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COMMERCIAL REALTY RESOURCES CO
MULTIFAMILY INVESTMENT SERVICES

2015 Mid-Year Apartment Report Oklahoma City Tulsa

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2015 Mid-Year
Multifamily Apartment Report

At mid-year 2015, the statistics are pretty clear; multifamily investments continue to reach for new heights. Cap rates have continued to compress, which has fundamentally changed the local apartment markets. It seems this has become the new normal. There are simply not enough apartments for sale to satisfy the over-abundance of investors searching for deals. The low inventory of "for sale" product and the "fear of missing out" has driven investors to pay high record pricing for apartments.

The risk premium - the spread between interest rates and cap rates, and the extra return that investors gain for putting their money into real estate - has lessened considerably. And for some, it simply doesn't matter anymore. Here's why. When investors pay top of the market pricing for "fear of missing out", they simply re-label the asset as a value add opportunity to make it look more promising. Why? Because value-add opportunities provide all the risk premium investors want. The numbers can get a quick boost from increased rents or reduced expenses. So, the cap rate just becomes a perception based on who's doing the math. Typically, value-add underwriting doesn't look at the trailing 12 month period but next year's projections. This makes it more difficult to hone-in on what the actual cap rate is for a value add transaction. It's further out on the risk spectrum, but easier for investors to place capital in value add as opposed to the idea of overpaying, or paying $125,000 to $150,000 per unit for new construction or an institutional grade asset. This changing perception can help in underwriting the value of an asset to a new high.

Consequently, value-add transactions have become more prevalent. Investors will differ on how to define value-add. But as new units are built, other product becomes dated. And in general, as something ages, it gets obsolete, which creates the opportunity for older assets to do renovations and increase rents and thus, the value-add component. But, don't think these deals (value-add) are selling at a discount. The mistaken belief is that a discounted price is associated with a value-add opportunity, but it's proven to be just the opposite. Value-add deals, especially those in good locations, are selling for a premium, if not record high pricing.

There is not a lot of exit strategy underwriting right now. Caution is really secondary to doing the deal for a lot of investors because being cautious could mean missing the deal entirely. Many investors today aren't looking to make money on the exit so much as just not to lose it. These elements have changed the apartment market creating a sense it can only go higher. But it does make one wonder how much higher prices can soar, and how low cap rates can go.

Eventually though, someone will "overpay" and not be able to exit without a loss. The thinking is that investors will see a breakdown in the fundamentals (the going-in math) before that point and sell off their asset with a profit. This leaves many wondering if investors today are unknowingly in the next bubble cycle or creating it for the next guy. The apartment market is cyclical and every cycle carries its own share of risks. I think one of the risks today may be aggressive pricing no matter how you label it, followed closely be short-term horizons. In other words, buying assets at record pricing and record low cap rates is dangerous without a long term horizon.

Multifamily construction is booming because vacancy is down and rents are rising. And millennials are going to shun the traditional single family home and live in apartments forever, right? That may just be wishful thinking. Marriage and children could change those dynamics as millennials start families and may prefer owning versus renting.

Despite what millennials say they may or may not be doing 10 years from now, I tend to think this generation will *(at some point)* have similar goals as prior generations; to get married, have children and own their own home. As I stated in my 2014 Report, Oklahoma City and Tulsa are among the most affordable big cities in the United States for homeownership. So, rising homeownership rates locally will not be welcome news for multifamily developers with lease-up on the horizon and new starts coming out of the ground.

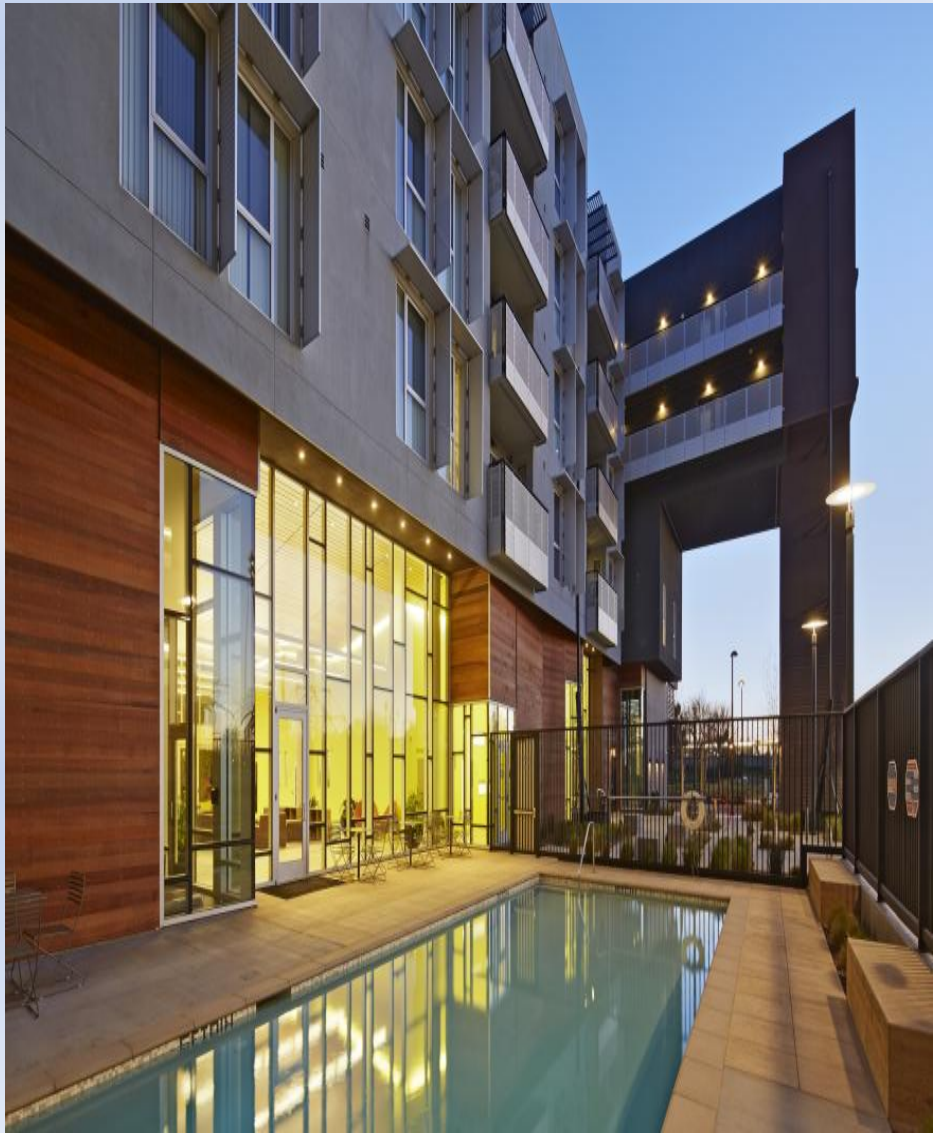
In contrast though, there may be another renter demographic for new construction. According to many national publications, the baby boom generation *(the oldest being age 69)* is increasingly interested in renting apartments. As many in this generation retire, sell the "nest" and enter a new lifestyle, they are increasingly seeking the maintenance free environment that renting can offer. And it's my own opinion that baby boomers turned renters will favor the nicest communities with the best amenities. I see this playing out on a very *(very)* small scale. My niece who is in her 20's and now adding a second child has recently built a new home versus renting, while my aunt and uncle who are in their 70's recently sold their home of 42-years and became renters to simplify their retirement. I think in another twelve to eighteen months we will better understand the tenant profile and if the markets are able to absorb all these new units and at what rent levels.

I do expect the economy's strength to support apartment fundamentals and construction levels going forward. Despite a struggling oil and natural gas industry, the state and local economies continue to grow. This comes from Oklahoma City University economist Russell Evans. According to Evans, Oklahoma and Oklahoma City have lost oil and natural gas jobs since the first of the year, but other industries have more than offset the energy declines. "If that holds up for the year and we continue to lose oil and gas jobs and gain jobs overall, that would be the first time in recent memory you could have a contraction in our primary industry but an expansion in our overall employment and growth". Evans went on to say in an article for The Oklahoman(1), "So far, the oil and natural gas job losses have been disproportionally in the rural parts of the state as relatively few of the office jobs in Oklahoma City and Tulsa have been cut". Evans doesn't think the price of domestic benchmark West Texas Intermediate crude will touch the $43 lows seen in March or run off to $80 highs, but he does expect slowly rising energy prices versus an aggressive rebound in the second half of the year. The price of oil set a high of $107.95 last June.

While the apartment market has changed, so has the Oklahoma economy that has more diversity and underlying economic strength than in previous cycles. The unemployment rate in April for the Oklahoma City metro was 3.4 percent, 3.8 percent in the Tulsa metro, and 3.8 percent in Lawton. All three metro areas in Oklahoma had lower jobless rates in April than a year earlier. I expect if oil prices remain low for a prolonged period it will eventually have an impact on the apartment industry. But for now, it has provided tenants with more discretionary cash they didn't have to spend on gasoline.

Transaction volume in Oklahoma City for the first six months of 2015 is $173.8 million. This is up 73% from the same period of 2014, and represents 3,797 units sold. There were really no core (Post-1990) sales in 2015, other than a per-bedroom student housing community in Norman that was built in 1999. So the $173.8 for 2015 is significant when you consider its make-up of only "B" and "C" assets.

Likewise, Tulsa had no core asset sales in either the 2014 or 2015 year-to-date statistics. Transaction volume for Tulsa was $85.3 million for the first six months of 2015, as compared to $93 million for the same period of 2014, with the same "B" and "C" transactions representing the totals. Much like in 2014, investors are looking beyond core assets in both markets to find opportunity in 2015.



Oklahoma City

For the first six months of 2015, there were 22 sales on properties that exceed 25 units in size, for a total of 3,797 units. This was up 46% from 2,609 units sold at Mid-year 2014. Total sales volume was $173.8 million in 2015, as compared to $100.6 million for the first six months of 2014. The overall average price per unit on apartment communities with 25 units or more is $45,799, which is 19% higher than the $38,587 for the same period of 2014.

For Pre-1980's properties, there were 17 transactions involving 2,501 units for an average per unit price of $40,721. We are definitely seeing more consistent sales in this category that exceed the $30,000 per unit threshold. It happened in a big way in 2015 with $79.8 million of the total $101.8 million for the category exceeding that pricing level. There was one distressed sale involving a 162-unit property that sold for $17,839 per unit and then another that set record pricing at $73,500 per unit. The record pricing was achieved by the $31 million sale involving the 424-unit Warwick West Apartments that was built in 1978 and has an irreplaceable location at 3120 NW Expressway across from Integris Medical Center. The commonality is that both transactions, while being at the opposite end of the field, were viewed as value-add by the buyer and record pricing by the seller. Are my suppositions for this report becoming more lucid?

The average for 1980's vintage is $49,604 per unit, as compared to $40,771 for the same time last year. Total volume for this category was $49.4 million, as compared to $81.6 million for the first six months of 2014. The 2014 figure included a five property $65 million transaction involving 1,657 units. The 2015 sales include the 356-unit Village at Stratford Apartments that sold for $15,800,000, representing $44,382 per unit, and the 96-unit Bryant Square Apartments in Edmond that sold for $41,205 per unit. While both sales were again considered value-add by the parties, I would classify the Bryant Square sale as a development opportunity. Meaning, the renovated units have porcelain faux wood floor and premium finishes with granite counters, dark oak cabinets, new light fixtures, and decorative fiberglass interior doors. They also re-did plumbing and electrical and have front-loading washer and dryers. The exterior has new windows and roofs and is being completely bricked to replace old composite siding. The level of renovation and premium finishes for a B-grade asset puts it in a different classification than the typical value-add by definition. Rounding out the three sales is the 544-unit Pinehurst Apartments at 12401 and 12301 N. MacArthur.

The only sale of Post-1990's properties involved the sale of a per bedroom student housing community in Norman at $15,750,000, or $100,961 per unit for the 156-unit property. There were no sales during the first six months of 2014 for a statistical comparison. *For a look at the per bedroom student housing market in Norman that is increasing by an additional 3,795 beds, see our 2014 Report.*

There was one sale involving a property developed in 1999 under the Low Income Housing Tax Credit Program. Chapel Ridge Apartments at 1900 Renaissance Drive in Norman sold for $6,900,000, or $47,916 per unit for the 144-unit community. While that may seem low for a newer vintage property, the pricing of LIHTC properties are usually held back because of the compliance period even though the asset may have exited the 15-year tax credit program. We saw a similar sale in 2014 for the Senior Cottages in Norman that sold for $3,100,000, or $36,904 per unit for the 84-unit property that was built in 1998 under the same LIHTC program.

Total Sales Volume

73%
Compared to Mid-Year 2014

Total Units Sold

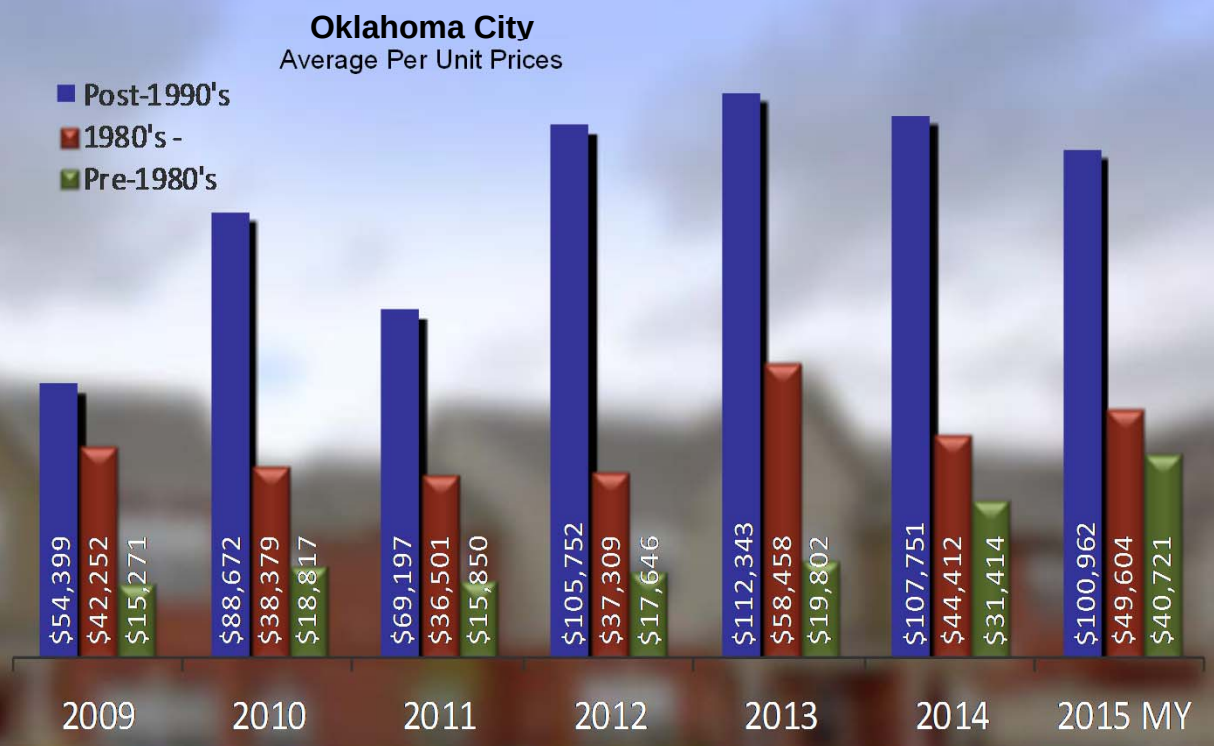
46%
Compared to Mid-Year 2014

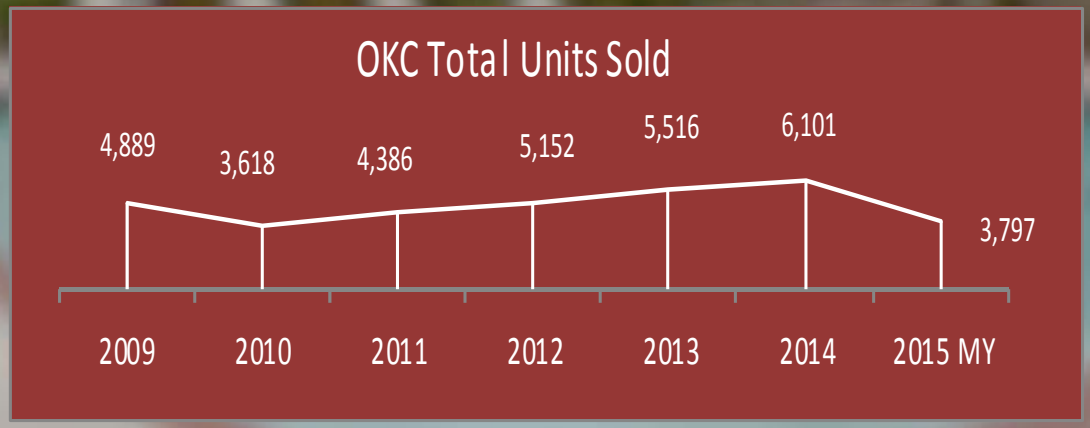
Average Price Per Unit

19%
Compared to Mid-Year 2014

No. of Transactions

47%
Compared to Mid-Year 2014





Tulsa

There were 10 sales in Tulsa during the first six months of 2015 on properties that exceeded 25 units in size, for a total of 2,171 units sold. This was down 33% from the 3,233 units sold at Mid-year 2014.

Total transaction volume in Tulsa was $85.3 million, as compared to $93 million for the first six months of 2014. The overall average price per unit in Tulsa was $39,330 versus $28,790 at Mid-year 2014.

For Pre-1980's properties, there were 5 transactions involving 787 units for an average per unit price of $31,799. Total volume represented $25 million for the category. There was only one distressed sale involving the 243-unit Waterstone Apartments at 1054 E. 57th Place. While considered a distressed sale because it was lender owned, the purchase price of $26,748 per unit didn't look distressed. Yet, another example of a buyer seeing value-add and a seller achieving a price they didn't expect to get.

There were five sales in the 1980's category for the first six months of 2015. These sales involved 1,384 units for an average per unit price of $43,613. Total volume for the category was $60.3 million, compared to $15.7 million during the first half of 2014.

There were no sales in the Post-1990's category during the first half of 2015 or 2014.

Oklahoma City	Post 1990's	Post 1980's	Pre-1980's
Number of Transactions	1	3	17
Total Number of Units	156	996	2,501
Total Number of Sales OKC		2	13
Total Number of Sales Edmond		1	
Total Number of Sales Norman	1		1
Total Number of Sales Other			3
Price High per unit Price Low per unit	$100,962 $100,962	$54,504 $41,205	$73,500 $17,839

Tulsa	Post 1990's	Post 1980's	Pre-1980's
Number of Transactions		5	5
Total Number of Units		1,384	787
Total Number of Sales Tulsa		5	4
Total Number of Sales Other			1
Total Number of Sales Broken Arrow			
Price High per unit Price Low per unit	NA NA	$61,625 $31,562	$40,476 $21,839

Total Sales Volume

8%
Compared to Mid-Year 2014

Total Units Sold

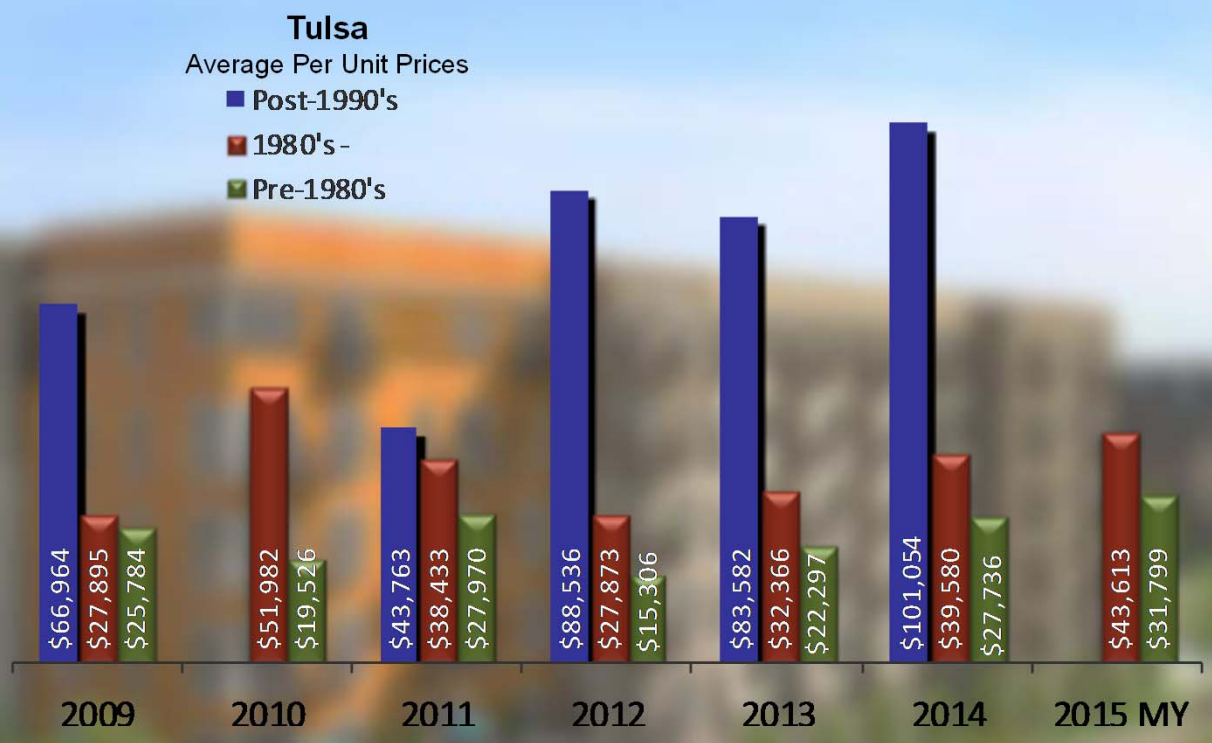
33%
Compared to Mid-Year 2014

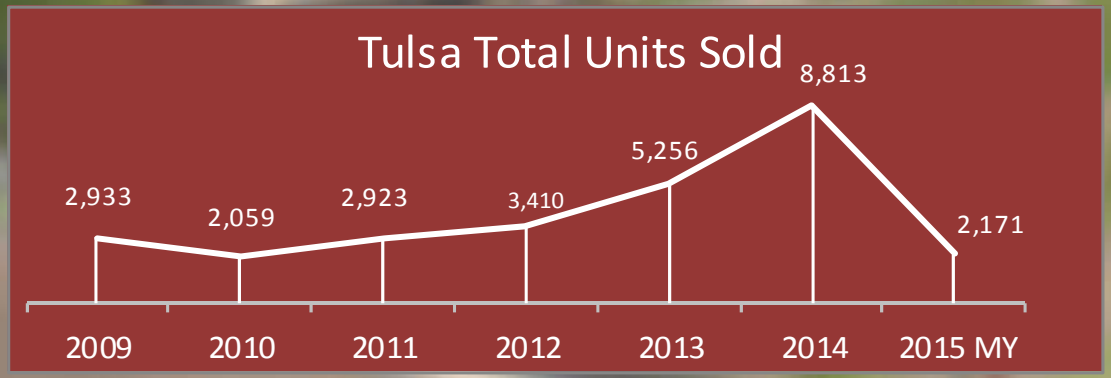
Average Price Per Unit

37%
Compared to Mid-Year 2014

No. of Transactions

41%
Compared to Mid-Year 2014





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Outlook

With the current spread on the risk premium shrinking and investment objectives that aren't motivated by yield alone, 2015 could be the best year yet in this cycle. The looming question is whether the market will slow down if interest rates increase in 2015? Historically, when interest rates go up, so do cap rates. But we don't think that will necessarily be the case now, at least not on a one-to-one correlation. Remember, everyone has predicted interest rates will go up for years now and look what the market has done. We are seeing sales today that are absolutely shocking. Depending on the deals, cap rates might not change much even with any upward movement in interest rates. I think there will continue to be a "fear of missing out" in the second half of 2015. This will put more pressure on buyers to invest their money while interest rates remain at historically low levels. And that means more deals ahead.

I think it is worth mentioning again that the challenge facing investors today is figuring out which properties offer the best risk/return combination. Using pro forma numbers on value-add projections means someone, at some point, will guess wrong. The market has become habituated to low interest rates. And borrowers need low rates to make low cap rate deals work. Even though times are good, investors might remind themselves how higher rates might impact values and to weigh the ability of income growth to outpace cap rate increases. There is good reason to be optimistic, but also wise to have an exit strategy if things don't go as planned.

I reiterate from my 2014 Mid-year Report, the best advice may be to sell sooner rather than later while investor demand is strong. Buyers vastly outnumber sellers, which means aggressive bidding, high prices and low cap rates. And as a seller, you have to think about that. Plus, owners should understand that they might achieve pricing today that would not have been possible even just a few short years ago.

1-The Oklahoman, Thursday, June 4, 2015. OK economy grows despite slowing of oil, gas industry.

Sale Highlights Oklahoma City

Property Name	Address	Price	No. of Units	Year Built	Price Per Unit
Village at Stratford	12831 N. Stratford Dr.	$15,800,000	356	1985	$44,382
University Greens	2900 Oak Tree Ave.	$15,750,000	156	1999	$100,961
Bryant Square	1730 E. 2nd Street	$3,955,750	96	1980	$41,205
Summer Oaks	1442 N. MacArthur	$5,425,000	196	1972	$27,678
Aspen Place	2700 Indian Creek	$16,050,000	358	1972	$44,832
Springdale	4300 S. Barnes	$3,440,000	128	1975	$26,875
Warwick West	3120 NW Expressway	$31,164,000	424	1978	$73,500
The Belmont	1800 N. Rockwell	$2,890,000	162	1969	$17,839
Madison Village	4215 SE 53rd Street	$5,000,000	212	1973	$23,584

Sale Highlights Tulsa

Property Name	Address	Price	No. of Units	Year Built	Price Per Unit
Brookwood	1325 E. 48th Place S	$1,786,000	73	1964	$24,465
Fairmont Terrace	1111 E. 60th Street S	$13,600,000	336	1975	$40,476
Silvercreek	10710 E. 41st Street S	$10,100,000	320	1980	$31,562
Boulder Plaza	1840 S. Boulder	$1,900,000	87	1953	$21,839
Waterstone	1054 E. 57th Place	$6,500,000	243	1965	$26,748
Eagle Point	5808 E. 71st Street S	$13,300,000	344	1980	$38,662
Sheridan Pond	8130 S. Lakewood Pl.	$14,790,000	240	1986	$61,625
Chardonnay	7209 S. 92nd Ave East	$10,170,000	200	1983	$50,850
Red River	1502 E. 71st Street	$12,000,000	280	1980	$42,857