APARTMENT ADVISORY

JANUARY 2018

REITS STILL LAG NATIONAL MARKET IN APARTMENT PERFORMANCE

Despite REITs boasting impressive occupancy rates, their revenue growth continues to lag the national market.

Annual effective rent growth among publicly traded apartment REITs was 1.7% in December, compared to 2.5% for the national apartment market as a whole. After outperforming the national market for the better part of six years following the Great Recession, REITs fell behind the broader market in March 2016 and have lagged since.

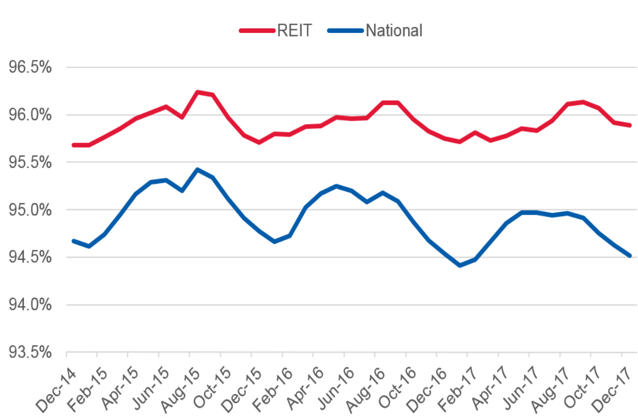
U.S. rent performance has increasingly been driven by late-recovery markets where new construction, which tends to limit rent growth, remains at relatively low levels. REIT-owned properties, on the other hand, tend to be in markets where construction has already achieved peak performance.

Because many REITs have invested in luxury class apartments in major metro areas, the recent steep decrease in Class A rent growth has disproportionately affected REIT properties. Rents in the top asset class saw slower growth in December 2016 than the year before, reflecting a 244 basis point drop from 2.8% to 0.4% year over year.

Thankfully, as the chart at the top right depicts, the gap between REIT and national rent growth has shrank in the past 15 months. Over that period, national rent growth at one point exceeded REIT growth by as much as 166 basis points. By December 2017, however, the difference between the two was only 81 basis points.

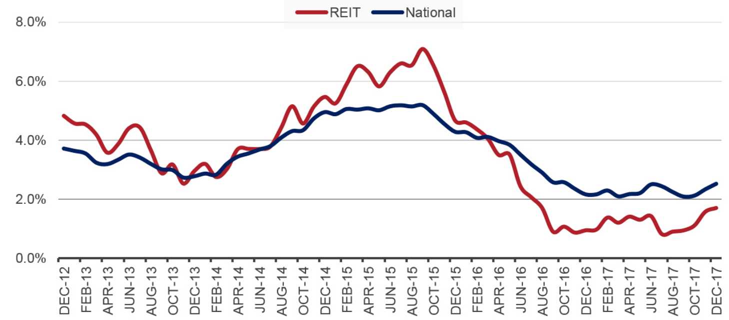
Meanwhile, Class A rent growth has climbed to the top position among asset classes. The top class registered 2.8% growth in December 2017, compared to 2.3% for Class B properties and 2.2% for Class C portfolios.

REIT vs. National Occupancy Rates



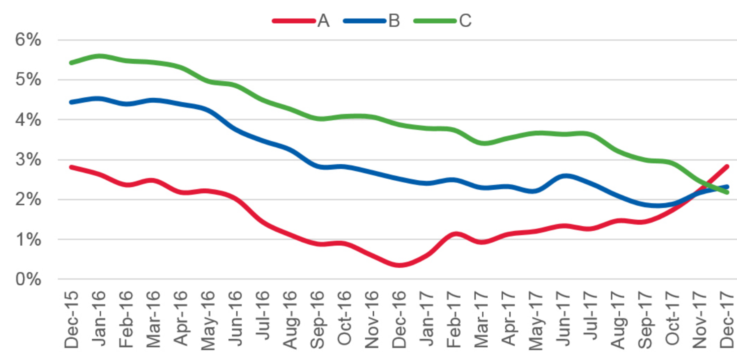
Source: Axiometrics, a RealPage company

Annual Effective Rent Growth



Source: Axiometrics, a RealPage company

National Effective Rent Growth by Asset Class



Source: Axiometrics, a RealPage company

REIT PORTFOLIOS STILL DOMINATE COMPARATIVE OCCUPANCY RATES

Meanwhile, REIT occupancy outpaced the national rate in December, as it has every month for the past nine years and more. That's no surprise given the number of undersupplied housing markets where REITs are most active.

Because revenue growth is derived from rent growth and change in occupancy, changes in rent tend to have a powerful influence over revenue growth. On a year-over-year basis, national revenue growth was 2.5% (the same as rent growth), while REIT revenues grew 1.8% (14 bps above rent growth).

While every single REIT outperformed the national average with regard to occupancy, just two, Aimco and Camden Property Trust, had higher year-over-year rent growth. As a result, just two REITs in 2017 could claim higher revenue growth than the nationwide apartment market.

PERFORMANCE VARIES IN DIFFERENT METROS

Of course, situations vary from market to market. A study dating to the start of 2011 done by analysts from RealPage's Axiometrics in November 2017 found that REITs generally outperformed the market in the metros with the highest REIT concentrations -- Anaheim, Atlanta, Boston, Dallas, Los Angeles, New York, San Francisco, San Jose, Seattle and Washington, DC.

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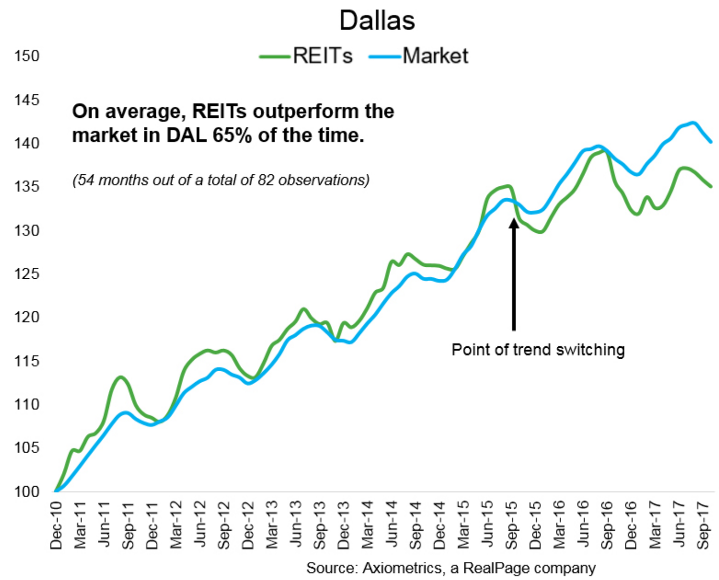
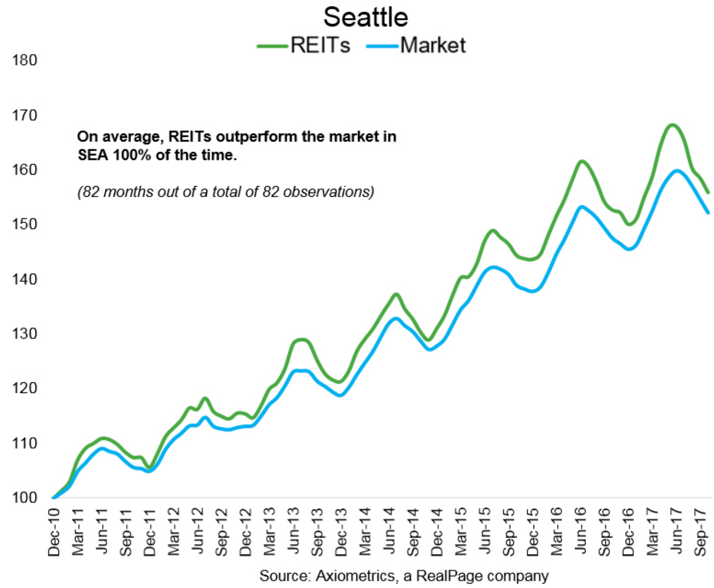




In 77% of the 820 instances studied – 82 months times 10 metros – REIT revenue growth was higher than the market's.

Seattle, for example, has had exceptionally strong REIT performance – as well as robust overall apartment market performance until the past several months. Despite the recent decline, REIT revenue growth in Seattle continued to exceed the market average in every one of the 82 months.

Seattle's REIT advantage can be credited to the fact that most REIT properties are located in the areas of Seattle's overall best-performing submarkets: Downtown/Capitol Hill/Queen Anne and Redmond in particular have been indicative of this trend, and to a lesser extent so have the Bellevue/Issaquah markets.

REITs NO LONGER DOMINANT IN DALLAS METRO AREA

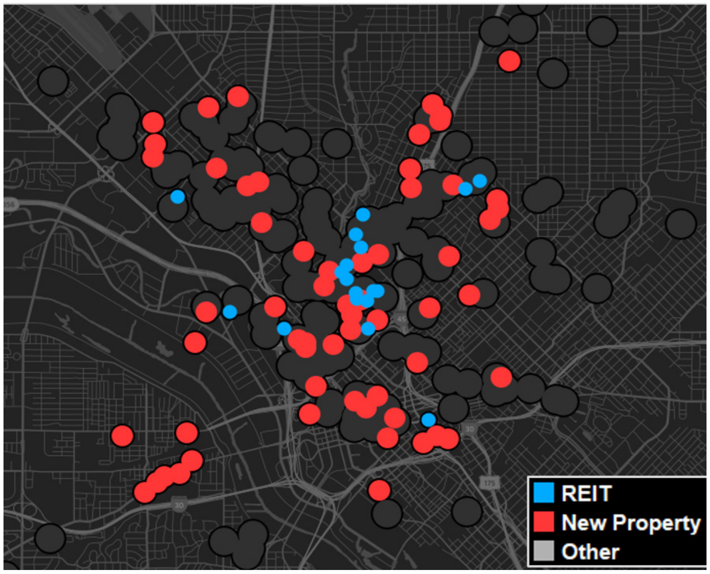
Compare this performance to that of Dallas, where the REIT-over-market advantage is still strong, but is no longer dominant. REIT properties in the Dallas metro outperformed the market 65% of the time, but much of that positive performance occurred before second quarter of 2015. Since then, REIT revenue growth has lagged the market, and that gap has continued to widen since mid-2016.

Many parts of Dallas where REITs have the highest concentrations of properties, such as the urban core Oaklawn submarket or the Plano/Allen/McKinney/Frisco area suburbs, have been hammered by new supply. In fact, the 2015 and 2016 dip almost perfectly coincided with the ramp-up of new supply in Dallas.

Four of the five submarkets with the largest REIT concentrations had the most new supply delivered over the past two years. These REIT properties likely have had to contend with new product, causing REIT revenue growth to slow in these submarkets.

Oaklawn Properties: New Properties* & REITs

New properties referring to those built in 2015 and later



URBAN CORE SUBMARKET INCLUDES MANY COMPETITORS

For example, in the uptown/downtown Oaklawn submarket, the map below compares the concentration of REIT properties (blue dots) to the total properties delivered since 2015.

With this much competition, it is no surprise that REIT-owned and operated properties have faced an uphill battle in terms of revenue growth.

These nuanced market dynamics show how local undercurrents can effectively roll up to the market level and impact rent and revenue growth for an entire metropolitan area.