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COVID-19: A Game Changer for Multifamily

The COVID-19 pandemic ended years of healthy multifamily fundamentals. Will the industry's pain be short-lived or the start of a new trend that is less favorable for the sector?

After nearly a decade of solid growth, multifamily asking rents dropped 0.4% nationally in April and May, with twice as many metros seeing rents decline (71) as increase (35), according to a study of 107 U.S. metros by Yardi Matrix. Metros with the most rent growth since the pandemic started—led by Portland, Maine (1.7% in April and May); Mobile, Ala. (1.3%); and Memphis (1.3%)—are primarily smaller markets, many in the Southeast and Midwest. Primary and secondary metros, with concentrations of urban properties in coastal centers, felt the most impact. Asking rents fell at least 0.6% in all primary markets, with the biggest decreases in Boston (-1.5%), Los Angeles (-1.4%) and San Francisco (-1.0%).

Demand has weakened, and renters are increasingly looking for more inexpensive stock. Newer luxury units with the highest rents have fared worse than more moderately priced units. Rents of luxury Lifestyle units nationally decreased by 1.2%, compared to a decline of only 0.5% for working-class Renter-by-Necessity units. New units coming online are taking longer to lease up, prompting owners of more expensive units to offer concessions or lower rents to attract tenants.

Whatever pain the industry feels over the short term, however, pales in importance to the potential long-term impact. Economic growth is now negative, and the shape of the recovery remains unclear. More important, the pandemic is spurring changes in working conditions and social trends that will impact housing demand for years to come.

Rent Growth Cycle Ends

Multifamily had a long run of strong performance –asking rents grew by 26% nationally between January 2015 and the first quarter of 2020—until the coronavirus hit. Since mid-March, more than 40 million Americans have lost jobs, at least temporarily, and the unemployment rate skyrocketed to 14%. The layoffs were disproportionately concentrated among hourly low-wage workers, who tend to be renters. Suddenly, property owners' primary concerns were collecting rent payments and maintaining occupancy. Many are rolling over leases of existing tenants with no increases.

Nationally, asking rents dropped 0.4% since then (all rent data cited is from Yardi Matrix). Energy-dependent Midland-Odessa, Texas (-8.6%) saw the biggest immediate decrease, but major markets were among the hardest hit. The 13 metros that experienced rent drops of 1.3% or more include San Diego (-1.8%), San Jose and Nashville (-1.7%), Boston (-1.5%), Los Angeles and Denver (-1.4%), and Austin and Seattle (-1.3%).

Some metros did see rents increase in April and May, mostly smaller or tertiary markets. Of the 18 metros that saw rent growth of 0.6% or more during that time, none are among the top 20 largest metros by population and half are in the Midwest. Those metros include Omaha, Cleveland, Columbus and Toledo (0.8%), and Grand Rapids, St. Louis, Wichita and South Bend (0.6%).

Reasons for the metro-level differences are varied. The initial impact occurred in large states with major travel hubs such as New York, New Jersey, California and Illinois that were the first to impose shelter-in-place orders that closed businesses. Coastal metros with high rents were affected, as property owners found it difficult to raise rents given the uncertainty about employment, calls for rent forbearance and eviction prohibitions. Some affected metros have concentrations in major industries such as energy or entertainment—Las Vegas and Houston, for example. Also disproportionately hit were some metros with a large amount of new inventory coming online, such as Nashville and Denver.

Issues related to urbanization and social distancing also loom large. With offices, restaurants, en-

Top 10 Markets: 2-Month Rent Change	
Portland ME	1.7%
Mobile	1.3%
Memphis	1.3%
Huntsville	0.9%
Omaha	0.8%
Cleveland–Akron	0.8%
Toledo	0.8%
Columbus (OH)	0.8%
Honolulu	0.7%
Grand Rapids	0.6%

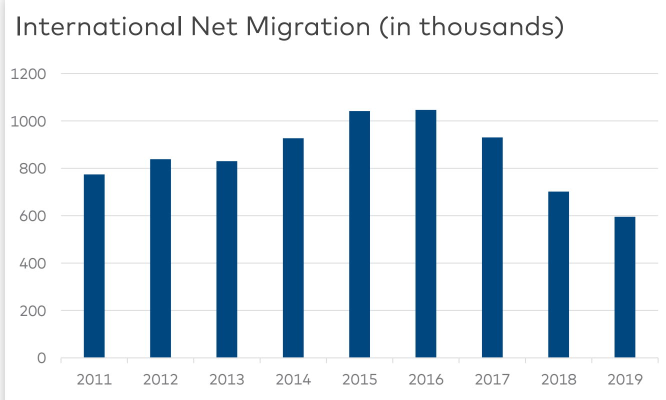
Source: Yardi Matrix

Bottom 10 Markets: 2-Month Rent Change	
Austin	-1.3%
Jacksonville	-1.4%
Denver	-1.4%
Tallahassee	-1.4%
Los Angeles	-1.4%
Boston	-1.5%
Nashville	-1.7%
San Jose	-1.7%
San Diego	-1.8%
Midland–Odessa	-8.6%

Source: Yardi Matrix

tertainment venues and schools closed, and residents ordered to stay six feet from others, the social advantages that led to the growth of walkable downtowns turned into drawbacks. Many city dwellers, especially those with children, decided they preferred to quarantine with relatives or friends in the suburbs, move to vacation or second homes, or in some cases make permanent moves outside of urban centers.

Asking rents are likely to drop more throughout the year as demand wanes. The economic shock from layoffs and furloughs will impact household formation, as some young adults will live with family or friends rather than rent on their own. Immigration into the United States has dropped steadily in recent years, falling 595,000 in 2019, the lowest level in 30 years and 43% less than 2016, according to the U.S. Census Bureau. Immigrants overwhelmingly rent rather than own, which cuts demand in large urban areas where they tend to migrate.



Source: Yardi Matrix

Changing Work, Lifestyle Preferences

The question for the industry is whether these negative trendlines are a short-term blip that recovers quickly after COVID-19 is under control or if the pandemic will create trends that are unfavorable for multifamily over the long term.

One key issue is whether social distancing will reverse the decades-long trend toward urbanization. Cities have benefited from trends that include growth of knowledge-based jobs. More than 70% of jobs created in the 2010s decade were in urban areas. City centers have thrived as adults—young and old—increasingly opt for their experiential lifestyles and the ability to live near jobs and avoid long commutes from suburbs.

As offices across America are now shut down or operating at partial capacity and many corporate employees are working from home, the composition of future multifamily demand depends to some extent on how workforce issues are resolved. It seems certain that office working arrangements will become more flexible, but to what degree? Will corporations find that they no longer need to congregate in high-cost metros such as New York, San Francisco and Chicago? Will they increase use of remote offices in secondary and tertiary markets?

Workers who are completely remote have much more freedom to live where they want than those who must work at an office two or three days a week. Will giving employees a choice of work location create an exodus from cities? Undoubtedly, for some it will. The pandemic has given many families with children an appreciation of suburban life with more open space. Will that generate different lifestyle decisions once the pandemic is over?

Urban growth has been predicated on lifestyle choices such as fewer people driving cars and a desire to have easy access to restaurants, work and entertainment venues—the axiomatic "live, work, play" standard in rapidly growing 18- or 24-hour cities. Young workers want to congregate in cities where they can socialize with like-minded peers and establish business networks to propel their careers. The pandemic has temporarily forced some to remain relatively isolated, and others have left cities to live with family while they are furloughed. When the pandemic is "over," however that plays out, what percentage of young adults will change their lifestyle preferences and be satisfied with the suburbs?

Urban centers in recent years have also attracted an increasing number of adults who are retired or near the end of careers, some of them choosing to stay in the city as a primary residence or maintain a city apartment along with a second home. Will the pandemic prompt these households to abandon the CBD residences?

Another question is how policy shifts. The national election in November could produce a change in the White House and Congress that would impact policy involving areas such as the social safety net, rent control, regulatory mandates, infrastructure spending and an increase in immigration to pre-Trump administration levels. The U.S. averaged 938,000 net immigrants per year between 2001 and 2017, per the Census Bureau.

More Questions Than Answers

Much of this analysis is framed in the form of questions because it is difficult to predict the result of an unprecedented situation. The largest uncertainty remains the course of the virus. Contrary to many expectations, cases of COVID-19 have increased in states such as Florida, Arizona and Texas that had fewer cases initially and opened their economies first. That could bode ill for the chances of a quick economic recovery and a rapid return to crowded workplaces, and lead to changes in metro-level performance.

Over the short term, the impact on the multifamily sector has been limited. The industry comes into the recession in a place of strength, with occupancy rates of stabilized units at 95% nationally. Enhanced unemployment aid, which has helped keep rent payments for professionally managed apartments close to historically normal levels, runs out in July and Congress has yet to approve an extension. Rents and occupancy levels have worsened only slightly to date, but performance could easily deteriorate if jobs don't bounce back or the federal government doesn't continue its financial support.

Bottom 10 Markets: 2-Month Change in Avg Rent	
Nashville	$(21.82)
Denver	$(22.25)
Central Coast	$(22.56)
Seattle	$(23.08)
San Francisco & East Bay	$(28.56)
Los Angeles	$(31.70)
Boston	$(33.66)
San Diego	$(35.53)
San Jose	$(49.65)
Midland–Odessa	$(117.26)

Source: Yardi Matrix

Multifamily fundamentals have taken their first real hit in a decade, but the immediate downside is likely to be shallow, absent extended economic obstacles or a premature withdrawal of government support. At the same time, the industry also will be forced to adapt to generational developments regarding the future of work and evolution of lifestyle preferences.

—Paul Fiorilla, Director of Research