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Strong Multifamily Fundamentals Create a Safe Haven for REITs in SoCal

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The ratio of homeowners to renters across the nation has been on a steady decline over the last several decades. This has been particularly evident in Los Angeles and Southern California – and that is good news for multifamily REITs.

A study by the Pew Research Center noted renters represent approximately 37 percent of all households, a 50-year high and a 6-percentage point increase from 10 years prior. The metric in Los Angeles is even more startling. The U.S. Census Bureau estimated that less than 36 percent of Angelenos own their home. This represents the fourth-lowest percentage of home ownership among the 50 largest cities in the nation. Only Miami, New York, and Boston have a greater percentage of renters, while neighboring Long Beach ranked fifth on this list with nearly 38 percent of residents owning their homes.

Renter's Climate

Several factors lead to the increase in renters. Rising housing costs play the biggest role as more and more residents are priced out of home ownership. Real estate data firm CoreLogic projects that housing values will continue to rise through the end of the year and into 2019 (at the least). This suggests the ratio of those favoring renting over owning is unlikely to reverse. Rising interest rates will only make it more difficult for Americans to afford a home.

Other factors creating a "renter climate" include a shift in attitudes towards renting derived from the housing crash of 2008 and the mobility, independence, liquidity and flexibility that renting provides, which is particularly attractive to young adults. A survey conducted by Freddie Mac concluded that more than ¾ of Millennials believe renting is a better option than buying.

Multifamily Investors Love LA

This stable increase of renters is good news for multifamily REITs with Los Angeles, in particular, presenting a compelling investment location. As a gateway city, LA is highly appealing to capital. Population growth and strong employment, overall market stability, a thriving diversified economy, the durability of the income stream, and the low construction-to-existing-stock ratio, means market watchers have begun to see why Southern California is unlike other markets. REITs derive a large portion of their value in producing strong operating performance in their assets through maintaining high occupancy rates and strong rent growth; both evident in the Los Angeles market.

The region's strength is being driven by investors and occupants alike. On the investment side, institutions are looking to reduce the average age of portfolios, shedding older assets ('80s and '90s vintage) for newer product. When they do pursue older assets, it is with an eye to value-add, especially in well-located markets that can ensure an upside and extend the lifetime of the asset. Meanwhile, pension funds and advisers are looking for plays that are, in general, safer and more secure. However, they also are actively looking to beef up their urban-core and coastal-market holdings.

What's in Demand

REITS are seeking core and core-plus product in the form of large, well-located, and well-maintained properties. These types of assets are in much tighter supply than the value-add, 30- to 50-unit complexes that are prevalent in the Los Angeles metro area. Many of the largest REITs that own and operate in the Los Angeles region witnessed very few completed trades in 2018. They expect the same level of activity in 2019 as competition ramps up for the available core and core-plus properties that become available. Consequently, we have witnessed REITs' increased willingness to provide equity for third-party sponsors over the past couple of years. Many have also entertained joint venture opportunities.

Within the multifamily housing segment, the student housing sector is also appealing to many REITs as it has seen significantly increased activity and may be poised for considerable growth. Some REITs have enjoyed incredible success and more institutional investors are considering student housing to be a viable alternative. While the overall multifamily market is mainly driven by economic factors such as employment availability and job growth, people will often return to school during economic downturns. Enrollment in postsecondary colleges and universities is projected to increase 14% over the next five to six years, According to the National Center for Educational Statistics.

Certain investors might be reevaluating their portfolios in anticipation of possible changes envisioned by proponents of a repeal of Costa Hawkins, but others are taking advantage of the rich opportunities that exist in the multifamily sector throughout Greater LA. They recognize that, beyond the impact of any political environment, the strong fundamentals of the SoCal multifamily market shine through. When the dust begins to clear post-midterm elections, investors will find themselves freed of the current uncertainty – and with clarity restored.

Investors remain in good shape as the continued need for multifamily – whether for students starting or returning to school, young Millennials looking for flexibility, or families priced out of home-ownership – combined with the lack of readily-available space for development, bodes well for this product type. REITs are well-positioned to take advantage of the readily available capital and managerial acumen to translate this growth into increased value for their investors.