GRIFFIN CAPITAL
guardians of wealth

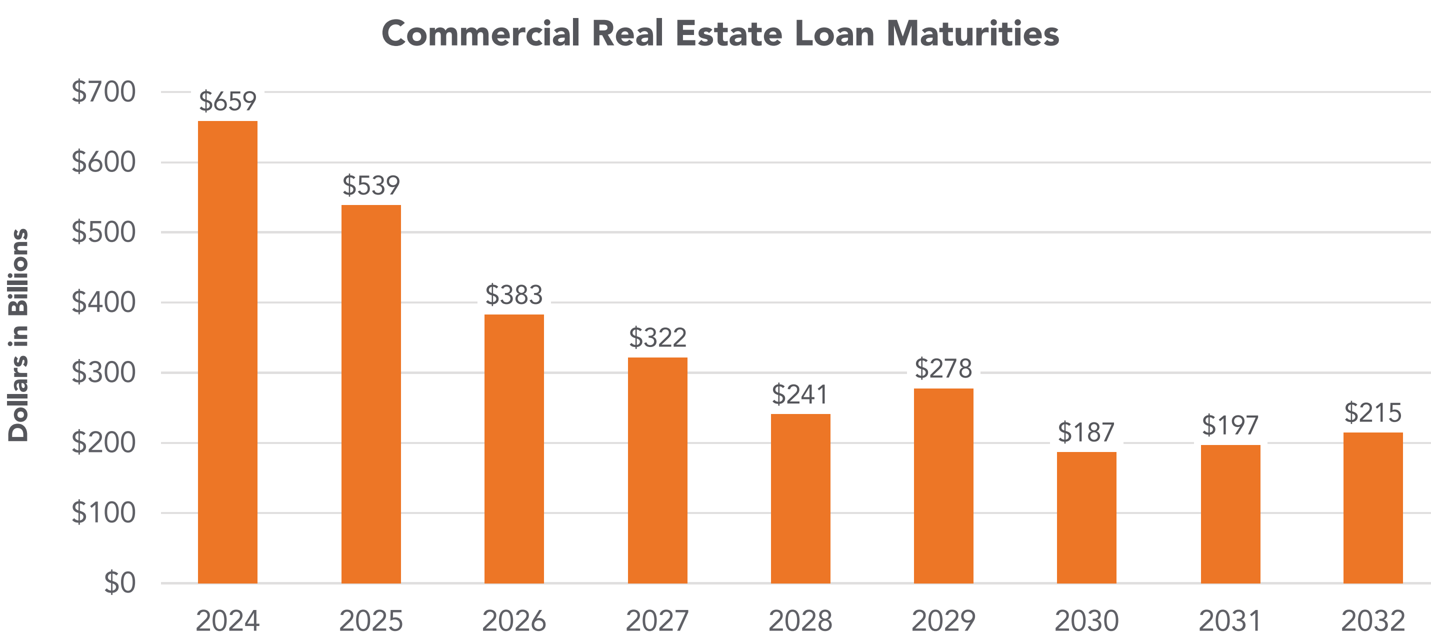
Five Themes for Multifamily in 2024

THEME 1

Good Assets - Bad Capital Structures

The great deleveraging of the property markets is underway.

As asset values appreciated rapidly during a low-interest rate, capital-abundant environment, a subset of borrowers seeking to enhance returns at the expense of increased risk did so. The music has stopped. The most aggressive of these investors utilized short-duration, variable-rate debt at high loan-to-values. As risk-free rates have expanded, so too have capitalization rates and net operating income growth has not grown at parity, resulting in reduced valuations. As credit conditions are likely to remain tight in the first half of 2024 due to broader market headwinds and a looming wall of maturities that includes $659 billion during the calendar year, opportunities will accelerate for well-capitalized investors. Investors who were smitten with the concept of shorter maturities and willing to take variable rate exposure are facing declining debt service coverage margins, higher loan-to-values on a mark-to-market basis, and a capital markets environment that is likely to leave them out in the cold well past winter. This subset of owners face the prospect of having to find capital to reduce their leverage, liquidate their positions, or relinquish their assets to their lenders. Every trade has two sides and depending on perspective, the opportunities created from this dislocation could set up for an attractive vintage for those with capital to deploy. Market participants will see opportunities to acquire good assets because of bad capital structures as we move into 2024 but given this is a small part of the market and broader underlying fundamentals across the property markets are fairly strong, the magnitude of this opportunity will not meet the headline expectations.



Source: Newmark United States Multifamily Capital Markets Report Q3 2023, Green Street, RCA, Trepp, MBA, Newmark Research as of November 7, 2023.

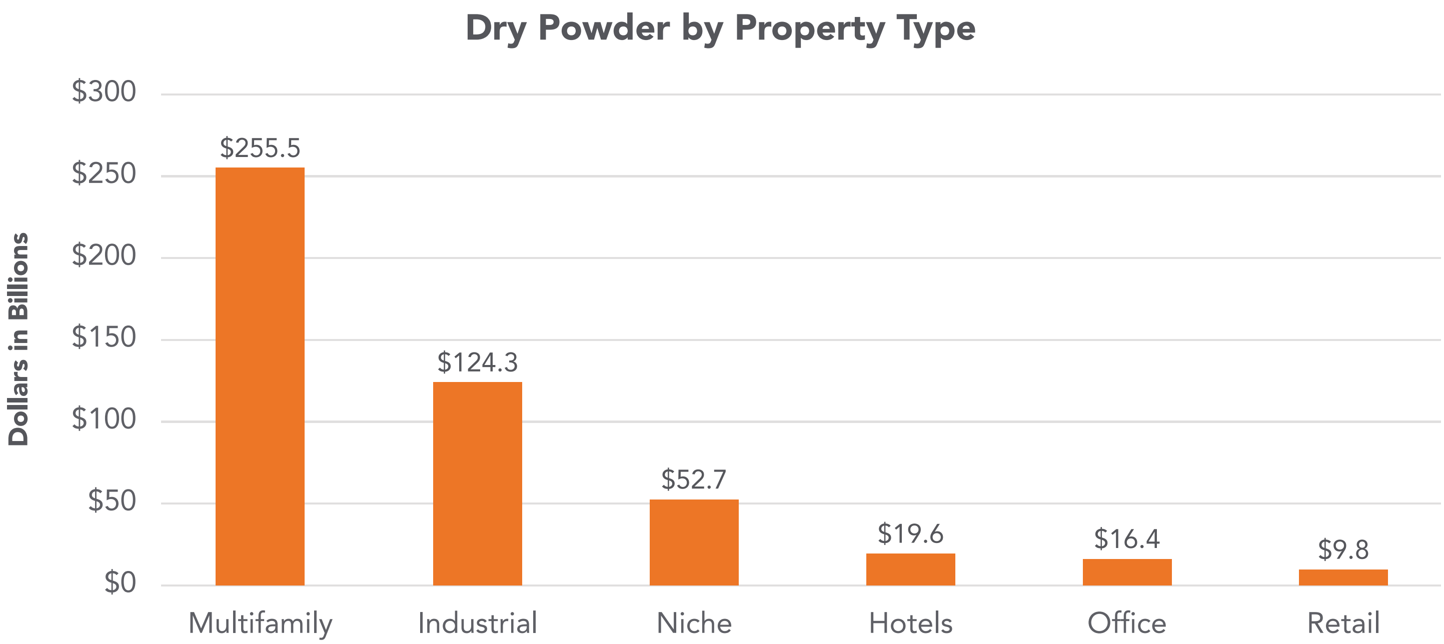
Past performance is no guarantee of future results.

THEME 2

Size Matters

Dislocation benefits the largest, most liquid investors.

Smaller investors will suffer disproportionately through 2024 as credit conditions remain tight, forcing them to be less active. Small and midsize developers unable to capitalize deals will be sidelined depressing new starts and giving larger investors the opportunity to acquire prime sites at a better basis. Market participants needing to enhance their liquidity will look to sell assets quickly to address their challenges, and transaction partners that can move swiftly and have the cheapest cost of capital will benefit. As a result, 2024 will present opportunities for larger investors to deploy capital as smaller investors either can't execute or face increasing levels of friction.



Source: Newmark United States Capital Markets Report Q2 2023, Preqin as of 7/26/23. Newmark looked at the percent called by vintage year and applied this to the total amount fundraised in each year to calculate the amount of uncalled capital (i.e. dry powder), broken out by main property type. Roughly half the dry powder was diversified funds. This was allocated to the various property types in proportion to their share of total dry powder, excluding diversified funds. Finally, Newmark grossed up the dry powder assuming 55% leverage would be used.

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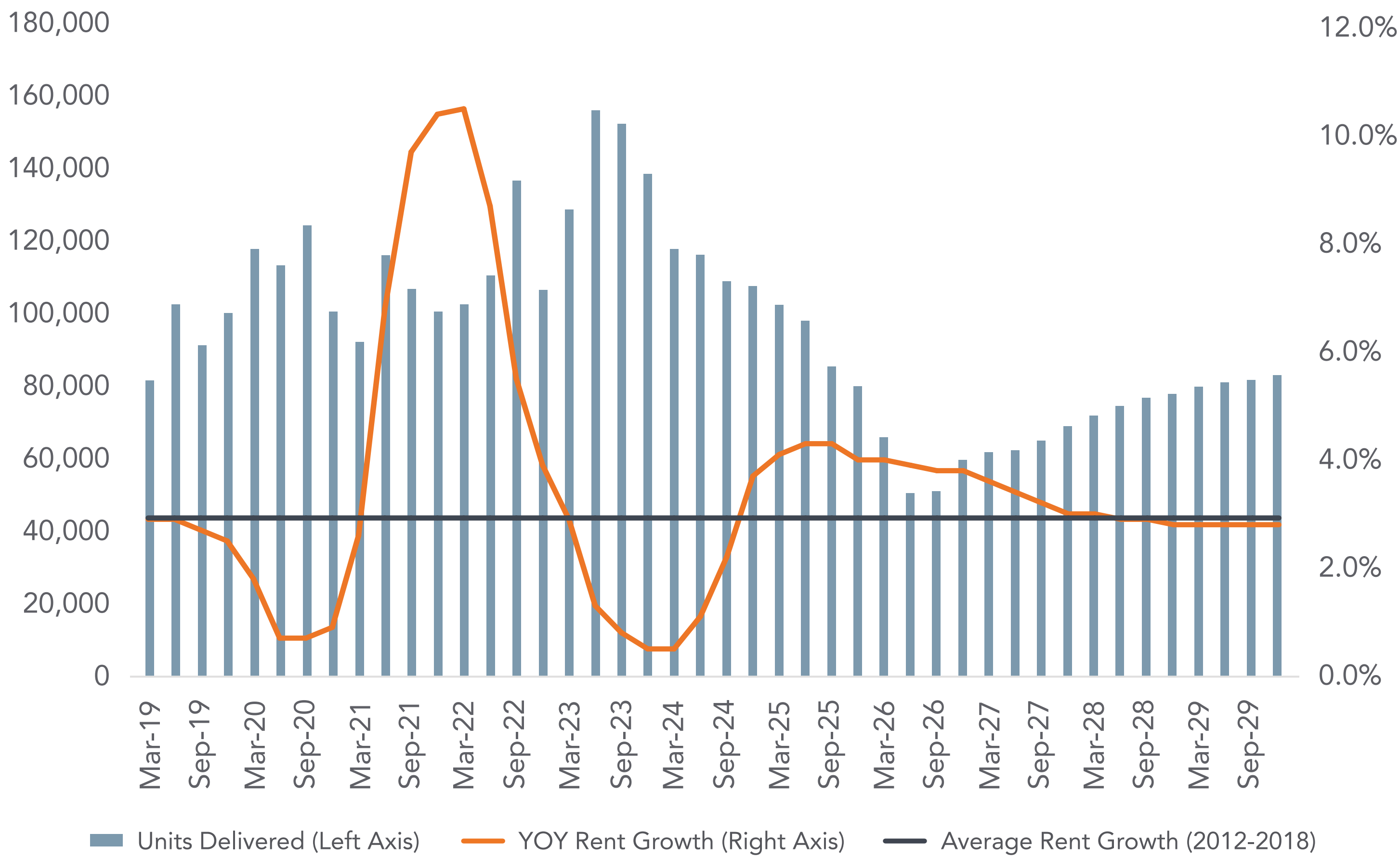
THEME 3

Survive and Advance

This is not classic oversupply; this is simply a lot of supply in a short period and the market needs to digest the inventory.

As demand fundamentals remain solid and occupancy levels remain steady, landlords will contend with crosscurrents from peak-cycle supply being delivered through 2024 and a deep and captive rental pool. 2024 rent growth will continue to decelerate or decline following the massive surge in 2021 and 2022 as landlords offer concessions to attract and retain tenants. We expect that continued demand tailwinds fueled by demographic trends a secular single-family housing shortage will reverse this dynamic as we get past 2024, but landlords will seek to manage occupancy and expenses from turnover in the near-term.

As Deliveries Normalize, so do Rents



Source: CoStar. Data retrieved December 13, 2023.

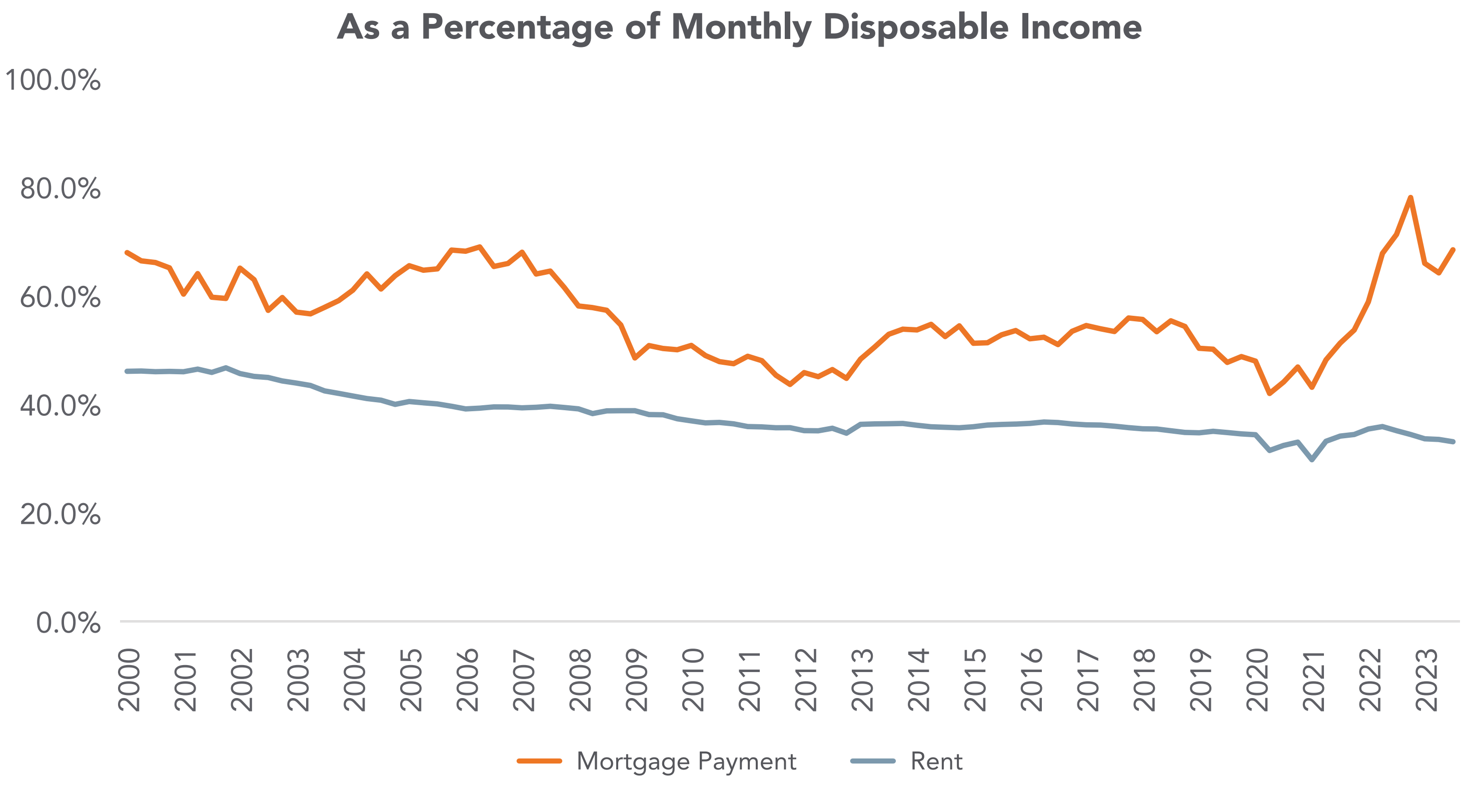
Past performance is no guarantee of future results.

THEME 4

Renting Remains More Affordable Than Owning

Renting will remain much more affordable than owning.

As single-family home values remain resilient and supply remains incredibly challenged, it will continue to be more affordable to rent than it will be to own. At the end of 2019, underproduction of housing was estimated to be 3.8 million units. Since that time, 5.1 million new housing units (single-family homes plus apartments) were completed[1] while 6.4 million households were formed.[2] The uptick in multifamily building over the past few years has not been able to address the shortage in a meaningful way. As mortgage rates have remained elevated, reducing home building activity and creating significant barriers to leave the rental pool, new home sales activity has been muted and builders have not accelerated their pipelines. The decoupling of income growth and home value appreciation presents a much stronger case for the relative affordability of renting, a theme that will continue through 2024 and beyond.



Source: Disposable personal income per capita as provided by the U.S. Bureau of Economic Analysis, Median Sales Price of Houses Sold as provided by the U.S. Census Bureau, and quarterly average 30-Year Fixed Rate Mortgage as provided by Freddie Mac, retrieved from FRED on December 13, 2023. Monthly rents represent market asking rents as provided by CoStar on December 13, 2023.

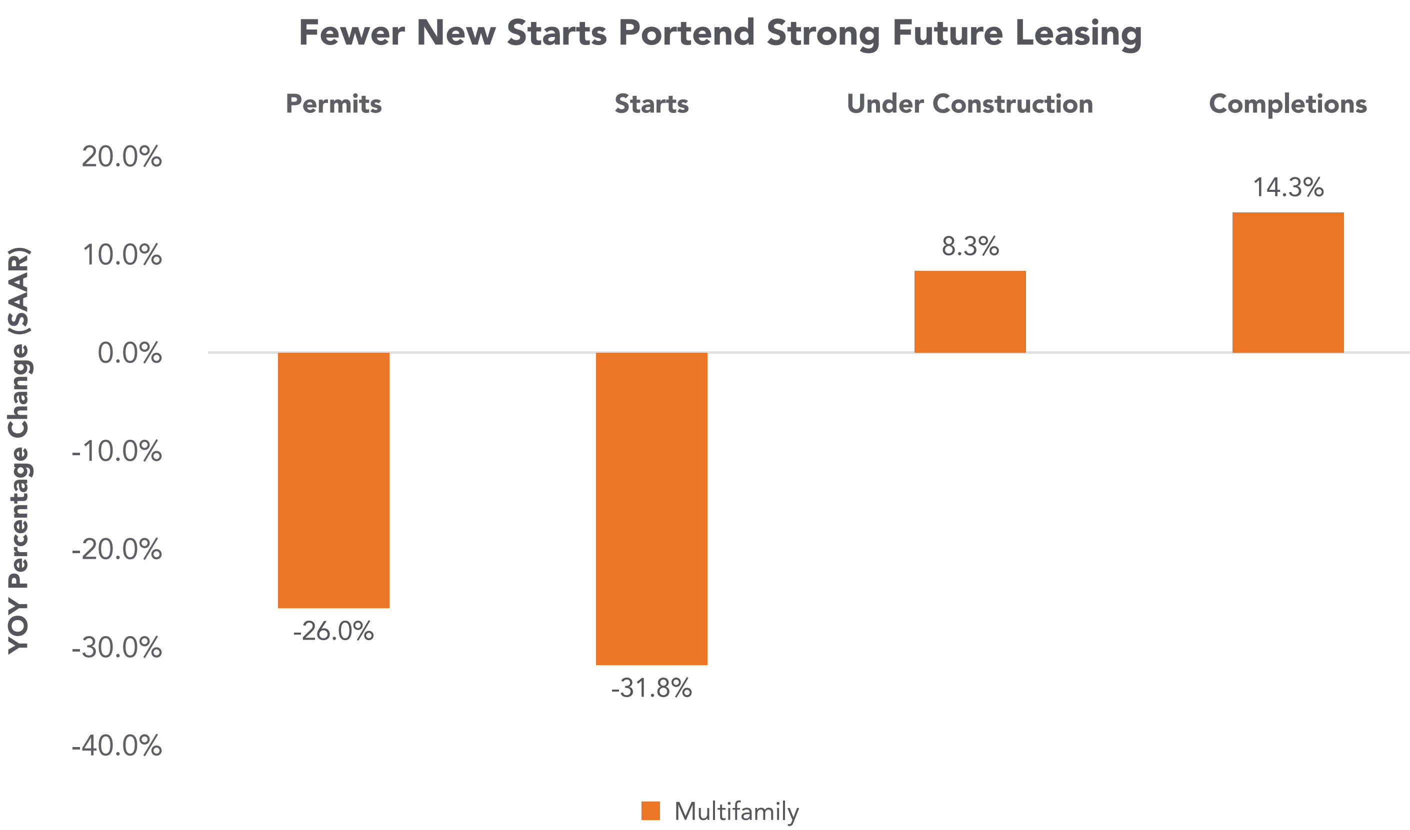
Past performance is no guarantee of future results.

1. U.S. Census Bureau and U.S. Department of Housing and Urban Development, New Privately-Owned Housing Units Completed: Total Units [COMPUTNSA] as of September 30, 2023, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/COMPUTNSA, January 10, 2024.
2. U.S. Census Bureau, Household Estimates [TTLHHM156N] as of September 30, 2023, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/TTLHHM156N, January 10, 2024.

THEME 5

Think Like the La Quebrada Cliff Divers

If you have ever visited Acapulco, Mexico, you may be familiar with the Cliff Divers of La Quebrada, a group of high divers who leap perilously into the ocean from the cliffs perched as high as 135 feet above. To land safely, they must jump when the risk seems the greatest; when the tide is going out, revealing the rock formation below. These divers know from experience that by jumping at the time that appears to be most inopportune, they reach the sea below as the tide will be coming in, providing a safe landing to accomplish their objective. For developers that can get deals capitalized today, 18-36 months from now will likely present an attractive time to be leasing new supply as these assets deliver.



Source: U.S. Census Bureau and U.S. Department of Housing and Urban Development. Retrieved from FRED, Federal Reserve Bank of St. Louis, on December 13, 2023. Data as of October 31, 2023. Multifamily defined as properties with five units or more.

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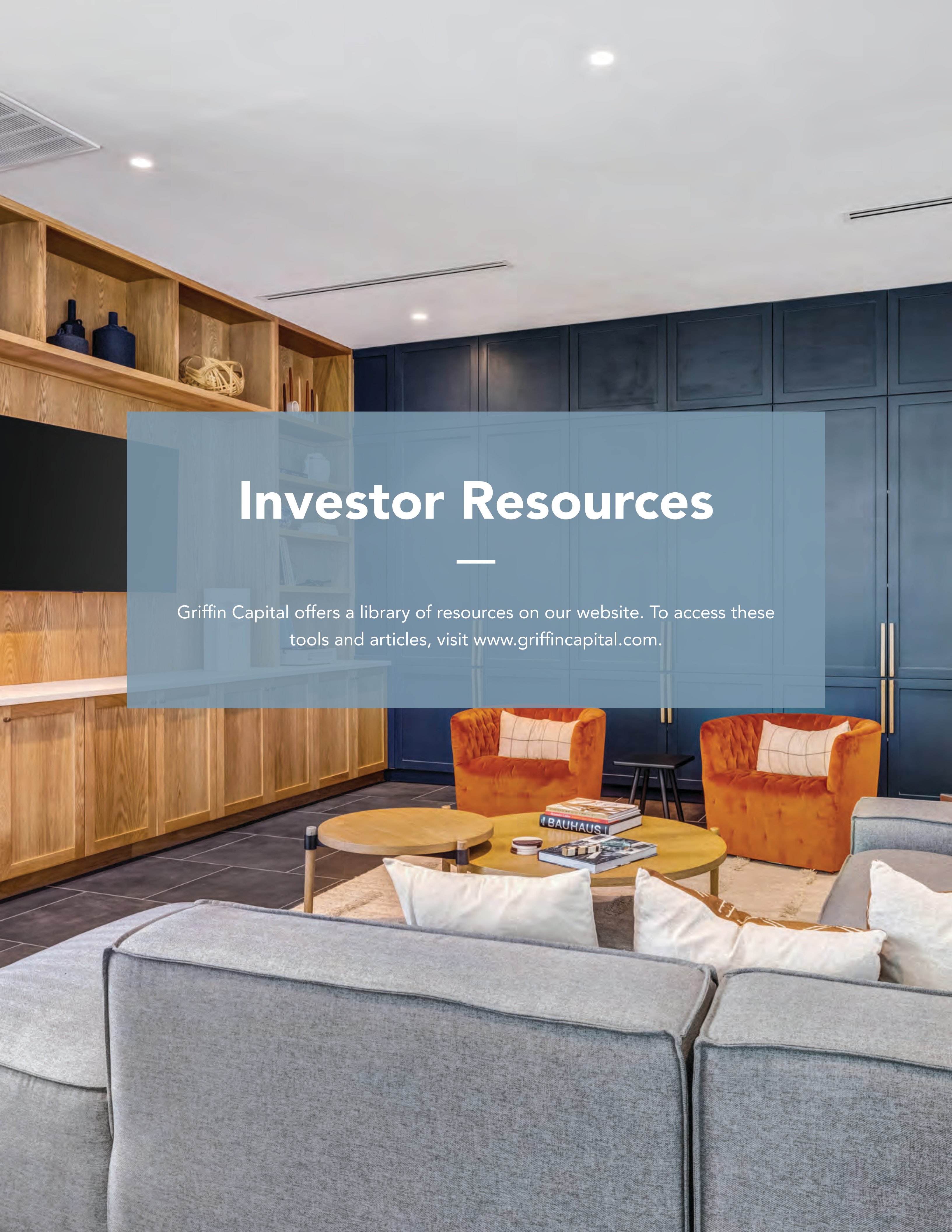

Investor Resources

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