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Why Are Multifamily Property Prices Falling?

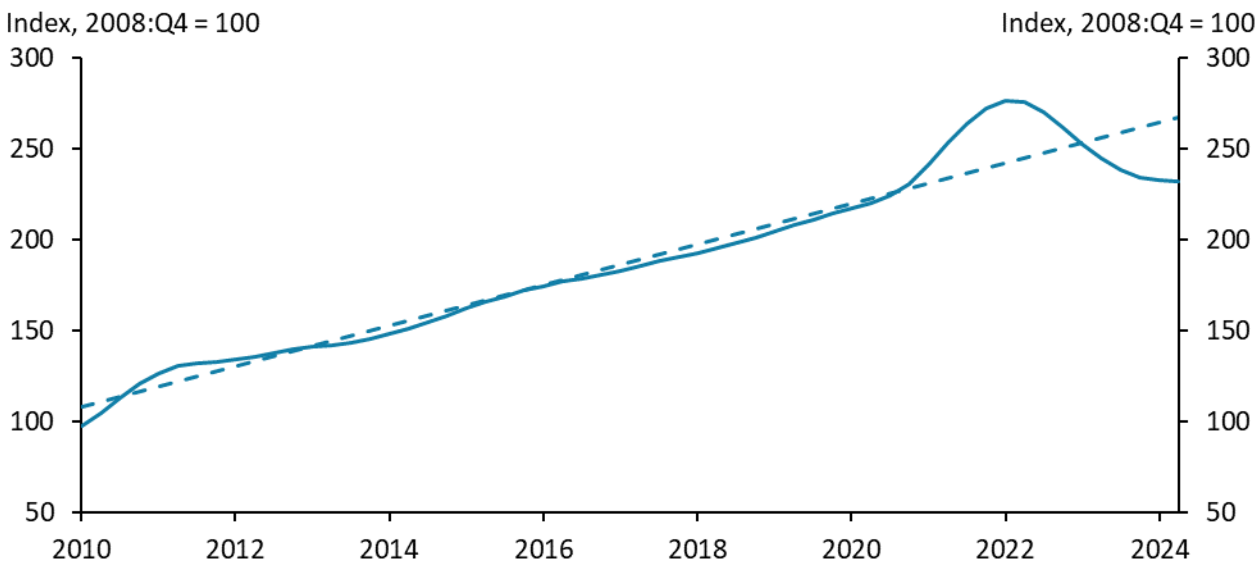
By Matt Hanauer, W. Blake Marsh, and Nicholas Sly

Multifamily property prices climbed to record levels in recent years amid low interest rates and surging housing demand. More recently, prices have retreated in the face of higher interest rates, slower rent growth, elevated operating expenses, and increased delivery of new units available for rent. However, the deterioration in these fundamentals does not fully explain recent property price declines, suggesting investors' near-term outlooks have been pessimistic.

Changes in the price of multifamily properties are important to monitor for both economic and financial stability reasons. The multifamily real estate market is one of the largest investor asset classes in the United States: as of mid-2024, multifamily properties have an estimated market capitalization of $4.6 trillion. Moreover, multifamily properties provide collateral on over $2 trillion in outstanding debt which, in turn, makes up a sizable secondary securities market (MBA 2024). Changes in the prices of multifamily buildings may be especially important to monitor in the coming year, as multifamily properties account for more than 40 percent of all commercial real estate loans set to mature through 2025 (Hoffman, Burke, and Jones 2024).

Chart 1 shows that after rising sharply during the pandemic, prices of multifamily buildings have since fallen. Multifamily property prices (solid blue line) rose 27.3 percent from 2020 to 2022 as rocketing shelter demand elevated investors' outlooks. Since their 2022 peak, however, prices have declined by 16.1 percent and now stand slightly below trend (dashed line).

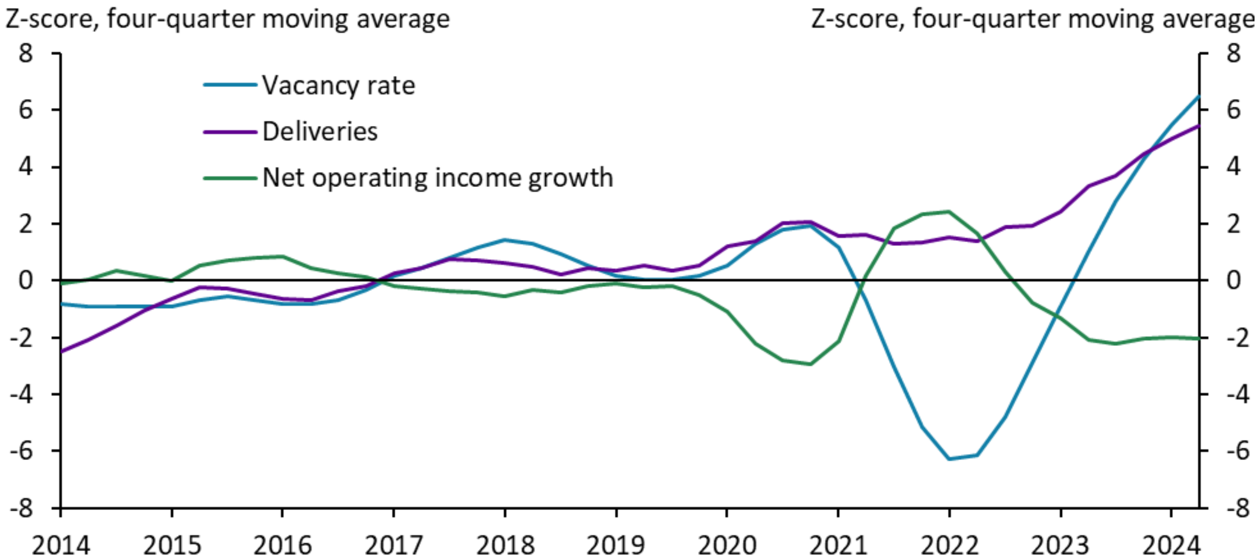
Chart 1: Multifamily property prices have fallen slightly below trend after sharp pandemic increases



Notes: Chart denotes multifamily property values indexed to 2008:Q4. Dashed line is a linear trend over the period 2010:Q1 to 2024:Q2.
Source: CoStar Group, Inc.

The rapid rise and decline in multifamily property prices was accompanied by similarly rapid swings in market fundamentals. The COVID-19 pandemic led to a sharp increase in demand for housing as social distancing and a higher prevalence of remote work changed preferences for living space and amenities. Chart 2 shows that during this period of rising housing demand and new household formation, vacancy rates for multifamily properties fell at the fastest pace in a decade (blue line), boosting growth in both rents and net operating incomes (green line). At the same time, the stock of multifamily housing became more constrained as the pace of deliveries of new units leveled off (purple line). These factors, combined with low interest rates, all supported higher prices for multifamily properties.

Chart 2: Multifamily property fundamentals have deteriorated in recent quarters



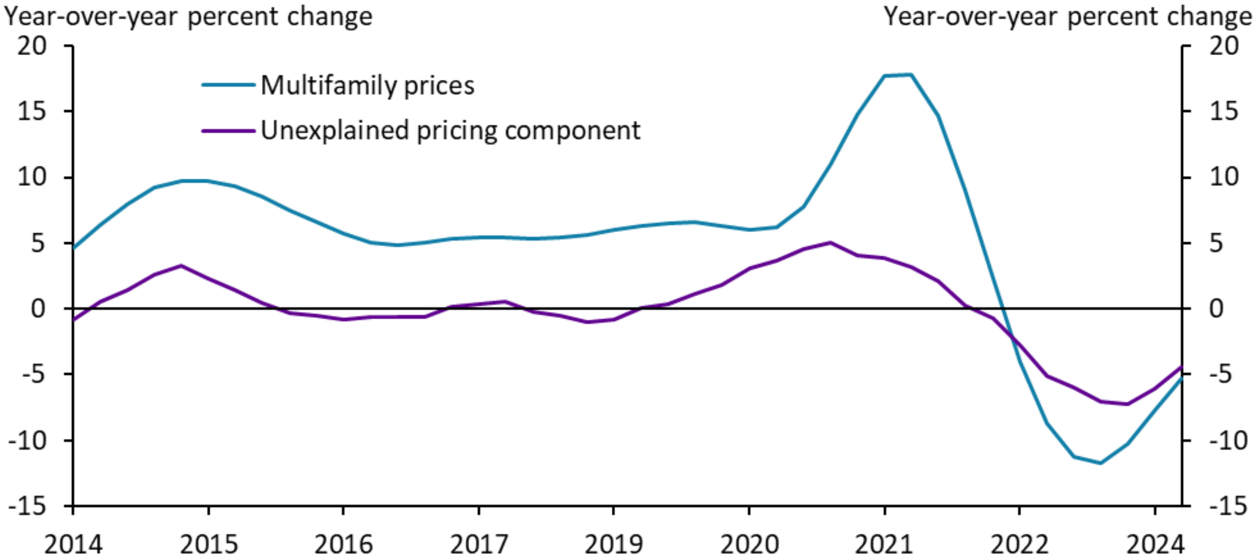
Notes: Chart depicts standardized vacancy rates, net newly delivered units, and net operating income growth. Standardized Z-score values are calculated as deviations from the pre-pandemic average in 2014–19 divided by the standard deviation over that period.
Source: CoStar Group, Inc.

More recently, the fundamentals underlying higher property prices have softened. Construction of new multifamily units has rebounded and even surged to outsized levels in several U.S. regions, leading to many new housing units coming available. The rising supply of multifamily housing has resulted in sharply higher vacancy rates that put downward pressure on rent growth. Higher interest rates have also reduced multifamily property valuations by raising interest expenses. Moreover, higher operating costs, such as increased insurance premiums and larger maintenance bills, have exacerbated the challenges of slowing rent growth, resulting in steep declines in net operating income growth.

However, broad deterioration in housing fundamentals may not fully explain the observed price declines for multifamily properties over the past two years. Chart 3 shows aggregate multifamily price changes (blue line) alongside the average amount of price changes across metro areas that is not explained by fundamental factors (purple line). The unexplained component is derived from a simple model of year-over-year price growth that accounts for net new deliveries, net absorption of new properties, year-over-year net operating income growth, and the change in 10-year Treasury yields by metro area.[1]

These factors track contemporaneous supply, demand, and financial conditions, respectively, in metro area multifamily property markets.

Chart 3: Changes in fundamentals do not fully explain market price declines



Note: Unexplained price changes are average residuals from metro level regressions that incorporate net operating income growth, net new deliveries, absorption rates, and the quarterly change in the 10-year U.S. Treasury yield.
Sources: CoStar Group, Inc., Board of Governors of the Federal Reserve System, and authors' calculations.

Although multifamily housing prices typically move in line with market fundamentals, the two have diverged in meaningful ways since the pandemic. The purple line in Chart 3 shows that prior to 2020, market fundamentals explain changes in metro area prices fairly well, as evidenced by the near-zero unexplained pricing component in that time period. However, during 2020 and 2021, prices of multifamily properties increased more than might be explained by improved fundamentals alone, suggesting accelerating rent growth and record low vacancies may have buoyed investor sentiment. Since 2022, the market seems to be exhibiting more cooling than might be expected given changes in fundamentals. That is, across metro areas, prices have declined by about 5 percentage points more, on average, than might be expected based on fundamentals alone.[2]

The recent disparity between predicted and realized price declines may suggest that investors and property owners feel more pessimistic about multifamily properties. On one hand, price declines may reflect investor concerns that recent deteriorations in cash flows will persist beyond the near term. On the other hand, these declines may simply reflect an unwinding of the investor optimism that pushed valuations up between 2020 and 2021, especially given the tightening of financial conditions over the past year and the extent of loan maturities looming over the coming year. This distinction is important: in the former case, the softening in multifamily property prices could continue if investors remain risk-averse to the multifamily property segment. In the latter case, growth in multifamily property valuations may normalize to the trends implied by market fundamentals over the near term, meaning property prices may be set to rise modestly.

Endnotes

[1] We estimate the model separately over 390 U.S. metro areas, which allows the factors to be independently determined across metro areas over the 2014–2024:Q1 sample period.

[2] One notable limitation of our model is that it excludes any forward-looking measures that might control for investors' outlooks. CoStar does collect self-reported cap rates; however, these cap rates are not available for all metro areas. As a robustness test, we run the same metro-level model on the aggregate U.S. data and include the forward-looking cap rate. We find that the price discrepancy declines a bit from the metro area model, but the results are qualitatively similar, with realized price growth lower than otherwise expected.

References

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