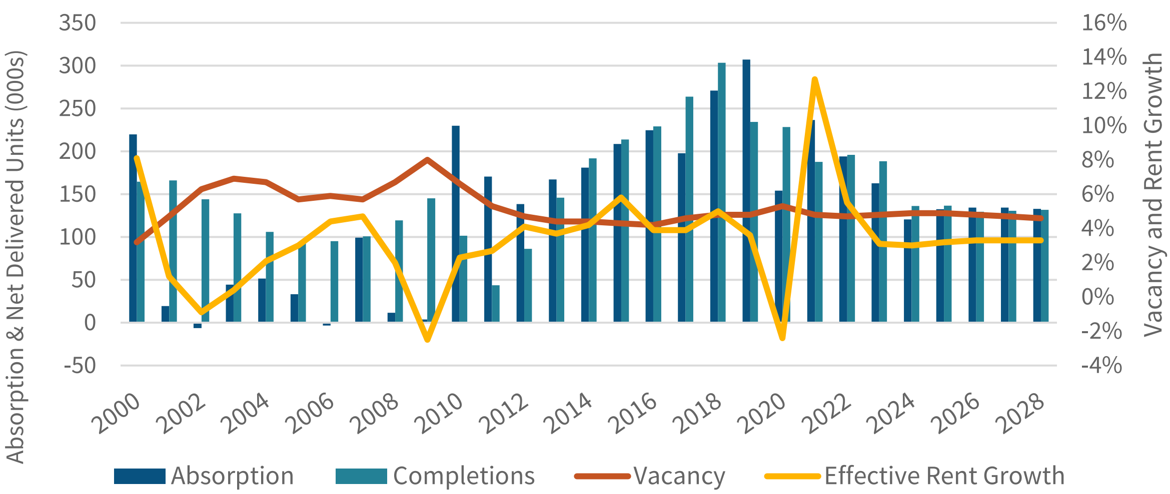
2022 Mid-Year Multifamily Market Outlook – Demand Remains Resilient

The multifamily sector experienced strong demand during the first half of 2022, resulting from a combination of favorable demographics, continued job growth, rising wages, and increased renter household formations. This demand is expected to continue for the remainder of the year, albeit at a more moderate pace. That said, it is important to note that although national trends are expected to remain above average over the next six months, multifamily fundamentals and demand can, and do, change and will vary by metro, submarket, and, in some cases, by neighborhood.

Further out into the forecast, our more tempered outlook for the sector is based on stubbornly persistent inflation, recession expectations, and elevated new multifamily supply, much of which is now expected to be completed and delivered over the next 18 months. Nevertheless, we also believe demand for multifamily rental housing will remain positive because elevated single-family housing prices along with higher interest rates are making homeownership far less affordable, perhaps convincing many renters-by-choice that staying in their units longer is the better option.

Forecasted National Multifamily Trends



Source: Moody's Analytics CRE

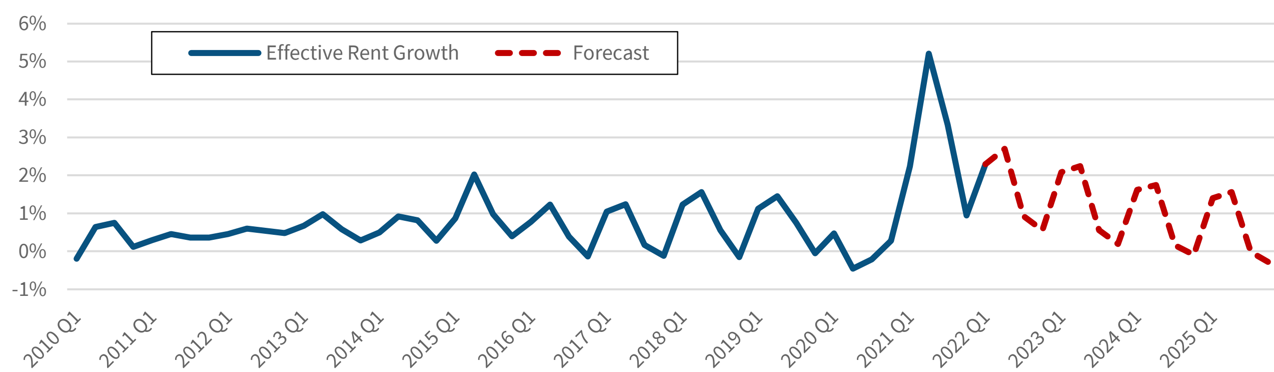
Multifamily Vacancy Expected to Rise Modestly

Although the national multifamily vacancy rate declined during the early part of 2022, we believe it will start to slowly rise over the remainder of the year, and into 2023. Despite expected ongoing multifamily rental demand, newly delivered supply is expected to remain elevated throughout the year, thereby keeping estimated vacancy levels relatively stable. In addition, supply chain constraints continue to impact the construction sector, pushing out delivery timelines. Therefore, many new completions that were expected in 2022 are now expected to be delivered n 2023. We believe this new supply could outpace demand, as illustrated in the chart above. As a result, we anticipate that the U.S. national multifamily vacancy rate will remain within an estimated range of between 4.75 percent and 5.0 percent by year-end 2022. Although we believe it could climb to 5.25 percent by year-end 2023, it would still be below its estimated 15-year average of 5.8 percent.

Rent Growth Expected to Decline but Normalize…

Rent growth has been positive thus far this year, as seen in the charts below. We are estimating that rent growth was 4.5 percent for the first half of 2022 due to continued rental demand stemming from positive job and wage growth. We expect that the trajectory of rent growth over the second half of the year will begin to ease, ending the year in the range of 6.0 percent to 7.0 percent. For comparison, as of July 7, 2022, CoStar is also expecting overall rent growth to be nearly 6.5 percent in 2022, and then to further decline over the next few years, as seen in the chart below.

Multifamily Effective Rent Change 2010 – 2025 – All Multifamily Classes



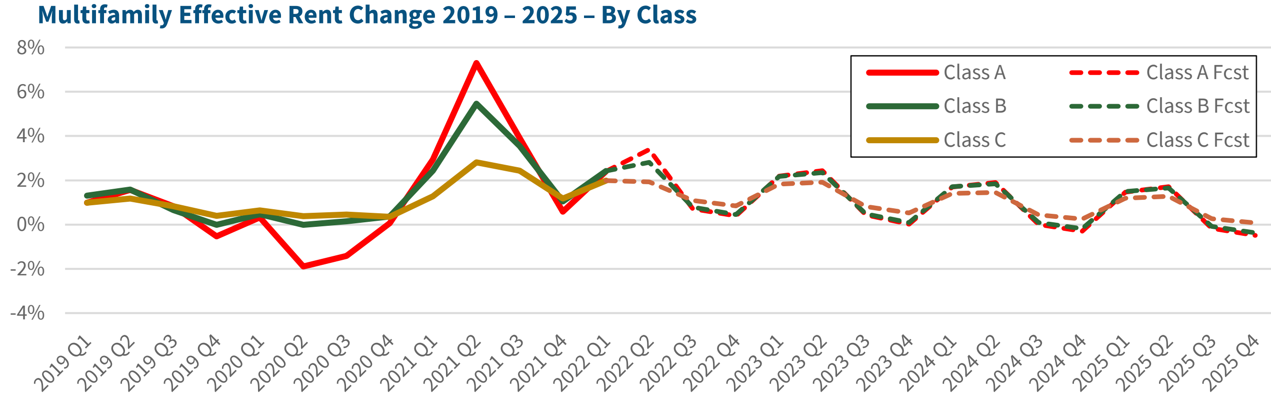
Source: CoStar, Inc. – Data as of July 7, 2022

… With Very Little Differentiation Between Classes

Demand for all classes of multifamily units has remained strong so far this year. In fact, as of July 7, 2022, CoStar is expecting Class A unit rents to see the highest level of rent growth this year, forecasted at 6.9 percent compared to 14.7 percent in 2021. Class B rents are not far behind at an estimated 6.5 percent in 2022, compared to 12.5 percent in 2021, and Class C units are forecasted to see rent growth of 5.9 percent this year, compared to an estimated 7.7 percent rent growth last year.

Further out into the forecast, CoStar is expecting that rents for all classes of units will trend downward, as seen below. However, overall demand is expected to remain steady, as evidenced by the minimal distinction in rent growth percentages between classes of units, with Class B rent growth expected to outpace Class A, as soon as early 2023.

Multifamily Effective Rent Change 2019 – 2025 – By Class



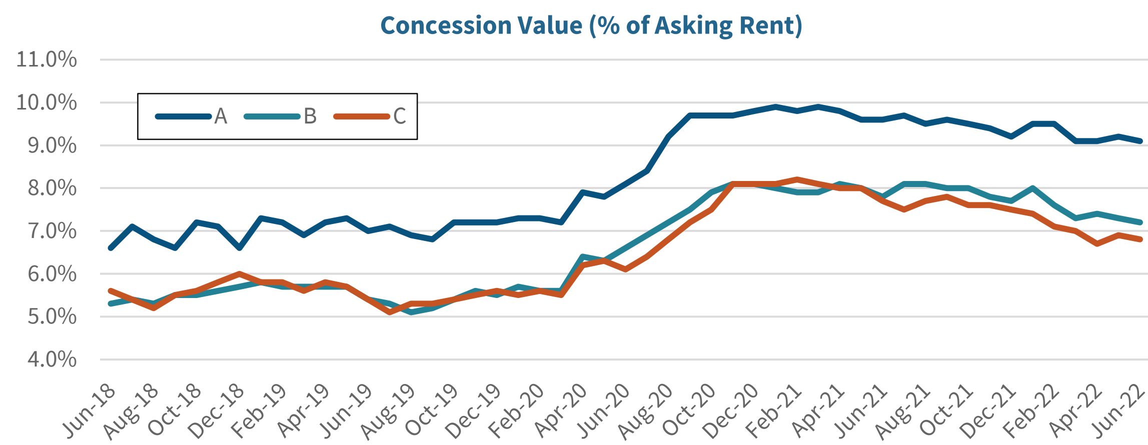
Source: CoStar, Inc. – Data as of July 7, 2022

Concessions Still Above Average but Scarce

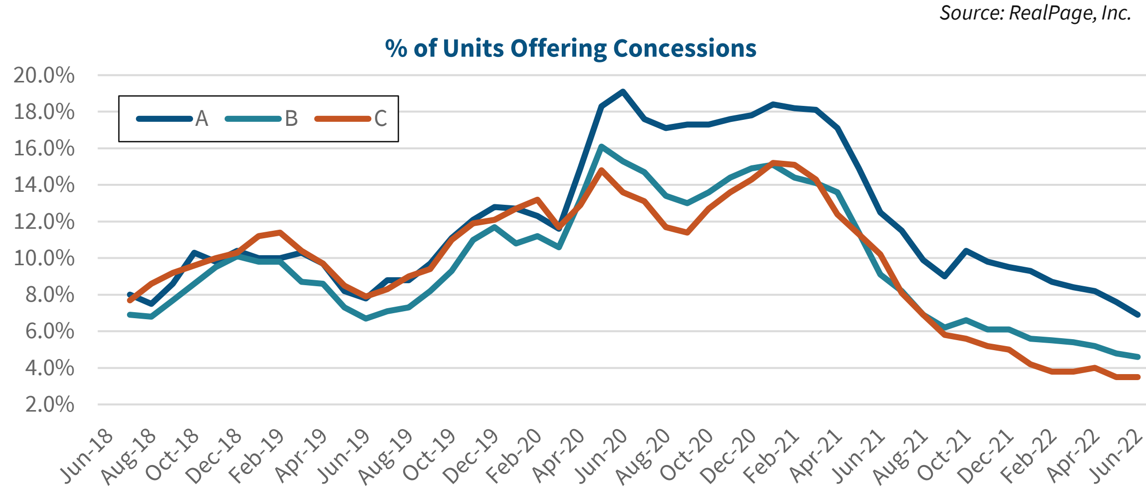
With rent growth trends remaining elevated for all classes of units, as seen in the charts on the previous page, the number of multifamily units offering concessions has been declining. As of June 2022, only 5.1 percent of all multifamily units are offering concessions, down from 10.7 percent in June 2021 and 15.9 percent in June 2020. Although the average national concession rate across all multifamily properties of 8.1 percent is lower than June 2021's 8.6 percent, it remains elevated compared to pre-pandemic trends closer to the 6.0 percent range.

Class A concession levels remain higher than those for Class B and C units, indicating that property owners are continuing to offer more generous concessions upfront for newer Class A units to compete with newly delivered supply. For those Class A units offering concessions, the average concession rate as of June 2022 was 9.1 percent – more than a month's free rent – and not much different from June 2021's 9.6 percent or even its recent peak of 9.9 percent in March 2021. Class B and C units have an average concession rate of 7.2 percent as of June 2022 compared to 7.8 percent as of June 2021, which is down from February 2021's peak of 8.0 percent for Class B and 8.2 percent for Class C.

National Concession Rates by Class



Source: RealPage, Inc.



Source: RealPage, Inc.

Ongoing Demand Keeps Net Absorption Positive

Demand for multifamily rental units appears to have remained positive during second quarter 2022, according to data from Moody's CRE, with quarterly demand estimated at about 30,000 units. As of July 7, 2022, CoStar is also projecting an increase in net absorption for second quarter 2022, with nearly 65,000 units absorbed compared to 62,360 units absorbed in first quarter. CoStar is expecting that more than 369,000 units will be absorbed this year, which is down from the more than 698,000 units estimated to have been absorbed in 2021.

Demand Pushed Up Rents…

Although new multifamily lease rates plunged at the end of March 2020 during the beginning of the pandemic, the trend reversed itself beginning in early 2021, with demand staying well above historic norms. As seen in the chart below, demand has been so strong that new leases have seen rental rate increases of nearly 20 percent as of June 2022, with renewals also at well-above-average levels with rental rate increases of more than 10 percent.

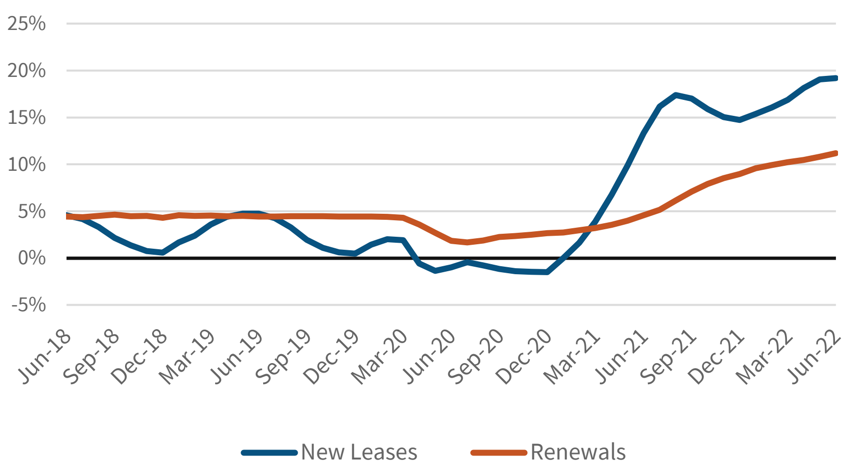
… and Revenues As Well

Year-over-year revenue rates also increased over the past year, as seen in the bottom right chart.

According to data from RealPage, although revenues for Class C increased slightly during the height of the pandemic in 2020, both Class A and B revenues had declined into negative territory. By late spring 2021, however, revenue growth was modestly positive for all classes of units. Indeed, as of June 2021, year-over-year revenues for Class A units had increased just 0.7 percent.

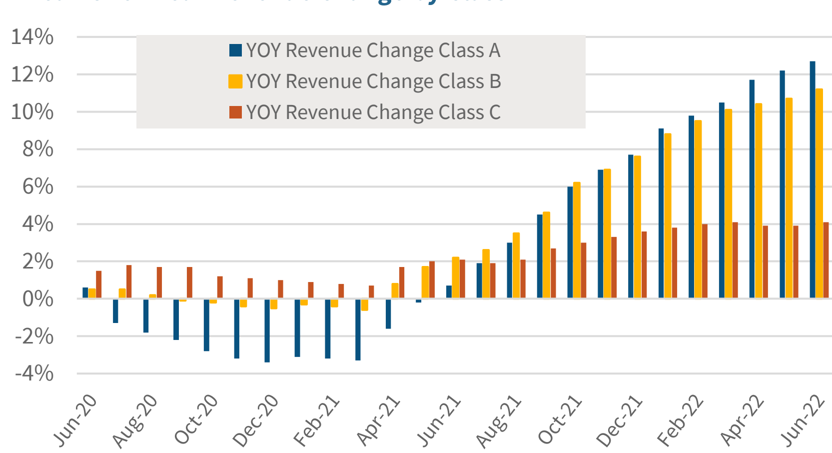
Since then, however, revenue growth has climbed at a fast clip. Class A revenue growth has surged by more than 12 percent over the past 12 months. Class B units have experienced a similar trend, with year-over-year revenues up more than 11 percent as of June 2022. Even Class C units, those offering the least expensive rents in a metro, still saw year-over-year revenue growth of slightly more than 4.0 percent as of June 2022.

Rental Rate Change for New Leases and Renewals All Multifamily Units



Source: RealPage, Inc.

Year-Over-Year Revenue Change by Class

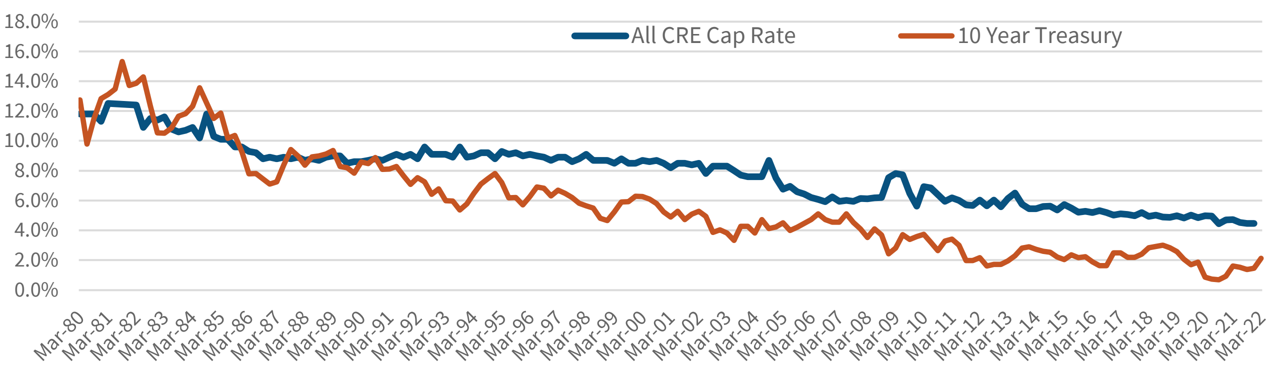


Source: RealPage, Inc.

Investors Remain Focused on Multifamily Sector

Although data from Real Capital Analytics show that multifamily sales volume for the first five months of the year is up compared to the same time last year, we do not expect it to reach 2021's historic peak of $360 billion for properties valued at $2.5 million or higher. Instead, we believe that the combination of rising interest rates and still-low capitalization rates is likely to keep a number of potential buyers on the sidelines this year. That said, there are anecdotal reports of recent multifamily buyers having cap rates that are below Treasurys or even their current mortgage rates – a phenomenon not seen since the 1980s, as shown in the chart below.

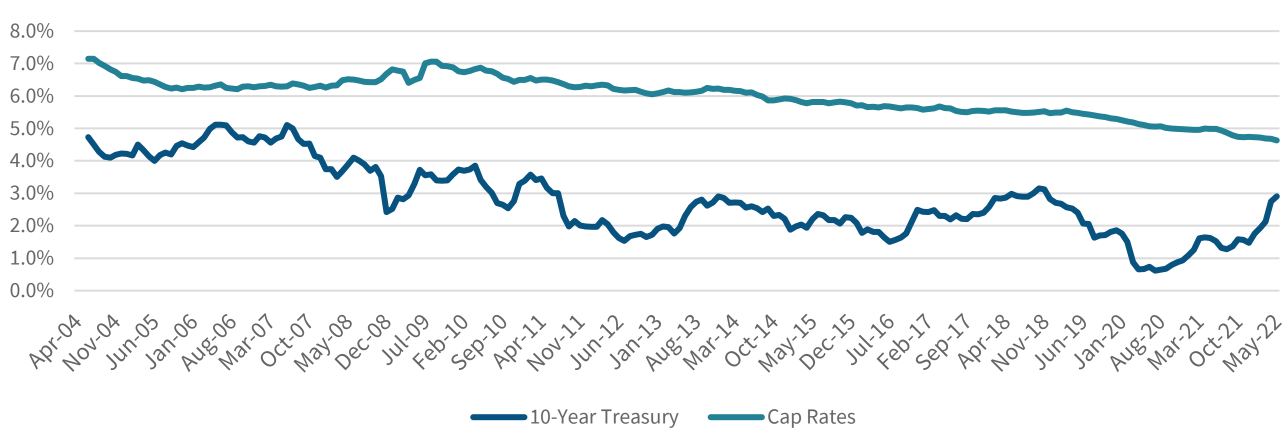
10-Year Treasury and ACLI All Commercial Property Capitalization Rates – 1Q1980 – 1Q2022



Source: ACLI, Commercial Mortgage Commitments (CMC) and Federal Reserve, Selected Interest Rates H.15, per Moody's Analytics

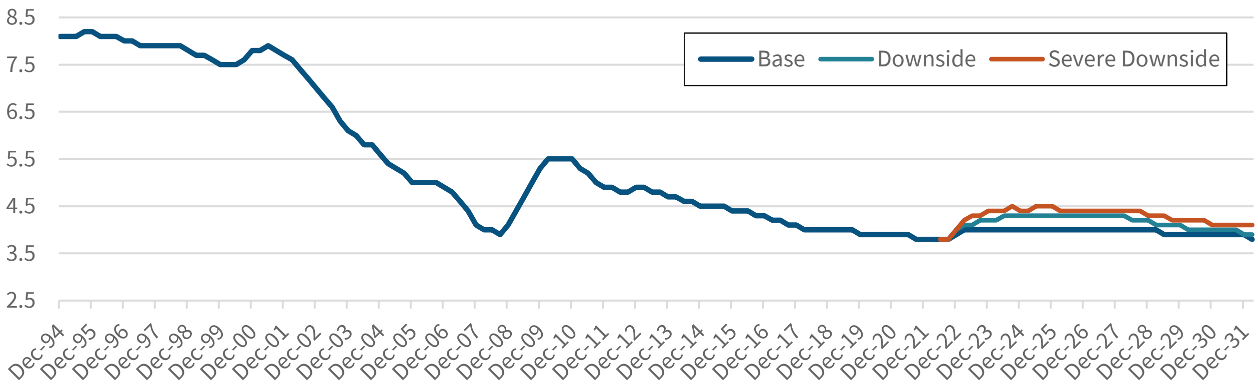
Nevertheless, we believe that multifamily cap rates will rise slightly during the second half of the year, from the current rate of about 4.7 percent to 5.0 percent by year end. Multifamily prices have risen by 23 percent year over year as of May 2022, according to the Real Capital Analytics Commercial Property Price Index. With a recession potentially looming, as well as consumer confidence weakening, it appears that many commercial real estate investors are deciding that future demand for multifamily is a better bet than for other property types, such as office or retail. Indeed, as of May 2022, office and retail cap rates remained well over 100 basis points higher than multifamily cap rates, averaging 6.3 percent and 6.4 percent, respectively, according to data from Real Capital Analytics.

10-Year Treasury and Multifamily Capitalization Rates



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

National Multifamily Cap Rate Forecast



Source: CBRE-EA

Not Much Differentiation in Multifamily Cap Rate Forecast Scenarios

As seen in the chart above, the various cap rate forecast scenarios reflect a tight band between baseline and severe downside, according to CBRE Econometric Advisors. Its baseline multifamily cap rate forecast as of May 2022 anticipates a 10-basis point increase by the end of 2022 and then an increase of another 10 basis points over the next three years. The downside scenario anticipates a 20-basis point increase by year end and then an increase of another 30 basis points by year end 2025. And for its severe downside forecast, CBRE Econometric Advisors expects a 70-basis point increase between now and year-end 2025. The key takeaway is that, as of May 2022, the real estate research firm is not anticipating a significant increase in multifamily cap rates over the next several years, even in the event of a severe economic downturn.

2022 Multifamily Mid-Year Outlook: Demand Remains Resilient

Our outlook for the multifamily sector for the remainder of 2022 remains positive. We expect rent growth to remain at above-average levels in 2022 (in the range of 6.0 percent to 7.0 percent) and vacancy rates to tick up to 5.0 percent by year end. We expect multifamily cap rates to increase only slightly, up to 5.0 percent from the current 4.7 percent. Further out in the forecast, we expect demand to moderate, as job growth slows, inflation remains elevated, and new multifamily supply starts to deliver in earnest. With interest rates expected to continue increasing over the next 12 to 18 months, we believe that the pace of multifamily property sales will slow, ending the year at an estimated $210 billion in volume, which is still above 2019's estimated sales volume of $193 billion, according to Real Capital Analytics.

As a result, we have revised downward our 2022 multifamily originations outlook to $425 billion, from our prior forecast of $475 billion, based on rising rates and current property sales trend, and an anticipated slowdown in the pace of delivery of new units due to ongoing supply chain issues, labor shortages, and volatile material prices. We expect 2021 multifamily originations to have been $450 billion, if not higher. As a comparison, the Mortgage Bankers Association's estimate for 2021 multifamily originations was adjusted upward to $470 billion, as of April 2022, but has been scaled back to $418 billion for 2022.

We believe a stable outlook is appropriate for the multifamily sector for the rest of 2022, based on demographic trends, expected job growth, and household formation trends. However, persistent inflation and recessionary fears are potential headwinds facing the sector in 2023.

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