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Casden Real Estate Economics Forecast

Multifamily Forecast | 2019 Conference

Changing The Cost Trajectory of Multifamily Housing

Friday, October 25, 2019

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 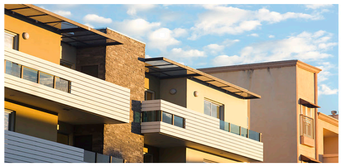  

Networking Breakfast

Welcome

Richard K. Green | Director | USC Lusk Center for Real Estate

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USC Casden Multifamily Forecast Industry Response

Moderator | Richard K. Green | Director | USC Lusk Center for Real Estate

Ziv Cohen | Chief Investment Officer | The Resmark Companies

Malcolm A. Johnson | Executive Director | J.P. Morgan

Christopher Thornberg | Founding Partner | Beacon Economics

Break

Keynote

Heather Worthington | Director of Long Range Planning for Community Planning and Economic Development | City of Minneapolis

Is Re-Zoning An Answer To Southern California's Housing Crisis?

Moderator | Greg Morrow | Executive Director | Real Estate Development + Design, University of California, Berkeley

Con Howe, Managing Director | Los Angeles Fund | CityView

Kevin Keller | Executive Officer of the Planning Department | City of Los Angeles

Sharon Lee | Executive Director | Low Income Housing Institute

Martha Welborne | Senior Advisor | HR&A Advisors

Reducing Development Costs: Making Rents Feasible for Southern California's Workforce

Moderator | Matt Horton | Associate Director | Milken Institute Center for Regional Economics

Jerome A. Fink | Managing Partner | Bascom Group

Jason Neville | Founder and CEO | Building Blocks

Amalia Paliobeis | Senior Director of Real Estate | West Coast, Common

Closing Remarks

Richard K. Green | Director | USC Lusk Center for Real Estate

Southern California Economic Dynamics

One of the great strengths of Southern California's economy is that it is well diversified. Table 1 contains location quotients for each major industry for each county in Southern California. A location quotient is the share of local employment in a particular industry divided by the share of national employment in a particular industry. Hence a location quotient of greater than one implies that a local economy is more reliant on a particular industry than the country; the converse is true for a location quotient of less than one.

In the vast majority of instances, location quotients for Southern California counties are between 0.8 and 1.2, meaning an absence of overreliance, or a paucity, of an industry.

San Diego County is particularly well-diversified, with all location quotients other than those for Natural Resources and "Unclassified" being between 0.8 and 1.25. But it is worth spending some time looking at the exceptions.

Los Angeles County is very reliant on the Information industry as a source of employment. Within California, only the Bay Area counties of San Francisco, San Mateo, and Santa Clara are more dependent on Information as an employer than Los Angeles. Coming out of the recession, Los Angeles' reliance on Information was an important and positive driver, as the sector grew faster than others, and provided higher wages than other sectors. Nationally, the average wage in the Information sector in the first quarter of 2019 was more than $2,500 per week, and the wage in that sector rose faster than any other. But employment growth in the sector, a leader for many years after the recession, has become a laggard, with growth between 2018 and 2019 at about half the rate of total employment growth. The disappointing performance of "unicorns" that have gone public (and the rather spectacular failure of one unicorn to even issue an IPO) may be a cause for concern about the Los Angeles economy going forward.

Note that within Southern California, however, Los Angeles is the only county with disproportionate employment in the Information Sector. Orange County relies most disproportionately on Professional and Business Services, whose sectoral employment growth has been faster than overall employment growth; wages in that sector are a little over $1450 per week.

San Diego County is very diversified, and has a recent of history of being the most economically resilient county in the region.

Figure 1

Southern California Location Quotients By County

	Los Angeles	Orange	San Diego	Ventura	San Bernardino	Riverside
Construction	0.67	1.32	1.15	1.03	1.00	1.79
Education and Health Services	1.17	0.88	0.9	0.91	1.02	0.94
Financial Activities	0.88	1.25	0.9	0.87	0.52	0.51
Information	2.43	0.81	0.82	0.77	0.34	0.44
Leisure and Hospitality	1.10	1.25	1.24	1.04	0.94	1.22
Manufacturing	0.87	1.12	0.89	0.92	0.85	0.69
Natural Resources and Mining	0.11	0.12	0.52	6.37	0.32	1.43
Other Services	1.10	0.94	1.15	0.83	0.84	0.89
Professional and Business Services	0.99	1.37	1.19	0.92	0.72	0.68
Trade, Transportation, and Utilities	1.00	0.84	0.81	0.94	1.51	1.17
Unclassified	0.23	0.16	0.19	0.11	0.09	0.11

Riverside Country relies heavily on construction (large amounts of Warehouse Space are being built in the County), and San Bernardino County relies heavily on Trade, Transportation and Utilities. Ventura County has an outsize presence in Natural Resources and Mining, representing its relatively large agricultural sector.

Skills

One of the most important determinants of income growth in an economy is educational attainment among the adult population, and specifically the share of adults with a Bachelor's degree or more. Using this definition of skilled, most of Southern California is more skilled than the United States.

A couple of things are worth underlining. First, while the bulk of Southern California people live in places that outpace the nation in adult share with a B.A., outside of San Diego and Orange Counties, the regional lags the state. Second, the eastern part of the region—the place with the most population growth—lags the country and the state substantially in educational attainment. Third, outside of San Diego, the country is catching up to the region in educational attainment. None of this is good news for the region's long-term competitiveness.

Figure 2

Educational Attainment: "Share of Adults with B.A. Degree or Higher"

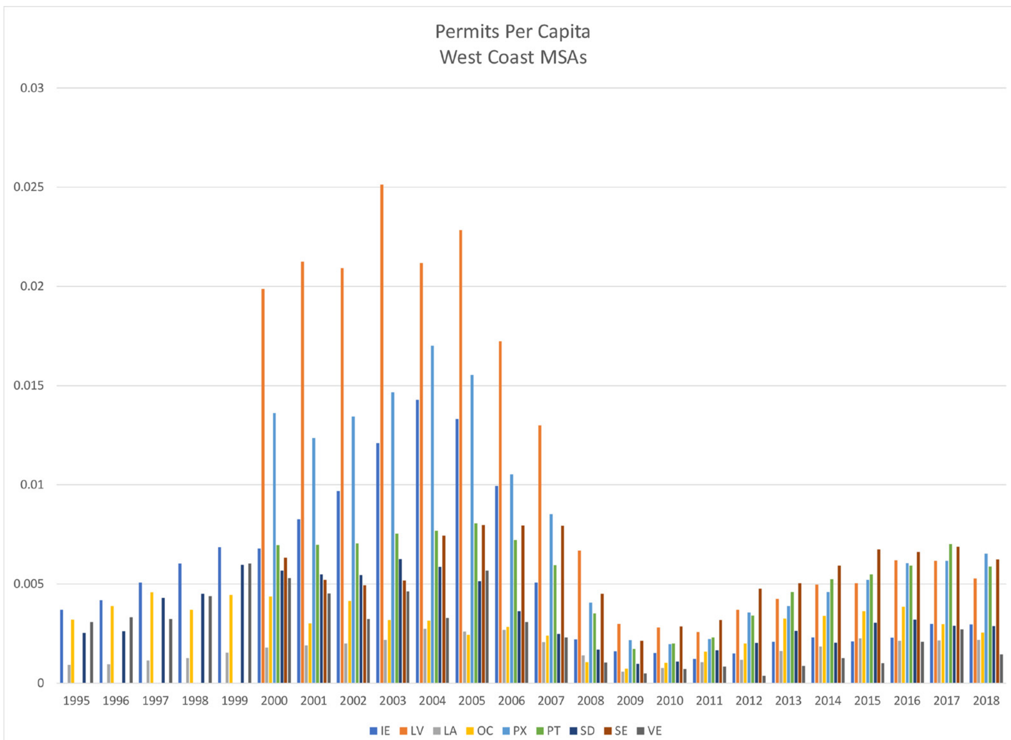
	2009	2017	Change
USA	27.5	30.9	3.4
California	29.7	32.6	2.9
Los Angeles	28.4	31.2	2.8
Orange County	35.2	39.1	3.9
Riverside	20.4	21.5	1.1
San Bernardino	18.2	19.8	1.6
San Diego	34	37.4	3.4
Ventura	30.3	32.6	2.3

Very little housing construction

For 11 years now, since the Global Financial Crisis, Southern California has built little housing, both compared with its history and compared with other cities in the West. Figure 3 depicts the number of housing units permitted per capita in the five areas covered in this report, Seattle, Portland, Las Vegas, and Phoenix. No region in Southern California permitted more than 3 units per 1000 people in 2018, and as of the year-to-date, construction permitting has fallen in Los Angeles, 30%. This contrasts with the other western cities, where new construction was at least 5 units per 1000 people.

Why the difference? American Community Survey data puts rents in Southern California above those in Phoenix, Las Vegas and Portland; rents in Seattle are slightly lower than those in San Diego, Los Angeles, and Orange Counties. On its face, if the cost of construction is the same everywhere, this implies that new construction should be more financially feasible in Southern California than its counterparts.

Figure 3



Of course, the cost of construction is not the same everywhere. Land values vary from place-to-place. Land in Las Vegas and Phoenix is much less expensive than in Southern California, meaning that developers can build feasibly to much lower rent levels. But the cost of construction also varies, in part owing to the nature of zoning and the time it takes to do development in California. Developers have shared pro formas with us that show soft costs are more expensive in California than elsewhere—a finding that is supported by Ivy Zelman[1] and Steven Oliner[2].

By right zoning for large scale development is practically non-existent in California, meaning that developers must spend money on legal and consulting fees not required of their counterparts elsewhere. But just as important is the issue of time. The longer it takes for development to get approved, the higher is the cost

[1]Zelman and Associates, High Fees and Lower FHA Limits "Impact" Growth, March 28, 2016.

[2]Steven Oliner, How Long Did it Take to Plan That Building? UCLA Economic Letter, January 2013.

to the developer, as she must pay her investors for the time over which the property is not earning money. Suppose the cost of land is half the cost of development, and that equity partners financing land require a minimum return of eight percent. That means that a project that takes three years will cost eight percent more than a project that takes one (two years longer multiplied by 50 percent multiplied by eight percent).

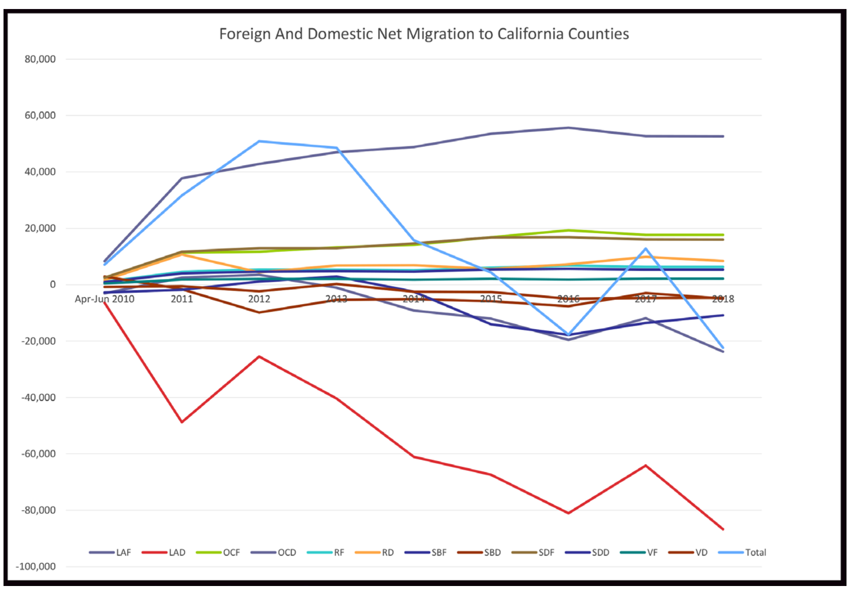
All of this makes feasibility more difficult in Southern California, and likely explains why so little is built relative to population.

Why aren't rents rising more?

Even though not much is being built in the region, rents rose fairly modestly last year, and we expect the increases to be modest next year—rents actually rose a little less than incomes, so affordability, while still poor, improved a tiny bit over the past year.

We expect the issue relates to affordability. Housing in Southern California is so expensive relative to incomes, people are leaving the region in large numbers (Figure 4). Domestic out-migration from Los Angeles County in 2018 was more than 86,000. Other than Riverside County (which absorbed migrants from the rest of the region), all areas of Southern California had domestic outmigration, and the region as a whole lost more than 20,000 people to other places, even taking into account foreign in-migration, which has slowed recently.

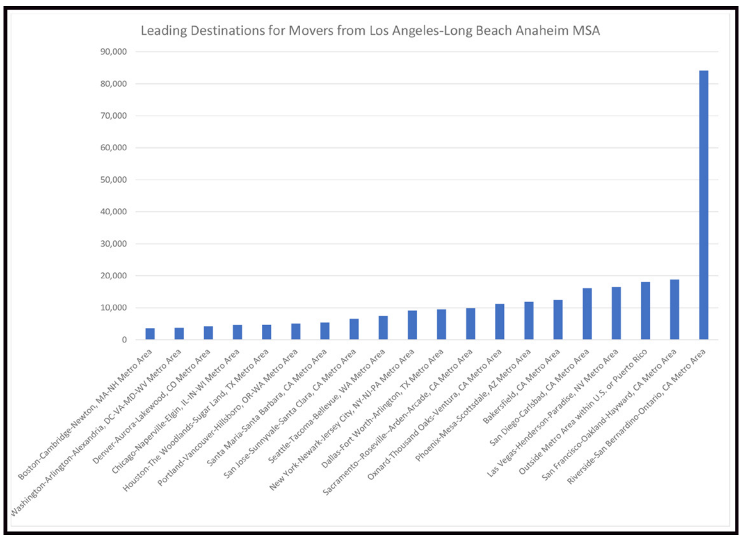
Figure 4



Where are these people going? Figures 5 through 8 show leading destinations for Los Angeles and Orange Counties (which are lumped together as one MSA in the US Census), San Diego County, the Inland Empire, and Ventura County. In almost all instances, the leading destination places outside of California for those leaving these metros are Phoenix and Las Vegas. The one exception is that the second and third leading non-California destinations for those leaving San Diego are Washington, DC, and Norfolk. We speculate that the military's large presence in San Diego, and in DC (at least in terms of contractors) and Norfolk explains this phenomenon.

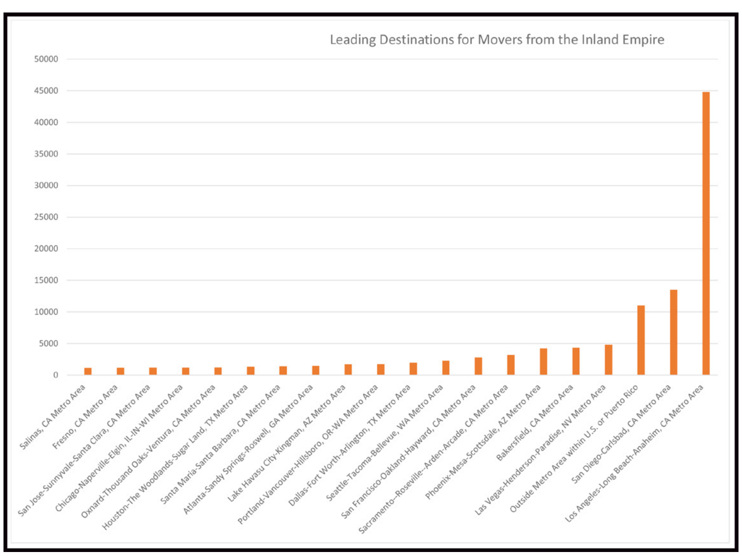
The large outmigration to Phoenix and Las Vegas is particularly striking given the very low unemployment rate currently in California. In years past, outmigration has usually been associated with periods of high unemployment, such as the "peace dividend" recession of the 1990s and the Global Financial Crisis. When we examine outmigration in California at the end of the last decade, we saw substantial movement to Texas, where the unemployment rate was considerably lower than in California. Now people are staying closer to home.

Figure 5



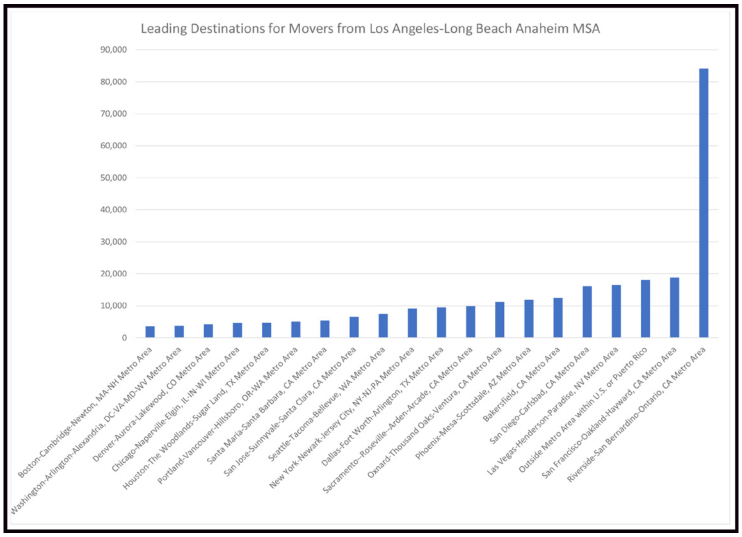
Leading Destinations for Movers from Los Angeles Long Beach Anaheim MSA

Figure 6



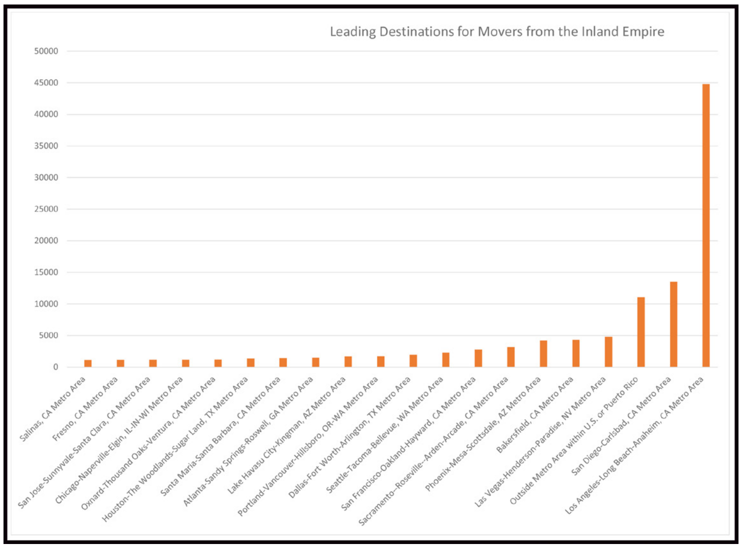
Leading Destinations for Movers from the Inland Empire

Figure 7



Leading Destinations for Movers from San Diego

Figure 8



Leading Destination for Movers From Ventura County

USC University of Southern California

Marshall School of Business

Sol Price School of Public Policy