MARKET REPORT

MULTIFAMILY

Tennessee Metros

IPA INSTITUTIONAL PROPERTY ADVISORS

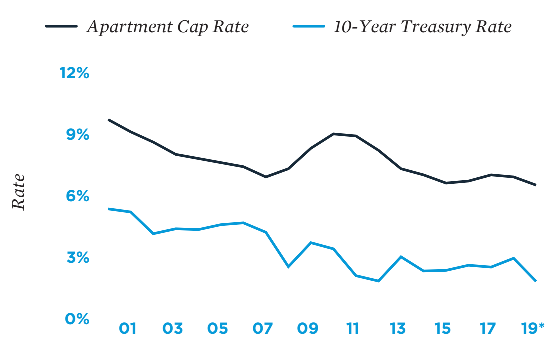
Q4/19

Robust Wave of Hiring Advances High-End Rental Demand in Nashville

Luxury segment highlights strong Music City apartment market. Nashville will remain among the nation's leaders in rent growth in 2019 as it expects a near-7 percent boost by year end. A decreasing use of concessions continues to support this trend, particularly in the Class A segment where the average effective rent increased 11 percent during the past year. Rates for luxury apartments are also being buoyed by the creation of high-wage jobs, elevating rental demand and driving down Class A vacancy. Availability of workforce housing has diminished as well, bolstered by Nashville's 2.7 percent unemployment rate. Pressure in the housing market has been partially relieved by a two-thirds expansion in apartment development over past five years. A majority of upcoming construction will be concentrated around the urban core.

Rents keep climbing despite the pace of new supply. Development in Memphis and Knoxville will notch some of its highest marks this cycle in 2019 as builders grapple with tight vacancy rates. The metros' central business districts will receive much of the new construction as continued revitalization efforts in Memphis and the expanding student population at the University of Tennessee in Knoxville foster increased apartment demand. Rent has yet to be impacted by the wave of new supply, as the metro's average effective rent lifted to 6.6 percent this period. The gain in Memphis was driven by the Class B segment, which posted a 8.9 percent jump during the past four quarters. Class B buildings also led growth in Knoxville, logging a 4.4 percent climb, and the metro's overall average effective rent advanced 4.1 percent.

Local Apartment Yield Trends



** Cap rate trailing 12-month average through 3Q; Treasury rate as of Sept. 30*
Includes sales $1 million and greater for Nashville, Memphis
Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2019 Forecast

Metro	Vacancy	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y Change
Nashville	4.9%	-40	$1,276	6.9%
Memphis	4.7%	-50	$905	6.2%
Knoxville	4.7%	140	$939	6.6%

Investment Trends

Nashville

- Buyers continue to target assets in the central business district priced above the metro's average cost per unit of $142,000. Trades in this area are completed for $200,000 to $300,000 per door.
- Neighborhoods slightly east and southeast of the city pose opportunities for buyers seeking deals at below-market entry costs. Class C assets in this area are changing hands for around $100,000 per unit.

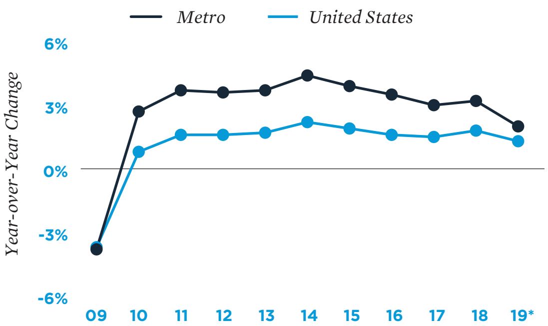
Memphis

- Suburban locations southeast of the city toward the Germantown submarket draw capital for new builds that are trading in the mid-$100,000 per unit range.
- Investors eye aged Class B/C apartments in the city of Memphis, as buildings in this area are acquired for less than the metro's average cost per unit of $72,000. These deals are producing cap rates in the 9 to 15 percent range, above the market's average rate of 8.0 percent.

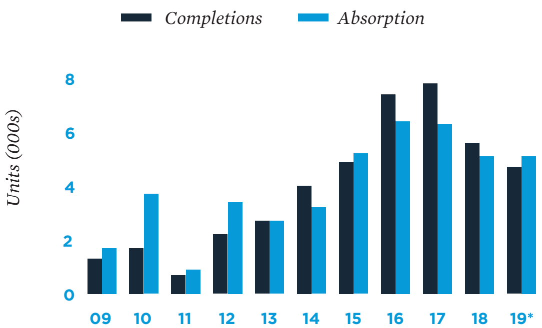
Knoxville

- Southwest of downtown toward the city of Farragut, aged apartment complexes can be acquired for less than 50 percent of the metro's average rate per square foot. New builds in this area are trading above $100 per unit.
- In the north Knoxville submarket, transactions can be closed for less than 50 percent the metro's average price per unit, attracting buyers pursuing returns near the market average cap rate of 6.8 percent.

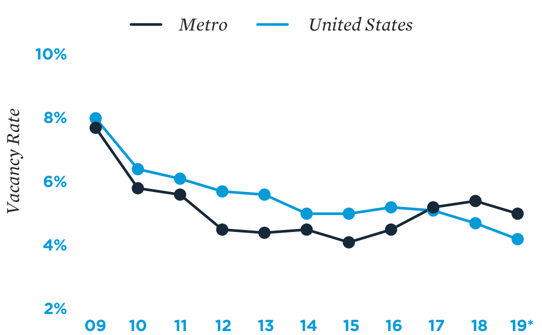
Employment Trends



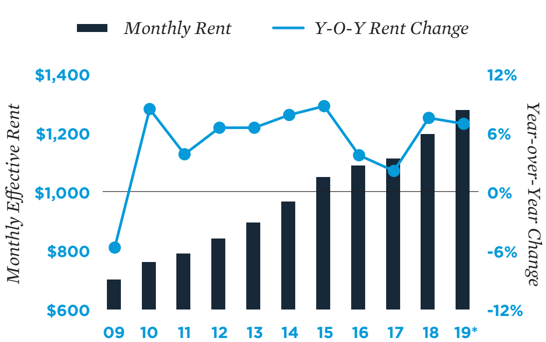
Completions and Absorption



Vacancy Rate Trends



Rent Trends



** Forecast*

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

3Q19 – 12-Month Period

EMPLOYMENT

1.7% increase in total employment Y-O-Y

- Low unemployment has kept hiring to a minimum during the past four-quarter period ended in September. About 17,500 employees were added in that span, a decrease from the 31,800 workers hired over the previous 12-month period.
- The leisure and hospitality sector led metro job creation, adding 5,600 workers in the past year, followed by the professional and business services sector, which generated 4,700 new positions.

CONSTRUCTION

3,600 units completed Y-O-Y

- Nashville's construction pipeline weakened to approximately two-thirds of last year's level of deliveries. This is the lowest annual delivery volume recorded since the 12-month period ended in December 2012.
- The West Nashville submarket will receive the largest influx of remaining deliveries this year, with the completion of over 700 units spread across three apartment complexes.

VACANCY

80 basis point decrease in vacancy Y-O-Y

- Heavy net absorption outweighed the metro's slowing construction pipeline, contracting vacancy to 3.8 percent. This is the largest contraction since 2012.
- Class C vacancy dropped 60 basis points to 3.0 percent year over year in September, followed closely by the Class B rate, which declined 80 basis points to 3.8 percent. Availability for Class A rentals ended September at 4.5 percent, down 170 basis points.

RENT

7.9% increase in the average effective rent Y-O-Y

- Tightening vacancy contributed to a sizable rent surge during the past four-quarter period as the average effective rate reached $1,274 per month.
- Class A rent growth amplified 11.0 percent year over year to $1,779 per month. The Class B sector also rose, moving up 6.5 percent to $1,219 per month, as Class C rent momentum weakened to $998 per month.

Demographic Highlights

3Q19 Median Household Income

Metro **$69,058**

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

3Q19 Affordability Gap

Renting is **$288** *Per Month Lower*

*Average Effective Rent vs. Mortgage Payment**

Multifamily (5+ Units) Permits⁺

5,837 *1H 2019*

17% *Compared with 1H 2016-2018*

3Q19 Median Home Price

Metro **$272,371**

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

Five-Year Household Growth**

73,800 *or* **1.9%** *Annual Growth*

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

Single-Family Permits⁺

12,688 *1H 2019*

6% *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

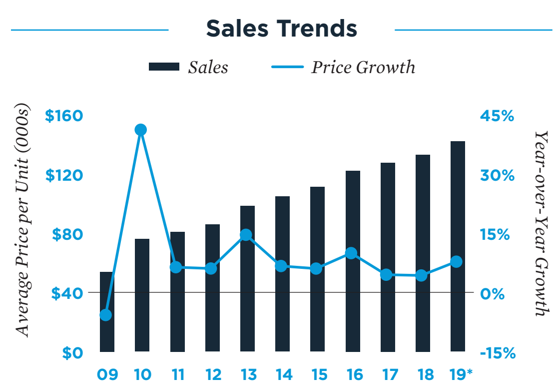
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y % Change
Murfreesboro/Smyrna	3.2%	-30	$1,116	6.3%
Sumner County	3.2%	-160	$1,127	5.1%
West Nashville	3.3%	-150	$1,338	5.4%
North Nashville	3.4%	-60	$1,123	5.8%
South Nashville	3.4%	-110	$1,191	5.2%
Southeast Nashville	3.5%	-200	$1,018	3.5%
Hermitage/Mount Juliet/ Lebano	3.7%	-110	$1,199	7.1%
Franklin/Brentwood	4.5%	70	$1,424	2.6%
Central Nashville	4.6%	-120	$1,836	10.7%
East Nashville	4.6%	-40	$1,148	8.1%
Overall Metro	**3.8%**	**-80**	**$1,274**	**7.9%**

SALES TRENDS

Trade Momentum on Class C Assets Rises Throughout Downtown and Suburban Communities

- Transaction activity picked up approximately 16 percent year over year since September of 2018. Class C assets accounted for a majority of deals as sales lifted 20 percent in this category.
- The average price per unit rose 7.8 percent year over year to $142,000 per unit. This is the largest gain since a 9.9 percent increase in 2016. The average cap rate has shrunk slightly to 5.6 percent.

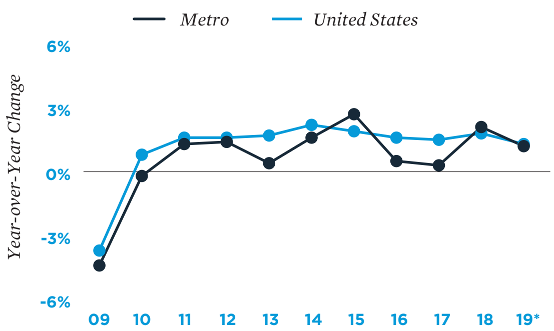
Outlook: Sales momentum continues southeast along I-24 toward Murfreesboro as buildings can be acquired here in the low-$100,000 range, nearly a third less than the metro's average cost.



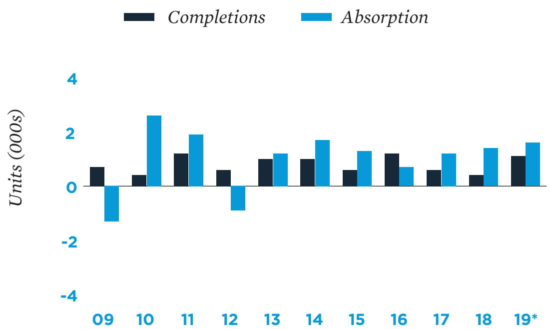
** Trailing 12 months through 3Q19*

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

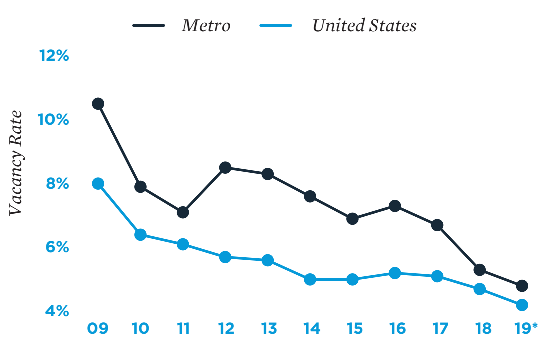
Employment Trends



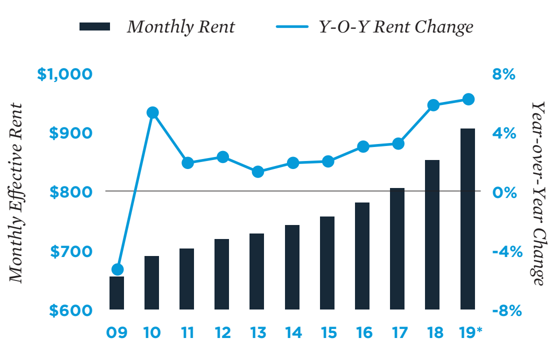
Completions and Absorption



Vacancy Rate Trends



Rent Trends



* Forecast

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

3Q19 – 12-Month Period

EMPLOYMENT

1.4% increase in total employment Y-O-Y

- Throughout the past annual period ended in September, employers hired 8,900 workers. This followed 8,000 person job expansion in the prior 12-month period.
- The professional and business services and leisure and hospitality sectors added the most new hires this period, creating 4,400 and 3,000 positions, respectively.

CONSTRUCTION

730 units completed Y-O-Y

- The construction pipeline picked up over the past four-quarter period ended in September, after contracting slightly in the prior annual period.
- Builders have 1,050 units underway to be delivered from October of this year through 2021. The Germantown submarket will receive the greatest delivery during this time as 296 new apartments will be added to the market in the summer of 2020.

VACANCY

70 basis point decrease in vacancy Y-O-Y

- Since September 2018, demand has surpassed supply for the second successive year, tightening vacancy to 4.0 percent. This is the lowest average vacancy rate on record.
- Class C building vacancy contracted the most this period, dropping 90 basis points to 4.6 percent. Class B availability also declined by a notable 60 basis points to 4.3 percent. Class A availability fell slightly, slipping 10 basis points to 3.5 percent.

RENT

6.6% increase in the average effective rent Y-O-Y

- Tight vacancy is promoting rent gains. The average effective rent grew to $903 per month during the past four-quarter period ended in September.
- Rent growth was headlined by Class B properties as the average effective rent expanded 8.9 percent year over year to $902 per month. The average monthly payment on Class A and C units grew 4.9 percent to $1,276 and $637.

Demographic Highlights

3Q19 Median Household Income

Metro **$54,574**

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

3Q19 Affordability Gap

Renting is **$184** *Per Month Lower*

*Average Effective Rent vs. Mortgage Payment**

Multifamily (5+ Units) Permits*

200 *1H 2019*

64% *Compared with 1H 2016-2018*

3Q19 Median Home Price

Metro **$184,002**

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

Five-Year Household Growth**

28,500 *or* **1.1%** *Annual Growth*

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

Single-Family Permits*

2,914 *1H 2019*

5% *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
West Memphis	1.9%	-120	$710	7.6%
Downtown Memphis	2.8%	-100	$1,232	3.2%
North Memphis	3.3%	-150	$731	6.1%
Midtown/East Memphis	3.6%	-170	$964	10.8%
Germantown/Collierville	3.7%	40	$1,197	5.5%
Southaven/Horn Lake/Olive Branch	3.9%	-140	$928	7.2%
Cordova/Bartlett	4.5%	0	$1,018	3.5%
South Memphis	5.0%	-30	$659	6.3%
Overall Metro	**4.0%**	**-70**	**$903**	**6.6%**

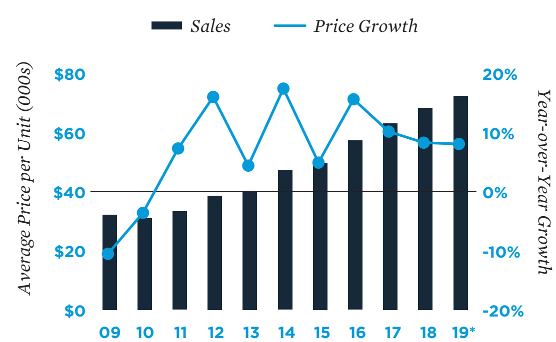
SALES TRENDS

Lower-Cost Acquisitions in Suburbs Yield Stronger Returns Than Market's Average Cap Rate

- The metro's average sales price advanced 8.0 percent to $72,000 during the past 12-month period ended in September. This is a slowdown from the 16 percent and 10 percent price surge in 2016 and 2017.
- Sales momentum reduced to 40 percent of the total number of deals completed this time last year. Class C and B properties made up the bulk of completed deals this period, trading in line with the metro's total number of transactions.

Outlook: Deals surrounding the Germantown submarket and Downtown provides yield near the metro's 7.8 percent average cap rate.

Sales Trends

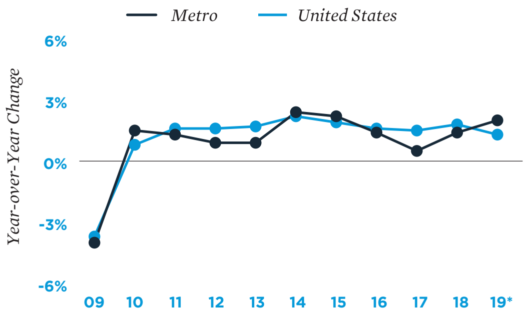


** Trailing 12 months through 3Q19*

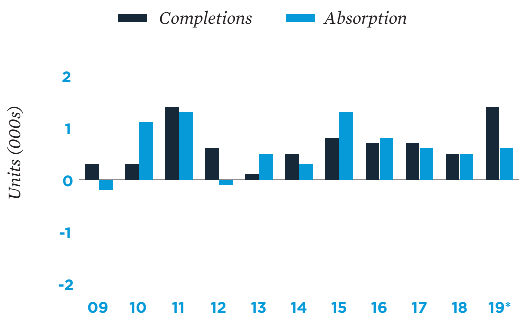
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

Current Trends

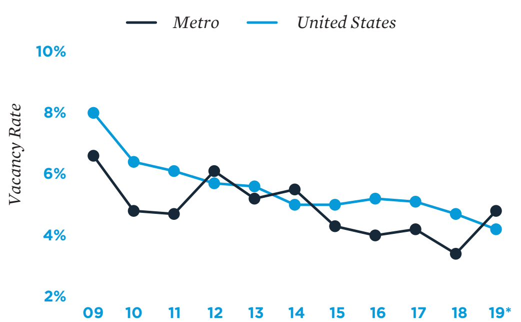
Employment Trends



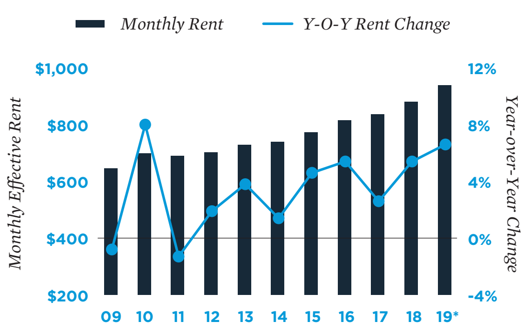
Completions and Absorption



Vacancy Rate Trends



Rent Trends



** Forecast*

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

3Q19 – 12-Month Period

EMPLOYMENT

2.0% increase in total employment Y-O-Y

- Metro employers added 8,000 positions throughout the past annual period ended in September. This is 2,000 more positions than what were generated the prior yearlong period.
- The trade, transportation and utilities as well as the education and health services sectors hired the greatest amount of employees this period, each creating 2,000 new roles.

CONSTRUCTION

700 units completed Y-O-Y

- Over the past 12 months ending in September, developers completed over 25 percent more units than the amount completed during the previous annual period.
- West Knoxville received the largest delivery this period, as builders added a 328-unit building to the area. Developers have another 1,030 apartments in the pipeline to be completed though the fall of 2020.

VACANCY

30 basis point increase in vacancy Y-O-Y

- The average vacancy rate tightened to 2.7 percent. On records dating back 2000, this is the lowest vacancy rate posted in Knoxville. Last year at this time, vacancy decreased 70 basis points.
- All multifamily classes dove below 3 percent in September. The lowest vacancy is among Class C buildings, with a rate of 2.4 percent. Class B availability follows narrowly behind at 2.5 percent, and Class A rental vacancy is at 2.9 percent.

RENT

4.1% increase in the average effective rent Y-O-Y

- Hefty net absorption that contracted vacancy helped raise the average effective rent to $931 per month in September. A 6.7 percent increase was posted in the prior 12-month period.
- Class C buildings posted the greatest rent gain, rising 4.3 percent to an average of $702 per month. The Class B rate rose 2.9 percent to $956 per month. Class A monthly payments remained at $1,183.

Demographic Highlights

3Q19 Median Household Income

Metro **$55,112**

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

3Q19 Affordability Gap

Renting is **$255** *Per Month Lower*

*Average Effective Rent vs. Mortgage Payment**

Multifamily (5+ Units) Permits*

1,141 *1H 2019*

66% *Compared with 1H 2016-2018*

3Q19 Median Home Price

Metro **$202,469**

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

Five-Year Household Growth**

22,600 *or* **1.2%** *Annual Growth*

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

Single-Family Permits*

3,658 *1H 2019*

14% *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

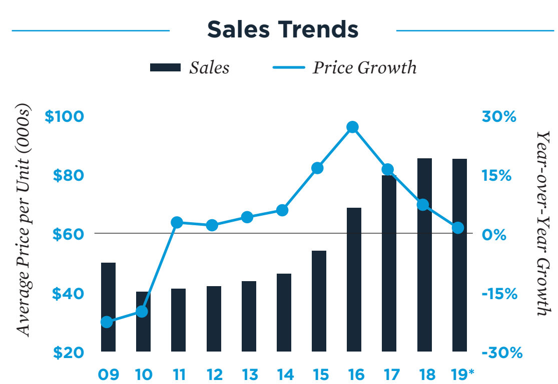
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y % Change
North Knoxville	2.2%	-10	$817	4.3%
Southwest Knoxville	2.3%	10	$986	5.8%
Downtown/University/South Knoxville	2.8%	-40	$935	-3.0%
West Knoxville	3.2%	-70	$953	4.7%
Overall Metro	**2.7%**	**-30**	**$931**	**4.1%**

SALES TRENDS

Deals Found in Suburban Knoxville Present Opportunity for Above-Market Rate of Return

- The deal pipeline contracted throughout the past four-quarter period ended in September, easing to a third of the number of completed transactions put together at this time last year.
- As a result of slowed deal flow, Knoxville's average price per unit lifted a small 1.4 percent to $85,000 per unit. This is the lowest price increase since sharp declines in 2009 and 2010.

Outlook: Above market rate deals can be found in southwest of Knoxville's downtown along I-40, as much of the new supply is being built near the Farragut submarket.

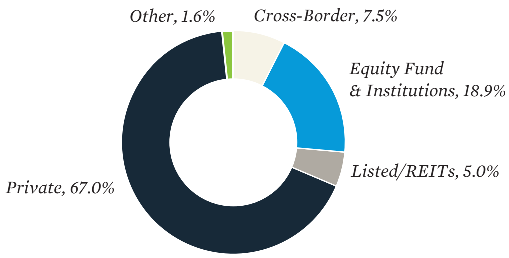


** Trailing 12 months through 3Q19*

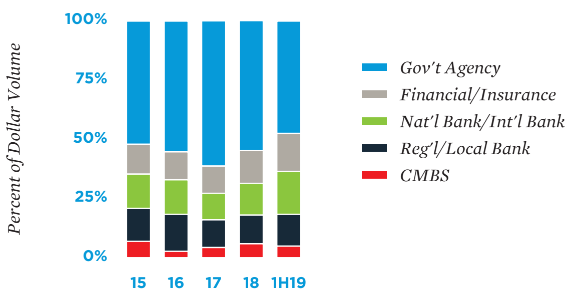
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

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

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.

National Multi Housing Group

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Price: $250

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