LMC Insights

2Q 2021

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Inside Look

Public Market Returns

	1Q21	1 Year	3 Year
S&P 500	6.17%	56.34%	16.77%
Dow	7.76%	50.48%	11.02%
Nasdaq	2.78%	72.03%	23.32%
FTSE NAREIT[1]	8.32%	34.25%	10.64%
Barclays Agg	-3.37%	0.72%	4.66%
10-yr Treasury[2]	1.74%	0.70%	2.74%
CPI[3]	1.69	0.44	1.23

Private Market Returns

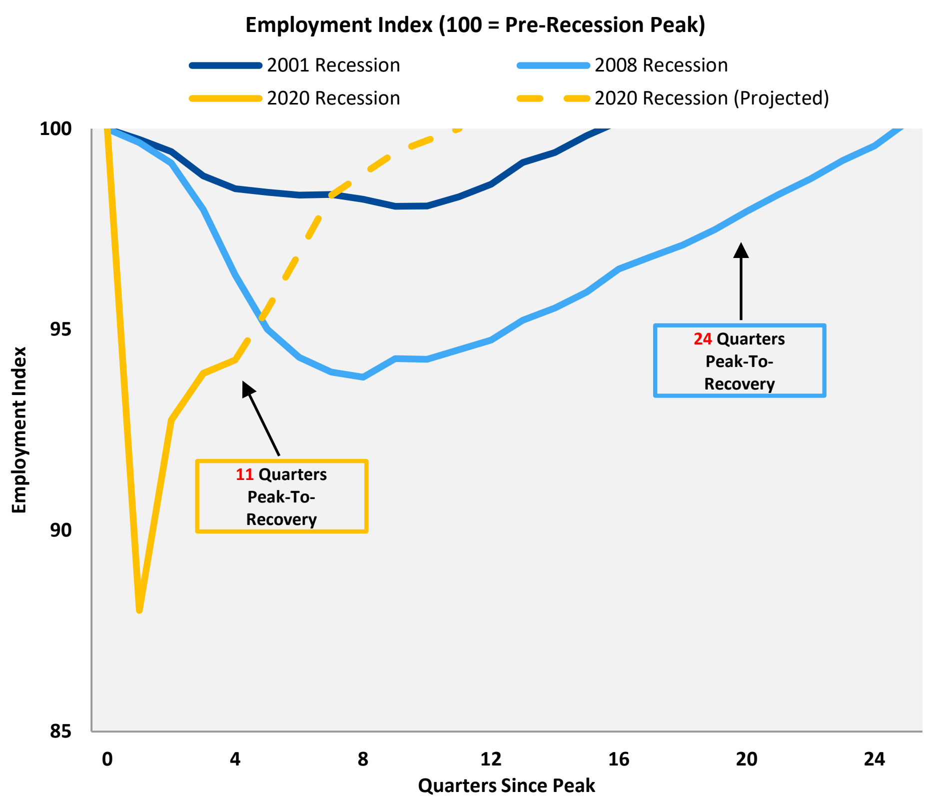
	1Q21	1 Year	3 Year
NCREIF Property Index			
Total Return	1.72%	2.61%	4.89%
Income	1.04%	4.14%	4.40%
Appreciation	0.67%	-1.48%	0.48%
Hospitality	-1.61%	-23.95%	-6.88%
Industrial	4.72%	14.11%	13.68%
Multifamily	1.69%	2.57%	4.52%
Office	0.99%	1.28%	4.69%
Retail	-0.45%	-5.96%	-1.63%

Source: NCREIF, Morningstar, FRED (St. Louis Fed)
(1) FTSE NAREIT All Equity REITs Index.
(2) Represents current yield at the end of 1Q21, 1Q20, and 1Q18, respectively.
(3) CPI expressed as a value.

Rapid U.S. economic resurgence provides glimpse into what's next for multifamily – increased demand and continued outperformance

State of the Economy

The first quarter of 2021 showed a U.S. economy gaining momentum, growing at an annualized rate of 6.4% as the virus retreated and the vaccine rollout more than doubled the Biden administration's goal of 100 million doses in 100 days. The labor market has led the way, recovering 68% of the 22 million jobs lost in the early days of the Coronavirus pandemic. In 2021 Q1, 1.5 million jobs were added, more than doubling the jobs added in the fourth quarter of 2020 as the U.S. economy received a boost from a reopening economy and significant economic stimulus. The latter has fueled projections that while the total job losses were significantly worse than during the Great Recession, the recovery is projected to be more than twice as fast.

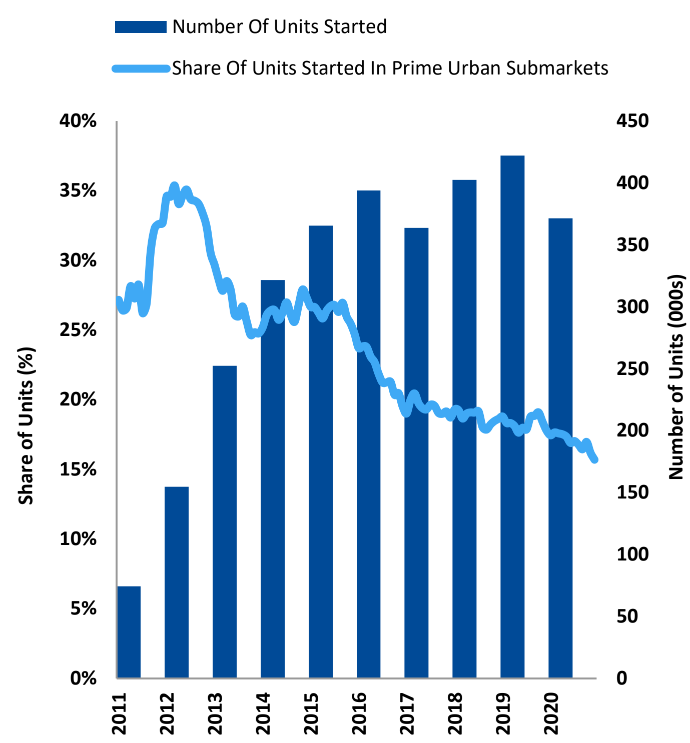


Source: CoStar Advisory Services, Bureau of Labor Statistics; Oxford Economics As of January 2021

The April 2021 jobs report added a disappointing 226,000 jobs, but it highlights some of the problems with a rapidly recovering economy colliding with massive stimulus and a still active pandemic. Hiring was not constrained by job openings, which were at their highest-level in January of 2019, but by the unwillingness of some workers to come off the sideline as a result of stimulus checks, boosted unemployment benefits, lack of childcare options and fear of the virus. Most of these are temporary concerns for growth however, as unemployment insurance expires in September and schools are expected to open fully in the Fall.

The current expectation is that inflation will be higher in the short term, as stimulus fueled demand pushed retail sales 17% higher than the pre-pandemic record and shortages have begun to take hold. Oxford economics predicts by the end of this year Core CPI will hit 3%, a full percentage point higher than the Fed target rate. Given the risk of higher inflation, the Fed has recently signaled that it is likely to move up its timeframe on when it will next raise interest rates to as soon as 2023. Despite this, their view is the factors that are pushing inflation higher are transitory and have yet to give any indication as to when it will begin cutting back on its aggressive bond-buying program.

Share of Units Started (T12) in Prime Urban Submarkets



Source: CoStar Advisory Services As of June 2021

A muted supply pipeline has also been helpful in tightening vacancy rates as total delivered multifamily units dropped below 75,000 in the first quarter, the lowest total for the past eight quarters. New starts were down significantly in the last year as well, as more speculative projects were shelved during 2020, especially in downtown areas. Slightly fewer than 18% of starts in 2020 were in prime urban submarkets, after averaging above 25% for the prior nine years.

With fundamentals improving, year-over-year rent growth hit 2% in the first quarter. Asking rents experienced a steep decline over the past 12 months, the strong first quarter exhibits an ability of the sector to re-adjust quickly across a variety of markets in a short span of time. While Sunbelt markets have posted steady rent growth for several quarters, pricey downtown markets like Boston, San Francisco and Seattle rank in the top 20 for year-to-date rent growth.

Multifamily Investment Outlook

As vaccinations for COVID-19 steadily progress and restrictions in the US continue to ease, prospects for the multifamily sector have improved immensely. An extensive stimulus bill signed into effect by President Biden in early March heralded continued support for renters across the U.S. Delayed or canceled projects have eased the glut of new units hitting the market and allowed renewed demand to compress vacancies. Nationally, the vacancy rate hit 6.4% at the end of Q1, the lowest figure since the third quarter of 2019.

Tremendous demand continuing into the first quarter indicates a wide swathe of Americans are still searching for new apartments. Roughly 139,000 units were absorbed between January and March, a record number for a first quarter and the highest since 139,580 units were absorbed in the second quarter of 2018. Demand continues to flow into slightly larger units as many tenants expect to work from home with increased regularity.

Despite this, transaction activity in the multifamily space continues to be down considerably from historic averages, in large part due to the dearth of large deals routinely made in New York and the major California markets. Los Angeles, for example, is down 40% in 2021 deal volume from recent levels, while volume in New York is down a stunning 80%. These drops in volume are partially due to owners being reluctant to part with assets for any discount. In aggregate, multifamily pricing is up 90 basis points YoY, according to CoStar's multifamily pricing index, from the relative plateaus of 2020 as appreciation has been strong both in Sunbelt markets like Phoenix, and suburban assets broadly, a testament to ability of multifamily to recover quickly from adverse market conditions.

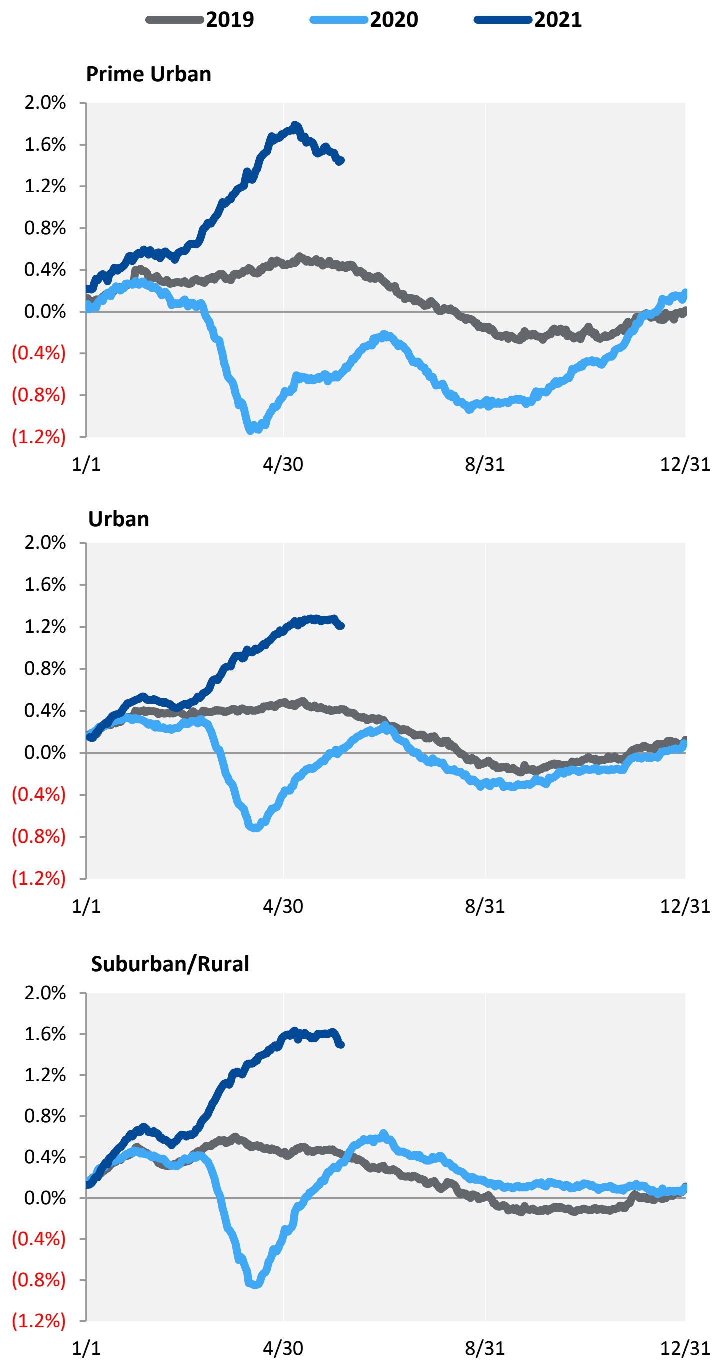
In Focus: Multifamily's Green Shoots Begin To Bloom

National multifamily conditions only offer a glimpse of the incredible resurgence of the property type in the beginning of 2021. A closer examination reveals outperformance across widely varying markets and segments, giving the distinct impression that "normal service has resumed" and understates how resilient multifamily is proving to be.

Multifamily's return to normalcy was forecast widely for the latter half of 2021 as industry analysts expected expanding vaccine distribution to gradually restore open economies and a cautious willingness on the part of tenants to find new apartments. The first quarter showed those predictions were pessimistic. Sustained demand in both urban and suburban submarkets nationally drew the vacancy rate from 6.8% at the end of 2020, to 6.4%, with suburban vacancies below 6% for the first time in more than 20 years. The extraordinary demand has allowed suburban owners to ratchet back concessions to normal levels, even while the remaining elevated concessions in downtown areas are having the desired effect of renewed renter demand.

Rent growth over the course of the first quarter was swift, increasing so rapidly that a continued pace through the remainder of 2021 would exceed 9% annualized growth. As asking rents nationally were relatively flat throughout 2020, these first quarter gains should put multifamily above pre-pandemic rent levels. When examined by geographic area, the numbers are uniformly impressive. Prime urban (downtown) rent growth spiked to nearly 1.2% by April, while suburban rents leapt ahead by 1.3%. A permanent exodus out of downtowns appears less likely, with major markets like San Francisco, Chicago, and Boston turning a corner for both demand and rent losses in prime urban submarkets.

28 Day Rent Change by Year



Source: CoStar Advisory Services   As of June 6, 2021

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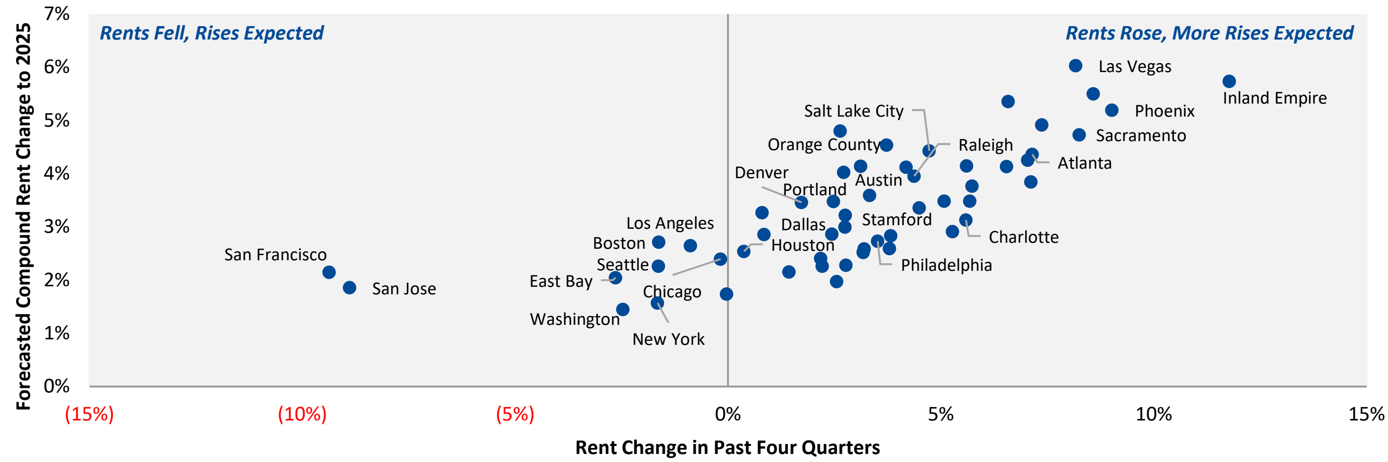
More rent gains are expected across the spectrum of the U.S., though markets in the Sunbelt and elsewhere that experienced healthy rent growth throughout the past four quarters look set to continue outperforming traditional core markets. Markets near major core locations like Sacramento (San Francisco) and the Inland Empire (LA), were strong performers as work from home drew households seeking lower cost areas, and are forecast to continue pushing rents in the near term.

The quick rebound of multifamily fortunes may not surprise investors who read our special topic a year ago (Playing Defense With Multifamily). A key takeaway was multifamily cap rates unwind the least of all property types during downturns, and that analysis has proven true despite the "black swan" occurrence of a global pandemic.

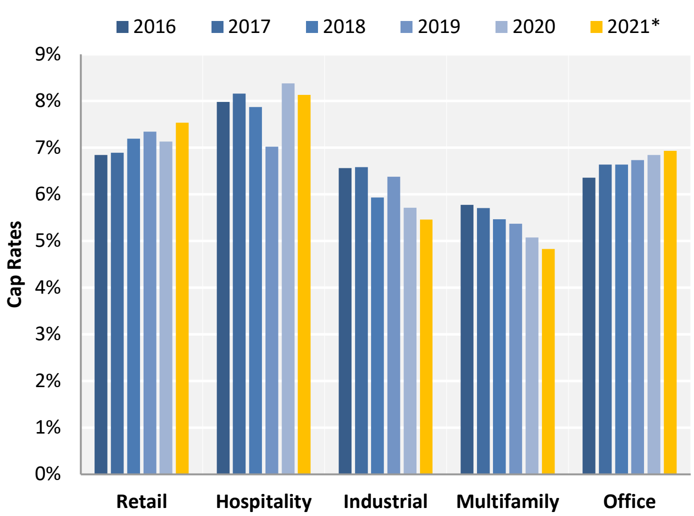
Multifamily cap rates continued to compress during 2020 despite lower volume, with the first quarter continuing this trend. Weighted average transactional cap rates dropped to 4.8% nationally and $28.2 billion in sales volume is only slightly off the pace of Q1 2020 ($34.6 billion) and Q1 2019 ($31.6 billion). Nearly all other property types saw cap rate expansion, while first quarter multifamily cap rates are 90 basis points lower than industrial cap rates, the second-lowest.

Though multifamily remains off the pace of the peaks reached prior to the pandemic, a brightening economic environment and rapidly re-emerging renter demand is placing the lows of 2020 firmly in the rearview and the potential of 2021 and beyond more clearly in focus.

Forecasted Rent Change to 2025



Weighted Avg. Transaction Cap Rates



Source (Rent Change Data): CoStar Advisory Services — As of 1Q 2021
Source (Cap Rate Data): CoStar Advisory Services — As of May 2021
Note (Cap Rate Data): Exclusive to 54 of the largest U.S. Markets; (*) YTD data

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(1) AUM as of 12/31/2020

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