

# Why Half-Million Dollars Per Unit Makes Sense For An Old Apartment

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By Paul Bergeron

Earlier this month, The Mogharebi Group (TMG) arranged a relatively modest transaction: the \$12.2 million sale of The Wilson Townhomes, a 24-unit development in Orange County's community of Costa Mesa. The buyer of the fully occupied property is a private investment group from nearby Newport Coast.

Built in 1961, The Wilson Townhomes is located on a low-density two-acre site bordering both Newport Beach and Huntington Beach. Each of the two-bedroom apartment units are housed in six two-story residential buildings.

But look a little closer and you can see that the sale of The Wilson Townhomes is more than just a routine transaction. It also illustrates just how pricey even average investments have become. Indeed, given the lack of supply of affordable, single-family homes and the great demand for apartment living overall, paying slightly more than half-million dollars per unit for a 61-year-old apartment community in Orange County, Calif., makes perfect sense in 2022's market.

Here's how.

## A Long-Term Bet on a Tight Market

Eli Randel, Chief Strategy Officer at CREXi, says that this sale appears to be a long-term bet on a tight market poised for continued rental rate growth and long-term value.

"While the going in cap rate probably offered modest yield, the deal likely had attractive financing options, was a bite-size which brings a wide buyer pool, and offers a safe place to park pent-up capital during uncertain times," Randel says.

"Deals like this during a period of rental rate growth, in a punitive cash environment given inflation, and when other investment vehicles feel choppy make plenty of sense."

According to TMG research, 224 multifamily units are planned in Costa Mesa over the next five years falling well short of the expected formation of 810 new households over that same period. It's something that is generally indicative of many parts of the country.

Kimberly Stepp is Principal with Stepp Commercial, a multifamily brokerage firm. Stepp focuses on the West Los Angeles/Santa Monica market. She says pricing for assets both new and old has risen dramatically over recent months and coastal properties in general secure premium pricing.

“Investors are looking to jump on opportunities to own in coastal markets and can justify per-unit pricing of more than \$500,000 for older assets due to tight inventory and rising rental rates in prime areas. In the Santa Monica market, we are seeing per-unit pricing fetching pricing between \$500,000 to \$550,000 and cap rates hovering around 3 percent,” Stepp says.

### **YoY Per-Unit Rise of 31 Percent**

The Wilson Townhomes sales price of more than \$508,000 per unit represented a 31 percent increase over last year’s per unit median price of \$386,236, and is indicative of the increasing investor appetite for multifamily assets in the area.

According to PwC and Urban Land Institute’s “Emerging Trends in Real Estate 2022,” Orange County ranked fourth nationally in multifamily investment favorability.

“Many households are being priced out of the for-sale housing market in Orange County with median home prices exceeding \$1.15 million and yet the supply of multifamily housing simply has not caught up with demand,” said TMG Senior Vice President Brett Bayless.

“Rental demand in Costa Mesa has been strong for decades and considering the current high occupancy of 98 percent, robust forecasted household formation and lack of new supply, it’s very likely that demand will remain extremely strong in the foreseeable future. As a result, we received multiple offers from a variety of investors.”

Michael Busenhart, Vice President of Real Estate at Archer, said that this increase in dollars per unit is in-line with the rising prices in Costa Mesa as the year-over-year home values in Costa Mesa have increased 25.6 percent with a median price of \$1,190,060, according to Zillow.

“The barrier to entry for new home buyers is extremely high in this market which will increase the demand and pricing for renters in the market,” Busenhart said.

This purchase at \$508,000 per unit is a substantial discount to current home values in the market. Archer’s automated underwriting software estimated a market price of \$12 million which is a roughly 3.7 percent cap on in-place income. This pricing in the market reflects recent trends with cap rates compressing into the 3 percent range.

Also, the purchase of a \$1.19 million house requires a \$240,000 down payment for 20 percent and roughly \$5,700 of monthly payments. The average rent of \$2,000 for the comps is a significant difference compared to home ownership highlighting the increasing difficulty for homeownership and the increased demand for rental properties.