Market Insights

San Diego Multifamily 2Q 2022

Northmarq

Construction Activity

5,869

Units under construction

1,165

Units delivered (YTD)

Market Fundamentals

3.7%

Vacancy

-60bps | Year over year change

$2,275

Asking Rent

+19.5% | Year over year change

Transaction Activity

$357,000

Median sales price per unit (YTD)

Vacancy Creeps Lower, Rents Maintain Upward Momentum

Highlights

- The San Diego multifamily market continued to strengthen during the second quarter, as asking rents pushed higher and the vacancy rate tightened. Multifamily developers are moving more projects into the construction pipeline, with nearly 5,900 units currently under construction.
- The local vacancy rate dropped 30 basis points during the second quarter, finishing the period at 3.7 percent. Year over year, the rate has improved by 60 basis points. Vacancy has declined in each of the past three quarters.
- San Diego apartment rents have recorded rapid gains in recent periods although the pace of growth slowed in the second quarter. In the past three months, asking rents increased by 2.2 percent to $2,275 per month. Asking rents have spiked by 19.5 percent during the past 12 months.
- The multifamily investment market gained momentum in the second quarter with sales activity accelerating from the start of the year. The median sales price thus far in 2022 rose to $357,000 per unit, up 11 percent from 2021 levels. Cap rates inched higher, averaging around 3.5 percent during the second quarter.

San Diego Multifamily Market Overview

The San Diego multifamily market posted gains during the second quarter. Asking rents continued to trend higher, following unprecedented rates of growth in recent periods. The vacancy rate improved in the first half of the year, finishing the second quarter at its lowest rate in more than four years. This marked the third consecutive quarter where vacancy has tightened. The areas that are farther away from the city center, including El Cajon, Escondido, and Oceanside, continue to record some of the tightest vacancy rates in the region and post below-average asking rents. Multifamily developers have been active to this point in the year, reflecting the recent swell in the construction pipeline.

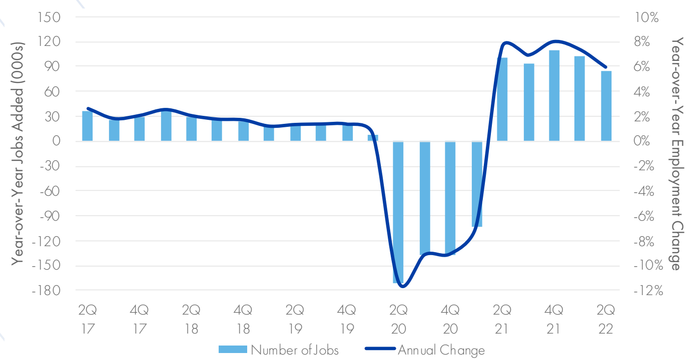
The multifamily investment market gained momentum in the second quarter. Prices have pushed higher than 2021 levels, particularly in sales of larger properties. Transaction activity accelerated in recent months, as sales volume during the second quarter outpaced the number of deals in the same period of the past four years. Although multifamily properties continue to trade throughout most of the county, the most active areas for recent sales include El Cajon and the South Bay region. These submarkets feature dozens of Class B and Class C buildings built in the 1970s and 1980s that can be acquired by local and regional operators. Cap rates averaged around 3.5 percent during the second quarter, up about 40 basis points from late 2021 and earlier this year.

Employment

- Employment growth was healthy in the second quarter with local employers adding 12,900 positions. During the past 12 months, the market has recorded rapid growth; nearly 85,000 jobs have been added year over year, an expansion of 5.9 percent.
- The local leisure and hospitality sector continues to recover after sharp contraction in 2020. Leisure and hospitality employment has expanded by 19.5 percent in the past year with the addition of 32,500 jobs.
- Amazon recently signed a lease for a 123,000-square-foot office space in the UTC area. With this expansion, the company plans to bring more than 700 corporate and tech jobs to San Diego in the coming years.
- **Forecast:** Area employers are expected to continue to add back workers in the coming quarters. In 2022, the local labor market is forecast to grow by 3.4 percent with the addition of roughly 50,000 jobs.

> Nearly 85,000 jobs have been added year over year.

Employment Overview



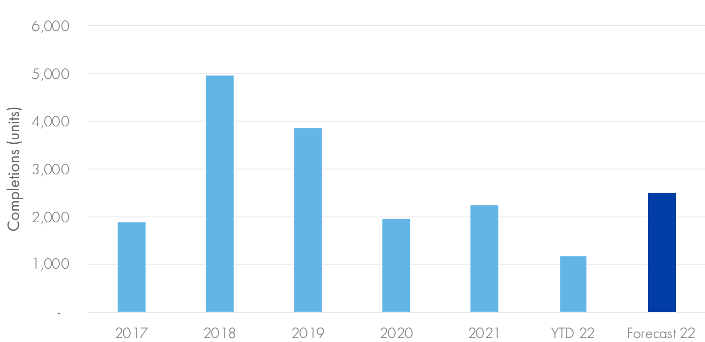
Sources: Northmarq, Bureau of Labor Statistics

Development and Permitting

> Nearly 5,900 units are currently under construction.

- Multifamily developers completed 315 units in the second quarter. Year to date, projects totaling 1,165 units have come online in San Diego. The pace of deliveries has been fairly consistent since 2020 but is expected to accelerate in the second half of this year and into 2023.
- Nearly 5,900 units are currently under construction in the region, a 34 percent increase from one year ago. While development in Downtown San Diego has been active for the past several years, new projects are breaking ground in outlying areas. More than 1,500 units are under construction in Chula Vista.
- Developers pulled permits for roughly 2,600 multifamily units during the first half of the year, down approximately 5 percent from the same period in 2021. Annual multifamily permitting totals have averaged around 5,500 units in the past five years.
- **Forecast:** The pace of apartment deliveries is expected to accelerate modestly in the second half of the year. Projects totaling approximately 2,500 units are forecast to come online in 2022.

Development Trends



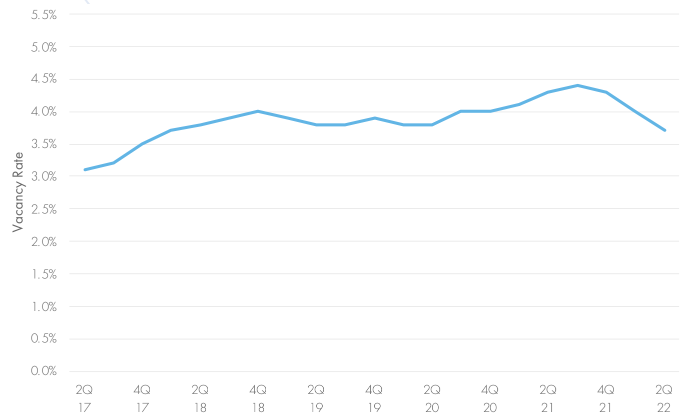
Sources: Northmarq, Reis, CoStar

Vacancy

- The vacancy rate dropped 30 basis points during the second quarter, falling to 3.7 percent. The current rate is at its lowest point since the end of 2017.
- Year over year, the vacancy rate is down 60 basis points. The largest vacancy decline occurred in the city center as the rate in Downtown San Diego dropped 460 basis points in the past year to 7.2 percent. Additional improvement is likely in Downtown as the economy more fully reopens and employees increasingly return to in-person work.
- San Diego's Class B and Class C units often have some of the lowest vacancy rates in the country. The combined vacancy rate in Class B and Class C units dipped 70 basis points in the past year to 1.8 percent. Vacancy in the mid- and lower tiers has not been above 3 percent in more than a decade.
- **Forecast:** Vacancy is forecast to inch slightly higher in the coming months, but the rate is on pace to record an annual decline in 2022. Local vacancy is expected to close the year at 3.9 percent, 40 basis points lower than the end of 2021.

> Year over year, the vacancy rate is down 60 basis points.

Vacancy Trends



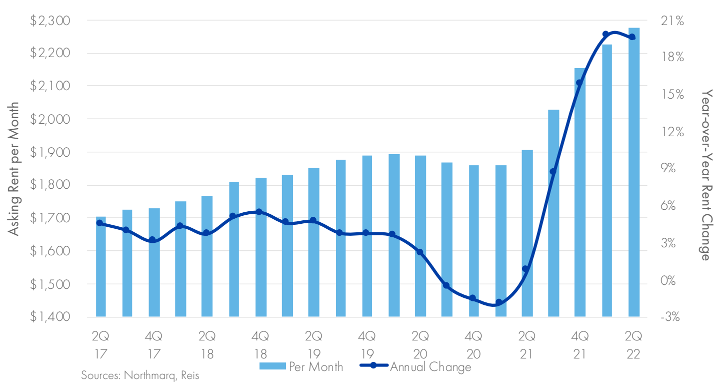
Sources: Northmarq, Reis

Rents

- Rents continued to push higher in recent months albeit at a more modest pace than in recent quarters. Asking rents increased 2.2 percent in the second quarter, rising to $2,275 per month. Quarterly rent increases averaged more than 4.6 percent in the preceding four quarters.
- Local asking rents spiked during the past 12 months, advancing 19.5 percent. The largest gains in the past year were recorded in the Mira Mesa/Rancho Bernardo submarket with average rents rising more than 24 percent to approximately $2,700 per month.
- Rents in Class A properties leveled off in the second quarter, following more than a year of rapid growth. Class A asking rents ended the second quarter at $2,687 per month, up 16.9 percent year over year.
- **Forecast:** With the local economy having fully recovered, rents in San Diego will continue to tick higher in the second half of the year. Asking rents are forecast to rise nearly 8 percent in 2022 to approximately $2,325 per month.

> Asking rents in the second quarter reached $2,275 per month.

Rent Trends



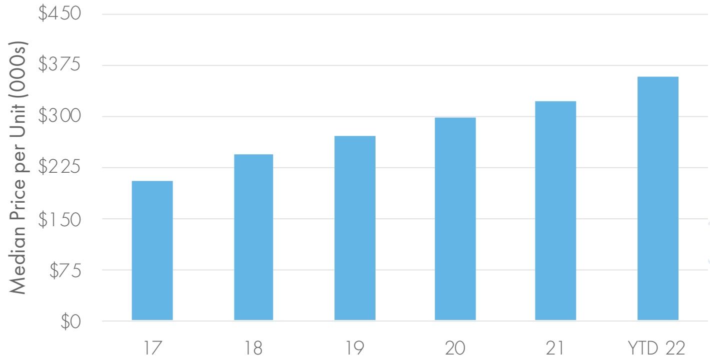
Sources: Northmarq, Reis

Multifamily Sales

- Transaction activity accelerated in recent months, as the number of sales during the second quarter doubled from the start of the year. Sales volume to this point in 2022 is up nearly 10 percent from the same period last year.
- The median sales price through the first half of the year reached more than $357,000 per unit, an 11 percent increase from the median price in 2021. While several transactions involving properties with fewer than 100 units sold in the first half, pricing in larger communities was higher. The median price in properties that are larger than 100 units is nearly $420,000 per unit.
- San Diego typically maintains some of the lowest cap rates in the country. Cap rates during the second quarter were about 3.5 percent, after averaging 3.1 percent in the previous six months.

> The median sales price in the first half was $357,000 per unit.

Investment Trends



Sources: NorthMarq, CoStar

Recent Transactions

Multifamily Sales Activity

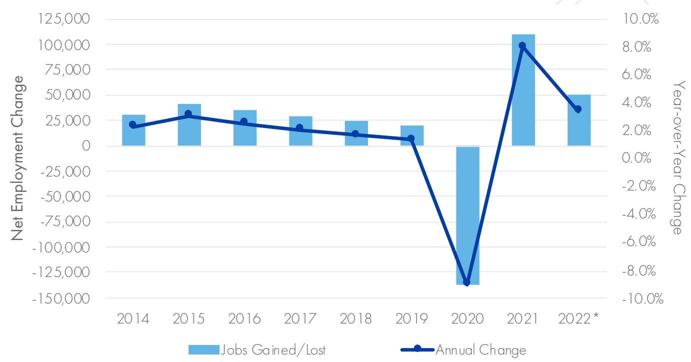
Property Name	Street Address	Units	Sales Price	Price/Unit
The Heritage	1471 8th Ave., San Diego	230	$118,500,000	$515,217
Celsius	100 Citronica Ln., Lemon Grove	102	$42,800,000	$419,608
The Arches Apartments	301 Shady Ln., San Diego	92	$24,800,000	$269,565
STUDIOS435	435 13th St., San Diego	86	$23,250,000	$270,349
Carriage Road Apartments	13126-13130 Carriage Rd., Poway	53	$19,000,000	$358,491

Looking Ahead

Following rapid gains in the first half of the year, the San Diego multifamily market is expected to record mostly steady performance through the remainder of 2022. With the recent uptick in the number of units under construction, multifamily developers are on pace to deliver more units than in the previous two years. The volume of completed apartment projects spiked in 2018 and 2019 before dipping lower in the next few years, largely due to supply chain-related challenges. New supply growth is expected to outpace absorption levels in the coming quarters, which will likely result in a slight uptick in the vacancy rate. Even if the rate ticks higher, vacancy is likely to remain below the five-year market average, and these tight conditions will support additional rent growth, particularly as employers add to local payrolls.

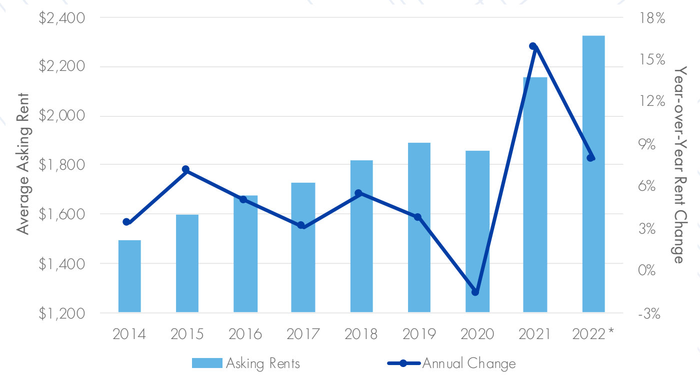
The San Diego multifamily investment market should sustain its momentum during the second half of this year. With the global pace of growth likely to slow, investors will target assets in markets with less downside risk. Most apartment properties in San Diego are insulated from significant competition from new development, and vacancies are persistently low, particularly in older buildings where rents are below the market average. Cap rates may inch up but are not expected to stretch much above the mid-3 percent average from the second quarter. While borrowing costs have trended higher, cap rates in San Diego have historically remained quite low in most interest rate cycles. The bulk of the latest interest rate increases has likely already occurred, and sellers are expected to resist any significant upward pressures on cap rates in the second half.

Employment Forecast



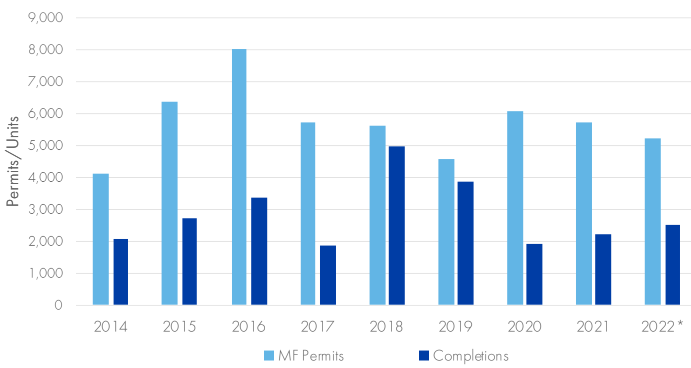
* Year End Forecast
Sources: Northmarq, Bureau of Labor Statistics

Rent Forecast



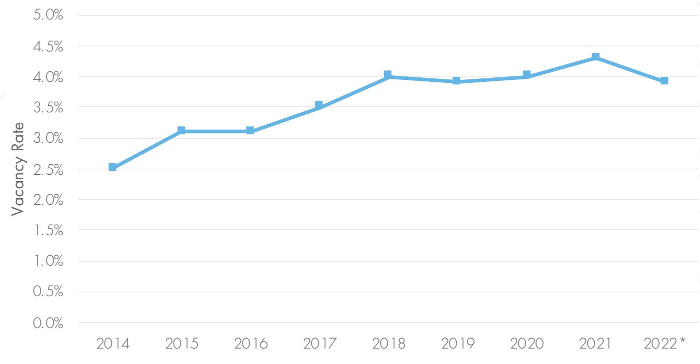
* Year End Forecast
Sources: Northmarq, Reis

Construction & Permitting Forecast



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

Vacancy Forecast



* Year End Forecast
Sources: Northmarq, Reis

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