



## Multifamily Market Commentary – January 2019

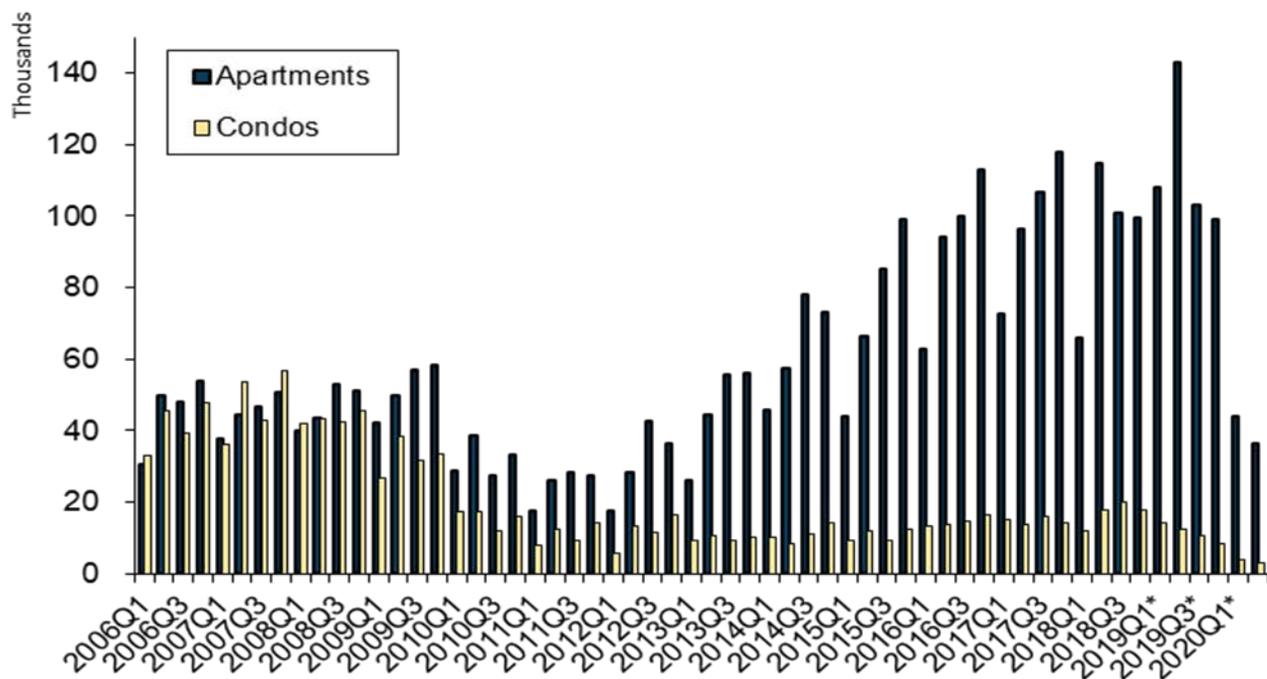
### 2019 Multifamily Market Outlook – Keeping an Eye on Supply

The U.S. multifamily sector has had a solid run since 2010, with increasing rent growth and low vacancies. Key fundamentals have propelled the multifamily sector over the past few years: favorable demographic trends, positive job growth, and continued renter household formations. Since many multifamily renters tend to be Millennials (those born between 1982 and 2000), and they are the nation’s largest population cohort, outnumbering even the Baby Boomers, according to the Census Bureau, Millennials are expected to continue driving demand for housing, especially multifamily rental housing, over the next few years.

#### Multifamily New Supply Expected to Peak in 2019

As seen in the chart below, the amount of multifamily new construction remains elevated, with deliveries expected to reach their peak in 2019. According to the Dodge Data & Analytics Supply Track data – which distinguishes between multifamily properties consisting of either apartment or condominium units – about 394,000 apartment units were completed in 2017, another 381,000 units or so are estimated to have been completed in 2018, and another 453,000 are expected in 2019. By comparison, roughly 59,000 condo units came online in 2017, with another 67,000 condo units estimated to have been completed in 2018, and only 46,000 condo units or so expected in 2019.

#### Multifamily New Construction



NOTE: Supply Track data is not an actual forecast of activity; it is a monitor of activity reported to date. As more projects are planned and tracked, figures in future periods might go up.

Source: Dodge Data & Analytics, January 2019 – Metros with 5,000 or more units underway or completed.

\*Anticipated delivery date.

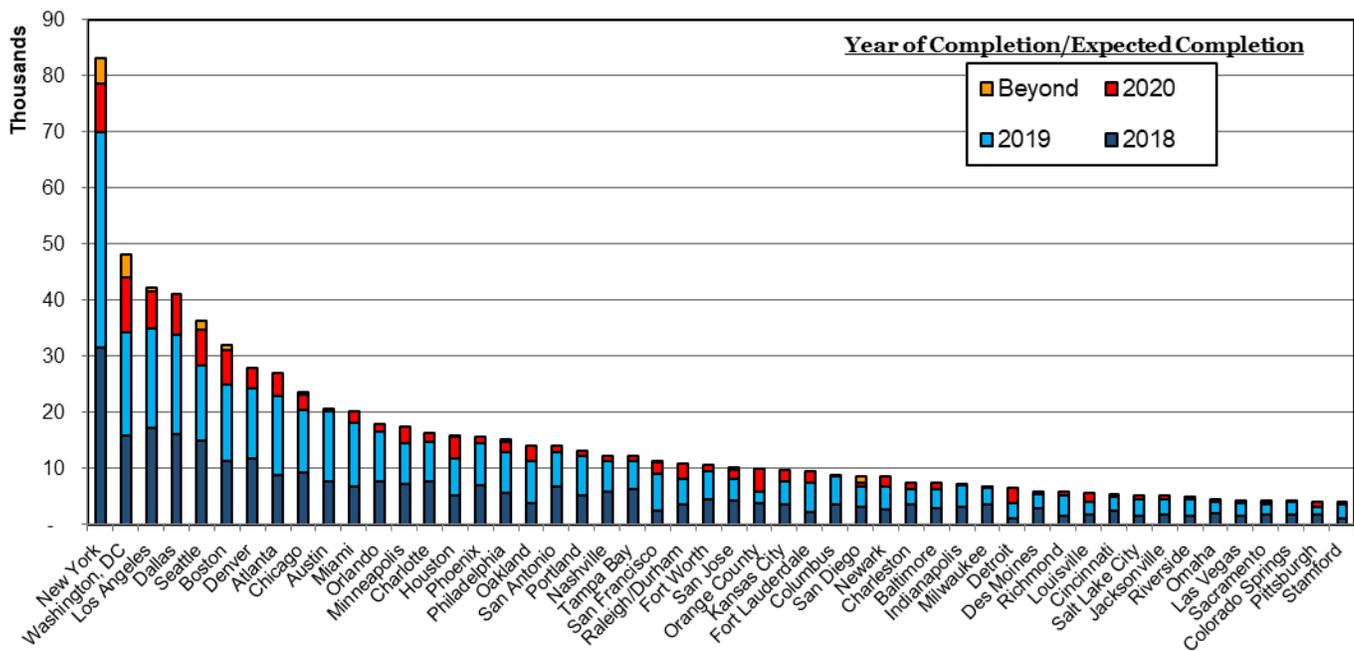


## Multifamily Supply Peaks Just as Job Growth Slows

At a national level, that amount of new multifamily units being added to the existing stock is expected to peak in 2019 just as job growth is expected to slow down, which in turn, is likely to dampen demand. Job growth is expected to be at 1.0 percent in 2019, according to Fannie Mae’s forecast, which would produce just 1.5 million new jobs. Based on that amount of job growth, multifamily rental demand theoretically could be in the range of between 250,000 units to as high as 370,000 units, just as more than 450,000 units are expected to complete and come online this year. As seen in the chart above, much of that new supply is expected to deliver earlier in the year, when job growth is expected to be slightly more robust than later in the year.

Nevertheless, much of the new supply is primarily concentrated in about 10 to 12 metros, as seen in the chart below, and most of that is further concentrated in certain submarkets. Additionally, the estimated amount of job growth, and its anticipated demand, differs widely metro by metro, meaning that some metros will be winners and some losers in terms of multifamily demand over the next 12 to 18 months.

## Multifamily Apartment Units Underway – Select Metros



Source: Dodge Data & Analytics, January 2019 – Metros with 4,000 or more units underway or completed.

NOTE: Supply Track data is not an actual forecast of activity, it is a monitor of activity reported on to-date. As more projects are planned and tracked, figures in future periods might go up.



## Metros with Possible Oversupply

Although the nation is expected to see positive job growth this year, it doesn't mean that all metros will experience the same level of employment growth, as illustrated in the two charts on the next page. Although Fannie Mae's forecast for 2019 is anticipating a national employment growth rate of just 1.0 percent, there are several metros that may be below the national estimate, including Boston, Chicago, and New York. And these are all metros with a large amount of new multifamily rental supply on the horizon, as seen in the chart on previous page.

The New York metro is expecting the largest amount of new supply, with more than 52,000 units underway, of which 38,000 units are expected to deliver this year alone. Based on Moody's Analytics' anticipated job growth rate of just 0.9 percent, conservatively the metro could produce demand for only about 21,000 multifamily rental units. Boston has nearly 21,000 multifamily units underway, of which nearly 14,000 units are expected to deliver in 2019. Based on Moody's anticipated job growth rate of just 1.1 percent, potential multifamily demand of about 9,500 units will fall short of upcoming supply. Chicago has more than 11,000 units expected to come online this year, yet job growth of 1.0 percent will conservatively produce demand for only about 9,500 units. In fact, these three metros have already been experiencing rising vacancy levels and negative rent growth in class A units over the past few months, according to data from RealPage, Inc.

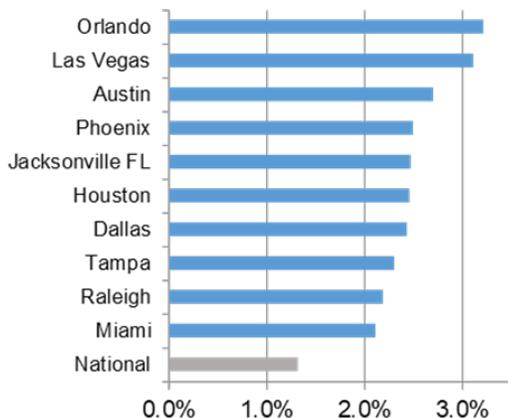
## Other Metros Possibly Undersupplied

Job growth in other metros is expected to fare better, as seen below. Similar to 2018, some of the Florida metros – including Orlando, Jacksonville, Tampa, and Miami – are expected to surpass the national employment growth average, as seen below. Dallas and Austin are expected to see job growth of more than 2.0 percent due to a continued expansion in the professional services, technology, healthcare, and transportation sectors.

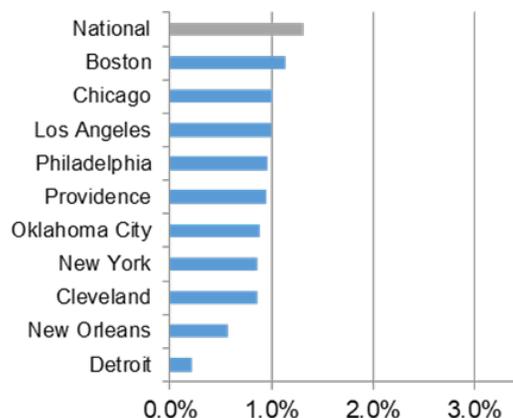
While some of the Florida metros have seen an increase in supply, based on the amount of expected job growth in metros such as Orlando and, to a lesser extent, Jacksonville, supply and demand are somewhat in balance looking ahead over the next 12 to 18 months. Miami is not one of these metros, however, with more than 11,000 new units expected this year but anticipated job growth will likely produce demand for only about 5,100 units. One offsetting factor is that Miami does attract international investment and is not as dependent upon job growth for housing demand as are other Florida metros.

On the other hand, Las Vegas is likely to be undersupplied. With Moody's expecting job growth of 3.1 percent in the area, there could be demand for at least 6,500 units, yet only about 2,200 units are expected to come online in 2019. Phoenix is another "winner" with anticipated job growth of 2.5 percent. That could produce demand for nearly 11,000 multifamily units, yet only about 7,400 units are expected this year.

**Select Markets with Higher Expected 2019 Employment Growth**



**Select Markets with Lower Expected 2019 Employment Growth**



Source: Moody's Analytics

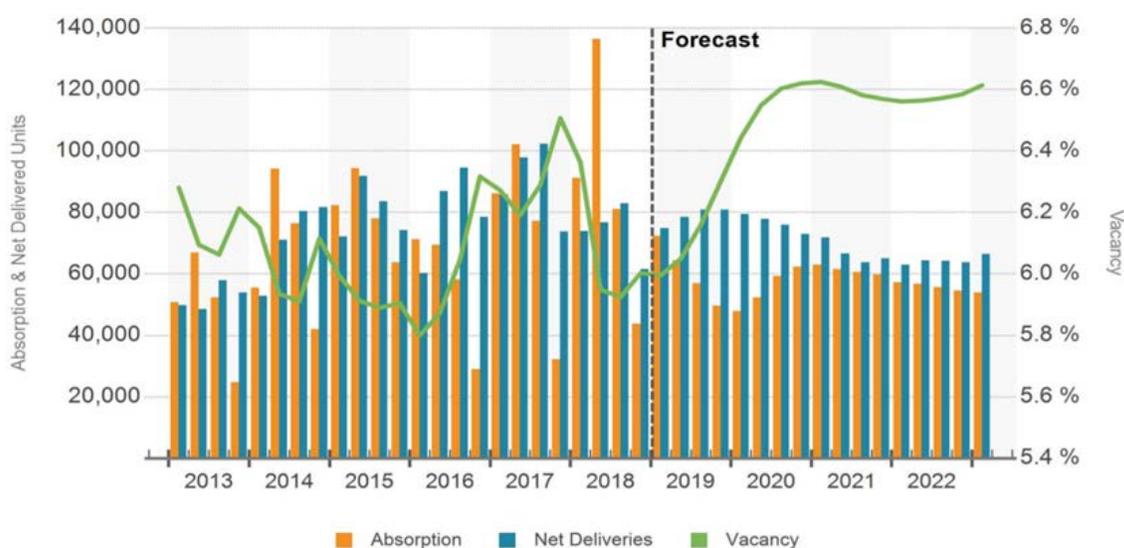


## Demand Expected to Continue

Demand remained positive in 2018 but it was not evenly dispersed. Some of the nation's major metros experienced slower rent growth and rising vacancies due to an oversupply of newly delivered class A units. In 2019, the national vacancy rate is expected to increase slightly, and while rent growth will remain positive it is expected to grow at a more modest pace. Nevertheless, the outlook for the national multifamily sector in 2019 is expected to be similar to 2018, with the sector likely seeing increasing vacancies, but also increasing rent growth.

## Forecasted National Multifamily Trends

ABSORPTION, NET DELIVERIES & VACANCY



Source: CoStar

## Net Absorption Expected to Remain Positive

Demand for multifamily rental units remained positive throughout 2018. Net absorption likely totaled about 350,000 units absorbed, according to data from CoStar. Expect net absorption in 2019 to remain positive, although at a lower level than last year, possibly falling to about 245,000 units absorbed, according to CoStar. Net absorption is expected to soften beginning later this year, but remain positive, as seen in the chart above.

## Vacancy Level Expected to Increase Modestly

The national multifamily vacancy rate is expected to rise in 2019, primarily due to the amount of new supply expected to complete and come online during the year. Since much of this new supply is concentrated in a limited number of submarkets in only about 10 metros, supply is expected to outpace demand in these metros, thereby pushing the national vacancy rate upward, as illustrated in the chart above. The vacancy rate is expected to return to more historical levels and then remain fairly stable further out into the forecast, due to ongoing favorable future job growth and demographic projections.

Indeed, the Fannie Mae Multifamily Economic and Market Research team is anticipating that the U.S. multifamily vacancy rate will remain in the 5.5 percent to 5.75 percent range during the early part of 2019 and could end the year at or near 6.0 percent. This would bring the national vacancy rate back to its recent historical average of 6.0 percent.



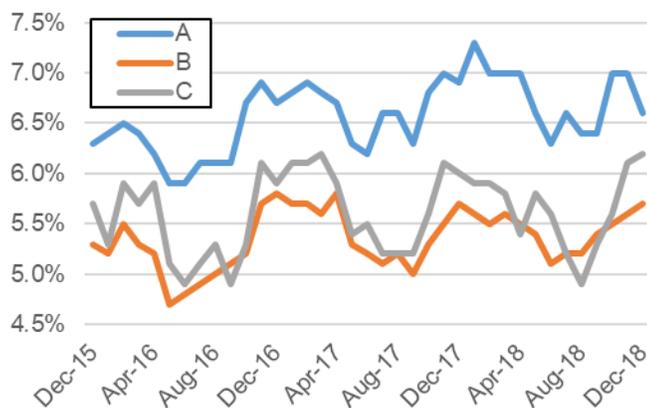
## Rent Growth Expected to Remain Fairly Stable

Rent growth was positive and likely ended 2018 at about 2.75 percent, which not only outpaced the rate of inflation, which was at 2.2 percent as of the end of November 2018, but was also higher than 2017's estimated national rental increase of 2.5 percent. There has been above-average rent growth since 2011, but it has only been since 2017 that estimated rent growth has been staying below 3.0 percent. The expectation for 2019 is that rent growth will once again be positive but may be slightly lower, in the range of 2.0 percent to 2.5 percent.

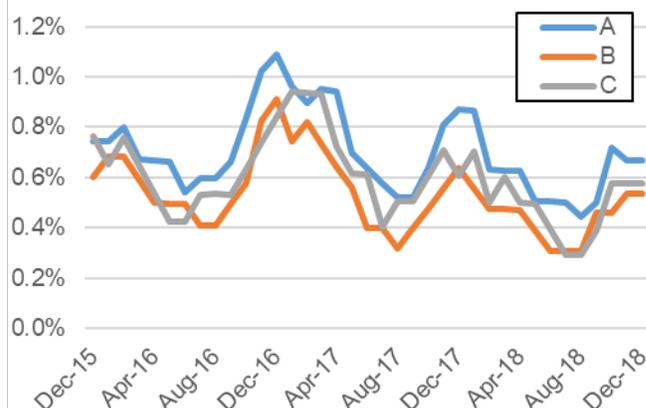
As seen in the chart below, the rates for national multifamily concessions for all property classes and averaged across all units, including those not offering concessions, remain at low levels. Class A concession levels remain higher than for class B and C units, indicating that property owners are likely offering more generous concessions up front for newer class A units to lock in higher asking rent levels. For those class A units offering concessions, the average concession rate ended the year at 6.6 percent, as seen in the chart below right, which is slightly more than three weeks of free rent. And it was fewer than three weeks of free rent for those properties offering concessions on class B and C units, at 5.7 percent and 6.2 percent, respectively, at year end 2018.

## National Multifamily Concession Rate by Class

### Properties Offering Concessions



### All Property Average

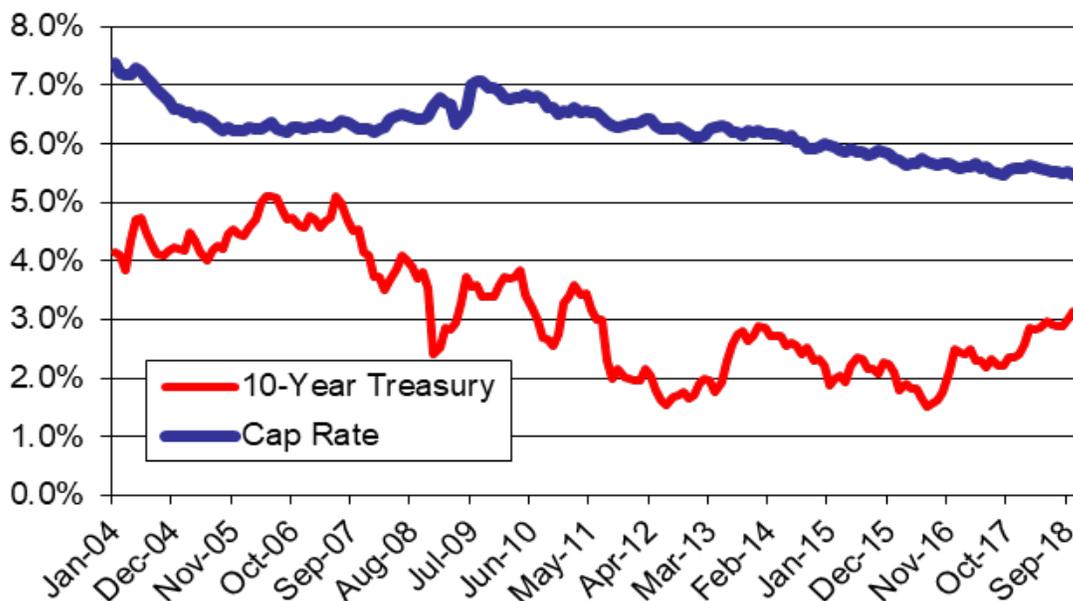


Source: RealPage, Inc.

In addition, national class C rent growth in 2018 was at 3.0 percent according to RealPage, Inc., just slightly lower than 3.3 percent for class A; but both are below class B's estimated 3.6 percent, suggesting that slightly less expensive units remain in demand, hence class B's lower concession rates. As more and more new supply comes online this year, the national concession rate is expected to increase, and likely rise more dramatically in certain metros that are expecting an onslaught of new class A units in 2019.



## Treasuries and Multifamily Capitalization Rates



Source: Real Capital Analytics, and Federal Reserve, Selected Interest Rates H.15, per Moody's Analytics

### Multifamily Investors Remain Bullish

Despite the increase in interest rates over the past few months, investors are convinced of both the current and future upside value in owning multifamily properties, keeping cap rates low. Multifamily cap rates have remained in the mid- to low-5.0 percent range over the past two years due to the ongoing influx of capital flows and investor demand for properties. And it seems these factors are expected to continue into 2019.

According to an article in National Real Estate Investor (November 26, 2018), the results of a recent NREI survey confirm that market participants are viewing the multifamily sector only slightly less positively than in previous years and expect lending and investment conditions to remain favorable. Indeed, survey respondents ranked the attractiveness of the multifamily sector in 2018 as one of the highest with a mean score of 7.7 (on a scale of 1 to 10), which is down only slightly from 2014's multifamily mean rating of 8.0. Even more revealing, 41.0 percent of survey respondents stated that they planned to buy more multifamily properties over the coming 12 months, with another 44.0 percent stating that they planned to hold on to their multifamily assets. Only 14.0 percent stated they planned to sell their multifamily properties.

Because of this anticipated investor interest, and despite elevated levels of new supply delivering over the next 12 to 18 months, investment in existing multifamily properties is expected to remain similar to 2018 levels. With multifamily cap rates remaining at low levels – currently at 5.4 percent, which is down from 5.6 percent at the end of 2017, according to Real Capital Analytics – it seems unlikely that cap rates will compress any further. But that doesn't mean that they will skyrocket either. The expectation is that national multifamily cap rates will increase only slightly in 2019, but likely staying below 6.0 percent.

### 2019 Outlook: Keeping an Eye on Supply

The outlook for the multifamily sector in 2019 remains positive but the headwinds of supply in many metros cannot be ignored. Nevertheless, based on anticipated investor demand, available liquidity, and construction projects whose loans should convert to permanent financing throughout this year, multifamily mortgage origination volume levels are expected to remain very similar to, if not higher than, 2018's activity level. The Mortgage Bankers Association is anticipating



multifamily originations volume will have reached \$302 billion in 2018 and is even more optimistic with a forecast of \$309 billion for 2019.

The amount of new supply expected to come online this year is mostly located in 10 metros, some of which are likely to experience a slowdown in demand due to slowing job growth. With fewer new jobs, household formations will likely slow as well, tamping down demand for this concentrated amount of supply – consisting primarily of class A units – causing a disruption in underlying fundamentals in certain metros. This will likely lead to rising vacancy levels and reduced or negative rent growth in certain submarkets. It is important to keep in mind that this slowdown is not expected to be prolonged since, at a national level, there continues to be a shortage of apartments, particularly affordable rentals. Rent growth has been outpacing inflation for several years now and the national vacancy rate remains well below its longer-term average of 6.0 percent. Both factors are the result of the nation's ongoing supply/demand imbalance in many places, and are placing stress on the supply of affordable housing.

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