2022 Q4

Mid-Atlantic Apartment

OUTLOOK

A Market Report for Multifamily Investors & Executives

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Washington Metro Area Fourth Quarter 2022 Trends

Class A absorption moderates, with 8,704 Class A units absorbed in the 12-month period ending December 2022. Absorption including Class B product totaled 7,924 units.

Metro area Class A rents increased by 3.8% over the year and are now 6.5% higher than they were prior to the pandemic. **Class B rents increased** 6.3% and are now 9.4% higher than they were prior to the pandemic.

The **stabilized vacancy rate for all classes of investment grade apartments increased by 70 basis points** over the past year and now stands at 3.2%; **Class A vacancy experienced a 110 basis-point increase to 4.5%.**

The **36-month development pipeline is up** from a year ago to 44,281 units, due to increases in all three substates.

11,644 units started construction over the 12-month period ending December 2022. During the fourth quarter, 1,431 units started construction.

Meanwhile, **12,111 units delivered in a 12-month span ending December 2022** and another 16,197 units are scheduled to deliver over the next year.

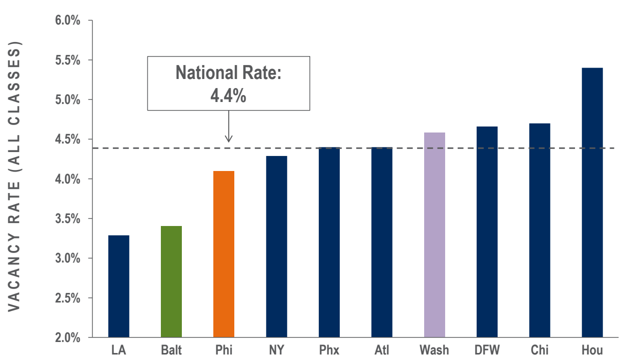
WASHINGTON METRO AREA CLASS A MARKET

VACANCY CREEPS UPWARD AS RENTS COOL OFF

The normalization of the Class A apartment market continues in the fourth quarter, as absorption and rent growth moderates, while vacancy creeps upward. Annual absorption is down nearly 47% from a year ago but is now running close to the long-term average. Rent growth is now in the single digits, compared to the red-hot growth experienced in 2021. Some rebounds have cooled off as now 7 of the 18 high rise submarkets are back down below pre-pandemic levels. In total, rents are 106.5% of March 2020 averages as other submarkets continue to gain past their pre-pandemic levels. A year ago, the stabilized vacancy rate for Class A apartments was just over 3%, which was unusually low for the Washington metro area. Vacancy has now gone up in all substates, arriving at 4.5% this year. Meanwhile, construction of new product is all but stagnant at only 1,431 units breaking ground during the fourth quarter, and none in the District. As interest rates continue to rise, we expect demand for apartments will continue to remain strong in the metro area as home ownership becomes less attainable for more people in the market.

APARTMENT VACANCY RATES

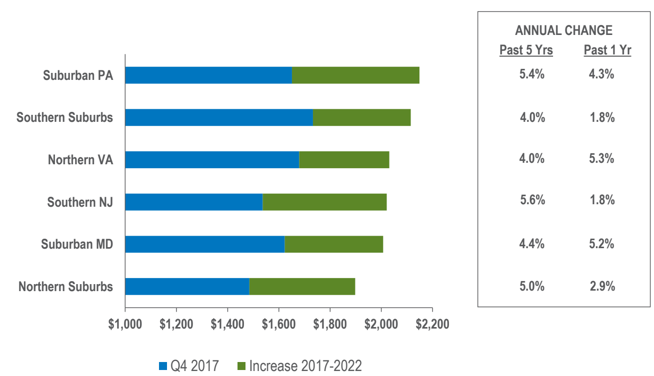
Major Apartment Markets | Q3 2022



Source: Reis, Delta Associates; December 2022.

ANNUAL AVERAGE EFFECTIVE RENT GROWTH

Mid-Atlantic Class A Low-Rise Apartments | December 2022



Source: Delta Associates, December 2022.

SUPPLY/DEMAND AND RENT OUTLOOK

While the 36-month pipeline remains elevated across the metro area, absorption continues to moderate, resulting in an increase in vacancy. When the prior year's absorption is compared to the development pipeline at the submarket level, 11 low-rise submarkets in Northern Virginia and Suburban Maryland have less than four years of supply (or one year's worth of product overhang). Ten of these submarkets have less than two years of supply and could be considered supply constrained. There are five high-rise submarkets with four years or less of supply and one with two years or less. This suggests development opportunities exist in submarkets throughout the metro area post-pandemic.

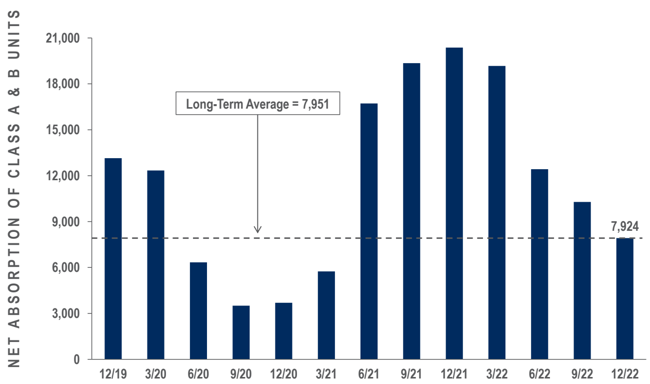
Another way of looking at the development pipeline at the submarket level is new supply relative to existing inventory. In 14 low-rise submarkets, the projected oncoming supply over the next 36 months represents less than 10% of existing inventory. Among high-rise product, no submarket has oncoming supply representing 10% or less of existing inventory. In submarkets where new pipeline represents a relatively smaller increase in inventory, negative impacts on vacancy and rent growth will be less than in other locations.

Given projected absorption and the delivery schedule of projects currently under construction, we expect the region-wide vacancy rate for stabilized Class A apartment properties will increase by 40 basis points in three years compared to today – resulting in a metro-wide rate of 4.9%; we expect vacancy to fluctuate in the interim.

Effective rent recovery to March 2020 levels has begun to stall now that rent rebounds have peaked and the economy worsens. Two of the District's submarkets were just below the March 2020 benchmark last quarter and have since increased to four submarkets this quarter. Although Class A rent growth slowed down a bit, it is still just above the long-term average as of December 2022. We expect rent growth to continue moderating closer to the long-term average near the tail end of 2022 and beyond. Rent growth will average between 3.2% and 4.2% in 2023 – 2025, after an increase of about 6.0% in 2022.

ANNUAL NET APARTMENT ABSORPTION

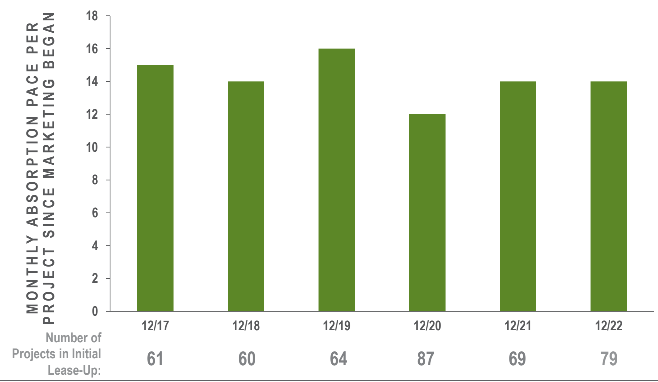
Class A & B Units | Washington Metro



Source: Delta Associates, December 2022.

ABSORPTION PACE PER PROJECT PER MONTH

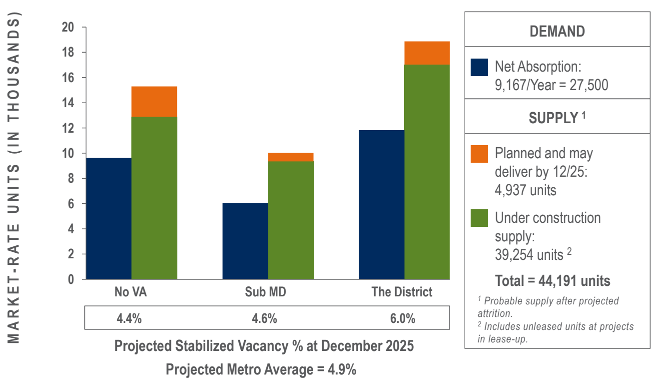
For Projects in Initial Lease-Up | Washington Metro



Source: Delta Associates, December 2022.

DEMAND AND SUPPLY PROJECTIONS

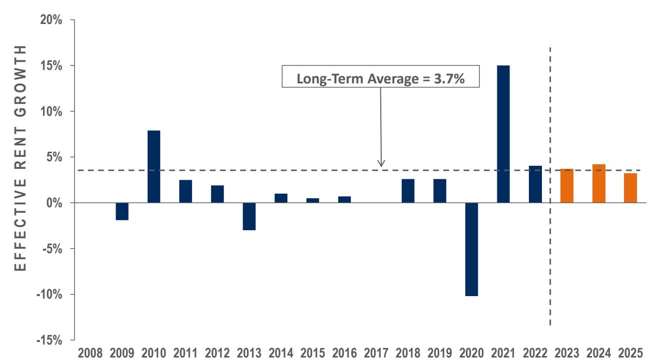
Washington Metro Class A Apartment Market
December 2022 – December 2025



Source: Delta Associates, December 2022.

ANNUAL CLASS A APARTMENT RENT GROWTH

Washington Metro | 2008 - 2025



Source: Delta Associates, December 2022.

DEMAND NORMALIZING

Class A apartment absorption in the Washington area was 8,704 units over the year ending December 2022. About 43% of the units absorbed over the past year were in the District, which recorded 3,768 units. Absorption was down significantly in all three substate areas, with the District recording the highest demand of its counterparts, although a decrease of 53% over the year. While absorption is down significantly from the prior year, demand is normalizing after setting a record in 2021.

We project annual demand averaging about 9,200 Class A units over the next three years with stronger absorption over the next year as the apartment market continues to recover, then moderating some.

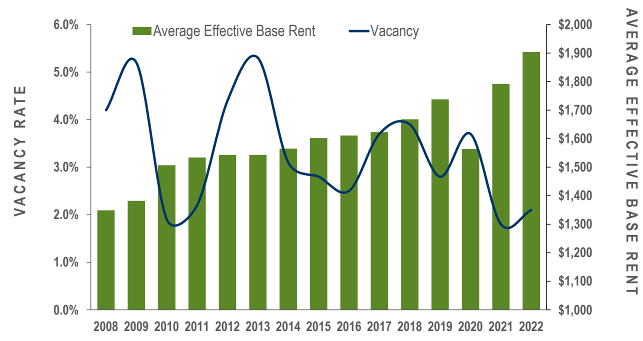
WASHINGTON METRO AREA CLASS B MARKET

RENT GROWTH REMAINS ABOVE-AVERAGE, VACANCY STARTS TO RISE

The Washington metro area Class B multifamily market has continued to stabilize in recent months as vacancy remains at low rates and rents growth stays elevated. Annual rent growth was positive in all but three submarkets in the Washington metro area with all sub-state areas posting annual increases above 5%. Metro-wide, Class B rents are up 6.3% in 2022. Class B rents on average have fully recovered from the effects of the pandemic as they are now 9.4% higher than they were at the beginning of the crisis back in March 2020; with Suburban Maryland rents up 12.9%, Northern Virginia rents up 8.0%, and District rents up 4.2%. Meanwhile, vacancy increased in two sub-state areas from a year prior: in Northern Virginia by 70 basis points and in the District by 20 basis points. Suburban Maryland continued to see a decline in vacancy with a 10 basis-point decrease year-over-year. All three sub-state vacancy rates remain well below their respective historical averages.

EFFECTIVE RENT AND VACANCY RATE

Class B Apartments | Washington Metro Area | 4th Quarter 2008 – 2022



Source: Delta Associates, December 2022.

- Suburban Maryland up 5.1%
- Northern Virginia up 6.5%
- District up 10.8%
- Metro-wide low-rise up 5.9%
- Metro-wide mid and high-rise up 6.9%

AN OVERVIEW OF THE CLASS B APARTMENT MARKET AT FOURTH QUARTER 2022 BY SUB-STATE AREA:

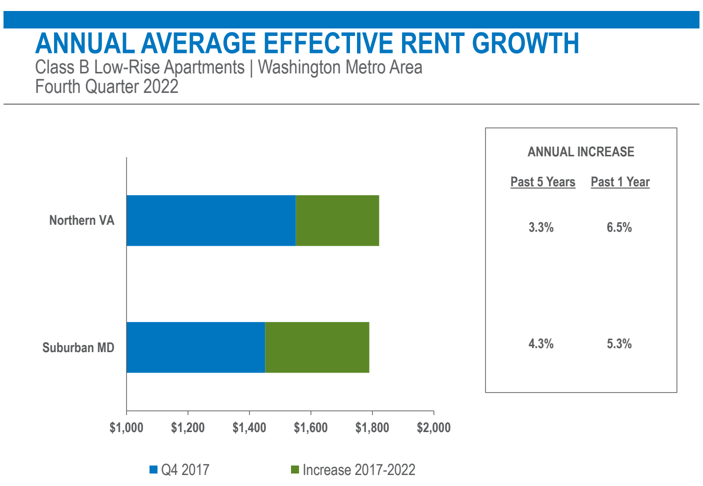
The Trend Since Fourth Quarter 2021

NORTHERN VIRGINIA	SUBURBAN MARYLAND	THE DISTRICT
FOR RENT — EFFECTIVE RENTS ▲ 6.5%	FOR RENT — EFFECTIVE RENTS ▲ 5.1%	FOR RENT — EFFECTIVE RENTS ▲ 10.8%

OUTLOOK FOR CLASS B APARTMENTS

Class B year-over-year rent growth (6.3%) is even higher than Class A growth (4.0%). While vacancy in Class B buildings (2.1%) increased 30 basis points from a year ago, it is still lower than Class A vacancy (4.4%). Several contributing factors will continue to impact vacancy and rents going forward:

1. **The Washington metro area job market has improved significantly since the beginning of the pandemic, providing opportunity for Class B apartment market demand**. Metro-wide job growth supported a sturdy Class B apartment market prior to the pandemic. In the Spring of 2020, many industries saw devastating job losses, but rebounded a year later as vaccinations were widely administered and confidence in the economy returned, including in sectors which support demand for Class B apartments. The greatest share of jobs in the region remains in the Professional/Business Services sector. Entry level positions in this sector do not pay enough to afford Class A apartment rents, making newly employed professionals search for Class B options with rents within their budgets. Many Professional/Business Services jobs can be done remotely, which has helped to shelter employment fluctuations in the sector during the pandemic.
2. **Interest rates hikes aim to cool inflation**. The Federal Reserve lowered interest rates in the first quarter of 2020 to help stimulate the economy as the COVID-19 pandemic influenced employment and consumer confidence over the course of 2020 and 2021. As high inflation and lower consumer confidence threaten another economic recession, the Fed has been swiftly hiking interest rates. In 2022, seven rate hikes have been implemented so far, including four large hikes of 0.75% over the summer and early fall and a 0.5% increase in December. These rate hikes have pushed the average 30-year fixed mortgage rate above 6% for the first time in over a decade, which will dampen demand for homebuying and result in a larger pool of renters.
3. **Prices keep homeownership out of reach for first-time homebuyers**. Metro-wide housing prices remain high, with the average sales price reaching record highs during the pandemic. Washington's home ownership rate increased by 3.2% in 2020 to 67.9% and exceeded the national average of 66.6% as many residents opted to become homebuyers further from the core of the region in search of more spacious living. In 2021, Washington's average decreased marginally to the national level. Despite this pandemic uptick in buying, many residents in the region are renters by choice, so even those who may be able to afford to buy have a preference to rent instead.
4. **Renovation activity shows a yearly improvement**. About 12,000 Class B units are under renovation in the metro area, up from 8,687 in December 2021. While this figure is more than last year's total it is still lower than the 14,500 units the Class B market averaged in the year leading up to the pandemic. Several projects were undergoing renovations before the pandemic temporarily halted plans until the full economic effects of COVID-19 came to light. We expect renovation activity to continue to rebound in 2023 but it may be a while before we see it back at pre-pandemic levels. Nevertheless, properties that do move forward with these improvements are achieving premium rents, which we continually expect to see in those still undergoing renovations.



Source: Delta Associates, December 2022.

ROWAN
2022 BEST LEASE-UP PACE FOR A DISTRICT OF COLUMBIA APARTMENT COMMUNITY, WASHINGTON, DC

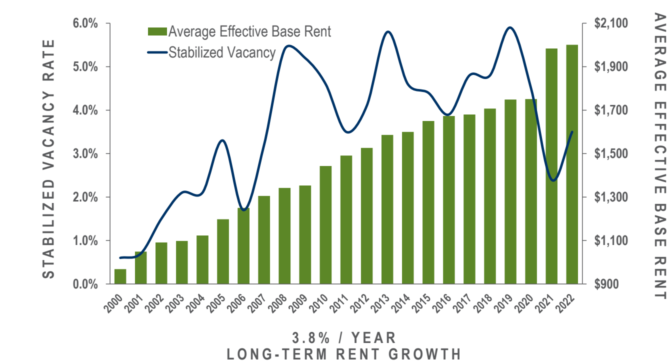
BALTIMORE METRO AREA CLASS A MARKET

HEAVY DECREASE IN ABSORPTION AS FEW UNITS DELIVER

Absorption dropped across the Baltimore metro area significantly by 96%. A year ago, annual absorption was quite strong with 3,051 units compared to just 137 units over the past 12 months. Absorption was abnormally high in 2021 due to the effects of the pandemic, but the rapid drop in absorption this year was caused by a lack of new product and an increase in vacancy. There are only 472 units that came on the market over the year – all in the Southern Suburbs. Meanwhile, annual rent growth is low at 0.8% across the metro area.

EFFECTIVE RENT AND VACANCY RATE

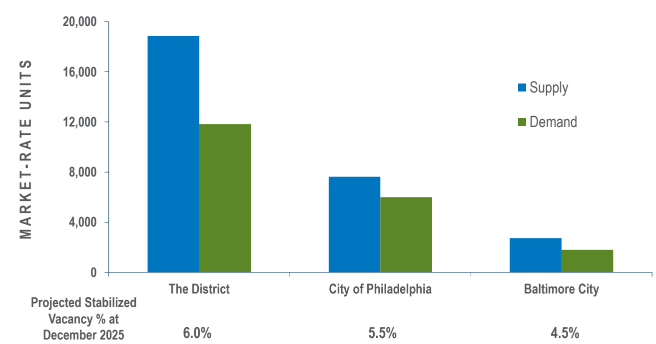
Class A Apartments | Baltimore Metro



Source: Delta Associates, December 2022.

SUPPLY/DEMAND RELATIONSHIP

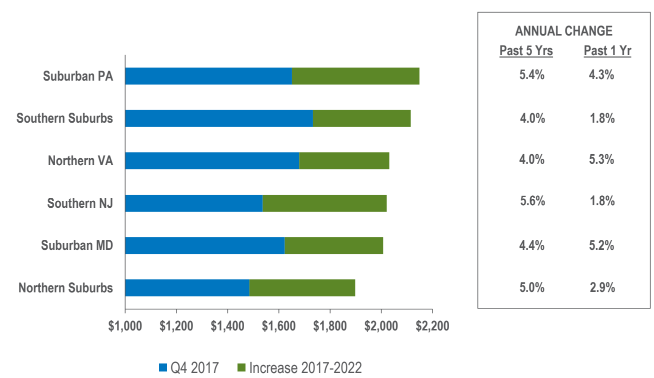
Mid-Atlantic Central City Class A Apartment Markets
Next 36 Months: Period Ending December 2025



Source: Delta Associates, December 2022.

ANNUAL AVERAGE EFFECTIVE RENT GROWTH

Mid-Atlantic Class A Low-Rise Apartments | December 2022

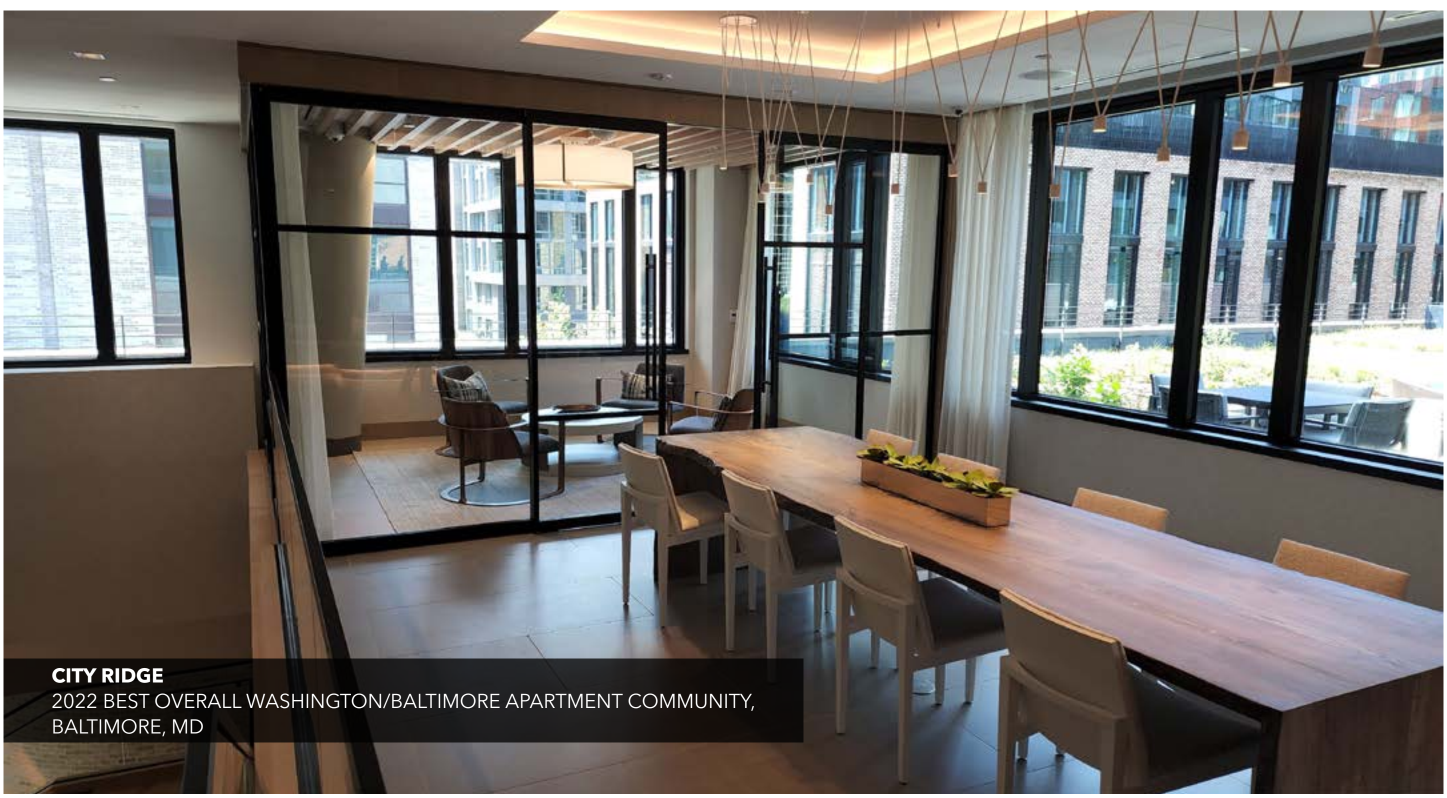


Source: Delta Associates, December 2022.

FOURTH QUARTER 2022 HIGHLIGHTS

- **Stabilized vacancy** in the Baltimore metro area increased 110 basis points from 2.3% a year ago to 3.5%. The vacancy rate in the suburbs is up by 130 basis points from 1.9% a year ago to 3.1%.
- **Average effective rents** in the metro area are $2,001 ($2.10 per SF). Rents are up over the year by 0.8% metro-wide. Rent growth was strongest in the Northern Suburbs – up by 2.9%, followed by Southern Suburbs with a 1.8% increase. Rent growth in Baltimore City was down 2.5% over the year ending December 2022.
- **Absorption** over the year was just 137 units, which was 96% lower than a year ago. This significant drop in absorption is due to the lack of deliveries over the year in the market.
- **Per project lease-up pace** for the four actively marketing projects in the Baltimore metro area currently averages 14 units per month, equivalent to the same period last year.
- **Deliveries** metro-wide stands at 472 units. The number of deliveries in the 12-month period ending December 2022 compares to 982 units over the prior year.
- **The supply pipeline** metro-wide experienced a 24% increase over the year. There are 5,537 unleased units under construction or planned for delivery in the next 36 months in the metro area after attrition. In Baltimore City, the 36-month development pipeline is up by 17%.
- **Apartment building sales** in 2021 included four transactions in low-rise buildings valued at $301.4 million ($298,462 per unit) and seven transactions in mid-/high-rise buildings valued at $613.15 million ($276,692 per unit). As of December 2022, there are four low-rise buildings valued at $238.1 million ($322,260 per unit) that closed and three mid-/high-rise buildings valued at $223.4 million ($266,250 per unit).

Of the 10 submarkets we track in the Baltimore metro area, three have less than two years of apartment supply based on absorption over the past 12 months. In addition, five submarkets will add less than 10% of existing inventory over the next 36 months. Baltimore's supply/demand relationship indicates that vacancy rates will increase 50 basis points to 4.0% by the fourth quarter of 2025; however, we expect vacancy to fluctuate during this three-year period. Rents are expected to grow above the long-term average during this three-year period.



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