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Apartment Transaction Volume Hinges on Fed's Next Move

Sellers "unwilling to budge much on pricing" results in deals mostly drying up, NMHC said.

Two Federal Reserve Board chairmen this week signaled that they favor a quarter-point rate hike at the next meeting Feb. 1.

That's down from the half-point hike the meeting before that and four consecutive increases of 0.75 points prior, which have translated to a higher cost of debt financing, causing buyers to seek a higher rate of return, according to a new report from the National Multifamily Housing Council (NMHC).

Mark Obrinsky, SVP of research and chief economist, NMHC, said in prepared remarks that "with sellers unwilling to budge much on pricing, apartment transaction volume has largely dried up."

NMHC's Quarterly Survey of Apartment Market Conditions for January 2023, which measures apartment finance fundamentals based on a survey of its members, saw its Market Tightness Index register at 14 this quarter—well below the breakeven level (50)—indicating looser market conditions for the second consecutive quarter.

Over three-quarters of respondents (78%) reported markets to be looser than three months ago, while only 5% thought markets have become tighter. Another 16% of respondents thought that market conditions were unchanged over the past three months.

'We've Never Been on the Phone More'

Kevin Crook, director of acquisitions and dispositions at Investors Management Group, tells GlobeSt.com that most multifamily buyers anticipate that rates will normalize in 2023.

"There are interesting deals out there that we're looking at in certain micro markets where rents and values will outperform," he said.

"But interest rate volatility creates a challenging environment for underwriting deals that will produce predictable returns.

"As buyers, we're not sitting on the sidelines waiting for conditions to improve after Q1. We've never been on the phone more. We've never been busier connecting with the industry heavyweights and referral partners in our network. We're putting in the work knowing that there are big opportunities to capture in this market shift."

Cost of Buying 'Simply Too High'

Michael J. Romer, Managing Partner, Romer Debbas, tells GlobeSt.com that inflation is the double-edged sword that the real estate market does not need.

"For far too many, especially those that require financing, the cost of buying is simply too high," he said. "It artificially inflates home prices (and seller expectations) while, at the same time, devaluing the dollar in every buyer's pocket. The real estate market desperately needs interest rate stability."

Sellers Must 'Meet the Market'

Thomas Olivetti, managing director, investment sales at Northmarq, tells GlobeSt.com that multifamily investment sales transaction volume has slowed dramatically over the past six months.

"The cost of capital is driving asset pricing with higher interest rates combined with lower leverage and overall economic uncertainty," Olivetti said.

"There is plenty of capital that needs to be deployed but deals are only happening when sellers are willing to meet the market. Some owners continue to internally value their assets without regard to current market conditions which creates a sizeable spread between what buyers are willing to pay vs. prices that make sense to sellers."

He said that properties that are currently being marketed offer sellers an opportunity for price discovery, and while many buyers continue to actively underwrite and offer, the sellers must decide if they are going to move forward.

Values are down 20% to 30% in some markets where going-in cap rates were in the low 3% range in early 2022 and are now 5%+ coupled with slowing rent growth and increases in vacancy.

"We expect sales transaction volume to be down significantly for at least the first half of 2023," according to Olivetti.

Interest Rates 'Not as Bad as Buyers Think'

Lisa K. Lippman, agent at Brown Harris Stevens, tells GlobeSt.com that although she is busy, completing at least a deal every two weeks, market volume is down.

"Whenever buyers and sellers don't agree on prices, nothing happens, and the market is at a standstill," Lippman said. "Sellers should look at the market through the eyes of a buyer; if rates go up even one point, pricing must be reflective. Cash buyers will expect a discount as well as they do not want to pay more than someone seeking a mortgage."

Working with buyers, Lippman said, "interest rates are not as bad as buyers think they might be, with many customers receiving rates in the high 4s to low 5s."

Lenders to Act with 'Significant Restraint'

Doug Ressler, business manager, Yardi Matrix, tells GlobeSt.com that debt availability will be constrained in 2023, with lenders acting with a significant amount of restraint.

“Lenders will focus on lower leverage, with an emphasis on debt service coverage,” Ressler said. “Fannie Mae and Freddie Mac remain active, in line with their mandate to provide liquidity to the market, but they have had their allocations reduced.”

Banks, life companies, securitization programs, and private equity funds all have constraints that will limit activity relative to recent years, he said.

Stronger Price Alignment Now Than Q4

Jon Morgan, Co-Founder and Managing Principal of Interra Realty, tells GlobeSt.com that in middle-market multifamily sales, he’s starting to see a stronger alignment between buyer and seller agreeing on bid versus ask than they were in the fourth quarter.

“Then, sales remained very strong in our space,” Morgan said. “There has clearly been some adjustment in both buyers’ and sellers’ minds to help bridge prior gaps in pricing. We have properties that we previously had on the market in prior years that did not transact. Many of these are now going to contract with renewed seller mindsets and rental rates that were materially stronger than they were during our prior efforts that have helped offset interest rate impairment to value.”

CA-Based 1031 Exchange Deals Worthy

Kimberly Stepp, principal, Stepp Commercial, tells GlobeSt.com that apartment transactions in the Santa Monica/West Los Angeles market have definitely slowed.

“However, investors that are trading out of a 1031 exchange or those that can pay all-cash have a significant advantage and are able to negotiate pricing with sellers given more certainty of closing,” she said.

“With tight inventory, more of these buyers are looking at fewer properties, so if a property is well-located and meets buyer criteria, we are getting fewer bids, but these bids are reasonable and can create a favorable situation for both the buyer and seller.

“This year, I believe that we will start to see more transactions take place beginning in the second quarter as overall, would-be sellers are in a holding pattern and are waiting to see what will happen in the capital markets before listing an asset.”

https://www.globest.com/2023/01/20/apartment-transaction-volume-hinges-on-feds-next-move/