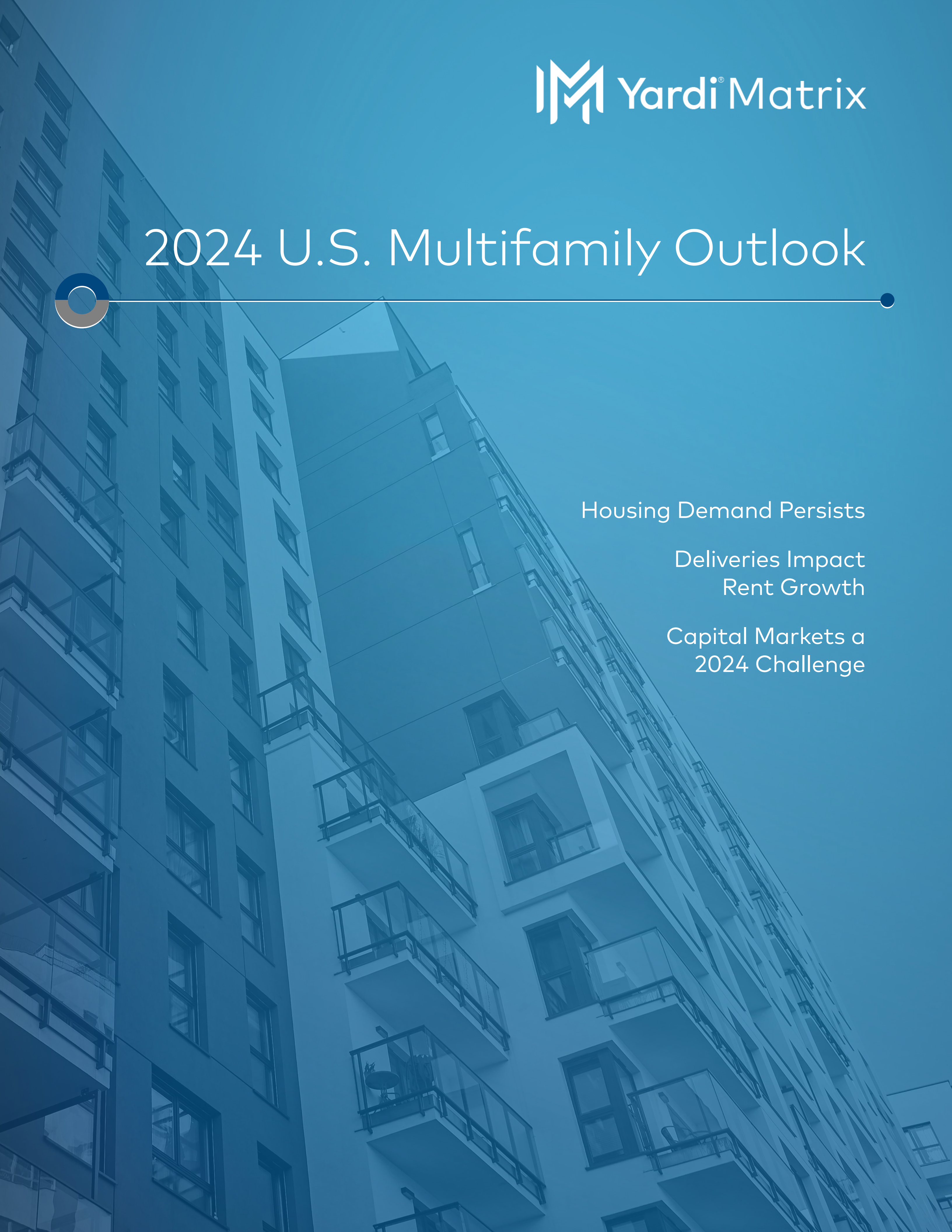

Yardi Matrix

2024 U.S. Multifamily Outlook

Housing Demand Persists

Deliveries Impact Rent Growth

Capital Markets a 2024 Challenge

Market Analysis
Winter 2024

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Multifamily Positioned Well, But Capital Markets a Challenge

- Multifamily faces a mixed outlook in 2024. Property performance remains healthy for most apartments, but challenges will come from a wave of deliveries, rapid growth in expenses, a potential economic slowdown, and the increase in mortgage rates.
- The U.S. economy has remained surprisingly resilient, helping to maintain strong demand for housing, led by robust employment growth and moderate gains in consumer spending. However, economic growth is likely to slow in 2024 due to the effects of a higher-for-longer interest rate scenario. For commercial real estate, that means a market reset with higher acquisition yields, higher financing costs, and lower leverage and values.
- We expect rent growth will be positive in 2024 but diminished by slowing absorption, supply growth and declining affordability after extraordinary gains in 2021-22. Growth will be led by metros in the Midwest, Northeast and smaller Southern and Mountain areas where demand remains consistent and deliveries are subdued. New York and Chicago will continue robust recoveries owing to strong demand and weak supply growth. Rapidly growing Sun Belt and West markets will see a temporary pause in rent increases due to the large number of units coming online, but long-term prospects remain bullish.
- Supply growth is at decades-long highs, with more than 1.2 million units under construction. Deliveries should top 500,000 units in 2024, with concentrations in rapidly growing markets in the South and West. However, the rise in construction financing is putting a lid on new starts, so 2024 is expected to be a peak year for deliveries.
- Multifamily expenses—particularly insurance but also labor, materials and maintenance—are rising rapidly. With income growth slowing, operating efficiency and cost-cutting will be focuses of the industry.
- Transaction volume fell by 70% in 2023 as falling values and rate volatility created pricing uncertainty. Activity is likely to remain weak in 2024, but could rebound later in the year if rate hikes have ended. Lenders are being cautious and borrowers are reluctant to lock in loans at high rates. Maturity defaults will be a growing issue as loans come due and properties qualify for proceeds that are less than the existing mortgages.

Economy: Still Standing

Heading into 2024, the U.S. economy has remained strong, consistently outperforming consensus forecasts of an impending recession. The rapid growth should slow in 2024, but even most pessimistic prognosticators have moved into the soft-landing camp. The economy has—defying most economic models—managed to maintain growth and nearly full employment while inflation decelerates.

The economy grew at a 2.6% pace through the third quarter of 2023, and the most recent GDP print came in at 5.2%. Through November 2023, the economy added 2.7 million jobs over the prior 12 months and 7.9 million jobs over 24 months. The unemployment rate was 3.7% in November and has been below 4.0% for 22 straight months. Corporate profits, more than $3 trillion in the third quarter, are near record levels. Meanwhile, the inflation rate subsided to 3.1% year-over-year through November, at 2.2% over six months, and the number is likely to continue falling in coming months when declining rent and shelter inflation are blended into the mix.

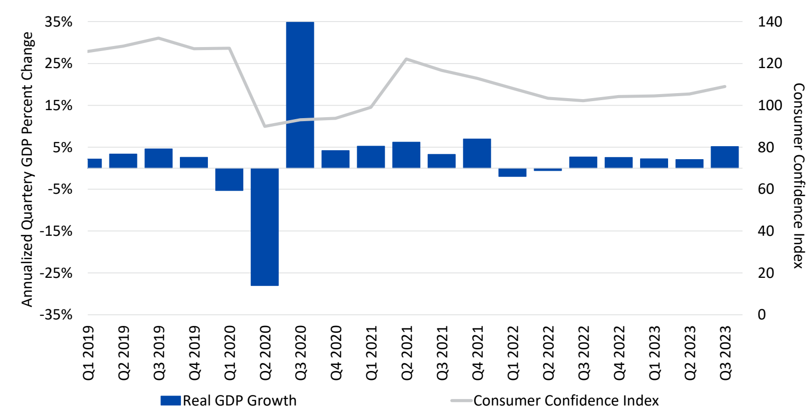
Key issues with the economy include whether the current trajectory is sustainable and how it impacts Federal Reserve interest rate policy. There are good reasons to expect growth to slow. The Fed increased interest rates by 525 basis points starting in the spring of 2022, and the impact on demand takes time to work through the economy. Though still strong, the labor market is showing signs of loosening. Job growth should slow as the number of able and willing workers shrinks due to lower population growth. And consumers may be worn down as excess savings dwindle and prices rise.

The health of consumers has been a major story in the recovery. Despite concerns that household budgets may be stretched, consumers are not acting that way. Personal consumption increased 3.2% year-over-year through October, and the increase was 4.3% excluding food and energy. Consumer debt is increasing, but measures such as debt relative to income or net worth remain healthy—certainly not at levels pointing to a recession. One reason is that millions of households and corporations locked in low-interest-rate mortgages before rates rose, providing homeowners with low debt-service costs and money left over to make other purchases.

Excess savings accumulated during the early part of the pandemic are wearing down, but given the levels of spending, they do not seem to be completely depleted. Higher rates provide a boost to savers, as dividend and interest income has increased over the last 18 months. Consumer confidence and attitudes about the economy also have been rising of late. While polls show concerns about the economy, most people report satisfaction with their personal financial situation.

The employment market is likely to weaken, but corporations are profitable and layoffs are low. Companies remain reluctant to cut workers because they might have a difficult time ramping up hires when business rebounds. Labor force partici-

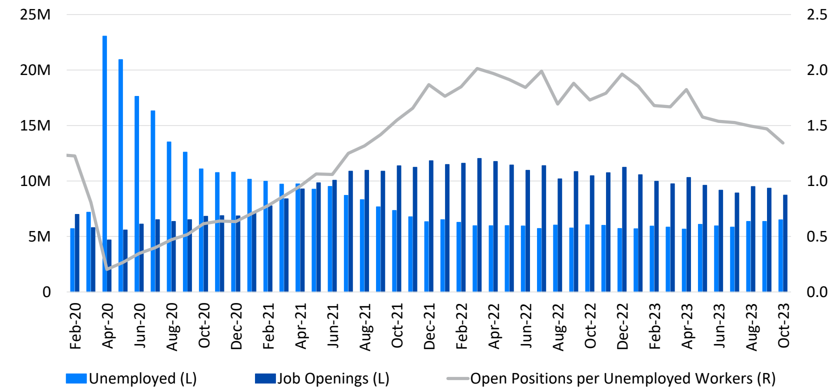
GDP Growth Surprises on Upside



Sources: Yardi Matrix; Moody's Analytics; U.S. Bureau of Economic Analysis pation was at 62.8% in Q3 2023, only 0.5% off pre-pandemic levels. With slowing population growth, it is an open question as to whether the country can find enough workers to maintain the pace of hiring, but work-from-home likely helps retain employees who otherwise would retire or quit.

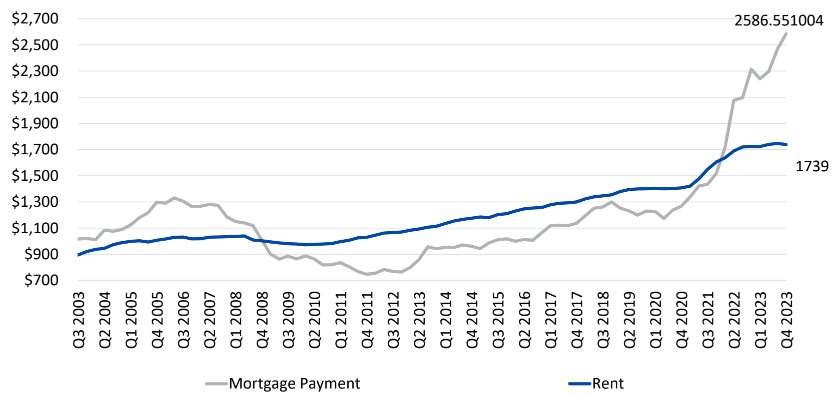
The increase in interest rates hasn't impacted all economic sectors equally. Staples such as groceries, restaurants, transportation, travel and health care are impacted less than rate-sensitive segments such as real estate. Home sales remain weak, and for-sale housing inventory is at historically low levels. Homeowners with low-rate loans are loath to sell homes, effectively leaving millions of families stuck in place. Whatever the impact on the single-family market, that does present a boost for multifamily by keeping some renters in place.

Labor Market Strong but Loosening



Sources: Yardi Matrix; Moody's Analytics; U.S. Bureau of Labor Statistics

Home Mortgage Payments Well Above Rent



Source: Yardi Matrix

The biggest economic question for the multifamily market is the direction of interest rates. While overall inflation remains just over 3% and above the Federal Reserve's 2.0% target, the Fed's preferred core measure that excludes energy and shelter was only 1.8% in November. As such, the conversation has changed from how high rates will go to how soon before rates start to go down. Multifamily players are hoping for a quick reversal of rate hikes, but they may be disappointed, as Fed chair Jerome Powell has made it clear he will wait until he sees a steady decline in the inflation rate.

That said, the direction of rates is likely downward, which could loosen some of the logjam in commercial real estate transactions. Since rates shot up in 2022, commercial property owners have been in a quandary. Without clarity about the direction of rates, decisions on buying, selling and refinancing become fraught with doubt, keeping deal flow at a standstill.

In all probability, interest rates are near their peaks, though it would be rash to declare anything with certainty, as it remains too soon to declare victory over inflation. Rates probably will remain flat for the first half of 2024, and modest cuts are likely in the second half of the year. Our expectations are that economic growth will be weak in 2024, with a soft landing the baseline likelihood, and that property owners should prepare for rates to remain higher than normal through most of the coming year.

Rents: Slow Growth Ahead

We expect demand for multifamily to remain healthy in 2024, but headwinds that include slower job growth, increasing supply and waning affordability in some markets will keep rent growth restrained again.

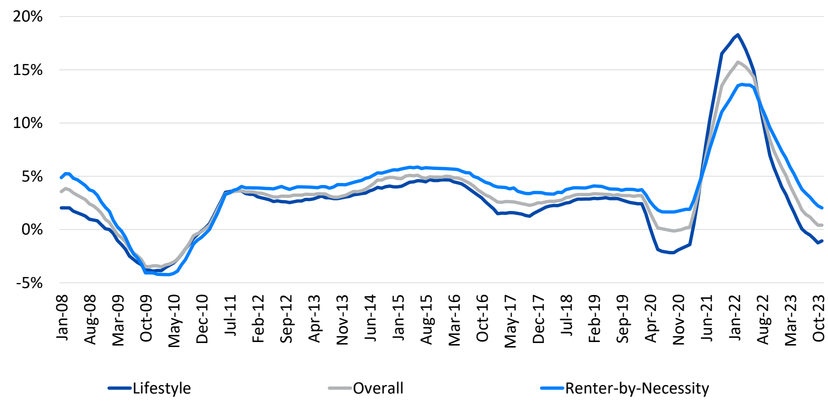
By now, the story is familiar. Coming out of the recession, rent growth surged to record levels as household formation rose sharply. Young adults left families and roommates, migrating to the Sun Belt and the suburbs. Rents rose a combined 23.5% nationally in 2021 and 2022. Rents inevitably decelerated in 2023, with year-over-year growth down to 0.4% through November 2023. After a record 600,000 apartment units were absorbed in the U.S. in 2021, absorption moderated closer to "normal" at about 200,000 in 2022 and 300,000 in 2023.

Many factors are boosting multifamily demand, even as the economy slows. One is the prevalence of hybrid-office work arrangements, which creates demand for renters to have their own spaces. Another is the weakness of the for-sale homeownership market. For-sale home inventory reached a multi-decade low in 2023, and homeowners with low-rate mortgages are effectively stuck in place. Mortgage rates should come down in 2024, but they remain at levels that put homeownership out of reach for some households. As of late 2023, homeownership was almost 50% more expensive than renting. Multifamily REITs report fewer tenants than usual are looking to buy homes.

Matrix forecasts a tepid 1.5% rent growth nationally in 2024 for several reasons. Perhaps the biggest reason is the growth in supply. Matrix forecasts 510,000 apartment units to be delivered in 2024, the highest number in decades. Occupancy rates slipped to 94.9% as of October 2023, which is healthy by historical standards but 1.3 percentage points lower than the peak in 2022. Renters have more options, given the growth in supply.

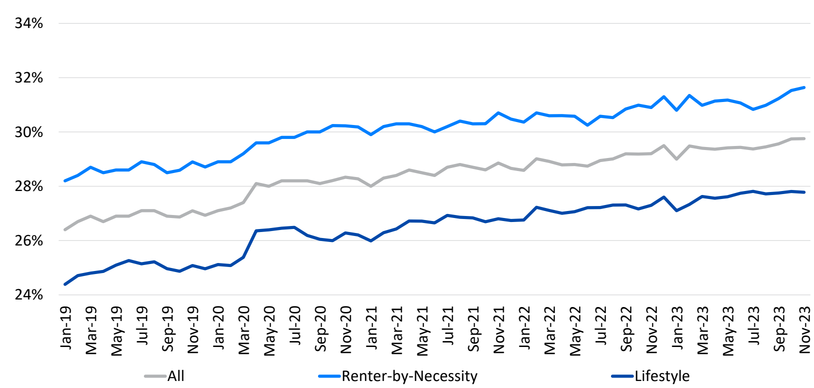
Another reason is affordability. The average rent-to-income level in the U.S. was 29.8% in November 2023, up 270 basis points since January 2020, just before the pandemic lockdowns. More evidence of affordability issues is that rent growth in high-end Lifestyle units, which soared to 18% year-over-year in early 2022 when demand increased, has turned negative

U.S. Multifamily Rent Growth Decelerating



Source: Yardi Matrix

Rent-to-Income Ratio at Multi-Year Highs



Source: Yardi Matrix

(-1.1% in November 2023). Meanwhile, demand and rent growth remain positive for working-class Renter-by-Necessity units, with rents up 2% year-over-year in November.

Multifamily performance, of course, is governed by local factors. Rent growth recently has been led by metros in the Midwest and Northeast. Though demand is only moderate in those regions, it is on par with or exceeds new supply. Plus, these markets did not see outsize rent growth during the post-pandemic period. We expect continued moderate growth in these markets. Our 2024 forecasts are led by Midwest metros, including Kansas City (2.0%), Columbus (1.9%), Indianapolis (1.8%) and the Twin Cities (1.7%).

Metros in the Sun Belt and West continue to experience in-migration from the coasts and job growth as businesses gravitate toward those areas, but rent growth is stalling due to a rapid increase in supply and declining affordability. Markets such as Austin, Nashville, Charlotte and Orlando continue to have robust job and population growth, but new supply is high, which means occupancy levels are dropping and renters have a greater number of properties from which to choose. Rents turned negative in some of these markets and may stay weak as demand catches up to supply and households digest the above-trend growth of recent years.

Some Western and coastal markets—such as San Francisco, Portland, Seattle and New York—are feeling the impact of slowing demand, cultural clashes and difficult regulatory regimes that put pressure on operators. Rent control leads to reduced supply as operators either avoid the markets altogether or decide to abandon units because renovations are more expensive than income from rent.

Expenses are an issue nationally, especially insurance. The average multifamily expense per unit rose 9.3% on a trailing 12-month basis through mid-year 2023. Insurance was up 19%, and even

2024 Forecast Rent Growth by Metro

Metro	YoY Rent Forecast 2024	Average Rent as of November 2023
Kansas City	2.0%	$1,258
Columbus	1.9%	$1,259
Indianapolis	1.8%	$1,233
Twin Cities	1.7%	$1,473
Nashville	1.5%	$1,634
Las Vegas	1.4%	$1,445
Philadelphia	1.4%	$1,726
Phoenix	1.3%	$1,583
Detroit	1.2%	$1,241
Houston	1.2%	$1,357
New Jersey	1.1%	$2,341
Raleigh - Durham	1.1%	$1,558
Charlotte	1.1%	$1,581
Dallas	1.1%	$1,540
Washington DC	1.1%	$2,118
Denver	1.1%	$1,903
Chicago	1.0%	$1,865
Seattle	1.0%	$2,162
Miami Metro	1.0%	$2,390
Portland	0.9%	$1,713
Baltimore	0.9%	$1,680
Los Angeles	0.9%	$2,570
Austin	0.9%	$1,643
San Diego	0.9%	$2,724
Tampa	0.8%	$1,795
Atlanta	0.8%	$1,657
Orlando	0.8%	$1,771
San Francisco	0.6%	$2,754
Boston	0.6%	$2,763
New York City	0.3%	$4,413

Source: Yardi Matrix

more in the Southeast and other areas with a large number of weather-related payouts. Labor, materials and maintenance are also rising at above-trend levels. For 2024, we expect demand and rents to increase moderately. As rent growth remains weak, successful operators will focus on maintaining occupancy and getting a handle on expense growth.

Supply: Boom While It Lasts

The multifamily market responded to the surge in demand and rent growth in recent years by ramping up the pipeline. As 2024 starts, some 1.2 million apartment units are under construction, the most since the suburban garden apartment boom of the 1980s. Yardi Matrix expects roughly 510,000 units to be completed in 2024, with new supply beginning to decline in 2025 to a still-sizable 450,000 units and bottoming in 2026 at around 375,000 units.

The growth in supply is both needed and an impediment to rent growth in the short term in some markets. Housing construction plunged in the wake of the 2008 recession, and even though supply is rebounding, the U.S. is short several million units, according to housing experts.

New construction is heaviest in Sun Belt and Western markets that have been targeted for migration and corporate job growth. Metros that could see deliveries in 2024 that total more than 5% of total stock include Austin (forecast to have 26,948 units delivered), Raleigh (14,611), Charlotte (15,178), Miami (22,796), Nashville (9,902), Denver (16,583) and Phoenix (17,788).

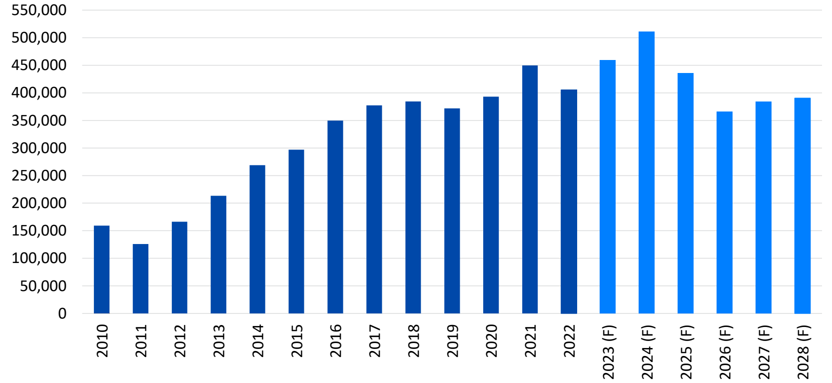
Both recent and forecast population growth in all of these metros supports the need for housing supply, but at the same time it could depress rent growth in the short term. As of October 2023, occupancy rates nationally were 94.9%, down 1.3 percentage points nationally since the peak in mid-2022, and even more in some of the high-supply markets. It will take some time to digest the new supply, which means longer lease-up times for new properties and an increase in concessions, but long-term demand trends remain favorable in these high-growth regions.

Many smaller markets located mainly in the Midwest and Northeast have also seen 2023 construction activity hold up or expand compared to 2022. For example, Baltimore's 3,218 units represent a 139% increase over 2022 levels. The New York City boroughs of Brooklyn (up 38%), Manhattan (57%) and Queens (87%) all recorded increases in activity. New construction also expanded in Huntsville, Ala. (168%), suburban Chicago (103%) and Kansas City (26%).

Larger markets that have recorded a notable decline in activity in 2023 compared to 2022 include Salt Lake City (-47%), suburban Atlanta (-45%), East Houston (-42%), Seattle (-41%), Austin (-39%), suburban Dallas (-35%) and Denver (-31%). Several large markets have recorded only a slight decrease or an increase in new construction. Phoenix is only down 3%, while Raleigh-Durham increased 46%, Tampa-St. Petersburg 58%, Boston 31% and the North Dallas market 47%.

New construction starts are dropping rapidly due to the problematic financing environment and difficulty

Multifamily Supply to Peak in 2024



Source: Yardi Matrix

2024 Forecast Supply Growth by Metro

Metro	2024 Forecast Deliveries	2024 Forecast Deliveries as a % of Stock
Atlanta	19,610	3.8%
Austin	26,948	9.5%
Baltimore	2,956	1.3%
Boston	6,548	2.5%
Charlotte	15,178	7.2%
Chicago	6,859	1.7%
Columbus	4,761	2.5%
Dallas–Ft Worth	39,034	4.5%
Denver	16,583	5.3%
Detroit	2,991	1.4%
Houston	21,210	3.0%
Indianapolis	4,935	2.8%
Kansas City	4,541	2.7%
Las Vegas	3,952	2.2%
Los Angeles	11,108	2.3%
Miami Metro	22,796	6.4%
Nashville	9,902	5.6%
New Jersey	14,198	3.5%
New York	17,304	2.9%
Orlando	11,223	4.4%
Philadelphia	8,241	2.3%
Phoenix	17,788	5.1%
Portland	6,042	3.4%
Raleigh	14,611	8.1%
San Diego	4,026	2.0%
San Francisco	5,446	1.9%
Seattle	12,717	4.4%
Tampa–St Petersburg–Clearwater	9,910	4.0%
Twin Cities	8,205	3.3%
Washington DC	12,162	2.1%

Source: Yardi Matrix

making deals pencil as rent growth slows and construction materials, land and labor become more expensive. Construction loans are more difficult to arrange as commercial banks try to reduce exposure to non-cash-flowing assets and commercial real estate. Debt funds are lining up to do deals, but at terms that are not appealing to most borrowers.

The increasingly long lead times required to start new construction most likely explain 2023's surprising new development persistence. A continued unfavorable financing environment combined with robust new-supply deliveries in 2024 that will extend into mid-2025 should materially depress construction starts in all markets in 2024. This suggests new supply will moderate after 2024.

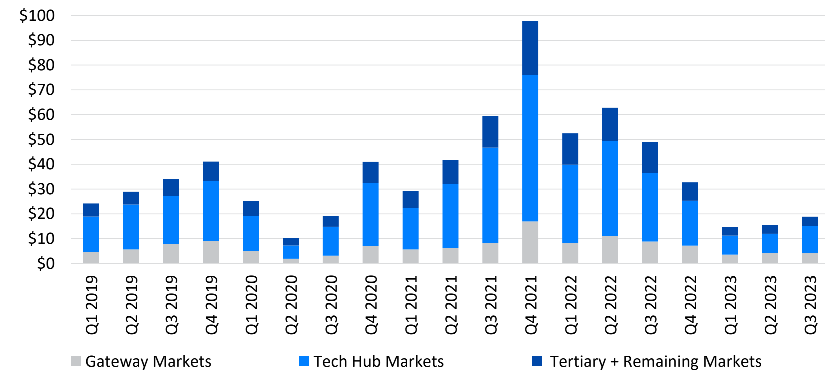
Capital Markets: Tread With Caution

While multifamily fundamentals remain solid, there is no hiding from the impact of higher interest rates. Property sales have slowed, and debt is less available and more expensive. Deal flow will remain sluggish until rates stabilize, whatever the level may be. Price discovery will be difficult until volatility wanes.

The drop in property sales has been dramatic, coming after a record-high $228.3 billion of multifamily sales in 2021 and $196.9 billion in 2022. Through November 2023, only $57.6 billion of multifamily sales were completed nationally, a 70% year-over-year drop. The main reason for the lack of transaction activity was not liquidity but the impact of interest rates and pricing uncertainty. Property values are down, but buyers and sellers can't agree on how much.

Apartment values have dropped in public and private indexes. Through mid-December 2023, apartment REIT values were down 5.2% year-over-year, with a 1.9% annual return over five years, according to the NAREIT Equity REIT Index. Apartment returns in the core fund National Council of Real Estate Investment Fiduciaries Property Index were -7.8% year-over-year through 3Q 2023, with -11.1% appreciation. However, property values are more likely down a greater amount—20-30%—based on the increase in capitalization rates.

Sales Volume Drops Amid Uncertainty



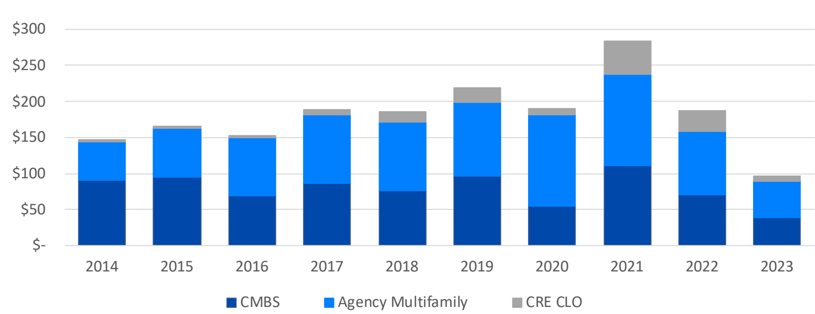
Source: Yardi Matrix

Investor demand for multifamily in the low rate environment through early 2022 led to record-high sales volume and cap rates of 4% or less for stable assets, and in the 4.5-5% range for value-add assets. But with the 10-year Treasury around 4.5% and the floating-rate index SOFR over 5%, mortgage coupons start at 6% and most are higher.

How much the increase in interest rates is affecting cap rates is not yet clear. History shows there is not a one-to-one correlation in the short term since investor views of future income growth is a key input. Investors are willing to shave risk premiums when they expect rent growth to increase. That said, today rates are up and rents and net income growth are slowing, which means investors are likely to demand a higher premium above mortgage rates. With interest rates likely to remain in the 4-5% range through at least the middle of 2024, deal flow is set to remain sluggish.

Debt capital is also constrained. While some lenders are out of the market or cutting back, the lack of debt is more a function of pricing than liquidity, as borrowers do not want to lock in high rates unless necessary. Lenders are reducing leverage and fixating on debt-service payments and borrowers' financial wherewithal. Five-year fixed-rate loans are popular.

CMBS, Agency Volume Down in 2023



Source: Commercial Mortgage Alert; 2023 Data Through December 2023

The government-sponsored enterprises Fannie Mae and Freddie Mac remain the best source for multifamily debt, but they are lending less. Fannie and Freddie securitized a combined $50.4 billion of loans in 2023, down from $87.5 billion in 2022 and $127.9 billion in 2021, per "Commercial Mortgage Alert." Recognizing that demand for loans will be weak, the GSEs' regulator, the Federal Home Finance Agency, reduced the 2024 allocations of Fannie and Freddie to $70 billion apiece, down from $75 billion in 2023 and $78 billion in 2022. Fannie and Freddie can still originate an unlimited number of loans that meet their mission criteria of supporting affordable housing.

Other lenders also have issues. Large money-center banks are limiting exposure to commercial properties at the behest of regulators, and also have less free capital, since many loans are being extended rather than getting paid off. Many regional and local commercial banks are cutting back on mortgages because they already have an outsize exposure to commercial properties.

CMBS and collateralized loan obligation programs are willing to lend but at very high rates, which makes them less competitive to borrowers. Combined CMBS/CLO volume fell in 2023 to $46 billion, 54% below the 2022 volume of $99.3 billion, per CMA. Private equity shops have raised tens of billions of dollars for debt funds that they are willing to deploy, but also at rates and terms that most borrowers would prefer to avoid. Private equity is increasing market share of construction lending at the expense of commercial banks.

Tapering liquidity is not the most pressing problem multifamily owners face. As property values reset lower, multifamily loan defaults are rising. How much is a subject of hot debate. Currently, multifamily defaults remain rare. The multifamily default rate as of November 2023 was 2.5% for CMBS, according to Trepp, and below 1% for other types of lenders.

The issue for borrowers is not a lack of cashflow to pay current debt service, but that many will be subject to maturity defaults as low-interest-rate loans come due and properties qualify for lower proceeds at higher interest rates and reduced leverage. In particular, defaults will be concentrated in the cohort of value-add properties acquired with short-term loans between 2020 and early 2022. Those properties have not had the benefit of years of cash flow growth, and also face the steepest increase in mortgage rates.

Not every underwater loan will default, though. Banks are likely to work with owners of properties with strong occupancy and cash flow and a willingness to put up additional reserves or pay down loan principal. The market-wide capital restructuring process should take years to complete.

Year of Challenges

Although property fundamentals are likely to hold up in 2024, multifamily faces a number of challenges that include maintaining occupancies in a slowing economy, putting a lid on expense growth and dealing with more expensive and less liquid capital markets. We are no longer in a rising-tide-lifts-all-boats market. The traditional property acquisition pipeline will likely remain stalled through most of the year, so near-term opportunities will be concentrated in debt investments and providing capital for property restructurings. The challenges are not insurmountable for owners with a long-term perspective, but they will take skill and expertise to navigate.

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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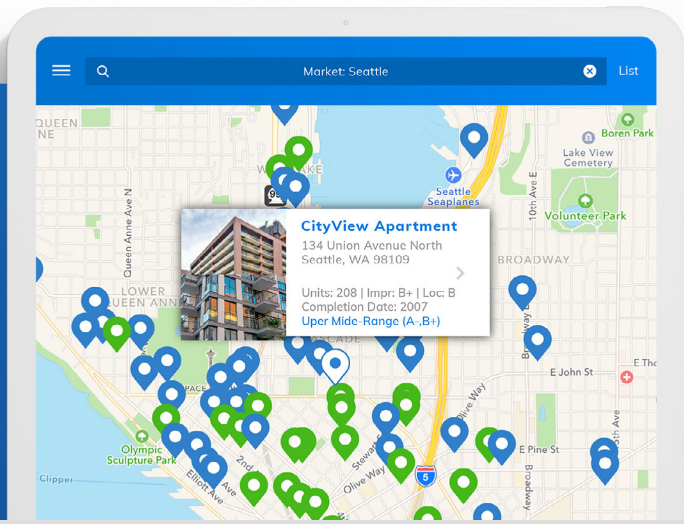

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