THE OUTLOOK

Marcus & Millichap

MULTIFAMILY

MIDYEAR 2021

Record Demand Emanates From Economic Momentum; Urban Core Recovery in Motion

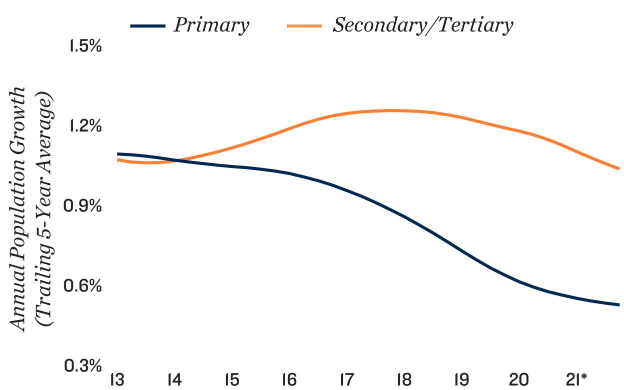
Job openings unleash household formation. The pandemic disrupted the pipeline of young adults graduating and finding in-office jobs, which typically fuels household creation and apartment demand in the markets where they relocate. Instead, many within this age cohort lived with family or friends during the health crisis. In the first half of 2021, firms accelerated hiring and brought workers into the office, translating to record apartment absorption. This will continue in the second half as young adults fill positions and are provided the financial stability to form their own households. Markets with greater job availability, particularly in fields that graduates are concentrated in, will lure new apartment renters as roles are filled. On a national level, more than 9.2 million jobs were open as of May. According to a LinkedIn study, hiring in the U.S. in June was up nearly 68 percent year over year. A handful of Sunbelt metros including Austin, Nashville, Tampa-St. Petersburg and Charlotte topped the list of employee migration destinations.

Transition out of rentals delayed. More of the millennial generation is aging into their typical homebuying years; however, the transition is thwarted by an extremely tight supply of homes available for purchase. The lack of inventory is a product of construction not keeping pace with the upward shift in demand, as well as existing owners staying in their homes longer. Many are locked into mortgages with attractive interest rates, providing less incentive to relocate. This combination has led to soaring purchase costs. In May, the median sale price of an existing residence rose 24 percent year over year, the fastest pace on record. Meanwhile the cost of a new house elevated 18 percent. The heightened expense of homeownership will keep many in the millennial cohort in rentals for longer than anticipated.

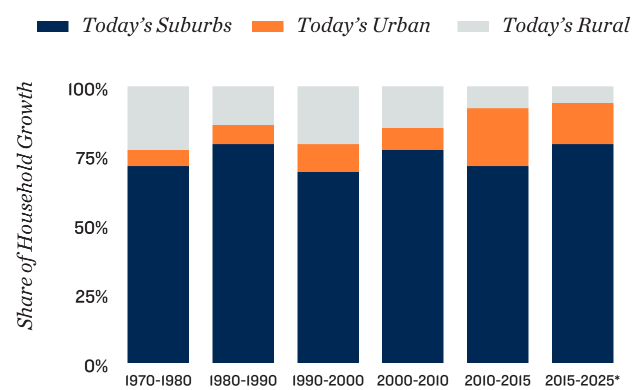
Urban core begins recovery. Demand for downtown apartments is growing as the preferences acquired during the health crisis, which drove many prospective tenants to the suburbs, are subsiding. Remote working enabled employees to distance themselves from the office at the same time that unit size became a top priority as home offices were commonplace. This shifted demand to the suburbs, where apartments are often less expensive and have more square footage. Now, more firms are bringing workers into the office as mass vaccination reduces the threat of virus transmission, which is recalibrating the urban and suburban demand balance. Alongside this, store and entertainment venues are reopening, which is bolstering the appeal of living downtown. Nevertheless, the outlook for suburban apartments remains strong. The suburbs were expected to generate a larger share of household formation prior to health crisis tailwinds, and some pandemic-induced preferences will persist.

Expiring moratorium unlikely to derail industry. The CDC eviction moratorium is set to expire at the end of July. It may still be prolonged, however, and local governments could institute their own protections. States including California, New York, Washington and Oregon have local moratoriums set to expire several months after the CDC order. Nonetheless, the expiration of moratoriums will likely not cause a wide-scale disruption to the industry. Rental assistance programs have supported financially troubled tenants and plentiful job openings should help many find sustainable income after unemployment funds dry up. According to the NMHC rent payment tracker, at least 93 percent of payments were made in each of the first five months of 2021, down only marginally from years past.

Population Expanding Faster in Smaller Metros



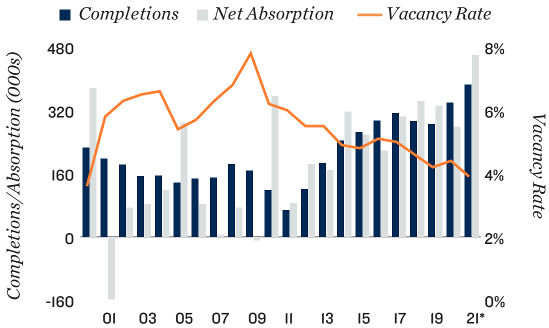
Suburbs to See More Growth



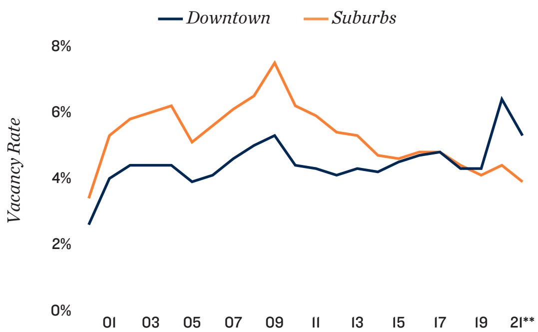
* Forecast

Sources: John Burns Real Estate Consulting; Moody's Analytics; U.S. Census Bureau

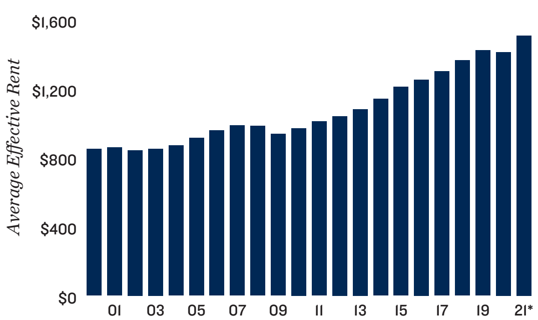
Demand to Outpace Lofty Supply Infusion



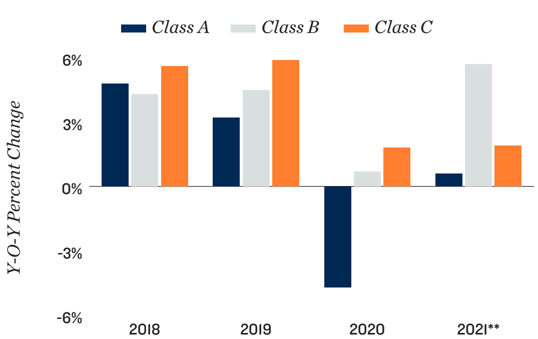
Downtown Vacancy Starting to Realign



Rent Growth Accelerating After Pause



All Classes Had Annual Rent Gains



** Forecast*
*** Through 2Q*
Sources: CoStar Group, Inc.; RealPage, Inc.

Urban Core and Luxury Apartments Gaining Steam

Record deliveries mostly concentrated in a few markets. More than 175,000 apartments were completed in the first half of 2021, raising the annual total to roughly 363,000 rentals. This was the largest completion volume over a four-quarter stretch in at least two decades. Construction activity differed throughout the nation, however, and the majority of markets are not facing distinct supply headwinds. Seven metros gained more than 10,000 units and accounted for almost one-third of U.S. deliveries in the past year. Dallas-Fort Worth received the most, adding 27,700 apartments, followed by Houston with 20,200. These were the only two metros to exceed the 20,000-unit threshold. Austin was the third Texas market to add at least 10,000 units. These and other Sunbelt markets that are adding rentals at a fast clip — such as Atlanta, Phoenix and Charlotte — are noting robust absorption fueled by in-migration, allowing demand to keep pace. Nevertheless, short-term pockets of supply pressure are possible in some submarkets. Other metros leading in deliveries since June 2020 include New York City and Washington, D.C. Elevated completions in more stressed gateway markets like these could prolong local recoveries.

Vacancy gap between urban and suburban tightening. Residents moving out of densely populated city cores during the health crisis to larger, less condensed apartments in the suburbs influenced occupancy. In the central business districts of major markets, the national vacancy rate peaked at 6.3 percent at the end of last year, but has since settled to 5.2 percent in June 2021. The rate is down 10 basis points year over year but still 100 basis points higher than the recording in 2019. Markets noting robust in-migration, paired with an accelerated reopening timeline like Austin and Orlando, had the largest annual CBD vacancy declines. On the other end of the spectrum, metros with weaker demand tailwinds such as Cleveland, Philadelphia, Indianapolis and Columbus had year-over-year CBD vacancy jumps larger than 200 basis points. Meanwhile the national suburban vacancy rate contracted 70 basis points annually to 3.8 percent in the second quarter. Leading the way with annual suburban vacancy abatements of larger than 200 basis points were West Palm Beach and Riverside-San Bernardino, metros that appealed to remote workers. Conversely, technology hubs like San Jose and San Francisco noted suburban vacancy increases as some workers relocated. Conditions remain bifurcated throughout the nation, but the vacancy margin between urban and suburban is tapering. Demand for urban apartments will continue to improve as employees return to offices and young adults, who often prefer the downtown lifestyle, find jobs in these settings.

Segments most impacted last year led second quarter charge. Tenants vacating high-rises in urban cores for more spacious and lower-cost apartments negatively impacted the national average rent figure during the pandemic. Through the first quarter of 2021 the average effective monthly rent was down 0.6 percent annually, mainly due to a surge in availability among top-tier apartments that led operators to expanded concessions. As the economy opened up and workers returned to jobs in urban cores, conditions improved and the forward-looking outlook looked bright. During the second quarter of 2021, the average effective rent nationwide rose among all class types and in both urban and suburban areas. The most impacted segments last year witnessed outsized gains from April through June of 2021. During that three-month span, the average effective rent for both the Class A and B tiers jumped 4.0 percent from the previous quarter to $1,860 and $1,448 per month, respectively. Rates in central business districts also soared 3.2 percent quarter over quarter. While momentum returned to the more beleaguered segments, Class C and suburban rates, which largely avoided pandemic headwinds, also sustained positive growth.

Buyer Pool Diversifying as Apartment Demand Strengthens

2021 Forecast

U.S. EMPLOYMENT:

4.6 percent Y-O-Y increase

- The U.S. is expected to create 6.5 million jobs in 2021, producing the highest annual growth rate in more than 30 years. Business closings in challenged industries, a shortage of workers and higher wages will delay the replacement of all 9.4 million positions lost in 2020 into next year, however.

U.S. CONSTRUCTION

385,000 units completed

- Annual deliveries will climb from last year's nearly 30-year peak of 339,000 units as inventory expands by 2.1 percent in 2021. Nevertheless, rising material, supply and labor costs could push the completion of some underway projects into next year.

U.S. VACANCY

50 basis point Y-O-Y decrease

- Despite elevated deliveries, robust demand that results from employment growth and barriers to homeownership will push the vacancy rate down to 3.9 percent at year end. Net absorption will total almost 460,000 units, up 64 percent from 2020.

U.S. RENT

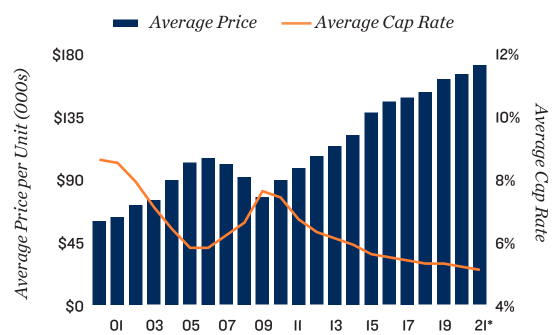
6.8 percent Y-O-Y increase

- Following the first rent decline in over a decade last year, the average effective rate will climb to $1,507 per month in 2021. This will be the largest annual jump since 1998. Tenants are competing for units as the vacancy rate becomes extremely tight, allowing operators to raise rent.

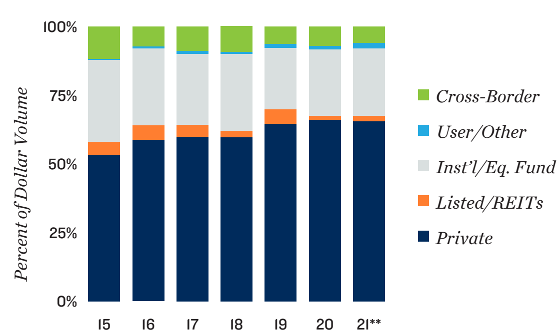
2021 INVESTMENT OUTLOOK

- **Deal flow recovering after health crisis hamper.** Nationwide, the trading of multifamily assets priced $1 million and above increased during the second quarter of 2021 compared with the previous three-month period. Deal flow from April through June also surpassed the trailing-five-year quarterly average, indicating a level of confidence in the property type. An array of investors were involved across various tiers of multifamily as improved economic conditions and apartment metrics fueled buyer demand for complexes in both urban and suburban settings.
- **Buyers drawn to emerging midsize markets.** Buyers are following renters to apartments in less densely populated metros. Trades in secondary/tertiary markets accounted for more than 60 percent of deal flow for the first time on record, after primary metros had comprised roughly that same share just 15 years ago. Midsize metros that recorded notable hikes in activity over the past year include Phoenix, Charlotte, Denver, Minneapolis-St. Paul and Tampa-St. Petersburg.
- **Well-capitalized investors returning.** After many institutional investors and REITs paused acquisitions for a portion of 2020, additional clarity brought more buyers to the table in the first half of 2021. Transactions of assets priced $20 million and above were more than 30 percent higher than the total recorded during the same six-month stretch in 2020. Renewed interest in luxury apartment assets also drove the overall average sale price up 4 percent from the end of last year to $171,000 per unit as of June. Meanwhile, the average initial yield fell to 5.1 percent in the second quarter as intense competition for apartment complexes is applying downward pressure to cap rates.

Sales Trends



Buyer Composition Trends



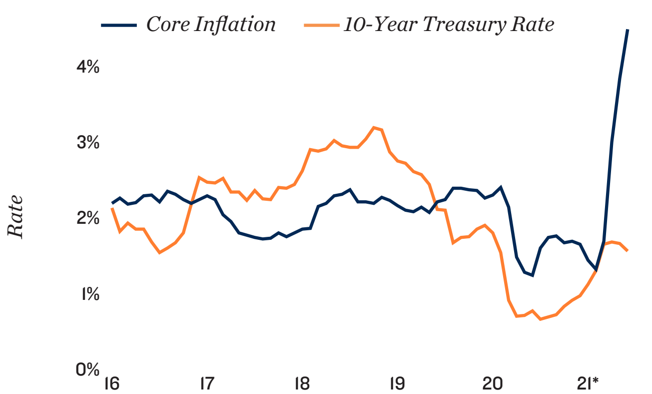
** Through 2Q; ** Trailing 12 months through 2Q*
Buyer composition for sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

Capital Market Operations Largely Resume; Inflation Concerns Becoming More Apparent

Fed positions for temporary higher-inflation period. Applying lessons learned from the global financial crisis, Congress and the Federal Reserve acted swiftly to preserve market liquidity and support borrowers amid the pandemic last year. As U.S. infections recede and the economy reopens, attention is shifting to the potential longer-term ramifications of these actions. The rapid increase in money supply from multiple stimulus provisions paired with low interest rates and disrupted supply chains has led to higher inflation, with core CPI climbing 4.5 percent annually in June. While above earlier expectations, the Federal Open Market Committee (FOMC) still considers this a transitory concern and intends to allow inflation to stay above the traditional 2 percent growth target for longer than it has in the past. The Fed also expects to keep the overnight lending rate low for the near future, citing still-high unemployment as one reason to hold off. More committee members are now open to the prospect of raising rates in 2023, however. Current quantitative easing practices will also remain in effect for the time being. The FOMC will wait for more substantial economic progress before tapering asset purchases, although some pandemic period programs have already expired.

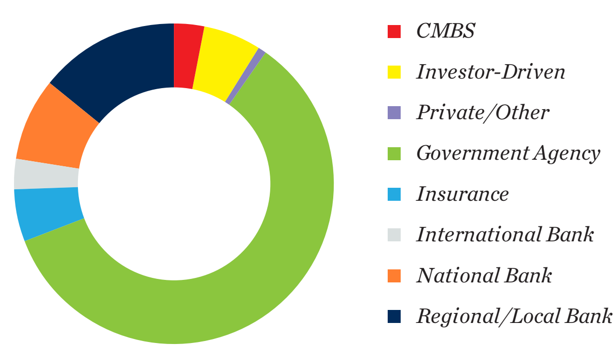
Lenders, like the economy, are opening back up, with financing available for quality properties. Following significant disruptions last year, the majority of lenders are now active and anticipating larger volume after 2020's slowdown. Sentiment is improving, aided by greater population mobility that will help properties in commercial and travel hubs that were disproportionately affected by lockdowns. Lenders are nevertheless favoring borrowers with whom they have an established and positive relationship. A borrower's credit worthiness and track record bear considerable weight when accessing capital, as does recent property performance, including rent collections. More opportunities are available for assets that demonstrated durability during the pandemic or are now in a strong recovery position. Banks and credit unions are offering competitive lending rates at generally pre-pandemic levels of leverage for a range of high-quality properties. Life insurance companies are modestly more selective by comparison, while CMBS securitizations are now underway. For more challenged assets, bridge financing may be available from debt funds and other sources, at correspondingly higher lending rates. Overall, while lending volume is not anticipated to recover to 2019 levels, the impact of the health crisis on capital availability is expected to be less severe than that of the global financial crisis. The external nature of the health problem and critical efforts taken by Congress and the Federal Reserve have maintained and are improving liquidity in the market.

Inflation and Interest Rate Trends



** Through June*
Sources: BLS; Federal Reserve; Real Capital Analytics

2020 Multifamily Lender Composition



Multi Housing Division

John S. Sebree
Senior Vice President | National Director, Multi Housing Division
Tel: (312) 327-5417 | john.sebree@marcusmillichap.com

Price: $1,500

Prepared and edited by
Benjamin Kunde
Research Analyst | Research Services

For information on national multifamily trends, contact:
John Chang
Senior Vice President | National Director, Research Services
Tel: (602) 707-9700
john.chang@marcusmillichap.com

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; John Burns Real Estate Consulting; LinkedIn Workforce Report; Moody's Analytics; Real Capital Analytics; U.S. Census Bureau