Fannie Mae

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2022 Outlook for Multifamily Affordability – Erosion in Affordability Unlikely To Be Reversed in 2022

Some of the strongest nominal wage growth in recent years for hourly and non-supervisory employees was seen in 2021. However, pent-up demand, coupled with an improving economy and generous concessions available on many multifamily units, allowed rent growth to soar to 10% in 2021. In addition, the multifamily vacancy rate fell by 1.0% in 2021 to 5.0%, below the long-term average of 6%. As a result, the long-term trend of erosion in affordability continued in many metros in 2021.

Wage Growth More Relevant for Rent

Wages measure earnings from work, while income can include non-work earnings such as interest and dividends. While growth in income will help with rental affordability, many renters rely solely on wages, making wage growth an important indicator of affordability.

Middle Market Affordability Eroding

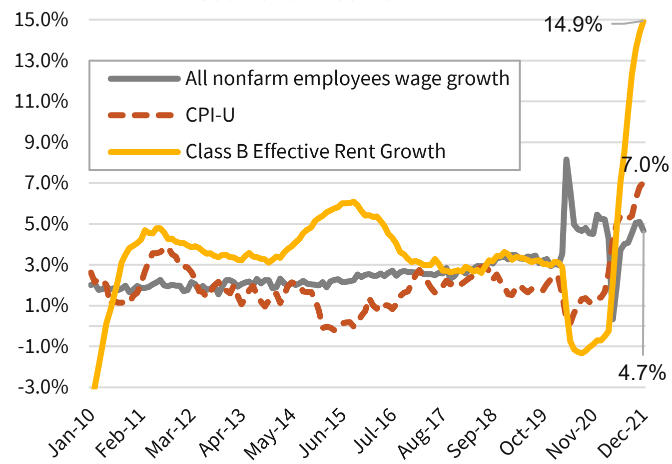
Improvement in rental affordability is primarily attained when wage growth meaningfully outpaces rent growth. Multifamily data provider RealPage, Inc., defines Class B rents as those rents that fall between the top 20% and bottom 20% of the rent distribution for a given market (and so are in the mid-60% of the rent distribution). However, as shown in the top adjacent chart, except for the 13-month period at the start of the pandemic-induced recession, year-over-year rent growth in the middle market Class B segment has outpaced wage growth almost every month since August 2010. In fact, according to Real Page, as of December 2021, year-over-year Class B rent growth was a whopping 14.9%, three times as high as the 4.7% wage growth recorded.

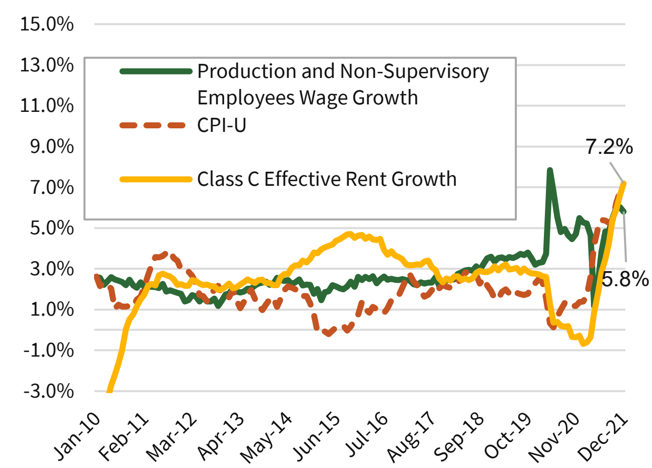
Class C Affordability Also Eroding

RealPage defines Class C rents as those in the bottom 20% of the rent distribution for a given market, making them the most affordable rents. These are also the types of units that tend to be affordable for production and non-supervisory employees.

Year-over-Year Change in Private Sector Nominal Average Hourly Earnings and Effective Rent*

Jul. 2010– Dec. 2021





- *Based on Same Store effective rents at multifamily properties. Same-store data includes only multifamily properties surveyed in all observation periods, which excludes lease-ups or other changes in sample.*

Source: Moody's Analytics, RealPage

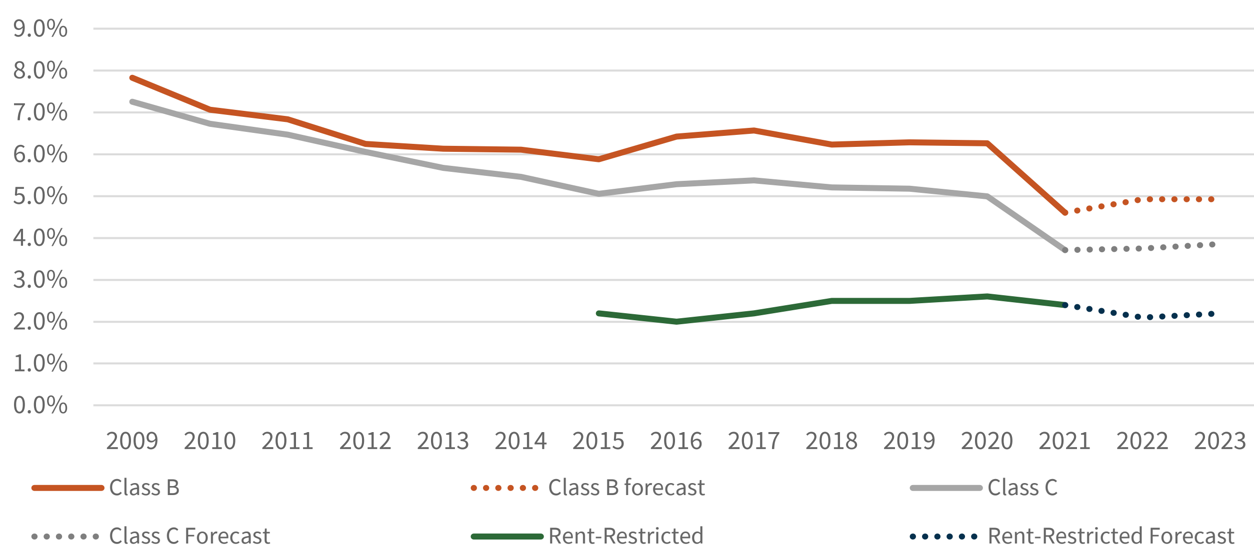
However, as shown in the lower chart on the previous page, while the gap between wages and effective rent growth has been smaller, Class C rent growth has recently also kept pace, or even outstripped, the wage growth of production and nonsupervisory employees. In 2021, Class C effective rent growth totaled 7.2%, easily outpacing wage growth of 5.8% for production and non-supervisory employees. In addition, inflation of 7.0% year-over-year as of December 2021 likely made renting even less affordable.

Vacancy Rates for Workforce Housing Compressed in 2021…

Class C apartment units, which are considered workforce housing because they are usually the most affordable units available in a market, recorded a marked decline in vacancy rates in 2021. According to data from CoStar, Inc., the national average vacancy rate for Class C units, which has hovered around 5.0% since the end of 2015, declined by 1.3 percentage points during 2021, ending the year at just 3.7%. Similarly, CoStar estimates that the average vacancy rate for Class B units, which are often also considered workforce housing in many places, fell by an estimated 1.7 percentage points in 2021 to an average vacancy rate of 4.6%. As might be expected, vacancies for properties assisted by federal Low Income Housing Tax Credits (LIHTC) had an even lower vacancy rate at just 2.4%, according to estimates from Moody's Analytics REIS.

The decline in the average estimated vacancy rate for Class B and C workforce housing units can be attributed to a combination of factors. It is often difficult to build new affordable units without local subsidies or federal assistance. In addition, continued demand for multifamily rentals has made older Class A-/B+ properties more attractive to investors as value-add projects, keeping them from naturally filtering down to more affordable Class B and C properties. Lastly, stimulus payments and eviction moratoriums helped renters stay in their more affordable units in 2021, keeping vacancy levels for units in the workforce housing category low.

Multifamily Vacancies by Class 2009 - 2023



Source: CoStar Group, Moody's Analytics REIS, Inc.
Note: Class A is approximated by CoStar as five- and four-star category properties. Class C is approximated by CoStar's two-star and one-star category data. Rent-Restricted data from Moody's Analytics REIS based on LIHTC units.

...and Are Expected to Remain Low in 2022-2023

As shown in the chart on the previous page, CoStar projects that the average 2022 vacancy rate for Class B units will only increase by an estimated 0.3 percentage points to 4.9%, remaining well below the recent 6.2% average. Conditions are not expected to change in the Class C segment, where CoStar projects the average vacancy rate will remain stable over the year, ending 2022 at an estimated 3.7%. However, some uncertainties include the expiration of eviction moratoriums and whether new COVID variants might result in additional shutdowns.

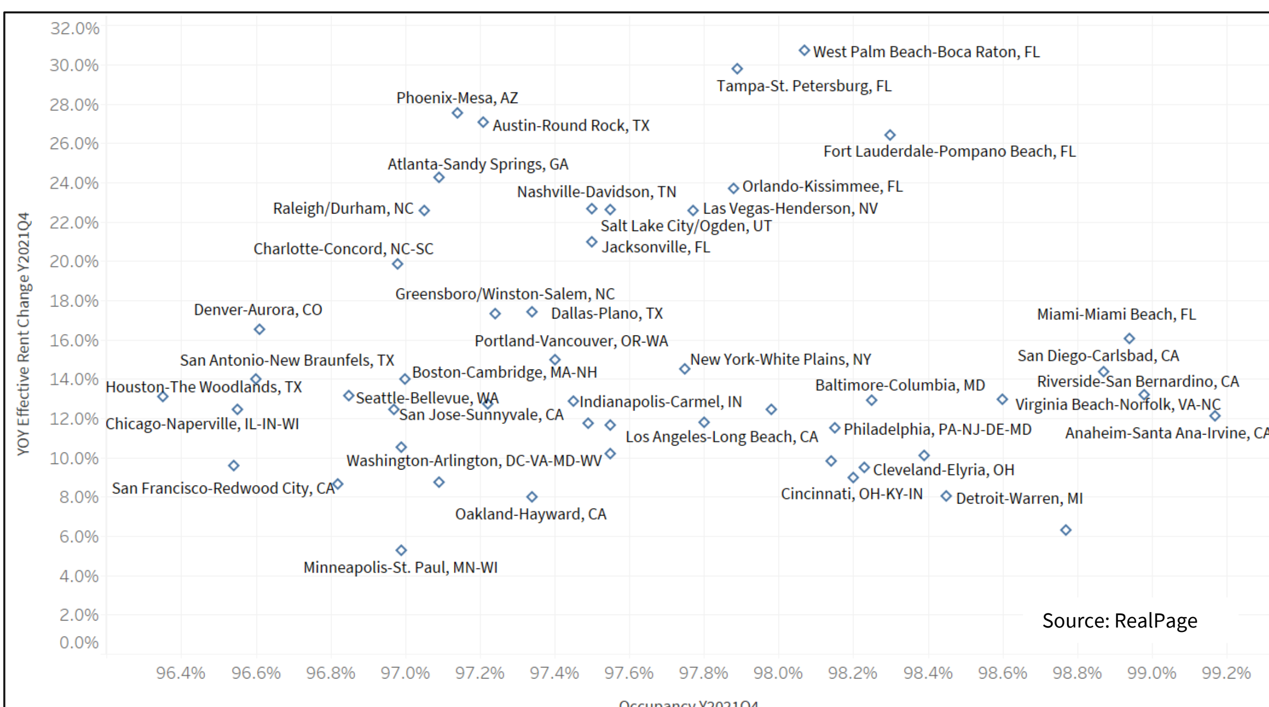
High Occupancy Rates Increase Pressure on Rents in Workforce Housing

According to RealPage, among the 50 major multifamily markets, occupancy at Class B properties is at historically high rates of 96.4% or higher. Tight vacancy rates and a recovering economy have also led to staggering increases in effective rents in just a single year for most workforce housing units. As shown in the chart below, 40 of the top 50 multifamily markets tracked by RealPage recorded increases of 10% or more in 2021.

Many Markets Recorded Unprecedented Class B Effective Rent Growth

With a 98.1% occupancy rate at Class B properties, the **West Palm Beach** metro area recorded the highest growth in Class B effective rents in 2021, with a 30.7% increase, as seen in the chart below. **Tampa** followed with a 97.9% occupancy rate at Class B properties and a 29.8% increase in effective rents. Other metro areas with Class B properties that have low vacancy rates and large single year increases in effective rents include **Nashville**, with an occupancy rate of 97.5% and a 22.7% increase; **Austin** with a 97.2% occupancy rate and a 27.1% increase; and **Fort Lauderdale** with a 98.3% occupancy rate and 26.4% effective rent growth. In all, RealPage recorded 12 markets with Class B effective rent growth of 20% or more in just a single year, all of which has had a negative impact on affordability as most households did not receive wage increases of 20% or more in 2021.

Select Metros Multifamily Occupancies as of Q4 2021 vs Effective Rent Growth Year over Year as of Q4 2021 – Class B



Midwestern Markets Also Saw Uncharacteristically High Rent Growth

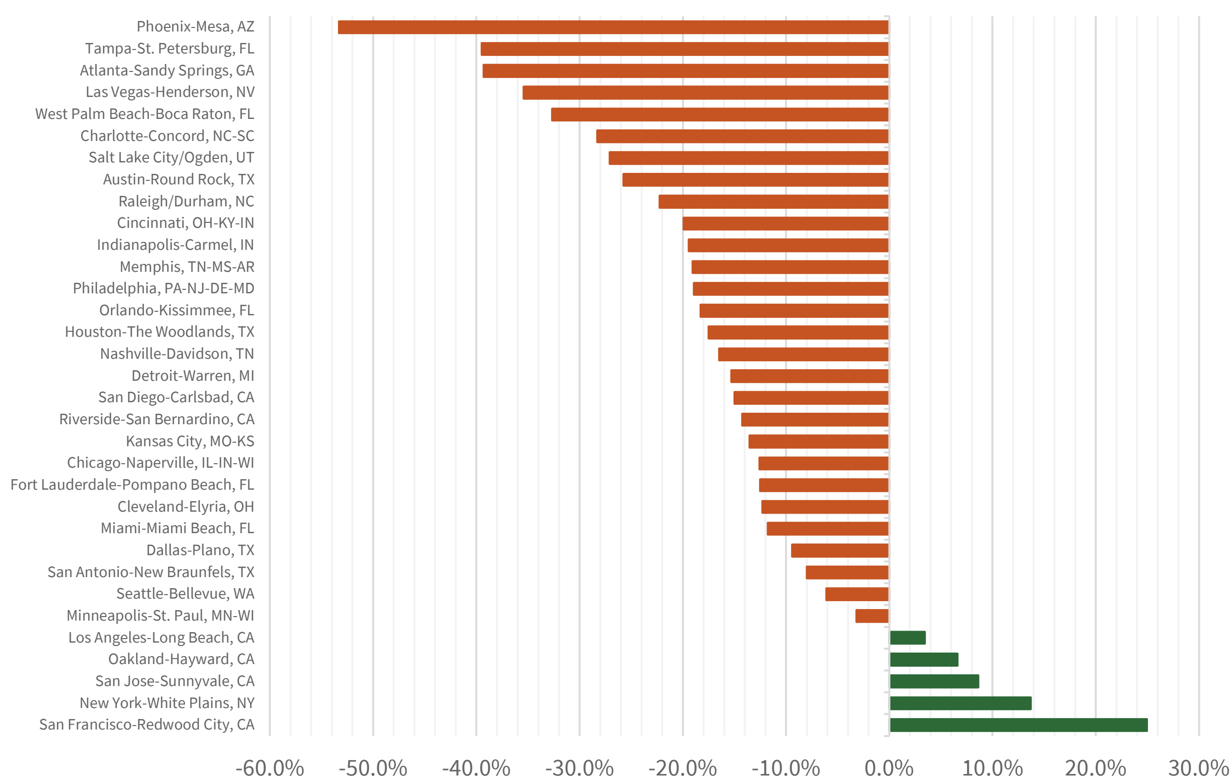
While typically not as high, tight vacancy rates and an unexpected increase in demand have also led to significant increases in effective rents at Class B properties in many Midwestern markets. For instance, according to data from RealPage, **Indianapolis**, **St. Louis**, and **Columbus** all had occupancy rates of around 97.5% in Q4 2021 and recorded effective rent growth at Class B properties of 12.9%, 11.7%, and 10.2%, respectively, in 2021. The **Cleveland** and **Detroit** metro areas recorded occupancy rates in excess of 98% as of Q4 2021 and effective rent growth of 9.5% and 8.0%, respectively, in 2021. As a result, these uncharacteristically high rates of growth eroded affordability for workforce housing renters in what are typically more affordable locations.

Most Metros Became Less Affordable Over the Past Five Years

While hourly wages recorded strong growth in 2021, most major multifamily markets have become less affordable when comparing cumulative wage growth to cumulative effective rent growth for Class B properties, even over the past five years. These include many traditionally more affordable markets in the Southeast and South.

As shown in the chart below, **Phoenix** has seen the greatest loss in affordability over the past five years as cumulative hourly wage growth of 15.5% was much lower than the cumulative effective rent growth for Class B properties of a whopping 68.8%. Similarly, cumulative wage growth of 17.4% in **Tampa** could not keep pace with the 56.9% increase in Class B effective rents. Cumulative wage growth of 14.1% in **Atlanta** was no match for the 53.4% cumulative increase in Class B rents. Other metros where wages fell far short of Class B effective rent growth include **Las Vegas**, **Charlotte**, **Salt Lake City**, and **Raleigh**.

Select Metros Cumulative Wage Growth Less Class B Effective Rent Growth Q1 2017-Q4 2021



Source: Moody's Analytics, RealPage

A Handful of Major Multifamily Markets Became Slightly More Affordable

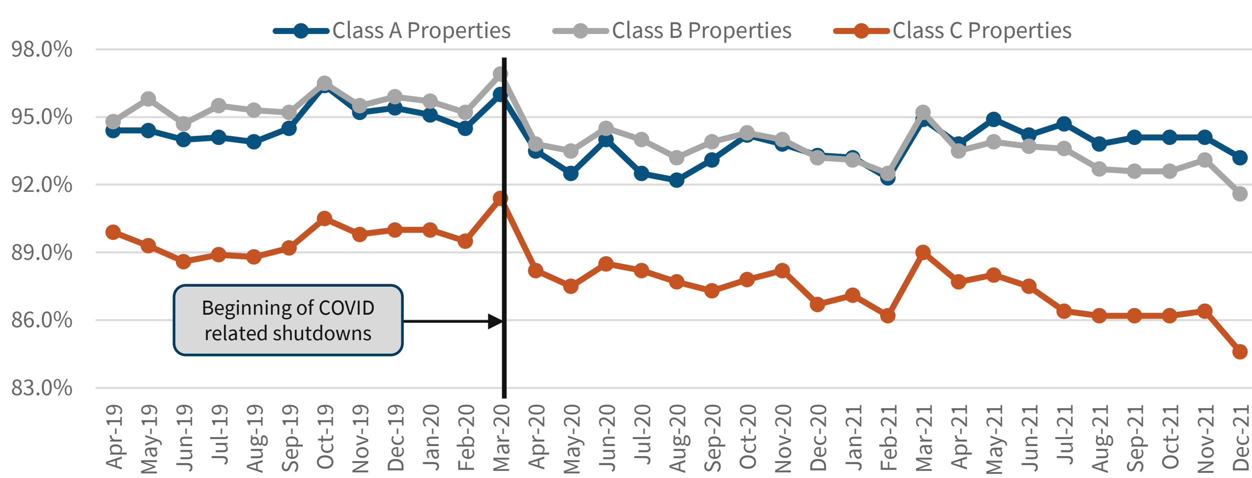
As shown in the chart on the previous page, only a handful of major multifamily metros became more affordable when comparing cumulative wage growth to Class B cumulative effective rent growth over the past five years. These include the metros where rents declined the most significantly. For instance, over the past five years, wages in **San Francisco** grew by an estimated 22.3%, according to Moody's Analytics, while Class B effective rents fell by 2.3%. Similarly, wages grew by 17.1% in the **New York** area, while rents barely eked out a 3.4% cumulative increase over the past five years. The other major metro areas that became slightly more affordable over the past five years include **San Jose**, **Oakland**, and **Los Angeles**. However, all five areas remain very expensive for renters as Class B effective rents were $2,400 per month or higher, as of Q4 2021. This would require a renter household to have a minimum income of $96,000 per year to be able to afford a Class B unit based on the U.S. Department of Housing and Urban Development's (HUD) affordability standard of households not spending more than 30% on rent and utilities.

Lower Income Renters Struggle to Pay Rent

Even prior to the pandemic, lower-income renters struggled to pay rent. As shown in the chart below, typical Class C rent payments between April and December 2019 trailed collections in Class A and B properties by between 5% and 6%, according to data from RealPage. The share of rent payments made by the end of the month by Class C renters during this time period was estimated to be 89.4%, compared to about 94.7% for Class A units and 95.5% for Class B units.

Despite strong wage growth for hourly workers, it appears that lower-income renters are still struggling to pay rent. As shown in the chart below, from July through November 2021, just over 86% of Class C renters were able to pay rent by the end of the month, compared to approximately 89% of renters prior to the start of the pandemic. While not as stark, middle market Class B renters have also seen some erosion in payments over the same time period, to just over 93% from 95.5%. With eroding affordability, expired eviction moratoriums, and job volatility in certain sectors, coupled with possible successive waves of COVID, there is concern that lower-income renters may be further impacted and struggle to pay rent in 2022.

Share of Rent Payments Made the End of the Month by Class (%) (April 2019 – December 2021)



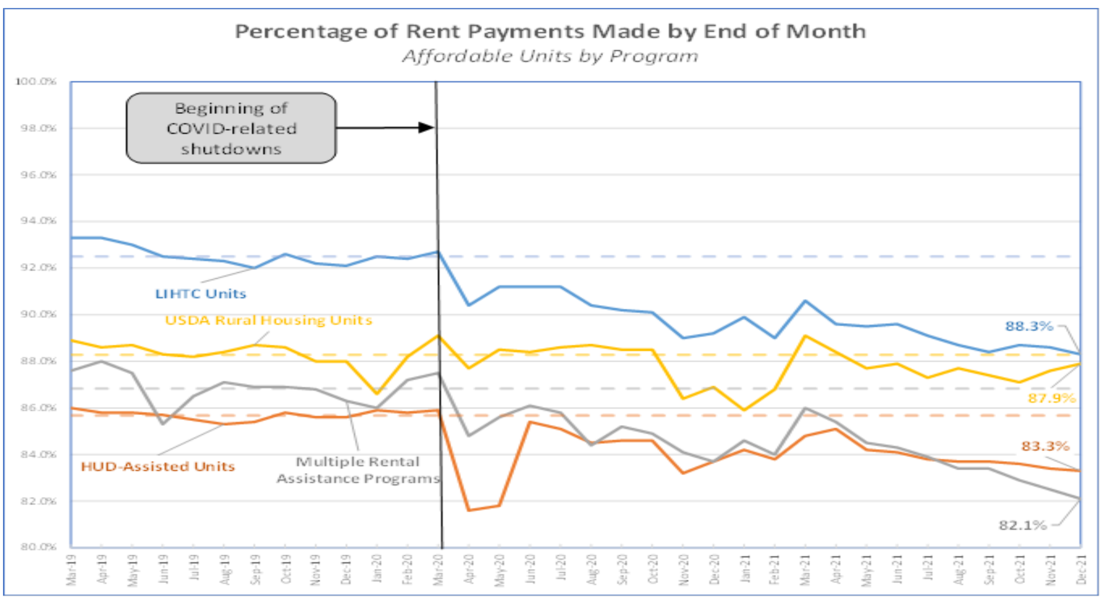
Source: RealPage, Inc.

Federally Assisted Rental Housing Not Immune

Renters who receive federal assistance are among the lowest paid workers. In fact, just under 56% of renter households living in properties assisted with LIHTC, and 80% of renter households living in properties assisted by the Project-Based Section 8 program earn less than $20,000 per year. Except for the LIHTC program, renters under federal assistance programs generally spend no more than 30% of their household income on rent and utilities.

Even so, these renters are still at risk because most work to afford their rent. According to HUD, the share of rent payments made at federally assisted properties declined to 85.4% in December 2021 from 88.8% in March 2020, prior to the start of pandemic-related shutdowns. This trend may be due to the large share of renters earning less than $20,000 annually living in these properties. Any disruption to income could affect their ability to pay rent.

Share of Rent Payments Made the End of the Month by Federally Assisted Program (March 2019 – Dec. 2021)



Source: U.S. Department of Housing and Urban Development

LIHTC Properties Fared Better Than Class C Properties

Interestingly, the share of payments made varied by the type of project-based assistance, as shown in the chart above. According to the National Housing Preservation Database, which contains information on most federally assisted rental properties in the country, about half of federally assisted rental homes receive LIHTC, making it the largest program providing federal assistance. As of June 2021, an estimated 2.5 million units were assisted by LIHTC. Unlike most federally assisted programs, the LIHTC program does not guarantee that residents in these units will spend no more than 30% of their income on rent and utilities. In fact, according to the National Council of Housing Finance Agencies (NCSHA) 2020 State HFA Factbook, more than a quarter of LIHTC-assisted units also receive assistance under the Project-Based Section 8 program to keep the rent affordable.

There has been some erosion in renters' ability to pay their rent at LIHTC properties, as the share of rents paid by the end of the month declined by about 4 percentage points as of December 2021 relative to the share paid prior to March 2020. Yet, an estimated 88.3% share of these renters in LIHTC properties paid their rent by the end of the month in December 2021, which is about 2 percentage points higher than the payment rate at Class C properties. Further, LIHTC properties continued to have the highest payment rate among all federally assisted properties in 2021 as shown on the chart above.

Rental Assistance Running Out…

With the decline in lower income renter households' ability to pay rent by the end of the month, emergency rental assistance has been crucial. According to the latest U.S. Treasury Department report released in January 2022, through November 30, 2021, $28 billion of the Emergency Rental Assistance Program (ERAP) funds have already been distributed, representing approximately 60% of the total amount allocated. Yet, the distribution of funds has varied widely. Eight states have allocated less than 20% of their ERAP funds: **Arizona**, **Nebraska**, **Louisiana**, **Vermont**, **North Dakota**, **South Dakota**, **South Carolina**, and **Wyoming**. However, more concerning is the fact that four states, including **New York**, **California**, **Connecticut**, and **Texas**, have distributed 100% of their ERAP allocations. Three of these four states have multifamily markets that saw effective rents rise by more than 20% in 2021 and will more than likely need additional assistance to help keep lower-income renters in their units.

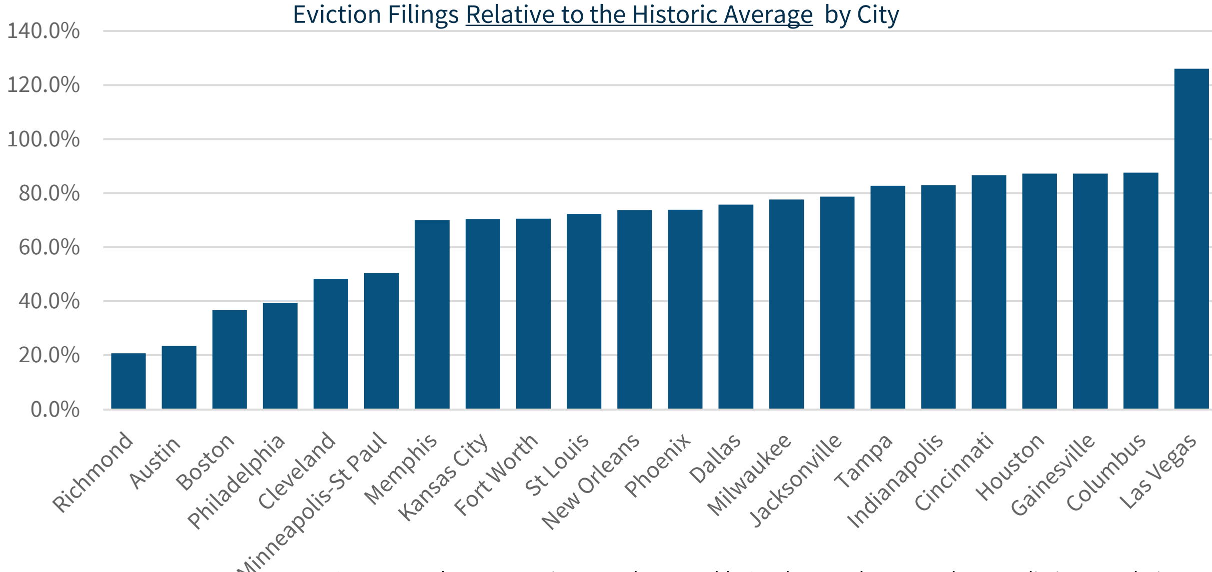
…but Evictions Remain Below Historic Levels

With more renter households having trouble paying rent it is not surprising that evictions are rising. The Eviction Lab at Princeton, which monitors eviction filings in 31 cities and six states across the country, has indicated that eviction levels have been rising since the lifting of the Centers for Disease Control eviction moratorium in August 2021.

According to the recently released report *Preliminary Analysis: Eviction Filing Trends After the CDC Moratorium Expiration,* which utilized Eviction Lab data, "…since the CDC moratorium ended, landlords have filed a growing number of cases, though still far fewer than are seen in a typical, pre-pandemic year." The same study noted that 20.4% more cases were filed in the three months after the moratorium expired than over the final three months that it was in place. However, it is important to note that at a national level eviction filings remain 65% below the historic pre-pandemic average.

Eviction filings vary widely by jurisdiction as shown in the chart below. So far, only **Las Vegas**, where 11,799 eviction cases were filed between August 27, 2021 and November 26, 2021, has exceeded the historic average running at 126% of historical filings. Seven additional cities have eviction rates over 80% of their historic average, including **Indianapolis**, **Tampa**, **Houston**, **Cincinnati**, and **Columbus**. With affordability eroding and ERAP running out of funds in many places, there is a possibility of eviction rates rising further in certain jurisdictions over the coming months.

Eviction Filings Relative to the Historic Average by City



Source: Jacob Haas, Jasmine Rangel, Juan Pablo Garnham, and Peter Hepburn, Preliminary Analysis: Eviction Filing Trends After the CDC Moratorium Expiration, Princeton University, December 9, 2021

Eroding Affordability Does Not Bode Well for Workforce Housing

While hourly wages in 2021 have seen some of the strongest growth recorded since the 1980s, rent growth in most major metro areas has outpaced wage growth, leading to a continuing erosion of affordability in 2021. In addition, some states with large multifamily markets have already fully allocated emergency rental assistance, leaving little cushion to absorb additional rent increases for lower-income renters. Moreover, rent growth is expected to moderate but remain in the 4.0% to 5.0% range in 2022, which is above the historical average of 2.5%. As a result, we believe it is unlikely that the erosion in affordability seen in 2021 will be reversed in 2022.

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