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2014 Mid-Year Apartment Report Oklahoma City & Tulsa

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2014 Mid-Year
Multifamily Apartment Report

The multifamily industry has not only recovered but is on the leading edge of what many consider to be the next building boom. Cap rates have compressed and supply and demand have reached a point that there are simply not enough apartments for sale to satisfy the over-abundance of investors searching for deals. Investors that can't get their hands on the product they want at the yield they want are turning to development. And because vacancy is down and rents are rising, multifamily construction is booming. There are really no other options for investors that want to be in the market and can't find existing core product.

Building age is a crucial factor when picking a core, value-add, or opportunistic strategy. After all, newer and older buildings come with different valuations. Yet, with demand outweighing supply, the gap between cap rates on newer and older buildings may be narrowing. Investor preferences have largely been on the side of newer properties that have caused prices to accelerate quickly. These core sales have been defined by high liquidity in the capital markets and optimistic valuations. But cap rates could start to push higher on newer assets over the possible concern that class "A" inventory could be more strongly affected by the growing supply wave. This could happen at the same time that cap rates on older properties are showing a downward trend, which would explain the narrowing gap between cap rates on newer and older buildings. I think we are definitely seeing more investors that favor older established assets, even with the added risk of a lower cap rate. Even though the fundamentals support it, there may just be more reservation in 2014 from investors wanting to pay record pricing for core assets.

I said last year that investors will have to look beyond core assets to find opportunity. For the first six months of 2014, transactional activity in Oklahoma City and Tulsa would suggest just that. There have been no sales of core assets in either market as of mid-year. Class "B" and "C" properties generally represent a good investment opportunity and that is where the activity has been in 2014. The reason is that there is potential to capture higher returns on stabilized "B" and "C" properties that offer upgrade opportunities. Don't mistake this though for buying at a low price per unit on an underperforming property. Buyers today are paying a premium for solid "B" and "C" properties in good locations with upside rent potential. The theory is simple; the *(potential)* rent growth may be greater on a $500 to $700 per month apartment than that of a $1,100 to $1,200 per month unit; especially if you are not competing with new inventory commanding rents exceeding $1,000 per month. New carpet, texture, faucets and lighting fixtures on a "B" or "C" asset can command a premium for the right deal. I know some might dismiss the idea as illogical, but the paradox of paying a premium to earn added value may not only have rationality, but sales to prove it. The key for investors is figuring out which properties have that potential and not over paying for those that don't.

Here's an example. A mid-80's property that I recently evaluated had rent growth of 24% between the years 2010 and 2013, an average annual increase of 6% per year. This owner has been able to implement selective upgrades to keep pushing rents upward. While this owner was ultimately not a seller, the example represents the type of property investors are feverishly trying to find. Don't think this property would have sold at a discount though back in 2010. It would have sold at a premium, but would have rewarded the buyer nicely. The mistaken belief is that a discounted price is associated with a value-add opportunity, and it is usually just the opposite.

2014 transactions will offer this perspective. Transaction volume in Oklahoma City for the first six months of 2014 is $100.6 million. This is down only marginally from the same period of 2013, and is a very healthy number representing 2,609 units sold.

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By comparison, there was $63.4 million of core assets that added to the $107.6 million sold during the first six months of 2013, versus no core sales in 2014. So the $100.6 is significant when you consider its make-up of only “B” and “C” assets. Tulsa may be even more impressive with no core asset sales in either 2013 or 2014 year-to-date statistics. Yet, transaction volume was $93 million for the first six months of 2014, as compared to $42.8 for the same period of 2013, with only “B” and “C” transactions. So the numbers don’t lie, investors are looking beyond core assets to find opportunity in 2014.

Oklahoma City

For the first six months of 2014, there were 15 sales on properties that exceed 25 units in size, for a total of 2,609 units. This was down from 2,696 units sold at Mid-year 2013. Total sales volume was $100.6 million in 2014, as compared to $107.6 million for the first six months of 2013. The overall average price per unit on apartment communities with 25 units or more is $38,587, which remained fairly consistent with $39,926 for the same period of 2013.

For Pre-1980’s properties, there were 8 transactions involving 606 units for an average per unit price of $31,366. This is significant because I have said in past reports that this category would not recover until we started to see more consistent sales above the $30,000 per unit threshold. In 2014, seventy percent of the sales in this category exceeded that level. There were no sales of distressed assets, compared to 37% of sales at Mid-year 2013. This represents a distinct rebound for circa 1970 apartments. At this time last year, I said that the real risk for investors may have been getting into the market too late. That seems to be proving true for assets within this category, and especially for those investors that were looking for bargains and didn’t find them.

The average for 1980’s vintage is $40,771 per unit, as compared to $46,759 for the same time last year. Total volume for this category was $81.6 million, as compared to $10.1 million for the first six months of 2013. The sale that surprisingly drove this category was a five property $65 million transaction involving 1,657 units. What made this sale unique was the seemingly low price per unit of $39,227. It also shows the desire and appeal for older, established assets. While the sale is not going to signify a low cap rate, it could be defined as opportunistic because of the buyer’s willingness to assume existing debt with an above market interest rate. By taking that interest rate risk, the buyer probably got near an 8 cap rate by assuming a mid to upper 5 percent interest rate. Over time though, the strategy could be very rewarding. The $45.86 million mortgage that was assumed was originated in March of 2006, marking a ten year maturity in 2016. If interest rates and cap rates at maturity are near the same they are today, then the buyer could have a near 100 basis point spread over his going-in cap rate. And like in my earlier example, there’s the potential of doing selective upgrades to push rental rates between now and 2016. Not a bad risk/return combination. The other significant sale in this category involved the 316-unit Bluff Creek Apartments that sold for $16,050,000, or $50,791 per unit.

There were no sales of Post-1990's properties during the first six months of 2014 for a statistical comparison. Total volume for this category though was $63.4 million during the first six months of 2013 and $210 million during the same period of 2012.

Tulsa

There were 17 sales in Tulsa during the first six months of 2014 on properties that exceeded 25 units in size, for a total of 3,233 units sold. This was up 74% from the 1,860 units sold at Mid-year 2013.

Opportunistic is the catch phrase for Tulsa as well. This can be seen with the acquisitions of Copper Mill and Lakewood Park at $30,330 and $32,142 per unit and Hunter's Creek at $44,417 per unit. All three acquisitions were 1970's vintage properties. The misconception is that opportunistic or value-add translates to steep pricing discounts. To the contrary, these assets sold at very good pricing for the sellers and offered the buyers what they hope to be a repositioning opportunity.

Total transaction volume in Tulsa was $93 million, as compared to $42.8 million for the first six months of 2013. The overall average price per unit in Tulsa was $28,790 versus $23,022 at Mid-year 2013. The big variance is because of opportunistic purchases; some as high as $43,000 to $44,000 per unit.

For Pre-1980's properties, there were 15 transactions involving 2,763 units for an average per unit price of $28,005. Total volume represented $77.3 million for the category. Sales of distressed assets accounted for only two percent of the total with the sale of the 79-unit Briar Village Apartments. As you might expect, the percentage of lender owned sales has decreased significantly from prior years while the value of distressed has increased. For instance, the most distressed sale for this category in 2012 brought $6,370 per unit, as compared to $8,984 in 2013 and $15,000 in 2014.

There were two sales in the 1980's category for the first six months of 2014. The two sales involved 470 units for an average per unit price of $33,404. Total volume for the category was $15.7 million, compared to $9.4 million during the first half of 2013. Southern Slope Apartments, a 142-unit property that was built in 1983, sold for $6,000,000 or $42,253 per unit. The property was lender owned and the buyer is planning to invest $3 million in interior and exterior improvements. So, there goes the theory that lender owned deals are selling on the cheap.

There were no sales in the Post-1990's category during the first half of 2014. Likewise, there were no sales for the first six months of 2013 either. You have to go back to 2012 to see any activity for this statistical time period when Steadfast Income REIT purchased the 336-unit Sonoma Grande Apartments at $95,833 per unit and the 294-unit Estancia Apartments at $94,898 per unit, which at the time set the upper benchmark on pricing in Tulsa.

Total Sales Volume

6%
Compared to Mid-Year 2013

Total Units Sold

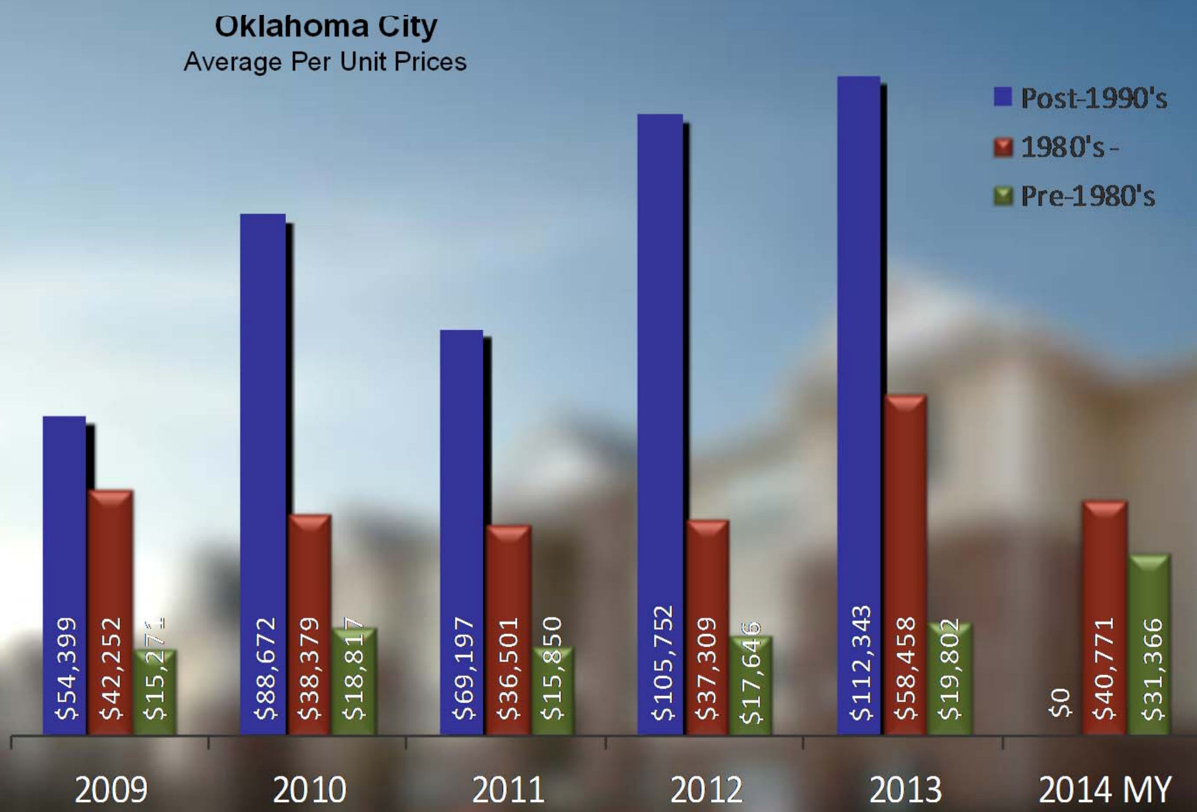
3%
Compared to Mid-Year 2013

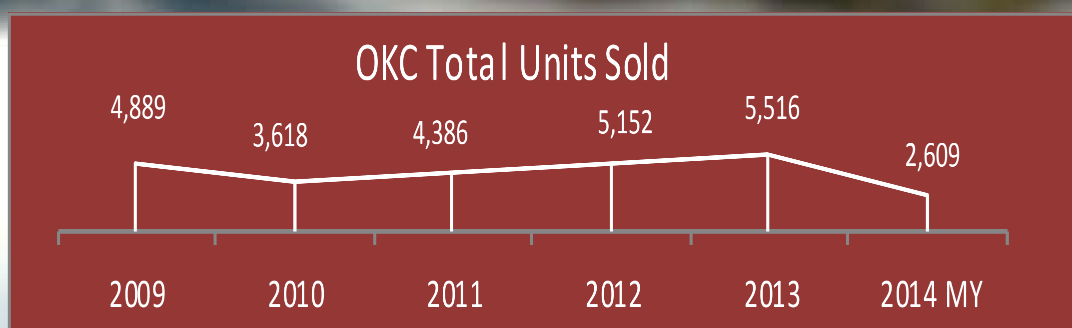
Average Price Per Unit

3%
Compared to Mid-Year 2013

No. of Transactions

6%
Compared to Mid-Year 2013





Economy

The local economy continues to be a driving force putting Oklahoma on the radar screen of investors from across the country. Oklahoma charted strong job growth in the first part of 2014, according to Chad R. Wilkerson, head of the Federal Reserve Bank of Kansas City's Oklahoma City Branch, as he reported in the Journal Record, May 14, 2014. "Oklahoma and Oklahoma City in particular, have outperformed the national economy". "While Tulsa's manufacturing base led it to mirror the nation's course, Oklahoma City emerged rapidly from the recession". Its workforce now exceeds pre-recession levels by 7 percent, according to Wilkerson. "The Sooner State as a whole now stands 2 percent above its pre-recession employment". Tulsa's recovery has exceeded the national rate since 2011, he said. Wilkerson credited Oklahoma City's recovery to its energy base, led by strongly performing exploration and production companies. He also pointed to the cumulative effects of the city's public works, business spending and the Oklahoma City Thunder.

Oklahoma City	Post 1990's	Post 1980's	Pre-1980's
Number of Transactions	0	7	8
Total Number of Units	0	2,003	606
Total Number of Sales OKC	0	6	4
Total Number of Sales Edmond	0	1	1
Total Number of Sales Norman	0	0	1
Total Number of Sales Other	0	0	2
Price High per unit Price Low per unit	NA NA	$50,791 $20,500	$39,801 $18,518

Tulsa	Post 1990's	Post 1980's	Pre-1980's
Number of Transactions	0	2	15
Total Number of Units	0	470	2,763
Total Number of Sales Tulsa	0	2	15
Total Number of Sales Other	0	0	0
Total Number of Sales Sand Springs	0	0	0
Price High per unit Price Low per unit	NA NA	$42,253 $29,573	$44,417 $14,912

Total Sales Volume

117%
Compared to Mid-Year 2013

Total Units Sold

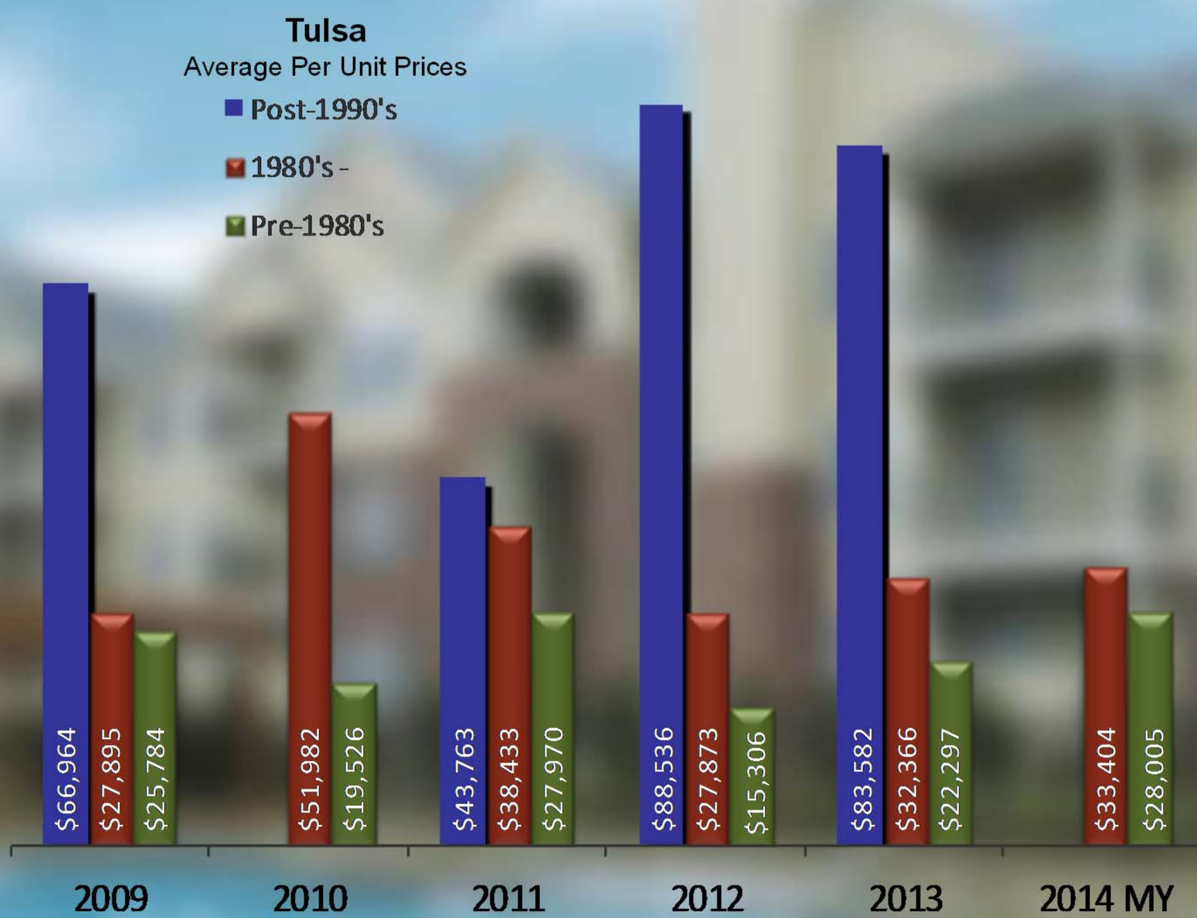
74%
Compared to Mid-Year 2013

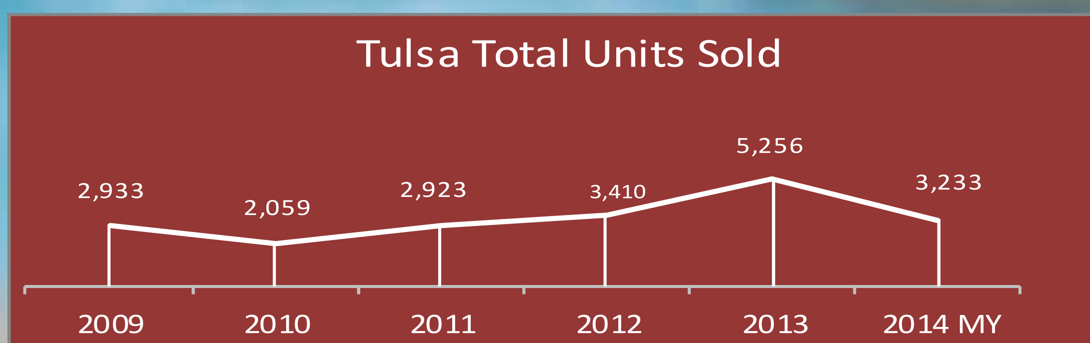
Average Price Per Unit

25%
Compared to Mid-Year 2013

No. of Transactions

113%
Compared to Mid-Year 2013





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Outlook

Demographic trends point to strong, long-term rental demand; investors continue to be attracted to the fundamentals; property values are increasing and apartment construction is ramping up. All signs that point to a robust industry. But, have investors been lulled by these favorable trends instead of what property fundamentals can support, especially in the wake of growing supply.

The challenge facing investors today is figuring out which properties offer the best risk/return combination. Buying core assets at $100,000 per unit (or more) at a 6 percent cap rate (or below) may have been fine up until now, but those assets have the most risk associated with them if interest rates do rise. Those valuations may only make sense for investors who plan to hold the assets forever rather than someone with shorter horizons.

Plus, there is inherent risk of a negative correlation between demand and the amount of new construction taking place. While we may in fact be in the midst of a building boom, it's too early to tell how the market and renter demand will respond to the growing inventory. So, the near-term outlook for multifamily remains bright, if not very bright. The long-term outlook is a little less clear, as vacancy could trend up and concessions could be more prevalent with the growing supply. Some pockets may have even greater exposure where there is a high concentration of new units being built.

The other question as we look forward to 2015 is what will rising interest rates mean to the industry? It will have an impact for sure, but hopefully any rise in interest rates will be moderate and not any severe upward trend.

The best advice for some owners may be to sell sooner rather than later while investor demand is strong and the field is crowded. There are more deals selling at a premium today than at any point in the past.

Property Name	Address	Price	No. of Units	Year Built	Price Per Unit
Sale Highlights Oklahoma City					
Ashwood	3451 SE 44th Street	$3,588,000	157	1972	$22,853
Los Pueblos	717 Santa Rosa	$8,000,000	201	1974	$39,801
Portfolio Sale	Various	$65,000,000	1,657	1984	$39,227
Chowning Heights	1012 N. Chartrand	$1,215,000	33	1968	$36,818
Monterey Square	3764 N. Nicklas	$1,235,000	41	1970	$30,121
Ann Arbor Place	3838 N. Ann Arbor	$615,000	30	1984	$20,500
Cedar Creek	404 S. 2nd Street	$1,550,000	40	1974	$38,750
Dutch Hollow	1215 Oakhurst Ave	$1,550,000	48	1974	$32,291
Bluff Creek	5757 W. Hefner Rd	$16,050,000	316	1985	$50,791

Property Name	Address	Price	No. of Units	Year Built	Price Per Unit
Sale Highlights Tulsa					
Southern Elms	4519 31st Street	$2,800,000	78	1964	$35,897
Foxfire	7324 S. Wheeling	$8,600,000	440	1977	$19,545
Canyon Creek	2102 E. 51st Street	$9,600,000	384	1979	$25,000
Old South	5137 E. 47th Place S	$850,000	57	1967	$14,912
Sand Dollar	910 E. 61st Street	$9,700,000	328	1982	$29,573
Hunters Creek	1563 S. 79th East Ave	$9,150,000	206	1972	$44,417
Lakewood Park	3625 S. Lakewood	$7,200,000	224	1973	$32,142
Coppermill	7110 S. Granite Ave	$16,500,000	544	1978	$30,330