CAPITAL SQUARE

A CLOSER LOOK AT THE MULTIFAMILY DEVELOPMENT PIPELINE

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TAKING A CLOSER LOOK AT THE MULTIFAMILY DEVELOPMENT PIPELINE

INSIGHTS

- Deliveries of multifamily will reach post-recessionary highs in 2023; however, shifting market conditions over the past twelve months mean that the development pipeline will dramatically decline.
- Capital Square's analysis shows that within markets that we track in the Southeast, new multifamily deliveries are expected to decline by 80.1% by 2026 as compared with 2023.[1]
- While the multifamily market faces headwinds in the near term, there are significant opportunities for developers with a long-term perspective to deliver into a market with little or no new supply in the coming years.

THE COMING SUPPLY OF NEW MULTIFAMILY DOESN'T TELL THE ENTIRE STORY

Browse any selection of articles on multifamily real estate and you will undoubtedly see the warning signs that a wave of new developments will totally upend supply and demand fundamentals for multifamily properties. Vacancy levels are increasing. Rental increases are cooling. The headlines would have you believe that we are only at the beginning. And it's true that deliveries of new development are projected to reach record levels for 2023. However, in digging a couple layers beneath the surface, one quickly sees that after the gush from the current wave of new units, the new construction market will all but dry up.

The discussion around the coming supply in the multifamily market fails to mention the coda to the story, which is that following the completion of projects currently under construction, there will be a massive decline in new development. On the developer side, higher interest rates, increasing project costs and greater equity requirements all limit the viability of new projects. For lenders, a potential "doom loop" in loan portfolio values, as described by *The Wall Street Journal*, limits the ability of lenders to make loan commitments amidst current uncertainty.[2]

The problems for both developers and construction lenders are leading to a rapid freezing of the market for new construction loans. The U.S. Department of Housing and Urban Development reported in July that permits for new multifamily construction have declined 32% year over year.[3] What this means is that while many deals are discarded or sidelined, only a select number of projects from top-quality developers will move forward. This dynamic presents a unique opportunity in the market for developers with a long-term perspective.

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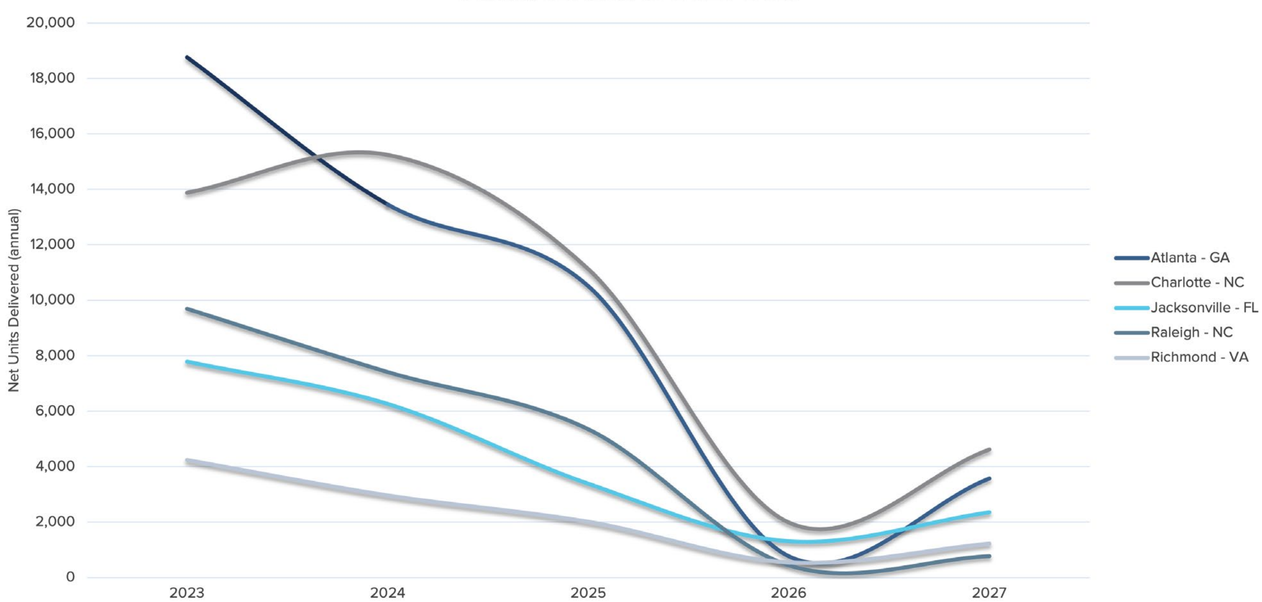
THE FLOW OF NEW SOUTHEAST MULTIFAMILY WILL SOON DRY UP

Capital Square assessed development pipeline data on 40 markets* that we actively track in the Southeast, Florida and Texas, in order to put numbers to the claims stated in the media. In these 40 markets, CoStar reports that net deliveries (i.e., new supply less any demolitions) of multifamily units will reach a 10-year high in 2023.[4] However, the figures around the shrinking development pipeline are just as substantial. CoStar reports that in Charlotte, North Carolina, groundbreakings have already cooled significantly. Just over 6,500 units broke ground in Charlotte in the first half of 2023, as compared to nearly 11,000 units in the first half of 2022.[5] The numbers are even more dramatic in Richmond, Virginia. After more than 4,800 units broke ground in Richmond in 2022, just under 300 units have broken ground in the first half of 2023.[6]

Aggregating the CoStar figures for the subject markets in the Southeast showed that net deliveries in 2026 are forecast to decline a staggering 80.1% as compared with the supply coming online in 2023. At the trough in 2026, net deliveries are expected to reach only 33.6% of the 15-year average for these markets.

The following table provides an illustration of the dramatic decline in new deliveries over the coming years in five Southeast markets that Capital Square actively tracks for development:[7]

NET UNIT DELIVERIES PROJECTED IN SELECT SOUTHEAST METROS 2023-2027



As illustrated in the graphic, after projects currently in the works in these markets reach completion in 2023 and 2024, there will be a massive decline in new deliveries in 2025 and nearly no new product that will deliver in 2026.

THE FEAST AND FAMINE PIPELINE WILL PROVIDE OPPORTUNITIES FOR PATIENT DEVELOPERS

A recent CBRE research brief titled "Looming Multifamily Oversupply Likely Will Be Short-Lived" puts context around the current development pipeline as it relates to housing demand in the U.S., as it notes, "Even with a surplus of multifamily units over the short-term, CBRE forecasts that an additional 2.3 million new units will be needed nationwide to maintain healthy market fundamentals over the next 10 years. Once the largest portion of the delivery wave has concluded in 2024, the nation will still need nearly 200,000 additional units annually to maintain proper supply and demand balance."[8]

In short, large swings in the near term will quickly give way to a stabilizing multifamily market, with vacancy rates and rent growth resetting around historical norms.

While current headlines focus on potential near-term headwinds for multifamily developments, the swings in the market also offer opportunity. For top developers with strong projects and excellent lender relationships, there is the ability to move forward with new developments that will deliver into a market with little or no competing new supply. Capital Square has a long-term viewpoint on the market. We are fortunate to be in the position of moving forward with several multifamily developments that are positioned to capitalize on the opportunities presented over the coming years.

*The subject markets of Capital Square's analysis include Asheville, North Carolina; Athens, Georgia; Atlanta, Georgia; Augusta, Georgia; Austin, Texas; Birmingham, Alabama; Charleston, South Carolina; Charlotte, North Carolina; Charlottesville, Virginia; Chattanooga, Tennessee; Columbia, South Carolina; Dallas-Fort Worth, Texas; Daytona Beach, Florida; Durham, North Carolina; Fort Lauderdale, Florida; Fort Myers, Florida; Gainesville, Florida; Greensboro, North Carolina; Greenville, South Carolina; Houston, Texas; Jacksonville, Florida; Kansas City, Missouri; Knoxville, Tennessee; Lakeland, Florida; Miami, Florida; Myrtle Beach, South Carolina; Nashville, Tennessee; New Bern, North Carolina; Norfolk, Virginia; Ocala, Florida; Palm Beach, Florida; Panama City, Florida; Pensacola, Florida; Raleigh, North Carolina; Richmond, Virginia; Sarasota, Florida; Savannah, Georgia; Tallahassee, Florida; Tampa, Florida; and Winston-Salem, North Carolina.

Sources

1. CoStar.com, accessed September 2023.
2. Shane Shifflett and Konrad Putzier, "Real-Estate Doom Loop Threatens America's Banks," The Wall Street Journal, September 6, 2023.
3. Leslie Shaver, "Permits for 5-plus units plummet 32%," Multifamily Dive, Aug. 22, 2023.
4. CoStar.com, accessed September 2023.
5. "Charlotte Multifamily Market Report," CoStar, accessed September 2023.
6. "Richmond Multifamily Market Report," CoStar, accessed September 2023
7. CoStar.com, accessed September 2023.
8. "Looming Multifamily Oversupply Likely Will Be Short-Lived," CBRE, March 2, 2023.

ABOUT CAPITAL SQUARE

Capital Square is a national real estate firm specializing in tax-advantaged real estate investments, including Delaware statutory trusts (DSTs) for Section 1031 exchanges, qualified opportunity zone funds, development funds and a real estate investment trust (REIT). As a vertically integrated company, Capital Square has also become an active developer of mixed-use multifamily and build-for-rent properties in the southeastern U.S. as well as a dedicated property manager through Capital Square Living, which launched in 2023. Since 2012, Capital Square has completed more than $7.5 billion in transaction volume. Capital Square's related entities provide a range of services, including due diligence, acquisition, loan sourcing, property/asset management and disposition, for a growing number of high-net-worth investors, private equity firms, family offices and institutional investors nationwide. Since 2017, Capital Square has been recognized every year by Inc. 5000 as one of the fastest growing companies in the nation. In 2017, 2018, 2020 and 2023 the company was also ranked on Richmond BizSense's list of fastest growing companies in central Virginia. In addition, Capital Square was named a "Top Workplace" by the Richmond Times in 2023. To learn more, visit www.CapitalSq.com.

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