ApartmentResearch
MARKET UPDATE

Marcus & Millichap

Boston Metro Area *Fourth Quarter 2009*

Class A Properties Face Challenges; Class B/C Assets Steadying

Supply-side pressures and employment reductions among white-collar sectors are driving vacancy higher in Boston's Class A apartments, while demand for more affordable housing continues to support steadier operations in the lower tiers. Since the beginning of the year, nearly 50 percent of job cuts in the metro have occurred in white-collar segments such as government and professional and business services. As such, demand for more expensive Class A apartments has moderated, causing vacancy to rise to the highest rate this decade, while owners have pushed up concessions to compete for tenants. Vacancy also has ticked higher in the metro's Class B/C properties, although demand for affordable units has kept the average rate in the mid- to high-5 percent range, where it will likely remain into mid-2010. On the supply side, a significant number of units will be delivered over the next 12 months, further softening top-tier operations.

Investment activity in Boston is expected to remain constrained through the end of the year as a result of buyers' uncertainty over the near-term direction of the local economy. Interest is centered on properties in close-in areas that offer a steadier performance, despite current market instability. As such, most deals this year have occurred in submarkets inside Route 128, specifically along the Massachusetts Turnpike, as renters are targeting apartments located along major commuting routes. Meanwhile, cap rates continue to push higher as investors underwrite acquisitions for greater risk of rising vacancy rates and concessions. Initial yields for Class A properties currently average in the high-6 percent to mid-7 percent range, up 50 basis points over the past year, while initial yields on Class B/C properties are in the 8 percent range. Looking forward, sales activity may increase in outlying locations such as the South/Southeast Suburban submarket, where softer operations could create distress, providing additional discount opportunities.

2009 Annual Apartment Forecast

2.7% decrease in total employment

Employment: This year, employers are expected to cut 65,000 workers, a 2.7 percent decrease in payrolls and up from the loss of 35,000 jobs in 2008.

3,400 units will be completed

Construction: Developers are projected to deliver 3,400 apartment units in 2009, down from 4,200 units last year. Over the past five years, annual completions have averaged 3,800 units.

110 basis point increase in vacancy

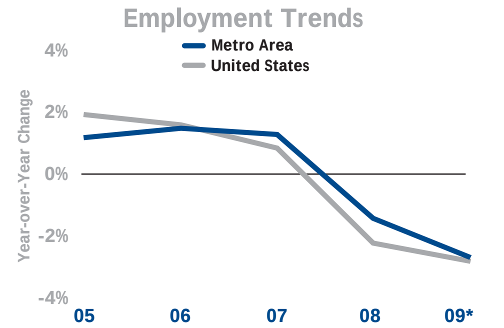
Vacancy: Ongoing construction and weaker demand stemming from job losses will push the vacancy rate higher through year end. In 2009, vacancy is forecast to rise 110 basis points to 7.1 percent.

1.5% decrease in asking rents

Rents: Asking rents are expected to drop 1.5 percent to $1,715 per month this year, while effective rents will fall 2.4 percent to $1,613 per month. In 2008, asking rents gained 3.6 percent, and effective rents rose 3.2 percent.

Economy

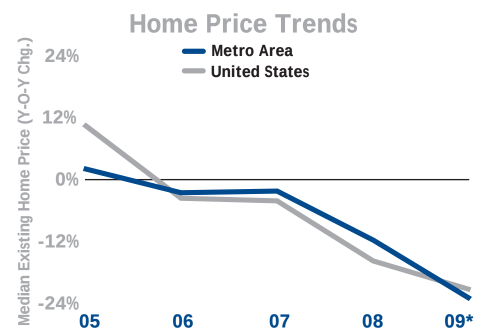
- From the end of 2008 to the third quarter of 2009, 50,000 positions were trimmed from local payrolls, including 14,000 workers in the third quarter. During the corresponding period a year ago, employers added 2,000 jobs.
- Cuts in the government and professional and business services sectors have contributed the most to the decline in overall employment so far this year. Government head counts have shrunk by nearly 14,000 workers year to date, and almost 13,000 professional and business services positions have been eliminated.
- In the third quarter, the unemployment rate in Boston was 8.3 percent, up from 6 percent at the beginning of the year and the highest rate this decade.
- **Outlook:** In 2009, employers are expected to cut 65,000 workers, a 2.7 percent decrease in payrolls. Last year, 35,000 jobs were lost in the metro.



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

Housing and Demographics

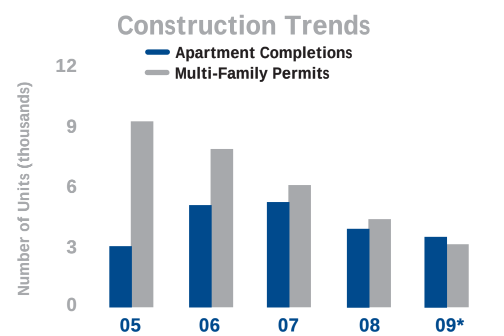
- Permits for 3,000 units of multi-family housing were issued over the year ending in the third quarter, down from 7,000 units during the preceding 12-month period. Single-family permit issuance declined nearly 50 percent in the most recent stretch to 10,000 units.
- The median price of an existing single-family home in the metro area was projected to end the third quarter at $274,000, 23 percent less than one year earlier. The decrease reflects sales of foreclosed homes and a drop in demand due to weaker employment conditions.
- The current median household income of $71,100 per year in the metro is 8 percent more than the minimum required to purchase the median-priced home. Housing is becoming more affordable in Boston; at this time in 2008, the median income was 24 percent less than the minimum required for a median-priced home.
- **Outlook:** While housing prices are falling, soft employment and uncertainty surrounding the for-sale market will keep many potential homeowners in the renter pool.



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

Construction

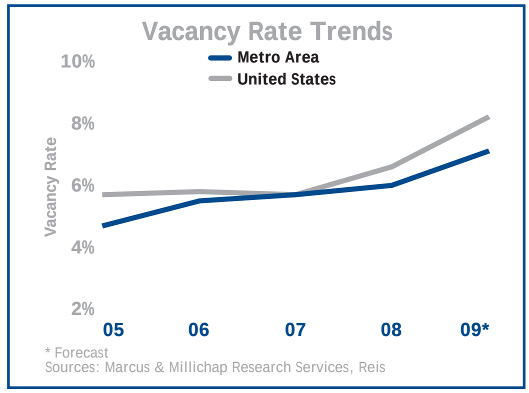
- In the 12 months ending in the third quarter, apartment stock expanded 1.9 percent, or by 3,700 units. In the previous year, approximately 5,300 units were added to inventory.
- Nearly 800 apartment units were completed in the third quarter, compared with 1,300 units delivered in the third quarter of 2008. The North Shore/Merrimack River Valley submarket received 400 units during the last quarter, the most in the metro.
- There are currently 2,300 units under way within the Boston metro and 7,900 units in the planning pipeline.
- **Outlook:** Developers are projected to deliver 3,400 apartment units in 2009, down from 4,200 units last year. Over the past five years, annual completions have averaged 3,800 units.



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

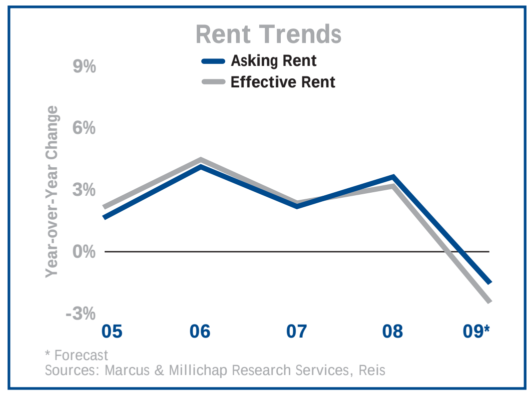
Vacancy

- An increase in inventory and weaker employment have resulted in a 70 basis point increase in vacancy since the third quarter of last year to 6.8 percent. The vacancy rate rose 30 basis points during the preceding 12 months.
- Over the past year, additions to apartment stock have underpinned a 120 basis point spike in Class A vacancy to 9.2 percent.
- Vacancy in the metro's Class B/C apartments has pushed up 60 basis points in the last year to 5.4 percent. Steady demand for affordable housing has helped to maintain a tight vacancy rate in lower-tier properties.
- **Outlook:** Ongoing construction and weaker demand stemming from job losses will drive up the vacancy rate through year end. In 2009, vacancy is forecast to rise 110 basis points to 7.1 percent.



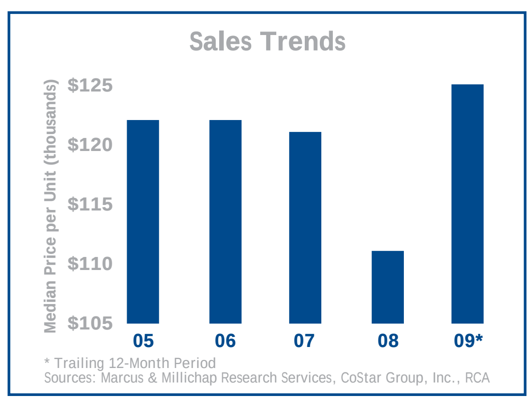
Rents

- In the third quarter, asking rents were estimated at $1,719 per month, down 1.2 percent from one year earlier. Effective rents have dropped 2.4 percent year over year to $1,620 per month, as owners have pushed up concessions to mitigate vacancy increases.
- Class B/C asking rents fell 1 percent to $1,427 per month during the 12 months ending in the third quarter, while a 1.5 percent drop to $2,167 per month was posted in the Class A segment. Top-tier asking rents are declining at a faster pace due to increased competition and waning renter demand resulting from job cuts in the professional and business services sector.
- Concessions accounted for 5.8 percent of asking rents in the third quarter, up from 4.8 percent of asking rents during the third quarter of 2008.
- **Outlook:** Asking rents are expected to drop 1.5 percent to $1,715 per month this year, while effective rents will fall 2.4 percent to $1,613 per month. In 2008, asking rents gained 3.6 percent, and effective rents rose 3.2 percent.



Sales Trends**

- Transaction velocity in the Boston metro slowed by 35 percent during the most recent 12-month period, following a 21 percent deceleration in the preceding year.
- The median price recorded in deals made over the past 12 months was $125,000 per unit, up 12 percent from the previous annual period. The appreciation is due primarily to a greater number of Class A properties trading, as investors are targeting stabilized, quality assets.
- In the last 12 months, cap rates have averaged in the high-6 percent to low-7 percent range for Class A assets and the mid- to high-7 percent range and above for Class B properties. Initial yields have risen about 75 basis points year over year.
- **Outlook:** In the coming months, investors' activity will center on assets located along transportation arterials in higher-demand, close-in residential areas. Class B properties in the more affordable Brookline/Brighton/Newton submarket, for instance, may provide buyers with greater short-term stability due to the area's more stable tenant demand.



*** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.*

Marcus & Millichap

NATIONAL MULTI HOUSING GROUP

Visit www.NationalMultiHousingGroup.com or call:
Linwood C. Thompson
Senior Vice President, Managing Director
National Multi Housing Group
Tel: (678) 808-2700
lthompson@marcusmillichap.com

Marcus & Millichap
Real Estate Investment Services

Prepared and edited by
Greg Clemmer
Market Analyst
Research Services

For information on national apartment trends, contact
John Chang
National Research Manager
Tel: (602) 687-6700 ext. 6803
john.chang@marcusmillichap.com

Boston Office:
Gary R. Lucas
Managing Director
glucas@marcusmillichap.com
400 Fifth Avenue
Suite 105
Waltham, Massachusetts 02451

Tel: (781) 373-7100
Fax: (781) 373-7110

Price: $150

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

- Class A apartments in the Brookline/Brighton/Newton submarket remain some of the most sought-after by tenants, keeping vacancy at these properties among the lowest in the metro. As of the third quarter, vacancy in the area's top-tier complexes was 3.6 percent, a 30 basis point year-to-date improvement.

- In 2009, about 610 apartment units will be completed in the North Shore/Merrimack River Valley submarket, the majority of the metro's new inventory. The additions are expected to push up vacancy in the area to nearly 8 percent, driving near-term concessions higher.

- Since the beginning of the year, almost 20 percent of all transactions made in the metro have occurred in locations close to the Boston City submarket, such as the Back Bay, as investors are seeking stable assets.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Brookline/Brighton/Newton	3.7%	-30	$1,860	-0.7%
2	Boston City	5.0%	180	$1,401	-1.3%
3	Central City/Back Bay/Beacon Hill	5.1%	-20	$2,462	-1.4%
4	Cambridge/Watertown/Waltham	5.9%	10	$2,121	-1.4%
5	West/Northwest Suburban	6.9%	90	$1,350	-2.7%
6	Mystic River North/Route 128	7.2%	40	$1,380	-2.3%
7	North Shore/Merrimack River Valley	7.5%	-60	$1,318	-1.9%
8	South/Southeast Suburban	7.8%	150	$1,120	-1.0%
9	South Shore/Route 128 South	9.5%	270	$1,405	-1.5%