APARTMENT ADVISORY

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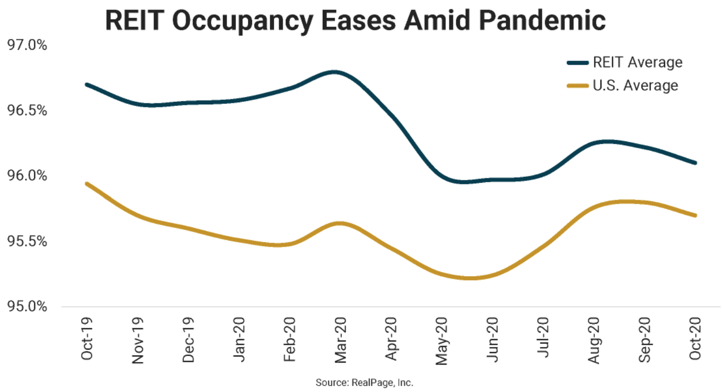
Many REITs have been facing an uphill battle during the COVID-19 pandemic, due to a heavy concentration of product in gateway markets and a skew toward Class A properties in the nation's urban cores.

Overall, the nation's apartment market has taken a hit in the wake of the COVID-19 pandemic. But there's been a range of individual market performances, with the more expensive gateway or coastal markets taking the biggest hits. Urban core areas have also been affected more acutely, as have the more expensive Class A properties. Because the nation's REIT assets tend to be Class A units in some of the most affected areas, these properties have been hurt disproportionately.

One thing that separates the coronavirus-driven recession from previous economic downturns is that the recovery has thus far looked vastly different from place to place as different sectors of the economy are also recovering at very different speeds.

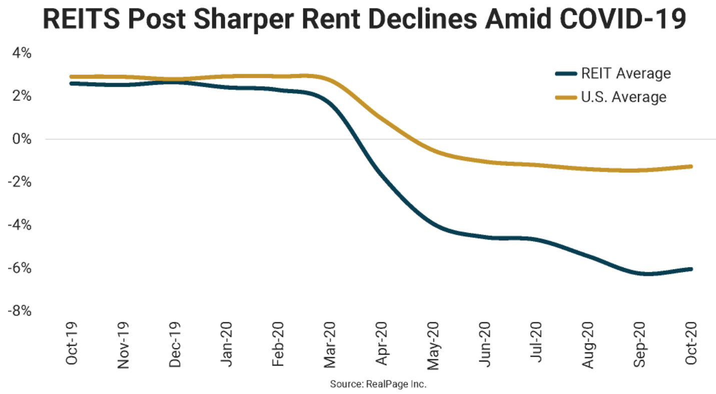
While apartment occupancy among the nation's REITs remains higher than the national norm, recent declines have been closing the gap. As of October, occupancy in REIT product averaged at 96.1%, a few ticks ahead of the national average of 95.7%. However, REIT product has seen occupancy fall 70 basis points (bps) from the March peak, quite a different performance from the 10 bps increase recorded in the nation overall during that same time frame.

With occupancy coming down in the wake of the COVID-19 pandemic, operators in REIT product were quick to sacrifice pricing power.



Year over year, effective asking rents were cut by 6% across REIT product as of October, according to survey data. This decline was much steeper than the national average price decrease of 1.3%. Just a year ago, in October 2019, REIT product was enjoying rent growth of 2.6%, about in line with the increase in the U.S. overall. In fact, the performance departure began about the same time the COVID-19 pandemic took hold.

Among the 15 major REIT markets, the Sun Belt metros of Austin, Dallas, Phoenix, and Atlanta are holding on relatively well compared to the coastal markets. But coastal markets such as Los Angeles, the Bay Area, Boston, and New York have lost more than 10% of their total job base in the past 12 months alone. Other major REIT markets such as Houston and Orlando are also struggling due to the sectors that drive those economies.



In general, though, demand among major REIT markets was strongest in the area between the Rockies and the Appalachian Mountains. Alternatively, the coastal areas have suffered through the pandemic. As a result of weak demand, gateway markets have really struggled to keep rent levels steady. In fact, gateway markets are seeing new lease rent cuts equal to nearly 10%.

Among Class A properties, cuts were more significant, at 11% to 12%. And in the worst-case scenarios such as Downtown San Francisco and Midtown Manhattan, Class A cuts are as deep as 25%.

Urban core areas are bearing the brunt of the economic downturn, even in non-gateway markets. Still, there's a clear gap between the gateway urban cores – which have lost 5% revenue over the past year – and the non-gateway urban cores – which have lost a little more than 1% over the past year. But the gap in performance becomes even more apparent when looking at an urban/suburban comparison.

Looking at individual REIT performances, Denver-based Aimco's occupancy is the best, with a rate of 97.8% in October. However, surveyed effective asking rents are down 5.1% as of October after increases steadily hovered between 2% to 4% the prior two years.

Among some of the largest markets with Aimco product, the impact in San Diego and Denver in particular are relatively stable, with economic stability boosting rent and occupancy readings. Meanwhile, product in the gateway markets is really struggling, with Washington, D.C., Boston, and Los Angeles losing both rent and occupancy ground over the past year.

Virginia-based AvalonBay Communities' effective asking rents have suffered the most, falling a little more than 10% year over year, while occupancy has come down 30 bps during that same period, landing at a respectable 96.6%.

Among AvalonBay markets, Baltimore and Long Island have maintained better performance. In the case of Baltimore, there may be some spillover from nearby Washington, D.C., as residents look for slightly more affordable living arrangements. In the case of Long Island, that could very well point to residents moving out of Manhattan or even Queens and Brooklyn into the more affordable Long Island metro.

Houston-based Camden Property Trust's profile is far more skewed towards the Sun Belt markets. As a result, it's not surprising to see rent change in many spots hovering between slightly positive to slightly negative. Overall effective asking rents are down by nearly 2% across the Camden portfolio. Meanwhile, occupancy is down 110 bps year over year, with the October rate landing at 95.2%.

By market, Tampa, Phoenix, and Denver take the lead for rent and occupancy growth in Camden's portfolio. Meanwhile the lagging markets of Houston and Orlando are dealing with some outsized economic challenges. The former ties to the energy sector while the latter ties to the tourism sector. The Austin market is seeing a better economic recovery than many markets, but new supply has really pulled down Class A performance and in turn, overall market readings.

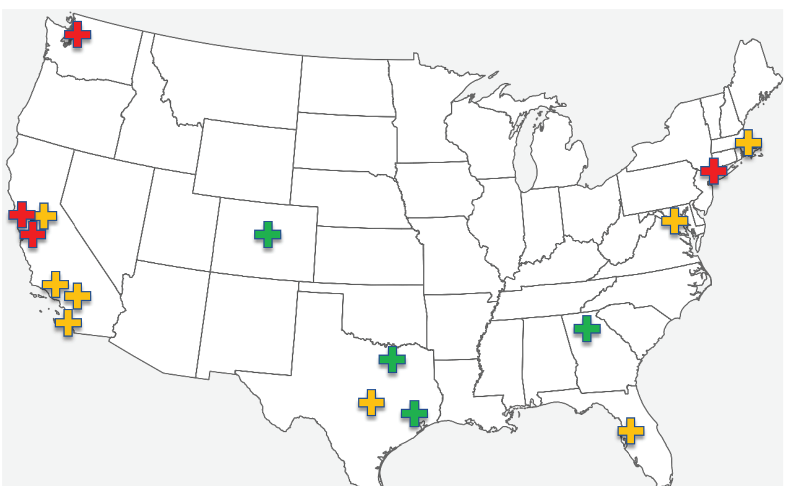
Chicago-based Equity Residential – with a portfolio that is pretty heavily concentrated in both urban cores and in gateway markets – saw the deepest rent struggle in the past year. Effective asking rents are down more than 10% year over year. Meanwhile, occupancy is still down 70 bps for the year and registers at 96.1% in October.

But not all markets in Equity's portfolio are seeing cuts. In fact, Riverside – the market that's seeing arguably the best performance in the nation – may serve as a good example of a gateway-adjacent market that's thriving despite the recession.

Riverside's rents run about $500 to $600 less than Los Angeles and Anaheim, on average. Additionally, a Class A apartment in Riverside rents for roughly $1,950 monthly. In comparison, a Class B apartment in L.A. runs an average of about $150 higher. In markets such as Boston, New York, and San Francisco, rents are down substantially.

Memphis-based Mid-America Apartment (MAA) Community's effective asking rents are down year over year, but at just 0.3%, the decline isn't to the degree that many of the coastal-heavy portfolios are. Occupancy rates are around 95.4%, down roughly 50 bps year over year.

Q3 Apartment Demand in the Top 15 REIT Markets



Source: RealPage, Inc.

Market	Demand (3Q20)
Atlanta	9,008
Houston	7,857
Dallas	6,154
Denver	4,020
Tampa	2,893
Austin	2,586
Los Angeles	1,983
Anaheim	1,962
Boston	1,768
San Diego	1,742
Oakland	1,576
Washington, DC	673
Seattle	-220
San Jose	-491
San Francisco	-3,509
New York	-10,725

While MAA's portfolio is spread out across a number of secondary markets, the primary markets in this portfolio generally range from flat to slightly negative rent change. Still, in a few instances such as Greenville, SC, and Huntsville, AL, there's still some positive rent growth occurring.

Yet again, we do see that the underperforming markets in this portfolio – namely Orlando and Nashville – are among those few Sun Belt markets with weaker-than-regional-norm economies, pointing to challenges in the tourism space.