



MIDYEAR 2022
Special Report

National multifamily outlook

Some adjusting of expectations in the second half

Northmarq

COMMERCIAL REAL ESTATE

Debt & Equity

Investment Sales

Loan Servicing

AT A GLANCE

KPI snapshot

ECONOMY

Trends in the economy have been mixed to this point in 2022. The labor market has remained tight, employers are adding workers, unemployment is near all-time lows, and wages are on the rise. The primary stress in the economy is inflation, which has dragged down consumer sentiment and is prompting the Federal Reserve to raise rates to curb demand.



8.5%

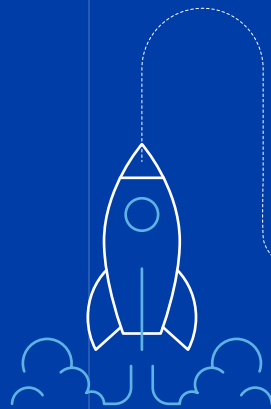
INFLATION

As of July 2022, consumer prices had posted some of their fastest increases in more than 40 years.

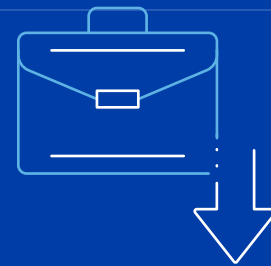
+3.2M

JOBS ADDED YTD

Employers continue to add workers, although gains slowed in the second quarter and further cooling is likely in the second half of 2022.



3.5%



UNEMPLOYMENT RATE

Low unemployment has led to higher wages, which has somewhat offset the impact of rising prices.

The primary stress in the economy is inflation, which has dragged down consumer sentiment and is prompting the Federal Reserve to raise rates to curb demand.

PROPERTY PERFORMANCE

Demand remains elevated for apartment properties. The vacancy rate has inched lower, even as the pace of new development has accelerated. Rents spiked last year and have continued to push higher thus far in 2022.



4.2%

VACANCY

Vacancy dropped 20 basis points in the first half of this year and should remain flat in the coming quarters.

+9.8%

RENT GROWTH YOY

Additional rent growth is forecast for the second half, but the pace of increases will be more modest.



750k



UNDER CONSTRUCTION

Developers are responding to strong renter demand by moving more projects into the construction pipeline.

INVESTMENT MARKET

After sales velocity spiked at the end of 2021, the investment market remained active in the first half. Transaction counts are up year-over-year and cap rates have remained low. Some cooling has been recorded at the start of the third quarter as buyers and sellers adjust to new pricing.



+12%

TRANSACTIONS

Investors continue to allocate capital to multifamily assets, and more properties traded in the first half of 2022 than changed hands in the same period one year earlier.

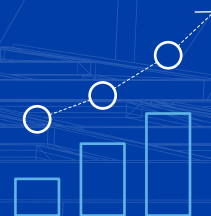
\$267k

MEDIAN PRICE PER UNIT

Rapid rent growth and tight vacancy conditions have supported prices. The median price is up about 5 percent from 2021 levels.



4.2%



AVERAGE CAP RATE

With interest rates on the rise, cap rates have ticked up from 2021 levels. Cap rates averaged 4.2 percent in the first half.

Introduction

AS RATES RISE AND THE ECONOMY COOLS, WILL APARTMENT PROPERTIES CONTINUE TO OUTPERFORM?

+ Multifamily properties reached unprecedented heights in 2021, with record levels of absorption driving vacancies lower and rents posting double-digit percentage rate gains. Momentum in the national multifamily market was sustained in the first half of 2022, although there are headwinds as the outlook turns towards the end of the year. Inflation is proving to be a persistent challenge, and rising price levels spill over into nearly every segment of the economy, including the rental markets.

+ The Federal Reserve is walking the fine line of trying to combat inflation without stalling the economy. This balancing act has introduced greater volatility into the economy and the multifamily market than was present at the beginning of the year. Uncertainty does not necessarily signal declining market performance. COVID presented a tremendous amount of uncertainty in the multifamily market and ended up sparking some of the strongest property performance in a generation.

Investors are responding to the changing conditions by taking a somewhat more cautious approach than during the previous 18 months. By any measure, multifamily properties are performing quite well across the country. Many major markets have recorded double-digit rent growth during the past year, and most vacancy rates are about 100 basis points lower than long-term averages. While this recent market performance buoys sentiment, investors and operators looking ahead see a more uncertain outlook.

Some of this uncertainty is the natural result of the rapid growth recorded in 2021. A year of record-setting rent gains, heightened competition for apartment properties, and very accommodative capital providers propelled the investment market. Transaction volume surged, prices spiked, and cap rates compressed. These conditions propelled the market, but could not reasonably be expected to continue for an extended period.

These trends have also sparked a wave of new development, particularly in Sunbelt markets. The next few years will be active ones for deliveries, potentially creating some supply-side pressures in previously under-supplied markets.

Cap rates remained low during the first half of 2022, but with interest rates trending higher and greater economic unpredictability present, it is hard to see how yields on multifamily properties can remain near all-time lows. In the interim, there will likely be a period of a quarter or two where buyers, sellers, and all participants in the capital markets adjust expectations.

In this special report, we will assess the current state of the multifamily market and identify key themes that will drive property performance and investment trends through the remainder of this year. The outlook for the sector is positive, although there are a greater number of challenges present today than at the beginning of the year.

There will likely be a period of a quarter or two where buyers, sellers, and all participants in the capital markets adjust expectations.

The economy

LABOR MARKETS GROWING STEADILY, INFLATION ELEVATED AND PERSISTENT.

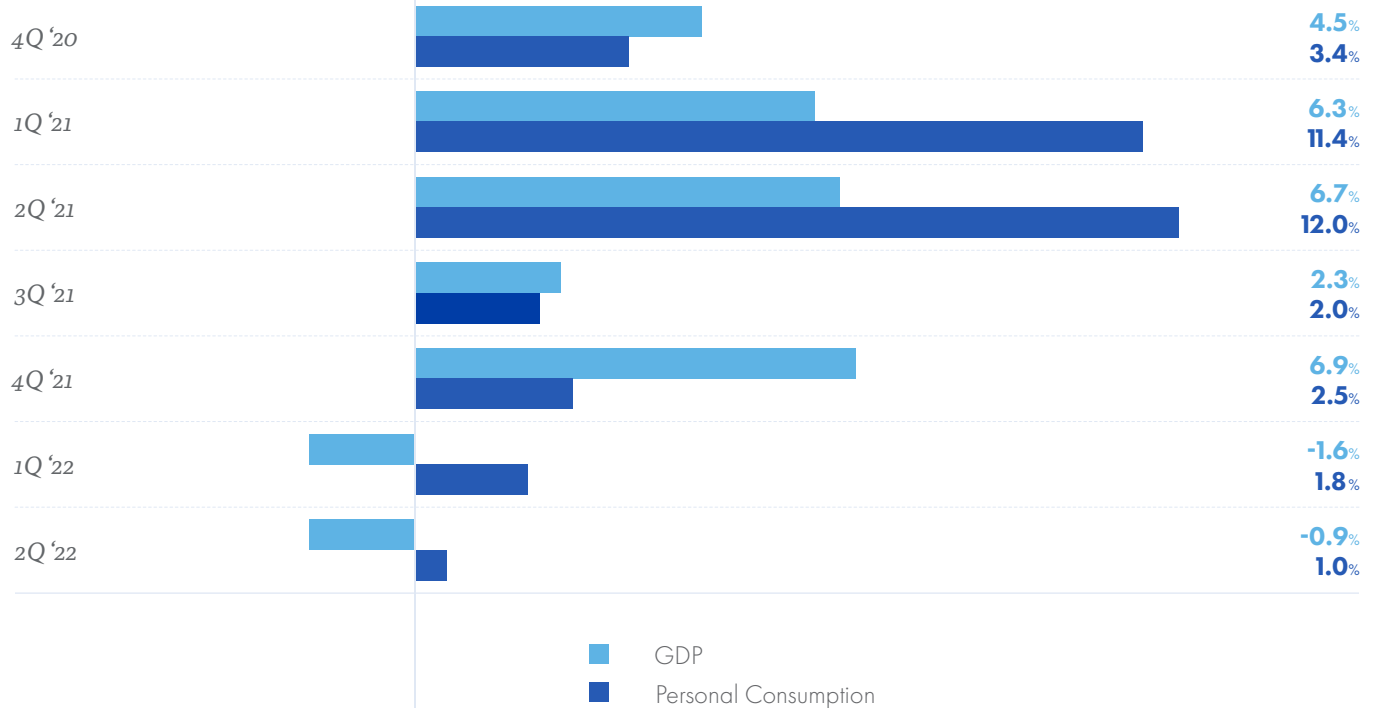
The U.S. economy fared better than much of the industrialized world in the first half of 2022, but global events have dragged on the domestic outlook. Supply-chain challenges were among the first sets of disruptions to hit the economy at the end of last year, and additional global events have impacted the economy in the first several months of this year.

Russia's invasion of Ukraine—and the sanctions that followed—restricted the flow of energy supplies and pushed fuel costs higher around the globe. The impact of rising fuel prices has a particularly significant impact on the economy as costs spill over to the manufacturing, transportation, or distribution of nearly every product.

These inflationary pressures came at a time when prices were naturally pushing higher in response to a release of pent-up demand. Consumers with healthy household balance sheets and accumulated gains in the housing and equity markets began 2022 looking to go out and spend after having consumption artificially weighed down by COVID.

Personal consumption spiked by nearly 8 percent in 2021, outpacing GDP growth by more than 200 basis points. Just as the consumer was moving off of the sidelines, prices for nearly every item in their basket of goods started to push higher.

ECONOMIC GROWTH SLOWING SINCE 2020



Personal consumption spiked by nearly 8 percent in 2021, outpacing GDP growth by more than 200 basis points.

While the coronavirus—and subsequent variants—dominated the economic news beginning in the first few months of 2020, that impact has waned considerably in the past year. Uncertainty persists however, with inflation, the reality of slower growth, the possibility of recession, and higher interest rates now taking center stage among the list of factors that will influence the economy as a whole and property markets specifically. The following paragraphs will outline some of the key economic data points and how they are expected to perform through the remainder of the year. That examination will then lead to an analysis of and our expectations for the multifamily property sector.

INFLATION

Consumer prices have been trending higher for more than a year, but the rapid pace of inflation recorded in recent months is stressing the economy. After inflation was running at a rate below 1.5 percent at the end of 2020, pressures first began to emerge early in 2021, when the economy started to fully reopen. At that point, several rounds of stimulus had been distributed and millions of people who had been essentially on lockdown for about a year began shopping, dining out, and traveling again.

Annual rates of inflation averaged 5.3 percent from May through September last year before spiking beginning in the fourth quarter. Inflation topped 6 percent last October and reached 7 percent by December. The initial thought was that rising prices were “transitory,” but that view gave way when oil prices spiked following the Russian invasion of Ukraine.

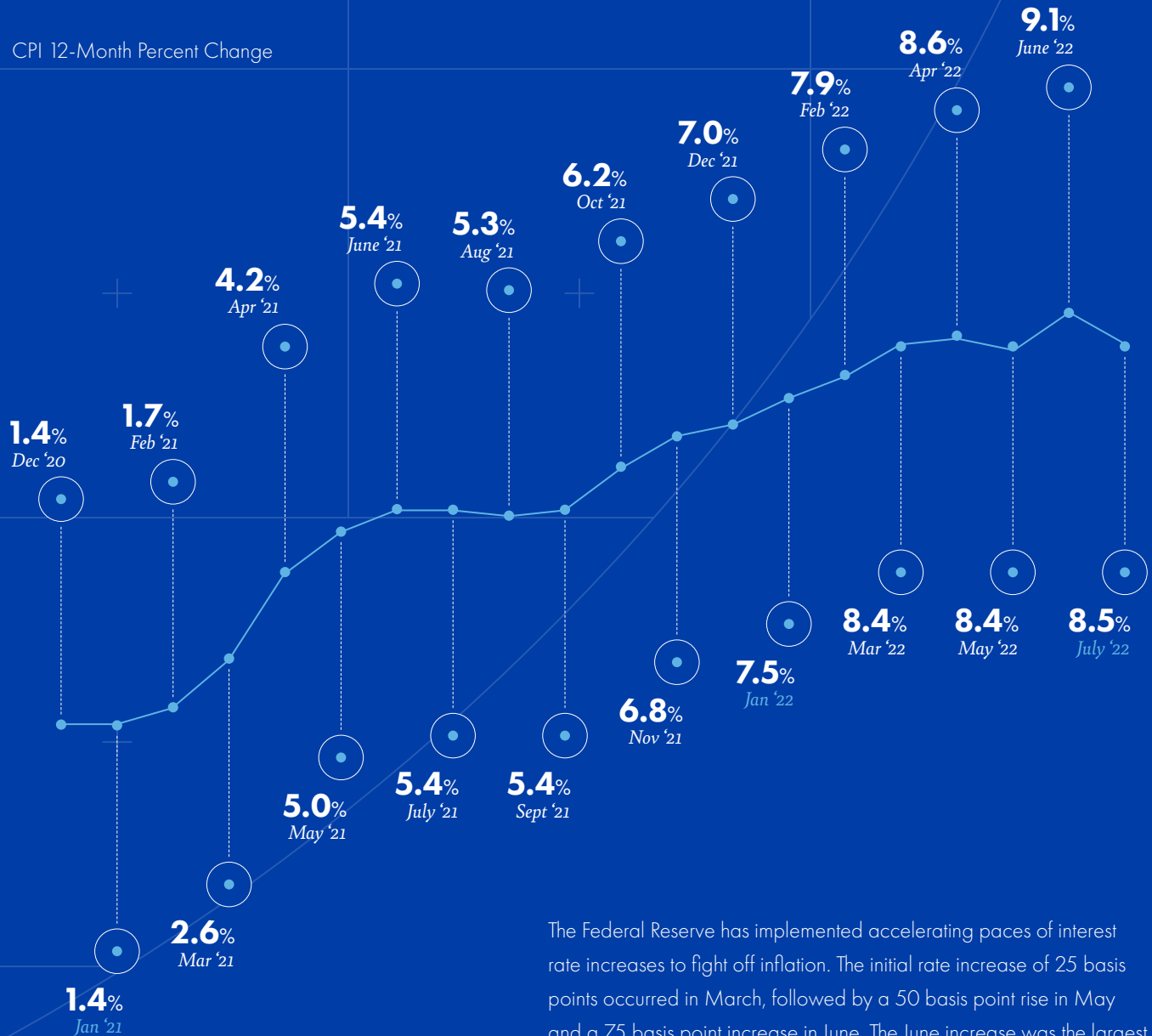
Inflation has now reached 40-year highs, with annual rates of increase spiking above 8 percent in each monthly reading since March, before topping 9 percent in June. The trend of rising prices continued at the outset of the second half; CPI was up 8.5 percent year over year as of July.

Year over year, groceries and gasoline have posted some of the fastest price spikes. Food and energy costs are traditionally some of the most volatile prices and these are often the inputs that consumers notice immediately, dragging down sentiment and restricting discretionary spending. In the latest monthly readings, gasoline costs are up nearly 45 percent from one year ago, while food prices are up more than 10 percent. Some modest relief appears to be in sight; gasoline prices trended lower from June to July, although food costs continued to trend higher.

The initial thought was that rising prices were “transitory,” but that view gave way when oil prices spiked following the Russian invasion of Ukraine.

INFLATION'S UPWARD CLIMB FROM NON-ISSUE TO PRESSING CONCERN

CPI 12-Month Percent Change



The Federal Reserve has implemented accelerating paces of interest rate increases to fight off inflation. The initial rate increase of 25 basis points occurred in March, followed by a 50 basis point rise in May and a 75 basis point increase in June. The June increase was the largest upward move in the benchmark rate since 1994. In July, the Fed raised rates an additional 75 basis points and the central bank has signaled at least one more interest rate increase is likely before year end.

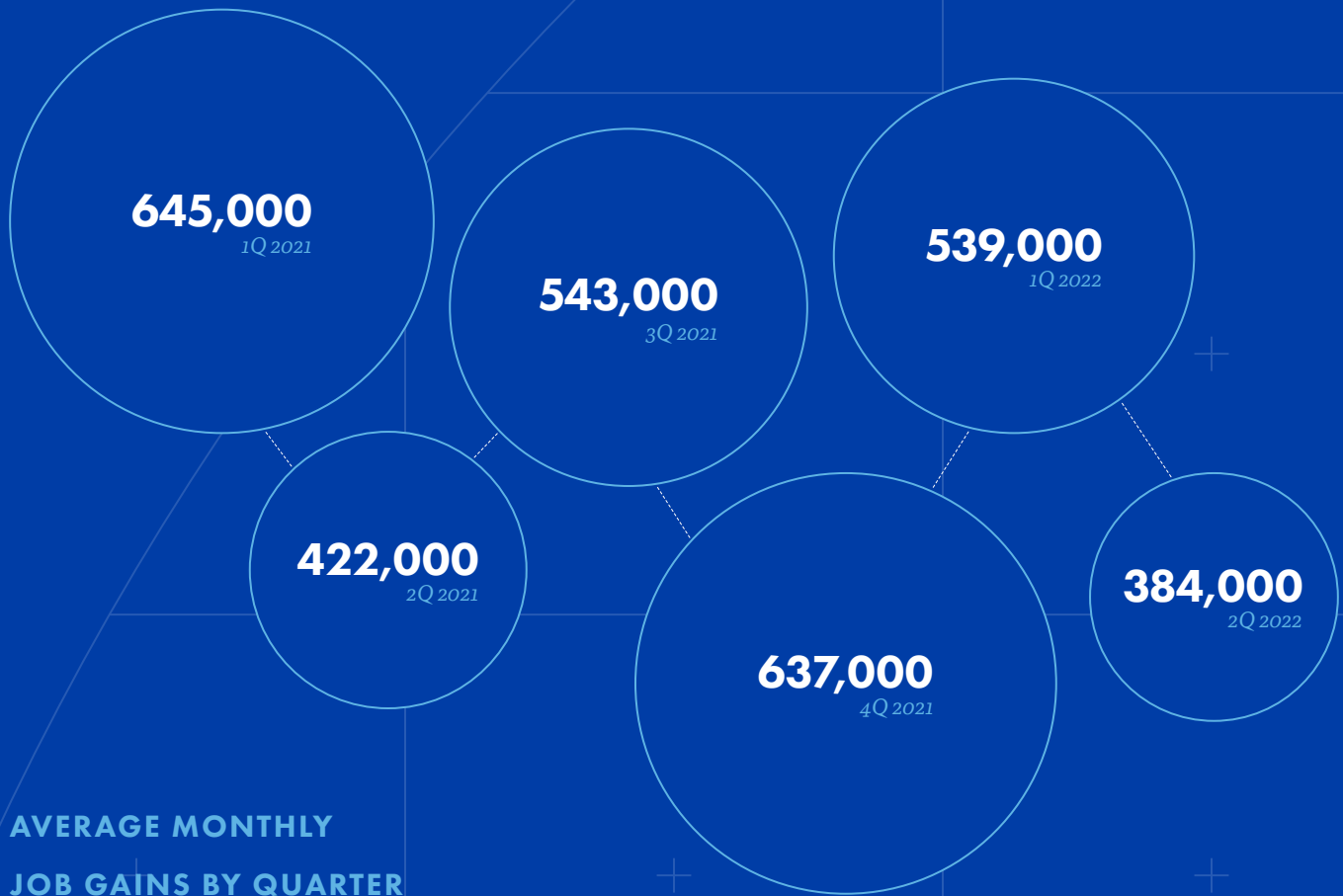
Sources: Northmarq, Bureau of Labor Statistics

EMPLOYMENT

While there is volatility in the larger economy, the employment market has proven to be particularly stable through the first half. Employers added more than 2.7 million jobs in the first six months of the year, including more than 1.1 million jobs created during the second quarter. Current employment totals surpassed the pre-COVID peak with the addition of more than 500,000 jobs in July.

The labor market has remained tight to this point in 2022, with unemployment averaging about 3.7 percent during the first half. The July rate of 3.5 percent matched the generational low recorded a few years ago.

The combination of low unemployment, an elevated number of openings, and a rapid pace of hiring has resulted in upward pressure on wages. As of July 2022, average wages had increased by 5.2 percent year over year, although the pace of growth was leveling off, having retreated from a 5.6 percent reading in March.



**AVERAGE MONTHLY
JOB GAINS BY QUARTER**

Sources: Northmarq, Bureau of Labor Statistics

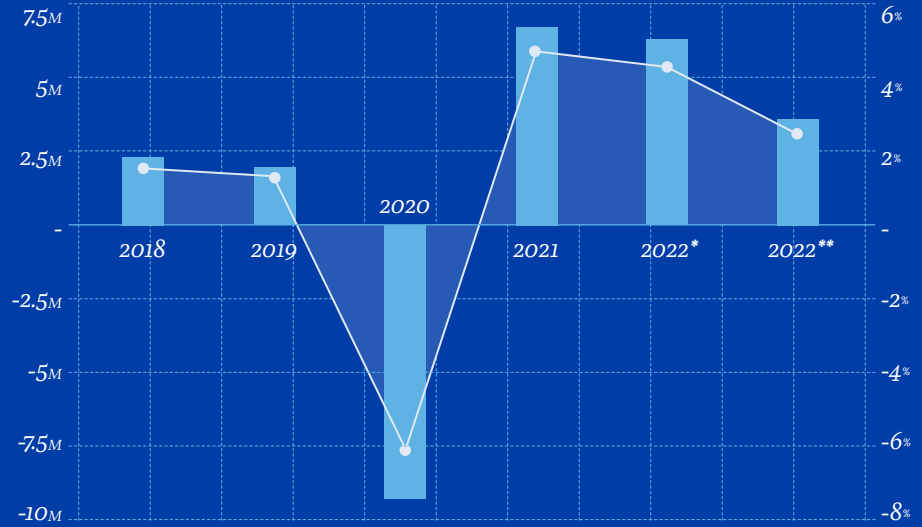
ANNUAL EMPLOYMENT CHANGE

- Jobs Gained/Lost
- Annual Change %

*Year-over-year change through June 2022

**Year-end forecast

Sources: Northmarq, Bureau of Labor Statistics

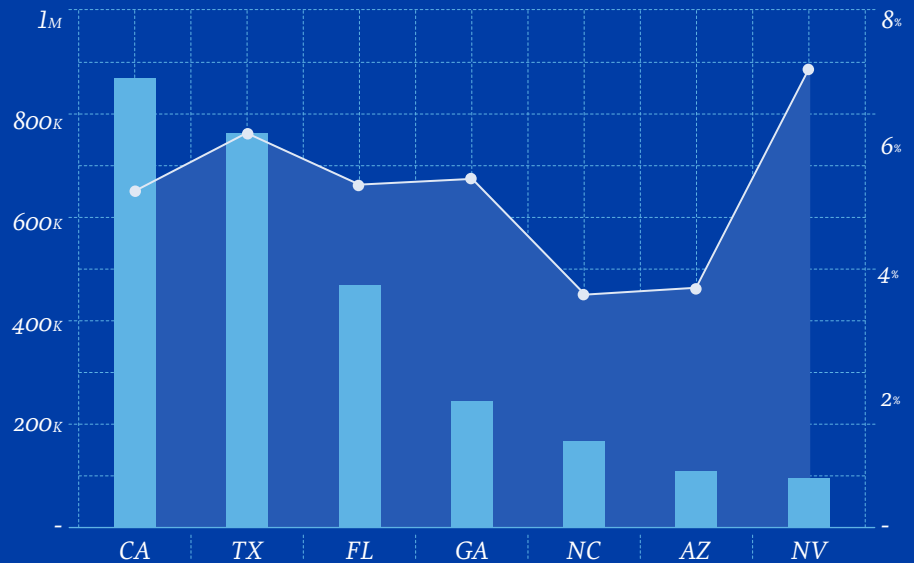


TOP STATES FOR JOB GROWTH*

- Job Growth
- Annual Change %

*Year-over-year change through June 2022

Sources: Northmarq, Bureau of Labor Statistics



While the labor market is recovering, there are a few necessary notes of caution. First, employment is generally seen as a lagging economic indicator and not the best predictor of what lies ahead. Second, prior to the July spike, the pace of job growth had been slowing. Employers added more than 540,000 jobs per month from 2021 through the first quarter of this year. During the second quarter, monthly job growth averaged 384,000 positions.

Looking ahead, businesses are expected to become more cautious, and growth in the second half is forecast to retreat closer to the longer-term trend of about 150,000 jobs added per month. A handful of large employers have indicated they plan to hire less aggressively than originally anticipated. Some industries will likely record layoffs, but on the whole, the labor market is forecast to end the year on stable footing.

Multifamily operating conditions

VACANCY

VACANCY REMAINED
LOW IN THE FIRST HALF

Strong demand conditions have remained in place through the first half of this year, with the vacancy rate inching down 20 basis points to 4.2 percent. Year over year, vacancy has dropped 60 basis points, fueled by persistent absorption of units.

While operating conditions are healthy, it is unlikely that the vacancy rate will trend much lower in the coming quarters. More likely, the rate will remain fairly close to current ranges or could creep higher, particularly in markets where the pace of deliveries rebounds after minimal construction activity in recent years. In the near-term, the slowing pace of employment growth should result in a more measured rate of new household formation and absorption of units.

Another factor that could drag on absorption in the second half of this year is doubling up, where renters add roommates. The rapid escalation in rents in recent years has increased the number of cost-burdened renters. Nearly half of all renter households spend more than 30 percent of their incomes on rent,

with about one quarter of renter households spending more than 50 percent of monthly incomes on rent. With the economy slowing, and prices rising across the board, some current renters may conclude sharing an apartment unit with a roommate may be the best way to offset rising costs.

The slowing pace of employment growth should result in a more measured rate of new household formation and absorption of units.



*Year-end forecast
Sources: Northmarq, CoStar, Reis

CONSTRUCTION

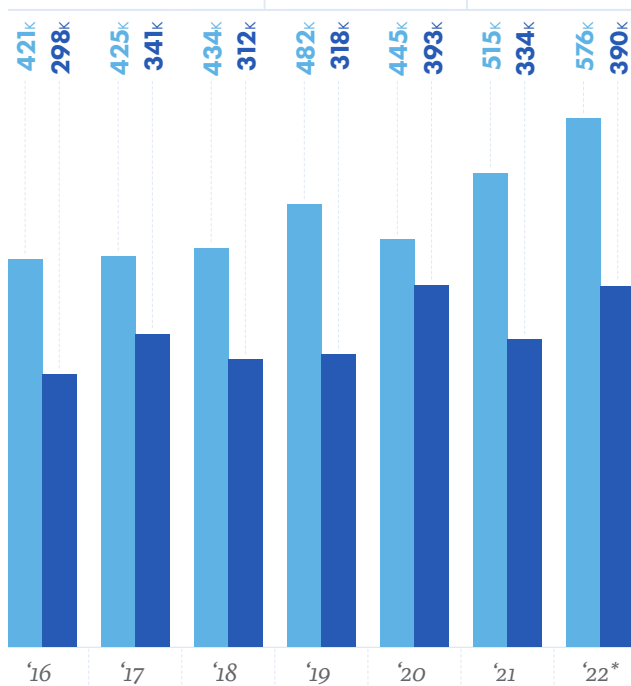
DEVELOPERS BRINGING NEW PROJECTS ONLINE TO MEET DEMAND

Another factor bringing supply and demand closer to equilibrium in the second half of this year should be an accelerating pace of new construction. Several high-growth markets have been undersupplied for the past several years, and the economic turbulence and supply-chain bottlenecks that have occurred in recent years only exacerbated the supply-demand imbalance.

Apartment construction is forecast to be elevated at least into 2024 as developers move projects through the pipeline. Projects totaling more than 750,000 units are under construction across the country, up more than 20 percent from 2020 and 2021 levels.

Projects totaling more than 750,000 units are under construction across the country.

Construction timelines have been extended, and projects that are under construction will be delivered over the next several quarters. Projects totaling approximately 390,000 units are slated to come online in 2022, with a similar total anticipated for next year.



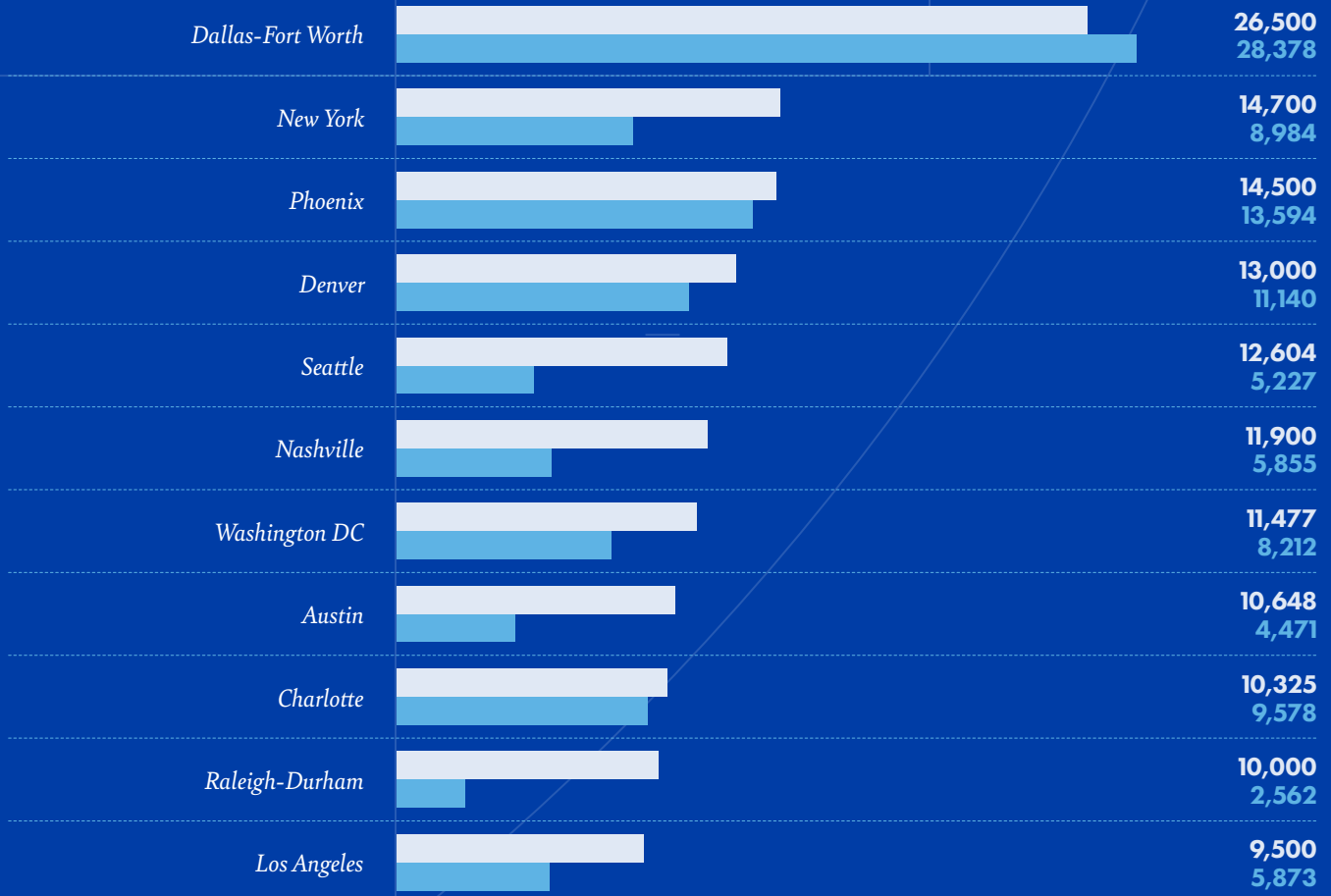
MULTIFAMILY CONSTRUCTION STARTS + COMPLETIONS

- Multifamily Permits
- Completions

*Year-end forecast

Sources: Northmarq, Census Bureau, CoStar, Reis

MULTIFAMILY CONSTRUCTION FORECAST BY METRO AREA



- 2022* Forecast
- 2021 Completions

Several markets are expected to record steep increases in deliveries in 2022, after below-average construction totals from 2020 and 2021 when projects were stalled by COVID-related forces. At the market level, there will likely be a few instances where the influx of new supply pushes vacancy rates higher, but in most cases, this will be a short-term change of direction after several years of tightening vacancy rates.

*Year-end forecast

Sources: Northmarq, Census Bureau, CoStar, Reis

RENTS

HEALTHY GAINS

CONTINUED IN FIRST HALF

Rents remained on an upward trajectory during the first half of 2022, although the pace of increases lagged heightened levels recorded last year. During the first half, rents rose 4.3 percent, including a 2 percent increase in the second quarter. This follows gains of over 5 percent in both the first half and second half of last year.

Year over year, rents have spiked 9.8 percent, following a 10.6 percent gain in 2021. Rents are up approximately \$150 per month from one year ago, after annual increases averaged about \$50-\$75 per month in the years leading up to 2020.

Rents are expected to continue to push higher in the second half, but the pace of increases will likely be closer to historical norms. Average rents are forecast to advance by about 2.7 percent in the second half of the year, bringing the total gain for all of 2022 to approximately 7 percent.

Rents are up approximately \$150 per month from one year ago, after annual increases averaged about \$50-\$75 per month in the years leading up to 2020.

One factor supporting continued rent increases in the second half of this year is the rising cost of for-sale housing, specifically, the increase in mortgage rates. Renters who began 2022 thinking about transitioning into home ownership are now finding 30-year mortgage rates that are up about 200 basis points from levels at the beginning of the year. The increases in mortgage rates widen the gap in the "rent vs. own" debate and allow operators more room to boost rents, particularly at the high-end of the market.

ASKING RENTS + ANNUAL CHANGE FORECAST



*As of 2Q 2022

** Year end forecast

Sources: Northmarq, Census Bureau, CoStar, Reis

Year over year, rents have spiked 9.8 percent, following a 10.6 percent gain in 2021.

Investment market

ACTIVITY LEVELS

TRANSACTIONS AHEAD OF LAST YEAR'S PACE

Monthly investment activity in multifamily properties has been fairly steady throughout 2022. Sales velocity in the second quarter was nearly identical to levels recorded in the first three months of the year, despite the volatility in the economy and the increasing costs of capital.

Total transaction activity in the first half of 2022 was up 12 percent from the same period in 2021. The cyclical peak in transaction volume occurred during the fourth quarter of last year, and while velocity has not matched those levels in 2022, investors have continued to buy and sell apartment properties.

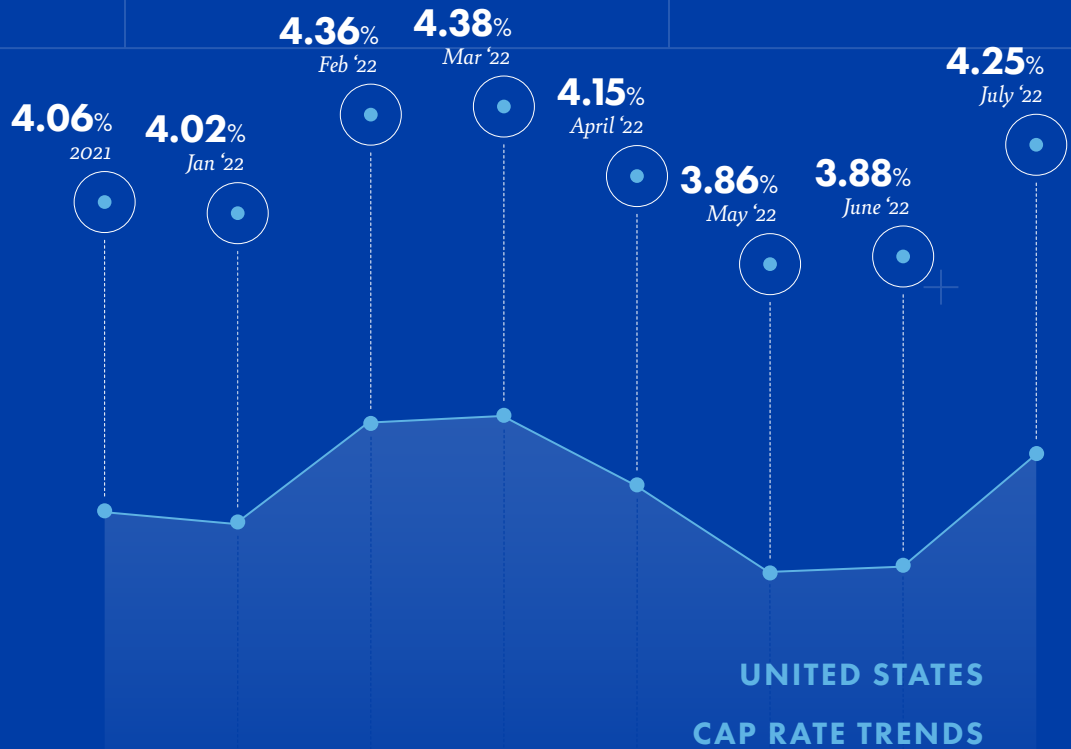
At the start of the second half, there are some conflicting forces that will likely influence sales velocity. The strong operational performance of rental properties should continue to buoy investor sentiment and support the sales environment.

While property fundamentals are expected to continue to perform at high levels, rising costs of capital will restrict some transaction activity. The value-add transactions that led the way in 2021 are expected to face more conservative underwriting, which could lead to a slowdown in the number of true value-add sales.

CAP RATES

While interest rates have increased, cap rates have remained in a tight range, at least to this point. In 2021, cap rates declined nearly 80 basis points, averaging approximately 4 percent. In the first few months of this year, cap rates began to trend higher, approaching 4.4 percent on average. That trend began to change course in the second quarter.

Cap rates inched below 4 percent in May and June, as investors accepted lower initial yields while anticipating returns would be realized by implementing additional rent increases. This trend will likely prove difficult to sustain if interest rates remain elevated for any significant period of time. In July, cap rates have inched up to an average of about 4.25 percent.



Sources: Northmarq, CoStar, Real Capital Analytics

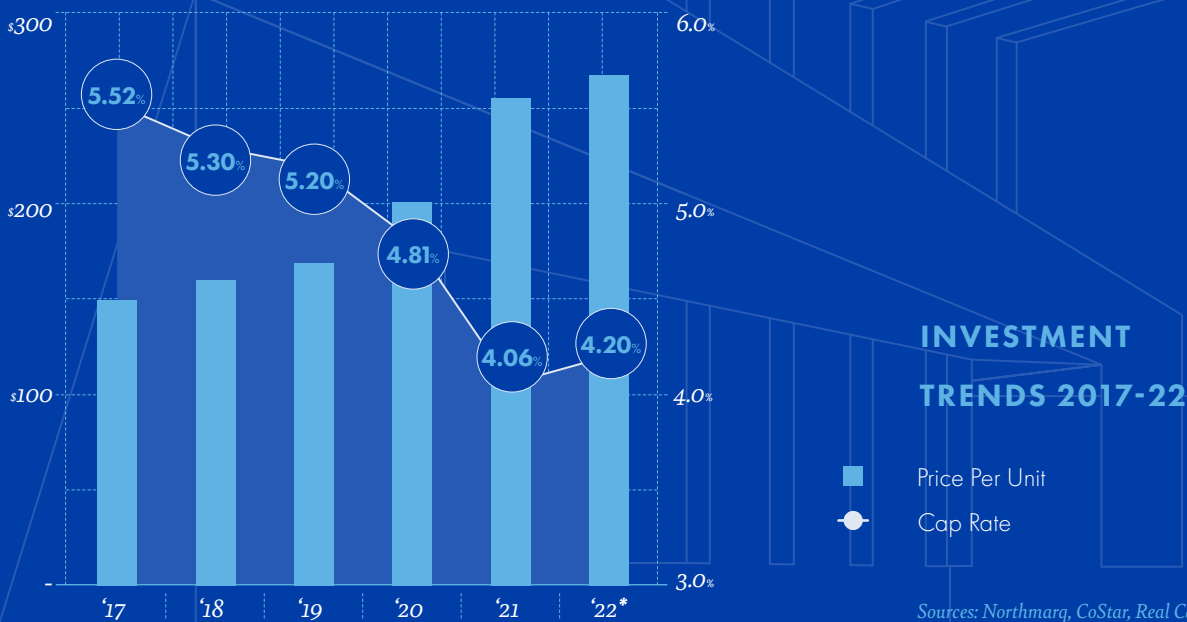
PRICING

The median price at the national level topped \$265,000 per unit during the first half of the year, slightly higher than the figure in 2021. This followed back-to-back years where prices rose by about 20 percent per year. Some of the slowing price growth was the result of increased transaction activity occurring in tertiary markets, where per-unit prices are generally lower. Long-term operators in these markets appear to be taking advantage of the strong investor demand for properties that still offer value-add potential.

Pricing has remained elevated among newer assets and in primary markets. Nearly 25 percent of the total number of sales during the first

half of the year changed hands at \$350,000 per unit or more, and dozens of transactions closed for more than \$500,000 per unit.

While activity has picked up in smaller markets, investors continued to target high-growth metro areas when making acquisitions. Top markets for sales velocity during the first half of this year included Dallas-Fort Worth, Atlanta, and Phoenix. These markets are benefiting from persistent in-migration from other parts of the country, as well as corporate expansions and relocations from higher-cost metro areas.



Sources: Northmarq, CoStar, Real Capital Analytics

INVESTMENT OUTLOOK

After an extended period of elevated and accelerating transaction volume, the multifamily investment market is expected to level off in the second half of the year. Transactions will still get done, although the investment climate will likely be less competitive than in the past 12-18 months.

The most likely scenario is buyers and sellers will undergo a period of price discovery in the coming months, as all parties adjust to the reality of higher borrowing costs and the potential for a slower pace of economic growth. Cap rates should inch higher, but any potential increases will likely more closely track rises in the 10-year Treasury than the Federal Funds rate.

Pricing will be a function of a number of factors, led by the individual assets that are being sold and the traditional measurements of vacancies, rents, and the pace of NOI growth. The expectation for the remainder of the year is the apartment market will continue to post strong performance in these metrics, supporting the investment market.

Top markets for investment activity through the first half of this year included Dallas-Fort Worth, Atlanta, and Phoenix.

Investors will also closely monitor levels of absorption, particularly as the pace of deliveries accelerates. New projects that deliver and are successfully leased-up will signal continued renter demand despite some economic cooling and could strengthen investor sentiment. If new projects require significant concessions to attract tenants, some investors may take a more cautious approach.



Financing climate

LOAN ORIGINATIONS

RATES RISING BUT ORIGINATIONS
AHEAD OF 2021 PACE

Multifamily mortgage originations began 2022 on an upswing, with the Mortgage Bankers Association reporting a 57 percent year-over-year spike in the first quarter. At the beginning of the year, lending volume was supported by increased competition outside of Fannie Mae and Freddie Mac.

AGENCY LENDERS

While the GSEs got off to a slower start to the year, they are expected to play a larger role in the coming quarters. Fannie Mae and Freddie Mac both have caps of \$78 billion in 2022, representing increases of more than 10 percent from 2021 levels. During the first quarter, Fannie Mae originated \$16 billion in multifamily loan volume, while Freddie Mac production totaled \$15 billion. Combined, the origination volumes for the two agencies were down about 12 percent from totals in the first quarter of last year.

During the first quarter, Fannie Mae originated billion in multifamily loan volume, while Freddie Mac production totaled \$15 billion.

As market conditions shifted early in the second quarter, the agencies showed signs of becoming more aggressive in underwriting transactions, which should lead to greater volumes through the end of the year. Current deals are generally being underwritten with LTVs ranging from the low- to mid-60 percent ranges. The agencies are particularly aggressive in underwriting deals that fall within their affordability mission.

TIMELINE OF FEDERAL RESERVE ACTION ON FED FUNDS RATE 2022

Sources: Northmarq, Federal Reserve



In recent months, debt funds have changed course, generally widening spreads and decreasing the amount of leverage in transactions.

DEBT FUNDS

One of the more significant changes to occur in the first half of this year has been the more conservative approach being undertaken by debt funds. In 2021, debt funds were particularly active in the value-add space. The market conditions that prevailed in 2021—low rates, elevated demand, tight vacancies, and surging rents—were ideal for debt fund/bridge execution for value-add transactions.

In recent months, debt funds have changed course, generally widening spreads and decreasing the amount of leverage in transactions. These changes have prompted borrowers to look to other sources, particularly the agencies and banks.

INTEREST RATES

The prospect of rising interest rates and additional Fed action will linger over the capital markets throughout the remainder of the year. Rate increases in four straight meetings, including the first 75 basis point increases since 1994, have adjusted market conditions.

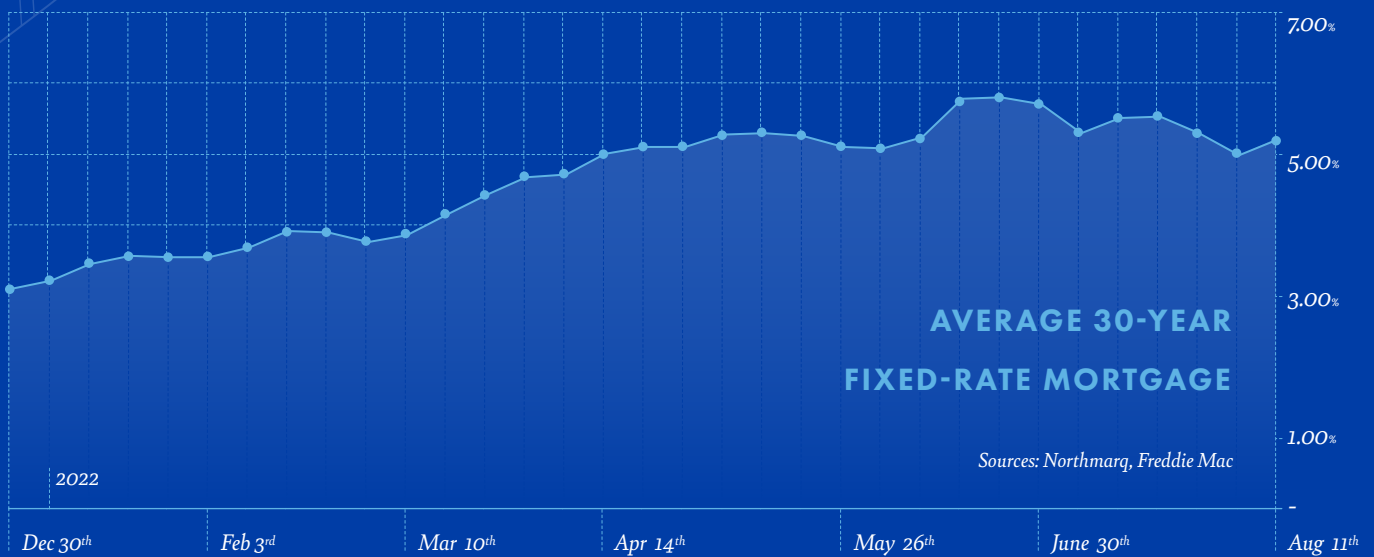
The current Fed Funds target range of 2.25 percent to 2.50 percent is 225 basis points higher than at the beginning of the year, and at least one more increase is forecast. The market consensus is for the rate to end 2022 around 3.5 percent. The Secured Overnight Financing Rate (SOFR) has been on a similar trajectory, starting the year at around 5 basis points before topping 2.25 percent in early August.

Yields have been volatile across maturities as the market tries to determine the economic outlook, the degree of the impact of inflation on the economy, and how dramatically and how swiftly the Fed will raise rates and move from Quantitative Easing (QE) to Quantitative Tightening (QT).

The yield on the 10-year Treasury started the year at about 1.7 percent, peaked at nearly 3.5 percent in mid-June and has since retreated to roughly 3 percent. The yield on the 2-year Treasury began 2022 at about 0.75 percent but topped 3 percent in July.

At the beginning of the year, we stated that the cost of capital was likely the greatest uncertainty in the capital markets heading into 2022. That statement still holds, although there is more clarity as the market has adjusted to the first series of rate hikes in more than three years. Additional increases may slow some of the momentum in the lending markets, but are not expected to completely disrupt financing activity.

The agencies showed signs of becoming more aggressive in underwriting transactions.



Looking ahead

A SLOWER SECOND HALF UNDERWAY

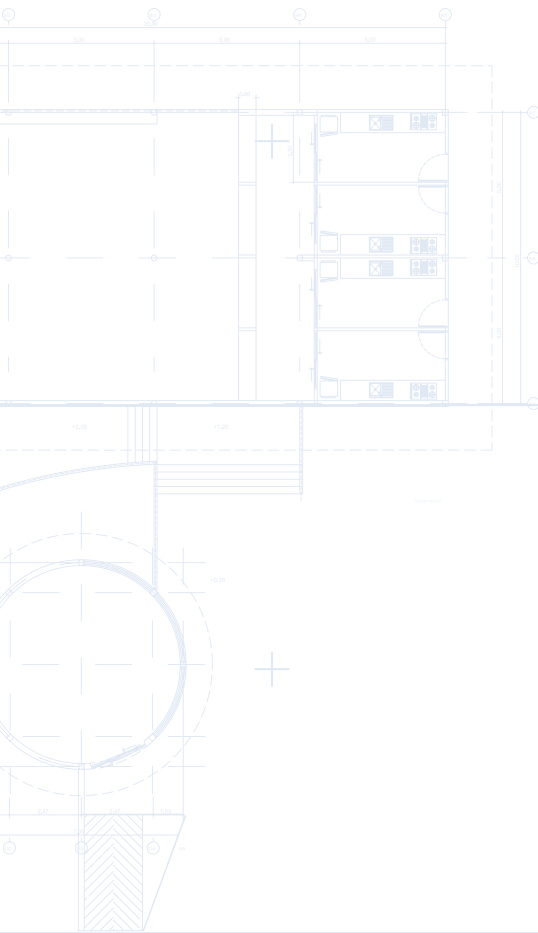
The national economic outlook is mixed, with a mild recession a possibility, but not a certainty. Some measurements paint a picture of continued growth, highlighted by a labor market where jobs are being added at a strong pace, wages are on the rise, and unemployment hovers near an all-time low.

Still other metrics illustrate the stresses present in the economy. Inflation is near a 40-year high and showing few signs of letting up, GDP declined in each of the first two quarters and a recent consumer sentiment survey recorded an all-time low result.

Businesses are in the position where input costs in the form of materials, labor, and transportation are on the rise, but future demand for goods and services are

showing signs of slowing. Debt and equity markets posted sharp pullbacks in the first half, further dragging down sentiment. A rally in July highlights the mixed messages in the financial markets.

Against this backdrop, the national multifamily market is outperforming the economy as a whole. Low vacancies and continued demand are allowing for further rent increases and sparking much-needed development in undersupplied markets. Some of the threats that are present in the economy will impact property performance and investment activity. Inflation is a concern, and how effective the Federal Reserve will be at balancing its dual mandate of maximum employment and price stability remains to be seen.



Renter demand for apartment properties is expected to remain healthy throughout the remainder of the year, but will lag 2021 levels. This forecast assumes the labor market will remain tight and businesses only slow the pace of additions and do not significantly reduce staffing levels. Tight vacancy levels should allow operators to increase rents, but at more modest levels than have been achieved since the middle part of last year. Concessions may rise in markets and submarkets where construction is the most active, after leasing incentives have been nearly eliminated in recent years.

The investment market faces a few more questions but is expected to continue to perform. The underlying fundamental health of multifamily properties will support investment activity, although transaction volume is not expected to reach the cyclical peaks recorded at the end of last year. Buyers and sellers will likely adjust price and cap rate expectations to reflect the new cost of capital, but deals will get done and it should not take too much time for cap rates to reach a new equilibrium.

One sign of health that is likely to continue to take shape is the recovery in some of the country's dense, urban cores. These cities, which often have some of the highest rents

in the country, were particularly hard-hit during the work-from-home conditions following COVID. Suburban areas thrived while downtowns struggled. These trends are beginning to change course, buoying performance in some of the nation's highest-profile markets.

While there are many moving parts influencing multifamily markets across the country, the broad takeaway is that conditions are very strong and should remain healthy through the remainder of 2022. The robust July employment reading was a signal of the general in the health of the economy.

There will be adjustments to demand—both from investors and renters—and the rapid levels of growth recorded since the second quarter of last year are unlikely to repeat. Instead, the market is expected to settle into a period of more modest growth, with some pockets of softer performance, particularly submarkets where new supply growth outpaces demand.

Low vacancies and continued demand are allowing for continued rent increases and sparking much-needed development in undersupplied markets.



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About Northmarq

As a capital markets leader, Northmarq offers commercial real estate investors access to experts in debt, equity, investment sales, and loan servicing to protect and add value to their assets. For capital sources, we offer partnership and financial acumen that support long- and short-term investment goals. Our culture of integrity and innovation is evident in our 60-year history, annual transaction volume of more than \$34 billion, loan servicing portfolio of more than \$76 billion and the multi-year tenure of our nearly 700 people.

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