Chicago Multifamily: Fundamentals Outpacing Perceptions

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KEY INSIGHTS

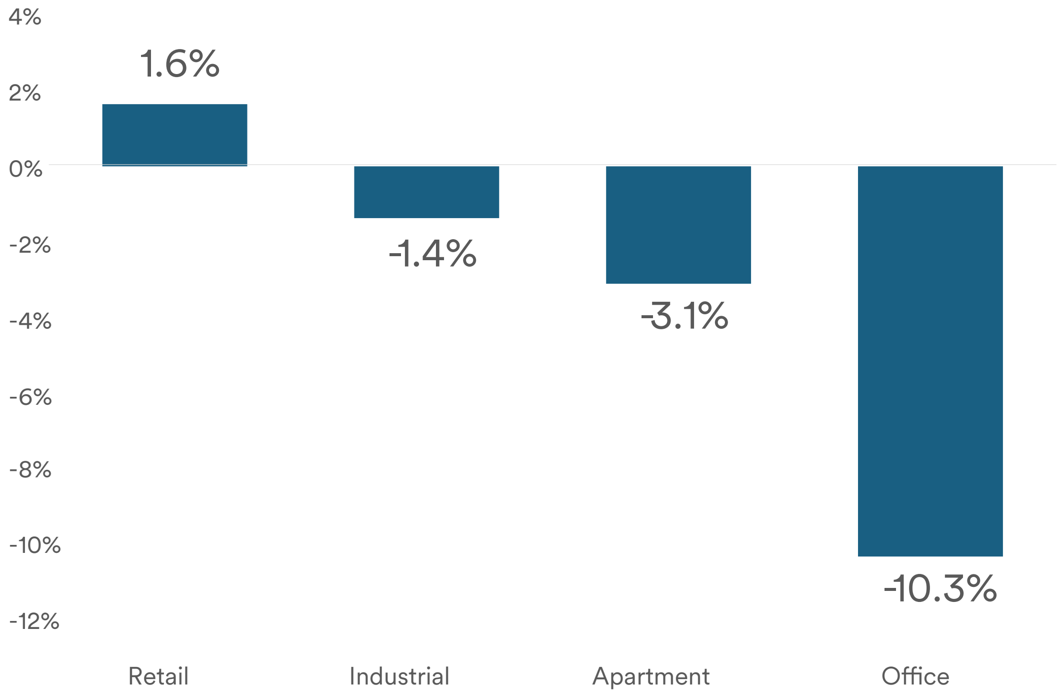
- Chicago commercial real estate has underperformed over the last decade. The gross unlevered return across all property types averaged 3.8% versus a 5.8% U.S. average, and the underperformance continued during the 3Q 2022 – 3Q 2024 commercial real estate (CRE) downturn.
- We attribute most of the underperformance to rising Cook County property taxes, with slow population growth as a secondary factor.
- Today, Chicago apartment fundamentals are among the strongest in the country.
- Recent transaction pricing suggests the market has overreacted to underperformance. In our view, average cap rates are 35 basis points (bps) higher than justified by fundamentals, or at a 6% unlevered price discount.

MetLife Investment Management

Multifamily Looking to Turn the Corner

Nationally, commercial real estate total returns declined by an average of 3.4% annually from the 2022 peak through 1Q 2025 (Exhibit 1), primarily due to the Federal Reserve's rate hikes. While these macro headwinds have affected all markets, our attention is now shifting to local supply-and-demand fundamentals, which will increasingly determine performance. In this context, Chicago's multifamily sector stands out: After years of underperformance, it now appears poised to close — and potentially reverse — its valuation gap relative to peers.

Exhibit 1 | NCREIF Total Returns By Sector, 3Q 2022 to 1Q 2025



Source: MIM, NCREIF. Annualized data as of 1Q 2025.

Strong Apartment Fundamentals in the Chicago MSA

Although Chicago is the 8th largest apartment market by value, it ranked only 12th in transaction volume in 2024,[1] reflecting investor concerns about crime, fiscal challenges and slow population growth. However, these negative perceptions are at odds with the market's fundamentals, which are among the strongest nationally. We expect apartment vacancy to be 250 bps below its historical average by year-end — near a 20-year low and the tightest spread among all major U.S. apartment markets.[2] Furthermore, with an extremely limited development pipeline, we anticipate that vacancy will remain low in Chicago through 2026 and beyond.

Exhibit 2 | Apartment Vacancy vs Historic Average

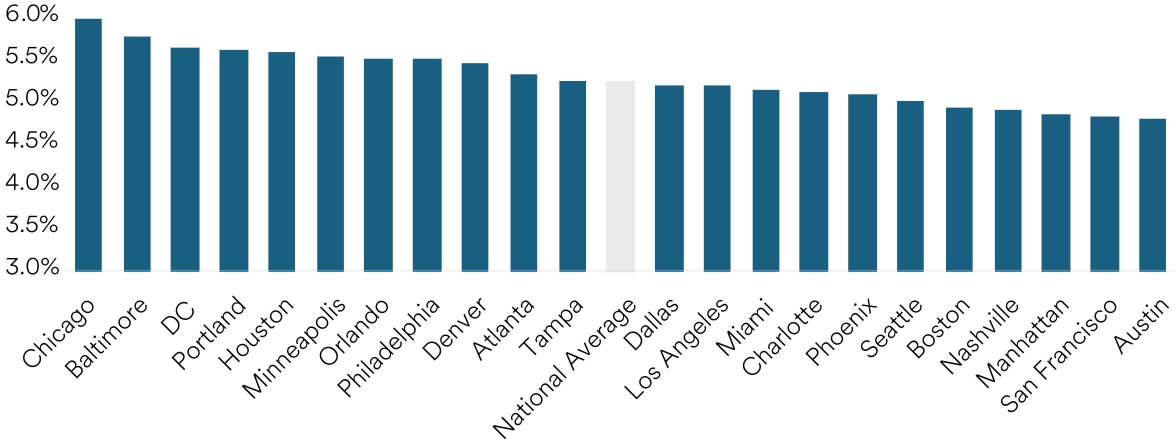
Geography Name	2025 Q4 (Forecast)	Historical Average	2025 Q4 vs. Hist. Average
Chicago	4.5%	7.0%	-2.5%
Palm Beach	5.9%	7.6%	-1.7%
San Francisco	4.8%	5.4%	-0.6%
New York	2.5%	3.1%	-0.6%
Los Angeles	4.6%	4.6%	0.0%
San Diego	4.8%	4.6%	0.2%
Boston	5.3%	4.9%	0.4%
Fort Lauderdale	6.7%	6.1%	0.6%
Philadelphia	6.9%	6.2%	0.7%
Seattle	7.2%	6.4%	0.8%
Baltimore	6.9%	6.1%	0.8%
DC	7.4%	6.4%	1.0%
National Average	7.5%	6.4%	1.1%
Tampa	8.7%	7.6%	1.1%
Miami	6.3%	5.2%	1.1%
Houston	10.7%	9.5%	1.2%
Portland	7.2%	5.6%	1.6%
Dallas	11.1%	8.7%	2.4%
Phoenix	11.3%	8.8%	2.5%
Atlanta	11.9%	8.9%	3.0%
Denver	10.7%	7.4%	3.3%
Nashville	10.4%	7.0%	3.4%
Austin	13.7%	8.7%	5.0%
Charlotte	12.9%	7.9%	5.0%

Source: MIM, Costar. Data as of 1Q 2025.

Construction completions in 2025 are projected to account for just 0.6% of the market's total stock, with completions over the next two years forecast at 0.8% of total stock. As a result, we expect Chicago apartment asking rents to rise 3.5% in 2025 and 3.25% in 2026, on average. Appraisers and other investors are generally underwriting 3% or less rent growth during these years.

Recent transactions also indicate that Chicago apartments are attractively priced. Cap rates in Chicago are the highest among primary markets, offering investors immediate positive leverage, even in today's higher interest rate environment (Exhibit 4). For example, Chicago's cap rates are nearly 110 bps higher than those in Manhattan and San Francisco, despite all three markets having similarly low vacancy rates. The premium is even more pronounced compared to distressed markets like Austin, Texas at 120 bps.

Exhibit 3 | Apartment Cap Rates By Market



Source: MIM, Green Street. Data as of 1Q 2025.

We believe the mismatch between pricing and fundamentals in Chicago represents a compelling opportunity, but it's also worth considering why other investors disagree. We believe the dislocation is being primarily driven by underperformance during 2020 – 2021 pandemic years (when there was more outmigration), flat population growth over the past 20 years and the fiscal condition of Illinois, Cook County and Chicago.

Fiscal Concerns Expected to Continue

Budget issues are pronounced in Chicago at the city, county and state levels. The City of Chicago is facing a nearly $1 billion budget shortfall in 2026.[3] Cook County, where Chicago is located, is facing its own budget shortfall of $218 million for FY 2025.[4] And while the State of Illinois has improved its financial standing in recent years, including an expected $211 million surplus in FY 2025, it is expected to seebudget shortfalls return in FY 2026 as pandemic-era temporary federal funds are set to run out.[5] Concerns over rising property taxes in Chicago and surrounding Cook County are top of mind for investors. We do not expect these fiscal concerns to be resolved in the near term, but this is something that is adequately reflected in pricing.

Fiscal and property tax concerns are primarily concentrated within the City of Chicago and Cook County. In contrast, neighboring suburban counties like Lake and DuPage have balanced budgets and are less exposed to these risks. These suburban markets also benefit from strong rental demand,[6] driven by lower rents, good transit access and diverse job opportunities. For investors, this combination of fiscal stability and solid fundamentals makes the suburbs — especially outside Cook County — an appealing alternative to the city core.

Concerns Over Population, Economic Growth

A concern with the Chicago apartment market is the weak outlook for population growth. The Chicago MSA is expected to have population fall by 0.1% in 2025, which will be followed by annual declines of 0.3% from 2026 to 2029.[7] This is well below the 0.4% level of annual growth that is forecast at a national level. While overall population is shrinking in the City of Chicago, population declines are concentrated in lower-income areas of the south and far west sides. More attractive submarkets, such as Downtown and the North Lakefront, are expected to experience modest population growth.

Likewise, over the coming years, GDP growth in Chicago is expected to be lower than the U.S. average. Despite slower growth, Chicago does have a large, diverse economy, which will help support fundamentals. The market's large manufacturing sector will be exposed to recently implemented tariffs, though logistics activity may see tailwinds from more manufacturing in the U.S. and increased trade with countries in the Americas.

Looking Forward

In summary, while fiscal challenges and slow population growth remain real risks, Chicago's combination of strong occupancy and attractive pricing makes it our highest-conviction market within the apartment sector.

When incorporating these risks into underwriting and considering the yield premium required for increased uncertainty, we believe Chicago apartment cap rates should be about 40 bps above the national average. Since actual trades have been 75 bps above the national average (see Exhibit 3), we believe investors are acquiring assets at a meaningful discount to intrinsic value. As a result, we expect Chicago apartment investors to outperform, particularly those who use financing to achieve immediate positive leverage.

Endnotes:

[1] MSCI Real Assets, Data as of 1Q 2025.

[2] CoStar, Data as of 1Q 2025.

[3] CBS News, 2025.

[4] Cook County Government, 2024.

[5] State of Illinois, 2024

[6] Hottest Rental Markets in Early 2025: Chicagoland Challenges Miami, 2025.

[7] Oxford Economics, Data as of Q1 2025.

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