STRONG INVESTOR DEMAND FOR CINCINNATI APARTMENTS DRIVES UP PRICING

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Cincinnati remains a highly sought-after market for multifamily investors as the U.S. emerges from the COVID-19 pandemic. The Cincinnati area's apartment market fundamentals, including rent growth, rent collections and occupancy levels are holding up well.

Significant amounts of capital — including local, out-of-state and international — are aggressively seeking to be deployed into multifamily assets, which continues to drive up pricing.

Multifamily has outperformed many other commercial real estate sectors during COVID, as many investors consider it a safe-haven investment. However, a lack of inventory for sale is slowing transaction activity.

COVID-19 impact

While delinquencies increased in 2020 due to pandemic-related layoffs and furloughs, many apartment owners in Cincinnati recorded strong rent performance, especially those properties that are well-managed and efficiently screen tenants. There was an eviction moratorium in Ohio, but it had a minimal impact. Workforce housing properties with lower-income tenants experienced the most negative effects during the pandemic.

Many operators in Cincinnati and throughout the Midwest recorded collections at or above 90 percent, which is typical. Owners may have had a couple of tenants who requested rent relief or deferred payments, but after the dust settled, most borrowers, owners and operators did not experience significant collections issues.

Where owners took advantage of the market in 2020 was in reducing operating expenses due to the lack of tenant turnover. Some owners even had record years across their portfolios.

Market conditions

Overall, Cincinnati's apartment market is strong, boasting a record-low vacancy of roughly 5 percent. Several submarkets are reporting even lower vacancy rates.

Pre-COVID, downtown Cincinnati and surrounding submarkets were red-hot. There was a strong appetite for apartments in the urban core, particularly in the central business district (CBD), and rents were rising. When COVID hit, people backed off from living downtown as they sought more space. The CBD is currently experiencing some softness.

Meanwhile, suburban submarkets have taken advantage of renters moving out of downtown and are experiencing solid activity.

What's drawing investors?

Investors like the longer-term growth story of the Cincinnati region. Cincinnati is not a boom-bust market but a steady, consistent market. While it has not experienced huge population growth, people continue moving there at a steady pace. The local economy is stable, cost of living is low/affordable and unemployment is typically low (currently 4.6 percent.)

The area is home to a number of Fortune 500 companies, including Procter & Gamble and Kroger, and several banking/financial services firms such as Fifth Third Bank and Western & Southern Financial.

The city is making a big push to draw new corporations and plans are underway for a new convention hotel to attract conventions and meetings. The region also attracts significant tech talent and startups.

NorthMarq arranged a $7.5 million loan for the refinancing of River Bend Apartments in Cincinnati. A life insurance company provided the loan.

Increasing competition

Increasing competition from local players; out-of-town buyers from California, Texas, Chicago and the East Coast; institutional funds; and international players are pursuing Cincinnati apartment deals, which is driving up pricing. Meanwhile, a limited supply of available product for sale is also fueling increasing prices. Additionally, owners may question if they sell, what will they purchase with the low supply.

Robust financing market

It is a great time to be an apartment borrower, as multifamily is one of the few property types that experienced limited negative impacts during COVID. For high-quality deals, there is an abundance of active lenders including banks, Freddie Mac and Fannie Mae, life insurance companies and CMBS lenders. Typically, CMBS lenders don't see a lot of apartment deals because Freddie and Fannie and other lenders gobble up this market. However, any deals that Freddie or Fannie did not fund, CMBS lenders were aggressively pursuing.

An abundance of debt funds and bridge lenders are playing in the space now. They can offer very low interest rates, which makes the debt attractive. Even bridge lenders are offering rates in the 3- to 4-percent range.

For debt, NorthMarq has obtained rates under 3 percent for lower-levered deals on high-quality apartment product. It is an opportune time to lock in long-term, fixed-rate debt, either recourse or nonrecourse.

Many NorthMarq clients locked in rates in 2020 below 3 percent on long-term deals. Those deals are more attractive to sell now because the loans can be assumed, and buyers will receive a favorable interest rate, even lower than in today's market. We expect that will drive a few more apartment listings.

Example of a deal

NorthMarq recently arranged the $7.5 million refinancing of the 120-unit River Bend Apartments in Cincinnati, following a complete renovation of the property. The transaction was structured with a 15-year term with one year of interest-only payments, followed by a 30-year amortization schedule. NorthMarq arranged the permanent fixed-rate loan for the borrower through its relationship with a life insurance company.

NorthMarq worked with the lender to issue an aggressive proposal that provided the requested loan proceeds, an attractive interest rate and deal structure. The borrower immediately jumped on it, and NorthMarq locked the rate in just two days.

Single-family housing

Cincinnati's for-sale single-family housing supply has shrunk significantly, which has boosted housing prices and made buying a home challenging. That has resulted in many renters staying put. Rental rates have risen considerably due to single-family home values increasing. Single-digit rent growth is occurring and will likely continue until the single-family housing market stabilizes and more inventory becomes available.

A balanced housing market has a six-month supply of inventory. Cincinnati has an inventory of less than two months. Low mortgage rates are helping fuel the frenzied activity in the single-family housing market.

Development trends

Cincinnati's hilly topography and zoning restrictions limit the amount of new development. This has created a redevelopment pipeline coming back toward the urban core as retail, office or industrial buildings are repurposed into upscale apartments. This is creating a value-add strategy for developers and/or investors to buy older buildings, renovate into apartments and raise rents.

Rising construction costs

A couple of announced multifamily developments in Cincinnati have been postponed due to the drastically increasing construction costs, shortages of materials and lack of labor.

For developments moving forward, skyrocketing construction costs mean rents must increase to make projects financially feasible. Renters have been willing to pay a premium for quality product. Class A apartment rents can be as much as $2,000 to $3,000 per month for two- or three-bedroom units in Cincinnati.

However, if renters bought a single-family home (if they can find or afford one), their monthly mortgage payment would most likely be less than the Class A apartment rents. The question is whether developers can achieve these higher rents to make new projects viable.