Demand for Mid-Priced Apartments Helps Stabilize Multifamily Market

Three-Star Properties Have the Largest Inventory of Units


The three-star Cypress Manor Apartments in Tampa, Florida, center, opened in 2021 and has an average asking rent of $1,748 per month, according to CoStar data. (CoStar)

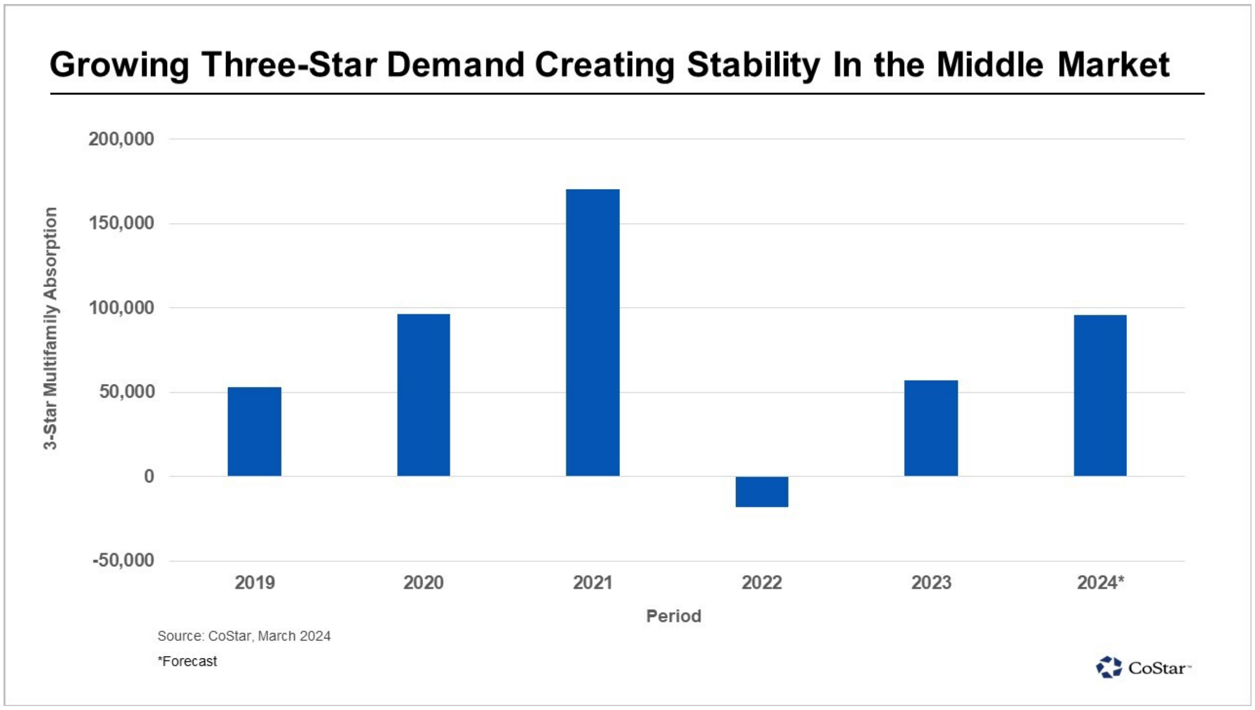
By Jay Lybik
CoStar Analytics

March 27, 2024 | 1:02 P.M.

Demand for mid-priced apartments rebounded in 2023 as rising consumer confidence, lower inflation, strong wage growth and waning recession fears allowed renters in cheaper apartments, and those living in their parent's house, to upgrade their living space or form their own households.

The University of Michigan Consumer Sentiment Index, a monthly survey of consumer confidence levels in the United States, increased by 17 points last year from its 40-year low in June 2022 — the largest 12-month change in the history of the index. Over the same period, inflation has decelerated from 9.1% to 3.2%.

Moreover, the Atlanta Federal Reserve Bank’s Wage Growth Tracker is 5% faster than the still-elevated inflation. That income growth is faster than inflation gives households more disposable income for goods and services as well as more money to cover rent in a new apartment lease.

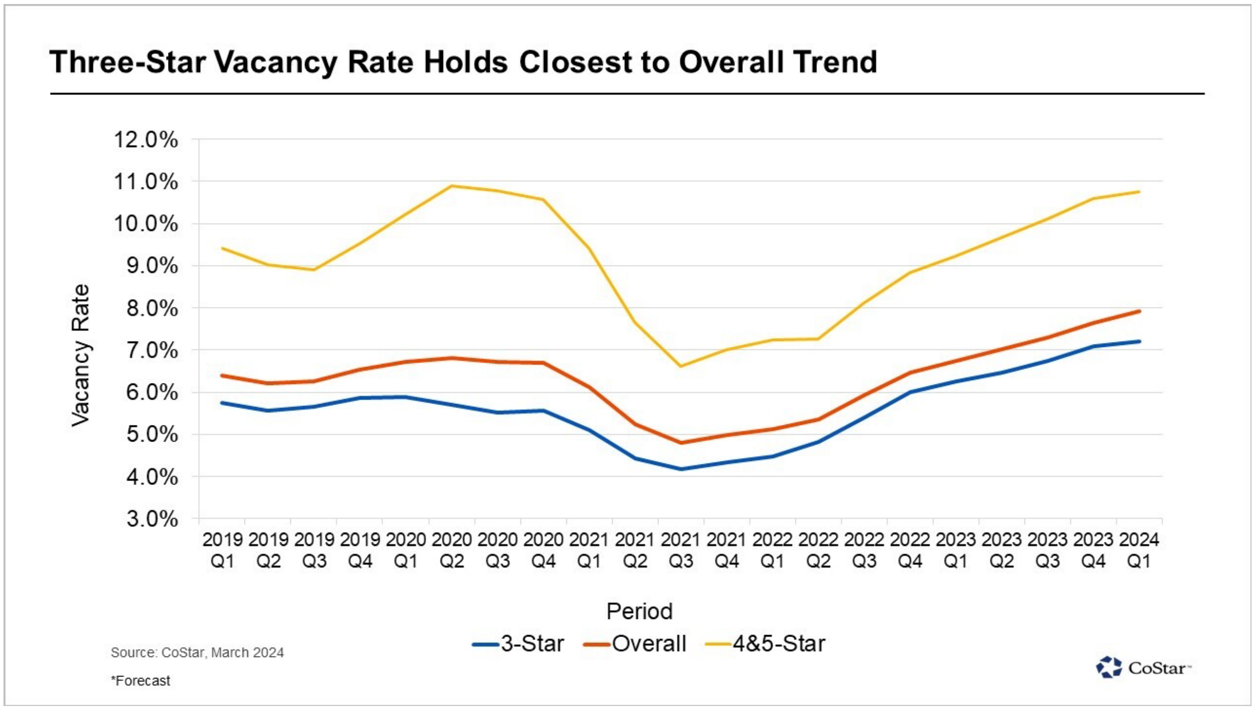


These positive economic changes resulted in the release last year of pent-up household formations, as renters that had held off on moving up in space and starting families of their own due to negative economic conditions signed new leases in the wake of an improved economy. Multifamily demand for units that cost in the range of three-star prices will expand further in 2024, CoStar forecasts.

Results from the first quarter show a solid 19,000 units of three-star demand, the highest quarterly total in three years.

The overall absorption — the difference in units occupied versus vacated — for 2024 stands at 410,000 units, with three-star units expected to account for almost 25% of that total. While that percentage doesn't seem significant, it's essential on an absolute basis because three-star units account for the most significant amount of multifamily inventory, with 7.7 million units of the 19 million total units. That means three-star apartments have an outsize impact on the trend of the overall multifamily market.

For example, since hitting its nadir in the third quarter of 2021, the national vacancy rate has increased by 310 basis points from 4.8% to 7.9%. That is basically in lockstep with the 300-basis-point rise for the three-star vacancy. At the same time, vacancies in high-end four- and five-star properties jumped 400 basis points to 10.7% as overconstruction has significantly thrown the luxury segment out of balance over the past two years.



Rising demand for three-star units in 2024 should cause the vacancy rate for mid-priced properties to stop increasing and stabilize in the 7.5% range. This three-star vacancy stabilization should be one of the factors for halting the rise in the overall vacancy rate during 2024. It will likely help pull it back to its five-year pre-pandemic average of 6.4%.