

ApartmentResearch

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

Marcus & Millichap

Washington, D.C., Metro Area

Third Quarter 2010

RECOVERY GAINING TRACTION IN METRO D.C.

A healthy local economy will continue to support strong demand for rental housing over the remainder of 2010, helping to retain the Washington, D.C., metro area's stature as the top apartment market in the country. The nascent recovery, however, will encounter setbacks in its early stages, evident by a small increase in marketwide vacancy in the second quarter. Indeed, job creation was strong in the first half of this year, but the pace of private-sector employment growth flagged at the end of the second quarter. Employment growth will proceed at a more measured pace in the second half as private-sector employers remain cautious amid a mixture of positive and negative signals from the economy. While vacancy will decline this year, the ongoing construction of new rentals presents a potential obstacle. New units typically are absorbed quickly, but the current recovery in demand has only started and remains susceptible to sudden economic shocks, potentially putting upward pressure on vacancy.

Fueled by motivated buyers and accessible financing at favorable terms, investment activity will remain centered inside the beltway over the coming quarters. In the district, apartment operators became active buyers in the first half, accompanied by developers and condo converters, who remain driven by a projected shortage of condominiums in the next few years. Demand for properties with under 100 units and boutique assets containing 30 units or fewer remains strong, with cap rates estimated in the low-6 percent range. Overall, cap rates inside the beltway compressed up to 100 basis points in the past six months. Local banks generally have stepped up to finance assets where the purchase price supports the resale of converted units. Preferred areas for conversion-oriented investors include established neighborhoods such as Dupont Circle and areas in transition where properties are proximate to the metro. Strong job creation will drive housing demand in Maryland and Virginia, but investors can require cap rates up to 200 basis points higher than for properties inside the beltway.

2010 ANNUAL APARTMENT FORECAST



Employment: The metro area will post one of the highest rates of job growth in the nation this year. Employers will add 64,000 jobs to local head counts in 2010, a 2.2 percent increase and an improvement from last year, when 51,900 positions were shed.



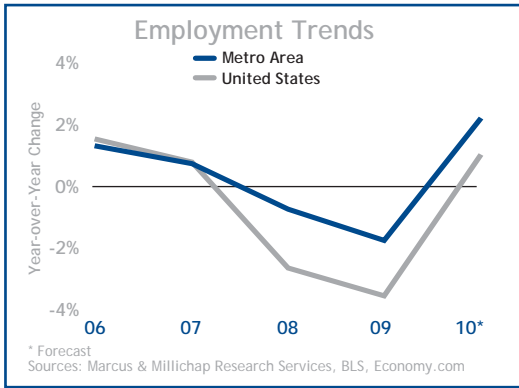
Construction: Builders remain on pace to complete 5,700 units in the metro area this year, down from nearly 5,900 apartments in 2009.



Vacancy: A modest easing in completions over the remainder of 2010, accompanied by continuing, albeit slower, job growth, will result in a 40 basis point drop in vacancy this year to 5.9 percent. The vacancy rate rose 80 basis points in 2009.

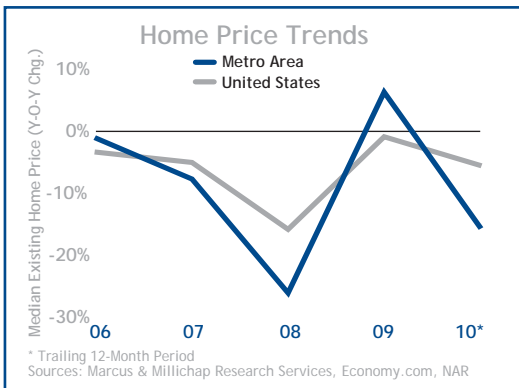


Rents: Asking rents will increase 2.9 percent in 2010 to \$1,370 per month, and effective rents will advance 3.8 percent to \$1,297 per month, one of the strongest rates of growth in the country. In 2009, asking rents fell 2.3 percent, while effective rents retreated 4.4 percent.



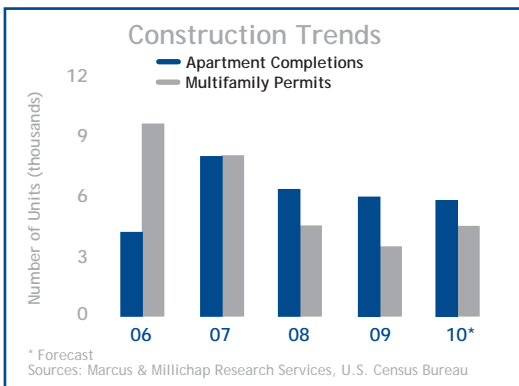
ECONOMY

- ◆ Driven by a resurgent private sector, 37,300 positions were added in the metro area during the first half of 2010, a robust 1.3 percent increase. The second quarter ended on a cautionary note, however, as 6,200 jobs were lost in June, partially offsetting strong gains in the prior two months.
- ◆ In the first six months of this year, nongovernment employers created 24,500 positions. Gains were recorded in the professional and business services sector, with 2,500 jobs, and education and health services, which added 6,200 workers. All told, five of 10 private employment sectors hired workers in the first half.
- ◆ The local labor force and number of employed individuals increased by equal amounts year to date, leaving the metrowide unemployment rate unchanged at 6.3 percent. Some populous areas recorded declines, however, with the rate in the district falling 150 basis points to 10.4 percent.
- ◆ **Outlook:** Employers in the metro area will add 64,000 jobs this year, a 2.2 percent increase and an improvement from 2009, when 51,900 positions were shed.



HOUSING AND DEMOGRAPHICS

- ◆ Single-family permit issuance increased 16 percent year over year in the second quarter to 10,100 units, while housing starts logged a similar rise. The upticks in permitting and starts were likely spurred by the first-time homebuyer tax credit, which expired at the end of June.
- ◆ Multifamily permit issuance also was up during the 12 months ending in the second quarter, rising 38 percent to 5,000 units. Half of the permits were issued in the first quarter of this year due to increases in Arlington and Montgomery counties.
- ◆ Household creation has remained strong throughout the recession and in the early stages of the recovery. An estimated 12,000 households were formed in the first half of 2010, about the same number as in the corresponding period last year.
- ◆ **Outlook:** Strong household creation will continue as a result of the metro's vigorous economy, fueling demand for housing and, in turn, encouraging developers to plan and build additional housing.



CONSTRUCTION

- ◆ Including the completion of 3,159 units in the second quarter, more than 6,900 apartments came online in the past 12 months, expanding rental stock 1.8 percent. Construction continues on an additional 4,300 units, of which approximately 2,300 are due to come online in the second half of 2010.
- ◆ Only 182 apartments were completed in the district during the second quarter, while the remaining deliveries were split virtually evenly between Maryland and Virginia.
- ◆ The extensive pipeline of planned projects contains 50,000 units. Proposed developments represent 19 percent of existing stock in the district, the highest proportion among the three regions of the market.
- ◆ **Outlook:** Builders remain on pace to complete 5,700 units in the metro area this year, down from nearly 5,900 apartments in 2009.

VACANCY

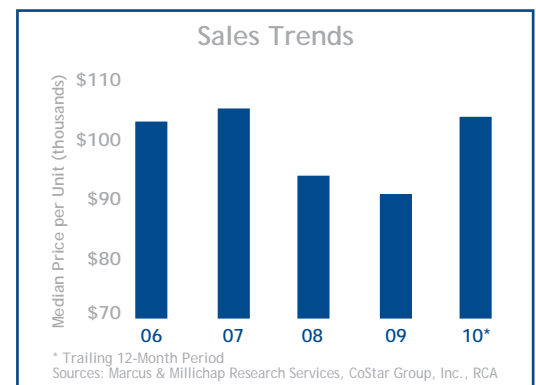
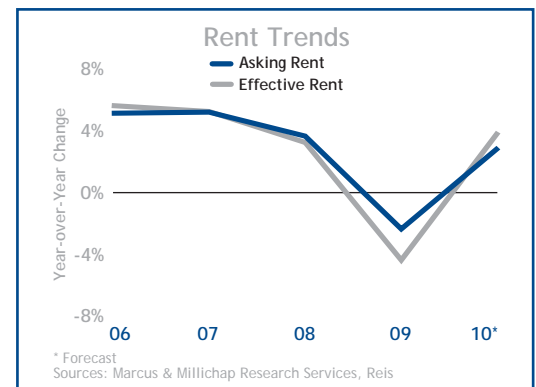
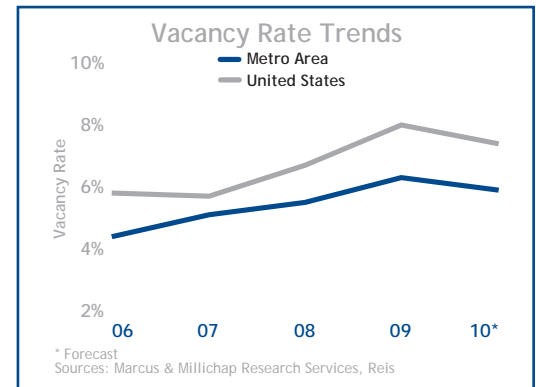
- ◆ Despite robust job creation, demand did not keep pace with supply growth in the second quarter, as metrowide vacancy climbed 30 basis points to 6.3 percent. Vacancy was unchanged in the first half of 2010, with net absorption of more than 3,200 units slightly exceeded by completed units.
- ◆ In the district, vacancy rose 30 basis points to 6.4 percent in the second quarter, as approximately 100 units became vacant in the period. Vacancy was also up 30 basis points year to date.
- ◆ Vacancy increased 30 basis points during the second quarter in both Maryland and Virginia to 6.6 percent and 6.0 percent, respectively, although the performance was slightly stronger in Maryland. Vacancy rises were functions of supply growth; in Maryland, apartment demand ticked up 0.7 percent uptick, while a 0.6 percent bump was registered in Virginia.
- ◆ **Outlook:** A modest easing in completions over the remainder of 2010, accompanied by continuing, albeit slower, job growth, will result in a 40 basis point drop in vacancy this year to 5.9 percent.

RENTS

- ◆ Driven by larger increases in Maryland and Virginia, metrowide asking rents inched up 0.7 percent in the second quarter to \$1,348 per month and also were up 1.1 percent year to date. Effective rents gained 1.2 percent in the quarter to \$1,272 per month, pushing down concessions; year to date, effective rents rose 1.8 percent.
- ◆ In Virginia, concessions fell to 5.2 percent of asking rents in the second quarter as effective rents increased 1.6 percent to \$1,340 per month and asking rents advanced 1 percent to \$1,413 per month. Asking rents in Maryland were \$1,254 per month in the second quarter, a gain of 0.9 percent, while effective rents rose 0.7 percent to \$1,171 per month.
- ◆ Asking rents in the district inched up only 0.1 percent in the second quarter to \$1,385 per month, but concessions fell 120 basis points to 4.6 percent of asking rents due to a 1.4 percent rise in effective rents to \$1,321 per month.
- ◆ **Outlook:** Asking rents will increase 2.9 percent this year to \$1,370 per month, and effective rents will advance 3.8 percent to \$1,297 per month.

SALES TRENDS**

- ◆ Led by a doubling in the number of transactions in Virginia, transaction velocity in the metro area increased 74 percent in the past year.
- ◆ The median price in sales executed in the metro during the last 12 months rose 14 percent to \$103,700 per unit. A 12 percent increase to \$90,800 per unit was recorded in the district as competition for properties intensified.
- ◆ Cap rates start in the low-6 percent range for properties to be operated as rentals in the district and the low-7 percent range for assets located in near-in areas of Maryland and Virginia with access to mass transportation.
- ◆ **Outlook:** Properties in the district will change hands at a brisk pace as apartment owners, developers and converters remain active. Local banks will continue to provide financing for acquisitions of assets with solid upside potential either as rentals or for-sale housing.



** 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 VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Dupont Circle/Adams Morgan	3.2%	0	\$1,494	-0.8%
2	Rosslyn/Ballston	4.0%	-160	\$1,667	2.5%
3	Kensington/Wheaton	4.3%	80	\$1,267	0.8%
4	Woodley Park/Cleveland Park/Van Ness	4.4%	90	\$1,732	2.4%
5	College Park/Greenbelt	4.7%	-130	\$1,157	4.5%
6	Seminary Road/Landmark	4.7%	-50	\$1,284	3.6%
7	West Fairfax County	5.0%	-70	\$1,294	0.8%
8	Gaithersburg/Germantown	5.1%	-70	\$1,224	-0.8%
9	Southeast Fairfax County	5.1%	-30	\$1,313	-0.1%
10	Falls Church/Annandale	5.4%	110	\$1,300	-0.6%
11	Downtown D.C./Logan Circle	5.5%	-100	\$1,498	-3.4%
12	Takoma Park	5.5%	30	\$1,088	0.8%
13	Pentagon City/Crystal City	5.6%	-140	\$1,900	-4.3%
14	Northeast Montgomery	5.7%	-150	\$1,163	1.2%
15	Hyattsville	6.1%	20	\$1,029	-2.3%
16	Northwest D.C./Georgetown	6.3%	50	\$1,571	-0.7%
17	Frederick County	6.4%	20	\$900	1.1%
18	Northeast Alexandria/Glebe Road	6.5%	140	\$1,065	3.4%
19	Silver Spring	6.8%	-60	\$1,345	-0.1%
20	Loudoun County	6.9%	190	\$1,260	-2.3%
21	Rockville	7.0%	-70	\$1,461	2.9%
22	Stafford County	7.0%	80	\$904	-0.2%
23	Anacostia/Northeast D.C.	7.2%	60	\$840	-0.5%
24	Forest Hills/Oxon Hill	7.5%	-60	\$971	3.3%
25	Fredericksburg City	7.5%	0	\$837	4.9%
26	Tysons Corner/Faifax City	7.5%	150	\$1,359	0.4%
27	Howard U./Mt. Pleasant/Brightwood	7.7%	-130	\$1,155	0.4%