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Multifamily housing starts plummet amid higher financing costs

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Multifamily housing starts plummeted in West Michigan last year at a rate far worse than national declines, a trend local experts attribute largely to higher borrowing costs.

Data provided to *Crain’s Grand Rapids Business* by Grand Rapids-based NAI Wisinski Great Lakes showed only 2,925 units of new multifamily housing under construction in West Michigan during the second half of 2023, a 43% drop from the 5,212 units during the same period a year earlier.

NAI’s reports — which are assembled using data from CoStar Group Inc., local public meeting minutes and media reports — consider multifamily housing starts as developments of five or more units in the Grand Rapids, Kalamazoo, Battle Creek, Lansing and Lakeshore markets. NAI defines the Lakeshore territory as the Lake Michigan shoreline from Benton Harbor to Muskegon.

The local decline in housing starts far exceeds the national average. A Feb. 27 report from the National Association of Home Builders showed multifamily starts totaled 472,000 units in 2023, down 14% compared to the previous year. The NAHB predicts multifamily starts will fall 20% in 2024 to a total of 379,000 units.

“Tight lending conditions and the high cost of development loans continue to hinder additional multifamily housing production,” Danushka Nanayakkara-Skillington, NAHB’s assistant vice president for forecasting and analysis, said at a press conference on the organization’s report last week.

Kevin O'Reilly, director of multifamily investment sales for NAI Great Lakes, attended the 2024 National Multifamily Housing Council annual meeting Jan. 30 in San Diego and heard from presenters that higher interest rates on debt financing is one of the leading factors depressing housing starts in most markets across the U.S.

Because "soft costs," like architecture and engineering firm fees and the cost of performing wetland surveys, are "at least 30% more expensive than 18 months ago," and building materials costs are still growing, O'Reilly said it's no wonder developers are reporting reduced viability for multifamily projects.

"It's a perfect storm in many respects for a slowdown … and the primary reason is the cost of financing," O'Reilly said.

Much like the NAHB, O'Reilly said he expects to see an even slower year for new multifamily starts in West Michigan in 2024, since many of the projects he's aware of that broke ground last year locked in their interest rates in 2022, before the Federal Reserve completed a series of 11 rate hikes to slow inflation.

"I think in the backside of this year, maybe Q3, Q4, we're going to see enough rate cuts to justify development again," O'Reilly said, though he added it can be tricky to predict the Fed's monetary policy when so many economic factors drive the decision-making.

Cella Building Company broke ground last fall on the 58-unit Wealthy & Sheldon Lofts project at 415 Sheldon Ave. SE in Grand Rapids. Credit: Courtesy of Mike Coyne

Developers get creative

Apartment developers across West Michigan have repeatedly cited financing and construction costs as the biggest barriers slowing their projects.

Third Coast Development Partner Dave Levitt told Crain's Grand Rapids in January that both factors are stalling plans for a 39-unit "attainable" housing project at a former union hall at 916 Benjamin Ave. NE.

Similarly, Honor Construction CEO and Victory Development Group partner Brad Laackman said in December that Victory's plan to break ground this summer on the planned 250-unit Victory on Celebration project was delayed as the developers continued to run into challenges assembling the financing pro forma.

Mike Coyne, CEO of Grand Rapids-based Cella Building Company, said his firm went through “a lot of different generations of the capital stack” for the 58-unit Wealthy & Sheldon Lofts project that broke ground last fall at 415 Sheldon Ave. SE in Grand Rapids. The firm secured a mix of state and local incentives to help defray costs, but it also looked to “nontraditional players” like private equity, Coyne said.

“For the most part, a lot of those (players) were people who were asking just too much, be it in equity or in a preferred return or those types of things,” he said. “What we eventually did, though, is we increased our equity with some outside investors with a preferred return that was much more acceptable to us, which brought down the amount of financing we would need to a much more reasonable level.”

Ryan Talbot, owner of Birmingham-based Talbot Development LLC, is the developer behind the 72-unit apartment project The Current that broke ground last fall at 220 Quimby St. NE in Grand Rapids’ Creston neighborhood.

Talbot secured a $2.65 million Michigan Community Revitalization Program loan, $367,680 in brownfield tax increment financing incentives from the state and a 15-year Neighborhood Enterprise Zone tax abatement for the project from the city, all of which brought the debt service coverage ratio down to an acceptable level for Lake Michigan Credit Union to issue a construction loan, he said.

“I have to give the lender a lot of credit,” Talbot said. “Lake Michigan Credit Union was very partnership-oriented. They were willing to work with me and dig into the numbers and find a way to make everything work and still stay within very reasonable lending parameters.”

Victory Development Group plans 240 apartments with 10,000 square feet of retail at the last developable parcel in Grand Rapids’ Celebration Village. Credit: Victory Development Group

Less lending competition

While regional and national banks have pulled back on lending or tightened their standards, some community banks remain eager to do business with multifamily developers.

Mercantile Bank is one such example. Mike Bishop, senior vice president and commercial banking group manager, said Mercantile's commercial lending for multifamily construction increased from $110 million in 2022 to $320 million in 2023, an increase of $210 million, or 190% year over year.

As well, the bank created a new subsidiary, Mercantile Community Partners, last June to finance affordable housing projects.

"If you talk to developers in West Michigan, you will hear there's less competition for construction lending," Bishop said. "That is a sentiment that I find true. Some of the larger players have certainly reduced their appetite for new construction lending … so you're left with community banks, generally speaking, trying to fill that gap."

He said besides tighter federal regulations in the wake of a few bank failures, like Silicon Valley Bank in March 2023, one reason larger regional and national banks have had to pull back on multifamily lending is that their commercial loan portfolios are distressed because of troubled office real estate assets.

"If you're taking losses on a lending portfolio, and commercial real estate happens to be on the office side, that's going to have an impact on a bank's particular appetite to do multifamily as well," he said.

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