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Apartment Markets Across America Continue to Stabilize in 2023

According to CBRE's latest research, the U.S. multifamily market showed signs of stabilization in the second quarter of 2023 with a rebound in absorption and modest uptick in vacancy.
The multifamily vacancy rate rose by 10 basis points (bps) quarter-over-quarter in Q2 2023 to 5.0%. This was a slower increase than the 30 bps rise in Q1 2023, and the 70 bps in Q4 2022. Notably, net absorption escalated to 70,200 units in Q2 2023--the highest since Q1 2022--indicating a recovery in renter demand.

"Despite a heavy supply pipeline, we are seeing renter demand remain solid as vacancy and rent growth stabilize across most markets," said Kelli Carhart, Executive Managing Director and leader of Multifamily Capital Markets for CBRE. "With inflation easing, we anticipate increased investment activity in the second half of 2023, notwithstanding capital markets volatility."

The average monthly net effective rent increased by 2.6% year-over-year in Q2 2023, consistent with the pre-pandemic five-year average of 2.7%, although significantly less than the record 15.2% in Q1 2022.

New construction deliveries of 91,400 units in Q2 2023 brought the four-quarter total to a record high 351,500. Declining construction starts in recent quarters will result in fewer new deliveries in 2024 and beyond.

Other Q2 2023 Multifamily Sector Highlights by CBRE:

- The Northeast/Mid-Atlantic region saw the highest year-over-year rent growth in Q2 2023, led by Newark (5.6%), Providence (5.3%) and Hartford (5.2%). The Midwest had the second-highest rent growth at 4.3%, followed by the Southeast (2.0%), South-Central (1.7%), Pacific (1.4%) and the Mountain West (-0.9%).
- Most markets (58 out of the 69) tracked by CBRE recorded positive net absorption in Q2 2023, led by Chicago (4,600 units), Orlando (4,100) and Denver (4,000).
- The top five markets for new deliveries over the past four quarters -- New York, Washington, D.C., Dallas, Orlando and Phoenix -- constituted 25% of the national total.
- Almost all markets (67 out of 69) tracked by CBRE had vacancy rates equal to or above 3.0%, with 58 markets exceeding 4.0%. New York had the lowest vacancy rate at just 3.1%, falling below its historical average of 3.5%.

Higher Vacancy, Steady Demand for Multifamily

Cushman & Wakefield's midyear report shows resilience as well as a mixed bag.

Multifamily is continuing to demonstrate strength throughout the halfway point of this year, a U.S. National Multifamily MarketBeat Q2 2023 Cushman & Wakefield report shows. However, not everything is trending upward, as vacancy rates increased for the eighth straight quarter. While overall conditions have weakened since 2021, there is resiliency in the markets.

Sam Tenenbaum, head of multifamily insights at Cushman & Wakefield and the author of the report, told Multi-Housing News that the increase in vacancy rates is partly due to high unit deliveries and close to a million more apartments under construction. "Our expectation is for supply to continue outpacing demand next year."

The numbers point toward strength

By the numbers, multifamily largely looks good. In the second quarter of this year net absorption increased by 64 percent quarter-over-quarter and 62 percent year-over-year to 85,235 units, the report shows. On the contrary, vacancy rates increased again for the eighth straight quarter to 7.5 percent. While vacancy rates did climb, multifamily has been experiencing extremely high delivery numbers with 114,000 units hitting the market in the second quarter of 2023.

Annual rent growth numbers have shown an increase of 1.5 percent year-over-year and 2.2 percent year-to-date. It is likely that rental growth will continue to look weak as economic volatility factors in, however, year-to-date rental growth is so far largely mirroring the average of 2.4 percent over the last eight years. Further, negative seasonal rental demands are expected to regulate after reaching dramatic heights last year.

“In 2022 there was effectively twice the normal amount of seasonality to make up for the year before,” said Tenenbaum. “There will be some hiccups in the second half of this year in certain markets and certain submarkets but broadly speaking we expect more normal seasonal trends to take hold in 2023.”

Where multifamily is thriving

In the second quarter of this year, overall vacancy rates were slightly higher in the South and West regions when compared to the first quarter of 2023, as opposed to the Northeast and Midwest which stayed the same. Tenenbaum explained to MHN that most of that is attributable to new supply.

“In the South in particular there have been a lot of markets in really high demand,” he said. “However, they’re also typically higher supply markets, and as a result, even if you have at the national level the third best quarter outside of the pandemic boom for apartment demand, there were still more deliveries that ultimately slightly drove vacancy.”
The Midwest continues to demonstrate resilience, topping the charts with year-over-year rent growth. Of the 90 markets the report tracked, Madison, Wis., Knoxville, Tenn., Fargo, N.D., and Omaha, Neb., ranked highest in rent growth.

Factors weighing in

Financing for multifamily is proving difficult as banks are reluctant to make what they perceive to be risky loans. Considering construction loans are often thought of as riskier than acquisition financing, Tenenbaum anticipates the next year will continue to be challenging when it comes to financing multifamily development.
“The factors that are affecting construction today are the same factors that are affecting the investment sales market, namely higher debt costs,” said Tenenbaum.

As with any property type, high-interest rates and recent bank failures are causing strain. As a result, many homebuyers are being priced out of the market. High-interest rates and the challenges facing the single-family market are creating a great number of opportunities for multifamily.

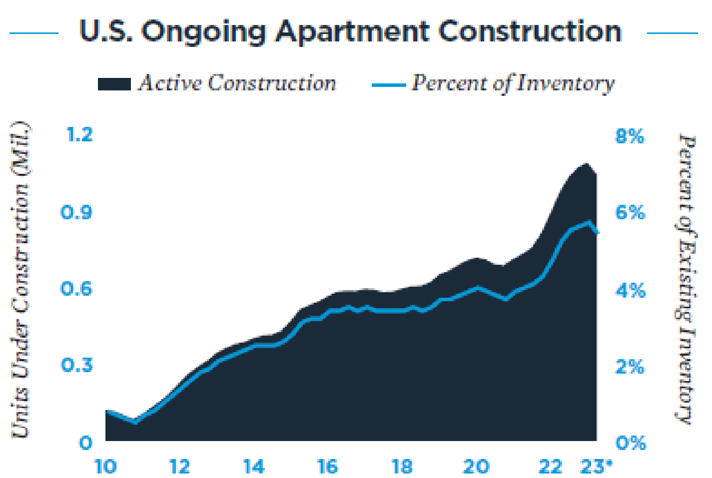
Historically, the principal and interest payment of a mortgage is much cheaper than overall rent. To buy a home you have taxes, insurance, upkeep, and all of these things that you’re responsible for,” Tenenbaum explained. As of the second quarter of 2023, the principal and interest portion of the mortgage payment was some $400 more expensive than a rent payment, before you take into account additional fees, said Tenenbaum. These numbers are playing a big factor, alongside other variables, in the sustained demand and resiliency of multifamily.

Pullback in Multifamily Construction Starts

Apartment Construction Starts Plummet Across the United States

Entering 2023, the country's most active apartment developers were generally anticipating that they would start construction on only about half as many units as they were able to get underway in 2021 or 2022. This anticipated sharp slowdown in early-stage building activity was registered during 2023's second quarter, as starts in key markets fell to slightly below half the earlier norm.

Less access to development capital has been the leading factor triggering the slowdown in construction. The largest banks were generally targeting less substantial capital allocations for real estate early in 2023; likewise, many smaller banks made strategy adjustments when a handful of regional lenders failed during the spring. All development capital sources also faced more challenging financials on new projects when the pace of rent growth cooled from earlier records and when operational expenses — particularly insurance costs — soared above past norms



Cooling Future Deliveries Set the Stage for a Rent Growth Comeback

Just over one million apartment units are now under construction across the U.S. However, building is not booming everywhere. About half the total construction pipeline is in 15 markets, where a slowdown in local starts will impact overall statistics. Most of the primary building centers are in the Sun Belt, but there's also notable activity in Washington, D.C., Los Angeles, Seattle and Philadelphia.

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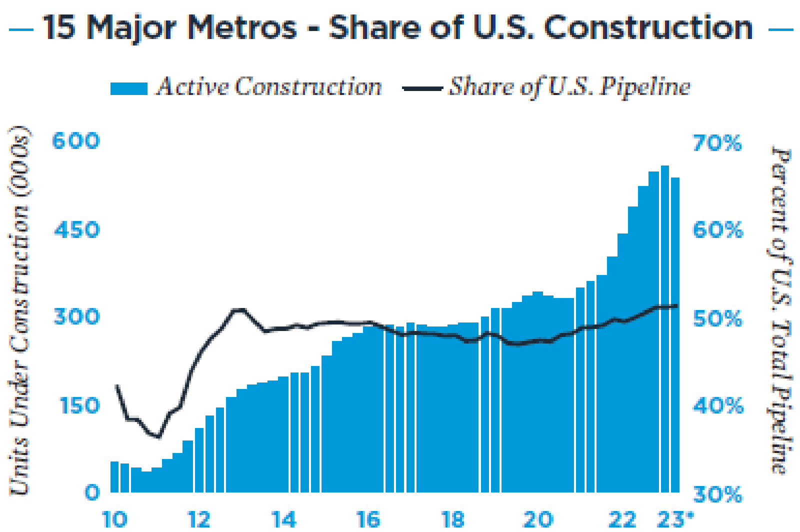
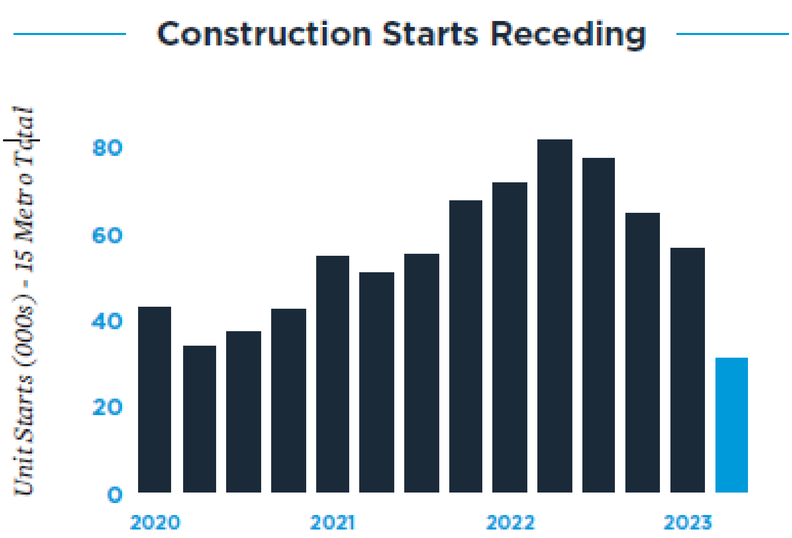
Apartment construction starts in the 15-market core building locations skidded to 30,800 units in the second quarter of 2023. That start volume is off 52 percent from the quarterly norm of 64,200 that was sustained for nine quarters from early 2021 through early 2023. Absolute peak quarterly starts totaled 81,500 units from April through June 2022.



Given that the typical apartment community takes 18 to 24 months to complete, delivery volumes should begin to wane in early 2025 and then drop notably during the last half of the year. Rent growth seems likely to regain momentum as early as spring 2024, when the normal seasonal upturn in leasing velocity should coincide with obvious signs that today's new supply excess is temporary. Price increases should then prove robust during 2025.



* As of 2Q
Sources: IPA Research Services; RealPage, Inc.

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Evergreen Insights:

For Evergreen Capital, the pullback in multifamily construction creates a unique opportunity with both upside and downside potential. While reduced competition and potentially lower entry points are attractive, the risk of oversupply and tight financing requires a cautious approach.

Here's a potential investment strategy:

- Focus on high-demand markets with strong job growth and limited existing supply.
- Prioritize quality assets with efficient operations and experienced management.
- Maintain a conservative financial profile, anticipating rising interest rates and slower exits.
- Consider bridge loans or alternative financing to navigate tighter bank lending.
- Monitor market trends closely and remain flexible to adjust strategies as needed.

By adopting a disciplined, data-driven approach and focusing on long-term fundamentals, Evergreen Capital can capitalize on the potential upside of this pullback while mitigating the downside risks. Remember, a strong exit strategy with clear timelines and diversification across markets and asset types will be crucial for managing potential oversupply in the future.