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MEMORANDUM

To:	Los Angeles County Department of Regional Planning
From:	HR&A Advisors, Inc.
Date:	March 29, 2022
Re:	Update on Market Conditions re: Inclusionary Housing Feasibility

As a follow-up to previous work completed in March 2020 to test the financial feasibility of an inclusionary housing requirement for prototypical multifamily development projects in unincorporated Los Angeles County (the "County"), HR&A Advisors, Inc. ("HR&A") was asked by the Los Angeles County Department of Regional Planning ("DRP") to provide an update on real estate market conditions and recommend whether changes in those conditions might alter HR&A's previous conclusions about the financial feasibility of inclusionary housing in certain County submarkets. This memorandum summarizes changes to multifamily rental market conditions in the submarkets of East Los Angeles ("ELA"), South Los Angeles ("SLA"), and Antelope Valley ("AV"), where HR&A's previous analysis found that market-rate multifamily development was financially infeasible or only marginally feasible and unable to support inclusionary housing requirements. The memorandum also includes an update on real estate market conditions for for-sale multifamily (i.e., condominiums and townhomes) in the SLA and AV submarkets, where previous analysis also indicated that an inclusionary housing requirement was not financially feasible. A map of these submarket areas is included in Appendix A.

HR&A's previous analysis to test the financial feasibility of inclusionary housing requirements in six submarkets comprising unincorporated Los Angeles County was undertaken just as the COVID-19 pandemic emerged in March 2020. Because of the pandemic's immediate adverse impact on real estate market conditions, the data utilized in the previous analysis reflected pre-COVID conditions at the end of 2019 to represent more stable market conditions suitable for long-term policy decisions. At that time, County real estate markets had generally been trending upwards for several years, driven by high demand for housing, with steadily increasing land values, rents and purchase prices, and modest increases in construction costs. HR&A's analysis was undertaken with the assumption that pandemic impacts on market conditions would dissipate relatively soon, which has largely been proven out, as conditions in most County submarkets now exceed their 2019 levels. However, at the same time, construction cost inflation has skyrocketed, due to global supply chain disruptions and a constrained labor market. These conditions may also be short-lived.

As shown in Table 1 and described in further detail on the following pages, apartment rents have increased substantially in the ELA and AV submarkets since 2019, and condo/townhome sale prices have increased at even greater rates in the SLA and AV submarkets. While construction costs have also grown substantially (outpacing rental rate growth and slightly less than sale price growth in SLA), the number of new entitlement applications for 5+ market-rate rental unit projects has also increased in percentage terms (though not much in actual number of applications), suggesting that some developers believe projects are now more financially feasible. As such, we believe that changed real estate market conditions warrant re-visiting whether inclusionary housing requirements for rental developments in the ELA, SLA and AV submarkets and condo developments in the SLA and AV submarkets are now financially feasible.

Table 1: Summary of Total Change in Key Multifamily Real Estate Market Indicators, 2019-2022

Submarket	PSF Rent Growth	PSF Sales Growth	Entitlement Application Growth	Construction Cost Growth
ELA	19%	N/A	100%	15%
SLA	9%	18%	25%	15%
AV	26%	29%	0%	15%

Source: HR&A Advisors, Los Angeles County Department of Regional Planning

RENTAL RESIDENTIAL MARKET

HR&A reviewed updated market data for the same set of newer multifamily rental properties that were analyzed in late 2019. Overall, rents have exceeded their pre-pandemic levels, with more substantial growth in the ELA and AV submarkets. Table 2 shows the average asking rents on a per square foot basis in January 2022 for the same set of properties analyzed in December 2019. Rental rate increases in SLA, ELA and AV have outpaced inflation in consumer goods, which grew roughly 8.0 percent over the same period.

Table 2: Changes in Average Rent Per Square Foot, 2019-2022

Submarket	Nov 2019 Avg. Rent PSF	Jan 2022 Avg. Rent PSF	Change
ELA	$2.39	$2.84	19%
SLA	$1.59	$1.73	9%
AV	$1.75	$2.20	26%

Source: CoStar; HR&A

FOR-SALE RESIDENTIAL MARKET

The condominium/townhome sales market also showed significant increases beyond pre-pandemic levels in the SLA and AV submarkets (ELA was not analyzed, as an inclusionary housing requirement for for-sale housing was adopted at the conclusion of our previous analysis). Median County-wide condominium sale prices grew roughly 23 percent between late 2019 and late 2021. Sale prices on a per-square-foot basis also grew, although by more than twice the rate of consumer price inflation in the SLA submarket and substantially more in the AV submarket. Table 2 shows the average sales prices on a per square foot basis for the full years of 2019 and 2021.

Table 3: Changes in Median Condo Sale Price Per Square Foot, 2019-2021

Submarket	2019 Sales Price PSF	2021 Sales Price PSF	Change
SLA	$329	$383	18%
AV	$159	$205	29%

Source: CoreLogic; HR&A

DEVELOPMENT PIPELINE

New entitlement applications can serve as a proxy for financial feasibility. To successfully construct a project, most developers must seek financing from lenders and provide reasonable proof that a completed project can generate enough revenue to cover loan debt service. Developers generally analyze the financial feasibility of projects before spending money on design work necessary to submit an entitlement application.

Despite the rent and sale price increases noted above, very few new multifamily projects (5+ units) have been proposed in the past two years, based on preliminary data prepared by DRP for annual reporting to the State Department of Housing and Community Development. In 2021, there were entitlement applications for 11 projects with 5+ market-rate rental units across the three submarkets. This was up slightly from 8 and 7 projects of this scale in 2020 and 2019, respectively. ELA and SLA had six and five new project applications located in their respective submarkets, but none in AV (and zero in 2019 and only one 2020). Table 3 shows the specific number of applications by submarket for each year evaluated, with 2021 data subject to change as DRP finalizes annual reporting for the year.

Table 4: Entitlement Applications for Multifamily Housing, 5+ Market-Rate Units, 2019-2021 (pending final data)

Submarket	2019	2020	2021	2021 Change (vs. 2019-2021 Avg.)
ELA	3	3	6	100%
SLA	4	4	5	25%
AV	0	1	0	0%

Source: Los Angeles County Department of Regional Planning; HR&A

The new projects range in size from five to 100 units, with an average of 32 units. Of the 11 new projects, six of them are mixed-income, with or without a density bonus. Three of the new mixed-income projects are in ELA, while three are in SLA; on average, 15 percent of the total units in the new mixed-income buildings are proposed to be affordable. Although a very limited sample, these mixed-income projects suggest that an inclusionary requirement in ELA and SLA may now be feasible with a density bonus, as was used by most projects.

CONSTRUCTION COSTS

Much like rents and sale prices, construction costs have increased substantially over the past two years. Global supply chain issues have impacted material availability and pricing. Labor shortages, due to illness, pandemic safety measures, wage spikes, and early retirement or relocation of workers have also increased costs. According to Engineering News Record's Business Cost Index ("BCI") construction costs for Los Angeles saw large swings in the 26 months between our analyses (Q4 2019 to Q1 2022). The BCI showed modest price decreases in the first five months of the pandemic, ranging between -0.3 percent to -1.5 percent. Then, starting in May 2021 through the present, there have been only double-digit monthly year-over-year increases, ranging from 10 percent to 21 percent. In total, the BCI has grown by 14.7 percent in this 26-month timeframe. It remains uncertain if and when the more recent spike in construction costs will moderate.

Table 5: Changes in Annualized Construction Growth Rates

Months	*Stable* Nov. 2019 – Mar. 2020	*Contraction* Apr. 2020 – Aug. 2020	*Slow Growth* Sep. 2020 – Mar. 2021	*Rapid Growth* Apr. 2021 – Jan. 2022	*Total* Nov. 2019 – Jan. 2022
BCI Growth, Annualized	0.7%	-1.2%	1.5%	16.0%	14.7%

Source: Engineering News Record; HR&A

SUMMARY

The different real estate market indicators for the ELA, SLA and AV submarkets all show substantial change, with many of them outpacing inflation, and in several cases pricing outpacing construction cost growth. The

AV submarket saw the greatest increases in both rents per square foot and condominium/townhome sale price per square foot, but no new entitlement applications for projects with 5+ market-rate units. The ELA and SLA submarkets showed increases in rents and sale prices and entitlement applications. On the other hand, there was also substantial growth in construction costs. All things considered, these changes over the past two years lead HR&A to recommend that the financial feasibility analysis of inclusionary housing requirements for both rental in the ELA, SLA and AV submarkets and condominiums in the SLA and AV submarkets should now be re-analyzed.

APPENDIX A: SUBMARKET AREAS