

The Multifamily Upcycle Still Has Legs

The Multifamily Rental Housing Sector Continues to Benefit from High Demand and Limited Supply

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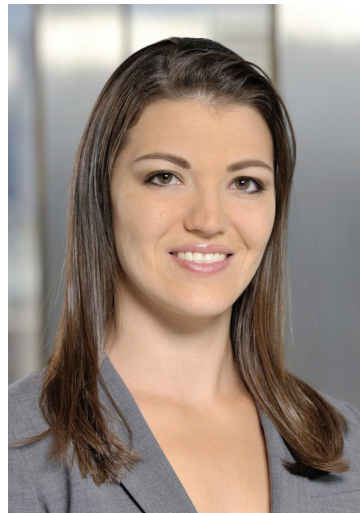
The multifamily for-rent housing sector remains strong and is continuing to attract capital investment. With demand for apartments consistently increasing over the past few years, efforts to develop sufficient supply has lagged behind. This trend appears to be setting the stage for investments in apartments to remain an attractive opportunity for savvy real estate investors and developers.

Several factors may be driving this trend, as conditions in the real estate and financial markets appear to be pushing consumers towards multifamily rentals and away from purchasing single-family homes.

In recent years, growth in demand for housing has bumped up against limited and expensive supply. Since 2008, increased demand for housing has largely been driven by population growth and expanded migration to major cities in the sunbelt states.^[i] Although the U.S. population has grown by more than 12 million



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people in this period, housing development has stagnated. Nationally, single-family housing continues to be quite expensive, and as of mid-2013 construction of new homes was largely on hold in nearly every state, with only moderate increases as of August 2014.^[ii] At a more local level, single-family and condominium home sales are down approximately 12 percent over last year in Southern California, ^[iii]

and in the 20 major U.S. cities there was an approximately 12 percent increase in average home prices for the year ending April 2013 and another 5 percent increase for the period ending July 2014. ^[iv]

Additionally, stringent underwriting standards and other market factors have created significant barriers to entry for new home buyers. The share of aggressively underwritten mortgages from Fannie Mae and Freddie Mac has decreased by approximately 10 percent since 2001, and the share of aggressively underwritten FHA mortgages

has decreased by approximately 40 percent since 2006. ^[v] Underwriters are requiring higher down-payments and better credit scores to qualify for financing, but soaring student loan default rates, unemployment rates and other financial difficulties are limiting consumers' ability to satisfy underwriting requirements. These elements have made financing for single-family home purchasers difficult to come

by, especially for low income individuals and minorities who are disproportionately impacted by these restrictions.[vi] Contrast this with the relatively cheaply priced financing options available through Fannie Mae and Freddie Mac for multifamily properties, making apartments a more attractive investment option.

This trend is also fueled by the impact of the Great Recession on attitudes about homeownership among the next generation of potential homeowners. Adults in their late-20s and early-30s have typically made up the bulk of new home buyers. However, this demographic (also known as Generation Y) is currently experiencing higher unemployment rates and higher student loan burdens than the rest of the population, making home ownership seem out of reach and somewhat undesirable to this group. Also, their potential entry into the housing market coincided with the recent housing crisis, depressing their outlook on homeownership and real estate investment as compared to prior generations. The instability in the job market and perceived risk of investing in the housing market has greatly impacted preferences for rental housing over homeownership among Generation Y.[vii]

These conditions appear to have collectively reduced enthusiasm among potential home buyers and led consumers to favor multi-family rental housing over homeownership. However, as consumers have been spurred to look toward the multi-family rental market to fulfill their housing needs, the market has struggled

to maintain sufficient supply to address consumer demands.[viii] Unfortunately, supply of multi-family housing is restricted by the difficult, expensive and lengthy process of acquiring suitable property and obtaining necessary entitlements for new development and re-development. Available rental apartments have continued to be absorbed by the market, with vacancy rates consistently declining over the past six years, and absorption within the first three months after completion up from 53 percent in the first quarter of 2009 to 64 percent in the first quarter of 2014.[ix] Additionally, development has typically lagged behind demand, largely as a result of the approximately year long process from initial permits to completion of a project.[x]

What does this mean for potential investors and developers? Well, it seems that multi-family rental housing remains in high demand and limited supply. The key for success in this landscape will be identifying the right opportunities and assembling an effective team of experts to navigate the acquisition and entitlements processes. [MHN](#)

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[i] The Atlantic: Citylab (Kolko, Jed), *Population Growth in Dense U.S. Cities: Short-Term Correction or Long-Term Trend?*, April 15, 2014.

[ii] Christian Science Monitor (Trumbull, Mark), *US Home Prices Rise Again: Why this Housing Market Has Legs*, June 25, 2013; U.S. Census Bureau News, *New Residential Construction in August 2014*, September 18, 2014.

[iii] Los Angeles Times (Khouri, Andrew), *Southern California Home Sales Plunge in July*, August 13, 2014.

[iv] Christian Science Monitor, *Ibid*; S&P Dow Jones Indices, *S&P/Case-Schiller 20-City Composite Home Price Index*, July 2014.

[v] For Fannie Mae and Freddie Mac, this reflects loans to borrowers with credit scores below 690 for properties with a loan to value ratio above 85%; for FHA, this reflects loans to borrowers with credit scores below 680. Joint Center for Housing Studies of Harvard University (Belsky, Eric), *Housing Demand*, May, 2014.

[vi] Joint Center for Housing Studies of Harvard University, *Ibid*.

[vii] Investor's Business Daily (Alva, Marilyn), *Home Sales Haven't Recovered with First-Time Buyers AWOL*, August 21, 2014.

[viii] Los Angeles Times, *Ibid*.

[ix] National Multifamily Housing Counsel, *Quick Facts: Market Conditions*, May, 2014; U.S. Census Bureau, *Survey of Market Absorption of New Multifamily Units Main; Table 1. Absorption Rates of Privately Financed, Nonsubsidized, Unfurnished Rental Apartments: 2008 to 2014*, First Quarter, 2014.

[x] National Association of Home Builders (Dietz, Robert), *How Long Does it Take to Build Multifamily Housing?*, November 15, 2013; U.S. Census Bureau, *Length of Time: Authorization to Start and Start to Completion*, 2013.