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VIEWPOINT
U.S. MULTIFAMILY

Multifamily's Recovery From COVID-19 2020 and Beyond

Nathan Adkins
Sr. Economist
Jeanette Rice
Research Director | Multifamily

EXECUTIVE SUMMARY

- Multifamily fundamentals are projected to follow a similar shape as the U.S. economy over the next two years: a sharp downturn followed by a quick recovery.
- CBRE Econometric Advisors (EA) expects the multifamily market to bottom in Q4 2020 and commence its recovery path in Q1 2021.
- Vacancy is expected to rise 3.1 percentage points from Q4 2019 (4.1%) to Q4 2020 (7.2%) and fully recover one year later.
- Rents are projected to drop 8.1% in 2020 and fully recover by Q1 2022.
- Multifamily entered the COVID-19 pandemic with strong momentum. We expect that momentum to contribute to a quicker recovery than experienced in the last recession.

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HOW WILL THIS CYCLE PLAY OUT?

Q2 2020 has been challenging for the U.S. economy, the multifamily market and, of course, for renters. The impact of the COVID-19 pandemic continues to evolve daily. Uncertainty looms large in the near term, as states lift stay-at-home orders and begin to reopen their economies. Assuming the virus is adequately contained, and there are no further shocks to employment, a rebound to the multifamily market and renters' financial health are likely to rebound in the medium-term.

EA recently completed new forecasts for the multifamily market. The forecasts provide a roadmap for the most likely trajectory of the sector's recovery. The forecast suggests that multifamily's 2020 downturn will be shorter than either the Dot Com Bubble or the Great Financial Crisis (GFC). This outlook may provide only partial comfort for the multifamily industry, which is experiencing a downward trend in fundamentals. However, the cycle will turn and recovery is expected in the not-so-distant future.

COVID-19 AND THE MACRO ECONOMY

COVID-19 has taken an historic toll on U.S. employment. The shock to employment was quick and brutal. From February to April, the U.S. shed 25 million jobs as businesses closed and citizens sheltered in place to halt the spread of COVID-19. The unemployment rate surged from a 50-year low (3.5%) in February to levels not seen since the Great Depression (14.7%) in April.

Recently, April shocks have given way to May and June green shoots, as the economy finds its footing amidst the constantly evolving COVID-19 pandemic. Though U.S. unemployment hit 14.7% in April, it shrank to 13.3% in May, before stay-at-home orders were even lifted in most states. Month-over-month payroll changes show people are coming back to work in many industries, including accommodations and food services (+1.22 million), construction (+464,000) health care (+391,000), and retail trade (+368,000).

Meanwhile, consumer sentiment is exceeding expectations, and high-frequency data – such as hotel occupancy, plane travel and restaurant reservations – indicate that activity is still low but rising.

EA's Baseline outlook is that U.S. employment will recover in two years. This "house view" is the most likely scenario given the current coronavirus outlook, employment trends and stimulus policies.

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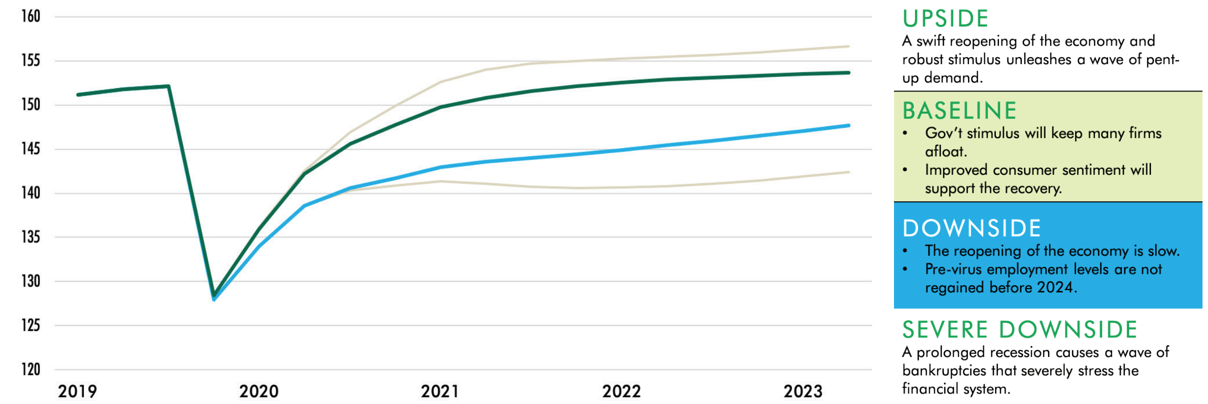
FIGURE 1: CBRE's Current Forecast Scenarios on U.S. GDP



Source: CBRE EA, Oxford Economics Q1 2020.

While EA has strong confidence in a broad V-shaped recession and recovery beginning in Q1 2021, there is uncertainty around the severity of the downside, the pace of recovery, and the likelihood of future employment shocks. The multifamily market is susceptible to these macro risks, as renters make household decisions based on the likelihood of future employment, choosing to take roommates, downsize or move home to hedge against labor market risk.

MULTIFAMILY PERFORMANCE IN COVID-19 PERIOD

Multifamily leasing, like most economic activity, froze at the outset of COVID-19 in March from the economic shock and the stay-at-home mandates. With implementation of virtual tours and other technologies, by late April, leasing activity was regaining momentum. Still Q2 multifamily demand is expected to come in negative with more residents moving out than moving in.

The CARES act, the largest federal fiscal stimulus package in U.S. history, has helped maintain stability in the multifamily market through direct cash transfers, enhanced unemployment benefits, and business loans. These stimulus measures, along with eviction moratoriums and rent deferment plans, have held vacancy to a modest increase of 30 basis points (bps) from March to May.

Also helping to bolster the market is higher-than-usual retention. Residents are holding on to their apartments, hunkering down to wait out uncertainty in the labor markets. Lease re-signing rates are high, with most residents re-signing for the same rent they paid in 2019. But, with fewer people moving into new units, the average effective rents for renewals and new leases fell 1.7% from March to May.

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Stress on the multifamily markets varies by locale and product characteristics. Class A properties are experiencing higher rent declines and more concessions. Many renters with loss of income or employment uncertainty have or will seek alternative housing arrangements, such as living with family or friends. Class C properties are experiencing more collections-related stress due to the preponderance of losses of hourly wage jobs.

Geography plays a role in market stress as well. With health care concerns leading to vastly reduced travel, metros with large tourism and hospitality industries (Las Vegas, Orlando) are acutely impacted. These labor and multifamily markets face more uncertainty and longer recovery times.

Metros which were high growth pre-COVDI (San Jose, Seattle, Nashville) showed above average stress in Q2 which will carry over into Q3. These markets have more interconnected labor markets with more downstream job losses, higher rents with more room to compress following years of growth, and high numbers of recent completions missing out on the typical spring leasing boom. Though market fundamentals in these high-growth metros are compressing more in the short-term, the markets will also bounce back quickly, and return to high-growth trajectories post-recession.

	LESS STRESS	MORE STRESS
CLASS	Rent collections: Class A Effective rent movement: Class C	Rent collections: Class C Effective rent movement: Class A
NEW	Stabilized assets	Properties in lease up
LEASE STRUCTURE		Corporate units, short-term rentals
URBAN/ SUBURBAN	Suburban	Urban
OTHER GEOGRAPHY	Markets based on more "durable" industries – tech, business & professional services, government Markets with less seasonality Regionally, Midwest and Mid-Atlantic, Northeast markets Smaller metros	Markets with high % of jobs in industries hardest hit (e.g., tourism/ hospitality) Formerly high growth, dynamic markets (critical: spring leasing and in-migration, also impacted by new supply) More stressed by coronavirus, high cost of living and/or politicized (i.e., New York, Southern California) Large student population

COVID-19 is also impacting multifamily revenues in ways beyond rents and vacancy and creating financial stress. This report does not address loss of fee income, income from amenities, credit defaults or other ways that properties are being impacted by the downturn.

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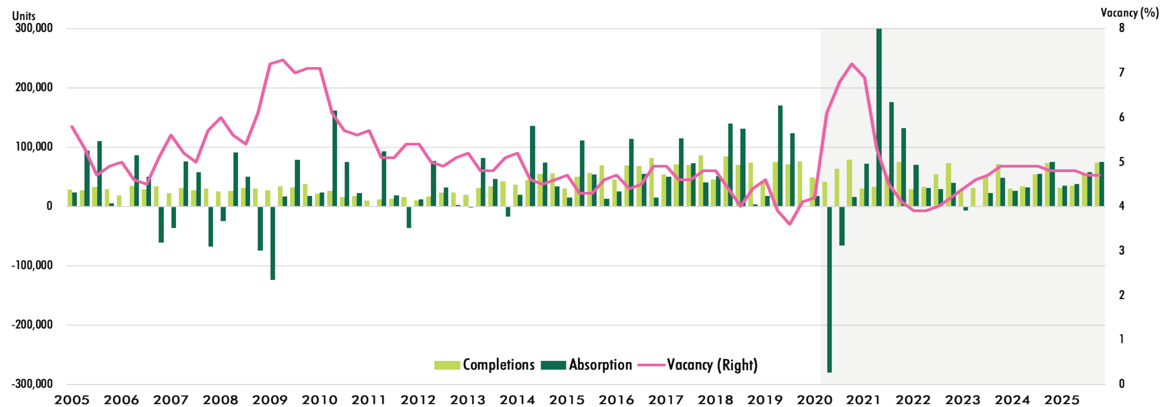
MARKET FORECAST

EA expects multifamily rent and vacancy to bottom out in Q4 2020, and then rebound fairly quickly through 2021. The U.S. market should return to its pre-COVID levels by Q1 2022, buoyed by pent-up demand and sustained preferences for metropolitan apartment living.

We expect absorption to slow with the economy in the near term, as residents wait out employment uncertainty, and then to spring back in 2021 when that pent-up demand is released. Policy intervention will likely smooth extreme points in the absorption forecast, allowing more economic activity in the short term, and relieving some pent-up demand in the medium term. We're already seeing signs of this smoothing, with recent evidence suggesting vacancy rates are holding up better than expected.

Supply is expected to remain relatively uniform. Current construction delays have been built into the forecast, but as 2020 was expected to see peak completions, these delays have merely reduced new units to levels comparable to recent history (260,000 in 2019 compared to 230,000 in 2020). These new units are putting more downward pressure on rents in some markets near term, but should be easily absorbed steadily by the oncoming pent-up demand in 2021.

FIGURE 2: Supply and Demand Forecast



Source: CBRE EA, RealPage Inc, Dodge Data & Analytics, Q1 2020.

In a year-over-year comparison, rent is projected to bottom out in Q4 2020 at 8.1% below Q4 2019. Vacancy is expected to reach 7.2% by the end of 2020, up 3.1 percentage points from Q4 2019.

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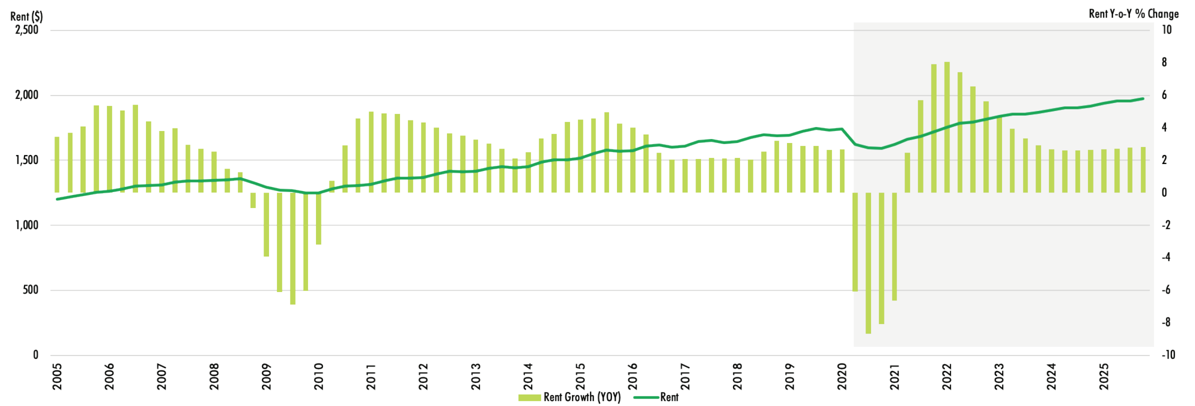
FIGURE 3: Forecast Recovery in H1 2022



Source: CBRE EA, RealPage Inc, Q1 2020.

Uncertainty in the near term may come in the form of missed rent payments. While public health concerns suppress economic activity, the largest threat to current rent stability is the end of enhanced unemployment. With future stimulus and labor market conditions uncertain, many apartment residents will seek some sort of rent deferral from their landlords. Also, some renters will misinterpret eviction moratoriums as a time to simply skip paying rent.

While both types of renter action will cause stress to owners and property revenues, most renters are continuing to pay their rents. In addition to the willingness of owners to work out rent payment plans with financially-stressed residents, government policy is increasingly aimed at providing economic relief for apartment renters (as well as owners stretched thin due to lower property income). These measures appear to be successful so far, with the National Multifamily Housing Council (NMHC) payment tracker reporting that May rent payments were only down 1.5 percentage points from May 2019.

COMPARISON TO PAST RECESSIONS

We expect multifamily markets to recover more quickly from this recession than the previous two, despite a similar bottom and more severe job losses. Both the Dot Com Bubble and the GFC saw rents fall approximately 8% from peak to trough, and it took roughly 3 years for rents to recover from both recessions. We predict an 8.1% fall in rents during this recession, but a 2-year recovery.

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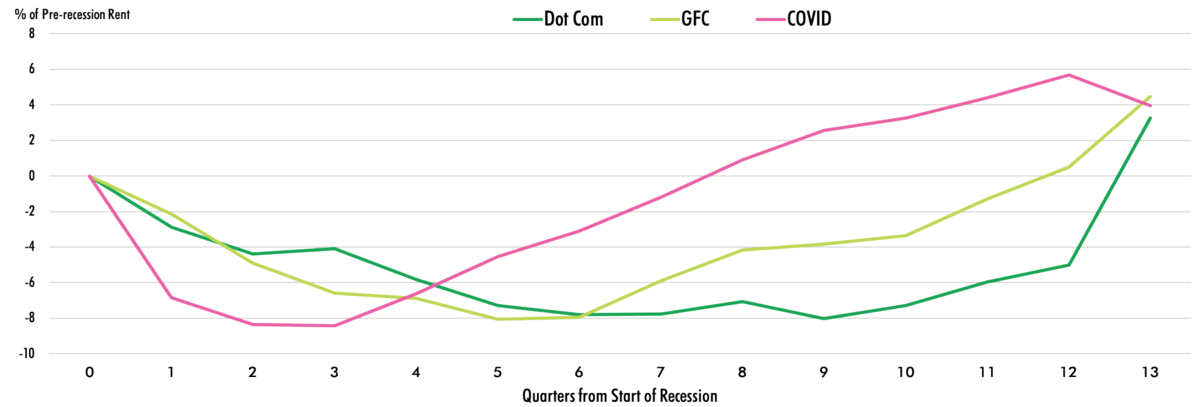
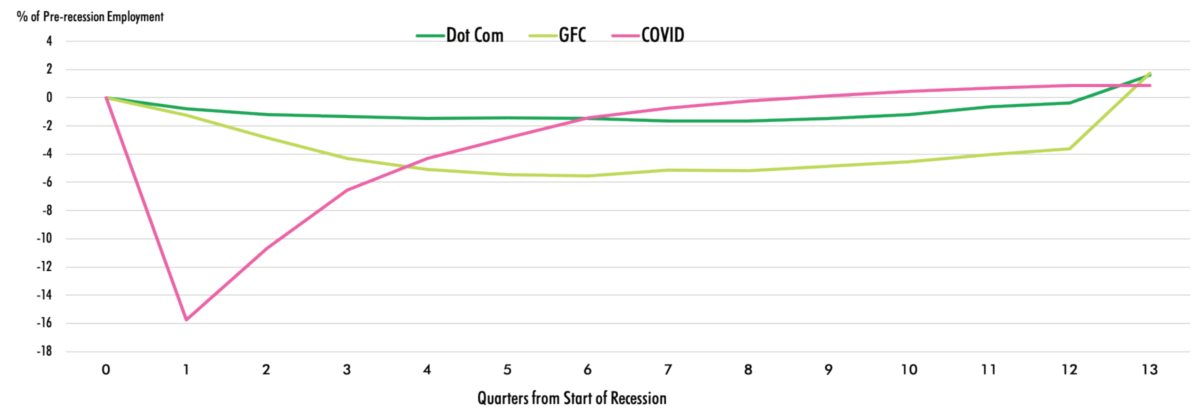
We predict this quicker recovery for three reasons. First, the COVID-19 recession is a different type of recession, in that there was no fundamental market inefficiency driving the downturn. Second, this recession is being met with an unprecedented level of government stimulus. And third, the U.S. multifamily sector showed strong momentum going into the COVID-19 outbreak. The sector had been experiencing a 10-year trend of growing rents and declining vacancies. The national vacancy rate hit 3.6% in Q3 2019, the lowest rate in over 25 years. This long trend was driven by steady economic expansion and job growth, shifting demographics, and increasing preferences for urban living.

FIGURE 4: Percent Change in Rent from Onset of Recession



Source: CBRE EA, RealPage Inc, Q1 2020.

FIGURE 5: Percent Change in Employment from Onset of Recession



Source: CBRE EA, Oxford Economics, Q1 2020.

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Figures 4 and 5 illustrate this point. The horizontal axis plots quarters since the beginning of the economic downturn for the Dot Com, GFC and COVID-19 recessions. Note the inverse relationship between severity of employment loss and the time to recovery—that is, multifamily has been recovering more quickly in recent years due to secular shifts in demand over time. We expected this relationship to hold for the current recession, and that this shift in demand, combined with the lack of market imbalance present in this recession, to propel multifamily to a relatively quick, 2-year recovery.

FOR MORE INFORMATION, PLEASE CONTACT:

Nathan Adkins
Sr. Economist
CBRE Econometric Advisors
+ 206 292 6163
Nathan.Adkins@cbre.com

Matt Mowell
Senior Economist
CBRE Econometric Advisors
+1 336 688 6637
Matt.Mowell@cbre.com

Jeanette Rice
Research Director | Multifamily
CBRE Americas Research
+ 214 979 6169
Jeanette.Rice@cbre.com

Jamie Lane
Senior Research Director
Economics & Forecasting
+ 404 812 5254
Jamie.Lane@cbre.com
Follow Jamie on twitter: *@Jamie_Lane*

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