

Los Angeles, California

Multifamily Housing Update

October 2007

EXECUTIVE SUMMARY

The bloom may be off California's housing-driven boom, but the state isn't facing imminent recession. Neither is Los Angeles County. To paraphrase Outkast's Andre Benjamin, the metro housing market is "cooler than cool." But while sales are ice cold (August velocity fell 34% from 2006, slumping to the slowest rate in fifteen years), home prices remain remarkably firm. Indeed, the median price of a home closed in August was up 5.8% year-over-year, according to DQNews. Although a shift in the mix of sales toward more expensive homes contributed to the positive trend, after adjusting for property mix, values were not worse than stable.

That real estate price levels did not plummet as widely predicted is largely attributable to the vital health of the metro economy. Notwithstanding the loss of several thousand construction and mortgage finance jobs, metro payrolls continued to rise at an approximate 40,000-job (1.0%) annual rate through the summer. Hiring in the knowledge industries was the catalyst, especially in health care, education and professional services. Health care providers added to payrolls at a 10,600-job, 2.9% y-o-y pace in 2Q07, while universities and private schools expanded at a 6,600-job, 6.7% rate. Expansion in the offices of lawyers, architects, engineers and accountants proceeded at a 9,900 (3.8%) job clip, representing the fastest growth recorded since the peak of the late-1990's technology mania.

With high-compensation job creation of this magnitude one expects broader employment growth to exhibit momentum, too, and some indicators point in that direction. For one, the "household survey" employment aggregate surged a seasonally-adjusted 73,000 jobs in July and August, representing the fastest increase recorded since January 2001. In addition, a net of 90,000 people entered the labor force in the same

period, about eight times as many as in the comparable period of 2006, demonstrating strong confidence among workers regarding near-term prospects.

The **RED CAPITAL** econometric payroll model doesn't detect prospective payroll job creation in the same degree, but the outlook is positive. The model yields a forecast of 43,000 (1.1%) jobs for YE2007. Next year, job creation should fall in a confidence band ranging from 29m to 49m, with point estimate of 38,000 (0.9%).

The apartment market rebounded from a soft 1Q07 with positive net absorption and solid rent growth. Owners net-leased 753 units, up from -1,771 in the prior quarter. Aided by a 100-unit condo conversion, vacancy fell 5 basis points to 3.35%. Asking rents increased an average of \$19 (1.4%), and owners burned-off \$2 of concessions to boost effective rents \$21 (1.6%) to \$1,348. Over-the-year, occupancy fell 35 bps from 97.0%, but effective rent surged 6.1% anyway, good for 9th place in the **RED 50**.

Reis forecast surging supply in 2H07 to lower average occupancy to 96.5% by year-end. Supply will persist at an elevated level thereafter, ultimately dropping occupancy to 95.1% by 2011. Rent trends will tumble accordingly, dropping from 5.7% this year to a 2.5% annual pace by 2010.

Investors exhibited more confidence, than Reis, snapping up \$1.4bn of L.A. properties January to May (RCA) to keep pace with FY2006's \$3.4bn take. Summer trade was largely comparable, as 15 \$10mm+ trades were consummated June to August for \$383mm. Buyers negotiated better initial yields, however, as cap rates drifted 40 bps higher into the low- to mid-4% range.

L.A. risk-adjusted returns are below average (5.6%), but fundamentals are compelling. Buyers should accumulate assets "*Opportunistically*."

SNAP SHOT

	Y-o-y change	Projected 2007
Vacancy (3.4% - 2Q07)	↑ 35 bps	↑ 10 bps
Effective Rents (\$1,348 - 2Q07)	↑ 6.1%	↑ 5.7%
Cap Rate (5.8% - 2Q07)	↑ 50 bps	↔ Unchd
Employment (4,137.3m - 2Q07)	↑ 46.1m	↑ 43m

KEY POINTS

- Hiring in the skilled services sector ignited solid payroll growth in 2Q07. L.A. County payrolls expanded at a 46,100 (0.9%) job annual pace. Business, educational and medical professional services industries accounted for about 40,000 net new jobs.
- Motion picture and entertainment industry payrolls declined modestly in 2Q07, but a surge of total employment detected in the BLS household survey suggests independent contractors found TV and film assignments plentiful, boding well for the future.
- After a soft first quarter, apartment demand rebounded in 2Q07. Renters absorbed 753 units, while 100 units were removed from inventory by condo conversion. With 497 units added to supply, occupancy rallied 5 bps to 96.65%. Effective rents climbed 1.6%, ranking 9th best in the **RED 50**.
- Financial turmoil contributed to a roughly 40 bps increase in cap rates during the summer. Yields persist in the mid- to low-4% range.
- Projected total returns from L.A. assets are 5th lowest in the **RED 50**. Volatility is above average. Although fundamentals are strong, investors should buy "*Opportunistically*."



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