

# 2008

## National Economic and Apartment Market

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Overview and Outlook – Client Teleconference  
June 17, 2008

**Marcus & Millichap**  
NATIONAL MULTI HOUSING GROUP

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# ***ECONOMIC and APARTMENT MARKET FUNDAMENTALS***

## ***OVERVIEW and OUTLOOK***

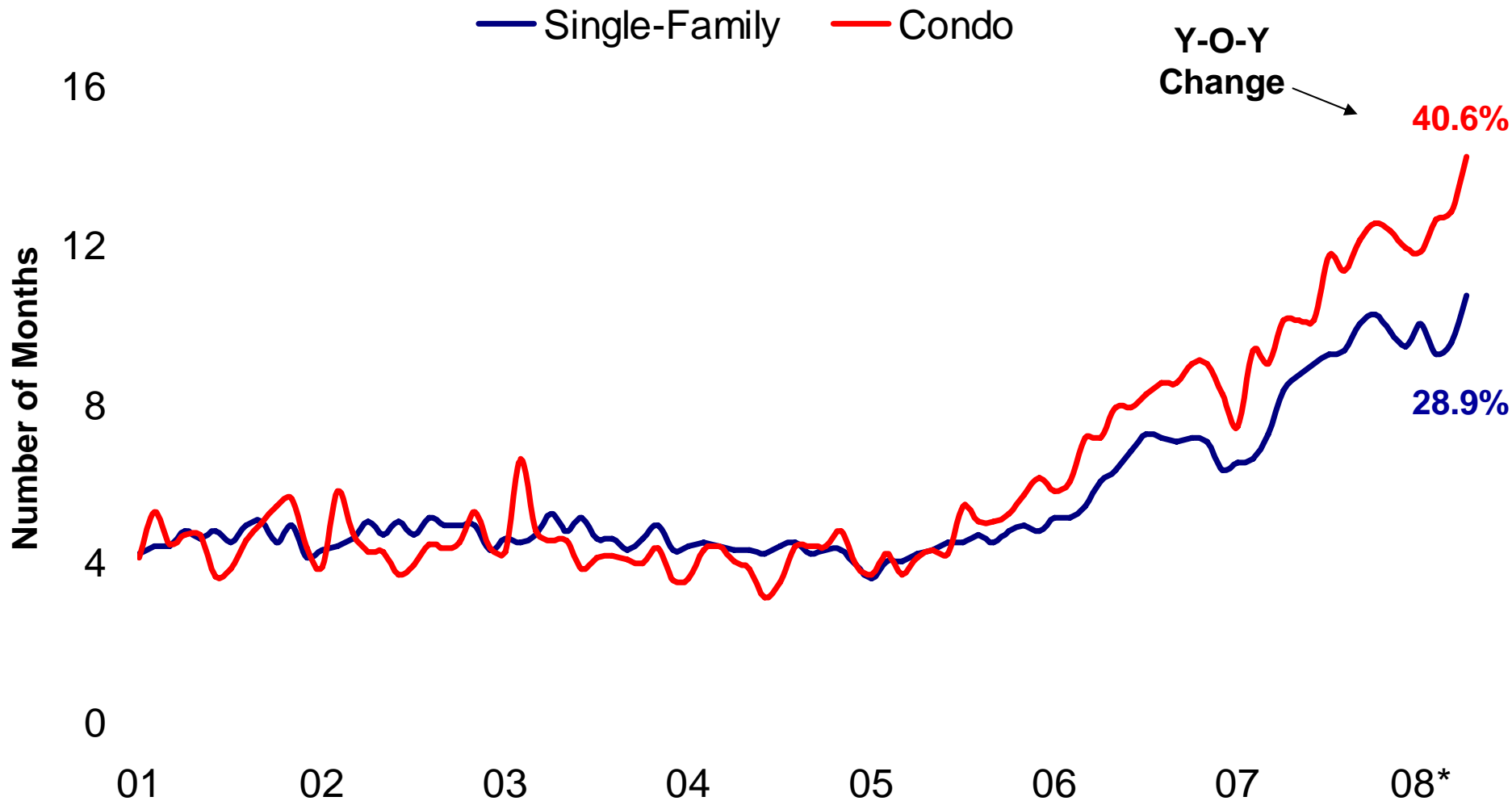
# Housing Continues to Hamper the Economy - Price Trends by Market

Top 15 Markets	1Q03 – 1Q06	1Q06 – 1Q08
Inland Empire	101%	-27%
Orlando	90%	-11%
Miami	89%	-14%
Las Vegas	85%	-22%
Los Angeles	83%	-18%
Phoenix	82%	-17%
Fort Lauderdale	75%	-16%
West Palm Beach	74%	-15%
Baltimore	69%	1%
Tucson	65%	-11%
Washington, D.C.	64%	-13%
Sacramento	63%	-31%
Orange County	59%	-16%
San Diego	56%	-24%
Seattle	55%	10%
United States	29%	-9%

Bottom 15 Markets	1Q03 – 1Q06	1Q06 – 1Q08
Oklahoma City	15%	4%
Boston	14%	-9%
Austin	11%	10%
Houston	10%	4%
Kansas City	10%	-7%
Pittsburgh	9%	4%
Dallas-Ft. Worth	9%	-3%
Denver	8%	-8%
Memphis	6%	-18%
Cincinnati	5%	-7%
Louisville	3%	1%
Columbus	3%	-7%
Indianapolis	3%	-6%
Cleveland	0%	-18%
Detroit	-9%	-11%
United States	29%	-9%

# Housing Downturn Yet to Reach Bottom

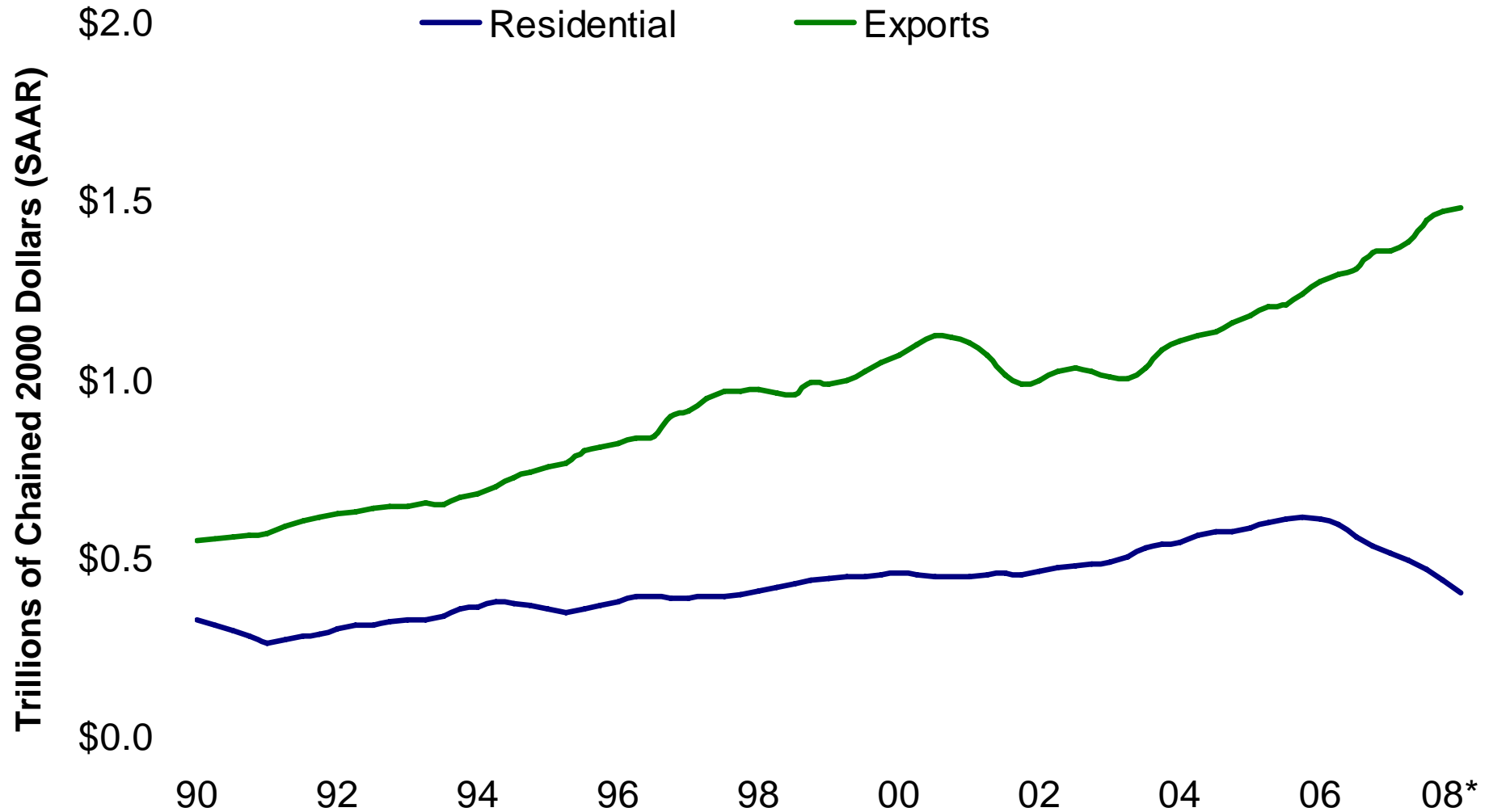
## Months Supply of Inventory



\* Through April

Sources: Marcus & Millichap Research Services, National Association of REALTORS®

# Growth in Exports a Major Contributor to Economic Activity, Housing Offset



\* As of 1<sup>st</sup> Quarter

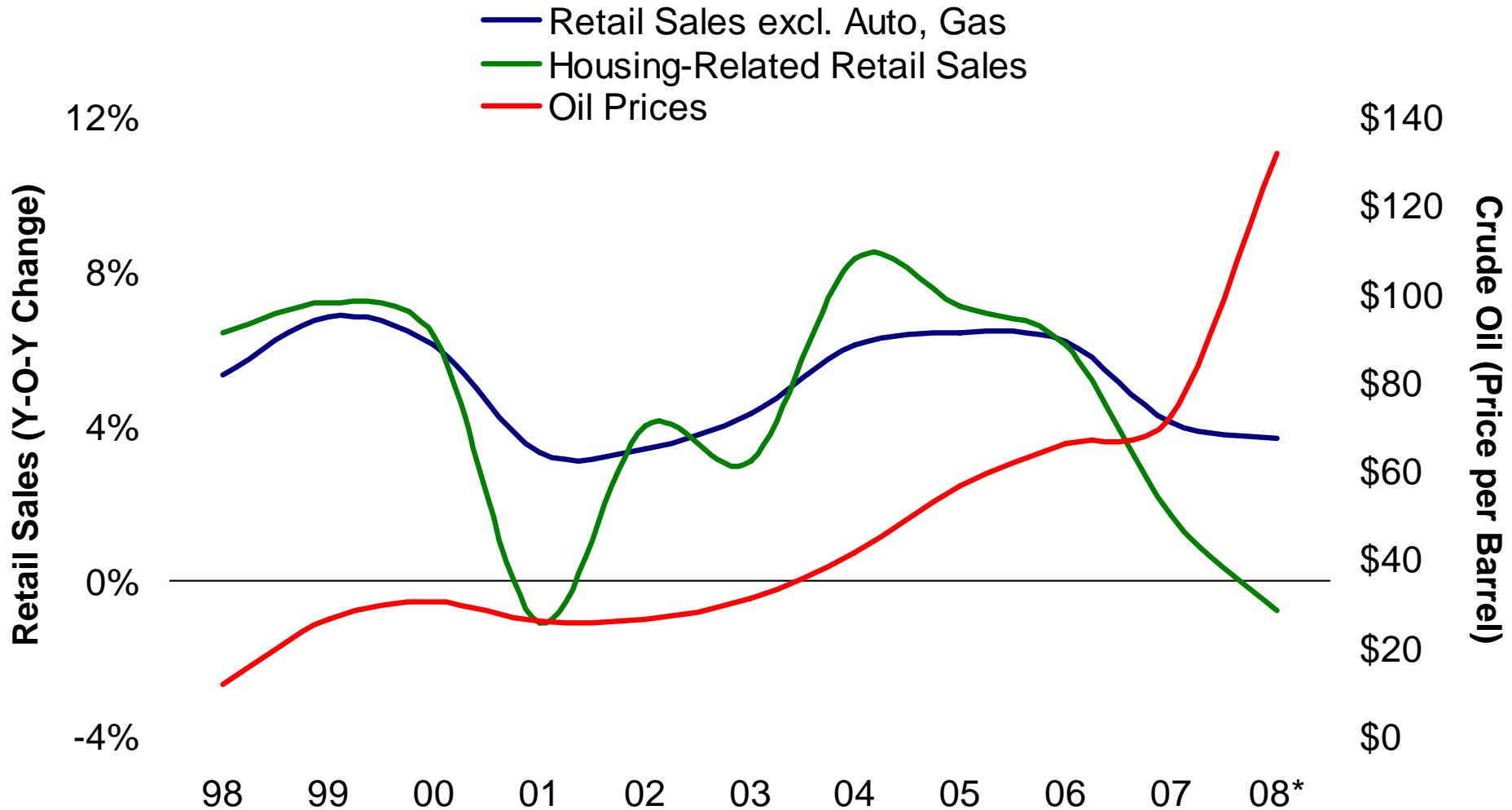
Sources: Marcus & Millichap Research Services, Bureau of Economic Analysis

# Growth Sectors Outweighed Contraction – Through 2007

U.S. Employment Sectors	2007 Second Half Absolute Change	Percent Change
Education & Health Services	287,000	1.6%
Leisure & Hospitality	184,000	1.4%
Professional & Business Services	185,000	1.0%
Trade, Transport & Utilities	80,000	0.3%
Other Services	4,000	0.1%
<b>Total Gain</b>	<b>740,000</b>	
Financial Activities	-32,000	-0.4%
Information Services	-15,000	-0.5%
Manufacturing	-120,000	-0.9%
Construction	-131,000	-1.7%
<b>Total Loss</b>	<b>-298,000</b>	

# Cash from Home Refinancing

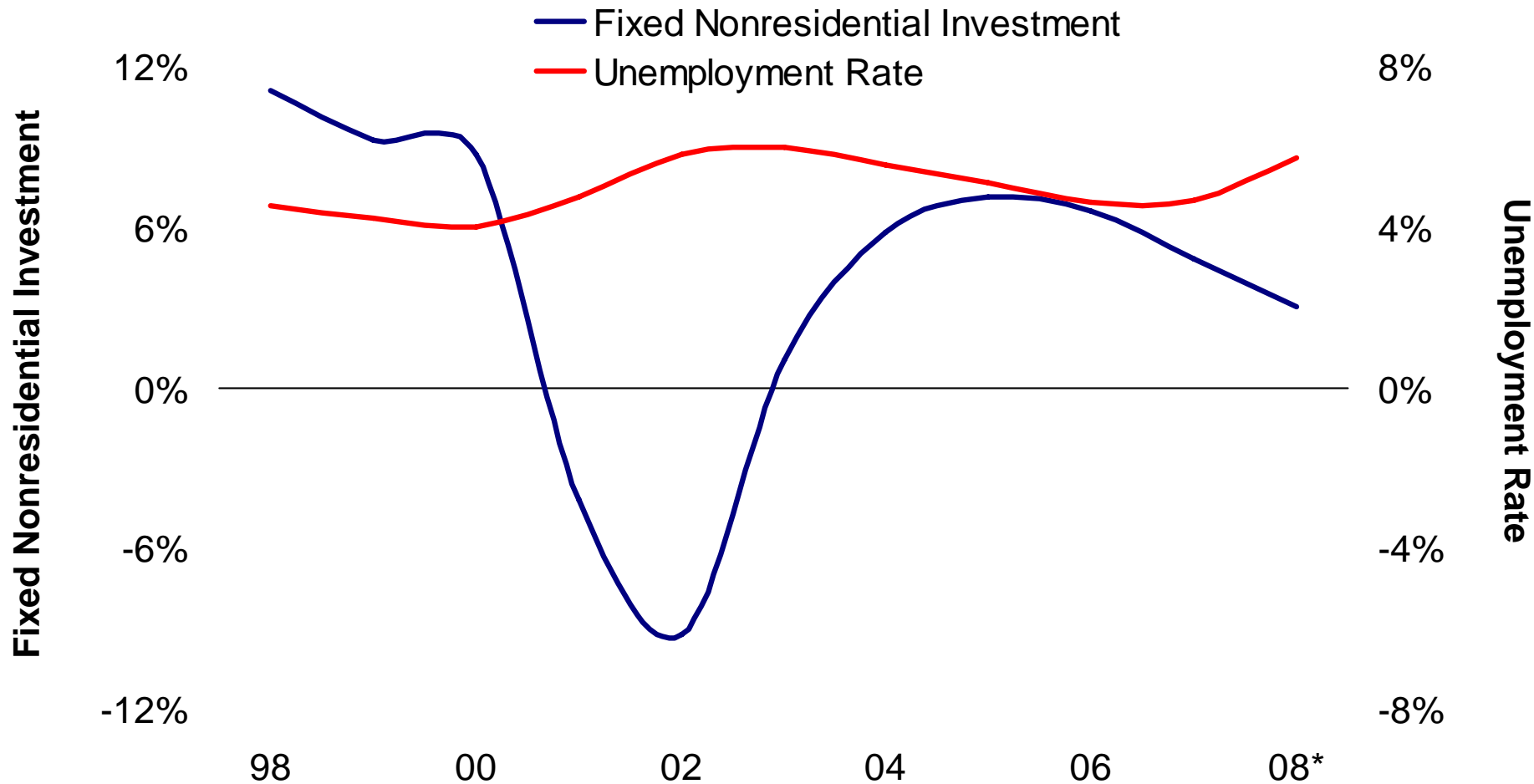
## No Longer Shielding Retail Sales from High Energy Prices



\* Retail Sales exclude Auto and Gas (Y-O-Y as of May), Oil Prices as of June 10<sup>th</sup>

Sources: Marcus & Millichap Research Services, Economy.com

# Corporate Investment Stalling Despite Healthy Balance Sheets, Unemployment Rising



\* Forecast

Sources: Marcus & Millichap Research Services, BLS, Economy.com



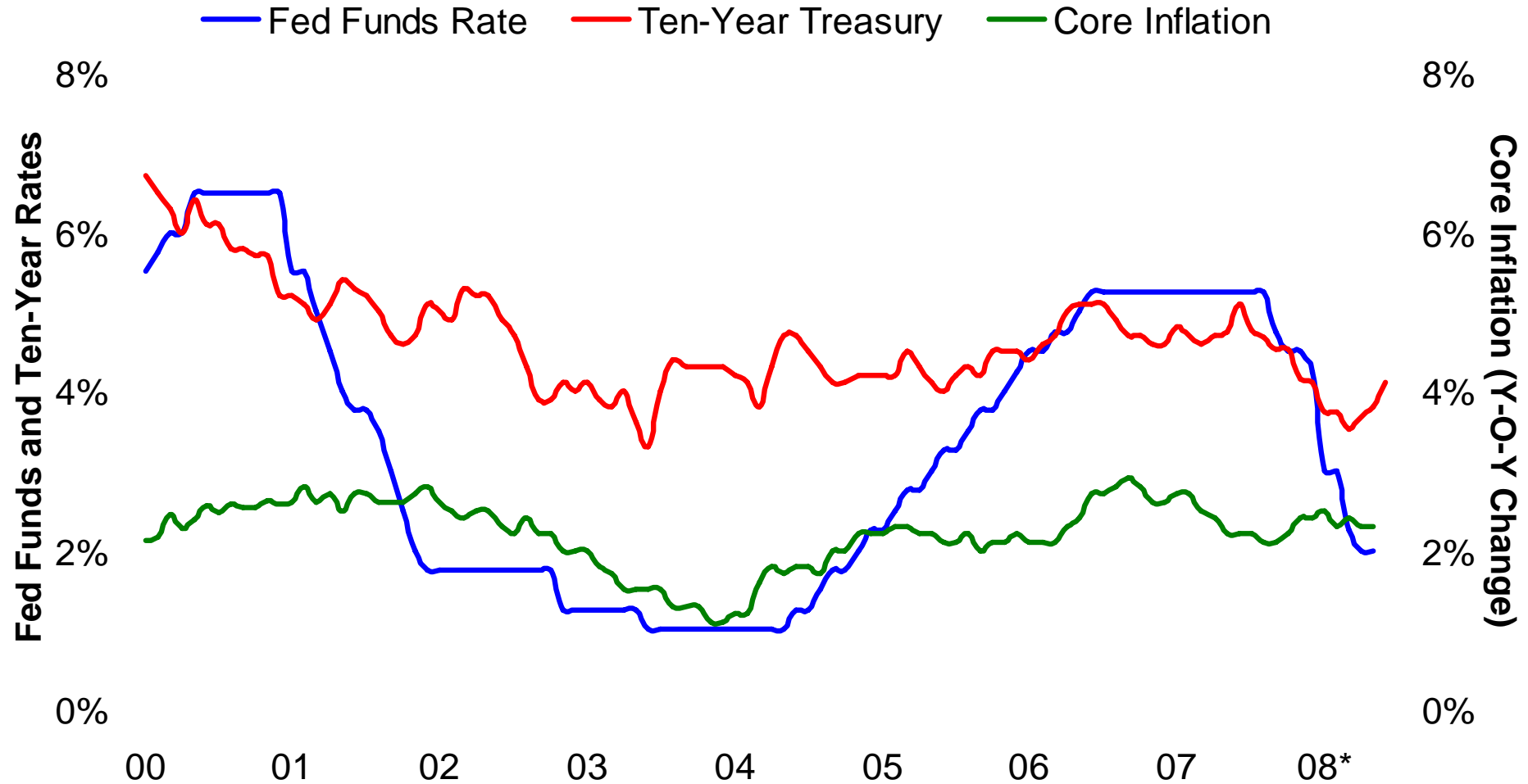
# Economy Stalled, Taking Toll on Employment

United States Employment Sectors	YTD 2008* Absolute Change	Percent Change
Education & Health Services	256,000	1.4%
Government	73,000	0.3%
Leisure & Hospitality	65,000	0.5%
Other Services	30,000	0.5%
Natural Resources & Mining	15,000	2.0%
<b>Total Gain</b>	<b>439,000</b>	
Information Services	-14,000	-0.5%
Financial Activities	-21,000	-0.3%
Professional & Business Services	-124,000	-0.7%
Trade, Transportation & Utilities	-193,000	-0.7%
Manufacturing	-203,000	-1.5%
Construction	-208,000	-2.8%
<b>Total Loss</b>	<b>-763,000</b>	

\* Through May

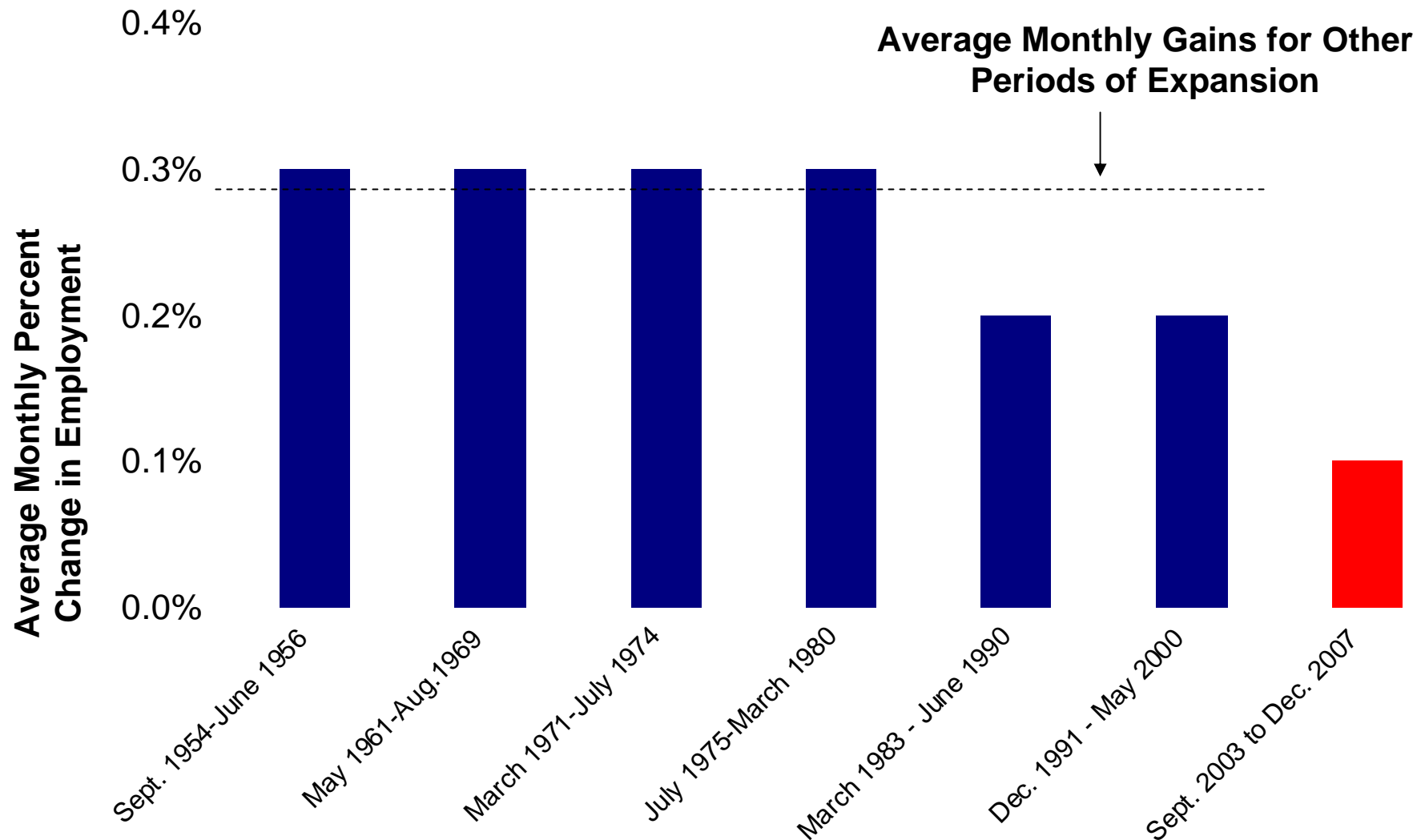
Sources: Marcus & Millichap Research Services, BLS, Economy.com

# Better Late than Never: The Fed Finally Aggressive On Rates, Liquidity – Inflation a Major Concern



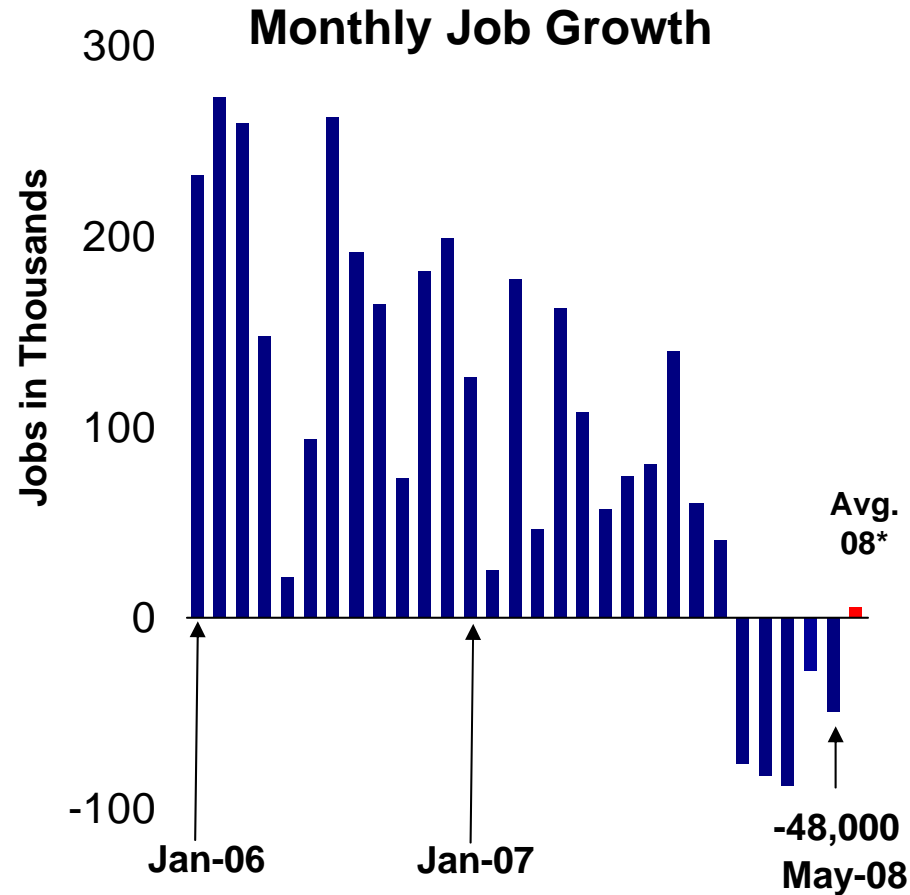
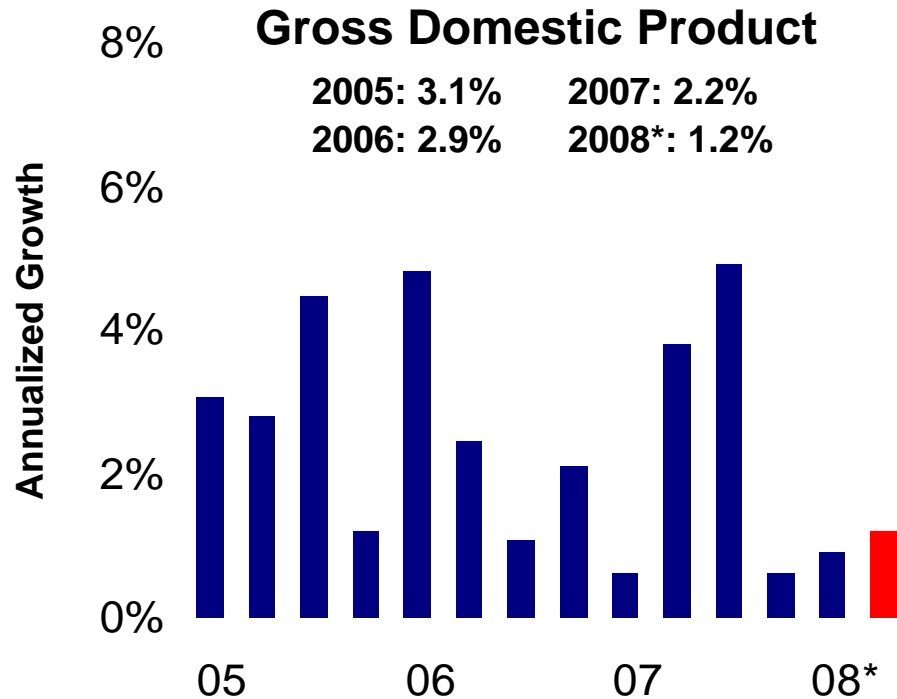
\* Core Inflation through May, Ten-Year/Fed Funds through June 10<sup>th</sup>  
Sources: Marcus & Millichap Research Services, Economy.com, Federal Reserve

# Employment Growth Was Lowest in Last Expansion and Should Result in Fewer Job Losses



# Technical Recession Unlikely – No Driver of Rebound in the Short-Term

## Risk Levels Elevated (Housing, Energy, Credit)



\* Forecast

Note: Technical Recession Defined as Two Consecutive Quarters of GDP Contraction

Sources: Marcus & Millichap Research Services, Economy.com

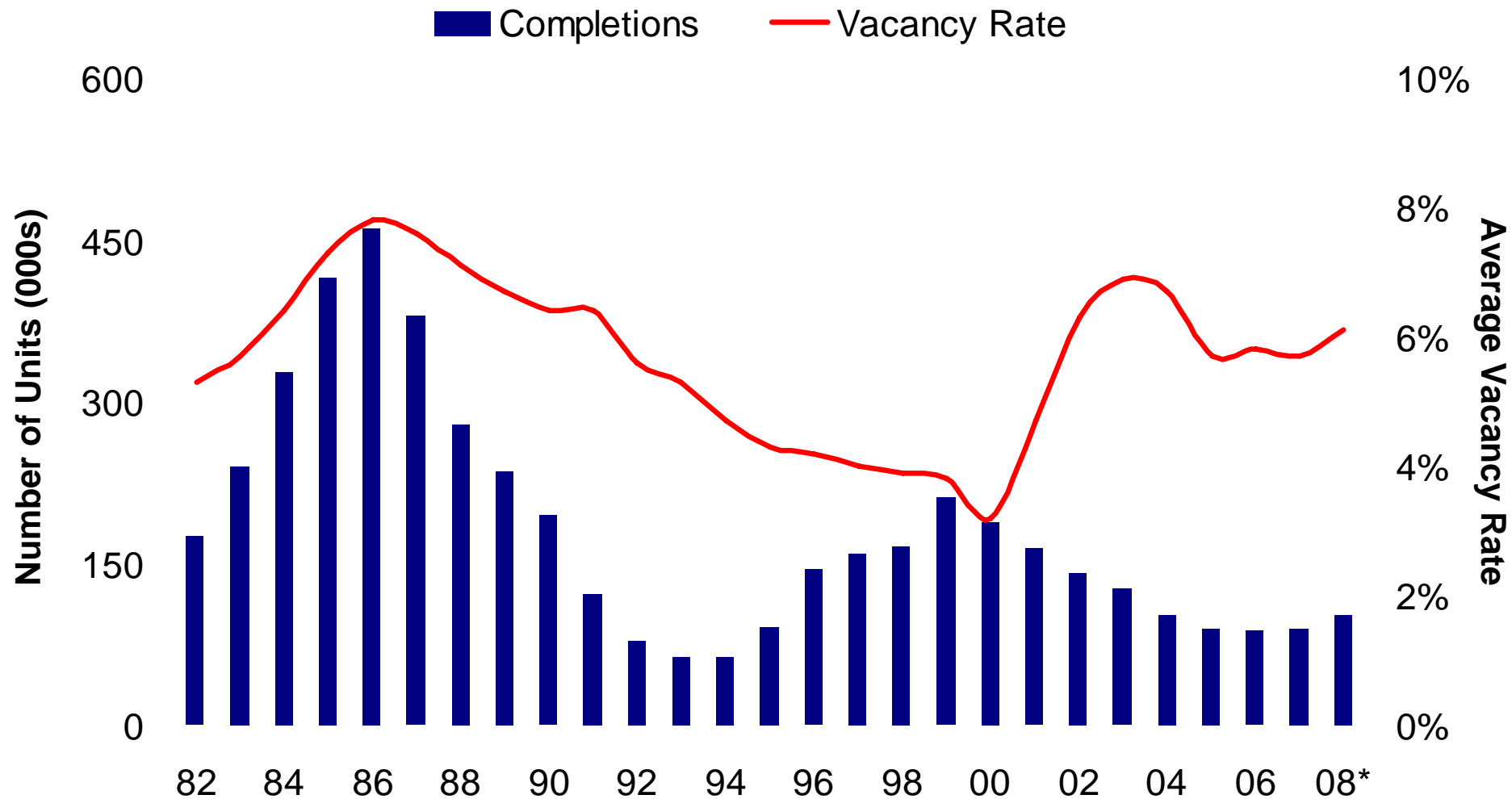
# Most and Least Improved Employment Markets

## Y-O-Y April 2008

Top 15 Markets	YOY Abs. Change	YOY % Change
Houston	71,500	2.8%
Austin	20,100	2.7%
San Antonio	19,100	2.3%
Dallas/Ft. Worth	66,800	2.3%
San Francisco	21,700	2.2%
Charlotte	16,900	2.0%
Seattle/Tacoma	34,000	2.0%
Denver	22,000	1.8%
San Jose	12,200	1.3%
Portland	13,700	1.3%
Atlanta	28,900	1.2%
Washington, D.C.	28,100	0.9%
New York	48,000	0.9%
Indianapolis	8,000	0.9%
Columbus	7,000	0.8%
<b>United States</b>	<b>462,000</b>	<b>0.3%</b>

Bottom 15 Markets	YOY Abs. Change	YOY % Change
Los Angeles	-1,000	0.0%
Jacksonville	-700	-0.1%
Phoenix	-2,900	-0.2%
Milwaukee	-1,800	-0.2%
Las Vegas	-3,400	-0.4%
St. Louis	-5,000	-0.4%
Cleveland	-4,900	-0.5%
Miami	-5,500	-0.5%
Oakland-East Bay	-6,600	-0.6%
Tampa	-13,000	-1.0%
Fort Lauderdale	-8,700	-1.1%
West Palm Beach	-7,000	-1.2%
Orange County	-19,400	-1.3%
Inland Empire	-16,800	-1.3%
Detroit	-51,000	-2.6%
<b>United States</b>	<b>462,000</b>	<b>0.3%</b>

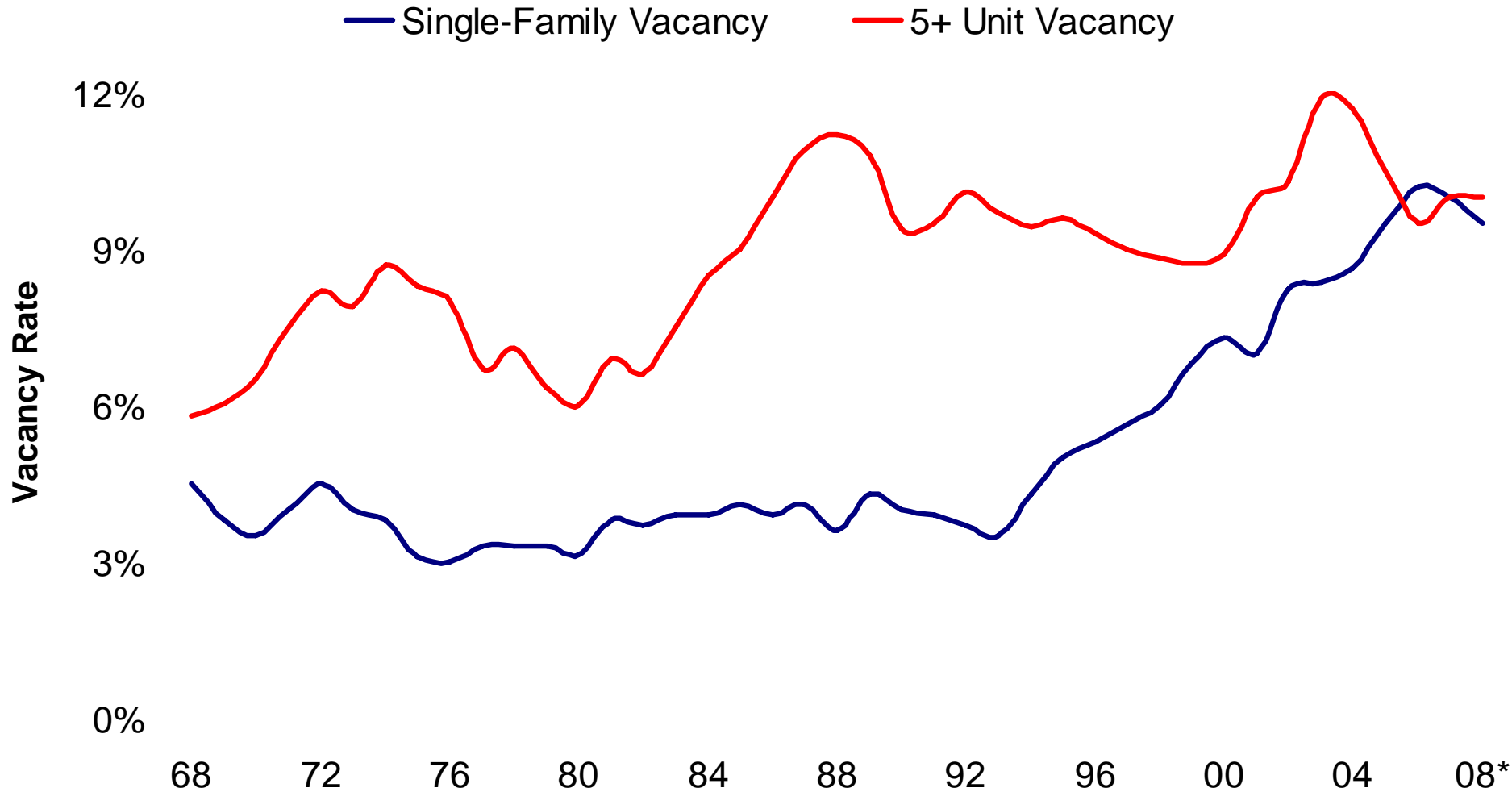
# Apartment Vacancies Rising Moderately Due to Weak Employment, “Shadow” Market Competition



\* Forecast

Sources: Marcus & Millichap Research Services, Reis

# Single-Family and Condo Rentals Are Competing with Apartments – Particularly in Over-Built Markets



\* Forecast

Sources: Marcus & Millichap Research Services, Equity Residential, U.S. Census Bureau

# Apartment Vacancy Ranking

## Top 15 and Bottom 15 Markets: Y-O-Y 1Q 2008

Top 15 Markets	1Q 08 Vacancy	Bps Change
Denver	6.4%	(170)
Cincinnati	7.1%	(160)
Indianapolis	8.1%	(140)
Oakland-East Bay	4.4%	(110)
St. Louis	6.9%	(100)
Cleveland	5.4%	(100)
Columbus	6.8%	(100)
Milwaukee	3.8%	(80)
Oklahoma City	8.2%	(80)
San Francisco	4.1%	(80)
Austin	6.8%	(80)
Detroit	6.4%	(80)
San Antonio	6.9%	(80)
Dallas-Fort Worth	6.3%	(70)
Seattle-Tacoma	4.5%	(60)
<b>United States</b>	<b>5.9%</b>	<b>-10</b>

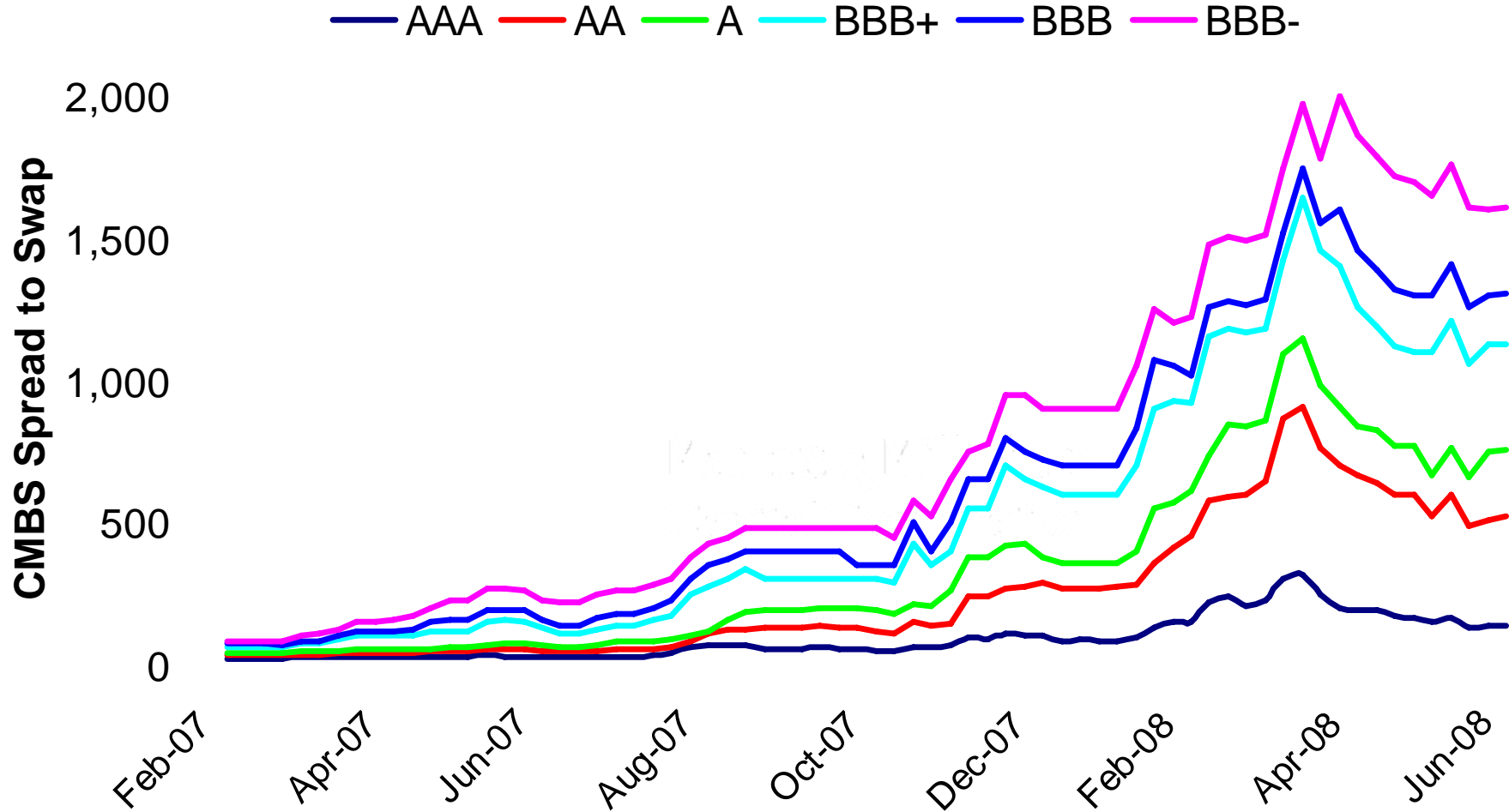
Bottom 15 Markets	1Q 08 Vacancy	Bps Change
Northern New Jersey	3.6%	20
Los Angeles	3.8%	40
Miami	4.3%	40
Orange County	4.0%	40
Washington, D.C.	5.4%	60
Tucson	6.2%	70
Inland Empire	6.5%	120
Palm Beach	8.0%	140
Las Vegas	6.5%	150
Houston	9.3%	150
Phoenix	8.7%	160
Tampa	7.4%	160
Ft. Lauderdale	5.7%	190
Orlando	7.8%	220
Jacksonville	10.4%	340
<b>United States</b>	<b>5.9%</b>	<b>-10</b>



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# ***CAPITAL MARKETS OVERVIEW and OUTLOOK***

# Commercial Mortgage-Backed Securities (CMBS) Spreads

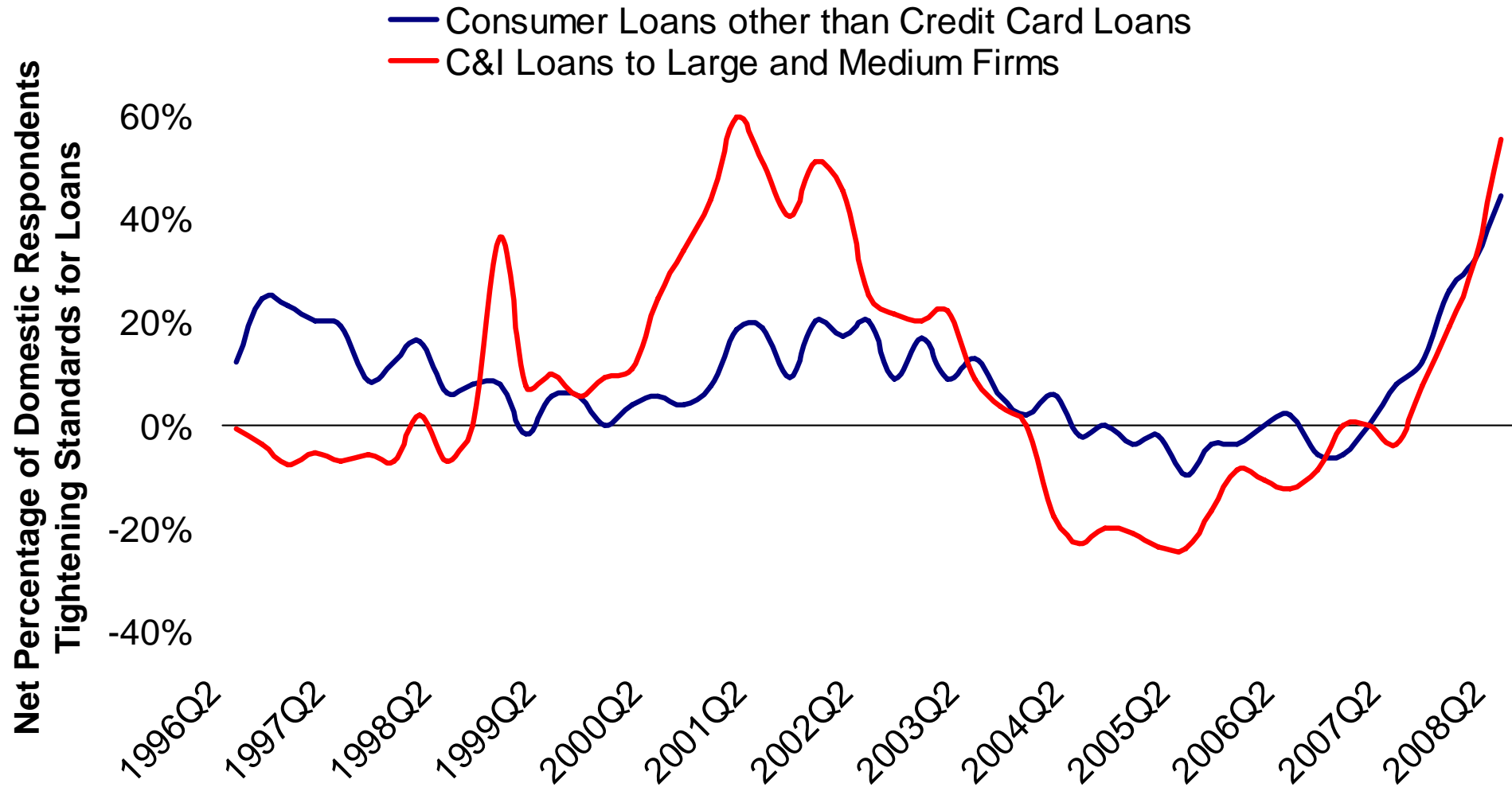


# Good News

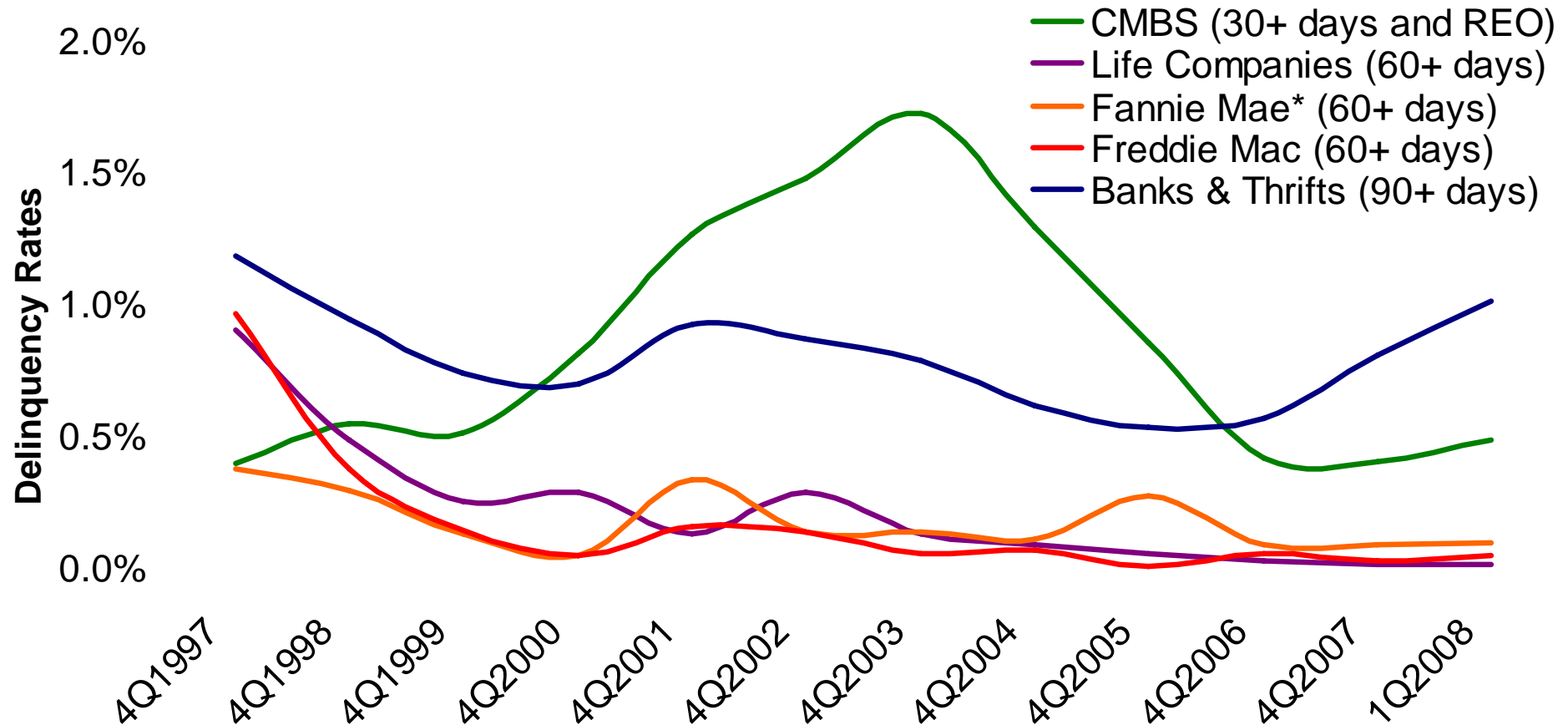
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- **UBS, Lehman and other Wall Street banks have raised capital.**
- **Last 3 deals issued by Citi, LB, UBS and JP were all received well by buyers.**
- **Black Rock acquires \$20 billion of UBS sub-prime debt securities for \$15 billion.**
- **According to Fitch, 3,345 CMBS fixed-rate loans with a balance of \$21.4 billion have successfully refinanced since August when the credit crunch began.**
- **We have already survived over 10 months of credit market turmoil.**

# Credit Standards Have Tightened Across the Board



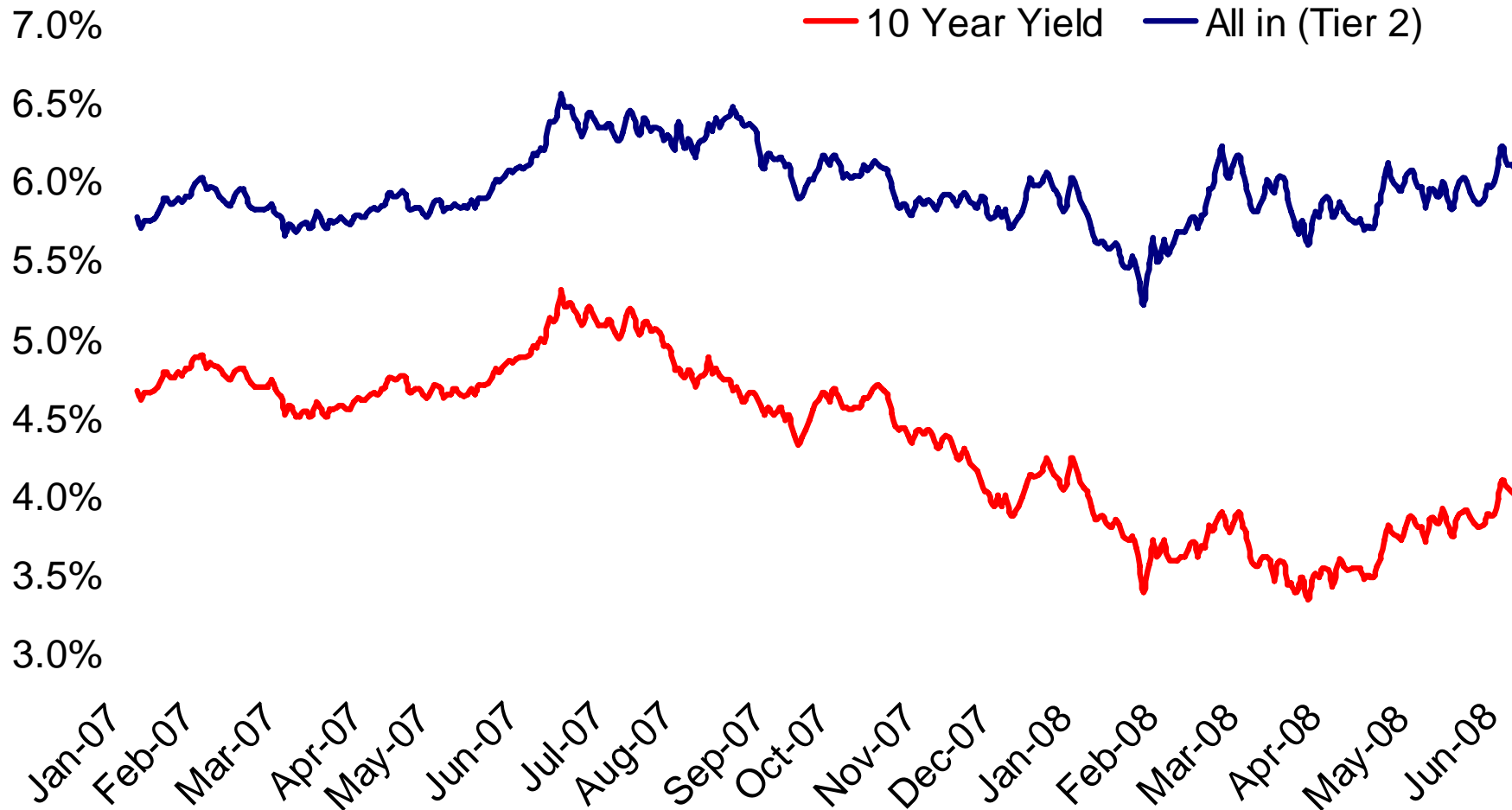
# Commercial/Multifamily Mortgage Delinquency Rates by Group



Delinquency rates at the end of each period

Sources: Marcus & Millichap Research Services, Federal Reserve Board

# 10-Year Treasury Yield and All-In Apartment Mortgage Rates

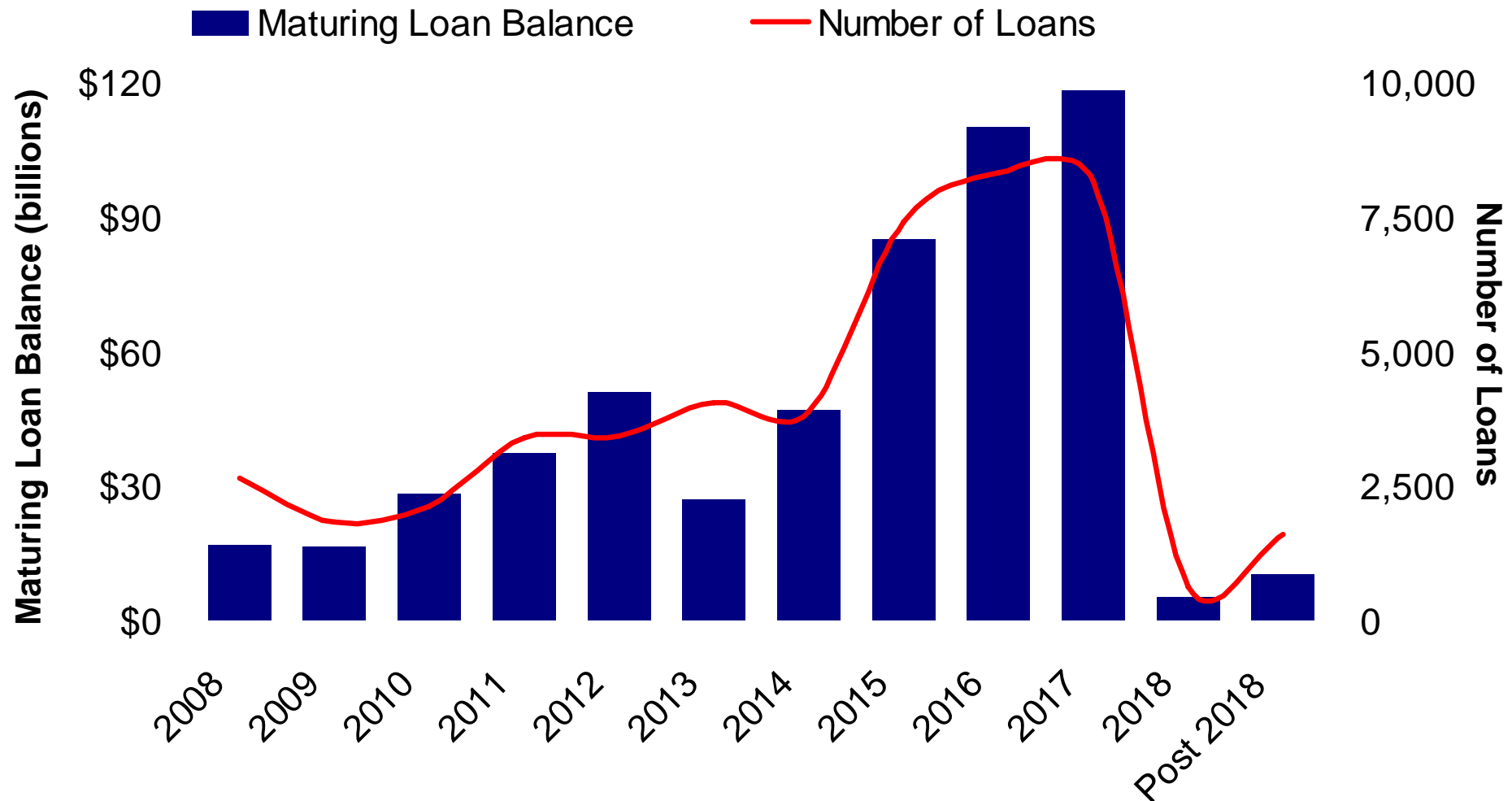


As of June 10, 2008

Sources: Marcus & Millichap Research Services, Federal Reserve Board

# Maturing Commercial Loan Volume Unlikely to Create Distressed Environment In the Short-Term

## S&P CMBS Fixed-Rate Final Maturities



# What Does the Future Hold?

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- 1. Commercial delinquencies expected to increase to a still-low 2 to 3%.**
- 2. Treasuries will increase moderately over the next 6 to 12 months.**
- 3. Credit markets stabilizing but vulnerable to additional shocks.**
- 4. Spreads coming in as markets stabilize.**
- 5. Underwriting will continue to be more conservative:**
  - a. I/O available, but loan dollars will not be based on I/O payments**
  - b. Well-grounded revenue, realistic uncollectible allowances**
  - c. Use of trailing 12-month operating expenses updated to market**
  - d. Debt Service Coverage Ratios - 1.25 most common**
  - e. More focus on sponsorship**
- 6. Market normalizing with LTV of 60% to 70%:**
  - a. Commercial Banks – 70%**
  - b. Agency Lender – 70%**
  - c. Life Companies – 60%**



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# ***APARTMENT INVESTMENT TRENDS and STRATEGIES***

# **Why Has The Apartment Market Been So Strong in the 2000s?**

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- **Low interest rates and spreads**
- **Apartments deemed a preferred product class and resulting capital flows**
- **Alternative investments have not been as favorable**
- **Investors were anticipating improving demographics and fundamentals**
- **Move towards “dynamic” vs. “static” underwriting and valuation techniques**

# **Why Has The Apartment Market Been So Strong in the 2000s?**

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**And a new reason...**

- Supply and demand of apartments is stable and favors increasing rents and appreciation**
  - Development sites scarce and expensive**
  - Construction costs high and volatile**
  - “Nimby”ism reduces approved sites, lengthens the approval process and increases impact fees**
  - required density and higher costs**

# State of the Apartment Industry

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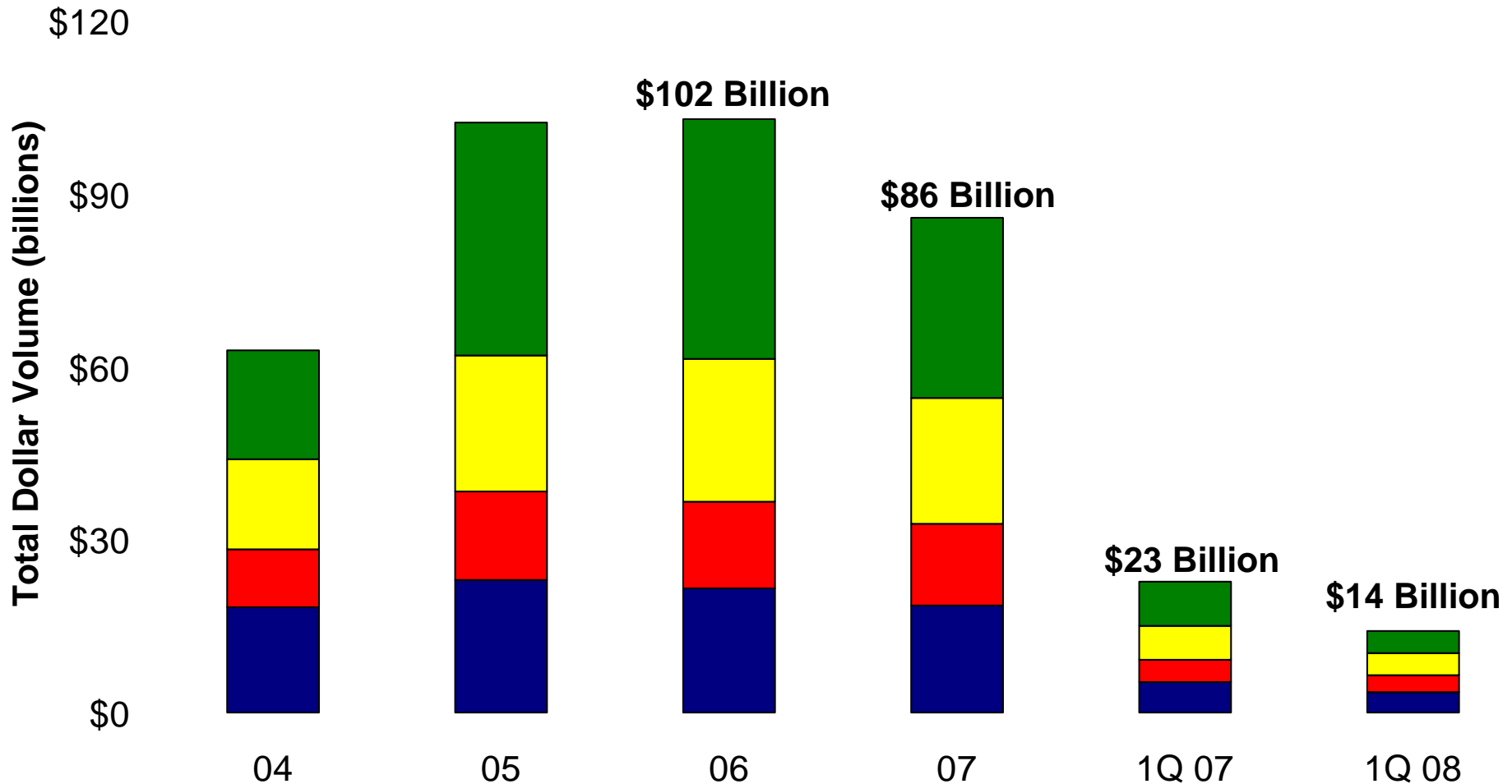
**Apartment fundamentals are solid:**

- **The national occupancy rate is 94%**
- **Supply: 100,000 market-rate units (1% stock)**
- **Effective rent growth: 3.0% to 3.5%**
- **Homeownership rate reversing**

# Apartment Investment Trends

## Sales Volume by Price Category

■ \$1M - \$9.99M ■ \$10M - \$19.99M ■ \$20M - \$39.99M ■ \$40M+



Excludes Archstone Privatization

Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics

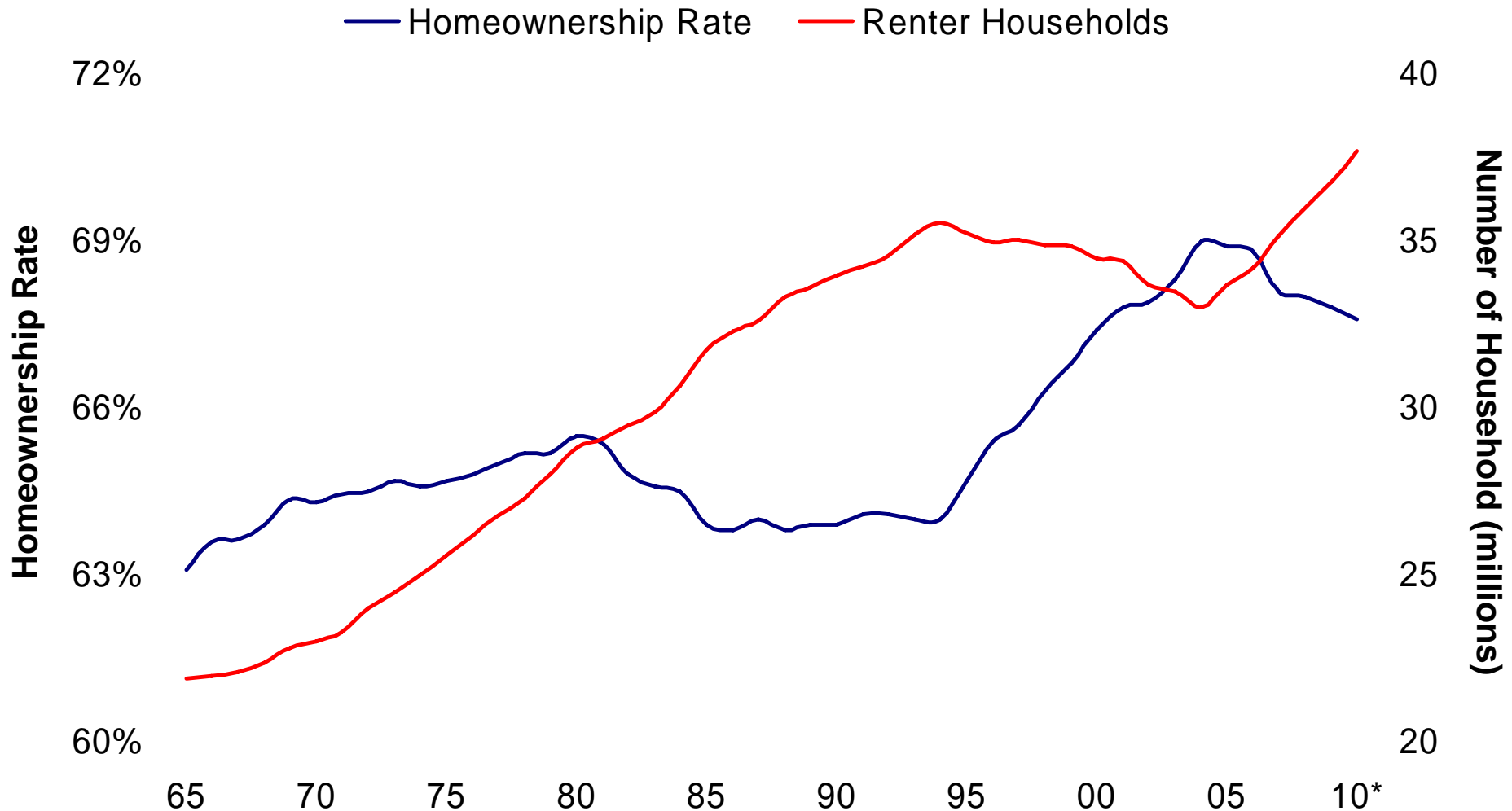
# Why The Disconnect ...

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**In a typical recession...**

- **Supply exceeds demand and there is usually a development overhang**
- **Occupancies are decreasing**
- **Asking rents are decreasing or concessions are wide-spread**
- **Effective rents are decreasing**

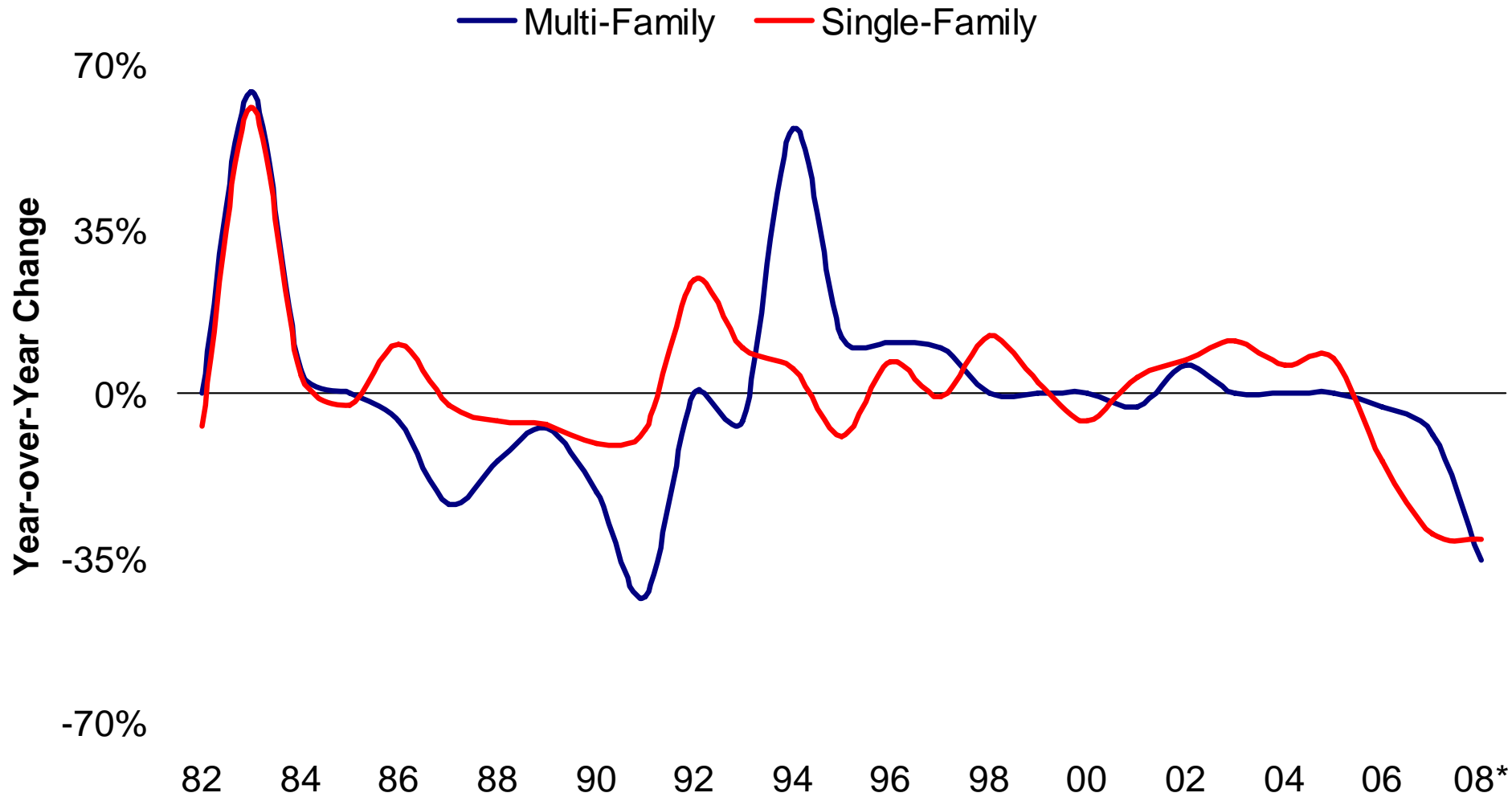
# Reversal in Home Ownership Rate Points to Increase in Renter Households



\* Forecast

Sources: Marcus & Millichap Research Services, U.S. Census Bureau, TWR

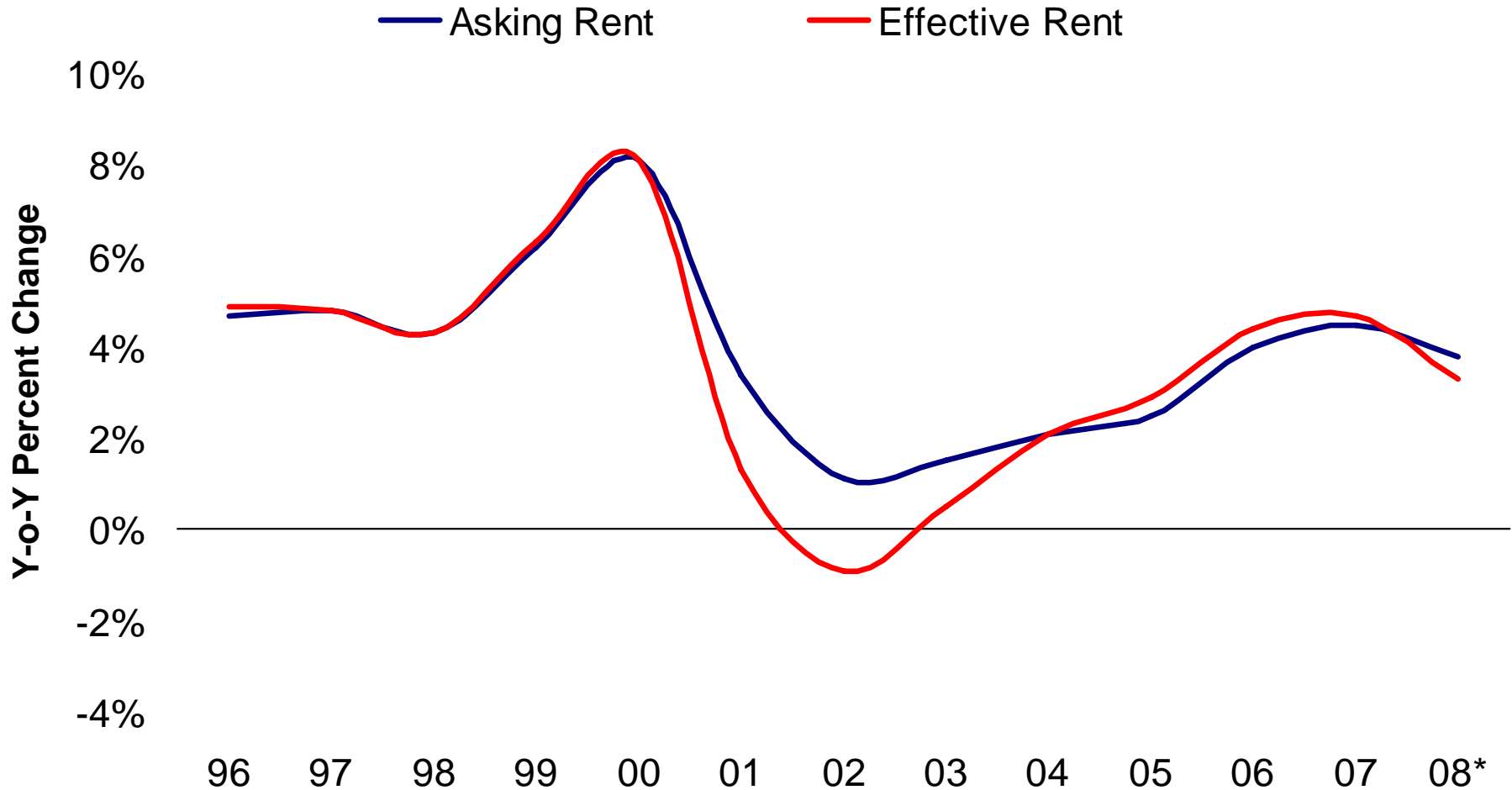
# Construction Starts Declining



\* Forecast  
Sources: Marcus & Millichap Research Services, Economy.com



# Apartment Rent Growth Slowing After a Strong Recovery Period



\* Forecast

Sources: Marcus & Millichap Research Services, Reis

# **Recession ... Or Recalibration?**

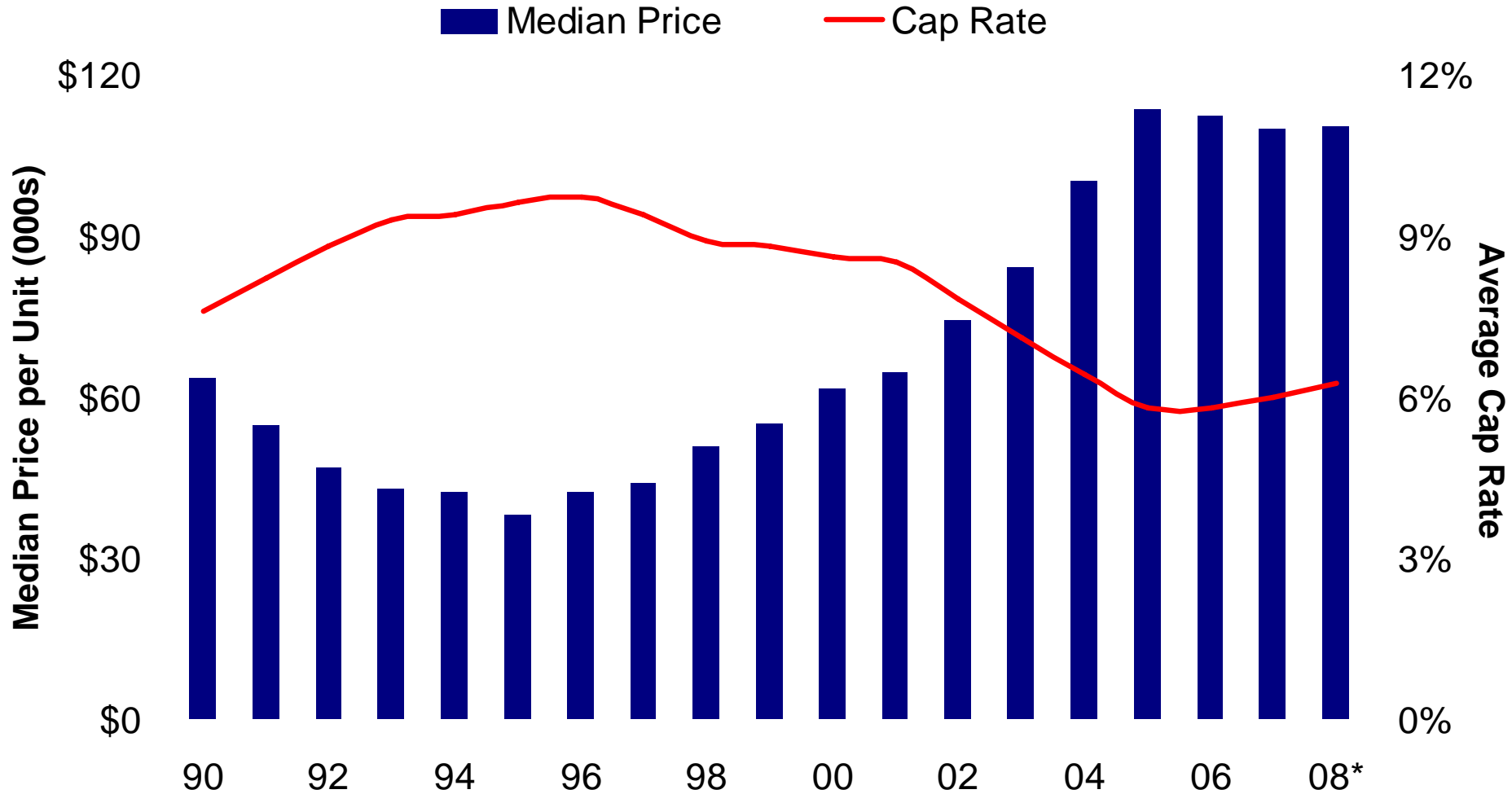
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**What's going on...**

- **Many investors are on the sidelines**
- **Most sellers are not willing to accept substantially lower prices**
- **Therefore ... Sales velocity has decreased**

# Apartment Investment Trends

## Pricing and Cap Rates



\* 1st Quarter  
Sales \$1 million and greater  
Sources: Marcus & Millichap Research Services, CoStar Group, Inc.

# **Recession ... Or Recalibration?**

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## **What's being recalibrated ...**

### **➤ Lender underwriting standards**

- **Attitudes re: interest-only loans**
- **Attitudes re: growth rates in models**
- **Attitudes re: reversion cap rates**
- **Attitudes re: debt coverage ratios**
- **Attitudes re: loan-to-value ratios**

### **➤ Equity yields**

### **➤ Some equity providers are being distracted in the “short run”**

# **Recession ... Or Recalibration?**

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## **What's going on ...**

- **There is a difference between:**
  - **Justifiable re-pricing**
  - **Opportunistic re-pricing**
- **The stress in the market is being recast as negativity by those who have a vested interest in an over-correction**

# **Recession ... Or Recalibration?**

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## **The result ...**

- **Lenders, equity providers and buyers want to believe that apartment prices have decreased**
- **If you add up the changes in their proposed metrics ... values would have to drop 15% - 25%.**
- **Meanwhile ... fundamentals are stable to improving in most markets**

# Apartment Cap Rate Adjustment Matrix

	Class "A"	Class "B"	Class "C"
Primary	<b>.25</b> (0 to 50 bps)	<b>.35</b> (25 to 50 bps)	<b>.50</b> (25 to 75 bps)
Secondary	<b>.35</b> (25 to 50 bps)	<b>.50</b> (25 to 75 bps)	<b>.75</b> (50 to 100 bps)
Tertiary	<b>.75</b> (50 to 100 bps)	<b>1.00</b> (75 to 125 bps)	<b>1.25</b> (100 to 150 bps)

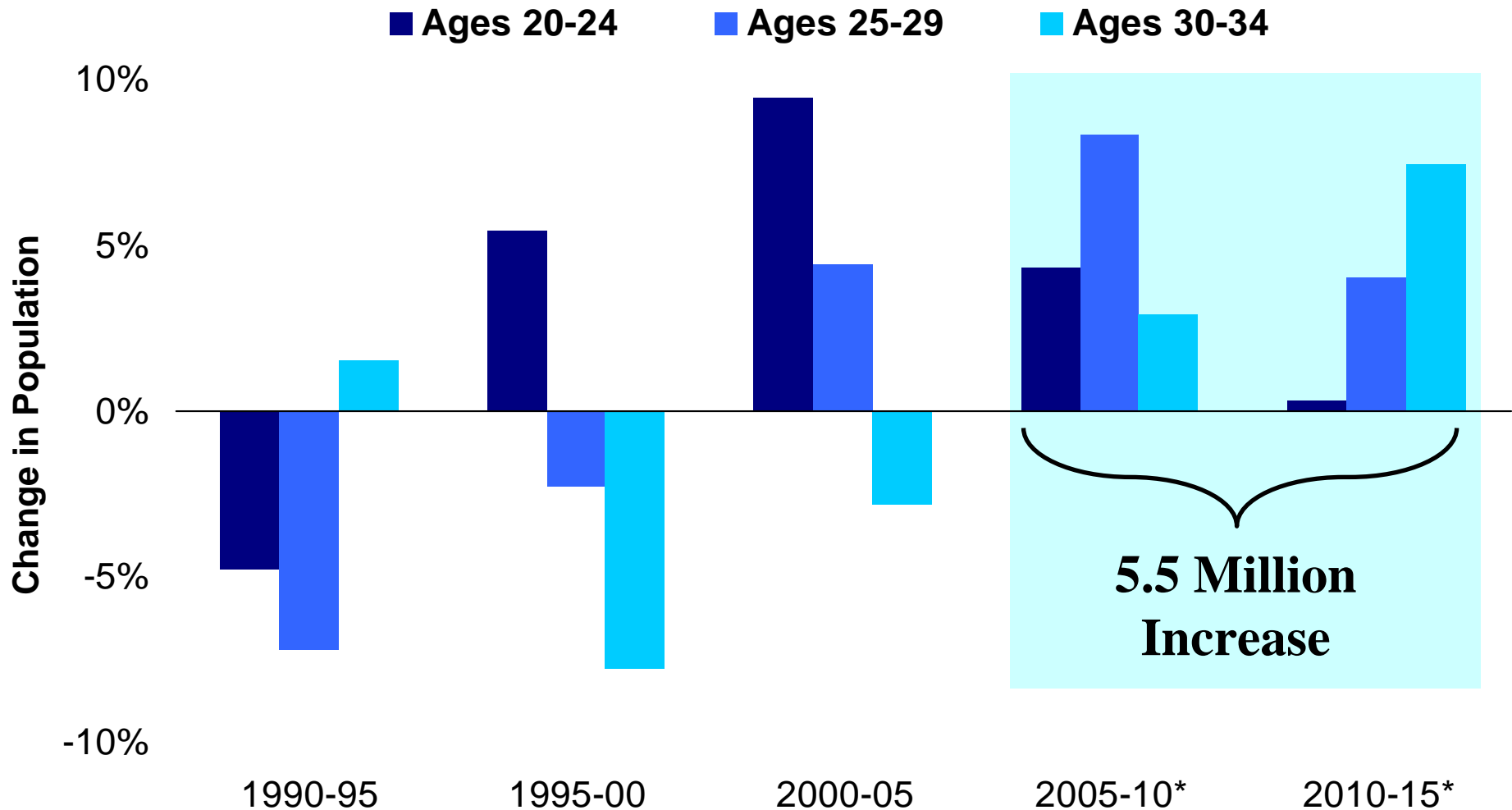
# How Long Will This Last?

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- **In a normal recession:**
  - **1 to 2 years to dig out to neutral**
  - **Another year to engage the growth engine**
- **In a period of recalibration ...**
  - **At worst, less time than a recession**
  - **At best ... 6 to 9 months**
- **Hard to predict ... but it will be quicker than the negative rhetoric suggests**



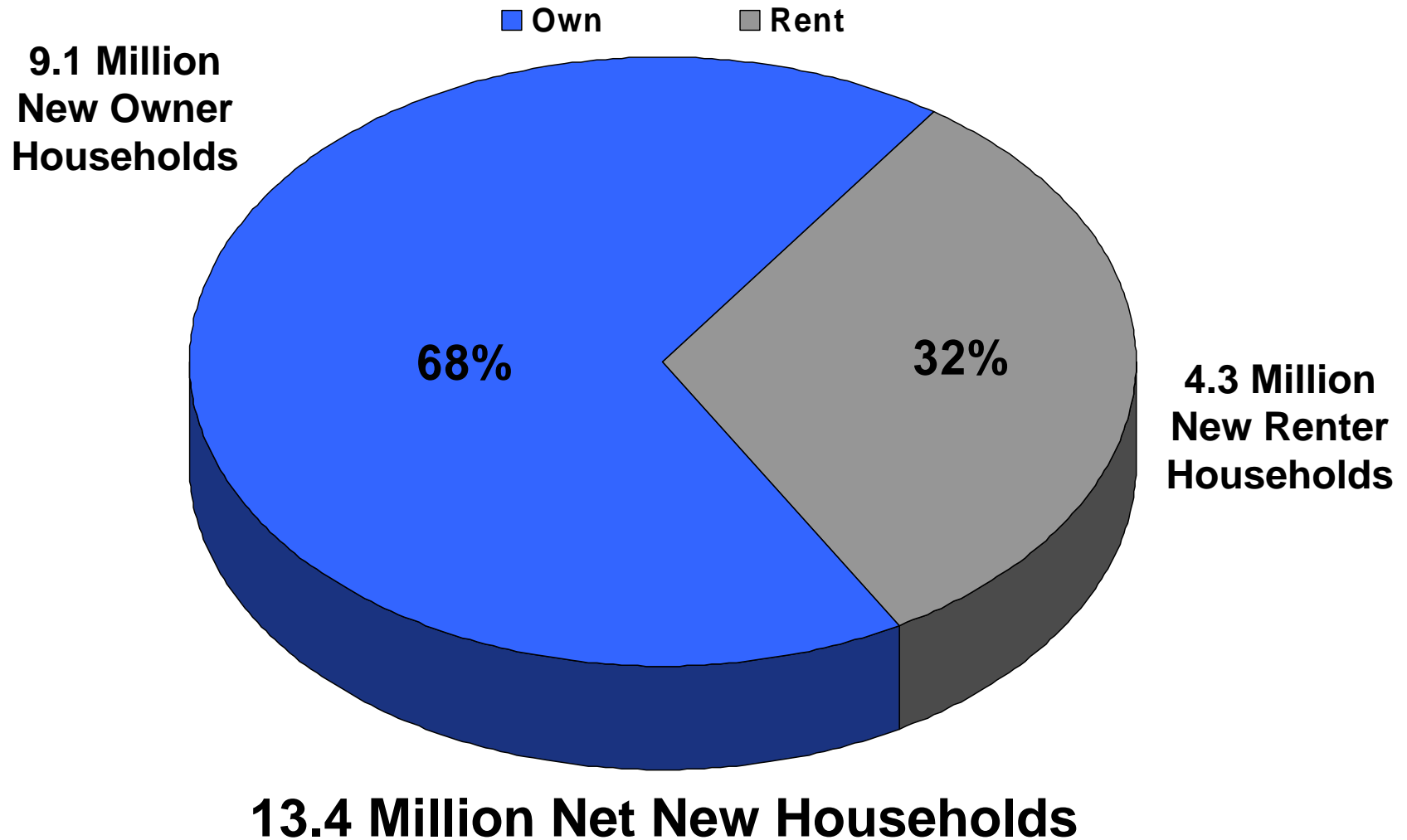
# Echo Boomer Demand Supports Appreciation



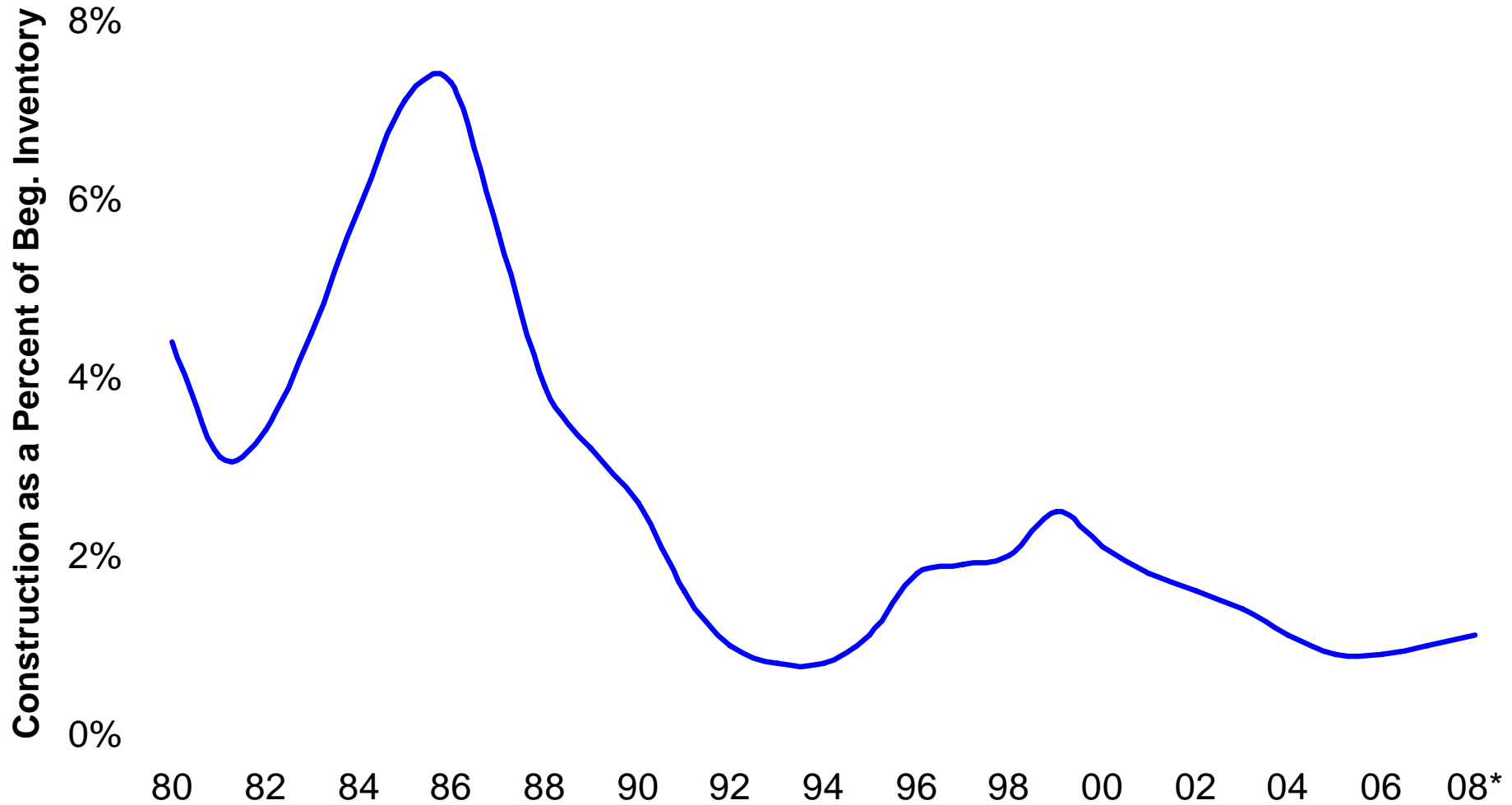
\* Forecast

Sources: Marcus & Millichap Research Services, Economy.com

# Household Growth Points to Strong Rental Demand 2005 – 2015 Projections



# New Supply Has Become Much More Constrained Apartment Construction as a Percent of Beginning Inventory



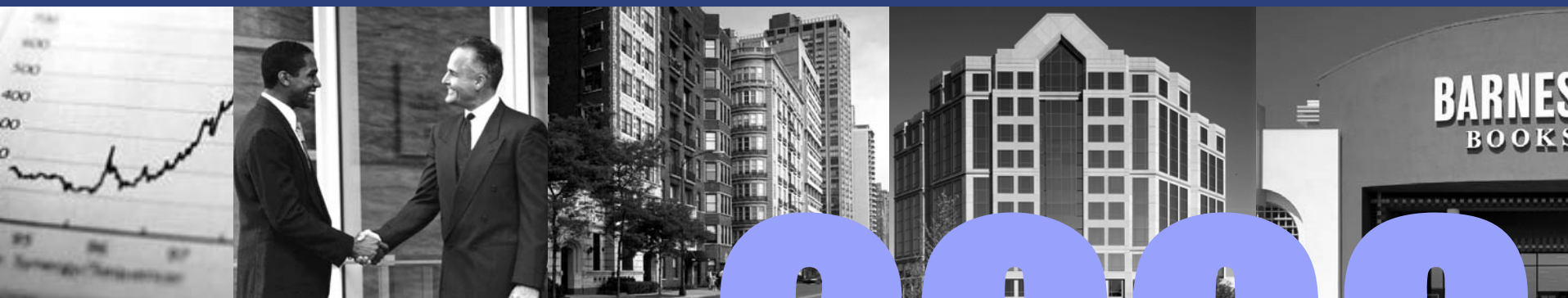
\* Forecast

Sources: Marcus & Millichap Research Services, Reis

# **Marcus & Millichap's NMHG Remains Bullish on U.S. Apartments**

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- **High levels of future demand**
- **Supply more difficult and expensive to deliver**
- **Unlikely the industry will meet demand**
- **Current rents in most markets do not justify development**
- **Significant future pressure on rents**
- **U.S. apartments will be dramatically more valuable in 2013 than 2008**



# 2008

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