

# ApartmentResearch

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

Marcus & Millichap

Oakland Metro Area

Third Quarter 2010

## EAST BAY APARTMENT MARKET FUNDAMENTALS TURN THE CORNER

Despite a lack of job creation in the East Bay during the first half, apartment vacancy declined after an extended period of weakness. The North Alameda, East Contra Costa and Fremont/Newark/Union City submarkets registered some of the more dramatic improvements in occupancy to date in 2010, but these areas also recorded above-average rent reductions over the past 12 months. Nonetheless, the apparent success of the rent-for-occupancy trade-off strategy suggests renter demand has finally returned to the East Bay market. This shift likely comes as a result of renters re-establishing their own households after doubling up through the downturn, either out of necessity brought on by job losses and housing woes or to conserve cash during uncertain economic times. Household formation in the metro area accelerated modestly in the first half and should escalate further this year as job growth resumes. At the same time, declining multifamily permitting in recent quarters points to another six months or more of reduced apartment construction in the East Bay, providing owners with an opportunity to fill units ahead of the next construction cycle.

Buyer demand for East Bay apartments remains focused on both ends of the spectrum, with investors targeting smaller distressed properties and turnaround opportunities, as well as high-quality stabilized properties in prime locations. Overall transaction velocity will continue at a reduced pace, however, due to limited for-sale inventory and a still-present, albeit narrowing, gap between buyers' and sellers' expectations. On average, cap rates in the East Bay apartment market increased 50 basis points over the past year to the low-7 percent range, but the trend varied dramatically by property quality and location. Cap rates for highly sought-after, top-quality assets, for instance, contracted modestly in recent months to the low- to mid-6 percent range. During the same period, lower-quality or distressed-property deals traded at cap rates starting in the 9 percent to 10 percent range.

### 2010 ANNUAL APARTMENT FORECAST



**Employment:** Despite the resumption of job growth in the second half, the metro area will lose 2,000 positions in 2010, a 0.2 percent decline. Last year, Oakland employers shed more than 60,000 jobs.



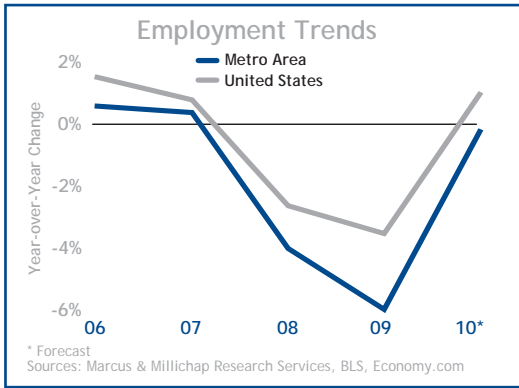
**Construction:** Developers will deliver 690 apartments to the Oakland metro this year, down from 1,210 units in 2009.



**Vacancy:** Reduced construction and the resumption of job growth later this year will allow for improvement in the vacancy rate. Vacancy will end 2010 at 5.5 percent, down 30 basis points from one year earlier.

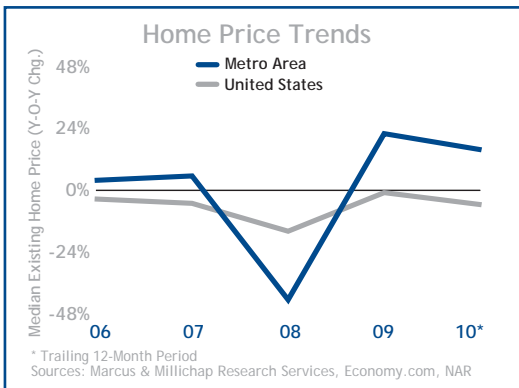


**Rents:** Slight gains through most of 2010 will offset reductions registered in the first quarter. Asking rents will end this year at \$1,265 per month, flat when compared to year-end 2009, while effective rents will finish 2010 at \$1,194 per month, up 1 percent.



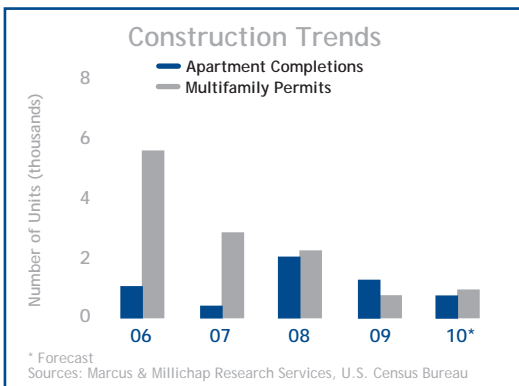
## ECONOMY

- ◆ Local employment contracted during the first half, but cutbacks were less severe than those recorded in the same period in 2009. Year to date, the metro area lost 6,600 jobs, compared to a reduction of 39,300 positions during the first half of last year.
- ◆ The most severe contractions this year were registered by the manufacturing and construction sectors, which, combined, shed 6,200 positions during the first half. The NUMMI shutdown accounted for a sizable share of the manufacturing losses, though the plant has since been purchased by Tesla Motors, which plans to build electric cars with Toyota at the facility.
- ◆ Two of the larger employment sectors in the metro area, professional and business services and government, posted modest growth during the first half. Between year-end 2007 and year-end 2009, these sectors lost 27,000 jobs.
- ◆ **Outlook:** Despite the resumption of job growth in the second half, metro employers will trim 2,000 positions during 2010. Last year, cuts totaled more than 60,000 jobs.



## HOUSING AND DEMOGRAPHICS

- ◆ At \$441,000, the median price for an existing single-family house in the metro area remains 40 percent below peak levels achieved three years ago, despite increasing 16 percent over the past year.
- ◆ The gap between the typical mortgage payment and average Class A asking rent in the market narrowed dramatically in recent years. At \$755 per month, however, the premium on ownership remains sufficient to prevent many apartment renters from purchasing.
- ◆ Builders pulled just 800 multifamily permits over the past year, down 50 percent from the preceding 12-month period and 86 percent below peak levels recorded in late 2006. Also during the last year, single-family permit activity increased 28 percent to nearly 2,200 units.
- ◆ **Outlook:** In addition to a sizable discrepancy between the average rent and mortgage payment, tight lending standards and increased downpayment requirements continue to bar a large share of renters from homeownership.

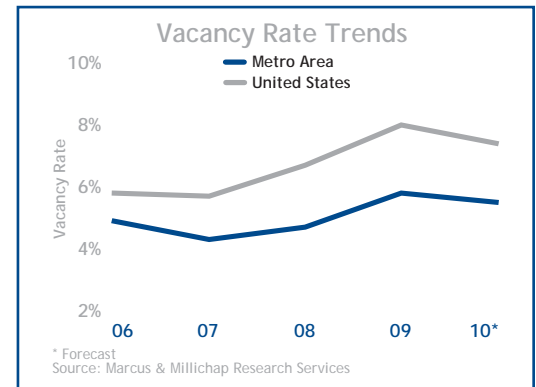


## CONSTRUCTION

- ◆ Developers completed nearly 1,100 apartments over the past year, including 300 units in the first half of 2010. Year to date, new supply has been split between the San Ramon/Walnut Creek and North Alameda submarkets.
- ◆ The largest project under way in the metro area is Avalon Walnut Creek. The first phase of the 422-unit complex came online earlier this year, with the second phase slated for fall 2010 and the remaining units scheduled for delivery in spring 2011.
- ◆ Developers have 6,000 units planned for the metro area, though start dates have yet to be announced for any of the projects. Approximately half of the units are located in the North Alameda submarket.
- ◆ **Outlook:** Developers will deliver approximately 690 apartments to the Oakland metro area in 2010, down from 1,210 units last year.

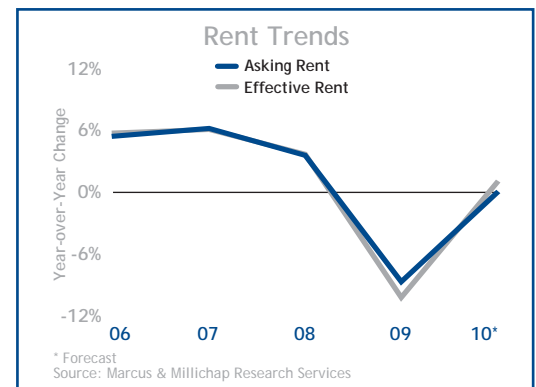
## VACANCY

- ◆ After retreating 30 basis points in the first quarter of 2010, vacancy in the Oakland metro area held steady at 5.5 percent through midyear.
- ◆ Improvements in vacancy were driven mostly by strengthening demand for Class A units. During the first half, Class A vacancy declined 80 basis points to 5.1 percent.
- ◆ The vacancy rate in the metro area's large Class B/C sector remained stable through the first six months of the year at 5.7 percent.
- ◆ **Outlook:** Reduced construction and the resumption of job growth later this year will allow for improvement in the vacancy rate. Vacancy will end 2010 at 5.5 percent, down 30 basis points from one year earlier.



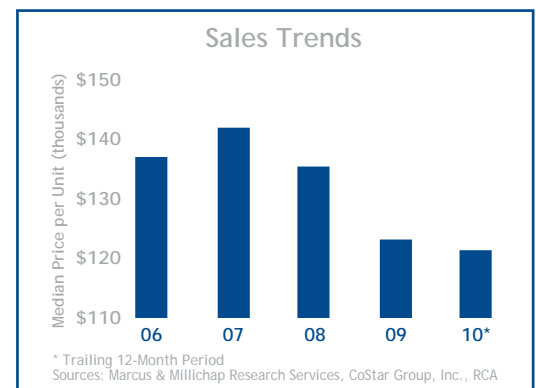
## RENTS

- ◆ After declining through the recession, rents appear to have turned the corner in the second quarter of 2010. During this period, asking rents ticked up 0.4 percent to an average of \$1,263 per month, while effective rents increased 0.8 percent to \$1,190 per month, respectively.
- ◆ Despite modest growth during the second quarter, rents remain below year-ago levels. Since mid-2009, asking rents have declined 4 percent, while effective rents have slipped 3 percent.
- ◆ When compared to their most recent respective peaks, Class A asking rents have decreased 9.2 percent to \$1,513 per month, while Class B/C rents have lost 8.9 percent to \$1,153 per month.
- ◆ **Outlook:** Modest gains through most of 2010 will offset reductions registered in the first quarter. Asking rents will end the year at \$1,265 per month, flat when compared to year-end 2009, while effective rents will finish 2010 at \$1,194 per month, up 1 percent.



## SALES TRENDS\*\*

- ◆ Transaction velocity in 2010 is on pace to meet or exceed last year's level. Most deals involve in-state investors purchasing smaller properties priced at less than \$1.5 million.
- ◆ Cap rates for transactions closed year to date average 7.2 percent, approximately 50 basis points above the average reported in 2009. Over the same period, the median price per unit declined just 2 percent to \$120,500.
- ◆ The cap rate spread between Class A and Class B/C product widened in recent quarters as investors' flight to quality continued. Top-quality properties in more sought-after locations can trade at cap rates from 6.0 percent to 6.5 percent, while lesser-quality or distressed assets tend to change hands at 9 percent or more.
- ◆ **Outlook:** Owners of high-quality properties should consider the significant pent-up buyer demand for such assets in the market today. Stabilized, high-quality apartment listings remain few and far between in the East Bay, resulting in strong competition and multiple offers on available properties.



\*\* 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

- ◆ After a surge in construction and vacancy early last year, Class A owners in the North Alameda submarket cut rents to attract tenants. The strategy appears successful; while top-tier rents in the area slipped 7 percent over the past year, Class A vacancy declined 850 percentage points to 10.9 percent.
- ◆ The northeastern part of Contra Costa County continues to face significant competition from shadow-rental stock. While occupancy in the area improved recently, it may take more time for apartment operators to regain any pricing power. During the past year, rents in the East Contra Costa submarket, which were already the lowest in the metro area, slipped 6 percent.
- ◆ If approved by voters later this year, a proposed hotel/casino at the Point Molate redevelopment in Richmond could generate thousands of jobs, boosting apartment demand in the West Contra Costa submarket.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	San Ramon/Walnut Creek	4.2%	-50	\$1,260	0.6%
2	Concord/Martinez	4.3%	0	\$1,064	-3.3%
3	San Leandro/Hayward	4.3%	70	\$1,073	-2.8%
4	Fremont/Newark/Union City	4.5%	30	\$1,240	-4.5%
5	East Alameda	5.1%	-80	\$1,347	-2.7%
6	East Contra Costa	6.1%	10	\$1,022	-6.0%
7	West Contra Costa	6.5%	120	\$1,189	-3.8%
8	North Alameda	8.4%	-210	\$1,283	-2.4%