Yardi® Matrix

U.S. Multifamily Outlook

Summer 2022

Growth Threatened by Inflation

Rent Increases Moderating, Slowly

Rate Hikes Shock CRE Liquidity

Market Analysis
Summer 2022

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Multifamily Outlook Hopeful Amid Volatile Economy

- Midway through 2022, the multifamily market is at an inflection point. Property fundamentals continue to be exceptional, with rents still growing at extraordinary levels and demand still robust. Growth will decelerate in the second half, but the question is by how much, as persistently high inflation threatens to roil the economy.

- The economy is likewise running hot, but not without storm clouds on the horizon. Two years of robust job growth have put the employment market within spitting distance of its pre-pandemic level, and consumers continue to spend record amounts. But the Federal Reserve's bid to reduce demand through rising rates and quantitative easing will cut growth, with the odds of a recession in 2023 or 2024 increasing rapidly in recent weeks.

- Multifamily rents are decelerating from 2021's record highs but remained at double-digit percentage growth levels through mid-year. Pent-up demand from the pandemic has mostly receded, but it continues to be driven by robust household formation, job growth, migration to suburbs and secondary markets, and the worsening affordability of single-family homes that is keeping potential first-time homebuyers in rentals. We expect average asking rents to increase by 7.9% by year-end.

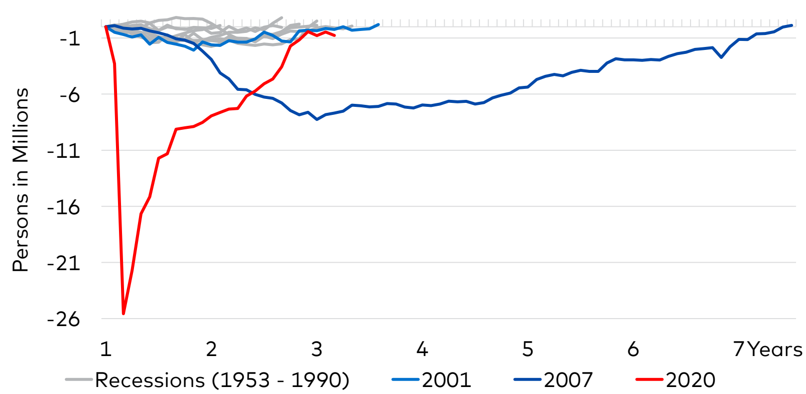
- The sector's strong performance and the nationwide housing shortage are helping boost multifamily supply, with more than 900,000 units under construction nationally. Unfortunately, prolonged supply-chain problems, rising commodity costs and reduced immigration have created material and labor shortages. Meanwhile, NIMBYism is increasing development costs and slowing the entitlement process, prolonging the time between project starts and deliveries. Consequently, about 420,000 units should be delivered this year.

- Capital conditions, a big part of the market's success over the last decade, turned bearish in the second quarter due to rising rates and investors' fears of a recession. With mortgage rates up 150 to 200 basis points, acquisition yields are rising. Lenders are becoming more conservative, focused on cash flow rather than income growth. Many investors and lenders are taking a step back to digest where the market is headed before they resume activity.

Inflation-Driven Economy

The U.S. economy features some strong fundamental metrics that are being overshadowed by inflationary pressures that stem from soaring energy and housing prices, global supply-chain issues, and the hangover from post-COVID-19 monetary expansion.

Change in U.S. Employment
From Beginning of Recessions (1953-2021)



Source: Bureau of Labor Statistics

The economic picture is not bleak for multifamily. The economy added 2.2 million jobs in 2022 through June and nearly nine million since the start of 2021. Unemployment is solid at 3.6%. Private worker wage growth has slowed somewhat but remained about 5% year-over-year as of May. Consumer balance sheets continue to be healthy. Households retain $2.7 trillion in excess savings relative to pre-pandemic, according to Moody's Analytics. Consumer spending is still strong, surpassing the pre-pandemic trend line. Though borrowing is high, debt-service levels are low by historical standards. All these economic measures contribute to strong growth in household formation and demand for multifamily.

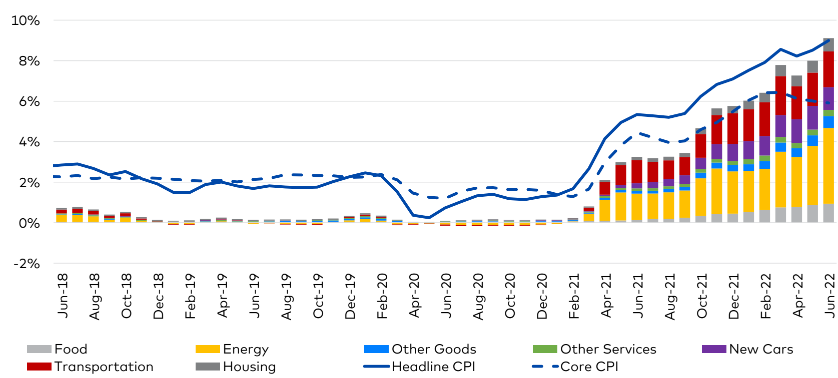
All eyes, however, are on the Federal Reserve and the inflation numbers. The consumer price index (CPI) rose to 9.1% in June, a four-decade high, due to a combination of elements including the breakdown of shipping pipelines, robust spending demand, the price of gas owing to Russia's war in Ukraine, the growth in home values and rent increases, and the overstimulation of the economy from pandemic relief packages. Housing, energy and food prices are all rising rapidly, which erodes the purchasing power of households.

After giving up on its contention that inflation is temporary and watching the stock market dip more than 20% into bear market territory, the Fed responded by raising policy rates by 75 basis points in June, the highest increase in nearly 20 years. The federal funds rate is now at 1.5% to 1.75% and is expected to rise another 100 to 200 basis points in coming months. The Fed also is speeding up the sale of the $9 trillion of bonds that it accumulated during the pandemic.

Questions about the economy include how much of an impact the Fed's action will have on reducing inflationary pressures, how much more the Fed will have to raise rates before all is said and done, and how much growth will slow as a result. While Federal Reserve Chair Jerome Powell is using the tools at his disposal to try to slow inflation, many of its causes—such as supply chains, war and chip shortages—are largely beyond the scope of the Fed's influence.

The cause of inflation is a debate that has implications for the near future. If, as some economists contend, price hikes are largely driven by temporary factors such as the war in Ukraine and pandemic-related supply chain issues, inflation may have peaked and will moderate. The evidence for this argument is that shipping and energy costs—though still high—have begun to recede. Oil prices have dropped under $100 a barrel in July, and most analysts expect them to settle in that range, down from the $140-a-barrel peak. Meanwhile, the base effect may also come into play, as the rate of increase from a year ago is likely to diminish.

Sector Contribution to Inflation



Source: Bureau of Labor Statistics

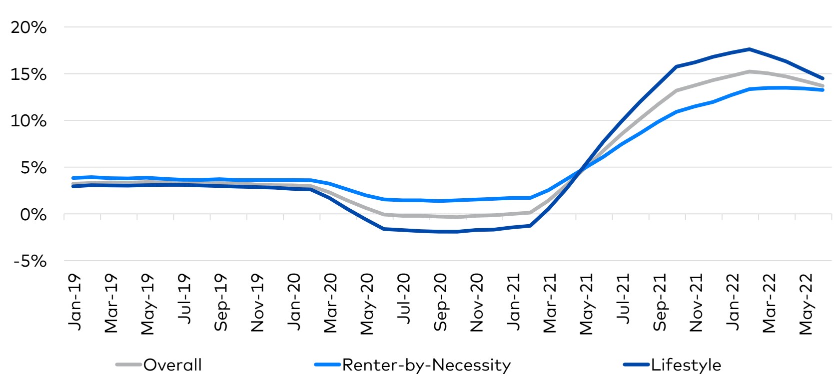
Others contend inflation is driven by too much cash in the economy, which won't be so easy to turn around without harsh measures that choke demand and provoke negative growth. The impact of rising housing costs, which represent nearly one-third of the CPI, is still growing. As inflation gets baked into expectations, it grows more difficult to retract. Consequently, it appears unlikely that inflation will recede to or even near the Fed's 2% target this year, which means that deflationary policies will continue for the foreseeable future.

The economic outlook has dimmed recently, but as the Richmond Federal Reserve pointed out in a recent release: "(T)he challenge in predicting a recession tomorrow is the strength of the aggregate data today." Given the significant segments of the economy that are performing well, a recession appears unlikely in 2022. But given how the economy got to the point it is at, and what likely needs to be done to reverse high inflation, a slowdown in growth and/or a mild recession is likely by 2024.

Rent Growth to Moderate

Coming off record-high rent growth of 14.7% in 2021, deceleration in multifamily rents in 2022 was inevitable, but the question was how much? Rent growth has started to come down, but slowly as the conditions that produced strong gains have persisted. Average national asking rents increased 5.7% in the first six months of the year. Year-over-year rent growth at the year's midpoint was 13.7%, down 100 basis points from the end of 2021 and 150 basis points from the February peak of 15.2%. While growth is moderating, we expect gains will continue to remain well above trend, with average asking rents increasing by 7.9% nationally by the end of 2022.

U.S. Multifamily Rents by Segment



Source: Yardi Matrix

The market continues to be ripe for growth. The economy has recovered almost all the jobs from its pre-pandemic peak and wage growth has been strong, though moderating. Soaring home prices and rising mortgage rates have made homeownership unaffordable for many first-time homebuyers, and the for-sale market is likely to remain weak throughout the year as interest rates rise and economic growth slows. That will keep more households renting either multifamily or single-family units.

Wage growth is steady, and the average rent is now less than the average mortgage payment, making the rental market more competitive but still a more logical choice for many consumers. However, inflation rates will take a while to recede, causing consumers to cut into savings and their ability to afford increasing rental rates to lessen as the year goes on. Demand should remain strong for the rest of the year. More than 145,000 multifamily units were absorbed in the first half of 2022, which is a solid number though a moderation from the nearly 500,000-per-year pace in 2021.

The highest year-over-year growth continues to be in the Sun Belt areas—the Southwest Florida Coast (27.2%), Orlando (24.0%), Miami (22.6%), San Diego (20.9%)—that saw high in-migration during the pandemic. Some Sun Belt markets that saw extremely high in-migration experienced a slowdown in demand during the first half of 2022. Las Vegas (-1.6%), Phoenix (-1.1%), Sacramento (-1.0%) and the Inland Empire (-0.8%) saw occupancy decreases in the second quarter. However, rent growth is still high in these metros and they will register increases of between 5% and 10% this year.

Our full-year forecasts are led by metros in the Sun Belt and West. Topping the rankings are some larger metros—such as San Diego (13.1%), Salt Lake City (12.4%), Charleston (11.7%), Knoxville

2022 Forecast Rent Growth by Metro

Metro	YoY Rent Forecast 2022	Average Rent as of June 2022
National	8.0%	$1,706
San Diego	13.1%	$2,618
SW Florida Coast	12.5%	$2,028
Salt Lake City	12.4%	$1,604
Tampa	10.6%	$1,839
Miami	10.4%	$2,311
Seattle	10.0%	$2,259
Raleigh	9.9%	$1,641
Dallas	9.8%	$1,706
Inland Empire	9.3%	$2,167
Charlotte	8.9%	$1,604
Philadelphia	8.8%	$1,654
Central NJ	8.7%	$1,956
Las Vegas	8.5%	$1,530
Chicago	8.2%	$1,522
San Antonio	8.1%	$1,296
Denver	8.1%	$1,936
Orange County	8.0%	$2,706
Austin	8.0%	$1,792
Los Angeles	7.9%	$2,813
Sacramento	7.1%	$1,969
Washington, D.C.	6.5%	$2,024
Boston	5.7%	$1,706
Phoenix	5.6%	$1,710
Pittsburgh	4.7%	$1,316
Twin Cities	4.6%	$1,427

Source: Yardi Matrix

(10.2%) and Seattle (10%)—that continue to be magnets for in-migration of young people and workers. While certain areas of the Sun Belt—such as the Southwest Florida Coast (12.5%), Tucson (11.2%), Tampa (10.6%) and Miami (10.4%)—also top the 2022 forecast rent growth and will continue to see increased demand.

Metros with the weakest growth include the Twin Cities (4.6%), Pittsburgh (4.7%), Baltimore and Phoenix (5.6%), and Boston (5.7%). It's important to note that even the metros with the lowest numbers are posting solid gains.

Demand Boosts Supply Growth

Strong demand for apartments nationwide and the prospects for high rent growth have boosted development in the sector. As of midyear, over 145,000 units were delivered and more than 900,000 units were under construction in the U.S. While demand for units increases as renting becomes more affordable than purchasing a home, it will further enable the multifamily growth in rents to continue.

We expect about 420,000 units to be delivered in 2022, an increase in stock of 2.8%. That's the highest number of deliveries since before the global financial crisis. Given the country's long-term shortage of housing supply, the new supply is necessary. However, in the short run the supply doesn't always match up exactly with demand. New supply is mostly at the high end of the pricing spectrum, and in some metros it may take some time to digest all the new deliveries.

New supply would be higher if not for market conditions. Labor shortages and inflationary increases in materials due to supply-chain disruptions have continued to prolong development timelines. However, increased demand in the Sun Belt mar-

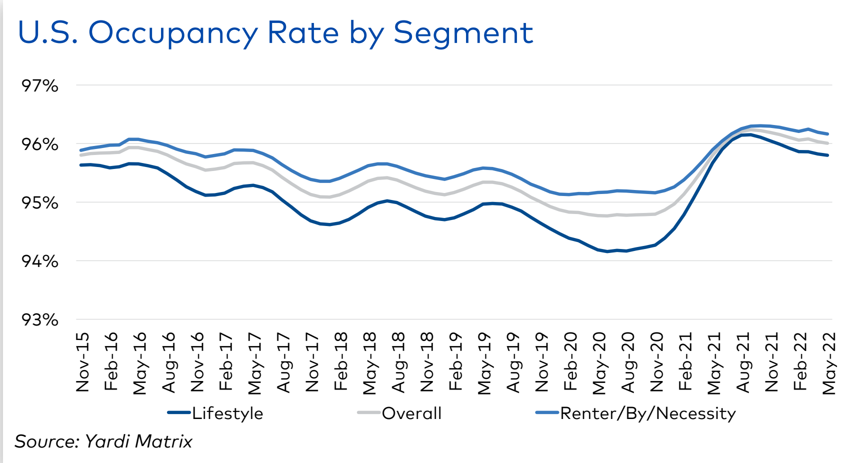
2022 Forecast Supply Growth by Metro

Metro	2022 Forecast Deliveries	2022 Forecast Deliveries as a % of Inventory
National	420,274	2.8%
Dallas	23,571	2.8%
Miami	19,125	5.7%
Austin	18,288	6.7%
Phoenix	15,988	4.8%
Seattle	14,147	5.1%
Washington, D.C.	12,096	2.1%
Denver	12,031	4.0%
Los Angeles	11,266	2.5%
Raleigh	10,136	5.9%
Charlotte	8,732	4.4%
Chicago	8,573	2.3%
Tampa	8,447	3.6%
Salt Lake City	6,429	5.6%
Twin Cities	6,336	2.7%
San Antonio	5,820	2.7%
Philadelphia	5,539	1.8%
Boston	4,842	1.9%
San Diego	3,937	2.0%
SW Florida Coast	3,872	4.7%
Las Vegas	2,928	1.6%
Inland Empire	1,458	0.9%
Central NJ	1,361	1.0%
Orange County	1,089	0.5%
Sacramento	751	0.6%
Pittsburgh	610	0.7%

Source: Yardi Matrix

kets and larger metros that are starting to see in-migration of workers has kept developers active in those markets.

Significant increases in demand continue to alleviate any concerns of overbuilding. Occupancy rates are maintaining the extremely high levels seen in the second half of 2021. The national occupancy rate in stabilized properties rose by over 100 basis points year-over-year, decreasing by only 15 basis points since the end of 2021. This has allowed for rents to continue to increase, but at lower rates than seen in 2021.



Source: Yardi Matrix

The gap in occupancy rates between Lifestyle and Renter-by-Necessity assets ended 2021 at only 29 basis points and has maintained a steady pace at mid-year, with an increase of only 7 basis points. The growth in projects geared toward the upscale segment decreased occupancy rates by 19 basis points by midyear.

On a metro basis, Dallas is once again projected to lead multifamily development, with over 23,000 units expected to come online by the end of the year, a 2.8% increase in stock. The metro has also led all markets in deliveries with 9,700 at midyear. Houston (7,200 units, 1.0%) and Central New Jersey (6,700, 4.9%) round out the top three for units completed in the first half of the year. Miami (19,000 units, 5.7%) and Austin (18,000 units, 6.7%) round out the top three U.S. metros for expected completions due to migration and corporate relocations, coupled with easier development approvals. Austin is projected to have the highest increase in stock in 2022, at 6.7% with over 18,000 units.

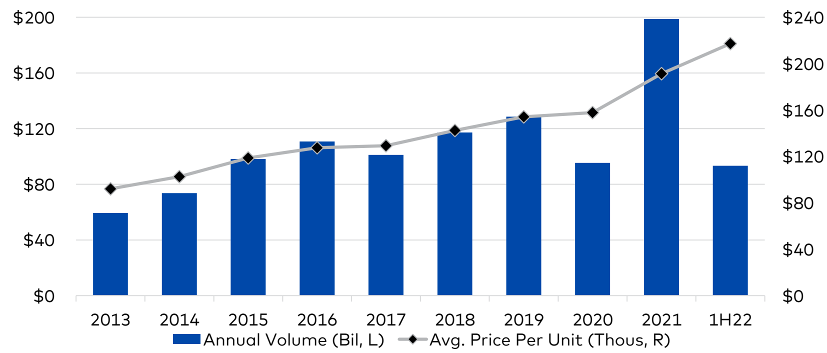
Hard-hit gateway markets will continue to enjoy varying levels of completions in 2022. San Jose, which added just over 7,000 units in 2021, had already completed nearly 5,000 units by midyear and is projected to complete over 3,000 units by the end of the year, 2.2% of stock. New York City, which added just over 3,300 units in 2021, completed just over 800 units by midyear and is projected to have over 12,000 units completed by the end of 2022, or 2.1% of stock. San Jose and New York City are also in the top three metros for year-over-year occupancy growth: San Francisco (2.0%), San Jose (1.8%), New York (1.4%).

Rising Rates Roil Capital Markets

Robust liquidity and insatiable investor demand drove commercial real estate's decade-long bullish cycle. Investors allocated a huge sum of capital to multifamily because of its stable cash flow, the favorable supply-demand fundamentals, and the belief that cash flow will grow as rents continue to rise at above-trend levels. While those conditions still largely exist, a major change in equity and debt conditions swept across the market in the first half of 2022 because of inflation and rising interest rates. For the first time in a long time, pricing turned negative, and lenders have become more cautious.

The spike in interest rates in the second quarter put a damper on transaction activity, which started the year as if it were going to match 2021's all-time volume record of $212 billion. Few industries are as sensitive to interest rates as commercial real estate, which is financed with copious amounts of debt. The jump in the cost of borrowing, combined with the growing expectation that a slowdown or even recession is imminent, put investors in a holding pattern.

U.S. Multifamily Sales Volume, Price Per Unit



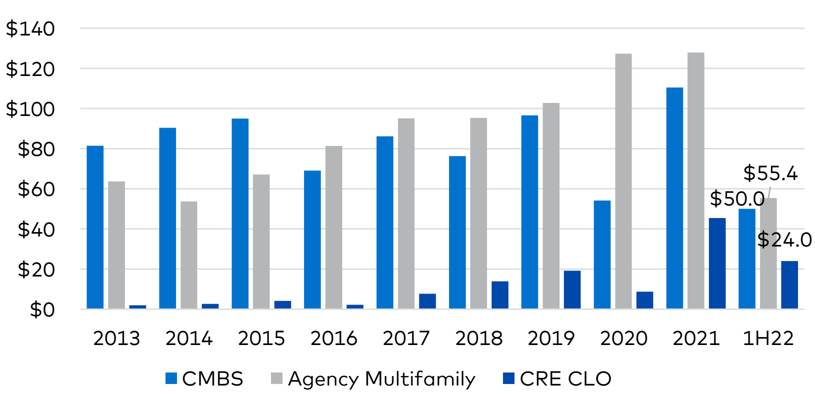
Source: Yardi Matrix

Bidders at aggressive acquisition yield levels dropped out. Many institutions froze buying activity until they can assess the landscape. Buyers using leverage of 70% or more are having difficulty finding financing. Property values—which rose around 20% in 2021—are down so far by 10% to 15% from the peak. However, the change in pricing has been slow to be recorded because many sellers took assets off the market rather than accept lower bids.

Acquisition yields, which averaged about 4.5% at the start of the year, will rise if debt costs remain at the higher levels. Investors are often willing to shrink the risk premium over Treasury rates when rent growth is strong, such as it has been since early 2021. But the threat of a recession has made the entire market more cautious. Investors and lenders must heed the lesson of the Global Financial Crisis and maintain discipline, avoiding underwriting unrealistic assumptions into transactions.

Riding strong first-quarter activity, multifamily recorded $93.3 billion of sales through June. That's slightly below the pace set during 2021's record $222.3 billion of sales. However, the second half is likely to be less active than 2H21, in large part due to the spike in debt costs. Most fixed-rate multifamily loans originated before the interest rate surge carried coupons of 2.75% to 4.25%, depending on leverage, sponsor and terms, but rates in the second quarter of 2022 rose by about 200 basis points. Fixed-rate loan spreads rose with Treasury rates and wider risk spreads, while floating-rate debt costs rose with wider spreads and the spike in the cost of interest-rate caps.

CRE Annual Securitization Volume (Bil)



Source: Commercial Mortgage Alert

The Mortgage Bankers Association has lowered its forecast for 2022 multifamily lending, now down more than 10% from a year ago. "The rapid rise in interest rates is expected to take some wind out of the sails of new lending activity, but healthy property fundamentals and strong property values should support the markets and keep commercial real estate mortgage demand at strong levels," the MBA said.

Securitization programs are taking the biggest hit in activity. Not only have interest rates jumped but CMBS and collateralized loan obligation spreads have increased significantly. Securitization programs were quoting loans with coupons of 5.75% or more, which is not attractive to borrowers. Fannie Mae and Freddie Mac loan spreads also have spiked, and their lending activity slowed down in the second quarter. However, if the agencies are well below their $78 billion annual allocations later in the year, they could choose to turn on the lending spigot. Portfolio lenders are less constrained by the cost of capital, but they are being selective with deals that meet sponsor and asset quality, conservative debt-service coverage and lower leverage.

We expect that capital markets will take a large breather in the third quarter of 2022. If financial markets stabilize and the economy appears to be recovering, deal flow should resume, albeit at more moderate levels. If economic conditions worsen and investors are less optimistic about prospects for rent growth, deal flow and mortgage originations are likely to drop even more sharply.

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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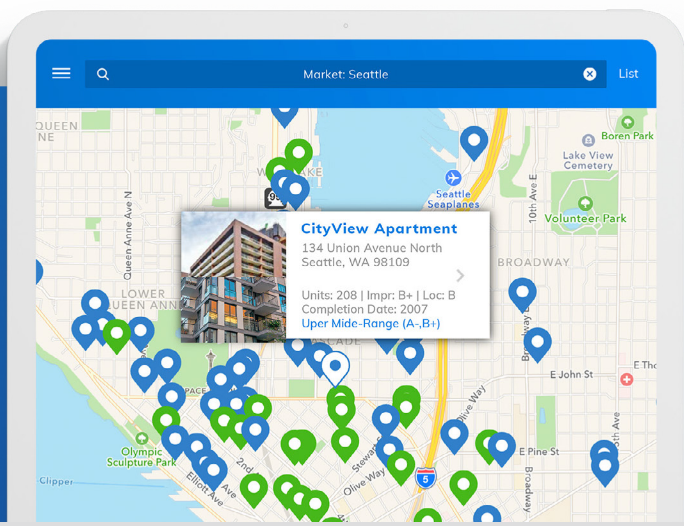
MULTIFAMILY KEY FEATURES

- Pierce the LLC every time with true ownership and contact details
- Leverage improvement and location ratings, unit mix, occupancy and manager info
- Gain complete new supply pipeline information from concept to completion
- Find acquisition prospects based on in-place loans, maturity dates, lenders and originators
- Access aggregated and anonymized residential revenue and expense comps



Yardi Matrix Multifamily provides accurate data on **19.7+ million units**, covering over **92% of the U.S. population.**

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