APARTMENT SECTOR OUTLOOK: HIGH HOPES FOR THE POST-COVID HIGH RISE

Zain Jaffer - Jan 18, 2021, 3:50 pm

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With record unemployment, eye-catching market lows, and an almost overnight rearrangement of renter priorities, would it be any surprise to say the apartment sector hasn't had a record year? Likely not. A glance around a once-busy city would let the cat out of the bag-more windows are dark, more units are empty, and it's as if you almost see the diminished deal flow.

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Luckily, that glance captures no more than half of the story. There are myriad factors determining the current sector outlook—some are COVID-related, others stand on their own. Likewise, there exists a wealth of counteracting market forces to understand, consider, and take into consideration before anyone ventures a guess regarding the short to medium-term market future.

Let’s allow the numbers to have the first word. This year saw a greater negative employment change than the worst of the Great Depression; U.S. payrolls were down 6.5%. Health and job insecurity was a reality nearly every renter had to face, and shelter-in-place orders completely altered the role of the apartment space in the average individual’s life. These were setbacks all market observers could see coming—effective rent dropped, net absorption was much lower than expected, and the average apartment occupancy fell 60 basis points compared to year-end 2019.

The Bigger Story

Having given some weight to the numbers, it’s now crucial to offer the context of the sector’s trajectory at large. ~~In their 2021 National Apartment Research Report~~, Berkadia offered a review of last year’s trends. The apartment sector saw new heights in 2019, with apartment occupancy rates continuing their many-year rise and hitting a cycle high. In response, the sector began construction on a whopping 364,400 new units, representing the largest addition in more than 20 years.

The fact that the sector as a whole is coming off a particularly strong year should impact the reading of key performance highlights. The 60 basis point drop in occupancy, for example, leaves the occupancy rate at 95.2% by the close of 2020—still 10 basis points higher than the sector's five year average.

Since May, the average rent collections in professionally managed properties have averaged 94.9%, not too far off the compared 96% of this time last year. The effective rent average has dropped only around 1.0% compared to last year, currently hovering at $1,410. And while deals are closing at a heavily reduced rate, the average transaction in the sector is up 6.7% from 2019.

It's hard to understand how a 6.5% decrease in national employment can coexist with a 1.1% drop in rent collections over the past three quarters. Softening the shock for renters and landlords alike have been assistance programs administered through the CARES Act and on the local government level. And many operators opted to slightly contract their monthly rate, effectively leading to a drop in rental prices rather than a massive gap in renter who are able to make their payments.

In short, the apartment sector hasn't been immune to the global recession, nor has it been exempt from the volatile changes in consumer needs, preferences, and purchase habits. Still, activity in the sector remains strong, and governmental programs have helped renters stay in the market and continue to make payments. 2020 didn't bring any cycle highs, but the sector as a whole seems to be weathering the impacts of the virus well, and all signs point toward a promising year ahead.

Reading The Signs: What To Expect

Like most sectors, the rebound of apartment real estate will begin at the beginning: the slow recovery of the U.S. job economy. ~~Experts are forecasting an accelerated hiring cycle~~, growing the workforce 2.6% this year and an additional 2.9% in 2022. Most of these positions are expected to be recovered at least initially in white collar industries; the financial sector as well as professional and business services are set for a quick return to hiring demand. With higher-paying roles seeing the first uptick in the job economy, Class A apartment operators are preparing for a resurgence in renter demand. A reported 700,000+ units are scheduled for lease-up over the next two years.

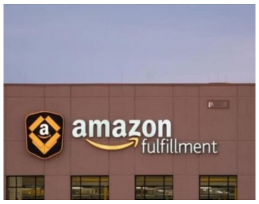
The optimism doesn't end there. As Americans continue to see a strengthening job economy, annual apartment leasing is expected to return to its pre-pandemic levels with relative urgency. Homeownership barriers remain high for most working families. And even though low interest rates might draw interest from homebuyers, the recent fluctuation in job security will likely be a vote toward renting. Even without layoffs or furloughs, many professionals are changing roles or changing companies after the impacts of the pandemic. Renting is expected to remain the preferred option at large.

Location, The New Everything

New consumer priorities might be the COVID-era change that most outlasts the pandemic. Most buyer priorities have been turned upside down. In years past, families have wanted to be near good schools, and working professionals have wanted to be a stone's throw from the office. But nearly all American's have surfaced a new-found freedom of location during the reduction in activity that could lead to different renter preferences in the future.

With the new understanding that remote work is possible, many companies will be switching to a hybrid approach, and demand for office space is expected to move away from high density metropolitan areas toward lesser density areas that are more business and cost friendly. ~~Berkadia's report~~ expects renter interest to follow; rent appreciation is expected to be highest in secondary and tertiary metros. Colorado Springs, for example, is expected to see a 6.1% increase in effective rent over the next year. Inland Empire, California, is expected to follow suit at 6.7%.

While the apartment sector hasn't been a COVID-era outlier, it's important to understand the sector's losses in the greater context of its recent success. The economic recession took a toll on renters, but rent collection remains strong under the help of the CARES Act, and pricing in the sector has remained surprisingly steady. Experts know the numbers won't be down for long; new development of Class A space is already underway, and operators are expecting to see a reliable resurgence in renter demand as employment continues to climb. Owners, ~~investors~~ and market observers will be smart to consider location in their plans for 2021 and beyond; "where" has become a real question in the COVID-era, and that's one market change that might be here to stay.



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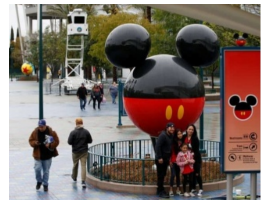

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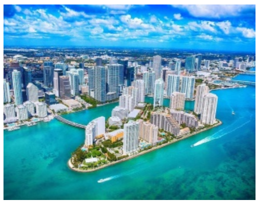

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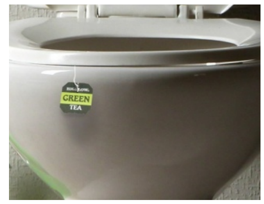

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