



2024 Midyear Multifamily Outlook

July 2024



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Through the first half of 2024, the multifamily market continues to feel the impacts of a multidecade, high level of new supply entering the market. Rent growth over the past year has been minimal, while vacancy rates have been trending up. For the rest of the year, we expect rent growth to be positive but below long-term rates, while vacancy rates are expected to continue their upward trend, but at a much slower rate than the prior few years. Cap rates have continued to trend up, along with high interest rates, which are putting downward pressure on property prices at a time when property performance is moderating. Given the headwinds, the multifamily finance market has remained sluggish, with volume down significantly from the highs seen in 2021 and 2022. Although the multifamily market is facing stress from high supply, high interest rates and moderating performance, over the longer term it will remain a favored asset class due to the lack of alternative housing options, continued economic strength and demographic tailwinds.

- The economy is performing well, but as the effects of higher interest rates take hold, growth is expected to slow.
 - Demand was strong toward the end of 2023 and into the first quarter of 2024, while new supply is expected to be at its cyclical high in 2024.
 - For 2024, we expect positive rent growth, but below long-term average growth rates, while vacancy increases are modest and remain above the long-run average.
 - New-unit deliveries are generally concentrated in the Sun Belt and Mountain West regions of the country, where demand has been strongest since the pandemic.
 - Metro-level performance will vary, generally favoring less expensive secondary and tertiary markets that are seeing lower levels of supply. Markets that saw booming rent growth in 2021 and 2022 and now have high supply are expected to be amongst the weakest performers.
 - Interest rates have remained elevated, and volatile, while cap rates have been steadily increasing, leading to a cap rate spread that is less than half the long-run average going back to 2001, while property prices have fallen nearly -19% from their highs in 2022.
 - Given the current elevated interest rate and continued volatility, transaction volume in the multifamily market could rebound modestly from the estimated 2023 level to about \$320 billion if market conditions improve during the second half of the year.
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Multifamily Market Performance is Steady, but Transactions are Muted

The multifamily market has remained resilient during the second half of 2023 and into 2024 as new apartment supply is at levels not seen since the 1980s. Overall market performance is holding up well all things considered, due in large part to above-average demand. However, in some markets, supply is significantly outpacing demand causing rent growth to slow and occupancy rates to tick down. Interest rates have been increasing for much of the year, generally between 3.8% to 4.7%, and have remained volatile in 2024 despite signs of stabilization at the end of 2023. The higher interest rate environment is putting upward pressure on cap rates and downward pressure on valuations.

The economy has been outperforming expectations but is slowing as higher-for-longer interest rates take a bite out of economic growth. The risk of an economic downturn remain elevated if the Federal Reserve miscalculates the economic trajectory, which could cause greater impact to the multifamily market especially given the high level of new supply entering the market. However, despite the potential short-term headwinds, the multifamily market appears to be on solid footing, with continued demand due to a long run of positive economic growth, a steadfast labor market, favorable demographics and a highly unaffordable for-sale housing market.

Still Waiting for the Economic Inflection Point

The interest rate hikes by the Fed in 2022 and 2023 have been slowing the economy steadily, as the full effects take a while to be felt throughout the economy. While the Fed has so far been successful in bringing inflationary pressures down without a large uptick in unemployment rate, the risks of an economic downturn remain. However, according to Moody's Analytics, there is a 30% chance of a recession in the next year, which is down significantly from above 50% a year earlier (as of May 2023). In line with that sentiment, the baseline expectation is for the Goldilocks "soft landing" scenario, although it is unlikely to be a smooth descent. Economic news both good and bad tends to have a significant impact on interest rate volatility.

Economic growth was robust during the second half of 2023, with third and fourth quarter real Gross Domestic Product (GDP) growth of 4.9% and 3.4%, respectively, according to the Bureau of Economic Analysis. However, GDP growth during the first quarter of 2024 was materially lower at 1.4%. A large portion of that decline is due to falling net exports, which have been quite volatile recently and prone to revisions, but according to Moody's Analytics, is not an indication of a faltering economy. The Federal Reserve Board of Philadelphia's Survey of Professional Forecasters¹ indicates that as of May 2024, GDP growth for 2024 is expected to be 2.5%, while growth for 2025 is projected to be 1.9%. Although these forecasts indicate that a soft economic landing is the most likely outcome, there are several risks that could cause the economy to falter. Chief among those risks is a misstep by the Fed keeping interest rates too high for too long and stifling economic growth. Other risks include an expansion of current or new geopolitical conflicts, a faltering of the banking or financial systems, a re-acceleration of inflation, a collapse of commercial property values, and political risk associated with the upcoming elections.

The Fed has held interest rates at the current 525-550 basis points (bps) range for nearly a year, with the last rate hike occurring in July of 2023. The last mile of inflation has been stubborn, and proved difficult to return to

¹ <https://www.philadelphiafed.org/surveys-and-data/real-time-data-research/spf-q2-2024#:~:text=On%20an%20annual%2Daverage%20over,estimates%20of%20three%20months%20ago.>

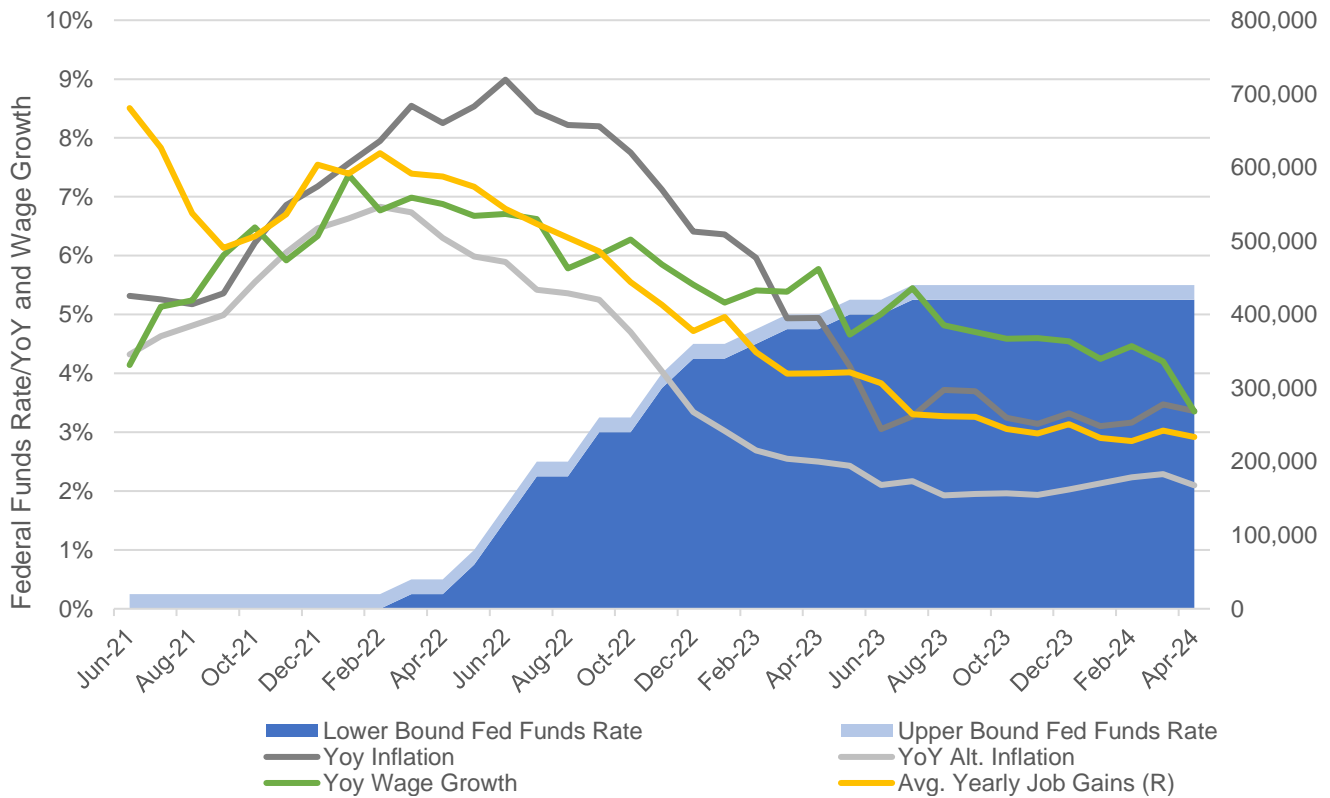
the target 2% rate. The 10-year Treasury rate has been elevated, with rates of about 4.3% as of mid-June. The 10-year rate has also been quite volatile in 2024, particularly in April and May when inter-monthly swings were 33 bps and 66 bps, respectively.

As of June, most forecasters are projecting two rate cuts during the remainder of 2024. Moody's believes that by early 2025, the 10-year Treasury rate will be at about 4%, with the 2-year rate and the federal funds rate dropping below the 10-year benchmark shortly thereafter. They believe the federal funds rate will reach its equilibrium rate of 3% over the next 24 to 36 months.

Inflation continues to be stubborn: As of April 2024, annual growth in the Consumer Price Index (CPI) was 3.4%, roughly in line with the year-over-year (YoY) growth rates for the past 12 months, but well below the peak seen in mid-2022. The core inflation rate, which exclude volatile items like gas and food, has been consistently decreasing over the past year, down from 5.3% in May 2023 to 3.6% in April of this year. Despite little to no multifamily rent growth over the past year, and the median home price increasing only modestly, the shelter component of inflation remains elevated due to lags in the data collection and methodology. Along with housing, the services component of inflation accounts for an outsized portion of inflation compared with pre-pandemic norms. It is believed that the shelter component will trend downward soon, and to that end, Moody's Analytics projects that by mid-2025 CPI inflation will be just above the Fed's 2% target. Given the known lags in the shelter component, an alternative index called the Penn State/ACY Alternative Inflation Index² replaces the CPI shelter index with a newly developed Marginal Rent Index, a real-time measurement of shelter costs. This alternative index for shelter brings overall inflation down to 2.1% in April 2024.

² The Penn State/ACY Alternative Inflation Index is constructed by replacing the rental price of both tenant- and owner-occupied housing with a new Marginal Rent Index (MRI) introduced by Ambrose, Coulson, and Yoshida (2022), <https://sites.psu.edu/inflation/>

Exhibit 1: Federal Funds Rate, Avg. Weekly Jobless Claims, Annual Wage Growth and Inflation



Sources: Moody's Analytics, U.S. Bureau of Labor Statistics (BLS), Federal Reserve Bank of St. Louis, Penn State, Freddie Mac

The labor market remains resilient, although slowing from a year ago. For the 12 months ending in April 2024, average monthly job growth was more than 233,000, which totals 2.8 million for the year. This remains robust in comparison with 2019, when job growth was about 1.6 million. Moody's has indicated that they believe the strong job growth is likely due to an influx of immigration, which is helping to propel job growth while keeping wage growth in check, a key component to tame inflation. Wage growth has been steadily falling from nearly 7% in the middle of 2022 to 3.4% in April of this year. Despite the strong job growth, the unemployment rate has been ticking up from the cyclical low of 3.4% in April 2023 to 4% in May 2024. At the same time, weekly jobless claims have been stable for much of the year, averaging about 213,000 per week so far, which is just below the average of 218,000 per week in 2019, per the Department of Labor. Voluntary quits rates have been stable through the first four months of 2024 at 2.2%, continuing the general trend of falling quits rates since 2022, when they were about 3%. While the overall labor force participation rate has declined since 2019 as many older workers chose to retire over the past four years, the labor force participation rate of the prime-age worker (25 to 54 years old) is 60 bps higher than it was before the pandemic at 83.6% as of May 2024.

The For-Sale Market: Volume is Recessionary yet Prices Keep Increasing

For the year ending in April 2024, just under 4.1 million homes were sold according to the National Association of REALTORS® (NAR), which is a decline of nearly 20% from calendar year 2022 and is nearly 34% less than the number of sales in 2021. The lack of sales is attributable to the lack of available inventory. Owners with low mortgage rates are disincentivized from moving due to the rate-lock effect. Older homeowners are choosing to age in place longer than expected, delaying moving to dedicated seniors housing facilities. Accordingly, the number of months of supply for existing sales is 3.4 months, which is up from the lows seen in 2022, but roughly half of the 6.7 months average seen from 1982 to 2019. As home prices increased, so have down payment requirements, property taxes and insurance costs. These increased costs have impacted first-time homebuyers, with NAR reporting that first-time homebuyers in 2023 represented 32% of the market, which is up from 26% in 2022 but well below the long-term average of 38% going back to 1981.

The monthly cost to finance a home, principal and interest (P&I), has increased nearly 10% over the past year as of the first quarter of 2024, as shown in Exhibit 2. The increase is attributable to a nearly 5% increase in the median home price combined with a nearly 50-bps increase in mortgage rates over that time. Over the past four years, since the onset of the pandemic, P&I costs have more than doubled from just over \$1,000 per month to nearly \$2,100 per month. Multifamily rents grew nearly 20% during the same time period and wage growth was up more than 22%. For-sale housing costs have far exceeded rent growth, making renting a relatively more affordable option. These increases in P&I will likely mean some would-be first-time homebuyers are priced out of the market and may choose to rent longer, keeping units occupied for longer.

Exhibit 2: Monthly P&I Costs for the Median Sales Price of a Home Compared with Rent

Year/ Quarter	For-Sale				Multifamily Monthly Rent	Multifamily YoY Rent Growth	YoY Wage Growth
	Mortgage Rate	Median Sales Price	Monthly P&I	YoY Change			
2020	3.1%	\$298,485	\$1,012	-17.6%	\$1,426	0.0%	4.6%
2021	3.1%	\$352,048	\$1,199	18.6%	\$1,535	6.9%	5.2%
1Q 2022	4.7%	\$383,695	\$1,586	37.4%	\$1,676	15.3%	7.0%
2Q 2022	5.7%	\$390,796	\$1,815	54.7%	\$1,740	14.5%	6.7%
3Q 2022	6.7%	\$383,470	\$1,980	65.2%	\$1,793	10.6%	6.0%
4Q 2022	6.4%	\$379,882	\$1,905	49.9%	\$1,783	6.6%	5.5%
1Q 2023	6.3%	\$379,473	\$1,883	18.7%	\$1,785	4.5%	5.4%
2Q 2023	6.7%	\$386,928	\$1,999	10.2%	\$1,810	2.4%	5.0%
3Q 2023	7.3%	\$392,881	\$2,157	9.0%	\$1,824	0.4%	4.7%
4Q 2023	6.6%	\$395,477	\$2,023	6.2%	\$1,806	0.2%	4.5%
1Q 2024	6.8%	\$397,180	\$2,069	9.9%	\$1,807	0.2%	4.2%
Change Since 2020	3.7%	\$98,695	\$1,058	101.0%	\$381	19.6%	22.6%

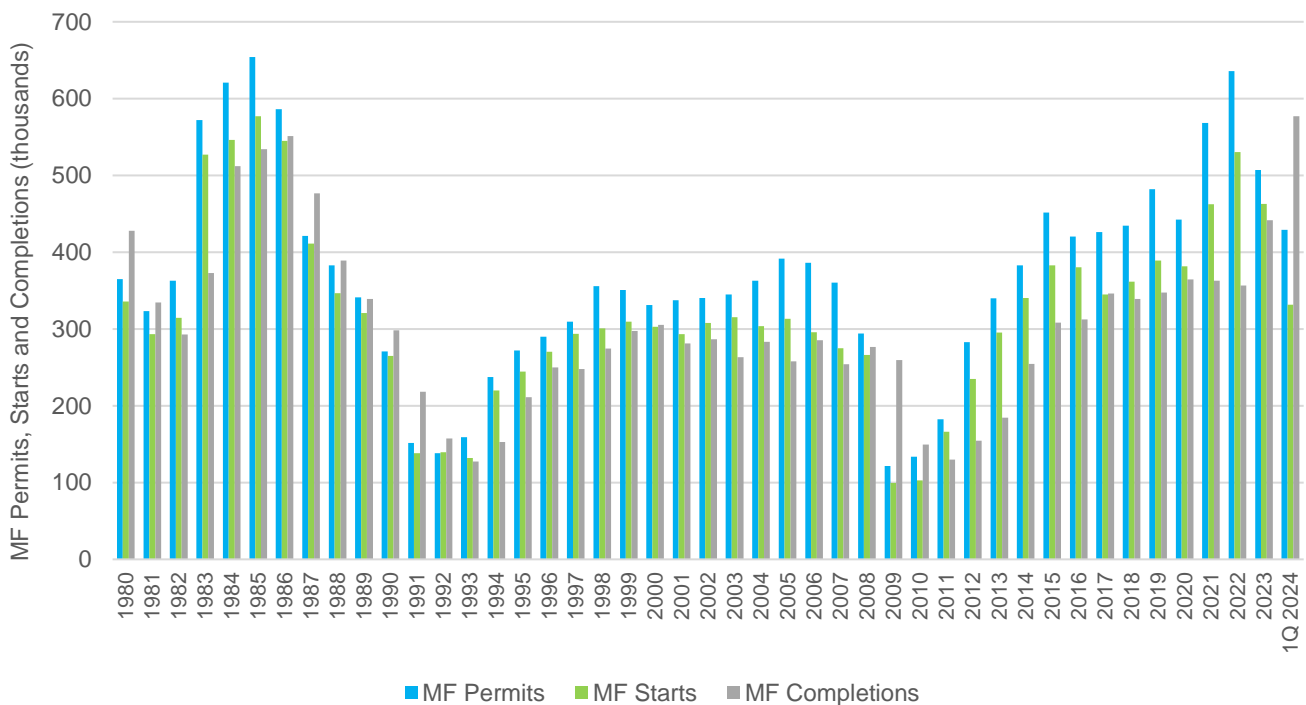
Sources: Freddie Mac, National Association of Realtors, RealPage

Note: For each period, assume a median-priced home, a 30-year mortgage and a 20% down payment. Monthly Rent dollar figures are from the “performance metrics” data from RealPage, but here and throughout the report, we use same-store growth rates which provide a better idea of how true rents have changed and may not have the same growth rate as the rent dollars shown. Same-store rent dollar figures are not available, but we provide the performance metrics to give context of rent cost to Monthly P&I. 2020 & 2021 data is the average of the quarterly data.

40-Year Supply Peak Expected this Year, Demand to Match?

While the overall housing shortage has not changed meaningfully due to the lack of for-sale housing over the past 15 years, multifamily rental housing stock has been increasing. According to data from the U.S. Census Bureau (Census), multifamily permits and starts peaked in 2022 — at levels not seen since 1985 — but as of first quarter 2024 are down -33% and -37% respectively. Due to construction timelines, the bulk of the units started in 2022 are expected to be delivered from 2024 through 2026. In the first quarter of 2024, deliveries peaked at their highest level going back to 1980 as shown in Exhibit 3.

Exhibit 3: Multifamily Permits, Starts and Completions (5+ Units)

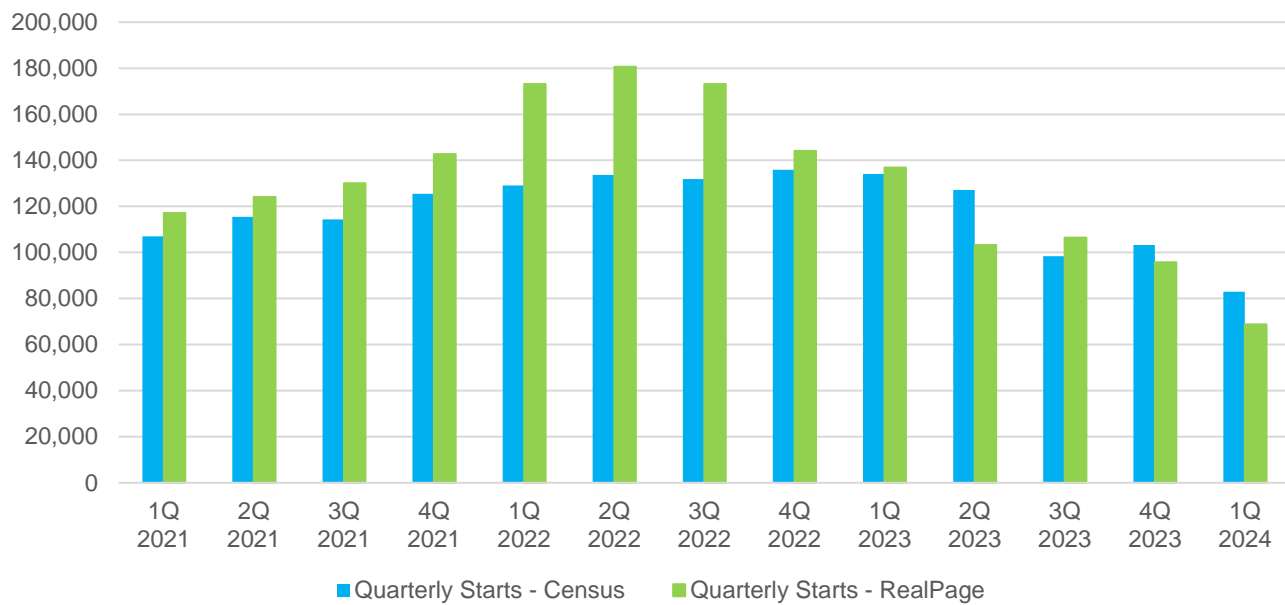


Sources: Freddie Mac, Census Bureau, Moody’s Analytics

However, RealPage indicates that the Census was underreporting starts from first quarter 2021 through first quarter 2023, and generally overreporting starts since second quarter 2023, seen in Exhibit 4. From the first quarter of 2021 through the first quarter of 2023, the Census reported that starts totaled about 1.1 million units, while over the same period RealPage indicates that starts totaled more than 1.3 million, a difference of more than

195,000 units or 17%. Conversely since the second quarter of 2023, Census reports that about 411,000 units were started while RealPage data suggested that 374,000 units were started, a difference of about 37,000 units.

Exhibit 4: Multifamily Starts and Units Under Construction

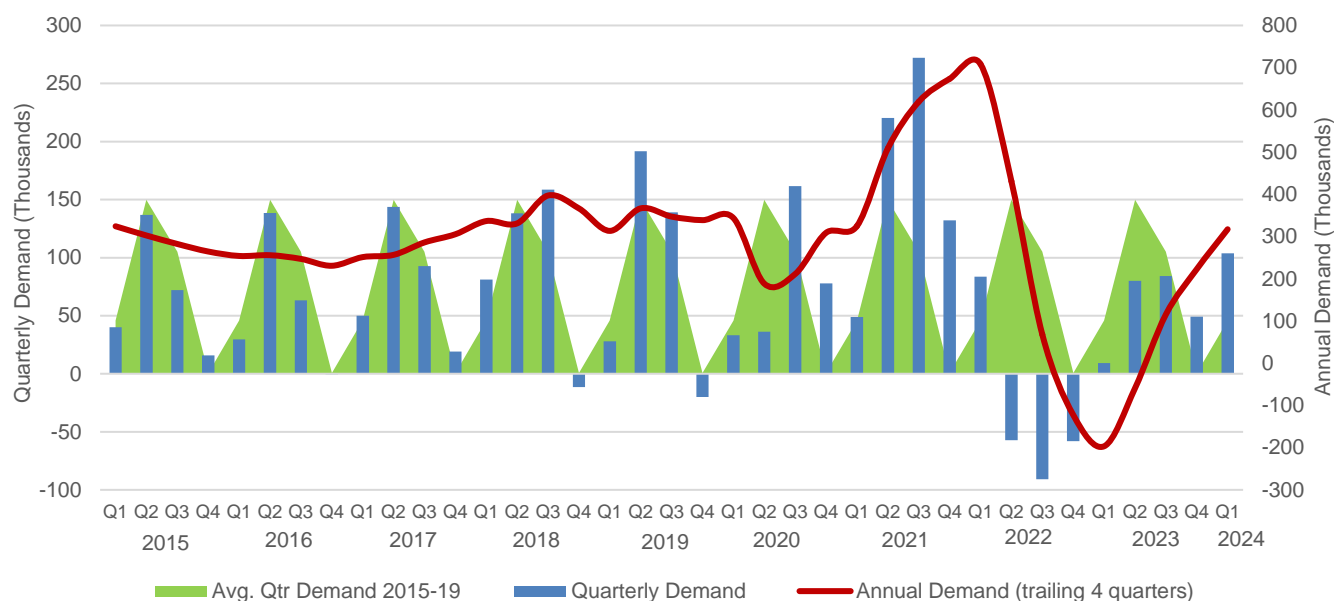


Sources: Freddie Mac, RealPage, Census Bureau, Moody's Analytics

Given construction timelines and the more than 670,000 units that were started in 2022, we expect 2024 to be the peak year for new unit deliveries of this cycle. RealPage projects that about 665,000 new units will be delivered during the year, which is more than double the annual average of about 300,000 units from 2015 through 2019. Although material and labor shortages are moderating, it is still reasonable to expect a fair number of those units expected to deliver in 2024 to slip into 2025. Even without any slippage, 2025 is also expected to see high levels of new supply, with an estimated 460,000 new units.

After quarterly demand turned negative for much of 2022, demand was positive for each quarter of 2023 and into the first quarter of 2024. As shown in Exhibit 5, quarterly demand for the first three quarters of 2023 was relatively weak, coming in below the quarterly average from 2015 through 2019. Demand is seasonal, with the peaks typically seen during the second and third quarters of the year, while the fourth and first quarters typically see much weaker demand. However, demand was strong during the fourth quarter of 2023 and the first quarter of 2024, with demand for the two quarters totaling 153,000 units, which is about three times more than the 2015 to 2019 averages. Annual demand (prior four quarters summed) for the year ending in first quarter 2024 was 317,000 units, which is modestly stronger than the annual average from 2015 through 2019 of about 300,000 units.

Exhibit 5: Quarterly and Annual Multifamily Demand, 2015-2019 Quarterly Average Demand



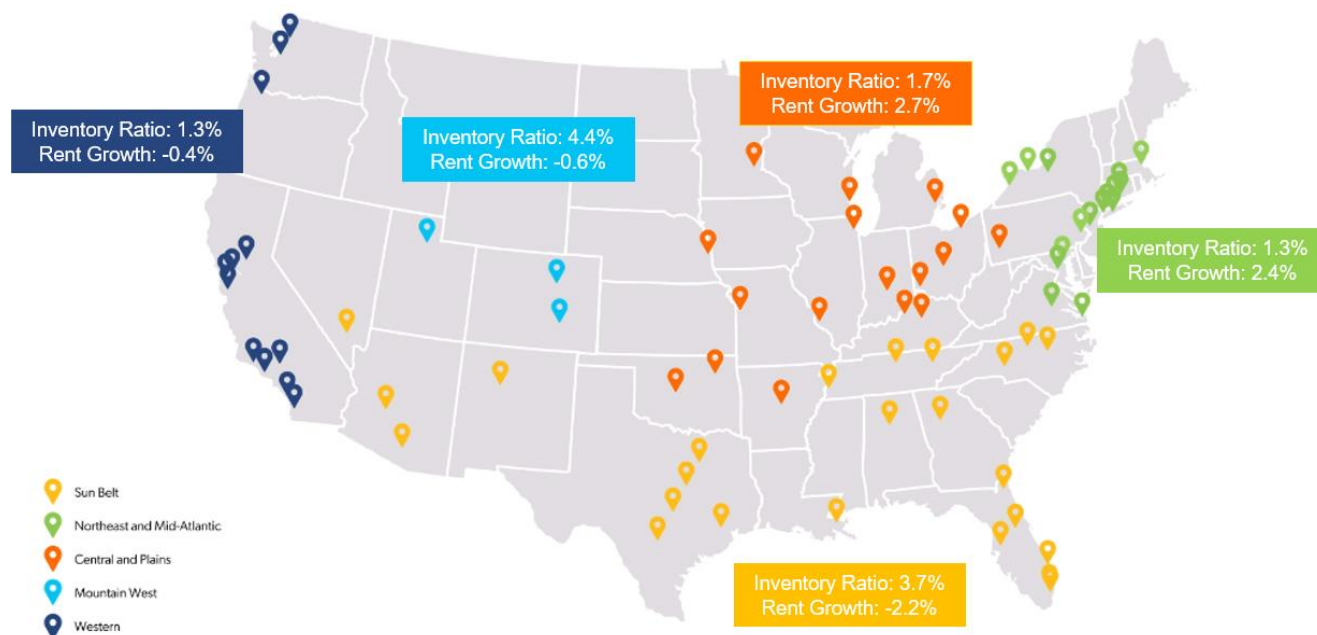
Sources: RealPage, Freddie Mac

Despite strong demand recently, high supply is doing what it's expected to, namely moderating rent growth and putting downward pressure on occupancy rates. According to RealPage, YoY rent growth was just 0.2%, as of May 2024, and has been at 0.3% or less since August 2023. Occupancy started to decline in 2022 and appears to have bottomed out in late 2023 at 94.1%. Since then, it has been mostly flat and has increased 10 bps to 94.2% as of May 2024. The modest rent growth combined with recently stabilizing occupancy indicates that operators are willing to forgo rent increases to keep units occupied.

Nationally, RealPage reports nearly 480,000 new units were delivered in the year ending in March 2024. This equates to an inventory ratio of 2.5% — defined as the number of units delivered during the prior 12 months compared with the overall inventory. However new supply is not uniform across the country, and areas with higher levels of new supply typically see more downward pressure on rents.

Exhibit 6 shows the new supply ratio and rent growth by region for the year ending in the first quarter of 2024. Markets in the Sun Belt and Mountain West are seeing the highest levels of new supply as a percentage of existing inventory, with inventory ratios of 3.7% and 4.4%, respectively. High supply is contributing to the YoY rent decline of -2.2% in the Sun Belt and -0.6% in the Mountain West. The markets with the highest supply ratio are Salt Lake City, Nashville, Charlotte, Austin and Raleigh/Durham, which have a new supply ratio of 6.2% or higher. Meanwhile, the Midwest and Northeast saw much lower new supply ratios, representing only 1.7% and 1.3% of inventory, respectively, and as a result, annual rent growth on average was positive at 2.7% and 2.4%, respectively. Much of the rent growth in these regions is attributable to less expensive secondary or tertiary markets that are seeing increased demand and little new supply. The individual markets with the lowest supply ratios are Syracuse, New Orleans, Buffalo and Rochester — all of which feature a new supply ratio of 0.4% or less. However, the West Coast has not generally followed this pattern, as new inventory is low at 1.3% but rents declined -0.4%. The rent decline seen on the West Coast is due to outmigration trends rather than new supply.

Exhibit 6: New Supply Ratio and Rent Growth by Region at 1Q 2024



Sources: RealPage, Freddie Mac

Despite the high levels of new supply concentrated in certain markets, those areas of the country are also experiencing some of the strongest demand. An analysis of demographic trends by Yardi³ indicates population growth rates — as a percentage of existing population over the next five years is concentrated in the Sun Belt and Mountain West regions. Markets with the highest population percentage gains are Las Vegas, Austin, Phoenix, Raleigh/Durham and Orlando ranging from 10% to 7.2%. Conversely many gateway markets are expected to see lower population growth. Notably through 2029, Chicago is expected to lose residents, Los Angeles and New York are expected to see nearly flat population growth of less than 0.2%, while Boston and San Francisco are expected to fare better seeing growth of 0.7% and 1.3%, respectively.

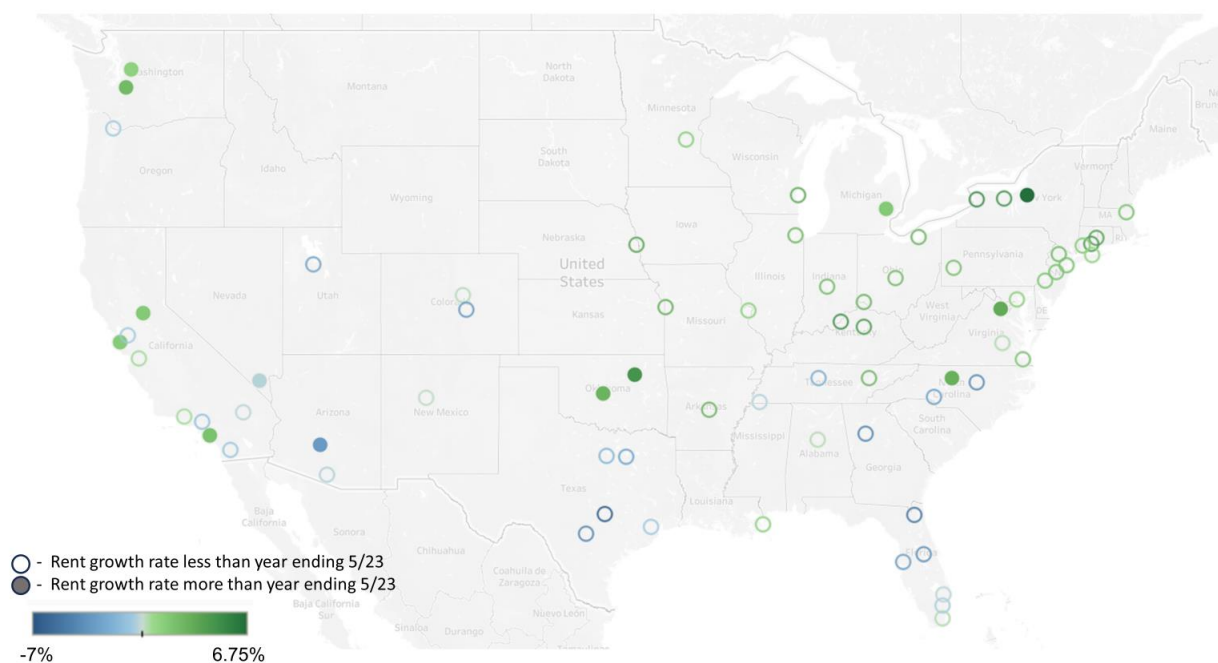
Over the past year, most metro areas, along with the nation, have seen the pace of rent growth slow from the previous year. The map in Exhibit 7 shows rent growth by market over the past 12 months (as of May 2024) along with the trend in rent growth compared with the 12 months ending May 2023. Those with filled circles indicate higher rent growth compared with last year, whereas those with open circles indicate a slower pace of rent growth. All but 13 markets nationwide have seen the pace of rent growth slow over the year. Similar to Exhibit 6, secondary and tertiary markets located in the Northeast or Midwest regions are leading the pack in YoY rent growth. Sacramento, Las Vegas, Tacoma and San Francisco are seeing rents up year over year and at a faster pace than in 2023, but growth is still muted, with each market seeing YoY rent growth of 2.4% or less.

³ <https://www.yardimatrix.com/Publications/Download/File/741-NationalAnalysisofDemographicShifts>

Conversely, Buffalo, Louisville and Rochester are seeing rent growth of about 5% over the past year, but YoY growth rates have declined since May 2023.

The markets seeing the greatest rent declines as of May 2024 are the pandemic boom markets that saw rents increase rapidly in 2021 and 2022 but have now seen higher levels of new supply. Austin, Jacksonville, Atlanta, San Antonio and Raleigh/Durham are all seeing rents decline and trending lower than the prior year. However, these areas generally performed better than most markets during the pandemic with cumulative rent growth since the first quarter of 2020 of 14% or more.

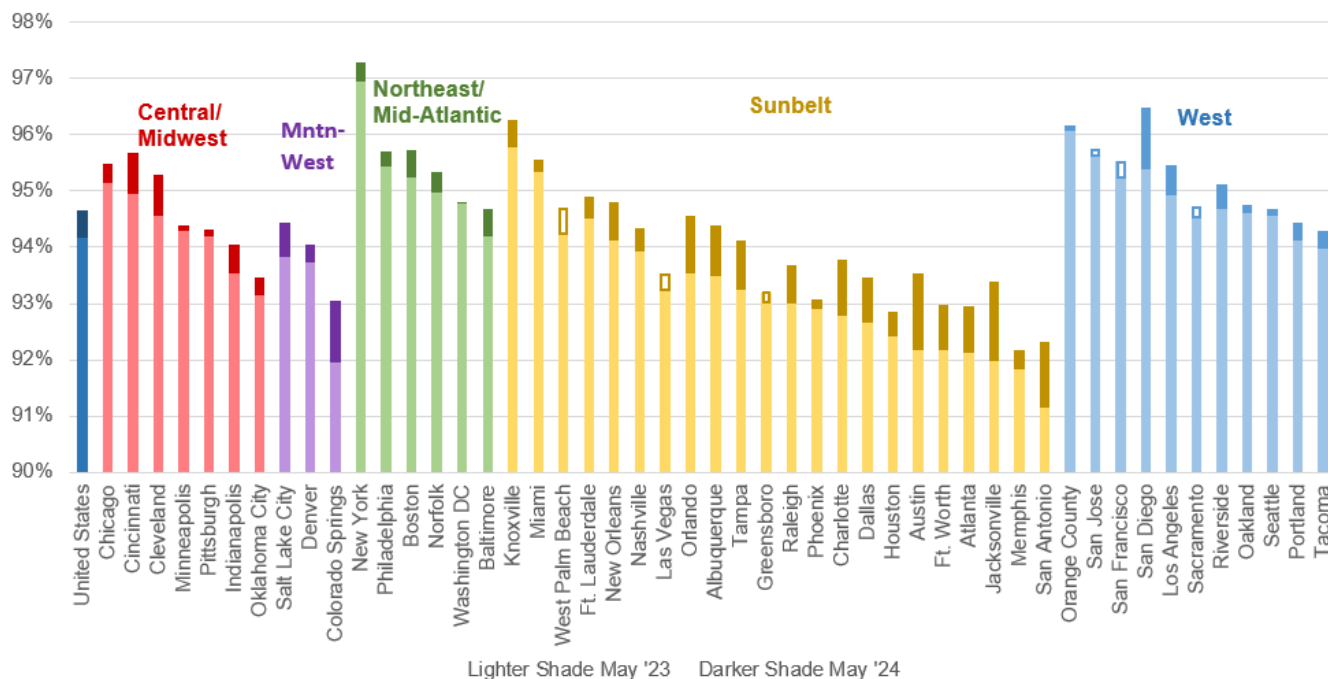
Exhibit 7: YoY Rent Growth by Market and Comparison with May 2023 Growth Rate



Sources: RealPage, Freddie Mac

While occupancy rates have been relatively stable in the past few months, nationally rates are down 50 bps YoY as of May 2024, and about 40 bps lower than the 2000 through 2022 long-term average. In Exhibit 8, we see occupancy rates in the past year are down the most in markets located in the Sun Belt and Mountain West regions, while the other areas of the country are generally seeing more modest declines. Over the past year, occupancy rates are down in all but six of the 49 markets covered and the nation. Markets that have seen occupancy levels increase over the past year include San Francisco, San Jose and Sacramento in the West, and West Palm Beach, Las Vegas and Greensboro in the Sun Belt. The highest occupancy rates are generally located on the West Coast as well as New York City, while the Sun Belt generally has the lowest occupancy rates. The Sun Belt markets of Jacksonville, Austin and San Antonio are seeing the largest occupancy rate decreases of 120 to 140 bps over the past year.

Exhibit 8: May 2024 Occupancy Rate Compared with May 2023



Sources: RealPage, Freddie Mac

Despite the fact that most of the new units being delivered to the market are Class A, rent growth in Class A units was strongest, increasing about 0.8% for the year ending in May 2024, reported by RealPage. This is about 60 bps higher than the Class B growth rate of 0.2%, while Class C rent has declined -0.5% for the year. Occupancy rates are consistent among all the property classes, with Class A the lowest at 94%, Class B the highest at 94.3%, and Class C in the middle at 94.2%. However, occupancy declined the most over the past year for Class C properties, down 80 bps from May 2023, while Classes A and B declined 40 bps and 30 bps, respectively. As is usually the case, Class A properties have the highest concessions on a dollar basis and as a percent of asking rent. Typically, as new supply enters the market and competition at the upper end of the market increases, both existing and newly leasing Class A properties tend to offer concessions.

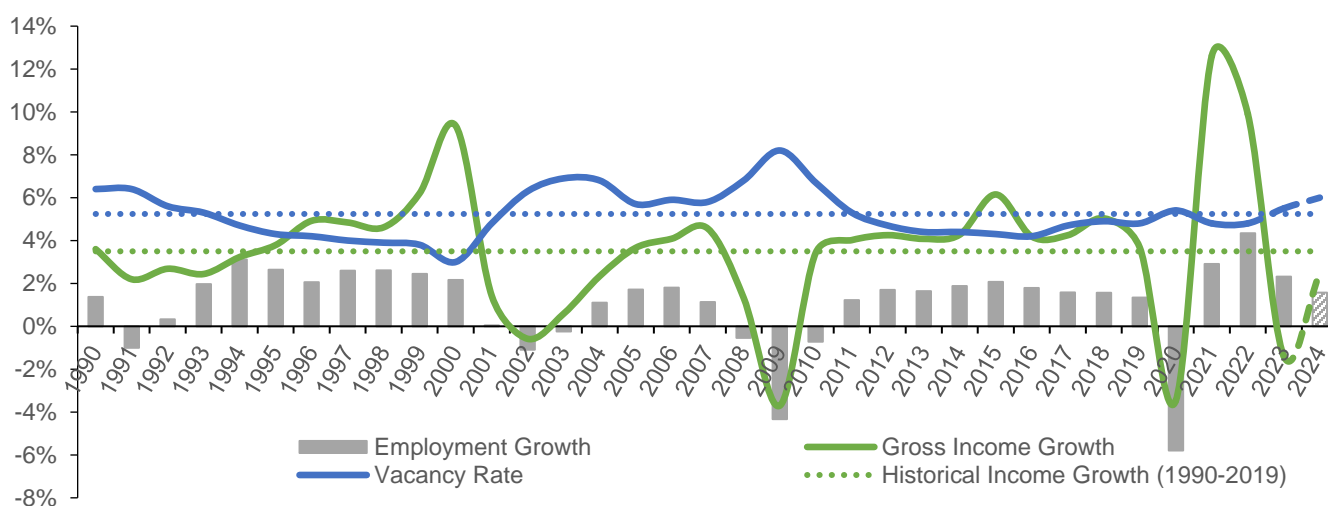
Multifamily Fundamentals Outlook for the Rest of 2024

If the soft-landing economic scenario comes to fruition, we expect the multifamily market to continue to see slow but positive growth as the market works through the cyclical high of new supply this year. We expect the economy and the labor market in particular to maintain positive growth, leading to continued multifamily demand. Our baseline forecast for 2024 is to see rent growth of 2.7% for the year, which is 20 bps lower than the 2000-to-2022 average of 2.9%, according to RealPage. Due to expected strong demand, vacancy is expected to increase to 6%, which is 70 bps higher than RealPage’s long-term average of 5.3%. Given moderate rent growth and increasing vacancy, we expect gross rental income growth of 2.5% for 2024. Our forecast is partially based on higher vacancy rates traded for more rent growth. However, in the past year, multifamily operators have typically chosen the inverse of less rent growth to maintain occupancy levels. If that trend continues, we expect occupancy to remain relatively stable with rent growth less than the 2.7% projected — albeit still positive rent growth. These

forecasts are based on the assumptions that the economy and labor market continue to grow — although at a slower pace than seen recently — inflation continues to moderate, and household income growth is sustained.

In the unlikely scenario that economic conditions deteriorate quickly and we see meaningful economic slowing this year, the multifamily market would likely see significantly weaker performance. The new supply slated to come to market this year will still likely be delivered and combined with a weakened economy will struggle to sustain demand. In that scenario, the multifamily market would see significant upward pressure on vacancy rates and downward pressure on rents.

Exhibit 9: Employment Growth, Vacancy Rate and Gross Income Growth, Historic and Forecast



Sources: Moody's Analytics, Reis for historic data, and Freddie Mac and Moody's projections for 2024 are represented by the dashed lines and striped box.

Gross rental income growth projections for 2024 generally favor secondary and tertiary markets, with concentrations in the southern plains and Sun Belt regions, that are lower-cost alternatives to a nearby larger, more expensive market, shown in Exhibit 10. For example, the Oklahoma markets could be considered a lower-cost alternative to Dallas and are active energy employment centers, while West Palm Beach and Riverside could be considered less expensive bedroom markets for Miami and Los Angeles.

The projected bottom 10 markets for 2024 comprises different size markets and are spread throughout the country, excluding the West Coast. Many of the bottom performing markets are expecting to see high levels of new supply, with Austin, Nashville and Raleigh/Durham expected to have more than double the national rate of new inventory. Among the bottom markets that are not seeing supply higher than the national average, many are higher-cost areas located along the coasts. Even among the weakest projected performing markets in 2024, all of them are expected to see at least slightly positive gross rental income growth for the year.

Exhibit 10: Top and Bottom 10 Metros by Gross Rental Income Growth for 2024

Metropolitan Area Top 10	2024 Growth in Gross Rental Income	2024 Vacancy Rate	Metropolitan Area Bottom 10	2024 Growth in Gross Rental Income	2024 Vacancy Rate
Oklahoma City, OK	5.3%	5.1%	Portland, OR	1.8%	6.6%
Tulsa, OK	5.2%	4.0%	New York, NY outer	1.7%	6.9%
Little Rock, AR	4.5%	3.7%	Philadelphia, PA	1.7%	6.0%
New Orleans, LA	4.5%	5.0%	Washington, DC core	1.7%	8.6%
West Palm Beach, FL	4.3%	5.8%	Omaha, NE	1.6%	5.5%
Hartford, CT	4.0%	3.5%	Raleigh/Durham, NC	1.5%	8.2%
Birmingham, AL	4.0%	3.8%	Fairfield County, CT	1.2%	6.9%
Norfolk, VA	3.9%	3.5%	Nashville, TN	0.9%	9.2%
Lexington, KY	3.8%	5.2%	Minneapolis, MN	0.5%	8.4%
Riverside, CA	3.8%	3.5%	Austin, TX	0.1%	10.7%
United States	2.5%	6.0%			

Source: Freddie Mac

Higher Rates Slowing Transactions and Stressing Asset Valuation

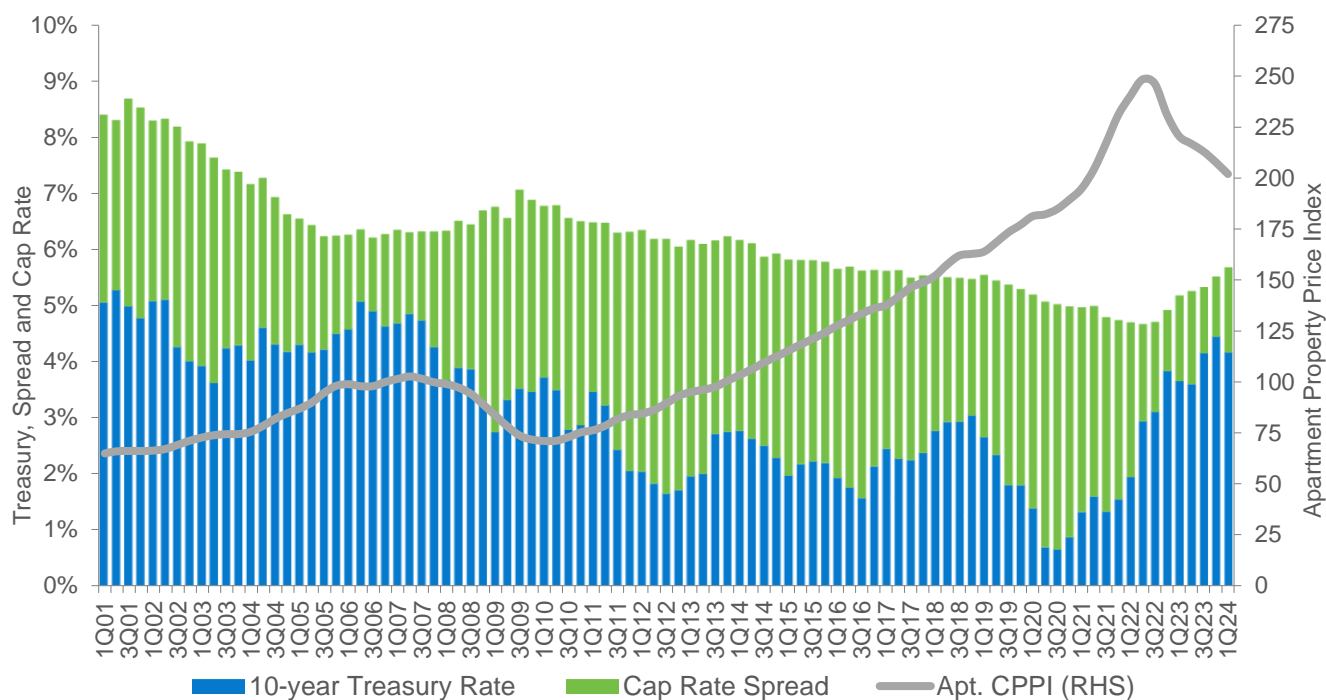
The multifamily origination market stalled throughout 2023, a trend that has continued into the first half of 2024. The lack of volume is attributable to several factors such as high and volatile interest rates, rising cap rates, lower property prices, and more modest property performance projections. By now, most industry participants expected the Fed to be well on the path of lower interest rates. However, inflation has proved to be stubborn causing the Fed to hold off rate cuts. Due to these factors, the Mortgage Bankers Association (MBA) projects 2023 volume down -45% from 2022 to \$264 billion as of May 2024.

Although the Fed has announced a pivot to no more rate hikes, the 10-year Treasury rate has been extremely volatile. The volatility makes transacting extremely difficult, as deals make financial sense one day, but don't the next. Interest rate stability is crucial for price discovery, with buyers and sellers viewing asset valuations differently given the ever-changing interest rate environment.

According to data from Real Capital Analytics (RCA), cap rates have increased 100 bps from the low seen during the second quarter of 2022 to about 5.7% as of the first quarter of 2024. The increase is difficult to gauge accurately since transactions are limited and data is difficult to collect. During that time, the 10-year Treasury rate averaged about 4.2% during the first quarter of 2024, indicating the cap rate spread is down below 120 bps, just above the historic low seen during the fourth quarter of 2023 when it hit 109 bps and less than half of the historic rate of just over 300 bps going back to 2000. The low cap rate spread is applying upward pressure on property prices as buyers are hesitant to accept such a low-risk premium compared with the risk-free rate. However, CBRE's cap rate survey indicates the average prime multifamily going-in cap rate has stabilized and declined modestly during the first quarter of 2024 for the first time since 2022.⁴

⁴ <https://www.cbre.com/insights/briefs/prime-multifamily-metrics-improve-for-first-time-in-two-years>

Exhibit 11: Multifamily Price Index, Cap Rate Spread and Treasury Rate



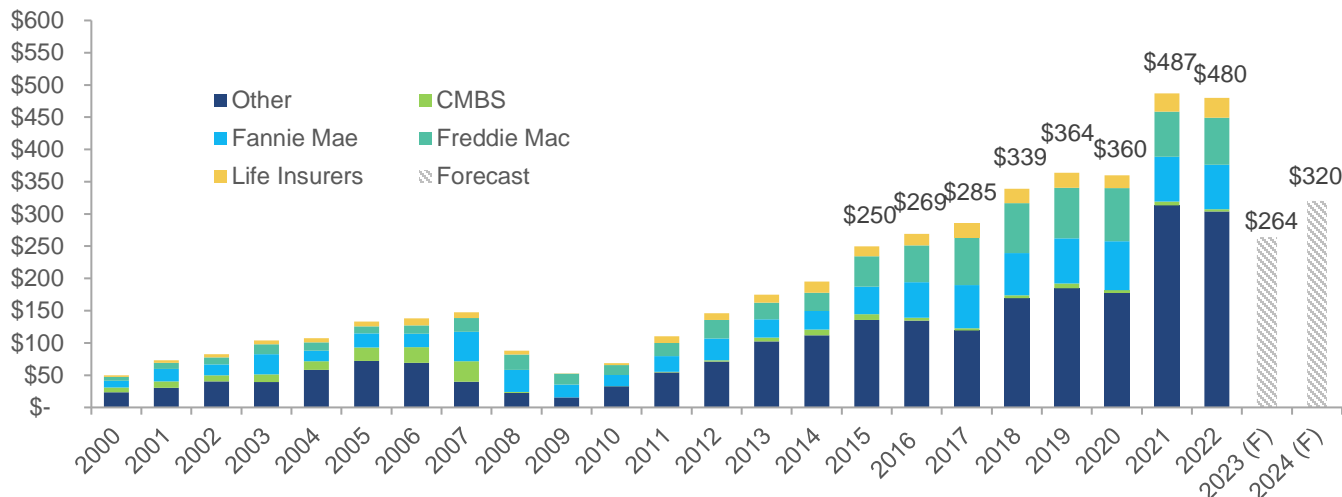
Sources: Freddie Mac, Real Capital Analytics CPPI, Federal Reserve Board, Moody's Analytics

Higher cap rates, along with slowing apartment market conditions has conspired to lower property prices. Since property prices peaked during the second quarter of 2022, they have declined -18.7% in the past seven quarters. Comparatively, property prices during the Great Financial Crisis were also down nearly 19% seven quarters after their peak in 2007. However, the slopes of the decline look very different. For the post-COVID-19 decline, the most severe YoY decline occurred during the fifth quarter at -13.5% whereas the Great Financial Crisis' most severe decline happened at the ninth quarter at -22% YoY. In today's decline, the severity was much steeper at the onset of property price drops and has since become shallower in the past few quarters. Currently, property values are still up about 12% over the past four years, since the onset of the pandemic (first quarter 2020). Evidence suggests the worst of the property decline is past us, based on CBRE indicating that cap rates may have peaked and Blackstone's \$10 billion purchase of Apartment Income REIT Corporation — known as AIR Communities⁵. The acquisition signals that Blackstone is betting that given current market dynamics and potential multifamily growth, apartment property values may have reached their bottom. This may propel the transactions market forward as one of the largest private equity companies is comfortable with current asset prices.

Given the interest rate hangover into the first half of this year, along with slower gross rental income growth and suppressed asset values, multifamily transactions have been down so far this year, with RCA reporting first quarter volume down -22% compared with first quarter 2023. We expect rate stabilization in the second half of this year, which could help boost total multifamily origination volume to about \$320 billion for 2024. If interest rates stabilize, or the market is surprised by more aggressive rate cuts, volume could increase a bit faster to \$365 billion. However, on the flip side, if interest volatility remains high throughout the rest of 2024 and fundamentals slip more, it is possible that 2024 volume looks a lot like 2023 in the \$250 billion range.

⁵ <https://www.multihousingnews.com/blackstone-to-acquire-air-communities-for-10b/>

Exhibit 13: Multifamily New Purchase and Guarantee Volume (\$ Billions)



Sources: Mortgage Bankers Association (MBA), ACLI, Wells Fargo, Intex Solutions Inc., Freddie Mac projections
 Note: 2023 and 2024 projections of \$285 billion from MBA and \$320 billion by Freddie Mac as of June 2024.

As interest rates have increased, maturity risk for multifamily loans has increased.⁶ Higher interest rates combined with slowing market performance means that maturing loans may not be able to refinance without an equity infusion. MBA reports that in 2024 and 2025 about \$500 billion of multifamily loans are maturing, which represents 42% of all commercial real estate loans maturing over that period. However, some of those loan may be eligible for extensions, and maturity dates could be extended. Generally speaking, the longer the loan term, the less risk is associated with maturity as 7- and 10-year loans experienced many years of strong property performance and price appreciation to help offset the higher interest rates. Short-term debt, particularly loans originated during the low interest rate environment of 2021 and 2022, faces more challenges when looking to refinance. These loans were originated when debt service cost was low and market performance was strong. Since then, interest rates have increased significantly and property cash flows moderated, putting downward pressure on debt coverage. Some loans may face challenges refinancing, but this risk is likely not systematic. While rent growth has been sluggish impacting property rental revenue, the other half of the multifamily property net operating income (NOI) equation is expenses, which since the onset of the pandemic has been increasing on par with inflation. The higher expenses from increased inflation, along with rent growth below inflation, could continue to stress NOI.

⁶ https://mf.freddie.com/docs/multifamily_maturity_risk_report.pdf

Conclusion

Although the economy and the labor market are still performing well, growth appears to be slowing, which is in line with the Fed's goal of slowing inflation while avoiding a recession. Assuming we do indeed achieve the soft landing, we expect the multifamily market to see positive but below-average rent growth in 2024. Despite economic growth slowing, we expect demand to remain healthy this year, but elevated new supply will be the main drag on multifamily performance. That being said, the impacts are not uniform, with the Sun Belt and Mountain West regions seeing much higher new unit deliveries but these regions also have the strongest demand. Meanwhile, the slower moving, lower-cost secondary and tertiary markets are expected to see comparatively stronger gross rental income growth. Interest rates have remained volatile, keeping multifamily transaction volume low. If the 10-year Treasury rate gains some stability, property prices and cap rates should stabilize, allowing buyers and sellers to agree on property values and increasing transaction volume. Although new supply is at a nearly 40-year high, that headwind will be short lived and is located in areas with high demand. Over the longer term, the multifamily market appears primed for growth due to an overall shortage of housing, an expensive for-sale housing market and favorable demographic tailwinds.

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