

ApartmentResearch

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

Marcus & Millichap

Dallas/Fort Worth Metro Area

Third Quarter 2010

OUT-OF-STATE INVESTORS RETURN TO METROPLEX APARTMENT MARKET

The resumption of job growth and significant reductions in new construction will support improvement in Dallas/Fort Worth apartment fundamentals through 2010. Occupancy weakened considerably last year, the result of a dramatic increase in new supply and drastic job cuts. That said, it is clear that the market has turned the corner, with vacancy declining in the first and second quarters of 2010. Rents also offer cause for optimism, with owners raising asking and effective rates during the second quarter for the first time since 2008. Renter demand has increased across most sub-markets and property classes, though gains have been most pronounced in the Class A sector. Rent reductions in recent years, along with increased concessions, allowed many renters to upgrade to higher-quality units, a trend that will ease as owners regain some pricing power in the quarters to come.

Local, private investors will account for the most transactions through 2010, but more out-of-state buyers will return to the Metroplex after a two-year hiatus. Texas-based investors will continue to target discounted, distressed properties offering turnaround opportunities, along with attractive REO deals cropping up across the market. At the same time, out-of-state investors will focus on higher-quality, stabilized assets, which often sell at discounts relative to other major high-growth metro areas in the nation. Already this year, the share of buyers from California increased from the low point reached in 2009, and the Metroplex has commanded more interest from East Coast and Canadian investors eager to enter the market ahead of more substantial improvements in fundamentals. Heightened demand has led to cap rate compression for higher-quality listings in the metro area, and more movement is likely as the economy and apartment fundamentals improve at an above-average clip. The financing climate also has loosened this year, particularly among community banks, which tend to favor seasoned local investors with strong balance sheets.

2010 ANNUAL APARTMENT FORECAST



Employment: Nonfarm employment in the Dallas/Fort Worth metro area will rise by 57,100 jobs in 2010, an increase of 2 percent over 2009. Last year, payrolls slipped by 90,000 positions, or 3 percent.



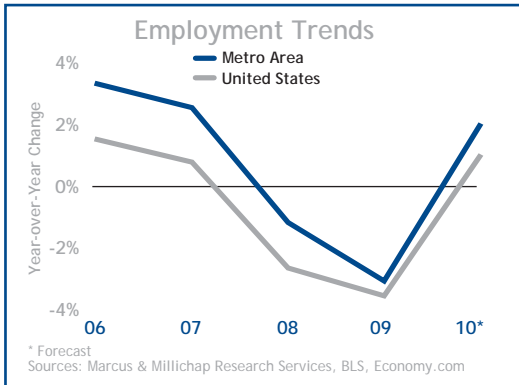
Construction: Developers will deliver approximately 7,600 apartments to the Metroplex this year, down nearly 56 percent from 2009 and more closely aligned with construction trends in 2006 and 2007.



Vacancy: The combination of employment growth and reduced completions will drive a 90 basis point decrease in the vacancy rate this year to 8.8 percent. In 2009, vacancy climbed 240 basis points.



Rents: After losing ground last year, rents will tick up modestly through 2010. For the year, asking rents will rise 1.2 percent to \$774 per month while effective rents increase 1.5 percent to \$693 per month.

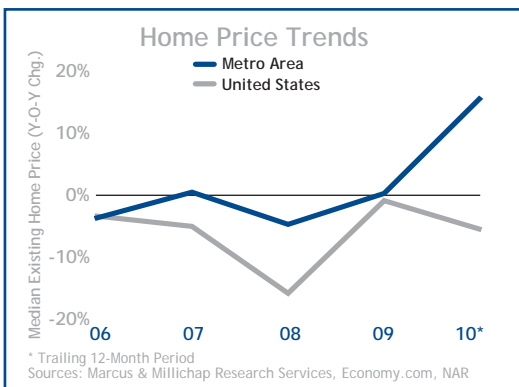


ECONOMY

- ◆ During the first half of 2010, employment in the Metroplex increased by 35,000 jobs, a welcome turnaround after the loss of 124,000 positions through the recession. Year over year, payrolls in the metro expanded 1 percent, compared to a drop of 4.3 percent during the prior 12-month period.
- ◆ The government, manufacturing, and education and health services sectors led job creation through the first half, adding more than 40,000 positions. During the same period, the information, construction, financial activities, and trade, transportation and utilities segments shed positions.
- ◆ The unemployment rate in Dallas/Fort Worth retreated roughly 60 basis points to 8.1 percent between early 2010 and midyear and remains well below the national average.
- ◆ **Outlook:** Nonfarm employment in the Metroplex will rise by 57,100 jobs in 2010, up 2 percent from 2009, when payrolls contracted by 90,000 positions.

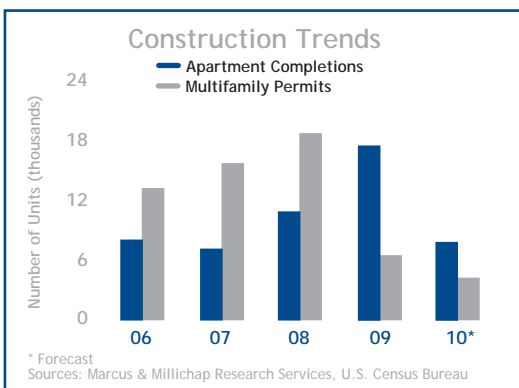
HOUSING AND DEMOGRAPHICS

- ◆ Over the past year, developers pulled just 2,750 multifamily housing permits for buildings with five-plus units, an 80 percent decrease from the previous 12-month period. Single-family permit activity increased 15 percent in the last year to more than 16,000 units.
- ◆ When compared to other major markets, home prices in Dallas/Fort Worth have been fairly resilient to the housing downturn. The median price for an existing single-family home in the area has slipped just 4.5 percent since peaking in late 2005 to \$146,000.
- ◆ The monthly mortgage payment on the median-priced home in the Metroplex falls short of the average Class A rent by approximately \$90. This comparison, however, assumes a 20 percent downpayment, which remains out of reach for many apartment renters.
- ◆ **Outlook:** Dallas/Fort Worth housing remains affordable. Home prices have declined only moderately, however, and residential lending standards have tightened, making it unlikely the apartment market will lose a larger share of renters to homeownership as the recovery progresses.



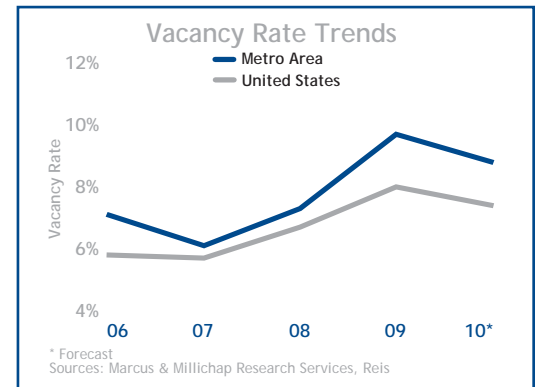
CONSTRUCTION

- ◆ Developers completed 16,000 units over the past year, exceeding the prior 12-month total by 31 percent. During the first half, nearly 5,200 units came online, accounting for 68 percent of this year's new supply.
- ◆ Construction remains focused on the Dallas portion of the metro, with developers in Tarrant County completing 2,675 units during the past year. New supply in Fort Worth was isolated to the North Arlington, Northern Tarrant County and Northwest Fort Worth submarkets.
- ◆ The Plano/Allen/McKinney and Northwest Dallas submarkets accounted for 40 percent of the new supply delivered to the Metroplex over the past 12 months. The construction pipeline in both submarkets has thinned dramatically, though, with just 600 units currently planned for completion in 2011.
- ◆ **Outlook:** Developers will deliver approximately 7,600 apartments in 2010, down nearly 56 percent from 2009 and more closely aligned with new supply trends in 2006 and 2007.



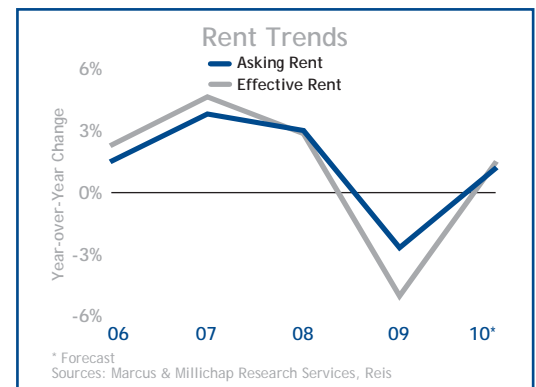
VACANCY

- ◆ After rising 360 basis points during the recession, apartment vacancy in the Dallas/Fort Worth metro area declined 80 basis points to 8.9 percent in the first half of 2010. Year over year, however, vacancy rose 50 basis points.
- ◆ The turnaround in vacancy can be attributed largely to stronger demand for Class A units. During the first half, Class A vacancy decreased 120 basis points to 8 percent, while the Class B /C sector registered a 40 basis point-drop to 9.8 percent.
- ◆ The resumption of job creation and a modest acceleration in household formation drove absorption of 9,250 units during the first six months of this year, marking the healthiest first-half demand figure this decade.
- ◆ **Outlook:** Employment growth and reduced completions will fuel a 90 basis point decrease in the vacancy rate this year to 8.8 percent. In 2009, vacancy climbed 240 basis points.



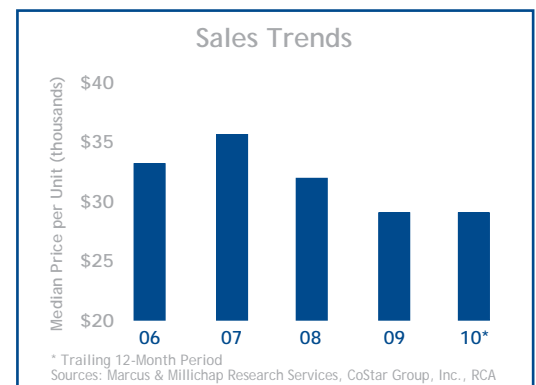
RENTS

- ◆ After stabilizing late last year, rents turned the corner in the second quarter. Asking rents gained 0.8 percent in that time to an average of \$771 per month, while effective rents increased 0.7 percent to \$690 per month.
- ◆ Despite modest growth in recent months, asking rents remain 1 percent below year-ago levels, while effective rents are down 2.3 percent.
- ◆ Class A asking rents ended the second quarter at \$932 per month, a year-over-year decline of 1.9 percent. During the same period, Class B/C asking rents slipped 1.1 percent to an average of \$619 per month.
- ◆ **Outlook:** Rents will tick up modestly this year, after losing ground in 2009. Between year-end 2009 and year-end 2010, asking rents will rise 1.2 percent to \$774 per month, while effective rents will increase 1.5 percent to \$693 per month.



SALES TRENDS**

- ◆ Sales velocity remains on track to meet or exceed last year's level. Most deals involve local, private buyers, though out-of-state activity has picked up. California buyers accounted for 23 percent of all transactions year to date, down from 2005 to 2007 but surpassing the 2009 level of 20 percent.
- ◆ At \$31,000 per unit, the median sales price year to date reflects a slight increase over 2009 but remains roughly 13 percent below the peak achieved in 2007.
- ◆ Cap rates for Class A and better-quality Class B assets contracted modestly in recent months. On average, Class A cap rates fall in the high-6 percent to low-7 percent range, while Class B deals trade in the high-7 percent to 8 percent range. Class C cap rates held relatively stable at 9 percent or greater.
- ◆ **Outlook:** Buyers' and sellers' expectations will continue to align this year, and more investors will scour the market for attractive deals, resulting in stronger sales velocity. Increased competition, particularly for stabilized, high-quality properties, will drive additional cap rate compression and price increases by year end.



** 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 VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Grapevine	5.4%	-150	\$763	-2.7%
2	Carrollton/Addison/Coppell	6.8%	30	\$711	-2.9%
3	Far North	6.9%	100	\$716	-2.8%
4	Northwest Denton County	6.9%	180	\$781	-2.6%
5	Richardson	6.9%	-30	\$745	-3.0%
6	Lewisville	7.0%	-70	\$761	-2.6%
7	Mesquite/Seagoville	7.2%	30	\$627	-2.6%
8	Hurst/Bedford/Euless	7.3%	20	\$690	-1.7%
9	North	7.4%	200	\$725	-4.9%
10	Southern Dallas	7.4%	-20	\$627	-3.8%
11	Garland	7.5%	70	\$615	-5.7%
12	Southeast Tarrant County	7.6%	20	\$667	-2.9%
13	Grand Prairie	7.9%	-20	\$588	-4.7%
14	Central Dallas	8.1%	-440	\$1,436	-10.9%
15	Far Northwest/Farmers Branch	8.1%	70	\$620	0.0%
16	South Irving	8.3%	170	\$598	-2.8%
17	North Irving	8.6%	20	\$747	-3.6%
18	Plano/Allen/McKinney	8.7%	0	\$822	-2.4%
19	Southwest Fort Worth	9.1%	-10	\$622	-2.7%
20	Southwest Dallas	9.2%	50	\$582	-3.5%
21	Southeast Dallas	9.4%	40	\$497	-3.5%
22	Central Arlington	9.6%	10	\$515	-2.3%
23	East Fort Worth	10.5%	-20	\$500	-0.6%
24	East Dallas	10.6%	-70	\$734	-1.6%
25	North White Rock	10.6%	120	\$606	0.7%
26	Northwest Fort Worth	10.6%	-80	\$688	-1.7%
27	North Arlington	10.7%	80	\$596	-2.5%
28	Northern Tarrant County	11.2%	40	\$705	-1.7%
29	South White Rock/I-30	11.6%	50	\$545	-1.1%
30	Oaklawn/Uptown/CBD	12.6%	670	\$1,068	1.1%
31	South Dallas	12.8%	140	\$658	-2.1%
32	Northwest Dallas	13.8%	640	\$782	12.0%
33	Far Northeast Dallas	14.5%	350	\$535	-2.6%