

MULTIFAMILY



Be cautious of quick conclusions

The rental apartment sector looks poised to maintain its leg up on other investment property types in 2021. Some of this is founded on a belief that households will prioritize rental payments even if they drastically cut back on other spending. Most metrics show that landlords are collecting substantial percentages—often 95 percent—of monthly rent, even if payments come later than scheduled. Many tenants are paying some rent, if not the full bill, even under conditions of the eviction moratoria put in place for pandemic relief. Such tenant protections will eventually be relaxed as 2021 proceeds, and it is uncertain how the market will sort this out.

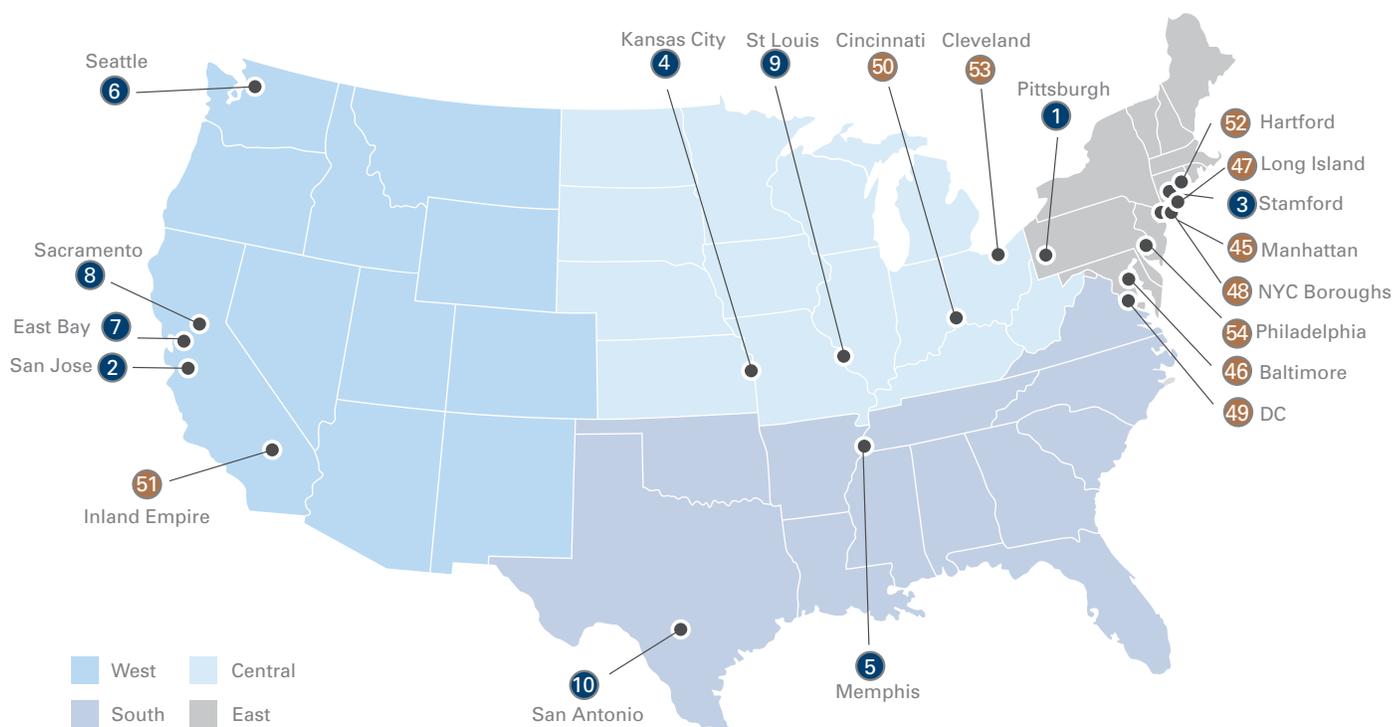
One of the promising signs of confidence is the report from many markets that construction remains active. This is a concrete act of faith in the health of the multifamily sector in the future. Meanwhile, though, pandemic adjustments are altering the desire of many for 'walk-to-work' apartments close to thriving CBDs. This is now favoring suburban complexes, a trend showing up in data indicating that garden apartments are capturing two-thirds of 2020 multifamily investment volume.

“The multifamily rental housing sector has been the darling of those looking for income-producing property assets.”

For more than a decade, since the battering of the single-family home market in the subprime mortgage debacle and the consequent Global Financial Crisis, the multifamily rental housing sector has been the darling of those looking for income-producing property assets.

There was a tectonic shift in residential property market behavior around 2008. From the point of view of homeowners, the expectation of uninterrupted appreciation in housing prices was rudely contravened. Not only did equity evaporate, but many found themselves underwater on their home mortgages and needed to resort to selling at distressed prices, whether or not they could get lenders to accept short sales to recover at least some of the principal amount owed.

TOP MARKETS BY MULTIFAMILY TRANSACTION VOLUME BASED ON YOY PERCENTAGE CHANGE



Bulls (Top 10)

2020 Rank	City	YOY Change	Total 4Q19-3Q20	Vol. Rank*
1	Pittsburgh	53.8%	\$855.7 M	39
2	San Jose	11.7%	\$1,913.3 M	22
3	Stamford	10.3%	\$440.9 M	50
4	Kansas City	-4.4%	\$1,063.6 M	34
5	Memphis	-5.6%	\$509.6 M	48
6	Seattle	-6.5%	\$5,524.9 M	4
7	East Bay	-7.8%	\$2,079.2 M	21
8	Sacramento	-8.9%	\$1,384.2 M	28
9	St Louis	-12.7%	\$649.6 M	45
10	San Antonio	-13.4%	\$2,139.7 M	20

Bears (Bottom 10)

2020 Rank	City	YOY Change	Total 4Q19-3Q20	Vol. Rank*
45	Manhattan	-46.6%	\$3,820.0 M	8
46	Baltimore	-47.3%	\$1,177.5 M	32
47	Long Island	-48.3%	\$469.5 M	49
48	NYC Boroughs	-49.0%	\$2,656.5 M	15
49	DC	-49.8%	\$795.2 M	41
50	Cincinnati	-59.3%	\$272.5 M	52
51	Inland Empire	-60.4%	\$1,035.4 M	35
52	Hartford	-63.2%	\$109.6 M	54
53	Cleveland	-66.9%	\$240.2 M	53
54	Philadelphia	-69.4%	\$1,013.4 M	36

* Volume Ranking is based on the overall transaction volume among 54 markets nationally

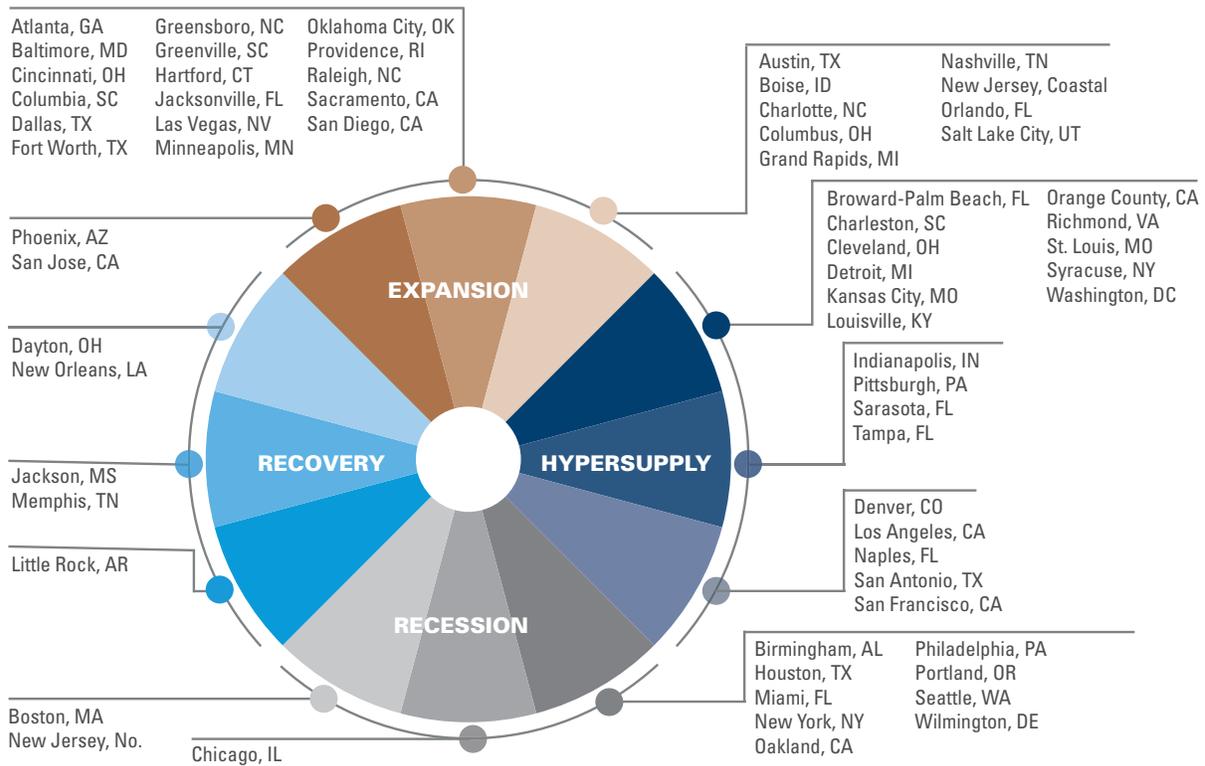
The carry-over into the 2010s was two-fold. First, there was a loss of creditworthiness that made qualifying for a new home mortgage difficult in the extreme. Second, there was a much wider acceptance of the concept of “renters by choice.” This latter condition was bolstered by two critical social and economic phenomena: the emergence of the Millennial generation as a key demographic for the housing market as a whole and the re-establishment of America’s downtowns as desirable places to “live, work, and play” in the parlance of 24-hour and 18-hour cities.

As these factors played out, the U.S. homeownership peak descended almost monotonically from 69.1 percent in 2005 to 62.9 percent in 2016. Then, quietly and almost unnoticed, it began to rise again. This did not at all discourage investors in the rental apartment sector. In 2016, apartments attracted \$160 billion in investment, the highest of all the property types, according to Real

Capital Analytics (RCA). Multifamily continued to have the highest volume of transactions through 2019, when it hit \$190 billion in aggregate price.

As of October 2020, apartments have held on to their top ranking in investment volume, with \$92.4 billion in year-to-date deals. But that figure represents a 40 percent decline year-over-year. Multifamily, then, appears to be in the same boat as commercial investment properties. A review of National Council of Real Estate Investment Fiduciaries (NCREIF) data shows that not only have total returns for apartment assets declined from 7.3 percent to 5.5 percent between 2016 and 2019, but in the 12 months ending September 2020, their return has dropped to just 2.3 percent. Interestingly, while income returns have remained fairly steady over the past five or so years, the appreciation component of total return has been weakening and has turned negative in 2020.

MULTIFAMILY MARKET CYCLE



EXPANSION

- Decreasing Vacancy Rates
- Moderate/High New Construction
- High Absorption
- Moderate/High Employment Growth
- Med/High Rental Rate Growth

HYPERSUPPLY

- Increasing Vacancy Rates
- Moderate/High New Construction
- Low/Negative Absorption
- Moderate/Low Employment Growth
- Med/Low Rental Rate Growth

RECESSION

- Increasing Vacancy Rates
- Moderate/Low New Construction
- Low Absorption
- Low/Negative Employment Growth
- Low/Neg Rental Rate Growth

RECOVERY

- Decreasing Vacancy Rates
- Low New Construction
- Moderate Absorption
- Low/Moderate Employment Growth
- Neg/Low Rental Rate Growth

Does that portend a reversal of fortune for multifamily investors? Don't jump too quickly to that conclusion. For one thing, uniquely among the major property types, apartments have sustained a reduction in cap rates over the course of 2020, according to RCA data. Both garden apartments and mid-to-high-rise properties had lower cap rates in October than they did in January. That means optimism about future returns for this sector. Furthermore, equity yields appear to be on the upswing, given the descent of mortgage interest rates on fixed loans to 3.09 percent reported in the American Council of Life Insurers (ACLI) database for the third quarter – 44 basis points lower than a year ago, improving the leverage of buyers.

Adding to the strong news from the debt markets, Trepp reports that 30+ days delinquency in multifamily CMBS is still relatively low at 3.11 percent, as of November. This compares to double-digit rates for retail and hotel securitizations. Delinquencies are, in large part, being triggered by rent collection issues in lower-quality apartment properties, although Class A and B assets are not totally exempt. The National Multifamily Housing Council's Rent Payment Tracker places rent payment at the 94- to 95-percent level during the May to October 2020 period, down about one to one-and-a-half percentage points from the prior year. Unfortunately, the trend in recent months has been weakening, and the eventual sunset of eviction moratorium may turn 2021 statistics downward, with an accompanying rise in properties being put into special servicing.

Thus, the approximately 50/50 split in markets deemed in expansion or recovery (33 metros, or 50.8 percent) versus those in recession or hypersupply (32 markets, or 49.2 percent) certainly betrays the awareness of IRR's professionals of the tension faced by apartment investors going into 2021. Numbers alone do not tell the story. Most of the nation's largest and most visible multifamily markets are those mired in recession: New York, Boston, Chicago, Miami, Houston, Seattle, and Portland, among them.

There appears to be an intriguing disconnect between the elements that renters and investors are prioritizing in this stress test that is the pandemic. For while the cycle indicators seem to reflect advantage accruing to the least expensive rental markets, the cap rate data show preference for urban properties over suburban assets, and Class A over Class B apartments – and this is true across regions, as well as being consistent in the discount rate and reversion rate pricing metrics.

This does make considerable sense. Renters themselves need to react to the emergency situation of loss of jobs and incomes, so immediate cost sensitivity is totally rational. For investors, however, in times of uncertainty, a "flight to quality" is a sign of risk aversion and a longer-term perspective that this public health and economic dislocation will not last forever. Let that positive note stand as our final word in this discussion.

REGIONAL RATES COMPARISON - MULTIFAMILY

	CAP RATE	DISCOUNT RATE	MARKET RENT (\$/UNIT)	VACANCY RATE	4Q '19 - 4Q '20 CAP RATE D
SOUTH REGION					
Urban Class A	5.36%	6.84%			0 bps
Suburban Class A	5.64%	6.95%	\$1,289.22	7.19%	▲ 9 bps
Urban Class B	6.13%	7.43%			▼ -2 bps
Suburban Class B	6.44%	7.66%	\$896.91	4.49%	▲ 3 bps
EAST REGION					
Urban Class A	5.58%	6.67%			▲ 17 bps
Suburban Class A	5.79%	7.00%	\$1,871.31	5.76%	▲ 17 bps
Urban Class B	6.22%	7.29%			▼ -1 bps
Suburban Class B	6.33%	7.58%	\$1,418.31	3.34%	▼ -14 bps
CENTRAL REGION					
Urban Class A	5.94%	7.48%			▲ 2 bps
Suburban Class A	6.02%	7.56%	\$1,275.65	5.84%	▲ 8 bps
Urban Class B	6.79%	8.21%			▲ 3 bps
Suburban Class B	6.75%	8.29%	\$845.32	3.68%	▼ -1 bps
WEST REGION					
Urban Class A	4.71%	6.36%			▲ 25 bps
Suburban Class A	5.02%	6.69%	\$2,009.26	5.93%	▲ 34 bps
Urban Class B	5.10%	6.78%			▲ 4 bps
Suburban Class B	5.45%	7.15%	\$1,418.49	3.45%	▲ 18 bps
NATIONAL AVERAGES/SPREADS					
Urban Class A	5.38%	6.83%			▲ 10 bps
Suburban Class A	5.60%	7.02%	\$1,546.09	6.39%	▲ 16 bps
Urban Class B	6.06%	7.42%			▲ 1 bps
Suburban Class B	6.26%	7.65%	\$1,094.03	3.89%	▲ 3 bps

SOURCES & REFERENCES

Multifamily

Top Markets by Multifamily Transaction Volume Based on YOY Percentage Change
 Source: Real Capital Analytics

Market Cycle
 Source: Integra Realty Resources
 Regional Rates Comparison
 Source: Integra Realty Resources



ABOUT VIEWPOINT

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COMPREHENSIVE COMMERCIAL REAL ESTATE MARKET RESEARCH, VALUATION AND ADVISORY SERVICES

ABOUT IRR

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Every IRR office is supervised by one of our more than 170 MAI-designated professionals, industry leaders who have over 25 years, on average, of experience in their local markets. Having more MAI-designated experts than any other firm is just

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