# Can Multifamily Sector Keep Up With Rising Demand?

Multifamily demand has risen to its highest level in more than 25 years (which roughly equates to the duration of one generation) thanks to demographic trends, population growth, and changing consumer preferences. More than nine million new renters signed on in the past 10 years alone, the largest decade-over-decade increase ever measured. With elevated demand, absorption has kept pace with deliveries.

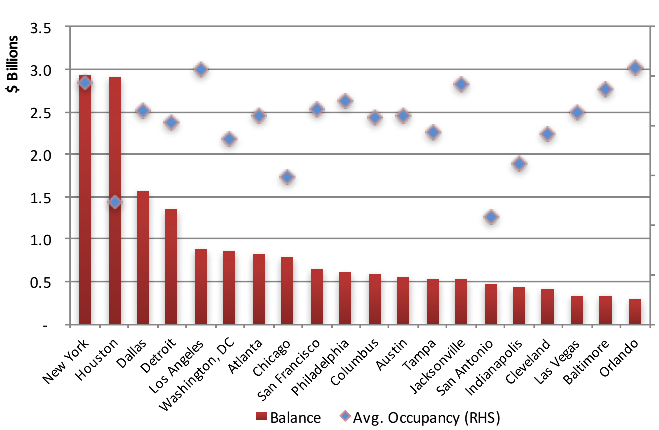
According to Trepp data, average multifamily loan occupancy has been trending downward over the past two years. Average occupancy declined from 94.0% at year-end 2016 to 93.6% in December, which is likely due to the influx of new supply in 2017. According to JLL, multifamily deliveries reached 115,000 units in Q3 2017, which marked the expected development cycle peak. The highest delivery counts from 2017 were observed in the Dallas-Fort Worth and Houston metropolitan areas. Dallas deliveries increased by 29,000 apartment units, and its average loan occupancy decreased by 0.32% year over year. Houston followed with 23,000 new units and an even larger drop in average occupancy (1.8%) year over year. The MSAs with the largest drops in average occupancy over the past year are Chicago (-2.5%), Charlotte (-1.9%) and San Francisco (-1.9%). On the other side, the MSAs that reported the highest occupancy growth in 2017 were Fayetteville, NC (3.4%), Jacksonville (0.9%) and New Orleans (0.7%).

## More New Loans Hit the Market

Private-label CMBS issuance for multifamily properties totaled $2.1 billion in the final quarter of 2017, bringing the year's total volume to $5.3 billion. This is a 7.0% increase year over year from the $4.9 billion issued in 2016. Conduit deals made up the majority — more than 65%—of last year's new issue balance. Large loans comprised 25% of the total, and the remaining 10% was devoted to single-asset/single-borrower deals. In terms of amortization type, interest-only loans (including partial interest-only) comprised 75.0% of 2017 issuance. That is up from 70.5% in 2017.

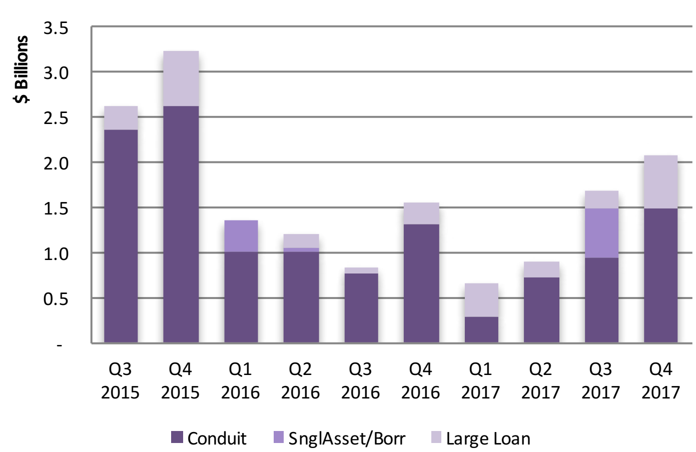
The weighted-average cap rate at securitization for new multifamily conduit loans also began to trend downward in the second half of the year, indicating that property values are being bid up. New issue LTVs have also started to shrink, with the weighted-average LTV for new multifamily issues dropping below 45 in November. Multifamily loans issued in 2017 had a weighted-average LTV of 57.6 and a weighted-average cap rate of 5.5%.

**GRAPH 1:** MULTIFAMILY CMBS BALANCE AND AVG OCCUPANCY



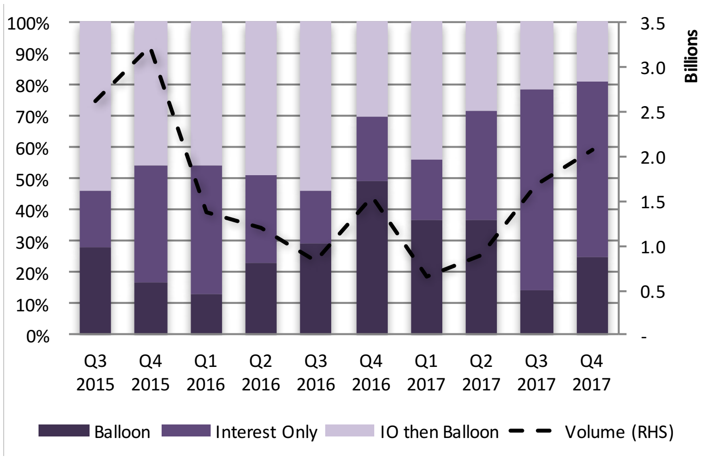

*Source: Trepp*

**GRAPH 2:** MULTIFAMILY CMBS ISSUANCE BY DEAL TYPE



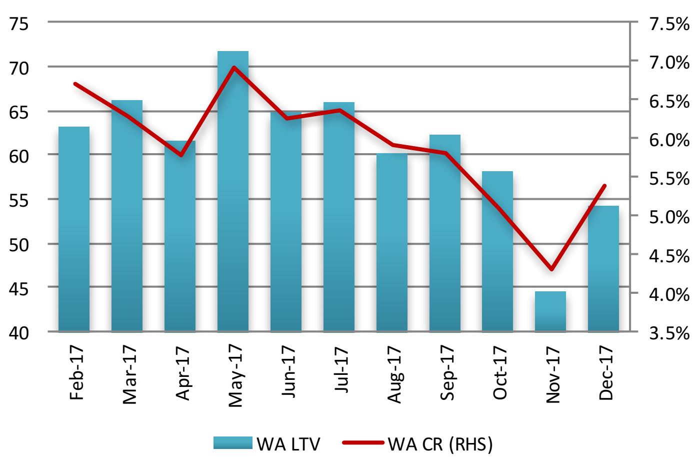

*Source: Trepp*

**GRAPH 3:** MULTIFAMILY ISSUANCE BY AMORTIZATION TYPE




*Source: Trepp*

**GRAPH 4:** CONDUIT MULTIFAMILY LTV & CAP RATE

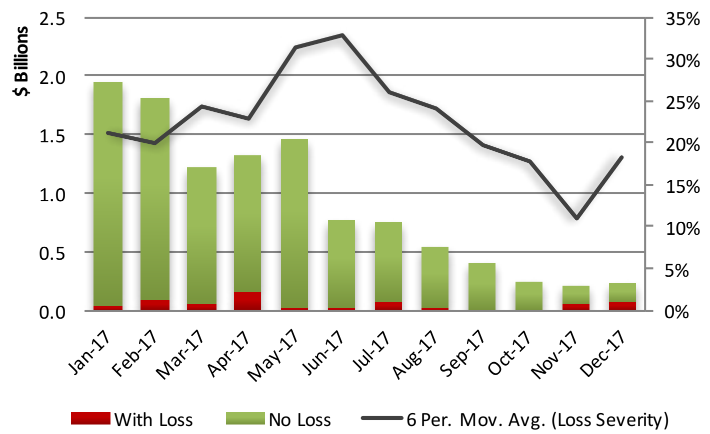



*Source: Trepp*

## Paradise Not Lost for Investors Behind Multifamily CMBS

As disposition volume shrunk toward the end of the year, the six-period moving average loss severity trended downward for much of the second half. However, there was an uptick in average loss severity at the tail-end of Q4 thanks to some significant losses in November and December. Realized losses totaled $60 million in Q4, compared to just $5.1 million in Q3. Even so, only 5.6% of the $10.9 billion in multifamily debt that was liquidated in 2017 paid off with a loss.

**GRAPH 5:** MULTIFAMILY MONTHLY DISPOSITIONS & LOSSES




*Source: Trepp*

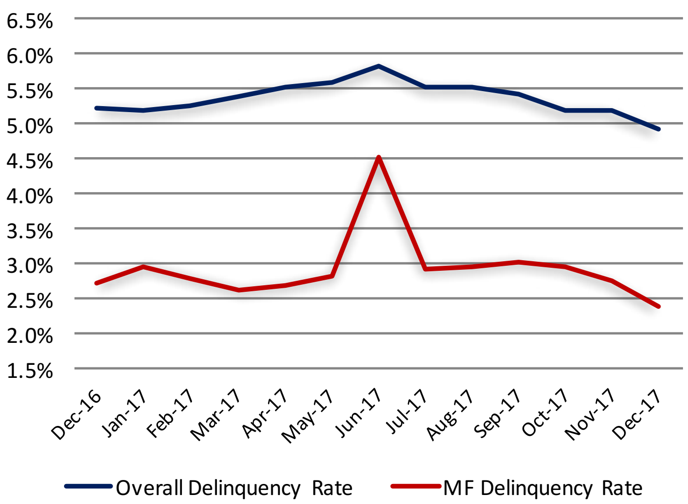
## Apartment Delinquencies Remain Low

The Trepp CMBS Delinquency Rate fell sharply in December, hitting a 15-month low of 4.89%. Delinquencies have now dropped in each of the last six months and further reductions are expected for 2018. Multifamily loan delinquencies have decreased consistently over the last five months, with the sector's delinquency rate reaching 2.4% in December. This is the lowest delinquency rate of all five major property types.

The multifamily CMBS delinquency rate remained below 3.0% for most of 2017 with the exception of June. The rate spiked to 4.5% in June as the $533 million Empirian Multifamily Portfolio loan defaulted at its underwritten maturity date. The collateral is made up of 157 apartment properties in various states, and they are separated into two pools. The loan is divvied up into four pieces and represents more than 60% of the remaining balance behind MLMT 2007-C1. In July, the portfolio's borrower exercised one of its two one-year extension options. The loan was subsequently made current on payments and received an updated maturity date of June 2018.

The largest loan to become newly delinquent in the fourth quarter was the $38.0 million NorthPointe Apartments loan which comprises 4.0% of COMM 2013-LC13. The underlying property is a 951-unit, high-rise apartment complex located in Euclid, Ohio. The

**GRAPH 6: MULTIFAMILY DELINQUENCIES**




*Source: Trepp*

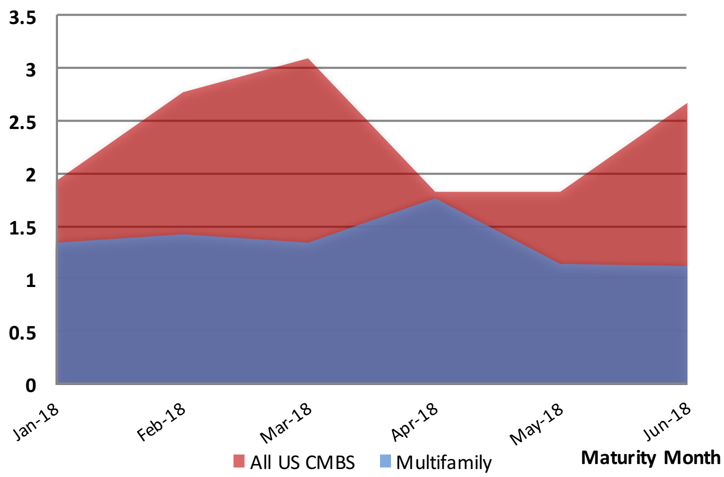
loan became 30 days delinquent in December and has since been transferred to special servicing due to imminent monetary default. The collateral's most recent financials indicate occupancy has dropped to 69%, while DSCR (NCF) has fallen to 0.84x.

Several other notes that became delinquent last quarter are secured by properties in the Houston metro area, many of which cited damage from Hurricane Harvey as the reason for distress. However, these loans are small with outstanding balances of $10 million or less.

## Large Swaths of Multifamily Debt Due in Mid-2018

Multifamily loans maturing over the next six months generally have below-average DSCRs compared to the weighted-average DSCRs of all US CMBS. Those multifamily notes maturing between January and June 2018 carry a weighted-average DSCR of 1.17x, compared to the average of 2.40x for all CMBS loans maturing within this time frame.

**GRAPH 7: WEIGHTED-AVERAGE DSCR – 2018 MULTIFAMILY MATURITIES**




*Source: Trepp*

Looking ahead, multifamily maturities drop off significantly this year, thanks to the final salvo of the Wall of Maturities in 2017. Multifamily debt maturing in 2018 totals just $2.4 billion, compared to the tally of $11.6 billion that came due last year. Multifamily loans comprise about 5.1% of the total amount of CMBS debt which matures in 2018.

June represents the high-water mark for multifamily maturities in 2018. More than $770.3 million of multifamily CMBS debt will mature in June, while every other month in 2018 has a maturing volume well below the $250 million mark. The bulk of this volume

**CHART 1: LARGEST NEWLY DELINQUENT MULTIFAMILY LOANS – Q4 2017**

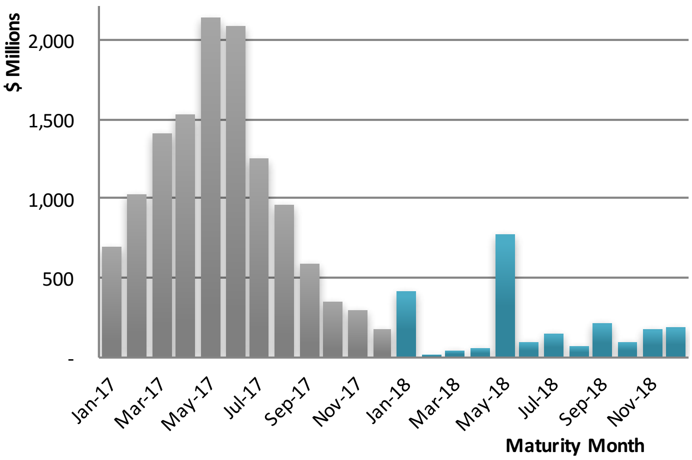
| CMBS DEAL | PROPERTY NAME | BALANCE | CITY | STATE | DELINQUENCY STATUS |
|---|---|---|---|---|---|
| COMM 2013-LC13 | NorthPointe Apartments | $38.0M | Euclid | OH | 30 Days |
| JPMCC 2016-JP4 | Timbergrove Heights | $10.2M | Houston | TX | 30 Days |
| COMM 2014-CR21 | Olde Towne Apartments | $8.2M | Springfield | IL | 30 Days |
| CSAIL 2016-C5 | Arthur Square | $6.7M | Port Arthur | TX | 60 Days |
| JPMBB 2014-C21 | The Reside Apartments | $4.0M | Houston | TX | 30 Days |

** Loan Balances and Delinquency Statuses are as of the loan's first delinquent month*

*Source: Trepp*

is devoted to two large portfolio loans which are both part of 2007 conduit deals. The larger of this pair is the aforementioned $533 million Empirian Multifamily Portfolio loan. The other large loan maturing in June is the $166.5 million Spring Gate, which is split between a $54.6 million A-note and a $111.9 million B-note. The underlying collateral for that loan is a group of 73 properties located across eight states. The debt makes up 62.8% of MLCFC 2007-8.

**GRAPH 8:** MATURING MULTIFAMILY LOANS




*Source: Trepp*

### What Lies Ahead for Multifamily?

*National Real Estate Investor* recently published an article which forecast that the multifamily sector will generally remain stable this year. The firm predicts that vacancies and rents may continue to inch up, as new supply completions are not expected to ebb until later in the year. Class-A assets are expected to remain attractive thanks to high demand in core urban and suburban markets. However, vacancy rates at luxury apartment buildings are also trending higher because the majority of recent multifamily construction falls within that category. *Multifamily Executive* forecasts that the class-B and -C markets will heat up significantly in 2018 due to increasing class-A supply, the rising cost of home ownership, and millennials entering the rental market by the millions. Class-B and -C apartment deals may increase in 2018 as those properties typically come with more value-add opportunities and lower property taxes. Additionally, class-B and –C assets attract a diverse demographic pool which includes millennials, middle-income individuals, and downsizing baby boomers. Foreign investors have also poured large amounts of capital into the US multifamily market in recent years, and continued interest may indicate that the sector offers stable growth opportunities.

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## About Trepp

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