MARKET REPORT

MULTIFAMILY

Milwaukee Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

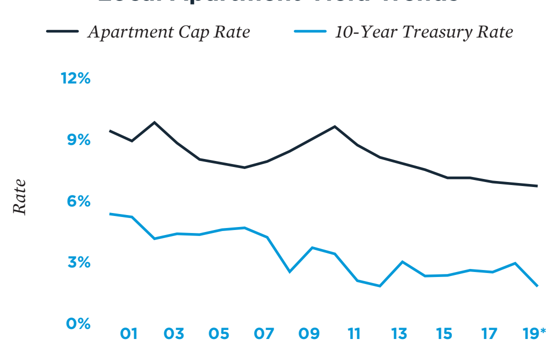
Q4/19

Household Creation Bolsters Rental Demand; Listings Generate Aggressive Offers

Renter demand reinforced by household growth. More households were created in Milwaukee over the past year ended in September than in any annual period since 2003. This spike is largely tied to growth within the education and health services sector, which expanded by 7,000 positions over the past two years and now accounts for 20 percent of the total employment base. Young professionals accepting jobs in these fields are creating new residences, boosting demand for a variety of rental housing options. In Wauwautosa and downtown Milwaukee, several med-tech employers are hiring high-wage workers, strengthening luxury housing demand there. Metrowide, residences are being formed as educators, hospital staff and other working-class individuals accept job offers. With luxury rents often out of reach, Class B/C demand has been enhanced. Particularly, apartments built in the 20th century have been more affordable options for these tenants, and vacancy within this tranche has receded.

Absorption of Class A rentals spearheads continued development. Luxury apartment construction was scarce up until earlier this decade when the local economy recovered from the recession and job growth escalated in 2013, prompting Class A development. These higher-cost rentals were slow to be leased at first, leading to a 8.0 percent Class A vacancy in 2017; however, absorption has been picking up, and vacancy has contracted 370 basis points to 4.3 percent since then. This strengthening demand for luxury units, specifically in Wauwautosa and downtown Milwaukee, is prompting the continued development of Class A projects in these locales this year. This transition toward increased high-scale apartment construction has prevented a rapid supply expansion of garden-style rentals. As demand remains robust for Class B/C apartments, tenant leasing has outpaced arrivals, leading to tight vacancy rates in the low- to mid-2 percent range.

Local Apartment Yield Trends



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

Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2019 Outlook

2,600 UNITS
will be completed

CONSTRUCTION:

This year, 300 more rentals will be finalized than in 2018. Total completions in 2019 will be 60 percent larger than the annual average over the past decade.

20 BASIS POINT
decrease in vacancy

VACANCY:

Following a 120-basis-point plunge in 2018, robust demand for rental housing will allow vacancy to tighten again this year to 3.3 percent.

4.5% INCREASE
in effective rents

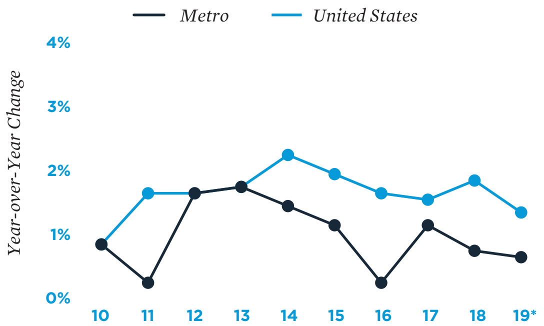
RENT:

Tightening vacancy is boosting effective rent growth, which will move up to an average of $1,172 per month, building upon a 5.4 percent expansion last year.

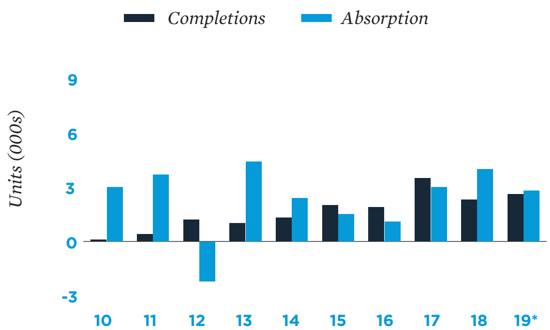
Investment Trends

- Class C assets traded with first-year yields in the 7 to 8 percent range on average. Of these properties, those built prior to 1980 enticed buyers targeting low-entry costs as the price per unit averaged $77,000. Apartments within this tranche traded 10 percent more often in the past four quarters ended in September than in the previous annual period.
- Complexes in downtown Milwaukee and the east portion of Milwaukee County were actively traded in the past year. Aggressive bidding pushed the average sale price up to $160,000 per unit, piquing the interest of longtime holders. Additionally, buyers seeking value-add assets targeted northeast Milwaukee County, where entry costs were relatively low at an average of $60,000 per unit.
- Apartments located near Marquette University and UW-Milwaukee continue to attract investors as the presence of thousands of students seeking short-term housing is driving demand, and limited completions have allowed existing properties to maintain tight vacancies.

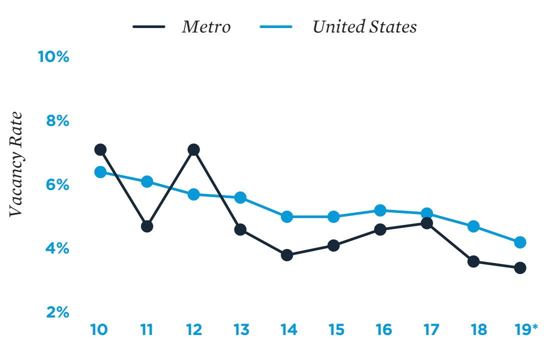
Employment Trends



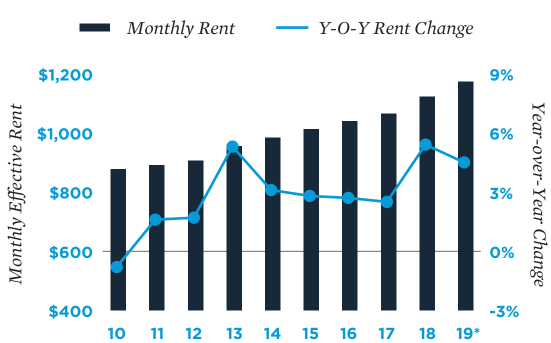
Completions and Absorption



Vacancy Rate Trends



Rent Trends



** Forecast*

Source: CoStar Group, Inc.

3Q19 – 12-Month Period

EMPLOYMENT

0.8% increase in total employment Y-O-Y

- Metro employers tacked on 6,600 roles over the past four quarters ended in September, advancing from the 0.6 percent expansion posted in the previous period. An unemployment rate in the low-3 percent range has stunted job growth potential.
- The education and health services sector strengthened its presence. This segment added 5,200 payrolls year over year, accounting for nearly 80 percent of net employment growth.

CONSTRUCTION

2,400 units completed Y-O-Y

- In the annual period ended in the third quarter, 200 more rentals were brought to market than in the previous year. Additionally, 800 units are underway with finalizations scheduled for late 2019.
- Nearly one-half of all completions were in either downtown Milwaukee or Waukesha County, with each area gaining 600 units. In Waukesha County, the cities of Brookfield and Menomonee Falls received the bulk of deliveries.

VACANCY

60 basis point decrease in vacancy Y-O-Y

- As of September, Milwaukee vacancy was at a three-year low of 2.8 percent. The contraction that took place in the past 12 months underscored the previous annual period's 50-basis-point decline.
- Class A vacancy retreated by the largest margin amongst classes, dropping 120 basis points year over year to 4.3 percent. Class B and C apartments each posted at least 50-basis-point reductions as well, to 2.6 and 2.1 percent, respectively.

RENT

5.3% increase in the average effective rent

- The average effective rent moved up to $1,172 per month in the third quarter. The growth rate over the past year ended in September was significantly higher than the previous three-year average of 3.1 percent.
- Racine posted the most elevated rent jump amongst submarkets in the past year, as the average effective rent surged by 8.2 percent. With relatively no construction here over the past few years, vacancy has receded to 2.0 percent, leading to an amplification in rental costs.

Demographic Highlights

3Q19 Median Household Income

Metro **$63,260**

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

3Q19 Affordability Gap

Renting is **$567** *Per Month Lower*

*Average Effective Rent vs. Mortgage Payment**

Multifamily (5+ Units) Permits⁺

1,221 *1H 2019*

47% *Compared with 1H 2016-2018*

3Q19 Median Home Price

Metro **$269,732**

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

Five-Year Household Growth**

19,500 *or* **0.6%** *Annual Growth*

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

Single-Family Permits⁺

1,601 *1H 2019*

7% *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**

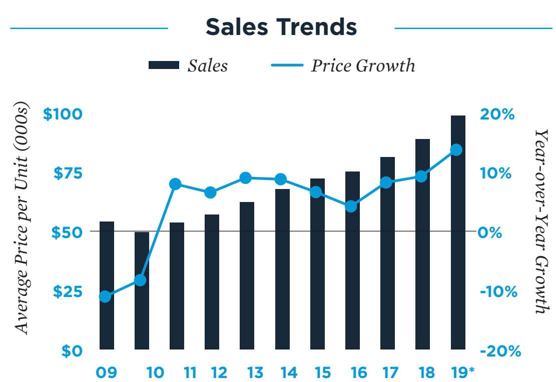
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y % Change
Franklin/Oak Creek	1.5%	20	$1,086	7.0%
Racine	2.0%	- 140	$888	8.2%
Waukesha County	2.3%	- 120	$1,229	5.5%
Washington/ Ozaukee Counties	2.4%	0	$1,267	3.2%
South Side/West Allis/Greenfield	2.8%	20	$958	6.7%
Far North Side	3.3%	- 130	$1,125	4.6%
Downtown/Shorewood	4.2%	- 80	$1,501	4.4%
Near North/West Side/Wauwatosa	4.2%	- 20	$1,242	2.1%
Overall Metro	**2.8%**	**- 60**	**$1,172**	**5.3%**

SALES TRENDS

Sellers Benefit From Historic Pricing Surge as Cap Rate Slides Down

- Average sale price escalated by 13.7 percent, the largest annual growth rate since 2000, reaching nearly $100,000 per unit. This caused a 10-basis-point ease in the average cap rate to 6.6 percent.
- Deal flow decreased by 12 percent over the past 12 months compared with the previous yearlong period. Class B/C properties priced in the $1 million to $10 million tranche accounted for 95 percent of trades.

Outlook: An undersupplied inventory will keep vacancy tight maintaining a competitive bidding market for Milwaukee assets. The ability to achieve a high price in the current environment underscores owners' opportunity to exchange into larger properties.



* Trailing 12 months through 3Q19

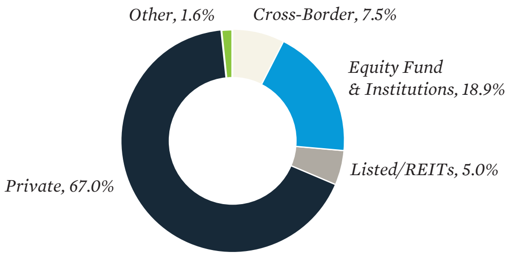
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

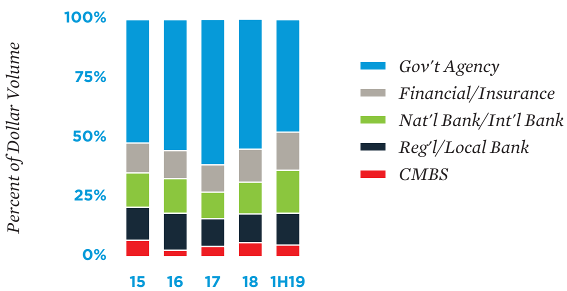
By DAVID G. SHILLINGTON, President, Marcus & Millichap Capital Corporation

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