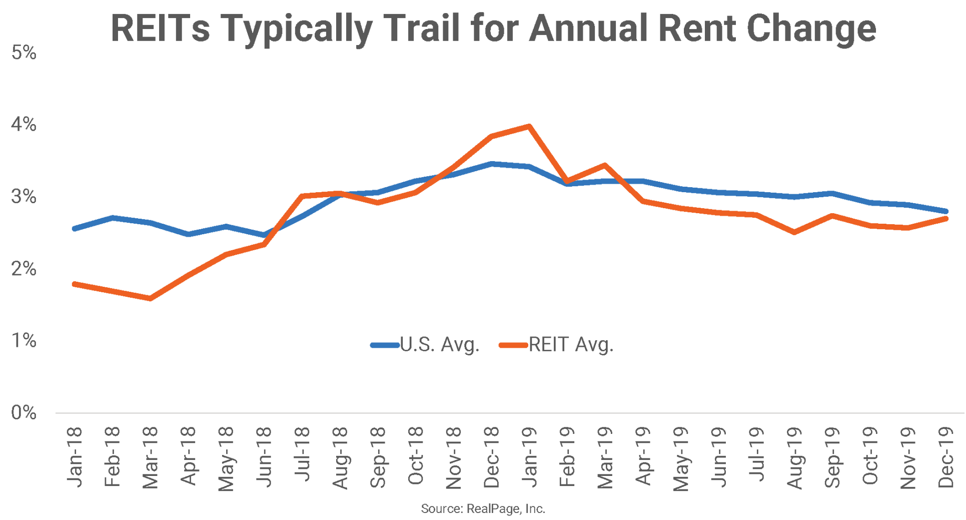
APARTMENT ADVISORY

FEBRUARY 2020

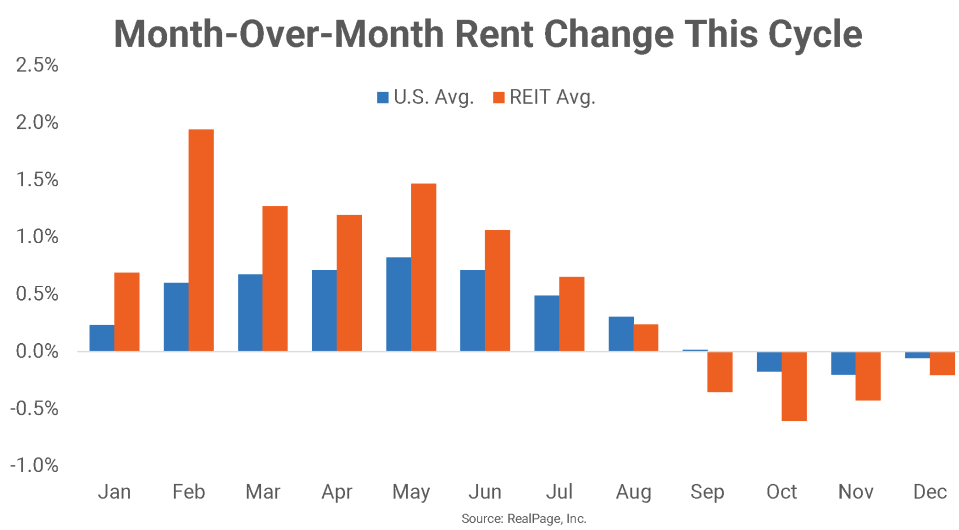
U.S. apartment fundamentals remained strong in 2019 as occupancy approached an all-time high during the peak leasing season and rents continued to grow at rate near 3%. Fundamental strength can be credited to robust demand, as well as a modest lull in new completions. The year's 250,000 new units was the lowest annual new supply total in five years.



National performance was supported by performance in the REIT sector. Properties held by the seven publicly traded apartment REITs averaged rent growth of 2.8% in 2019, on par with the U.S. average. Last year's increase among REIT properties was up 35 basis points from 2018. Comparatively, U.S. annual rent change ticked up about 20 basis points from 2018 to 2019.

Perhaps an even more important metric for the REIT sector than rent growth, however, is occupancy. REITs maintained their standard occupancy premium in 2019, though both the REIT and national norm climbed about 40 bps over last year. At year-end, REIT occupancy stood at 96.5%, and even that figure has waned a bit from the 96.9% occupancy seen during peak leasing season, the six-month stretch in the middle of the year when the weather is warm and most leases are signed.

Unlike the U.S. market at large, REIT assets tend to see less seasonality in occupancy, particularly in this economic cycle. Nationally, occupancy tends to sag at the end of each year, as demand softens due to renters staying in place during the holidays and avoiding moving in cold weather. U.S. peak-to-trough occupancy rates can fluctuate from 60 bps to 200 bps in any given year. Comparatively, occupancy at REIT-owned properties tends to not lose as much traction at the end of the year. REIT occupancy swings have ranged from 30 bps in 2016 at the small end to 90 bps in 2014 at the large end.



Some of the reduced seasonality can be attributed to how operators of REIT-owned properties structure pricing throughout the year. REITs tend to outperform the market in terms of rent growth throughout the first seven months of year. Outperformance is especially pronounced in the first quarter of each year. But at the end of the year, operators of REIT-owned properties tend to lower rents more than other conventional operators. Late-year pricing discounts suggest operators prefer to preserve occupancy at REIT properties rather than maximize rents.

Additionally, REITs are active in many warm weather markets that tend not to see seasonal swings to same degree as cold weather markets. In fact, four of the most active REIT markets – New York, Boston, Washington, D.C. and Seattle – could be considered cold weather markets. The 11 other markets where REITs concentrate their assets are in the warmer climates of the South and West regions of the country.

The 15 largest REIT markets – based on total REIT-owned assets in those markets – generally saw healthy performance in 2019.

The biggest total market year-over-year improvements occurred in Austin and Dallas, even considering that both of those markets got heavy new supply in 2019. But with healthy economic growth and lots of in-migration into these Texas markets, new supply was well absorbed. Although not in the Lone Star state, the same trend holds true in Seattle.

New York and Washington, D.C.'s performances were somewhat surprising. Both markets have been modest rent growth performers through much of the current cycle, but rent increases in both rose to either match or approach the U.S. norm through 2019. Of note, Washington, D.C. has considerable development headwinds in the coming year, making this market one to keep a watch on.

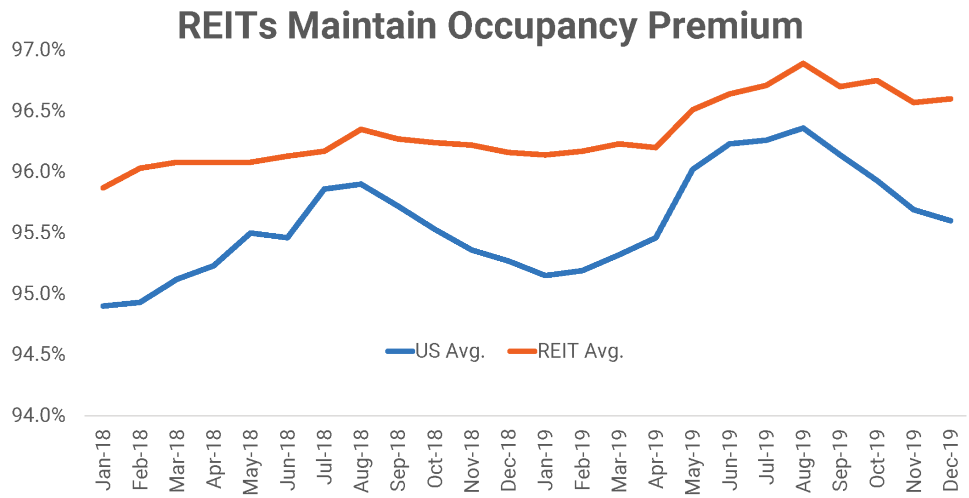
Many markets with slowing rent growth momentum were concentrated in two states: California and Florida.

In California, massive new supply volumes on the way present a cause for concern. In Los Angeles, the forthcoming wave of new supply in 2020 is the true leading story. With almost 18,000 units expected to deliver through in 2020, Los Angeles will see almost 10,000 more units than previous year– a staggering year-over-year increase of 131%. In the Bay Area, scheduled completions in 2020 are about 150% more than 2019's totals.

In the Florida markets – particularly in Orlando – supply continues accelerating at a rapid enough pace to temper local operators' expectations. The market is expected to expand its existing inventory base by 3.5% in 2020 and another 3.3% in 2021.

On a national level, increasing supply is the key metric for 2020. More new units are forecasted to deliver in 2020 than at any other point in this economic cycle, which began in 2010.

Given the volume of new units coming online, overall U.S. rent growth is forecasted to ease slightly through the year with occupancy pulling back closer to 95% – what is considered effectively full. Nearly 371,000 new units are forecasted to come online in 2020, a 50% increase from the number that opened 2019.



Source: RealPage, Inc.

Healthy Rent Growth in Large REIT Markets in 2019

Market	New Lease Rent Change (2019 Annual Avg.)	Year-Over Year Change
Austin-Round Rock, TX	4.4%	182
Dallas-Plano-Irving, TX	3.1%	152
New York-White Plains, NY	2.8%	150
Washington-Arlington-Alexandria, DC-VA-MD-WV	2.5%	130
Seattle-Bellevue-Everett, WA	3.4%	120
Boston-Cambridge-Newton, MA-NH	3.0%	30
Anaheim-Santa Ana-Irvine, CA	2.3%	5
Atlanta-Sandy Springs-Roswell, GA	4.5%	-9
San Francisco-Redwood City-South San Francisco, CA	3.5%	-40
Los Angeles-Long Beach-Glendale, CA	2.8%	-132
Tampa-St. Petersburg-Clearwater, FL	3.7%	-143
Houston-The Woodlands-Sugar Land, TX	0.9%	-159
San Diego-Carlsbad, CA	2.7%	-178
San Jose-Sunnyvale-Santa Clara, CA	2.2%	-206
Orlando-Kissimmee-Sanford, FL	2.8%	-407

Source: RealPage, Inc.