San Diego Multifamily

NORTHMARQ

Vacancy Ticks Higher, Remains Tight in Suburban Areas

Highlights

- The San Diego multifamily market softened somewhat during the third quarter. Vacancy rose and rents dipped following stable property conditions during the first half of the year.
- Vacancy rose 20 basis points during the third quarter, reaching 4 percent. Vacancy rates in less costly suburban areas outside of the city of San Diego are generally tighter, averaging between 2 percent and 3 percent.
- Asking rents dipped 1.2 percent in the third quarter. Year over year, asking rents are down 0.5 percent at $1,868 per month.
- The multifamily investment market included just a handful of transactions during the third quarter. The median price was approximately $244,300 per unit through the first three quarters, and cap rates have averaged 4.2 percent.

Q3 Snapshot	San Diego Market
Market Fundamentals	
Vacancy	**4.0%**
- Year Over Year Change	**+20 bps**
Asking Rent	**$1,868**
- Year Over Year Change	**-0.5%**
Transaction Activity	
Median Sales Price Per Unit (YTD)	**$244,300**
Cap Rates (Avg YTD)	**4.2%**
Construction Activity	
Units Under Construction	**6,897**
Units Delivered YTD	**1,139**

San Diego Multifamily Market Overview

Apartment fundamentals in the San Diego metro area softened during the third quarter with vacancy inching higher and rents falling back a bit. The local labor market has begun to bounce back, but jobs are being added at a far slower pace than they were initially cut during coronavirus shutdowns. If the current pace of additions is maintained, it will take several more quarters for total employment to return to pre-COVID levels. While job losses have dragged on renter demand, apartment supply growth in 2020 will come in below levels from the past few years, keeping vacancy near long-term ranges. Despite economic cycles, San Diego is generally one of the most consistent markets in the country, and any further softening will likely be short-lived.

Investment activity in San Diego started to regain momentum late in the third quarter, but transaction volume levels are still trailing the 2019 pace. The slowing activity is a natural reaction to the uncertainty brought into the market by the coronavirus outbreak. Despite limited sales velocity, pricing is fairly consistent with last year's levels and cap rates have compressed slightly in response to falling interest rates. While there has been some economic uncertainty, rent collections to this point are nearly identical to figures from one year ago when the economy was thriving. This consistent pace of collections, if it continues, will likely support investment activity in the coming quarters.

Employment

- Employers in the San Diego metro added back nearly 32,000 jobs in the third quarter, but there is still a long way to go before the market reaches pre-pandemic levels. Year over year, total employment is down approximately 8 percent with a loss of roughly 120,000 jobs.
- The professional and business sector has been the strongest-performing industry in the months following the health crisis, and roughly 70 percent of losses from earlier in the year have been added back to payrolls. Year over year, local professional employment has expanded slightly, inching up 0.6 percent.
- A handful of companies are thriving in the current economy, and one of the top performers is expanding in San Diego. During the third quarter, Amazon announced plans to add 200 new technology jobs in University City.
- **Forecast:** All markets are forecast to record job losses in 2020, and recovery in San Diego will likely be stronger in 2021 than in late 2020. For the full year, local employment is forecast to contract by approximately 7 percent.

Employment Overview

Sources: NorthMarq, Bureau of Labor Statistics

During the third quarter, Amazon announced plans to add 200 new technology jobs in University City

Vacancy

- Multifamily vacancy ticked higher in San Diego during the third quarter, increasing 20 basis points to 4 percent. The current rate is also just 20 basis points higher than during the third quarter of last year.
- San Diego's vacancy rate has been very stable since the beginning of 2018. During the past 11 quarters, local vacancy has remained between the range of 3.7 and 4 percent.
- Vacancy in the suburbs outside of San Diego, with more affordable rents, has been tight. The vacancy rate in areas such as the El Cajon/Santee/Lakeside and Escondido/San Marcos submarkets currently sits below 2 percent.
- **Forecast:** Construction activity is forecast to pick up in the coming months, though it will still take a while longer for the local economy to regain momentum. This should put some modest upward pressure on area vacancy rates. Vacancy is forecast to end 2020 at 4.4 percent.

Vacancy Trends

Sources: NorthMarq, Reis

Since 2018, local vacancy has held between the range of 3.7 and 4 percent

Rents

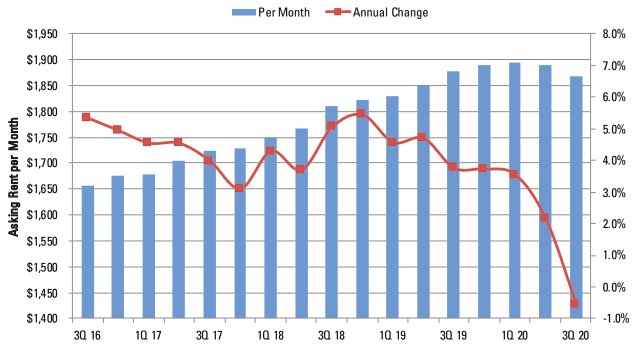
> Rents in San Diego ticked lower during the third quarter, following a trend recorded across the majority of markets in the country. Asking rents ended the third quarter at $1,868 per month, down 1.2 percent from the second quarter.

> After declining in both the second and third quarters, current rents are a few ticks lower than one year ago. Year over year, local asking rents have retreated 0.5 percent.

> The El Cajon/Santee/Lakeside submarket has arguably been the steadiest through the pandemic, and a vacancy rate below 2 percent in the area has allowed for modest rent growth. Asking rents in the submarket advanced 2.1 percent during the past 12 months.

> **Forecast:** Following several years of average annual rent increases topping 4 percent, asking rents are expected to contract in 2020. Average asking rents are forecast to dip approximately 1.5 percent this year.

Rent Trends



Sources: NorthMarq, Reis

Asking rents ended the third quarter at $1,868 per month

Development and Permitting

> Apartment construction has been slowed by the COVID-19 outbreak. Projects totaling approximately 1,100 units have been delivered year to date through the third quarter. Construction was far more active last year, and developers brought more than 2,100 units to market in the first three quarters of 2019.

> The development pipeline has been building, and construction is forecast to pick up in the next few quarters. Projects totaling nearly 6,900 units are currently under construction, up about 40 percent from one year earlier.

> While deliveries have slowed, multifamily permitting has remained active throughout 2020. This year, developers have pulled permits for more than 3,500 units, up 19 percent from the same period last year.

> **Forecast:** After a slow start, deliveries of new projects are forecast to gain momentum to close out the year. Projects totaling approximately 2,600 units are forecast to come online in 2020, down 15 percent from the 2019 total.

Development Trends

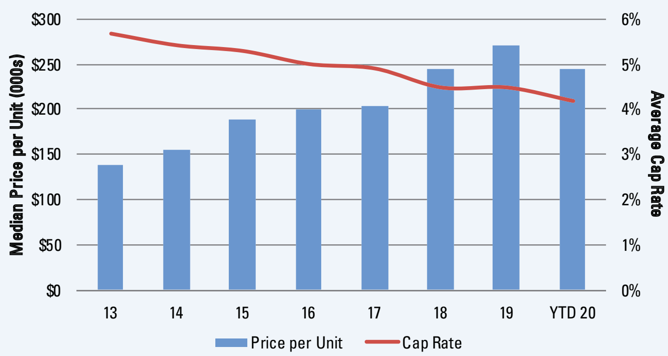
Sources: NorthMarq, Reis

Projects totaling nearly 6,900 units are currently under construction

Multifamily Sales

- After a consistent start to the year, transaction activity dipped in the third quarter and only a handful of significant properties changed hands. Year to date, sales velocity is down roughly 30 percent from the same period last year.
- The median price in transactions that have closed thus far is $244,300 per unit, down 10 percent from the median price in 2019. In recent months, a few transactions have closed with per-unit prices much higher than the median price.
- Cap rates continue to hold steady from quarter to quarter. The average cap rate through the first three quarters of 2020 is 4.2 percent, down 30 basis points from the figure in 2019.

Investment Trends



Sources: NorthMarq, CoStar

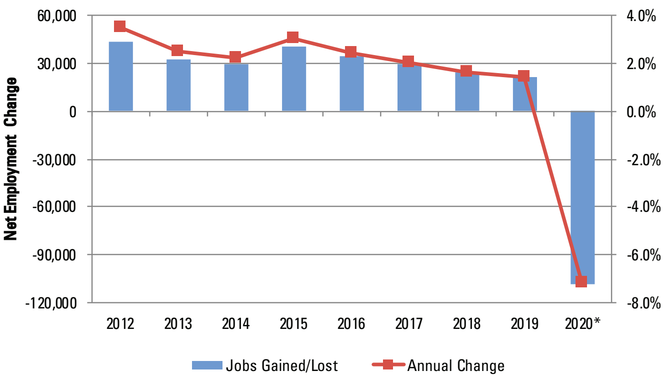
The median price in transactions that have closed thus far is $244,300 per unit

Looking Ahead

The San Diego multifamily market will be impacted by the economic downturn associated with the coronavirus outbreak, but any downturn in property fundamentals is expected to last only a few quarters. Evidence of this is already apparent in many of the San Diego area's suburban submarkets, where vacancy remains tight. In a few areas where new development has been active in recent years, led by Downtown, there will likely be some lingering weakness as demand growth is outpaced by expanding supply.

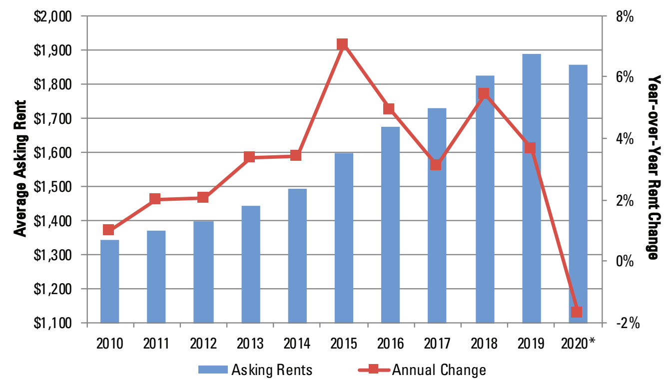
Multifamily investment trends in San Diego are generally fairly consistent from year to year, with the market not often recording significant highs and lows. While transaction activity in 2020 is not expected to reach levels from recent years, pricing and cap rate trends are likely to remain near recent averages. A consistently limited supply of available properties generally keeps demand elevated, and with acquisition financing rates low, potential buyers are expected to remain motivated in the coming quarters.

Employment Forecast



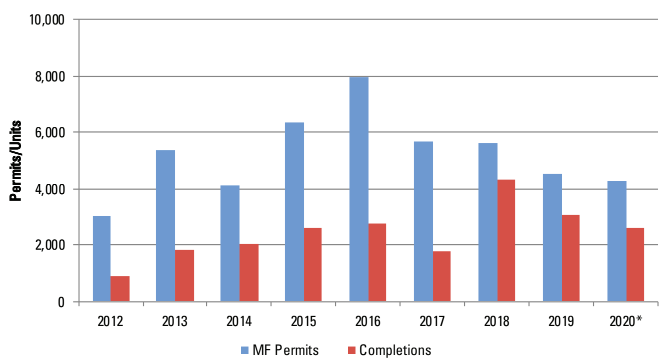
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



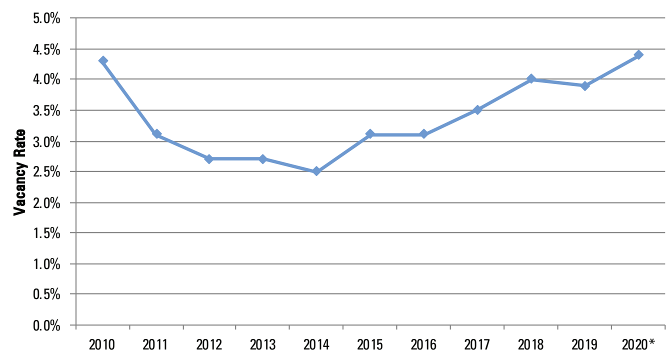
* Year End Forecast
Sources: NorthMarq, Reis

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 more than $14 billion, loan servicing portfolio of more than $61 billion and the multi-year tenure of our nearly 600 people.

For more information, contact:

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

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

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

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

NORTHMARQ