When the U.S. Eviction Moratorium Ends: Implications for the Multifamily Sector

AUGUST 2021

WHAT HAPPENED?

After several extensions, The Centers for Disease Control and Prevention (CDC) rental eviction moratorium for nonpayment of rent and the Federal Housing Finance Agency (FHFA)'s foreclosure moratorium on government-backed properties expired on July 31, 2021. The situation remains fluid, however, and the cessation of the moratorium was short-lived. Already, the FHFA has opted to suspend evictions on real estate owned properties until September 30, 2021 and the FHA, VA and USDA have similarly extended its eviction moratorium for mortgages under their remit. Moreover, the Biden administration issued a new moratorium on August 4, 2021 that will be in effect at least until October 3, 2021 in areas with large coronavirus outbreaks. At the time of writing, this moratorium applies to the majority of U.S. counties. The order will be challenged in court, and it is unlikely to survive that challenge. There are meanwhile efforts in the House to extend the moratorium on a firmer legal basis, but it is far from clear whether these will be successful. In sum, an eviction moratorium remains in effect in much of the country (which parts can fluctuate from week to week) but it is unclear for how long.

What we do know is that these programs have contributed to reducing evictions and foreclosures. In fact, Princeton's Eviction Lab found that evictions were 65% below pre-pandemic levels in 2020 in areas where data is available.[1] In addition, the Mortgage Bankers Association found that the share of loans in foreclosure declined from 0.73% in Q1 2020 to 0.54% in Q1 2021.[2] Evictions and foreclosures will undoubtedly increase after eviction moratoria end, but questions remain as to how much they will increase and how real estate markets will be able to absorb the changes.

WHAT THIS MEANS FOR SINGLE FAMILY

Two million homeowners are receiving loan accommodations presently—equivalent to 4% of borrowers with a first mortgage. This represents an upper limit for potential foreclosures. For perspective, there were approximately 3.8 million foreclosures during the Great Financial Crisis (GFC) from 2007-2010. Foreclosures during the current period are unlikely to be anywhere near this upper limit, let alone GFC levels. There are several reasons for this:

1. Banks have little desire to take possession of properties, a lesson learned painfully during the GFC. They have every incentive to work through distress with borrowers, including loan modifications and, in some cases, short sales. The FHFA moratorium only applies to properties with government-backed mortgages, but forbearance rates on government-backed properties are either lower (Fannie Mae & Freddie Mac) or modestly higher (Ginnie Mae) than the rate on properties serviced by independent mortgage brokers.[3] This suggests that lender patience is not solely a result of the FHFA's order, but rather, it reflects lenders' organic incentives as well. It also implies that a foreclosure cliff is highly unlikely when the moratorium ends.
2. Home prices have risen significantly across much of the country and inventories of homes available for sale have plummeted as buyers have snatched them up. The result is that exceedingly few homeowners are underwater on their mortgages. According to a report by Consumer Financial Protection Bureau, only 1% of borrowers in forbearance have loan-to-value ratios (LTV) over 95% while 50% have LTVs

1 https://evictionlab.org/us-eviction-filing-patterns-2020/
2 Mortgage Bankers Association, National Delinquency Survey
3 https://www.mba.org/2021-press-releases/june/share-of-mortgage-loans-in-forbearance-decreases-to-404-percent

under 60%.[4] Lenders are more likely to work through difficulties with borrowers who have substantial equity. These borrowers also have more options as alternatives to foreclosure, including refinancing supported by historically low rates—or by selling into the market.

As a result, it is doubtful that the end of the FHFA moratorium will cause a large immediate increase in foreclosure activity. Instead, the number of borrowers in forbearance will likely continue to decline. Most of the decline will be due to borrowers resuming payments as their financial situations, along with the overall economy, recover. A smaller share will exit forbearance following loan modifications while a still smaller group will choose to sell their homes. Only the smallest fraction is liable to go through the foreclosure process. There may be a modest increase in homes available for sale, but mostly concentrated in less affluent submarkets.

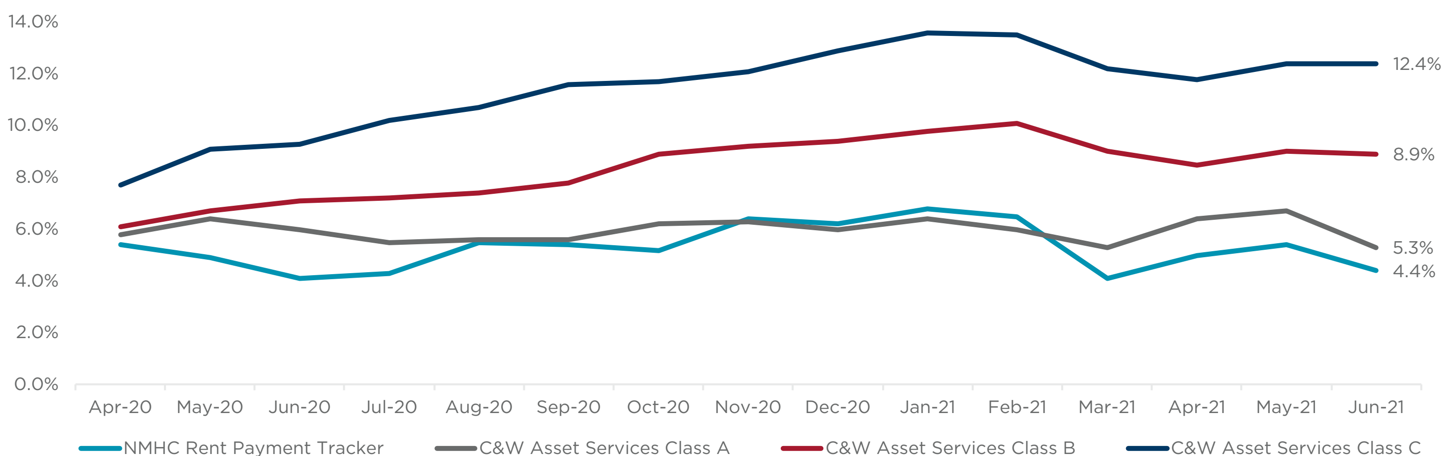
WHAT THIS MEANS FOR MULTIFAMILY

Early in the pandemic, the Census Bureau began a weekly survey of around 70,000 households each week, asking them a range of questions, including if they are caught up on their rental payments and how worried they are about near-term eviction. As of the July 5 survey, the Census Bureau estimates there were 7.4 million households behind on their rent, or 16% of all rental households. Of these, 1.4 million or 3% of all renter households reported that they are "very likely" to be evicted in the next two months, which increases to 8% if you include those who were "somewhat likely." Moody's Analytics looked at a variety of data and estimated that there were closer to 5.6 million delinquent renters in June, down from 9.4 million in January.

The big gap between the Census Bureau and Moody's Analytics' estimates alone suggests we should be cautious. The Census Bureau data has two major problems. First, the sample size is relatively small, so the potential estimate errors are large, which they alert users to in the first place. Second, there is no pre-pandemic data to benchmark the data, making statistical extrapolation even more fraught. A 16% delinquency rate in this data has a very different interpretation if the pre-pandemic rate was 10% than if it were 5%. Fortunately, we have high quality data sets that we can use to test the Census Bureau data.

The figure below shows delinquency rates from the National Multifamily Housing Council (NMHC) and Cushman & Wakefield Asset Services.[5] Similar to the Census Bureau data, these show that delinquency rates rose throughout 2020, peaking in early 2021 and are now declining. Where they differ is that at every point, they show significantly lower delinquency rates. Moreover, for the NMHC data and Cushman & Wakefield Class A, they show that delinquencies have recovered to pre-pandemic levels. These suggest that the Census Bureau data are directionally useful, but that its absolute values are likely inflated and furthermore that delinquency rates are most likely not that far above where they were under normal market conditions (i.e., pre-pandemic). That said, the NMHC and Cushman & Wakefield data are based on sets of professionally managed properties, whereas the Census Bureau data includes tenants of small landlords as well. Unless the Census Bureau data vastly oversampled

NATIONAL MULTIFAMILY RENT NON-PAYMENT RATE



Source: NMHC, Cushman & Wakefield Asset Services

4 https://www.consumerfinance.gov/data-research/research-reports/characteristics-mortgage-borrowers-during-covid-19-pandemic/
5 Note that NMHC reports the percent of units with uncollected rent (with a sample size of more than 11.3 million conventional, market rate, professionally-managed units with general tenancy) and C&W Asset Services reports the percent uncollected of rent dollars owed (with a sample size of 146,000 units with varied product types).

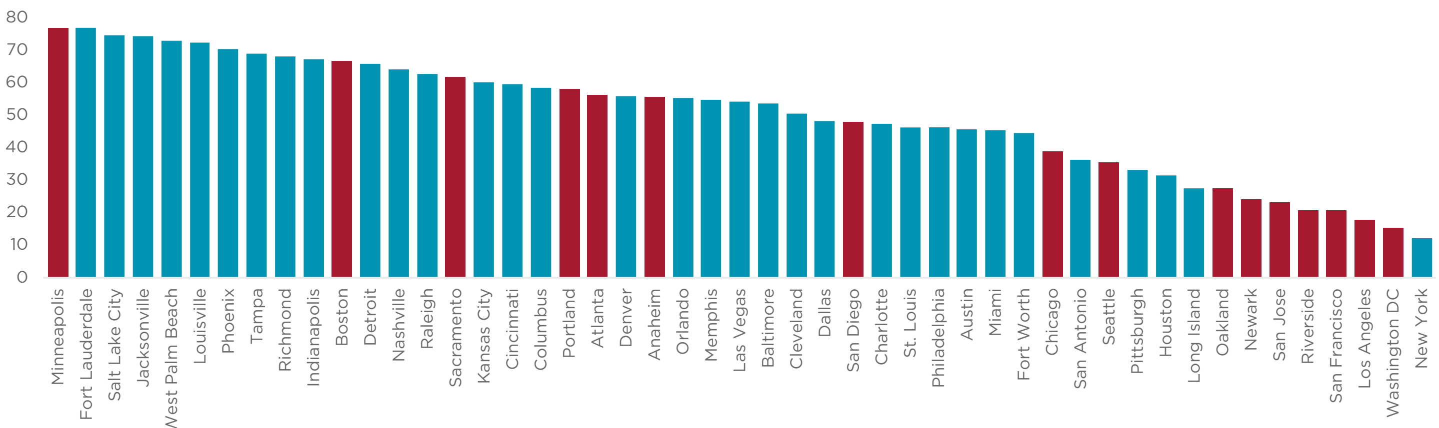
the latter group, this difference would not be enough to account for the discrepancies, but it is consistent with the observation within the Census Bureau data that 73% of delinquent renters earn less than $50,000 a year. Cushman & Wakefield asset services data corroborates this point as Class C delinquencies have risen most significantly and have been slower to normalize, though they too have been improving.

In conclusion, delinquency and therefore the risk of an eviction wave coursing through the professionally-managed, let alone the institutional grade multifamily markets, is highly unlikely to occur either now or in the future. Moreover, the risk of this is declining daily as labor markets across the country continue to recover. The risk is notably higher for lower quality properties including the small landlord sector. This risk, however, is further mitigated by the continued rollout of emergency rental assistance programs (ERA 1 and 2). These programs have a combined $46.5 billion in funds available to tenants making less than 80% of their area's median income—the vast majority of delinquent households—and can be used to pay rental expenses in arrears as well as several months of prospective rent in the case of ERA 2.[6] Moody's Analytics conservatively estimates that delinquent households owed $23.9 billion in back rent in June 2021, so these funds are more than enough. The problem facing renters and their landlords has been slow rollout at the state and local levels. Less than 7% ($3 billion) of the rental assistance available via both ERA programs has been awarded to renters through June 2021[7] and 40% of multifamily small-scale owners were unaware of the rental assistance as of May 2021.[8] Fortunately, disbursements are ramping up rapidly now and most state programs either require or heavily encourage landlords not to evict in exchange for participating in these programs. Realistically, these programs represent the only way for these landlords to be made whole in the case of the more financially distressed renters. The implication is that even where delinquencies are elevated, landlords have strong incentives not to suddenly evict every delinquent renter.

Notwithstanding the above, evictions are bound to increase after the moratorium is lifted, and not all markets will be impacted equally. Several states have enacted their own moratoria with varying expiration timelines in order from nearest to latest termination date as of the date of this report:[9] Hawaii, Illinois, and Maryland (early August 2021); New York (end of August 2021); Minnesota (mid-September for renters ineligible for federal assistance); California and Washington (end of September 2021); Delaware, Washington, DC, and New Mexico (until end of emergency is declared); and New Jersey (two months after end of emergency is declared). In order to assess market resilience to eviction, we developed a simple model, consisting of:

- Unemployment rate (lower is better) (25%)
- Census Bureau Pulse Survey delinquency percentage, using state or metro level as available (lower is better) (25%)
- Change in Class C effective rent per square foot since February 2020 (higher is better) (25%)
- June 2021 Class C occupancy rate (higher is better) (25%)

EVICTION RESILIENCE INDEX (0 TO 100)



Source: Census Bureau Household Pulse, Bureau of Labor Statistics, Axiometrics, Cushman & Wakefield Research
**Red highlighted markets have in place local eviction moratoria*

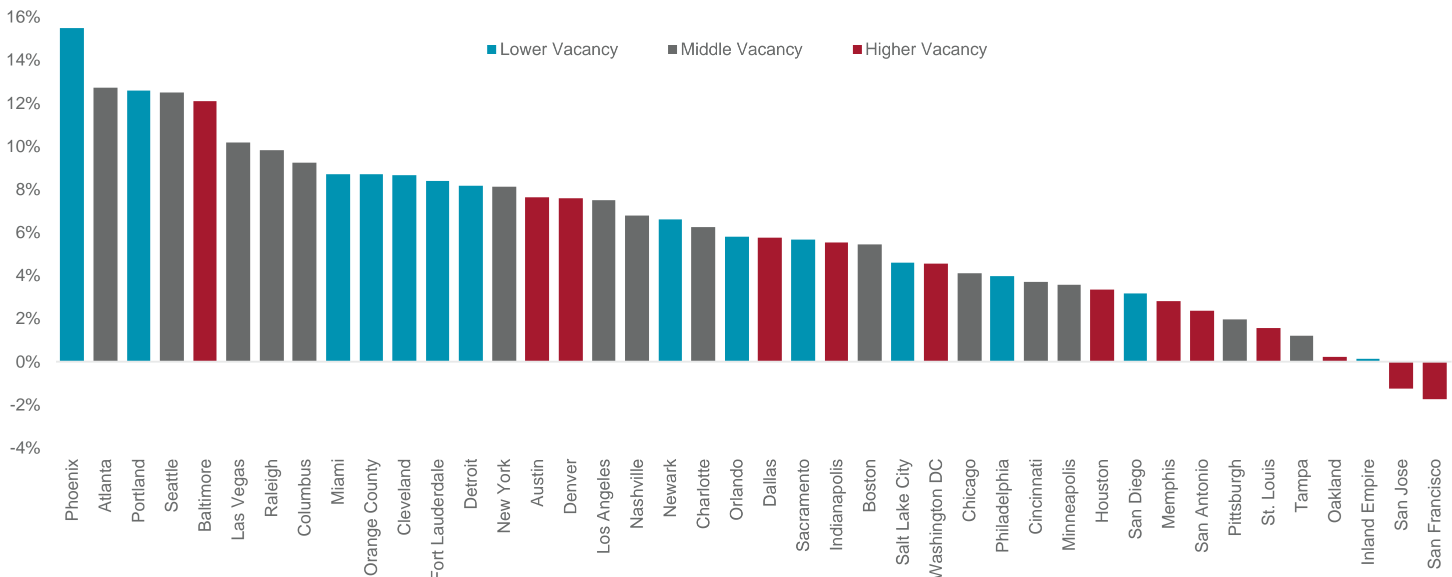
6 U.S. Department of the Treasury; https://home.treasury.gov/policy-issues/coronavirus/assistance-for-state-local-and-tribal-governments/emergency-rental-assistance-program
7 U.S. Department of the Treasury; https://home.treasury.gov/news/press-releases/jy0284
8 Urban Institute, https://www.urban.org/urban-wire/just-month-left-eviction-moratorium-many-mom-and-pop-landlords-and-tenants-are-still-unaware-federal-rental-assistance
9 https://www.nolo.com/evictions-ban

Many of the markets with the greatest eviction risk have in place local moratoria (see red highlighted markets). The most resilient markets consist mostly of fast-growing Sunbelt (Ft. Lauderdale / West Palm Beach, Phoenix, Tampa) and steady Midwest markets (Minneapolis, Louisville, Indianapolis).

HOW TO PLAY IT

The end of the eviction and foreclosure moratoria are unlikely to have significant impacts on the institutional-grade multifamily investment market, particularly for higher quality product and/or in markets with more complete labor market recoveries. Class C properties in less recovered markets and submarkets face greater exposure. On the one hand, this means that owners will have renewed freedom of action. On the other, were there to be a significant increase in turnover in the market as a result of increased evictions, occupancies would fall, likely resulting in a decline in rents. The incentives for evictions are twofold: 1) the obvious, the renter is not paying and 2) Class C rents have risen broadly compared to pre-pandemic. To illustrate, new lease rates among Class C properties in June 2021 were on average 5.9 percentage points higher than renewal rates in June 2020 according to RealPage data. New lease trade-out premia are highest in low and moderate vacancy markets as illustrated in the figure below. Phoenix, Atlanta, Portland, Seattle and Baltimore all have new lease premia compared to renewal trade-outs 10 percentage points. Meanwhile, San Jose and San Francisco are the only markets were the increases in Class C rents upon renewal are higher than those on a new lease.

CLASS C NEW LEASE VS. RENEWAL TRADE-OUT PREMIUM



Source: Realpage, Cushman & Wakefield Research

Note: Lower vacancy refers to markets with vacancy rates in the bottom third, middle in the middle third and higher in the top third, respectively as of June 2021.

The catch is that in pursuing these new rents, landlords will likely find it more difficult to recoup rent in arrears that, with additional patience, can be obtained through state and local ERA programs. In assessing the tradeoff here, landlords should pay attention to the exact implementations of ERA programs in their jurisdictions, particularly to what extent they can negotiate short-term lease extensions while still participating. In most cases, patience will be the best course. Moody's Analytics estimates that the average rental arrears is equal to 2.9 months' rent. For a new 12-month lease to make up for the loss of those rental arrears, the new rent would need to be 25% higher than the in-place lease. Ironically, the incentive increases with the extent that the renter is more behind, though this is partially offset by the higher likelihood that such a tenant would fall into arrears again.

As so often happens in commercial real estate, property-by-property and tenant-by-tenant strategy will depend on specific considerations, but the balancing equation will consist of the same elements in each case: 1) what is the risk of foregone rental arrears, 2) what is the potential lease trade-out premium and 3) how strong is the labor market as a proxy for the risk of future delinquency. Investors keen on working through these tradeoffs may find opportunities acquiring properties with significant rental arrears and taking over rent receivables with the property.

More broadly, the end of the eviction and foreclosure moratoria will have little impact on the wide-ranging factors driving returns to multifamily investors. The multifamily sector has several strong years of fundamentals ahead of it. This is particularly true for the lower-to-middle end of the market given strong demographic forces and ongoing shortages in housing in this segment.[10] Geographically, continued strong migration to Sunbelt markets—if anything, enhanced by the pandemic—will drive rents and occupancies. Suburban submarkets have outperformed across most markets in the last year, but urban core counties are recovering at an accelerating rate in recent months, a topic we explore in detail in a forthcoming piece. These forces will drive cash flow performance across the sector, supporting valuations and attracting new capital to the multifamily sector.

10 Freddie Mac estimates that there is a housing supply deficit of 3.8 million units as of Q4 2020; http://www.freddiemac.com/fmac-resources/research/pdf/202105-Note-Housing_Supply-08.pdf

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