

Despite higher-than-ever demand, Peninsula developers struggle to get housing built

As jobs continue to spring up across the Peninsula, developers are struggling to keep up with the voracious demand for housing.

Consider Pinefino, a 69-unit apartment building in South San Francisco that started leasing at the end of August. It had a waiting list 1,000 people long when construction started, and was fully leased in less than two months. A similar phenomenon is taking place in Belmont, where thousands of people are on a waiting list to buy into Sares Regis' 74-unit condo project when it's done.



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Ali Warner, managing director, Northern Calif. and Pacific N.W. at Greystar.

Despite higher-than-ever demand, many developers face significant roadblocks in securing sites and financing to construct housing across the Peninsula. Sky-high construction costs, a shortage of labor, lengthy entitlement and permitting processes, environmental lawsuits and community pushback can delay a project for years, or make it so financially infeasible it never even gets off the ground.

"We're still in business, but it's very risky. The underwriting today for a new project is much more difficult because fees and land and construction costs are at very high levels," said Robert Freed, the CEO of SummerHill Apartment Communities, which is developing over 2,000 units across the Peninsula.

Ali Warner, managing director of the Northern California and Pacific Northwest markets for Greystar, which has over 5,000 units in its Peninsula pipeline, said in an email, "We estimate construction costs have increased by over 10 percent per year for the last five years. Municipal fees are also significantly higher with some communities carrying fees that make new development challenging."

The tenuous situation has developers studying their bottom lines and asking themselves if it makes more economic sense to build condos or apartments.

The short answer: It depends.

Drew Hudacek, chief investment officer at Sares Regis, said that developers will often decide whether to build condos or apartments based on which one will end up being more lucrative.

Sares Regis has almost 3,000 townhomes, condos and apartments in its Peninsula development pipeline.

"On a certain piece of land, in some towns and in some periods of time, apartments might pay more," Hudacek said. "In the next town over, condos might pay more. It's a matter of economics on the front end."

Hudacek said sometimes developers find creative solutions to economic challenges.

For example, Freed said that SummerHill has been able to make some projects pencil by mixing condos and apartments. SummerHill has a project under construction in Burlingame that consists of 268 apartments and 22 adjacent for-sale townhomes. SummerHill settled on this mixture after the community said it wanted to preserve the long-term-homeowner feel of the neighborhood.

Freed said the townhomes act as a buffer between the single-family homes nearby and the denser apartment project.

However, not all developers have the ability or desire to build both types of housing.

KB Home intends to stay focused on developing condos.

"We've stayed in the for-sale space because it's a model that suits us," said Chris Apostolopoulos, president of KB Home's Northern California division. "It's a different business model and investment strategy, and a different financial strategy" than rentals.

Paul Zeger, founding partner of real estate consulting and marketing firm Polaris Pacific, said that a developer's particular financial needs dictate the type of housing that gets built.

"If my goal is to go long-term and get 6 percent returns, I should build apartments. If I want a 25 percent return on my investment, I should go for-sale," Zeger said.

Zeger added that it is generally less risky to build apartments, because there are always people interested in renting, rents tend to increase with time and the value of apartments over time has remained stable.

Condos may be riskier and their returns less predictable, but Zeger thinks that's where the Peninsula market is heading.

After the 2008 recession, both banks and investors were reluctant to loan the amount of capital required to build condos, which led to a housing market dominated by apartments. As the economy has strengthened, demand for for-sale housing has grown throughout the Bay Area, including on the Peninsula.

In 2015, around 5,000 apartments and 500 condos were delivered in Silicon Valley. Around 4,000 apartments and 500 condos were delivered in 2016. In 2017, Silicon Valley saw 2,000 apartments and 2,000 condos hit the market, according to Polaris Pacific.

Apostolopoulos said there's a simple explanation for the upward tick in condo development:

"Homeownership and the consumer's desire for it is alive and thriving." He added that this trend is visible even among millennials.

Peninsula residents have been considering homeownership more and more, Apostolopoulos said, because “There have been points in time when the monthly rent for an apartment exceeded what a mortgage payment would be.”

Zeger said that it is beginning to make more sense for developers to build condos as well, because the cost of development on the Peninsula has gone up so much that the returns apartments bring no longer justify the investment to build them.

In addition to the economic forces that may be driving the development pendulum to swing towards condos, there are also strong social forces at play.

Suzanne Lo, L.F. George Properties’ project manager of Hillsdale Terraces, a 68-condo site that will soon be under construction in San Mateo, said that part of the reason why LFG decided to develop condos was because the neighbors wanted them to.

“After talking with the community, we saw that condos were much more relevant here, because homeowners wanted to see some type of community and homeowners have more of a stakeholder mentality in the community than apartment dwellers do,” Lo said.

Hudacek, of Sares Regis, said that there is “general fatigue at the city and neighborhood level” when it comes to development. Due to the “long positive economic cycle, the public has the perception there’s been nothing but construction, and they’re sick and tired of construction and all the issues that come with it.”

But whether developers ultimately pursue condos or apartments, there is no question that they are going to have to keep building.

“The fundamental economics of this region are far and away the best in the country,” Apostolopoulos said.