Multifamily Economic and Market Commentary

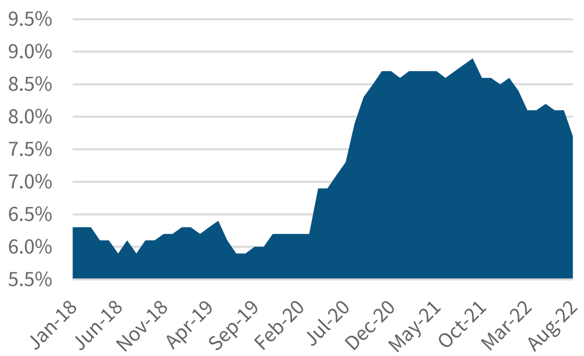
OCTOBER 2022

Concessions Declining Amid Strong Fundamental Growth

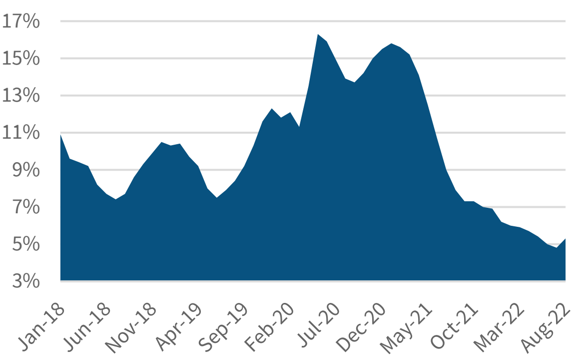
Multifamily market fundamentals have continued tightening in 2022, despite concerns about inflation and the ongoing pandemic. The economy has been coping with high levels of inflation, and rising housing costs have been a significant contributor to overall higher costs for consumers. Recent rent growth in the multifamily sector has been remarkable, and we do not expect the levels achieved earlier this year to continue, especially considering the robust pipeline of new apartment rental projects underway in many metros around the country.

In the multifamily apartment rental market, concessions are incentives with an economic value for renters, such as periods of free rent, free utilities, or other amenities. And in a competitive market when property owners need to fill vacant units, concessions are one of the ways they attract tenants. As seen in the charts below, recent concessions data from RealPage shows that the multifamily market had been significantly tightening over the past year: There are fewer units offering concessions than a year ago – down from 7.9% of all units in August 2021 to about 5.3% of all units in August 2022. Additionally, the value of the concession being offered has declined, from 8.8% in August 2021 to 7.7% in August 2022, though the overall level of concessions remains well above the low levels observed just before the pandemic.

National monthly multifamily concession rate



Percent of units offering concessions



Source: RealPage

New Supply Still On The Way

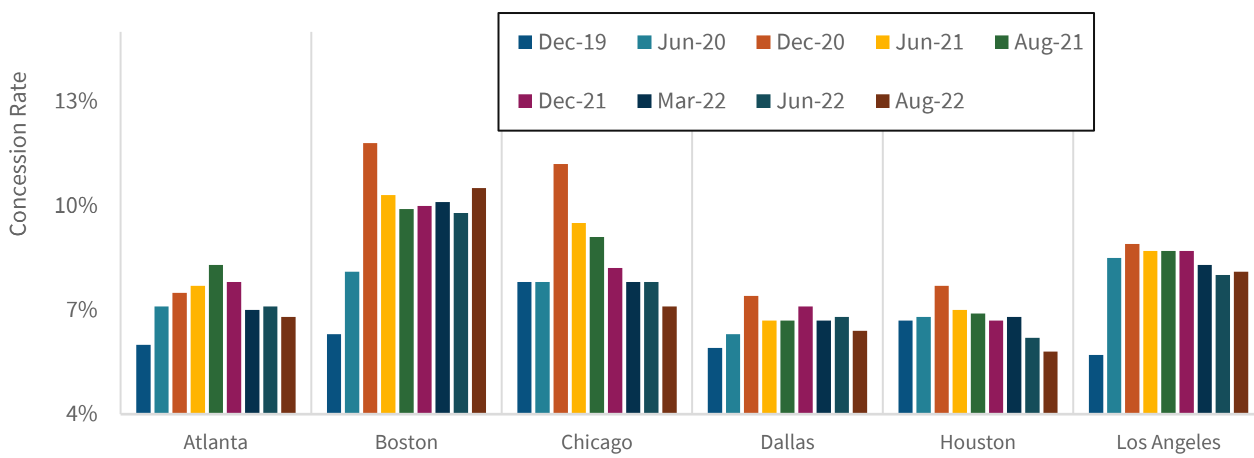
Many of the nation's large multifamily markets continue to see a surge in the supply of new apartments. Since mid-2021, some challenges confronting the construction sector have diminished slightly, though supply chain interruptions, high construction material prices, and ongoing labor shortages remain a concern for developers. According to Dodge Data & Analytics, through July 2022, the industry completed over 180,000 new apartment units, with another 300,000-plus units scheduled to complete before the end of the year. It is important to note that we expect actual completions to be in the same range of what has been completed in the prior two years, due to the very challenges mentioned earlier. Indeed, the industry delivered almost 404,000 units in 2020 and 396,000 units in 2021, despite the delays caused by the pandemic and supply chain interruptions.

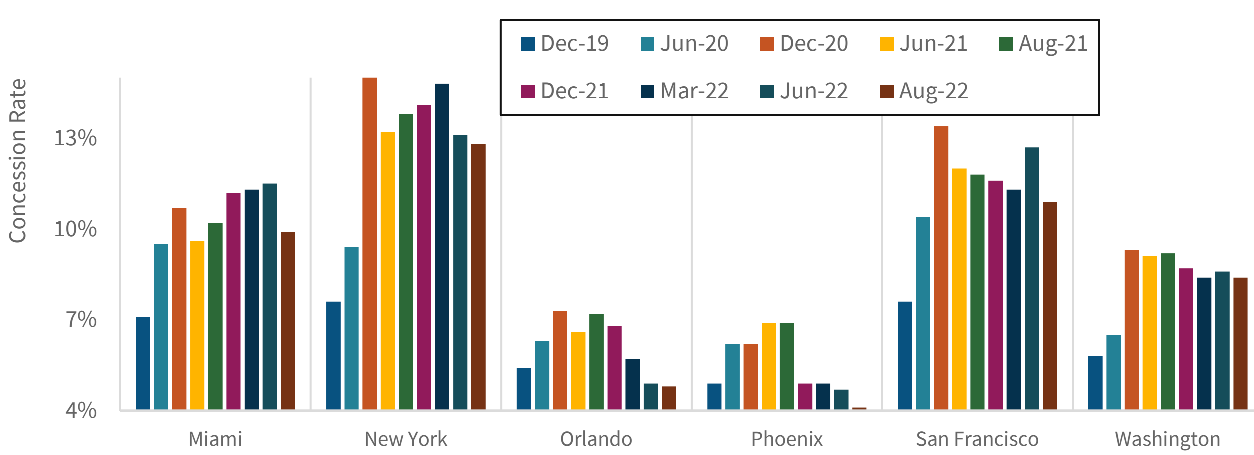
Concessions Declining in Most Major Markets

As has been the case for the current national multifamily development cycle, new apartment supply has been concentrated in the nation's largest metropolitan areas. Additionally, the development is generally further concentrated in specific submarkets in these markets. Overall, more than 400,000 new apartment units may be completed in 2022, and the most active metros in the country for apartment development continue to be New York, Washington, D.C., Dallas, Austin, and Los Angeles. New York has more than 80,000 units underway, D.C. has nearly 45,000 units underway, and Dallas has more than 41,000 units underway. Austin, Los Angeles, Seattle, and Phoenix follow with more than 27,000 units underway each, and Atlanta, Orlando, and Philadelphia round out the top 10.

Despite robust supply in many of these markets, concessions continue be modest and declining in nearly all of them. As seen in the charts below, New York, Dallas, and D.C. have experienced a supply surge, but all three have seen concession rates fall in August 2022 compared to August 2021. Only Boston experienced a modest increase in concessions in August 2022 compared to August 2021 among the markets shown below.

Multifamily monthly concession rate by market – select metros





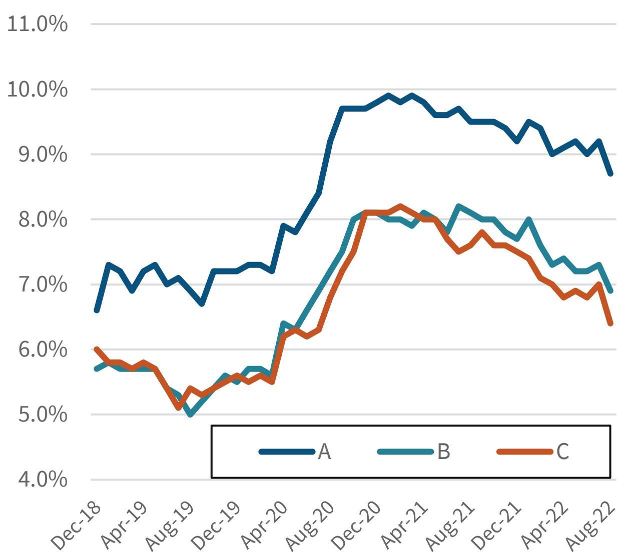
Source: RealPage

Class A Concessions Remain Higher

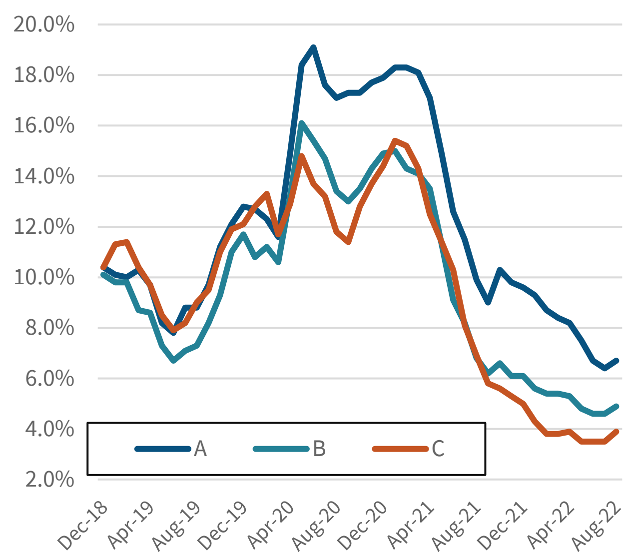
Multifamily builders have primarily been building more expensive, luxurious, and amenity-offering units during the current development cycle. With increased competition among this so-called Class A inventory, it is not surprising that property owners have had to offer concessions. As seen in the chart below, the value of concessions offered by this property class began to rise at the onset of the pandemic and has remained comparatively high, and above Classes B and C during this period.

But the strong fundamental demand for apartments evident over the past year is also seen in the declining level of concessions being offered by all property classes. As of August 2022, Class A concessions were 8.7%, according to RealPage, which is down from 9.5% in August 2021. Classes B and C have also had concessions level fall in 2022, as seen below. Class B concessions for August 2022 were 6.9%, down from 8.1% in August 2021. Since June 2021, Class C concessions have consistently been the lowest among the property classes, and as of August 20222 Class Concessions were 6.4%, down from 7.6% in August 2021.

National monthly concession rates by class



Percent of units offering concessions by class



Source: RealPage, Inc.

The percent of units offering concessions by class shows similar trends relative to the value of concessions. According to RealPage's data, more Class A units are offered with concessions compared to the other classes, with 6.7% of Class A units offering concessions in August 2022. Though that is down from 9.9% in August 2021, it is well above the 4.9% of Class B and 3.9% of Class C units in the same period. And Classes B and C have seen similar declines compared to August 2021, with the percentage of Class B units offering concessions falling by 1.9% and Class C falling by 3.0%.

Softening Market Will Likely Lead to Rising Concession Rates

We expect the remarkable growth in rent levels in 2021 and 2022 to ease over the next several quarters, with modest rent declines possible for brief periods. Nevertheless, we expect demand for multifamily housing through the remainder of 2022 to remain strong. We believe ongoing job growth and continued demand for multifamily housing is unlikely to be permanently interrupted, though with a recession likely looming, we believe there will be increased investor uncertainty in the market.

For these reasons, we think the the number of units offering concessions may rise in the near future. It is noteworthy that with such exceptional rent increases over the past several quarters that the value of the typical concession offered by property owners has only fallen modestly, remaining well above the level offered prior to the pandemic. This is likely due to the ongoing supply surge that resulted in many newer Class A properties having to continue offering concessions, despite property owners' ability to significantly raise rents.

With a robust pipeline of supply expected to continue delivering for at least the next 24 months, we believe there will pressure on more owners to offer concessions, especially if unemployment increases and rental household formations begin to slow. In our view, this includes all classes of units, including the more affordable Class B and Class C.

Although these conditions may potentially jostle the multifamily market in the short term, with interest rates forecasted to remain relatively high, we believe that many renters-by-choice may be priced out of the homeownership market and continue renting. Such a scenario would keep rent growth in place, albeit at a more moderate pace, and may provide enough underlying demand to prevent more property owners from offering even higher levels of concessions through the end of 2023.

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