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2012 Multifamily Forecast

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The 10th Annual Casden Multifamily Forecast Program

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

Alan Casden | Chairman and Chief Executive Officer
Casden Properties, LLC

Casden Real Estate Economics Multifamily Market Forecast
Tracey Seslen | Senior Research Associate
USC Casden Real Estate Economics Forecast

Multifamily Outlook
Moderator
Lewis G. Feldman | Partner
Goodwin Procter LLP

Panel
Jerry Brand | Senior Managing Director
Greystar

Brian Hansen | Director
Wood Partners

Greg Willett | Vice President, Research & Analysis
MPF Research

Break

Multifamily REITS

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

Craig Leupold | President
Green Street Advisors

Houses for Rent – Opportunities in Single Family Home Rentals

Moderator

Kitty M. Wallace | Senior Vice President
Colliers International

Panel

Scott W. Simon | Managing Director
PIMCO

Scott Gable | Chief Operating Officer
Waypoint Homes

Michael L. Meyer | Managing Principal
Twinrock Partners

Sudha Reddy | Managing Principal
Haven Realty Capital

Closing Remarks

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

Networking Lunch

Report Authors

TRACEY SESLEN | Senior Research Associate

USC Casden Real Estate Economics Forecast

Tracey Seslen received her Ph.D. in Economics from the Massachusetts Institute of Technology in 2003 and has been an Assistant Professor of Clinical Finance and Business Economics since 2006. She currently teaches Real Estate Finance in the Marshall School of Business and the School of Policy, Planning, and Development at USC. She is also one of the core finance instructors for the Ross Minority Program in Real Estate. Her past research has focused on housing cycles, the capitalization of risk and return into housing prices, household mobility behavior, and termination risk in commercial mortgages.

For the past year, she has been the co-author of the Casden Real Estate Report and in that role has developed new models for predicting price and vacancy movements for office, industrial and multi-family markets in Southern California. Her expertise in real estate finance has led to quotes in the LA Times, Wall Street Journal, OC Register, LA Business Journal, Long Beach Business Journal, California Real Estate Journal, SmartMoney.com, Downtown News, and other local and national publications. In addition, she has appeared on the Today Show, Marketplace Radio, and various local network news broadcasts. Recently, she has worked as an expert witness on real estate valuation issues.

When not working in the field of real estate, she is an avid international traveler, photographer, and skier. She lives in Marina del Rey with her husband and 3-year-old daughter.

SKYE TIRSBIER | MBA/MPL Dual Degree Candidate | University of Southern California

Skye Tirsbier is a Master of Business Administration/Master of Planning dual degree candidate at USC. Before attending USC, she worked as a project manager for real estate developer New Urban West in Santa Monica. Skye managed the entitlement process and secured approvals for a large mixed-use community in Southern California. Her academic honors include selection as a Marshall MBA Fellow and an invitation to join Beta Gamma Sigma. After graduation, Skye will be joining SanDisk Corporation in the Bay Area as a Senior Financial Analyst.

Multifamily REITS

Richard Green | Director, USC Lusk Center for Real Estate

Richard K. Green, Ph.D., is the Director of the USC Lusk Center for Real Estate. He holds the Lusk Chair in Real Estate and is Professor in the School of Policy, Planning, and Development and the Marshall School of Business.

Prior to joining the USC faculty, Green spent four years as the Oliver T. Carr, Jr., Chair of Real Estate Finance at The George Washington University School of Business. He was Director of the Center for Washington Area Studies and the Center for Real Estate and Urban Studies at that institution. Green also taught real estate finance and economics courses for 12 years at the University of Wisconsin-Madison, where he was Wangard Faculty Scholar and Chair of Real Estate and Urban Land Economics. He also has been principal economist and director of financial strategy and policy analysis at Freddie Mac. More recently, he was a visiting professor of real estate at the University of Pennsylvania's Wharton School, and he continues to retain an affiliation with Wharton. He is or has been involved with the Lincoln Institute of Land Policy, the Conference of Business Economists, the Center for Urban Land Economics Research, and the National Association of Industrial and Office Properties. Green also is a Weimer Fellow at the Homer Hoyt Institute, and a member of the faculty of the Selden Institute for Advanced Studies in Real Estate. He was recently President of the American Real Estate and Urban Economics Association.

Green earned his Ph.D. and M.S. in economics from the University of Wisconsin-Madison. He earned his A.B. in economics from Harvard University.

His research addresses housing markets, housing policy, tax policy, transportation, mortgage finance and urban growth. He is a member of two academic journal editorial boards, and a reviewer for several others. His work is published in a number of journals including the American Economic Review, Journal of Economic Perspectives, Journal of Real Estate Finance and Economics, Journal of Urban Economics, Land Economics, Regional Science and Urban Economics, Real Estate Economics, Housing Policy Debate, Journal of Housing Economics, and Urban Studies. His book with Stephen Malpezzi, A Primer on U.S. Housing Markets and Housing Policy, is used at universities throughout the country. His work has been cited or he has been quoted in the New York Times, The Wall Street Journal, The Washington Post, the Christian Science Monitor, the Los Angeles Times, Newsweek and the Economist, as well as other outlets. He recently gave a presentation at the 31st annual Federal Reserve Bank of Kansas City Economic Symposium, where his work was cited by Federal Reserve Chairman Ben Bernanke. The National Association of REALTORS, the Ford Foundation, and the Lincoln Institute for Land Policy have funded grants to support some of Dr. Green's research. He consults for the World Bank.

In 1995, Green was honored as "Teacher of the Year" by the University of Wisconsin Graduate Business Association, and soon thereafter was inducted into that University's Teaching Academy.

Craig Leupold | President, Green Street Advisors

Leupold is Green Street's primary liaison to the investment community and oversees the firm's client relationships and interactions. He is very active in the firm's research processes. Prior to becoming President in October 2007, he established and managed the firm's residential research efforts, covering the apartment, student housing, and manufactured housing sectors.

Leupold is a member of the National Multi-Housing Council (NMHC), a four-time recipient of Realty Stock Review's Outstanding Analyst award, and a recipient of Zacks' Five-Star Analyst award in 2001. In 2006, he was recognized as the fourth most influential person in the multifamily industry by Multifamily Executive. Leupold is an active participant and speaker at real estate industry events. His 20+ years of industry experience includes real estate consulting at Kenneth Leventhal & Co. and real estate finance at Union Bank of California. Leupold earned his M.B.A. in Finance/Real Estate from Columbia University and B.A. from University of California, San Diego.

Multifamily Outlook

Jerry Brand | Senior Managing Director, Greystar

Jerry Brand joined Greystar in June 2011. Brand is responsible for multifamily development in the western region including California, The Pacific Northwest and Phoenix. Brand has sourced, structured and developed in excess of $8B of apartment transactions during his real estate career. Prior to joining Greystar Brand served from March 2009 through June 2011 as Managing Director at Pacific Urban Residential, an apartment developer and investor focusing in the California and Pacific Northwest markets. From 1989 through March 2009 Brand was Managing Director of Western development and capital markets at Fairfield Residential.

Brand is a graduate of Yale University, (Bachelor of Science) and John Marshall Law School, Chicago, IL. Brand is a member of the Urban Land Institute, the National Multifamily Housing Council, and PREA. Mr. Brand is co-founder of the University of California Athletic Advisory Council and currently serves on its Board of Directors.

Lewis G. Feldman | Partner, Goodwin Procter LLP

Lewis G. Feldman is a partner in Goodwin Procter's Business Law Department and a member of the Real Estate, REITs & Real Estate Capital Markets Group. He serves as Chair of Goodwin Procter's Los Angeles office and heads the Firm's Public/Private Development Practice. Mr. Feldman is considered to be among the nation's leading real estate and public finance attorneys, specializing in structuring, entitling and executing large-scale financings for government and the private sector.

Feldman has advised clients on more than $75 billion in debt and equity financings for market-rate and affordable apartments, master-planned residential communities, industrial and manufacturing facilities, urban entertainment centers, primary, secondary and university educational facilities, retail malls, hospitals, mixed-use projects, destination resorts and hotels, brownfield remediation, green building, mitigation banks, transportation projects and all forms of public infrastructure, such as water, wastewater, and energy facilities.

Feldman is an active participant in many of the industry's most eminent organizations and groups, including the Board of Directors of the University of California, Los Angeles, Ziman Center for Real Estate, of which he is a founding member and head of the Public Policy Committee; the University of Southern California, Lusk Center for Real Estate; the City of Hope Cancer Center's Los Angeles Real Estate Industry Council; and for five years served as a Board Member of the United Way of Greater Los Angeles. He is an active member of the California Redevelopment Association, the Urban Land Institute, the National Association of Bond Lawyers, and the International Council of Shopping Centers. Additionally, Feldman is a member of the Urban Land Institute's Public Private Partnership Council and participates on the Boards of Bet Tzedek, and the Milken Institute California Center Advisory Council.

Feldman has been recognized by the California Real Estate Journal as one of "California's Dealmakers" (2008) and was recognized by the Los Angeles Daily Journal as one of the "Top 100" leaders in the California legal community (2008). He is listed in Chambers USA: America's Leading Lawyers for Business, Best Lawyers in America in the real estate category (2000-2012), Lawdragon's "Top 500 Lawyers in America," The Legal 500 (2008, 2009, 2010, 2011), the "Leading 500 Dealmakers in America" (2007) and is individually rated "AV-Preeminent" by Martindale-Hubbell.

Other notable honors include recognition in the Los Angeles Business Journal's "Best of Bar" and "Who's Who in Law" (2007); the Los Angeles Daily Journal's "Leading Rainmakers in California" and "Top 100 Lawyers in California, Real Estate Southern California's "Top Southern California Real Estate Lawyers" and American Lawyer Media's "Top 100 Attorneys" in Los Angeles County. He has also been recognized by Law & Politics magazine as a "Southern California Super Lawyer" (1st Edition through 2012).

Feldman received his Juris Doctorate from the University of California at Davis in 1982 and was Executive Editor of the UC Davis Law Review. He completed his undergraduate degree with highest honors from the University of California at Santa Cruz in 1978, where he received degrees in Economics and Environmental Planning.

Brian Hansen | Director, Wood Partners

Brian Hansen is Development Partner with responsibility for Wood Partners' Southern California territory. His responsibilities include the oversight of development, financing and asset management for all Wood Partners' activities in Los Angeles County, Orange County, San Diego County and the Inland Empire.

Hansen joined the company in 2006 and, since then, has been actively involved in the management, origination and financing of more than $450 million worth of developments.

Before joining Wood Partners, Brian earned his MBA with a concentration in Real Estate from Kenan-Flagler Business School, University of North Carolina, and his bachelor's degree from Colby College. Brian's previous work experience includes time as a Senior Analyst for Analysis Group, an economic consulting firm and, prior to that, was employed at The Federal Reserve in Washington D.C. working as a Research Analyst for the national GDP forecast.

Greg Willett | Vice President, Research & Analysis, MPF Research a division of RealPage, Inc.

Greg Willett heads the research and analysis team at MPF Research, monitoring and evaluating trends in multifamily market fundamentals. This group produces quarterly publications examining multifamily market performances in more than 60 metropolitan areas, with trends tracked for more than 500 individual neighborhoods. Willett thus is well versed on multifamily market conditions and activity nationally, by metro and in many individual neighborhoods. He has written articles for periodicals such as Multifamily Executive, Urban Land and Multifamily Trends, and is a regular contributor to numerous other publications serving the multifamily housing industry.

Willett joined the staff of MPF Research in 1984. He began his tenure as a data analyst and later served as a research consultant specializing in feasibility evaluations of new apartment community development and existing property acquisition. Willett holds a bachelor's degree from Western Kentucky University and a master of liberal arts degree from Southern Methodist University.

Houses for Rent: Opportunities in Single Family Home Rentals

Scott Gable | Chief Operating Officer, Waypoint Homes

Scott Gable leads Waypoint Real Estate Group's business operations, including acquisition, construction, leasing, financial fitness, and property management. He joined Waypoint in August 2011.

Gable brings over twenty-four years of hands-on operations, business management, and planning experience to his role. He has worked with small, mid-sized and large companies at all stages of development. For eleven years he was with Wells Fargo where he served as EVP of the Home and Consumer Finance Group, leading a 5,000 person real estate underwriting, processing, servicing and collections organization. Previously he also served as Chief Operating Officer for Hercules Technology Growth Capital, head of bank operations for United Commercial Bank, a principal with Booz*Allen and Hamilton management consulting, and as a management consultant to the UK government on their mortgage rescue programs. Scott has built and led sales teams, marketing, and new product development initiatives. He has extensive experience in applying technology solutions and improving business processes to enable and support fast growing businesses.

Gable holds an MBA from Harvard Business School and an AB in International Relations from Stanford University.

Michael L. Meyer | Managing Principal, Twinrock Partners

Michael L. Meyer retired September 30, 1998 as managing partner of the E & Y Kenneth Leventhal Real Estate Group of Ernst & Young LLP (EYKL) Orange County Office. Having started with Kenneth Leventhal & Company in Los Angeles in 1963, Mr. Meyer has been active in the Southern California and national real estate industry for more than 40 years, and he was a key partner in growing the firm to become the largest group of real estate accounting and consulting professionals in the nation.

Twin Rock Partners, formerly AMG Realty Investors, is a commercial and residential real estate investment company, which pursues direct investments as a sponsor, as well as investing equity capital with developers and owners. In addition, the company delivers asset management and capital advisory services backed by established market relationships and offers expert investment management services to a diverse investor base. The business model is focused on opportunistic investments in segments and locations that are tactically identified by management..

Together with partners, Meyer has invested in shopping centers, office and industrial buildings, multi-family projects, residential tract and condominium developments, mortgages, public storage properties and land developments. He also was a member of two entities that acquired Japanese non-performing real estate bank loans and an office building in Japan.

Meyer was inducted into the California Building Industry Foundation Hall of Fame in June 1999 for outstanding achievements in the real estate industry and community. Meyer has been honored by the United Way (Alexis de Tocqueville Society Award) and City of Hope (Spirit of Life Award). He and his wife Nancy received the Humanitarian Award by the British American Business Council in 2005 and they are members of the United Way Tocqueville National Society.

Meyer is a board member of Opus Bank, KBS Legacy Partners Apartment REIT, KBS Strategic Opportunity REIT, Paladin Realty Income Properties, Inc. and South Coast Repertory; and founder and board member emeritus of the Orange County Forum. He is currently executive advisory board member of the UCI Paul Merage Graduate School of Business-Center for Real Estate; and Associate of the USC Lusk Center for Real Estate. He also is a member of the Urban Land Institute (ULI), and an honorary member of the American Institute and California Society of Certified Public Accountants (AICPA). He is a native of Omaha, Neb., and graduate of the University of Iowa. A resident of Laguna Beach, Meyer and his wife have four children and three grandsons.

SUDHA REDDY | MANAGING PRINCIPAL, HAVEN REALTY CAPITAL

Sudha Reddy has over a decade of real estate and general finance experience, spanning the gamut from investment banking to principal-level real estate ownership and management. In his role as Chief Executive Officer of Haven Realty Capital, Reddy oversees all aspects of the Finance and Acquisitions platforms.

Reddy began his career as an Equity Research Associate at CIBC World Markets where he covered the Internet and Defense sectors for the firm. After CIBC, Sudha became a Senior Analyst in the Private Wealth Management division of Goldman Sachs, working on a team that actively managed over $9 billion for high net worth families, foundations, and institutions.

Following his time on Wall Street, Reddy returned to his native Los Angeles and assumed all day-to-day management responsibilities of his family's legacy multi-family portfolio located in the South Bay of Los Angeles. Shortly after assuming control, Reddy created a more formalized organizational structure by founding R3 Properties, a vertically integrated real estate investment and property management firm focused on high demand rental housing in Los Angeles and surrounding submarkets.

R3's platform provided the initial foundation for the management infrastructure of what would eventually become Haven Realty Capital. Since Haven's inception, Reddy has overseen its growth into one of the largest operators of single family rental housing in the region.

Reddy holds an MBA from the Marshall School of Business at USC, a Masters in Real Estate Development (MRED) from the School of Policy, Planning and Development at USC and a BA in Psychology from Yale University.

SCOTT W. SIMON | MANAGING DIRECTOR, PIMCO

Simon is a managing director in the Newport Beach office, a senior member of PIMCO's portfolio management and strategy groups and head of the mortgage and asset-backed securities teams.

Prior to joining PIMCO in 2000, he was a senior managing director and co-head of MBS pass-through trading at Bear Stearns. He also authored The Daily MBS Commentary there. Simon has seven times been named to positions on the Institutional Investor All-America Fixed-Income Research Team, including first place in MBS pass-throughs and overall MBS strategies. He has 29 years of investment experience and holds both master's and undergraduate degrees in industrial engineering from Stanford University.

KITTY M. WALLACE | SENIOR VICE PRESIDENT, COLLIERS INTERNATIONAL

Kitty Wallace joined Colliers International as Executive Vice President in January 2010. Named Los Angeles County's Number One Multifamily Agent by Pierce-Eislen, Wallace specializes in the sale of apartment buildings, land development, condominium conversions, student housing, affordable housing and special assets throughout Southern California and the Western United States.

Wallace is recognized is a recognized leader in the industry. She is a five-time winner of Real Estate California's Most Powerful Women in Real Estate award and she has also made the magazine's Hot Broker List multiple times. Wallace holds the record for achieving the highest cost-per-unit and cost-per-square foot sale in Los Angeles County.

Wallace previously served as Senior Vice President for Sperry Van Ness in West Los Angeles. Since joining Sperry Van Ness in 1997, she set and exceeded performance standards within that company and in the commercial real estate industry as a whole. Kitty ranked as Sperry Van Ness' number one multifamily advisor nationwide. For eight years running, she was also the number two Sperry Van Ness agent across all product types.

Wallace is on the Board of Directors for the Upward Bound House, a private non-profit providing transitional housing, facilities, and life skills education for homeless individuals. She recently worked pro-bono on their acquisition of The Sun Bay Hotel in Culver City which was converted into an emergency shelter for families. This shelter is the only program of its kind on the Westside and provides emergency housing for 68 families and over 150 individuals.

Executive Summary

Although the economy still has a long way to go to fully recover from the financial crisis and crushing economic slowdown of 2008-2009, 2011 was a very good year for Southern California apartment demand, with positive net absorption and increased occupancy rates for all four metro areas. Los Angeles County and San Diego both experienced higher levels of net absorption than in 2010, while Orange County and the Inland Empire were unable to repeat their 2010 performances. All four metro markets have returned to vacancy rates that are very close to their "natural" levels – the level at which inflation-adjusted rents remain constant -- and exceeded the overall occupancy rate for the US as a whole (94.6 percent). Only the Inland Empire fell short of the occupancy rate in the West region (95.2 percent).

Southern California rents also rose across the board, both on an average and same-store basis. To go along with a remarkable 22,340 net move-ins (nearly quadruple the number from 2010), average rents in LA jumped 6.2 percent, the most of any metro area. Orange County reported the largest increase in same-store rents, with an increase of 4.9 percent, and the weakest performance in average rents, with an increase of only 3.2 percent. Overall, the Southern California region fell short of the same-store rent growth experienced in both the US as a whole (4.7 percent) and the West region (5.2 percent).

Thirty-nine out of 40 submarkets in Southern California saw positive rent growth on an average and same-store basis. This is a vast change from two years earlier, in which only three submarkets reported rising average rents. Between a sharp drop in new construction, a dwindling supply of shadow-market units, a migration of households from shadow-market to "traditional" multifamily units, and improvements in the macroeconomy, we are observing a continued strengthening in fundamentals on both the supply and demand side, which is serving to boost asking rents, reduce or eliminate concessions, and fill units.

We forecast continued rising rents for all four metro areas over the next two years, and believe that the growth rate will be slower in 2013 than in 2012. We expect LA to record the strongest performance among the metro areas, followed by Orange County, San Diego, and the Inland Empire.

Los Angeles County

The Los Angeles apartment market showed a substantial improvement in both rents and occupancy from 2010; all eleven submarkets recorded positive growth in rents and all eleven submarkets experienced positive net absorption. The strong performance in the rental market came in spite of only modest improvements in the local labor market: only 19,000 nonfarm jobs were added in 2011. The greatest gains came in the Professional and Business Services, Educational and Health Services, and Leisure and Hospitality sectors. The largest losses came in Local Government, Manufacturing, and the Arts, Entertainment, and Recreation sectors. The unemployment rate ended the year at 11.6 percent, down from 12.4 percent in December 2010.

West Los Angeles showed the largest increase in average rents (11.5 percent), followed by Hollywood (8.1 percent) and the Tri-Cities submarket (6.3 percent). West Los Angeles also posted the largest gain in same-store rents at 7.1 percent. Though still positive, the East Los Angeles submarket showed the weakest performance, with a rise in same-store rents of only 0.7 percent. As of Q4 2011, average rents for the county are off only 1.1 percent from their Q2 2008 peak. The average monthly rent for an average-sized unit was $1596, or $1.86 per square foot. Average rents for Los Angeles county were up 6.2 percent for 2011.

For the third year in a row, Los Angeles County recorded an increase in apartment demand, with 22,340 net move-ins. This figure was on par with 2009 and nearly quadruple the net move-ins of 2010. All eleven submarkets recorded positive net absorption for 2011. Intown Los Angeles and Santa Clarita Valley reported the largest relative gains in demand, with 4340 and 750 net move-ins, respectively. The overall occupancy rate rose 1.9 percentage points to 96 percent.

New units were delivered in all submarkets except The Santa Clarita and Antelope Valleys. Completions for 2012 are expected to fall just short of 2011 figures. Two-thirds of the anticipated 2,375 completions will come on-line in the Hollywood, West Los Angeles, and San Fernando Valley submarkets.

Orange County

Following a gain of 6,500 nonfarm jobs in 2010, Orange County witnessed the creation of an additional 15,600 nonfarm jobs in 2011. The largest gains came in the Professional and Business Services, Leisure and Hospitality, and Trade, Transportation, and Utilities sectors, while the largest losses came in the Financial Activities, Construction, and Educational Services sectors. The unemployment rate in December 2010 was 7.8 percent, down from 9.0 percent a year earlier.

Although demand for apartments increased for the third year in a row, Orange County recorded only half as many net move-ins in 2011 as in 2010 (2290 versus 5830). Occupancy increased 0.9 percentage points during 2011, bringing the overall rate to 95.8 percent.

Average rents increased by 3.2 percent, while same-store rents increased by 4.9 percent. The average monthly rent for the county at the end of 2011 was $1,523, or $1.72 per square foot. The submarkets with the strongest growth in average rents were Santa Ana and South Orange County, which both logged growth of 5.0 percent. The Irvine area recorded the highest growth in same-store rents at 7.2 percent.

After adding 3,187 new units in 2010, new deliveries dropped precipitously in 2011: only 263 new units were delivered across four submarkets. Completions are expected to bounce back again in 2012, with 2,883 anticipated deliveries. A staggering 97 percent of these completions will go on-line in the Irvine submarket. The remaining three percent are being constructed in Anaheim.

Inland Empire

The multifamily housing markets in the Inland Empire, which were severely affected by the recession, began to see some improvement in 2011. This improvement was likely spurred, in part, by an improvement in the local labor markets. Although Riverside and San Bernardino still maintain the highest unemployment rates among the Southern California counties, at 12.5 and 11.9 percent, respectively, they are down significantly from a year earlier. Furthermore, the Riverside County unemployment rate is only three-tenths of a percent above that of Los Angeles County. The two-county combined area saw the creation of 8,200 nonfarm jobs in 2011, with the largest gains coming in the Leisure and Hospitality, Education and Health, and Professional and Business Services sectors. The largest losses came in the Financial Activities, Construction, and Local Government sectors.

As in Orange County, demand for apartments in the Inland Empire increased during 2011, but fell well short of 2010 levels. The region ended the year with 1,960 net move-ins, down 54 percent from the prior year. Southwest Riverside logged the strongest relative increase in demand, with 560 net move-ins. The Outer Riverside and San Bernardino submarket showed the weakest demand for the second year in a row, and was the only submarket to experience net move-outs for 2011 (250).

Average effective rents increased by 3.4 percent, while same-store rents increased by 2.8 percent. At the end of 2011, the average monthly rent stood at $1,069, or $1.22 per square foot. The Riverside/Corona submarket logged the highest average rent growth at 5.8 percent. The Foothill area experienced the strongest same-store rent growth at 3.8 percent. The Inland Empire's Outer Riverside/San Bernardino submarket was the only submarket in all of Southern California to report a decline in either average or same-store rents; average rents fell 6.8 percents, while same-store rents fell 0.4 percent.

Again, like Orange County, completions dropped substantially from 2010. After adding 2,068 units in 2010, the metro area received only 657 new deliveries in 2011. But unlike Orange County, completions are expected to remain low in 2012. Just 450 new units are anticipated for completion across three submarkets: Southwest Riverside County, the Foothill area and the Coachella Valley.

San Diego County

The unemployment rate fell to 8.9 percent from 10.1 percent during 2011, maintaining San Diego's position of having the second-lowest unemployment rate among Southern California Counties. After witnessing the creation of 5,200 jobs in 2010, the County gained another 11,700 in 2011. The Educational and Health Services, Professional and Business Services, and Leisure and Hospitality sectors experienced the largest job gains, while the Local Government, Manufacturing, and Financial Activities sectors posted the biggest losses.

San Diego County experienced positive demand for apartments for the third year in a row, logging 4,070 net move-ins. This figure represents an increase of 19 percent over the 2010 level of net absorption.

Average rents grew by 4.3 percent to $1.53 per square foot. At the end of 2011, average monthly rents stood at $1,377. Same-store rents rose by 2.8 percent. The strongest average rent increases were posted in the Intown/Coronado and West San Diego submarkets (10.4 percent and 6.8 percent, respectively). West San Diego also posted the strongest gain in same-store rents, with a 5.5 percent increase.

Completions logged in at 407 for 2011, down nearly 85 percent from 2010. Intown/Coronado, Chula Vista/Imperial Beach, and Escondido were the only submarkets to receive new units. The pace of construction is expected to pick up in 2012, with anticipated deliveries of 1,583 new units across six different submarkets. The Chula Vista/Imperial Beach submarket, with 9.8 percent of the county's total apartment stock, is expected to receive about 40 percent of the new units.

Multifamily Market Forecast

All four multifamily metro markets experienced a turnaround in 2011, with strongly increasing rents and declining vacancy. Over the next year, we expect the trend to continue at varying paces across all four markets. From Q4 2012 to Q4 2013, we expect the improvements to slow and vacancy to creep up in some areas as the pace of construction returns to more typical levels.

Los Angeles was the top performer in 2011 with an average rent increase of 6.2 percent. We anticipate that pace of improvement to continue for 2012, but then slow for 2013. We expected the remaining three metro areas to log relatively similar performance over the next year, with growth rates between 3 and 3.4 percent. In 2013, we expect Orange County and San Diego to record another two percent rent growth; the Inland Empire will lag a bit behind. At the moment, Los Angeles, Orange County, and the Inland Empire have vacancy rates between 0.5 and 1.5 percent above their historical averages from 2002-2007, so under improving economic conditions, there is room for improvement in vacancy. San Diego has already surpassed its average historical vacancy rate, so the opportunity for improvement is more limited, barring a significant positive economic shock to the area

Overall, the future health of the multifamily market will be dependent upon several factors:

The employment picture. During the last half of 2011 and first months of 2012, the US as a whole witnessed very strong job creation. Unfortunately, Southern California has not matched the pace of the US job creation as a whole (relative to its size) and has, in fact, seen substantial job losses in the first months of 2012. The purchasing power of households, as determined by their employment situation, will have a strong impact on multifamily rents and will determine whether households choose to live with parents, live alone in an apartment, or double-up with other households.

Home prices. Home affordability is still bleak in Orange County and San Diego, which bodes well for the multifamily market in these areas. In areas such as the Inland Empire, however, high foreclosure rates have led to price declines that now make purchasing a home an attractive option to well-capitalized renters. The recent loosening of credit markets will encourage the transition to homeownership in affordable areas even more. Indeed, housing transactions have risen in recent months. The question that remains is whether there will be enough of a pipeline of young renters with new jobs coming into the market to fill the holes left by renters leaving apartments for homeownership.

Shadow market inventory. Residential rental inventory grew tremendously during 2008 and 2009 when homeowners looking to move found themselves unable to sell or unwilling to take a large hit to their equity. The increase in competition put significant downward pressure on rents in traditional multifamily product. Going forward, the impact of shadow market inventory is expected to be very different across the four metro areas discussed in this report. In Orange County and San Diego, shadow market rentals are not expected to have much impact on the multifamily market. The inventory is believed to be relatively small, and not competitively priced versus traditional multifamily product. In the Inland Empire, shadow market inventory is believed to be a more serious threat to the traditional multifamily market. It is also believed that speculators are buying up much of the distressed inventory in the area and are attempting to rent the units out as they wait for home prices to improve. If this is indeed the case, the shadow market may be putting significant downward pressure on rents and occupancy in that area.

Construction activity. Completions took another tumble in 2011, due in part to deteriorating market fundamentals in 2008-2009, and in part to the freezing of the market for construction loans. Orange County and San Diego took the biggest hits to supply, witnessing declines in deliveries of 92 and 84 percent, respectively. These incredible declines in supply will no doubt put upward pressure on rents and occupancy in the existing stock. In 2012, however, the Irvine submarket is expected to receive 2,800 new units. Sluggishness in the labor market could spell trouble for lease-up of the newly constructed units, and raise vacancy significantly for that submarket, if not Orange County as a whole. In the Inland Empire and San Diego County, most of the completions for 2011 and expected completions for 2012 are age- or income-restricted developments, so we could see some upward movement in those areas' market-rate, non-age-restricted product.

Rising Oil Prices. Oil/gasoline prices have risen sharply over the last several months, and with no end in sight to the political turmoil in the Middle East, the upward trend is likely to continue. Rising gasoline prices should generate higher demand for multifamily product closer to the economic centers of Southern California. Farther-flung submarkets such as the Antelope Valley of Los Angeles or Outer Riverside/San Bernardino may see declining rents as residents move closer to their workplaces and attempt to lessen the cost of their commute.

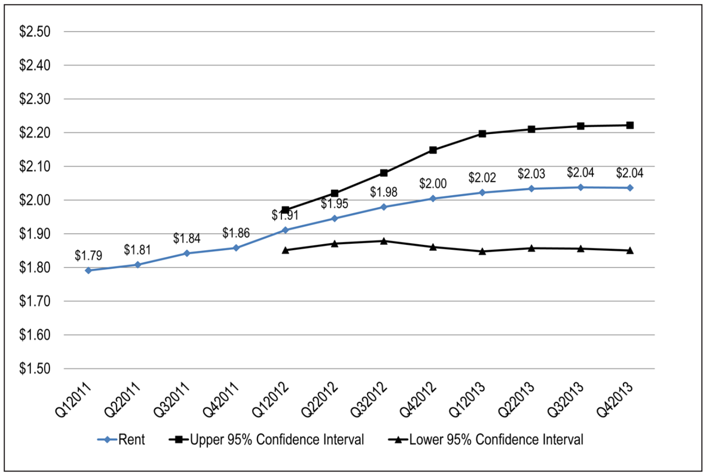
In summary, the interplay of these five factors will guide the future path of rents and vacancies. If Southern California follows the path of the nation as a whole in its macroeconomic recovery, we should continue to see strong performance in the multifamily sector. Should the area witness a hiccup in employment, or a sharp increase in supply in the next two years, or even more attractive conditions for homebuying, the metro markets could take a significantly different turn.

A Note on Confidence Intervals

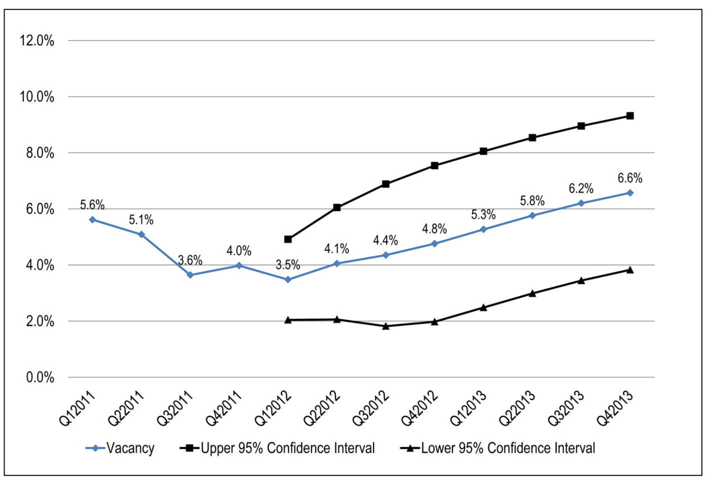
For the second year in a row, the Casden Forecast is reporting 95 percent confidence intervals on our forecast estimates. These intervals, depicted in the forecast graphs by black lines, represent the upper and lower bounds between which the "true" rent or vacancy rate is likely to fall with 95 percent probability. As the reader will observe, the confidence intervals are relatively narrow for Q1 and Q2 2012 and get wider as we move further into the future. In other words, accurately predicting the next quarter or two of rent is relatively easy; predicting beyond that with much precision is difficult. So even though we can rank the four metro areas in terms of the trends in the actual forecast estimates, the true realization may paint a very different picture.

Los Angeles Forecast

Forecast Average Rents for Los Angeles



Forecast Vacancy Rates for Los Angeles



The positives

- Renters have been moving out of shadow market inventory and back into traditional multifamily product. Although much of this has been by necessity -- due to foreclosures or sales of the shadow market properties -- many households simply have discovered that they prefer the amenities and lifestyle associated with living in traditional multifamily units. This trend is expected to continue through 2012.
- Completions were down 53 percent from 2011, to 2,483 units, and completions are expected to remain at that level for 2012. Only 32 of the units under construction are part of condominium re-positioning projects.

The negatives

- Per MPF Research, 35,000 to 40,000 jobs are expected to be created in 2012, but at the moment, the County has a large hole to dig itself out of based on the job losses already incurred in the first months of 2012.
- Home prices continue to fall and transactions are up. As a result, the Los Angeles County multifamily market may lose its most creditworthy renters to home purchases.

Other notes

The Intown submarket is expected to see the largest growth in supply at 0.5 percent. Hollywood is expected to come in second, with 0.4 percent growth in supply. The anticipated growth in supply for the metro area as a whole is 0.2 percent.

What the econometric model predicts

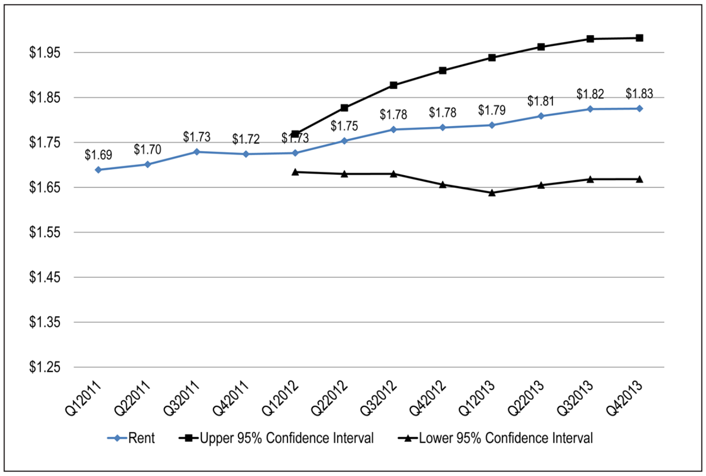
Our econometric modeling techniques report an increase in average rents of about 7.9 percent for 2012, and total growth of 9.6 percent through the end of 2013. Rents are expected to finish 2012 around $2.00 per square foot and 2013 around $2.04 per square foot. During 2012, vacancy could rise as much as 0.7 percentage points, and rise further in 2013 as rent growth slows.

Our "take"

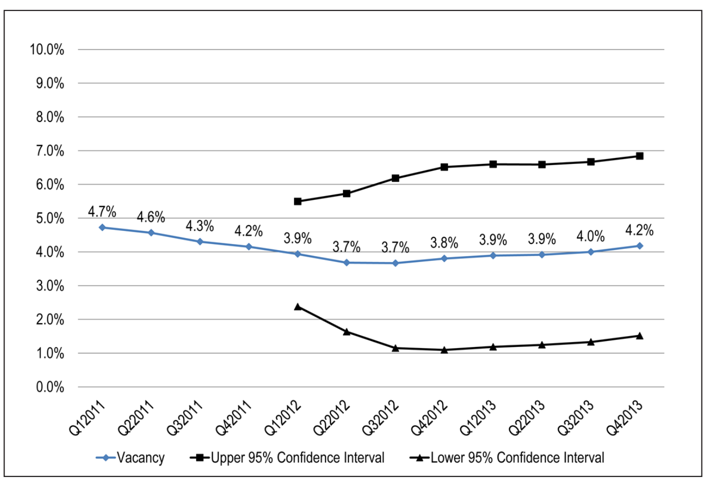
Although in the historical rent and vacancy series for Los Angeles, we do witness short periods of simultaneous rent and vacancy growth, such simultaneous upward movement is not sustainable in the long run. It should be noted that the average rents presented in the trends attempt to represent landlords' current rent structure (incorporating concessions) and exclude the impact of leases signed in previous quarters, so we should not see much of a lag between increases in vacancy and downward adjustment of rents. In the end, much will depend upon the employment picture and completions over the next two years. Completions will remain low relative to historic norms, keeping rents supported, but the benefits could get eaten away by a sluggish job picture. Although the rest of the nation has been generating jobs at a pre-recession pace, Los Angeles County has already recorded 20,000 seasonally-adjusted job losses in the first two months of 2012. With vacancy at 0.8 percentage points above the 2002-2007 average, there is room for improvement under stable-to-positive economic conditions, but the local economic picture is not looking good at the moment.

Orange County Forecast

Forecast Average Rents for Orange County



Forecast Vacancy Rates for Orange County



The Positives

- Home prices are the least affordable in Southern California by a wide margin. Any decline in home prices should not have much of an impact on multifamily demand or rents, at least in the short run.
- Shadow market competition is believed to be low and will remain so for the coming year.

The Negatives

- According to MPF Research, the area is expected to see the creation of 20,000 to 25,000 new jobs in 2012, but like Los Angeles, the County has started out the year in negative territory.
- Nearly 3,000 new units are expected to be delivered to the Orange County market in 2012 (a ten-fold increase over 2011), but these units are confined almost entirely to the Irvine submarket. Only Irvine (or "competitor" submarkets) should see an impact from these deliveries.

Other Notes

Irvine is expected to see the largest growth in supply among submarkets, with expansion of 7.3 percent. The metro level stock is expected to increase by 1.3 percent overall.

What the econometric model predicts

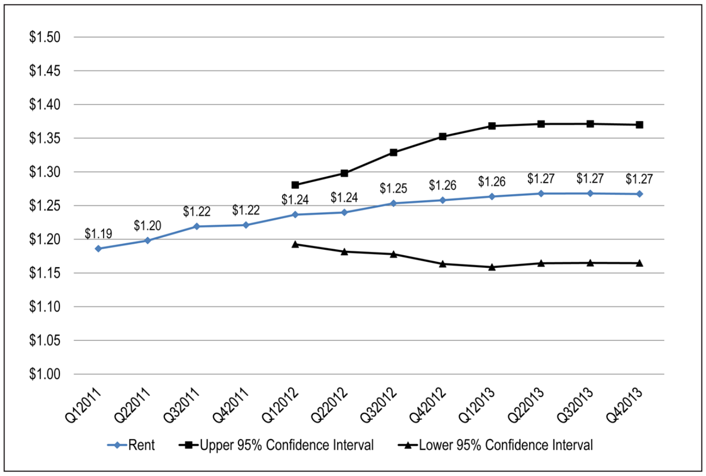
Our econometric modeling techniques report an increase in average rents of about 3.3 percent for 2012, and total growth of 5.1 percent through the end of 2013. Rents are expected to finish 2012 around $1.78 per square foot and 2013 around $1.83 per square foot. Vacancy is expected to remain relatively stable during this time.

Our "take"

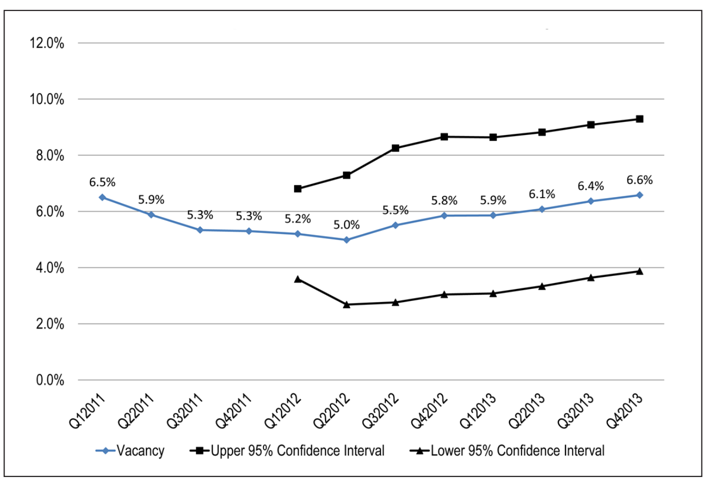
Orange County vacancy stands at about 0.4 percentage points above its historical average from 2002-2007, indicating room for improvement in vacancy under positive economic conditions. Like Los Angeles, the two biggest factors influencing the multifamily market are likely to be construction completions and employment growth. After a record-low year for completions, the multifamily stock is expected to increase substantially in 2012. Out of the 2883 units scheduled for completion in 2012, 1677 of these are expected to come on line simultaneously in October in Irvine Communities' Cypress Village. It would be quite surprising if this bump in supply did not generate a rise in vacancy around the time of completion even in the best of economic conditions. In the first eight months of the year, only 333 units are expected to come online, which bodes well for rents and vacancy rates in the county during that period. On the economic front, Orange County has also seen seasonally-adjusted job losses in the first two months of 2012 – fewer than Los Angeles, though, on an absolute and relative basis. If the employment picture does not turn around in the next two-to-three months, we should expect rising vacancy and much slower growth in rents.

Inland Empire Forecast

Forecast Average Rents for Inland Empire



Forecast Vacancy Rates for Inland Empire



The positives

- Completions are expected to fall for the second year in a row, to about 22 percent of their 2010 level
- All of the expected completions are age- or income-restricted projects, which cater well to the economic struggles of the area. No completions of market-rate product will help support rents and occupancy in that product type.

The negatives

- Per MPF Research, the area is expected to add 10,000 to 15,000 new jobs in 2012. But job creation in 2012 is currently behind the pace predicted by labor economists.
- Home prices are down slightly for 2011 and remain the most affordable in Southern California by a large margin. Improvements in the job picture could tip the scales in favor of purchasing a home rather than continuing to rent.
- Many of the homes sold in 2008-2010 went to investors who have put them back into the shadow-market rental pool while they wait for home prices to improve.

Other notes

The Southwest Riverside Submarket is expected to see the largest relative increase in supply, with expansion of 0.7 percent. The metro market as a whole is anticipating a 0.3 percent increase in supply.

What the econometric model predicts

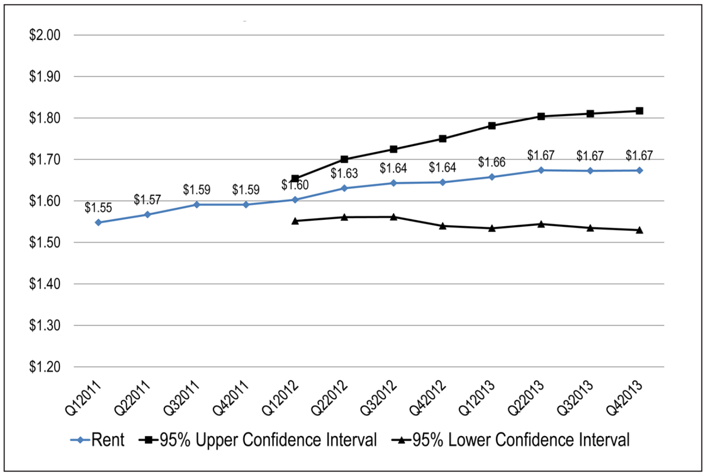
Our econometric modeling techniques report an increase in average rents of about 3.0 percent in 2012 and 3.8 percent total through the end of 2013. Rents are expected to finish 2012 around $1.26 per square foot and 2013 around $1.27 per square foot. Vacancy is expected to fall initially, and then rise by as much as 1.2 percentage points as rent growth begins to slow.

Our "take"

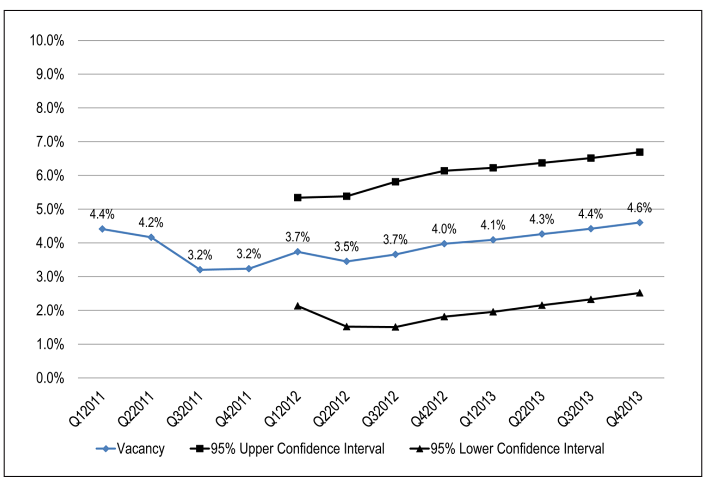
The Inland Empire, which was decimated by the economic downturn, remains the weakest market in terms of current rent and vacancy conditions, as well as expected future performance. With a vacancy rate at 1.3 percentage points above its historic 2002-2007 average, the area shows great opportunity for improvement under the right conditions. Unlike the other metro markets, the movement of home prices and shadow market inventory are expected to have a major impact on traditional multifamily vacancy and rents. With the housing market so slow to recover, investors in distressed housing have finally resorted to renting out their units in an attempt to generate cash flow. The longer it takes for housing prices to bounce back, the longer the shadow market inventory will play a negative role in the traditional multifamily market. On the construction side, the Inland Empire is the only metro market expecting a significant decline in completions for 2012. The 450 units expected for delivery represent a decline of 32 percent from 2011. The region has typically been a popular location for builders, and annual deliveries between 2002 and 2010 have averaged around 2800 units. The slow growth in supply should lead to a drop in vacancy, all else equal. On the employment side, the area has witnessed the creation of about 900 jobs in the first two months of 2012 on a seasonally-adjusted basis. While certainly better than the performance of Los Angeles and Orange County, this figure is off a bit from what labor economists have predicted in annual employment growth for the region. Overall, we expect rents to behave as our model predicts. The vacancy rate should exhibit steady improvement if job creation meets economists' predictions.

San Diego County Forecast

Forecast Average Rents for San Diego



Forecast Vacancy Rates for San Diego



The positives

- Completions will increase four-fold over 2011, but will remain about one-third below historic annual averages. Chula Vista/Imperial Beach submarket (for the second year in a row) is expected to receive the bulk of the 1,583 units expected for delivery, due to the behind-schedule completion of Greenfield Village's Garden Communities project.
- Home affordability is the second lowest in Southern California, keeping renters out of the homebuying market.
- Competition from shadow-market supply is low.

The negatives

- Per MPF Research, the San Diego submarket is expected to add 20,000 to 25,000 jobs in 2012, but like all of the other metro markets, it has already witnessed job losses in the first months of the year.

Other notes

- Chula Vista/Imperial Beach is expecting growth in supply of 2.4 percent, which is significantly greater than the 0.6 percent growth in supply at the metro level.

What the econometric model predicts:

Our econometric modeling techniques report an increase in average rents of about 3.4 percent in 2012 and 5.2 percent total through the end of 2013. Rents are expected to finish 2012 around $1.64 per square foot and 2013 around $1.67 per square foot. Vacancy is expected to fall initially, and then rise by as much as 1.4 percentage points as rent growth begins to slow.

Our "take"

The San Diego area is the only metro market with a vacancy rate below its historic average for 2002-2007, leaving little room for improvement except under very strong economic conditions. Like Orange County, completions are expected to rebound in 2012, but only to about two-thirds the annual average level from 2002-2010. Although economists expect the addition of 20,000 to 25,000 jobs in 2012, the area is already showing losses of 1900 nonfarm jobs on a seasonally-adjusted basis. One additional factor to consider that is unique to the San Diego market is the housing demand of military families. Although San Diego County is home to one percent of the US population, it is home to eight percent of the nation's military personnel. About 70 percent of military personnel participate in the Basic Allowance for Housing (BAH) program, which offers an allowance (based on local housing costs) for living in local, non-government housing. Cuts in the BAH, or cuts to defense spending more generally, will no doubt have a strong impact on the San Diego multifamily market.

Notes

Notes

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Marshall School of Business
Sol Price School of Public Policy