

# ApartmentResearch

M A R K E T U P D A T E

Marcus & Millichap

Detroit Metro Area

Third Quarter 2009

## JOB LOSSES DRIVING POPULATION DECLINE, RISING VACANCY

In the Detroit metro, a weakened employment base continues to place downward pressure on local apartment fundamentals. Over the past year, steep layoffs have pushed vacancy rates in both Class A and Class B/C complexes higher, with top-tier vacancy rising to its highest level in more than two decades, forcing owners to lower rents. Staff reductions have been severe in the manufacturing and professional and business services sectors, which have eliminated a total of more than 100,000 workers year over year, suppressing absorption. Restructuring at the Ford Motor Co. headquarters, for instance, has contributed to Class A vacancy in the Dearborn/Dearborn Heights submarket spiking more than 300 basis points over the last year to the low-8 percent range. While further downsizing in the auto industry will clearly have both near- and long-term implications on local household growth, as more residents choose to leave the metro, some encouraging signs have emerged. Both Chrysler and General Motors Co. have exited bankruptcy protection in record time. Despite leaner payrolls, major restructuring among the Big Three could better position the firms for stronger long-term health, helping to stabilize the metro's auto-industry employment base going forward.

Although local apartment assets provide some of the nation's highest initial yields, investment activity continues to slow due to the high level of distress in the Detroit economy. The drop-off in sales velocity has accelerated since year-end 2008, with year-to-date closings accounting for just one-third of all sales during the past 12 months. With buyers and lenders shying away from making large commitments in the market, properties priced below \$2 million have comprised more than 60 percent of metrowide sales over the last six months, compared with just 25 percent in the previous two quarters. Moreover, REO asset deals have represented approximately 50 percent of the closings since the start of 2009, highlighting the growing level of distress. Risk-averse buyers have gravitated toward Oakland and Washtenaw counties, where operations are outperforming the metro average, though velocity is still below historical trends.

### 2009 ANNUAL APARTMENT FORECAST



**Employment:** Restructuring in the auto industry and general economic weakness will continue to stifle employment in Detroit. In 2009, roughly 142,000 workers are forecast to be laid off, thinning the metro's work force by 7.8 percent. Last year, employers trimmed 112,500 positions from local payrolls.



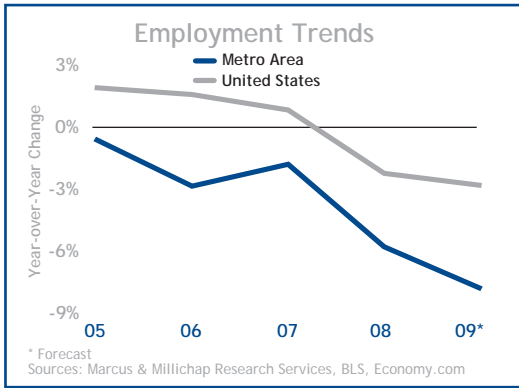
**Construction:** Following the delivery of 280 apartment units last year, 320 units are projected to be added in 2009, expanding rental inventory by 0.1 percent. Over the past five years, completions have averaged 580 units.



**Vacancy:** A contracting number of households and more residents doubling up will cause vacancy to trend higher. In 2009, vacancy is forecast to climb 140 basis points to 8.3 percent, primarily driven by operational challenges in the metro's large Class B/C inventory.

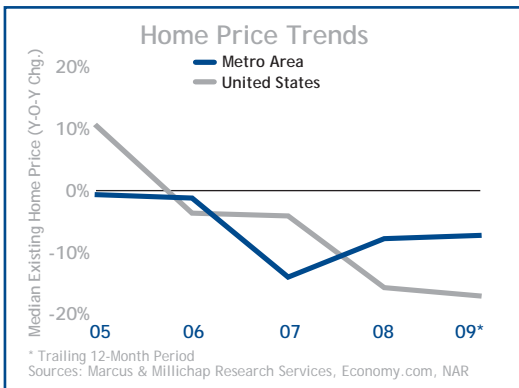


**Rents:** This year, asking rents are expected to shrink 1.7 percent to \$821 per month, while effective rents will fall 3.5 percent to \$741 per month. In 2008, asking rents rose 0.1 percent, and effective rents retreated 0.4 percent.



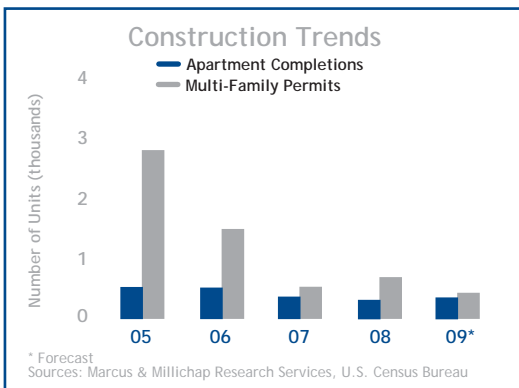
## ECONOMY

- ◆ During the 12 months ending in the second quarter, approximately 176,600 workers were laid off, reducing metrowide employment by 9.2 percent; 53,600 spots were cut one year earlier. Since the start of 2009, roughly 95,600 positions have been eliminated.
- ◆ Widespread restructuring among auto-related industries has resulted in steep job cuts in the Detroit manufacturing sector. Year over year, this segment has shrunk by 26 percent, or 62,650 jobs, with 42,500 workers released in the last two quarters.
- ◆ To help combat ongoing budget deficit struggles, the Detroit Public Schools system has announced that it will let go almost 2,500 employees this year, cutting staff levels by nearly 18 percent.
- ◆ **Outlook:** Restructuring in the auto industry and general economic weakness will continue to stifle employment in Detroit. In 2009, roughly 142,000 workers are forecast to be laid off, thinning the metro's work force by 7.8 percent. Last year, employers trimmed 112,500 positions from local payrolls.



## HOUSING AND DEMOGRAPHICS

- ◆ Developers pulled approximately 320 single-family housing permits in the 12 months ending in the second quarter, down 45 percent from one year earlier. Permits for multi-family housing, on the other hand, ticked up to 330 units.
- ◆ The median price for a single-family home in the metro fell 7.4 percent year over year to \$120,100 in the second quarter. The median household income slipped 5.9 percent to \$51,550 per year in that span, 62 percent above the minimum required income to qualify for a median-priced home.
- ◆ Using traditional financing for a median-priced residence, the monthly mortgage payment is roughly \$320 per month less than the metro's average Class A asking rent.
- ◆ **Outlook:** Deteriorating local job and housing markets will deter many residents from making that transition into ownership this year, despite the affordability of homes.

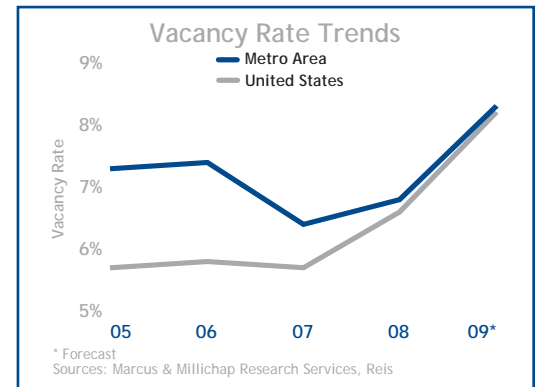


## CONSTRUCTION

- ◆ The inventory of apartment units in Detroit has expanded by almost 330 units, or 0.2 percent, over the past year, nearly identical to the number of units delivered in the preceding 12-month period.
- ◆ Approximately 390 apartment units are under way across the metro, roughly 70 percent of which are slated for completion this year. Most of the units being built are located in the Westland and Ann Arbor submarkets. For-sale builders, meanwhile, have more than 700 condo units under construction.
- ◆ The planning pipeline contains 2,600 rental units; however, given the current economic climate and challenges securing construction loans, it is unlikely that many of these projects will break ground in the near term.
- ◆ **Outlook:** Following the delivery of 280 apartment units last year, 320 units are expected to be added in 2009, expanding rental inventory by 0.1 percent. Over the past five years, completions have averaged 580 units.

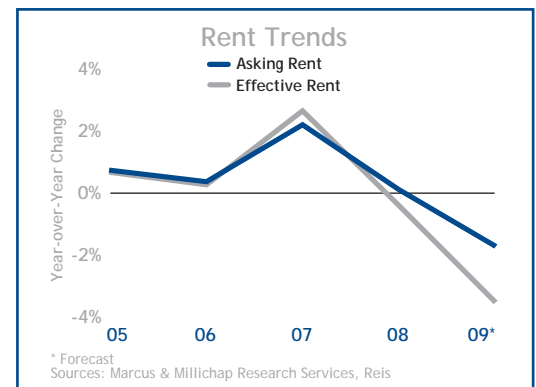
## VACANCY

- ◆ A rapidly deteriorating employment market has weighed on metrowide absorption levels, elevating vacancy. Over the last year, the average vacancy rate has climbed 110 basis points to 7.5 percent. Vacancy has risen 60 basis points year to date.
- ◆ During the past 12 months, job cuts in office-using sectors have softened top-tier space demand, underpinning a 120 basis point increase in Class A vacancy to 7.1 percent.
- ◆ The vacancy rate in the lower tiers has pushed up 110 basis points in the last year to 7.7 percent. The rise is the result of ongoing weakness in the economy, most notably in the manufacturing sector.
- ◆ **Outlook:** A contracting number of households and more residents doubling up will cause vacancy to trend higher. In 2009, vacancy is forecast to climb 140 basis points to 8.3 percent, primarily driven by operational challenges in the metro's large Class B/C inventory.



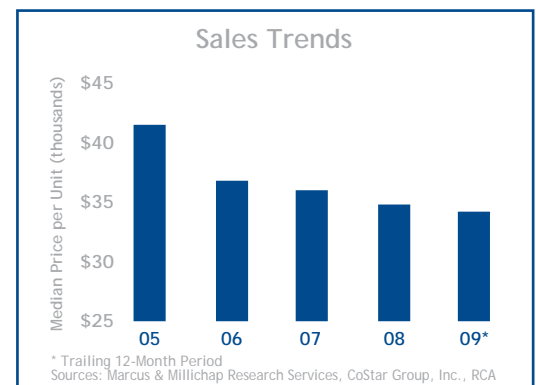
## RENTS

- ◆ During the 12 months ending in the second quarter, asking rents slipped 0.5 percent to \$829 per month, and effective rents fell 1.8 percent to \$756 per month. As job losses have accelerated in the last six months, asking and effective rents have dropped 0.7 percent and 1.6 percent, respectively.
- ◆ Class A asking rents have increased 0.1 percent to \$1,034 per month year over year, while Class B/C asking rents have receded 0.8 percent to \$716 per month.
- ◆ Revenues have contracted by 3 percent over the last year and 2.3 percent since the start of 2009 due to rent reductions and increased concessions.
- ◆ **Outlook:** This year, asking rents are expected to shrink 1.7 percent to \$821 per month, while effective rents will fall 3.5 percent to \$741 per month. In 2008, asking rents rose 0.1 percent, and effective rents retreated 0.4 percent.



## SALES TRENDS\*\*

- ◆ During the past year, distress in the employment market has caused sales velocity to slow by nearly 20 percent. The decline has sharpened since the beginning of this year, when economic and job market concerns intensified.
- ◆ The median price of an apartment asset in Detroit has contracted 10 percent to \$34,100 per unit year over year. Some of the depreciation is due to a higher concentration of distressed assets and lender-owned properties changing hands recently.
- ◆ In most cases, cap rates currently average from the mid-8 percent to low-9 percent range, up roughly 60 basis points from the preceding year.
- ◆ **Outlook:** Challenges securing larger loans will drive buyers toward assets priced below \$5 million over the next few quarters. Cash-equipped investors, however, may find less competition when bidding on larger assets in areas such as Ann Arbor. Although this submarket typically records modest velocity, some owners may look to divest in order to meet certain loan obligations, enabling buyers to acquire properties that have not been on the market in some time.



\*\* 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

- ◆ During the first quarter, multi-family mortgage originations were 61 percent below year-earlier levels and 79 percent lower than the late-2006 peak. Though considerable, the reduction in apartment originations remains less significant than declines among other core commercial property types, due largely to the availability of financing through Fannie Mae and Freddie Mac.
- ◆ Portfolio lenders are issuing apartment financing at all-in rates of 6.0 percent to 6.3 percent for three-year loans and up to 6.8 percent to 7.5 percent for a 10-year term. Loan-to-value requirements range from 55 percent to 75 percent.
- ◆ Agency lenders are offering five-year loans at all-in rates of 4.8 percent to 5.0 percent with 10-year mortgages available at rates averaging 5.35 percent and 5.7 percent, respectively. Maximum leverage among agency lenders ranges from 55 percent to 75 percent.
- ◆ Freddie Mac recently completed a \$1 billion securitization of multi-family debt, the first issuance to hit the market since last June. The securities, dubbed "K Certificates," vary from traditional CMBS in that buyers are provided a guarantee by Freddie Mac. In addition to the potential for another similar offering, government programs designed to increase credit flows into commercial real estate could be operational by late summer/early fall.

## SUBMARKET OVERVIEW

- ◆ Investors may want to track ridership levels at the recently opened Rosa Parks Transit Center. Located at Michigan and Cass avenues in the Downtown submarket, the new transit hub may help to bolster the appeal of apartments near the rail line and other boarding stations.
- ◆ General Electric Co. has announced plans to build a \$100 million advanced manufacturing, technology and software center in Van Buren Township, located in the Downriver/South Wayne submarket. The facility will employ 1,200 workers, helping to support demand for local housing.
- ◆ Risk-averse buyers may want to examine opportunities in the Ann Arbor submarket, where the University of Michigan provides a large pool of renters. Near-term softening aside, the student body and a modest building pipeline should help to limit weakening and restore operations going forward.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Oak Park/Royal Oak	4.2%	60	\$641	-2.3%
2	Westland	5.2%	-70	\$706	-2.4%
3	Southfield	5.5%	-60	\$805	-1.5%
4	Farmington Hills	6.4%	160	\$911	-2.7%
5	Downriver/South Wayne	6.7%	70	\$660	-1.8%
6	Macomb County	6.7%	40	\$672	-0.7%
7	Troy	6.9%	120	\$945	0.6%
8	Ann Arbor	7.4%	280	\$821	-3.6%
9	Dearborn/Dearborn Heights	8.3%	320	\$719	-4.9%
10	Novi/Livonia	8.9%	-70	\$789	0.3%