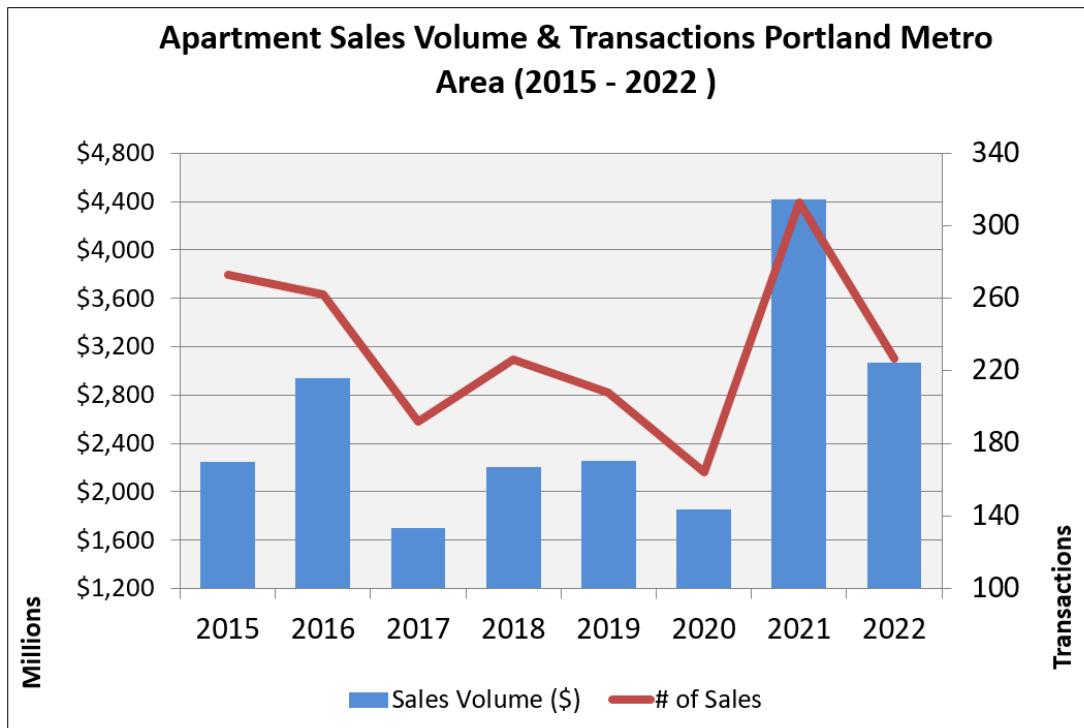


Spring 2023 – Apartment Fundamentals & Trends

The whiplash in the apartment market continues as we enter a tumultuous 2023 with many questions unanswered. We've gone from dread after the onset of COVID in 2020, to enthusiasm during 2021, to increasing anxiety throughout the second half of 2022 and YTD 2023. Many of our apartment fundamentals are shifting towards a market in balance which is a new phenomenon for those who entered the market over the past 10 years. This article will address Portland Metro apartment fundamentals, value, sales, and rental trends for 2022 and YTD 2023.

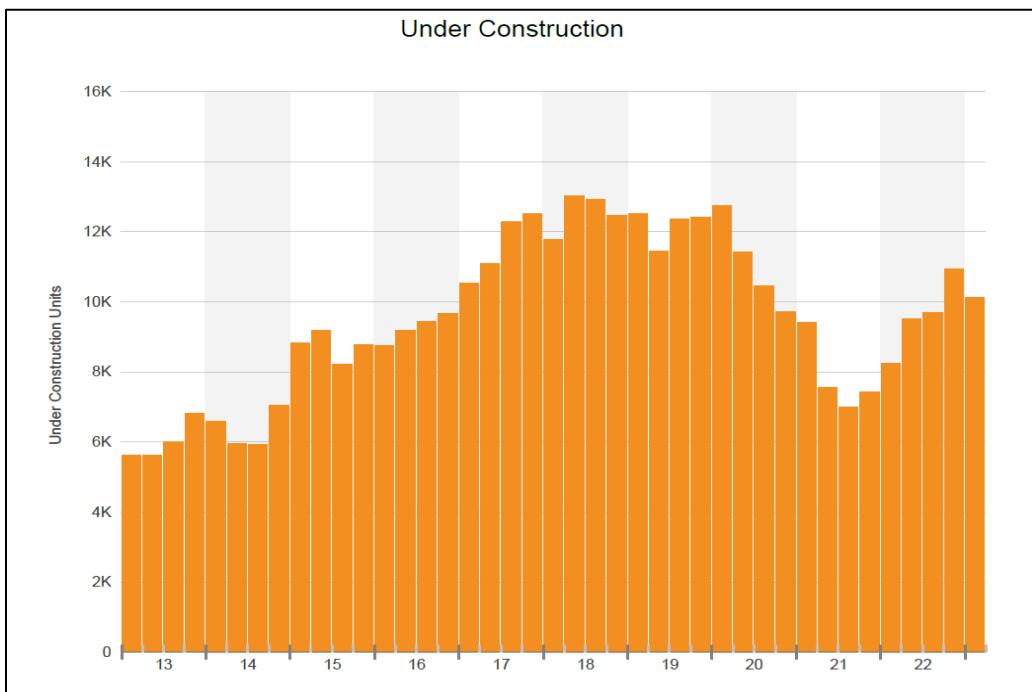
Apartment Sales Volume & Transactions – During 2022, there were 225 transactions totaling just over \$3.0 billion. While 2022 sales activity was well below 2021, 2022 was one of the busiest years on record for the apartment market. However, November and December 2022 showed a dramatic slowdown with an average of eight sales per month while the balance of the year averaged 21 sales per month. The slowdown in sales during YTD 2023 has been astonishing and unprecedented. **Through March 27, 2023 CoStar is reporting a total of nine transactions across Multnomah, Washington, Clackamas and Clark County.** While there may be some delayed reporting, the first three months of 2023 may be the slowest three months the Portland apartment market has experienced. For comparison, 2008 was one of the slowest years on record and the market averaged nine transactions per month.



Apartment Construction – There is a renewed focus on housing production, with an ambitious goal of 36,000 new units per year across Oregon. A significant increase in housing production would help Oregon maintain their competitive advantage over other west coast cities with regards to lower housing costs, which in turn helps to attract employers and population. However, housing producers in Oregon have faced many headwinds in recent years with increased apartment regulation, challenges throughout the urban area, slowing population growth, a

permitting system marred in delays, and one of the nation's highest tax rates. Some recent changes in the banking industry along with shifting apartment fundamentals may create additional challenges to housing producers.

The peak construction years of 2017 through 2019 was a driving force slowing rent increases prior to 2020. The total number of units under construction across the metro area dropped from around 12,500 in early 2020 to 7,000 in mid-2021. As of early 2023, there are around 10,000 apartment units under construction across the metro area. In recent years, housing development has shifted away from Multnomah County, which now represents around 30 percent of new units compared to around 60 percent of new units prior to Covid. While multifamily permits are up across the Metro area, some uncertainty may result in few units actually being built.



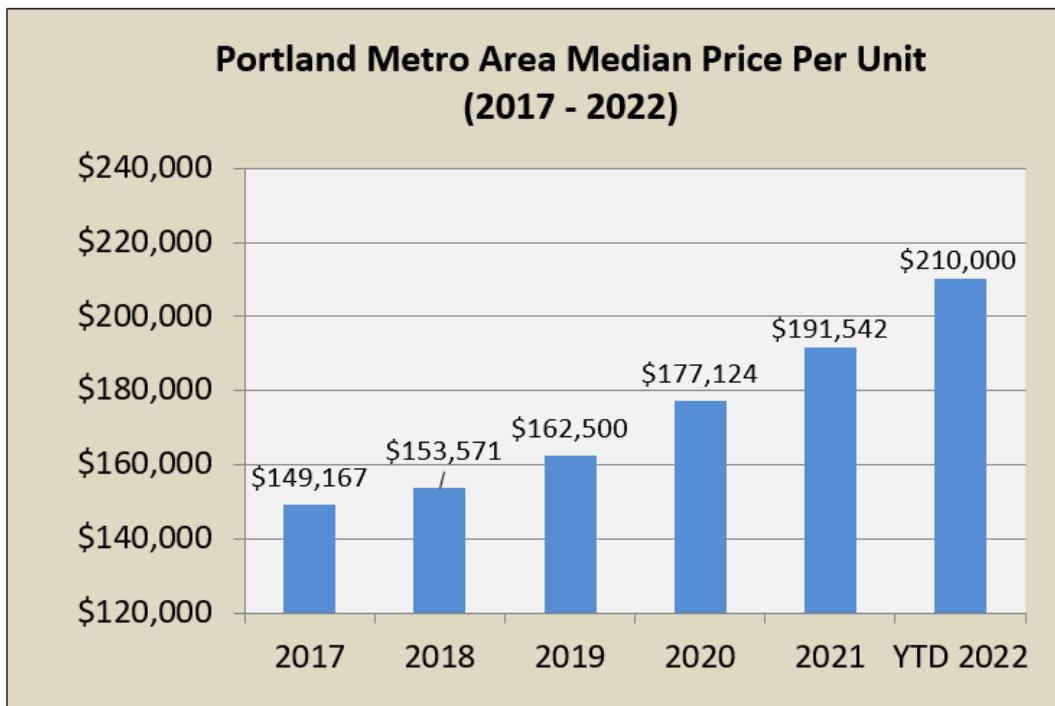
Source: CoStar

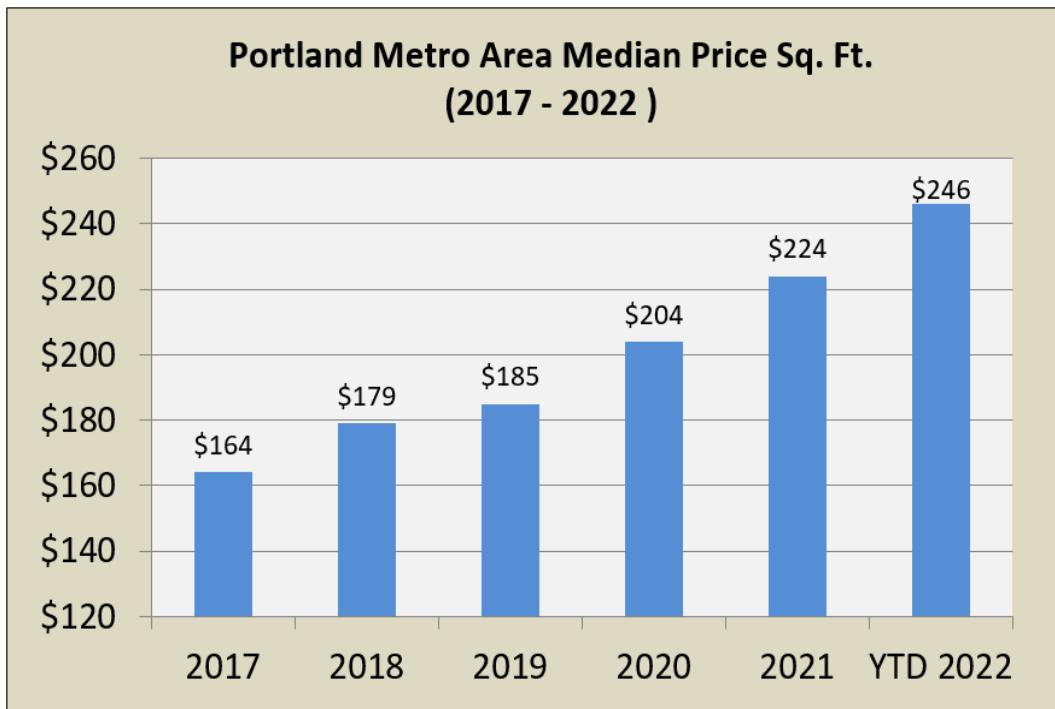
Vacancy and Rent Trends – As we now know, the drop in vacancies and increasing rents from 2020 to mid-2022 were driven by increasing household formation alone. With population growth stagnating and a high likelihood of household formation slowing, the current supply of new units is projected to outpace demand and is forecast to do so through 2024. Vacancies have increased up by 100 to 150 basis points over the past 12 months. During this same period, rent increases have slowed and some submarkets have shown declining rents. Any decline in rents will be minor compared to the gains experienced since 2020. Most forecasts are calling for slowing rent growth in the years ahead, ranging from 1.0 to 3.0 percent per year across Portland Metro through 2024. Vacancies are forecast to show further increases of 50 to 150 basis points in the years ahead

The rental survey herein reports Metro vacancy rates at around 5.1 percent and or an increase of 150 basis points since Fall 2022. In a major shift from recent reports, 17 of the 20 submarkets surveyed reported increasing vacancy rates and seven submarkets reported decreasing rents. The return of demand to the urban area has remained slow. The five most urban submarkets in this survey show an average vacancy rate of 6.5 percent while the

remaining 15 submarkets which are mostly suburban show an average vacancy rate of 4.8 percent. Only Aloha and Milwaukie show vacancy rates below 4.0 percent.

Apartment Value – There were around 225 transactions in 2022 and these sales show a median per unit price of \$210,000 and median price per Sq. Ft. of \$246 per Sq. Ft. The 2022 per unit and per Sq. Ft. prices were up 9.6 to 9.8 percent year over year, respectively. The increasing prices in apartments can be attributed to low interest rates through the first half of the year and stable fundamentals. It is too early to make any conclusions for YTD 2023 based on just nine sales. Given the higher interest rate environment, considerable economic uncertainty, major price increases since 2020, increasing vacancy rates, and slowing rents, it is unlikely that prices will show any significant increases in 2023 and a decline in prices is possible.





Risks

Many of the risks that emerged in late 2022 and will remain significant concerns throughout 2023. Some of the more notable risks are summarized below.

- There is a higher interest rate environment and there is turmoil in the banking sector. There are concerns regarding the availability of future financing and at what terms. The phrase 'cash-in refinance' may be more common place by the end of 2023
- A gap remains between buyers and sellers evidenced by only nine sales through late March 2023. Until common ground is established between buyers and sellers, the sales market will likely remain paralyzed. The lack of transactions will adversely impact brokers along with all those that rely on transactions.
- Changes in population growth patterns as Oregon, along with Portland Metro have shown limited if any population growth in recent years. If this trend of stagnant population growth continues in to 2023 and 2024, there will be major concerns regarding the economic outlook, including future apartment development.
- With little hope for a significant decline in interest rates in the near future, overall capitalization rates on future sales will likely show an increase.

Summary

There is no question that 2022 was a strong year with robust sales and record high prices. However, the turmoil in the final months of 2022 and YTD 2023 has overshadowed any positive feelings about last year's achievements. Apartment fundamentals are expected to transition to a balanced market, though crucial questions remain regarding apartment values and overall capitalization rates. Until sales activity increases, questions regarding values and overall capitalization rates will remain unanswered.