The Apartment Vacancy Report Executive Summary

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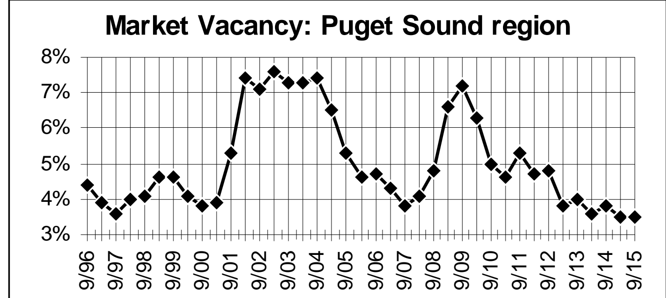
Vacancies Stay Low & Rents Keep Climbing — Is There A Repeat Button? Nope. Not Likely.



The market vacancy rate is 3.5% in the Puget Sound region, unchanged from last spring. The market rate excludes vacancies in new properties in lease-up. Counting those, the gross vacancy rate is 4.8% now, compared to 4.7% in March.

We thought both rates would be a little higher than that, hovering around 4% and 5% respectively until the middle of next year. But job growth and in-migration were stronger than expected, which increased demand. Also, some new projects that were scheduled to open in the past six months were delayed.

Fear not, they will be opening soon. Developers opened almost 7,000 units already this year. And they hope to open another 4,800 units by year-end if their subs show up and weather cooperates. There will be delays. But 2015 will still be a big year for apartment development. In fact, developers will open more units this year than we've seen since 1990. Of course, our population and economy are a lot larger now, but that's still impressive.

Rents rose 5.6% in the region since March and are 8.3% higher than they were a year ago. Most of each year's rent growth usually takes place between spring and fall, and this year is no exception.

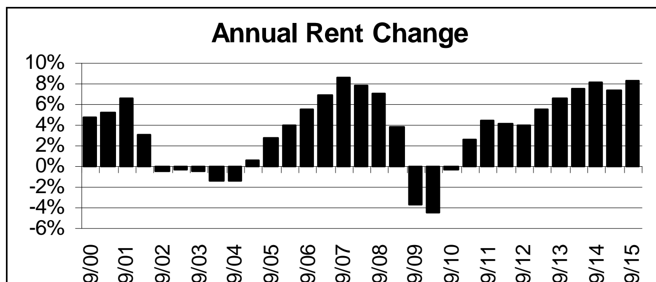
But properties didn't really raise their rents that much. One thing investors need to be careful about right now is the impact that new construction has on rent trends. New units rent for more, distorting rent trends. We call this the *skew of the new*. New construction costs more and typically gets a rent premium of more than 40%. And with so much new construction happening, and a lot more to come, this rent distortion is becoming significant. Investors need to take this into account more than ever.

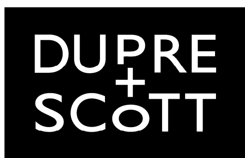
Here's why. When you exclude the new units that opened this year rents rose 6.4%, not 8.3% over the past year. That's a more accurate measure of actual rent increases. And we're just beginning to see the distortion that new construction will create.

New construction doesn't just impact rent trends. It also has an impact on rents in existing properties. What kind of an impact? Moderating, at best.

And we're already starting to see that happen in Seattle where a lot of the new construction is taking place. Rents rose 5.1% in Seattle over the past 12 months excluding new units that opened this year. That's a smaller increase than the 6.9% increase the rest of the region, excluding Seattle, experienced. And it's down from the year before when Seattle rents climbed 8.1%, excluding new units that opened last year.

But wait, there's more. If you look at the in-city Seattle market where a lot of the new units are happening, between the stadiums, Ship Canal, Lake Washington, and Puget Sound, the impact of new construction on rents is even





We provide research on apartment investment and market trends in the Puget Sound region. Our goal is to enhance the quality of information available to help our clients make better decisions. We believe the long-term health of the Puget Sound region's rental housing market is important to everyone involved in this housing market. We are convinced the market will work best when informed, timely, reliable, and unbiased market information is available. Thank you for supporting this research.

Patty Dupré + Mike Scott

more obvious. Adjusting for new construction, rents went up just 3.9% in the past twelve months. That's down from 8.4% a year earlier. We expect the rate of rent increases to slow further as more new units open over the next few years.

And survey respondents agree. Last fall 72% of the survey respondents told us they planned to increase rents in the next six months by an average of 2.9%. They were close. Rents rose 2.6% between last fall and this spring. Now only 32% say they expect to raise rents by next March. As a result, we expect rents to increase about 1.5% by spring. Oh what a difference a year makes.

As you can see from the chart on page 1, rents are cyclical. Sometimes investors forget that. They shouldn't. Since 2000, rents have gone up, down, and flattened out, resulting in an increase of just 2.8% compounded annually, excluding the distortion caused by new construction. By comparison, real estate taxes and utilities increased 5.4% compounded annually over the same period.

There is a very significant and unsustainable disconnect between these cost increases and apartment rents. That's particularly true since these are the two largest operating expenses investors have. And it happened even though most investors have invested significantly in energy conservation measures over the past five to ten years to rein in utility costs.

Although the region's gross vacancy rate edged up a little bit in the past six months, it wasn't much of an increase, at least in most areas. You can thank a strong economy for that. And not just strong. Stronger than expected. A new quarterly forecast from Conway Pedersen Economics expects our region will add close to 64,000 jobs this year. That's 13,000 more jobs than they anticipated back in March. We haven't seen that kind of job growth since the late 1990s.

Another positive trend is in-migration to the region. While not exactly a measure of in-migration, driver license data is close to a "real time" substitute and valuable because it is updated monthly. The number of people in this region who turned in out-of-state licenses is up 9% in the first eight months of this year compared to the same period in 2014. And it's up 17% compared to 2013.

Investors should expect the rental market to soften soon due to trends impacting both demand and supply. On the demand side, Conway Pedersen forecasts a significant slowing in job growth over the next few years. It will still be positive, just not as positive as this year.

And then there's the supply side. In addition to 11,000 new units we expect developers to open this year, we count another 11,000 units scheduled to open next year. That's not all. Developers are working on another 30,000 units they hope to open in 2017 and 2018. That's a total of 52,000 new units between 2015 and 2018.

They probably won't all happen, at least not as scheduled. There will be delays and some projects may get shelved. Even so, we're looking at a lot of new units. Plus, there's still time for developers to find sites and get projects built by the end of 2018. And we're seeing them do just that almost every week.

Can demand keep up with all this new supply? The honest answer is, who knows. Demand in King, Pierce, and Snohomish counties has averaged just over 7,900 units a year over the past three years. That worked well for investors in 2013 when developers opened 7,100 new units. It worked again last year when 7,600 new units hit the market.

But will demand match the 11,000 new units expected this year and even more to come over the next few years? It's possible. We've seen it before. Demand averaged just over 11,000 units a year between 1986 and 1990. It mostly depends on the economy.

Only one in a dozen properties we surveyed offer concessions, averaging $874. That's not a lot of properties offering concessions. But this is the largest concession we've ever seen. And the size of concessions keeps growing. They averaged $600 a year ago and $461 the year before that. We expect the use and size of concessions will grow significantly over the next six to twelve months. Why? Look at the "Units in lease-up chart below." That's why.

More than half the properties include at least one parking space in the rent. Paid parking rates have not changed much since last fall. For example, garage parking averages $111 a month, up from $107 a year ago. Parking is likely to become a more valuable commodity though, since new construction is putting in an average of less than one parking space per unit.

These are some of the findings of our fall survey of 20-unit and larger apartments in the Puget Sound region, published in the *Apartment Vacancy Report*. The survey ended on Friday, September 18th. We proofed the data on Saturday and published the results online on Sunday. We survey the entire market and collected reliable information for 233,473 units in 2,257 properties. That's 87.5% of the market. D+S