ApartmentResearch
MARKET UPDATE

Marcus & Millichap

Seattle-Tacoma Metro Area *Third Quarter 2010*

Accelerating Construction Limiting Vacancy Improvement

The Puget Sound apartment market will recover more rapidly than most major metro areas in 2010, driven by employment gains that will far exceed the national average. Offsetting this growth, however, the region will be one of the few metros in the country where apartment completions will accelerate this year, with deliveries projected to increase local stock by more than 2 percent, the fastest rate of growth in nearly a decade. As a result, the metrowide vacancy rate will dip only 70 basis points, and vacancy will rise in areas where completions are concentrated, including the Bellevue/Issaquah and North Seattle/Northgate submarkets. While deliveries increased through the recession, starts and permitting activity slowed, and more modest apartment completions are likely beginning in 2011. Vacancy will remain above pre-recession lows, although operators will respond to growing renter demand by pushing rents higher. This trend has already begun to take shape, as rents rose in both the first and second quarters, with the strongest gains recorded in the popular Downtown/Capitol Hill/Queen Anne and Redmond submarkets.

While fundamentals started to improve in the first half, investor demand lagged year-earlier levels, and it will likely take a few more quarters to gain momentum, particularly in tertiary submarkets. Distressed properties will continue to account for a significant share of closed transactions in the second half and into 2011, although opportunistic buyers showed greater caution when pursuing these assets in recent months. Cash-heavy investors will likely alter strategies in the coming quarters, placing greater emphasis on performing properties in premier locations. Cap rates in areas such as Bellevue and downtown Seattle begin near 6 percent, approximately 100 basis points lower than the Puget Sound average. Outside of top assets and deeply discounted, distressed properties, the investment market will remain fairly soft, and higher initial yields will be required to close deals. Properties in areas such as southern King County and Pierce County will trade with cap rates in the mid-8 percent range.

2010 Annual Apartment Forecast

1.9% increase in total employment

Employment: Employment growth in the Puget Sound will nearly double the national rate of expansion in 2010, reaching 1.9 percent with the addition of 31,000 jobs. Last year, 94,200 positions were eliminated.

4,800 units will be completed

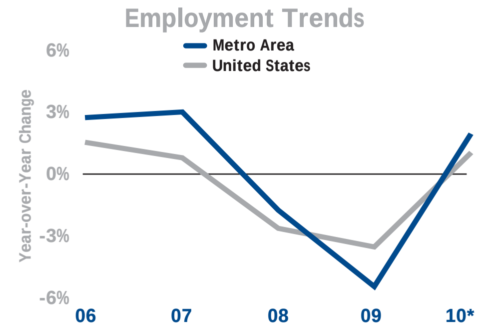
Construction: Developers will deliver 4,800 apartment units this year, following the completion of 3,859 units in 2009. Over the past five years, annual completions have averaged 2,300 units.

70 basis point decrease in vacancy

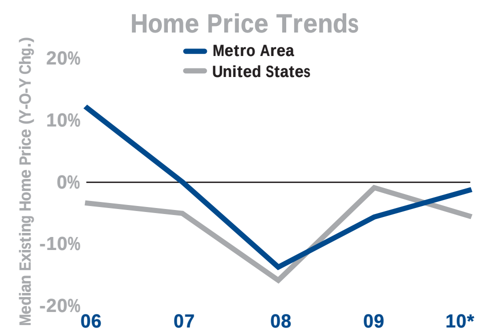
Vacancy: After spiking 170 basis points last year, vacancy will decline 70 basis points to 6.8 percent in 2010, driven by net absorption of approximately 6,000 units metrowide.

3.7% increase in asking rents

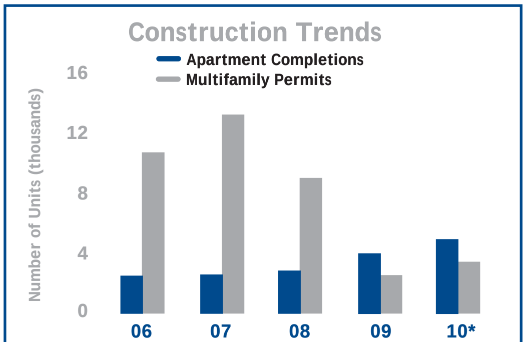
Rents: Employment gains and strong household growth will allow apartment owners to push rents higher this year. Asking rents will advance 3.7 percent to $990 per month, while effective rents will increase 4.1 percent to $923 per month. In 2009, asking rents fell 5.8 percent, and effective rents dropped 7.4 percent.



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



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



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

Economy

- Local employers added 17,400 positions in the first half of 2010, compared to the elimination of 58,600 workers during the first six months of last year. Over the past 12 months, net losses totaled 8,600 jobs, a 0.5 percent decrease.
- The financial activities sector continues to lag the recovery, contracting by 2,700 positions during the first half. Cuts will persist in the second half; Wells Fargo announced plans to close its 14 Wells Fargo Financial stores in the Puget Sound, which will likely result in the loss of approximately 100 jobs.
- Following the elimination of more than 10,600 leisure and hospitality positions in 2009, the segment began to recover during the first half, adding 3,900 jobs. Another 3,100 positions will be created over the next six months.
- **Outlook:** Employment growth in the Puget Sound will nearly double the national rate of expansion in 2010, reaching 1.9 percent with the addition of 31,000 jobs. Last year, 94,200 positions were eliminated.

Housing and Demographics

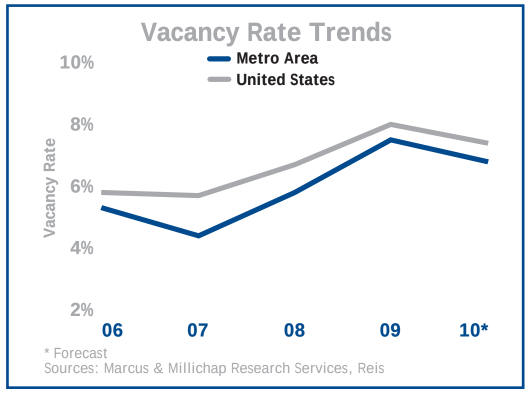
- Permit issuance was mixed during the past year; developers pulled permits for 6,800 single-family units, a 40 percent increase from the preceding year, though permits for fewer than 2,200 multifamily units were issued, down 54 percent from one year earlier.
- The median existing home price stabilized over the past 12 months, declining just 1.5 percent to $313,000. Class A asking rents average $500 per month less than the typical mortgage payment, using traditional financing, on a median-priced single-family home in the metro.
- Household growth remains a driver of apartment demand, despite the volatile labor market. During the past 12 months, the number of households in the metro expanded by 20,000, or 1.5 percent. In the previous year, growth of 1.4 percent was recorded.
- **Outlook:** Despite low mortgage rates and the median home price declining approximately 15 percent during the past two years, apartments will remain an attractive option for most renters. Currently, the median household income of $59,000 per year is 20 percent below the amount required to qualify for a median-priced metro home.

Construction

- Approximately 5,500 units came online during the past year, including 3,200 rentals in the first half of 2010. In the 12-month period ending one year ago, 2,700 apartments debuted.
- Nearly 3,100 apartments are under construction, with 1,600 units to be delivered in the second half of 2010. Construction is concentrated in the Seattle area, with only one project under way in Tacoma.
- Builders will remain active in the Puget Sound, with 15,200 units planned. Four projects, totaling 1,250 units, have scheduled start dates within the next 12 months.
- **Outlook:** Developers will deliver 4,800 apartment units this year, following the completion of 3,859 units in 2009.

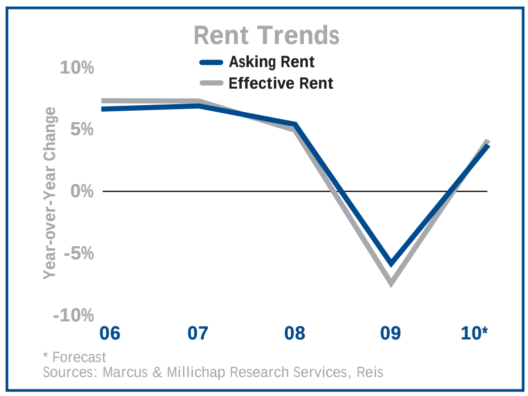
Vacancy

- Metrowide vacancy fell 50 basis points in the second quarter to 7 percent and was 10 basis points lower than one year earlier. Despite the recent improvement, the rate was 150 basis points higher than the average achieved from 2004 to 2008.
- Renters continue to migrate from lower-tier apartments as new units are completed; year to date, the Class A vacancy rate has declined 90 basis points to 6.8 percent. The rate in the metro's top properties is 80 basis points lower than one year ago.
- Class B/C vacancy rose 40 basis points in the past year to 7.1 percent. Thus far in 2010, the vacancy rate in the lower tiers has dropped 30 basis points, although significant improvement in the second half is unlikely.
- **Outlook:** Following a 170 basis point spike last year, vacancy will decline 70 basis points to 6.8 percent in 2010, driven by net absorption of approximately 6,000 units metrowide.



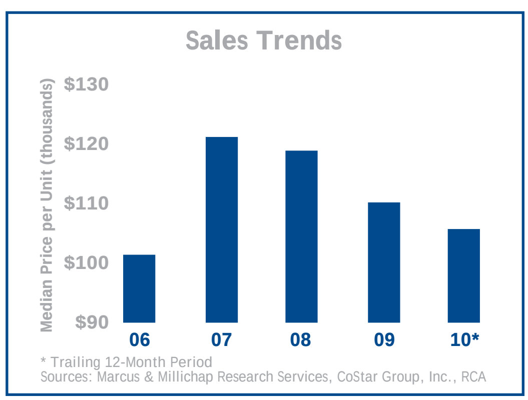
Rents

- Asking rents advanced 1.8 percent during the first half of 2010, including a 1.1 percent gain in the second quarter to $972 per month. Effective rents have jumped 2.5 percent year to date to $909 per month. Recent gains largely offset earlier losses; asking and effective rents are each flat year over year.
- Rent growth is strongest in the Class A segment, where asking rents rose 2.2 percent in the first half to $1,140 per month. In the lower tiers, asking rents are up 1 percent year to date at $834 per month.
- Revenues were flat year over year but accelerated in the first half and will continue to gain momentum through year end. In 2010, average property revenues will increase 4.8 percent as rents creep higher.
- **Outlook:** Asking rents will advance 3.7 percent to $990 per month this year, while effective rents will increase 4.1 percent to $923 per month. Last year, asking rents fell 5.8 percent, and effective rents dropped 7.4 percent.



Sales Trends**

- During the past 12 months, sales velocity slowed 28 percent, including a 24 percent decline in the first half of 2010. Investors will maintain a cautious stance as they weigh the competitive impact of new stock on operating fundamentals and evaluate the sustainability of the economic recovery.
- The median price of all properties sold in the past year dropped 7 percent to $105,500 per unit. In deals closed year to date, however, the median price dropped to $88,600 per unit, as distressed and REO assets accounted for a greater share of properties clearing the market.
- Cap rates in deals involving stabilized assets average in the mid- to high-6 percent range, approximately 40 basis points higher than one year ago. Investors pursuing distressed opportunities evaluate assets primarily on a price-per-unit basis, rather than emphasizing cap rates.
- **Outlook:** While improving fundamentals ultimately will stabilize valuations, the impact of distressed properties changing hands will likely push prices lower in closed deals.



*** 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.

Market Overview

- A recovering job outlook in the Seattle portion of the metro continues to drive improved property performance, despite elevated completions. Vacancy in the Seattle submarkets declined 50 basis points in the first half to 6.9 percent and is 30 basis points lower than one year ago. Asking rents in Seattle are $1,031 per month, up 1.7 percent from year-end 2009.
- Fundamentals in the Tacoma section are recovering at a more modest pace, with vacancy declining 30 basis points in the first half to 7.8 percent. Despite this recent improvement, the rate still averages 150 basis points higher than one year ago. Asking rents in Tacoma have risen 1.2 percent year to date to $752 per month and will tick up further in the second half.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Edmonds/Lynnwood	5.0%	-20	$816	-3.8%
2	Tukwila/Sea-Tac	5.1%	-30	$720	-3.6%
3	University Place/Fircrest	5.1%	140	$711	-0.4%
4	Auburn/Enumclaw	5.6%	-20	$764	-0.7%
5	Renton	6.1%	-60	$860	-1.9%
6	Kent	6.3%	0	$824	-0.5%
7	Kirkland/Juanita	6.3%	-120	$1,144	-1.0%
8	Des Moines/West Kent	6.4%	-110	$795	-1.1%
9	North Tacoma	6.4%	80	$730	1.5%
10	Everett/Mukilteo/Mill Creek	6.5%	-50	$819	-4.0%
11	West Seattle/Burien	6.8%	-220	$792	-2.5%
12	North Seattle/Northgate	7.1%	-80	$964	0.5%
13	Redmond	7.1%	-20	$1,103	4.2%
14	Parkland/Spanaway/Midland	7.4%	-80	$679	-1.9%
15	Downtown/Capitol Hill/Queen Anne	7.5%	70	$1,251	2.7%
16	South Tacoma	7.5%	110	$697	-2.1%
17	East Tacoma	7.6%	70	$775	-1.1%
18	Federal Way	7.9%	-40	$787	-1.5%
19	Bothell/Woodinville	8.0%	-300	$1,004	0.1%
20	Bellevue/Issaquah	8.5%	120	$1,124	1.8%
21	Beacon Hill/Rainier Valley/Skyway	9.5%	-40	$905	-0.3%
22	McChord Air Force Base	10.4%	430	$572	0.9%
23	Lakewood	11.1%	400	704	-2.5%

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