The Janus Face of Multifamily Real Estate

Two reports reveal contradictory picture for national rental market

BY **BRIAN PASCUS** APRIL 10, 2023 4:51 PM

THE DALLAS-FORT WORTH MSA HAD BEEN THE SECOND MOST ACTIVE MARKET IN 2022 FOR CMBS MULTIFAMILY ORIGINATIONS WITH $3.9 BILLION.PHOTO: VALERIE MACON/AFP VIA GETTY IMAGES

It is a tale of two economies when it comes to the multifamily space in commercial real estate.

A pair of reports by data research firms Yardi Matrix and MSCI paint a dueling picture of the national multifamily market: rental prices and occupancy rates have stabilized amid a challenging first quarter, revealing

strong fundamentals, but monthly transaction volume and pricing for the buildings themselves fell in February, threatening investors' returns.

"Two things are happening in our economy simultaneously," said Christopher Thornberg, founding partner of Beacon Economics. "We're repricing assets on the basis of huge increases in the cost of debt — there's credit scarcity, interest rates are up, it's hard to get a loan — but that is an entirely separate conversation from consumer demand. Consumer demand is absolutely on fire."

There are few places where consumer demand is higher than in housing, specifically multifamily apartment rentals. Rents and the national occupancy rate were unchanged in the first three months of the year, while 21 of the top 30 metro areas recorded rent gains in March, according to Yardi Matrix. The average U.S. asking rent hit $1,706 in March, while the national occupancy rate stood at 95.2 percent.

National rents started their unprecedented climb in April 2021, moving from just over $1,400 in 2020 to more than $1,700 by November 2022, according to Yardi Matrix.

"What stands out to me in multifamily is that demand has largely remained solid, despite widespread concern about a hard landing for apartments and commercial real estate in general," said Paul Fiorilla, director of research at Yardi Matrix.

Fiorilla noted that demand for apartments remains strong across the country, absorption continues to be positive, and rents are rising again despite going down a bit from their all-time highs in the fall of 2022.

"Although there are headwinds, including the potential for a recession in the second half, the outlook is more positive than negative," he said. "Big picture: things look solid."

But the economy tells a different story on the investment side, where things are far from optimistic.

Gone are the halcyon days of 2021 and 2022, when dependable yields in a near-zero interest rate environment promised appetizing returns for investors in a multifamily sector that seemed immune to the large scale changes being wrought across the CRE landscape during Covid-19.

Instead, there's been a reckoning in 2023

"Apartment deal volume and prices fell at a fast clip in February," stated an MSCI capital trends report for February 2023. "Declines have been underway over a number of months now, but the scale of recent drops is starting to bring the pace of deal activity below normal levels."

February deal volume fell by 54 percent compared to the average February deal volumes in the five years prior to the COVID-19 pandemic, according to MSCI. Total year-over-year deal volume of all multifamily transactions through February fell by 76 percent from one year ago, reaching just $4.8 billion.

Anything exceeding $10 billion annually is a more normal market, said **Jim Costello**, chief economist at MSCI and author of the report.

“There’s less liquidity out there because cap rates have gone up, and mortgage rates are much higher,” Costello said. “You’re in a situation where if you’re buying something, the debt you’d get is not as helpful as it would’ve been a short while ago.”

Apartment sector pricing tumbled too, falling nearly nine percent from February 2022, as the average loan-to-value offered in the first mortgage position shrank in 2022 compared to 2021, according to MSCI.

“From an investment side it’s falling because of the repricing underway,” Costello said. “The cost of capital changes makes it harder for buyers and sellers to come to an agreement on where assets should be priced.”

Perhaps no market better illustrates the contradictions in the multifamily space than New York City.

Rob Hinckley, senior manager of capital markets at **JLL**, said the transaction market in New York City is down because of a number of factors that have no relationship to on-the-ground fundamentals that have made things beneficial for landlords and building owners.

Higher interest rates, a change in capital appetites, a decrease in pricing, and “a recessionary risk that people perceive” have all impacted transaction volumes in New York, Hinckley explained. But he added that things “couldn’t be worse” from a tenant standpoint in that rents have

gone up, there's very little supply (and likely less in the near future), and an elimination in traditional tax abatements have given developers less incentive than ever to build more housing in the Big Apple.

"It's the perfect storm of a high-demand city," said Hinckley, who noted New York City's population increased after the pandemic and that apartment unit deliveries have decreased in the last couple of years and are unlikely to increase for several years into the future. "You have the perfect recipe for higher rents."

And while landlords and building owners stand to benefit from higher rents and surging demands, that doesn't mean the multifamily market in New York will remain as healthy as it was during the pandemic.

"Even though landlords may be achieving higher rents, the macro and interest rate environment has hurt them such that it still doesn't make sense to transact," said Hinckley, "because those other factors have outweighed the fundamental factors on the ground like rent increases."

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