Multifamily

OUTLOOK

St Elmo Apartments
Austin, Texas
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We have a favorable outlook for multifamily in 2022, supported by various macro trends, including rising inflationary pressures, a low-interest rate environment, and further tightening of the housing market. 2021 was a record year for multifamily, the dominant sector in commercial real estate, accounting for 42% ($335 billion) of deal activity according to Real Capital Analytics*. Demand for multifamily soared in the aftermath of the COVID-19 pandemic, and we see continued growth for the sector in 2022. CBRE reported that the overall vacancy rate for multifamily fell by 2.2% yearly to a record-low of 2.5%, while the average net effective rent increased by 13.4% year-over-year. Occupancy in this sector has remained strong, with a new absorption record of 617,500 units in 2021, up 238% from 2020 and up 97% from 2019.

Due to high demand, the multifamily asset class is substantially more expensive than just a year ago. In their 2022 U.S. Real Estate Market Outlook, CBRE stated that the overall health of the multifamily sector will make 2022 a record year in terms of pricing. With occupancy levels forecasted to remain above 95% in the foreseeable future, constricted supply amid increasing demand will create an environment poised for continuous rent growth. CoStar* estimates a well-above-average annual rent growth in the first half of 2022, which is forecasted to stabilize at 6.2% annual increase by year-end 2022, assuming supply can catch up with increasing demand for multifamily. Green Street Advisors*** is projecting a record 13.5% net-operating-income (NOI) growth for apartments in 2022. According to Forbes, rental demand will also be bolstered by a rise in home prices, an additional 2.9% on top of 2021 highs, as well as a gradual uptick in mortgage rates. Other demand drivers include overall job growth, wage growth, and consumer confidence, particularly in some of the nation's fastest-growing markets.

**Real Capital Analytics - Capital Trends. US Big Picture, 2021*

***CoStar - US Multifamily Annual Rent Forecast, 2022*

****Green Street Advisors - U.S. Commercial Property Outlook, 2022*

OPPORTUNITY

For multifamily, we see two strategies as most viable right now. First, we will continue to favor ground-up multifamily developments in 2022. Tremendous yearly rent growth in 2021 led to the massive appreciation of this asset class, outpacing the increase in construction costs which are up 17.5% year-over-year, the highest in the last 50 years. We will focus on assets we believe can stabilize by the third year (after being built and leased up). Historically, we have looked for projects that deliver a stabilized yield-on-cost that is 150 bps higher than its exit cap. Currently, a stabilized multifamily project typically offers a spread as high as 250 bps.

The second strategy is value-added multifamily acquisitions.These well-located properties have "good bones" but need substantial renovations to achieve potentially significantly higher rents. We will look for projects where investing, for example, $10,000 into a unit upgrade can yield more than $150 or more in increased rent. We expect rent growth to moderate over the next few years, which suggests to us that value-add plays in multifamily present a window of opportunity that may subside in the next few years. See which multifamily markets we are the most excited about in our 2022 Best Places to Invest report.

The Rae at Westlake
Bethesda, Maryland
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