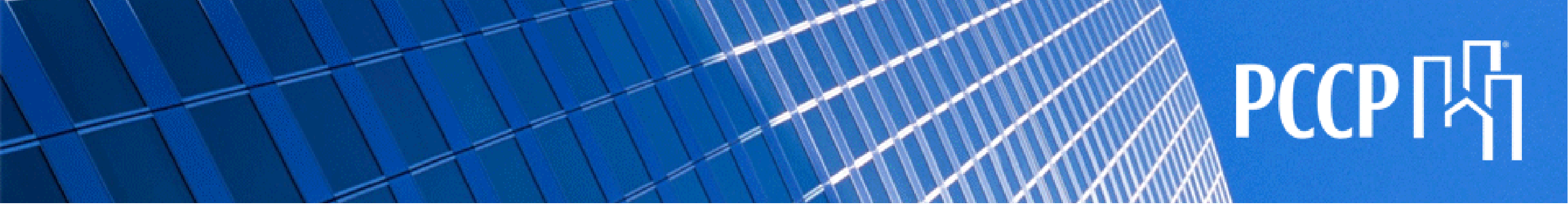


PCCP MARKET COMMENTARY

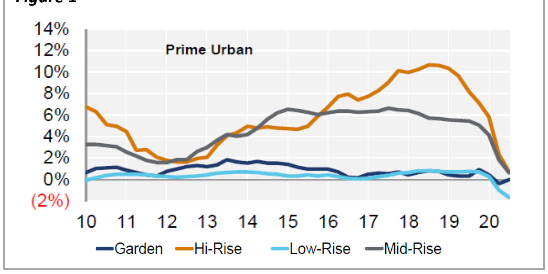
First Quarter 2021

Birds of a Feather, Garden Style

As the COVID-19 pandemic stretches into 2021, we are peppered with news articles attempting to describe and anticipate its social and economic impacts. One of the more fascinating narratives has focused on how the pandemic has changed the way people live – and, more specifically, where they live. The stories in the media suggest that apartment dwellers in the central business districts of cities are flocking to the suburbs as a result of a COVID-induced need for more space. Is the media getting this story right? Our research indicates that while the pandemic has certainly exacerbated the problem, the softening of the urban rental market, and related suburban boom, began before the pandemic hit, and were likely a function of pre-pandemic economic factors like overbuilding and income vs. rent misalignment. A full understanding of this trend and its causes is critical for informed decision-making on potential investment opportunities in these areas.

YoY Demand Growth

Figure 1



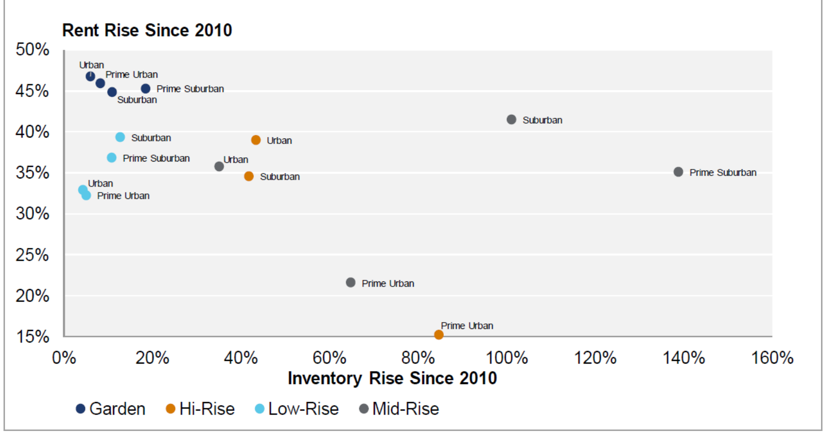
Source: CoStar Advisory Services *As of 20Q3*

There is no question that during the pandemic, the central business districts of cities, also referred to as CBDs or Prime Urban areas, have experienced a drop in demand. In fact, vacancy rates in hi-rise and mid-rise product in Prime Urban areas increased from approximately 7% in 4Q2019 to 12% by 4Q2020 according to CoStar Analytics. However, as exhibited in the graph to the left, year-over-year renter demand for Prime Urban product has been decreasing steadily since early 2019, particularly in hi-rise product. One reason for this decline may be the growing misalignment between average median income (AMI) and asking rents for new hi- and mid-rise product in many CBDs. According to CoStar Analytics, nearly 90% of properties under construction require a qualifying household income above $75,000[1], while only 24% of households residing in multifamily properties nationally earn more than $75,000 annually[2].

In addition, the softness of the CBD market is likely a function of significantly increased product availability in Prime Urban areas in recent years. As outlined in the graph below, since 2010, Prime Urban mid-rise and hi-rise product inventories have increased 65% and 85%, respectively. This has resulted in cumulative rent growth of only 22% for hi-rise product and 15% for mid-rise since 2010. This is particularly striking when compared to the cumulative rent growth of garden and low-rise product, which has increased 50% over the same time period.

Rent Rise and Inventory Rise Since 2010

Figure 2



Source: CoStar Advisory Strategy *As of 20Q3*

The bottom line is that the supply of mid-rise and hi-rise product in Prime Urban areas has outpaced demand over the past 10 years. This has resulted in lackluster cumulative rent growth, particularly relative to these products in suburban locations, which have seen large inventory increases and higher rent growth. While COVID-19 exacerbated the 2020 demand decline, Prime Urban areas were already softening.

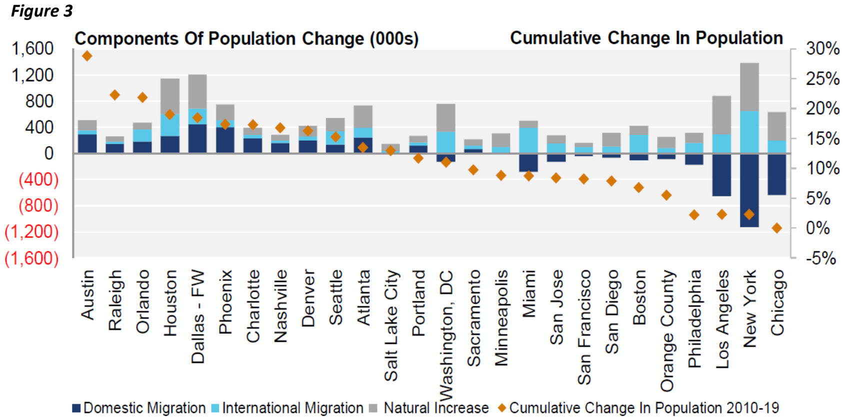
[1] SOURCE: COSTAR PORTFOLIO STRATEGY, ASSUMES 20% OF INCOME NEEDED, AS OF 19Q2

[2] SOURCE: U.S. CENSUS ACS SURVEY; COSTAR PORTFOLIO STRATEGY; AMERICAN COMMUNITY SURVEY DATA THROUGH 2019, AS OF 20Q3

Let us look at Austin as a case study. Austin's population has grown 30% cumulatively over the last 10 years – the highest rate in the nation – with the majority of that growth the result of domestic migration, as shown in Figure 3.

Components of Populations Change

Figure 3



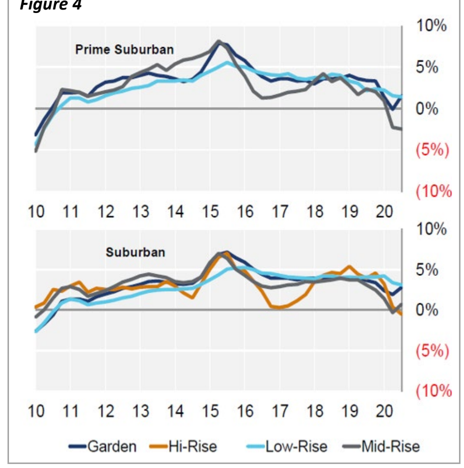
Source: U.S. Census, CoStar Advisory Services *As of 20Q3*
Note: Includes only CoStar's top 54 metros

According to CoStar Analytics, inventory in the overall Austin apartment market has increased 50% cumulatively since 2010, with average annual deliveries of 7,600 units, and average annual absorption of 6,400 units over that same time period. This has resulted in a 32% increase in the overall market vacancy rate, from 7.7% in 2010 to 10.2% in 2020. When we look solely at Austin's CBD apartment market, inventory has doubled since 2010 (from 2,382 to 4,713 units) while annual absorption has fallen from a peak of +550 units in 2015-2016 to 74 in 2018 and -15 in 2019, doubling vacancy from 5% in 2018 to 10% in 2019[3]. This trend suggests that even in the highest growth markets with regard to population, submarkets with aggressive supply additions (and aggressive asking rents) were softening prior to the global pandemic, which then further exacerbated the trend.

In contrast, garden and low-rise product inventory, which has been historically underbuilt as shown in Figure 2, has increased less than 20% in both products categories (despite location) since 2010. This has resulted in 30-50% cumulative rent growth since 2010. COVID-induced absorption of suburban product, which is predominantly low-rise and garden, has resulted in positive rent growth in 2020 for predominantly all product types.

YoY Rent Growth

Figure 4



Source: CoStar Advisory Services *As of 20Q3*

In conclusion, the data suggests that the media is generally correct that the pandemic has contributed to the lackluster performance of CBDs and strong performance of suburban multifamily product but misses the pre-COVID-19 origins of this trend. At PCCP, we began following the movement of rental market strength from urban centers to prime suburban areas before they were accentuated by the pandemic and have sought to capitalize on this trend with numerous strategic investments. We expect these opportunities to increase as the COVID-induced softening in CBDs continues. We anticipate increasing opportunity for acquisitions of underperforming product at a discount to last cycle's peak pricing, even as cap rates continue to compress. In particular, we foresee an opportunity to lean into these product profiles in high growth markets such as Austin and the other leaders in Figure 3, and to look back to lesser growth markets (New York, Los Angeles, Chicago, etc.) for distress opportunities, while keeping a close eye on supply.

Our thanks to PCCP's Tina Ramos in drafting this quarterly newsletter.

Greg Eberhardt	**Kate Giordano**	**Brian Heafey**	**K.C. Kriegel**	**JD Park**	**Bryan Thornton**
geberhardt@pccpllc.com	kgiordano@pccpllc.com	bheafey@pccpllc.com	kkriegel@pccpllc.com	jpark@pccpllc.com	bthornton@pccpllc.com
(310) 414-2004	(646) 971-3352	(415) 732-7548	(646) 308-2102	(310) 356-2216	(415) 732-7649

[3] SOURCE: COSTAR