APARTMENT INDEX

CAPITAL FLOWS OVERSHADOW SUPPLY WOES

Although annual apartment returns were down by half in 2017 from where they were in 2015, total returns for the multifamily sector firmed to nearly 6½% annually through the 1st quarter of 2018. This performance essentially kept pace with both office and hotels, while industrial properties remained the darling of commercial real estate with 13½% gains and retail reported decelerating sub-5% returns.

New supply represents the primary headwind in the multifamily space as lease-up competition and concessions weigh on apartment fundamentals. Though rent increases have decelerated from the cyclical peak reached in mid-2015, both rent growth and occupancy remained steady in early 2018. Even as deliveries have trend higher, investor appetite has continued. Going-in/income returns have softened each year since 2011 and dipped below 4.4% annually as of 1Q18 (under the 10-year average of 5%).

Throughout most of this cycle, construction has been concentrated in or near the urban core, while the suburbs have been more resistant to multifamily housing. The effect of this is clearly seen in the returns across property subtypes in the NCREIF data. Garden apartments, which tend to be priced at relatively affordable price points and located where entitled land is most scarce, generated a total return of 9.3% in the year ending 1Q18 and far exceeded its 10-year norm of 7.3%. By comparison, high-rise apartments (competing most intensely with newly built projects in urban locations) provided only a 4.8% total return. Between these extremes, low-rise apartments generated a near-normal return of 7%.

Despite moderating fundamentals, capital continues to flow into multifamily and resulted in returns due to appreciation rising to nearly 2% over the past year. This strength was partly due to the investment sales market rebounding from the uncertain capital markets environment post-election. More importantly, investors understand that the track record for apartments looks very compelling. NMHC recently released a study that used NCREIF data to highlight that apartments have outperformed not just over the long term (15-year holding period), but across almost every short- (1- to 3-year) to medium-term (5- to 10- year) hold scenario as well. These outsized returns resulted in one-off/individual asset sales volume increasing to all-time highs through 1Q18 and cap rates holding steady (or edging lower) despite rising U.S. Treasuries.

Looking forward, apartment completions should climb further this year to top 355,000 units (levels not seen since the 1980s) before moderating afterward as disciplined capital and tighter development margins limit future new supply. Apartment leasing should remain strong and fill most of the new product coming online, buttressed by three pillars of demand: 1) an expanding economy creating jobs and lifting wages, 2) a rising propensity to rent apartments as households across all ages increasingly choose 5+ multifamily rentals and 3) home-buying move-outs from the apartment market remain limited (though likely higher than early in the recovery). Investors understand the favorable long-term demand outlook and attractive risk-adjusted returns, which should continue to draw capital in the coming years despite more normal operating fundamentals.

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APARTMENT TOTAL RETURNS

	Total NPI	Total Apartment	East	Midwest	South	West
1st Q 2018	1.70	1.50	1.33	0.96	1.86	1.57
4th Q 2017	1.80	1.62	1.13	0.85	1.75	2.17
One Year	7.12	6.38	5.13	4.22	6.55	7.99
Three Years	8.72	7.99	6.26	6.36	7.36	10.63
Five Years	10.00	8.99	7.01	8.10	9.39	10.98
Ten Years	6.09	6.10	4.14	6.93	6.92	7.34
Twenty Years	9.31	9.17	8.88	8.59	9.12	10.22

APARTMENT INCOME RETURNS

	Total NPI	Total Apartment	East	Midwest	South	West
1st Q 2018	1.12	1.06	1.03	1.07	1.13	1.05
4th Q 2017	1.16	1.07	1.03	1.04	1.14	1.07
One Year	4.66	4.37	4.19	4.39	4.58	4.38
Three Years	4.78	4.54	4.34	4.51	4.87	4.51
Five Years	5.03	4.72	4.44	4.78	5.12	4.69
Ten Years	5.53	5.04	4.68	5.29	5.49	4.97
Twenty Years	6.55	5.89	5.75	6.01	6.20	5.77

APARTMENT APPRECIATION RETURNS

	Total NPI	Total Apartment	East	Midwest	South	West
1st Q 2018	0.58	0.44	0.30	-0.11	0.74	0.52
4th Q 2017	0.63	0.55	0.10	-0.19	0.61	1.11
One Year	2.38	1.95	0.90	-0.16	1.90	3.50
Three Years	3.81	3.34	1.86	1.80	2.41	5.92
Five Years	4.79	4.12	2.49	3.21	4.11	6.08
Ten Years	0.54	1.03	-0.52	1.57	1.37	2.29
Twenty Years	2.64	3.15	3.02	2.47	2.79	4.27

APARTMENT INDEX—QUARTILE RANGE OF RETURNS