COVID-19 Crisis Looms Large Over the Apartment Market

Apartment owners are facing a more challenging environment. A growing supply and demand imbalance is leading to sharply higher vacancies. Landlords in many major markets have already begun to slash rents.

COVID-19 Crisis Taking the Air Out of Apartment Rents

Apartment market fundamentals are being hit hard by the coronavirus crisis. Widespread efforts to suppress the pandemic have led to massive job losses, predominantly among hourly workers in the leisure & hospitality and retail industries, who disproportionately tend to be renters. Even though the labor market looks to be on the mend, a full recovery is far off and generally weak employment conditions are weighing heavily on rental demand. The supply side is equally concerning. Over the past decade, there has been a boom in new apartment construction centered in a handful of dense urban areas in the major gateway markets and rapidly growing secondary markets. While new development has started to pull back, many of these markets are set for a wave of new supply as major projects are completed this year.

The growing imbalance between supply and demand is beginning to take a toll on rents. The primary tenant rents sub-index of the Consumer Price Index has slowed markedly since March and, during June, registered the weakest yearly gain since 2014. Digging deeper, several large markets appear to be behind the slowdown. Since the onset of the COVID-19 crisis, landlords in many of the largest apartment markets have been slashing rents, according to data from CoStar. The trend is most evident in the relatively high-cost markets of San Francisco, New York City and Los Angeles. Along with having large numbers of workers in the embattled hospitality and retail industries, these metros have a heavy concentration of workers in office-using industries (such as tech, media, and finance). The sudden ability to work remotely has spurred an exodus of residents to the more affordable surrounding suburbs or other states. After all, why pay higher rent to live in an urban area, when the restaurants, bars and cultural amenities are closed? Rents have been more buoyant in Dallas-Fort Worth, Charlotte and Nashville. Even before the public health crisis, these areas had long been beneficiaries of residents and businesses fleeing high-cost areas, a trend which is now helping support rents. Apartment rents in Miami, where COVID-19 cases continue to surge, appear to be sliding. Miami has seen a record number of units delivered over the past three years and has more on the way. In addition to a supply overhang, the Miami economy is in part driven by the battered international trade and tourism sectors, meaning demand will likely be slow to return.

Challenging times for apartment owners are likely to persist for some time. The bounce back in job growth in recent months has likely already subsided. Bars, nightclubs and cultural attractions have shut down again or reduced hours. Mortgage rates recently hit new lows, which may pull some renters towards homeownership. Even though new apartment construction will surely slow, a deluge of new units are set to be delivered in coming months. We expect vacancy rates to rise over the next year and look for the slowdown in rent growth to continue, with higher-cost markets getting hit the hardest.

Source: U.S. Department of Labor, CoStar and Wells Fargo Securities
Wells Fargo Securities Economics Group

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