"A Little Bit Country, a Little Bit Rock 'n' Roll"

The Impact of New Multifamily Supply in Austin and Nashville

Music fans have long enjoyed legendary music venues and performances in Nashville and Austin, and the recent apartment market conditions in these cities have been as vibrant as their music scenes. Since the Great Recession, robust employment growth in both markets has outpaced many other metropolitan areas across the South and the nation. Multifamily conditions in these markets also have benefited from strong housing demand, although a large increase in construction has raised the possibility of oversupply and weakening multifamily market fundamentals. **How will these key market drivers in each city along with new supply affect the near-term forecast for apartment rents and vacancies?**

Nashville's Grand Ole Opry began in 1925, when the city's population was just shy of 400,000 -- more than double Austin's back then. By the time Austin's South by Southwest Festival (SXSW) was established, in 1987, the gap had narrowed substantially. Since then, Austin has pulled ahead, with almost two million residents, versus Nashville's population of 1.8 million. Austin's faster growth is partially attributed to a push starting in the 1970s and 1980s to attract more technology businesses. As a result, Austin has become a hub for major technology firms as well as start-ups, attracting talent from across the country. In the meantime, Nashville has been attracting new businesses of its own, such as those in the auto and health care industries, contributing to its industrial diversification and strong economic growth.

Over the past three years, employment has grown on average 4 percent per year in Austin compared to 3.3 percent in Nashville--both impressive growth rates compared to the national average of 1.7 percent, as illustrated in Exhibit 1. The strong employment growth has attracted many people to these areas. According to Witten Advisors, in 2014 Austin and Nashville topped the list in domestic migration, at 1.8 percent and 1.1 percent, respectively. Both have seen above-national-average population growth, but Austin saw much higher growth of 25-to-34-year-olds. This has helped boost its multifamily housing demand even further because of this age group's tendency to rent their homes.

Exhibit 1: Comparison of Economic Factors between Austin and Nashville

	Employment			Population	
Metro	Avg. Annual Empl. Growth (Past 3 Yrs)	Empl. Growth since Recession Trough	Empl. Growth since Pre-recession Peak	Avg. Annual Pop. Growth (Past 3 Yrs)	Avg. Annual Pop. Growth 25 - 34 Year Olds (Past 3 Yrs)
Austin	4.0%	20.0%	17.0%	2.9%	3.1%
Nashville	3.3%	17.0%	10.0%	1.8%	1.6%
U.S.	1.7%	8.0%	1.0%	0.8%	1.1%

Sources: Moody's Analytics, U.S. Census Bureau, Freddie Mac

In response to growing demand for housing, multifamily construction has picked substantially in the years following the Great Recession, as shown in Exhibits 2 and 3. Both cities have seen some of the highest levels of construction across major U.S. metropolitan areas in the past few years. Austin's recovery started sooner than Nashville's and, while still elevated compared to the pre-recession average (calculated from 1995-2007), multifamily construction in Austin has peaked and started to ebb. In 2014, multifamily construction starts were 49 percent higher than the pre-recession average, compared to 91 percent higher in 2013. Meanwhile, Nashville's development is still growing. Permits and starts in 2014 reached their highest level post-recession.

Exhibit 2: Multifamily Permits, Starts, and Completions for Austin

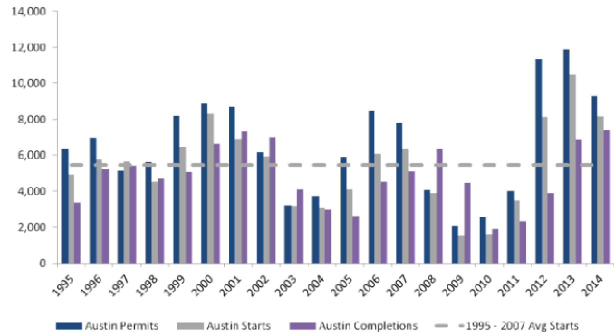
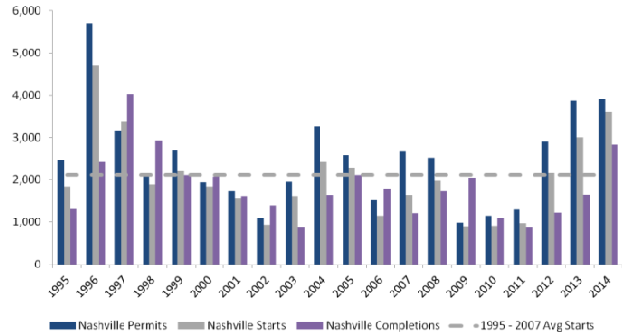


Exhibit 3: Multifamily Permits, Starts, and Completions for Nashville



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

Austin traditionally has had more multifamily stock despite having a smaller population until the late 2000s. This can partially be attributed to the local policies. Texas is known for its very relaxed policies regarding housing construction, while Nashville has had very strict residential policies. In fact, from the mid-1970s to the late 1990s, residential projects were not allowed in many downtown areas. Nashville recently changed zoning codes in downtown to allow for more residential projects. Those regulations were relaxed further in the past few years as zoning and parking requirements have been repealed in some areas, mostly downtown.

The Austin multifamily sector has also been more volatile in the past than Nashville's, as shown in Exhibits 4 and 5. Like most technology markets, Austin's multifamily sector was thriving during the technology boom early in the 2000s, with very low vacancy rates and nearly double-digit rent growth. But Austin's multifamily sector shattered during the tech bust; the impact was smaller in Nashville, as expected. On the other hand, Austin weathered the Great Recession slightly better than Nashville did; rents remained flat in Austin but declined in Nashville. On average, though, both markets have experienced similar rent growth and vacancy rates. Furthermore, the performance has been very robust since the recession, despite continuously adding new units. However, both markets experienced slight moderation in performance in 2014 according to REIS. Vacancy rates in Austin ticked up a bit and rent growth stayed the same, compared to the year before. Vacancy rates improved in Nashville in 2014, but rent growth slowed a bit compared to 2013.

Exhibit 4: Vacancy Rate for Austin and Nashville

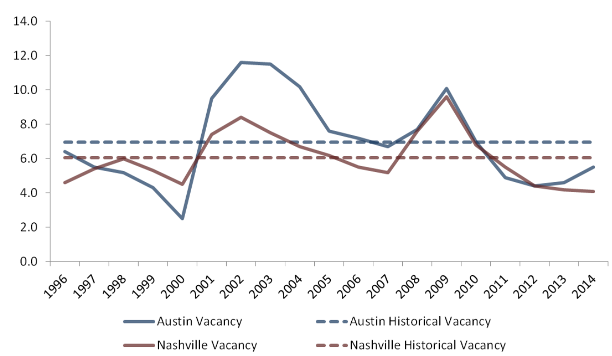
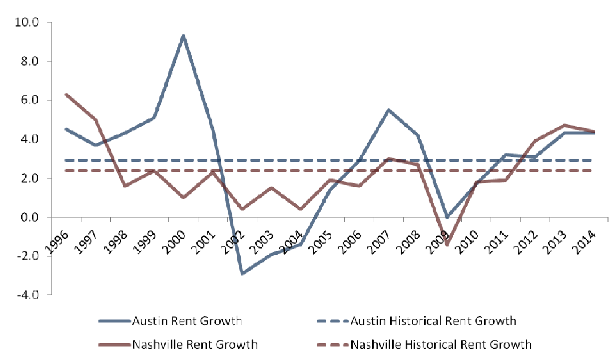


Exhibit 5: Market Rent Growth for Austin and Nashville



Sources: REIS, Freddie Mac

As new supply continues to flow into these markets, its impact on their multifamily vacancy and rent growth in the near term will depend on the strength of their employment markets. In 2015-2016, an estimated 15,700 to 16,400 new units will be added to Austin's multifamily sector and 7,400 to 8,800 units will be built in Nashville. This new supply makes up 7.5 percent and 6 percent of Austin and Nashville's total multifamily inventory, respectively. Meanwhile, nationally new supply will account for only 2 percent of the total multifamily inventory and completions in the major markets will constitute around 4 percent of the aggregate stock in those markets. Our scenario analysis reveals how well these markets can sustain the expected increase in supply. Exhibit 6 shows the impact of new supply on each market's vacancy and rent growth under various employment-growth assumptions.

Exhibit 6: Multifamily Vacancy and Rent Growth under Various Employment Growth Assumptions

Austin			**Nashville**		
	Vacancy	Rent Growth		Vacancy	Rent Growth
Historical	7.0%	2.9%	Historical	6.0%	2.4%
2014 Values	5.5%	4.3%	2014 Values	4.1%	4.6%
Employment Growth (expected range)			*Employment Growth (expected range)*		
2.5%	8.4%	0.0%	2.5%	6.9%	2.3%
3.0%	7.5%	1.7%	3.0%	6.0%	3.4%
3.5%	6.5%	3.4%	3.5%	5.1%	4.5%
4.0%	5.5%	5.2%	4.0%	4.2%	5.5%

Sources: Freddie Mac, REIS, Census Bureau
Note: Employment and rent growth estimates are annual rates.

The analysis indicates that employment in Austin will need to grow more than 3 percent to sustain market performance in the vicinity of its historical rates. If employment growth slows meaningfully from its current trend, then Austin will experience elevated vacancy and flat rent growth in the years to come. The recent slowdown in new supply may help the market to recover quickly and perform above its historical norm in the mid-term.

With annual employment growth of 2.5 percent or more, Nashville's multifamily growth will remain above its historical norm. But as discussed above, the outstanding multifamily permits and starts indicate that more supply is expected in the mid-term. As such, Nashville may experience a slowdown in the mid-term if employment growth eases.

We expect employment growth to moderate in both markets in the years to come, but not enough to bring the multifamily sectors well below their historical performance. Nevertheless, sustained robust demand growth is required to avoid some decrease in occupancy and rent growth in the next two years. But as these markets continue to attract new businesses and young professionals, they have the potential to absorb the expected supply without a major disruption in overall multifamily performance.

Whether your tastes favor Hank Williams or The Burning Lips, music fans know that they'll find great shows in both cities. Similarly, knowledgeable multifamily sector participants know that dynamic markets like these can produce investment opportunities.

Contacts

Multifamily Investments, Research & Modeling Team

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Steve Guggenmos Steve_Guggenmos@freddiemac.com	Multifamily Investment, Research & Modeling Senor Director	571 – 382 – 3520
Harut Hovsepyan harutyun_hovsepyan@freddiemac.com	Multifamily Investment, Research & Modeling Manager	571 – 382 – 3143
Sara Hoffmann sara_hoffmann@freddiemac.com	Multifamily Investments & Portfolio Management Senior	571 – 382 – 5916