MARKET REPORT | 2Q/2020

San Diego Multifamily

NORTHMARQ

Local Investment Activity Continues Uninterrupted

Highlights

- The San Diego multifamily market continued to post steady performance in the first half of 2020, even with the economic obstacles brought on from COVID-19. Renter demand remains elevated, with absorption nearly matching the pace of new supply growth in recent years.
- Vacancy held steady at 3.8 percent during the second quarter, and the rate is unchanged from one year ago. While the Downtown area is recording an elevated vacancy rate, the suburban submarkets are posting rates generally ranging from 2 percent to 3.5 percent.
- Rent trends have been mixed. Asking rents ended the second quarter at $1,890 per month, down 0.3 percent from the first quarter. Rents are up from one year ago, but that is due to gains recorded in the second half of 2019.
- Multifamily investment volume was consistent from the first quarter to the second quarter. Year to date, the median price is approximately $242,700 per unit, while cap rates have averaged 4.2 percent.

Q2 Snapshot	San Diego Market
Market Fundamentals	
Vacancy	**3.8%**
- Year Over Year Change	**0**
Asking Rent	**$1,890**
- Year Over Year Change	**+2.2%**
Transaction Activity	
Median Sales Price Per Unit (YTD)	**$242,700**
Cap Rates (Avg YTD)	**4.2%**
Construction Activity	
Units Under Construction	**6,131**
Units Delivered YTD	**304**

San Diego Multifamily Market Overview

The San Diego multifamily market has been posting very steady operational performance at a time when the economy has been quite volatile. The local vacancy rate has held in a tight range, recording only minimal fluctuation over the past 10 quarters. There could be some supply-related fluctuation in the coming quarters. The first half of this year was a slower period of new deliveries than in recent periods, but there are several projects currently in the development pipeline that are likely to come to the market in the next 12 months. Employment took a massive hit in March and April but has since been rebounding, as employers regained more than a quarter of pandemic-related job losses.

Investment activity in the San Diego multifamily market has demonstrated remarkable stability even as swirling conditions in the national economy have stifled activity across most primary and secondary markets. Through the first half of 2020, the investment market in San Diego looks quite similar to previous years. Properties come to market with little or no vacancy, investor demand remains elevated, and transaction volumes are consistent. One area where the market has fluctuated somewhat is in deal size. Thus far in 2020, the bulk of the transactions have occurred under $50 million, compared to last year when larger deals accounted for nearly 40 percent of all transactions.

Employment

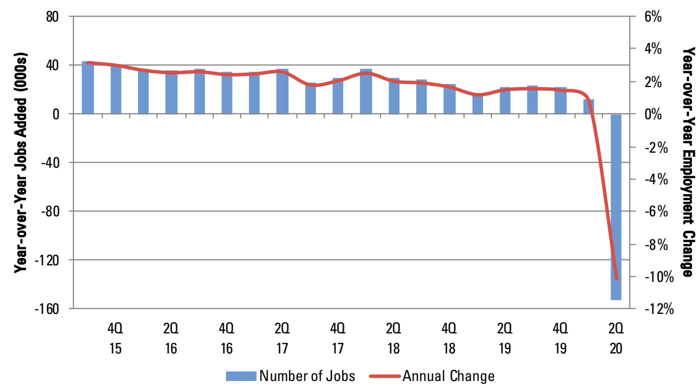
> Job cuts in the San Diego employment market were sharp during the second quarter, with the pace of layoffs slightly more severe than the national average. Year over year, employers have shed 153,100 net jobs, an annual decline of roughly 10.2 percent.

> The San Diego area has a large leisure and hospitality industry, and this sector recorded approximately 40 percent of all layoffs during the shutdown. The sector has rebounded in recent months, recapturing nearly 50 percent of pandemic-related job losses.

> Businesses have begun to reopen, allowing payrolls to begin to bounce back. Employers added back more than 25 percent of all COVID-19-related job losses during May and June, and additional recovery is likely in the second half of the year.

> **Forecast:** All markets are forecast to record job losses in early 2020, and the large tourism industry makes San Diego particularly vulnerable to sharp declines in leisure and business travel. Local employers are expected to bring back workers through the end of the year, but the exact pace of rehiring is uncertain.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

Employers added back more than 25 percent of all COVID-19-related job losses in May and June

Vacancy

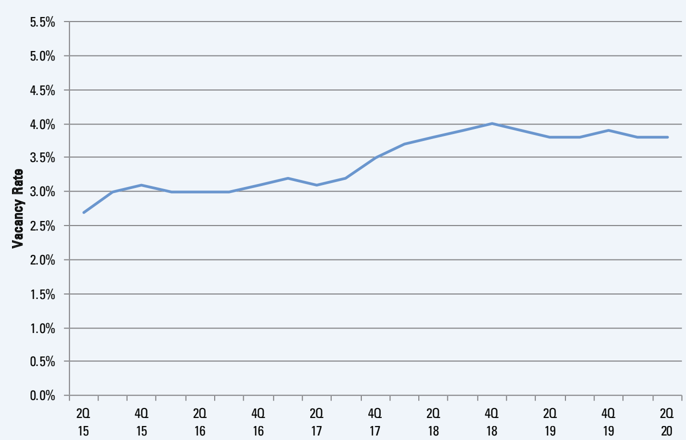
> After inching lower in the first quarter, vacancy held steady in the second quarter at 3.8 percent. Year over year through the second quarter, the local vacancy rate is unchanged.

> Vacancy Downtown ended the second quarter at 8.9 percent, much higher than the market average. In most other submarkets, vacancy rates are generally between 2 percent and 3.5 percent.

> Vacancy in San Diego's Class B and Class C units has remained relatively steady over the past several quarters. The combined vacancy rate for Class B and Class C properties sits at 2.4 percent, unchanged from one year earlier.

> **Forecast:** The local vacancy rate is expected to trend higher in the second half of the year. Vacancy is forecast to end the year at 4.6 percent, 70 basis points higher than at the end of 2019.

Vacancy Trends



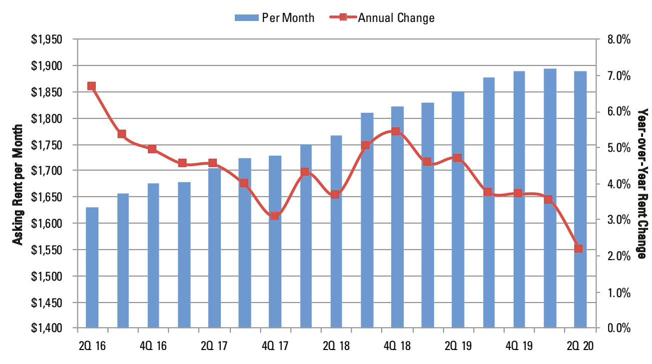
Sources: NorthMarq, Reis

Year over year through the second quarter, the vacancy rate in San Diego is unchanged

Rents

- Asking rents in San Diego dipped by 0.3 percent in the second quarter, offsetting the gains made during the first three months of the year.
- Boosted by gains in the second half of 2019, local asking rents have advanced 2.2 percent year over year, ending the second quarter at $1,890 per month. Annual rent growth one year earlier was 4.7 percent.
- Local asking rents for Class B and Class C buildings have advanced 2 percent in the past year, finishing the second quarter at an average of $1,560 per month.
- **Forecast:** Asking rents in San Diego are expected to record modest losses in the second half of 2020, ending the year at approximately $1,875 per month.

Rent Trends



Sources: NorthMarq, Reis

Asking rents dipped by 0.3 percent in the second quarter, offsetting earlier gains

Development and Permitting

- After no significant projects delivered in the first quarter, approximately 300 apartment units were brought online in the second quarter. The pace of construction has slowed; during the first half of 2019, approximately 1,050 apartment units were completed.
- While deliveries have been modest through the first half of this year, there are significant future projects in the construction pipeline. Projects totaling nearly 6,100 units are currently under construction, a figure that is up nearly 25 percent from one year ago.
- Multifamily permitting increased from the first quarter to the second quarter, and developers pulled permits for more than 1,400 units. Through the first half of the year, permitting is up 5 percent from the same period in 2019.
- **Forecast:** Construction should pick up in the second half, as approximately 3,650 units are scheduled to deliver by the end of the year.

Development Trends

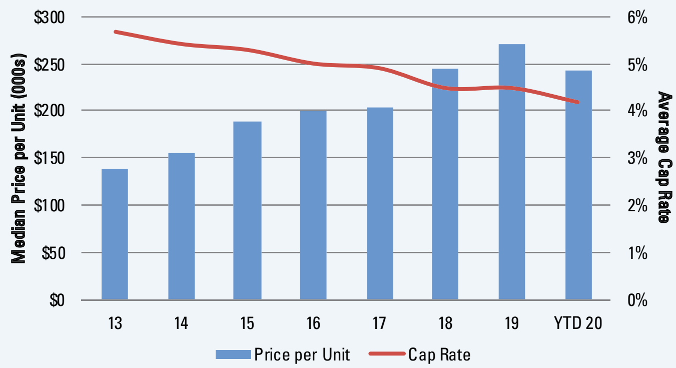
Sources: NorthMarq, Reis

Projects totaling nearly 6,100 units are currently under construction, up nearly 25 percent from one year ago

Multifamily Sales

- Transaction activity held steady, and the number of properties sold in the second quarter matched the amount from the first quarter. Sales velocity in the first half of the year is down 10 percent from the same period in 2019.
- Prices fell 9 percent from the first quarter to the second quarter. Year to date, the median price is approximately $242,700 per unit, 10 percent below the median price in 2019.
- Cap rates compressed, averaging 4.2 percent in the first half of 2020. The average cap rate for San Diego in 2019 was 4.5 percent.

Investment Trends



Sources: NorthMarq, CoStar

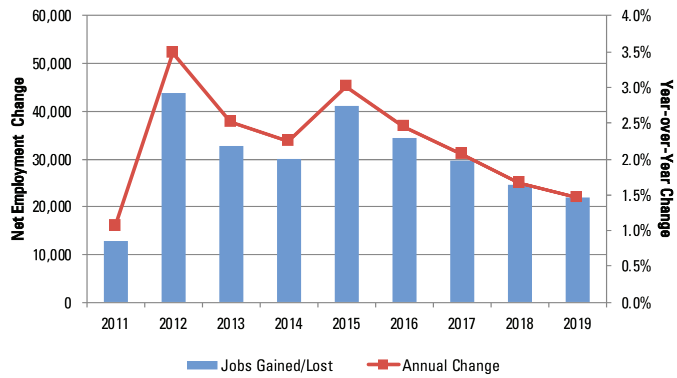
Cap rates compressed, averaging 4.2 percent in the first half of 2020

Looking Ahead

The San Diego multifamily market is traditionally one of the lowest-vacancy markets in the country, but the rate is expected to edge higher in the second half of this year. Net absorption has remained positive even through the economic contraction to this point in 2020, but levels are down approximately 70 percent when compared to the first halves of the past two years. The slowdown in absorption occurred at a time where new supply growth was limited, but construction is forecast to gain momentum in the coming quarters while absorption will likely lag levels of new inventory growth.

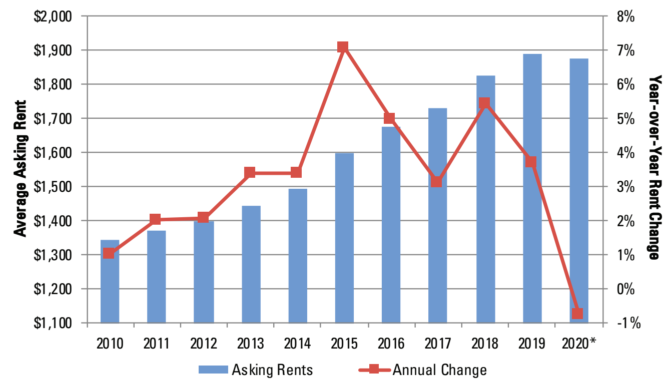
While many markets in the country have recorded steep declines in investment activity in recent months, demand for San Diego's apartment properties has remained steady for the past several years, a trend likely to continue in the second half of this year. Several factors drive the steady investment volume, led by consistently strong renter demand for apartments and low housing affordability. These conditions will persist into the extended future and continue to support investor demand.

Employment Forecast



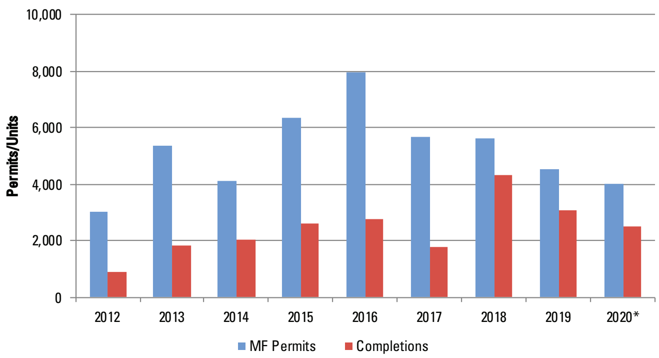
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



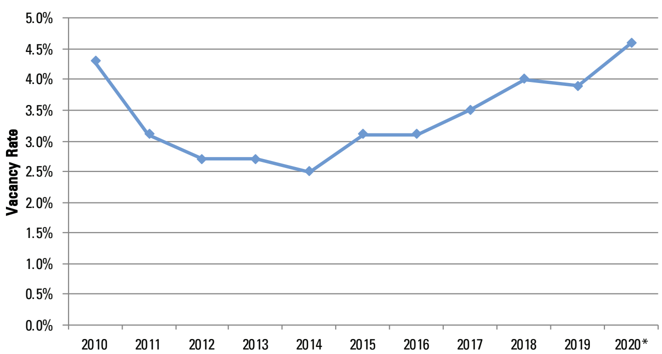
* Year End Forecast
Sources: NorthMarq, Reis

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.

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