

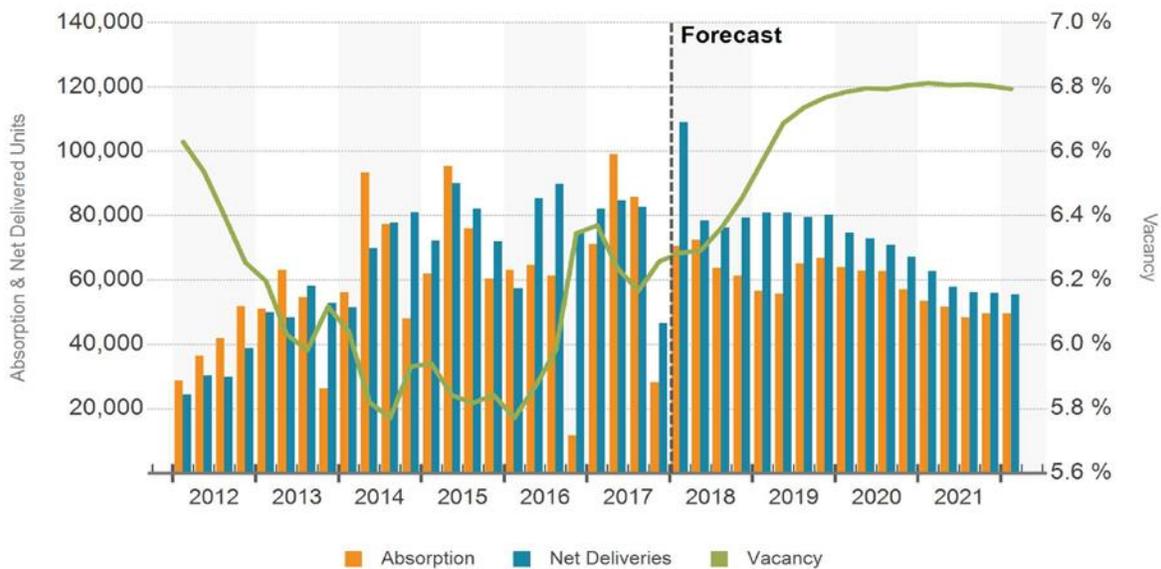


Multifamily Market Commentary – January 2018 2018 Multifamily Market Outlook – Continued Demand, Just Not Everywhere

The U.S. multifamily sector has had a solid run since 2010, with increasing rent growth and low vacancies. Key fundamentals have propelled the multifamily sector over the past few years: favorable demographic trends, continued job growth, and increasing renter household formations. There are more than 80 million Millennials, making them the nation’s largest population cohort, according to the Census Bureau, and this is the cohort that is expected to continue driving demand for housing, including multifamily rental housing, over the next few years.

Demand remained positive in 2017, but that was not the case everywhere. Too much supply of Class A units in some of the nation’s major metropolitan areas resulted in lower rent growth and rising vacancies. In 2018, the national vacancy rate is expected to increase slightly, and, while rent growth should remain positive, it is expected to grow at a more modest pace. Nevertheless, the outlook for the national multifamily sector is that it should remain fairly stable in 2018.

Forecasted National Multifamily Trends



Source: CoStar

Net Absorption – Continued Slowdown Expected

Demand for multifamily rental units remained positive throughout 2017. Net absorption likely totaled about +279,000 units absorbed, according to data from CoStar. CoStar expects net absorption in 2018 to remain positive, although at a lower level than last year, possibly falling to about +267,000 units absorbed. Net absorption is expected to improve beginning in mid-2019, as seen in the chart above.



Vacancy Level Expected to Keep Increasing

The national multifamily vacancy rate is expected to rise in 2018, primarily due to the onslaught of new supply expected to complete and come online over the next 12 to 18 months. Since most of this new supply is concentrated in a limited number of submarkets in only about 12 metros, supply is expected to continue outpacing demand in these metros, thereby pushing the national vacancy rate upward, as illustrated in the chart above. The vacancy rate is likely to return to more historical levels and then remain fairly stable further out into the forecast, due to ongoing favorable future job growth and demographic projections.

Indeed, the Fannie Mae Multifamily Economic and Market Research team is anticipating that the U.S. multifamily vacancy rate will remain in the 5.5 percent range during the early part of 2018, from 5.25 percent as of third quarter 2017, and could end the year in the 5.75 to 6.0 percent range. This would bring the national vacancy rate nearer its recent historical average of 6.0 percent.

Rent Growth Expected to Remain Fairly Stable

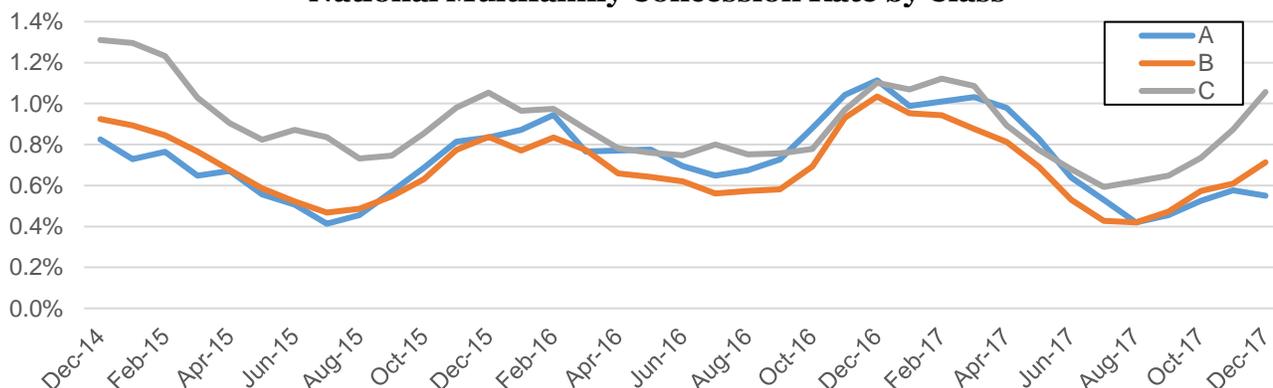
Rent growth was positive but likely ended 2017 at about 2.5 percent, slightly ahead of the pace of inflation, which grew 2.2 percent year over year as of the end of November 2017. There has been above average rent growth since 2011, and 2017 was the first time since then that the national estimated rent growth was below 3.0 percent. The expectation for 2018 is that rent growth will once again be positive but is likely to moderate and range from 2.0 percent to 2.5 percent.

As seen in the chart below, multifamily concessions for all property classes remain at low levels, despite recent trends. Although it appears that Class C concessions have significantly increased, it appears to have been influenced by one metro in particular: Honolulu, with a Class C concession rate at nearly -11 percent.

In addition, national Class C rent growth in 2017 was at 2.2 percent according to Axiometrics, compared to just 1.7 percent for Class A, indicating that property owners are offering more generous concessions up front for Class C units to lock in higher rents.

As more new supply comes online this year, the national concession rate is expected to increase, and more dramatically in certain metros that are in the midst of an oversupply of Class A units. Yet, some property owners are already starting to forego offering larger concessions and are just dropping asking rents. For example, the New York metro concession rate is well above the national average at -1.3 percent as of December 2017, but its rent growth is also negative at -0.5 percent. And rent growth is even worse for its Class A segment, at -1.0 percent, according to data from Axiometrics.

National Multifamily Concession Rate by Class



Source: Axiometrics

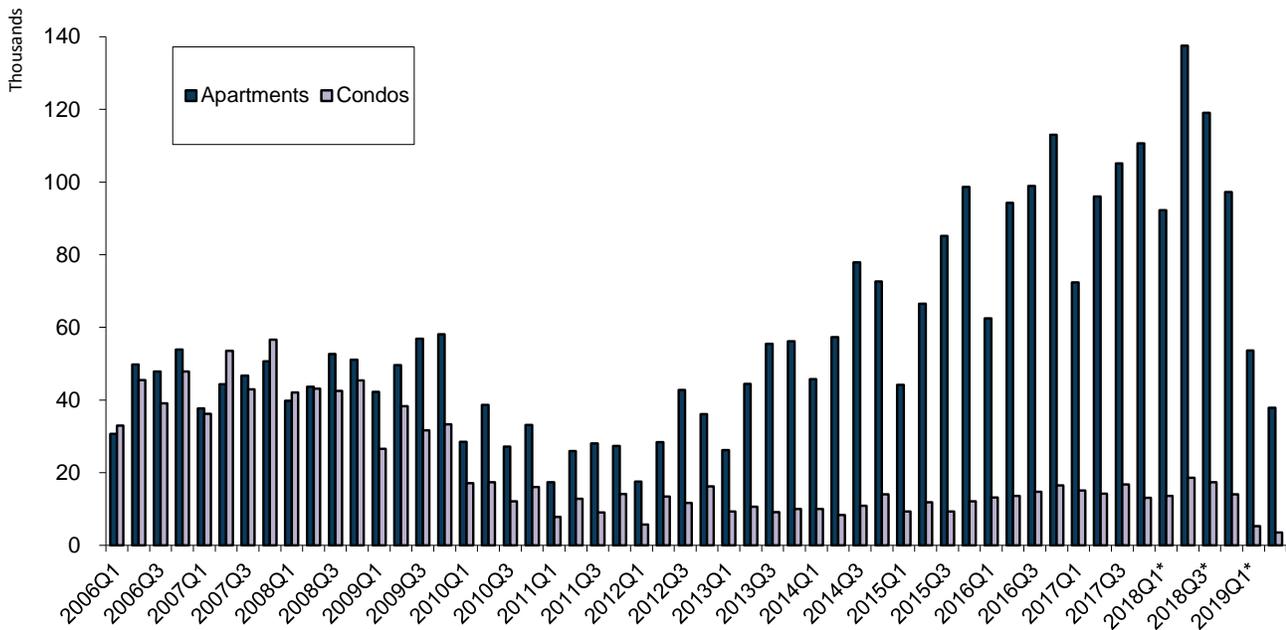


Multifamily New Supply Expected to Peak in 2018

As seen in the chart on the following page, the amount of multifamily new construction remains elevated, with deliveries expected to peak in 2018.

According to the Dodge Data & Analytics SupplyTrack data, which distinguishes between multifamily properties consisting of apartment and condo units, about 381,000 apartment units were completed in 2017, with another 443,000 units expected to come online in 2018. In comparison, only about 59,000 condo units came online in 2017 and there are only about 64,000 condo units expected in 2018. The biggest concern for the multifamily sector is that most of the new apartment rental supply underway is believed to consist of Class A units, which command the highest rent level. But in many metros, it is these Class A units that are already starting to experience declining rents.

Multifamily New Construction



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.

Source: Dodge Data & Analytics, January 2017 – Metros with 5,000 or more units underway or completed.

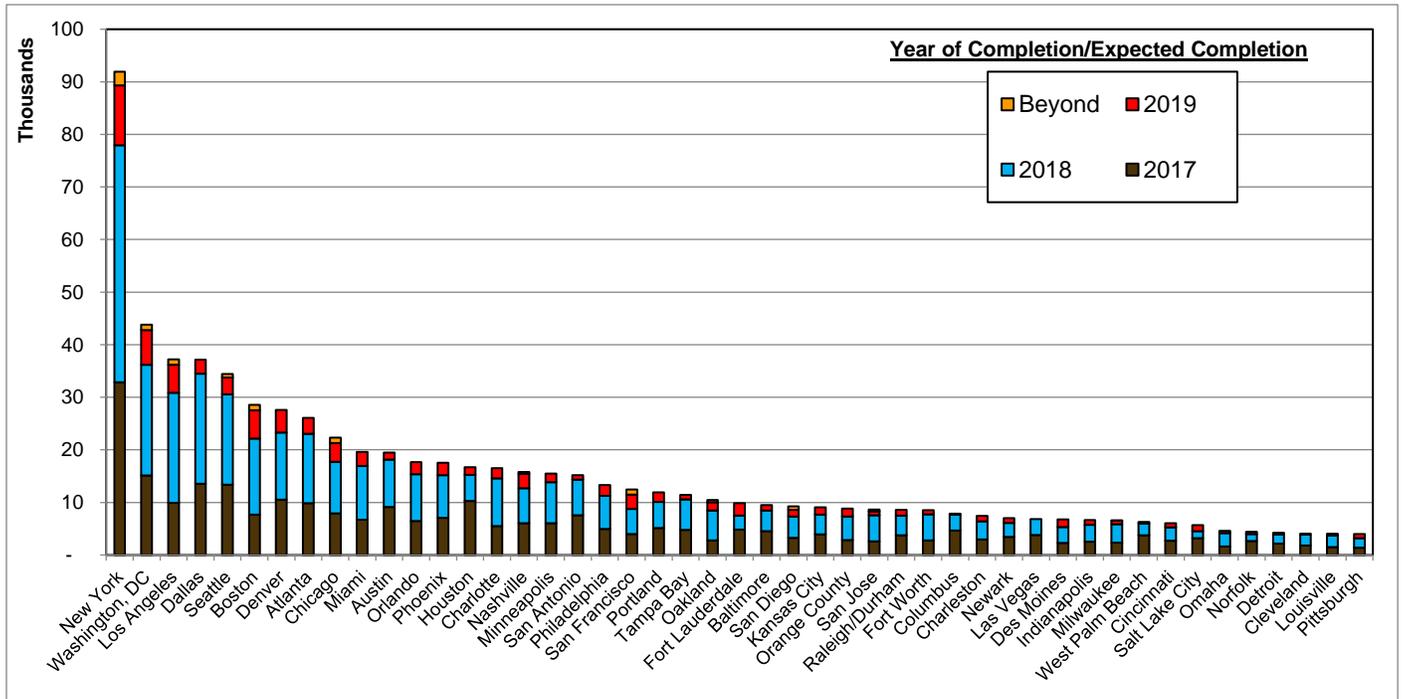
*Anticipated delivery date.

Too Much Supply in Some Metros

At a national level, that amount of new multifamily units being added to the existing stock is not that unreasonable. Job growth is expected to be at 1.5 percent in 2018, according to Fannie Mae’s Economic and Strategic Research Group forecast, which would add about 2.3 million new jobs. Based on that amount, multifamily rental demand could range from 380,000 units to 460,000 units.



Multifamily Apartment Units Underway – Select Metros



Source: Dodge Data & Analytics, January 2018 – Metros with 4,000 or more units underway or completed.

NOTE: SupplyTrack 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.

The reason that level of multifamily rental demand is not likely to occur is because much of the new supply is primarily concentrated in about 10 to 12 metros, as seen in the chart below, and most of that is further concentrated in certain submarkets. And the estimated amount of national job growth, and its anticipated accompanying demand, is not going to be concentrated in just a handful of metros, which is why supply is expected to outpace demand in many of these metros over the next 12 to 18 months.

Job Growth Slowing in Some Metros with New Supply

Although the nation is expected to see positive job growth this year, that doesn't mean that all metros will experience the same level of employment growth, as illustrated in the two charts below. Although Fannie Mae's Economic and Strategic Research Group forecast for 2018 anticipates national employment growth rate of 1.5 percent, there are a number of metros expected to have employment growth below the national estimate, including **Boston**, **New York**, and **Washington, DC**, all metros with a large amount of new multifamily rental supply on the horizon.

The **New York** metro is expecting the largest amount of new supply, with more than 59,000 units underway, of which 45,000 units are expected this year alone. Based on its lackluster anticipated job growth rate, at best the metro could produce demand for only about 23,000 multifamily rental units. **Boston** has nearly 21,000 units underway, of which nearly 15,000 units are expected to deliver in 2018. Based on an anticipated job growth rate of just 1.2 percent, potential multifamily demand of about 4,100 units will fall far short of upcoming supply. **Washington, DC** has more than 21,000 units expected



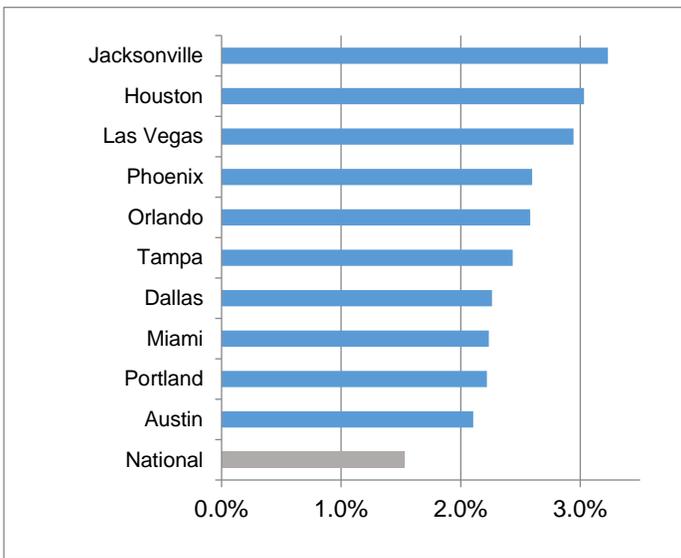
to come online this year, yet anticipated job growth of 1.2 percent will at best produce demand for just 10,000 units. As a result, all three of these metros began experiencing negative rent growth during the latter part of 2017 and will likely continue to do so in 2018.

Other Metros Possibly Undersupplied

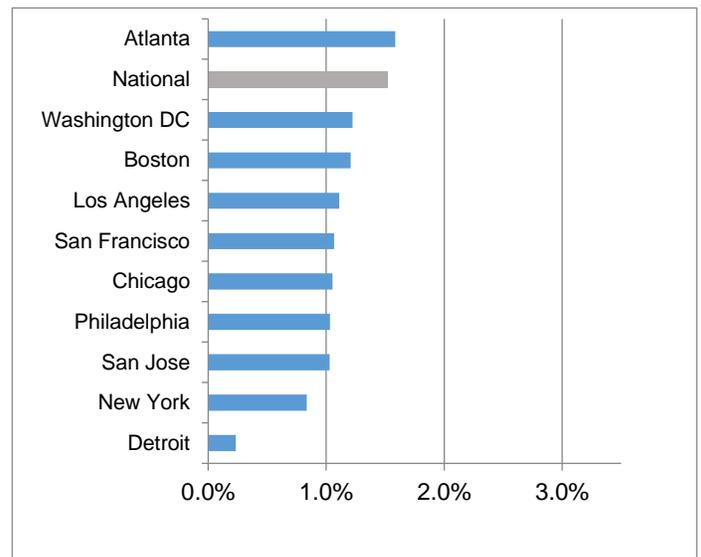
Job growth in other metros is expected to fare better, as seen below. Some of the Florida metros, including **Jacksonville**, **Orlando**, **Tampa**, and **Miami**, are expected to far surpass the national average. **Dallas** and **Austin** are expected to see job growth of more than 2.0 percent due to continued expansion in the professional services, technology, healthcare, and transportation sectors.

At 3.2 percent, **Jacksonville** has one of the highest projected job growth rates in the nation. The metro could easily produce demand for a minimum of 3,600 units, yet fewer than 1,800 units are expected this year. **Las Vegas** is even more compelling. With expected job growth of nearly 3.0 percent, there could be demand for at least 6,000 units, yet only about 3,000 units are expected to come online in 2018. **Phoenix** is another “good news” story, with anticipated job growth of 2.6 percent. That could produce demand for at least 10,000 units, yet only about 8,000 units are expected this year.

Select Markets with Higher Expected 2018 Employment Growth



Select Markets with Lower Expected 2018 Employment Growth



Source: Moody's Analytics



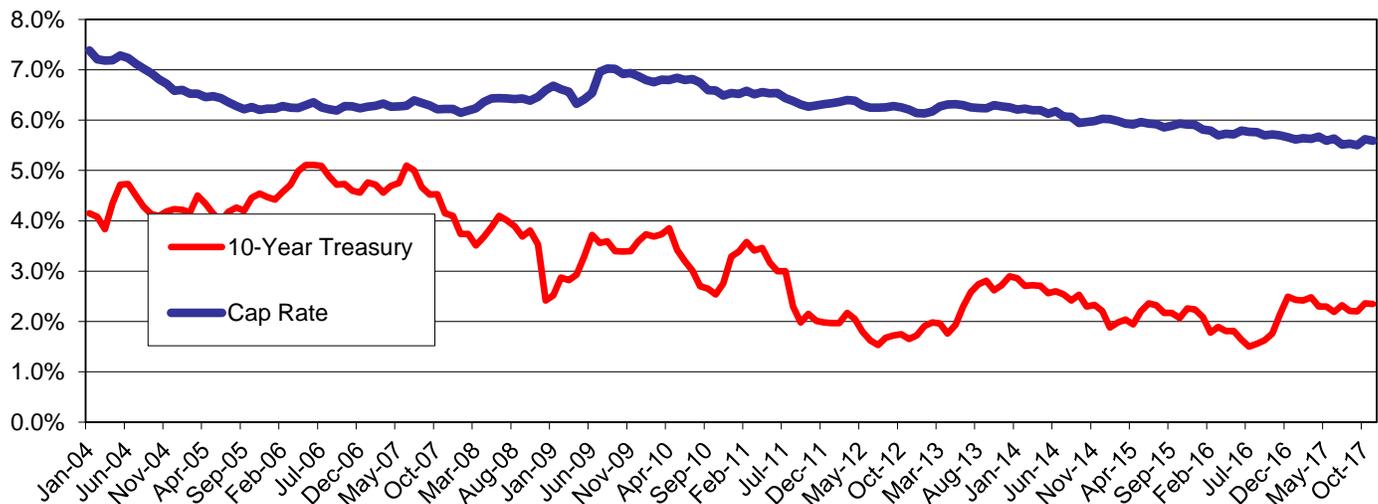
Cap Rates Likely to Remain Low

With multifamily cap rates at historically low levels – currently 5.6 percent, according to Real Capital Analytics – it would seem that they have nowhere to go but up. But with the passage into law of the Tax Cuts and Jobs Act of 2017, will they?

Multifamily cap rates have remained in the 5.6 percent range for most of 2017 due to the ongoing influx of capital flows and investor demand. With interest rates also staying low and real estate investment expected to get a boost from the recent tax cut legislation, it seems likely that investors will stay interested in the multifamily sector as well. In fact, according to a November 29, 2017 article in *National Real Estate Investor*, the multifamily sector remains “... a favored property type among commercial real estate investors. When asked to rate the attractiveness of the different core property types on a scale of 1 to 10, [NREI] survey respondents scored multifamily the highest at 7.9...”

As a result of this anticipated investor interest, while an uptick in new multifamily construction investment is not expected due to oversupply concerns in many submarkets, investment in existing multifamily properties is expected to remain on par with 2017 levels. Therefore, the projection is that multifamily cap rates are likely to remain stable in 2018.

Treasury and Multifamily Capitalization Rates



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



2018 Outlook: More of the Same

The outlook for the multifamily sector in 2018 remains positive but relatively stable. Multifamily mortgage origination volume levels are expected to remain similar to, or slightly lower than, 2017's activity levels. The Mortgage Bankers' Association anticipates multifamily originations volume to reach \$258 billion, down compared to its estimated \$271 billion for 2017.

The amount of new supply expected to come online this year is mostly located in about 10 to 12 metros, some of which are likely to experience a slow-down in demand due to upcoming oversupply. While there should be job growth spurring continued rental household formations, this concentrated amount of supply – consisting primarily of Class A units – will likely cause a disruption in underlying fundamentals in certain metros. Rising vacancy levels and reduced or negative rent growth could occur in certain submarkets, which in turn is likely to negatively affect overall trends in the nation's oversupplied metros.

It is important to keep in mind that this slowdown is expected to be short-lived, occurring over the next 12 to 18 months. After that time, we expect that the multifamily sector's underlying fundamentals will improve, as new supply slows and stable job growth and demographic trends continue, resulting in increased demand.

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