Predictions for the Apartment Market – 2009 to 2021
by Phillip J. Oh, CCIM

Where will the apartment real estate market be in the next two years or even the next six years and how will this affect your investment or retirement plan?

We are all aware of the present housing real estate market which started in 2006. Many economists are predicting when it will reach the bottom and what percentage of value it will lose from the previous peak value. I have not seen any articles predicting the apartment real estate market with actual data so… I will provide you with that data so you can decide your next investment plan or retirement plan.

First, let us look at what people think affects or causes of the up and down cycles in the real estate market.

Interest Rates
1973 to 1980 - Interest rates were up and prices went up
1990 to 1997 - Interest rates declined and prices went down.
1997 to 2002 - Interest rates were low and prices went up.
2006 to 2008 - Interest rates declined to historical rates and prices went down.

So, it is not true that when the interest rate is low the price is high or vice versa. There is no correlation between the interest rate and real estate price.

Affordability
High affordability is a sign of a depressed real estate market such as we are in now and people do not buy even if the price is lower than the previous price. Let me repeat here! People are not buying even if the price is lower than in 2005-2006. (In Los Angeles County the average of price of homes lost 35% - 45%) Low affordability is a sign of high prices and people do buy, because they think prices will keep going up. So, affordability works opposite of what people think and what the California Realtors Association said.

Unemployment
In 1990, the real estate market was in the beginning of a down cycle. According to the U.S. Bureau of Labor Statistics in 1990, the California unemployment rate was 5% and increased to 10% in 1993 to 1994. In 2007, another down cycle, unemployment was at 5%. Now in 2009, we are at 10.9%.

Migration
(Limited to Los Angeles County only.) According to the California State Department of Finance Demographic Research Unit, in years 1995 to 1999 Los Angeles County lost 267,863 people to other states. In 2000 we had the first small gain of migration from other states. But in 2003 we lost 59,483, in 2004 we lost 88,097, in 2005 we lost 114,794, in 2006 we lost 126,481 and in 2007 we lost 100,384.

Apartment Units Sold in Los Angeles County
According to Los Angeles County Recorder's office, there were about 500 properties sold in 1990 to 1995. It picked up the pace in 2000 with 2,550 buildings and thereafter it went up to 3,398 in 2003 and slowed down again in 2004 to 2007. In 2008 there were only 630 properties sold in Los Angeles County.

Capitalization Rate (CAP) and Gross Rent Multiplier (GRM)

(*Note: CAP and GRM: Source Costar Com*)

Year	Apt. Bldgs Sold	CAP Rate %	GRM
1990-1995		7-12	8-10
1995-1998		8-9	9-10
2000	2,550	7.5 - 8.0	9-10
2001	2,733	6.5 - 9.0	9-10
2002	3,398	6.0 - 6.5	10-11
2003	3,396	5.5 - 6.0	10.5-11
2004	1,658	4.5 - 5.5	11-14
2005	1,273	4.5 - 5.5	12-14
2006	1,072	4.0 - 5.0	12-14
2007	802	4.0 - 5.0	12-14
2008	630	5.0 - 6.0	11.0
2009	Projection	6.5 - 7.5	9-10
2010	Projection	9.0+	8-10
2011	Projection	11.0+	?

My research is limited to Los Angeles County, exclusively 5 to 50 units. All other counties' data is available in the source mentioned above and I believe there are many similarities in all southern California counties.

There is a lot of other data we can compare, discuss and look at it, but in my opinion there are Three categories that really affect the real estate cycle.

1. Unemployment data
2. Migration of people leaving or coming to California.
3. CAP and GRM

Below are other comments and data I discovered:

"The commercial real estate crunch will be a repeat of the housing meltdown. It will begin as a slow bleed that will gain momentum and will likely spread evenly across the nation. ***Source: Allenbaugh Samini Ghoshethllp, May 20, 2009.***

The first sub-prime mortgage rate resets were in 2007 to 2008 and look at what happened to the housing market. Next Alt-A mortgage rate is due to reset in 2010-2011. ***Source: Credit Suisse***.

"End of the first quarter of 2009, $4.3 billion in nonperforming loan in multifamily." That's just the first quarter of this year! ***Source: The nation's FDIC-insured Bank.***

Apartment market conditions continue to worsen, "This global downturn has led to the most challenging economic conditions in at least five decades, and the apartment industry is suffering like other industries," noted Mark Obinsky NMHC's Chief Economist. May 2009. ***Source: National Multi Housing Council's (NMHC).***

Nearly $14 billion delinquent/unpaid loans and delinquencies are up 270% (03/09 vs. 03/08). Total unpaid CMBS (Commercial Mortgage Back Security) balance is at $843 billion. ***Source: Realpoint.***

Also, interesting to note is that our national gross domestic product in 2008 was negative 6.5% from previous adjusted annual rate and in year 2000, it was also negative. ***Source: Bureau of Economic Analysis.***

<u>So, What Should YOU Do?</u>

If you are planning to sell within the next six years, I would recommend selling now, as prices will continue to decrease. If the history repeats itself, capitalization rates should increase and gross rent multipliers (GRM) should decrease and stay at the bottom for the next two to three years - gradually increasing in small increments from 2015 to 2019 and peaking in 2020-2021.

Back in 2003 and 2004, I recommended my clients sell these properties or carry back the financing as lenders. Those who have made the adjustments are in a great position. My clients who sold high paid their capital gain tax (15%) and state franchise tax (rate varies depend on your income). This was a wise choice because their property values declined an average of 30%. Those clients who did an owner carry-back received a large down payment, deferred the capital gains tax payment and a have a positive cash flow every month.

Phillip J. Oh, CCIM is with AOA's Commercial Brokerage division. He has over 23 years of experience in commercial real estate acquisition and disposition and leasing. Phillip has an undergraduate degree in electrical engineering with a background in law and strongly believes in the multi-disciplinary and collaborative networking strategies to give the best possible service and meet the needs of each client. He is an active member of the CCIM, the National Realtor Association and Commercial Brokerage Profession and has worked in the diverse areas of southern California, Oregon, Washington and Nevada.