NATIONAL REPORT
MULTIFAMILY

IPA INSTITUTIONAL PROPERTY ADVISORS

3Q/23

Coastal Hubs Exhibit Resilience; Climbing Operating Costs Pose a National Concern

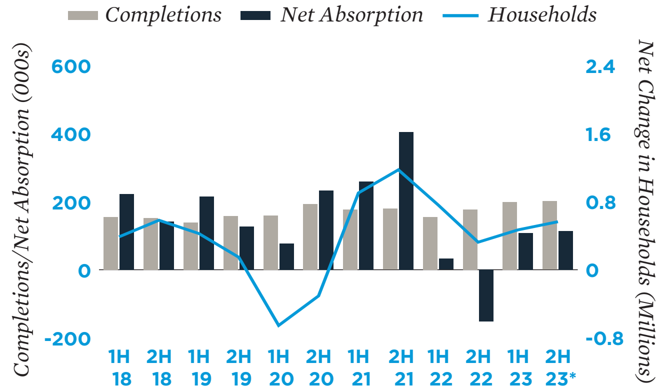
Multifamily demand returned to a favorable level. After the pandemic had disrupted normal seasonal patterns, the spring months of 2023 were once again a strong period for apartment demand. From April through June, about 80,000 units were absorbed on net, the largest quarterly total since the opening three months of 2022. At the same time, net absorption fell short of the 107,400 rentals finalized during that span, keeping vacancy on the ascent. These dynamics foreshadow the remainder of 2023. Household creation is gradually improving, yet continues to be hamstrung by economic uncertainty and inflation. As a result, net absorption will remain in positive territory through year-end, but will trail record construction.

Construction is sizable, but mostly condensed to certain metros. The 200,000 units finalized during the first half of 2023 marked the largest total over a six-month span on record. An additional 200,000 units are expected to deliver during the second half, placing annual inventory growth at a historic 2.1 percent for 2023. Construction is clustered, however, with Sun Belt migration favorites receiving an outsized share of new supply. Austin, Charlotte, Jacksonville, Nashville, Raleigh, Reno and Salt Lake City are each on pace for 5-plus percent inventory growth this year. Conversely, some of the nation's largest population hubs — Chicago, Los Angeles, New York City, Orange County and San Diego — will note sub-1.5 percent supply expansions.

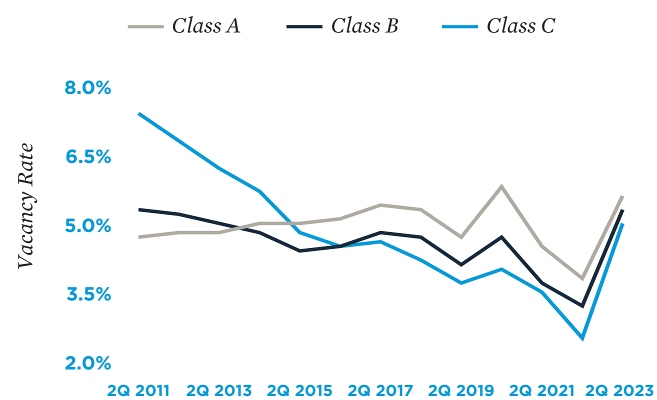
Gateway markets stand out. Some metros are better weathering recent headwinds. As of 2023's mid-point, just 10 major U.S. markets had both year-over-year vacancy increases below 200 basis points and sustained sub-5 percent rates entering July. That list included six of the nine major markets with average effective rents above $2,500 per month: Boston, Los Angeles, New York City, Orange County, San Diego and San Jose. Despite relatively high living costs, these cities remain attractive spots to work and reside. Extreme homeownership barriers, meanwhile, make renting a comparatively affordable option.

Wide affordability gap bodes well for Class A demand. While multifamily rent growth has softened, single-family home prices and borrowing costs have continued to increase. As a result, the difference between a typical monthly mortgage payment on a median priced home and the average Class A rent swelled to $660 per month in the second quarter of 2023. This, coupled with the challenges of saving for a down payment amid the resumption of federal student loan obligations in October, will keep renters in Class A apartments for longer.

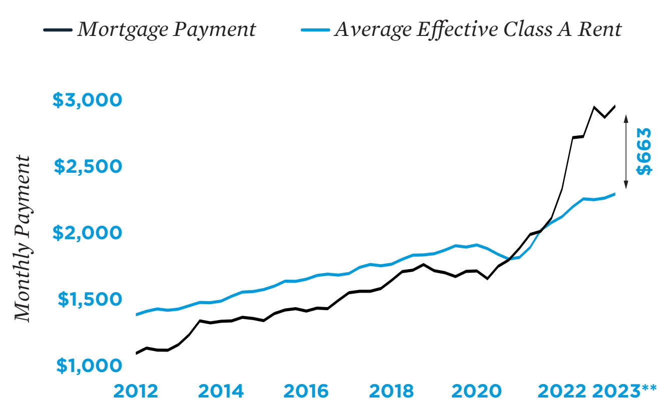
New Households Improving Rental Outlook



Vacancy Recalibration Spans All Segments



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*

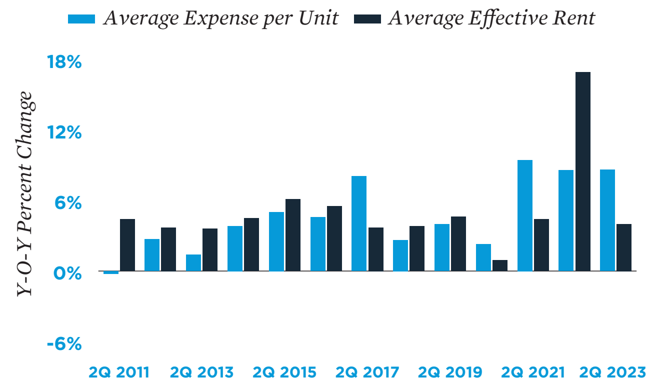
Sources: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Moody's Analytics; National Association of Realtors; RealPage, Inc.; U.S. Census Bureau

Operators and Developers Likely to Recalibrate Amid Higher Expenses

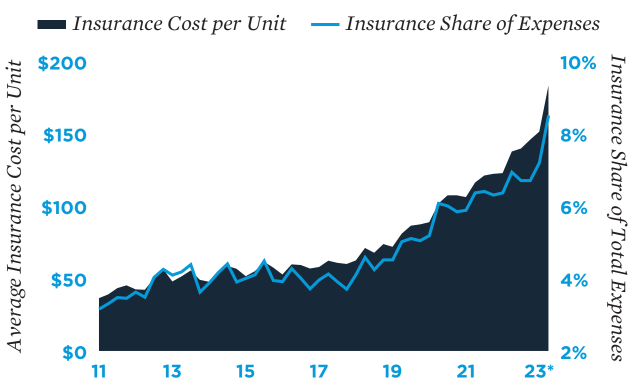
Expenses have grown faster than rents, impacting operations. After the average effective rent rose at nearly twice the pace of expenses during the yearlong period ending in June 2022, those trends inverted over the following 12 months. Operational costs grew by 8.6 percent on average year-over-year in the second quarter of 2023, as persistent inflationary pressures drove up expenses from multiple directions. Turnover, marketing and insurance costs each rose by more than 10 percent year-over-year, while administrative, taxes, management and payroll also grew more than 7 percent. The pace of expense growth has, however, begun to taper after peaking at the end of last year.

Insurance costs escalated nationwide. Increasing by 33 percent year-over-year on average in the second quarter of 2023, insurance costs per unit have been the primary catalyst for expense growth. This is impacting operations at existing apartments, as well as influencing construction. Higher debt costs, coupled with rapid insurance hikes, have stalled a few project proposals and created delays at build sites. Some developers may shorten hold times upon completion to tap cash, after unexpected cost adjustments strained budgets.

Expenses Outpacing Rent Growth Recently



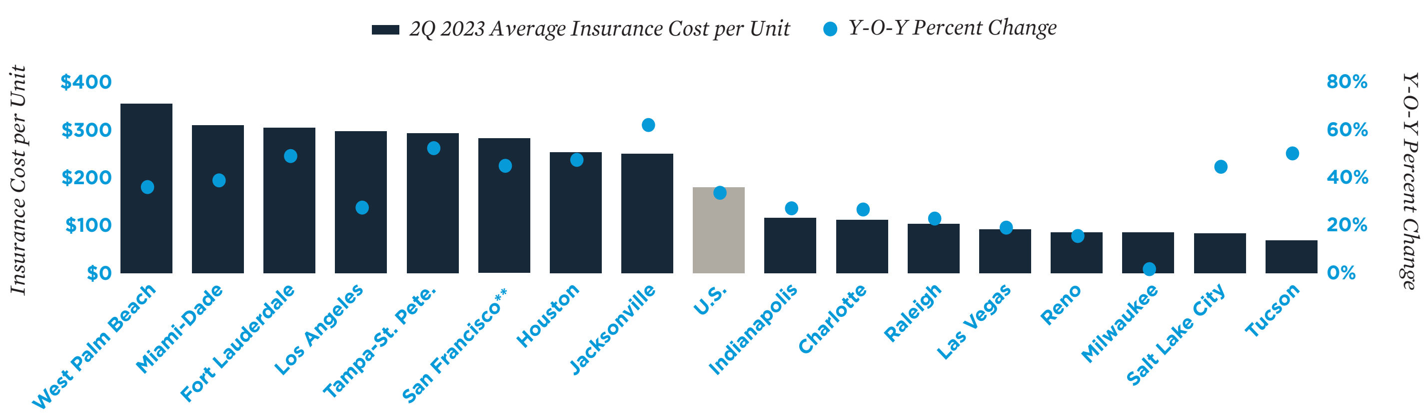
Insurance Costs Impact Operational Margins



Natural disaster-prone metros command costly insurance. Seasonal hurricane risk, susceptibility to floods and earthquakes among other natural disasters, have historically made apartments in certain markets more expensive to insure. This has become particularly visible over the past year. The six major Florida metros each saw insurance costs rise at a faster pace than the national mean over the past 12 months. Insurance rates per unit in these Florida markets exceeded the overall U.S. metric by $35 to $175 on average in the second quarter of 2023. Other locations with notable insurance hikes over the past year include Kansas City, Oakland, Orange County and Phoenix.

Lower premiums found in Midwest and select Sun Belt markets. Insurance costs per unit rose by less than 10 percent year-over-year on average in just five major U.S. markets as of the second quarter of 2023. This grouping included Columbus, Detroit, Milwaukee, Pittsburgh and St. Louis. Other metros like Charlotte, Las Vegas, Raleigh and Reno, meanwhile, had relatively mild adjustments and remained among the 10 lowest major markets for insurance costs per unit. Some developers and institutions may shift their attention to these locations.

Most and Least Expensive Major Markets for Insurance Costs



** Through 2Q*

*** San Francisco metro is defined as San Francisco-Redwood City-South San Francisco*

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

2023 Forecast

EMPLOYMENT

1.6% increase Y-O-Y

- Nearly 1.9 million jobs were added year-to-date through August, keeping unemployment tight in the sub-4 percent territory. Low joblessness and higher debt costs may soften hiring, but a strong start bolsters a 2.5 million forecast gain in 2023.

CONSTRUCTION

400,000 units completed

- Apartment completions during the second half of 2023 replicate the opening six month's 200,000-unit addition. This creates a record-high delivery volume and grows national inventory by 2.1 percent this year, well above the 1.7 percent expansion noted in 2022.

VACANCY

80 basis point increase Y-O-Y

- Entering the mid-point of 2023 at 5.3 percent, vacancy is expected to rise by another 40 basis points over the second half. A year-end rate of 5.7 percent exceeds the historic mean by 20 basis points. Among tiers, the Class A rate has been holding steadiest.

EFFECTIVE RENT

3.1% increase Y-O-Y

- Coming off a two-year surge of nearly 25 percent across 2021-2022, rent growth is slowing as vacancy rises. The annual pace of increase moves below the 3.8 percent long-term mean, reaching an average effective rate of $1,838 per month at year-end.

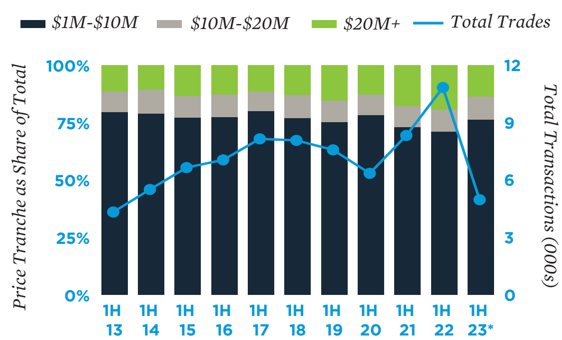
2023 INVESTMENT OUTLOOK

- **Dry powder has accumulated as institutions remain sidelined.** Multifamily deal-making has been challenged for several quarters as many institutions took a wait-and-see approach amid financing hurdles and misaligned buyer/seller expectations. First half 2023 multifamily deal flow was down about 32 percent from the equivalent trailing-decade average, pulled down by a steep decline in $15 million-plus trades. Considerable dry powder has accumulated in the meantime and is primed to be deployed once capital markets fluctuations settle and interest rates stabilize. Tempered inflation and job growth in recent months bodes well for this to materialize.

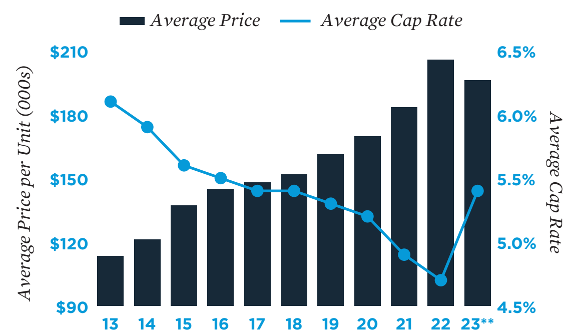
- **Buyers and sellers are moving toward alignment**. Cap rates have been rising as sale prices inch down, reflecting an investment market that is adjusting after a span of uncertainty. Apartments changed hands with a per-unit price of $196,100 on average during the 12-month period ending in June 2023, down about 5 percent from the full-year 2022 recording. The mean cap rate, meanwhile, rose to 5.4 percent, the highest mark since 2018.

- **Institutions recalibrate, may look to diversify.** Supply pressure, insurance hikes and localized economic headwinds could prompt some repositioning. Institutions holding assets that enjoyed robust appreciation over the past few years, particularly in secondary and tertiary Sun Belt metros that performed exceptionally well during the pandemic, may opt to diversify as those locations face some near-term uncertainty. Sturdier performance and extreme homebuying barriers in gateway metros could garner attention.

High-Value Trading Lull Condenses Market



Investment Sales Trends



** Preliminary estimate; ** Trailing 12 months through 2Q*

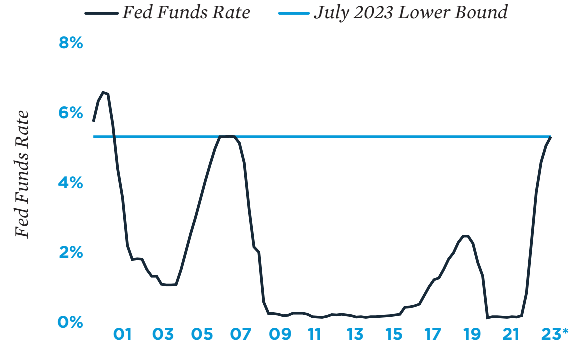
Sources: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Moody's Analytics; Real Capital Analytics; RealPage, Inc.; U.S. Census Bureau

Lending Hurdles Persist, but Tempered Debt Costs and Potential Soft Landing Bode Well

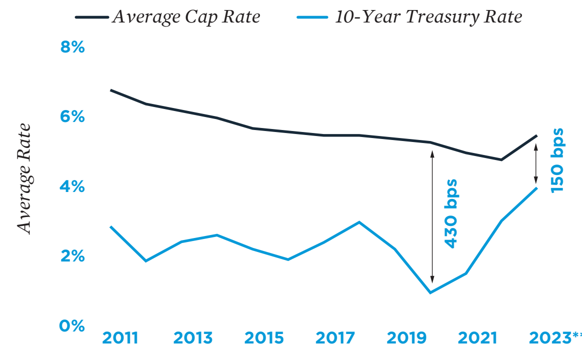
After a brief hiatus, the Federal Reserve resumed rate hikes. The Federal Open Market Committee raised the benchmark lending rate by 25 basis points at its July meeting to a lower bound of 5.25 percent, marking the 11th increase since March 2022. This follows a pause in June, as the central bank took time to assess the cumulative economic impact of their monetary policy decisions so far. Although interest rates are at the highest level in over two decades, some encouraging signs may indicate that the Federal Reserve will take a more measured approach at its September meeting and beyond. Headline CPI inflation rose by 3.2 percent annually in July 2023, down from 8.5 percent growth in the same month of last year. The Fed's preferred measure, Core PCE, recorded a 0.2 percent monthly gain in June and again in July, the smallest increase over a two-month stretch since late 2020. Meanwhile, the nation's labor market has been resilient amid the Fed's efforts to combat inflation, increasing the likelihood that the economy could be slowing to a soft landing. The U.S. added nearly 1.9 million jobs through the first eight months of this year, keeping unemployment historically tight at 3.8 percent. As Core PCE inflation, at 4.2 percent year-over-year in July, moves closer to the central bank's target rate of 2 percent, the need for future rate increases becomes less certain. The FOMC has committed to making data-dependent assessments at future meetings to determine if additional rate hikes will be necessary. This may provide greater rate stability moving forward, and could help lenders and investors become more closely aligned with the current state of capital markets. At the same time, the potential for U.S. banks' credit rating to be downgraded could lead financiers to widen spreads near-term.

Potential rate stability could assuage hurdles, but financing remains choppy. The apartment sector's comparatively low cap rates, in relation to other commercial real estate asset classes, have created pronounced challenges amid interest rate hikes. These obstacles were exacerbated by several bank seizures earlier this year and corresponding liquidity constraints, adding headwinds to an already conservative lending climate. Loan-to-value ratios have typically been in the 55 to 65 percent range early in the third quarter of 2023, occasionally nearing 70 percent in markets with higher cap rates. Agency financiers have been the most steadily active in recent months; while banks and credit unions are engaged, but often require significant recourse, as well as shorter amortization periods. Meanwhile, CMBS lenders are quoting rates about 100 basis points higher — in the mid-6 percent range — and have not been very competitive in recent months. Mezzanine debt and bridge financing options are starting to come into play for assets facing cash flow challenges, particularly for operators of value-add strategies that took on large debt and are falling short of NOI projections. As the market begins to absorb cap rate and valuation adjustments, these complications should subside. Interest rates are expected to be more stable in the second half of 2023 as well, although the Fed has indicated that rate cuts may not be on the near-term agenda.

Federal Funds Rate Over Time



Apartment Cap Rate vs. Treasury



** Fed Funds Rate as of July*

*** Cap rate is a trailing 12-month average as of 2Q; Treasury rate as of July*

Sources: IPA Research Services; CoStar Group, Inc.; Federal Reserve; Moody's Analytics; Real Capital Analytics; RealPage, Inc.

IPA Multifamily

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