



# Multifamily Market Commentary – December 2018

## Small Multifamily a Big Deal in Los Angeles

Small multifamily properties – those with five- to 50-units – are getting more attention as an important source of affordable housing. Nationwide, it is estimated that there are over 315,000 properties with between five and 50 apartment rental units. However, about 17 percent of these properties are located in one place: Los Angeles County. The county comprises more than 4,000 square miles and includes the cities of Los Angeles and Long Beach, as well as areas that have widely varying income levels, such as Beverly Hills and Compton. With such a high concentration of properties, it is worth taking a closer look at the small multifamily segment in Los Angeles County.

### A Big Amount of Small Multifamily

Small multifamily properties are the predominant type of apartment property in Los Angeles County. As shown in the left chart below, an estimated 52,600 multifamily properties, representing a whopping 94 percent of all the apartment properties in Los Angeles, fall into this category. CoStar estimates that the average property has about 13 apartments, leaving Los Angeles County with an estimated 656,000 units.

By contrast, CoStar estimates that there are only 3,100 properties in Los Angeles that have 50 or more apartment units each. However, with the average property containing an estimated 126 units, this relatively small number of larger properties represents about 37 percent of all multifamily units in Los Angeles. Interestingly, units in both types of properties are similar in size, averaging about 800 square feet, according to CoStar.

Share of Small Multifamily Properties in LA County



Share of Units in Small Properties in LA County

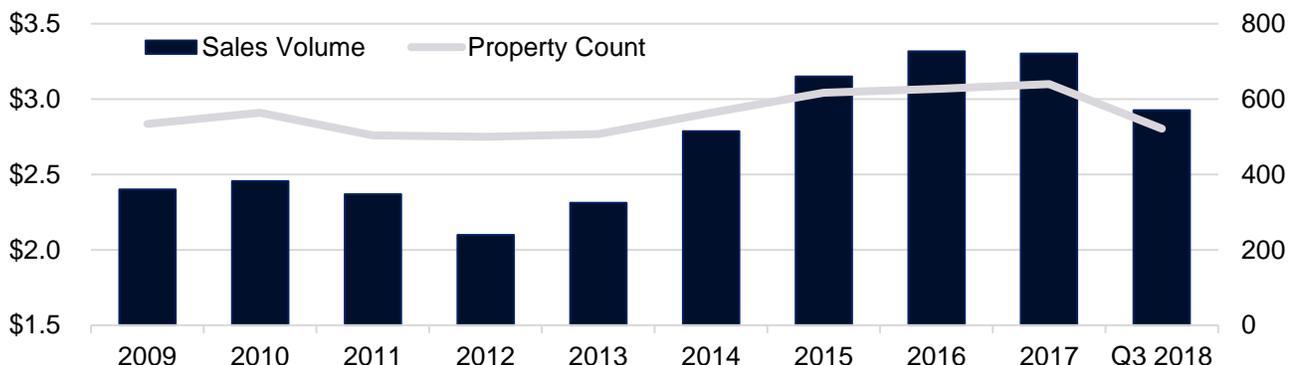


Source: CoStar

### Steady Increase in Sales Volume

As shown in the chart below, since the end of the Great Recession, the sales volume of small multifamily properties in Los Angeles has been rising slowly but steadily. In 2017, the last full year of data, sales of existing small multifamily properties totaled about \$3.3 billion on just under 650 properties, averaging about 21 units per property, according to Real Capital Analytics (RCA). However, while this represents an increase of about 38 percent in sales volume since 2009, it is only a 20 percent increase in the number of sales, reflecting the fact that many of these properties are owned by individual operators who tend to hold on to them as longer term investments.

Los Angeles County Small Multifamily Property Sales



Source: Real Capital Analytics

Note: Properties and portfolios \$2.5 million and greater



Sales will likely be incrementally higher this year as the sales volume totaled an estimated \$2.9 billion on just over 520 properties for the first nine months of the year. The average sales price per unit has grown by nearly 50 percent since 2010, to about \$306,000 in 2018, reflecting the increasing interest in this asset class by investors in Los Angeles County.

### Predominant Buyers are Private Entities

As shown in the adjacent chart, the vast majority of investors in small multifamily properties in Los Angeles County, 94 percent, are private entities – either privately-held companies or high net worth individuals. Another 2.2 percent were considered institutional investors, such as life insurance companies and pension plans.

Similarly, the investor composition remains unchanged for recent sales. Nearly 95 percent of buyers were private entities and another 2.6 percent were institutional entities. Since January 1, 2017, Arcadia, California-based Positive Investments was the private entity with the highest number of acquisitions, acquiring 36 properties with an average price of \$4.1 million. Los Angeles-based Xenon Investment Corporation was second, acquiring 13 properties with an average sales price of \$8.0 million.

Rounding out the top three buyers of small multifamily properties in Los Angeles County was San Francisco-based Prana Investments, a private equity fund which is considered an institutional investor. Since 2017, Prana has purchased 12 properties with an average sales price of \$5.3 million.

### Few Portfolios Changed Hands

Surprisingly, most of the 1,200 properties that changed hands were individual sales. Only 21 portfolios were sold since January 1, 2017, containing an estimated 655 units. Most portfolios consisted of just two properties and only a handful consisted of three properties. Xenon Corporation, one of the most active buyers in the county, acquired two portfolios: a \$15.1 million two-property portfolio in Burbank with 44 units, funded with a \$5 million loan from Banc of California; and an \$8.6 million two-property portfolio consisting of 36 units in Van Nuys.

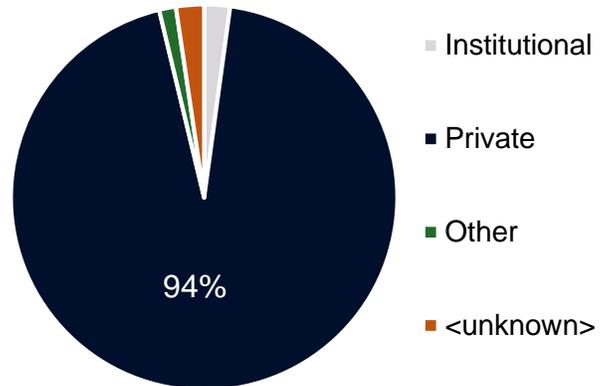
### Great Variation in Sales Prices

Sale prices of individual small multifamily properties sold since January 1, 2017 have varied greatly. Perhaps surprisingly, the highest overall sales price for a small multifamily property was not in Malibu or Beverly Hills, but in the East Los Angeles/Long Beach submarket. According to RCA, Greentek Investments purchased the 47-unit mid-rise 608 Westlake Apartments in June 2018 for \$31.5 million. The highest average prices per unit were still found in Beverly Hills, Malibu, and Santa Monica, however. The lowest sales price reported by RCA was for the six-unit 2743 Fairmount Avenue in Los Angeles, which sold for an estimated \$1 million.

### Cap Rates Remain Tight

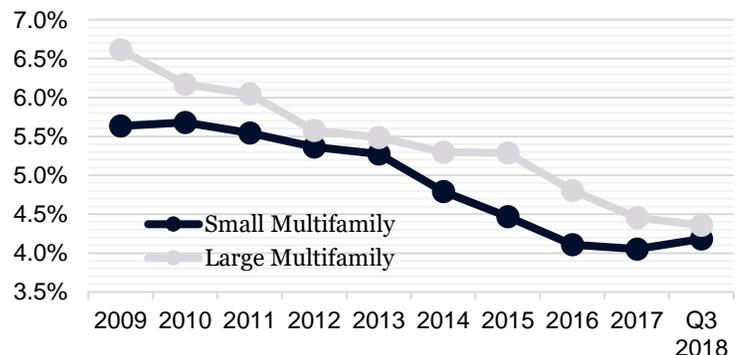
Cap rates for all types of multifamily in Los Angeles have been falling since the end of the Great Recession due to healthy job growth coupled with continued low interest rates. As shown in the chart to the right, cap rates on small multifamily properties fell to 4.1 percent in 2017 from 5.6 percent in 2009. Cap rates for small multifamily properties have generally been slightly below cap rates for larger properties. While cap rates inched up in the first nine months of 2018, they remain low at an estimated 4.2 percent and remain slightly below the 4.4 percent recorded for larger multifamily properties.

**Share of Los Angeles County Small Multifamily Properties by Investor Type (As of November 28, 2018)**



Source: Real Capital Analytics  
Note: Properties and portfolios \$2.5 million and greater

**Small vs. Large Multifamily Average Cap Rates in LA County**



Source: Real Capital Analytics  
Note: Properties and portfolios \$2.5 million and greater



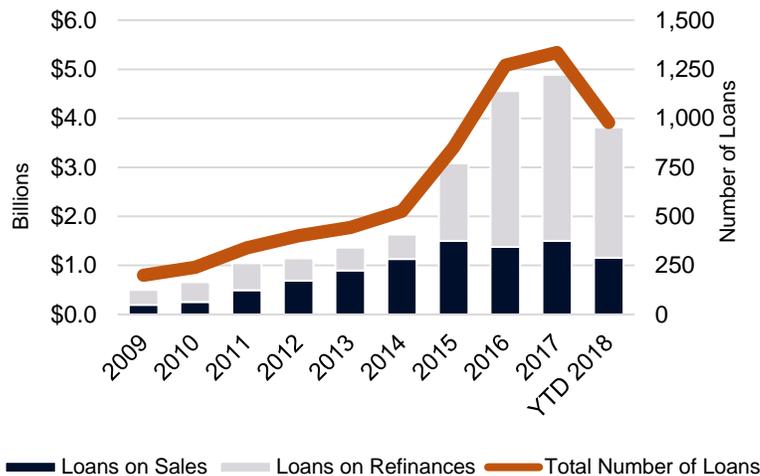
## Significant Refinancing Volume

Lending volume has been rising steadily since the end of the Great Recession. Loan volumes on small multifamily properties in Los Angeles totaled \$4.9 billion in 2017 on approximately 1,350 loans. That's up from an estimated 200 loans with a total loan volume of \$500 million in 2009.

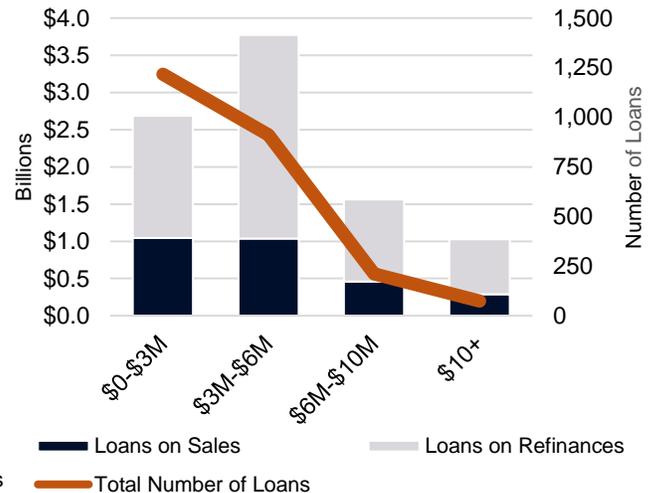
However, as shown in the left chart below, growth has primarily been in refinances. Refinance volume grew to \$3.4 billion on under 900 loans in 2017, up from \$300 million on approximately 120 loans in 2009. By contrast, loans on sales of small multifamily properties grew to \$1.5 billion on about 450 properties in 2017, up from an estimated \$200 million on under 100 properties in 2009 – another indication that these properties do not change hands frequently.

### Small Multifamily Lending Volume and Number of Loans...

... by Year  
(Jan. 1, 2009 – Year to Date 2018\*)



... by Balance Category  
(Jan. 1, 2017 – Year to Date 2018\*\*)



\* Through September 30, 2018

\*\* Through November 28, 2018

Source: Real Capital Analytics

Note: Properties and portfolios \$2.5 million and greater.

## Most Lending Under \$6 Million

Loans with balances under \$3 million represented the majority of loans, with \$2.7 billion on 1,217 loans originated between January 1, 2017 and November 28, 2018. Measured by lending volume, loans with balances over \$3 million and up to \$6 million, accounted for the majority of lending, with \$3.8 billion on an estimated 912 loans

There was also some large loan lending on small multifamily properties over the past 18 months. For example, the highest balance loan originated since January 1, 2017 was the \$22.5 million refinance of the 44-unit mid-rise property located at 850 Crenshaw in the city of Los Angeles that was financed by JP Morgan in July 2018.



### Mortgage Bankers Also Show High Volume

Another measure of lending on small multifamily properties are loans with very small balances. Generally loans originated under \$1 million in Los Angeles are most likely to finance properties with 5-50 units. [probably well under 50 units...]

According to the Mortgage Bankers' Association's 2017 Annual Survey of Multifamily Lending, the Los Angeles metro area recorded the highest dollar volume of very small multifamily loans in 2017[?], with a \$1.1 billion volume on 1,743 of closed loans in 2017. The average loan size was \$659,000.

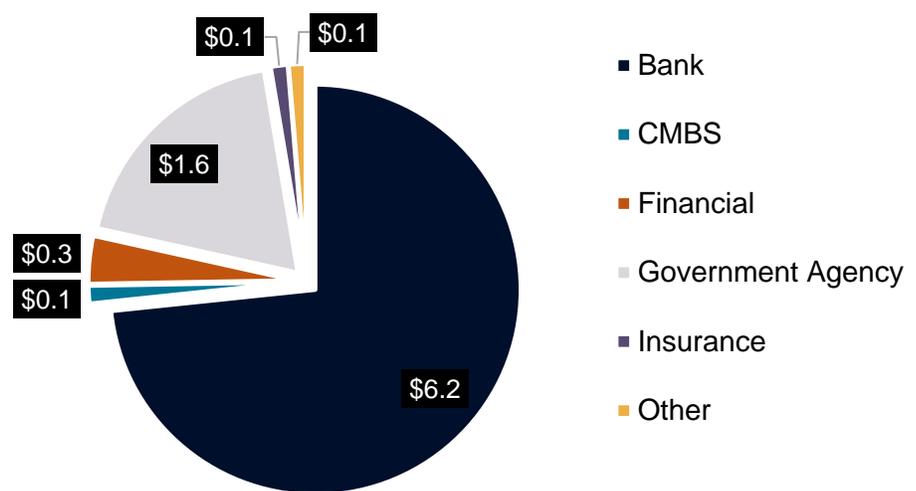
### Banks are Predominant Funders

The majority of financing on small multifamily loans in Los Angeles County by lending volume is done by banks, as shown in the adjacent chart. Since January 1, 2017, banks financed an estimated \$6.2 billion in small multifamily loans. Government Agencies, including Fannie Mae and Freddie Mac, came in a distant second with \$1.6 billion.

J.P. Morgan led the banking segment financing with an estimated \$2.9 billion on 816 small multifamily transactions.

Other active lenders in the banking segment included Banc of California with an estimated \$423 million on 91 loans; First Republic Bank financing about \$285 million on 80 loans; and Luther Burbank Savings financing about \$238 million on 67 loans. Opus Bank rounded out the top five lenders, financing \$190 million on 54 loans.

**Distribution of Small Multifamily Financing by Type of Lender (\$B)  
(January 1, 2017 – December 6, 2018)**



Source: Real Capital Analytics  
Note: properties and portfolios \$2.5 million and greater.

### Small Multifamily Performing Well

Vacancies for all types of apartment properties in Los Angeles were tight as of third quarter 2018, as shown on the table on the next page. However, vacancies in small multifamily properties were 3.1 percent as of the end of the third quarter of 2018 compared to 4.5 percent in larger multifamily properties. Further, vacancies in small multifamily properties fell by -0.3 percent year over year in Los Angeles as of the end of the third quarter, while vacancies rose by a similar amount in larger multifamily properties.

### Small Multifamily Appears to be More Affordable...

The average asking rent for an apartment in a small multifamily property in Los Angeles is \$1,500 compared to \$2,000 for an apartment in a larger multifamily property. Further, rents in the smaller properties grew more slowly, at 1.8 percent year over year as of the third quarter 2018, compared to larger multifamily properties in which rents grew by an estimated 3.2 percent. This is most likely because units in small properties tend to be older and usually do not have the sorts of amenities



that command the area's highest rents. As shown in the table on the next page, the average year built for a small multifamily property in Los Angeles is 1957 compared to 1977 for a large multifamily property.

**Los Angeles Multifamily Market Performance (existing properties)**

	Los Angeles Small Multifamily (5-50 units)	Los Angeles Large Multifamily (51+ Units)
Asking Rent	\$1,500	\$2,000
Rent Growth (Year over Year)	1.8%	3.2%
Vacancy (%)	3.1%	4.5%
Vacancy Growth (Year over Year)	-0.3%	0.3%
Average Year Built	1957	1977

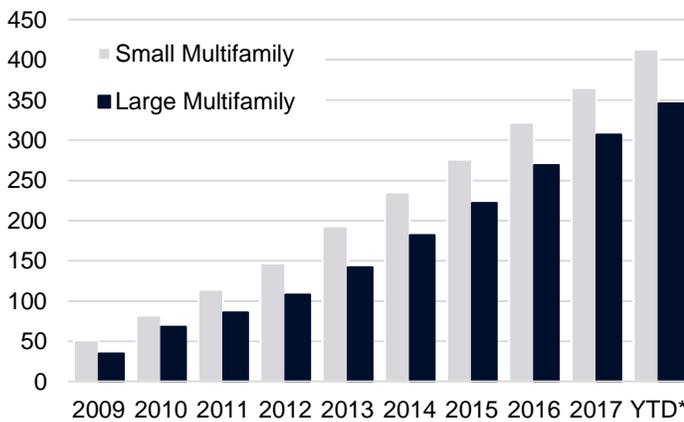
Source: CoStar

**...but New Units are Expensive**

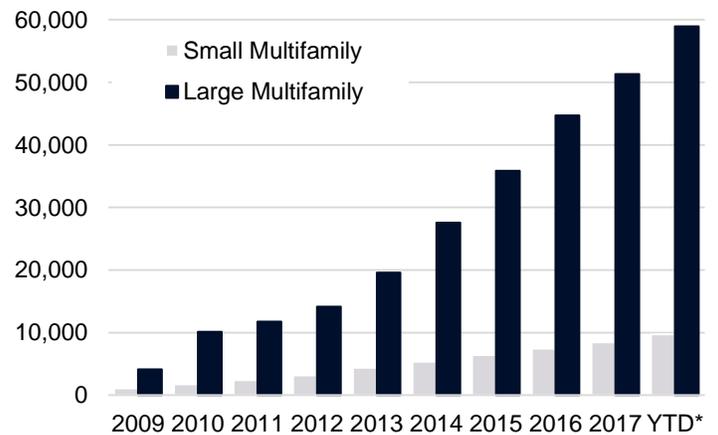
Like other major metros, Los Angeles has seen new multifamily supply added in both the small and large segments. As shown on the charts below, over the past decade, 415 properties containing approximately 9,700 units, have been added in the small multifamily segment. Over the same time period, approximately 350 new properties containing almost 59,000 units were added in the larger multifamily sector.

There is not a significant difference in the rent level of new units between small multifamily and large multifamily buildings. For instance, the average rent of a unit in a large multifamily property built during the past decade was about \$2,900 as of the end of third quarter 2018. Similarly, the average rent for a unit in a small multifamily property built during the past decade was about \$2,700. Rents are typically considered affordable when a renter household spends no more than 30 percent of household income on rent and utilities. In both cases, a renter household would have to earn in excess of \$100,000 per year to be able to afford the rent for a relatively new unit in Los Angeles. As a result, it would appear that the comparative affordability advantage for small multifamily comes from the age of the housing stock, rather than the number of units at the property.

**Cumulative New Properties, LA Multifamily Market**



**Cumulative New Units, LA Multifamily Market**



Source: CoStar

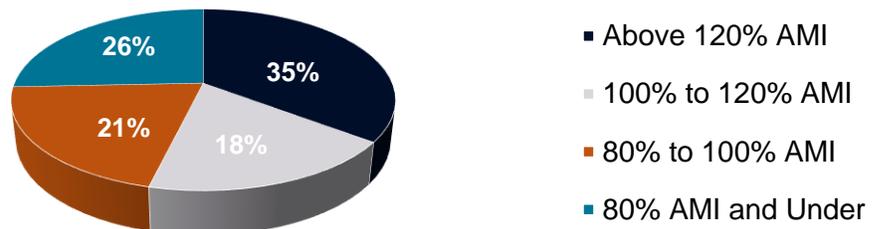
YTD through September 30, 2018



## Variation in Affordability

CoStar has assessed the relative affordability of units in small multifamily properties by comparing rents to the 2018 area median income (AMI) of \$69,300 for the Los Angeles metro area. As shown in the chart below, only an estimated 26 percent of the share of small multifamily units in Los Angeles are affordable to low income renters, defined as those renter households earning 80 percent of the area median income (AMI) for Los Angeles. Another 39 percent of units are middle income market rentals, affordable to renters earning more than 80 percent but less than 120 percent of AMI. However, an estimated 35 percent of units in small multifamily properties are only affordable to higher income households earning more than 120 percent of AMI, which equates to a renter household earning over \$83,000 per year.

**Distribution of Small Multifamily by Affordability to Income Level of Renter Household**



Source: CoStar

Note: Only includes units in small multifamily properties with current rent data.  
80% of AMI = \$55,440, 100% of AMI = \$69,300 and 120% of AMI = \$83,160

## Small Multifamily a Viable Affordable Option

Small multifamily properties represent a significant share of the multifamily rental stock in Los Angeles and present some options for affordable housing. However, with the average age of these properties at 60 years, many of these properties are likely in need of renovation. Without at least some modest updates, these properties risk becoming obsolete. If this happens, these properties may be replaced with newer properties with more expensive units, making Los Angeles even less affordable to all levels of renters, but especially lower income renters.

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