

2023 Q2

Mid-Atlantic Apartment

OUTLOOK

A Market Report for Multifamily Investors & Executives



Washington Metro Area Second Quarter 2023 Trends



Class A absorption is near the long-term average, with 7,943 Class A units absorbed in the 12 months ending June 2023. Absorption including Class B product totaled 7,883 units.



Metro area Class A rents increased by 2.9% over the 12-month period ending June. For Class A and Class B combined, metro area rents increased by 4.2%.



The stabilized vacancy rate for all classes of investment grade apartments increased by 60 basis points over the past year and now stands at 2.9%; Class A vacancy experienced a 110 basis-point increase to 4.3%.



The 36-month development pipeline is up from a year ago to 44,584 units, due to increases in all substate areas, especially Suburban Maryland.



15,112 units started construction over the 12-month period ending June 2023. During the second quarter, 2,712 units started construction.



Meanwhile, 12,252 units delivered in a 12-month span ending June 2023 with more than half of the total in the District and another 17,721 units are scheduled to deliver over the next year.

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Published by:



www.DeltaAssociates.com

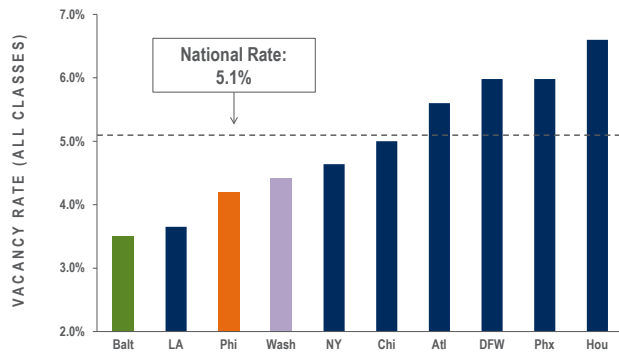
WASHINGTON METRO AREA CLASS A MARKET

SLOWER RENT GROWTH AS VACANCY CREEPS UPWARD

Annual rent growth in the Washington metro area Class A apartment market is trending below the long-term average in the second quarter of 2023, which is the result of a highly competitive environment as a record number of new projects are now available. Meanwhile, vacancy is up across the metro in all substate areas. Net absorption trailed deliveries throughout the region over the past year. The largest gap between net absorption and deliveries exists in the District where a wave of new deliveries has outpaced absorption. We expect competitive market conditions to persist as deliveries are expected to rise significantly in the suburbs over the next two years, similar to the heightened level of deliveries in the District over the past 12 months. Higher construction and financing costs have caused a slowdown in construction starts over the past year although a couple larger-scale projects started in the District during the second quarter, resulting in an increase metro wide in starts compared to the first quarter.

APARTMENT VACANCY RATES

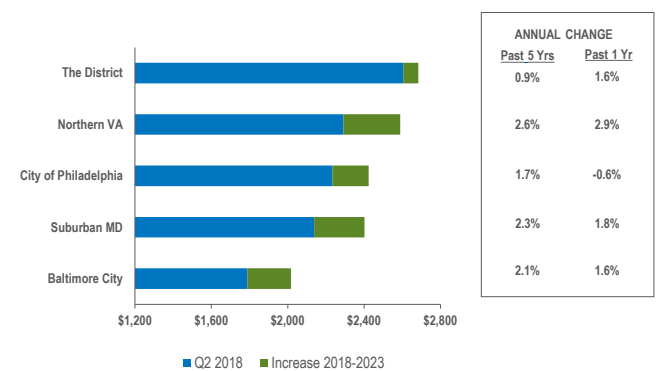
Major Apartment Markets | Q1 2023



Source: Reis, Delta Associates; June 2023.

ANNUAL AVERAGE EFFECTIVE RENT GROWTH

Mid-Atlantic Class A Mid- and High-Rise Apartments | June 2023



Source: Delta Associates; June 2023.

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, 15 low-rise submarkets in Northern Virginia and Suburban Maryland have less than four years of supply (or one year's worth of product overhang). Thirteen of these submarkets have less than two years of supply and could be considered supply constrained. There are seven high-rise submarkets with four years or less of supply and one with two years or less (Northeast). This suggests development opportunities exist in submarkets throughout the metro area post-pandemic.

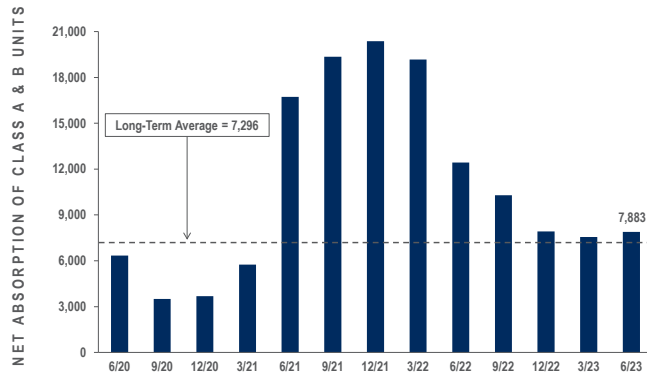
Another way of looking at the development pipeline at the submarket level is new supply relative to existing inventory. In 14 low-rise submarkets, the projected oncoming supply over the next 36 months represents less than 10% of existing inventory.

Among high-rise product, one submarket has oncoming supply representing 10% or less of existing inventory (Silver Spring). 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 80 basis points in three years compared to today - resulting in a metro-wide rate of 5.1%; we expect vacancy to fluctuate in the interim. We expect rent growth to be mostly below the long-term average over the next three years. Rent growth will average between 2.5% and 4.5% in 2023 - 2026.

ANNUAL NET APARTMENT ABSORPTION

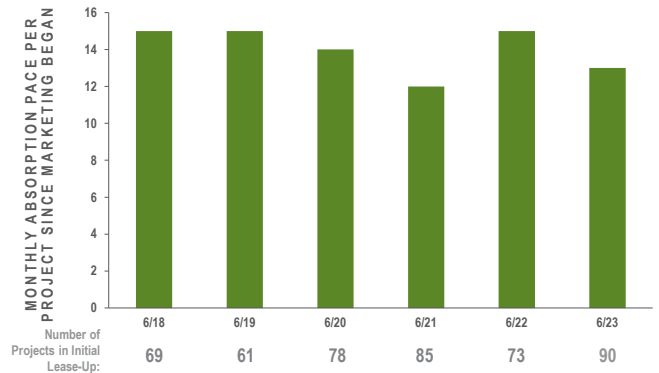
Class A & B Units | Washington Metro



Source: Delta Associates, June 2023.

ABSORPTION PACE PER PROJECT PER MONTH

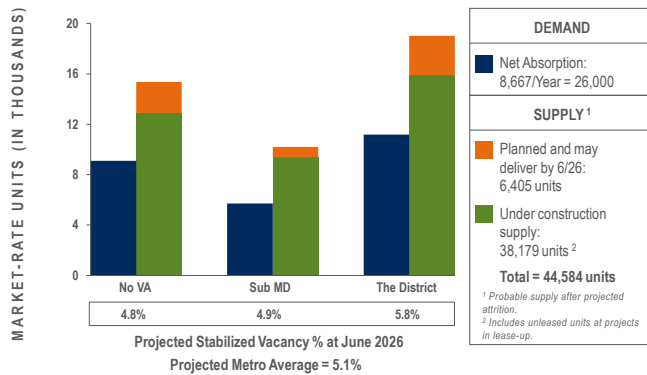
For Projects in Initial Lease-Up | Washington Metro



Source: Delta Associates, June 2023.

DEMAND AND SUPPLY PROJECTIONS

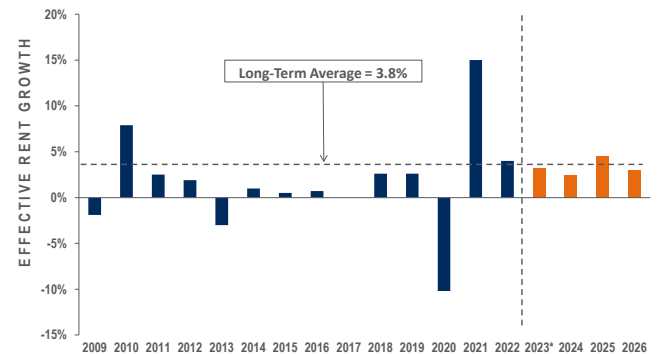
Washington Metro Class A Apartment Market
June 2023 – June 2026



Source: Delta Associates, June 2023.

ANNUAL CLASS A APARTMENT RENT GROWTH

Washington Metro | 2009 - 2026



Source: Delta Associates, June 2023.

*Annual rent increase of 2.9% as of Q2 2023.

DEMAND NORMALIZING METRO-WIDE, BUT ABNORMALLY LOW IN NORTHERN VIRGINIA

Class A apartment absorption in the Washington area is 7,833 units over the year ending June 2023, which is near the long-term average. About 51% of the units absorbed over the past year were in the District, which recorded 3,985 units. Absorption is down significantly in Northern Virginia, to the lowest level in more than a decade. This is due primarily to lackluster performance along the Rosslyn/Ballston corridor, which is one of the largest submarkets in Northern Virginia and has experienced a rise in vacancy in recent months despite limited new competition.

We project annual demand averaging about 8,650 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 in the following two years.

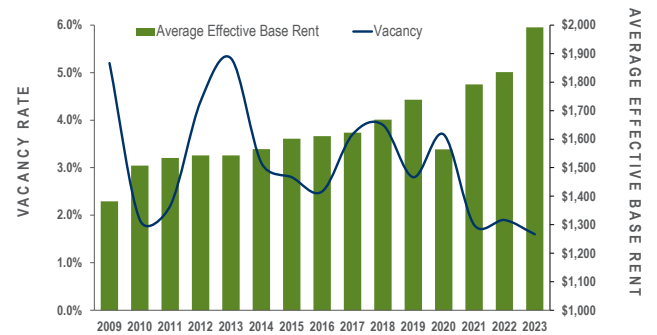
WASHINGTON METRO AREA CLASS B MARKET

STEADY VACANCY RATES AND ROBUST RENT GROWTH BOLSTER THE CLASS B MARKET

The Washington metro area’s Class B multifamily market is on a positive trajectory with vacancy rates showing stability and robust rent growth. Rent growth in the region was strong at 5.2% over the 12-month period ending June 2023. In Northern Virginia, the vacancy rate increased slightly to 1.5% during the same period, but remained very low. Suburban Maryland has also maintained its low vacancy rate with no change recorded since June 2022. Rent growth in Suburban Maryland over the year was 4.9%. Meanwhile, in the District, vacancy slightly decreased to 1.8%. The District had the strongest rent growth at 7.7% year-over-year; however, rents have yet to recover to pre-pandemic levels in two submarkets. Looking at the Washington metro area as a whole, rent growth outpaced the five-year average and vacancy remained low, exemplifying the Class B multifamily market’s resilient recovery post-pandemic and the flight to affordability given the current state of inflation and economic uncertainty.

EFFECTIVE RENT AND VACANCY RATE

Class B Apartments | Washington Metro Area | 4th Quarter 2009 – 2nd Quarter 2023



Source: Delta Associates, June 2023.

- > Suburban Maryland up 4.9%
- > Northern Virginia up 5.2%
- > District up 7.7%
- > Metro-wide low-rise up 5.2%
- > Metro-wide mid and high-rise up 5.3%

AN OVERVIEW OF THE CLASS B APARTMENT MARKET AT SECOND QUARTER 2023 BY SUB-STATE AREA:

The Trend Since Second Quarter 2022

NORTHERN VIRGINIA



EFFECTIVE RENTS
5.2%

SUBURBAN MARYLAND



EFFECTIVE RENTS
4.9%

THE DISTRICT



EFFECTIVE RENTS
7.7%

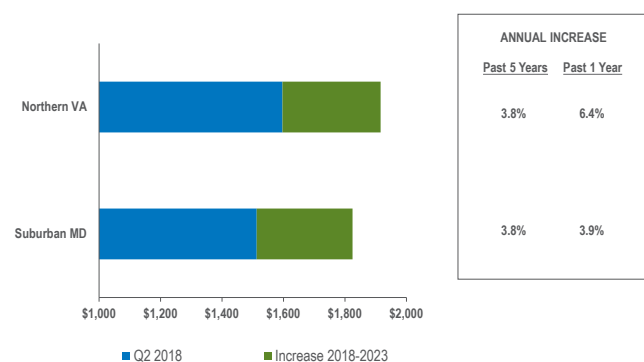
OUTLOOK FOR CLASS B APARTMENTS

Class B year-over-year rent growth (5.2%) continues to outpace Class A growth (2.9%). Vacancy in Class B product (1.6%) remained unchanged from a year ago but is still much lower than Class A vacancy (4.4%). Several contributing factors will continue to impact vacancy and rents going forward:

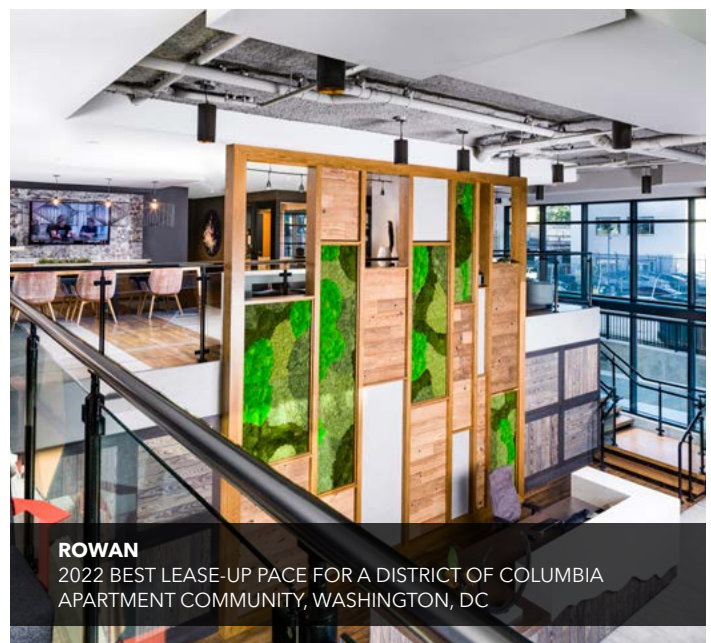
- 1. Revival of the Washington metro area’s Class B apartment market in the post-pandemic era.** Metro-wide job growth supported a sturdy Class B apartment market prior to the pandemic. In the Spring of 2020, many industries saw devastating job losses, but rebounded a year later as vaccinations were 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 plateau at decade high as Federal Reserve hits pause.** After over a year of consecutive interest rate increases, the U.S. Federal Reserve officials have announced a temporary halt, leaving rates at 5% to 5.25% in June. The Fed embarked on a series of hikes beginning in March 2022, when rates were at zero, raising them 10 consecutive times, a level of aggression not witnessed since the 1980s. The hikes have varied from 0.75% during periods of peak inflation to more modest increments of 0.25% recently. The current rate is the highest since 2007, before the financial crisis. This comes as a significant shift from the Fed’s approach in the first quarter of 2020 when it lowered interest rates to stimulate the economy amidst the COVID-19 pandemic’s impact on employment and consumer confidence. The recent hikes, initiated in response to high inflation and deteriorating consumer confidence threatening another recession, have resulted in the average 30-year fixed mortgage rate surging above 7% for the first time in over a decade, consequently dampening the demand for home buying and potentially leading to a larger pool of renters.
- 3. Prices keep homeownership out of reach for first-time homebuyers.** In the Washington metropolitan area, the cost of housing continues to deter prospective homeowners, particularly those looking to invest in property for the first time. The average price of houses across major cities hit an all-time high amidst the pandemic but growth has cooled recently. Production over several years has not caught up with demand, which has also contributed to the high cost of housing in the region. In addition to these challenges for first-time homebuyers, there remains a significant segment of the population that prefers to rent, opting for the convenience and versatility that renting offers over buying a property.
- 4. Renovation activity continues to increase year over year.** Nearly 14,000 Class B units are under renovation in the metro area, up from about 10,000 units in June 2022. While this figure is more than last year’s total it is still slightly 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 and is now approaching pre-pandemic activity. Properties that do move forward with these improvements are achieving premium rents, which we continually expect to see in those still undergoing renovations.

ANNUAL AVERAGE EFFECTIVE RENT GROWTH

Class B Low-Rise Apartments | Washington Metro Area
Second Quarter 2023



Source: Delta Associates, June 2023.



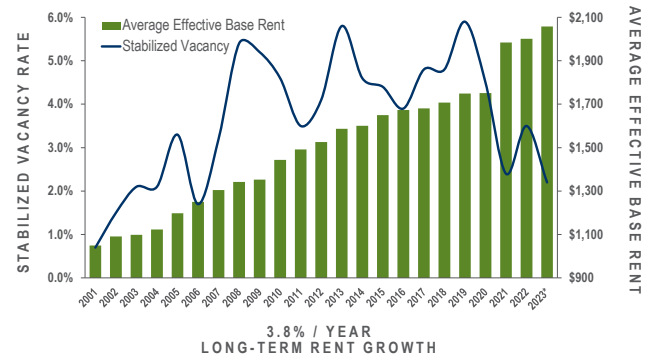
BALTIMORE METRO AREA CLASS A MARKET

ABSORPTION IMPROVING BUT STILL BELOW AVERAGE

Absorption dropped across the Baltimore metro area over the year by more than 50%. In the prior 12-month period, annual absorption was quite strong with 1,548 units compared to 702 units over the past 12 months. Over the last 12 months, 1,684 units delivered, a large increase over the 275 that were delivered in the year ending June 2022. Meanwhile, annual rent growth is below average at 1.7% across the metro area.

EFFECTIVE RENT AND VACANCY RATE

Class A Apartments | Baltimore Metro

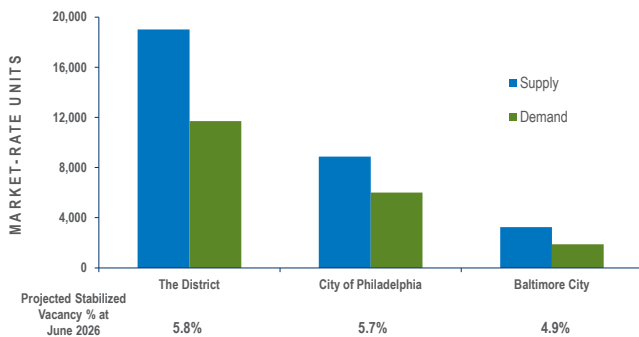


Source: Delta Associates, June 2023.

*As of June 2023.

SUPPLY/DEMAND RELATIONSHIP

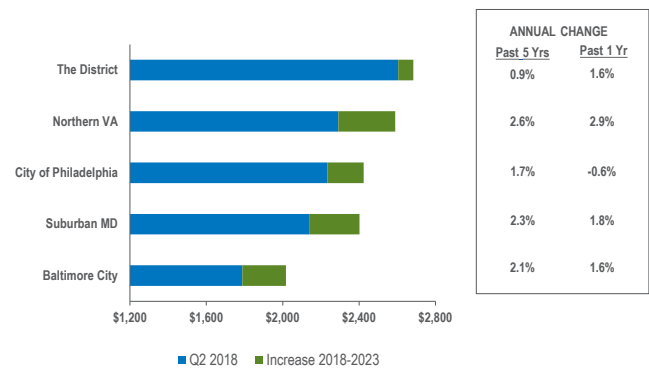
Mid-Atlantic Central City Class A Apartment Markets
Next 36 Months: Period Ending June 2026



Source: Delta Associates, June 2023.

ANNUAL AVERAGE EFFECTIVE RENT GROWTH

Mid-Atlantic Class A Mid- and High-Rise Apartments | June 2023



Source: Delta Associates, June 2023.

SECOND QUARTER 2023 HIGHLIGHTS

- > **Stabilized vacancy** in the Baltimore metro area increased 50 basis points from 1.7% a year ago to 2.2%. The vacancy rate in the suburbs is up by 50 basis points from 1.6% a year ago to 2.1%.
- > **Average effective rents** in the metro area are \$2,058 (\$2.17 per SF). Rents are up over the year by 1.7% metro-wide. Rent growth was strongest in the Southern Suburbs - up by 3.1%, followed by Baltimore City with a 1.7% increase. The Northern Suburbs had negative rent growth of -0.5% over the year ending in June 2023.
- > **Absorption** over the year was 702 units, which was over 50% lower than a year ago. This is an improvement over the first quarter, when annual absorption was even lower.
- > **Deliveries** metro-wide stands at 1,684 units over the past 12 months. The number of deliveries in the 12-month period ending June 2023 compares to 275 units in the prior year.
- > **The supply pipeline** metro-wide experienced a 35% increase over the year. There are 5,968 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 39%.
- > **Per project lease-up pace** for the nine actively marketing projects in the Baltimore metro area currently averages 15 units per month, down one unit from the same period last year.
- > **Apartment building sales** in 2022 included four transactions in low-rise buildings valued at \$238.2 million (\$322,260 per unit) and three transactions in mid-/high-rise buildings valued at \$223.2 million (\$266,250 per unit). As of June 2023, there are no recent transactions to report

Of the 10 submarkets we track in the Baltimore metro area, only one has less than four years of apartment supply (East & NE Baltimore County) based on absorption over the past 12 months (less than two years of apartment supply). In addition, two 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 180 basis points to 4.0% by the second quarter of 2026; however, we expect vacancy to fluctuate during this three-year period. Rents are expected to grow below the long-term average during this three-year period.



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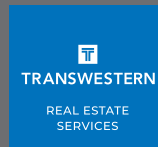
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