Northmarq

MARKET INSIGHTS

Rents remain on upward trajectory

HIGHLIGHTS

- The San Diego apartment market posted strong performance during the second quarter as asking rents trended higher and vacancy remained fairly tight. Multifamily deliveries were limited in the first half but are expected to ramp up by year end.
- The local vacancy rate rose 30 basis points during the second quarter to 3.8 percent but remains nearly identical to the region's long-term average. During the past 12 months, the rate has inched up just 10 basis points.
- Asking rents in San Diego have pushed higher for two straight years. During the second quarter, rents reached $2,348 per month, and year over year, rents are up 3.2 percent.
- Multifamily investment activity in San Diego slowed during the second quarter, and sales velocity in the first half of 2023 is down from year-earlier levels. The median sales price year to date is $264,900 per unit, while cap rates in recent transactions have been between 4.5 percent and 5.5 percent.

SAN DIEGO MULTIFAMILY MARKET OVERVIEW

The San Diego multifamily market continues to record healthy conditions, with vacancy remaining tight and rents pushing higher. While the pace of deliveries is forecast to accelerate, only a handful of new apartment projects came online in the first half of 2023, including developments in East Village, Balboa Park, and Mission Valley. Area vacancy rose slightly during the second quarter, but the rate continues to closely track the region's trailing five-year average. The consistently low vacancy conditions allowed operators to continue to push rental rates higher. Rent growth in San Diego outpaced nearly every major West Coast market during the past 12 months, even as the trajectory of increases moderated.

Local apartment sales activity has cooled significantly to this point in the year, as many investors are struggling to complete deals in a heightened interest rate environment. The number of transactions in the first half of 2023 fell by more than 50 percent from the same period last year. Further, a decline in average transaction size has resulted in dollar volume falling by 67 percent. As the pace of deals slowed and cap rates trended higher in recent periods, pricing also crept lower, although more properties traded at higher per-unit prices in the second quarter than during the first few months of the year. Cap rates edged higher in recent months, generally ranging between 4.5 percent to 5.5 percent during the second quarter.

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	5,580
UNITS DELIVERED	685

MARKET FUNDAMENTALS

VACANCY RATE	3.8%
YEAR-OVER-YEAR CHANGE	+10bps
ASKING RENTS	$2,348
YEAR-OVER-YEAR CHANGE	+3.2%

TRANSACTION ACTIVITY (YTD)

MEDIAN PRICE PER UNIT*	$264,900

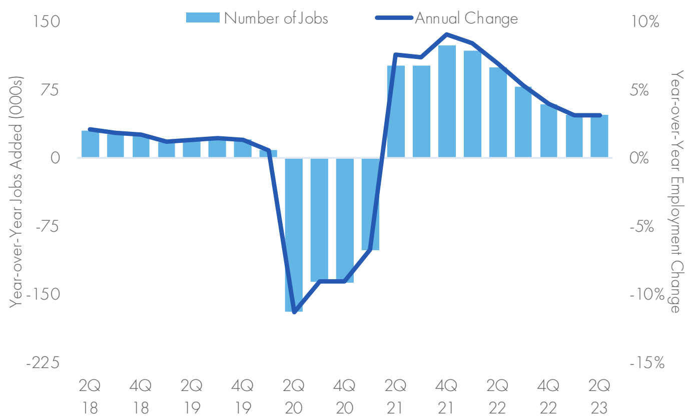
San Diego Multifamily
2Q 2023

EMPLOYMENT

- The pace of hiring has been steady in recent periods, with local businesses remaining in expansion mode. Area employers added 12,500 workers to payrolls during the second quarter; year over year, total employment advanced by 47,400 positions, a gain of 3.1 percent.
- The healthcare and social assistance industry has been a major driver in the San Diego economy. During the 12-month period that ended in the second quarter, the sector expanded by 7.3 percent with the addition of 14,400 positions.
- Biotechnology company Genentech is expanding its local manufacturing capabilities with a $450 million investment at the company's Oceanside campus. The new expansion is projected to be operational by 2025 and will create more than 150 full-time jobs in North County. The company currently has more than 1,000 employees in Oceanside.
- **FORECAST:** Area employers are expected to add jobs at a slightly slower pace through the remainder of the year. Total employment in San Diego is projected to expand by nearly 2 percent in 2023 with the addition of roughly 30,000 workers.

Year over year, employment advanced by 47,400 positions.

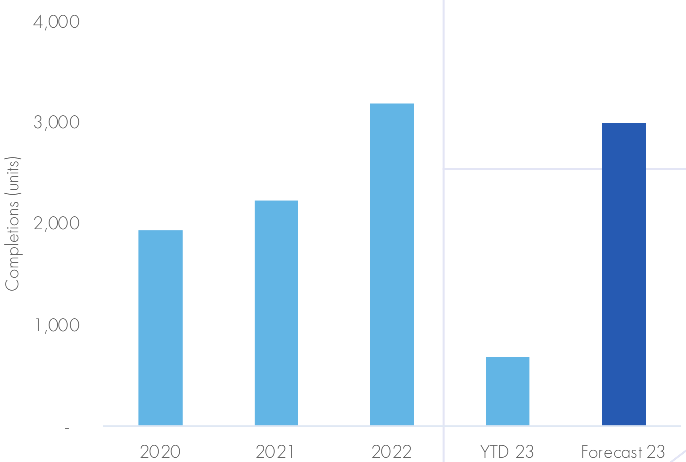
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

Projects totaling 5,580 units are currently under construction.

DEVELOPMENT TRENDS



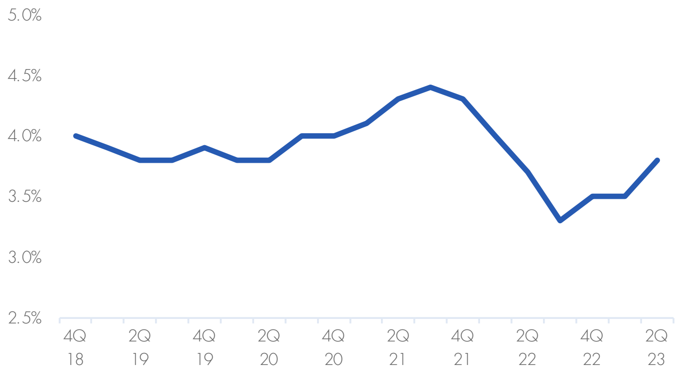
Sources: Northmarq, CoStar

DEVELOPMENT & PERMITTING

- Apartment completions have been fairly limited to this point in the year with only 685 units delivered during the first half. Following the recent slowdown, the pace of multifamily completions should pick up significantly by the end of 2023.
- While new projects continue to break ground, the development pipeline has thinned a bit from the peak recorded last year. Projects totaling 5,580 units are currently under construction in San Diego, after the development pipeline included more than 6,000 units in early 2022.
- Multifamily permitting was mostly stable from the first quarter to the second quarter with 1,050 permits pulled in the last three months. Nearly 2,130 permits were issued year to date, down about 2 percent from levels during the second half of 2022.
- **FORECAST:** The pace of apartment deliveries is projected to ramp up in the second half of the year with projects totaling approximately 3,000 units slated to come online in 2023.

Vacancy has remained in a consistent range for the past several years.

VACANCY TRENDS



Sources: Northmarq, REIS

VACANCY

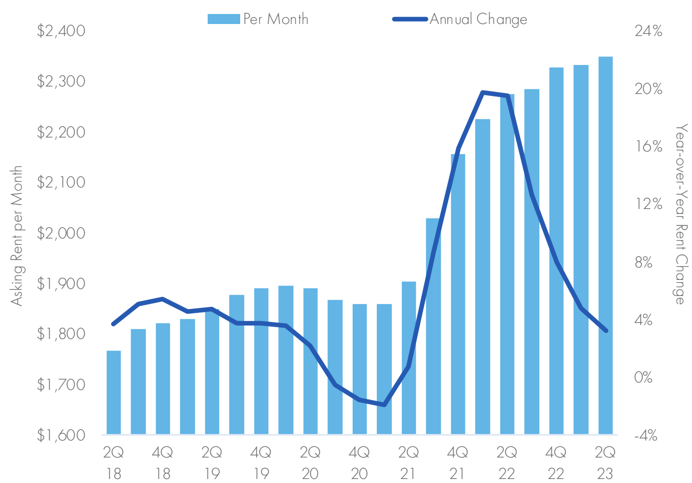
- Vacancy in San Diego trended slightly higher in recent months, rising 30 basis points during the second quarter to 3.8 percent. Despite the recent increase, the rate has remained in a very consistent range for the past several years; vacancy has inched up 10 basis points during the past 12 months.
- Vacancy conditions Downtown have been improving during the past year, although the submarket still records the highest vacancy rate in the region. Vacancy in the city center fell 60 basis points from one year ago to 6.8 percent. In recent years, Downtown vacancy has averaged above 10 percent, but the rate in the submarket began to tighten significantly in 2021.
- Local vacancy continues to be lowest in mid-tier and lower-tier properties, as demand for lower-cost units continues to exceed supply in San Diego. The combined vacancy rate in Class B and Class C units ended the second quarter at just 1.9 percent, nearly identical to the rate one year ago.
- **FORECAST:** As construction activity picks up in the second half of the year, vacancy in San Diego is expected to tick higher. Area vacancy is projected to finish 2023 at 4 percent, up 50 basis points for the full year.

RENTS

- Apartment rents in San Diego continued to trend higher, rising 0.6 percent in the second quarter to $2,348 per month. Year over year, local asking rents are up 3.2 percent.
- Rent growth was strongest in the Mission Bay/Pacific Beach submarket during the past year, due to its desirable location and limited supply growth. Asking rents in this submarket advanced 9.5 percent during the past 12 months to $2,542 per month. Rent growth in the submarket has averaged nearly 6 percent per year since 2017.
- Class B and Class C apartments posted the largest rent gains during the past year. Combined apartment rents in mid-tier and lower-tier units rose 4.8 percent from one year ago to $1,933 per month. Average Class A asking rents ended the second quarter at $2,828 per month.
- **FORECAST:** Annual rent growth in 2023 is expected to taper off from the last two years. Asking rents in San Diego are forecast to rise 2.5 percent this year to $2,385 per month.

Year over year, local rents are up 3.2 percent.

RENT TRENDS



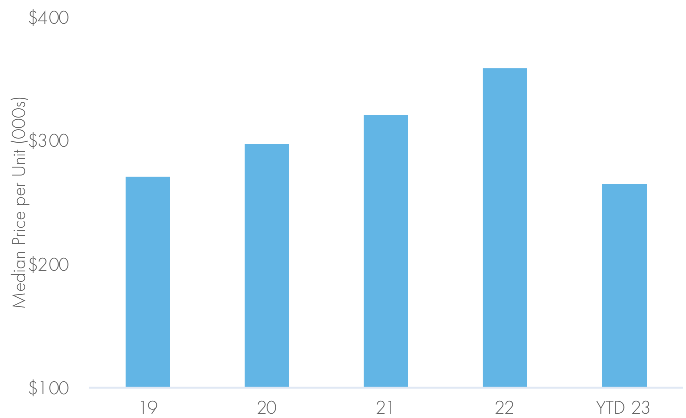
Sources: Northmarq, REIS

MULTIFAMILY SALES

- Multifamily sales activity continued to slow in recent months as the number of transactions declined 30 percent from the first quarter to the second quarter. Additionally, deal volume year to date is down more than 50 percent year over year. The bulk of the transactions that closed during the second quarter were properties with between 30 to 65 units.
- The properties that are changing hands are trading at prices below last year's peak levels. The median sales price thus far in 2023 is $264,900 per unit, down 26 percent from the median price last year. During the second quarter, a larger share of properties traded at above $300,000 per unit.
- Cap rates continued to trend higher in the last three months. During the second quarter, cap rates ranged between 4.5 percent and 5.5 percent, up roughly 150 basis points from one year ago.

The median sales price thus far in 2023 is $264,900 per unit.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

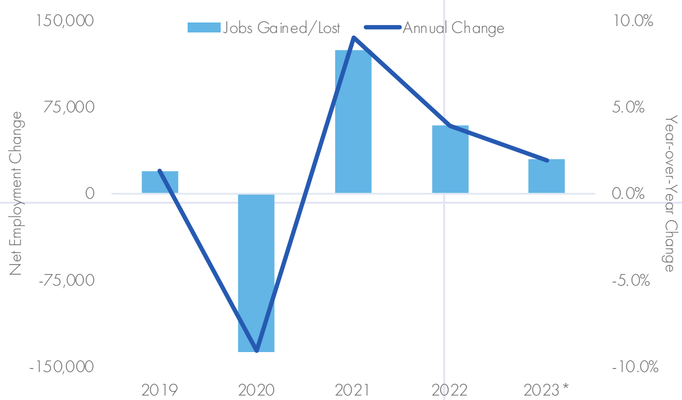
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
Allina La Jolla	3417 Lebon Dr., San Diego	400	$177,300,000	$443,250
Mr Robinson Lofts	3752 Park Blvd., San Diego	34	$28,215,500	$829,868
Hawaiian Gardens	1031 Imperial Beach Blvd., Imperial Beach	63	$19,000,000	$301,587
Vista de Helix	8707 Troy St., Spring Valley	28	$6,315,000	$225,536
Wisconsin Terrace	299 Wisconsin Ave., El Cajon	22	$5,775,000	$262,500

LOOKING AHEAD

Apartment completions throughout San Diego have been fairly limited to this point in the year, following a spike in deliveries in 2022. Looking ahead, the pace of completions is forecast to accelerate in the coming quarters, with projects totaling roughly 3,000 units scheduled to come online this year. The influx of new inventory is expected to outpace absorption levels, putting some modest upward pressure on local vacancy. The vacancy rate is expected to finish the year at 4 percent, slightly higher than the current figure, but still in line with the long-term trend in the region. Rent growth is scheduled to taper off from recent years, with a forecast increase of 2.5 percent likely in 2023, about half the long-term rate of growth in the region.

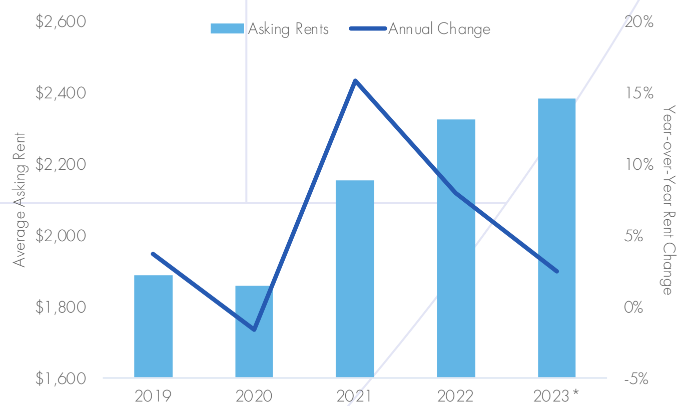
Multifamily properties in San Diego are trading, but in limited numbers, and with the bulk of the transactions involving assets with fewer than 100 units. Looking ahead, the pace of transactions will likely hold fairly steady, although there could be some increasing deal flow near the end of this year. Investors may require a few more periods of price discovery before sales velocity gains any significant momentum. Local cap rates have approached 5 percent on average, but have not historically stretched much higher than current levels. While market cap rates and current lending rates create challenges underwriting acquisitions, investors looking to allocate capital into San Diego apartment properties will likely rely on future rent growth for deals to pencil.

EMPLOYMENT FORECAST



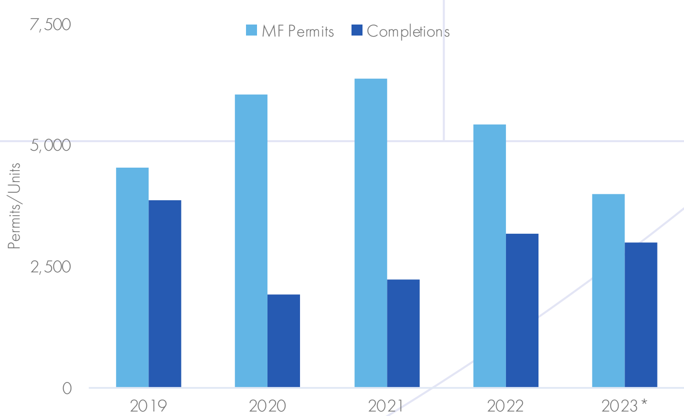
* Year End Forecast
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



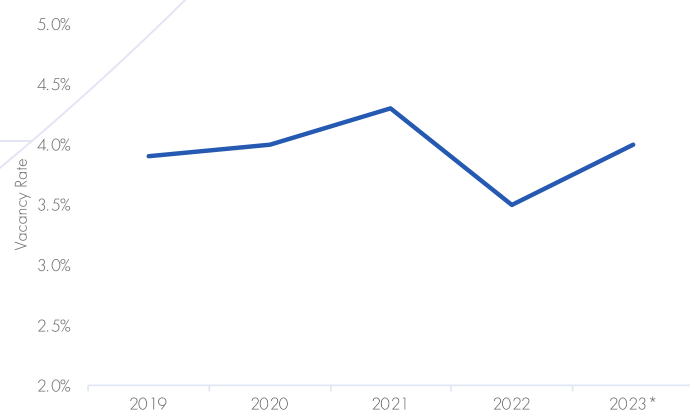
* Year End Forecast
Sources: Northmarq, REIS

CONSTRUCTION & PERMITTING FORECAST



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

VACANCY FORECAST



* Year End Forecast
Sources: Northmarq, REIS

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