MARKET REPORT | 2Q/2019

San Diego Multifamily

NORTHMARQ

Vacancy Tightens, but Deliveries to Pick Up in the Second Half

Highlights

- Multifamily property fundamentals in San Diego improved during the second quarter. Vacancy inched lower, rents rose, and employment growth fueled absorption of units.
- Vacancy dipped 10 basis points in the second quarter, falling to 3.8 percent. The rate is down 20 basis points year to date. Vacancy has ranged between 3 percent and 4 percent since the second half of 2015.
- Asking rents in San Diego rose 1.1 percent in the second quarter and are up 4.7 percent from one year ago. Current asking rents are $1,850 per month.
- Despite the market's strong performance, fewer multifamily properties sold in the second quarter than changed hands during the first quarter. The median price in transactions year to date is approximately $258,200 per unit, while cap rates have averaged 4.7 percent. Both measurements are nearly identical to 2018 figures.

Q2 Snapshot	San Diego Market
Market Fundamentals	
Vacancy	**3.8%**
- Year Over Year Change	**0**
Asking Rent	**$1,850**
- Year Over Year Change	**+4.7%**
Transaction Activity	
Median Sales Price Per Unit (YTD)	**$258,200**
Cap Rates (Avg YTD)	**4.7%**
Construction Activity	
Units Under Construction	**4,932**
Units Delivered YTD	**1,055**

San Diego Multifamily Market Overview

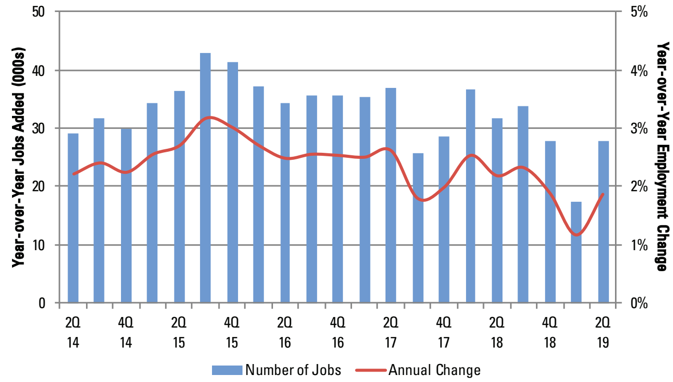
The San Diego multifamily market posted two consecutive strong quarters to start 2019. After slowly creeping higher for much of 2018, the local vacancy rate inched down 10 basis points in both the first and the second quarters. Part of the improvement has been fueled by a healthy pace of hiring, which has supported renter demand for units. In addition to the uptick in demand, apartment supply growth has been modest thus far in 2019, but there are several projects under way and scheduled to come online before the end of this year.

While market fundamentals continued to improve during the second quarter, investment activity slowed. The dip in sales velocity in the second quarter was most pronounced in transactions in excess of $50 million; transaction activity in building sales priced between $10 million and $30 million closely tracked levels recorded during the first quarter. Even with fewer properties changing hands, pricing has been stable, with the median price year to date nearly identical to the median price from 2018. Cap rates averaging approximately 4.7 percent are also quite similar to the 2018 average.

Employment

- Employers stepped up their pace of hiring in the second quarter. Year over year, total employment in San Diego grew by 1.9 percent, with the addition of 27,800 new jobs.
- High-wage industries have been leading the way in recent quarters. The professional and business services sector has added 8,000 new jobs in the past year, expanding by 3.2 percent.
- In addition to white-collar professional jobs, growth has also been concentrated in the education and health services sector. Total employment in the sector grew by 7,400 new positions during the past 12 months, a growth rate of 3.6 percent.
- **Forecast:** Employers in San Diego have been growing payrolls at a steady pace. This year, total employment is forecast to expand by 1.9 percent with the addition of 28,000 jobs. Gains have averaged approximately 30,000 net new jobs per year during the past three years.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

High-wage industries have been leading the way in recent quarters

Vacancy

- Multifamily vacancy in San Diego inched lower during the second quarter, dipping 10 basis points from the first quarter to 3.8 percent. The rate is down 20 basis points from the end of 2018.
- The current vacancy rate is identical to the rate from one year earlier. The rate gradually inched higher in 2016 and 2017 but has leveled off in recent quarters.
- Vacancy in the southern portion of the San Diego market is generally very low. The vacancy rates in areas such as the Chula Vista and La Mesa/Spring Valley submarkets are generally in the low- to mid-2-percent range. Conditions in these submarkets are likely to remain favorable for property owners as only modest competition from new development is expected in these areas.
- **Forecast:** With construction scheduled to accelerate in the second half of the year, vacancy is forecast to tick higher and end 2019 at 4.1 percent, 10 basis points higher than at the end of last year.

Vacancy Trends

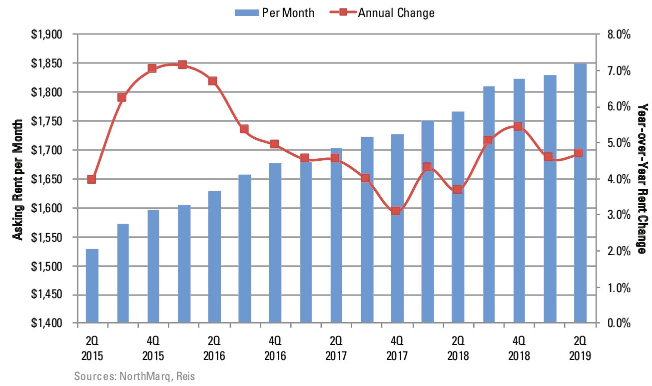
Sources: NorthMarq, Reis

The vacancy rate is down 20 basis points from the end of 2018

Rents

- Asking rents rose 1.1 percent during the second quarter, following an increase of just 0.4 percent during the first quarter. Quarterly rent increases have averaged 1 percent since the beginning of 2017.
- Year over year, asking rents in San Diego are up 4.7 percent to $1,850 per month. Annual rent growth has averaged 4.8 percent for the past five years.
- After rising 5 percent in 2018, rents in Class A properties trended higher at a more measured pace during the first half of this year. Class A asking rents ended the second quarter at $2,263 per month, up 1.6 percent year to date.
- **Forecast:** This year is forecast to be one of steady rent growth. Asking rents are expected to rise 4 percent in 2019, ending the year at approximately $1,895 per month.

Rent Trends

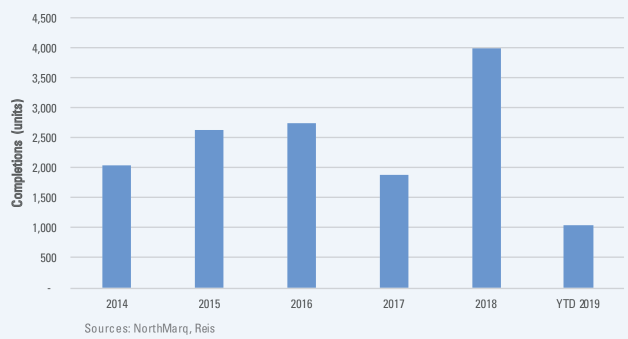


Year over year, asking rents are up 4.7 percent to $1,850 per month

Development and Permitting

- After more than 1,000 units were delivered in the first quarter, completions were minimal during the second quarter. Apartment completions in the first half were down more than 50 percent when compared to deliveries in the first half of 2018.
- The development pipeline includes approximately 4,900 apartment units that are currently under construction. More than half of the units currently under construction are located in the Downtown San Diego submarket.
- Multifamily permitting gained momentum during the second quarter, with permits pulled for nearly 2,000 units. Despite the recent rise, permitting for multifamily units in the first half of this year was down more than 40 percent from the same period in 2018.
- **Forecast:** Developers are forecast to complete 4,200 apartment units in the San Diego market in 2019, a 5 percent increase from last year. Annual deliveries in San Diego have averaged approximately 2,700 units during the past five years.

Development Trends

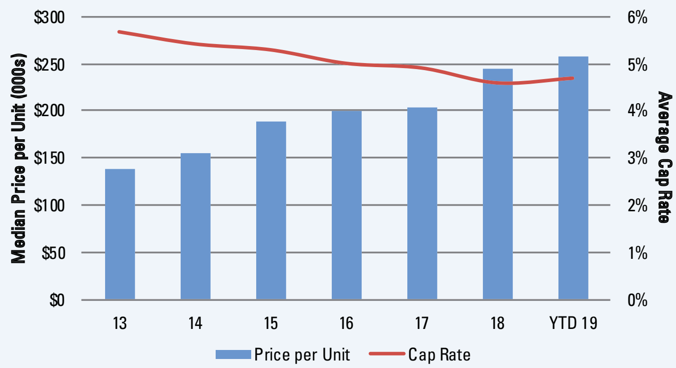


Completions in the first half of 2019 were down more than 50 percent from the first half of 2018

Multifamily Sales

- After a healthy start to the year, sales velocity slowed by approximately 50 percent during the second quarter. The number of sales in the first half of 2019 is down 18 percent when compared to the first half of last year.
- Year to date, the median price is approximately $258,200 per unit, nearly identical to the median price in 2018. In sales of properties built since 2000, the median price thus far in 2019 is approximately $377,000 per unit; in 2018, the median price in the sales of these newer properties was $344,000 per unit.
- Cap rates are closely tracking levels from 2018. The average cap rate in transactions that have closed to this point in the year is 4.7 percent.

Investment Trends



Sources: NorthMarq, CoStar

Cap rates are closely tracking levels from 2018

Recent Transactions in the Market

MULTIFAMILY SALES ACTIVITY

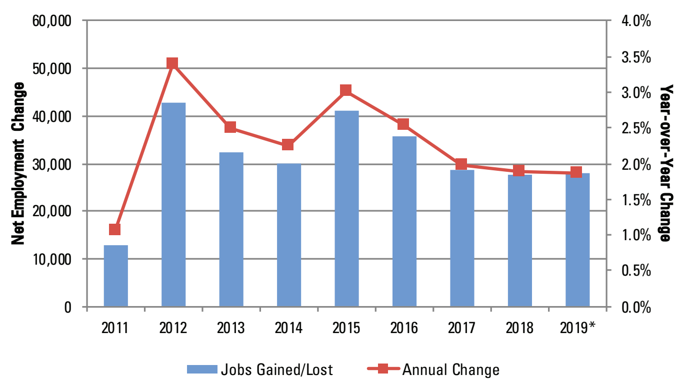
Property Name	Street Address	Units	Sales Price	Price/Unit
Hanover Mission Gorge	4440 Twain Ave., San Diego	374	$149,000,000	$398,396
The Springs	8070 Orange Ave., La Mesa	129	$28,300,000	$219,380
Vista Pacific	1035 4th Ave., Chula Vista	55	$14,200,000	$258,182

Looking Ahead

Following a strong start to 2019, the San Diego multifamily market is expected to be impacted by an increase in new development during the second half of the year. Projects totaling approximately 3,000 units are on track to be delivered in the coming quarters, which could put some upward pressure on vacancy in a few areas in the San Diego market. The submarket that is likely to be most impacted by supply growth is Downtown, where vacancy is already in the double digits. The vacancy rate in areas outside of Downtown is expected to end the year ranging between 3 percent and 5 percent.

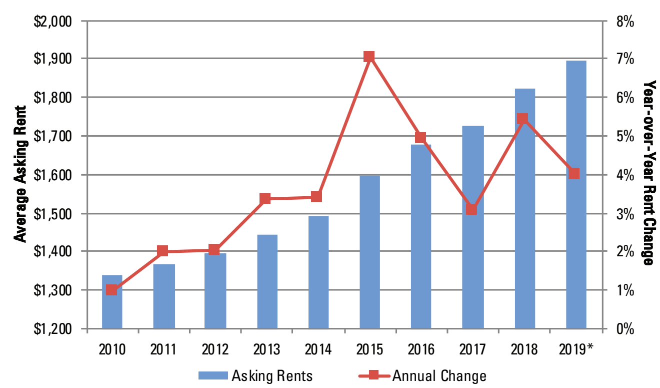
Investment conditions are expected to remain favorable in the coming quarters, although there could be a few periods of inconsistent activity levels as the market assesses the competitive impact of new development. After a very active end to 2019, deliveries should slow beginning in 2020, and the market vacancies and rents should stabilize. Consistently low vacancy rates are a primary driver of the investment market in San Diego, and once the new inventory is absorbed, sales velocity will likely regain momentum. In sales that do occur, low interest rates should support private capital transactions and keep cap rates below 5 percent.

Employment Forecast



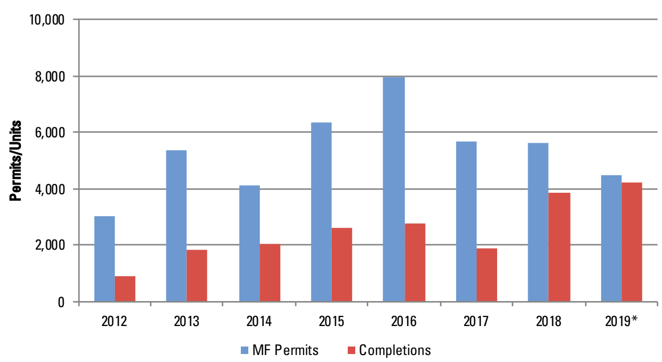
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



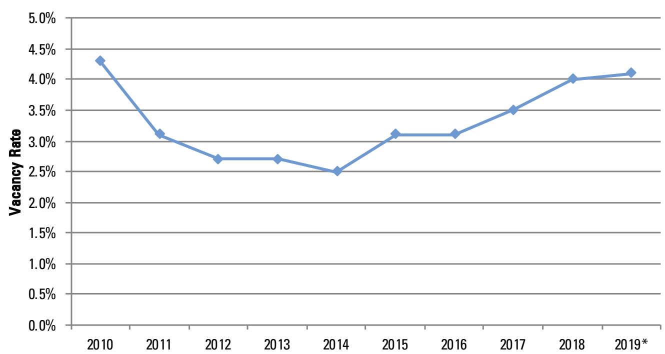
* Year End Forecast
Sources: NorthMarq, Reis

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.

For more information, contact:

Kyle Pinkalla
MANAGING DIRECTOR – INVESTMENT SALES
858.675.7865
kpinkalla@northmarq.com

Eric Flyckt
SVP, MANAGING DIRECTOR – DEBT & EQUITY
858.675.7640
eflyckt@northmarq.com

Shane Shafer
SVP, MANAGING DIRECTOR – INVESTMENT SALES
949.270.3690
sshafer@northmarq.com

Trevor Koskovich
PRESIDENT – INVESTMENT SALES
T 602.952.4040
tkoskovich@northmarq.com

Pete O'Neil
DIRECTOR OF RESEARCH
602.508.2212
poneil@northmarq.com

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