'BUY LOCAL' TAKES ON NEW MEANING IN SAN DIEGO'S RETAIL MARKET

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San Diego is quite a boomtown as of late. The region is experiencing construction and development of new ground-up retail centers, large mixed-use projects and the rehab of older centers. All of this new space is getting absorbed quite rapidly, particularly by food users, but not just by any restaurants. Rather, it's being snatched up by many local and regional brands that are in high demand.

Westfield has almost completed its first phase remodel of the tired Plaza Camino Real. The $300-million facelift will be a game-changer for the Carlsbad trade area. New tenants will include 24 Hour Fitness, Luna Grill, Panera Bread, Peet's Coffee & Tea and San Diego's first Bone Fish Grill. One very exciting second phase lease was recently signed by Tesla Motors for its first flagship showroom and service station. Other Westfield-owned regional malls set to undergo extensive renovations will be University Town Center and Horton Plaza.

Shea Properties will shortly break ground on Del Sur, a Target-anchored center near the 4S Ranch community east of Rancho Bernardo. Shea is targeting more local, regional retailers and restaurants that will resonate with the affluent neighboring communities. This bucks a long-standing trend of institutional owner's desire to sign deals with credit tenants and national chains. Shea is not the first landlord to have a change of philosophy. Donahue Schriber has taken this approach with the lease-up of Del Mar Highlands Town Center in Carmel Valley, a smashing success. Donahue is going for round two, with renovations almost complete at Beachside Center on the west side of Del Mar Heights Road. Developer Coast Income Properties is taking a similar approach with Village at Pacific Highlands, focusing on local and regional emerging brands.

Unfortunately, many of the sexier, more local restaurant and bar tenants suburban developers are trying to attract are timid about expanding or starting their business outside of San Diego's urban core. More than 520,000 square feet of new retail is proposed or under construction in Downtown as of this past July, according to Civic San Diego. Little Italy and East Village are seeing the most velocity of growth in the urban core with new mixed-use projects sprouting up all over.

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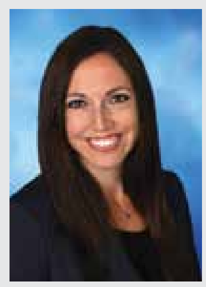
HG Fenton has been quietly acquiring properties in Little Italy over the past few years. One of these properties, formerly occupied by the *San Diego Reader*, will feature 97 apartments, 17,000 square feet of retail and an 11,000-square-foot public plaza. New leases signed in the area include the 20,000-square-foot lease-up of the Ariel Suites tower on the corner of Beech and Kettne by two new restaurants, Pan Bon and soon-to-come Bracero from celebrity chef Javier Plascencia. Alliance's Broadstone Little Italy also boasts 199 residential units and 9,500 square feet of retail fully leased by Café Gratitude from Los Angeles.

DEMAND FOR APARTMENTS GROWS IN SAN DIEGO



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The San Diego multi-housing market is poised for significant growth in 2015. The third quarter of last year recorded 4.5 percent annual rent growth countywide, the highest rent growth numbers seen in more than a decade, according to CBRE Econometric Advisors (CBRE EA). Vacancy, meanthile, remained at 2.7 percent, the lowest level seen since 2007. Countywide average rents are at $1,548, an 8 percent premium over the 2008 peak levels.

CBRE EA found that UTC/La Jolla remains the top rental market in the county, with overall rents averaging $1,958. UTC also witnessed the second-highest rent growth in the county last year, at 7.3 percent. UTC/La Jolla solidifies its position as the county's top rental market due to strong resident demographics, planned infrastructure improvements and the trolley addition, Westfield's expansion, and the presence of several major employers, as well as the University of San Diego and the biotech cluster of Torrey Pines.

Downtown has emerged as San Diego's hottest development market, with Class A projects now commanding rents of $2,652, or $2.98 per square foot. There were 929 units in four projects added last year, bringing the total inventory in Downtown to 4,840 units in 23 buildings (100-plus units, market-rate only). Although Downtown San Diego has a healthy development pipeline with four projects under construction and 20 additional more in the planning stages, there remains significant demand for new product.

Millennials now make up more than 30 percent of the Downtown demographic. This 25- to 34-year-old group is twice as concentrated in the Downtown area as compared to Greater San Diego. Millennials continue to seek lifestyle-type product that caters to the 24/7 live-work-play culture they desire.

Developers are also moving to the boutique hotel concept, as opposed to a traditional apartment complex. New complexes are amenity rich and feature top-of-the-line interior design. Rental units are becoming smaller as they are tailored to the average Downtown household size of only 1.55. The majority of for-rent development is happening Downtown, and we foresee a shift to include condominium complexes in the near future.

About 75 percent of Downtown's residents are renters, a much higher percentage than anywhere else in the county. With an additional 3,600-plus new residents anticipated over the next four years, absorption should remain strong.

Accelerated rent growth countywide has set the stage for new development, according to CBRE EA, with more than 60 projects totaling more than 16,900 units currently in the countywide pipeline. The top five most active developers are Garden Communities, R&V Management, Fairfield Residential, Trammell Crow Company and Alliance Residential.

San Diego's multifamily rental supply has historically lagged in demand, and today is no exception. CBRE EA forecasts countrywide rents to grow an additional 3.6 percent, to $1,616 in 2015. Vacancy is projected to remain low at 3.7 percent. The rental market is ripe and ready for the 3,700 units anticipated to come on line next year.