Fannie Mae

MAY 2023

Small Multifamily Properties Are a Key Source of Rental Housing in Many Places

Although large multifamily properties, defined as properties with more than 50 units, are usually what come to mind when thinking of an apartment building, in most areas of the country small multifamily properties, defined as properties with between five and 50 units, are the predominant property type of multifamily. For instance, in Portland, Maine, a metro with fewer than 70,000 residents according to the 2020 U.S. Census, data from real estate provider CoStar, Inc. shows that there are 80 conventional small multifamily properties, compared to 34 conventional large multifamily properties.

There are several reasons for this phenomenon. Outside of more expensive metros, including coastal areas, land costs tend to be cheaper, making single-family rentals a more predominant form of rental housing. In addition, historically, there hasn't been as much demand for large apartment buildings in some of these locations. Instead, smaller properties were constructed. Also, in the suburbs of larger, more populous metros, local zoning restrictions have, in many instances, put limits on the number of units and height of structures to help ensure that the properties were more of a fit architecturally with their surroundings, making small multifamily properties a likelier choice for developers. Hence, small multifamily properties are an important source of rental housing in many smaller markets.

Small Multifamily Units More Affordable than Larger Multifamily Units

According to data from CoStar, small multifamily properties remain more affordable than large multifamily properties. As shown in the table below, although year-over-year average asking rent growth as of first quarter 2023 was 2.4% and 2.7%, respectively, for small and large multifamily properties, rents at small multifamily properties continued to be lower overall. The average asking rent for an apartment in a small multifamily property was $1,350 as of first quarter 2023. By contrast, the average asking rent for an apartment in a large multifamily property was about 25% higher at $1,685 per month.

The relative affordability of a unit in a small multifamily property likely had an impact on the average vacancy rate, with the average vacancy rate in a small multifamily property rising just 0.5% year over year as of first quarter 2023 to 5.0%. By contrast, the average vacancy rate rose more sharply at large multifamily properties over the same time period, with the average vacancy rate increasing by 2.0 percentage points to 7.5%.

Small vs. Large Multifamily Estimated Market Performance as of Q1 2023

Statistic	Small Multifamily (5-50 Units)	Large Multifamily (51+ Units)
Asking Rent	$1,350	$1,685
Rent Growth (Year over Year)	+2.4%	+2.7%
Vacancy (%)	5.0%	7.5%
Vacancy Growth (Year over Year)	+0.5%	+2.0%

Source: CoStar, Inc. Note: Excludes Federally Assisted, Seniors, Military, Vacation, Corporate, Student and Manufactured Housing Communities

Many Small Units in Just a Few Markets

A few metros have an exceptionally high number of small multifamily units. As shown in the table below, Los Angeles has the highest number of small multifamily properties – 55,000 containing 665,000 units. However, as properties in New York City are slightly larger on average with 15 units per property, New York City actually has the highest number of *units* with 675,000 units in 46,000 properties. The San Francisco-Oakland, Chicago, and San Diego metros round out the top five. In fact, the top five combined have an estimated 1.8 million units in about 145,000 properties.

Top Five Metros for Small Multifamily as of Q1 2023

Market	Number of Small Properties	Number of Units	Average Units
Los Angeles	55,000	665,000	12
New York	46,000	675,000	15
San Francisco-Oakland	16,000	185,000	12
Chicago	16,000	210,000	13
San Diego	10,000	110,000	11

Note: Excludes Federally Assisted, Seniors, Military, Vacation, Corporate, Student and Manufactured Housing Communities

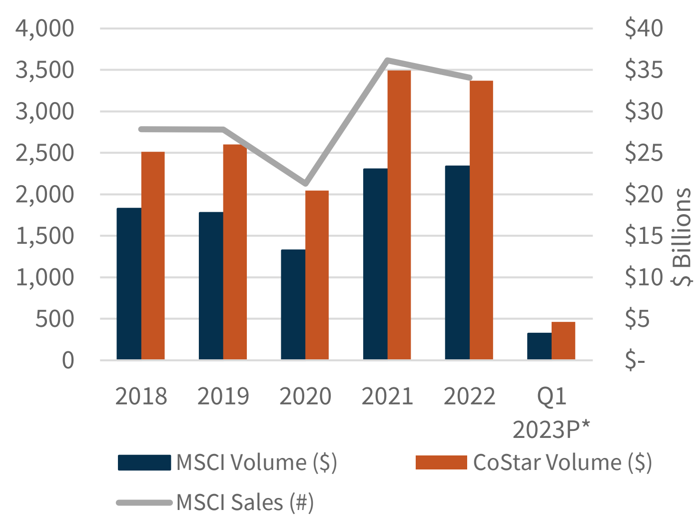
Source: CoStar, Inc.

Sales Volume Remained Elevated in 2022

According to MSCI Real Assets, which tracks multifamily property transactions of $2.5 million and greater, sales of small multifamily properties totaled an estimated $23.4 billion in 2022, with an average sale price of $6.9 million, consisting of just over 103,000 units. As shown in the adjacent chart, while 2022's volume was on par with 2021's volume of $23.0 billion, it was above 2019's pre-pandemic volume of $17.8 billion, when just under 83,000 units exchanged hands.

CoStar, which also includes transactions below $2.5 million, recorded an average sales price of $2.9 million. Nevertheless, CoStar data shows a similar trend with $33.7 billion in sales in 2022 on just over 207,000 units, slightly below 2021's $34.9 billion but well ahead of its 2019 pre-pandemic recorded volume of $26.0 billion on an estimated 231,000 units.

Small Multifamily Property Sales Q1 2018 – Q1 2023



Source: CoStar Portfolio, Inc., MSCI Real Assets - Based on sales of properties and portfolios priced $2.5M or greater, with at least 10 units.

** Preliminary*

Multifamily Economic and Market Commentary

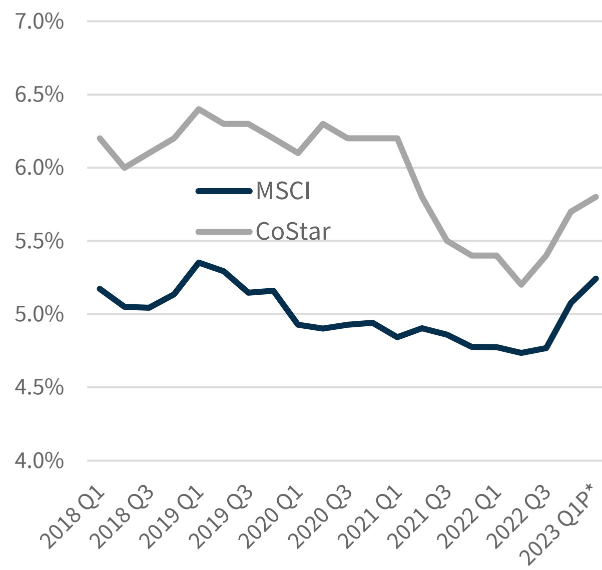
A Slower Start to 2023

MSCI Real Assets preliminary data for first quarter 2023 shows small multifamily property sales totaled just $3.2 billion, while CoStar recorded preliminary sales of $4.6 billion. While these figures may change as additional transaction data becomes available, CoStar estimates that sales for first quarter 2023 totaled $5.7 billion, indicating that 2023 is off to a slower start. This is consistent with the increase in cap rates for small multifamily recorded over the past few quarters.

Cap Rates Ticked Up

With rising interest rates increasing the cost of financing and pushing some would-be buyers out of the market, capitalization rates for small multifamily properties have begun to increase. According to MSCI Real Assets, the average cap rate for small multifamily property sales increased to an estimated 5.2% in first quarter 2023 from a low of 4.7% as of second quarter 2022. CoStar data also shows a similar trend with its average cap rate for small multifamily rising to 5.8% in first quarter 2023 from 5.2% over the same timeframe.

Small Multifamily Average Cap Rate



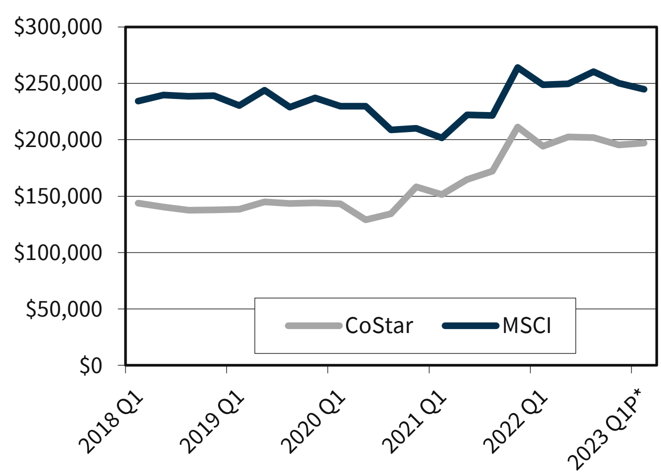
Source: CoStar, MSCI Real Assets - Based on sales of properties and portfolios priced $2.5M or greater, with at least 10 units.
**Preliminary*

Price Per Unit Exceeds Pre-Pandemic Levels

According to data from MSCI, the average price-per-unit declined to a low of about $202,000 back in first quarter 2021. However, the average price-per-unit then rose by about 31% to an estimated $264,000 by fourth quarter 2021. Although the price-per-unit appears to be declining, it remains above pre-pandemic levels. According to preliminary data from MSCI, the price per unit fell to just under $245,000 which is still slightly above the $237,000 per unit recorded as of fourth quarter 2019.

CoStar data shows an even stronger disparity. CoStar estimates that the first quarter 2023 price-per-unit is $197,000, which is still 37% higher than the pre-pandemic fourth quarter 2019 price-per-unit of $144,000, indicating that investors are still willing to pay up for small multifamily – at least for now.

Small Multifamily Sales Price per Unit



Source: MSCI Real Assets; Based on sales of properties and portfolios priced $2.5M or greater, with at least 10 units.

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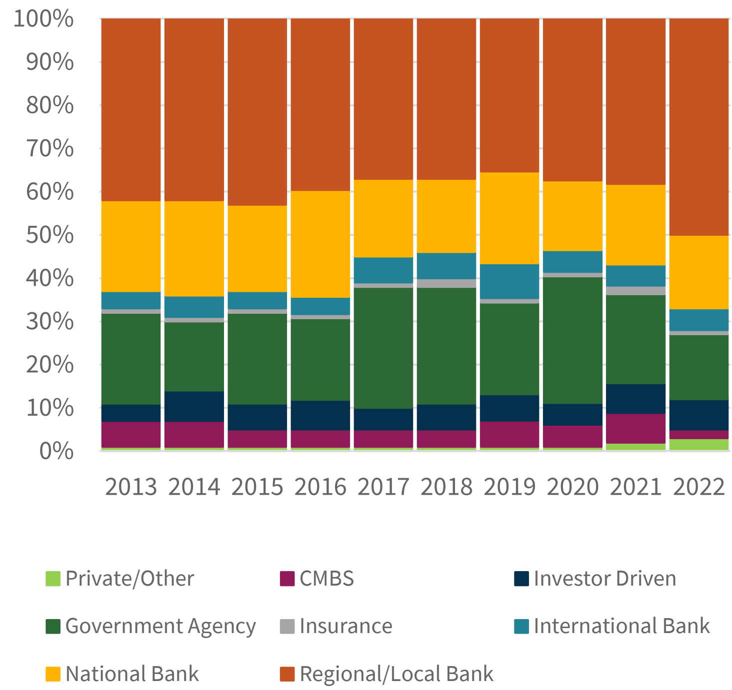
** Preliminary*

Lending by Smaller Banks Jumped in 2022

As shown in the chart on this page, most small multifamily property lending continues to be done by regional, national, and some international banks, with these three entity types alone providing about 60% of financing for small multifamily properties annually from 2018 to 2021.

However, the share of financing provided by banks appears to have increased sharply by 9 percentage points in 2022 with banks providing about 72% of financing. Most of this is due to smaller regional and local banks that expanded their market share to provide an estimated half of all financing for small multifamily properties. By contrast, the share of financing provided by the government agencies category, which includes Fannie Mae and Freddie Mac, declined by 6 percentage points in 2022 to 15%.

Composition of Small Multifamily Lenders
January 1, 2018 – December 31, 2022



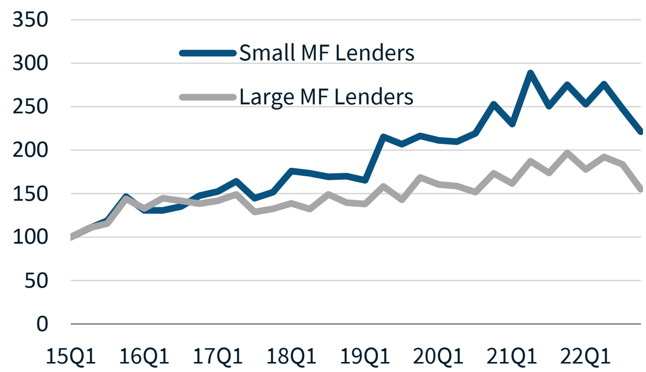
Source: MSCI Real Assets; Based on sales of properties and portfolios priced $2.5M or greater, with at least 10 units.

Agencies Stepped in During Pandemic

Market segmentation in 2022 stands in sharp contrast to the market segmentation in 2020, during the height of the pandemic. In 2020, banks of all types provided an estimated 58% of all financing to small multifamily properties, pulling back in a period of uncertainty, compared to 64% in 2019. By contrast, the government agencies category, which includes Fannie Mae and Freddie Mac, financed an estimated 29% of the lending volume for small multifamily properties in 2020 – compared to just 21% in 2019 – stepping in when lenders perceived increased credit risk.

Interestingly, the pullback from perceived credit risk seems to have been from larger national and international banks whose market share declined to an estimated 21% share of lending volume in 2020 from 29% in 2019, prior to the pandemic. Smaller regional and local banks, which tend to have longer-standing client relationships in localized markets, appeared to have maintained their market share at 37% of lending volume, consistent with their pre-pandemic market share.

Lender Momentum Index – Unique Lenders (Q1 2015-Q4 2022)



Source: MSCI Real Assets; Based on property and portfolio sales of $2.5 M or greater, with at least 10 units.

Originators for Small Multifamily Grow

As shown in the chart on the left, based on the MSCI index of unique lenders, banks appear to remain very interested in small multifamily assets. The index shows that the growth in the number of originators for small multifamily assets has outpaced that for large assets since 2015.

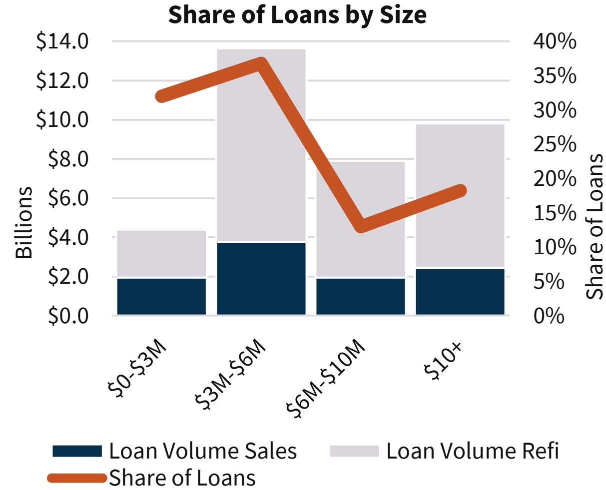
In addition, while both components of the market saw the number of unique originators fall over the past two quarters, overall, the number of small multifamily originators remains 20 percent higher than in 2015.

Most Loans are for $3 Million - $6 Million

As shown in the adjacent table, loan size for small multifamily properties varied quite a bit in 2022. However, only 18% of loans in 2022 were $10 million or higher, and these tended to be in high-cost areas such as New York and Los Angeles.

As might be expected, loans for small multifamily properties tend to be smaller, with an estimated 32% of loans coming in under $3 million. However, 37% of loans fall in the $3 million to $6 million range. As a result, just under 70% of loans in 2022 for small multifamily properties were for $6 million or less, which is consistent with the GSEs' small balance lending program guidelines.

Small Multifamily 2022 Lending Volume and Share of Loans by Size



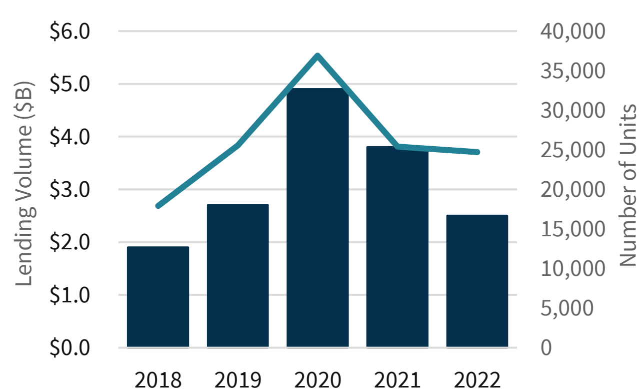
Source: MSCI Real Assets; Based on property and portfolio sales of $2.5 M or greater, with at least 10 units.

Fannie Mae Finances Small Multifamily

As shown in the adjacent chart, over the last five years, Fannie Mae has financed an estimated $15.8 billion for small multifamily properties. As shown on the previous page, as lenders pulled back from financing in 2020 due to the pandemic, Fannie Mae provided just under $5 billion in financing for just under 37,000 units.

In 2022, as many lenders returned to the small multifamily lending market, Fannie Mae's acquisitions of small multifamily loans dipped to $2.5 billion, which financed more than 24,000 units.

Fannie Mae Small Multifamily (5-50 unit) Financing Volume and Number of Units Financed (2018 – 2022)



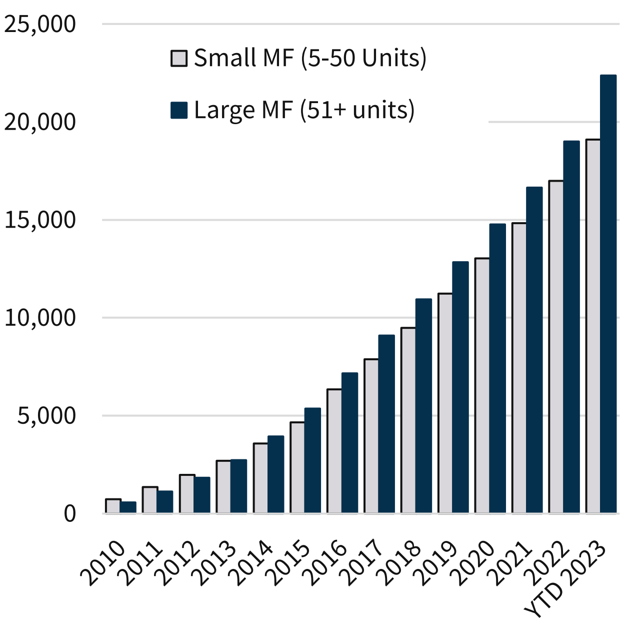
Source: Fannie Mae Annual Mortgage Report, Table 1B. Available at: https://www.fhfa.gov/PolicyProgramsResearch/Programs/AffordableHousing/Pages/Fannie-Mae-Housing-Goal-Documents.aspx

Fewer New Units Completed in Small Multifamily

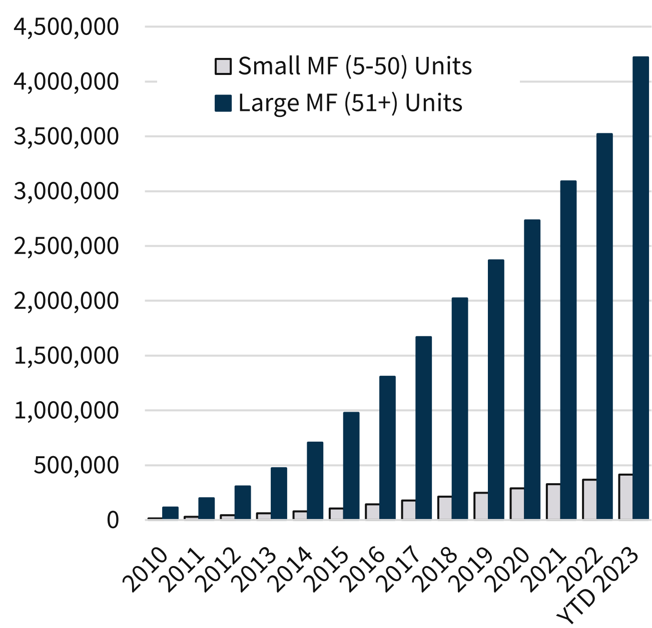
As shown in the below-right chart, the number of units completed in large multifamily properties has vastly outpaced small properties since the start of 2010, with an estimated 4.2 million units completed in large properties compared to just under 415,000 units in small properties. Given high construction costs, we expect this to be an ongoing trend.

Nevertheless, as shown in the below-left chart, the number of new small multifamily *properties* completed has been nearly on par with the number of new large multifamily properties. From the start of 2010 through April 2023, an estimated 19,100 new small multifamily properties have been completed, compared to 22,400 large multifamily properties completed during the same time period. We believe this indicates that investors remain interested in small multifamily properties.

Cumulative New *Properties*, Small Multifamily vs. Large Multifamily (2010- YTD 2023)



Cumulative New *Units*, Small Multifamily vs. Large Multifamily (2010-YTD 2023)



Source: Dodge Data & Analytics SupplyTrack
Note: YTD 2023 indicates 2023 year to date data through April 2023

Small Multifamily Properties Are an Important Source of Rental Housing

While the number of units in large multifamily properties has been growing over recent years, overall, there are still many units in small multifamily properties. According to the most recent data from the Rental Housing Finance Survey, which collects data for rental properties at a property level, there were an estimated 8.2 million units in just over 490,000 small multifamily properties in 2021, showing that small multifamily remains an important segment of the rental housing market.

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