ALL SIGNS SAY GO…SLOW: FLAT APARTMENT RETURNS BELIE STRONG UNDERLYING FUNDAMENTALS

If we look at the NPI first quarter return for the apartment sector relative to historical performance, the data suggests that conditions remained soft through the first three months of 2019. Apartments posted a total return of only 1.35% in 1Q2019, unchanged quarter-over-quarter yet down 15 basis points year-over-year, with an annualized total return of 5.90%. This marks the lowest return since 2009, when the total return was negative. Of the annualized 5.90%, appreciation comprised 1.58%, while income comprised 4.27%. These appreciation/income allocations are also unchanged from the prior quarter. In comparison, the overall NPI posted a quarterly total return of 1.80% (an improvement from a total return of 1.37% in 4Q2018), with an annualized total return of 6.83%. The apartment sector was bested in 1Q by the industrial, office, and retail sectors.

According to the most recent results, top performing metros in 1Q2019 were Columbus, OH (6.46% percent); Riverside, CA (3.63% percent); Phoenix, AZ (3.35% percent); and Charleston, SC (2.57% percent). Laggards included the Baltimore and Dallas metro areas (0.61% and 0.47% percent, respectively), with Chicago, Ventura County, and Baton Rouge posting negative returns.

NPI apartment performance in the first quarter was undoubtedly affected by the fear of ongoing interest rate hikes and general uncertainty surrounding the U.S. economy, due in large part to talks of trade wars. However, the Federal Reserve has most recently pledged to take a “patient” approach to further rate hikes and has indicated that no increases in 2019 are likely unless the data changes significantly. But the current strength of the national economy is a double-edged sword: “full” employment amplifies the universe of potential tenants but also fuels increased construction costs and strains the qualified labor pool.

And yet, while the apartment NPI is the lowest its been in the past eight years, the multifamily sector remains attractive to investors, touted by many as a defensive investment strategy thanks to strong renter demand and waning fears of declining rent growth. Though millennials are increasingly embracing homeownership, boomers and other “by choice” renters are making up a historically larger share of the apartment tenant demographic. Scarcity of affordable single-family homes, relatively low new condominium construction, and ongoing rigid mortgage guidelines persist as tailwinds, and the decline in construction starts should bring balance to those submarkets experiencing elevated vacancy.

Lastly, as Real Capital Analytics notes, “Greater stability in the financing markets for apartments seems to have put a floor under the deal activity for this sector.” Forecasts are for increased sales activity of multifamily properties in the coming months. Case in point, Nuveen Real Estate is planning a significant expansion of its multifamily real estate business in the U.S. Recently announced in February 2019, Nuveen’s “U.S. Cities Multifamily Fund” just closed on its first investment round, which raised $550 million to invest in multifamily real estate. With that capital on hand, the fund will seek to acquire “well-located properties with high, stable occupancy levels located in top-tier cities and select growth markets across the U.S.”

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