TA Realty

Strong tailwinds ahead for the multifamily sector

While the pandemic has negatively affected certain areas of commercial real estate, the U.S. multifamily market has remained resilient, and we expect this resiliency to continue.

Real estate fundamentals' recent performance highlights the sector's strength. Multifamily absorption rebounded sharply to historic levels in the first and second quarters of 2021. Occupancy gains through the first half of the year exceeded the full-year totals for both 2020 and 2019, and rent growth reached double digits. At the same time, supply growth has remained near constant at slightly above 3 percent, and vacancy rates have fallen to a two-decade low of 5.3 percent.[1]

This performance is due to both cyclical and secular tailwinds — a combination of economic growth, the abundance of millennial-generation renters, and a supply-and-demand imbalance in for-sale housing that will become even more acute over the next couple of years — that support strong multifamily market momentum in the longer term.

While more of the millennial generation is aging into their traditional home-buying years, the transition out of rentals is being delayed by the rising costs of homeownership and the short supply of affordable for-sale housing.

Aging millennial generation is reshaping the housing landscape

In 2021, 4.6 million millennials (out of a total of 72 million) will turn 33, the median age of first-time homebuyers. This is up from 30 years old a decade ago, according to the U.S. Census Bureau. As a result, household formation in the United States is expected to grow at its fastest annual pace in more than a decade and remain historically high, underpinning the demand for both for-sale and rental housing.

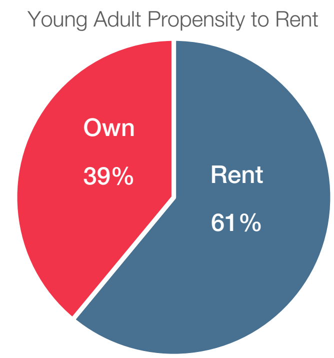
Homeownership, however, has been challenging for millennials for years. Even before the pandemic, this generation was struggling to save for a down payment, due in part to soaring living costs, student debt and the fallout of the Great Recession.

By virtue of these factors, for the millennial generation, renting is the most common form of housing. For millennials ages 25 to 34, only 39 percent own homes. In comparison, 48 percent of Generation X and 51 percent of baby boomers owned homes when they were the same age.[2]

Lack of affordable homes impedes path to homeownership

The U.S. housing market is facing a substantial supply shortage, which continues to grow. Between 2018 and 2020, the U.S. housing supply shortage increased from 2.5 million to 3.8 million units.[3]

Figure 2: Renting is the most common form of housing for millennials



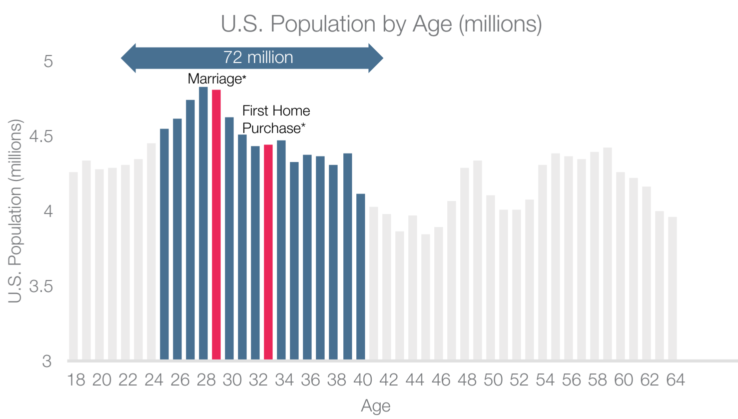
Source: U.S. Census Bureau, Current Population Survey, July 2021.
**Young adult is ages 25–34.*

For the millennial generation, the housing shortage is even more acute. The supply of entry-level housing, or "starter homes," is near a five-decade low.[4]

In 2020, only 65,000 entry-level homes were completed, while 2.38 million first-time homebuyers looked to purchase homes.[5] Not all renters looking to purchase their first home were in the market for a starter home; however, the large supply-demand imbalance illustrates the significant and rapidly widening gap between entry-level supply and demand.

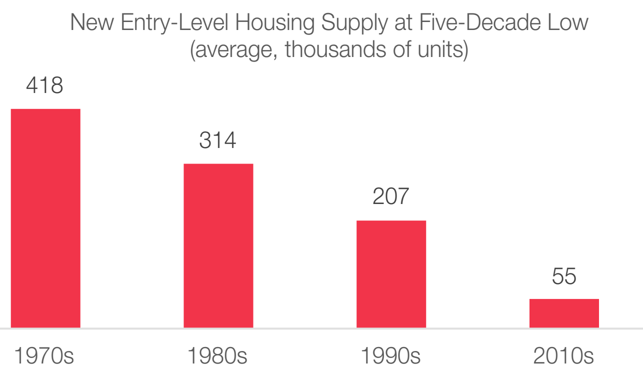
In the first half of 2021, the high cost of building materials and labor, along with supply-chain disruptions for housing supplies, slowed the pace of home construction. This slowdown in new home starts has exacerbated the shortage for first-time buyers. In addition, other factors have contributed to this situation, such as anti-development sentiment and limited zoning for dense residential housing. Consequently, the current housing shortage will likely intensify over the long run, as the robust demographic tailwinds continue to take hold.

Figure 1: Demographic trends underpin housing demand



*Sources: U.S. Census Bureau, TA Realty Research. *Median age as of 2020*

Figure 3. Entry-level housing new supply at five-decade low



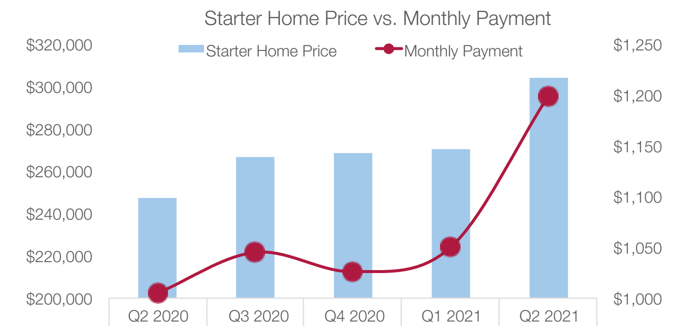
Source: Freddie Mac. Entry-level homes are defined as homes with 1,400 square feet or less.

The pandemic further eroded first-time homebuyer purchasing power

Affordability is another factor driving demand for multifamily rentals, as potential millennial homeowners are confronted with quickly rising prices and the increasing cost of financing.

U.S. homes have become increasingly unaffordable, with home prices exceeding 2006 peak levels by 40 percent, according to the National Association of Realtors (NAR). This pricing pressure has been compounded by the spike in home prices in early 2021, amid rising demand.

Figure 4: Starter homes became less affordable after the onset of the pandemic



Source: National Association of Realtors (NAR)

Since the onset of the pandemic, the price for the average starter home in the United States has risen by $57,000, or 23 percent, to $304,000 (Figure 4). By comparison, the median sales price for all existing homes has grown by 18 percent.[6]

Further challenging the market for the millennial buyers, the monthly payment for a starter home has risen nearly 20 percent to $1,200 per month, an increase of $200 per month. Meanwhile, median incomes for first-time buyers increased by just 1.2 percent, according to the NAR. Consequently, many millennials, even those who move to low-cost markets and suburbs, will be challenged to afford a home.

The already difficult home-buying market has become even more challenging due to the pandemic, particularly in suburban and traditionally low-cost areas where millennials are heading as they look to settle down and start families. Supply growth will remain steady; however, the multifamily sector is well positioned to benefit from considerably more renter demand, going forward.

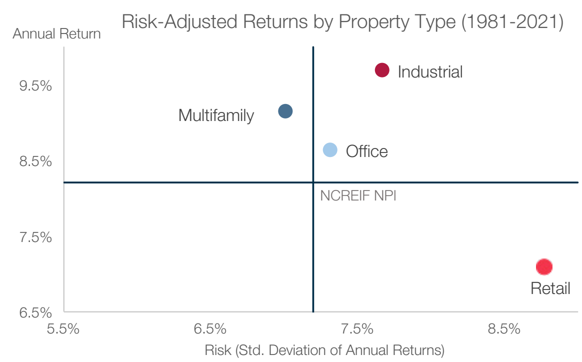
Demographic tailwinds build on a history of strong returns

These tailwinds underscore the ongoing value of the multifamily asset class. Yet the U.S. multifamily sector has a 40-year history as one of the strongest performing real estate asset classes. During the last four decades, the sector has generated stronger risk-adjusted returns, as compared with other property types.

The sector has consistently seen increased demand from institutional real estate investors and has become an integral part of real estate investment portfolios.

Multifamily trends that were well under way before COVID-19 will continue in the coming years. More specifically, Sun Belt states, low-cost metros, most tech hubs, select suburban submarkets, and garden-style formats have all shown the strongest recent performance.

Figure 5: Multifamily sector relatively lower volatility for higher returns



Source: National Council of Real Estate Investment Fiduciaries (NCREIF), Second Quarter 2021. Represents the average annual risk-adjusted return during a 10-year hold period, using a dataset from 1981 to 2021.

Outlook

Investment activity is on pace to exceed peak levels experienced in 2019. Investment confidence in multifamily is strengthening, after the record-setting second-quarter performance and an outlook that is bolstered by the aging millennial generation and a lack of moderately priced homes available for purchase.

While the spread of COVID-19 variants pose a risk to the outlook, the long-term prospects for the multifamily market should remain favorable, as the United States is undersupplied in housing relative to the demographic-driven demand expected.

Notes: [1] CoStar, U.S. multifamily, second quarter 2021; [2] U.S. Census Bureau, Current Population Survey, 1976–2020; [3] Freddie Mac, *Research Note,* "Housing Supply: A Growing Deficit," May 7, 2021; [4] Freddie Mac, *Research Note,* April 15, 2021; [5] National Association of Realtors, First-Time Homebuyer Affordability, Quarterly Index, August 12, 2021; [6] National Association of Realtors, Housing Statistics, July 2021

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CORPORATE OVERVIEW

TA Realty is among the largest and most experienced providers of real estate investment management services to U.S. and non-U.S. institutional investors. Since its inception in 1982, TA Realty has managed more than $30 billion of real estate assets through value-add and core strategies and customized separate/advisory accounts. TA Realty's investment philosophy focuses on creating diversified real estate portfolios that aim to generate strong cash flow, receive intensive asset management and seek to achieve long-term value creation. For more than three decades, TA Realty has maintained this philosophy through multiple real estate and economic cycles, a strength recognized by pension funds, endowments, foundations and high-net-worth individuals. For more information, please visit www.tarealty.com.

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