



## INDUSTRY INTERVIEW: Multifamily Real Estate: Adapting to the Economic Climate

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### **How reliable is the market information that you are receiving right now?**

Information is coming in daily from the properties that we track, but it's still very early on in the process. We may not see Q1 numbers reflect the true nature of the situation at hand, because all of this started in the last two weeks of March and the quarter only ended on March 31. And during this time, we all had to pivot from trying to figure out how this pandemic was going to affect us to how we quickly we could start working from home. Everything has moved so rapidly.

In other words, although we are receiving the best information possible across the many property types we are tracking, so much of this situation is new and we need time to process data as it comes in. To paraphrase Stephen Hawking, the uncertainty means that it feels like we aren't just rolling the dice about how this will all pan out in the future: we're on our hands and knees looking for the dice.

## **What impact is all of this having on multifamily real estate?**

We've not seen a huge decline in the population, and because multifamily is a basic good, there has not been a notable shift. In addition, top line numbers, such as occupancy and rents, have not seen a major change. At some point, we wonder if we will experience a sizeable drop-off in the amount of information that we collect, but that hasn't happened yet. Our regular market respondents could either be too busy to take our calls, or there is so much distress that they don't want to give out actual numbers. If this happens, we need to adjust our statistical models to account for a greater proportion of censored data.

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## **What can history teach us about the impact of potential impact that COVID-19 could have on real estate?**

After the September 11 attacks, the worst prediction was that Lower Manhattan and Washington, DC would be sites for future terrorist attacks and that businesses and residents would move out of these areas. That never happened, which leads us to believe that the worst case scenario is not necessarily always the one that we will see in the end.

In 1994, the Northridge earthquake in Los Angeles destroyed many multifamily properties, but instead of driving people away, it ended up increasing tenancy and rent growth. Mind you, this was at a time when there was an urban revitalization in LA and many other US cities, but it had the opposite effect of what most people would have assumed. In contrast, Hurricane Katrina had a very negative effect on the city of New Orleans. They ended up losing a third of their population, resulting in a massive decline in property demand.

What remains to be seen is whether there will be a reallocation of households as a result of COVID-19. In other words, will people living in one of the epicenters decide to move away from those areas? This may have negative effects for the areas that residents choose to vacate, but benefit some communities that are far removed from coronavirus epicenters.

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### **How might new developments evolve as a result of the COVID-19?**

As we look at the entire ecology of the built environment of specific geographic areas, we need to seriously consider what future developments will look like. If we assume that this is not the last pandemic-like scenario that we have to deal with, there is a possibility that we will start to see a self-contained ecology in the form of mixed-use developments. In other words, retail supporting multifamily, supporting nearby office space. Of course, this concept would have to accommodate the new norms in social distancing, but it has the potential to be a more advantageous than the current setup, where retail in a downtown district suffers because people are no longer going to their offices. Self-sustaining communities, such as mixed-use developments, create microcosms of highly functional city environments without the downside risks that we are seeing today.

With all of this in mind, I project that we will hear more about mixed-use developments, as well as a rethink of the communal use amenity in multifamily developments. These changes may include collapsible walls and dividers, and in-house daycare.

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### **Do you see NOI being impacted?**

There are surveys suggesting that only a fraction of multifamily tenants paid their rent in April. I think it's safe to assume that NOIs are going to drop by a significant amount. I would estimate that these losses will be concentrated in Q2. This is because of the shutdown, as well as the record rate of economic contraction that we should be anticipating. The last record contraction was 10% in 1958, and we're expecting a drop along the lines of at least 30% this quarter. We will see a combination of unemployment, unpaid rents, but weigh that against many places where governments have banned evictions. The movement of households will, therefore, likely be constrained: I don't think many people will be moving, nor will they want to. This will be a zero-sum game leaving landlords with lower NOIs.

On a brighter note, I do think that multifamily will recover quickly, much like it did in 2008-09. This is in contrast to retail, which is going to struggle greatly.



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