

Tuvia Multifamily Memo

What is in Store for Los Angeles Multifamily in 2021?

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Through the first quarter of this year, we have seen many different investor profiles actively purchase both value-add opportunities and stabilized multifamily products. When compared to previous years, Brokers have been continually reducing the prices of their listings, showing certain sellers are coming to terms with the reality of the LA multifamily investment market.

Since the start of the Pandemic, cap rates have been slowly increasing for stabilized products. For example, newer products built after 2000 have been trading for a median cap rate of 4.65% and renovated, stabilized rent control products have been trading for a median cap rate of 4.7%. In 2019, the median cap rate was 4.4% for newer products and 4.6% for renovated, stabilized products.

Interestingly, the increase in cap rates has investors receiving a much higher level of net return, as compared to investor's cost of capital in the low to mid 3% range. For a good amount of last year to now, investors are getting a solid 4% return on their equity, which is something we have not seen in a few years in Los Angeles. As investors continue to look at different investment vehicles and products, multifamily locally remains a very strong proposition. As the stock market continues its volatility, bonds barely offer a return, making multifamily look better now in many ways. Additionally, as cap rates creep up, investors are able to capitalize on better leverage with some deals getting done in the 60% - 70% loan to value range versus the normal 50% LTV we were accustomed to for the past few years.

Is Inflation Coming?

Most investors on Wall Street and in the commercial real estate industry are starting to predict a spike in inflation in the near term. Recently, The Fed has stated there will be no rate hikes for the foreseeable future, however most investors are thinking otherwise as GDP is expected to rise by over 6% this year. As of now, there is incredibly positive news from the vaccine and stimulus, which is expected to increase prices for goods and services. Eventually, inflation will cause interest rates to rise on multifamily loans, which may affect cap rates moving forward. Should we start seeing more serious inflation later this year, multifamily interest rates could go closer to the 4% range, increasing cap rates. For multifamily owners, the positive to inflation is higher rates on vacant units. If rents start rebounding in Los Angeles as many predict, local values should remain stable even with slightly higher interest rates.

Regardless of when we see the effects of inflation, it makes sense for multifamily owners to either capitalize on selling their building at low cap rates, based on low rates in the market, or refinance their property if they plan to hold long term.

Which Submarkets are the Most Active Now?

Looking back at transactions for the past 90 days, the most active submarket has been the Hollywood/Koreatown submarket with 60 transactions, followed by the greater Westside submarket with 48 transactions. As both Hollywood and Koreatown have seen a rise in supply alongside a fall in rents, some sellers are understanding that this is a significantly different market than pre-pandemic. Sellers that are more realistic are offering some discounts to the original asking price. The adjacent submarkets of Los Feliz and Silver Lake have been quiet so far with only 15 transactions, showing many sellers are holding out for top level pricing in prime locations.

Have Rents Hit a Floor?

Many analysts are bullish that rents have bottomed out in Los Angeles after dropping 10%, depending on the submarket. Many owners are still offering concessions, such as 1 or 2 months free, however in 2021, rents have stopped falling. As our local economy re-opens, many landlords are banking on decreasing concessions and attempting to push rents. Traffic has gotten much worse over the past month or two showing many jobs may be returning to the local market, which should put landlords in a more competitive position.



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