Trepp®

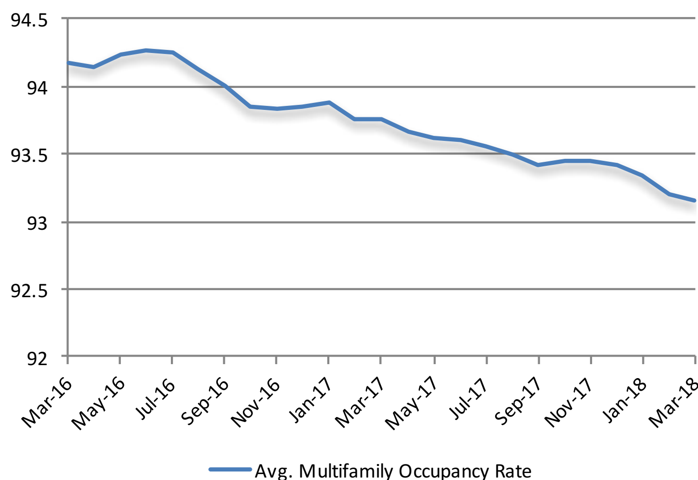
CRE Research

April 2018

Apartment Construction Begins to Slow but Demand Remains High

With homeownership rates sagging over the last 11 years thanks to shifts in demographic trends, apartments have become one of the most in-demand property types. As we wrote in our previous multifamily snapshot, apartment demand rose to its highest level in 25 years in 2017, which is a generational peak. However, some of the sector's underlying financials are beginning to decelerate – at least when it comes to loans in CMBS. According to Trepp data, the average occupancy for multifamily CMBS loans has been trending downward over the past two years. Average occupancy was measured at a recent low of 93.1% in March, which is 60 basis points lower year over year.

GRAPH 1: AVERAGE OCCUPANCY RATE - MULTIFAMILY CMBS LOANS



Source: Trepp

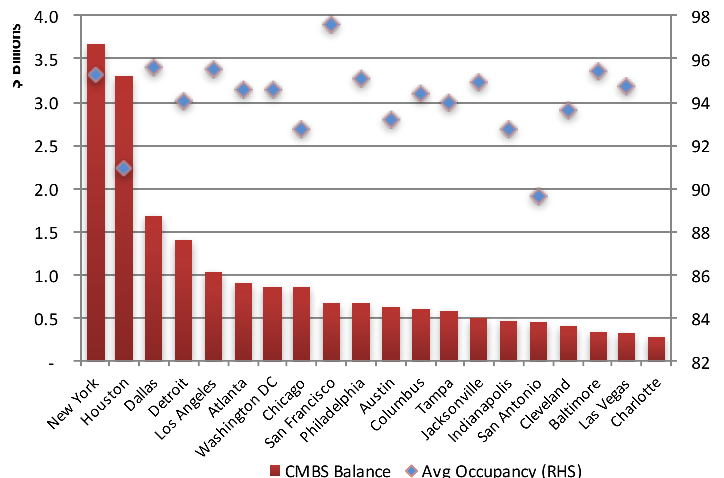
Per *Multifamily Biz*, construction starts for seven of the 10 largest US multifamily markets dropped in 2017 when compared to 2016. The overall volume of multifamily construction starts was $194.7 billion last year, which is 7% lower year over year. However, it seems that the elevated levels from previous years continue to weigh on occupancy levels.

Multifamily construction pullbacks are another catalyst for this decrease, as construction for the sector was down 12% compared to the 3% decline for commercial building starts. This is likely due to rising development costs, tighter construction financing, and mounting caution levels. These factors are likely to continue throughout 2018 and industry experts believe they could pull deliveries down about 12% from the 2017 level. Higher interest rates may also add to this drop-off.

Despite the deceleration of apartment completions, absorption remains at peak levels across many markets. This indicates apartment demand — driven by millennials, downsizing baby boomers, and increasing single-family home prices — is still extremely high.

JLL observes that primary market transactions accounted for 40.3% of US apartment property activity in 2017, down from 44% in 2016 and 48% in 2015. This decrease was largely due to New York City's sales volume falling nearly 50% year over year. As a result, Dallas-Ft. Worth surpassed NYC as the most active multifamily market

GRAPH 2: MULTIFAMILY CMBS BALANCE AND AVERAGE OCCUPANCY



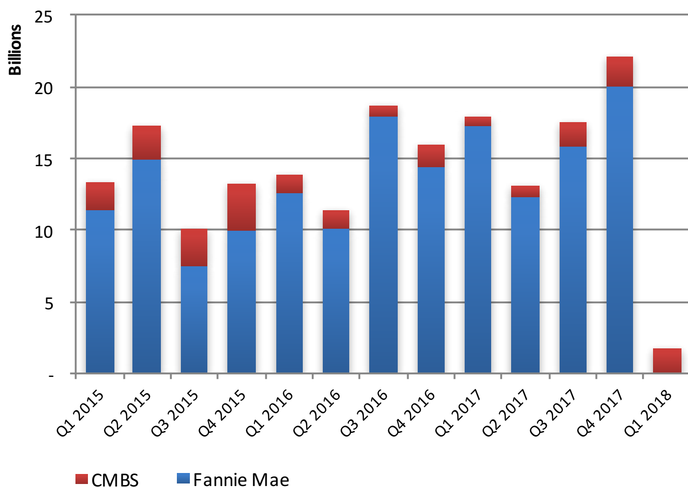
Source: Trepp

for transactions in the country. Secondary and tertiary markets such as Milwaukee, Detroit, Salt Lake City, and Jacksonville, Florida each posted significant increases in transaction activity last year as well.

Private-label CMBS and Fannie Mae MBS Issuance on the Rise

Fannie Mae data show the housing agency issued $65.4 billion of multifamily MBS debt last year, up roughly 19% from $55 billion in 2016. Private-label CMBS multifamily loan issuance also followed a positive trend. According to Trepp data, apartment loan securitizations totaled $5.3 billion last year, which is up 7.0% from the $4.9 billion issued in 2016.

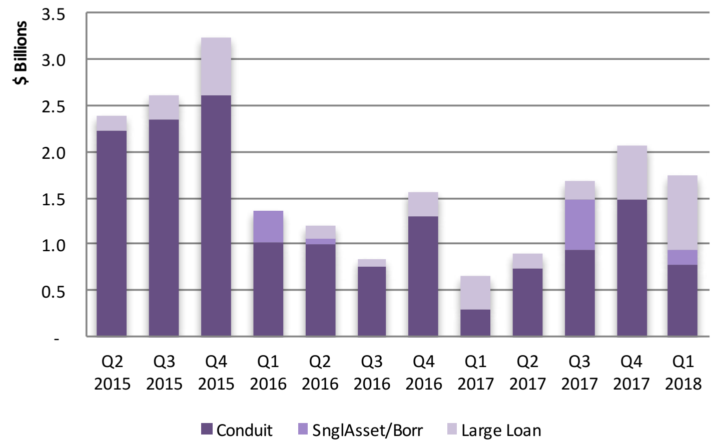
GRAPH 3: MULTIFAMILY LOAN ISSUANCE



Source: Trepp

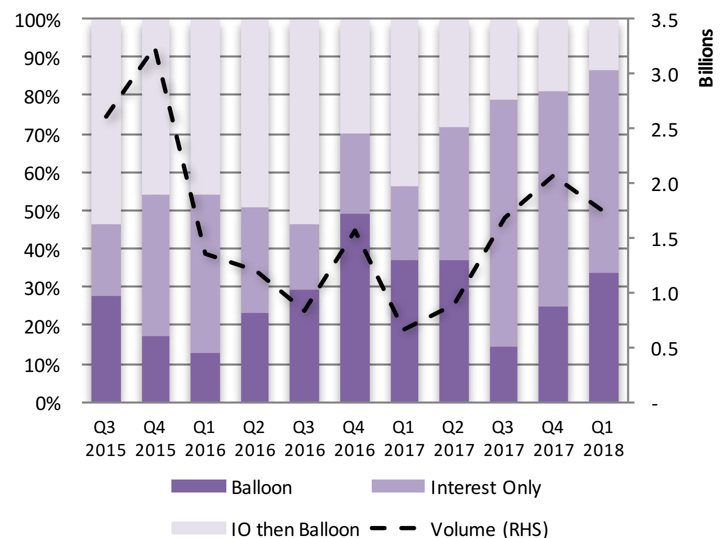
Private-label CMBS issuance reached $1.7 billion in the first quarter of 2018. Conduit deals made up more than 65% of last year's new CMBS issues, but only represented 44.1% of the Q1 2018 issuance. Large loan deals made up the greatest portion of first quarter securitizations (46.1%) and surpassed $800 million. In terms of amortization type, interest-only loans (including partial interest-only) comprised 66.5% of Q1 2018 issuance, compared to 75.0% of loans in 2017.

GRAPH 4: MULTIFAMILY CMBS ISSUANCE BY DEAL TYPE



Source: Trepp

GRAPH 5: MULTIFAMILY CMBS ISSUANCE BY AMORTIZATION TYPE

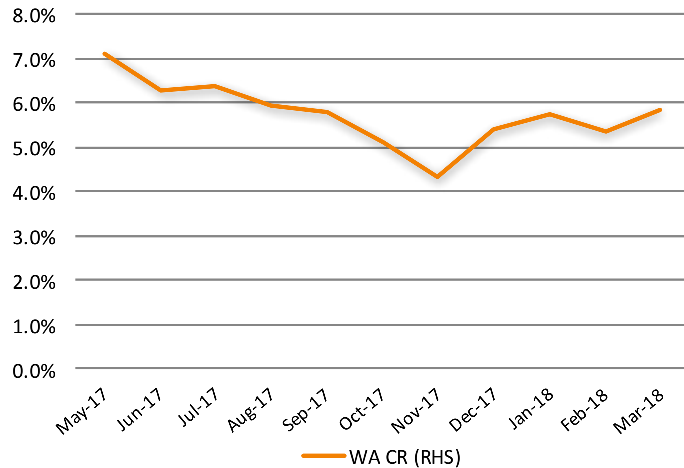


Source: Trepp

To be sure, this all pales in comparison to pre-crisis levels before the run-up in GSE market share. The percentage of multifamily loans in private-label CMBS has plummeted since 2008.

The weighted-average cap rate at securitization for conduit multifamily loans has assumed an upward trend since year-end 2017, indicating that property values are being bid lower. The rate reached a 12-month low of

GRAPH 6: CONDUIT MULTIFAMILY LOAN CAP RATES



Source: Trepp

4.3% in November but rose to 5.9% in March. Conduit multifamily loans issued in 2017 carried a weighted-average cap rate of 5.5%.

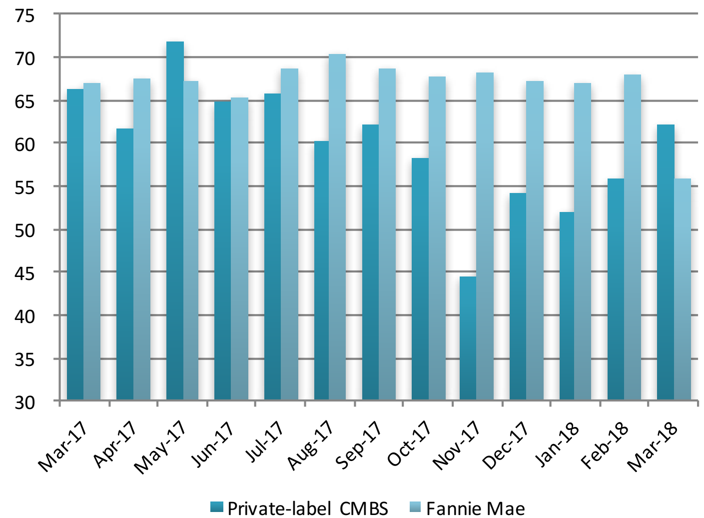
Conduit loan LTVs also dipped near the end of 2017, but have since trended back up to 62.2 for loans securitized last month. Conduit multifamily loans issued in 2017 had a weighted-average LTV of 57.6. On the other hand, Fannie Mae loans have reported a relatively flat weighted-average LTV between 67 and 70 since the second half of 2017. According to Trepp data, the average LTV for Fannie loans issued last month slid to 55.9.

Delinquencies Remain Low

For the first time in eight months, the Trepp CMBS Delinquency Rate rose in March. The March reading of 4.55% is only slightly up from February's rate of 4.51%. Multifamily loan delinquency assumed the same trend and dipped slightly from its January and February rates to 2.4% in March. However, the sector's delinquency rate has remained consistently below 2.5% for the last four months, and is still the lowest delinquency rate of all major property types.

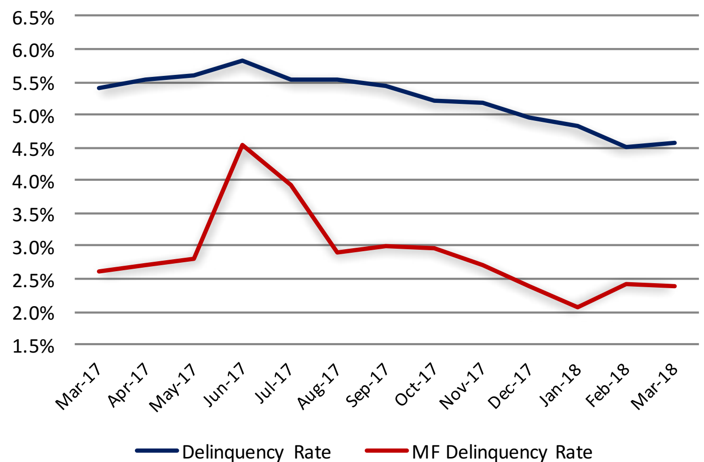
The largest multifamily loan to become newly delinquent in the first quarter of 2018 was the $57.5

GRAPH 7: WEIGHTED-AVERAGE LTV AT SECURITIZATION - MULTIFAMILY CMBS



Source: Trepp

GRAPH 8: MULTIFAMILY CMBS DELINQUENCIES



Source: Trepp

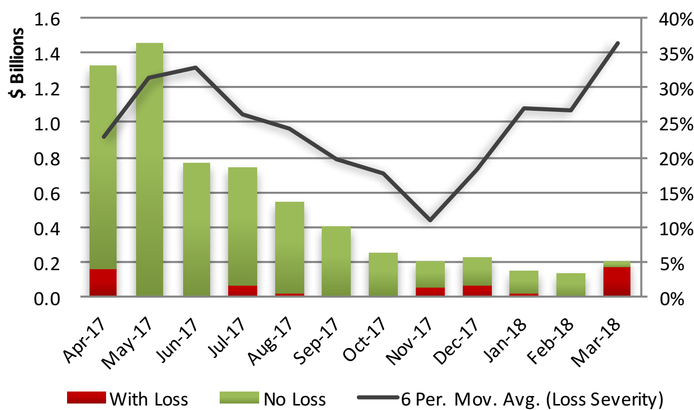
million Eagle Ridge Village loan, which comprises 5.6% of GSMS 2013-GC12. The underlying asset is a 648-unit military housing complex in Evans Mills, New York, which is about 20 miles south of the Canada-US border. The collateral was built in 2008 and caters primarily to military service members and their families. The loan was transferred to special servicing in January due to imminent monetary default. The property has endured steep declines in occupancy

due to a reduction in military subsidies, aggressive competitor marketing, and flows of deployment and relocation.

Another note that became delinquent last quarter is secured by a student housing community in Newark, Delaware. The $26.9 million Studio Green Apartments loan has not been able to re-stabilize after occupancy dropped from 71% to 48% in 2016. The student housing subsector is one to monitor, as its fundamentals have been challenged over the past five years due to supply growth outpacing that of university enrollment.

Although Liquidation Volume Remains Low, Average Loss Severity Rises

GRAPH 9: MONTHLY MULTIFAMILY LIQUIDATION AND LOSS TOTALS



Source: Trepp

The monthly liquidation volume for multifamily CMBS loans continues to dwindle as a mere $201 million was written off in March. (Of course, most of this speaks to pre-crisis loans.) The six-period, moving average loss severity receded in the second half of last year. However, that average severity has hiked back up since year-end 2017 and jumped about 10% to 36.4% last month. In March, realized losses neared $100 million for a hefty severity of 59.5%. Of all multifamily loans that were liquidated in the first quarter of 2018, 38.6% paid off with a loss.

Maturing Loans: Multifamily Debt Reporting Relatively Low DSCR

Multifamily loans maturing over the next six months generally have below-average DSCRs compared to the weighted-average DSCR of all US CMBS debt. Multifamily loans maturing between April and September 2018 have a weighted-average DSCR of 1.20x, compared to the average of 1.49x for all CMBS loans maturing within this time frame.

Multifamily maturities drop off significantly this year thanks to the end of the Wall of Maturities in 2017. Multifamily debt coming due in 2018 tallies just $2.4 billion, compared to the total of $11.6 billion that came due last year. Multifamily loans comprise about 5.3% of the total amount of CMBS debt maturing in 2018.

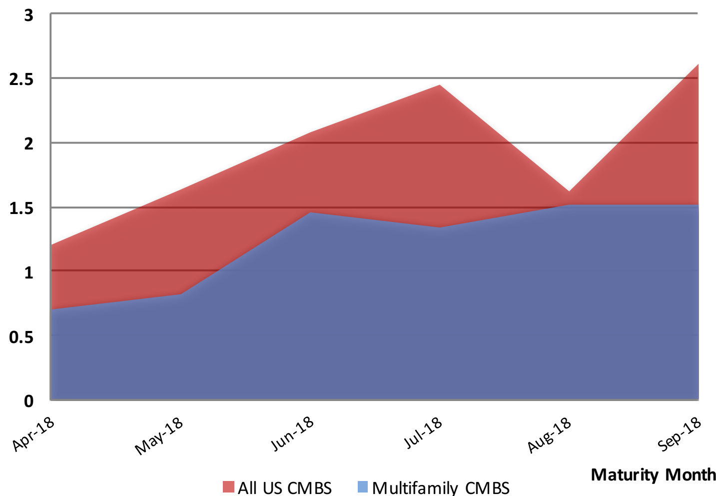
Class-A apartment properties are expected to remain attractive, as demand is particularly high in urban core and suburban markets. However, investors should continue to monitor class-A assets since the majority of recent multifamily deliveries fall within that

CHART 1: LARGEST NEWLY DELINQUENT LOANS – Q1 2018

CMBS DEAL	PROPERTY NAME	BALANCE	CITY	STATE	MARCH DELINQUENCY STATUS
GSMS 2013-GC12	Eagle Ridge Village	$57.5M	Evans Mills	NY	30 Days
WFRBS 2013-C12	Studio Green Apartments	$26.9M	Newark	DE	Foreclosure
COMM 2014-CR18	22 Exchange	$18.9M	Akron	OH	60 Days
COMM 2014-CR21	Olde Towne Apartments	$8.1M	Springfield	IL	30 Days
JPMDB 2016-C2	120 Halsted Street	$7.2M	East Orange	NJ	30 Days

Source: Trepp

GRAPH 10: WEIGHTED-AVERAGE DSCR FOR MATURING MULTIFAMLY CMBS



Source: Trepp

category. As a result, vacancies at luxury apartment buildings advanced to 6.3% in 2017 and continue to trend higher. Many industry experts forecast that the class-B and -C apartment segments will heat up significantly in 2018, as they provide higher cap rates and greater upside potential. Class-B and -C apartment deals are becoming more appealing because they provide more value-add opportunities than the class-A category, come with a lower property tax level, and attract a wide demographic that ranges from millennials to middle-income individuals to downsizing baby boomers.

A 2017 study from the National Multifamily Housing Council and National Apartment Association concluded that at least 325,000 new units need to be constructed each year until 2030 in order to keep pace with demand. The average annual number of deliveries over the past decade is still significantly lower than that at 250,000 units. Therefore, the multifamily sector's risk of oversupply appears to be a short-term obstacle concentrated in core and major markets, but the US apartment market is still undersupplied on a national level. This brightens the outlook for the multifamily CMBS sector as renting fundamentals remain sturdy.

For more information about Trepp's commercial real estate data, contact info@trepp.com.

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About Trepp

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