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MULTIFAMILY MARKET INTELLIGENCE

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Renter Demand for Luxury Apartments

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Renter Demand for Luxury Apartments Surges

Transaction volumes for U.S. luxury Class A apartments have soared to all-time highs over the past year or so, pushing pricing for this property segment to new records. The voracious investor appetite for high-end units isn't surprising when you consider that renter demand in this niche of product has been robust, sending vacancy rates down and rent achievement up.

Looking ahead, it's important to understand how renter demand for high-end rental product has reached such strong levels, and to think about market influences that will need to come together for substantial absorption of Class A apartments to remain sustainable.

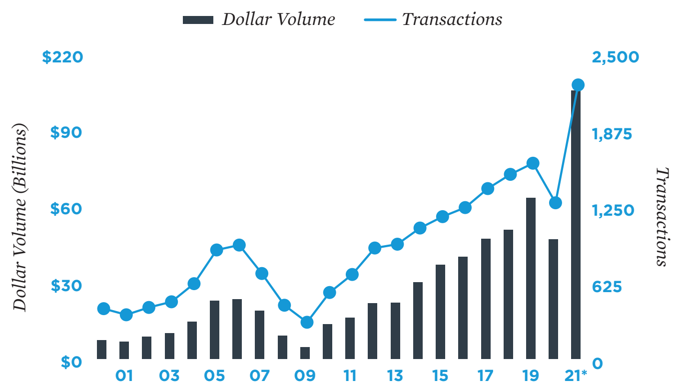
Class A Performances Impress

U.S. renter demand for apartments surged to a stunning level of roughly 724,000 units during the year-ending in first quarter 2022. The only other period when the annual product absorption pace reached similar heights was during the late 1970s to early 1980s, coinciding with the peak in the number of baby boomers in their early 20s. Looking at top demand levels registered over the past three decades, yearly absorption of apartments peaked out at not quite 400,000 units in 2000, 2010 and 2018.

Demand for Class A units proved especially strong in 2021 and early 2022. You can make the argument that limited availability of moderately priced Class B apartments and lower priced Class C units pushed demand toward Class A communities, and it's true that product option constraints influenced the decisions of some households; however, most households renting expensive apartments are not stretching their budgets to afford luxury units. They generally have household incomes that comfortably cover expensive housing costs (more to come on that point).

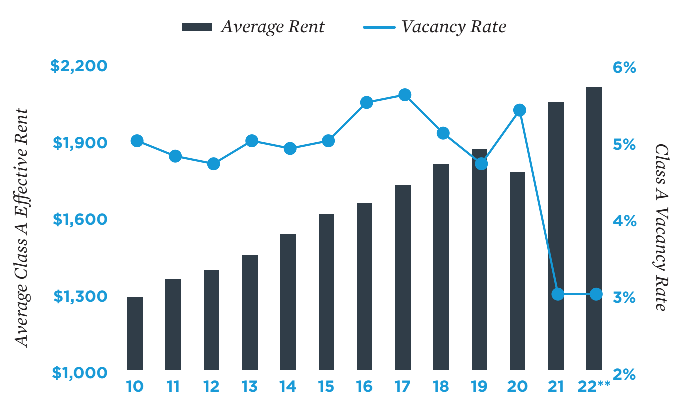
Monthly lease-up levels at brand-new luxury properties still building an initial base of residents climbed past developer expectations in most metros during 2021 and early 2022. At the same time, vacancy plunged within the existing base of high-end projects. Vacancy at stabilized Class A properties (excluding projects in initial lease-up from the calculations) dropped to a record low of 3 percent as of 2022's first quarter. Giving you a few key comparison points, Class A vacancy averaged just over 5 percent over the past couple of decades, and recent high points in vacancy were 5.7 percent in the middle of 2020 and 7.3 percent in early 2009.

Class A Multifamily Sales Trends



Apartment Cap Rate Trends by Class

Class A Vacancy and Rent Trends



* Estimate ** Forecast

Higher Paying Employment Categories Provide Support

The most obvious trigger for luxury apartment absorption over the past year or two is simply the addition of a big block of jobs that pay quite well. There's been lots more success replacing previously lost jobs – or even adding positions, on net – in the higher wage employment categories than in their lower paying counterparts.

While today's total employment in the U.S. still trails the February 2020 pre-pandemic count by slightly more than 1 million jobs, we've got over 700,000 additional positions in the Professional and Business Services employment category. These Professional and Business Services positions pay about $38 an hour.

Current employment has moved just beyond the breakeven point versus the spring 2020 count in Financial Activities, with wages averaging about $41 an hour. The same is true in the tech and telecommunication-heavy Information category, with $45 typical hourly earnings.

For further evidence that the creation of higher paying jobs is supporting renter demand for luxury apartments, look at the income numbers for households moving into Class A apartments. Those signing new move-in leases at Class A apartment properties during the year-ending first quarter 2022 reported annual incomes of topping $94,000, up about 8 percent from the income levels seen for those who moved in 2019-2020.

While there are many job openings for positions that pay well, the nation's labor shortage will be a headwind, making it somewhat tougher to produce near-term additions at the same pace achieved in the immediate past. That's especially true in the Financial Activities and Information employment categories, where BLS information shows the unemployment rate at minuscule levels of 2.0 percent and 2.3 percent, respectively. The unemployment rate stands at 4.0 percent in the Professional/Business Services sector.

For-Sale Housing is Expensive and in Short Supply

It's getting more difficult for many households to make the transition from renting to buying.

Class A apartment rents jumped sharply over the course of the past year, climbing roughly 18 percent. While those aggressive price increases would generally encourage renter households to explore home purchases, for-sale housing pricing jumped at roughly the same pace. The typical monthly payment for a home bought in the first quarter tops today's average apartment rent by roughly $440.

Rising mortgage interest rates are another factor placing some constraints on the size of the pool of renters who now meet the financial qualifications to purchase housing.

Even for renter households who can afford to buy, the completion of a purchase can be a challenge when product shortages are severe. The number of existing homes offered for sale as of early 2022 has been running at about 850,000 units, only half the level that was normal in recent years. Furthermore, product that does come to market now is usually only available for a very brief period, in part because so many homes at entry-level price points are being snapped up by investors planning to offer the housing as rentals.

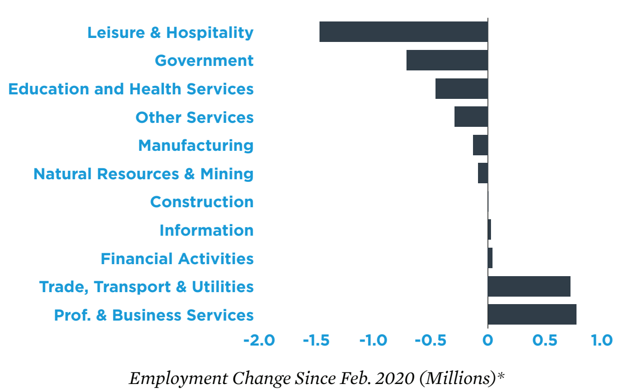
723,000

Number of Jobs Exceeding the Pre-Pandemic Level in the Professional and Business Services sector as of March 2022

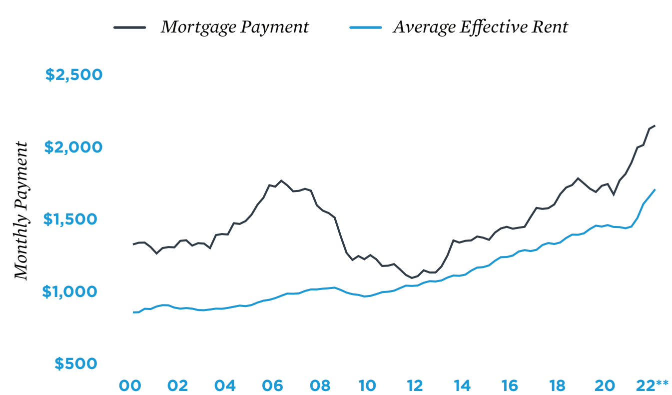
850,000

Number of Existing Homes Listed for Sale as of Early 2022. Volume has declined to about half the normal level.

Pre-Pandemic Employment Change



Apartment Rent and Home Payment Trends



** As of March 2022 ** Preliminary estimate through 1Q*

Luxury Rental Product Availability Will Climb

If for-sale product shortages appear likely to dampen consumer demand for that housing product during the near term, does that same situation hold true in the rental sector?

It's certainly the case that developers were not able to deliver apartments at a pace that kept up with consumer demand in 2021 and early 2022. Furthermore, apartment builders trying to add new supply face the same struggles with labor and materials shortages that are making it so hard to complete for-sale product.

However, viewed relative to the historical norm, the volume of ongoing apartment building activity is substantial. More than 700,000 market-rate apartments are under construction across the U.S. right now, with about 400,000 of those units scheduled for completion in calendar 2022. While several developers are trying to introduce product lines that can be offered for rents a bit under the typical prices for luxury units, that's tough to do. At least two-thirds of all new supply to come to market normally commands Class A rents. Deliveries that offer lower rents tend to be properties built in exurban or one-off urban/suburban locations where cheaper land prices have reduced overall costs.

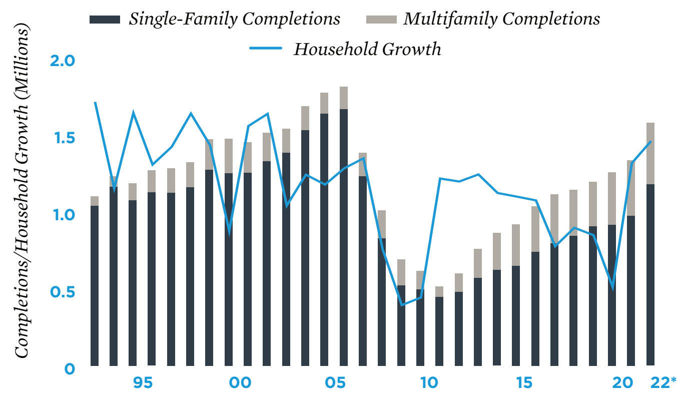
Additional Housing Options are Emerging

Affluent renter households will have a variety of housing options to choose from during the near future, reflecting the introduction of more build to rent single-family home communities, plus the addition of traditional apartment deliveries in a wider array of locations.

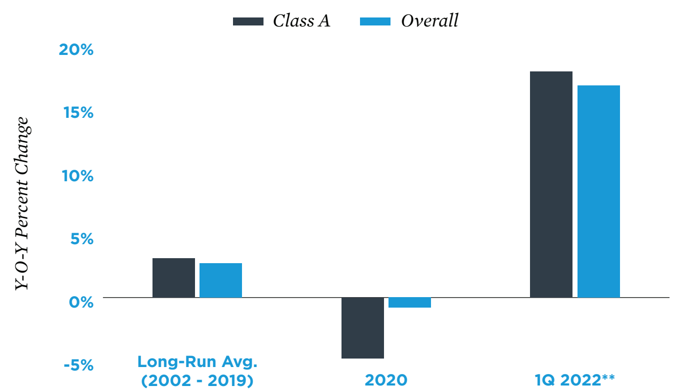
A little more than half of the nation's renters lease single-family homes, mostly renting from small private operators, such as individuals who may own a handful of rental homes. Build to rent subdivisions where the product is professionally managed comprise only a tiny share of the total selection of for-rent units, but significant blocks of this type of product will come on stream in 2022 and the subsequent few years. Right now, build to rent single-family properties look more like a substitute for individually owned single-family rentals than for traditional apartments, but that can certainly change over time as the audience for build to rent projects gets defined more clearly.

Another product that's emerging to compete for high-income renters consists of traditional apartments in spots that might be thought of as "Lifestyle Zoomtowns." These locations are simply small markets with desirable lifestyle characteristics that allow them to attract households from sizable urban markets, now that more households can work from anywhere. There's been a significant run-up in renter demand for apartments in beachfront, mountain and desert locations over the past couple of years. It is possible that these areas will begin to lose households once more employers pull workers back to work in office environments; however, Lifestyle Zoomtowns are still growing so far, allowing newcomers to begin to put down roots.

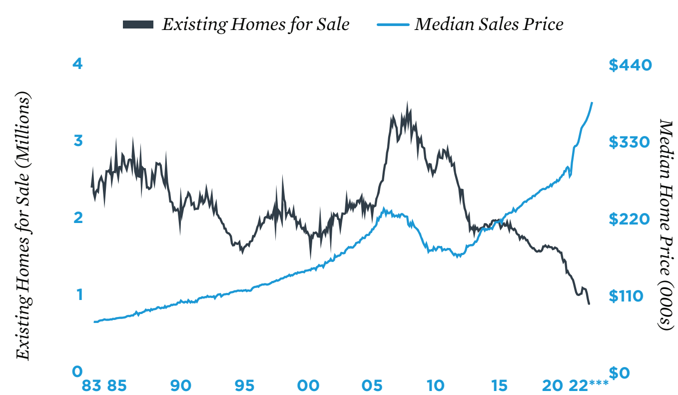
Household Formation Limited by Availability



Annual Apartment Rent Growth



Existing For-Sale Housing at Record Low

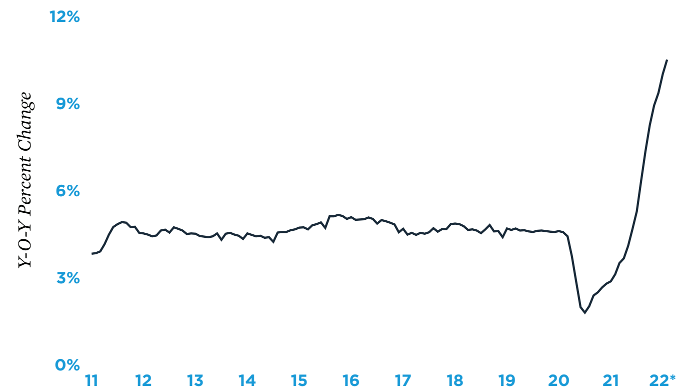


* Forecast ** Preliminary estimate *** Through February

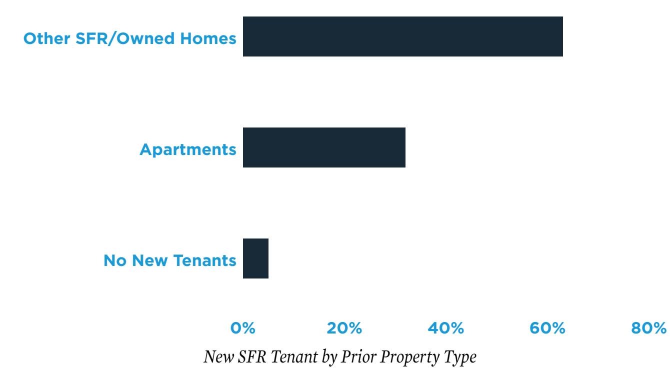
Sustained Demand for Luxury Apartments Appears Promising

- Renter demand for luxury Class A apartments has soared, driving down vacancy and pushing up pricing in this property niche. Robust product absorption rates appear likely to continue during the near term, pending further creation of jobs in industries that pay well.
- For-sale homes that are expensive and in short supply provide tailwinds, boosting renter demand for luxury rental units.
- A sizable block of Class A new apartment supply is on the way, so product should be available to help meet hefty renter demand capacity.
- Build to rent single-family home communities and traditional apartments in small resort-like locations are housing options to watch; however, in the near term, they probably won't capture luxury rental demand at a level that would derail Class A apartment performances in key metros.

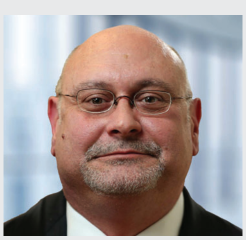
Class A Lease Renewal Rent Increases



SFR Tenants Mostly from Single-Family Previous Residence:



** Through February*



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