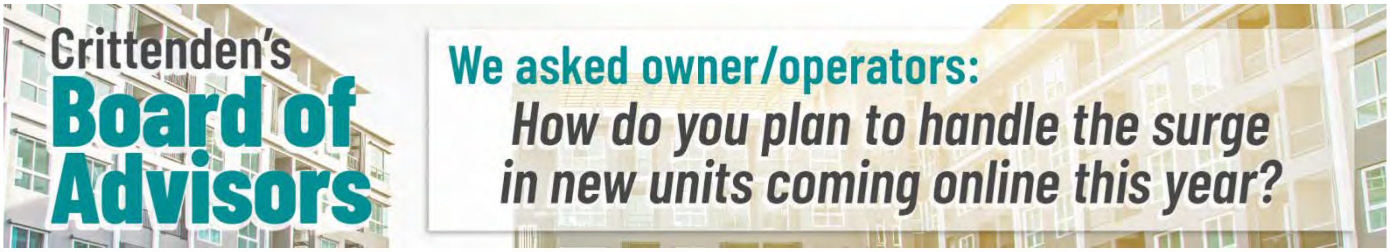
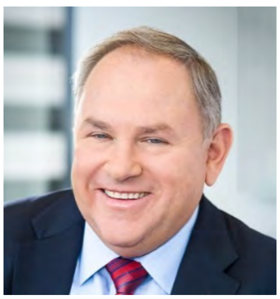
The Apartment Report™

CRITTENDEN RESEARCH, INC. • P.O. BOX 635107, SAN DIEGO, CA 92163 • CUSTOMER SERVICE: (800) 421-3483

Vol. 29, No. 14 **March 9, 2020**





Robert E. Hart, President/CEO – TruAmerica Multifamily

Fortunately, in the majority of the markets in which we operate, Los Angeles, Orange County, Denver, Phoenix, Las Vegas, Orlando and Raleigh, there is still a much larger net rental cost disparity between Class B (workforce housing) unit prices and Class A in those same markets. Class A renters tend to be renters by choice, as opposed to Class B renters (our renters) which are generally renters by necessity. Those Class A rents are typically north of $2.50 per square foot, where as our rents are typically in the $1.50 per square foot range at most. That creates enough of a delta in affordability to insulate us from new supply.

Cindy Clare, COO – Bell Partners

We are focusing on improving the customer experience and creating a strong sense of community for both our prospective and existing residents. We are currently testing AI tools to not only provide services to current residents, but also to guide prospective residents more quickly to what they need. This will allow our teams to be as responsive as possible and prioritize their work more effectively. That said, the best way to handle a surge of units in a market is to keep the residents you have.

Joe Lubeck, CEO – American Landmark

The new units coming online are Class A product, which don't satisfy the middle-market sector that demands workforce housing nationwide. This is actually an opportunity that allows us to satisfy that demand through value-add renovations which provide an improved living experience, without the premium rents one might see from brand new construction.

Mark Hamilton, CEO/Founder – Hamilton Zanze

In this cycle, supply has been largely concentrated in the urban core, and several markets dominate the supply landscape (e.g., Dallas-Fort Worth, Washington, D.C., Houston, Seattle, Atlanta, Los Angeles, New York/New Jersey, Boston). Though Hamilton Zanze continues to target new acquisitions in some of these metro areas, we remain focused on suburban assets in infill locations with high barriers to new development. While suburban deliveries are projected to increase, suburban multifamily is expected to outperform urban product in the year ahead.

Continued on Page 2

CRITTENDEN'S BOARD OF ADVISORS: MARK HAMILTON…

Continued from Page 1

Our research and transactions teams pay close attention to the conditions within our targeted markets and submarkets, as the supply pipeline is not uniformly distributed across our markets. Supply does not pose the same risk to operating fundamentals in each market. We see a potential spectrum of outcomes: a significant supply pipeline coupled with robust demand may still produce strong occupancy and rent growth, whereas as a minimal supply pipeline coupled with weak demand may produce weak operating conditions. Our teams are consistently evaluating market and submarket conditions to ensure we are targeting the right markets and assets for our investors.

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

Despite the influx of new supply, concessions are minimal (less than 1.5%) in the Class A space given the strength of the DFW job market, thus maintaining a meaningful spread between value-add and new construction rents. This spread allows Westmount to continue to execute on our value-add business plan and still offer an affordable alternative to the newer product. Additionally, the majority of new construction product is concentrated in more core and infill urban locations, while Westmount tends to target will located suburban and workforce locations that will not compete directly with the majority of new supply.

DEVELOPMENT SPEEDS AHEAD OVER NEW HURDLES

Developers will keep construction pipelines active, buoyed by the combination of low interest rates and plenty of capital. Expect new multifamily starts to lose some momentum this year among developers that haven't already put in the legwork to expand their platforms. Caution is creeping into the development space with projections that construction costs and employee salaries will rise at a pace faster than the 2% to 3% rent increases in many regions. This uncertainty will encourage more stringent underwriting for future deals. Searching for off-market legacy land deals will help offset rising costs.

While leverage for construction loans might reach as high as 70%, it will more realistically be at 65%. Banks will continue to have an appetite for construction-to-perm with experienced developers that have strong balance sheets, but life companies and GSEs will dominate the perm space after stabilization. Debt funds have compressed their yields to be more competitive in construction lending. They are typically at about 100+ basis points for a recourse loan and 275+ basis points over Libor for non-recourse financing. Debt funds will also be a consistent option to hit 70% LTC. Their money will cost a little more but the extra leverage and non-recourse money will be an attractive option.

A greater number of equity sources now have more reasonable return expectations than in the past few years. From a pure cash-flow and immediate cash-on-cash return, it's more challenging to get development deals to pencil out, but as cap rates compress, development returns look more attractive compared to acquisitions and other alternative investments. Most developers can easily hit 7% to 9% unleveraged returns or an IRR in the mid-teens. With that said, equity will be increasingly discriminating and favor quality sponsors.

Consistently strong demand and fundamentals support this on-going positive outlook. Many growth markets will still see population growth and people dealing with longer commute times continuing to create demand for new buildings closer to job centers. A decent amount of supply is coming online, but absorption hasn't showed any signs of slowing. While markets with a glut of supply see some concessions, it's nothing completely upside-down. Opportunity zones are also spurring development, allowing companies to pull the trigger on deals in up-and-coming areas that may not be quite ripe for new multifamily despite the capital gains deferral now maxing out at 10%.

Labor will still be the biggest thorn in developers' sides. Finding subcontractors with availability has delayed projects during the past few years, but taking this into account has made the development pace more predictable.

Continued on Page 3

DEVELOPMENT SPEEDS AHEAD OVER NEW HURDLES…

Continued from Page 2

Underwriting should also reflect increasing real estate taxes and insurance costs in projected NOIs. The coronavirus hitting China could cause a short-term increase in material costs by requiring companies to source materials from countries with higher labor costs, but it's too early to say for sure.

Altman Companies expects to start approximately five communities totaling at 1,800 units. While still active in Florida, the firm is expanding into the Atlanta market through developments and value-add acquisitions. It has land control for about 4,100 units, just shy of $1B in development. During 2019, Altman started four developments with about 1,200 units; three in South Florida and one in north Tampa. **BBX Capital** bought a 50% stake in the company in 2018 and Altman expects to ultimately grow from the deal. It typically builds three-story garden, four-/five-story elevator with surface parking and midrise multifamily. The company plans to shift from being a merchant builder to taking a build-to-hold approach for some properties. This change means it will partner with more high-net-worth equity comfortable with longer holds.

Marquette Companies recently stepped up its development front and plans to break ground on four developments during the summer. The projects consist of about 500 units in Fulton, Ill., and 600 in Chicago's medical district. It's looking for more development sites in Nashville. The firm will target one or two acquisitions of infill/workforce housing in Minneapolis, Denver and Phoenix. Marquette has been successful in getting off-market deals done with older legacy owners.

While **Beztak** has no new starts planned this year, it currently has five projects under construction totaling 1,173 units. The projects under construction consist of a senior housing development in Tucson, Ariz., and another four that are a mix of senior housing, mixed-use and conventional apartments in Michigan. The company plans to work through its development pipeline and start new projects in 2021. Beztak wants to diversify in both market and product; it will look for conventional apartment, student housing, senior housing, office and retail deals. Beztak will be active in Arizona, the Carolinas, suburban New York and Washington, D.C. The firm is a long-term holder and has about 32,000 units in its management portfolio. It also targets value-add, redevelopments and pre-stabilized assets opportunistically and upgrades the 10-year product in its portfolio.

The United Group of Companies plans to develop 600 units of active adult units and 400 of conventional multifamily this year. Though it is bullish on Northeastern states such as Massachusetts and New York, it has a presence in eight states. The company plans to shift the diversity of its multifamily portfolio as most of its recent growth has been in the active adult sector, with 1,000 units both developed and managed. For conventional multifamily, it netted 1,500 total units. The firm also operates a 3,000-bed student housing portfolio.

Wangard Partners wants to start 600 to 700 units by the end of 2020, so it's hoping for a busy Q4. The company operates in Wisconsin, Illinois and the Twin Cities. It will also chase one or two acquisitions, either value-add or Class A, in addition to industrial deals and retail selectively. The company plans to start a 150-unit project on the eastside of Milwaukee this April and broke ground on a 278-unit project during late 2019.

CRITTENDEN

MULTIFAMILY CONFERENCE

MARCH 25 - 27, 2020 · DALLAS, TX

REGISTER TODAY

MEMBERS RECEIVE 20% OFF ALL REGISTRATION FEES

CLICK HERE

Stacy G. Hunt
Greystar
MODERATOR

Steve Lamberti
Starwood Multifamily Partners / Highmark

Rick L. Graf
Pinnacle

Margette Hepfner
Lincoln Property Company

Bradley Cribbins
Alliance Residential Co.

KEYNOTE SESSION #101: State of the Multifamily Industry

click here for more information on our upcoming conference sessions

THANK YOU TO OUR SPONSORS*

PLATINUM
WAYFINDER TAX RELIEF, LLC
MONEY 360, INC.
EMERALD CREEK CAPITAL

SILVER
BURGESS CONSTRUCTION CONSULTANTS, INC.
DIGGER SPECIALTIES, INC.

BRONZE
NORTHWIND FINANCIAL
NORTHEAST BANK
FORENSIC ANALYTICAL CONSULTING SERVICES
VELOCITY MORTGAGE CAPITAL
PRODEAL
SPOT ON NETWORKS
PARAKEET
DORMAKABA
LENDINGONE

*CURRENT SPONSORS AS OF FEBRUARY 19, 2020

#multicon20 www.crittendenmultifamily.com

OWNERS, DEVELOPERS, LENDERS & MANAGEMENT FIRMS

Altman Companies: 1515 S. Federal Highway, Suite 300, Boca Raton, FL 33432. Seth Wise, Co-CEO, (561) 997-8661.

Beztak: 31731 Northwestern Highway, Suite 250W, Farmington Hills, MI 48334. Sam Beznos, Principal, (248) 855-5400.

Calvera Partners: 60 S. Sixth St., 28th Floor, Minneapolis, MN 55402. Brian Milovich, Managing Principal, (415) 765-7126.

Castle Lanterra Properties: 1 Executive Blvd., Suite 204, Suffern, NY 10901. Elie Rieder, CEO, (212) 201-8055.

CGI Strategies: 6300 Canoga Ave., Suite 1100, Woodland Hills, CA 91367. Gidi Cohen, Founder/CEO, (310) 773-9518.

Davlyn Investments: 999 Corporate Drive, Suite 100, Ladera Ranch, CA 92694. Aaron Pacillio, Chief Investment Officer, (949) 756-1110.

FCP: 4445 Willard Ave., Suite 900, Chevy Chase, MD 20815. Steve Walsh, Principal/Chief Credit Officer, (240) 395-2008.

Fogelman: 4151 Ashford Dunwoody Road, Suite 280, Atlanta, GA 30319. Mike Aiken, SVP, Investments, (404) 564-4291.

Marquette Companies: 135 Water St., Fourth Floor, Naperville, IL 60540. Darren Sloniger, President/ Chief Investment Officer, (630) 420-4737.

Praedium Group, The: 733 Third Ave., 24th Floor, New York, NY 10017. Chris Hughes, Co-Chief Investment Officer, (212) 224-5619.

Providence Management Company: 3201 Old Glenview Road, Suite 200, Wilmette, IL 60091. Kevin Finkel, EVP, (847) 904-1453.

United Group of Companies, The: 300 Jordan Road, Troy, NY 12180. Jeff Arnold, COO, (518) 687-7300.

ValCap Group: 3203 McKinney Ave., Dallas, TX 75204. Rich Fishman, President/Founder, (210) 504-3339.

Wangard Partners: 1200 N. Mayfair Road, Suite 310, Milwaukee, WI 53226. Stu Wangard, CEO/Founder, (414) 777-1200.

VALUE-ADD SUPPLY TO SURGE

Watch for value-add buyers to hit the market and competition to ramp up as they vie for the same deals. Broker appraisals for properties have been through the roof, which usually signals more transactions will hit the market sooner rather than later, as election cycle volatility isn't ideal for a seller. **Providence Management Company** hopes to double its 2019 acquisition volume to buy $500M in multifamily value-add in the Southeast, Midwest and Mountain West. **Davlyn Investments** could boost its value-add acquisitions by 50% this year. **Castle Lanterra Properties** plans to double the number of units it has under management from 7,500 to 15,000 this year through acquisitions. It also hopes to enter the Carolinas.

While deal volume will heat up, the composition of the list of major buyers has become more complex amid increased competition for those deals. Many foreign investors – some from countries with negative interest rates – are fine taking a lower yield. Crowdfunding groups will take a more aggressive stance on both value-add and Class A opportunities after chasing smaller B and C assets earlier in the cycle. Look out for a surge in loan assumption opportunities going forward as well. When interest rates were on the rise during 2018, owners locked in rates and now face large prepayments.

Continued on Page 5

VALUE-ADD SUPPLY TO SURGE…

Continued from Page 4

Count on cap rates to compress even further. There's about a 160 basis point spread between cap rates and the U.S. Corporate BBB Effective Yield, which is below 2.8% and expected to fall even further after The Fed announced an interest rate cut to curb coronavirus-related economic worries. Expect many markets to see cap rates fall to mid- to low-4%. Competition for value-add deals will be most fierce in primary markets as cap rate compression has driven primary, secondary and tertiary markets down to similar levels, and savvy investors will naturally flock to the stronger markets that pose less risk if a downturn hits during CapEx. For a similar reason, more firms will look at stabilized assets positioned to perform well independent from an upgrade plan.

Fogelman will be more focused on major markets, such as Atlanta, Dallas and Houston, because smaller markets have been bid up to a similar level and it wants to compete in diversified economies that offer less risk. Fogelman will target five to eight purchases this year with a total value in the range of $250M to $350M. It completed six value-add transactions during 2019 for $300M; four in Atlanta and two in Houston. The company may also explore the core-plus space more this year than in prior years.

Castle Lanterra is changing its approach to future acquisitions to focus on stable cash-flowing properties and less so on growth properties that typically provide little cash flow until the business plan is complete. This strategic change stems from CLP's market outlook, as it prepares its portfolio for a stabilized but low-growth market that can affect property enhancement execution. While CLP primarily focuses on a value-add strategy, it made two acquisitions of newly-constructed properties because their cap rats compressed in strategic growth markets. The company's target markets include the New York City metro, the Tri-State area, South Florida, Orlando, Tampa, Denver, Austin, Seattle, Atlanta and Washington, D.C. It acquired six properties during 2019 and more than doubled its year-over-year transaction volume by dollar amount.

The availability of true untouched value-add deals is still slim compared to overall demand. At the same time, rent growth is expected to taper off as the cycle matures. Tighter margins will push buyers to keep an open mind to both value-add and core-plus opportunities. Owners who will be able to enhance the experiences and lifestyles of their tenants at affordable rents will increasingly develop greater tenant loyalty. Expect to see softness in some markets for one-bedrooms, as years of rent increases have made the idea of roommates splitting two- and three-bedroom units more popular.

Equity, specifically institutional players, will increase their level of due diligence for partners; expect them to flock to experienced, specialized operators. Leverage for debt may still reach up to 80% LTV]. The agencies' new requirement as to what qualifies as affordable – a change made at the end of Q3 2019 – can now equate to a 15 to 25 basis point difference on quotes for deals depending if a property meets that threshold or not.

Providence Management Company is specifically firing up expansion efforts in Midwest and Mountain West, where it had a presence beforehand. The firm also shifted to looking for late '90s product with nine-foot ceilings and garages, planning to spend $7K to $10K on renovations. It now plans to extend holds to five to 10 years.

Continued on Page 6

VALUE-ADD SUPPLY TO SURGE…

Continued from Page 5

The Praedium Group plans to capitalize on continuing demographic trends supported by demand and the undersupply of middle-income rental housing with disciplined property selection and boosting value by adding amenities, improving services and upgrading properties where needed. These value-add assets provide its investors with distributable and durable cash flow with protection from downside risks. Praedium targets suburban markets with strong job and population growth, predominantly in the western and southern regions. It purchased and sold $1.4B in assets in 2019 with acquisitions in Arizona, California, Colorado, Florida and Texas.

FCP seeks Class B and C deals in the Southeast and Texas with plans to buy $125M to $150M in equity or $350M in total assets this year. The firm pushed out about $200M to close deals on about 23 assets last year with a total of 5,000 units, as well a few commercial investments. It also plans to dedicate $75M to development or mezz debt. FCP targets all major markets and requires properties have at least 150 units.

ValCap Group is still bullish on multifamily due to fundamentals, but not as bullish on heavy value-add. It's looking for more management plays and some product that's been stabilized. Expect the company to also be more focused on operations and trying to create more efficiency in maintenance and renovations. ValCap hopes to buy a couple thousand units this year, mostly in the Dallas-Fort Worth metroplex and some in southern Mid-Atlantic states. It acquired four assets last year; three in DFW and one in the Memphis MSA. The firm expects to use more capital sources that are comfortable with less deal flow and more moderate returns, such as friends and family, crowdsourcing and pref equity.

Calvera Partners is raising its third fund and looking to deploy $20M to $30M of equity or acquire about $75M to $100M with leverage. It targets value-add opportunities in the San Francisco Bay Area, Minneapolis-St. Paul, Phoenix, Las Vegas, Charlotte, Raleigh and Austin. Calvera will place a larger focus on branding and marketing to reflect the storytelling used in the boutique hotel industry. One example is the renovation of a 1960 property in Sunnyvale, Calif., that included renaming it pksl (pronounced "pixel") and using a retro gaming theme with materials and a color palette reminiscent of an Atari 2600 console (Atari was founded in Sunnyvale). Calvera's renovation budgets typically range from $5K to $20K per unit, but pksl's budget went up to $60K per unit. The company expects returns to be in the mid-teens.

Davlyn Investments plans to target $100M to $150M in deals throughout California this year. Last year, it closed just shy of $100M in Southern California. It primarily focuses on value-add opportunities but will buy new construction if the property is compelling. The firm is a long-term investor with holds typically of seven to 10 years and leverage levels of 55% and 62% to protect cash flow in the event of a downturn.

CGI Strategies will be bullish on value-add and core-plus acquisitions in the Southeast. Altogether, it will look for $100M to $300M for the year and a net gain of 1,000 units. The firm will also start two ground-up developments this year, one each in Los Angeles and Oakland, Calif. CGI also entered the hospitality industry last year with the acquisition of two California hotels.

The Apartment Report Team
editor@crittendenapartmentreport.com

Customer Service
(800) 421-3483
membership@crittendenresearch.com

Newsroom Fax: (619) 923-3294

The Apartment Report™ is published by Crittenden Research, Inc., 1682 Novato Blvd., Suite 201, Novato, CA 94947. Send address changes to *The Apartment Report*™, P.O. Box 635107, San Diego, CA 92163. Contents copyright © 2020 Crittenden Research, Inc. Sample reports may be requested online at http://www.crittendenonline.com.

Crittenden publishes *The Apartment Report*™, *The Crittenden Report on Real Estate Financing*™ and *Crittenden Retail Tenants*™, and associated directories. For more information about our publications, go to http://www.crittendenonline.com.