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Multifamily Market Close-up: Seattle MSA

Overview and Economy. The Seattle MSA multifamily vacancy rate increased by 180 bps year-over-year to 7.3% in the second quarter of 2023. The average real asking rent fell by 4.8% over the same period, to $1,874 per unit, according to CoStar. These metrics compare to the U.S. vacancy rate and average rent of 6.3% and $1,544 per unit, respectively. The area's 40th percentile real rent, as published by the U.S. Department of Housing and Urban Development (HUD) was $2,748 per unit in 2023, 132% higher than the comparable U.S. rent of $1,184.

The MSA continues to grow and has an estimated population of 4.1 million, making it the 15th-largest in the U.S. With a median age of 35.2 years in 2020, the MSA population is below the nation's median age of 38.8, while the local median household income ($52,142) is 26.3% lower than the national median ($70,784).

MSA employment was 2.1 million jobs in February 2020 and decreased by approximately 300,000 jobs (14.9%) over the following two months due to the pandemic shutdown. The MSA was below the national recovery of 19.7% through July 2023, with 380,000 (16.6%) additional Payroll Survey jobs since its pandemic low. Standing at 2.2 million jobs in July 2023, the MSA's employment base is 2.7% above the pre-pandemic level. Year-over-year through July 2023, the largest MSA job gains occurred in education and health services (+20,000 jobs); leisure and hospitality (+14,000); and government (+12,000). Major employers in the MSA include Microsoft, Boeing, Starbucks, Amazon, and Google.

In previous issues, we have discussed a covariance analysis that was first published in the *Wharton Real Estate Review* (spring 2007) and updated regularly in this publication. The analysis examines how various economic indicators behave in individual metropolitan areas based on national economic changes. Specifically, for each MSA, we estimated an equation, which summarizes how a 100-basis point (bp) change in national employment affects local job growth. The equation consists of a constant ("alpha") for each market and a "beta," which is a multiplier applied to the national percent change in employment. The alpha indicates MSA growth that is independent of national growth. If there is no national job growth, the alpha is the expected annual percentage change in MSA employment. The beta for the U.S. is defined as 1.0. An MSA with a beta of 1.0 registers (on average) an increase of 100 bps in employment growth around its trend plus alpha when national employment rises by 100 bps. A beta that is less than 1.0 indicates that the MSA does not boom (or bust) relative to its trend to as great an extent as the national economy, while a beta of greater than 1.0 indicates that such an MSA experiences swings of greater magnitude (compared to the local base) than percentage changes at the national level.

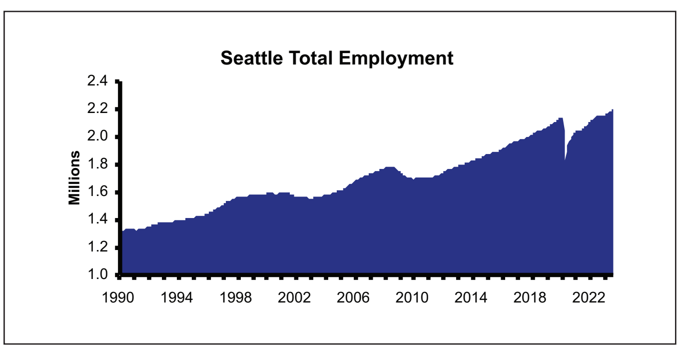


figure 1

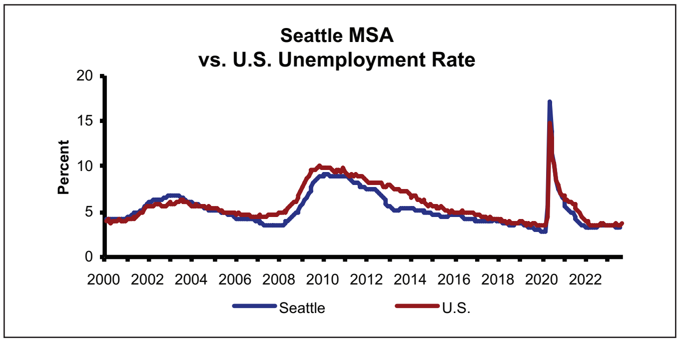
The Seattle MSA has an employment beta of 1.08, indicating that local employment moves closely with the national trend and grows (or shrinks) 8% more (around its local trend) than the percentage change in U.S. employment. With an alpha of 0.43, the MSA is expected to experience a 0.43% annual increase in employment when U.S. employment growth is zero. As a result of the alpha-beta interaction, the MSA's breakeven job growth rate is -0.4%. This means that U.S. job growth can be as low as -0.4% per annum, and the MSA will still have expected positive job growth. The MSA's R-squared statistic of 0.81 indicates that the forecasting model for MSA employment growth explains future job growth with a solid 81% "fit."

Our model projects that the Seattle MSA should have lost 5.9% of jobs given that the nation lost 6.3% of its jobs during the Great Recession. The projection was moderately above the actual MSA job loss of 4.7% over that period. U.S. employment grew by 17.5% from the Financial Crisis bottom through February 2020, while the MSA's employment increased by a strong 26.3% from the bottom, on par with our prediction of 24%. With the reopening of the economy after the pandemic shutdown, national employment increased by 23.6% from the low in April 2020 through July 2023, implying expected job growth of 22.4% in the MSA. However, the Seattle MSA has underperformed, with actual employment growth of 16.6% over the same period.

Seattle's unemployment rate peaked at 9.1% in the first quarter of 2010 before falling to a low of 2.8% in

February 2020 prior to the shutdown. As the pandemic hit, the official MSA unemployment rate spiked to 17.1% in April 2020 before dropping to 3.3% in July 2023 (latest available). In comparison, the national rate stood at 3.5% in February 2020 and reached 14.7% two months later before dropping to 3.8% in August 2023.

Vacancy. The MSA's vacancy rate increased 180 bps over the last year and stood at 7.3% in the second quarter of 2023, according to CoStar. This is 160 bps higher than the long-term average vacancy rate of 5.7% (since 1982). The National Council of Real Estate Investment Fiduciaries' (NCREIF) reports a Seattle multifamily vacancy rate of 7.3% in the second quarter of 2023, reflecting an increase of 180 bps and 40 bps over the last year and quarter, respectively for higher quality properties.



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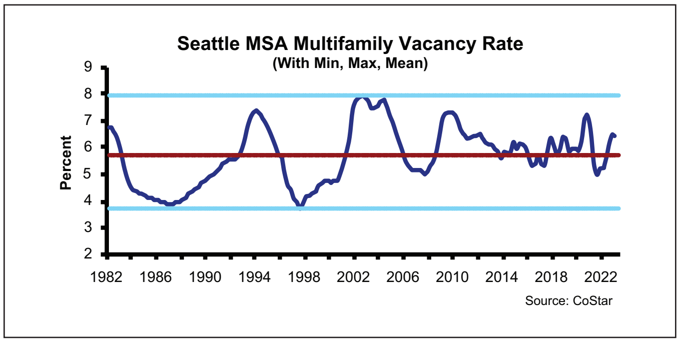

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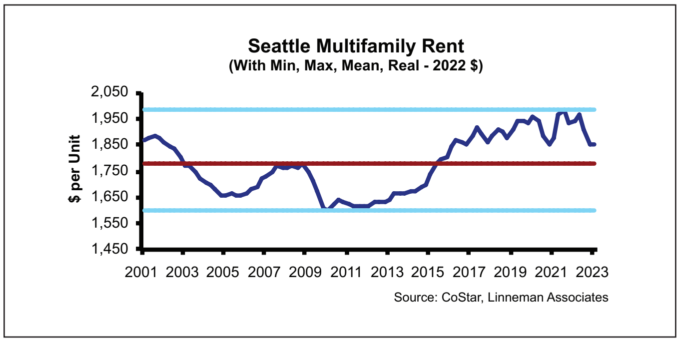

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Rental Rates and Leasing. At $1,874 per unit, the real average asking rent decreased 4.8% over the year and was flat since last quarter, according to CoStar. The current real rent is 17.2% above the 20-year average. In comparison, the HUD-reported real rents (2022 dollars) paid by the 40th percentile renter in the MSA averaged $2,748 per unit in 2023, up by 19.1% from $2,307 in 2022.

Development/Construction Pipeline. According to CoStar, the MSA will deliver about 4,000 new multifamily units through year-end 2023, followed by about 40,000 units total through year-end 2028. In comparison, Berkadia reports that as of the second quarter of 2023, there were 19,000 multifamily units under construction and 26,000 units in the planning stage in the MSA.

Submarkets

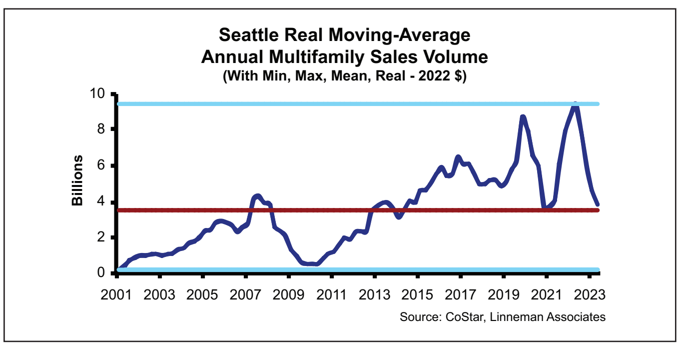
- ***Downtown Seattle.*** With an inventory of 26,000 units, the submarket had a vacancy rate of 8.7%, real rent of $2,468 per unit, and 4,000 units under construction in the second quarter of 2023. The submarket saw a trailing 12-month sales volume of $52.6 million.
- ***Central Seattle.*** With an inventory of 27,000 units, the submarket had a vacancy rate of 5.6%, real rent of $1,800 per unit, and 2,200 units under construction in the second quarter of 2023. The submarket saw a trailing 12-month sales volume of $214 million.
- ***Bellevue.*** With an inventory of 20,000 units, the submarket had a vacancy rate of 4.8%, real rent of $2,500 per unit, and 1,300 units under construction in the second quarter of 2023. The submarket saw a trailing 12-month sales volume of about $34.1 million.
- ***Tacoma***. With an inventory of 38,000 units, the submarket had a vacancy rate of 6.9%, real rent of $1,500 per unit, and 2,300 units under construction in the second quarter of 2023. The submarket saw a trailing 12-month sales volume of about $126 million.
- ***North Seattle.*** With an inventory of 15,000 units, the submarket had a vacancy rate of 4.9%, real rent of $1,700 per unit, and 2,200 units under construction in the second quarter of 2023. The submarket saw a trailing 12-month sales volume of $46.5 million.
- ***Kirkland.*** With an inventory of 11,000 units, the submarket had a vacancy rate of 4.8%, real rent of $2,400 per unit, and 700 units under construction in the second

quarter of 2023. The submarket saw a trailing 12-month sales volume of about $173 million.

- ***Everett.*** With an inventory of 20,000 units, the submarket had a vacancy rate of 5.9%, real rent of $1,800 per unit, and 300 units under construction in the second quarter of 2023. The submarket saw a trailing 12-month sales volume of about $261 million.
- ***Kent.*** With an inventory of 13,000 units, the submarket had a vacancy rate of 8.2%, real rent of $1,800 per unit, and 190 units under construction in the second quarter of 2023. The submarket saw a trailing 12-month sales volume of about $24.6 million.

Investment and Sales. According to CoStar, the MSA's second-quarter 2023 multifamily real four-quarter rolling sales volume was $3.8 billion for the year, down 56.6% from last year's high of $9.4 billion. The latest real rolling four-quarter sales volume is 9.2% above the long-term average.

In the second quarter of 2023, the average CoStar cap rate of 4.9% in the Seattle multifamily market was 90 bps above the 20-year low seen last year. It stood 90 bps lower than the historical mean.



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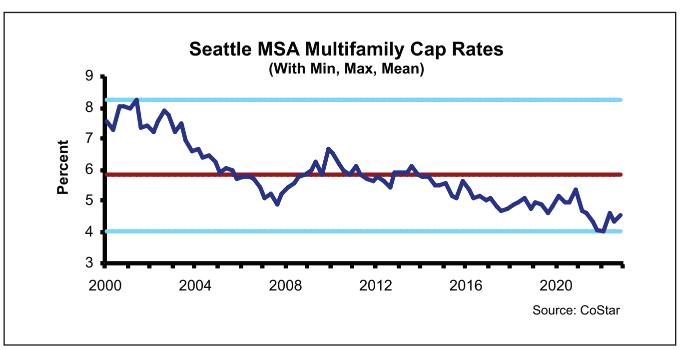

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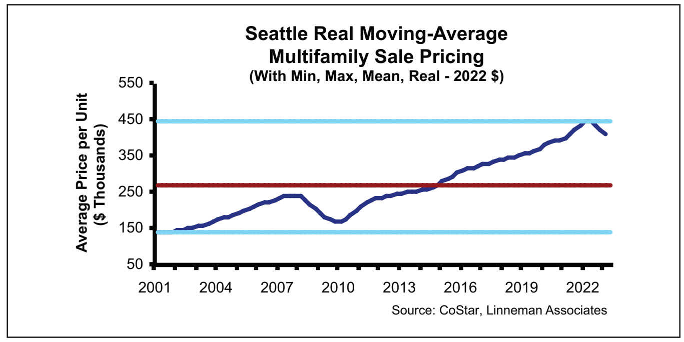

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In the second quarter of 2023 the four-quarter rolling average real price per multifamily unit (2022 dollars) in Seattle was roughly $394,000, or 61.2% higher than the U.S. average unit pricing of $240,000. The latest MSA pricing is 11.5% below the MSA's all-time high of $445,000 seen in the second quarter of 2022. The latest unit pricing stands 47.4% and 182.5% above the real long-term (2001-present) average and low of $268,000 and $140,000 per unit, respectively.

According to CoStar, major sellers of MSA multifamily properties over the past two years include Greystar Real Estate Partners ($1.1 billion in dispositions); Blackstone ($959 million); Security Properties ($833 million); Goodman Real Estate ($653 million); and Kennedy Wilson, Inc. ($621 million).

Major buyers of multifamily properties over the past two years include Marcus & Millichap ($903 million in acquisitions); Security Properties ($860 million); Blackstone ($672 million); Rise Property Trust ($643 million); and Acacia Capital Corporation ($612 million).

Opportunities and Challenges. Seattle's economy is driven by a mix of older industrial companies, "new economy" internet and technology companies, and service, design, and clean technology companies. Seattle's multifamily market experienced booming renter demand in 2021 and most of 2022, as people moved out from parents/roommates. While absorption is slowing modestly in 2023, the market remains tight. There are almost 14,000 units in multiple projects scheduled for completion by year-end 2024 in the metro area. In 2022 the MSA saw strong multifamily construction, a trend that is continuing in 2023. As more tech companies bring workers back to work in the office the Seattle multifamily market will continue to grow.

Our research indicates that the MSA's employment breakeven statistic is -0.40%, indicating that that U.S.

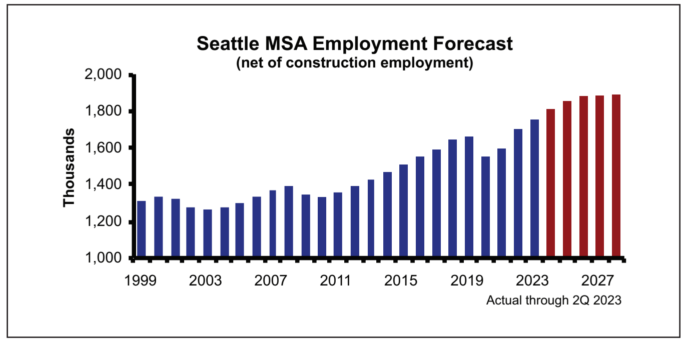
employment can be as low as -0.40% per year, and the MSA will still have positive expected employment growth. Its 1.08 alpha reveals its resistance to a national economic downturn. While both the national and MSA economies may slow modestly, depending on Fed actions among other factors, we do not predict a recession. CoStar data indicate an average increase in multifamily inventory of 2.4% per year.

Over a five-year period, Washington will receive about $8.4 billion in funding through the Infrastructure Investment and Jobs Act passed in November 2021. Federal highway programs ($5.3 billion) will receive the bulk of the funding, while public transportation ($100 million), drinking water infrastructure ($226 million), airports ($1.9 billion), bridge replacement and repairs ($537 million), electric vehicle charging network ($408 million), broadband expansion ($100 million), wildfire protection ($53 million), and cyberattack protection ($42 million) will also receive allocations. These investments will generate near-term jobs, while improving infrastructure to help long-term growth.

Seattle-Tacoma International Airport recently announced it is beginning construction on the first update to its concourse since 1980. The Concourse Evolution project is projected to cost $1.5 billion dollars and will include modernizing building systems, adding earthquake resiliency, updating design and amenities, and including additional space for restaurants and lounges. Construction is set to begin later this year with an estimated completion in 2031.

Construction continues on the Puget Sound Gateway Program, a major expansion of I-5 and nearby local roads. The goal of the project is to improve freight traffic between the Ports of Seattle and Tacoma and the Seattle-Tacoma International Airport. In addition to improving freight traffic, the project seeks to improve civilian congestion on the Interstate and to build 6.5 miles of bike/pedestrian paths and 3.5 miles of new sidewalks. The project began in 2015 and is expected to be completed in 2029 at a total cost of $2.7 billion.

Outlook. Our employment forecasts are net of construction jobs due to the volatility and short-term nature of that sector. We forecast that the MSA will add an average of almost 46,000 net non-construction jobs per year in 2023-2028, or an aggregate of 230,000 over that period. The second-quarter 2023 multifamily vacancy rate stood at 7.3% and is expected to fall consistently to 4% by year-end 2028 (given the known pipeline).



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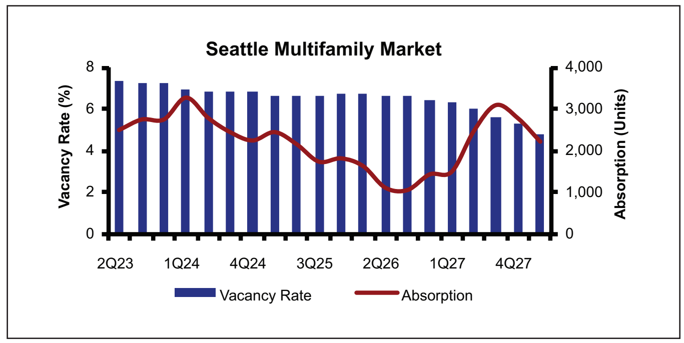

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