ANDER&CO

MHN
MULTI-HOUSING NEWS

What's the Fed's Next Move? Multifamily Braces for Another Interest Rate Decision

By Jordana Rothberg May 2, 2023

Following nine consecutive hikes, experts weigh in on whether No. 10 is coming—and how it would impact multifamily.

One month later it and seems the industry is experiencing déjà vu. Multifamily is again racked with uncertainty over the **Federal Reserve Bank's** upcoming meeting. In March the central bank's decision was another rate hike of 25 basis-points, upending some experts' and economists' predictions. This month's meeting has set off a new round of guessing.

Currently, the target interest rate range is 4.75 percent to 5 percent, a result of nine consecutive rate increases. In March of last year the federal funds rate was almost zero. However, the need to curb inflation and reach price stability led the Fed to a series of repeated hikes. Now experts are wondering when the increases will stop. Meanwhile, the multifamily space considers what the impact of a hike would be.

Consensus points towards one more increase

To fully execute the task of bringing down inflation, many are suggesting that another rate hike may be in order. However, with signs of cooling inflation as well as recent bank failures, others are signaling that now is the time to stop.

"During prior months, the Fed has done a good job of setting the market's expectations prior to announcing their rate hikes and delivering in sync with those expectations," Diego Bonet, managing partner at **LD&D**, told *Multi-Housing News.* As the market is again pricing this rate hike, he is anticipating a 25-basis-point rate hike.

Morris Kaplan, president of **Kaplan Residential**, reached the same conclusion, expecting a quarter percent increase. "That is because right now, the volatility of the market has slowed down and inflation is going in a positive direction," Kaplan explained. "Hopefully, we can avoid a hard crash and get closer to the target inflation rates."

With strong certainty, Henry Manoucheri, CEO and Chairman of **Universe Holdings**, also agrees. "The employment numbers have come in strong and the GDP has grown in the last quarter by 1.1 percent," he said. "This gives the Fed enough ammunition to continue their fight against inflation."

However, following the May 3 Fed decision, Manoucheri highly doubts interest rates will continue to increase. This opinion is shared amongst most of the industry, considering no significant external impacts come into play.

"The market is pricing no more hikes for this year and cuts starting in the second half of the year," said Bonet. "We don't believe there will be additional rate hikes after the one from this meeting, but we also believe that rates may remain 'higher for longer' and expected cuts later this year may not materialize as the market is pricing."

How further hikes would influence multifamily markets

The multifamily market is already feeling the impacts of previous rate hikes. Acquiring the right financing and getting projects off of the ground has been much more difficult than in the couple of years past. The impacts of this rate hike snowball on what the industry is already seeing.

"A rate hike above what the market is pricing would potentially create more uncertainty and cause investors to remain on the sidelines," Bonet said. "A pause in hikes or a dovish message from the Fed could incentivize investors to re-enter the market."

Should the Federal Reserve raise interest rates according to what most believe will happen, a 25-basis-point increase, Kaplan does not believe the impact would be significant, as multifamily is already feeling the impacts of the central bank's previous decisions. On the contrary, multifamily could benefit from a pause.

"A lot of equity and debt groups are sitting on the sidelines because of uncertainty," Kaplan told *CPE*. "Should the Fed choose to pause, it would help restore confidence, and push debt and equity groups back into the marketplace. Cost to build is still a challenge, but if banks are willing to look at deals knowing that they are prepared to lend, it could open the market."

Buyers may return to the multifamily market in the case of a pause on rate hikes. However, another increase will cause borrowers with variable rate debt to be further squeezed, Manocheri said, adding that the price of cap rates will also increase.

"With a pause, under the assumption that this also leads to stability in the treasury market, I see transaction volume picking up again," Brennen Degner, CEO of **DB Capital**, said. "I do, however, anticipate a prolonged bid ask spread until the existing financing maturities start to cause more pain."

Where the industry is already seeing the effects

The central bank's previous rate hikes have caused a significant decline in multifamily investment activity. Recently, a *Colliers' Capital Market report* stated that multifamily sales volume was down 64 percent in the first quarter of 2023 when compared to the first quarter of 2022. A contributing factor towards this slow is how cap rates follow interest rate and debt expectations, Karlin Conklin, Principal, Co-President & COO, **Investors Management Group**, told *MHN*.

"As interest rates rise, cap rates rise, and given the inverse relationship of cap rates to values, higher cap rates translate into lower values and pricing," she said. "Sellers are reeling at the loss in values right now, particularly if they purchased in the last several years when deals traded at cap rates in the low 4s for desirable, top-tier markets. Those same deals would be underwritten today in the high 4 percent to low 5 percent range."

These higher cap rates result in a 12 percent to 18 percent loss of value causing sellers to hold onto their assets until value recovers, she continued. But its not only sales volume feeling the effects of rising interest rates. Development activity has been severely impacted as capitalizing projects has increased in difficulty leading towards higher rent prices and a worsening housing crisis.

"I estimate that it [the difficulty of acquiring financing] has impacted about 75 percent of projects around the country," said Kaplan. "The lending landscape is so restrictive that it has pretty much slowed down multifamily to a standstill."

Higher rate levels, contributing towards overall market uncertainty, has created a serious dwindling of transaction volume in multifamily, Bonet said, in alignment with the other expert opinions. "There are a lot of well-capitalized investors who need to put capital to work and are looking to re-enter the market once there is more certainty about what the economic path forward may look like," he explained.

Now, multifamily must wait for debt and equity groups to re-enter the industry and get the transaction ball rolling once more. Opportunities lay ahead.

"We're clearly at the start of a new cycle and believe property values will find an equilibrium with time," said Conklin. "Real estate investing is a long game and the fundamentals for multifamily are in place for a recovery."

Unique Monthly Visitors: 49,013

https://www.multihousingnews.com/whats-the-feds-next-move-multifamily-braces-for-another-interest-rate-decision/