

Market Insights

San Diego Multifamily 3Q 2022



Construction Activity



4,431

Units under construction

2,871

Units delivered (YTD)

Market Fundamentals



3.3%

Vacancy

-110bps

Year over year change

\$2,285

Asking Rent

+12.6%

Year over year change

Transaction Activity



\$355,600

Median sales price per unit (YTD)

Vacancy Dips to Five-Year Low

Highlights

- Property performance in San Diego improved during the third quarter. Area vacancy continued to tighten, and asking rents inched higher in recent months. The pace of new development remains steady as developers attempt to match renter demand for units.
- Area rents ticked higher during the last three months but at a slower pace than in previous periods. Average asking rents rose less than 1 percent during the third quarter to \$2,285 per month. Year over year, rents are up 12.6 percent.
- The multifamily investment market slowed during the third quarter, while pricing remains above last year's figure. The median sales price to this point in the year is \$355,600 per unit, 10 percent higher than the median price in 2021. Cap rates averaged approximately 3.5 percent in both the second and third quarters.

San Diego Multifamily Market Overview

Operating conditions in the San Diego multifamily market improved during the third quarter, as asking rents inched higher, and the vacancy rate fell for the fourth consecutive quarter. Strong property performance continues to support an active pace of multifamily construction. Developers have targeted projects in Downtown San Diego and the South Bay for several years, a trend that remains in place. Additionally, development has picked up in the neighborhoods immediately north of Balboa Park, with projects totaling more than 825 units under construction in University Heights and North Park. These areas feature a strong in-place renter base and growing millennial populations. Despite ongoing construction throughout San Diego, renter demand still outpaces supply growth, fueling competition for available units and driving the vacancy rate to a five-year low during the third quarter.

The local multifamily investment market demonstrated some mixed messages during the third quarter. In the properties that sold, per-unit prices remained elevated, and cap rates maintained similar levels to the first half of the year, even as interest rates pushed higher. Cap rates averaged about 3.5 percent in the second and third quarters, lower than multifamily loan rates. There was a significant quarterly decline in the number of transactions, signaling that an expectations gap may be present between many buyers and sellers. It may take a few more months until cap rates settle in at a new market equilibrium. To this point in 2022, the median sales price across all asset classes is \$355,600 per unit, while the median price in upper-tier and middle-tier assets combined reached \$415,000 per unit.

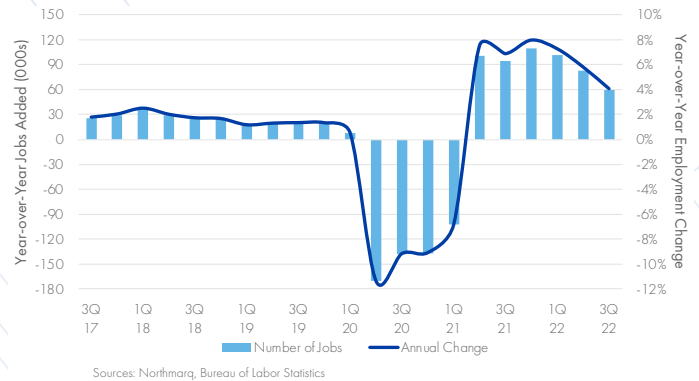
Employment

- Area employers added jobs in the third quarter but at a more modest pace than in recent periods. The labor market expanded by 6,200 workers in the third quarter; year over year, total employment has surged by nearly 60,000 positions, a gain of 4.1 percent.
- White-collar employment has recorded steady growth in recent quarters. During the past 12 months, the professional and business services sector added more than 15,500 jobs, a 6 percent expansion.
- International shipping services company DHL recently relocated its facility in San Diego to a space that is more than double the size of its previous location. With more than 86,000 square feet of warehouse and office space, the new facility in Southeast San Diego is now the company's third-largest pickup and delivery facility in the U.S.
- **Forecast:** Local employers are projected to continue to add jobs in the coming months. Total employment is expected to grow 2.8 percent in 2022 with the addition of 41,000 positions.



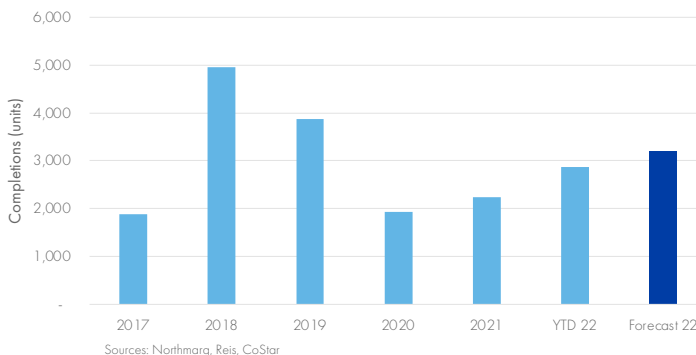
Year over year, total employment has surged by nearly 60,000 positions.

Employment Overview



More than 1,700 units were delivered during the third quarter.

Development Trends



Development and Permitting

- Multifamily development gained momentum in recent months as more than 1,700 units were delivered during the third quarter. Year to date, projects totaling roughly 2,870 units have been completed in San Diego.
- As the pace of deliveries accelerated, the construction pipeline thinned in recent months. Projects totaling more than 4,400 units are currently under construction, down 5 percent from one year ago.
- Following a strong start to the year, permitting activity dipped during the third quarter. Developers pulled permits for approximately 1,320 multifamily units in the last three months, a 30 percent decline from the previous quarter. The number of permits issued year to date is up slightly from the same period in 2021.
- **Forecast:** Projects totaling 3,200 units are scheduled to come online in 2022, the highest number of annual completions since 2019. Nearly all of the projects included in this total have already been delivered.

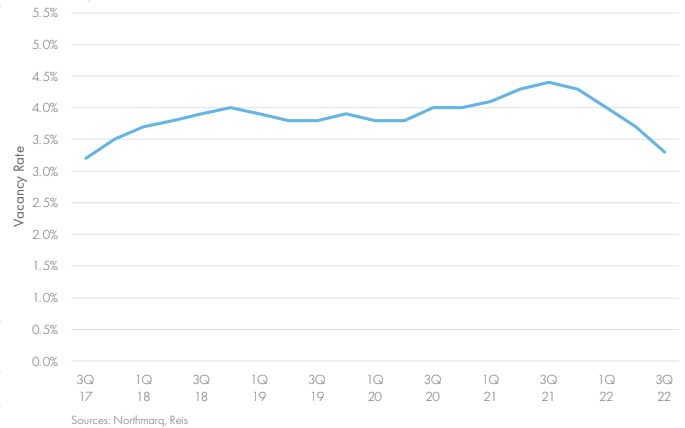
Vacancy

- Local vacancy dropped 40 basis points during the third quarter to 3.3 percent. While the rate of apartment construction has been on the rise, developers have not been able to keep pace with renter demand in San Diego, and the region's vacancy rate is one of the lowest in the country.
- Year over year, the vacancy rate improved by 110 basis points, reaching its lowest figure in the San Diego area in five years. Area vacancy averaged around 3.9 percent from 2017 to 2021.
- Vacancy is tightest in most of the outlying suburban submarkets including Escondido/San Marcos and El Cajon/Santee/Lakeside, both with rates of around 1.5 percent. Demand in these submarkets is consistently elevated because of asking rents that are below the metro average. Supply-side pressures have also been limited, with the submarkets having had reduced construction activity in recent years.
- Forecast:** After reaching a five-year low, the vacancy rate is expected to tick slightly higher in the next quarter. Vacancy is projected to finish the year at 3.5 percent, 80 basis points lower than at the end of 2021.



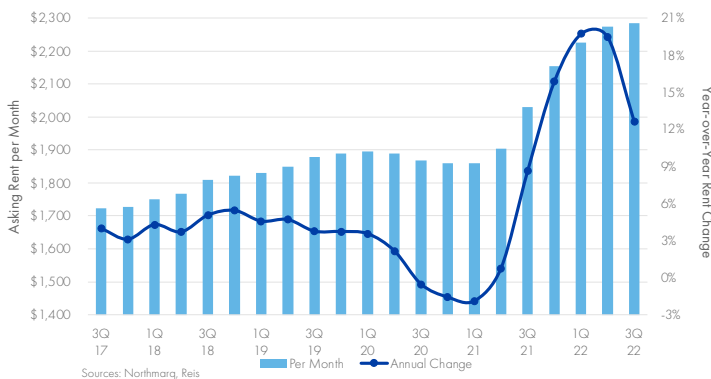
Year over year, the vacancy rate improved by 110 basis points.

Vacancy Trends



Year over year, apartment rents have climbed 12.6 percent.

Rent Trends



Rents

- Asking rents inched higher during the third quarter, following strong increases in previous periods. During the last three months, average rents rose less than 1 percent to \$2,285 per month.
- Year over year, apartment rents have climbed 12.6 percent. Downtown San Diego continues to record the most expensive rents in the metro area at more than \$3,100 per month.
- Middle-tier and lower-tier properties recorded significant rent increases in recent quarters. The combined average asking rent in Class B and Class C units rose 11 percent during the past year to \$1,855 per month.
- Forecast:** Apartment rents are expected to continue to tick higher at a modest pace through the remainder of this year and into 2023. Local asking rents are projected to end the year at \$2,290 per month, an annual gain of 6.3 percent.

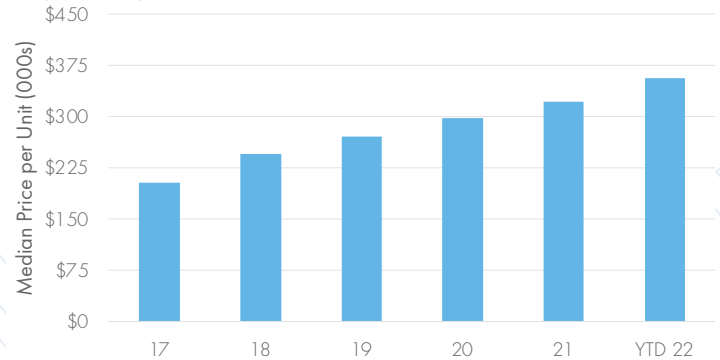
Multifamily Sales

- Multifamily sales activity slowed in recent months as the number of deals that closed during the third quarter declined 66 percent from the previous period. The recent drop in activity has caused transaction volume thus far in 2022 to be down 20 percent from the same period in 2021.
- While fewer properties are changing hands, pricing continues to push higher, supported by tight operations and spikes in rents. The median sales price year to date is approximately \$355,600 per unit, up 10 percent from the median price in 2021.
- Cap rates in San Diego have been fairly steady during the past few months, averaging around 3.5 percent in the third quarter. To this point, rising borrowing costs have been offset by the ability for operators to push rents higher.



The median sales price year to date is approximately **\$355,600 per unit.**

Investment Trends



Sources: NorthMarq, CoStar

Recent Transactions

Multifamily Sales Activity

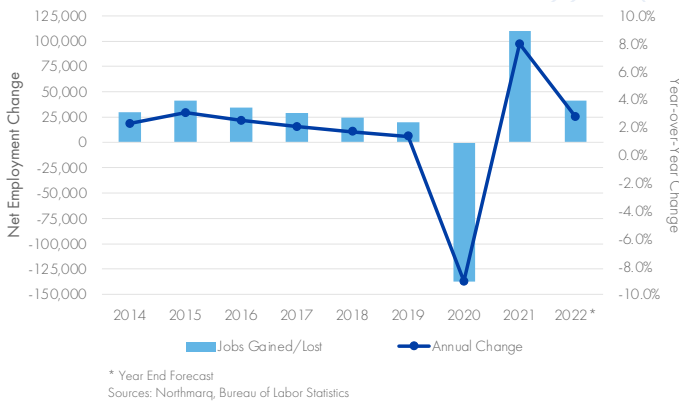
Property Name	Street Address	Units	Sales Price	Price/Unit
The Madison	1360 E Madison Ave., El Cajon	110	\$34,000,000	\$309,091
Park East Apartments	111 W Pennsylvania Ave., San Diego	56	\$23,550,000	\$420,536
Nook East Village	330 15th St., San Diego	91	\$20,100,000	\$220,879
Villa Patricia	632-640 S First St., El Cajon	53	\$14,900,000	\$281,132

Looking Ahead

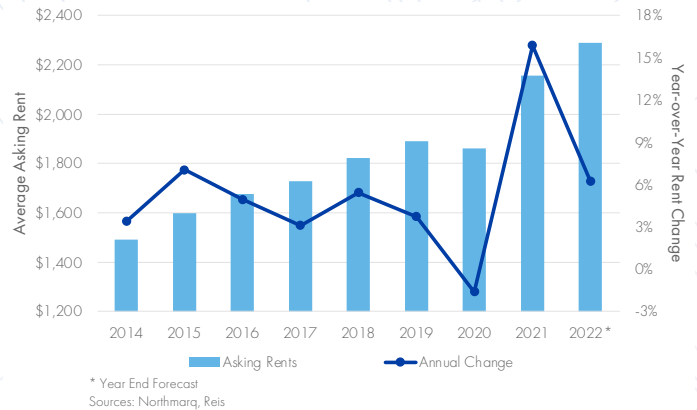
The San Diego multifamily market is far less cyclical than most other regions of the country and should continue to post healthy performance, even if the national economy levels off. Local apartment properties will likely record modest gains in the final months of the year. Rents will be pushed higher by continued renter demand for units and a vacancy rate that has tightened to new lows in recent quarters. The construction of new rental units will outpace deliveries from the past few years, but the bulk of the new inventory slated for 2022 has already been delivered and mostly leased-up. Apartment vacancy may inch higher in the final few months of the year, but the rate is on pace to end 2022 at its lowest year-end closing figure since 2017.

The San Diego multifamily investment market should maintain fairly consistent performance during the next few quarters. While the number of deals in the fourth quarter will likely trail last year's levels, investor demand will remain healthy across the region, fueled by strong operational performance among area properties. Transactions were most active in Downtown San Diego and East County in recent quarters, a trend that will likely continue. Investors that are more attracted to Class A and Class B assets will target the city center. Class C transactions often account for a significant share of total transaction volume, particularly in outlying suburban areas such as El Cajon. There could be some upward pressure on cap rates in the coming quarters as interest rates rise.

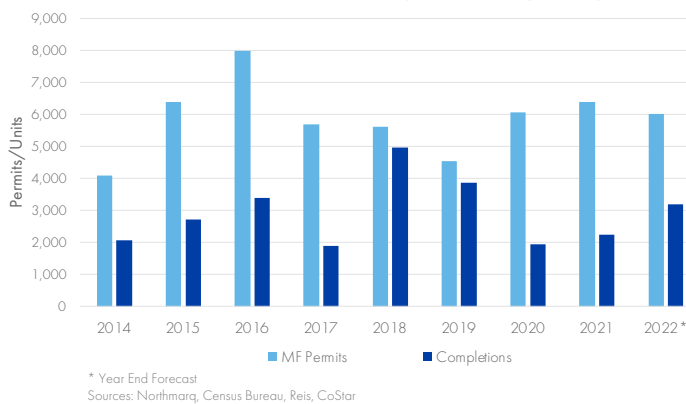
Employment Forecast



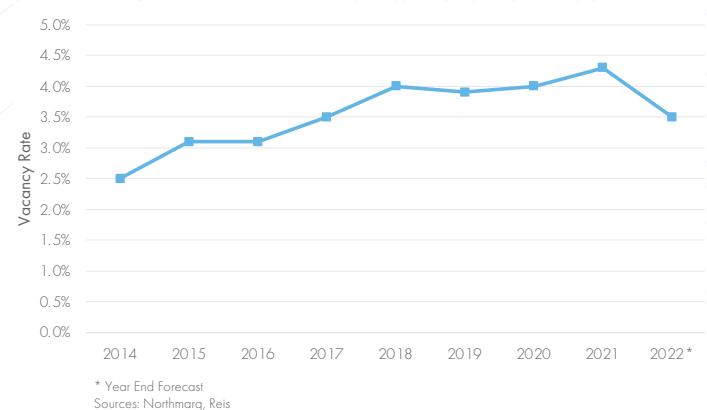
Rent Forecast



Construction & Permitting Forecast



Vacancy Forecast





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About Northmarq

Northmarq offers real estate investors access to experts in debt, equity, investment sales and loan servicing. We combine industry-leading capabilities with an open, flexible structure, allowing our team of seasoned professionals to do the best work on behalf of clients and lenders. Our solid foundation and innovative approach have led to substantial growth, with more than 700 employees, loan servicing volume approaching \$70 billion, and \$30+ billion in transaction volume.