Q2 2014 Apartment Market Trends

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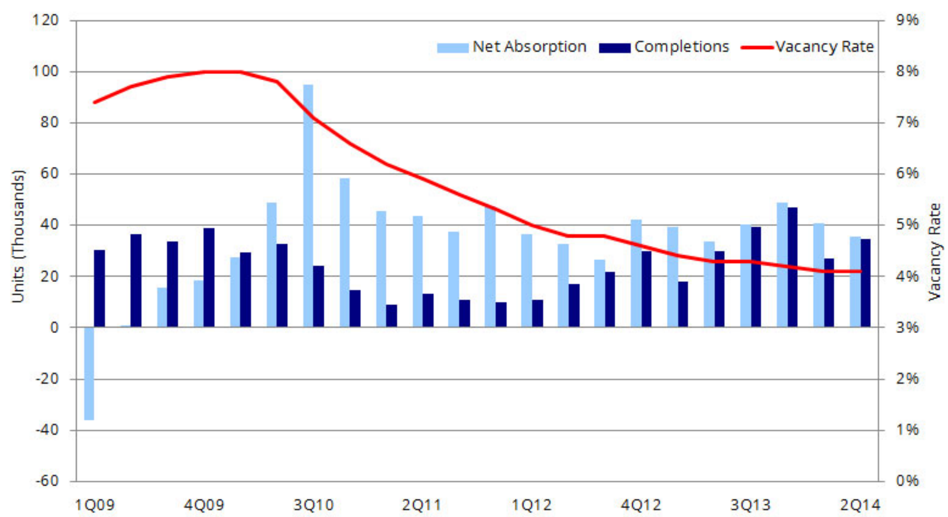
by Victor Calanog on August 22, 2014

Vacancy Compression Stalls in the Second Quarter

The national vacancy rate remained unchanged at 4.1% during the second quarter, a potentially worrisome result for those who fret about the near-term future of the apartment sector. However, this is not unexpected, and a moderation in the brisk pace of improvement in fundamentals has been built into our forecasts for some time.

Supply growth quickened in the second quarter, with over 34,000 units coming online versus approximately 27,000 in the first quarter. Again, this is not unexpected. Net absorption, however, continued to outpace supply growth, clocking in at over 35,000 units.

While supply growth is expected to accelerate in the latter half of the year, there is little reason to expect demand for apartment rentals to weaken significantly. Job growth has been robust, with close to 230,000 jobs created per month, on average, through July. There are, however, admittedly several MSAs where job creation and household formation have not kept up with additions to inventory.



Rent Growth Comparable to Last Year

Asking and effective rents grew by 0.8 and 0.9 percent, respectively, in the second quarter, faster than the prior period but quite in line with seasonal strength during the Spring and Summer months. On a year over year basis, asking rents grew by 3.2 percent, and effective rents grew by 3.4 percent.

Rent growth for the first half of 2014 is roughly comparable to the first half of 2013, suggesting that the ability of landlords to raise rents may have reached some equilibrium rate that is slower than its strongest rate, recorded in 2012. Asking and effective rent growth have also been approximately equal, or within 10 basis points of each other, since the latter half of 2012, implying that landlords may have little runway left by way of concession reductions to boost effective rent growth. The recovery has been so broad, and has progressed for so long (four years at this point), that we appear to be approaching a new point in the business cycle.

Not a Downturn

We must be careful when we discuss topics like “new points in the business cycle” for the apartment sector. If the robust recovery that apartment investors, lenders and owners have enjoyed since early 2010 is over, the next few years appear to herald nothing approaching a “downturn” or “contraction,” but more of a state where fundamentals revert to historical averages and long-term potential.

The long-term national vacancy rate stands at 5.4%, and Reis forecasts suggest a gradual rise in vacancies over the next five years. Rent growth will stabilize as well at or around 3%. This means some markets will have occupancies deteriorating—from 97% to 94%, for example. Hardly cause for worry, but a reality to be planned for nonetheless, especially if future projections were built on much rosier assumptions.

Market Highlights

Several of the markets normally near the top of the rankings, such as the California markets, were further down the list, some of which registered no vacancy decline this quarter. This indicates that although the recovery in the apartment market was already widespread, markets that had been lagging during the recovery are now starting to gain ground while markets that led the recovery are losing a bit of steam, especially as construction in those markets ramps up. With supply growth accelerating in many major markets, the tide is already turning a bit for vacancy. Although 17 markets now register a vacancy rate lower than 3.0%, a post-recession high, there were only 45 markets that registered a vacancy decline. That is down significantly from what we have observed in recent quarters. While it could be an isolated event, the supply pipeline intimates that we should see fewer markets registering vacancy compression going forward.

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