Cap Rates Equalizing Across Metros

Even in cities like San Francisco and New York where they've typically hovered much lower.

By Lynn Pollack

Cap rates across major US markets are becoming increasingly similar, even in cities like San Francisco and New York where they've typically hovered much lower than in other major cities.

According to a new analysis from Moody's Analytics CRE, the average underwritten multifamily cap rates for cities like Dallas, Atlanta, Houston, Austin, Nashville, and Miami have been trending closer to New York's over the past decade. But while the average cap rate spread for those markets was between 100 and 200 basis points higher for the first part of the past decade, it has narrowed to less than 100 basis points for all markets except Houston.

The analysis reviewed CMBS data from Moody's Analytics Structured Finance group tracking cap rates by property type over time to better gauge how investors have viewed cities across the South and West, which have benefited from strong in-migration, relative to markets like New York, San Francisco, and Boston. And it found that "investors view these markets as less risky today and are willing to accept a lower rate of return," the analysis from Blake Coules and Jeffrey Havsy notes. "Clearly, the migration from New York and San Francisco to these southern markets is one of the key drivers. The migration is fueled by societal changes, such as the acceptance of remote working arrangements, as well as structural changes, such as higher taxes in New York and San Francisco."

Under these circumstances, owners and investors have at least two options: "refinance to potentially repatriate expensive equity," according to Coules and Havsy, or "sell under the assumption that cap rates, at this level, aren't sustainable i.e., the asset has reached its' peak value with a stabilized NOI.

And "if you are a banker: you are watching this and trying to determine if these cap rates are sustainable," the pair write. "If they are, from a loan to value basis, there is real opportunity to get more of your bank's money out earning additional rate and fees on an asset and with a customer you should know well. From a loan to cost basis, you are looking to see if net operating income increases are keeping up with interest rate hikes."