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multi-family residential report

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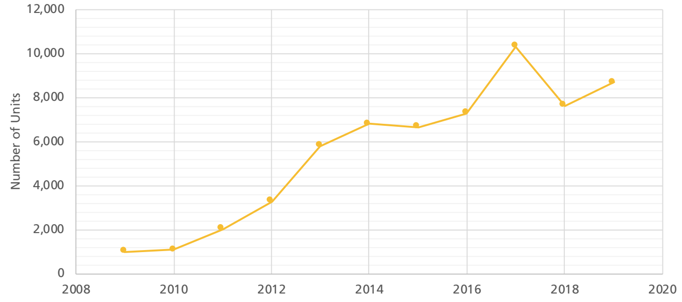
Typically, the Q1 report provides a brief glance at how the previous year concluded with a focused examination on the first quarter of the new year. This year, however, is anything but typical. While the year started off as expected with continued rent escalation, high occupancy, high construction and labor costs and a healthy supply pipeline, news from around the globe about a novel coronavirus spreading across borders started creeping into the mainstream media in February. As March began, the virus started spreading rapidly in the US, gaining steam mid-month and leading to an unprecedented about-face halt to the US economy.

It is a startling contrast to look at the first 2.5 months of the Quarter in comparison to the state of the economy today. By all intents and purposes, 2020 was off to a roaring start, with murmurs of a recession still lingering in the background. However, on March 11th, the World Health Organization officially declared COVID-19 a pandemic, which is defined as the global spread of a new disease. This led to a shutdown of economic activity in major segments of the economy. With people quarantined in their homes to help curb the spread of COVID-19, the real estate market is feeling the effects of the deep uncertainty in the public realm about what will happen and how the world will look on the other side of this, with no precedent upon which to turn.

The following sections will first examine the multifamily housing data from the first quarter, where many of the reports do not yet indicate the effects of COVID-19 pandemic, then provide a brief update of the effects of COVID-19 in the last 4-6 weeks. With the drastic change of where the economy is today, it would be remiss not to deliver a real-time update in order to convey a more layered and current report on the state of the multifamily market in the Portland Metropolitan region and beyond.

APARTMENT PERMITS 2009-2019 FOUR COUNTY METRO AREA



The Barry Apartment Report Spring 2020

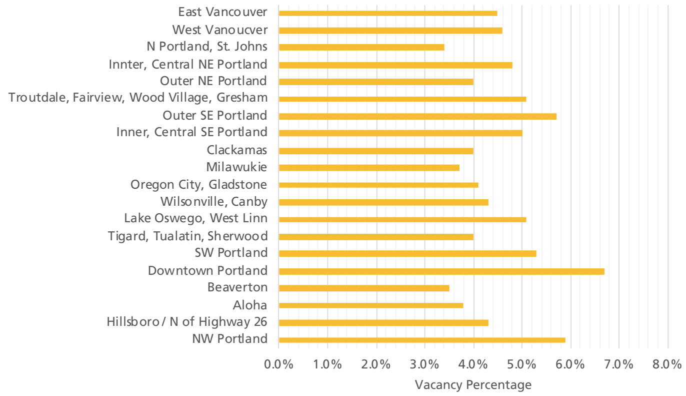
SUPPLY, PERMITTING

The previous year ended strongly with apartment construction continuing at a brisk pace, with permits in for nearly 8,700 units at Year End 2019, up 14% from the previous year. Along those lines, 2019 also ended with a surge of completions at 6,500 units delivered, indicative of the last wave of approved projects prior to the Inclusionary Zoning policy adopted in early 2017. In looking at Q1 2020, there are approximately 7,100 units under construction in the Portland Metro Area.

However, on the 1st day of the second Quarter, we see a very different picture. Most construction projects in the planning stages are delayed, with some early-stage projects on indefinite holds. Many are in "wait-and-see" holding patterns, with developers and investors choosing to see how the economy recovers – and waiting to better understand how long that might take – before moving dirt. Still others were legally hamstrung by the construction stop-order in the state of Washington, deemed as a non-essential business, greatly affecting projects in the Vancouver portion of the greater Portland Metropolitan area. However, on 4/24/20, Governor Inslee eased up on his state's construction ban by allowing sites to reopen with strict social distancing protocols, allowing construction to start back up in the state. In general, though, the construction moratorium in Washington lasted over a month, and these types of holdups all compound the supply constraints in the coming months, with each week of delay pushing projects back weeks, months and possibly even years.

Conversely, the projects in Oregon lucky enough to already be under construction at the time of the shelter-in-place order have continued without pause. Certain changes are evident, with social distancing requirements and strict sanitation protocols being enforced across job sites by superintendents and OSHA alike. Friction appears mostly in the form of supply chain issues in delays on materials deliveries, with added complications when shipping from other parts of the country where manufacturing facilities and factories have been affected by shutdowns. As an example, it has been difficult to extract orders, supplies and labor from neighboring Washington due to their strict shelter in place order, leading to schedule delays and some scrambling to find alternate suppliers. In reaction, many project managers are frantically stockpiling needed items early – especially those with already-long lead times such as cabinets, windows, etc. – in anticipation of even greater supply chain delays as things start to reopen and projects rush to get their orders produced. However, in general construction that is already underway appears to be continuing smoothly throughout the quarantining period and many still claim they will be delivering on time later this year.

AVERAGE MARKET VACANCY RATE PERCENTAGE



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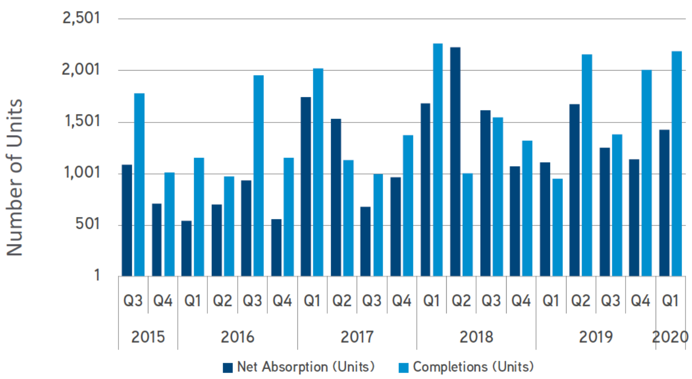
NET ABSORPTION & COMPLETIONS



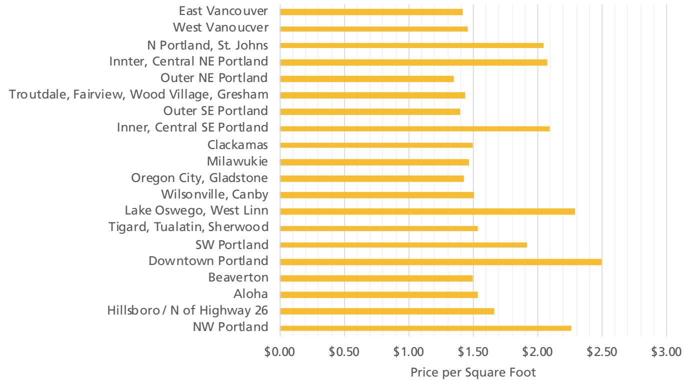
Colliers International Portland Metro Q1 2020 Multifamily Report

DEMAND, ABSORPTION

In 2019, there was a slight dip in absorption at around 5,150 units, with completions outpacing absorption leading to increased vacancies across the Metro area. Vacancy overall increased slightly in Q1 standing at 4.69%. The newer and more expensive Class A apartment properties bear relatively more vacancies than others, with the steep prices accompanying new-construction units creating longer lease-up periods.

With most of the country on government-mandated stay-at-home guidelines and no tangible end date in sight, it will be difficult to know the full impact on the housing market as it depends largely on how long the regulatory restrictions remain. This goes not only for those quarantining at home, but also in regard to emergency measures put in place by jurisdictions to curb the effects of the spiking unemployment rate and plunging economy, such as eviction moratoriums on commercial and residential tenants. While the hope is that the remainder of 2020 will be enough time to recover with a healthy 2021 on the horizon, it will largely depend on consumer confidence returning to “normal” flow and spending, and how long it might take to return to the pre-pandemic booming economy. As such, it will require several more months to see the true effect on absorption in the rental market. The previously mentioned 7,100 units under construction in Q1 2020 are in a very difficult position, especially those in the lease-up phase. One caveat is that with the expectation that the economy will need at least the rest of 2020 to fully recover if not longer, apartments historically do well during down periods, as people put-off buying homes and remain renters, or move “down” to more affordable units. As such, there is a strong possibility that absorption will remain strong. However, those that may suffer losses are the newer expensive properties which the market is typically too weak to support in recovery periods.

AVERAGE RENT PER SQUARE FOOT



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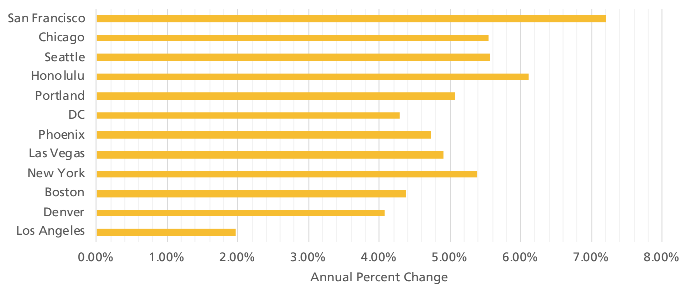
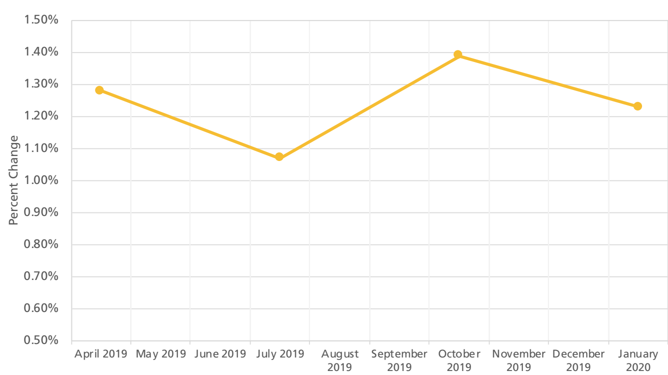
US COMPARATIVE COST INDEX – PORTLAND CONSTRUCTION COST INDEX



Rider Levett Bucknall Q1 2020 Construction Cost Report

CONSTRUCTION ACTIVITY CYCLE



Rider Levett Bucknall Q1 2020 Construction Cost Report

RATES, COSTS

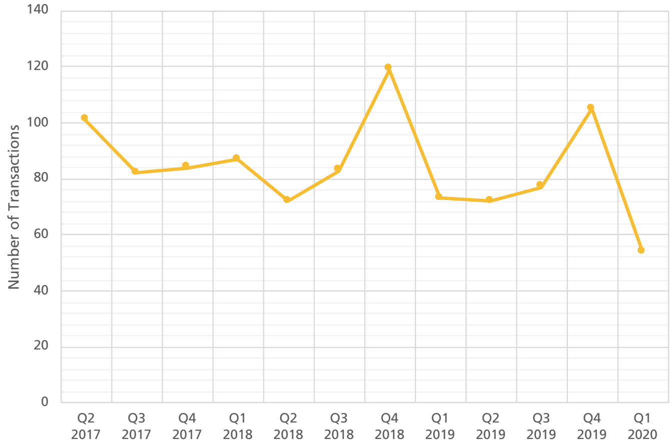
Rental rates did not move much in Q1, staying relatively constant within the previous quarter. Some regions experienced overall decline, but minimally. Certain areas saw marginal growth, with the Southeast Portland, Lake Oswego and St. Johns areas seeing 4-6% rental rate increases. Per Colliers, the greater Portland Metro region's average rent per square foot was at $1.58 PSF for the Quarter, with the highest rates coming from the Downtown area at $2.49 and the next highest in Lake Oswego at $2.29.

Costs in Q1 dipped marginally compared to Q4 2019, not enough to be of marked interest. By contrast, cities like New York and San Francisco experienced jumps in construction cost in Q1 2020.

In examining the graphic below, you can see that Portland is on the declining side of the activity cycle, with NY and SF still in the early peak area.

As previously noted, the pandemic has put many construction projects on hold. We suspect most of those that fell through outright were on the periphery of penciling out financially and the volatility of the market made it too risky to take on. Looking ahead, concerns about how the recession will affect supply chain manufacturers of goods and equipment for construction projects is a key potential roadblock in the months ahead. The supply chain freeze in China in Q1 that led many to scramble for alternative suppliers was a good reminder about the importance of flexibility and diversification of materials sources beyond China and across the region to provide more options in the case of supply chain disruptions in the future.

NUMBER OF TRANSACTIONS Q2 2017- Q1 2020



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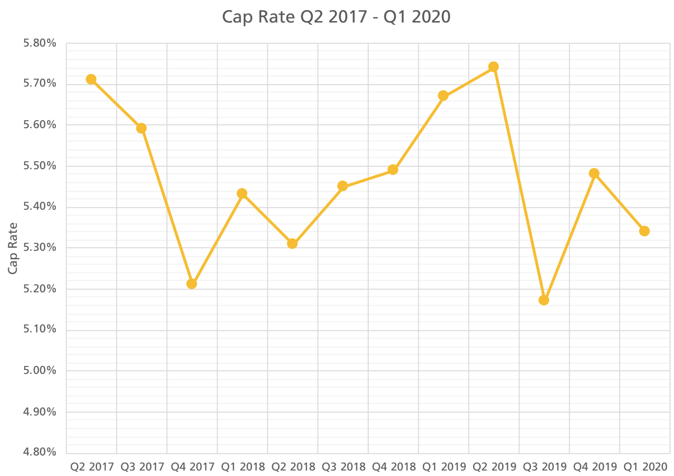
CAP RATE Q2 2017 - Q1 2020



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SALES ACTIVITY

There is some conflicting information regarding transactions in Q1 in the Portland Metro region, but overall, they are down compared to the previous Quarter. This is likely due to numerous deals working in late February or March that paused until the economic uncertainty of the pandemic has passed. In any case, the number of transactions dipped precipitously in comparison to the previous Quarter.

Looking past the uncertainty of COVID-19's current hold on the economy, there is hesitation about how the capital markets will react and rebound from this. Large portfolio owners and institutions will be focusing on how to re-balance their operations and recover from the effects of the stifled economy, so there is a likelihood that their spending will pause until they've stabilized their assets. Those nimbler with less debt will likely see the down market as an opportunity to dive in and capitalize, but there is a chance they self-select into smaller deals. One example where this is being capitalized – on a massive scale – is private equity firm Blackstone Group, which has seen Q1 losses on its portfolio values due to the pandemic, but has $21 billion in capital reserves dedicated to investment in US real estate and ready to deploy, with an additional $41 billion available to invest globally. They are well-positioned to use their unmatched reserves to their advantage by investing in properties where the prices have fallen due to the health crisis. It will be interesting to observe the transactions closing over the course of 2020 as the fallout of the pandemic leads to a plunge in valuations and a lucrative opening for opportunistic investors.

LOOKING AHEAD

It is tough to imagine what this report will look like when examining Q2 2020 simply because we are living in unprecedented times and the economic fallout as a result of the pandemic is continuing to shock the world and worsen. Multi-Housing News' Paul Fiorilla published an article on 4/23/29 noting that per the National Multifamily Housing Council's latest weekly survey, 89% of renters across the US made April's rent payments at only 5% down from the same period the previous year, much to the surprise and delight of landlords. However, May's rental payments expect to look very different, with the belief that most paid April rent with March wages, and the impact of the layoffs fully taking effect in April will severely hurt May's collection prospects. Furthermore, it remains a tough balancing act for landlords between renters who can't afford rent and those who can but might withhold due to eviction moratoriums. In general, the longer businesses remain shut down, the more difficult rent collections will become as unemployment continues to go up.

To bring it down locally, the Portland Metropolitan area appears to reflect similar data, if not a bit higher. Jamie Goldberg of the Oregonian published an article on 4/15/20 reporting that 89.3% of renters in the greater Portland region had paid their rent by April 5th. However, older Class C apartment properties and affordable housing properties are experiencing disproportionately lower collection rates compared to the larger market. With potential supply delays and a lack of movement in existing residents, the pandemic is expected to further exacerbate the already-critical housing crisis.

One Washington County property manager who oversees 300+ apartment units across multiple properties reported an April collection rate of 94%, noting that the average for Portland comps appeared to be around 5% delinquency, going up to 10% depending on the property. She mentioned that a large percentage did not pay on time and in fact many residents paid between the 5th and the 10th of the month, presumably with a "wait and see" attitude at the start of the month. However, she indicated that many residents in the recent weeks leading into May have signed up for payment plans, with a large uptick in sign-ups once they sent out information about signing up online through their resident portal. She explained that Yardi's RentCafé platform recently rolled out a payment plan option in response to the pandemic, and this option has been popular for residents preferring a more "anonymous" way to sign up online rather than in-person or even over the phone. We expect tools like this to continue appearing in the coming weeks and months as concerns mount about the state-wide eviction moratorium in place and what the ugly truth about what collections – and evictions – will look like later in the year once that policy is lifted.

SOURCES

The Barry Apartment Report Spring 2020:

Rider Levett Bucknall Q1 2020 Construction Cost Report

Multifamily Northwest Apartment Report Spring 2020

Colliers International 2020 Q1 Portland Metro Multifamily Report

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