TAX CREDIT GROUP
Marcus & Millichap

MARKET UPDATE
CALIFORNIA

Sacramento • Bay Area • Los Angeles • Orange County • San Diego

Valued Clients:

Investor interest in the California LIHTC market has been strong this year. In light of this, we have prepared up to date market research on California's top multifamily housing markets and are pleased to share some of our findings with you. The data outlined in this update shows that market rate multifamily in major California metro areas continued solid performance throughout 2013. This report summarizes some of the market highlights from PPR Global's fourth quarter apartment information and trends report. Please note that PPR reports on all market-rate multifamily product classes, but we find the trends are relevant to LIHTC assets, particularly for the B and C asset classes.

TCG remains bullish on the California LIHTC market for 2014. We have always been exceptionally active in California and have a solid track record for LIHTC property sales. In 2012 and 2013, we completed 31 LIHTC sales in the state totaling 5,357 units for a sales volume of more than $600 million. So far this year TCG has successfully transacted 8 LIHTC properties in California with a total real estate value of nearly $117 million. Additionally, we have 12 properties in our California pipeline consisting of nearly 2,000 units.

As always, please give us a call if you want to discuss market activity in California or would like any specific submarket information. You can also request research reports from TCG Research Services on the Tax Credit Group website at: www.taxcreditgroup.com/research.

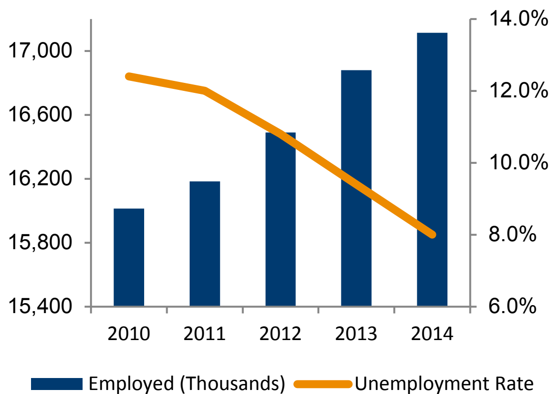
Sincerely,

Jeff Kunitz
Senior Director
jeff.kunitz@tcg-mm.com

Tim Flint
Director
timothy.flint@tcg-mm.com

California Overview

The California economy continued its slow but steady pace of recovery in 2013. From its low in February, 2010 of just over 14 million jobs in the state, California has gained 1.23 million jobs to reach 15.35 million employed in February, 2014. For the 12 months ending in February, 2014, California added 336,000 jobs for a growth rate of 2.3%, 80 basis points above the national rate of 1.5% for the same time period.

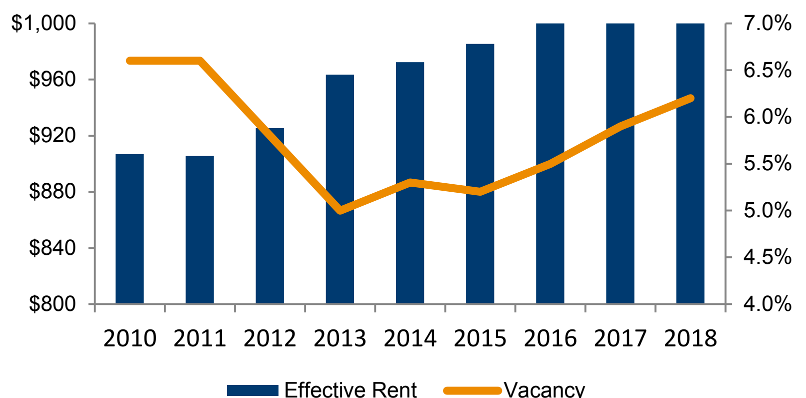


Statewide, the unemployment rate in February was 8.0%, an improvement of 140 basis points over February, 2013. Jobs were added in all the labor sectors except manufacturing, which retracted 0.2%. Construction topped all labor sectors expanding by 6.2%. Other sectors experiencing strong growth included Professional & Business Services (4%), Education & Health Services (3.4%) and Leisure & Hospitality (3%). According to the BLS, California was third in the country in job growth in 2013, expanding 3%. The California economy strengthened so much in 2013 that the state regained its title as the world's eighth largest economy.

Many factors contribute to the positive forecasts for California's apartment market over the next 3 to 5 years, not the least of which is continuing economic expansion and job growth. One major reason operators can be optimistic about the future is that homeownership is out of reach for most residents in the major metro areas. But affordability is also becoming a challenge within the rental market. Rent acceleration over the past 4 years has far outpaced income growth, pushing greater numbers of tenants into lower tier properties. Vacancy in Class C assets has declined in every major metro area between 30 and 180 basis points over the past 12 months. As rents continue to escalate, expect renters to migrate to the properties and submarkets offering the most value for their dollar. Providing affordable options for the California renter cohort may be the top challenge for the market going forward.

Sacramento

The Sacramento metro area referred to in this report includes El Dorado County, Placer County, Sacramento County, and Yolo County. California's capitol suffered much greater recessionary job losses and, thus far, subpar recovery job growth when compared to other major California metro areas. Sacramento's unemployment rate in February 2014 was 8.1%, down from 9.4% a year ago. Between February 2013 and February 2014, 11,900 new jobs were added in the region, an expansion of 1.4%. State and local government has been the biggest drag on the recovery. This sector makes up by far the largest component of the metro's workforce and remains more than 8% below prerecession levels, despite recent improvements. The largest contributor to job growth since the bottom of the downturn has been professional and business services, which has added almost 15,000 new positions. A majority of these jobs were concentrated in administrative and support services, as the metro's low business costs attract firms with back-office operations. Other top job creators include education and health services, retail trade and accommodation, and food services sectors.



Market Rate Multifamily

Sacramento's apartment market recorded solid progress in 2013 despite the significant headwinds the metro faced, namely a still weak economy and shadow market inventory. During 2013, the

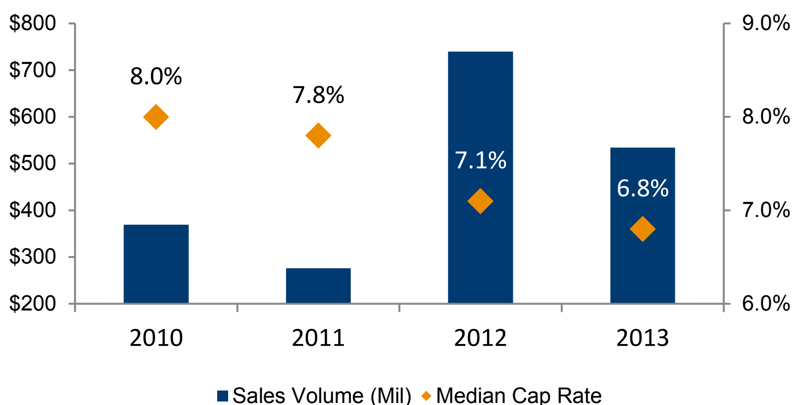
Sacramento apartment market absorbed 2,178 units, pushing vacancy down 0.8% year–over–year to 5%, the second lowest rate in over a decade. The recovery has not been constrained by large-scale supply additions, which allowed vacancies to drop below the market's 2002–2012 historical average of 6.2%. Projections call for vacancy to remain below that 6.2% average over the next five years.

With occupancy stronger than expected, operators in the Sacramento metro area continued to boost effective rents throughout 2013, taking rents up 4.1% on a year ago basis to $963 per month. Increasing levels of net migration and solid demographics will help to boost demand and rent growth over the 5-year forecast period. While minimal when compared to other California markets, Sacramento should see rents grow approximately 5% over the forecast period passing the $1,000 per month rate by 2018. Overall, the fundamentals in this market should remain relatively healthy over the next five years.

Asset Class Performance

Class	4Q13 Vacancy	Y-O-Y Change	4Q13 Eff. Rent	Y-O-Y Change
A	3.8%	-20bps	$1,189	1.30%
B	3.5%	-110bps	$974	4.10%
C	3.9%	-180bps	$794	1.70%

The current market-rate apartment inventory in the Sacramento metro area totals 122,904. Of interest to LIHTC stakeholders, the California Tax Credit Allocation Committee (CTCAC) reports there are currently more than 15,500 active LIHTC rental units in 137 apartment communities in Sacramento. As PPR Global does not separately track LIHTC units, it is reasonable to assume the bulk of the LIHTC units will fall into the Class B and C data that follows. PPR Global tracked 88,911 units in 4Q2013 for purposes of its class cut analysis. Of those units, 83.8%, or 74,491 units, were B and C Class assets. Projections for separate asset classes are not available, so it is difficult to forecast how the individual asset classes will fare going forward. But over the past 12 months, all asset classes performed well in Sacramento. Still unable to afford a single-family home, higher-income renters turned to institutional grade top tier properties where vacancy compressed by 20 basis points in the 12 months ending in the fourth quarter. But the real gains were in B class assets where vacancy improved by 110 basis points to 3.5% while effective rent jumped 4.1% to $974 per month.



Sales Activity

Sales volume fell more than 27% during 2013 as buyers struggled to find suitable listings. The largest decline occurred in the Class B segment, where velocity retreated 33%, though every apartment class recorded some deterioration in velocity. Although the number of transactions dipped, rising NOIs and healthy buyer demand supported a 30 basis point reduction in the median cap rate to 6.8%.

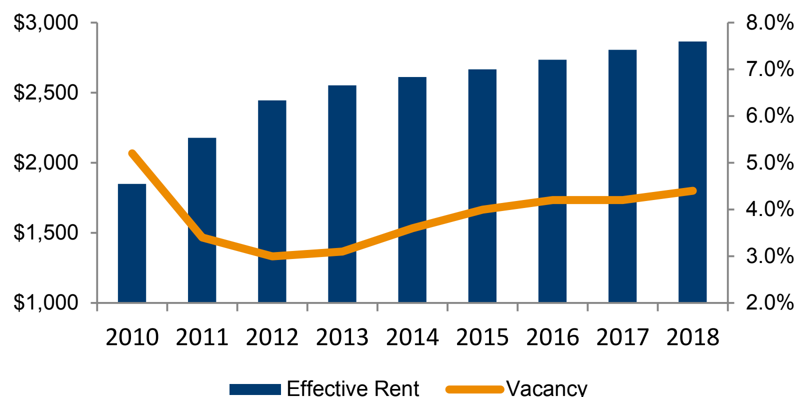
A surge in sales activity when both job creation and rent growth forecasts were more significant has given way to a more subdued market. Additionally, investors from the Bay Area have exhibited a greater amount of due diligence and restraint during this cycle compared to the buying frenzy during the middle of the last decade. While the right listing will still generate multiple offers, management-intensive Class C deals have mostly been left for local investors with longer market tenure and relationships with local banks.

Bay Area

Geographically, in this update the "Bay Area" is inclusive of Marin County, San Mateo County, and San Francisco County. While California struggled to find its footing in the recovery, the Bay area saw one of the strongest economic rebounds in the country. Blessed with a highly educated workforce and being the home to some of the world's most innovative tech companies- like Apple, Cisco Systems, EBay, Google, Intel, Salesforce.com and Yahoo – the local economy has continually ranked among the top five economies nationally. While the US is still recovering from recessionary losses, the Bay area's employment is about 4% above prerecession highs, and at 5.1% the unemployment rate is well below the national average. The pace of job growth in the Bay Area was strongest in metro San Jose which saw payrolls increase 4.4% in the year ending February 2014. During that same time San Francisco recorded employment growth of 3.1%, adding 32,100 new jobs between February, 2013 and February, 2014. Over one third of the 32,100 new jobs created in San Francisco, or 12,600 jobs, were created in the professional and business services sector. Altogether, total employment levels in the Bay Area now exceed the prerecessionary peak by 122,100 jobs, or 4.1%. Fueling the economic expansion in the Bay Area last year was the influx of $12.1 billion spread out across 1,247 deals in venture capital accounting for nearly 42% of all venture capital funding in 2013. Venture capital dollars will continue to support the creation of new jobs at a brisk pace which bodes well for apartment operators.

Market Rate Multifamily

Like most of the major metro areas in the country, apartment development across the Bay Area has accelerated to unusually high levels by local standards. During the past year completions topped the 7,000–unit mark. Additionally, at the end of the first quarter of this year work was underway on more than 16,500 new units. Yet in the face of 20–year–high construction levels, effective rent growth actually accelerated 4.4% during 2013 to end the year at $2,553 per month. And while effective rent growth will slow due to the oncoming wave of new supply projections call for average annual rent growth of 2.8% through 2018.



The booming economy coupled with constrained development in recent years pushed vacancies in 2012 to their lowest levels since the tech–boom. Bottoming out at an area–wide vacancy of 3%, vacancy started to tick up slightly last year as new projects began hitting the market. But the core strengths of the Bay Area economy and the prohibitively high price of homeownership will continue to drive demand keeping vacancy below 4.5% over the next five years.

Asset Class Performance

Class	1Q14 Vacancy	Y-O-Y Change	1Q14 Eff. Rent	Y-O-Y Change
A	3.1%	-340bps	$3,019	6.20%
B	4.0%	no change	$2,389	5.90%
C	1.6%	-40bps	$1,999	6.60%

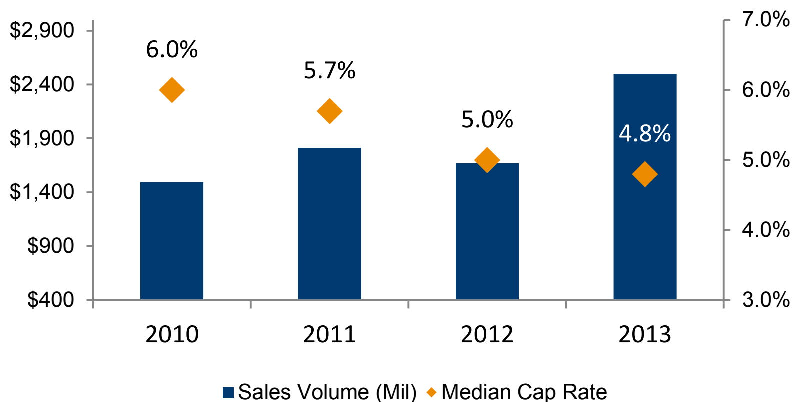
The current market-rate apartment inventory tracked by PPR in the Bay Area totals 222,905. According to the California Tax Credit Allocation Committee (CTCAC) there are currently more than 10,500 active LIHTC rental units in 110 apartment communities in the Bay Area. PPR Global tracked 53,613 units in 1Q2014 for purposes of its class cut analysis. Of those units, 76.6%, or 41,067 units, were B and C Class assets. With homeownership unattainable for most Bay Area residents, demand in all 3 asset classes during the 12 months ending in February drove vacancy down and effective rent up. Higher income residents quickly absorbed the new product as it came online driving Class A vacancy down 340 basis points

to 3.1% while operators pushed effective rent up 6.2% to just over $3,000 per month. Interestingly, Class B assets made no gains in occupancy ending the same 12-month period with the highest vacancy at 4%. Skyrocketing rent increases in the other tiers forced many renters to seek lower housing costs by moving into Class C properties, compressing vacancy 40 basis points to virtually full status at only 1.6% vacancy. Taking advantage of the demand, C Class landlords were able to grow effective rent an enviable 6.6% to just under $2,000 per month.

Access to affordable housing for low-income residents in the Bay Area is at a crisis point. With Class C rents now averaging more than the average mortgage payment in most of the country, more affordable options in the multifamily market are sorely needed.

Sales Activity

Investors remain keen on the San Francisco apartment market, which resulted in a whopping 49% rise in sales volume during the 12 months ending in February. The largest jump occurred in the Class B segment, where deal flow increased by more than 75%. The median unit sales price rose 16% during the period to $250,000 as intense buyer demand pushed up valuations. Mid-tier apartments transacted at a median sale price of $229,700 per unit. Average cap rates for Class B properties are in the mid-4% range in the current market, with top-tier assets changing hands close to 4%.



The wave of new product scheduled to enter the market over the next 12 to 18 months will slow rent growth and put upward pressure on vacancy rates. These operational shifts together with higher interest rates will push cap rates up in the coming months.

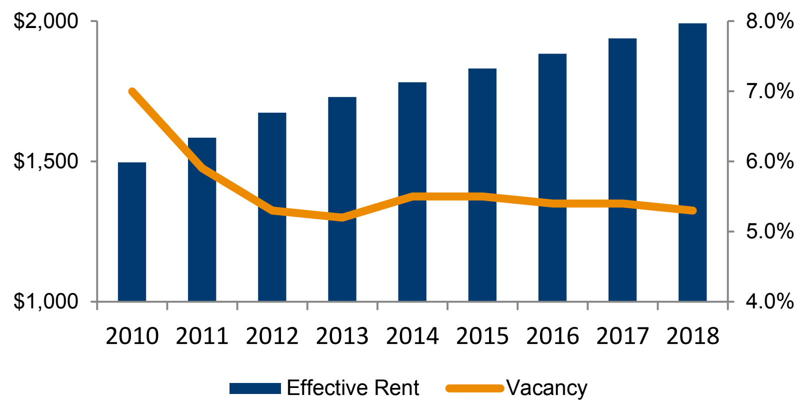
Los Angeles

The recession has caused fundamental cyclical and structural changes to the Los Angeles economy. Migration patterns, employment trends, and apartment fundamentals have all been undergoing a distinct post–recession shift. First, population growth has slowed particularly among the apartment renter cohort. Metro Los Angeles saw the second–largest millennial outmigration during the recession and immediately afterward, behind only Metro New York City. Next, job growth in the Los Angeles market since the recession has been concentrated in lower – paying sectors, and even in those sectors the rate of growth has lagged behind that of other California metro areas. Finally, the current apartment supply pipeline has reached nearly a two–decade high. The concern is that a market mismatch can develop between apartment demand generated by the dominant growth in low-paying jobs and the new apartment supply, most of which is coming in as high-priced and high-end product. Even with the sluggish employment growth, the unemployment rate in Los Angeles dropped 2.5% during the 12 months ending in February, 2014 to 8.7%. In that 12 month period, Los Angeles added 86,100 new private sector jobs, growing employment by 2.1%. Most of the employment sectors saw some degree of growth in the past 12 months. Construction led the way expanding 8.8%. Other strong showings came from Information Services (4.4%) and Professional and Business services (4.7%). An important labor segment that has been in a long–term decline is the Manufacturing sector. Between 2000 and 2013, this sector lost 261,000 positions and continues to shed jobs today. Just in the past 12 months manufacturing positions contracted by an additional 2.9%, or 8,800 jobs. The Government sector is also a drag on the Los Angeles economy shrinking by another 3,200 jobs. Going forward, there is both good and bad news for the Los Angeles multifamily market. On the positive side, operators should not worry about losing renters to homeownership as the median home sale price in the Los Angeles market was $439,600 in February, well out of reach for most households. But strong headwinds in the form of low-wage, slow job growth and

record-breaking inventory additions of over 14,500 units this year and next will keep operators scrambling to maintain occupancy and rent growth. For perspective, the metro has only averaged approximately 4,700 new units per year since 2000.

Market Rate Multifamily

The headwinds for the market noted above prevented much vacancy compression last year, dropping only 10 basis points to end 2013 at a metro-wide average of 5.2%. It must be remembered, though, that the Los Angeles MSA includes 7 submarkets where fundamentals varied widely. The highest vacancy at the end of last year was in the central LA submarket where vacancy averaged 7.4%. At the same time, 4.3% vacancy existed in the west LA and Tri-Cities submarkets. When looking at product niches, occupancy rates were the highest in the oldest most affordable product that being units built prior to 1970 where occupancy ended the year at 97.1%. As might be expected occupancy was the weakest in the 2000+ segment, the priciest niche product. Moving forward, vacancy will increase over the next two years while the Metro struggles to absorb the new product coming online before reaching equilibrium in the mid-5% range through 2018.



Following significant rent cuts in 2008 and 2009, rent growth in Los Angeles has been modest. While 2011 and 2012 were healthy at 3.6% and 4.5% respectively, effective rent growth began to taper as the construction activity increased. Last year's rent growth equaled 3.1% ending 2013 at $1,729 per month. As more product is brought to market over the next 2 to 3 years forecasts call for rent growth to average 2.7 to 2.8% annually through 2018.

Asset Class Performance

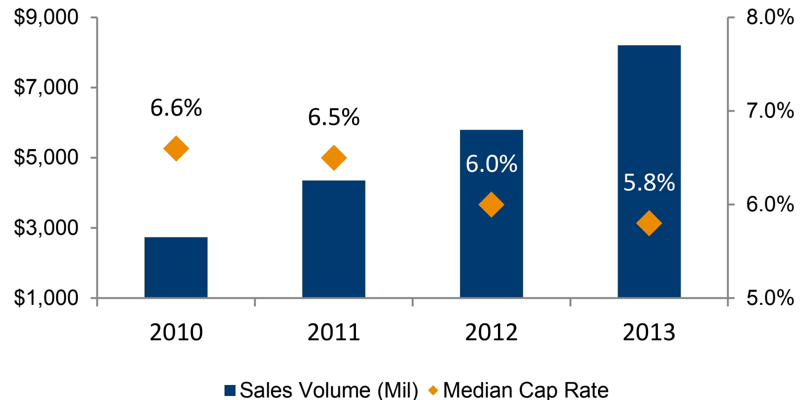
Class	1Q14 Vacancy	Y-O-Y Change	1Q14 Eff. Rent	Y-O-Y Change
A	4.6%	+20bps	$2,358	3.15%
B	3.0%	+20bps	$1,558	3.87%
C	1.9%	-40bps	$1,249	3.65%

The current market-rate apartment inventory tracked by PPR in Los Angeles totals 1,002,409 units. According to the California Tax Credit Allocation Committee (CTCAC) there are currently more than 39,600 active LIHTC rental units in 657 apartment communities in the Los Angeles metro area. PPR Global tracked 233,020 units in 1Q2014 for purposes of its class cut analysis. Of those units, 79%, or 184,184 units, were B and C Class assets. The vacancy trend over the 12 month period ending in March, demonstrates the growing affordability challenge in Los Angeles. While all 3 classes experienced healthy effective rent growth, those escalating rents drove more renters into the older, C Class assets. While both the A and B class properties saw vacancy increase by 20 basis points, C Class properties enjoyed a 40 basis point vacancy compression. As forecast rent growth continues to outpace wages in Los Angeles, expect to see the move to the more affordable C Class assets continue.

Sales Activity

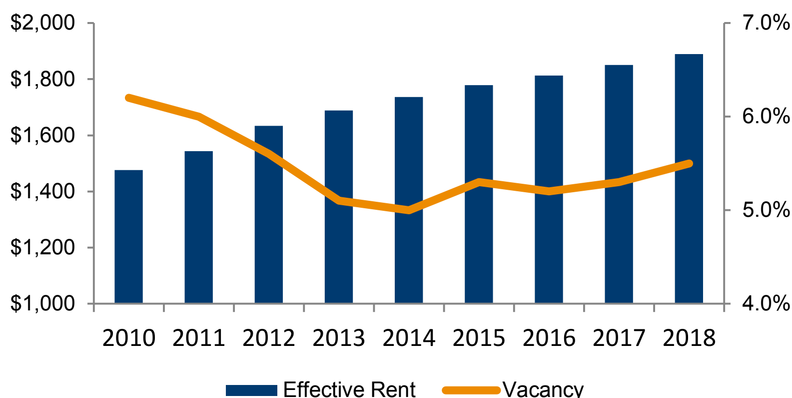
While trading volume began to cool last year, pricing remained as hot as ever. In the second half of 2013, apartment trading activity regressed from the dizzying pace of the last few years. The number of units changing hands was more in line with 2011-level activity. The slowdown would have been noticed in the first half of the year as well had the AvalonBay/Archstone deal not propped up volume. The low yields and high prices may be starting to turn some investors off of LA apartment acquisitions. In the current investment climate, Class A properties trade below 4% near the coast and up to the mid-4% range moving inland. Class B apartments have

average cap rates in the mid 5% range, while Class C deals generally close at first-year returns in the low- to mid 6% area. Although the balance between buyers and sellers is shifting, multiple investors per listing are still common in the metro. Investors paid a metro-wide average median sales price of $133,300 per unit over the past year, a 7% increase from the previous period.



Orange County

Orange County's economy continued its solid growth pace during the 12 months ending in February, 2014, adding 32,000 jobs for a 2.3% increase. Over the past two years, Orange County ("OC") has expanded its private sector employment base by nearly 70,000 positions. In addition, job growth was broad-based, with every major private sector employment category except the Financial Activities segment expanding over the past year. While tourism is a vital component of OC's economy, the Los Angeles-Long-Beach-Santa Ana MSA, (of which Orange County is an important part) is the third largest exporter in the US, behind New York-New Jersey-Long Island and Houston-Sugar Land-Bayton MSAs. The high-tech clusters of Orange County dominate exports. The top three categories over the past 12 months were Construction, Computer and Electronic Products, and Transportation Equipment. Other key industries for OC merchandise exports include Chemical, Machinery, Petroleum and Coal Products, Food, Fabricated Metal Products, and Electrical Equipment and Appliances. Rounding out the positive economic picture is the large number of Fortune 1,000 employers located in OC. White-collar jobs with higher income levels are being generated from this employment base at levels above the national norm. As of February, the unemployment rate in OC dropped to 5.8%, well below Los Angeles at 9% and the statewide unemployment rate of 8.5%. Projections call for the economy of OC to continue adding 30,000 to 35,000 jobs per year in 2014 and 2015.



Market Rate Multifamily

Vacancy crested at 7.9% during the third quarter of 2009 and steadily retreated to stabilize at 6% or less every quarter since the first quarter of 2011. At the end of the first quarter of this year, metro-wide vacancy sat at an enviable 5.2%, an improvement of 30 basis points over the same period in 2013. Unlike many of the major metro areas now experiencing a market cool-down in the face of new supply outpacing absorption, OC's demand has kept pace with new deliveries, keeping vacancy low. In the short-term, metro-wide vacancy will remain steady, dropping to 5% by the end of 2014. In fact, vacancy is not projected to reach the mid-5% range until 2018.

With fundamentals favoring the landlords, rents have continued their ascent. Since regaining pricing power in 2011, landlords have been able to aggressively push rents. For the last three calendar years, average effective rents grew 4.5%, 4.8%, and 3.4% respectively, closing 2013 at $1,689 per month. During the first quarter of this year, effective rents ticked up slightly to average $1,690 metro-wide.

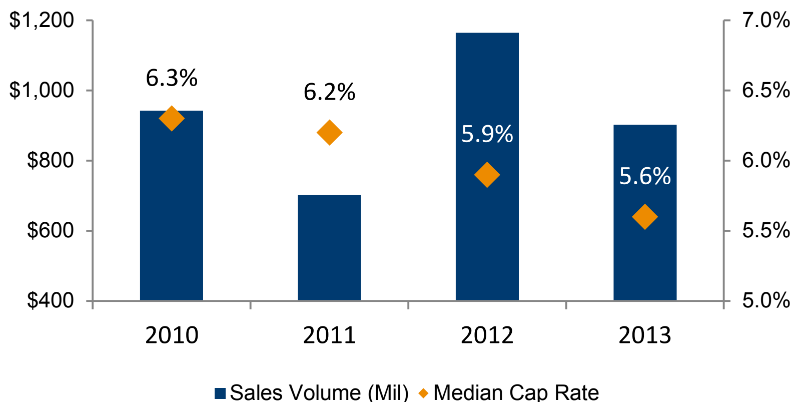
Rents will continue to rise at a slower rate over the next five years, constrained by the new apartment supply hitting the market. PPR projects an annual average rental growth rate of 2.3% over the next five years.

Asset Class Performance

Class	1Q14 Vacancy	Y-O-Y Change	1Q14 Eff. Rent	Y-O-Y Change
A	4.5%	+10bps	$2,069	2.2%
B	3.5%	no change	$1,652	3.9%
C	2.5%	-30bps	$1,327	3.7%

The current market-rate apartment inventory in Orange County tracked by PPR Global totals 223,898 units. The California Tax Credit Allocation Committee (CTCAC) reports there are currently more than 12,000 active LIHTC rental units in 122 apartment communities in Orange County. PPR Global tracked 147,790 units in 1Q2014 for purposes of its class cut analysis. Of the 147,790 units, 77%, or 114,179 units, were B and C Class assets. Following the pattern of the other major California metro areas, the 12 month period ending in March of this year was marked by strong vacancy compression in the C Class properties in the OC. While occupancy either stagnated or fell slightly in the upper tier assets, C Class properties saw vacancy shrink by 30 basis points, dropping vacancy to 2.5%. After a strong 12 month run in the institutional grade top tier properties where vacancy compressed by 30 basis points by the end of 2013, some of those gains were lost in the first quarter of this year with a 10 basis point increase in vacancy. Vacancy settled at 2.5% in the Class C assets and 3.5% for Class B at the end of March of this year. It should come as no surprise that such strong occupancy supported healthy rental growth in all three classes. Even though the top tier properties had substantially higher starting rents, Class A assets enjoyed healthy 12 month rental growth of 2.2%. Class B rents expanded 3.9% and the Class C rents increased 3.7% in the same 12 month period.

Like Los Angeles, a major challenge for rent growth in the OC is that job growth is dominated by low-wage positions. Projections call for this trend to continue for the foreseeable future. Thus affordability will continue to temper rent growth and drive renters to the lower tier properties in Orange County.



Sales Activity

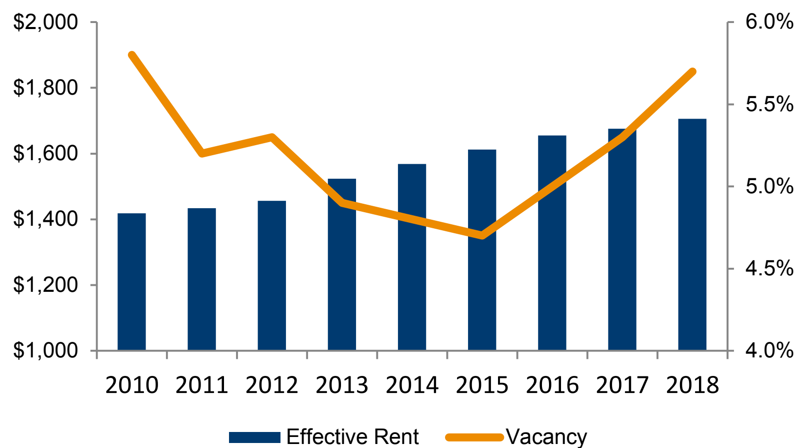
The recent slowdown in pricing growth doesn't mean the OC market is cooling off. The reason that pricing growth has recently stagnated is that the mix of assets trading is changing: More Class B and C communities are trading now than in the past few years. The median sales price inched down 2% during 2013 to $171,100 per unit. The high volume of Class C deals likely masked an actual upswing in property valuations. More telling than price is the behavior of cap rates. Average cap rates were in the low-5% range during the past 12 months, down 10 basis points from the previous period. Class C assets changed hands in the low-to-mid 6% range. With Class A assets trading at mid-to-high 4% cap rates, investors started moving capital into the lower tier properties. A run on Class C assets hints at investors' concerns with oversupply at the high end of the market. Watch for that trend to continue as investors branch out on the risk spectrum looking for value-add investments. No true Class A sale has been recorded since April 2012. Recent Class C transactions like those of the 169-unit Palmilla Villas Apartments in Anaheim and the 160-unit Arbors in Santa Ana traded at around $160,000 per unit.

San Diego

San Diego's recovery has maintained its momentum over the past three years supported by the strength of the business and professional services sectors. Strong performing subsectors include IT- and biotech-related jobs. Employers added 27,700 new jobs during the 12 months ending February 2014 increasing payrolls by 2.1%. As of February, the unemployment rate in San Diego was 7.0%, well below Los Angeles at 8.7% and the statewide unemployment rate of 8%. Professional and business services posted the greatest year-over gain, adding 6,700 jobs. Professional, scientific, and technical services (up 6,200) contributed to more than 90% of the growth in this sector. Seven other nonfarm sectors also added jobs year-over-year. The most notable employment growth came from leisure and hospitality (up 4,800); educational and health services (up 4,700); and construction (up 4,800). Sequestration and defense cutbacks are factors to watch this year but the metro should be able to avoid major defense cuts because it specializes in the future of military spending- unmanned drones and cybersecurity. Additionally, the recent naval decision to place more assets in the Pacific theater will result in deploying 10 to 15 ships from Norfolk Virginia to San Diego establishing the metro as a major US naval hub. The additional personnel stationed in San Diego as the result of this expansion should create additional retail spending throughout the metro as well as bolster demand for apartments near the military bases, further supporting forecasts for San Diego's recovery to strengthen in 2014 and 2015.

Market Rate Multifamily

The effects of the Great Recession on the San Diego apartment market were, by comparison, mild and short lived. Vacancy crested at 6% during the first quarter of 2009 and quickly retreated to 5.6% or less every quarter since then. At the end of last year, metro-wide vacancy sat at an enviable 4.9%, an improvement of 40 basis points over the same period last year. Unlike many of the major metro areas now experiencing a market cool-down in the face of new supply outpacing absorption, San Diego's demand has kept pace with new deliveries, keeping vacancy low. In the short-term, metro-wide vacancy will continue to fall, hitting the mid-4% range by the end of 2014. In fact, vacancy is not projected to cross into the low-5% range until early 2017.



With fundamentals now favoring the landlords, rents have continued their ascent. Since regaining pricing power, landlords have been able to push rents at a moderate rate. Between the third quarter of 2008 and the third quarter of 2010, average effective rents dropped 6.2%, to $1,415 per month. Since then, landlords have gained back 7.7% in effective rent, closing 2013 at $1,524 per month. Rents should continue to rise at a predictable rate over the next 5 years, constrained somewhat by the large percentage of renters residing mostly in the South County Submarket for economic reasons. PPR projects an annual average rental growth rate of 2.6% over the next 5 years. Concessions are a non-factor in San Diego. Concessions amount to less than 1% of asking rents, which means that unless a property is in lease-up, concessions are not necessary. This is not all that new, as San Diego historically is not a high-concession market.

Asset Class Performance

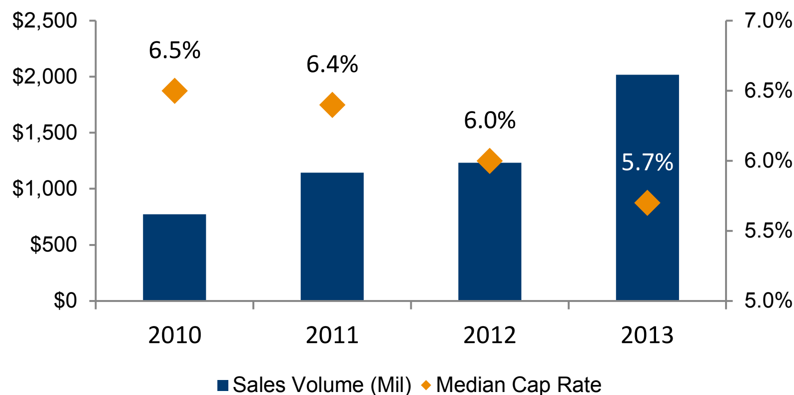
The current apartment inventory in the San Diego metro area tracked by PPR Global totals 272,013 units. The California Tax Credit Allocation Committee (CTCAC) reports that there are currently more than 15,900 active LIHTC rental units in 188 apartment communities in San Diego County. PPR Global tracked 131,037 units in first quarter of 2014 for purposes of its class cut analysis. Of

Class	1Q14 Vacancy	Y-O-Y Change	1Q14 Eff. Rent	Y-O-Y Change
A	6.7%	+250bps	$1,925	6.90%
B	2.4%	-40bps	$1,417	2.80%
C	2.0%	-30bps	$1,140	2.80%

the 131,037 units, 76%, or 99,994 units, were B and C Class assets. Class A operators in San Diego experienced a schizophrenic twelve-month run ending in March of this year. While they were busy raising effective rents by 6.9%, the largest increase of all five metros, they saw vacancy increase 250 basis points to 6.7%, 210 basis points higher than the next closest metro area, Los Angeles. The renter flight from the top tier properties caused by the extreme jump in rental rates benefited both class B and C assets as vacancy compressed 40 basis points and 30 basis points respectively. Class B properties ended the first quarter of this year at 2.4% vacancy and the C class properties bested that by 40 basis points ending the quarter at 2.0% vacancy. The 6.9% increase in effective rents put the top tier assets at more than $500 a month higher than the B class properties, settling at $1,925 per month. Like the other metros, affordability challenges are driving cost-conscious renters to the less expensive, lower tier assets. Class B properties averaged $1,417 per month in effective rents while C class properties ended the quarter at $1,140 per month.

Sales Activity

Even average assets are expensive in San Diego. Cap rates of 5.5% and below are becoming the norm even for well-occupied Class B assets. A notable example was the Missions at Sunbow, which traded for $90 million ($267,000/unit) at a 5.2% cap rate. The property sold at 5% above its 2006 sale price and was 96% occupied at the time of sale. Similar properties sold at cap rates from 4%–5% during the peak of the market, indicating that pricing is as strong as it was prerecession. For Class A assets, cap rates around 4.5% are the becoming the average, with both the Reserve at 4S Ranch (540 units, I-15 Corridor) and Legacy Apartment Homes (412 units, I-15 Corridor) traded at 4.4% and 4.5% respectively. Of the more than 65 properties that have traded for over $5 million since the beginning of 2012, only eight have been Class A properties, and the average price per unit of these properties was north of $250,000, about 45% higher than last year's average. With such expensive pricing in Class A assets, expect the capital to continue to flow into Class B and C assets as investors search for value-add investments.



Sources: PPR Global; CoStar; BLS; Marcus & Millichap Research Services; MPF Research; Economy.com; State of California, Employment Development Department, Labor Market Information Division; California Tax Credit Allocation Committee.