

ApartmentResearch

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

Marcus & Millichap

Austin Metro Area

Fourth Quarter 2009

CALIFORNIA, LOCAL CAPITAL EMPLOYED IN AUSTIN

Although the economic downturn in Austin is expected to subside in the fourth quarter, Class A apartment owners will face operational challenges into the first half of next year. Homes are becoming increasingly affordable, which will likely entice some renters into ownership in the coming months, despite the scheduled expiration of the first-time homebuyer credit. In addition, the glut of new apartment units that has come online this year is widening options for potential renters and encouraging owners to raise concessions to the highest level since the dot-com recession earlier this decade. Nonetheless, the metro area's long-term economic forecast is among the most promising in the country, which should attract job seekers. Also, Class B/C demand is expected to shift into top-tier units as leases expire and rents retreat. As a result, Class A occupancy could begin to stabilize in the first six months of 2010, while a lower-tier supply/demand balance is anticipated to emerge in mid-2010.

Sales velocity has been sluggish thus far in 2009, though some capital is moving off of the sidelines to take advantage of higher cap rates. In fact, average first-year yields recently breached the 8 percent threshold and are expected to push higher through the end of the year. While local buyers recently have been taking a more active role than their out-of-state counterparts, some California money has begun to trickle back into the market. Through the end of the year, however, local investors will be the primary purchasers in Austin, employing cash acquired before the surge in 1031-exchange activity drove down cap rates a few years ago. This trend will likely increase the average deal size, as investors who had targeted smaller properties to avoid competing with out-of-state buyers can negotiate better terms for larger complexes. Submarkets adjacent to the metro's core will be particularly attractive in the coming months, as cost-conscious renters in these areas support demand.

2009 ANNUAL APARTMENT FORECAST



Employment: Payrolls are anticipated to expand in the fourth quarter, limiting job losses in Austin this year to 5,000 positions, a modest 0.6 percent decline. Since the dot-com recession, the market has added nearly 130,000 jobs.



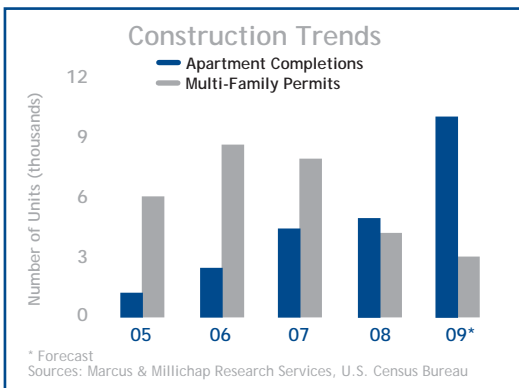
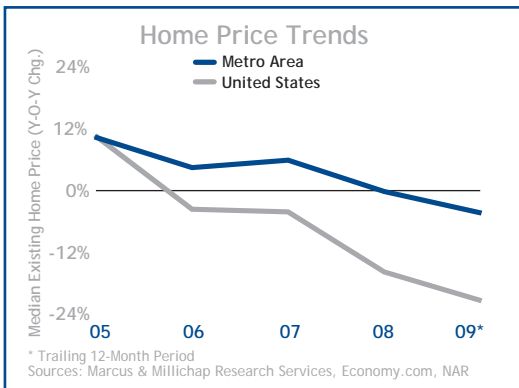
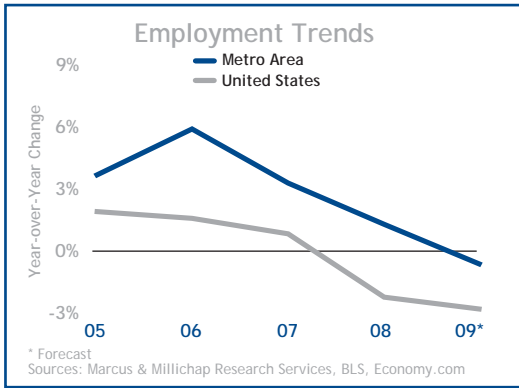
Construction: The pace of development in Austin will remain robust in 2009 as 9,900 units come online. A slowdown in permitting activity and thin development pipeline suggest a significant decline in construction in 2010.



Vacancy: The addition of new stock will underpin a 360 basis point increase in vacancy this year to 11.3 percent. Despite the rise, demand for apartments is expected to tick up 2.5 percent.



Rents: Asking rents are forecast to end the year at \$852 per month, a 2.1 percent decline, while effective rents are projected to fall 4.7 percent to \$747 per month.



ECONOMY

- ◆ After a late arrival, the national recession is weighing on payrolls in Austin. Since the beginning of 2009, employers have eliminated 7,400 positions, a 0.9 percent decline.
- ◆ A slowdown in commercial and residential development has resulted in the loss of 4,200 construction jobs over the past 12 months, nearly 10 percent of the sector's work force. The education and health services and government segments continue to expand, growing by 4.3 percent and 2.7 percent, respectively, during the last year.
- ◆ In the third quarter, the unemployment rate in Austin reached 7.4 percent, up 260 basis points from the same period in 2008. Still, the local rate is significantly lower than the national average.
- ◆ **Outlook:** Employment is anticipated to turn positive in the fourth quarter, limiting job losses in Austin this year to 5,000 positions, a modest 0.6 percent decrease. Since the dot-com recession, the market has added nearly 130,000 jobs.

HOUSING AND DEMOGRAPHICS

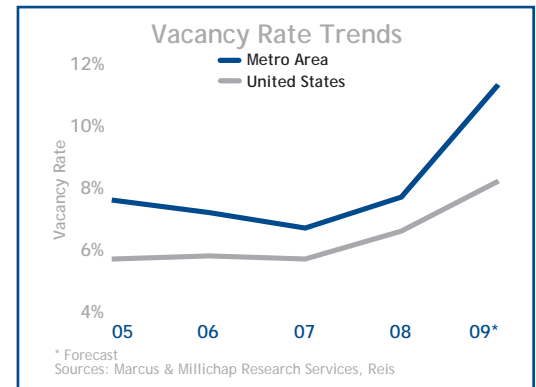
- ◆ Developers pulled 6,300 single-family permits in the most recent 12-month period, a 31 percent decline from the previous year. A reduction in condo and apartment construction plans resulted in a 51 percent decrease in multi-family permitting activity to 2,800 units.
- ◆ The median price for a single-family home slipped just 4.3 percent in the past year to an estimated \$181,000 in the third quarter. After a 1.8 percent drop to \$56,500 annually, the median household income is \$8,200 per year over the minimum qualifying income for a median-priced home.
- ◆ Using traditional financing, Class A asking rents are \$88 per month lower than the mortgage obligation for a median-priced home. The gap has narrowed in recent quarters, applying further downward pressure to rents in the top tier.
- ◆ **Outlook:** The cost between renting and owning is closing, which could entice some residents into homeownership in the coming months. Nonetheless, the bulk of the renter pool is supported by a large population of students and young professionals who gravitate to the city's core, where home prices are still elevated.

CONSTRUCTION

- ◆ So far this year, builders have added 7,370 units to inventory, a 5 percent rise in apartment stock.
- ◆ The number of apartments under way in the metro has fallen to 2,600 units, while another 6,900 units are planned, indicating a slowdown in construction in 2010.
- ◆ Developers are expected to add nearly 2,600 units in the Round Rock/Georgetown submarket this year, a 28 percent increase to area stock.
- ◆ **Outlook:** The pace of development in Austin will remain robust in 2009 as 9,900 units come online.

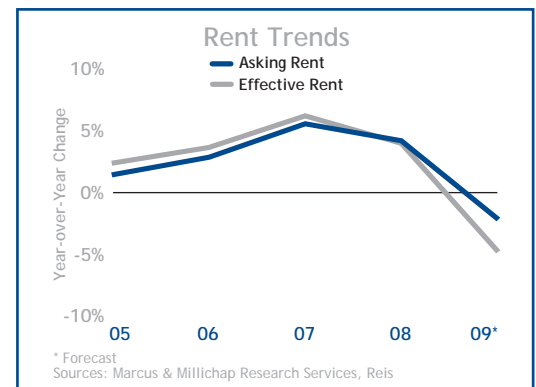
VACANCY

- ◆ According to preliminary estimates, the marketwide vacancy rate was 10.7 percent in the third quarter, up 300 basis points from year-end 2008. The rise has abated, as vacancy increased just 120 basis points during the most recent six months.
- ◆ In the metro's Class A segment, vacancy has jumped 420 basis points since the beginning of the year to 12.6 percent. Much of the rise came in the first quarter, when vacancy soared 300 basis points as new construction expanded top-tier inventory by 4.6 percent.
- ◆ With supply-side pressure minimal in the Class B/C segment, vacancy has ticked up 160 basis points this year to 8.5 percent in the third quarter.
- ◆ **Outlook:** In 2009, the addition of new stock will underpin a 360 basis point increase in vacancy to 11.3 percent. Despite the rise, demand for apartments is expected to gain 2.5 percent.



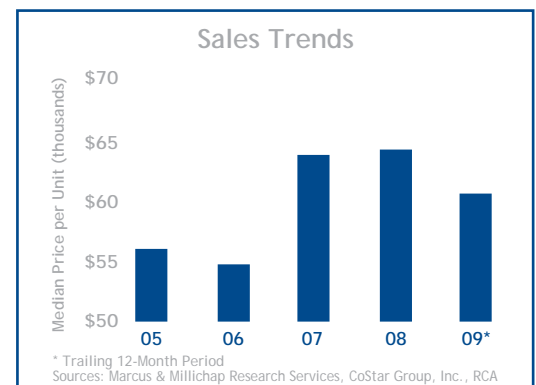
RENTS

- ◆ Asking rents slipped to \$862 per month in the third quarter, while effective rents retreated to \$763 per month, annual decreases of 0.7 percent and 2.9 percent, respectively. Over the past 12 months, owners have added one week of free rent to concessions, which now total 42 days.
- ◆ Class A rents have fallen 2 percent to \$998 per month in the last year due to continued pressure from declining home prices and relatively low mortgage rates. Class B/C asking rents are 0.4 percent lower than one year ago at \$706 per month.
- ◆ Although owners in every submarket have expanded leasing incentives during the last 12 months, the rise in the Near North Central submarket has been mitigated by tight occupancy levels. In the third quarter, concessions in the area were 10 days of free rent lower than the metro average.
- ◆ **Outlook:** Asking rents are forecast to end the year at \$852 per month, a 2.1 percent decline, while effective rents are projected to fall 4.7 percent to \$747 per month.



SALES TRENDS**

- ◆ In the most recent 12-month period, sales velocity dropped 37 percent. Deal flow from out-of-state buyers fell 55 percent, as exchange activity continues to dissipate.
- ◆ The median sales price has decreased 22 percent to \$60,600 per unit over the past year. In the few deals that have been recorded in the last two quarters, the median price was \$45,800 per unit.
- ◆ Average cap rates in the most recent 12-month stretch were in the mid-7 percent range, up 110 basis points from the previous year. The average cap rate for properties under contract is over 8 percent.
- ◆ **Outlook:** Cash-heavy local buyers are expected to leave the sidelines in the coming months to acquire properties that out-of-state investors were targeting in recent years. Nonetheless, cap rates will likely trend higher to help buyers overcome financing hurdles.



** 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

- ◆ Compared to other core property sectors, apartments have fared best due to the availability of financing through government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Recent modifications to GSE guidelines will impact lender decisions, however, as borrower requirements include more substantial apartment ownership experience.
- ◆ Loan-to-value requirements range from 55 percent to 75 percent. Portfolio lenders are issuing loans at all-in rates of 6.00 percent to 6.75 percent for a five-year term and 6.9 percent to 8.0 percent for a 10-year term. Rates among agency lenders are roughly 150 basis points to 175 basis points lower. The government recently assumed full control of Fannie Mae and Freddie Mac, which may boost confidence in the GSEs, putting downward pressure on rates, but it also creates several near-term uncertainties.
- ◆ Delinquencies will rise further as a wave of maturities approaches; however, at-risk borrowers may find lenders amenable to loan extensions/modifications. Furthermore, Freddie Mac is under way on its second securitization of multi-family debt this year, and the government's TALF program is expected to at least provide a much-needed spark to the traditional CMBS market.

SUBMARKET OVERVIEW

- ◆ In the Far South submarket, vacancy has climbed 460 basis points since the beginning of the year as area inventory has expanded by 9 percent. No projects are slated for delivery in the fourth quarter, which should limit the vacancy rise in the coming months.
- ◆ Asking rents in the Near South Central submarket have increased 2.8 percent year over year; however, effective rents have contracted by 0.7 percent, as owners have raised concessions. In the third quarter, leasing incentives averaged 46 days of free rent, up 11 days from one year earlier.
- ◆ Increased enrollment at Texas State University has helped to buoy demand in the San Marcos submarket. Fall enrollment at the school grew by 5.9 percent from last year to 30,800 students, supporting the tightest vacancy rate in northern Texas.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	San Marcos	5.9%	160	\$706	-1.9%
2	Near North Central	6.1%	160	\$655	-1.9%
3	Far Northwest	6.6%	60	\$841	-0.6%
4	Near Northwest	8.0%	230	\$746	-5.9%
5	Southeast	8.8%	170	\$673	-1.9%
6	Far North Central	8.9%	230	\$558	-4.7%
7	East	9.1%	420	\$605	-3.7%
8	Highway 183/Cedar Park/Leander	10.3%	200	\$710	-4.4%
9	Near South Central	11.0%	320	\$930	-0.7%
10	North Travis	12.3%	490	\$713	-4.2%