GlobeSt.com™

How Multifamily is Penciling Deals Amid an Uncertain Capital Market Environment

"Now our focus is on liquidity and not what this thing is worth but what you can sell it for in a reasonable amount of time."

By Melea VanOstrand

The multifamily sector is thriving nationwide as demand for more apartments continues to grow. But it hasn't escaped the impact of rising interest and cap rates on lenders and investors.

Lending and capital experts at GlobeSt's Spring Multifamily Conference, shared their take on the impact of interest and cap rates, and their predictions for 2023.

"Not much is trading, and if it is, it has to," said Doug Faron, founding partner of Shoreham Capital. "More will transact before rates have the chance to come down, but we're certainly optimistic we'll see some normalizing of rates and or normalizing spreads too."

According to Faron, the multifamily sector was benefiting and powered by a low-interest rate environment.

"Today, we're seeing that shift. If it was a marvelous opportunity that could be a 3 cap or a 2.75 cap. I think the equivalent asset today is coming out at 5 cap," he said.

Tom Noble, senior vice president, and COO of Archway Capital, said it's hard to see a path forward unless rental growth also goes down.

"Because rents are such a large component of the core inflation metric the Fed looks at, you can't have both," Noble said. "Either rents are going to keep going up, or rates will probably stay high or rise, or rents are going to moderate and go down and rates will follow. In the multifamily sector, that's the big headwind that we have a really hard time penciling. That's been true of the last year."

The state of the market has been good for lenders, panelists say.

"When banks are pulling back and transitional capital markers are feeling some frictions and deals aren't penciling through the bank or credit union and the capital, that's our time to shine. It's our busiest time," said Noble. "We're firmly lending in the mid-9s about 10%. Our coupon is traditionally a little higher than what you're seeing out there. We were very focused on the asset and the value of that. Now our focus is on liquidity and not what this thing is worth but what you can sell it for in a reasonable amount of time."

But it's a different story for multifamily investors.

"If you're buying a multifamily project, or any commercial project really, and you're in significant rental growth, sharpen your pencil," said Noble.

One of the biggest challenges for multifamily investors is to structure their investment. For Hen Shoval, principal and director of investments at Pensam Capital, the key to achieving that is to source the right type of capital, especially if you're a long-term investor.

"If you focus on a business plan and work the asset, then I think you really have a shot at making a lot of money," Shoval said.

According to Faron, in West Palm Beach the office supply has doubled in the past two years as new-to-market employees seek a high quality of life and seek apartments as people are deciding to rent rather than buy.

“We believe this massive growth we saw in Covid is only the first wave,” he said. “We’re seeing tempering but in the next five to ten years we’ll still see growth in this market, since people are thinking about the big picture and what quality of life needs to happen.”

As the economy changes, deal terms and strategies are changing, Shoval said.

“Most deals have cash flow challenges which means more reserves upfront, you definitely want the cash. There’s interest rate risk, and most cases require either money or at-market interest rate caps which tend to be pretty expensive,” said Shoval. “I would say that most recently, the biggest changes that we’ve seen in the types of deals we do is just more flexibility when it comes to debt covenants.”

As Faron sees it, building relationships is most important as the market is uncertain. “You want a partner, not someone just like, okay, here’s the test, see you later,” he said.

Going forward, the panelists agree that rents have to see a decline before rates temper.

“The one thing we discuss a lot is the notion that interest go up to moderate inflation but it’s basically destroying the opportunity to develop a new product. It’s a formula that’s difficult to predict which is in part why I’m still bullish on multifamily long-term because I think rents will have grown. Maybe they’ll readjust in the short-term but in the long-term in theory, we should see positive growth,” said Shoval.

GlobeSt.com™

R[AR]E
PUBLIC RELATIONS