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Multifamily Absorption Resumes After COVID-19 Slump: How Durable Is Demand?

Apartment demand rebounded in the third quarter in many metros, a good sign for the industry after a weak first half that was caused in large part by the fallout from COVID-19. The rebound helped to stabilize the multifamily market and prevented asking rents from declining as much as would have been expected considering the historic decline in economic performance in the second quarter.

Increased absorption in July and August was led by many secondary metros in the Southeast and West—including Dallas, Denver, Atlanta, Phoenix and Charlotte—resuming the strong demand that those markets experienced over the decade before the pandemic hit.

The recovery remains stalled, however, in high-priced gateway markets, which have had the largest population defections and may face the longest and most difficult recoveries. San Francisco, Chicago, Los Angeles and San Jose had steep drops in rent growth and absorption year-to-date through August, while New York rents have also declined sharply amid weak absorption.

The study of 17 million apartment units in Yardi Matrix's database demonstrates that rent growth so far this year has been closely tied to the overall expense of apartments by market. Metros with higher average rents generally saw negative growth, while rent growth in less expensive metros was modestly positive or flat. That is consistent with renters being more budget conscious at a time of economic hardship. Higher-end units have had the largest decreases in rents and occupancy post-COVID-19.

The recent rebound demonstrates the resilience in apartment demand, although it's too soon to say how long it will last if the economy suffers a setback from a second wave of infections during the winter. Multifamily performance will decline if unemployment remains high and consumers feel uncertain about their prospects.

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Absorption Trends

Multifamily absorption was weak in the first half of 2020 as many states implemented shelter-in-place orders starting in March due to the pandemic. Only 65,000 apartment units were absorbed nationally in the first six months of 2020, 60% less than the 165,000 units that were absorbed during the same period in 2019 and the lowest first-half number since 2011.

First-half absorption was strongest in Dallas (7,700), Denver (4,700) and Atlanta (3,500), markets that have grown rapidly during the past decade. Demand was down from cycle peaks but still positive. Metros with the most negative absorption included Los Angeles (-2,300), San Francisco (-2,100), Chicago (-2,100) and Miami (-750).

Absorption trends are driven by a host of factors, including the timing and extent of the shutdowns in each metro. New York, New Jersey and California were among the first to order residents to shelter in place and are reopening in phases. Metros in states such as Texas, Florida and Arizona were slow to implement precautions and have not closed businesses as thoroughly as states with gateway metros.

Multifamily demand picked up in July and August, as 50,000 units were absorbed nationally, almost as many as in the first six months of the year. The main reason is that commerce is gradually reopening, helping to restore 10.6 million of the 22.2 million jobs that were lost in the pandemic's first wave. Another driver is pent-up demand from households that might have been reluctant to move during the early part of the pandemic.

Some of the same secondary Sunbelt/Western metros that did relatively well in the first half continued to lead in absorbed units in July and August. The top metros for absorption during those two months were Dallas (4,000), Denver (3,600) and Atlanta (3,000), while Phoenix (2,100) and Charlotte

Metro	Net Absorption Jan-Jun 2020	Net Absorption Jul-Aug 2020
Dallas	7,719	4,060
Denver	4,794	3,567
Atlanta	3,478	3,019
Washington DC	1,407	2,683
Phoenix	3,073	2,163
Charlotte	2,268	1,567
Houston	2,413	1,530
Portland	466	1,370
Philadelphia	799	1,275
Inland Empire	1,715	1,089
Orlando	53	1,056
San Diego	1,388	1,026
Raleigh–Durham	1,394	1,014
Sacramento	865	975
Austin	3,052	929
Columbus	1,637	748
Seattle	1,472	737
Nashville	1,478	723
Las Vegas	2,090	718
San Antonio	2,265	679
Twin Cities	1,591	677
Tampa	2,081	402
Miami	-754	310
Boston	538	115
Pittsburgh	-157	109
New York	3,301	106
San Jose	-151	-322
Los Angeles	-2,339	-531
Chicago	-2,088	-1,320
San Francisco	-2,121	-2,546

Source: Yardi Matrix

Geography	Absorption % Stock Jan-Aug 2020	YTD Rent Growth Jan-Aug 2020
Midwest	0.4%	1.4%
Northeast	0.5%	-2.1%
Southeast	1.0%	0.3%
Southwest	1.1%	-0.5%
West	0.8%	-1.2%
Gateway	0.0%	-3.0%
Secondary	1.2%	0.0%
Tertiary	0.8%	1.4%

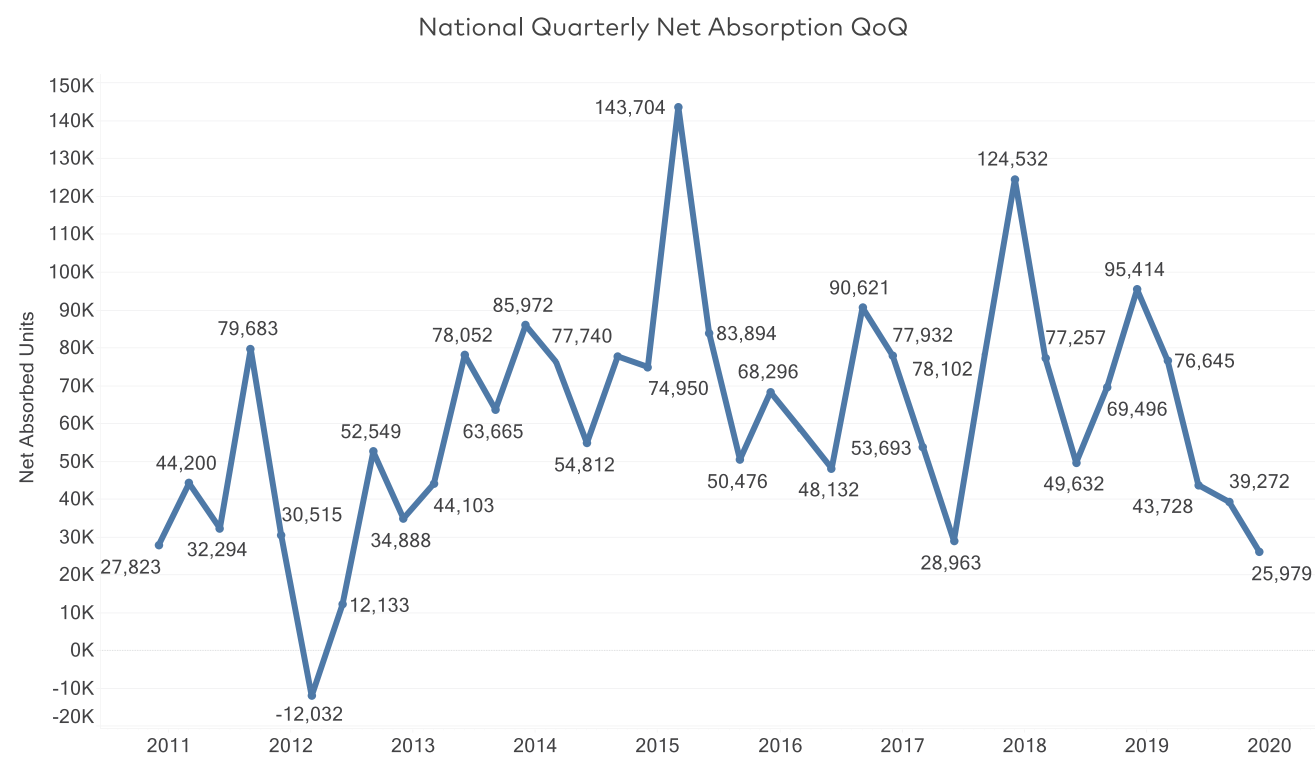
Source: Yardi Matrix

(1,500) were also among the leaders. These metros are reverting to the strong levels of absorption seen over the last cycle, thanks to rapid job growth and affordable housing.

Although Washington, D.C., has rebounded strongly, with 2,700 units absorbed in July and August, the other gateway metros continue to struggle. New York, Boston, Chicago, Los Angeles and San Francisco had a combined -4,300 units absorbed in July and August.

Gateway metros have experienced a mass exodus of residents during the pandemic. In some cases, young workers who are drawn to these urban cities for the lifestyle have left as service jobs have dried up and entertainment venues remain closed. Some office workers have relocated to the nearby suburbs, since they work from home and no longer need to be close to their places of employment. Some can no longer afford the extraordinarily high rents and have moved to cheaper metros or to live with family or friends. And concerns about social unrest in cities with persistent social protest activity may be contributing to the exodus.

On a regional level, the Southeast and Southwest have had the strongest demand year-to-date through August. Southeast metros have absorbed 41,400 units (1.0% of total stock), while Southwest metros have absorbed 28,800 units (1.1%). West metros have absorbed 23,500 units (0.8%), the Northeast 12,000 units (0.5%) and the Midwest 9,500 units (0.4%). By metro size, secondary markets have had the strongest absorption at 1.2% of stock, with tertiary markets absorbing 0.8% of stock and gateway markets flat at 0.0%.



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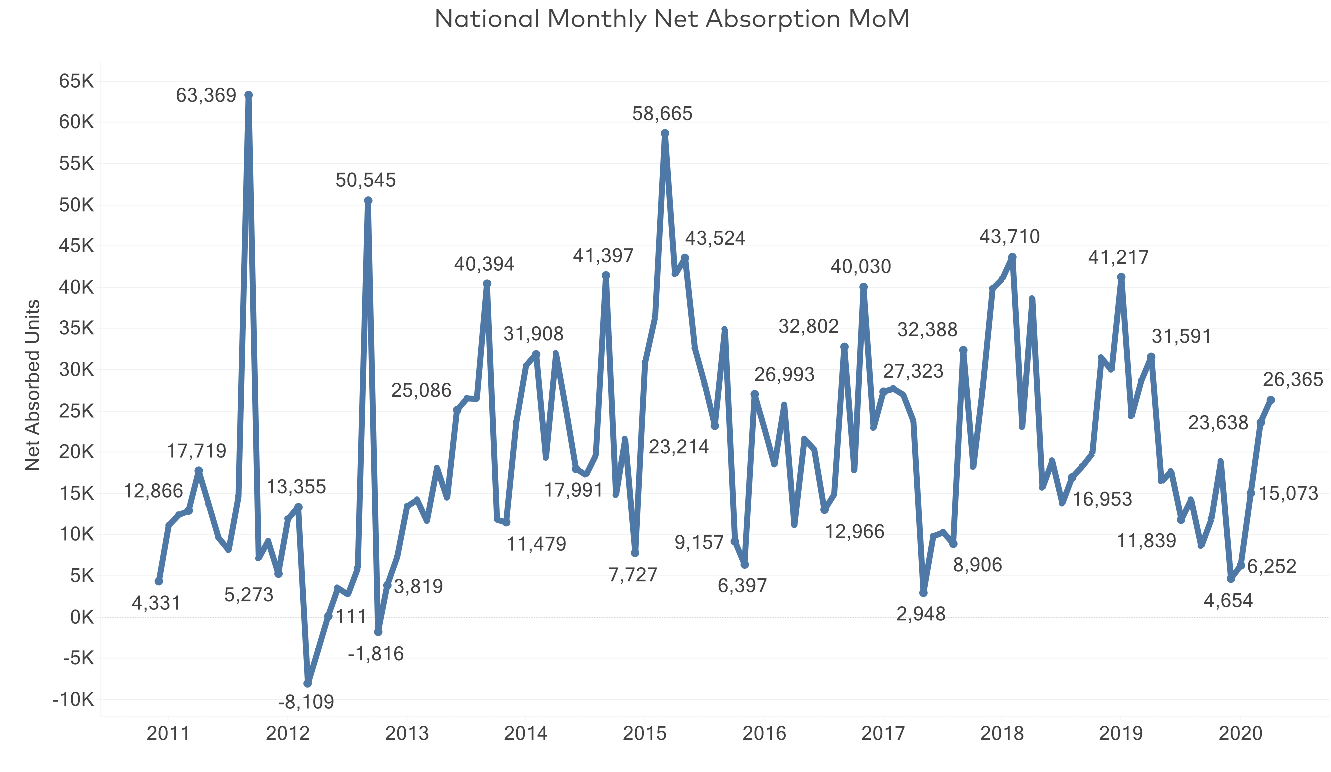


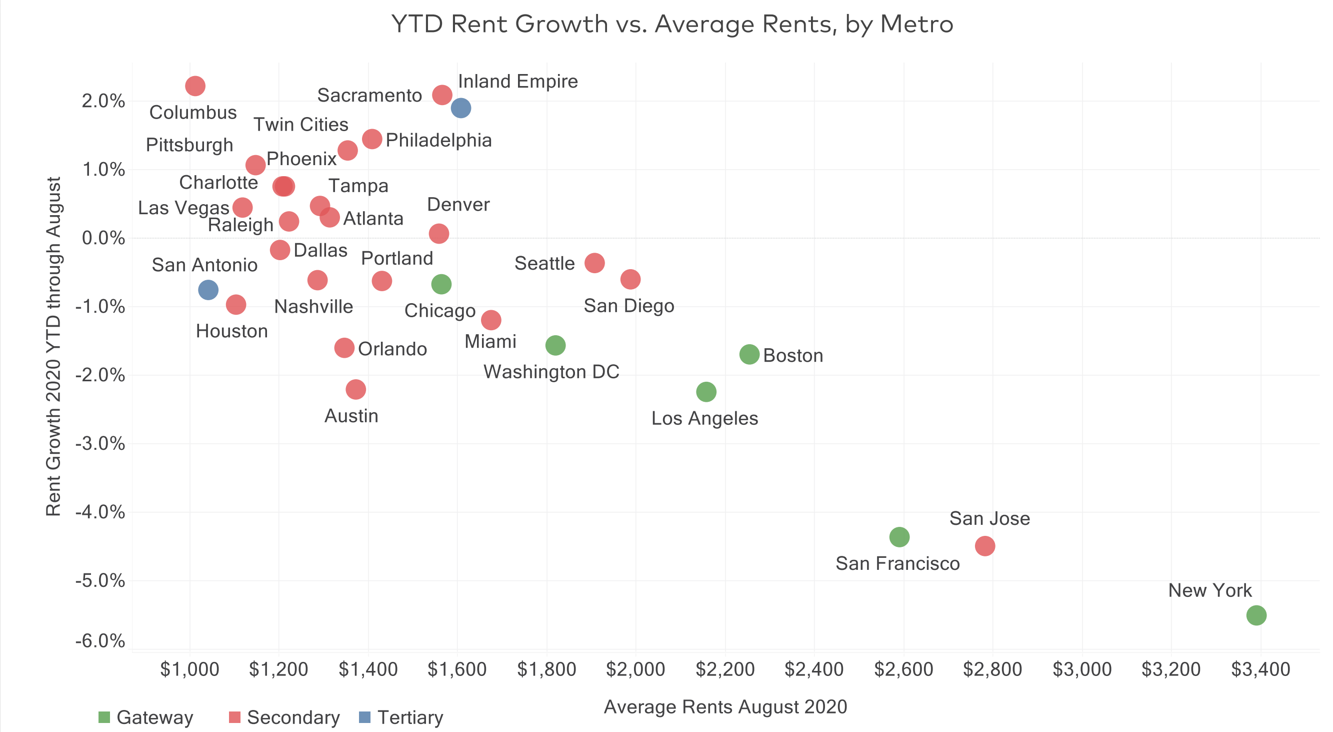
Source: Yardi Matrix

Rent Drivers

Nationally, rents have declined only modestly, but on the metro level there are large variances. What's driving these disparities? The numbers indicate a clear correlation among cost, demand and rent growth. Metros with the highest rents have had the least rent growth, while less expensive metros have fared better. Year-to-date through August, Columbus had the lowest average rent ($1,013) of our top 30 metros and the highest rent growth (2.2% year-over-year).

On the other end of the spectrum, the San Francisco Bay Area and New York had the highest average rents and the largest drops in rents year-to-date through August. In fact, the nine metros with the highest average rents all have had negative rent growth, averaging -2.6% year-to-date through August. Rents increased 1.9% year-to-date in the Inland Empire, the metro with the 10th-highest average rent. Even so, expense is a factor there. Despite its relatively high cost on a national level, the Inland Empire is a less expensive housing alternative to Los Angeles and Orange County. That demonstrates another feature of the pandemic: Tenants are moving to cheaper markets that are within an hour or two drive from gateway metros. The pandemic has left many renters struggling to make monthly payments.

Absorption was also a factor in metro-level rent performance over the first eight months of 2020, but not as closely correlated as cost. For example, rent growth in Dallas and Denver was basically flat despite positive absorption, in large part because supply growth was high enough to reduce occupancy rates. Rents are likely to remain muted in metros that have a heavy supply pipeline, with a particular impact on new luxury product, which will take longer to fill. Many property owners are renewing existing tenants with little or no increase in rents in order to maintain occupancy and to avoid gouging during a time of economic hardship.



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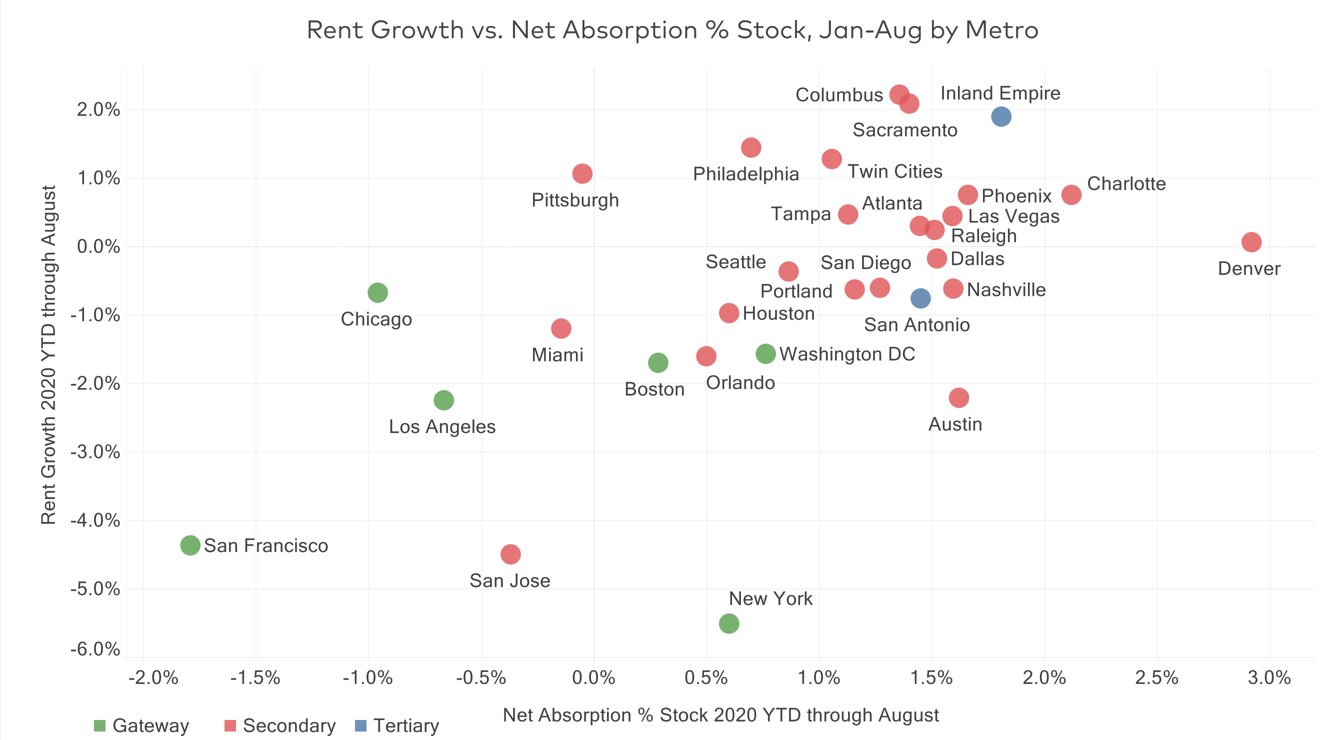

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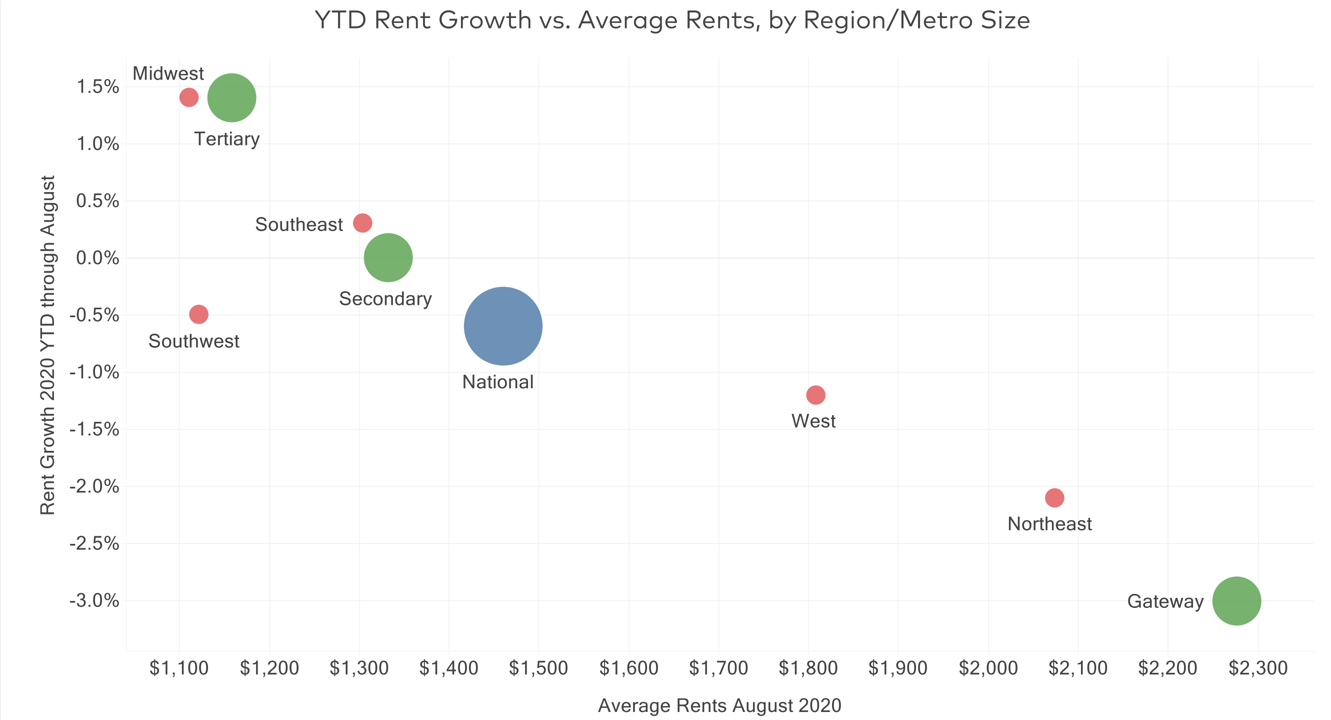

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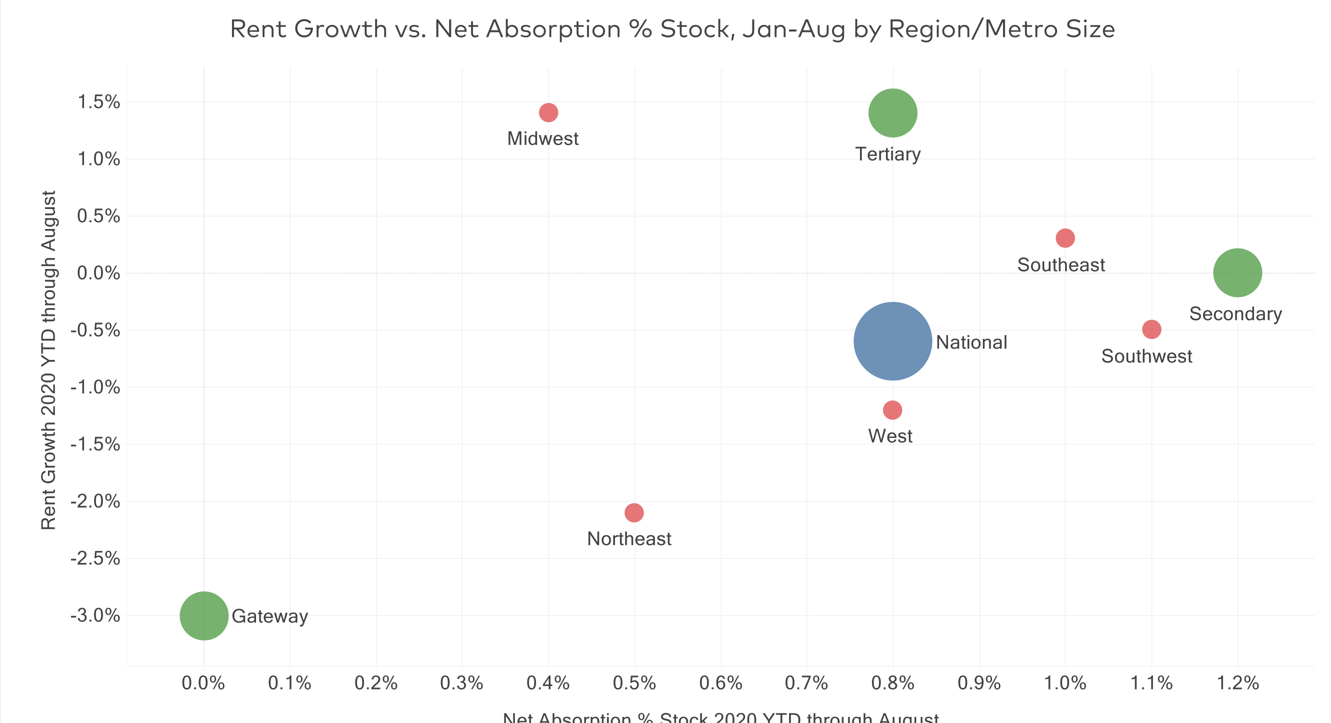

Source: Yardi Matrix

Conclusion: Recovery Uncertainty

COVID-19 put an end to years of strong multifamily demand, with the first half seeing the weakest growth since the Great Recession more than a decade before. Early signs show that a recovery is in progress, but how deep that recovery is and how long it lasts remain open questions. Demand going forward will depend on economic performance, demographic and social trends such as the growth of the prime renter age population, urbanization of young workers and retirees, and the reduction in homeownership.

The prime 20-to-34-year-old renter age population is slated to continue to grow for several more years, but whether they can afford to create new households depends on finding good jobs. Despite recent job gains, the percentage of working-age population that is employed remains stubbornly low at 57%, while a recent Pew Research Center study found that more than half of young adults live with parents, a decades-long high.

Pre-pandemic, homeownership was on the downswing, but the rate jumped to 67.9% in the second quarter of 2020, up 2.6 percentage points from the first quarter and 3.8 percentage points year-over-year, according to the Census Bureau. Low interest rates have made mortgages more affordable, and many families have sought extra space in the suburbs to accommodate being stuck at home. Whether the swing back toward homeownership represents a short- or long-term trend is debatable.

Another question is where multifamily demand will be moving forward. Gateway cities and urban areas that have grown during the past decade are now facing losses, as pandemic-era cities lack the amenities that made them appealing in the first place. It's not yet clear when a COVID-19 vaccine will be available and how long it will take people to feel comfortable returning to routinely crowded spaces.

COVID-19 has created some short-term disruptions, but with total employment still more than 11 million less than at its peak, financial markets exhibiting volatility and an upcoming election, the long-term uncertainty will not likely abate soon.

—Paul Fiorilla, Director of Research and Casey Cobb, Research Analyst

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Twin Cities	1,591	677
Washington DC	1,407	2,683
Midwest	3,338	6,151
Northeast	7,422	4,653
Southeast	22,684	18,734
Southwest	18,450	10,354
West	13,357	10,112
Gateway	-95	-154
Secondary	45,690	33,322
Tertiary	19,655	16,837

Source: Yardi Matrix

Appendix

Yearly Net Absorption *2020 through August

	2016	2017	2018	2019	2020
National	225,301	251,210	329,523	285,284	115,254
Dallas	12,554	8,989	23,240	22,766	11,779
Denver	7,164	7,544	13,645	12,145	8,361
Atlanta	6,155	8,474	11,267	9,246	6,497
Phoenix	4,566	6,960	9,166	7,997	5,236
Washington DC	10,112	9,710	12,402	10,791	4,090
Austin	8,813	7,548	11,597	9,067	3,980
Houston	9,339	24,274	4,772	9,831	3,943
Charlotte	7,031	5,351	5,893	6,392	3,835
New York	9,118	10,859	12,800	10,885	3,407
San Antonio	5,058	5,022	5,839	3,497	2,944
Las Vegas	1,972	1,874	5,367	1,403	2,809
Inland Empire	1,439	447	837	1,122	2,804
Tampa	1,594	3,849	6,592	4,311	2,483
San Diego	3,315	1,697	3,214	2,912	2,414
Raleigh–Durham	2,144	2,989	5,616	5,952	2,408
Columbus	2,883	2,283	5,023	2,439	2,386
Twin Cities	2,711	3,527	5,364	5,612	2,268
Seattle	9,393	8,135	9,192	13,159	2,209
Nashville	3,655	3,712	7,975	5,591	2,200
Philadelphia	4,969	1,970	5,848	5,077	2,074
Sacramento	158	61	1,148	352	1,840
Portland	1,781	3,002	5,452	4,218	1,836
Orlando	3,371	7,562	5,564	5,590	1,109
Boston	4,165	6,207	7,303	5,580	654
Pittsburgh	2,170	2,097	2,236	1,280	-48
Miami	7,732	7,851	12,592	12,245	-445
San Jose	2,864	2,876	1,959	2,266	-473
Los Angeles	8,714	7,938	5,993	6,197	-2,870
Chicago	4,366	5,113	8,668	7,704	-3,408
San Francisco	6,432	3,754	5,396	3,928	-4,667
Southeast	64,237	73,615	107,830	87,564	41,418
Southwest	47,791	64,148	64,502	59,990	28,803
West	54,078	48,869	69,669	61,263	23,469
Northeast	34,691	35,148	43,967	35,813	12,075
Midwest	24,504	29,429	43,555	40,654	9,489
Secondary	117,874	139,726	180,507	166,535	79,012
Tertiary	57,448	62,269	88,385	67,324	36,492
Gateway	49,979	49,215	60,631	51,425	-249

Source: Yardi Matrix

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