Seattle Multifamily

Market Trends

	Current
Vacancy	3.4%
Est. 2016 Construction	14,509 units
Avg. Rental Rate (all ages)	$1,457

Notable Transactions 1Q 2017

Somerset, Kent
329 units
$49,700,000 | $151,064/unit

Carroll & Kensington, Seattle
58 units
$23,000,000 | $396,552/unit

Pavilion, Federal Way
518 units
$93,100,000 | $179,730/unit

Centre Pointe Greens, Everett
186 units
$31,000,000 | $166,667/unit

Vive, Seattle
91 units
$24,150,000 | $265,385/unit

Alaire, Renton
357 units
$67,500,000 | $189,076/unit

Hangar 128, Everett
223 units
$44,250,000 | $198,430/unit

Beaumont Grand, Lakewood
267 units
$35,200,000 | $131,835/unit

Radius, Seattle
282 units
$141,000,000 | $500,000/unit

Union Bay, Seattle
73 units
$24,000,000 | $307,692/unit

The regional apartment market vacancy rate is currently 3.4%, well below the 20-year average of 4.9%. Vacancy last peaked at a rate of 7.2% in Fall 2009 as the recession was fully felt. Occupancy increased ever since, with vacancy oscillating from 3.3% to 4.0% over the past three years as consistent demand has nearly matched the significant amounts of new inventory. Rental rates are at historic highs but only recently has the rate of increase moderated in the close-in markets. Some suburban markets are seeing increased rent growth as they started their recovery later.

Demographic, economic and philosophical factors have changed over the past decade, increasing demand within the apartment market:

- Household creation peaking in the 25 to 34 age bracket; a group traditionally skewed to renting
- The changed "rent" vs. "own" psychology, due to more transitory lifestyles
- Growing preference for urban housing, to be close to the bulk of new jobs being created and allowing residents to be less automobile reliant
- Lack of affordable home or condominium inventory in the neighborhoods most desirable to many new households

These factors have increased and stabilized demand for apartment units, and are expected to be in force for the foreseeable future.

The apartment market was the first category to recover from the recession. Development started in earnest in 2012 with more than 31,900 units delivered in 2012-2015. The 2015 total of 10,531 was the highest annual production since 1991. Currently, 23,454 units are under construction, part of 68,162 planned for delivery in 2017-2021, peaking at 21,247 units in 2019. These apartment deliveries are expected to increase vacancy, if only temporarily. Small increases in vacancy have already been seen, enough to cool rent growth that had been in double digits in close-in markets during 2012-2015. Rent growth

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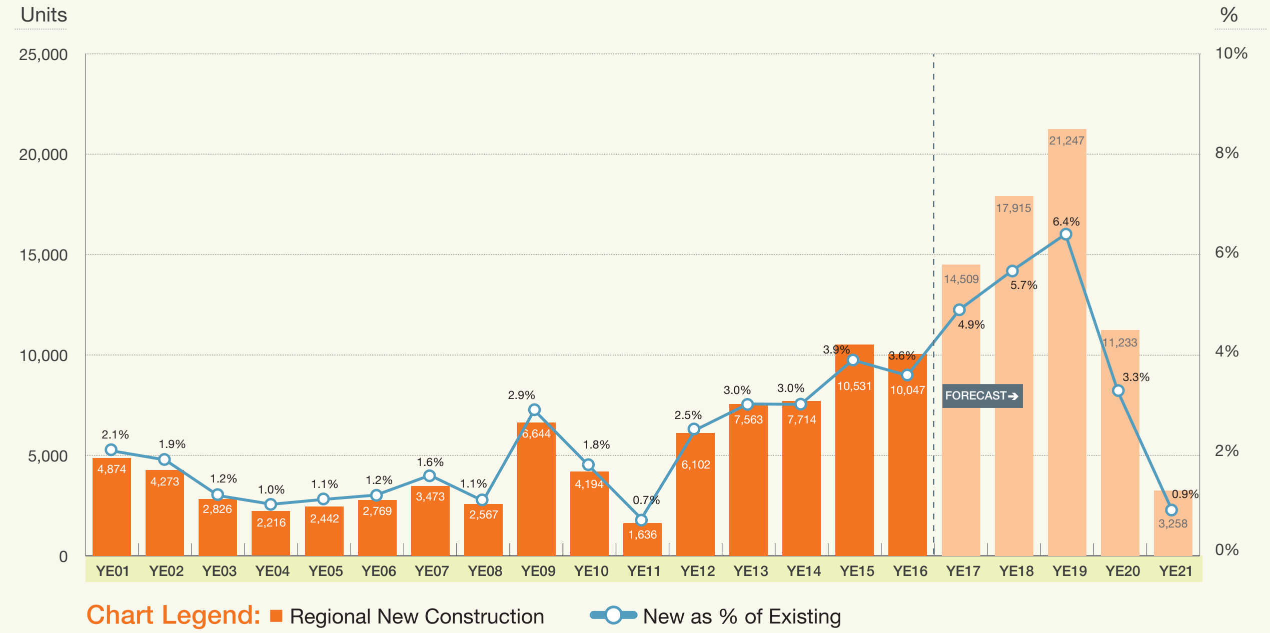
Regional Apartment New Construction (Units/Year)



more typical of a stabilized market and higher construction costs are also squeezing profit margins, which may then delay delivery of some of that anticipated inventory.

Vacancy Trends

According to the Spring 2017 Dupre+Scott Vacancy Survey, the regional (five county) vacancy rate is estimated at 3.4%, down slightly from Fall 2016 report, an encouraging result considering the number of new units opened in the interim. This is a measure of “market” vacancy that excludes projects in lease-up or undergoing significant renovation. Including these units, the “gross” market vacancy is 4.8%. The margin between net and gross vacancy has increased over the past two years and will continue to be wider than shown historically, keyed to high new construction volumes.

Rental Rate Trends

Over the past twelve months the average regional rent increased from $1,343 to $1,457 (8.5%). The King-Central sub-region has the highest overall rent in the region, currently averaging $1,876/month ($2.77/sq ft/month), up 6.2% over the past year. The King-Eastside sub-region has the second highest overall rent, currently averaging $1,832/month ($2.04/sq ft/month), up 6.8% over the past year. It is important to note that a portion of the increase is attributed to the higher prices of new units delivered over the past three years, especially in the smaller Eastside submarkets.

Current Inventory/Supply

Currently there are an estimated 282,155 market rate units in complexes with 20 or more units in the five-county region. King County has the largest share of the inventory at 63.6%. That lead is likely to increase as 85.9% of the planned new development over the next four years is in King County. Pierce and Snohomish will account for about 7.3% and 5.0% respectively.

Historically, new construction peaked between 1985 and 1991 with more than 86,000 units delivered during this period -- a 70% total increase or 14,350 units per year on average. Excluding this period, new construction delivered averaged about 4,160 units per year since 1980. In comparison the annual average from 2012 to 2016 was 8,128 units.

Partially offsetting new construction is the loss of some apartment units demolished or converted to another use, most often to condominiums for sale. Since 2000, these losses averaged 528 units per year, excluding the period from 2005 to 2007 when conversion to condominiums for the housing bubble spiked the loss at an average of 5,480 units per year. There was a significant net loss of overall regional apartment inventory in each of those three years. During that time, condominium conversions accounted for 80% of lost apartments, up from the longer-term average of 30%. The net effect was apartment inventory falling back to 2000 levels.

In 2008, after losing nearly 16,500 units over the previous three years, the trend reversed with some projects planned as condominiums were redirected to rental use. Looking forward, the loss to either demolition or conversion is expected to be limited as most obvious under-utilized properties have already been replaced and new financing and renters-rights laws make conversion much more difficult (and expensive).

Projected Future Supply

An estimated 10,531 units were completed regionally in 2015, a 3.9% increase over 2014; 2016 saw 10,047 units, a 3.6%

increase. Deliveries are set to jump up significantly in 2017 (14,509) and 2018 (17,915), peaking at 21,247 in 2019 before slowing 2020 to 11,233 units.

As apartment construction became feasible, developers looked for sites already entitled with plans that could beat the competition to market. That window has now closed and buyers are willing to entitle their own sites as they look past the peak in 2018-19. Most projects shown as due in 2017 will be completed as most are already under construction or nearing a start, after that the attrition of projects increases significantly.

Of the 68,162 units planned for delivery over the next five years (2017 through 2021), 58,533 units (85.9%) are located in King County; 36,604 units (53.7% of the region) are in the Seattle sub-region; defined as the King-Central and King-North markets.

Estimate of Future Apartment Demand

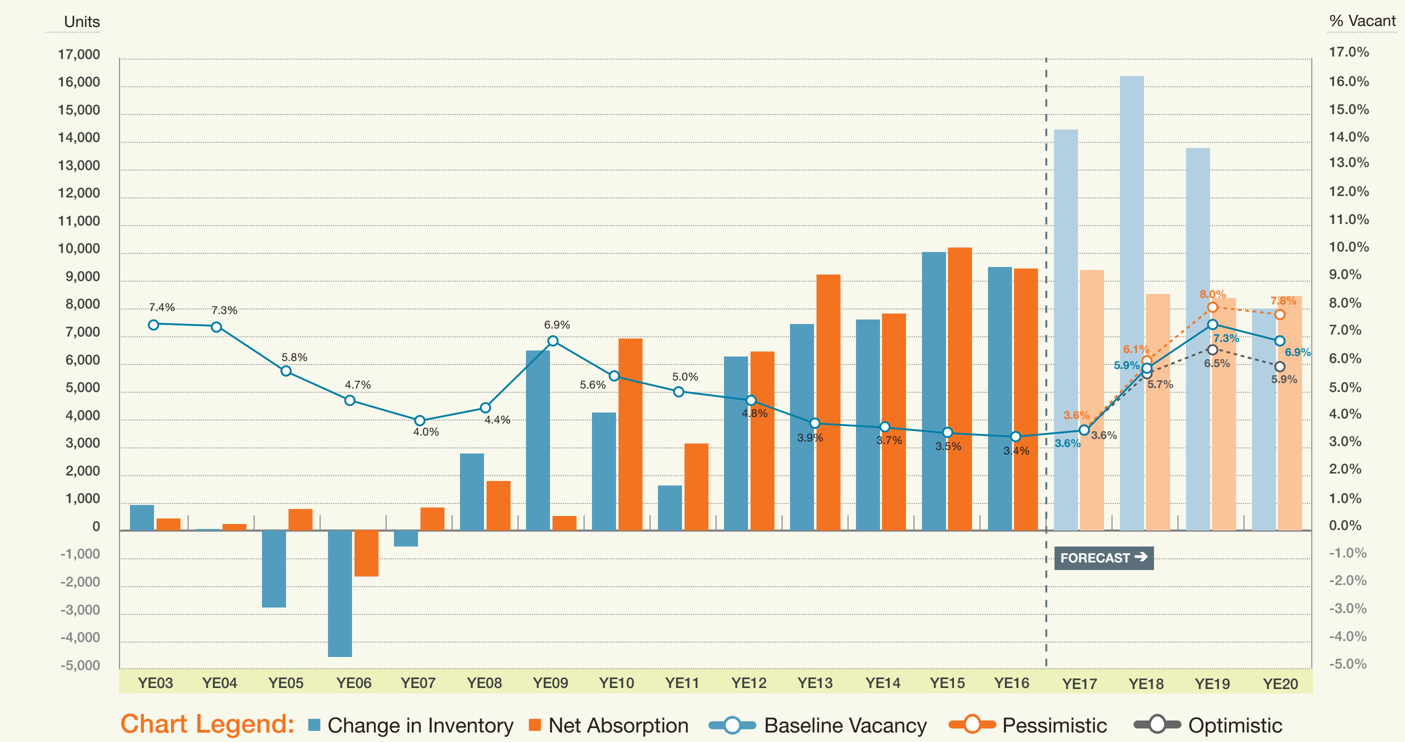
The primary demand driver for apartment units is population growth which is mostly supported by employment growth. The latest employment figures for the greater Puget Sound region (including Thurston county) are estimated at 2.15 million jobs. There are an estimated 270,400 occupied apartment units in the region for yearend 2016, inferring demand for one apartment for every 7.95 jobs. That ratio has gradually declined over the past nine years (it was 9.1 in 2007) as fewer households are buying homes, either by choice or due to prices jumping up in close-in neighborhoods and financing being more difficult to obtain. The downward trend in homeownership may slow; however, most economists expect it will continue to decline. This trend will be accelerated when interest rates increase, pricing more potential buyers out of the homebuying market. It is estimated that every 50 basis point increase disqualifies about 6% of the potential buying households.

One element offsetting this demand is that that higher rental rates and a slowing economy will decrease the number of single-occupant apartments, a category that has grown over the past ten years. In the forecast on the previous page, primary demand is based on the job/apartment ratio starting at 7.9 in 2016 and declining by about 0.10 per year through the forecast.

Investment Activity

Sales velocity in the Puget Sound Region previously peaked in 2005 with 267 sales ($2.64 billion in volume). Volume fell off slowly as the financial crisis led up to the late 2008 crash. In 2009, the number of sales dove to 53 with combined sales volume of about $333 million, reflecting both lack of confidence and the impossibility of securing financing. Institutional investors began to view real estate, particularly apartments, as a safe haven in mid-2010 and sales volume more than doubled for the year. The activity continued to improve with volume for 2014 at $3.05 billion (167 sales) exceeding the previous 2005 peak. This trend continued to a total of $5.56 billion in 2016, even though the transaction count was down to 141 sales. There was a definite change in the second half of 2016 with activity moving out from the Seattle core and into suburban markets as larger investors chased rate and better upside in these slower to recover submarkets.

Historic Absorption and Forecast



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In fact, sales in the core King-Seattle submarket fell from 151 for a total of $2.07 billion in 2015 to 141 sales totaling $1.36 billion in 2016. This was the result of both the move of capital in to other submarkets, but also the fact that 2015 included institutional acquisition of four major tower projects.

So far in 2017, the first quarter sales are off 2016's activity, primarily due to a limited number of institutional sales. It has been reported that this pull-back was based on the increased risk of near-term weak rent growth and a fulfilment of allocations to this property type. Some of those investors have moved to value-add apartment acquisitions, but many are moving into office and industrial properties where long-term leases will provide more consistent income growth over the next two to five years.

It is expected that total sales volume for 2017 will still be good, but likely closer to the long-term average around $3 billion. All investor classes remain very interested in the market which does have strong fundamentals with broad-based job growth and barriers to entry that limit new construction in a number of regional submarkets. Local individuals and partnerships have been very active in the number of sales in secondary and small to mid-sized markets, prompted by attractive lending terms on these types of assets, and improved confidence in and diversification into real estate by investors concerned with the higher ratios of risk/return in other investments. This trend expanded through yearend 2015 and 2016.

Overall capitalization rates were unchanged over the past year, ending 2016 at 5.1%. It is somewhat surprising that the rate didn't increase as slowing rent growth, increasing operating expenses (especially property taxes) and gradually rising interest rates have nibbled away at equity return rates over the past two years. It is also surprising that the recent Fed interest rate hike has not yet increased lending rates even more. The bottom line is that recent sales of newer projects with rents close to market are still attracting numerous potential buyers at 4.5%-5.0% returns, reinforcing the perceived positive risk/return at these rates to be better than many other investments.

Regional Conclusion

The regional apartment market remains on a plateau at the top of this cycle. The general long-term outlook for the Puget Sound region continues to be better than most markets nationwide, but there are definite signs that the market trends will be changed by the combination of slower job growth and the 2017/2018 spike in new unit deliveries. Rental rates have reached historic highs. However, the rent growth rates have slowed in core markets already, a trend that is expected to continue over the next few years

In 2015, 10,531 units opened – the highest level of production since 1991. The total fell slightly in 2016 to 10,047 units, then increasing to 14,509 units in 2017, 17,915 units 2018, and 21,247 units in 2019. Through the Spring 2017 surveys, vacancy remained at low levels following the first two years of accelerated deliveries, falling to 3.5% at the end of 2015 and again to 3.4% in the most recent survey. The rate is now expected to gradually start inching up this year and that upward trend will continue through 2019.

Based on the latest unit delivery timelines projected by Dupre+Scott, our forecast predicts the regional vacancy peaking at about 7.3% in late 2019, then falling back to a more long-term pattern. This spike will further moderate rent growth, as existing properties face increased competition and new properties use lease-up concessions to fill their units. This may cause some of the planned projects, especially among the proposed towers, to delay their timelines.

Apartment investment volume closed out 2016 at another all-time high; however the end of the year and the first quarter of 2017 showed a slowing, especially in the core of the Seattle market. Institutional investors continue a move into value-add and secondary market properties and some have refocused on other asset categories as the apartment market is peaking. Local and regional partnerships and local individuals have picked up some of the slack. Values should continue to increase, although at a more moderate rate as rent growth slows, capitalization rates remain flat and operating expenses continue to increase. This trend should continue until the next significant increase in interest rates.

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