

# U.S. Multifamily Outlook

Summer 2021

## Multifamily Emerges Strong From the Pandemic

Rent Growth Surges Nationally

Gateway Markets Rebound

Capital Providers Favor Apartments

## Market Analysis

Summer 2021

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# Conditions Ripe for Strong Second-Half Performance

- Multifamily has emerged from COVID-19 in an extremely strong position. While the pandemic had a negative impact on demand and performance, particularly in urban core submarkets, on a national level rents in most metros remained positive. Pent-up demand and the recovering economy have produced robust rent growth this spring.
- The U.S. economy is growing at its fastest rate in decades, as progress with the COVID-19 vaccine has allowed people to resume normal activities. The huge uptick in savings during the pandemic and federal stimulus—combined with pent-up demand for restaurants, travel and entertainment—has turbocharged growth. Potential headwinds include rising inflation and whether employers can find enough workers.
- Fueled by robust demand, rent growth came roaring back in the first half of 2020. Some 174,000 units were absorbed nationally through May, putting 2021 on track to be among the hottest years since the 2008 recession. Eye-popping second-quarter growth put asking rents up 6.3% year-over-year as of June. Many secondary markets continued to post dazzling increases, and gateway markets such as New York and San Francisco are rapidly rebounding from the pandemic.
- New supply, which dipped only moderately during the pandemic, is expected to bounce back to about 334,000 units in 2021. Solid growth is almost across the board in fast-growing secondary metros such as Dallas and Phoenix, tertiary metros such as Northwest Arkansas and Wilmington, N.C., and gateway metros like Miami and Boston. The rising cost of materials is complicating the pipeline and could lead to a slowdown in starts.
- Capital markets remain one of the strongest aspects of the multifamily business. Buoyed by the optimistic demand expectations, stability of income and high returns relative to other investment segments, investors have flocked to multifamily. Also helping matters is the liquidity in the debt markets, with a bevy of lending options led by Fannie Mae and Freddie Mac, CMBS, life companies and private equity lenders. Loan coupons are near all-time lows.

## Economic Outlook

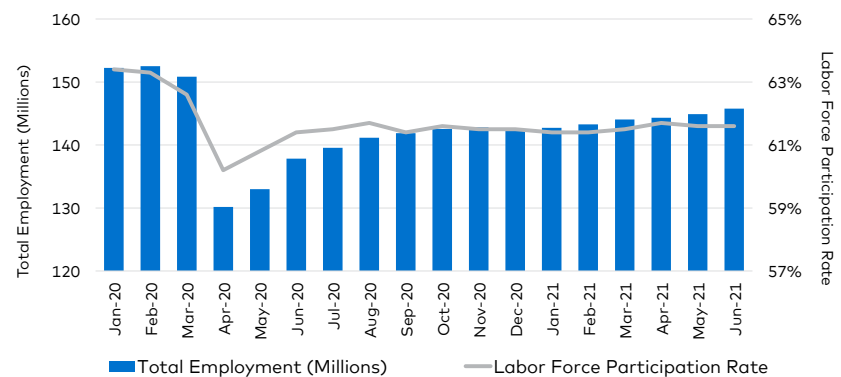
As the U.S. emerges from the COVID-19 pandemic, significant volatility is developing across economic sectors. The strong initial wave of vaccinations propelled a spate of business reopenings in the second quarter, and much of the U.S. economy has returned to its pre-COVID capacity. However, there have been some major pitfalls as a result.

One glaring issue is the supply and demand balance of workers, especially in service industry sectors hit hard by the pandemic. Restaurants, for example, are struggling to rehire staff and meet demand, as Americans rush back to in-person dining. Many other service industries are facing the same challenge, as workers have either found new career opportunities or chosen to wait before they re-enter the workforce.

Reasons for the hesitation to return to work are myriad. Some lack access to affordable childcare or continue to have concerns about health. In many states, extended unemployment benefits helped offset loss of income, which in turn encouraged some workers to remain unemployed even as the economy reopened. Those additional benefits are being pulled back, which could incentivize workers to return to their jobs.

In office-using employment sectors, the discussion is centered around the future of remote work, as many employees adapted and relished their opportunity to work from home or from anywhere. As companies begin reopening offices with an expectation that employees return to their desks to at least some degree, many workers are considering job changes. Before COVID, many tech companies touted the benefits and amenities

### Employment Recovering, But Labor Participation Remains Flat



Source: Bureau of Labor Statistics

provided at the office, including free meals, access to fitness facilities, childcare and more. Now the most sought-after perk may be a flexible schedule, with the ability to work from home full time or on a hybrid model. As companies attract talent, they may have to embrace flexibility to stay competitive in the job market.

Employment, however, is not the only volatile sector of the economy. Inflation has surged in 2021, although the large increases in headline inflation can be attributed to a comparison to 2020's weak economy. Many economists—including Federal Reserve Chair Jerome Powell and Treasury Secretary Janet Yellen—believe that the current inflationary environment will be transitory and expect prices to stabilize in the next year. But not to be overlooked is the importance of the global supply chain. The U.S. has begun a strong recovery, perhaps faster than other countries, but COVID-19 is still a significant issue worldwide, especially as new variants of the virus emerge.

As different countries approach reopening in their own way, previously smooth-running supply chains continue to be disrupted. The result will be additional challenges sourcing raw materials

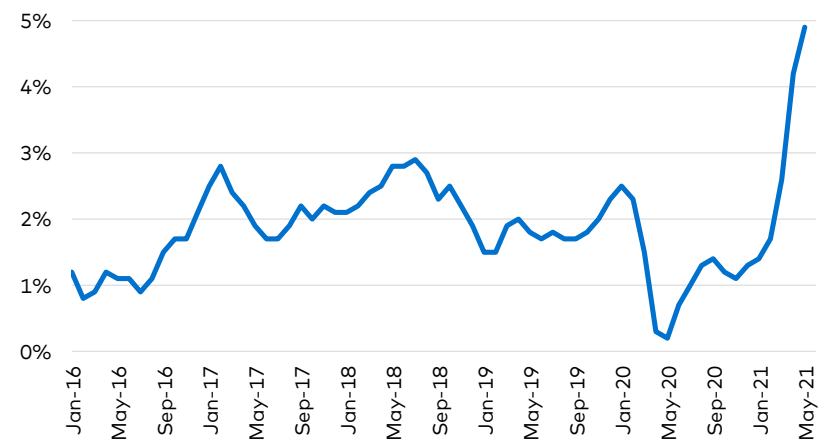
and finished goods in the U.S. As it relates to multifamily, steel, lumber and copper prices have all risen dramatically, with copper and lumber prices more than doubling from this time last year. Not only is demand for building materials coming back in full force but pandemic restrictions are making it more difficult to obtain them.

Volatility is likely to continue for a few years as the world fights to contain the virus, until global vaccine implementation allows economies to fully recover and return to pre-pandemic stability. However, that does not mean there won't be strong economic growth in certain sectors and geographies in the short term.

Despite inflationary pressures and economic volatility, U.S. Treasury rates have remained fairly stable in 2021. The Federal Reserve has intimated that it may start winding down its easy money policies sooner than expected, but any change in Fed policy will not likely materialize until 2022 or 2023. Consequently, borrowing costs for commercial and multifamily real estate will remain very low by historical standards.

The U.S. economy stands on solid footing and is poised to begin a new growth cycle. The employment market was strong going into the pandemic and is recovering quickly as COVID restrictions are lifted. Multifamily has weathered this storm particularly well. New development will continue despite increased construction costs, and a favorable borrowing environment will continue to drive value for owners, developers and investors alike.

### Consumer Price Index (% Change YoY)



Source: Bureau of Labor Statistics

## Rent Growth Trends

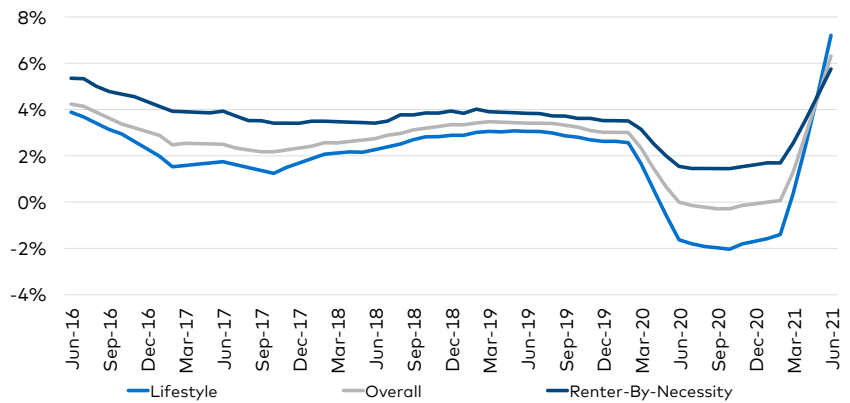
The multifamily industry had an extremely strong first half of 2021, as national asking rents rose 5.8% in the first six months of the year. Nationally, year-over-year asking rent growth is well above pre-pandemic performance at 6.3% as of June 2021. Many tech hub and tertiary metros have even surpassed pre-pandemic performance, and most metros in the Southwest and Southeast are seeing asking rent growth pushed to levels not seen in decades. Gateway markets—which took a big hit in the last three quarters of 2020—have begun to recover, as well, posting extremely strong rent increases starting in March of this year.

Fast-growing tech hubs in the Southwest and Southeast such as Phoenix (17.0% YoY rent growth as of June 2021), Tampa (15.1%), Las Vegas (14.6%) and Atlanta (13.3%) have benefited from in-migration and fewer restrictions during the pandemic than the gateway markets, allowing a faster reopening. Job losses were much more modest in most of these metros, contributing to robust local economies.

Rent growth will not be able to continue at these levels indefinitely, but conditions for above-average growth in these metros are likely to persist for months. With rents increasing by almost double digits in many markets on a year-over-year basis, the cost-of-living gap between what were considered “lower-cost cities” and gateway markets is starting to narrow. People migrating into these cities can afford the large price increases. But longtime residents are deeply affected by the accelerated rent growth.

Rents are driven by buoyant demand. Absorption has been solid this year, with more than 173,000 units, or 1.2% of stock, nationally absorbed year-to-date and 378,000 units absorbed in the 12 months through May 2021. Absorption is almost certain to surpass 275,000 units in 2020. On the metro level, top markets for absorption this year are fast-growing metros like Miami (8,500 units absorbed, 2.7% of stock), Charlotte (4,500 units, 2.4%) and Orlando (4,900 units, 2.1%). Surpris-

### U.S. Multifamily Rent Growth (% Change YoY)



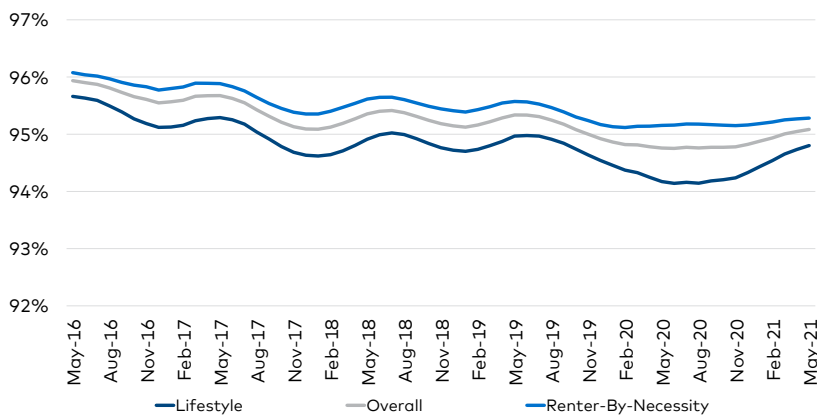
Source: Yardi Matrix

ingly, Chicago also tops the list, with almost 7,800 units absorbed this year, or 2.2% of stock.

The recovery of the gateway markets has varied by metro but has been healthier than many initially projected. New York has had a strong first half of the year, with rents up 6.0% in the first six months of 2021. New York is home to many large financial institutions that are requiring employees to return to work in the office in the coming months. The return to work, coupled with the full reopening of the city, has brought back people who fled during the pandemic.

San Francisco is not recovering as quickly, but still at a decent rate, with rents increasing by 3.4% during the first six months of 2021. San Francisco has a large concentration of technology companies that have not been as adamant about their employees being in the office. This has likely led the people who relocated during the pandemic to reconsider whether they want to

### National Multifamily Occupancy Rate



Source: Yardi Matrix

return to San Francisco or continue working from a lower-cost location. Recovery is in full swing in other gateway markets, with rents up 6.5% in Chicago, 6.4% in Miami, 5.0% in Boston, 4.0% in Los Angeles and 3.3% in Washington, D.C., during the first half of 2021.

## Supply

Deliveries in 2021 are off to a strong start, with almost 213,000 units, or 1.5% of stock, delivered through mid-year. New supply was not as severely impacted in 2020 as many initially projected, with 285,000 units delivered, down 7% from 307,000 units in 2019. This year we expect about 334,000 new units to be delivered in the U.S., up about 17% from last year.

The large number of projects in the pipeline—some 863,500 units are currently under construction, representing 6.0% of existing stock—pose a challenge for gateway markets that are still in the process of recovering. Among the gateway markets, Miami has the most forecasted deliveries at 3.7% of stock, followed by Boston (3.6%), San Francisco (3.3%), Los Angeles (2.6%), Washington, D.C. (2.3%), New York (1.8%) and Chicago (1.3%). These new projects might have a difficult time leasing up, as there is already much supply in these metros with limited new demand, especially in the Lifestyle segment.

Among the leaders in completions in the past 12 months as a percentage of stock are Austin (4.4% of total stock), Charlotte (4.3%), the Twin Cities (3.7%) and Raleigh (3.6%). Earlier this year, Charlotte was the only metro among the top four that was able to sustain strong rent growth while dealing with a surge in deliveries. However, rent growth has picked up substantially in all these metros in the last few months, driven by in-migration and a surge in demand for apartments.

## Rent Growth by Metro

Metros	YoY Rent Growth June 2021
National—All Markets	6.3%
Phoenix	17.0%
Tampa	15.1%
Inland Empire	15.1%
Las Vegas	14.6%
Atlanta	13.3%
Sacramento	12.6%
Miami Metro	11.2%
Charlotte	10.6%
Raleigh	10.2%
Baltimore	9.0%
Austin	8.9%
Orlando	8.1%
Denver	8.1%
Portland	7.8%
Nashville	7.7%
Orange County	7.5%
Dallas	7.3%
Indianapolis	7.2%
Philadelphia	7.0%
Kansas City	5.2%
Houston	4.7%
Chicago	4.1%
Los Angeles	3.5%
Boston	2.4%
Twin Cities	1.9%
Wash DC	1.8%
Seattle	0.9%
San Francisco	-3.2%
New York	-5.7%
San Jose	-5.8%

Source: Yardi Matrix

Looking at all 136 Matrix markets, the fastest growth in stock is coming in tertiary metros. Northwest Arkansas leads the list with 8.8% of stock expected to be delivered this year, followed by Wilmington, N.C. (7.0% of stock expected to be delivered this year) and the Southwest Florida Coast (6.8%). Northwest Arkansas and Wilmington, N.C., have limited existing supply, so any new projects delivered look large as a percentage of stock.

On an absolute basis, the metros with the most forecasted deliveries for 2021 include Dallas (21,318 units, 2.6% of existing stock), Phoenix (15,846 units, 5.0%), Houston (15,760 units, 2.2%) and Washington, D.C. (12,607 units, 2.3%). Dallas, Phoenix and Houston will likely be able to absorb the new deliveries, while Washington, D.C., might struggle. Washington lacks demand, in part due to remote work and migration out of the metro.

Urban cores are still forecasted to deliver the most units over the next few years, compared to the suburban or rural markets. But suburban population growth is likely to pick up due to lower prices or more space per unit, so we expect construction there to increase to meet the demand.

The rising cost of construction materials is a wild card that looms over apartment development. Lumber futures more than doubled year-over-year as of late June, only to have 2021 gains wiped out recently. Prices for granite, insulation and concrete blocks have increased, as well. Construction has yet to slow down much, likely because these higher costs are passed on to renters and because projects are already underway. But if material prices continue to stay high, new starts will likely slow and developers will be forced to choose between raising rents and reducing profit margins.

## 2021 Forecasted Completions by Metro

Metros	Top Markets 2021 Forecast Completions	2021 Completions as a % of Stock
National—All Markets	334,053	2.3%
Dallas	21,318	2.6%
Phoenix	15,846	5.0%
Houston	15,760	2.2%
Washington DC	12,607	2.3%
Austin	11,919	5.0%
Los Angeles	11,761	2.6%
Atlanta	11,409	2.5%
Miami	11,235	3.7%
Charlotte	10,803	6.0%
Orlando	10,139	4.6%
San Francisco	8,841	3.3%
Boston	8,626	3.6%
Twin Cities	8,355	3.8%
Northern New Jersey	8,354	3.7%
Tampa	8,002	3.6%
Denver	7,479	2.6%
New York	7,141	1.8%
Raleigh—Durham	6,597	4.2%
Seattle	6,595	2.5%
San Jose	5,625	4.4%
Richmond—Tidewater	5,543	2.5%
Kansas City	4,967	3.1%
SW Florida Coast	4,872	6.8%
Philadelphia	4,762	1.6%
Jacksonville	4,659	4.4%

Source: Yardi Matrix

## Capital Markets

Commercial real estate's recovery from the global financial crisis in the 2010s was fueled by a so-called "wall of capital" that created liquidity and pushed prices higher. After a brief pause when COVID-19 started, the capital has come roaring back into multifamily and may be as strong as ever. Property values and acquisition yields have remained at record-high levels, while property owners have a plethora of favorably priced debt options.

Transaction activity increased in the first half of 2021 compared to the previous year. Some \$56.0 billion of deals closed, up more than 50% over the first half of 2020, when deal flow ground to a halt in the spring as COVID-19 lockdowns began in March. A strong second half could put the market near the \$128.4 billion closed in 2019.

The only limit to deal flow is a dearth of sellers, since the ranks of buyers are plentiful. Anecdotes abound about properties put on the market getting dozens of bids from all types of buyers, including private equity, REITs, high-net-worth individuals and large institutions. Plus, foreign capital is increasingly abundant, with non-U.S. investors moving into secondary and tertiary markets they have avoided in the past. One

industry expert called it "a perfect storm of money coming from everywhere."

The explosion of capital is driven by a variety of factors. One is the strength of multifamily fundamentals. Outside of a handful of submarkets in primary metros, occupancy rates and rents remained consistent during the pandemic, and investors are optimistic that property performance will be healthy in coming years.

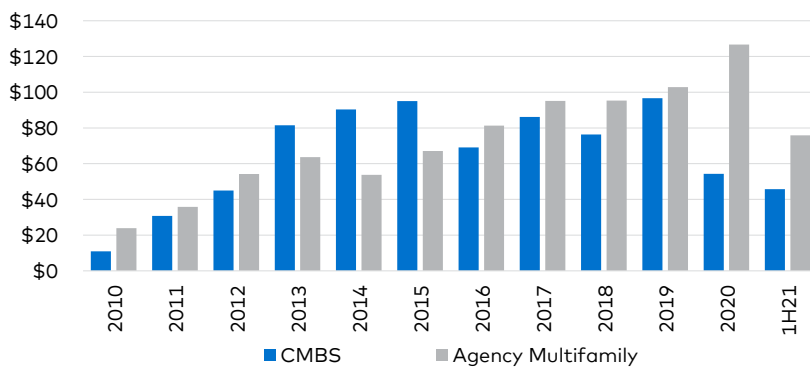
Another big driver is that investors are eager to increase holdings of commercial real estate in general, and multifamily is seen as a safe bond-like investment and hedge against inflation. Multifamily's steady dividends are attractive in a low-interest-rate environment relative to sovereign debt or corporate bonds. Multifamily and industrial are the darlings of the real estate world, as prospects are mixed for office, retail and hotel. Capital is also flowing to niche sectors such as student housing and senior living.

Capital flow has produced low acquisition yields—4% to 5% in most markets, but in the 3% range for quality properties and in-favor markets. Low yields have helped drive growth in private equity debt, by investors attracted to very similar yields in a more senior portion of the capital stack. With so much capital looking for investments,

there remains a substantial amount of dry powder in both equity and debt markets. The dry powder includes capital looking for COVID-19-related distress, which has yet to materialize because of stronger-than-expected cash flow, lender forbearance policies and federal pandemic aid.

Facilitating the growth of private equity lenders in 2021 is the increased demand for floating-rate debt. Many borrowers are

### CRE Securitization Volume (Bil)

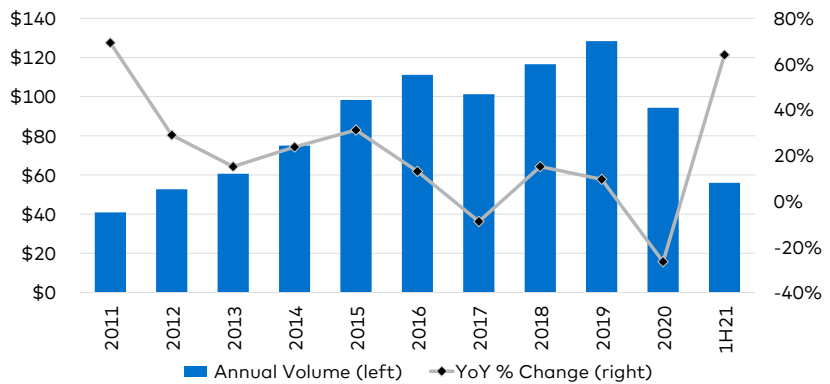


Source: Commercial Mortgage Alert



taking out short-term loans on the bet that cash flow growth will increase after the economy improves post-pandemic, and at that point they can refinance at a higher dollar amount. Variable-rate debt is also convenient for value-add property owners that are buying, fixing and re-leasing properties with higher rents. In addition, CMBS has taken advantage of investor demand for floating-rate paper with increased issuance of single-borrower floating-rate deals.

### U.S. Multifamily Sales Volume (Bil)



Source: Yardi Matrix

All types of lenders, including banks and life companies, are all-in on multifamily. Government-sponsored enterprises Fannie Mae and Freddie Mac had allocations slashed by \$10 billion in 2021 to \$70 billion, so they have had to manage originations to avoid running out of money in the second half, but they are seeing as much business as they can handle.

Although lenders have been relatively disciplined on leverage and debt-service coverage, loan spreads are extremely tight. Loan coupons typically range between 2.75% and 3.75%, depending on loan-to-value and term, and pricing on mezzanine debt is also extremely tight by historical standards. There are concerns that competitive pressures will lead to an erosion of terms. For example, GSEs no longer require loan reserves that borrowers had to provide in the wake of the pandemic. But to date, frothiness is limited.

## Conclusion

Multifamily's remarkable fundamental performance can't continue indefinitely, but in the short term, conditions for the above-par growth are likely to persist. Yet demand, rent growth and healthy capital markets conditions are likely to last due to drivers such as migration to markets with lower costs and attractive lifestyles, the post-pandemic recovery of gateway markets, weakness in new supply, and investor demand based on bullish projections.

## 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.

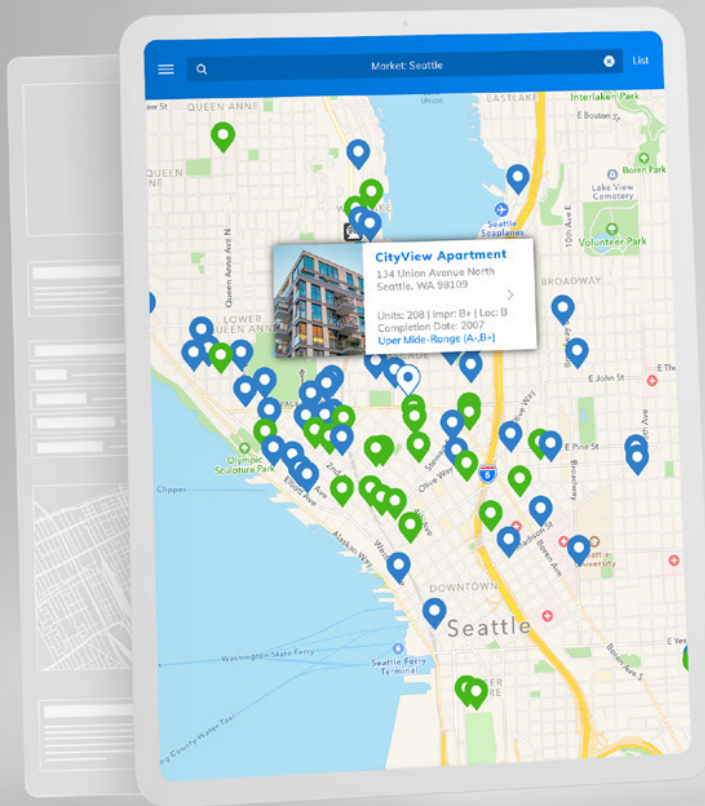
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