RED CAPITAL GROUP®

Market Overview

# Los Angeles, CA



**Multifamily Housing Update** — **March 2011**

## EXECUTIVE SUMMARY

Hollywood studios remained a bright spot for the LA economy, although the pace of hiring decelerated in the fourth quarter. The motion picture and sound recording sector added 12,100 workers year-over-year, down from the 18,300-job annual increase observed in 3Q10. Leisure, education and health care service providers helped pick up the slack, adding a combined net of 18,300 jobs y-o-y in 4Q10.

Unfortunately, the balance of the job market continued to shed rather than create jobs in the fourth quarter. Goods-producing (construction and manufacturing) industries trimmed –18,000 positions from payrolls y-o-y. Trade, transportation and utilities headcounts plunged –7,600 and financial and business services cut –4,100 workers. Even government payroll headcounts declined –17,000, owing to local government cuts.

The Los Angeles County Economic Development Corporation predict a modest 24,100-job (0.6%) payroll gain in 2011 as private sector hiring outpaces public sector job losses. The source expects particularly strong growth among retail (4,200 jobs), professional, scientific and technical service providers (5,700 jobs), administrative support services (5,400 jobs), health care (4,800 jobs) and leisure and hospitality (6,800 jobs) employers.

The **RED CAPITAL Research** (**RCR**) econometric model produces a slightly lower growth estimate of only 6,200 (0.2%) net new jobs this year. Stronger growth is in store for 2012 however, as payroll gains accelerate to 38,100 (1.0%) new jobs.

Area home prices were weak in recent months. According to the FHFA purchase-only home price index, LA County home values dipped –2.7% y-o-y in 4Q10, the first recorded decline since the same period of 2009 (-0.6%). Additionally, the median LA County home price fell –7.7% to $300,000 in the twelve-month period ended in January.

Apartment demand was subdued in the fourth quarter. As a result, the county occupancy rate was unchanged sequentially at 95.1%. Positive net absorption totaled 1,458 units, narrowly outpacing the delivery of 1,078 units from October to December. Class-A rentals outperformed Class B/C assets as occupancy rose 30 basis points sequentially to 94.3%.

Rent trends rebounded, however. The average effective rent increased 0.3% sequentially to $1,347 in 4Q10. Likewise, annual effective rent growth rebounded from –0.8% in 3Q10 to +0.6%. Falling concessions were partially responsible for the increase. The size of the average concession package fell from 4.2% of asking rent in 4Q09 to 3.5%.

Reis foresee improving market fundamentals over the next couple of years. The service predicts that occupancy will rise to 96.1% by year-end 2012. Additionally, the pace of y-o-y effective rent growth is forecast to accelerate to 1.9% in 2011 and 2.3% next year.

Real Capital Analytics identify 191 investor-grade property transactions, totaling $1,947.6 million in sales proceeds in 2010. The source estimates that the average price per unit was $188,481.

Based on an assumed 4.5% going-in yield, **RCR** calculate a 5.0% expected rate of total return, the lowest figure among the **RED** 50. Sluggish rent growth is to blame. Reis predict that effective rent will rise at a 2.7% annual rate through 2015, far lower than the 3.7% **RED** 50 mean.

## SNAP SHOT

| | Y-o-y change | Projected 2011 |
|---|---|---|
| Vacancy (4.9% - 4Q10) | ↓ 40bps | ↓ 60bps |
| Effective Rents ($1,347 - 4Q10) | ↑ 0.6% | ↑ 1.9% |
| Cap Rate (4.8% - 4Q10) | ↓ 100bps | ↔ |
| Employment (3,788.5m - 4Q10) | ↓ 13.5m | ↑ 6.5m |

## KEY POINTS

- At 4.9%, the metro vacancy rate was unchanged sequentially and down 40 basis points year-over-year in 4Q10. Robust apartment demand in the third quarter was largely responsible for the over-the-year improvement. Positive net absorption totaled 4,956 units during 3Q10 and 6,485 units during the calendar year.
- The size of the average concession package continued to decline from 4.2% in 4Q09 to 3.5% in 4Q10. As a result, the average effective rent increased at a modest 0.6% year-over-year pace to $1,347.
- LA County registered a -2.7% year-over-year decrease in the FHFA purchase-only home price index. By comparison, the source observed a 0.4% year-over-year gain in the previous period.
- Real Capital Analytics report that multifamily asset sales volume rose 103% from $960 million in 2009 to $1,947.6 million in 2010. Similarly, the average price per unit rose 4.0% to $188,481.
- At an assumed 4.5% cap rate, **RCR** calculate a 5.0% expected rate of total return, lowest among the **RED** 50.