

SUPPLY/DEMAND IMBALANCE TO WEAKEN CLASS A FUNDAMENTALS

Although the Portland metro's quality of life and emerging prospects as an alternative energy hub will support household formation averaging roughly 2.2 percent annually over the next five years, the effects of the recession will take their toll on local apartment fundamentals in 2009. In the near term, moderate supply growth and continued work force reductions will drag on apartment market conditions. While Class B/C properties will register some softening this year due to job cuts in blue-collar industries such as manufacturing and construction, the high-end segment will record a weaker performance. Class A vacancy is forecast to rise metrowide as projects that broke ground before the economic downturn intensified are delivered. The increase in top-tier vacancy is expected to be pronounced in the Northwest/Downtown submarket, where most of this year's developments will come online. In this area, supply growth amounting to more than 1,200 units from both traditional apartments and condos that have reverted to rentals is expected to push Class A vacancy above the 7 percent mark in 2009, despite some renter demand.

The investment landscape will continue to transition this year as elevated buyer caution limits sales activity. Year-to-date transaction velocity has slowed considerably as investors hold out for further price declines, given anticipation for marketwide fundamental softening. Cap rates have trended higher as a result, with properties closing at initial yields in the low- to mid-7 percent range in recent months and some lower-tier deals trading in the 8 percent area. Despite near-term weakness and elevated competitive threats, assets in downtown Portland remain attractive to investors, though some buyers may have to stretch to acquire such properties, as cap rates average in the mid- to high-6 percent range for core assets. Looking ahead, opportunities may emerge in the close-in Eastside area, as steady renter demand and minimal new construction should maintain stable fundamentals.

2009 ANNUAL APARTMENT FORECAST



Employment: The recession will deepen in 2009, as employers are forecast to trim payrolls by 5.4 percent, or 40,000 workers, after eliminating 55,000 positions last year.



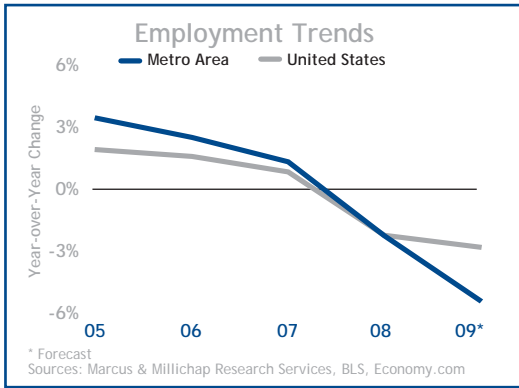
Construction: Developers are on pace to bring 1,400 units online this year, slightly less than in 2008, when close to 1,500 units were completed. Stock additions in 2009 will expand inventory by 1.4 percent.



Vacancy: Vacancy is expected to end the year at 6.8 percent, 160 basis points higher than last year. Moderate construction activity and continued job losses will further weaken occupancy levels.



Rents: As owners attempt to stabilize operations, downward pressure on rents will remain. In 2009, asking rents are forecast to slip 1.2 percent to \$815 per month while effective rents drop 2.4 percent to \$746 per month.

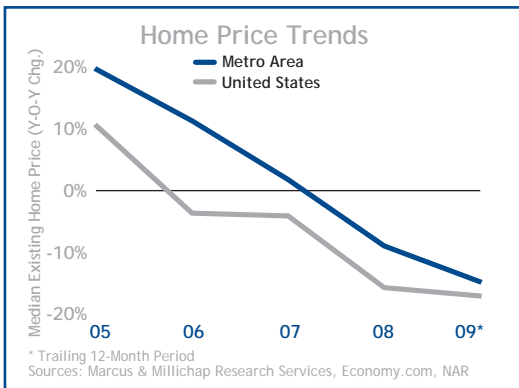


ECONOMY

- ◆ Local employment has retreated 5.3 percent during the past 12 months with the elimination of 54,600 positions. Since the start of 2009, 34,000 jobs have been cut.
- ◆ The manufacturing and construction sectors have led the metro in payroll reductions over the last year, shedding a combined 11,300 workers through the second quarter.
- ◆ Nike announced earlier this year that it will reduce its worldwide work force by 5 percent, or 1,750 positions, including 500 jobs at its Beaverton headquarters, due to lower profitability.
- ◆ **Outlook:** The recession will deepen in 2009, as employers are forecast to trim payrolls by 5.4 percent, or 55,000 workers, after eliminating 23,400 positions last year.

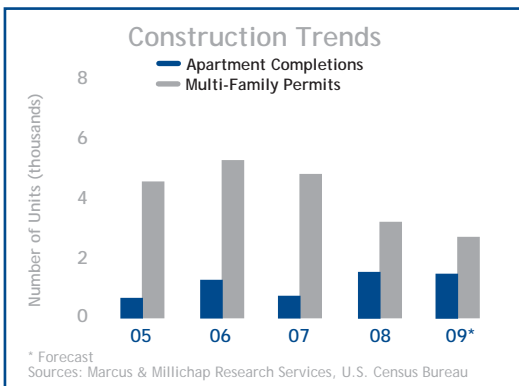
HOUSING AND DEMOGRAPHICS

- ◆ Weakness in the local economy has resulted in a drop-off in permitting activity. Over the past year, single-family builders have pulled permits for roughly 4,100 units, down 33 percent from the previous 12 months. Multi-family permit issuance has declined 21 percent in the last year to 2,800 units.
- ◆ The median price for a single-family home slipped nearly 15 percent year over year to \$241,000 in the second quarter. The median household income fell 7 percent in that time and is \$5,100 short of the minimum amount required to qualify for a median-priced residence.
- ◆ The mortgage payment for a median-priced home, using traditional financing, was approximately \$400 more than the average Class A asking rent in the second quarter.
- ◆ **Outlook:** Although declining home values continue to narrow the affordability gap in the Portland metro, the economic downturn and potential homeowners' greater aversion to debt will likely discourage the migration of renters into for-sale housing in the near term.



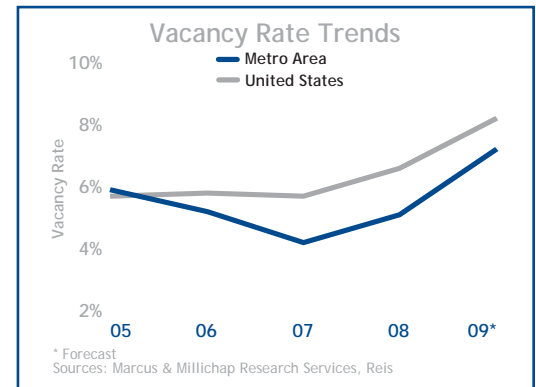
CONSTRUCTION

- ◆ Developers have expanded inventory by 1 percent during the last year with the delivery of 1,200 apartment units, slightly higher than in the previous 12 months, when 1,100 units came online. Since the start of 2009, builders have completed roughly 620 units.
- ◆ There are approximately 1,600 units under way, almost all of which are located in the Northwest/Downtown submarket. Developers have more than 1,800 units in the various planning phases, though start dates have not yet been set for most of the projects.
- ◆ The Northwest/Downtown submarket will receive nearly all of this year's stock additions as revitalization projects that broke ground before the economic downturn took effect come to fruition in downtown Portland.
- ◆ **Outlook:** Developers are on pace to bring 1,400 units online this year, slightly less than in 2008, when close to 1,500 units were completed. Stock additions in 2009 will expand inventory by 1.4 percent.



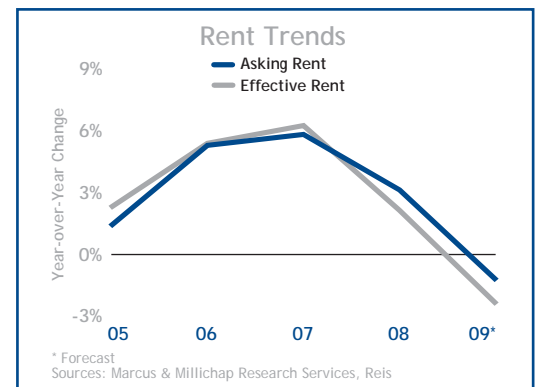
VACANCY

- ◆ Metrowide vacancy jumped 80 basis points to 5.8 percent over the last year as elevated job losses dragged on tenant demand. Vacancy levels have remained relatively stable in the second quarter.
- ◆ An uptick in new inventory, along with increased alternative housing options, has pushed up Class A vacancy 150 basis points to 6.4 percent during the past year.
- ◆ In the Class B/C segment, despite job cuts within lower-paying industries such as construction and manufacturing, persistent demand for affordable housing helped vacancy to maintain steady levels. In the second quarter, lower-tier vacancy reached 5.3 percent, a 30 basis point year-over-year rise.
- ◆ **Outlook:** Vacancy is expected to end the year at 6.8 percent, 160 basis points higher than last year. Moderate construction activity and continued job losses will further weaken occupancy levels.



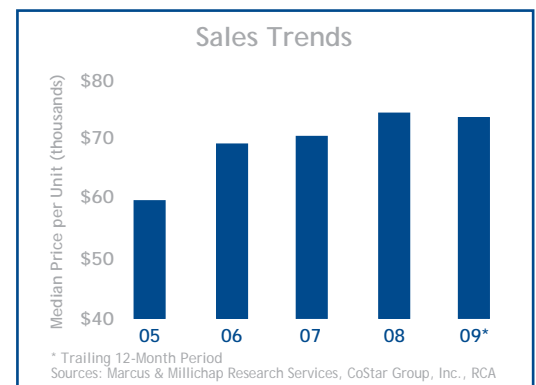
RENTS

- ◆ Owners were able to retain some of the rent gains made in 2008, as asking rents have edged up 0.9 percent to \$824 per month year over year. Since the start of 2009, however, asking rents have decreased 0.1 percent. Effective rents have dipped 0.8 percent during the past year and 1.2 percent in the last six months to \$755 per month.
- ◆ Asking rents for Class A units advanced 1.4 percent to \$946 per month over the 12 months ending in the second quarter, while asking rents in the lower tiers remained flat at \$712 per month.
- ◆ Increased concessions have driven a 6.4 percent decline in average revenues during the last year, following a 5.5 percent gain in the previous 12 months.
- ◆ **Outlook:** As owners attempt to stabilize operations, downward pressure on rents will remain. In 2009, asking rents are forecast to slip 1.2 percent to \$815 per month while effective rents drop 2.4 percent to \$746 per month.



SALES TRENDS**

- ◆ Sales activity has decelerated by 18 percent during the last 12 months, as weakened economic conditions have elevated buyer caution and reduced out-of-state trading. In fact, out-of-area transaction velocity has dropped by more than 40 percent in the past year, compared to a 6 percent decrease in local investment activity.
- ◆ Despite slowed sales velocity, the median price has risen 3 percent in the last 12 months to \$72,500 per unit. Valuations have begun to soften in recent quarters, however, as apartment properties traded at \$70,300 per unit during the most recent six-month span.
- ◆ Metrowide cap rates have averaged in the low- to mid-7 percent range recently, though some core assets in dense locations may still garner initial yields roughly 50 basis points below the average.
- ◆ **Outlook:** Buyers will remain cautious when evaluating potential deals, limiting sales activity, though further price reductions could spur trading toward the end of the year. Well-operated lower-tier properties east of Interstate 205 may generate interest, as a deep renter pool has maintained relatively steady fundamentals in this area.



** 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 with extended horizons should monitor the progress of a redevelopment proposal for the former Boise Cascade site along the Columbia River in the Vancouver submarket. Plans call for 1 million square feet of office space, 250,000 square feet of retail space, and up to 3,300 housing units.
- ◆ SolarWorld recently began construction on an expansion adjacent to its current campus in Hillsboro, scheduled for completion in late 2009. By 2011, the company plans to employ 1,000 workers at its facility, which could generate additional demand for housing in the area.
- ◆ The influx of new, more expensive inventory that has come online in the Northwest/Downtown submarket over the past year has resulted in solid effective rent gains. As vacancy continues to climb, however, owners will likely reduce rates in order to stabilize operations.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Outer Northeast/Outer Southeast	4.5%	-10	\$675	-1.2%
2	Milwaukie/Oregon City	4.7%	10	\$684	-1.7%
3	Beaverton/Aloha	5.1%	-10	\$732	-3.8%
4	Tigard/Tualatin/Sherwood	5.6%	10	\$748	-2.7%
5	Inner North/Northeast/Southeast	6.0%	210	\$806	2.0%
6	Vancouver	6.0%	250	\$712	-1.2%
7	Northwest/Downtown	11.6%	470	\$1,048	7.5%