

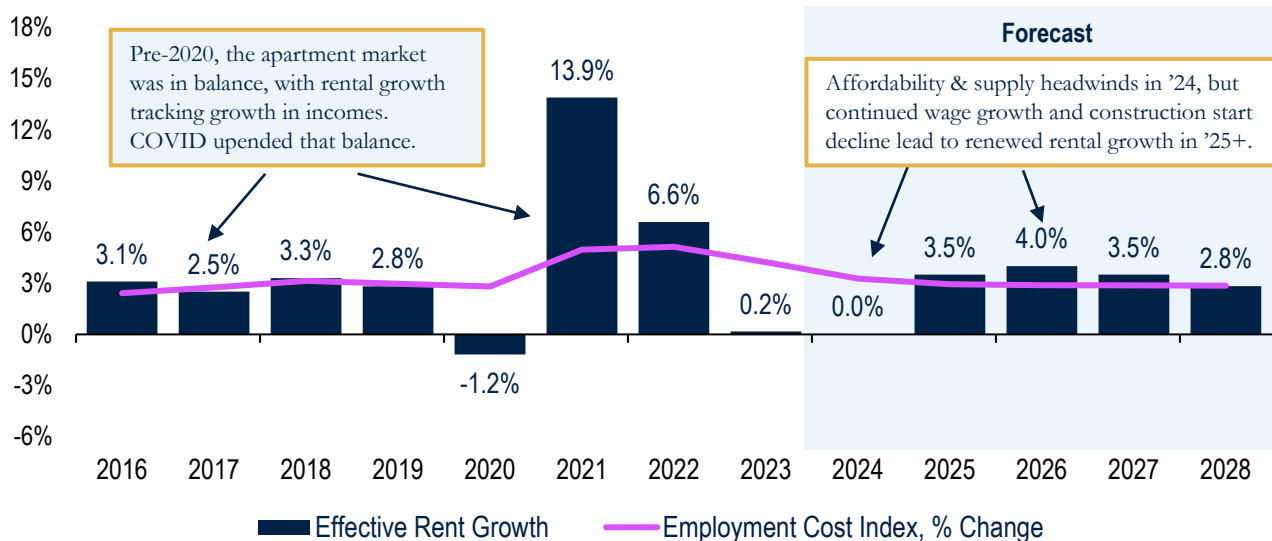
After a Post-COVID Boom, Can Apartment Rents Keep Rising?

The traditionally close relationship between income growth and apartment rents has broken down since 2019, as shown in **Exhibit 1**. In 2020, rents fell even as incomes rose. That proved to be a temporary hiccup, followed by two years when rents spiked. Then, last year two things happened at the same time. New apartments were built at the highest rate in over 20 years, and renters

became cost-conscious. Rent growth abruptly stopped. We expect rents will remain flat for another year, until incomes catch up and the supply wave peaks.

Exhibit 1: Rents Need Another Year to Catch Up With Incomes

U.S. Apartment Rent Growth vs. Wage/Salary Growth (Employment Cost Index*)



* We use the Employment Cost Index as a proxy for income growth because the ECI is a high frequency indicator that controls for changes in workforce occupations.

Sources: RealPage, Moody's Analytics, PGIM Real Estate. As of February 2024.

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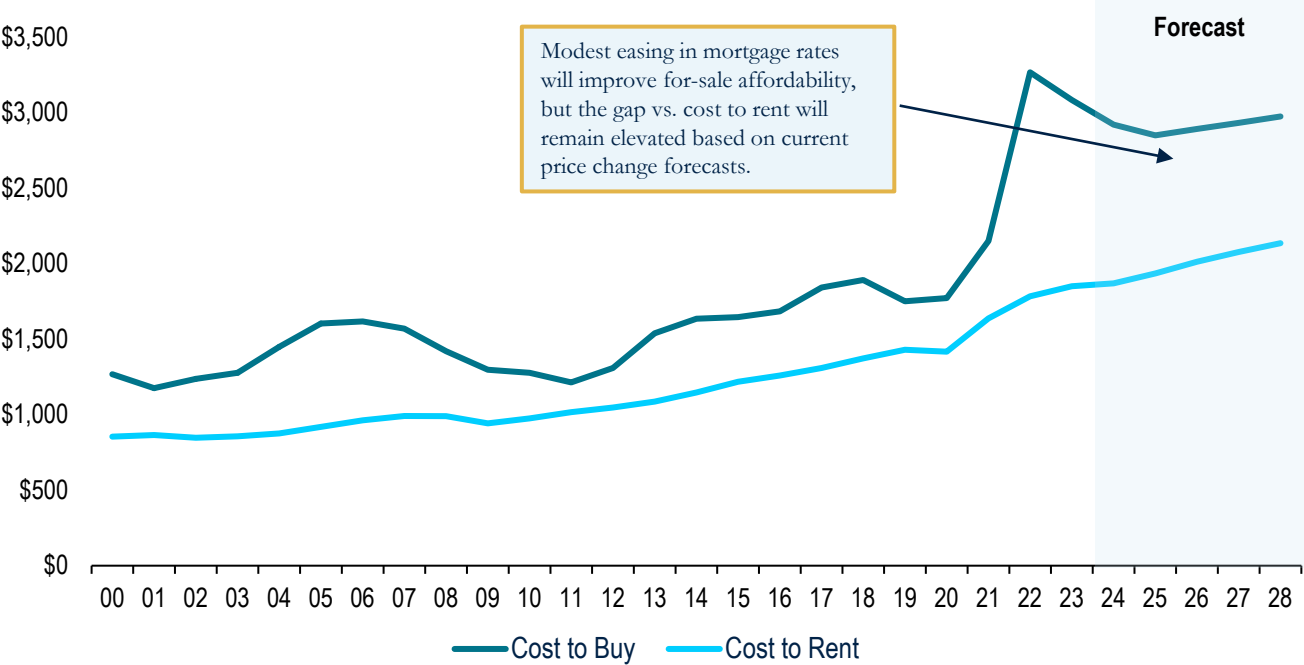
With rents rising well ahead of incomes, and a wave of new supply that will persist into 2025, one might wonder why average rents aren’t declining. (In some of the more oversupplied markets, they are falling, though this is counterbalanced by gradually rising rents in cities that have less new construction.)

The answer is shown in **Exhibit 2**, which compares the average cost of renting with the average cost to buy a residence. The increase in home prices and

mortgage rates has made homeownership far more expensive than renting, keeping many who otherwise would have become homeowners in the renter pool for longer. Absent an economic downturn, this puts a floor under rents around today’s levels, while also setting the stage for rent growth to resume once supply pipelines thin out after 2024.

Exhibit 2: Expensive Homeownership Costs Limit Rent Declines

Cost to Buy vs. Cost to Rent, Monthly Payment



Sources: Federal Reserve Board, Oxford Economics, RealPage, Moody's, American Community Survey, PGIM Real Estate. As of February 2024.
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That average tells an incomplete affordability story for apartments. While rents outpaced average income growth in 2021 and 2022, this affordability squeeze was not borne equally across renters. As shown in **Exhibit 3**, rent-to-income ratios rose more in the Class B and Class C segments than in Class A** rentals.

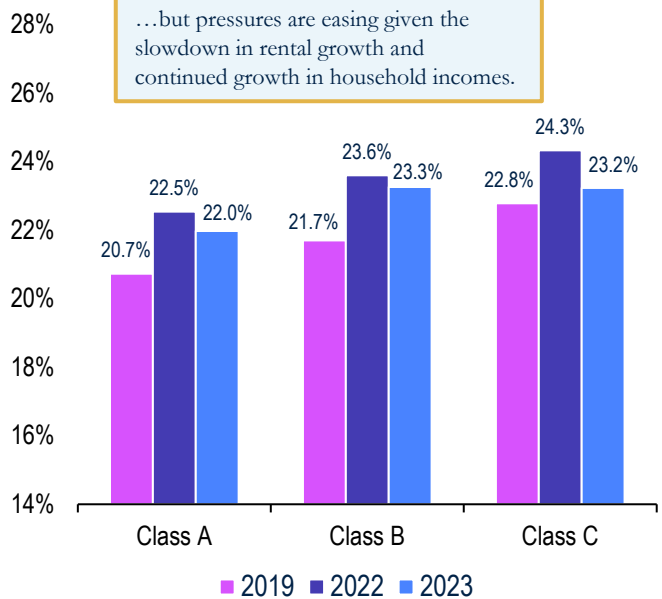
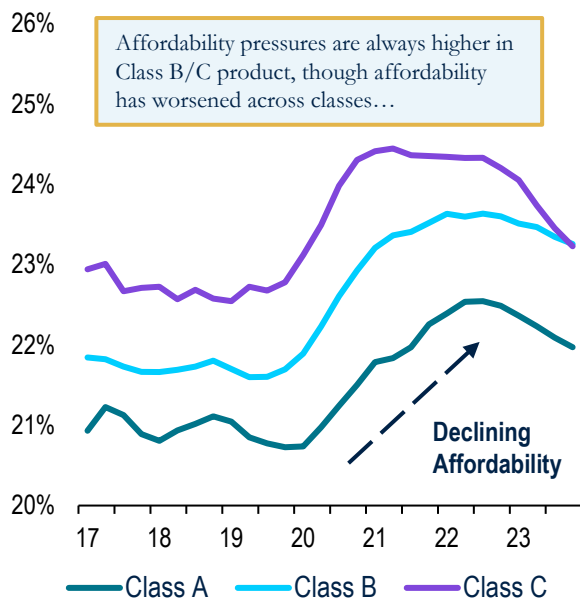
Since 2022, apartments have become more affordable across classes, as incomes grew and rent growth slowed, yet with significant differences. Class A renters have benefited from the addition of more

units, giving them better bargaining power. Class C renters have benefited the most from tight labor markets, with wage growth for the lower-income households increasing faster than average- and high-income households.

That has left middle-income renters the most strained. Rent-to-income ratios for Class B renters have only declined by 30 basis points since the 2022 peak, and are now the same as for Class C renters. We expect these renters to push back most on rent increases this year

Exhibit 3: Affordability Pressures Are Highest in Class B/C Rentals

Median Rent to Income by Apartment Class*



*Institutionally owned properties as tracked by RealPage.

** Class A represents apartments that have the highest rents per square foot, accounting for approximately 1/3 of the stock at the national level, followed in quality by Class B and Class C.

Sources: RealPage, PGIM Real Estate. As of February 2024.

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