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Multi-family trends - Part 2 - by William Pastuszek

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A previous article dealt with valuation considerations regarding multi-family assets. Based on additional conversations, the following discusses market trends noted while analyzing and observing apartment markets.

Debt and Real Estate Lending: The cost and availability of debt makes a big difference, but maybe not as big a difference as we think. Why? Markets are adaptable and multi-family markets are getting used to the high interest rate environment. To be sure, lenders are acting with greater discipline in the current environment. Adaptation is taking place on both borrower and lender sides. Higher rates affect cash flow, but investors still want to invest. On the debt side, conventional lenders try to find ways to make deals work as they compete with various lenders sources for fewer deals. There is financing out there, contrary to the hype. Deals are being done, but under different assumptions based on the current environment. And the conventional wisdom is tending towards not expecting rates to move downward any time soon. In fact, they may go up.

Rent vs. Buy: What do aging Baby Boomers and Millennials have in common? Both groups are desirable target markets for apartment developers. As baby boomers transition to retirement, developers are responding to the needs of downsizing empty nesters. Studies indicate that rental demand contribution by baby-boomers is a significant demand driver. Households headed by a person 65 and over were up over 40%, with the “rentership” rate going up as well. Going forward, many boomers will not want the responsibilities of ownership. A similar trend is evident with current upcoming young professionals. Mobility is prized by the current generation with fewer cars, less attachment to jobs, and less concern with home ownership and its responsibilities and fixity of location. Newer apartment communities provide more on-site services, more common areas, and are in more accessible locations to meet the desires of both groups. Catering to both groups represents attractive opportunities for apartment developers. Despite the continuing societal goal of home ownership, the concept has become a bit more complicated due to differing tastes in the population.

Fannie Mae notes that “high barriers to homeownership are supporting demand for luxury housing among certain demographics, such as millennial renters, and this will remain the case into the next year. Demand for smaller, more affordable units has also persisted over the last couple of years, and the average size of a multifamily unit is shrinking.”

Remote Work. Here to Stay? Yes, but markets are figuring it out. For many industries and professions, work at home is almost a no brainer. It improves job satisfaction and efficiency, as well as quality of life, for workers that can work remotely. Companies benefit from happier employees and lower real estate costs as less space is needed. Clearly, some industries and companies want on-site employees and are in the process of discouraging remote work and require physical in-building presence. This trend will sort itself out. How does this play out for apartment dwellers and developers? Apartments need to accommodate remote workers. Again, developers and landlords can work to meet this marketplace need.

Housing Affordability: Do high bars for home ownership stimulate rental demand? Yes, despite high rents, too. Millennials have a clear interest in home ownership but housing prices, housing shortages, and high interest rates act as major barriers to that goal. Renting is the clear alternative as many renters are priced out of ownership. Rental affordability varies and the great rent increases over COVID are over but rental growth is still apparent in many major markets. Some markets are seeing pressure on rents and occupancy given continued additions to supply within those markets.

Risk. Is Multi-Family Risk Higher? Yes, but not excessively so. Fannie Mae notes that, “Multifamily housing will remain a low risk as housing shortages in the U.S. continue to drive demand over the next couple of years. Even amid uncertain market conditions, multifamily development can be a fairly low-risk asset class as demand remains high and remains a better investment than office or retail projects.”

Concessions. Are Concessions a Fact in the Marketplace? Yes, but... Fannie Mae reports that concessions are “stable.” It was noted that the average concession level for all units remains at 4.5% – less than one month’s free rent on average – but increases are expected...class A concession levels remain higher than those for class B and C units.

To summarize, should we be concerned? One survey noted that “The multifamily sector experienced subdued but positive demand during the first half of 2023.” Multi-family values show some declines with significantly slowing sales volumes. As a result, the multi-family sector is showing some vulnerability and “normalization” after peaking over the past several years. Expect higher cap rates, lower prices, some loan workouts, and more focused investor demand. However, it is a sector that is adaptable and provides needed housing in a difficult housing environment.

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