EVERGREEN
CAPITAL

Apartment Demand is Normalizing, But Soaring Supply Flattens Rents

Apartment Demand Rebounds as Rent Growth Flattens

Despite rent growth flattening, apartment demand in 2023 continues to rebound. This phenomenon, known as rent disinflation without demand destruction, can be attributed to one key factor: supply. The third quarter of 2023 witnessed the highest levels of apartment completions since the 1980s, indicating a surge in supply.

It's important to note that the challenges faced by the apartment sector today are not related to demand fundamentals, but rather to a combination of factors such as increased apartment construction, expense pressures, and a significant spike in interest rates disrupting the financing market.

According to RealPage Market Analytics, the U.S. apartment market absorbed 90,827 units in the third quarter of 2023. While this falls short of the robust demand seen in 2021, it is still the largest quarterly tally in nearly two years and aligns with long-term seasonal norms.

Interestingly, the correlation between high mortgage rates and apartment demand has been weak. Apartment demand was strongest in 2021 when mortgage rates were lower and more homes were being sold. In contrast, apartment demand declined in 2022 despite an initial jump in mortgage rates. This suggests that slowing inflation and a strong job market, rather than mortgage rates, are driving consumer confidence and encouraging household formation among young adults who are more likely to rent apartments.

Supply Shifts Balance of Power in the Rental Market

The deal volume decline was evident in both the garden and mid- and high-rise segments. Both fell at over 70% YOY in August. Individual sales of mid- and high-rise properties declined 44%, while those trades for garden apartments dropped 69%.

Supply Shifts Balance of Power in the Rental Market

The influx of new apartment supply has rapidly shifted the balance of power in the rental market back to renters. With over 128,000 units coming online nationally, renters now have more options than ever before. This increase in supply is reflected in the occupancy rate, which dropped by 10 basis points in September, reaching 94.4% by the end of the third quarter. Notably, demand is primarily concentrated in areas where supply is also increasing, particularly in the Sun Belt region, with several Northeast markets also experiencing strong demand.

To protect cash flow, many operators prioritize occupancy over pricing. As a result, rents have been falling in many markets despite solid demand, leading to a normalization of vacancy rates and flat-to-falling rents.

High Supply Leads to Flattening Rents

The significant increase in supply over the past 18 months has transformed the rental market from one characterized by record-low vacancy rates and record-high rent growth to a market with normalized vacancy rates and flat-to-falling rents. Nationally, effective asking rents decreased by 0.3% in September, resulting in year-over-year rent growth of just 0.1%, compared to 9.0% from one year ago. On an annual basis as of September, rent cuts are already common across the West and South regions of the country, while the Northeast and Midwest regions continue to experience moderate rent growth.

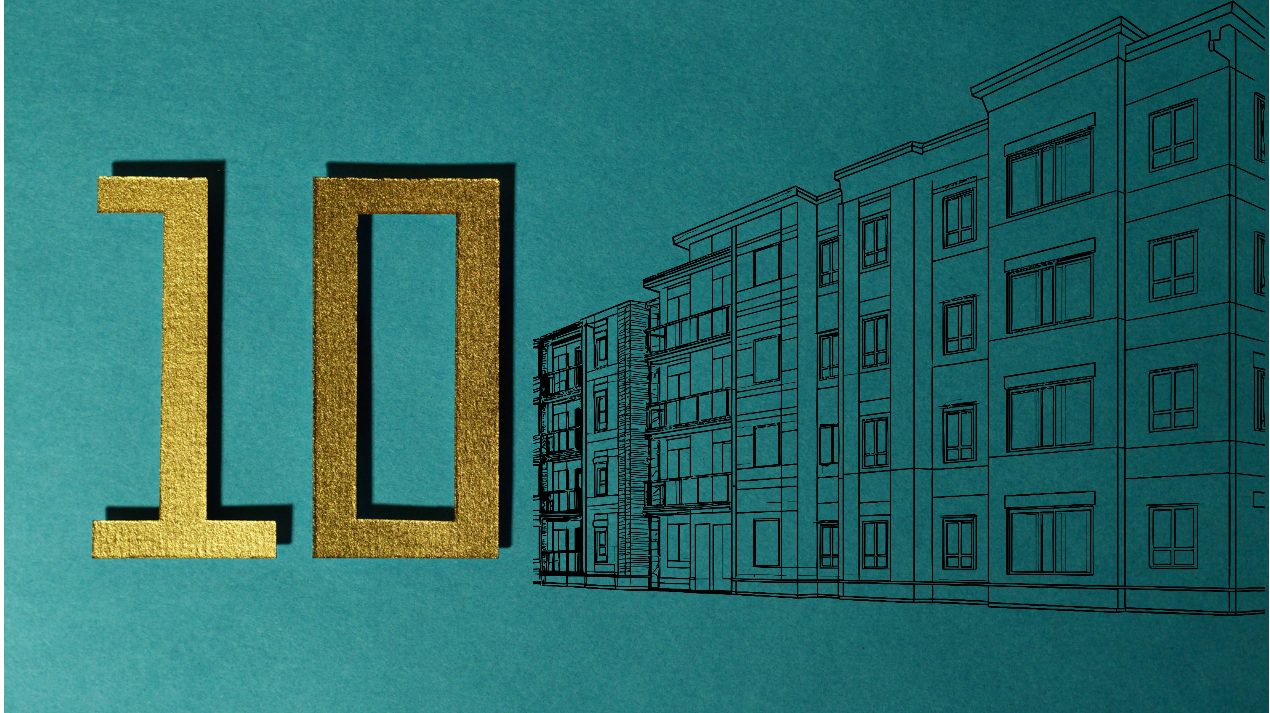
In 26 of the nation's 50 largest metro areas, rents have declined over the last year. Four once-hot markets, namely Austin, Phoenix, Las Vegas, and Jacksonville have seen rent cuts exceeding 4%. Conversely, only six large metros recorded rent increases above 3%, with Newark-Jersey City, NJ leading the pack at 4.3%. A clear relationship exists between supply levels and rent growth. In the 10 large metro areas with the deepest rent cuts, the average rate of apartment supply expansion was nearly double the U.S. average. Conversely, the markets with the largest rent increases had supply expansion rates below the national average.

Evergreen Capital Insights:

For Evergreen Capital, the flattening rent landscape presents a strategic shift requiring both caution and opportunity. While slowing demand growth might sound ominous, the surge in supply signifies long-term market correction and potential entry points. Focus on value-added assets in high-demand, high-growth Sun Belt markets. Prioritize operational efficiency and renter retention to navigate price competition. Monitor regional nuances and adjust strategies accordingly, remembering that demand fundamentals remain strong. By navigating this transitional phase with a data-driven, opportunistic approach, Evergreen Capital can capitalize on the emerging value proposition of the US apartment sector.

EVERGREEN
CAPITAL

The Top 10 Markets Driving Rent Growth



Welcome to our latest edition of the Multi-Housing News newsletter! In this issue, we'll be discussing the top 10 markets in the US that are driving rent growth, despite what has been a difficult time for the multifamily industry as a whole. So without further ado, let's take a look at these leading markets!

1. Cincinnati, Ohio

With a year-over-year rent growth of 4.3 percent, Cincinnati is currently leading the nation when it comes to rent growth. A relatively low supply in Ohio's largest metropolitan area has resulted in a healthy balance of supply and demand.

2. Northern New Jersey, New Jersey

Establishing itself as the top market for rent growth in the Northeast region, Northern New Jersey has seen a slight above-average rent growth of 3.9 percent, behind only Cincinnati.

3. Norfolk, Virginia

With an almost 3.9 percent year-over-year rent growth, Norfolk has made the top 10 for rent growth in the second consecutive quarter this year. This Virginia market has low levels of new construction and stable demand from its naval base to thank for this.

4. Columbus, Ohio

With over 3.8 percent rent growth in Q2, Columbus has remained in the top 10 markets for rent growth since late 2022. The capital city of Ohio has enjoyed a healthy balance between supply and demand, leading to consistent growth.

5. Indianapolis, Indiana

The affordability and limited development in Indiana have resulted in 3.8 percent rent growth during Q2, keeping this Midwest market as a rent growth leader for over a year.

6. Chicago, Illinois

Chicago's above-average rent growth of 3.5 percent in Q2 has been sustained by modest development which has kept pace with demand, leading to low vacancy rates.

7. Boston, Massachusetts

Favorable conditions such as low supply and high absorption have resulted in high rent growth of 3.5 percent during Q2, keeping Boston in the top 10 markets for two consecutive quarters

8. Kansas City, Missouri

In 2023, the Kansas City market has outpaced the rent growth it saw during and before the pandemic with a 3.5 percent year-over-year increase in Q2.

9. St. Louis, Missouri

With a year-over-year rent growth of 3.4 percent, St. Louis has maintained its position as a top 10 market for rent growth this year.

10. Cleveland, Ohio

Cleveland joins Cincinnati and Columbus in the top 10, with a 3.1 percent asking rent growth year over year since Q2 of 2022, representing Ohio’s position as a new rent growth leader.

Multifamily Starts Plunge as Completions Increase

We hope this newsletter finds you well. Today, we share with you the latest news from the Census Bureau regarding the state of the US housing market.

We bring to you the latest release from the Census Bureau about the state of the US housing market. Unfortunately, multifamily starts witnessed a drop of 26.3% from July's annual rate to 334,000, while declining 41% from last year. The bigger picture shows an increase in multifamily completions by 45.8% from July to 433,000 units, which is an increase of 32% from the previous August. This puzzling divide is most likely caused by funding and other concerns causing delays in starts.

Housing Market Updates: Single-family Permits on the Rise, Residential Starts Decline, and Multifamily Permitting See a Drop

On a separate note, single-family permits experienced a steady increase, rising by 2% from July and 7.2% from last year, reaching a total of 949,000 units. However, single-family completions witnessed a decline of 6.6% last month, falling by 5.8% from last year to 961,000 units. Residential starts have dropped significantly, decreasing by 11.3% from last month and 14.8% from last year to 1.283 million units. Even though the number of permits and starts has been increasing, the year-over-year rate fell by 2.7%.

Among all four regions, multifamily permitting rates have decreased, especially in the Northeast, down 27.8% to 49,000 units. Multifamily starts also declined significantly, with the Northeast down 63.7% to 41,000 units. Although authorized but unstarted multifamily units increased by 7.1% to 135,000 units, it's still 8.8% lower than last year. In summary, multifamily starts have dropped, likely due to funding and other issues, while single-family permits and starts are on the rise, leading to the overall decline in the year-over-year rate.

Multifamily Permitting Trends in New York, Houston, Dallas, and Austin

New York once again led the nation in multifamily permitting but with a declining trend. According to the August data, a total of 24,341 units were permitted in the 12 months ending August, down by more than 17,600 units from last year and about 800 less than in July. This trend could signify a shift or slowdown in the New York multifamily market. On the other hand, Houston returned to the #2 spot with 22,498 units permitted, a decrease of just 186 units from last year but 827 units fewer than last month. Dallas retained the #3 spot with 22,097 units permitted in the past 12 months. Austin made a significant leap of three spots to land at the 4th position with 19,065 units permitted for the year. This could be an indication of potential growth in the Austin multifamily market. It's also worth noting that a significant slowing in annual multifamily permitting occurred in Philadelphia, Seattle, Denver, Colorado Springs, Fort Worth, and Boston. This could suggest a potential slowdown in the multifamily markets in those cities.

Individual Permits for August in Austin, Los Angeles, Houston, and Atlanta

In August, Austin remained in the #1 position on the individual permits list, with 12,398 units permitted. Los Angeles, Houston, and Atlanta switched their July positions to #2, #3, and #4 spots, respectively. This data suggests that these cities have strong, active multifamily markets. Why is this Important for the Investor? If you're a real estate investor, keeping up with the latest multifamily permitting trends and data can be crucial for identifying potential investment opportunities. For example, a shift or slowdown in a market could signify a need for a change in investment strategy or exploring other cities with potential growth in the multifamily market. On the other hand, actively growing markets like Austin could indicate a potential opportunity to invest early in a thriving market. Stay tuned for our next Metro-Level Multifamily Permitting Newsletter for more insights and trends!

Evergreen Capital Insights

For Evergreen Capital, the mixed signals in the housing market necessitate a nuanced approach. While the plunge in multifamily starts across most regions raises caution flags, the steady increase in single-family permits and starts in high-growth areas like Austin offer compelling opportunities. Embrace a two-pronged strategy: focus on value-add multifamily investments in select Sun Belt markets experiencing temporary supply hiccups, and capitalize on the emerging single-family demand by strategically entering markets like Austin early in their growth cycle. Diversification across asset types and geographic regions, coupled with close monitoring of regional trends and risk factors, will be key to navigating this dynamic market and maximizing returns. Remember, flexibility and data-driven decisions will be critical for capturing both defensive and offensive opportunities in this evolving landscape.