



First Glance—Apartment Sector

Pre-Release Analysis of **First-Quarter 2005** Reis Findings in the Apartment Sector



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In recent quarters the two forces that have exerted the most substantial drag on U.S. apartment markets—historically low interest rates leading to record home ownership, and sluggish job formation—have lessened, if not entirely abated. The favorable impact on the apartment sector registers clearly in Reis’s data. Despite erratic job growth continuing through the first quarter of 2005, and the still near-record purchasing of both new and existing single family homes, even marginally positive increases in interest rates and employment are sufficient to move the needle in the right direction for apartment investors.

Simply stated, there are more households inclined to rent today than there were in the dark days that began in 2001 and stretched into the first quarter of 2004. After finishing last year with three straight quarters of positive absorption, downward trending vacancies, and rising effective rents, the U.S. apartment market continued to bat three-for-three with respect to these indicators during the first quarter of 2005. The 8,600 units of positive absorption recorded during the first quarter,

while modest in comparison to last year’s second and third quarters, represents a reasonably strong performance for the first quarter of a year, and a positive difference of more than 26,000 units over the same period in 2004. Considering that demand during the winter season is typically softer than in summer months, when newly-minted college graduates enter the work force, this absorption performance is impressive, and represents the best first quarter outcome recorded since 2001.

The Reis Recovery Index Number of Top 64 Apartment Markets Experiencing Positive Symptoms			
	Positive Absorption	Falling Vacancy	Rising Effective Rent
Q1 2005	39	33	50
Q4 2004	41	26	45
Q3 2004	49	38	58

In the top 64 metropolitan markets tracked by Reis, the average vacancy rate edged downward 10 basis points to 6.6%. Effective rents rose 0.6%, up from the 0.3% increase of the previous quarter. Landlords may have been emboldened by the slackening pace of new construction. During the quarter only 16,800 units were added—the lowest quarterly completions total recorded since the beginning of the downturn—reducing the formidable competition presented to

existing properties by the market entry of new units.

The Reis Recovery Index shows modestly more winners than losers in terms of absorption and falling vacancy, but a landside victory for winners in effective rent. Of the top 64 markets tracked by Reis, 39 recorded positive absorption, 33 falling vacancy, and 50 rising effective rents. Only three markets recorded negative results in all three categories: Birmingham, Louisville, and, somewhat surprisingly, Philadelphia. Twenty-six markets recorded positive results in each category.

As always, beneath the simple plus or minus indicators there is considerable variation in performance from market to market. The rate of absorption was highest in Atlanta (1,597 units), Phoenix (1,326), Tampa (948), Houston (736), and Raleigh-Durham (732). Among the markets recording the weakest absorption were Miami, Northern Virginia, and Fort Worth, with negative absorption of 995, 954, and 898 units, respectively.

Palm Beach recorded a 1.4 percentage point decrease in vacancy, followed by Wichita with a 0.8 percentage point drop, and six metropolitan markets each recording vacancy rate decreases of 0.6 percentage points: Orlando, Charlotte, Greensboro/Winston-Salem, Salt Lake City, Tampa, and Tucson. At the other end of the

yardstick, Fort Worth, Birmingham, and Albuquerque recorded percentage point vacancy increases of 0.9, 0.8, and 0.6, respectively.

But it is rent growth performance that we have pegged as the welcome latecomer to our recovery. Ten metropolitan markets recorded increases for the quarter of 1.1% or greater. Leaders in this category were Palm Beach (1.8%), Las Vegas (1.5%), San Bernardino (1.4%), Jacksonville (1.4%), and Norfolk (1.3%). Among the only ten markets recording declines in effective rent, Pittsburgh, Birmingham, and Salt Lake City “led” the way with decreases of 0.6%, 0.5%, and 0.5%, respectively.

As we admonished last quarter, there remains at least one factor on the horizon that stands to dilute the beneficial effects of a moderate economic recovery, and that is the pace of new construction. Reis is tracking units slated for market entry that exceed the expected absorption rate by 5,600 units in 2005, 8,000 units in 2006, and by more than 15,000 per year from 2007 through 2009. Because of this imbalance, the vacancy rate will see only modest declines during the same period, and will not dip below 6.0% until 2008, though effective rent growth will begin to exceed 3.0% starting in 2006.

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