Yardi® Matrix

Twin Cities' Solid Foundation

Multifamily Report Winter 2018

Occupancy Rate Tops Nation

Education, Health Services Employment Soars

Affordability Concerns Mount

Market Analysis

Winter 2018

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Strong Demand Pushes Occupancy to Top

Twin Cities' multifamily market remains one of the most vigorous in the region, as evidenced by steady employment gains and an increasing population. Although investor appetite continues to be high, deliveries—especially for low-income renters—haven't kept up with demand. One result is that the market boasts the highest occupancy rate among major U.S. metros, at 97.7%, enabling 3.9% year-over-year rent growth through November, well above the 2.5% national average.

Benefiting from a strong talent pool coming from prominent universities and a thriving health-care industry, the metro added 44,200 jobs in the 12 months ending in September, about one-third of which were in the education and health services sector. Apart from the $5.6 billion DMC initiative that broke ground on its first phase, Health Partners opened a $75 million Neuroscience Center in St. Paul. One of the largest infrastructure projects—the light-rail line linking downtown Minneapolis to Eden Prairie—will spur more opportunities for transit-oriented development, with authorities slated to begin work on the extension in 2018.

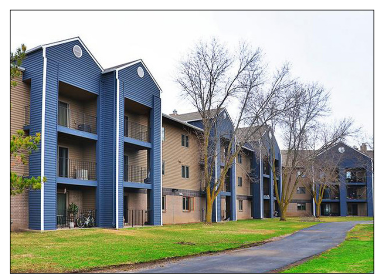
Roughly 6,700 units were underway as of November, most targeting high-income residents. This has put pressure on affordability, leading municipalities to step in by endorsing nonprofits to acquire Class B/C buildings in exchange for keeping rents low. The issue might escalate going forward, especially since investors are looking for old suburban stock that can be renovated into higher-rent housing.

Recent Twin Cities Transactions

The Grand Reserve at Eagle Valley

City: Woodbury, Minn.
Buyer: Goldman, Sachs & Co.
Purchase Price: $97 MM
Price per Unit: $245,622

Park Place



City: Plymouth, Minn.
Buyer: Investors Real Estate Trust
Purchase Price: $92 MM
Price per Unit: $184,600

Vintage on Selby

City: St. Paul, Minn.
Buyer: Zurich Alternative Asset Management
Purchase Price: $87 MM
Price per Unit: $414,286

Arrive Eden Prairie

City: Eden Prairie, Minn.
Buyer: FPA Multifamily
Purchase Price: $85 MM
Price per Unit: $166,831

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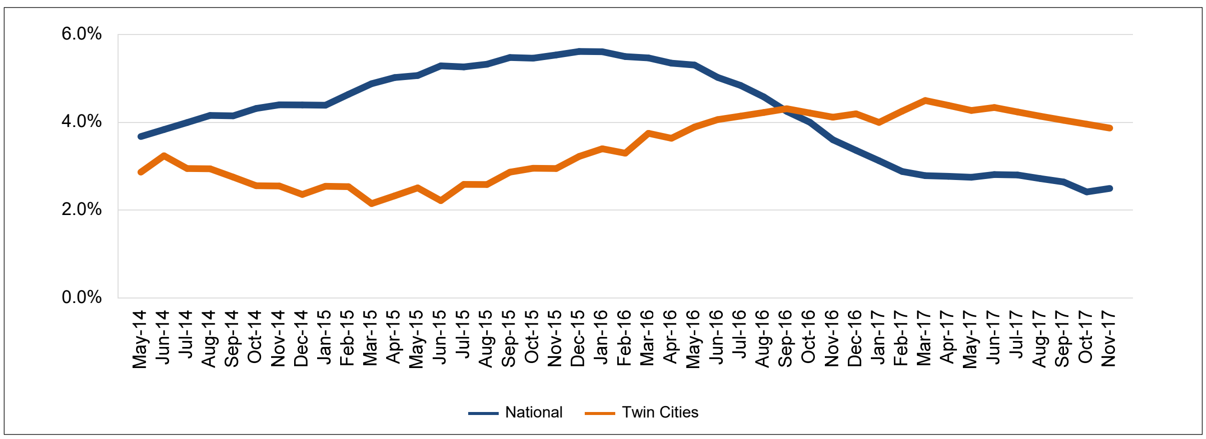
Rent Trends

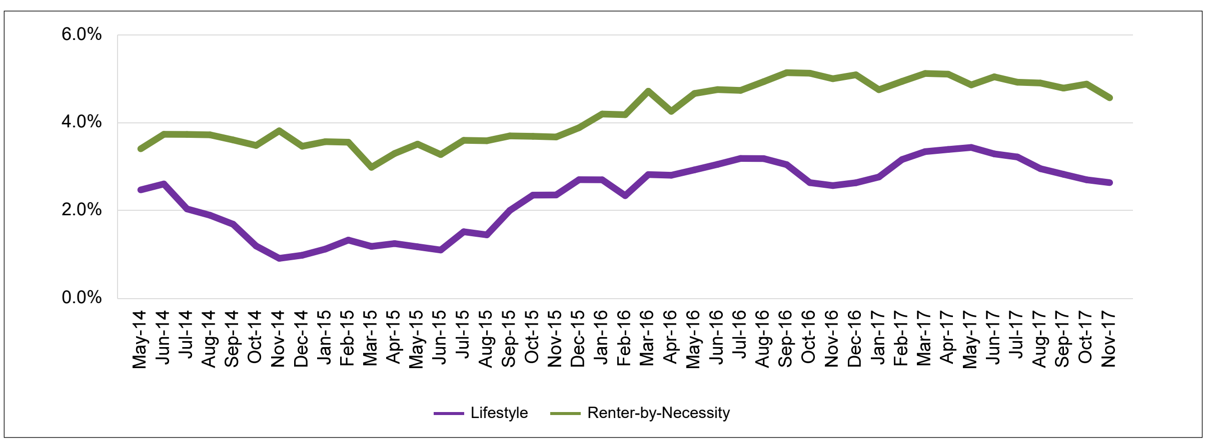
- Rents in Minneapolis-St. Paul rose 3.9% year-over-year through November, well above the 2.5% national rate. However, the average rent of $1,210 is still nearly $150 below the national average. The increase in new households, strong job growth and expanding acceptance of renting as a lifestyle have kept demand solid.
- The working-class Renter-by-Necessity segment continued to lead growth, with rents up 4.6% to $1,054. At $1,559 as of November, Lifestyle segment rents rose only 2.6% year-over-year. With developers heavily catering to high-income renters, there is little new stock for middle- and low-income renters, which will make affordability a mounting issue.
- New supply helped dampen rent growth in some core submarkets such as Sauk Rapids (-2.9%), Chisago City (-2.7%) and Minneapolis–Phillips (-0.5%). At the same time, other central areas are leading gains, most significantly in Cambridge (8.7%) and St. Paul–Summit Hill (8.5%). The northern submarket St. Paul–St. Anthony had the highest rent in the metro—$1,780 in the 12 months ending in November.
- With existing affordable housing being purchased and renovated into higher-rent housing and developers stepping up deliveries in the upscale segment, rents are likely to continue to rise.

Twin Cities vs. National Rent Growth (Sequential 3-Month, Year-Over-Year)



Source: YardiMatrix

Twin Cities Rent Growth by Asset Class (Sequential 3-Month, Year-Over-Year)



Source: YardiMatrix

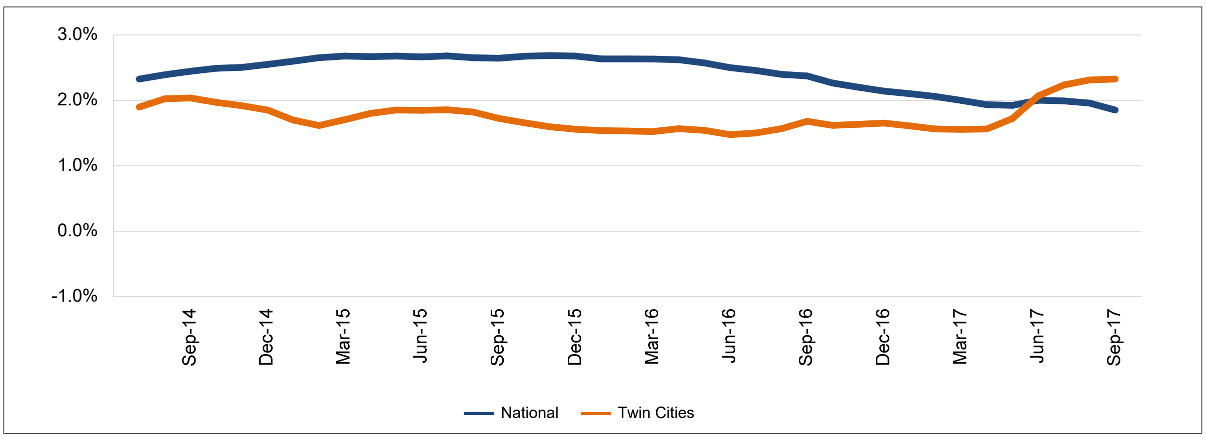
Economic Snapshot

- The metro added 44,200 jobs in the 12 months ending in September, a 2.3% rise yea-over-year, 40 basis points above the U.S. rate. Employment has been consistently solid in the Twin Cities, with the rate last dipping below 1.5% in June 2016. All signs point toward continued improvement.

- Leading the way is the education and health services sector, which added 14,900 jobs, marking a 16.8% uptick. The Twin Cities' strong education system creates a highly educated workforce that is rapidly absorbed by the 17 Fortune 500 companies based in Minnesota, the most concentrated cluster in the country. The ambitious $5.6 billion Destination Medical Center project in Rochester—the largest in state history—finally broke ground on its first phase, which consists of a four-story, 90,000-square-foot building designed to support health-related therapies and technologies. Professional and business services, as well as the manufacturing sector, also added almost 14,000 new jobs combined. With the completion of the U.S. Bank Stadium in Minneapolis, the region will be in the spotlight by hosting the National Football League's Super Bowl LII in February.

- Although the metro is adding well-paid jobs at a fast pace, office space absorption continued to be negative in the third quarter of 2017. However, new speculative buildings have broken ground. In the Minneapolis CBD, United Properties is building The Nordic, a mixed-use project set to offer 195,000 square feet of office space.

Twin Cities vs. National Employment Growth (Year-Over-Year)



Sources: YardiMatrix, Bureau of Labor Statistics (not seasonally adjusted)

Twin Cities Employment Growth by Sector (Year-Over-Year)

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
65	Education and Health Services	359	16.8%	14,900	4.3%
60	Professional and Business Services	340	16.0%	8,300	2.5%
30	Manufacturing	218	10.2%	5,600	2.6%
40	Trade, Transportation and Utilities	382	17.9%	5,100	1.4%
90	Government	267	12.5%	4,500	1.7%
15	Mining, Logging and Construction	95	4.5%	3,900	4.3%
80	Other Services	85	4.0%	1,500	1.8%
70	Leisure and Hospitality	199	9.3%	1,400	0.7%
55	Financial Activities	147	6.9%	-300	-0.2%
50	Information	39	1.8%	-700	-1.8%

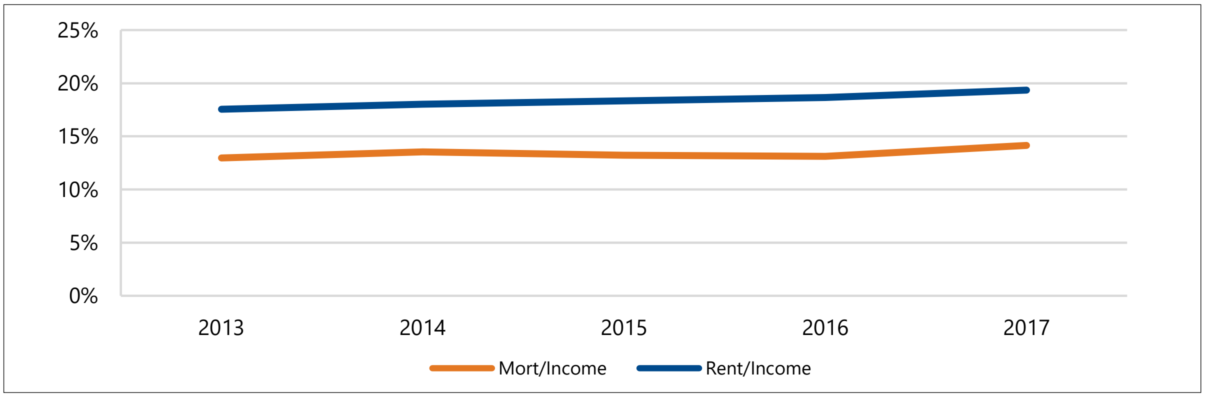
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

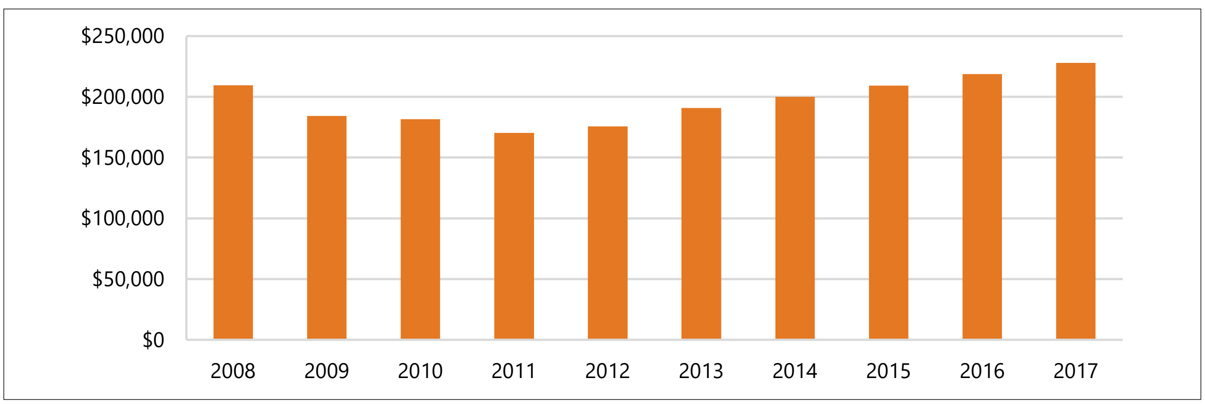
- Home prices have continued to rise during the past six years, hitting a new cycle high of $227,955 in 2017, amid strong demand and population increases. Homeownership—which accounted for 14% of the metro's median income—remains more affordable than renting, which comprised 19% of the metro's median income.
- Most of the new inventory is in the Lifestyle segment, so housing affordability may be a growing concern in many areas of the metro. In order to moderate demand, more micro-units are being added, especially in Uptown, the North Loop and near the University of Minnesota. Moreover, local authorities are supporting nonprofits in purchasing Class B/C apartment buildings in exchange for keeping rents affordable.

Twin Cities Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

Twin Cities Median Home Price



Source: Moody's Analytics

Population

- The Twin Cities' population grew by 32,800 in 2016, marking a 0.9% increase, 20 basis points above the national growth rate.
- Over the past six years, Twin Cities has gained more than 197,000 residents.

Twin Cities vs. National Population

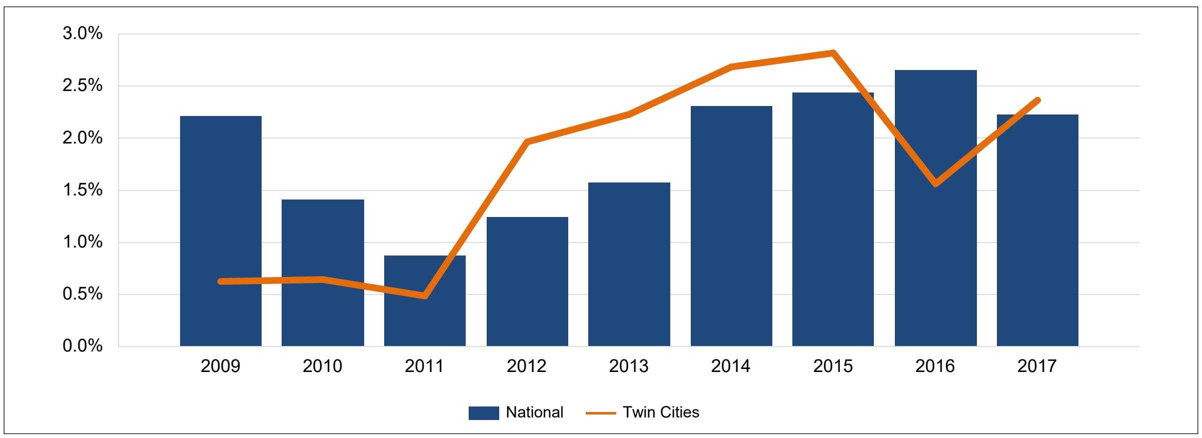
	2012	2013	2014	2015	2016
National	313,998,379	316,204,908	318,563,456	320,896,618	323,127,513
Twin Cities Metro	3,422,542	3,458,513	3,491,838	3,518,252	3,551,036

Sources: U.S. Census, Moody's Analytics

Supply

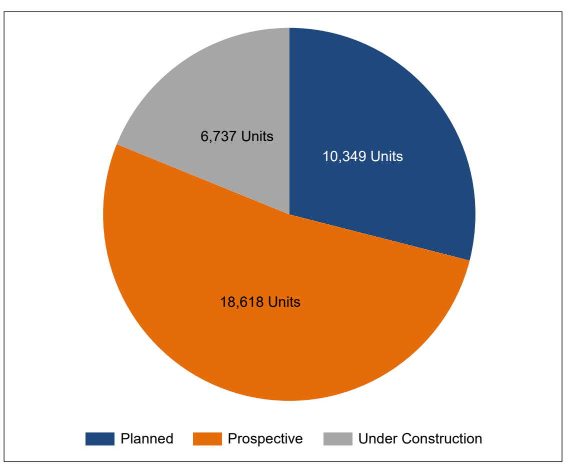
- Multifamily development in the Twin Cities has struggled to keep up with demand. Roughly 4,200 units were delivered in 2017 as of November, already exceeding last year's completions by more than 1,000 units. Nonetheless, demand still outpaces supply, especially in suburban areas. As of October, the occupancy rate in stabilized properties was 97.7%, the highest among all major metros.
- About 6,700 units were under construction as of November, while another 30,000 units are in the planning and permitting stages. Job growth in downtown Minneapolis continues to underscore the need for apartments across the metro.
- Development is concentrated in core submarkets such as Minneapolis–Central (1,342 units) and Minneapolis –University (1,242 units), with construction almost exclusively focused on luxury apartments. Fortune 500 companies based in the metro continue to fuel in-migration, which has spurred demand for amenity-rich communities in transit-oriented locations.
- Doran Cos.' 610 West in Brooklyn Park is the largest project underway and one of the few new assets recently built in the suburban area of the Twin Cities. Almost half of the 484 units were pre-leased as of October.

Twin Cities vs. National Completions as a Percentage of Total Stock (as of November 2017)



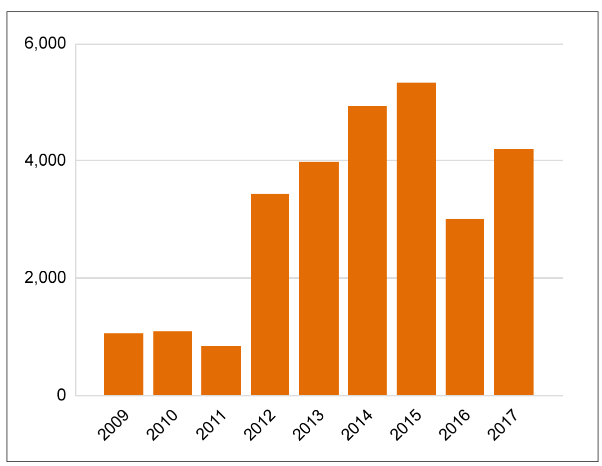
Source: YardiMatrix

Development Pipeline (as of November 2017)



Source: YardiMatrix

Twin Cities Completions (as of November 2017)

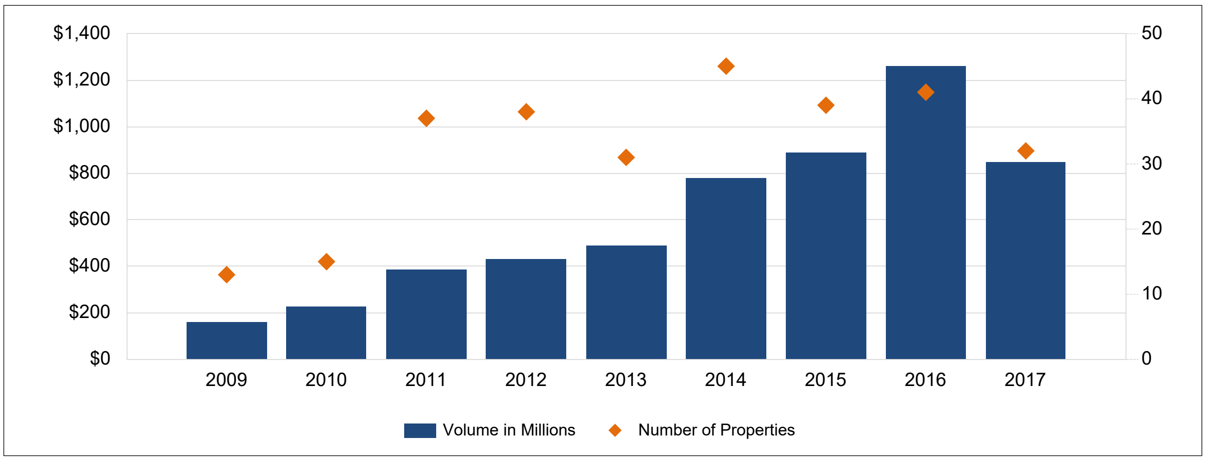


Source: YardiMatrix

Transactions

- Investment activity has stayed elevated in the Twin Cities, with roughly $850 million in multifamily assets changing hands in 2017 through November. Although the investment volume is unlikely to top last year's cycle high of $1.2 billion, it will be the second highest of the current expansion. Investors targeted older suburban stock that can be repositioned with higher rents, leading to a smaller overall volume.
- The average price per unit rose to a new cycle high of $160,637 during the first 10 months of 2017, which is well above the $136,099 national average. Properties trading in Eden Prairie, Woodbury/Cottage Grove and Burnsville were the most coveted, totaling $390 million in sales in the 12 months ending in October.
- Goldman Sachs' purchase of The Grand Reserve at Eagle Valley is the largest deal to be completed this year. Invesco Real Estate sold the 394-unit community for $97 million, or $245,622 per unit.

Twin Cities Sales Volume and Number of Properties Sold (as of October 2017)



Source: YardiMatrix

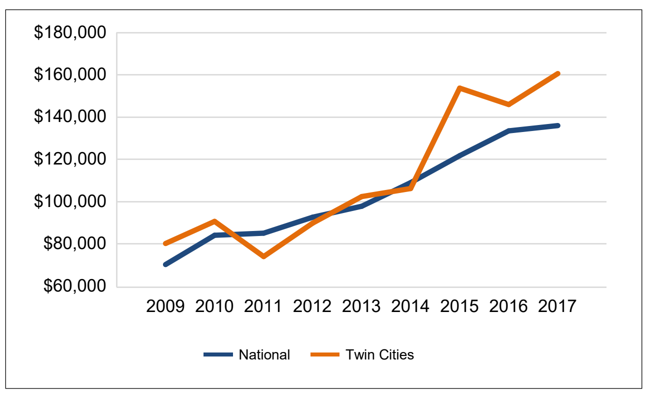
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Eden Prairie	145
Woodbury/Cottage Grove	129
Burnsville	116
Plymouth	92
Minneapolis–Central	87
St. Paul–Lexington Hamline	87
Minneapolis–Calhoun Isle	84
St. Paul–West Seventh	62

Source: YardiMatrix

[1] From November 2016 to October 2017

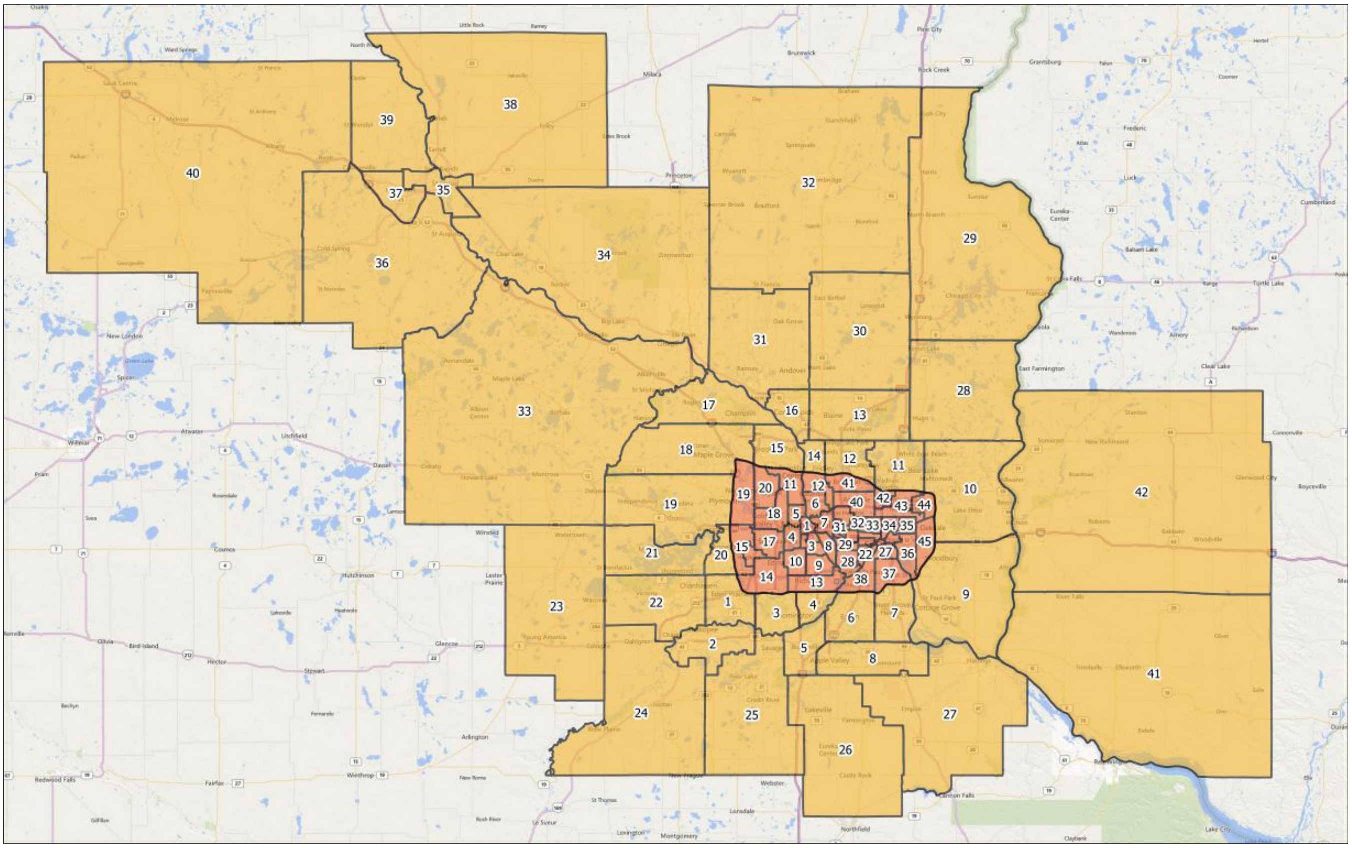
Twin Cities vs. National Sales Price per Unit



Source: YardiMatrix

Photo by Gian Lorenzo Ferretti Photography/iStockphoto.com

Twin Cities Submarkets



Area #	Submarket
1	Minneapolis–Central
2	Minneapolis–Phillips
3	Minneapolis–Powderhorn
4	Minneapolis–Calhoun Isle
5	Minneapolis–Near North
6	Minneapolis–Northeast
7	Minneapolis–University
8	Minneapolis–Longfellow
9	Minneapolis–Nokomis
10	Minneapolis–Southwest
11	Brooklyn Center/Camden
12	Columbia Heights
13	Richfield
14	Edina/Eden Prairie
15	Minnetonka

Area #	Submarket
16	Hopkins
17	St. Louis Park
18	Golden Valley
19	Plymouth
20	New Hope/Crystal
21	St. Paul–Downtown
22	St. Paul–West Seventh
23	St. Paul–Summit Hill
24	St. Paul–Summit University
25	St. Paul–Thomas Dale
26	St. Paul–Dayton's Bluff
27	St. Paul–West Side
28	St. Paul–Highland
29	St. Paul–Macaleste Groveland
30	St. Paul–Lexington Hamline

Area #	Submarket
31	St. Paul–St.Anthony
32	St. Paul–Como
33	St. Paul–North End
34	St. Paul–Payne-Phalen
35	St. Paul–Greater East Side
36	St. Paul–Sunray Battlecreek
37	West St. Paul
38	Mendota
39	Falcon Heights
40	Roseville
41	New Brighton
42	Little Canada
43	Maplewood
44	Oakdale–North
45	Oakdale–South

Definitions

Lifestyle households (renters by choice) have wealth sufficient to own but have chosen to rent. Discretionary households, most typically a retired couple or single professional, have chosen the flexibility associated with renting over the obligations of ownership.

Renter-by-Necessity households span a range. In descending order, household types can be:

- *A young-professional, double-income-no-kids household* with substantial income but without wealth needed to acquire a home or condominium;
- *Students*, who also may span a range of income capability, extending from affluent to barely getting by;
- *Lower-middle-income ("gray-collar") households,* composed of office workers, policemen, firemen, technical workers, teachers, etc.;
- *Blue-collar households*, which may barely meet rent demands each month and likely pay a disproportionate share of their income toward rent;
- *Subsidized households*, which pay a percentage of household income in rent, with the balance of rent paid through a governmental agency subsidy. Subsidized households, while typically low income, may extend to middle-income households in some high-cost markets, such as New York City;
- *Military households*, subject to frequency of relocation.

These differences can weigh heavily in determining a property's ability to attract specific renter market segments. The five-star resort serves a very different market than the down-and-outer motel. Apartments are distinguished similarly, but distinctions are often not clearly definitive without investigation. The Yardi® Matrix Context rating eliminates that requirement, designating property market positions as:

Market Position	Improvements Ratings
Discretionary	A+ / A
High Mid-Range	A- / B+
Low Mid-Range	B / B-
Workforce	C+ / C / C- / D

The value in application of the Yardi® Matrix Context rating is that standardized data provides consistency; information is more meaningful because there is less uncertainty. The user can move faster and more efficiently, with more accurate end results.

The Yardi® Matrix Context rating is not intended as a final word concerning a property's status—either improvements or location. Rather, the result provides reasonable consistency for comparing one property with another through reference to a consistently applied standard.

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