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2024
Multifamily Mid-Year Update

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As we head further into summer and the second half of 2024, an extended winter in the property markets is giving way to renewed optimism and improved investor sentiment. While lots of ink continues to be spilled about the property markets, and dominant headlines have focused on the distress experienced by a subset of investors in very challenged segments of the market, something very different is taking shape in sectors underpinned by secular demand where fundamentals and valuations have remained extraordinarily resilient.

The past two years have been marked by significant uncertainty regarding the path of interest rates and the associated impacts on valuations and economic activity. Both buyers and sellers have been reluctant to transact as conflicting data caused forecasts to swing between both future hikes and rate cuts. However, recent data and Fed comments have strengthened the consensus view that we are at the end of the rate hiking cycle, allowing investors to more confidently assess property valuations. In addition, forward looking data indicates that the uptick in construction activity has peaked, creating greater certainty about future supply and demand. As a result, investment sentiment has strengthened around the notion that now is the time to begin deploying capital.

Of the major property types (multifamily, industrial, office, retail, hospitality), we see this sentiment most pronounced in the multifamily sector, which has historically held the distinction of being the most liquid sector based on transaction volume and the largest target allocation for institutional investors over the past several years. However, similar to all sectors, multifamily transaction volumes fell precipitously in the face of elevated interest rates and economic uncertainty. Recently, this trend has shown clear signs of reversal, with two of the largest institutional investors, Blackstone and KKR, signaling they plan to grow their allocations and have taken significant steps to do so. In April, Blackstone acquired AIR Communities, adding 76 multifamily communities and a little over 27,000 apartment units to their portfolio at a price of approximately $10 billion. This was followed by KKR's announcement in June that they acquired 18 multifamily communities totaling over 5,200 units from Lennar's Quarterra at a price of approximately $2.1 billion, marking its largest ever multifamily acquisition. Both portfolios contain multifamily communities spread across both Coastal and Sun Belt markets and neither traded at pricing that would indicate distressed acquisitions.

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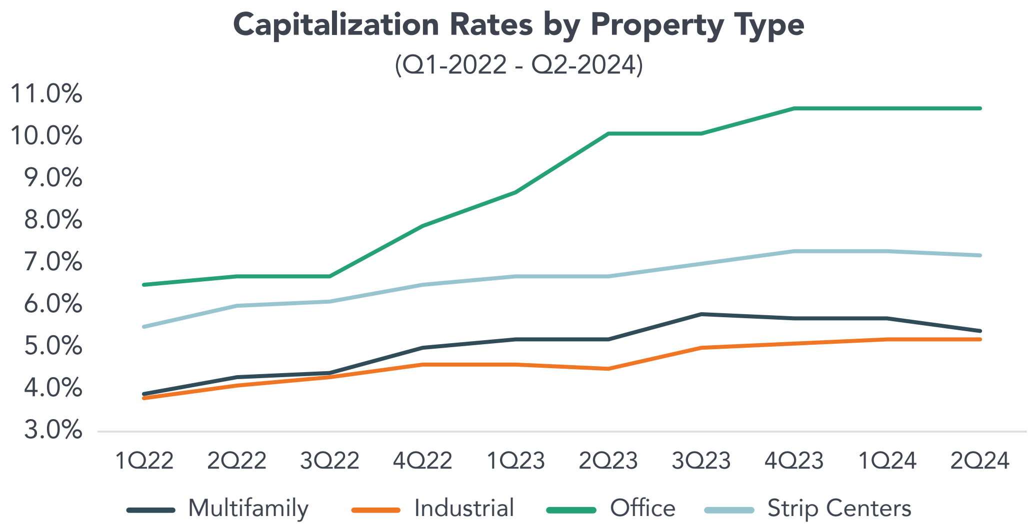
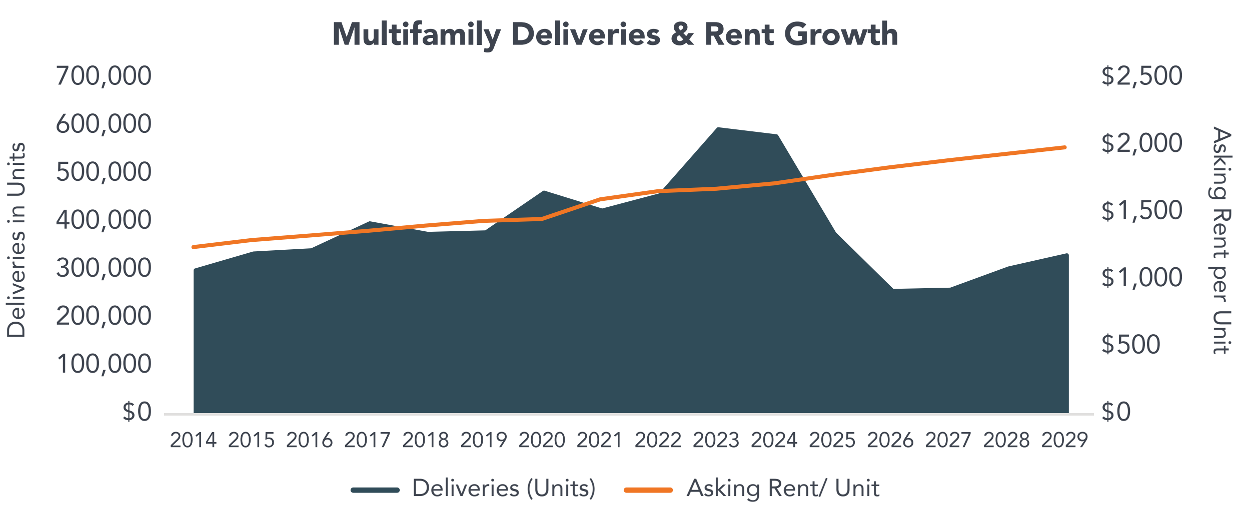
So why are the largest investors deploying capital in the multifamily sector? It is their ability to see the forest through the trees and to understand that a window of unique opportunity will close as other market participants become more active. It is the early cycle opportunities that the well-positioned investors are able to identify and seize upon, and for which they are often most handsomely rewarded. More specifically, institutional investors growing appetite for multifamily assets is being driven by three key factors:

1. **Entry-Point:**
   From a buyer's perspective, it is unlikely that it will get a lot better than it is now. As rates have risen and uncertainty has prevailed, valuations have adjusted, enabling attractive entry points. At the same time, replacement costs have continued to rise, providing a protective moat for buyers. If borrowing costs remain steady or decline going forward, the upside convexity in valuations becomes increasingly attractive with more limited downside. Though multifamily values have declined over the interest rate hiking cycle, they have been far more resilient than most anticipated as fundamentals have remained quite strong, also limiting potential downside performance in the asset class.



Source: Green Street.

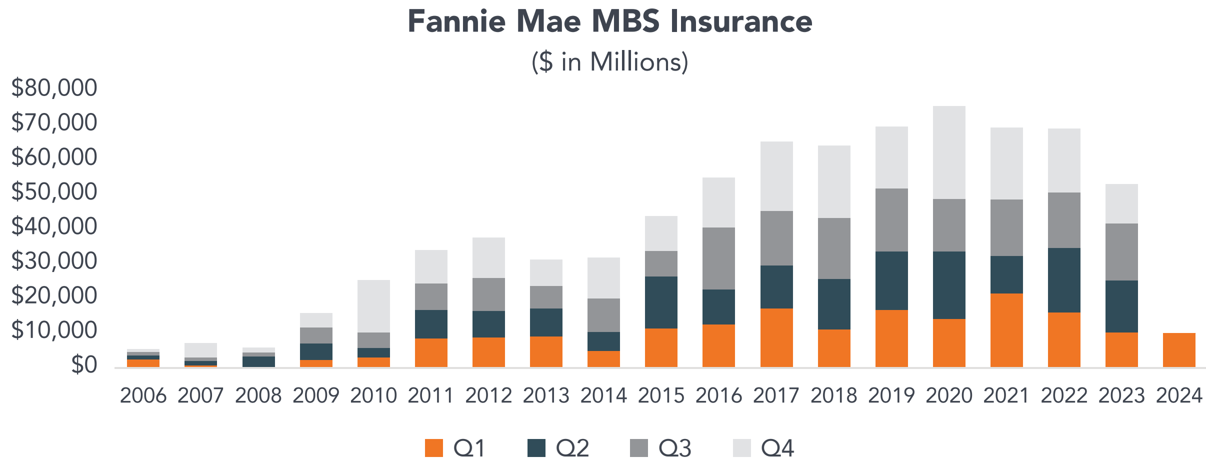
2. **Fundamentals:**
   Investors deploying capital today have a strong likelihood of being able to grow the cash flow they are acquiring in the very near future. After record rent growth in 2021 and the first half of 2022, new apartment supply has given investors concerns about both occupancy and rent growth. This uncertainty put an additional governor on investment activity as market participants waited patiently to evaluate the associated impacts of record new deliveries in 2023 and the first half of 2024. The market has proven much more resilient than anticipated, as household formation, shifting population demographics, lack of single-family housing supply and high mortgage rates have created a very deep and sticky rental pool. Overall occupancy levels have remained above 94%, absorption levels have been historically robust, and rents have been fairly stable. What is now clear to investors is that as we look forward to 2025, new deliveries will decline dramatically, creating a much more favorable operating environment for owners.



Source: CoStar. Data retrieved July 9, 2024. Data is forecasted for years 2024 and forward.

3. Tightening of Credit:

Not only have rates risen but the availability of credit has tightened materially in recent years. This dynamic disproportionally impacts smaller investors who rely on higher amounts of leverage to fund acquisitions and have less equity on their balance sheet to support loan guarantees. As a result, these investors are perceived as riskier borrowers and lenders have been reluctant to extend capital to them, even at higher costs, effectively squeezing them out of the market and onto the sidelines. Fewer market participants lead to more opportunities for those that are well-capitalized and can act quickly. It also creates opportunities to acquire good assets currently held by smaller investors who bought when values were higher using elevated leverage that have loans that are now maturing. In addition, materially tighter credit conditions have dramatically reduced new construction starts, which will inevitably lead to fewer deliveries as we get into 2025, leading to a less competitive operating environment for landlords and likely a strong rent growth cycle.



Source: Fannie Mae Multifamily.

This Window Is Temporary

Today's tighter credit dynamics will not persist in perpetuity. Inevitably, capital markets will thaw, spreads will tighten, and base rates will ease. This will lead to more market participants and improved valuations. The new supply coming to the market today will continue to be absorbed by a deep rental pool across all age cohorts that remain gated from the single-family market due to housing production shortfalls and associated affordability challenges. The currently elevated level of new deliveries falls off dramatically over the ensuing 12 months, which is expected to lead to dynamics that favor landlords and their ability to grow rents on the back of strengthening demand/supply fundamentals. Well-positioned investors with dry powder understand that today represents an opportune entry point to acquire multifamily communities, and multifamily owners with high-quality assets in desirable markets with conservative capital structures understand they are sitting on highly coveted assets. Investors able to underwrite short-term softness while maintaining flexible hold periods are becoming increasingly emboldened by their confidence in the intermediate and long-term structural strength of rental housing fundamentals. Combined with less reliance on the debt capital markets, we expect the next 24 months to be a unique period of opportunity for the best-positioned investors looking to acquire as well as those selectively and thoughtfully looking to sell. By the time the narrative begins to shift, as it often does, the best deals of the next cycle may be in the rear-view mirror as both transaction and capital markets revert to more normalcy.

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