APARTMENT ADVISORY

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Among the many hot button topics in the multifamily industry right now, there is one overwhelmingly positive narrative driving strong performance: the demand story.

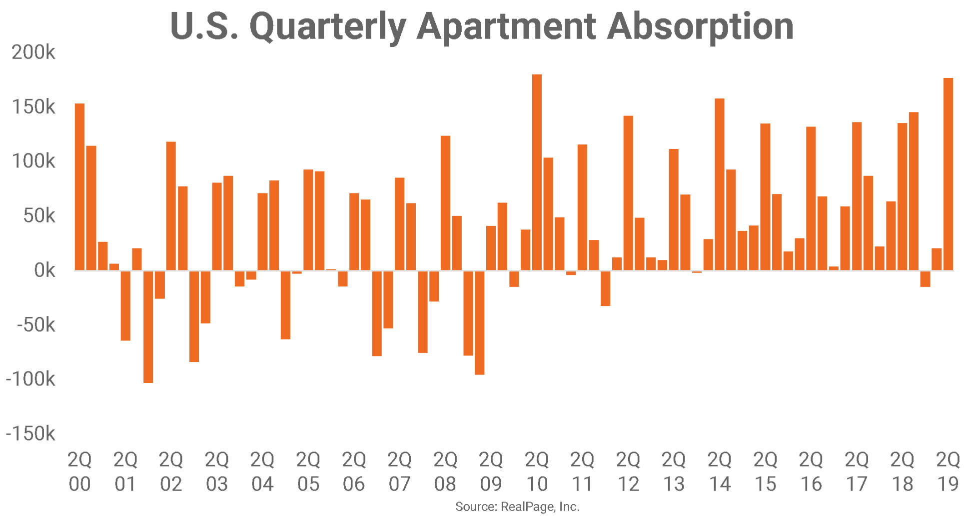
Continued strong performance points towards incredible demand, particularly in the past year. With strong leasing activity of late, occupancy improved 50 basis points (bps) year over year, landing at 95.9% as of 2nd quarter 2019, the highest rate since 2001. Meanwhile, annual rent change also enjoyed a 60 bps bump from its year-earlier rate of 2.5%.

Much of that demand strength ties back to household formation and the overall share of that household formation being captured by the multifamily rental market.

Consider that in 2nd quarter 2019, quarterly absorption was the second-highest total ever recorded across the U.S. The 176,500-plus units that were filled trailed only the 180,000 units filled in the post-recession pop of 2010's 2nd quarter. Further, that tally of 176,500-plus units absorbed in 2nd quarter 2019 pushed annual demand to nearly 328,000 units – a number that comfortably surpassed the 285,000 units that completed.

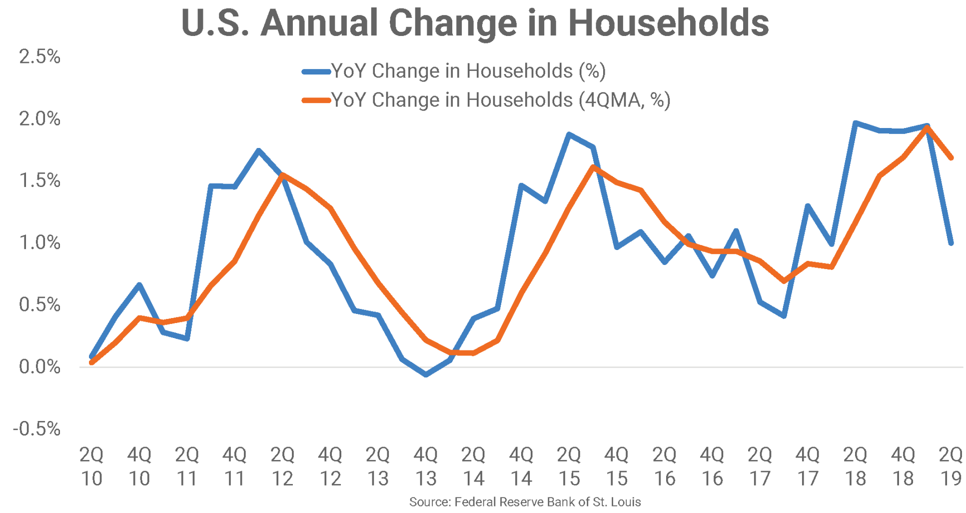
Driving the national demand figure, many local markets saw cycle-high absorption figures as well. Dallas/Fort Worth's combined quarterly absorption surpassed 11,600 units. Denver, Phoenix and Boston each experienced absorption of more than 4,000 units. In North Carolina, demand was exceptional, with Charlotte, Raleigh/Durham and Greensboro all hitting cycle-high absorption totals.

Such strong demand suggests there is likely some increased household formation across many of these markets and the U.S. as a whole. Although the U.S. Census Bureau's Housing Vacancies and Homeownership data isn't available at the metro level, the national level figures are telling. Within that dataset, a total household estimate is provided from which a year-over-year change in household formation rate can be calculated.



As such, it's worth exploring those numbers to illustrate recent strength of household formation.

While the year-over-year figure is difficult to discern due to noise in the data, the four-quarter moving average change shows that total household formation has increased over the past year. In fact, the average rate of 1.9% in 1st quarter 2019 marked a cycle best and was in fact the best rate dating back to the mid-1980s. That said, 2nd quarter 2019's average year-over-year household change rate did dip, and that decline seems large in comparison to the large increase in the 1st quarter 2019 rate. But it's important to contextualize the 2nd quarter year-over-year change of 1.0% against the average change between in 2016 and 2017, which was 0.9% over that eight-quarter

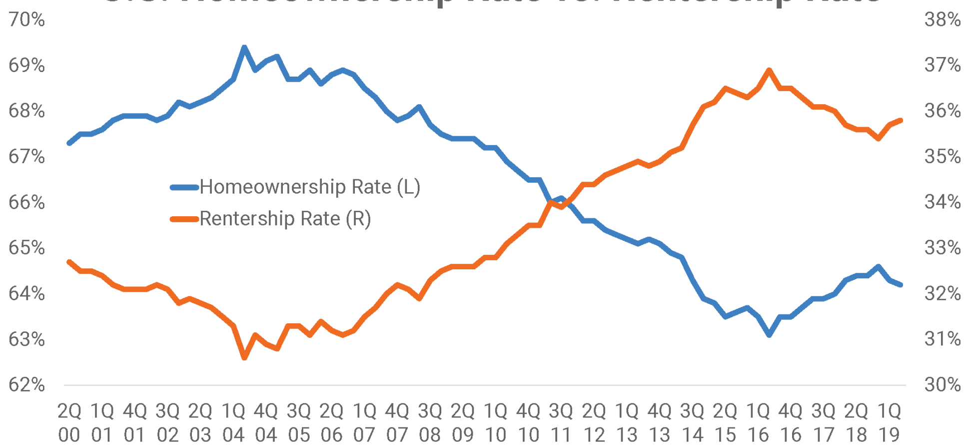


period.

Substantial household formation by itself might explain some of the nation's recent demand strength, but likely doesn't paint the full picture. With household formation not being limited to multifamily demand, it's important to understand single-family market fundamentals as well.

The following chart highlights that homeownership rates are still far below pre-recession levels despite improving from 2016 lows.

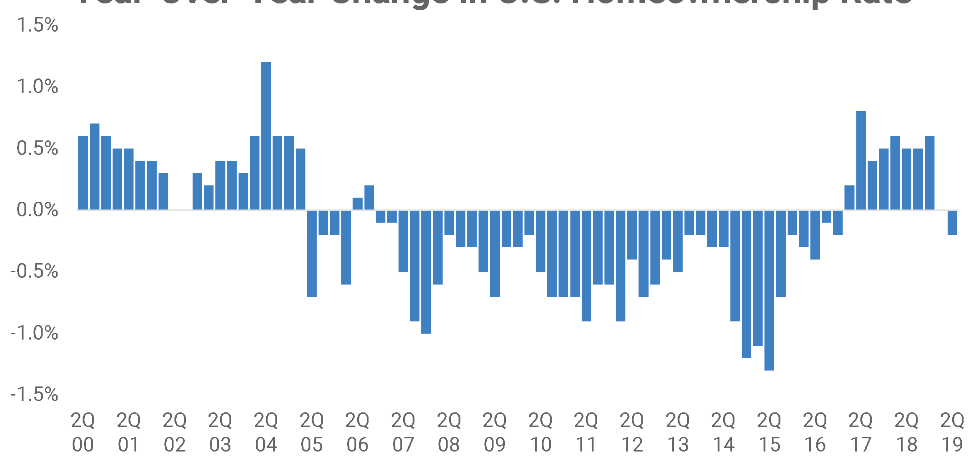
U.S. Homeownership Rate vs. Rentership Rate



Source: U.S. Census Bureau (Quarterly Seasonally Adjusted Homeownership Rates)

The U.S. homeownership rate as of 2nd quarter 2019 landed at 64.2%. As a result, the rentership rate – simply an inverse of the homeownership rate – landed at 35.8%. The downturn in homeownership rate during 2019's 2nd quarter marked the first quarter in which the homeownership ticked downwards since late 2016. As indicated by the accompanying graphic below, homeownership rates in 1st quarter 2019 remained unchanged from one year earlier.

Year-Over-Year Change in U.S. Homeownership Rate



Source: U.S. Census Bureau (Quarterly Seasonally Adjusted Homeownership Rates)

Broadly speaking, this highlights the recent strength of apartment demand, as multifamily properties are capturing a larger share of demand than had been the case over the past two years.

Helping explain some of that share of demand are some barriers to entry with single-family product. While multifamily rents have steadily increased this cycle – rising about 35% from 2010 to mid-2019 – single-family home prices have increased more – about 47%, according to Moody's Analytics data.

The larger increase in home prices than in apartment rents has placed additional pressure on those looking to purchase a home, particularly those looking to do so for the first time. This is especially true in local markets with low vacancy among single-family homes priced at the traditional "starter home" point. Looking at data provided by the Federal Reserve Bank of Dallas, for example, there is an exceptionally tight single-family market in Texas markets.

According to that data, homes priced less than $150,000 have slightly less than three months existing inventory. That tightens even further when looking at the $150,000 to $199,999 price range, where this is just 2.3 months of existing inventory. Bear in mind that the black dotted line at six months is widely thought of as the "balanced" level of supply. This trend is seen across markets nationwide.

Considering such tight inventories among single-family product then, it stands to reason that multifamily housing is being provided a demand boost, as new household formation is filling more multifamily product than single-family product. This data is highlighted in the median home price increase versus the average rental rate increase, and also in areas with exceptionally tight single-family inventories.