

ApartmentResearch

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

Marcus & Millichap

Minneapolis-St. Paul Metro Area

Third Quarter 2010

INVESTOR INTEREST STRENGTHENS; LISTINGS REMAIN LIMITED

The Minneapolis-St. Paul apartment market has begun to mend, supported by light building activity through the recession and the recent resumption of hiring. Indeed, employment increased during the first half of 2010, following seven consecutive quarters of net job losses, and will continue to rise through year end. With the development pipeline nearly empty and with local employers expected to recoup a quarter of the positions cut during the downturn, absorption activity will strengthen as households “debundle,” or reverse the doubling-up trend that occurred as job losses mounted. Occupancy rates will increase at a faster clip in the Southwest submarket, where inventory additions over the last five years were among the lowest in the metro and where attractive concessions continue to encourage in-migration from residents seeking to live closer to major employers. In communities outside the interstate belt, however, including the outer reaches of the Dakota County, Washington County and West submarkets, owners still face challenges competing for tenants. Subsequently, concession burn-off in these areas will lag the metrowide pace. Throughout the Twin Cities, vacancy rates will start to tighten this year, albeit gradually, allowing owners to decrease concessions and push up rents.

With the local labor force and property metrics stabilizing, area buyers are returning to the market, though few quality investment opportunities exist. Accordingly, sales activity continued to slow through the first half of 2010. Many owners of distressed assets have sold already, while those not under immediate duress continue to hold as revenues improve. With a lack of deeply discounted assets available, investors have targeted well-located, stabilized complexes, specifically those in core areas and near major employers. As buyer competition for these properties intensifies, owners looking to exchange into more passive investment vehicles will list assets, buoying deal flow. In the suburbs, though, fewer stabilized complexes will be listed, keeping marketing times elevated.

2010 ANNUAL APARTMENT FORECAST



Employment: Local employers will expand staffing levels by 1.7 percent this year, or 28,000 employees. During the recession, employers shed 116,000 workers, including more than 80,000 positions in 2009.



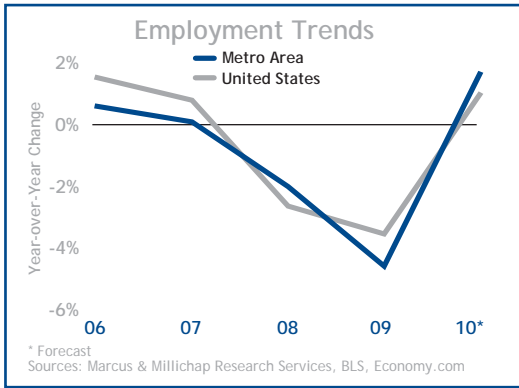
Construction: Following the completion of 688 units last year, developers will deliver roughly 330 units in 2010, a 0.2 percent inventory addition and 52 percent less than the five-year average.



Vacancy: Moderating construction activity and strengthening job growth will drive down vacancy this year. Vacancy will decrease 40 basis points in 2010 to 5 percent, after rising 100 basis points last year.

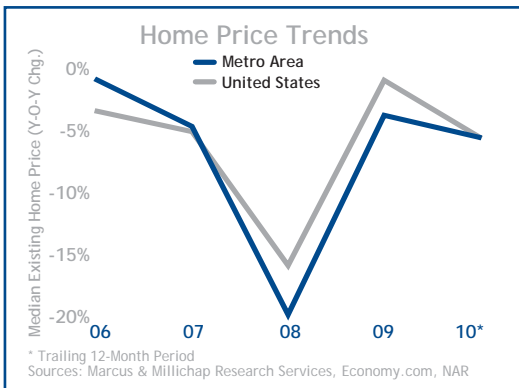


Rents: Owners will continue to utilize concessions, but to a lesser extent than in 2009. This year, asking rents will advance 1.9 percent to \$947 per month, while effective rents will grow 2.4 percent to \$892 per month.



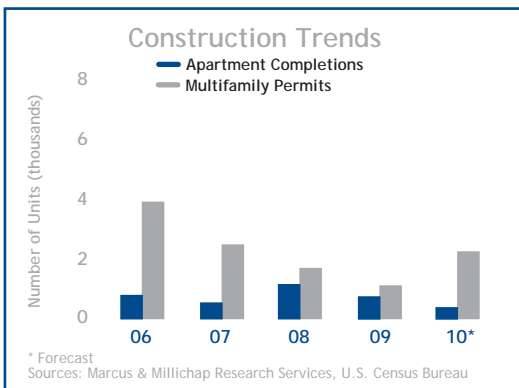
ECONOMY

- ◆ Hiring has resumed in the Twin Cities, with employers adding 18,200 workers in the first half of this year. Measured on a year-over-year basis, however, employment shrank by 0.2 percent, or 3,400 positions.
- ◆ Leisure and hospitality employers lead year-to-date job gains, creating 11,500 jobs in that time. The manufacturing sector has regained its footing since losing 21,700 workers one year ago, expanding by approximately 4,900 workers since the start of this year.
- ◆ After peaking at 8.2 percent in June 2009, the metro's unemployment rate steadily improved to reach 6.6 percent in June of this year, below the national unemployment rate of 9.5 percent. The local unemployment rate has decreased 50 basis points since the start of 2010.
- ◆ **Outlook:** Twin Cities employers will expand staffing levels by 1.7 percent this year, or 28,000 employees. During the recession, employers shed 116,000 workers, including more than 80,000 positions in 2009.



HOUSING AND DEMOGRAPHICS

- ◆ The number of single-family permits pulled during the year ending in the second quarter increased 42 percent to 4,900 units. Still, this total falls nearly 70 percent below the average recorded between 2003 to 2007. Multifamily permit issuance declined 14 percent in the last year to 1,130 units.
- ◆ The median price of a single-family home in the Twin Cities was \$170,900 in the second quarter, down almost 6 percent from one year earlier. In that same span, the metro's median household income grew 0.7 percent to \$56,280 annually, an amount that is \$14,600 higher than the minimum household income needed to purchase a median-priced home.
- ◆ As of the second quarter, the typical mortgage payment, using traditional financing, was \$177 per month less than the average Class A asking rent, up from the \$75 per month disparity recorded during the same quarter in 2009.
- ◆ **Outlook:** Rising home prices will allow Class A operators to increase rents, though strong gains are not expected until well into next year.

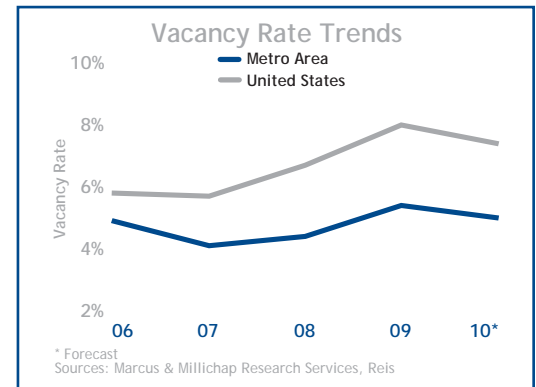


CONSTRUCTION

- ◆ The completion of 170 apartments during the first half of 2010 brought year-over-year deliveries to approximately 790 units, a 0.5 percent inventory increase. One year earlier, builders added nearly 960 rental units.
- ◆ Almost 580 units are being constructed across the metro, 28 percent of which are scheduled for delivery this year. The largest project under way is the second phase of the Uptown at Citywalk, which will add 242 units to the Washington County submarket in late 2011.
- ◆ The planning pipeline contains 6,000 rental units, nearly half of which are located in the Minneapolis submarket.
- ◆ **Outlook:** Following the completion of 688 units in 2009, deliveries will slow to roughly 330 units this year, a mere 0.2 percent inventory addition and 52 percent less than the five-year average.

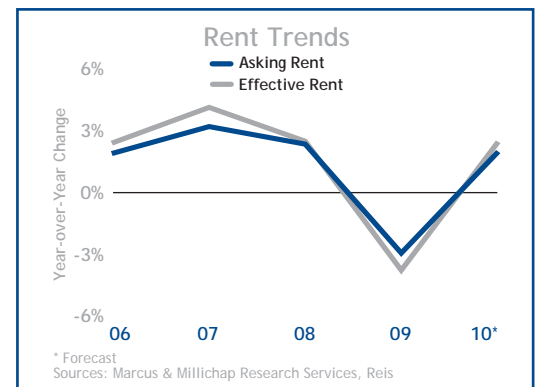
VACANCY

- ◆ Although the vacancy rate in second quarter was up 40 basis points from one year earlier at 5.1 percent, employment growth has strengthened renter demand, pushing down vacancy 30 basis points year to date.
- ◆ Vacancy at Class A complexes was 5.7 percent in the second quarter, up 30 basis points from the same period in 2009. The resumption of job creation, however, improved vacancy by 50 basis points during the first half of 2010.
- ◆ Household formation has contributed to lowering the vacancy rate at Class B/C properties by 20 basis points year to date to 4.6 percent, in line with the sector's five-year annual average.
- ◆ **Outlook:** Slower construction activity and projected job growth will drive down vacancy this year. Vacancy will decrease 40 basis points in 2010 to 5 percent, after rising 100 basis points last year.



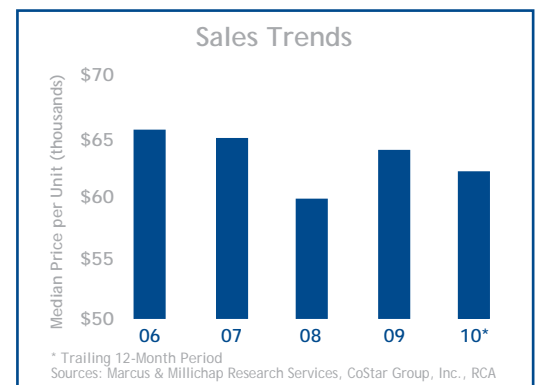
RENTS

- ◆ Over the last year, asking rents slipped 2.2 percent to \$928 per month, and effective rents decreased 1.9 percent to \$872 per month. Stronger operations during the first half of 2010, however, encouraged owners to hold concessions, as asking rents stayed relatively flat and effective rents increased just 0.1 percent.
- ◆ Asking rents among Class A properties fell 0.5 percent during the past two quarters to \$1,105 per month, while Class B/C asking rents edged up 0.3 percent to \$786 per month.
- ◆ With occupancy improving, revenues increased 0.4 percent in the first half of this year, easing the year-over-year rate of decline to 2.3 percent.
- ◆ **Outlook:** Owners will continue to utilize concessions, but to a lesser extent than in 2009. This year, asking rents will advance 1.9 percent to \$947 per month, while effective rents will grow 2.4 percent to \$892 per month.



SALES TRENDS**

- ◆ Transaction velocity decreased 30 percent during the past 12 months, largely due to a lack of quality product on the market.
- ◆ The median price of an apartment property in the Twin Cities held flat at \$62,300 per unit during the past year. In year-to-date closings, however, the median price dropped to \$58,400 per unit due to a higher concentration of sales involving smaller assets.
- ◆ In the last year, cap rates averaged in the low- to mid-8 percent range, up 100 basis points from the prior 12-month average.
- ◆ **Outlook:** As buyer competition increases for the few quality listings and NOIs strengthen, upward movement in cap rates will slow. This year, initial yields for Class C assets will average in the low- to mid-8 percent range, while stabilized, well-located Class A and Class B properties will likely register cap rates in the low- to mid-7 percent 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

- ◆ 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

- ◆ The largest tract of developable land in the metro, 430 acres in Arden Hills, is scheduled for auction in the third quarter. Zoning allows for several housing options after environmental cleanup, including apartments, a seniors housing complex and single-family homes.
- ◆ The Minneapolis school board plans to relocate its staff to a \$27 million headquarters in northern Minneapolis upon the facility's scheduled completion in 2012. The relocation of 500 employees to the new site will boost area housing demand.
- ◆ Early in 2011, U.S. Bancorp will move approximately 1,600 jobs from St. Paul to Richfield, located in the Southwest submarket, potentially hindering apartment operations in the already hard-hit St. Paul submarket.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Minneapolis	4.5%	-30	\$1,009	-3.3%
2	Northeast	4.6%	0	\$778	-3.2%
3	Northwest/Anoka County	4.7%	40	\$739	-2.5%
4	Southwest	4.8%	-10	\$892	-0.3%
5	West	5.2%	50	\$921	-1.6%
6	Dakota County	5.7%	80	\$848	-2.0%
7	Washington County	5.8%	-10	\$927	-0.9%
8	St. Paul	6.1%	170	\$850	-0.5%