REALIZED

2022

Commercial Real Estate Market Analysis Report

Q3 2022

Multifamily properties can be a lucrative investment property to hold in a real estate portfolio. Whether a duplex, small apartment complex, or a commercial-grade apartment building, these properties can offer investors several benefits, including the ability to adjust rental rates frequently based on current market demand as leases cycle.

At Realized, we strive to help investors understand the macro and microeconomic factors at play when evaluating an investment property. Rent growth is a key factor that drives investment performance and returns depend upon these projections so investors should evaluate how realistic the rent growth projections are. Let's take a look at the state of the multifamily rental market and additional factors investors should consider prior to making an investment.

20220812-2340783

Key Takeaways

- Multifamily investment property owners have seen sustained rent growth throughout the country over the last several years, making them a potentially lucrative investment opportunity and a hedge against inflation.
- 2021 proved to be a record year for rent growth, but several factors are indicating that 2022 may not show the same amount of growth as seen in pervious years.
- In this report, we'll outline several factors to evaluate in addition to rent growth projections if you are considering investing in a multifamily property.

Considerations for Investors When Evaluating Multifamily Investments – What Story Do Rising Rents Actually Tell?

The recent trend in high inflation rates has enabled multifamily property owners the ability to increase rents on a continual basis. In 129 of the top 150 markets, rent growth has outpaced inflation with no rental decline during the same period.[1] This could lead many to wonder if this trend will continue for the foreseeable future, or if there will be a tipping point in which rents will no longer be projected to grow.

Current State of the Multifamily Market

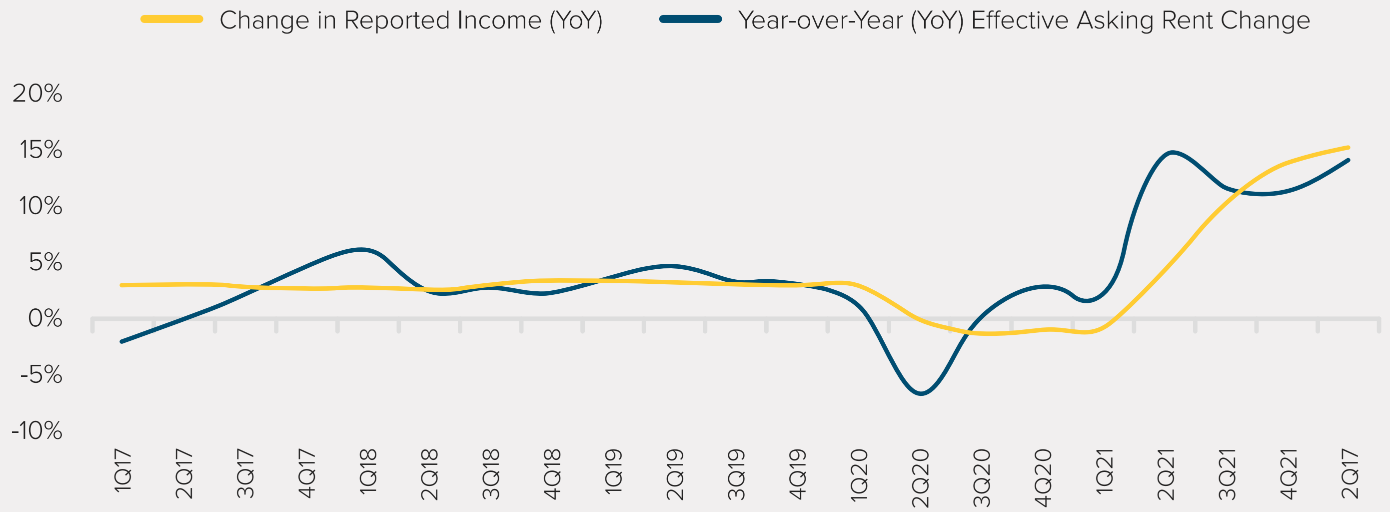
Sustained rent growth has been the norm for markets across the country. Yardi Matrix's survey of 140 markets showed rents grew 14.3% year over year in April, 14.8% in March, and 15.4% in February.[2] While 2022 predictions for rent growth may not follow the record growth seen in 2021, 2022 showed year over year rent growth over 14% for five consecutive months.

This trend in rental increases has been seen alongside increases in household income. According to data from Berkadia, rent increases have been on pace with income increases over the last five years.[3] Aside from a brief dip at the beginning of the pandemic, renter incomes have grown in tandem with rental increases, dispelling myths that rental increases are widely outpacing wage growth.

[1] United States Multifamily Capital Markets Report.
[2] Mutlifamily Real Estate News
[3] Berkadia RealPage - April 2022

Income Growth And Rent Growth Have Generally Aligned In Recent Years

Data sourced from RealPage new lease signee reported incomes



Source: RealPage, Inc. (Lease Transaction Data)

As of April 2022, Berkadia reported that the average new lease signee reports an annual income of $72,000 on their application, which represents a 13% year over year increase. By comparison, the inflation rate in April 2022 was 8.3% compared to the same time period a year prior.

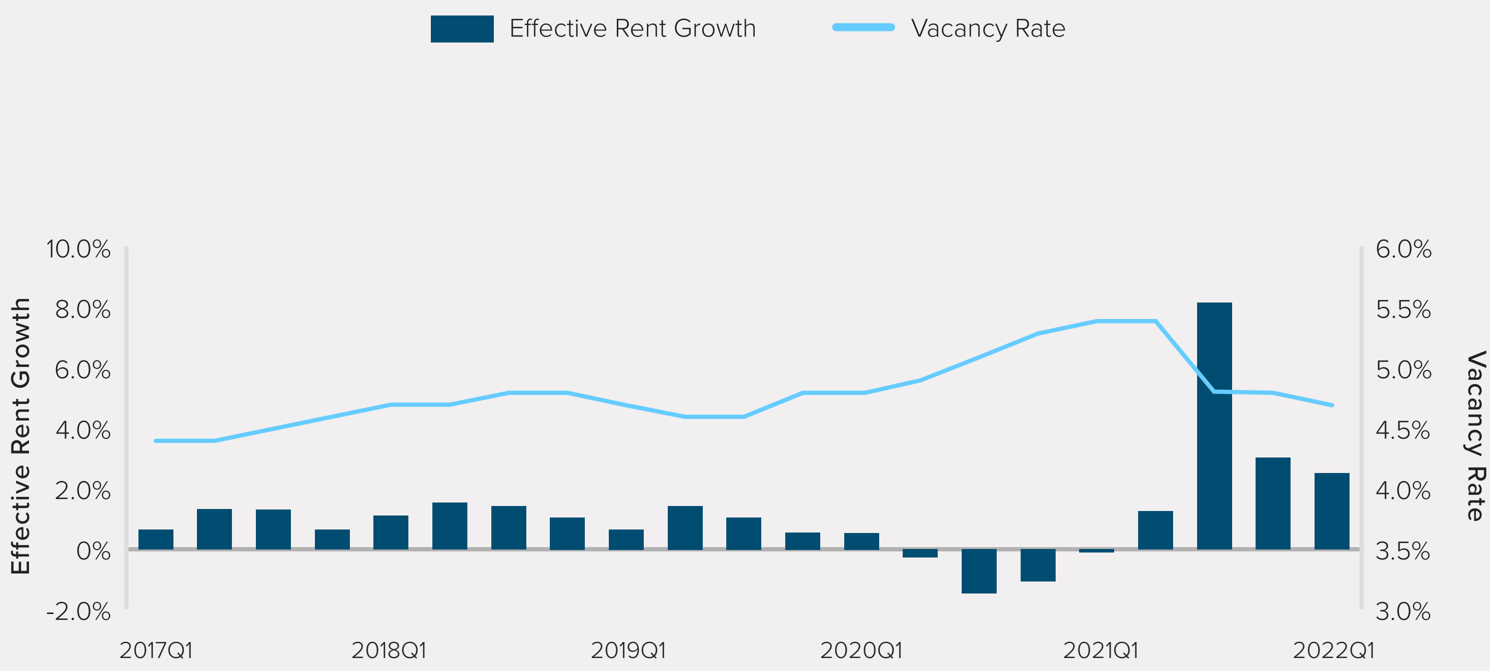
Additionally, even as rents increased, demand for these properties also remained high. According to Moody's, vacancy rates have stayed consistently lower than rent growth since Q3 2021.[4]

Rent growth is unlikely to slow down until demand cools and vacancy rates increase. This will likely only happen if the job market cools (reducing wages) or supply for multifamily units increases (cooling demands). Rents will not keep growing if the labor market is unable or unwilling to pay for them, but the big question remains:

What will be the breaking point at which the rental market will start to cool?

[4] Q1 2022 Apartment First Glance - Moody's Analytics

Apartment Vacancy And Effective Rent Growth



Source: Moody's Analytics CRE

Are We at a Tipping Point?

2021 proved to be a record year for rent growth but rent growth is expected to slow in 2022. According to Moody's, the geopolitical crisis will have an indirect effect on multifamily investments.[5] Rising oil prices lead to higher energy costs for families and tenants, which could cause a reduction in spending as prices increase. This in turn could constrain landlords from raising rents, which is why Moody's predicts a smaller amount for rent growth compared to the record-setting amounts seen in 2021.

Construction pipelines may also play a role in expected rent growths for 2022 and beyond. Research from Zellman and Associates shows the number of new construction projects expected to be completed in 2022 is 13% higher than the number of projects completed in 2021.[6] This trend is expected to continue for the next three years, leading to the largest amount of new multifamily completions seen since 1988. However, this will vary according to market as the United States overall is still short on rental units. It's best that investors analyze the supply and demand at a macro level to determine what the supply and demand is where their particular investment opportunity is located.[7]

A decline in home prices may also be a factor for investors to consider. Mark Zandi, Moody's Analytics chief economist, said if a recession hits, national home prices could fall 5%.[8] For markets where home prices are significantly overpriced, prices could fall 15% to 20%. These declines in prices could potentially open the door to home ownership for tenants who may have previously been priced out of purchasing a home due to limited supply and increasing demand – assuming they have the financial ability to purchase a home during a recession. It is good to note that an increase in housing affordability (meaning reductions in housing costs) may potentially be partially offset by increased mortgage rates, which are still expected to increase through the end of 2022.

With so much unknown about the potential growth velocity of the rental market, what should an investor evaluate before investing in a multifamily investment property?

[5] Q1 2022 Apartment First Glance - Moody's Analytics
[6] Walker and Dunlap - Multifamily Outlook Spring 2022
[7] The Future of Apartment Demand - National Apartment Association.
[8] 40 overvalued housing markets that could see 15% to 20% home price declines in a recession by Lance Lambert for Fortune.com

Evaluating Future Rent Growth

Attempting to project the future rent growth of a multifamily property requires more than analyzing the historical rent trends. Inflation is one factor to consider, and while economists do their best to predict how much longer the trend of rising inflation rates will continue, it often seems hard to predict. Luckily, there are additional considerations that investors can evaluate when they are considering whether to invest in a multifamily investment property.

Here are three factors to consider before potentially adding a multifamily property to your investment portfolio.

AFFORDABILITY

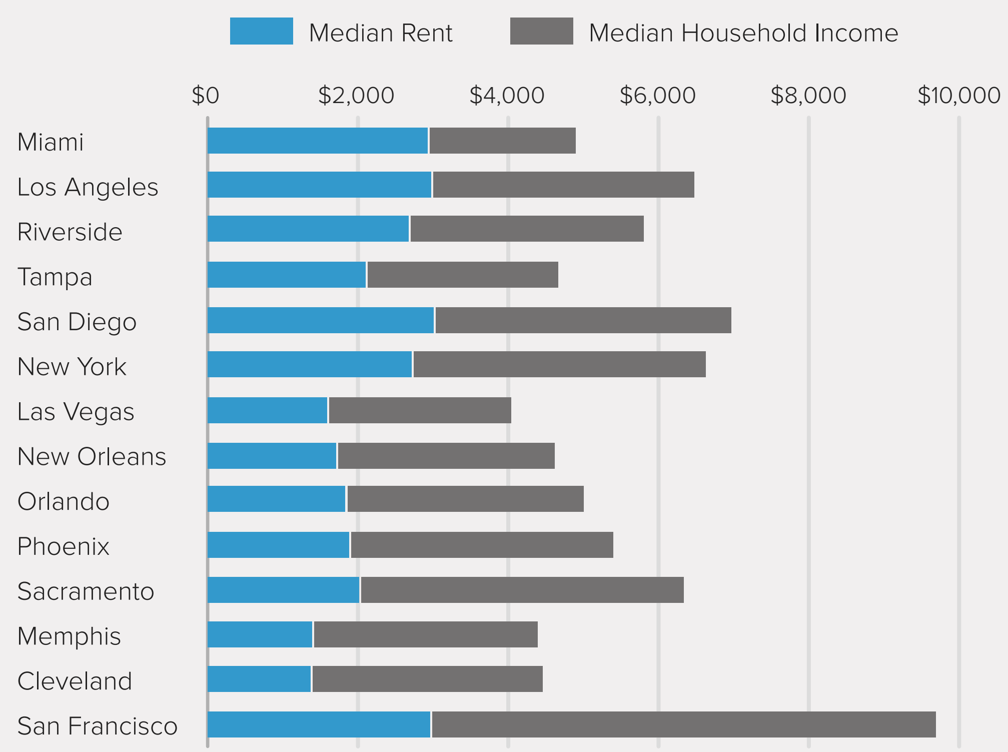
How affordable is the multifamily property compared to the income and wages in the surrounding market? In February, the median monthly rent made up more than 30% of the monthly income in several metropolitan areas, including Miami, Los Angeles, San Diego, and New York.

Another thing to consider is the average income for current and prospective tenants in the multifamily property compared to the rest of the surrounding market. For a Class A multifamily apartment building, the median monthly incomes for tenants may be higher than the median incomes in the surrounding market, which can make it difficult to determine how affordable a specific property is compared to others in the area.

Ideally, you want rents to represent 30% of the median tenant income as the baseline, preferably at 25% or 20% so there is room for future rent increases that tenants can afford.[9] Knowing the tenant incomes at your prospective property level can help you determine whether rents can continue to increase or if they are already at the top of tenants' price points.

[9] Home Costs and Rents Are Soaring. When Buying Makes Sense. by Evie Liu for Barron's.

Median Monthly Rent And Income In Metro Areas



Source: Realtor.com

JOB GROWTH

Evaluate the current job market and projected growth for the market of the property. Examining the Bureau of Labor Statistics and local unemployment rates can help you analyze whether there is growth potential and security in the local job market. If more jobs are expected to come to the market, that could be a good indicator that additional housing needs are soon to follow.

CONSTRUCTION PIPELINES

How much new construction is in the area? The volume of additional inventory coming to the market compared to the demand for the current area can help you determine whether there is more supply than demand. An overflow of supply could lead to slower rent growths as tenants have more options available.

Investors may be able to track permits and look at zoning requirements but that may not be likely in all areas. Third-party resources like REIS, which provides in-depth property data, trends and forecasts for markets and submarkets, and more, can usually provide this data if investors subscribe to receiving this information.

An overflow of supply could lead to slower rent growths as tenants have more options available.

Comparing Markets

By evaluating construction pipelines, job growth, and affordability, you can get a more holistic understanding of the rent growth potential for an investment property. The following is an example of two booming real estate markets, Dallas and Tampa.[10]

[10] Moody's Analytics CRE Q1 2022 Dallas (& Tampa) Apartment Market Report

Rents in Tampa grew at a higher rate than Dallas, and both markets absorbed more leases than the net new supply that was delivered, showing demand that is outpacing supply. The population and income levels increased more than Tampa, making it a slightly more affordable market currently. All of these underlying factors can help an investor determine whether a property can meet their investment goals and objectives.

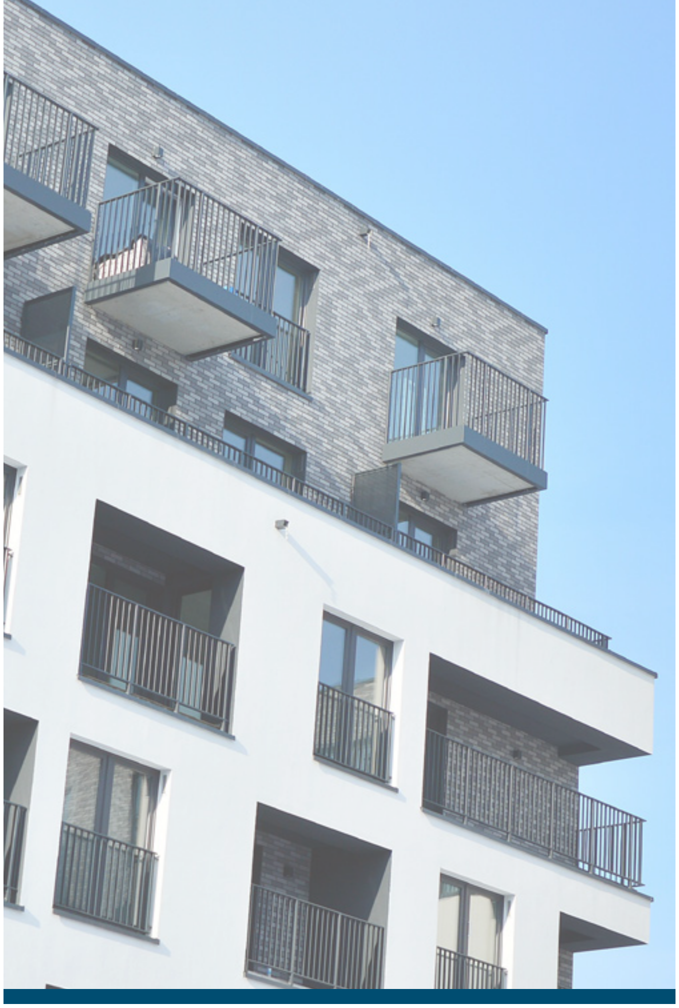
Comparison of Real Estate Markets: Dallas vs. Tampa

	Dallas	Tampa
Q1 2021 vs Q1 2022 Effective Rent Growth	18.7%	27.6%
Q1 2022 Effective Rent Growth (ANNUALIZED)	12.9%	22.2%
New Supply Delivered Since Start of 2021	26,000 units	6,000 units
Unit Absorption Since Start of 2021	52,400	10,8000
Construction to Absorption Ratio	~50%	~55%
Moody's Analytics CRE Q1 2022 Rent	$1,445	$1,533
Avg. Household Income % Change	1.46%	0.32%
Q1 Population % Change	0.38%	0.25%

Source: Moody's Analytics CRE

Conclusion

The multifamily market is still expected to grow, albeit not at the same rates seen in 2021. When evaluating the potential for rent growth on a specific investment property, investors should consider several underlying factors specific to the market and individual property to help determine what the expected growth rate may be. These factors will vary from one market to another and should be taken into consideration alongside historic rent growth percentages and expected projections on the property.



For more info, contact Realized:

Realized Holdings, Inc.
Austin, TX

(877) 797-1031
sales@realized1031.com
www.realized1031.com

22H02V1H05

REALIZED®

20220812-2340783