U.S. Multifamily Market Still Thriving
10 Years Past Recession

AN ANALYSIS BY JEANETTE I. RICE, CRE®
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The U.S. multifamily market remains healthy even 10 years into the recovery/expansion period. The key driver is demand. Multifamily demand is very strong and, even in a climate of elevated construction activity, net absorption continues to outpace new supply leading to favorable vacancy and rent growth performance.

**BALANCED SUPPLY AND DEMAND**

The multifamily supply-demand fundamentals reveal peak and essentially balanced activity. Net absorption over the four quarters ending Q1 2019 totaled an impressive 285,800 units, higher than the 266,700 units delivered over the same period. Both figures were down slightly from 2018 where the demand total hit the high-water mark for this cycle (317,000 units). Completions in 2018 were slightly under the 277,000-unit cyclical peak reached in 2017.

Many years of high levels of building activity in urban core submarkets has led to pockets of softness around the country. Yet, the silver lining in current construction activity is that development is more diffused geographically in most markets; more suburban product is being delivered now (relative to urban), and the suburban submarkets are better positioned to absorb the new supply.

Demand remains strong for many reasons. The nation’s sustained economic expansion continues to contribute to job opportunity, consumer confidence and wage growth – all important to the multifamily market. Many significant lifestyle trends have also contributed to high multifamily demand. These include delayed marrying and starting families (traditional trigger points for buying a home), preferences for urban living and preferences for flexible housing tenure (not tied down due to a mortgage). The third major factor is the cost of homeownership; it is still out of reach for a high percentage of renters. With over 60% of millennials at least 30 years old in 2019, outmigration to home-buying is increasing and a trend to watch closely. Nevertheless, this migration, so far, remains moderate, and not one likely to significantly erode multifamily demand.

For Q1 alone, both deliveries and demand slowed, but the longer-term trend of peak level performance is likely to be sustained. The under-construction and starts data indicates that completions in 2019 and 2020 will probably reach or exceed the 2017 completions peak. There are currently 635,000 multifamily units under construction, the highest level for the cycle. Longer construction periods are keeping new developments in the under-construction number longer, but the high figure also reflects a very active pipeline. Furthermore, both permitting activity and construction starts remain high.

**VACANCY AND RENT GROWTH FAVORABLE**

Multifamily vacancy fell by 20 bps year-over-year to 4.6% in Q1. For the past six quarters, the vacancy rate has fallen on a year-over-year basis, reversing the trend of slightly rising vacancy in 2016 and 2017. The multifamily sector’s vacancy rate has remained under 5% for the past five years. Monthly effective apartment rents averaged $1,669 per unit in Q1, up a solid 3.0% from the prior year based on “same-store” comparisons.

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REIT performance has improved this year over 2018 providing a cautiously optimistic outlook. 1Q19 earnings season indicated that a better capital environment and solid operating fundamentals foretell a promising year for many REITs. Attendees at recent conferences dismiss the idea of a 2019 recession, but are undecided about 2020. Of note are how REITs fared year-end 2018, REIT performance during 1Q19, and the major issues to consider this year.

**U.S. REITS PERFORMED WELL AT YEAR-END 2018 AND 1Q19**

U.S. REITs posted total returns of -4.1% at year-end 2018 and 16.7% at March 29, 2019 leading the S&P by +3% — the best 1Q19 since 2000. 225 U.S. REITs hold an equity market capitalization at 1Q19 of $1.2 trillion (vs. $1 trillion at YE19), a little more than the $876 billion market cap of Amazon at 1Q19. Real estate was the second best performing S&P 500 sector in 1Q19. Preliminary results indicate that 1Q19 earnings hold promise due to reduced capital costs, broad access to capital, solid operating fundamentals for most sectors, and a rebound in REIT stock prices. REITs tend to own the strongest assets with best locations for some sectors in their markets, so should perform better than many of their non-REIT peers.

REIT issuance of equity, unsecured debt and preferred stock declined to $46.7 billion at year-end 2018 and $19.5 billion at 1Q19 from a high of $92.1 billion in 2017 (see Figure 1).

Reasons for the decline are that:
1. Most REITs have been proactively addressing their debt maturities while accessing the equity market aggressively over the past years as interest rates declined and ahead of potential movements in interest rates, and
2. Due to low cap rates, it is more difficult to find acquisitions that pencil out, although many REITs still have strong acquisition pipelines.

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In April 2009, the CRE Foundation approved a proposal by the late Marc Louargand, CRE, to strengthen the role that Counselors of Real Estate play in preparing the next generation of leadership for the real estate industry. Marc’s proposal “Counselors in the Classroom,” outlined a partnership with the American Real Estate Society, in keeping with the ARES objective to “improve communication and exchange of information in real estate and allied matters among college/university faculty and practicing professionals.” (Marc, in addition to being a prominent CRE, was a past president of ARES.) In supporting the Counselors in the Classroom, the CRE Foundation noted that the effort would be “building on current involvement that Counselors have in real estate education while helping establish the Counselors’ image as the senior designation for young and aspiring professionals.”

Counselors, then and since, have been generous participants in university real estate programs across the country and internationally. This has been nicely in keeping with CRE’s deserved reputation as thought leaders. Counselors have served as invited guest lecturers, adjunct faculty at more than a dozen institutions, and as full-time faculty and program leaders in many notable colleges and universities. These have included such programs as MIT; Harvard (Ray Torto, CRE); Villanova (Joe Nahas, Jr., CRE); DePaul (James Shilling, CRE), NYU (Constantine Korologos, CRE), the University of Wisconsin—Madison (Fred Campbell, CRE; Jim Curtis, CRE; Alan Hembel, CRE; and Joe Walsh, CRE); the College of Charleston (Elaine Worzala, Ph.D., CRE); the University of California, Berkeley (Paige Mueller, CRE); the University of San Francisco (Larry Souza, Ph.D., CRE); the University of Utah (Danny Wall, CRE); Roosevelt University (Tom Hamilton, Ph.D., CRE); and many others.

The strong linkage between the Counselors of Real Estate and Fordham University Real Estate Institute in New York exemplifies, in tangible and powerful ways, the impact of experienced practitioners on those eager to learn from them. From Fordham’s side, growth has been exceptionally strong. The university took in its first Masters of Science in Real Estate class in January 2018. And, as of May 2019, its MSRE enrollment has surpassed the 100 student mark. From a standing start, Fordham has become a prominent force in the New York real estate community, under the leadership of its Executive Director, Robert Morgenstern. In no small measure, success has flowed from the commitment to the values of collaboration and excellence which Fordham shares with the Counselor organization.

The University has identified four essential pillars to the contemporary real estate educational project. These are:

1. What do graduates need to know?
2. What do graduates need to know how to do?
3. How can graduates exercise mature judgment in life and business?
4. How can graduates prepare to be responsible leaders in the larger society?

These principles resonate with Counselors, whose practice is based upon an awareness that real estate expertise and thought-leadership depend upon more than mere technical facility. CREs have taught Fordham courses in Market Studies, Economic Analysis, Private Equity, and Real Estate Law, and the professors have included two from out of the local area, Stanley Gniazdowski, CRE, from Connecticut and Brian Blaesser, CRE, from Massachusetts. Counselors Neil Madsen, Tom Fink, and I serve on the Fordham Real Estate Institute’s Executive Advisory Council, along with a dozen other representatives of the development, finance, legal and accounting, construction industry, real estate services, and public sector segments of the real estate industry. “Serving on the Executive Advisory Council and teaching at the Fordham Real Estate Institute have been deeply enriching experiences,” says Neil Madsen, CRE. “The former has provided an opportunity to collaborate with other seasoned real estate professionals in shaping the program from its earliest stages of formation. The latter has allowed me to participate directly in classroom application and witness the profound effects the program is having on the next generation of real estate leaders, whose enthusiasm and commitment to professional growth is truly inspiring.”

Fordham students are offered the opportunity to connect one-on-one with an experienced mentor from the industry. One hundred percent of the students enrolled in the Spring, Summer, and Fall MSRE entering classes have been matched with mentors, and connections for the Spring 2019 new students are now being finalized. Members of the Counselors have been actively engaged in mentorship, with no fewer than a dozen actively serving as volunteers. George Vallone, CRE, has included his students in client meetings and site visits as part of the mentorship experience.

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HIGHER EDUCATION
Counselors Energize Higher Education
BY HUGH F. KELLY, PH.D., CRE
SPECIAL ADVISOR
FORDHAM UNIVERSITY REAL ESTATE INSTITUTE AT LINCOLN CENTER
HOUSING AFFORDABILITY IS NOT JUST A MULTIFAMILY PROBLEM

Since the market trough in Q4 2009, multifamily rents have risen by 35.3% or an average of 3.3% per year while wage levels have risen on average 2.1%. However, a contributing factor to the rise of rents is the “value-add” redevelopment activity, robust especially over the past six years. This activity has helped improve the quality of the nation’s multifamily stock and given longer life to many of the older communities.

The housing affordability discussions also make it clear that multifamily housing must be analyzed within the context of the entire housing market. The decline in housing affordability also stems from the rise of single-family home prices which have climbed annually by 5.2% since the recession. In addition, over the past decade, housing construction (single family and multifamily) has not kept pace with household formation. In the 2010s, U.S. household formation has averaged 1.04 million per year while new housing units built has averaged 880,000 units, creating an average annual shortfall of 160,000 housing units.

MULTIFAMILY REMAINS VERY ATTRACTIVE TO INVESTMENT CAPITAL

The healthy property fundamentals continue to attract capital from all types of investors. In 2018, the multifamily sector reached a new record investment total of $175 billion. Multifamily was also the leading property type for investment for the third year in a row. In the first four months of 2019, multifamily acquisitions totaled $46 billion, up 5.6% year-over-year. In contrast, investment activity for all commercial real estate fell 11.3% year-over-year.

Multifamily pricing also is firm, providing further evidence of investors’ sustained interest in the sector and willingness to buy at relatively higher prices (low cap rates). This is especially true for value-add buying activity. For all acquisitions in Q1, the average cap rate compressed by 17 bps year-over-year.

MULTIFAMILY OUTLOOK FAVORABLE

The multifamily market is still performing very well, even 10 years after the recession and with fairly high levels of new supply. The robust construction pipeline as well as aging millennials moving into homeownership are two key trends to monitor. However, the multifamily’s market strengths, so far have mitigated the impact of these trends and kept market performance at healthy levels.

As long as the national economy continues to expand, this pattern should prevail. And even if/when there is a national recession, the impact on multifamily could very well be more moderate than in previous cycles.

HIGHER EDUCATION (CONTINUED FROM PAGE 4)

Vallone says, “Throughout history the best teachers teach by telling stories. These stories all have one thing in common. They have an important lesson embedded in a real life experience. The students learn from the story because they can relate to the actors, the situation, and the ending or result.” Casey Kemper, CRE, remarked on his student’s enthusiasm in connecting what she is learning in the classroom with how the learning is applied in practice. Kemper assisted in the student establishing a written set of goals to guide her entry into the real estate field.

Additional Counselors who have volunteered as mentors include Cate Agnew, Victor Brown, Victor Calanog, Harry Dublinski, Bill Kinn, Geetha Ganeson, and Mike Hedden.

The culture of collaboration widens the opportunities for the university and industry to stimulate thought. The NY Metro chapter of the Counselors worked together with the Professional Women in Construction to organize and present a joint Fordham/Columbia University event on “Urban and Suburban Real Estate” in October 2018, and will again bring an event on “Late Cycle Real Estate Strategies” to Fordham’s Lincoln Center campus on October 2, 2019. James Nelson, CRE has also been instrumental in organizing topical events at Fordham with the Real Estate Services Association (RESA) covering subjects such as Tax Reform (at the Lincoln Center campus) and Opportunity Zones (at the Westchester campus).

Although the evolution of the relationship between Fordham’s Real Estate Institute and members of the Counselors of Real Estate has gone beyond the specific vision of the “Counselors in the Classroom” proposal of a decade ago, there is little doubt that the spirit of Marc Lourand’s ideas continue as an animating force. I expect that continued collaboration will benefit the University and the Counselors. But, more importantly, these efforts will assist the upcoming generation of industry leaders and serve as a template for other schools and other CRE chapters to extend Marc’s vision in the decade ahead.
THE COUNSELOR • SPRING 2019

2019 MIDYEAR MEETINGS
Disruptors: Are You Prepared?
APRIL 28 - 30, 2019
CHICAGO, IL

The Counselors’ Midyear Meetings, held April 28-30 in Chicago, focused on the global and domestic issues likely to have a sustaining effect on real property and the industry in general. Spencer Levy, head of research and senior economic advisor for CBRE, discussed the “new city,” urban meccas that will prosper by offering three key attributes: (1) talent generation through universities, (2) a work-live-play environment, and (3) capital from foreign sources. “Your city is immovable. Talent and capital are not, so get more of both,” Levy told a full room of Counselors.

Levy shared seven megatrends he believes will impact the industry: the new city, local versus national politics, demographics, workplace amenities, death of retail, green, and transportation. While Levy believes bricks and mortar retail will survive, he said the preferred property sectors for investment will be industrial and multifamily. “The megatrends that matter depend on your time horizon and a little bit of courage.”

Mary Ludgin, Ph.D. managing director and head of global investment research at Heitman, and Mario Lefebvre, CRE, vice president of research for global real estate markets at Ivanhoe Cambridge Inc., discussed the global economy and the economic realities in several countries, including Australia, comparing them to the U.S. economy. “In the U.S., the check on supply is a recession. In Australia, the check on supply is ‘don’t build it because there is no demand,’” said Ludgin. She added Australia has seen 29 years of economic expansion without a recession, with the population of Sydney increasing by 2% per year. “This is growth at work.”

Lauro Ferroni, senior vice president of JLL, said commercial real estate transaction volume is expected to decrease by 10% in 2019, which will require creative strategies to grow assets under management. “There is an elevated perception of risk in the markets,” said Ferroni. “This presents opportunity for those with a risk appetite where there is no precedent.” He added these issues are directly leading to investors structuring transactions in opportunity zones. Ferroni estimates there’s been $55 billion in transactions within opportunity zones to date and says about 10% of all real estate is in these census tracts, including 23% of industrial supply.

“Not all opportunity zones are created equally,” said Teya Moore, Esq., CRE, managing partner of BBRE. “Some have much higher income levels than others.”

Additional session topics included demographic trends, leveraging data, asset disposition and reposition, sustainability, the art of collaboration, marginalization, small business opportunities, and the upcoming Top Ten. Several development tours highlighted land conservation, modern senior living, historical developments that influenced Chicago, and the new mega projects that will reshape the city’s neighborhoods and skyline for the next generation.
REIT returns rebounded in 1Q19 to 15.9% for Americas REITs vs. 15.6% for Asia/Pacific REITs, 15% for Global REITs, 11.7% for European REITs, and 1.4% for Middle East/Africa REITs. The top-performing REIT sectors on a total return basis in 2018 were health care, infrastructure, and residential, not far from 1Q19’s top performers of infrastructure, residential and timber (see Figure 2).

ISSUES FOR REITS

Retail
Although all sectors are performing well in 2019 on a total return basis, retail is subject to the overhang of e-commerce, consumer sentiment, and elevated store closure announcements in 2019 that could approach 2017 levels. However, as with most sectors, there is a greater bifurcation between the higher and lower quality properties.

REIT Mergers & Acquisitions
REIT M&A in 2018 surpassed 2017 ($26 billion) and other years with ten deals totaling $74 billion, most of which were public to public transactions. The main reason for the busy M&A year is the dichotomy between public and private valuations where many public REITs trade below NAV. Real estate M&A activity in 2018 was 140% above the 5-year trend with Brookfield and Blackstone deploying over half of the total. Private investors with a long-term focus are perceived to be more patient vs. public investors that are earnings focused and reactive to daily market volatility. Public companies are often not rewarded for growing complex businesses through JVs or acquisitions.

Technology Innovation/PropTech
Technology is the current disrupter. Various REITs have invested in property technology (PropTech) ventures with other REITs to evaluate, finance and test the emerging technologies. Whether it is a PropTech investment or creating a new property database, model or app, the intersection of technology with the real estate business should provide better, more reliable and different ways to access real estate information. Many REITs are also experimenting with technology to address customers’ needs, increase operating efficiencies, and cut costs.

The bottom line is that REIT fundamentals continue to improve as they refinance through debt and equity issuances, dispose of non-core properties, and create more portfolio opportunities through the use of technology.

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