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IN FOCUS:
**SILICON VALLEY, CALIFORNIA –
FROM DOT-COM BUST TO BOOM**

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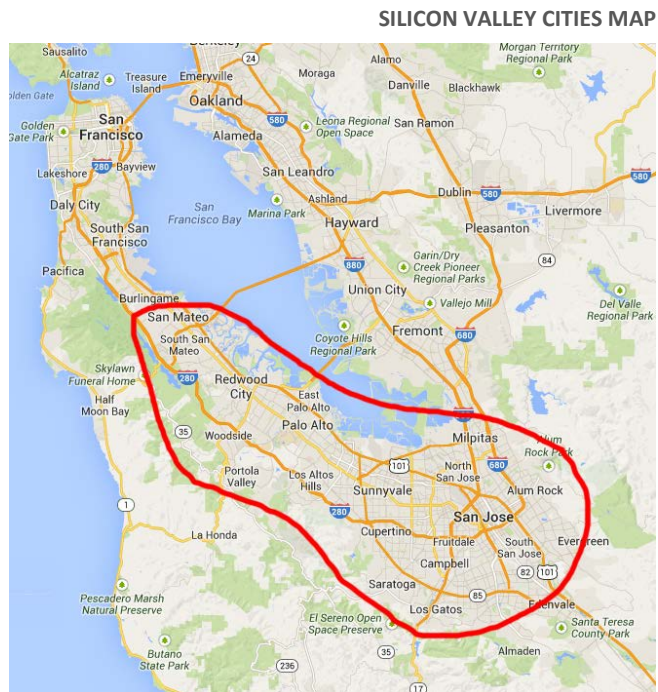




Silicon Valley’s tech firms, venture capital, cleantech companies, and private developers are leading vigorous economic development and growth in the region and giving its lodging market a robust outlook.

Roughly covering the southwestern region of the San Francisco Bay Area, Silicon Valley is home to approximately 2.9 million residents, hundreds of blue-chip technology companies, and thousands of start-ups.¹ The Valley is a leading global hub for high-tech R&D and entrepreneurship, and accounts for 1/3 of all venture capital investment in the United States.²

Its geographical boundaries vary: historically, the area’s core was identified as Santa Clara County with some adjacent portions of San Mateo, Alameda, and Santa Cruz counties. Since 2009, economic development organizations have also included all of San Mateo County in order to reflect the driving industries and employment patterns. In this article, we limit our discussion of Silicon Valley to the following communities, which primarily run along the main thoroughfares of State Highways 101 and 82 (also known as El Camino Real) and Interstate 280: San Mateo, Redwood City, Menlo Park (San Mateo County); Palo Alto, Mountain View, Los Altos, Sunnyvale, Santa Clara, San Jose, Milpitas, Cupertino, Campbell, Saratoga, Los Gatos, (Santa Clara County).



Hotels in Silicon Valley have traditionally been constructed along the spine of the El Camino Real, the historic main connection between these cities. The typical property is older (constructed ±50 years ago) yet well-maintained, and may once have been branded yet is now independently run. Full-service properties are primarily concentrated in Palo Alto and San Jose, with a smattering in between. These locations have enough demand to support upscale developments with higher rates. Clusters in downtown San Jose and Santa Clara have full-service hotels catering to conventions and self-contained group meeting business. The market draws both tech guests and weekend retreaters, with a mix of select- and limited-service and independent boutique hotels throughout.

AREA ECONOMICS

According to Forbes, the San Francisco/San Mateo/Redwood City metro area currently has the strongest economy in the U.S., largely led by the technology and information sectors and robust local housing market. Much the same can be said about the San Jose/Sunnyvale/Santa Clara metro division (Southern Silicon Valley), which holds a #7 ranking on Forbes’ “Best Big Cities for Jobs 2013” list due to 3.4% job

¹ <http://www.siliconvalleyindex.org/index.php/component/content/article?id=101>

² http://en.wikipedia.org/wiki/Silicon_Valley



growth last year and 25% growth in information jobs since 2007.³ Census data also shows that these tech jobs can be highly remunerative – nearly 16% of Silicon Valley residents rank in the richest 5 percent of the country (second in the nation for wealth concentration).⁴

The area’s unemployment rates for August 2013 stood at 6.7% for Santa Clara County and 5.3% for San Mateo County, showing improvement from 8.7% and 6.9% respectively from August 2012. In comparison, California’s overall unemployment rate stands at 8.9% (down from 10.4% from August 2012). The national unemployment rate decreased in August to 7.3%.

MAJOR DEVELOPMENTS

Development activity has not been seen at these levels since the prior peak of the market in the late 1990s (before the dot-com bust). Since the epicenter of that bust was Silicon Valley, that market essentially missed out on the mid-2000’s development cycle. Currently, a number of major developments are planned or underway in Silicon Valley that will significantly reshape the landscape.

Levi’s Stadium

The new \$1.3 billion **Levi’s Stadium** in Santa Clara is on target to open for the San Francisco 49ers’ 2014 season, and has already won the bid to host the Super Bowl in 2016. The stadium will be near the current Santa Clara Convention Center and Great America. A pair of development companies are presently seeking city approval of their plans that could transform the area directly north of Levi’s Stadium into an entertainment hub. Related California’s \$1.5 billion proposal for **City Place Santa Clara** includes 500 housing units, 350,000 ft² of office space, a hotel, and 1 million ft² of retail (includes food and cinema uses). Phase 1 of the project involves 80 of the 215 acres of city owned land that is currently a golf course and bicycle motocross track. Meanwhile, Joe Montana’s Montana Property Group joined with Lowe Enterprises to propose a \$400 million **Centennial Gateway** project that includes a 200-room luxury hotel, office and entertainment on 9.5 city-owned acres directly across the street from the new stadium. The Gateway plan also includes a second, 125-unit hotel in a later phase that could be built as a residential tower if the market demands it. Also notable, the city is studying the “Tasman East Focus Area” (a 45-acre industrial area) for possible conversion to high-density residential with some commercial use in 2015.

DEMAND GENERATORS/ATTRACTIONS
Google
Facebook
Apple
LinkedIn
IBM
Dell
Symantec
Samsung
Santa Clara Convention Center
San Jose Convention Center
Stanford University
NASA Ames Research Center
Santana Row
Great America
SAP Center / San Jose Sharks

Downtown Cupertino Mixed-Use Development

Peter Pau’s Sand Hill Property Company broke ground in September 2013 on the long-awaited \$330 million downtown mixed-use development on 17 acres that includes 130,000 ft² of retail, 260,000 ft² of office space, a park and town square, 120 “live/work” rental lofts, and a 180-room Residence Inn by

³ <http://www.forbes.com/sites/joelkotkin/2013/05/06/americas-best-cities-for-jobs-2013/>

⁴ “Valley No.2 for Wealth Concentration; Median Income Falls,” Lauren Hepler, *Silicon Valley Business Journal*, February 12, 2013.

Marriott. Known as “**Main Street Cupertino**,” the development has excellent timing – Apple recently revealed plans to build a nearby campus that could house up to 14,000 workers.

San Jose McEnery Convention Center

The **McEnery Convention Center** in San Jose recently added 125,000 ft² of exhibit space, conference rooms and ballrooms to its existing 425,000 ft², which should make the expanded facility more competitive for larger events and therefore have a larger economic impact on the city.

North San Jose Office Megaproject

Developer Peery-Arrillaga’s ambitious 2 million ft² **North San Jose office development** on 31 acres next to Norman Y. Mineta International Airport is planned to be built in one phase for completion in fall 2015. As of press time, the mystery tenant(s) had not yet been made public.

Corporate Expansions

New headquarters are being built by no less than **Apple, Facebook, Google, Samsung, LinkedIn, Juniper Networks, and Amazon.com**. **Apple’s** “spaceship” Campus 2 plan in Cupertino recently cleared City Council with unanimous approval. The 2.8 million ft² main building will be one of the largest single office buildings in the world and is expected to cost \$5 billion with completion by mid-2016. **Facebook’s** new 22-acre West Campus in Menlo Park is being designed by Frank Gehry and will feature a rooftop park. **Google** has also been busy building its real estate empire in Mountain View. It moved into the famous “Googleplex” in 2004, and almost 10 years later owns or leases over 8.5 million ft² of office and R&D space in the city. Google is planning two additional campuses from the ground up, and the city is currently considering a plan to allow 3.5 million ft² of additional office development in its North Bayshore area. **Samsung**, the second largest semiconductor manufacturer in the world, broke ground on its North San Jose campus in July 2013. The project is estimated to cost \$300 million and will increase Samsung’s office capacity from 300 to 2,000 employees.

HOTEL SUPPLY

The Silicon Valley lodging supply currently includes approximately 250 properties with over 28,000 guestrooms. As shown in the summary table on the next page, new hotel development is largely clustered in the cities of Palo Alto, San Jose, and Santa Clara, with the greatest development activity and interest occurring in San Jose. While there are a large number of hotel development projects in the pipeline, only 1,134 rooms (or 21%) at nine properties are actively under construction at present. In this development cycle, only about half of the properties (or 2,268 rooms) below have estimated opening dates; as in any development cycle, a proportion of these projects will not get built.

Of those proposed hotels with estimated opening dates, 87% are upscale select-service and extended-stay type hotels, which reflects a similar trend in the types of new hotel construction happening throughout the country. One difference, however: five of those hotels are larger in size (>150 rooms) than the typical select service product, which are prototypically designed with ±120 rooms. This indicates developers have a more bullish outlook on lodging demand in this market to be able to support the higher room counts. Also of note is the handful of full-service and boutique hotel projects proposed for these various markets. Pockets of Silicon Valley are now generating the ADRs that can support these higher cost projects, and demand by sophisticated travelers is strong.

SILICON VALLEY HOTEL DEVELOPMENT SUMMARY

Proposed Property	Product		Est. Open		Developer	Development Stage
	Type	City	Rooms	Date		
Residence Inn by Marriott	ES	Cupertino	180	15-Sep	Sand Hill Property Company	Construction Early 2014
Enchanté Hotel	B	Los Altos	18	15-Apr	The Abigail Company	Under Construction
"North 40 Development" Hotel	TBD	Los Altos	135	-	Grosvenor Americas	Environmental Review
Residence Inn by Marriott	ES	Menlo Park	138	14-Jun	Sand Hill Property Company	Under Construction
Menlo Gateway Hotel	TBD	Menlo Park	230	-	Bohannon Development Company	Early Development
McCarthy Ranch Marketplace Hotel	TBD	Milpitas	240	-	The Torgan Group	Application Pending
Residence Inn Expansion	ES	Mountain View	32	14-Oct	Innkeepers USA Trust (Owner)	Approved
The Village Hotel at San Antonio Center Phase II	TBD	Mountain View	200	-	Merlone Geier Partners/OTO Development	Application Pending
The Clement Hotel	FS	Palo Alto	23	16-Jan	Pacific Hotel Development Venture	Application Pending
The Epiphany Hotel	FS	Palo Alto	86	14-Apr	Joie de Vivre	Under Construction
Staybridge Suites	ES	Palo Alto	147	15-Jun	HG Investment Associates	Early Development
Homewood Suites	ES	Palo Alto	136	14-Jul	Barry Swenson Builder	Under Construction
Hilton Garden Inn	SS	Palo Alto	171	14-Sep	OTO Development	Under Construction
Courtyard	SS	San Jose	157	14-Jan	Hunter Properties	Under Construction
Residence Inn	ES	San Jose	175	14-Jun	Huntington Hotel Group	Under Construction
Springhill Suites	ES	San Jose	146	14-Jun	Huntington Hotel Group	Under Construction
Hampton Inn	SS	San Jose	162	15-Jun	FPG Development Group	Application Pending
Aloft North San Jose	SS	San Jose	175	15-Jan	CalTex Hospitality	Approved
Residence Inn Santana Row	ES	San Jose	110	16-Mar	Shashi Corporation	Early Development
Winchester Boulevard Hotel	TBD	San Jose	160	16-Sep	Winchester Investments	Early Development
Bay 101 Card Room & Hotels (2)	TBD	San Jose	470	-	Bumb Family (Owner)	Early Development
Casino M8trix and Hotel	TBD	San Jose	350	-	Lunardi & Swallow (Owners)	Speculative
Diridon Station Hotels (2)	TBD	San Jose	900	-	Metro. Transportation Commission	Speculative
Towneplace Suites	ES	Santa Clara	107	14-Jan	TMH Hotels	Under Construction
Centennial Gateway Ph.1 Hotel	TBD	Santa Clara	200	-	Montana Property/Lowe	Early Development
Centennial Gateway Ph.2 Hotel	TBD	Santa Clara	125	-	Montana Property/Lowe	Early Development
City Place Hotel	TBD	Santa Clara	200	-	Related California	Early Development
Courtyard by Marriott	SS	Sunnyvale	145	15-Jan	T2 Development	Early Development
Sheraton Expansion	FS	Sunnyvale	134	-	Archon Group (Owner)	Early Development
Total Hotel Projects			5,452	Rooms		
Total Under Construction			1,134	Rooms		
Percent of Total Projects Under Construction			21%			

Key: FS=Full Service
 ES=Extended Stay
 SS=Select Service
 B=Boutique

Source: HVS

HOTEL MARKET PERFORMANCE

An HVS survey of select lodging facilities in the San Jose/Central-Southern Silicon Valley market achieved an average occupancy of 72% with an ADR of \$145, representing a year-over-year increase from 2011 of 4 percentage points and 9%, respectively. The market's 2012 average RevPAR was \$105, an increase of approximately 16% over the previous year. HVS projects average occupancy to remain near 77% for 2013, but to decline in 2014 due to the influx of newly constructed hotel rooms coming online. San Jose marketwide ADR for 2013 is running at approximately \$159. Year-end RevPAR for 2013 is estimated at \$122, reflecting an increase of more than 16% over 2012 levels. Average rate growth through 2014 is expected to remain robust at ±8.0%.

In 2012, select-service hotels in Palo Alto/Northern Silicon Valley operated at an average occupancy of 82% with an ADR of \$181 (representing a year-over-year increase from 2011 of 1 percentage point and 9%, respectively). Average 2012 RevPAR was \$148, an increase of 12% over the previous year. HVS projects average occupancy for 2013 to remain close to 83% at \$197 ADR and \$162 RevPAR, with positive ADR (+8%) and RevPAR (+10%) trends to continue through 2014. By comparison, full-service hotels operated at a slightly lower average occupancy of 80% with a higher ADR of \$213 in 2012, representing a

year-over-year increase from 2011 of 2 percentage points and 10%, respectively. That market's 2012 average RevPAR was \$170, an increase of 12% over the previous year. HVS projects average occupancy for 2013 to remain near 80% at \$232 ADR with \$186 of RevPAR. Positive ADR (+8%) and RevPAR (+5%) trends are projected to continue through 2014.

According to the California Lodging Industry Performance jointly published by CH&LA and STR, the San Francisco/San Mateo achieved occupancy of 83.8% and ADR of \$186.00, resulting in a RevPAR of \$155.87 for the 9 month period through September 2013. This hotel market has the 2nd highest occupancy rate in the state and the 4th highest ADR. (The San Jose/Campbell market year-to-date for September 2013 shows occupancy at 74.8% with an ADR of \$131.24 and RevPAR of \$98.20.) The San Jose hotel market ranks 8th in the state for occupancy levels, and 11th for ADR.

RevPAR growth is driven primarily by ADR growth as markets sustain peak occupancy levels, with extensive extended-stay demand driven by the tech industry. With the RevPAR performance of the markets' select-service hotels close to those of the full-service set, it is not surprising that so much of the new hotel development in the market is being geared toward the upscale select-service and extended-stay segments, particularly given the lower construction costs typically associated with these types of developments.

RECENT TRANSACTIONS

Hotel transactions in this market have increased significantly over the last few years due to the favorable financing environment. (When compared to hotel pricing in the city of San Francisco, where recent sales prices have regularly exceeded \$250,000 per room, these prices reflect a relative value for prospective buyers looking to enter the Bay Area/Silicon Valley hotel real estate market.) It is also interesting to note that these sales prices are largely below the per key development costs for many of the new development projects previously discussed. (HVS compiles hotel development cost data from numerous market and feasibility studies for projects.) Per room development costs in the the Silicon Valley market exceed \$200,000 per room for select service hotels inclusive of land and entitlement costs. Given the pricing levels of the following hotel transactions, it appears savvy investors are still able to find value opportunities for hotel real estate in the Silicon Valley market.

Notable transactions include the sale of four high quality full-service hotels, all of which sold encumbered with brand and management. The remainder of sales were of smaller independent hotels and several branded mid-tier and economy assets. (The Silicon Valley hotel market is unique in the high number of independent hotel transactions relative to those for branded properties.) Several of these independent hotels are older properties that have been able to extend their economic life as "boutiques" because of the strength of demand and the lack of new supply during the mid-2000's development cycle. These may become more challenged as new branded properties enter the market.

Another interesting transaction is the Holiday Inn & Suites which achieved a relatively high price per room for an older property in this market. However, it was purchased with the Comfort Inn San Francisco Airport South as part of a portfolio, which, when both properties are factored together, moderates the price to \$125,000 per room. The two hotels will be converted into one Holiday Inn & Suites.

SILICON VALLEY HOTEL TRANSACTIONS 2008-2013

Name	Location	Sale Date	Buyer	Rooms	Price	Price/Room	Est. Cap Rate
Hyatt Regency	Santa Clara	13-Sep	Inland American Lodging Group	501	\$93,000,000	\$185,629	6.70%
Holiday Inn & Suites	San Mateo	13-Aug	Urban Commons LLC	110	21,750,000	197,727	
Comfort Inn SFO South	San Mateo	13-Aug	Urban Commons LLC	110	5,750,000	52,273	
Travelodge	Palo Alto	13-Jul	Palo Alto Motel LLC	29	3,750,000	129,310	
Marriott	San Jose	13-May	CBRE Strategic Partners	506	85,295,000	168,567	6.20
San Jose Airport Hotel	San Jose	13-May	Urban Commons/Brighton Management	196	15,200,000	77,551	
Fontaine Inn	San Jose	13-Feb	AMBA Hotel LLC	54	4,175,000	77,315	10.99
Caravelle Inn & Suites	San Jose	12-Dec	T & V Investment	50	3,000,000	60,000	
Pacific Hotel Lodge (Hotel Vue)	Mountain View	12-Nov	MV Hospitality	57	5,700,000	100,000	
Sofitel San Francisco Bay	Redwood City	12-May	Lodging Capital Partners/Prudential Real Estate Advisors	421	92,500,000	219,715	6.10
Valley Park Hotel	San Jose	12-Feb	Tri-Lin Holdings LLC	55	7,000,000	127,273	7.60
Sainte Claire	San Jose	11-Dec	Wolff Urban Developments LLC	170	17,000,000	99,415	
Toll House Hotel	Los Gatos	11-Dec	MetWest Terra Hospitality	115	15,000,000	130,435	
Corporate Inn	Sunnyvale	11-Nov	Corporate Residential LLC	73	8,800,000	120,548	
Cypress Hotel	Cupertino	11-Oct	CH Cupertino Owner LLC	224	56,500,000	252,232	7.00
La Quinta Inn Airport	San Jose	11-May	Chic Hospitality LLC	148	10,300,000	69,595	
Stanford Terrace Inn	Palo Alto	10-Oct	Fortune Sun Inc.	80	14,525,000	181,562	5.50
Summit Hotel	San Jose	10-Jul	360 Global Venture LLC	208	10,500,000	50,481	

Source: HVS

CONCLUSION

The prevalence of biotech and high-tech firms, startup venture capital, plus emerging cleantech companies, places Silicon Valley in an advantageous position for future economic development and growth. Furthermore, the capital invested in state-of-the-art technology and infrastructure for such companies is an indication of investors' long-term confidence in the market.

Overall, the outlook for the Silicon Valley market is strong, supported by the expansion of several key employers. Increased office space will generate additional lodging demand from visitors contracting and doing business with corporate tenants and increase overall commercial travel. The recent expansion of the San Jose Convention Center, the upcoming opening of the new Levi's Stadium in Santa Clara, and the multiple planned retail and entertainment developments, are expected to induce lodging demand into the market which will support the numerous proposed hotel projects. The ultimate balance between supply and demand will depend upon the timing of the area's substantial projects proposed over the next decade.



About HVS

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