Multifamily Research Market Report

Marcus & Millichap

First Quarter 2018

Orange County

Investors Harvest Crop of Listings; Development Remains Robust

Demand drivers support tight vacancy during a rise in large-scale construction. Orange County's apartment inventory expanded by 6,000 units last year, the largest annual delivery total in at least 20 years. Properties comprising more than 300 rentals accounted for most of this new supply, including a group of projects in Irvine and Anaheim, yet these communities' impact on overall vacancy was minimal. Instead, continued job creation and household formations underpinned demand for rentals while home prices remained out of reach for most residents. This translated to historically strong absorption, which held metrowide vacancy at or below 4 percent for a fourth straight year.

Metro positioned for second wave of deliveries. Developers will finalize more than 5,000 apartments this year, with completions concentrated in Anaheim, Huntington Beach and South Orange County. Strong wage growth and an uptick in professional service-related jobs bodes well for luxury rental demand; however, the influx of new units moderately increases metrowide vacancy. A second year of rising availability prompts property managers to offer incentives at new properties and nearby Class A complexes. Overall, tight Class B and C vacancy negates a rise in concessions, allowing year-over-year improvement in rent growth.

Multifamily 2018 Outlook

5,100 units will be completed

Construction: Completions remain heightened though slightly below last year's cyclical peak. Anaheim and Huntington Beach each welcome more than 1,000 units.

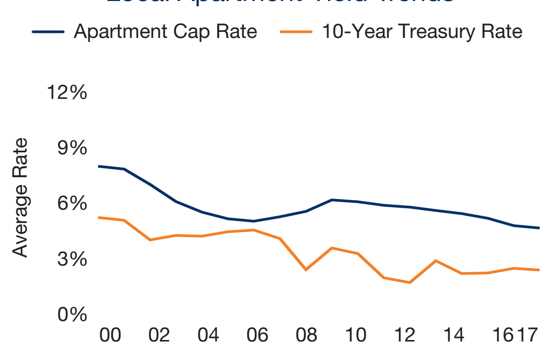
50 basis point increase in vacancy

Vacancy: A second wave of deliveries place upward pressure on vacancy in 2018. The rate reaches 4.5 percent after last year's 30-basis-point increase.

4.7% increase in effective rents

Rents: The average effective rent reaches $2,108 per month, a 4.7 percent gain following last year's 3.5 percent rise.

Local Apartment Yield Trends



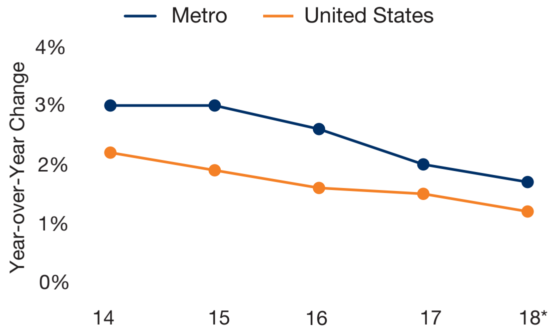
Sources: CoStar Group, Inc.; Real Capital Analytics

Investment Trends

- A mix of Southern California buyers covet opportunities to acquire value-add assets in Orange County while metrowide Class C vacancy remains under 3 percent and above-average rent gains persist. Investors in the $2 million to $5 million tranche focus on the market's ample supply of 1960s- to 1980s-built properties that produce solid NOI growth following specific amenity and in-unit upgrades.
- This past year, North County had the most Class B acquisitions along with a host of older sub-30-unit listings that netted low-3 to low-5 percent yields. Higher-quality properties trade most frequently in Fullerton.
- Buyers seeking affordability gravitate to Santa Ana and Anaheim. Here, Class C properties generate mid-3 to high-4 percent cap rates. In the coastal communities of Costa Mesa and Huntington Beach, investors accept minimum returns in the 2 percent range and pricing that exceeds $400,000 per unit.

4Q17 – 12-MONTH PERIOD

Employment Trends

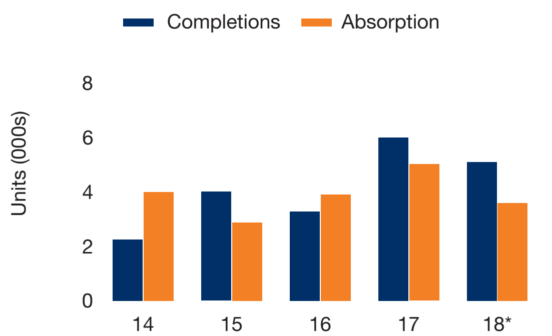


EMPLOYMENT:

1.7% increase in total employment Y-O-Y

- Employers added 31,900 positions over the past 12 months as sub-3.2 percent unemployment prevented a higher level of job growth. Organizations bolstered staffs by 40,200 workers during the previous period.
- The hospitality and construction sectors drove recent hiring via the creation of 13,700 jobs, offsetting the loss of nearly 1,400 manufacturing positions.

Completions and Absorption

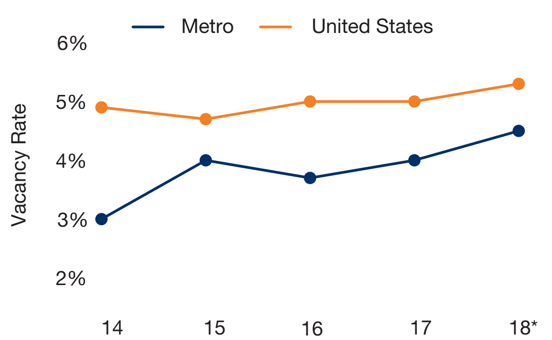


CONSTRUCTION:

6,000 units completed Y-O-Y

- The delivery of 6,000 rentals in 2017 represented the largest annual total spanning the past two cycles, eclipsing the 3,300 apartments finalized during the previous period. Irvine recently welcomed 2,000 new rentals, including the 583-unit Westview.
- Construction is underway on 6,600 rentals with completions extending into the second quarter of 2019.

Vacancy Rate Trends

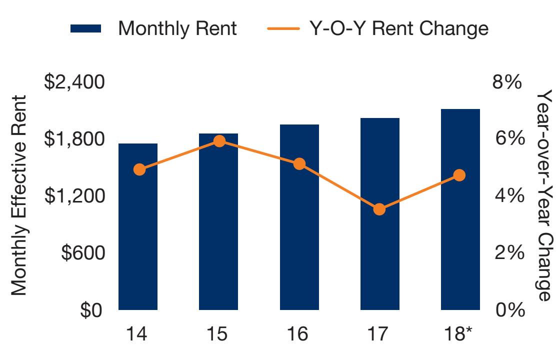


VACANCY:

30 basis point increase in vacancy Y-O-Y

- The elevated pace of deliveries outpaced the absorption of 5,000 units, lifting vacancy to 4 percent.
- Vacancy adjusted minimally in the metro's tightest submarkets, with availability in Buena Park/Cypress and Santa Ana sitting at 2.3 percent and 3.0 percent, respectively. Mission Viejo/Lake Forest recently recorded a dip of 50 basis points, lowering vacancy to 5.1 percent.

Rent Trends



RENTS:

3.5% increase in effective rents Y-O-Y

- Following a 5.1 percent gain during the previous 12-month period, the average effective rent rose to $2,013 per month in December.
- Rent growth was led by the Garden Grove/Westminster submarket, where it rose 7.8 percent to $1,721 per month. Entering 2017, the local vacancy rate was 2.1 percent.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*

37,600

4Q17 POPULATION AGE 20-34
(Percent of total population)

Metro 21.4%

U.S. 21%

4Q17 MEDIAN HOUSEHOLD INCOME

Metro $83,425

U.S. Median $58,714

FIVE-YEAR HOUSEHOLD GROWTH*

50,000

POPULATION OF AGE 25+
PERCENT WITH BACHELOR'S DEGREE+**

Metro 31.3%

U.S. Average 29%

4Q17 TOTAL HOUSEHOLDS

49% Rent

51% Own

* 2017-2022

**2016

*LOS ANGELES -LONG BEACH-ANAHEIM, CA METROPOLITAN STATITICAL AREA

SUBMARKET TRENDS

Lowest Vacancy Rates 4Q17

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Buena Park/Cypress	2.3%	10	$1,698	4.4%
Santa Ana	3.0%	-10	$1,956	3.8%
West Anaheim	3.3%	80	$1,606	2.1%
Costa Mesa	3.4%	40	$2,010	1.7%
South Irvine	3.6%	0	$2,515	5.0%
Huntington Beach	3.7%	-10	$1,987	3.5%
Garden Grove/Westminster	3.8%	170	$1,721	7.8%
North Orange County	3.8%	0	$1,783	0.6%
Tustin/West Santa Ana	3.8%	80	$1,881	4.2%
East Anaheim/Orange	4.0%	30	$1,914	4.8%
Fullerton	4.0%	80	$1,711	2.9%
Overall Metro	**4.0%**	**30**	**$2,013**	**3.5%**

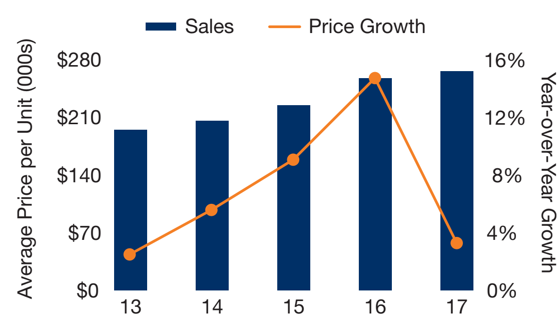
SALES TRENDS

Buyer and Seller Expectations Align; Class C Plays Steer Deal Flow

- Following a two-year span during which the average pricing escalated by roughly 25 percent, more owners opted to list properties in 2017, equating to a nearly 12 percent rise in sales activity.
- Investors recently paid an average of $266,000 per unit, a year-over-year rise of 3.3 percent, marking a slowdown in multifamily pricing. The average cap rate held at 4.4 percent amid the subdued increase.

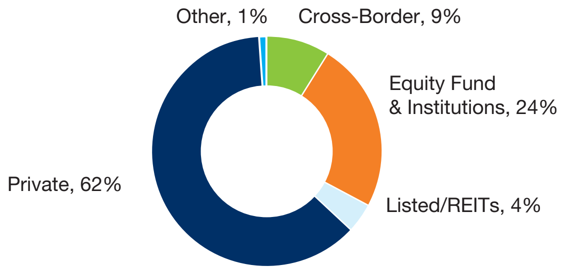
Outlook: Buyer competition heats for value-add assets in the metro's largest inland and coastal communities, prompting owners to list while pricing remains elevated.

Sales Trends

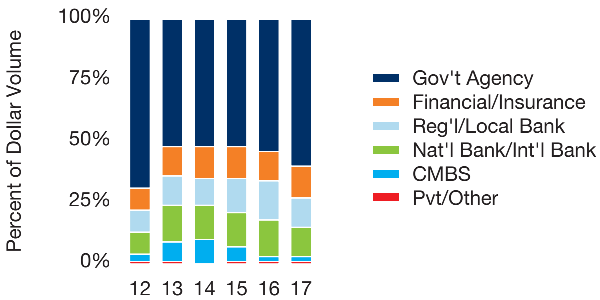


Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

2017 Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



Include sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- **Fed raises benchmark interest rate, plots path for additional increases.** The Federal Reserve increased the federal funds rate by 25 basis points, lifting the overnight lending rate to 1.5 percent. While the Fed noted that the inflation outlook had moderated in recent months, an upgraded economic forecast factoring in recent tax cuts and a rollback in regulation strengthened growth projections for the next two years. As a result, the Fed has guided toward two additional rate hikes this year, while setting the stage for as many as four increases in 2019.
- **Lending costs rise alongside Fed rate increase.** As the Federal Reserve lifts interest rates, lenders will face a rising cost of capital, which may lead to higher lending rates for investors. However, in an effort to compete for loan demand, lenders may also choose to absorb a portion of the cost increases. While higher borrowing costs may prompt buyers to seek higher cap rates, the positive economic outlook should provide rent growth that outpaces inflation over the coming year. As a result, sellers remain committed to higher asking prices, which has begun to widen an expectation gap as property performance and demand trends remain positive.
- **The capital markets environment continues to be highly competitive.** Government agencies continue to consume the largest share, just slightly over 50 percent, of the apartment lending market. National and regional banks control approximately a quarter of the market. Global markets and foreign central banks are keeping pressure down on long-term interest rates. Pricing resides in the 4 percent realm with maximum leverage of 75 percent. Portfolio lenders will typically require loan-to-value ratios closer to 70 percent with interest rates in the high-3 to mid-4 percent range. The passage of tax reform and rising fiscal stimulus will keep the U.S. economy growing strongly and rental demand will remain high with the national apartment vacancy rate at 5 percent at the end of 2017.

National Multi Housing Group

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; National Association of Realtors; Moody's Analytics; Real Capital Analytics; Real Page Inc.; TWR/Dodge Pipeline; U.S. Census Bureau