NATIONAL REPORT
MULTIFAMILY

IPA INSTITUTIONAL PROPERTY ADVISORS

2Q/23

Longer-Term Sector Momentum is Building As Multifamily Acclimates to Recent Hurdles

Softer economy remains a weight on performance. Apartment vacancy has now risen in four straight quarters, after hitting an all-time low of just 2.5 percent in early 2022. Class A availability increased by the smallest margin among property tiers during that span, despite competing with record amounts of new supply. Residents are choosing and staying longer at luxury units, as the difference between an average Class A rent in the U.S. and the typical monthly mortgage payment on a median priced home roughly tripled over the past year. While higher vacancy has flattened rent growth, the luxury segment has been less impeded. As of the first quarter of 2023, the overall average effective apartment rent nationally was down about 0.6 percent from 2022's peak, but Class A achieved a new record-high in March. The large construction pipeline likely keeps vacancy on an upward path near-term, while also reinforcing luxury tier rents. The potential for supply overhangs in select markets is likely, yet population and housing dynamics imply that these new units are needed longer-term.

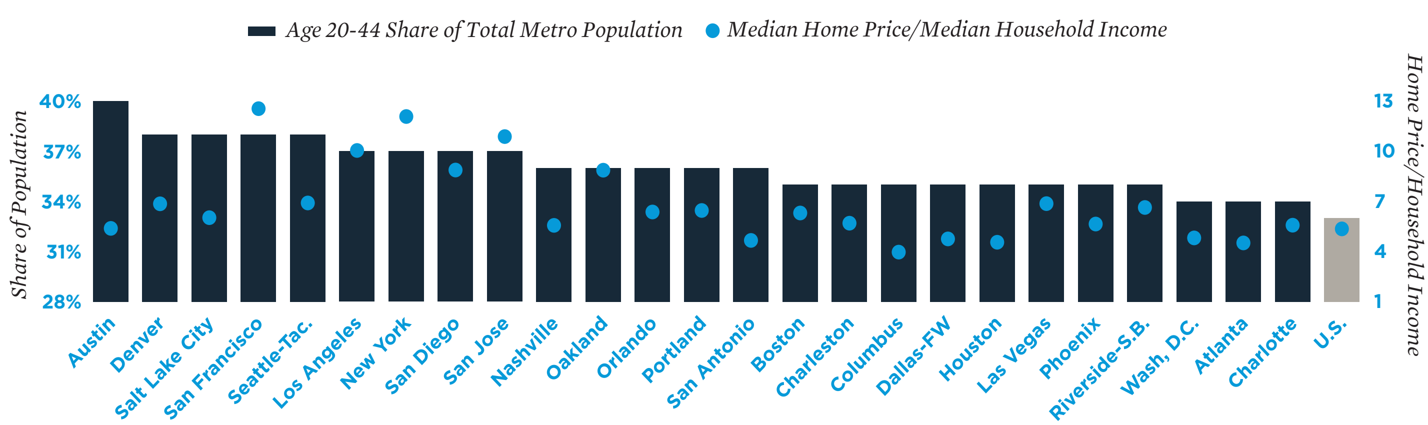
Obstructed household creation sets stage for future tailwinds. The share of young adults living with parents surged to new heights during the pandemic. Economic headwinds and inflation are now further stunting household creation in this cohort, but once more young adults gain the financial confidence to move out on their own, pent-up household formation will release. Meanwhile, millennials are remaining renters for longer amid significant homeownership barriers, and immigration is trending up, brightening the outlook.

Homeownership challenges will broaden the renter base. The inventory of single-family homes available for purchase remains less than half the historic mean, which is reinforcing elevated prices. Alongside this, the average 30-year mortgage rate is about twice as high as the same point in 2022, making borrowing costly and reducing the incentive for owners to sell. Broad inflation has made it harder to save for a down payment as well. None of these obstacles for prospective buyers are likely to ease near-term, coaxing the largest population subset, late-20 to early-30 year olds, to remain renters. Economic and career uncertainty is meanwhile prompting residents to sit tight, evidenced by longer rental leases and a lack of homes coming to market.

Longer Leases Favored Amid Uncertainty

* Through April

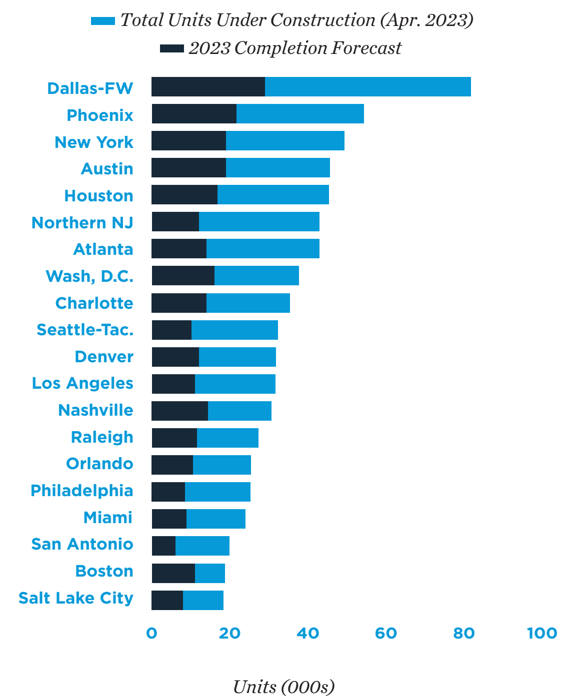
Metros Ripe for Long-Term Rental Sector Strength



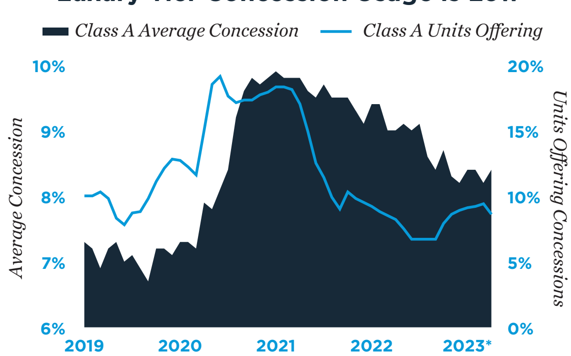
Note: Includes top 25 markets by population share as of 2022; Home price and household income as of 1Q 2023
Sources: IPA Research Services; CoStar Group, Inc.; Moody's Analytics; National Association of Realtors; RealPage, Inc.; U.S. Bureau of Labor Statistics; U.S. Census Bureau

High-Growth Markets Face Supply Pressure, but Appetite for New Units is Improving

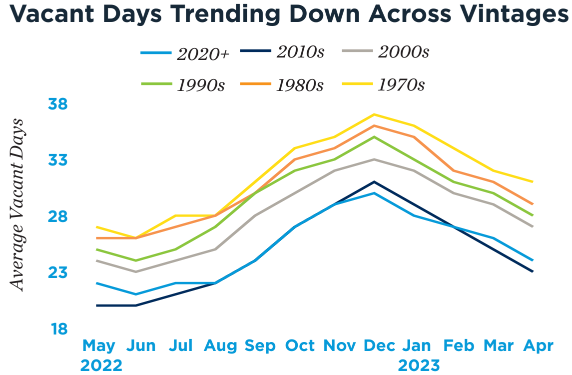
Heightened Delivery Pace Will Extend Beyond 2023



Luxury Tier Concession Usage is Low



Vacant Days Trending Down Across Vintages



** Through April*

Sources: IPA Research Services; CoStar Group, Inc.; RealPage, Inc.

SUPPLY TRENDS

- More than 950,000 units were underway across the U.S. entering the second quarter of 2023. Roughly 400,000 rentals are expected to finalize throughout this year, equating to the largest annual delivery volume on record and implying the 2024 slate will also be substantial. Despite some fundamental softening in recent quarters, new supply has yet to produce a meaningful bump in concession usage. Multifamily project permits rose during early 2023 as well, reflecting developer confidence in the long-term outlook.

- Construction is largely concentrated in a handful of Sun Belt markets with strong foundations for sustained long-term economic growth. Dallas-Fort Worth, Phoenix, Austin, Houston and Atlanta combine for over one-fourth of the units underway nationally. These same metros are also expected to comprise nearly 20 percent of the country's total household creation over the next five years. Job availability, cost-of-living and quality-of-life considerations will maintain these metros' appeal as top migration destinations.

- The list of metros projected to have smaller inventory growth in 2023 relative to last year is thin, but includes several of the nation's largest markets. New York, San Francisco, Oakland, San Jose and Seattle-Tacoma will all have reduced inventory growth in 2023. These were some of the harder-hit areas during the pandemic, yet remain among the most compelling places for young professionals to reside.

DEMAND TRENDS

- Net absorption turned positive during the opening quarter of this year, following three straight negative measures from April through December 2022. While the figure was below apartment completions, keeping vacancy on an upward path, the tides may be shifting. During the final nine months of this year household creation is expected to tick up, allowing annual absorption to surpass 200,000 units.

- Seven major U.S. markets posted year-over-year vacancy rises exceeding 350 basis points in March, all of which are located in the Sun Belt and performed exceptionally well during the pandemic. Tucson, Phoenix, San Antonio and Las Vegas had the most extreme jumps in availability, as the fast pace of building in these metros outstripped softer demand. For similar reasons, Dallas-Fort Worth, Austin and Jacksonville also had sizable vacancy elevations.

- Only two major markets registered year-over-year vacancy declines — Northern New Jersey and San Francisco — which have slightly different dynamics. Northern New Jersey is benefiting from remote work models still prevalent in the Northeast region, as workers can opt for cheaper living costs here. Meanwhile, San Francisco is gradually undergoing a delayed recovery from the pandemic. The construction pace here has also settled, helping reduce availability. New York logged a minimal vacancy increase due to similar characteristics.

Population Dynamics Amid Homeownership Barriers Should Keep Institutions Tuned In

2023 Forecast

U.S. EMPLOYMENT

0.5% increase Y-O-Y

- Economic headwinds slow the overall pace of hiring, while more challenged industries reduce staff counts. Spans of net job loss, mixed with stretches of growth, result in an annual headcount rise of 700,000 roles.

U.S. CONSTRUCTION

400,000 units completed

- Apartment deliveries hit a historic mark nationally this year, expanding inventory by the largest margin on record. Project starts and permits also surged in early 2023, implying a high completion figure next year.

U.S. VACANCY

80 basis point increase Y-O-Y

- Vacancy rises by a much smaller margin than last year's 230-basis-point hike to reach 5.7 percent in 2023. Class A availability faces greater upward pressure from new supply, but the segment has been resilient thus far.

U.S. EFFECTIVE RENT

3.1% increase Y-O-Y

- From 2020 through 2022, the average effective apartment rent in the U.S. grew at a near-8 percent mean annual pace. This year, the rate of increase more closely aligns with the 4 percent trailing 20-year average.

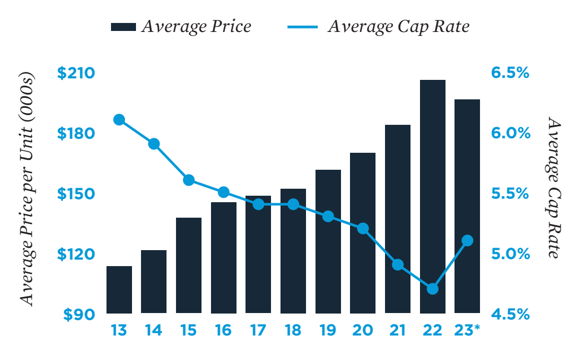
2023 INVESTMENT OUTLOOK

- **Capital markets landscape keeps institutions on the sidelines.** After apartment asset sale prices surged in recent years, which correspondingly compressed cap rates to historic lows, the rapid interest rate hikes that followed created pronounced challenges. Tight cap rates placed yields in a difficult position to move deals forward, as the margin between implied returns and debt service costs became unfavorable. Institutions have largely gone to the sidelines taking a wait-and-see approach, with capital accumulating and ready to be deployed once conditions stabilize. Mild buyer-side competition should present opportunities for active institutions.

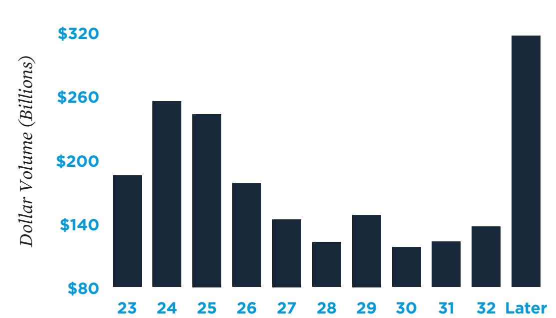
- **Prices and cap rates reflect changing landscape.** A general slowdown in the transaction market, alongside private buyers accounting for a larger share of overall deal flow, is influencing sales metrics. The average cap rate on assets traded during the trailing year ended in March rose 40 basis points to 5.1 percent, while the mean sale price fell roughly 5 percent to $196,000 per unit.

- **Massive pipeline represents the future of the transaction market.** With nearly 1 million units underway across the U.S. entering the second quarter, the next few years will include a barrage of new supply. These deliveries may present investment opportunities and development partnerships to institutions and well-capitalized buyers. Investors may also find upside in mid-tier properties in areas where new supply lifts market rents, or in well-located assets rooted in neighborhoods where development is less practical.

Investment Sales Trends



Upcoming Multifamily Loan Maturities



** Through 1Q*

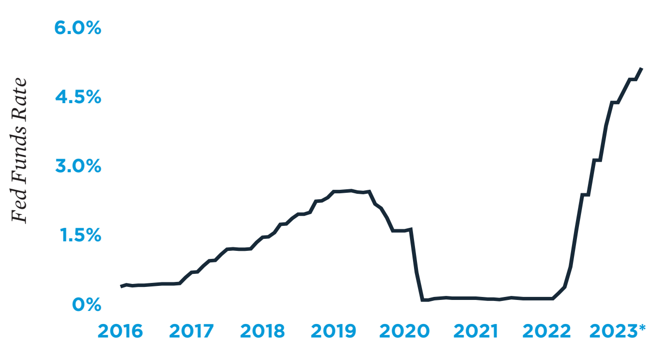
Sources: CoStar Group, Inc.; Mortgage Bankers Assocation; Real Capital Analytics; RealPage, Inc.

Less Assertive Monetary Policy Tightening Could Help Alleviate Transaction Hurdles

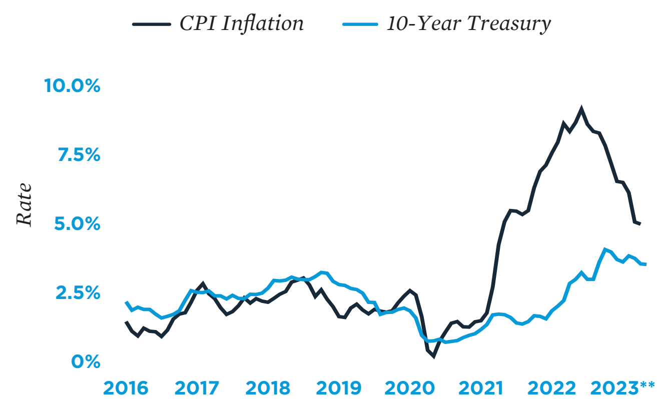
Federal Reserve enacts 10th rate hike in 14 months, indicates increased caution going forward. The Federal Open Market Committee lifted the federal funds rate by 25 basis points at the March meeting and subsequently did the same on May 3, marking the third upward adjustment of that scale this year and moving the lower bound to 5.00 percent. Prior to the March rate hike, the market was anticipating a 50-basis-point increase, but the seizures of Silicon Valley Bank and Signature Bank prompted caution. Nevertheless, the Fed remains intent on curbing inflation and cooling the job market, making their future actions a balance of several dynamics. CPI inflation held above the target range in April at 4.9 percent, but the metric has come down considerably from the 9.1 percent peak recorded last June. The Fed's preferred measure, Core PCE, has also been on the decline, with the March measure being the lowest since October 2021. Meanwhile, the labor market has been resilient despite higher debt costs, with the U.S. adding 800,000-plus jobs in eight straight quarters to produce a headcount that topped the pre-pandemic peak by over 3 million roles in March. If the FOMC suspended future rate hikes, the interest rate stability would allow buyers to better work with sellers and capital providers, aiding multifamily deal flow.

Lenders remain active, but with heightened due diligence. Multifamily's proven track record, crucial role in the nation's housing landscape, and strong outlook amid homeownership barriers instill a level of confidence in the sector. Conventional lenders, as well as agencies like Fannie and Freddie, remain engaged despite hurdles. The recent treasury rate softening is allowing financiers to better navigate the environment, though many are utilizing an artificial rate floor. Some stress in the banking sector that emerged during the first quarter is likely to result in a general lending pullback and prompt increased due diligence, but agencies have capital available and should serve as a backstop. Nonetheless, LTVs may be heavily scrutinized, and lenders could take more conservative underwriting and debt service coverage approaches. These current challenges, however, do not deduct from the medium- to long-term value proposition of apartments. The sector is well-positioned amid homeownership hurdles and pent-up household formation, while ongoing valuation adjustments are marginal relative to the sector's 70-plus percent average sale price growth across the past decade.

Fed Funds Rate Over Time



Inflation and Interest Rate Trends



** Fed Funds Rate through May 10*
*** Treasury Rate through May 2; Inflation through April*
Sources: IPA Research Services; Federal Reserve; U.S. Bureau of Labor Statistics

Multi Housing Division

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Sources: IPA Research Services; CoStar Group, Inc.; Federal Reserve; Moody's Analytics; Mortgage Bankers Association; National Association of Realtors; Real Capital Analytics; RealPage, Inc.; U.S. Bureau of Labor Statistics; U.S. Census Bureau