

Yardi® Matrix

U.S. Multifamily Outlook

Summer 2017

Steam to Spare

Strong Job Market
Supports Demand

Rent Growth Drops
to "Normal" Levels

Worker Shortage
Slows Supply Boom

Market Analysis

Summer 2017

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Apartment Momentum Chugs Forward

During this extreme hurricane season, the old post office motto comes to mind when describing the multifamily market: Neither snow nor rain nor heat nor gloom of night can do much to dent the sector's consistent performance. Although fundamentals have been downgraded from great to merely consistently good, the apartment market's strong run likely has some steam left in it, fueled by the slow-moving demographic tide and healthy performance of the economy.

And there's nothing wrong with a little bit of luck. The main negative aspect in the market—concerns that development is getting overheated in some trendy markets—now appears to be diminishing as an immediate problem, as deliveries have begun to slip below expectations. The main cause of the slowdown—the construction industry labor shortage—will only be exacerbated by the post-Harvey and Irma reconstruction efforts. A significant number of workers will likely migrate to Texas and Florida, which means a slower delivery schedule for apartments.

Economy: Although the unemployment rate has dipped to 4.3% and the available pool of workers should seemingly be nearly depleted, the economy has continued to produce 150,000 to 200,000 jobs per month in 2017. Economists debate why wage growth remains in the mid-2% range and whether there are enough job seekers to continue at that growth level, but that hasn't stopped the hiring. And the dysfunction in Washington doesn't seem to affect growth, although it's not entirely clear whether the inability to pass legislation is a net positive or negative for the economy.

Rents: Rent growth has been steadily decelerating for a year-and-a-half, although rents have been rising modestly all year. Through August, average national rents were up 2.4% year-over-year. Given that gains through 2016 were unsustainably high, the moderation is not unexpected. The slowdown in deliveries should help rents continue to increase at moderate levels.

Supply: We have revised our forecast for deliveries nationally to 300,000, down from the 360,000 we expected in the spring. There's no shortage of projects—the 480,000 units under construction are plenty. But our database shows that after averaging 17,700 per month in 2016, deliveries fell to 14,500 in the first quarter of 2017, 12,700 in the second quarter and fewer than 10,000 in July and August.

Capital Markets: Multifamily market capital trends remain healthy, despite less robust fundamentals and prospects for slower growth. Transaction volume dropped in the first half of the year and price appreciation leveled off, but the sector remains popular with investors for its steady income stream. Led by Fannie Mae and Freddie Mac, which are lending at record levels, debt availability continues to be strong.

Economic Outlook

Employment continues to bolster the economy, and new job formation has exceeded expectations for much of 2017. Through the first eight months of 2017, average monthly job creation was above 175,000. Despite a lack of overall wage inflation, certain high-skilled positions such as programmers and computer scientists have seen incomes increase. Tech-centric markets such as San Francisco, Austin, Denver and Seattle remain in high demand for both corporate and personal migration, which should strengthen the local multifamily and commercial office markets.

The unemployment rate was 4.4% in August and has oscillated between 4.3% and 4.5% since March, after steadily declining over the second half of 2016 and the early months of 2017. Of the 54 metropolitan statistical areas with a population larger than one million, all but eight saw year-over-year declines in unemployment as of July. Detroit led all large metros, with unemployment down to 3.3% in July, an improvement of 1.9% year-over-year.

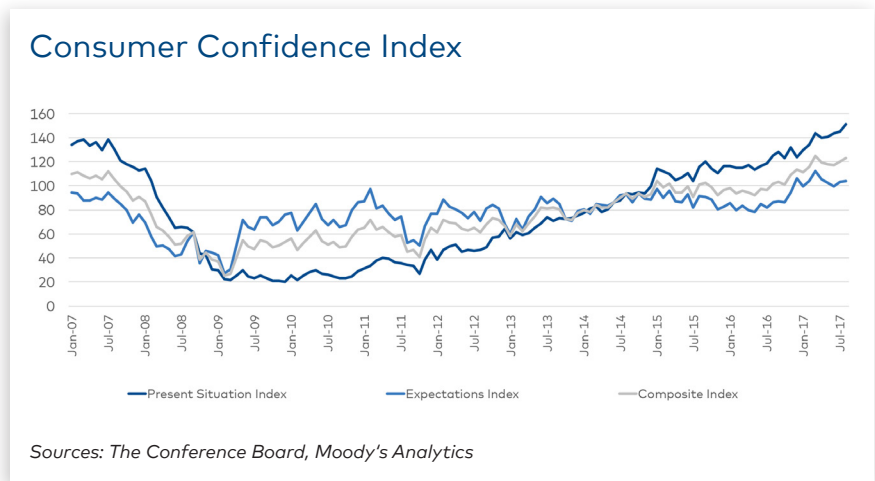
Metropolitan Area	Change in Unemployment Rate	July 2016 Rate	July 2017 Rate
Detroit-Warren-Dearborn, MI	-1.9%	5.2%	3.3%
Birmingham-Hoover, AL	-1.4%	5.6%	4.2%
Chicago-Naperville-Elgin, IL-IN-WI	-1.2%	5.8%	4.5%
Portland-Vancouver-Hillsboro, OR-WA	-1.2%	4.8%	3.6%
Nashville-Davidson-Murfreesboro-Franklin, TN	-1.2%	3.8%	2.6%
Memphis, TN-MS-AR	-1.2%	5.3%	4.1%
Milwaukee-Waukesha-West Allis, WI	-1.1%	4.5%	3.4%
Indianapolis-Carmel-Anderson, IN	-1.1%	4.1%	3.0%
Denver-Aurora-Lakewood, CO	-0.9%	3.2%	2.3%
Charlotte-Concord-Gastonia, NC-SC	-0.8%	4.7%	3.9%

Source: BLS

However, the labor force participation rate remained unchanged at 62.9%, still well below pre-recession levels. Whether that reflects an increasing number of retirees, the gig economy or something else, the disconnect between the unemployment and labor force participation rates makes it impossible to say the country has reached full employment. With a labor force as tight as it is—especially in places such as Denver (2.3% unemployment), Nashville (2.6%) and Portland (3.6%)—employers are having difficulty hiring qualified candidates.

Despite the strength of the economy and the measured short-term interest rate hikes from the Fed, long-term Treasury rates have remained flat thus far in 2017. Following a 50-basis-point increase at the end of 2016 and a subsequent rise through the first quarter of this year, the yield on the 10-year Treasury retreated to a recent low of 2.01% in early September. With international bond yields still well below those of the United States and inflation expectations staying relatively flat, long-term borrowing costs—and the interest rates to which they are tied—will likely remain low.

Equity values continue to help the U.S. economy as well, and the S&P 500, NASDAQ and Dow Jones Industrial Average have registered numerous all-time highs throughout 2017. Combining the equity markets with growing home values, household wealth continues to increase across the country, providing discretionary income to many Americans.



Consumer confidence is at an all-time high, but drilling into the survey yields some interesting results. While the overall read of 122.9 is nearing its 16-year peak from March, the Present Situation Index (151.2) and the Expectations Index (104.0) remain split. Since the beginning of 2015, the two indices that make up the composite reading have been diverging steadily. What does this mean? While many American consumers believe the economy is performing well today, there is growing pessimism surrounding the future of economic growth.

For evidence of changing consumer practices, look no further than the auto industry. Car and light truck sales fell to an annualized rate of 16.7 million in July, a decline of more than one million cars from a year earlier. Auto loan credit has grown significantly, and Americans are becoming increasingly hesitant to purchase cars.

Ride-sharing services such as Uber may be putting downward pressure on auto sales, and sales may be reverting to the mean after a number of high-growth years, but with that being said, it is important not to overlook the sales decline as a potential indicator of deteriorating economic conditions.

In Washington, disagreement and the inability to pass legislation continues to be the main theme for Congress and the President. After multiple attempts to repeal the Affordable Care Act failed in spring and early summer, the current Congress has yet to pass any significant legislation. In the new congressional season, tax reform and immigration are the main issues on the agenda.

Republicans want to reduce top rates for individuals and corporations, and the question is whether reform will also include revenue-enhancing provisions to make the package revenue neutral. Areas of keen interest to commercial real estate include 1031 exchanges, immediate expensing versus depreciation of real estate assets and tax deductibility of interest expenses. While material changes to any of the aforementioned tax benefits would have a significant impact on the commercial real estate industry, the likelihood that major tax legislation gets passed remains less than even, due to the divisions among House and Senate members.

Most economic indicators point toward a healthy and growing economy, despite the stagnation and rhetoric coming from Washington. While there may be a few indicators to monitor in the coming months, such as car sales and auto credit, the general economy is well balanced and should continue to support the steady growth of commercial real estate.

Rent Growth and Occupancy

Rents continued to decelerate during the summer of 2017, an expected trend as rent growth returns to long-term norms while the supply boom enters its third year. National average rents were up 2.4% on a year-over-year basis in August, down from 4.6% at this point last year.

We anticipate that rent growth deceleration is mostly over as the supply boom nears its apex. Fundamentals and demographic trends remain favorable for the long-term outlook of the multifamily industry, which should mitigate the impact of continued levels of high supply. Millennials are forming households, wage growth is solid if unspectacular, and the economy is for the most part healthy.

Many of the top metros for rent growth continue to be secondary markets with slow supply responses. Tacoma (8.1%), Sacramento (7.7%), Colorado Springs (7.6%) and the Inland Empire (4.3%) are four of the five fastest-growing markets this year, and each is expected to add less than 1% to its stock in 2017.

These fastest-growing markets appear to be experiencing at least some sort of spillover effect, benefiting from their proximity to larger markets—such as Seattle, the Bay Area, Denver and Southern California—

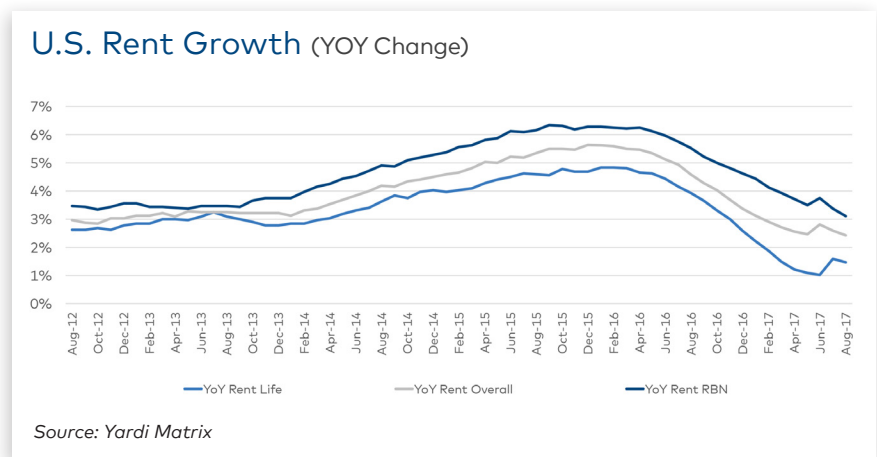
Metros	2017 Rent Forecast % Change	YoY Change 2017 Indexed Rents - August 2017
National-reported markets	2.9%	2.5%
Albuquerque	2.8%	2.7%
Atlanta	3.6%	3.2%
Austin	1.1%	0.3%
Baltimore	1.4%	1.1%
Birmingham	1.5%	2.3%
Boston	2.4%	2.2%
Bridgeport	1.0%	1.5%
Charleston	3.8%	1.0%
Charlotte	2.5%	2.1%
Chicago	2.3%	1.3%
Cincinnati	2.3%	1.9%
Cleveland-Akron	1.7%	1.8%
Colorado Springs	8.0%	7.6%
Columbus	3.8%	3.2%
Dallas	4.3%	3.1%
Denver	2.0%	2.7%
Detroit	3.4%	3.5%
Houston	-0.7%	-2.5%
Indianapolis	3.0%	2.7%
Inland Empire	4.8%	4.3%
Jacksonville	2.9%	2.8%
Kansas City	2.3%	1.7%
Knoxville	3.0%	2.9%
Las Vegas	3.5%	3.4%
Long Island	3.5%	3.6%
Los Angeles	3.9%	4.0%
Louisville	2.7%	2.4%
Memphis	2.4%	3.3%
Miami	2.9%	1.6%
Milwaukee	1.9%	1.6%

Metros	2017 Rent Forecast % Change	YoY Change 2017 Indexed Rents - August 2017
Nashville	2.0%	0.9%
New Jersey-Central	3.7%	3.3%
New Jersey-Northern	3.1%	1.8%
New Orleans	1.5%	0.3%
New York City	-1.0%	-2.5%
Oklahoma City	-1.2%	-0.9%
Orange County	3.0%	3.3%
Orlando	4.2%	4.1%
Philadelphia	1.8%	1.7%
Phoenix	4.8%	3.0%
Pittsburgh	1.0%	1.5%
Portland	2.5%	1.7%
Raleigh	3.0%	2.7%
Richmond	2.7%	2.5%
Sacramento	8.2%	7.7%
Salt Lake City	4.6%	3.6%
San Antonio	1.5%	1.1%
San Diego	3.6%	4.0%
San Francisco	0.8%	1.6%
San Jose	1.2%	2.6%
Seattle	5.0%	5.9%
Southwest Florida Coast	3.0%	0.3%
St Louis	1.8%	0.9%
Tacoma	7.5%	8.1%
Tampa-St Petersburg	3.8%	3.0%
Tucson	3.3%	3.6%
Twin Cities	4.1%	3.6%
Washington DC	1.5%	0.8%
White Plains	3.3%	0.4%
Winston-Salem	3.3%	3.3%

Source: Yardi Matrix

that have robust employment growth and are magnets for domestic migrants, especially Millennials. Cities such as Tacoma and Colorado Springs offer similar lifestyle attributes that attract many young people leaving the Midwest and Northeast for Seattle and Denver—and at a fraction of the cost.

One outlier to this trend is Seattle, which maintained strong rent growth (5.9%) despite heavy supply increases, as employment and population growth drive housing demand. There is some question as to how Seattle's aggressive minimum wage law is impacting rents. The minimum wage has jumped from \$9.47 in early 2015 to \$13 today. This could be causing wage inflation, which in turn could explain some, but not all, of the rent growth that has continued full speed ahead despite extraordinary levels of new supply.



The markets on the low end of the rent growth spectrum remain the same as earlier in the year. New York City rents decreased (-2.5%) despite robust demand, largely due to affordability issues. That negative trend is likely to continue in the near term, as new supply—led by Brooklyn—is expected to add 3.4% to stock this year. Houston (-2.5%) and Oklahoma City (-0.9%) continue to suffer the ill effects low energy prices are having on their economies. (Houston's fundamental equation was changed significantly by Hurricane Harvey. We estimate between 45,000 and 72,000 apartment units were damaged, which will fill up many of the vacancies in the metro and turn rent growth moderately positive.)

One unexpected entrant to the bottom of the rent growth rankings is Nashville (0.9%), which saw rents grow 6% a year ago. However, the supply response was incredibly quick; the stock of apartment units has increased 10% since the beginning of 2015 and consequently has caused rent growth to come to a screeching halt. The metro remains one of the fastest-growing markets in the country on an economic and population basis, so we believe that rents will recover once the influx of inventory is absorbed.

Another trend that persisted well into 2017, and that we expect will continue, is the bifurcation of rent growth between the Lifestyle and Renter-by-Necessity (RBN) asset classes. Nationally, Lifestyle rents have grown by 1.4% while RBN rents have grown 3.1%. Eighty percent of new units are in the Lifestyle category, and the glut of new supply on the high end is weighing down rent growth for the Lifestyle assets. Increasing construction and land costs have made it hard for builders and lenders to underwrite new RBN assets. In 53 of the top 60 markets, RBN rents are growing faster on a year-over-year basis than Lifestyle. Notably, in all seven markets where Lifestyle rents are growing faster than RBN, the spread between the two asset segments is less than 100 basis points.

The concentration of new supply on the high end has also led to higher occupancy rates for the RBN assets. This development began in mid-2015, and the gap between occupancy rates for the Lifestyle and RBN assets expanded quickly but has since stabilized in the range of 60 to 80 basis points. Overall, occupancy rates remain above 95% on a national level, suggesting that generally the supply boom has not yet exceeded the demand for new apartments.

Supply

Apartment construction has increased annually since its trough in the wake of the financial crisis, and the trend is expected to continue in 2017. The surge in luxury unit deliveries led to the threat of oversupply and decelerating rent growth. However, the growing number of deliveries may not be as large as first feared due to a recent slowdown in completions. There is no shortage of activity—Yardi Matrix data shows that some 480,000 apartment units are under construction. But the number of deliveries has been on a steady decline since the first quarter. The reasons for the slowdown are myriad, but the common thread is a labor shortage.

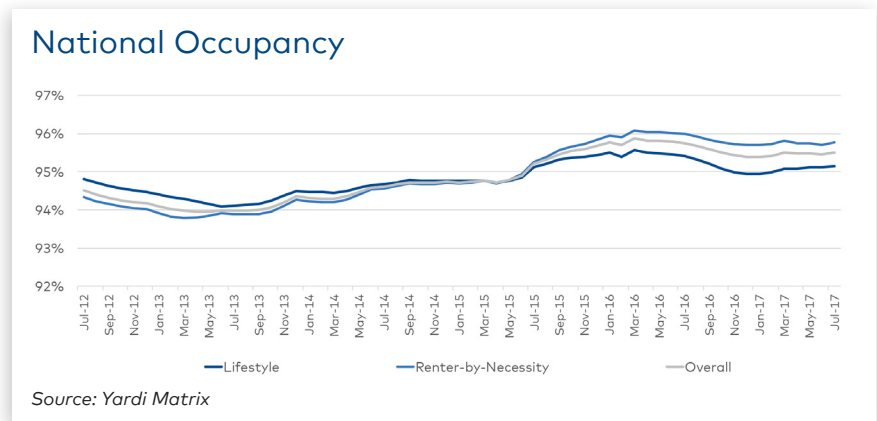
As a result, we now expect many deliveries scheduled for 2017 will be pushed into 2018, with supply leveling off starting in 2019. We forecast 300,000 units will be delivered by year-end, a 2.3% increase to existing stock and only 6.7% more than the 281,000 delivered in 2016. With the current healthy state of the economy and robust multifamily demand, this slowdown in supply could help rent growth in markets with heavier pipelines and rapidly decelerating rents.

Metros	Total Inventory as of 8/17	2017 Forecast Completions	2017 Completions % Change
National-All Markets	12,893,751	300,000	2.3%
Albuquerque	52,033	115	0.2%
Atlanta	415,331	8,526	2.1%
Austin	211,106	7,169	3.4%
Baltimore	214,236	4,037	1.9%
Birmingham	69,191	678	1.0%
Boston	206,172	5,739	2.8%
Bridgeport	125,804	2,633	2.1%
Charleston	54,123	3,162	5.8%
Charlotte	157,520	6,804	4.3%
Chicago	324,558	6,682	2.1%
Cincinnati	105,473	1,220	1.2%
Cleveland-Akron	155,105	1,647	1.1%
Colorado Springs	37,094	355	1.0%
Columbus	158,879	3,180	2.0%
Dallas	692,581	18,465	2.7%
Denver	242,756	13,051	5.4%
Detroit	206,349	724	0.4%
Houston	611,981	11,945	2.0%
Indianapolis	166,473	2,598	1.6%
Inland Empire	148,872	831	0.6%
Jacksonville	94,126	3,237	3.4%
Kansas City	145,058	2,759	1.9%
Knoxville	38,096	894	2.3%
Las Vegas	166,900	3,640	2.2%
Long Island	48,623	618	1.3%
Los Angeles	403,472	10,393	2.6%
Louisville	72,941	1,858	2.5%
Memphis	97,286	238	0.2%
Miami	263,622	11,236	4.3%
Milwaukee	77,122	2,368	3.1%

Metros	Total Inventory as of 8/17	2017 Forecast Completions	2017 Completions % Change
Nashville	117,675	6,302	5.4%
New Jersey-Central	121,406	1,550	1.3%
New Jersey-Northern	209,323	4,277	2.0%
New Orleans	54,375	518	1.0%
New York City	540,587	18,140	3.4%
Oklahoma City	100,139	1,473	1.5%
Orange County	193,930	4,043	2.1%
Orlando	198,269	5,375	2.7%
Philadelphia	280,071	4,151	1.5%
Phoenix	288,706	6,246	2.2%
Pittsburgh	86,361	821	1.0%
Portland	142,056	4,429	3.1%
Raleigh	141,665	4,577	3.2%
Richmond	208,462	3,228	1.5%
Sacramento	126,593	911	0.7%
Salt Lake City	87,372	3,489	4.0%
San Antonio	184,120	7,821	4.2%
San Diego	177,549	4,555	2.6%
San Francisco	242,286	4,911	2.0%
San Jose	118,722	3,204	2.7%
Seattle	222,516	10,302	4.6%
Southwest Florida Coast	57,578	1,812	3.1%
St. Louis	118,833	1,439	1.2%
Tacoma	62,983	381	0.6%
Tampa-St. Petersburg	201,994	6,076	3.0%
Tucson	66,514	287	0.4%
Twin Cities	194,037	5,740	3.0%
Washington, D.C.	495,104	9,374	1.9%
White Plains	65,028	867	1.3%
Winston-Salem	80,834	1,827	2.3%

Source: Yardi Matrix

National occupancy is high at 95.5%, indicating the market will absorb the new supply. Demand remains strong, so a peak in new deliveries in 2018 doesn't come with concern. Rent growth continues to decelerate as the market accepts new supply, with year-over-year growth of 2.4% as of August. Future rental demand looks strong, with the rental age cohort expected to grow in the coming years. Strong fundamentals combined with fewer completions may result in a short-lived deceleration in rent growth.



Though demand remains strong with a steady renter population and healthy economy, multifamily housing starts are declining due to a lack of construction workers and tighter profit margins for developers.

The Dallas Metroplex will have the most deliveries this year, with 18,400 new units coming online. Dallas has experienced solid employment, wage and population growth, and maintains its strong economy with companies relocating or expanding in the market. New York City—led by Brooklyn and Manhattan—follows closely behind Dallas, with 18,100 new deliveries expected in 2017. New York City—a landing point for many immigrants—has had limited supply growth over the years and is among the markets with the highest rents in the country.

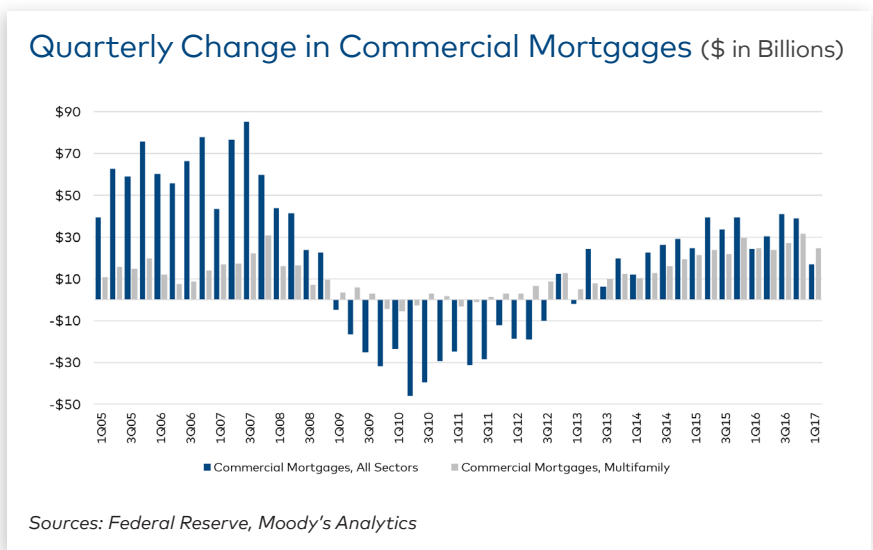
The markets with the most forecast completions as a percentage of existing stock include Charleston (5.8%), Denver (5.4%) and Nashville (5.4%). Charleston has had notable population growth, particularly among Millennials, driving demand for rental units. Occupancy hovers around 95%, and new supply will likely be absorbed, though some submarkets may fare better than others. Nashville's economy is booming, thanks to the emergence of health care and other knowledge-based industries, broadening the labor force and attracting highly educated workers to the market. Denver has also experienced substantial growth, and though there has been a threat of overbuilding, demand remains high as the population continues to soar with the expanding employment market, particularly in finance and tech. All three markets are expected to absorb the new supply, though rent growth will continue to decelerate with the increased competition in these markets.

Rent growth and occupancy are the highest in the Renter-by-Necessity asset class, as the majority of new supply has been added to the high-end lifestyle segment. As demand for affordable rentals continues to grow, rent and occupancy will remain strong among the lower asset classes.

Capital Markets

Real estate capital markets remain healthy as we move into the final months of 2017. Although the flood of equity capital is not as robust as it was during the high point of the cycle, particularly from outside the U.S., there is no shortage. The number of bidders for most properties has moderated, and buyers are being less aggressive, but on the whole investors remain committed to commercial real estate.

Debt capital continues to be plentiful, especially in the multifamily industry. Government-sponsored enterprises Fannie Mae and Freddie Mac are on pace for a record year in 2017, and banks and life insurance companies are eager to lend to multifamily investors, as apartments remain the most attractive real estate asset class. GSE reform may be debated in Congress before the year is out; however, with higher priorities such as the debt ceiling, hurricane relief funds and tax reform, the likelihood of any action related to the GSEs is quite small. As the GSEs remain in conservatorship of the federal government, the multifamily industry will continue to benefit from the liquidity Fannie Mae and Freddie Mac provide. With borrowing costs poised to remain low, investor sentiment will be strong throughout the fourth quarter.



The CMBS market is on track for an unexpected strong year, despite concerns going in that the new risk-retention regulations implemented as part of the Dodd-Frank Act would have a negative impact on issuance. The new rules that now require issuers to maintain 5% on their books has increased the cost of capital for investors, but the change has been modest. Through September 8, CMBS issuance was \$58.3 billion, up roughly 40% from the same period a year ago. Volume is likely to wind up between the \$75 billion floated in 2016 and the 2015 post-financial crisis peak of \$101 billion. As the final 2007 pre-recession CMBS loans known as the "wall of maturities" come due, the delinquency rate has ticked upwards, but has remained below 10% throughout 2017.

Commercial mortgage origination across asset classes decelerated swiftly in the first quarter, a trend that began early last year. For the first time since the third quarter of 2015, multifamily-specific mortgage origination also decelerated, according to the Federal Reserve. The overall trend in mortgage origination remains positive; however, recent indications show a softening demand for commercial mortgages.

Bank lending increased in the second quarter, with large national banks increasing their loan portfolios faster than medium-size regional and small community banks, according to Trepp. By category, medium-size banks increased their commercial mortgage holdings the fastest, especially in the South and West, while multifamily mortgages were led by all types of banks in different geographic regions.

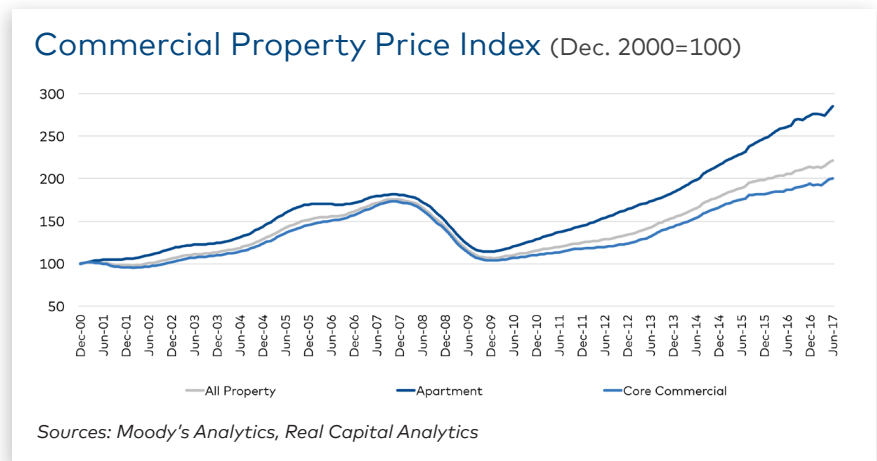
Large banks expanded their loan portfolios the fastest in the South, while the Midwest was led by community banks and the Northeast and West were dominated by medium-size banks.

Property values have flattened, although that's not necessarily a bad thing since they are at an all-time high. The Real Capital Analytics Commercial Property Price Index (CPPI) stayed

essentially flat from September 2016 through March 2017, but has shown signs of life through the summer, increasing 4% from March through June. The flattening of appreciation is in line with the cautious tone of the market. Many investors believe that the market is at or near a peak, and are reluctant to keep pushing the pricing envelope higher.

What's more, policy uncertainty continues as Congress struggles to pass legislation, and issues of importance to the market—such as the potential elimination of mortgage interest deductions and 1031 exchanges—are hard to handicap. Without a clear plan for tax reform in Congress, and with a multitude of other pressing issues to deal with—including hurricane relief—the chances of passing widespread tax legislation this year are low.

The capital markets remain strong, and many CRE players have been keeping their powder dry. As employment gains remain robust, the GDP shows signs of steady growth and federal legislation stalls, real estate investors are becoming more optimistic about market conditions. That could help boost transaction volume, which was down about 25% year-over-year through the first half. Supported by a strong and stable CMBS market, interested lenders on both the banking and life insurance sides, together with the continued presence of the GSEs, should support healthy transaction volume throughout the rest of 2017.



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Definitions

Lifestyle households (renters by choice) have wealth sufficient to own but have chosen to rent. Discretionary households, most typically a retired couple or single professional, have chosen the flexibility associated with renting over the obligations of ownership.

Renter-by-Necessity households span a range. In descending order, household types can be:

- A young-professional, double-income-no-kids household with substantial income but without wealth needed to acquire a home or condominium;
- Students, who also may span a range of income capability, extending from affluent to barely getting by;
- Lower-middle-income ("gray-collar") households, composed of office workers, policemen, firemen, technical workers, teachers, etc.;
- Blue-collar households, which may barely meet rent demands each month and likely pay a disproportionate share of their income toward rent;
- Subsidized households, which pay a percentage of household income in rent, with the balance of rent paid through a governmental agency subsidy. Subsidized households, while typically low income, may extend to middle-income households in some high-cost markets, such as New York City;
- Military households, subject to frequency of relocation.

These differences can weigh heavily in determining a property's ability to attract specific renter market segments. The five-star resort serves a very different market than the down-and-outer motel. Apartments are distinguished similarly, but distinctions are often not clearly definitive without investigation. The Yardi® Matrix Context rating eliminates that requirement, designating property market positions as:

Market Position	Improvements Ratings
Discretionary	A+ / A
High Mid-Range	A- / B+
Low Mid-Range	B / B-
Workforce	C+ / C / C- / D

The value in application of the Yardi® Matrix Context rating is that standardized data provides consistency; information is more meaningful because there is less uncertainty. The user can move faster and more efficiently, with more accurate end results.

The Yardi® Matrix Context rating is not intended as a final word concerning a property's status—either improvements or location. Rather, the result provides reasonable consistency for comparing one property with another through reference to a consistently applied standard.

To learn more about Yardi® Matrix and subscribing, please visit www.yardimatrix.com or call Ron Brock, Jr., at 480-663-1149 x2404.

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