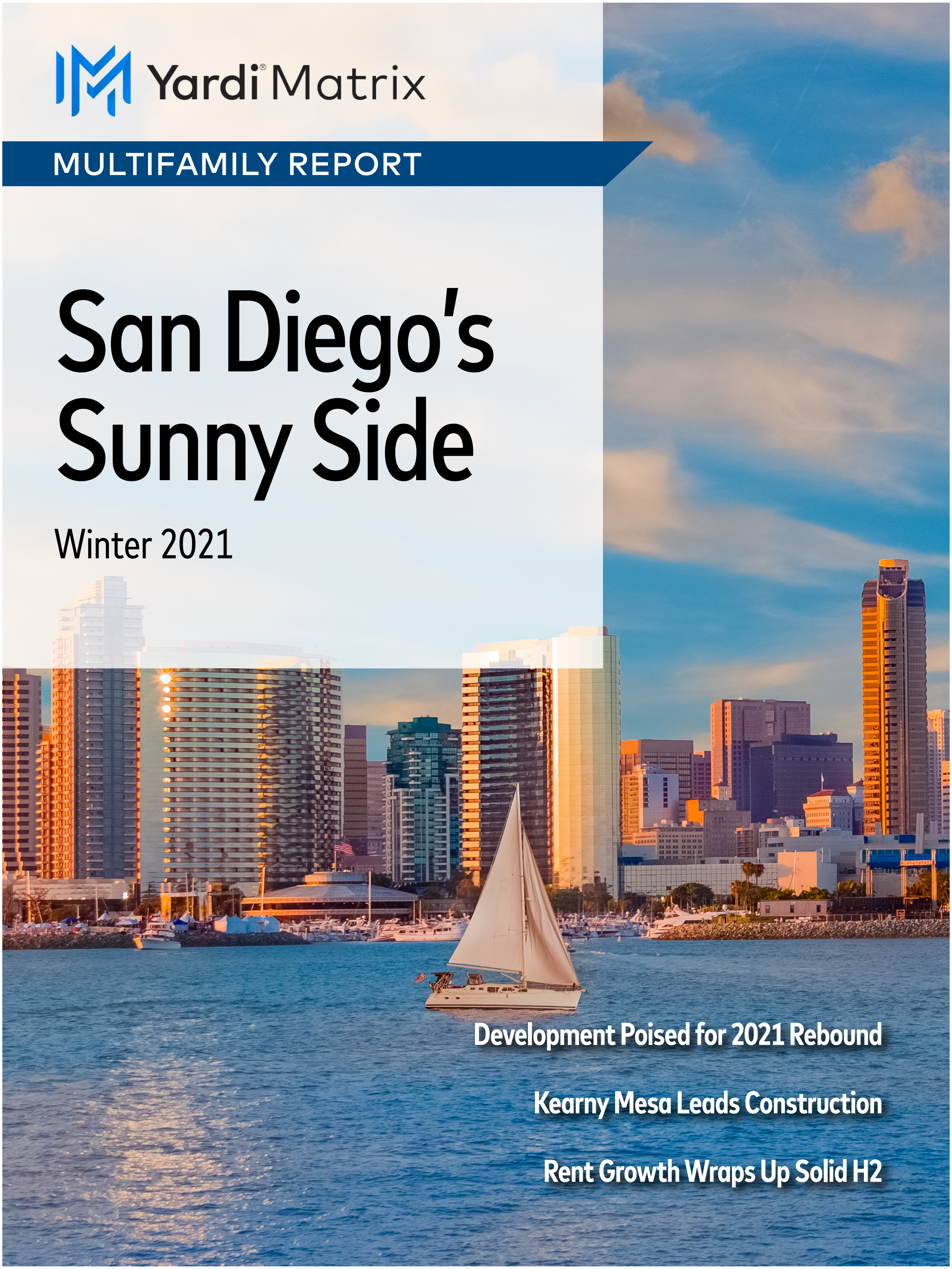
Yardi Matrix

MULTIFAMILY REPORT

San Diego's Sunny Side

Winter 2021



Development Poised for 2021 Rebound

Kearny Mesa Leads Construction

Rent Growth Wraps Up Solid H2

SAN DIEGO MULTIFAMILY

Yardi Matrix

Recovery in Sight

Following a bumpy second quarter, San Diego's multifamily sector recorded a stronger second half of 2020, as it hummed along toward recovery. The average San Diego rent dropped 0.3% last year, close to the -0.8% U.S. rate and somewhere between a booming Inland Empire (7.3%) and a struggling San Jose (-13.7%). Meanwhile, occupancy inched up 10 basis points over 12 months to 96.0%, as of November 2020.

While San Diego's economy managed to recover many of the jobs that were lost at the beginning of the health crisis, the city still shed nearly 100,000 positions in the 12 months ending in November 2020, marking an 8.2% contraction, with leisure and hospitality (-45,100 jobs) taking the strongest hit. Meanwhile, the unemployment rate steadily appreciated to 6.6% as of November from the 15.2% high in May, with two employment sectors recording gains over 12 months: professional and business services (7,300 jobs) and mining, logging and construction (2,000 jobs).

The pandemic and ensuing economic volatility affected both transaction volume and development in 2020. Only $494 million in multifamily assets traded last year in San Diego, a sharp drop from nearly $1.6 billion one year prior. Meanwhile, completions recorded the slowest year since 2015, but are slated to bounce back, with 8,426 units underway at the start of 2021.

Market Analysis | Winter 2021

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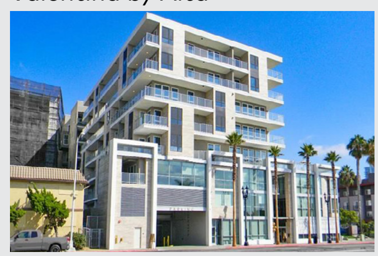
On the cover: Photo by Patricia Elaine Thomas/iStockphoto.com

Recent San Diego Transactions

The Modern

City: San Diego
Buyer: Prime Group
Purchase Price: $107 MM
Price per Unit: $289,260

Valentina by Alta



City: San Diego
Buyer: TA Realty
Purchase Price: $78 MM
Price per Unit: $709,091

Villas at Carlsbad

City: Carlsbad, Calif.
Buyer: John Jaffe Co.
Purchase Price: $41 MM
Price per Unit: $400,000

Villa Grande

City: El Cajon, Calif.
Buyer: Clear Sky Capital
Purchase Price: $19 MM
Price per Unit: $172,727

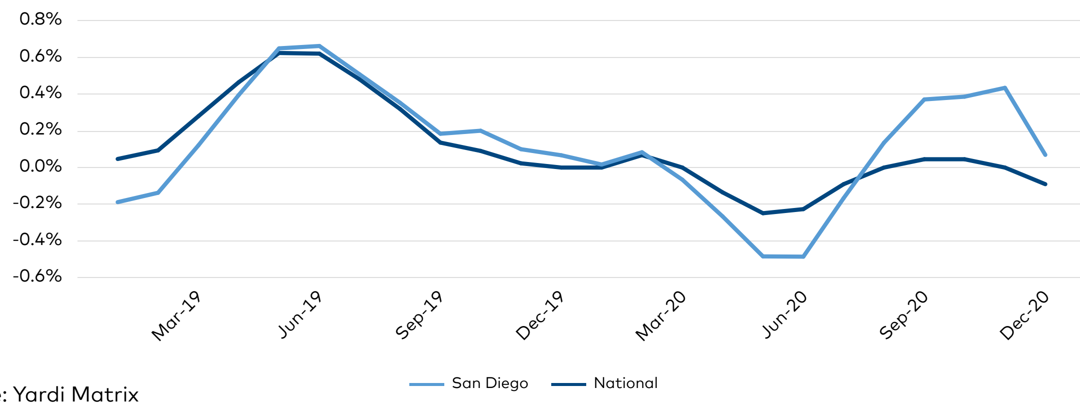
RENT TRENDS

- The average San Diego rent was up 10 basis points on a trailing three-month (T3) basis as of December, reaching $1,996, while the U.S. rate contracted 10 basis points to $1,462. Despite economic turbulence, the metro consistently outperformed the nation on a T3 basis during the second half of 2020. San Diego occupancy in stabilized assets inched up 10 basis points over 12 months to 96.0%, as of November.

- California told a story of strong contrasts in 2020, with expensive metros such as San Jose (rents down 13.7% for the year) and San Francisco (-9.4%) recording some of the sharpest drops in the country, while the Inland Empire (7.3%) and Sacramento (6.1%) emerged as beneficiaries of low supply and demographic shifts. San Diego fell somewhere in the middle, with the average overall rent dropping 0.3% in 2020, not far from the -0.8% national rate. As was the case with most of the country, San Diego's working-class Renter-by-Necessity segment outperformed other asset types (rents up 1.1% in 2020), while upscale Lifestyle rents were down (-1.8%).

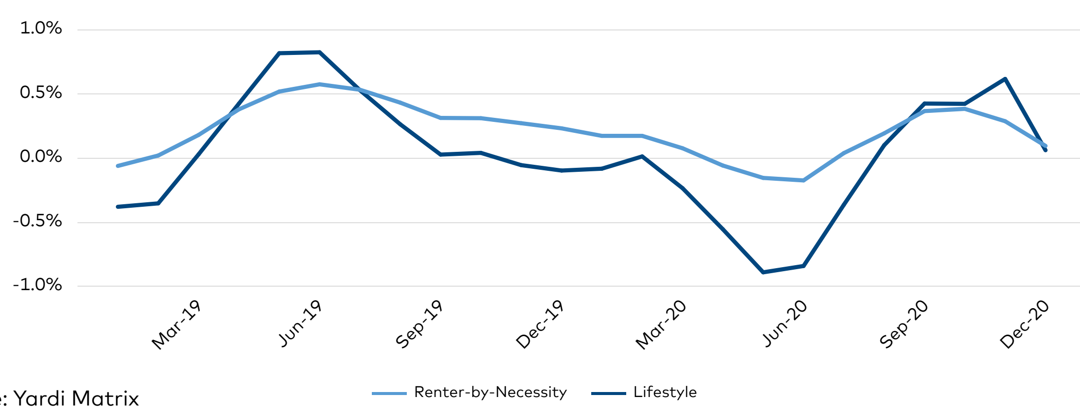
- Noncore San Diego submarkets with large workforce components fared best in 2020, with Spring Valley (5.3% to $1,882), Ramona (4.7% to $1,528) and Lemon Grove (4.6% to $1,495) recording the strongest gains. Meanwhile, rents were down across five otherwise dynamic submarkets, including University (-9.2% to $2,252), Del Mar (-2.3%) to $2,744) and North San Diego (-0.5% to $2,145).

San Diego vs. National Rent Growth (Trailing 3 Months)



Source: Yardi Matrix

San Diego Rent Growth by Asset Class (Trailing 3 Months)



Source: Yardi Matrix

ECONOMIC SNAPSHOT

- San Diego unemployment dropped to 6.6% as of November 2020, close to the 6.7% U.S. figure, according to preliminary BLS data. That's still a far cry from the 2.0%-3.0% band recorded prior to the pandemic, but marks steady improvement from the 15.2% May peak.

- San Diego's otherwise strong leisure and hospitality sector took the hardest hit in the 12 months ending in November, shedding 45,100 positions, followed by government (-17,500 jobs) and trade, transportation and utilities (-12,000 jobs). Meanwhile, two sectors recorded gains: professional and business services (7,300 jobs) and mining, logging and construction (2,000 jobs). The difference in performance underpins the possibility of a K-shaped recovery: Mostly due to the peculiarity of the current downturn, different sectors of the economy and real estate are moving in different gears toward recovery.

- Like most of the country, San Diego's economy is facing crosswinds on its road to recovery. On one hand, a strong resurgence in COVID-19 cases is bringing yet another slowdown in economic activity. On the other hand, the $900 billion December rescue package and ensuing stimulus measures are helping prop up the economy while vaccinations continue.

San Diego Employment Share by Sector

		Current Employment	
Code	Employment Sector	(000)	% Share
60	Professional and Business Services	268	18.8%
15	Mining, Logging and Construction	86	6.0%
55	Financial Activities	75	5.3%
50	Information	20	1.4%
30	Manufacturing	110	7.7%
80	Other Services	46	3.2%
65	Education and Health Services	209	14.7%
40	Trade, Transportation and Utilities	218	15.3%
90	Government	237	16.6%
70	Leisure and Hospitality	157	11.0%

Sources: Yardi Matrix, Bureau of Labor Statistics

Population

- San Diego lost 5,000 residents in 2019. Since 2010, however, the metro gained 235,000 people for a 7.6% hike, above the 6.1% national figure.

- Ongoing negative domestic migration since 2015 is San Diego's primary slowdown factor, offset by strong immigration and natural growth.

San Diego vs. National Population

	2016	2017	2018	2019
National	323,071,342	325,147,121	327,167,434	328,239,523
San Diego Metro	3,310,280	3,325,468	3,343,364	3,338,330

Sources: U.S. Census, Moody's Analytics

SUPPLY

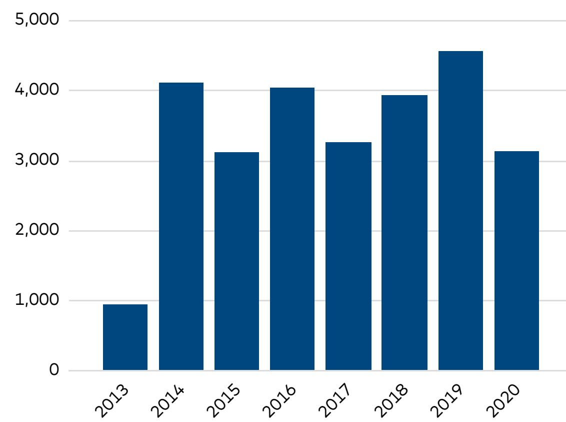
- On the heels of a tepid year for deliveries, San Diego had 8,426 units underway across 35 communities at the start of 2021, most of which were in the Lifestyle segment. However, some 1,300 were in fully affordable projects.

- A total of 3,139 units came online in 2020 in metro San Diego, accounting for 1.6% of total stock and behind the 2.3% U.S. average. Last year was the slowest for deliveries since 2015, partially due to disruptions brought on by the COVID-19 pandemic, including supply chain issues and new on-site health measures. However, 2021 is expected to see a rebound in completions, which should meet heightened demand in the second half of the year.

- Kearny Mesa (2,757 units under construction) and Central San Diego (2,294 units) continued to lead construction activity—the two submarkets accounted for nearly two-thirds of apartments underway. Vista (691 units) rounded out the top 3.

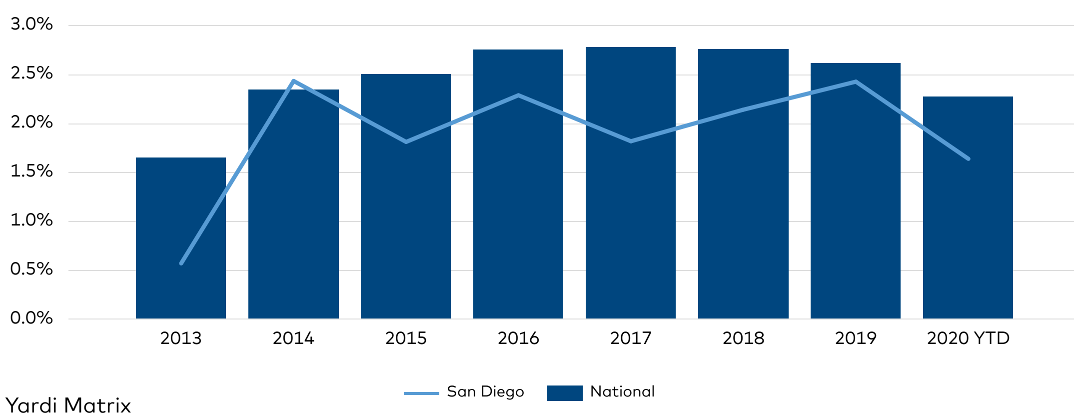
- Holland Partners' 840-unit Town & Country project in the Kearny Mesa submarket was the metro's largest development at the end of 2020. The $500 million project is located on 10 acres within the Town and Country Resort, with the developer paying $82 million for the land in 2018 and breaking ground on the transit-oriented development one year later. The metro's second-largest multifamily project underway is Pinnacle's 618-unit 11th & Broadway in Central San Diego.

San Diego Completions (as of December 2020)



Source: Yardi Matrix

San Diego vs. National Completions as a Percentage of Total Stock (as of December 2020)

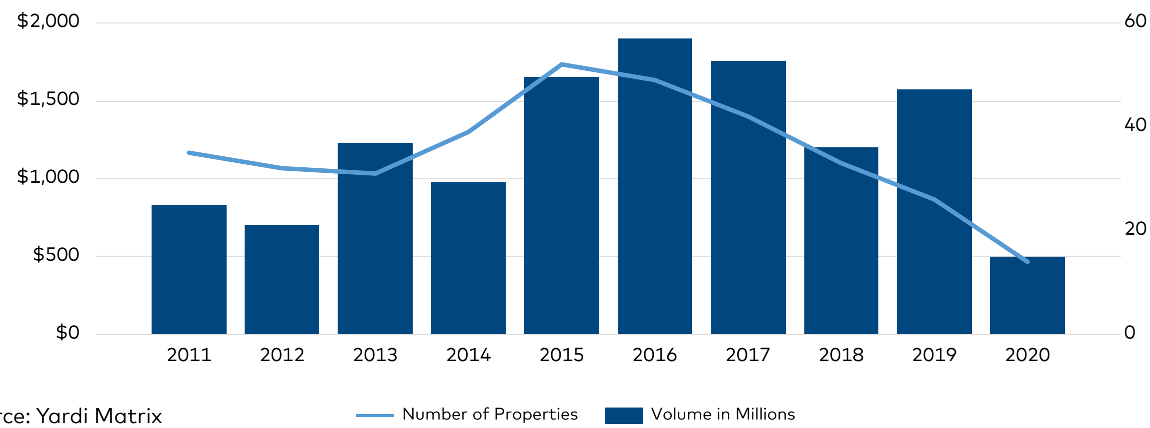


Source: Yardi Matrix

TRANSACTIONS

- Only $494 million in multifamily assets traded last year, less than one-third of the metro's $1.6 billion five-year average.
- Mirroring nationwide trends, San Diego transaction activity decelerated sharply in 2020, mainly due to pandemic-induced volatility.
- The average San Diego per-unit price dropped nearly 20% to $250,862 last year, but remained well above the $169,709 national figure. The price drop, however, had more to do with deal composition than pandemic-related discounts. Only 1 of 14 transactions in 2020 involved a Lifestyle asset, while 2019 recorded 10 Lifestyle deals out of a total 26.
- The largest deal of 2020 was Prime Group's $107 million acquisition of The Modern in the Kearny Mesa submarket. Goldrich Kest sold the 370-unit garden-style property for $289,260 per unit after nine years of ownership.

San Diego Sales Volume and Number of Properties Sold (as of December 2020)



Source: Yardi Matrix

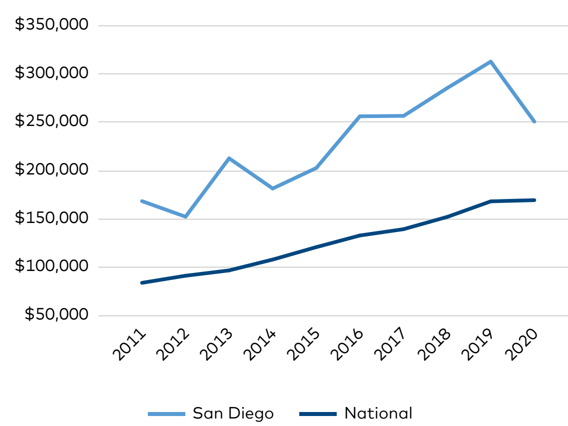
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Central San Diego	165
Kearny Mesa	107
Carlsbad	41
El Cajon	35
La Mesa	34
Southeast San Diego	34
National City	22

Source: Yardi Matrix

[1] From January 2020 to December 2020

San Diego vs. National Sales Price per Unit



Source: Yardi Matrix

How the Quest for Low Population Density Is Benefiting the Sun Belt

By Laura Calugar

The economic volatility resulting from the ongoing pandemic is accelerating suburban growth, with low-density areas experiencing a large uptick in demand. Additionally, several secondary markets are also seeing increased interest from multifamily investors. Cushman & Wakefield's Tai Cohen and Robert Stickel reveal which markets in the Sun Belt region are the most sought after, especially for those coming from expensive markets across the Northeast and Midwest.

How have Sun Belt multifamily investors responded to the COVID-19 crisis?

Cohen: There was certainly a pause in transactions between March and May while owners assessed their current portfolios and COVID-19's impact on resident job loss and bad debt. Once they felt comfortable again, everyone flooded back in, especially into the Sun Belt. Now investors are underwriting the same as they were before COVID-19.

How has the pandemic impacted the region's multifamily industry?

Cohen: Multifamily has come out as the winner relative to other asset types because it's proven to be fairly recession-proof. There are still hurdles with bad debt, but people will always need a place to live. A big difference in multifamily capital markets is that we have two government agencies that lend, Freddie Mac and Fannie Mae.

Right now, debt is extremely cheap, trading around 3 percent, and you can lock in good long-term debt relative to other asset types, which is driving capital toward multifamily. Investors are drawn to the Sun Belt because of the lower cost of living. The warmer weather and open cities are driving people to relocate and driving investor confidence.

Tai Cohen *(left)* and Robert Stickel *(right)*

What are some of your biggest concerns, nine months into the pandemic?

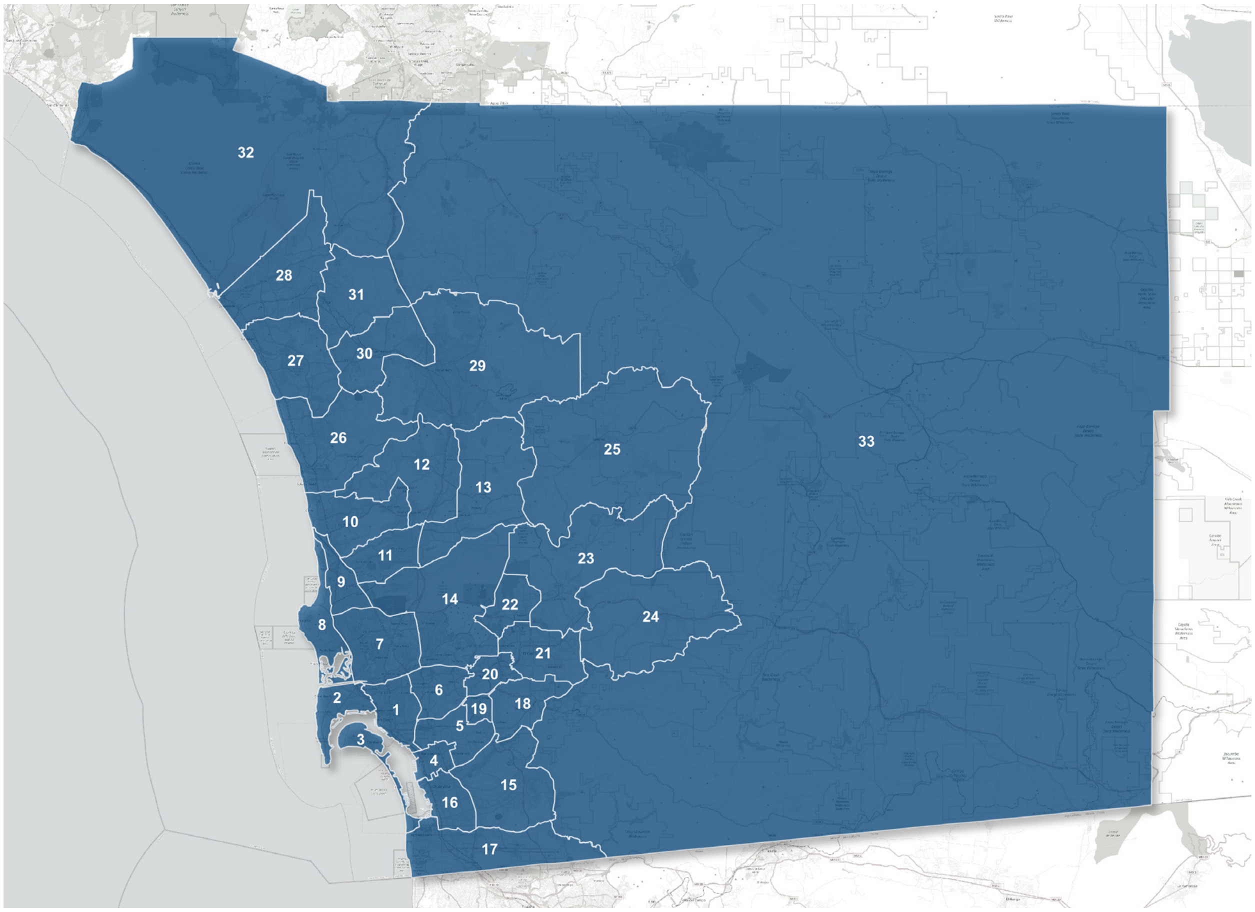
Stickel: While the pandemic has certainly been challenging for everyone in different ways, it has also created a lot of opportunities, specifically for multifamily investments in the Sun Belt region. Aside from everyone's health and safety, one concern is the ability for people to conduct business in a relational way—i.e. touring properties, market overview meetings, etc. Some clients have expressed concerns about 1031 exchanges being eliminated as these are meaningful transactions in our industry.

How do you expect the region's multifamily market to perform next year?

Stickel: Aside from biased optimism, I believe there are several good reasons the region will perform very favorably this year. We anticipate seeing increased capital flow from other regions of the country, while also other sectors within real estate. Transaction volume was down from 2019 to 2020, but, for our group specifically, 2020 was still better than 2017 and 2018. We believe 2021 could be onward and upward with record-setting stats.

(Read the complete interview on multihousingnews.com.)

SAN DIEGO SUBMARKETS



Area No.	Submarket
1	Central San Diego
2	Peninsula
3	Coronado
4	National City
5	Southeast San Diego
6	Mid-City
7	Kearny Mesa
8	Coastal
9	University
10	Del Mar
11	Mira Mesa
12	North San Diego
13	Poway
14	Elliot–Navajo
15	Sweetwater
16	Chula Vista
17	South Bay

Area No.	Submarket
18	Spring Valley
19	Lemon Grove
20	La Mesa
21	El Cajon
22	Santee
23	Lakeside
24	Alpine
25	Ramona
26	San Dieguito
27	Carlsbad
28	Oceanside
29	Escondido
30	San Marcos
31	Vista
32	Fallbrook
33	Outlying San Diego County

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 December 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 December 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, December 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.