Tuvia Multifamily Memo

Los Angeles Multifamily Market Update

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Where are Interest Rates Now for LA Multifamily?

Many lenders have programs in the mid to high 5% range which is around 50 basis points lower than the last quarter when we saw inflation growing at a higher rate. Wall Street and overall commercial real estate industry are underwriting for higher rates longer term than was expected months ago. Many analysts are expecting the federal funds rate to cap out in the 5% range. This is still another 50 - 100 basis points from where we are at today which means there is quite a bit of risk for rates to increase in the near term for multifamily debt. I wouldn't be surprised to see rates over 6% within the next few months. Many of the recent inflation readings have shown inflation is going to be persistent and we may not see a cut until well into 2024.

What is the Best Option if you Have Debt Adjusting or Coming Due?

Many buyers who bought apartments in 2018 – 2019 took out five year debt and have their loans adjusting or coming due relatively soon. Most multifamily operators will have a tough time refinancing the same debt amount with rates in the 5s or 6s unless there was significant rent growth. Some owners will have to add capital to refinance while others may choose to go to market and sell. We expect inventory to rise based on many owners unwilling to do a cash in refinance. The cash in refinance will be new to many investors that have not seen many real estate cycles and may not have an option to do a capital call.

How About Construction Debt?

Many construction lenders are now very conservative with their underwriting for new construction and are underwriting no rent growth to limited rent growth in comparison to developers expectations of pro forma rents when the project completes. This in turn has lowered construction loans which will require developers to come up with more capital to start their projects. Some developers may delay building their projects which will be positive for rent growth in Los Angeles as their will be less units coming online and limit the pipeline of units for the next few years.

What's the Biggest Risk to the LA Multifamily Market Now?

Clearly local legislation is the biggest risk to multifamily owners in Los Angeles. The LA city council effectively made all buildings rent control (even new construction). By limiting all housing to a maximum increase of 10% without paying relocation costs, investors have limited options on increasing cash flow on all product within LA. Single-Family homes are now included, even though they were previously viewed as non-rent control. One of the more alarming new laws is the threshold needed for eviction, which is now one month of fair market rent. This means tenants can pay partial rent pretty for a prolonged period of time without getting evicted. Some have viewed it as an ongoing rent concession for tenants to not pay their full rent.

Most apartment owners in LA are accustomed to hearing about the possibility of Costa Hawkins getting repealed every few years. Instead of having California voters decide if there should vacancy control, which would mean getting fair market value on vacant units, there is a new proposal SB466 which would dissolve Costa Hawkins. If vacancy control gets enacted in LA, the city has a high probability to lose any institutional capital in LA, and many owners that bought buildings for the rental upside (which is the majority of deals in LA), would be underwater and either forced to sell at low valuations or continue to operate at a loss.

How Much Lower is Commercial Real Estate Volume?

Nationwide commercial real estate volume saw a 63% drop in the fourth quarter from the previous year. Multifamily was the most active sector though and LA was the most active market for all commercial estate.

Throughout all of 2022, there were 1,919 sold multifamily buildings in LA County in comparison to 2,219 sold buildings in 2021. Additionally, there are 748 apartment buildings on the market now in LA County which is roughly the same number of buildings that sold in the entire second half of 2022. Given the slow rate of absorption in the past few months, much of the current inventory will need to get repriced.

Where is the Best Place to Find Yield Now?

With financing costs being so high today, even attractive cap rates have not been offering a high real cash on cash return. The average asking cap rate is 3.97% for all the listed Marcus & Millichap multifamily in LA County, which would require a lofty down payment just to break even. Some of the higher returns we have been achieving recently for clients have been in newer built apartment buildings in LA that offered cap rates in the low to mid 5% range and were free from RSO. This has been a very popular trade over the past few years out of underperforming rent control in LA.

What is a Good Reason to Sell Now?

With values down, one of the few reasons to sell now is cap rates are not fully adjusted to where the debt markets are currently, and where they could be headed. With Treasury bills yielding around 5% and cap rates for LA multifamily lower than T bills, there are good opportunities to sell and exchange into higher yielding opportunities such as new construction in LA or out of state apartments, which are seeing cap rates rise as well.

How is the Downtown LA Market Performing?

Vacancy has ticked up quite a bit in Downtown. Currently the vacancy rate is 10.3% and has nearly doubled from first quarter of last year. Downtown absorbed just 300 units during 2022 in comparison to 2,700 units absorbed in 2021. Rental rates have not moved much over the past year, down roughly 1.4%. While demand seems to be moderating, Downtown LA is expecting 1,400 units to come online this year with another 2,350 coming in 2024. The number of units coming online over the next two years represents 12% of the current multifamily inventory in DTLA. We are just starting to see defaults in the office Downtown LA market and will be interesting to see if that spills over into multifamily as well.

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Tuvia Group Recent Closings

4047-4053 Perlita Avenue
Los Angeles, CA 90039
Submarket: Atwater Village

PRICE: $2,295,000
UNITS: 8
PRICE PER UNIT: $286,875
PRICE PER SF: $271.02
GRM: 15.89
CAP RATE: 3.77%

1252 West 89th Street
Los Angeles, CA 90044
Submarket: South Los Angeles

PRICE: $1,775,000
UNITS: 8
PRICE PER UNIT: $221,875
PRICE PER SF: $232.85
GRM: 10.73
CAP RATE: 6.27%

4420 South Broadway
Los Angeles, CA 90037
Submarket: South Los Angeles

PRICE: $3,150,000
LAND SF: 24,710 SF
ZONING: LAC2-2D-CPIO
PRICE PER SF: $127.48
BUILDABLE UNITS: 106
TOC: TIER 3

2015 East 2nd Street
Los Angeles, CA 90033
Submarket: Boyle Heights

PRICE: $1,225,000
UNITS: 7
PRICE PER UNIT: $175,000
PRICE PER SF: $377.16
GRM: 11.99
CAP RATE: 5.25%

8360 Blackburn Avenue
Los Angeles, CA 90048
Submarket: Beverly Grove

PRICE: $2,480,000
UNITS: 7
PRICE PER UNIT: $354,286
PRICE PER SF: $417.16
GRM: 16.59
CAP RATE: 3.82%

1046 Laguna Avenue
Los Angeles, CA 90026
Submarket: Echo Park

PRICE: $1,600,000
UNITS: 5
PRICE PER UNIT: $320,000
PRICE PER SF: $492.31
GRM: 12.51
CAP RATE: 5.64%

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