The Multifamily Market Outlook

By **Caitlin Walter**

Throughout this long economic recovery period, investors have found multifamily to be an attractive sector, with solid fundamentals and strong returns. In fact, transaction volumes reached historic levels last year and were on track, through the third quarter, to do the same this year.

At the same time, though, there's been some softening in key market metrics, suggesting that 2016 could be the inflection point in this cycle. Coupled with political and economic uncertainty, these market shifts are leaving investors unsettled.

However, let's not confuse the sector's recent easing with a downturn. Longer-term analysis points to strong demand and measured production, suggesting this year's performance reflects the market returning to a more normalized pace after years of historic performance.

Why There's Concern

Respondents to NMHC's October Quarterly Survey of Apartment Market Conditions indicated declining conditions in its four indexes—Market Tightness, Sales Volume, Equity Financing and Debt Financing. Digging deeper into the data, most concerns appear localized, attracting media and investor attention but not reflecting the sum of the apartment market.

For example, the high volume of new class-A units in select markets like Denver and Washington, D.C. is leading to more supply-demand equilibrium in those areas. More balance means slower absorptions and moderating rents. However, that's not the story everywhere.

Similarly, the caution equity and debt sources are exercising is reflective not only of changes in market conditions but also regulatory requirements that restrict lending.

But overall rent growth has decelerated this year. MPF Research reported a third-quarter increase of 4.0 percent in same-store rents, 160 basis points below third quarter 2015. While this slowdown is noteworthy, rent growth remains positive while vacancy rates are at historic levels.

The Fundamentals Remain Positive

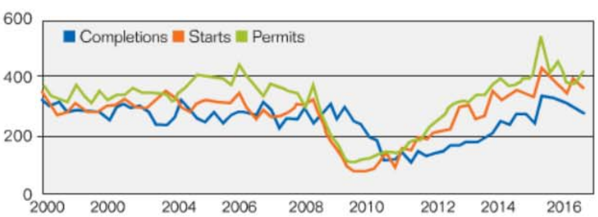
With all the noise in the market, it's important to look at the underlying fundamentals. On the supply side, apartment construction has increased since the 2008 recession, with multifamily permits in 2015 reaching their highest level since 1986.

However, at 310,300 new units delivered last year, new supply is healthy but not super-sized. NMHC estimates that 300,000 to 400,000 new units are needed annually to keep up with demand.

Completions are on pace to hit a similar number in 2016, according to the U.S. Census Bureau, but permitting activity is moderating, suggesting overall supply is in check.

Demographics also provide a strong case for long-term optimism. Since 2011, roughly 5.8 million more rental households have formed, with many finding apartments the right kind of home for their needs. The demand pipeline continues well into the future.

U.S. Multifamily Permits, Completions and Starts (in thousands)



Source: U.S. Census Bureau

According to Census data, 21 million Millennials were still living with their parents in 2015, accounting for a lot of pent-up demand. Moreover, Baby Boomers are a rapidly growing renter segment. Even a small percentage of the almost 73 million Boomers choosing to transition to apartment living buoys long-term demand.

The year ahead is unlikely to be as record-setting as prior years in this cycle. Multifamily investors, owners and operators are keeping close watch on some of the issues that have begun cropping up this year. While recent political events have thrown more uncertainty in the mix, the multifamily sector's fundamentals suggest a largely positive outlook for 2017. ■

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