ApartmentResearch

MARKET UPDATE

Marcus & Millichap

Los Angeles County *Third Quarter 2009*

Weak Port Traffic, Job Cuts Driving Down Demand

Persistent employment reductions will drag on apartment fundamentals in Los Angeles through the rest of 2009, despite limited new supply. International trade, a traditional economic driver in the region, has struggled mightily since the onset of the global recession. The ports of Long Beach and Los Angeles have posted container traffic declines of 27 percent and 15 percent, respectively, thus far in 2009, contributing to a drop in apartment demand. Apartment operators are responding to the downturn by trimming rents and offering moderate concessions, trends likely to continue in the quarters to come. The Greater Downtown area is expected to be under the greatest stress due to a surge of multi-family construction in recent years that was done as part of a long-range redevelopment plan. A short-term oversupply downtown will drive the deepest rent declines in the county this year.

While weakened fundamentals are slowing investment activity throughout the metro, different strategies are emerging, depending upon asset location. Buyers are seeking distressed properties in the Greater Downtown area, where prices have dropped considerably, though many owners of stabilized assets are choosing not try to compete with bargain-level prices and are subsequently not listing properties. Distress in the Westside Cities has largely been limited to aggressively underwritten complexes purchased at the peak of the market. Prices have not come down considerably for these assets, however, due to attractive locations and assumptions for healthy renter demand over the long term. The South Bay/Long Beach area is benefiting from a nearly empty development pipeline, although the impact of reduced port activity on apartment demand has been significant, causing many investors to remain on the sidelines. While the San Fernando Valley's steady household growth will ultimately attract investment activity, buyers are wary of properties with above-average vacancy or competitive threats from nearby new developments. Countywide, cap rates are averaging in the high-5 percent to mid-6 percent range, but vary considerably by location and property quality.

2009 Annual Apartment Forecast

4.1% decrease in total employment

Employment: Following the loss of more than 138,000 jobs in 2008, payrolls in Los Angeles County are forecast to contract by 4.1 percent, or 162,000 workers, this year.

1,900 units will be completed

Construction: Only 1,900 apartment units will come online in 2009, down from approximately 4,600 units last year. This year's deliveries will represent a scant 0.2 percent addition to inventory.

160 basis point increase in vacancy

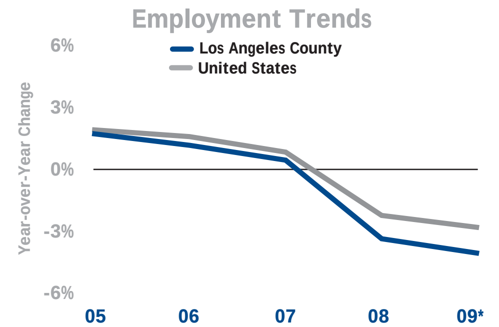
Vacancy: Despite subdued completions, vacancy in Los Angeles County is forecast to reach 5.9 percent this year, a 160 basis point rise. In 2008, vacancy crept up 70 basis points.

4.1% decrease in asking rents

Rents: As demand wanes, operators will lower rents and increase concessions in an attempt to attract and retain renters. In 2009, asking rents are forecast to fall 4.1 percent to $1,403 per month, while effective rents will drop 6.4 percent to $1,320 per month. Last year, asking and effective rents advanced 2.6 percent and 2.1 percent, respectively.

Economy

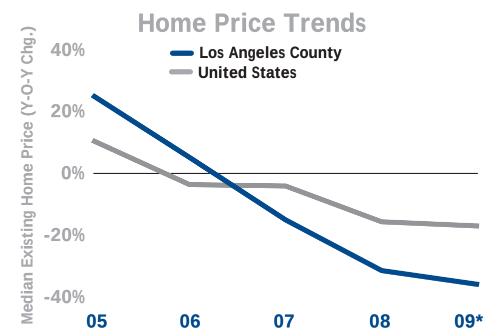
- During the past 12 months, employment in Los Angeles County has contracted by 4.5 percent with the loss of 183,800 jobs. Thus far in 2009, 85,800 positions have been shed.
- Declining container traffic at the ports of Los Angeles and Long Beach has driven a 5.2 percent year-over-year decrease in employment within the trade, transportation and utilities sector. Roughly 42,500 jobs have been cut in the industry during this period.
- Professional and business services and financial activities, two of the metro's traditionally highest-paying sectors, have cut a combined 49,000 jobs during the past 12 months. The pace of layoffs accelerated recently, as nearly 30,000 positions were cut in these segments in the first half of 2009.
- **Outlook:** Following the loss of more than 138,000 jobs in 2008, payrolls are forecast to contract by 4.1 percent, or 162,000 workers, this year.



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

Housing and Demographics

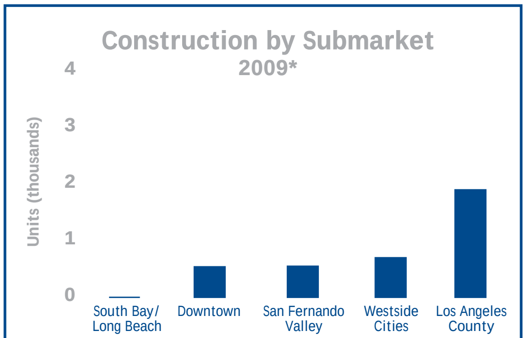
- In the past year, approximately 2,400 single-family housing permits have been issued, 50 percent fewer than were pulled in the preceding 12 months. Developers have obtained 5,600 multi-family permits in the last year, down 45 percent from the year-earlier level.
- Year over year through the second quarter, the median home price in Los Angeles County declined 36 percent to $241,700. Area home prices have plummeted more than 55 percent from the peak in early 2007.
- Although prices have dropped precipitously, homes remain expensive. The median household income of $51,600 per year is approximately $10,200 less than the amount required for the monthly mortgage obligations on a median-priced home, using traditional financing.
- **Outlook:** Falling home prices and income levels are putting pressure on rents. The average Class A asking rent is more than $500 per month higher than the mortgage payment on a median-priced residence in the county. One year ago, the monthly mortgage payment for a median-priced home exceeded the average Class A asking rent by $450 per month.



* Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, Economy.com, NAR

Construction

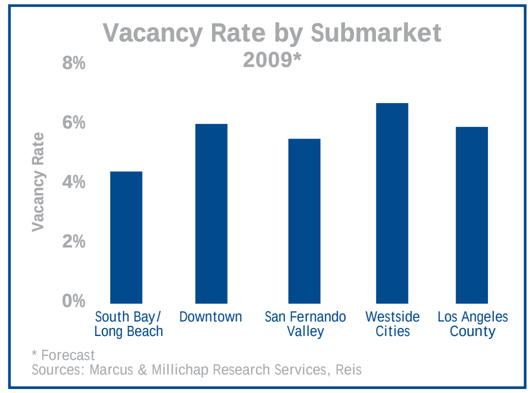
- Developers have delivered approximately 2,700 rentals in the metro in the past year, down from the more than 5,000 units that came online in the preceding 12 months. Only 650 apartments have been completed year to date.
- Approximately 3,200 units are under construction, but roughly 2,000 of these apartments will be delivered in 2010 or later. Nearly 10,000 units are planned, up from 8,700 units one year ago.
- While completions have been limited in recent months, additions to inventory should spike in the third quarter, as more than 900 units are scheduled to come online. Deliveries are expected to cool in the fourth quarter of 2009 and first quarter of 2010.
- **Outlook:** Only 1,900 apartment units will be added in 2009, down from approximately 4,600 units last year. This year's deliveries will represent a scant 0.2 percent increase in inventory.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

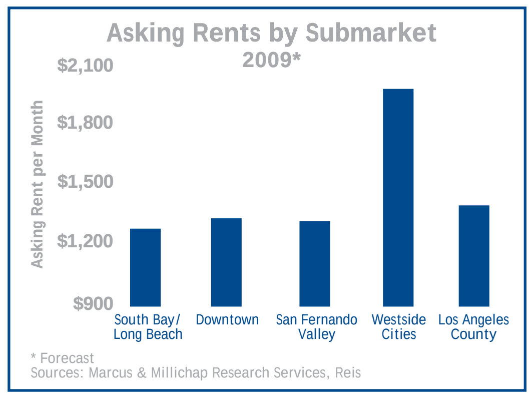
Vacancy

- Vacancy ticked up just 10 basis points to 5.4 percent in the second quarter, as no new inventory was added. During the past 12 months, countywide vacancy has increased 120 basis points.
- In the Class A segment, vacancy has pushed up 70 basis points to 7.1 percent year over year. All of the increase occurred in the first half of 2009, and the rate is expected to approach 8 percent by year end.
- Vacancy in Class B/C properties has risen 140 basis points in the last year to a still-tight 4.7 percent. Negative net absorption of more than 9,400 lower-tier apartments has been recorded over the past six quarters.
- **Outlook:** Despite subdued completions, vacancy in Los Angeles County is forecast to reach 5.9 percent this year, a 160 basis point rise. In 2008, vacancy crept up 70 basis points.



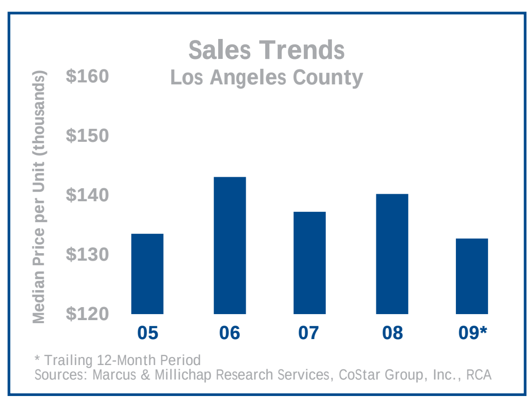
Rents

- Year over year, asking rents have fallen 1.9 percent to $1,432 per month, and effective rents have dropped 3.0 percent to $1,366 per month. Declines are accelerating as vacancy pushes higher; asking and effective rents have dipped 2.1 percent and 3.1 percent, respectively, year to date.
- As vacancy has risen and incomes have contracted, owners have eased rents in the top tier. Class A asking rents have declined 3.0 percent during the past 12 months to $1,887 per month. Asking rents in Class B/C properties have dropped 1.1 percent in the same period to $1,232 per month.
- Rising vacancy has driven a 4.5 percent decrease in revenue during the past year; average revenue is expected to contract by nearly 7 percent in 2009.
- **Outlook:** As demand wanes, operators will lower rents and increase concessions in an attempt to attract and retain renters. In 2009, asking rents are forecast to fall 4.1 percent to $1,403 per month, while effective rents will drop 6.4 percent to $1,320 per month.



Sales Trends**

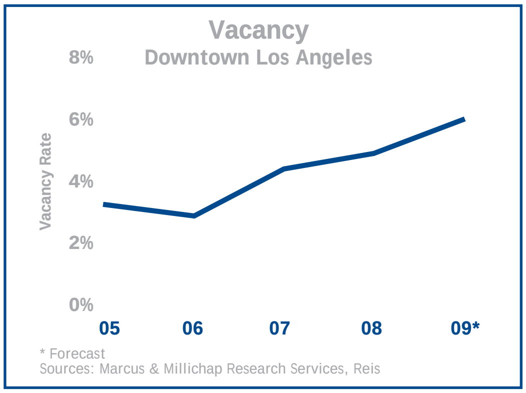
- Sales velocity has declined 49 percent year to date compared to the same period in 2008. During the past two quarters, investment activity has fallen more than 40 percent from the previous six-month stretch.
- Prices have slowly declined in recent quarters. In the past 12 months, the median price was $132,500 per unit, down 4 percent from the year-earlier period. Thus far in 2009, the median price has been $128,500 per unit, 6 percent lower than in the first half of last year.
- Cap rates for core properties are averaging in the high-5 percent to mid-6 percent range, 50 basis points to 70 basis points higher than in 2008. Pricing has been more volatile in distressed deals, where some assets are trading with cap rates as high as 8 percent.
- **Outlook:** Investors are expected to target properties that were purchased at the peak of the market and underwritten aggressively; these assets will be the most likely to fall into distress and be deeply discounted. Buyers may find attractively priced properties in downtown, where tight credit markets and softening fundamentals could stall some redevelopment projects in the coming quarters.



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

Downtown Los Angeles Apartment Market

Construction and Vacancy

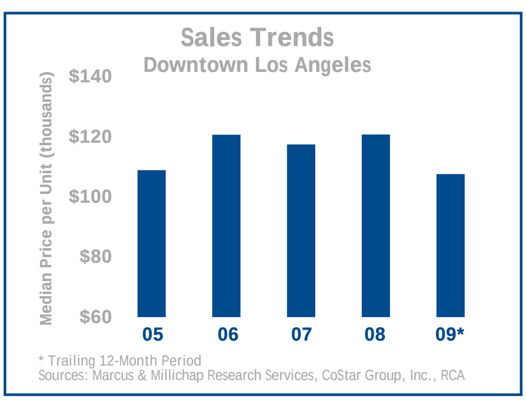


- During the past 12 months, developers have completed approximately 440 apartments in the Greater Downtown area, nearly all of which came online in the second half of 2008. In the preceding year, more than 1,600 units were delivered.
- There are roughly 1,250 apartments under construction downtown, although more than 700 of the units will be delivered in 2010 or later. For-sale construction is more prevalent; nearly 2,000 condo units are under way, with the bulk of the units scheduled for delivery in late 2009 and early 2010. The planning pipeline contains 4,300 rentals and 5,600 condos.
- Vacancy has increased 50 basis points year over year to 5.2 percent although the rate was unchanged in the second quarter, as no new apartment units were delivered.
- **Outlook:** Approximately 550 apartments will come online in the Greater Downtown area in 2009, following the delivery of more than 900 units last year. Demand for space is weakening, though, and vacancy is forecast to rise 110 basis points to 6 percent.

Rents

- During the past year, asking rents in the Greater Downtown area have dropped 3.1 percent to $1,387 per month. All of the decline has occurred thus far in 2009; asking rents have retreated 3.4 percent in the last two quarters.
- As vacancy has increased and more condo units have been employed as rentals, owners have offered greater concessions to attract tenants. Effective rents have declined in each of the past four quarters, falling 4.7 percent in that time to $1,327 per month.
- Average revenue has receded 5.2 percent in the past year, following a 5.4 percent increase in the preceding 12-month period. Concessions now total 16 days of free rent, up from 10 days of free rent one year ago.
- **Outlook:** Asking rents are expected to decline 6.8 percent in 2009 to $1,338 per month, while effective rents will tumble 8.9 percent to $1,267 per month.

Sales Trends**



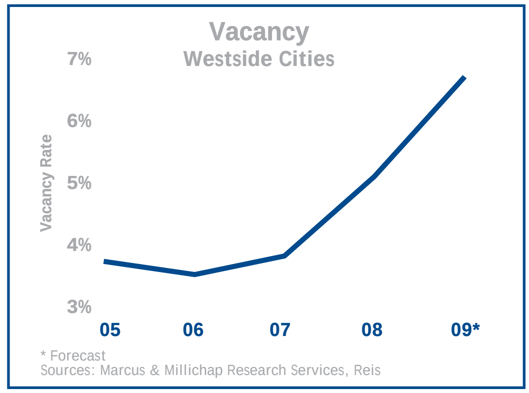
- Weakening fundamentals have deterred investors, causing sales velocity in the Greater Downtown area to slow 40 percent in the last year. During the past six months, investment activity dropped 37 percent from the preceding six-month period.
- The average cap rate in all properties that have changed hands so far in 2009 is 7.5 percent, although some stabilized properties have sold with initial yields in the low-6 percent range. Distressed assets often trade with cap rates above 8 percent.
- The median price has retreated 11 percent in the past year to $107,100 per unit. Buyers are increasingly targeting distressed properties; the median price was $92,500 per unit in deals closed thus far in 2009.
- **Outlook:** While prices have dropped in recent quarters, redevelopment projects downtown should present upside over the long term.

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

Westside Cities Apartment Market

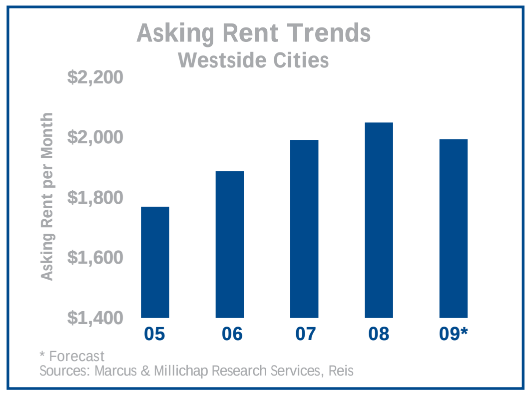
Construction and Vacancy

- In the past year, developers have delivered more than 1,400 apartments to the Westside Cities, increasing area inventory by 0.9 percent. The 284-unit 5600 Wilshire complex in the Beverly Hills/West Hollywood/Park La Brea submarket was the largest development to be delivered this summer.
- There are 860 apartment units under construction and another 1,850 units planned. In addition, 400 condos are under way, and 2,600 for-sale units are proposed, though some of these projects could come online as Class A rentals if weakness in the housing market and economy persists.
- Vacancy has increased 100 basis points year over year to 6.2 percent. The rate held steady through the early months of the recession but has risen 110 basis points year to date, as some residents have moved to less expensive areas in order to reduce housing expenses.
- **Outlook:** Developers are on pace to complete 700 rental units this year, down from more than 1,500 units in 2008. Despite easing deliveries, vacancy is expected to reach 6.7 percent, a 160 basis point annual spike. Last year, vacancy rose 130 basis points.



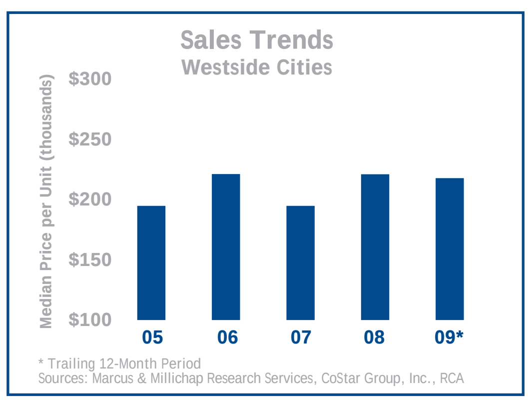
Rents

- Asking rents in the Westside Cities have fallen 1.3 percent year over year to $2,021 per month. During the second quarter, asking rents dipped 0.7 percent.
- Rather than significantly cutting asking rents, owners are offering greater concessions to secure lease commitments. As such, effective rents have dipped 3.1 percent in the past year to $1,898 per month. Following a 1.6 percent retreat in the first three months of 2009, effective rents contracted 1.8 percent in the second quarter.
- Average concessions were 22 days of free rent during the second quarter, up from 16 days of free rent one year earlier. Average revenue has declined 4.2 percent in the past year.
- **Outlook:** The soft economy will put downward pressure on rents in the Westside Cities, where rates are typically the highest in Los Angeles County. Asking rents are forecast to dip 2.7 percent this year to $1,990 per month while effective rents fall 6.2 percent to $1,841 per month.



Sales Trends**

- Sales velocity has decreased 36 percent over the past 12 months. Year-to-date investment activity is down 44 percent from the first half of 2008.
- Cap rates are averaging in the mid-5 percent to mid-6 percent range, up approximately 75 basis points from one year ago.
- The median price has remained flat during the last year at $216,700 per unit, although the median price in deals closed so far in 2009 has ticked down to $208,300 per unit.
- **Outlook:** Despite modest weakening in NOIs, many owners are reluctant to lower prices significantly and are choosing to ride out the downturn, a trend that will likely limit transaction activity in the months ahead.



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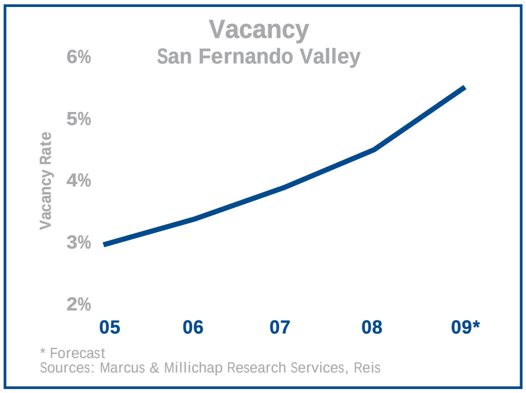

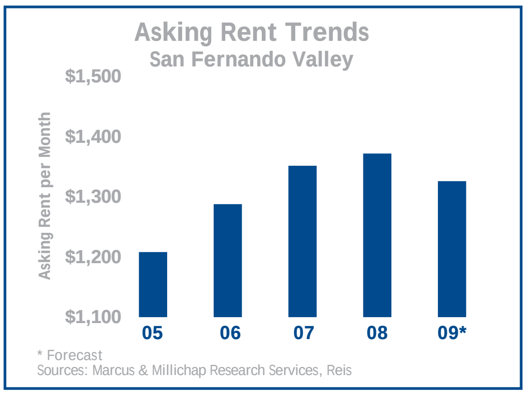

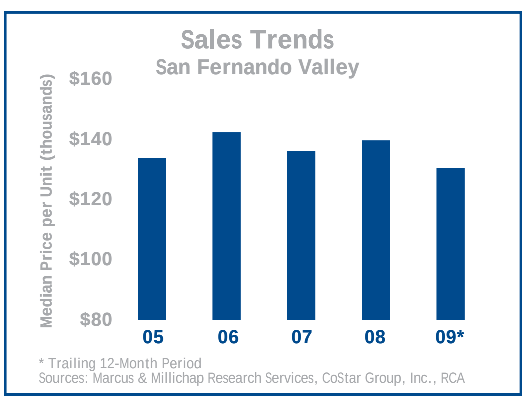

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San Fernando Valley Apartment Market

Construction and Vacancy

- Completions in the San Fernando Valley slowed during the second half of last year but picked up modestly in the first two quarters of 2009. Over the past 12 months, fewer than 300 new apartment units have come online, down from the 2,250 units delivered in the preceding year.
- Construction should accelerate in the coming quarters. There are approximately 900 units under construction in the area, with another 1,850 units planned. The 264-unit first phase of the Carillon project in Woodland Hills, due in the third quarter, will be this year's largest delivery. Nearly 1,600 condos are planned, some of which could compete with traditional rentals.
- During the past 12 months, vacancy has increased 60 basis points to 5.1 percent. A 40 basis point rise was recorded in the first quarter, followed by a 20 basis point uptick in the most recent three months.
- **Outlook:** Approximately 550 apartments are forecast to be completed in the San Fernando Valley this year, after an average annual delivery of more than 1,100 units during the past three years. Demand will ease as renters double up, causing vacancy to rise 100 basis points to 5.5 percent by year end.

Rents

- Asking rents have crept 1.6 percent lower in the past 12 months to $1,353 per month. Year to date, asking rents are down 1.2 percent.
- Effective rents have retreated 2.6 percent year over year and 2.4 percent thus far in 2009 to $1,288 per month. Effective rents in the Panorama Hills/San Fernando/Pacoima submarket have been essentially flat due to the lowest vacancy rate in Los Angeles County.
- During the second quarter, concessions were 18 days of free rent, up from 14 days of free rent one year earlier. As vacancy and concessions have increased over the past 12 months, average revenue has dipped 3.3 percent.
- **Outlook:** Asking rents in the San Fernando Valley are expected to retreat 3.4 percent this year to $1,324 per month. Effective rents rose 1.5 percent last year but are forecast to drop 5.9 percent to $1,242 per month in 2009.

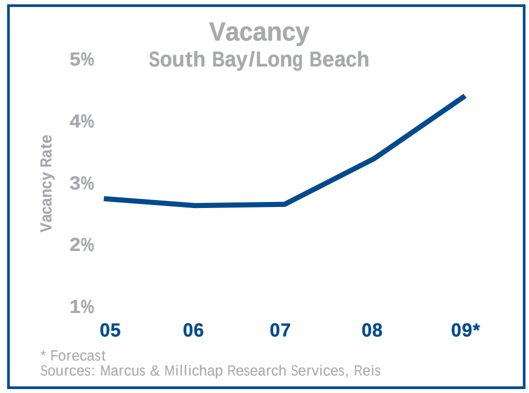
Sales Trends**

- Buyers are responding to weakening fundamentals and the rise in competition stemming from recent inventory increases by scaling back investment activity. During the past 12 months, sales velocity has dropped 47 percent.
- Cap rates for most stabilized properties are in the low- to mid-6 percent range, but a few assets with above-average vacancy rates have sold with initial yields above 7 percent since the start of this year.
- Buyers are hesitant to purchase complexes that are underperforming, a trend that has kept prices from falling significantly. In the past year, the median price has declined just 2 percent to $130,800 per unit.
- **Outlook:** With oversupply one of the primary concerns to buyers in the near term, property owners in areas near new construction, such as the Woodland Hills/Tarzana/Encino and Van Nuys/North Hollywood submarkets, may have to discount assets in order to meet the market.

South Bay/Long Beach Apartment Market

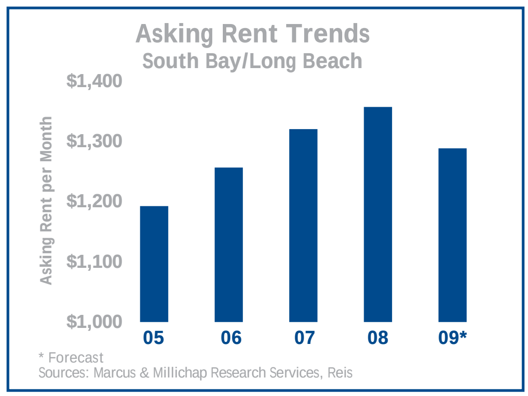
Construction and Vacancy

- Historically, construction has been limited in the South Bay/Long Beach area, a trend that continues; no new apartment units have been completed during the past 12 months, and no projects are under construction. One 128-unit development is planned.
- While inventory levels have remained stable, renter demand has eased as port traffic has receded. As such, vacancy has jumped 100 basis points year to date to 4.4 percent
- Vacancy in the Hawthorne/North Torrance submarket has risen 100 basis points year over year to 3.8 percent, still the lowest rate in the South Bay/Long Beach region. Renter demand for area apartments has remained fairly heathy during the recession due to the submarket's low rents.
- **Outlook:** No new apartments are forecast for South Bay/Long Beach this year, after the completion of 136 units in early 2008. Vacancy is expected to level off in the second half at 4.4 percent, up 100 basis points from the end of 2008 and the highest rate in more than a decade.



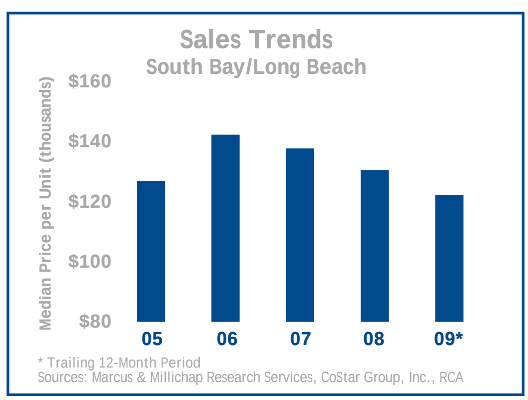
Rents

- During the past 12 months, asking rents in the South Bay/Long Beach region have ticked down 1.7 percent to $1,317 per month. The pace of declines has accelerated, with asking rents falling 2.8 percent year to date.
- Leasing momentum is slow due to continued job cuts. As a result, operators are offering concessions as an inducement to prospective renters. Effective rents declined 3.8 percent in the first two quarters of this year to $1,261 per month. The El Segundo/Hermosa Beach/Redondo Beach submarket, which has the highest rents in the South Bay/Long Beach area, has posted only a 2 percent effective rent drop over the past year.
- Concessions account for 15 days of free rent, up from 10 days of free rent one year ago. The rise in concessions has driven a 4.4 percent year-over-year fall in average revenue.
- **Outlook:** Asking rents in the South Bay/Long Beach region are forecast to drop 5.1 percent this year to $1,317 per month while effective rents slip 6.2 percent to $1,261 per month. Asking and effective rents ticked up 2.8 percent and 2.3 percent, respectively, in 2008.



*Sales Trends***

- Sales activity has decelerated by 28 percent over the past 12 months. Velocity slowed 50 percent in the first half of 2009 from the same period last year.
- Cap rates average in the mid-6 percent to low-7 percent range, approximately 70 basis points higher than in 2008.
- The median price has remained essentially unchanged in the last year at $121,700 per unit. The median price has ticked down to $120,000 per unit in deals closed so far this year.
- **Outlook:** The South Bay/Long Beach area will remain popular with investors due to limited threats of new construction. Deal flow is unlikely to pick up significantly, however, as owners typically hold assets for extended periods.



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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 Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Panorama Hills/San Fernando/Pacoima	3.4%	30	$1,036	0.2%
2	Mid-City/West Adams/Pico Heights	3.4%	20	$1,003	-1.5%
3	Hollywood/Silver Lake	3.5%	80	$1,350	-4.1%
4	South/Central L.A.	3.5%	50	$900	-2.0%
5	East L.A./Alhambra/Montebello/Pico Rivera	3.5%	30	$1,074	-3.1%
6	Mar Vista/Palms/Culver City	3.8%	50	$1,418	-3.0%
7	Hawthorne/North Torrance	3.8%	100	$979	-1.1%
8	Van Nuys/North Hollywood	4.1%	120	$1,052	-2.7%
9	Santa Monica	4.1%	100	$2,293	-0.4%
10	Chatsworth/Canoga Park	4.2%	-240	$1,190	-3.6%
11	El Segundo/Hermosa Beach/Redondo Beach	4.3%	210	$1,690	-2.0%
12	Carson/San Pedro/East Torrance/Lomita	4.3%	210	$1,128	-0.7%
13	Paramount/Downey/Bellflower/Norwalk	4.6%	140	$1,140	-3.3%
14	Inglewood/Crenshaw	4.7%	140	$966	-1.4%
15	East Long Beach/Los Altos	4.7%	140	$1,341	-3.1%
16	Beverly Hills/West Hollywood/Park La Brea	4.9%	-150	$1,776	-2.3%
17	Tujunga/La Crescenta/Montrose	5.1%	300	$1,220	-1.1%
18	Burbank/North Glendale	5.2%	270	$1,374	-4.2%
19	North Long Beach/Lakewood/Artesia	5.2%	210	$1,134	-3.2%
20	West Torrance/Ranchos Palos Verdes	5.3%	310	$1,479	-2.3%
21	West L.A./Westwood/Brentwood	5.4%	140	$2,143	-3.6%