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Invesco Real Estate Webinar: The Outlook for Global Multifamily

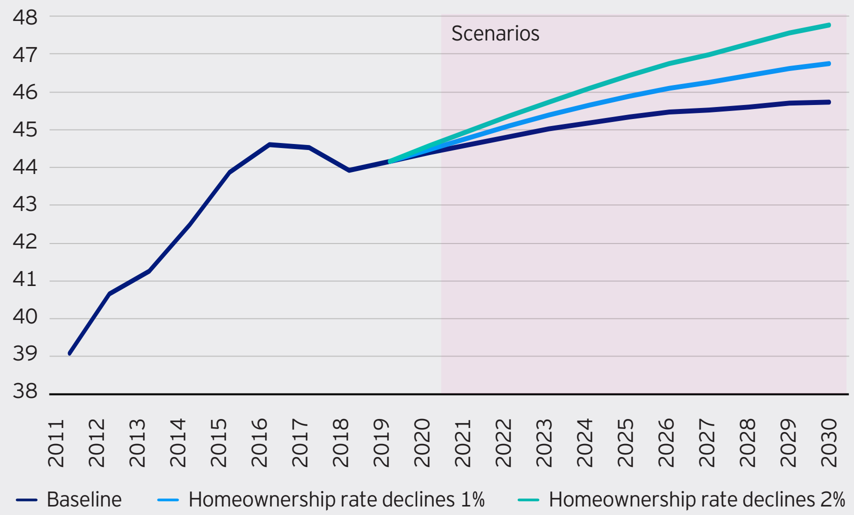
Introduction

The multifamily sector plays an important role in global real estate, and the extent of that role varies across regions of the globe. According to data from MSCI regarding sector share representation in global core real estate, the highest percentage weighting of multifamily investment is in the US (26.8%) and in Europe (18.2%), so our webinar focused on what has been happening in these two regions. Multifamily is a sector whose performance oscillates up and down relative to other sectors over time, so the impact of COVID-19 makes now a particularly good time to understand the current factors affecting the multifamily cycle.

Webinar Summary

In this webinar, we explored how the COVID-19 pandemic has impacted the multifamily sector and how the sector may be affected going forward. We explored the need for multifamily, the tenant experience during COVID-19 and the multifamily sector as an investment. The global pandemic has caused more people to work from home, which in turn has caused tenants to look at their living arrangements through the lens of their work environment. In this discussion, our panel concluded that beyond the near-term challenges presented by COVID-19, the demand outlook for multifamily remains positive, particularly in areas with stronger job growth, places where homeownership is more expensive than renting, and in innovation centers.

Figure 1 - US renter population of 25-44 year-olds (Millions)
Expect homeownership to drop and renters to rise post-COVID



Source: Invesco Real Estate as of July 2020

The Need

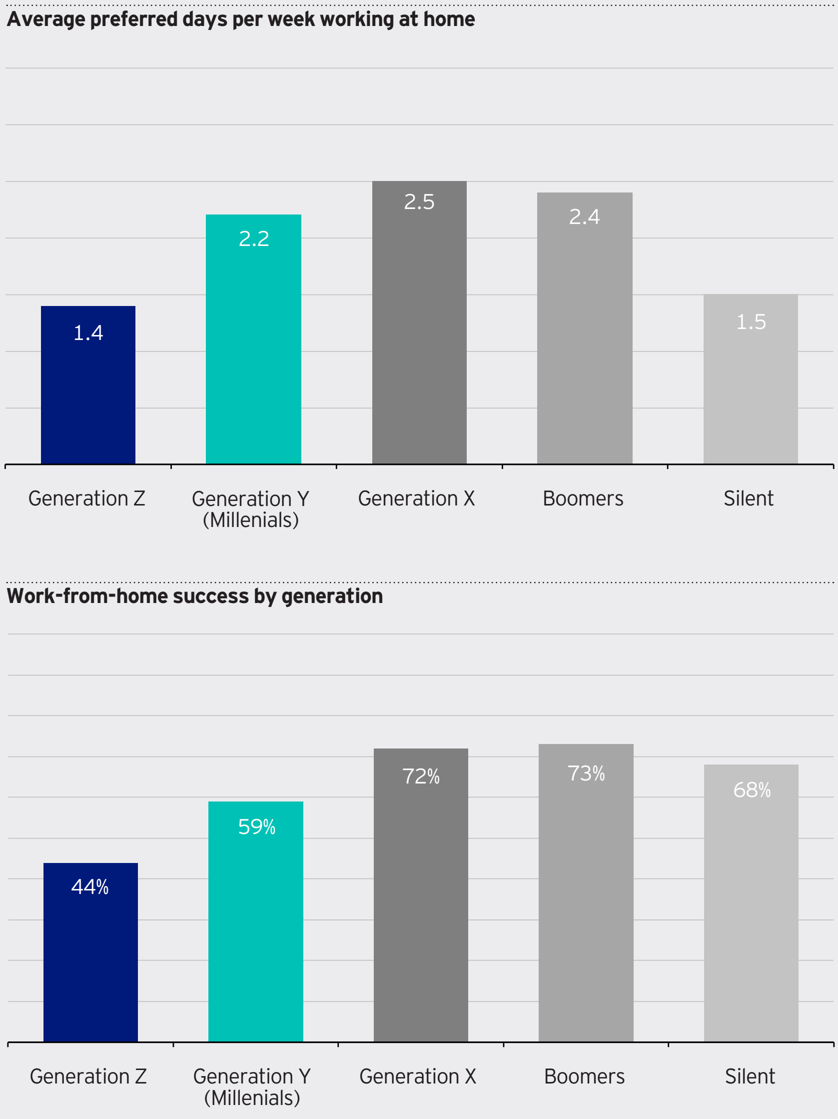
In the US, the CARES act allows for forbearance for homeowners struggling with making mortgage payments. There are currently 4.2 million Americans receiving these benefits. What happens when the benefits run out? Homeownership could fall. A 1% decline in the US homeownership rate is the equivalent of about one million households moving into the rental market, which would increase demand for US multifamily (Figure 1).

In the EU, homeownership levels vary widely across countries. Countries with lower homeownership rates are typically comprised of larger rental markets, thus presenting an opportunity to create modern, institutional grade stock in those markets.

Tenant demand for multifamily in the US has evolved during COVID-19. Although there has been a decrease in corporate short-term rentals, typically 4-6% of the urban demand, the subsequent vacancies are being absorbed by other tenants. Demand is now trending back up. In particular, there is increased demand in suburban markets. As some tenants can work remotely and do not need proximity to the office at present, they are seeking more space for less cost. It remains to be seen if this demand for lower-density product will persist after COVID-19. While there was some resistance to longer-term leases earlier this year with a shift to shorter leases and lower rents, lease terms appear to be trending back to normal levels.

In Europe, where there are fewer corporate tenants, there has been no material shift away from specific unit types. Overall demand for multifamily has been slightly less impacted in Europe than in the US and leasing continues to be active.

Figure 2 - Preferred work-from-home by generation[1]



Source: Global Work-from-Home Experience Survey, 2020 Iometrics and Global Workplace Analytics.

Tenant Experience

With a sudden sharp shift to working from home (WFH), WFH days increased from an average of 0.5 days a week to five days a week during the COVID-19 lockdown phase. While most people are expected to return to the office once the pandemic has passed, many people are expected to continue WFH at least part of the week as the home front and workplace converge more closely together. Figure 2 shows the results of a recent Global Work-from-Home Experience Survey by Iometrics and Global Workplace Analytics. They found significant differences in working location preferences and WFH productivity between generations. Millennials and Gen Zers prefer less time WFH and find themselves less productive at home than the older generations.

WFH has affected design trends. Tenants have better success working from home in units with defined sleeping and working areas, not studios. The need for better defined areas or for more space is in contrast to the development trend in the prior cycle toward smaller unit sizes. Some buildings had added co-working environments to help tenants adjust to the WFH trend. But in COVID-19, tenants have either been unable to access these amenities or have chosen to avoid common areas altogether. At least in the short term, growing demand for larger units to allow for more space for living and WFH seems likely. In Europe, there are typically fewer amenities offered than in the US multifamily properties. European tenants value access to outside spaces such as balconies and courtyards. They have also moved to an increased use of technology in older stock such as digital keys and fiber optics. Quality Wi-Fi is clearly a necessity while WFH.

Multifamily as an investment

Relative performance of the multifamily sector has varied globally. While European residential investments have outperformed the European index, in the US, multifamily has underperformed the NCREIF index over the last few years. This underperformance is likely more due to the relative strong outperformance of the industrial sector than weakness in the multifamily sector itself.

We asked our panel about their views on aspects of multifamily performance:

Panel views on aspects of multifamily performance

- **What are the drivers of relative performance? Site selection matters.** Important asset attributes include durable incomes, lower operating volatility, and rent levels that are discounted to the upper rental tiers.
- **What will the pricing be like following COVID-19? The outlook remains unclear.** Thus far, there is no sign of pricing discounts in Europe but as time goes by, there may be pressure on home and condominium builders to sell their units to multifamily investors if home sales start to slow. In the US, there has been little transactional evidence of any material price difference for prime properties. Indeed, we anticipate that there may be potential for some yield/cap rate compression due to the expected volume of investor interest.
- **How will rent regulations affect multifamily?** In Europe, there is greater pressure on local governments to set regulations and create rent control programs. However, newer builds are less regulated than older stock and generally are not subject to rent control. In the US, historically, rent control has not been successful in maintaining affordable housing. Rent control regimes such as in New York or San Francisco tend to constrain investor and developer interest and hence inhibit the housing supply over time. This has the effect of putting upward pressure on rents as a result of supply shortages.
- **Will demand for single family rental homes increase?** In an environment of increased demand for residential space, renters-by-choice in the US may seek out single family rentals in lower density areas. However, it is not clear that this would necessarily be at the expense of overall demand for apartments. As Millennials age and move into the next life stage, they may choose to move into single family rentals rather than to purchase homes. This appears to be an expanding portion of the rental housing sector.
- **If the supplemental unemployment benefits in the US drop from $600 to $200 or $400, will there be an impact on multifamily investments?** The effect is likely to vary by class of property. Reduced unemployment benefits may impact some multifamily properties with tenants unable to make rent payments, but this is most likely to occur at B and C class properties. Class A apartments, which make up much of the institutional investment stock, are likely to be less affected. Thus far, rental collections in the US have exceeded 90% for Class A properties.

Conclusion

Multifamily is an increasingly important part of core real estate portfolios around the world. Development has been a major source of investment opportunities over recent years and this appears likely to continue, COVID-19 notwithstanding. Asset selection and design are increasingly important. As new apartments are built, we expect there to be an increase in the number of larger units and the creation of apartment layouts with dedicated work alcoves or dens to accommodate an increase in time spent WFH. In the near term, there may be some switching of demand from the urban core to lower-density suburbs, but there appears still to be ample demand for urban multifamily.

Our multifamily core investment strategy is to position investments for future growth by selecting locations where rents have already adjusted, targeting job clusters as the supply subsides, seeking low or diminishing supply locations with stable property taxes, and diversifying within mid- and above-average rent tiers.

Notes

1. Note: Generation differences are statistically significant ($p < .0001$). According to Pew Research, Generation Z was born 1995-2015, Generation Y (Millenials) 1981-1996, Generation X 1965-1980, Boomers 1944-1964, Silent 1928-1945.

Risk Warnings

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Property and land can be difficult to sell, so investors may not be able to sell such investments when they want to. The value of property is generally a matter of an independent valuer's opinion and may not be realised.

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