Is There Multifamily Distress on the Horizon?

The pandemic threw the world into uncertainty, causing disruption across industries, including real estate. Supply chain issues greatly impacted construction and increased input costs up to 38.7% from February 2020 to February 2024.[1] Low mortgage rates, combined with work-from-home mandates, created a for-sale market heavily favoring sellers, elevating housing prices beyond the reach of many first-time buyers. Then, on top of already high for-sale housing values, mortgage rates went upwards of 7% while wage growth slowed, "keeping renters-by-choice renting."[2] Priced out of single-family housing, apartment rental living was the next-best option for many home hunters.

Several factors soon collided to spur an increase in multifamily supply: (1) lower costs of living in certain metro areas boosted their popularity; (2) the pandemic created the need for people to work from home and/or have more space; (3) construction supply chain backlogs were easing, and/or (4) developers were observing the buyer constraints in the for-sale housing market.

By the end of 4Q23, multifamily rent growth had turned negative in cities with oversupply, such as Austin and Phoenix, while the national average rent growth was only slightly positive at 0.75%.[3] In the first quarter of 2024, the number of new multifamily units under development in Austin, Charlotte, Nashville, Raleigh and Salt Lake City equaled 9% or more of current inventory — several basis points above the other 35 markets observed[4] — indicating elevated supply levels. As of June 2024, construction of approximately 9% more multifamily units than a year prior was underway across the country.[5] Markets such as these that were overbuilt with rental units in the last five years may experience distress if supply and demand cannot rebalance in the near term.

Compounding the current imbalance of this asset class is the ongoing uncertainty surrounding interest rate cuts. If the Fed continues with aggressive cuts,[6] first-time buyers eager to not miss out this time around may leave their rentals behind to seek out single-family homes. While home affordability constraints in popular (but overbuilt) metros like Austin and Nashville may offset this shift, investors should look at their portfolios for over-exposure to multifamily assets and consider a rebalancing or strategy shift of their own.

Many unknowns still lie ahead, including: recession or not, how many rates cuts and by how much and a new administration and policies. Right now, the big topic is interest rates, the downward movement of which could stimulate new development and investment in both single-family and multifamily housing. More single-family homes would have a positive effect on supply for that asset class and potentially on home prices due to increased inventory, whereas more multifamily units would push supply up even further, put downward pressure on rents, increase concessions and intensify competition for tenants — all factors that would impact an investor's bottom line.

Which considerations do you think will have the biggest impact on multifamily rental assets?

Oversupply	Job Growth
Vacancy	Household Debt
Rent Concessions	Government Policy/Administration
Interest Rates	Single-Family Home Prices
Materials Costs	Labor Costs
Recession Uncertainty	For-Sale Inventory
Other?	

Endnotes

1 Kapadia, Shefali, "Supply chain headaches persist 4 years into pandemic," Construction Dive (29 Feb. 2024), www.constructiondive.com/news/construction-materials-supply-chain-shortage/708866/.

2 "Multifamily Market Commentary 2024 Multifamily Market Outlook: Instability Expected as Skies Remain Cloudy," Fannie Mae (18 Jan. 2024), https://multifamily.fanniemae.com/news-insights/multifamily-market-commentary/2024-multifamily-market-outlook-instability-expected.

3 Ibid.

4 "Multifamily Economic and Market Commentary: Mid-2024 Multifamily Construction Pipeline Update," Fannie Mae (23 Jul. 2024), https://multifamily.fanniemae.com/news-insights/multifamily-market-commentary/mid-2024-multifamily-construction-pipeline-update.

5 Ibid.

6 On September 18, 2024, the Federal Reserve cut interest rates by 50 basis points, emphasizing to investors to not "assume 'this is the new pace.'" As reported by CNBC, "[t]hrough 2025, the central bank forecasts interest rates landing at 3.4%, indicating another full percentage point in cuts. Through 2026, rates are expected to fall to 2.9% with another half-point reduction." (Mercado, Darla, "Fed meeting recap: Chair Jerome Powell defends central bank's decision to go big with first cut," CNBC.com (18 Sep. 2024), https://www.cnbc.com/2024/09/18/fed-meeting-live-updates-traders-await-september-interest-rate-cut.html.

ROB RAYMOND
Managing Director
+1 248.860.4915
rob.raymond@fticonsulting.com

LAURA MCLEOD
Senior Director
+1 773.750.3275
laura.mcleod@fticonsulting.com

CHRIS LUNG
Senior Consultant
+1 646.632.3863
chris.lung@fticonsulting.com

FTI CONSULTING™