The Weekly Take

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Home Sweet Home: Inside the Thriving Multifamily Sector

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Spencer Levy
I'm Spencer Levy, and this is The Weekly Take. The topic of this show requires little introduction. It's one of the supercharged sectors that I've called the land of milk and honey, a sector where demand is strong and has been throughout the pandemic – and where there is still room to grow. On this episode: multifamily residential, perhaps the hottest sector around.

Ric Campo
When you think about going forward, 2022 is going to be the best year we've ever had.

Spencer Levy
That's Ric Campo, the chairman and CEO of Camden Property Trust, a pioneer in the multifamily REIT space. The Houston-based company he took public almost 30 years ago is now a buyer, builder and manager, which holds more than 60,000 apartments in 10 states with a current market cap of $21 billion.

Matt Vance
The flame is white hot. Every metric you look at in multifamily seems to be breaking a new record.

Spencer Levy
And that's Matt Vance, a senior economist at CBRE and America's head of multifamily research. Matt leads our data driven insights platform and also works with CBRE’s Econometric Advisors Team. We'll look at the numbers to set the stage and talk about where the trends are most evident. In specific markets and market types – urban versus suburban, and how the distinction may be fading. We'll look within the sector, too, comparing multifamily to the emergence of single family residential development, as well as purpose-built properties, subdivisions, retrofits and more. And we'll discuss a big question for investors: Is now the time to put the shovel in the ground? Coming up, we dig into multifamily residential. That's right now on The Weekly Take.

Spencer Levy
Welcome to The Weekly Take and this week we're going to be talking about maybe the hottest sector within real estate, which is multifamily. And to join us for this show we are honored to have with us, Ric Campo, the chairman and CEO of Camden Living. One of the largest publicly traded rates in the multifamily sector. Ric, thanks for joining us.

Ric Campo

Thanks, Spence, glad to be here.

Spencer Levy
Glad you are here. And my longtime friend and colleague Matt Vance, America's head of multifamily research for CBRE. Matt, thanks for joining.

Matt Vance
Absolutely. Great to be here. I am deep in the data spans and it is a fascinating time to be poring over the details of multifamily.

Spencer Levy
Well, that's great, Matt. The numbers are so strong right now that it seems like the story tells itself, but there are numbers behind that. So give us a very brief overview of – am I right? Is it that good right now in multifamily?

Matt Vance
It is. The flame is white hot in very metric you look at in multifamily seems to be breaking a new record last year. That's the most recent data we've got. Of course, monthly data is trickling in this year. But almost 14 percent rent growth nationally last year. Sub three percent vacancies across many, many markets nationally, two and a half percent vacant. That is driving that rent growth. And it's quite obviously the attention of a global wall of capital. Very, very interested in multifamily. And it's why we're seeing records being set for investment volumes across the country and nationally cap rates that have compressed further than they ever have. Pricing fundamentals, everything's just incredibly strong. You're absolutely right.

Spencer Levy
So Ric, would you agree with that assessment?

Ric Campo
I would. If you look at our portfolio, we're growing rents faster than the national average because of where we are. We primarily are in the Sunbelt, and those are some of the hottest markets in America. 2022 will be the best year that Camden has had in the last twenty nine years from a revenue perspective and also a net operating income growth perspective.

Spencer Levy
Well, let's talk about these markets for a second Ric because I was taking a look at your investor guide and I kind of saw where your assets were. What we might call the smile states, but starting further south, the smile states used to go all the way up to Northern California. You don't you really start sort of in the southeast and then loop around to Texas? Have you always been in those markets, or was that a change that happened in the last decade or so as demographics changed?

Ric Campo
We love our markets. So we tend to be in pro-business environments with a good population growth and employment growth because that's what ultimately drives multifamily demand.

Spencer Levy

So, Matt, let's now talk about that for a moment. You know, the smile states south of maybe D.C. and south of San Francisco. Do you see that continuing? And how do we see those markets that are above it, the traditional big six?

Matt Vance
I'll tell you, we do see that momentum carrying into the near-term for medium and long term for those Sunbelt and smile states. If you look at the outlook for job growth and job creation and population growth It absolutely favors Texas first and the rest of the Sun Belt not far behind. So, you know, Houston number two, four total jobs added between now and 2030, according to our friends at Oxford Economics. Dallas right behind but Atlanta, Phoenix and others right in that top tier. So absolutely incredible demand drivers pushing multifamily fundamentals in those states. However, the coasts and those sexy six, as Ric referred to them earlier, they are not to be forgotten. In fact, when you look at our outlook, our forecast for value growth in multifamily assets, it is actually the coasts that are favored pretty heavily. They rival their strong Sunbelt counterparts for the outlook over the next five years, and I'll tell you why. Number one, they were hit the hardest during the pandemic. And I'm sure we'll get into that. So there's more to recover from. And number two, they have recovered in many ways. And so rent growth in the Bay Area still below pre-crisis levels, but has recovered in Boston more than recovered in New York. And what's driving that is the fact that all of these markets have now recovered from an occupancy standpoint. Demand has flooded back into these urban dense, expensive coastal markets. And the rent growth is to follow. That's what we expect.

Ric Campo
Well, the interesting thing about our portfolio is Matt just said the coastal markets went down big time like big rent declines. We didn't see that in the Sunbelt markets. Our revenues were actually up in 2020, not down, right? And so the occupancy levels that we have now, the fact that our rents didn't drop the rent growth or we're getting now is just pretty amazing. I think that when you think about going forward, 2022 is going to be the best year we've ever had. But if you look at historic recessions and then snap back from recessions, usually you have two or three years after the bottom of the recession, where you have above normal growth. And 2022 teams can be way above normal. We think that it will start moderating. I don't think you can have 14 to 20 percent increases in rents, you know, for multiple years, and you just haven't seen that over the cycles that we've been through. But you'll be above trend over the next couple of years because of strong job growth and just the economy overall.

Spencer Levy
Let's talk about product type. Pre-COVID we had seen the the B asset class within multifamily actually outperforming the A asset class. Partially because you can put Capx in and be able to drive rent. What are we seeing today if you were to break it down by type of multifamily, what's performing the best and what's lagging?

Matt Vance
Well, as I said before, those densest markets were hit the hardest. That's true both between markets, but it's also true within market, right? The urban submarkets, particularly downtowns, were hit the hardest. And so in terms of the geography of performance, suburban assets went largely unaffected by the pandemic. And so we expect and we're seeing play out a very strong bounce back in these urban high rise type assets. We're also seeing the same thing play out across classes of assets, as you said Spence. The class A the expensive product, the properties that are the best locations with live work play elements. They were hit the hardest when live and work and play were disrupted during

the pandemic. And so over the near term, we expect to see some very strong performance out of those higher quality assets in those higher quality, I call them but denser locations where again, they have more to recover from. That's near term. Long term, we think there is absolutely a very compelling story for both suburban and urban multifamily across all asset classes. We know there's tremendous demand for lower cost living, not just geographically in the country, but also lower on the quality spectrum for lower quality or workforce type housing.

Ric Campo
When you look at our portfolio, for example, we're sixty four percent Class B and 60 percent of suburban and 40 percent urban. And then that would be thirty six percent if you on high end urban properties. And so right now, because of where we're located, both are just on fire. I mean, we didn't see the same kind of urban weakness during the pandemic. And as a matter of fact, there's an interesting property that we're releasing up in downtown Houston. A 22 story tower in downtown Houston. Even though during the pandemic, Houston had maybe 10 percent to 20 percent of the people going to the office once they restarted. We leased up a twenty two story building that at a very fast rate. So people were actually moving into the urban core in the Sunbelt cities when they were leaving the urban core in New York and San Francisco.

Matt Vance
That's interesting. Somebody just asked me, right, is the return to office going to drive demand for downtown and urban multifamily. And I had to tell him it's the other way around. The demand for these urban locations is exceptional today. And it's that very fact that the office occupiers are going to rely on as they start to think about calling their people back to the office.

Spencer Levy
Well, you know, I'm not going to be contrarian just to be contrarian here. But I'm going to just state when I analyze real estate I always look at all the asset classes together because I you see tea leaves in them that will impact yours. And the statistic that I always use is office using job growth is the most important statistic in real estate because it has a multiplier effect. And one of those multiplier effects is on multifamily demand. So a back of the napkin way of looking at it is for every six office using jobs you have demand for one more multifamily unit. And then you have demand for two more retail jobs, eight more hotel nights, things like that. So Ric, is that still true? Or you think that that has been disproven by what you're seeing today in urban markets?

Ric Campo
I'm not sure it's true, and I think it'll play out over time. And let me give you a reason why. I think that's the case. Because, you know, the five day a week office job is dead. I don't think it'll ever come back. In just based on my own experience at Camden. We’re working on Flex Tuesday, Wednesday, Thursday. And I bet half the people that are supposed to come in Tuesday, Wednesday, Thursday don't come in. The other day, my computer broke and I called the guy, my tech guy, who always fixes it for me in Houston, and he calls me back and said I told him to come down and he calls you back and said, I moved to North Carolina like a month ago. But I can fix your computer. And he went online and got into my system and fixed it. And so I think that work from home, the fact that people can telecommute and do these Zoom calls and things like that is going to really affect where people are. When you get down to it, people always need a home, they need a place to live, but they don't necessarily need to be in an office today.

Spencer Levy
Let's be a little bit more specific on the where, okay? We've now talked about urban versus suburban. We've talked about the smile states starting in the south. But I see a major trend in office once again as relates to what we would call CBD office, which our client at Heywood Properties calls BBD office: Better Business District office. And I think that's because multifamily is now in these BBDs. It's in these places that are live-work-play. Matt do you agree with that.

Matt Vance
I do. Yeah, we're seeing it from our office leasing folks, where the activity is. It is very much downtown, but it's also very much in the BBD's those dense live work play or denser live work play environment surrounding the city as well.

Ric Campo
Yeah, if you think about it, the development that we've done over the years. When we think about a site for multifamily, whether it be suburban or urban – and not necessarily CBD urban, but a BB urban, right. We look for where's the job growth, where people working, where's the live-work-play scenario work out. And so I think that generally speaking, you're not going to see a massive shift in those markets. And the other challenge you have is right now we're ninety seven percent occupied and all this product, right? So if including urban so you have to build a lot in the suburban areas, if you really think that you're going to have that, people are going to move there because there's no place to go when they're full

Spencer Levy
Well in terms of building a lot it brings up my next question about mixed use. This particular show is not about retail, but we've had several retail shows on The Weekly Take. And so what we're seeing in a lot of these open air retail sites is people putting multifamily on out pads to create that sort of virtual live work play environment. Matt, is that is that happening? Is that the future of multifamily and suburban environments?

Matt Vance
Well, we know that retail, especially walkable retail, is absolutely an amenity from the perspective of the renter. If they can walk out their front door and access the bars, the restaurants and the shopping, they pay for that. They are absolutely happy to pay for that. And so when we think about suburban, we're not really talking about greenfield developments much. When we do, we're really talking about developments that do have some mixed use component to them that gives those residents access to some of that retail experience. And we're seeing that trend develop more and more. And when we look at where developers are putting their capital and putting their shovels in the ground, there's always been a disproportionate number of units being built and developed in suburban America. It's also true that there's been a growing concentration of urban development, particularly downtown. But it's still just a quarter of all units being delivered each year. There's a tremendous number of units being built in the suburbs. And a growing number of them are identifying the non asset specific amenities that residents are looking for.

Spencer Levy
So Ric, as you know, building vertical multifamily and suburban areas isn't easy. There's probably was not easy anywhere, but particularly many of these suburban areas that have zoning rules that don't allow you to go vertical. But at the same time, many of them have open air retail that's underperforming. So my question for you is, are you looking to buy

maybe some of these open air retailers. A covered land play in order to build multifamily? Are you building on the out pads? And then a related question is there are other uses for these lights single-family rental homes?

Ric Campo
Well, I think the answer is absolutely. Because people are densifying and even the suburban areas. With these retail areas, we've developed about $5 billion worth of multifamily and bought about $3 billion in the last seven or eight years. And we definitely look for the work live play when we're looking at sites either for buy or build. We're looking for where's the retail? Is it walkable? What's the transportation situation? Where do the people work and how that all interplay is with the whole concept of location, location, location? And it doesn't necessarily mean CBDs. It means in the nodes where all those activities are because people do want to be able to live, work and play in the same place and tha. Or within close proximity. They definitely don't want to drive here.

Matt Vance
And you describe that. It reminds me that we as CBRE, we really started to rethink this – even the idea of urban versus suburban. It's such a continuum of very, very urban to very, very suburban. And it's hard to distinguish where urban stops and suburban begins nowadays.

Spencer Levy
As part of that, there is a new competitor – or I would say, new-ish competitor to multifamily, which is single family rental. And built to be single family rental for communities. Do you see that as a competitor to you, Ric, or as a complement?

Ric Campo
I don't see it as a competitor at all. Because if you look at the single-family rental market, it's about the same size as the multifamily rental markets 22 million single family homes rented in America today. The difference is that multifamily is a more institutionalized with companies like Camden. Somewhere between 15 and 20 percent of all multifamily is owned by public companies and other institutions. Yet, in single-family, it's only about two percent. So when you think about single family rental, it's a different demographic that rents a single family home. It’s 80 square feet. It's more urban than a single family, and that single family properties are more like eighteen hundred feet two thousand feet. So it's I think it's a really interesting business. And as a matter of fact, we have two single family rental developments that we’re starting in 2022, that are purpose-built, one hundred and eighty eight units and one in Houston on 15 acres. We think it's a great complement to our business and we don't think it's a competitive set at all.

Spencer Levy
I find it very interesting, Ric, because, well, since you've been in the REIT business for twenty nine years, you know that many of the REIT’s are trying to be as pure play, quote unquote as possible. And you're now expanding your definition of pure play to be housing rental housing. Is that a fair way to put it?

Ric Campo
Absolutely. We have tested other types. For example, we've been in the student housing business. We've been in the age restricted business and those two, those are definitely driven by different things. And the residents are very different then the market rate multifamily. But single family is a different animal. It's very similar to multifamily. The biggest issue that I've had with it over the years is that I didn't want to own disparate

properties all over the place. But the idea of purpose built subdivisions that are 100 percent rental that we own. That we can run the way we run a multifamily built building makes a lot of sense.

Spencer Levy
Matt, let's talk about cap rates for just a moment. Multifamily cap rates for the best product out there are squarely in the threes. And yes, a few have traded with a two handle on it. Is that sustainable in the environment that we're in today? A lot of people talk about inflation or other risk factors? Or is this a secular change of how multifamily will be priced?

Matt Vance
You know, we just underwent our quarterly underwriting survey of prime multifamily assets across most major U.S. cities. And we found exactly that. Texas leads consistently with the lowest going in underwritten cap rates, somewhere between a 275 and a three. Most markets, as you said, squarely in the 3s, only a couple still at a four to four and a quarter. It is sustainable with a few caveats. And the one I would make first is that these incredibly tight cap rates, they tell us a lot about investor appetite and investor demand. But they also tell us something about the underwritten rent growth assumptions that are going into this. And I say that because if you take a three percent cap rate today, all right, and it's 98 percent occupied building or even higher. And you go to your software that helps you manage this property, it's going to tell you to expect 15 percent rate growth over the next 12 months. And if you bake in that 15 percent growth in in NOI if your occupancy remains stable and operating expenses remain stable, which is maybe a little bit of an assumption with the inflation going on. But what that implies is that a year from now, your cap rate looks more like a three and a half when you've gotten that big jump in in NOI. And so in some ways, these buyers are able to go in aggressively on cap rates with the assumption that they're going to be able to push rents. Now that I think as Ric said earlier and I would agree with that party isn't over, but the momentum is going to decelerate slightly. We expect closer to seven percent rent growth this year nationally. Some markets will outperform, others will continue to lag. But if we take some of the wind out of that sale, I think we might see potentially a little bit of an upward pressure there on those aggressive cap rates.

Spencer Levy
So Matt, let me try to sum up your answer. Your answer is essentially the fundamentals were so good in 21, and they're going to be exceptional 22, probably not as strong as 2. But because rent growth is so good, it's going to counterbalance any changes that we're seeing in the capital markets. Particularly the rise in the cost of debt. To the point where while we might have upward pressure on cap rates, we're not going to see upward movement in cap rates. Is that a fair way to put it?

Matt Vance
It is. And Spencer, you're a capital markets guy. I want to turn this around and ask you, what do you think?

Spencer Levy
Well, Matt, I'm glad you asked because I speak to our debt and structured finance teams every day. I speak to our clients every day and this is what they're doing. First of all, from a debt and structured finance perspective, we're seeing clients number one do more floating rate debt, number 2 do lower leverage debt. And number three, we are seeing some clients willing to accept some negative leverage in the near term, knowing that the rent growth will make it positive in the short term within the next year or so. Will we see

somewhat smaller bidding pools in the near term? We will, because some of our buyers are high leverage and that's the only way that they can operate. But putting those buyers aside, we believe that the institutional capital marketplace is so deep that while yes, I agree with you, Matt, there will be upward pressure on cap rates. There will not be upward movement on cap rates in the multi-family sector. So Ric, I'd love to get your point of view on this.

Ric Campo
Well, the way we look at it when we think about buying or building today is that we're a long term owner, right? So if I happen to miss the market and the entry point or recessionary scenario that happens, it'll recover at some point. Right. And so our cost of capital has gone down along with everybody else's cost of capital. And then with the wall of capital that's out there, that's what's driven these cap rates to where they are. But when you look at the growth rates that you get, as Matt pointed out. Your cap rate and your cash on cash returns go up pretty substantial. I'll give you an example. Last year we bought six hundred and fifty million dollars real estate, mostly at the beginning of the year. The last one we bought was in the fall. But we invested in two properties in Nashville at a mid three cap rate. And today, after 15 or 20 percent growth, it's a four and some change today in terms of cap rates. So I think the cap rates will stay low until you do have a deceleration of rent growth when people can't make their math work. From an inflation perspective, it's interesting because when you think about multifamily, since we reprice our our leases every single night. And our average lease is about 14 months, so we're going to turn over the whole portfolio within a year. We are pretty good inflation hedge, assuming that supply and demand stays in balance. Because of supply and demand gets out of balance and you have too much supply, then inflation really doesn't help you. And and then you have a real issues about what cash flows really are.

Matt Vance
And I would say our expectation is for supply and demand to remain in balance. If we thought about what could bring on a slowing of that rent growth normally right, I would appeal to classical economics. I would say, let's examine the supply and demand dynamics. You look at last year record setting numbers. Surely there's going to be an exceptional supply response to that, but we're not seeing it. All right. Supply is healthy, what's under construction and what we're tracking today, but it's manageable. All right. And in fact, based on permitting and some pretty consistent trends, we expect a 15 percent drop in starts this year when compared to last year. And so it really falls on the the demand side in terms of tea leaves, Spencer, we expect demand to remain fairly healthy and to more or less keep pace with supply, keep occupancies above 96 percent over the near medium term. So it's a good picture for multifamily.

Ric Campo
When you think about Supply two, you have the supply chain disruptions and labor issues. So even properties that start today are going to take a lot longer to build. We'll start $500 million this year and new new starts, and we have about a billion three behind that. And we've added 60 to 120 days to all of our schedules, plus one percent inflation per month as a result of the labor shortage and supply chain problems that we all face today.

Spencer Levy
The question I was asked on CNBC the other day is do I put the shovel in the ground today or do I wait for a year from now when inflation many of us, we are one of them, believe inflation is going to calm down. My answer is today. And my answer is today, because notwithstanding the fact you may have lower cost of goods a year off now your

labor costs are going to be higher and your cost of capital is going to be higher. You share that point of view, Matt?

Matt Vance
I certainly do. Yes.

Ric Campo
I do as well. Absolutely. You know, when you think about it, like I said before, we're getting one percent per month, so call it 12 percent in a year, right? So if I put a shovel in the ground today, I know that my cost is going to be less than it is going to be in the future if I wait a year. And so at the end of the day, you end up with rents are going to be what they're what they are whenever you deliver, whether it's a year from now or two years from now. And so I'd rather have a lower cost going in than wait to start a property in a year or so. And that's always been our view. And, you know, slowing down when you're in a process of building always costs you more money.

Spencer Levy
I'm going to ask a wrap up question. I'll start with you, Matt. So Matt, you are a leader of multifamily and you've covered other sectors as well. So let's fast forward now four or five years looking back. What do you think multifamily is going to look like five years from now in terms of the number of units, some of the challenges and opportunities it might face?

Matt Vance
Well, I think it's going to look a lot like it does today. It's going to be a little bigger and better. I think we're going to add several hundred thousand more units across the country. But I think the trends are pretty sticky. And I think developers have got your thumb on the pulse of what renters are looking for. And I think Ric made that abundantly clear today,. And that's from physical asset and location. A lot of what we've talked about urban, suburban and where in the U.S. I also think it's going to look very similar from an investment perspective. I think we'll continue to see a growing diversification of the sources of capital chasing multifamily. We saw several new folks enter the top 10 list for the most active investors last year. But by and large, it's a pretty diverse group spread across the globe. Obviously, a heavy influence here from domestic investment and rents will be a little higher. You know, there's no way around it. And we just hope that wages keep up enough anyway to keep that housing affordability in check. And I think as long as the population continues to show a preference for these lower cost but vibrant sunbelt and southeast markets, I think we're going to continue to see a balance in demand that keeps that affordability in check.

Spencer Levy
So, Ric, same question to you, but I'm going to add a twist to it. The question I'm going to ask you is about retrofit in the next five years. Look, we've had episodes on this show several times about the future of office. We're bullish on it, but there is a split of CBD versus BBD, as we discussed. But how much retrofit do you see in the next five years and does that create an opportunity for Camden?

Ric Campo
On the question of five years out, I agree with Matt. It's going to be–it's going to be great for the next five years. On the issue of adaptive reuse for office, where you take office and turn it into multifamily, you know, I've tried to do that for years. The challenge is that office floor plates are larger, it's more complicated. And you're better off with a piece of land as opposed to an office building being adapted. In some cases they will be adapted. But I

think it's more difficult to doing that than you would think. And I've challenged my teams to look at it and try to figure it out. But every time we have looked at a building, it's just easier and more cost effective because you have all these sort of constraints that an office building has. And that constraint tends to be costly. And then you end up with floor plates that don't look good or units that are kind of wacky and that kind of thing. So I would love to see it, but but I'm not sure it's going to happen.

Spencer Levy
What about hotels? There was some talk when hotel rooms were shutting down in New York and elsewhere that that might represent an opportunity.

Ric Campo
Yeah, hotel hotels are better or a better deal. And as a matter of fact, we rehabbed a hotel in D.C. two blocks from the White House,. And it's a wonderful property. And a great historic rehab that we did in a hotel. I think hotels are definitely easier than office buildings because they were designed for people to live in right. As opposed to an office building, has big wide floor plates and no balconies and just more difficult to adapt to a residential unit. Great.

Spencer Levy
So on behalf of The Weekly Take, we had a great conversation today about multifamily with Ric Campo, chairman and CEO of Camden. One of the largest publicly traded REITs in the multifamily space. Ric, terrific job and thank you for joining the show.

Ric Campo
Thanks, Spence.

Spencer Levy
And then we had Matt Vance, my friend, colleague and America's head of multifamily research. Thanks for joining the show.

Matt Vance
Thank you.

Spencer Levy
For more on the multifamily sector and on our show, please visit our website. CBRE.com/TheWeeklyTake. Also, please remember to share the show and share your feedback with us. And don't forget to subscribe, rate and review us wherever you listen. We'll be back next week with a special conversation we recorded at the recent CBRE Institute conference in Arizona. I sat down with futurist Erica Orange, who shared her unique view on the future of work and real estate, and her simple mission to help make people smarter about what they do – an outlook and insights you won't want to miss. We look forward to you joining us for that next week. And of course, we thank you for joining us now. I'm Spencer Levy. Be smart. Be safe. Be well.