

San Diego, California

Multifamily Housing Update

February 2011

EXECUTIVE SUMMARY

The San Diego economy improved in the fourth quarter as employers added a net of 3,100 (0.3%) positions to payrolls year-over-year, marking the first over-the-year gain since 1Q08 (+1,300 jobs). Similarly, data from the BLS's household survey show that the metro unemployment rate fell from 10.3% in December 2009 to 10.1% in the same month last year.

Recent improvement was partially fueled by job growth in the business service super-sector. In aggregate, employers created 5,100 jobs y-o-y in 4Q10, although growth was largely attributable to temp agency hiring. Indeed, employment service firms accounted for 4,200 net new jobs in 4Q10.

Trade and manufacturing firms also contributed to the turnaround. After trimming -1,500 jobs y-o-y in 3Q10, trade, transportation and utilities employers added 1,400 workers in 4Q10. Area manufacturers eliminated a monthly y-o-y average of 4,500 jobs in the first nine months of 2010, but only -1,200 during the final three month period.

The Manpower Employment Outlook Survey suggests that employment growth will broaden in the first quarter. As of December, 18% of area firms expected to add workers in 1Q11, above the 7% than planned to contract. Among the sectors that reported hiring plans were construction, non-durable goods manufacturing, transportation / utilities, wholesale / retail trade, information, financial services, business service, education / health care, leisure / hospitality and other services.

RED CAPITAL Research (RCR) are optimistic that payroll employment trends will rebound this year. Our payroll model predicts a 20,700

(1.7%) job gain in 2011, followed by a stronger 27,700 (2.2%) advance in 2012.

Housing market data were mixed. Metro home prices were up in the fourth quarter, with over-the-year gains ranging from 0.6% (National Association of Realtors) to 2.3% (FHFA purchase-only home price index). Sales activity declined, however. The San Diego Association of Realtors report that 6,934 home sold in 4Q10, down -15% from the same period last year.

Apartment demand was robust in the second half of 2010. Property managers net leased 580 units in 1H10 and 1,456 units in 2H10. Additionally, developers did not complete any units in the second half of the year, following delivery of 637 units in 1H10. As a result, the metro occupancy rate surged 80 basis points from 95.1% in June to 95.9% in December. Reis predict that apartment demand will remain strong through 2015, producing a 110 basis point increase in occupancy over the period.

Consistent with the up-tick in rental demand, effective rent growth accelerated in 2H10. During the first six months of 2010 property managers increase effective rent 0.7% by reducing concessions from 3.7% of asking rent to 3.3% of asking rent. The pace of effective rent growth accelerated to 0.9% in the second half. As a result, the pace of annual effective rent growth rose to 1.6% at year-end, the fastest annual increase since 4Q08.

Data from Real Capital Analytics demonstrate rising investor interest for San Diego apartment assets. The source reports that sales volume rose 134% from \$320 million in 2009 to \$748 million in 2010. Similarly, the average price per unit increased 49% y-o-y to \$192,899.

SNAP SHOT

	Y-o-y change	Projected 2011
Vacancy (4.1% - 4Q10)	↓ 80bps	↓ 40bps
Effective Rents (\$1,299 - 4Q10)	↑ 1.6%	↑ 4.2%
Cap Rate (4.9% - 4Q10)	↓ 210bps	↔
Employment (1,221.1m - 4Q10)	↑ 3.1m	↑ 20.7m

KEY POINTS

- The metro vacancy rate fell 40 basis points sequentially and 80 basis points year-over-year to 4.1% as apartment demand outpaced supply. Managers of Class-A assets net leased 1,265 units during 2010, while only 637 units were added to the rental stock. Class B/C vacancy fell 70 basis points year-over-year to 3.6% as positive net absorption totaled 772 units during the year.
- The pace of year-over-year effective rent growth accelerated from 0.9% in 3Q10 to 1.6% in 4Q10. But Reis are optimistic that faster gains are in store this year. Specifically, the source believes that effective rent will rise 4.2% to \$1,354 by year-end.
- According to the Case-Shiller home price index, housing prices rose at a modest rate in the year-ended in December. At mid-year, index was up 11.2% year-over-year. But the pace of growth decelerated to only 1.7% by December.
- Real Capital Analytics were aware of 43 transactions involving properties priced at or above \$5 million in 2010. Sales volume totaled \$748.3 million.



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