Yardi® Matrix

U.S. Multifamily Outlook

Winter 2020

Strong Fundamentals Support Lasting Growth

No Letup in Demand

Occupancy Remains Healthy

Dollars Flow to the Sector

Market Analysis

Winter 2020

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Still Room to Run for Multifamily, Despite Prolonged Cycle

- The multifamily market has performed consistently well for several years, and little is expected to change in 2020. The healthy job market and demographics have produced robust demand. We expect economic growth to remain moderate.

- Rent growth nationally has only briefly dipped below the 2.5% long-term average since early in the cycle, as the occupancy rate remains above trend and wages grow at a reasonable level. Rent gains should remain healthy in most metros, continuing to be led by rapidly growing metros in the Southwest and Southeast. Affordability is a growing problem, however, and the high cost of rents is starting to put a strain on increases in many of the higher-cost metros.

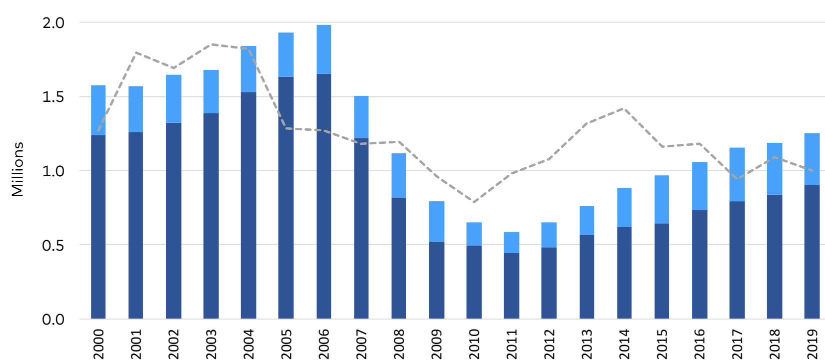
- More than 1.5 million units have been delivered over the last five years, and we expect new supply of roughly 300,000 again in 2020. Deliveries have slowed in part because of the labor shortage that has lengthened start-to-finish construction times. Supply growth is heaviest in tech centers and popular lifestyle markets such as Seattle, Denver, Raleigh and Nashville.

- Although absorption remains robust in most markets and the national occupancy rate of stabilized properties is near 95.0%, rent growth is slowing in some markets as new supply is digested.

- Investor demand for multifamily is likely to remain insatiable. Transaction volume was just below record highs in 2019, and acquisition yields have stayed at record lows for several years. The sector will remain in demand among equity investors for its stable cash flows. On the debt side, Fannie Mae and Freddie Mac have a combined $160 billion of allocations for 2020, while other lenders including CMBS and private equity are trying to increase multifamily originations.

Economic Outlook

Housing Demand: Household Formations vs. Deliveries



Sources: Yardi ® Matrix, National Association of Realtors, U.S. Census Bureau

At the dawn of a new decade, economic growth remains steady in most U.S. markets. With GDP growth seemingly stuck in the 2% range and no immediate indicators of a recession or major slowdown, most signs point to the expansion continuing through 2020 and into 2021.

While there is no doubt the trade war with China has had a negative impact on the manufacturing sector, the overall growth in employment, specifically technology and services employment, has been more than enough to maintain steady economic activity. The labor market continues to tighten, defying forecasts on a regular basis, and while growth has slowed, the U.S. economy is stronger than in much of the developed world.

The domestic economy has been encountering crosswinds for several years. Job growth has provided a steady tailwind throughout the expansion. One of the mysteries of the U.S. economy is where to find people to fill the two million new jobs per year when unemployment is at a historic low and immigration numbers are waning. Whatever the reason, the job market has stayed hot. Growth was aided by the stimulus from the 2017 tax reform, although benefits from Trump's keystone legislation seem to have run their course.

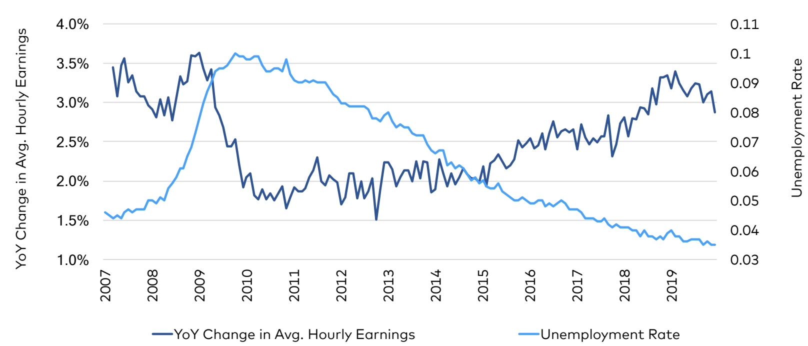
The headwinds include slowing growth in Europe and China and the escalating trade tensions with Beijing, while new concerns are emerging over the prospect of war with Iran, following the recent military action in the Middle East. We are also in the midst of an impeachment trial as the presidential election campaign season enters full swing, with an economic downturn likely unwelcome news for the incumbent.

However, increased global oil supply has kept a lid on goods inflation, and continued technological advances have limited services inflation for the most part

Long-term interest rates continue to be helpful to the real estate industry. After climbing to 3.2% in 2018, the 10-year Treasury fell below 2.0% last year and has oscillated in a tight range between 1.5% and 2.0%. The Federal Reserve reversed course mid-last year and began cutting rates, but now appears content to leave the overnight rate in the 1.5-1.75% range. This leaves the yield curve ever so slightly positive, and while a major economic or geopolitical event could certainly invert the curve once again, it seems to be holding steady for now. The Fed has indicated that it plans to maintain rates unless a change in the economy dictates otherwise, so a severe change in rates is unlikely.

Despite the current expansion running longer than a decade, homebuilders have not kept up with the demand for housing, especially on the single-family side, and as a result the nation faces

Tight Labor Market: Unemployment vs. Wage Growth



Source: Bureau of Labor Statistics

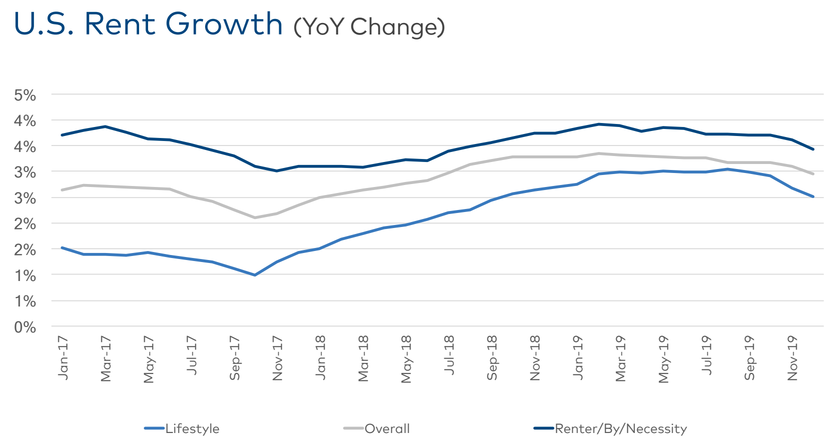
a significant housing shortage. With housing production yet to fully recover from the last recession, many metros are facing an undersupply. The tight labor market and 3% wage growth have produced ongoing robust household formation. Job openings have outnumbered unemployed job seekers for more than a year and a half, and while the unemployed and the open positions remain both geographically and skill-set divergent, the trend of continued hiring remains. Even if employment were to cool and the economy to face a mild recession, we expect the housing market, and multifamily specifically, to ride through the downturn with relatively little impact.

One potential problematic side effect of robust rent growth is policy. The imbalance between demand and supply has spurred rent increases that have led to rent control legislation in high-cost coastal states. California, New York and Oregon passed new measures in 2019, and other states and municipalities are considering similar legislation to artificially control rents.

Overall, the economy continues to walk a fine line of slow economic expansion. From a real estate perspective, especially for multifamily, the fundamentals of supply, demand and cost of capital remain very well balanced and indicate continued steady growth for the foreseeable future, barring a major shock to the capital markets and macro economy on par with the global financial crisis.

Rent Growth Trends

Following a year of steady rent gains—growth did not dip below the 3.0% mark at any point during 2019—the market is poised for similar growth in 2020. While there may be pockets of weakness in metros digesting supply, and in submarkets where rents are bumping up against limits of affordability, we expect broad-based rent increases this year averaging 2.7% nationally.



Source: Yardi Matrix

Market fundamentals are holding up well, as deliveries, though still lopsidedly favoring the high-end segment, have done little to affect overall occupancy in stabilized assets. Inventory growth has generally trailed housing demand for the better part of the current expansion. With single-family homes falling even shorter, supply is unlikely to create significant issues overall. We expect demand to remain elevated in 2020, so the consistent inventory expansion should not dent confidence in the multifamily sector. Demand has come from both ends of the demographic spectrum—particularly from downsizing baby boomers and millennials who are forming households in the healthy employment market. Employment has been solid, averaging nearly 176,000 new jobs per month, which means that the market will continue to absorb new inventory easily, at least in the short term in most metros.

Rents have grown above the 2.5% long-term average for several years, which is increasingly producing affordability concerns in many metros. That has led policymakers to look to rent control as a stopgap, especially in coastal areas. Rent control is a damper on development, which could exacerbate the problem over the long term, and it is a drag on transaction activity, as investors are likely to look for markets with higher growth potential, such as up-and-coming secondary markets with solid economies and strong demand. Markets such as Phoenix, Atlanta, Austin, Denver, Seattle and Charlotte have added high-value jobs in technology and manufacturing, facilitating demand for rental housing.

After leading the nation in rent gains for the past 18 months, Phoenix (7.7%) and Las Vegas (5.4%) are poised to continue their strong runs, bolstered by population growth and economic development. Pushing in from nearby California, residents can get more value for their dollar in markets that have consistently diversified their employment pool. Growth in Las Vegas is poised to maintain similar levels in 2020 (5.4%) due to continued economic development. Meanwhile, we expect rent growth in Phoenix to temper to 3.7% but remain well above the U.S. average.

Technology-driven markets pulling in coastal talent will continue to perform well above average in 2020, leading rent growth. Seattle (5.8%) and Salt Lake City (4.2%) still benefit from significant demand, despite having some of the more robust multifamily development pipelines. Another big rent growth driver will continue to be the spillover effect in smaller markets within commuting distance of larger markets that have had above-trend growth during the current cycle: Colorado Springs (4.4%), Milwaukee (3.8%), Tacoma (3.7%) and the Inland Empire (3.7%).

Florida markets such as Orlando (5.4% forecast for 2020), with a growing retiree cohort, and Jacksonville (5.2%), with broadening appeal to a diversifying economy, are likely to see rent growth bounce back to some of the highest levels in the nation. Tampa (3.6%) and the Southwest Florida Coast (2.9%) are likely to exceed the U.S. average, as demographic and economic expansion continues in the state. One Florida market that may struggle somewhat is Miami, where multifamily competes with the growing condominium inventory and demand from foreign tenants might weaken. We foresee 2.5% rent growth in Miami in 2020.

Following a strong showing in 2019, Washington, D.C., is headed for a slowdown in growth in 2020, with rent increases projected below 1.0%. Other markets where the pendulum is about to swing, pushing growth well below the national pace, include Sacramento, Charlotte and Raleigh—rent growth is likely to stay positive but significantly wane to below the national average, following gains of 4.6% to 5.3% in 2019.

Metros	2020 Rent Forecast % Change	YoY Change Dec 2019
National—All Markets	2.6%	3.0%
Seattle	5.8%	2.6%
Las Vegas	5.4%	5.4%
Orlando	5.4%	1.3%
Jacksonville	5.2%	2.6%
Portland	5.2%	3.4%
Colorado Springs	4.4%	6.3%
Salt Lake City	4.2%	2.5%
Milwaukee	3.8%	2.6%
Memphis	3.8%	3.6%
Long Island	3.8%	3.7%
Phoenix	3.7%	7.7%
Tacoma	3.7%	5.4%
Tampa–St. Petersburg	3.6%	3.0%
Boston	3.5%	3.6%
Indianapolis	3.5%	3.7%
Tucson	3.4%	5.5%
Houston	3.3%	1.1%
Louisville	3.2%	3.5%
White Plains	3.2%	2.0%
Inland Empire	3.2%	4.1%
Columbus	3.1%	2.3%
Twin Cities	3.1%	3.4%
New Jersey–Central	3.0%	2.5%
New Jersey–Northern	3.0%	2.1%
Winston-Salem	3.0%	4.7%

Source: Yardi Matrix

Supply

Multifamily development activity has been consistently strong throughout the second half of the economic cycle, with rental completions holding around the 300,000-unit mark for the past few years. That trend is poised to continue in 2020, with 288,000 units scheduled for completion, an increase of 2.1% in total stock.

With demand surging in Western and Sun Belt markets that had previously lagged in rent growth, construction activity is on an upward swing. Meanwhile, emerging tech markets that are pulling talent away from supply-constrained and cost-burdened gateway cities have also done quite a lot to keep overall development activity at elevated levels. The ongoing drought in construction labor has prolonged development timelines, helping to extend the cycle.

Demographic trends are mostly positive but decelerating across major U.S. multifamily markets. The 82 million-strong millennial generation that helped produce demand in the prime renter age cohort is still strong but beginning to wind down. Although deliveries no longer exceed new household formation, most major metros have largely avoided the oversupply conversation, with average occupancy in stabilized assets coming in at a solid 95.1% as of November 2019. That rate is unlikely to see major swings in either direction through the short term, especially at the current rate of incoming supply. With rent growth expected to stay positive moving forward, this is a strong indicator that most of the incoming inventory is being absorbed at a healthy rate.

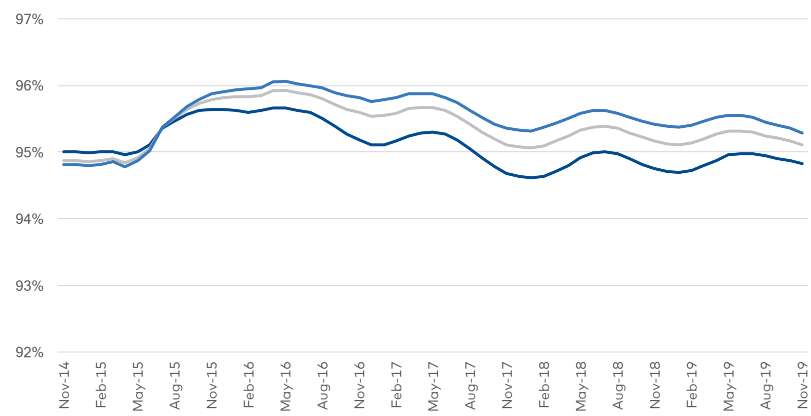
The largest rental development pipelines are in rapidly growing secondary markets that have become major employment centers during this cycle, with natural demographic growth

Metros	2020 Forecast Completions	2020 Completions % Change
National—All Markets	288,000	2.1%
Dallas	20,935	2.8%
Washington DC	14,436	2.7%
Denver	11,497	4.2%
Miami	11,491	3.9%
Seattle	10,981	4.4%
Austin	9,604	4.1%
Houston	9,098	1.4%
Atlanta	8,934	2.0%
Chicago	8,443	2.4%
Los Angeles	8,439	2.0%
New York City	8,140	1.4%
Charlotte	7,538	4.3%
Phoenix	7,408	2.4%
Boston	6,828	3.0%
Orlando	6,280	2.9%
San Francisco	5,951	2.3%
New Jersey–Northern	5,214	2.4%
Twin Cities	5,193	2.5%
Raleigh	4,966	3.2%
San Antonio	4,877	2.5%
Nashville	4,661	3.5%
Tampa–St. Petersburg	4,600	2.1%
Philadelphia	4,347	1.5%
Portland	4,116	2.7%
Salt Lake City	4,003	4.0%

Source: Yardi Matrix

coupling with strong domestic in-migration—Seattle (10,981 units slated for delivery; 4.4% of total stock), Charlotte (7,538 units; 4.3%), Denver (11,497 units; 4.2%) and Austin (9,604 units; 4.1%). Tech hubs largely dominate the ranking, with most of the markets delivering well in excess of their 10-year average—at a late point in the expansion, no less.

National Occupancy Rate



Source: Yardi Matrix

Gateway markets depend on international immigration to sustain positive demographic trends, especially as some residents prefer moving to more affordable markets where employment is still on the upswing. Los Angeles and New York City, the two largest economic centers in the nation, are lined up to add a combined 16,500 units in 2020. That's well below the expected national rate of delivery, while rents in these markets remain among the highest in the U.S. Rent control measures in New York and California may further affect activity in these markets going forward.

By sheer volume of units, larger markets will continue to dominate, though some are likely to be involved in inventory surplus conversations—specifically Dallas (20,935), Washington, D.C. (14,436), Denver (11,497) and Miami (11,491). These markets are all also likely to see rent growth rates dip below the national average this year. Pipelines are geared toward Lifestyle renters making above-average wages, while Renter-by-Necessity stock is witnessing a stagnation in new inventory, making it the primary segment for rent increases in most markets.

Elsewhere, some markets that have struggled to add units throughout this cycle—despite significant demand and consistently growing rents—will likely continue to grow incrementally: Sacramento (994 units; 0.8% of total stock), the Inland Empire (1,391 units; 0.9%) and Albuquerque (560 units; 1.0%). California continues to be a difficult state to get approvals, as municipalities fight the state efforts to build badly needed housing.

Capital Markets

Unrelenting might be the best way to describe the healthy capital markets in multifamily going back almost a decade. The segment is a magnet for both equity and debt, and the outlook for 2020 is likely to stay positive.

On the equity side, transaction activity maintained its robust pace in 2019, and pricing held firm despite the movement in Treasury rates during the year. The year saw $108.8 billion of multifamily properties traded. Although that's down 6.0% from 2018's record high, it is the second-highest year for volume and the fourth consecutive year with multifamily transactions topping $100 billion.

Investor demand shows no signs of changing, and in fact could increase as the cycle lengthens and buyers look for a safe landing spot for capital. Multifamily is a safer bet than other property types in the event of a downturn. For example, office must deal with weakening demand from workplace trends, and retail is only beginning to work through the fallout from growth in online shopping. Many investors are counting on demand for apartments to remain relatively consistent even if the economy weakens due to demographic and social trends.

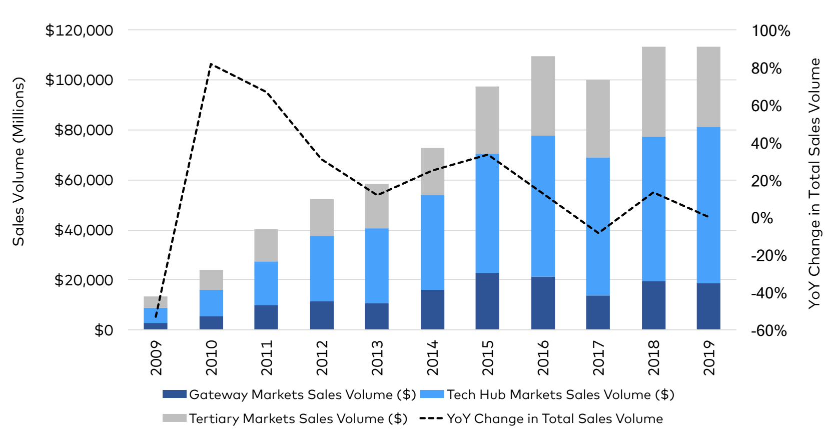
The demand is demonstrated in the pricing trends, as acquisition yields and price per unit have hovered at record lows for several years despite Treasury yields moving up and down by more than 150 basis points during that time. That means investors are willing to pay up even as market conditions change. The average price per unit in 2019 was $155,000, up 8.8% from 2018.

One troubling exception to the consistent pricing is New York City, where multifamily property values were hit hard by the new rent control law that limits rent growth, the ability to bring vacant units up to market rates and the ability to raise rents in conjunction with property repairs. Transaction activity for rent-stabilized apartments fell off in the second half as owners tried to determine how much values have fallen, with estimates ranging between 25% and 50%.

There are no negatives to report in the debt capital markets, at least for 2020. All types of lenders are active, with some growing market share. Although final numbers for 2019 are not yet in, volume is expected to match 2018's record $339 billion in multifamily lending, according to data compiled by the CRE Finance Council. The only real question surrounds the future of the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac, but major changes aren't expected to take hold until 2021 or later.

Under a plan announced in September by the GSEs' regulator, the Federal Housing Finance

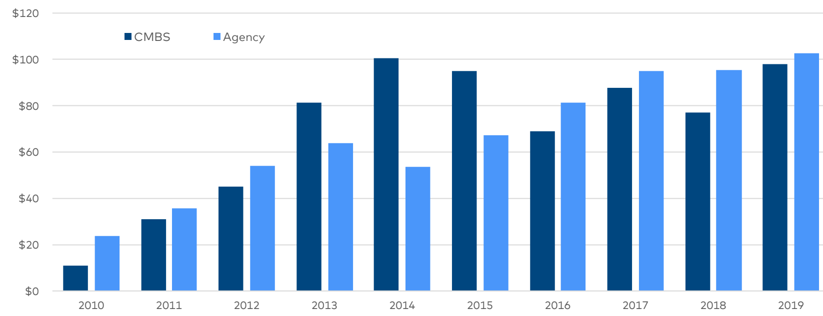
Sales Volume by Market Type



Source: Yardi Matrix

Authority, Fannie and Freddie can produce $100 billion of loans apiece between the fourth quarter of 2019 and the end of 2020, or $20 billion per quarter. The GSEs generated roughly $145 billion of loans through their correspondent programs in 2018, while the cap essentially sets volume at $160 billion combined for 2020.

CMBS, Agency Bond Issuance



Source: Commercial Mortgage Alert

The Treasury plan aims to transition the GSEs from conservatorship and level the marketplace to allow private lenders to compete and increase market share. The plan contemplates recapitalizing the GSEs and making them adhere more closely to their core missions of providing support for affordable housing and liquidity in the housing market during downturns. While it seems that the administration is serious about reform and change is likely in 2021, details of how the goals will be accomplished remain murky.

Fannie and Freddie have been the leading providers of multifamily debt in recent years, accounting for more than 40% of total volume over the last decade, but other lender types such as CMBS and private equity funds have been increasing market share in the segment.

Low interest rates and the Treasury Department's announcement of a GSE reform plan in the fall helped CMBS more than double its origination of multifamily loans in 2019. CMBS issuers securitized $12.5 billion of multifamily loans in 2019, up 107.7% from the $5.7 billion of multifamily loans securitized in 2018. CMBS accounted for 12.5% of the market's $95.2 billion total in 2019, up from 7.6% of total issuance the previous year (all data from "Commercial Mortgage Alert").

The precipitous drop in Treasury spreads in 2019 made CMBS more competitive versus other lender types. The average weighted coupon of loans in CMBS deals in the fourth quarter was 3.7%, compared to 4.7% for the full year in 2018. The other reason for the surge in multifamily CMBS was that Fannie and Freddie slowed down originations following the Treasury announcement about their hard lending caps so as not to burn through their allocations too quickly. The GSEs are intended to provide liquidity for debt so housing can be financed even during downturns, when banks might not be active. The GSEs stepped up in the wake of the global financial crisis. Today, they remain the chief debt source for the industry, as other types of lenders strive to increase multifamily originations.

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Definitions

Lifestyle households (renters by choice) have wealth sufficient to own but have chosen to rent. Discretionary households, most typically a retired couple or single professional, have chosen the flexibility associated with renting over the obligations of ownership.

Renter-by-Necessity households span a range. In descending order, household types can be:

- A young-professional, double-income-no-kids household with substantial income but without wealth needed to acquire a home or condominium;
- Students, who also may span a range of income capability, extending from affluent to barely getting by;
- Lower-middle-income ("gray-collar") households composed of office workers, policemen, firemen, technical workers, teachers, etc.;
- Blue-collar households, which may barely meet rent demands each month and likely pay a disproportionate share of their income toward rent;
- Subsidized households, which pay a percentage of household income in rent, with the balance of rent paid through a governmental agency subsidy. Subsidized households, while typically low income, may extend to middle-income households in some high-cost markets, such as New York City;
- Military households subject to frequency of relocation.

These differences can weigh heavily in determining a property's ability to attract specific renter market segments. The five-star resort serves a very different market than the down-and-outer motel. Apartments are distinguished similarly, but distinctions are often not clearly definitive without investigation. The Yardi® Matrix Context rating eliminates that requirement, designating property market positions as:

Market Position	Improvements Ratings
Discretionary	A+ / A
High Mid-Range	A- / B+
Low Mid-Range	B / B-
Workforce	C+ / C / C- / D

The value in application of the Yardi® Matrix Context rating is that standardized data provides consistency; information is more meaningful because there is less uncertainty. The user can move faster and more efficiently, with more accurate end results.

The Yardi® Matrix Context rating is not intended as a final word concerning a property's status—either improvements or location. Rather, the result provides reasonable consistency for comparing one property with another through reference to a consistently applied standard.

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