Multifamily Research

Market Report

First Quarter 2018

San Antonio Metro Area

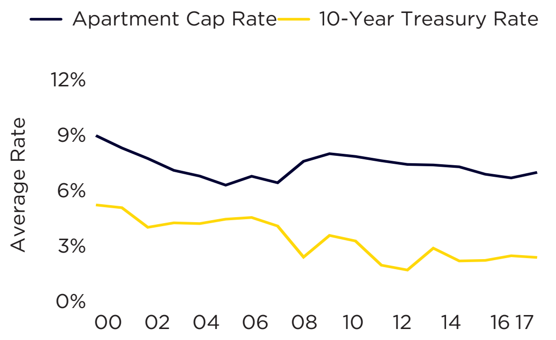
Institutional Property Advisors
A Division of Marcus & Millichap

Redevelopment in Core Brings Slight Shift in Development, Investment

Job growth and redevelopment returns to San Antonio's core. A shift back to the downtown area is occurring much later in the growth cycle than many other major markets across the country. Just east of downtown, Essex Modern City, an urban infill mixed-use project, is slated to begin construction this year. The 8-acre development will include a mix of housing options, retail and office space, transforming the Denver Heights neighborhood. Frost Tower, the first new office building in downtown San Antonio since 1989, broke ground last year and is expected to attract more development nearby. USAA is also moving employees downtown, and 400 IT workers will relocate from its suburban headquarters campus to an office building it is renovating in the core. The company will have 1,000 employees in the downtown area by early 2019, with plans to move an additional 1,000 jobs downtown. As employers commit to expansion and growth in the area, residents will follow, increasing demand for housing nearby.

Apartment development activity rising in the core, south. Much of the new development has occurred in the northern half of the metro over the past few years, with limited new apartment supply coming online downtown or south of downtown. The announcement of major projects in the core has prompted a slight shift in activity, with more than 2,600 units underway in areas that have realized limited additions to inventory compared with northern submarkets in recent years.

Local Apartment Yield Trends



Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2018 Outlook

6,900 units will be completed

Construction: Overall deliveries decline this year, but areas such as near the Medical Center and Lackland Airforce Base are set to receive an uptick in new supply.

30 basis point decrease in vacancy

Vacancy: A slower pace of additions contributes to vacancy declining for the first time in two years, reaching 7.1 percent. Last year, the rate increased 90 basis points.

3.4% increase in effective rents

Rents: The average effective rent advances to $966 per month this year. San Antonio continues to boast the most affordable rents of the state's major markets.

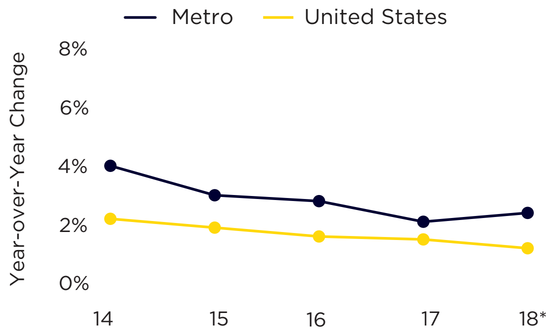
Investment Trends

- The search for yield has spurred investors to seek opportunities in San Antonio, which has resulted in a surge of transaction volume for $20 million-plus properties. Over the past year, sales volume has surged by 30 percent to more than $1.2 billion as the number of transactions closing increased by a similar 35 percent.
- The strong construction pipeline has been a major outlet for private and institutional capital to deploy into the market. Newly built properties have accounted for a significant amount of recently closed properties above $20 million with cap rates typically in the mid-5 percent range.
- Value-add listings have become sparse at this point in the investment cycle, especially in the northwest submarkets, which remain heavily favored for investment. Those looking to expand their search parameters may find opportunities in submarkets in the southern part of the metro.

San Antonio

4Q17 – 12-MONTH PERIOD

Employment Trends

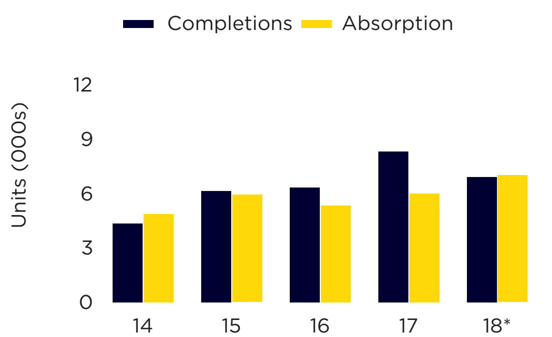


EMPLOYMENT:

2.1% increase in total employment Y-O-Y

- Nearly 21,600 positions were added in San Antonio during 2017. The leisure and hospitality segment gained the largest number of new employees as 6,300 positions were created over the last 12 months.
- An 80-basis-point reduction pushed the metro's unemployment rate to 3.1 percent in 2017.

Completions and Absorption

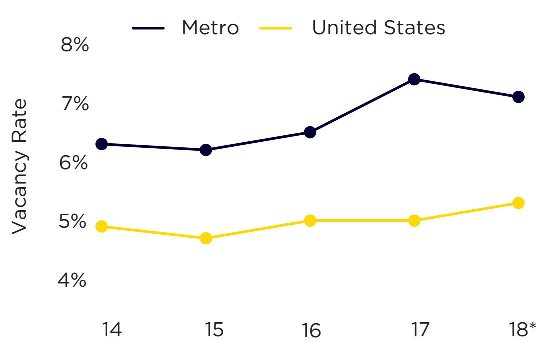


CONSTRUCTION:

8,300 units completed Y-O-Y

- More than 8,300 apartments were delivered during 2017, reaching the highest level in more than 15 years.
- Deliveries will remain elevated in the Far Northwest submarket this year as an additional 2,500 units come online. Development begins to pick up on the south side, however, and more than 1,000 units will come online in Southwest and West San Antonio this year.

Vacancy Rate Trends

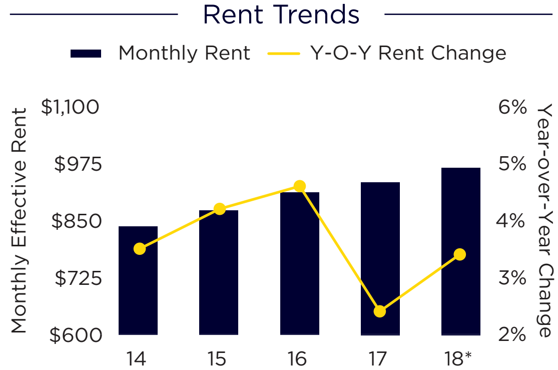


VACANCY:

90 basis point increase in vacancy Y-O-Y

- A glut of new supply coming online during 2017 placed upward pressure on the vacancy rate, which reached 7.4 percent in the fourth quarter.
- Demand for units in the Far Northwest remains strong, with absorption topping 3,000 units last year. As a result, vacancy in the submarket ticked up just 20 basis points to 6.9 percent.

Rent Trends



RENTS:

2.4% increase in effective rents Y-O-Y

- Rising vacancy over the last two years contributed to a slower pace of rent growth during 2017 to an average of $934 per month.
- The Airport Area, Alamo Heights, and the space from north of Wurzbach Parkway along Highway 281 through Spring Branch recorded dips in rent last year. Declines ranged from 0.1 percent to 1.5 percent.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*

201,900

4Q17 POPULATION AGE 20-34
(Percent of total population)

Metro 22%

U.S. 21%

4Q17 MEDIAN HOUSEHOLD INCOME

Metro $57,255

U.S. Median $58,714

FIVE-YEAR HOUSEHOLD GROWTH*

82,000

POPULATION OF AGE 25+
PERCENT WITH BACHELOR'S DEGREE+**

Metro 26%

U.S. Average 29%

4Q17 TOTAL HOUSEHOLDS

33% Rent

67% 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
Far West San Antonio	5.7%	-70	$963	2.2%
North Central San Antonio	6.1%	80	$961	-0.7%
Central San Antonio	6.2%	150	$1,143	4.2%
Airport Area	6.4%	30	$862	-0.2%
West San Antonio	6.6%	110	$730	0.0%
New Braunfels/Schertz	6.6%	130	$998	3.6%
Far Northwest San Antonio	6.9%	20	$1,095	2.1%
Northwest San Antonio	7.2%	130	$895	2.6%
Far N Central San Antonio	7.5%	20	$1,169	-0.1%
Northeast San Antonio	7.9%	170	$826	0.1%
South San Antonio	8.1%	50	$814	4.1%
Overall Metro	**7.4%**	**90**	**$934**	**2.4%**

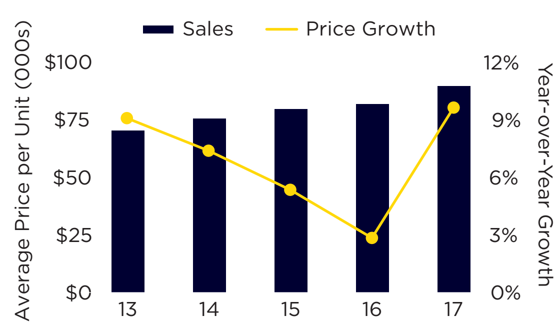
SALES TRENDS

Investors Target San Antonio for Higher Initial Returns

- Out-of-state investors looking to capitalize on the strong fundamentals and higher yields have contributed dramatically to the rise in $20 million-plus transaction volume over the past four quarters.
- New developments trade between $120,000 and $160,000 per unit. Cap rates are in the mid-5 percent range, 50 to 100 points higher than in primary markets.

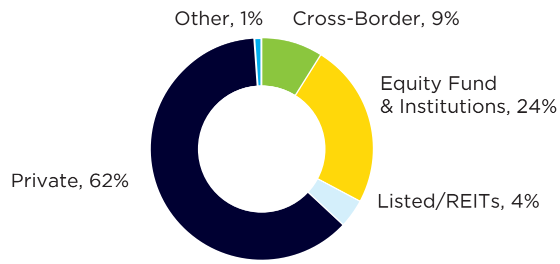
Outlook: With high demand for assets, activity should remain robust throughout the year as owners list properties to take advantage of existing pricing conditions.

Sales Trends

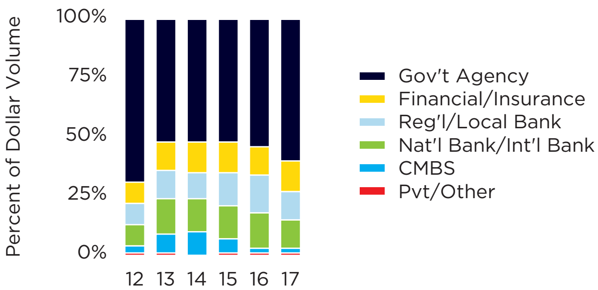


Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

2017 Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



Include sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

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.

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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