

BUYERS SEEKING HIGHER INITIAL YIELDS FOR PERCEIVED RISK

In Charlotte, an increase in apartment completions and weaker employment-driven demand will force up vacancy for the second consecutive year, causing owners to reduce rents. On the demand side, concerns linger over the health of the banking industry, although Bank of America Chief Executive Kenneth Lewis expects the company to be profitable this year, barring any unforeseen meltdowns. This cautious optimism illustrates the delicate state of the banking system and underlies economic uncertainty at the local and national levels. In mid-March, the governor announced budget plans that would potentially eliminate 1,400 positions, including many from renter-generating employers such as the Department of Corrections. As a softer job base restrains apartment demand in the near term, apartment projects that commenced just a few years ago are nearing lease-up. Additions to supply in 2009 will exceed last year's completions by nearly 60 percent, exerting upward pressure on the vacancy rate.

Buyers were reluctant to enter the market during the latter part of 2008, a trend that has carried into this year. Investors are seeking greater yields to compensate for lower revenues resulting from occupancy losses and increased concessions. Current cap rates, however, are averaging in the mid- to high-7 percent range, about 50 basis points to 75 basis points below buyers' expectations. Velocity will pick up later in the year, although much of the activity will likely involve distressed assets. Investors with long-term value enhancement strategies may find properties that fit their criteria south of the metro, along the state line. Many companies are relocating to York, Lancaster and Chester counties due to a more favorable business climate. As such, assets in the North Pineville and Carmel submarkets could register steadier tenant demand in the near term, thereby bolstering property revenues.

2009 ANNUAL APARTMENT FORECAST



Employment: Employers are expected to eliminate 22,000 positions this year, a 2.6 percent decline in total employment and the most workers cut in any year this decade. In 2008, 15,600 jobs were lost in the market.



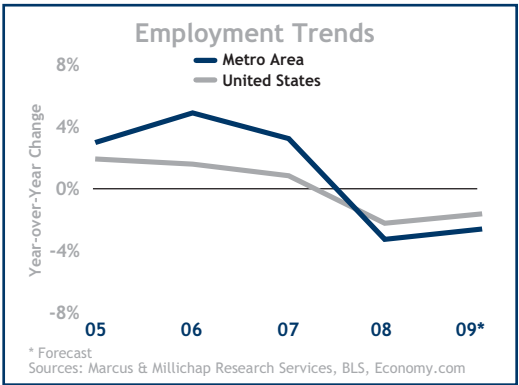
Construction: Approximately 3,200 apartment units will be delivered in 2009, up from 2,000 units last year. Over the past five years, annual completions have averaged 1,700 units.



Vacancy: Weaker employment-generated demand will cause vacancy to increase 180 basis points this year to 9.8 percent, following a 200 basis point spike in 2008.

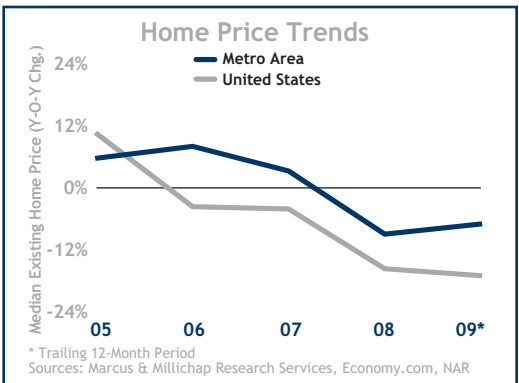


Rents: Rents are expected to fall in 2009 due to a supply and demand imbalance. Asking rents are forecast to drop 1.5 percent to \$786 per month, while effective rents will decrease 2.9 percent to \$695 per month.



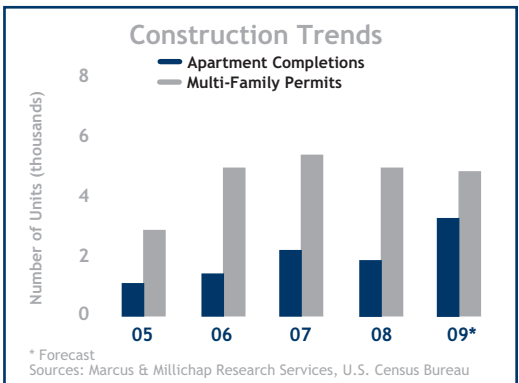
ECONOMY

- ◆ With the estimated trimming of 16,600 jobs in the first quarter, local employers have shed approximately 42,000 positions over the past 12 months. The pace of job losses appears to be slowing, however, as 18,700 workers were released during the fourth quarter of 2008.
- ◆ Payroll reductions in the professional and business services; trade, transportation and utilities; and manufacturing sectors are weighing heavily on the metro. Year over year in the first quarter, nearly 13,400 positions have been cut in these industries.
- ◆ While bank restructuring will be a drag on the local economy this year, some companies are expanding. International engineering firm Fluor will add 100 high-paying jobs in the market over the next few months.
- ◆ **Outlook:** Employers are expected to eliminate 22,000 positions this year, a 2.6 percent decline in total employment and the most workers cut in any year this decade. In 2008, 15,600 jobs were lost in the market.



HOUSING AND DEMOGRAPHICS

- ◆ Permit issuance for multi-family construction, which includes condominiums and apartments, fell 23 percent to 5,000 annualized units in the first quarter. On the single-family side, the number of permits pulled dropped 45 percent to an annualized rate of 5,300 units.
- ◆ The median price of a single-family home in the metro area depreciated 7 percent last year to approximately \$190,000 and was on course to decline by roughly 3 percent in the first quarter. The metro's median income was \$50,600 annually during the first three months of 2009, more than the minimum income of \$45,173 per year needed to purchase a home.
- ◆ The average Class B/C asking rent in the Charlotte market is \$340 per month less than the typical mortgage payment on a median-priced home; Class A asking rents are \$98 per month less.
- ◆ **Outlook:** While affordability has improved, stricter mortgage underwriting and an uncertain employment market will prevent the migration of many renters into for-sale housing.

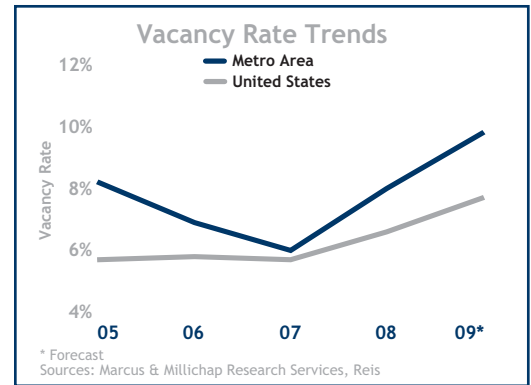


CONSTRUCTION

- ◆ In the 12-month period ending in the first quarter, rental inventory expanded by 2.5 percent, or 2,300 apartments. In the previous year, completions totaled 1,900 units.
- ◆ The pipeline of planned projects contains 9,400 units, most of which are scheduled in the Fairview North, North Pineville and Harris Boulevard/Mallard Creek Church Road submarkets.
- ◆ In addition to rental units that are either planned or under construction, nearly 1,600 condos are under way, including roughly 800 units slated for completion in 2009.
- ◆ **Outlook:** Approximately 3,200 apartment units will be delivered this year, up from 2,000 units in 2008. Over the past five years, annual completions have averaged 1,700 units.

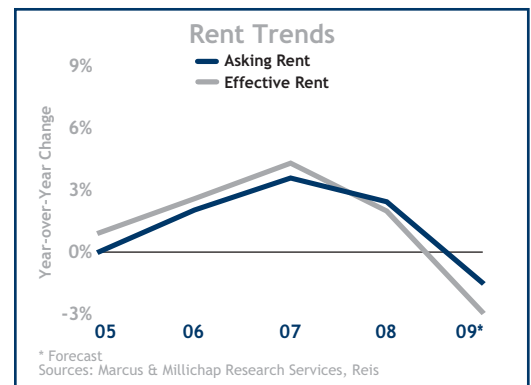
VACANCY

- ◆ Marketwide vacancy of 8.3 percent in the first quarter was 180 basis points more than the rate in the corresponding period last year, as supply growth outweighed demand. In the previous year, vacancy fell 40 basis points.
- ◆ In the Class A segment, vacancy was 7.7 percent in the first quarter, up 240 basis points year over year. The increase was driven primarily by 4.1 percent supply growth in the segment, or the addition of 1,800 units.
- ◆ Vacancy in Class B/C properties rose 80 basis points to 8.2 percent during the 12 months ending in the first quarter, as demand waned amid softer employment in lower-wage sectors such as construction.
- ◆ **Outlook:** Weaker employment-generated demand will cause vacancy to increase 180 basis points this year to 9.8 percent, following a 200 basis point spike in 2008.



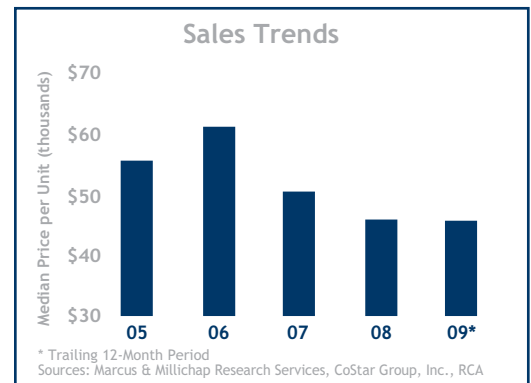
RENTS

- ◆ Estimated asking rents of \$795 per month in the first quarter were 1.1 percent greater than one year earlier, while effective rents fell 0.1 percent to \$709 per month. During the first quarter, asking rents dipped 0.4 percent, and effective rents decreased 1.6 percent.
- ◆ Asking rents at Class A properties increased 1.1 percent to \$918 per month in the 12 months ending in the first quarter. In the preceding year, top-tier asking rents advanced 3.5 percent. First quarter asking rents of \$676 per month in the Class B/C sector reflect a gain of 1 percent from the same quarter in 2008.
- ◆ Revenues have fallen as a result of rising vacancy. Over the past year, the average gross revenue has declined 2 percent, after increasing 5.1 percent in the previous 12 months.
- ◆ **Outlook:** Asking rents are forecast to drop 1.5 percent to \$786 per month in 2009, while effective rents will decrease 2.9 percent to \$695 per month.



SALES TRENDS**

- ◆ Transaction velocity has declined 56 percent during the past 12 months, following a 7 percent increase in the prior year. More conservative underwriting and concerns over the local economy are slowing deal flow.
- ◆ The median price of properties sold has dropped 11 percent year over year to \$45,800 per unit. The decrease is attributable to buyers underwriting for higher vacancy rates and declining rents.
- ◆ Current cap rates are in the mid- to high-7 percent range, up slightly during the past year. Slower transaction velocity and tighter financing will raise cap rates further over the next 12 months.
- ◆ **Outlook:** Despite the decrease in prices, buyers are still seeking to purchase at initial yields approximately 50 basis points to 75 basis points higher in the to the mid- to high-8 percent range. Buyer activity will remain limited to distressed assets until the pricing expectations gap narrows.



** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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CAPITAL MARKETS

BY WILLIAM E. HUGHES, SENIOR VICE PRESIDENT, MARCUS & MILLICHAP CAPITAL CORPORATION

- ◆ Despite ongoing uncertainty in the financial markets and among some of the country's largest banks, debt financing remains available for multi-family loans. Standards have tightened considerably, however, with lenders requiring LTVs of 55 percent to 75 percent marketwide. Debt-service coverage ratios are in the 1.25 to 1.30 range, higher than in recent years, but closer to historical norms.
- ◆ The apartment sector has benefited from the presence of Fannie Mae and Freddie Mac, as both agencies continue to fund deals. The yield on the 10-year Treasury has been volatile, dropping to nearly 2 percent late last year, prompting many lenders to favor all-in rates, which are averaging in the high-5 percent to mid-6 percent range for agency loans. Commercial banks and life insurance companies are issuing loans with all-in rates ranging from the mid-6 percent range to 8 percent.
- ◆ With apartment fundamentals weakening and delinquencies creeping higher, lenders are devoting greater attention to sponsorship. A borrower's asset base and potential economic stresses that may affect the underlying assets are playing a significant role in determining loan terms.

SUBMARKET OVERVIEW

- ◆ More than one-third of the metro's new inventory this year will be added in the southern submarkets of North Pineville and Fairview North. As a result, Class C properties are expected to register a greater degree of operational weakness; vacancy in the areas' lower-tier assets will likely exceed the low-10 percent range by year end.
- ◆ Employment losses among lower-paid residents are expected to weaken demand for affordable rental housing in the North Tryon and East Charlotte/Albemarle Corridor submarkets. Consequently, effective rents in these areas are forecast to decline by 3.0 percent to 3.5 percent this year, the largest drops since 2002.
- ◆ Accelerated supply growth over the past two years has caused vacancy to climb in the Carmel submarket. Since 2007, the area has received approximately 1,000 units, driving up vacancy a cumulative 380 basis points over the past 24 months. Looking forward, minimal new development should keep vacancy in the submarket within the low-9 percent range.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Fairview North	5.8%	-100	\$791	0.1%
2	East/Central Avenue	6.9%	260	\$645	1.7%
3	Harris Blvd./Mallard Creek Church Rd.	7.0%	210	\$800	0.6%
4	Gaston County	7.0%	50	\$622	0.2%
5	Downtown	7.2%	120	\$1,120	-3.4%
6	West Charlotte/Airport	8.1%	-90	\$560	1.6%
7	North Pineville	8.4%	240	\$696	-2.0%
8	Concord/North Concord	8.9%	330	\$645	3.2%
9	Carmel	9.1%	380	\$815	1.4%
10	Northwest Charlotte	9.1%	50	\$818	3.7%