



Multifamily Report

Q3 2017
GALLELLI REAL ESTATE MARKET REPORT

Overview

Despite a slight uptick in vacancy, local rents continued to climb during the third quarter of 2017, as the region's continuing lack of new supply and increasing levels of demand keep pushing rental rates up. Investor demand in the region remains strong, and Q3 saw the sale of one of the newest multifamily projects in Downtown.

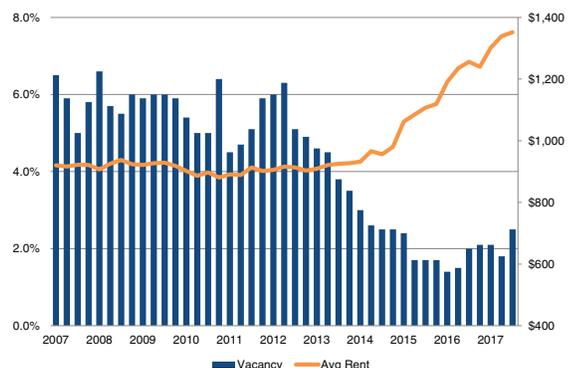
Market Trends

- Regional apartment vacancy increased from 1.8% to 2.5% during Q3. Vacancy rates have hovered within the 1.0% to 2.5% range for the last ten consecutive quarters. Year-over-year, vacancy rates have increased from 2.0% to 2.5%.
- The overall average asking rent for complexes 40 units and over jumped \$20 over the last three months, increasing from \$1,339 to \$1,359 per month. The Sacramento remains first in the nation for year-over-year rent growth, a distinction it has held for the last 16 months. Local rents have increased 8.2% over the last 12 months and 48.8% over the last five years.
- Unemployment within the Sacramento-Roseville Arden-Arcade MSA (Sacramento, Placer, El Dorado & Yolo Counties) fell from 5.2% in August 2017 to 4.5% in September 2017. This compares with an unemployment rate of 4.7% for California and 4.1% for the nation. One year ago, Sacramento's unemployment rate stood at 5.0%. Year-over-year job growth is up, with the region adding 17,900 jobs between September 2016 and September 2017.



- Year-to-date, the market has seen only 417 units delivered in total, with 2,351 units currently under construction throughout the region – 523 in the Downtown CBD market and 1,828 in the Suburban markets, 743 of which are slated to be completed by the end of the year. 2017 is on track to deliver just 1,160 multifamily units in 2017. Though the region has added an annual average of 22,000 residents over the last five years, multifamily construction has remained stalled.
- Local rental rates continue to climb across the board; however, they still do not justify the rising costs of ground-up construction, except in markets such as Downtown/Midtown, Roseville Rocklin, Folsom, and Davis, where rental rates are much higher than regional averages.

Historical Vacancy & Average Rental Rate Growth



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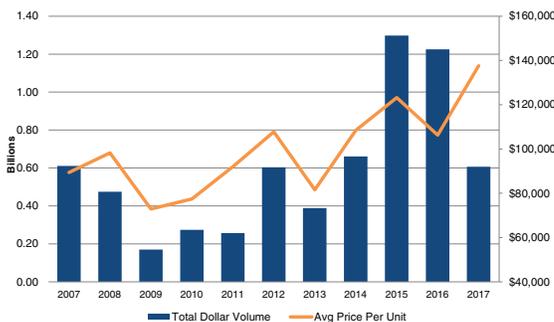
Available quality assets are starting to become a tough find in the region.

<p>Vacancy</p> <p>2.50%</p> <p>▲</p>	<p>Avg. Asking Rate</p> <p>\$1,352 UNIT</p> <p>▲</p>	<p>Avg. Rent PSF</p> <p>\$1.60 PSF</p> <p>▲</p>
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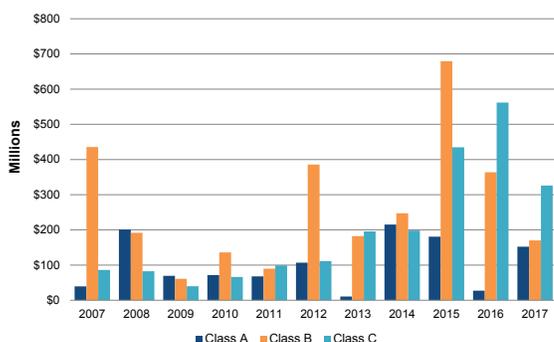
Investment Highlights

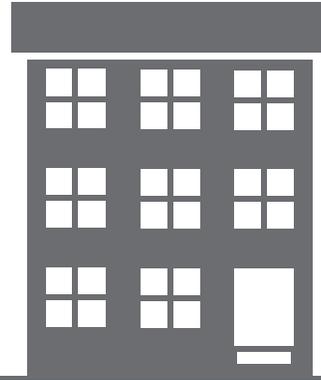
- Apartment investment activity saw a minor decline during Q3, with the market recording \$244.5 million in total sales volume over 18 transactions, compared to \$311.9 million over 20 transactions in Q2. Year-over-year investment volume is flat – one year ago, the market saw \$244.1 million in total sales volume.
- The average price per unit jumped from \$121,339 to \$191,289 – this was primarily due to the two Class A projects that sold during the quarter, which both fetched significantly higher prices per unit.
- Q3 saw two Class A apartment sales that averaged \$342,200 per unit; Class B product averaged \$130,884 per unit; and Class C product average \$100,784 per unit.
- As the region’s continuing rental growth draws more investor demand to the region, available quality assets are starting to become a tough find in the region. Though Class A product would likely sell quickly, Class A owners are holding on to their properties, content with their current cash flows. With virtually no Class A product and very little Class B product left, Class C product is all that remains for investors. As a result, the market has seen a significant increase in Class C sales over the last 12 months.
- The three largest investment sales of the quarter included:
 - Sycamore Terrace apartments, located at 40 Park City Court in Sacramento. This 244-unit, Class A complex sold for \$57.4 million, or \$235,246 per unit.
 - Eviva Midtown, located at 1531 N Street in Midtown, Sacramento. This 118-unit, modular construction Class A project is one of the newest multifamily buildings in Midtown and completed in fall of 2016. Eviva Midtown sold for \$53 million (\$420,000 per unit when taking into account the retail portion of the property) at a 4.78% cap rate.
 - Alhambra at Mace Ranch apartments, located at 4500 Alhambra Drive in Davis. This 160-unit, Class B complex sold for \$28.5 million (\$178,125 per unit) at a 5.45% cap rate.

Multifamily Investment Sales Volume



Historical Multifamily Sales Volume by Class





Units Under Construction

2,351



Sacramento Unemployment

4.5%



US Unemployment

4.1%



Spotlight On: Sacramento's Tight Investment Market

Climbing rents, minimal new construction, and a large supply of un-renovated, value-add properties has drawn multifamily investors to the Sacramento region in droves over the last few years. The last two years have seen total investment sale volume over \$1.2 billion, which is the largest amount of sale volume the market has seen in over 10 years.

However, after the investment activity seen during 2015 and 2016, Sacramento is now seeing very little quality product on the market for sale. Class A product has been scarce for some time, as the continually climbing rents and high local occupancy rates have given Class A owners no incentives or reasons to sell. With little-to-no Class A product available, investors went ahead and snatched up every Class B project they could, and now we are seeing these opportunities disappearing as well. There are currently only 11 availabilities across the region for projects 20 units and over, the majority of which are Class C product. Sales of Class C multifamily projects have been steadily increasing over the last three years, as the number of sales doubled between 2014 and 2015. Total sales volume for Class C product also saw a significant jump between 2014 and 2015, rising from \$198.1 million to \$434.7 million, and seeing another jump to \$561.5 million during 2016. Year-to-date, Class C product has accounted for well over half (54%) of the region's total investment sales volume.

What does this mean for the region's multifamily investment market? With such little available product on the market, the region has already begun to see a slowdown in investment activity, and this slowdown will likely continue through the rest of the year and possibly into the next, until either local rents reach a level to spur new construction, or rents begin to slow to the point where it makes more sense for owners to sell.

Outlook

Despite an uptick in vacancy, Sacramento's apartment market remains tight. Continued population growth and little new development will continue to drive demand in the region through the year and into the next. The recent wildfires in Sonoma, Napa, Solano, Yuba and Butte counties will put even more upward pressure on labor, materials and construction costs throughout the state, increasing developers' reluctance to build and further stalling new development in the region. Continually increasing rents have created more income for investment properties, raising property values across the region. With little in the development pipeline and huge levels of demand, regional rent growth is unlikely to slow any time soon.



CA Landlord Update

AB 646 – Flood Zone Notification

This bill was signed into law by Gov. Brown in October and requires landlords with “actual knowledge” that is or her property is in a flood-hazard area to disclose this information to prospective tenants. Property owners with actual knowledge include those notified by a government agency, as well as owners required to carry flood insurance for the property. Beginning July 1, 2018, owners will have to make this disclosure in the rental agreement.

Housing Bill Package

On September 29th, Gov. Brown signed a slate of 15 housing bills designed to try to alleviate the California housing crisis by cutting red tape and encouraging more affordable housing development. A summary of a few of these bills include:

AB 676 – This will expand the existing Housing Accountability Act, which requires that local governments follow certain legal mandates before denying housing projects that comply with their general plan and zoning rules. The expansion of this act imposes penalties, including fines for government that fail to comply with the act. That money will be placed into a housing trust fund for the construction of affordable housing.

AB 352 – This bill will increase the state’s stock of micro apartments by preventing local governments from establishing roadblocks to ‘efficiency dwelling units’, which usually measure 220 square feet or less. These units are used by some cities to provide housing for university students as well as shelter and services for the homeless.

SB 35 – This bill will create a streamlined process for housing in cities that have failed to meet their housing goals.

SB 2 – This bill will establish a permanent funding source for affordable housing through a fee of \$75 to \$225 on recorded documents. The Bill exempts residential real estate sales and is anticipated to generate between \$229 and \$258 million annually.

SB 3 – This bill will place a \$4 billion statewide affordable housing bond before voters in the November 2018 election.

SB 540 – This bill will streamline the approval process to spur housing construction by having cities identify where housing needs to be built and adopting specific, up-front plans and conducting all necessary environmental reviews and public engagement.

Source: Caanet.org

About Gallelli Real Estate

Gallelli Real Estate is a private firm that specializes in commercial estate services and property management. We believe that as a boutique firm whose understanding of the business runs as deep as our core values, our advantage is large. We take pride in our unique approach to offer more individual solutions that address the ever changing needs of our clients and the industry. After all, our success is measured by the success of our clients and the strength and longevity of our relationships. For the latest news from Gallelli Real Estate, visit GallelliRE.com, or follow us on Twitter: @Gallelli_RE and LinkedIn.

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