

San Francisco Market Update: Q4 2008

Q4 2008 UPDATE

10+ UNITS: In Districts 1-8, price per square foot dropped to an average \$305/sq ft in Q4 2008 (11 sales) compared with \$391/sq ft in Q4 2007 (9 sales). December's unsold buildings included one in Pacific Heights with a 13.96 multiple. Six buildings came on the market in Q4, with multiples ranging from 8.7 in the Tenderloin to 14.6 in Van Ness/Civic Center.

he average GRM for sold properties finally dropped to 14 last quarter of 2008. Compare this with 15.1 in Q3 2008, 15.1 in Q2 2008, 17.6 in Q1 2008 and 15.1 in Q4 2007.

900 Powell in Nob Hill sold for \$4.225M, more than \$1 million below list. Nicely renovated to corporate housing standards, **this could have a 13 multiple** assuming \$1800/month for each of the 1 bedroom rentals.

1043 Fell sold for \$2.24M. List price was \$2.499M. Annual gross income of \$200K means a **multiple of 10.95**, with some renovated units.

115 Haight sold for \$2.475M. List price was \$2.999M. Annual gross income of \$227K means a **multiple of 10.82**.

2-4 UNITS: The smaller multi-units also saw price drops. Again the following numbers exclude the softer markets in Districts 9 and 10. Also excluded were properties without parking, which are a tougher sell.

The **least affected were fourplexes** with an average \$391/sq ft in Q4 2008 compared with \$394/sq ft in Q4 2007. However, **triplexes saw a 35% price drop** from an average \$579/sq ft in Q4 2007 to \$377/sq ft in Q4 2008. **Duplexes dropped 17%** from \$567/sq ft in Q4 2007 to \$472 in Q4 2008.

What continued to plague sellers were dated properties with below market rate rents, and especially those with protected tenants.

Cases in point: Four-unit 6 Leroy Pl with a unique owner's unit in Nob Hill had several tenant issues. 2825 Greenwich (2-3 units?) had two below market rate tenants. Both had deferred maintenance and respectively sold at \$247/sq ft. and \$316/sq ft.

Contrast this to 2814 Sacramento, a renovated (but not stunning) vacant triplex that sold for \$620/sq ft.

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2009 FORECAST

FOR 10+ UNITS, buyers were looking for **6% cap rates** all last year. Assuming NOI at 60% of gross, that **requires a multiple of 10** and little deferred maintenance.

Going back 40 quarters to Q1 1999, the average GRM in Districts 1-8 was 10 or below only three times: Q1 1999, Q2 1999 and Q1 2002. Even in 1999, three buildings north of California sold at multiples of 15, 24 and 14 respectively. So will returns really improve to 1998 levels? Indicators to watch:

1. Available Investment options. For cash buyers on the sidelines, what justifies a <6%+ return? Perhaps it will be the prospect of a relatively fixed stream of income and some pent up demand.

Regardless of the fluctuating value of the underlying asset, i.e. the building, cash on cash at about 5%, may look attractive compared with dividend cuts, CD rates and even some tax free muni bonds. This analysis ignores the value of appreciation and the notorious "upside potential".

2. Interest rates. With commercial rates at about 6.5% or more, only a 6.5%+ cap rate increases one's rate of return using leverage. Rates will be a downward pressure in SF and/or shrink the buyer pool.

3. Softer rents. Higher rent areas are experiencing falling rents. Investors will factor this into their offers.

2-4 UNITS: This buyer pool will also shrink.

Sales of tenants-in-common interests should continue to slow. More buyers may choose to avoid relying on co-owners' financial stability or lenders' commitment to fractional loans.

Single owner users will analyze more carefully the financial benefits of any given multi-unit over a single unit property.

Property owners with protected tenants will continue to bear the brunt of a market that will have choosier and fewer buyers. For these sellers, the issue is how long to hold on to an underperforming asset if their sales proceeds could be better used elsewhere

More details and charts at www.quinnsolutions.com