INVESTMENT FORECAST

Multifamily

Los Angeles

IPA INSTITUTIONAL PROPERTY ADVISORS

2020

High Ownership Costs Sustain Rental Demand But Supply Additions Overwhelm

Tight conditions preserved amid wave of supply additions. In each of the previous three years rental demand in Los Angeles outpaced elevated levels of construction activity, compressing vacancy to a cycle-low level entering 2020. Limited unit availability occurs at an opportune time, as the county's rental inventory will swell by an additional 14,000 units this year, the third largest total among major U.S. metros. While core Los Angeles continues to record the largest influx of new apartments, deliveries are more evenly distributed between Downtown Los Angeles, Mid-Wilshire and Hollywood than in previous years. Elsewhere, the San Fernando Valley will record a large increase of new units, welcoming more than 4,000 rentals, 40 percent of which are in Woodland Hills. Throughout the county, projects in lease up will benefit from steep home prices and income growth, but concessions usage will increase as developers seek to achieve stabilization in under a year. With solid demand drivers in place, the overall impact of cycle-high delivery volume will be moderate, with metro vacancy rising to 4.0 percent.

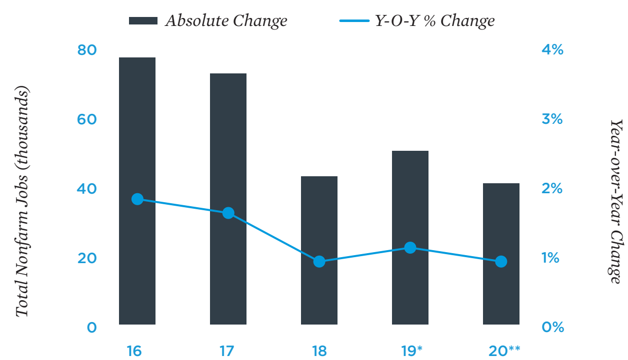
Investors assess valuation impacts and strategy due to new legislation. Rent control has once again entered into the transaction market after the California Legislature passed a statewide cap on rental rate increases. After investors shook off the potential threat from Proposition 10, which was defeated by voters in November 2017, the new cap on rental rate increases for properties 15 years or older has caused a pause in the sales activity. Investors are busy attempting to understand the long-term potential impact to valuations and reassessing their strategies as well as how to underwrite future rent growth with the new caps in place. One potential outcome of the new regulation could be an increased focus on newly developed assets as these properties are immune to the rent restrictions until they are 15 years old. Furthermore, economic research has shown that properties not covered by rent control in rent-controlled markets actually see higher rent growth than if no rent restrictions were in place. Thus, owners could see outsized revenue expansions for these newer properties, which could positively impact current underwriting and valuations. The steadily rising construction pipeline offers a deep potential pool of acquisition targets. Furthermore, the highest rental rate increases have been occurring in the Class C space, where vacancy rates are the tightest and the largest impacts to valuations could be seen in this subset of the transaction market.

23.0% *2019 share of local population between 20 and 34 years old*

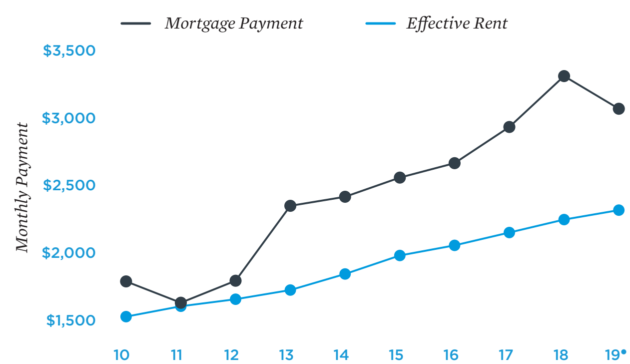
31.0% *of local population hold bachelor's degree or higher❖*

$603,272 *2019 median home price*

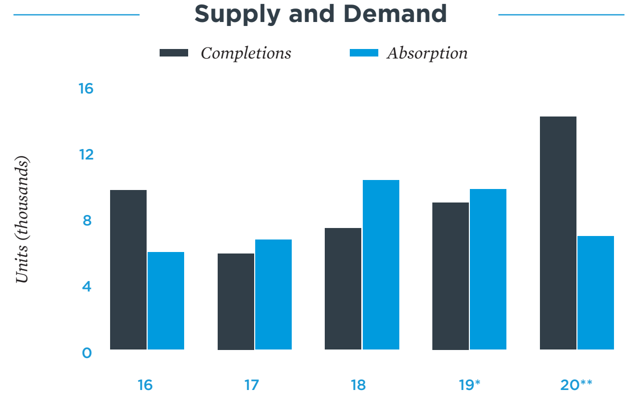
Employment Trends



Housing Affordability Gap



Supply and Demand



* Estimate ** Forecast • Through 3Q

❖ 2019: 25+ years old

Sources: Marcus & Millichap Research Services; RealPage, Inc.

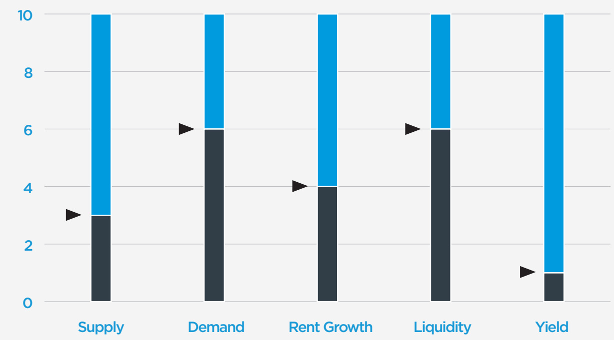
2020 Investment Outlook

Demand slid two points from 8 to 6 since over the past six months. Most likely the drop in demand will prove temporary as the high propensity to rent in Los Angeles and long-run drivers should overcome short-term demand bumps. However, rent growth also lost a notch, so these variables should be watched closely.

Limited assets for disposition hold back the transaction market, which keeps liquidity stable to finish the year. Demand, however, persists as investors underwrite strong revenue growth, which pushes yield down two points in the second half of the year.

Note: The Key Performance Index provides a metro-level relational benchmark scaled from 1-10 for five key metrics.

Key Performance Index



2020 Market Forecast

Employment
40,600 jobs
Metro **0.9%**
U.S. **1.0%**

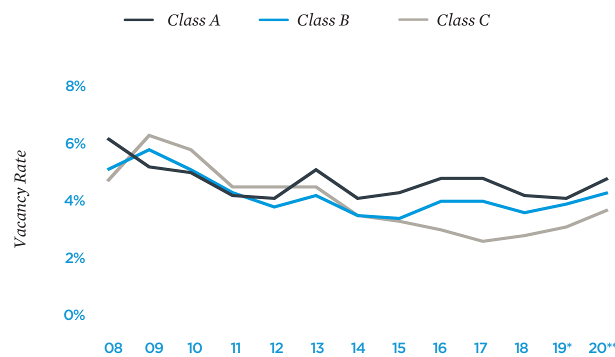
Construction
as % of inventory❖
Metro **1.3%**
U.S. **1.7%**

Class A Vacancy
Up 70 bps
Metro **4.7%**
U.S. **5.3%**

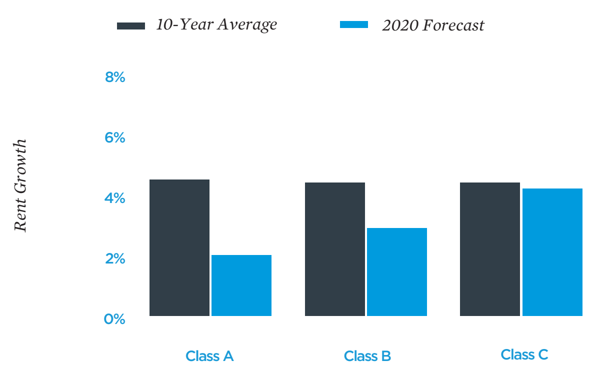
Class A Rent
$3,059 per month
Metro **2.0%**
U.S. **3.3%**

Investment
3-yr. avg. activity
$20+ million
Deals: **59**
Volume: **$3.8 billion**

Vacancy By Class



Rent Growth By Class



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** Estimate ** Forecast*
❖ Arrow reflects completions trend compared with 2019
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; RealPage, Inc.; Real Capital Analytics