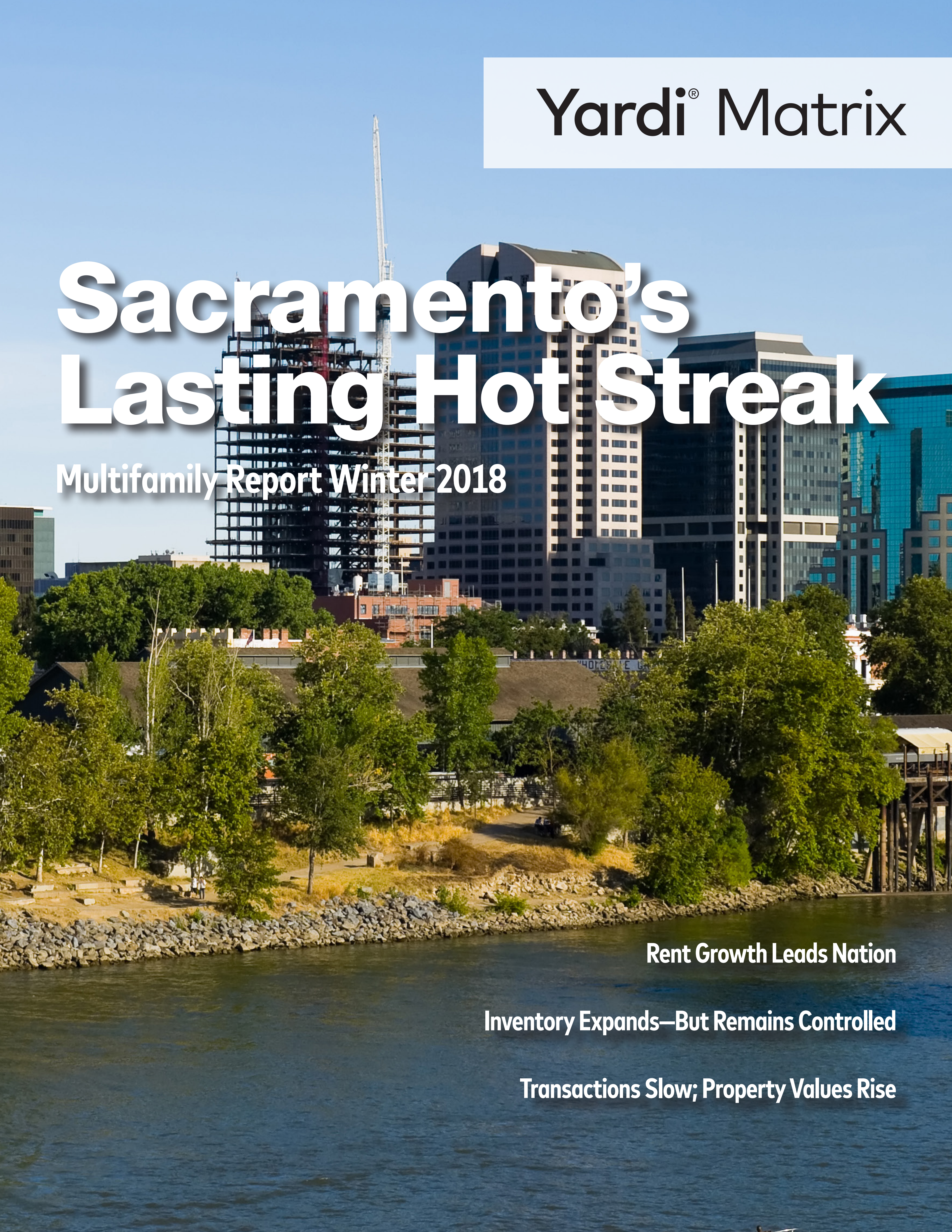
Yardi® Matrix



Sacramento's Lasting Hot Streak

Multifamily Report Winter 2018

Rent Growth Leads Nation

Inventory Expands—But Remains Controlled

Transactions Slow; Property Values Rise

Market Analysis

Winter 2018

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Rent Growth Continues in California's Capital

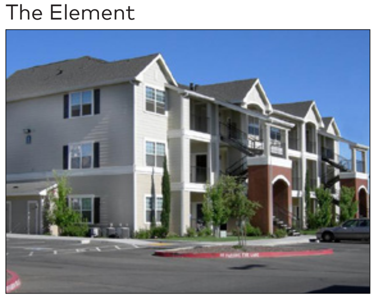
Sacramento's reign as the top market for multifamily rent growth continued in 2017, and it is poised to do the same in 2018, at a time when most markets will look to find their footing. With completions set to hit a new cycle peak nationally, a slight uptick is in the cards for Sacramento, although demand is likely to keep outpacing supply.

Ongoing economic improvement is being fueled by development projects in the market's core. Leisure and hospitality expanded rapidly in 2017, with construction of a number of facilities throughout the market, driving the need for labor. With Bay Area residents increasingly flocking to lower-cost Sacramento, developers have set up extensive projects throughout the metro, including 4 million square feet of office assets in the planning and permitting stages. The continued need for space has generated a large pipeline of projects at the Railyards and Downtown Commons, as Sacramento finds its stride.

Sacramento's multifamily pipeline has filled out, with 2,680 units under construction as of January, while another 14,100 units are in the planning and permitting stages. With a projected 1,100 units coming to the market in 2018, which would mark a cycle high, rent growth is bound to shift down to around 7.2% by year-end.

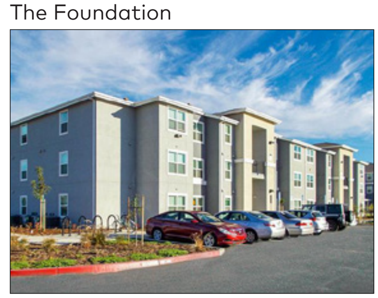
Recent Sacramento Transactions

The Element



City: Sacramento, Calif.
Buyer: Nelson Brothers
Purchase Price: $82 MM
Price per Unit: $284,323

The Foundation



City: Sacramento, Calif.
Buyer: Scion Group
Purchase Price: $71 MM
Price per Unit: $333,333

The Eleven Hundred

City: Sacramento, Calif.
Buyer: OpenPath Investments
Purchase Price: $69 MM
Price per Unit: $122,124

Sycamore Terrace

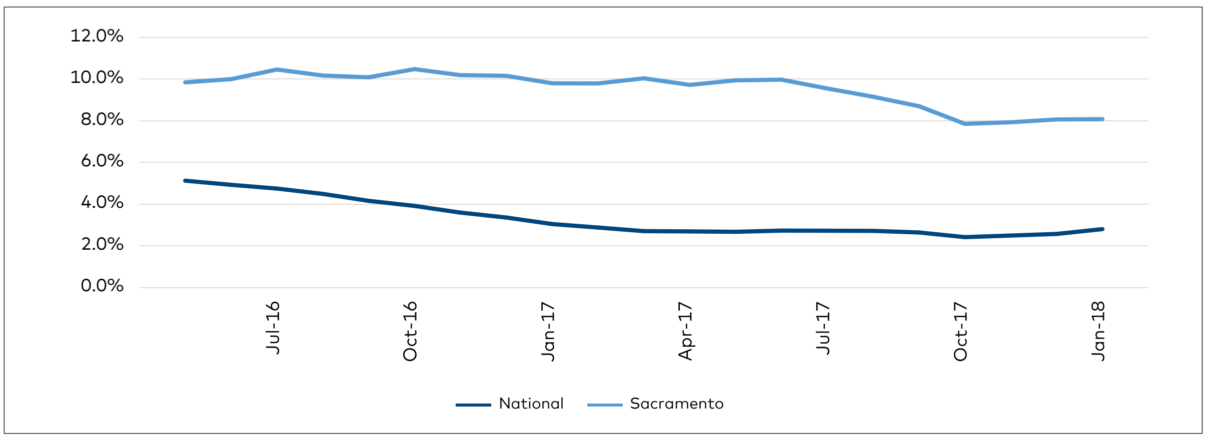
City: Sacramento, Calif.
Buyer: Security Properties
Purchase Price: $57 MM
Price per Unit: $235,246

On the cover: Photo by photoquest7/iStockphoto.com

Rent Trends

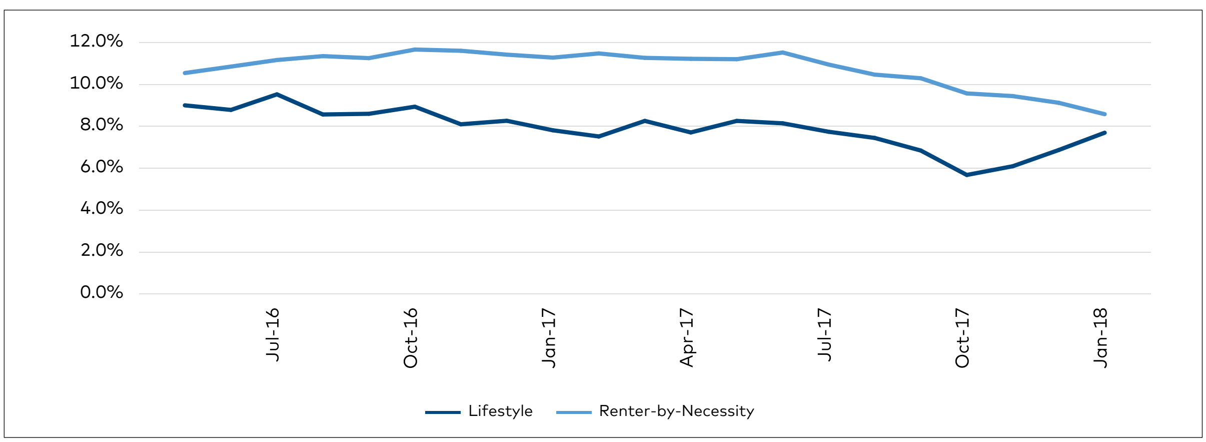
- Rents in Sacramento rose 8.1% year-over-year in January—a rate significantly higher than the U.S. average of 2.8%—cementing the California capital's position as the strongest market for rent growth among major metros. At $1,389, Sacramento's average rent has eclipsed the average national rent of $1,362.
- The working-class Renter-by-Necessity segment drew the largest amount of interest from renters, yielding 8.6% rent growth year-over-year, at $1,253 as of January. With inventory growth still tepid and the bulk of activity focused on upscale apartments, renters are finding that affordable apartments are fewer and further between. Lifestyle rents improved as well, up 7.7% year-over-year, reaching $1,680.
- Rent growth occurred at the highest rates in submarkets in the eastern end of the city, as those located in the core and along the major transit corridors toward San Francisco become overstuffed and overpriced for the average renter: Northeast Carmichael/West Fair Oaks (13.8%), Mira Loma/Marconi (12.4%), North Rancho Cordova (11.8%), Elk Grove (11.2%) and Bellview/Howe Edison (10.7%) led gains.
- Although inventory expansion is set to nearly double last year's totals, we expect rent growth to continue at the strongest rate in the nation in 2018, an improvement of 7.2% by year-end.

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



Source: YardiMatrix

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



Source: YardiMatrix

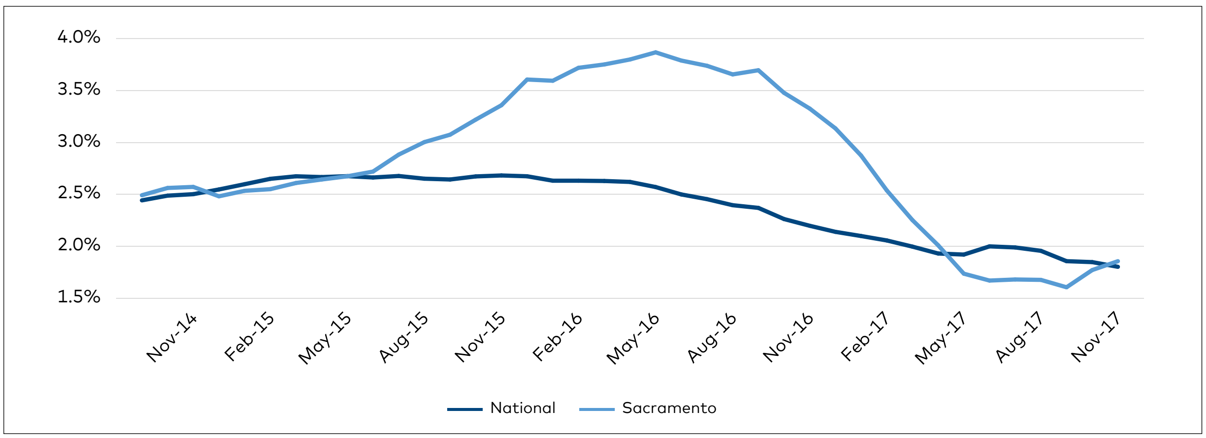
Economic Snapshot

- Sacramento added 18,200 jobs in the 12 months ending in November, representing an employment growth rate of 1.9%. Since the inauguration of Golden 1 Center in downtown Sacramento, new hotels have been delivered to the market, fueling employment growth in the leisure and hospitality sector—6,600 jobs added year over year. With six hotels underway in and around the city's core, the industry is poised to continue its growth.

- Education and health services added 4,600 jobs, remaining one of Sacramento's strongest and best-performing employment sectors. Kaiser Permanente's new medical facility at the Railyards has been pushed back a year into 2024, but the 1.2 million-square-foot health-care center is likely to generate continued interest in the sector.

- The spillover effect that has been so important to the metro's housing market is also crucial to its office sector. The potential of new development at the Railyards, the city's master-planned urban infill district, and proximity to the overcrowded Bay Area are attracting interest to the city's commercial real estate market, leading vacancy in Class A and A+ office properties to drop below the 9.0% mark, Yardi Matrix data shows. With a planned and prospective office development pipeline of more than 4 million square feet, Sacramento may soon find itself in the midst of a commercial construction boom.

Sacramento vs. National Employment Growth (Year-Over-Year)



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

Sacramento Employment Growth by Sector (Year-Over-Year)

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
70	Leisure and Hospitality	106	10.8%	6,600	6.7%
65	Education and Health Services	154	15.7%	4,600	3.1%
40	Trade, Transportation and Utilities	161	16.4%	4,400	2.8%
90	Government	242	24.6%	3,100	1.3%
60	Professional and Business Services	134	13.6%	1,600	1.2%
55	Financial Activities	54	5.5%	800	1.5%
80	Other Services	30	3.0%	-300	-1.0%
50	Information	13	1.3%	-600	-4.4%
15	Mining, Logging and Construction	56	5.7%	-600	-1.1%
30	Manufacturing	34	3.5%	-1,400	-3.9%

Sources: YardiMatrix, Bureau of Labor Statistics

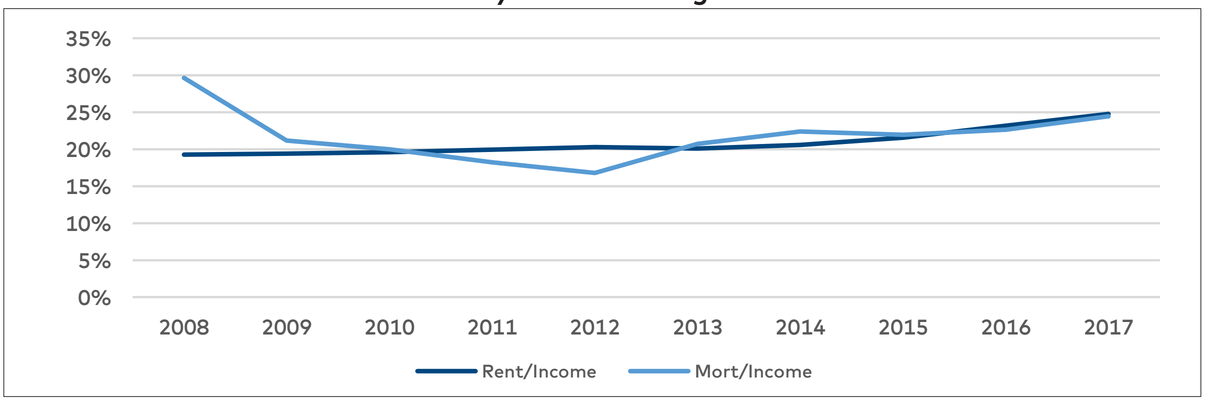
Demographics

Affordability

- The metro's median home price was $349,387 in 2017, with property values continuing their rapid rise. Values are up 66% since 2011, when the market bottomed out. Appreciation over the past six years is pressuring homebuyers, leading the average mortgage payment to take up 24% of incomes.

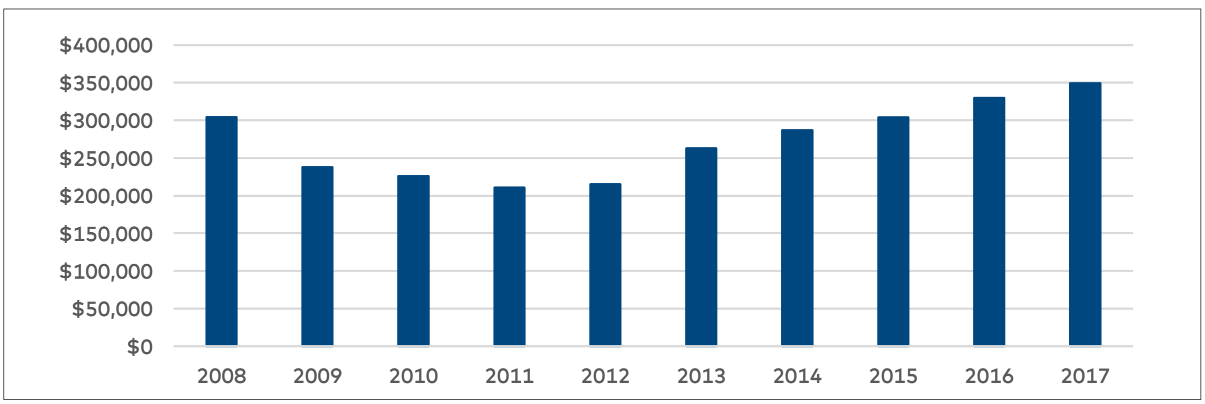
- Renting has also rapidly become less affordable, as rents now comprise a quarter of the median income. While historically homeowning has been the significantly more costly option in Sacramento, the current expansion has marked a shift in household dynamics, as rents were more expensive than mortgage payments in 2017.

Sacramento Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

Sacramento Median Home Price



Source: Moody's Analytics

Population

- Population has increased at a rate of 1.3% in 2016, pushing up housing costs.

- The metro added more than 100,000 residents between 2010 and 2016, marking a 4.7% expansion.

Sacramento vs. National Population

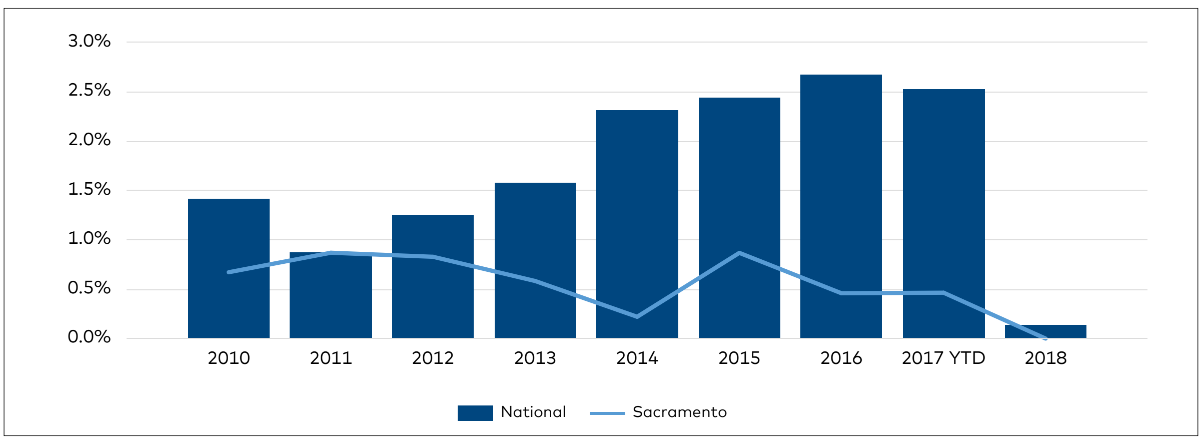
	2012	2013	2014	2015	2016
National	313,998,379	316,204,908	318,563,456	320,896,618	323,127,513
Sacramento Metro	2,193,741	2,214,570	2,240,391	2,267,588	2,296,418

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

Supply

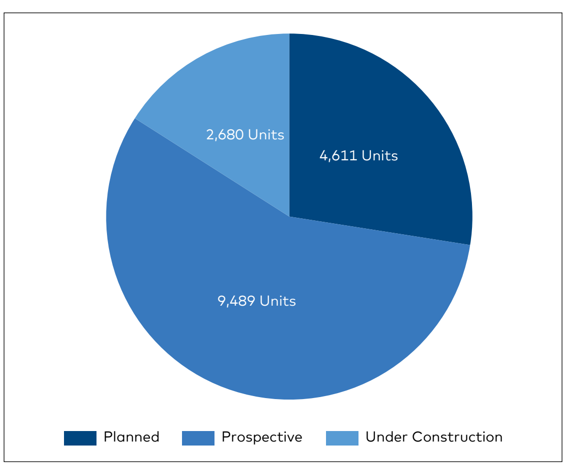
- Developers added only 600 units in Sacramento in 2017, just 0.5% of total stock, well below the national average growth rate. The metro's rate of delivery has been notoriously low throughout the current expansion, an important factor in the nation-topping rate of rent growth seen in the market over the past few years.
- Roughly 2,700 units were under construction in Sacramento as of January, with an additional 14,100 apartments in the planning and permitting stages. With the nation heading toward a peak year for multifamily completions, Sacramento is likely to see an uptick in deliveries, as Yardi Matrix expects that about 1,100 units will be added in 2018.
- Although inventory expansion has been limited throughout the cycle, the market's occupancy rate in stabilized properties has slowly decreased, reaching 96.6% in December 2017.
- Development activity was highest in Rocklin/Roseville (446 units underway), Central Business District (378 units), Laguna West (324 units), Greater Folsom/El Dorado Hills/Shingle Springs (304 units) and North Sacramento (232 units). The largest project under construction in the metro as of January was LandCap Investment Partners' 324-unit Vasari in Laguna West, slated for delivery in mid-2018.

Sacramento vs. National Completions as a Percentage of Total Stock (as of January 2018)



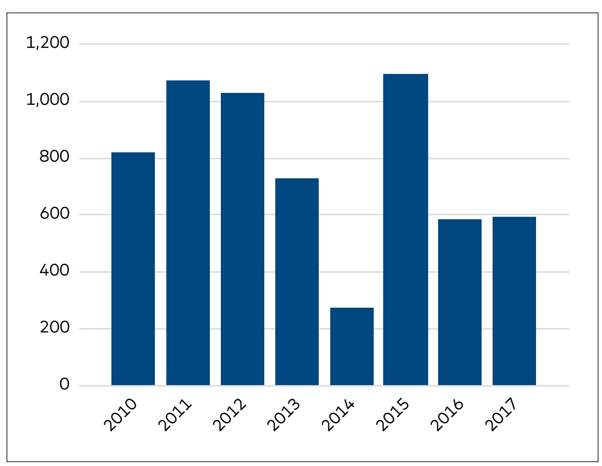
Source: YardiMatrix

Development Pipeline (as of January 2018)



Source: YardiMatrix

Sacramento Completions (as of January 2018)



Source: YardiMatrix

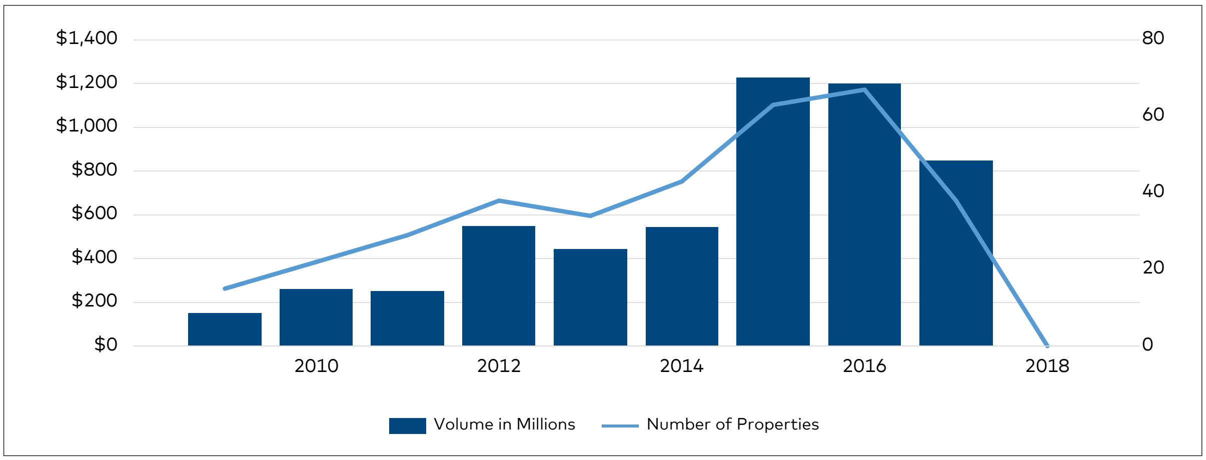
Transactions

- Roughly $850 million in multifamily properties changed hands in 2017, a noticeable decrease as compared to 2015 and 2016 levels but still well above the annual cycle average.

- Property values in Sacramento have significantly risen to a point where the per-unit average hit $153,862, more than $15,000 over the national average. With acquisition yields compressing, investment activity has slightly tapered.

- Activity was highest in the southern end of the metro, especially in submarkets situated along major thoroughfares facilitating transit into the Bay Area and Central Valley: Florin/Southeast Sacramento ($153 million), Laguna West ($104 million), Pocket/West Greenhaven ($91 million) and Elk Grove ($81 million). The largest transaction of 2017 was Nelson Brothers' $82 million purchase of the 288-unit Element student community from Vermilion Development.

Sacramento Sales Volume and Number of Properties Sold (as of January 2018)



Source: YardiMatrix

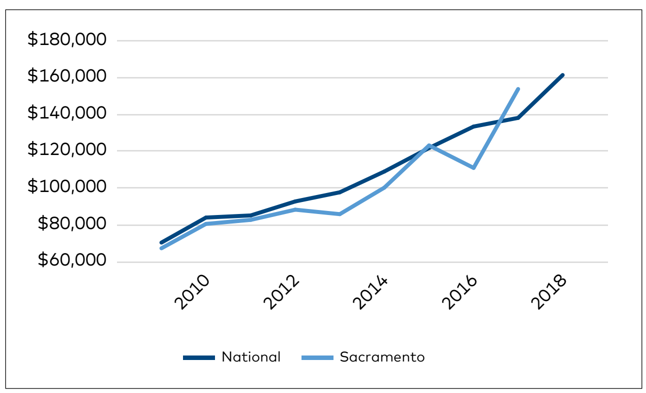
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Florin/Southeast Sacramento	153
Laguna West	104
Pocket/West Greenhaven	91
Elk Grove	81
Central Business District	75
Encina/Ethan/Woodside	69
Central Davis	42
Natomas	27

Source: YardiMatrix

[1] From January 2017 to December 2017

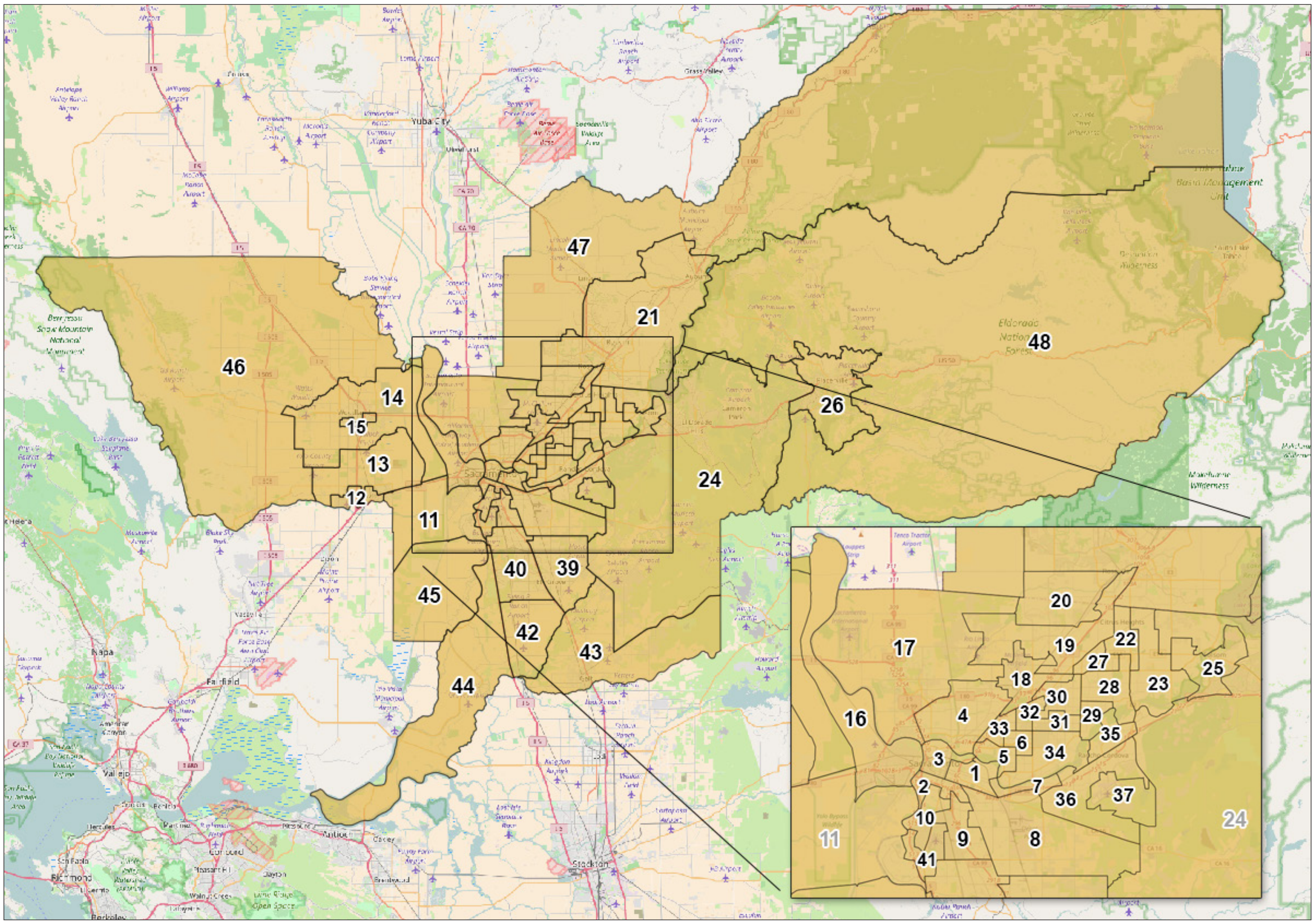
Sacramento vs. National Sales Price per Unit



Source: YardiMatrix

Photo by Jerry Moorman/iStockphoto.com

Sacramento Submarkets



Area #	Submarket
1	Midtown
2	Broadway Corridor
3	Central Business District
4	North Sacramento
5	Encina/Ethan/Woodside
6	Arden Gardens/Arden Terrace
7	La Riviera
8	Florin/Southeast Sacramento
9	Parkway/South Sacramento
10	Land Park
11	Pocket/West Greenhaven
12	Central Davis
13	Greater Davis
14	North Woodland
15	South Woodland
16	North West Sacramento

Area #	Submarket
17	Natomas
18	North Highlands
19	Foothills Farms/West Citrus He
20	Antelope
21	Rocklin/Roseville
22	Central Citrus Heights
23	Fair Oaks
24	Greater Folsom/El Dorado Hills
25	Central Folsom/South Orangeval
26	Placerville
27	Southwest Citrus Heights
28	Northeast Carmichael/West Fair
29	Southeast Carmichael
30	West Carmichael
31	Arcade Village/Mission
32	Mira Loma/Marconi

Area #	Submarket
33	Bellview/Howe Edison
34	Arden Manor/Sierra Oaks Vista
35	North Rancho Cordova
36	South Rancho Cordova/Rosemont
37	Mather Airport
39	Elk Grove
40	Laguna West
41	East Greenhaven/South Land Par
42	Franklin/Laguna
43	Galt
44	Outlying Sacramento County
45	South Yolo County
46	Western Yolo County
47	Outlying Placer County
48	Outlying El Dorado County

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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