CAPITAL SQUARE

MARKET DYNAMICS ARE SHIFTING IN FAVOR OF MULTIFAMILY LANDLORDS

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TAKEAWAYS

- The multifamily market is witnessing a dramatic adjustment. National vacancy readings leveled off for the first time in three years in Q3 2024, as new unit deliveries slowed and a growing pool of renters leased up available units.
- New unit deliveries are projected to decline further. CoStar data shows a 55% reduction in expected unit completions in 2025, and permit issuance reveals a continued thinning of the supply pipeline thereafter.
- Demand is increasing as several forces unleash pent up need for rental units. In contrast to renting, purchasing a home continues to represent an expensive and unattractive alternative.
- As the supply of new units continues to decline and increased demand for rentals absorbs the current available inventory, leverage will continue to shift in favor of multifamily landlords and investors.

> The current market conditions can be boiled down to supply and demand factors that are all trending to multifamily landlords' benefit.

SUBTLE CHANGES SHOW THE TIDE SHIFTING IN FAVOR OF MULTIFAMILY LANDLORDS

The narrative in the media has made the environment look bad for multifamily owners. These landlords have witnessed historically large numbers of new development projects entering the rental market with only modest rates of "positive absorption," defined as a net increase in the pool of renters in a market. Increasing numbers of empty apartments required landlords to offer concessions to attract residents.

While these general dynamics played out in some markets over the past year or two, industry datapoints from the second half of 2024 indicate this trend is fading. In fact, CoStar data shows that over Q2 and Q3 2024, national vacancy rates remained steady for the first time in three years based upon the slowing delivery of new units and increasing rates of renters absorbing the supply.[1] The trendlines strongly point toward these dynamics continuing, which is a bullish indicator for multifamily landlords and their pricing power moving forward.

THE SUPPLY PIPELINE IS DRYING UP AND NEW RENTERS ARE RAPIDLY ABSORBING NEW UNITS

Beginning in late 2022, rising interest rates and weakening operating fundamentals quickly put the brakes on many planned multifamily housing developments. Because of the lag in the development cycle between initial planning and the delivery of rentable units, that trend has taken until recently to become apparent in the market. In the interim, softening rental conditions reinforced the halting of projects, leading to a dramatic drop off in the supply pipeline.

Compared with the 672,000 multifamily units that will be completed nationally in 2024, CoStar data shows a staggering 55% expected reduction in completions in 2025. Looking ahead, permit issuance also provides a good indicator of future unit completions. Capital Square analyzed year-over-year permits issued in many of our most active southeastern markets and found similar declines in multifamily communities permitted for future development.[2] The table below shows that future unit development, as forecasted by permits issued over the past year, is set to continue thinning out the multifamily housing pipeline:

YEAR-OVER-YEAR MULTIFAMILY UNIT PERMITS - SELECT SOUTHEASTERN MARKETS TARGETED BY CAPITAL SQUARE (YEAR ENDING SEPTEMBER 2024)

Market	Units Permitted	Unit Difference (YOY)	% Change (YOY)
Athens-Clarke County, GA	738	(113)	-13.3%
Atlanta-Sandy Springs-Roswell, GA	13,468	(7,050)	-34.4%
Charleston-North Charleston, SC	1,752	(1,713)	-49.4%
Charlotte-Concord-Gastonia, NC-SC	9,256	(955)	-9.4%
Durham-Chapel Hill, NC	1,444	(3,524)	-70.9%
Huntsville, AL	1,011	(754)	-42.7%
Jacksonville, FL	3,282	(5,635)	-63.2%
Louisville-Jefferson County, KY-IN	3,497	(577)	-14.2%
Miami-Fort Lauderdale-West Palm Beach, FL	11,100	(6,111)	-35.5%
Raleigh-Cary, NC	8,295	(1,325)	-13.8%
Richmond, VA	4,574	(435)	-8.7%
Tallahassee, FL	1,134	(350)	-23.6%
Virginia Beach-Chesapeake-Norfolk, VA-NC	1,317	(1,101)	-45.5%

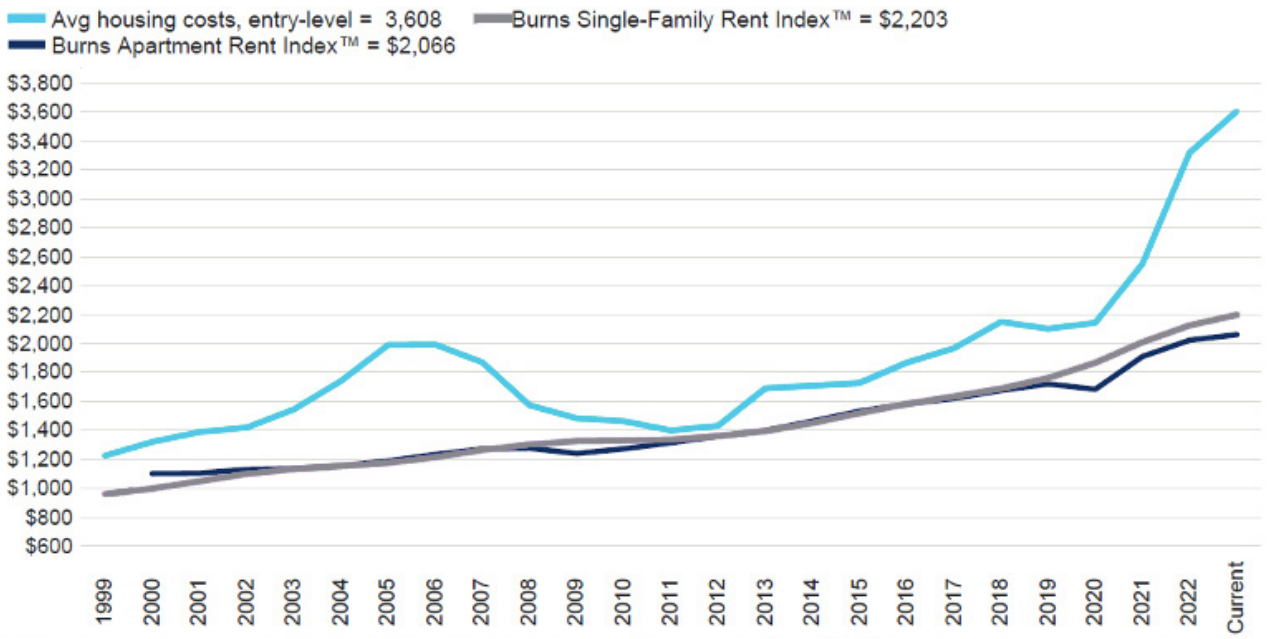
While the wave of new deliveries is already in dramatic decline and will decrease further, market conditions have also led to a large increase in the net demand for rental units. Across the country, as of Q3 2024, the quantity of new units being rented increased 108.5% as compared with this same measurement of net absorption from Q3 2023, according to CoStar data.[3] Several factors are driving this trend, including:

- Pent up demand for household formation (e.g., young adults moving out of their parents' houses, or roommates splitting up and renting their own units) has entered the market as lingering effects of the pandemic fade.[4]
- Workers called back to the office have often needed to move back into urban centers.[5]

PRICING CONSTRAINTS FORCE MANY WOULD-BE HOME BUYERS TO DWELL IN RENTALS

Additionally, home-ownership affordability remains "near its all-time worst" compared with the cost of renting, as of John Burns Real Estate Consulting's latest analysis in June 2024.[6] Specifically, the current costs for an entry-level home nationally are estimated to be $1,405 more than renting, as seen in the following table.[7] Accordingly, many would-be home buyers are opting to continue renting.

COST TO PURCHASE, ENTRY-LEVEL VS. ASKING APARTMENT RENT VS. SF RENTS
Annually Weighted Average of 82-Market Roll-Up



We base the entry-level housing costs on 80% of the market's median detached resale price, a 5% down payment, 30-year FRM, PITI payment plus mortgage insurance, and maintenance costs ranging from 0.85% to 1.25% of the home price set in 2014 and historically adjusted for inflation, factored in monthly. Our analysis assumes no tax deduction. Apartment rent data is the market's average asking rent. Annual values (excluding the current quarter) are for Q4 of each year. | Note: The Burns-Single Family Rent Index models historic and current single-family rent trends. The index tracks the median single-family home listed for rent on the open market and represents new leases, not renewals. We've enhanced our Burns Single-Family Rent Index™ with more listings data via adding a new source. Please see the "US Single-Family Rent Growth" page in our Forecasts section for more information.

Source: John Burns Research and Consulting, LLC based on aggregated data from RealPage, Inc. (Data: Dec-23, Pub: Feb-24)

EVOLVING SUPPLY AND DEMAND TRENDS WILL FURTHER EMPOWER MULTIFAMILY LANDLORDS AND INVESTORS

The current market conditions can be boiled down to supply and demand factors that are all trending to multifamily landlords' benefit. On the supply side, the delivery of new multifamily units has already begun to decline. New completions scheduled for 2025 and permit issuance evidencing future deliveries demonstrate that additions to supply will dramatically decrease over the coming years, implying strengthening operating fundamentals in 2025 and 2026.

On the demand side, newly built units across many markets are quickly finding renters due to pent up household formation and immigration, among other factors. The housing market is amplifying the trend, as historically high housing costs are an unattractive alternative to renting. In total, fewer new units hitting the market, greater rental demand quickly absorbing the current supply, and no better housing alternatives all indicate that multifamily landlords should see the opportunity to begin re-establishing pricing power soon as the market shifts dramatically in their favor.

Moreover, multifamily real estate investors will also gain the advantage in this housing market adjustment.

Sources

1. CoStar National Multifamily Report, accessed November 2024.
2. CoStar data, accessed November 2024.
3. ibid.
4. CoStar National Multifamily Report, accessed November 2024.
5. Will Parker, "America's Empty Apartments Are Finally Starting to Fill Up," The Wall Street Journal, November 5, 2024.
6. James Penner, Ken Perlman, "Dear Consultant: Can people still afford homes with high rates and increased inflation, or are they more likely to rent?" John Burns Research & Consulting, June 5, 2024.
7. John Burns Research and Consulting, LLC based on aggregated data from RealPage, Inc., February 2024.

ABOUT CAPITAL SQUARE

Capital Square is a vertically integrated national real estate firm specializing in tax-advantaged real estate investments, including Delaware statutory trusts for Section 1031 exchanges, qualified opportunity zone funds for tax deferral and exclusion and a real estate investment trust (REIT). The company is also an active developer and manager of multifamily communities. Since 2012, Capital Square has completed more than $7.9 billion in transaction volume. Capital Square's mixed-used development projects total over 2,000 apartment units with a total development cost in excess of $800 million, and Capital Square Living, the firm's property management division, now manages over 7,000 apartments across multiple states. Capital Square's related entities provide a range of services – including due diligence, acquisition, loan sourcing, property/asset management and disposition – for a growing number of high-net-worth investors, private equity firms, family offices and institutional investors. The company has been recognized by Inc. 5000 as one of the fastest growing companies in the nation for eight consecutive years. Learn more at www.CapitalSq.com.

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