

NEW INVENTORY, LAYOFFS HINDER SUPPLY/DEMAND EQUILIBRIUM

Although employment losses are expected to subside modestly in the East Bay this year, economic weakness will continue to drag on apartment fundamentals in the near term. Softening will vary by class, however, and depend on tenant profile and the submarket. Job losses in the traditionally lower-paying trade, transportation and utilities and construction industries, for example, have totaled approximately 19,000 workers in the last year. This has supported demand for Class B/C rentals, as residents are doubling up and moving to close-in areas near job centers like the San Leandro/Hayward submarket, where higher concentrations of these positions are located. In the San Ramon/Walnut Creek and North Alameda submarkets, thinning professional and business services head counts have adversely affected Class A properties; spikes in upper-tier vacancy in these areas have been among the highest in the metro due to soft renter demand, in addition to a dramatic rise in construction activity in the North Alameda submarket.

Ongoing economic challenges and prospects for further fundamental softening have deterred many investors from entering the Oakland market, slowing transaction velocity over the past year. Risk-averse buyers are largely targeting stabilized properties in densely populated areas, while some opportunistic investors are seeking deeply discounted assets in an effort to capitalize on attractive deals ahead of a turnaround. Prices have begun to soften, especially since the beginning of 2009, and metrowide cap rates continue to edge higher, averaging in the mid-6 percent area in recent months. While the North Alameda submarket will remain a favorable option for buyers with extended horizons, investors should be cognizant of the near-term supply/demand imbalance in the area. The glut of recently completed units has resulted in a dramatic spike in vacancy and will continue to drag on revenues until economic conditions start to rebound.

2009 ANNUAL APARTMENT FORECAST



Employment: This year, employment losses will ease, as the East Bay was more severely affected during the beginning of the national economic downturn. Local firms are forecast to reduce head counts by 3.5 percent, or 35,000 positions, following 39,900 job cuts in 2008.



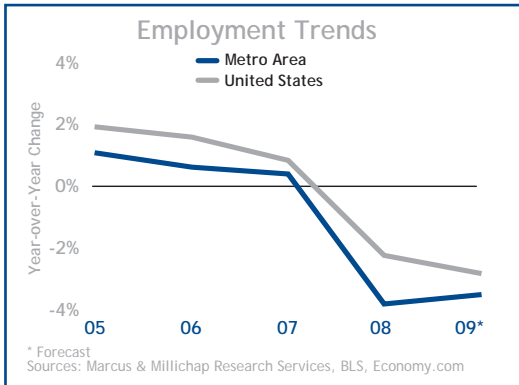
Construction: Developers are on pace to deliver roughly 1,200 units in 2009, down from last year, when nearly 2,000 units came online. This year's stock additions will expand inventory by 0.8 percent.



Vacancy: Despite slowed construction activity, weakened demand will increase vacancy 210 basis points to 7.4 percent this year, following a 20 basis point uptick in 2008.

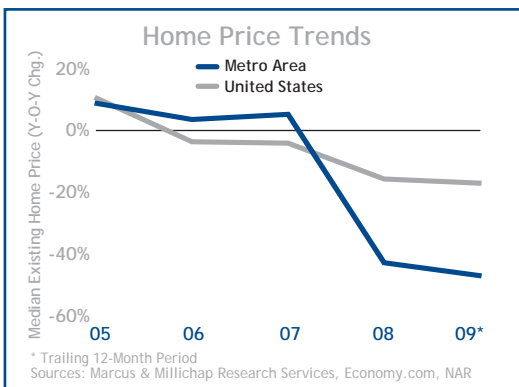


Rents: In 2009, weakened occupancy will cause asking rents to fall 7 percent to \$1,304 per month, while effective rents will end the year at \$1,218 per month, an 8.6 percent contraction.



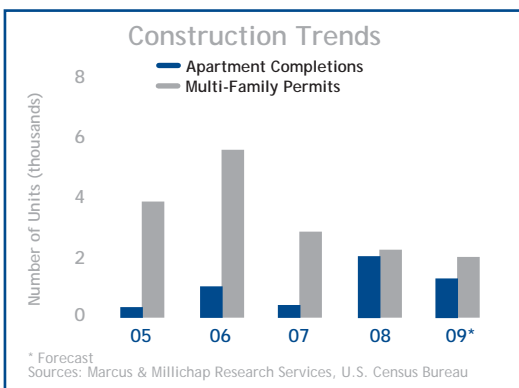
ECONOMY

- ◆ Preliminary estimates indicate that local employers trimmed 44,800 positions during the 12 months ending in the second quarter, a 4.3 percent contraction. Since the start of this year, 21,300 jobs have been eliminated.
- ◆ As developers delay projects due to the weakened fiscal environment, construction employment continues to decline. Over the past year, nearly 10,000 positions have been shed, a 15.7 percent drop.
- ◆ Biotechnology company AnaSpec Inc. relocated its headquarters and 100 employees from San Jose to Fremont in the second quarter, which could spur demand for rental housing nearby.
- ◆ **Outlook:** This year, employment losses will ease, as the East Bay was more severely affected during the beginning of the national economic downturn. Local firms are forecast to reduce head counts by 3.5 percent, or 35,000 positions, following 39,900 job cuts in 2008.



HOUSING AND DEMOGRAPHICS

- ◆ In the most recent 12 months, developers pulled 1,600 single-family permits, a 38 percent decline from the previous period. The year-over-year decrease in multi-family permitting activity was less pronounced at 28 percent, or 2,200 units.
- ◆ The median price for a single-family home in the metro has dropped 47 percent to \$312,300 over the past year. Despite the decline in home prices, the median household income still falls \$10,200 short of the minimum amount required to qualify for a median-priced residence.
- ◆ The affordability gap has narrowed in recent quarters, as home prices continue to decline. The typical mortgage payment for a median-priced home, using traditional financing, is \$185 more than the average Class A asking rent.
- ◆ **Outlook:** Although home prices have fallen dramatically, uncertainty surrounding the job market will sustain a wide renter pool, especially for more affordable lower-tier units.

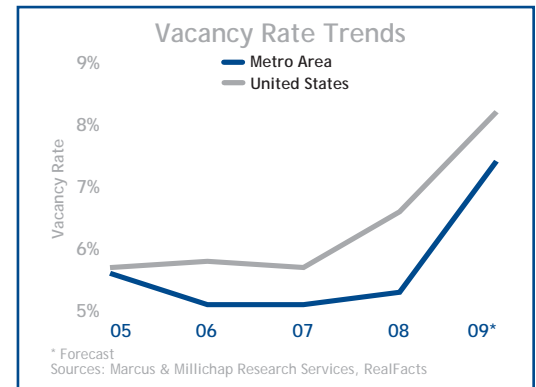


CONSTRUCTION

- ◆ Developers completed nearly 1,200 units year over year in the second quarter, expanding metrowide inventory by 0.7 percent. Year to date, 460 units have come online.
- ◆ Approximately 1,500 units are under way in the metro, half of which are slated for delivery this year. The construction pipeline is full, with 4,500 units in the planning phases, up from 3,100 units one year ago.
- ◆ Revitalization efforts continue in downtown Oakland. One such development, The Bond, came online in the second quarter near Jack London Square, expanding inventory in the North Alameda submarket by 100 units.
- ◆ **Outlook:** Developers are on pace to deliver roughly 1,200 units in 2009, down from last year, when nearly 2,000 units were completed. This year's stock additions will expand inventory by 0.8 percent.

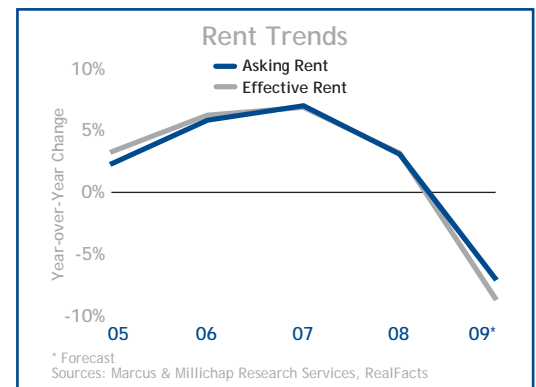
VACANCY

- ◆ During the last 12 months, vacancy has climbed 210 basis points to 6.4 percent as a result of modest inventory additions and contracting demand. In the second quarter, however, vacancy shed 50 basis points.
- ◆ Class A vacancy reached 7.7 percent in the second quarter, a 300 basis point spike from one year earlier, due to ongoing construction activity.
- ◆ Continued job cuts in lower-paying sectors such as trade, transportation and utilities and construction have weighed conditions in the Class B/C sector, though occupancy has held steadier due to persistent demand for affordable housing. Year over year, lower-tier vacancy has risen 170 basis points to 5.8 percent.
- ◆ **Outlook:** Despite slowed construction activity, weakened demand will increase vacancy 210 basis points to 7.4 percent this year, following a 20 basis point uptick in 2008.



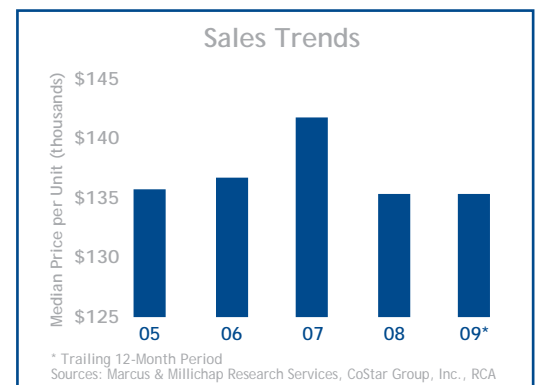
RENTS

- ◆ Challenging market conditions have placed downward pressure on rents. Year over year in the second quarter, asking rents dropped 4.7 percent year over year to \$1,329 per month, while effective rents slid 6.5 percent to \$1,242 per month. Since the start of the year, asking and effective rents have declined 5.2 percent and 6.9 percent, respectively.
- ◆ Class A asking rents have slipped 5.5 percent in the last year to \$1,592 per month as owners compete with an oversupply of alternative housing options. In the lower tiers, asking rents have decreased 4.4 percent to \$1,214 per month.
- ◆ A steep decline in effective rents has resulted in an 8.6 percent fall in revenues in the past 12 months, compared with a 7.1 percent gain one year ago.
- ◆ **Outlook:** In 2009, weakened occupancy will cause asking rents to fall 7 percent to \$1,304 per month, while effective rents will end the year at \$1,218 per month, an 8.6 percent contraction.



SALES TRENDS**

- ◆ Sales activity has dropped off by 39 percent during the past 12 months due to fewer qualified buyers in the market. Since the start of 2009, transaction velocity has slipped 50 percent compared to the same period one year ago.
- ◆ The median price has dipped 6 percent to \$131,700 per unit in the last year and has fallen to \$122,900 per unit year to date.
- ◆ Cap rates have averaged in the low- to mid-6 percent range in recent months, with some lower-tier properties trading with cap rates in the high-7 percent to low-8 percent area.
- ◆ **Outlook:** A lack of transaction velocity in recent months has elevated caution among potential buyers, though further softening in valuations may generate activity from well-capitalized investors in the months ahead. Dense infill communities along the Interstate 880 corridor will likely receive the most attention.



** 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

- ◆ Developers continue to focus on transit-oriented developments such as the recently completed first phase of Avalon Union City. This project, which is situated near the Union City BART station in the Fremont/Newark/Union City submarket, added 271 units to stock earlier this year.
- ◆ Elevated construction activity from redevelopment efforts in downtown Oakland has driven a dramatic vacancy spike in the North Alameda submarket during the past year. Furthermore, the glut of unsold condos coming to market as rentals has added to the supply/demand imbalance.
- ◆ In the East Contra Costa submarket, the oversupply of alternative housing options from the residential building boom in previous years has dragged on fundamentals, elevating caution among potential buyers. As such, initial yields in the area are well above the metro average, ranging from 7 percent and 8 percent in recent months.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	San Leandro/Hayward	4.1%	70	\$1,115	-7.2%
2	Fremont/Newark/Union City	4.2%	100	\$1,313	-6.6%
3	Concord/Martinez	4.9%	100	\$1,111	-7.3%
4	San Ramon/Walnut Creek	5.4%	190	\$1,266	-9.1%
5	West Contra Costa	6.1%	190	\$1,249	-7.0%
6	East Alameda	6.8%	140	\$1,399	-8.0%
7	East Contra Costa	6.9%	160	\$1,099	-4.3%
8	North Alameda	12.0%	590	\$1,329	-3.1%