Fannie Mae

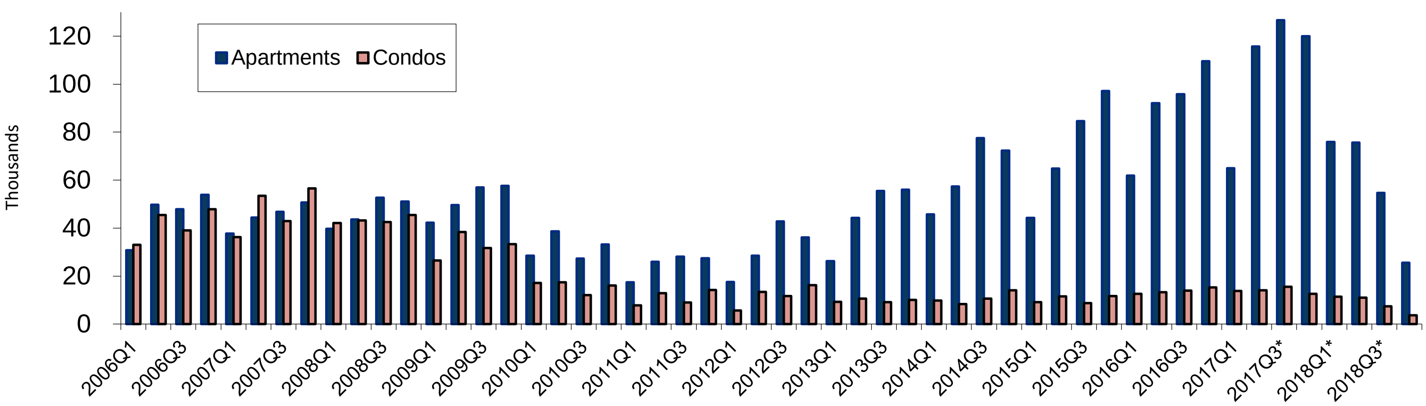
Multifamily Market Commentary – June 2017

Multifamily Supply and Demand Varies by Metro

Across the country, there are more than 630,000 new multifamily units currently underway with more than 400,000 of those units expected to complete and come online this year. That is in addition to the nearly 900,000 multifamily units delivered between 2014 and 2016. These totals are for multifamily rental units only; there are fewer than 84,000 condominium units in total underway, with only about 53,000 condo units expected this year.

And while this sounds like a *lot* of new units, in fact, at a national level, the potential demand for new multifamily units likely outstrips the current supply. At a national level, the amount of new multifamily units being added to the existing stock is not unreasonable. Job growth is expected to be about 1.6 percent this year, according to Moody's Analytics, which would be an estimated addition of 2.3 million new jobs. Based on that amount of job growth, theoretically multifamily rental demand could be in the range of about 460,000 units. Unfortunately, much of this potential demand – and supply – varies greatly from metro to metro.

Construction Pipeline



Source: Dodge Data & Analytics, May 2017

NOTE: Pipeline data is not an actual forecast of activity, it is a monitor of activity reported to date. As more projects are planned and tracked, figures in future periods might go up.

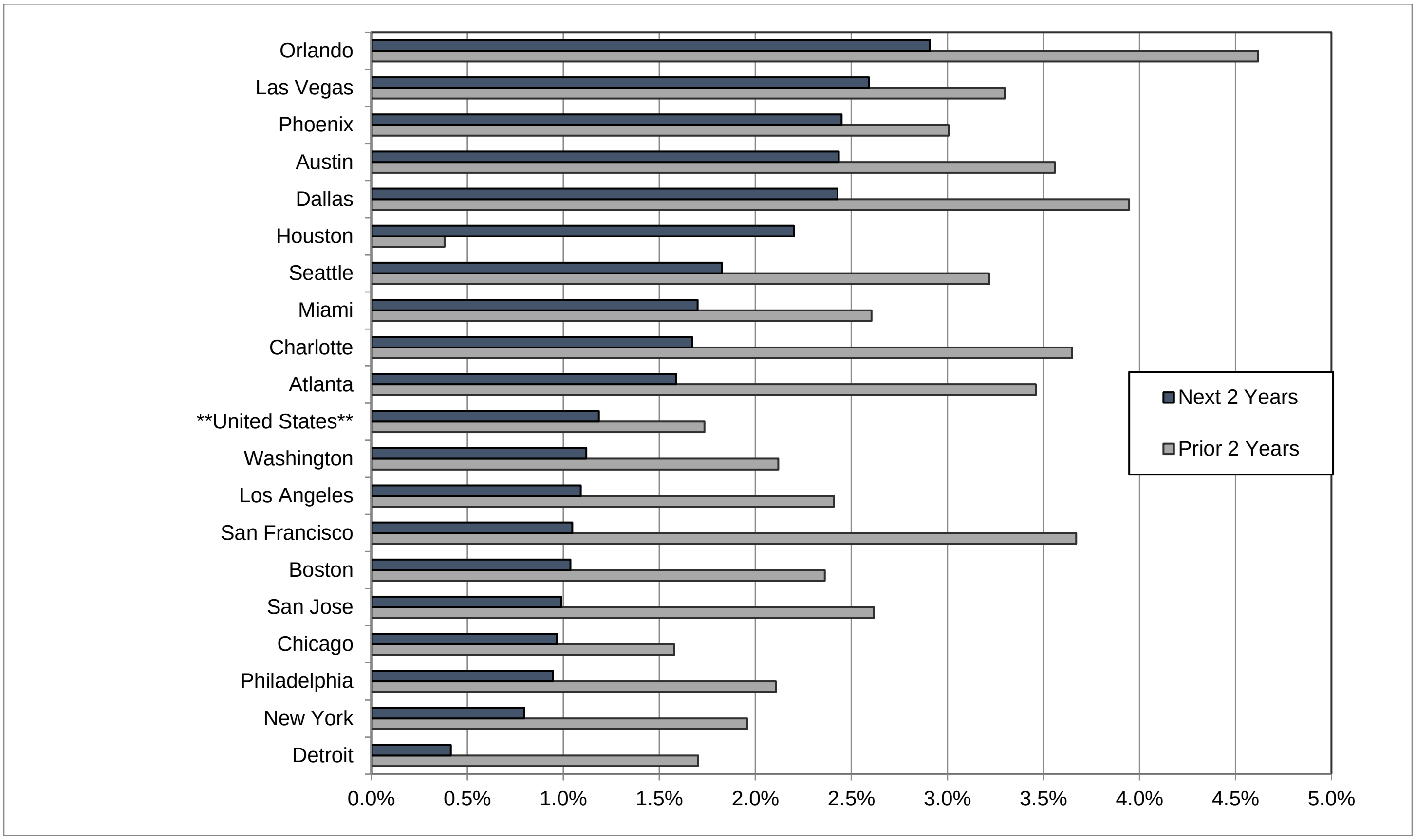
Moderating Job Growth

As seen in the chart below, positive job growth is expected in most of the nation's major metros over the next two years. Job growth over the past seven years is bringing the nation to near full employment, as reflected in the May 2017 unemployment rate of just 4.3 percent. So, it isn't surprising that slower job growth is expected in most metros over the next two years.

Some of the metros with the best anticipated job growth are also those that suffered some of the biggest job losses during the Great Recession—notably **Orlando**, **Las Vegas**, and **Phoenix**. **Houston** appears poised for improved job growth, but much of that projection is based on rising energy prices. With oil prices hovering in the sub-$50 per barrel range, this forecast may be optimistic.

Job growth projections in some of the nation's most expensive rental housing metros, such as **San Francisco**, **San Jose**, **New York**, and **Boston**, are expected to slow down quite significantly. Much of this anticipated decrease is likely due to the slowing of the high-tech industry, which had been fueling job creation in many of these metros, especially on the West Coast.

Change in Employment (CAGR) – Select Metros



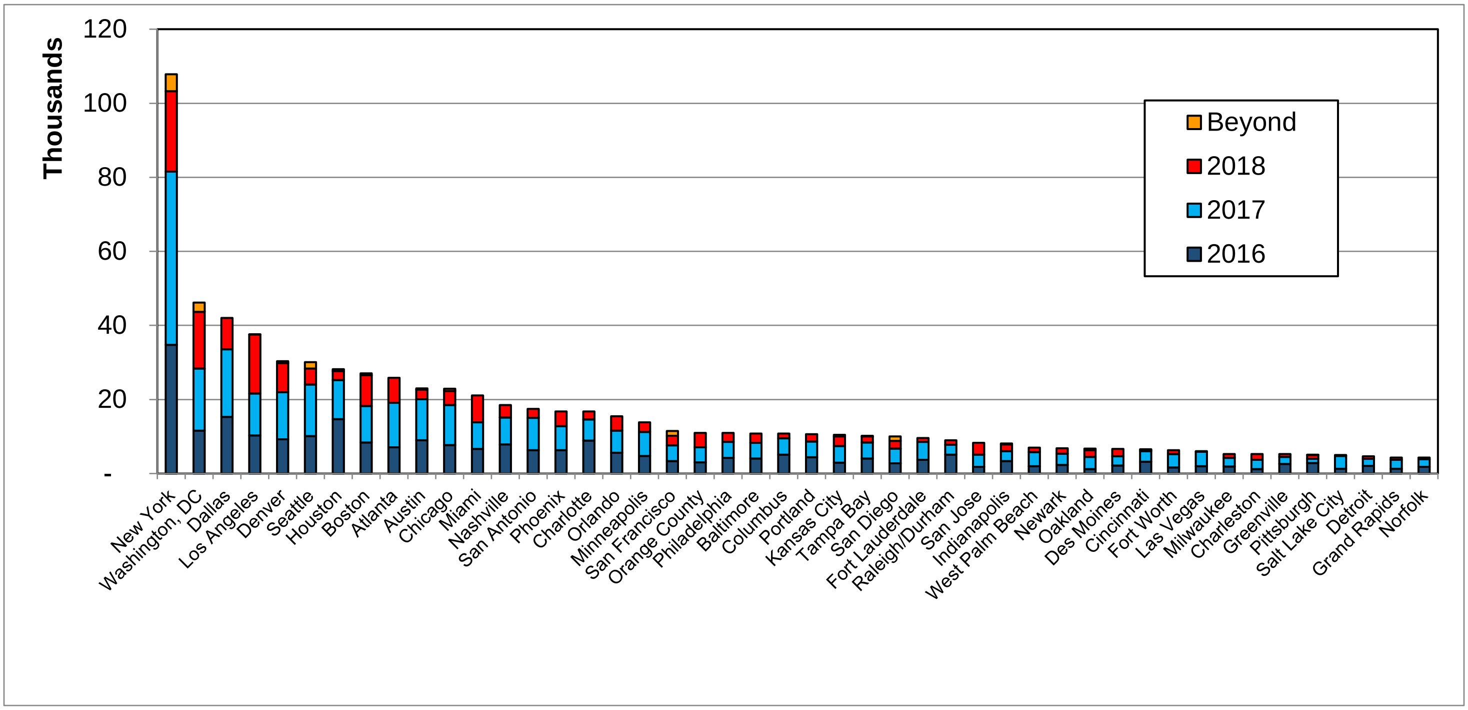
Source: Moody's Analytics, 1Q2017

New Supply Concentrated in a Handful of Metros

As seen in the chart below, only 12 metros have more than 20,000 units that are completed or underway since 2016. This new supply is not evenly distributed throughout these metros and instead is concentrated in a limited number of submarkets. Even in the **New York** metro, about 43 percent of its nearly 86,000 multifamily units under construction are located in just two boroughs: **Brooklyn** and **Queens**. In fact, with more than 20,000 multifamily rental units underway, Brooklyn has more units underway than **Manhattan**, which has about 18,000 units underway. As a result, concessions currently are at just -2.0 percent for the greater New York metro according to Axiometrics, but above -8.3 percent for both Manhattan and Brooklyn, which is more than a month's free rent.

At nearly 35,000 units, **Washington, DC** has the second-highest level of new multifamily rental supply underway. The bulk of the DC metro's new multifamily construction is located within the District itself, with more than 16,000 units underway. The most impacted District submarkets include Anacostia, Northeast, Capitol Hill, Logan Circle, the Southwest Waterfront, Brightwood, and Mt. Pleasant. The Northern Virginia submarkets have more than 8,500 multifamily rental units underway, located primarily in Tysons Corner, Rosslyn, Ballston, Shirlington, and Old Town Alexandria.

Multifamily Apartment Units Underway – Select Metros



Source: Dodge Data & Analytics, April 2017 – Metros with 4,000 or more units underway or completed.

NOTE: Pipeline 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.

Developers Focused on High-Cost Metros

Why are developers building so many new multifamily units primarily in higher-cost metros? The leading reason is rising construction costs. According to the Engineering News-Record's Construction Cost Index, overall construction costs have risen about 2.6 percent annually on average over the past five years. The cost of most building materials doesn't really fluctuate regardless of the location of the construction project. Therefore, many developers have been focusing on those metros that boast a trifecta of solid job growth, positive demographic trends, and above-average asking rents.

This helps explain why metros such as Indianapolis or Cincinnati – both of which have had positive job growth over the past few years – do not have elevated levels of new multifamily supply underway. For example, Cincinnati had job growth of 1.8 percent in 2016 and is expected to have at least 1.6 percent job growth this year. And while about 2,900 units are due to complete and come online in 2017, there is potential demand for about 3,800 multifamily rental units this year alone. But Cincinnati's average asking rent is estimated at just $850, as of the fourth quarter of 2016. That rent level is not much of an incentive for developers to build new multifamily projects in Cincinnati if there isn't much of a project cost differential between it and a higher asking-rent metro, such as Seattle.

A Variety of Oversupplied Metros
As seen in the table to the right and highlighted in yellow, there are some metros that are considered oversupplied over the next 12 to 24 months, based on projected job growth. Some of the larger and higher-cost metros include **New York**, **Washington, DC**, and **Miami**, but even smaller, less expensive rental metros have not been spared. These include **San Antonio**, **Nashville**, and **Charlotte**.

Portland is one example of a smaller metro that has been attracting residents and investment. Expansion of the high-tech sector here has helped boost much of Portland's job growth, representing nearly 8 percent of the employment base.

While jobs in this sector tend to pay well, it can also be quite volatile, especially since the metro's largest employer is Intel, with more than 17,000 local employees. As a result of the influx of younger, well-educated, and well-paid residents, developers have focused on catering to this particular Millennial cohort, thereby creating too much expensive multifamily development in too few submarkets. About 70 percent of the units underway are Class A units but are located in just three submarkets: Northwest, Northeast, and Beaverton.

High-Tech Metros Equals High Levels of Supply
Other oversupplied metros include high-tech-centric metros such as **Austin**, **Seattle**, and **Denver**. In **Austin**, nearly one-tenth of jobs are in the high-tech sector, particularly in semiconductor and computer manufacturing. Some of the metro's largest employers include Google, Apple, Facebook, IBM, and Samsung. This has led to an abundance of new multifamily supply geared toward Millennials who want to work and live downtown.

As a result, Austin's apartment market is likely in for some volatility as some of the new jobs expected over the next few years may not come from the high-tech sector nor pay enough to support Austin's escalating asking-rent levels.

Undersupplied Might be an Overstatement
It is important to remember that estimating job growth and potential multifamily demand is just that: an estimate. In some cases, it is also an expectation that all of a metro's economic drivers will coalesce at the same time. This can result in a metro appearing to be undersupplied but is nevertheless experiencing increasing concessions coupled with moderating or even negative rent growth.

Houston is one such example. Although the metro could produce enough jobs to create demand for 29,000 multifamily rental units, there is already too much supply resulting from nearly stagnant job growth over the past few years, leading to a current concession rate of 3.0 percent—about triple the national average. In addition, much of that projected job growth is dependent upon an expectation of rising oil prices over the next two years.

Expected Supply and Potential Demand of New Multifamily Units

	Total New Units Expected	
Metro Area	Supply (Units)	Potential Demand
New York	85,908	56,106
Los Angeles	34,925	35,838
Washington	32,880	23,578
Dallas	31,683	39,943
Miami	27,626	21,208
Seattle	22,909	20,020
Atlanta	19,307	23,023
Denver	18,501	12,414
Boston	17,609	18,210
Chicago	15,406	20,571
Houston	14,166	29,242
Austin	14,128	12,843
San Francisco	13,960	15,721
Nashville	12,907	8,113
Orlando	12,153	16,732
San Antonio	11,518	9,334
Phoenix	10,586	20,324
Philadelphia	10,496	12,497
Charlotte	10,045	8,782
Portland	9,982	9,392

Source: Dodge Data & Analytics and Moody's Analytics

Note: Supply equals total number of apartments units completed in 2017 and 2018 per Dodge Pipeline. Potential Demand is estimated by factoring in both the amount of new supply and the total number of new jobs expected in the metro in 2017 and 2018, per Moody's Analytics.

Positive Job Growth Encouraged Too Much Supply
There are a number of metros that are expected to have above-average job growth between 2016 and 2018, as seen in the table to the right. Unfortunately, that projected job growth encouraged developers to start building too many units in too few places.

One of the more startling examples of this supply/demand imbalance is **Nashville**. Nashville's multifamily rental sector has had robust deliveries of new units in the past several years, riding a wave of strong job and population growth, as well as an impetus to replace multifamily units lost in the floods of 2010. Unfortunately, it has simply been too much of a good thing, with more than 20,000 units completed since 2012 and another 13,000 units underway. As a result, modest rent growth, rising concessions, and increasing vacancy rates are expected in the near term.

Some Metros Need More Supply
Orlando and **Phoenix** are both poised once again to see some of the best job growth in the nation this year, as seen in the table to the right, due primarily to growth in the professional services, healthcare, and tourism sectors. Yet both metros are likely to be under-supplied. Orlando is expected to see job growth of nearly 7 percent between 2016 and 2018 but supply will likely fall short of demand by more than 4,500 units. Phoenix is also likely undersupplied. Its job growth should produce demand for more than 20,000 multifamily units, but only about half that amount is underway.

Brighter Outlook Longer-Term
It is important to keep in mind that this mismatch of supply and demand in many metros is expected to be short-lived, lasting only over the next 12 to 24 months. After that time, it is expected that the multifamily sector's underlying fundamentals in these metros will at least stabilize, if not improve, as this new wave of supply finally ebbs, allowing anticipated positive job growth and demographic trends to create more normalized—and even increasing—multifamily rental demand.

Expected Change in Jobs and Multifamily Units

	% Increase: 2016 vs. 2018		
Market	**MF Inventory**	**Total Jobs**	**Difference**
Nashville	9.6%	4.2%	-5.4%
Denver	6.1%	3.4%	-2.7%
Kansas City	5.4%	2.8%	-2.6%
Charlotte	6.0%	3.8%	-2.3%
San Antonio	6.8%	4.5%	-2.2%
San Jose	3.8%	1.7%	-2.1%
Washington	4.6%	2.9%	-1.7%
Austin	6.7%	5.1%	-1.6%
Seattle	5.6%	4.1%	-1.5%
Boston	3.9%	2.7%	-1.2%
New York	2.9%	1.8%	-1.1%
Portland	4.9%	4.1%	-0.8%
Baltimore	2.9%	2.3%	-0.6%
Philadelphia	2.7%	2.2%	-0.5%
Columbus	3.9%	3.5%	-0.4%
Minneapolis	3.0%	2.6%	-0.4%
Indianapolis	3.3%	3.0%	-0.3%
Virginia Beach	2.4%	2.2%	-0.3%
San Francisco	2.7%	2.7%	-0.1%
Honolulu	1.6%	1.6%	0.0%
Los Angeles	2.4%	2.4%	0.0%
Milwaukee	2.4%	2.5%	0.1%
Atlanta	4.0%	4.3%	0.2%
St. Louis	1.9%	2.2%	0.3%
Pittsburgh	2.2%	2.7%	0.5%
Chicago	1.6%	2.2%	0.6%
Sacramento	1.7%	2.3%	0.7%
San Diego	1.8%	2.6%	0.8%
Dallas	4.7%	5.6%	0.9%
Miami	2.8%	4.1%	1.2%
Cleveland	1.2%	2.6%	1.4%
Orlando	5.3%	6.8%	1.5%
Detroit	0.9%	2.5%	1.6%
Tampa	2.5%	4.2%	1.7%
Riverside	0.8%	2.6%	1.8%
Cincinnati	1.4%	3.4%	2.1%
Phoenix	3.0%	5.1%	2.1%
Houston	2.2%	4.9%	2.7%
Las Vegas	2.2%	5.6%	3.4%

Source: Dodge Data & Analytics and Moody's Analytics

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