

PRIVATE INVESTORS TARGET VALUE-ADD OPPORTUNITIES AS INSTITUTIONS DOMINATE TOP TIER

As the development pipeline thins and population growth generates housing demand, the Austin apartment market will strengthen this year. Additions to supply will decrease by roughly 70 percent in 2010, after spiking last year, facilitating absorption as companies resume hiring. With employment growth gaining momentum, aided by several corporations relocating their headquarters to the region, more job seekers will migrate to Austin, fueling renter demand. Further, the recent expiration of the federal homebuyer tax credit will buoy demand in the coming months, as some would-be homebuyers remain in the rental pool. Class A properties will benefit most from these trends in submarkets where construction levels were minimal last year, including North Travis, Far South and Near South Central, as top-tier vacancy rates in these areas will improve more rapidly in the second half. Conversely, the Round Rock/Georgetown/Hutto submarket, where more than 30 percent of the metro's new inventory came online in 2009, will lag the recovery, forcing owners of recently built complexes to delay withdrawing concessions. The metro's building cycle is ending, though, which will allow owners to gradually trim concessions and increase rents in the coming months.

The volume of distressed listings in the metro failed to reach the levels once anticipated by buyers, encouraging investors who raised significant capital for REO purchases to deploy funds toward performing assets. As a result, investment activity has intensified year to date, and cap rates have begun to stabilize. More institutions are competing for the few top-tier complexes listed in densely populated communities, outbidding large, private buyers who have re-surfaced in search of Class A and Class B deals. Consequently, some high-net-worth investors have acquired mid- and lower-tier assets with value-add potential. The for-sale pipeline is filling, however, as some bank-owned listings come to market and highly leveraged out-of-state owners sell underperforming assets. These listings will be most prevalent in oversaturated suburban areas where generous concessions have weighed on operators' ability to meet mortgage obligations.

2010 ANNUAL APARTMENT FORECAST



Employment: Employers will add 19,100 jobs to Austin payrolls this year, a 2.5 percent increase. In 2009, head counts contracted by 18,400 positions, or 2.4 percent. During the last economic upswing, job growth averaged 3.4 percent annually.



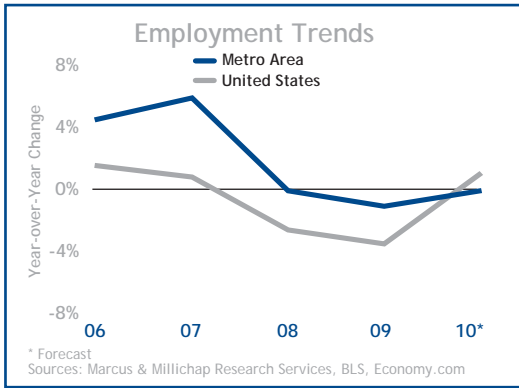
Construction: The development pipeline will thin considerably in 2010, easing supply threats. After delivering 10,340 apartment units in 2009, builders will complete 2,860 units this year, increasing metrowide stock by 1.8 percent.



Vacancy: Strong employment gains and a more than 70 percent decrease in apartment deliveries will help improve vacancy in 2010. Vacancy will fall 110 basis points this year to 9 percent, after a glut of new supply drove up the rate 240 basis points in 2009.



Rents: In 2010, asking rents will appreciate 2.4 percent to \$864 per month, following a 3 percent slide in 2009. Effective rents will climb 3.4 percent to \$783 per month, restoring last year's losses.

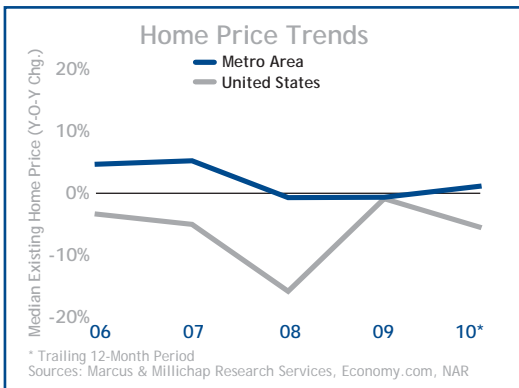


ECONOMY

- ◆ The recovery of the Austin job market is under way. Since the start of the year, employers have hired 10,800 workers, bringing the 12-month total to 7,100 new positions, a 0.9 percent gain. In the prior year, local employment contracted by 17,500 jobs.
- ◆ While nearly every employment sector has expanded in 2010, the metro's information segment continues to reduce staffing levels. Year to date, the sector has contracted by 300 workers, similar to cuts six months earlier.
- ◆ The unemployment rate in Austin reached 7.2 percent in June, up 20 basis points from one year earlier. The rate fell 10 basis points since January, however and, as of the second quarter, was 230 basis points below the national rate.
- ◆ **Outlook:** Employers will add 19,100 jobs this year, a 2.5 percent increase. In 2009, head counts contracted by 18,400 positions, or 2.4 percent.

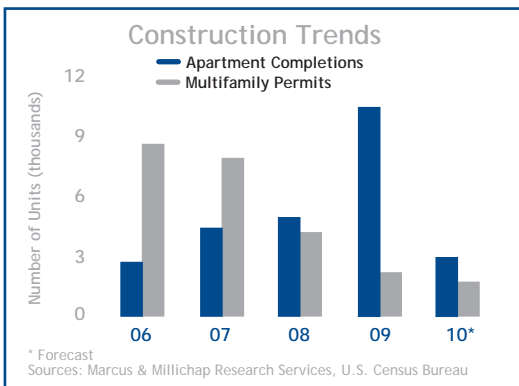
HOUSING AND DEMOGRAPHICS

- ◆ Driven by the federal tax credit for homebuyers, single-family permit issuance increased 12 percent to 7,100 units during the year ending in the second quarter. Pulled permits for multifamily housing, however, dropped nearly 67 percent in that time to 1,140 units.
- ◆ The median existing home price in Austin has appreciated 1.8 percent so far this year to \$188,400, bringing values on par with the levels recorded a year ago. Homes remain affordable, as the median household income of \$54,770 per year is 14 percent more than the minimum required to qualify to purchase a median-priced residence.
- ◆ The monthly mortgage payment on a median-priced home in the metro is almost \$100 below the average Class A asking rent.
- ◆ **Outlook:** The expiration of the homebuyer tax credit will deter some would-be homebuyers from stepping into ownership, helping to maintain a large pool of renters. Last year's flood of new units, however, will encourage operators of recently built complexes to maintain above-trend concessions through lease-up.



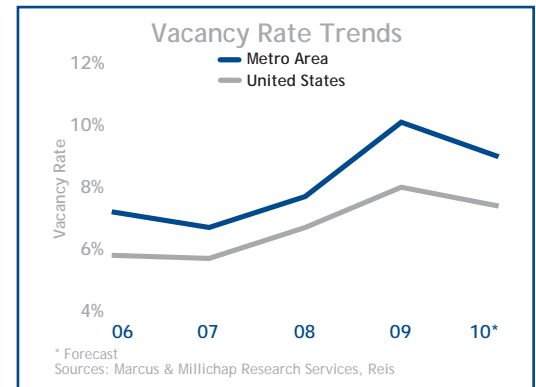
CONSTRUCTION

- ◆ The delivery of 1,390 apartment units during the first half of this year brought the trailing 12-month total to more than 5,650 units, or an inventory expansion of 3.6 percent. During the previous 12-month period, builders completed 9,000 units.
- ◆ Approximately 1,540 apartment units and 2,600 for-sale units are under construction throughout the metro. The Central submarket contains the largest share of rental units slated for delivery this year, with roughly 470 new units expected to come online.
- ◆ Planned apartment projects total 18,800 units, or 12 percent of existing inventory, though fewer than 300 units have scheduled groundbreaking dates.
- ◆ **Outlook:** The development pipeline will thin considerably this year, easing supply threats. After delivering 10,340 apartment units in 2009, builders will complete 2,860 units in 2010, increasing metrowide stock by 1.8 percent.



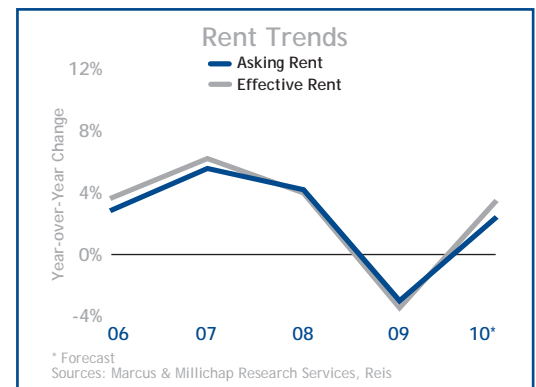
VACANCY

- ◆ Resumed job growth and a significant decrease in completions supported positive net absorption of nearly 6,400 units over the past year, translating into a 90 basis point vacancy improvement to 9.6 percent.
- ◆ Since peaking in the second quarter of last year, the average Class A vacancy rate improved 260 basis points to 9.7 percent in the second quarter of 2010, fueled by generous incentives in recently built complexes offered to prospective renters. Year to date, top-tier vacancy decreased 110 basis points.
- ◆ As job growth drives some households to “debundle,” the pace of Class B/C weakening slowed. Over the past year, the lower-tier vacancy rate climbed 100 basis points, but rose only 10 basis points in the first half of this year.
- ◆ **Outlook:** Strong employment gains and a more than 70 percent decrease in apartment deliveries will help improve occupancy levels in 2010. Vacancy will fall 110 basis points this year to 9 percent, after a glut of new supply drove up the rate 240 basis points in 2009.



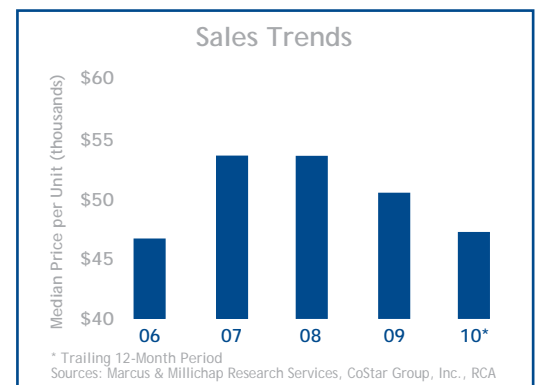
RENTS

- ◆ During the 12 months ending in the second quarter, asking rents fell 1.7 percent to \$848 per month, and effective rents retreated 0.6 percent to \$765 month. Owners are leveraging occupancy gains to raise rents and withdraw concessions. In the first half of 2010, asking and effective rents grew by 0.5 percent and 1.1 percent, respectively.
- ◆ Through the second quarter, Class A asking rents fell 1.8 percent annually to \$984 per month. Year to date, top-tier rents advanced 0.4 percent. At \$685 per month, lower-tier rents are 0.3 percent above rates recorded six months earlier but 2.4 percent lower than year-ago levels.
- ◆ Operational improvements have contributed to increasing revenues 1.6 percent year to date, following a 1.2 percent drop in the prior two quarters.
- ◆ **Outlook:** This year, asking rents will appreciate 2.4 percent to \$864 per month, after slipping 3 percent in 2009. Effective rents will climb 3.4 percent to \$783 per month, restoring last year’s losses.



SALES TRENDS**

- ◆ Sales velocity slowed by 40 percent year over year, but trade volume increased recently. The number of deals recorded during the first half doubled transaction counts posted in the same period last year.
- ◆ During the past 12 months, the median price for a multifamily property in the Austin metro decreased 9 percent to \$47,200 per unit.
- ◆ In the last year, cap rates for performing assets averaged in the mid-8 percent range, up 80 basis points from the previous 12-month period.
- ◆ **Outlook:** Buyer demand will stabilize cap rates in the low-8 percent range through the second half of 2010. Opportunistic investors may find distressed assets in outlying areas offered with returns near 10 percent, but such properties will receive multiple offers.



** 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

- ◆ Mixed economic indicators, stock market volatility and concerns surrounding the European debt crisis continue to drive investors to safety. As a result, the yield on the 10-year U.S. Treasury has declined since peaking at 4 percent in April; as of late July, the yield had fallen to 3 percent.
- ◆ Capital markets loosened over the past year, with life insurance companies ramping up lending and CMBS showing renewed signs of life. Nonetheless, the agencies remain the dominant sources of multifamily lending. This trend will continue through 2010 as the GSEs' multifamily portfolios outperform their residential mortgage operations, reducing the likelihood of drastic government-mandated changes to their apartment lending arms.
- ◆ Multifamily loan originations increased 37 percent in the second quarter but remained below levels reported during the same period last year. Fannie Mae and Freddie Mac's origination volume followed a similar pattern, rising in the second quarter but falling short of year-earlier levels.
- ◆ Loan-to-values range from 60 percent to 75 percent for portfolio lenders and push up to around 80 percent for best-of-class, agency-financed deals. All-in rates for five-year agency loans fall into the low-4 percent range, while 10-year loans price between 4.75 percent and 5.15 percent. While life companies will compete at these levels for best-of-class deals, most portfolio lenders are 100 basis points to 225 basis points higher.

SUBMARKET OVERVIEW

- ◆ Samsung Electronics Co. plans to spend \$3.6 billion to expand its manufacturing complex in northeastern Austin, creating up to 500 jobs by 2011 and providing a healthy boost to housing demand in the area.
- ◆ Investors recently purchased a 476-unit apartment complex in the North Austin submarket. The deal was partially funded by tax credits from the Texas Department of Housing and Community Affairs and City of Austin Affordable Housing GO Bonds, making this the state's largest deal of its kind under the American Recovery and Reinvestment Act.
- ◆ Despite weakened near-term operations, the extended outlook for the Round Rock/Georgetown/Hutto submarket remains positive, bolstered by the projected addition of 25,000 new residents by 2014, or 4 percent annual growth. The in-migration will support healthy demand trends.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	North Travis	7.0%	-460	\$703	-2.2%
2	Near South Central	7.2%	-320	\$891	-5.1%
3	Far Northwest	7.4%	120	\$825	-2.7%
4	Near Northwest	8.5%	90	\$741	-1.5%
5	Far South	8.8%	-290	\$833	0.1%
6	Ranch Road 620 N./FM 2222	9.0%	-460	\$1,008	-1.1%
7	Central	9.4%	-260	\$1,014	3.6%
8	Highway 183/Cedar Park/Leander	10.0%	-80	\$697	-2.7%
9	San Marcos/North Hays County	10.6%	230	\$707	-0.7%
10	Southeast	11.1%	170	\$674	-0.7%