Multifamily Research

Market Report

Third Quarter 2017

Kansas City Metro Area

Institutional Property Advisors

A Division of Marcus & Millichap

Record-Setting Hiring Supporting Rent Growth Despite Rising Supply

Professional and business services headcounts surge. Kansas City metro employment continues to grow at a pace well above the national rate due to substantial gains in the professional and business services sector. The 11,400 jobs added in this segment in the past 12 months represent the largest gain in more than 25 years. Rental demand by employees filing these jobs helped keep effective rent gains at healthy levels in the last year; however, the construction pipeline caused concession offerings to expand. More than 2,170 units, all market rate, are underway in the Central Kansas City submarket, with 710 rentals expected to be completed before the end of the year. The majority of the late-year completions are in and around the Power & Light District. Although this submarket's vacancy is up 160 basis points in the past four quarters, the midyear rate of 6.3 percent remains slightly below the long-term average. Additionally, while concessions grew in Central Kansas City, the submarket's effective rents grew at twice the marketwide pace, indicating resilient demand for new apartments despite the short-term surge in local supply.

Multifamily 2017 Outlook

4,675 units will be completed

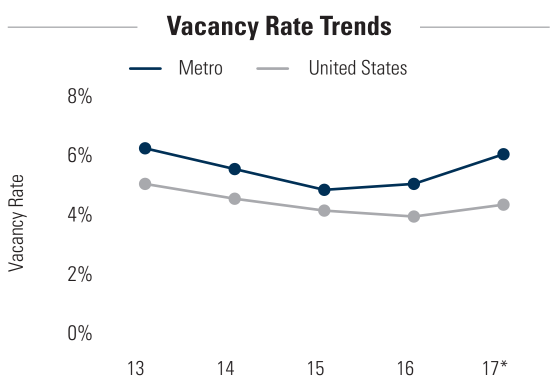
Construction:
Following the completion of 3,350 units in 2016, builders will measurably ramp up the pace of deliveries this year.

100 basis point increase in vacancy

Vacancy:
Apartment operators will note positive net absorption of 2,900 rental units this year, though vacancy is projected to end 2017 at 6.0 percent.

2.8% increase in effective rents

Rents:
The rise in vacancy will not erode operators' abilities to lift rents. After effective rents rose 2.7 percent in 2016, rents will reach $890 per month by December.

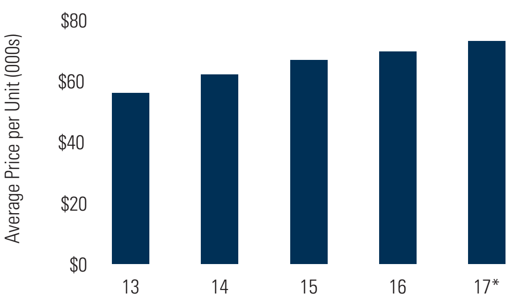


HIGHLIGHTS

- Considerable job creation in the professional and businesses sector will help lift overall staffing levels by 20,000 positions this year. The 1.9 percent increase in total employment expected in 2017 matches average annual employment growth over the past five years.
- Builders are on pace to add 4,675 units over the course of 2017, of which 90 percent are market-rate rentals. The second quarter is expected to be the quarterly high in deliveries in 2017 with 1,420 units; however, approximately 1,650 units are anticipated for the first quarter of 2018 with deliveries easing in subsequent quarters.
- Class C deal flow accelerated 18 percent in the last 12 months as velocity was unchanged among other asset classes. Meanwhile, the average price for Class C apartments grew 13.0 percent to $59,170 per unit.

* Forecast

Pricing Trends



* Trailing 12 months through 2Q
Sources: CoStar Group, Inc.; Real Capital Analytics

SALES TRENDS

Value-Add Plays Bolster Transaction Volume

- Persistent job growth, particularly in higher-wage industries, is maintaining investment activity in the Kansas City metro area. The number of apartment transactions increased 12.7 percent in the past 12-month period.
- The average price advanced 7.5 percent year over year to $73,040 per unit. The rising values pushed down the marketwide cap rate 10 basis points in the last 12 months to 7.3 percent.

Outlook: Demand will persist for Class A multifamily product, though the lack of inventory for sale will keep investor interest focused on the Class B segment, where out-of-state buyers are pushing cap rates down into the high-5 percent range for well-located 1980s- and 1990s-vintage assets.

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; National Association of Realtors; Moody's Analytics; Real Capital Analytics; MPF Research; TWR/Dodge Pipeline; U.S. Census Bureau.

CAPITAL MARKETS

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- **Monetary policy in transition.** Despite the Fed raising its benchmark short-term rate three times in seven months and signaling another rise before the end of the year, long-term rates have remained stable. The yield on the 10-year U.S. Treasury bond remained in the low- to mid-2 percent range throughout the second quarter of 2017. The Federal Reserve wants to normalize monetary policy and, in addition to rate hikes, will likely start paring its balance sheet.
- **Sound economy a balancing act for Fed.** With unemployment hovering in the low-4 percent range, the lowest level since 2007, the Federal Reserve will remain vigilant regarding the possible rapid increase in inflation if wage growth takes off. Additionally, business confidence and job openings are near all-time highs. Businesses finally have the assurance to expand their footprints after years of tepid growth following the Great Recession. These conditions are allowing pent-up households to form, creating new apartment demand. The Fed, however, must now balance economic growth and job creation against wage growth and inflationary pressures.
- **Underwriting discipline persists; ample debt capital remains.** Overall, leverage on acquisition loans has continued to reflect disciplined underwriting, with LTVs typically ranging from 65 percent to 75 percent for most apartment properties. At the end of 2016, the combination of higher rates, conservative lender underwriting and fiscal policy uncertainty encouraged some investor caution that slowed deal flow, a trend that has extended into 2017. A potential easing of regulations on financial institutions, though, could liberate additional lending capacity and higher interest rates may also encourage additional lenders to participate.