Multifamily Economic and Market Commentary

Fannie Mae

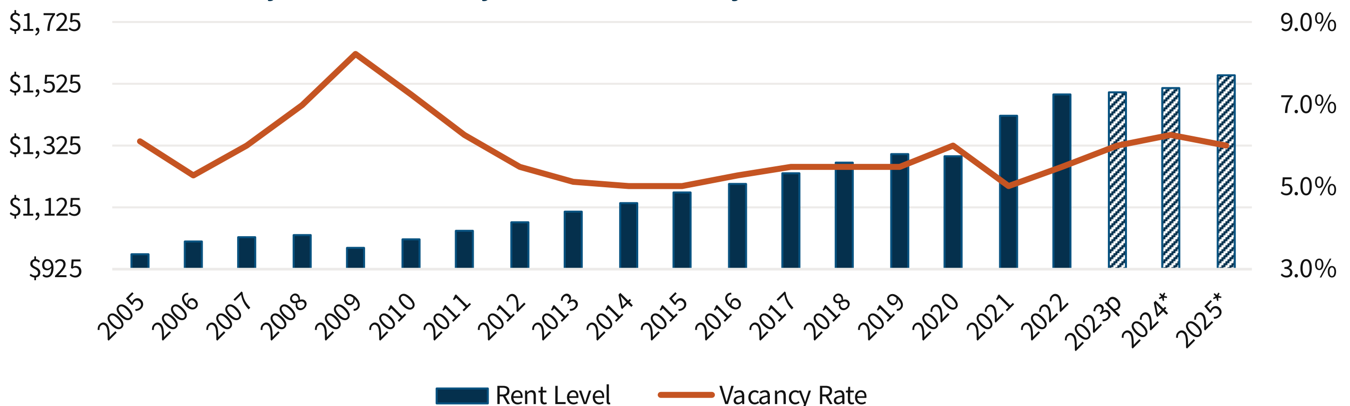
JANUARY 2024

2024 Multifamily Market Outlook: Instability Expected as Skies Remain Cloudy

Based on preliminary data, multifamily rental growth is estimated to have turned negative during the fourth quarter of 2023, after having been at more moderate levels earlier in the year. Our prediction of turbulence in the multifamily market last year was correct, and it appears that it is likely to continue into 2024. Rental demand differed depending upon the metro: Those with a lot of new supply, such as **Austin**, **Phoenix**, and **Jacksonville**, have seen negative rent growth over the past six to 12 months. In contrast, metros that are supply constrained, such as **Kansas City**, **Cincinnati**, and **St. Louis**, have seen above-average rent growth, according to data from RealPage. At a national level, rental demand remained positive for much of 2023, due to stronger-than-expected job growth, smaller-but-continued wage increases, elevated interest rates, and an overall shortage of housing, especially for-sale housing, keeping many renters-by-choice renting – for now.

We expect the economy to grow at a below-trend rate in 2024 and note that the risk of a recession remains elevated. Coupled with more than one million multifamily rental units underway, we are once again expecting lower-than-normal rent growth this year along with a slightly higher national vacancy rate. We expect rent growth to be in the range of just 1.0% to 1.5% in 2024, and we believe it could stumble if job growth worsens significantly. The national multifamily vacancy rate is expected to rise to 6.25% this year, as illustrated in the chart below, and then begin to stabilize at 6.0% in 2025. The pace of absorption is expected to remain positive but only slightly higher this year due to the high number of new units delivering over the next 12 to 18 months. We also expect that the percentage of units offering concessions will increase and that concession levels will rise in oversupplied markets.

Annualized Multifamily Rent and Vacancy – Estimated and Projected



*Source: Fannie Mae MF ESR   p = preliminary   * Projected*

Demand Expected to Improve Later in 2024

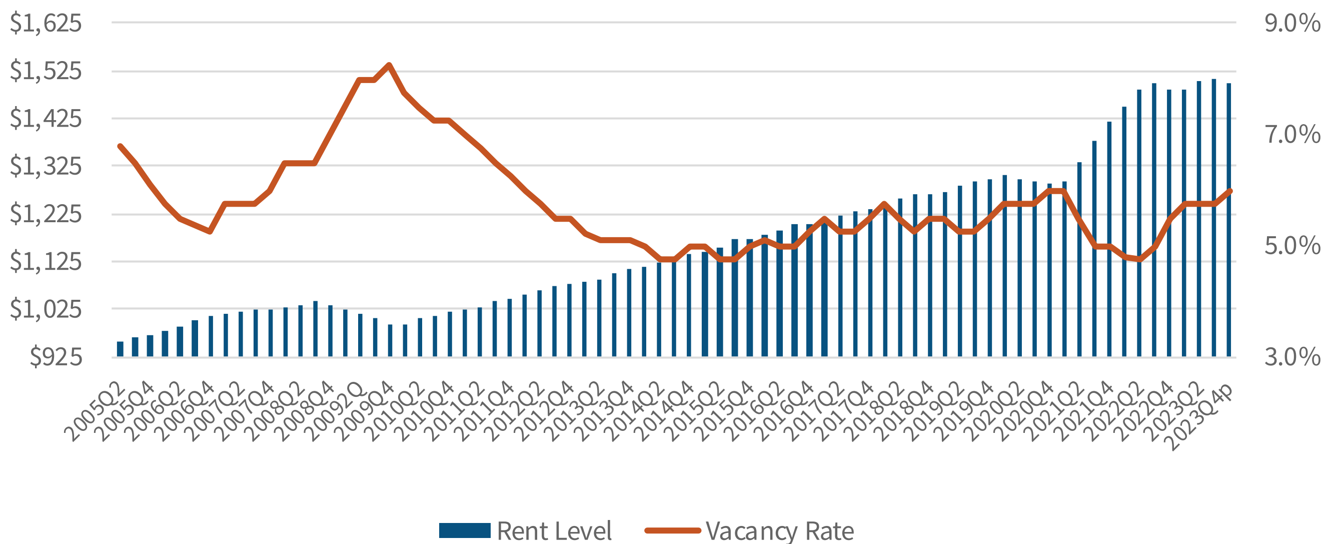
Demand for multifamily rental units started out slowly in 2023 and picked up during the second and third quarters but then slowed during the last three months of the year. According to data from CoStar, annualized multifamily demand was estimated at 331,533 units at the end of 2023, compared to an estimated 148,160 units in 2022. In addition, CoStar is anticipating that demand will rebound in 2024, ending the year with an annualized 424,902 units of multifamily demand.

Vacancy Expected to Increase

The national multifamily vacancy rate is estimated to have risen in late 2023 and is expected to rise again in 2024, primarily due to the amount of new supply expected to deliver this coming year, on top of the more than 500,000 units that were expected to have been added in 2023. Much of this new supply consists of more expensive, class A units in many places, which should help improve the pace of filtering down the existing multifamily housing stock, resulting in a higher number of less expensive class B units.

As a result, we expect that the amount of new supply completing over the next 12 months will push the national vacancy rate up to 6.25% in 2024. It is important to note that this elevated level is expected to be short-lived and is expected to drop back down to 6.0% by 2025, as seen in the chart on the previous page. Additionally, a vacancy level of 6.0% to 6.25% is not that much higher than the long-term average of 5.75% from 2005 through 2022.

Estimated National Vacancy and Rent Trends through Fourth Quarter 2023



Source: Fannie Mae Multifamily ESR *Note: p = preliminary*

Rent Growth Expected to Remain Below Average

We believe that national rent growth was positive in 2023, but just barely, at an estimated 0.75%, despite turning negative at the end of the year. Last year's annualized rent increase is down significantly from an estimated 4.75% in 2022 and estimated 10% in 2021. We expect rent growth to start the year negative, but then turn slightly positive during the second and third quarters, and then turn negative again in the fourth quarter, resulting in an annualized range of between 1.0% and 1.5%.

However, it is important to note that if job growth turns significantly negative, and the broader economy slows down or enters a recession, rent growth could stagnate further or even end the year negative. There is still too much uncertainty at this stage to know how rent growth might ultimately be impacted over the coming months.

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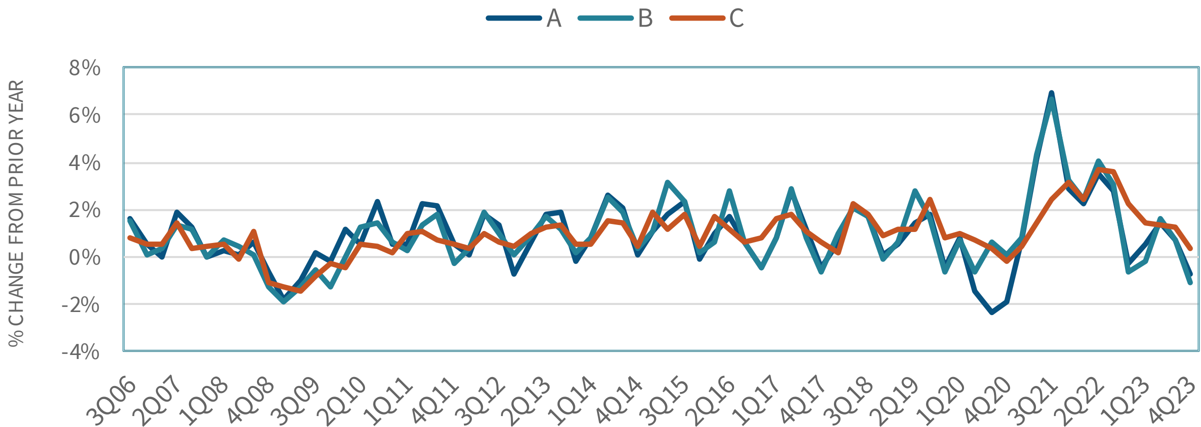
All Classes Experienced Below-Average Rent Growth in 2023

Demand for all classes of multifamily units remained subdued through much of 2023, as illustrated below. According to data from RealPage, Inc., as of fourth quarter 2023, quarterly effective rent growth for class A and B units had turned negative, to negative 0.69% for class A and negative 1.11% for class B. Class C rent growth was estimated to have remained positive but just barely at 0.33% for the quarter. We believe that the slowing in rent growth across all classes later in the year was the result of new supply entering many local markets, as well as weaker demand from new renters.

National Effective Rent Growth by Class



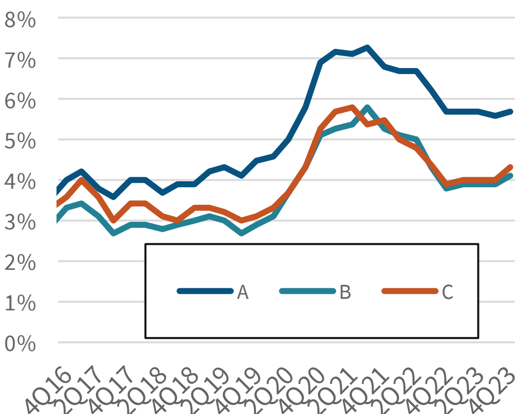
Source: RealPage, Inc.

Concessions Likely Heading Up in 2024

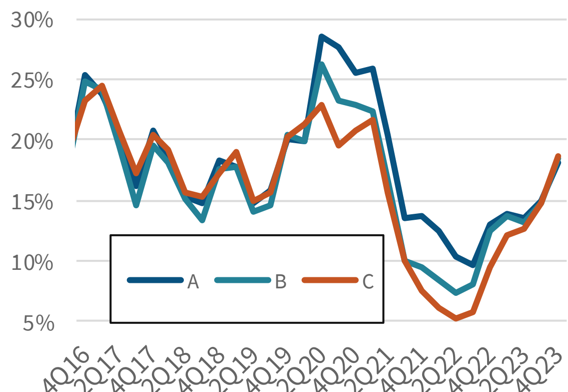
The number of properties offering concessions increased throughout much of last year, as seen in the chart below right. As of fourth quarter 2023, an estimated 18.1% of class A units were offering concessions, up from 13% a year ago. Class B units increased to 18.5% from just 12.5% in fourth quarter 2022, as did Class C units, which reached an estimated 18.6% as of fourth quarter 2023 compared to 9.5% a year ago.

Although the percentage of units offering concessions has been increasing for quite awhile, the concession levels themselves remained below one month's free rent, or 8.3%, as seen in the chart below left. Nevertheless, we expect that both the value of concessions and the number of units offering them will increase in 2024, primarily in oversupplied metros.

National Multifamily Concession Rate by Class



Percent Of Units Offering Concessions



Source: RealPage, Inc.

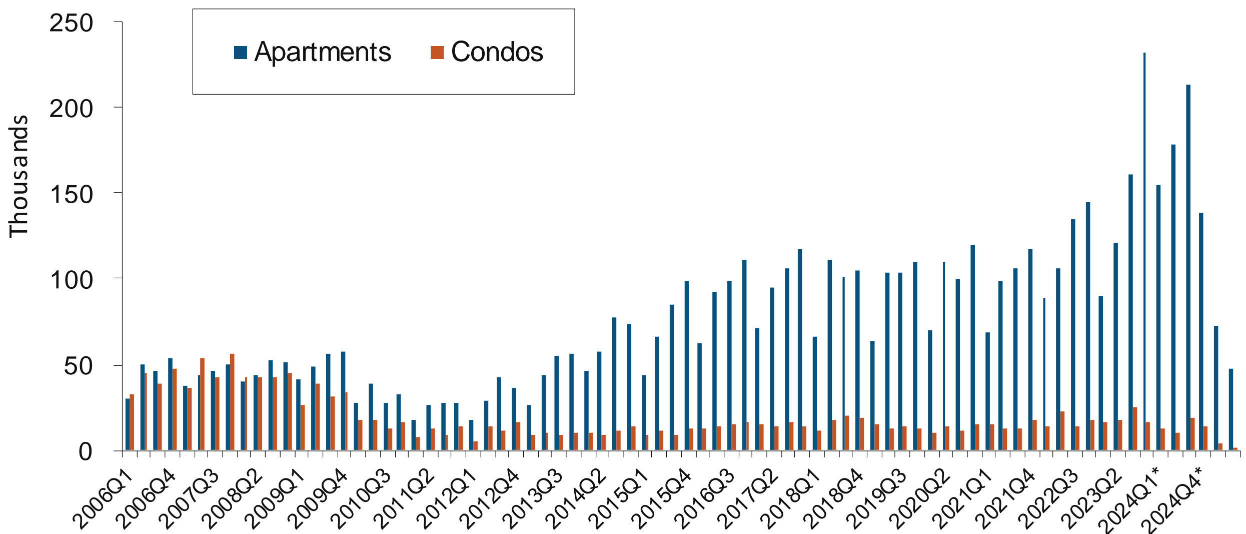
New Multifamily Supply Expected to Peak in 2024

According to preliminary data from Dodge Data & Analytics Supply Track, which distinguishes between multifamily properties consisting of apartment and condominium units, more than 500,000 apartment units were likely completed in 2023, up notably from 2022's 475,000 units – the most recent peak year for new deliveries. Although Dodge Data & Analytics is currently tracking nearly 736,000 multifamily rental units slated for completion in 2024, we believe it is very unlikely that all those units will be completed before year end, due primarily to ongoing construction labor shortages, rising material costs, economic uncertainty, and delays, notably permitting and financing delays.

Indeed, according to the National Multifamily Housing Council's *Construction Survey*, as of December 2023, 84% of respondents reported construction delays, with most stating the delays were caused by either permitting requirements or in actually getting the project started. And of those experiencing delays getting their projects started, 83% stated it was due to economic uncertainty and 79% said it was due to construction financing concerns.

Higher material costs were another issue, specifically noting that electrical component prices increased 11% and appliance costs increased 7%. And although 19% of respondents noted that there were more construction workers available, the majority, about 74%, noted that it was about the same as it was during the prior quarter.

Multifamily New Construction



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.

Source: Dodge Data & Analytics Supply Track, January 2024

** Anticipated completion date.*

Subdued Multifamily Demand Expected to Continue in 2024

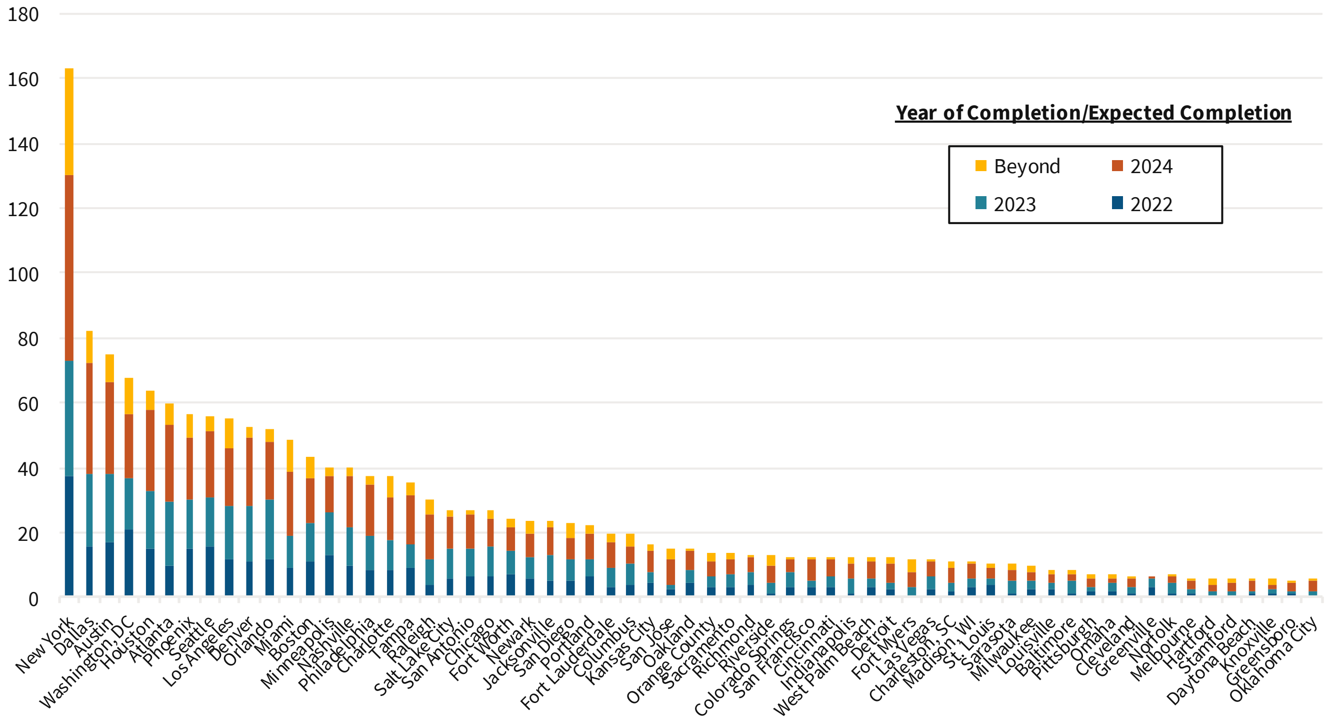
At a national level, we believe that there will continue to be a supply/demand imbalance this year, based on the amount of new multifamily units expected to come online compared to the anticipated increase in job growth. Although it is unlikely that all 736,000 new units slated for completion will be delivered by year-end 2024, the possibility of slower growth or even possible recession coupled with slowing job growth means that there is unlikely to be enough demand to keep up with the wave of new deliveries in some metros.

Year-over-year job growth is expected to be positive but subdued by the end of 2024, according to Fannie Mae's latest economic forecast, resulting in only a slight increase in the number of new jobs being added. That would likely keep new multifamily rental demand weak, just as an elevated level of new units are expected to deliver.

Much of this new supply is primarily concentrated in about 15 metros, as seen in the chart below. In addition, several of the impacted submarkets are located in some of the most expensive metros in the country, including **New York**, **Washington**, **DC**, **Seattle**, and **Los Angeles**.

Although Moody's Analytics is expecting some metros to see positive job growth in 2024, such as **Austin**, **Orlando**, and **Phoenix**, the amount of expected new units could still easily outstrip demand.

Multifamily Apartment Units Underway – Select Metros



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.

Source: Dodge Data & Analytics, January 2024– Metros with 5,000 or more units underway or completed.

Many Metros are Oversupplied...

There are a number of oversupplied metros across the country, in terms of the amount of new supply underway compared to the current inventory of multifamily units. As seen in the chart below, metros such as **Austin**, **Denver**, **Charlotte**, **Miami, Orlando**, **Nashville**, **Raleigh**, **Colorado Springs**, and **Huntsville**, all have more than 10% of their respective multifamily inventories underway. In general, a market is considered in balance when it has between 2% and 4% of inventory underway, and with some of these metros expecting below average job growth this year, many are expected to remain oversupplied over the next 12 to 18 months.

Multifamily Units Underway and Percent of Market Units – Select Metros

Units Underway (Thousands): 0, 10, 20, 30, 40, 50, 60, 70

Units Underway % of Market Units: 0%, 2%, 4%, 6%, 8%, 10%, 12%, 14%, 16%, 18%

New York, Dallas, Austin, Atlanta, Phoenix, Denver, Washington, Charlotte, Miami, Houston, Seattle, Los Angeles, Orlando, Philadelphia, Nashville, Tampa, San Antonio, Minneapolis, Northern New Jersey, Raleigh, Boston, Chicago, Jacksonville, Fort Lauderdale, Columbus, Indianapolis, Salt Lake City, Las Vegas, San Diego, San Jose, Portland, Kansas City, Richmond, Inland Empire, Colorado Springs, Huntsville, Palm Beach, Detroit, Charleston

■ Units Underway ● Units Underway % of Market Units

Source: CoStar

... But Others Are Not

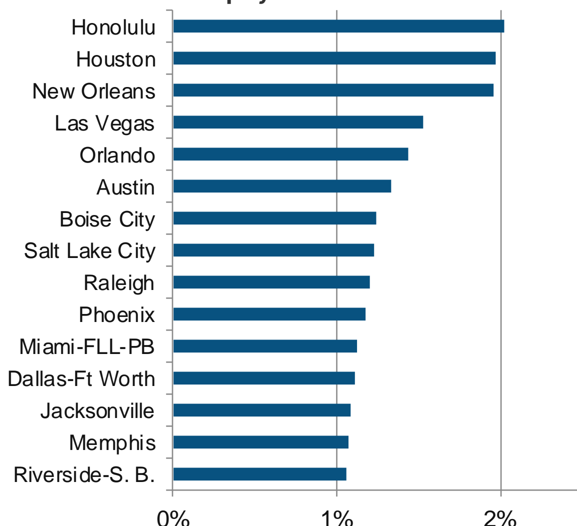
In contrast, some metros could be undersupplied, including **New York**, **Los Angeles**, **Chicago**, **Houston**, the **Inland Empire**, **Portland**, and **San Diego**, all with about 4% or less of inventory underway. For example, many California metros are likely to remain undersupplied, despite a recent increase in new construction, due to pent-up demand for rental housing after decades of underbuilding coupled with elevated single-family housing prices.

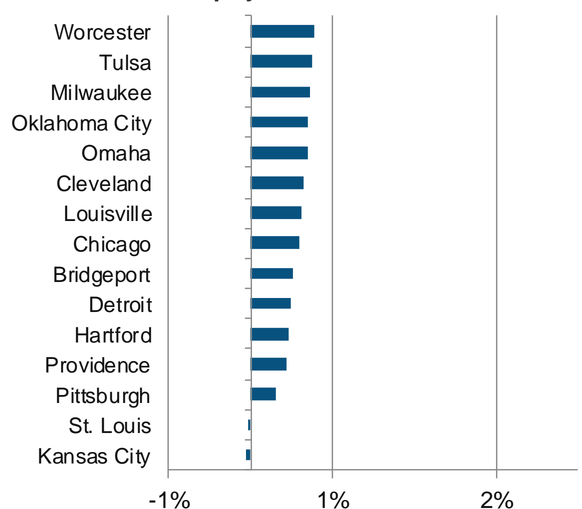
Positive Job Growth Will Not Be Enough in Some Metros…

Although at a national level job growth is expected to be just 0.6% in 2024, Moody's is expecting a number of metros will see job growth exceed the national average, as illustrated below. Some **Texas** metros, such as **Austin**, **Dallas**, and **Houston**, are all expected to have job growth of between 1.0% and 2.0%, making them some of the best performing in the nation. Yet it is not expected to be enough to keep up with all the potential new supply. For example, with job growth forecasted at 1.3% this coming year, **Austin** could produce demand for about 5,900 new multifamily units, but the new supply expected to deliver in 2024 totals more than 28,000 units, meaning an excess of more than 22,000 units. **Dallas** is expecting about 34,000 new multifamily units in 2024 but based on Moody's Analytics' anticipated job growth rate of 1.1%, the metro would likely only have demand for a little more than 12,000 units, leaving a potential excess of 29,000 units. **Houston**, which Moody's expects to have some of the nation's best job growth at 2.0% this year, is expecting nearly 25,000 multifamily units, but the expected number of new jobs is likely only going to produce demand for about 13,000 units, leaving an excess of more than 11,000 units.

… But Others Become Undersupplied by 2025

There are some metros, such as **Las Vegas**, **Los Angeles**, **Chicago**, and **Orlando**, that might have too much supply this year, but could be undersupplied by as soon as 2025. For example, **Las Vegas** has more than 5,500 units expected to deliver by the end of 2025, and while it is expected to be oversupplied in 2024, by the following year, it couldactually be undersupplied by more than 2,500 units. **Los Angeles** is also expected to be briefly oversupplied this year, by about 5,800 units, but will likely fall short by an estimated 3,400 units by 2025. Similarly, **Chicago** is expected to be oversupplied by about 5,300 units this year but will be undersupplied by about 2,100 the following year. **Orlando** has a projected oversupply of more than 11,000 units in 2024, but just a year later could be short by a little more than 1,250 units. In some metros, patience will likely be a virtue in terms of waiting for a multifamily supply/demand balance.





Source: Moody's Analytics

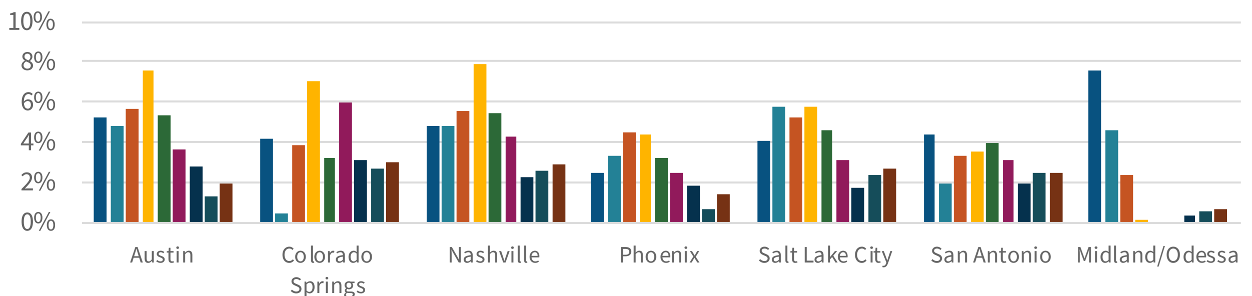
Some Metros May See Higher Than Average Vacancy Rates for Awhile

As a result of increased new construction, many oversupplied metros may find that their average multifamily vacancy rates are going to stay higher longer. In taking a closer look at some of these metros, although the amount of new supply tends to decline over the next five years, as seen in the charts below, the vacancy rates stay relatively elevated.

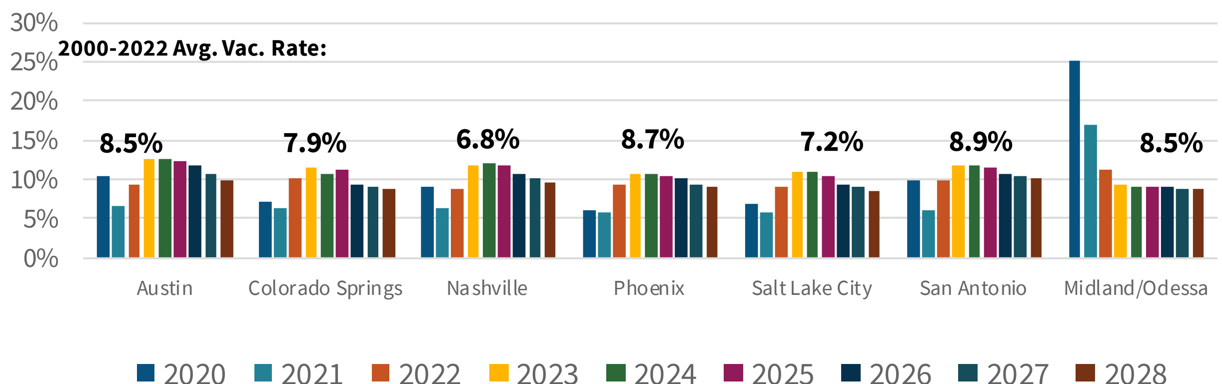
For example, according to third quarter 2023 projections from CoStar, despite **Austin's** new construction pipeline declining to just under 2% of its multifamily inventory by 2028, its vacancy rate is expected to be 10% that same year, well above the metro's long-term average of 8.5%. Similarly, CoStar believes that **Nashville** is also poised to see a higher-than-average vacancy rate of nearly 10% by 2028 compared to its long-term average of 6.8%.

In contrast, **Phoenix** is likely returning to its long-term average vacancy rate due to all its new supply. With its new construction pipeline falling to an estimated 1.3% of inventory by 2028, CoStar is expecting the metro's vacancy rate to be about 9%, which is only slightly above its long-term average of 8.7%. **Midland-Odessa** is in a similar position, with its vacancy rate expected to be an estimated 8.8% by 2028, which is only slightly higher than its long-term average of 8.5%.

Units Completed By Year (% of Market Inventory) – Select Markets



Historical and Forecasted Vacancy Rates – Select Markets



Source: CoStar, Q3 2023

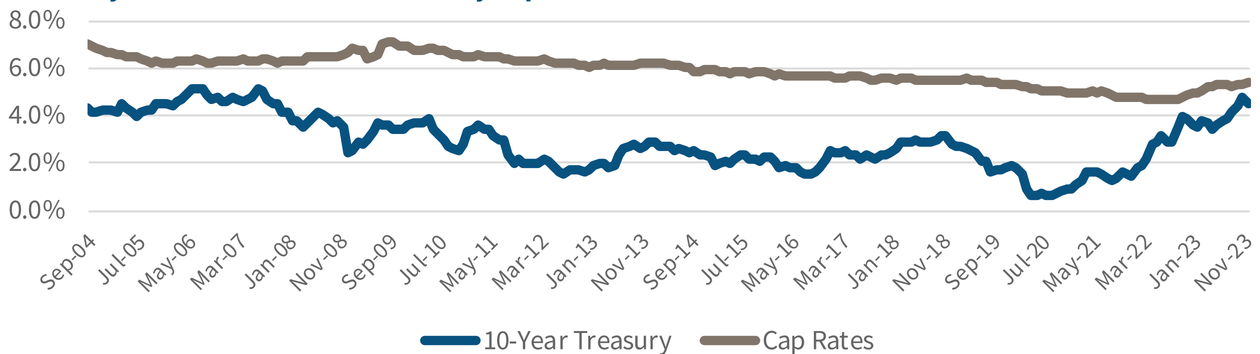
Source: Moody's Analytics

Multifamily Property Sales Volume Expected to Remain Subdued in 2024

Higher interest rates dampened investor appetite for purchasing commercial real estate properties in 2023, and multifamily properties were no exception. Sales of U.S. multifamily properties plummeted last year, totaling just an estimated $105.5 billion year to date through November 2023 for properties valued at $2.5 million or higher, according to data from MSCI Real Assets.

As expected, November's average cap rate was estimated at 5.36%, which was up slightly from 5.32% in October and up quite a bit from 4.82% as of November 2022, according to data from MSCI Real Assets and as seen in the chart below. We anticipate that cap rates could inch up higher this coming year, perhaps climbing to as high as 5.75% before declining back to between 5.5% and 5.25% over the next 12 to 18 months, in response to any interest rate reductions.

Treasury Interest Rates and Multifamily Capitalization Rates



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

2024 Multifamily Outlook: Skies Remain Cloudy

We continue to maintain a cautious outlook for the national multifamily sector in 2024. We expect the multifamily sector will see a further softening in demand this year, possibly resulting in negative rent growth during the first quarter of 2024 due to new supply entering the market, especially during what is normally a slow lease-up time of the year, as well as again during the fourth quarter due to the additional stressor of expected slower job growth.

At a metro level, demand will vary. In some metros, especially those with a large amount of supply expected to come online during the year, we believe rents could remain flat to negative much of the year, in turn pushing up concession rates as well as the number of units offering them, but that is likely to be at a localized, submarket level. In other undersupplied metros, rent growth is expected to be positive but will not be at sufficient enough levels to dramatically alter the overall national outlook.

As a result, we expect multifamily origination volume levels will remain subdued. As of October 2023, the Mortgage Bankers Association is estimating that multifamily originations volume will be $285 billion in 2023 and $339 billion in 2024, but that is subject to change. Based on current trends, our estimated annual multifamily originations are in the same general range, albeit slightly lower: $255 billion to $275 billion in 2023 and $295 to $325 billion in 2024.

It is important to note that Fannie Mae expects economic growth to slow in 2024 and the risk of recession remains elevated. We expect the multifamily rental market to see continued softness in demand from both tenants and investors, and a return to more normalized trends is not anticipated until mid-2025.

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