

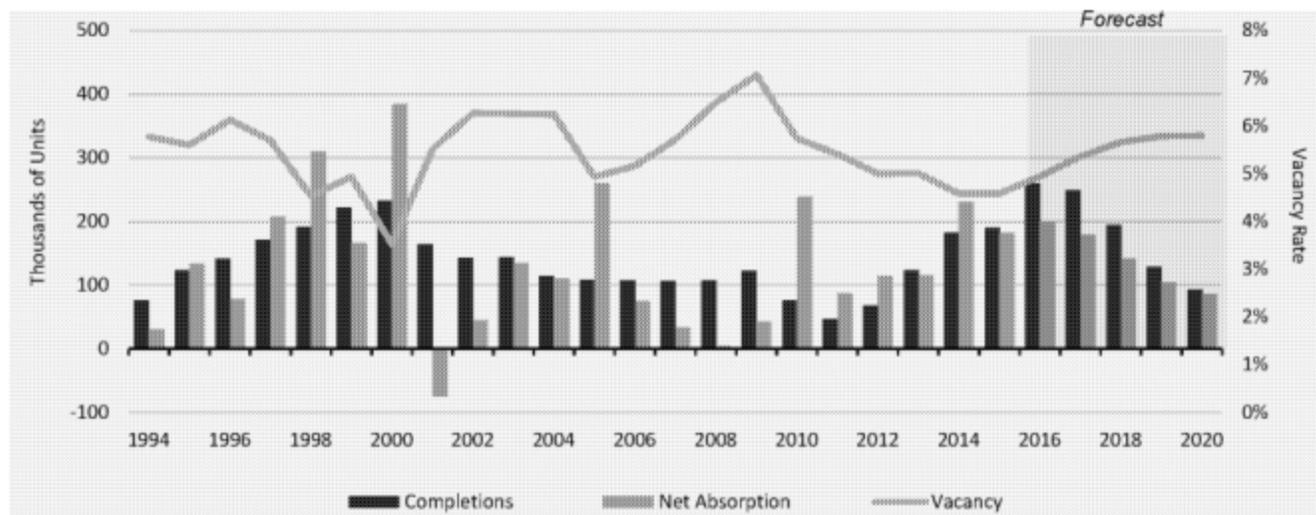
7 Apartment Sector

7.1 Current Conditions

The apartment market remained tight in early 2016, but signs that the sector is moving towards the mature stage of the cycle continue to emerge. The nation's vacancy rate was 4.4% at mid-year, up 10 basis points from a year earlier, the first increase since late 2009.⁴² While vacancy remains near its lowest level since 2000, rent growth likely peaked last year. Despite these signs, investors continue to covet the stable cash flow that apartments provide, keeping yields at historic lows.

Demographics and lifestyle preferences that have delayed homeownership still support strong apartment demand, as does steady job growth. Nearly 29,300 units were absorbed in the first quarter of 2016, the highest figure for a first quarter since 2010.⁴³ Homeownership remains near its lowest point in several decades.⁴⁴ We believe the homeownership rate has likely bottomed, but should remain at current levels for several years. The housing market is improving, but inventory is low, especially for homes that would be affordable for much of the prime renter cohort currently living in apartments.⁴⁵ This should restrict any large outflows of renters into homeownership. Moreover, according to the Nielsen Company, 62% of Millennials prefer to live in mixed-use communities found in urban centers, closer to shops, restaurants, and the office.⁴⁶ Low homeownership and demand for city living has led to a wave of apartment construction projects as developers have rushed to capitalize on demand. Multifamily permits totaled 428,061 units in the 12 months ending May 2016, compared to 398,648 units over the previous 12 months.⁴⁷ Metros with a significant annual increase in permitting include Dallas, Atlanta, Denver, Orange County, Portland and San Diego.

Exhibit 14: Apartment Fundamentals



Sources: CBRE-EA (history); Deutsche Asset Management (forecasts). Data as of June 2016. No assurance can be given that any forecast or target will be achieved.

Despite increases in apartment completions over 2014 and 2015, renter demand was strong enough to push effective rent growth higher. However, new supply and elevated rent levels are already impacting rent growth. After reaching 5.2% (year-over-year) in mid-2015, growth decelerated to 3.5% in June 2016 as a wave of new supply delivered and rent level fatigue set in, especially within CBDs.⁴⁸ Markets where rent growth slowed markedly in the first half of 2016 include San Francisco, San Jose, Oakland, Portland, Denver, New York and Boston. In particular, downtown submarkets in many major metros saw rent growth pull back significantly. Meanwhile, rent growth remained quite robust in suburban submarkets which have not experienced the same level of supply growth as

⁴² CBRE Econometric Advisors. Data as of June 2016.

⁴³ CBRE Econometric Advisors. Data as of March 2016.

⁴⁴ Census Bureau. Data as of April 2016.

⁴⁵ National Association of Realtors. Data as of June 2016.

⁴⁶ Nielsen Company. Data as of January 2016.

⁴⁷ Census Bureau. Data as of June 2016.

⁴⁸ Axiometrics. Data as of June 2016.