HOULIHAN LOKEY

MULTIFAMILY MARKET UPDATE

The Impact of COVID-19 on Q1 2020

Market Update

As of April 23, the COVID-19 crises has resulted in more than 26 million Americans losing their jobs and many others having increased financial uncertainty. While rent collections held strong for April 2020, owners are planning for the potential of increased collection loss. This uncertainty is combined with the increased volatility and slowing of activity in the commercial real estate markets. The following major trends emerged in the U.S. multifamily market during first month of a near nationwide series of stay-at-home orders and mass closures of commercial business:

Rent growth forecasts are likely to be bleak for the foreseeable future

- Multifamily REIT revenues for 2021 are estimated to decline 3%–4%, and NOI by 15% in 2022.[(1)]
- REIS's protracted economic slump scenario projected effective rent and occupancy levels to be lower than 2019 through 2023.[(2)]

Transaction volume sees a sharp decline

- 19% of multifamily transactions scheduled to close in April 2020 have been canceled.[(3)]
- Multifamily transaction volume from March 1 to April 27 totaled 444 deals, down 64% from the same period in 2019.[(4)]

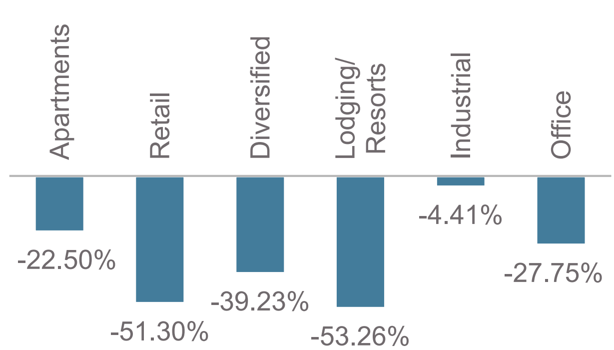
Rent delinquencies rose dramatically and may continue to grow

- 11% of renters missed April 2020 rent payments (as of April 19) compared to 7% the previous year.[(5)]
- Use of credit cards to pay rent rose 30% month over month between March and April 2020.[(6)]

Capitalization rates and valuations are starting to reflect COVID-19 impact

- Green Street's 4/19/2020 Residential Sectors report indicates that the net asset values of seven major apartment REITs have declined by 11%–15%.[(7)]
- Multifamily REIT cap rates have been revised upwards by 20–30 basis points, and REIT NOI growth estimates have been reduced by roughly 500 basis points through 2022.[(7)]
- YTD total returns for public apartment REITs witnessed a 22.5% decline.[(8)] To the right is a chart comparing YTD public REIT returns by asset type.

YTD Relative Returns By Asset Class



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Vacancies projected to grow despite government protections

- The national vacancy rate is forecasted to grow from 5.1% in 2020 to 8.1% in 2021.[9]

Construction is more constrained

- Construction starts for buildings of more than five units dipped 32.1% between February and March, from 511,000 starts to 347,000.[10]
- A survey of major apartment developers indicates that 77% of them have already experienced permitting delays and 70% have seen construction start delays due to COVID-19.[11]

Forecasting strong and weak multifamily markets

- Seattle (minimal impact from Boeing layoffs), the Washington, D.C., metropolitan area (government and military jobs should shore up rent trends), the Carolinas (economy is less dependent on banking compared to 2008), and Philadelphia (sizeable healthcare and education base) will likely see strong rent growth after the pandemic ends.[12]
- Conversely, rent growth is expected to lag behind in Los Angeles (weak leasing trends and elevated delinquency rates among private market portfolios), Orange County (hospitality job losses and extra supply from converted vacation rentals), Orlando (hospitality job losses), and Houston (oil).[12]

Government action is providing relief to multifamily owners

- The $2 trillion CARES Act allows multifamily owners with federally backed mortgages to seek forbearance. However, owners who request forbearance cannot charge late penalties, pursue evictions, or issue negative credit reports on delinquent tenants.[13]

Multifamily debt rates still relatively low, although higher than in prior months

- In the wake of the pandemic, Freddie Mac multifamily rates for 10-year fixed-rate date has been in the 4.06%–4.23% range (assuming 60% LTV/1.35x DSCR).[14]

The financial future of the multifamily industry is unquestionably in flux, but one promising sign is that landlords, tenants, and the federal government have all shown flexibility in responding to potential rent delinquencies. In the midst of this uncertainty, owners and investors are carefully considering the impact on their portfolios.

In this challenging environment, Houlihan Lokey stands ready to assist multifamily owners and investors with assessing their real estate portfolios and provide guidance to best position the sector to weather the storm.

Action Items

Have an assessment done on your property values to understand the potential impact of COVID-19, if any.

Evaluate whether now is a good time to consider planning a property tax appeal.

Reevaluate or delay any nonessential planned capital expenditures in order to conserve cash on hand.

Review existing credit agreements and consider liability management strategies.

Enlist professionals that can assist in assessing strategic alternatives and new purchase opportunities.

CONTACT US

Houlihan Lokey has a successful track record in assisting its real estate investors and owners through times of extreme volatility and exogenous events.

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Sources:
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2) *Moody's Analytics REIS, "COVID-19 Outbreak: Impact on CRE."*
3) *Mark Heschmeyer, "Canceled Deals Surge During Pandemic." CoStar (April 23, 2020).*
4) *Real Capital Analytics.*
5) *National Multifamily Housing Council, NMHC Rent Payment Tracker (April 19, 2020).*
6) *Will Parker, "Out-of-Work Apartment Tenants Putting. Monthly Rent on Plastic." Wall Street Journal (April 15, 2020).*
7) *Green Street Advisors, Residential Sectors (April 19, 2020).*
8) *Nareit (April 24, 2020).*
9) *Moody's Analytics REIS. Ibid.*
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11) *National Multifamily Housing Council, 2020 NMHC Construction Survey (Round 2).*
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13) *Marcus & Millichap, Capital Alert (April 17, 2020).*
14) *Marcus & Millichap, Freddie Mac SBL Rates (April 21, 2020).*

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