Apartment First Glance

2018 Quarter 2

Pre-Release Analysis of Second Quarter 2018 Reis Findings in the Apartment Sector

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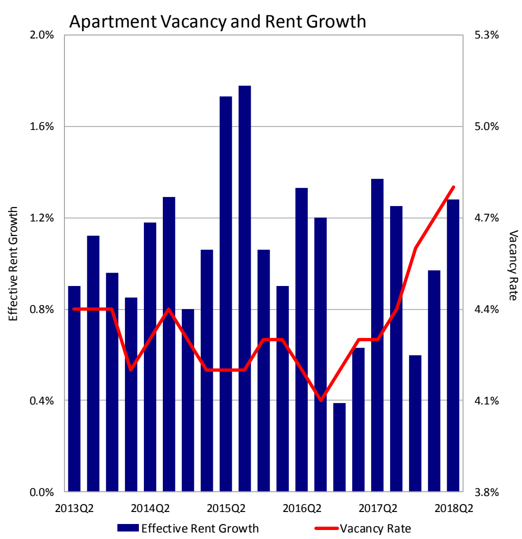
The Rising Tide of Vacancies Isn't Lifting Any Boats

The national vacancy rate for the apartment sector rose by 10 basis points, ending the second quarter at 4.8%. With the exception of a slight pause in the first half of 2017, the vacancy rate has ticked up consistently on a quarterly basis since hitting what appears to be its cyclical trough of 4.1% in mid-2016.

Not Unexpected, And Not Altogether Calamitous

Rising vacancy rates were not unexpected, given the flood of new supply that hit the market particularly in 2017 and will continue through this year. Reis has been issuing warnings about the amount of new construction scheduled to hit the market as early as four years ago. With that said, although heightened competition between new and existing stock has dampened effective rent growth, for most markets effective rent growth still tended to eke out slight gains quarter-over-quarter.



National asking and effective rent growth came in at 1.3% in the second quarter, 10 to 30 basis points below the same quarterly rent growth figures for the second quarter of 2017.

Deliveries Have Actually Begun to Slow (For Some Markets)

Given the vagaries of forecasting scheduled new completions, deliveries have actually begun to slow for some markets relative to what was expected only two quarters ago. At the end of 2017, New York vacancies spiked to a historic high of 5.4%, driven by new deliveries of over 13,000 units—almost double the previous record set in 1986. According to developer expectations that Reis tabulated in late 2017, that record was set to be broken in 2018, pushing expected vacancies to another record high—but in early 2018 developer surveys suggested that some projects had been delayed or repurposed, with total new supply figures easing relative to 2017 totals. Metros like New York—and submarkets like Downtown Los Angeles—will still need some time to absorb the new supply that has and will come online, but at a national level Reis expects new deliveries to slow down significantly in 2019, easing pressure on multifamily markets. Sources of new construction financing recognized the oversupply risk about two years after Reis began issuing warnings, and slowed down lending for new projects as early as mid-2016.

Rental Demand Remains Strong

Multifamily optimists can justifiably point to continuing resilience in apartment demand. There does not seem to be evidence of large cohorts of renters turning into homebuyers, and neighborhood trends suggest that during months when deliveries slow, vacancies tend to drop. In Downtown Los Angeles, for example, the second quarter of 2017 had over 1,500 of new completions coming online, representing supply growth of over 10% in a three month period. Understandably, vacancies rose from 8.9% to 10.1%. However, with deliveries slowing in the remainder of the year, and with few units opening doors in 2018, vacancies have eased back to 7.5% in the second quarter of 2018.

The proportion of markets with moribund occupancies remained about the same, with 69 markets out of Reis's top 82 markets registering flat or declining occupancies in the second quarter. However, 81 out of 82 markets posted an increase in effective rents, suggesting relative strength despite the onslaught of new deliveries.

Second Quarter 2018 Market Performance
Improving Fundamentals / Flat or Declining Fundamentals

	Absorption	Occupancy	Effective Rent
Q2 2018	75 + / 7	13↑ / 69	81↑ / 1
Q1 2018	71 + / 11	16↑ / 66	80↑ / 2
Q4 2017	68 + / 14	12↑ / 70	68↑ / 14
Q3 2017	74 + / 8	20↑ / 62	75↑ / 7
Q2 2017	76 + / 6	41↑ / 41	79↑ / 3

Figures are based on 82 metro markets.

Market Highlights

Of the 69 metros with flat or declining occupancy rates, 47 showed an increase in vacancy: as expected, higher construction figures in these metros exceeded net absorption. Metros with the highest vacancy rate increase include Charleston, Raleigh-Durham, Louisville, Nashville and

Westchester. All of these metros, however, posted positive rent growth. In fact, 50 metros saw an increase in effective rent of 1.0% or more including Boston, Orange County, Raleigh-Durham, Fort Lauderdale and Columbus that saw effective rent growth of 1.9% or more in the second quarter. Thus, rent growth has not been impacted by increases in vacancy and has been higher in metros with robust construction. Metros that saw the sharpest vacancy decline include Greenville (SC), Tulsa, Norfolk/Hampton Roads, Lexington and Houston. No metro posted a rent decline in the quarter, but Tulsa's effective rent growth was flat.

Apartment Outlook

Reis expects construction to remain robust for the rest of 2018 and in early 2019 before completions drop off in subsequent periods. Vacancy rates are expected to continue to increase as new supply outpaces demand in the short run, but as evidence throughout 2017 and the first half of 2018 shows, rent growth has not turned negative except for a handful of submarkets during some periods. Monthly data also suggest that during periods when deliveries slow, vacancies often tick downwards, implying that rental demand continues to remain resilient.