2017 Year-End Review

Income Property Organization

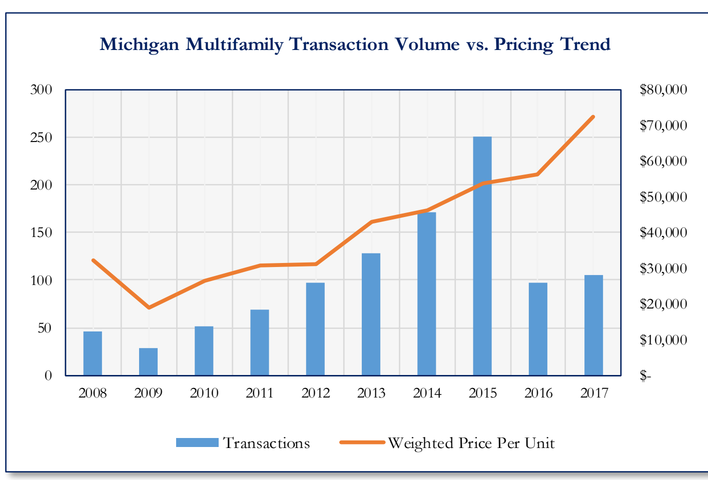
Income Property Organization Newsletter **January 2018**

Another year in paradise...

The last few years have been recording-setting in all aspects for the apartment industry: pricing, deal volume, cap rates, interest rates, occupancy rates, debt & equity availability, collections, etc. By virtually every conceivable metric the business is healthy, both in near and long-term outlooks. Since bottoming out in 2009, there have been year-over-year gains in all of the most pertinent metrics. While the industry had a very robust year again in 2017, this is the first year since 2009 that there is empirical data to indicate a slowdown and decline, albeit small, in some of the most fundamental aspects of the apartment business.

In addition to brokering multifamily assets, we spend time reviewing industry data and trade publications to provide the most current feedback on where markets may be heading and where they have been. In this newsletter we have condensed a significant amount of research to provide you with the pertinent information needed to make your multifamily investment decisions. IPO focused our investigation on transactional volume, sales prices, cap rates, effective rent growth, occupancy rates, new housing supply, interest rates and housing choices, both on national and local levels. At the time of writing, 2017 year-end data had not fully posted so much of the analyses were based on outcomes and trending through Q3.

Occupancy rates in many major metros peaked between 1 and 4 years ago depending on the market in question. The national occupancy rate dropped from 95.2% in 2016 to 94.9% in 2017 as determined by Axiometrics, so this is a negligible decline. Locally, occupancy rates appear to have peaked in 2016 & 2017, with most operators reporting 95% occupancy or above. Interestingly, vacancy rates are lowest for Class C product, at 4.1% nationwide, versus Class A product, at 8.9%. Given the majority of Michigan's apartment stock is Class C product this trend does not pose much of a threat to operations.



Year-over-year rent growth also started to decline nationally in 2017, and rent growth appears to have peaked in 2015-2016. Notable is the fact that CoStar compiled the top 20 rent growth markets in the United States for 2017, and Sacramento lead the way at 8.1%, and Detroit came in 14th at 3.5%, illustrating how Detroit has suddenly entered the national scene with rent growth. Another stat we are fond of is CoStar's conclusion that rent growth was strongest in Class C product over higher-end communities, at nearly double the average growth of Class A product. From a supply/demand perspective, there are many data points that lead economists and industry analysts to be very bullish on apartment fundamentals over the long-term. Homeownership rates are currently at 63.7%, still well below their 2006 peak of nearly 70%, but they did begin to inch upward in 2017, at a very modest rate. Millennials have started to buy homes but still are overwhelmingly renters. Delivery of new multifamily units nationally is still well below the 30-year average of around 400,000 units per year, and especially here in Michigan operators do not face the risk of new units coming online except for a few key markets experiencing a building boom, such as downtown Detroit and Grand Rapids. Furthermore, since 2011, the number of new renters entering the market annually is averaging 1.7 million, and this demand is not slowing down with the National Multifamily Housing Council predicting 4.6 million new units needed by 2030 to meet demand trends. So there will be plenty of renters to go around for the foreseeable future.

As for transaction and pricing data, there has been a remarkable drop in cap rates over the past 5 years, both nationally and locally; however, cap rates have now plateaued locally and begun to rise nationally. Real Capital Analytics reports that national apartment sales volume is down in 2017 when compared to 2016. Through the third quarter of 2016 it was $80.8 Billion nationwide, whereas through three quarters of 2017 it was $64.8 Billion. This reflects a sizeable decline of almost 20%. Locally, Michigan sales were relatively consistent between 2016 and 2017, as it appears Michigan is slightly behind some of the apartment trends being observed in other states and major metros. On a national level, Class C product cap rates increased in 2017 by 25 basis points compared to 2016. Since the Michigan market has been behind the national level for many years now, we expect this to be coming soon to a neighborhood near you. This is especially true with the fed raising rates this month and projecting another three interest-rate increases in 2018. The cost of borrowing has gone up and we expect an increase over the next year, which will have an impact on cap rates. When balancing all this data and trends, we have concluded that given the strength of both operating and sales fundamentals it is safe to say there is good money to be made as either a buyer or seller of apartments in the current marketplace. That is why the transactional volume has been so robust.

IPO 2017 Sales

West Wind - Niles/Buchanan, MI

IPO sold this three property 366-unit portfolio in September, 2017 for $14,000,000, or $38,251 per unit. The complex was 98% occupied and the sales price reflected a 7.5% cap rate. IPO closed on this off-market transaction within months and at 97% of the asking price.

Campus Habitat - Laramie, WY

Campus Habitat is a 121-unit/481 bed student property adjacent to the University of Wyoming. IPO sold this asset for $9.45M, or $78K per unit to a student operator. In addition to the sale, IPO successfully negotiated a seller position in the deal.

Wakefield Forest - Southfield, MI

Wakefield Forest closed in June, 2017. This 67-unit townhome community is located in Southfield, Michigan. IPO utilized a bid-deadline sales format and exceeded our sellers expectations with a sales price of $7,068,500, or $105,500 per unit. At the time of the deadline, IPO had fielded 6 highly competitive offers. The purchaser utilized CMBS financing and closed within two months of executing.

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IPO Pending Sales

Cottages of EL - East Lansing, MI

The Cottages of East Lansing is a purpose-built, cottage-style property serving the students of Michigan State University in East Lansing, MI. IPO is currently under contract with an out-of-state purchaser, who has holdings in the area. This property is scheduled to close mid-January.

University Green Portfolio - Ypsilanti, MI

The University Green Portfolio is comprised of three properties totaling 468 units in Ypsilanti, MI. The portfolio is a blend of conventional and student serving the greater Ypsilanti area and students of Eastern Michigan University. IPO is scheduled to close by mid-March.

Bailey Park - Battle Creek, MI

Bailey Park Apartments is a 267-unit property located in Battle Creek, MI. Over the course of the last three years it has received considerable capital improvements and is operating exceptionally well. IPO is under contract with a local purchaser who is utilizing agency financing. Closing is scheduled to occur by early April.

The party continues…

In 2017, IPO experienced another record-breaking year, brokering the sale of 70 multifamily communities across Michigan and Ohio, representing nearly $150 Million in sales volume, and most importantly delivering some tremendous results for our Sellers. Many of our transaction were acquired by international and out-of-state investors, demonstrating the depth of our marketing reach. Our sales cover all the major local markets, including Detroit, Metro Detroit, Lansing, Kalamazoo, Grand Rapids, Saginaw, Bay City, and Flint. Our firm continues to expand and our recent personnel additions are quickly getting many apartment sales under their belts. Our market share continues to grow in both Michigan and Ohio. IPO would like to thank our clients for a year that will go down in the records books, and we wish you happiness and prosperity in 2018. We hope to be your trusted apartment investment advisor for years to come.

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