Multifamily Outlook 2016

Executive Summary

Demand for multifamily rental housing was higher than expected in 2015, absorbing much of the newly completed supply. Therefore, vacancy rates remained low and rents continued to rise in most markets. As more supply enters the market in 2016, multifamily fundamentals will moderate, more so in some geographic markets than others.

Sustainable Market Growth

Steady economic growth and key drivers will keep the multifamily market moving forward in 2016.

- Multifamily rental demand kept pace with the large wave of new supply in 2015 and will remain strong into the foreseeable future.
    - Favorable demographic trends, strength in the job market and reduced affordability of owning a home will continue to fuel strong demand for multifamily rental units.
    - As more supply enters the markets, the national vacancy rate will increase slightly, but it will remain less than the historical average through 2016. As a result, rent growth will remain strong until new supply can catch up with demand.
- In 2015, 306,000 multifamily units were completed and entered the market – the most in a single year since 1989. The level of new multifamily supply is expected to remain elevated over the next few years, given that the number of new construction permits rose again in 2015.
- The labor market added 2.7 million jobs and is near full employment as the unemployment rate finished 2015 at 5 percent. The strengthening labor market will put upward pressure on wage growth in 2016.
- Despite the Federal Reserve's decision to increase interest rates in December 2015, multifamily property price growth will remain strong and capitalization rates will not be significantly affected in the short-term.
- Multifamily origination hit record volume in 2015. It may have another record year in 2016 because of increasing property prices, new completions and maturities, all of which present favorable investment opportunities.

Vacancy and Rent Growth at the Geographic Market Level

For the majority of markets, vacancy rates remain below and rent growth above their historical averages. Gross income growth (average rent adjusted for vacancy) is mixed across markets and will further disperse as new supply enters the markets.

- Our top 10 list of metros based on 2016 gross income growth is dominated by West Coast markets, the exceptions being New York and Chicago.
- Vacancy rates in Washington, D.C. will increase further above their historical average in 2016; but multifamily construction started to slow down at the end of 2015. Boston, Jacksonville, and Norfolk are also projected to finish 2016 with vacancy rates above their historical average. Stronger-than-anticipated demand in Austin will outpace supply in 2016, keeping vacancy rates below the historical average.
- As oil prices near decade lows, several metros in Texas along with Denver will feel the impacts as employment growth slows as a result.

- Employment growth forecasts available to us forecast Houston growth will remain positive in 2015, but well below levels seen in the past few years. Vacancy rates will increase through 2016 and rent growth will moderate but remain strong enough to beat historical averages.
- Denver and Fort Worth will also see employment growth fall short of the last few years. Multifamily fundamentals will remain robust there, but with more moderation.

Multifamily Market-level Sensitivity Analysis

We test the sensitivity of multifamily performance across a range of economic growth forecasts from Moody's Analytics; strong growth, slow growth, moderate recession and low oil prices. These analyses reveal that even in stressed scenarios, gross income in nearly all markets is projected to grow, albeit at lower rates compared to the baseline scenario.

- In the strong growth scenario, gross income will grow more than the baseline scenario, but only by a modest amount because of the already above-average performance seen in the majority of markets.
- In the case of slow growth, all metros will see potential for lower gross income growth, but the majority will remain above their historical averages. A moderate recession will cause all metros to drop to or below their historical averages; some will turn negative.
- In the low-oil-price scenario, markets in Texas – including Houston, Austin, Dallas, San Antonio, and Ft. Worth – along with Denver and Oklahoma City would feel the biggest impact on gross income growth in 2016, but growth will remain above historical averages in each of those markets, except for Houston and Austin.

Multifamily Outlook 2016

- The multifamily rental market experienced its strongest post-recession growth in 2015, despite a wave of new supply.
- In 2016, new supply of multifamily units will continue to enter the market at levels not seen since the 1980s; meanwhile, plans for additional construction continue to increase.
- Multifamily performance at the national level will remain robust into 2016, but some individual markets are starting to moderate.
- We stress test multifamily performance based on strong and weak economic forecasts. Our analysis indicates even if economic growth slows down, gross income will continue to grow in nearly all markets, albeit at lower rates compared to the baseline scenario.

The multifamily rental market had another fantastic year in 2015. Demand kept pace with new supply, despite a large wave of new properties delivered to the market. Vacancy rates barely budged and rent grew at the highest rate since 2000. The market's extended period of growth confirms that rental housing is a growing segment of the housing market and not just experiencing a temporary correction after the Great Recession.

In 2016, we expect another good year for multifamily. Despite some headwinds in the economy, favorable demographic trends and economic growth will fuel household formations and strong multifamily growth. As more supply is delivered, most markets will moderate, but market cooling is not a given. Looking back over the last few years, some markets with the greatest gross income growth (average rent adjusted for vacancy) were those taking on a significant amount of new supply.

Low oil prices, reduced housing affordability in both rental and ownership and interest rate adjustments will also impact the multifamily market, some metros more than others. Although fundamentals began to moderate slightly by the end of 2015, more factors are poised to encourage continued growth than to constrain it.

Section 1 – Multifamily Market Drivers

The economy continued to improve steadily during 2015 and most macro-economic forecasters expect the trend to extend through 2016. Gross domestic product (GDP) for 2015 was revised downward to 1.8 percent, but still subject to revisions, and predictions for 2016 are in the range of 2.5 percent. While this level of economic growth will allow the economy to continue its steady recovery, the growth falls below the long-run average of 3.2 percent going back to 1948. However, on average, the economy is expected to see more moderate growth in the long-term. The Bureau of Labor Statistics stated in its Employment Projections 2014-2024 report, with more people retiring, labor-force growth will slow and lead to suppressed economic growth at the national level. GDP is expected to grow only 2.2 percent on average per year over the next decade.

The Federal Reserve increased short-term interest rates in December 2015 for the first time in nearly a decade. The Fed's decision to raise rates came from steadily declining unemployment, consistent real economic growth, and a strengthening housing sector. Tighter monetary policy is not expected to generate a spike in longer-term interest rates in the near-term, however. Mortgage rates will rise modestly but remain near historical lows. Continuing strong job and income growth will result in increasing household formations through 2016.

Global geopolitical issues that influence economic conditions are often unpredictable but still can affect real estate investment conditions. Many foreign investors still turn to U.S. Treasury bonds (Treasuries) as a stable investment during instability, keeping the long-term interest rate low and strengthening the dollar. However, the impact of a major global slowdown could ripple through the U.S. economy.

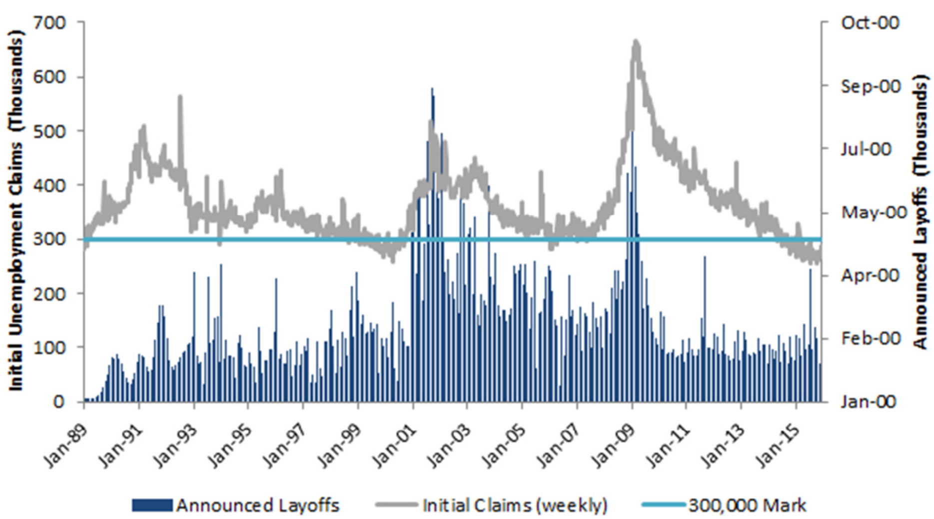
Economy Near Full Employment

Employment growth remained strong in 2015, albeit more subdued than in 2014. A total of 2.7 million non-farm jobs were added, the second largest annual gain since 2000. The unemployment rate dropped 60 basis points (bps), to 5 percent, in 2015. Similar job growth is expected in 2016, but only lowering the unemployment rate to 4.8 percent, as more people who stayed on the sidelines are expected to enter the labor force. Most industries will continue their healthy growth, except for manufacturing and energy; the strong dollar and struggling oil prices have led to slowdowns in these two industries.

Despite the low unemployment rate and high number of job openings, wage growth continues to disappoint. Wage growth in 2015 was stronger than in previous years, but the modest gains compared to historical growth indicate slack in the labor market. Job growth slowed across all wage tiers in 2015 compared to 2014, but all tiers are still hiring. According to Witten Advisors, middle-wage jobs had the most job gains in 2014 and 2015, outpacing low-wage job growth that dominated the first three years following the Great Recession. Meanwhile, high-wage job gains were hurt in 2015 partially because of the energy sector's contraction.

Announced layoffs in 2015, according to the Challenger Report, were at their highest since 2011 at 598,510. The energy sector announced the most layoffs, with 94,409 in 2015 compared to 14,262 in 2014. However, weekly initial unemployment claims have been below 300,000 – a level generally indicative of a strong labor market– for 46 straight weeks, as of January 16. This is the longest streak of claims below 300,000 since at least 1989, as shown in Exhibit 1.

Exhibit 1: Announced Layoffs and Initial Unemployment Claims



Sources: U.S. Employment & Training Administration; Challenger, Gray & Christmas, Inc.; Freddie Mac

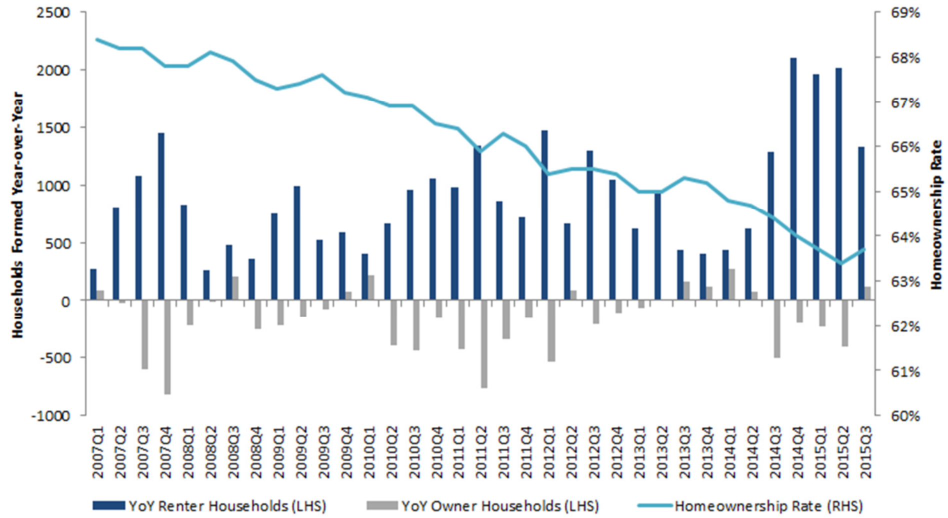
Strong Rental Household Formations

The strength in the broader economy and labor market continues to fuel household formations. Total household formations increased by 1.5 million in the first nine months of 2015. While slightly lower than the prior three quarter's year-over-year change, it marks the fourth quarter that total formations exceeded one million.

Household formations have been heavily skewed toward renters over the last nine years, as shown in Exhibit 2. Since 2007, eight million renter households have been formed, while owner-occupant households have decreased by 1.8 million. The homeownership rate did increase 30 bps over the prior quarter to 63.7 percent, the first quarter-over-quarter increase since third quarter of 2013. The pick-up in ownership most likely resulted from households who were on the fence about owning finally taking the plunge before an anticipated interest rate hike.

Increased owner-occupancy will positively affect rental housing in the long-run; more household formation, regardless of tenure, benefits the economy, creating more jobs, which spurs further household formations.

Exhibit 2 - Annual Renter and Owner Household Formations and Homeownership Rate (2007Q1 - 2015Q3)



Sources: U.S. Census Bureau, Freddie Mac

One factor that could slow renter household formations is the declining affordability of rental housing. There is a growing disconnect between renter income and asking rent for new multifamily units. Many new units are not built to accommodate households in the lower-income distribution. According to the Joint Center for Housing Studies (JCHS), only 10 percent of new units built had asking rents at levels considered affordable to about half of the renter population.

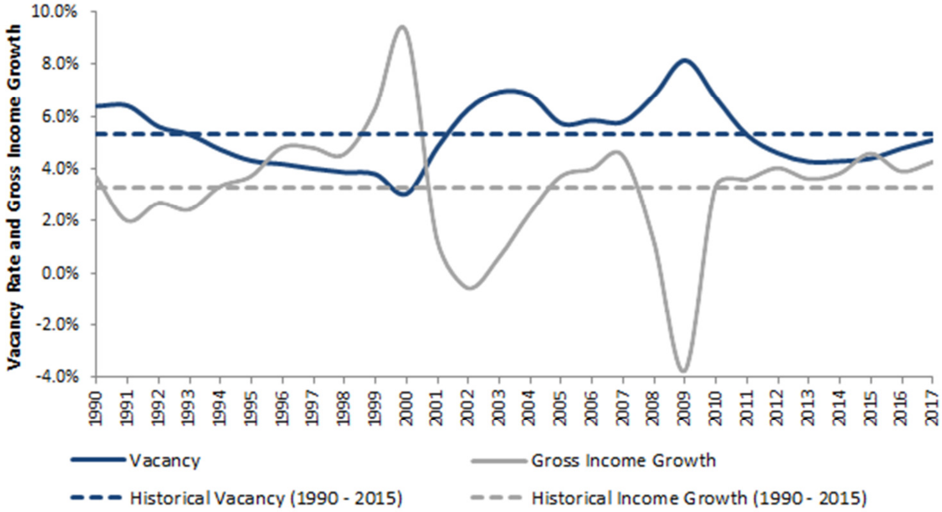
Despite reduced housing affordability, we expect renter household formations to remain strong because of favorable demographics and pent-up demand following the Great Recession. While the pace of renter household formations is expected to slow from the robust pace of the past few years, the JCHS estimates 4.4 million renter households will form by 2025 based on adult population growth alone.

Exceptional Multifamily Performance

The multifamily sector performed better than anticipated in 2015 despite the large flow of new completions to the market. Vacancy rates barely budged, increasing to 4.4 percent from 4.3 percent. Gross income growth reached 4.6 percent in 2015, exceeding expectations and reaching the highest level of growth since 2000, according to REIS. A combination of stronger-than-anticipated demand and slower-than-anticipated property deliveries suggests that multifamily market fundamentals will remain solid.

Through 2016, multifamily supply will continue to enter the market at elevated levels. Demand will remain strong enough to absorb most of the units, but supply is expected to outpace demand by the end of 2016. Vacancies will rise slightly to 4.8 percent and gross income growth will remain above historical average at 3.9 percent by year-end, as shown in Exhibit 3.

Exhibit 3 - Vacancy Rate and Gross Income Growth, History and Forecast

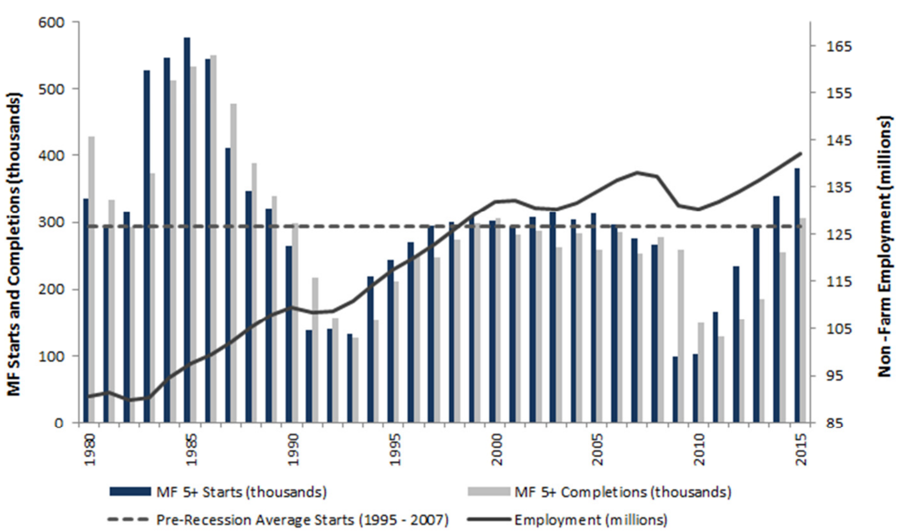


Sources: REIS, Freddie Mac projections

Multifamily Completions Up, Total Housing Supply Insufficient

Multifamily completions in 2015 hit 306,000 units, slightly more than the previous cyclical peak of 305,000 in 2000 and the most since 1989, as shown in Exhibit 4. In second quarter 2015, the market registered the largest quarter-over-quarter increase in completions since 2000, with 80,000 new units delivered. The multifamily market's performance throughout 2015 indicates that demand met the large amount of new supply.

Exhibit 4 - Multifamily Starts and Completions (5+ Units) and Employment



Sources: Freddie Mac, U.S. Census Bureau, Moody's Analytics

Multifamily starts continued to increase in 2015, as shown in Exhibit 4, indicating that completions will remain at high levels through 2016 and 2017. The elevated level of multifamily construction is a testament to many investors' confidence in the multifamily sector. By the end of 2015, multifamily performance started to moderate under the weight of new deliveries, causing some investors to worry that new construction will outpace demand.

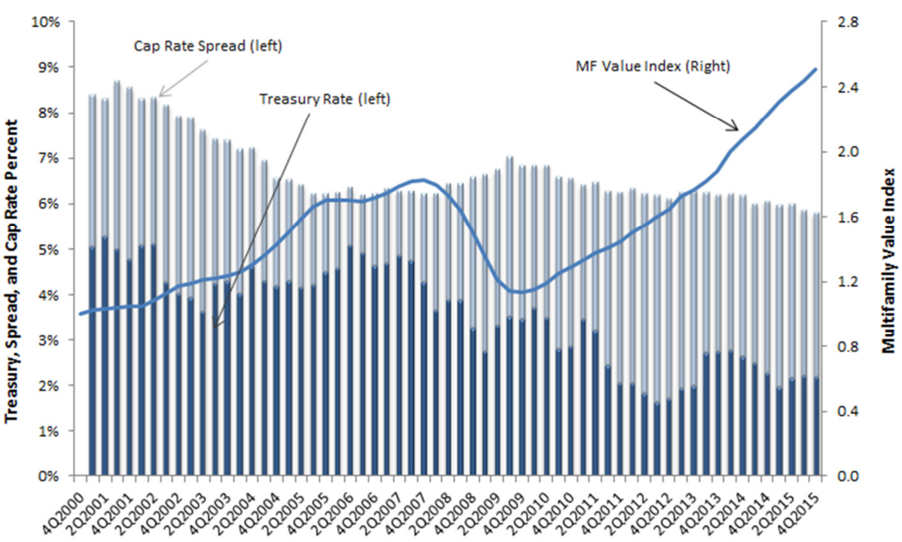
One crucial factor to consider is the overall level of housing supply. Despite the large increase in multifamily starts, the total number of housing starts in 2015 (which includes one-unit, two- to four-unit, and five-plus-unit buildings) was 30 percent less than the historical average, measured from 1970 to 2007. Therefore, the housing market is experiencing below-average housing construction, creating a shortage of total housing supply, which is being partially filled by the increase in multifamily construction.

Strong Property Price Appreciation and Rising Interest Rates

Multifamily property prices have grown remarkably since the low that followed the Great Recession. Surging demand and lack of supply have resulted in annual price appreciation between 13 and 15 percent. As of December 2015, property prices were 38 percent higher than the pre-recession peak. There is a concern, however, that the Federal Reserve's decision to increase interest rates in December 2015 may have a negative impact on property prices. Another concern is that property prices are growing faster than property cash flows which is not sustainable for an extended period of time.

Multifamily capitalization rates (cap rates) are not expected to be significantly impacted by the interest rate hikes in the short-term. The spread between cap rates and the 10-year Treasury remains historically wide, as shown in Exhibit 5, and will be able to absorb some of the interest rate increases. As of December 2015, cap rates dropped below 6 percent to 5.9 percent, according to Real Capital Analytics (RCA). Cap rates for the higher quality properties in more desirable locations are typically lower than the overall average, and have been around 5 percent since mid-year 2014. These markets have seen some of the strongest price appreciation and cap rates are expected to remain around 5 percent. For the overall multifamily market, we project that cap rates could increase slightly but will stay in the low 6 percent range through 2016. This forecast assumes steady employment growth, the 10-year Treasury rate remaining below 3 percent, and spreads continuing to tighten mildly to 300-330 bps.

Exhibit 5 - Multifamily Value Index, Cap Rate Spread and Treasury Rate



Sources: Freddie Mac, RCA CPPI™, U.S. Census Bureau, Moody's Analytics

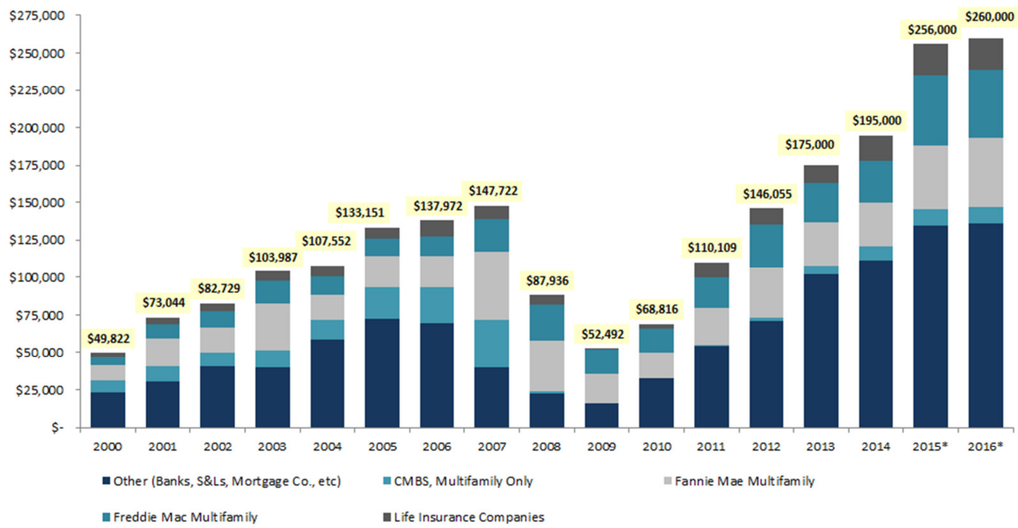
Record Origination Volume

Multifamily origination volume is expected to set another record high in 2015, at $225 billion. We expect origination volume to be even higher this year, because of increasing property prices, increasing construction pipeline, a large wave of maturities, and a relatively low – albeit starting to rise – interest rate environment. As shown in Exhibit 6, we anticipate that 2016 origination volume will reach between $240 billion and $250 billion.

The growth among the government-sponsored enterprises (GSEs), Freddie Mac and Fannie Mae, constituted the largest portion of the 2015's increase over 2014. As the economy continues to improve, other market participants will increase their market presence.

However, a change in regulatory guidelines on banks could create a headwind for origination volume. U.S. regulators expressed concern about the growing commercial real-estate sector and the possible rise in risky lending. The regulators may require banks to hold more capital or take other actions in 2016 if their commercial real-estate lending is deemed more risky. These regulator actions could affect the amount of multifamily volume banks can originate and lower the total 2016 volume.

Exhibit 6 - Multifamily New Purchase and Guarantee Volume ($ Millions)



Sources: Mortgage Bankers Association, Freddie Mac
Notes: 2015 and 2016 numbers are projections as of December 2015

Section 2 – Multifamily Market-level Outlook

Many metropolitan areas have had exceptional growth in their multifamily sector, thanks to strong demand. Stronger-than-anticipated demand in 2015 kept rent growth above historical average in many markets.

Our list of the top 10 markets based on forecasted gross income growth for 2016, is shown in Exhibit 7, along with actual growth for 2015, as reported by REIS. The ranking of markets remains consistent with previous results as many of the top 10 are West Coast markets, mostly in California. Chicago and Orange County moved into the top 10 as limited new construction has allowed rents to grow while vacancy rates stayed low. But in most of these markets performance is expected to be slower in 2016 than in 2015, except in Chicago, Orange County, and Los Angeles where gross income growth will accelerate in 2016.[1]

[1] Our forecasts also incorporate an update to our forecasting model. Adjustments were implemented to capture more movements among metros, which led to higher rent growth in some markets. These updates and results are consistent with market expectations and provide a better forecasting model for future vacancy rates and rent growth.

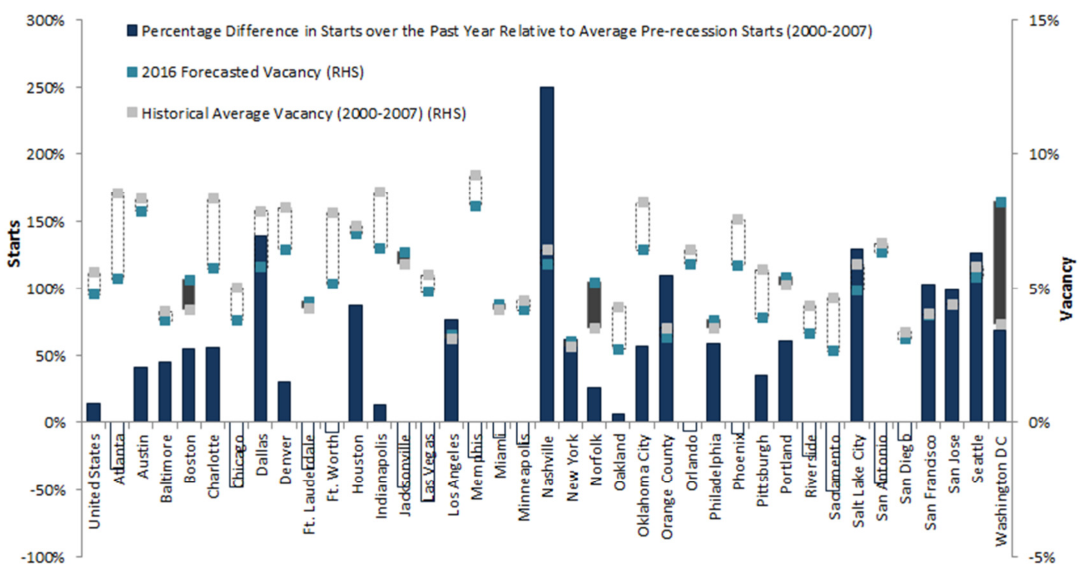
Exhibit 7 - 2016 Forecasts for Top 10 Metro Markets' Gross Income and Vacancy

	Annualized Growth in Gross Income		Vacancy Rate	
Metropolitan Market	2016	2015	2016	2015
San Francisco, CA	8.2%	10.7%	4.0%	4.1%
Oakland, CA	6.5%	6.5%	2.8%	2.7%
Seattle, WA	6.0%	7.4%	5.4%	5.3%
Los Angeles, CA	5.9%	5.0%	3.3%	3.3%
Sacramento, CA	5.8%	7.0%	2.7%	2.4%
San Jose, CA	5.2%	5.5%	4.4%	3.9%
New York, NY	5.2%	6.0%	3.0%	3.1%
Orange County, CA	5.2%	3.7%	3.2%	3.0%
Chicago, IL	5.1%	3.5%	3.8%	3.8%
Portland, OR	4.9%	6.2%	5.4%	5.0%
United States	3.9%	4.6%	4.8%	4.4%

Source: REIS, Freddie Mac projections

On the supply side, many markets continue to experience above-average construction, but vacancy rates in most of these markets will remain below average, as shown in Exhibit 8. Supply started to moderate in many markets by the end of 2015, which will help them absorb the new inventory and continue to grow at or above historical average levels. Construction levels in a few markets were higher by the end of 2015 than six months prior, such as Nashville, Dallas, and Salt Lake City. However, vacancy rates in these three markets are expected to stay below their historical averages in 2016.

Exhibit 8 - Multifamily Starts and 2016 Forecasted Vacancies Relative to History

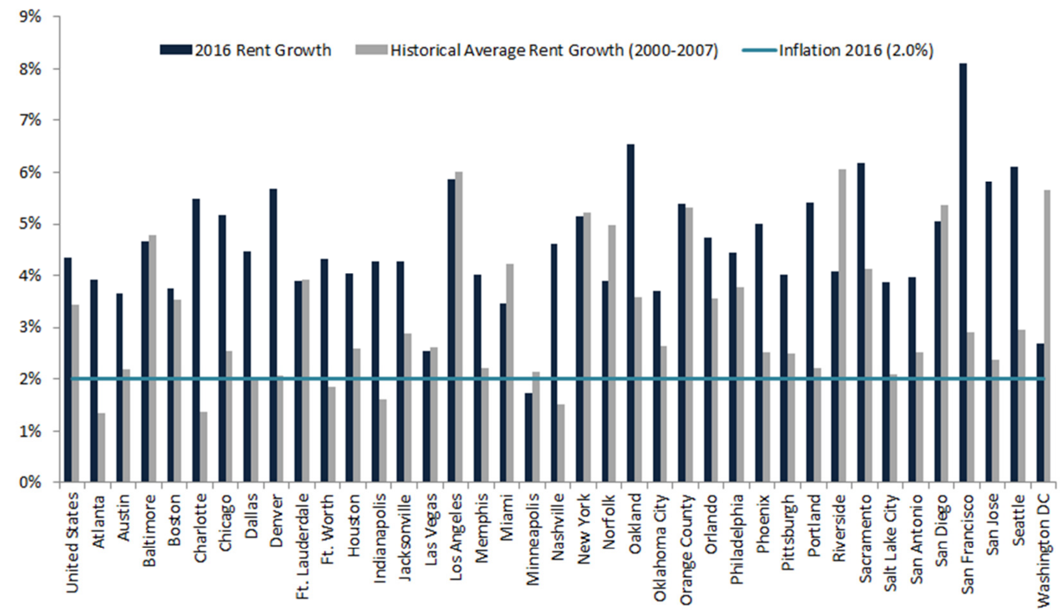


Sources: REIS, Moody's Analytics, Freddie Mac projections

Despite a meaningful slowdown in construction in the Washington, D.C. area over the past six months, the gap between 2016 and historical vacancy rates will widen as new supply enters the market. Boston, Jacksonville, and Norfolk will also most likely experience vacancy rates in 2016 above their historical averages. Vacancy rates in most markets will increase as new supply becomes available over the course of 2016; nevertheless, vacancy rates will stay below average in the majority of the markets.

In 2016, rents will grow more slowly than in 2015 in the majority of metros but still at a pace above historical averages and the expected inflationary target of 2 percent, as shown in Exhibit 9. Expectations are higher than previously forecast because of stronger-than-anticipated demand and expected wage growth. Strong demand will put upward pressure on rents, while increased wages will boost household formations and allow some to upgrade their living situations. Most metros will see growth rates moderate in 2016, but much less than previously anticipated. The relatively low vacancy rate in most markets also will continue to contribute to the strong rent growth; high occupancy coupled with high demand allows landlords to increase rents.

Exhibit 9 - Rent Growth Forecasts for 2016 Relative to History



Sources: REIS, Freddie Mac projections

Rents continue to grow most in markets in California as well as Seattle. The markets forecasted to experience the least rent growth are generally those that have gained significant supply in recent years, such as Washington, D.C. and Austin, or weaker economies, like Minneapolis and Las Vegas. Rents in Washington, D.C. and Minneapolis, despite a relatively strong showing in 2015, will roll back in 2016. Minneapolis has been experiencing a relatively strong rebound so far, but in 2016 employment growth is projected to slow down due to the strong dollar constraining the manufacturing sector, a key employment sector in Minneapolis, and subsequently slowing rent growth below its historical average. Meanwhile, in Austin and Las Vegas, rents are rising less than in most other metros but are still growing at or above historical averages.

Despite the low oil prices, most energy dependent areas continue to perform above average. Houston has the most risk associated with low oil prices and has seen the largest slowdown in employment growth. Annual non-farm employment growth slowed to 0.8 percent, as of November 2015, significantly below the pace achieved in the last few years. As a consequence, Houston's 2016 rent growth and vacancy rates will moderate but perform inline or better than the historical average.

Other energy dependent metros have been much less affected by oil price drops than Houston; as a result, job creation has not slowed as much. Annual employment growth in Austin, Dallas, and San Antonio remained strong through November 2015 and is on pace to match the annual growth rates of the last two years. In Ft. Worth, job growth slowed below the national average as of November 2015, but this market did not experience the rapid job growth that other Texas metros did in the past few years. Meanwhile, outside of Texas, job growth slowed in Denver compared to prior years, but is still above the national average.

If oil prices remain near or below $35 per barrel over the next several months, the labor markets in these markets could be impacted more severely, which would put further stress on their multifamily fundamentals.

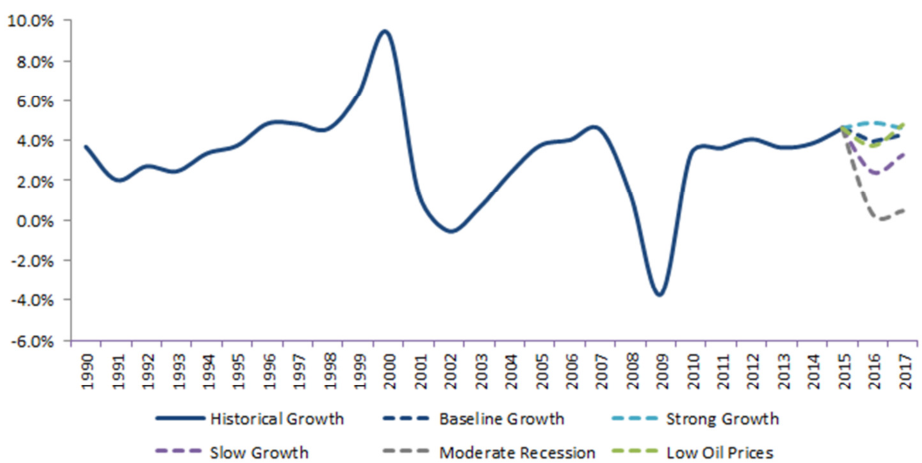
Section 3 – Multifamily Market-level Sensitivity Analysis

To assess the potential outcomes of multifamily performance for 2016, we project gross income growth across a range of economic forecasts that come from Moody's Analytics.[2]

We ran our multifamily market performance model based on Moody's Analytics baseline scenario and compared it to four alternative economic scenarios: stronger near-term growth, slower near-term growth, moderate recession, and low oil prices.[3] Each scenario includes assumptions related to the strength of the dollar and subsequent U.S. exports, Europe's and China's potential growth, oil prices, and interest-rate movements. These assumptions have varying impacts on drivers that affect gross income growth; employment, house price appreciation, consumer price index, and per capita income. While most industry participants expect consistent growth will continue into 2016, others anticipate a slowdown in the near-term. From our results, we can see that a slow-growth scenario would not be enough to derail most multifamily markets; however, a moderate recession would cause all markets to drop below their historical average gross income growth.

Exhibit 10 shows the results of our analyses at the national level. Multifamily performance previously described in Section 2 was forecasted using the baseline scenario. As mentioned, gross income will moderate in 2016 as vacancies increase and rent growth slows. A stronger economy in the near-term will drive more job growth, higher per capita income, higher inflation, and higher single-family house prices, all of which will bolster multifamily performance. On the other hand, a more sluggish economy will hamper growth in all of these variables, which, in turn, will weaken multifamily performance. In the strong growth scenario, gross income growth is expected to be 4.9 percent and 4.6 percent in 2016 and 2017, respectively. On the other extreme, a moderate recession will drag gross income growth down to 0.3 percent and 0.5 percent in these years, respectively.

Exhibit 10 - Gross Income Growth Projected for Moody's Analytics Scenarios



Sources: REIS, Moody's Analytics, Freddie Mac projections

[2] Similar case studies were published in 2015 which looked at specific markets and the impact of different economic forecasts: "A Little Bit Country, a Little Bit Rock 'n' Roll": http://www.freddiemac.com/multifamily/pdf/little_bit_country_little_bit_rock_n_roll.pdf .
"Oil Price Impacts and Multifamily Housing": http://www.freddiemac.com/multifamily/pdf/oil_price_impacts_multifamily_housing.pdf

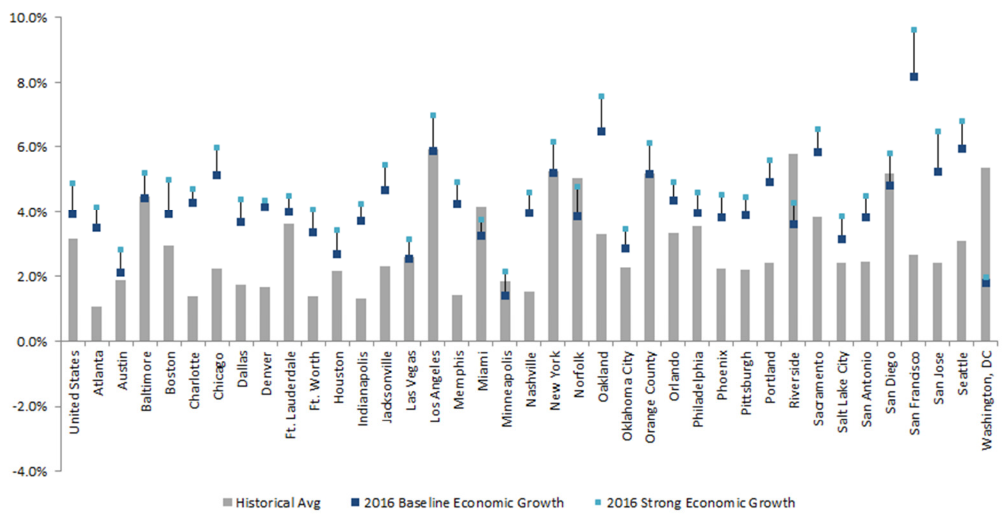
[3] The stronger near-term recovery scenario assumes the U.S. economy grows at a faster pace than the baseline scenario. The slower near-term recovery scenario projects a slower U.S. economy in 2016 but no recession. The moderate-recession scenario assumes the U.S. economy enters a recession in first quarter 2016 that lasts through fourth quarter 2016, but with less severity than the 2008-2009 downturn. The low-oil-price scenario assumes that West Texas Intermediate (WTI) remains near $35 per barrel through 2018 versus the baseline assumption that WTI will increase steadily to $70 per barrel during that period. For more information regarding the scenario assumptions, refer to Moody's Analytics. https://www.economy.com/home/products/samples/Moodys-Analytics-US-Alternative-Scenarios.pdf

Employment growth is one of the main drivers impacting multifamily performance. In the baseline scenario, employment grows by 1.9 percent in 2016. In the strong growth and low oil price scenarios, the economy would see more job growth than the baseline scenario because of a stronger economy. Job growth in these two scenarios is forecasted to be 2.4 percent and 2 percent, respectively. Meanwhile, in the slow growth and moderate recession scenario, employment growth slows to 0.9 percent and -0.9 percent, respectively.

Another key driver of multifamily performance is the amount of multifamily construction. But, any new completions delivered in the short-term forecast have already begun construction in the past two years and would not meaningfully impact the 2016 forecasts. However, these impacts would be seen in later years.

At the individual market level under the baseline scenario, most markets are expected to perform better than their historical averages in 2016. In the strong-growth scenario, the multifamily sector in all markets will experience even higher gross income growth in 2016, between 20 bps to 150 bps more, with an average increase of 70 bps. Exhibit 11 shows how results compare to the baseline. The additional boost in San Diego and Minneapolis will allow gross income to rise above their historical averages, whereas Norfolk, Riverside, Miami and Washington, D.C will still fall short of their historical averages.

Exhibit 11 - Gross Income Growth Scenario in 2016: Projected Strong Economic Growth

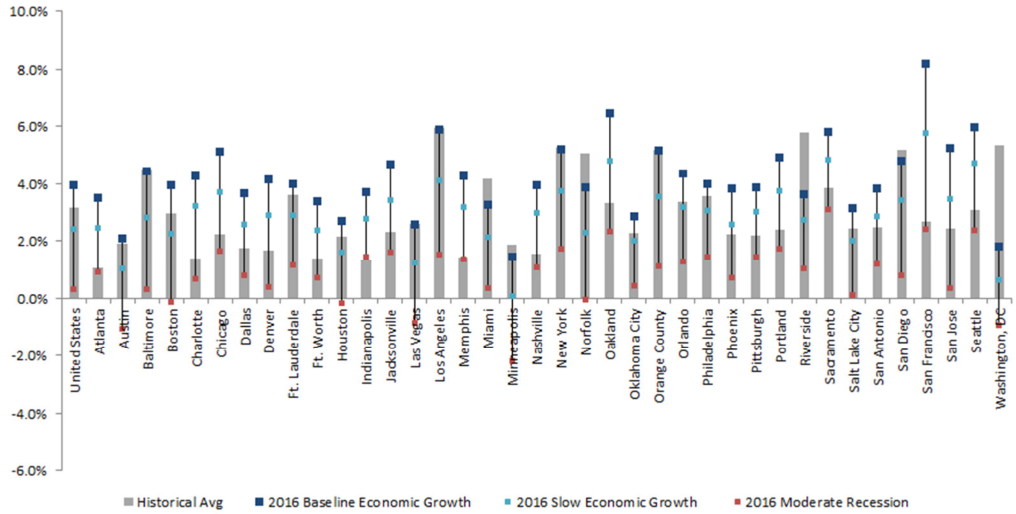


Sources: REIS, Moody's Analytics, Freddie Mac projections

The markets that will deliver the best results are those already expected to have the highest growth for 2016, including Los Angeles, Oakland, and San Francisco. Housing demand is already high in these markets because of strong employment growth; any additional household demand would push up gross income growth even further. Furthermore, any construction started in response would take a few years to complete.

In the slow-growth and moderate-recession scenarios, gross income growth will slow compared to the baseline scenario, as shown in Exhibit 12. The steepest declines will be in those markets with higher growth under the baseline scenario, such as the Bay Area and Southern California.

Exhibit 12 - Gross Income Growth Scenarios in 2016: Projected Slow Growth and Moderate Recession



Sources: REIS, Moody's Analytics, Freddie Mac projections

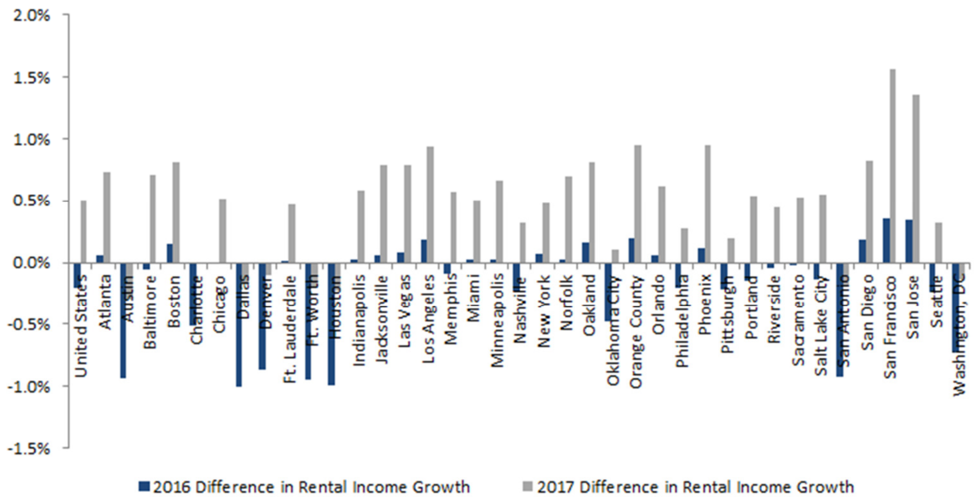
In the slow-growth scenario, gross income growth for most markets will remain above historical averages in 2016 but will be 130 bps less on average than in the baseline scenario. Growth will fall below the historical average in eight markets under this scenario: Austin, Boston, Ft. Lauderdale, Houston, Las Vegas, Orlando, Philadelphia, and Salt Lake City. Properties in these markets will have difficulty covering expenses and costs if new loans were based on historical performance.

The impact on multifamily performance is much more severe in the moderate-recession scenario. Most markets will experience a negative shock that will exacerbate the performance decline. On average, gross income growth will be 330 bps less than in the baseline scenario or another 200 bps less than the slow-growth scenario. All metros will experience gross income growth below or at their historical average levels.

In this scenario, gross income will shrink more than 4 percent in Boston, Los Angeles, Oakland, Orange County, San Francisco, and San Jose. It is not unexpected that the California markets, which had some of the highest income growth in 2016 under the baseline scenario, would expect a significant drop. Boston though, does not follow that same pattern of well-above historical income growth under the baseline scenario. Instead, Boston's sizable decrease in both scenarios is because of the relatively high vacancy rate compared to its historical average. In the event of a slowdown, there will be even greater pressure on vacancy rates to rise, causing rent and income growth to fall further.

In the low-oil-price scenario, projected performance across markets is mixed, as shown in Exhibit 13. In 2016, gross income growth in about half of the markets will be greater than in the baseline scenario and decrease in the other half.

Exhibit 13 - Change in Gross Income Growth from Low-oil-price Scenario to Baseline (2016-2017)



Sources: REIS, Moody's Analytics, Freddie Mac projections

For most markets, the impact will be minimal; but markets with a heavier reliance on the energy sector will feel a greater impact. In metros such as Austin, Dallas, Denver, Ft. Worth, Houston, Oklahoma City and San Antonio, gross income growth would decrease on average 90 bps compared to the baseline scenario. However, that decrease would only be enough for income growth in Houston and Austin to dip below the historical average. Income growth in the other five markets will decrease but remain above historical average in 2016. Washington, D.C. will also experience a significant negative impact to gross income growth; low-oil prices would boost employment growth but impact house prices which would negatively impact gross income growth in 2016.

However, the overall economic impact of lower oil prices will be positive once the energy sector stabilizes, beginning in 2017. That year, gross income growth at the national level will exceed expected growth in the baseline and strong-growth scenarios. Likewise, growth for the majority of the metros will be higher under the low-oil-price scenario in 2017, except Texas markets, Denver, and Washington, D.C.

Conclusion

Following a year that greatly exceeded expectations, the multifamily market overall will remain strong in 2016 but with more moderation. The wave of new supply that was delivered to the market mid-2015 was met with strong demand, keeping vacancy rates low and allowing landlords to increase rents. Fundamentals began to moderate by the end of 2015 as vacancy rates started to increase. Favorable demographic trends and an improving economy will generate robust demand for multifamily properties. Even if the economy experiences extended low oil prices or slow near-term growth over the next year, most multifamily markets will continue to perform above average. Dispersion across individual markets will continue, but increased supply or economic headwinds in some markets will not derail the multifamily market's growth at the national level.

For more insights from the Freddie Mac Multifamily Research team, visit the Research page on FreddieMac.com/Multifamily.

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