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Why Multifamily Will Continue To Have Legs

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COSTA MESA, CA—Millennials are not looking for their piece of the rock like previous generations did—and many wouldn't qualify for a home loan even if they were, say panelists at RealShare Orange County.

Warren Berzack comments on the continued demand for housing and the future of multifamily in Southern California.

COSTA MESA, CA—Millennials are not looking for their piece of the rock like previous generations did—and many wouldn't qualify for a home loan even if they were, said panelists at RealShare Orange County here Tuesday. These are among the many factors that make for a continued robust **multifamily** market—particularly in Orange County, where home prices are high.

Speakers on the panel, **"Multifamily: On the Rise or at its Peak"** were consistent in their appraisal of the market as far from over, although it depends which market you're looking at, said Gary Goodman, SVP | acquisitions for PASSCO Cos. LLC. Goodman said the largest group of Americans is age 23, and they have college debt and are waiting longer to marry and have children, which means they tend to rent apartments for longer than previous generations did. "There are a lot of structural changes going on in multifamily that bode well for the industry—we have a long way to go."

Chuck Packard, CFO for Pacific American Real Estate Development, said that regulations like Dodd-Frank will limit lending for home mortgages, which is good for multifamily. He added that "Millennials are not looking for their piece of the rock like we did," another good sign for the sector.

Moderator Bob Champion, founder, president and managing director for Champion Real Estate Co., said the market is strong because there's "still tremendous undersupply." He added that we could be looking at multiple cycles at work, with the end of a credit super-cycle near.

With a nod to Brexit, Packard said, "We forget that we're a global community, and what happens there affects us and vice versa." That said, he added, "I believe apartment owners today will do well in the next three to five years."

Stephen Anderson, director of investments for CityView, said if you can get into those markets west of the I-405, you're in good shape, and he added that there's a reurbanization going on in Orange County. "You have to do a lot of land-use gymnastics to do development deals in built-out markets."

With regard to cap rates, panelists said they range from 3% to 5% in this market, with vacancy rates of 3% or lower in some areas. "There's definitely a demand for housing," said **Warren Berzack**, a principal and national director of the multifamily advisory group for **Lee & Associates**.

Goodman said a lot of people forget what cap rates represent, which is rental growth. “The expectation that rental rates will increase dramatically” is not necessarily realistic. “Cap rates don’t necessarily have to go up.”

Packard said, “We are at a new normal. If interest rates rise and cap rates rise, we will pay more for units because of the supply/demand curve.” He added that he believes cap rates will remain level or adjust downward.

Anderson said unit mix is extremely important to his firm; all one-bedroom units in a community are a red flag because one-bedrooms are the most expensive to rent. He added that in many cases, even if the renter is making six figures, they prefer to share a two-bedroom with a roommate than to bear the expense of a one-bedroom.

Regarding new areas of opportunity for multifamily in Orange County, Packard said definitively, “There are no new niche areas in Orange County that haven’t been exploited yet.” Anderson mentioned Dana Point, but few other options were listed. Champion said one of the problems in multifamily is, “We’re all building to the class-A renter, but the average renter can’t afford class-A” in many coastal markets like Orange County.

In discussing value-add multifamily, Goodman called the concept “a head scratcher. In most cases, you’re paying the seller for value that you’re going to add, and you’ll get caught with your pants down in a recession because the property is a lot older” than other developments in the market. “Value-add is a little oversold.” He added that a lot of people have backed off from buying core assets.

With regard to debt and equity, most panelists said 60% to 65% leverage is the way they typically operate, although Packard said his firm was hoping for 80% leverage but is now looking at 50% equity, which is “more realistic.” In closing, he said Orange County still has significant multifamily growth going forward. “Young people need a place to live; the apartment market will continue to grow in Orange County, and Orange County real estate will grow, even in the event of a recession.”