APARTMENT ADVISORY

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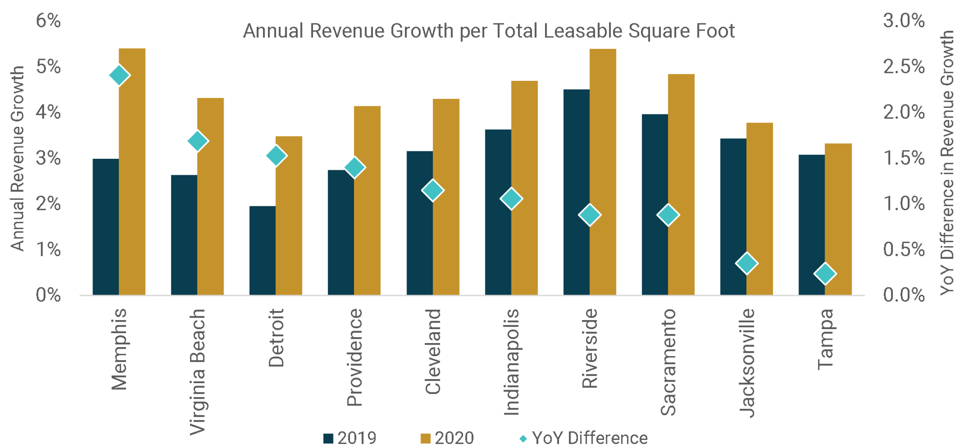
As 2021 pushes forward, it's hard to imagine how it's already been a full year since the onset of the COVID-19 pandemic and the resulting economic shifts. Although essentially every part of the nation's economy has experienced an adjustment, not all changes have been of similar magnitude.

Ten Markets Saw Better Revenue Growth in 2020 Than 2019



Source: RealPage, Inc.

Across the major commercial real estate sectors, apartment market performance has maintained relative strength in comparison to office and retail in particular – at the national level, at least. For example, the nation's annual revenue change per leasable square foot of apartment space has remained positive through the entirety of 2020 and into 2021. As of February 2021, revenue growth sits at 1.3%.

While that 1.3% is down from last year, it's almost certainly a welcomed performance level considering the scale of economic challenges – most notably, the nation's employment base being down by more than 20 million jobs year over year at its worst point in 2020.

Despite all of the challenges that have faced the nation's apartment market, there have been a number of local markets where 2020 revenue growth was actually stronger than the 2019 figure. In fact, 10 of the nation's 50 largest markets actually saw better revenue growth in 2020 than they did in 2019.

However, most of these markets aren't historically the most sought after by investors due to their low-reward profile. But they are low-risk markets, and in recessionary years that type of resilience can yield positive results. When economic shifts of this scale occur, there are inevitably longer-term impacts on individual markets and their local apartment fundamentals.

Analyzing which of the 2020 outperformers might be longer-term beneficiaries – in other words, "new and improved" markets – could be a common exercise among investor groups in the coming year or so. We've included our take on some of the "new and improved" markets and reasons why we think these metros might be longer-term beneficiaries.

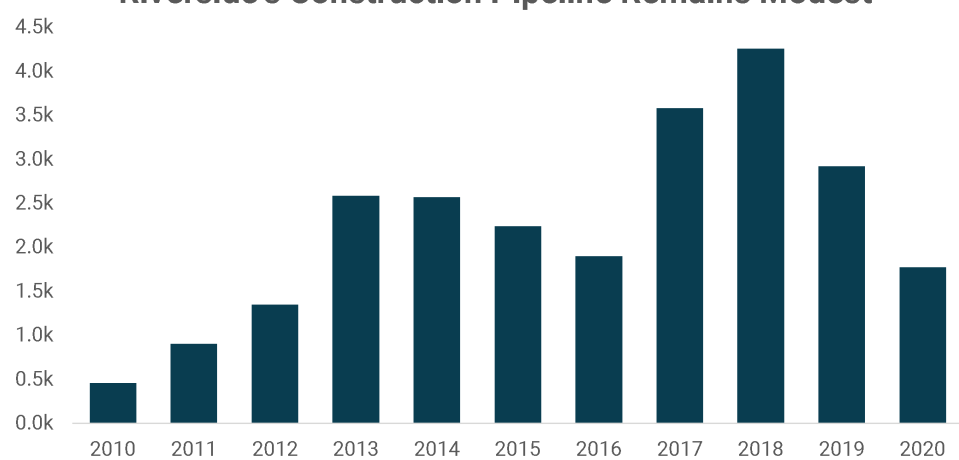
New and Improved #1: Riverside
Riverside has been a bright spot in the otherwise dreary Southern Cal-ifornia apartment market through-out 2020. But Riverside's story isn't one of a strong economic rebound. In fact, the market lost some 7.1% of its employment base in 2020 ranking 20th worst among top 50 markets.

Rather, Riverside has been the benefi ciary of its proximity to Los Angeles and Anaheim and its relative aff ord-ability by Southern California stan-dards.

Average rents in the Inland Empire are just a bit over $1,730 per month. That's about $400 less than neigh-boring Anaheim and roughly $500 less than Los Angeles. In other words, renters who have moved to Riverside from LA and Anaheim over the past year are saving about 18% to 23% on rents.

With limited building expected for at least a few more years – Riverside has just 1,800 units under construction, accounting for less than 1% of its ex-isting inventory base – there is reason to believe that Riverside can remain an

Riverside's Construction Pipeline Remains Modest



Source: RealPage, Inc.

outperforming market.

Still, some downside risk is present with any market. Should building activity pick up, it wouldn't be surprising to see performance levels rein in a bit. That's especially true considering Riverside's economy is primarily comprised of blue-collar employment which may be more sensitive to absorbing upper-tier Class A new construction.

New and Improved #2: Memphis

Memphis performance levels tend to be fairly stable, rarely remarkable for either good or bad reasons. Since 2011, Memphis' worst year for revenue change was about 1.5%. Meanwhile, 2020 was a highwater mark with the market achieving 5.2% growth. As such, the difference between worst year and best year is just 380 basis points – the nation's 38th smallest delta for that metric.

It's not necessarily that Memphis excels in any one category. Occupancy tends to mimic many other affordable Sun Belt metros. Rent growth tends to be moderate in any given year. And its economy hasn't seen massive growth, but instead slow but consistent improvement.

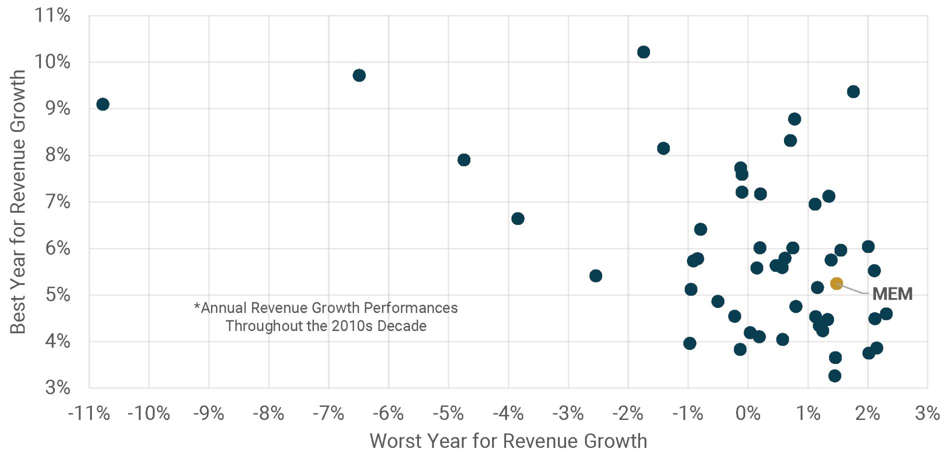
But the consistency in Memphis' economy has underpinned much of the market's recent success. In 2020, Memphis only lost about 2.7% of its employment base, or just 17,600 em-ployees. That 2.7% job loss ranks sev-enth best nationally in percentage terms and fourth best in absolute terms.

Much of the local recovery owes to Memphis' higher concentration of product distribution jobs – such as warehousing, logistics, and transpor-tation – which is a segment of the economy that has held up pretty well amid the broader economic slow-down.

Further benefi tting Memphis is limit-ed new construction. Just 2,400 units are underway currently, accounting for about 2% of all existing stock. By comparison, nearby Nashville has more than 14,000 units or a stagger-ing 9% of its existing base underway.

There's certainly some upside in Memphis going forward, especially as the product distribution space re-mains strong in the evolving econo-my. As a result, Memphis may serve as a lower-risk, lower-reward invest-ment option to those who are priced out of the Nashville market.

Memphis Tends to be a Lower-Risk, Lower-Reward Market



Source: RealPage, Inc.

New and Improved #3: Sacramento

California's capital doesn't receive nearly as much attention as the other major metros in the state, but Sacramento has been a stalwart on the leaderboard for revenue growth for some time now.

Throughout the 2010s decade, the market averaged slightly better than 5% growth annually. That rate was only surpassed by eight other top 50 markets – three of which were in the Bay Area.

In 2020, Sacramento remained a national leader despite numerous statewide economic challenges. Although Sacramento's economic recovery hasn't been a leader – the 6.9% job loss in 2020 ranked #29 among major markets – its employment base has been far more stable than nearby San Francisco, where job losses have been closer to 9%.

Helping keep Sacramento more resilient both in terms of economic recovery and apartment market performance is the higher share of government jobs in the metro. About 14% of the Sacramento economy is employed in the government sector which ranks as the 7th-highest share nationally.

Similar to Riverside, Sacramento's proximity to a larger, more expensive market has undoubtedly benefitted recent performance. Sacramento is the closest major metro to the Bay Area, and rents of about $1,600 in Sacramento are far more affordable than the broader Bay Area, where rents run about $2,500 per month, or 36% higher.

Whether Sacramento is a long-term beneficiary of the Bay Area exodus or only experiencing a near-term blip is yet to be seen. But barring a significant increase in construction activity over the coming few years, it's likely that Sacramento will be a solid-to-great performer although urban core investors may use some additional caution in Sacramento.