LUMENT

MARKET REPORT

ORANGE COUNTY, CA: RENTER DEMAND KEEPS PACE WITH SURGING SUPPLY

2024 MARKET SPOTLIGHT

ORANGE COUNTY, CA MARKET REPORT: RENTER DEMAND KEEPS PACE WITH SURGING SUPPLY

Orange County, CA: Renter Demand Keeps Pace with Surging Supply, one of Lument's two Q1 2024 market spotlights, was **developed in partnership with Rosen Consulting Group,** and gives an in-depth look at the Orange County, CA market.

HIGHLIGHTS

- **Orange County apartment demand is supported by many structural factors** including a diverse employment base and demographic makeup, limited single-family affordability, and a high quality of life.
- **Nearly 8,000 investment-grade multifamily units completed in 2022 and 2023,** a 75% increase from the number of units delivered in 2020 and 2021. The majority of these units came online in the Santa Ana and South Orange County submarkets.
- Although Orange County apartment transaction volume declined by 33% in 2023, **the drop in activity was shallower than both California and the U.S.**
- **Rising risk of rent control and other tenant protections** may negatively affect the Orange County market going forward.

RESILIENT DEMAND FUELS ABSORPTION

Supply-demand dynamics in Orange County remained tight into early 2024. Robust underlying demand drivers offset the surge of new development in recent years.

Apartment demand in Orange County was bolstered by several demographic and economic factors:

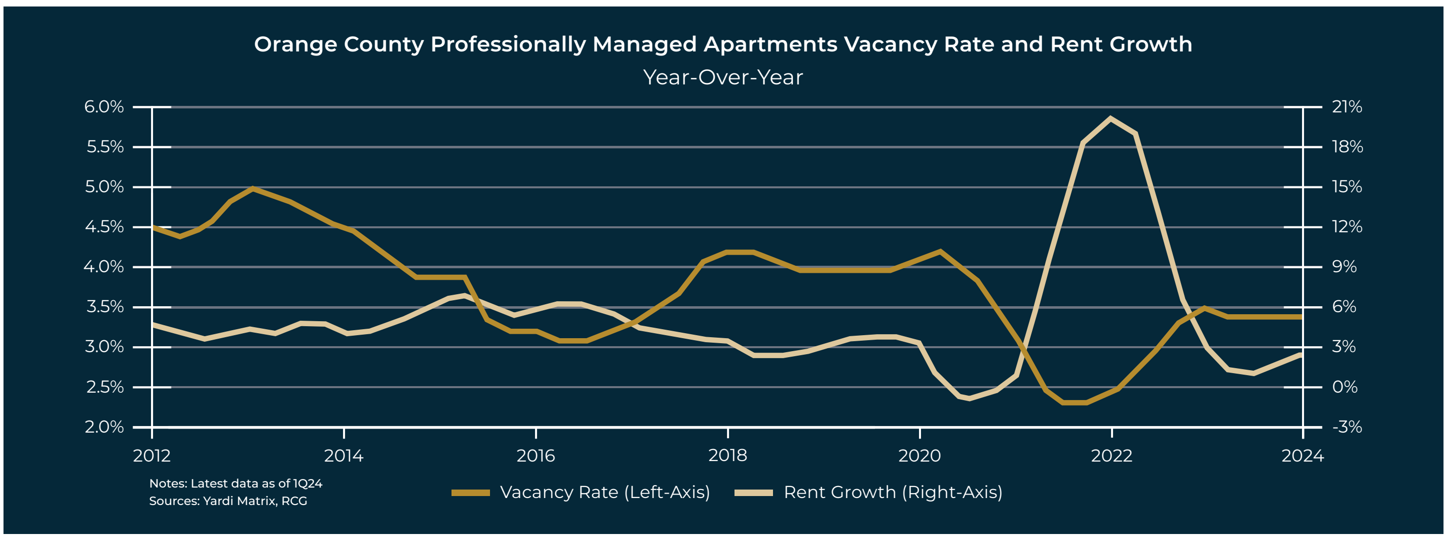
- The region has a diverse employment base with companies in a variety of industries including technology, tourism, education, and healthcare. The range of sectors boosted demand for properties across the pricing spectrum.
- The student population at institutions of higher-education such as California State University, Fullerton; University of California, Irvine; and Orange Coast College bolster Orange County apartment demand. Students provided steady demand for a wide array of rental segments including affordable and high-end apartment communities.
- The high cost of single-family housing kept many households in the rental market. Orange County was among the least affordable markets in the country with less than 17% of households able to afford the monthly expense of purchasing the median-priced single family home as of year-end 2023. High-income households that were not able to make the transition to homeownership were one of the main demographic groups supporting demand for luxury multifamily product.

- Out-migration from Orange County to lower-cost markets slowed in recent years, as the housing affordability gap narrowed. The average cost of renting increased at a faster pace in the adjacent Inland Empire and secondary markets such as Phoenix and Las Vegas since the end of 2019. At the same time, the cost of purchasing a home rose at a similar rate in these markets during the same period.

Together, these factors led to resilient rental demand in Orange County across all property classes and property types, including student housing and luxury apartments. More broadly, Orange County remained a highly desirable market for renters of all ages to live in because of its attractive job opportunities, highly ranked public school systems, moderate climate, and relatively low rate of crime.

Steady renter demand translated into strong market conditions. The professionally managed apartment vacancy rate held steady at 3.4% during the first quarter of 2024, one of the tightest markets in the nation. The vacancy rate was particularly low in the Class C segment at 2.8%. Vacancies were lowest in the northern part of the market, including La Habra, Buena Park, and Garden Grove. Conditions were also favorable in the area surrounding the California State University, Fullerton campus, where many students reside in both student housing units and privately owned apartments.

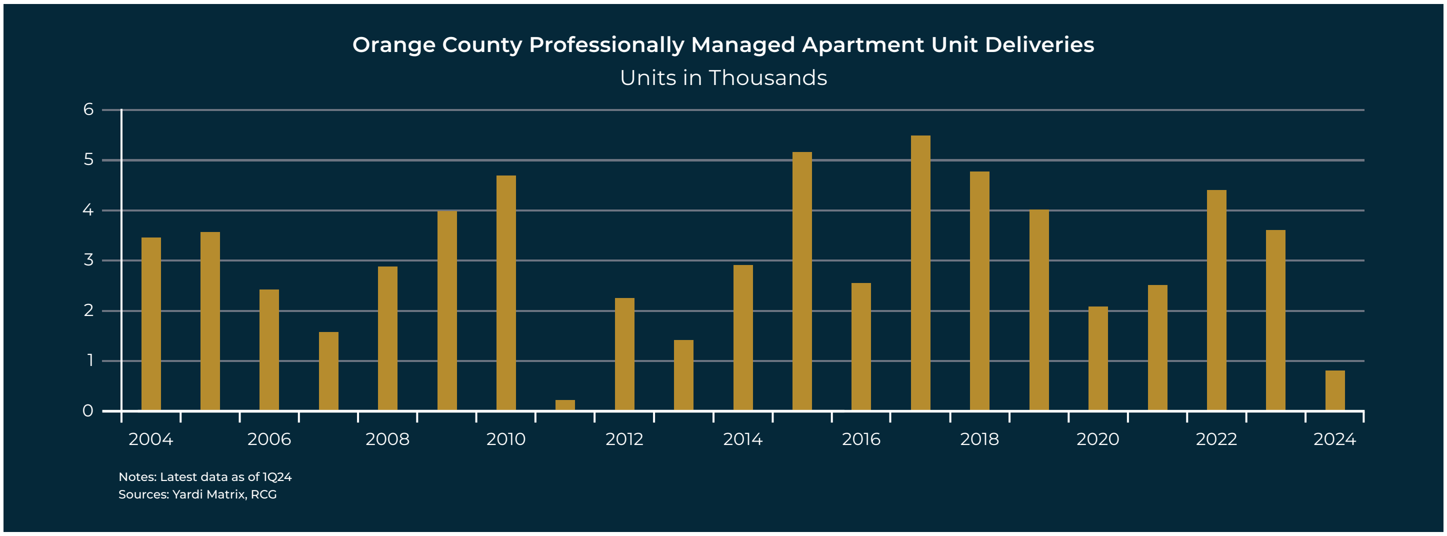
Annual apartment rent growth in Orange County increased to the 2% range in the first quarter of 2024, following growth in the 1% range throughout most of 2023. Rent gains during the past year were strongest in Newport Beach, an affluent submarket, and West Anaheim, a submarket where many middle-income households live and work.



Operating metrics were strong despite a wave of deliveries. Nearly 8,000 apartment units completed in Orange County in 2022 and 2023, a 75% increase from the combined level of construction in the prior two years. The majority of new construction was located in the Santa Ana and South Orange County submarkets. However, several variables mitigated the effect of the surge in development:

- Orange County had a substantial amount of pent-up housing demand because of chronic underbuilding that failed to scale with the influx of new residents. The lack of construction was partially due to the regulatory environment, as well as the scarcity of developable land.
- The need for rental housing increased sharply during the past few years as households decoupled because of a tight labor market and wage growth. Additionally, hybrid work schedules allowed some employees working in the Greater Los Angeles region to move to Orange County, a more desirable living location for many households.
- Apartment unit deliveries in 2022 and 2023 only accounted for 3.7% of the 2021 stock. This rate was less than the California and U.S. ratios of 4.2% and 5.8%, respectively.

Currently, nearly 7,000 new units are under construction in Orange County, the largest shares of which are luxury apartment complexes in the Tustin and West and South Irvine submarkets. These submarkets are conveniently located near John Wayne Airport, major highways, job clusters and universities.



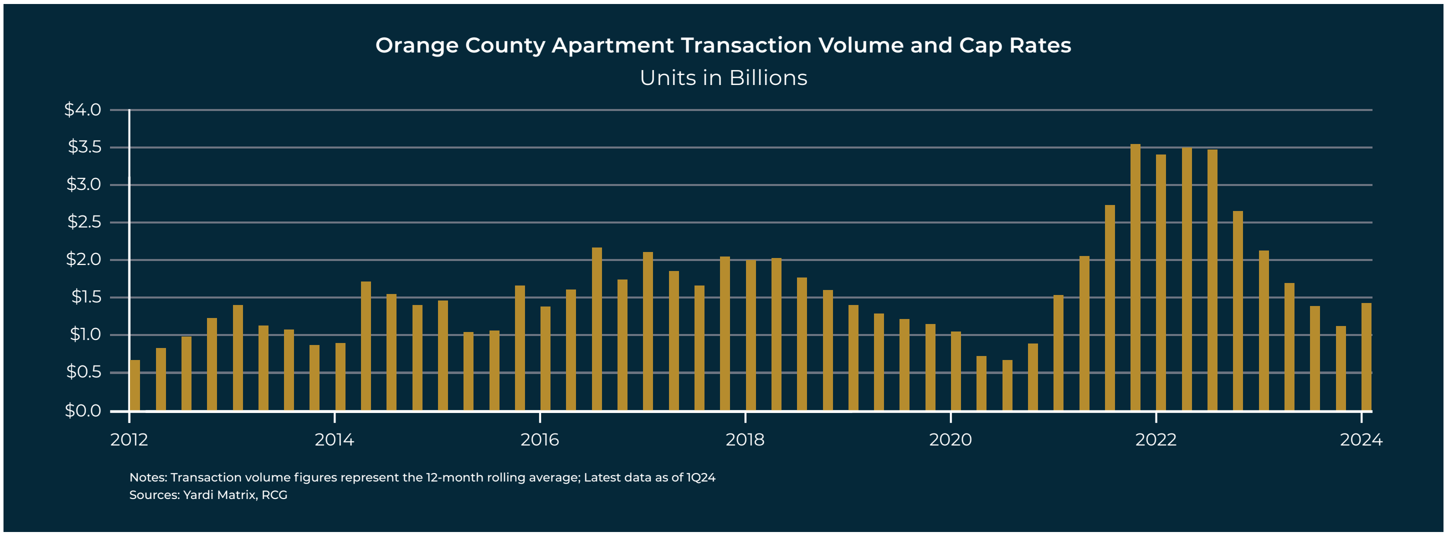
BIFURCATED INVESTMENT MARKET

Investment activity in the Orange County apartment market was relatively strong despite broader capital market difficulties. Annual transaction volume declined by 33% compared with the prior year, a more limited slowdown than the 57% reduction in apartment investment nationwide. Investment trends in Orange County were more stable, in part, because of the resilient operating metrics and underlying rental demand drivers.

The majority of apartment sales volume occurred in the cities of Costa Mesa, Huntington Beach, and Laguna Niguel. These three areas accounted for nearly half of all the volume in Orange County during the past year. Additionally, there were a number of smaller transactions involving buildings with 30 or fewer units in the city of Anaheim.

The transactional cap rate increased to 4.4% through the beginning of 2024, 60 basis points greater than the level one year prior. However, the level was on par with the average of the last 10 years. The cap rate increase largely stems from the challenging capital environment. Because of the cost and difficulty of securing multifamily financing, investors turned to relatively risk-free government bonds at elevated yields for their income stream.

Rising regulatory risk in Southern California could lead to large shifts in transaction activity. Within Orange County, Santa Ana recently implemented new administrative burdens on rent-controlled buildings to ensure compliance with rent stabilization policies. Local voters will also have the opportunity to affirm or deny existing rent control policies on the November 2024 ballot. Sales activity may spread to other submarkets within Orange County, or possibly leave the county entirely if there is a perceived risk of stricter regulations spreading throughout the region. Changes in regulation would have a significant impact on new development within the market, as many projects would no longer pencil with reduced cash flows.



OUTLOOK

Strong tenant demand should partially offset an increase in new development within the market in the near term. Nearly 5,000 units are projected to deliver in 2024, a 37% increase compared with 2023. While operating conditions may ease slightly, there is likely to be significant variation by submarket. The best performing neighborhoods should be the ones with the least new construction or the ones with stable demand from students or tenants with less mobility. By segment, student housing, subsidized apartments and Class C segment units are expected to have the strongest and most steady demand. In the longer-term, favorable demand drivers, including the demographic makeup of the market and the high desirability of living within the region, should support the rental housing market for the foreseeable future.

In the investment market, sales volume is expected to remain constrained by the challenges of sourcing debt financing and equity capital. However, transaction volume is expected to be relatively strong compared with other California markets because investors should highly value the long-term structural factors supporting rental demand. Beyond the immediate term, investors are expected to return to the market as the capital environment stabilizes.

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