APARTMENT ADVISORY

APRIL 2021

Class C apartment stock has proven resilient throughout the COVID-19 pandemic – surprisingly so, given historic job losses in some key employment sectors. This product line is the most affordable in the conventional market, with effective asking rents for new leases averaging $1,151 in March. That's a rough discount of $250 a month from what is considered middle-market product and $650 from the nation's luxury apartments.

With lower rents for Class C product, then, these units tend to be leased by workers in mid- and lower-paying industries. Perhaps the largest is the Leisure and Hospitality sector, an employment category that includes workers in restaurants, bars and entertainment venues, among others. This sector was particularly hard hit by the COVID-19 pandemic, losing more than 20% of its job base in the year-ending February 2021, according to the Bureau of Labor Statistics. That decline accounted for a loss of 3.3 million jobs, which is more than one-third of the nation's jobs lost in the past year.

Among 48 of the nation's largest 50 apartment markets, Leisure and Hospitality was the employment sector with the deepest share of job losses. In the worst-case scenario, the San Francisco Bay Area and New York have lost more than 40% of Leisure and Hospitality jobs in the past year alone. Only Houston (where the energy market has struggled due to the pandemic) and West Palm Beach have other employment sectors with deeper job losses.

Adding in two other service sectors reveals even larger disparity. Trade, Transportation and Utilities (made up primarily of retail-based employment) and Other Services (encompassing services such as hair salons and laundromats) make up another 13% of the nation's total losses in the past year. Added together, those three sectors make up almost half of the nation's 9 million total job losses.

Class C Dominates in the Past Year

	Average Annual Rent Change	Average Occupancy Rate
Class A	-1.6%	94.5%
Class B	-0.4%	95.6%
Class C	0.2%	96.2%

Source: RealPage, Inc.

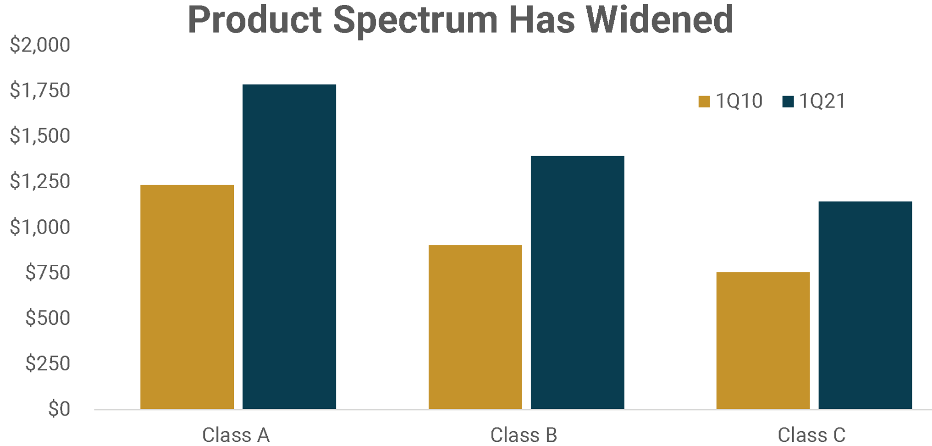
Despite historic losses in these key employment sectors, Class C stock has seen relative stability. This stock managed to hold onto effective asking rent growth until October, quite a bit longer than the other two product lines, which turned to rent cuts as early as May. As a result, between March 2020 and March 2021, Class C assets were the only product type to average any rent growth. Additionally, the average occupancy rate among Class C assets (96.2%) in the past year has run about 60 basis points tighter than the showings in Class B units and a hefty 170 bps tighter than the Class A performance.

Stronger occupancy within Class C product likely points to movement toward more affordable product. As economic uncertainty persisted into the summer and early fall months, there were many residents that sought to save money by renting cheaper units. The same can be said for some Class A renters who sought more affordable Class B product amid economic uncertainty.

In turn, demand for more affordable product saw a surge in the first few months of the pandemic. Stronger demand translated to steadier rent growth among Class C stock – an asset class where rent growth generally gets capped by a combination of wage growth and inflationary pressure.

That trend was counter to the patterns seen in previous recessions. Historically, the gap between product lines was modest enough that a concession could entice a renter to move up the product spectrum.

Gap in Effective Asking Rents Across Product Spectrum Has Widened



Source: RealPage, Inc.

Today, however, there is a larger gap between effective asking rents among product classes. The variance between Class A and B product has widened by about $50 since 2010, while the gap between Class B and C stock is now about $100 wider than it was a decade ago.

Building new product within the Class B and Class C range is cost

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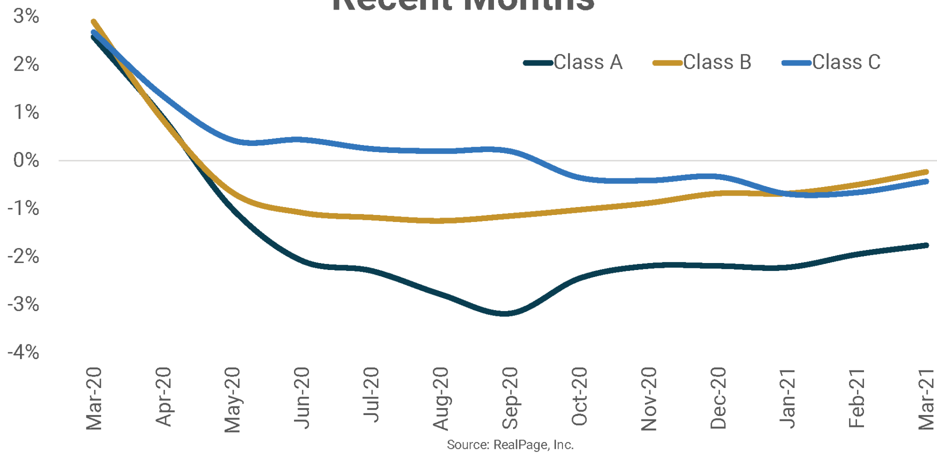
prohibitive. And the popular value-add/rehab play among investors over the past decade has thinned out a lot of the traditional Class C product.

The relative strength of Class C product over the past year is beginning to show some deterioration, however.

Class C Pricing Resilience Has Waned in Recent Months



While Class C stock held onto rent growth longer than the other two product lines, this asset class did turn to rent cuts starting in October, and as of January 2021, dipped below the performance in Class B stock. Although still within negative territory, Class B product has shown slow-yet-steady improvement through the back half of 2020 and into 2021.

Meanwhile, Class C rent positioning has struggled to maintain its initial momentum. As of March, annual rent cuts were at 0.4%. Although that was a little improved over February cuts of 0.7%, the progress was modest at best. Meanwhile, Class B stock went from annual cuts of 0.5% in February to cuts of 0.2% in March.

Occupancy rates among both Class B and C product remain unchanged year-over-year, while Class A stock is still seeing a modest decrease in performance.

Despite recent weakening, there are still a few markets in the country where Class C performance ranges from good to excellent.

Unsurprisingly, markets with solid overall performance – Atlanta, Phoenix, Greensboro, Memphis and Riverside – also maintained strong Class C rent change. As the adage goes, a rising tide lifts all boats and the overall robust demand in these metros is keeping Class C fundamentals strong.

On the opposite side of the chart are metros that have been generally hit hard by the downturn. That's especially true in New York (Class C rents down nearly 13% annually) and the Bay Area, where regional rent cuts total some 16% (reaching 21% in San Francisco alone).

Perhaps the biggest challenge that lies ahead for Class C product, however, is the oversized share of delinquencies and missed rent payments. That's been true since the onset of the pandemic, as Class C rent collections have lagged both Class A and Class B payments by a considerable margin.

In the week-ending March 27, 2020, roughly 91.4% of Class C residents had paid rent, compared to payments of 96% to 97% among Class A and Class B residents, according to the National Multifamily Housing Council. Over that same period for 2021, Class C payments have fallen to 89%, down 2.4 percentage points year over year. Meanwhile, Both Class A (94.9%) and Class B (95.2%) stock appear to be in far better shape.

Class C Annual Rent Change by Market (March 2021)

Rent Change >5%	Rent Change 2.5% to 5%	Rent Change 0% to 2.5%	Rent Change -2.5% to 0%	Rent Change <-5%
Atlanta	Memphis	Virginia Beach	***U.S. Average***	Oakland
Phoenix	Charlotte	Columbus	Los Angeles	New York
Greensboro	Jacksonville	Cincinnati	Houston	San Jose
Baltimore	Las Vegas	Milwaukee	Boston	San Francisco
West Palm Beach	Riverside	Fort Worth	Denver	
	Sacramento	Tampa	Washington, DC	
	Salt Lake City	San Diego	Seattle	
	Philadelphia	Orlando	Austin	
	Detroit	Indianapolis		
	Miami	Newark		
	St. Louis	Kansas City		
	Fort Lauderdale	Providence		
	Cleveland	Chicago		
		Raleigh/Durham		
		Nashville		
		Minneapolis		
		Dallas		
		Anaheim		

Source: RealPage, Inc.