

APARTMENT INDEX

MULTIFAMILY SECTOR SHOWS SIGNS OF STABILIZATION

Over the past year, multifamily performance has weakened in response to successive rate hikes from the Federal Reserve. Although both multifamily fundamentals and capital markets are still softening, recent data, and comments from the Fed, suggest fundamentals are stabilizing, and hint that stabilization in capital markets is on the horizon.

The Federal Reserve responded to the highest inflation in 40 years by aggressively raising interest rates, putting upward pressure on cap rates and downward pressure on total returns. According to the latest NCREIF Property Index, total multifamily returns fell 2.1% in the first quarter of 2023, and have fallen 5.2% since total returns began to decline in mid-2022. This decrease is primarily due to declining appreciation returns, which fell by 3.05%, while income growth remained steady at 0.95%, up from 0.91% in Q4 2022. CBRE Econometric Advisors (EA) estimates, based on a survey of real estate capital markets professionals, mirrors this, showing a decline of 5.1% in Q4 2022 (the latest quarter available), and a 70-basis-point increase in cap rates from mid-2021. We expect cap rates to continue to rise, and valuations to fall, in the near term, as transaction volume increases, and price correction intensifies.

We expect this near-term increase in trade because we expect interest rates to stabilize. A May 3 comment from the Federal Reserve omitted a sentence from its previous statement that “some additional policy firming may be appropriate,” informing the CBRE baseline view that the Fed will hold rates in the current range of 5.0% to 5.25%. This reduction in interest rate volatility provides an opening for investors who have been waiting on the sidelines for clarity in both operating fundamentals and capital markets. Lenders can now execute on a transaction with greater certainty around their expected returns and DSCR risk.

Market fundamentals typically lead movements in the capital markets, and CBRE EA’s Q1 2023 data release shows both vacancy and rent deterioration slowing down. Though the national vacancy rate rose 30 bps to 4.9% in Q1 2023, it decelerated from a 70-bp increase in Q4 2022, and an 80-bp increase in Q3 2022. Likewise, rent growth fell only 0.1% in Q1 after falling 0.8% in Q4 2022.

Looking forward, despite an expected moderate recession in late 2023, the scarcity of affordable single-family homes will bolster rental demand. Currently, the monthly payment for the median for-sale single-family home exceeds the median monthly apartment rent by a staggering 42%, putting homeownership out of reach for many renters, causing them to remain renters for longer. This will partially counterbalance recessionary headwinds, holding vacancy rates to a gradual increase, peaking at 5.4% in Q2 2024, before dropping back below the long-run average of 5% in 2025. We forecast rent growth to remain positive, hitting a low of 1.9% in Q2 2024, and then recovering to near its long-run average of 2.5% in 2025.

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APARTMENT TOTAL RETURNS

| | Total NPI | Total Apartment | East | Midwest | South | West |
|--------------|-----------|-----------------|-------|---------|-------|-------|
| 1st Q 2023 | -1.81 | -2.10 | -1.62 | -2.37 | -1.10 | -3.30 |
| 4th Q 2022 | -3.50 | -3.21 | -3.17 | -2.32 | -2.10 | -4.35 |
| One Year | -1.63 | -0.40 | -0.05 | -1.58 | 3.18 | -3.44 |
| Three Years | 7.15 | 8.24 | 6.91 | 3.13 | 12.29 | 7.20 |
| Five Years | 6.71 | 7.13 | 5.97 | 3.04 | 9.73 | 6.99 |
| Ten Years | 8.34 | 8.06 | 6.49 | 5.54 | 9.56 | 8.96 |
| Twenty Years | 8.43 | 8.17 | 6.99 | 6.72 | 9.21 | 8.99 |

APARTMENT INCOME RETURNS

| | Total NPI | Total Apartment | East | Midwest | South | West |
|--------------|-----------|-----------------|------|---------|-------|------|
| 1st Q 2023 | 1.01 | 0.95 | 0.97 | 1.06 | 0.99 | 0.88 |
| 4th Q 2022 | 0.95 | 0.91 | 0.92 | 1.04 | 0.98 | 0.81 |
| One Year | 3.92 | 3.72 | 3.79 | 4.18 | 3.92 | 3.42 |
| Three Years | 4.08 | 3.76 | 3.75 | 3.94 | 4.03 | 3.53 |
| Five Years | 4.26 | 3.97 | 3.93 | 4.08 | 4.20 | 3.80 |
| Ten Years | 4.64 | 4.34 | 4.18 | 4.43 | 4.66 | 4.24 |
| Twenty Years | 5.49 | 4.89 | 4.66 | 5.08 | 5.26 | 4.78 |

APARTMENT APPRECIATION RETURNS

| | Total NPI | Total Apartment | East | Midwest | South | West |
|--------------|-----------|-----------------|-------|---------|-------|-------|
| 1st Q 2023 | -2.82 | -3.05 | -2.59 | -3.43 | -2.09 | -4.18 |
| 4th Q 2022 | -4.45 | -4.12 | -4.09 | -3.36 | -3.08 | -5.16 |
| One Year | -5.39 | -4.01 | -3.74 | -5.59 | -0.72 | -6.69 |
| Three Years | 2.98 | 4.35 | 3.07 | -0.79 | 8.02 | 3.58 |
| Five Years | 2.37 | 3.07 | 1.98 | -1.01 | 5.36 | 3.10 |
| Ten Years | 3.58 | 3.60 | 2.24 | 1.08 | 4.73 | 4.58 |
| Twenty Years | 2.83 | 3.17 | 2.26 | 1.58 | 3.80 | 4.07 |

APARTMENT INDEX—QUARTILE RANGE OF RETURNS

