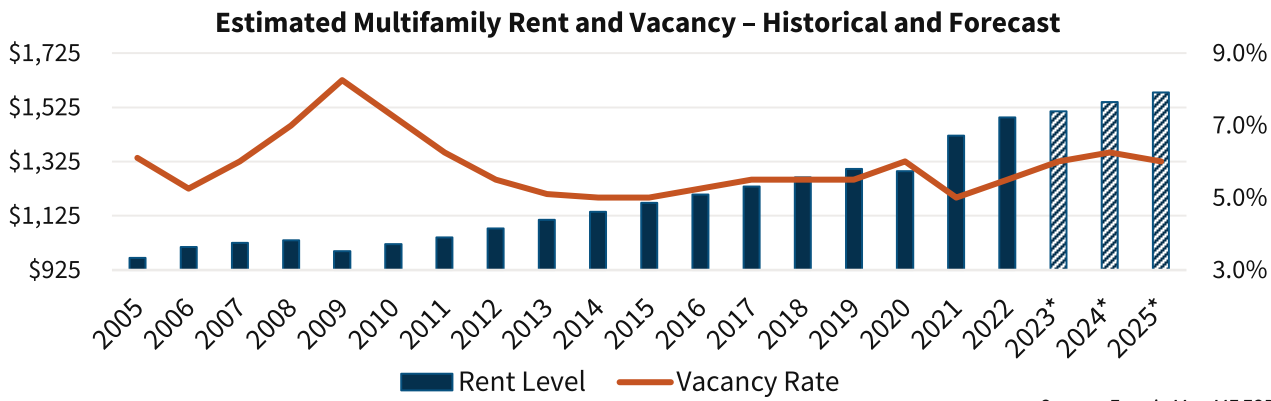
July 2023

# 2023 Mid-Year Multifamily Market Outlook – Demand Subdued But Positive

The multifamily sector experienced subdued but positive demand during the first half of 2023, primarily occurring during the second quarter, due to slowing but still-positive job growth, elevated single-family housing prices in many locations across the country, and favorable demographics. This demand is expected to remain stable for the remainder of the year, with rent growth increasing slightly but with vacancies likely rising. It is important to note that multifamily fundamentals and demand can, and do, change and will vary by metro, submarket, and, in some cases, by neighborhood.

Further out into the forecast, our more tempered outlook for the sector is based on the expectation of a recession occurring in the fourth quarter of 2023 or the first quarter of 2024. An economic slowdown, combined with elevated new multifamily supply of more than one million units underway, is expected to place additional stress on the multifamily sector, dampening rental demand in the short term, thereby pushing up vacancies and curtailing rent growth over the next 18 months. Nevertheless, we believe that demand for multifamily rental housing will remain stable over the short term due to home affordability constraints. This may be influencing renters that could pursue homeownership to stay in their units for another year or two.




*Source: Fannie Mae MF ESR*

## Multifamily Vacancy Expected to Rise

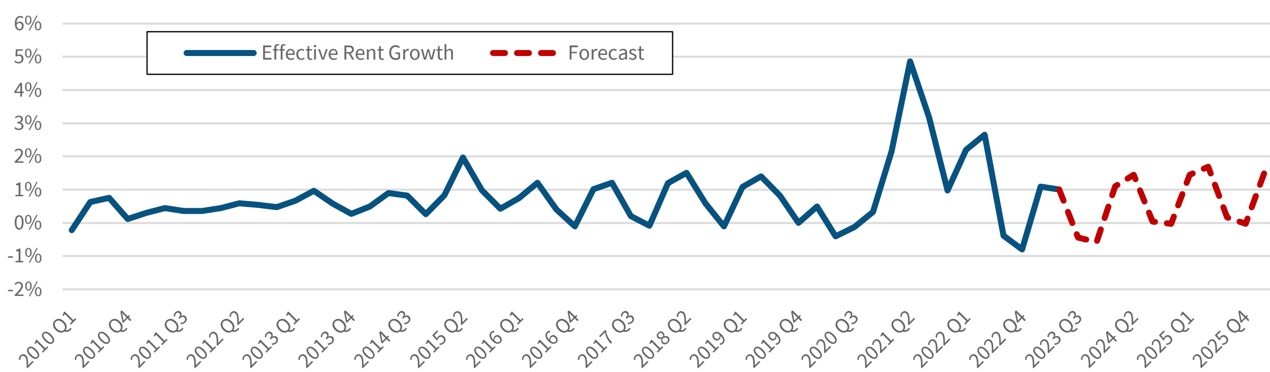
Although the national multifamily vacancy rate increased slightly during first quarter of 2023 and remained unchanged during the second quarter, we expect it to rise over the remainder of the year and possibly into early 2024. Despite expected ongoing multifamily rental demand, newly delivered supply is expected to remain elevated throughout this year and next, thereby pushing up estimated vacancy levels, as seen in the chart above.

As a result, we anticipate that the U.S. national multifamily vacancy rate will rise to an estimated 6.0 percent by year-end 2023, which would take it above its estimated 15-year average of 5.8 percent. We do expect the national vacancy rate to peak at 6.25 percent in 2024. However, we then expect it to decline to 6.0 percent by 2025 as economic conditions and job growth improve after the recessionary slowdown.

## Rent Growth Expected to Decline but Normalize Longer-Term…

Rent growth turned positive this year, but we do not expect it to keep its momentum over the remainder of the year. We are estimating that rent growth was 1.0 percent for the first half of 2023 due to positive-but-subdued rental demand stemming from ongoing job growth. We expect that the trajectory of rent growth over the second half of the year will begin to ease, ending the year in the range of 1.5 percent to 2.0 percent. For comparison, as of July 17, 2023, CoStar is also expecting overall rent growth to be positive at 1.1 percent in 2023, and then to further improve over the next few years, as seen in the chart below.

### Multifamily Effective Rent Change 2010 – 2025 – All Multifamily Classes



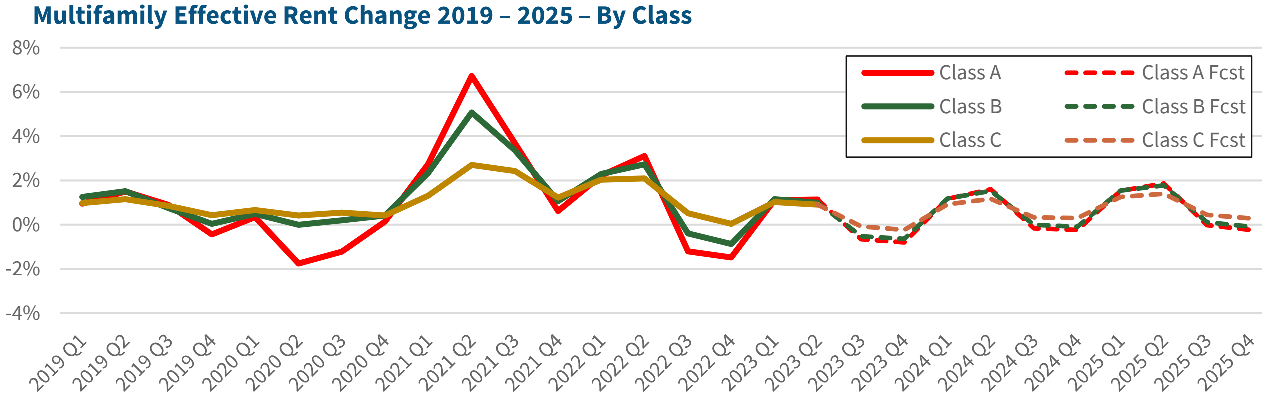

*Source: CoStar, Inc. – Data as of July 17, 2023*

## … With Very Little Differentiation Between Classes

Demand for all classes of multifamily units has been positive but still below recent trends. In fact, as of July 17, CoStar is expecting Class A unit rents to experience the lowest level of rent growth this year, forecasting just 0.8 percent growth compared to 2.6 percent in 2022. Class B rents are not far behind at a forecasted 0.9 percent in 2023, compared to 3.7 percent in 2022, and Class C units are forecasted to see rent growth of 1.6 percent this year, compared to 4.7 percent rent growth last year.

Further out into the forecast, CoStar expects that rents for all classes of units will remain below average this year, as seen below. However, overall demand is expected to improve starting next year, as evidenced by the minimal distinction in rent growth percentages between classes of units, with Class C rent growth expected to slightly outpace both Class B and Class A in 2024 and 2025.

### Multifamily Effective Rent Change 2019 – 2025 – By Class



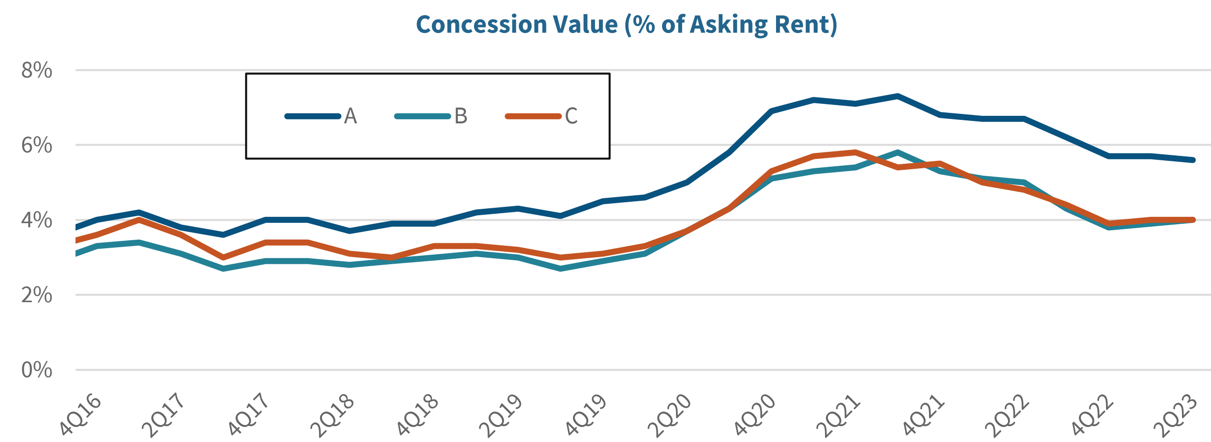

*Source: CoStar, Inc. – Data as of July 17, 2023*

## Concessions Stable

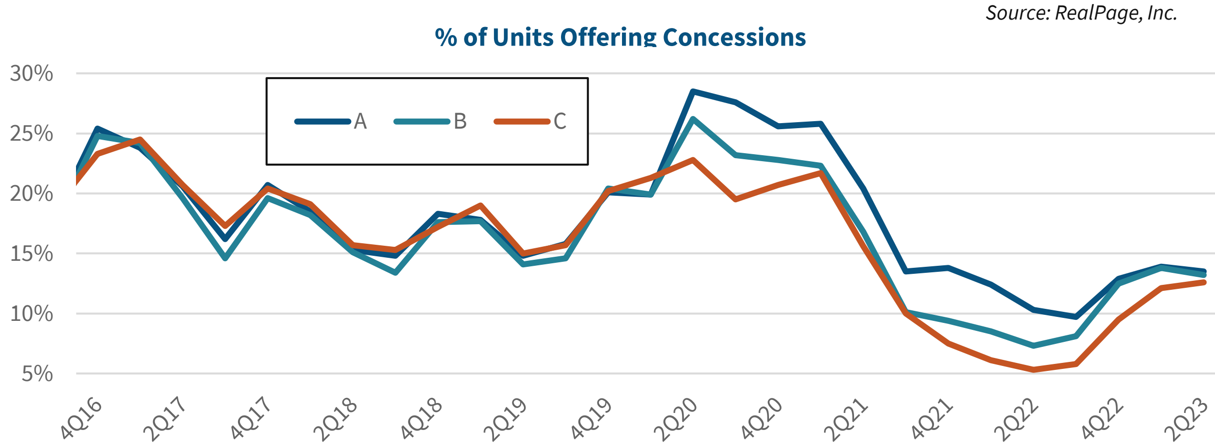
With rent growth trends trailing the historical average, concessions have remained unusually stable for all classes of units during the first half of the year, as seen in the charts below. The same is true regarding the number of multifamily units offering concessions. According to data from RealPage, as of second quarter 2023, a total of 13.1% of units were offering concessions. Just 13.5% of Class A units were offering concessions during the quarter, with Class B units close behind at 13.2%. Class C rose slightly to 12.6%, as seen in the chart below right. While the average concession level for all units remains at 4.5% – less than one month's free rent on average – we expect it to increase by year end.

Class A concession levels remain higher than those for Class B and C units, indicating that property owners are continuing to offer more generous concessions upfront for newer Class A units to compete with newly delivered supply. For those Class A units that are offering concessions, the average concession rate as of second quarter was 5.6 percent – less than a month's free rent – and down quite a bit compared to second quarter 2022's 6.7 percent. Class B and C units have an average concession rate of just 4.0 percent as of second quarter 2023 compared to about 5.0 percent as of second quarter 2022.

## National Concession Rates by Class




*Source: RealPage, Inc.*

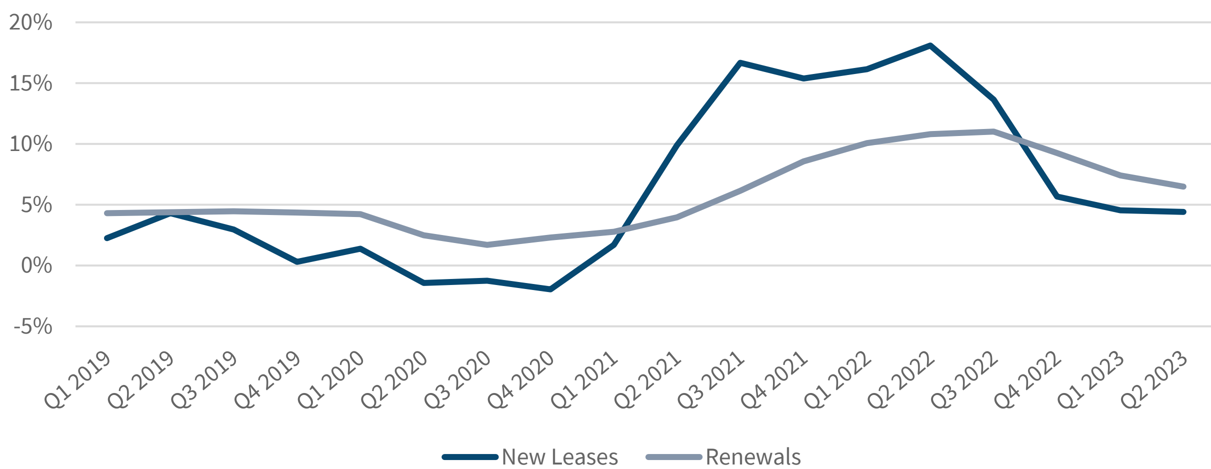



*Source: RealPage, Inc.*

### Lease Rates Normalizing

Usually, the rental increase rate for lease renewals tend to be slightly higher than those for new leases. While that might seem counter-intuitive, it is because property owners are often competing with other new developments for tenants, as well as the use of concessions. However, that trend changed starting in 2021 and did not revert back until late 2022. As seen in the chart below, renewals are only slightly above new leases as of second quarter 2023.

#### Rental Rate Change for New Leases and Renewals - All Multifamily Units

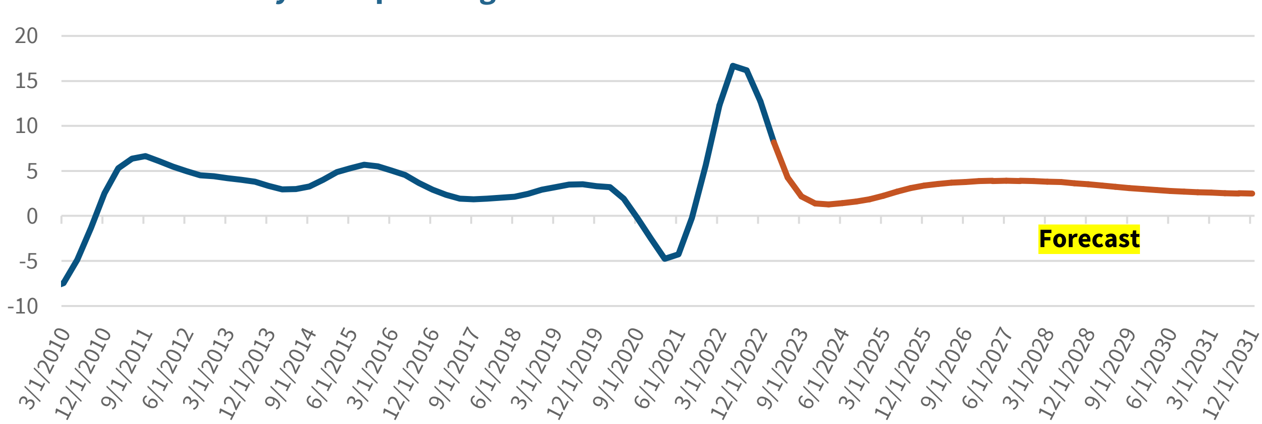



*Source: RealPage, Inc.*

### Net Operating Income Growth Slowing but Expected to Remain Positive

Although net operating income growth has been slowing down quite significantly since last year, this decline is not unexpected. Indeed, the sudden increase in net operating income growth during 2021 and early 2022 was unsustainable in our view and stemmed from the sharp spike in rental demand during the pandemic but also due to the decline in rental income at the beginning of the pandemic. As seen in the chart below, CBRE Econometric Advisors is expecting net operating income growth to decline this year but then stabilize next year, and then increase slightly further out into the longer-term forecast.

#### National Multifamily Net Operating Income Growth - Historical and Forecast

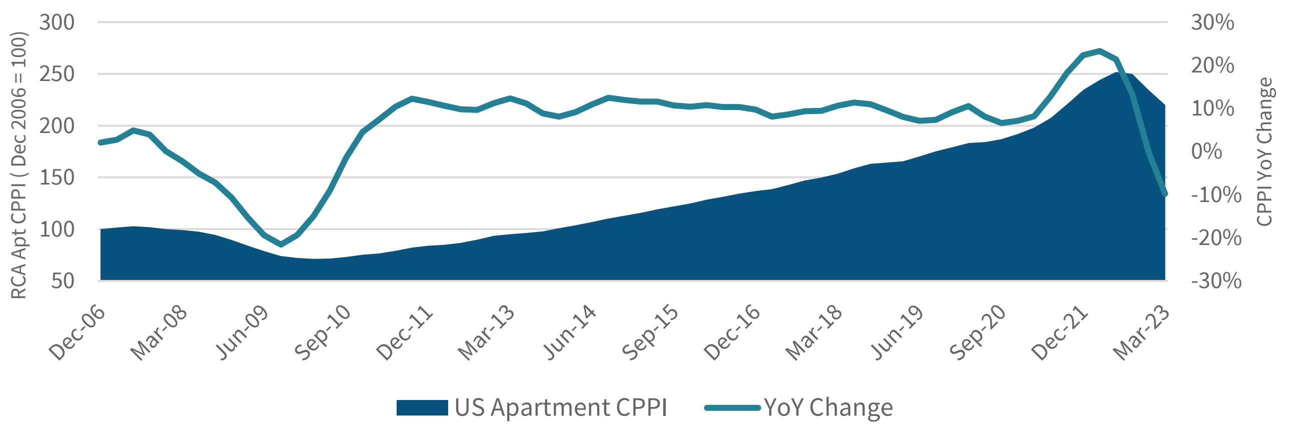



*Source: CBRE Econometric Advisors*

## Multifamily Property Values Declining…

Data from MSCI Real Assets shows that multifamily property values have been declining since the beginning of the year. We expect this trend to continue through the second half of 2023, perhaps declining within a range of -15 percent to -20 percent. However, multifamily property values peaked at an increase of nearly 24 percent in first quarter of 2022, suggesting that the current rate of deceleration is the beginning of a return to a more normalized trend over the long-term.

### MSCI Real Assets Commercial Property Price Index - Multifamily

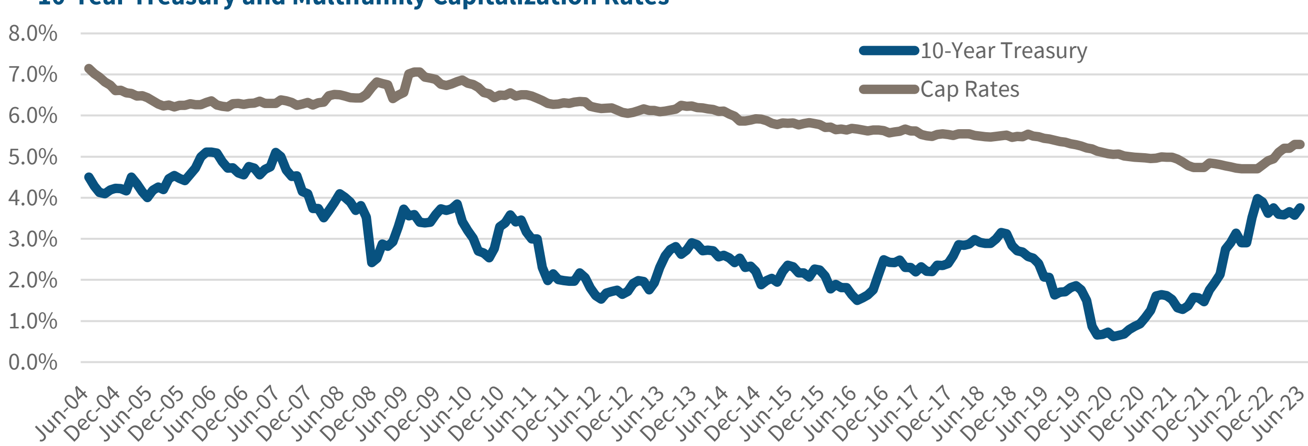



*Source: MSCI Real Assets*

## … and Sales Volume Slowing Significantly

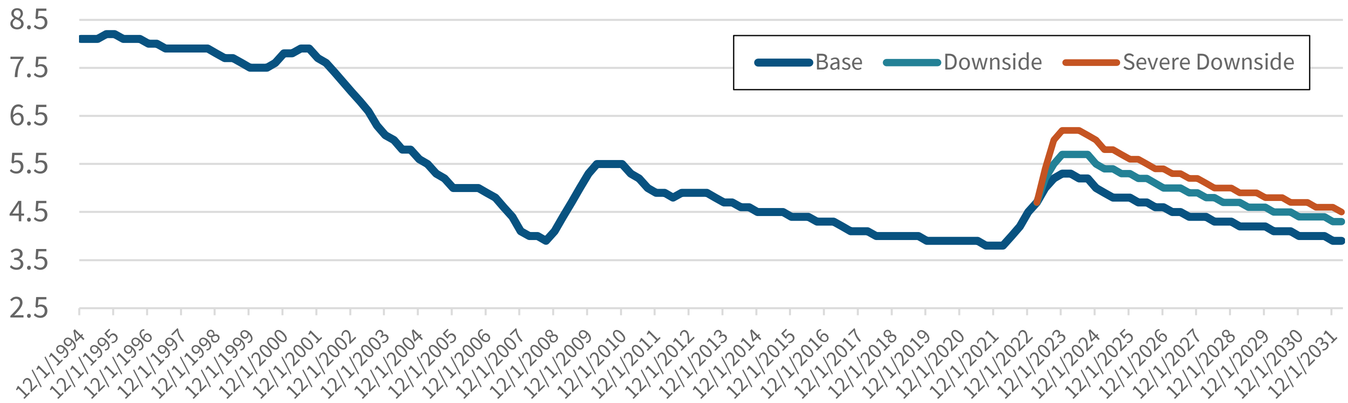
The pace of property sales has declined as well. Given the year-to-date performance for the first half of the year, we expect multifamily sales will slow in 2023, possibly totaling less than $200 billion compared to $304 billion in 2022. And with multifamily cap rates having increased for several quarters, and property prices facing downward pressures, we believe cap rates are likely to further increase during the second half of the year, from the current rate of about 5.3 percent to between 5.5 percent and 6.0 percent over the next 12 to 18 months.

### 10-Year Treasury and Multifamily Capitalization Rates




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

### National Multifamily Cap Rate Forecast




*Source: CBRE-EA*

### Multifamily Cap Rates Expected to Peak in Early 2024

As seen in the chart above, the various cap rate forecast scenarios reflect a peak difference of nearly 100 basis points between baseline and severe downside occurring in 2023, according to CBRE Econometric Advisors. CBRE-EA's baseline multifamily cap rate forecast anticipates that although multifamily cap rates peak at 5.3 percent in 2023, they will decline to 5.0 percent by year-end 2024. In contrast, the severe downside scenario is that cap rates will peak at 6.2 percent in early 2024 and improve to 6.0 percent by year-end 2024. CBRE-EA's downside scenario is closer to our view, with multifamily cap rates reaching 5.7 percent this year and then ending 2024 at 5.5 percent.

### 2023 Multifamily Mid-Year Outlook: Turbulence Still Expected

We maintain a cautious outlook for the multifamily sector for the second half of 2023. As expected, we have seen a softening in demand during the first half of the year, resulting in a below-average estimated rent growth of just 1.0 percent. But the national trend is not representative of all the nation's metros. Some metros have seen flat-to-negative rent growth, including Austin, Las Vegas, San Francisco, and Phoenix. Other metros both large (such as Boston, Chicago, and San Diego) and small (such as Knoxville and Midland-Odessa) have experienced rent growth of more than 2.0 percent. In other metros, especially those with a large amount of supply expected to come online over the next 12 to 18 months, rent growth could decline and concessions increase to compete with new completions.

With interest rates expected to remain elevated, coupled with declining property sales, we expect multifamily origination volume levels will decrease in 2023 compared to 2022. As of May 2023, the Mortgage Bankers' Association estimates that multifamily originations volume will be $375 billion in 2023 and $456 billion in 2024, but that is subject to change. Based on current trends, our estimated annual multifamily originations tend to be lower: $310 billion to $350 billion in 2023 and $410 billion to $450 billion in 2024.

As a result, our outlook has not changed much since the start of the year. We still expect the multifamily housing market to experience a softening in demand in 2023 and extending into 2024.

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