NATIONAL REAL ESTATE Investor

Multi-Family Demand Surges Amid Turbulence in Mortgage Market

By Buck Wargo

Nov 7, 2007 2:24 PM

Apartment properties remain one of the strongest investments in the commercial real estate market, says Brian McAuliffe, managing director and chief investment officer with RREEF Alternative Investments.

Demand for multifamily housing has surged as potential homebuyers face tougher mortgage requirements, higher debt payments and declining home values, McAuliffe said at a seminar on capital markets and investment trends at the fall meeting of the Urban Land Institute in Las Vegas. He anticipates more construction of garden apartments nationally because commodity costs for lumber and drywall are coming down with the drop in home construction.

"That is the sector we are very bullish on," McAuliffe says. "When you look at the demand of the apartment sector, you have to look at two areas — one is the existing tenants that you have in your community, and the other is the demand for vacant space. Obviously, we feel very confident on the renewal rates," he says.

"We have already seen signs where it is increasing, and we expect that to continue. That is because the ability to get financing today is much more challenging. You need higher debt. The other factor is the fear factor of being in a position to buy a home today and find out six months or a year from now that it's worth less. I think there is going to be a lot more patience by the existing renters."

The office market is solid because of the inherent value of leases, he says, but he expects the warehouse and distribution sectors to slow a bit. McAuliffe says that because of supply, the retail market has peaked.

But Daniel Hurwitz, president and chief operating officer of Developers Diversified Realty, disagrees. He says retail continues to have steady rent growth, and it doesn't have the big swing in the market that other sectors do.

"The supply pressure in retail doesn't mean it's overbuilt," Hurwitz told seminar participants. "It means we are under-demolished. If you look at our vacancy rates, they can move a little bit, but they don't move very much because most retail has 10 percent or less of spec space. It is all done build-to-suit."

Ron Sturzenegger, the global head of real estate and lodging with Banc of America Securities, says investors with a lot of money are lined up on the sidelines trying to figure out a way to get back into real estate, "but they just don't know where to come in for them market," he says.

The current problem the market faces is debt, which hit the wall in July, he says. The big financial institutions committed to loans through June but stopped selling the debt, he says.

"They found themselves with a real large inventory of real estate loans that they couldn¹t sell," for the prices they anticipated, Sturzenegger says.

"Their balance sheets are stuck right now," he says. "They are all holding them waiting for the CMBS market to come back at a price they are comfortable selling. Once those go through the system, you will see the real estate lending market come right back in. The reason I feel so confident about it is because there is so much liquidity."

The current difficulty is not a credit problem, Sturzenegger says, but rather a pricing problem — and the task is to find the right price for property. "You will see as much as $50 billion in real estate loans go back into the market between now and the end of the first quarter of next year, and we will have a more liquid real estate market once again."

Hurwitz says he will be watching the capital markets. "The best way to make money in real estate is to have money when no one else does, but during the past five years everyone had money," he says. As a result, margins have been much thinner. As some capital dries up on the private side, that will offer an opportunity to fuel growth through access to capital, which is relatively unabated, he says. "We are really bullish on the next year to year-and-a-half, which is how long we think the cycle will go."

There is one other factor to add to the watch list -- the 2008 presidential election, which has prompted speculation, Hurwitz says. "I think there is a perception that if the Democrats come in, there is going to be a massive overhaul of tax policy."

"The holders of a lot of large private real estate portfolios are watching the situation very carefully," he says.