Multifamily Acquisition Advisors
ACQUIRE MORE. SPEND LESS.

March 2024

"No deal is better than a bad deal."

For calendar year 2023, transaction activity across the multifamily industry declined over 50 percent.

Our activity level has dropped commensurately. Acquisitions are our life-blood. But an old business maxim comes to mind: "No deal is better than a bad deal."

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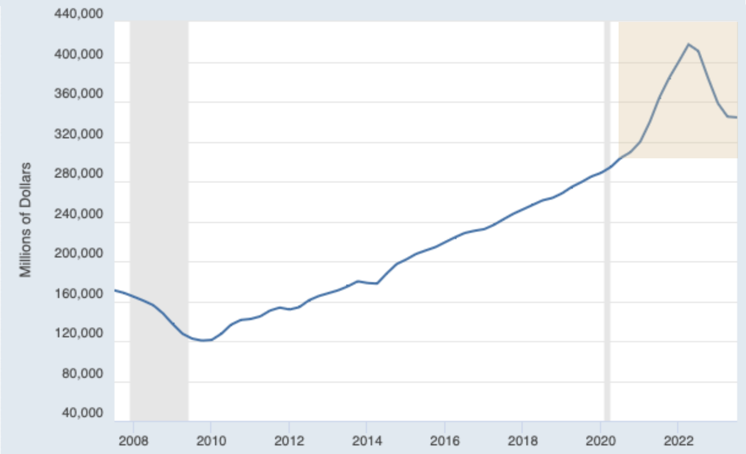
Where Are We on the Valuation Curve?

The St Louis Fed Multifamily Real Estate Apartment Pricing Index looks back at general multifamily values. **The index reached its peak in Q2 2022 at 417,220 and as of Q4 2023 was 344,116, implying a general drop in value of 17.5% between those periods. We await the data series for Q4 2023 (which should arrive in early/mid March) but expect further deterioration of 5% or so.**

It is fair to say that on average, a property leveraged to 80% LTV during 2022 is currently worth the loan amount after costs. **It is notable that the current pricing level is equal to that of Summer 2021, which itself was roughly double the price level of year-end 2013.**

Interest Rates and Price Indexes;
Multi-Family Real Estate, Level Apartment Price Index



Shaded areas indicate U.S. recessions.
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org

With moderating NOI growth in 2024 and limited drivers not already baked in that would lead to significant cap rate expansion or compression, we may be at a consolidation pricing level for the next year in conventional multifamily.

Our Recent Activity

The period beginning with the onset of the Covid pandemic and associated lockdowns through the present represents a sort of mini-cycle in the multifamily investment sector. **Unprecedented events, volatile price movements and material changes in operating fundamentals and the capital markets all occurred within a relatively short period of time.**

During this period from early 2020 through 2023, entities owned and/or operated by **MAA engaged in 22 acquisitions, dispositions or other capital events such as refinancing.**

To paraphrase Henry Ford, the better you can look back, the better you can look forward. Looking back, there are **five simple but critical measurements of performance during the recent mini-cycle.**

1) **From an operations standpoint, employing best practices in leasing, retention and managing bad debt during the "meat" of the Covid lockdowns.**
2) **If acquiring, executing on the lower part of the upward price curve.**
3) **If selling, executing prior to major price declines.**
4) **Exploiting the rate curve to lock-in historically low fixed rates on both new acquisitions and existing holdings.**
5) **Mitigating forward risk by avoiding the variable rate bridge loan trap.**

We certainly experienced distress at times in operations during the lockdown. But we made timely changes in our management teams when we felt it necessary, and this paid dividends. We ethically exploited all available pandemic-era programs and resources. And we limited renovation and capital expenditures to only those that were necessary to preserve an asset or that were undeniable value-drivers.

Save for one, we acquired all of properties during the mini-cycle by late 2021, well before the peak in pricing.

We sold or initiated sale on all disposed properties beginning in August of 2022, at the peak of the market. 9 of our 11 refinances were executed when 10-Year Treasuries were yielding about 70 basis points. And we eliminated all bridge loans originated in-cycle during a brief but welcome window: the point when values had not deteriorated substantially below our basis even though lenders were quoting replacement debt at 25% lower LTV than we were carrying.

In reflecting on our actions during these market movements, ***we weren't perfect, but using this checklist, most of our decisions were good ones and consequently we are well-positioned going forward.***

What Do We See for 2024?

- Market clarity and optimism have increased moderately and will result in a cautious increase in transaction activity.

- From an operations standpoint, fundamental demand is strong. However, there are temporary challenges. Owners will focus this year on occupancy. In many markets, renewal premiums will generally be lower and retention more difficult due to lease-up of substantial new supply coming online.

- Plunging construction starts point to firming of rents again beginning in 2025 and beyond.

- Increases in operating expenses will outpace rent increases in many markets, albeit at a slower pace than in 2023, mitigating NOI growth.

- Cap rates for well-located A/B product are settling into the mid 5% range with a premium or discount from this base rate depending on individual property attributes. Expected Fed rate cuts leading to lower 10-Year Treasury rates will likely have little impact on these rates as any decrease will be "soaked up" by an expanding spread between the two. The spread between cap rates for investment-grade and lower-tier properties will expand as investors focus on higher level of required capital expenditures and "tip of the spear" economic vulnerabilities of these tenants in a downturn.

- Those expecting a wave of distress selling fueled by properties over-levered by variable rate bridge loans will likely be disappointed. Many of these loans were originated by debt funds who will quietly assume ownership from the borrower and happily wait for a favorable price environment to liquidate.

- In part, because of the above factors, LP equity is generally taking the form of a preferred equity piece with traditional pari-passu participation return requirements tantalizingly just out of reach of prevailing projections.

Our Current Focus

Our focus during a period of reduced activity in the conventional multifamily sector is three-fold:

Improve our platform.	We have used a lull in acquisition activity to build new capital relationships, refine underwriting and presentation capabilities and otherwise improve our platform so that we may be even more effective in our next acquisition cycle.
Renew our focus on consulting and asset management.	During this lull, we recognize that different investors have different costs of capital, deployment mandates and goals. Thus, some are active when we are not. Using our resources and expertise to help active investors with their acquisition and asset management functions during our pause period makes sense. And in an environment of tightening operating margins, we can add real value to other investor's holdings with our "line-item-by-line-item" approach.
Exploit alternative but related opportunities.	With cap rates "settling in", no massive rent growth tailwind and expenses still subject to persistent inflationary pressure, it is tough to forecast organic appreciation for a “vanilla” multifamily property. So, while *vanilla* takes a breather, other segments such as Senior Living (assisted living, memory care) can offer a risk-return equation that resembles early teens conventional multifamily. In the hands of a seasoned operator, the higher variability of the business component can lead to higher potential increases in net revenue and value than that of a conventional multifamily asset in this environment. And the long-term effects of an ageing population on this sector are favorable. <u>We are currently building the foundation for a significant program push into Senior Living.</u>