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Job Outlook, Limited Supply Make Local Apartment Market Attractive to Investors

REAL ESTATE: San Diego Ranks No. 2 in the Nation, Marcus & Millichap States

■ By LOU HIRSH

Relatively strong employment prospects and continued tight supply helped San Diego's apartment investment market finish second in the U.S., in a newly released ranking of the nation's 44 major metro areas.

San Diego moved up four places from last year, and was outranked only by Washington, D.C., in the 2010 National Apartment Report by commercial real estate brokerage and research firm Marcus & Millichap.

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As a guide to potential investors, the annual report ranks metro markets according to an index based on 12-month, forward-looking indicators of supply and demand. Markets are ranked by average scores for factors including forecast employment change, vacancy, construction, rental rates and affordability.

"San Diego apartment fundamentals will outperform much of the country this year, as additions to supply will be modest and payrolls will expand for the first time since 2007," analysts said in their latest report.

Chris Zorbas, vice president of investments in the San Diego office of Encino-based Marcus & Millichap, said by phone that investors are generally getting more optimistic after spending most of 2009 on the sidelines, waiting to find out where the economy was heading.

"There's a sense in the community that the worst is behind us," Zorbas said. "But there is still a lot of money on the sidelines waiting to be invested."

Some Job Growth Expected

Part of the expected uptick in investment, he said, is due to projected slight gains in San Diego-area jobs this year — about 12,500 positions, mostly in the government sector — after more than 70,000 local jobs were lost in the last two years.

For instance, Marcus & Millichap researchers said, the USS Carl Vinson is scheduled to rejoin the U.S. Navy's Pacific Fleet in 2010, "returning thousands of relocated families to the metro area and providing a boost to rental hous-

TOP APARTMENT INVESTMENT MARKETS

Here are the top 10 U.S. apartment investment markets in the Marcus & Millichap report, with last year's ranking in parentheses.

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|-----------------------------|-----------------------|
| 1. Washington, D.C. (1) | 6. New Jersey (5) |
| 2. San Diego (6) | 7. Orange County (13) |
| 3. New York City (8) | 8. Boston (4) |
| 4. Minneapolis-St. Paul (3) | 9. San Francisco (17) |
| 5. Philadelphia (2) | 10. San Jose (18) |

ing demand." Also, the local leisure and hospitality sector is forecast to grow by approximately 2 percent this year as the economy improves.

Meanwhile, there is expected to be a slight rise in regional apartment vacancy, to 5.4 percent, but the increase will be concentrated in the downtown area, which is expected to see an approximate 12 percent vacancy rate by year's end, the report said.

That's in part because of a glut of condos that came on the market in the downtown area just as the local housing market started to decline, and many of those units are now being rented out.

However, the region as a whole has not seen a major blitz of apartment construction activity since the boom years of the 1980s.

"There's not a lot of new supply coming online to dilute the apartment stock," Zorbas said. "At this point you can buy an existing building for a fraction of the replacement cost for a new one."

Buyer Interest Increasing

In 2009, San Diego saw 166 sales of apartment buildings of five units or more, a 28 percent drop from the 232 closed transactions in 2008, according to Mar-

cus & Millichap. In 2010, there were 31 closed apartment sales transactions as of March 30.

But overall, Zorbas said, more properties are going on the market and receiving more buyer interest compared with the first quarter of 2009, and owners are fielding multiple offers at the right price points.

Local representatives of brokerage firm Cushman & Wakefield Inc. said rising interest among investors has been signaled by at least two big-ticket sales of large apartment complexes in the first three months of 2010.

In January, Equity Residential closed on a \$44.75 million purchase of the 180-unit Del Mar Ridge apartment community in Del Mar from DMG Associates. Then in March, BRE Properties Inc. acquired the 194-unit Monarch at Scripps Ranch apartment complex in San Diego for \$46.2 million, from **Interwest Capital Corp.**

"This sale shows the increasing demand among institutional investors for well-located, high quality and amenity-rich apartment communities in San Diego County," said Ed Rosen, executive director with Cushman & Wakefield's San Diego office, in a statement discussing the Monarch

deal. "In 2009, not a single apartment community was acquired by a (real estate investment trust), but already in the first quarter of 2010 we have seen two such transactions."

Short- and Long-Term Potential

Cushman & Wakefield represented the buyer and seller in both transactions. John Chu, another local executive director with the firm, said the San Diego region's relatively limited supply of land for new development, combined with rising demand for apartments, is offering investors good near- and long-term "upside potential."

In its own recent report on the region's multifamily real estate market, the brokerage firm **Cassidy Turley BRE Commercial** said demographic trends are likely to attract investors increasingly to San Diego apartments in coming years.

For instance, the region's Generation Y population — generally those ages 20 to 34 — is estimated to be more than 900,000 and is larger than the local baby boomer set (ages 45-63), currently at 770,000. The firm cites SANDAG, aka the San Diego Association of Governments, figures indicating nearly 705,000 of the Generation Y group is at the prime renting age, between 24 and 34, and that group is expected to increase by 5.5 percent in 2010.

Also, Cassidy Turley notes, there is rising demand for senior housing, because of increasing life expectancy and medical advances. The 65-and-older group is expected to rise 44.2 percent between now and 2020.

"In the coming year, expect to see many seasoned cash-rich investors, who initially searched for higher returns elsewhere, return to the San Diego market," the firm said in its report.