Cassidy Turley / Commercial Real Estate Services

Multifamily Market Snapshot

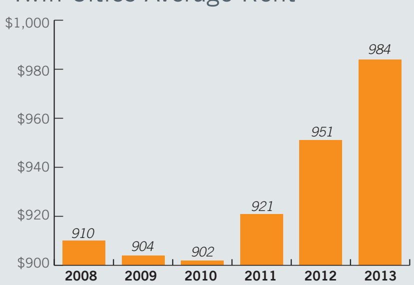
Minneapolis-St. Paul • 2013 | Year End Report

Economic Indicators

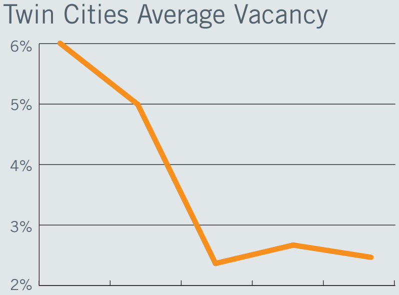
	Q4 12	Q4 13
Twin Cities Employment	1.76M	1.79M
Twin Cities Unemployment*	5.1%	4.1%
U.S. Unemployment*	7.6%	7.0%
U.S. Consumer Confidence Index	65.1	72.4

**Not seasonally adjusted*
Source: Bureau of Labor Statistics

Twin Cities Average Rent



Twin Cities Average Vacancy



Source: Marquette Advisors Apartment Trends 3rd Quarter 2013

Movin' on Up and Out

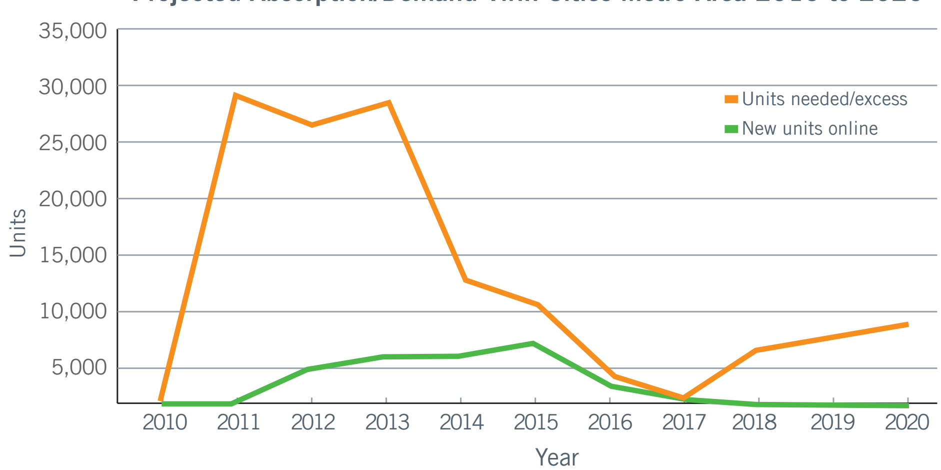
Demand for apartments in the Twin Cities metro area remains strong due to a stabilizing employment situation and demographics that point toward continued population growth. In fact, more than 2,300 new units were absorbed year-to-date through September 2013, compared to approximately 1,200 units for all of 2012. Despite the significant absorption activity, multifamily vacancy increased slightly (0.2 percentage points) from mid-year to 2.5% at the close of 3rd Quarter 2013 according to "Marquette Advisors' Apartment Trends" report. Down from 2.7% one year ago, the metro area's vacancy rate compares very favorably to a national apartment vacancy of 4.8% as of 3rd Quarter 2013.

While pent-up demand has been the primary driving force behind the multifamily market in recent years, projected employment and associated household growth are expected to sustain the market over the next several years. According to the Minnesota Department of Employment and Economic Development, the seven-county Twin Cities metro area has added 53,326 new jobs since 2010. As a result, the metro area's unemployment rate decreased to a modest 4.1% as of October 2013.

Moody's Economy.com employment forecast for Minneapolis-St. Paul optimistically predicts a gain of 41,410 jobs (2.3%) for all of 2013 and gains are expected to remain between 40,000 and 50,000 jobs in each of the subsequent three years, building on an employment level that was already at a new high. With the low unemployment rate, new workers will be drawn to the metro area and Moody's Economy.com predicts a population increase of more than 30,000 per year through 2017.

Additionally, apartment rentals remain a very attractive option for many households due in part to recent increases in mortgage rates, which have deterred some potential home buyers. In fact, according to the U.S. Census Bureau, the percentage of people owning a home declined for the fifth consecutive year in 2012, dropping to 63.9% – the lowest rate recorded since the survey was implemented in 2005.

Projected Absorption/Demand Twin Cities Metro Area 2010 to 2020



The above graph illustrates demand versus projected supply based on growth trends and current announced projects. Demand intersects with supply in 2017 based on current estimated completions. If projects are delayed or abandoned or there are more projects added to the pipeline, the intersection of the supply and demand lines would shift either forward or backward. Data provided by Maxfield Research.

The new luxury developments are also attracting many nontraditional first-time renters, such as empty nesters seeking an urban lifestyle. This trend is likely to expand the renter pool throughout the metro are as recovering housing prices give baby boomer more options when selling and downsizing.

Development Bandwagon Rolls On

Year-to-date, approximately 1,675 new apartment units have been added to the Twin Cities' multifamily marketplace, and an additional 1,225 units have been completed by year-end 2013, for an annual total of 2,900 units. Absorption is projected to total approximately 2,800 units by year-end. The gap reflects new units delivered at the very end of 2013.

Demonstrating an insatiable appetite for apartments, developers have an additional 6,700 apartment units currently under construction. In contrast, only two condo projects are underway for a total of 229 units. The vast majority of the new projects are located in downtown Minneapolis and St. Paul and the Uptown neighborhood of Minneapolis. Most notably, two new high-rise projects are under construction in downtown Minneapolis, which hasn't seen multifamily high-rise construction since 1989. Currently underway are LPM Apartments, a 36-story project by Magellan, and the 26-story Nic on Fifth by Opus. Similarly, Mortenson has announced the 30-story 4Marq and Houston-based Hines has announced the addition of a 25-story building to its Dock Street Flats development in Minneapolis' North Loop neighborhood.

As the rental apartment boom continues in the Twin Cities, developers are increasingly eyeing locations outside of the central cities for new projects. Top on the list are first-tier suburbs which are centered in high employment concentrations and have convenient access to major thoroughfares, such as St Louis Park, Golden Valley, Edina and Bloomington. Multiple projects are either under construction or planned for development in each of these communities.

There is also multifamily development activity along the new light rail transit Green Line, which will connect downtown Minneapolis and St. Paul in 2014, and considerable interest in areas along the proposed Southwest Corridor line. Multifamily housing adjacent to public transit is expected to perform well as evidenced by successful projects along the existing Blue Line (Hiawatha LRT).

New construction is lagging in the second and third-tier suburbs and in the northern communities of the Twin Cities metro area. The primary reason for this is there remains a larger gap between existing rents and what new construction rents must generate to support financial feasibility for market rate units. Although more projects have been proposed in suburban communities this year, absent a public-private partnership or some developer incentives on redevelopment sites, new suburban construction is expected to continue to lag the central cities and first-tier communities. This should support strong demand and reduced vacancy rates for most areas outside of the core developed markets.

The Twin Cities rent growth historically lags other national markets with similar vacancy rates. However, between the 3rd quarter of 2012 and 2013, market-wide rents increased by 3.5% indicating that landlords are starting to take advantage of the tight rental market to increase rents. A portion of the rent increase, however, is attributable to the high rent structure associated with new units coming on-line – the majority of which are well above $2 per sq ft. During 3rd Quarter 2013, the average market rent in Downtown Minneapolis increased to $1,343 per month, from $1,257 a year ago (+6.9%). Downtown Minneapolis continues to have the highest rents among all submarkets. At the same time, vacancy increased slightly downtown from 1.7% a year ago to 3.3% as of 3rd Quarter 2013 given the addition of 1,100+ units to the downtown market in 2013.

Multifamily Submarket Statistics

Submarket	Vacancy Q3/13	Average Rent Q3/12	Rent Increase Year over Year
Downtown Minneapolis	3.3%	$1,343	+6.4 %
Downtown St. Paul	2.1%	$1,196	+ 0.9%
Minneapolis	1.8%	$918	+ 2.8%
St. Paul	2.7%	$906	+ 5.8%
North Central Suburban	2.9%	$880	+ 1.0%
Northeast Suburban	2.1%	$873	+ 3.8%
Northwest Suburban	2.7%	$944	+ 3.3 %
South Central Suburban	2.1%	$956	+ 3.2%
Southeast Suburban	3.2%	$1,017	+ 3.6%
Southwest Suburban	2.6%	$1,076	+ 2.4%
Total Metro	**2.5%**	**$984**	**+3.5%**

Source: Marquette Advisors Apartment Trends 3rd Quarter 2013

Significantly affecting new construction rents are the upgraded features and extensive amenity packages being introduced in new projects. It seems as though each new development brings to the market another unique feature in addition to what has now become relatively standard in most new apartment buildings. Features such as high ceilings, oversized windows, open floor plans, unit finishes that include hardwood or polished concrete floors, maple or cherry cabinets, granite counters, center kitchen islands, fully wired Internet and cable, wireless connections, tile floors in bathrooms, underground heated parking with car wash bay, and concierge services are becoming commonplace. Additional common area amenities often include large exercise rooms, outdoor swimming pools with sundecks, fire pits, barbecue grills, rooftop social areas and dog runs, among other features.

Investment Market Heating Up

Investors continue to eye the Twin Cities as one of the top multifamily markets in the country, based on the low vacancy and overall strength of the market. In fact, for the first time in years, the Twin Cities is appearing in the list of the top ten multifamily markets among national research trend surveys.

A number of institutional investors are seeking value-added buys throughout the Twin Cities, purchasing Class B properties and then upgrading the units and common areas for upside returns. This strategy is likely to continue to experience success in suburban locations because the supply of new product is more limited.

While multifamily properties in the metro area are indeed changing hands, there remains a limited supply of properties available for purchase and prices are rising as a result. Dallas-based L&B Realty Advisors recently completed its first apartment purchase in the Twin Cities, acquiring the 158-unit Class A Lake Calhoun City Apartments in South Minneapolis. This transaction represents a new high watermark in terms of sale price, which exceeded $236,000 per unit.

Several other out-of-state investors also made their entry into the Minneapolis/St. Paul multifamily market in 2013, including: Forum Real Estate Group (Denver, CO), KBS Legacy Partners (Foster City, CA), Randolph Street Capital (Chicago, IL), Virtu Investments (Carlsbad, CA), and Weidner Apartment Homes (Seattle, WA).

Even with the slight uptick in interest rates, cap rates have been holding steady in the apartment market. Class A properties are trading in the low to mid 5% range while Class C properties are trading at cap rates in the low to mid 7% range. Cap rates will, however, eventually be affected by higher interest rates although not in direct correlation as spreads will shrink. Most immediately, cap rates will rise on Class A assets, where spreads were already quite narrow before the Treasury re-priced. With long-term rates well below historical levels, favorable conditions exist for borrowers to either obtain acquisition financing or refinance.

Given the financing climate, continued modest vacancy levels, and encouraging growth projections, the Twin Cities multifamily investment market is expected to remain strong over the next 24 months. Specifically, look for some of the new, larger development projects to change hands as they are completed and occupied.

Key 2013 Multifamily Sales Transactions

	PROPERTY	AGE	# OF UNITS	SELLER/BUYER	PRICE	CITY
	Oakdale Village	1970	175	Nationwide Housing/ Dominium	$11,500,000 $65,714 per unit	Oakdale
	Buena Vista	1966/ 2002	420	Forum Real Estate Group/ Bankruptcy Trustee	$25,300,000 $60,238 per unit	Richfield
	Stoneleigh at the Reserve	2003	361	Weidner Apartment Homes/ Capri Capital Advisors	$53,000,000 $146,814 per unit	Plymouth
	Lake Calhoun City Apartments	2006	158	L&B Realty Advisors/ Village Green	$37,300,000 $236,076 per unit	Minneapolis
	Promenade Oaks	1997	281	Condor Corp./ Cornerstone Real Estate Advisors	$41,000,000 $145,907 per unit	Eagan

Source: Cassidy Turley, Real Capital Analytics

Market Equilibrium Three Years Out

Moving ahead, a considerable number of new apartment units are slated to come on-line in 2014 with the potential to fuel a rise in vacancy. In downtown Minneapolis, 2,218 units will be added to the market, including the two high-rise projects that combine for 607 units. New units will also come on-line in Bloomington (532), Edina (466), and several other communities (994) for a total of 4,210 additional units throughout the market.

Rental demand is likely to remain strong in the near-term as the existing for-sale home supply is at its lowest point in years. Until more new home lots are brought onto the market to support demand and the number of existing homes for sale increases, there will again be considerable price inflation on existing single-family homes and apartment rentals will remain a viable alternative.

Expect absorption to continue to exhibit strength due to ongoing, pent-up demand. But as more new units come on-line, particularly in downtown Minneapolis, look for signs of slowing absorption as new units exceed the pace of demand.

If job growth continues its current upward trajectory, an absorption slowdown will in all likelihood be delayed further into 2016 and the market will reach a point of equilibrium sometime in 2017.

Beyond 2017, many have asked what will happen to the multifamily market when all of the Millennials start exiting their downtown apartments for the suburbs and the coveted detached house and yard. Several key factors may cause their dreams to differ greatly from those of their parents' generations, namely:

- They have more student debt than ever before, slowing their ability to secure financing.
- They don't have adequate funds for the down payment required to purchase.
- They accept renting as a favored alternative.
- They want mobility and have low tolerance for commuting.
- They accept urban living as preferable to the 'burbs.

While those Millennials that have children are likely still destined for the suburbs due to the lack of urban school options, the Twin Cities multifamily market is well positioned for the future.

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