INSTITUTIONAL INSIGHTS

MULTIFAMILY MARKET INTELLIGENCE

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IPA | INSTITUTIONAL PROPERTY ADVISORS

Southern California Market Overview

June 2022

Southern California Apartments Emerge From Pandemic in Strong Position

The Southern California apartment market is as tight as it's ever been, with performance metrics at record levels. Chronic housing shortages across the region position the rental stock for solid investment return potential, although there are downside risks to be considered and neighborhood opportunity variations to take into account.

Demand Stays Solidly Positive

While some households have left Southern California for places like Las Vegas, Phoenix or various parts of Texas, the migration out of the region has not prevented the area's occupied apartment count from continuing to climb as demand exceeds supply.

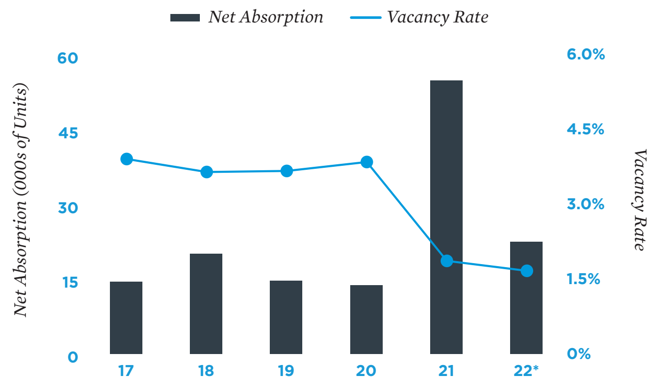
Across metro Los Angeles, Orange County, the Inland Empire and metro San Diego, net demand for rentals registered at roughly 5,900 units during the first quarter of 2022. That early 2022 increase in occupied apartments suggests demand this year will at least match the annual norm of approximately 15,000 units recorded over the past decade.

Regional absorption capacity, in fact, appears to be even stronger, but severe inventory shortages are holding back leasing activity in parts of the area, especially select neighborhoods in Orange County and metro San Diego.

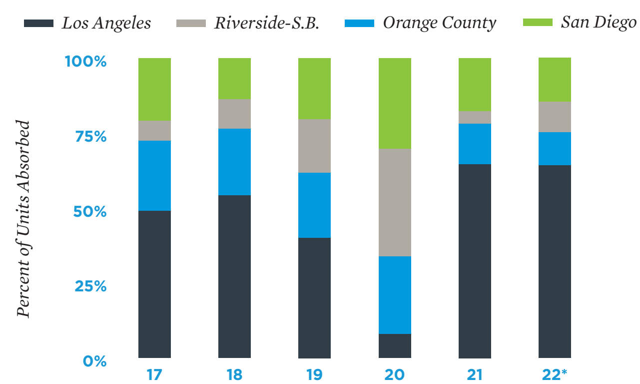
Looking back to last year, Southern California apartment demand soared to a stunning total of 54,800 units in the calendar year 2021, fueled by an impressive comeback for the expensive Los Angeles County neighborhoods that had taken a demand hit during the first half of 2020 and the earliest days of the COVID-19 pandemic. Apartment absorption in the Los Angeles metro during calendar 2021 alone topped 35,000 units.

Even during the 2020 COVID-19 lockdown, regional rental demand came in reasonably close to a normal level, with some 13,800 units being absorbed. However, there was a big shift in demand across submarkets. Most notably, more affordable areas in Riverside and San Bernardino counties flourished at the same time that higher cost locations in Los Angeles floundered. The Inland Empire's share of Southern California regional demand in 2020 surged to 36 percent, up from the past norm of about 15 percent.

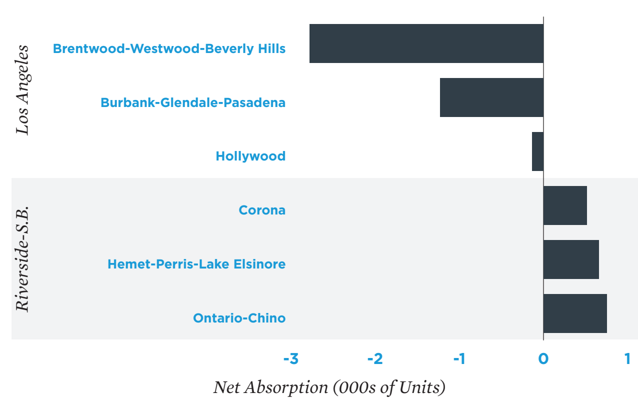
Southern California Multifamily Trends



Southern California Net Absorption Trends

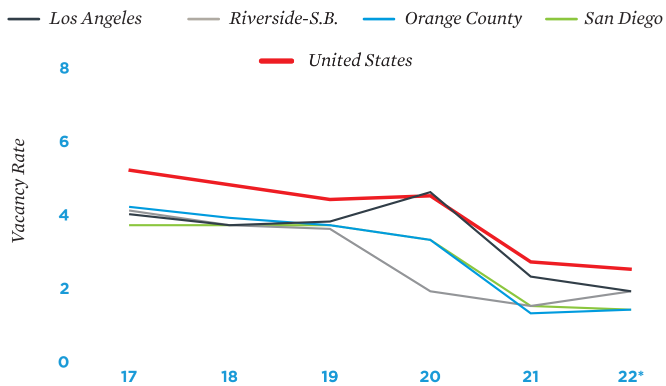


Select Rental Demand Shifts in 2020

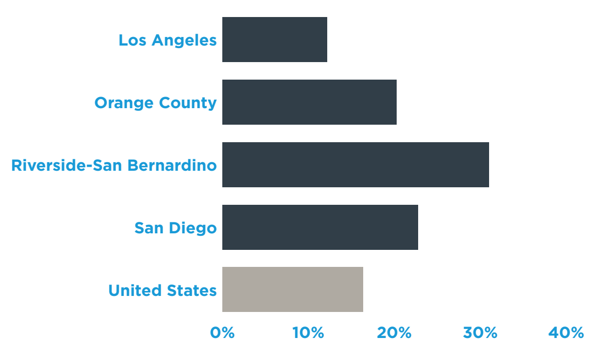


* Forecast
Source: RealPage, Inc.

Vacancy Low Across Southern California

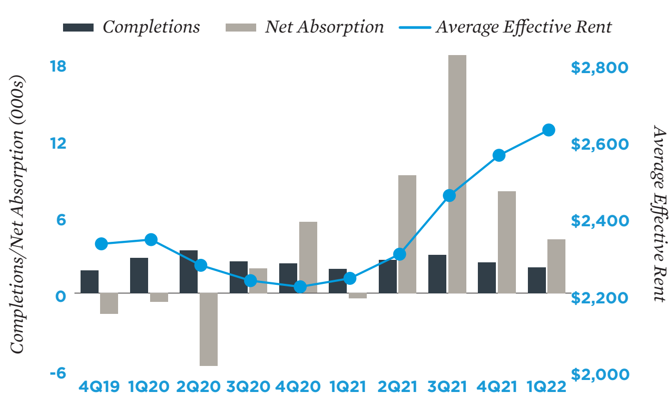


Regional Metros Outpacing U.S. Rent Growth



Two-Year Effective Rent Change (1Q 20 - 1Q 22)

Los Angeles Multifamily Trends



** Forecast*
Source: RealPage, Inc.

Vacancy Plunges to Record Lows

Apartment vacancy levels in Southern California have dropped to metrics well under the performance recorded in the early 2020 pre-pandemic period. Shortages of rental housing are most apparent in Orange County and metro San Diego, both registering vacancy rates of 1.3 percent in the first quarter.

The Inland Empire's vacancy rate is only a little higher at 1.6 percent, and the Los Angeles County reading is at 2.0 percent.

Early 2020 apartment vacancy was near the 4.0 percent mark across all four metropolitan areas.

Rent Shifts Vary

Given recent demand trends and vacancy movement, it is not surprising that rents have soared in the Inland Empire. Typical monthly pricing for move-in leases is up to $2,095, a whopping 31 percent over early 2020 rental rates. Among the country's larger metros, only Phoenix and select Florida locations have registered comparable rent growth during the past two years.

Today's average monthly rents come in just over $2,500 in San Diego and just under $2,600 in Orange County, with pricing up 20 to 23 percent over the past two years.

Typical monthly rents in metro Los Angeles are the most expensive in the region at $2,629, but two-year price appreciation of roughly 12 percent is less than the increases posted elsewhere. Los Angeles rents dropped in 2020, before making a big comeback in 2021 and early 2022.

Downtown Los Angeles is Back in Good Shape

Entering the early days of the pandemic period, there was quite a bit of recently delivered new product moving through initial lease-up in downtown Los Angeles. In turn, vacancy was already a bit elevated at just over 6 percent in early 2020. Availability became even more pronounced once demand for urban core units took a hit, moving to 8.5 percent at its worst in fall 2020.

However, the recent performance comeback for downtown proved robust. Vacancy has now cooled to 3.4 percent as of the first quarter of 2022, the lowest reading seen in more than a decade.

In turn, rents have more than recovered. Today's average price downtown comes in at $2,841 per month, up 8 percent from the pre-pandemic figure of $2,620 and up 23 percent from the low-point rents of roughly $2,300 seen in late 2020 to early 2021.

Home Prices Provide a Tailwind to Apartment Demand

Impacted by long-standing massive shortages of available product, for-sale homes in Southern California rank among the most expensive across the nation. The typical home price is two to three times the U.S. norm across the Orange County, San Diego and Los Angeles metros. Even in the comparatively affordable Inland Empire, the standard home price tops the national figure by more than 50 percent.

The share of Southern California households who can afford to buy homes is shrinking even further now that mortgage interest rates have pushed above 5 percent.

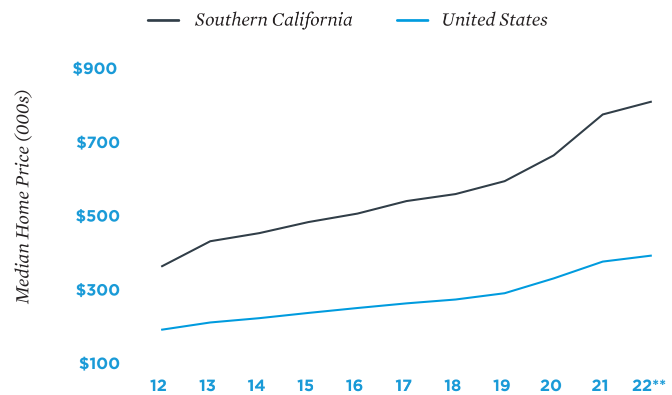
Home purchase affordability challenges will continue to provide support for rental housing in the Southern California region during the foreseeable future, helping boost resident retention in the area's apartment communities.

Modest Additional Stock is on the Way

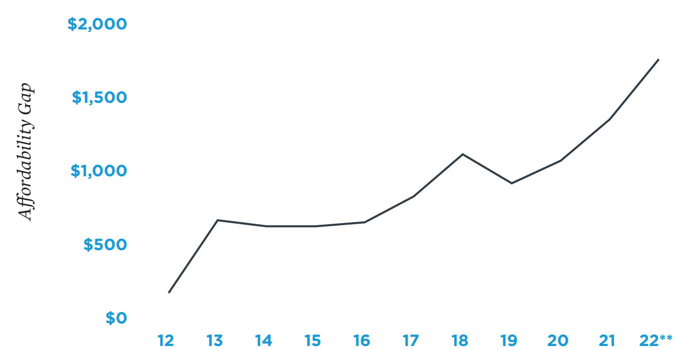
Ongoing apartment construction across the four-metro Southern California region totals 46,800 units, with 59 percent of that future stock on the way in metro Los Angeles.

Viewed relative to historical activity across the area, today's development tops the typical volume, although there is some slowdown from the total seen a couple years ago. Even with future new supply surpassing the volume that was standard over the past decade, these additions will not come close to alleviating the region's housing shortage, especially for lower-cost dwellings. However, near-term completions could create enough leasing competition to help tame the sizable rent growth posted of late in the luxury segment.

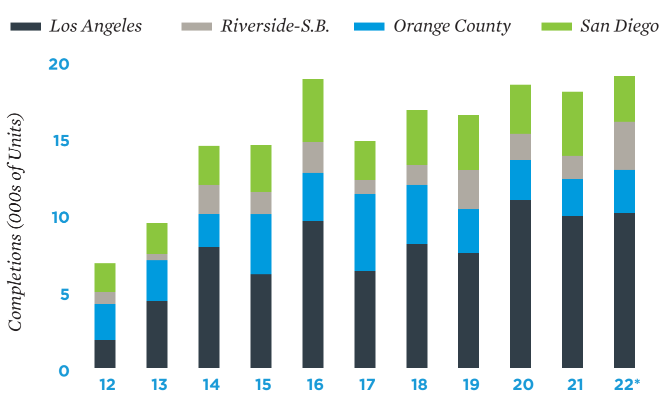
Home Prices Rising Sharply in Region



Los Angeles Affordability Gap



Southern California Construction Trends



Riverside-San Bernardino Affordability Gap

** Forecast ** Through 1Q*

Affordability gap: difference between mortgage payment on median-priced single-family home and average effective apartment rent

Mortgage payment based on quarterly median home price for a 30-year fixed rate mortgage, 90% LTV, taxes, insurance, and PMI

Sources: Freddie Mac; Moody's Analytics; National Association of Realtors; RealPage, Inc.

A Few Headwinds Should Be Considered

Select challenges to the apartment sector outlook in Southern California are worth noting.

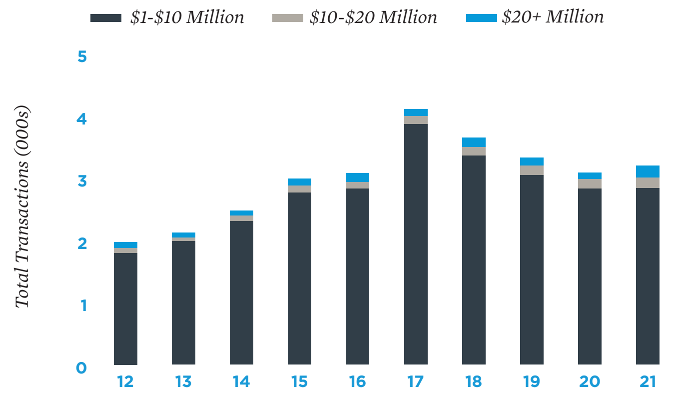
First, it's not clear whether bad debt buried in the rent rolls of some communities will ever be feasible to collect. The number of missed rent payments suffered in metro Los Angeles over the past couple years ran high relative to the patterns posted in much of the rest of the country. Given eviction moratoriums also lingered longer in Los Angeles, it has only been in the past few months that property owners owed sizable back rent have been able to pursue those funds. Evictions of those who have not been paying rent could push up vacancies slightly, although vacancy rates would still compare favorably to long-term historical standards.

Notably, rent collections never moved more than a hair below past norms in Orange County, the Inland Empire or San Diego.

The second and larger issue, risk of more stringent rent control measures and other regulatory changes that could be unfriendly to apartment owners can dampen enthusiasm for investment in Southern California.

While state-wide initiatives to strengthen rent control settings have failed a couple times in recent years, local level moves remain a possibility. Most recently, the Orange County city of Santa Ana added rent control regulations that could cool the appetite for apartment ownership in the area.

Southern California Transaction Velocity



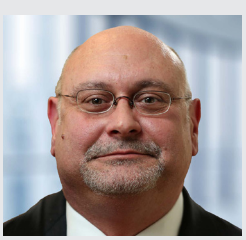
Sources: Marcus & Millichap Research Servics; CoStar Group, Inc.; RealCapital Analytics

Sales Prices Still Have Room to Climb Despite Already Hitting High Marks

Sun Belt markets like Dallas-Fort Worth, Atlanta and Phoenix are attracting growing shares of the country's apartment investment activity, while the share of total dollars going to gateway locations like Southern California is not quite at the levels seen in recent years. Still, total transaction volumes remain enormous across the region, with properties valued at over $26 billion trading hands in calendar 2021.

Furthermore, typical trades here command some of the nation's highest prices. A notable run-up in Southern California sale prices began around 2014, and since then, the average price per door has soared from roughly $175,000 to a norm of $323,000 as of the initial quarter of 2022.

Today's pricing in the region compares to a U.S. average that's a hair under $200,000 per unit.



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Sources: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Moody's Analytics; Mortgage Bankers Association; National Association of Realtors; Real Capital Analytics; RealPage, Inc.; U.S. Census Bureau