BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

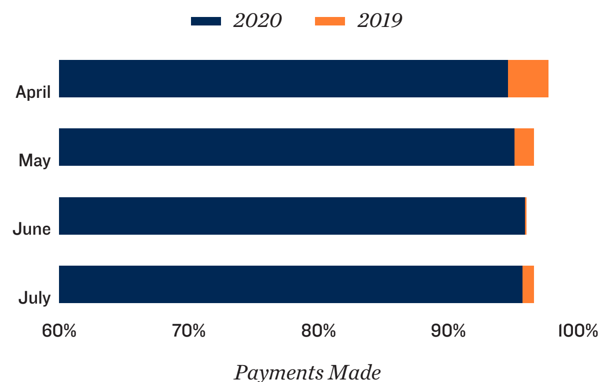
SPECIAL REPORT MULTIFAMILY

THIRD QUARTER 2020

Government Stimulus Softened the Blow From the Pandemic, But True Impact of the Health Crisis May Come If Support Subsides

Multifamily rent collections exceed expectations. Jobless claims were filed at a record pace in the second quarter and continued to come in at an elevated rate through July, posing a threat to the multifamily sector. Typically, jobless renters struggle to pay rent, but the $600 per week federal unemployment supplement mitigated the impact on rent collections. For some workers, the expanded benefits surpassed their previous paychecks, which helped many of the jobless meet obligations. However, the $600 per week federal supplement expired at the end of July and while Congress has been working on an extension, a recent executive order has obfuscated the process. In an environment with lower federal benefits, collections may begin to erode.

Rent Collections Have Held Firm

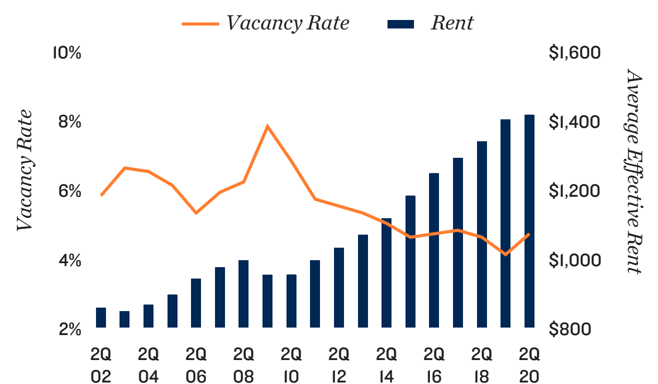


State unemployment benefits could dictate headwinds. In the absence, or possible reduction, of federal unemployment benefits, state benefits will carry more weight for jobless renters. State-level benefits vary widely across the nation, with Massachusetts offering a max monthly benefit close to $5,000 a month, while Arizona provides just 20 percent of that allotment. Markets that demand higher rents within states that offer comparatively modest benefits may experience a significant drop-off in collections. Most of the major metros in Florida and California are at a higher risk of this as unemployment benefits fall well below average rental rates. On the other hand, jobless renters in states with lower costs of living and ample unemployment protections such as Ohio and Texas will be better equipped to meet rental obligations without federal aid.

Multifamily fundamentals regressed in the second quarter. The U.S. vacancy rate moved up 30 basis points to 4.7 percent in the second quarter. Although, this may not reveal the true economic vacancy as eviction moratoriums allowed renters to occupy units despite failing to meet obligations. While mass eviction in the second half of this year is unlikely given recent job additions and talks to extend federal programs, vacancy will continue to face upward pressure as re-emerging COVID-19 threats keep much of the economy shut down and millions jobless. Subdued demand and more frequent renewals at flat rates will weigh on rent growth, as was the case last quarter when the average effective rent fell 0.9 percent to $1,415 per month. Rent within the Class A segment will face additional pressure going forward as more operators use concessions to draw tenants amid competition from new supply.

Unemployment Benefits Offset Lost Wages

Economic Headwinds Push Up Vacancy



Note: Rent collection data as of the end of each month, from between 11.1 million-11.5 million units.
Sources: Marcus & Millichap Research Services; BLS; U.S. Census Bureau; U.S. Department of Labor; RealPage, Inc.; CoStar Group, Inc.; National Multifamily Housing Council; Bureau of Economic Analysis

Jobless Renters in California and Florida Face Significant Hurdles With Less Federal Assistance

Market	Unemployment Rate *	Average Effective Rent *	State	State Max U.E. Benefit	Unemployment Benefits to Rent Differential
Atlanta	9.7%	$1,245	Georgia	$1,460	$215
Austin	10.8%	$1,285	Texas	$2,084	$799
Baltimore	9.3%	$1,348	Maryland	$1,720	$372
Boston	15.2%	$2,360	Massachusetts	$4,880	$2,520
Charlotte	12.4%	$1,173	North Carolina	$1,600	$427
Chicago	14.5%	$1,542	Illinois	$2,596	$1,054
Cincinnati (OH)	10.9%	$1,008	Ohio	$3,208	$2,200
Cincinnati (KY)	10.9%	$1,008	Kentucky	$2,208	$1,200
Cleveland	13.5%	$976	Ohio	$3,208	$2,232
Columbus	10.7%	$999	Ohio	$3,208	$2,209
Dallas/Fort Worth	11.7%	$1,184	Texas	$2,084	$900
Denver	10.0%	$1,514	Colorado	$2,388	$874
Detroit	17.7%	$1,020	Michigan	$2,284	$1,264
Fort Lauderdale	14.3%	$1,262	Florida	$1,100	-$162
Houston	13.3%	$1,113	Texas	$2,084	$971
Indianapolis	9.9%	$938	Indiana	$1,560	$622
Kansas City (MO)	10.4%	$996	Missouri	$1,280	$284
Kansas City (KS)	10.4%	$996	Kansas	$1,952	$956
Las Vegas	27.4%	$1,090	Nevada	$1,800	$710
Los Angeles	19.4%	$2,264	California	$1,800	-$464
Louisville	11.0%	$912	Kentucky	$2,208	$1,296
Memphis	10.3%	$933	Tennessee	$1,100	$167
Miami	11.2%	$1,682	Florida	$1,100	-$582
Milwaukee	12.2%	$1,191	Wisconsin	$1,480	$289
Minneapolis-St. Paul	10.0%	$1,370	Minnesota	$2,868	$1,498
Nashville	10.7%	$1,264	Tennessee	$1,100	-$164
New Haven-Fairfield County	4.4%	$1,857	Connecticut	$2,896	$1,039
New York City	18.4%	$2,763	New York	$2,016	-$747
Northern New Jersey	6.7%	$1,965	New Jersey	$2,784	$819
Oakland	13.3%	$2,351	California	$1,800	-$551
Orange County	15.0%	$2,105	California	$1,800	-$305
Orlando	20.7%	$1,262	Florida	$1,100	-$162
Philadelphia (PA)	13.0%	$1,399	Pennsylvania	$2,320	$921
Philadelphia (NJ)	13.0%	$1,399	New Jersey	$2,784	$1,385
Phoenix	8.0%	$1,185	Arizona	$960	-$225
Pittsburgh	13.2%	$1,170	Pennsylvania	$2,320	$1,150
Portland	13.4%	$1,423	Oregon	$2,592	$1,169
Raleigh	10.5%	$1,165	North Carolina	$1,600	$435
Riverside-San Bernardino	14.7%	$1,588	California	$1,800	$212
Sacramento	13.4%	$1,513	California	$1,800	$287
Salt Lake City	8.0%	$1,174	Utah	$2,240	$1,066
San Antonio	12.1%	$1,005	Texas	$2,084	$1,079
San Diego	14.6%	$2,018	California	$1,800	-$218
San Francisco	11.7%	$2,821	California	$1,800	-$1,021
San Jose	11.0%	$2,825	California	$1,800	-$1,025
Seattle-Tacoma	14.3%	$1,829	Washington	$3,160	$1,331
St. Louis (MO)	11.1%	$979	Missouri	$1,280	$301
St. Louis (IL)	11.1%	$979	Illinois	$2,596	$1.617
Tampa-St. Petersburg	11.6%	$1,245	Florida	$1,100	-$145
Washington, D.C.	8.6%	$1,807	Washington, D.C.	$1,700	-$107
West Palm Beach	12.7%	$1,660	Florida	$1,100	-$560

** Through second quarter*
Note: Some metropolitan areas cross into multiple states with different benefit levels
Sources: Marcus & Millichap Research Services; BLS; CoStar Group, Inc.; RealPage, Inc.; U.S. Census Bureau; U.S. Department of Labor

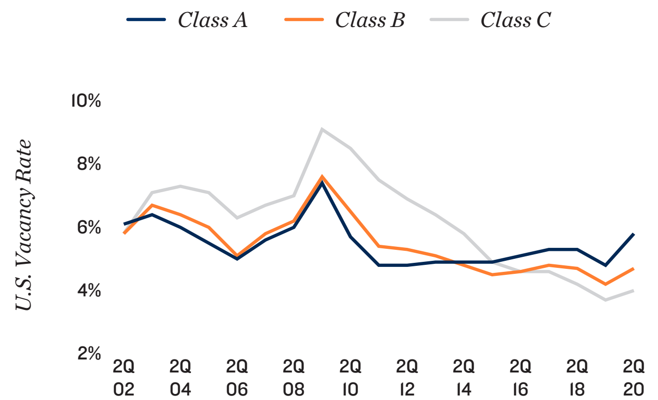
Lower-Tier Rentals Less Impacted in 2Q, Though Headwinds May Intensify

Vacancy rises in all three classes with more pressure on the horizon. Despite the federal unemployment benefits that reinforced the multifamily sector, occupancy still regressed in the first half of this year. Class A vacancy rose by 100 basis points year over year, largely driven by new development, reaching its highest level since 2009. The jumps within Class B and C were more subdued and only pushed vacancy near 2018 levels. Higher-end space will continue to face upward pressure as slow wage growth limits new potential tenants, and aging millennials with sufficient savings may be inclined to seek single-family housing. Mid-tier and lower-tier space will also face new headwinds in the coming months as backloaded evictions could work through the legal system. However, the new economic environment could underpin demand for lower-tier space as financial burdens lead more to seek housing options that do not stretch their budgets.

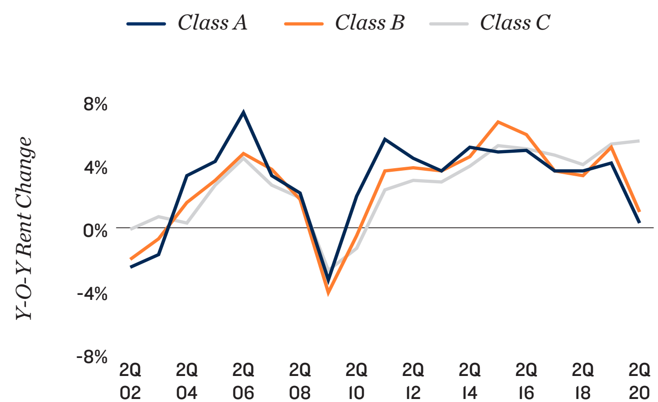
Rent correction hits higher tiers first. The first half of the year typically coincides with strong rent gains for apartments as leasing activity is elevated in the spring season. However, the global health crisis kept potential renters hunkered down this year and many owners chose to offer renewals at flat rates, stunting overall rent growth. Class A and B space had to endure muted leasing activity amid competition from new supply additions, which likely induced concessions and pressed on rental rates. On the other hand, rent within the Class C segment was up more than 5 percent year over year as of the second quarter. This segment remains undersupplied, and the economic disruption may persuade more renters to seek lower-cost housing, which could hold rents more stable. Adjustments to Class C rent will likely be smaller than within Class A and B space. However, rates could slip later this year as finding tenants for newly vacant space remains a challenge.

Deliveries consistent with previous quarters despite shutdowns. Roughly 150,000 units were completed in the first half of 2020 as construction was able to resume after brief shutdowns in the spring. These newly built complexes are facing challenges filling units as the global health crisis has stalled moving plans and complicated the leasing process. Future projects in planning may be under higher scrutiny in markets where fundamentals have shifted dramatically over the past few months. However, the multifamily sector as a whole is still undersupplied and developers remain confident in the long-term outlook for the sector. Additionally developers may be learning from COVID-19 trends and altering design concepts to meet renters priorities. Units that accommodate remote working through dens and have the infrastructure to facilitate seamless e-commerce and food delivery will be on the top of many potential renters' wish lists going forward.

Class A Vacancy Climbed the Most in 2Q



Class C Rent More Stable



Supply Pipeline Keeps Moving Along

Sources: Marcus & Millichap Research Services; RealPage, Inc.; CoStar Group, Inc.

Vacancy Rose by the Greatest Margin in High-Cost Coastal Markets; Rents in a Few Smaller Midwest Metros More Resilient

Market	2Q Completions (units)	2Q Vacancy Rate	Q-O-Q Basis Point Change	2Q Average Effective Rent	Q-O-Q Percent Change
Atlanta	2,863	5.6%	20	$1,254	-1.5%
Austin	2,447	5.7%	60	$1,285	-2.0%
Baltimore	1,046	4.9%	-20	$1,348	0.2%
Boston	1,845	4.4%	60	$2,360	-1.8%
Charlotte	1,824	5.1%	40	$1,173	-1.1%
Chicago	1,738	5.1%	20	$1,542	-0.6%
Cincinnati	781	3.8%	10	$1,008	0.9%
Cleveland	129	3.7%	-10	$976	1.7%
Columbus	761	4.4%	10	$999	0.3%
Dallas/Fort Worth	6,319	5.7%	30	$1,184	-0.2%
Denver	2,002	5.4%	10	$1,514	-0.6%
Detroit	311	3.6%	-20	$1,020	1.3%
Fort Lauderdale	1,164	4.7%	50	$1,626	-1.5%
Houston	4,343	7.1%	30	$1,113	-1.2%
Indianapolis	686	5.1%	-40	$938	0.8%
Jacksonville	928	5.2%	10	$1,095	-0.4%
Kansas City	1,128	4.8%	0	$996	0.1%
Las Vegas	647	4.9%	-20	$1,090	-2.2%
Los Angeles	3,520	4.8%	90	$2,264	-2.8%
Miami	2,528	4.7%	90	$1,682	-1.4%
Milwaukee	551	3.4%	10	$1,191	0.9%
Minneapolis-St. Paul	1,383	3.7%	10	$1,370	-0.1%
Nashville	1,731	5.0%	0	$1,264	-1.7%
New York	4,055	2.0%	10	$2,763	-0.8%
Northern New Jersey	1,728	4.8%	10	$1,965	-1.2%
Oakland	1,315	4.3%	50	$2,351	-1.8%
Orange County	357	4.2%	70	$2,105	-2.2%
Orlando	1,229	5.0%	60	$1,262	-2.3%
Philadelphia	1,250	3.7%	0	$1,399	0.2%
Phoenix	2,421	4.4%	50	$1,185	-2.1%
Portland	1,253	4.9%	40	$1,423	-0.7%
Raleigh	1,474	5.6%	70	$1,165	-0.8%
Riverside-San Bernardino	621	3.6%	-10	$1,588	-0.3%
Sacramento	397	3.4%	-20	$1,513	-0.1%
Salt Lake City	1,038	4.5%	-10	$1,174	-0.2%
San Antonio	1,487	6.9%	20	$1,005	-0.7%
San Diego	961	4.2%	50	$2,018	-1.6%
San Francisco	1,069	6.5%	80	$2,821	-3.2%
San Jose	1,241	4.7%	110	$2,825	-3.8%
Seattle-Tacoma	1,374	4.4%	50	$1,829	-0.9%
St. Louis	710	4.8%	0	$979	0.1%
Tampa-St. Petersburg	1,193	5.0%	40	$1,245	-0.7%
Washington, D.C.	3,514	4.3%	20	$1,807	-0.8%
West Palm Beach	429	5.6%	130	$1,660	-2.6%
United States	**82,104**	**4.7%**	**30**	**$1,415**	**-0.9%**

Sources: Marcus & Millichap Research Services; RealPage, Inc.; CoStar Group, Inc.

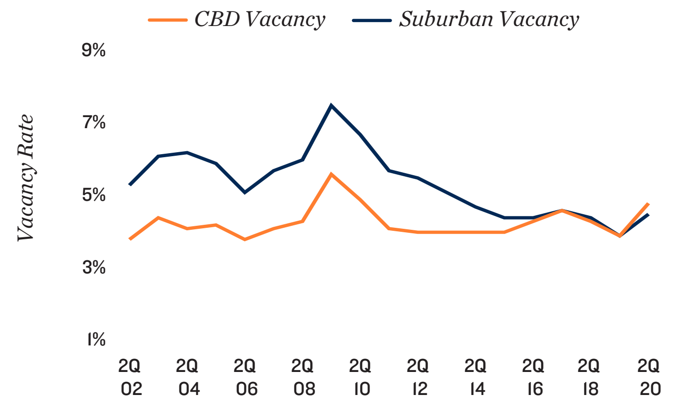
Suburban Apartments Outperforming the Urban Segment as Some Renters Relocate

Suburban rentals gain favor as remote working sways priorities. Major technology companies such as Uber and Facebook have already committed to remote work through June 2021, and more firms will follow suit if health concerns persist. Some companies may even transition to long-term virtual working, which will influence renter preferences. Space may become a higher priority over location as renters seek an accommodating work-from-home setup. Outdoor communal areas could also be in high demand after renters experienced the realities of spending excess time in their apartments during the pandemic. These trends may push more individuals to the suburbs, which could create new suburban employment hubs within metros that in turn fuel strong household formation. Population migration to less densely populated and lower-cost metros could also play out over the coming years. Markets in the Sunbelt and inland California may attract renters and employers relocating from pricier coastal metros such as the Bay Area and Los Angeles.

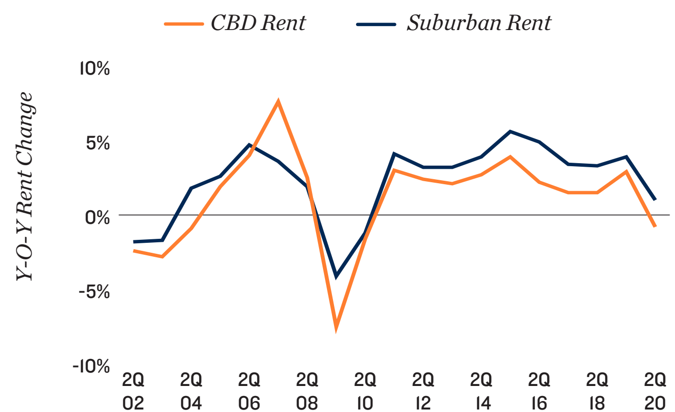
Downtown apartments face multiple headwinds. The demand for multifamily in core locations is being subdued by a variety of factors. Health concerns are making people wary of crowded locales, many of the offices that operate in the CBD are allowing employees to work from home, and desirable urban amenities remain shut down. Additionally, the economic disruption could apply additional downward pressure to demand as fewer potential tenants may be willing to pay high rents amid sluggish wage growth. However, these could be relatively short-term obstacles, as proximity to urban amenities and walkability will draw renters downtown and Gen Z will backfill units that are vacated by millennials moving to the suburbs. There could be a notable adjustment to rent in core locations in the near term, though, as vacancy faces upward pressure from multiple angles.

Despite the rising homeownership rate, high home values will keep many renting. The global health crisis accelerated the trend of aging millennials entering homeownership. Those on the fence and with the purchasing power to buy a home may have leaped in as they valued space amid lockdown. However, the limited supply of single-family housing is bolstering values, making homeownership difficult for people with less financial power. As the gap between apartment rents and mortgage payments remains significant, those on the margin will continue to rent, likely within the upper-tier segment. Additionally, the lingering economic impacts will limit career advancement, and those that were previously considering buying a single-family home will now stay renters for longer. The flexibility and amenities of multifamily living continue to offer an appealing alternative.

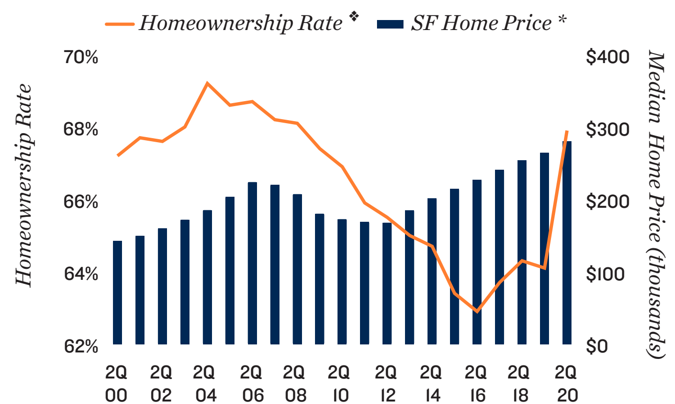
Suburban Vacancy Holds Below CBD



CBD Rent Down for the First Time in 10 Years



Home Prices Out of Reach for Many



❖ *Currently reported rate is elevated by a statistical anomaly due to a change in methodology*

* *Trailing-12-month average*

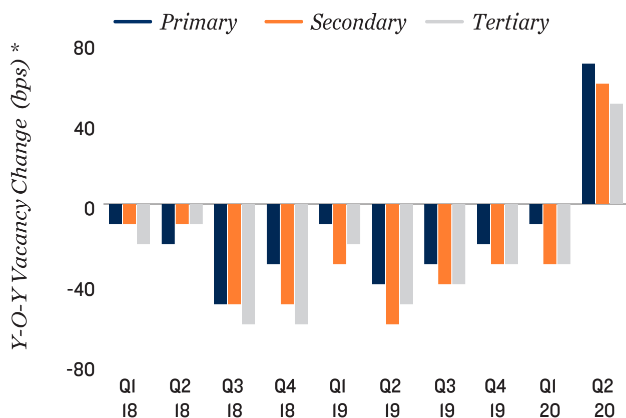
Sources: Marcus & Millichap Research Services; RealPage, Inc.; CoStar Group, Inc.; U.S. Census Bureau; National Association of Realtors

Pricing and Cap Rates Stable Amid Limited Transactions; Secondary and Tertiary Metros Have Increased Momentum

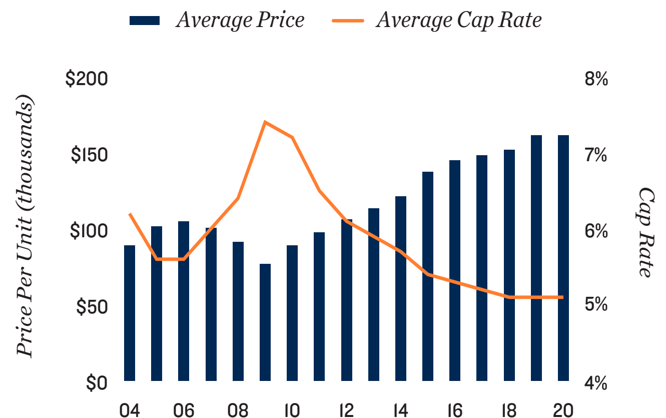
Movement out of high-density areas could support secondary and tertiary metros. The global pandemic could permanently alter the population's living preferences, prompting more people to search for residences in less crowded cities. While distinguished coastal markets such as Los Angeles and New York will always attract a demographic seeking this urban lifestyle, inland metros may gain favor with some. Additionally, cost-conscious renters will find more options within their budgets in smaller markets. Aging millennials seeking more space to accommodate marriage and children fueled the early stages of this shift, benefiting metros such as Phoenix, Austin and Nashville. Strong population in-migration trends and continued robust economic growth in some secondary and tertiary metros over the next decade will provide investors with greater upside potential.

Disconnect delays price and cap rate adjustments. Investment activity was down roughly 50 percent year over year in the second quarter largely due to valuation uncertainty and logistical complications. Meanwhile, average pricing and cap rates remain unchanged through the first half of 2020 as the decreasing cost of capital helped offset potential revenue declines. The next few months should help price discovery as the impacts delayed by generous federal unemployment benefits and eviction moratoriums will come to light. Investors with a long-term mindset will remain keen on multifamily as underlying demand trends are favorable. Suburban garden-style complexes may be on investors radars as household growth trends shift out of urban cores. Meanwhile, downtown properties could experience a more dynamic adjustment, yet the long-term prospects are promising.

Vacancy Rose by Less in Smaller Markets



Prices and Cap Rates Holding Steady So Far



** Primary is the aggregate of 17 markets, secondary is the aggregate of 18 markets, and tertiary is the aggregate of eight markets.*
Sources: Marcus & Millichap Research Services; RealPage, Inc.; CoStar Group, Inc.; Real Capital Analytics

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Sources: Marcus & Millichap Research Services; BLS; Bureau of Economic Analysis; CoStar Group, Inc.; Federal Reserve; Freddie Mac; National Association of Realtors; National Multifamily Housing Council; Real Capital Analytics; RealPage, Inc.; Small Business Administration; U.S. Census Bureau; U.S. Department of Labor

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