Yardi® Matrix

Orange County Apartments Blossom

Multifamily Report Winter 2018

Net Absorption Stays Strong

Construction Leads Job Gains

Developers Target Anaheim

Market Analysis

Winter 2018

Contacts

Paul Fiorilla
Associate Director of Research
Paul.Fiorilla@Yardi.com
(800) 866-1124 x5764

Jack Kern
Director of Research and Publications
Jack.Kern@Yardi.com
(800) 866-1124 x2444

Author

Adriana Pop
Senior Associate Editor

Landlords Hold Pricing Power

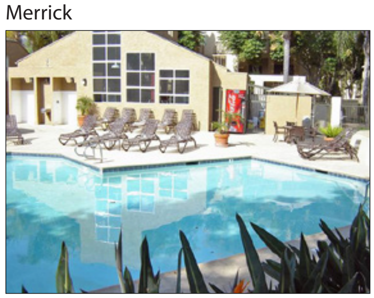
Demand for apartments continues to be strong in Orange County, where high construction costs and surging land values maintain the housing market as one of the most expensive in the country. Following this year's surge in construction, occupancy has remained tight, indicating rapid absorption of new deliveries, while rent growth dropped to 2.6% as of October.

The multifamily market received a boost from high-paying jobs in sectors that attract the region's educated workforce, such as technology, biotech, finance, health care, aerospace and higher education. Despite a slowdown, the labor market continues to expand, fed by a boom in construction. A notable mixed-use project, LT Global Investments' $450 million LT Platinum Center in the fast-growing Platinum Triangle, is slated to encompass office, retail, hotel space, apartments, condominiums and a movie theater. Large office developments include the 1.1 million-square-foot Five Point Gateway and the 38-acre Flight at Tustin Legacy.

Escalating market pressures point to an affordable housing shortage. For investors seeking value-add opportunities, apartments have become hot commodities, but, as rents rise following renovations, low-income residents are being displaced by a higher-earning cohort. Moreover, while legislation keeps property taxes low for existing owners, it does not keep rates from reaching current market levels once a property changes hands, further contributing to rent hikes.

Recent Orange County Transactions

Merrick

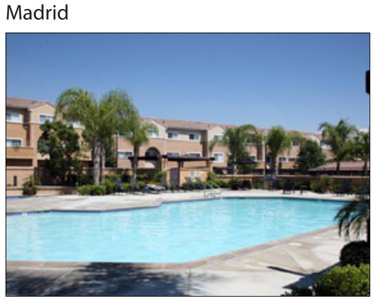


City: Placentia, Calif.
Buyer: Fairfield Residential
Purchase Price: $104 MM
Price per Unit: $250,962

The Villas at Tustin

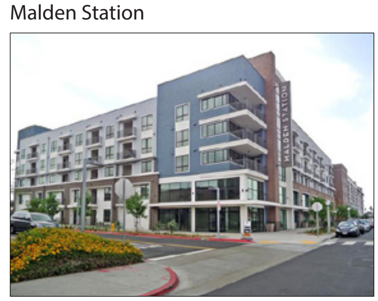
City: Santa Ana, Calif.
Buyer: Bascom Group
Purchase Price: $94 MM
Price per Unit: $231,527

Madrid



City: Mission Viejo, Calif.
Buyer: Acacia Capital
Purchase Price: $83 MM
Price per Unit: $360,870

Malden Station



City: Fullerton, Calif.
Buyer: Invesco Real Estate
Purchase Price: $78 MM
Price per Unit: $388,158

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Hollie Zepke
Audience Development Specialist
Hollie.Zepke@Yardi.com
(800) 866-1124 x5389

On the cover: Photo by Davel5957/iStockphoto.com

Rent Trends

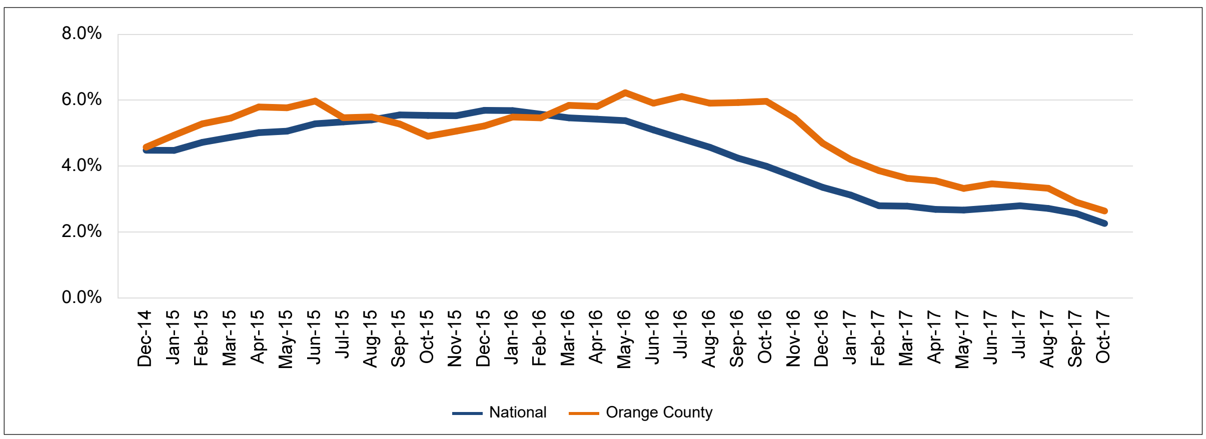
- Mirroring the national trend, rent growth is decelerating in Orange County, with rates up 2.6% year-over-year through October, still outpacing the 2.3% U.S. average. Occupancy in stabilized properties stood at 96.5% as of September, down 50 basis points in one year, partially due to the surge in rental construction.

- Rents in the working-class Renter-by-Necessity segment rose 3.7%, to $1,810, while Lifestyle rents increased by 1.4%, to $2,346. Sustained by a rising population, demand continues to slightly outpace supply in the context of a severe shortage of workforce housing, maintaining the market as one of the most expensive in the nation. Many middle-class families are being priced out, which has led to net population losses in the 35-54 age group, according to IRS data. Government surveys also indicate that many workers commute from outside the county.

- Rent growth was highest in Yorba Linda (7.4%), Westminster (6.4%), La Habra (6.5%), Anaheim–West (5.1%), Tustin (4.3%) and Anaheim Hills (4.0%). On the other end of the spectrum, rents have contracted in two of the most expensive submarkets: Newport Beach (-3.9%, to $2,535) and Seal Beach (-6.2%, to $2,067).

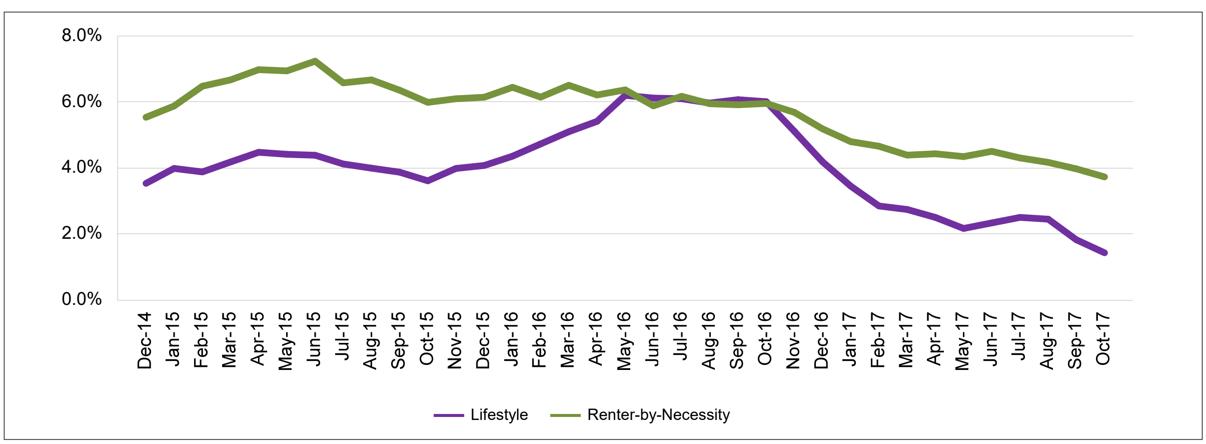
- A high barrier to ownership coupled with steady employment gains are expected to maintain a strong absorption rate, leading to a rent increase of 3.0% in 2017.

Orange County vs. National Rent Growth (Sequential 3-Month, Year-Over-Year)



Source: YardiMatrix

Orange County Rent Growth by Asset Class (Sequential 3-Month, Year-Over-Year)

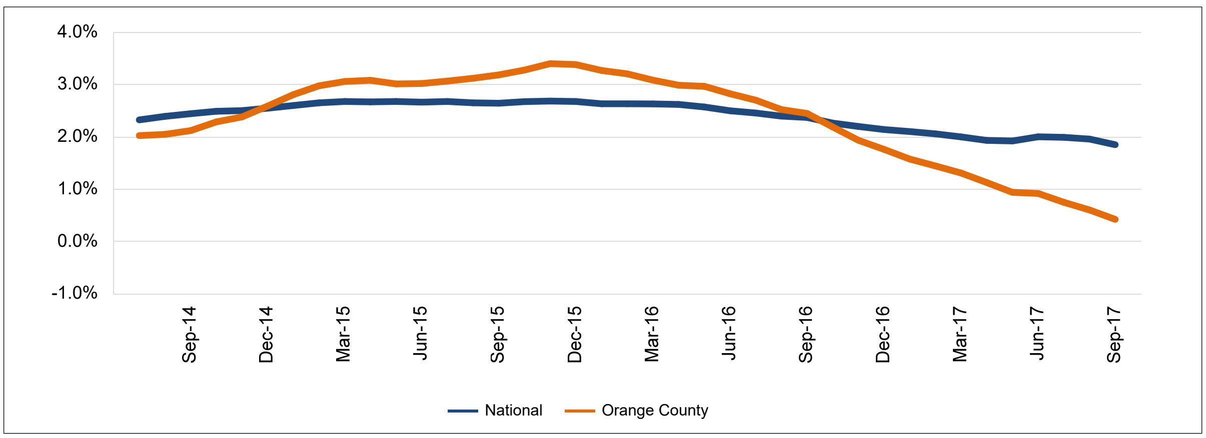


Source: YardiMatrix

Economic Snapshot

- Employment growth is lagging: Orange County added 5,700 jobs in the year ending in September, a 0.4% increase, well below the 1.9% national average. The local unemployment rate rose to 4.2% as of August, a slight uptick from the first six months of the year, when the figure remained consistently below 4.0%.
- Construction was the fastest-growing sector, with most new jobs coming from specialty trade contractors. The region is booming with new projects, many in the increasingly popular Platinum Triangle. For instance, Hong Kong-based LT Global Investment is planning a $450 million mixed-use development with office, retail and hotel space, 200 apartments, 150 condominiums and a movie theater near Angel Stadium. Construction could begin in late 2017, with completion in 2022. The project would provide 5,000 construction jobs and 1,100 permanent jobs. Tourism is also expanding, according to a recent report released by the Orange County Visitors Association. Last year, 48 million visitors spent $13 billion, marking a 6.6% increase over 2015. Meanwhile, the county lost 5,300 manufacturing jobs, mostly in food and pharmaceuticals, along with 3,200 government positions.
- At the end of the first half of 2017, the metro's office vacancy rate reached a cyclical low, continuing the positive net absorption trend of the past six years. Notable office projects include the 1.1 million-square-foot Five Point Gateway in Irvine Spectrum and the two-phase, 38-acre Flight at Tustin Legacy campus.

Orange County vs. National Employment Growth (Year-Over-Year)



Sources: YardiMatrix, Bureau of Labor Statistics (not seasonally adjusted)

Orange County Employment Growth by Sector (Year-Over-Year)

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
15	Mining, Logging and Construction	107	6.7%	7,800	7.9%
70	Leisure and Hospitality	219	13.8%	4,500	2.1%
80	Other Services	52	3.3%	1,700	3.4%
65	Education and Health Services	205	12.9%	500	0.2%
40	Trade, Transportation and Utilities	260	16.3%	300	0.1%
50	Information	26	1.6%	100	0.4%
55	Financial Activities	118	7.4%	-100	-0.1%
60	Professional and Business Services	299	18.8%	-600	-0.2%
90	Government	154	9.7%	-3,200	-2.0%
30	Manufacturing	152	9.6%	-5,300	-3.4%

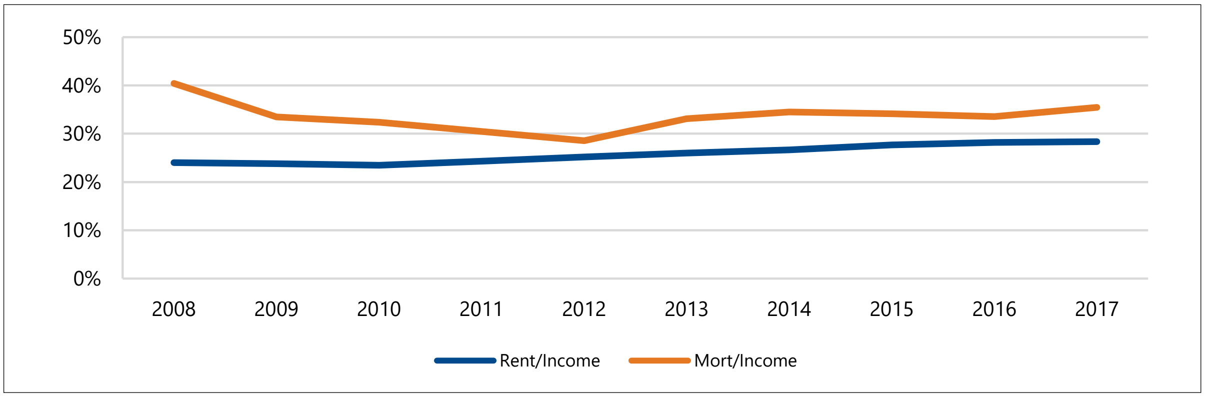
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

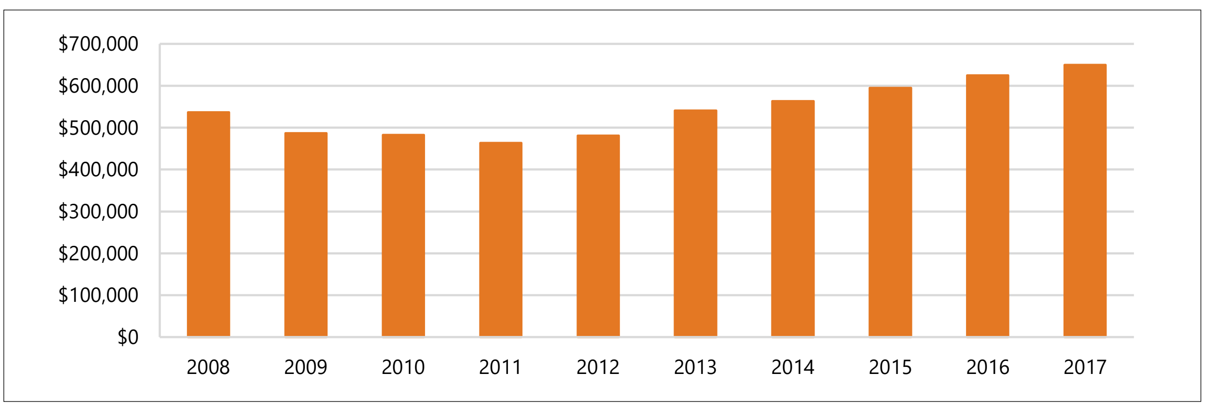
- The median home price in Orange County rose to $650,114, marking a new post-recession high, but remains below the $700,000 historic peak recorded in 2007. The average mortgage payment accounted for 35% of the area's median income, while the average rent remained more affordable, comprising 28%.
- Expensive land and high construction costs are maintaining a high barrier to homeownership across the region, but demand continues to be strong, spurred by a large percentage of international buyers, most of whom come from China, Korea, India and other Asian countries. Even in higher-density developments, prices start in the $400,000-$600,000 range for a two- to three-bedroom, two-and-a-half-bath home.

Orange County Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

Orange County Median Home Price



Source: Moody's Analytics

Population

- Orange County added 15,959 residents in 2016, marking a 0.5% uptick, below the national growth rate of 0.7%.
- Since 2012, the metro's population grew by 2.8%, or 87,597 people, trailing the 2.9% U.S. average.

Orange County vs. National Population

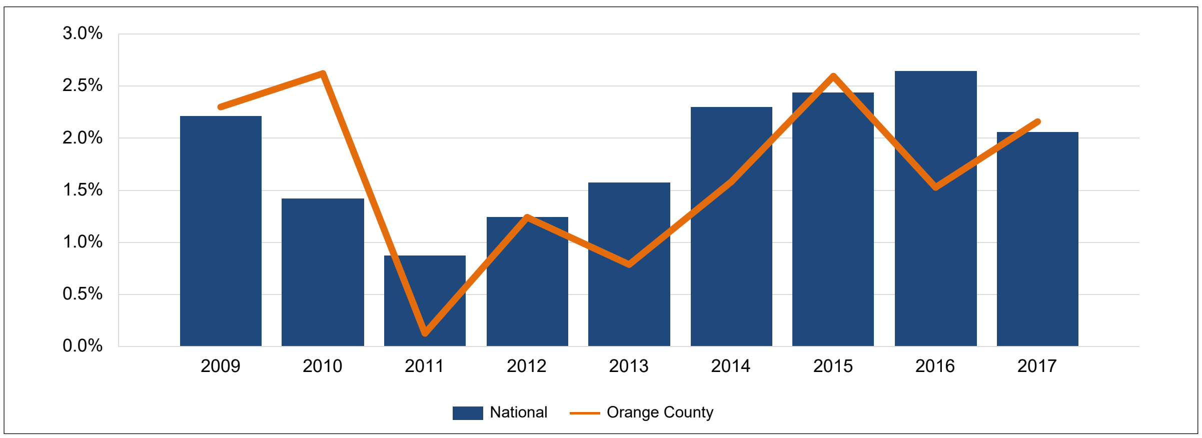
	2012	2013	2014	2015	2016
National	313,998,379	316,204,908	318,563,456	320,896,618	323,127,513
Orange County Metro	3,084,935	3,112,576	3,134,438	3,156,573	3,172,532

Sources: U.S. Census, Moody's Analytics

Supply

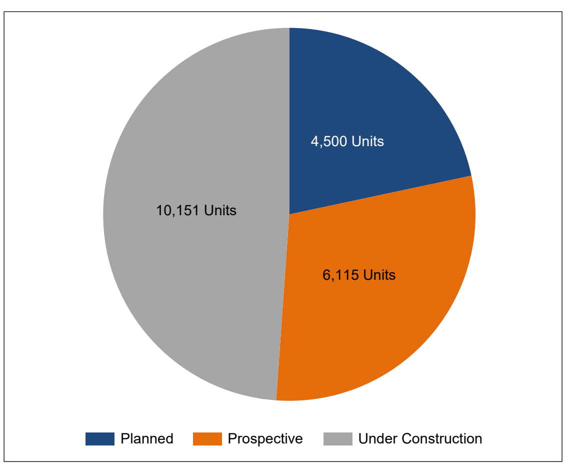
- More than 4,200 units came online in the first 10 months of 2017, exceeding 2016's pipeline of 2,931 units. As of October 2017, another 2,479 units were scheduled for completion by year-end, meaning 2017 could surpass the 2015 cycle peak.
- New deliveries are on the rise, with 10,151 units under construction as of October and another 10,615 units in the planning stages. Demand is expected to keep up, bolstered by the high cost of single-family housing.
- Anaheim–Central had the most units underway (2,117), a figure which is expected to increase, especially in the fast-growing Platinum Triangle, where the 371-unit Jefferson Stadium Park community—the initial component of a three-phase, mixed-use development calling for a total of 1,079 market-rate apartments—broke ground in February. Long-term demand is projected to remain strong in Platinum Triangle: 28,000 residents are expected to live there within two decades. Other developments in Anaheim include UDR Inc. and Wolff Co.'s 785-unit Katella Grand; Lennar Corp.'s 43-acre A-Town Metro, which will feature 1,400-1,746 condominiums and apartments with retail space; and LT Global's $450 million mixed-use project, which is slated to add 200 new apartments.

Orange County vs. National Completions as a Percentage of Total Stock (as of October 2017)



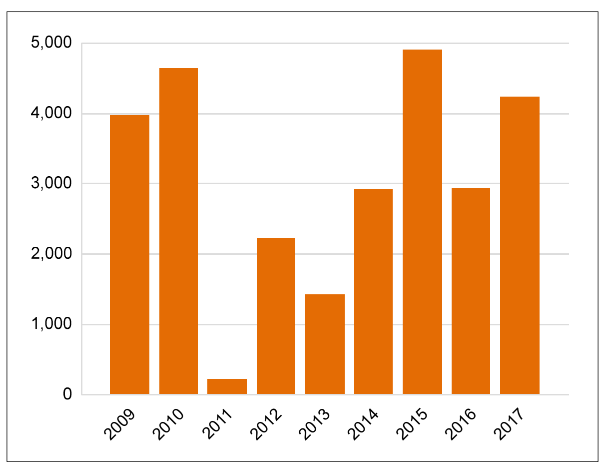
Source: YardiMatrix

Development Pipeline (as of October 2017)



Source: YardiMatrix

Orange County Completions (as of October 2017)

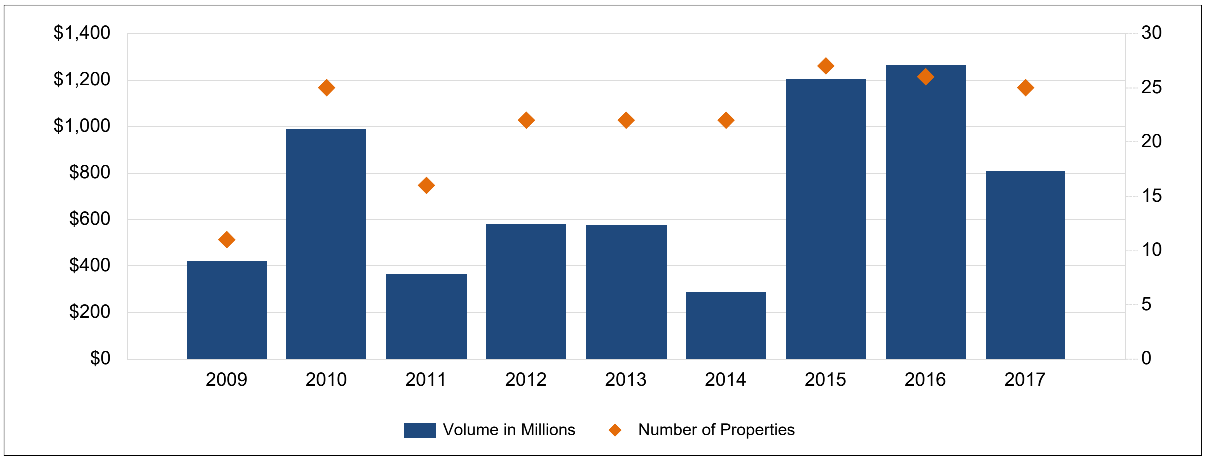


Source: YardiMatrix

Transactions

- More than $800 million in multifamily deals closed this year through October, at an average price per unit of $222,083, higher than the national figure of $135,622 but lower than last year's tally of $277,133. Domestic, as well as foreign investors, mostly focused on Renter-by-Necessity assets.
- Apartments in Orange County have become a hot commodity, especially for investors in search of value-add opportunities. Acquisition yields are around 4.5% for stabilized Class A properties, but can go as high as 6.5% for value-add communities. Meanwhile, returns for Class B assets go as high as 7.25% and can exceed 8.5% for Class C properties. Since affordable workforce housing is scarce, higher investor demand has a detrimental effect on low-income tenants, especially on those paying below-market rents to long-term landlords, who are less aggressive about raising rents. What's more, local legislation maintains property taxes low for existing owners, but those rates jump to current market levels when a property sells, further contributing to rent hikes.

Orange County Sales Volume and Number of Properties Sold (as of October 2017)



Source: YardiMatrix

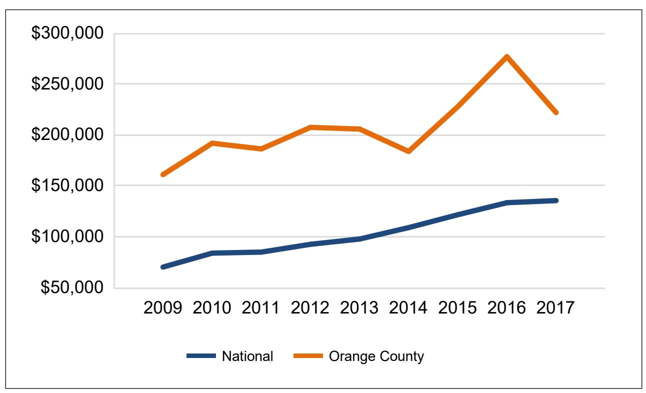
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Santa Ana	150
Tustin	112
Placentia	104
Mission Viejo–Lake Forest	83
Anaheim–West	80
Garden Grove	80
Fullerton–North	78
Anaheim–Central	57

Source: YardiMatrix

[1] From November 2016 to October 2017

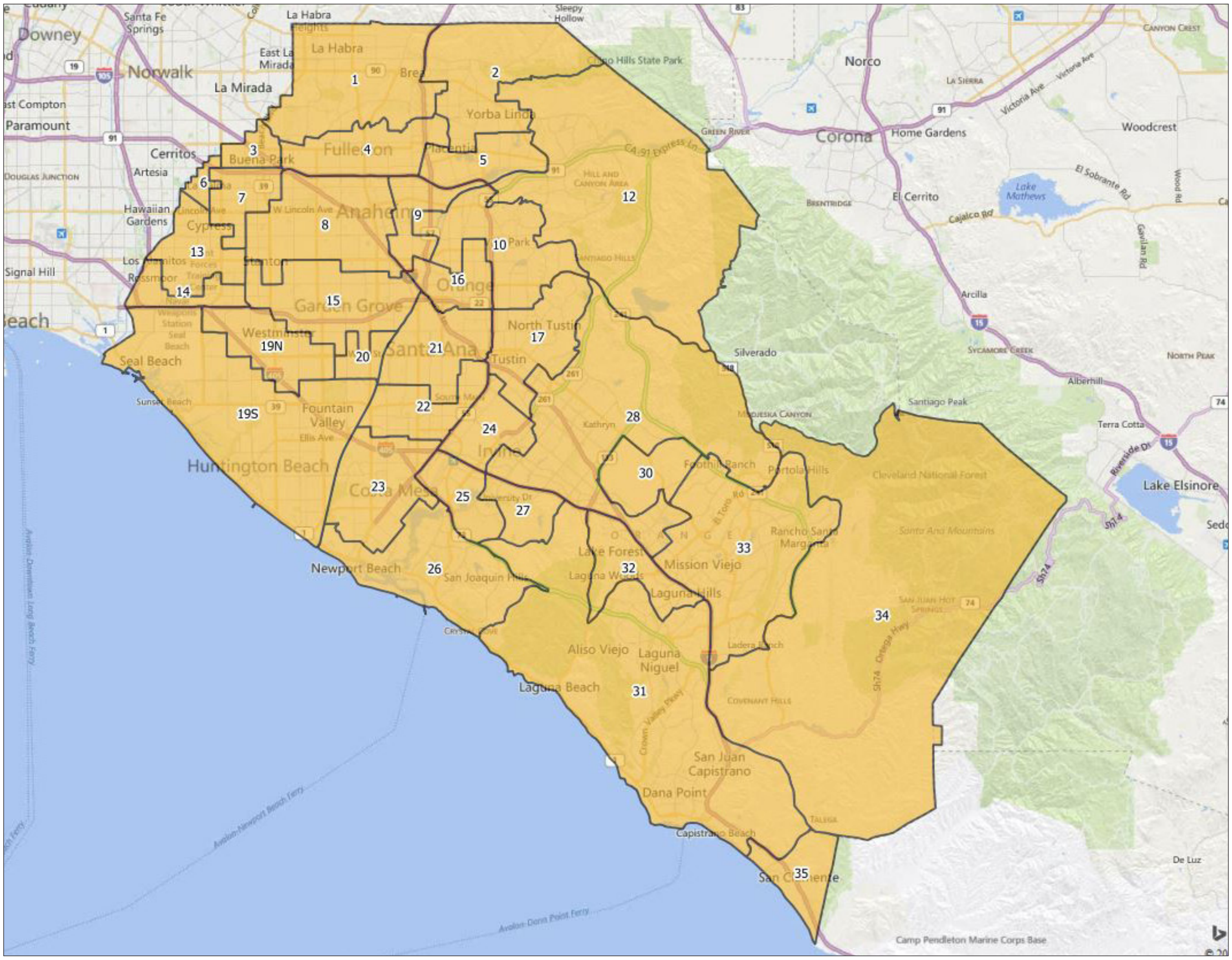
Orange County vs. National Sales Price per Unit



Source: YardiMatrix

Photo by Lagunatic Photo/iStockphoto.com

Orange County Submarkets



Area #	Submarket
1	La Habra
2	West Yorba Linda/Brea
3	North Buena Park
4	Fullerton
5	Placentia
6	West La Palma
7	South Buena Park
8	West Anaheim
9	East Anaheim
10	Central Orange
12	East Yorba Linda/Anaheim Hills
13	Cypress
14	Los Alamitos
15	Garden Grove
16	West Orange
17	Central Tustin
20	West Santa Ana

Area #	Submarket
21	Central Santa Ana
22	South Santa Ana
23	Costa Mesa
24	Irvine North
25	West Irvine
26	Newport Beach
27	East Irvine
28	Central County
30	Lake Forest
31	Laguna Beach
32	Laguna Hills
33	Mission Viejo
34	Santa Margarita
35	San Clemente
19N	Westminster
19S	Huntington/Seal Beach

Definitions

Lifestyle households (renters by choice) have wealth sufficient to own but have chosen to rent. Discretionary households, most typically a retired couple or single professional, have chosen the flexibility associated with renting over the obligations of ownership.

Renter-by-Necessity households span a range. In descending order, household types can be:

- *A young-professional, double-income-no-kids household* with substantial income but without wealth needed to acquire a home or condominium;
- *Students*, who also may span a range of income capability, extending from affluent to barely getting by;
- *Lower-middle-income ("gray-collar") households,* composed of office workers, policemen, firemen, technical workers, teachers, etc.;
- *Blue-collar households*, which may barely meet rent demands each month and likely pay a disproportionate share of their income toward rent;
- *Subsidized households*, which pay a percentage of household income in rent, with the balance of rent paid through a governmental agency subsidy. Subsidized households, while typically low income, may extend to middle-income households in some high-cost markets, such as New York City;
- *Military households*, subject to frequency of relocation.

These differences can weigh heavily in determining a property's ability to attract specific renter market segments. The five-star resort serves a very different market than the down-and-outer motel. Apartments are distinguished similarly, but distinctions are often not clearly definitive without investigation. The Yardi® Matrix Context rating eliminates that requirement, designating property market positions as:

Market Position	Improvements Ratings
Discretionary	A+ / A
High Mid-Range	A- / B+
Low Mid-Range	B / B-
Workforce	C+ / C / C- / D

The value in application of the Yardi® Matrix Context rating is that standardized data provides consistency; information is more meaningful because there is less uncertainty. The user can move faster and more efficiently, with more accurate end results.

The Yardi® Matrix Context rating is not intended as a final word concerning a property's status—either improvements or location. Rather, the result provides reasonable consistency for comparing one property with another through reference to a consistently applied standard.

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