The Apartment Report™

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Jason Morgan, Principal – Morgan Properties

In 2020, urban, Class A multifamily will continue to experience lease-up and supply challenges. There has been a tremendous amount of new construction in every city across the country and all of these projects are leasing up against one another. On the other hand, Class B workforce housing, which is Morgan Properties' area of expertise, will continue to be the golden child. I anticipate that investor appetite for Class B multifamily will increase given its recession resiliency, ability to be acquired at a significant discount-to-replacement cost, and better demand dynamics than its Class A peers. Two other trends to keep an eye on this year are interest rates and rent control. Interest rates will continue to remain low, while rent control will continue to pose a threat to the industry.

Joe Lubeck, CEO – American Landmark

The economy will remain strong in the new year, supporting multifamily fundamentals and its status as CRE's darling product type. Because of this and the high amount of dry powder waiting to be placed in investment vehicles, we can expect more competition chasing the same number of deals in this arena.

Dean Henry, CEO – Legacy Partners

I believe the next 12 months are likely to result in fewer developments being built in most MSAs across the country. There will be exceptions, but most areas are nearing balance of supply and demand. At the same time, costs are escalating at a pace greater than incomes – although at a pace that is slower than they were in 2018 and a significant part of 2019 – which results in entry yields on ground-up development deals being less attractive than they once were.

Concurrently, and partially as a result of timing early in the new year, leasing activity on newly built properties has slowed and concessions are more common.

There continues to be adequate capital for development deals that meet the hurdles targeted by investors, but those deals are fewer than we developers would like. Capital has always been the key to making development work, and finding that capital is now harder than it once was.

Continued on Page 2

CRITTENDEN'S BOARD OF ADVISORS…

Continued from Page 1

Robert E. Hart, President & CEO – TruAmerica Multifamily

I predict 2020 will be another robust transaction year for the multifamily industry as interest rates are still at an all-time low and the availability of agency, bank and conduit lending remains high. In addition, job formation is steady and in migration of renter oriented population to gateway cities and suburban growth areas continues to trend in a positive manner. Strong rental demand especially for higher quality Class B (workforce) housing will expand categorically for the foreseeable future as overall U.S. housing demand and formation of new smaller households continues unabated. All of these positive demographic trends, coupled with $3 trillion of unallocated capital in the global financial system looking for durable long-term cash flow and predictable returns on that equity, will drive multifamily valuations, which will underpin investor demand in 2020 and beyond.

James Flynn, CEO – Hunt Companies

We are currently in the midst of the longest U.S. economic expansion in history, and some of the signs you would expect to see late in the multifamily cycle are starting to manifest. Don't get me wrong, we are still seeing strong fundamentals, they are just starting to moderate in terms of growth. The next year is slated to be yet another strong year of new unit deliveries. If that happens, we would expect to see vacancies trend up slightly, while rent growth would trend down from the 3% to the mid-2% range.

However, if the upcoming year plays out similarly to past years, new supply could be delayed due to things like labor costs, zoning issues, lack of feasible sites, and in some cases, weather. Such a delay would mean that multifamily fundamentals would keep marching on at their existing rates. Regardless of how many units end up being delivered, there is a major shortage of attractive rental options, particularly in the workforce and affordable housing space. Preserving the affordable housing options that exist remains a top priority for our firm and our partners at **Fannie Mae**, **Freddie Mac** and **FHA**. Transactions that fit into a mission-driven criteria will continue to see the most favorable terms.

Homeownership will be another area to keep a close watch on for 2020. While millennials are increasingly examining homeownership as they form families, affordability issues are curtailing widespread adoption. At the same time, tight labor markets will support wage growth and the cost of borrowing remains near historic lows. Time will show how this plays out.

Cliff Booth, Founder/President/CEO – Westmount Realty Capital

Delinquencies and bankruptcies are low, tenants are profitable, expanding and renewing and they are paying rent increases. When these important indices change, our view of the investment climate will change accordingly. Having said that, we see slightly less activity and there are a few pressures that we think will contribute to a moderately less robust economy than in 2019. We have heard from multiple tenants that the effects of the tariffs have been challenging for their businesses.

Certainly, if history is to be considered, decision making in an election year becomes more problematic and stilted. The recent turmoil in the Mideast creates more uncertainty. All this leads us to think that 2020 should be a good year and not meaningfully different than 2019, but with slightly less growth and with some increased risk of some flash points that could erupt into more significant issues.

Owners, Developers, Lenders & Management Firms

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WinnCompanies: One Washington Mall, Suite 500, Boston, MA, 02018. Gilbert Winn, CEO; Larry Curtis, President/Managing Partner, WinnDevelopment; Patrick Appleby, President, WinnResidential, (617) 742-4500.

Value-Adders Broaden Search

The limited incoming supply of true value-add opportunities coupled with extreme competition will push value-add buyers into unfamiliar territory. Smaller to midsized investors will explore core-plus options, search secondary and tertiary markets, and consider both student and senior housing. These tactics will also be a part of these companies' desire to avoid bullish institutional and foreign buyers.

The number of unrenovated properties is much smaller now after the value-add investment strategy exploded in popularity over the last decade, with a plethora of value-add funds popping up to chase finite inventory. Cap rates these days make the margin for error so narrow that any hiccup during CapEx could throw off the business plan. Smaller firms have greater flexibility to look outside traditional major MSAs as they aren't as limited when it comes to structuring funds.

Leverage for value-add acquisitions will be more rate-driven as companies will take lower proceeds to get the best terms. Multifamily is still favored by most types of lenders. Agency capital will be readily available to meet their caps. Terms and pricing this year will be better than that seen during 2019, with value-add and core-plus pricing very close. When an investor can borrow at a sub-4% interest rate, longer-term and newer deals make more sense, especially for those looking at risk premium and relative delta. For example, five years ago the return differential of a value-add property could have been 50% more than a core-plus deal; something that won't be true this year.

Cap rates will remain steady this year despite the value-add space not being as competitive as it was during the last two years due to a lack of supply. This fierce competition for value-add product is a testament to the fundamentals of multifamily targeting the workforce. Working in favor of multifamily are millennials' lower homeownership rates, their tendency to marry later, and the fact that they carry more student debt longer.

In addition to the challenges of building new workforce housing, multifamily remains more resilient than the other major asset classes. Cap rates didn't expand as much for multifamily as they did for other asset types during the Great Recession and no one is predicting the economy will get hit that hard again in the near future. Despite the expected volatility during an election year, most buyers aren't forecasting further compression of yields.

Hamilton Zanze hopes to acquire $500M of both value-add and core-plus product. The company will search the Mountain and Mid-Atlantic states, and the Southeast and Midwest. All its acquisitions are financed through agency debt and variously with private capital, exchange executions, and with institutional JV partners. The firm acquired 13 properties totaling $650M during 2019 following a similar strategy.

Continued on Page 4

VALUE-ADDERS BROADEN SEARCH…

Continued from Page 3

Tower 16 Capital Partners' investments generally range from $10M to $100M. Its primary focus is on value-add product ranging from '70s to early '90s vintages with plans to spend $12K to $15K per unit on renovations. The firm currently focuses on high-growth markets in the West, such as Las Vegas, Phoenix and California's Inland Empire. The four major Texas markets are also on its radar. The company is less than three years old and was founded by former **Lennar** heads. Tower 16 has acquired eight deals to date with about 2,600 units and plans to double its size by closing two deals per quarter during 2020. Leverage typically falls near 65% to 70% for senior loans with Tower 16 usually putting 5% to 10% of skin in the game. It targets 18% to 20% IRRs and underwrites to a four- to five-year hold.

Pathfinder Partners finished allocating capital from its value-add fund raised during 2018 and will shift gears slightly toward stabilized assets/core-plus opportunities for long-term holds to take advantage of today's low interest rates. It still look for value-add deals that aren't overbid. Pathfinder will continue to search for deals in its western footprint, targeting markets such as Seattle, Portland, San Diego, Phoenix, Denver, Sacramento and Las Vegas. The company takes a fairly conservative leverage strategy of 60% to 65%.

Ezralow will actively look for value-add deals in and around Nashville, Charlotte, Raleigh, Phoenix and Las Vegas. The firm doesn't have a hard target and will take an opportunistic approach. It will also keep an eye on tertiary markets to avoid fierce competition for deals and new deliveries. The company holds properties for the long-term and is currently converting a 272-room hotel in Sacramento into apartments.

CRES Management aims to acquire four deals or 1,000 units this year. It targets Class B properties in secondary and tertiary areas that might fly under the radar of competitive institutions. It will be active in Texas and the Midwest.

WINNCOMPANIES CHARGES FORWARD

WinnDevelopment expects to complete four properties this year, start two others, finish one substantial rehab, and make one acquisition. The company moved into North Carolina where it's developing a mixed-income project in Durham. In Boston it will open a $46M national "veterans village" of permanent housing with on-site supportive services for an independent population of veterans at all income levels.

The company's management portfolio currently includes more than 600 properties with 101,000 units in 22 states and Washington, D.C. It is the largest affordable housing manager and LIHTC operator in the industry. It has a massive presence in Massachusetts, with 17,290 units, and expects more growth in California, where it has 14,611 units. The current Winn-owned portfolio includes 116 properties with 14,750 units in 12 states and the District of Columbia. **WinnResidential** quietly moved into Texas as 2020 began, winning management responsibilities for 4,500 public housing units from the Housing Authority of the City of El Paso.

Spending on training, recruiting and HR for six years is paying dividends for parent company **WinnCompanies**, especially as the labor market for property management remains strong and the advent of a growing regulatory atmosphere requiring compliance. CEO **Gilbert Winn** invested in more robust property management technology, including mobile work orders, expanded recruiting and training staff, created a mentoring program and professional development program to identify and nurture in-house talent, and established a comprehensive onboarding program for hires at all levels. WinnCompanies had one person in its training division in 2014 and now has a team of five dedicated to that task. During 2015, it had one recruiter and now has six. The firm's goal is to help team members work more efficiently and support their needs from career growth to benefits and allow them to focus on service.

WinnDevelopment is also coming up on its 40th adaptive reuse project for residential purposes. Generally, the company looks for historic, vacant former industrial or academic properties that have the architectural and engineering qualities needed to support preservation and reuse. They are usually publicly owned in a community that wants to return them into good use and put them back on the tax rolls. The firm is moving toward its largest new construction project with the redevelopment of the 1,016-unit Mary Ellen McCormack public housing project, Boston's oldest public housing community. It will also finish the residential portion of a 1.1 million s.f. adaptive reuse property in Rochester, N.Y. Workforce housing is a major focus for the company, and it has five middle-income projects underway. It encourages states to create their own workforce funding programs to get this housing built without impacting traditional affordable housing programs.

WinnResidential's priority is to zero in on opportunities for strategic relationships with committed owners who see high-quality property management services as critical to their business goals. It's a quality-versus-quantity decision that allows it to be more selective in pursuing high-level management opportunities. As a company with almost 50 years of experience as a developer and owner in all income categories, it knows firsthand what owners and investors might face when seeking to improve returns, turn-around troubled properties, or strengthen resident satisfaction.

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