

# **What's Happening in the San Diego Apartment Market**

## **By Hendricks & Partners**

### 2006 REVIEW

The San Diego metro apartment market noted healthy improvements in 2006, led by a strong rebound in demand during the second half of the year.

- Although closing the year in positive territory by 145 units in the fourth quarter, apartment absorption totaled 100 net move-outs in 2006, yet significantly improving from the 2,563 net move-outs tallied in 2005.
- New apartment construction brought 1,434 new units online during the fourth quarter, with deliveries consisting of 905 units in the city of San Diego and 529 units in the city of San Marcos.
- Multifamily construction permitting slid substantially during the course of the year, with permits awarded for 3,885 units in 2006, down approximately 30% from 5,572 units permitted in the year prior.
- The San Diego average apartment vacancy rate was recorded at 5.3% in the fourth quarter, up slightly from 4.9% registered in the year prior.
- Steady demand enabled a 3.7% increase in the market's average apartment rent over the year ended in December, surpassing the 3.5% increase witnessed one year ago, as the average rent rose to \$1,298.

### FORECAST 2007 / 2008

#### ECONOMY

The San Diego Metro Area economy will show moderate gains in 2007, as the region continues to strengthen. Local non-farm employment will rise approximately 2% in 2007, adding roughly 25,000 jobs, before reaching stride in 2008. Job growth will remain strong in the leisure / hospitality, service, health care, and biotechnology industries, which accounted for nearly 80% of all job growth in 2006. In addition, employment will increase steadily in the region's software cluster, as the predictive software industry looks to become the next big economic driver in the San Diego Metro Area. While the region's overall job growth will remain healthy through the forecasted period, due to the recent slide in residential development, employment growth in the local construction sector is projected to remain stalled.

#### DEMAND / SUPPLY

As witnessed in 2006, a disconnect will persist between the health of the local economy and the strength of its rental market. Regardless of lackluster employment trends, healthy population growth will anchor demand for apartments in the region. Supported by immigration and the area's sluggish for-sale market, apartment absorption will return into positive territory through the forecasted period, measuring roughly 1,000 units in 2007 and 1,500 units in

2008. Development activity will dip moderately to approximately 1,500 units in 2007, before 2,000 units come online in the following year. Centers of activity will be Downtown San Diego and the city of La Jolla.

#### OPERATIONS

A gradual downward trend of vacancy rates will persist through the forecast period, with the market's average falling to 3.4% by the close of 2008. Aided by a lack of competition from the local for-sale market, apartment rental rates will continue to gain ground at a healthy pace of 4.5% and 4.1 % for 2007 and 2008, respectively.

#### INVESTMENT MARKET

Following two years of record pricing and a strong investment market, due in part to robust condo conversion activity, sales velocity in the San Diego metro apartment market continues to slow tremendously, reflecting the difference between seller and buyer expectations. In 2006, there were 59 apartment transactions in the San Diego Metro Area, down approximately 50%, from the 116 sales in 2005.

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