GDS

From 2022 to 2023

The state of multifamily real estate

Table of contents

Preamble

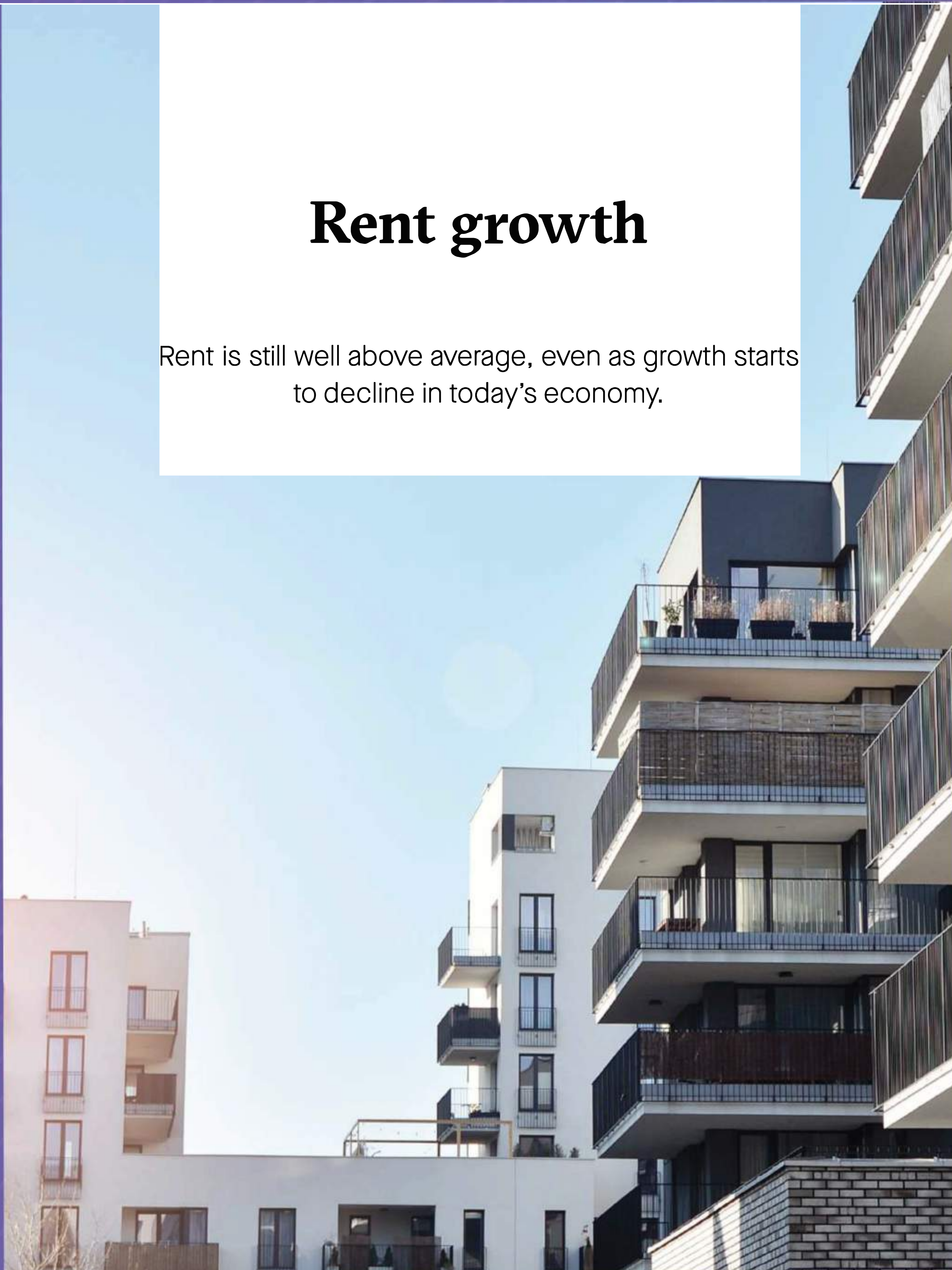
The multifamily market has seen tremendous growth in the last few years—driven by increased demand from renters, investors, and local governments looking to take on affordable housing. Renting is at the highest level in half a century. There are a total of 43.7 million renters now in the market, with more to join as mortgage interest rates rise (Rent Cafe). However, as the pandemic-inspired shuffle slows down, supply chain issues become the norm, and inflation heats up, the market is changing.

Looking into 2023, we're seeing a new type of forecast. One that is driven by growth but stifled by its own demand. The exponential potential we've come accustomed to lately may be behind us but the market is strong. In this report, you'll learn what this means for operators, renters, and the industry as a whole. You'll have access to the data but also recommendations based on our time working with partners who own and manage over 6 million rentals across the United States.

It's a great time to be in the multifamily business. Together we can make a difference in the lives of our renters—because everyone deserves a safe home.

Rent growth

Rent is still well above average, even as growth starts to decline in today's economy.



Rent growth

In June 2022, median US rent rose to above $2,000 a month for the first time ever. However, as we enter into the new year, it's clear that the accelerated rent growth the market saw during the height of the pandemic has ended for most regions—with the exception of the Sun Belt where markets in Florida, North Carolina, and Tennessee are still seeing strong growth above 10%. Here's what the data is showing: (Multihousing News)

The current state of the industry

Rent growth drops, but is still well above average

In September 2022, rent growth fell below 10 percent for the first time since July 2021. While we're still well above the average monthly rent growth, this downward trend is new and partly the result of the cooling economy and the Federal Reserve's actions to curb inflation (Multihousing News).

There are now more renters than homeowners

Renting is now at the highest level in half a century. There are over 43.7 million households currently living in single-family and multi-family rentals.

Renters have now surpassed homeowners in 41% of zip codes in the 50 largest US cities (RentCafe).

Lease renewals are increasing across the US

In August 2022, year-over-year renewal increased for the first time since February, up more than 60 basis points.

Meanwhile, year-over-year renewal rent growth was up 50 basis points—which is an 18.3% rise since March 2020.

This means that more renters are staying put for another year, even with rises in rent prices (Multihousing News).

Demand is high, but trending toward "normal"

In 2021, we saw record demand for rental units. Over 600,000 were absorbed nationally, fueled by consumer savings collected during the pandemic, a rebound in jobs, and the increase in the average wage. These extra funds helped renters form more households.

However, this year, multifamily absorption has dropped to 223,000 units. This puts it closer to the values that are deemed as "normal" (Multihousing News).

How to take action

Add amenities to reach new renters, especially the Gen Z and 65+ age group

The rental market will change significantly in the coming years due to the newest generation entering the market and the rise of the 65+ age group—of which 1 in 5 Americans will be a part of by 2030.

Investing in amenities, as well as leasing and rental methods that matter to these groups will help edge out the competition in both the short and long term.

Top amenities and programs for Gen Z renters include good digital connectivity, lower upfront move-in costs, and shared spaces.

Meanwhile, the 65+ population is interested in maintaining the standards they've had in their homes in the past—two sinks, washer and dryers, private outdoor spaces (NAAHQ).

Invest in properties in secondary markets

Between huge demand/low supply of homes for sale in major cities and the shift to remote work, consumers are migrating to secondary markets. This has led to increased demand in areas that have fewer than 20,000 units available—like Madison, WI, and Fayetteville, AR.

Occupancy rates and rental growth in these areas are some of the highest in the US, and construction costs are lower than in major cities, making them a great investment for multifamily operator portfolios (Connect CRE).

Hot market alert!

Miami-Dade County tops the list as the nation's most competitive apartment market.

Inflation

From 1960 to 2021, US inflation averaged 3.8% per year. In 2022, the inflation rate has reached 8.5%. This is the highest rate the nation has seen in over four decades. The federal reserve has been increasing interest rates to try to give some relief to consumers, but the effects of the historic increase on the multi-family industry are already being felt. However, it's possible that help is on the way. Here's what the data shows (Forbes).

What the data shows

Rent has risen above inflation and will likely continue to grow

Over the last five years, the cost of all goods and services increased by 16% due to inflation. However, rent has risen even further and faster, rising by 18%.

It's likely that this annual growth will continue out-growing inflation, the stock market, and home values (Pew Research).

Inflation is hitting hardest in the suburbs

After a year of the pandemic, suburban rent growth has exceeded core city rent growth by 4.8%. After two years, the gap has widened and is now 6.6% (Apartment List).

The government is getting involved

On Aug. 16, 2022, President Biden signed the Inflation Reduction Act (IRA) of 2022. This act includes $1 billion in total grants to help states adopt recent residential and commercial building energy codes and $837.5 million for HUD to provide grants or loans to affordable housing properties that include certain energy-efficient or sustainable building features.

It also includes just over $3 billion in funding for state and local governments to improve neighborhood access and equity, including infrastructure improvements and anti-displacement policies (Multifamily Dive).

How to take action

Keep a close eye on cash-flow

Having as much cash on hand as possible during times of high inflation is a necessity. One way you can increase your access to cash flow is by offering GDS's security deposit insurance to your renters. With GDS, you can make claims for what a traditional deposit covers and see reimbursement within 4 days on average, even mid-lease. Plus, your renters save on move-in costs by 90%.

Create new opportunities for income

With high inflation, comes high operational costs. To offset these costs and increase revenue per unit, think beyond rent. Try offering on-site services, like rentable co-working spaces, cost-sharing services, like dog walkers, or bulk-purchased services, like high-speed internet, and car sharing opportunities.

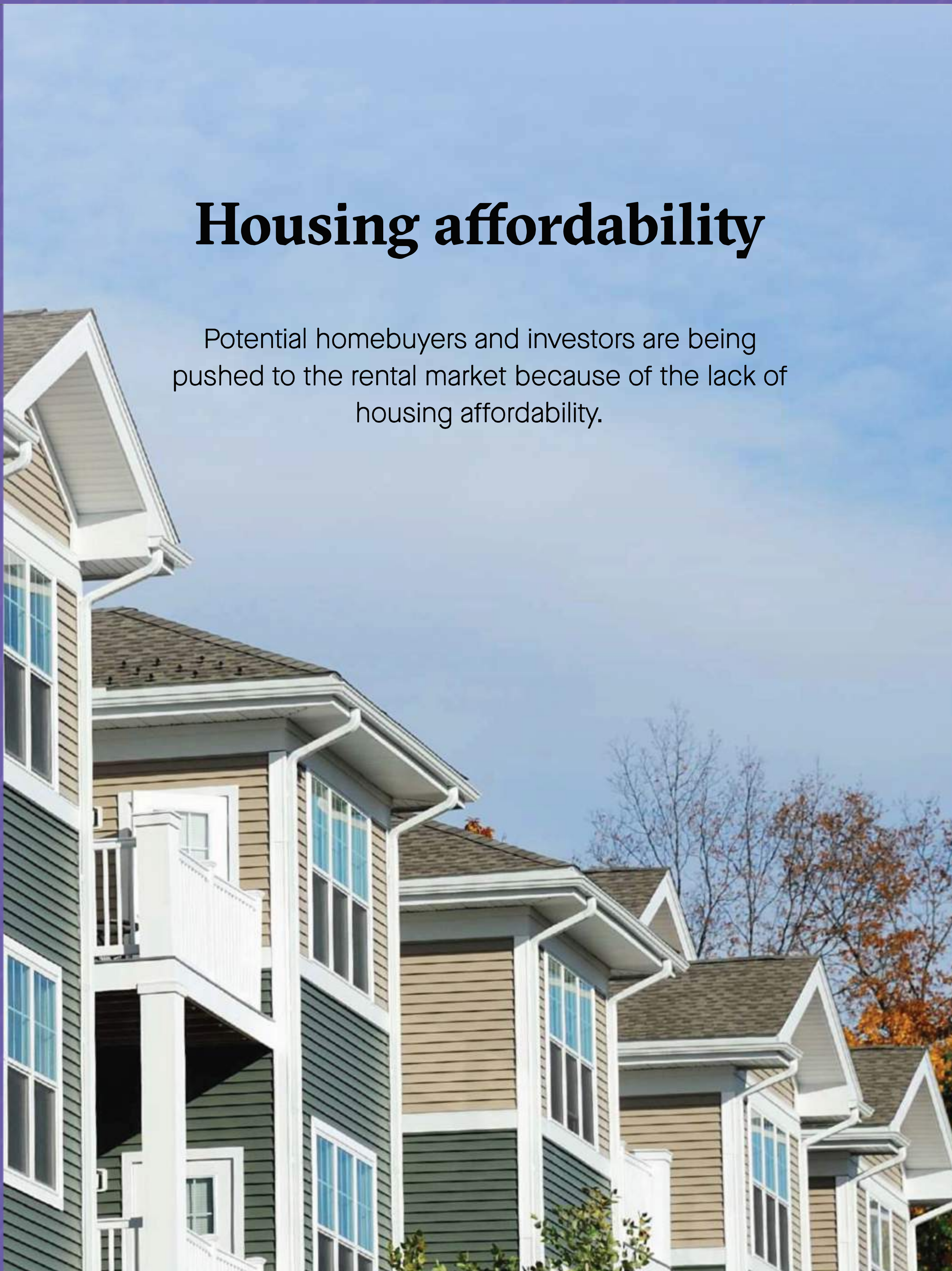
Expert opinion

"We estimate that since March 2020, rents have increased by an average of 19.8% in the core cities of large metros, while the suburbs of these metros have seen rents spike by 27.2%."

— Chris Salviati and Rob Warnock, Apartment List

Housing affordability

Potential homebuyers and investors are being pushed to the rental market because of the lack of housing affordability.



Housing affordability

The pandemic, inflation, and supply chain issues have exasperated housing affordability issues in the US. We're now seeing housing affordability rates worsen to levels not seen since early in the 2000s financial crisis (Bloomberg). The Biden administration is stepping in with the Housing Supply Action Plan.
In the meantime, potential homebuyers (and investors) are being pushed into the rental market instead. Here's what the data shows.

By the numbers

The median home is expected to cost **$464,000** in 2023.

The median home in 2020 cost **$383,000.**

Where are priced-out buyers going? **To rentals** (Fannie Mae).

Home buyers are holding off on purchasing and going with renting instead

When mortgage rates hit a record low of 2.65% in January 2021, buyers flooded the market. As of October 2022, rates are now closer to 6.66% and many buyers are holding off on purchasing new homes (NMHC).

The rental market is experiencing pressure from the lack of housing affordability

According to S&P Global Ratings, it will now take 11.3 years for a first-time buyer with median income to save for a 10% down payment, and twice as long for 20%. Before the pandemic, each took half as long (Bloomberg).

The US is experiencing a massive decline in affordable apartments

As housing costs have increased, 6.95 million owned housing units priced less than $200,000 were lost between 2015 and 2020. There were also an estimated 4.7 million rental units with rents less than $1,000 per month lost (NMHC).

How to take action

Offer flexible payment for renters

When asked in October 2022, nearly 50% of Americans said that they felt their financial health was bad (AP News). This, matched with a lack of affordable housing, has left renters behind on rent. Offering flexible payment options helps to elevate this burden and keep your units occupied.

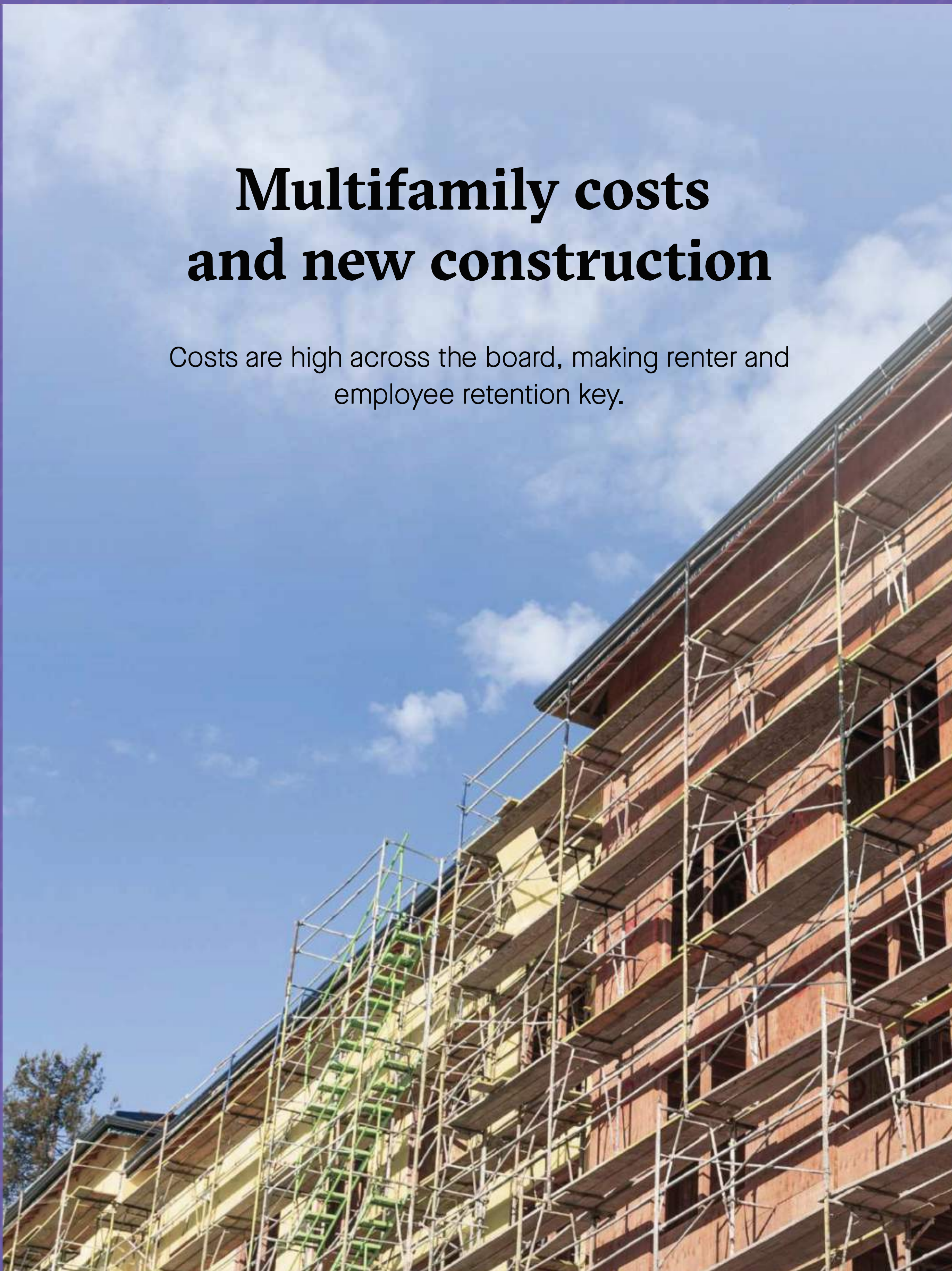
Expert opinion

“When interest rates are higher, people are more likely to rent.”

— Kia Crooms, Area Vice President at Morgan Properties

Multifamily costs and new construction

Costs are high across the board, making renter and employee retention key.



Costs

Costs to develop, build, and maintain multifamily properties are rising. Meanwhile, so is the demand for units. It's unlikely that the US will have the single-family housing inventory it needs for years, so the industry, government, and consumers will turn to multifamily. This means that while costs are up, investments are worth it—if done right. Here's what the data shows (Forbes).

Costs are up across the board

Everything from building materials and supplies to maintenance and repairs to payroll are more expensive for multifamily property operators now (Multifamily Executive).

Insurance and property taxes are rising

Inflation, supply chain issues, labor shortages, climate change risk, and offsetting financial losses from the pandemic have all contributed to most properties seeing insurance premiums jump anywhere from 20% to 40% in 2021 (Multifamily Executive).

The industry is still seeing a great resignation

Annual employee turnover used to be around 30-50%. However, in 2021 some evidence showed the numbers were closer to 70%. This included many of their most experienced property managers and maintenance personnel. The industry is still seeing record-high movement (Multifamily Executive)

Expert opinion

"The multifamily industry has used essentially the same [staff] headcount per 100 units for 40 years. Meanwhile, the workload has increased significantly."

— Melanie French CPM, SPHR, Managing Principal, DLP Capital

How to take action

Take employee retention seriously

Burnout across the multifamily sector is real. Property managers and operators are leaving jobs for more money, flexibility, and recognition. By taking these concerns seriously, your investment in your staff will mitigate costs in the long run.

Focus on renter retention to minimize costs for marketing and advertising

It can cost, on average, $5,000 to get a new renter into a property. Own 100 apartments? That's $500,000 a year. By focusing specifically on renter retention, you're able to cut costs and keep your NOI high.

New construction

While costs to build are rising, demand for multifamily units continues to climb. This means new construction is needed and fast, even at extra cost. Unfortunately, multifamily projects typically have longer lead times than single-family homes and construction will slow in 2023 due to costs, inflation, and interest rates (Forbes). Here's what the data shows.

Demand for multifamily units is increasing as the nation experiences a serious undersupply

Demographic growth is expected to generate demand for another 3.7 million new rental properties with 5 or more units through 2035 (NMHC).

To keep up with the increasing demand for rentals, builders have used Q3 2022 to shift to building multifamily. In fact, multifamily starts are at the highest level seen in years (Zillow).

Meanwhile, the number of units completed has been lower than the historical average for over a decade. That problem is exacerbated in the most sought-after areas of the US (Infogram).

Developers are experiencing construction delays due to rising costs

Even with rising needs, new construction growth is slow. In June 2022, 97% of apartment developers reported experiencing construction delays. Of those experiencing overall delays, 83% reported delays in permitting and 93% reported delays in starts (NMHC).

Construction is mostly on upper levels of the market leading to more unaffordability

During the pandemic, supply costs rose—some nearly quadrupling in price. For example, wholesale prices for plywood increased from $400 to $1500 per thousand square feet at the height of the Pandemic (USDA).

While these prices have come down, inflation has stopped them from coming down to pre-pandemic levels. This means that the new supply of construction is more expensive and only focuses on the upper levels of the market which is already unaffordable to many renters (NMHC).

How to take action

Focus on markets that need the support

According to the National Apartment Association, out of the 1.5 million new rental units built since 2014, 32% are located in just three states: California, Texas, and Florida. They found that these three markets account for 44% of new supply needed or 1.5 million of the 3.4 million new units needed to meet demographic growth by 2035 (NMHC). When looking at opportunities for new constructions, focusing on these markets will help ensure housing is available.

Look into alternative buildings before new constructions

Using historically preserved buildings, like banks, offices, and schools, as the foundation for builds saves costs and time. It even may come with rewards from local governments, as the renovations can help to revive communities. For example, designated properties in a historic district or individually listed in the National Register of Historic Places (NRHP) are eligible to receive Federal and State Historic Tax Credits. Combining these tax credits allow qualifying rehabilitation work to receive up to 45% towards the cost of qualifying rehabilitation works (Globest.com).

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