

San Diego Multifamily

Transaction Activity Regains Momentum to Close 2020

Highlights

- > The San Diego multifamily market delivered a relatively steady performance in 2020, despite the local economy's challenging circumstances.
- > Vacancy held steady from the third quarter to the fourth quarter, remaining at 4 percent. For the year, vacancy ticked up 10 basis points, following a minimal decline in 2019.
- > Apartment rents in San Diego pulled back slightly in 2020, breaking the 10-year streak of annual growth. Asking rents fell 1.6 percent to \$1,860 per month.
- > The local investment market gained momentum in the fourth quarter. Prices rose and cap rates compressed in 2020, and activity spiked in larger-dollar transactions late in the year.

San Diego Multifamily Market Overview

After more than a decade of fairly consistent strengthening, the San Diego multifamily market recorded minor softening during 2020. Because of government restrictions and a heavy dependence on tourism, the pandemic disrupted California's employment market more than other areas. With job losses still lingering at the end of the year, apartment rents inched lower in 2020. The local vacancy rate has been one of the tightest in the country, and vacancy was essentially flat for most of the year.

Q4 Snapshot

San Diego Market



Market Fundamentals

Vacancy	4.0%
- Year Over Year Change	+10 bps
Asking Rent	\$1,860
- Year Over Year Change	-1.6%



Transaction Activity

Median Sales Price Per Unit (YTD)	\$297,500
Cap Rates (Avg YTD)	4.2%



Construction Activity

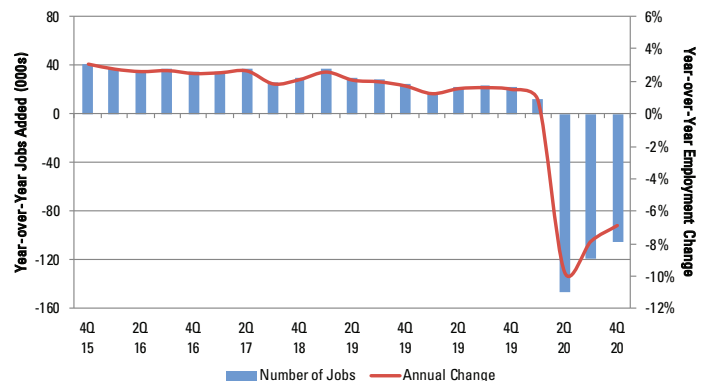
Units Under Construction	5,181
Units Delivered YTD	1,597

Sales velocity for multifamily properties spiked in the fourth quarter, following minimal transaction activity in the third quarter. With more properties changing hands, prices rose, with the greatest increases occurring in property sales that closed in the fourth quarter. After the first three quarters of the year were dominated by activity ranging from \$20 million to \$40 million, the bulk of the sales at the end of the year were in excess of \$60 million. Cap rates compressed for the seventh straight year, averaging 4.2 percent in 2020.

Employment

- > Employers added 19,000 jobs to their payrolls during the fourth quarter, building on a gain of nearly 35,000 positions during the third quarter. Total employment contracted by roughly 105,000 jobs in 2020, an annual decline of 6.9 percent.
- > Employment in the leisure and hospitality sector is down more than 25 percent from the end of 2019. As the economy reopens and vaccinations become more widespread, the leisure and hospitality industry should bounce back quickly.
- > The effects of COVID-19 have not impacted San Diego's rapidly growing biotech industry. In December, Guardant Health announced plans to open a new office in the Torrey Pines area, adding more than 100 jobs. The company develops blood tests for cancer diagnoses and is looking to tap into San Diego's large pool of life sciences talent.
- > **Forecast:** Markets in Southern California will benefit significantly as the local economies come back to life, with the strongest gains likely in the second half of 2021. The local labor market is forecast to expand by nearly 3 percent in 2021, with the addition of approximately 42,000 net new jobs in 2021.

Employment Overview



Employers added 19,000 jobs to their payrolls during the fourth quarter

Vacancy

- > A steady pace of renter demand and a slowing pace of new development kept apartment vacancy fairly steady in 2020. The rate ended the fourth quarter at 4 percent, matching the figure from the third quarter.
- > Vacancy rose just 10 basis points in San Diego in 2020, reversing the slight improvement recorded in 2019. Vacancy has recorded minimal changes in recent periods, remaining between 3.7 percent and 4 percent for the past 12 quarters.
- > While the vacancy rate in Class A buildings has been more volatile recently, vacancy in lower-tier assets has been remarkably stable. The combined vacancy rate in Class B and Class C units closed the year at a tight 2.5 percent.
- > **Forecast:** The local vacancy rate is not expected to move outside of its recent ranges in 2021. New supply may slightly outpace demand growth in the year ahead, which will likely push vacancy up 10 basis points higher to 4.1 percent.

Vacancy Trends

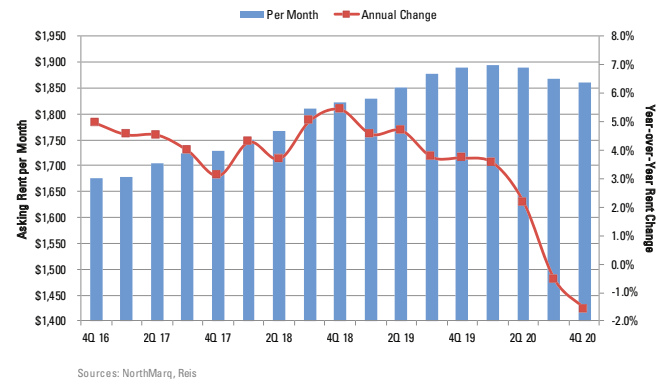


Vacancy rose just 10 basis points in San Diego in 2020

Rents

- > Apartment asking rents in San Diego fell minimally during the fourth quarter, ending 2020 at \$1,860 per month. San Diego historically has been one of the most consistent markets in the country, and any further losses should be short term and minor.
- > Rents in San Diego contracted 1.6 percent during 2020, a loss that was more modest than most metro areas in California. The dip marked the first annual decline in multifamily rents in San Diego since 2009.
- > A few high-demand areas in San Diego posted rent increases in 2020, despite economic uncertainty. Apartment rents in the North Beaches area expanded 3 percent in 2020, reaching \$2,048 per month.
- > **Forecast:** Apartment rents in San Diego are expected to push higher in the year ahead. Asking rents are forecast to increase 3.5 percent, reaching \$1,925 per month by the end of 2021.

Rent Trends

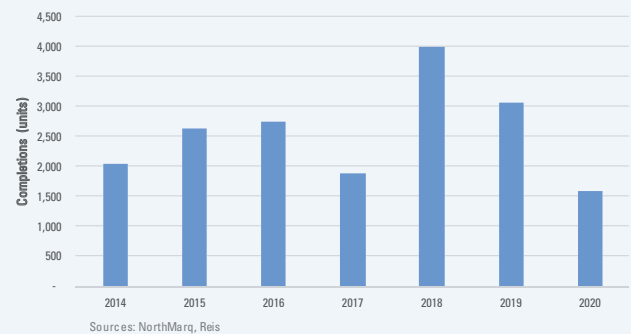


Asking rents are forecast to increase 3.5 percent, reaching \$1,925 per month

Development and Permitting

- > The pace of deliveries slowed in 2020, following two consecutive years of active development. Projects totaling approximately 1,600 units were completed during 2020, down from more than 3,000 units delivered in 2019.
- > Projects totaling nearly 5,200 units were under construction at the end of 2020. Approximately half of the units currently under way are slated to be delivered in 2021. While much of the recent development activity has been high-rise buildings in Downtown, a few garden-style and mid-rise buildings in suburban areas have entered the development pipeline.
- > Multifamily permitting surged in the fourth quarter, and developers pulled permits for approximately 2,250 units. For the full year, permits for more than 6,000 multifamily units were issued, up 33 percent from 2019.
- > **Forecast:** Apartment construction is forecast to accelerate in the coming year, following a bit of a lull in 2020. Projects totaling approximately 2,800 apartment units are forecast to complete during 2021.

Development Trends

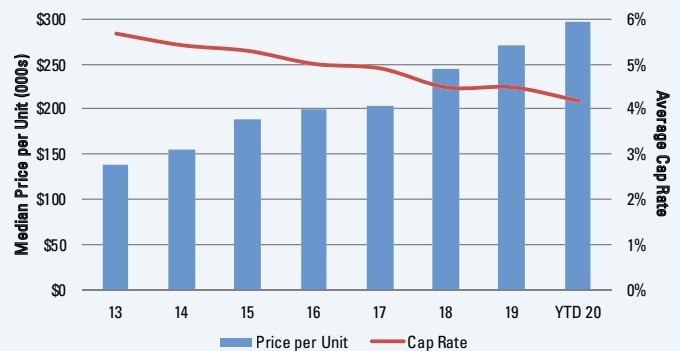


Nearly 5,200 units were under construction at the end of 2020

Multifamily Sales

- > Investment activity accelerated during the fourth quarter, with a flurry of sales closing in December, and the market recorded the most active period since late 2017. Despite the surge in volume at the end of the year, sales velocity in 2020 was down approximately 20 percent from the previous year.
- > The median price in sales in 2020 was \$297,500 per unit, up 8 percent from the median price in 2019. Pricing was strongest during the fourth quarter. The median price in sales that closed in the fourth quarter was approximately \$380,000 per unit with several sales topping \$400,000 per unit.
- > Cap rates averaged approximately 4.2 percent in 2020, 30 basis points lower than the average in recent years. A handful of properties sold with cap rates at or below 4 percent.

Investment Trends



Sources: NorthMarq, CoStar

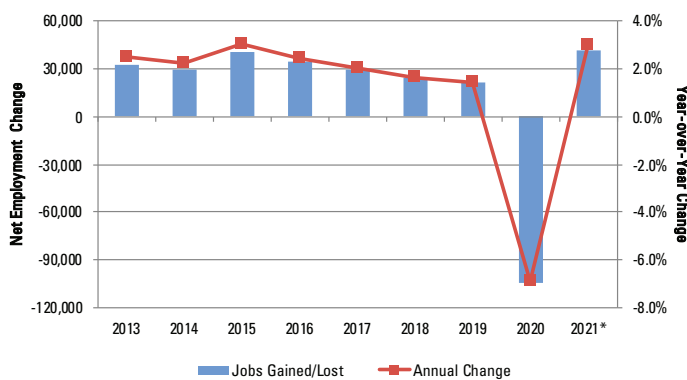
The median price during 2020 was \$297,500 per unit, up 8 percent from 2019

Looking Ahead

The San Diego multifamily market is forecast to record healthy operating conditions in 2021. Rent growth should resume in the coming months, particularly as businesses bring back workers and leasing momentum accelerates. After slowing in 2020, apartment deliveries are scheduled to resume at a fairly active pace in the coming quarters, which will likely result in a minimal vacancy uptick. Overall vacancy rates should remain quite low in nearly every submarket in San Diego, although the Downtown area is likely to have some supply-side stresses for at least another year.

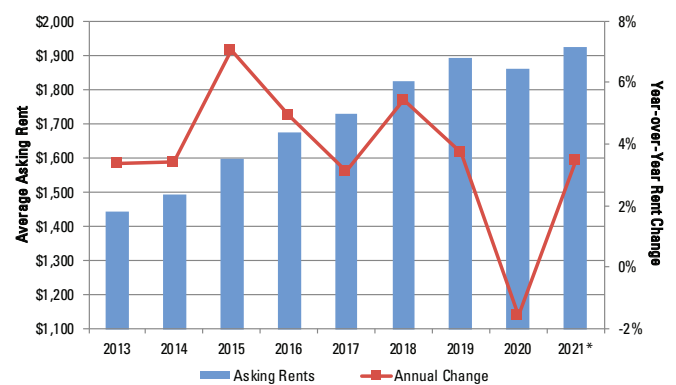
The San Diego investment market is generally marked by stability, but activity in 2020 was more uneven than most years. The surge in transaction volume at the end of 2020 set the stage for a return to more traditional levels of sales velocity in 2021. Already in the first few weeks of 2021, transactions have begun to close. With many demand drivers in place, the greatest uncertainty in the current environment is the pace of a broader reopening of the local economy. Assuming the market is not hit with another significant shock, the local investment climate should closely track levels from recent years.

Employment Forecast



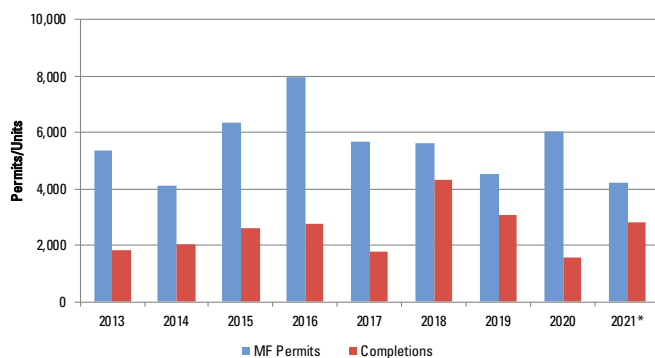
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



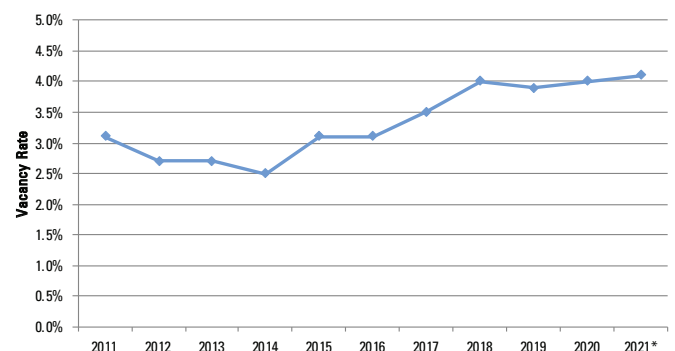
* Year End Forecast
Sources: NorthMarq, Reis

Construction & Permitting Forecast



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

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Reis

About NorthMarq

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