YARDI® Matrix

Steady San Diego

Multifamily Report Spring 2017

Rent Growth Cools Off

Development Hits New High

Bullish Investors Push Prices Up

Market Analysis

Spring 2017

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Strong Demand Drives Pipeline Growth

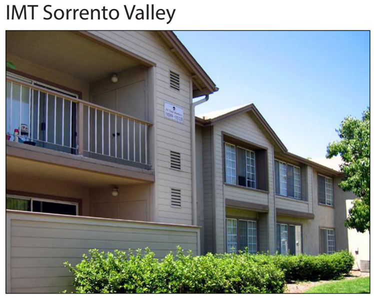
Gaining jobs across most sectors and rapidly adding residents, San Diego continues to be a strong and stable multifamily market. At 96.8%, the metro's occupancy rate is one of the highest in the country, underlining the city's housing shortage and justifying the growing construction pipeline. Rents were up 4.8% in the year ending in March, continuing to outperform the national average.

Anchored by international trade, biotechnology, military operations and tourism, San Diego's economy is a mixed basket benefiting from a deep talent pool as the city's network of universities and research facilities offers startups solid ground and a cheaper alternative to Silicon Valley. With the $2 billion trolley expansion underway, San Diego continues to draw large-scale projects. Manchester Pacific Gateway, a $1.3 billion mixed-use development, will house the new U.S. Navy headquarters. Greystar's Ballpark Village, the mega-project slated to bring 713 rental units to downtown, is also in the works. The list also includes the $1.2 billion Seaport project and FS Investors' proposal for the Qualcomm Stadium site.

Offering acquisition yields akin to those of Los Angeles and San Francisco, the metro remains a fairly predictable and hot secondary market, with roughly $3.5 billion in assets having traded over the past two years. And as supply is slowly catching up with demand, Yardi Matrix expects rent growth to remain at sustainable levels, reaching 4.5% in 2017.

Recent San Diego Transactions

IMT Sorrento Valley



City: San Diego
Buyer: IMT Capital
Purchase Price: $214 MM
Price per Unit: $284,574

BLVD63

City: San Diego
Buyer: TIAA
Purchase Price: $156 MM
Price per Unit: $469,880

Pulse Millenia

City: Chula Vista, Calif.
Buyer: Northwestern Mutual RE Investors
Purchase Price: $94 MM
Price per Unit: $343,590

Dylan Point Loma

City: San Diego
Buyer: LaSalle Investment Management
Purchase Price: $90 MM
Price per Unit: $500,000

On the cover: Photo by Meinzahn/iStockphoto.com

Rent Trends

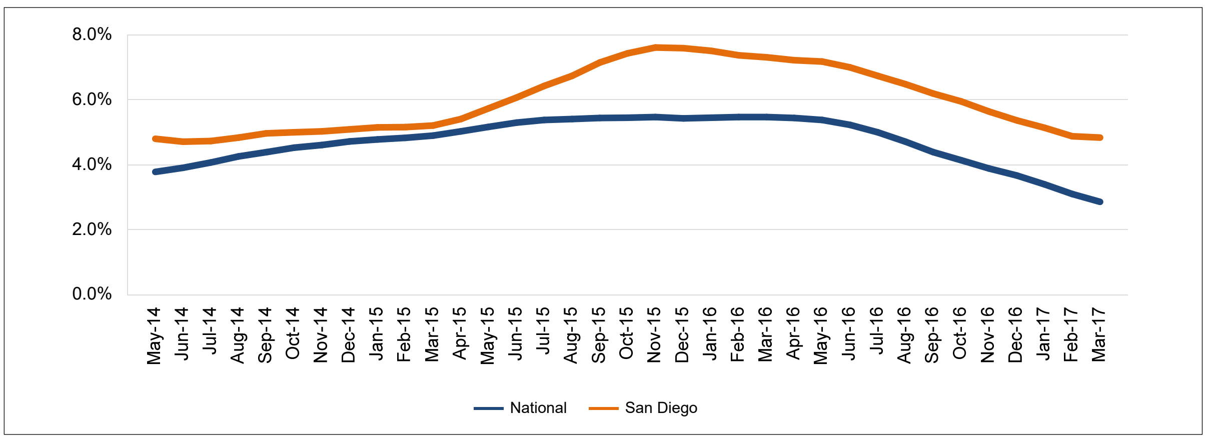
- Rents in San Diego were up 4.8% in the year ending in March, 210 basis points above the U.S. growth rate. Since spiking at 7.7% in October 2015, growth steadily decelerated due to new supply. The average rent was $1,762 at the end of the first quarter, $450 over the national average.

- Although completions accelerated in 2016, the city's population gains and housing shortage continue to translate into steady rent increases, especially in the case of blue-collar households. With developers concentrating almost exclusively on Class A assets, the working-class Renter-by-Necessity segment led growth at 6.8% year-over-year, reaching $1,536 in March. Meanwhile, rents in the Lifestyle segment grew by 2.7%, to $2,166. The growing gap between rent hikes in the two segments further deepens the city's affordability issues.

- Demand is kept in check in Central San Diego, where rents grew by 4.2%. Nearby submarkets—including Mid-City (9.6%), Coronado (7.8%) and Southeast San Diego (7.8%)—continue to grow at a faster rate. Due to saturation, Del Mar (-3.5%), one of the city's priciest areas, was the only submarket where rents contracted.

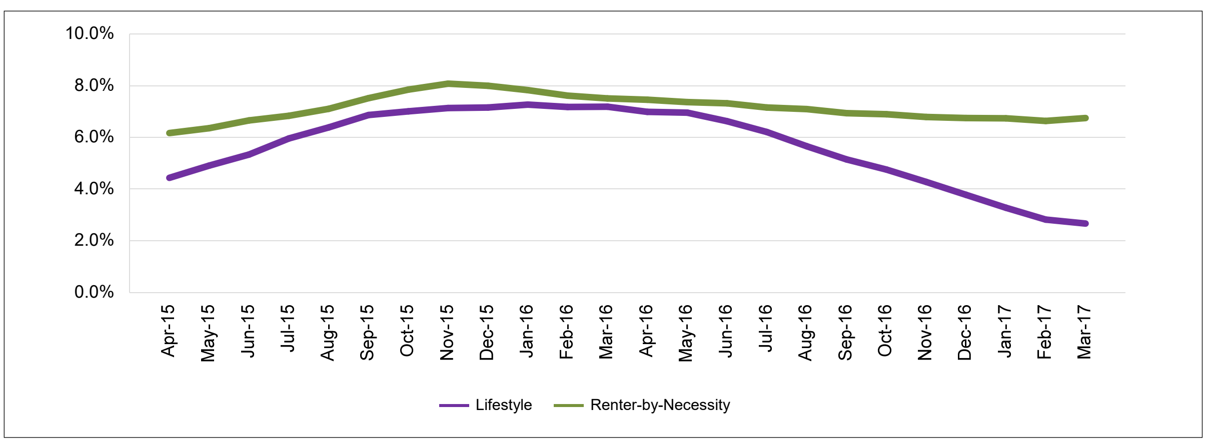
- As supply is slowly but steadily catching up with demand due to a growing pipeline, San Diego is bound to sustain moderate rent growth levels in the foreseeable future. Yardi Matrix expects a 4.5% increase for 2017.

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)

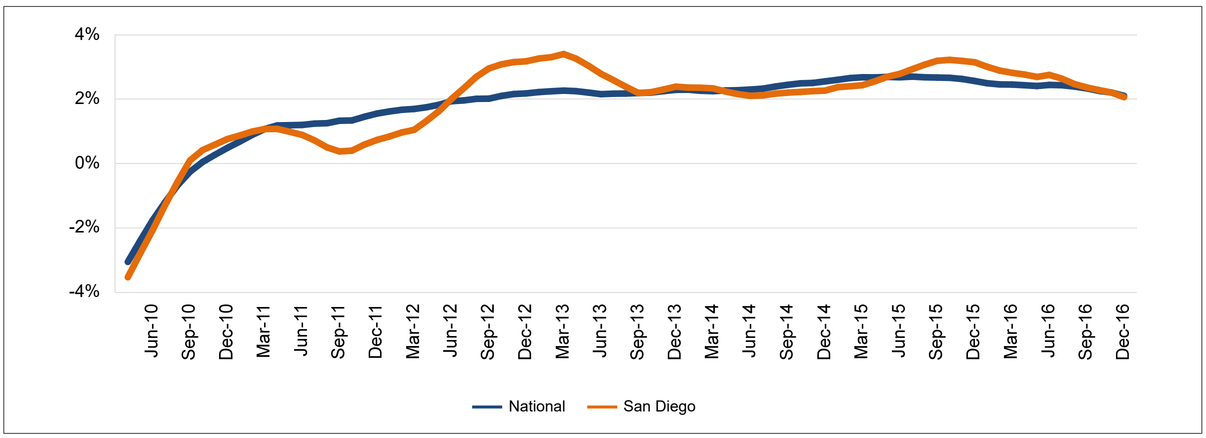


Source: YardiMatrix

Economic Snapshot

- San Diego added 28,900 jobs in 2016, on par with the national 2.1% growth rate. Benefitting from a deep talent pool, strong universities and research centers, large naval contractors and a long-established biotech scene, the city continues to add positions across the board. At the same time, the hospitality industry and the U.S. Navy continue to offer stability to an already diversified workforce.
- Government, education and health services, along with professional and business services, added a total of 17,500 positions last year, further expanding the city's white-collar population. The leisure-and-hospitality sector (5,400) continues to thrive in San Diego and is poised for future expansion due to record levels of visitors in 2016 and intense hotel construction activity.
- Mirroring the city's economic gains, San Diego's office market recorded positive net absorption and contracting vacancy rates in 2017's first quarter. At about $2.70 per square foot, the average rent hit another cyclical high.
- San Diego's strong economic climate is attracting developers. Work has begun on the $2 billion trolley expansion, and the $1.2 billion Seaport San Diego project is moving forward. Manchester Pacific Gateway, a 3 million-square-foot mixed-use development, will house the new U.S. Navy headquarters. FS Investors unveiled plans for SoccerCity, a mixed-use initiative calling for the redevelopment of the Qualcomm Stadium site.

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	%
90	Government	247	17.1%	6,300	2.6%
65	Education and Health Services	205	14.2%	5,700	2.9%
60	Professional and Business Services	240	16.7%	5,500	2.4%
70	Leisure and Hospitality	188	13.0%	5,400	3.0%
40	Trade, Transportation and Utilities	231	16.0%	2,500	1.1%
55	Financial Activities	75	5.2%	2,200	3.0%
80	Other Services	54	3.7%	2,100	4.0%
15	Mining, Logging and Construction	72	5.0%	400	0.6%
50	Information	24	1.7%	400	1.7%
30	Manufacturing	105	7.3%	-1,600	-1.5%

Sources: YardiMatrix, Bureau of Labor Statistics

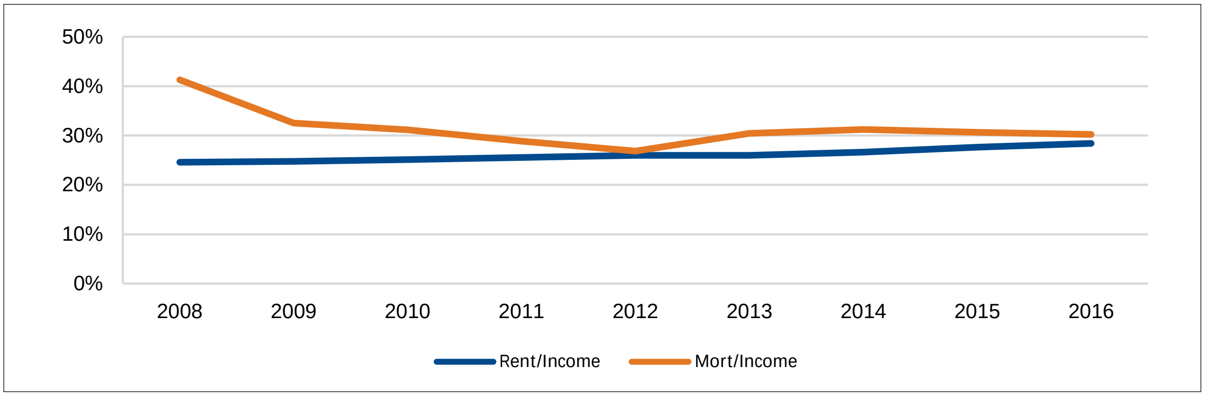
Demographics

Affordability

- San Diego's median home price rose to $484,558 in 2016, reaching another cyclical peak after five years of growth. Although relatively less expensive than the Bay Area or Los Angeles, San Diego remains one of the least affordable U.S. metros. To address the issue, the city is supporting a new state measure that would allow local authorities to get involved in mixed-income, workforce housing on top of fully affordable properties.

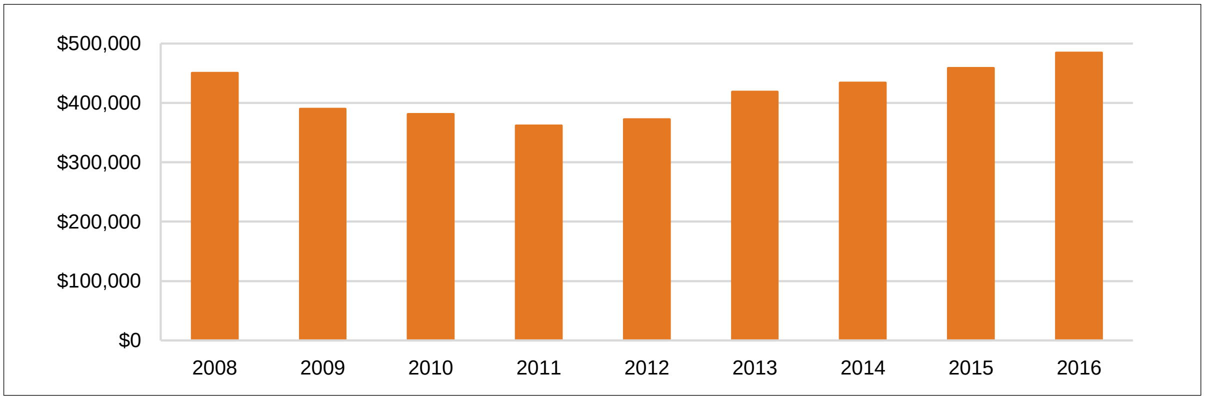
- With rents and home values both surging, affordability continues to pose a challenge, especially in the case of blue-collar households. Rent accounts for about 28% of the median income, while the average mortgage comprises as much as 30%.

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

- Between 2011 and 2015, the metro's population grew by 5.0%, some 200 basis points above the national average.

- San Diego added roughly 34,000 people in 2015 alone, a 1.0% expansion.

San Diego vs. National Population

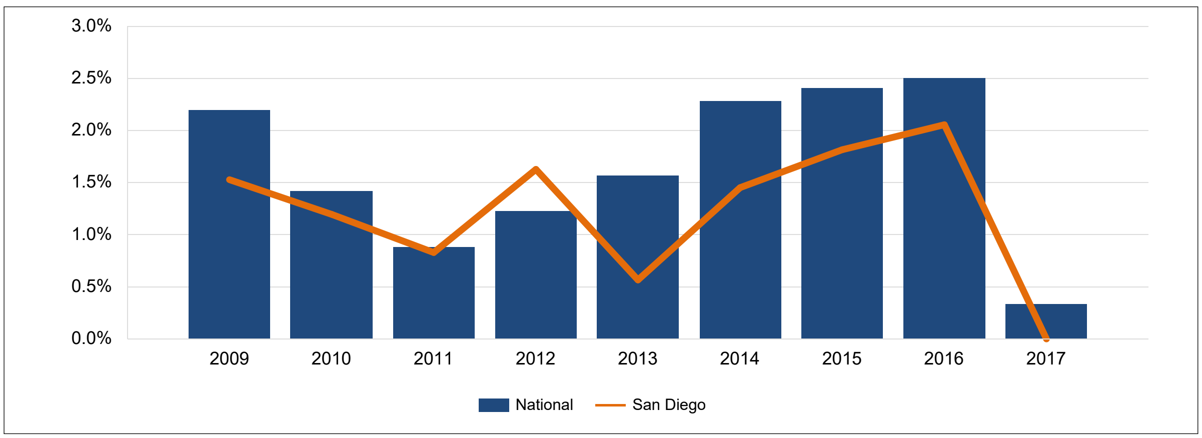
	2011	2012	2013	2014	2015
National	311,718,857	314,102,623	316,427,395	318,907,401	321,418,820
Metropolitan Statistical Area	3,142,256	3,184,358	3,223,645	3,265,700	3,299,521

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

Supply

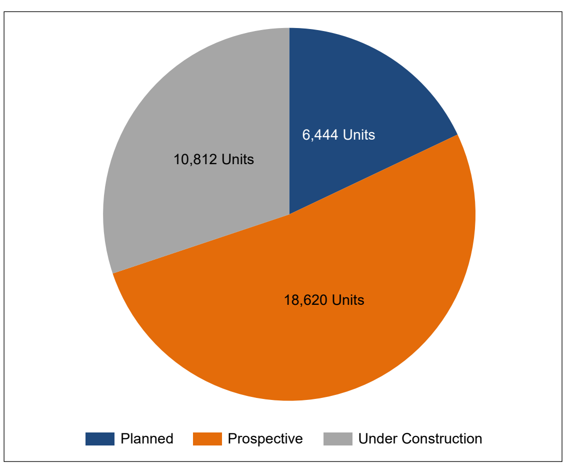
- San Diego added 3,612 units in 2016, hitting a cyclical record and marking a 2.1% inventory expansion. Even so, the city's percentage of new stock falls 40 basis points behind the U.S. average. San Diego is trailing the national rate of new supply for the fourth consecutive year, which further emphasizes the city's housing crisis. Although new stock is slowly catching up with demand, geographical restrictions and strict zoning regulations continue to influence the level of supply.
- The metro has more than 35,000 units in different stages of development, roughly 11,000 of which have already broken ground. Upcoming supply is concentrated in core submarkets, with Central San Diego (4,000 units) accounting for more than a third of apartments under construction. The submarket has an additional 5,400 units on the drawing board, underlining downtown's role during the current expansion and hinting toward future development in nearby submarkets once Central San Diego hits saturation.
- Due to the market's stable fundamentals, developers are betting on the longer run, as well. Several large projects, including the 713 units developed by Greystar at Ballpark Village and Garden Communities' 560-unit Monte Verde tower, are slated for completion in 2018.

San Diego vs. National Completions as a Percentage of Total Stock (as of March 2017)



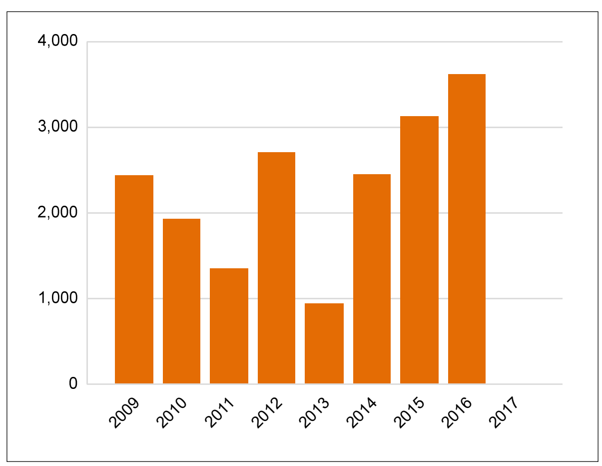
Source: YardiMatrix

Development Pipeline (as of March 2017)



Source: YardiMatrix

San Diego Completions (as of March 2017)

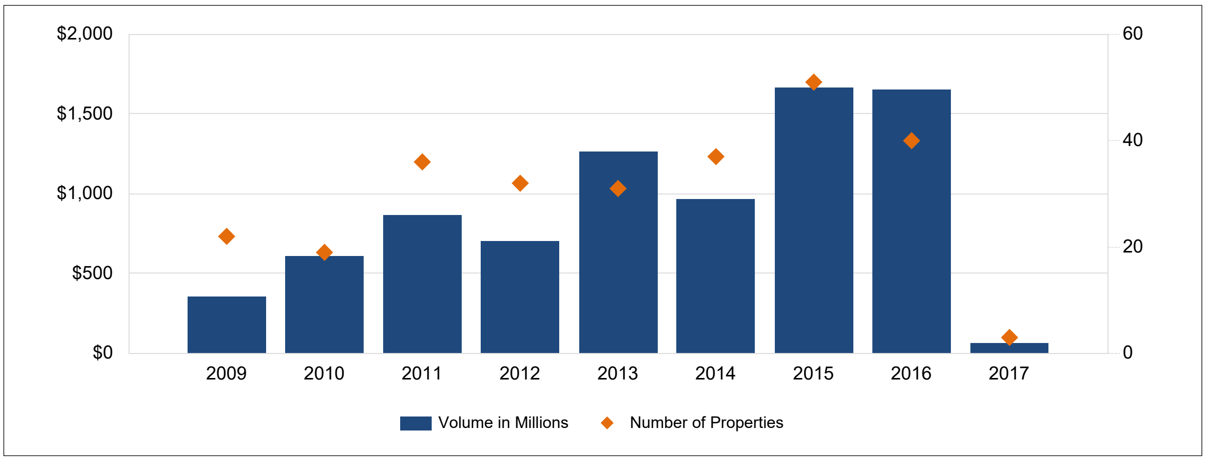


Source: YardiMatrix

Transactions

- Investor appetite remains high, as some $1.7 billion in assets traded last year, matching 2015's cycle high. San Diego continues to be viewed as a safe and predictable market, with acquisition yields hovering around the 4% mark for Class A stabilized properties, on par with San Francisco and Los Angeles.
- Bullish investors are pushing prices up, with the average unit trading for $255,000 last year, almost double the national average. While value-add transaction activity was strong throughout 2016, several large sales of upscale Lifestyle assets in the fourth quarter have significantly contributed to the price surge.
- R & V Management, the city's largest owner, expanded its portfolio by 634 units in the year ending in March. At an average unit price of $305,000, the company bought Seta in La Mesa for $70 million, Emerald Glen in Escondito for $68 million and Parc One in Santee for $56 million.

San Diego Sales Volume and Number of Properties Sold (as of March 2017)



Source: YardiMatrix

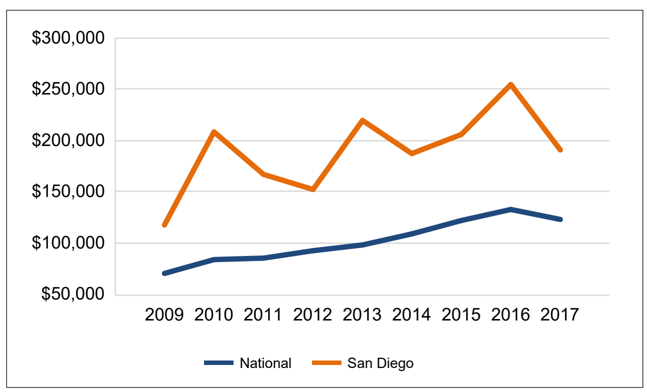
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Mid-City	239
Mira Mesa	214
Oceanside	145
Sweetwater	139
La Mesa	138
Peninsula	118
Escondido	93
Elliot - Navajo	57

Source: YardiMatrix

[1] From April 2016 to March 2017

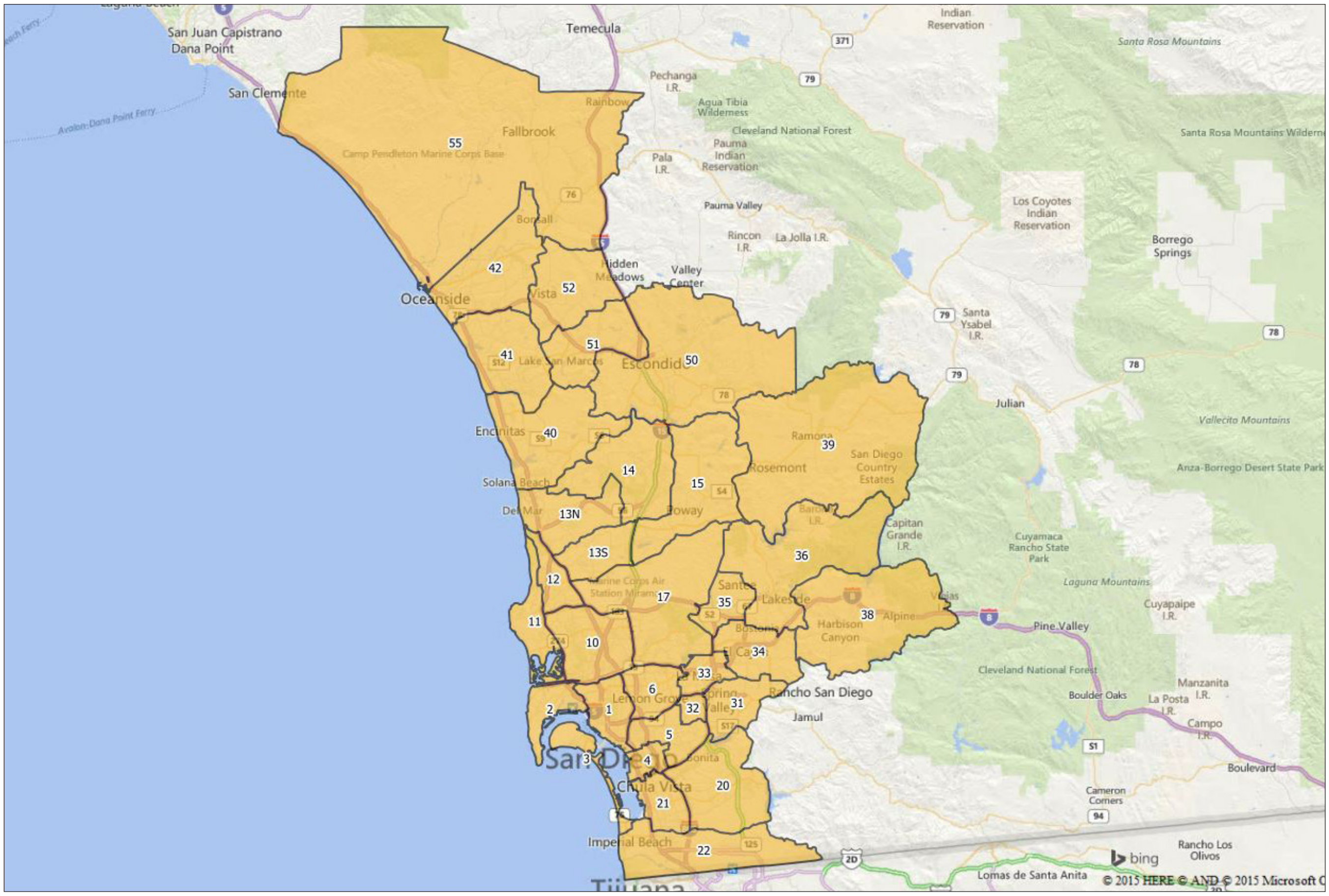
San Diego vs. National Sales Price per Unit



Source: YardiMatrix

Photo by photoquest7/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

Area #	Submarket
22	South Bay
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.