Multifamily Economic and Market Commentary

Fannie Mae

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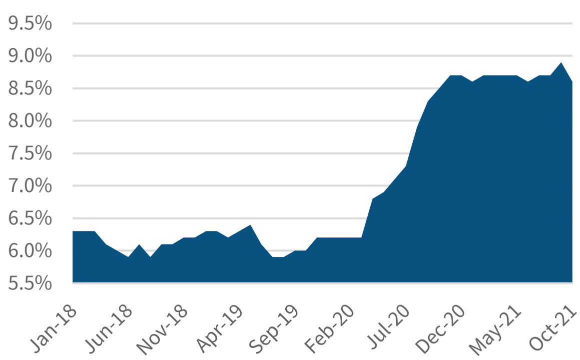
Concessions Remain Elevated Despite Spike in Rents

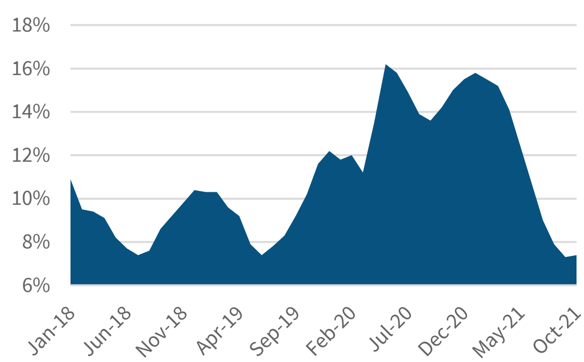
Multifamily market fundamentals have strengthened considerably this year, despite the ongoing challenges posed by the COVID-19 pandemic. The rebound in the economy, most especially in job growth, coupled with pent-up demand for housing and increased household savings, have led to significant rent increases this year, particularly during the spring and summer months. Yet, in many metros there has also been an increase in new supply, resulting in an unusual situation of both elevated rents and concession levels.

In a competitive market, concessions are one of the ways property owners attract tenants. Concessions are enticements with an economic value for renters, such as periods of free rent, free utilities, or other amenities. As seen in the charts below, recent concessions data from RealPage shows that although there are fewer units offering concessions than a year ago – down from a high of about 16% of all units in May 2020 to about 7.4% of all units in October 2021 – the national concession rate remains at about 8.6%, or slightly more than one month's free rent.

National monthly multifamily concession rate



Percentage of units offering concessions



Source: RealPage

New Supply Impacts Demand – and Concessions

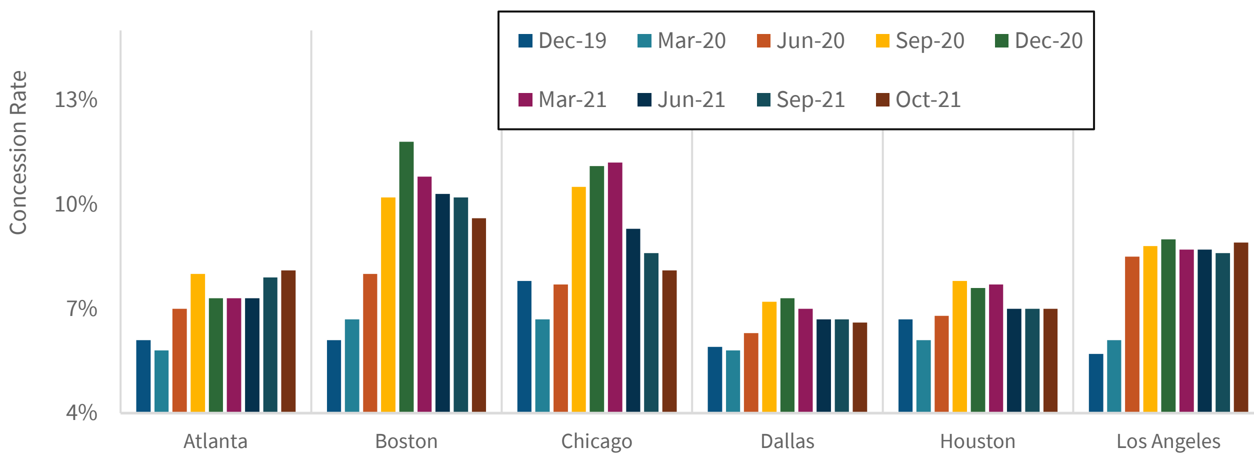
Despite the challenges confronting the construction sector over the past 18 months, including supply chain constraints, volatile material prices, and labor shortages, many of the nation's multifamily markets continue to see a surge in the supply of new apartments. So far in 2021, the industry has completed over 280,000 new apartment units, with another 150,000-plus units scheduled to complete before the end of the year, according to Dodge Data & Analytics. That's after the industry delivered more than 404,000 units in 2020, despite the delays caused by the pandemic.

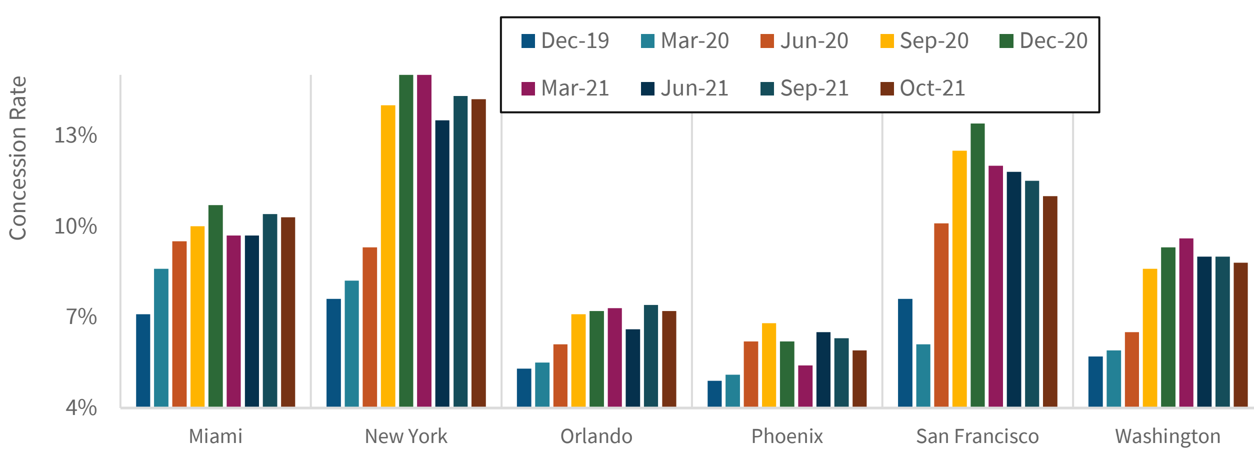
Concessions Higher in Expensive Markets

Although approximately 430,000 new apartment units may be completed in 2021, these units are not evenly distributed on a national basis. As has been the case for the past several years, much of the new apartment supply is concentrated in specific submarkets in approximately 12 metropolitan areas. The most active metros in the country for apartment development continue to be New York, Washington, D.C., Dallas, Austin, and Los Angeles. New York has more than 74,000 units underway; D.C. has more than 41,000 units underway; and Dallas is at more than 31,000 units. Austin, Los Angeles, Seattle, and Phoenix follow with more than 24,000 units each, and Atlanta, Orlando, and Houston round out the top 10.

However, it is not always just competing new supply causing an increase in concessions. As seen in the charts below, although Dallas, Orlando, Phoenix, and Houston all have a lot of new supply underway, their concession rates remain lower than those in the more expensive metros of New York, San Francisco, Miami, Boston, and Washington, D.C. – all of which have much higher asking rent levels, thus necessitating higher concession rates.

Multifamily monthly concession rate by market – select metros





Source: RealPage

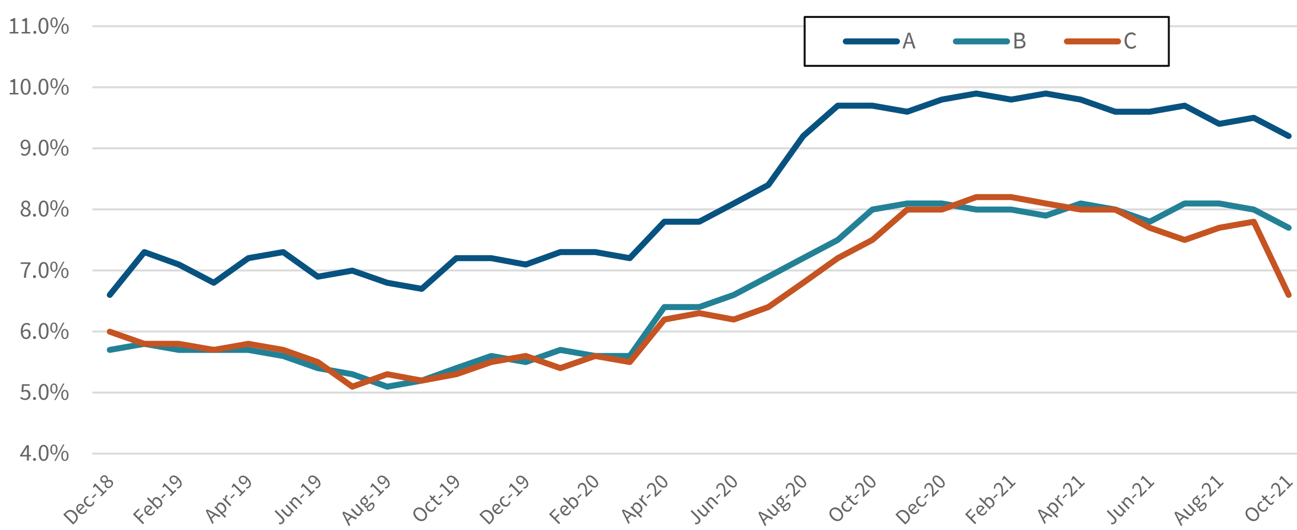
Class A Concessions Higher but Declining

Developers have primarily been building more expensive Class A units over the past decade. As has been the case for the past several years, increased competition among these projects has resulted in property owners often having to offer more generous concessions, which accelerated with the onset of the pandemic.

At the end of 2019, the level of Class A concessions was 7.1%. It remained approximately at that level until April 2020, when it rose 0.7% during the month to 7.8%. It continued to rise throughout 2020 and into early 2021, peaking at 9.9% in March 2021. And although the concession rate has been trending lower since then, it remains high at 9.2% as of October 2021 due to competing new supply entering many local submarkets.

Classes B and C were not immune to rising concessions in 2020 and early 2021, as seen below. Class B concessions ended 2019 at 5.5%, but recently peaked at 8.1% during the summer of 2021. Class C began 2020 at 5.4%, and while it surpassed Class B during the earlier part of 2021, it has now begun to trend downward, to 6.6% as of October 2021.

National monthly concession rates by class



Source: RealPage, Inc.

Typically, when Class A demand softens, some tenants use the opportunity to rent more expensive units with better amenities, given that rents for these higher quality units are now within their reach. However, the reverse happens infrequently: Tenants tend to not move back into lower quality units when those rents fall. So as Class A rents declined and concessions rose, a similar trend occurred with Class B and C units, as seen in the chart above. And now that Class B and C concession rates are trending downward, that suggests that demand is increasing, likely keeping asking rent levels elevated.

Sticker Shock Ahead?

The multifamily sector has experienced the effects of an increase in pent-up demand this past year, resulting in higher-than-average asking rents. And although tenants appeared to have benefited in the form of concessions, it may be fleeting, because the discounted rent from the concessions is only good for a short period of time (typically anywhere from the first month or so of free rent to discounted rent over the period of the lease). This suggests that there might be a form of "sticker shock" at the end of the lease term for many tenants. That is when the new rent increase will be based on the full amount of the rent, prior to the discount resulting from the concession. There is some concern that tenants may expect yet another concession to offset that increase, but that remains to be seen.

Although the national concession rate remains elevated, fewer units are offering concessions. That trend is expected to continue over the coming months. And as seen in the case of Class C units – the most affordable units in a location – the declining trend in concessions offered has recently started accelerating, most likely due to the improving economy and increased job growth.

As a result, we expect that concessions will continue decreasing, particularly for Class B and C units. We expect that the trend trajectory for Class A units will lag slightly behind, as new supply delivers over the next several quarters. But with the economy expected to continue and rental housing demand remaining firmly in place, we believe that concessions will decline throughout 2022, returning to more normalized levels by the end of the year.

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