Freddie Mac
MULTIFAMILY

2023 Midyear Multifamily Outlook

August 2023

Multifamily Research Center

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Multifamily rental demand returned during the first half of 2023, which has led to modest rent growth so far this year, while occupancy rates have been stabilizing. Although the growth rate feels slow compared with the rapid increases seen during the pandemic, or even the years leading up to it, the market is returning to more normal patterns. Higher interest rates, slow moving cap rates, and lack of price agreement between sellers and buyers have led to slowing multifamily origination volume. As interest rates have climbed significantly, cap rates have been slow to react, and the cap rate spread is much tighter than the historic average. The economy is maintaining positive momentum, although slowing, while the labor market in particular has proved to be quite resilient. Over the short term we expect the multifamily market will slow but maintain strength in 2023, and over the longer run will remain a favored asset class due to its long-term tailwinds.

- After falling month over month for much of the second half of 2022, rent growth has returned in 2023, although at a more moderate pace than the past few years.
- Vacancy rates increased throughout 2022 but the rate of increases has slowed in the first half of 2023. In the second quarter of 2023, rates remained flat and near the long-term average.
- We expect multifamily fundamentals to perform slightly below long-term averages this year, which will feel slow especially in comparison with the pandemic boom years, and even the years leading up to it.
- The multifamily construction pipeline remains robust with about 1 million units currently under construction, with a vast majority of those units expected to complete at the top-end of the market.
- The markets we expect to see the highest gross income growth in 2023 are concentrated in Florida, and parts of the West Coast as well as the mid-south, while our weakest performing markets are a mix of small and large markets primarily in the eastern half of the county, many of which have high levels of new supply expected.
- Since the middle of 2022 cap rates have been increasing slowly, while interest rates remain elevated, leading to tight cap rate spreads. The upward pressure on cap rates has caused downward pressure on property prices, which have declined on a year-over-year basis for the first time since 2010.
- Due to higher and somewhat volatile Treasury rates, and overall economic uncertainty, we project origination volume in 2023 to fall about 17% from 2022 to about $370 billion in 2023.

The Stabilizing Multifamily Market

Through the first half of 2023 the multifamily market appears to be returning to a more normal seasonal pattern, although slightly weaker than the years leading up to the pandemic. After falling during much of 2022, rental demand was positive during the first half of 2023, which led to positive rent growth. Meanwhile occupancy rates have declined slightly so far in 2023, albeit at a much slower pace than what was experienced in 2022. Despite an extremely active pipeline of new units entering the market, largely in the Class A space, the multifamily market continues to perform, which is at least partially attributable to the economy's steady performance, especially the labor market.

The multifamily investment market is still slow throughout the first half of 2023. Cap rates have increased since the middle of 2022, but at a slower pace and magnitude than interest rates, as buyers and sellers struggle to get deals done. These market pressures are likely to put additional downward pressure on property prices, but multifamily is still among the more favored asset classes due to the long-term demographics — 70 million Generation Z, young adults in or close to prime renting age, an overall housing shortage, and the continued strength of the labor market which is propelling new household formation. Despite the economy skirting by a recession so far, there remains several headwinds that could disrupt this stability. We expect rent growth this year to remain muted as the market works through the uncertainty.

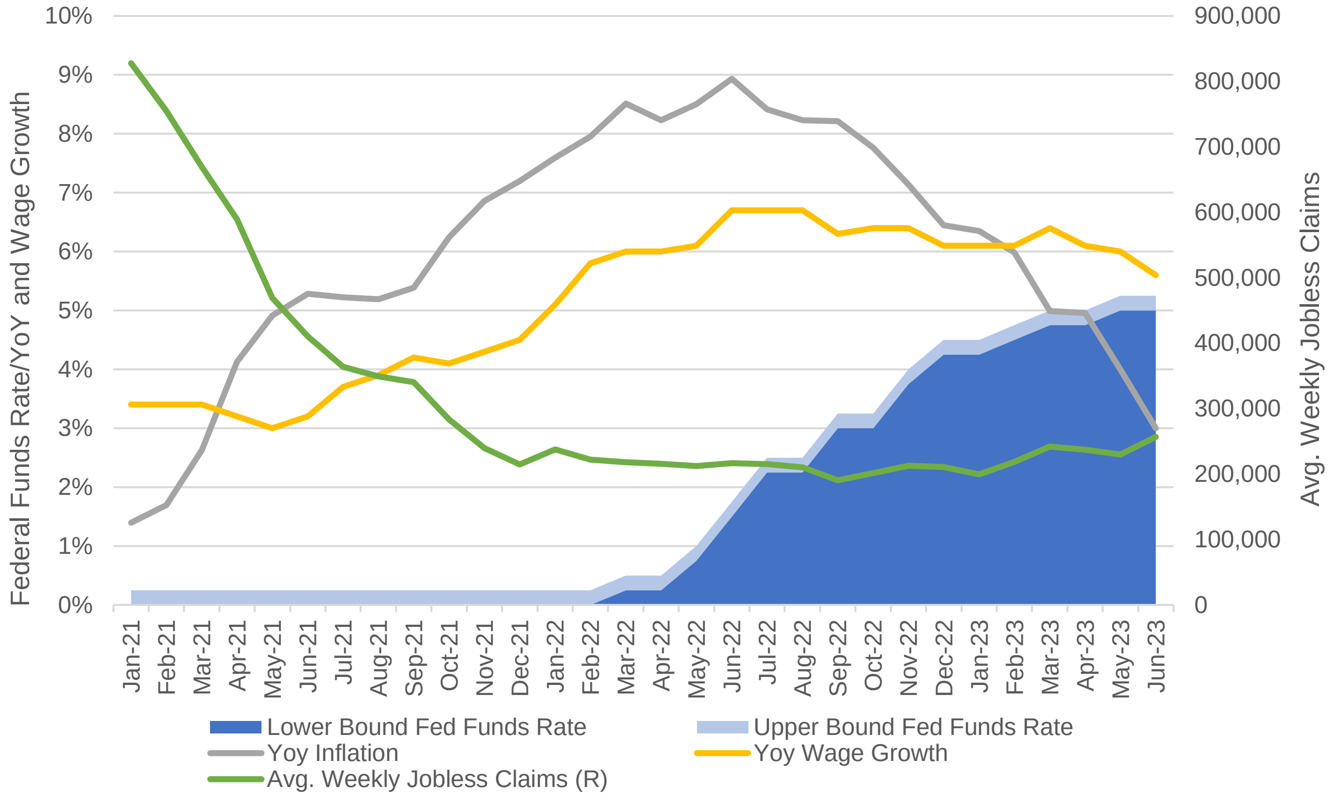
Recession – Slow-Cession[1] – No-Cession?

As of June 2023, Moody's Analytics reports that there is about a 33% chance of a recession before the end of 2023. This is down from earlier estimates of 50% due to timing and the strength of the labor market. If a recession will occur in 2023, economic conditions would have to deteriorate quickly. Real Gross Domestic Product (GDP) in the first quarter of 2023 grew at a revised annualized rate of 2% but according to Moody's is expected to end the year just below 1%. This has led to the expectation of a 'slow-cession' given the modest overall economic growth. Although the recessionary concerns have lessened since the start of the year, there are potential headwinds. Potential issues that could veer the economy into recessionary territory include the spending stipulations in the debt limit agreement, the resumption of student loan payments, and, to a lesser extent, the banking crisis, which appears contained at this point due to a strong governmental response. However, due to the strength of the job market, broad economic conditions would have to deteriorate very quickly for a recession to occur in 2023, although the chances of a recession in 2024 are a coin flip — the biggest risk coming from a misstep by the Federal Reserve Board. Other significant risk factors include an expansion of the Ukraine–Russia war, rising tensions with China and a bank credit crunch.

In 2023 the Federal Reserve Board lowered the magnitude of the federal funds rate hikes, with three 25-bp hikes, and during the June meeting declined to raise rates for the first time in over a year. For much of 2023 the 10-year Treasury rate has remained volatile, generally in a range from 3.5% to 4%, but from mid-March to mid-May the rate stabilized around 3.5%. Since then, the rate has again shot up and crested 4% in early July before receding again.

[1] A phrase coined by Moody's Economics to describe a period of temporary economic slowing during which industrial production, hiring and retail sales are reduced but not to the degree consistent with a more pronounced recession.

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 Atlanta, Federal Reserve Bank of St. Louis, Freddie Mac

Inflation has come down significantly from the peak seen during the middle of 2022 but is still comparatively high at 3% for the year ending in June of 2023, and higher than the Federal Reserve Board's stated goal of 2% annual growth. However, core inflation growth, which excludes volatile categories such as food and energy, remains persistently high at 4.8% for the year ending in June 2023. Despite flattening home prices and rental costs, the shelter component of the Consumer Price Index (CPI) is up 7.8% for the 12 months ending in June due to the lags in data collection methodology. Shelter is the single biggest segment of the CPI and is also part of the core inflation calculation. Due to data collection methodology used by the BLS, the slower rent growth and moderating home prices (which are not directly included in the calculation) seen over the past year are just now being realized. Moody's Analytics expects that inflation growth will continue its downward trend for the rest of 2023 and is projected to total 2.2% for 2024.

Despite the overall slowing of the economy, dour sentiment and expectations levels, the labor market is still performing comparatively well. Through the first six months of 2023, the U.S. economy added on average nearly 280,000 jobs per month — which is nearly 100,000 jobs per month more than the average seen in 2019. As a result, the unemployment rate remains very tight, at 3.6% in June. Wage growth remains robust as well; as of May, wages increased 5.6% over the past year, which is well above the 1997 to 2019 annual average of 3.6%. The labor force participation rate increased 40 bps from the 2022 average to 62.6% in June of 2023 but is still about 70 bps below the peak rate seen during the fourth quarter of 2019. Despite an aging population, the strong labor market and wage growth are likely encouraging a higher percentage of the population to work.

Announced layoffs have increased markedly during 2023. Through the first half of the year, nearly 460,000 job cuts have been announced[2], already more than the roughly 364,000 announced layoffs for all of 2022. Nearly one-third of those announced job eliminations have come from the information/technology industry, which ramped up job creation during the pandemic. If a recession does occur, we believe white-collar jobs would be the ones primarily impacted, and would likely be mild and short-lived, similar to the tech-induced recession of the early 2000s. Similarly weekly jobless claims are slightly elevated in 2023 compared with 2022, averaging about 231,000 per week this year compared with 214,000 weekly in 2022. However, given the strong job and wage growth, low unemployment rate and increasing labor force participation rate, the labor market appears to be quite resilient.

Increased Housing Costs are Outpacing Income Growth

On the single-family housing side, the market continues to remain tight. According to the National Association of REALTORS® (NAR), the number of months of supply for existing sales has fallen from 3.5 in December of 2022 to 3.0 months in May of 2023. This rate is still well above the 1.5 months of inventory in January 2022, but is less than half of the long-term average of 6.7 months from 1982 to 2019. Despite modest drops in home prices at the end of 2022 due to higher interest rates, home prices have increased modestly in the first quarter of 2023 according to the Case-Shiller index. The combination of higher interest rates and rapidly rising home prices has caused average monthly principal and interest costs for a newly purchased home to increase 85% since the first quarter of 2020 — which does not take into account property taxes and insurance premiums that have also increased as home values and replacement costs have increased.

As the cost of purchasing a home has nearly doubled since the outbreak of the pandemic, wage growth has increased as well, but at less than one-fifth of the pace of monthly home costs. In the three years since the first quarter of 2020, wages have increased 16.6%. Over the past three years, rent has increased about 19%, about 2.5 percentage points more than wage growth. Part of the reason for the lack of for-sale inventory and upward pressure on prices is that many current homeowners have extremely low mortgage rates. Owners are reluctant to sell their current homes because the cost of financing a newly purchased home has increased so much over the past few years that moving makes little financial sense.

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

Quarter	For-Sale					Multifamily YoY Rent Growth	YoY Wage Growth
	Mortgage Rate	Median Sales Price	Amount Financed	Monthly P&I	YoY Change		
1Q 2020	3.50%	$284,711	$227,769	$1,023	-16.8%	2.8%	3.5%
2Q 2020	3.13%	$278,490	$222,792	$955	-21.0%	-0.3%	3.8%
3Q 2020	2.90%	$311,640	$249,312	$1,038	-13.9%	-1.4%	3.5%
4Q 2020	2.67%	$317,447	$253,958	$1,026	-18.8%	-1.2%	3.4%
1Q 2021	3.17%	$335,588	$268,470	$1,157	13.1%	-0.9%	3.4%
2Q 2021	3.02%	$347,218	$277,774	$1,174	22.9%	4.1%	3.2%

[2] As reported in the Challenger, Gray & Christmas Inc.: June Job Cut Report

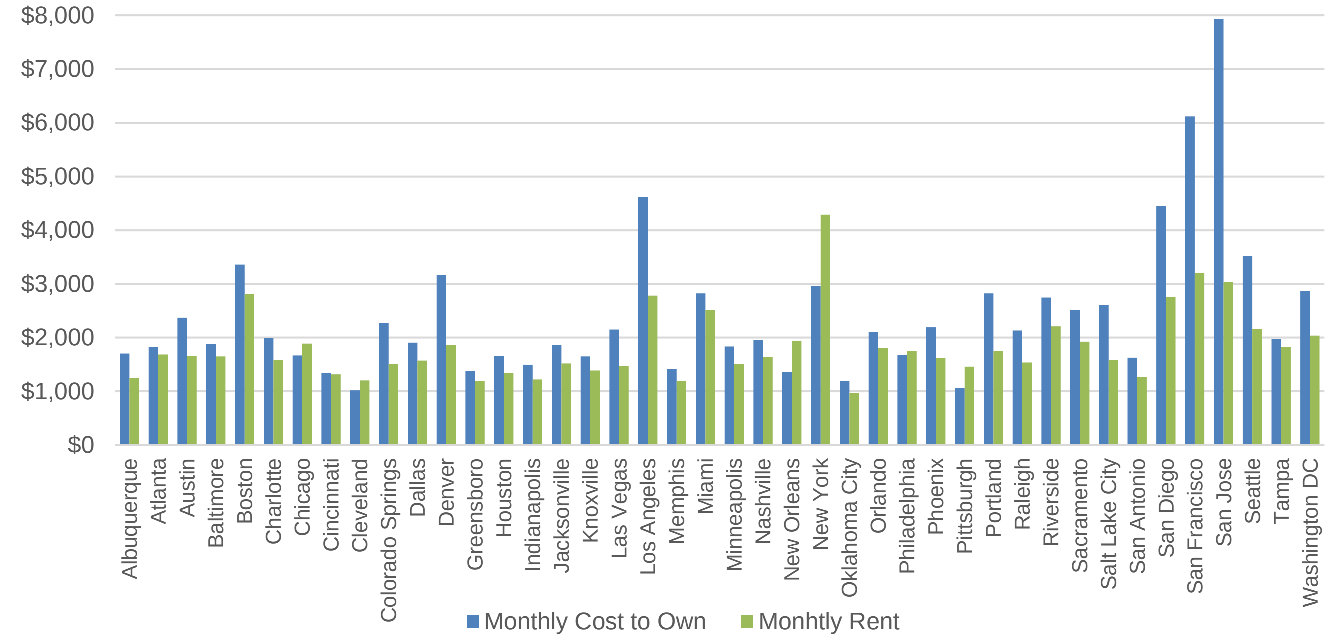
Quarter	For-Sale					Multifamily YoY Rent Growth	YoY Wage Growth
	Mortgage Rate	Median Sales Price	Amount Financed	Monthly P&I	YoY Change		
3Q 2021	3.01%	$354,924	$283,939	$1,199	15.5%	10.4%	4.2%
4Q 2021	3.11%	$368,457	$294,766	$1,260	22.8%	13.9%	4.5%
1Q 2022	4.67%	$384,659	$307,727	$1,590	37.5%	15.3%	6.0%
2Q 2022	5.70%	$391,734	$313,387	$1,819	54.9%	14.5%	6.7%
3Q 2022	6.70%	$383,071	$306,457	$1,977	65.0%	10.6%	6.3%
4Q 2022	6.42%	$376,409	$301,127	$1,888	49.8%	6.6%	6.1%
1Q 2023	6.32%	$381,001	$304,800	$1,891	18.9%	4.5%	6.4%
Change Since 1Q 2020	2.82%	$96,290	$77,032	$868	84.8%	19.3%	16.6%

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.

Breaking this down by geography, in Exhibit 3, we show how the cost of ownership (monthly principal and interest costs for a median-priced home) compares with the average rent across metropolitan areas, as of the first quarter of 2023. Across the 42 markets shown, renting was less expensive on a monthly basis in all but six markets[3] and the average discount to rent versus ownership is 17%. The Bay Area, San Francisco and San Jose have by far the most expensive for-sale housing and among the most expensive rents, but the monthly spread between renting and owning is nearly $3,000 in San Francisco and $4,900 in San Jose. New York has the highest average rent at nearly $4,300 per month, while for-sale housing is comparatively less expensive at about $3,000 per month, but this can be explained by the concentration of extremely expensive rental homes within the five boroughs while for-sale housing is spread out across a much larger area. The decision to rent or buy a home is not strictly based on the monthly costs. However, as costs have risen, many potential first-time homebuyers have been priced out of the market by rising interest rates and prices, which increase monthly costs as well as the downpayment requirements. In April, 29% of home sales were to first-time homebuyers which is well below the typical 40%, according to the NAR.

[3] This does not take into account any tax benefits, nor the declining principal balance of mortgages.

Exhibit 3: Monthly Median-Priced Home Costs Compared with Rent by Market 1Q 2023



Sources: RealPage, National Association of Realtors, Freddie Mac
Note: Assumes 20% downpayment

Multifamily Performance — A Return to Normalcy That Doesn't Feel Like It

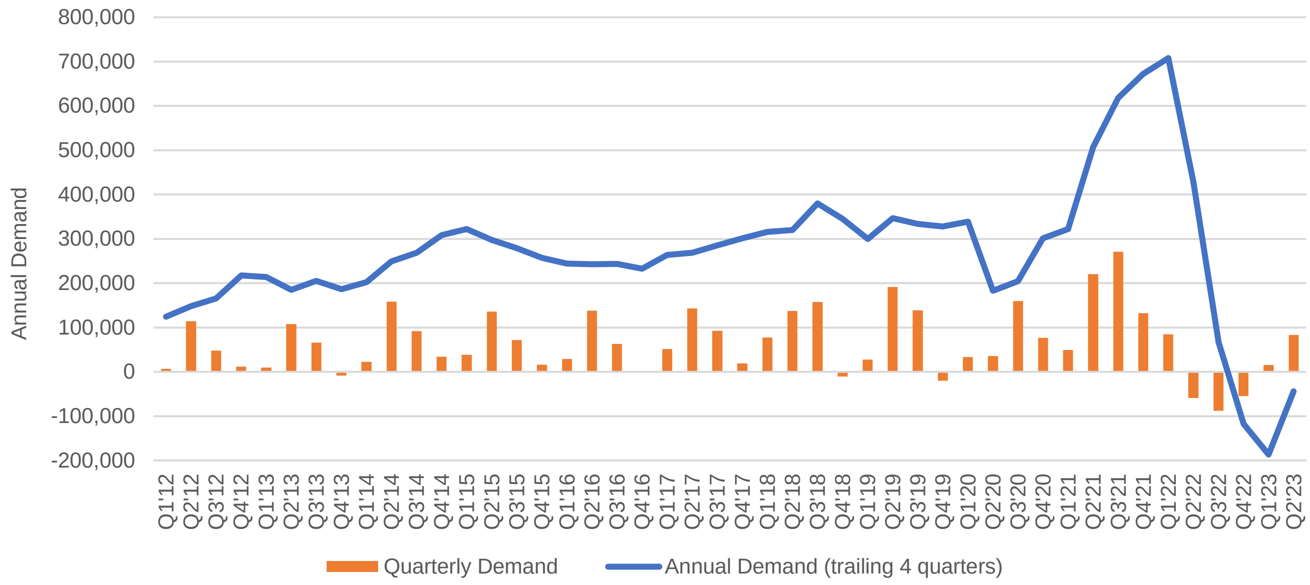
Through the end of 2022 and into the beginning of 2023, the multifamily market had reached an inflection point with rents falling and occupancy decreasing. RealPage reported that rents declined -1.7% during the final four months of year, while Reis reported a drop in rents during the first quarter of 2023, as opposed to the fourth quarter of 2022. However, rent growth has rebounded: RealPage reports rent up 0.7% in the first quarter and up 1.2% in the second quarter, while Reis shows rents up 0.9% in the second quarter. This follows the typical seasonality pattern of multifamily rent growth — slower growth in the fourth and first quarters, with stronger growth in the second quarter but at a slightly weaker rate. The rent growth seen so far this year feels weak in comparison with not only the post-pandemic years, but also when compared with conditions seen going back to 2000. For the year ending in June 2023 RealPage reports that nationally rent growth totaled 1.5%, which is below the annual average growth seen from 2012-2022 of 4.3%, and the longer-term average from 2000 through 2022 of 2.9%.

At the same time, the national occupancy rate fell drastically from record highs of about 97% to just under 95% in the span of 12 months, according to RealPage. Through the first five months of 2023, occupancy rates have started to stabilize, falling just 30 bps from the end of 2022 to June 2023 to 94.7%, and have been unchanged over the prior three months. This rapid decline in occupancy reflects a correction from the post-pandemic volatility. When compared with both the long-term rate of 94.6% from 2000 through 2022, and the post-great financial crisis rate of 95% from 2012 to 2019, it looks much more normal.

The slowdown in rents experienced at the end of 2022 was a result of a decline in demand the last three quarters of 2022. Demand returned during the first half of 2023 but was relatively weak, with the first quarter totaling about 15,000 units and the second quarter absorbing about 83,000 units, or just under 100,000 units for the first half of the year. While demand picked up slightly in the second quarter, it remains weak on average. Total demand so far this year is well below the average from both the 2012-2019 first half of the year average of about 175,000 units and the 2021 and 2022 average of 145,000 units during the first six months of the year.

To help explain the drop-off in demand late in 2022 and into early 2023, we look at overall household formations, which have slowed drastically since the middle second quarter of 2022. On a quarterly basis, household formations were extremely strong from the second quarter of 2021 through the second quarter of 2022, when on average more than 530,000 new households were formed per quarter. This is roughly double the quarterly average from 2000 through 2019 of 272,000. From the third quarter of 2022 through the first quarter of 2023, the nation has grown on average 170,000 household per quarter. The lack of new households helps explain the lack of new apartment demand during that time.

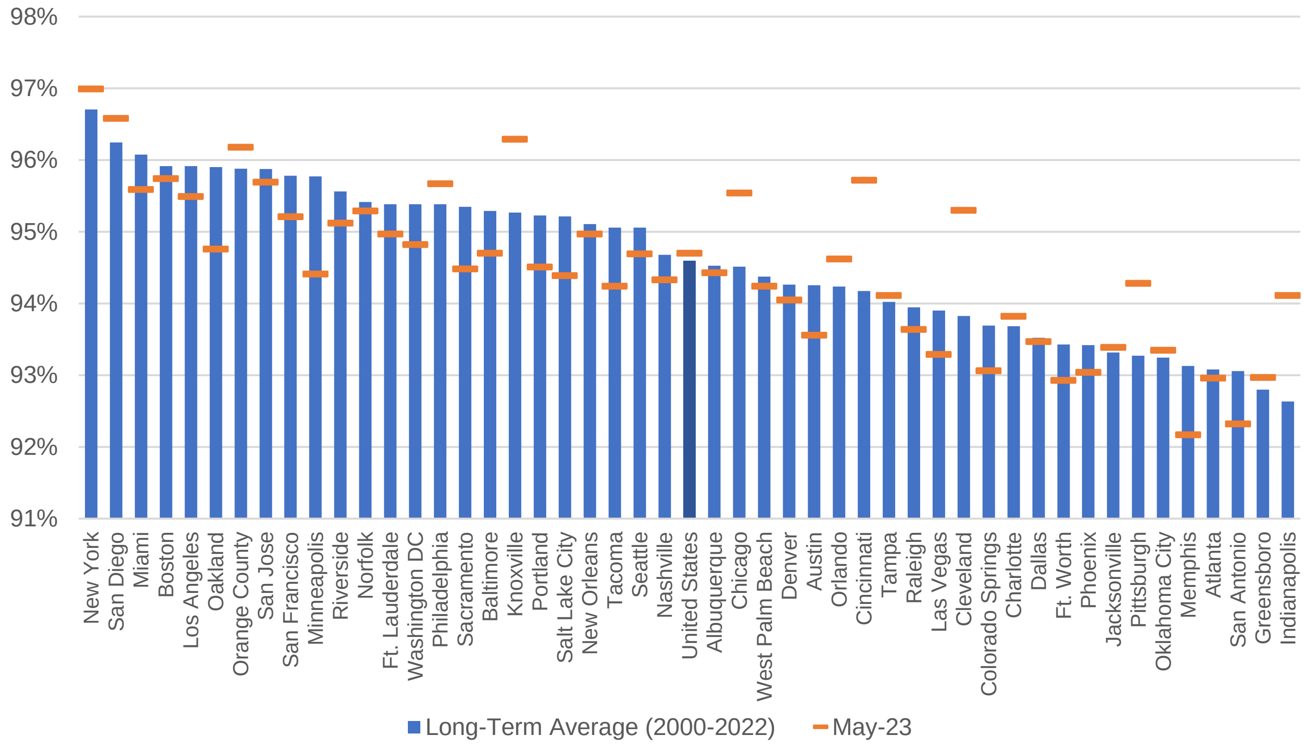
Exhibit 4: Quarterly and Annual Multifamily Demand



Sources: RealPage, Freddie Mac

Exhibit 5 shows the May 2023 occupancy rate compared with 2000 to 2022 long-term average nationally and by individual market. Across the U.S. as of May 2023 the occupancy rate is down 180 bps from one year earlier but is 10 bps higher than the long-term 2000 through 2022 average. In all but three markets, the occupancy rate in May 2023 is lower than a year prior. As seen in Exhibit 5, in roughly two-thirds of markets, the occupancy rate as of May 2023 is lower compared with the long-term average. Markets with current occupancy well above the long-term averages are Cincinnati, Indianapolis and Cleveland, which all have May 2023 occupancy rates 150 bps higher than their long-term averages. Meanwhile, markets with current occupancy well below the long-run averages are Minneapolis, Oakland and Memphis, which are 140 bps, 110 bps and 100 bps respectively below their 2000–2022 average occupancy rate.

Exhibit 5: May 2023 Occupancy Rate Compared with 2000 to 2022 Average

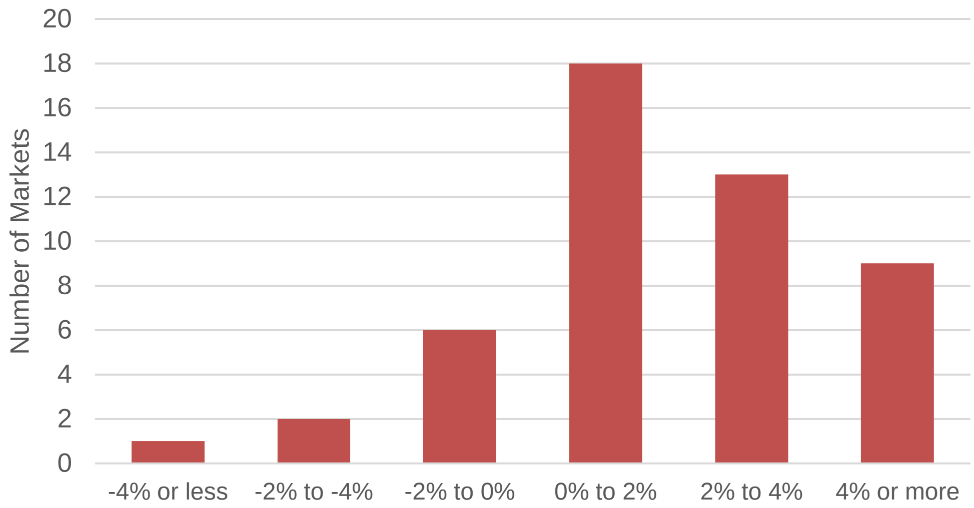


Sources: RealPage, Freddie Mac

Although the pace of rent growth is slowing as the market comes down from the record-breaking rent growth seen in early 2022, more than 80% of the top 49 markets have seen flat or positive rent growth for the year ending in May 2023. Rent growth has been strongest in smaller markets, with Knoxville leading the way with rent growth of 9.2% over the past year, followed by Cincinnati and Indianapolis at 6.4% and 6.1% respectively. Rent has declined the most in the markets that saw some of the highest rent growth during the pandemic boom. Markets such as Phoenix (-4.1%), Las Vegas (-3.5%) and Sacramento (-2.4%) have seen the steepest rent declines for the 12 months ending in May. All of the large gateway markets[4] other than San Francisco are seeing positive rent growth between 1.8% to 5.4%, while San Francisco has seen rents fall -0.8% year over year in May.

[4] Gateway markets include Boston, Chicago, Los Angeles, Miami, New York, San Francisco and Washington D.C.

Exhibit 6: Distribution of Annual Rent Growth by Metro Areas as of May 2023



Sources: RealPage, Freddie Mac

Rent growth by property class for the 12 months ending in May of 2023 is relatively consistent with Class A increasing the most at 2.9%, Class B the lowest at 2.0% and Class C in the middle with rent growth of 2.4%. Over the year ending in May, occupancy levels are the highest in Class C at 95.0% but have fallen the most over the past year, down 260 bps from the May 2022 level. Class A occupancy has fallen the least at 180 bps, but it also has the lowest occupancy rate at 94.4%. Class B's 94.7% occupancy rate is down 210 bps from May of 2022 through May of 2023.

Although inflation has been easing, expense growth is still elevated. Data from RealPage indicates that over the 12 months ending in May of 2023 expenses have increased 7.8%, with taxes and insurance rising the most. The rate of expense growth is much higher than inflation growth, which has flattened, and as of May is now up 4% for the past 12 months.

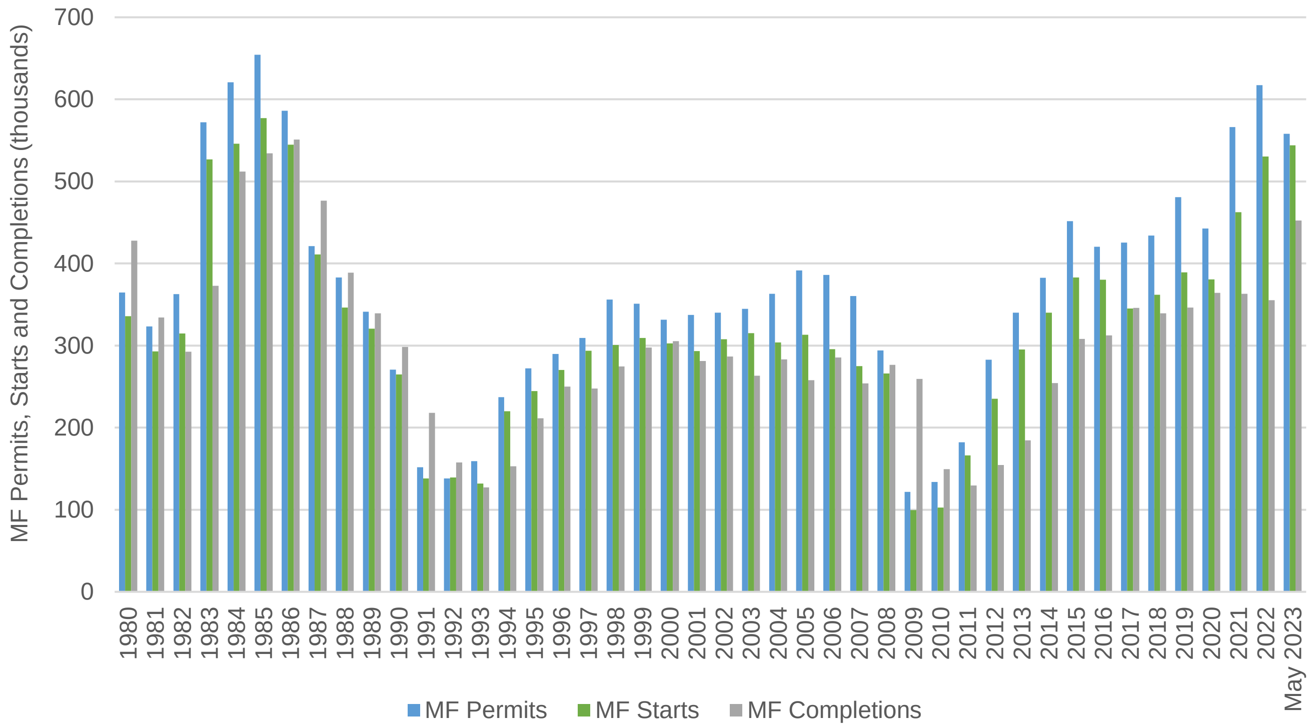
Permitting through the first five months of 2023 has declined from 2022 levels to about 560,000 units annually. Through May, starts are similar to the 2022 level, at about 545,000 annual units. However, completions have increased markedly so far this year. Through the first five months of 2023, completions are about 27% higher than 2022, at 450,000 units, and if the trend continues through the rest of the year, about 100,000 more units will be completed in 2023 compared with 2022. This indicates that the construction labor shortage and supply chain issues that plagued the market in 2021 and 2022 appear to be abating.

RealPage reports that roughly 1 million units are currently under construction across the country as of early 2023, a total not seen in nearly 50 years. However, the difference is that today the size of the multifamily market is more than double the size it was during the 1970s. Therefore, as a percentage of total inventory, 1 million units is a much smaller percentage of the market today, at 2.2% of inventory compared with 6.5% in 1973. A vast majority of those new units will be high-end Class A units, targeted at high-income earning households.

Of those 1 million units currently under construction, about 946,000 units are located within the top 72 markets tracked by RealPage. The five markets with the greatest number of units under construction include Dallas (6.1%

of all units under construction), Phoenix (5.2%), New York - Five Boroughs (5.2%), Austin (4.4%) and Northern New Jersey (4.4%). Collectively, just those five markets represent more than 25% of all the units currently under construction. Nine markets have more than 10% of their current inventory under construction. Colorado Springs has the highest percentage of current inventory under construction at 16.5%, Nashville has the second highest level at 15.7%, and Austin and Charlotte each have 14.5% of current inventory under construction, while Raleigh rounds out the top five at 13.8%. Colorado Springs, Nashville and Raleigh are all relatively small markets but have seen a substantial amount of new development, leading to the outsized growth rate as a percentage of existing units.

Exhibit 7: Multifamily Permits, Starts and Completions (5+ Units)



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

Multifamily Fundamentals Outlook for the remainder of 2023

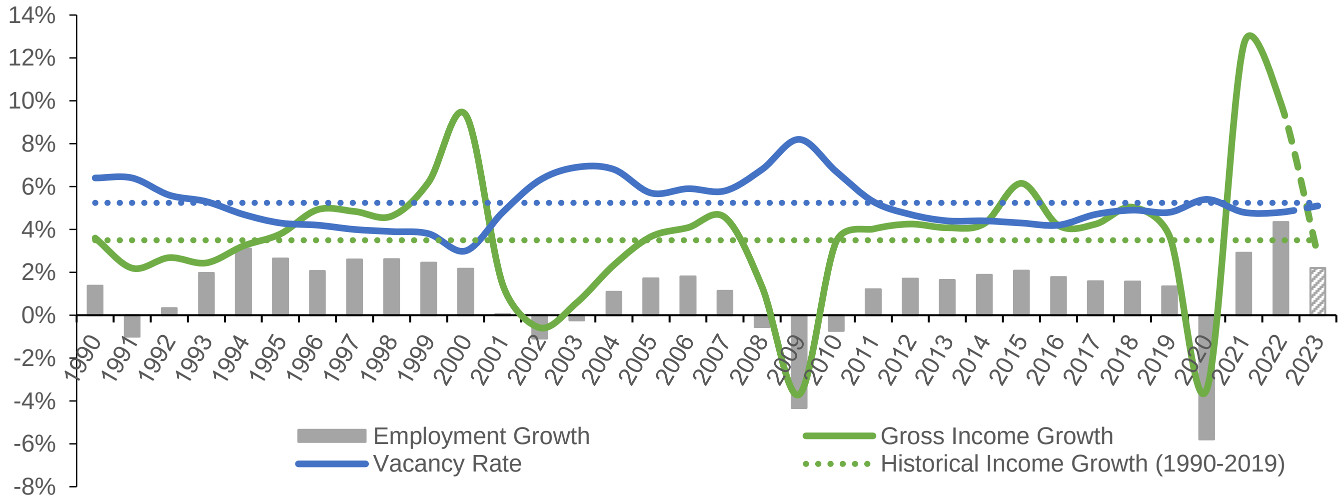
For the remainder of 2023, we expect the multifamily market to continue its return to a more normal pattern; although it may fall short of the prior decade, it should remain relatively stable given the state of the overall economy. The first half of the year was relatively calm with modest demand and rent growth, and stabilizing occupancy rates. We expect much of that to continue throughout the rest of 2023, but at a more moderate pace assuming the labor market does not see significant slowing. Our baseline forecast for the end of 2023 is to see vacancy end 2023 at 5.1% and rent growth to total 3.1% for the year. As previously mentioned, according to RealPage, the average vacancy rate going back to 2000 was 5.4% and rent growth was 2.9%. Going back a bit further, from 1990 through 2022 using Reis data, vacancy has averaged 5.2%, while annual rent growth has averaged 3.7%. Therefore, we expect 2023 to be average for vacancy levels but below the annual average for rent growth.

Gross income growth for 2023 is expected to total 2.8%, which is 100 bps lower than the average from 1990 through 2022, and just below Moody's Analytics projected inflation growth rate for 2023 of 3%. In making these forecasts we assume that the economy will continue to create jobs, household income growth remains in place, and that inflation continues its downward trajectory. Coupled on top is the elevated level of new supply entering the market and slower economic growth, which contributes to the lower-than-average expected growth rates in the multifamily market for 2023.

However, the risk of a recession remains elevated and if those assumptions do not come to fruition, then the elevated levels of new supply combined with sagging demand will lead to materially lower multifamily market performance. If the economy avoids a recession and the labor market remains relatively strong, then we believe that the high levels of new supply will be absorbed, although specific markets may see more softening than others. One of the key drivers of our forecast is the expected household income growth, but there is a realistic possibility that given the strength of the labor market, income growth is beyond current expectations, which would push rent growth higher.

If we do slip into a recession in 2023 or 2024, Moody's expects it be mild. For comparison purposes we look at the slowdowns in 1991 and 2002, where employment declined by about 1% during each of those recessions. In 1991 the gross income growth remained positive but was slightly negative in 2002 at -0.6%. If a recession does occur, we believe multifamily performance would likely be in a similar range.

Exhibit 8: Employment Growth, Vacancy Rate and Gross Income Growth, Historic and Forecast



Sources: Moody's Analytics, Reis for historic data, Freddie Mac and Moody's projections for 2023 are represented by the dashed lines and striped box.

Breaking out gross income growth projections across markets, three of the top 10 markets are located in Florida, along with primary and secondary markets on the West Coast and mid-south, shown in Exhibit 9. The pandemic boom markets of Phoenix, Las Vegas, Austin and Orlando have seen their gross income expectations fall, with projected 2023 performance for each of those markets to be among the bottom half of all markets. However, of those markets only Phoenix is expected to be among the bottom performing 10 markets for 2023.

The bottom 10 markets at this time are a geographically diverse mix of large and small markets. Several of these markets are seeing high levels of supply entering the market, which is limiting income growth. Many of the bottom 10 Midwest markets are typically slow growing, and even more so given the uncertain economic conditions. Even though these markets are expected to perform the worst nationally, they are still expected to see gross income growth of roughly 1% to 2% in 2023.

Exhibit 9: Top and Bottom 10 Metros by Gross Income Growth for 2023

Metropolitan Area Top 10	2023 Annualized Growth in Gross Income	2023 Vacancy Rate	Metropolitan Area Bottom 10	2023 Annualized Growth in Gross Income	2023 Vacancy Rate
Miami	4.2%	5.1%	Fairfield County, CT	1.1%	5.9%
Tacoma	4.0%	4.2%	Little Rock	1.4%	5.5%
San Diego	3.9%	3.5%	Cincinnati	1.8%	4.2%
Dallas	3.8%	5.9%	New York - 5 Boroughs	1.8%	3.4%
Seattle	3.6%	6.8%	Raleigh/Durham	1.9%	6.4%
Oklahoma City	3.6%	5.5%	Baltimore	2.1%	3.8%
West Palm Beach	3.6%	5.1%	Nashville	2.1%	7.6%
Oakland	3.6%	5.4%	Phoenix	2.1%	6.2%
Tampa	3.5%	4.8%	Minneapolis	2.1%	7.2%
Richmond	3.5%	4.8%	Louisville	2.1%	5.1%
United States	**2.8%**	**5.1%**			

Source: Freddie Mac, Reis and RealPage

Multifamily Cap Rates and Valuations on the Move

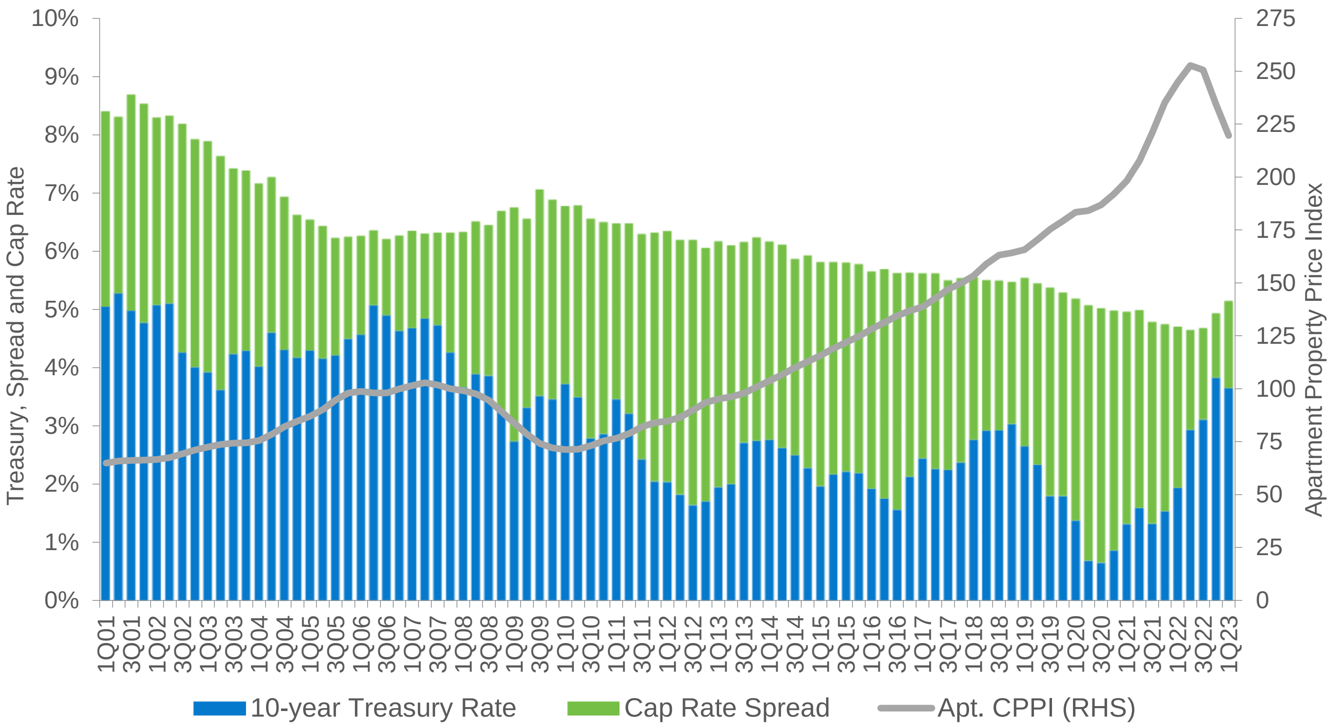
While multifamily fundamentals in terms of rent and demand are returning to more stable conditions, the valuation and debt market are still adjusting to the higher interest rate environment. Since the end of 2022, cap rates and property prices have started to acclimate to the higher interest rate environment, with cap rates moving up and valuations down.

Following slowly decreasing cap rates during 2021 and into 2022, cap rates increased roughly 50 bps, up to 5.2%, from the third quarter of 2022 to the first quarter of 2023, according to Real Capital Analytics (RCA). As interest rates increased, the cap rate spread has compressed to some of the tightest levels since 2001. In the first quarter of 2023, the cap rate spread was 150 bps, slightly wider compared with 110 bps in the prior quarter, but still remains well below the average going back to 2001 of 310 bps. Since the first quarter, cap rates have continued to inch up, reaching 5.3% as of May. We do not expect the cap rate spread to remain this tight for an extended period of time which will put further upward pressure on cap rates given the higher interest rate environment.

The 10-year Treasury rate was somewhat volatile throughout the first six months of 2023 ranging between roughly 3.5% and 4%. On a month-to-month basis changes were commonly in the range of 50 bps. Those swings in the 10-year Treasury rate slow the multifamily transaction market, because a deal that works for buyer and seller one day may not the next because financing costs change.

As cap rates increased, property valuations have started to decline, rather steeply. In the first quarter, property prices were down -6.3% quarter over quarter and -10.3% year over year, according to RCA. Prices have continued to decline in the second quarter, down -12.5% year over year as of May, but at a slower pace so far than in the first quarter. Additional upward pressure on cap rates will put downward pressure on property prices.

Exhibit 10: Multifamily Price Index, Cap Rate Spread and Treasury Rate

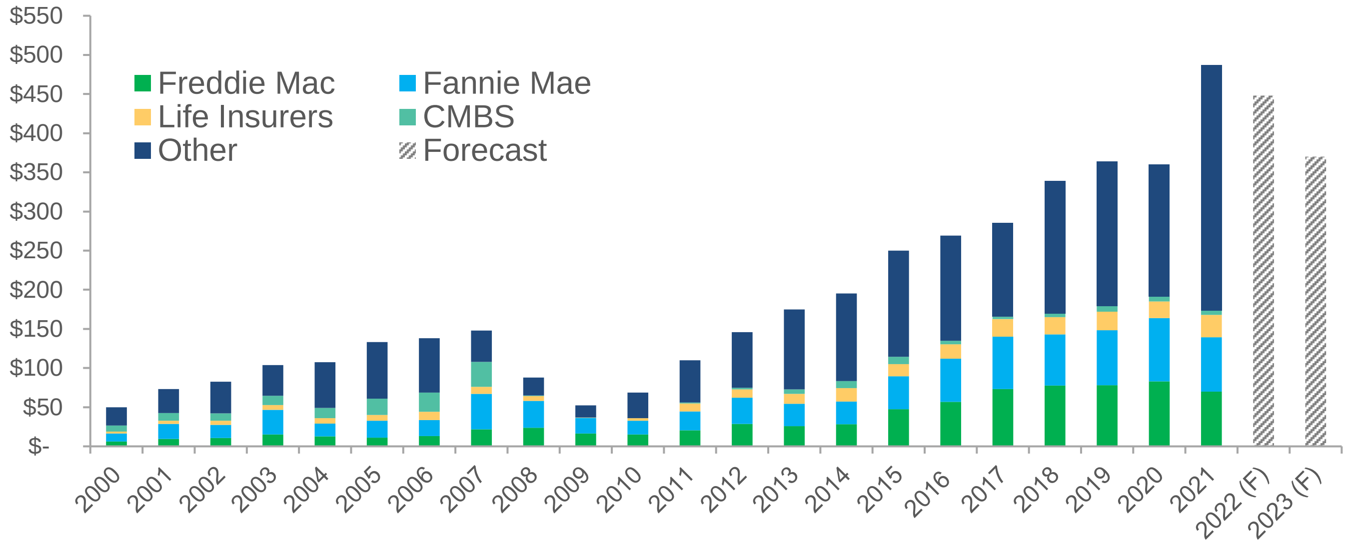


Sources: Freddie Mac, Real Capital Analytics CPPI, Federal Reserve Board, Moody's Analytics

Market Uncertainty Leading to Origination Volume Forecast Declines

The headwinds facing the multifamily investment market will negatively impact the transaction volume through the end of 2023. For 2023 we expect volume to decline to about $370 billion, down roughly 17% from 2022. We believe volume will continue its downward slide because of the decline in property prices along with elevated and fluctuating 10-year rates slowing the transaction market. Despite interest rates remaining relatively stable through much of the first half of 2023, the continued uncertainty in the economy could lead to additional interest rate hikes from the Federal Reserve Board. As a result, investors are waiting for the market to stabilize.

Exhibit 11: Multifamily New Purchase and Guarantee Volume ($ Billions)



Sources: Mortgage Bankers Association, ACLI, Wells Fargo, Intex Solutions Inc., Freddie Mac projections
Note: 2022 and 2023 projections of $448 billion and $370 billion are by Freddie Mac as of May 2023.

Conclusion

The economy has been on unstable footing, with high inflation, rising interest rates and slowing GDP, but at the same time experiencing a resilient job market. Assuming that we do avoid a recession in 2023, we believe that multifamily vacancy will remain stable, and rents will see modest positive growth but weaker in comparison with the growth prior few years. If there is a recession, it is likely to be mild and short lived. Elevated levels of new multifamily units entering the market, along with slower economic growth, will put some stress on multifamily fundamentals, resulting in less-than-average growth for 2023. Meanwhile, the multifamily transaction market is expected to remain sluggish in 2023 due to comparatively high and volatile interest rates, sagging property values, and slow-moving cap rates. However, the multifamily market will continue to be propelled over the long term due to an overall housing shortage, expensive for-sale housing and favorable demographics.

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