

APARTMENT INDEX

APARTMENT RETURNS DOWN, BUT BETTER THAN INITIALLY ANTICIPATED

The second quarter of 2020 will go down in history as the first full quarter when the impact of the COVID-19 pandemic became visible in US economic and real estate data. The economic shutdown designed to contain the coronavirus' spread battered the labor market. The US national unemployment rate averaged an unprecedented 13% over the quarter, the highest rate since modern records began.

Despite the extraordinarily bad economic performance, US apartment fundamentals held firmer than many had anticipated at the beginning of the quarter. According to data on just over 11 million apartment units from the National Multifamily Housing Council, tenants made an average of 95.2% of their rental payments in the quarter. This figure is down marginally from the 96.8% payment rate in Q2 2019, but remarkably high considering the economic backdrop.

Robust rental collections still could not offset the impact of deteriorating capital markets sentiment on apartment total returns. National NPI total returns contracted by 0.63% quarter-over-quarter (q-o-q). Every region in the country saw total return declines, ranging from -1.06% q-o-q in the Midwest to -0.54% q-o-q in the South. By property subtype, garden-style apartments performed the best (-0.14% q-o-q), followed by low-rise (-0.35% q-o-q) and high-rise (-0.90% q-o-q). Income returns helped support total returns, with US national income returns gaining 1.01% over the quarter and registering positive in every region.

Appreciation returns, by contrast, weighed heavily on total returns. US national apartment values fell 1.64% during the quarter. By region, the Midwest saw the steepest value declines (-2.11% q-o-q), while declines were smallest in the West (-1.55% q-o-q). Negative appreciation returns stemmed from weak NOI growth, investor risk aversion, and the paucity of apartment transactions over the quarter. Real Capital Analytics data shows 808 transactions over \$2.5m in Q2 2020, a 70% decline in transaction volumes compared to Q2 2019 and a 66% decline versus Q1 2020. That represents the largest year-over-year decline in transaction volumes since 2009 and the largest quarterly decline on record.

Apartment capitalization (cap) rates fell by 10 basis points during the quarter to end at 4.1% on a value-weighted basis. The fact that appreciation returns were negative when cap rates fell suggests net operating income was weaker than expected. The market had little price discovery with so few transactions in the quarter, so investors will have to wait to see what impact the COVID-19 pandemic will have on apartment cap rates.

Investor risk aversion and aggressively expansionary monetary policy pushed the US 10-year treasury yield to a post-WWII low of 0.7%. Thus, the apartment cap rate spread over treasuries stood at 340 basis points, 150 basis points higher than the same quarter in the previous year and the widest spread since 2012. The widening spread between apartment cap rates and treasuries suggests that investors see elevated risks in apartment investing.

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APARTMENT TOTAL RETURNS

	Total NPI	Total Apartment	East	Midwest	South	West
2nd Q 2020	-0.99	-0.63	-0.65	-1.06	-0.54	-0.58
1st Q 2020	0.71	0.95	1.02	0.17	0.90	1.12
One Year	2.69	2.98	2.38	0.54	3.51	3.74
Three Years	5.44	5.06	4.09	2.59	5.55	6.26
Five Years	6.77	6.23	4.96	4.01	6.14	8.11
Ten Years	9.70	9.71	8.33	8.75	9.94	11.24
Twenty Years	8.42	8.29	7.57	7.18	8.50	9.51

APARTMENT INCOME RETURNS

	Total NPI	Total Apartment	East	Midwest	South	West
2nd Q 2020	1.01	1.01	1.03	1.05	1.03	0.97
1st Q 2020	1.10	1.05	1.04	1.09	1.09	1.02
One Year	4.40	4.23	4.23	4.34	4.36	4.11
Three Years	4.52	4.28	4.19	4.30	4.46	4.23
Five Years	4.63	4.40	4.26	4.39	4.66	4.36
Ten Years	5.19	4.83	4.56	4.96	5.20	4.75
Twenty Years	6.09	5.43	5.23	5.54	5.77	5.33

APARTMENT APPRECIATION RETURNS

	Total NPI	Total Apartment	East	Midwest	South	West
2nd Q 2020	-2.00	-1.64	-1.67	-2.11	-1.57	-1.55
1st Q 2020	-0.39	-0.10	-0.02	-0.91	-0.19	0.09
One Year	-1.65	-1.21	-1.80	-3.68	-0.83	-0.37
Three Years	0.89	0.76	-0.09	-1.65	1.05	1.97
Five Years	2.07	1.77	0.68	-0.37	1.43	3.64
Ten Years	4.35	4.72	3.64	3.65	4.56	6.28
Twenty Years	2.22	2.75	2.25	1.57	2.62	4.02

APARTMENT INDEX—QUARTILE RANGE OF RETURNS

