**Some of us have always wanted to be apartment owners, a past profitable investment for many people, but now it doesn’t sound like a great investment, especially when the investor incurs debt.**

**News for Apartment Owners, spiking interest rates have become a financial nightmare to recent apartment investors.**

**With borrowing costs doubling, rent growth slowing and building expenses rising, this past profitable investment is now a tenuous pursuit.**

**As interest rates have recently increased so quickly, declining building values have forced landlords to refinance at much higher rates.**

**Reportedly multifamily-building owners in cities like Los Angeles, Houston and San Francisco have defaulted on loans against thousands of apartments**

**Few apartment investors anticipated that interest rates could rise so quickly, deflating building values and pressuring landlords to refinance at much higher rates. Regional banks, a crucial source of funding, are lending far less today, making it harder to refinance mortgages.**

**Also, inflation and growing insurance premiums have increased the cost of running buildings.**

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**Apartment Landlords Face Peril As Their Debt Costs Skyrocket**

**BY KONRAD PUTZIER AND WILL PARKER, *The Wall Street Journal* | Page A001, 8 August 2023**

**Apartment buildings, long considered a real-estate haven, are emerging as the next major trouble spot in the beleaguered commercial-property world.**

Investors bid up the prices of multifamily buildings for years, attracted by steadily rising rents and the prospect of outsize returns. Many took on too much debt, expecting they could raise rents fast enough to pay it down.

Unlike office buildings and malls, which have been hit hard by remote work and e-commerce, rental apartments have low vacancy rates. **The apartment sector’s main problem isn’t a lack of demand— rents have soared since 2020— it is interest rates.**

The sudden surge in debt costs last year now threatens to wipe out many multifamily owners across the country. Apartment-building values fell 14% for the year ended in June after rising 25% the previous year, according to data company CoStar. That drop is about the same as the fall in office values.

Mortgage delinquencies in the multifamily category are low but increasing. Borrowing costs have doubled, rent growth is slowing and building expenses are rising. Data provider Trepp earlier this year identified one type of rental-apartment debt as accounting for a large share of the commercial mortgages at risk of default.

Apartment landlords face a “hydrogen-bomb scenario,” said Peter Sotoloff, a veteran real-estate finance executive, a former founding member of Blackstone’s property debt business and former managing partner at Mack Real Estate Credit Strategies.

Outstanding multifamily mortgages more than doubled over the past decade to about $2 trillion, according to the Mortgage Bankers Association. That is nearly twice the amount of office debt, according to Trepp. The data provider adds that $980.7 billion in multifamily debt is set to come due between 2023 and 2027.

“Everyone is focused on office,” Sotoloff said. The risk of apartment defaults, he said, “is a really big issue that is not getting the attention it deserves.”

**Multifamily-building owners in Los Angeles, Houston and San Francisco have defaulted on loans against thousands of apartments.** Blackstone, the world’s largest alternative-asset manager, is in special servicing on mortgages related to 11 Manhattan apartment buildings, according to a person familiar with the matter A spokeswoman for Blackstone said the buildings have unique issues and are “not representative of the strength we’re seeing in our broader rental-housing portfolio.”

Apartment buildings have a reputation as a lower-risk commercial real-estate investment. They have performed relatively well even at times of recession, including during the 2008-2009 financial crisis when the housing market crashed. People always need a place to live, and during times of crisis former homeowners would flood into the rental market.

Inflation also allowed landlords to raise rents higher than usual, which boosted the values of their buildings. Asking rents rose 25% over 18 months spanning 2021 and 2022, according to rentals website Apartment List.

To many investors, these factors justified paying high prices. Apartment-building owners often borrowed more than 80% of the building value from bond markets. Most apartment loans are fixed-rate, long-term mortgages. During the pandemic, however, investors took out more shorter-term, floating-rate loans.

Many of these investors raised rents aggressively, betting that they could sell the buildings or refinance their debt at much higher valuations once their buildings generated higher rental income.

**But** **few anticipated that interest rates could rise so quickly, pushing down building values and forcing landlords to refinance at much higher rates**. Regional banks, a crucial source of funding, are lending far less today, making it harder to refinance mortgages. Rent growth has slowed sharply in many U.S. cities, while inflation and growing insurance premiums have raised the cost of running buildings.

A new crop of private real-estate firms, funded mostly by floating-rate debt and small-investor cash, have become bigger competitors in the multifamily market. Some paid higher prices based on rosy expectations of steep rent increases for years to come. Now, they are having trouble making the numbers work.

Los Angeles-based Tides Equities has acquired more than $6.5 billion in rental property since 2016, mostly lower- and middle-income apartment buildings in Southwestern cities. In 2021, at a property in a Dallas suburb, the company expected to push up rents 44% over the course of three years, ratings-agency reports show. In June, Tides told investors the strategy wasn’t going as planned. Renters were “becoming too tight on cash,” the company said in a letter. Some properties were no longer earning enough money to cover debt payments, and investors would likely need to put in more money to save buildings from default, the letter said.

In an interview, Tides’s cofounders Sean Kia and Ryan Andrade said they were working with lenders on ways to avoid default at properties that faced difficulties.

Houston-based Nitya Capital, owner of about $3 billion of multifamily buildings, notified investors in March that it was slashing profit expectations because of steeper interest rates.

“We are essentially paying the higher mortgage costs instead of making cash distributions,” Nitya Chief Executive Swapnil Agarwal wrote in an investor letter.

Apartment landlords still have reasons for optimism. Fannie Mae and Freddie Mac offer a reliable source of government-backed lending even as banks retreat. Most analysts expect housing shortages, and high rents, to persist. If interest rates come down, property prices could bounce back quickly. Multifamily owners with fixed-rate mortgages are better positioned to ride out any near-term turbulence.

Still, other threats are mounting. The unusually high number of new apartment opening this year and next poses a supply concern.

Further, apartment-building values are more vulnerable to higher rates than their commercial counterparts because they are closely tied to the price of 10-year Treasury notes, which plunged as rates rose, said Chad Littell, CoStar’s national director of capital-markets analytics.

Even some veteran real-estate investors that weathered past storms look vulnerable. Veritas Investments, one of San Francisco’s largest landlords, and partners defaulted on debt backing 95 rental buildings during the past year. It stands to lose more than one-third of its San Francisco portfolio as a result.

“The multifamily real-estate sector is facing many of the same financial challenges as have been reported on for other asset classes including office, retail and hotel-hospitality,” the company said earlier this year.