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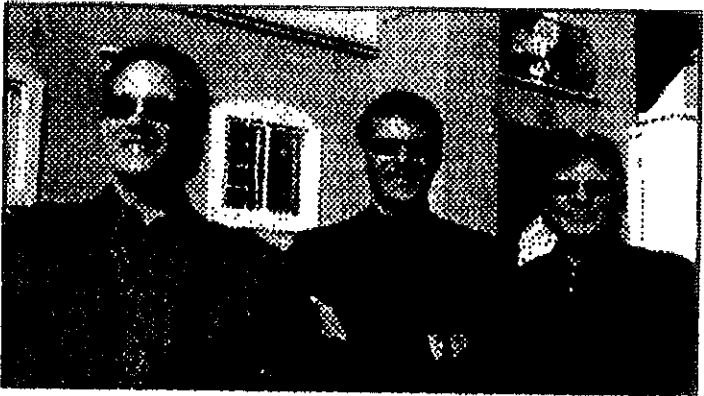
# REAL ESTATE JOURNAL

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## THIS WEEK

### FORECAST 2003

CREJ's statewide real estate forecast wraps up with multifamily properties.



# Smart Growth Continues in San Diego

The many multifamily redevelopment projects in the works this year won't meet the market's housing needs, ensuring high demand for apartments

BY JULIE NAKASHIMA  
CREJ Staff Writer

**D**uring San Diego's booming economy of the past few years, developers, understandably, stepped a little hard on the gas pedal.

But even so, the multifamily market remains underbuilt, according to Kevin Mulhern, a first vice president of CB Richard Ellis. He expects San Diego apartments to put in a solid performance this year.

"We're one of the two or three healthiest multifamily markets in the country," Mulhern said.

The factors that drive the market, of course, are population and job growth. In terms of the latter, Mulhern noted that the county added 20,000 jobs in the last 12 months.

On the development side, he said, the county issued from 1,000 to 1,500 permits a year for new residential units between 1991 and 1997.

"When you put it in the perspective of this being an MSA [metropolitan statistical area] of 3 million people, that's virtually zero construction," Mulhern said.

Since then, the numbers have picked up. According to Mulhern, San Diego County for the past two or three years issued from 4,500 to 5,000 permits annually.

While that's still just a drop in the bucket, he said, it does help account for the fact that the average occupancy in San Diego has declined to 97 percent from 98 percent a year and a half ago.

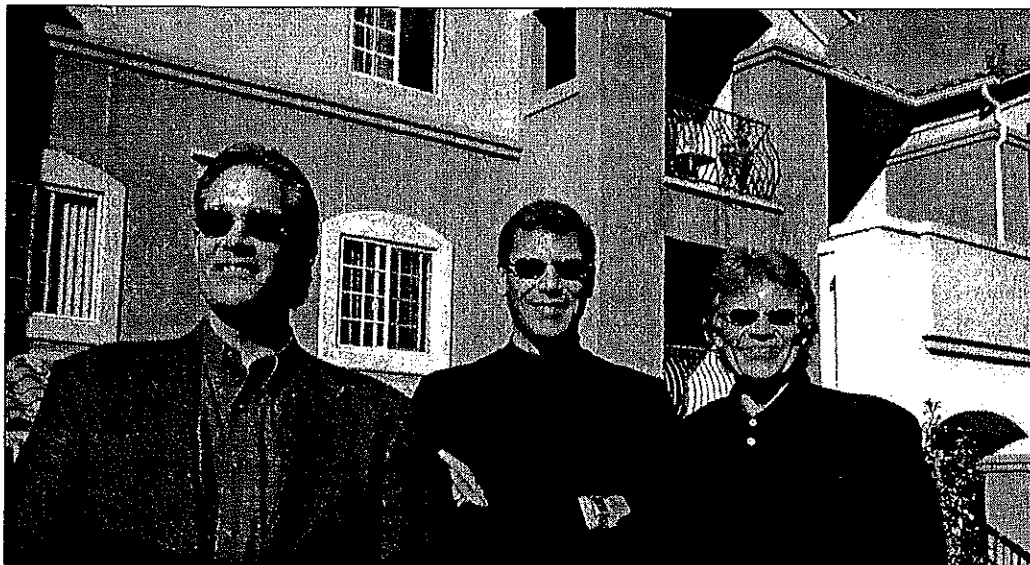
According to a report by Burnham Real Estate Services, the number of permits for new condominium units in San Diego County surged to 587 units in the third quarter from 81 units a year ago. In addition, the firm said that 1,268 condominium permits were issued for the first nine months of 2002 compared with 813 units for the same period of 2001.

However, the number of apartment permits approved fell 38 percent to 702 units in the most recent third quarter from 1,143 units during the same period of 2001. For the first nine months of 2002, 2,261 apartment permits were issued compared with 2,849 permits for the same period of 2001. But in terms of new construction, apartments continue to outstrip condominiums by a significant margin, the Burnham report noted.

### Class Divisions

Looking over the San Diego apartment market, Mulhern describes a dichotomy in which Class A product is plentiful, with vacancy that is above the county's current average of 3 percent, while the more affordable B and C units are undersupplied.

Mulhern noted that of the 20,000 new jobs that were created in San Diego, half were in the service sector, and a good portion of the remainder were government or military-related — relatively low-paying jobs.



Kyle Martin, Randy Friend and Kenneth Melton, all principals of Eagle Real Estate Group, savour the hot multifamily market at Teresina at Lomas Verdes, a 440-unit apartment community in Chula Vista, which the apartment investment firm bought recently for \$52.5 million.

Given the high cost of housing in San Diego, the broker observed that this largely puts those workers into Class B and C rentals.

"That part of the market is as tight as a drum," Mulhern said.

Indeed, as is the case in many areas of Southern California, not all segments of San Diego's multifamily market are performing equally, observed one investor.

"When you look at this market, it's segmented," said Kenneth R. Melton, principal in Eagle Real Estate Group, an Anaheim-based firm that invests exclusively in apartments. Eagle recently purchased Teresina at Lomas Verdes, a 440-unit apartment community in Chula Vista, for \$52.5 million.

The market includes a large number of "1980s-vintage," Class B product commanding rents that are 7 percent to 10 percent lower than Teresina's, Melton explained. Those properties have fewer common-area and interior amenities.

At the other end of the market are new projects that are primarily luxury in nature, boasting all the bells and whistles in terms of interior amenities as well as exterior amenities.

"Their rents are a couple of hundred dollars a month higher than [Teresina]," Melton said. Eagle's "sweet spot" is in-between those two ends of the market, he said, describing it as "better than the old stuff, but [offering] better value than the newer triple-A stuff."

"We're positioned between the Class A stuff and the more garden-variety, 20-year-old gar-

den-style B stuff," said Eagle principal Randall J. Friend.

The firm believes that many markets soften first at the top.

"We're not as susceptible to the concessions that some of the luxury product is experiencing," he said.

Eagle plans to spend an additional \$1 million to upgrade Teresina, which was built in 2000 in the master-planned community of Otay Ranch, and enhance its curb appeal. Eagle has set aside 20 percent of the community's units for very low-income families.

This was the firm's first acquisition in San Diego County and one of the county's largest multifamily transactions last year.

The company prefers the north and south areas of San Diego County for investment. South County, in particular, has had a migration of blue-collar workers, which fits in with Eagle's focus on workforce housing.

### Growing Smartly

Among other multifamily trends, Mulhern reports a pickup in condominium conversions to create entry-level housing — as opposed to the ongoing luxury high-rise condo development in downtown San Diego — and an increased propensity toward higher-density, smart-growth projects. Like many other places in Southern California, mixed-use projects that include a residential component are finding favor, he added. The redevelopment of dated or underutilized retail and office buildings for residential units is also popular.

"That's becoming much more popular, especially downtown," Mulhern said. "You're seeing reinvestment in old sites for new uses."

With 9,000 new-for-sale and rental residential

units either under way or soon to begin construction, downtown San Diego has emerged as a major housing hotbed. In its report, Burnham attributed the jump in condominium activity to downtown renewal efforts. According to the brokerage firm, 73 percent of the condominium permits and 32 percent of the apartment permits issued through the first nine months of 2002 were located downtown.

This residential development is on top of the more than 11,000 units that exist downtown, according to the Centre City Development Corp., the redevelopment agency for San Diego's downtown. The city envisions a downtown population of 51,340 by 2025.

The new projects include Douglas Wilson Cos.' Parkloft, a \$60 million, 120-unit luxury loft development in the East Village neighborhood of downtown (home of the future San Diego Padres ballpark); Renaissance, a 22-story twin-tower luxury condominium project; and Treo @ Kettner, a residential project comprising two 24-story towers and a five-story midrise building.

Brokers who specialize in other property types view the changes as positive and are supportive of the attention being paid to the downtown area.

The addition of new residential units — along with the ballpark under construction and the recently expanded San Diego Convention Center — create an "exciting buzz" for downtown, said Kraig Kristofferson, a senior vice president with CB Richard Ellis who specializes in office.

"It is becoming the live-work-play atmosphere that we had all envisioned it to be one day with a 24-hour, urban environment," he said.

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KEVIN MULHERN  
CB Richard Ellis