Multifamily Economic and Market Commentary

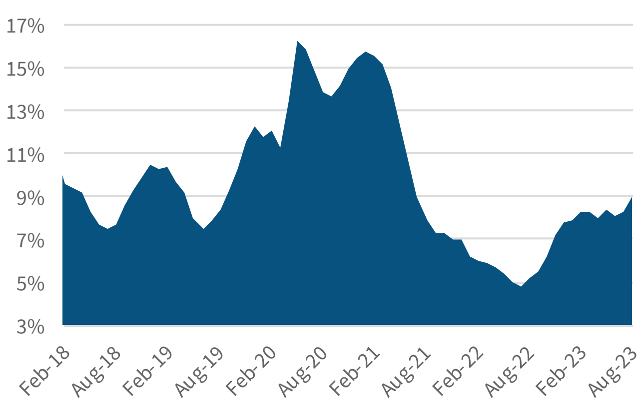
OCTOBER 2023

Rising Number of Multifamily Properties Offering Concessions

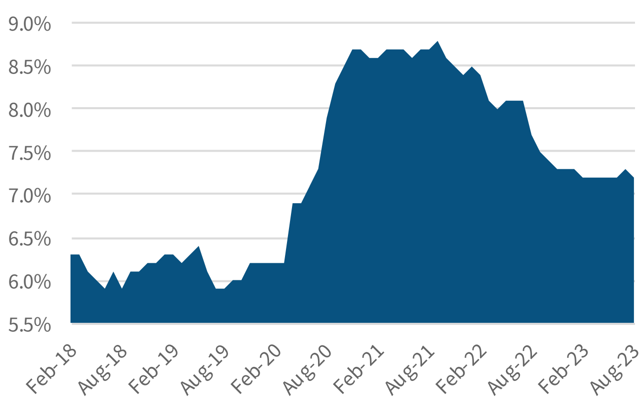
Multifamily market fundamentals have softened in 2023 compared to the prior year, the result of mixed economic trends including slowing-but-still-positive job growth, elevated single-family housing prices keeping many renters in place, and continued favorable demographics. Rent growth was exceptional over the past two years, and, of course, unsustainable, thus 2023 has seen a substantial slowing of rent growth rates. There remains a robust pipeline of new apartment rental projects that are underway in the nation's largest metros, and with recessionary concerns there has been a rise in the number of properties across the country offering concessions.

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 show that the multifamily market has seen softening trends over the past year: There is a notably higher percentage of units offering concessions than a year ago – up from 5.2% of all units in August 2022 to 9.0% of all units in August 2023. However, the value of the concession being offered has slightly declined, from 7.7% of asking rent in August 2022 to 7.2% in August 2023, which is slightly less than one month's free rent. It's important to note that the overall level of concessions continues to be well above the low levels observed just before the pandemic.

National % of multifamily units offering concessions



Multifamily concession rate



Source: RealPage

Supply of New Units Remains High

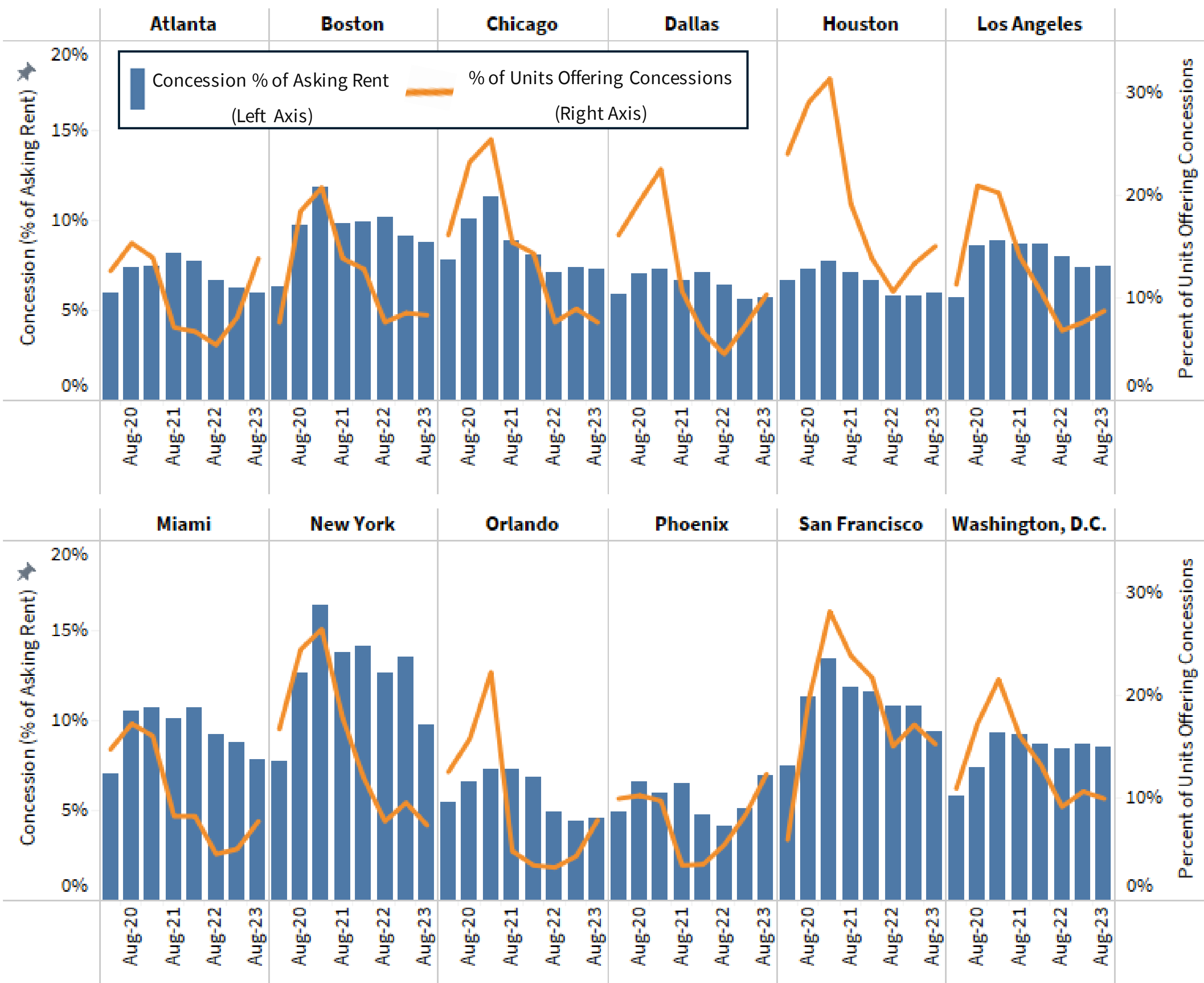
According to the Dodge Data & Analytics Supply Track construction pipeline data, the number of apartment units completed across the country may reach a record in 2023. According to Dodge, as of the middle of 2023, nearly 730,000 units were underway with completion dates expected in 2023, though only 164,000 were completed year to date through April. That's compared to full-year totals of 479,000 units in 2022 and 395,000 units in 2021. The overall pipeline underway is slightly lower than it was in the prior year: As of July 2023, 1,116,000 units were underway, compared to 1,141,000 in July 2022. With supply chains operating more efficiently in 2023 than in 2022, substantially more units may be completed this year than last, which we believe might lead to about 500,000 units delivering this year.

Concessions Declining in Most Major Markets

As has been the case for several years, new apartment supply has been concentrated in the nation's largest and rapidly growing metropolitan areas. New York City continues to be the most active metro in the country, with nearly 150,000 units either recently completed or underway, with Dallas next at 74,000 units. Houston and Atlanta are also each expecting at least 50,000 units will be completed this year.

The robust supply in many of these markets, along with consumer skittishness over economic trends, appears to have impacted demand. As seen below, with the exceptions of New York and Chicago, all have seen the percentage of units offering concessions rise compared to the prior year. Atlanta, Dallas, and Phoenix have each seen increases of more than 5%. It is noteworthy, however, that eight of the 12 markets shown below have seen concession values decline over the prior year, and that the largest increase, in Phoenix, was just 2.8%. We believe that these mixed trends suggest that demand for rental apartments has declined so quickly, especially over the past few months, that combined with competition from new units coming online, Class A unit property owners are instead dropping asking rents to lure in new tenants.

Multifamily monthly concession rate by market – select metros



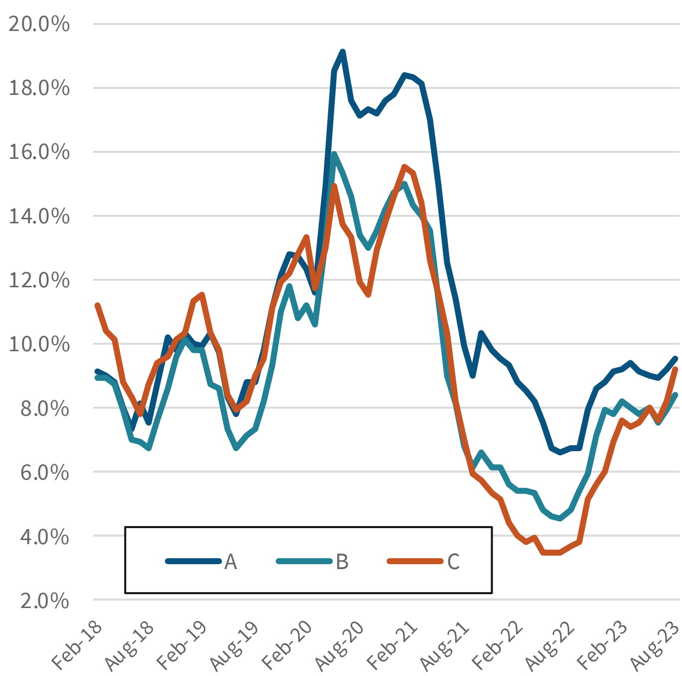
Source: RealPage

Higher Class A Concessions Continue, More B and C Offering Concessions

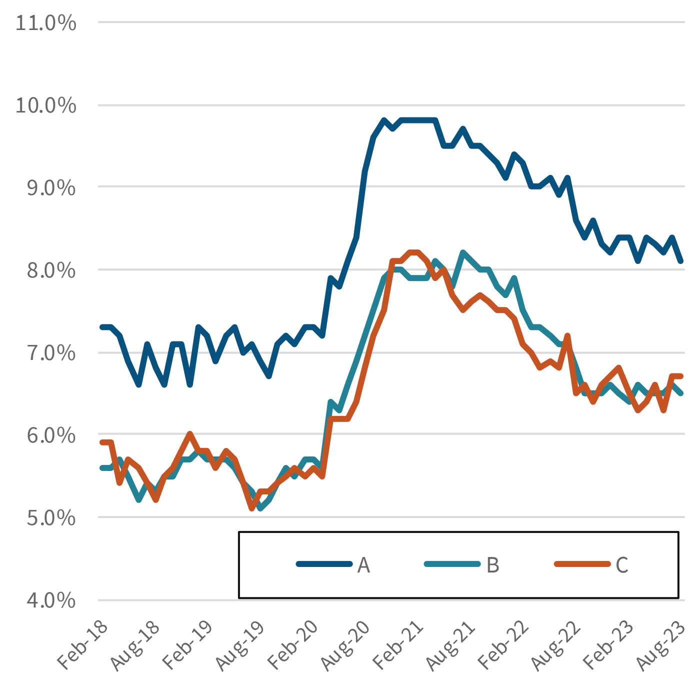
During the current multi-year development cycle, multifamily builders have primarily been constructing more expensive, amenity-offering apartments, usually referred to as Class A units. As seen in the charts below, with increased competition among this class, property owners have had to offer a generally higher level of concession, as well as more properties having to offer them. The value of Class A concessions increased significantly at the beginning of the pandemic and has remained comparatively high, well above Class B and C units during this period. And over the past year, as demand has softened compared to the prior year, the value of concessions for Class A units has declined slightly, from 8.6% in August 2022 to 8.1% in August 2023, most likely due to the decrease in asking rents. But the percent of Class A units offering these concessions has risen more notably, from 6.7% a year ago to 9.5% as of August 2023.

The softening demand for apartments over the past year is also observed in the rising percentage of units offering concessions in Class B and C units. As of August 2022, 4.8% of Class B units were offering concessions, while just 3.7% of Class C were. But both classes have seen noteworthy increases: As of August 2023, 8.4% Class B units were offering concessions, up 3.6% from the prior year, and 9.2% of Class C units were, up 5.5% from the prior year.

Percent of units offering concessions by class



National monthly concession rates by class



Source: RealPage, Inc.

Its is noteworthy, however, that the value of the concession being offered has not changed significantly among Class B and C units over the past year. Class B units have slightly decreased the value of the concessions being offered, from 6.8% a year ago to 6.5% in August 2023. However, the value of Class C concessions has risen slightly, increasing from 6.5% a year ago to 6.7% in August 2023.

The mixed signals across all three classes of properties indicate that overall demand has softened and that many property owners have decided to move quickly by dropping asking rents combined with offering a slightly lower concession as an offset in an attempt to bring in new tenants.

Further Softening Expected to Lead to More Concessions and Stagnant Rent Growth

After exceptional rent growth rates in 2021 and 2022, it was generally expected that 2023 would see easing of multifamily rent growth and overall fundamentals, including vacancy rates. In general, that has been the case. Softening in demand during the first half of this year resulted in a below-average rent growth of just 1.0% for the nation, and a modest rise in vacancies. But some metros had notably weaker results, experiencing modest rent contractions, including Austin, Las Vegas, San Francisco, and Phoenix.

Because of this fundamental demand softness, and our current expectation of a mild recession in the first half of 2024, a further rise in the number of units offering concessions may be on the horizon. It is noteworthy that amid significantly weaker conditions in 2023 compared to 2022 the value of concessions offered by property owners has been generally stable; instead, property owners have moved to offering lower asking rent levels.

However, with a robust pipeline of supply expected over the next 18 months, we believe there will continue to be pressure on owners to offer more generous concessions along with lower rents. Combining that new competition with likely unemployment increases and a rental household formation slowdown would likely result in owners using a combination of both options to not only retain their current tenants but to also gain new ones. And that would still include all classes of units, including the more affordable Class B and C.

We believe the forecasted economic slowdown, combined with the robust supply of new apartment units that are underway, will likely add stress to the multifamily sector over the next 12 to 18 months. But we continue to believe that demand for multifamily rental housing will remain stable over the longer term due to home purchase affordability constraints and higher interest rates keeping many tenants from moving to homeownership. As a result, we believe that many renters-by-choice will stay in their units for slightly longer, especially if they are able to take advantage of lower rent levels and more generous concessions.

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