ApartmentResearch
MARKET UPDATE
Marcus & Millichap
Orlando Metro Area *Third Quarter 2010*

Positive Signs Appear, but Sustainability Uncertain

The Orlando apartment sector reached a turning point in the first half of this year, but a sustained and vigorous rebound in primary measures of property performance will not occur until economic expansion accelerates. Vacancy declined in the first two quarters of 2010 as job growth resumed and some former homeowners found refuge in rental housing. Single-family home foreclosures remain elevated in Orlando, so the ongoing migration of homeowners will continue to bolster apartment demand. A tentative pace of hiring in private employment sectors, however, will maintain household creation below historical trends. Relocations from other regions, a key driver of tenant demand in the second half of most calendar years, will remain weak as the soft housing market and few job openings force many households to stay put. While vacancy declined so far in 2010, rents also fell, signaling the continued use of incentives at many properties, a trend that will remain in place until more normal economic and household growth patterns are restored.

While apartment operational challenges persist in Orlando and stability remains a viable near-term objective for owners and investors, properties will continue to attract interest when listed. Experienced local buyers have become particularly active, devoting considerable attention to Class B REO listings. Though these assets typically perform well as rentals, many were purchased as condo conversion opportunities before the housing market collapsed and have subsequently generated insufficient income to cover the high debt service. In these deals, many investors are assuming 9 percent to 9.5 percent returns in the second year of ownership following occupancy improvements and concession burn-off. Overall, cap rates for solid Class A assets built in the past 10 years start in the low- to mid-7 percent range, while Class B properties generally price about 200 basis points higher. The investment market for small Class C properties has yet to return due to typically high vacancy rates and pricing ambiguity.

2010 Annual Apartment Forecast

0.9% increase in total employment

Employment: Total employment will increase 0.9 percent in 2010 with the creation of 8,700 positions, the first annual job gain since 2007. Last year, 50,100 jobs were eliminated.

1,400 units will be completed

Construction: Projects totaling 1,400 apartments will be delivered in 2010, down from nearly 2,200 units last year. Permitting remains depressed, and the planning pipeline has thinned to 7,300 units.

20 basis point increase in vacancy

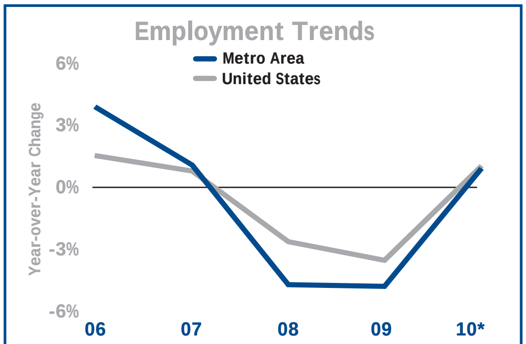
Vacancy: With slower job growth expected in the second half of 2010, vacancy will remain near the level recorded in the second quarter. On an annual basis, vacancy will rise 20 basis points this year to 11.4 percent, following a 120 basis point jump in 2009.

2.6% decrease in asking rents

Rents: This year, asking rents will dip 2.6 percent to $820 per month, while effective rents will slide 3.1 percent to $749 per month. Asking rents fell 5.4 percent in 2009, accompanied by a 6.3 percent contraction in effective rents.

Economy

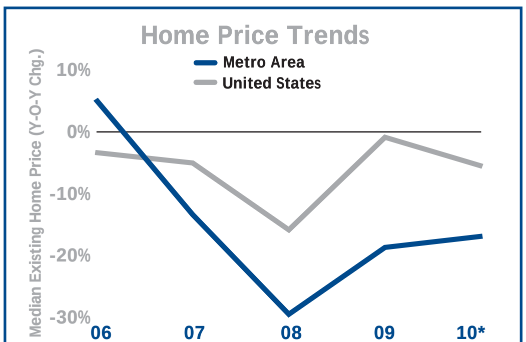
- In the first half of the year, 8,000 jobs were created in the metro area, compared to a loss of 37,200 positions in the corresponding period in 2009. The recovery in the job market has been somewhat erratic, however, as jobs were created in only three months during the first half of 2010.
- The government sector added 1,800 positions in the first half of this year, but many of these workers will be terminated in the second half as census work ceases. In other sectors, a resurgence in home building contributed to the addition of 2,500 construction workers, while education and health services created 1,300 positions.
- Approximately 2,400 jobs were added in the key leisure and hospitality sector during the first half of 2010. Hotel occupancy has rebounded modestly from recession lows, driven by an increase in room demand.
- **Outlook:** Total employment will expand 0.9 percent in 2010 with the creation of 8,700 positions, the first annual job gain since 2007.



* Forecast
Sources: Marcus & Millichap Research Services, BLS, Economy.com

Housing and Demographics

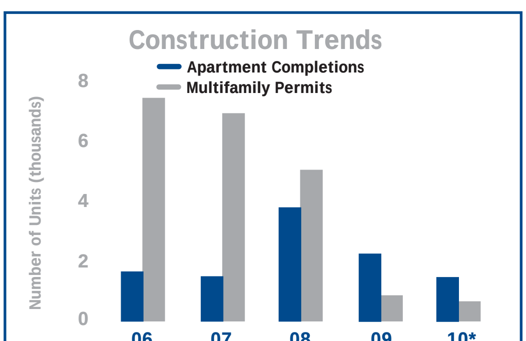
- Over the 12 months ending in the second quarter, permits for residential construction decreased 6 percent to 5,500 units. The multifamily segment led the way, as only 650 units were permitted during the past year, a 70 percent decline and one of the lowest 12-month totals in 30 years.
- Single-family developers started to build again, perhaps spurred by the first-time homebuyer tax credit. In addition to registering a 30 percent increase in permits to 4,900 over the past year, construction started on 2,700 homes in the first half of 2010, up from 1,600 homes in the first six months of 2009.
- Limited relocations from other areas and a tepid, albeit recovering, job market continue to constrain household formation. In the first half of this year, an estimated 4,000 households were created, about the same number as in the first half of 2009 but well below pre-recession levels of about 20,000 households annually.
- **Outlook:** While depressed permitting bodes well for the multifamily sector in the coming quarters, continuing acceleration in single-family home building poses a potential hurdle in the recovery of the local housing market.



* Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, Economy.com, NAR

Construction

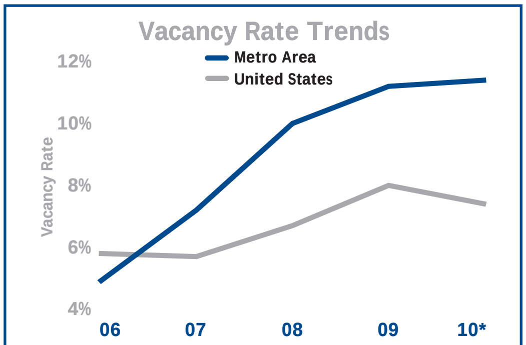
- In the 12 months ending in the second quarter, developers completed 2,360 units in Orlando, a 2 percent increase to stock but a decline from the 3,000 apartments delivered in the preceding one-year stretch.
- Year to date, more than 1,300 units were completed in the metro. Recent additions to stock include the 377-unit 55 West on Church Street in downtown Orlando and, in Kissimmee, 432 units in the Village at Secret Lake. Another 1,000 apartments in three projects are under construction.
- The pipeline of planned projects has thinned considerably, with 7,300 units proposed, compared with 9,400 units earlier this year.
- **Outlook:** Projects totaling 1,400 apartments will be delivered in 2010, down from nearly 2,200 units last year.



* Forecast
Sources: Marcus & Millichap Research Services, U.S. Census Bureau

Vacancy

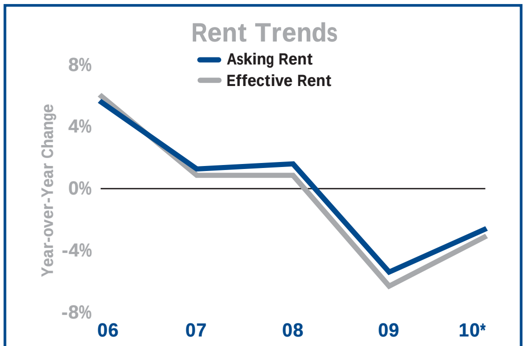
- Job growth, the relief of pent-up demand and the migration of former homeowners into multifamily rentals supported a 50 basis point drop in vacancy in the second quarter to 11 percent. Overall, vacancy decreased 20 basis points in the first half, as net absorption of more than 1,400 units exceeded additions to supply.
- Leasing incentives at recently constructed properties contributed to a 50 basis point decline in Class A vacancy in the second quarter to 9 percent. Net absorption was more than 500 units in the period, following an increase in occupied stock of 248 units in the first quarter.
- Class B/C vacancy receded 50 basis points in the second quarter to 12.7 percent, the first quarter-over-quarter decline in nearly four years. Additional improvements may be far more modest as tepid job growth in low-paying employment sectors limits the creation of new renter households.
- **Outlook:** This year, vacancy will rise 20 basis points this year to 11.4 percent, following a 120 basis point jump in 2009.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Rents

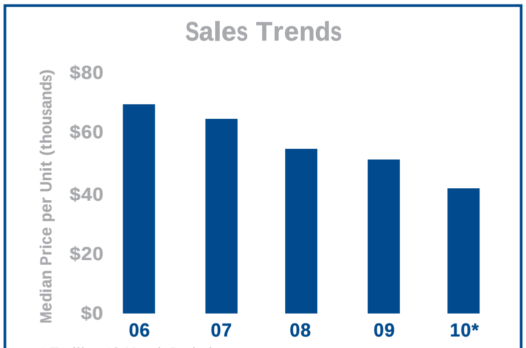
- In the second quarter, marketwide asking rents slid 0.7 percent to $836 per month and also were down 0.7 percent year to date. Concessions rose in the second quarter, as effective rents slipped 1.0 percent to $767 per month, erasing a modest gain in the prior period. Effective rents have fallen 0.8 percent since the end of 2009.
- Class A asking rents continued to fall during the second quarter, receding 0.6 percent to $968 per month; this amount also marks a 0.7 percent drop year to date. Class B/C asking rents fell for the seventh consecutive quarter, dipping 0.7 percent to $724 per month.
- After sliding in the first three months of the year, concessions climbed 30 basis points in the second quarter to 8.3 percent of asking rents. Concessions average more than 9 percent of asking rents in the Maitland/Winter Park and South Central submarkets, where new properties came online in the past year.
- **Outlook:** In 2010, asking rents will dip 2.6 percent to $820 per month, while effective rents will decrease 3.1 percent to $749 per month.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Sales Trends**

- Transaction velocity rose about 10 percent in the past year, based upon a limited number of deals. Deal volume is down 75 percent from the peak of the market in 2006.
- Sales of distressed assets contributed to an 18 percent drop in the median price over the past year to $41,700 per unit. The median price was more than $70,000 per unit four years ago.
- Stabilized Class B/C properties in areas with strong demand generators typically price at cap rates in the low- to mid-9 percent range.
- **Outlook:** Sales of large, stabilized properties will continue to establish pricing benchmarks and lead to more deals. The market-clearing price for smaller properties experiencing operational distress, though, may take longer to establish without additional deals.



* Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

*** 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

- More than 2,800 rental units are planned in the Maitland/Winter Park submarket, representing about 70 percent of existing stock. None of the projects is scheduled to start construction, but the area's proximity to downtown employers will continue to attract developers.
- Recent job cuts in blue-collar employment sectors contributed to increasing Class B/C vacancy in the Northwest submarket by more than 900 basis points to 24.6 percent over the past year. More than 600 lower-tier units were vacated during the period.
- Multifamily permit issuance has declined in each county of the market, but the most substantial drop has occurred in Lake and Osceola counties. In the latter, only 50 units were permitted in the past year, half the total recorded in the preceding annual period.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	West Altamonte Springs	7.1%	-70	$724	-7.9%
2	East Altamonte/Casselberry	8.0%	20	$718	-6.5%
3	Far South/Lake Buena Vista	8.2%	-260	$893	-5.4%
4	Northeast/436	8.4%	-80	$751	-5.2%
5	Southwest/435	8.8%	100	$816	-4.8%
6	Southeast/Airport	9.5%	-90	$786	-5.9%
7	Far North	10.2%	110	$793	-6.3%
8	South Central	13.2%	110	$734	-4.4%
9	Maitland/Winter Park	14.2%	180	$806	-0.5%
10	Kissimmee/Osceola	15.2%	-120	$766	-4.7%

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