INVESTORS PUT THE 'WORK' IN WORKFORCE HOUSING

The multifamily markets is undergoing a shift out West where focus has turned to B and C class properties, also dubbed "workforce housing."

By Nellie Day

Multifamily has been the darling of commercial investment for some time now. This started during the subprime mortgage crisis in 2007 when homeownership was either snatched away or moved even further out of reach for many out West. Now 10 years removed from the Great Recession that followed, the buy-versus-rent debate still rages on. Except the economy is strong today, unemployment is low, GDP growth is steady and job creation continues.

The tide is starting to turn, however.

"For much of the recovery, investors enjoyed strong gains from solid rent growth across the higher-end apartment market," notes CBRE's latest Los Angeles and Orange County MarketFlash report. "As the cycle matured, the market became saturated with Class A apartments and yields on expensive dwellings were squeezed to historic lows…Smaller gains in the high-end space, coupled with a lack of affordable housing, shifted investor attention to older, less expensive Class B and C apartments [known as] workforce housing, where rent growth surged in 2015 and has been outperforming Class A product since."

The report goes onto cite that Class A apartment rents in Los Angeles have climbed 41.4 percent since 2010. This pace of year-over-year rent growth had slowed to 2.5 percent by the third quarter of 2018. Workforce housing rents, meanwhile, increased 3.5 percent year-over-year in that same quarter.

Much of the workforce housing supply out West consists of older (pre-2000s), Class B and C garden-style properties in a metro's suburban communities. Many of these buildings have not undergone significant renovations, making them a prime target for value-add investors. In fact, investors spent $1.5 billion on workforce housing in Los Angeles in the third quarter of 2018, CBRE notes, representing a 43 percent increase from the same time one year ago.

This could be a good bet, as one-year returns for garden-style assets in Los Angeles averaged 10.5 percent in the third quarter of 2018, according to the National Council of Real Estate Investment Fiduciaries (NCREIF). This is nearly double the returns achieved in the overall multifamily market, which equaled 6.6 percent.

Marcus & Millichap's 2019 Multifamily North American Investment Forecast points to a similar conclusion.

"Much of the new demand will center on apartments that serve the traditional workforce: Class B and C properties," the report notes. "The most affordable segment of the market, Class C apartments, faces strong demand and vacancy for these rentals is expected to tighten to 3.9 percent, its lowest year-end level in 19 years."

Douglas Emmett is addressing the workforce housing issue by converting a 25-story office building in downtown Honolulu into a 500-unit workforce housing project. The apartments will serve families in the 80 percent to 120 percent average median income range.

Southern California Tackles Affordability Issue

It's not surprising that demand for workforce housing is at an all-time high in Los Angeles. The county only has about 928,000 workforce housing units, something investors like Universe Holdings hope to improve upon. The privately held multifamily investment, ownership and management firm acquired a 15-unit community in Inglewood for $3.8 million in January through Chateau Park Casino Royale V.

The asset was built in 1962 and has never been renovated. Located at 232 W. Olive Street, the community is about five minutes from the Hollywood Park redevelopment and the new NFL stadium. It is also centrally located to employers like Los Angeles International Airport (LAX), Centinela Hospital and the tech industry in Silicon Beach.

Henry Manoucheri, CEO of Universe Holdings, identified Inglewood as a strong multifamily market two years prior to the Rams' decision to build the new stadium complex.

"A lot of investors shied away from Inglewood, but what we saw was a high-density community with a large inventory of workforce housing in a submarket located adjacent to markets where rising rents are pricing many people out," he says. "We also saw stable occupancy and the opportunity to acquire a number of value-add properties. For us, the size of the properties was not a concern. We have properties ranging in size from 15 to 50 units. We believed in what we were doing and time has proven us right."

This marks the fund's ninth Inglewood acquisition over the past four years. Universe plans to double its footprint in the area in 2019. This begins with implementing a significant capital improvement program to bring the latest acquisition's exterior and interior units up to modern standards, on par with newer product in the market. Universe is timing these renovations to coincide with the opening of the new stadium and entertainment complex.

"We take pride in investing millions of dollars in improvements in our properties elevating our tenants experience, lifestyle and creating jobs in Inglewood," Manoucheri says. "Our continuing goal is to provide affordable, high-quality workforce housing for a community we're in for the long haul."

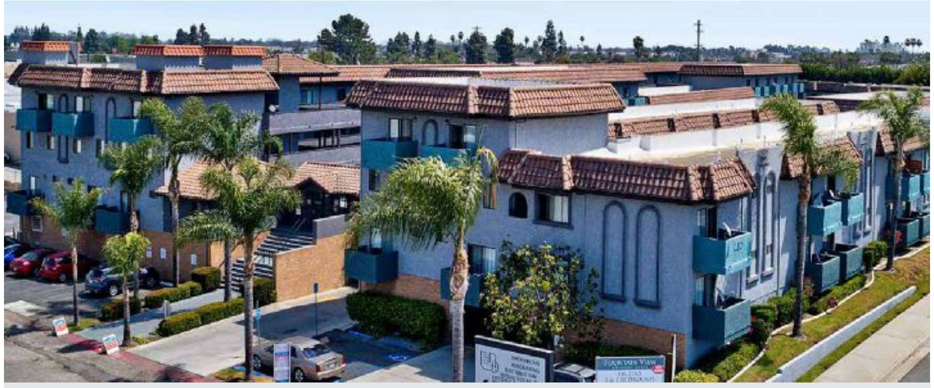
Canyon Partners Real Estate LLC is taking a similar approach. Its Multifamily Impact Fund platform seeks to enhance multifamily properties by making material, long-term capital improvements and instituting social impact initiatives in low- and moderate-income communities across the United States. Its latest fund, Canyon Multifamily Impact Fund III LLC (CMIF III) – a joint venture between Canyon and CIT – is targeting opportunities in Southern California where there is an opportunity to invest in the betterment of the communities in which CIT serves.

This includes the 153-unit Fountain View Apartments in Long Beach, which the fund purchased in December. Capital improvements will enhance the asset's fitness center and outdoor areas, with select units receiving additional renovations. The fund will also institute a variety of social impact programs at the Fountain View Apartments. CIT's Real Estate Finance business provided a $26 million senior loan to fund the acquisition, as well as these improvements.

"The acquisition of the Fountain View Apartments represents CIT's commitment, through CMIF III and Canyon, to create quality workforce housing in Southern California located in close proximity to transportation, employment, education and healthcare," says Mike Pedone, a managing director in CIT's Real Estate Finance group. "Our improvement plans for the property will help enrich the lives of its residents. We are proud of the positive impact CMIF III will have on this community."

Though value-add opportunities are one way to enter the workforce housing space, they aren't always free flowing, especially in land-locked places like Southern California. That's why AMG & Associates, in partnership with Pacific Companies and Jamboree Housing, is building it instead. The partners recently completed a 99-year ground lease for a 6.84-acre affordable housing development project in Santa Ana that is valued at $287 million.

The ground lease incudes three parcels at 2110, 2114 and 2020 East 1st Street that will eventually contain two, six-story buildings totaling 552 workforce housing units and about 10,000 square feet of ground-floor retail space. Once complete, the project will be one of the largest affordable housing projects in California. Construction is expected to commence around April. The lessor, Broomell Commercial Properties, was represented by David Knowlton and Kirby Greenlee of NAI Capital's Irvine office.



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"This important project will help alleviate the chronic shortage for affordable housing in Santa Ana and the surrounding communities," Knowlton asserts.

Communities Take Care of Their Own

Another state facing a serious affordable housing crisis is Hawaii. Its location and topography create natural barriers to entry, along with challenges that include increased costs. This makes it all the more important for investors to provide housing options to all island residents. Douglas Emmett is addressing this issue by converting a 25-story office building in downtown Honolulu into a 500-unit workforce housing project. The apartments will serve families in the 80 percent to 120 percent average median income range.

"The Douglas Emmett team is focused on addressing the critical need for workforce rental housing in Hawaii, and we are working hard to get through the planning and permitting process so we can begin the conversion," says Jordan Kaplan, Douglas Emmett's president and CEO. "Bringing hundreds of new residents into the Central Business District will also contribute significantly to transforming downtown Honolulu into an active 24-hour community."

The new apartments will be located at the corner of Bishop and Hotel streets near the center of downtown. While projects of this kind are much needed on the islands, plans to convert vacant office space to apartments is a process that is expected to take several years. The first apartments are currently scheduled to be occupied in 2020.

"We need to build more attainable housing options for local residents," adds Honolulu Mayor Kirk Caldwell. "Douglas Emmett's plans to convert an office building into workforce rentals demonstrates the type of creativity and commitment our community needs to solve our housing crisis and ensure a vibrant future for the downtown area for generations to come."

Hunt provided a $34.4 million Freddie Mac Loan to finance the construction of the Village of Wintergreen, a 156-unit workforce housing project in Keystone, Colo., this past August. The mixed-income, workforce housing community will offer a number of housing types to a variety of income levels.

While Douglas Emmett tackles affordability in Hawaii, Hunt Real Estate Capital is focusing on the Southwest and Mountain States. The loan servicer and originator provided a $34.4 million Freddie Mac Loan to finance the construction of the Village of Wintergreen, a 156-unit workforce housing project in Keystone, Colo., this past August.

The mixed-income, workforce housing community will offer a number of housing types to a variety of income levels. Construction commenced in July, with conversion projected for June 2020. This is one of the first Freddie Mac non-LIHTC Forward Permanent Loans intended to facilitate the development of workforce housing that falls outside the Low-Income Housing Tax Credit program. The loan is a 15-year fixed rate cash loan with a 30-year amortization schedule after a 12-month interest-only period. The borrower is Gorman & Company LLC.

"The workforce housing is set aside in the area for individuals who are working year-round in Summit County as housing supply is in dire short supply and constantly being reduced," says Tim Hoppin, director at Hunt Real Estate Capital. "Due to high construction costs, and the recent growth of AirBnB and VRBO, affordable housing has become more of a crisis in an already burdened community."

The year-round workforce housing will be an important housing product for this market, as there is strong demand for workforce and affordable housing for permanent and seasonal workers in the area. The Village of Wintergreen will be accessible to nu-

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