A Look Ahead at Our 2022 Affordability Goals

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Multifamily Research

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One of the pillars of our mission at Freddie Mac is to support liquidity in the debt market for properties that provide affordable, quality housing for low-income households. A majority of all the rental housing units we finance each year are affordable to households that earn less than the area median income (AMI).[1]

However, data suggests the supply of rental housing that qualifies as affordable has shrunk over time because income growth has not kept pace with rising rents. This squeeze in the supply of affordable housing is felt more severely across households that earn well below the AMI, which is where we focus our mission and affordability goals.

As we look ahead to our 2022 goals, we examine forecasted affordability trends and how it could impact our ability to meet those goals. While the forecasts indicate that these goals are attainable, they will certainly be a challenge given the ongoing affordability crisis. Even though the economy is experiencing strong growth, inflation has become a growing concern and is an important development that bears watching in the year to come. Inflation has averaged more than 5% year over year each month since late spring of 2021. And though there has been upward pressure on prices recently, it is unknown how long the elevated inflation levels will last.

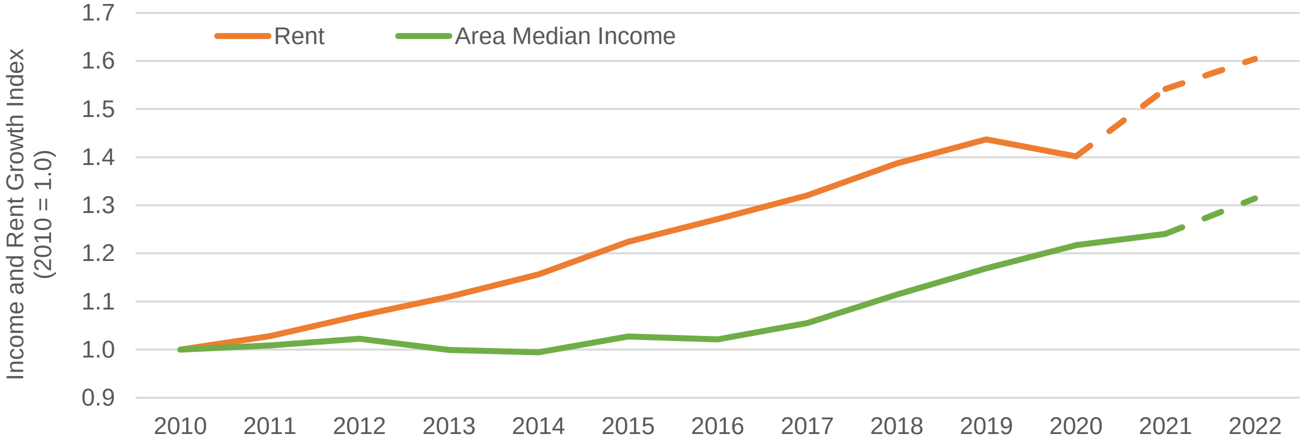
Rising Rents Are Causing Diminishing Affordability

Over the past 10 years, the average rent cost has steadily grown and outpaced the average income growth. Nationwide, rents have increased by 40% from 2010 through 2020, whereas income has only increased by 22% during the same time period. This implies that, in 2010, the average rent was affordable to households making 59% of the AMI[2], whereas in 2020, the average rent was affordable to households making roughly 68% AMI. Applying the forecasted rent and income growth trends to 2022, we project that gap to widen out further, up to roughly 72% AMI.

All else equal, renters are paying a higher percentage of their income to rental payments than they were 10 to 12 years ago. While this increase captures the trend of diminishing affordability at the national level, for many renting households, the situation is much worse.

[1] https://mf.freddiemac.com/docs/financing_affordable_units.pdf
[2] Assuming 30% of income is spent on rent

Exhibit 1: Rent Growth Compared with Income Growth 2010-2022



Sources: Reis Historical and Forecast Rent, Freddie Mac tabulations of American Community Survey PUMS data, CBO Economic Projections

After modest rent declines nationally in 2020 and slow growth early in 2021, the apartment market has begun to accelerate rapidly. Reis reported that effective rents across the country were up a record shattering 7.9% during just the third quarter of 2021. Vacancy nationally was down 60 bps during the third quarter of 2021 and 40 bps over the past year, sitting at 4.7%. This is well below the average vacancy rate of 5.4% we've seen since 2000.

Unprecedented levels of demand are fueling these historic market performances. RealPage reports annual demand of over 600,000 units in the third quarter and this demand is strong across all geographies and asset classes, including lease-up properties. Supply is also expected to be elevated for the remainder of 2021 and into 2022. Despite the tight market conditions and possible construction delays due to supply chain constraints, we expect to see strong multifamily market fundamentals continue.

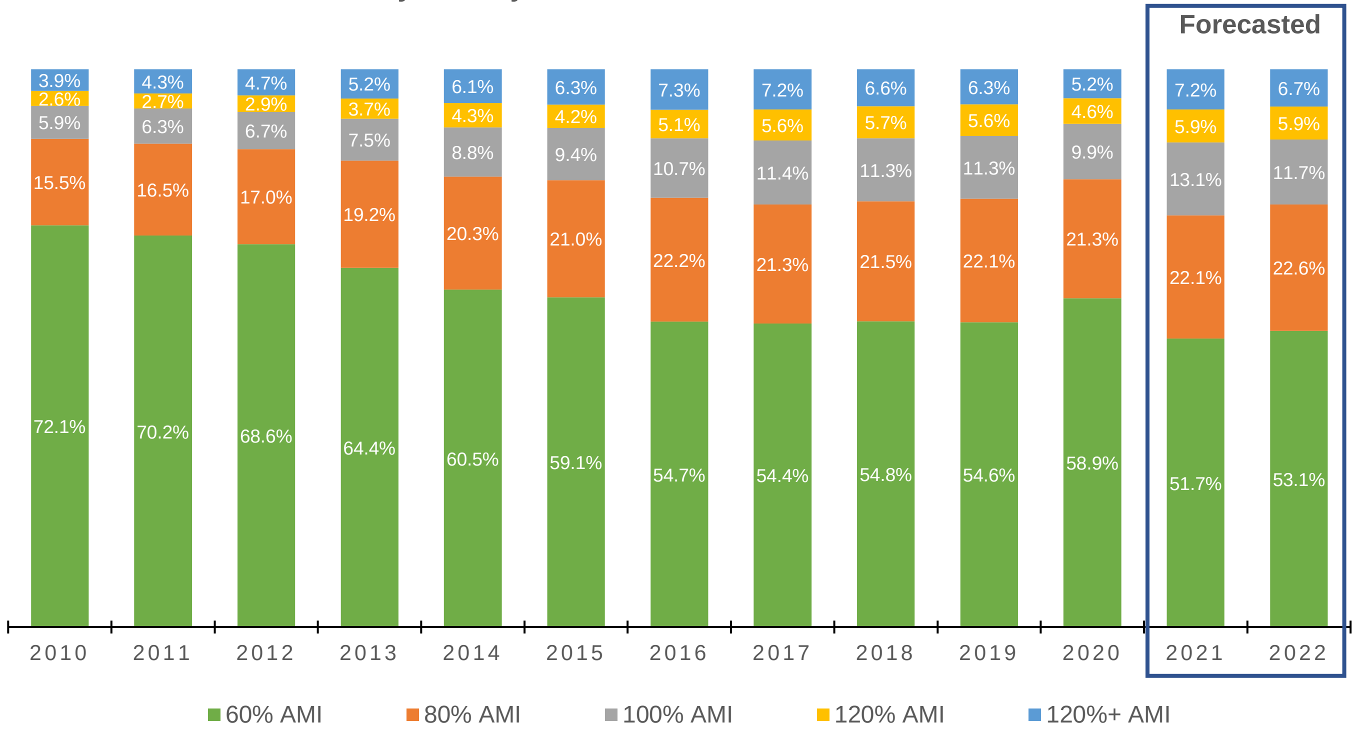
Increasing Focus on Affordable and Mission Goals

Millions of lower-income families struggle to find adequate rental housing they can afford, and the need continues to grow. In 2021, Freddie Mac Multifamily's goal, set by the Federal Housing Finance Agency, was that 20% of our funded business – or $14 billion of our $70 billion of allowable volume under the FHFA Multifamily Loan Purchase Cap – would support properties affordable to households making up to 60% AMI. In 2022, that goal will increase to 25% of our business and our overall volume cap will increase by 11.4% – for a total of $19.5 billion if we do business equal to our new cap of $78 billion.

Exhibit 2 shows that the percentage of the overall rental market that is considered affordable to households earning up to 60% AMI has fallen nearly 20 percentage points since 2010. In 2010, 72.1% of units were affordable to families earning 60% AMI. By 2022, this is projected to be down to 53.1%.

With rents outpacing incomes, fewer rental units are affordable at 60% AMI. Given that the Government Sponsored Enterprises are tasked with supporting debt financing for an increasing number of units affordable up to 60% AMI, Freddie Mac is adjusting its strategy to meet the challenging benchmark set by the Multifamily Loan Purchase Cap.

Exhibit 2: Affordable Multifamily Units by AMI



Sources: Freddie Mac tabulations of American Community Survey PUMS data, RealPage Forecasts, CBO Economic Projections

Getting Clues from our Past Affordable Business

To better understand our affordability goals in the context of our business, we look at our funded business by unpaid principal balance (UPB), and the number of units financed in 2020 and year-to-date (YTD) 2021 (through September). We trend this data forward using projected rent and income growth for 2021 and 2022 to determine if we would hit our goals based on the composition of the actual funded business. The results are mixed.

In 2020, 25% of our business – of an $82.5 billion total funded volume – was affordable to households earning 60% AMI or less. However market trends since 2020 have changed the affordability profile of that business. Trending our 2020 actuals by 2021 and 2022 projected rent and income growth, we would not hit the 20% target in 2021 or the 25% target in 2022. The impact to us is that it is difficult to reach the cap if we maintain the same mix of business that we did in 2020. The impact to renters is that they cannot find affordable units as easily as they did just two years ago, as seen in Exhibit 2, which shows that the stock of affordable housing at 60% AMI could drop 5.8 percentage points from 2020 to 2022.

However, we see signs that our actual 2021 YTD business may not follow that trend. So far this year, it appears our business is above the 25% target. When trended using projected growth for 2022, we would make the 25% goal.

Exhibit 3: Freddie Mac Funded Business Trended

Affordable at 60% AMI	2020 Actuals	2021	2022 Trended
2020 Actuals – UPB	25%	17% *(trended)*	19%
2020 Actuals – Units	36%	25% *(trended)*	28%
2021 YTD – UPB		29%	31%
2021 YTD – Units		41%	44%

Sources: RealPage Forecasts, Freddie Mac tabulation of forecasted AMI, CBO Economic Projections, Freddie Mac 2020 and YTD (through September) 2021 Funded Business

Rent Growth in 2021 Outpaces Income Growth, Squeezing Affordability

Disentangling the data and inputs, trending 2020 data to 2021 applies an average rent growth of nearly 11%, whereas incomes are up just 2%. Since rents grew dramatically faster than income, this is estimated to reduce the population of affordable units at 60% AMI. This would consequently also reduce our percentage of business affordable at 60% AMI to 17% — far below the threshold we are targeting to achieve.

Expected Stronger Income Growth in 2022 May Affect Affordability

However, we could see some of that trend reverse in 2022, with income growth outpacing rent growth. Rent growth is expected to grow above the long-run average but cool from record-high levels seen in 2021. Meanwhile, income levels are set by FHFA, which can be trended for future years based on lagged census data and inflation projections. Inflation is widely expected to boost income in 2022, although the impacts may not be equally distributed across the income spectrum.

When we trend business done in 2020 and YTD 2021 into 2022, the percentage of our business affordable at 60% AMI increases by roughly two percentage points. This would imply that, if our composition of business in 2022 is similar to what we have seen so far in 2021, we are on track to hit our 25% target.

However, there’s a lot of uncertainty in these forecasts. If we see a similar impact like in 2021, when rental increases were much stronger than income growth, that could make the 25% goal much more challenging. Given the extreme rent increases in the second half of 2021, this is a very real concern.

While at the national level, income in 2022 may outpace rent growth, those metrics may differ in individual metro areas. Many southwestern and southeastern metro areas have experienced a large inflow of migration, which is increasing demand and rents in those areas faster than the national average. Areas such as Phoenix, Atlanta and Tampa are examples where rents are expected to outpace income growth into 2022 by three to six percentage points. As a result, those metro areas will become even less affordable.

2022 Cost-Burdened Markets Definition Increases Ability to Reach Goal

Along with our 60% AMI goal, we have another goal that captures a broader segment of the affordable rental market. Our mission goal from FHFA, as defined in Appendix A, sets a threshold that half of our business should qualify as mission-focused business that serves affordable and underserved market segments.

Using our YTD 2021 business through mid-November[3], we found that our mission-focused business would increase from 59% up to 63% with the adaptation of the 2022 definition compared with 2021. This increase is mainly due to the reclassification of cost-burdened markets. Our mission definition allows for higher AMI thresholds in metro areas that are deemed cost burdened. These areas, mostly around the gateway areas such as New York City, San Francisco and Boston, typically have much higher housing costs in relation to their median incomes. This allows us to be present and support affordable housing in most markets across the country, including severely cost-burdened areas where residents generally pay a higher percentage of their income to rent.

The analysis above is based on our previously funded business as well as possible scenarios for 2021 and 2022. The additional $8 billion in our 2022 lending cap could further impact our composition of business in 2022. In fact, with the trends of declining affordability in the overall market, growing volume suggests that it will be more challenging to add business that is as equally affordable as our current mix of business.

[3] Our funded and firm business through 11/16/2021, which encompasses loans that are expected to fund in 2021.

Smaller Loans and Smaller Markets Have Higher Affordability

In our 2021 report entitled, New Multifamily Cap Rules: How They Could Impact Our Business, we found that the majority of 60% AMI business is found in smaller, interior markets, that are separate from the coastal, gateway markets.

As seen in Exhibit 3, the percent of our business affordable at 60% AMI by UPB is much lower than the percent by units. Over the past two years, our affordable business by unit count is 35%-40%; however, that corresponds to only 25%-30% of our business by UPB, therefore, a higher concentration of affordable units are being financed by way of our Small Balance Loans.

These factors will reinforce the need for Freddie Mac Multifamily to maintain a strong focus on affordable housing in order to meet our goals.

So What Lies Ahead?

Rental affordability challenges will continue to plague the housing industry and economy. These challenges will be driven by a combination of very strong rental demand and insufficient supply being unable to offset the fact that rents are growing faster than incomes. While new supply of multifamily units is expected to complete at record-high levels, the majority of that supply is not expected to be affordable to the lower end of the income spectrum.

Freddie Mac’s commitment to affordable, quality rental housing is the core of our mission and drives the products and services we offer. We continue to focus our efforts on financing affordable housing and to hit our targets for 2022. It may not be easy, but it’s a challenge we embrace, and we anticipate another successful year.

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