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LOS ANGELES MULTIFAMILY MARKET INSIGHTS

Greetings. If this is your first time receiving this newsletter, it is tailored specifically for apartment building owners who own/operate apartments in the Greater Los Angeles market. All content has been created by David Evans of the Kidder Mathews Multifamily Investments group, unless identified otherwise. Subscribers can expect to receive an email monthly keeping you updated on the most current events and data to help you make informed decisions in operating your multifamily properties.

THE RELATIONSHIP BETWEEN OVERSUPPLY OF NEW RESIDENTIAL DEVELOPMENTS, INCREASING VACANCY RATES, AND LOWER RENTAL DEMAND FOR CLASS C APARTMENTS

The demand for new residential housing construction may have created oversupply in primary markets in Los Angeles, causing the softening of rents where there is an imbalance of supply vs. renter demand. In markets such as West Los Angeles, Downtown LA and Inglewood, developers riding the coattails of commercial real estate development boom in gentrifying markets, is converging with a market cooldown. Rising costs of food, transportation and fuel is affecting consumers ability to pay top of the market rents, causing them to stay in their existing residence or move further east or south where rents are more affordable. This in turn, is causing new construction developments to offer incentives for new tenants to sign leases in exchange for discounted rent. For neighboring Class C multifamily, many owners are starting to feel the cooling demand when they have vacancies at their properties, which combined with the end of the county eviction moratorium arriving last month, many owners have already begun to experience.

What does this mean for owners of class C multifamily? It means that it may take longer to find qualified tenants, especially those willing to pay market rate for their units, especially when there are new construction properties near theirs offering attractive rent concessions.

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THE EFFECTS OF MEASURE ULA AND GS ON REAL ESTATE TRANSACTIONS IN LOS ANGELES AND SANTA MONICA

As of the writing of this article, there have only been seven sales (two of which were bankruptcy sales and one being a recapitalization), exceeding $5M in Los Angeles post April first when ULA was enacted.

In Santa Monica, where Measure GS was passed, only one transaction above $8M threshold has been sold since April 1st.

The passing of the law has concerned not only potential sellers of commercial real estate but buyers who have shorter holding periods as well. Furthermore, it has affected sales tax income that would be collected on property sales above $5M, instead of the city of Los Angeles (and Santa Monica) receiving one percent of the normal amount of sales transactions. From March 31, 2023, to March 2022, there were 425 CRE transactions exceeding $5M in LA and in Santa Monica there were 43.

In addition to the loss of transfer tax revenue that would have gone to the cities of Los Angeles and Santa Monica, the related industries that would have serviced these transactions have felt the slowdown. Title and escrow companies, the property management firms that would have taken on the new properties, and of course sales brokers and their firms.

The Howard Jarvis Taxpayers Association and the Apartment Association of Greater Los Angeles have filed lawsuits with the intent to repeal Measure ULA. The state court has combined their suits against the city of Los Angeles. In the meantime, it is not only the real estate industry, but the cities of Los Angeles and Santa Monica, which have suffered the loss in transfer tax revenue, which were earmarked for addressing the housing crisis in both cities.

WHY "GIVING IT TO YOUR KIDS" ISN'T ALWAYS THE BEST OPTION WHEN TRANSFERRING FAMILY WEALTH IN CRE

The Los Angeles multifamily market, with the exception of a few, has the lowest sales velocity in the United States. A fact that only varies slightly depending on the class of the neighborhood a property is located in and the condition of the property. In general, sales velocity ranges between two to four percent of the total inventory annually, meaning that if there are 100 buildings in an area, only two to four of them will sell in a given year.

Many owners hold on to these properties expecting their children to keep and operate it as they had but that doesn't always happen.

A significant percentage of those two to four percent of sales are due to an individual, or a family, inheriting an apartment building and deciding to sell it, taking advantage of the step up in basis (not being required to pay capital gains taxes the original owner would be subject to). Oftentimes they sell it for a variety of different reasons:

1. They would rather have a lump sum payment vs. whatever monthly cashflow the property is providing after expenses and management are paid.

2. The members of the family fail to agree on how to operate the property.

3. The inherited property has a significant number of repairs required, that would require more money than the property is producing.

4. State or local regulations make operating the property untenable for the individual or family.

THE DOWNSIDES OF LEAVING IT TO THE KIDS VS. SELLING IT WHILE YOU CONTROL THE ASSET:

1. The children may let the property fall into disrepair and fail to pay property taxes if you fall ill-their focus will be on taking care of you and not the property.

2. Thanks to prop 13 you benefit from a low tax basis. When there is a transfer of ownership, that benefit does not transfer to your heirs. The property then becomes subject to prop 19, which reassess the property value, increasing the property taxes.

3. While you may manage the property directly, unless your children are in the property management business, they will likely utilize third party management, which will further eat into their returns.

4. And unless you are charging market rate rent (or close to), it is unlikely that they will be able to increase rents at the property to market rate, unless there is significant tenant turnover.

Selling the property while you are alive puts you in control of the process and ensures that you will receive the highest price that the market will command vs. your heirs selling the property upon your passing and being subject to the market conditions of the time they decide to sell the property.

With the constant changes in the debt markets and local government regulation, property values fluctuate more frequently than in years past. Contact our team by phone or email to obtain an no obligation valuation on your property.

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