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Eager Buyers Snap Up **Pre-Stabilized** Rentals

New apartment buildings that are still in their initial lease-up phase are suddenly in vogue.

Investors are bidding up prices on "**pre-stabilized**" multi-family properties — those that were completed less than a year ago and haven't yet reached 90% occupancy. Market pros attribute the surge in demand to the vast amount of capital pouring into the apartment sector, encouraging news about the pandemic and the economy, and the availability of low-cost debt.

In some cases, **pre-stabilized** properties are commanding stabilized prices, particularly in coveted suburban markets in the Southeast and Sun Belt, said Shea Campbell, an Atlanta-based executive vice president in CBRE's multi-family institutional properties group.

"There is more pressure to put money out, and there's also a belief that once we get on the other side of this pandemic, things will loosen up, and it's an opportunity to get control of the deal right now," he said. "It's almost like there's been a mandate: We need to get money out the door and we believe in the dynamics of multi-family, so we're going to step up and bid aggressively on these **pre-stabilized** deals that are 60% leased — and we're going to close before the property is 80% leased."

Helping fuel those deals is the availability of attractively priced and structured debt, in the form of both bridge loans and low-leverage insurer loans, pros said. Competition among bridge lenders has picked up sharply in recent months, due to an influx of fresh capital from investors seeing opportunity amid economic recovery. The field has become even more crowded with this year's resurgence of the commercial real estate CLO market, which some bridge lenders use to fund their originations.

That has led to attractive pricing on loans for transitional properties, especially those in favored sectors like multi-family. And that brings new buyers to the table for **pre-stabilized** listings.

"With the improved pricing in the bridge-lending space, private levered buyers are able to compete in a space historically dominated by all-cash buyers," said Kris Mikkelsen, executive vice president of investment sales and capital raising for Walker & Dunlop.

While the multi-family sector has always been viewed as a haven by private investors and institutions seeking protection from economic storms, it's especially attractive to buyers and lenders now. That's because other major property types — such as hotels, retail properties and some office buildings — have been hit particularly hard by Covid-19. Meanwhile, the federal government's pandemic-relief and stimulus efforts also have bolstered the apartment sector more directly than most, by ensuring tenants can pay their rent.

Mikkelsen said the current mismatch between capital trying to buy apartments and the availability of listings has created what he describes as a "scarcity effect." Investors that typically purchase stabilized apartment properties — and are eager to make up deal volume that they lost during last year's pandemic-induced slump — are hitting a wall. To get around it, some are willing to buy properties before they are fully occupied — even if it means assuming lease-up risk.

“Buyers [are becoming] willing to take on the operational risk associated with a lease-up in exchange for getting access to product,” said Mikkelsen.

Richard Kulick, a managing partner at Beacon Real Estate of Coral Gables, Fla., said investors also find that the playing field in the pre-stabilization space is less crowded.

“Some investors who are used to value-add returns have been priced out of that investment thesis, because there is so much capital chasing it — pushing valuations up via compressing cap rates,” he said. “There are less buckets of money that can do these types of [**pre-stabilized**] deals.”

Properties in their initial lease-up phase lack the track record of steady occupancy and lease-renewal rates that lenders typically look for. But Mikkelsen said that with lenders eager to increase their multi-family allocations, “assets in markets where we can demonstrate operational resiliency are receiving favorable terms and structure before fully proving out their cashflow.”

While the multi-family sector held up better than many had anticipated during the pandemic, owners of new Class-A apartments have faced headwinds in leasing them up. A heavy development pipeline and weakened demand due to high levels of unemployment have forced landlords to ramp up the use of concessions, such as rent-free periods, to attract tenants.

Nevertheless, starting in February, **pre-stabilized** Class-A apartment listings started to flood the market, and the flow shows no signs of abating. They’re emerging largely in markets and submarkets that have demonstrated resiliency through the pandemic, aren’t burdened by a large supply of new product, and where social-distancing restrictions have been eased in a bid to spur their local economies.

“It’s a good time for the developers and sellers of this product because there is a lot of capital on the sidelines trying to be deployed, and there is just not a lot of buying opportunities,” said Scott Ramey, a senior managing director for Newmark in Orlando. “But now, you have buyers willing to look at **pre-stabilized** opportunities and still pay aggressive pricing because they need to deploy capital.”

He added: “Buyers have seen the lease-up story still pan out even during the pandemic, so they’re more comfortable taking on that risk to finish out the lease-up because they want to have a deal they can buy.”