

San Diego Multifamily

Larger Sales Lead the Way at the Close of 2018

Highlights

- > The San Diego multifamily market recorded strong renter demand and even more robust supply growth in 2018. The vacancy rate crept higher, while rent growth was strong throughout the year, with the greatest gains recorded in the second half.
- > Vacancy rose 50 basis points in 2018, ending the year at 4 percent. The market recorded a 10-basis-point uptick during the fourth quarter.
- > Despite some upward pressure on vacancy, local rents rose at their fastest rate since 2015. Asking rents in San Diego spiked by 5.4 percent in 2018, reaching \$1,822 per month.
- > The investment market strengthened at the end of 2018, with activity accelerating, cap rates compressing, and the median price spiking.

San Diego Multifamily Market Overview

In 2018, the San Diego multifamily market was marked by strong renter demand and an active period of new apartment construction. Developers delivered nearly 3,900 units to the market in 2018, the highest annual total in more than a decade. As a result, the local vacancy rate ticked higher, although increases were generally concentrated in submarkets where the most new units came online. Downtown San Diego was the clearest example of this trend. Outside of Downtown, most submarkets in San Diego are recording strong operating performance, with vacancy rates in the low- to mid-single digits and rents trending higher.

Market Indicators

Quarterly Changes	4Q/2018
Vacancy	↑
Rents	↑
Transaction Activity.....	↑
Price Per Unit.....	↑
Cap Rates	↓

Summary Statistics

San Diego Market

Vacancy Rate.....	4.0%
- Change from 4Q 2017 (bps).....	+50
Asking Rents (per month).....	\$1,822
- Change from 4Q 2017.....	5.4%
Median Sales Price (Per unit YTD).....	\$241,900
Average Cap Rate (YTD).....	4.6%

San Diego Multifamily Market Overview (cont.)

Sales of apartment buildings closed 2018 on an upswing, with transaction activity accelerating and prices pushing higher during the fourth quarter. The bulk of the sales transactions in 2018 occurred in suburban areas including Escondido and San Marcos. The median price surged by approximately 20 percent from 2017 to 2018, and cap rates

compressed into the mid-4-percent range. The transactions that closed in the second half of the year were generally larger—with the bulk of the activity taking place in complexes with more than 150 units—after several properties with 50-100 units changed hands at the beginning of 2018.

Submarket Statistics

Submarket Name	4Q 2018 Vacancy	4Q 2017 Vacancy	Annual Vacancy Change (BPS)	4Q 2018 Rents	4Q 2017 Rents
El Cajon/Santee/Lakeside	1.8%	2.1%	(30)	\$1,342	\$1,291
Mission Bay/Pacific Beach	1.8%	2.3%	(50)	\$1,913	\$1,830
San Diego/East of I-15	2.0%	2.2%	(20)	\$1,362	\$1,313
Escondido/San Marcos	2.2%	2.3%	(10)	\$1,538	\$1,487
North Beaches	2.6%	1.8%	80	\$1,884	\$1,826
National City/Chula Vista	2.8%	2.2%	60	\$1,588	\$1,519
La Mesa/Spring Valley/Lemon Grove	2.9%	2.9%	-	\$1,741	\$1,682
Oceanside	3.4%	3.2%	20	\$1,713	\$1,609
La Jolla/University City	3.5%	3.5%	-	\$2,436	\$2,274
Mira Mesa/Rancho Bernardo	4.0%	2.8%	120	\$2,239	\$2,133
Balboa Park/West of I-15	4.1%	3.5%	60	\$1,435	\$1,350
Vista	4.5%	4.2%	30	\$1,611	\$1,520
Ocean Beach/Point Loma Blvd.	5.3%	4.4%	90	\$1,849	\$1,800
Clairemont/Linda Vista Mission	6.4%	5.6%	80	\$1,953	\$1,850
Downtown San Diego	11.5%	10.4%	110	\$2,383	\$2,202

Employment

- > Employment growth in San Diego was steady in 2018, with employers adding 27,700 jobs, a 1.9 percent increase. This figure closely matched the total job growth from 2017.
- > The education and health services sector has been a consistent source of job growth over the past several years. In 2018, the sector expanded 3.3 percent with the addition of 6,900 new jobs. During the past five years, nearly 32,000 education and health services jobs have been added.
- > With the economy strengthening, business and leisure travel is on the rise. Employment in the local leisure and hospitality sector expanded 3.2 percent in 2018 with the addition of 6,200 new jobs.
- > **Forecast:** Employers are forecast to add approximately 25,000 new jobs in 2019, a growth rate of 1.7 percent. This is a continuation of growth trends from the past several years.

Employment Overview



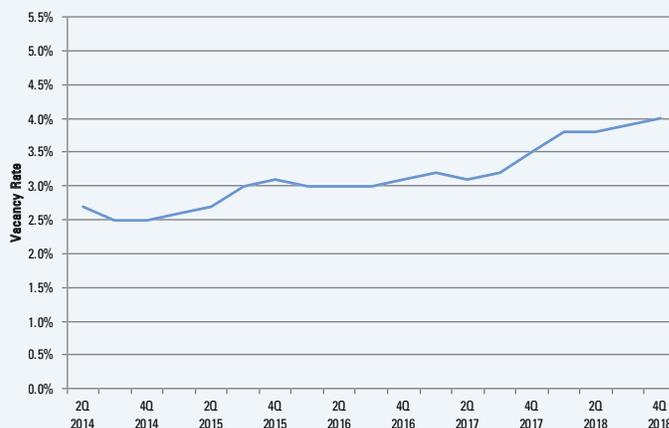
Sources: NorthMarq, Bureau of Labor Statistics

Employers added 27,700 jobs in 2018, a 1.9 percent increase

Vacancy

- > Vacancy in the San Diego multifamily market inched higher during the fourth quarter, ticking up 10 basis points to 4 percent. The rate rose 50 basis points in 2018, after remaining in the low- to mid-3 percent range in 2016 and 2017.
- > The vacancy increases recorded in 2018 were almost entirely in the Class A segment of the market as new product was delivered to the market. The Class A vacancy rate rose 80 basis points in 2018, ending the year at 6.1 percent.
- > The vacancy rate for apartments in Class B and Class C buildings has remained quite low for the past several years, ending 2018 at just 2.4 percent.
- > **Forecast:** Construction of new units is forecast to be active again in 2019, creating supply-side pressures that will likely drive a modest uptick in the local vacancy rate. Vacancy is forecast to tick up 30 basis points this year to 4.3 percent.

Vacancy Trends



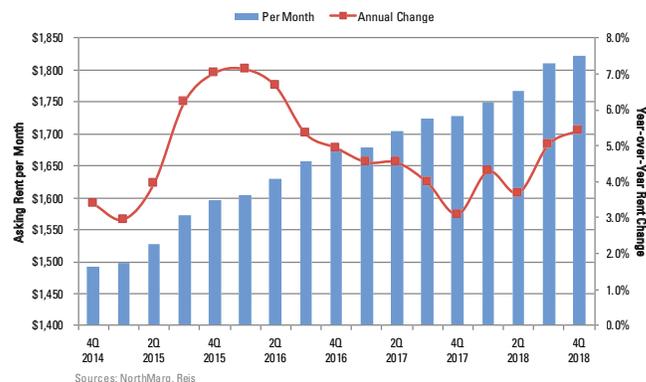
Sources: NorthMarq, Reis

The vacancy increases in 2018 were almost entirely in the Class A segment of the market

Rents

- > Rents continued to rise during the fourth quarter, closing out a year of strong gains. Asking rents rose 5.4 percent in 2018, reaching \$1,822 per month. Growth was strongest in the second half, rising 3.1 percent in the final six months of the year.
- > The newer product entering the market is driving up rents in the Class A segment. Asking rents in Class A units rose nearly 6 percent in 2018, topping \$2,200 per month.
- > Rents in the most expensive submarkets posted some of the strongest gains in 2018. Asking rents in the La Jolla/University submarket rose more than 7 percent in 2018, ending the year at \$2,239 per month.
- > **Forecast:** Asking rents are forecast to rise an additional 4.5 percent in 2019, with demand expected to remain strong and newer units continuing to command higher rents. Asking rents are expected to top \$1,900 per month by year end.

Rent Trends

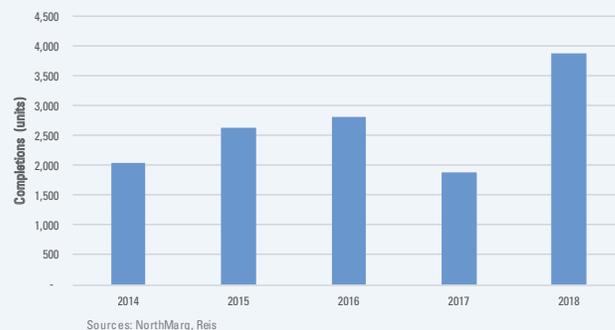


Asking rents in Class A units rose nearly 6 percent in 2018

Development and Permitting

- > Apartment construction was active in 2018, with developers bringing approximately 3,900 new units to the market for the year, more than doubling the completions from the preceding year.
- > Supply growth is forecast to remain elevated in the next two years. There are currently more than 5,000 apartment units under construction in the San Diego metro area.
- > Projects totaling approximately 2,500 units are currently under way in the Downtown San Diego submarket alone. The inventory of apartments in the Downtown submarket has expanded more than 35 percent since 2014.
- > **Forecast:** Developers are expected to complete approximately 4,400 apartment units in San Diego in 2019, an increase of 13 percent from the completions volume in 2018.

Development Trends



There are currently more than 5,000 apartment units under construction in the San Diego metro area

Multifamily Sales

- > Sales velocity accelerated during the fourth quarter, although total transaction activity in 2018 was down about 30 percent from 2017 levels. The greatest uptick in transactions was in complexes of 150 units or more.
- > With activity picking up, sale prices rose to close 2018. The median price during the fourth quarter was \$277,400 per unit. The median price for all of 2018 was \$241,900 per unit, up 23 percent from the median price in 2017.
- > Cap rates compressed, averaging approximately 4.6 percent in 2018. Cap rates were in the mid-4-percent range during the fourth quarter.

Investment Trends



With activity picking up, sale prices rose to close 2018

Recent Transactions in the Market

MULTIFAMILY SALES ACTIVITY

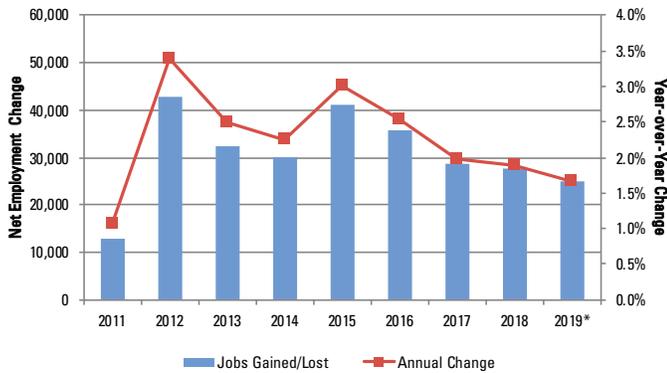
Property Name	Street Address	Units	Sales Price	Price/Unit
Marc	1045 Armorldite Dr., San Marcos	416	\$141,500,000	\$340,144
Veranda La Mesa	5401 Baltimore Dr., La Mesa	405	\$99,400,000	\$245,432
Avalon Fashion Valley	7084-7148 Friars Rd., San Diego	161	\$70,750,000	\$439,441
Barham Villas	570 E Barham Dr., San Marcos	168	\$52,200,000	\$310,714
Hidden Hills	311 Weston Cir., Vista	154	\$41,000,000	\$266,234

Looking Ahead

The San Diego multifamily market is likely to record strong supply growth and continued apartment demand growth in 2019. Development has been active since 2013, with developers bringing more than 15,000 units to the market in that time, including deliveries of approximately 3,900 apartments in 2018. Renter demand has been sufficient to offset much of the new inventory, with absorption averaging approximately 2,000 units per year. With deliveries likely to outpace net absorption in 2019, the vacancy rate is expected to trend higher by year end. This will likely be a trend that only lasts another 18-24 months. The development pipeline is projected to thin beginning in 2020, and vacancy should begin to tighten by the end of next year.

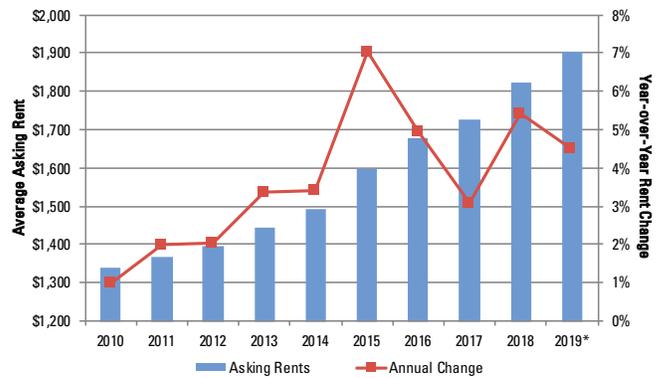
While the number of properties that change hands in 2019 will depend on which properties are listed and is therefore difficult to forecast, the investment market should remain quite healthy. In 2018, prices rose and cap rates compressed. While cap rates are unlikely to inch much lower in the year ahead, prices could tick higher as rents are trending up and investor demand is likely to remain elevated. With developers bringing thousands of units to the market, some of these newer projects could begin to sell. A handful of newer projects have traded in recent years, at prices in excess of \$300,000 per unit.

Employee Forecast



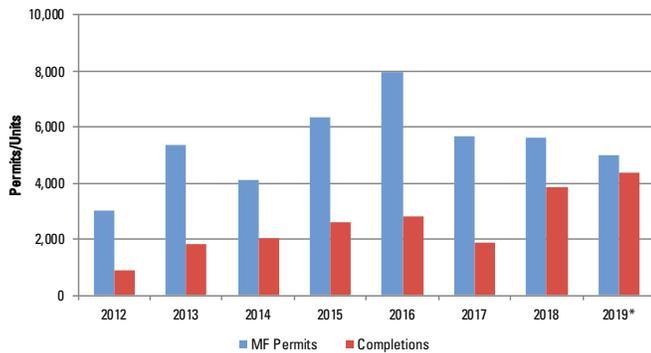
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



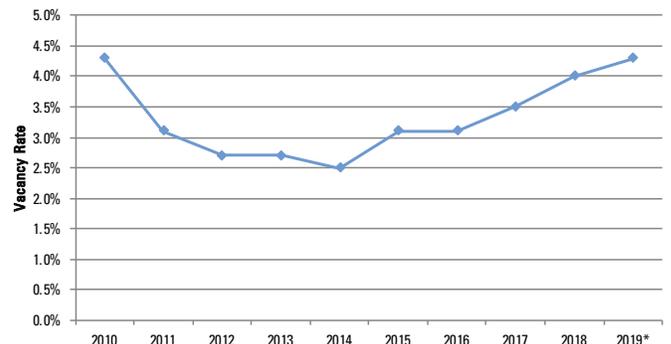
* Year End Forecast
Sources: NorthMarq, Reis

Construction & Permitting Forecast



* Year End Forecast
Sources: NorthMarq, Census Bureau, Reis

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Reis

About NorthMarq

As a capital markets leader, NorthMarq offers commercial real estate investors access to experts in debt, equity, investment sales, and loan servicing to protect and add value to their assets. For capital sources, we offer partnership and financial acumen that support long- and short-term investment goals. Our culture of integrity and innovation is evident in our 60-year history, annual transaction volume of \$13 billion, loan servicing portfolio of more than \$55 billion and the multi-year tenure of our more than 500 people.

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