MARKET REPORT

Multifamily

San Diego Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

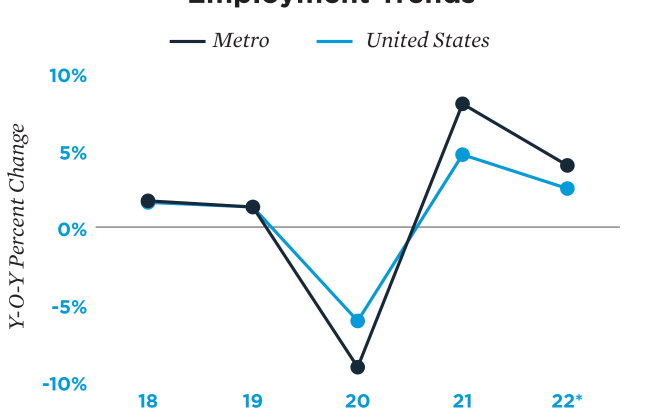
2Q/22

Vacancy Falls to 20-Year Low Amid Homeownership Roadblocks

Demand in larger submarkets outpaces sparse deliveries. San Diego apartment fundamentals are among the strongest in the nation. Spanning the past two years ended in March, 7,700 units were delivered, yet vacancy fell 240 basis points, highlighted by Class B and C vacancy rates falling to 1.0 percent and 0.5 percent, respectively. Additionally, availability in all submarkets but Downtown San Diego is below 2 percent and demand for urban rentals is improving, evident by the 560-basis-point compression registered in the CBD over the past year. The lack of upcoming completions in downtown suggests core vacancy may further compress in the near term. Similar to downtown, the Highway 78 Corridor and East County submarkets, which account for 30 percent of the metro's rental stock, lack supply additions in 2022.

Affordability gap steers more households to upper-tier units. Class A vacancy entered the second quarter below 2 percent and is poised to hold below that threshold during the remainder of 2022. Delivery volume is slated to fall under the prior five-year average, while diverse job creation is expected to support the strongest healthy household formation. Purchasing a single-family residence will not be an option for many of these households, as the metro's affordability gap, the difference between an average rental rate and a mortgage payment on a median priced home, is the largest in the past 14 years at $1,800 per month.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.; RealPage, Inc.

Multifamily 2022 Outlook

60,000 JOBS
will be created

EMPLOYMENT:

Highlighted by biotech expansion and improving tourism, diverse hiring lifts San Diego's job count to a record mark during 2022. This year's pace of employment growth surpasses the national rate of increase by 1.5 percent.

3,000 UNITS
will be completed

CONSTRUCTION:

At least 3,000 units are finalized for a fifth consecutive year, increasing inventory by 1 percent. Supply additions are concentrated in Chula Vista and San Diego proper, with completions in the latter city located primarily outside of downtown.

10 BASIS POINT
decrease in vacancy

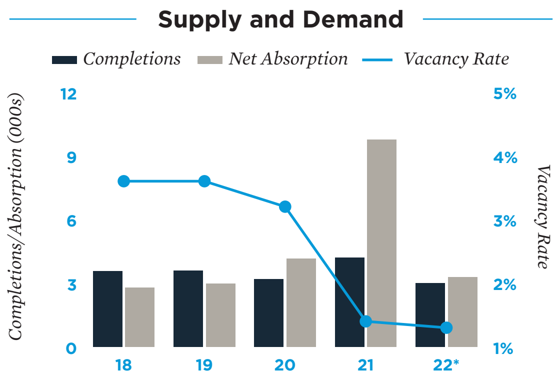
VACANCY:

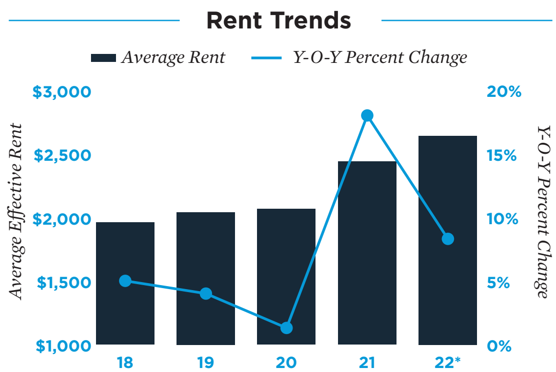
Out-of-reach home prices support robust demand for apartments, translating to a third consecutive year of vacancy compression. At 1.3 percent, the metro's year-end availability rate ranks as the second-lowest among major United States markets.

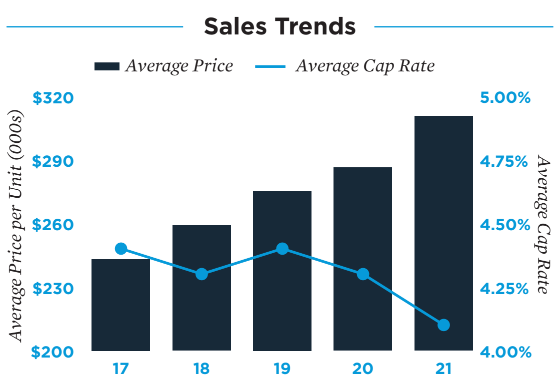
8.3% INCREASE
in effective rent

RENT:

Sub-2 percent vacancy across most submarkets allows owners to raise the average effective rent to $2,641 per month. The rate of growth noted in 2022 represents the second-strongest gain in the past 20 years, trailing only last year's 18 percent boost.







* Forecast

Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

1Q 2022 - 12-Month Period

CONSTRUCTION

4,933 units completed

- Rental stock grew by 1.6 percent over the past year ended in March, highlighted by additions in Downtown and Northeast San Diego.
- Properties in Otay Ranch and Downtown San Diego account for half of the metro's active pipeline, which totaled roughly 6,000 units at the onset of the second quarter.

VACANCY

210 basis point decrease in vacancy Y-O-Y

- Renters absorbed roughly 11,400 units during the last four quarters, slashing vacancy to 1.3 percent — one of the lowest rates in the nation.
- Leasing activity was strong in the Downtown, Northeast and Northwest San Diego submarkets, along with La Jolla-University City. Across asset tiers, the Class A sector recorded the largest compression at 280 basis points.

RENT

19.8% increase in the average effective rent Y-O-Y

- Extremely limited unit availability supported significant rent growth in the Class A and B tiers over the past year, conditions that lifted the metro's average effective rate to $2,510 per month.
- La Jolla-University City, Far North San Diego and Northwest San Diego all noted rent spikes that exceeded the metrowide gain.

Investment Highlights

- Record multifamily transaction velocity was observed in the metro last year, with only Phoenix notching more closings among U.S. secondary markets. Heightened investor demand for San Diego properties and recently strong NOI growth lifted the average sale price 8 percent to $310,000 per unit, while the mean cap rate fell to 4.1 percent.
- Among Southern California-based buyers, competition is fierce for complexes in the county's tightest submarkets and locales with large pools of young renters. Neighborhoods adjacent to Balboa Park, as well as the coastal communities of Pacific Beach and Ocean Beach, are top destinations for sub-20-unit Class C trades, with these assets providing buyers with 3 percent to mid-4 percent returns. Across these submarkets, pricing below $300,000 per unit is rare, with most deals in Pacific Beach closing for more than $400,000 per door.
- Home to some of the tightest vacancies in the metro, below-average rent and a lack of new construction, El Cajon and neighborhoods proximate to San Diego State University are also attractive to Class C buyers. Here, pricing below $250,000 per unit remains obtainable, with first-year yields reaching the high-4 percent band.

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Price: $250