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"An investment in knowledge pays the best interest."

-- Benjamin Franklin, Founding Father, Inventor, Author, & Scientist

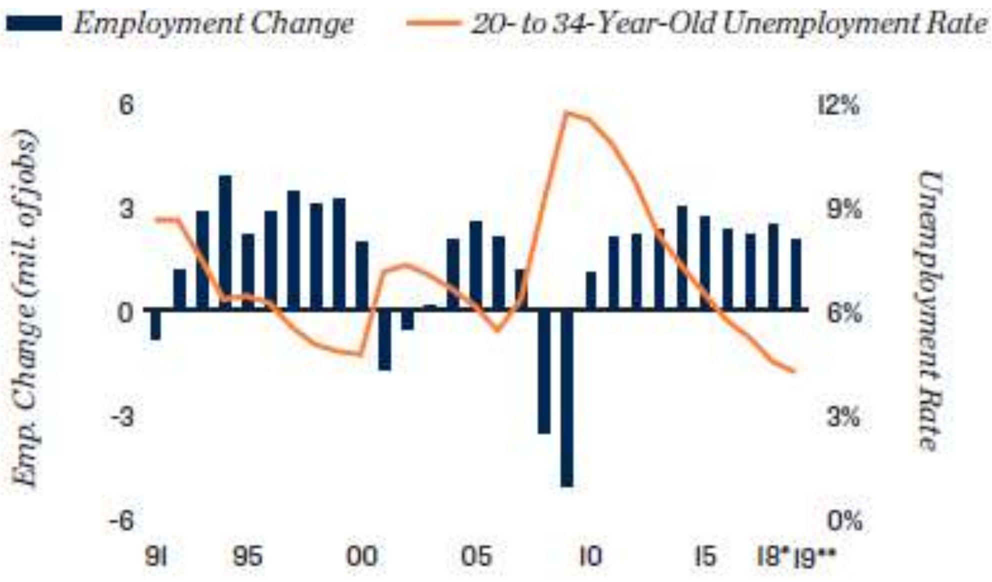
Multifamily Market Review: Fundamentals Still Strong but Prices Are High

Multifamily Apartment asset class is too big to ignore. The U.S. multifamily apartment market is a massive investment asset class, one we estimate is valued at $3 Trillion to $4 Trillion. We continue to build exposure here on an ongoing basis, and rank and file investors should as well due to benefits that include diversification from equities and bonds, depreciation tax benefits, and long-term capital gains tax benefits. Given the size of this market, it's always good to analyze the data and assess where we are at. Note, we are not performing a deep dive assessment of the overall economy, which is critical to one's exit price assumptions on any investment. Nevertheless, it is important to track apartment market health indicators and other drivers of the rental market.

Key Conclusion – Multifamily apartment fundamental remain strong, but asset prices are very high. In short, the data below suggests that multifamily apartment fundamentals remain very strong, with vacancy rates low, rent growth levels strong, inventory in check, and new supply being absorbed into key markets. Workforce housing, and apartments that rent for below $800 per month could move into short supply. As one might expect given still-low interest rates and robust fundamentals, and nearly 10-years since the last US recession, multifamily apartment asset prices are very high. Sellers want the moon! This creates some substantial risks for new buyers that are not discerning enough, and are predicated on substantial and continuing rent growth assumptions. That said, this market is an inefficient market, and discerning buyers that weigh risks and opportunities, and hold enough cash on hand, can still make find some very strong investment opportunities. As such, we continue to carefully build exposure to the sector as rents and wages continue their march higher.

Both strengths and risks highlight the US economy. The economy remains robust. The Fed has done a good job so far of threading the needle between keeping our 'Goldilocks' economy's performance intact while raising interest rates. We think rates have risen enough, and that too many more raises could induce the next downturn. Importantly, employment remains robust, wages (even at the low end) are now rising nicely, and individuals have more household wealth than in past years due to rising asset prices in equities and real estate. These factors are a plus. Obviously, risks remain. Recessions are cyclical and usually happen by not widely foreseen circumstances that cause businesses to pull back from hiring, expansion, and capital spending, thus driving a self-fulfilling prophecy. Some cracks are showing including that a record 7 million Americans are at least three months delinquent on their car payments, though this is still less than peak delinquency rates achieved in 2010. Indeed, overall consumer debt is high. Other risks exist including A) the Fed's balance sheet remains bloated with the Fed now decreasing liquidity in the banking system by selling off these assets (reverse quantitative easing); B) interest rates have risen many times in the past couple years; C) asset prices are high (possibly suggesting an asset bubble); D) and the US has dramatically underfunded Social Security and pension liabilities at the federal, state, and local levels as Baby Boomers and retirees become a larger portion of the population. Despite these substantial risks, the economy keeps chugging along, and life happens. So we continue building exposure to the multifamily apartment market, albeit carefully.

Figure 1. Jobs Numbers Strong, Unemployment Rate Low



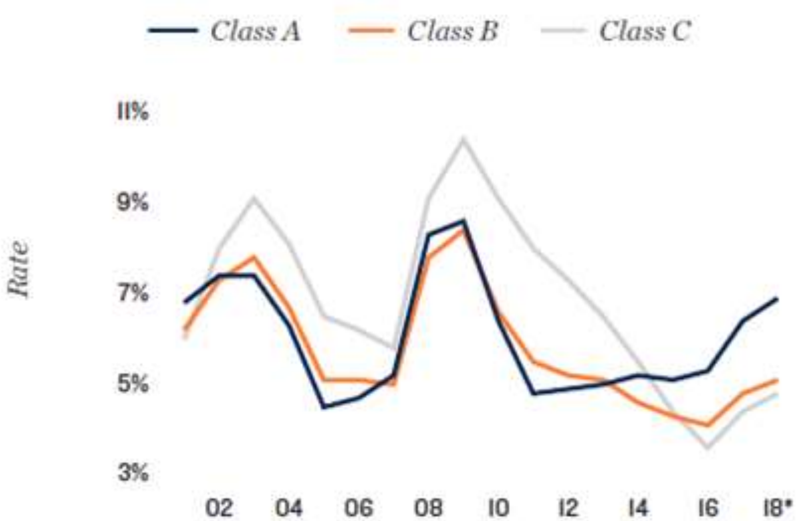
Source: Marcus & Millichap

Apartment fundamentals remain strong, with vacancy low and supply in check. The following charts generally show that apartment market fundamentals remain robust for owners and investors due to a number of varying reasons. One primary reason is that home prices and interest rates have both risen, thus pushing home affordability more out of reach for many renters. A second reason for robust Multifamily Apartment investor fundamentals is that construction costs and materials costs have risen so dramatically that only expensive 'Class A' apartments are being built, and little to no new Workforce Housing apartment properties are under construction. This limits lower-end renters to apartment properties built in the 1980s or earlier, and supply of these apartments is fixed to shrinking.

Figure 2. Household Formation Continues to Outpace Home Construction Rates

Source: Marcus & Millichap

Figure 3. Vacancy Rates Remain at Low Levels, Particularly in Workforce Housing



Source: Marcus & Millichap

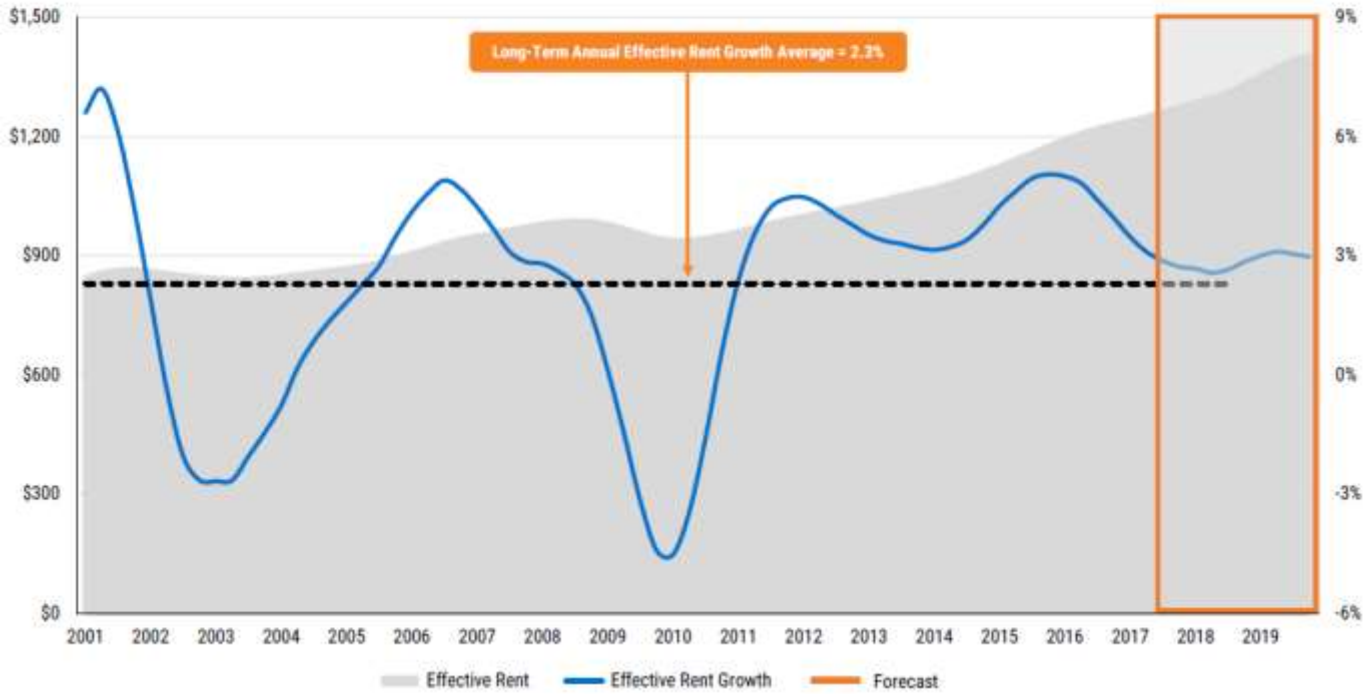
Widening gap between home ownership payments and rental payments means more people likely to rent. Below we see that the total monthly payment on a median-priced home grew by $175 in 2018 to nearly $1,700 per month. That's a hefty increase driven by higher home prices and higher interest rates, and means a home buyer must allocate $2100 more per year of after-tax income to home ownership costs versus the median buyer in 2017. For the typical working class family, that's a lot of extra dough! The disparity gap between a mortgage payment and average monthly rent has widened to $339, according to Marcus & Millichap, thus restraining many people's ability to afford home ownership.

Figure 4. Renting vs Owning Payment Gap is Widening; More People Must Rent

Source: Marcus & Millichap

And rental growth rates have been strong! Different research provides slightly different data, but the conclusion is the same…rental rate growth in the U.S. has been strong over the past eight years. Per Marcus & Millichap in the above charts we see that since 2010, national rents have risen from an average of $950 to about $1350 today…that's 42% growth in rental rates in the past eight years! Per NKF's data in the chart below, rents have risen by roughly the same amount. 42% growth in eight years is a 4.5% annual compounded growth, well above inflation and one major cause of apartment properties' price appreciation.

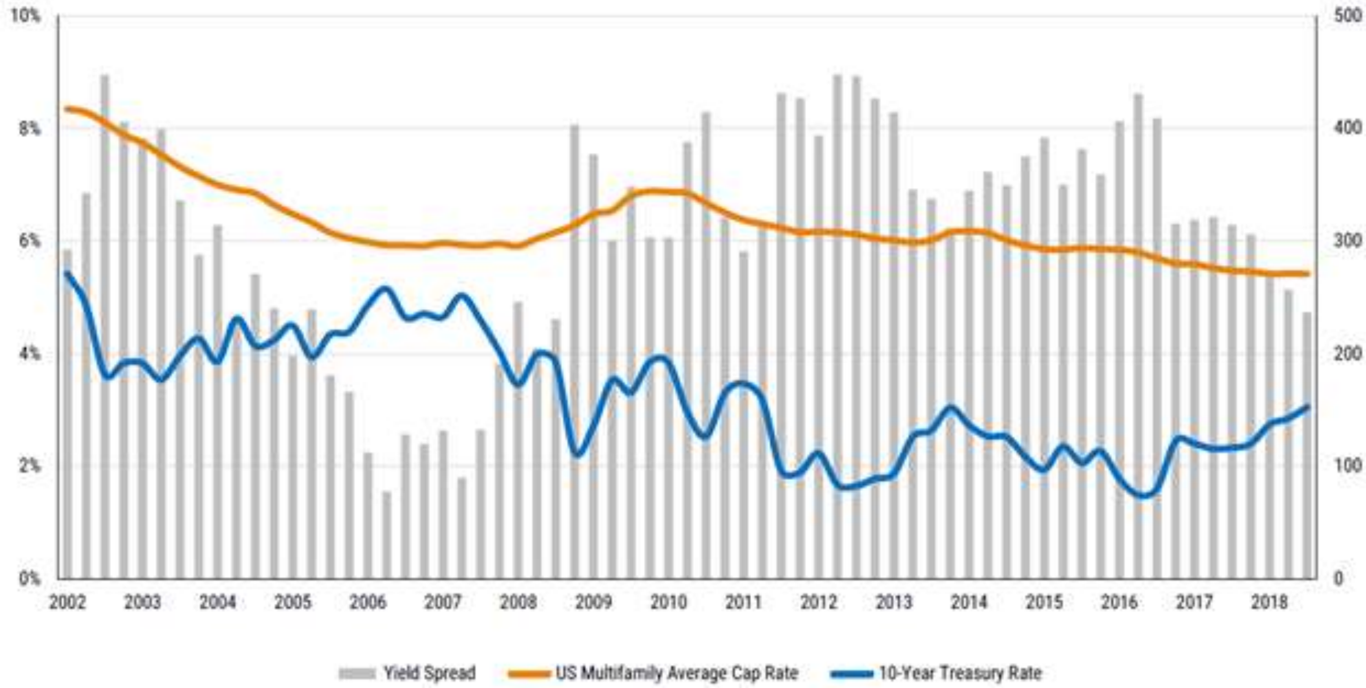
Figure 5. Rent Growth Has Been Very Strong Since Downturn



Source: NKF Research, Axiometrics

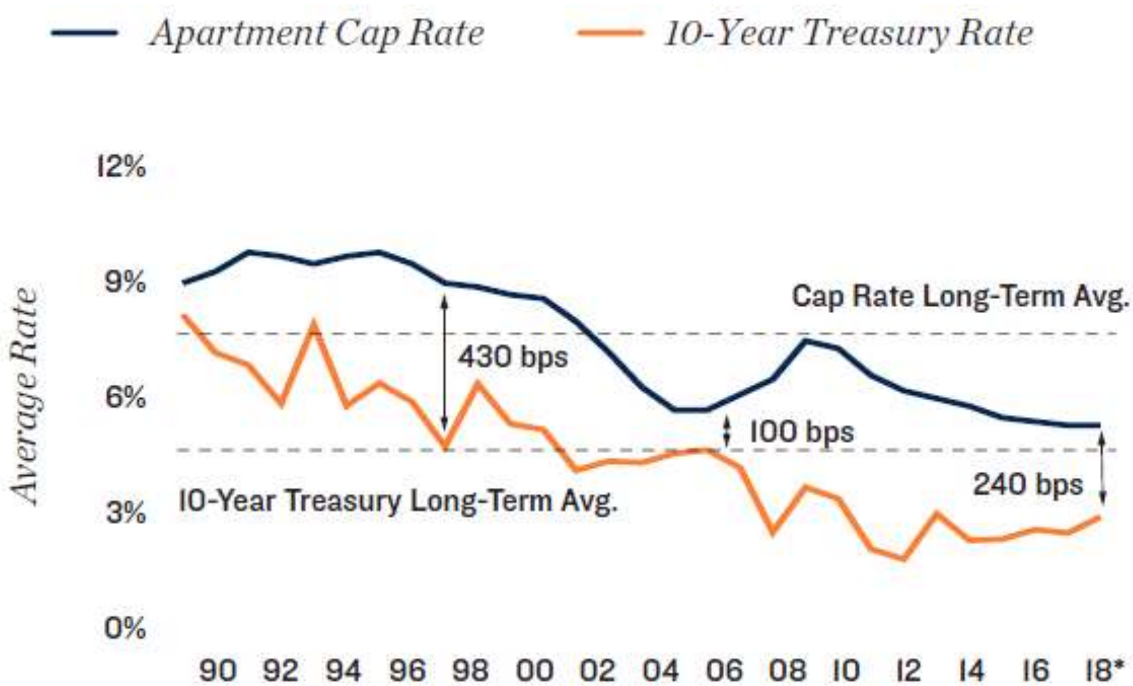
But, Multifamily Apartment prices remain high and that is the biggest risk to the sector. From an investor standpoint, the biggest risk to investing new money in multifamily apartment assets now is that prices are very high, and have gotten higher in each successive quarter over the past ten years. As investors, we need to make money, both from ongoing cash flows generated from these properties and from appreciation-driven gains when we sell. In the figure below, we see that cap-rates versus 10-year Treasury Rates have continued to compress and are now at levels not seen since 2006-2008. This means there is less cash flow being generated by these properties, and a lower chance of capital appreciation upon property sale. Those that follow the data would have seen that 2012-2013 and even 2015-2016 were great times to invest in Multifamily Apartment assets, and that more caution is warranted at present.

Figure 6. Multifamily Cap-Rate versus Treasury Rate Spreads are at 10-Year Lows



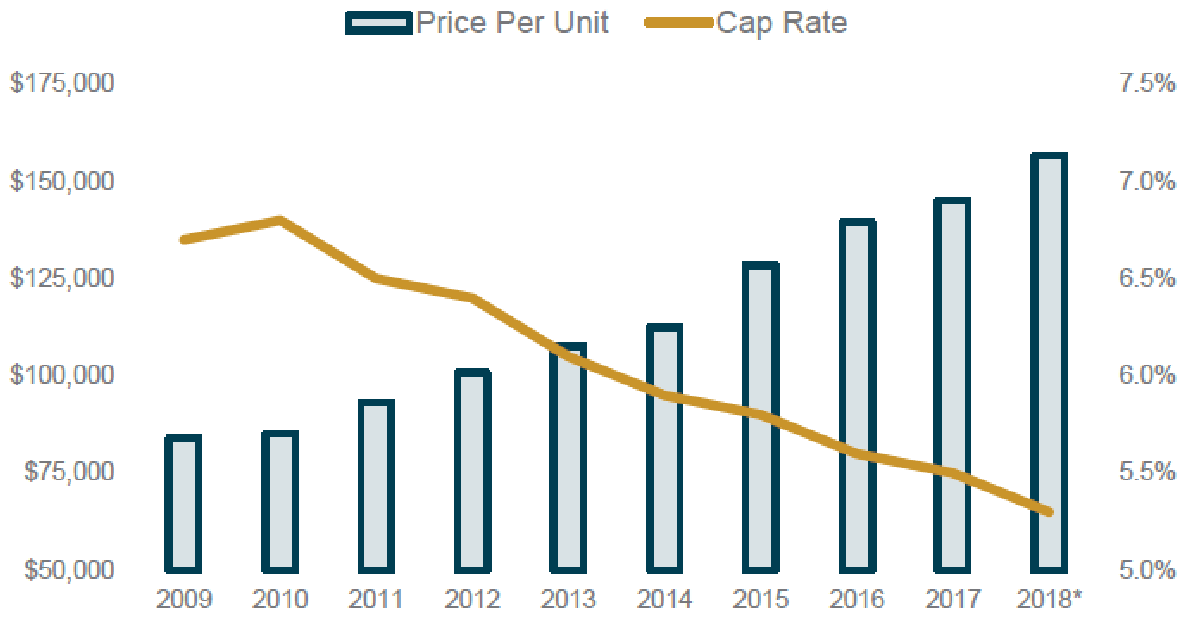
Source: NKF Research, Real Capital Analytics

Figure 7. Same Data, But a Longer Time Horizon



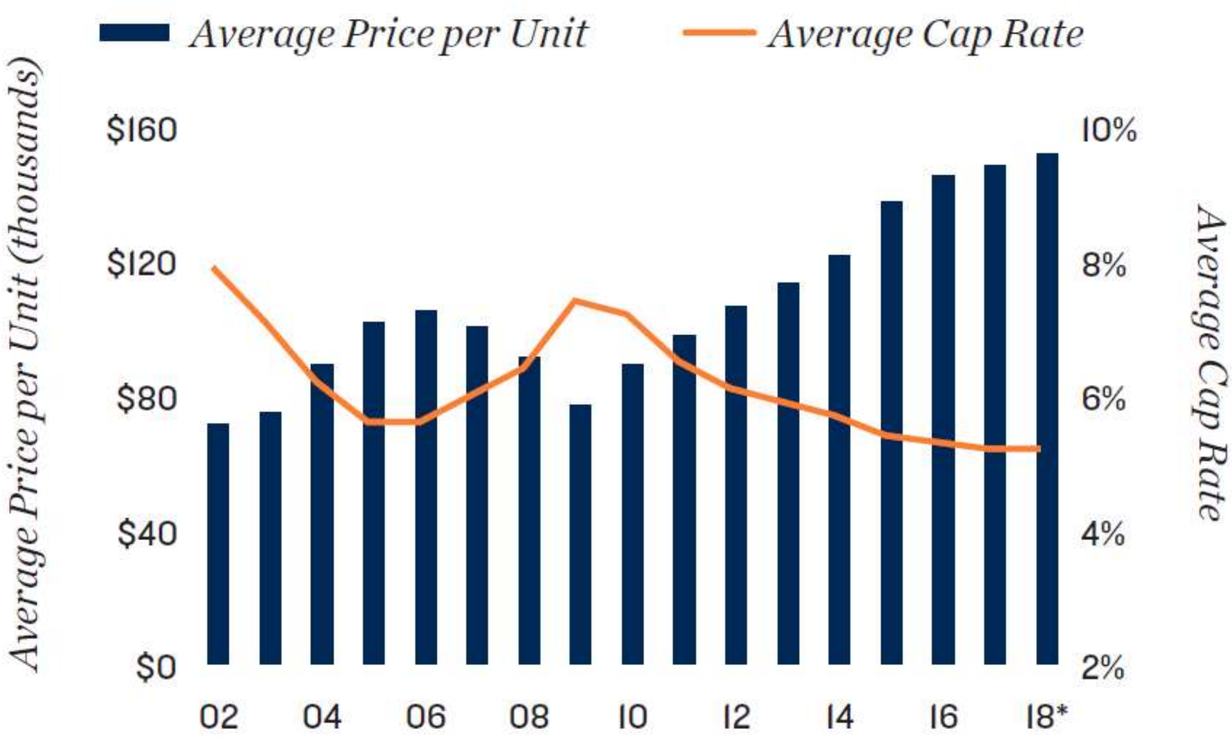
Source: Marcus & Millichap

Figure 8. Price Per Unit Has Risen Dramatically, a Risk



Source: Berkadia, Real Capital Analytics

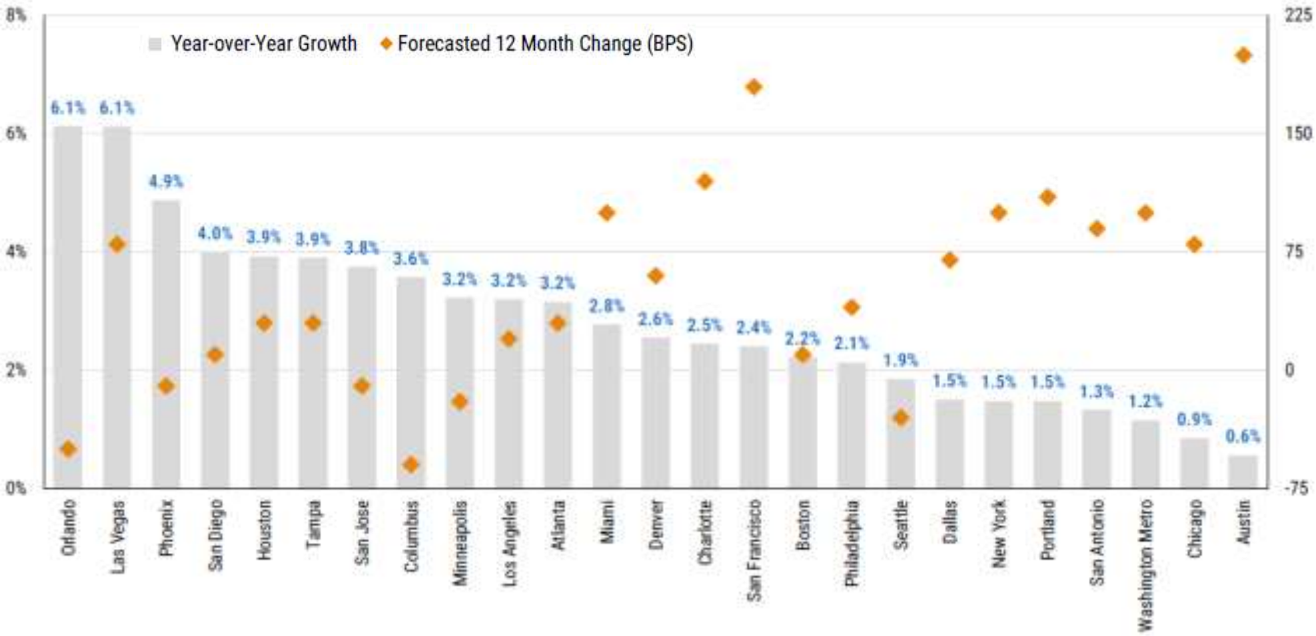
Figure 9. Different Data, Same Conclusion: Price Per Unit Has Risen Dramatically



Source: Marcus & Millichap

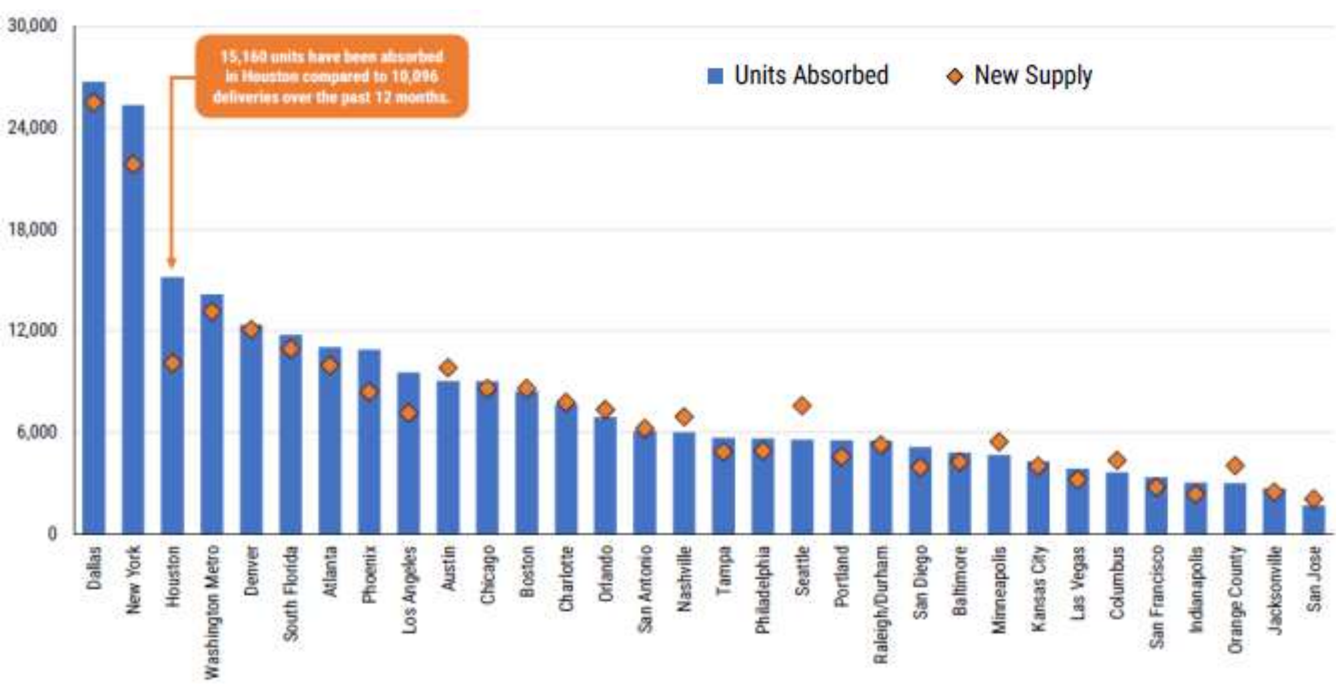
Multifamily Market Review: City Specific Data is Helpful

Figure 10. Rent Growth Strongest in Orlando, Las Vegas, and Phoenix



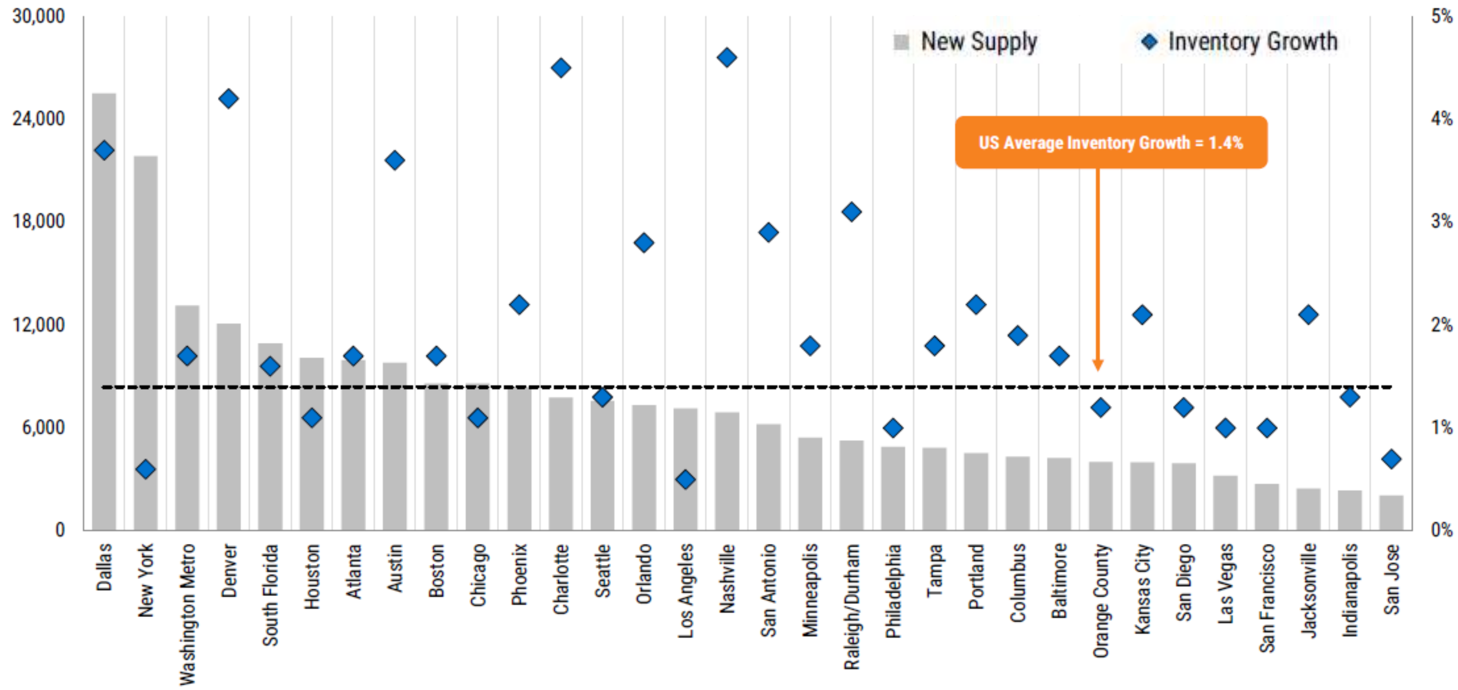
Source: NKF Research, Axiometrics

Figure 11. Supply Absorption Progressing Well; Houston & LA Leading While Seattle, Nashville, and Orange County are Lagging



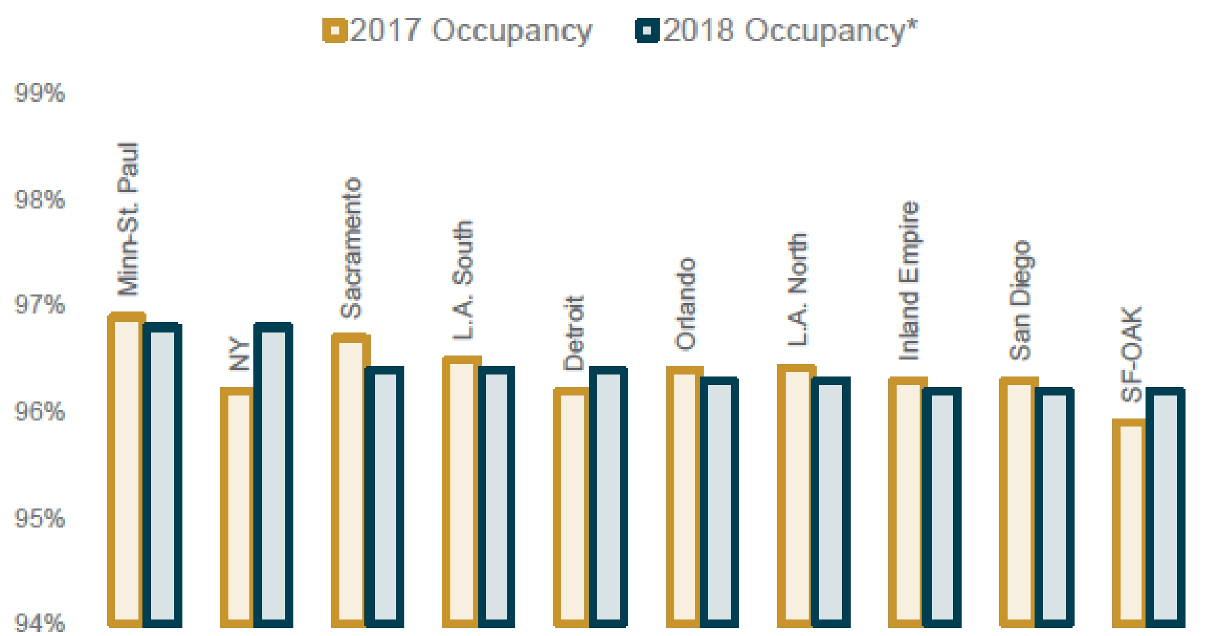
Source: NKF Research, Axiometrics

Figure 12. Inventory Growth Highest in Nashville, Charlotte, and Denver; Lowest in Los Angeles, New York, and San Jose



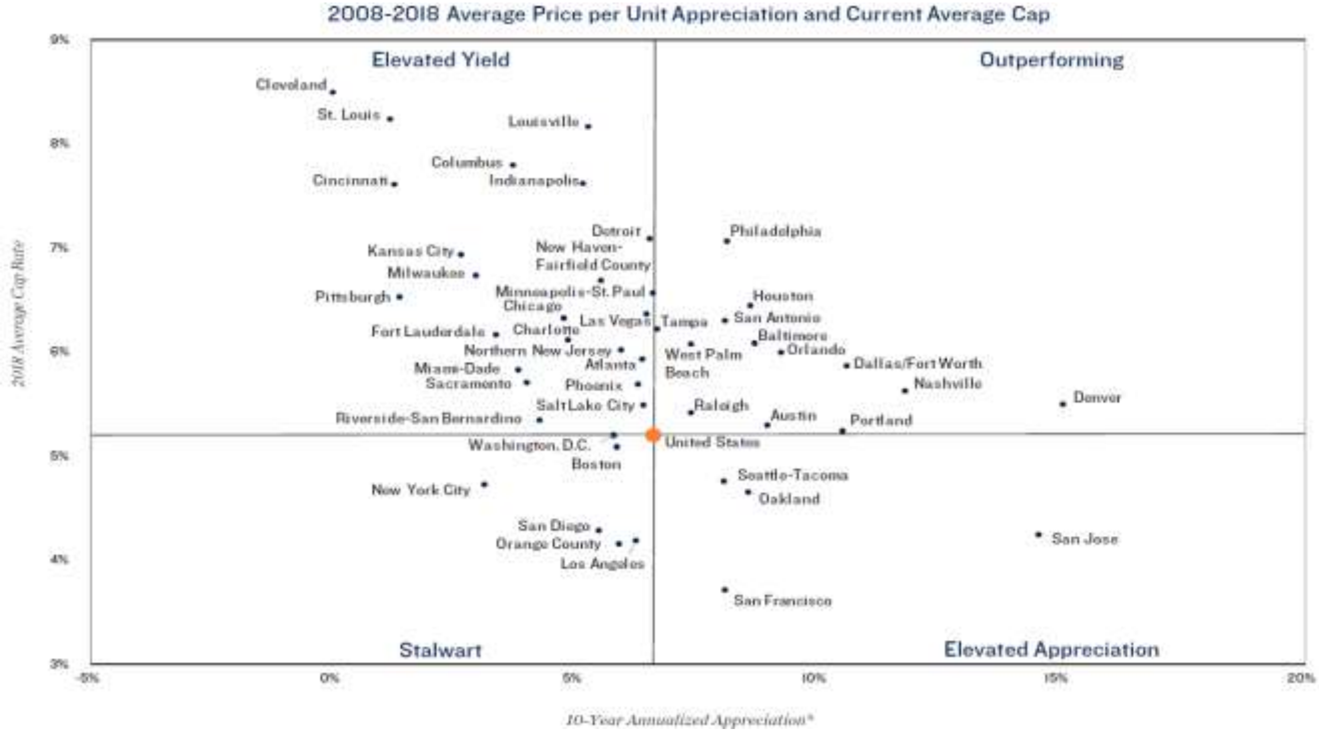
Source: NKF Research, Axiometrics

Figure 13. Highest Occupancy Markets Include Minneapolis, New York, Sacramento



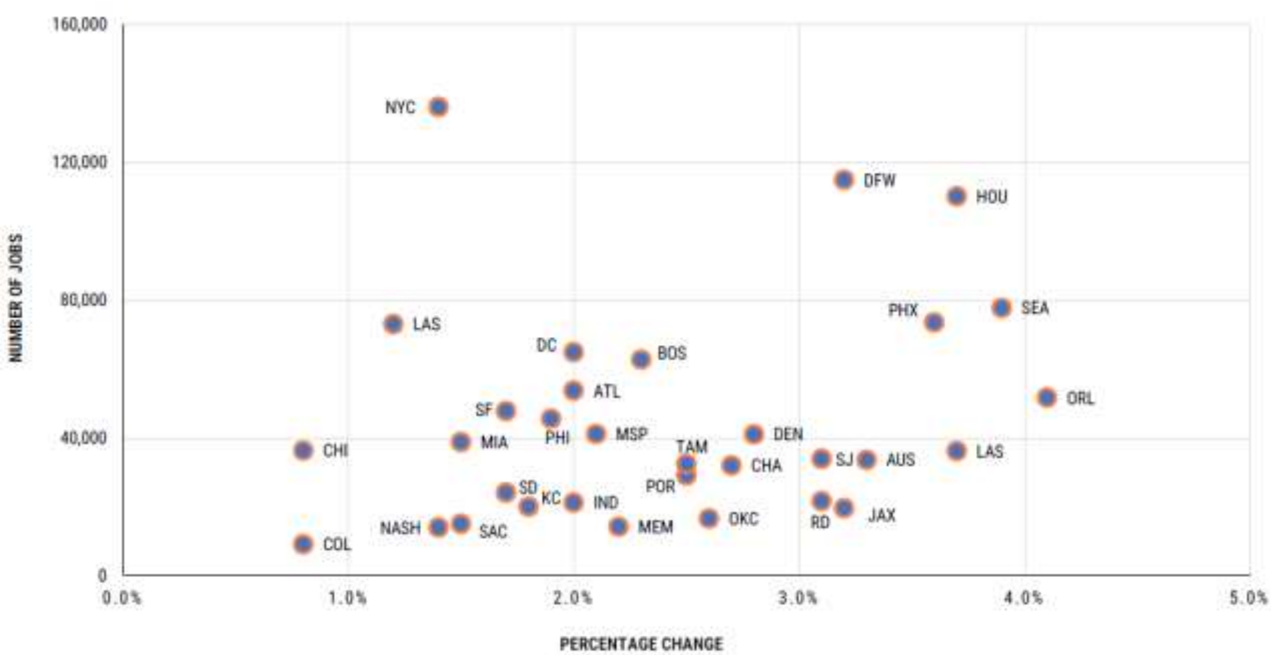
Source: Berkadia, Axiometrics

Figure 14. 10-Year Yields versus Current Cap-Rates: Denver, Nashville, Dallas, Orlando, San Antonio, Houston, Austin, Philadelphia Perform Well



Source: Marcus & Millichap

Figure 15. Job Growth Trends: Orlando, Seattle, and Houston Lead the Way



Source: NKF Research, U.S. Beaureu of Labor Statistics

We Seek Off-Market Deals

Let us know if you are looking to sell any of your Multifamily or Hospitality assets. We will underwrite the asset quickly and can give you a fair price, while allowing for a quiet and easy exit.

Investors are Welcome to Reach Out

We are always working on our next deal, and continuously seek well-capitalized Equity partners to work with as Limited Partners, or even on a co-JV basis. We are open to deal structure and seek the most strategic partners that we can find as we carefully build and scale our portfolio further. We focus on creating tremendous Customer Experiences, realizing solid cash-on-cash yields, and managing risk at all levels of the Project and throughout our organization. Please Contact Us Here if you are interested in discussing this further.

About Avid Realty Partners

Founded by a former Wall Street equities analyst, Avid Realty Partners brings high-powered analytics, risk management, and institutional sophistication to commercial Real Estate investing, allowing us to deliver outsized Alpha for our Investors. Our passion is owning Multifamily Apartments, Hotels and other Commercial Realty Assets that deliver the best possible Customer Experience, while generating robust risk-managed returns for our investors. In Multifamily apartments, we focus on Class B/C value-add properties in growth markets where we proudly bring enhanced unit upgrades and property renovations to our Residents, improving their Quality of Life metrics. In Hotels, we build or buy properties that deliver everything that our Guests deserve, and more than they expect. We are proud of the hard work and results that our Team delivers everyday on behalf of our Customers, Investors, and other Stakeholders.

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