Kidder Mathews

Year-End 2017

Real Estate Market Review

West Coast Multifamily

The multifamily sector is experiencing a renaissance unparalleled in its history, with demand approaching the highest level on record. Even encumbered by a burdensome entitlement process and regulatory constraints, new development in 2017 did not slow from the previous year's frenetic pace. In fact, new construction increased by almost 13% year-over-year. By any measure, the sector is performing at the highest levels. Transaction volume remained strong, cap rates have stabilized, ranging between 4.7 and 4.9%, and average sales prices increased by nearly 30%.

On account of the record setting pace of new construction, concerns of oversupply are often voiced regarding the sector. However, they are belied by certain demographic facts and the character of the current construction. From 2010 to the end of 2016, 8.3 million households formed in the United States. To house them, developers built about 4.9 million new housing units—a shortfall of some 3.4 million homes. This supply-demand imbalance largely offsets the overbuilding of the 2003–06 period, and although this imbalance cannot persist indefinitely, in the near to mid-term, household formation is expected to exceed supply of new multifamily and single-family housing units. Moreover, developers have largely neglected single-family home construction in favor of high-end, urban rentals, creating an abundance of supply for affluent renters while leaving middle- and lower-income renter households undersupplied and would-be homebuyers with few options. These underserved markets are thus ripe for enterprising developers to capitalize. Although premium, high-end, amenity rich product face upward vacancy pressure, demand for such multifamily units is still extremely strong. Vacancy, in fact, dropped 3.4% year over year in 2017. All of these signs portend continued growth in the sector for the near to mid-term.

Data Source: CoStar

Overall Market Breakdown

	2017	2016	2015	ANNUAL % CHANGE
Completed Construction/Unit	51,138	54,012	58,861	-5.32%
Under Construction/Unit	142,459	126,324	107,075	12.77%
Vacancy Rate	4.54%	4.70%	4.60%	-3.40%
Average Asking Rate/Unit	$1,604	$1,523	$1,462	5.32%
Average Sales Price/Unit	$237,749	$183,540	$171,232	29.54%
Cap Rate	4.70%	4.94%	5.23%	-4.86%
Net Absorption/Unit	49,968	44,079	56,999	N/A

Market Reviews

Seattle

22,238 SF	5.5%	9,105 SF	$1,489
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↑	↑	↑

The Seattle apartment market remains hot, attracting both foreign and domestic demand. In terms of job growth, Seattle continues to outperform the national average with high-paying positions in sectors like tech and life sciences. Seattle maintains one of the most educated populations in the country driving the demand for apartments upward, therefore pushing rental rates higher. With a heavy delivery schedule on its way, upward pressure on vacancies could transpire, but if demand persists, we may see vacancies begin to level out.

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Portland

10,973 SF	5.6%	4,419 SF	$1,207
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↑

Portland's population growth continued to remain robust, as the State of Oregon has ranked in the top five nationally for in-migration moves. As a result, new multifamily construction products continue to apply upward pressure on vacancy. With strong inflow of well-educated young professionals transferring to Portland, any concerns of supply pressures should be alleviated. Rent growth was amongst the strongest in the nation in 2015, but since slowed due to vacancy increases. As new product will become available in the near future, we can expect gradual rent growth to continue.

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Oakland / East Bay

7,767 SF	3.7%	1,042 SF	$1,762
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↑	↑	↑

With East Bay's lower rents, transit-oriented properties offering short commutes to downtown San Francisco are attracting tenants. Thus, strong market demand has caused vacancies to remain below the historical average, triggering rent growth. This proved most beneficial for landlords as they enjoyed steady rent growth, outpacing growth from the year prior. Additionally, the current construction pipeline represents a 30% growth to current inventory in the market. This may apply upward pressure on vacancy as these units become available. Due to East Bay's current strong fundamentals which are buoyed by steady inflow of tenants, affordable housing opportunities and heavy construction schedule, we can expect the market to improve in 2018.

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San Francisco / Peninsula / San Mateo

8,625 SF	4.7%	4,019 SF	$2,719
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↑

Structural factors such as exorbitant rents and East Bay's more affordable housing options, have limited rent growth in San Francisco. However, San Francisco continues to benefit from a strong local market which has provided robust demand in the area. Overall vacancies continue to fluctuate with over 9,000 units having been delivered since 2015 and another 5,900 units currently under construction. This influx of new supply, accompanied by the highest rents in the country, has reduced rent growth in 2017. Additionally, cap rates proceed to remain amongst the lowest in the nation.

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Silicon Valley

10,035 SF	4.9%	2,441 SF	$2,312
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↓	↑

The San Jose market continues to revolve around the IT industry. Demand has grown at an exceptional pace over the past four years, due to the market's outstanding employment and population growth. Developers remained active in this market delivering almost 10,000 units since the start of 2015, with an additional 8,400 scheduled for completion by the end of the year. Expansion in the local resident base continues to outpace the national average with new units becoming leased quickly, keeping vacancies moderately in check. Slower rent growth is slated to occur as new developments will become available in the market, which can cause cap rates to continue to decline. Market fundamentals will remain strong as the labor market will continue to bolster population growth, expanding the multifamily sector.

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Sacramento

1,552 SF	4.3%	18,000 SF	$1,231
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↑	↓	↑

Sacramento's fundamentals continue to remain healthy as job growth proceeds to outperform the national average since 2012. Additionally, UC Davis's increase in enrollment will have a potential impact on vacancies. Elevated demand, enhanced by Bay Area residents searching for affordable accommodations, has outpaced the limited amount of deliveries this cycle. These factors have contributed to landlords aggressively increasing rental rates in recent years. With a number of new construction projects breaking ground to compensate for strong demand in the market, rental rates may revert back to marginal increases. With persistent demand from Sacramento and Bay Area residents migrating into the market, strong market growth will continue to occur.

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Reno

1,585 SF	3.9%	-43,000 SF	$1,013
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↓	↑

Reno's outstanding economic fundamentals have provided consistent growth in the multifamily market. Population and employment growth continues to outpace the national average due to low cost living and business-friendly environments. Construction projects continue to break ground with over 1,500 units under construction in 2018 and over 500 units scheduled for delivery in the first quarter alone. This represents two straight years of substantial development in the market. With the expectation of Tesla's Gigafactory employing up to 6,500 workers, we can expect strong demand. As Reno continues to grow in all fundamentals we anticipate another strong year for the multifamily market.

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Los Angeles

35,430 SF	3.6%	11,959 SF	$1,700
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↑

Los Angeles remains to be attractive to many multifamily investors and developers. With a large and diverse economy, alongside a widespread housing shortage, market fundamentals in Los Angeles will remain strong. Vacancy rates continue to remain tight as Los Angeles has the highest rate of renter households at 52%, due to the relatively young population. 2018 and 2019 are expected to be the heaviest years for new deliveries, assisted by the consistent strong demand in the market. An overall housing shortage in LA County should keep demand robust as the cost of buying a home pushes more residents into the bountiful pool of renters. With the recent selection to host the 2028 Summer Olympics expect substantial increases in infrastructure spending and development across the area.

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Orange County

9,837 SF	4.3%	4,393 SF	$1,854
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↑

Demand drivers in the multifamily market remain durable as increases in population growth along with increases in home prices proceed to push out residents. Additionally, renters are faced with increasingly fewer alternatives to finding affordable living options in Orange County with rental rates steadily surging over the last several years. Orange County remains attractive for developers as they continue to bring in high-end luxury units to the market, propelling rental rates upwards with no signs of slowing down. Irvine remains to be the economic driver in the market having attracted over 100 companies that have rooted their headquarters in the city's office submarkets. With population and employment opportunities continuing to increase, expect demand to keep pace with new deliveries that enter the market.

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Inland Empire

3,897 SF	4.2%	1,976 SF	$1,219
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↓	↑

Strong employment growth and an improving economy has provided the Inland Empire's multifamily market with a firm foundation. The Inland Empire's strengthening performance has further compressed the vacancy rate below historical averages. An influx of residents from neighboring counties like Los Angeles and Orange County proceed to drive demand upwards. Construction levels have increased with more than 5,000 new units delivered since 2014. Meanwhile, the Paseos at Ontario is expected to provide 800 units during the first quarter of 2018, which may apply short-term pressure on vacancy. Rental rates in the Inland Empire is comparatively affordable, however year-over-year rent growth exceeds gains from nearby markets. As market fundamentals improve, expect the Inland Empire's multifamily market to remain strong.

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San Diego

11,015 SF	3.7%	5,080 SF	$1,587
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↑

The San Diego apartment market remains lucrative for landlords as rents continue to rise and vacancy decreases, despite record-high construction. Low vacancies have led to impressive rent gains over the last five years, leading to a sustained development wave that is predicted to last for the next couple of years. Projects continue to break ground in nearly every submarket across the metro, but these have put minimal downward pressure on rents as developers have largely focused their attention on luxury units due to the high costs of construction. Investors remain active in San Diego, and although the transaction volume slowed in 2017 compared to 2016, the dollar volume is almost equivalent, as the average price per unit has increased. With San Diego having a strong economic base buoyed by innovation, tourism, the military, and some of the most desirable weather in the U.S., the apartment market remains on firm footing heading into the New Year.

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Phoenix

19,505 SF	6.8%	5,559 SF	$958
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↔	↑	↑

Strong employment and population growth have sustained strong demand in Phoenix. Population continues to grow at three times the national rate powered by better housing affordability and employment opportunities. Current employment growth continues to also outpace the national average, in large part, by corporate relocations and expansions. These demand drivers will apply downward pressure on vacancies despite the vigorous increases in construction projects breaking ground. Yet, Phoenix is currently ranked top ten nationally in rent growth, demonstrating a market that can sustain robust growth regardless of heavy supply additions. Investors will remain bullish on Phoenix's fundamentals, exceeding $4.5 billion for a second year in a row. Expect Phoenix to improve its market fundamentals heading into 2018.

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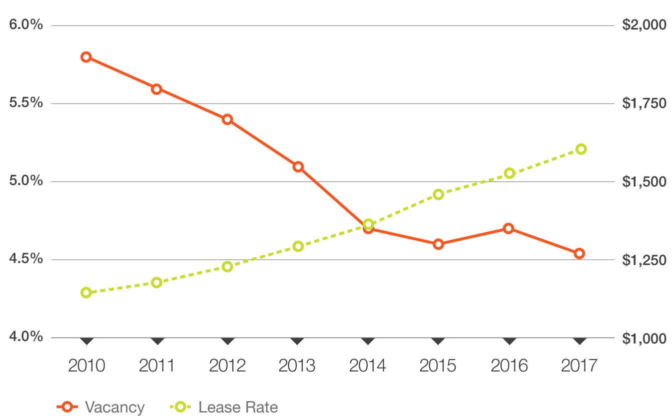
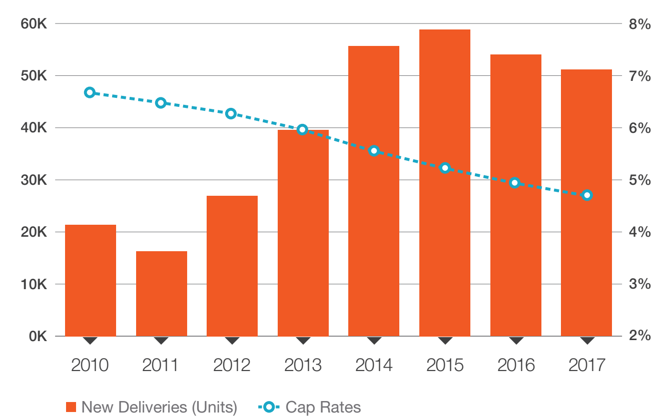
Year-End 2017 West Coast Multifamily Statistics

	TOTAL INVENTORY	ASKING RATE/UNIT	ASKING RENT GROWTH/YEAR	TOTAL VACANCY	YTD NET ABSORPTION	UNDER CONSTRUCTION	YTD DELIVERED UNITS	AVG GROSS RENT MULTIPLIER	AVG CAP RATE	AVG SALES PRICE/UNIT
Seattle	435,541	$1,489	2.90%	5.50%	9,105	22,238	11,012	13.06	4.93%	$245,108
Portland	252,348	$1,207	1.20%	5.60%	4,419	10,973	4,345	12.48	5.55%	$163,085
Pacific Northwest	**687,889**	**$1,386**	**2.28%**	**5.54%**	**13,524**	**33,211**	**15,357**	**12.85**	**5.16%**	**$215,018**
Oakland / East Bay	156,940	$1,762	2.80%	3.70%	1,042	7,767	1,539	12.47	5.01%	$252,945
Peninsula / San Mateo	71,195	$2,609	1.90%	5.60%	960	2,718	1,399	19.82	3.66%	$157,820
San Francisco	153,987	$2,770	0.10%	4.30%	3,059	5,907	3,227	17.42	3.72%	$373,102
Silicon Valley	200,889	$2,312	2.30%	4.90%	2,441	10,035	2,156	15.93	3.87%	$353,010
Sacramento	95,563	$1,231	5.30%	4.30%	18	1,552	77	9.76	5.50%	$143,975
Reno	46,994	$1,013	8.80%	3.90%	(43)	1,585	678	10.60	6.22%	$123,331
Northern California	**725,568**	**$2,093**	**2.72%**	**4.44%**	**7,477**	**29,564**	**9,076**	**14.72**	**4.43%**	**$274,070**
Los Angeles	1,119,075	$1,700	3.20%	3.60%	11,959	35,430	8,348	14.81	4.23%	$257,548
Orange County	308,244	$1,854	3.10%	4.30%	4,393	9,837	5,505	13.98	4.26%	$256,361
Inland Empire	278,102	$1,219	4.10%	4.20%	1,976	3,897	1,571	12.42	5.04%	$267,574
San Diego	399,947	$1,587	4.00%	3.70%	5,080	11,015	4,867	13.84	4.39%	$247,377
Phoenix	425,455	$958	4.40%	6.80%	5,559	19,505	6,414	9.01	6.05%	$118,451
South West	**2,530,823**	**$1,523**	**3.61%**	**4.30%**	**28,967**	**79,684**	**26,705**	**13.32**	**4.65%**	**$233,514**
West Coast Total	**3,944,280**	**$1,604**	**3.22%**	**4.54%**	**49,968**	**142,459**	**51,138**	**13.49**	**4.70%**	**$237,749**

VACANCY VS. ASKING LEASE RATE



HISTORICAL NEW CONSTRUCTION & CAP RATES



Offices

PACIFIC NORTHWEST

Seattle, Tacoma, Bellevue, Olympia, South Seattle, Portland

Brian Hatcher
Executive VP, Brokerage
206.296.9600
bhatcher@kiddermathews.com

NORTHERN CALIFORNIA / NEVADA

San Francisco, Sacramento, Redwood Shores, Roseville, Silicon Valley, Reno

Reed Payne, SIOR
Executive VP, Brokerage
408.970.9400
rpayne@kiddermathews.com

GREATER LOS ANGELES

Los Angeles, Long Beach, Commerce, Orange County, El Segundo, Inland Empire

Robert Thornburgh, SIOR, CCIM
Executive VP, Brokerage
562.472.0071
robertt@kiddermathews.com

SOUTHWEST

Carlsbad, San Diego, Phoenix

Mark Read
Executive VP, Brokerage
858.509.1200
mread@kiddermathews.com