YARDI® Matrix

San Diego: Biotech Capital of the West

Multifamily Summer Report 2016

Rents Top National Average

New Grads Drive Demand

Supply Low but Pipeline Growing

Market Analysis

Summer 2016

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San Diego Catches Silicon Valley Fever

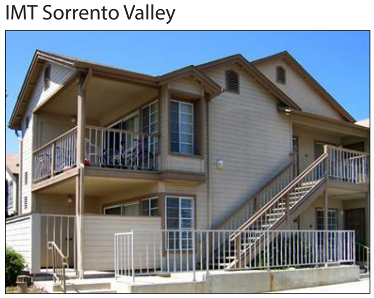
With broad-based job gains and above-average population growth, San Diego continues to produce a healthy climate for multifamily. The metro's occupancy rate is a phenomenal 97%, on par with Los Angeles and among the highest in the country, while demand is strong and rents are growing at above-trend levels.

The combination of a deep pool of talent, venture capital and quality office/lab space is drawing a large number of tech and biotech companies to the area, turning San Diego into an alternative to Silicon Valley. Indeed, the metro is developing a reputation as the biotech capital of the West. Other segments that are driving growth include defense/military, manufacturing, international trade, hospitality, healthcare, and research and education. The versatility created by this mix helped San Diego during the financial crisis and can act as a potential safety net for investors during a future downturn.

Multifamily fundamentals are healthy on all fronts, and rents grew 6.9% year-over-year through May. The development pipeline, investment volume, home prices and rents are all at or near their highest point in the current cycle. Investor appetite is strong, with a record transaction volume of $1.5 billion. Though demand for units will remain solid, there are 32,000 units in the pipeline, which will help slow rent growth to a more sustainable 5.5% in 2016.

Recent San Diego Transactions

IMT Sorrento Valley



City: San Diego
Buyer: IMT Capital
Purchase Price: $214 MM
Price per Unit: $284,575

eaves Rancho San Diego

City: El Cajon, Calif.
Buyer: R&V Management
Purchase Price: $158 MM
Price per Unit: $233,728

The Reserve at Carlsbad

City: Carlsbad, Calif.
Buyer: Decron Properties
Purchase Price: $112 MM
Price per Unit: $248,889

Form 15

City: San Diego
Buyer: Essex Property Trust
Purchase Price: $98 MM
Price per Unit: $403,504

On the cover: Photo by Michael Svoboda/iStockphoto.com

Rent Trends

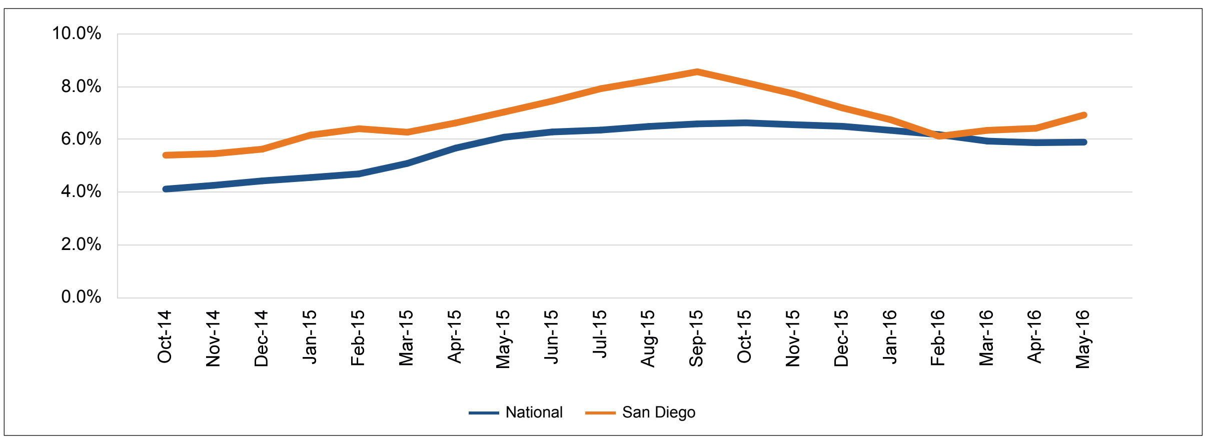
- San Diego rents rose by 6.9% year-over-year through May, outperforming the national growth rate by 90 basis points. Average rents have climbed to $1,651, well over the $1,204 national average. The metro boasts a concentration of highly skilled Millennials that graduate from nearby universities or are drawn to the area for its weather and lifestyle, so demand is likely to remain robust for the foreseeable future.

- The metro is one of the more expensive in the country, as higher-end Lifestyle rents average $2,104 per month and working-class Renter by Necessity units average $1,466. Even so, San Diego is one of the more affordable metros in California, especially when compared to the San Francisco Bay area.

- Mid-City (6.7%), Vista (6.7%) and Oceanside (6.3%) recorded the highest rent growth year-over-year through May. Remote Fallbrook, at $988, remains the only submarket with a median rent under the $1,000 mark, while rents were more than twice that level in upscale Del Mar ($2,855), Poway ($2,104) and amenity-rich, biotech- and research-oriented University ($2,066).

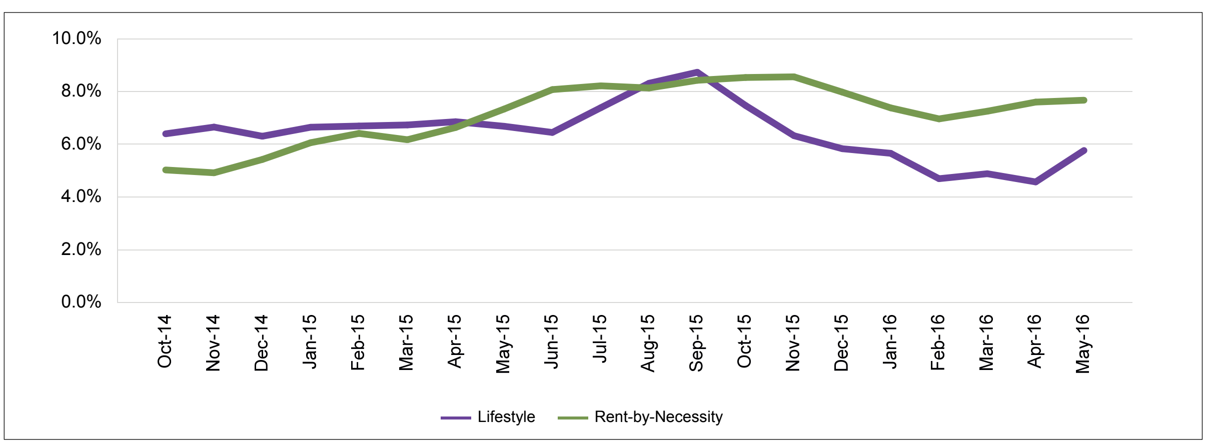
- While we expect demand for units to remain strong, Yardi Matrix forecasts that rent growth will moderate this year as affordability increasingly becomes an issue and the development pipeline continues to grow. As a result, rent growth should be a more sustainable 5.5% in 2016.

San Diego vs. National Rent Growth (Sequential 3 Month, Year-Over-Year)



Source: YardiMatrix

San Diego Rent Growth by Asset Class (Sequential 3 Month, Year-Over-Year)



Source: YardiMatrix

Economic Snapshot

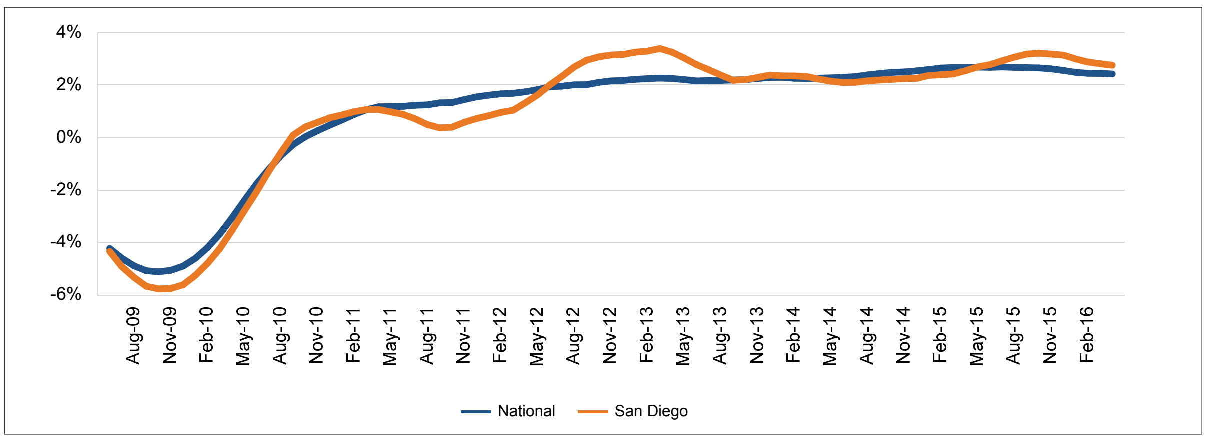
- San Diego added 39,700 jobs in 2015, a 2.9% year-over-year increase, 40 basis points over the national average and in line with the metro's 2014 growth of 3%. Once again, gains were led by professional and business services (7,300) and education and health services (7,000).

- The leisure and hospitality sector added 5,600 jobs. The metro's iconic attractions, climate and beaches, plus its convention center, are a major draw for tourism and conferences. Other segments producing new jobs include military facilities and defense contractors, health care, international trade, the area's network of universities and colleges, and startups doubled by a research-and-development cluster that generates $14.4 billion worth of economic activity.

- As an affordable alternative to the San Francisco Bay area, San Diego attracts and retains a growing number of highly skilled Millennials, as well as a growing number of tech and biotech companies. A recent report by a group of think tanks led by the U.S. Chamber of Commerce named San Diego a top-five U.S. destination for startups in the digital field, thanks to its "strong talent and capital base, dense community and growing specializations in health and IT."

- The construction sector added 5,000 jobs in 2015, due to projects including accelerated downtown development, the 70-acre Seaport Village project and the proposed expansion of the convention center and the stadium housing the NFL's San Diego Chargers franchise.

San Diego vs. National Employment Growth (Year-Over-Year)



Sources: YardiMatrix, Bureau of Labor Statistics (not seasonally adjusted)

San Diego Employment Growth by Sector (Year-Over-Year)

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
60	Professional and Business Services	235	16.7%	7,300	3.2%
65	Education and Health Services	199	14.1%	7,000	3.7%
70	Leisure and Hospitality	185	13.1%	5,600	3.1%
90	Government	242	17.2%	4,800	2.0%
40	Trade, Transportation and Utilities	219	15.6%	4,400	2.1%
15	Mining, Logging and Construction	71	5.0%	4,000	6.0%
55	Financial Activities	73	5.2%	3,200	4.6%
30	Manufacturing	107	7.6%	2,500	2.4%
80	Other Services	53	3.8%	700	1.3%
50	Information	24	1.7%	200	0.8%

Sources: YardiMatrix, Bureau of Labor Statistics

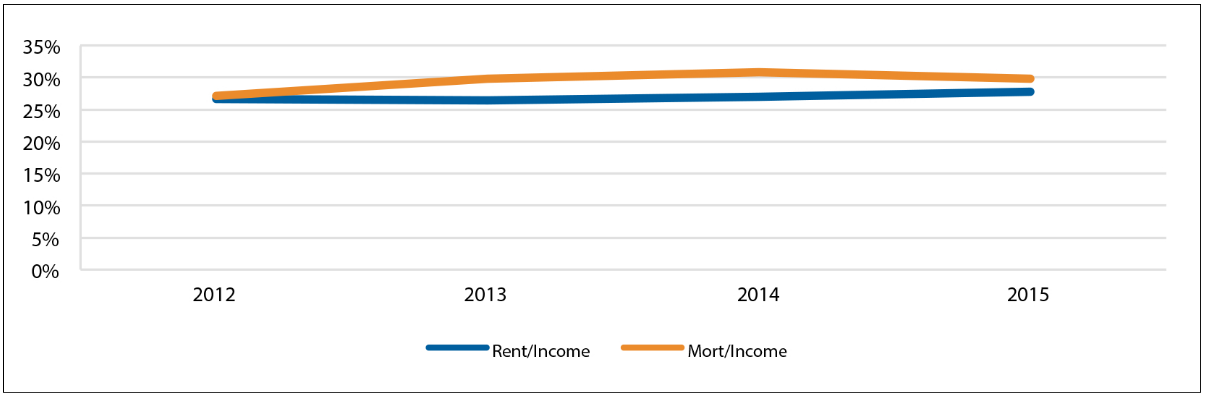
Demographics

Affordability

- San Diego's average home price hit $458,460 in 2015, the highest point in the current cycle. With homes costing more than twice the national average, San Diego is one of the least affordable metros in the U.S. On top of that, San Diego County has lost 61% of its federal and state funding for residential development since 2008-9, further deepening its affordability issues and mostly impacting lower-income households.

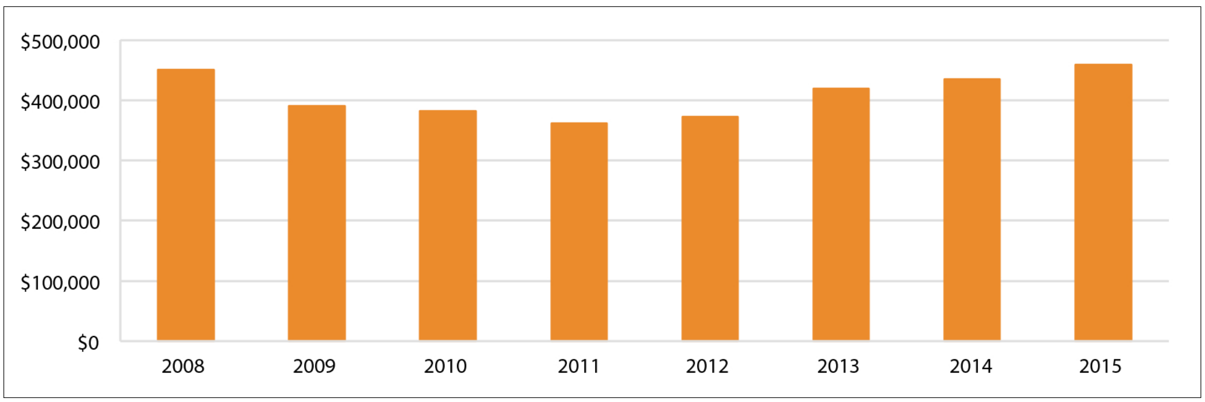
- Homeownership in San Diego is barely at the 50% mark, less than the 54% level in California and the 63.5% point for the U.S. Affordability is limited for renters and owners, as the average mortgage is 30% of the metro's median income of $68,524, while renting comprises around 28%.

San Diego Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

San Diego Median Home Price



Source: Moody's Analytics

Population

- From 2010 to 2014, the metro's population grew by 5.1%, well over the national 3.1% rate.

- With 27.4% of the population aged 18-34 in 2014, the San Diego-Carlsbad MSA continues to draw Millennials.

San Diego vs. National Population

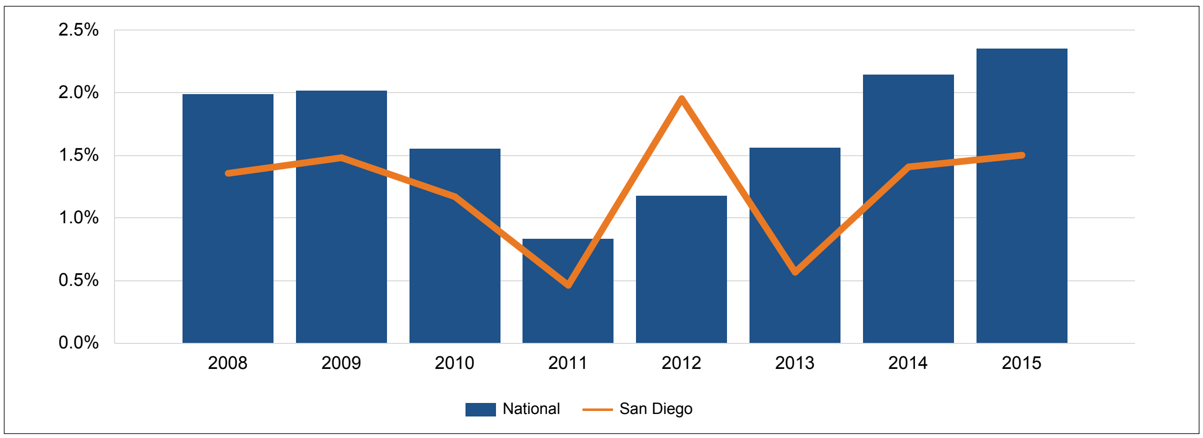
	2010	2011	2012	2013	2014
National	309,347,057	311,721,632	314,112,078	316,497,531	318,857,056
San Diego-Carlsbad, CA Metro	3,104,543	3,141,768	3,183,413	3,222,558	3,263,431

Source: U.S. Census

Supply

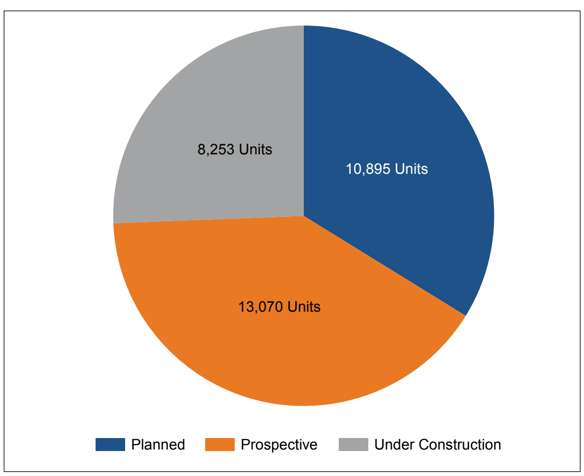
- San Diego added 3,125 units last year, 671 more than in 2014. With a 1.8% stock expansion in 2015, the metro continues to trail the national percentage of new supply for the third year in a row.
- However, supply is growing. More than 32,000 units were in the works as of May, with 8,253 under construction. The total pipeline grew by more than 10,000 units during the past year, an indication that San Diego is finally likely to start balancing its supply-demand ratio.
- Core and coastal submarkets dominate the pipeline, with Central San Diego, Mira Mesa and Kearny Mesa contributing roughly 4,700 units currently under construction. Casa Mira View in Mira Mesa is the nation's largest multifamily project slated for the second half. Once its final development phase is complete, the community will have added 1,620 units to the metro's inventory.
- Even if population and employment growth continue to outperform national trends, the city's constant need for new multifamily projects is underserved, due to geographical restrictions and rigid zoning regulations.

San Diego vs. National Completions as a Percentage of Total Stock (as of May 2016)



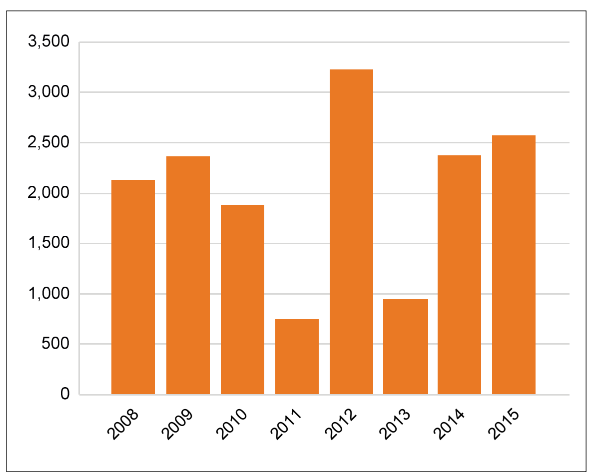
Source: YardiMatrix

Development Pipeline (as of May 2016)



Source: YardiMatrix

San Diego Completions (as of May 2016)

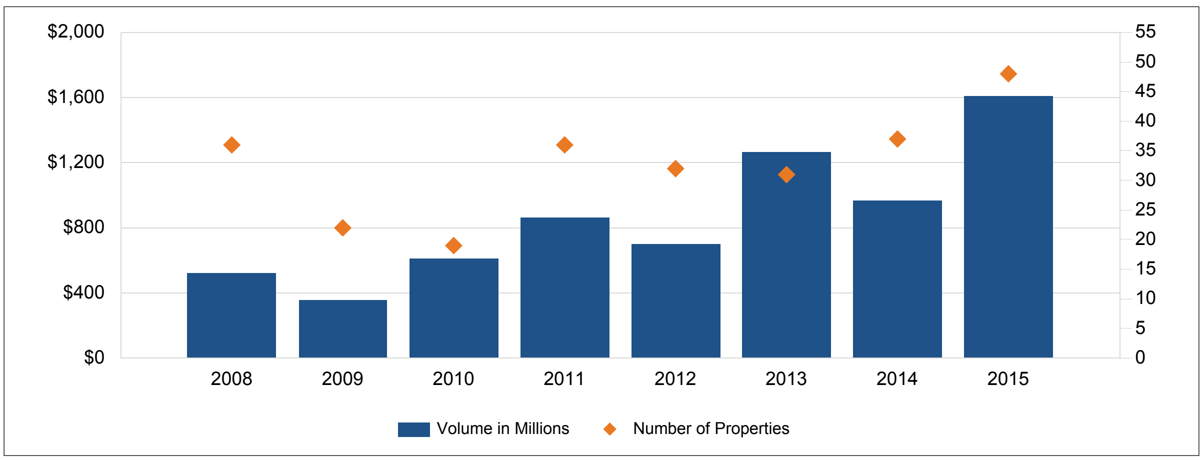


Source: YardiMatrix

Transcractions

- Demand for multifamily is getting stronger in San Diego, as 46 properties traded in 2015 for a total investment volume of almost $1.5 billion. This figure marks a 30% increase over 2014, reaching a new high in the current cycle. Investors have a strong appetite for West Coast metros, and San Diego is slightly less pricey than the core markets in San Francisco and Los Angeles.
- With investors focusing on value-add opportunities, the Renter-by-Necessity sector remains the driving factor for sales, accounting for 75% of all volume in 2015.
- Bullish appetite translates into record prices, with San Diego's average price per unit reaching $222,000 in April, or 77% over the national median. The 752-unit IMT Sorrento Valley in Mira Mesa, for example, sold for $214 million, or more than $284,000 per unit, in April 2016, having traded for $138,000 per unit just 16 months prior.

San Diego Sales Volume and Number of Properties Sold (as of May 2016)



Source: YardiMatrix

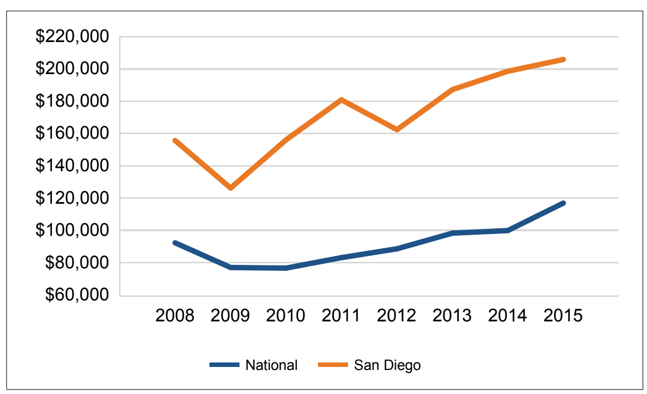
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Mira Mesa	254
Central San Diego	202
Spring Valley	172
Carlsbad	138
La Mesa	109
South Bay	88
Mid-City	86
Chula Vista	67

Source: YardiMatrix

[1] From June 2015 to May 2016

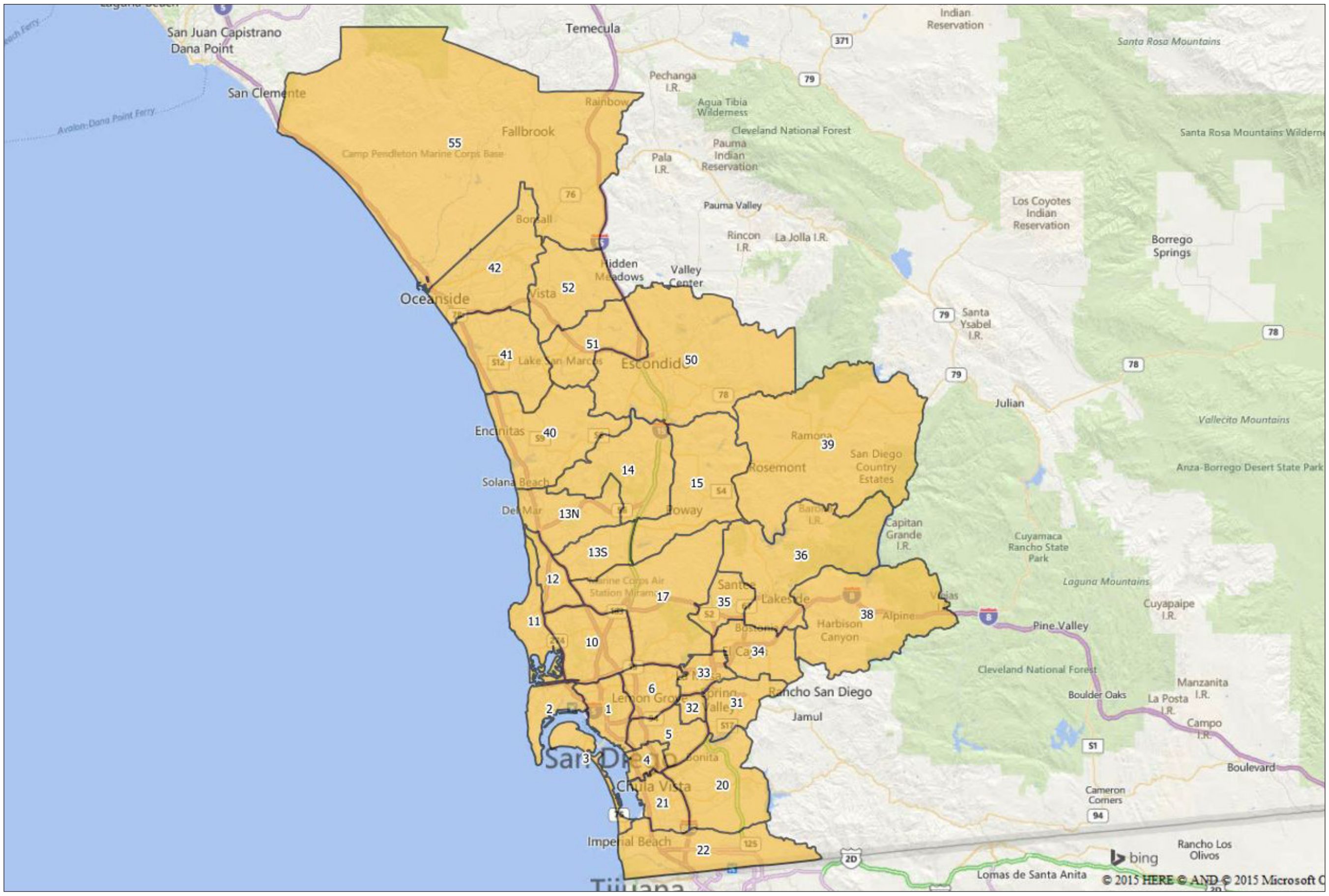
San Diego vs. National Sales Price per Unit



Source: YardiMatrix

Photo of San Diego by Art Wager/iStockphoto.com

San Diego Submarket Map



Area #	Submarket
1	Central San Diego
2	Peninsula
3	Coronado
4	National City
5	Southeast San Diego
6	Mid-City
10	Kearny Mesa
11	Coastal
12	University
13N	Del Mar
13S	Mira Mesa
14	North San Diego
15	Poway
17	Elliot-Navajo
20	Sweetwater
21	Chula Vista
22	South Bay

Area #	Submarket
31	Spring Valley
32	Lemon Grove
33	La Mesa
34	El Cajon
35	Santee
36	Lakeside
38	Alpine
39	Ramona
40	San Dieguito
41	Carlsbad
42	Oceanside
50	Escondido
51	San Marcos
52	Vista
55	Fallbrook

Definitions

Lifestyle households (renters by choice) have wealth sufficient to own but have chosen to rent. Discretionary households, most typically a retired couple or single professional, have chosen the flexibility associated with renting over the obligations of ownership.

Renter by Necessity households span a range. In descending order, household types can be:

- *A young-professional, double-income-no-kids household* with substantial income but without wealth needed to acquire a home or condominium;
- *Students*, who also may span a range of income capability, extending from affluent to barely getting by;
- *Lower-middle-income ("gray collar") households,* composed of office workers, policemen, firemen, technical workers, teachers, etc.;
- *Blue-collar households*, which may barely meet rent demands each month and likely pay a disproportionate share of their income toward rent;
- *Subsidized households*, which pay a percentage of household income in rent, with the balance of rent paid through a governmental agency subsidy. Subsidized households, while typically low income, may extend to middle-income households in some high-cost markets, such as New York City;
- *Military households*, subject to frequency of relocation.

These differences can weigh heavily in determining a property's ability to attract specific renter market segments. The five-star resort serves a very different market than the down-and-outer motel. Apartments are distinguished similarly, but distinctions are often not clearly definitive without investigation. The Yardi® Matrix Context rating eliminates that requirement, designating property market positions as:

Market Position	Improvements Ratings
Discretionary	A+ / A
High Mid-Range	A- / B+
Low Mid-Range	B / B-
Workforce	C+ / C / C- / D

The value in application of the Yardi® Matrix Context rating is that standardized data provides consistency; information is more meaningful because there is less uncertainty. The user can move faster and more efficiently, with more accurate end results.

The Yardi® Matrix Context rating is not intended as a final word concerning a property's status—either improvements or location. Rather, the result provides reasonable consistency for comparing one property with another through reference to a consistently applied standard.

To learn more about Yardi® Matrix and subscribing, please visit www.yardimatrix.com or call Ron Brock, Jr., at 480-663-1149 x2404.