THE BUSINESS JOURNAL

EXPERTS WEIGH SCENARIOS FOR MULTI-FAMILY REAL ESTATE

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May 14, 2020

File Photo

Even good properties may turn bad as job losses and business closures translate to an unstable market for apartment owners if renters can't or won't make payments.

April's due date for rent came and went, with reports of more people making their rent obligations than predicted. Rental return averages were at roughly 98-95% of the previous month, according to Robin Kane, Fresno-based senior vice president with the Mogharebi Group, a real estate brokerage specializing in multi-family units.

"Everybody had basically March income to pay April 1," Kane said. "Now what all the owners are bracing for is May 1, because now you're going to see the true impact of people who lost their job or had their hours cut back or were furloughed."

Occupancies have largely remained static as no one is in a hurry to move. But if rental payments decline to numbers around 15% — as some property owners fear — necessary cutbacks may send owners into a spiral of deciding whether to lower rents on properties purchased at historic highs or lowering credit standards to accept tenants who would not have been approved in the past.

A safe haven turns rocky

In the lead up to the pandemic, multi-family real estate was seen as a safe haven for investment. Buyers bought high because of outlook on rent growth. "The scale was tipped very heavily in the favor of sellers because there was lots of buyers and very few sellers," Kane said.

Prices were built out "to perfection," meaning they would work so long as everything went right, he said.

Austin Herzog, president of Ideal Capital Group, a local real estate investment firm, oversees 5,000 rental units across the state, including Fresno.

On average, rent revenue dropped between 9-10% for their units. Many tenants have worked out deals with property owners to get rents in. But just as there tenants negotiating on rent, there have been those not communicating altogether, said Herzog.

"Then there are other residents who just aren't answering their phone that know they can't get evicted that haven't paid us a dime either," he said.

And if there is another 90 days of waiting before the eviction moratorium is lifted and courts open back up, it can be another 90 days to go through the process.

It doesn't take many tenants skipping rent payments to start property owners on a downward spiral.

Demand is down

People looking for new places to live have dropped 50%, Herzog said.

If job losses persist, young people who have driven occupancies up may move back home, as they did during the Great Recession, Kane believes. Rental rates priced for a booming economy may become unmanageable. Landlords will have to react or face an exodus of renters. Capital improvement projects will be delayed, as well as unnecessary costs. "That's usually the first telling signs — you'll drive down the street and all of a sudden, the landscaping is overgrown," Kane said.

Especially for properties purchased in the last 12-18 months, it won't take long to start taking on water.

This leaves owners with two possibilities — relaxing credit standards or lowering rents.

Before the pandemic, landlords could afford to really scrutinize renters' credit history. And good tenants have an eye for that. If they see problem renters come in, they know they have options.

"Good tenants don't complain, they just leave," said Kane.

Course of action

Lowering rents is the other possibility. Lenders may also be feel forced to pull the trigger on an asset quickly falling in value.

Banks may foreclose, handing management of the property over to a trustee. A short sale could also be done, as happened during the Great Recession. What also could happen are lenders selling the debt to opportunistic buyers.

"They will just make your life miserable. Why? Because their end-game is either for you to pay off your property in-whole or to take your property back," Kane said.

Before COVID-19, prices between $1.35 a square foot and $1.40 in the Fresno area were beginning to justify new construction on multi-family construction — a resource badly needed to prevent housing prices from spiraling out of control.

But as rents soften, there will be less incentive for new developments to come online, said Herzog. Mid-to-lower market housing will be more challenged as many blue-collar jobs have fewer options when it comes to working from home.

The affordability challenge

While typically a safe haven for investments because of subsidies, affordable housing has its own challenges. Self-Help Enterprises operates 1,600 affordable rental units throughout the Valley. About 92% of rents came in for April, which made Tom Collishaw, CEO of Self-Help "happy." Many of his tenants are considered essential and are still working.

But other developments in the state have seen rental returns at only 70% of what they were in March. The 36 projects in Self-Help's portfolio each have capital reserves to last between 60-90 days.

What worries Collishaw is if lenders aren't making money, incentives to buy tax credits and invest in affordable housing may drop.

"You only need tax credits if you're making money," said Collishaw. "Our sense is that the banks are worried they're going to have losses going forward because of COVID-19 because their loans are going to default and therefore they are being very careful about any new commitments."

Affordable housing does have bond money from a bill approved by California voters in 2018.

Self-Help can weather losses of 15% before other projects have to be put on the shelf, putting a number of construction jobs at risk, just as what happened during the last recession. Rising construction costs and lowered rent outlook jeopardize all forms of development. And while California still has a lot of unused bond money for affordable housing from bills passed in 2018, Collishaw fears the virus could precipitate an even worse housing crisis.

“We went into COVID-19 with a housing crisis,” he said. “I think there’s at least a 40% chance this can have a longer term, deleterious impact on housing and the availability of housing in California.”