2023 Q4

Mid-Atlantic Apartment

OUTLOOK

A Market Report for Multifamily Investors & Executives

Washington Metro Area Fourth Quarter 2023 Trends

Class A absorption is above the long-term average, with 11,206 Class A units absorbed in 2023. Absorption including Class B product totaled 10,138 units.

Metro area Class A rents increased by 3.5% over the past year. For Class A and Class B combined, metro area rents increased by 3.8%.

The **stabilized vacancy rate for all classes of investment grade apartments increased by 40 basis points** over the year and now stands at 3.6%; **Class A vacancy experienced a 30 basis-point increase to 4.8%.**

The **36-month development pipeline is down** from a year ago to 38,818 units, due to decreases in all three substate areas, most significantly in the District.

Just 5,439 units started construction in 2023. During the fourth quarter, only 527 units started construction.

Meanwhile, **10,828 units delivered in 2023.** The District, which accounted for 44% of the deliveries, led the substate areas. Another 17,606 units are scheduled to deliver in 2024.

Prepared by:

TRANSWESTERN REAL ESTATE SERVICES

www.twMidAtlanticMultifamily.com

Published by:

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www.DeltaAssociates.com

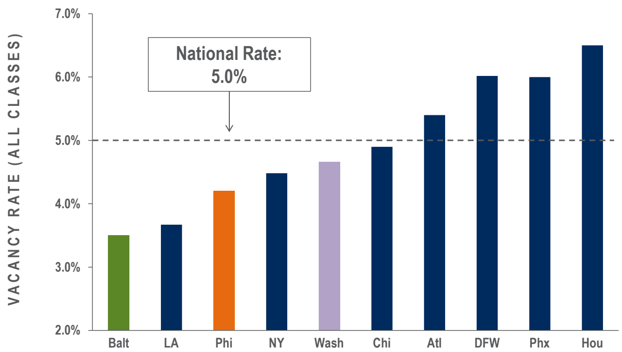
WASHINGTON METRO AREA CLASS A MARKET

MODERATE RENT GROWTH AS ABSOPRTION CONTINUES UPWARD TREND

Annual rent growth in the Washington metro area Class A apartment market is trending near the long-term average in the fourth quarter of 2023, as the development pipeline has moderated and demand remains strong. Meanwhile, vacancy is up in the District and Northern Virginia. Suburban Maryland was the only substate area which experienced a decrease in vacancy. Net absorption outpaced deliveries in the District and Suburban Maryland over the past year. The largest gap between net absorption and deliveries exists in Northern Virginia where a wave of new deliveries came online in 2023. We expect competitive market conditions to persist as deliveries are expected to rise significantly throughout the metro area in 2024. Increasing construction and financing costs, as well as tighter lending standards have caused a slowdown in construction starts in 2023, a trend that has continued into the fourth quarter in which starts are down from the third quarter.

APARTMENT VACANCY RATES

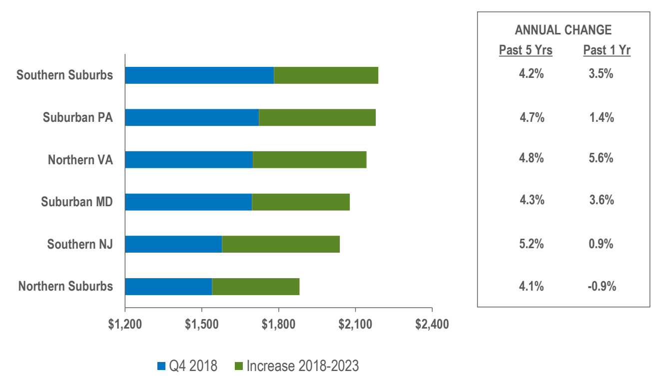
Major Apartment Markets | Q3 2023



Source: Reis, Delta Associates; December 2023.

ANNUAL AVERAGE EFFECTIVE RENT GROWTH

Mid-Atlantic Class A Low-Rise Apartments | December 2023



Source: Delta Associates, December 2023.

SUPPLY/DEMAND AND RENT OUTLOOK

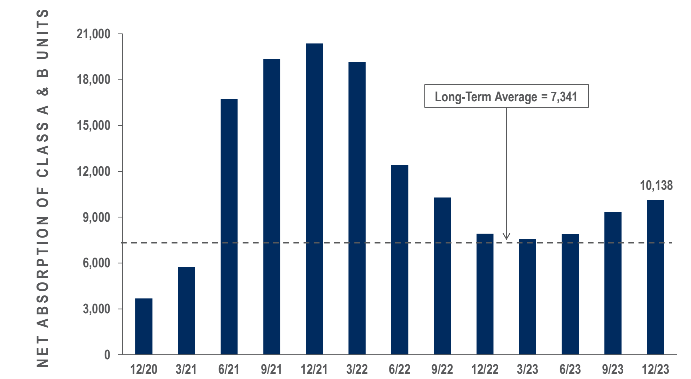
As the 36-month pipeline has declined across the metro area, absorption outpaced deliveries in the District and Suburban Maryland. When the prior year's absorption is compared to the development pipeline at the submarket level, 17 low-rise submarkets in Northern Virginia and Suburban Maryland have less than four years of supply (or one year's worth of product overhang). Fourteen of these submarkets have less than two years of supply and could be considered supply constrained. There are eight high-rise submarkets with four years or less of supply, four with two years or less. This suggests development opportunities exist in submarkets throughout the metro area.

Another way of looking at the development pipeline at the submarket level is new supply relative to existing inventory. In 16 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/Wheaton). 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 10 basis points in three years compared to today – resulting in a metro-wide rate of 4.9%; we expect vacancy to rise to 5.5% in 2024 before gradually decreasing below 5.0% by 2026. We expect rent growth to be mostly below the long-term average over the next three years; however, we expect stronger growth in 2025. We project rent growth of 2.0% in 2024, followed by a 4.0% increase in 2025 and 3.7% in 2026.

ANNUAL NET APARTMENT ABSORPTION

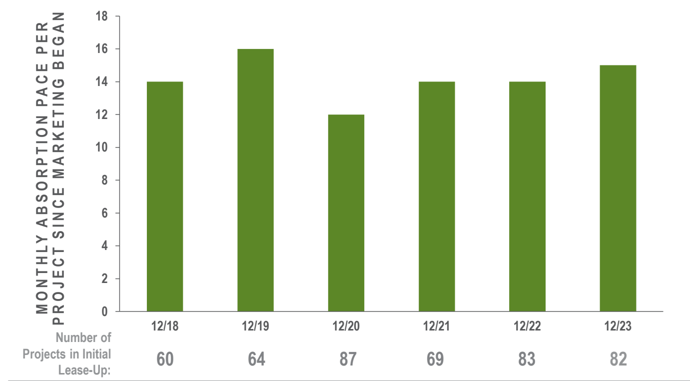
Class A & B Units | Washington Metro



Source: Delta Associates, December 2023.

ABSORPTION PACE PER PROJECT PER MONTH

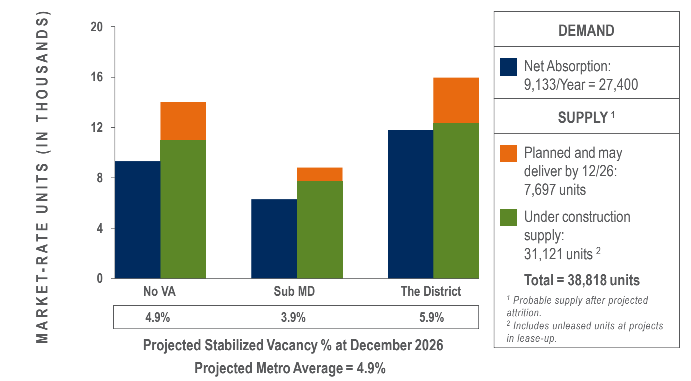
For Projects in Initial Lease-Up | Washington Metro



Source: Delta Associates, December 2023.

DEMAND AND SUPPLY PROJECTIONS

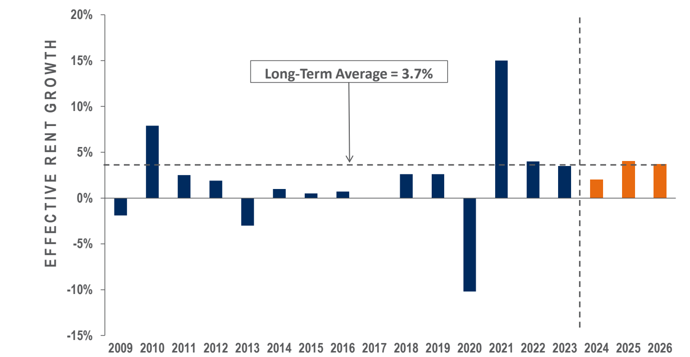
Washington Metro Class A Apartment Market
December 2023 – December 2026



Source: Delta Associates, December 2023.

ANNUAL CLASS A APARTMENT RENT GROWTH

Washington Metro | 2009 - 2026



Source: Delta Associates, December 2023.

DEMAND ABOVE-AVERAGE METRO-WIDE, GROWTH LED BY THE DISTRICT AND SUBURBAN MARYLAND

Class A apartment absorption in the Washington area in 2023 is 11,206 units, which is 40% above the long-term average. About 47% of the units absorbed over the past year were in the District, which recorded 5,152 units, an increase of 37% from 2022. Absorption is also up in Suburban Maryland and Northern Virginia by 36% and 15%, respectively.

We project annual demand averaging about 9,100 Class A units over the next three years with much stronger absorption in 2024 (projected at 13,400 units) as a record number of units enter the market, then moderating significantly in the following two years.

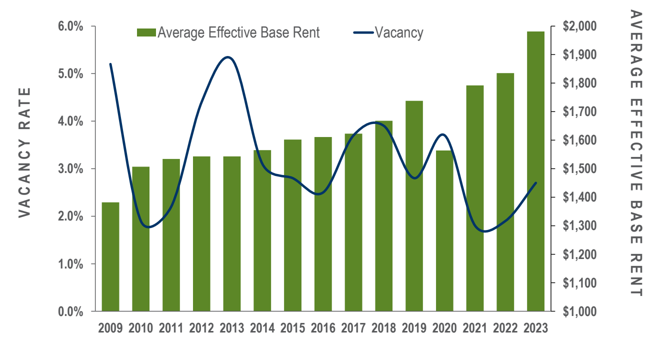
WASHINGTON METRO AREA CLASS B MARKET

RENT GROWTH IN SUBURBS OUTPACE THE DISTRICT

The Washington metro area's Class B multifamily market is experiencing rising vacancy while rent growth remains robust (at least in the suburbs). Rent growth in the region was solid at 4.1% in 2023. In Northern Virginia, the vacancy rate increased 20 basis points to 2.6% while rents were up by 4.9%. Suburban Maryland also maintained its low vacancy rate with only a 30 basis-point increase since December 2022. Rent growth in Suburban Maryland over the year was 3.9%. Meanwhile, in the District, vacancy rates increased 160 basis points to 3.5%. Rent growth was negative in the District with a -0.8% decrease in 2023. Metro-wide, rent growth outpaced the five-year average (except in The District) 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 – 4th Quarter 2023



Source: Delta Associates, December 2023.

- Northern Virginia up 4.9%
- Suburban Maryland up 3.9%
- The District down 0.8%.
- Metro-wide low-rise up 4.6%
- Metro-wide mid and high-rise up 3.4%

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

The Trend Since Fourth Quarter 2022

NORTHERN VIRGINIA

FOR RENT

EFFECTIVE RENTS ▲ 4.9%

SUBURBAN MARYLAND

FOR RENT

EFFECTIVE RENTS ▲ 3.9%

THE DISTRICT

FOR RENT

EFFECTIVE RENTS ▼ 0.8%

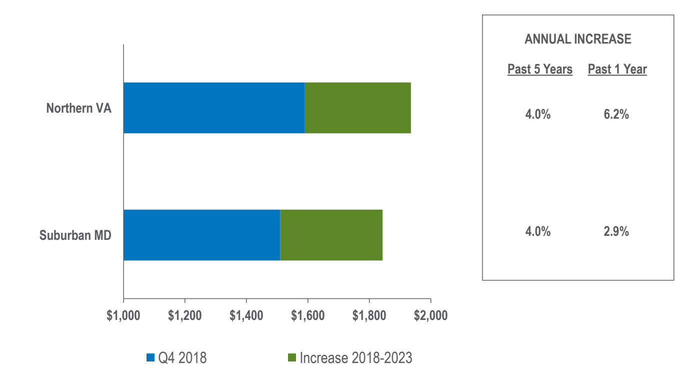
OUTLOOK FOR CLASS B APARTMENTS

Class B annual rent growth (4.1%) continues to outpace Class A growth (3.5%). Vacancy in Class B product (2.7%) increased 60 basis points from a year ago and is still much lower than Class A vacancy (4.8%). Several contributing factors will continue to impact vacancy and rents going forward:

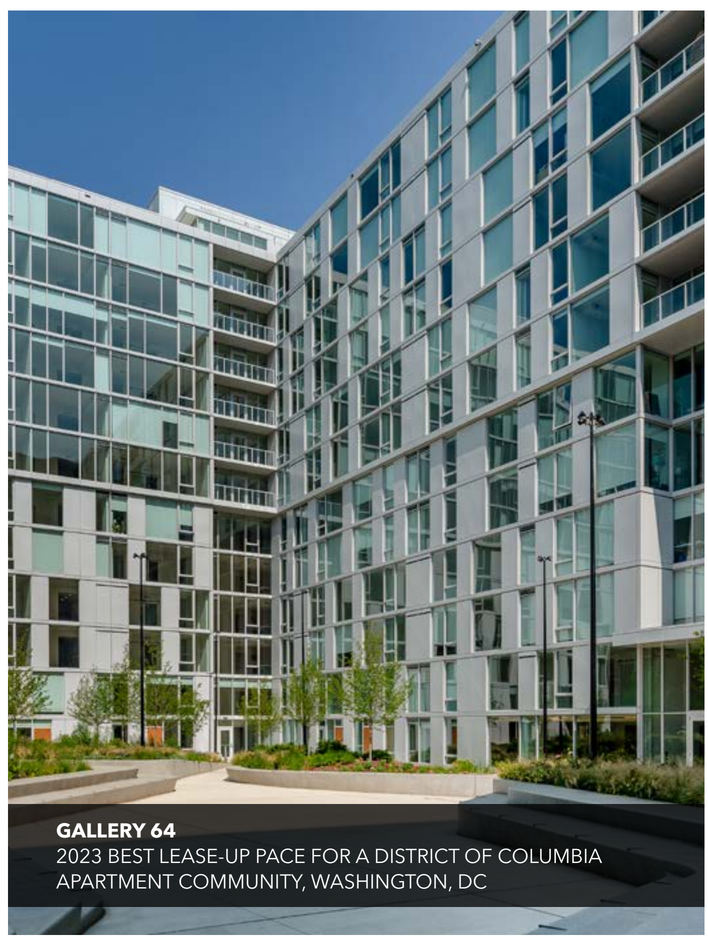
1. **Gap between Class A and Class B rent is narrowing.** The increase in Class B rent over the years has outpaced Class A. There's only a $227 difference in effective rent between Class A and Class B low rise and a $440 difference in mid/high-rise. This showcases the continuing narrowing of the gap between Class A and B rents over the years.
2. **Interest rate dynamics:** From rapid increases to a steady state. Interest rates have reached a plateau, with the Federal Reserve halting further hikes after 11 consecutive increases since March 2022. This series of rate increases by the Fed have pushed mortgage rates to levels not seen in many decades. As a result of these policy decisions, there's been a notable decline in home buying demand, expanding the pool of renters. As of mid-December 2023, mortgage rates have dropped, with 30-year rates falling below 7% for the first time since the summer. The Fed is poised to start lowering the federal funds rate next year, which means mortgage rates should go down in 2024.
3. **Challenge of new homeownership.** Soaring property prices are making it increasingly difficult for first-time buyers to own homes, especially in the Washington metro area. During the pandemic, housing prices in major cities reached record highs, and the imbalance between supply and demand has further aggravated the issue of housing affordability. Even though there has been a slowdown in growth recently, the production of housing still falls short of the rising demand, pushing up prices in the area. Potential homeowners are finding it difficult to enter the market with such high interest rates.
4. **Renovation activity on a consistent upward trend.** Renovation activity continues to increase year over year. Renovation activity for Class B units has surpassed 15,000 this quarter. These units are presently undergoing renovations, a substantial increase from approximately 12,000 units in December 2022. Several renovation projects, initially stalled by the pandemic, resumed upon economic stabilization. The forecast for 2024 indicates a persistence of renovation activity surpassing pre-pandemic levels. 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
Fourth Quarter 2023



Source: Delta Associates, December 2023.



GALLERY 64
2023 BEST LEASE-UP PACE FOR A DISTRICT OF COLUMBIA APARTMENT COMMUNITY, WASHINGTON, DC

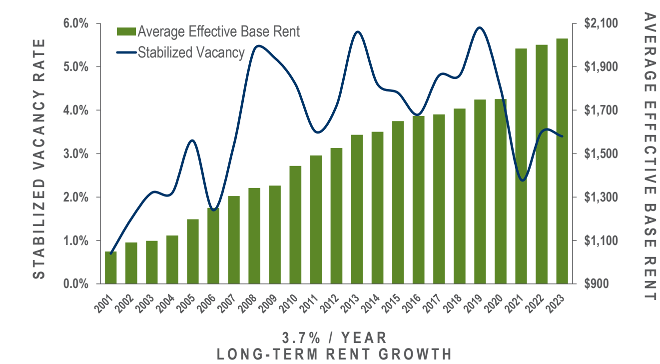
BALTIMORE METRO AREA CLASS A MARKET

ABSORPTION REBOUNDS AT A FASTER RATE

Absorption increased significantly across the Baltimore metro area in 2023. In 2022, annual absorption was quite weak with 244 units compared to 1,760 units absorbed in 2023. Over the past year, 2,209 units delivered, a 127% increase over the 972 that were brought to market in 2022. Meanwhile, annual rent growth is well below the long-term average at 1.5% across the metro area.

EFFECTIVE RENT AND VACANCY RATE

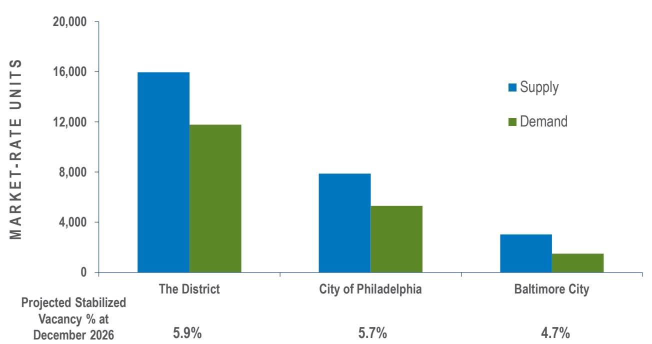
Class A Apartments | Baltimore Metro



Source: Delta Associates, December 2023.

SUPPLY/DEMAND RELATIONSHIP

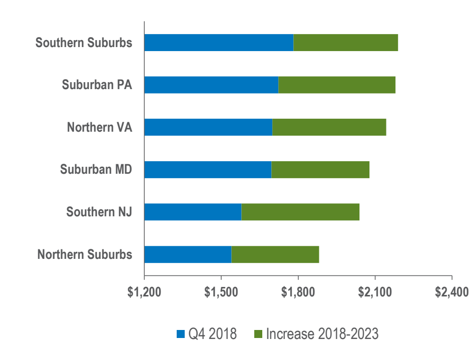
Mid-Atlantic Central City Class A Apartment Markets
Next 36 Months: Period Ending December 2026



Source: Delta Associates, December 2023.

ANNUAL AVERAGE EFFECTIVE RENT GROWTH

Mid-Atlantic Class A Low-Rise Apartments | December 2023



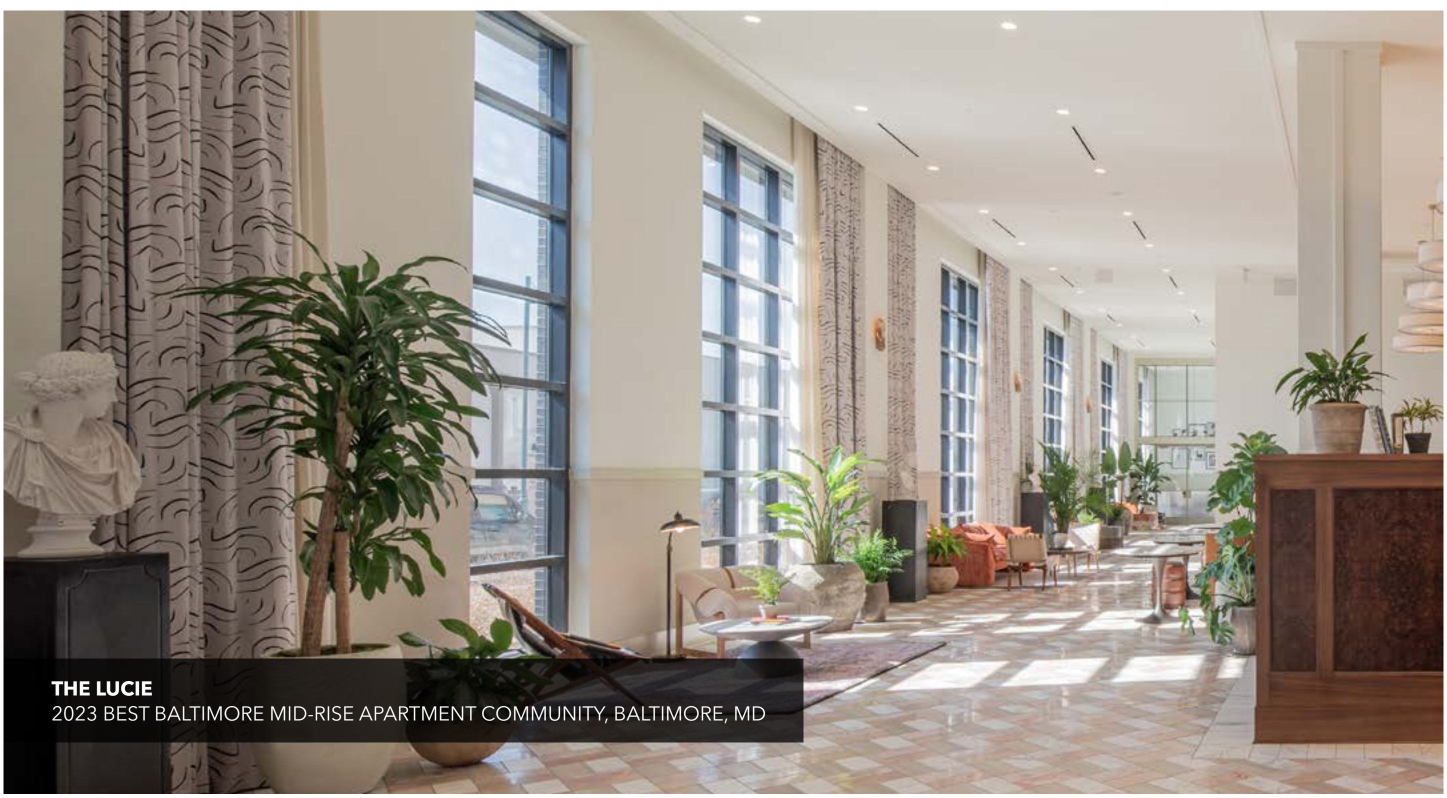
	ANNUAL CHANGE	
	Past 5 Yrs	Past 1 Yr
Southern Suburbs	4.2%	3.5%
Suburban PA	4.7%	1.4%
Northern VA	4.8%	5.6%
Suburban MD	4.3%	3.6%
Southern NJ	5.2%	0.9%
Northern Suburbs	4.1%	-0.9%

Source: Delta Associates, December 2023.

FOURTH QUARTER 2023 HIGHLIGHTS

- **Stabilized vacancy** in the Baltimore metro area decreased 10 basis points from 3.5% a year ago to 3.4%. The vacancy rate in the suburbs remained unchanged over the same period.
- **Average effective rents** in the metro area are $2,030 ($2.14 per SF). Rents are up by 1.5% metro-wide in 2023. Rent growth was strongest in the Southern Suburbs – up by 3.5%, followed by Baltimore City with a 1.1% increase. The Northern Suburbs had negative rent growth of -0.9%.
- **Absorption** in 2023 was 1,760 units, which was significantly higher than a year ago.
- **The supply pipeline** metro-wide experienced a 10% decrease over the year. There are 5,120 unleased units under construction or planned for delivery in the next 36 months in the metro area, after attrition. Meanwhile, in Baltimore City, the 36-month development pipeline is up by nearly 7%.
- **Deliveries** metro-wide stands at 2,209 units in 2023. Deliveries are up significantly compared to 2022, in which 972 units were delivered.
- **Per project lease-up pace** for the 12 actively marketing projects in the Baltimore metro area currently averages 18 units per month, up four units from the same period last year.
- **Apartment building sales** in 2022 included three transactions in low-rise buildings valued at $204.4 million ($322,319 per unit) and five transactions in mid-/high-rise buildings valued at $282.6 million ($260,709 per unit). As of December 2023, at least one sale was recorded for a 335-unit property trading at $105 million ($313,433 per unit).

Of the 10 submarkets we track in the Baltimore metro area, four have less than four years of apartment supply based on absorption over the past year (three submarkets have less than two years of supply). In addition, three 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 60 basis points to 4.0% by the fourth 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 and absorption will moderate some in 2024 and 2025, averaging about 1,300 units per year.



THE LUCIE
2023 BEST BALTIMORE MID-RISE APARTMENT COMMUNITY, BALTIMORE, MD

TRANSWESTERN
REAL ESTATE SERVICES

DELTA ASSOCIATES
A Transwestern Company

MULTIFAMILY SALES:

DEAN SIGMON
301.896.9089
Executive Vice President, Director

ROBIN WILLIAMS
301.896.9070
Executive Vice President, Director

MICHAEL D'AMELIO
301.896.9077
Vice President

MOLLIE ZITO
301.896.9021
Graphic Designer

MULTIFAMILY PRACTICE TEAM:

WILLIAM E. L. RICH, CRE
202.778.3121
President

MITESH PATEL
202.778.3101
Senior Associate

FAROUQ MURAD
202-778-3103
Associate

COLIN CHAPMAN
202-778-3105
Associate

DR. TERRY L. CLOWER
703.993.8419
Of Counsel on the Economy

TRANSWESTERN
REAL ESTATE SERVICES

MID-ATLANTIC LEADERSHIP:

PHIL MCCARTHY
301.896.9011
Executive Managing Director- Market Leader

KEITH FOERY
301.896.9028
Executive Managing Director- Market Leader

TOM ROGERS
703.749.9412
Senior Managing Director

Bethesda
6700 Rockledge Drive
Suite 500-A
Bethesda, MD 20817

Washington, DC
1717 K Street, NW
Suite 1000
Washington, DC 20006

Northern Virginia
7900 Tysons One Place
Suite 600
McLean, VA 22102

Baltimore
7160 Columbia Gateway Drive
Suite 210
Columbia, MD 21046

Visit us online
www.transwestern.com