APARTMENT ADVISORY

JANUARY 2021

Apartment operations companies have done a wonderful job navigating uncharted and oftentimes turbulent waters through the ongoing COVID-19 pandemic and subsequent recession. One of the operational adjustments that has heavily overlapped with renter preference has been the shift to increasing resident retention.

In order to understand shifts in resident retention trends in recent months, it's important to first examine what was happening before the pandemic.

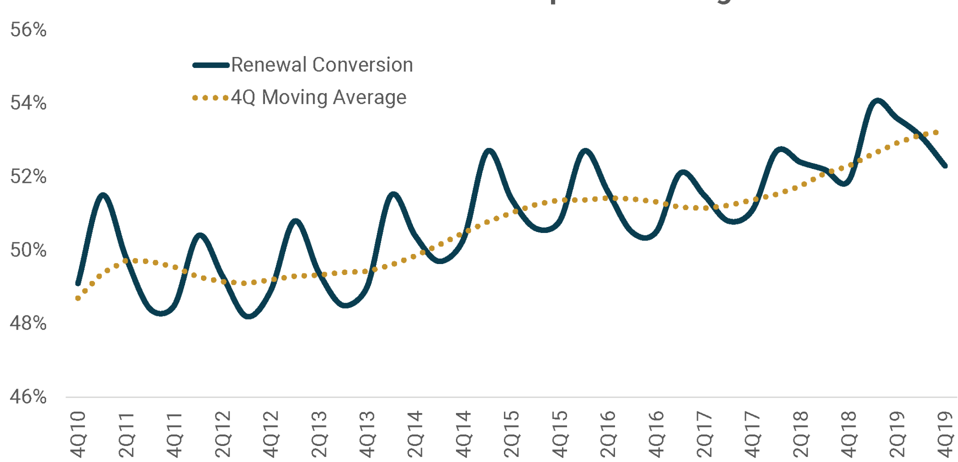
Resident Retention: Pre-COVID-19

Resident retention rates steadily trended upward throughout the past decade. The rise in retention rates was a slow, yet steady climb throughout the 2010s. Removing seasonality through a four-quarter moving average, it's easy to see the increase.

Retention rates are calculated based on the share of renters with expiring leases choosing to renew, using rent roll data covering millions of market-rate apartment units nationally serviced by RealPage.

At the end of 2010, 48.7% of all expiring leases were renewed. By the end of 2019, that figure had increased to 53.3%. Although climbing by 450 basis points (bps) may not seem like much over the course of almost a decade, it's important to remember just how many millions of lease renewals that translates to in a given year.

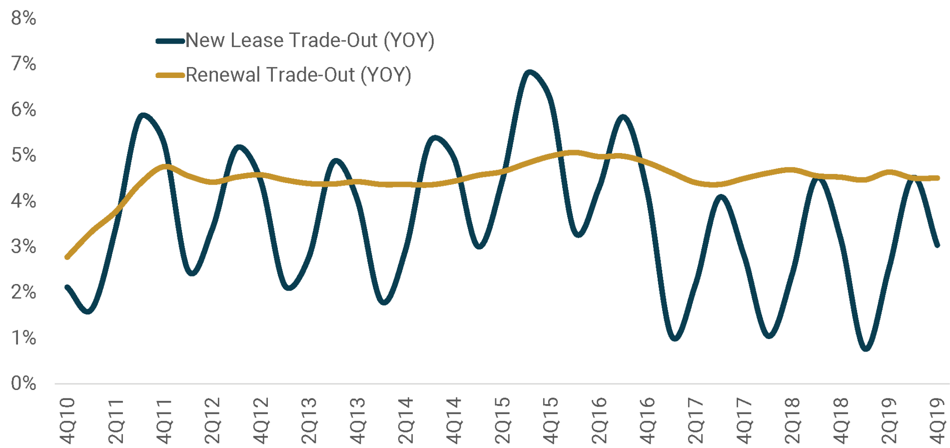
Resident Retention Rates Trended Upward Through the 2010s



Source: RealPage, Inc.

From a rent growth perspective, renewal trade-out has historically been far more stable. Between 2010 and 2019, new lease trade-out averaged 2.9% growth annually, although normal seasonal patterns indicate a lot of variation around that mean. Comparatively, renewal trade-out averaged 4.3% with almost no variation from that norm.

Renewal Trade-Out Has Been Steadier Than New Leases



Source: RealPage, Inc.

Resident Retention: 2020 Evolution

By all measures, resident retention was already in line to hit record levels in 2020 based on the preceding trend. But the onset of COVID-19 was a catalyst as residents sheltered-in-place beginning in late March and into April.

In times of uncertainty, the first response of most households is to simply do nothing while they assess. As shelter-in-place orders were issued in mid-March and additional unknowns began emerging in the second half of the month, many expiring leases were renewed. RealPage began seeing this trend in the first weeks after the mid-March shutdowns through analyzing the number of move-out notices that were rescinded.

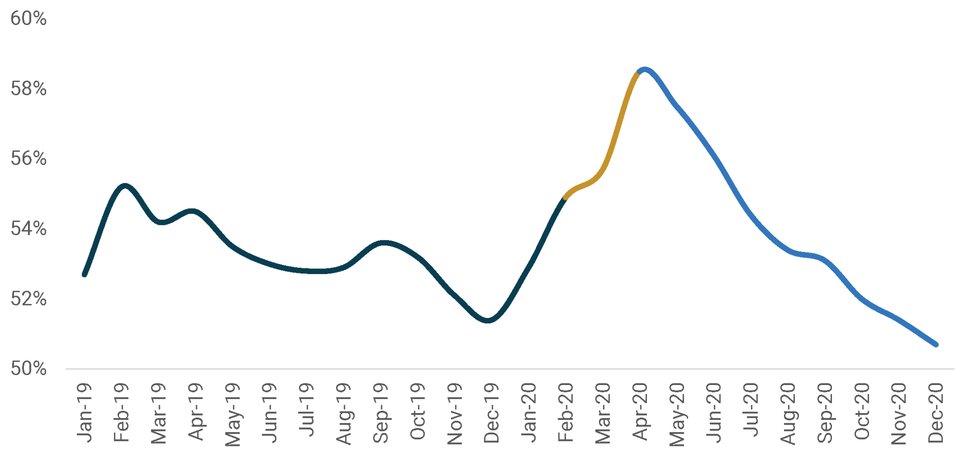
The result was a rate that, even in those first weeks, was about 50 bps above the previous record peak set in February 2019.

What came in April and May was perhaps even more drastic than initially assumed. Retention soared to a record level as residents stayed put either by mandate or by choice. The U.S. resident retention rate in April hit 58.5%, a 400 bps increase year-over-year.

Perhaps even more telling was how many individual markets hit record retention in April. More than half of the largest 50 U.S. apartment markets hit all-time records in April. An additional 14 peaked within another month in 2020 – many in May.

Among the few markets that didn't hit record retention rates were the hard-hit gateway markets and the tourism-dependent markets of South Florida, an area that also tends to experience reverse seasonality.

Resident Retention Peaked in April, Then Moderated by 2020's End



Source: RealPage, Inc.

While May and June retention eased from the April high, a huge number of residents were still extending leases. In fact, the year-over-year increase in resident retention rates between April and June sat about 3% to 4% higher than the previous year's mark.

Beginning in third quarter 2020, resident retention began to further moderate. While still well above the previous year's level in July and August, the September retention rate indicated there was likely a combination of influences pushing resident retention closer to last year's pace.

The first is that many renewal leases being signed were short-term leases – likely month-to-month leases – as opposed to the typical 12-month lease. That trend shows up beginning in April when looking at the average renewal lease length term.

The typical lease renewal length had been slowly trending upward through the second half of the 2010s decade, culminating in a late spring peak of 11.8 months on average. That likely indicates operators were taking an increasingly defensive approach should demand begin slowing.

By April, though, the average length of leases signed plummeted almost overnight, almost certainly pointing toward a huge increase in month-to-month leases signed as residents and operators weathered the ongoing pandemic and recession.

The second component of that trend indicates renters began shopping around for new leases beginning in third quarter 2020. Indeed, quarterly absorption suggests skyrocketing third quarter and even fourth quarter new lease demand.

Adding together third and fourth quarter demand – two quarters in which demand was at its best in over a decade – shows just how much new shopping occurred during the back half of the year. In the third quarter, some 156,000 units were absorbed while nearly 79,000 units were absorbed in fourth quarter.

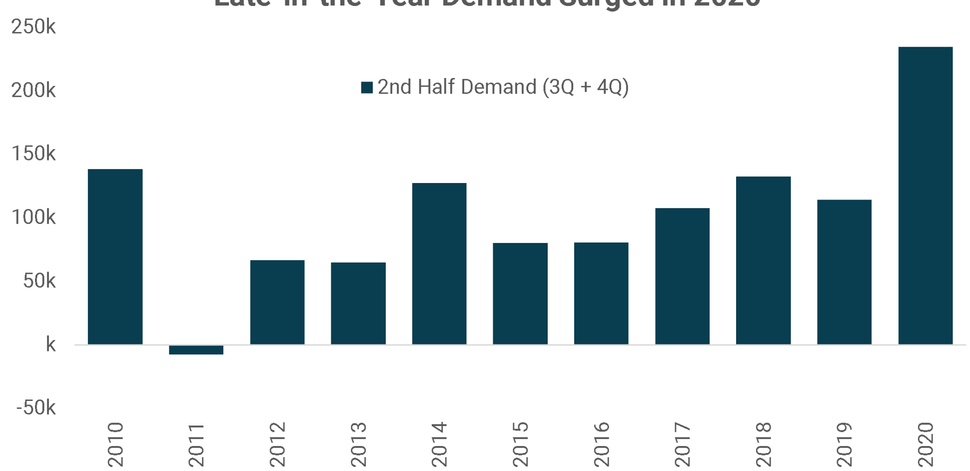
Together, that resulted in about 234,000 new leases during the second half of 2020. That was 70% greater than the previous second half of the year peak, a comparatively meager 138,000 units in 2010.

The surge in new lease volume came at the expense of resident retention. By fourth quarter 2020, retention rates further moderated toward a long-term norm ending the year at 50.7%. Additionally, each of the last three months of 2020 saw a year-over-year decline in retention rates ranging from 70 bps to 120 bps.

What does all this mean for 2021?

It's likely that renewals will be harder to secure. But that's not due to mass move-outs. Rather, it's likely due to the continued moderation from the early 2020 peak towards longer-term norms. Secondly, it'll be critically important that operators monitor the balance between renewal pricing and new leases. If renewals get too top-heavy, it may incentivize renters to shop around for new leases at a cheaper rental rate.

Late-in-the-Year Demand Surged in 2020



Source: RealPage, Inc.