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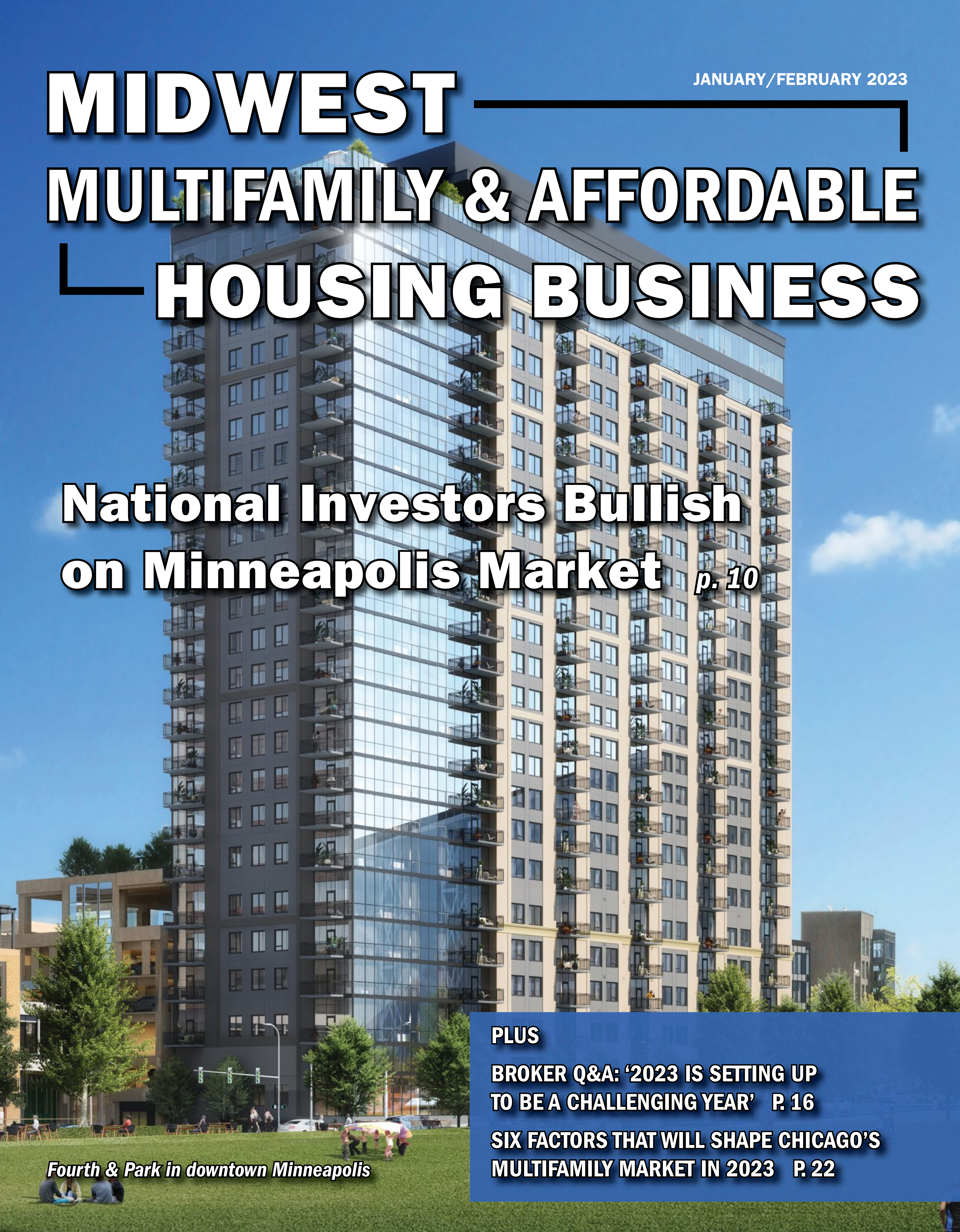
MIDWEST MULTIFAMILY & AFFORDABLE HOUSING BUSINESS



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Fourth & Park in downtown Minneapolis

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Six Factors That Will Shape Chicago's Multifamily Market in 2023

Despite the spike in interest rates and concerns over high property taxes, investors in the Windy City benefit from strong rent growth and limited supply.

Kyle Stengle

By most measures, Chicago's multifamily market has emerged from the pandemic stronger than ever, with robust rent growth supported by rising occupancy in both the city and suburbs. Faced with rising interest rates and a declining inventory of for-sale homes, many would-be buyers are continuing to rent. That trend, coupled with a slowdown in unit deliveries, has kept the market tilted in favor of landlords.

The question is for how long?

While many in the industry are bullish on the market's performance even as fears of a recession grow, some assets will perform better than others amid inflationary pressures and other economic headwinds that will impact how much renters are willing to — or able to — pay for housing going forward.

What follows are six key factors that will shape Chicago's multifamily market in 2023 and beyond:

• **Impact of rising interest rates on investment sales velocity** — This is the elephant in the room. Interest rate movement has impacted velocity in the near term but improving property performance metrics should help maintain an active marketplace, which saw sales velocity climb to record heights during the first six months of 2022, bolstered by low vacancy in the suburbs and high rent growth and improved conditions in the downtown core.

Although fewer deals are being completed as bid-ask spreads widen, there is no shortage of interested buyers in the market, which should bode well when interest rates begin to fall again.

• **The tax man cometh** — Cook County Assessor Fritz Kaegi has drawn the ire of many commercial property owners who feared that sweeping reassessments over the last couple of years in Cook County would significantly increase their tax bills. As the reassessment process became a reality, many owners found themselves with large increases of anywhere from 10 to 200 percent, depending on the building.

However, it wasn't all bad news. The completion of the reassessment process throughout 2022 removed some of the uncertainty that had kept investors away from Cook County. Meanwhile, existing property owners have been successful in getting their assessed values lowered by appealing to the Board of Review. Northern Cook County properties are undergoing their first reassessment since 2019, causing some investor reluctance in the north and northwest Cook County suburbs.

• **Rents fly high** — Chicago is on pace to record its strongest two-year stretch of rent growth on record. Rents saw a nearly 27 percent lift since the start of 2021, which brought the average effective rent to $1,980 per month at the end of 2022, according to estimated figures from Marcus & Millichap.

With people moving back into the city, Chicago neighborhoods like the West Loop, Lincoln Park and Lakeview have rebounded nicely. In addition, new college graduates hoping to move into the city — but who have a low inventory to choose from — will help to keep rents high across the city. As long as employment remains strong in early 2023, rental demand is expected to continue.

• **Demand outpaces supply** — Builders in 2022 completed the smallest quantity of units in the Chicago area since 2015, when just under 5,000 apartments were delivered. This decrease in new units increased demand for existing rental stock, as inventory expanded by only 0.8 percent in 2022, according to Marcus & Millichap. While construction is expected to pick up in 2023 and 2024, historically high construction costs and interest rates, along with tighter lending standards, will support continued rent growth.

• **No amenities? No problem for some renters** — Urban apartment dwellers have shown a desire to live in buildings with plentiful amenities that complement hybrid work schedules and active lifestyles, including coworking areas and indoor/outdoor spaces for recreation and socialization.

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Owners of older buildings are having to get creative with their common areas to meet renter expectations, a trend that is likely to continue for the near term. Renter demand is also growing for unamentized buildings that offer updated units at a more attainable price point, amid inflationary pressures that are putting a strain on household budgets.

• **Suburban stability** — Research from Marcus & Millichap shows that even as Chicago's urban core reopened, momentum in the suburbs did not dissipate. Net absorption exceeded 8,000 units in the suburbs over a 12-month period ending in the third quarter of 2022, up from 6,000 units the prior year.

This suggests the pandemic-induced suburban flight was more of an acceleration of migration trends as opposed to a temporary surge. Garden-style apartment complexes are in especially high demand due in part to their more affordable rents, larger unit sizes and lower-density designs, which became a selling point during the pandemic.

Despite having experienced some volatility, the Chicago apartment market remains a favorable investing environment due to strong occupancy, rent growth and a gradual return to pre-pandemic living. Financing remains available through community and regional banks and agency lenders. While interest rates may be higher, they offer borrowers the opportunity to forge ahead with deals today — when they may face less competition — and refinance in the future when rates recede. ●

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