Apartment First Glance

2015 Quarter 1

Pre-Release Analysis of First Quarter 2015 Reis Findings in the Apartment Sector

Victor Calanog PhD
Chief Economist &
Senior Vice President

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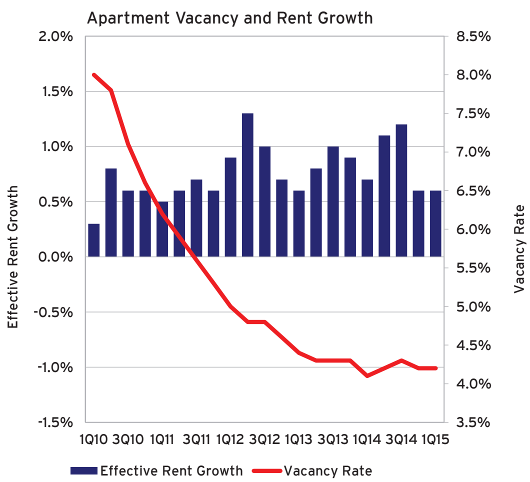
Vacancies Stay Flat in the First Quarter

The national vacancy rate for multifamily properties stayed flat at 4.2% in the first quarter of 2015. Vacancies have not moved much since the end of 2013, bouncing around a tight 10 basis point band around 4.2% and 4.3%. This will likely change very soon.

The fact that national vacancies have stayed relatively flat is actually a testament to continued strength in demand for apartments over the past five to six quarters. Supply growth is catching up fast to demand, with new deliveries rising by about 25% in 2014 versus the comparable figure in 2013.



The figure for new completions in the first quarter of 2015—just slightly over 29,000 units—actually represents a relative lull in deliveries. It is roughly comparable to the number of units that came online in the first quarter of 2014. However, we are expecting around 240,000 units to open their doors by the end of this year. That represents a 43% increase in deliveries compared to 2014, and is well over 100,000 units above the 10-year trailing annual average. From our detailed project-level research for new construction, the bulk of these new projects are slated to come online in the second and third quarters. The most die-hard multifamily optimists will have their beliefs tested in the next six months.

Rent Growth Appears to be Peaking

Asking and effective rents grew by 0.5% and 0.6%, respectively, in the first quarter, following a declining trend in quarterly rent growth that is evident over the last few quarters (although seasonality typically depresses rent increases in the colder first few months of the year). Over the last four quarters, rent growth for asking and effective rents was 3.3% and 3.6%, respectively. For perspective, asking rents grew by 3.5% in 2014, its strongest cyclical showing since the sector started recovering in early 2010. Effective rent growth, on the other hand, appears to have peaked back in 2012, rising by 3.9% - its performance has been less than stellar after that period, closely tracking asking rent growth.

The combination of higher supply growth, asking rent growth that may have peaked, and effective rents that aren't rising as quickly all suggest that fundamentals for the apartment sector will not be as robust as the most sanguine of projections expect. With that said, vacancies hovering at or around 4% to 5% still means the market is relatively tight, allowing landlords to continue charging rent growth in excess of inflation. As vacancies rise past the long-run average of 5.4% landlords will have less pricing power; in markets hit with supply growth in excess of demand (like Washington, DC), we are already seeing a significant slowdown in rent growth and even some declines.

Market Highlights

The share of individual metros with improving fundamentals did not change much in the first quarter, with most markets posting positive absorption and improvements in occupancy; 77 out of 82 markets posted a rise in effective rents. Yes, the apartment sector appears to face an inflection point this year, but so far fundamentals are holding steady.

First Quarter 2015 Market Performance
Improving Fundamentals / Flat or Declining Fundamentals

	Absorption	Occupancy	Effective Rent
Q1 2015	81+ / 1	51↑ / 31	77 ↑ / 5
Q4 2014	79+ / 3	41↑ / 41	71 ↑ / 11
Q3 2014	79 + / 3	28↑ / 54	82 ↑ / 0
Q2 2014	82 + / 0	35↑ / 47	82 ↑ / 0
Q1 2014	78 + / 4	53 ↑ / 29	74 ↑ / 8

Figures are based on 82 metro markets.

What's Up with Low Energy Prices?

With the massive decline in oil prices since last summer, Houston has been in the press frequently and has been on everyone's minds. The good news, as we predicted, is that the downturn in oil was likely to have little to no immediate impact on the apartment market in Houston, given how the local economy has diversified away from basic exploration since the 1980s (note that this relative safety from diversification will not apply as strongly to markets like Odessa-Midland).

During the first quarter of 2015 the vacancy rate in Houston was unchanged at 5.8%. This stands in contrast to the office sector in Houston where the decline in oil has already had a slightly deleterious impact on the market. Rent growth in Houston remained among the strongest in the country despite zero change in the vacancy rate.

Although the price of oil remains depressed versus last year's levels, the worst appears to be over with most energy analysts anticipating price increases during the balance of 2015. That should be good news for Houston's economy and property markets. However, in the case of apartments, the largest risk in Houston is not the oil price – the vacancy rate in Houston was already rising slightly before falling oil had an impact on the market. The real threat is and will continue to be the massive amount of new supply that is anticipated to come online over the next few years. Interestingly, word from clients with an interest in new projects in Houston reveals that the completion of several buildings have been delayed, with such setbacks being attributed to fear and uncertainty around low energy prices. Less projects coming online actually does imply that occupancies and rent growths for *existing* buildings will face less competitive threats.

California currently dominates the rankings for tightest markets in the country as measured by lowest vacancy rate. 7 of the top 11 markets ranked by lowest vacancy rate in the country are located in California. The title for most expensive market in the US resides with New York, at roughly $3,200 per unit per month. This is roughly $1,000 more per month than the second market on the list San Francisco. However, effective rent growth in San Francisco continues to grow far faster than rents in New York, causing the gap between the top two markets to narrow.

Apartment Outlook

Although demographics are favorable to apartment demand, demand is likely to be unable to keep pace with new supply growth. With that said, occupancies remain relatively tight, and we do not expect vacancies to rise past 6% for another few years.

This year, we expect national vacancies to jump by 70 to 80 basis points because of the spike in new deliveries. Rent growth will likely remain relatively strong and rise in the range of the low to mid 3s this year. Revenue growth will slow as vacancy increases, but rising rents will prevent revenues from flatlining or falling.