Marcus & Millichap

Multifamily Research
Market Report

Fourth Quarter 2016

Detroit Metro Area

Inventory Expands as Apartment Demand Flourishes in Detroit

Soaring demand fills apartments as deliveries reach a 10-year high. Vacancy in the Detroit metro has fallen to the tightest rate in 16 years, remaining well below long-term equilibrium despite the largest quarterly supply growth since 2006. A significant portion of the demand for rentals comes from job creation. Annualized employment growth has topped more than 30,000 positions for eight consecutive quarters, dropping the unemployment rate to the lowest level since 2001. The availability of jobs draws new residents to the region, allowing household formation to proliferate. Tenant demand for units is widespread with vacancy resting below 4 percent in nearly all the metro's submarkets. As a result, apartment developers have projects underway in more suburban areas and roughly half are slated to receive new inventory this year. The significant demand for rentals coupled with the vast supply of new inventory being brought into service in higher-priced neighborhoods is driving rents higher. In the third quarter, average effective rent rose above $900 per month for the first time, improving operator NOI. Effective rents remain 43 percent below the national level and are among the lowest in the U.S. for a city of its size.

Yield potential lures investors to Detroit. Buyers from around the globe are drawn to apartment assets in southeast Michigan by the desire for higher yields and lower entry costs than are available in many other markets. Favorable news coverage regarding Detroit's renaissance has many out-of-state investors seeking to capitalize on the improving multifamily market. Strengthening rent growth and a perceived lack of assets to trade into, however, make many owners hesitant to divest of assets. The lack of marketed listings is placing buyer demand well above available listings, keeping many potential investors waiting on the sidelines. Class A buildings in desirable areas such as Ann Arbor or downtown Detroit remain the focus of many buyers at cap rates that generally begin in the mid- to high-5 percent area. With competition stiff for these assets, investors must be willing to expand their portfolio parameters or move farther from the core into redeveloping neighborhoods in Detroit. Others are considering assets in tertiary suburbs at yields that typically begin in the mid-7 percent range.

2016 Multifamily Forecast

1.9% increase in total employment

Employment:

Employers are expected to increase staffs 1.9 percent in 2016 with the addition of 38,000 new workers. While job growth is widespread, many of the positions will be related to auto companies and their suppliers. Last year, employment headcounts rose 1.8 percent.

2,380 units will be completed

Construction:

Developers will complete 2,380 apartments in 2016, the largest annual total in 10 years. The Ann Arbor and Downtown/Midtown/Rivertown submarkets will receive the largest portion of this year's deliveries. Last year 1,500 units were placed into service.

10 basis point decrease in vacancy

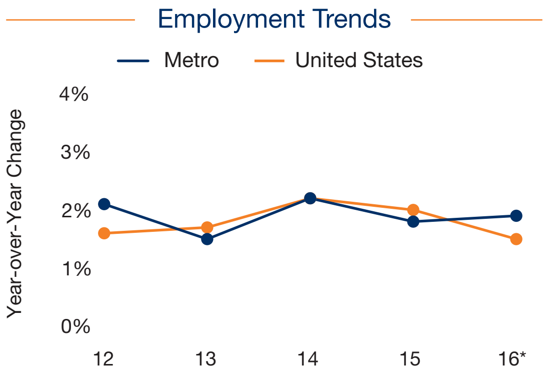
Vacancy:

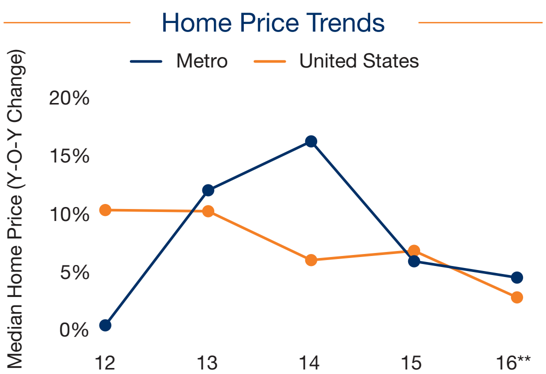
Strong demand for rentals amid a wave of new inventory will slow vacancy improvement this year. Vacancy will end 2016 at 2.6 percent, down 10 basis points for the year as net absorption reaches nearly 2,650 units. Last year, the vacancy rate dropped 80 basis points.

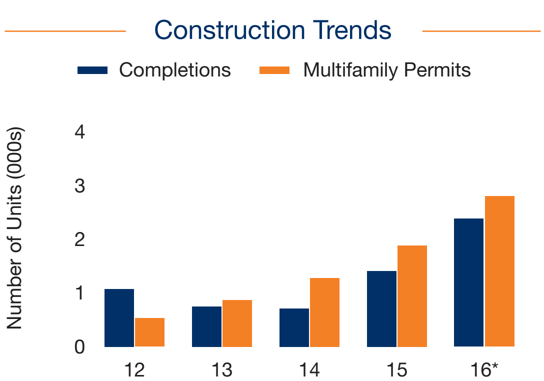
5.7% increase in effective rents

Rents:

Tight vacancy across the metro will underpin rent gains this year. During 2016, effective rent will jump 5.7 percent to an average of $910 per month, the highest growth rate since 2012. During 2015, a 4.1 percent climb was recorded.







* Forecast
** Trailing 12 months through 3Q

Economy

- In the last four quarters, metro employers created 37,000 jobs, a 1.9 percent gain. During this time, growth was led by the office-using sectors, which advanced 4.4 percent. In comparison, a 2.2 percent expansion in total employment was registered last year.
- The unemployment rate in the Detroit metro sat at 5.1 percent in the third quarter, the lowest rate since 2001 and just 10 basis points above the U.S. level. One year ago, the rate was 70 basis points higher than that of the nation.
- Fuyao North America, an automotive glass manufacturer, has purchased a warehouse in Plymouth, where it plans to open a finishing plant in 2017 that will provide roughly 1,000 jobs by 2020. The company also expects to add a research and development department at the site.

Outlook: Metro employers will create 38,000 positions in 2016, a 1.9 percent increase with gains spread across most employment sectors.

Housing and Demographics

- Employment opportunities are drawing new residents to the region and boosting household formation. In the last four quarters, nearly 7,500 new households were established, generating demand for housing. During this time, builders pulled 2,400 multifamily and 4,800 single-family permits.
- More people working and a lower unemployment rate are boosting incomes. During the last 12 months, the median household income advanced 3.1 percent to almost $57,700 per year in September. In the same period, the median home price jumped 4.4 percent to $145,700.
- The average rent on an apartment in the metro is $65 less than the monthly mortgage payment on a median-priced home including taxes and insurance. This may limit the amount some operators can bump up rents before more tenants consider homeownership, particularly in more affordable areas.

Outlook: Rising home prices, especially in many desirable suburban neighborhoods, will keep demand for rentals in these areas elevated.

Construction

- Rising rents are allowing more apartment projects to pencil throughout the metro. Developers brought 560 units into service during the third quarter of 2016, the highest quarterly delivery pace in 10 years. Year over year, 1,690 apartments have been completed.
- Builders will remain active as there are more than 4,580 rentals under construction with delivery dates scheduled into 2018. Numerous other developments are working through the planning process.
- Shapero Hall in the Lafayette Park neighborhood of Detroit is being converted into 180 micro apartments. The building formerly housed the pharmacy school at Wayne State University and is due for completion in the opening quarter of 2017. More than 200 additional micro units are under construction in downtown Detroit.

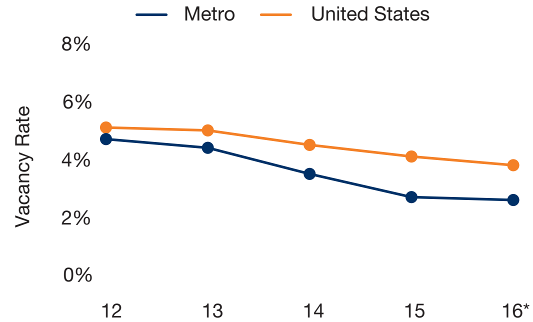
Outlook: Developers are on track to complete 2,380 apartments during 2016, the largest annual total in 10 years. The majority of units will be delivered in the desirable Ann Arbor and Downtown/Midtown/Rivertown areas of Detroit.

Vacancy

- With more households being established, demand for apartments surged during the third quarter as net absorption topped 2,500 units. This dropped the vacancy rate 40 basis points year over year to 2.2 percent in September, even though deliveries reached a 10-year high. The vacancy rate is 130 basis points below the U.S. level.
- The availability of rentals is especially sparse in the Pontiac/Waterford/Auburn Hills and Troy/Rochester Hills submarkets, at 1.1 percent in the third quarter. During the last 12 months, the vacancy rate in each of these submarkets dropped 70 basis points.
- Demand for new rentals is strong. The lowest vacancy rate by vintage is in apartments built since 2010 at 1.2 percent in September. The rate has contracted 140 basis points during the last four quarters.

Outlook: Multiple buildings that have begun leasing will slow vacancy improvement in the last quarter of 2016, resulting in the vacancy rate ending 2016 at 2.6 percent, down 10 basis points from one year earlier.

Vacancy Rate Trends

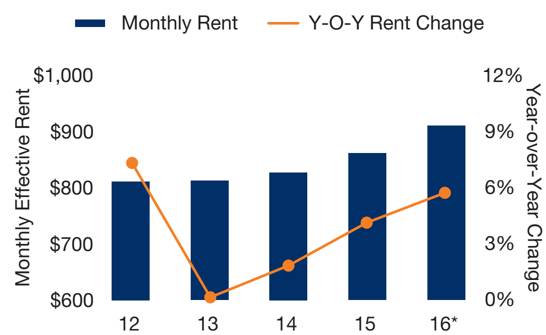


Rents

- Effective rents continue their upward trend from a cyclical low growth rate in 2013 as vacancy tightens. Year over year, effective rents jumped 5.9 percent to an average of $909 per month in the third quarter. This builds on the 3.7 percent increase posted one year earlier.
- By vintage, the strongest rent growth was recorded in apartments built since 2010, due in part to a wave of new inventory that was brought into service. Effective rents in this category jumped 12.6 percent over the last four quarters to $1,963 per month in September, more than twice the metro average.
- In the third quarter, 2.0 percent of apartment operators offered concessions, down from 10.9 percent two years ago. The average concession remains near three weeks of free rent.

Outlook: Significant demand for rentals amid a tight supply of available units will drive rent growth. During 2016, effective rents will reach a new high of $910 per month, an annual jump of 5.7 percent.

Rent Trends

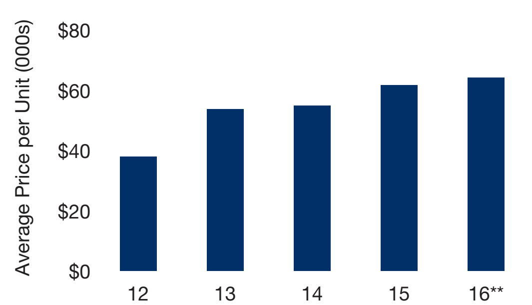


Sales Trends

- Transaction activity during the most recent four quarters was hindered by a lack of quality marketed assets, especially in Macomb and Oakland counties. This is moving more buyers farther from the metro core to search for available apartment properties.
- Prices vary widely throughout the metro. In the last four quarters the average price in Lincoln Park was $29,100 per unit, while a new asset near the University of Michigan in Ann Arbor fetched more than $400,000 per door. Metrowide the average price reached $64,200 per apartment, up 11 percent annually.
- Cap rates for listed properties typically begin in the low-5 percent area for well-located premium assets. Older assets in less desired neighborhoods will extend into the 9 percent range, placing the metrowide average in the mid-7 percent span.

Outlook: The surge in construction and the renovation of older properties along high-demand transit corridors will attract new buyers to the region. Others will be drawn to the region's lower entry costs and higher yields than are available in their home markets.

Sales Trends



* Forecast
** Trailing 12 months through 3Q
Sources: CoStar Group, Inc.; Real Capital Analytics

Marcus & Millichap

National Multi Housing Group

Visit www.NationalMultiHousingGroup.com

John Sebree
First Vice President | National Director
National Multi Housing Group
Tel: (312) 327-5417
john.sebree@marcusmillichap.com

Detroit Office:

Steven Chaben
Senior Vice President | Regional Manager
Tel: (248) 415-2600
steven.chaben@marcusmillichap.com

Two Towne Square
Suite 450
Southfield, Michigan 48076

Capital Markets

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

- The initial reading of third quarter GDP of 2.9 percent and consistent growth in employment are fanning expectations that the Federal Reserve will raise its benchmark short-term lending rate at its December meeting. Other economic data showing steady improvement in the housing market and the stabilization of oil prices around $50 per barrel offer signals that the U.S. economy is growing at a sustainable pace.
- Increasing rental housing demand underpinned a decline in the U.S. apartment vacancy rate of 60 basis points to 3.5 percent year to date through the third quarter, the lowest level this cycle. Apartment builders have responded to growing demand and favorable demographic trends by ramping up construction. Completions will rise to 320,000 units this year and peak in 2017.
- Capital markets remain highly competitive, offering an assortment of fixed-rate products available through commercial banks, life-insurance companies, CMBS and agency lenders. Fannie Mae and Freddie Mac are underwriting loans of 10 years at maximum leverage of 80 percent. Rates will typically reside in the high-3 to low-4 percent range, depending on underwriting criteria. Portfolio lenders will also price in this vicinity but will typically require loan-to-value ratios in the 65 to 75 percent band. Floating-rate bridge loans and financing for asset repositioning are typically underwritten with LTVs 70 to 75 percent of stabilized value (80 to 85 percent of cost) and price 300 basis points above Libor for recourse deals and extending to 450 basis points above Libor for non-recourse transactions.

Local Highlights

- Apartment development is gaining traction throughout the metro. More than 500 units are under construction in Shelby Township. The largest project is the 330-unit Shelby Park Manor North, which is due for completion in 2017.
- Demand for apartments in the city of Detroit is getting a boost from companies moving from the suburbs into downtown. International Bancard is one of the more recent companies to make the transition. The firm will vacate its offices in Clawson and occupy the upper two floors of the office building at 1505 Woodward Ave.
- Ground has been broken on a six-story mixed-use project in the New Center neighborhood of Detroit dubbed Third and Grand. The building will contain 231 apartments, 21,000 square feet of commercial space and a parking garage. Nearly 20 percent of the rentals will be affordable.
- The city of Detroit has received $4 million in federal money to assist in the redevelopment of the vacant I-94 Industrial Park on the city's east side. The portion of the funds will be used to widen and resurface Georgia Street in the 200-acre site. The goal of the project is to create 5,000 jobs over the next five years. This should generate demand for rentals nearby.

Prepared and edited by
Nancy Olmsted
Senior Market Analyst | Research Services

For information on national apartment trends, contact:
John Chang
First Vice President | Research Services
Tel: (602) 687-6700
john.chang@marcusmillichap.com

Price: $250