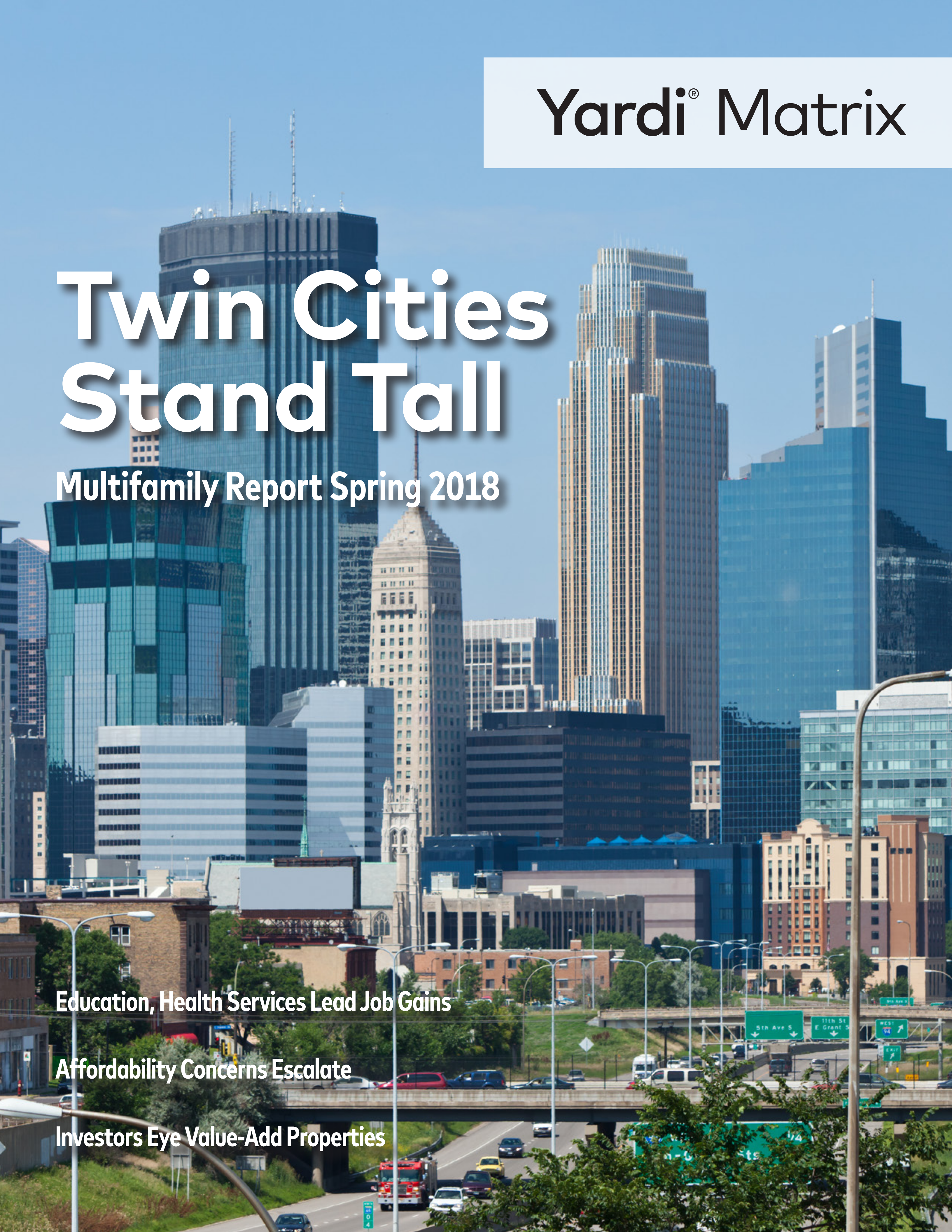
Yardi® Matrix

Twin Cities Stand Tall

Multifamily Report Spring 2018



Education, Health Services Lead Job Gains

Affordability Concerns Escalate

Investors Eye Value-Add Properties

Market Analysis

Spring 2018

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Robust Demand Keeps Occupancy Up

Boasting strong population growth and accelerated job gains, the Twin Cities has become a magnet for multifamily investors. Meanwhile, solid demand has kept stabilized properties across the metro near full occupancy—97.2% as of February, the highest rate among major U.S. metros.

Anchored by several Fortune 500 companies and a strong education system, the Twin Cities added almost 48,000 jobs in 2017. Education and health services continues to lead job growth, with more than 13,000 new positions. Fueled by strong development along major thoroughfares, the transportation and construction sectors generated 16,500 jobs and are likely to continue to be an important employment engine. United Properties revealed design plans for a 33-story tower on the north end of Nicollet Mall in Minneapolis, a project that is estimated to cost about $330 million. Additionally, Vermillion Development intends to convert a block along the Green Line in Prospect Park to condos, apartments and commercial space.

Roughly 7,500 units were under construction in the metro as of March, with the completion of new luxury projects and the repositioning of several value-add properties providing an additional boost to rents. Demand coming from the working-class segment is also poised to remain high, leading Yardi Matrix to forecast rent growth of 3.7% in 2018.

Recent Twin Cities Transactions

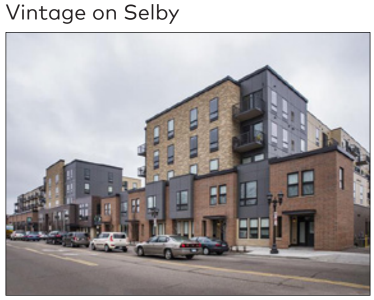
The Grand Reserve at Eagle Valley

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: $182,600

Vintage on Selby



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

Stadium View

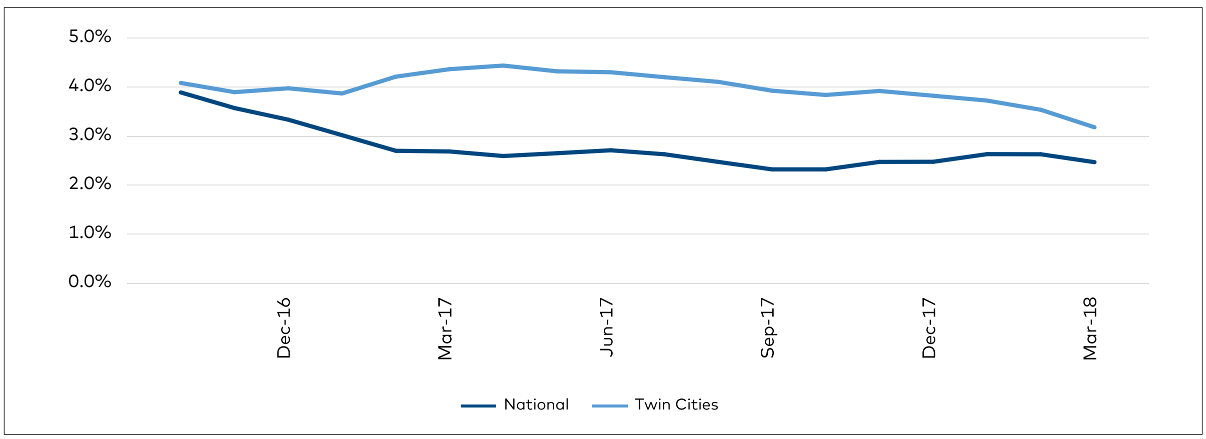
City: Minneapolis
Buyer: University Partners
Purchase Price: $69 MM
Price per Unit: $250,542

On the cover: Photo by Kubrak78/iStockphoto.com

Rent Trends

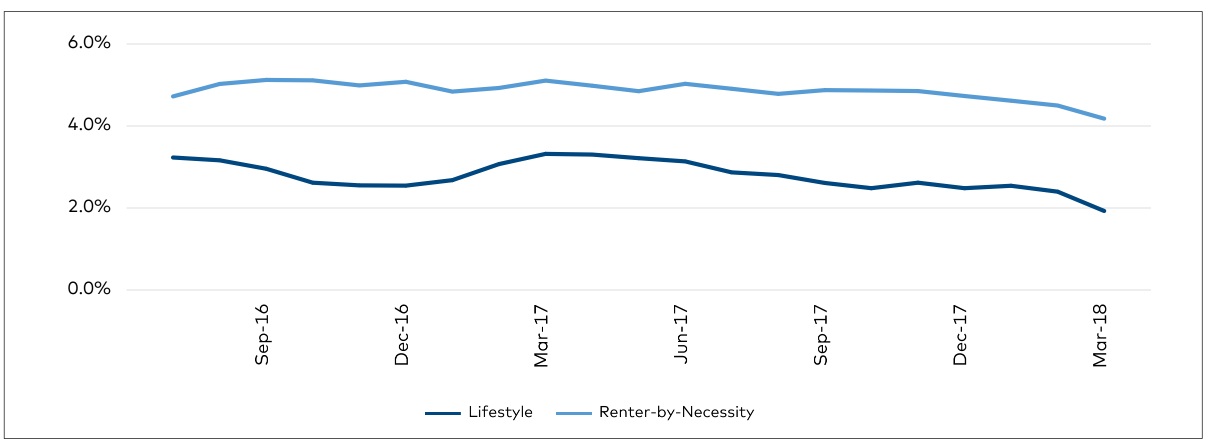
- Although rents were up 3.2% year-over-year through March, 70 basis points above the U.S. rate, the overarching trend in the Twin Cities reflects the national pattern of deceleration. The average rent in the metro was $1,234, nearly $140 below the national figure. A substantial part of rental demand in Minneapolis-St. Paul comes from a strong employment market luring young professionals to the area.
- The growth gap between the lower-end and the upscale segments is widening, with rates in the working-class Renter-by-Necessity cohort increasing 4.2% year-over-year through March to $1,072, while Lifestyle rents were up only 1.9%, to $1,585. High-income renters remain developers' main target, with high-end assets in core areas and suburban value-add plans dominating the pipeline. Consequently, finding market-rate units and affordable housing options is becoming increasingly challenging for low- and middle-income renters.
- Rents grew at the fastest rates in Cambridge (12.6% to $1,018) and St. Paul–St. Anthony (10.7% to $1,846), with the latter submarket recording the highest average rent as of March. With builders struggling to find workers and demand remaining high, Yardi Matrix expects rents to appreciate 3.7% for the whole of 2018.

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)

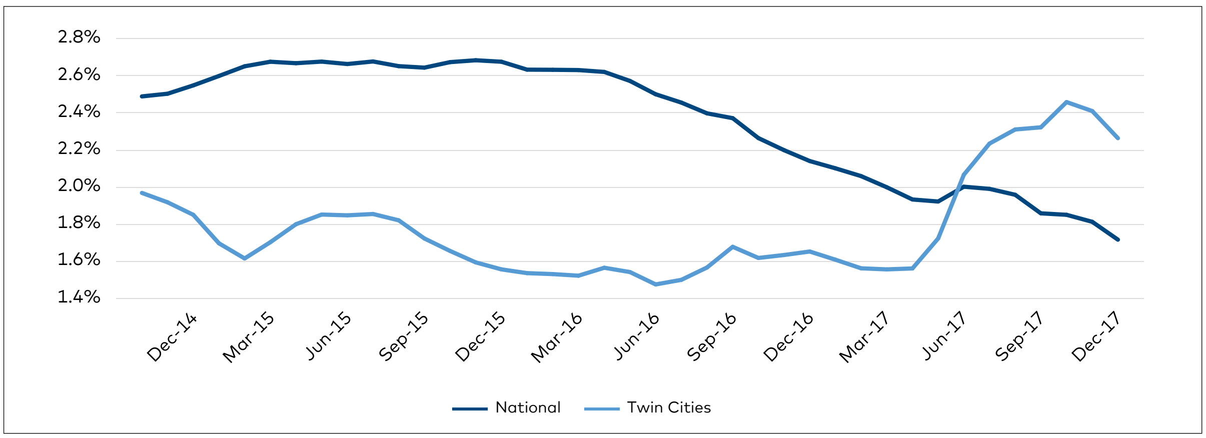


Source: YardiMatrix

Economic Snapshot

- Minneapolis-St. Paul added almost 48,000 jobs in 2017, a 2.3% year-over-year gain, 60 basis points above the national rate. The metro's accelerating, healthy economy is mirrored by a rapidly growing population and an unemployment rate significantly lower than the national average.
- The metro's education and health services sector led growth, adding 13,000 jobs last year for a 3.7% expansion. The sector is highly likely to remain a source of steady, long-term growth, with the University of Minnesota feeding a deep talent pool. Mayo Clinic's Destination Medical Center, a $5.6 billion investment over two decades, is underway and represents the largest public-private economic development initiative in the state's history. Following a $220 million investment, Hennepin County's 377,000-square-foot Medical Center opened in downtown Minneapolis. Due to high demand, a major airport and a busy transportation corridor along interstates 35 and 94, the metro continues to attract many out-of-state investors: Construction and trade, transportation and utilities also recorded significant gains, adding a total of more than 16,500 positions.
- A tight labor market is motivating companies to spend more on office spaces in order to retain white-collar employees. The metro's medical office market is recording particularly robust construction activity, with projects such as Hazelwood Medical Commons responding to the uptick in demand.

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	363	17.0%	13,000	3.7%
40	Trade, Transportation and Utilities	396	18.6%	8,700	2.2%
15	Mining, Logging and Construction	84	3.9%	7,800	10.2%
70	Leisure and Hospitality	187	8.8%	7,200	4.0%
30	Manufacturing	217	10.2%	4,500	2.1%
90	Government	274	12.9%	3,700	1.4%
60	Professional and Business Services	338	15.9%	3,700	1.1%
80	Other Services	85	4.0%	1,600	1.9%
50	Information	39	1.8%	-500	-1.3%
55	Financial Activities	146	6.9%	-1,800	-1.2%

Sources: YardiMatrix, Bureau of Labor Statistics

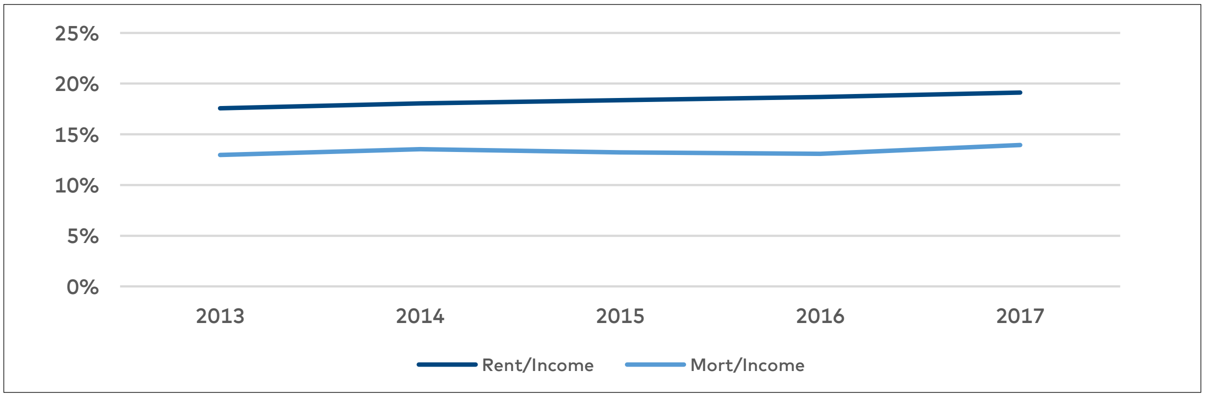
Demographics

Affordability

- Home prices steadily increased throughout the cycle, hitting a new peak of $228,343 in 2017. And with the vast majority of construction projects geared toward higher-income residents amid demographic expansion, values are likely to maintain their upward trajectory. Owning—which accounts for 14% of the area's median income—is still more affordable than renting, with the average rent comprising 19%.

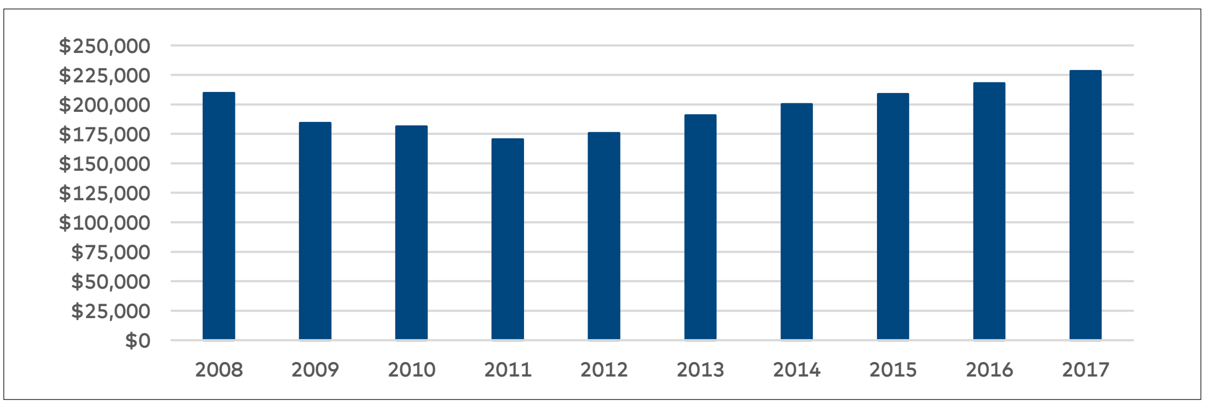
- Minnesota Housing, the state's housing finance agency, reported that the number of cost-burdened households increased by 58% between 2000 and 2016. Broad-based employment and steady population growth are likely to feed the affordable housing shortage in the coming years.

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 added 43,342 residents in 2017, a 1.2% uptick, 50 basis points above the national growth rate.
- Since 2013, the metro grew by roughly 142,000 people. This marks a 4.1% increase, well above the 3.0% U.S. average.

Twin Cities vs. National Population

	2013	2014	2015	2016	2017
National	316,234,505	318,622,525	321,039,839	323,405,935	325,719,178
Twin Cities Metro	3,458,299	3,493,226	3,521,325	3,557,276	3,600,618

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

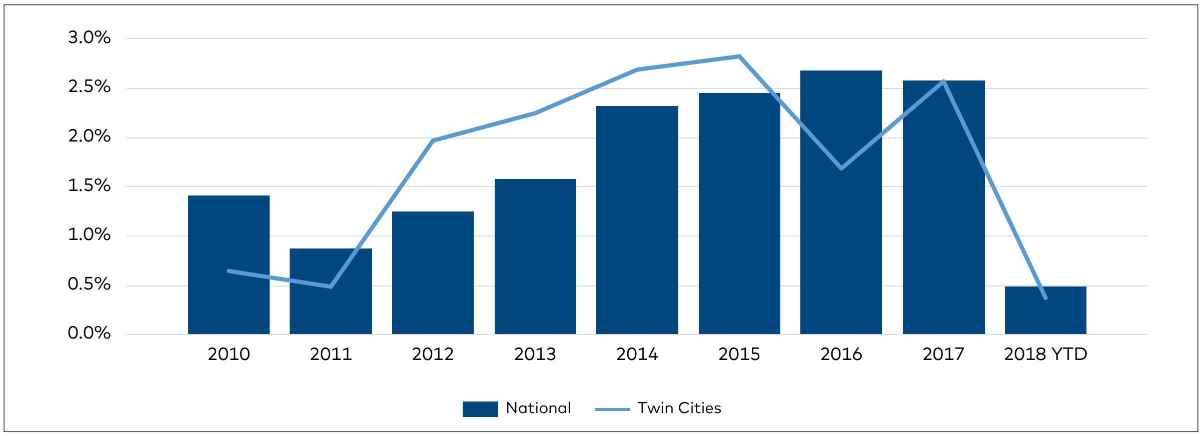
Supply

- Roughly 5,000 units were completed last year in the Twin Cities, accounting for 2.6% of total stock, in line with the national average. Another 739 units were delivered in the first quarter of 2018. Despite the steady influx of new supply over the past four years, demand remains high and overbuilding is not an impending risk. Strong job growth coming from Fortune 500 companies based in the metro and in-migration maintain a steady absorption rate.

- About 7,500 units were under construction in the metro as of March, while another 35,000 were in the planning and permitting phases. New development is mostly geared toward high-income earners preferring core submarkets such as Minneapolis–University (1,242 units) and Minneapolis–Central (1,081 units). Although down 70 basis points in 12 months, the metro's occupancy rate in stabilized properties continues to be the highest among major U.S. metros, at 97.2% as of February.

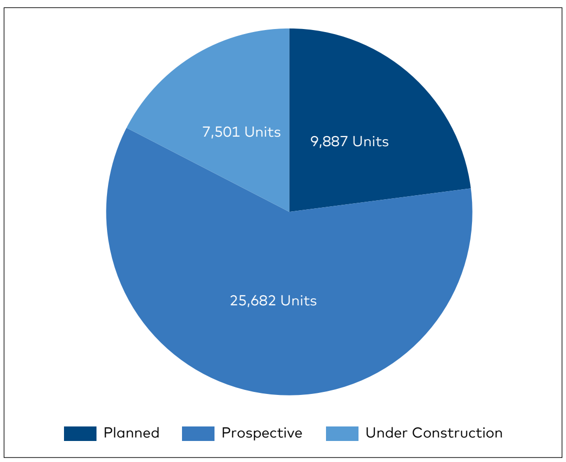
- Developers tend to follow the workforce and concentrate on areas close to employment hubs. The largest project underway is Doran Cos.' 484-unit 610 West in Brooklyn Park, which is less than a mile away from Target's Northern Campus. Half of the apartments were pre-leased as of March.

Twin Cities vs. National Completions as a Percentage of Total Stock (as of March 2018)



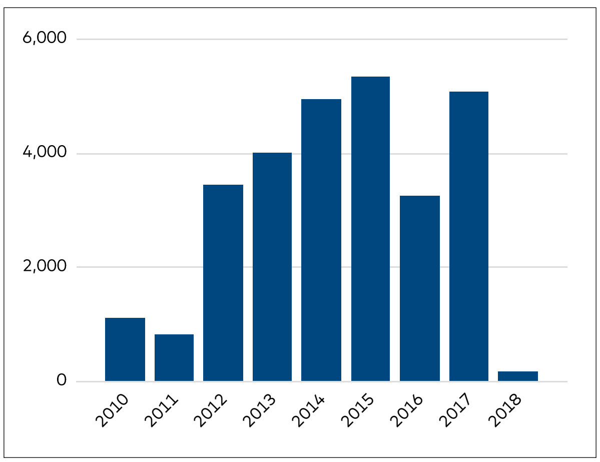
Source: YardiMatrix

Development Pipeline (as of March 2018)



Source: YardiMatrix

Twin Cities Completions (as of March 2018)



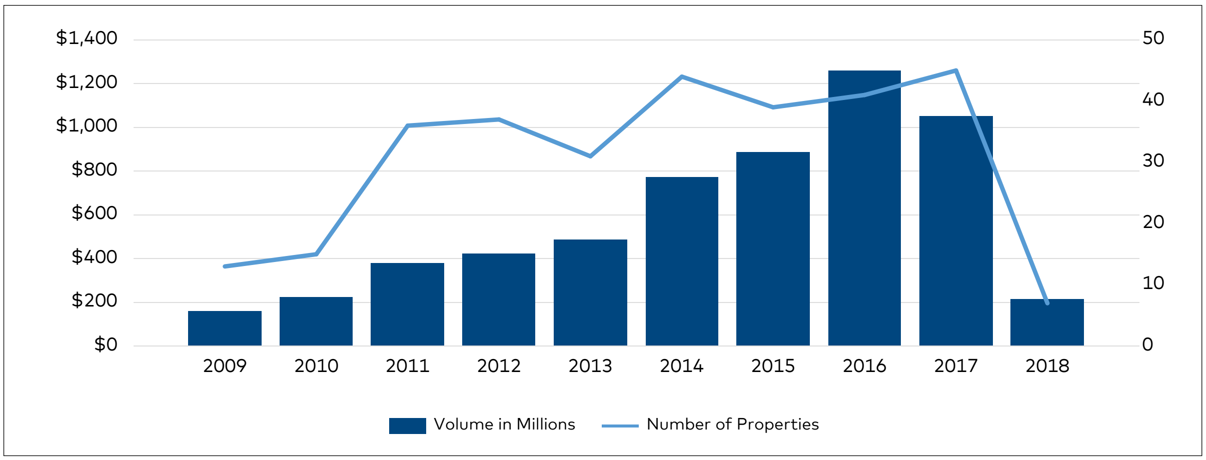
Source: YardiMatrix

Transactions

- Reflecting the competitive multifamily market, transaction volume exceeded the $1 billion mark in Minneapolis-St. Paul in the year ending in February. As capital flows are dwindling in many gateway markets, the metro is attracting national investors due to its strong and diversifying economy. With shorter holding periods and a focus on higher-yielding assets, this group of investors is likely to push up sales volume in 2018. The average price per unit rose to $153,747 last year, surpassing the national average but clocking in slightly below 2015's cycle high. Class B and C assets remain the most appealing.

- Suburban areas continue to be popular among investors, with Eden Prairie, Woodbury/Cottage and Plymouth Grove totaling $380 million in sales in the 12 months ending in February. Goldman Sachs' $97 million acquisition of the 394-unit The Grand Reserve at Eagle Valley in Woodbury and Investors Real Estate Trust's $92 million purchase of the 500-unit Park Place are indicative of this preference.

Twin Cities Sales Volume and Number of Properties Sold (as of February 2018)



Source: YardiMatrix

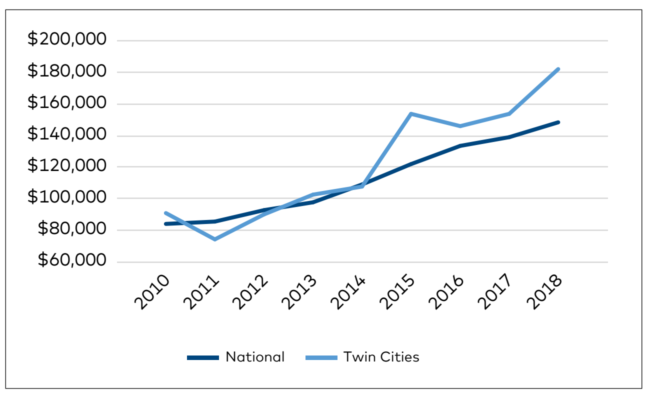
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Eden Prairie	159
Woodbury/Cottage Grove	129
Minneapolis–Central	99
Minneapolis–University	97
Plymouth	92
St. Paul–Lexington Hamline	87
St. Paul–West Seventh	62
St. Louis Park	56

Source: YardiMatrix

[1] From March 2017 to February 2018

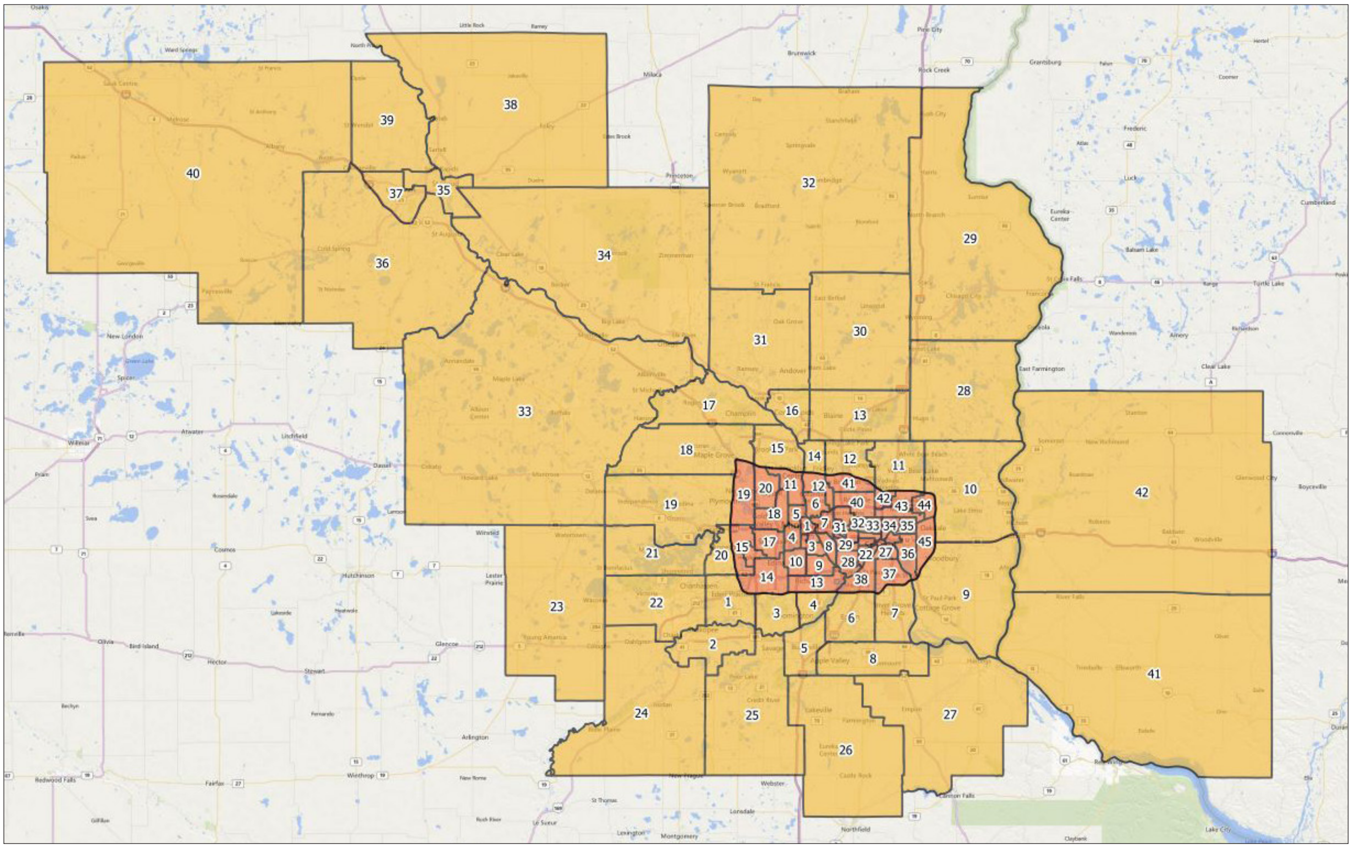
Twin Cities vs. National Sales Price per Unit



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.

To learn more about Yardi® Matrix and subscribing, please visit www.yardimatrix.com or call Ron Brock, Jr., at 480-663-1149 x2404.

Market Data & Analysis

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