MULTIFAMILY IS MULTIFACETED

by Steve Brown

In many homes and offices throughout the country, people have installed decorative glass block walls. These walls are multifaceted, reflecting light in a variety of directions. In banking, many lending sectors can also be viewed in many different ways. We consider this, as we explore the multifamily sector.

Multifamily or apartment lending is generally doing quite well right now in many different areas of the country. Many experts predict in fact, that multifamily vacancy rates will continue to tighten in 2008, pushing rents higher. This group, who we will refer to as "positive on the multifamily sector," says things will remain strong for some fundamental reasons.

To begin, this group points to increased demand for apartments due to the slowdown in housing. Some are renting as they wait for home prices to bottom out, while others have lost their homes and moved into apartments. Demand is also increasing simply due to population growth.

These positive factors weighing in favor of multifamily are why vacancy rates could fall below 5% nationwide by the end of 2008. If that happens, average rents could rise more than 4% in many markets. Those most likely to see sharp rental price increases are also those with the lowest apartment vacancies. Specifically, these areas include Los Angeles, Minneapolis, Nashville, New Jersey, Pittsburgh, Philadelphia, Salt Lake City, San Jose and San Diego (all with vacancy rates below 3%).

This is all very good news for community banks active in the multifamily sector, but there are some risks. This group of naysayer's, who we identify as "negative on the multifamily sector," has their own reasons for feeling that way.

This group begins by pointing out increasing economic stress could strain property cash flows and defaults could increase on loans reaching their balloon dates (where borrowers cannot find new funding, due to a tighter credit environment).

In addition, those negative on the sector point to a sharp increase in rental units in certain markets. The completion of multifamily projects and an acceleration of condominium conversions to rental units are adding particular stress in such markets AZ, FL, MI, NV, TN, TX and MI. As with all things real estate, location matters. Condo conversions in 2008 are projected to reach a 3Y high, so danger may be lurking behind the glass blocks.

The negative group also discounts the notion that people who have lost their homes will rent apartments. They point to the fact that most apartments still require a 2-month security deposit (which these presumed renters will not have) and the impact of blighted credit ratings (many also won't qualify). In addition, recent studies show many people who have lost their homes to foreclosure are also moving in with relatives. As a result, of all these factors, this group expects apartment vacancy to rise above 6% by the end of the year (compounded by further softening in the economy and a large number of apartments and condominiums being delivered).

While no data exists telling us whether homeowners who have lost their homes to foreclosure are moving into apartments, it seems the logical choice.

Whether you are in the "positive" or the "negative" camp when it comes to multifamily, one thing is for sure. Sectors are an important consideration in lending, but community bankers know the multiple facets of their local markets (and the players within them) better than anyone.

BANK NEWS

Downsizing Citi

Their CEO announced that they will sell $400B in assets over the next 3Ys in order to return the bank to an 18% or greater target ROE. Already, Citi has agreed to sell their employee benefits, Diners Club Int'l and CitiCapital (leasing co) subsidiaries.

Risk-Based Scoring

A proposal by the FTC and Fed would require lenders to disclose when consumer credit is extended under less favorable terms than average. The proposal stems from the assumption that consumers should know when they receive less favorable terms (i.e. a higher price) due to risk-based scoring.

Earnings Update

With 55% of the Fortune 1000 reporting 1Q numbers, average earnings are down 23%. Telecommunications fared the worst, followed by financials. All banks/thrifts were down 49%, while commercial banks fell 18%. Utilities, industrial and tech were all in positive territory.

Union Bank of CA

The S.F. based regional bank said it looks to expand in the Seattle and Portland markets through acquisition as soon as its BSA regulatory order is lifted (estimated to be the end of the year)

Biz Clients

A new study finds 40% of small business owners co-mingle funds from their personal and business accounts.

Business Bankruptcy

Government data just released shows business bankruptcy cases soared 44% in 2007, compared to 2006, as economic stresses increased.