Market Insights

San Diego Multifamily 3Q 2021

Northmarq

Construction Activity

4,649
Units under construction

1,159
Units delivered (YTD)

Market Fundamentals

4.4%
Vacancy

+40bps | Year over year change

$2,029
Asking Rent

+8.6% | Year over year change

Transaction Activity

$296,700
Median sales price per unit (YTD)

3.9% | Cap rates (YTD)

After a Steady First Half, Investment Activity Gains Momentum

Highlights

- Despite a minimal vacancy increase, apartment operating conditions improved in San Diego during the third quarter. Rent growth recorded its strongest quarter on record, and the annual pace of rent increase reached its highest total in approximately 20 years. Continued recovery in the local labor market should support renter demand in the coming quarters.
- Vacancy rose 10 basis points in the third quarter, reaching 4.4 percent. The rate is up 40 basis points year over year. Nearly all of the increase is being recorded in the Downtown area; in most other submarkets, vacancy ranges from 2 percent to 4 percent.
- Asking rents have advanced 8.6 percent year over year, reaching $2,029 per month. The strongest gains were recorded during the third quarter when rents spiked 6.5 percent.
- Quarterly sales activity has been consistently strong throughout most of 2021, outpacing levels from recent years. Transaction velocity gained momentum during the third quarter. Cap rates have compressed somewhat this year, averaging approximately 3.9 percent, while the median price has reached $296,700 per unit.

San Diego Multifamily Market Overview

The San Diego multifamily market gained traction in the third quarter. Asking rents spiked across the region with the largest increases occurring in the Mira Mesa/Rancho Bernardo, Downtown, and Vista submarkets. Vacancy continues to inch higher in San Diego, although the submarkets in the eastern portion of the metro still have exceedingly low vacancy rates between 1.5 percent and 2 percent. Multifamily development was fairly active in the last two quarters, and apartment deliveries should accelerate in the final months of the year. Renter demand remains high in the city, fueled by an expanding employment market.

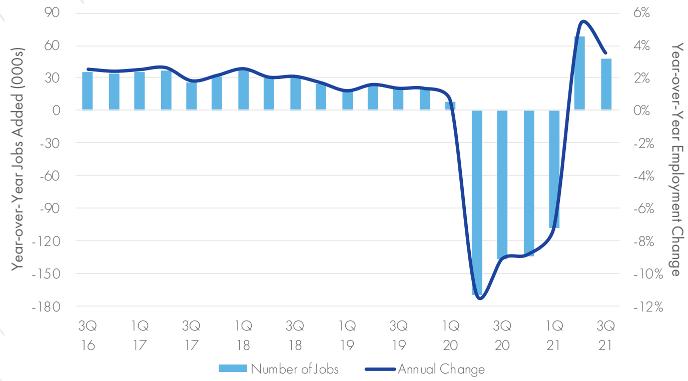
Sales velocity accelerated during the third quarter, outpacing levels recorded in recent periods. Many of the properties that have changed hands in recent months are located in some of the outlying suburban areas of the region including National City, Oceanside, and La Mesa. The transaction mix during the third quarter largely consisted of Class B and Class C properties, as prices held steady from last year's median. Cap rates inched lower since the end of 2020, ending the third quarter just below 4 percent. Some of the volatility that has been recorded in other California markets over the past year has largely missed San Diego.

Employment

- The local labor market in San Diego continues to recover at a rapid pace. Area employers added nearly 14,000 jobs during the third quarter, following the addition of more than 25,000 positions in the first six months of 2021. Although employment in San Diego is still down from its pre-pandemic levels, the local labor market has expanded more than 3.5 percent year over year.
- The professional and business services industry has outperformed most other sectors in the past year. Professional employment in the San Diego area has grown by more than 9,200 jobs in the last 12 months, an expansion of almost 4 percent.
- San Diego remains one of the hottest markets in the country for tech startups and life science companies. Connecticut-based biotech company Quantum-Si recently announced plans to expand its operations into a new 25,500-square-foot facility in Sorrento Valley. The new development will bring more than 50 high-paying jobs to the region in the coming quarters.
- **Forecast:** The San Diego labor market is forecast to continue to improve in the remainder of the year. For the full year, total employment is expected to grow more than 3.5 percent with the addition of 50,000 jobs.

> Nearly 14,000 jobs were added during the third quarter.

Employment Overview



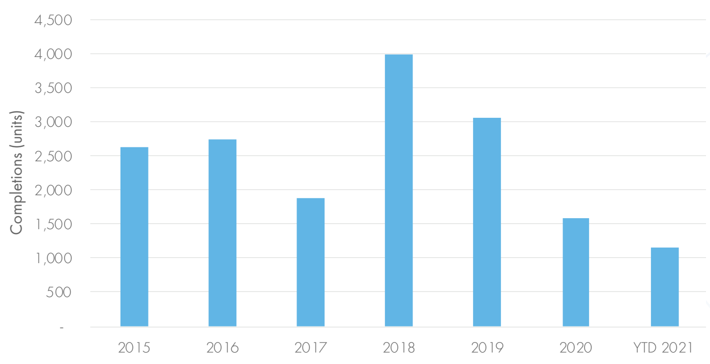
Sources: Northmarq, Bureau of Labor Statistics

Development and Permitting

- Developers remained fairly active in the third quarter as nearly 550 units were delivered, bringing the year-to-date total to 1,159 units. Apartment construction peaked in 2018 when more than 4,300 units came online, but the market's long-term average is closer to about 1,750 units per year.
- Projects totaling more than 4,600 units are currently under construction in San Diego. The most active submarkets for new construction include Downtown, Clairemont/Linda Vista, and Mira Mesa/Rancho Bernardo.
- Multifamily permitting has accelerated to this point in 2021 as more than 4,300 permits have been pulled year to date. Permitting activity through the third quarter is up approximately 13 percent from the same period last year.
- **Forecast:** Multifamily construction activity in San Diego is expected to accelerate in the final quarter of 2021. Projects totaling more than 3,000 units are forecast to be delivered by the end of the year.

> Projects totaling more than 4,600 units are currently under construction in San Diego.

Development Trends



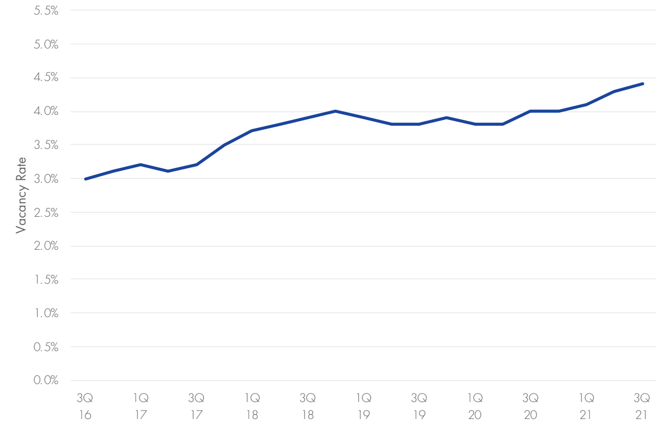
Sources: Northmarq, Reis

Vacancy

- Vacancy in San Diego ticked up 10 basis points during the third quarter, reaching 4.4 percent. While vacancy generally remains in a very tight range in the region, the current figure is near the top of that range. The rate has averaged 3.4 percent since 2010.
- Year over year, vacancy rose 40 basis points in San Diego. The overall market vacancy rate has been gradually trending higher since 2013 in response to rising construction totals. Vacancy in Class A properties ended the third quarter at 6.9 percent.
- The combined vacancy rate in the region's Class B and Class C properties has remained fairly steady during the past several quarters. Year over year, vacancy in Class B and Class C units dropped 10 basis points, ending the third quarter at 2.4 percent.
- **Forecast:** Vacancy in San Diego is forecast to end this year at 4.3 percent, 30 basis points higher than at the end of 2020.

> Vacancy in San Diego crept up 10 basis points during the third quarter, reaching 4.4 percent.

Vacancy Trends



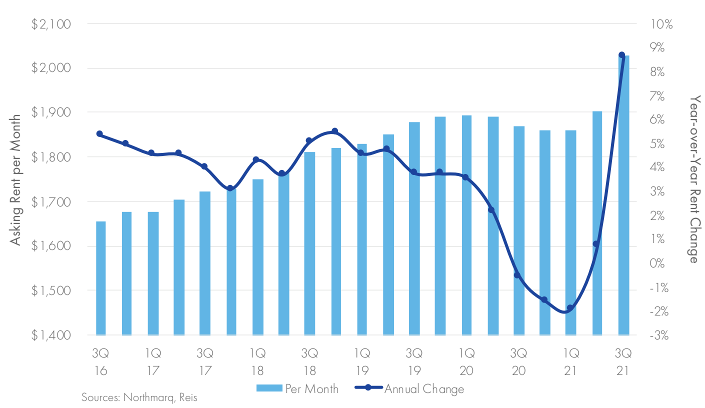
Sources: Northmarq, Reis

Rents

- Rents continued to push higher in the third quarter, building on healthy gains in the second quarter. Local asking rents jumped 6.5 percent—or more than $100 per month—during the third quarter, reaching $2,029 per month.
- Asking rents in San Diego are up 8.6 percent year over year, despite some modest contraction at the end of 2020. The current pace of expansion is more rapid than recent periods; from 2015 to 2020, rent growth averaged 3.8 percent annually.
- Despite an elevated vacancy rate, the Downtown submarket's rents remain the highest in the region, spiking almost $290 per month during the third quarter. Downtown rents ended the third quarter at $2,900 per month, advancing 11 percent from the previous quarter.
- **Forecast:** After spiking during the third quarter, asking rents are expected to creep higher in the remainder of the year. Average rents are forecast to end 2021 at $2,040 per month with an annual growth of 9.7 percent.

> Asking rents reached $2,029 per month during the third quarter.

Rent Trends



Sources: Northmarq, Reis

Multifamily Sales

- After slowing by about 20 percent in 2020, the local investment market has gained momentum this year. Quarterly transactions have been mostly steady, with the pace picking up during the third quarter. Total year-to-date transaction activity has already surpassed the full-year totals for each of the past three years.
- As the transaction volume grew, sales prices held fairly steady from the 2020 figure. The median sales price thus far in 2021 is approximately $296,700 per unit, nearly identical to the median price in 2020. Nearly all of the properties that have sold to this point in 2021 include 1970s- and 1980s-vintage Class B and Class C projects.
- Cap rates in San Diego are traditionally among the lowest in the country and have tightened somewhat in 2021. The average cap rate recorded year to date is approximately 3.9 percent, about 30 basis points lower than the 2020 average.

> The median sales price thus far in 2021 is approximately $296,700 per unit.

Investment Trends

Sources: NorthMarq, CoStar

Recent Transactions

Multifamily Sales Activity

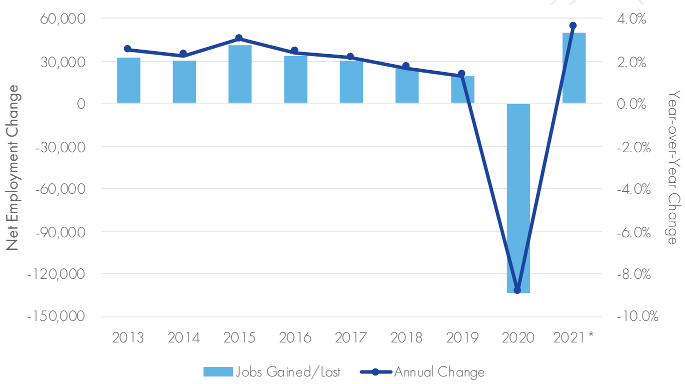
Property Name	Street Address	Units	Sales Price	Price/Unit
The Dylan	550 Los Arbolitos Blvd., Oceanside	208	$74,100,000	$356,250
Harborview Apartments	819-825 D Ave., National City	83	$32,000,000	$385,542
Echo Point	4300 Echo Ct., La Mesa	80	$26,800,000	$335,000
Sunset Cliffs Apartments	180 Terrace Dr., Vista	52	$13,575,000	$261,058
Olive Avenue Apartments	3240 Olive St., Lemon Grove	50	$12,200,000	$244,000

Looking Ahead

Strong rent growth is likely to continue in the San Diego multifamily market in the coming quarters, even if the vacancy rate inches higher as the pace of deliveries strengthens. Renter demand is being boosted by a recovering local labor market, and the introduction of new, more expensive units into the local inventory will likely pull average rents higher. This trend has been on display in the Downtown submarket, where rents ended the third quarter up 15 percent year to date, despite a vacancy rate that is nearly three times as high as the marketwide rate.

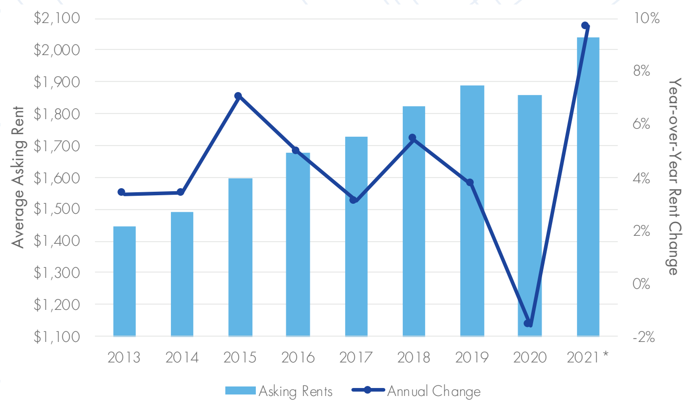
Investor demand for multifamily properties in San Diego is forecast to remain elevated through the remainder of this year and into 2022. In the next year, the widespread cap rate compression occurring throughout the country could bring some additional investment activity to Southern California markets. Several markets where cap rates have historically been 100 basis points to 200 basis points higher than average cap rates in Southern California, currently have cap rates that are in line with pricing in San Diego. Without the cap rate premium in other markets, investors could target acquisitions in supply-constrained markets including San Diego.

Employment Forecast



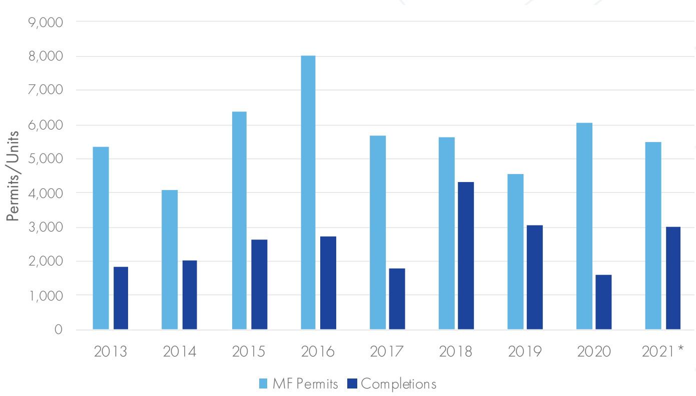
* Year End Forecast
Sources: Northmarq, Bureau of Labor Statistics

Rent Forecast



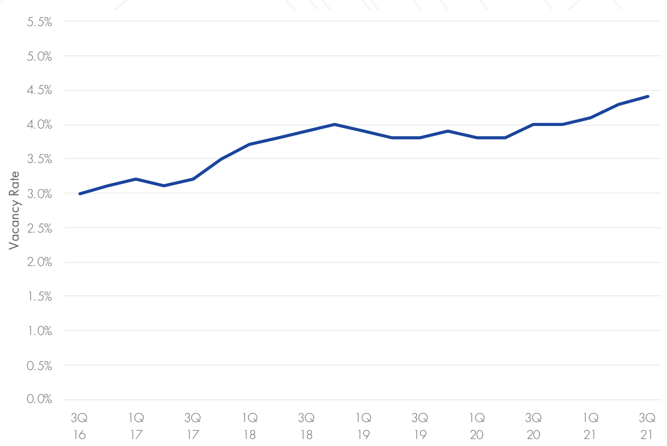
* Year End Forecast
Sources: Northmarq, Reis

Construction & Permitting Forecast



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

Vacancy Forecast



Sources: Northmarq, Reis

For more information, please contact:

Kyle Pinkalla
Managing Director – Investment Sales
858.675.7865
kpinkalla@northmarq.com

Erik Anderson
Associate Vice President – Investment Sales
858.675.7641
eanderson@northmarq.com

Tobin Hecker
Associate – Investment Sales
858.401.9335
thecker@northmarq.com

Eric Flyckt
SVP, Managing Director – Debt & Equity
858.675.7640
eflyckt@northmarq.com

Aaron Beck
SVP, Senior Director – Debt & Equity
858.675.7862
abeck@northmarq.com

Conor Freeman
Vice President – Debt & Equity
858.675.7661
cfreeman@northmarq.com

Wyatt Campbell
Vice President – Debt & Equity
858.675.7860
wcampbell@northmarq.com

Pete O'Neil
Director of Research
602.508.2212
poneil@northmarq.com

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