Yardi Matrix

Twin Cities: Steady Rhythm

Multifamily Report Summer 2019

Construction Sector Leads Job Gains

Soaring Home Prices Sustain Rent Growth

Core Urban Areas Remain Development Hubs

Market Analysis
Summer 2019

Contacts
Paul Fiorilla
Associate Director of Research
Paul.Fiorilla@Yardi.com
(800) 866-1124 x5764

Jack Kern
Director of Research and Publications
Jack.Kern@Yardi.com
(800) 866-1124 x2444

Author
Laura Calugar
Senior Associate Editor

Occupancy Slips, Rent Growth Endures

The Twin Cities multifamily market has remained resilient, despite a slowdown in employment gains across the metro due to a tightening labor market. At 3.1% as of May, year-over-year rent growth was still 60 basis points above the national average.

Large-scale developments are transforming the metro's urban areas, with construction leading job gains. In the 12 months ending in March, the sector added 2,500 positions, remaining one of the main sources of employment growth. Several infrastructure projects are underway or about to kick off—the Minnesota DOT announced that $1.2 billion of transit-related projects will commence this year. Meanwhile, education and health services was hit the hardest, losing 4,000 jobs. Employers across the state are having trouble finding workers for nursing facilities and outpatient clinics.

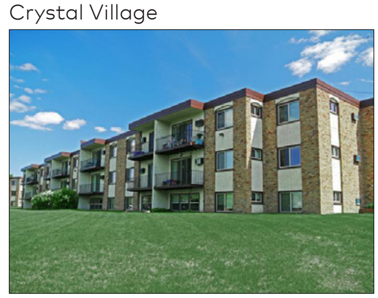
Owners tend to have a long-term hold strategy in the Twin Cities, inhibiting transaction activity. Investment volume in the metro over the past three years averaged $1.5 billion, but only eight properties traded during the first five months of 2019. And although occupancy in stabilized assets dropped 60 basis points over 12 months, to 96.6% as of April, the rate remained one of the highest among major U.S. metros. Demand, especially for workforce housing, is likely to remain high. We expect rents to advance 4.0% in 2019.

Recent Twin Cities Transactions

Avana Southview

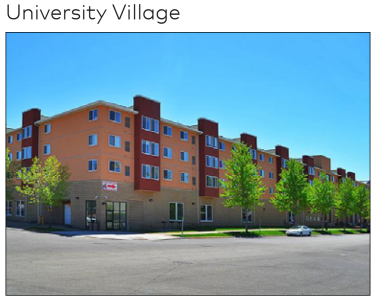
City: Inver Grove Heights, Minn.
Buyer: Greystar
Purchase Price: $70 MM
Price per Unit: $164,505

Crystal Village



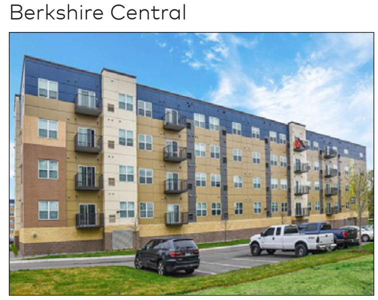
City: Crystal, Minn.
Buyer: The Wall Cos.
Purchase Price: $51 MM
Price per Unit: $111,413

University Village



City: Minneapolis
Buyer: University of Minnesota Foundation
Purchase Price: $43 MM
Price per Unit: $494,253

Berkshire Central



City: Blaine, Minn.
Buyer: Berkshire Group
Purchase Price: $36 MM
Price per Unit: $187,979

On the cover: Photo by Gian Lorenzo Ferretti Photography/iStockphoto.com

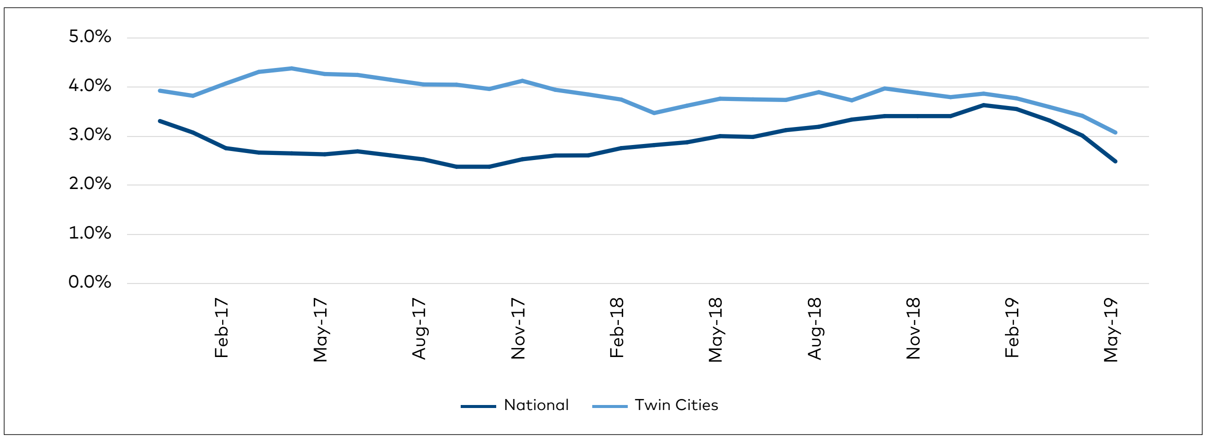
Rent Trends

- Minneapolis–St. Paul rents were up 3.1% year-over-year through May, 60 basis points over the U.S. average and slightly above other Midwestern markets, such as Detroit (2.6%) and Indianapolis (2.5%). The $1,307 average rent was $135 below the U.S. figure. This May was the second time since February 2016 when growth fell below 3.5%, which is mainly due to sustained development in recent years. However, in-migration and rapidly rising home prices are expected to further fuel rental demand.

- Working-class Renter-by-Necessity rates rose 4.3% to $1,130, while Lifestyle rents advanced only 1.3%, to $1,659. The temporary slowdown in deliveries during the first months of 2019 is likely to maintain occupancy at relatively high levels. As of April, occupancy in stabilized properties was at 96.6%, down 60 basis points over 12 months but still one of the highest among major U.S. metros. Furthermore, the shortage of affordable workforce units has pushed occupancy in Renter-by-Necessity assets to 97.3%.

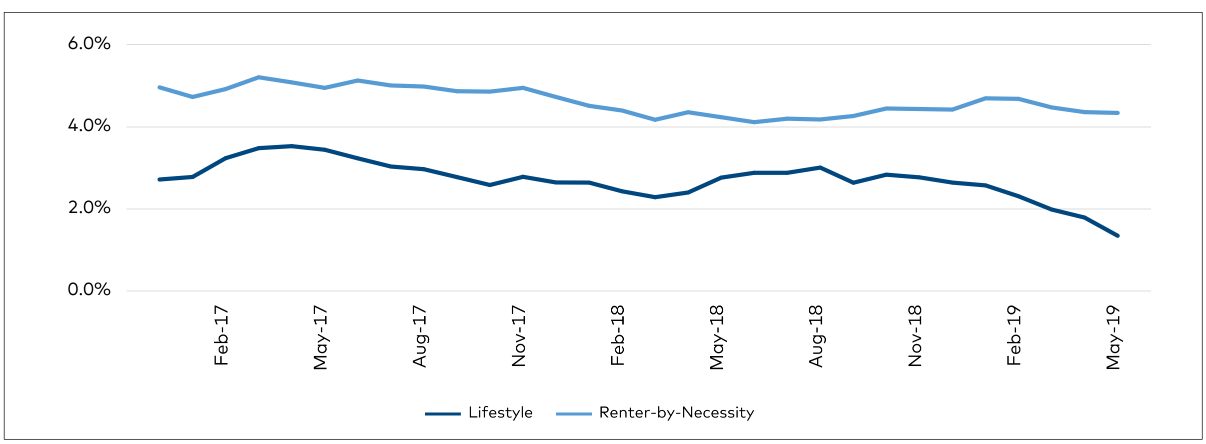
- Although all eyes have been on downtown Minneapolis over the past few years—the focal point of the construction boom and one of the metro's most expensive areas—urban submarkets such as St. Paul–St. Anthony ($1,830) and St. Paul–West Seventh ($1,773) commanded the highest rents as of May. Even so, rents grew fastest in suburban areas such as Minnetonka (8.4% to $1,576) and Blaine (7.2% to $1,236). Yardi Matrix expects the overall average rent in the metro to rise 4.0% in 2019.

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

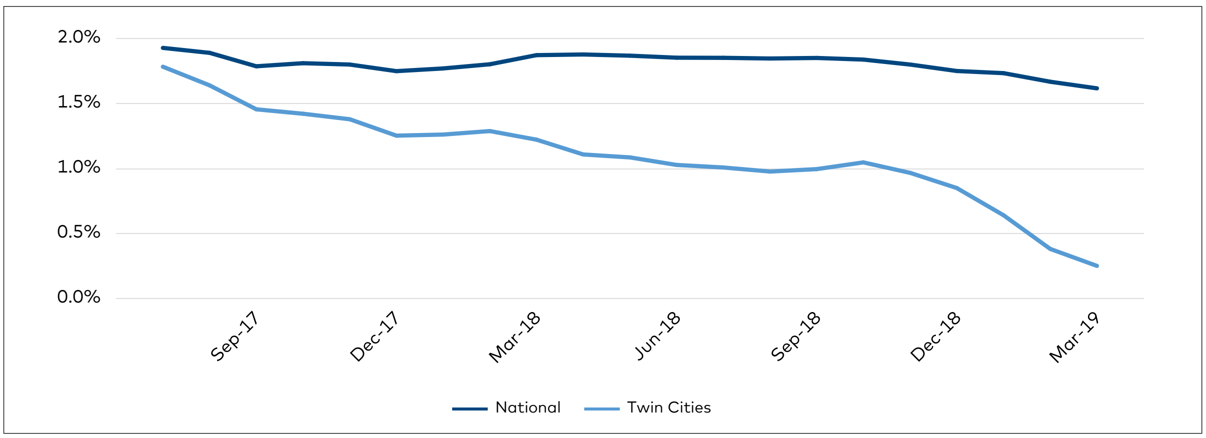
Economic Snapshot

- In the context of a tight employment market, Minneapolis–St. Paul added only 1,600 jobs in the 12 months ending in March, a 0.3% increase, heavily trailing the 1.6% U.S. rate. However, the metro's 3.6% unemployment rate as of March stood 20 basis points below the U.S. figure.

- Gains were led by the mining, logging and construction sector, which added 2,500 jobs. A $2 billion light-rail project is underway to connect downtown Minneapolis and Eden Prairie, with hundreds of workers on site daily. At the same time, bus service along an 8.5-mile corridor linking Brooklyn Center to north and downtown Minneapolis was launched in June. Using a mostly electric fleet, the bus line is the second of five planned to operate in the metro area by 2024. The construction sector is expected to receive another boost when Google's planned $600 million data center in Becker breaks ground. The facility is slated to be powered by two Xcel Energy wind farms.

- Education and health services, along with professional and business services, lost a total of 5,300 jobs. One of the biggest hits to Minnesota residents was felt in the wake of the liquidation of 34 Shopko stores, which affected more than 1,000 workers. Locally headquartered U.S. Bancorp also announced plans to lay off around 700 workers, with some of the job losses set to impact the Twin Cities area.

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	%
15	Mining, Logging and Construction	80	3.8%	2,500	3.2%
55	Financial Activities	155	7.4%	1,700	1.1%
30	Manufacturing	212	10.2%	1,500	0.7%
80	Other Services	83	4.0%	1,400	1.7%
70	Leisure and Hospitality	192	9.2%	1,300	0.7%
40	Trade, Transportation and Utilities	378	18.1%	400	0.1%
50	Information	38	1.8%	-700	-1.8%
90	Government	267	12.8%	-1,200	-0.4%
60	Professional and Business Services	325	15.6%	-1,300	-0.4%
65	Education and Health Services	355	17.0%	-4,000	-1.1%

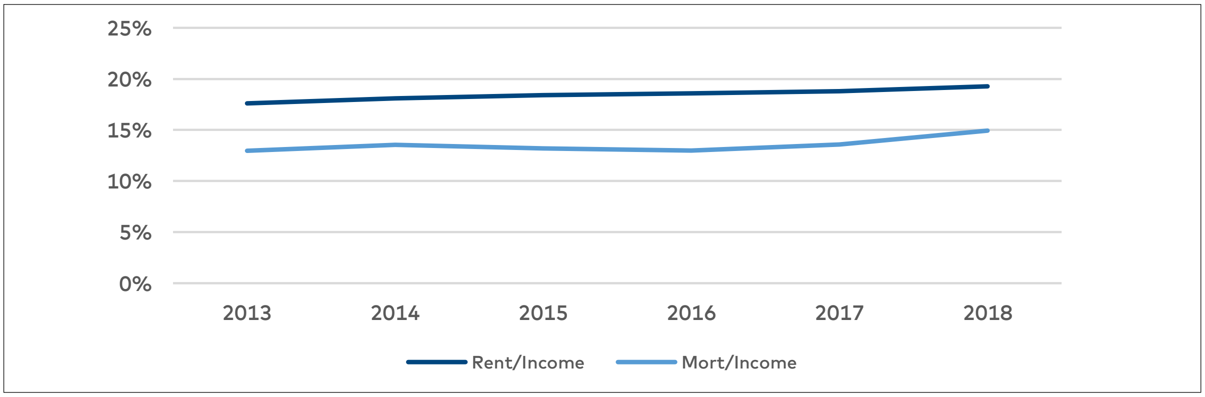
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

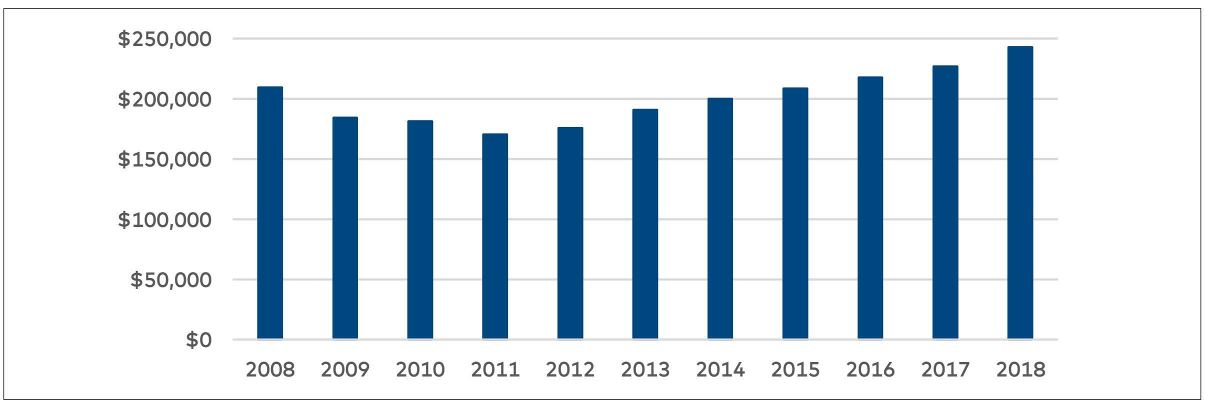
- The median home price continued to grow in 2018, hitting $242,819, a new cycle high. A lack of options offering the same lifestyle appeal as apartment living is pushing aging Millennials and empty nesters toward renting. Last year, the average rent equated to 19% of the area median income, while the average mortgage accounted for only 15%.
- Since 2011, the seven-county metro lost more affordable housing than it added, according to the Met Council. The agency determined that the Twin Cities added nearly 9,000 new affordable homes, far below the goal of 51,000 units needed until 2020 to keep pace with demand.

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

- In 2017, the Twin Cities gained more than 43,000 residents, a 1.2% increase.
- Between 2013 and 2017, the metro grew at one of the fastest rates in the Midwest, up 4.1% and 110 basis points above the U.S. rate.

Twin Cities vs. National Population

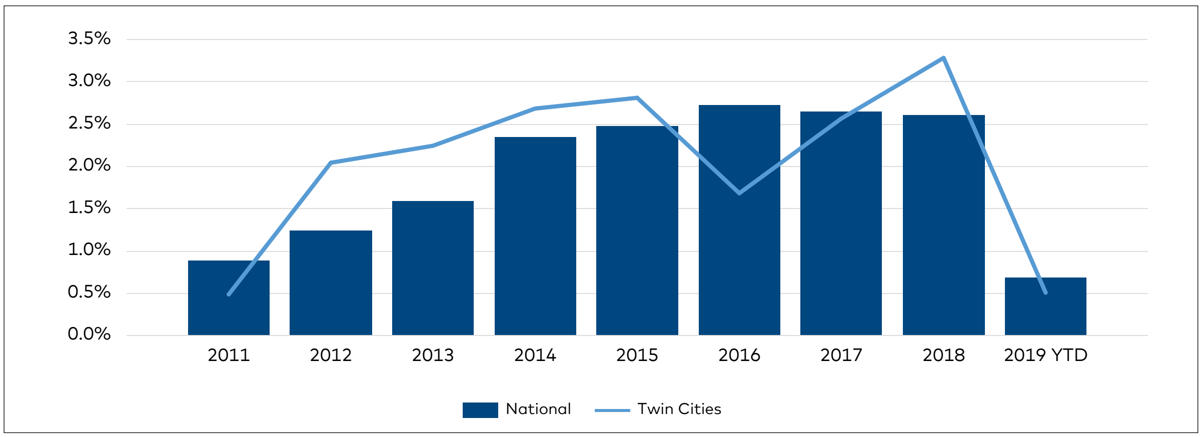
	2013	2014	2015	2016	2017
National	316,234,505	318,622,525	321,039,839	323,405,935	325,719,178
Twin Cities Metro	3,458,299	3,493,226	3,521,325	3,557,276	3,600,618

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

Supply

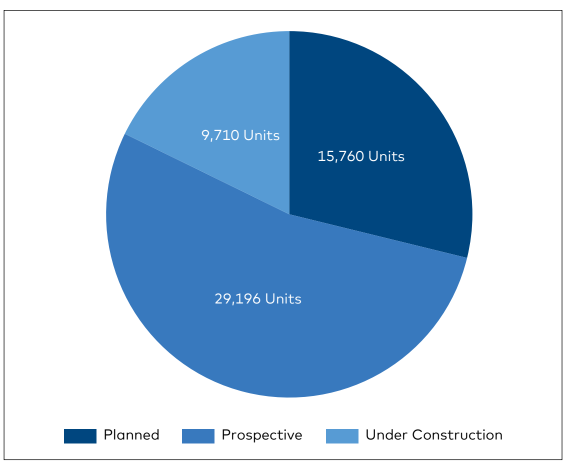
- Some 9,700 units were under construction in the metro as of May, almost three-quarters of them in Lifestyle projects. Minneapolis–Central led development by far, with 1,502 units underway, followed by another core urban submarket: Minneapolis–University (853 units). Demand is expected to remain high, backed by strong demographic growth.
- Deliveries for this cycle peaked last year, when 6,715 units came online. Developers primarily focused on projects within or near downtown Minneapolis. In the first five months of 2019, more than 740 units were completed, mostly in the northern part of the metro.
- Although 6,570 units are slated to come online in 2019, many ongoing projects are likely to face delays due to construction labor shortages and extreme weather events—including a polar vortex—that the metro withstood last winter. The largest project underway as of May was Dominium's Millberry Apartments in the St. Anthony Park neighborhood of St. Paul. The project's first phase includes 121 units reserved for low-income families and 241 apartments for seniors.

Twin Cities vs. National Completions as a Percentage of Total Stock (as of May 2019)



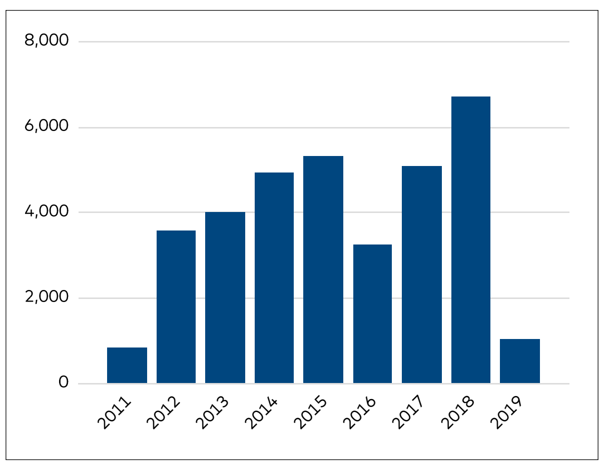
Source: YardiMatrix

Development Pipeline (as of May 2019)



Source: YardiMatrix

Twin Cities Completions (as of May 2019)



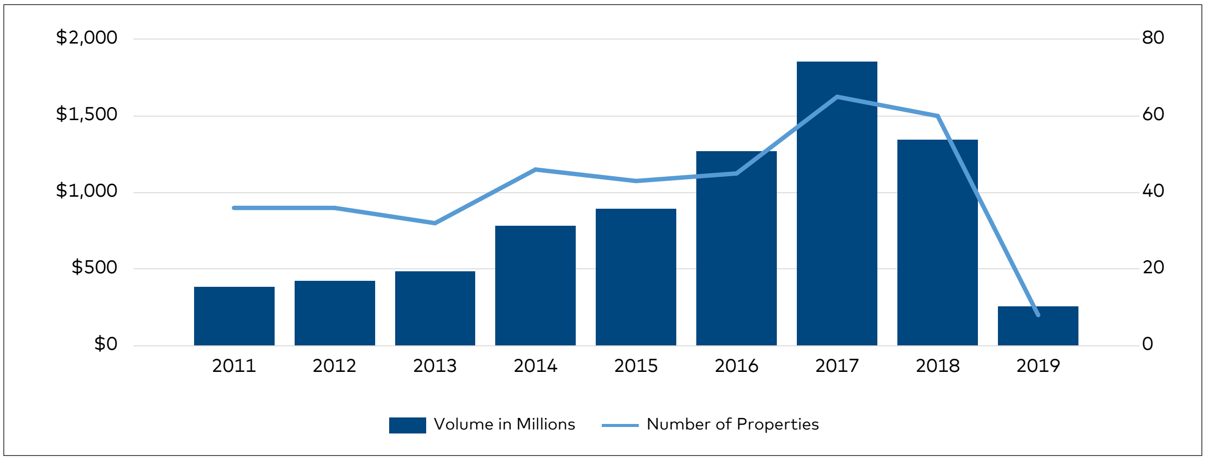
Source: YardiMatrix

Transactions

- Following a strong 2017, when $1.9 billion in assets traded for a cycle peak, investment activity in the Twin Cities shifted down a gear last year, for a total of $1.3 billion. During the first five months of 2019, the average price per unit was $178,452, above the $156,206 U.S. figure. Acquisition yields were in the 5.0% band, with value-add properties continuing to draw the lion's share of capital.

- In the 12 months ending in May, core submarkets such as Minneapolis–Central ($206 million) and Minneapolis–University ($161 million) attracted the most capital. LaSalle Investment Management, one of the most active players in the market, spent more than $157 million on five core Minneapolis properties. The five assets, which LaSalle acquired from Clarion Partners and TE Miller Development in two separate portfolio transactions, all came online over the past seven years. The communities traded at an average per-unit price of $286,566.

Twin Cities Sales Volume and Number of Properties Sold (as of May 2019)



Source: YardiMatrix

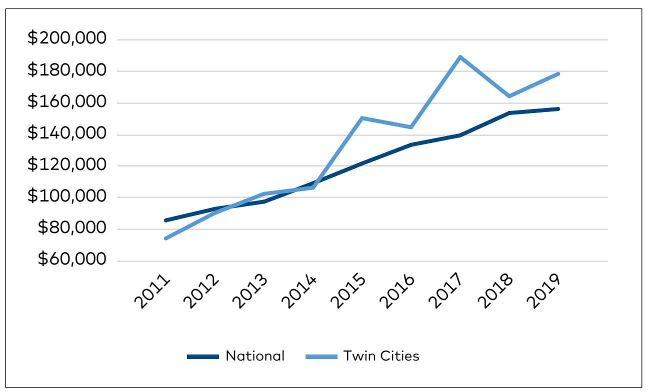
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Minneapolis–Central	206
Minneapolis–University	161
Richfield	104
Plymouth	83
West St. Paul	74
Hopkins	74
Oakdale–South	68
New Hope/Crystal	61

Source: YardiMatrix

[1] From June 2018 to May 2019

Twin Cities vs. National Sales Price per Unit



Source: YardiMatrix

News in the Metro

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LMC Breaks Ground on 445-Unit Minneapolis Property

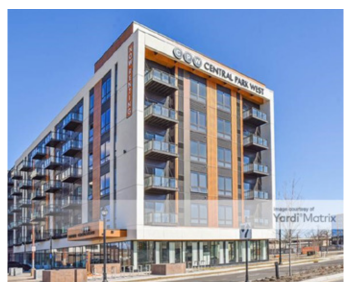
The property on First Avenue will include 8,000 square feet of retail and is slated for completion in the fall of 2020. Dubbed Odin, the project is set to include 335 rental units.

Trio of Midwest Communities Commands $100M

With this acquisition, The Habitat Co. enters the Minnesota market, while expanding its multifamily portfolio in Michigan to more than 2,500 units. Together, the properties total 1,263 apartments.

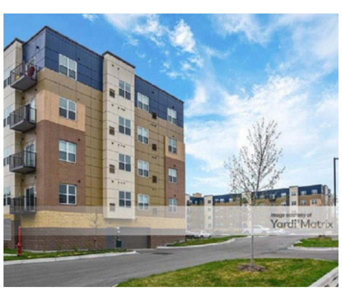
New Minneapolis Community Trades For $25M

Roers Cos. sold Mezzo, a 110-unit property in the city's Arts District. JLL originated a $16.2 million loan for the new owner.



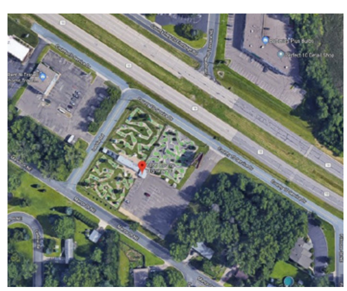
Dekel Capital Arranges $41M Loan For MN Community

Central Park West includes a total of 199 units, six of which are affordable. The community is close to downtown Minneapolis.



Berkshire Acquires Recently Completed MN Community

The Park Off Central is located less than 20 miles from Minneapolis and St. Paul. The new owner has plans to rebrand the 191-unit asset.



Affordable Senior Housing Community Opens in MN

The Legends of Spring Lake Park is close to a variety of parks, shopping venues and restaurants, and includes a mix of one-, two- and three-bedroom units.

Executive Insight

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Development in the Twin Cities: A Bittersweet Story

By Laura Calugar

Deliveries reached a cycle peak in 2018, when more than 6,700 units were completed in the Twin Cities, according to Yardi Matrix. After completing two apartment projects in Minneapolis' North Loop, Opus Development started construction on its third community in the same neighborhood.

Vice President & General Manager Matt Rauenhorst and Director Nick Murnane evaluate the Twin Cities' multifamily landscape and discuss the challenges developers face in a market with good demographics. The two also share the company's business strategy going forward.

How would you describe the Twin Cities multifamily market in 2019?

Rauenhorst: The Twin Cities multifamily market remains strong in 2019. A very strong spring leasing season has the new deliveries leasing well, and existing buildings are pushing rents in nearly every submarket. Construction activity continues in the strongest urban and suburban markets, where rents can support the cost of new construction.

What is driving multifamily demand in the metro?

Rauenhorst: Simply put, job growth. Coming out of 2010, the Twin Cities' economy and job growth outpaced the national average. With unemployment rates of 2.8 percent, employers are finding it challenging to fill open positions and need to look outside the Twin Cities to attract talent.

What are the greatest challenges you come across when developing new multifamily projects in the Twin Cities?

Nick Murnane *(left)* and Matt Rauenhorst *(right)*

Rauenhorst: The market has seen rent growth, but it has not kept pace with construction cost increases. There are many reasons why construction cost increases have outpaced rent growth for a number of years, but the result is significantly fewer sites that will support new multifamily development. There are very limited submarkets with demand and corresponding rents to offset the higher costs.

Which areas of the metro perform better in terms of new development and why?

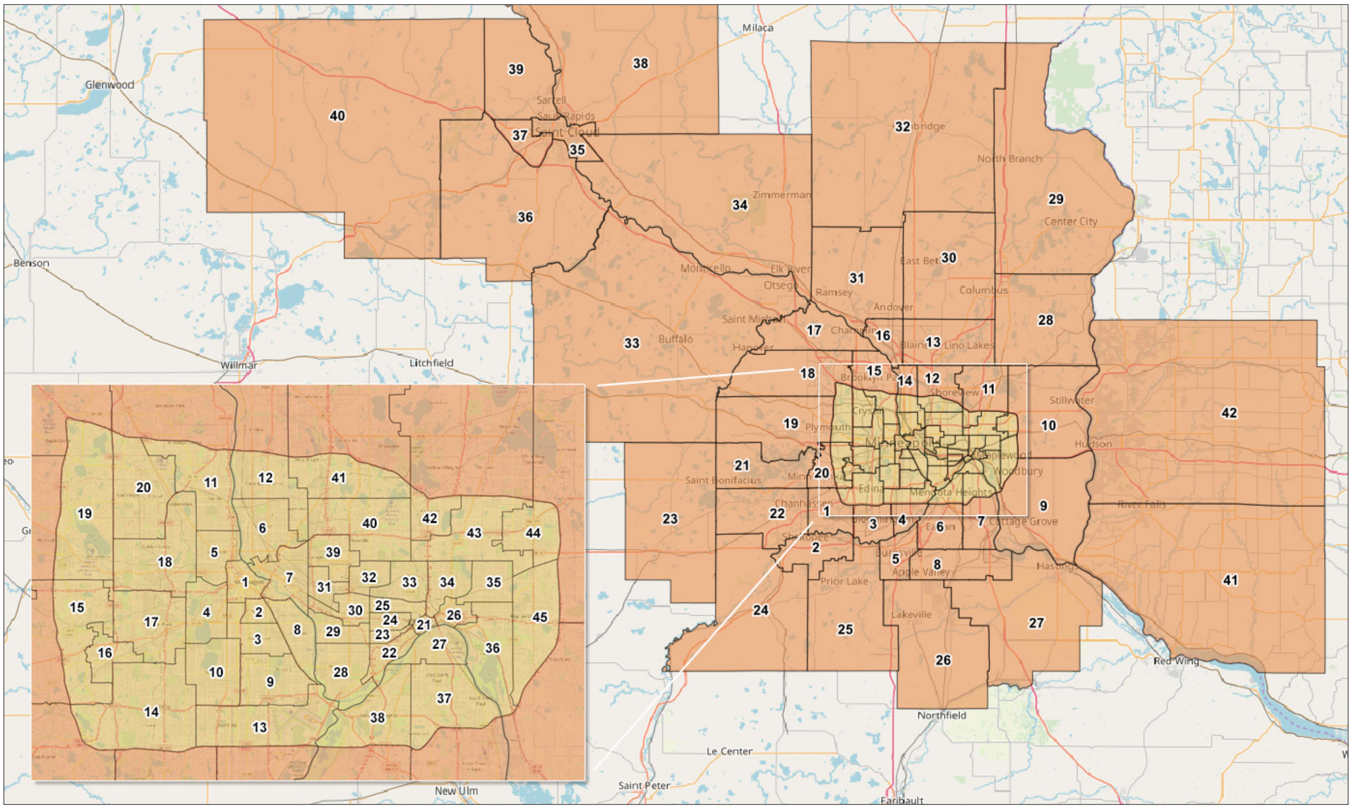
Murnane: Developers have found success in both suburban and urban markets. Our team has primarily focused on the downtown and very near downtown submarkets that provide a live-work-play environment. These sites meet the needs of young professionals and empty nesters moving out of the suburban home and back to the city. We see this trend continuing and are looking at additional developments in the downtown core and adjacent submarkets.

How do you expect the Twin Cities multifamily market to evolve?

Murnane: We see some slowing in the number of projects starting construction in the next two years. Given the strength in demand and moderate slowing in supply, we believe the market will continue to see rent growth. The projects that are most successful will be located in neighborhoods that offer residents close proximity to the amenities they look for. These amenities include restaurants, entertainment, transit and employment.

(Read the complete interview on multihousingnews.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

Area #	Submarket
1	Eden Prairie
2	Shakopee
3	Bloomington–West
4	Bloomington–East
5	Burnsville
6	Eagan
7	Inver Grove Heights
8	Apple Valley
9	Woodbury–Cottage Grove
10	Stillwater
11	White Bear Lake
12	Mounds View
13	Blaine
14	Fridley
15	Brooklyn Park

Area #	Submarket
16	Coon Rapids
17	Champlin–Rogers
18	Maple Grove
19	Plymouth
20	Minnetonka
21	Spring Park
22	Chaska
23	Wacoma
24	Jordan
25	Savage
26	Lakeville
27	Hastings
28	Forest Lake
29	Chisago City
30	Andover

Area #	Submarket
31	Anoka
32	Cambridge
33	Buffalo
34	Elk River
35	St. Cloud–North
36	St. Cloud–South
37	Waite Park
38	Sauk Rapids
39	Sartell
40	Melrose
41	River Falls
42	Hudson

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.