PROFILE OF THE LOCAL APARTMENT MARKET

Market Area

The local apartment market is defined for this report as properties located in Sioux City and Sergeant Bluff, Iowa, South Sioux City and Dakota City, Nebraska, and North Sioux City and Dakota Dunes, South Dakota.

Submarkets

The Siouxland area offers a wide array of multi-family options – creating a diversified rental market with a multi-tiered development pattern targeted to the specific needs and income levels of various tenant groups. Apartment properties at the upper end of the local market include downtown apartments at the United Center and Virginia Square, plus high amenity suburban properties such as Sterling Green Estates and Dakota 303 at Dakota Dunes, which are targeted to young professionals, mature singles, empty nesters and snowbirds. Properties at the other end of the apartment market are numerous older Class C and Class D buildings in secondary locations and suffering from deferred maintenance and inadequate upkeep over the years.

The local market is also divided into several distinct submarkets, based upon geographic location and market orientation, and include the following:

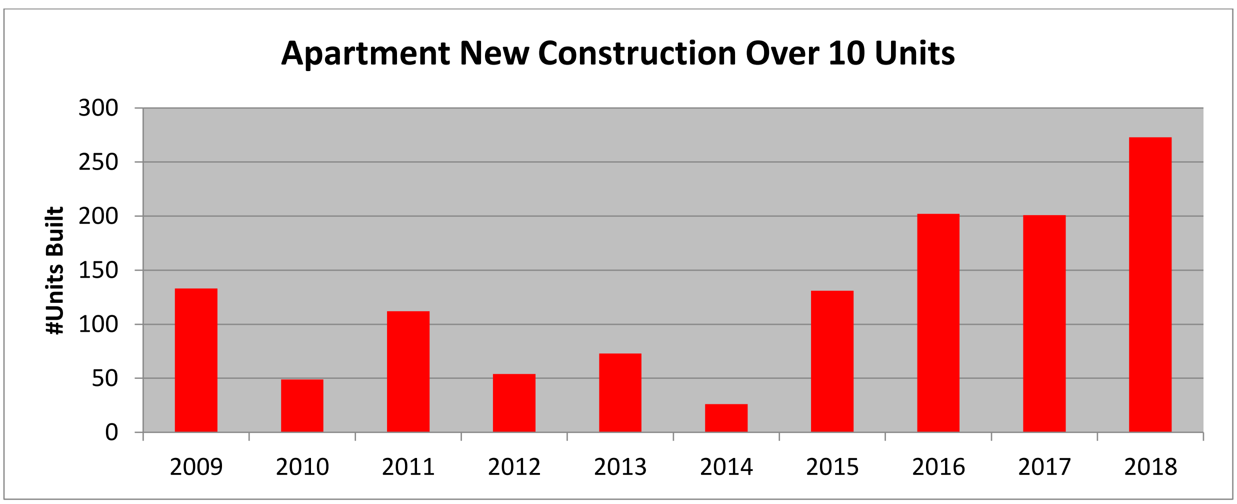
- **Market Rate Properties**
    - Northside
    - Morningside/Sergeant Bluff
    - Southern Union County
    - South Sioux City
    - Midtown
    - Westside/Riverside
    - Downtown
- **Low Income Housing Tax Credit properties**
- **Low income rent subsidized properties**

For the specific purpose of this study, the primary focus was placed upon market rate projects. Please also note that the Midtown market rate market consists mostly of properties built prior to 1950 that contain relatively small rental units and few amenities.

New Construction

Real estate construction often goes through recurring cycles starting with an initial development phase followed by an overbuilt period, and then gradual absorption during the stages of economic recovery. One of the most troubling aspects of many multi-family markets is non-rational competition. Developers often overbuild and lenders sometimes lend without consideration of supply/demand relationships. This has not typically been the case in the Sioux City area.

1,257 apartment units (ten units or larger) have been built in the tri-state metro area over the last ten years. The peak year was 2018 when 273 units were delivered, followed by 2016 with 205 units and 2017 with 201 units. Of the 1,257 units constructed since 2009, 69% were market rate apartments (863 units), 18% were tax credit (221 units,), 12% were senior independent living apartments (157 units), and 1% were HUD Section 8 elderly apartments (16 units).



Although the economic challenges impacting the nation also impacted the Siouxland area, construction activity did not drop dramatically during the Great Recession. Multi-family new construction totaled 112 new units in 2011, followed by 54 units in 2012, 73 new units in 2013 and 26 units in 2014. Traditionally, developers will stay on the sidelines until the apartment vacancy rate falls well below 10% – so the combination of a prolonged period of limited new construction and a large drop in the vacancy rate resulting from rising local employment set the stage for a new round of market rate construction beginning in 2015, when new construction increased to 131 units followed by 205 units in 2016, 201 in 2017 and 273 in 2018.

Over the past ten years the greatest share of construction activity was concentrated in the Sioux City/Sergeant Bluff market (832 units), but prior to the 2016-2018 period the Dakota Dunes/North Sioux City area had the largest share. No market rate apartments over 10 units have been built in South Sioux City since the 192-unit Arbors in 1998 (which was developed as a tax credit project and then converted to market rate units after a bankruptcy by the original developer). Federally subsidized or tax credit projects comprised 19% of market share of all multi-family construction over the past ten years, while construction in the senior independent living sector accounted for 12%.

Apartment New Construction by Submarket:

SUBMARKET	10 YR. # UNITS NEW CONST.	MARKET SHARE
• Market Rate Apartments	863	69%
• Sioux City/Sergeant Bluff	636	51%
• South Sioux City	0	0%
• Dakota Dunes/North Sioux City	227	18%
• Subsidized/Tax Credit Apartments	237	19%
• Sioux City/Sergeant Bluff	39	3%
• South Sioux City	96	8%
• Dakota Dunes/North Sioux City	40	3%
• Senior Independent Living Apartments	157	12%

Source: Tri-State Valuation & Consulting research

New Construction/Proposed Properties

Recently completed market rate properties include the 47-unit Dakota 303 at Dakota Dunes, 20-unit Creamery Building and 30-unit Hopper Building at Virginia Square in Downtown Sioux City, 225-unit Summit at Sunnybrook in the southeast Morningside area of Sioux City, 156-unit Riverbend Townhomes in Sergeant Bluff, and 72-units in the former Bekins warehouse building downtown, plus the 46-unit tax credit Aberdeen Apartments in the former Central High Annex building were completed in 2018.

Market rate projects that are proposed or under construction include 87 units in the Commerce Building in Downtown Sioux City and an additional 73 units at the Summit at Sunnybrook, plus 30 units in the former Hatch Furniture building and a new 45-unit building at Virginia Square downtown. In addition, a 39-unit tax credit project is proposed on the former site of West Middle School, and there is a long-range plan to renovate the former Methodist Hospital at 2825 Douglas into 69 market rate apartments.

Rental Rate and Vacancy Survey

The following rental and vacancy data was furnished by apartment owners and property managers, and was obtained through telephone interviews, e-mail correspondence and courthouse research. The survey was completed in mid-2018, and is not intended to be a complete inventory of local multi-family rental units, but rather is a representative sample of land properties, generally 20 units or more, in each of the respective submarkets. 42 market rate properties containing a total of ±3,600 rental units were surveyed.

Apartment Asking Rents, Growth Rates and Vacancies:

SUBMARKET	# PROPERTIES	TOTAL UNITS	# VAC. UNITS	% VAC. UNITS	1 BR AVG. RENT	2 BR AVG. RENT	3 BR AVG. RENT	% CHGE. 2017-2018
Market Rent								
Northside	8	995	22	2.2%	$741	$ 888	$1,007	+6%
Morningside/Sgt. Bluff	6	700	62	8.9%	$716	$ 845	$ 950	+3%
Union County	8	774	17	2.2%	$791	$ 973	$1,249	+1%
South Sioux City	6	554	15	2.7%	$669	$ 732	$1,043	+5%
Midtown	7	349	26	7.4%	$572	$ 650	$ 850	+4%
Westside/Riverside	2	160	11	6.9%	$663	$ 832	$ 950	+3%
Downtown	5	73	4	5.5%	$963	$1,016	$ --	+3%
Market Rate Total/Avg.	42	3,605	157	4.4%	$731	$ 848	$1,008	+4%

Source: Tri-State Valuation & Consulting research

Rents: Apartment rents did not decline during the 2008-2010 national recession, in contrast to many other property types, and the recent trend of most apartment rents has generally exceeded the rate of inflation and increased property operating costs. Most quoted rents for modern market rate units now range between $600 and $975 per month for a one-bedroom unit, $700 to $1,200 for a two-bedroom apartment, and $800 to $1,500 for a three-bedroom unit. A typical lease is one year with some special move-in promotions or free rent (typically one month) in a few properties.

Rental rates go up and down over the years depending on the level of demand, and often change at a different rate than property values, but have generally increased for all unit types and all locations in recent years. Rents increased an average of nearly 6% in market rate properties between mid-2014 and early 2016. The rate of increase slowed to only ±2% between 2016 and 2017, but the average increase was nearly 4% between 2017 and 2018, and most local properties are continuing to increase their rents at a moderate pace.

Location often explains more of the variation in rental rates than any other characteristic. The lowest apartment rents are generally in the South Sioux City and Midtown submarkets, while the highest median rents are Downtown and at Dakota Dunes.

Vacancy Rates: Overall apartment vacancy rates in the Sioux City area have varied greatly over the years, depending primarily upon local economic factors and the pace of new construction. Vacancies have generally remained low over the last few years due to the limited amount of new construction combined with an influx of job seekers to fill positions created by expanding local employers and for major construction projects, and the overall apartment vacancy rate fell to only ±2% by early 2016.

The completion of the CF Industries construction project, combined with the construction of an increasing number of new market rate units, resulted in an increase in the overall vacancy rate in 2017. However, a mid-2018 survey of ±3,600 market rate units indicated that the current overall vacancy rate was approximately 4%, which is a decline from a ±8% overall average in 2017, and demonstrates that local job growth has been resulting in sufficient demand to keep pace with the increasing supply. A sampling of other properties since the date of survey indicate that overall vacancy levels have not changed significantly since mid-2018.

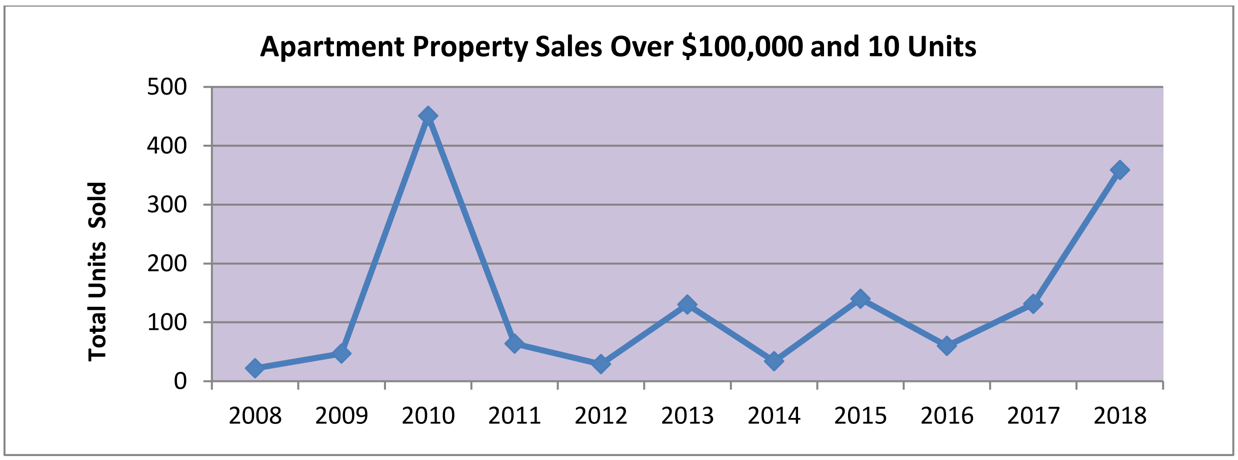
Property Values

There is a wide gap in the quality of the multi-family properties that have sold. Many older facilities are still profitable for their owners, but they tend to lose significant value relative to that of newer apartment buildings with little or no deferred maintenance and modern kitchens.

The Siouxland area has not historically experienced an active multi-family investment market, with very few Class A asset sales. Most trading activity has been in the lower half of the market. The most significant transactions over the last two years include the early 2018 sales of the 160-unit Morningside Country Estates for $7,850,000 and a 48-unit property on Lincoln Way for $2,800,000.

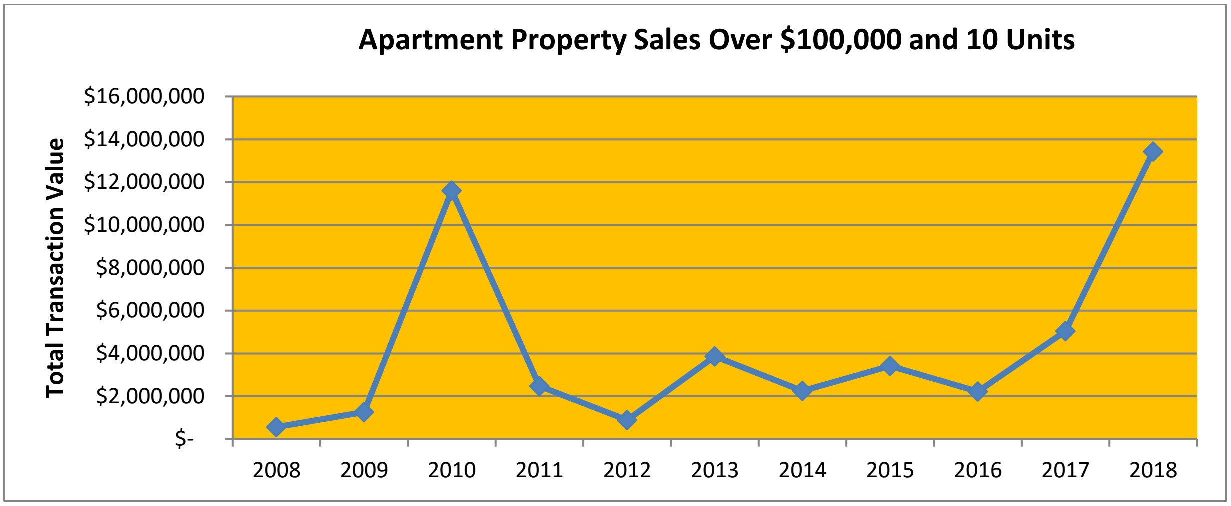
Apartment Property Sales Over $100,000 and 10 Units:

YEAR	# SALES	# UNITS SOLD	AGGREGATE PRICE	MEDIAN PRICE/ UNIT
2008	2	22	$ 560,000	$24,709
2009	2	47	$ 1,265,000	$22,590
2010	5	451	$11,595,000	$28,490
2011	3	64	$ 2,472,500	$46,875
2012	2	29	$ 885,000	$29,532
2013	3	130	$ 3,860,000	$28,571
2014	3	34	$ 2,240,000	$68,750
2015	4	140	$ 3,415,000	$18,304
2016	3	60	$ 2,220,000	$37,000
2017	3	131	$ 5,043,395	$38,499
2018	7	359	$13,422,000	$32,650



Source: Tri-State Valuation & Consulting research

The total dollar volume of apartment property sales over $100,000 and ten units was just $885,000 in 2012, but increased to $3,860,000 in 2013. Three properties containing a total of only 34 units sold in 2014, but the median sale price per unit was very high due to the sale of two high quality properties. Four properties with a total of 140 units sold in 2015, and the much lower median sale price is indicative of the fact that three of the sales were old Midtown apartment buildings. Only three properties containing a total of 60 units sold in 2016, and three properties containing a total of 131 units sold in 2017, but market activity increased significantly in 2018, with 7 sales and a total transaction volume of $13,422,000.



Source: Tri-State Valuation & Consulting research

The data does not indicate a clear price trend, but the 2018 transactions indicate a significant increase in values over the last few years.

Existing Housing Units, Tenure and Vacancy

According to the 2010 U.S. Census there were 68,633 housing units in the Sioux City MSA, and 65% of occupied housing units were owner-occupied. Comparatively, ±64% of new residential units built over the last decade were owner-occupied, but ±53% of new construction in 2016-2017 consisted of apartments 5 units or larger. Site to Do Business estimates that the number of housing units as of early 2018 was 70,931. ***Based upon construction trends over the last year, the current total number of housing units in the Sioux City MSA is estimated to be approximately 71,400.***

Demolitions

The local housing stock is aging, with over one-third of the homes in the Sioux City area constructed prior to 1950. A large number of older residential dwellings and conversions were demolished in central Sioux City locations over the last decade due to their extremely poor condition, and/or to make way for new development projects, with an average of 40 to 50 housing units per year demolished in the City of Sioux City alone. However, demolitions are expected to decline due to a new city-wide program that provides greater financial incentives to investors who rehabilitate old structures.

Demand for Housing

The demand for housing is best measured on the basis of population and household growth, and is generated from three forces:

(1) Internal Mobility: Existing households expanding or contracting their living requirements, or moving to a more convenient/desirable location within the Sioux City MSA.

(2) Replacement Demand: Existing households being forced to relocate due to demolition, change in property use, etc.

(3) Derived Demand: New households created from within the community, or people moving to the Sioux City area from other areas.

Most of the demand in the Sioux City area has historically resulted from a combination of internal mobility (i.e. households relocating from other areas in the Sioux City MSA) and from derived demand (i.e. households relocating from other areas outside the MSA for employment opportunities).

The following projections estimate that effective demand for apartments will account for 35% of the total new housing units to be constructed in the local market (similar to historic ratios). A maximum demand of ±1,150 new apartments over the next five years assumes 2.59 people per household (the current local average), a 1.0% per year population increase, a 6% vacancy rate to maintain competitive choices in the marketplace, and a demolition allowance of 40 units per year to replace demolished dwelling units. Stable population and a 6% vacancy rate still produces an effective demand for ±30 new apartments per year.

Five Year Projected Demand for New Homes:

	MOST OPTIMISTIC	MOST PESSIMISTIC
Anticipated Population Gain/Loss Per Year	+1.0%	- -
Estimated 2019 MSA Population	175,000	175,000
Estimated 2024 MSA Population (Rd)	184,000	175,000
Household Demand @ 2.59 People (Rd)	71,000	67,600
Shift in Tenure	- -	- -
MSA Vacancy Factor @ 6%	4,260	4,056
Demolition Allowance (Replacement)	200	200
Total MSA Housing Units Needed (Rd)	75,500	71,900
Total MSA Housing Units available (current estimate)	-71,400	-71,400
Total New Housing Units required in the Sioux City MSA	4,100	500
Percent of New Housing Units to be developed in Sioux City and Sergeant Bluff, Iowa, South Sioux City, Nebraska, and southern Union County	x 80% 3,280	x 80% 400
Percent attributable to rental apartments	x 35%	x 35%
Estimated demand for rental apartments (Rd)	±1,150	±140
Average per year (Rd)	±230	±30

Source: Tri-State Valuation & Consulting, U.S. Census Bureau, Site to Do Business

The previous estimate reflects the likely level of demand for housing in the Sioux City MSA as a whole, but does not distinguish between locations. Housing growth areas, such as Southern Union County, Downtown, and Southeast Morningside, are likely to continue to experience an increase in demand for housing even if the MSA as a whole does not continue to grow.

Conclusion – Market Trends

- **New Construction:** Construction activity has increased significantly over the last few years and additional projects are either under construction or proposed.
- **Vacancy Rates:** There are several additional apartment properties under construction or proposed, but a significant increase in vacancies is not expected because the number of new units projected to come on-line over the next two years

is relatively modest based upon recent and anticipated absorption trends. In addition, if mortgage interest rates continue to increase some prospective entry level home buyers will be pushed out of the market and will be forced to continue to rent, which would also have a positive influence on apartment demand.

- **Asking Rents:** There has been a clear upward trend in recent years as landlords have profited amid a combination of only modestly growing supply and strong demand, and rents are likely to continue to increase at a moderate pace.

- **Property Values:** Market fundamentals suggest that apartment property values are likely to remain stable to slightly increasing in the near term, unless interest rates rise dramatically and result in significantly higher overall cap rates.

VACANCY AND COLLECTION LOSS ESTIMATE

Average vacancy rates in apartment properties in the Sioux City area have historically ranged from 5% to 15% depending upon location, condition, market conditions, etc., with the strongest demand in well-maintained moderately priced properties. Vacancies declined significantly in most properties over the last several years due to strong demand for housing resulting from new and expanding local businesses, combined with limited new apartment construction, and the overall local apartment vacancy rate reached a low of only 2% by mid-2016.

Vacancies rose in 2017 due to the completion of the CF Industries and Seaboard-Triumph Foods construction projects, which required housing for a large number of temporary workers, and a comprehensive survey of ±3,600 market rate rental units that was completed in mid-2017 indicated that the overall vacancy rate was ±8%. However, a mid-2018 survey of a similar number of units indicated that continued job growth resulted in the absorption of many of the vacant units because the overall vacancy rate had declined to only ±4%, despite the construction of a relatively large number of new units over the last two years.

The subject property itself had only one vacant unit at the time of inspection (±1% vacancy rate) and the comparable rental properties analyzed in this reported the following vacancy rates, according to the property managers:

Property Name	# Units	# Vacant	% Vacant
Country Club Apartments	88	2	2%
Candlewick Apartments	168	3	2%
Ridge Oaks Apartments	132	4	3%
Indian Hills Apartments	120	4	3%
Valley Park Apartments	150	3	2%
Glen Oaks Apartments	144	3	2%
Total/Average	802	19	2%