Marcus & Millichap

Multifamily Research Market Report

First Quarter 2018

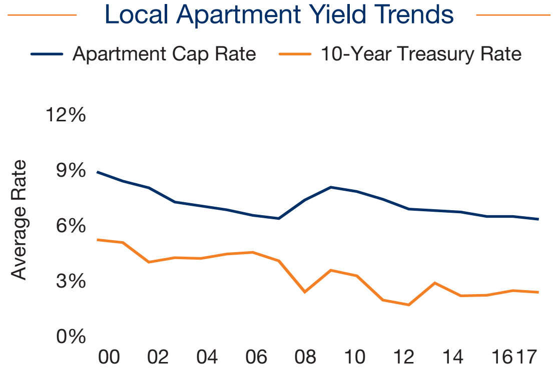
Chicago Metro Area

Booming Construction Pipeline Edges Apartment Vacancy Up

Development takes center stage in urban Chicago, testing structural demand drivers. The rebirth of urban-core Chicago is entering a mature stage as the construction cycle peaks this year, resulting in a modest uptick in vacancy. Beyond 2018, core locations are well positioned to overcome temporary supply-side pressure as several firms and developers push forward with expansion plans. The Old Main Post Office, for example, is being redeveloped into 2.8 million square feet of Class A office space and could be ready for occupancy in early 2019. Elsewhere, the former Chicago Tribune distribution site is being redeveloped into multifamily and office space. As new workspace comes online, employees will absorb nearby apartments.

Suburban apartment fundamentals on solid footing as developers finally catch up with rental demand. After the area was overlooked by developers since the current recovery began, rising rents in the suburbs have enticed builders to re-enter. Since 2013, rents within the core and suburbs have climbed at similar rates, though the pace of growth is accelerating outside the core. Although the balance of construction is equalizing, conditions in the suburbs are sufficiently tight to enable operators to lift rents significantly again this year.

Local Apartment Yield Trends



Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2018 Outlook

10,500 units will be completed

Construction:

Development remains relatively steady this year as inventory climbs 1.5 percent. The Loop and Streeterville/River North submarkets receive 4,900 units.

30 basis point increase in vacancy

Vacancy:

Rising employment helps offset another year of robust construction, resulting in a year-end vacancy rate of 6.3 percent.

3.0% increase in effective rents

Rents:

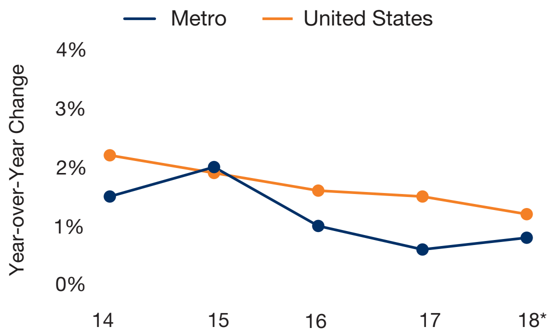
After a 5.3 percent increase in 2017, the pace of the average rental growth will slow this year. Effective rents will finish this year at $1,463 per month.

Investment Trends

- Institutional buyers may shy away from core locations until demand has an opportunity to match the influx of supply coming online. Lower-tier assets, however, should continue to draw capital from local and out-of-state investors. Average cap rates for lower-tier properties can reach into the low-7 percent range.
- DuPage County is growing in attractiveness among buyers seeking to take advantage of the area's high incomes. Eastern suburbs from Glen Ellyn to northeast DuPage County are attracting renters who opt to commute into the city.
- First-year returns have a wide spread in the Chicago metro. Top-tier apartments can trade in the low-5 percent area, while Class C deals average in the low-7 percent range. Between core and suburban locations, first-year returns can vary by 150 basis points within the same class.

4Q17 – 12-MONTH PERIOD

Employment Trends

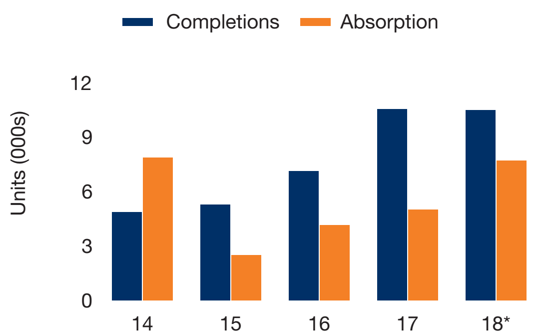


EMPLOYMENT:

0.6% increase in total employment Y-O-Y

- Employers added 29,300 jobs last year, as nine of 11 sectors expanded. The construction and financial activities sectors expanded by a combined 15,800 spots.
- The professional and business services sector, which expanded by 7,000 positions last year, will get another boost this year. Walgreens recently announced plans to add 300 technology workers in the downtown area.

Completions and Absorption

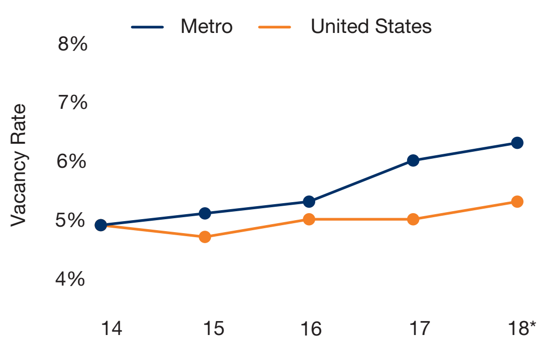


CONSTRUCTION:

10,545 units completed Y-O-Y

- **Urban:** Builders remain focused on urban locations, completing 5,535 units over the last 12 months. Inventory in the market climbed 3.2 percent during the period.
- **Suburban:** Development has risen in suburban locations of Chicago, though apartment stock only increased 1.0 percent as 5,000 units came online. In the previous five years, average annual completions totaled 1,900 units.

Vacancy Rate Trends

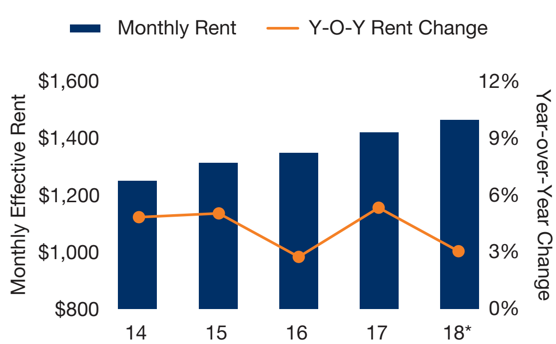


VACANCY:

70 basis point increase in vacancy Y-O-Y

- **Urban:** Surging construction resulted in a 140-basis-point increase in vacancy last year to 6.5 percent. Elevated construction will put upward pressure on Class A vacancy this year.
- **Suburban:** Apartment vacancy was more stable in suburban submarkets, where the rate inched up just 30 basis points to 5.2 percent.

Rent Trends



RENTS:

5.3% increase in effective rents Y-O-Y

- **Urban:** Apartment rent growth slowed to 3.4 percent in 2017, marking the third year in a row that operators have been more conservative in the face of competition.
- **Suburban:** Effective rents soared 6.9 percent to $1,221 per month as the market allowed aggressive rental hikes. Before last year, the five-year average rent hike was a lackluster 3.0 percent.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*
34,200

4Q17 POPULATION AGE 20-34
(Percent of total population)
Metro 21%
U.S. 21%

4Q17 MEDIAN HOUSEHOLD INCOME
Metro $68,249
U.S. Median $58,714

FIVE-YEAR HOUSEHOLD GROWTH*
133,000

POPULATION OF AGE 25+
PERCENT WITH BACHELOR'S DEGREE+**
Metro 35%
U.S. Average 29%

4Q17 TOTAL HOUSEHOLDS
36% Rent
64% Own

* 2017-2022

**2016

SUBMARKET TRENDS

Lowest Vacancy Rates 4Q17

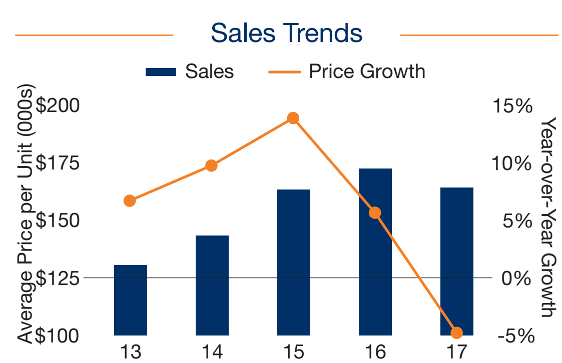
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Central Cook County	4.1%	-40	$1,306	16.5%
Lake County/Kenosha	4.2%	40	$1,124	8.7%
North Cook County	4.9%	-80	$1,355	0.4%
South Cook County	5.1%	70	$947	1.3%
North DuPage County	5.1%	140	$1,139	3.9%
Southeast DuPage County	5.2%	-10	$1,255	3.9%
Will County	5.2%	10	$1,049	6.1%
Evanston/Rogers Park/ Uptown	5.3%	130	$1,532	10.8%
Lincoln Park/Lakeview	5.7%	230	$1,695	-0.8%
Central DuPage County	6.0%	40	$1,420	6.3%
Overall Metro	**6.0%**	**70**	**$1,420**	**5.3%**

SALES TRENDS

Older Vintage Apartment Properties Garner Buyer Attention

- Deal flow jumped 5 percent in 2017 as buyers targeted more suburban assets. The average sales price declined 5 percent to $164,100 as more older and smaller properties changed hands.
- Average cap rates inched down 10 basis points to the mid-6 percent range last year. Transactions thus far in 2018 show modest compression.

Outlook: Lower-tier properties in both urban and suburban locations will remain popular with investors. Buyers will be more cautious when targeting Class A and Class B assets in core areas.



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

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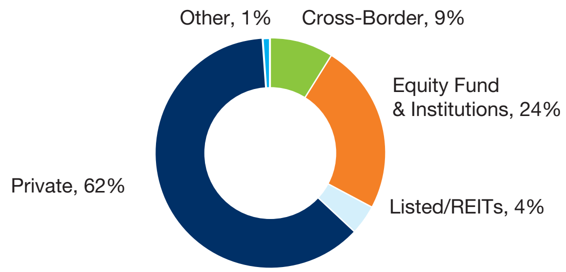
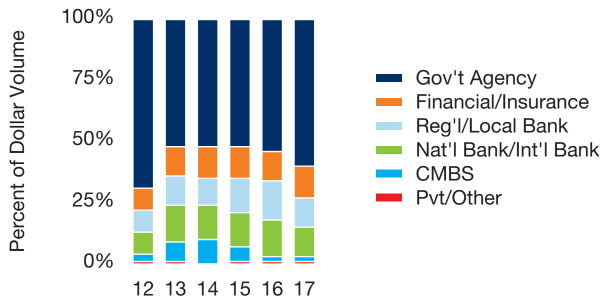
2017 Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



CAPITAL MARKETS

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- **Fed raises benchmark interest rate, plots path for additional increases.** The Federal Reserve increased the federal funds rate by 25 basis points, lifting the overnight lending rate to 1.5 percent. While the Fed noted that the inflation outlook had moderated in recent months, an upgraded economic forecast factoring in recent tax cuts and a rollback in regulation strengthened growth projections for the next two years. As a result, the Fed has guided toward two additional rate hikes this year, while setting the stage for as many as four increases in 2019.
- **Lending costs rise alongside Fed rate increase.** As the Federal Reserve lifts interest rates, lenders will face a rising cost of capital, which may lead to higher lending rates for investors. However, in an effort to compete for loan demand, lenders may also choose to absorb a portion of the cost increases. While higher borrowing costs may prompt buyers to seek higher cap rates, the positive economic outlook should provide rent growth that outpaces inflation over the coming year. As a result, sellers remain committed to higher asking prices, which has begun to widen an expectation gap as property performance and demand trends remain positive.
- **The capital markets environment continues to be highly competitive.** Government agencies continue to consume the largest share, just slightly over 50 percent, of the apartment lending market. National and regional banks control approximately a quarter of the market. Global markets and foreign central banks are keeping pressure down on long-term interest rates. Pricing resides in the 4 percent realm with maximum leverage of 75 percent. Portfolio lenders will typically require loan-to-value ratios closer to 70 percent with interest rates in the high-3 to mid-4 percent range. The passage of tax reform and rising fiscal stimulus will keep the U.S. economy growing strongly and rental demand will remain high with the national apartment vacancy rate at 5 percent at the end of 2017.

National Multi Housing Group

Visit www.NationalMultiHousingGroup.com

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; National Association of Realtors; Moody's Analytics; Real Capital Analytics; Real Page Inc.; TWR/Dodge Pipeline; U.S. Census Bureau