

APARTMENT INDEX

PERFORMANCE COMPRESSION REMAINS PREVALENT ACROSS THE MAJOR US MARKETS

Apartment sector fundamentals remained exceptionally strong in 2Q19. National rent change on an annual basis achieved its 36th consecutive quarter of positive growth. Even more amazing is that occupancy achieved its highest rate since 2001. All this comes despite more than 2.4 million new units being built since the cycle began in 2010.

Underpinning these strong fundamentals is healthy demand for multifamily rentals. But looking at the capital markets side of the industry, the picture isn't as clear. It's probably unfair to say that investor appetite in the apartment sector is cold. After all, the industry saw \$36.8 billion worth of assets transact in the year-ending 2Q19, marking the 15th straight quarter in which annual transaction volumes remained above the \$30 billion mark. But deconstructing the components of that sum suggests that – at least to some degree – investor interest may have cooled slightly of late.

It's difficult to say whether any cooling is tied to genuine softer interest from investors, or if prices have risen enough that it's keeping some investors sidelined for the time being. The average property sales price in 2Q19 was \$68.2 million, the second highest total ever recorded. The 581 properties sold in the year-ending 2Q19, however, marked the second lowest total since early 2012. This, in turn, has led to continually tightening cap rates across the sector.

While it may be difficult to pinpoint whether fewer transactions is truly demand-driven or due to price pressure, here's what we do know: total returns in the year-ending 2Q19 were the fourth lowest since the recovery began nearly a decade ago.

Only four markets achieved total returns greater than 3% in year-ending 2Q19, led by Durham, NC (3.4%). San Antonio, Columbus, OH, and Phoenix, AZ all recorded returns equal to 3.1%. An additional eight markets saw returns equal to or greater than 2%.

Conversely, the nation's worst performing market was Kansas City, MO-KS, which saw slightly negative returns. Baton Rouge, LA and Charleston, SC tied for the second lowest total returns, both at 0.3% in the year-ending 2Q19.

Compression in the range of returns across markets follows market fundamentals. The gap between outperformers and underperformers in terms of market fundamentals has narrowed as the cycle continues to mature.

Consider that at the cycle peak in 3Q15, the annual rent change gap between the best performing major market and the worst performing major market was a little more than 12%. Looking at total returns at that same point, the gap between the highest returns (8.3% in Fort Worth, TX) and lowest returns (-0.3% in Bridgeport, CT) was equal to an 8.6% swing. Most recently in 2Q19, that top-to-bottom gap among the rent growth leader and laggard had closed to about 9%. And regarding total returns, the top performing market of Durham, NC and bottom performing Kansas City, MO-KS showed just a 3.6% swing.

In short, then, the overarching theme is market-wide compression – a theme that will likely continue until a broader macroeconomic shift resets expectations. But the tailwinds propelling multifamily investment sentiment are still strong, and in many ways tie back to factors driving consumer demand for apartments. And as long as demand for multifamily rentership remains healthy, there will continue to be investment activity following that demand.

Carl Whitaker
 Manager, Market Analytics
 RealPage, Inc.

| APARTMENT TOTAL RETURNS | | | | | | |
|-------------------------|-----------|-----------------|------|---------|-------|-------|
| | Total NPI | Total Apartment | East | Midwest | South | West |
| 2nd Q 2019 | 1.51 | 1.42 | 1.20 | 1.24 | 1.52 | 1.61 |
| 1st Q 2019 | 1.80 | 1.35 | 1.30 | 0.29 | 1.43 | 1.60 |
| One Year | 6.51 | 5.78 | 4.82 | 2.87 | 6.31 | 7.08 |
| Three Years | 6.89 | 6.18 | 5.07 | 3.93 | 6.16 | 7.81 |
| Five Years | 8.83 | 7.95 | 6.15 | 6.36 | 8.12 | 10.06 |
| Ten Years | 9.25 | 9.37 | 7.83 | 9.01 | 9.63 | 10.91 |
| Twenty Years | 8.88 | 8.73 | 8.18 | 7.80 | 8.83 | 9.88 |

| APARTMENT INCOME RETURNS | | | | | | |
|--------------------------|-----------|-----------------|------|---------|-------|------|
| | Total NPI | Total Apartment | East | Midwest | South | West |
| 2nd Q 2019 | 1.12 | 1.06 | 1.05 | 1.09 | 1.09 | 1.05 |
| 1st Q 2019 | 1.11 | 1.05 | 1.02 | 1.05 | 1.11 | 1.04 |
| One Year | 4.53 | 4.27 | 4.16 | 4.29 | 4.48 | 4.22 |
| Three Years | 4.62 | 4.37 | 4.22 | 4.36 | 4.61 | 4.34 |
| Five Years | 4.79 | 4.53 | 4.31 | 4.52 | 4.85 | 4.50 |
| Ten Years | 5.42 | 4.98 | 4.69 | 5.14 | 5.38 | 4.91 |
| Twenty Years | 6.29 | 5.62 | 5.44 | 5.73 | 5.96 | 5.52 |

| APARTMENT APPRECIATION RETURNS | | | | | | |
|--------------------------------|-----------|-----------------|------|---------|-------|------|
| | Total NPI | Total Apartment | East | Midwest | South | West |
| 2nd Q 2019 | 0.38 | 0.36 | 0.14 | 0.14 | 0.43 | 0.56 |
| 1st Q 2019 | 0.69 | 0.30 | 0.28 | -0.76 | 0.32 | 0.57 |
| One Year | 1.91 | 1.46 | 0.64 | -1.38 | 1.77 | 2.77 |
| Three Years | 2.19 | 1.75 | 0.83 | -0.41 | 1.49 | 3.37 |
| Five Years | 3.90 | 3.31 | 1.78 | 1.78 | 3.16 | 5.39 |
| Ten Years | 3.68 | 4.24 | 3.04 | 3.73 | 4.08 | 5.79 |
| Twenty Years | 2.46 | 2.98 | 2.63 | 1.99 | 2.76 | 4.19 |

