisco's near-term economic fortunes ride with prospects for the tech sector, which has directly accounted for 25.3 percent of the jobs created in San Francisco over the past year and more than 32.1 percent of job growth in Silicon Valley. Tech employment has grown more slowly in Oakland-East Bay but has been a major influence on that region's recent spurt in population growth. The influence of the tech sector is much greater than the direct number of jobs it creates. Research by University of California economist Enrico Moretti suggests that five additional jobs are created in other industries for every job created in the tech sector. Moretti's multiplier strikes us as a bit high but even if it is half of what Moretti shows, the 10,000 tech jobs created in San Francisco over the past year have supported 25,000 jobs in other industries, accounting for 63 percent of all jobs created over the past year. The numbers are even more dramatic for the San Jose area, with the 12,000 jobs added in the tech sector over the past year supporting some 30,000 jobs in other industries, or close to 80 percent of overall job growth during this period.

Figure 17

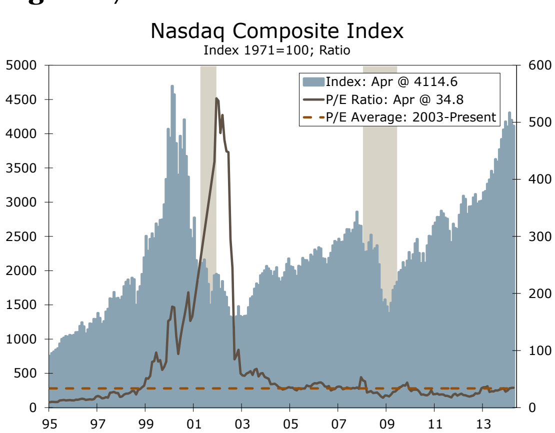
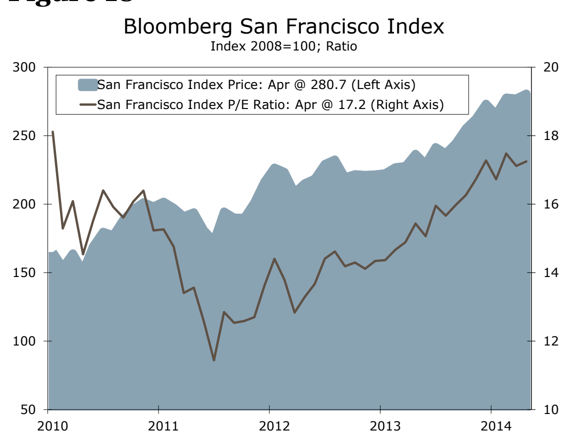


Figure 18



Source: Bloomberg LP and Wells Fargo Securities, LLC

The dependence on technology has raised concerns about the vulnerability of the Bay Area's economy to another dot com crash. The prospect has gained increased attention in recent months, which have seen a number of extremely highly valued acquisitions of tech startups and a few disappointing IPOs. While every boom must eventually end, traditional valuation measures are much different than they were during the run-up during the tech bubble in the late 1990s. The price/earnings (P/E) ratio of the NASDAQ is much lower today than it was back then, and a much larger proportion of tech firms have an identifiable product and earnings stream than they did in the previous boom. The product mix of these emerging companies is also more diverse, encompassing e-commerce, social media, internet security, cloud computing, life sciences and Clean Energy; products which are much more ingrained into the broader economy. Valuations also seem more appropriate. The P/E ratio for the NASDAQ is currently 34.8, compared to 175.4 in March 2000. The P/E ratio for the Bloomberg San Francisco index, which includes

90 firms operating in a wide range of industries throughout the Bay Area is 17.1 and seems well within historical norms.

Even with some moderation in the tech sector, strong momentum remains in place. Nonfarm employment in the San Francisco-Oakland-Hayward metro area is expected to increase 3.4 percent this year, while employment in San Jose should rise 4.5 percent. Unemployment rates will likely fall a half percentage point throughout the Bay area. The build out of major projects already underway will help support a high rate of construction activity over the next three years and the addition of office space and apartments should help stem the rapid appreciation in rents. Moreover, the opening of the Levi's Stadium and continuing improvements to Caltrain, BART and other transit systems will help encourage development in other parts of the Bay Area, including communities along the Peninsula as well as downtown San Jose. Oakland and other communities throughout the East Bay will also see more growth come their way. The mix of new development is different in many ways, however, with a much stronger desire for urban lifestyles and increased demand for housing and offices with easy mass transit access among two of the most notable trends.

California Economic Outlook

	Actual					Forecast	
	2009	2010	2011	2012	2013	2014	2015
Real Gross Domestic Product, Millions	1,667,152	1,672,473	1,692,301	1,751,002	1,814,200	1,890,400	1,972,500
Annual Rate	(5.1)	0.3	1.2	3.5	3.6	4.2	4.3
Nominal Personal Income, Millions	1,536,430	1,579,148	1,683,204	1,768,039	1,817,010	1,916,946	2,031,963
Percent Change	(3.7)	2.8	6.6	5.0	2.8	5.5	6.0
Population, Thousands	36,961	37,334	37,669	38,000	38,333	38,700	39,075
Change, Thousands	357	372	335	331	333	367	375
Households, Thousands	12,215	12,406	12,469	12,553	12,675	12,815	12,975
Change, Thousands	38	192	62	84	122	140	160
Nonfarm Employment, Thousands	14,370	14,210	14,359	14,706	15,075	15,425	15,750
Change, Thousands	-872	-160	149	347	369	350	325
Unemployment Rate, Annual Average	11.4	12.4	11.8	10.4	8.9	7.7	7.0
Total Housing Permits	33,259	43,242	45,207	57,491	77,630	86,800	100,000
Single-Family Permits	24,140	24,928	22,202	27,217	36,265	40,275	48,500
Multifamily Permits	9,119	18,314	23,005	30,274	41,365	46,525	51,500
Existing Single-Family Home Sales, Thousands	475	417	423	440	414	460	480
CoreLogic Home Price Index, Percent Change	(2.4)	(2.3)	(4.9)	13.6	20.1	8.3	4.7

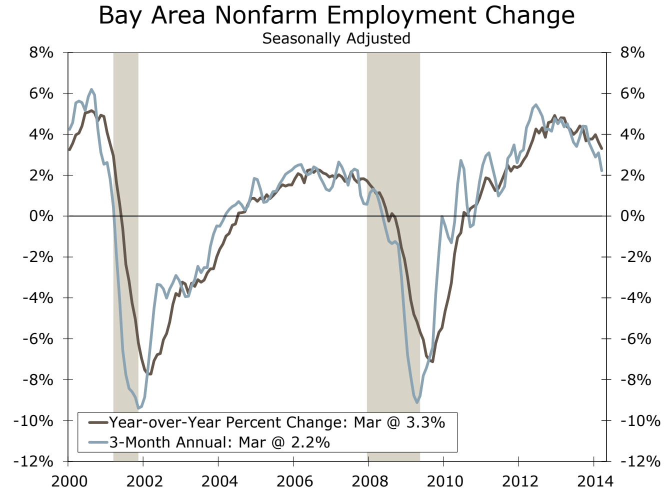
San Francisco Bay Area Economic Outlook

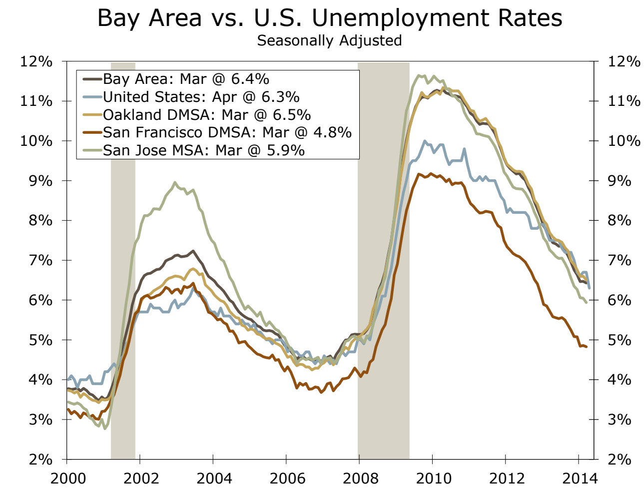
San Francisco-Oakland-Hayward MSA	2009	2010	2011	2012	2013	2014	2015
Real Gross Domestic Product, Millions	289,434	287,818	288,606	309,847	328,438	348,473	368,684
Annual Rate	-5.3%	-0.6%	0.3%	7.4%	6.0%	6.1%	5.8%
Population, Thousands	4,303	4,345	4,396	4,454	4,516	4,585	4,655
Change, Thousands	59	42	51	58	62	69	70
Nonfarm Employment, Thousands	1,948	1,918	1,950	2,025	2,105	2,180	2,250
Change, Thousands	-111	-30	32	75	80	75	70
Unemployment Rate, Annual Average	9.6%	10.2%	9.4%	8.1%	6.6%	5.5%	5.0%
Total Housing Permits	3,569	4,662	5,748	9,490	10,976	11,885	12,600
Single-Family Permits	2,277	2,138	1,907	3,105	3,601	3,885	4,350
Multifamily Permits	1,292	2,524	3,841	6,385	7,375	8,000	8,250
San Jose-Sunnyvale-Santa Clara MSA	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Real Gross Domestic Product, Millions	142,138	154,993	166,828	171,495	183,500	196,528	210,285
Annual Rate	-5.3%	9.0%	7.6%	2.8%	7.0%	7.1%	7.0%
Population, Thousands	1,820	1,842	1,867	1,893	1,920	1,950	1,985
Change, Thousands	24	23	25	25	27	30	35
Nonfarm Employment, Thousands	868	865	886	921	962	1,005	1,050
Change, Thousands	-57	-3	21	35	41	43	45
Unemployment Rate, Annual Average	10.9%	11.2%	10.0%	8.6%	7.0%	5.6%	5.1%
Total Housing Permits	1,083	4,189	3,089	5,661	7,734	8,200	8,700
Single-Family Permits	622	862	993	1,513	1,891	2,000	2,200
Multifamily Permits	461	3,327	2,096	4,148	5,843	6,200	6,500

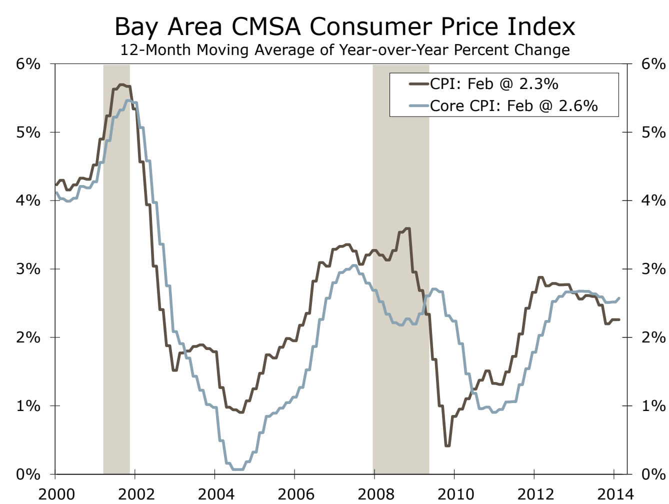
Sources: CoreLogic, California Association of Realtors, U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities, LLC

San Jose-San Francisco-Oakland CSA

- Growth in the San Jose-San Francisco-Oakland combined statistical area has moderated from the breakneck speed seen earlier in the recovery. Nonfarm employment is now 2.6 percent higher than a year ago, although it remains 2.6 percent below the peak reached during the dot com boom.
- The region's tech sector and strengthening tourist trade are the primary drivers of the region's economy. Higher-paying scientific and technical positions have been responsible for most of the recent upswing in employment, with job gains concentrated in the San Francisco metro division. The growth in the tech sector has fueled gains in construction and supporting services, resulting in a broad-based expansion.
- The Bay Area's housing market continues to make strong gains. Home prices have risen sharply in recent years and are now well above their prerecession peak. The run-up in prices and exceptionally tight inventories have cooled off demand. Home sales declined in the Bay area, with San Francisco and Napa posting the largest drops. Multifamily construction remains near its prerecession peak, though growth has moderated a bit recently. Single-family permits are well below their long-run historical average, which is a big part of the reason inventories are so tight and prices have risen so rapidly.
- The San Francisco Bay Area is one of the most vibrant economies in the world. Strong job and income growth have encouraged a wave of in-migration, which has sent home prices and rents soaring. The Bay Area's high cost of living is reshaping the economic landscape by encouraging more urban and urban-style development. The bulk of the growth is occurring in east San Francisco, where former industrial areas are giving way to office and apartment development. Development is also following the region's commuter train network south along the San Francisco Peninsula and into Silicon Valley. The region's higher cost-of-living also presents some near-term risks. Conflicts have arisen from some residents that have not seen their incomes keep pace with the region's soaring costs. Some businesses are also leaving the region or choosing to expand in less expensive locations.



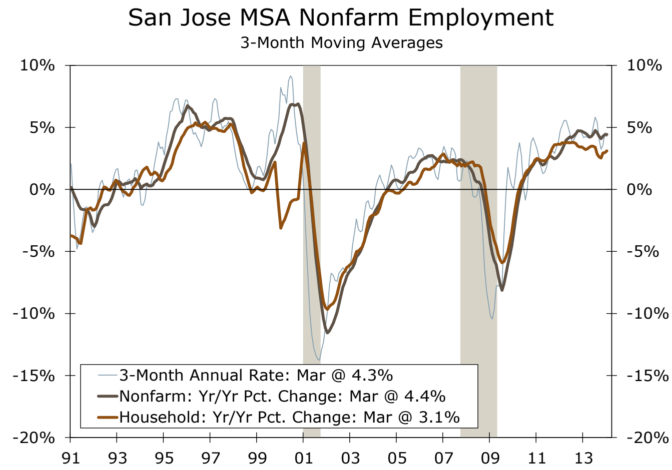


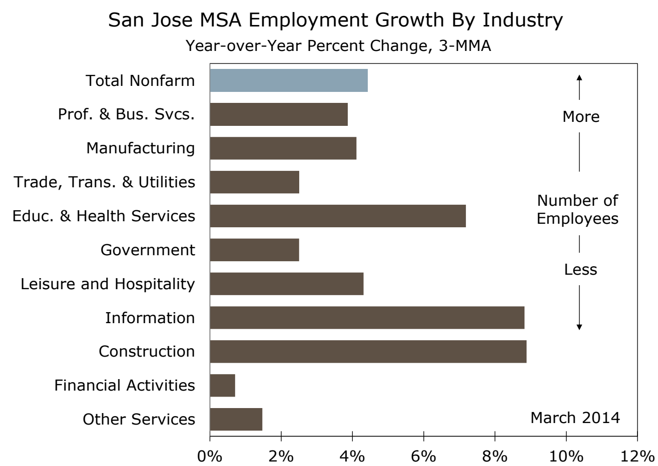


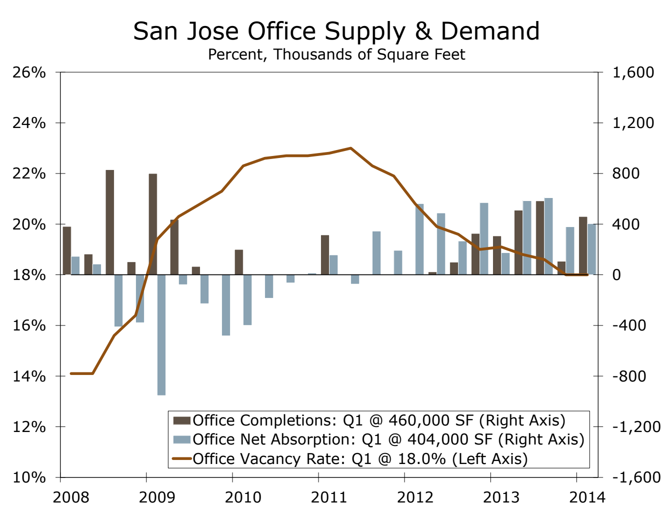
Source: U.S. Dept. of Labor and Wells Fargo Securities, LLC

San Jose

- San Jose remains the state's strongest metro area in terms of job growth. Nonfarm employment rose 4.3 percent over the past year. Growth has been broad-based, with every major industry group posting employment gains. Financial activities, however, have been a weak spot. Despite the industry's sluggish growth, the metro area continues to attract huge sums of venture capital and has plenty of angel investors. This has been a crucial ingredient for startups and is critical to the region's growth.
- Construction employment continues to make very strong gains, with the pace of hiring outpacing the state and national averages. Several high-profile projects are adding to the industry's growth. The construction of Apple's massive campus is under way, as is Samsung Semiconductor's new facility and the 49ers' new stadium, which opens in August. Google is also rapidly expanding its footprint and snatching up properties throughout the area. In addition, Google is helping support the development of a private 240,000-square-foot air terminal to be operated by Signature Flight Support at San Jose International Airport.
- Multifamily permits reached new highs in 2013, and the single-family market has made steady gains. With strong economic gains and a population growing about twice the national rate, new home construction should continue to expand. The supply of existing homes available for sale remains tight and has been a key driver of the metro area's 18.1 percent year-over-year home price appreciation. Prices are now above their prerecession peak.
- Even amid the region's booming job market, there are a few soft spots. Professional, scientific and technical services employment growth decelerated significantly, likely resulting from a handful of large layoffs at major employers, such as Cisco, Lockheed Martin, NetApp and Trend Micro. In addition, EMC, another major tech company, plans to make some cuts. Employment at device manufacturers is another weak spot, likely suffering from sluggish growth in capital spending in the United States, as well as decelerating growth in China. This year should see improvement on both fronts, while stronger growth in Europe is expected.



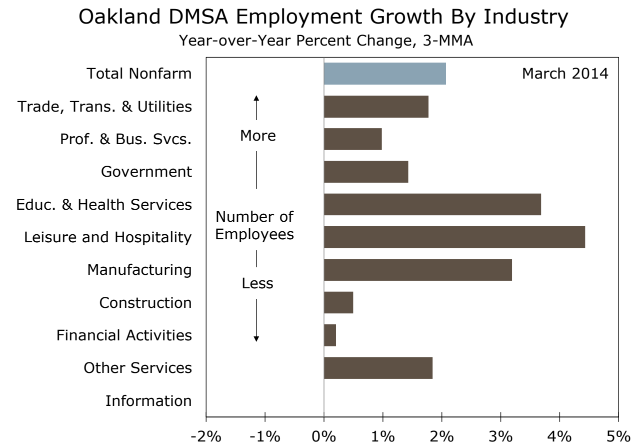


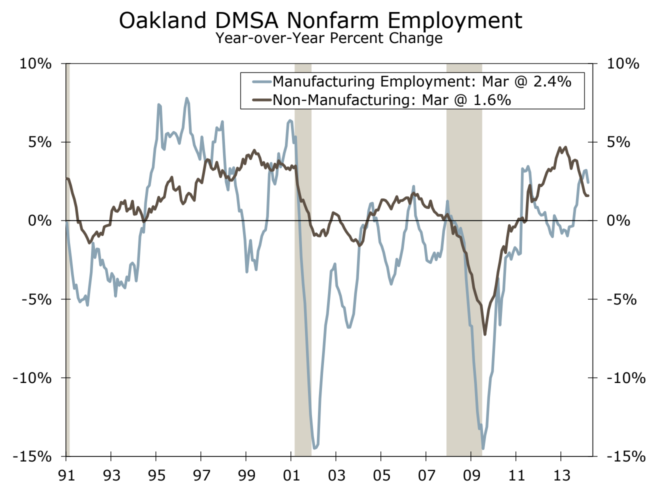


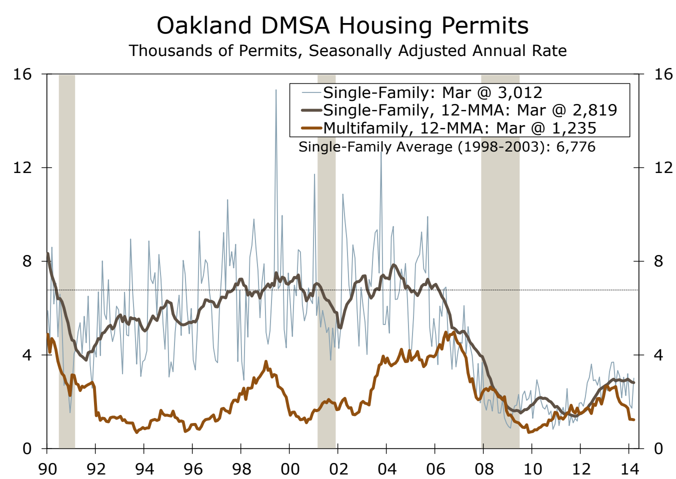
Source: U.S. Dept. of Labor, REIS and Wells Fargo Securities, LLC

Oakland-Fremont-Heywood MD

- Oakland's economy is quietly regaining strong momentum. The latest data show every major industry posting year-to-year job gains. Payroll growth has moderated to 1.9 percent year over year, which is below the state average but above that of the nation. Total employment is still 1.6 percent below its prerecession peak, which is a larger gap than that of the state or nation. A resurgent restaurant scene has helped boost leisure and hospitality payrolls 3.4 percent over the past year, though these gains have moderated recently.
- Transportation and utilities are posting strong gains, with employment up 5.2 percent over the past year. Wholesalers have also seen growth accelerate. Traffic of loaded containers through the port of Oakland was up 2.2 percent in 2013. Employment in retail trade has been less buoyant, particularly after the bump enjoyed from the opening of the Paragon Outlets.
- Although Oakland has not reached the high-tech hub status of San Francisco or San Jose, the metro division was ranked the 11th best place for tech startups. Scientific and technical services employment has perked up recently. In addition, startups are attracted to the relatively low cost environment that Oakland provides, while remaining close to the venture capitalists and the Bay Area's skilled workforce. Notable tech names include Pandora in Oakland and Tesla's operations in Fremont.
- Despite a solid rebound over the past two years, home prices are still nearly 20 percent from their prerecession peak. Home sales have slipped as investor demand declined. Even with prices up and inventories coming down, building activity is having a tough time getting restarted. Multifamily permits are trending lower and growth in the single-family market is tapering off. Oakland, however, benefits from having relatively few foreclosures and low prices compared to neighboring areas.
- Oakland's population is growing at about twice the national rate, which should help fuel gains in supporting services and retailing. In addition, the metro area's high proportion of the population that has at least a bachelor's degree is a powerful draw for emerging businesses.



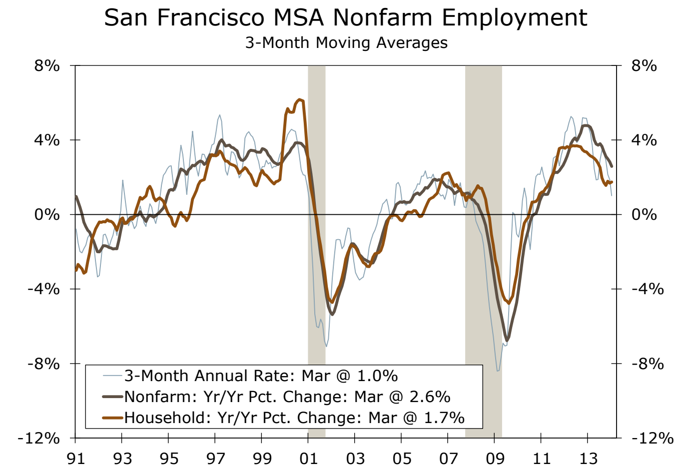


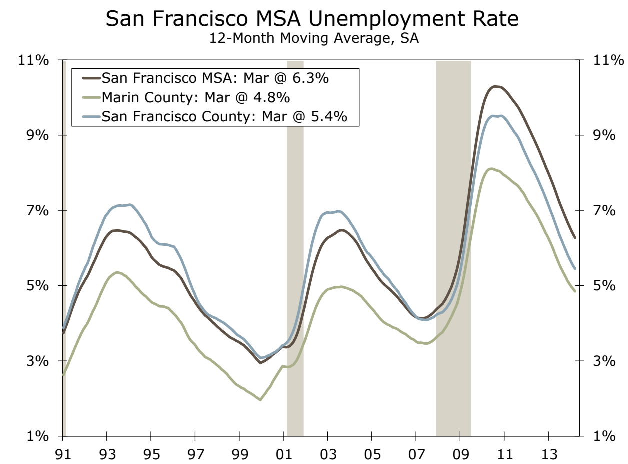


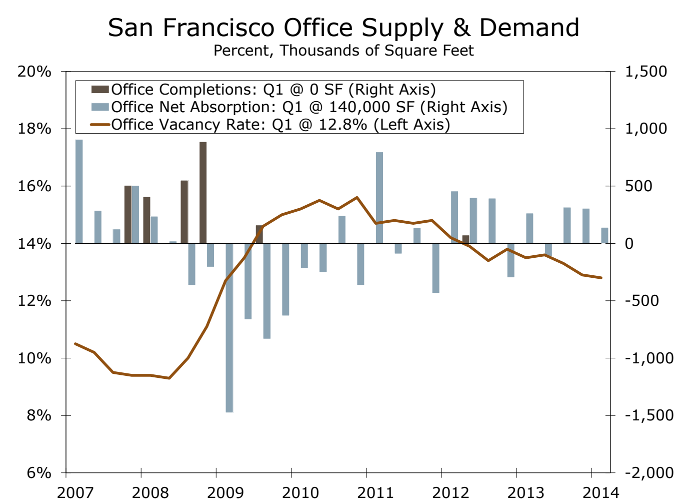
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities, LLC

San Francisco-San Mateo-Redwood City MD

- With employment above its prerecession peak, the San Francisco metro division is one of the nation's strongest job markets and Marin County's unemployment rate, which fell back to 4.5 percent in March, is the lowest in the state. Job growth has been particularly strong in scientific and technical services, thanks to the expanding presence of tech firms. Younger workers increasingly prefer to live and work in urban environments near public transportation, and employers have responded accordingly. Although job growth remains strong, it has moderated in most industry groups, and in financial services and government, in particular.
- Construction is one industry where growth is accelerating, with employment surging 10.3 percent over the past year. Construction of the Transbay Transit Center and adjacent office tower, which is expected to be the tallest on the West Coast, is well underway. Salesforce, a software company, will occupy about half of the tower, the largest real estate deal in the city's history and expects to hire another 1,000 workers this year. In addition, Marin General's $643 million redevelopment and construction of a new arena for the Warriors in Mission Bay should support building activity for some time.
- Residential building has also contributed to the construction industry's rebound. Multifamily permits remain at some of their highest levels, while single family permits continue to rise. Home prices are above their prerecession peak and are now 19.0 percent higher than a year ago. A dearth of foreclosures and delinquencies has added fuel to home price appreciation in the area. Inventories in the metro division have also declined to low levels, which has likely contributed to the weak sales numbers and higher prices. Exceptionally high home prices may force would-be buyers to look elsewhere.
- San Francisco has plenty of growth in the pipeline. Recently announced expansions by major tech employers and several mega construction projects will keep momentum going. Strong income growth and the region's improving demographics should boost consumer spending. With more than half of the population holding a bachelor's degree, business investment should continue to pour in.







Source: U.S. Dept. of Labor, U.S. Dept. of Commerce, Reis, Inc. and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah Watt House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Blaire Zachary	Economic Analyst	(704) 410-3359	blaire.a.zachary@wellsfargo.com
Peg Gavin	Executive Assistant	(704) 410-3279	peg.gavin@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

WELLS FARGO SECURITIES