Access to Fresh Capital Optimizes Outcomes for Owners

Long-term Capital and Expert Management are Key to Owners' Solutions

Owners Hit by Sudden Changes to the Multifamily Environment

After the historically low cap rates of 2021 and 2022, owners have been hit by a near-perfect storm of challenges. With NOI under pressure from slower rent growth and increasing expenses, the near doubling of interest rates makes it a difficult time to own property. But this time will pass for those with access to great management and the fresh, patient, capital to support them through the next 24 – 36 months.

The post-COVID, multifamily property changed hands at record-low cap rates; often at negative leverage. This made sense given the boom period we were experiencing. Then the market turned. Stable expenses and strong lease trade outs were replaced with stagnant (or negative) rent growth and inflation-fueled expenses. As actual performance slipped below expected performance, pressure started to build on owners.

Some sponsors that did not see the expected NOI growth are now facing the end of a bridge loan or rate cap. For others, capex budgets have proven to be insufficient or sub-par management has failed to deliver the expected occupancy and variable expenses. The property is unable to produce sufficient income to meet mortgage payments when loans reset to current market rates and loan proceeds on refinance will not be adequate to take out in-place debt.

Financial challenges cause Problems with Lenders

The owner's problem soon becomes a problem for the lender. More properties are in distress and lenders are expecting to have the keys handed back on an increasing number of assets. Without the resources to manage the properties, and facing significant capital losses if they sell, lenders are open to reaching an agreement that delivers a better outcome for all parties involved.

According to Naftali Tilson of TG Advisory, "Even excellent real estate can be impacted at times like this. Those who are long-term real estate investors have seen cycles and are confident that the wheel will turn."

Tilson believes that quality multifamily real estate inevitably returns to be an attractive risk-adjusted investment if bought right. The challenge is managing and funding the assets to optimize NOI until the market returns to a more normal balance between interest rates, income, and cap rates. This requires investors with a patient mindset and long-term view.

Capital that takes a Different Approach is Required

"Patient capital is willing to forego distributions for a few years and take over management to build and share in the upside three to five years from now. The key is entering the property at a value that gives new capital confidence that they will achieve a fair return," Tilson explained.

Investors offering patient capital today require a partnership with the existing owners, lenders, and the management team. Only when all stakeholders are on the same page will new capital willingly bring in fresh money and subordinate returns to an underperforming property. TG Advisory insists that this includes a strong manager who will be able to implement the agreed strategy for the property; including allocation of necessary capex.

Tying Management to Capital Ensures All Stakeholders, even Lenders, are Aligned

TG Advisory recommends bringing in a management partner that invests its own money alongside the patient capital. "When management has skin in the game, negotiations with lenders progress more smoothly because everyone's interests are aligned," according to Adam Goodvach at TG Advisory.

Lenders are not always aware of a property that is under performing even when owners are providing monthly numbers. With loan books riddled with distressed properties, only those in the worst condition are likely to get any attention. This providers owners with the opportunity to be proactive with lenders and provide a solution before the lender is fully aware of the problem.

Compromises are easier to reach before lenders approach the sponsor with a problem. Offering fresh equity, the right management and a long-term plan can be an attractive alternative to a lender facing a poorly performing property. "Providing lenders with a solution that protects their interests and improves the performance of the property is always well received," Tilson remarked. "Presenting new capital with management credibility who is willing to subordinate their returns shows real commitment to the long-term performance of the property. That is the basis to optimize the best outcomes for all stakeholders."

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