

ApartmentResearch

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

Marcus & Millichap

St. Louis Metro Area

Third Quarter 2010

BUYERS TARGETING DISTRESS, VALUE-ADD DEALS IN ST. LOUIS

The St. Louis apartment market continues to improve, with vacancy projected to tighten through year end as employers expand payrolls and supply additions remain limited. While the resumption of hiring largely drove recent improvements in operating fundamentals, residential foreclosure activity spiked during the first two quarters of 2010, forcing some homeowners into the rental market. With year-to-date default notices up more than 40 percent from the corresponding period in 2009, foreclosure filings will continue to support renter demand in the coming months. As a result, operating performance will strengthen in the coming months, though the recovery will not be uniform. In the St. Louis North submarket, for instance, cautious professional and business services hiring through the second half, along with shadow rentals siphoning renter demand, will delay more considerable occupancy gains in the Class A segment. Consequently, area owners will continue to utilize generous concessions. Metrowide, though, incentives will ease as owners raise rents. This trend will materialize first in lower-tier complexes in the St. Charles County and South submarkets, as Class B/C vacancy rates in both areas currently average below 6 percent.

Deal flow will pick up in the coming months as seasoned local buyers increase activity and purchase long-term value-add deals. While the thawing of capital markets has stimulated sales involving assets with more than 100 units, local buyers primarily focus on distressed Class C properties. Properties with fewer than 50 units facing high vacancies account for the bulk of closings, particularly in downtown St. Louis, where more than half of the past year's sales occurred. Some opportunistic cash buyers have acquired vintage assets in the St. Louis City North and South submarkets, targeting the investments for redevelopment, and are giving more consideration to per-unit prices than cap rates. For the most part, however, assets facing distress will sell with first-year returns above 9 percent and, in some instances, exceeding 10 percent, while the few stabilized assets that come to market will offer initial returns in the mid-8 percent range.

2010 ANNUAL APARTMENT FORECAST



Employment: Metrowide employment will increase by 1.1 percent this year with the addition of 13,900 jobs. In 2009, staff reductions totaled 45,300 workers.



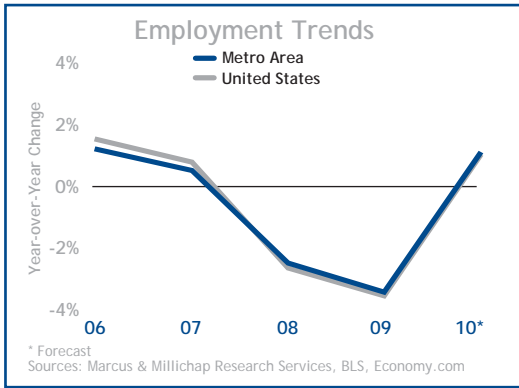
Construction: Approximately 80 apartments will be added to market inventory in 2010, down from 267 units last year. During the past five years, completions averaged 440 units annually.



Vacancy: Employment growth will bolster renter demand as households slowly “debundle.” This year, vacancy will improve 70 basis points to 8.5 percent, after jumping 140 basis points in 2009.



Rents: Asking rents will appreciate 1 percent to \$715 per month in 2010, while effective rents will advance 1.2 percent to \$670 per month. Last year, owners lowered asking and effective rents by 2.9 percent and 3.5 percent, respectively.

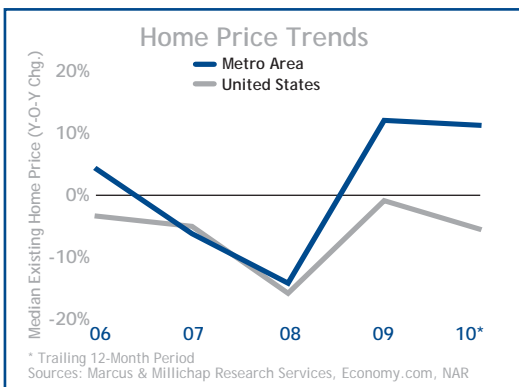


ECONOMY

- ◆ Metro employers added 8,100 workers to payrolls during the past six months, bringing year-over-year gains to 400 positions. During the previous 12-month period, 68,900 jobs were slashed.
- ◆ The manufacturing and government sectors led employment growth over the past year, creating a total of 5,600 positions. Hiring of temporary census workers skews government employment trends, however, and many of the jobs added in the first half will be terminated in the third quarter.
- ◆ Tech Aerospace Group Inc., a manufacturer of airplane parts, will construct a 75,000-square foot plant in the city of Washington, adding 100 jobs over the next two years. The facility eventually will employ 220 workers, helping to strengthen demand for rental housing on the western edge of the metro.
- ◆ **Outlook:** Employment levels in St. Louis will increase by 1.1 percent in 2010 with the addition of 13,900 jobs. Last year, 45,300 positions were cut.

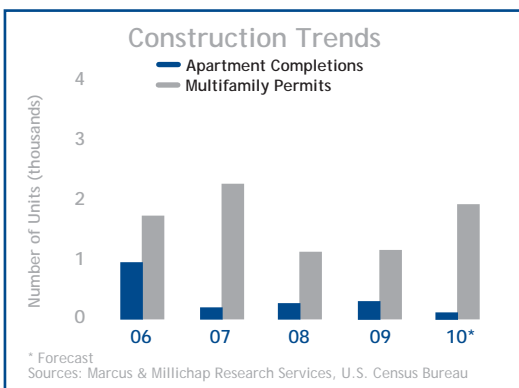
HOUSING AND DEMOGRAPHICS

- ◆ Single-family home sales rose 15 percent during the past year. Encouraged by stronger sales, developers pulled 4,600 single-family permits in that time, roughly 23 percent more than one year earlier. Multifamily permit issuance, meanwhile, spiked 83 percent to 1,470 units.
- ◆ Since mid-2009, the metrowide median home price has climbed 11 percent to \$136,300. Although the median household income of \$46,500 per year is down 1.4 percent from this time in 2009, annual household earnings are 38 percent more than the income required to get a mortgage on a median-priced home.
- ◆ Using traditional financing, the monthly mortgage obligation for a median-priced metro home was \$134 less than the average Class A asking rent as of the second quarter.
- ◆ **Outlook:** Despite growing multifamily builder confidence, securing construction loans remains a challenge, which will prevent many approved projects from breaking ground over the near term.



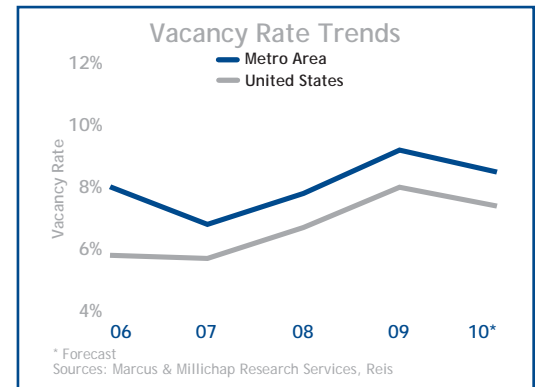
CONSTRUCTION

- ◆ Following the addition of 261 apartment units in the previous year, developers completed 110 units in the past 12 months, expanding metrowide inventory by 0.1 percent.
- ◆ The most recent delivery was the 80-unit Crown Square building, which came online in the St. Louis City North submarket during the second quarter. The project redeveloped the former 14th Street pedestrian mall.
- ◆ The development pipeline is currently empty, with no units under construction. Planned projects total 2,150 units, though only a handful of complexes are scheduled to break ground in 2011.
- ◆ **Outlook:** Approximately 80 apartments will be added to market inventory this year, down from 267 units in 2010. During the past five years, completions averaged 440 units annually.



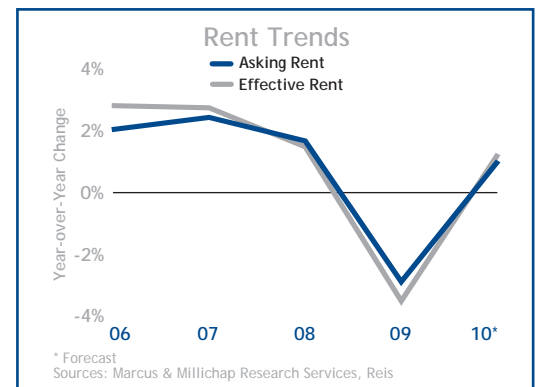
VACANCY

- ◆ Vacancy in St. Louis remained flat year over year in the second quarter at 8.8 percent. Since peaking at 9.2 percent in the fourth quarter of 2009, however, the vacancy rate has improved 40 basis points.
- ◆ Limited deliveries and strengthening payrolls drove down Class A vacancy 70 basis points over the past year to 7.9 percent. The top-tier vacancy rate has declined for three consecutive quarters.
- ◆ Lower-tier vacancy reached a cycle high in the fourth quarter of 2009 and has decreased 30 basis points since to 9.2 percent. Year over year through the second quarter, though, the rate rose 40 basis points.
- ◆ **Outlook:** Employment growth will bolster renter demand as households slowly “debundle.” This year, vacancy will improve 70 basis points to 8.5 percent, after jumping 140 basis points in 2009.



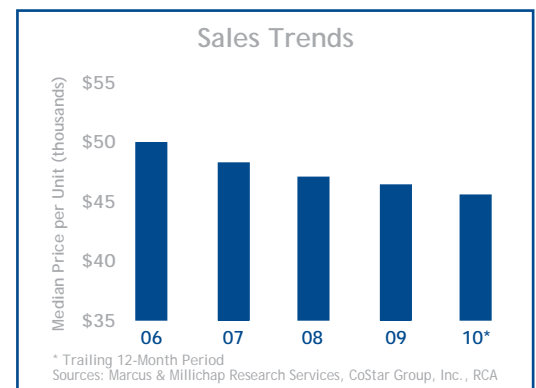
RENTS

- ◆ As of the second quarter, asking rents in the metro were \$710 per month, down just 0.1 percent from one year earlier, while effective rents of \$662 per month were 0.5 percent less than year-ago levels. Recent occupancy gains, however, have encouraged owners to raise rents; year to date, asking rents have ticked up 0.3 percent and effective rents have held flat.
- ◆ Class A asking rents appreciated 1 percent in the first half to \$893 per month. Operators of Class B/C buildings, however, lowered asking rents by 0.3 percent in that time to \$621 per month.
- ◆ With occupancy rates firming during the past two quarters, owners increased rents, causing average revenues to rise 0.4 percent year to date.
- ◆ **Outlook:** Asking rents will tick up 1 percent this year to \$715 per month, while effective rents will advance 1.2 percent to \$670 per month. In 2009, owners lowered asking and effective rents by 2.9 percent and 3.5 percent, respectively.



SALES TRENDS**

- ◆ Transaction velocity increased 10 percent during the most recent 12-month span, largely supported by an uptick in REO sales.
- ◆ With high-vacancy assets and lender-owned properties accounting for approximately 20 percent of the past year’s sales, the median price fell 19 percent in that time to \$45,500 per unit.
- ◆ Stabilized assets will trade with cap rates in the low- to mid-8 percent range, while distressed properties or assets with significant deferred maintenance issues will change hands with first-year returns above 9 percent.
- ◆ **Outlook:** Risk-averse buyers will target assets near major employment centers in the Clayton/Mid-County and Manchester/West County submarkets. Area owners not pressured to sell will continue to hold, but with vacancies averaging well above historical norms, some operators can no longer meet mortgage obligations, which could present strong value-add opportunities.



** 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

- ◆ Peabody, the only remaining Fortune 500 company in downtown St. Louis, is considering a city tax incentive to stay when its lease expires in 2012. Other offers under consideration by the coal giant, however, could result in the loss of 500 jobs, which would hinder the area's recovery.
- ◆ Apartment owners in the Airport/I-70 submarket will benefit from the recent opening of the Express Scripts pharmacy automation center, which created 300 jobs in the area during the second quarter. Year to date, the average Class A apartment vacancy rate in the submarket improved 110 basis points to 10.7 percent.
- ◆ The recent groundbreaking of a \$100 million archives and records facility for the U.S. General Services Administration bodes well for northeastern St. Louis County. In addition to creating temporary construction jobs, the site eventually will employ 800 permanent workers, strengthening housing demand in the area.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	South	5.5%	-50	\$600	-3.4%
2	St. Charles County	6.1%	-50	\$689	0.6%
3	East of I-44	7.2%	20	\$588	-0.2%
4	Manchester/West County	7.9%	-80	\$790	-1.1%
5	St. Louis City South	8.2%	-120	\$550	-2.7%
6	Maryland Heights/N.W. County	8.6%	-50	\$726	1.0%
7	Airport/I-70	9.9%	20	\$510	0.0%
8	St. Louis City North	10.6%	50	\$742	1.6%
9	Florissant/North County	10.6%	60	\$582	-0.2%
10	Clayton/Mid-County	10.8%	190	\$784	-3.6%