MULTIFAMILY REAL ESTATE

Experts share opportunities ripe for 2023
Between higher interest rates, inflation and a potential economic slowdown, 2023 has started with plenty of uncertainty. That doesn’t mean you should put your investing goals on hold. Story asked five real estate experts to share where they see opportunities for investors this year.

By Lauren Zumbach       Story by J.P. Morgan
Renovate and be ready to make a deal

I see three opportunities multifamily investors can focus on in a rising interest rate environment.

First, I believe it’s always a solid bet to invest in your portfolio by continuing to rehabilitate your buildings and units to make sure they remain relevant to tenants and sellable through any kind of economic market.

Second, as interest rates rise, cap rates and the prices at which investors are willing to buy and sell properties will continue to adjust. I think it’s a great time for owners to focus on their core markets and position themselves to buy deals that might become available as changing economic conditions push investors to sell. Be patient, and focus on building liquidity and managing relationships with lenders so you can quickly take advantage of opportunities that arise.

Lastly, as some loans approach the end of their fixed rate period, they will either convert to short-term adjustable-rate mortgages with higher rates or need to be refinanced into a new permanent loan, also at today’s higher rates. That may create opportunities for investors with ample liquidity to partner with property owners facing an increase in rates. For example, an investor with a strong liquidity position may be able to buy an ownership stake in a property if the current owner needs additional equity to qualify for a loan refinance that requires a loan paydown due to the higher interest rates.
Multifamily is still in a great place compared with other real assets or commercial property types. Office and retail are going through an evolution. There’s even an argument that we may have too much industrial warehouse or distribution center space.

When it comes to concerns about a recession, it’s really hard to find where the U.S. economy has overreached. Even in tech, while it makes the headlines that companies like Facebook are laying people off, they’ll still end up with more employees than they had in 2021. This isn’t the year 2000, when overvalued internet companies that weren’t making money created a bubble. I do think there’s reason for optimism that any kind of economic downturn will be relatively short and shallow.

The real source of optimism for a property type like multifamily is demographics. The oldest members of Generation Z are now turning 25 or 26. Gen Z will be driving multifamily demand over the next 20 years, and that’s how you need to plan your business.

The age at which people start buying their first home has been pushed forward for a lot of reasons: high student loans, stagnant wages, high home prices and now high interest rates. If the youngest of the Gen Z folks don’t buy their first house until they’re 35 or 40, we’re looking at 15 years of pretty solid demand for multifamily. If demographics is destiny, then the destiny of multifamily is looking fairly bright.
Workforce housing will remain a solid performer

In times of volatility, workforce-level multifamily properties, which are affordable for middle-income individuals and families, have been a more consistent source of cash flow for investors than luxury and high-end rentals.

We saw this most recently in many metropolitan areas during the COVID-19 pandemic. With multifamily vacancy rates at a five-year low and a growing crisis with the shortage of affordable housing units available in the U.S., I expect the stability of workforce housing to prove out again in 2023.

Additionally, with interest rates at potentially double the level at which some loans were made a few years ago, investors with debt coming due may be interested in bringing in a partner or may even consider selling an asset altogether, which can create new investment opportunities. When thinking about those opportunities, contemplate the stability of that income stream and level of risk you are willing to take on in this environment. In times of volatility, the wrong investment can lead to a quick depletion of liquidity and equity.
Property price cuts can justify buying at higher rates

I think it’s a great time for people to jump into the market. You’re starting to be able to get **discounts on property prices** that far surpass the impact of interest rate increases.

There are a lot of people who hung on for a long time waiting to sell, and now they’ve reached the point in the cycle of ownership where they’re ready to be done.

There are sales happening now where cap rates are far higher than we’ve seen in a long time. Even though interest rates are higher, **property prices have come down** enough to justify buying at those rates. We’re also seeing properties stabilize with **stronger leasing** after the pandemic.
Be cautious — but know there are options

While there are reasons to be cautious now, oftentimes when people are concerned about getting into the market is when opportunities come about. It wasn’t long ago that interest rates were in the 3% range and capitalization rates followed suit at around 3% or 4%, but when interest rates and cap rates are at historical lows, there’s a more limited upside on valuations. Today, as we see cap rates edging north of 5% and even reaching 6% and 7%, there is a larger margin of error for the purchaser and an easier path to both increased property values and cash flow.

Interest and cap rates tend to move together — not one for one, but they generally run in tandem. When interest rates and cap rates rise, property values will go down and interest payments increase. When interest rates and cap rates go down, on the other hand, the value of your property goes up and your interest payments go down — both good things. If you buy with interest rates and cap rates at 3% to 4%, there’s not much room for them to fall, but when you start at higher rates, there’s more potential to get those winds in your sails.

We have started seeing cap rates adjust to the rising rates in New York and, as a result, there have been more opportunities than before for investors who have cash available to invest. As interest rates have gone up and expenses have gone up, owners who were aggressive in taking on debt and were perhaps just breaking even may need to cut their losses and sell. We are starting to see more purchase deals, and I expect this to continue. You have to find the opportunities, but patient money wins out.
For more multifamily news and insights, visit story.jpmorgan.com