SPECIAL REPORT

Class A Multifamily Outlook

IPA INSTITUTIONAL PROPERTY ADVISORS

Midyear 2023

Homeownership Barriers Help Higher-End Rentals Navigate Supply-Side Pressure

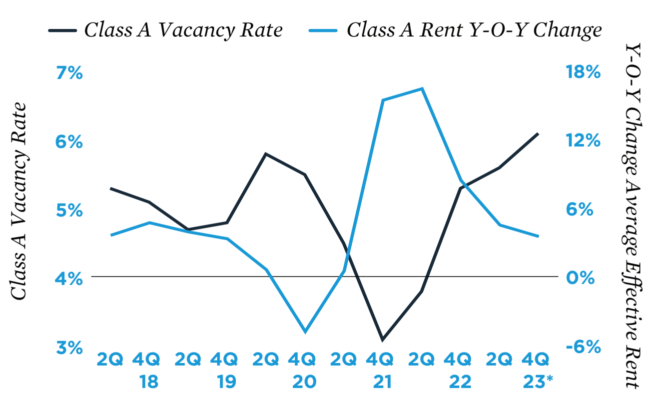
Luxury apartments proving resilient thus far in 2023. The renter demand slowdown that coincided with economic uncertainty and increasing interest rates has impacted all apartment segments, but the luxury tier has held up relatively well in recent periods. From the end of 2022 through the mid-point of this year, Class A vacancy rose by 30 basis points, compared to elevations of 40 and 80 basis points in the Class B and C segments, respectively. Luxury tier resilience is particularly notable, given the supply-side competition that Class A rentals are facing amid record construction. Nearly 200,000 new units were delivered nationwide during the first half of 2023, surpassing the prior record-tally for the opening six months of a year by almost 25,000 rentals. Economically curbed demand amid historic development will nevertheless keep Class A vacancy drifting up and normalize rent growth through year-end.

Rent momentum settling after historic run. Entering the third quarter of 2023, the average effective Class A rent was up 4.5 percent year-over-year. While this is well-below what was seen during the abnormally strong 2021-2022 period, it aligns with more typical years spanning the prior decade. From 2010-2019, the average year-over-year growth rate in the second quarter was 4.1 percent. In the second half of 2023, however, the pace is expected to continue softening as vacancy rises. Progress will nevertheless stay positive on an annual basis as the opening of high-quality units helps offset some flat renewals and discounted rates. Concession usage has also not yet risen dramatically. About 9 percent of Class A units were offering concessions in June 2023, compared to 7 percent in the same month of 2022.

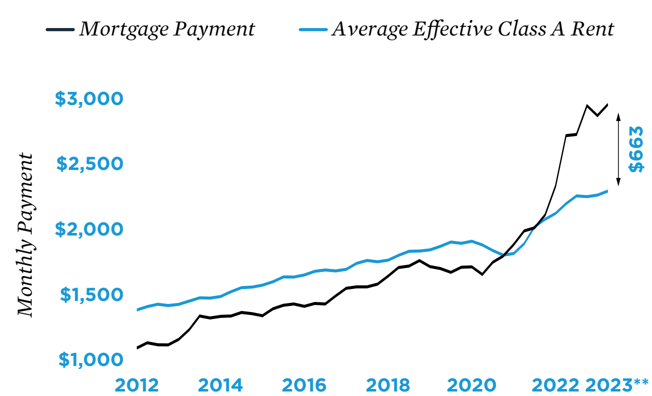
Record construction justified, but sustains pressure. Apartment completions during the final six months of 2023 are expected to mirror the historic first half total, resulting in a new annual record. About 400,000 units will open across this year, with 2024 setting up to be even more active. Of the more than 1 million rentals underway as of July 2023, over 60 percent of them had a preliminary completion date scheduled for 2024. Labor constraints, approval delays, insurance adjustments and softer conditions are likely to push a portion of those deliveries to later years, however, tempering 2024's probable volume. Multifamily project starts in June were also down almost 10 percent year-over-year, potentially foreshadowing a longer-term slowdown. At the same time, a stalled single-family market is providing little relief for the national housing shortage, as many homeowners are hesitant to list and trade out lower rate mortgages established prior to recent hikes. As a result, the median home price ticked up in the first half of 2023, while borrowing costs also rose, enhancing the comparative affordability of higher-end apartments.

Distinct affordability gap keeps renters in apartments. Millennial homeownership is trending below prior generations, a dynamic poised to continue with Gen Z. Contributing to this, the difference between renting a Class A apartment and a typical monthly mortgage payment on a median priced home in the U.S. swelled to about $660 per month in the second quarter of 2023. Cost-saving benefits during an extended period of inflation and uncertain career advancement will keep renters in apartments for longer. Resuming student loan payments in the fall will also impact young adults' ability to save for a down payment.

Higher Vacancy Normalizing Rent Growth



Luxury Rentals Offer Cost-Saving Benefits

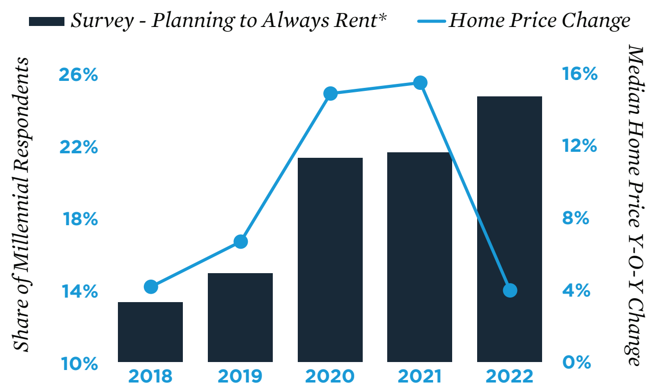


** Forecast*

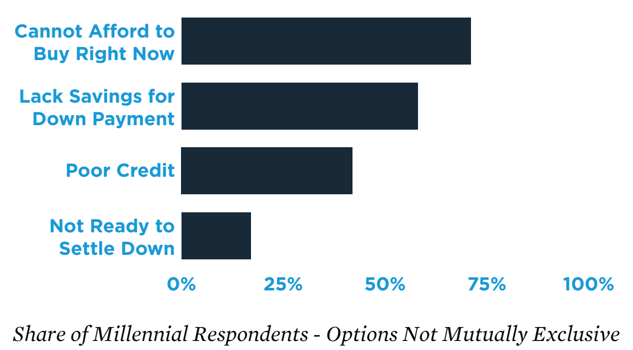
***As of 2Q 2023; Mortgage payments based on quarterly median home price for a 30-year fixed rate mortgage, 90% LTV, taxes, insurance, and PMI*

Sources: IPA Research Services; CoStar Group, Inc.; Moody's Analytics; National Association of Realtors; RealPage, Inc.; U.S. Census Bureau

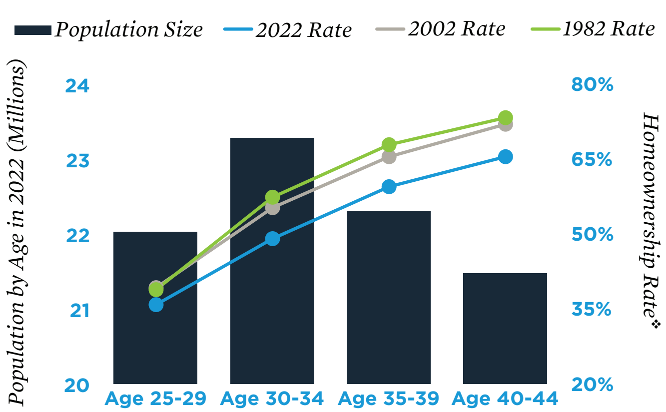
Debt Costs Further Strain Homebuying Plans



Top Reasons Millennials are Waiting To Buy Homes**



Typical Homeownership Flow to be Delayed



*Annual Apartment List Survey; Sample limited to millennials who do not currently own a home
** 2022 Apartment List Survey; Sample limited to millennial renters who plan to buy a home one day
+ Homeownership rate by age of householder
Sources: IPA Research Services; Annual Apartment List Survey; Moody's Analytics; National Association of Realtors; U.S. Census Bureau

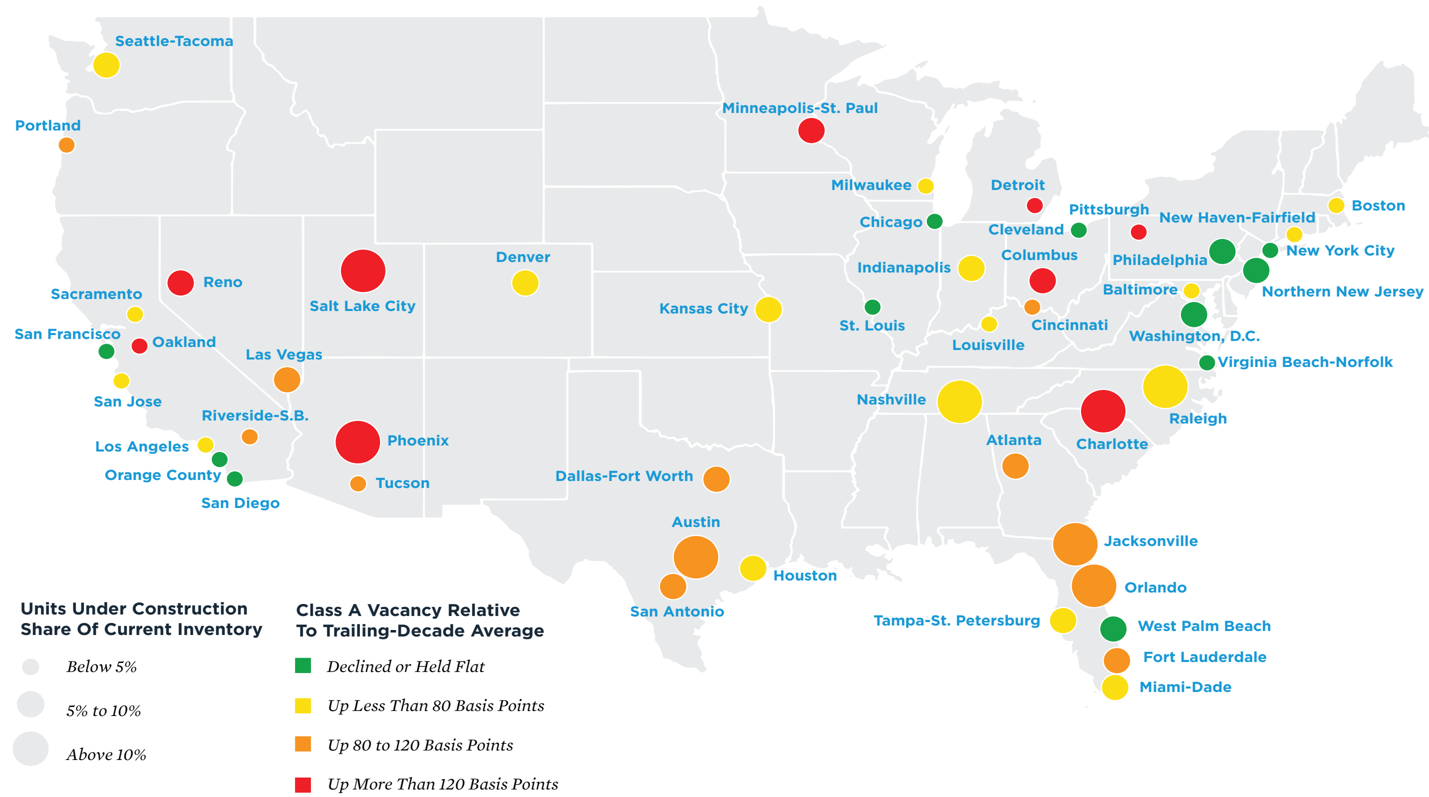
Renter Survey Sheds Light on Changing Perspectives Toward Homebuying

Uninviting home market bolsters Class A apartment demand. Residents on the verge of becoming first-time homeowners have been thwarted from multiple directions for several years. During 2020 and 2021, a rush to buy homes when borrowing costs were low and people sought larger living spaces drove up prices at an extreme pace. Subsequently in 2022, a series of rapid interest rate hikes abruptly cooled demand and normalized price growth. However, it also locked many current owners into lower rate mortgages, limiting listings and keeping valuations from dropping despite softer purchasing activity. That dynamic extended into this year. The average 30-year fixed-rate mortgage approached 7 percent at the halfway point of 2023, while the median single-family sale price notched a 12-month high in June. As a result, an increasing share of millennial renters are abandoning the pursuit of homeownership altogether. This cohort on the margin could seek out higher-end apartments that offer lifestyle advantages or meet preferred specifications to accommodate a growing household.

Expanding renter households could have particular preferences. Apartment List's 2022 Annual Survey reflected that a large share of millennial renter households are ready to settle down, but are unable to become first-time homeowners due to several affordability-based constraints. This likely translates to a growing number of renter households that are starting to find partners, raise children, adopt pets or progress through various other life stage events. Higher-quality apartments in areas with preferred school systems, public parks and lower crime rates may be increasingly favored by this cohort. Complexes with outdoor spaces and pet-friendly designs could also gain appeal. Larger unit sizes and storage to assist with household expansion and possessions accumulated may be another top consideration. Single-family rentals will compete for these tenants in suburbs of some markets, but premium urban apartments where single-family rentals are impractical continue to offer greater access to dining, entertainment, shopping and transit.

Metros with certain qualities positioned for strength. Locations with large young adult populations or extreme homebuying barriers are situated to have robust Class A apartment demand tailwinds. Austin, Denver, New York City, Salt Lake City, San Francisco, San Jose and Seattle-Tacoma represent the major U.S. markets where more than 30 percent of the total population was within the age 25 through 44-year-old bracket as of last year. Meanwhile, the list of metros with Class A affordability gaps exceeding $2,000 per month as of the second quarter of 2023 includes Boston, Denver, New York City, Oakland, Orange County, Portland, San Diego, San Francisco, San Jose and Seattle-Tacoma.

Development Clusters Elevating Vacancy; High-Density Coastal Hubs Hold Tighter



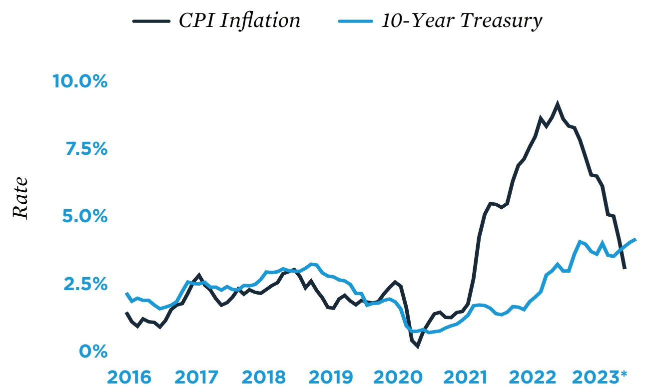
Note: Construction as of July 2023; Vacancy as of 2Q 2023 relative to the trailing-decade 2Q average
Sources: IPA Research Services; CoStar Group, Inc.; RealPage, Inc.

Localized Supply Pressure Warranted by Longer-Term Growth Projections

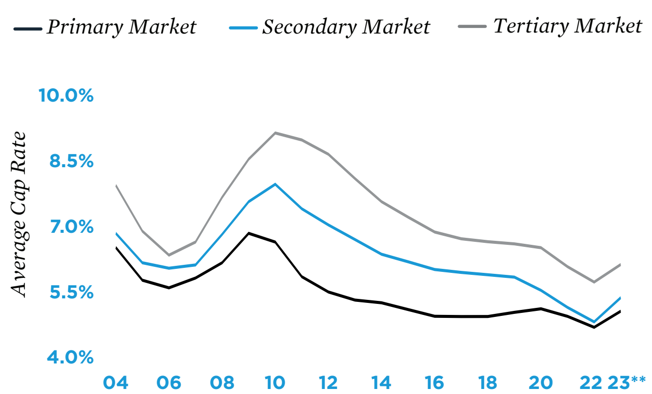
Largest Class A vacancy jumps correlate with migration-fueled development. Luxury tier vacancy rates rose by over 200 basis points year-over-year in 15 major U.S. markets as of the second quarter of 2023. This list was characterized by Sun Belt metros that outperformed during the pandemic, which encouraged robust construction that has since produced more intense recalibrations as cascades of new supply outpace economically-hindered demand. Markets with annual inventory growth of more than 5 percent as of June 2023 — Charlotte, Nashville and Salt Lake City — had corresponding Class A vacancy increases of 230 basis points or greater. Other locations that ranked in the top 10 major U.S. markets for supply expansion — Austin, Orlando and Phoenix — had similar outcomes. While these six markets will continue to face Class A vacancy pressure in the near-term, they have foundations for above-average growth to help absorb new supply. Through 2030, Austin, Orlando and Phoenix are each expected to witness triple the national rate of household creation, while Charlotte, Nashville and Salt Lake City also rank near the top of the country in this metric.

Vacancy more stable in nation's most populated metros and regionally-discounted areas. The 10 smallest Class A vacancy adjustments over the past year ending in June 2023 can primarily be categorized into two groupings: gateway metros with dense populations and extreme homeownership barriers, and markets with regional affordability advantages. Boston, Chicago, New York City, Seattle-Tacoma and Washington, D.C. each recorded luxury tier vacancy changes of 120 basis points or less over the past 12 months. Additional metros with vacancy movement within this range include Northern New Jersey, Reno, Sacramento and West Palm Beach — locations that offer renters, and especially hybrid workers, comparative discounts to nearby markets. Meanwhile, San Francisco had the nation's largest Class A vacancy drop during the past year as it continues to rebound.

Inflation and Interest Rate Trends



Cap Rates Drift Upward Across Market Types



** Treasury Rate through August 3; Inflation through June*
*** Preliminary estimate through 2Q*
Sources: IPA Research Services; CoStar Group, Inc.; Federal Reserve; RealPage, Inc.; Real Capital Analytics; U.S. Bureau of Labor Statistics

Cooler Inflation and Rate Stability Should Help Release Dry Powder from Sidelines

Federal Reserve rate hike pause is likely on the horizon. While persistent core pricing pressures may coax the Fed to enact a few more small rate hikes before the end of 2023, other positive indicators have shown that the fight against inflation has taken hold. The headline consumer price index rose in June 2023 by the smallest year-over-year margin since March 2021. A tight labor market and above-average wage growth, however, will likely keep the Fed vigilant through the second half of 2023. While rate cuts are not expected immediately following the final hike, greater interest rate stability should nevertheless help enable price discovery and allow investors to better work with lenders. This should bring more institutions off the sidelines in the second half of 2023, as considerable dry powder has been accumulating and is primed to be deployed.

Recent focal points registered sharpest drops in trading. Based on preliminary estimates, transaction velocity in the $15 million-plus category during the first half of 2023 was down about 65 percent from the opening six months of last year. Compared to the first half average from 2010-2019, the number of trades was within 2 percent. The metros that recorded the largest number of $15 million-plus trades during the opening six months of 2023 include Atlanta, Dallas-Fort Worth, Houston, Los Angeles and New York City. Meanwhile, locations where institutional-level deal flow improved relative to the first half of 2022, or fell by a relatively small margin, include Chicago, New York City, Riverside-San Bernardino, San Jose and Seattle-Tacoma. Moderate supply pressure and elevated barriers to homeownership are helping keep Class A vacancy tighter in these markets. Conversely, the metros that noted the steepest contractions in trading include Charlotte, Dallas-Fort Worth, Houston, Las Vegas and Salt Lake City. Robust migration and household creation likely shift institutional attention back to these Sun Belt markets in the medium-term, but accelerated cap rate compression during the pandemic and notable supply pressure could remain a weight on deal flow.

IPA Multifamily

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