Yardi Matrix

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Strong Capital Flows Point To Rebound in Multifamily Deals

- Multifamily transaction activity has fallen sharply in 2020 due to the fallout from COVID-19. Through three quarters in 2020, $50.6 billion of multifamily property sales were completed in the U.S., down 41.7% from $86.5 billion through the same period a year ago, according to Yardi Matrix. There's little hope full-year volume will get close to 2019's record high of $127.8 billion.

- The impact has been uneven across metros, regions and property types. Gateway and coastal metros have generally seen a larger decline in deal flow than secondary and tertiary markets in the Sun Belt and Southwest.

- Much of the change could be described as a "filtering" effect: investors moving from urban cores to inner-ring suburbs, from primary to secondary metros and from secondary to tertiary metros. This phenomenon results from several factors, including owners putting fewer properties on the market, disagreement between buyers and sellers about prices, the composition of buyers, and the competition for assets.

- Sales recovered in the third quarter after hitting a trough in 2Q20, but like so much about the economy, a return to "normal" transaction activity is hard to predict. Until the pandemic recedes and people can return to daily activities with the help of an effective vaccine, uncertainty will linger.

- Despite worrying economic signals—U.S. unemployment numbers remain high, gateway market occupancy rates and rents have plummeted, and December rent payment data shows more tenants not making payments—multifamily fundamentals have held up better than other commercial property segments and loan delinquencies remain low.

- Capital availability is strong due to lack of better alternatives, optimism about future demand for housing, and the stability afforded by the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Acquisition yields have barely budged despite the pandemic.

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Gateways Take Biggest Hit in Activity

Multifamily transaction activity abruptly hit a wall when shelter-in-place orders started in March. Transaction volume fell to $9.4 billion in the second quarter, the lowest quarterly total since the first quarter of 2011 and a decline of 62.0% from 1Q20 and 67.2% year-over-year, according to Yardi Matrix data. Deal flow picked up to $16.5 billion in the third quarter, though that is still 51.1% below 3Q19 volume of $33.8 billion. Through three quarters of 2020, total volume was $50.6 billion, down 41.7% year-over-year.

But the impact is not being felt evenly across the country. On a regional basis, the Northeast (-54.6%) and West (-51.0%) had the biggest declines, while the Midwest (-32.6%) and Southeast (-34.1%) fell the least. Urban and suburban multifamily sales have dropped by roughly the same percentage, but there has been a difference by region. Sales volume of urban apartments in the Northeast fell 63.2%, compared to only 47.0% for suburban. Meanwhile, in the Midwest, suburban multifamily sales fell by 25.7%, compared to 41.0% for urban properties.

By market size, gateway markets were down 46.4%, compared to 44.5% for secondary markets and only 29.2% for tertiary metros. Secondary markets, with $28 billion of transactions, dominated activity, representing 55.6% of all property sales. Metros with the most volume included Washington, D.C. ($3.5 billion), Denver ($2.9 billion), Atlanta ($2.8 billion), Phoenix ($2.8 billion) and Dallas ($2.6 billion).

There has been a large variance at the metro level. Only one of the 30 largest metros—Austin at 1.6%—saw an increase in sales year-over-year through nine months. Metros in which transactions declined ranged from San Jose, down 11.6%, to San Diego, which saw a drop of 76.0%. Other metros in which year-over-year sales were down by two-

Transactions by Region

Region	2019 Full Year (Mil)	2020 Jan-Sep (Mil)	2020 YTD % Change
Midwest	$9,278	$4,221	-32.6%
Southeast	$44,750	$20,532	-34.1%
Southwest	$25,495	$10,853	-39.7%
National	**$127,762**	**$50,603**	**-41.6%**
West	$34,900	$11,099	-51.0%
Northeast	$13,340	$3,898	-54.6%

Source: Yardi Matrix

Transactions by Metro Size

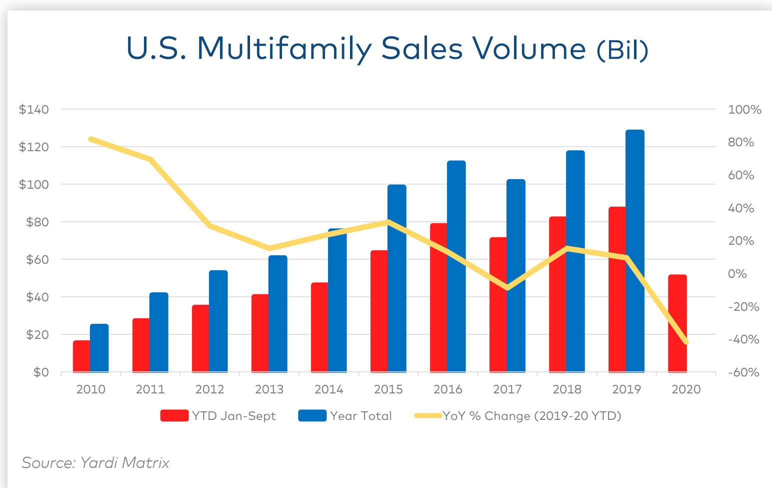
Metro Size	2019 Full Year (Mil)	2020 Jan-Sep (Mil)	2020 YTD % Change
Tertiary	$27,055	$13,140	-29.2%
Southeast	$44,750	$20,532	-34.1%
National	**$127,762**	**$50,603**	**-41.6%**
Secondary	$74,030	$28,166	-44.5%
Gateway	$26,678	$9,296	-46.4%

Source: Yardi Matrix

Transactions by Urban/Suburban

Property Type	2019 Full Year (Mil)	2020 Jan-Sep (Mil)	2020 YTD % Change
Urban	$75,553	$29,735	-41.0%
Suburban	$52,187	$20,708	-42.8%

Source: Yardi Matrix



Source: Yardi Matrix

thirds or more include Philadelphia (-74.9%), the Inland Empire (-71.3%), Boston (-70.1%), Seattle (-69.0%) and Los Angeles (-65.8%).

Reasons for the decline in activity are myriad. Facilities and activities necessary to complete deals—such as site visits, inspections, and corporate and government offices—were closed in some cities. Many banks and other sources of debt stopped lending until they could assess the landscape. And some equity sources either withdrew bids or sought to retrade deals that were under contract but not closed.

Maybe the biggest drawback—something that has not entirely diminished to this day—was the uncertainty about underwriting future cash flows and appraising values. More than 22 million jobs were lost in the first few months of the pandemic, primarily in low-paying service jobs, which produced expectations for a wave of non-payments of rent and jump in vacancy rates.

Following the Money

COVID-19 lockdowns started in March, so the impact on transaction volume to date is a small enough sample that caution is warranted when drawing conclusions. Some of the change in activity by metro could have been caused by logistical factors, such as how long and how thoroughly cities enforced shelter-in-place orders. Travel bans and limits on gatherings and office shutdowns made closing deals more difficult, if not impossible.

Even so, it is probably not coincidental that the variance in sales activity by metro reflects a shift in investor sentiment that is in line with the uneven change in metro-level fundamental performance such as rent growth and occupancy rates since the start of the pandemic. High-cost gateway and coastal metros have experienced sharp drops in rents and occupancy levels, while many secondary and tertiary metros in the Sun Belt and Midwest have surprisingly maintained modest growth.

Transactions by Metro

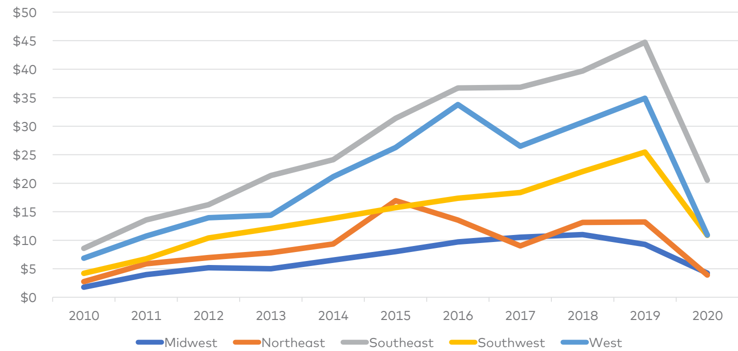
Metro	2019 Full Year (Mil)	2020 Jan-Sep (Mil)	2020 YTD % Change
Austin	$2,132	$1,499	1.6%
San Jose	$1,421	$554	-11.2%
Denver	$5,274	$2,920	-14.6%
Washington DC	$6,295	$3,502	-15.0%
San Antonio	$1,589	$744	-20.3%
Nashville	$1,537	$783	-26.7%
Pittsburgh	$234	$110	-33.3%
Raleigh–Durham	$2,854	$1,121	-39.1%
Orlando	$3,049	$1,366	-39.7%
Dallas	$6,321	$2,591	-40.7%
National	**$127,762**	**$50,603**	**-41.6%**
Miami Metro	$2,838	$1,267	-43.5%
Twin Cities	$1,237	$513	-43.6%
Charlotte	$3,062	$1,052	-46.0%
Atlanta	$7,767	$2,805	-48.3%
Houston	$4,844	$1,683	-48.4%
Chicago	$2,787	$783	-49.5%
Phoenix	$7,323	$2,788	-50.6%
New York	$3,265	$936	-51.0%
Sacramento	$1,074	$364	-51.6%
San Francisco	$3,725	$1,305	-53.7%
Tampa	$3,841	$1,305	-53.9%
Columbus	$601	$164	-55.2%
Portland	$1,792	$584	-55.5%
Las Vegas	$3,476	$762	-64.3%
Los Angeles	$4,924	$1,172	-65.8%
Seattle	$5,888	$987	-69.0%
Boston	$3,104	$568	-70.1%
Inland Empire	$1,640	$341	-71.3%
Philadelphia	$1,707	$339	-74.9%
San Diego	$1,574	$249	-76.0%

Source: Yardi Matrix

The rise in unemployment—the U.S. lost 22 million jobs from its peak and remained down by almost 10 million in November—and the decision by corporations to allow employees to work from home has led many city dwellers to migrate from urban submarkets in the most expensive metros to suburban markets in the same metro or even to secondary markets.

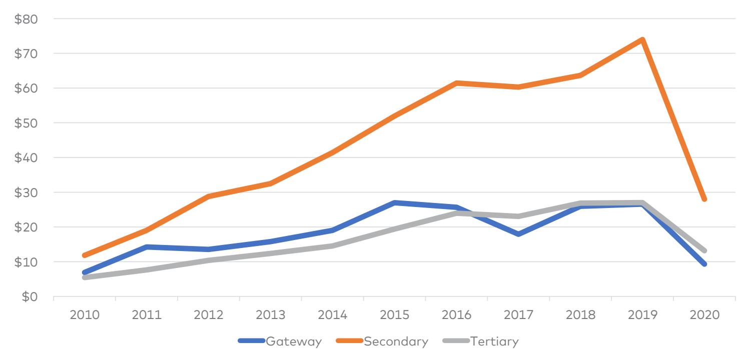
Whether the shift is permanent remains an open debate, but investors seem to be voting with their wallets, given the shift in capital away from gateway metros to secondary and tertiary metros. The top metro for sales volume year-to-date through September was Washington, D.C., a gateway metro that is stable during downturns from its connection to the federal government. The other six metros with $1.5 billion or more of volume were Atlanta, Phoenix, Denver, Dallas, Houston and Austin, all growing secondary markets that are poaching jobs and population from coastal centers.

Annual MF Sales by Region (2020 Jan-Sep, Bil)



Source: Yardi Matrix

Annual MF Sales by Metro Size (2020 Jan-Sep, Bil)



Source: Yardi Matrix

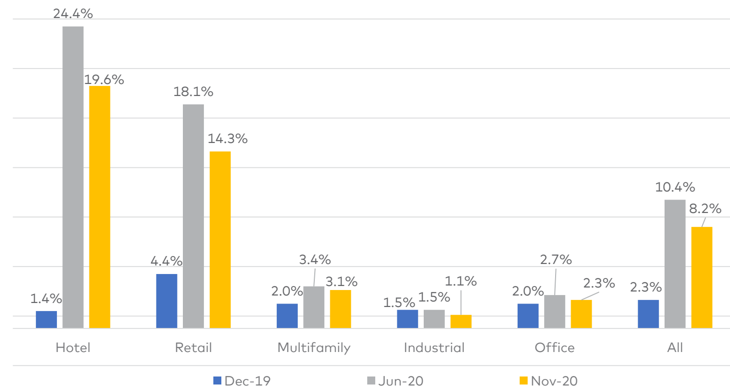
Resilient Capital Flows

The decline in multifamily property sales is caused by several factors, but a lack of capital is not among them. After a short pause in deal flow in the spring when the market collectively tried to get its bearings, multifamily once again became a sought-after asset class.

Many investors remain bullish on the prospects for multifamily demand. U.S. multifamily rents declined 0.5% year-over-year during the first eight months of the pandemic, per Yardi Matrix. However, more than 100 secondary and tertiary markets are doing better than the national average, with the declines in rent growth and demand mostly confined to large, high-cost coastal markets. Many metros in the South, West and Midwest, as well as suburbs surrounding gateway centers, have maintained occupancy and rent growth. Given the national long-term shortage of reasonably priced housing, population growth projections and homeownership trends, demand for multifamily is projected to remain strong, especially in the Renter-by-Necessity and affordable segments.

Another feature in multifamily's favor is the continued availability of debt capital, led by Fannie Mae and Freddie Mac, which are explicitly set up to provide support to the industry in economic downturns. It's not just the GSEs, though. Most lender types are eager to increase holdings in multifamily because they consider the segment as one of the safest asset classes.

Equity investors see multifamily as a highly appealing investment product. Apartments typically produce 4-6% dividend yields, which is a better return than sovereign bonds or investment-grade corporate bonds. Multifamily also is attractive relative to other commercial property classes, except for industrial. The growing work-from-home trend calls into question future levels of demand for office space, while retail and hotel properties have suffered greatly from the pandemic-related closures.



Loan delinquency rates demonstrate the performance divide. As of November 2020, 19.6% of hotel loans and 14.3% of retail loans in CMBS pools were delinquent, while the rate was 3% or less for multifamily, office and industrial, according to Trepp. It's possible—but not likely—that multifamily defaults will spike in 2021 if unemployment rates remain high, renters run out of the financial wherewithal to pay rents, and the government relief (including $600 a week of additional unemployment insurance per week) that helped in the early stage of COVID-19 is not extended.

Rent payments have been strong all year but are showing some signs of strain. The National Multifamily Housing Council's rent tracker found that 7.8% fewer tenants paid rent in early December than during the same period a year ago. Between April and November, the tracker has consistently found a roughly 2 percentage point decrease in rent payments year-over-year, so the increase in non-payments could be a sign that some tenants are finally being stretched beyond their means.

Vaccines that could help the country return to normal activity seem imminent, but it could take several months or even several quarters before people return en masse to offices, stores, restaurants, public transportation and other crowded venues. Without renewed government support, non-payments could rise, which could lead to a spike in forbearance requests or loan defaults.

Unchanging Yields

Early in the pandemic, deal flow was hampered by the big gap in the bid-ask spread; buyers sought higher yields on the idea that COVID-19 created greater downside, but sellers balked. Unless there was a compelling need, most sales were put on hold. Usually a sales slowdown leads to higher cap rates, but through the course of the year, acquisition yields have barely budged. Property performance is generally solid, demand is high, and interest rates have fallen from pre-pandemic levels, making borrowing cheaper.

Falling Treasury yields help keep prices stable. The 10-year Treasury rate was above 1.5% until late February. It fell as low as 0.50% in March before recovering to about 0.90% in mid-December. That gives property buyers a large premium over the risk-free rate and cost of debt, even with historically low cap rates.

The upshot is that demand for multifamily properties is high and should remain so for the foreseeable future. Barring a sharp and unexpected economic downturn or a health crisis that would create another shutdown, or disruption in the capital markets, multifamily transaction activity is poised to rebound in 2021 closer to pre-pandemic levels.

—Paul Fiorilla, Director of Research, and Casey Cobb, Senior Analyst

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