RED CAPITAL GROUP®

Market Overview

Orange County, CA

Multifamily Housing Update — **March 2011**

EXECUTIVE SUMMARY

Conditions in the Orange County economy improved in the fourth quarter as the pace of annual payroll job growth accelerated from 9,100 (0.7%) net new jobs in 3Q10 to 18,800 (1.4%) jobs in 4Q10. Faster hiring among manufacturing, finance, health care and leisure service firms contributed to the gain. Combined, the sectors added 9,000 jobs year-over-year in 3Q10 and 14,900 jobs in 4Q10.

Hiring activity pushed unemployment down and also urged disenfranchised job-seekers back into the labor pool. As of December, the OC unemployment rate was 8.9%, down from 9.5% in the same month of 2009. Additionally, the labor force expanded 1.5% in the twelve-month period ended in December but remained –1.9% below the December 2007 comparison.

The Los Angeles County Economic Development Corporation expect solid employment growth this year. The source projects gains for each major private employment sector, lead by 4,100 net new jobs from leisure and hospitality firms and 4,600 new jobs from business service providers. But the LACEDC foresee government headcount contraction totaling 4,000 jobs this year.

The **RED CAPITAL Research** (**RCR**) econometric model produces optimistic payroll estimates over the next two years. Area employers are forecast to add 37,900 (2.8%) workers this year and another 42,100 (3.0%) jobs in 2012. Still, the gains are insufficient to return Orange County payroll headcounts to pre-recession levels.

The Orange County housing market lost steam, following the expiration of the federal home buyer credit in June. According to the Federal Housing Finance Agency's purchase-only home price index, Orange County home values dipped –3.0% y-o-y in 4Q10, the first decrease recorded since 3Q09. Similarly, DQ News reports that home sales velocity plunged –12.2% y-o-y as 14,883 homes sold in 2H10.

Home sales were weak in the second half of 2010 but apartment demand surged. Property managers net leased 1,645 units in 3Q10 and 1,166 units in 4Q10, doubling 1H10 net absorption (1,398 units). As a result, the Orange County apartment occupancy rate rose 100 basis points from 93.6% in June to 94.6% in December. Reis expect occupancy to rise to 95.2% by year-end and to 95.4% in 2012.

Increased apartment demand translated into faster rent growth and falling concessions. Class-A face rents advanced 0.7% in 2H10, comparing favorably to the 0.1% increase observed in 1H10. Similarly, average asking rent among Class B/C properties was unchanged in 1H10 and rose 0.4% in 2H10. Additionally, the size of the average concession package fell from 3.9% of asking rent in 2Q10 to 3.6% in 4Q10, giving rise to a 1.4% y-o-y increase in effective rent in the fourth quarter.

Investors were more active in Orange County last year. Real Capital Analytics calculate sales volume of $1,028.5 million in 2010, up 141% from $426 million last year. Likewise, the average price per unit increased 12% y-o-y to $212,230.

Based on an assumed 4.5% going-in yield, **RCR** calculate an 8.3% expected rate of total return, below the 9.0% **RED** 50 average. Similarly, elevated levels of historic rent trend volatility produce the 35th highest measure of risk-adjusted return in the group.

SNAP SHOT

	Y-o-y change	Projected 2011
Vacancy (5.4% - 4Q10)	▼ 100bps	▼ 60bps
Effective Rents ($1,461 - 4Q10)	▲ 1.4%	▲ 5.6%
Cap Rate (5.1% - 4Q10)	▲ 50bps	▼
Employment (1,372.5m - 4Q10)	▲ 18.8m	▲ 37.9m

KEY POINTS

- The metro vacancy rate decreased 50 basis points sequentially and 100 basis points year-over-year to 5.4% in 4Q10. Robust apartment demand was responsible for the gain. Positive net absorption totaled 1,166 units from October to December and 4,209 units in 2010.
- Partially owing to falling concessions, the average effective rent rose at a 1.4% year-over-year pace in 4Q10. The size of the average concession package fell from 4.2% of asking rent in 4Q09 to 3.6%.
- Reis were aware of three apartment properties (840 units) under construction in February. The service predicts that two (115 units) will open this year.
- According to the FHFA purchase-only home price index, Orange County home prices declined –3.0% year-over-year in 4Q10.
- Real Capital Analytics were aware of 31 transactions involving properties priced at or above $5 million in 2010, totaling $1,028.5 million in sales proceeds. The average price per unit was $212,230. By comparison, sales volume totaled only $426 million in 2009.