

TUVIA MULTIFAMILY MEMO

How High are Cap Rates on LA Rent Control Multifamily?

December 2022

By: Jason Tuvia

Within the past 90 days throughout all of Marcus & Millichap closed rent control LA multifamily the average cap rate is still very low at 4.25%. The highest closed cap rate was 6.7% with the lowest at 2.72%. It is impressive to consider how low the average cap rate is even when buyers were closing on locked in debt from 30 – 45 days ago in the low 5% interest range.

Currently interest rates are in the low 6% range with the average asking cap rate in LA County at 4.15% based on the nearly 500 buildings on the market today. According to Costar, there are only 88 properties under contract with a 5%+ cap rate in LA County. Listings are clearly being absorbed at much lower levels than we are accustomed to as active multifamily brokers.

Over the past 30 days, almost all my listings that have gone under contract are at cap rates no less than 4.25% with some going in the low 5%. As the gap widens between buyer and seller expectations, I would expect transaction volume to drop off in the early part of 2023.

On the flip side, there is still an exorbitant amount of capital chasing the same few assets. For example, last week a 7 unit I had listed in Beverly Grove received nearly a dozen offers, with half of the offers either non contingent from day one or above list price. I have seen similar situations for multiple of my other listings over the past two months when the listing was priced around today's actual market value.

Where is the Distress Investors are Expecting?

The Fed has made it clear the top priority is fighting inflation with minimal concern for multifamily investors equity position. As most lenders were very conservative on leverage over the past few years, very few multifamily owners are under water. Cash flow margins have been notoriously thin; however, rents are still stable which means most sellers are not heavily discounting their properties. Sellers that have been active in this climate are either trading out of state into higher cash flowing opportunities, or they estimate that higher rates for a longer period will diminish their equity even further.

Out of the 144 listings in the Marcus & Millichap system for LA County multifamily nearly a third of the listings have received a price reduction with the average price reduction in the 6% range.

How Much are Loan to Values (LTVs) Getting Cut?

As a buyer, one of the more challenging aspects of this market is leverage. The typical deal has their loan amount cut in the 10% range from where it was early this year. I was accustomed to seeing buyers on my listings get loans in the 60% LTV range for a 4 cap deal that barely squeeze by a 50% today. The 70% - 75% leverage is long gone with higher cash flowing deals at 65% leverage.

As buyers need to put more down to debt service the loan, the expectation is for the seller to lower their price so a similar equity position can be achieved.

Higher Rates for Longer?

Most economists and investors are anticipating higher rates for a longer period. This will definitely have an effect on multifamily investors as they have to plan to refi their low rates in next few years at much higher rates than 3%. Many owners may have to add capital to refinance in the future unless there is rent and NOI (net operating income) growth. Market rents are still very high throughout Los Angeles; however, the majority of rent control units are not turning as often and with the rent moratorium still in place for over another year, NOI growth will be pretty limited. This may present solid buying opportunities for investors in the years to come. Even if rates stabilize in the next few years in the 5% range, many current loan amounts will not underwrite with the higher rates.

Why Sell Now While the Market is Down?

The main advantages to selling now is there is a lack of quality inventory on the market now giving many sellers a low level of competition. In the past 30 days, only 23 apartment buildings went to market in the Marcus & Millichap system. A well-priced listing today should still generate a tremendous amount of interest and go non-contingent within weeks of marketing. As the market seems to be getting cheaper with higher rates, many more opportunities will come for 1031 buyers who are taking their buildings to market now to sell. First quarter should bring more inventory from motivated sellers, making a 1031 in a downward trending market more attractive.

Where are Rents Projected to be Over the Next 24 Months?

USC economists are expecting very minimal rent growth throughout Southern California multifamily over the next two years. The economists are forecasting 2.4% annual rent growth over the next two years which is far from the current rate of inflation of 7.7%.

Our double digit rent growth looks like it will be coming to an end at least in the near term. The main reason for this forecast is mainly due to net migration out of LA County. Certain submarkets are forecasted to do better than others overall such as 6.6% rent growth in the San Fernando Valley versus 2.3% rent growth in Koreatown.



JASON TUVIA

Senior Managing Director Investments
Senior Director - National Multi Housing Group
Encino Office
Tel: (818) 212-2735
Cell: (818) 448-4415
Fax: (818) 698-8372
jason.tuvia@marcusmillichap.com
License: CA 01772495



Marcus & Millichap
TUVIA GROUP
LOS ANGELES MULTIFAMILY

TUVIA GROUP RECENT CLOSINGS



858 N LA FAYETTE PARK PLACE
Los Angeles, CA 90026
Submarket: Silver Lake

PRICE: \$2,050,000
UNITS: 11
PRICE PER UNIT: \$186,364
PRICE PER SF: \$237.76
GRM: 12.69
CAP RATE: 5.11%



1330 PORTIA STREET
Los Angeles, CA 90026
Submarket: Echo Park

PRICE: \$3,800,000
UNITS: 10
PRICE PER UNIT: \$380,000
PRICE PER SF: \$641.57
GRM: 13.49
CAP RATE: 5.20%



1050 WEST 84TH PLACE
Los Angeles, CA 90044
Submarket: South Los Angeles

PRICE: \$1,200,000
UNITS: 6
PRICE PER UNIT: \$200,000
PRICE PER SF: \$348.43
GRM: 11.38
CAP RATE: 6.10%



1656 NORTH ALVARADO STREET
Los Angeles, CA 90026
Submarket: Echo Park

PRICE: \$1,525,000
UNITS: 3
PRICE PER UNIT: \$508,333
PRICE PER SF: \$514.85
GRM: 12.90
CAP RATE: 5.87%



2448 NORTH BEACHWOOD DRIVE
Los Angeles, CA 90068
Submarket: Beachwood Canyon

PRICE: \$1,550,000
UNITS: 11
PRICE PER UNIT: \$140,909
PRICE PER SF: \$504.89
GRM: 10.07
CAP RATE: 6.27%



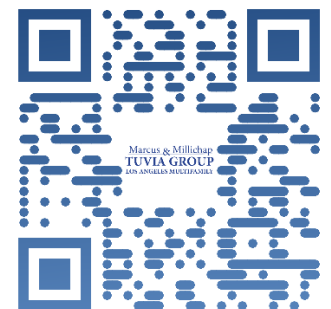
1633 MICHELTORENA AVENUE
Los Angeles, CA 90026
Submarket: Silver Lake

PRICE: \$4,305,000
UNITS: 8
PRICE PER UNIT: \$538,125
PRICE PER SF: \$539.20
GRM: 17.08
CAP RATE: 3.99%



JASON TUVIA

Senior Managing Director Investments
Senior Director - National Multi Housing
Group
Encino Office
Tel: (818) 212-2735
Cell: (818) 448-4415
Fax: (818) 698-8372
jason.tuvia@marcusmillichap.com
License: CA 01772495



SCAN ME