Multifamily *Investment Outlook*

United States | Q2 2016

MULTIFAMILY

Broadly resilient and strong multifamily sector across markets supports volume gains

U.S. Multifamily property market		U.S. Multifamily investment	
-30	1.6%	$68.2	3.5%
12-month change in total vacancy (bps)	12-month net absorption (as a % of inventory)	Investment sales (YTD, billions of $US)	YTD investment sale growth (%)
1.9%	4.5%	4.4%	-15
12-month completions (as a % of inventory)	12-month rent growth (per unit, %)	Average cap rate (%)	12-month change in cap rate (bps)

An unprecedented streak of employment gains support advances in multifamily. U.S. employers added 287,000 jobs to their payrolls in June, surpassing economists' expectations. This substantial addition has continued an unprecedented 69-month streak of employment gains. Employment across the U.S. is at an all-time high. The record-setting length of job growth gains have resulted in a gradual boost in wage growth. These steady job and wage gains have supported the continued strength of the leasing market for multifamily, as effective rents have steadily grown throughout the current cycle.

A homeownership bottleneck preserving a stable, strong rental pool. Existing home sales, which constitute approximately 90.0 percent of all home purchases in the U.S. climbed in June to the highest level since February 2007. This has occurred in conjunction with continued inventory shortages, propelling prices to new peaks throughout the year. In spite of the gradual gains in the U.S. housing market, renter-occupied household formations have surpassed owner-occupied household formations for the past nine years running.

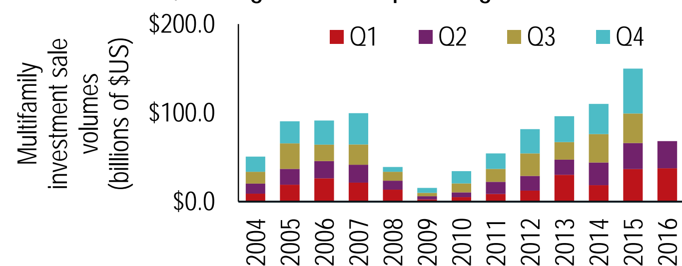
National annual rent growth softens from peak while maintaining above average levels. Rent growth softened 50 basis points in the first quarter of 2016 from the current cycle high of 5.0 percent, set in the fourth quarter of 2015, to the current rate of 4.5 percent. While annual rent growth may have peaked for the cycle, 4.0 percent rent growth continuing in the short-run is likely, a function of resolute demand and the continued completion of new product.

Leasing markets remain tight in spite of sustained completions, moderating absorption. Completions nationally edged up 10 basis points compared to the first quarter of 2015. In conjunction with this, national absorption with respect to inventory modestly declined 10 basis points year-over-year. In spite of this divergence, all tracked markets maintain positive absorption, and the 4.5 percent current national vacancy rate bests the long-term average by 100 basis points.

Multifamily sales have the potential to outpace 2015's record-setting volumes. The multifamily asset type saw nearly $30.6 billion of investment sales activity during the second quarter of 2016. The year-to-date figure of $68.2 billion represents a 3.5 percent increase compared to the first half of 2015. Cap rates continue to compress in response to sustained investor appetite, sitting 21 basis points above prior peak levels.

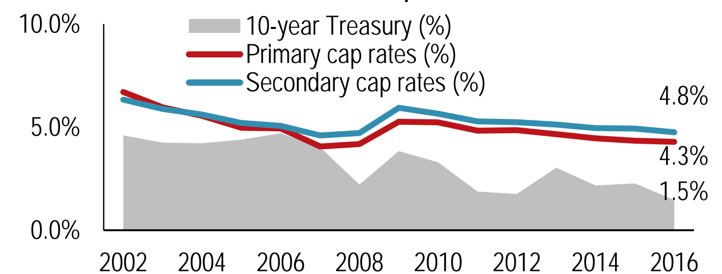
Diversified growth and pricing discount retaining investor focus on secondary markets. Mid- and high-rise activity year-to-date in secondary markets is up 56.7 percent. With leading economies and sustained levels of absorption and rent growth, Western region markets continued to outperform peers, validating their quality and dynamism.

Multifamily investment sales are up 3.5 percent compared to the first half of 2015, the largest second-quarter figure on record.



Source: JLL Research, Real Capital Analytics (Transactions larger than $5.0m)

Despite sustained, historic levels of deal flow and concerns on recent deliveries in select markets, cap rates remain stable.



Source: JLL Research, NCREIF, Board of Governors of Federal Reserve

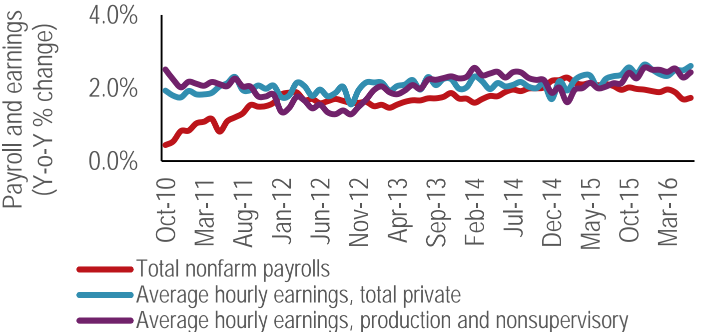
TOP 6 MULTIFAMILY THEMES

1 An unprecedented streak of employment gains support consolidated advances in multifamily

The domestic economy's resilient expansion reinforces associated developments in the multifamily sector. Domestic labor markets have consistently supported this period of economic strength. U.S. employers added 287,000 jobs to their payrolls in June, surpassing economists' expectations before the data's release on July 8th. This substantial addition has continued an unprecedented 69-month streak of employment gains. Employment across the U.S. is at an all-time high. With these gains, the national unemployment rate is currently at 4.9 percent. Sustained sub-5.0 percent unemployment rates encourage those on the sidelines of the economy to actively seek work. As a result, more people entered the labor force to look for work in June, signifying confidence in the job market. Moreover, a healthy domestic economy encourages employers to attract workers by offering higher pay. This played out in earnings gains, which grew 2.6 percent for all workers compared to June 2015's pace of 2.0 percent with nonsupervisory workers growing from 2.0 to 2.4 percent over the same period of time. The record-setting length of job growth gains have resulted in a gradual boost in wage growth. These steady job and wage gains have supported the continued strength of the leasing market for multifamily, as effective rents have steadily grown throughout the current cycle. The aforementioned strength in job growth combined with generational lows in homeownership rates indicate a deep pool of renters and prospective renters for the foreseeable future, more recently spurring the continued strength of absorption in the multifamily sector.

The U.S. economy added 287,000 jobs to June payrolls

A 2.6 percent yearly gain in earnings accompanies an all-time high in employment across the U.S., encouraging consolidated gains in household formations.



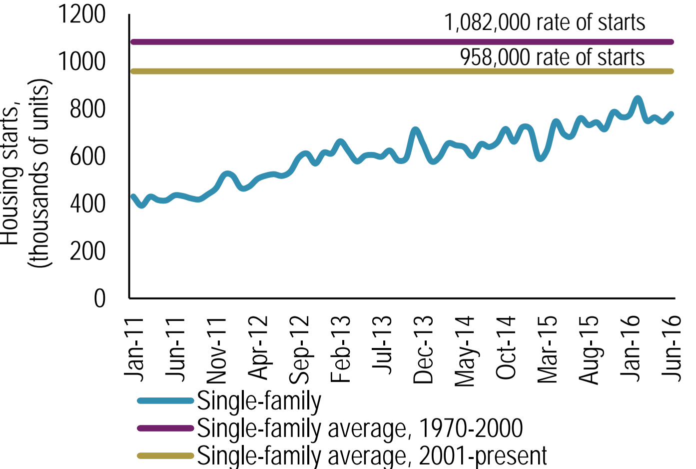
Source: JLL Research, U.S. Bureau of Labor Statistics

2 A homeownership bottleneck preserving a stable, strong rental pool

Continued structural supply constraints throughout the single-family housing market have resulted in a homeownership bottleneck, preserving a stable and strong rental pool. Existing home sales, which constitute approximately 90.0 percent of all home purchases in the U.S., climbed in June to the highest level since February 2007 with a seasonally adjusted rate of 5.57 million. While the gain in momentum for home sales is a positive development for the domestic economy, continued inventory shortages have propelled prices to new peaks throughout the year. Unsold inventory is at a 4.6 month supply at the current sales pace, down from a 5.0 month supply one year prior and moving even further away from the 6.0 month equilibrium rate. As a result, the current median sales price of an existing home is $247,700, an all-time high and up 4.8 percent year-over-year. The Case-Shiller National Home Price Index reflects a similar outlook, currently within 4.0 percent of its 2006 peak. These sustained price gains can act as a barrier to entry, in spite of steady wage growth and cheap mortgage rates. The rate for a 30-year, fixed-rate mortgage most recently averaged 3.45 percent for the period of July 15–21, down nearly 60 basis points from 2015's 4.04 percent.

There were 778,000 single-family housing starts in June 2016

This figure trails the 1,082,000 average rate of single-family starts from 1970–2000 by 28.1 percent.



Source: JLL Research, U.S. Census Bureau

Single-family housing starts have gradually increased in response to the gradual improvements in the economy. As of June 2016, the seasonally adjusted rate of starts on single-family homes was 778,000, while the average on the year is 776,000. These figures have risen in excess of 13.0 percent year-over-year. Despite continued gains, these figures remain over 28.0 percent below the 1,082,000 average rate of starts from 1970 until the end of 2000. Comparatively, the current year figures trail the 958,000 average rate of starts from 2001 to the present by 18.9 percent.

In spite of the gradual gains in the U.S. housing market, the millennial demographic continues to support sustained demand for multifamily housing. Renter-occupied household formations have surpassed owner-occupied household formations for the past nine years running. The 1.605 million renter-occupied household formations in 2015 far surpassed the 279,000 owner-occupied formations during the same time. Additionally, these owner-occupied gains were the first annual gain since 2011. Any gains in the single-family housing space have been incremental and have not broadly affected the demand for multifamily housing.

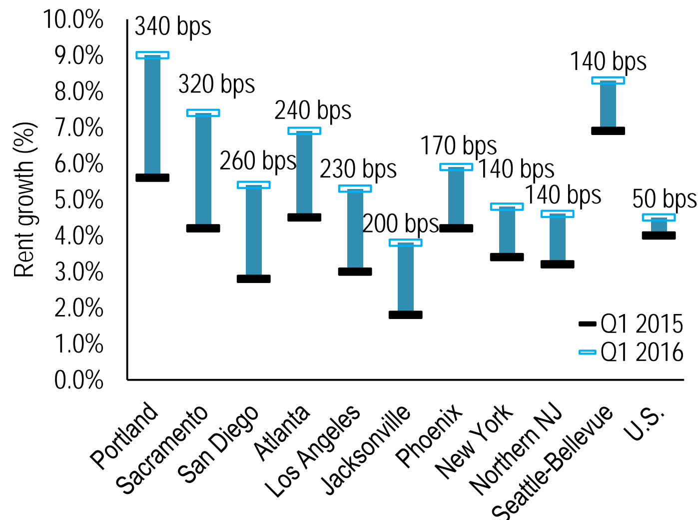
3 National annual rent growth softens from peak while maintaining above average levels

National annual rent growth softened 50 basis points in the first quarter of 2016 from the current cycle high of 5.0 percent, set in the fourth quarter of 2015, to the current rate of 4.5 percent. While annual rent growth may have peaked for the cycle at the end of 2015, 4.0 percent rent growth continuing in the short-run is likely, a function of resolute demand and the continued completion of new product. The current rate of growth has actually gained 50 basis points year-over-year. This sustained growth is the result of consistent positive forces in labor, housing and demographics—most strongly felt in the Western region. Western markets continue to lead the way with respect to rent growth, as the four fastest-growing markets–Portland, Seattle-Bellevue, San Francisco and Sacramento–have each grown between 7.4 and 9.0 percent year-over-year. Additionally, the Western region features eight of the top ten markets for annual rent growth with Denver, Oakland-East Bay, Phoenix and Silicon Valley each seeing annual rent growth gains between 5.8 and 6.3 percent.

The vitality of rent growth is apparent when considering this is the fifth consecutive quarter of growth at or above 4.0 percent. Furthermore, all tracked markets saw gains this quarter with Baltimore (2.9 percent), Milwaukee (2.7 percent), Washington, DC (2.3 percent) and Pittsburgh (2.1 percent) lagging peer markets. Unlike last cycle, underlying conditions indicate that markets have set a new equilibrium for leasing indicators, and markets are currently able to handle the new equilibrium, with little evidence of looming, near-term bubbles in the sector. However, the rate of growth is currently slowing, but remains above average relative to the current and prior cyclical norms. While affordability considerations will remain a topic of discussion with respect to rents, the market has thus far proven its ability to support current rents. Rent growth of 4.0 percent or greater is likely to continue in the short-run, especially as the second and third quarters traditionally result in heightened leasing activity.

National rent growth up 50 bps in the first quarter

Led by Portland and Sacramento, Western region markets accounted for six of the top ten gainers.



Source: JLL Research, Reis

4 Leasing markets remain tight in spite of sustained completions, moderating absorption

Completions nationally edged up 10 basis points compared to the first quarter of 2015—currently 1.9 percent of inventory. In conjunction with this, national absorption with respect to inventory modestly declined 10 basis points year-over-year to 1.6 percent of inventory. In spite of this divergence, all tracked markets maintain positive absorption. Moreover, while the national vacancy rate has softened 30 basis points from the cycle peak of 4.2 percent set in the first quarter of 2015, the current 4.5 percent rate bests the long-term average (from 1999–2015) by 100 basis points.

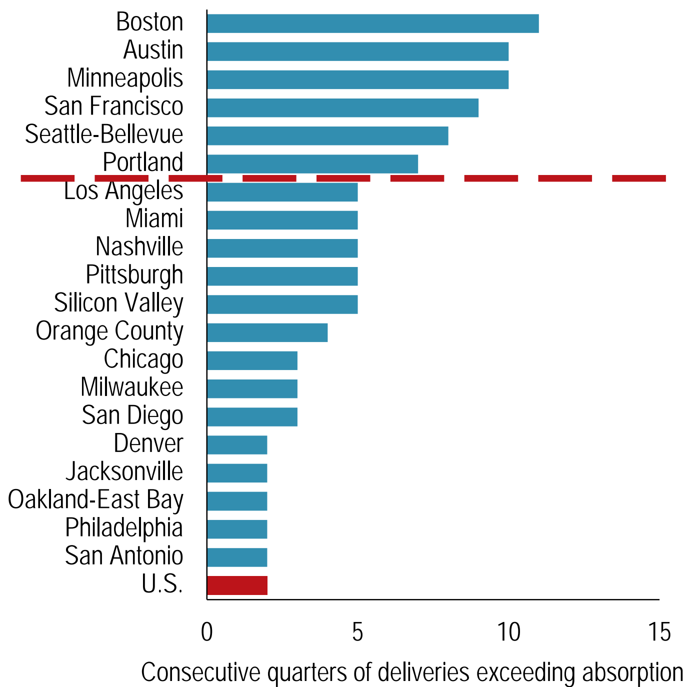
With tight market fundamentals, multifamily units under construction in the 32 largest markets remains elevated, increasing 34.9 percent year-over-year. While primary markets New York, Houston and Dallas-Ft. Worth each have over 30,000 units currently under construction, secondary markets in the Southeastern region have seen the greatest acceleration in the past year. Raleigh-Durham, Tampa, Nashville, Charlotte and Orlando comprise five of the top six gainers. Each of these markets has seen increases of units under construction above 75.0 percent year-over-year. Secondary markets in the South and West led completions this quarter, as Austin, Orlando and Portland each saw completions with respect to inventory range between 4.2 percent and 4.5 percent. Orlando notably saw a 120 basis point increase from the 2015 year end figure of 3.1 percent. Denver (3.7 percent), Nashville (3.2 percent) and San Antonio (3.1 percent) were additional secondary markets in the South and West to deliver in excess of 3.0 percent of current inventory.

Given the high levels of new deliveries, Western region markets are further along in supply cycles and more likely to face short-term imbalances. Of the six markets currently leading with consecutive quarters of deliveries exceeding absorption, three are from the Western

region–San Francisco, Seattle-Bellevue and Portland. The remaining three are Austin, Boston and Minneapolis. In spite of these markets currently seeing outpaced deliveries compared to absorption, Austin, Portland, Seattle-Bellevue and Boston continue to exhibit strong absorption at rates +50 basis points above the national average. Going forward, prudence with respect to multifamily construction will be necessary as the current cycle matures. Supply-side risks remain elevated, notably for lower barrier to entry markets. However, economic and demographic factors remain accretive to multifamily housing demand, and markets remain in favor of landlords overall.

Select markets have steadily seen deliveries outpace absorption

Austin, Portland, Seattle-Bellevue and Boston are absorbing above the 1.6 percent national rate.



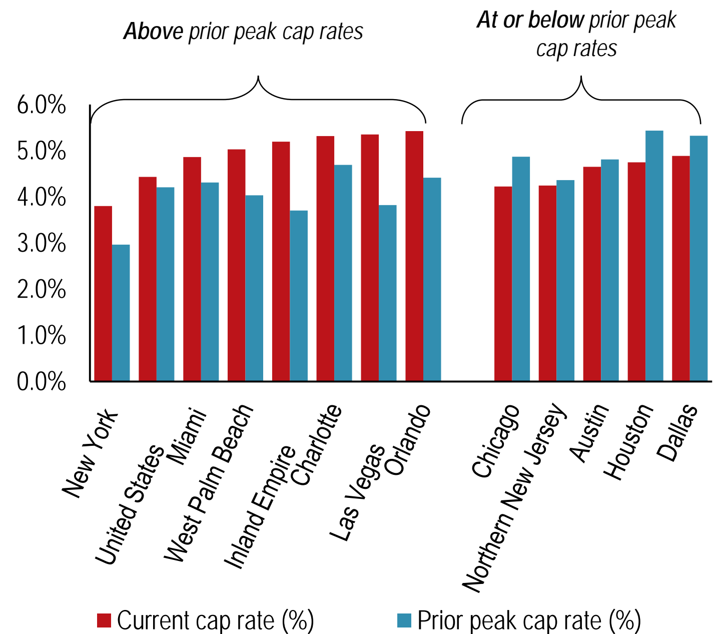
Source: JLL Research, Reis

5 Multifamily sales have the potential to outpace 2015's record-setting volumes

While the rate of growth is slowing from last year's unprecedented record, multifamily sale volumes have maintained the pace of the first quarter with potential to slightly surpass 2015's record-setting volumes at year-end. With $30.6 billion of activity in the second quarter, multifamily investment sale volumes are up 3.5 percent year-to-date. With this, cap rates continue to compress in response to sustained investor appetite and improving sector fundamentals, reaching 4.4 percent and sitting 21 basis points above prior peak levels. This is being driven by secondary markets, as the primary markets have remained essentially unchanged for the previous three quarters. Single asset sales of mid- and high-rise properties have seen growth of 14.7 percent year-to-date, while garden-style properties have declined slightly by 3.1 percent. This is supported by high liquidity for mid- and high-rise product, especially newer product in the CBD or in close proximity to mass transit. In Boston, General Investment & Development (GID) acquired Windsor at Cambridge Park for $215.0 million, or over $540,000 per unit at a 4.1 percent cap rate.

Portfolio and entity-level transactions are down 41.5 percent quarter-over-quarter. That being said, half-year portfolio volumes remain up 5.4 percent year-over-year. The recent decline in portfolio investments stems from the absence of larger, national opportunities and the shift toward smaller, single market focused offerings, which have increased 32.3 percent year-to-date. In the largest single market portfolio transaction of the quarter, Oaktree and Bascom Group acquired nearly 5,000 units across 16 garden-style, multifamily properties in Las Vegas for $630.0 million. Sunbelt markets drove single market portfolio gains with a high composition of garden-style units and value add opportunities. Phoenix additionally saw nearly $300.0 million of such activity in the second quarter with the vast majority of transacted assets delivered prior to the year 2000. Looking forward, the current demographic cycle will continue to mitigate sector risks for investors, supporting resilient multifamily capital markets and underwriting in CBD markets, but also for well-located suburban, garden-style product.

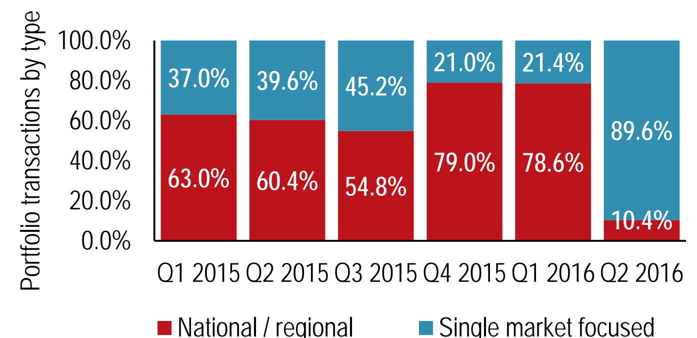
National cap rates remain 21 basis points off of previous cycle peaks; several Southeastern markets remain above prior peaks



Source: JLL Research, NCREIF

Increase in single market focused multifamily portfolios

Sun Belt markets drove gains of single market focused activity, up 32.3 percent year-over-year.



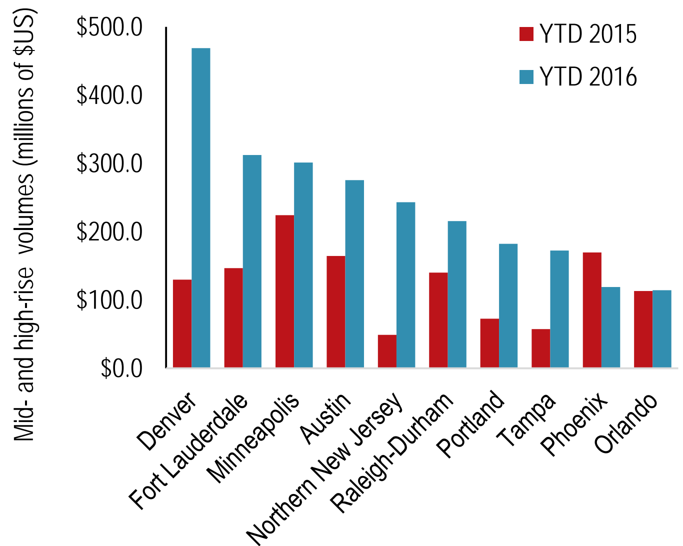
Source: JLL Research, Real Capital Analytics (Transactions larger than $5.0m; Assets over 50 units)

6 Diversified growth and pricing discount retaining investor focus on secondary markets

Secondary markets have seen sustained attention in the first half of 2016, as investors seek to acquire well-positioned product aligned with favorable economic and labor market trends. Mid- and high-rise activity year-to-date in secondary markets is up 56.7 percent. With leading economies and sustained levels of absorption and rent growth, Western region markets continued to outperform peers. Denver continues to outperform, seeing $373 million in mid- and high-rise investment sales this quarter and at record pricing levels. While properties in the cities are perennially attracting sustained investment attention, diversifying institutional capital and private equity funds are bringing liquidity to the suburbs as well. IMT Capital bought the 240-unit IMT at the Park in Denver for nearly $71.0 million, or over $295,000 per unit. In addition to the notable uptick and diversity of transactions in Denver, Portland is another growing multifamily market for investment, seeing a 150.8 percent year-to-date increase in mid- and high-rise investment sales. These markets and others are validating the dynamism of secondary multifamily markets, notably for quality properties developed within the past decade in high-growth secondary markets with strong leasing fundamentals.

Secondary mid- and high-rise activity jumps 56.7 year-to-date

Denver and Portland's respective 260.7 and 150.8 percent year-to-date growth highlight increased attention in secondary market activity in mid- and high-rise properties.



Source: JLL Research, Reis

Primary markets compress 10 basis points; overall cap rates tighten 15 basis points year-over-year

Seattle-Bellevue 4.0 – 4.5%
Portland 4.3 – 4.8%
Sacramento 4.4 – 5.0%
San Francisco Bay 3.6 – 4.3%
Las Vegas 5.0 – 5.3%
Los Angeles 3.6 – 4.2%
Inland Empire 4.5 – 5.3%
San Diego 4.0 – 4.4%
Phoenix 4.9 – 5.3%
Albuquerque 5.8 – 6.3%
Denver 4.5 – 5.5%
Minneapolis 4.5 – 5.5%
Chicago 4.0 – 5.0%
Dallas-Fort Worth 4.0 – 5.5%
Austin 4.0 – 5.5%
Houston 5.0 - 6.0%
San Antonio 5.0 – 6.0%
Columbus 6.0 – 7.0%
Cincinnati 5.8 - 6.5%
Pittsburgh 5.8 – 6.5%
Nashville 4.5 – 5.0%
Atlanta 4.5 – 5.0%
Raleigh 4.8 – 5.3%
Charlotte 4.8 - 5.3%
Central-North Florida 5.2 – 5.5%
South Florida 4.0 – 5.0%
Washington, DC 4.5 – 5.5%
Philadelphia 4.8 – 5.5%
New Jersey 4.3 – 5.0%
New York 2.9 – 3.9%
Boston 3.9 – 5.5%

WA OR ID MT ND MN WI MI NY VT NH ME MA SD WY NE IA IL IN NV UT CA CO KS MO KY WV AZ NM OK AR TN SC NC AL MS LA TX FL

4.00 – 5.00%
5.00 – 6.00%
6.00 – 7.00%
7.00 – 8.00%
8.00 - 9.00%
9.00% +

Notable primary market single asset transactions, Q2 2016

Market	Property	Buyer	Seller	Price ($)	Size (units)	Price (per unit)
Washington, DC	Riverside Apartments	WRIT	AIMCO	$244,775,000	1,222	$200,307
Chicago	North Harbor Tower	Crescent Heights	FL State Board of Admin	$237,000,000	600	$395,000
Boston	Windsor at Cambridge Park	GID	The Hanover Co	$215,000,000	398	$540,201
San Francisco (Mid-Peninsula)	Franklin 299	TIAA	Greystar	$212,650,000	305	$697,213
Washington, DC	Flats 8300	Invesco	StonebridgeCarras / Walton Street Capital	$207,000,000	359	$576,602
Los Angeles	One Santa Fe	Berkshire Income Realty	Cowley RE Partners JV Canyon Partners	$200,000,000	438	$456,621
New York	Sky	SL Green	Moinian Group	$160,000,000	1,176	$136,054
Chicago	850 Lake Shore Drive	JP Morgan	Integrated Development Group / National Real Estate Advisors	$140,000,000	198	$707,071
New York	Serrano	Bonjour Capital	Glenwood Management	$139,600,000	265	$526,792
New York	112-120 East 11th St & 85 East 10th St	Lightstone Group	Manocherian Brothers	$127,500,000	181	$704,420

Notable secondary market single asset transactions, Q2 2016

Market	Property	Buyer	Seller	Price ($)	Size (unit)	Price (per unit)
San Diego	Summerset Village	Investors Management	Gables Residential (Clarion)	$214,000,000	752	$284,574
Denver	Alara Union Station	American Realty Advisors	Greystar / Goldman Sachs	$154,300,000	314	$491,401
Austin	The Catherine	Christopher Commercial Inc	StreetLights Residential / Hunt Companies	$129,000,000	300	$430,000
Denver	Joule Apartments	GID	Lynd / Snavely Group	$120,000,000	224	$535,714
Fort Lauderdale	Edge at Flagler Village	TIAA	Morgan Group	$114,395,000	332	$344,563
Nashville	The Landings of Brentwood	Steadfast Apartment REIT	Venterra Properties / GE Capital	$110,000,000	724	$151,934
New York Boroughs	124-128 Columbia Heights	Vincent Viola	Jehovah's Witnesses	$105,000,000	308	$340,909
Phoenix	Citrine	Simpson Housing	JLB Partners	$93,912,000	312	$301,000
Orlando	GrandeVille on Avalon Park	Oxford Properties / Preferred Apt Communities	LeCesse Development Corp	$92,250,000	487	$189,425
Northern New Jersey	Sterling Parc at Hanover	Cornerstone	Invesco	$91,000,000	316	$287,975

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