

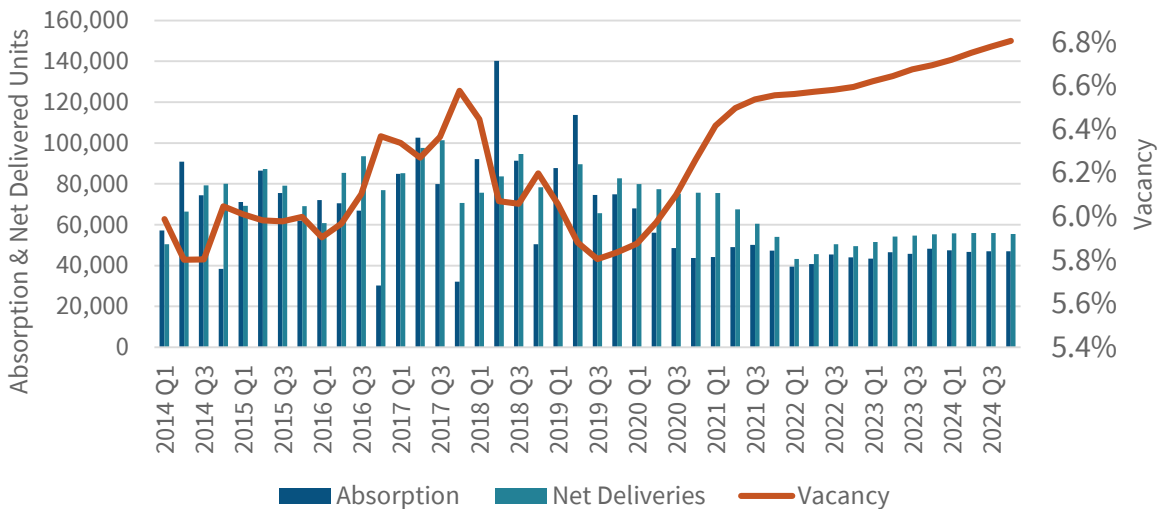
JANUARY 2020

2020 Multifamily Market Outlook – Staying the Course

Over the past decade, the U.S. multifamily sector has benefited from solid demand, increasing rent growth, and low vacancies, thanks to favorable demographic trends, ongoing job growth, and continued renter household formations. The same trends are expected to continue into the first year of the current decade. The biggest driver of multifamily demand has come primarily from the nation’s more than 80 million Millennials (those born between 1982 and 2000). They are the largest age cohort, outnumbering Generation Z (those born after 2000) and even Baby Boomers, according to the Census Bureau. Millennials, combined with Gen Z, the oldest of whom are starting to reach young adulthood, are expected to continue driving demand for housing, especially multifamily rental housing.

Looking to the coming year, we expect the national multifamily sector to stay the course, as fundamentals are expected to remain essentially the same. We expect the vacancy rate to increase slightly and rent growth to remain positive in 2020, similar to last year’s pace.

Forecasted National Multifamily Trends



Source: CoStar

Net Absorption Expected to Remain Positive

Demand for multifamily rental units remained positive throughout 2019. Net absorption is estimated to have totaled about 317,000 units last year, according to data from CoStar, which is down compared to 2018’s estimated 366,000 units absorbed. Net absorption is expected to remain positive this year, although likely slowing to about 275,000 units, according to CoStar. Net absorption is expected to remain elevated earlier in the year and then slow down later in the second half, as seen in the chart above.

Not Much Change Expected in Vacancy

The national multifamily vacancy rate is expected to rise slightly in 2020, primarily due to the amount of new supply expected to complete and come online this year. Since much of this new supply is concentrated in a limited number of submarkets (only about 10 metros), it is possible that supply could outpace demand in some places this year. As a result, the national vacancy rate is expected to inch upward later in the year, as illustrated in the chart on the previous page. Despite an anticipated increase in the national vacancy rate, it is expected to remain low, due to demand stemming from anticipated positive job growth and favorable demographic projections.

Fannie Mae is anticipating that the U.S. multifamily vacancy rate will remain in the 5.5 percent to 5.75 percent range during the early part of 2020 and could end the year near 6.0 percent. This would bring the national vacancy rate back to its recent historical average of 6.0 percent.

Rent Growth Expected to Remain Stable

Rent growth was positive in 2019 and is estimated to have ended the year at about 2.5 percent – once again outpacing the rate of inflation, which was at 2.1 percent as of the end of November 2019. There has been above average rent growth since 2011, but only since 2017 has rent growth stayed below 3.0 percent. Our expectation for 2020 is that rent growth will once again be positive, though perhaps slightly lower than 2019, as we project it to be in the range of 2.0 percent to 2.5 percent.

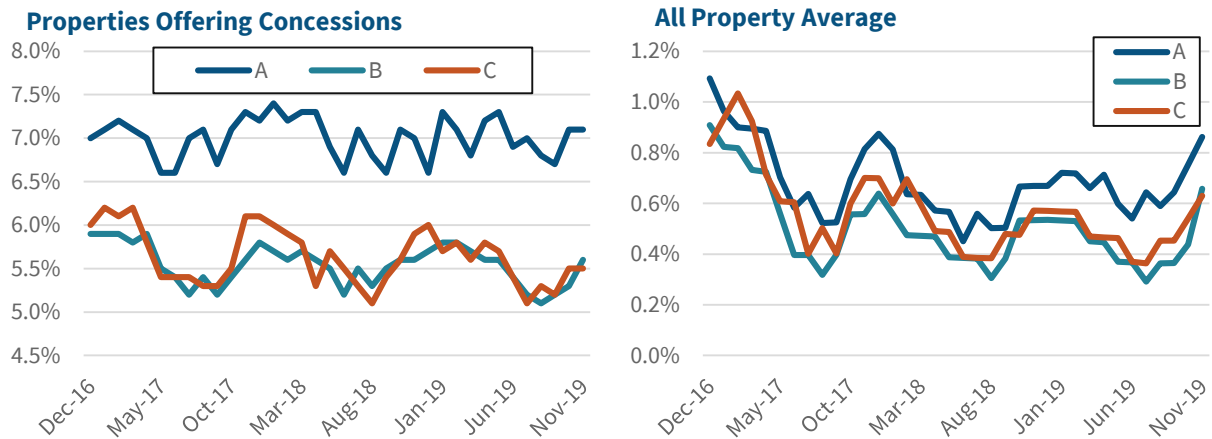
National multifamily concessions for all property classes (averaged across all units, including those not offering concessions) remain at low levels. Only about 15 percent of all multifamily units are offering concessions, according to data from RealPage, Inc. Class A concession levels remain higher than class B and C units, indicating that property owners are likely offering more generous concessions up front for newer class A units to lock in higher rent levels upon lease renewal. For those class A units offering concessions, the average concession rate as of November 2019 was 7.1 percent, which is slightly less than a month of free rent. It was approximately three weeks of free rent for those properties offering concessions on class B and C units, at 5.6 percent and 5.5 percent, respectively, as of November 2019.



Multifamily Economic and Market Commentary

National class C rent growth in 2019 was estimated at 2.5 percent, according to RealPage, slightly lower than 2.9 percent for class A and 3.0 percent for class B. It appears that although less expensive units remain in demand, there isn't much room to push rents higher, as evidenced by class C's lower concession rates and 3.9 percent vacancy rate. As more new units deliver over the coming months, we expect the national concession rate to increase, albeit slightly. Class A concession rates may rise more dramatically for those metros with elevated levels of new deliveries in 2020.

National Multifamily Concession Rate by Class



Source: RealPage

Multifamily New Supply Could Peak in 2020

As seen in the chart on the following page, the amount of multifamily new construction remains elevated, with deliveries now expected by Dodge Data and Analytics to reach their peak of more than 476,000 units in 2020. However, we believe that number of completions to be unlikely, based on the ongoing scarcity of construction workers. According to the Associated General Contractors of America's 2019 Workplace Results survey, more than 80 percent of firms surveyed stated that it was difficult filling all positions, both hourly and salaried, but with hourly craft workers being the most difficult to replace. We do not expect that trend to improve in 2020.

According to the Dodge Data & Analytics Supply Track, which distinguishes between multifamily properties consisting of either apartment or condominium units, about 396,000 apartment units were completed in 2017, making it the most recent peak year for new deliveries. About 377,000 units are estimated to have completed in 2019. The focus remains on rental: Condo completions recently peaked in 2018, with nearly 70,000 units, compared to only about 55,000 units in 2019. Dodge expects fewer than 50,000 condo units to be completed this year.



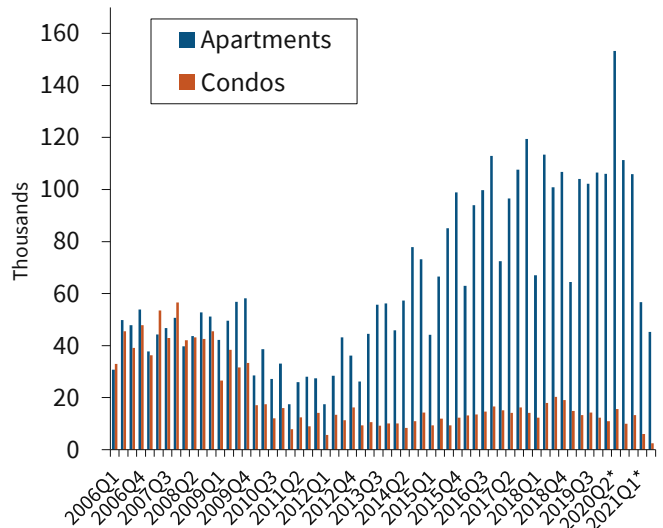
Continued Multifamily Demand Expected

At a national level, we believe there is the potential for a slight supply/demand imbalance this year, based on the amount of new multifamily units expected to complete. Even though not all of the projected units are expected to actually deliver, the amount of expected job growth might not produce enough demand for all these new class A units. Job growth is expected to be 1.2 percent in 2020, according to Fannie Mae’s economic forecast, which should produce 1.8 million new jobs. Based on that amount of job growth, national multifamily rental demand could be between 300,000 and 360,000 units this year.

As seen in the chart to the right, much of that new supply is expected to deliver earlier in the year, when job growth is expected to be more robust than later in the year.

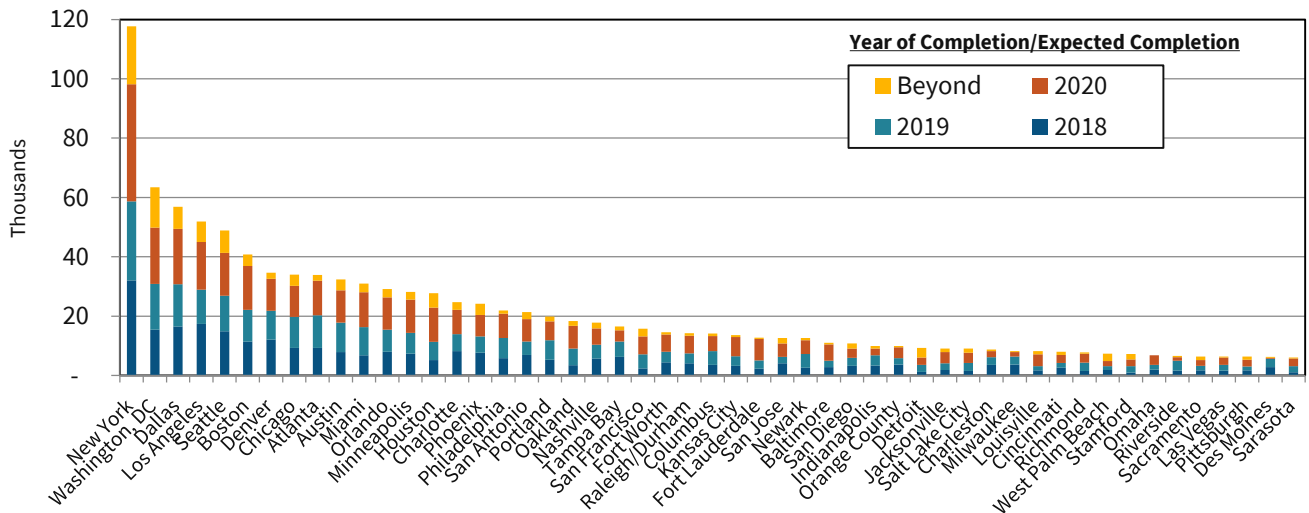
Nevertheless, much of the new supply consists of more expensive, class A units and is primarily concentrated in about 10 to 12 metros, as seen in the chart below, with much of it concentrated in only a few submarkets. The estimated amount of job growth, and its anticipated demand, differs widely from metro to metro, meaning that some metros are expected to experience more demand than others over the next 12 to 18 months.

Multifamily New Construction



Source: Dodge Data and Analytics

Multifamily Apartment Units Underway – Select Metros



Source: Dodge Data & Analytics, January 2020 – Metros with 6,000 or more units underway or completed.

NOTE: Supply Track 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.



Supply and Demand Vary by Metro

Although the nation is expected to see positive job growth this year, it is not expected to be consistent everywhere, as illustrated in the two charts on the next page. Fannie Mae's forecast for 2020 anticipates a national employment growth rate of 1.2 percent, but there are a number of metros that are expected to be below the national estimate, including Boston, Chicago, New York, and Philadelphia. These metros also happen to have a large amount of new multifamily rental supply on the horizon, as seen in the chart on the previous page.

The New York metro is expecting the largest amount of new supply, with more than 59,000 units underway, of which nearly 40,000 units are expected to deliver this year alone. Based on Moody's Analytics' anticipated job growth rate of just 0.4 percent, conservatively the metro could produce demand for fewer than 10,000 rental units. Chicago has more than 10,000 multifamily units expected to come on line this year, yet job growth of 0.5 percent could conservatively produce demand for fewer than 5,000 rental units. Although Philadelphia doesn't have as much new supply underway as other metros, its projected below average job growth of just 0.4 percent could produce demand for fewer than 1,000 rental units, despite more than 8,000 units expected in 2020 alone.

Other Metros More in Balance...

Job growth in other metros is expected to fare better. Some Texas metros, such as Austin, Dallas, and Houston, are expected to surpass the national employment growth average. All three are expected to see job growth of 2.0 percent or higher, due to a continued expansion in the professional services, technology, healthcare, and transportation sectors. And while Austin and Dallas have elevated levels of new multifamily supply, the expectation of robust job growth should allow the multifamily sector to stay in balance over the course of the next 18 months.

Austin's new supply is anticipated at 14,000 units between now and 2021, but potential new demand is not expected to be that far behind at nearly 13,000 units. Dallas's new supply appears elevated at more than 18,000 multifamily units delivering this year, but with 2.4 percent job growth projected this year, demand could easily be as high as 15,000 rental units. More importantly, by 2021, Dallas could actually be undersupplied, if job growth projections remain on track.

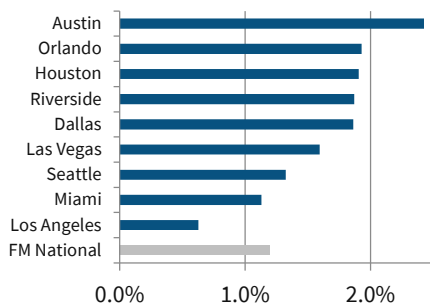


Multifamily Economic and Market Commentary

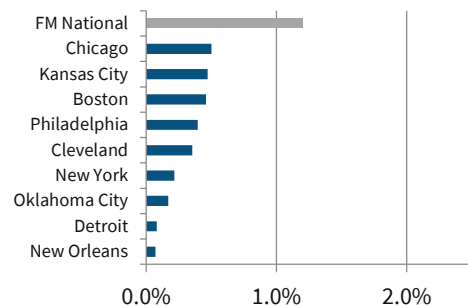
... And Some Need More Supply

Once again, Las Vegas is likely to be undersupplied. With Moody's expecting job growth of 1.5 percent, there could be demand for more than 4,000 rental units, yet only about 2,500 multifamily units are expected to deliver in 2020. Even Riverside, with a renter household population of just 37 percent, is another metro that is likely to be undersupplied. With potential rental demand of between 6,000 and 7,000 units in 2020 (thanks to an expected job growth rate of nearly 1.9 percent), there are just 1,200 multifamily units expected to complete this year.

Select Markets with Higher Expected 2020 Employment Growth



Select Markets with Lower Expected 2020 Employment Growth



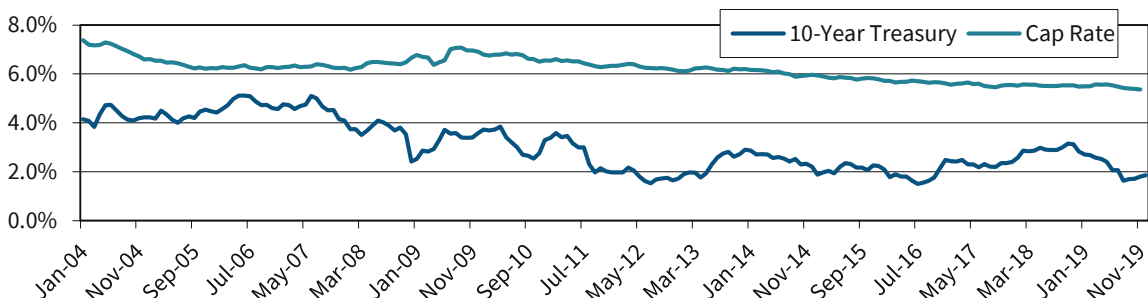
Source: Fannie Mae (National); Moody's Analytics (Metros)

Multifamily Investors Remain Bullish

With interest rates staying low over the past few months, investors are likely even more enticed to focus on multifamily, keeping cap rates stable. Multifamily cap rates have remained in the mid- to low-5.0 percent range over the past two years due to the ongoing influx of capital flows and investor demand for properties. We expect these factors to continue into 2020.

As a result of this anticipated investor interest, along with favorable fundamentals, investment in existing multifamily properties is expected to remain similar to 2019 levels. Although multifamily cap rates have remained at low levels – currently at about 5.4 percent, according to Real Capital Analytics – if the 10-Year Treasury Note yield declines any further, then cap rates would likely compress as well. But with our current economic forecast expecting the 10-Year to remain flat over the next 12 months, the expectation is that national multifamily cap rates are likely to remain low in 2020, staying well below 6.0 percent.

Treasuries and Multifamily Capitalization Rates



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



Rent Control Expansion Continues

Recently, there have been a spate of rent control or rent stabilization laws passed, including in Oregon, New York, and California. These laws, whether at a state or local level, limit the amount of rent private property owners can charge in market rate rental housing, either through imposing a maximum rent amount or a percentage increase each year.

As a result, the expansion of rent control measures in a number of states across the country may pose some challenges for the multifamily sector in the coming year.

Some in the industry have raised concerns that rent control can actually cause pressure on market rents to increase and reduce the number of affordable units available for rent. Another factor is that rent control can cause developers to convert existing properties to condos, thereby leading to less available multifamily rental supply. Other concerns note that rent control laws can create a hesitancy for property owners to maintain their properties since the owners cannot always pass through the cost of improvements to the tenants through rent increases. Lastly, rent control expansion could end up leading to waning investor interest in multifamily properties in certain locations, as evidenced already in the change in focus of metros by investors. For example, according to a recent report from CBRE, the New York City metro area experienced a 9.2 percent year-over-year decline in multifamily investment during the first eight months of 2019, which some partly attribute to its expansion of rent stabilization.

2020 Multifamily Outlook: Staying the Course

Our outlook for the multifamily sector in 2020 remains positive despite elevated levels of new construction. Based on anticipated investor demand, available liquidity, low interest rates, and construction projects whose loans should convert to permanent financing throughout the year, we expect 2020 multifamily mortgage origination volume levels to be higher than 2019. The Mortgage Bankers' Association is anticipating multifamily originations volume will have reached \$364 billion in 2019. It is even more optimistic with a forecast of \$395 billion for 2020, which, as of this writing, does not appear unreasonable. For commercial real estate investors, as long as job growth holds up, multifamily is expected to remain a favored asset class in 2020, leaving open the possibility for further cap rate compression, increased sales, and, in turn, higher origination levels.



Multifamily Economic and Market Commentary

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