

ApartmentResearch

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

Marcus & Millichap

Portland Metro Area

Third Quarter 2010

FUNDAMENTALS IMPROVING, BUT INVESTMENT ACTIVITY LAGS

A significant drop in apartment construction, combined with resumed employment gains and ongoing household formation, will improve Portland apartment fundamentals this year. The outlook brightens further beginning in 2011, as multifamily permitting activity is near historical lows, indicating existing properties will receive much of the future renter demand. Vacancy declined by more than 100 basis points in the first half of the year, though with the bulk of the metro's deliveries slated for the second half, the rate will level off through year end. Rents improved significantly during the second quarter, which is typically one of the metro's strongest periods, and further, albeit more modest, gains are expected for the remainder of 2010. The Northwest/Downtown submarket will likely record the most rapid fundamental improvement. A wave of deliveries caused vacancy there to spike above 14 percent late last year, but nearly all of the metro's net absorption year to date occurred in this area. By year end, vacancy in the submarket could drop below 10 percent, while vacancy throughout much of the rest of the metro will remain near current ranges.

While operating fundamentals are stabilizing, it will be a few more quarters until investment activity moves off the bottom. Velocity declines are concentrated in larger properties, and the market for smaller complexes remains relatively active. Properties with fewer than 20 units are highly sought-after by local, private buyers; these assets made up 60 percent of all deals closed thus far in 2010, compared with approximately 40 percent to 45 percent of transactions over the past few years. With investors favoring smaller assets, some competitive bidding will return to the market, stabilizing prices and cap rates, which average in the low- to mid-7 percent range. Initial yields vary by property quality and location, with assets in desirable areas such as Beaverton and Hillsboro changing hands with cap rates as low as 6.5 percent. Properties on the eastern edges of the metro will likely require cap rates above 7.5 percent to meet the market. Prices have dropped more than 15 percent from the peak, though buyers waiting for more significant declines risk missing opportunities.

2010 ANNUAL APARTMENT FORECAST



Employment: Payroll expansion in Portland will be similar to the national growth rate, as employers will add 9,600 local workers in 2010, a 1 percent gain. Far more robust growth will be necessary to dramatically improve labor conditions and stimulate renter demand; more than 160,000 jobs were slashed during the recession.



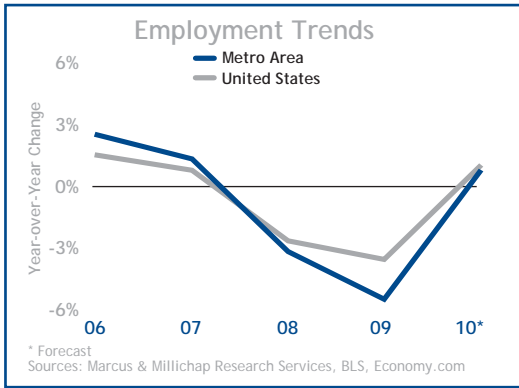
Construction: This year, only 660 apartments will come online, following the delivery of more than 2,000 units in 2009. Over the past five years, annual deliveries averaged 1,200 rental units annually.



Vacancy: In 2010, the vacancy rate will drop 110 basis points to 5.8 percent, fueled by steady demand for apartments and minimal additions to inventory.

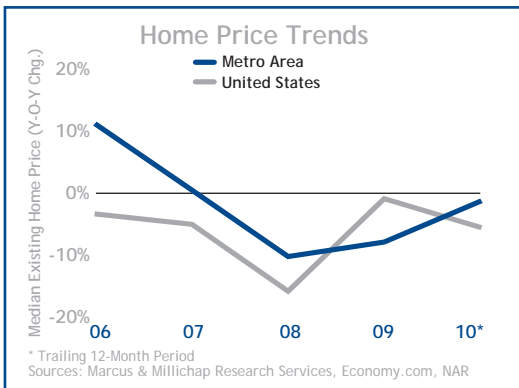


Rents: Improving vacancy will allow owners to raise rents modestly. This year, asking rents will advance 2 percent to \$819 per month, while effective rents will gain 2.3 percent to \$742 per month. In 2009, asking rents fell 2.7 percent, and effective rents contracted 5.1 percent.



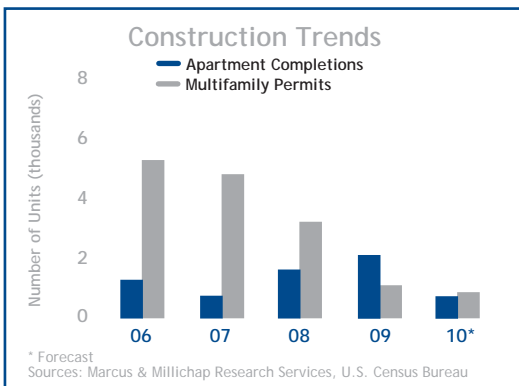
ECONOMY

- ◆ Payrolls expanded slowly in the first half of this year with the addition of 4,000 jobs. Nevertheless, metrowide employment levels fell 1.5 percent year over year, as 14,200 positions were slashed. Gains will continue through the rest of 2010.
- ◆ Employment in the trade, transportation and utilities sector, the largest in the local economy, will likely receive a boost from the \$137 million West Vancouver Freight Access project at the Port of Vancouver. The multiphase development is slated for completion in 2014 and should help attract imports from Asia. Year to date, local trade, transportation and utilities employment increased by 1,000 workers.
- ◆ Approximately 2,200 jobs added thus far in 2010 were in the government sector, which will likely contract in the second half as temporary census positions expire.
- ◆ **Outlook:** Portland employers will add 9,600 workers in 2010, a 1 percent gain. Far more robust growth will be necessary to dramatically improve labor conditions and stimulate renter demand; more than 160,000 jobs were slashed during the recession.



HOUSING AND DEMOGRAPHICS

- ◆ Single-family permit issuance increased 17 percent during the past year to 3,900 units. A far different trend emerged in the multifamily segment, where developers pulled permits for only 700 units, a 63 percent decline from one year earlier.
- ◆ The minimum qualifying income for a mortgage on a median-priced metro home is nearly identical to the current median household income of \$56,100 per year. Still, rents remain affordable compared to mortgage payments; the average Class A asking rent is \$350 per month less than a mortgage payment on a median-priced, single-family Portland residence.
- ◆ The unemployment rate in Portland ended the first half at 10.5 percent, 100 basis points above the national average and unchanged from the end of last year. A decline in the local unemployment rate will be necessary to further spur renter demand for apartments.
- ◆ **Outlook:** Household growth in Portland will prove resilient and ultimately support improving apartment fundamentals. More than 17,000 new households will be added in 2010, following average annual increases of more than 15,000 households in 2008 and 2009.

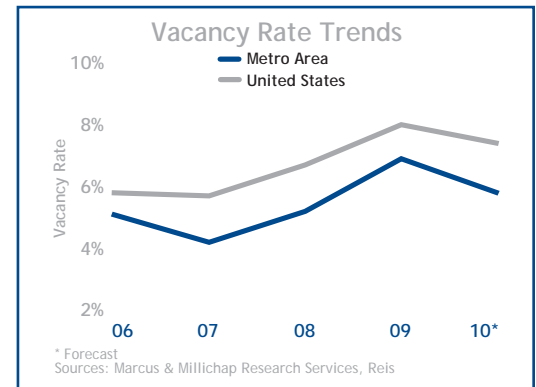


CONSTRUCTION

- ◆ Over 1,500 apartments were delivered during the past 12 months, but only 152 units came online in the first half of 2010, stabilizing inventory levels.
- ◆ Approximately 510 rentals are under construction, all of which will be delivered by year end.
- ◆ Nearly 1,600 units are planned, similar to levels at the end of last year. With the recovery fairly tepid, developers will be slow to fill the development pipeline, and supply will remain in check.
- ◆ **Outlook:** This year, only 660 apartments will come online, following the delivery of more than 2,000 units in 2009.

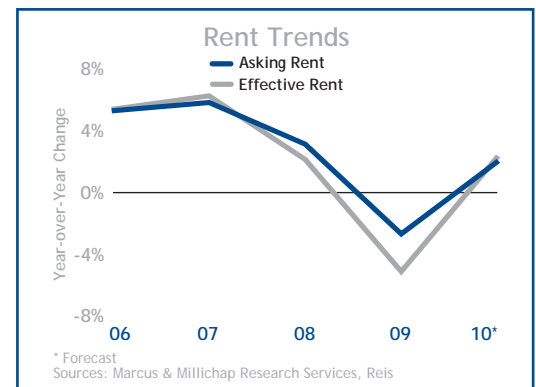
VACANCY

- ◆ Fueled by a 60 basis point drop in the second quarter, vacancy fell 110 basis points in the first half of 2010 to 5.8 percent, an average that is also 40 basis points lower than one year ago. Renter demand in the first half was far stronger than in the same period last year, and construction remained minimal.
- ◆ Vacancy in Class A properties declined 90 basis points in the first half to 7 percent but is still 30 basis points higher than at this time in 2009. It will take a few more quarters of economic growth for units delivered at the end of last year to be filled and the top-tier vacancy rate to return to its long-term average between 4.5 percent and 5.5 percent.
- ◆ Class B/C vacancy fell 80 basis points in the first half of 2010 to 5.2 percent and has decreased 40 basis points year over year. Vacancy has averaged between 4.0 percent and 6.1 percent for the past four years.
- ◆ **Outlook:** The Portland vacancy rate will drop 110 basis points this year to 5.8 percent, driven by steady demand for apartments and modest additions to inventory.



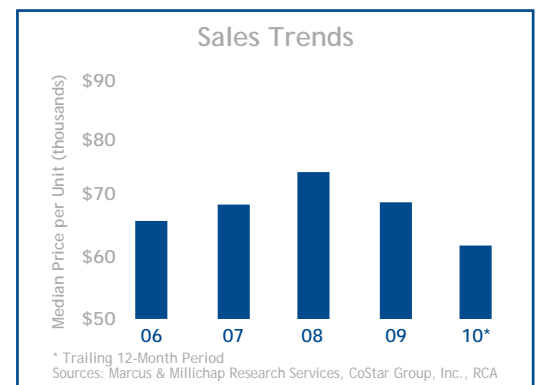
RENTS

- ◆ Asking and effective rents gained 1.1 percent and 1.5 percent, respectively, in the second quarter. Asking rents fell just 0.2 percent in the last year to \$805 per month, while effective rents dipped 1.1 percent to \$731 per month.
- ◆ In the metro's Class A units, asking rents ticked up 0.2 percent year over year to \$932 per month, including a 1.6 percent advance in the second quarter. Asking rents in Class B/C properties dropped 1 percent annually to \$691 per month but are up 0.6 percent year to date.
- ◆ Average revenues are down 0.7 percent year over year, however, the trend began to reverse in the first half, and revenue gains will approach 3 percent by year-end 2010.
- ◆ **Outlook:** Improving vacancy will allow owners to raise rents modestly. This year, asking rents will advance 2 percent to \$819 per month, while effective rents will gain 2.3 percent to \$742 per month. In 2009, asking rents fell 2.7 percent, and effective rents contracted 5.1 percent.



SALES TRENDS**

- ◆ Sales activity slowed 38 percent during the past 12 months, and velocity during the first half of 2010 lagged year-earlier levels by 14 percent. A lack of out-of-state buyers restricted sales activity.
- ◆ With fewer properties changing hands, the median price fell 12 percent year over year to \$62,100 per unit. The median price stabilized in the first half, reaching \$62,700 per unit.
- ◆ Cap rates range from as low as 6.5 percent to 7.0 percent in the best locations to 7.5 percent to 8.0 percent for lesser properties or assets in the Outer Northeast/Outer Southeast submarket.
- ◆ **Outlook:** Cap rates average 100 basis points higher than one year ago but likely will not reach the long-term average of 8 percent as long as interest rates remain near current ranges.



** 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

- ◆ Renter demand in the Beaverton submarket could benefit from an anticipated 500-employee expansion by IBM Corp. The company plans to add workers in the area to develop mortgage software, which would also boost the metro's information employment sector.
- ◆ The 152-unit Broadstone Enso complex came online in the Northwest submarket during the second quarter and was the metro's only notable rental completion in the first half. Despite the increase to inventory, Class A vacancy in the submarket fell 550 basis points to 15.9 percent from the end of last year.
- ◆ While completions and permitting are slowing, several small complexes are planned in the Vancouver submarket. These projects total 425 units, or nearly 3 percent of the area's existing inventory.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Outer Northeast/Outer Southeast	4.9%	30	\$641	-3.2%
2	Vancouver	4.9%	-120	\$695	-0.6%
3	Tigard/Tualatin/Sherwood	5.1%	-80	\$716	-2.5%
4	Milwaukie/Oregon City	5.2%	-30	\$648	-3.4%
5	Beaverton/Aloha	5.4%	0	\$698	-2.8%
6	Inner North/Northeast/Southeast	6.6%	20	\$768	-2.9%
7	Northwest/Downtown	10.7%	-120	\$1,073	4.3%