



## Multifamily Market Commentary – August 2018

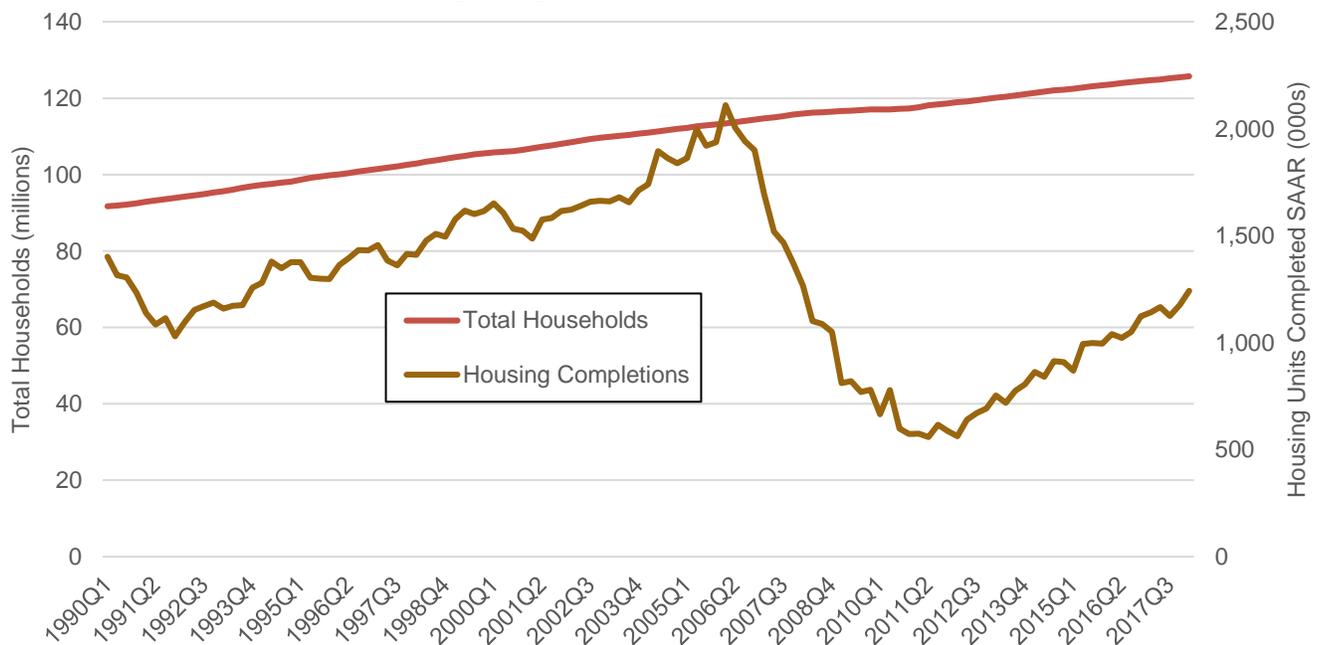
### A Lingering Housing Shortage

With multifamily rent levels continuing to grow to historic highs and multifamily construction on the rise in many of the country’s major metros, valid concerns exist about potential overbuilding or overvaluation within the multifamily sector. However, a closer look at demographic and housing development data suggests that multifamily rents and single-family home prices have been rising over the past several years primarily as a result of increasing demand stemming from a growing population and steady job market, coupled with limited housing supply.

Between 1990 and 2006, approximately 1.5 million housing units were completed each year, while approximately 1.4 million new households were formed annually, as seen in the chart below. While there may have been housing market surpluses and shortages at points between 1990 and 2006, over the entirety of the period supply and demand were likely in balance, especially considering annual obsolescence of an estimated 100,000 units per year.

At the peak of the housing boom, in early 2006, annual completions rose to a pace of approximately 2 million units per year but fell precipitously to fewer than 600,000 units by 2011. While the pace of household formation declined during the Great Recession, similar to what occurred in other recessions since 1990, household formations recovered shortly thereafter.

**Housing Completions and Total Households**



Source: Census, per Moody’s Analytics

Note: Does not include annual shipments of manufactured homes, which averaged 171,000 units per year 1990-2017 (Census)

But this time the level of housing construction has not yet risen to match the pace of household formations, as illustrated in the chart above. Nor has it risen to satisfy the needs of today’s larger population and the resulting need for a sufficient supply of vacant housing units necessary for the smooth functioning of healthy real estate and job markets. Rather, since 2008 housing completions have averaged just 870,000 units per year, but household formations during the same period have risen to nearly 970,000 units per year. This 100,000 unit per year deficit, coupled with the estimated annual 100,000-unit loss from obsolescence and destruction, which has accumulated for nearly 10 years now, likely indicates that nationwide there are at least 2 million fewer units in the housing market today than are needed for a long-term, balanced market.



## Shortage of Supply, Abundance of Demand

Single-family home prices and multifamily asking rents have more than recovered from the lows of the housing bust and are even exceeding previous peaks in most metros. The overall economy has recovered, as well, with increasing consumer spending and historically low unemployment. However, the residential construction industry has faced a more stagnant recovery. Historically, housing construction has tended to move in line with housing demand, especially during periods of increasing employment. With these components faring well, it is expected that homebuilders would undertake as many opportunities as possible to build and sell new homes – but that has not been the case.

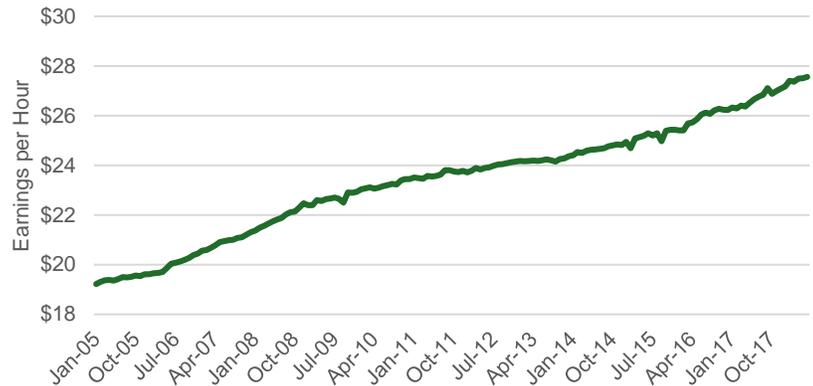
### Where did Everybody Go?

There are a few roadblocks to new construction. One is labor. The U.S. lost 2.3 million construction jobs from 2006 to 2011. Developers have offered higher wages to win back these workers, and the effort has been successful in getting the numbers back up: As of June 2018, 282,000 total construction workers have been added to the industry year over year, bringing the construction unemployment rate below 5.0 percent. Still, that is not enough workers to meet demand, and many of the most skilled laborers from a decade ago have been slow to return to the market as retirement and other employment prospects have likely drawn them away. As a result, the average hourly earnings for most construction workers have been increasing, as seen in the chart to the right.

### Material Costs Volatile

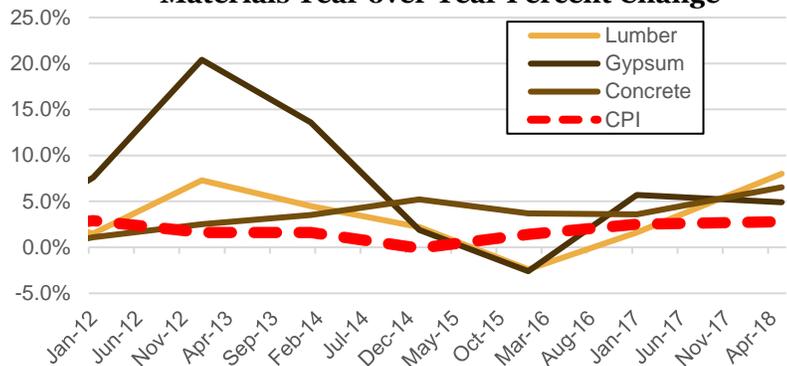
Increasing operational and material expenses are also construction headwinds. Lumber costs, which are currently subject to tariffs, are beginning to rise again. This expense alone has caused an increase in multifamily market pricing by an estimated \$2,430 per unit, according to a National Association of Home Builders April 2018 report. Other crucial materials like gypsum and concrete are seeing increases that are also outpacing inflation, as seen in the chart to the right. In contrast, tariffs on raw steel and aluminum are not as worrisome. Although they are expected to have a slight impact on construction costs, the overall impact on commercial construction activity is expected to be negligible, according to CBRE's March 2018 *U.S. MarketFlash Report*. Developable land prices for multifamily projects have also been fairly volatile, as seen in the chart to the right. All of these costs, combined with diminishing subsidies for affordable housing development, suggests that developers can only achieve acceptable profit margins by building higher-end Class A units in areas that are capable of sustaining high rents.

### Average Hourly Earnings of Non-Supervisory Construction Workers



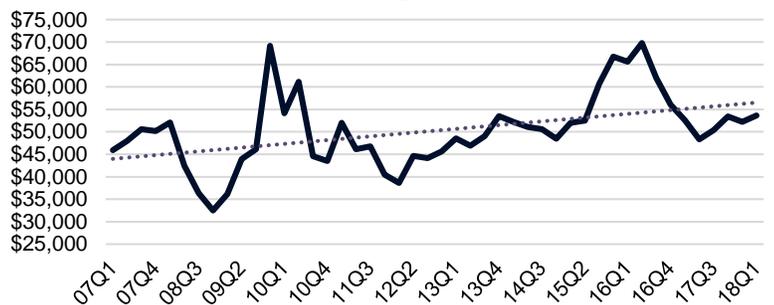
Source: Bureau of Labor Statistics, per Moody's Analytics

### Materials Year over Year Percent Change



Source: BLS Producer Price Index

### Multifamily Development Site Land Prices



Note: Prices are per buildable unit, based on a trailing 12-month average  
Source: Real Capital Analytics



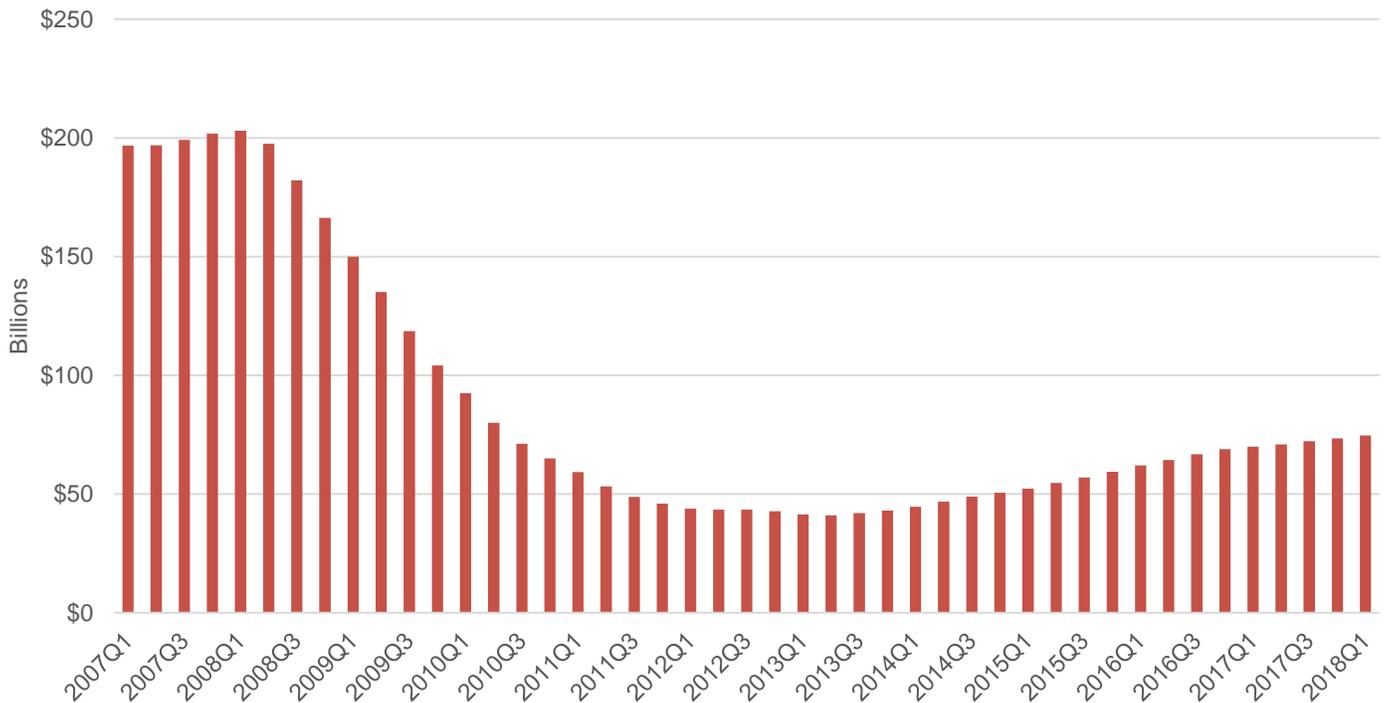
## Prior Overbuilding Leads to Underbuilding Now

Another factor contributing to the housing bust of 2008 was oversupply from overbuilding. Developers churned out housing units, primarily single-family houses, to take advantage of historically high housing prices and consumer demand during the early 2000s. Consumers had more options to move into their own homes with new loan products and easier access to credit. Institutional and global investors helped spur the housing demand through increasing purchases of private label mortgage-backed securities. All this demand made it relatively easy for homebuilders to justify development plans and for lenders to offer financing. But when the housing bust took place, sales volumes fell, prices declined, and foreclosures climbed. Demand for owning single-family housing then plummeted.

In the wake of the housing bust, lenders have been more wary of financing residential construction. Developers continue to build, but credit for residential real estate development and construction remains relatively tight compared to prior to the housing bust. Between 2008 and 2012, lending for single-family residential units decreased 73 percent, as seen in the chart below. Additionally, the nation's largest banks shrunk their market share by 7.0 percent.

According to a 2017 NAHB *Eye On Housing* report, the majority of housing construction loans are currently made by small- or mid-sized commercial banks with fewer than \$10 billion in assets, of which between 1 and 3 percent are concentrated in residential construction lending.

### Value of Residential Construction Loans Outstanding



Source: FDIC

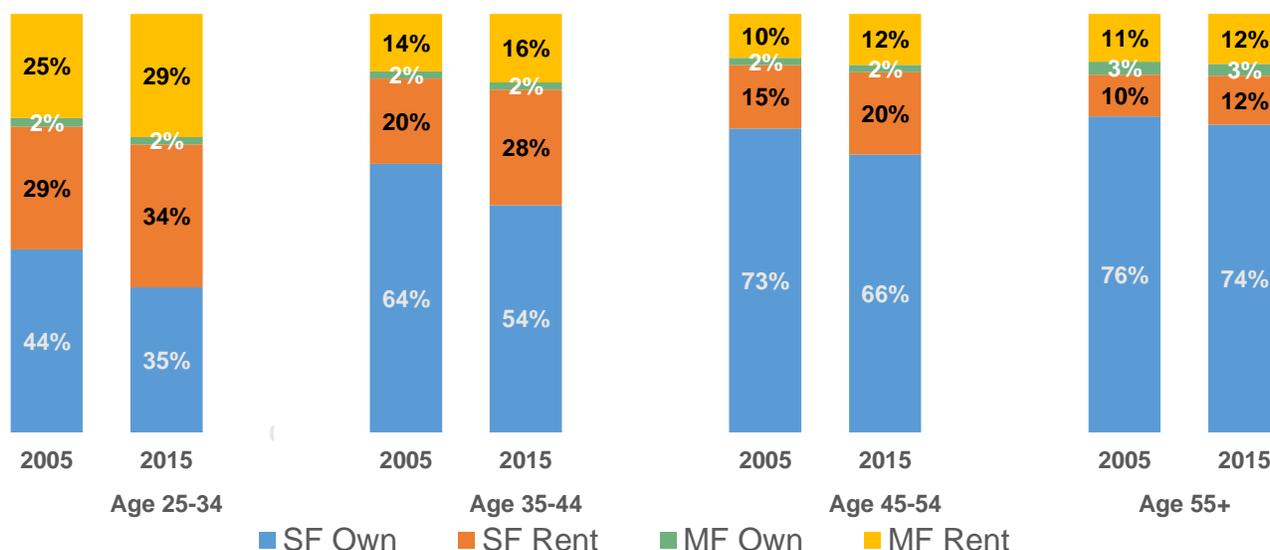


## Millennial Demand for Multifamily Housing a Bright Spot

While overall housing inventory has lagged, multifamily demand has continued to grow. With an increasing population and a recovering economy, more people are seeking multifamily homes that suit their particular preferences. While the largest cohort renting multifamily units are Millennials, a small number of Baby Boomers and Gen-Xers have also turned to renting multifamily, as illustrated in the chart below.

Millennials, a portion of whom are beginning to age into higher homeownership levels, according to previous Fannie Mae research, still remain a meaningful driver of multifamily demand. Many young millennials are entering peak renting ages as they continue to rent near urban centers offering most employment and educational opportunities. They remain the single largest cohort of renters.

### Cohort Structure/Tenure Share



Source: U.S. Census Bureau, American Community Survey 1-Year Estimates.

Note: Single-family includes housing units in structures with 1-4 units. Multifamily includes units located in 5+ unit structures. Excludes manufactured/mobile homes and other less common types of housing units (e.g., boat or RV).

## Housing Demand Will Only Increase

Despite the feeling that a new apartment complex is popping up on every street corner, there is indeed a national shortage of housing that is making both homeownership and renting increasingly expensive and, in many cases, unaffordable. An expanding economy produces more jobs, which, in turn, produces more households. This then leads to increased housing demand spread across the country, not just in coastal markets or the urban cores. There is an ongoing need for more housing, especially more affordable housing, in both the single-family and multifamily sectors, and that demand is not expected to subside in the near future. Innovative and creative ideas are needed to reduce building costs – such as coming up with more efficient modular homebuilding techniques or leveraging 3-D printing technology to boost new supply. The time is now to ease the nation’s lingering housing shortage.



**Harry Paul**  
**College Intern**

**Tim Komosa**  
**Economist Manager**

**Multifamily Economics and Market Research**  
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