Yardi® Matrix

Manufacturing Knoxville's Future

Multifamily Report Fall 2018

Investment Sales Stay Elevated

Occupancy Rises Due to Supply Constraints

Lifestyle Rents Accelerate Over Summer

Market Analysis
Fall 2018

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Knoxville Finds a Second Wind

The metro's multifamily market is in the midst of a resurgence, with rents bouncing back to a 4.1% year-over-year growth rate as of August, while supply continues a slower pace of increase. With occupancy rates returning to some of the highest marks this cycle, further rent improvement is in the cards for Knoxville's rental market.

Demand is being driven by improvement in the hospitality sector, as well as manufacturing, which is slowly developing as a niche. In fact, new manufacturing investments continue to pour capital into Knoxville. Expansions at Denso's Maryville facility and MVP's Hardin Business Park's operation continue to be solid drivers for both the area's economy and image as a manufacturing haven. Through the 12 months ending in June, Knoxville's manufacturing sector grew at by far the fastest rate among major Tennessee metros.

Transaction activity stayed high through the first half of the year, and is on track to keep up the strong investment values that the metro has posted throughout the cycle's second half. As construction activity continues to stall, with only 2,000 units underway and an additional 1,700 in the planning and permitting stages, further rent growth is likely in Knoxville.

Recent Knoxville Transactions

The Preserve at Hardin Valley

City: Knoxville, Tenn.
Buyer: Grimley Residential
Purchase Price: $48 MM
Price per Unit: $162,463

The Commons at Knoxville

City: Knoxville, Tenn.
Buyer: Timberline Real Estate Ventures
Purchase Price: $38 MM
Price per Unit: $178,909

Evergreen at the Bluffs

City: Knoxville, Tenn.
Buyer: Origin Development Partners
Purchase Price: $18 MM
Price per Unit: $113,863

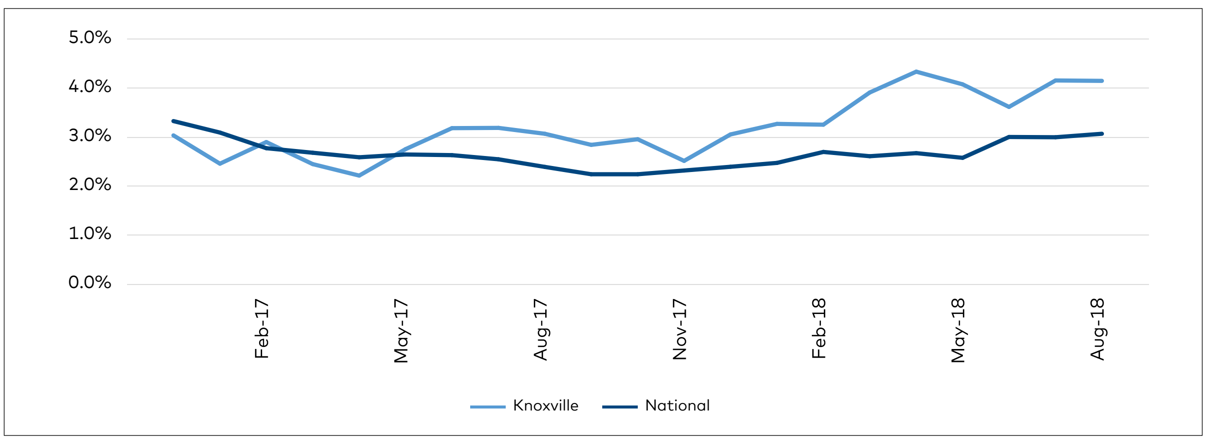
Redpoint Knoxville

City: Knoxville, Tenn.
Buyer: Scion Group
Purchase Price: $17 MM
Price per Unit: $253,846

Rent Trends

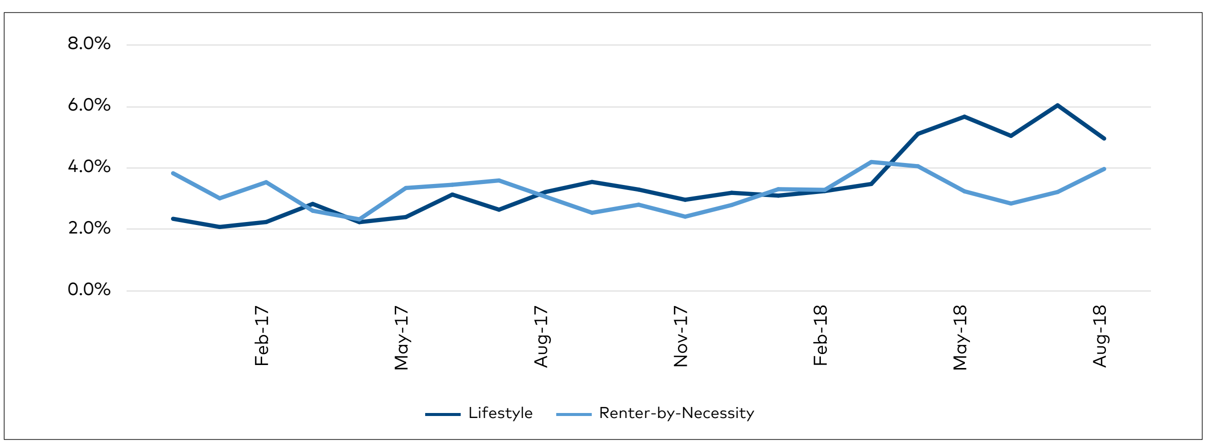
- Rents in Knoxville rose 4.1% year-over-year through August, 100 basis points above the U.S. rate. The average overall rent was $980, well below the $1,412 U.S. figure. Rents in the metro are also considerably lower than in nearby Nashville, although a very high level of completions has significantly tempered rent appreciation there.
- With construction stalling and demand slowly pushing the average occupancy rate in stabilized properties upwards, to 96.3% as of July, prices for rental units continue to rise. Rents for Knoxville's Lifestyle assets grew at a higher rate—up 5.0% year-over-year—after accelerating throughout the summer, reaching a $1,312 average. Renter-by-Necessity assets claimed an average rent of $838, up 4.0% year-over-year.
- Rents in Knoxville–Downtown (up 14.4% year-over-year), Karns (7.3%), Middlebrook (6.5%), Powell (6.1%) and Cedar Bluff (6.1%) rose at the fastest rates in the metro. No submarkets saw contractions in rent level over the past 12 months, leading to strong overall improvement for the local multifamily market.
- Going forward, conditions are likely to further push rent levels in Knoxville.

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



Source: YardiMatrix

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

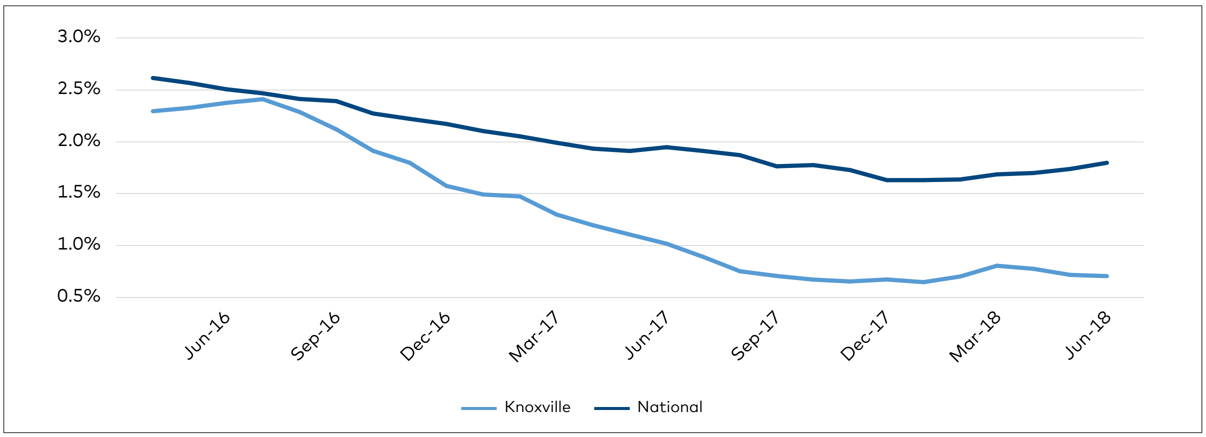


Source: YardiMatrix

Economic Snapshot

- Knoxville added 2,300 jobs in the 12 months ending in June, an employment growth rate of 0.7% year-over-year. That's 110 basis points lower than the national rate of improvement and considerably lower than the state's main job center—Nashville (2.4%). Some of the metro's main economic drivers saw contractions, including education and health services, government, and professional and business services, which jointly lost 3,700 positions, although that was offset by significant improvement in a few key sectors. Manufacturing and leisure and hospitality, for instance, added 4,400 jobs.
- The manufacturing sector now employs more than 10% of the metro's active population, a strong rate that has only improved of late. Denso's $1 billion expansion in Maryville is set to add 1,000 new jobs once fully operational, strengthening the company's position as Blount County's largest employer. Additionally, composite application equipment manufacturer MVP is building an 80,000-square-foot facility as part of the Hardin Business Park, furthering the area's propensity for manufacturing.

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



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

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

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
30	Manufacturing	41	10.4%	2,200	5.7%
70	Leisure and Hospitality	45	11.4%	2,200	5.2%
40	Trade, Transportation and Utilities	79	20.0%	1,400	1.8%
15	Mining, Logging and Construction	19	4.8%	600	3.3%
80	Other Services	15	3.8%	200	1.3%
50	Information	6	1.5%	-100	-1.7%
60	Professional and Business Services	64	16.2%	-400	-0.6%
55	Financial Activities	19	4.8%	-500	-2.6%
90	Government	56	14.2%	-600	-1.1%
65	Education and Health Services	51	12.9%	-2,700	-5.0%

Sources: YardiMatrix, Bureau of Labor Statistics

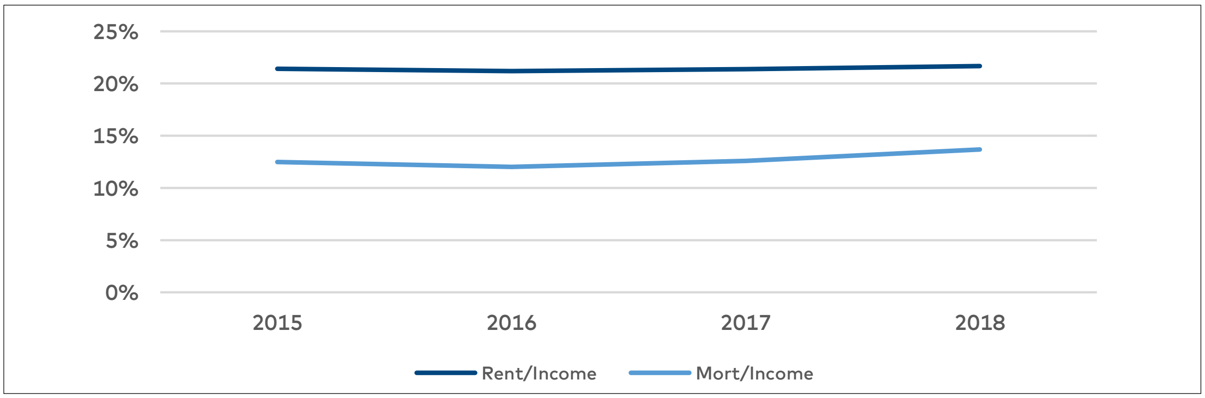
Demographics

Affordability

- Knoxville's median home price is on the rise, following a prolonged period when home values essentially plateaued. At $150,915 as of 2018's halfway point, prices are 30% higher than they were in 2011, the cycle's lowest point. The average mortgage payment accounted for 14% of the median income, although down payments remain an issue for potential homebuyers.

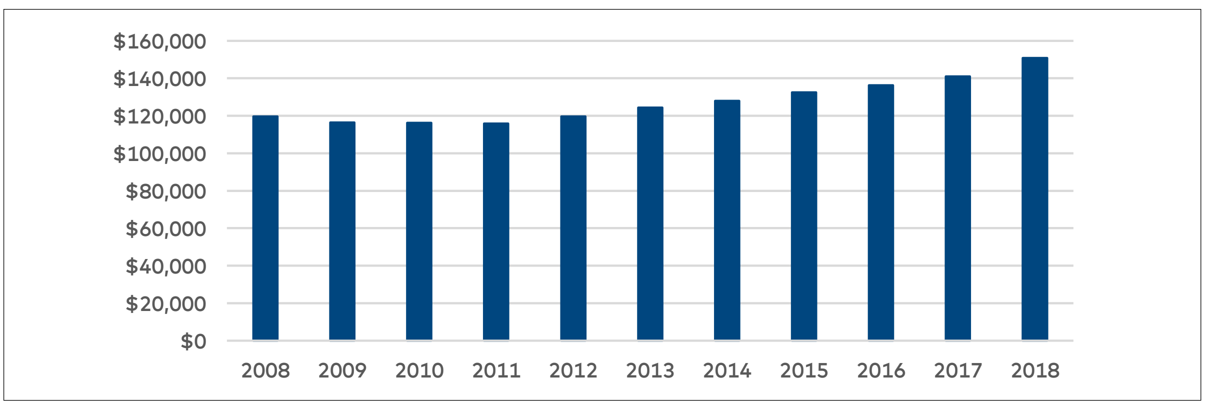
- Rents in the metro hit $980 as of August, on the back of revitalized growth throughout 2018. That means that renting is now significantly more costly than buying, with rents encompassing 22% of the area's median income.

Knoxville Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

Knoxville Median Home Price



Source: Moody's Analytics

Population

- Knoxville's population expanded by 1.1% last year, 40 basis points above the U.S. average.

- The metro added 9,300 residents in 2017, the highest increase in years.

Knoxville vs. National Population

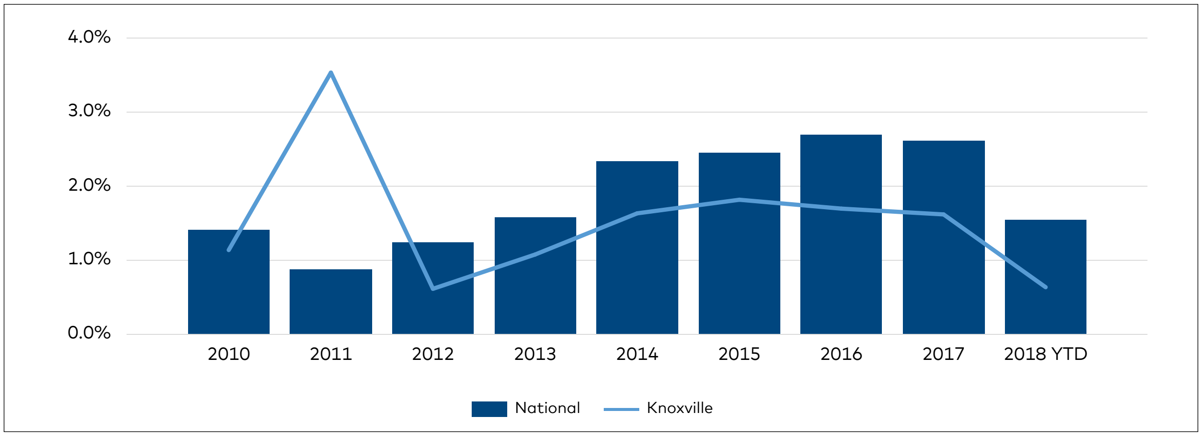
	2013	2014	2015	2016	2017
National	316,234,505	318,622,525	321,039,839	323,405,935	325,719,178
Knoxville Metro	851,377	855,695	860,398	867,870	877,104

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

Supply

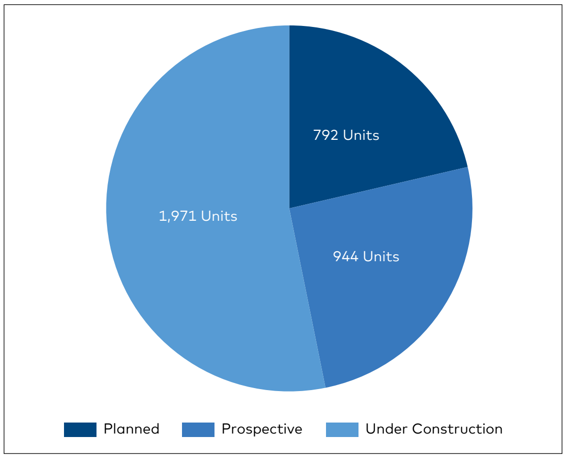
- Completions continued to lag this year, with only 246 units delivered in Knoxville as of August, about 0.6% of total stock. That's well below the U.S. rate of 1.5%, but consistent with the overall trend, with Knoxville's rate of deliveries exceeding the nation only once during the current cycle.
- Roughly 2,000 rental units were underway in Knoxville as of August, while another 1,700 were in the planning and permitting stages. That points to a limited rate of deliveries going forward. With Aventine Northshore being the only rental community with more than 50 units that came online this year through August, limited stock expansion is likely to contribute to further rent growth and the tightening of the metro's occupancy rates. Average occupancy in stabilized properties was 96.3% as of July, 40 basis points higher than it was at the start of the year. That rate is also considerably higher than the other Tennessee metros—Chattanooga (95.7%), Nashville (95.1%) and Memphis (94.8%).
- Albeit limited, construction has a few hot spots. Hardin Valley (550 units underway), South Knoxville (451 units) and Maryville (296 units) lead the way for development activity. The metro's largest project under construction as of August was Greystone Pointe in Hardin Valley, which will include 330 units.

Knoxville vs. National Completions as a Percentage of Total Stock (as of August 2018)



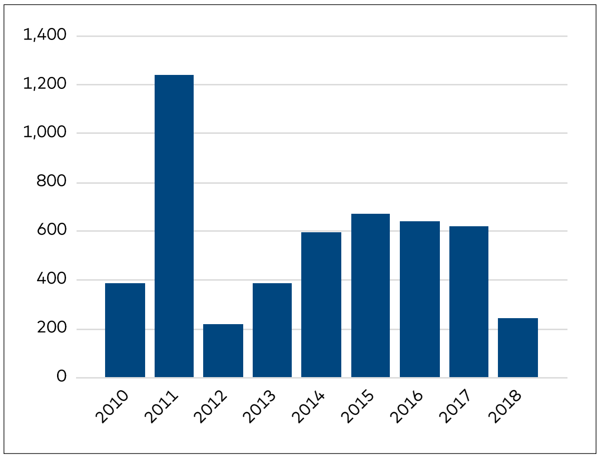
Source: YardiMatrix

Development Pipeline (as of August 2018)



Source: YardiMatrix

Knoxville Completions (as of August 2018)



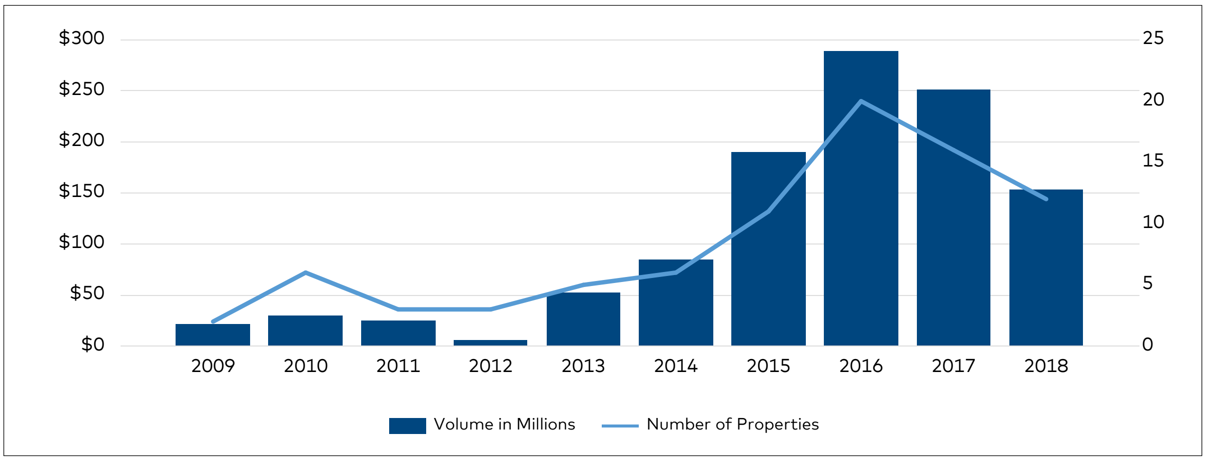
Source: YardiMatrix

Transactions

- Transaction volume hit $153 million year-to-date through July, as investment activity stayed high by the market's standards. The first half of the cycle saw a far more limited number of deals, and the total investment volume topped out at just under $200 million between 2010 and 2014. Since then, sales have picked up, with multifamily assets claiming $880 million since 2015.

- Per-unit prices have also climbed, as higher interest from buyers of Lifestyle assets pushed the average in 2018 to $142,084. That's still $5,000 lower than the national average, highlighting how affordable upscale assets are in Knoxville. However, as soon as investors shift to value-add opportunities, prices are bound to come down to earth. Investment activity was mostly focused in Cedar Bluff ($100 million), Knoxville–West ($58 million), Hardin Valley ($48 million) and Middlebrook ($40 million).

Knoxville Sales Volume and Number of Properties Sold (as of July 2018)



Source: YardiMatrix

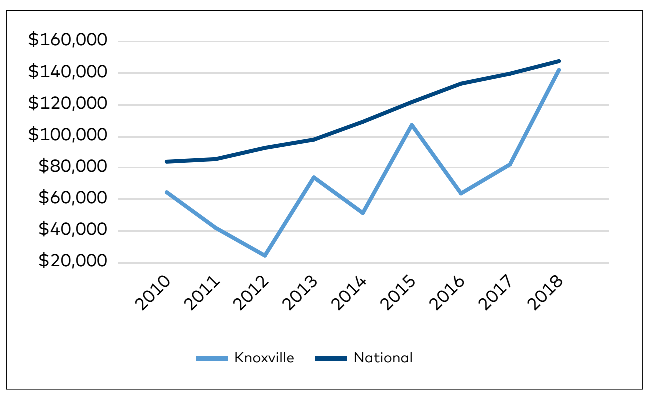
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Cedar Bluff	100
Knoxville–West	57
Hardin Valley	48
Middlebrook	40
Powell	18
Seymour	17
Northshore	11
Corryton	8

Source: YardiMatrix

[1] From August 2017 to July 2018

Knoxville vs. National Sales Price per Unit



Source: YardiMatrix

Executive Insight

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MULTI-HOUSING NEWS

What Attracts Investors to the Southeast

In an interview with Multi-Housing News Senior Writer Alexandra Pacurar, West Shore's Lee Rosenthal evaluates the potential of the region's markets and describes what makes a community appealing to Millennials and empty nesters.

Boston-based West Shore LLC has built a $750 million multifamily portfolio in the two years since the company was founded. Most of its properties are in Southeastern markets, but West Shore is considering expansion to other areas as well, while consolidating its presence in states with favorable tax conditions. Rosenthal, president of the company, discusses the organization's investment strategy and what modern renters look for in a community.

How do you see the U.S. multifamily market today? What are the main trends in the business?

The multifamily market is thriving across the country. A strong economy, continued revitalization of midsize cities and their surrounding close-in suburbs, as well as the ongoing growth and demographic trends in all of our markets indicate a continued upswing. In midsize cities that have growing high-skilled jobs and employment, we are seeing great opportunities to provide the kind of rental housing that attracts and serves these workers.

West Shore has focused on investing in the Southern and Southeastern markets. What can you tell us about the particularities of these regions when it comes to trends and challenges in the multifamily sector?

We have had great success with the assets we have acquired in Florida, the Carolinas, Texas, Tennessee, Kentucky and Georgia. We are likely to acquire additional assets in other fast-growing areas that have strong

job growth and favorable demographic and tax conditions. Most of the new opportunities we are evaluating right now are in similar markets in the Southeast and the Southwest. These growth markets are increasingly attractive to renters, including young individuals and couples, as well as retirees looking for better weather in a comfortable setting with upgraded amenities. We've also seen a lot of interest from empty nesters that want to stay near their friends and communities as they downsize.

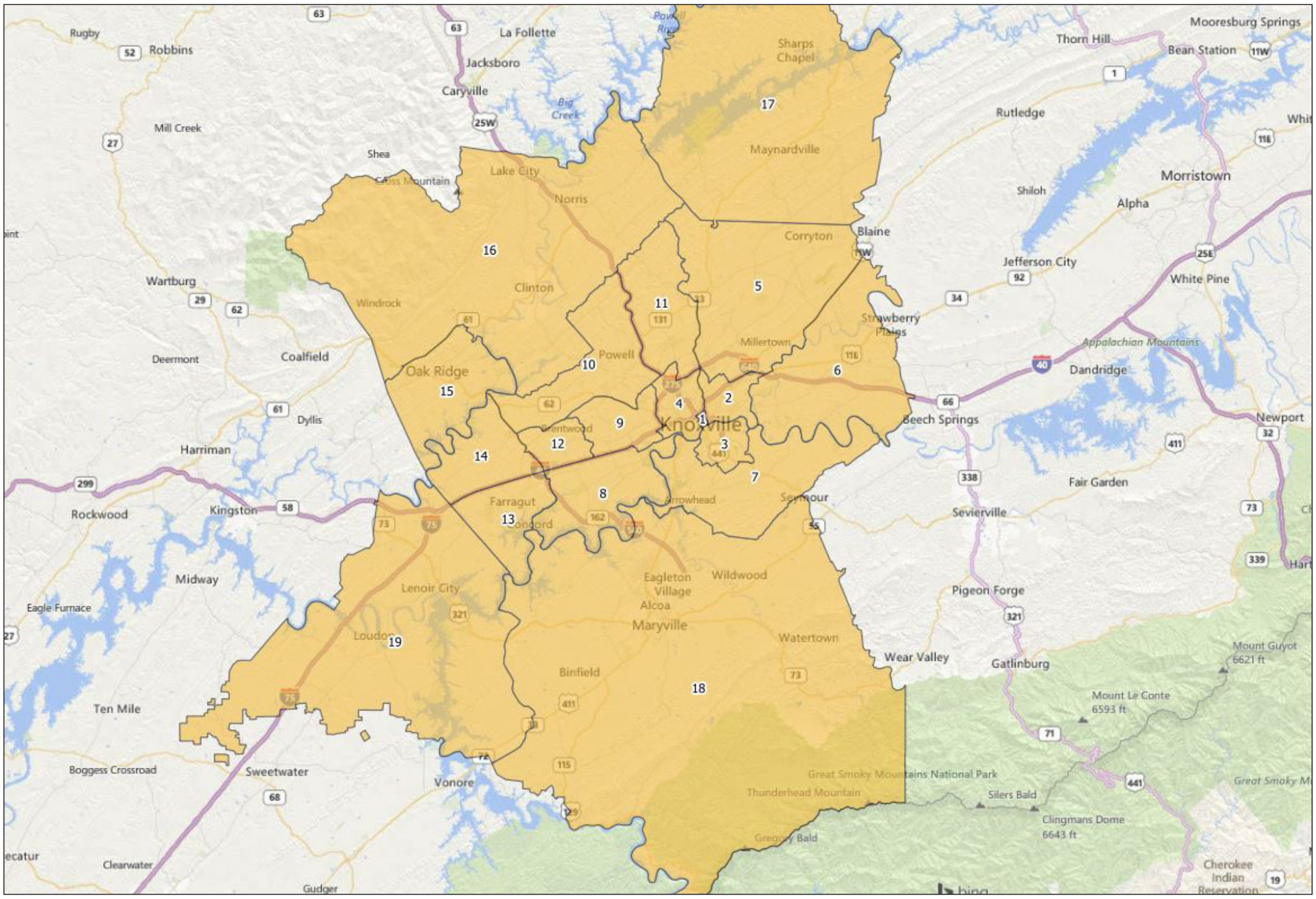
What other markets are you considering for a portfolio expansion and why?

In addition to the markets where we currently own, in which we expect to expand our footprint in a meaningful way, we are actively considering investing in other markets with significant job growth, positive demographic trends and favorable tax conditions.

What are your predictions regarding the multifamily sector?

The prognosis for multifamily is excellent in both the short and long term in our markets. The economy continues to grow and favor high-skilled jobs, particularly in cities and markets that were left out of prior employment booms and now have favorable tax and demographic conditions. The pool of Millennials and empty nesters is growing in our markets. Interest rates may be going up somewhat, but they remain at historic lows. In any event, history shows that rent growth will outpace interest rate increases and inflation.

Knoxville Submarkets



Area #	Submarket
1	Knoxville–Downtown
2	Knoxville–East
3	South Knoxville
4	Knoxville–West
5	Corryton
7	Seymour
8	Northshore
9	Middlebrook
10	Karns

Area #	Submarket
11	Powell
12	Cedar Bluff
13	Farragut
14	Hardin Valley
15	Oakridge
16	Anderson
18	Maryville
19	Loudon

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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Market Data & Analysis

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