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Finding the Money, the Deals and the Tenants: Multifamily Development in Today's Market

After years of sluggish demand and slow construction, developers and capital markets are starting to get bullish on multifamily housing, according to panelists at Reznick Group's April 18, 2012 session on multifamily development in Atlanta.

Economist and keynote speaker Rajeev Dhawan, Director of the Economic Forecasting Center at the J. Mack Robinson College of Business at Georgia State University, sounded a note of caution, however. While the worst part of the recession may be over, the low percentage of high-paying jobs is limiting migration into Georgia. Meanwhile, college graduates, saddled by debt and limited job prospects, continue to live at home. The result: few net new renters at the regional level.

But there is light at the end of the tunnel. Tax collections, which Dhawan says are a better indicator of economic health than unemployment numbers, are on the rise in Georgia. Dhawan also pointed out that, after a pre-bubble supply of rental units that far outpaced job growth, the period of limited construction has equalized supply and demand.

Shifting demographics and lifestyle preferences also are driving an urban renaissance, drawing renters inside the Perimeter and to other established, close-in locations, often at the expense of aging properties in less desirable locations. The U.S. Census Bureau's recent population estimates show that growth in Fulton and Dekalb outpaced growth in Gwinnett and Cobb last year by 26 percent.

The addition of a sixth runway at Atlanta-Hartsfield Airport is another positive for the region. Strengthening one of Atlanta's biggest competitive advantages can only mean good things for developers of all types of real estate. "A rising tide lifts all boats," said panelist Bennett Sands, Development Director for Wood Partners.

Finding the Deals

Even with a mixed economic forecast, multifamily development is heating up, said developers and investors in a panel on how deals are being made.

"Finally, after four years, there is excitement in the real estate industry, and it is multifamily that is leading the charge," according to Eddie Lusk, Principal with Reznick Group and moderator of the panel.

But locations and types of deals are shifting. High barriers to entry are driving multifamily development out of the suburbs. "I've never before seen a time when there were so few sites and so many barriers to entry," noted Charlie Roberts of Roberts Realty. Many suburban Atlanta municipalities are enforcing anti-apartment zoning laws and buying old apartments and converting them into green space. Rather than moving farther away from their jobs and leisure activities, the renters displaced by these changes are choosing to move in town, where they can walk to these activities.

That younger generation will be a driving force in the deals made today and for years to come. Panelist Marvin Banks, President and CFO of investment firm Cortland Partners, is watching closely the wave of 81 million Gen Yers coming into their prime renting years. While job-growth prospects remain uncertain, what is certain is limited supply. Aging multifamily properties and little to no new development mean that “we can’t deliver enough supply fast enough” to keep up with demand from these 22 to 30-year-olds, Banks said.

These younger renters also have high expectations, driven by their experience in luxury student housing. Amenities such as granite countertops, black appliances and resort-style pools are becoming standard fixtures in universities, and grads expect to maintain that standard of living, said Stephen Hendrix, President of Development and Construction at TriBridge Residential. Sands also pointed to the increasing numbers of single adults driving up the typical rental lifespan.

As a result of this impending wave of demand for high-end products, panelists agree that now is the time to find the deals while prices are still depressed, before valuations go through the roof.

Banks warns against the costs of being too conservative: “When you look back at major economic dislocations, and you ask investors what they would have done differently, they say, ‘I would have invested earlier.’”

Finding the Money

Investment is dependent on access to capital. Fortunately, the purse strings are loosening – if you have the right combination of factors.

Michael Hartman, Managing Director of Reznick Capital Markets Securities and moderator of the panel on finding the money, says a deal must meet one or more of the following criteria:

- The right market
- The right location within that market
- The right supply/demand equation
- The right sponsor

As far as the right market, panelists agreed that financing remains hard to come by in small markets. Panelists also echoed the sentiment heard throughout the day that urban infill is preferable to suburban sites. As for the sponsor, institutions want to fund developers with experience, integrity, demonstrated success and solid balance sheets. “Integrity and character are paramount,” said Kurt Collier, Managing Principal of The Bridgeview Company. “The recession has been a litmus test for lenders to see how clients would react in bad times.”

Panelists also expressed a strong bias toward core investment or value-added deals versus new development. This may be a bitter pill to swallow for Atlanta’s pro-development environment, but developers are better off bringing lenders a project to fix up rather than one to start, said C. MacLaine Kenan, head of U.S. real estate for Arcapita.

Hartman elaborates: “When I talk to investors, the idea of funding development is not top of mind, because it is so risky relative to other things they can do with their money.”

Whereas pre-2008 capital markets were all about growth and acquisition, today’s financiers are all about return on assets, said David Hudson, Atlanta Market Team Lead for the Commercial Real Estate Bank.

After the heady days of 1.1x or even 1.0x debt service coverage ratio and 80 percent financing or higher, institutions now expect DSCR of 1.25x to 1.35x and are lending only about 60-70 percent of the total cost, Collier said. Developers also need to demonstrate that their projects can support themselves on reasonable rents with conservative projections.

Finding the Tenants

Reznick Group wrapped up the day with a case study of one of Atlanta's high-end mixed-use developments. Emory Point is one of the few new development deals where the best conditions have converged: an in-town Atlanta location, adjacent to Emory University and the Centers for Disease Control (CDC), sponsored by two large, established developers (Cousins and Gables Residential).

It's no surprise that the deal generated enthusiastic response from lenders when it was proposed in 2006. Cousins and Gables obtained a $60 million loan from PNC Bank with limited recourse and an interest rate below 3 percent, said David Reece, Senior Vice President of Gables Residential.

While there will be few deals like Emory Point in this cycle, the panelists highlighted several lessons any developer can apply.

- **There is demand for high-end rental housing in Atlanta.** In the first week of pre-leasing, apartments were going for $1.72 per square foot – 12 percent higher than the developers' pro forma of $1.54.
- **Know your target market.** By partnering with Emory, the developers got to know the students and employees who would constitute a large portion of their residents and customers. They also studied the surrounding neighborhoods, which would supply another large chunk of retail shoppers, and determined the right balance of food, retail and services for the ground-floor properties.
- **Location, location, location.** The key to this development's success is its location immediately adjacent to Emory University, Emory Hospital and the CDC. An estimated 30,000 employees work within a two-mile radius, and the area is underserved in terms of affordable housing and retail. "Inside the Perimeter is where the action is, and it's hard to find land," Jonathan Bartlett, senior manager in Reznick Group's commercial real estate consulting group, said. "If you have the inside track on a piece of dirt or a redevelopment site, there may be great opportunities for smaller deals, but you have to be creative to make it work financially."

Creativity Key to Successful Deals

A common theme throughout the day was the need for creativity in approaching deals and financing and in attracting tenants. "You have to get creative to find that story to sell," Hendrix said.

For example, with the days of raising substantial money from friends and family behind us for now, developers are forming joint ventures with institutional investors or site owners to gain a better position to pursue financing. While joint ventures can help get a transaction completed, panelists emphasize the importance of identifying the right partner who is familiar with the market.

Developers also are getting more creative about how they identify and pursue off-market deals. When asked about Cortland Partners' success in closing these deals, Banks highlighted a focus on market research. By analyzing the economics of deals, they are able to project when the property will become distressed, and then Cortland can make successful bids for these properties before they hit the market.

The upshot of the day's discussions: Multifamily development opportunities are there, if you know how to read the signs. Developers who know their target market and get back to the basics of financial management will be better positioned to find those opportunities *and* the capital needed to finance them.