APARTMENT ADVISORY

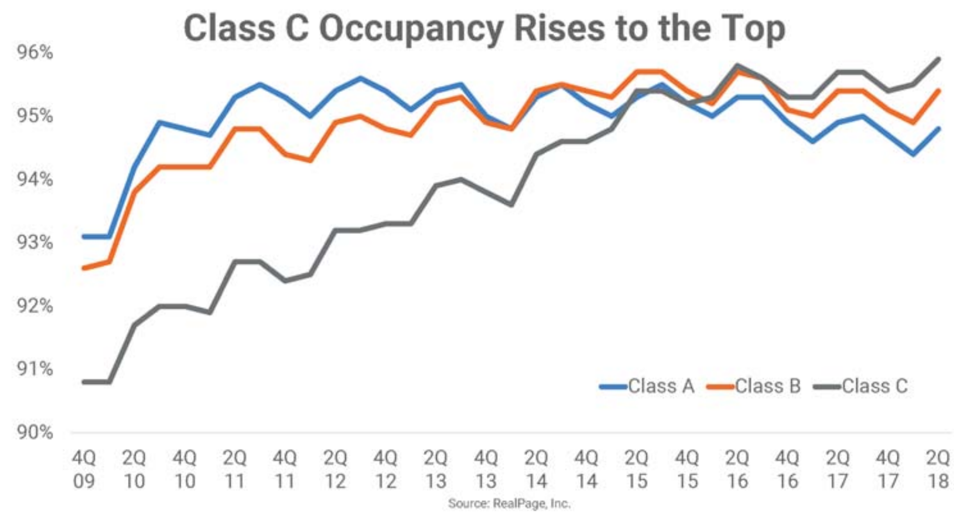
SEPTEMBER 2018

While luxury apartments tend to command a significant slice of national attention, slower momentum in that Class A segment has begun to shift the spotlight to middle- and lower-tier product. Apartments further down the product spectrum are not as susceptible to the same competitive pressures slowing top-tier product. Instead, these middle- and lower-tier product niches are experiencing unique trends.

One of the most pronounced trends relates to occupancy among Class C product. While performance in the nation's Class C apartment product has historically lagged the U.S. norm, this lower grade of stock has gained significant ground during the current economic cycle, and now boasts tighter occupancy rates than its pricier counterparts.

While Class A and B units bottomed out at around 93%, the Class C product trailed notably behind at under 91%. All product lines saw occupancy increase rather quickly during the first two years of the cycle, but Class C stock started showing signs of closing the gap at the end of 2012. By the end of 2015, five years into strong economic growth, the lower tier was essentially full and performing right in line with the middle- and upper-tier product lines. In the first six months of 2018, however, the Class C stock backfilled even more vacancies, leaving occupancy in the other two groups at least 50 basis points (bps) behind.

As of 2nd quarter 2018, occupancy in Class C stock is at 95.9%, while Class B units are still running in line with the national average of 95.4%, and Class A product is the laggard at 94.8%. Before this recent performance, the last time Class C units registered occupancy ahead of the other two product segments was a short blip at the start of 2002.



The lower-end product lines are now significantly ahead of where they were pre-cycle, with occupancy up 510 bps in Class C apartments and 270 bps in Class B product. In comparison, Class A stock climbed a more modest 120 bps.

Metros that have seen the most occupancy progress among Class C product during the current cycle were Memphis, Orlando, Jacksonville, Atlanta and Phoenix.

Weighing on occupancy in Class A units was the abundance of new supply delivered in recent years.

Occupancy Progress

Asset Class	2Q 18 Occupancy	Cycle Change
A	94.8%	120 bps
B	95.4%	270 bps
C	95.9%	510 bps

Source: RealPage, Inc.

In total, new apartment additions have swelled the existing national base by an incredible 11.3% over the course of the current cycle. While the supply wave didn't hinder Class A progress during the first four years, when completions averaged at about 175,000 units annually, occupancy has struggled to remain above 95% since 2014, with aver-

Market Leaders for Class C Occupancy Growth

Rank	Market	Class C Occupancy 4Q 09	Class C Occupancy 2Q 18	Change
1	Memphis, TN-MS-AR	81.0%	93.0%	1,200 bps
2	Orlando-Kissimmee-Sanford, FL	86.9%	98.8%	1,190 bps
3	Jacksonville, FL	84.0%	95.4%	1,140 bps
4	Atlanta-Sandy Springs-Roswell, GA	84.0%	95.1%	1,110 bps
5	Phoenix-Mesa-Scottsdale, AZ	85.3%	96.1%	1,080 bps
6	Columbus, OH	88.5%	97.1%	860 bps
7	Las Vegas-Henderson-Paradise, NV	86.1%	94.5%	840 bps
8	Charlotte-Concord-Gastonia, NC-SC	88.2%	96.5%	830 bps
9 (t)	Dallas-Plano-Irving, TX	87.7%	95.6%	790 bps
9 (t)	Greensboro/Winston-Salem, NC	85.9%	93.8%	790 bps

Source: RealPage, Inc.

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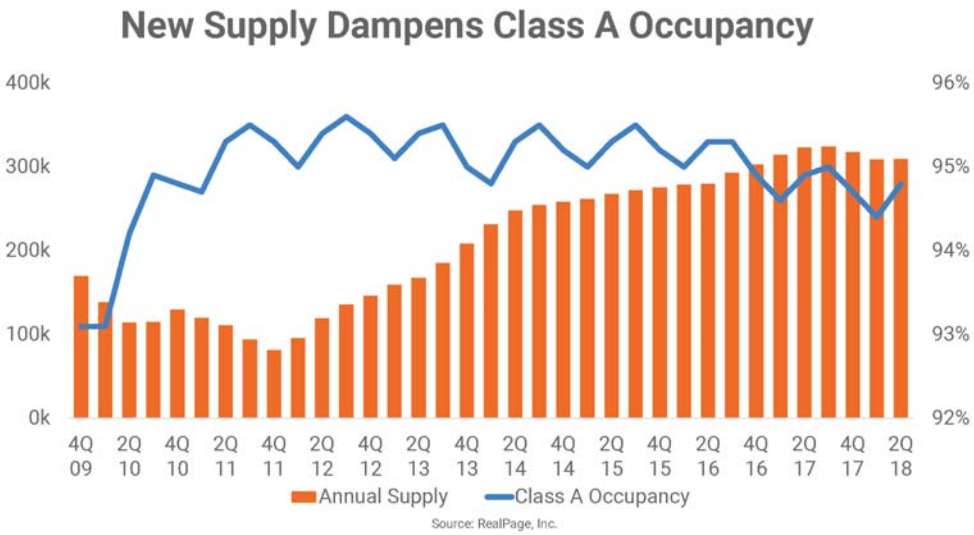

age annual deliveries churning up to 280,000 units.

Like the occupancy showing, rent change across asset classes has compressed recently, as the national performance moderates. When the cycle started, all product lines were logging rent cuts, but the Class C stock was slashing prices by a steeper tilt. It took longer for rent growth to return to Class C product, but by the end of 2010, all stock was registering price increases, and progress has been the norm since.

As of 2nd quarter 2018, Class B stock has pulled out in front, registering annual rent growth ahead of the national average at 2.7%. Though, the other product classes aren't far behind, each with increases of 2.4%.

While Class A and C units are both registering performances below the national norm, the way those increases weigh when considering historical trends diverges. The latest hike in Class C stock is well ahead of that product line's historical average, while Class A price increases are registering below long-term norms for the luxury segment.

Rent Progress

Asset Class	2Q 18 Effective Rent	Cycle Change
A	$1,763	41%
B	$1,276	32%
C	$989	15%

Source: RealPage, Inc.

While Class B and C stock are excelling, however, Class A product hasn't completely relinquished the spotlight. When looking at total cycle rent growth, the Class A stock still shines over the lower-end product classes, with a total increase of 40.7% in the past eight years. Class B stock logged total growth of 32% during that time frame, while Class C units recorded an increase of 14.6%.

Lower rent growth among Class C units despite those having higher occupancy indicates that affordability issues have influenced pricing power. Those units are more affected by weak wage growth seen throughout the post-recession recovery period. Likewise, affordability does influence rents in middle-market Class B units, though not to the same degree as in the Class C product line. Additionally, this Class B product segment reached the essentially full occupancy mark well before Class C units, placing sustained upward pressure on rents.

Meanwhile, rents for Class A product have grown due to a variety, including the type of the product delivered in this cycle. Developers have tended to favor high-rent, luxury product in expensive areas – namely, downtowns and affluent suburbs of major metros. Additionally, high-income households earning $100,000 or more have made up a significant share of new renter households in the current cycle. However, similar to occupancy trends, competition from new supply has weighed on recent performances in these top-tier units.