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Multifamily Buyers, Sellers Waiting for the Other Side to Blink

Yardi Matrix expects distress to increase.

By Paul Bergeron

It's a bit of same ol', same ol' for now in multifamily deal-making two months into 2023 – not a whole lot.

"Buyers are cautious, facing higher financing costs and downgraded projections of future rent growth," writes, Paul Fiorilla, director of research, Yardi Matrix.

Cap rates averaged 5% at year-end 2022, up from the low- to mid-4% range at the beginning of the year, per Matrix.

"Most apartment owners are holding on to properties unless there is a reason to sell, such as a death, the dissolution of a partnership, or a capital event like a maturing mortgage that creates a need for restructuring," Fiorilla said.

He said he expects distress to increase.

"Banks have become conservative with the prospect of a widely projected economic downturn, so borrowers are facing both rising rates and less leverage."

There are several scenarios that will lead to distress in 2023, according to the report.

Properties that were financed at historically low rates in recent years coming up for maturity at higher prevailing rates; properties whose interest rate cap has expired and are now facing a large jump in debt-service payments; and properties that have a downturn in performance.

Indeed, despite the sector's issues, many investors view multifamily as a safer place to park capital, Fiorilla said.

"Transaction activity will pick up when market conditions return to some semblance of stability and market players believe they can underwrite with a higher level of certainty than exists today," he said.

Sellers Could Forgo Refinancing and Sell

Ian Bel, managing principal and CEO of Olive Tree Holdings, tells GlobeSt.com that market transaction activity will begin to recover in the second half of 2023.

"Given where debt and rate cap pricing are today, we expect to see an uptick in sellers that are opting to forgo refinancing and put their assets on the market," Bell said.

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“While volatility remains in the treasury rates, the swings have become more muted, allowing more certainty and visibility into the debt pricing. We are optimistic that this reduction in volatility will encourage more lenders to come into the market and hopefully reduce spreads.

“When the capital markets begin to thaw, lender demand is likely going to be largest for stabilized cash flowing assets in Tier I markets.”

Sellers Still Want 2021 Prices and Exit Cap Rates

But John Drachman, co-founder, Waterford Property Company, does not believe that transaction volume on the multifamily side will recover anytime soon.

“The bid-ask spread right now is extremely wide as buyers deal with the rising interest rates mixed with the near-term, choppy property fundamental outlook and sellers still want 2021 prices and exit cap rates,” Drachman said.

“In many ways, both sides are waiting for the other side to blink which has slowed the market. You also have many sellers who locked in long-term fixed-rate financing in 2020-2022 which does not make them feel forced to sell at all.

“You will see transaction volume pick up early next year when the realities of the current cycle hit and groups with short-term floating rate debt feel the pressure to sell. Until then transaction volume will be down.”

Fewer Sellers Means More Competition

Robert Stepp, Principal with Stepp Commercial Group, tells GlobeSt.com that in 2022, Stepp Commercial Group had a significant number of listings with Los Angeles-area sellers who were frustrated with rent control and other problematic apartment legislation.

Stepp Commercial Group completed over $200 million in transactions throughout greater Los Angeles last year and helped identify 1031 exchange opportunities in several states including Arizona, Florida, and Texas.

Clients were looking to trade into states that provided a stronger ROI for the long-term and fewer restrictions, Stepp said.

“We see that trend continuing into 2023 as owners seeking a passive income want to enjoy stability and realize wealth management goals,” he added.

“The market experienced a slowdown in transactions in late 2022 and that is continuing in Q1 2023. With interest rates rising, sellers are having to look at their asking cap rates and adjust their pricing accordingly.

“The good news is that with fewer sellers, there is more competition for the assets on the market. While the listings aren’t resulting in as many offers as a few years ago, they are still garnering strong attention from fewer buyers who have a significant amount of capital to put down, many paying all cash.

"Ultimately, many major markets across the nation continue to experience a dearth of rental housing options. With fewer construction starts due to higher development and labor costs, we can expect to see more multifamily trades later this year as confidence in the market is likely to return as we ease into an adjusted selling environment."

Staying Committed to Multifamily Sector

Steve Figari, co-founder and managing partner at Shoreham Capital, tells GlobeSt.com that despite an overall slowdown across the industry, markets like Florida and the larger Sun Belt region, are still experiencing significant demand.

"We are focusing on areas with positive supply/demand dynamics and long-term growth rates," Figari said. "We are also looking at deals that may arise from special situations, including distress, where there are opportunities to recapitalize and reposition properties."

He said that Shoreham remains committed to the multifamily sector because, "with this approach, we believe we will emerge with an irreplaceable portfolio as market fundamentals stabilize."

Secondary Markets Could be First to Get New Capital

Mike Madsen, vice president of acquisitions and economics, RealSource Properties, tells GlobeSt.com that month-over-month changes in macro rental rates have normalized since August but lag in Consumer Price Index trailing 12-month measurements.

"The case for the Fed to achieve their desired soft landing is building as employment remains resilient," Madsen said.

"If the Ukraine-Russia conflict deescalates during the first half of the year that could also put downward pressure on energy, transportation, and food prices. Although uncertainly remains, the record levels of capital ready to bounce could move quickly back into buy mode in Q3, aiming for a discount from peak prices.

"We expect the 10-year rate might front-run a Fed pause, opening a window to lock in lower commercial mortgage rates from the peak. A soft landing and top in the Fed Funds rate in Q3 could be a scenario the lights could turn on as quickly as they turned off as lender cautionary levers and spreads bake in less risk of weakening rental demand.

"Capital could first jump into select secondary metros with strong rent growth expectations without oversupply threats."

Renters Won't Be Becoming Home Buyers

Joe Smazal, senior managing partner, Interra Realty in Chicago, tells GlobeSt.com that in the middle-market space, he's still seeing healthy sales velocity for well-located assets in Chicagoland.

“Private capital remains interested in acquiring multifamily assets for long-term ownership, and investors have been encouraged by strong rental market and operations in Chicago,” according to Smazal. “We also don’t expect to see much attrition from renters going into first-time homeownership this year.”

Relative to other markets that were more popular over the last couple of years, Chicago has shown a lot of stability and, depending on the specific location within the city, still presents opportunities to acquire deals with cap rates at or above interest rates, Smazal said.

“If we see rates come down and/or less trepidation from the macroeconomic uncertainty, we’ll see the floodgates open.”