

Greystar

# The rental housing sector in a capital markets context



**Chase McWhorter**, Institutional Real Estate, Inc.'s managing director, Americas, recently spoke with several members of Greystar's Investment Leadership Team: **Kevin Kaberna**, executive director for North America and investment management leader; **Jennifer Ciullo**, senior managing director, investor relations; and **Jordan Kabbani**, strategy director, investment. Following is an excerpt of that conversation.

*What is your view on the general macroeconomic outlook through 2023, and how will it impact commercial real estate?*

**Kevin Kaberna:** A number of factors will ultimately guide where the United States will land from a macro perspective this year. From the Fed's rate increases to bank failures, there is no question we have started to see some pullback in growth dynamics, which will likely make 2023 a period of relatively sluggish growth, while we get inflation under control. The banking dynamics, in tandem with higher rates, will likely pull forward the probability and timing of a recession, although it is important to note the consensus expectation is for a shallow recession and a more modest increase in unemployment. The glimmer of hope continues to be the health of the labor market and the U.S. consumer.

Our view is that the Fed's action will help expedite a decrease in inflation through 2023, and we see this dynamic already priced into the current market expectations. As of today, the market expects to see some rate cuts in the near- to medium-term, depending on the progress we make with inflation during the coming quarters.

Commercial real estate has been impacted by a higher cost of capital, so it is likely to stay a bit tighter in the short term, but we view this as an opportunity to buy better-priced assets during a unique window. We are still seeing strong growth fundamentals in multifamily.

*How is your target consumer holding up? Have you seen challenges around affordability impacting performance?*

**Jordan Kabbani:** We have certainly seen strength in the labor market, particularly for the institutional renter base, which held up very well during the pandemic. In the period of inflation that followed, tremendous wage gains have helped the consumer stay strong, even with rates increasing and some cooling macro indicators. Specific to our portfolio, we saw wage gains during the past couple of years in excess of 10 percent, which has meant that, although we have had rent growth, the affordability ratio is right. The amount

of income being spent on housing has stayed consistent. You see headlines around affordability concerns, but from everything we have seen in the market, collections have stayed resilient, income affordability ratios are healthy, and consumers aren't chasing more affordable units. The consumer remains a bright spot, which should continue to support strong multifamily performance. Unemployment is at a 40-year low, and for the demographic that tends to live in institutional products, the unemployment rate is impressively low at less than 2 percent.

*How are significantly higher mortgage rates along with record home prices affecting demand for multifamily?*

**Kaberna:** There is no doubt higher mortgage rates are impacting decisions for residents, as they compare owning versus renting. Generally, about one-third or slightly more are moving out to buy homes, and when mortgage rates went over 5 percent, we observed the number of residents moving out to buy homes cut in half. When you compare the cost of owning today versus renting, the value proposition is one of the widest we have seen since the global financial crisis. "For sale" starts have slowed considerably, as well, as homebuilders are feeling the pinch of higher rates on their cost of capital along with the buyers' cost of capital. This decreased supply and stickier resident base means people are renting for longer, bolstering multifamily fundamentals.

*We've seen a number of headlines saying rent growth has cooled. What are your expectations for the rest of 2023? What helps inform your views here?*

**Kabbani:** We have seen quite a lot of sensationalist articles talking about how quickly rents are falling, but many compare mid-summer with end-of-year, which is not accurate given the seasonal nature of our business. More people generally rent in the summer, particularly in markets where it is very cold in the winter. At the end of 2022, we saw the return of seasonality, which was largely absent from the market the year before. What we have seen on a year-over-year basis are healthy performance and positive rent growth, but as we get inflation under control, we anticipate those numbers will normalize back to the pre-pandemic levels of around 3 percent to 4 percent. Our expectation for the end of 2023 is that inflation continues to decrease and rent growth normalizes.

With our platform, we can measure these trends in real time given our scale and access to internal data. We've invested a

tremendous number of resources into our data and analytics capabilities, which inform our go-forward views on growth as it pertains to acquisitions, dispositions and operating strategies. At our scale, this has been a tremendous advantage in keeping us nimble with a view of where the market is moving during these periods of volatility.

***Which segments of the market and product are you seeing outperform and underperform?***

**Kaberna:** Most segments in rental housing are relatively well-positioned to weather the market turbulence this year. When we look across our portfolio, there is definitely a benefit to being in a high-growth market but with little discrepancy between class A and class B products. Our primary sector, rental housing, continues to benefit from strong fundamentals, as do our key adjacencies: logistics and life sciences. One niche market that stands out is student housing, given its resiliency during the past economic downturns, with people pushed out of the job market often returning to school. The current lack of supply at the best universities was somewhat exacerbated during the pandemic, as many builders discontinued projects. Now the combination of strong enrollments, low acceptance rates and a lack of supply has made student housing an attractive sector.

The headwinds in rental housing will come from pockets of new supply in submarkets with elevated deliveries and weakened consumer confidence, which lead to a reduction in household formation. Areas with a significant amount of the highest-end product probably pose the most risk.

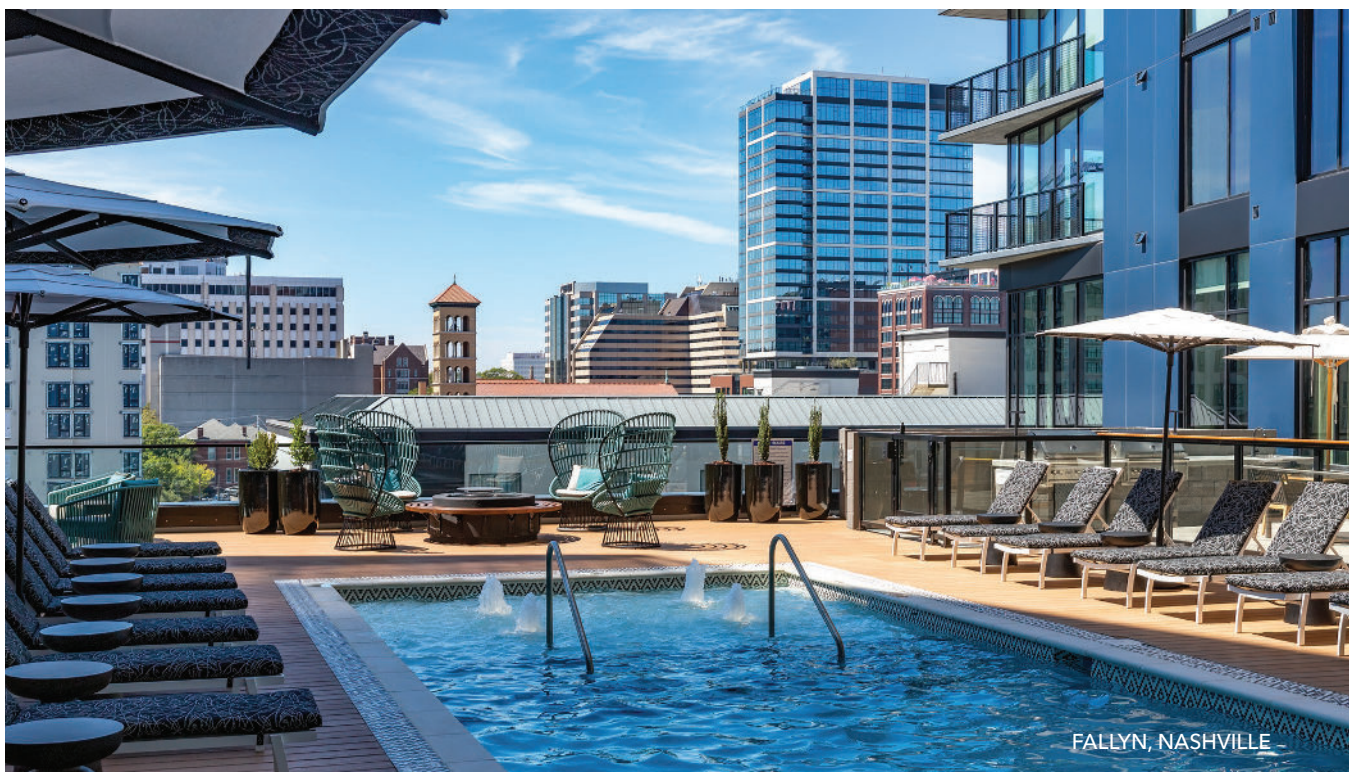
**Kabbani:** 2023 deliveries are going to be structural, since most are already under way, and they are going to have to lease up in this environment in the near term. The success of those lease-ups in this environment is highly dependent

on your view of consumer sentiment over the next year as those deliver. We know housing is structurally undersupplied and more is needed. We are not adding a supply glut to the market by any means, but it remains a headwind for select submarkets with a lot of supply.

**Jennifer Ciullo:** In terms of relative outperformance, we can point to the credit space, where opportunities are stemming from the banking turmoil. To find opportunities in today's lending environment, we are looking at some favorable pricing and lending opportunities at strong loan-to-value ratios. It relates less to the different markets and more to the specific capital structure.

***How are the significant rate hikes from the Fed affecting transaction markets and capital flows?***

**Kaberna:** Rate hikes have created choppy transaction markets as buyers grapple with a much higher cost of capital. Generally, acquisition financing is still available, but rates are higher, which has created the widest bid-ask spread in recent memory. Buyers are requiring higher going-in yields, while sellers are still hoping to transact at yesterday's pricing. We have seen a bigger price adjustment in the tertiary markets or with older-vintage assets as the market has shied away from risk. There are still a few newer vintage assets trading at low yields in high-growth markets, but most of these investors are high-net-worth, private buyers who are less dependent on leverage. Demand is highest where there is assumable financing in place. The market is definitely going through a period of price discovery. This is a great time to have dry powder and to be in a position to invest at higher yields. Historically, a market disruption like this has created an incredible "vintage" investment opportunity for us, so we are cautiously optimistic as we look to invest.



FALLYN, NASHVILLE



## CONTRIBUTORS



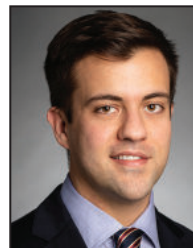
**Kevin Kaberna**  
Executive  
Director,  
North America  
Investment  
Management  
Greystar

Kevin Kaberna is an executive director for Greystar and leads the company's investment management platform, including fund management, portfolio management and asset management in North America. Kevin is also a member of the Executive Committee. Under Kevin's leadership, the North America investment management business has grown to more than 173,000 owned units and student beds. Kevin maintains oversight of rental housing investments, including conventional, student, build-for-rent, active adult and credit.



**Jennifer Ciullo**  
Senior  
Managing  
Director,  
Investor Relations  
Greystar

Jennifer Ciullo is a senior managing director of investor relations for the global investment management business and is a member of the Executive Committee. Jennifer is responsible for North American institutional investor relationships and fundraising for all of Greystar's global investment strategies. She also supports investment management business's development efforts and maintains specific investor relations oversight for the company's closed-ended value-add funds and North American separate account ventures.



**Jordan Kabbani**  
Strategy  
Director,  
Investment  
Greystar

Jordan Kabbani is a senior director of investment strategy at Greystar. Jordan works across all U.S. residential product types, including conventional multifamily, student housing, active adult and single-family rental strategies. He is responsible for the formulation, capitalization and deployment of the company's U.S. investment strategies, as well as broader corporate strategy efforts.

**Kabbani:** What makes the price discovery challenging is that fixed financing two years ago would have looked unattractive, but all of a sudden, it is very attractive. There has been a proliferation of deals with assumable financing, which makes the few trades that are in market unique because of the financing. That has made this "fog of war" around price discovery more acute.

**Ciullo:** This investor appetite for staying away from riskier, less-liquid markets also translates into how investors are working with sponsors. They are leaning toward those with whom they have longstanding relationships, those with evergreen business models, and focusing on higher-quality markets and assets. Investors are also evaluating their portfolios. There is continued demand for more rental housing and considerably more interest in alternative residential, such as student housing, build for rent and age-restricted multifamily. We are seeing a repricing in the risk associated with those assets, not necessarily on a numerical basis, but in terms of their acceptance as a more permanent part of investors' portfolios.

**What are you seeing in the lending markets for multifamily? There has been a lot of chatter about a more challenging construction financing environment. Will there be impacts on future supply?**

**Kaberna:** Volatile markets and the high cost of capital have made financing more difficult to obtain. Fortunately, multifamily benefits from agency financing, which continues to provide liquidity for existing assets. Development financing is more challenging, however. Already last year, a majority of lenders were moving toward the best sponsors, with a strong preference for multifamily relative to property sectors such as office and retail, which have uncertainty around demand fundamentals and operating performance. Greystar has benefited from this with a robust development pipeline, with

\$29 billion of global assets under development and nearly \$12 billion of global development pursuit. Other commercial property sectors are struggling to obtain financing, and this is likely to be magnified by the distress of regional banks. Banks with less than \$250 billion in assets have historically provided 80 percent of commercial real estate lending. In general, even before the banking stress, many developers had reduced their development pipelines significantly, some as much as 25 percent or more. The current credit dynamics will likely cull these pipelines even further. Because of this, we have seen stronger demand for bridge financing and construction lending in the private markets, which has been a new area of focus for us in recent years. Our credit team has been incredibly busy in 2023, and we see this continuing into 2024 as the market attempts to fill the void from banks.

**How have return profiles changed during the past year, as rates have climbed?**

**Kaberna:** Today's going-in yields have improved materially, but leverage is less accretive today, so the cumulative effect is that unlevered returns are elevated, but levered returns are about the same.

**Are you seeing defaults and distress in the multifamily space, like we hear about in some other sectors?**

**Kaberna:** Greystar is well positioned, given our disciplined business planning process and diversified businesses across management, development and investments. Fortunately, we have not seen much evidence of multifamily distress. We are watching to see if buyers who took big bets several years ago on extremely low yields and highly levered floating-rate loans will eventually see some distress, but it is unclear whether that will come at scale, given the supportive cash-flow profile and strong fundamentals in the multifamily sector.

### *During this period, what has investor sentiment been toward new commitments?*

**Ciullo:** I would characterize investor sentiment in the rental housing sector for the first half of 2023 as cautiously optimistic. Investors are more bullish on multifamily and are seeing those long-term fundamentals in supply and demand. Supply looks even more dire than it ever has been. Investors look for demographically driven property sectors versus economically driven sectors – and that leads you to rental housing, multifamily and industrial. Investors want to be able to take advantage of opportunities when they come, which translates to increased interest in closed-end, blind-pool funds to be able to invest in the next 12 months to 24 months. Most investors are expecting a dramatic reprice, and this vintage is going to be exciting to be in. In core-plus, open-end funds, investors are also looking to pick their spot in quality, well-diversified portfolios. Finally, investors are also interested in credit, where they can realize strong cash flows and near-term relative value as they wait for equity markets to reprice.

### *Do you anticipate any additional changes in sector capital flows during the coming year?*

**Kaberna:** Multifamily and industrial will likely emerge from this period as the winners of capital flows, which is a trend that has already started. Multifamily flows increased from 30 percent to 40 percent of total transaction volumes between 2018 and 2021, and industrial moved from 15 percent to 25 percent during that same period. Given the large amount

of dry powder in the system, we anticipate this trend will continue to favor multifamily and industrial as capital moves away from the office and retail sectors.

**Ciullo:** Real estate alternatives are here to stay. Whether it be in rental housing, student housing, build-for-rent, life sciences or logistics, you will likely see capital flows out of the traditional big four property types into these alternatives.

### *As you previously touched upon, housing is still structurally undersupplied. What is Greystar doing to address this shortage?*

**Kaberna:** As one of the largest managers, developers and owners of rental housing, we believe we can play a meaningful role in addressing the housing crisis that exists in the United States. In addition to our robust development pipeline, we have invested heavily in innovative technologies that focus on the production and operation of attainable rental housing. For example, we have invested in modular construction technology that should allow us to build units quicker and at a better cost basis. We have also created a brand called Ltd., which is committed to the resident experience, while also addressing affordability and rent transparency. Our goal with Ltd. is to deliver high-quality housing at lower rents to meet the demand of this underserved portion of the market. Historically, that has been very difficult given the cost of new development, and we are excited about this new opportunity.

## ABOUT GREYSTAR

**Greystar** is a leading, fully integrated global real estate company offering expertise in property management, investment management, development and construction services in institutional-quality rental housing, logistics and life sciences sectors. Headquartered in Charleston, S.C., Greystar manages and operates more than \$250 billion of real estate in 234 markets globally with offices throughout North America, Europe, South America and the Asia Pacific region. Greystar is the largest operator of apartments in the United States, manages more than 817,000 units/beds globally, and has a robust institutional investment management platform comprised of more than \$69 billion of assets under management, including over \$29 billion of development assets.

Greystar was founded by Bob Faith in 1993 to become a provider of world-class service in the rental residential real estate business. To learn more, visit [www.greystar.com](http://www.greystar.com).



**GREYSTAR™**

## CORPORATE CONTACTS

**Kevin Kaberna**  
Executive Director, North  
America Investment  
Management  
kkaberna@greystar.com

**Jennifer Ciullo**  
Senior Managing Director,  
Global Head of Investor  
Relations  
jennifer.ciullo@greystar.com

**Jordan Kabbani**  
Strategy Director,  
Investment  
jordan.kabbani  
@greystar.com

**Liza Kunkel**  
Managing Director, Global  
Head of Communications  
liza.kunkel@greystar.com

*This article presents the authors' opinions reflecting current market conditions. It has been prepared for informational and educational purposes only and should not be considered as investment advice or as a recommendation of any particular security, strategy or investment product.*

Copyright © 2023 by Institutional Real Estate, Inc. Material may not be reproduced in whole or in part without the express written permission of the publisher.