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# Regional Intelligence Report

Produced by Beacon Economics, LLC



## San José State University Economic Summit

WEDNESDAY, JUNE 30, 2021

10:15am – 12:00pm Virtual Event

### CONFIRMED PANELISTS

Ro Khnanna, *Congressman*

Christopher Thornberg, *Founding Partner, Beacon Economics*

A panel of notable experts will forecast Silicon Valley's economic landscape and discuss how this may impact your business.

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Founded in 2007, Beacon Economics, an LLC and certified Small Business Enterprise with the state of California, is an independent research and consulting firm dedicated to delivering accurate, insightful, and objectively based economic analysis. Employing unique proprietary models, vast databases, and sophisticated data processing, the company's specialized practice areas include sustainable growth and development, real estate market analysis, economic forecasting, industry analysis, economic policy analysis, and economic impact studies. Beacon Economics equips its clients with the data and analysis required to understand the significance of on-the-ground realities and to make informed business and policy decisions.

## PRACTICE AREAS

- Economic, Fiscal, and Social Impact
- Economic and Revenue Forecasting
- Regional and Sub-Regional Analysis
- Housing, Land Use, and Real Estate Advisory
- Litigation and Testimony
- Sustainable Growth and Development

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# UNITED STATES FORECAST

BY CHRISTOPHER THORNBERG, PHD

## HIGHLIGHTS

### *Lagging Labor Market Recovery*

The recent uptick in the U.S. labor market is welcome news following an exceptionally rough 2020. The heaviest and most persistent damage to the economy last year was sustained in the labor market, which shed around 22 million jobs in March and April of 2020 following the outbreak of the novel coronavirus pandemic and the public health responses to it. The crisis sent the U.S. unemployment rate soaring from 3.5% to 14.8%. While it was initially hoped that many of these job losses would be temporary, as of March 2021, only 62% of the jobs lost have been recovered, 8.5 million positions below pre-pandemic levels, or around 5.5% lower. The U.S. unemployment rate has fallen to 6.0% since the height of the crisis. While no sector of the economy gained jobs in 2020, some sectors fared better than others. Around 40% of the job losses occurred in Leisure and Hospitality alone, although strong growth is expected in this sector in 2021. Financial Activities and Professional, Scientific, Technical and Management Services were relatively unscathed. As these figures suggest, lower income workers have been hit the hardest by the labor market fallout.

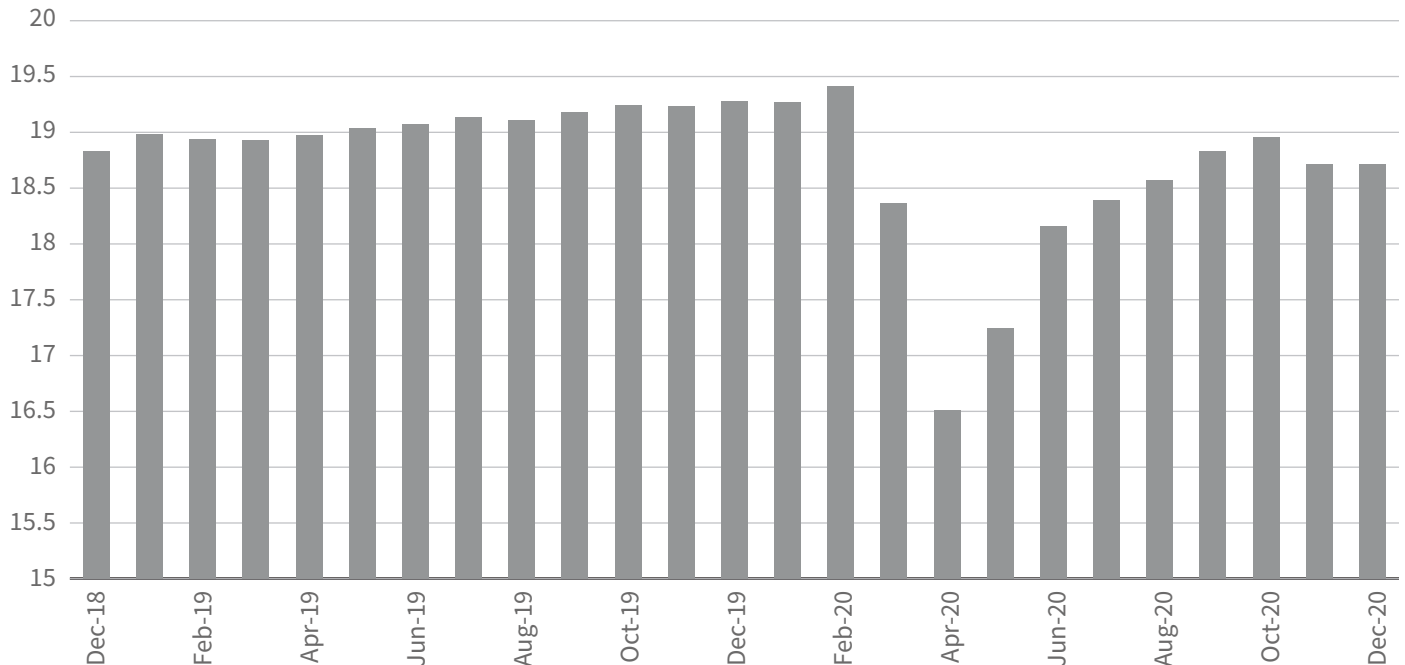
## Housing Strength

If the labor market has been the weakest aspect of the U.S. economy, residential real estate has been by far the strongest. Sales of single-family homes in the nation increased 23% from December 2019 to December 2020, compared to 10% growth from December 2018 to December 2019. At the same time, home prices increased by 13% throughout 2020, compared to 8% growth across 2019. The strength of the housing market has been driven by two primary factors: 1) mortgage rates hit historic lows in 2020, as the Federal Reserve slashed interest rates in response to the pandemic's economic fallout; and 2) since the labor market damage in 2020 predominantly affected lower-income workers, the typical home-owner, who is wealthier, has been relatively unaffected. With inventories at record lows, and increased savings (U.S. savings rates have proliferated during the pandemic), this created a cocktail for sharp price jumps. Looking ahead, low inventory and still-friendly mortgage rates, should continue driving significant sales and price appreciation in 2021.

## A Strong Year Ahead

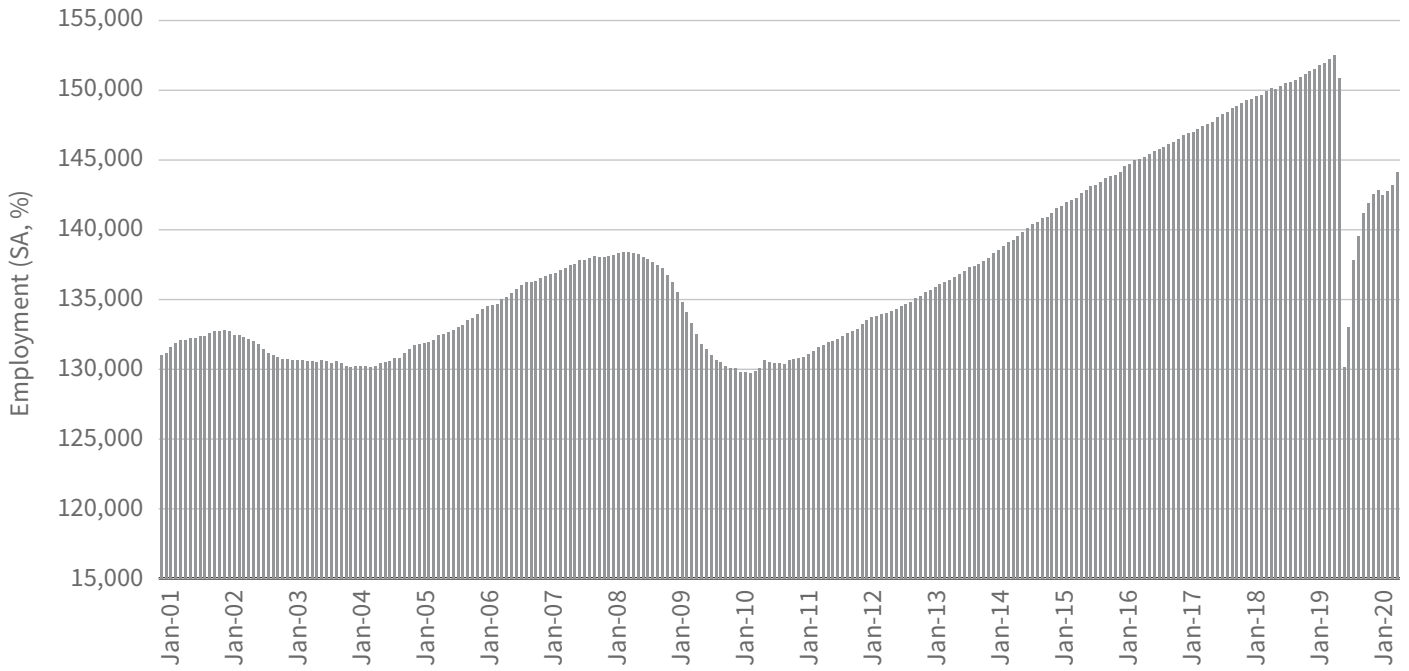
With the fast pace of the vaccine rollout and with restrictions on business activity being scaled back nationally, 2021 will herald a strong bounce in hiring for the U.S. economy. A combination of high savings rates and continued fiscal and monetary support have set the stage for the economy to return to its pre-pandemic trend by the end of the year.

### MONTHLY REAL GDP - UNITED STATES



Source: U.S. Bureau of Economic Analysis; Analysis by the UCR Center for Economic Forecasting and Development

## TOTAL NONFARM EMPLOYMENT - UNITED STATES



Source: Bureau of Labor Statistics; Analysis by the UCR Center for Economic Forecasting and Development

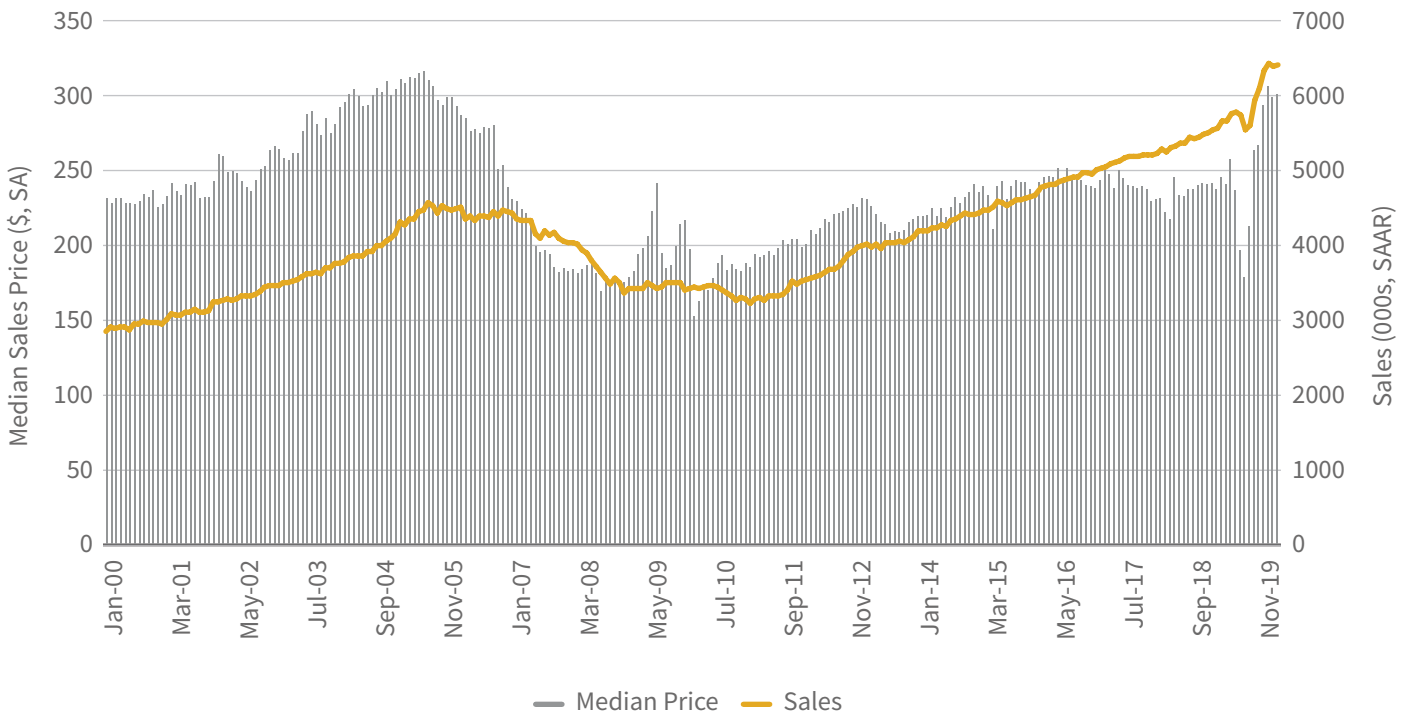
## UNEMPLOYMENT RATE - UNITED STATES



Source: Bureau of Labor Statistics; Analysis by the UCR Center for Economic Forecasting and Development



### UNITED STATES HOME PRICE AND SALES



Source: CoreLogic; Analysis by the UCR Center for Economic Forecasting and Development

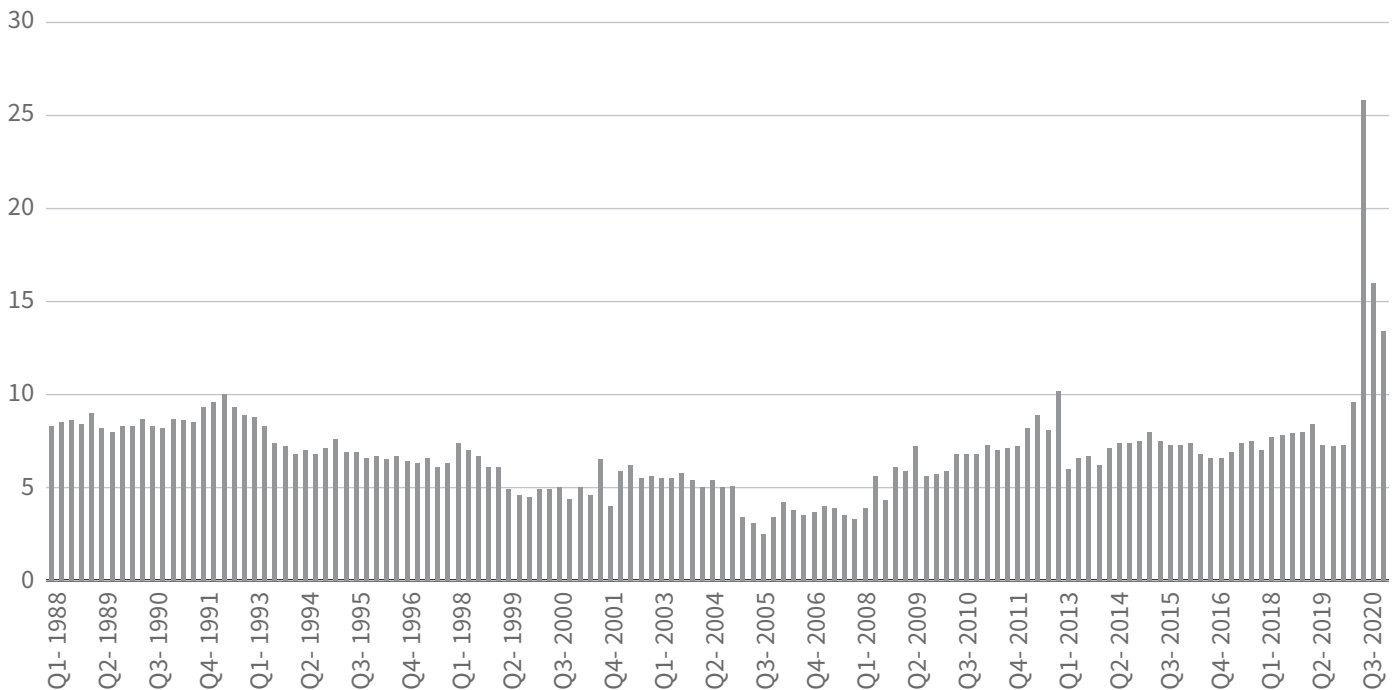
# LIGHT AT THE END OF THE PANDEMIC TUNNEL

As of April 28, 48% of the U.S. population has received at least one vaccine, while more than 29% of the population is fully vaccinated. The containment of the COVID-19 virus is critical because the recent economic recession was driven by the pandemic and the reactions to it, not by economic fundamentals. With the spread of the virus coming under control, strong consumer health, and unprecedented fiscal and monetary stimulus, the year ahead will see exceptional economic growth.

## HEALTHY CONSUMERS

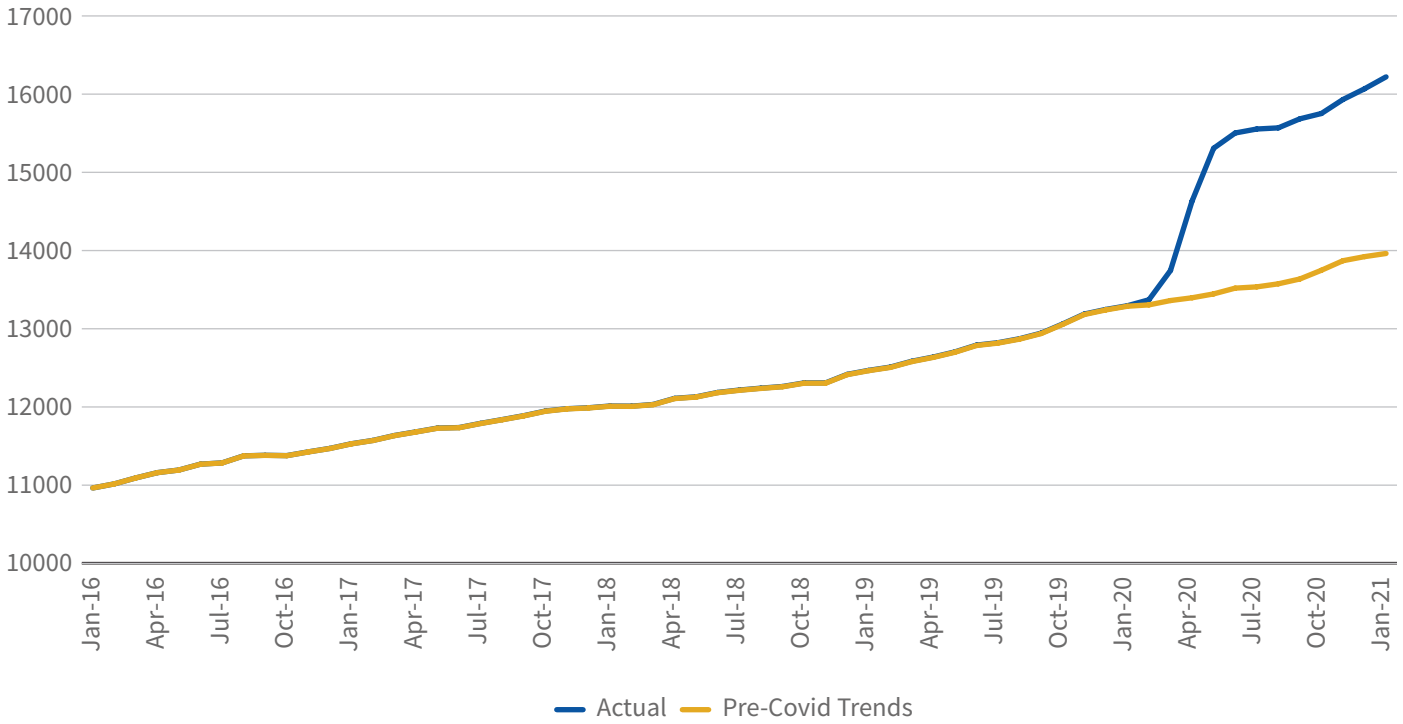
While U.S. GDP experienced its largest annual decline in decades in 2020, these losses will be offset and the economy will return to trend this year. Growth in 2021 will be driven primarily by consumers. Over the past year, the U.S. household savings rate shot up to levels never seen in the nation's history: 25% in the second quarter of 2020 and a still high 13.4% by the end of last year. This was driven by the fiscal stimulus but also by the fact that spending dropped significantly more than incomes grew. Aggregate disposable personal income in the nation surged during 2020, with government payments offsetting earned income losses by a ratio of 2 to 1. As a result, commercial bank deposits swelled like never before, increasing by \$3 trillion compared to 2019 levels. These factors have had the combined effect of rendering household debt at its lowest share of household income in decades. Along with the expected recovery in the labor market, strong consumer spending will drive economic growth in 2021.

### PERSONAL SAVINGS AS % DPI - UNITED STATES



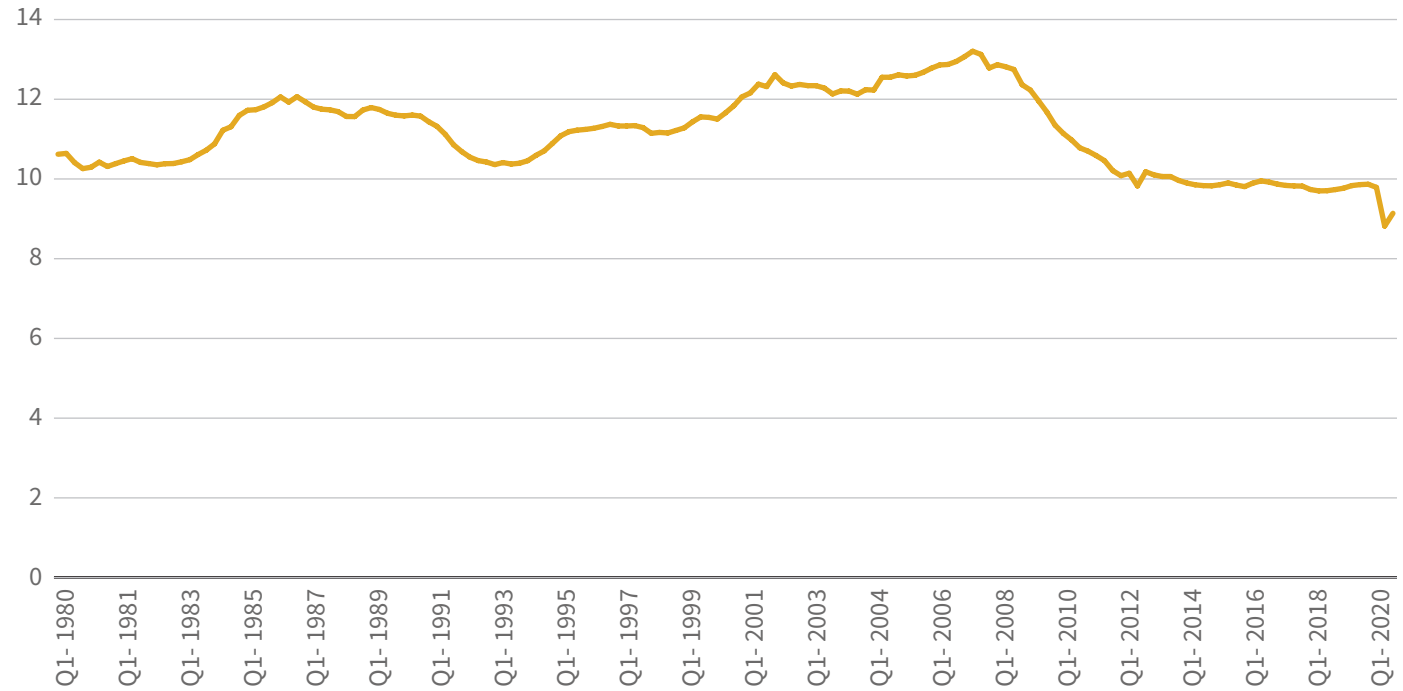
Source: U.S. Bureau of Economic Analysis; Analysis by the UCR Center for Economic Forecasting and Development

### U.S. COMMERCIAL BANK DEPOSITS \$BILLIONS, SA



Source: Board of Governors of the Federal Reserve System (US); Analysis by the UCR Center for Economic Forecasting and Development

### U.S. HOUSEHOLD DEBT SERVICE PAYMENTS AS PERCENT OF DISPOSABLE PERSONAL INCOME, PERCENT, QUARTERLY, SA



Source: Board of Governors of the Federal Reserve System (US); Analysis by the UCR Center for Economic Forecasting and Development



# CALIFORNIA FORECAST

BY TANER OSMAN, PHD

## HIGHLIGHTS

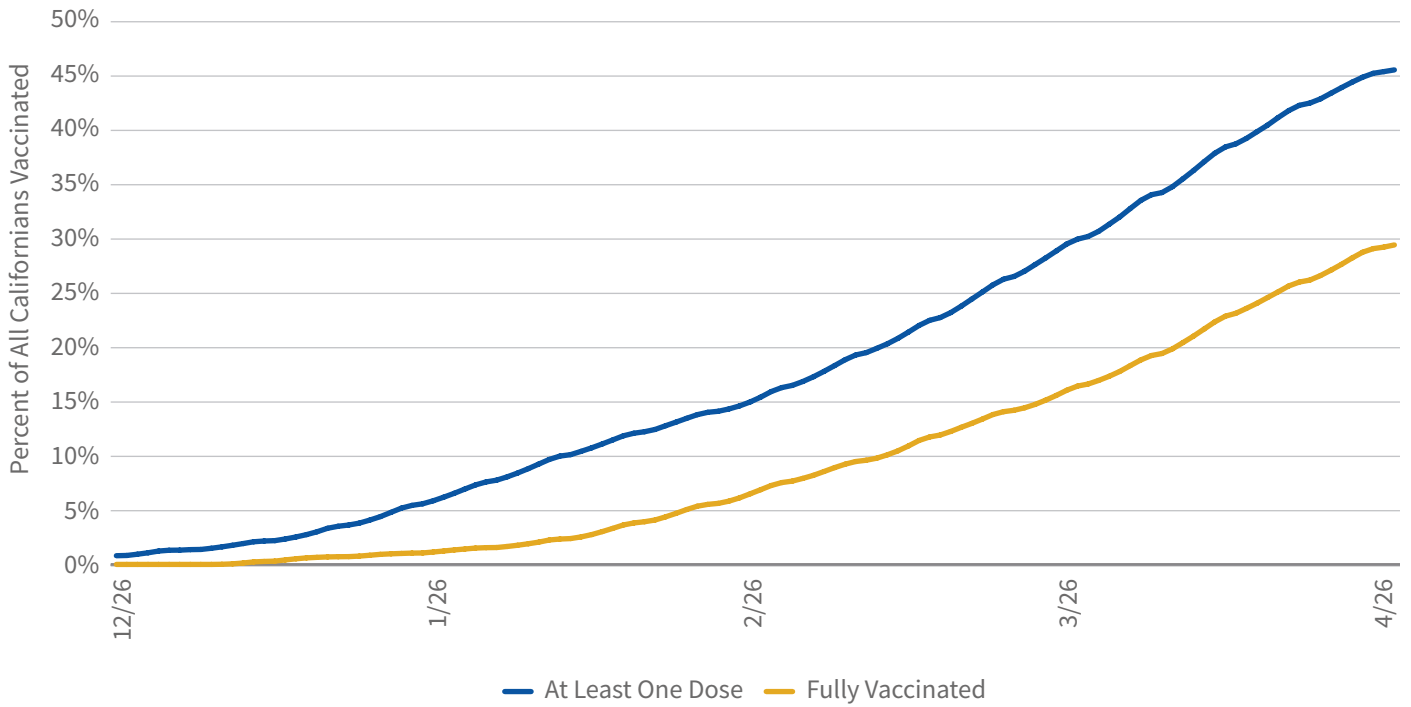
### *Vaccine Rollout Gathers Speed*

As is the case nationally, the pace of vaccinations in California has gathered significant momentum over the past month. Importantly, the state has reached its target of administering 4 million COVID-19 vaccine doses specifically within its most disadvantaged areas — a goal that makes it easier for counties to widely reopen businesses and other public spaces. As vaccines boost consumer confidence in returning to their normal activities, and lead to a further easing of business restrictions, the labor market recovery in the state will accelerate.

### *California Labor Market Recovery Lagging Nation*

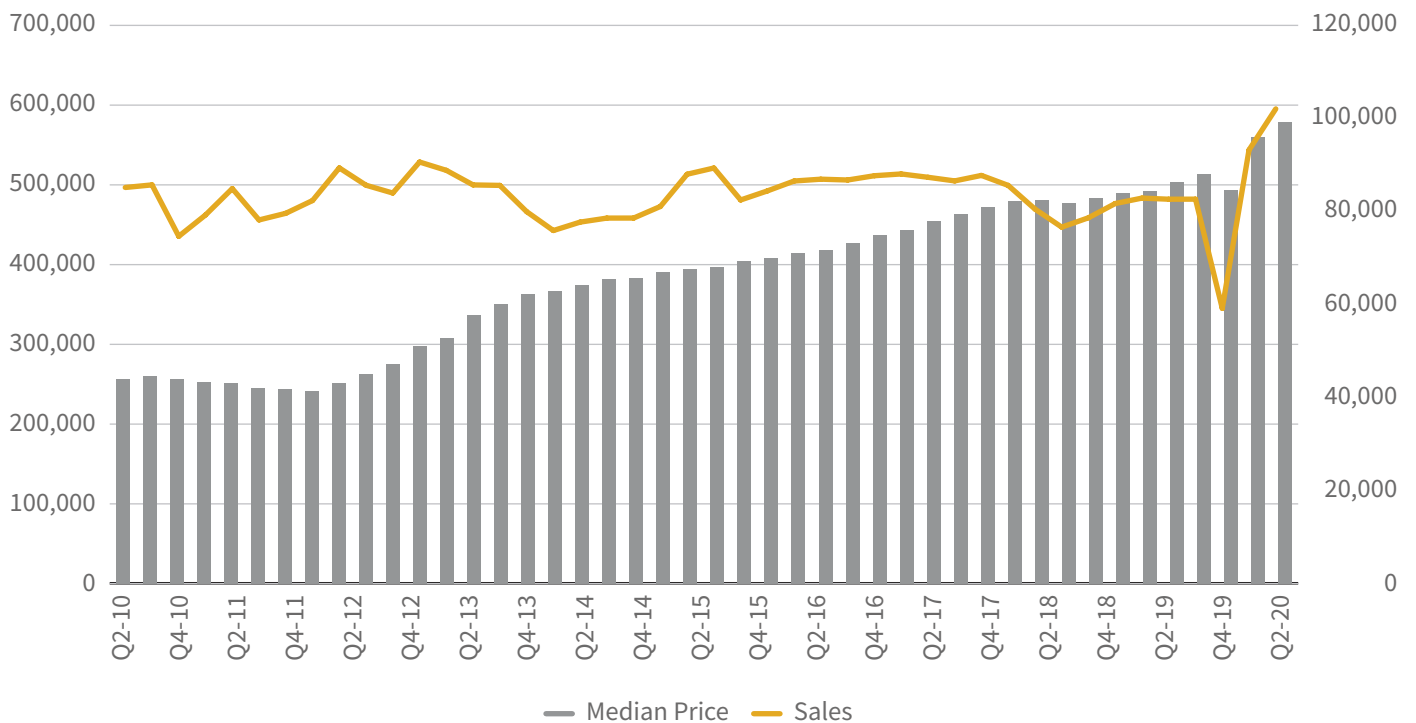
The performance of California's labor market helped to fuel national job gains in February and March. The state's unemployment rate also declined to 8.3% in March, down from 9.0% at the beginning of the year. Still, unemployment in California remains elevated relative to the United States overall (6.0%). Furthermore, the state finds itself in a deeper hole with respect to jobs lost than is the case nationally. As of March, the state had 8.6% fewer jobs compared to pre-pandemic levels, while the national economy had 5.5% fewer jobs. California's relative underperformance in the labor market will likely translate into higher job gains in 2021.

## VACCINATIONS IN CALIFORNIA



Source: Los Angeles Times' Datadesk; Analysis by the UCR Center for Economic Forecasting and Development

## CALIFORNIA HOME SALES AND PRICES



Source: CoreLogic; Analysis by the UCR Center for Economic Forecasting and Development

# A DARK YEAR GIVES WAY TO A BRIGHT OUTLOOK

The 2020 recession was unlike any other in recent history as it was not caused by an imbalance or problem in economic fundamentals. Prior to the outbreak of the pandemic, unemployment rates were at generational lows, wages were rising, and consumers and businesses were healthy. The economic fallout from the pandemic happened quickly and hit the economy hard. With the decline in new COVID-19 cases in the state, and with an accelerated vaccination roll out, the worst effects of the economic fallout surrounding the pandemic are in the past. In terms of containing the virus by vaccination, the state has performed slightly better than the nation overall: 44% of the U.S. population has received at least one shot compared to 48% in California. The share of the nation's population that is fully vaccinated, 30%, matches the state. The containment of the virus in California sets the stage for a year of extraordinary growth.

The pandemic did its worst damage in California in the labor market. As of March, there were still 1.5 million fewer people employed in the state than there were prior to the crisis. Moreover, both the job losses and the recovery has been very uneven. The Transportation, Warehousing and Utilities sectors actually gained jobs during the pandemic, buoyed by the increase in online shopping and deliveries of goods. On the other hand, more than 50% of the total job losses have been within just two sectors of the economy: Leisure and Hospitality and Other Services (the latter includes personal services businesses such as hair and nail salons). As the economy opens up, however, these sectors should see a strong bounce back with solid employment gains in 2021.

## CALIFORNIA NONFARM EMPLOYMENT BY INDUSTRY

Sector	Employment Mar-21	Chg. Feb-20 to Mar-21 (#)	Chg. Feb-20 to Mar-21 (%)
Total Nonfarm	16,133,600	-1,527,300	-8.6
Mining and Logging	19,000	-3,300	-14.8
Construction	886,200	-27,100	-3.0
Manufacturing	1,249,800	-78,000	-5.9
Wholesale Trade	641,200	-45,100	-6.6
Retail Trade	1,581,300	-67,200	-4.1
Transportation, Warehousing & Utilities	772,300	40,100	5.5
Information	527,000	-54,100	-9.3
Finance & Insurance	533,200	-9,600	-1.8
Real Estate & Rental & Leasing	274,100	-31,900	-10.4
Professional, Scientific & Technical Services	1,325,900	-32,200	-2.4
Management of Companies & Enterprises	241,900	-12,500	-4.9
Administrative & Support & Waste Services	1,075,800	-83,000	-7.2
Educational Services	326,700	-61,300	-15.8
Health Care & Social Assistance	2,412,400	-62,100	-2.5
Leisure & Hospitality	1,408,100	-650,100	-31.6
Other Services	459,300	-134,000	-22.6
Government	2,399,400	-215,900	-8.3

Source: Bureau of Labor Statistics; Analysis by the UCR Center for Economic Forecasting and Development

The economic fallout from California's labor market losses disproportionately impacted the lowest wage earners. However, an unprecedented policy response by the federal and state governments went some way towards dulling the pain. Since California's labor market underperformed the nation in 2020, the expectation is that this will translate into higher job gains for the state's economy in 2021. As the economy opens up, there will be more room for growth in California's labor markets.

While the state's job recovery still lags other economic indicators, many aspects of the economy have already returned to their pre-pandemic trends, and some, such as the housing market, boomed over the past year. Indeed, home prices in the state increased by 15% from the 4th quarter of 2019 to the 4th quarter of 2020, compared to just 5% growth from the 4th quarter of 2018 to the 4th quarter of 2019. A severe shortage of housing supply in California will continue to place upward pressure on home prices in the year ahead.

Sales of single-family homes in the state also increased – by 24% from the 4th quarter of 2019 to the 4th quarter of 2020. The year before, home sales grew by just 8%. This rate of sales growth is unsustainable in 2021, however, as supply and inventory constraints will act as significant headwinds.

Given the underlying strength in the economy, unprecedented consumer savings, and the high level of fiscal and monetary support from the government, the pandemic's economic effects will increasingly diminish, and soon public discourse will, and in some respects has already started to, turn towards the state's long-standing challenges surrounding housing affordability, inequality, population growth, and tight labor markets.



## SOUTH BAY REGIONAL INTELLIGENCE REPORT

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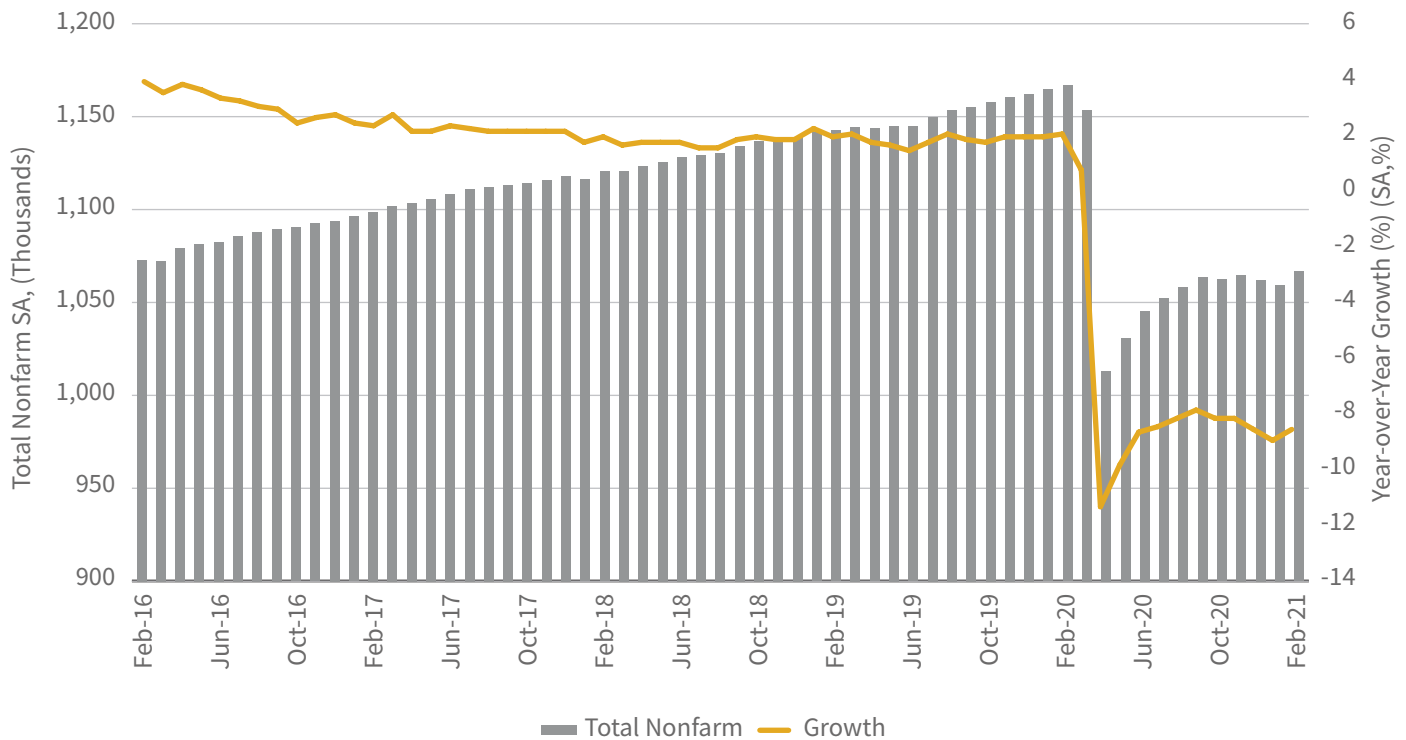
The South Bay has not been immune from the economic fallout seen throughout the nation, following the emergence of Covid-19. The following report tracks the performance of the region's labor market, residential and commercial real estate markets over the past year. As the number of new Covid-19 cases falls in the region, and the vaccine rollout gathers significant momentum, a healthy consumer will ensure a strong year for the region's economy.

## SOUTH BAY LABOR MARKET

The South Bay labor market has continued to steadily recover from the COVID-19 pandemic, adding 53,600 jobs since April's lows. Despite the ongoing labor market recovery, year-over-year employment fell 8.6% (-100,000 jobs), one of the largest annual declines on record. Even so, employment growth in the South Bay is outpacing that of the state (-9.4%) but has trailed the nation (-6.2%) over the last year.

The majority of the declines in the labor market have been driven by the response to COVID-19, whether these be through public health mandates or changes in consumer behavior to help mitigate the pandemic's health impact. The fundamentals of what will drive long-run growth remain strong, with households seeing minimal losses in income and some households even able to bolster their savings over the last year. As a result, there is a significant amount of pent-up demand for consumer consumption. Once the economy begins to open-up and the health concerns related to COVID-19 begin to wane, the economy and thus the labor market should recover at a rapid pace in 2021.

### SOUTH BAY TOTAL EMPLOYMENT AND GROWTH



Source: California Employment Development Department; Analysis by Beacon Economics

The South Bay's unemployment rate has also improved from the lows of early this year. It is now 5.5%, a far cry from the 2.7% rate a year earlier. The rate in the region is remains well below California's 8.5% and the nation's 6.2%.

Although unemployment rates have fallen in recent months in the South Bay, these declines have been partly driven by declines in the region's labor force. From February 2020 to February 2021, 38,700 workers left the South Bay's labor force, a 3.6% decline. This decline is more substantial relative to declines in the state (-2.5%) and nation (-2.6%) over the period. Without the decrease in South Bay's labor force, the region's unemployment figure would be slightly higher than the current figure.

Unsurprisingly, the largest job losses have been concentrated in the region’s Leisure and Hospitality sector, with 45,600 fewer workers than a year earlier, a 43.3% decline. Other significant job losses have occurred in Education, Government, Other Services (a sector that includes hair and nail salons), and Retail Trade. These are the sectors most impacted by government mandates and consumer reticence. The stay-at-home orders implemented in December have begun to ease in many parts of the state, which should help alleviate much of the slowdown that occurred in December and January. Beacon remains optimistic. With more and more people receiving the vaccine each day, containment of the virus is in sight, and these sectors should have significant job gains as companies ramp up production to meet surging consumer demand.

## SOUTH BAY INDUSTRY EMPLOYMENT

Sector	Feb-20 (000s)	YoY Change (%)	YoY Change (000s)
Total Nonfarm	1,066.7	-8.6	-100.0
Information	109.1	1.7	1.8
Transport/Warehouse	16.4	-1.2	-0.2
Management	15.0	-4.5	-0.7
Financial Activities	38.0	-4.0	-1.6
Wholesale Trade	28.6	-7.4	-2.3
Manufacturing	169.5	-1.5	-2.6
Prof Sci Tech	164.8	-1.9	-3.2
Admin Support	60.5	-5.2	-3.3
NR/Construction	51.1	-6.8	-3.7
Health Care	128.3	-5.0	-6.7
Retail Trade	74.4	-8.6	-7.0
Other Services	21.0	-26.8	-7.7
Government	91.6	-8.3	-8.3
Education	38.8	-19.2	-9.2
Leisure and Hospitality	59.6	-43.3	-45.6

Source: California Employment Development Department; Analysis by Beacon Economics

Although job losses have been widespread, a few bright spots exist. The South Bay’s Information sector has continued to expand, adding 1,800 employees over the last year, a 1.7% increase. This growth is in stark contrast to the 10.6% decline in the Information sector in the state overall over the same period.

The surge in e-commerce has helped keep the region’s Transportation and Warehousing fairly resilient over the last several months. Payrolls in Transportation and Warehousing fell by just 1.2% over the last year, compared with a 3.1% increase in the state overall over the period.

## WAGES

Average annual wages across the South Bay rose significantly from the third quarter of 2019 to the third quarter of 2020, growing by 17.9% to \$148,400. The main factor for this increase is a change in job mix in the South Bay over the last year. Public health mandates related to COVID-19 have disproportionately impacted the region's low sectors, and has resulted in the average annual wage figuring rising substantially. As a result of this change in job mix the substantial growth in average annual wages is temporary. Indeed, as more low wage jobs come back to the South Bay average annual wage will begin to fall. Average annual wages for the Leisure and Hospitality sector, the sector that has seen the greatest jobs losses as a result of the pandemic, are just \$38,933 or just 26% of the overall average for the South Bay.

Despite the top level average annual wage overstating growth over the last year, wages are up across all sectors in the South Bay over the last year. Professional and Business Services have led the way, with average annual wages expanding by 20.5% over the last year. Other sectors posting strong growth for the year were Other Services (18.8%), Retail Trade (15.3%), Manufacturing (14.5%), Wholesale Trade (12.3%), and Education (11.8%).

### Q3-2020 ANNUAL AVERAGE WAGE BY INDUSTRY, SOUTH BAY

Industry	Q3-2020 (\$)	1-Year % Growth
Total Private	148,361	17.9
Professional/Business	186,428	20.5
Other Services	53,678	18.8
Retail Trade	55,136	15.3
Manufacturing	213,985	14.5
Wholesale Trade	147,026	12.3
Education	101,473	11.8
Leisure/Hospitality	38,933	11.7
Information	303,821	7.6
NR/Construction	89,821	6.1
Logistics	82,866	5.7
Financial Activities	134,805	5.1
Health Care	74,883	4.2

Source: Quarterly Census of Employment and Wages; Analysis by Beacon Economics



## COVID-19 TRENDS AND LOCAL SPENDING

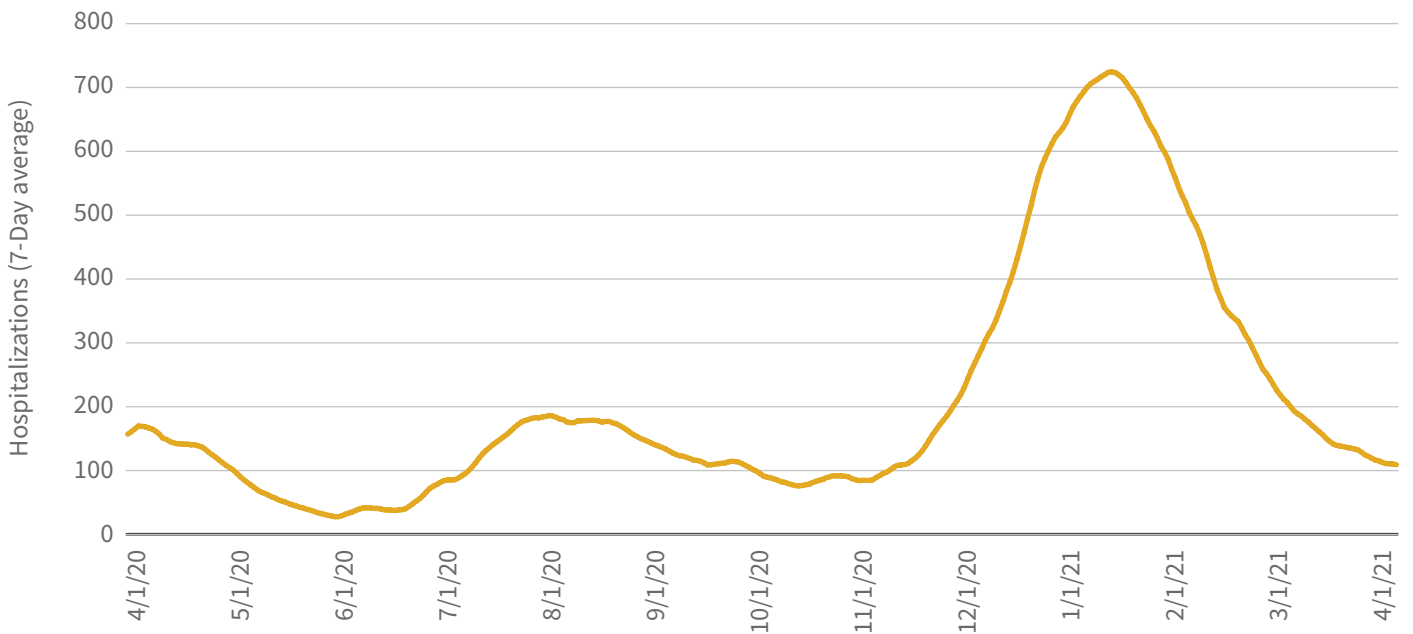
Containing COVID-19 will be essential to sustaining the economic recovery in the South Bay and the nation. The surge in cases that occurred in the South Bay in December and January have fallen dramatically in recent months. At the beginning of April, the 7-day moving average for new daily COVID-19 cases in the South Bay was 111, a significant improvement from the over 1,500 new daily COVID-19 cases in South Bay to begin the year. With these improvements the public health mandates have begun to ease and businesses are able to return to more normal operations.

## SOUTH BAY COVID-19 CASES



Source: Los Angeles Times, California Department of Public Health; Analysis by Beacon Economics

## SOUTH BAY COVID-19 HOSPITALIZATIONS

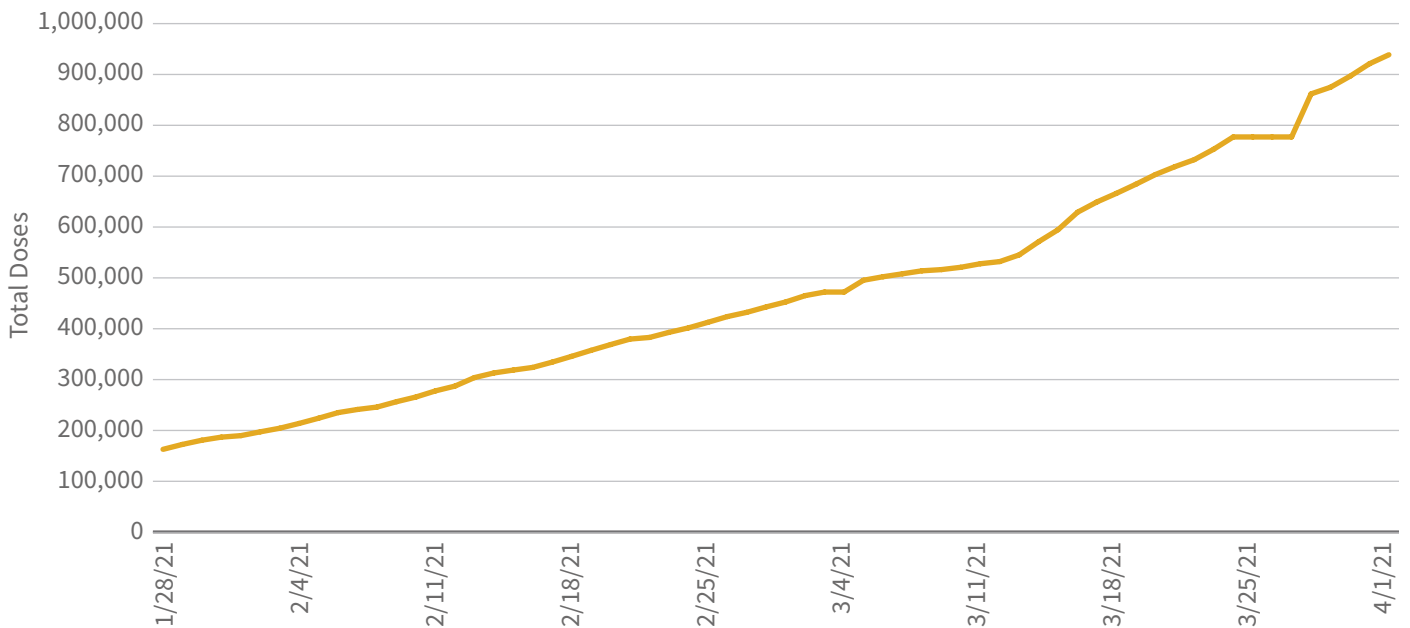


Source: Los Angeles Times, California Department of Public Health; Analysis by Beacon Economics



The decline in COVID-19 cases in the South has also eased the strain on hospital beds. In mid-January there were over 700 patients in local hospital beds who had tested positive for COVID-19, this number has fallen to just over 100 for the South Bay. This is a welcomed sign for local hospitals, which won't have to shift resources to COVID-19 patients.

### SOUTH BAY CUMULATIVE VACCINATION DOSES



Source: Los Angeles Times, California Department of Public Health; Analysis by Beacon Economics

Vaccinations will play a key role in the South Bay’s and California’s re-opening efforts in the coming months. As of 4/1/2021, the South Bay has supplied over 940,000 doses of the COVID-19 vaccine. The state is slated to open vaccinations up to a wider pool of people in the coming weeks, which should help get the region closer to herd immunity and further re-openings.

## SOUTH BAY SALES TAX RECEIPTS BY CATEGORY

Category	Q4-2020 (\$ Thousands)	1-Year Change (%)
County & State Pool	27,546.8	16.1
Business and Industry	39,916.9	14.6
Building and Construction	9,139.9	5.6
Food and Drugs	4,405.7	-6.2
Autos and Transportation	14,163.2	-10.1
General Consumer Goods	14,287.6	-22.2
Fuel and Service Stations	3,942.0	-40.1
Restaurants and Hotels	8,155.2	-41.7
<b>Total</b>	122,249.0	-3.9

Source: Source: HdL Cos.; Analysis by Beacon Economics

From the fourth quarter of 2019 to the fourth quarter of 2020, taxable receipts in South Bay fell 3.9%. Declines were most pronounced at Restaurants and Hotels, which fell by 41.7% over the last year. This shouldn’t come as a surprise given that this was the sectors most impacted by the stay-at-home orders and public health mandates.

Declines were also pronounced at Fuel and Service Stations, which fell by 40.1%. This is due to less car travel during the pandemic. Other sectors with significant declines in consumer spending were General Consumer Goods (-22.2%) and Autos and Transportation (-10.1%).

The pandemic has led to a surge in spending at some locations. E-commerce has surged during the pandemic, spending is up 16.1% year over year for the County & State Pool, the category that collects taxes for e-commerce sales. Business to business spending has also grown significantly over the last, growing by 14.6%. The South Bay’s Construction sector has also been aided by the pandemic: With people spending more time at home, many have done home upgrades in recent months, so spending at Building and Construction stores grew 5.6% year over year.

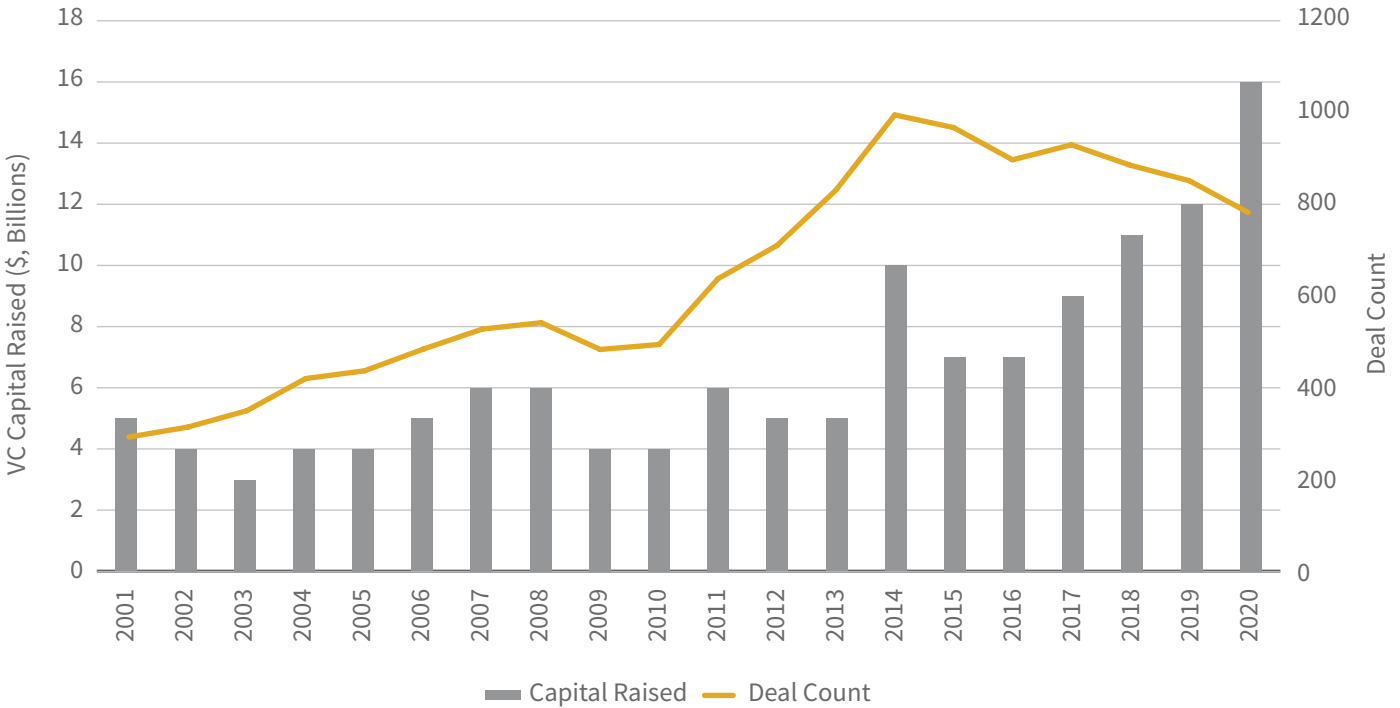


## VENTURE CAPITAL

With Silicon Valley home to some of the world’s most prominent tech company headquarters, venture capital plays a vital role in the South Bay economy. Over the past few years, the region has had massive increases in capital raised across various industries and verticals, and 2020 was no exception. From 2019 to 2020, total capital raised in the South Bay increased 32.7% to \$15.7 billion—the largest amount ever raised in the region. Furthermore, year-over-year growth was stronger than the 12.2% increase in 2019. The total number of deals in 2020 was 784, slightly lower than the 854 in 2019, but the capital raised per deal was much higher.

Automotive deals had another strong year in 2020. Waymo completed a deal for \$3 billion which accounted for 19.1% of all venture capital raised in 2020. Other companies receiving a large amount of VC investment in 2020 were Rubrik (\$373.5 million), ChargePoint (\$367.25 millions), Netskope (\$340 million), and SentinelOne (\$267 million).

### SOUTH BAY VC CAPITAL RAISED AND DEAL COUNT



Source: Pitchbook; Analysis by Beacon Economics

As we approach the second quarter of 2020, significant deals have already been completed in the South Bay. As early March, SambaNova Systems, in the Business/Productivity Software industry, completed a deal for \$650 million. Other companies receiving a large amount of VC investment so far in 2021 were Lacework (\$525 million), Nuro (\$500 million), Plume (\$270 million), and Next Insurance (\$250 million).

## 2020'S TOP 15 DEALS, SOUTH BAY

Company Name	Deal Date	Deal Size	Primary Industry Code	HQ Location
Waymo	May-20	3,000.00	Automotive	Mountain View, CA
Rubrik	Oct-20	373.50	Systems and Information Management	Palo Alto, CA
ChargePoint	Aug-20	367.25	Energy Infrastructure	Campbell, CA
Netskope	Feb-20	340.00	Network Management Software	Santa Clara, CA
SentinelOne	Nov-20	267.00	Network Management Software	Mountain View, CA
Cohesity	Apr-20	250.00	Database Software	San Jose, CA
Confluent	Apr-20	250.00	Business/Productivity Software	Mountain View, CA
Next Insurance	Sep-20	250.00	Commercial/Professional Insurance	Palo Alto, CA
SambaNova Systems	Feb-20	250.00	Business/Productivity Software	Palo Alto, CA
ThoughtSpot	Aug-20	248.00	Business/Productivity Software	Sunnyvale, CA
NUVIA	Sep-20	239.86	Application Specific Semiconductors	Santa Clara, CA
PsiQuantum	Apr-20	229.70	Computers, Parts and Peripherals	Palo Alto, CA
Carta	Jun-20	210.00	Financial Software	Palo Alto, CA
Fungible	Jan-20	200.00	Systems and Information Management	Santa Clara, CA
QuantumScape	Jun-20	200.00	Electrical Equipment	San Jose, CA

Source: Pitchbook; Analysis by Beacon Economics

## 2021'S TOP 15 DEALS YEAR-TO-DATE (MARCH), SOUTH BAY

Company Name	Deal Date	Deal Size	Primary Industry Code	HQ Location
SambaNova Systems	Apr-21	650.00	Business/Productivity Software	Palo Alto, CA
Lacework	Jan-21	525.00	Network Management Software	San Jose, CA
Nuro	Mar-21	500.00	Road	Mountain View, CA
Plume	Feb-21	270.00	Business/Productivity Software	Palo Alto, CA
Next Insurance	Mar-21	250.00	Commercial/Professional Insurance	Palo Alto, CA
PlusAI	Mar-21	220.00	Road	Cupertino, CA
PlusAI	Feb-21	200.00	Road	Cupertino, CA
TripActions	Jan-21	155.00	Business/Productivity Software	Palo Alto, CA
Clari	Mar-21	150.00	Business/Productivity Software	Sunnyvale, CA
News Break	Jan-21	115.00	Publishing	Mountain View, CA
Redis Labs	Apr-21	110.00	Database Software	Mountain View, CA
Workato	Jan-21	110.00	Business/Productivity Software	Mountain View, CA
BrightInsight	Mar-21	101.00	Enterprise Systems (Healthcare)	San Jose, CA
Ghost	Jan-21	100.10	Automotive	Mountain View, CA
Turntide Technologies	Mar-21	80.00	Electrical Equipment	Sunnyvale, CA

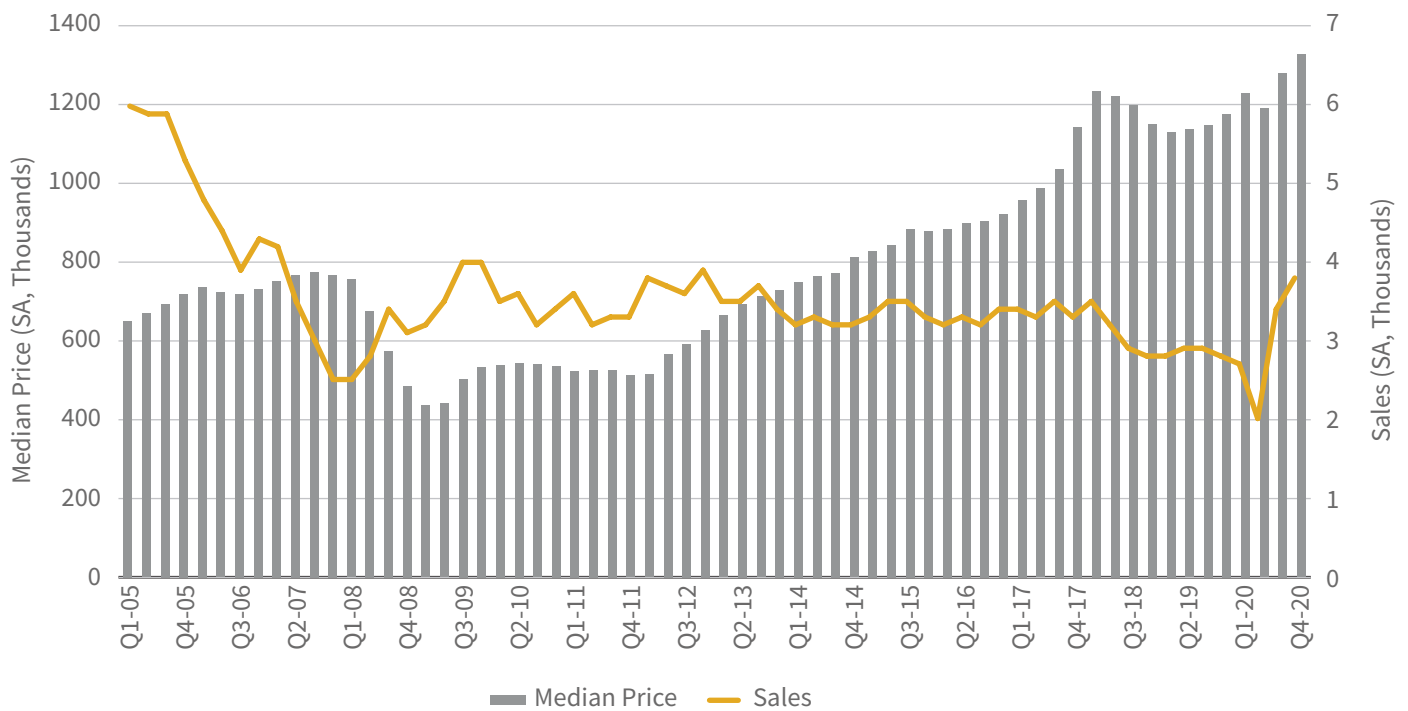
Source: Pitchbook; Analysis by Beacon Economics

## RESIDENTIAL REAL ESTATE

The housing market is by far the brightest spot of the 2020 economy in the South Bay. The strong performance of the region’s housing market is likely driven by three factors. First, typical homebuyers (higher income earners) have been less affected by the labor market fallout. Second, mortgage rates are at historically low levels, spurring purchasing activity. Third, inventories are near historic lows in many parts of the state.

Home prices in the South Bay continue to increase steadily. From the fourth quarter of 2019 to the fourth quarter of 2020, the median single-family home price rose 12.8%. This was in line with growth the East Bay (13.9%) and more robust compared to growth in San Francisco (MD) 7.2%).

### SOUTH BAY SINGLE-FAMILY HOMES



Source: CoreLogic; Analysis by Beacon Economics

Economic stimulus and low interest rates have increased demand for housing in throughout California, however supply has not increased to meet these demands. In February 2021, there were just 2.2 months of supply in Santa Clara County. For context, a balanced market typically equates to 6-7 months of supply; while a buyer’s market equates to 7 months of supply and above; and a seller’s market equates to 6 months of supply and under.<sup>1</sup> These historic low levels of inventory have pushed home prices up by considerable margins over the last year despite the weaknesses in the labor markets and low levels of inflation. That said, the growth in home prices this year is unsustainable, and we should expect interest rates to tick up at some point in 2021.

<sup>1</sup> National Association of Realtors

Demand for homes in the South Bay also remains relatively strong. After sales dropped during the second quarter of 2020 because of the pandemic, they surged in the third and fourth quarters. Indeed, the fourth quarter had the highest level of home sales in the region since 2012. With the strong sale numbers in the third and fourth quarters, existing single-family home sales increased by 4.1% in the South Bay from 2019 to 2020, less than in San Francisco (MD) (494%), but outpaces growth in the East Bay (-0.7%).

The apartment market in the South Bay had a rough year. Vacancy rates grew to 4.5%, a 0.4-percentage-point increase from a year earlier. Effective rents fell a sizeable 8.8% to \$2,397 per unit per month, but that still keeps the South Bay more affordable than in San Francisco (MD) (\$2,682), but more expensive relative to the East Bay (\$2,152). With more companies allowing telecommuting, especially those in the tech space, households have been able to move to more affordable regions of California

2020 was the weakest year for residential construction in the region since 2011. The South issued 2,151 multifamily permits and 1,853 single-family permits in 2020 a change of -35.2% and -24.9% respectively. Continuing to add units to the housing stock of the South Bay will be essential to sustain economic growth in the coming years.

### SOUTH BAY RESIDENTIAL PERMITS



Source: Construction Industry Research Board (CIRB); Analysis by Beacon Economics



## COMMERCIAL REAL ESTATE

While there has certainly been some economic fallout for the commercial real estate market in the Bay Area, the declines are not as severe as headlines would have you believe. More importantly, the declines that have been seen are likely to be temporary in nature. The majority of the declines in the commercial real estate market have been driven by the response to COVID-19, whether these be through public health mandates or changes in consumer behavior to help mitigate the pandemic's health impact. The fundamentals of what will drive long-run growth remain strong, with households seeing minimal losses in income and some households even able to bolster their savings over the last year. As a result, there is a significant amount of pent-up demand for consumer consumption. Once the economy begins to open-up and the health concerns related to COVID-19 begin to wane, the economy and thus the commercial real estate market should recover at a rapid pace in 2021.

Demand for office properties has fallen in the South Bay over the last year. Office vacancy rates in the South Bay increased to 19.3% in the fourth quarter of 2020, up 10.1-percentage-point from a year earlier. Effective rents fell a modest 0.6% over the last year to an annual rate of \$37.35 per square foot, keeping office space in the South Bay more affordable than in San Francisco (MD) (\$40.63), but more expensive relative to the East Bay (\$28.62).

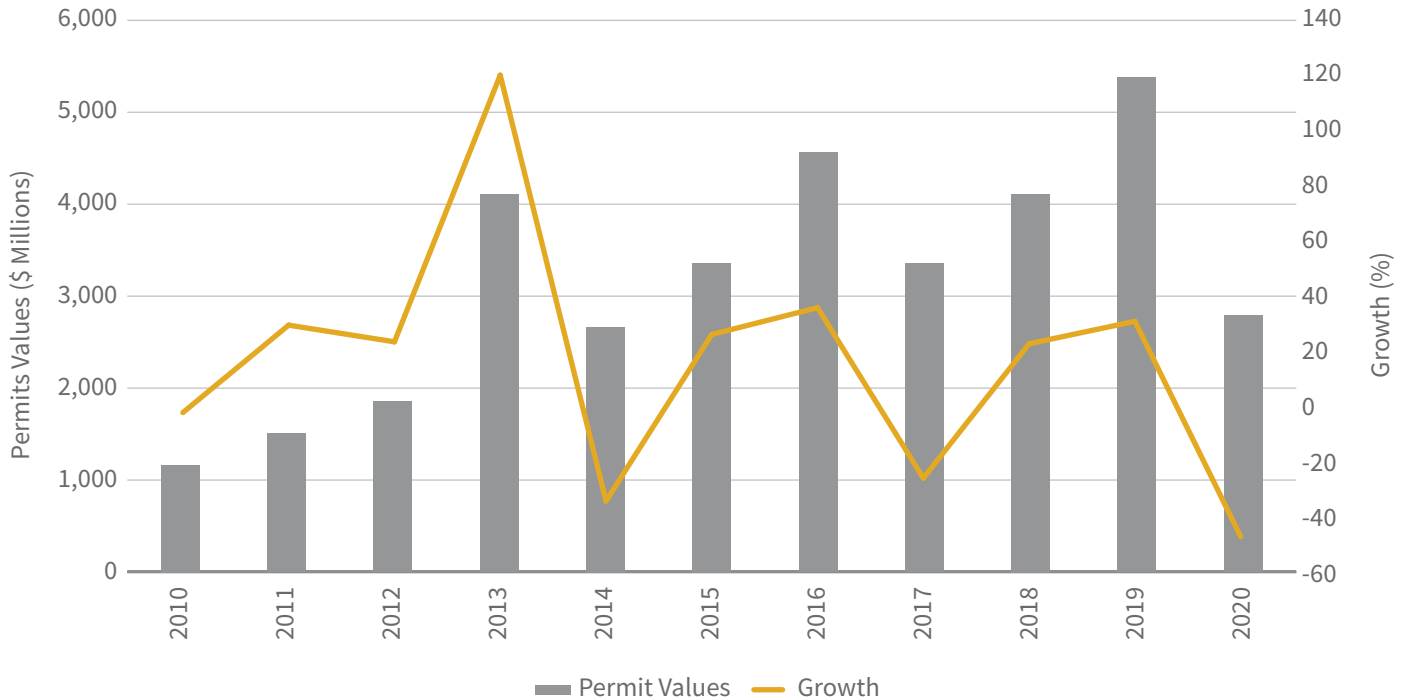
Demand for retail space in the South Bay has also fallen over the last year as a result of the government mandates and consumer reticence amid the COVID-19 pandemic. Retail vacancies in the South Bay grew to 5.7% in the fourth quarter of 2020, a 0.2-percentage-point increase from a year earlier. Effective rents fell 0.6% to an annual rate of \$32.92 per square foot, keeping retail space in the South Bay more affordable than in San Francisco (MD) (\$36.94), but more expensive relative to the East Bay (\$28.33).

Vacancy rates for warehouse properties in the South Bay increased to 9.1% in the fourth quarter of 2020, a 0.8-percentage-point increase from a year earlier. In addition, effective rents grew a modest 1.3% over the last year to an annual rate of \$7.91 per square foot, but that still keeps warehouse space in the South Bay more affordable than in San Francisco (MD) (\$9.66), but more expensive relative to the East Bay (\$6.28).

Vacancy rates for Flex/R&D properties in the South Bay grew to 13.9% in the fourth quarter of 2020, a 1.9-percentage-point decline from a year earlier. Effective rents grew a modest 0.6% over the last year to an annual rate of \$15.96 per square foot, keeping Flex/R&D space in the South Bay more affordable than in San Francisco (MD) (\$16.07), but more expensive relative to the East Bay (\$10.50).

Nonresidential permitting has fallen considerably over the last year, declining 48% from 2019 to 2020. The largest declines were in nonresidential alterations and additions permitting, which totaled just \$1.37 billion during in 2020, off 40.8% from 2019. Permitting for commercial properties, totaled just \$1.27 billion, was 43.7% lower than 2019 levels.

## SOUTH BAY NONRESIDENTIAL PERMITS



Source: Construction Industry Research Board (CIRB); Analysis by Beacon Economics

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