

## BUYER DEMAND INTENSIFYING; LISTED INVENTORY LIMITED SO FAR

The Orange County apartment market will begin a modest recovery this year, setting the stage for a more significant improvement in fundamentals in 2011. Following more than three years of job losses, employers began to expand payrolls in the first half of 2010, with additional gains forecast through the remainder of the year. Continued hiring will generate renter demand for apartments, and vacancy declines will accelerate as the development pipeline thins. Areas where construction was minimal during the downturn, including the coastal submarkets of Huntington Beach, Newport Beach and Laguna Beach/Dana Point, will record modest rent growth early in the cycle due to tight vacancy rates and strengthening renter demand; countywide, however, rents will contract slightly. While the overall vacancy rate rose during the recession, concessions in most core properties remained relatively modest, reaching approximately two weeks of free rent. Going forward, significant concession burn should be limited primarily to properties delivered in the last 24 months, where owners offered above-average incentives during lease-up periods.

Investor demand strengthened in the first half of the year and will gain momentum into 2011. Improving buyer sentiment may not translate into an immediate jump in sales velocity, however, as the number of listed properties remains limited compared to market norms, and distressed properties will play a minimal role as operating conditions stabilize. As a result, buyer competition for the small inventory of available assets has generated multiple offers for performing properties, driving prices higher and causing cap rates to compress to the low- to mid-6 percent range in deals closed year to date. As market sentiment improves and pricing ticks higher, more owners will list assets they held through the downturn and pursue 1031-exchange transactions, likely beginning in the first half of 2011. While financing will remain available, all-cash private buyers will continue to play a significant role in making acquisitions, particularly for assets in the \$1 million to \$3 million range.

## 2010 ANNUAL APARTMENT FORECAST



**Employment:** Following the loss of 97,000 workers last year, local employers will boost payrolls 2.8 percent in 2010 with the addition of 37,000 jobs. Most industries will register growth, although soft conditions in the construction sector will persist.



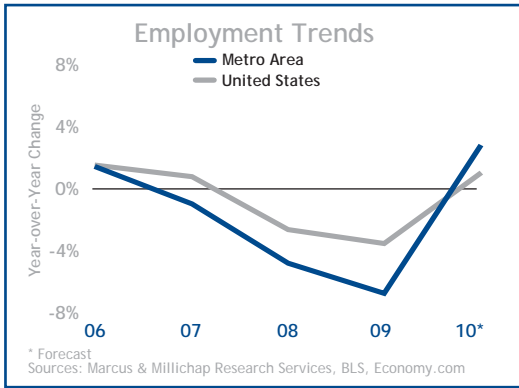
**Construction:** Builders will deliver 2,300 units this year, down from the more than 3,600 units that came online in 2009 but over 20 percent higher than the five-year average.



**Vacancy:** The countywide vacancy rate will fall 40 basis points in 2010 to 6 percent, after increasing for four consecutive years. In 2009, the vacancy rate spiked 130 basis points.



**Rents:** Despite modest vacancy declines, operators will trim rents in 2010; asking rents will dip 0.9 percent to \$1,450 per month, while effective rents contract 0.7 percent to \$1,385 per month. Rent reductions will be far more modest than last year, when asking rents dropped 6.9 percent, and effective rents fell 7.9 percent.

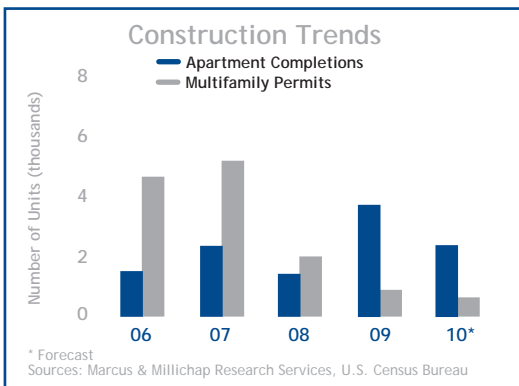
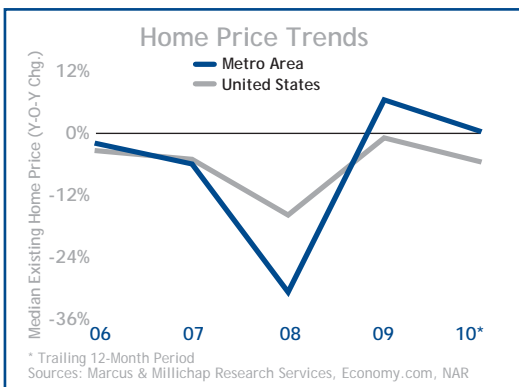


## ECONOMY

- ◆ Despite the addition of 24,800 jobs in the first half of 2010, payrolls remain below year-ago levels. During the past 12 months, net losses totaled 7,200 positions, a 0.5 percent decline.
- ◆ While most sectors are expanding, construction employment continues to contract. Year to date, construction companies slashed 2,700 positions, with additional cuts likely in the second half. Construction employment has fallen 40 percent since the onset of the recession.
- ◆ The unemployment rate in Orange County is in the mid-9 percent range, a 40 basis point decline year to date. The rate remains similar to the national average but is nearly 300 basis points lower than the statewide rate.
- ◆ **Outlook:** Following the loss of 97,000 workers last year, local employers will boost payrolls 2.8 percent in 2010 with the addition of 37,000 jobs.

## HOUSING AND DEMOGRAPHICS

- ◆ During the 12 months ending in the second quarter, single-family permitting activity surged 40 percent from recent lows to 1,650 units. Permits for multifamily units dipped 11 percent year over year to 825 units.
- ◆ While the median home price has dropped nearly 40 percent from the peak in 2006, mortgage payments remain considerably higher than asking rents, which should support apartment owners' ability to raise rents as the economy recovers. Class A average rents average approximately \$700 per month less than the monthly mortgage obligation on a median-priced home in Orange County, using traditional financing.
- ◆ Persistent labor market weakness slowed household formation during the recession. This trend has begun to reverse, however, with nearly 10,000 households forecast to be added this year, a 1 percent gain, which should support apartment demand.
- ◆ **Outlook:** While home prices have come down from market highs and interest rates are still low, for-sale housing remains expensive relative to the median household income. Home prices have started to inch higher, which ultimately will provide operators room to increase rents, although significant gains are unlikely before 2011.

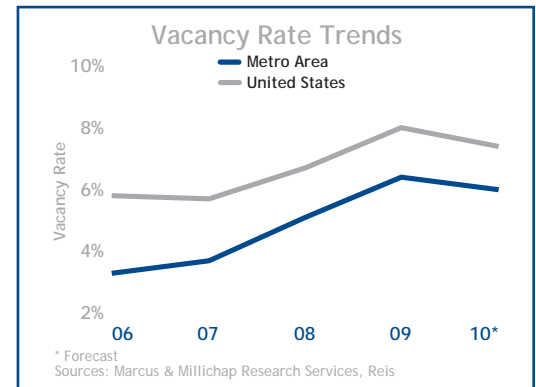


## CONSTRUCTION

- ◆ Developers delivered approximately 3,450 units during the past year, including 1,640 apartments thus far in 2010. Completions will slow in the second half.
- ◆ Three projects totaling 660 units are under way, with another 3,200 apartments planned. One proposed development is scheduled to break ground in the fourth quarter of this year.
- ◆ The 755-unit first phase of the Park at Irvine Spectrum was the largest rental complex completed in the second quarter. This development accounts for more than 85 percent of the units expected to come online this year in the Irvine submarket.
- ◆ **Outlook:** Builders will deliver 2,300 units in 2010, down from more than 3,600 units last year but over 20 percent higher than the five-year average.

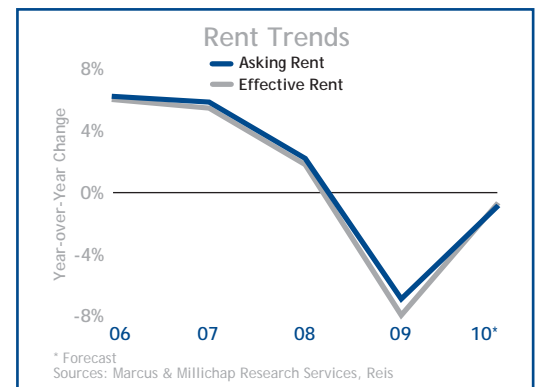
## VACANCY

- ◆ Vacancy was unchanged in the first half of 2010 at 6.4 percent, and has remained relatively steady for the past several quarters; since the beginning of 2009, the rate has fluctuated between 6.0 percent and 6.4 percent.
- ◆ In the county's Class A units, vacancy rose 60 basis points in the first six months of 2010 to 7.6 percent. The top-tier rate is now 300 basis points higher than the 10-year average prior to the recession.
- ◆ Vacancy in the lower tiers ended the second quarter at 5.9 percent, up just 20 basis points from one year earlier. The rate should improve as the economy picks up steam.
- ◆ **Outlook:** The countywide vacancy rate will fall 40 basis points in 2010 to 6 percent, after increasing for four consecutive years. Last year, the vacancy rate spiked 130 basis points.



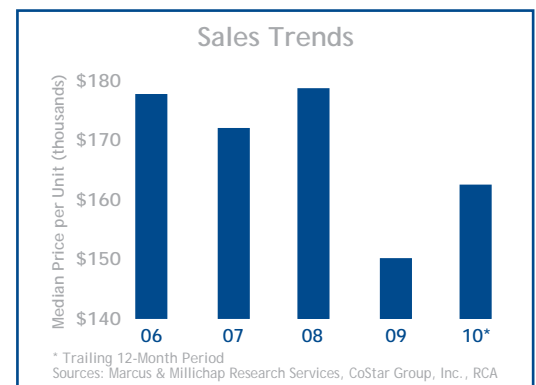
## RENTS

- ◆ During the past year, asking rents fell 3.6 percent to \$1,465 per month, while effective rents slipped 3.3 percent to \$1,401 per month.
- ◆ Asking rent decreases were fairly consistent across classes, falling 3.6 percent year over year in Class A assets and 3.2 percent in the lower tiers. Asking rents in the top tier ended the second quarter at \$1,706 per month, while Class B/C asking rents reached \$1,334 per month.
- ◆ Average revenues dropped 3 percent in the past year but steady in 2010 as vacancy improves. Measurable revenue gains are likely next year.
- ◆ **Outlook:** Despite modest vacancy declines, operators will trim rents in 2010; asking rents will dip 0.9 percent to \$1,450 per month, while effective rents contract 0.7 percent to \$1,385 per month. Rent reductions will be far more modest than last year, when asking rents dropped 6.9 percent, and effective rents fell 7.9 percent.



## SALES TRENDS\*\*

- ◆ Transaction velocity slowed by 3 percent during the past 12 months, and deal flow in the first half of 2010 was nearly identical to the same period last year. Listed properties attract more offers than a year ago, highlighting a modest increase in investor demand.
- ◆ Increased buyer competition drove up the median price 5 percent year over year to \$162,400 per unit. In deals closed in the first half of 2010, the median price reached \$164,000 per unit.
- ◆ Cap rates inched down approximately 40 basis points in the last year as the local outlook brightened and properties received more offers. Cap rates for most performing assets average in the 6.0 percent to 6.5 percent range.
- ◆ **Outlook:** Properties will continue to change hands in the second half as buyers return to the market. Downward pressures on cap rates should ease as more owners list assets in response to increased capital. While financing will remain available, all-cash buyers will still acquire properties priced between \$2 million and \$3 million.



\*\* Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

# Marcus & Millichap

## NATIONAL MULTI HOUSING GROUP

Visit [www.NationalMultiHousingGroup.com](http://www.NationalMultiHousingGroup.com) or call:

**Linwood C. Thompson**

Senior Vice President, Managing Director

National Multi Housing Group

Tel: (678) 808-2700

[lthompson@marcusmillichap.com](mailto:lthompson@marcusmillichap.com)

# Marcus & Millichap

## Real Estate Investment Services

Prepared and edited by

**Peter O'Neil**

Senior Market Analyst

Research Services

For information on national  
apartment trends, contact

**John Chang**

Vice President, Research Services

Tel: (602) 687-6700 ext. 6803

[john.chang@marcusmillichap.com](mailto:john.chang@marcusmillichap.com)

Newport Beach Office:

**Joseph Cesta**

Regional Manager

[jcesta@marcusmillichap.com](mailto:jcesta@marcusmillichap.com)

19800 MacArthur Boulevard

Suite 150

Irvine, California 92612

Tel: (949) 419-3200

Fax: (949) 419-3210

**Price: \$150**

© Marcus & Millichap 2010

[www.MarcusMillichap.com](http://www.MarcusMillichap.com)

## CAPITAL MARKETS

By WILLIAM E. HUGHES, SENIOR VICE PRESIDENT, MARCUS & MILLICHAP CAPITAL CORPORATION

- ◆ Mixed economic indicators, stock market volatility and concerns surrounding the European debt crisis continue to drive investors to safety. As a result, the yield on the 10-year U.S. Treasury has declined since peaking at 4 percent in April; as of late July, the yield had fallen to 3 percent.
- ◆ Capital markets loosened over the past year, with life insurance companies ramping up lending and CMBS showing renewed signs of life. Nonetheless, the agencies remain the dominant sources of multifamily lending. This trend will continue through 2010 as the GSEs' multifamily portfolios outperform their residential mortgage operations, reducing the likelihood of drastic government-mandated changes to their apartment lending arms.
- ◆ Multifamily loan originations increased 37 percent in the second quarter but remained below levels reported during the same period last year. Fannie Mae and Freddie Mac's origination volume followed a similar pattern, rising in the second quarter but falling short of year-earlier levels.
- ◆ Loan-to-values range from 60 percent to 75 percent for portfolio lenders and push up to around 80 percent for best-of-class, agency-financed deals. All-in rates for five-year agency loans fall into the low-4 percent range, while 10-year loans price between 4.75 percent and 5.15 percent. While life companies will compete at these levels for best-of-class deals, most portfolio lenders are 100 basis points to 225 basis points higher.

## SUBMARKET OVERVIEW

- ◆ The improving economy is driving renter demand growth in areas near major employment centers. Class A vacancy in Irvine, for example, fell 180 basis points year over year to 6.3 percent on net absorption of approximately 1,400 units. Further declines are likely in the second half of the year.
- ◆ Affordable properties near the beach continue to post some of the tightest occupancy rates in the county. Vacancy in Class B/C assets in Huntington Beach, for instance, dipped 50 basis points in the first half of 2010 to 4.1 percent, unchanged from the same period last year.
- ◆ The Mission Viejo submarket is one of the top performers in southern Orange County, particularly in the Class A sector, where vacancy declined 150 basis points to 5.1 percent during the past year. With new supply limited, conditions should continue to tighten.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Newport Beach	3.9%	-20	\$1,858	-6.4%
2	Buena Park	4.3%	10	\$1,230	-3.2%
3	Huntington Beach	4.3%	0	\$1,310	-5.7%
4	Brea	4.8%	-160	\$1,284	-2.2%
5	North Santa Ana	4.8%	-10	\$1,148	-1.6%
6	Laguna Beach/Dana Point	5.5%	-20	\$1,562	-5.2%
7	Orange	5.5%	-50	\$1,373	-3.0%
8	Mission Viejo	5.8%	-130	\$1,451	-2.2%
9	Fullerton	6.0%	20	\$1,218	-2.9%
10	Tustin	6.2%	40	\$1,344	-5.0%