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SPECIAL REPORT

Multifamily Fundamentals Prepare Industry for Macro Uncertainties Ahead

By Ivan Kaufman and Sam Chandan

ARBOR

About The Authors

As founder of the Arbor real estate finance and investment companies, Ivan Kaufman brings more than 30 years of real estate finance experience to the Arbor platform, with a significant track record of success across both the residential and commercial markets. Ivan serves as Chairman, President and CEO of Arbor Realty Trust, a leading national multifamily lender and mortgage real estate investment trust listed on the New York Stock Exchange (NYSE:ABR). In addition to leading Arbor Realty Trust, Ivan also serves as a Principal for Arbor Multifamily Acquisition Company (AMAC), an acquirer of multifamily properties which he established in 2012, and as the CEO of ArborCrowd, an online real estate investment platform which he formed in 2016. He has previously served as the chair of the Independent Judicial Election Qualification Commission for the 10th Judicial District of New York, on the national and regional advisory boards of Fannie Mae, and on the board of directors of the Empire State Mortgage Bankers Association. He has been named regional "Entrepreneur of the Year" by Inc. Magazine, and he has served as a regional spokesperson for Global ReLeaf, a program of the American Forestry Association. He has guest lectured at Harvard Business School's Real Estate Club, Columbia University and Wharton Business School.

Sam Chandan is a professor of finance at the NYU Stern School of Business and head of the Stern Center for Real Estate Finance. He joined the Stern faculty in late January 2022. From 2016 through early January 2022, he was the Larry & Klara Silverstein Chair and academic dean of the Schack Institute of Real Estate at the NYU School of Professional Studies, one of the world's largest centers of real estate education. He is also the founder of Chandan Economics, an economic advisory and data science firm serving the institutional real estate industry, a contributor to Forbes, and host of the Urban Lab on Apple Podcasts. Dr. Chandan is chair of the Real Estate Pride Council, a global association of lesbian, gay, bisexual, and transgender leaders in the professions of the built environment. Dr. Chandan is a Fellow of the Royal Institution of Chartered Surveyors (FRICS), the Royal Society for Public Health (FRSPH), and the Real Estate Research Institute (RERI), and an Associate Member of the American Society for Microbiology (ASM). His multifaceted research interests address real estate as well as urban epidemiology and the preparedness of global cities and other systemically important urban areas in managing novel public health threats.

Key Findings

- Labor shortages and a consumption shift toward goods over services are key factors contributing to supply chain disruptions, stoking inflation.
- The Federal Reserve's monetary tightening is front and center heading into the new year as the central bank anticipates three rate hikes in 2022 and 2023, setting the stage for higher costs of capital.
- Historically low vacancy rates reflect a rental housing market where household demand continues to exceed available supply.
- Changes in where and how people work are allowing Americans to choose housing options across a wider geographic area.

A Balancing Act Recovery

The emergence of the Omicron variant in the last days of 2021 cast a dark cloud over the new year's global economic outlook. Quickly reintroducing limits on mobility, governments worldwide hope to stem the spread of the new threat. The impacts on international trade and the supply chain are simultaneously dragging on growth and stoking inflation. These challenges reinforce the pandemic's continued role in our lives, tempering economists' and policymakers' short-term forecasts.

As we move into 2022, the retrospective data reveal an economy at once constrained by the pandemic and bolstered by extraordinary interventions. The Wall Street Journal's October 2021 Economic Forecasting Survey projects the U.S. economy will grow an impressive 5.2% in 2021, lifted by federal support for businesses and households. Annualized gross domestic product approached $19.5 trillion during the third quarter, fueled by robust consumer activity that surpassed its pre-crisis peak (*Chart 1*).

The resulting demand for goods and the pandemic's shift away from services has pushed inflation well above the Federal Reserve's target, reaching 6.8% year-over-year in December. Before the shutdown, consumers had a generally stable set of purchasing preferences, with roughly 69% of all consumer spending going toward services (*Chart 2*). Spending began to shift toward goods during the pandemic, and even as the economy re-opened and cultural touchpoints became accessible again, the share of spending on goods remained elevated. Increased demand for goods has worsened existing supply chain disruptions, further challenging the speed of the recovery.

CHART 1
Real Gross Domestic Product
Seasonally Adjusted Annual Rate, Measured in Trillions $, Through Q3 2021
Source: Bureau of Economic Analysis

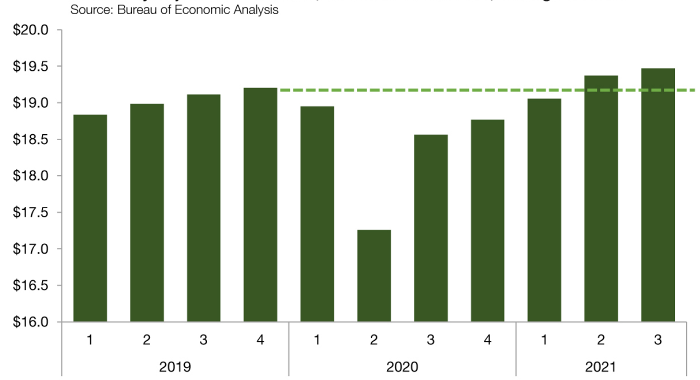
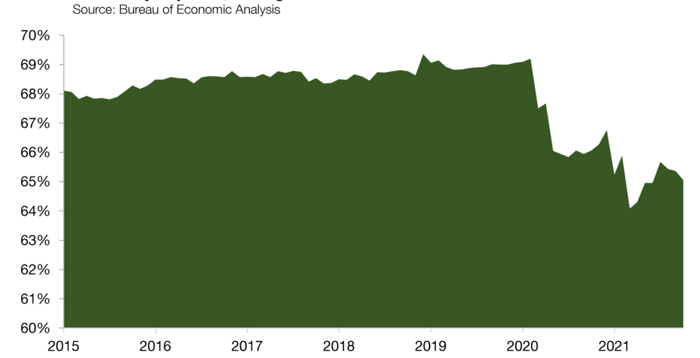


CHART 2
Services as a Percent of Personal Consumption Expenditures
Seasonally Adjusted, Through October 2021
Source: Bureau of Economic Analysis



Due to rising prices and continued labor market progress, the Federal Open Market Committee (FOMC) has updated its guidance on the course of monetary policy in the year ahead. The December release of the FOMC's summary of economic projections signals the Federal Reserve anticipates three rate hikes per year in 2022 and 2023 (*Chart 3*). While the tightening may be more aggressive than economists were forecasting, there are still fears the central bank may be behind the curve in removing monetary accommodation. Our macroeconomic recovery has exposure to both up-and-downside risks heading into the new year. It's essential that the Federal Reserve successfully calibrates its tightening schedule, but it also faces the challenge of doing so in an environment of heightened uncertainty.

Apart from supply chain bottlenecks, record imbalance in the labor market has seen the tally of job openings spike to record highs while companies' capacity to fill those positions has declined. The latest job numbers have fallen short of the mark. Payroll employment rose by just 210,000 jobs in November, even as the inventory of unfilled positions sits above 10 million. Aggregate employment totals remain down from pre-pandemic peaks by more than 2%, despite more job openings per unemployed worker today than at any point in history. Businesses' desperate search for workers has resulted in significant wage pressures (*Chart 4*).

The juxtaposition of a labor market with excess demand and an untapped pool of potential workers is unusual, but the pandemic's unique conditions have created structural access barriers preventing labor engagement.

CHART 3

FOMC Median Federal Funds Rate Forecast

Measured Using FOMC Summary of Economic Projections, Through December

Source: Federal Open Markets Committee

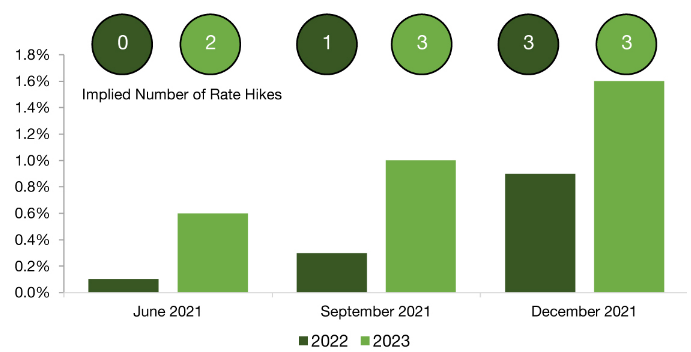
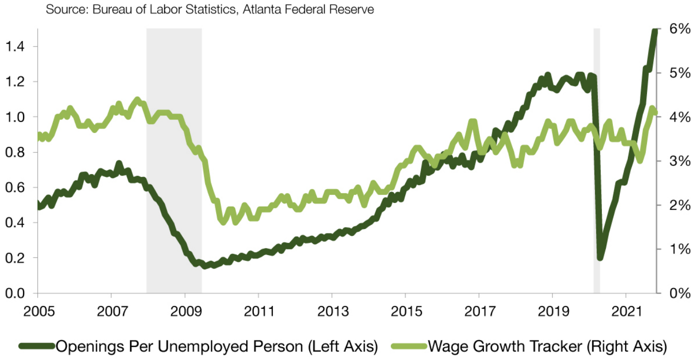


CHART 4

Ratio of Job Opening to Unemployed Persons & Atlanta Fed Wage Growth Tracker

Through October 2021

Source: Bureau of Labor Statistics, Atlanta Federal Reserve



For unmarried men, a demographic group that is the least likely to have children, employment totals have surpassed their pre-pandemic peak (*Chart 5*). For women and married men, employment totals remain stubbornly far-off from a full recovery. Last year's unpredictability of child schooling put a significant additional time burden on working parents. The continued rapid spread of Omicron and its unclear impact on in-person schooling in early 2022 validates the concerns of childbearing adults weighing the tradeoffs of re-seeking employment. Further-more, the question of who is most likely to re-enter the labor force and who will stay out indefinitely is becoming more important in assessing where full employment is in the post-pandemic economy.

CHART 5

Current Employment Totals vs. Pre-Pandmeic Peak

Percent Change, Through November 2021

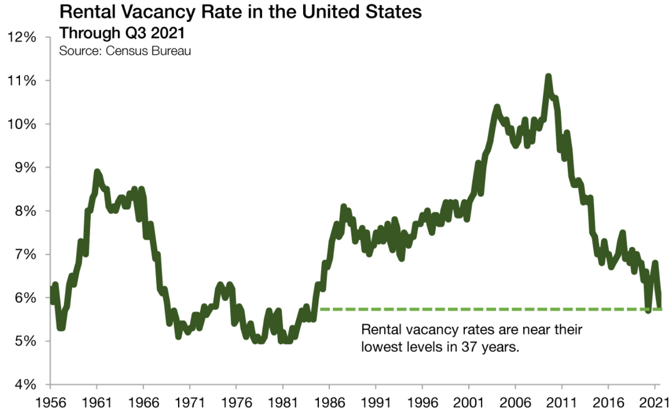
Source: Bureau of Labor Statistics

Continued Strength in Rental Housing

The forces impacting the broader economy have proven powerful tailwinds for a wide swath of the nation's multifamily markets. Concerns about mass evictions undermining housing security and upending the larger multifamily ecosystem of renters, owners and lenders, have not borne fruit. Eviction moratoria provided some relief to the pandemic's most impacted renters, but renters' prioritization of housing has been the more important driver of market stability. According to the National Multifamily Housing Council's reporting on more than 11 million professionally managed units, 93% of renters paid rent in November.

An even broader measure of rental performance from the Census Bureau showed vacancy rates across all rental housing fell to 5.8% during the third quarter of 2021— down from 6.4% a year earlier and currently near its lowest level in 37 years (*Chart 6*).

CHART 6
Rental Vacancy Rate in the United States
Through Q3 2021
Source: Census Bureau



As the pandemic upends long-held norms governing place and time of work, employers continue to update and refine their strategies for balancing the benefits of in-person collaboration with employees' proven ability to work remotely effectively. The structural adjustment is ultimately favorable for rental housing.

The dominant narrative has focused on the regional migration of skilled professionals, generally favoring Sunbelt markets at the expense of the Northeast and Midwest. Rents and investment volume in the Sun Belt skyrocketed in 2021. However, the data show the economy's evolving dynamics are allowing Americans to choose housing preferences across a wider geographic area.

Dispersion from downtowns into the suburbs represents a partial reversal of the last cycle's focus on core urban areas. The shift is fueling demand for a broader range of rental housing options, most notably single-family homes for rent (SFR). Historically high prices for homes, the need for larger down payments and the possibility of higher residential mortgage rates pushed many would-be homebuyers into the SFR market in 2021.

While many secondary markets certainly benefitted from pandemic-related migration shifts, gateway markets have also seen a recovery in rental demand.

To be sure, the rental housing market will not be without challenges in the coming year. The potential for tighter monetary policy and an increase in the economy-wide cost of capital will exert some pressure on investment and lending.

Erosion in affordability from rising rents has also sustained calls for local intervention, sometimes in the form of far-reaching rent controls. However, many in the industry support a supply-side solution to address affordability in the long-term.

2022 and Beyond

Even as the Omicron variant evades our collective vaccine protection and prompts recalibrated expectations for the new year, our economic sensitivity to the viral threat is markedly less than it was in spring 2020.

A potential outcome is the pandemic will gradually fade into a highly contagious though comparatively manageable endemic through this upcoming year and beyond. The execution of the Federal Reserve's monetary tightening and the ability of investors to absorb higher costs of capital will be among the most impactful storylines of the year to come. Still, even as new housing construction has rebounded above its pre-pandemic pace, the growing demand for high-quality, affordable housing options continues to outpace our ability to add new supply. On balance, while the recovery may sometimes prove uneven, underlying fundamentals remain broadly supportive for rental housing in 2022 and beyond.

About Arbor

Arbor Realty Trust, Inc. (NYSE:ABR) is a nationwide real estate investment trust and direct lender, providing loan origination and servicing for multifamily, single-family rental (SFR) portfolios and other diverse commercial real estate assets. Headquartered in Uniondale, New York, Arbor manages a multibillion-dollar servicing portfolio, specializing in government-sponsored enterprise products. Arbor is a leading Fannie Mae DUS® lender and Freddie Mac Optigo® Seller/Servicer. Rated by Standard and Poor's and Fitch Ratings, Arbor is committed to building on its reputation for service, quality and customized solutions with an unparalleled dedication to providing our clients excellence over the entire life of a loan.

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