BERKADIA®

Insiders' Insight: Los Angeles Multifamily Investor Update, August, 2016

What In The World Inning Are We In?

Having grown up in Boston, I never understood how people on the West Coast could possibly leave a baseball game in the 5th inning. This blasphemous act will earn you an earful or more from the die-hard fans. Which is pretty much everyone in Boston. Now that I've lived in Los Angeles for over 18 years, I get it. Baseball is where you go to relax, catch up with friends, and maybe pay a little attention to the game. By the 5th inning it's time to wrap it up, beat the traffic and if you're lucky, catch the last inning at home on TV.

Over the past year, Dean and I have repeatedly been asked what inning we think it is in the multifamily cycle. Some people say we are in the bottom of the 9th, others say we are in the top of the 13th. I've even heard the 4th inning of a double header. One developer told me that the game is over and the stadium manager is about to turn off the lights and lock up.

So...what in the world inning are we really in, anyway?

The answer to that depends entirely on whom you are asking. Many of our larger developer clients have seen massive cost increases over the past three years - from materials to subcontractors to land values. It is not surprising that a good deal of them feel the LA market has peaked, effective rents have hit all-time highs, and it is time to circle the wagons and wait until the market corrects a bit before they purchase raw dirt and endeavor to build another large-scale development. Financing for these deals, while available, has become increasingly more difficult.

Talk to mid-sized developers and you'll hear them say they still have a hearty appetite for smaller 'by-right' deals, particularly under 50 units that keep to on-menu incentives and avoid public site plan reviews. And in some of the more desirable areas where condo and small lot projects have gained strength, developers are still quite bullish. As long as they can find a construction lender that shares their optimism.

Major apartment operators, private equity firms and high net worth individuals and families have told us they think the market will have legs for the foreseeable future, and they consequently remain very hungry for new opportunities. The lens through which they are looking at this market is generally rosy for at least the next 18 months, maybe more.

While there has been a recent uptick in concessions for institutional product due to a glut of high-end inventory coming online, there still remains a strong demand for B and C properties throughout Los Angeles. Many of these assets are of older, rent controlled vintage that have the potential to be renovated over time. The most coveted of these are in prime and prime-adjacent locations, and while not providing the highly amenitized features of their Class A rivals, offer tenants a less expensive yet comfortable alternative to the luxury 'resort-style' living experience.

We have also begun to see investors expand their geographic parameters to include surrounding markets like the San Gabriel Valley, Long Beach, and the 605 corridor. Cities in these areas are not subject to rent stabilization, and may offer slightly higher returns than Los Angeles proper.

Overall rent growth is slightly off from its peak a couple years ago, however it is still exceeding 4% in the majority of infill locations, and even higher in tertiary markets. One key metric to watch is the cost to rent vs. income ratio. Over a third of Angelenos pay around 50% of their disposable income towards gross rent. Even so, elevated single family home values and stringent lending requirements will likely cause would-be first-time owners to continue to rent for the foreseeable future.

Because of the anemic growth of the US economy coupled with certain external forces such as Brexit and the upcoming elections, interest rates are predicted to remain at all-time lows throughout the remainder of the year. And when the Fed does inevitably decide to increase rates, it is expected that it will be a slow, gradual climb.

We never really know when a market peaks until we look back and say, oh yeah, it peaked. Despite the wide range of opinions as to where we are in this cycle, people are still flocking to LA, rents are still increasing, and deals continue to trade.

Maybe we're still in the dugout. Play ball!

Mark Ventre