Rising interest rates could increase rental demand in San Diego, report says

Park 12 is a luxury apartment building near Petco Park which started renting in July. It has the most units of any apartment building in downtown San Diego. (K.C. Alfred / San Diego Union-Tribune)

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Higher mortgage interest rates will push more people into the San Diego County rental market and likely increase rents, said a new report from Marcus & Millichap.

The national commercial real estate brokerage firm's fourth quarter analysis said the gap between between a monthly mortgage payment and average rent has grown, making renting a better — and necessary — option for most San Diegans.

Right now, the firm said the monthly mortgage cost is about $1,724 more than renting. That is roughly $500 more than last year, making homeownership even further out of reach.

"You are starting to see rent growth accelerate right now," said Aaron Bove, a senior vice president at Marcus & Millichap. "We're really going to see it (accelerate more) in 2019 if everything stays the same."

The firm forecasts rent will increase 7.8 percent in 12 months by the end of the year. Bove said the market could see rents go up even faster next year given a strong economy, large amount of new (and expensive) apartments constructed and rising interest rates boosting demand.

At the end of November last year, the interest rate for a 30-year, fixed-rate loan was 3.98 percent, said Mortgage News Daily. It was 4.94 percent Monday.

That means the monthly cost for a San Diego County median home price, $575,000 in September, increased in a year by $327 a month.

Marcus & Millichap anticipates 4,960 new multifamily units will be constructed by the end of the year, up from 3,000 new rentals last year. Most new construction is more expensive, driving up the average rental rate.

Kelly Cunningham, senior economist at San Diego Institute for Economic Research, said even though home price increases are slowing, the median price is so high that it still prices out a number of buyers.

“The only alternative is renting,” he said. “Or, we have a number of people that live up in Riverside (County) or commute from Tijuana. That’s the alternative. Buy and go somewhere else, or rent.”

While it might seem like the county is getting over-saturated with new apartments, there still isn’t a lot available for those searching. The vacancy rate is below 3 percent in more than half of the metro’s submarkets, Marcus & Millichap said. The Santee-El Cajon-Lakeside market has the lowest vacancy, 2.2 percent, the firm said.

However, it can be difficult to compare the cost benefits of monthly rent payments to mortgage payments, said Dana Kuhn, real estate lecturer at San Diego State University. In addition to assuming someone has 20 percent for a down payment, which is unlikely for many San Diegans, Kuhn said home maintenance and other variables increase the actual price of ownership.

Rather than cause a bunch of people who want to buy going into the rental market, he said it’s more likely that the ideal group for future homeowners — renters of luxury units — will just rent longer.

But, he was skeptical rents would rise dramatically.

“I think what the interest rate changes will do, it will forestall them becoming homeowners,” Kuhn said of affluent renters. “Will it generate an ability for them to pay more rent? That’s debatable. They are already stretched really, really thin.”

The defeat of Proposition 10 in November, a statewide measure that would have allowed rent control in communities that wanted it, is expected to get investors who were on the fence before more interested in buying up multifamily units, Marcus & Millichap said.

Investors have paid an average $240,000 a unit over the last 12 months, an year-over-year increase of 3.7 percent.