MULTIFAMILY MARKET REPORT | 1Q2024

Demand is strong but falling short of supply; rent growth is flat nationally

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- **EMPLOYMENT:** Job growth slowed throughout 2023 but remains resilient and stronger than expected. Payrolls should slow further throughout 2024. The unemployment rate edged higher from last month at 3.8 percent as of March 2024, up only 30 basis points (bps) from 3.5 percent a year ago.

- **VACANCY:** Construction levels are at a 50-year peak and have moved vacancy higher. Stabilized apartment vacancy rates averaged 5.8 percent in 1Q2024, up from 5.2 percent a year ago. Because of the surging number of completions expected in 2024, we expect the vacancy rate to remain above the historic average, ticking up potentially by another 20 bps before moving back down to 5.0 to 5.5 percent nationally over the long term.

- **SUPPLY:** Peak supply is upon us, with almost one million units currently underway nationally, concentrated in the South and Southeast. About 430,000 units delivered in 2023 and another 660,000 units are expected to deliver in 2024. Slowing permits and starts numbers are pointing to much lower completions in 2025-2026.

- **DEMAND:** Net absorption was strong in 2023 and the total for the year—223,000—was in line with the 20-year historic average. Further, 1Q2024 marked the highest first quarter absorption since 2000 at 104,000 units. Demand for apartments should remain strong, given healthy population growth, cooling inflation, and a resilient job market. Nevertheless, demand is expected to lag supply in the face of record deliveries in 2024.

- **RENT GROWTH:** After double digit gains in 2022 and a cumulative five-year gain of 30.8 percent, rents are flat on a national basis. Generally, rents are growing in low-supplied markets and falling in high-supplied markets, averaging out to zero nationally. Annual effective rent growth for market rate apartments averaged 0.4 percent in 1Q2024. We expect modest rent growth for 2024—1.0 to 2.0 percent on an annual basis—based on the impact of new construction and slowing job growth.

- **CAP RATES/SALES TRENDS:** Apartment cap rates again rose in 1Q2024, averaging 5.8 percent, a 4 bp rise from last quarter and 54 bps higher than a year ago. Apartment CPPI declined by 8.4 percent YOY. Sales activity in 1Q2024 remains at a low level of $20.6 billion, an annual drop of 25 percent.

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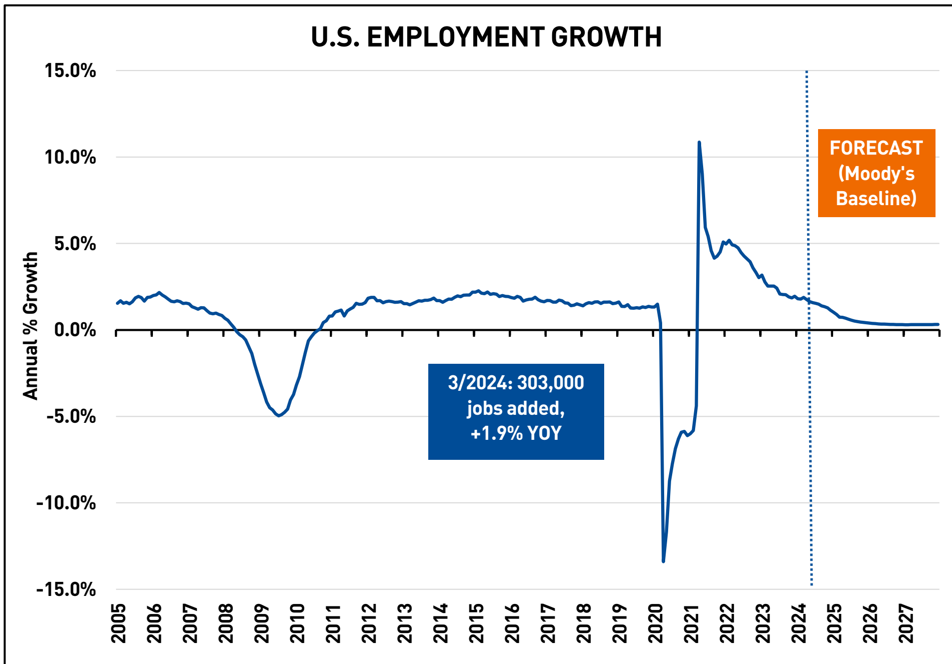
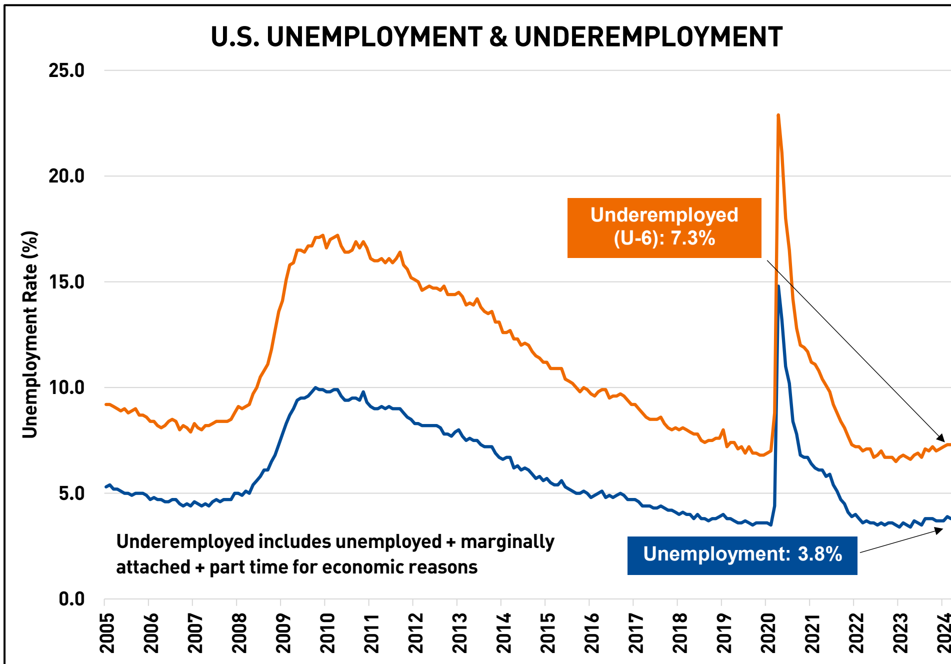
ECONOMY

The U.S. job market has been decelerating steadily since the beginning of 2022. In 2023, the U.S. economy added an average of 250,000 jobs per month, down from an average of 377,000 in 2022. The March jobs report showed a gain of 303,000 positions, a 1.9 percent rise over last year. PNC's economists expect job growth to slow further and the unemployment rate to rise to above 4.0 percent by the end of 2024; however, they are no longer forecasting a recession in 2024. In fact, PNC is now expecting the current expansion to continue throughout 2024 and into 2025.



Source: Bureau of Labor Statistics, Moody's Analytics, PNC REMA

The household survey showed unemployment remaining mostly stable over the last few months at 3.8 percent in March, up 30 bps from one year ago. The unemployment rate has been below 4.0 percent for more than two years straight, the longest period since the late 1960s.



Data as of 5/2/2024; Source: Bureau of Labor Statistics (BLS); Moody's; PNC REMA

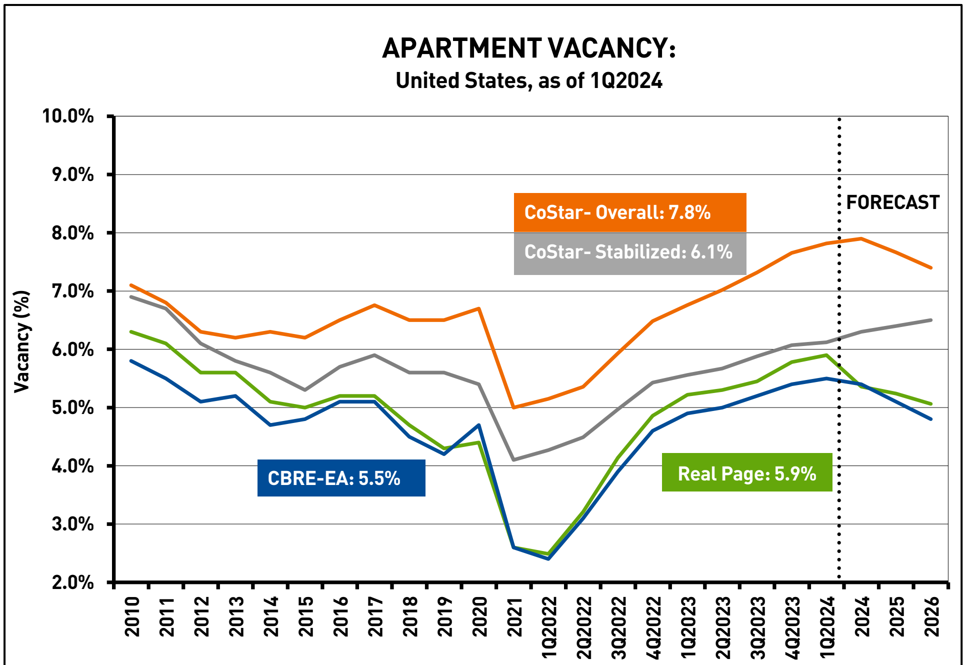
The Federal Open Market Committee (FOMC)'s tightening of monetary policy since the spring of 2022 has weighed on economic growth, although the economy continues to expand. The April/May meeting yielded an unchanged federal funds rate of 5.25 to 5.50 percent; many economists expect the FOMC to hold rates steady in the near term given the still-strong labor market and begin to cut rates later in the year.

Core inflation is gradually slowing toward the Federal Reserve's 2.0 percent objective, although it remains elevated. Softening wage growth is beginning to contribute to a slowing in inflation. The Core PCE (Core Personal Consumption Expenditure Index), which excludes volatile food and energy prices and is a better measure of underlying inflation trends, was 2.8 percent in March. This compares to the peak of above 5.0 percent in 2022. Fed officials have stated that they expect to cut the federal funds rate at some point this year. Since we are within range of their 2.0 percent target inflation number, this should allow for rate cuts in the second half of 2024.

APARTMENT MARKET TRENDS

VACANCY

The first quarter reflected an increase in vacancy levels, with vacancy for investment grade stabilized apartments averaging 5.8 percent, up from 5.2 percent a year ago. This shows a moderation from recent tight vacancy levels, a normalizing trend. While vacancy is close to historic levels, it is beginning to be elevated. Vacancy for all apartments (Census) rose 10 bps to 7.8 percent, 40 bps above the rate from a year ago; however, it is still well below its 20-year average of 10.0 percent.



Sources: CBRE-EA; Real Page; CoStar; PNC Real Estate Market Analytics

The second adjacent table shows the effect of lack of supply, with Northeast and Coastal markets having the tightest vacancies. Markets in the South, Southeast, and Southwest are experiencing higher vacancies, due to supply outpacing demand. The following two pages outline the ongoing wave of apartment construction and specify those markets currently experiencing rising vacancies (i.e., San Antonio, Atlanta, Austin, etc.) and likely to cut rents.

The rises in vacancy are due to the 50-year supply surge. Given that about 1 million units are under construction, we expect investment grade vacancy rate to temporarily rise to slightly above 6.0 percent. Owners and operators will be challenged as they work to increase lease traffic and fill those units. In place residents are facing a choice between a renewal rent that may be more than a brand-new apartment when factoring in a concession.

Occupancy Ranking 1Q2024

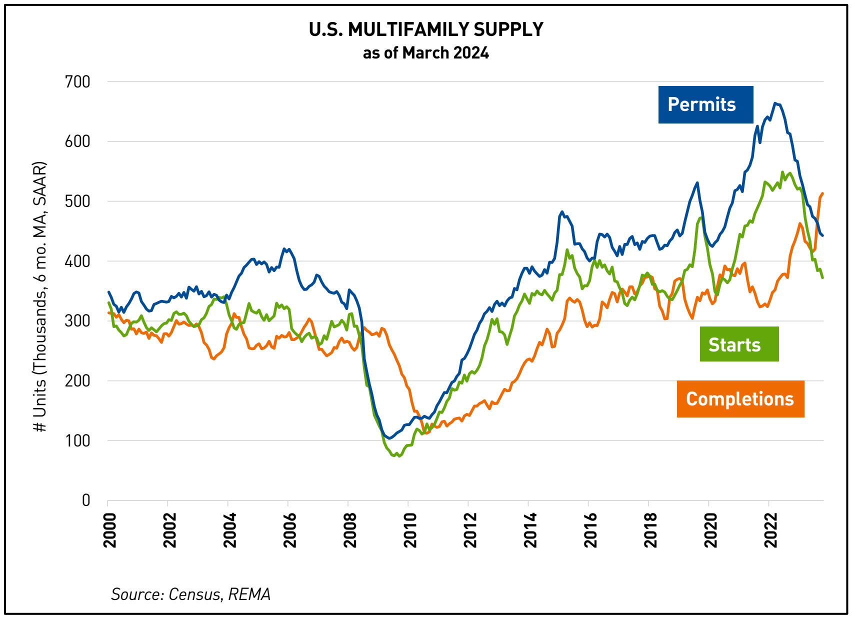
BEST			WORST		
1.	New York-White Plains	96.8%	1.	San Antonio	91.2%
2.	Newark-Jersey City	96.3%	2.	Memphis	91.8%
3.	Anaheim-Santa Ana	96.2%	3.	Fort Worth	92.0%
4.	San Francisco	95.5%	4.	Jacksonville	92.0%
5.	San Jose	95.4%	5.	Atlanta	92.2%
6.	San Diego	95.3%	6.	Austin	92.3%
7.	Boston	95.3%	7.	Houston	92.4%
8.	Philadelphia	95.2%	8.	Tucson	92.5%
9.	Chicago	95.1%	9.	Phoenix	92.7%
10.	Los Angeles	95.0%	10.	Dallas	92.8%
National Average		**94.1%**			

Source: Real Page; PNC Real Estate Market Analytics

Looking ahead to 2025 and 2026, completions will drop dramatically as permits and starts slow. Because of tailwinds supporting the multifamily market, such as long-term demographic trends and mid- to long-term financial/inventory/interest rate issues with the for-sale housing market, vacancy is likely to remain near 5.0 to 5.5 percent nationally over the long term, which is consistent with pre-Covid historical averages.

SUPPLY

Apartment construction is at a cyclical high, with about 440,000 units delivered in 2023. As shown in the adjacent chart, the number of multifamily permits (5+ units, apartments, condos, etc.) grew significantly between 2020-2022, leading to this surge of completions. These deliveries have helped satisfy a chronically undersupplied market. Although some markets are experiencing some oversupply, on a national basis, apartment supply is at last reaching normal historic levels necessary to meet new demand, which is estimated at 300,000 to 400,000 units annually. More supply availability in the short term, however, is impacting vacancy and rents.



The chart above shows March 2024's completion level of 513,000 units is elevated compared to the 20-year average of 287,000. However, permits and starts are slowing dramatically and are expected to continue dropping given higher interest rates/fewer construction loans. Therefore, we expect completions should taper off beginning in 2025-2026.

Markets with the Largest Expansion of Existing Supply, as of 1Q2024

	Market	Existing Inventory	Vacancy Rate	Vacancy BP Change, Last 12 Months	Units Under Construction	Expansion to Existing Supply	Rent Change, Quarterly
1	Austin	282,550	7.7%	130	37,896	13.4%	-6.7%
2	Raleigh	163,438	6.8%	70	20,813	12.7%	-3.0%
3	Charlotte	197,409	7.1%	100	20,113	10.2%	-2.5%
4	Nashville	183,341	6.4%	90	16,501	9.0%	-2.6%
5	Salt Lake City	115,390	6.2%	80	9,847	8.5%	-2.9%
6	Jacksonville	132,337	8.0%	150	11,255	8.5%	-4.8%
7	Colorado Springs	59,531	7.5%	100	4,908	8.2%	-2.1%
8	Richmond	94,765	5.8%	30	6,924	7.3%	0.2%
9	Dallas	621,740	7.2%	100	43,987	7.1%	-2.0%
10	Miami	329,709	4.7%	70	23,068	7.0%	0.8%
11	Phoenix	403,581	7.3%	70	27,794	6.9%	-3.8%
12	San Antonio	217,660	8.8%	130	14,979	6.9%	-3.6%
13	Orlando	257,861	6.4%	110	17,586	6.8%	-4.1%
14	Atlanta	490,304	7.8%	120	32,896	6.7%	-4.4%
15	Tampa	284,575	6.6%	100	18,662	6.6%	-2.3%

Source: CBRE-EA. PNC Real Estate Market Analytics

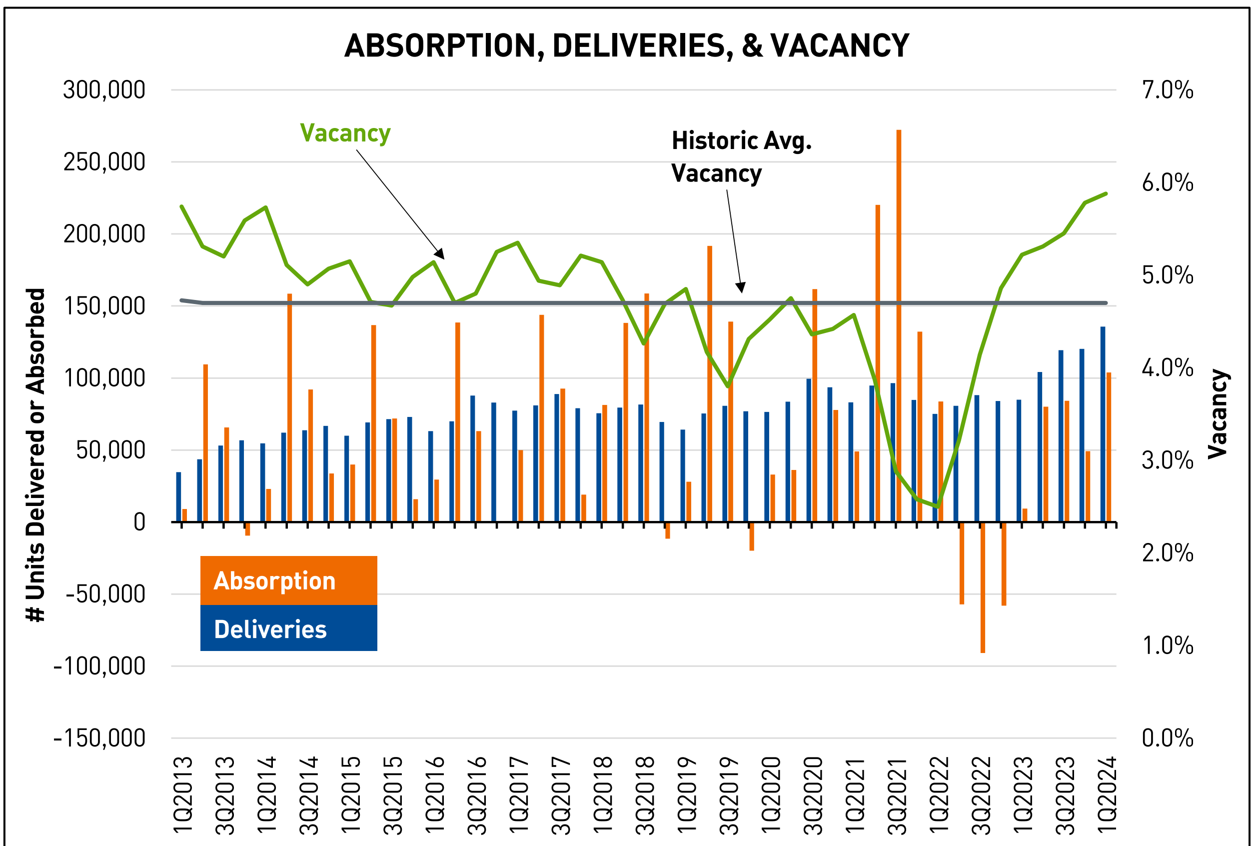
High levels of new construction concentrated in a handful of markets in the Sunbelt continues to warrant caution. The table above lists markets with the highest construction levels and inventory growth rates. Most of the markets in the list show rising vacancy rates of more than 100+ bps from a year ago and all but two show quarterly rent declines. It is important to note that while the South claimed about half of the nation's new apartment supply, it claimed a disproportionately larger share of net demand.

DEMAND

After a strong showing of 223,000 units of net absorption for 2023, 1Q2024's demand number (104,000 units) was unexpectedly high, considering first quarters are typically slow leasing seasons. This non-seasonal sharp jump was the highest first quarter absorption number since 2000. Looking at the 12-month trailing average of 317,000 units, absorption is gaining momentum. Florida led the nation with nearly 20,000 units absorbed in 1Q2024, followed by Mountains/Desert with almost 18,000 and Texas with almost 18,000 units absorbed. The West Coast, Midwest, Mid-Atlantic, and Northeast also recorded healthy levels of absorption in 1Q2024.

Nevertheless, the peak supply levels eclipsed even these strong demand numbers. We expect new supply to overtake demand as the market takes time to lease the overhang of new units that delivered in 2023 and the new units projected to deliver in 2024. Further acceleration in apartment absorption is expected in 2024, but it will fall short of the number of deliveries, further pressuring rents and raising vacancy in some markets.

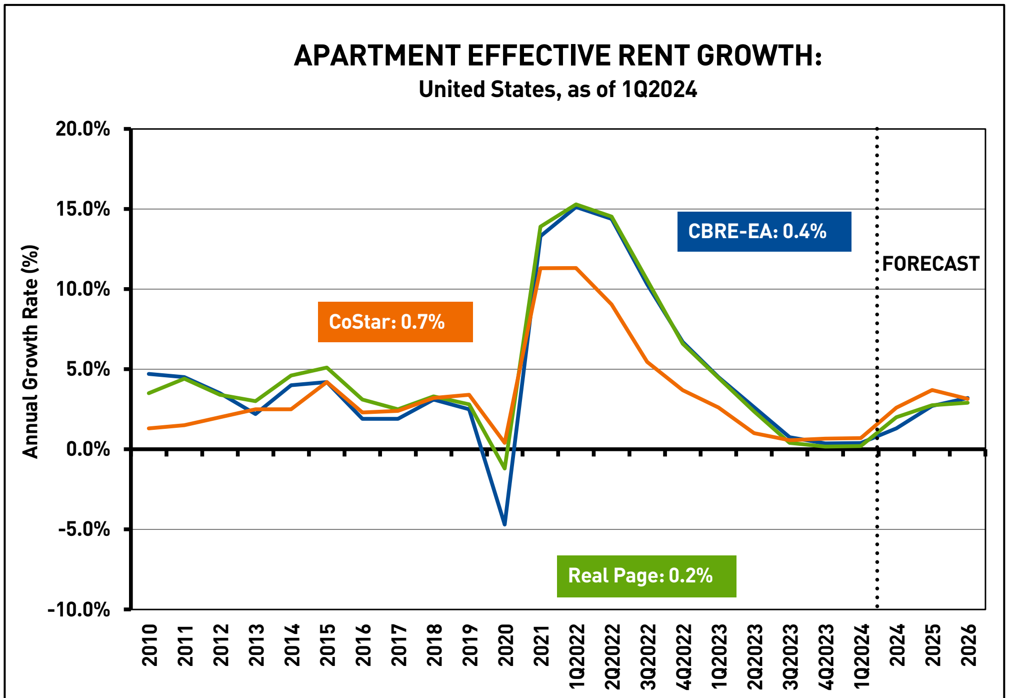
It is important to note that while net absorption is currently robust on a national level and in many markets with high levels of completions, it may not *seem* so strong given the sheer number of properties having to compete for their share of renters. Leasing activity is distributed over a growing number of newly delivered properties, so while there has been a 20 percent increase in *overall* absorption, there has been a 10 percent annual decline in leasing velocity *on a per property per month basis*. In other words, realized demand at the property level is being diluted by available supply and properties are taking longer to stabilize.



Source: Real Page; PNC Real Estate Market Analytics

RENT GROWTH

After double-digit gains in 2022, annual effective rent growth for the nation in 2023 flattened. Rent growth rates in 1Q2024 range from 0.2 to 0.7 percent, averaging 0.4 percent. Nevertheless, the five-year cumulative rent gain (since 1Q2019) was 30.8 percent.



Sources: Real Page; CBRE-EA; CoStar; PNC Real Estate Market Analytics

The Midwest and the Northeast regions led the way with the strongest rent gains, while surging supply in the South and parts of the West are leading to rent declines. As shown in the adjacent chart, Austin, Atlanta, and Orlando as well as a handful of other markets are experiencing annual rent declines. Given the amount of new supply expected to deliver this year, as well as slower per-project lease rates, we expect these rent declines could persist, with the high supply markets identified on page 4 likely taking longer to reach bottom. Lease-up properties dealing with increased competition are having to both reduce asking rents and offer concessions.

On a national basis, we expect rent growth to rebound to 1.0 to 2.0 percent annually in 2024. Third-party data sources estimate that annual rent growth will range from 1.3 to 2.6 percent through 2024, slightly higher than our expectations. Low supply or stable markets in the Midwest and Northeast could see continued healthy rent growth.

Effective Rent Growth Ranking 1Q2024

(Year-over-Year rate)

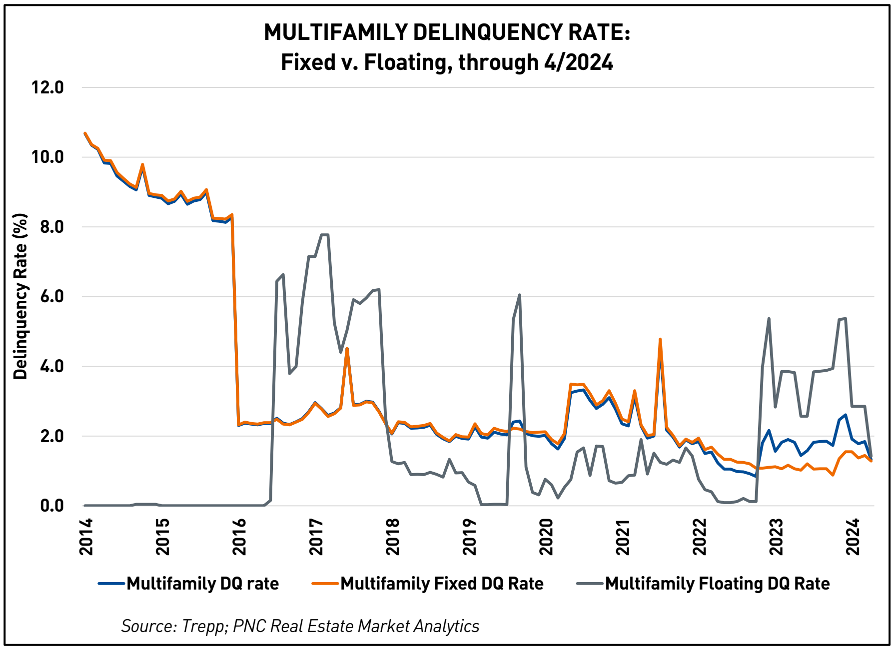
BEST			WORST		
1.	Cincinnati	3.3%	1.	Austin	-6.7%
2.	Washington, DC	3.1%	2.	Atlanta	-4.5%
3.	Chicago	3.1%	3.	Orlando	-4.2%
4.	Boston	3.0%	4.	San Antonio	-3.7%
5.	Virginia Beach	3.0%	5.	Phoenix	-3.7%
6.	Indianapolis	2.9%	6.	Raleigh	-3.1%
7.	Cleveland	2.9%	7.	Portland	-2.7%
8.	Newark-Jersey City	2.8%	8.	Nashville	-2.6%
9.	Kansas City	2.6%	9.	Charlotte	-2.6%
10.	Anaheim-Santa Ana	2.5%	10.	Tampa	-2.3%

National Average: 0.2% 1Q2023-1Q2024

Source: Real Page; PNC Real Estate Market Analytics

DELINQUENCIES

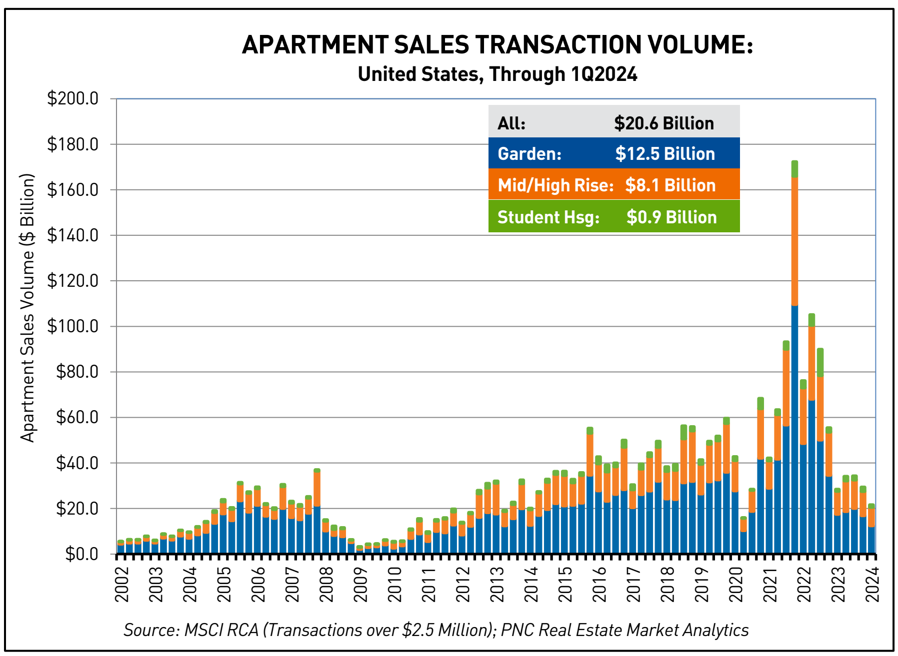
The overall CMBS delinquency rate for all property types was 4.7% as of 1Q2024, having increased from 4.2% in the beginning of 2022. Generally, the fixed-rate loan delinquency rate has historically trended higher than the floating-rate delinquency rate. However, in 2023, floating-rate delinquency rates have now surpassed the fixed-rate loan delinquency rate.



Looking at multifamily delinquencies in particular, the sector is starting to show some areas of weakness, but the rate is still lower than other property types at 1.3%. The floating-rate delinquency rate spiked at the end of 2022 and has remained above the fixed-rate delinquency rate for the multifamily sector. Over the last year, the rate has fluctuated, driven by major SASB (single-asset, single-borrower) deals being taken in and out of delinquency status. The declines in the rate in recent quarters can be attributed to large loans being disposed, such as the January 2024 disposal of the $447.6 million Veritas loan, an SASB apartment loan in San Francisco.

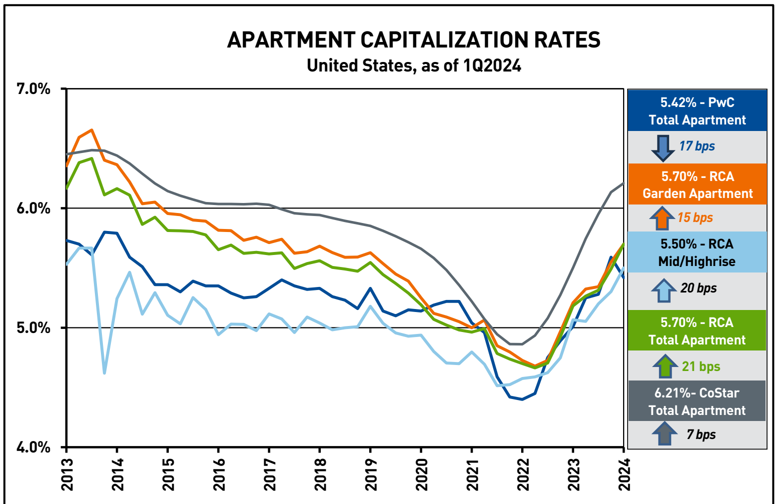
APARTMENT SALES TRENDS

Apartment deal volume continued to fall in 1Q2024, a drop of 25 percent year over year, standing at $20.6 billion including student housing. Deal activity remains depressed from pre-pandemic levels. The Garden sector continued to lead the way, with $12.5 billion in sales.

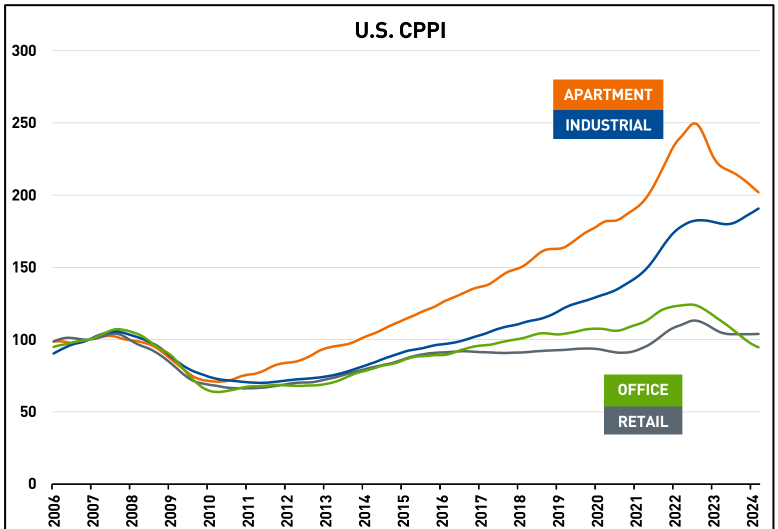


Cap rates for the apartment sector have been increasing for over a year and averaged 5.8 percent in 1Q2024. This was a 4 bp rise from last quarter and 54 bps higher than a year ago. Along with downward pressure on property prices, this suggests that cap rates will increase further this year, to between 5.5 and 6.0 percent. Industry experts had believed the cap rate peak would take place in 1Q2024 before moving back to the mid-5.0 percent range by the end of 2024. As shown in the adjacent chart, the cap rate reported by PwC showed a 17 bp decline from last quarter, while all the other sources reported continued increases.

Property prices for the apartment sector declined by 8.4 percent in March 2024 from a year ago, the second-steepest drop of all property types after office, as evidenced by MSCI RCA's CPPI index (third adjacent chart). However, the apartment CPPI was a slight 0.9 percent decline from last month yet 11.0 percent above the April 2020 level, when the pandemic's impact was first apparent in pricing. This suggests the current rate of deceleration is a return to a more normalized trend over the long term.



Sources: PwC Real Estate Investor Survey, MSCI RCA, CoStar, PNC REMA



Source: MSCI RCA, PNC REMA

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