

# Sacramento apartment rents growing at fastest rate in U.S.

No relief for renters due to little new construction

Sep 2, 2016

Ben van der Meer • Staff Writer • Sacramento Business Journal

A rare confluence of factors has made the Sacramento region stand out nationally as the top metropolitan region for rent growth, creating a boom time for investors in multifamily housing.

The trend might have reached its apex, local rental market experts believe. But that doesn't mean that renters will see relief anytime soon. Few expect rents to move the other way in the near future.

"I have been in this business for 25 years, and I've never seen anything like this," said Steven Nelson, a senior associate with Marcus & Millichap's Sacramento area office. "And it doesn't seem like we're at the end of anything either. This train keeps rolling."

The roots of Sacramento's multifamily rent explosion can be found in the economic downturn of the late 2000s. For virtually all types of buildings, the construction pipeline ground to a halt, even as people who lost single-family homes to foreclosures moved into rentals.

Until economic recovery began to take hold about three years ago, rents rose only by modest amounts of about 2.5 percent annually. But nearby, the Bay Area's economy roared back from the recession with a new surge in tech jobs. With thousands of people moving there for work, multifamily rents and property prices soared.

## Escape from the Bay

That led two groups to start searching for bargains to the east. Especially in the East Bay, renters began looking at Sacramento and other cities as an escape hatch from what they had to pay there, according to research by apartment data firm Yardi Matrix. That pushed up rates here, as higher Bay Area incomes competed against lower incomes around Sacramento for many of the same units.

"You could say rents in Sacramento look like a bargain compared to the Bay Area and even cities like Vacaville," said Tony DeLoney, a Marcus & Millichap broker who specializes in multifamily sales.

Investors and property owners were the other migratory group. Because multifamily property prices had shot up in the Bay Area, the cheapest close alternative was in Sacramento. And if a current property owner in the Bay Area chose to sell, the odds of finding another property there that one could afford were slim, prompting a search for elsewhere to put money.

As new renters and investors began to push into the Sacramento market, rents began to rise faster than incomes. And there was a third factor that didn't allow any relief valve: a lack of new inventory.

## Little new construction

In its most recent report, Yardi Matrix found new units comprised just 0.4 percent of the total local apartment stock in July. Compared to a year earlier, rents in the Sacramento metropolitan statistical area rose by nearly 14 percent, or more than twice as quickly as the 5.5 percent rise seen nationally. In 2015, Sacramento-area rents rose by 7 percent, suggesting the trend accelerated this year.

Nat Kunes, vice president for property management software maker AppFolio Inc., said there are about 250 active apartment building permits in the Sacramento region today. Las Vegas, by comparison, has 2,300, he said.

Apartment developers say that even as rents rose over the last few years, they had good reasons to hold back on new projects.

"Development costs, fees and land costs have all gone up," said Lex Economou, an executive vice president who heads western U.S. multifamily developments for Stockton-based AG Spanos Cos. "Rents had to rise to make new development happen."

In the last two years, AG Spanos has filed plans for two new apartment complexes in the region, one in El Dorado Hills and the other in Rancho Cordova. But Spanos said the projects also have to make sense in context. Those looking to rent a new apartment these days want livability, energy efficiency and walkability to nearby shopping, work and transit, he said. The most ideal apartment project sites will check all those boxes.

"We think these are long-term trends that renters will always see as important," he said.

Sacramento also didn't see the job growth the Bay Area did in recent years. So investors who finance apartment projects wisely placed their bets on projects there that were more likely to fill up, said Geoff Brown, CEO of Roseville-based apartment developer USA Properties Fund Inc.

USA Properties typically builds affordable multifamily projects, for which financing can be easier to find through government sources, such as tax credits. Even that market has gotten more difficult, however, since the state did away with local redevelopment agencies in 2012.

## Upward pressure on costs

Even if the projects make it off the drawing board and through entitlements, other factors can keep costs rising. The AG Spanos project in El Dorado Hills

went on hold when El Dorado County residents filed a suit to stop it. Though the litigation is still active, the company has submitted a revised proposal that would appear to address some of the plaintiffs' concerns.

Economou said projects that fit what renters want are often in already-developed areas, making it more likely that current residents will oppose the new apartment projects. That's true for a high-end project like his company's, for which rents will likely average \$1,600 a month, and for affordable projects like one Anton Development Co. LLC is building in Arden-Arcade, which ultimately prevailed over a lawsuit from neighbors.

"The barriers to entry keep going higher and higher," Economou said.

Those factors are why most who follow Sacramento's multifamily market say the upward pressure on prices is unlikely to abate anytime soon.

Even now, only two types of projects are financially feasible in Sacramento, said brokers Nelson and DeLoney. Those are affordable projects that usually require subsidies, and high-end projects for which the rents are often going to be at the top of the market.

Neither of those sorts of projects help alleviate rent pressure at existing apartment properties.

It's becoming increasingly rare to find apartments with rents aimed at middle-class workers, DeLoney said. That's especially true in Sacramento-area submarkets not considered "A," such as Fair Oaks and Citrus Heights.

"We're slow and steady, but compared to Portland, Seattle, San Diego, the Bay Area, we're far behind," DeLoney said.

### Landlords aiming higher

Meanwhile, owners of existing multifamily properties are aiming higher. Many of the sales brokered by Marcus & Millichap, Colliers International Sacramento and other firms are of properties built in the 1980s or earlier. The new investors, taking advantage of low interest rates, often can re-invest in those properties — sometimes with only the most minimal upgrades — and immediately charge more.

Owners of older properties in the best submarkets, like Roseville and Rocklin, are under pressure to do the same, according to Yardi Matrix. In some cases, rents for such properties can be \$100 a month below the going rate, meaning owners are leaving money on the table.

All of this, of course, may be making for boom times for multifamily property owners, investors and contractors busy renovating older apartment complexes.

### Threat to restaurants

But there may be a downside for the local economy. For middle-market tenants, the squeeze is on. They generally have two options, said Bruce Hester, a senior vice president with Colliers in Sacramento. One option is to find roommates and keep costs in control. The other is to look for housing in more outlying areas such as Yuba City or Stockton, and commute to jobs in and around Sacramento.

As Sacramento becomes less livable for middle-market apartment tenants, workers may become harder to find for some kinds of businesses. This is already an issue in the Bay Area.

And as consumers are forced to spend more of their incomes on rent, they are likely to have less disposable income for expenses such as dining out, potentially threatening sectors of the economy such as restaurants, which have been increasingly important to the region in recent years.

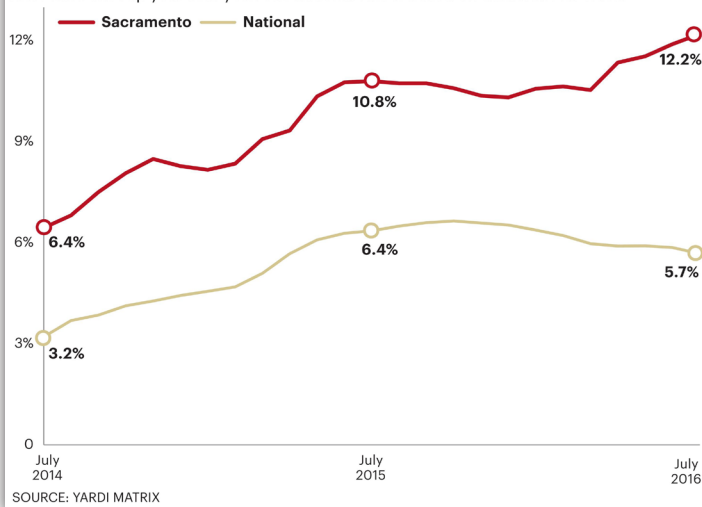
"It's not good for the economy for housing to become too much of one's income," Brown said. "It affects all segments."

For at least the next couple of years, neither developers nor brokers expect much change in the region's apartment market. The rate of rent increase is expected to drop — estimates vary from about 3 percent to about 6 — but rents are still expected to rise overall.

"It's about finding a balance," said developer Economou. "We have to meet market demand. And right now, we're not."

### SACRAMENTO RENT-RATE INCREASES SHOW DRAMATIC CLIMB

Buoyed by increasing demand — especially from workers fleeing the more expensive Bay Area — and a dramatic lack of new supply, the Sacramento metro area's apartment rental rates have shot up year over year. The national rate is based on data from 111 cities.



### BY THE NUMBERS

**\$1,017.69:** Average monthly rent for a Sacramento metro area apartment in July 2014.

**\$1,269.36:** Average monthly rent for a Sacramento metro area apartment in July 2016.

**1:** Sacramento's rank nationally of about 30 markets for apartment rental growth by percentage.