MARKET REPORT

MULTIFAMILY

Central Valley Region, California

IPA INSTITUTIONAL PROPERTY ADVISORS

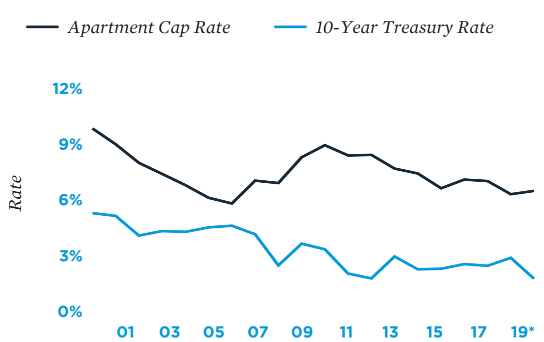
Q4/19

Central Valley Apartment Market Finds Equilibrium; Forecast Average Rent Gain Below New State Law

Consistent fundamentals define apartment fundamentals. Steady population and employment growth in the Central Valley are supporting apartment demand, keeping vacancy well below the 5 percent threshold. Payroll expansion in the region has centered on the government and education and health services sectors, which added 17,800 jobs over the past 12 months. The other nine sectors contributed another 4,000 spots, lifting the rate of employment growth above Los Angeles and Orange counties. Apartment demand is relatively balanced throughout the spectrum in the Central Valley. In fact, Class A, B and C vacancy are huddled just under 4 percent for the region. As a result, effective rent growth will remain strong across the board and provide landlords leverage to raise revenue in the coming quarters.

California's multifamily sector grapples with regulatory changes. In early October, Assembly Bill 1482 was signed into law by Gov. Newsom, making California the third state to implement statewide rent control. Effective January 2020, the legislation will limit rent increases at pre-2005-built properties to 5 percent plus inflation or 10 percent, whichever is lower. While average rent growth in seven of the state's eight major metros was at or below 5 percent during the past 12 months ending in September, it is probable each market's stock of lower-cost apartments could be impacted by the implications. Spanning the past year, Class C rent in the eight-metro group rose an average of 8 percent. Limited rate increases at these properties moving forward could increase the appeal to renters of an already limited stock of vacant units. Though tight conditions tend to increase investor interest, rent control could alter returns on some investments, particularly properties that still have value-add potential.

Local Apartment Yield Trends



** Cap rate trailing 12-month average through 3Q; Treasury rate as of September 30*

Sources: CoStar Group, Inc.; Real Capital Analytics

Central Valley Region consists of the following counties: Fresno, Kern, Kings, Madera, Merced, San Joaquin, Stanislaus and Tulare.

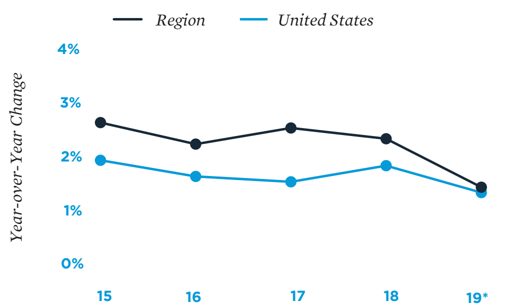
Multifamily 2019 Forecast

County	Vacancy	Y-O-Y Basis Point Change	Effective Rent	Y-O-Y Change
Fresno	3.7%	30	$987	3.7%
Kern County	4.2%	-10	$927	4.6%
Kings County	4.4%	30	$919	4.9%
Madera County	3.3%	-30	$832	2.6%
Merced County	2.9%	10	$925	2.6%
San Joaquin	4.1%	10	$1,167	3.7%
Stanislaus	3.2%	-20	$1,141	4.2%
Tulare County	5.2%	-30	$899	2.5%
Central Valley	**4.0%**	**20**	**$1,011**	**4.0%**

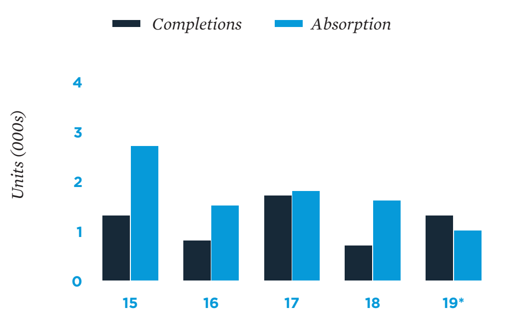
Investment Trends

- The pace of sales was relatively flat year over year as buyers exercised caution amid uncertain legislation and for-sale inventory remained tight. Although some smaller counties posted gains, San Joaquin County recorded the largest jump in transactions during the period, while Fresno County witnessed a surge in Class B deals. Taken together, this trend could signal retrenching from the out-of-market investors. The inversion of the yield curve and Fed rate cuts may have produced temporary risk aversion for investors.
- Buyers paid more for properties during the past 12 months as the average price per door price inched close to $100,000 per door. Among the larger counties, San Joaquin posted the largest value gains. Average cap rates remained in the mid-6 percent range during the past year. First-year returns for Class B properties were close to 6 percent, while Class C assets captured rates in the mid- to high-6 percent area, depending on location and deal metrics.

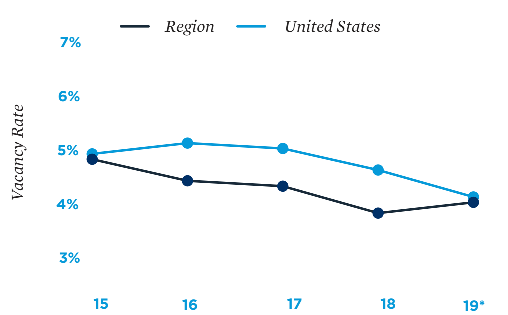
Employment Trends



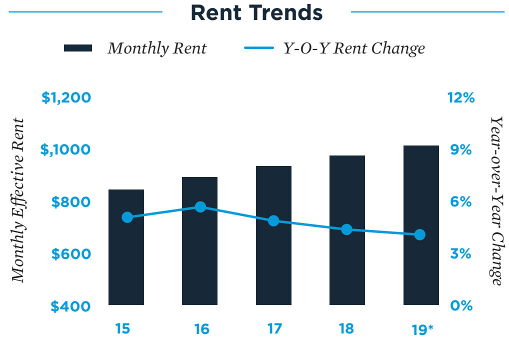
Completions and Absorption



Vacancy Rate Trends



Rent Trends



3Q19 – 12-Month Period

EMPLOYMENT

1.6% increase in total employment Y-O-Y

- During the 12-month period ending in the third quarter, employers in the Central Valley added 21,800 jobs, lifting payrolls by 1.6 percent. In the previous year-long period, 33,100 positions were created.
- Education and health services employers expanded headcounts 4.1 percent as 9,200 jobs were created in the last year. Government departments hired 8,600 additional workers, lifting sector employment 2.9 percent.

CONSTRUCTION

830 units completed Y-O-Y

- Over the past year, developers expanded inventory by 0.4 percent as more than 800 units came online. Builders completed approximately 500 units during the prior period.
- The number of apartments underway in the Central Valley dipped to 1,800 units at the end of the third quarter, down from 2,500 units under construction at the cyclical peak. Less than 400 units have broken ground this year, indicative of further slowing.

VACANCY

no change in vacancy Y-O-Y

- Vacancy held steady at 3.8 percent during the last 12 months after inching up 10 basis points in the third quarter. The rate has stabilized in the high-3 percent range for more than a year.
- Apartment demand is consistent across the property classes in the region. Class A vacancy was 3.9 percent in the third quarter, while both Class B and C vacancy registered at 3.8 percent.

RENT

3.8% increase in the average effective rent Y-O-Y

- Effective rent surpassed $1,000 for the first time in the third quarter, ending the period at $1,004 per month. Year-over-year rent growth remains impressive, though gains has slowed.
- Class A effective rent jumped 3.8 percent annually to $1,485 per month, while Class B rent advanced 4.2 percent to $1,100 per month in the third quarter.

** Forecast*

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

Employment and demographic data based on the following MSAs: Bakersfield, Fresno, Hanford-Corcoran, Madera, Merced, Modesto, Stockton-Lodi, Visalia-Porterville.

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Demographic Highlights

3Q19 Median Household Income

Metro **$56,667**

U.S. Median **$65,205**

3Q19 Affordability Gap

Renting is **$480** *Per Month Lower*

*Average Effective Rent vs. Mortgage Payment**

Multifamily (5+ Units) Permits⁺

1,869 *1H 2019*

32.3% *Compared with 1H 2016-2018*

3Q19 Median Home Price

Metro **$279,833**

U.S. Median **$272,227**

Five-Year Household Growth**

73,200 *or* **1.1%** *Annual Growth*

U.S. **1.0%** *Annual Growth*

Single-Family Permits⁺

10,150 *1H 2019*

10.9% *Compared with 1H 2016-2018*

*Mortgage payments based on quarterly median home price with a 30-year fixed-rate conventional mortgage, 90% LTV, taxes, insurance and PMI. **2019-2024 ⁺ Annualized Rate*

SUBMARKET TRENDS

Lowest Vacancy Rates 3Q19

County	Vacancy Rate	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y % Change
Merced County	2.9%	0	$922	2.6%
Stanislaus County	3.2%	-30	$1,140	4.2%
Madera County	3.4%	-50	$827	2.6%
Fresno County	3.7%	20	$980	3.7%
San Joaquin County	3.9%	10	$1,169	3.7%
Kern County	4.3%	-10	$912	4.6%
Kings County	4.4%	60	$914	4.9%
Tulare County	4.8%	-30	$912	2.5%
Overall Region	**3.8%**	**-**	**$1,004**	**3.8%**

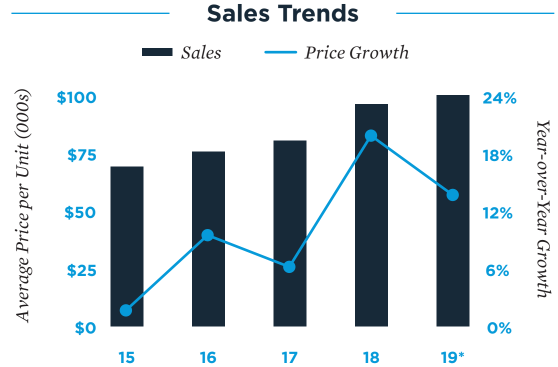
SALES TRENDS

Risk-Averse Buyers Target Populated Central Valley Counties; Attractive Opportunities in Most Areas

- Deal flow during the most recent 12-month period was relatively flat compared with the previous year. Merced and San Joaquin counties recorded modest gains, while Fresno and Stanislaus counties posted small declines.
- Year over year, average cap rates in the Central Valley ticked up 10 basis points into the mid-6 percent range. First-year returns for Class B properties are in the low-6 percent range.

Outlook: Coastal capital continues to flow into the Central Valley in concert with an active local investment community. Valuations may be shaped by investors' reaction to a recent statewide rent control legislation, though Class B and Class C deals should remain attractive.

Sales Trends



** Trailing 12 months through 3Q19*

Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

CONSTRUCTION

474 units completed Y-O-Y

- Fresno County remains the most active area of the Central Valley region. Following 160 units opening last year, approximately 310 apartments have been completed to date in 2019.
- Approximately 600 units are underway in the county, representing just 0.8 percent of stock. The 255-unit Residences at The Row is the largest project underway and is undergoing lease-up in the fourth quarter.

VACANCY AND RENT

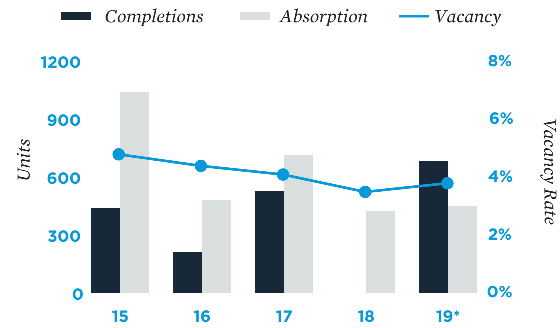
20 basis point increase in vacancy Y-O-Y

- The vacancy rate ticked up to 3.7 percent in the third quarter, marking the first annual increase since 2012. Class C vacancy was 3.4 percent last quarter.

3.7% increase in effective rent Y-O-Y

- Average effective rent jumped 3.7 percent during the last 12 months to $980 per month. The Class B segment recorded a 4.7 percent rise to $1,151 per month.

Supply and Demand



Investment Highlights:

- Approximately 35 percent of transactions in the Central Valley occurred in Fresno County during the most recent 12-month period. Class C deals accounted for nearly 80 percent of the properties that changed hands.
- A lack of Class A trades kept average cap rates in the high-6 percent range over the past year, modestly above the prior annual period. Class B properties traded at average first-year returns below 6 percent.

KERN COUNTY

CONSTRUCTION

0 units completed Y-O-Y

- Developers remained inactive in Kern County thus far in 2019, marking 12 consecutive quarters without new supply.
- A single project is underway. The second phase of the Mira Sol Gardens will be added to inventory in the fourth quarter, expanding local stock by 216 units. The Bakersfield Commons master-planned community could be the next project to add apartments to the market.

VACANCY AND RENT

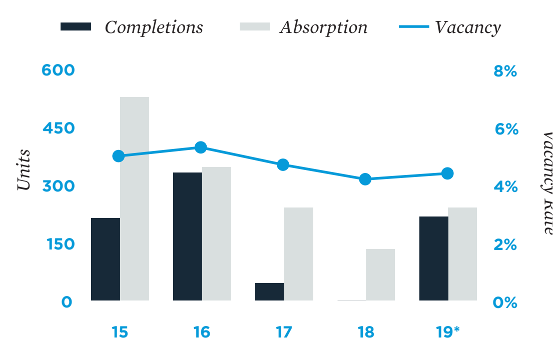
10 basis point decrease in vacancy Y-O-Y

- Average vacancy dipped 10 basis points to 4.3 percent in the third quarter, matching the decline in the prior annual period. Class A vacancy is low at 1.9 percent.

4.6% increase in effective rent Y-O-Y

- Effective rent reached $912 per month last quarter. The county's low top-tier vacancy rate supported a 7.0 percent increase in Class A effective rent to $1,277 per month.

Supply and Demand



Investment Highlights:

- Deal flow remained steady year over year in Kern County. Investors targeted Class B properties at a slightly higher rate than the region average during the last 12 months, while the size of each transaction was below the region mean.
- First-year returns inched up into the mid-6 percent range during the past year, mirroring the Central Valley average. Mid-tier cap rages were in the low-6 percent area.

** Forecast*

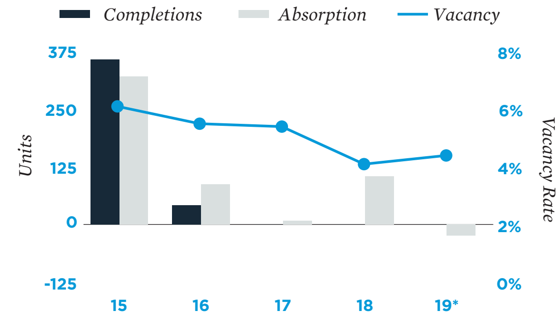
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

CONSTRUCTION

0 units completed Y-O-Y

- Development of new apartments has been muted in Kern County since the fourth quarter of 2016.
- Only one project is currently in the planning stage. The Village at Hanford Square has two phases in planning stages, though no break-ground dates have been announced. If completed, the project will add 268 units to inventory.

Supply and Demand



VACANCY AND RENT

60 basis point increase in vacancy Y-O-Y

- In the third quarter, vacancy was 4.4 percent. Most of the annual rise in vacancy appeared in the Class C sector, where vacancy jumped 90 basis points to 5.0 percent.

4.9% increase in effective rent Y-O-Y

- Effective rent soared to $914 per month in the third quarter, maintaining a trend of accelerating rent gains. Rising vacancy may ease the pace of growth in the coming quarters.

Investment Highlights:

- Buyers remain inactive in Kings County when considering larger properties. A handful of smaller properties changed hands during the past couple of years.
- The relatively small inventory for sale in the county will keep activity relatively light. However, strong effective rent growth will encourage buyers to consider apartment properties when they become available.

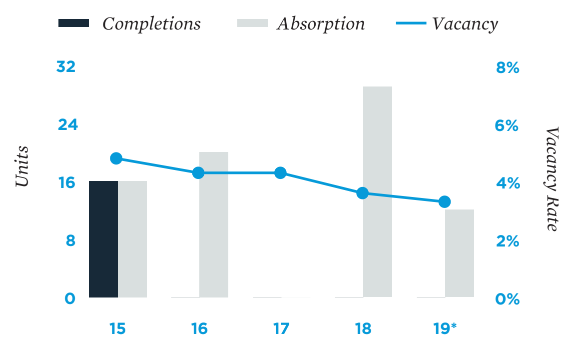
MADERA COUNTY

CONSTRUCTION

0 units completed Y-O-Y

- Developers failed to add any new competitive units to Madera County, keeping inventory flat year over year. The last addition to stock to occurred in 2016.
- The pipeline remains empty as builders focus their efforts elsewhere within the state. As a result, owners face only limited competition from new home construction.

Supply and Demand



VACANCY AND RENT

50 basis points decrease in vacancy Y-O-Y

- Countywide vacancy declined to 3.4 percent in the third quarter, fueled by a 50-basis-point decline in Class B vacancy to 4.0 percent. Class C vacancy was 3.3 percent.

2.6% increase in effective rent Y-O-Y

- During the most recent 12-month period, effective rent inched up to $827 per month. Class B rent jumped 3.6 percent over the past year, while Class C rent rose 2.3 percent.

Investment Highlights:

- A handful of Class C properties traded in Madera County during the most recent 12-month period. Overall deal flow ticked lower after no Class B assets transacted.
- Average cap rates in the county were approximately 50 basis points above the regional rate, largely due to the lack of Class A and Class B deals. Over the past year, average first-year returns were approximately 7 percent, though that level is largely deal-dependent.

* Forecast

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

CONSTRUCTION

0 units completed Y-O-Y

- No inventory has been added in Merced County thus far in 2019, down from the 90 units added in early 2018.
- Approximately 460 units are in various planning stages. The largest project is the mixed-use University Village, which could add a few hundred units aimed at college students at the University of California, Merced.

VACANCY AND RENT

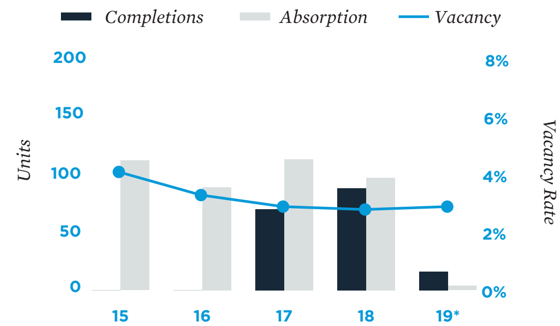
No Change in vacancy Y-O-Y

- Despite steady vacancy over the past year, the county boasts the lowest rate in the Central Valley at 2.9 percent. Class C vacancy declined 10 basis points over the past year.

2.6% increase in effective rent Y-O-Y

- In the third quarter, the average effective rent was $922 per month. Much of the increase in effective rent can be attributed to the 3.3 percent rise in Class B units.

Supply and Demand



Investment Highlights:

- Sales velocity climbed 20 percent in Merced County during the past year on limited activity. The entire increase was present in the Class C sector.
- Average cap rates in the county vary significantly due to the foundations of each deal. Overall, first-year returns trended lower than the regional average.

SAN JOAQUIN COUNTY

CONSTRUCTION

200 units completed Y-O-Y

- San Joaquin remains one of the more active counties in the Central Valley, though construction remains limited. Only 200 units came online in the past 12 months, about half of the deliveries in the prior period.
- The 210-unit Gateway Station project in Tracey is currently in lease-up and will come online this year. More than 500 units are in various planning stages.

VACANCY AND RENT

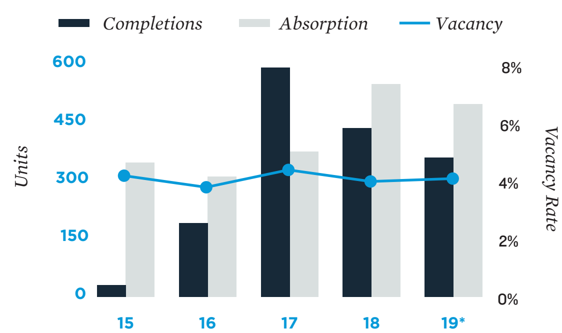
10 basis point increase in vacancy Y-O-Y

- Vacancy has hovered in a narrow range since mid-2018. In the third quarter, vacancy was 3.9 percent, supported by a 3.6 percent rate at Class A buildings.

3.7% increase in effective rent Y-O-Y

- Effective rent climbed to $1,169 per month last quarter. Class A rent soared 4.5 percent to $1,782 per month and Class C rent jumped 4.0 percent.

Supply and Demand



Investment Highlights:

- Nearly 25 percent of the apartment deals in the Central Valley occurred in San Joaquin county over the past 12 months. Deal flow surged 35 percent after Class C transactions soared by approximately 75 percent.
- Class B properties changed hands at first-year returns near 6 percent, relatively unchanged from the prior year. Average cap rates for Class C deals were north of 6.5 percent.

** Forecast*

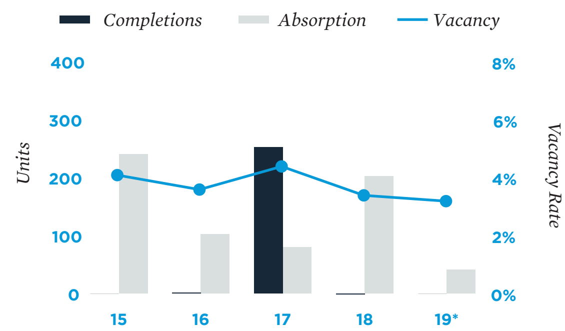
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

CONSTRUCTION

0 units completed Y-O-Y

- No additions to apartment stock have been completed since the second half of 2017.
- The planning pipeline in the county remains thin, containing just a handful of projects that are predominately subsidized multifamily units. Less than 110 units have been announced, though a few projects have not identified total size.

Supply and Demand



VACANCY AND RENT

30 basis point decrease in vacancy Y-O-Y

- The vacancy rate was 3.2 percent last quarter, down 30 basis points year over year. The rate in the Class A sector ticked up 10 basis points annually to 2.2 percent.

4.2% increase in effective rent Y-O-Y

- Effective rent ticked up to $1,140 per month in this year's third period, fueled by a 5.0 percent jump to $1,101 per month at Class C properties.

Investment Highlights:

- Sales velocity eased during the past year due to a sharp decline in Class B deals. The decrease can be attributed to a lack of listings rather than waning buyer interest.
- Buyers should remain active in the submarket, though value-add seekers may have fewer options in the coming months. Low vacancy and elevated rent growth is limiting owners' desire to list assets.

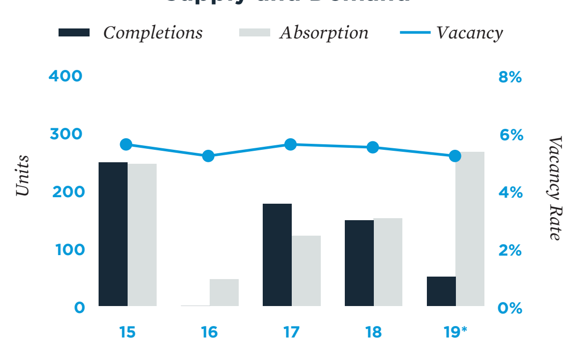
TULARE COUNTY

CONSTRUCTION

150 units completed Y-O-Y

- Developers added just 150 units to inventory over the last four quarters, up from 50 apartments during the prior year.
- Less than 300 units are planned in county spread across five properties. The largest potential project is a 200-unit complex in Visalia, though no break-ground date has been released.

Supply and Demand



VACANCY AND RENT

30 basis point decrease in vacancy Y-O-Y

- Vacancy dipped to 4.8 percent in the third quarter, down 30 basis points year over year. Class B and Class C vacancy both hover near the countywide average.

2.5% increase in effective rent Y-O-Y

- High vacancy relative to the Central Valley average limited effective rent growth over the last 12 months. In the third quarter, the average effective rent was $912 per month.

Investment Highlights:

- Investors lowered their presence over the past month as sales velocity dipped 33 percent. Declines were observed in both the Class B and Class C sectors, though a handful of Class A properties changed hands.
- Average cap rates ranged from below 5 percent for the few Class A deals that transacted during the most recent 12-month period to near 7 percent for Class C assets.

** Forecast*

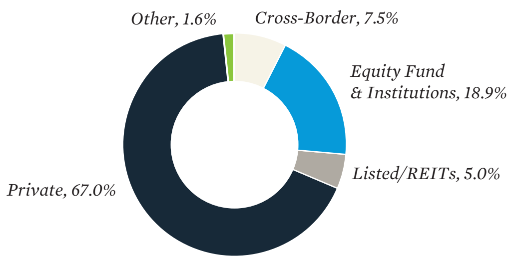
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

CAPITAL MARKETS

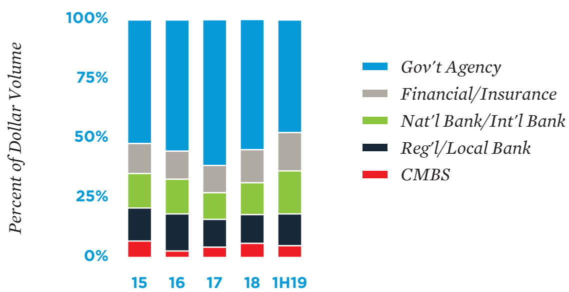
By DAVID G. SHILLINGTON, President, Marcus & Millichap Capital Corporation

- **Fed cuts rate again, while balancing assortment of factors.** The Federal Reserve cut the overnight rate by 25 basis points at the end of October, the third reduction in less than 100 days in an attempt to lengthen the economic runway. Muted inflationary pressure and continued trade negotiations have boosted the probability for an additional rate cut in December as it is anticipated by some domestic and foreign markets. However, at the end of October, the U.S. and China were in talks for finalizing the first phase of a trade deal, potentially erasing the need for another rate reduction if the preliminary agreement quickly comes to fruition. This, along with positive economic indicators like strong wage growth, sustained job creation and a rising 10-year Treasury, will continue to make future decisions difficult for Fed members as they balance the array of forces tugging at both ends of possible outcomes. Global developments including slowing European economies as well as the progression of Brexit and its potential aftermath will also help determine future Fed decisions. Though recession risks remain, the economy's solid foundation has softened it in recent months, signaling continued domestic growth in the near future.
- **Abundant liquidity balances conservative underwriting.** Debt financing for apartment assets remains strong, supported by a variety of lenders. Fannie Mae and Freddie Mac, two mainstay apartment capital sources, were recently given increased lending caps, allowing the two Government Sponsored Enterprises to purchase $100 billion in loans during a yearlong period that started at the beginning of the fourth quarter 2019. A wide range of local, regional and national banks; pension funds; insurance companies and CMBS sources will also remain active. All have responded to the falling interest rate climate by reducing mortgage rates, but lender spreads have widened as the 10-year Treasury rate remains near cycle lows. Given the downward pressure on interest rates, lender caution has risen, particularly for construction loans. Though lending is still available for these types of projects, investors may need to blend mezzanine debt with other capital sources until they prove out their concepts and substantially fill units. For stabilized existing assets in most major markets, financing remains plentiful.

1H19 Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



Includes sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

National Multi Housing Group

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Price: $750

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