

# Multifamily Market Commentary – September 2012

## Multifamily Construction Gaining Steam

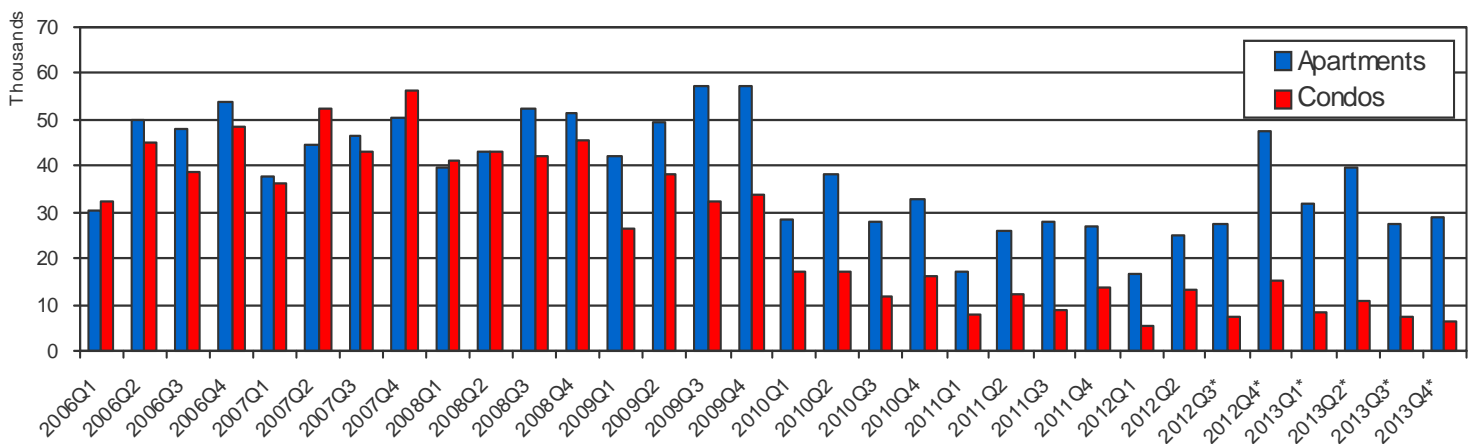
Multifamily construction starts increased during the first six months of 2012 to an annualized rate of over 220,000 units on average, based on data from the Census Bureau. The recent trend of increasing multifamily starts indicates that the sector could return to a more normalized annual rate of approximately 245,000 units started by as early as the end of this year. On the other hand, the number of completions expected to occur in 2012 and early 2013 remain below recent historical norms.

### Anticipated Short-Term Completions Remain Muted

Although there is a potential of over-supply occurring in late 2013 into 2014, it is likely limited to a small number of submarkets. In reality, the overall national rental market's pace of supply may not meet future demand based on expected annualized obsolescence of approximately 120,000 units on average, as well as anticipated household formation trends over the next few years.

That's because the current level of apartment projects under way is actually fairly low. According to the CBRE-EA/Dodge Construction Pipeline, approximately 118,000 apartment units that are currently under way are expected to reach completion this year. The bulk of these apartments (approximately 75,000) are expected to complete during the second half of the year. There are slightly more apartment units currently under way and expected to finish construction in 2013 (approximately 128,000 units). But this number could change dramatically – and quickly – if starts keep picking up at the current rate.

**National Condo and Apartment Completions and Units Under way**



Source: CBRE-EA/Dodge Pipeline, August 3, 2012

\* Expected completion date

## Increase in Projects in a Few Metro Areas

Compared to just six months ago, the number of projects under way has increased, especially in certain metro areas. For example, Dallas, TX went from about 8,000 units that are under way back in February to more than 13,000 units by August. Austin, TX also saw a dramatic increase to more than 8,800 units under way from about 3,800 just six months ago. Fortunately, according to Moody's Analytics, Austin's projected employment growth is expected to be fairly robust at 3.0 percent this year and again next year, with Dallas close behind at 1.9 percent and 2.3 percent, respectively.

The greater New York City metro area has the most units under way – nearly 19,000 – but should still experience positive net absorption due to ongoing rental demand growth combined with a steady job growth projection rate of 1.9 percent this year and in 2013.

Washington, DC, on the other hand, might see a much slower net absorption of new units. With 4.5 million people, the DC metro area is much smaller compared to New York's 11.6 million person population, but DC's 16,000-unit pipeline rivals New York's. More concerning, the DC metro area is projected to have a 1.2 percent job growth rate this year and a 0.9 percent rate next year, according to Moody's Analytics. While that is an improvement over earlier job growth projections, it is nevertheless far more lackluster than New York's, yet with nearly the same amount of new units coming online over the same timeframe.

## Multifamily Construction Planning Pipeline Expanding

Although there have been changes in the multifamily construction planning pipeline over the past six months, most of the change has been isolated to the planning stage. Despite the fact that multifamily completions are expected to remain at historically low levels for the rest of this year and into early 2013, the number of apartment projects in the construction planning stage has continued to mushroom.

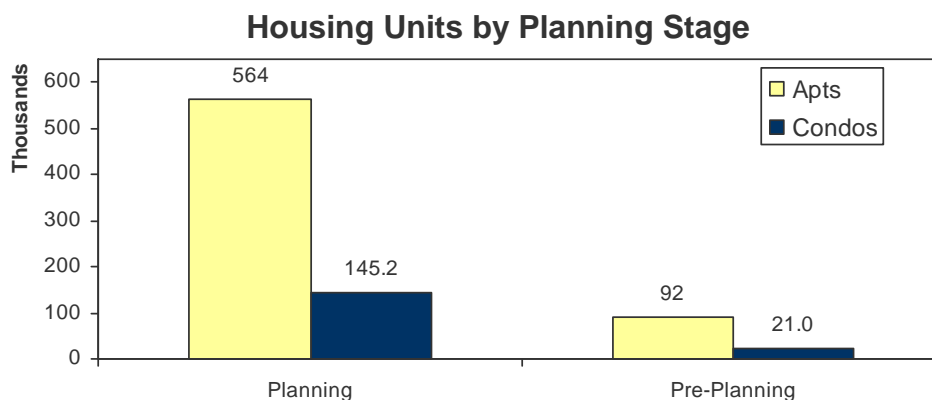
Just six months ago, there were about 483,000 apartment units in the planning stage. Today there are at least 564,000, according to the CBRE-EA/Dodge Construction Pipeline. Even the pre-planning stage has seen an uptick in proposed projects with 92,000 apartment units as of August 2012 compared to 77,000 in February.

## Multifamily Permitting Up

According to the Census Bureau, multifamily housing permits saw consistent year-over-year increases throughout 2011, and once again in 2012, reaching its most recent high point in March with 281,000 multifamily permits issued. As of July 2012, multifamily permits fell slightly to 274,000, but still showed an increase of 10 percent from just one month earlier, and up a significant 47.3 percent from July 2011. It is important to note that while the current level appears high, the number of multifamily permits from the late 1990s through 2007 tended to be in the range of 300,000 to 400,000 units.

## More Projects in the Planning Stage

McGraw-Hill Construction's Dodge Pipeline data provides a clear picture of the current state of the multifamily construction sector. As seen in the chart below, there are more than 700,000 multifamily and condo units in the planning stage as of August 7, 2012.



Source: CBRE-EA/Dodge Pipeline, August 7, 2012

## Planning Stage Determines Likelihood of Completion

The likelihood of projects making it to groundbreaking differs depending upon which stage of the planning process each is in. According to McGraw-Hill, approximately 44 percent of multifamily projects in the pre-planning stage make it to groundbreaking, and the percentage is slightly higher at 58 percent for those in the planning stage.

Projects classified as being in the pre-planning stage have an architect who is in the process of working on the schematic. In comparison, projects in the planning stage are well along in the planning process, having received local government approvals, but still encounter a “fairly low probability of starting,” according to McGraw-Hill’s definition. This suggests that although the bulk of the units are in the planning stage, they may remain at this stage for awhile and some may never make it to groundbreaking.

## Future Demand for Multifamily Expected to Remain Stable

We expect that multifamily development will increase over the next two years, since many metro areas still have the majority of their projects in the planning stage. But with fewer and fewer projects being either deferred or outright abandoned, the planning stage continues to increase, which in turn means more projects will likely make their way to groundbreaking.

As of second quarter 2012, the number of new rental household formations was on pace to reach approximately 685,000 for the year. It is important to note that not all of these potential new households will be renting traditional multifamily apartment units, rather a number of them will likely opt for a one-to-four-unit single-family structure. Therefore, the question is: Will there be enough demand to absorb the potential new multifamily supply coming online in the near future?

According to forecast data from Reis, multifamily net absorption this year should total approximately 148,000 units. With approximately 118,000 new units expected to come online this year, it appears that the multifamily demand/supply balance is not in jeopardy, at least not on a national level. Digging more deeply into the numbers, however, reveals that the issue may not be a matter of too much multifamily planned overall, but rather that there is too much multifamily being planned and built in a limited number of places.

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September 2012

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