

ApartmentResearch

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

Marcus & Millichap

Charlotte Metro Area

Fourth Quarter 2009

NEW INVENTORY TO CHALLENGE CHARLOTTE APARTMENT SECTOR

Supply-side pressures and weaker employment-generated demand are softening Charlotte apartment operations, although some areas are expected to offer greater near-term stability. Significant staff reductions since the beginning of the year within the manufacturing and professional and business services sectors have affected the performance of every apartment class, pushing vacancy near levels last recorded in 2001. While the pace of job cuts may be starting to slow now, new supply is expected to challenge owners well into 2010; this year's inventory additions are projected to be the largest in eight years, as a number of projects planned during more stable market conditions are finally reaching the market. Nearly half of this year's inventory is scheduled to be delivered to the Harris Boulevard/Mallard Creek Church Road submarket, expanding stock in this area by 10 percent and underpinning spikes in both vacancy and concessions. The close-in Fairview North submarket should provide a more stable performance into 2010, however, due to the area's proximity to Uptown, affordable housing options and lack of additional competition.

Apartment investment activity in Charlotte remains near historic lows as a result of buyers' concerns over the near-term direction of the local market. Most of the transactions that have closed since the beginning of the year have been smaller in size, averaging under \$2 million, as investors are seeking to manage capital risk through smaller acquisitions. Current cap rates are difficult to discern due to the limited number of Class A deals during the past year, though average yields are believed to start in the 8 percent range. Cap rates have increased about 100 basis points over the past year and will likely trend higher as a result of investors' expectations of short-term declines in revenues, along with still-limited buyer interest.

2009 ANNUAL APARTMENT FORECAST



Employment: Total employment is forecast to decline by 5.3 percent, or 45,000 positions, this year as a result of weakness in the banking industry and professional and business services sector. In 2008, 28,500 jobs were eliminated.



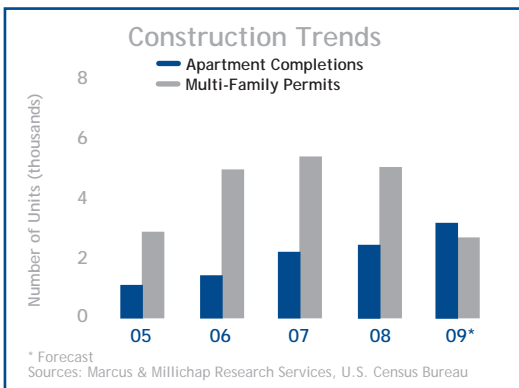
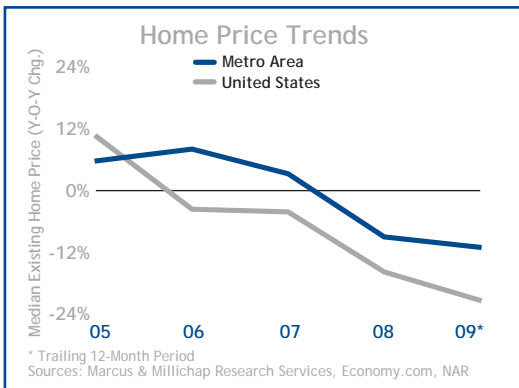
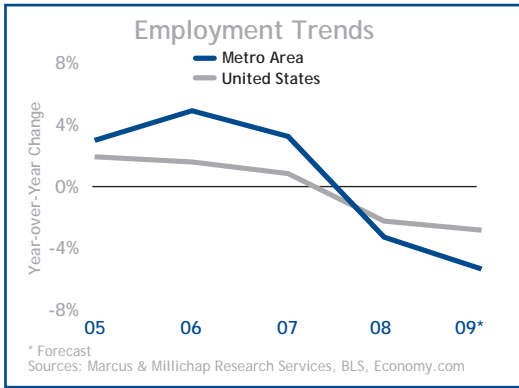
Construction: Developers are expected to deliver 3,100 apartment units to the Charlotte metro in 2009, up from 2,400 units last year. Over the past five years, completions have averaged 1,800 units annually.



Vacancy: A weak job market will limit housing demand, while rental stock will expand in the short term. As a result, vacancy is forecast to increase 400 basis points this year to 12.2 percent, following a 220 basis point rise in 2008.



Rents: In 2009, asking rents are expected to drop 3.2 percent to \$772 per month, while effective rents will fall 4.2 percent to \$686 per month, pushing up concessions. Asking rents rose 2.4 percent last year, and effective rents gained 2 percent.



ECONOMY

- ◆ With the estimated loss of 4,200 jobs during the third quarter, approximately 40,000 positions have been eliminated in the metro over the past 12 months. In the preceding year, employment decreased by 4,000 jobs.
- ◆ In the 12 months ending in the third quarter, 12,900 professional and business services positions were cut; 1,600 positions were created in the segment during the previous year. Also in the last year, 12,800 jobs have been cut in the trade, transportation and utilities sector, which includes retail positions, following the loss of 3,600 workers in the preceding 12 months.
- ◆ The unemployment rate was an estimated 12.3 percent in the third quarter, up from 8.9 percent at the end of 2008.
- ◆ **Outlook:** Total employment is forecast to decline by 5.3 percent, or 45,000 positions, this year as a result of weakness in the banking industry and professional and business services sector. In 2008, 28,500 jobs were eliminated.

HOUSING AND DEMOGRAPHICS

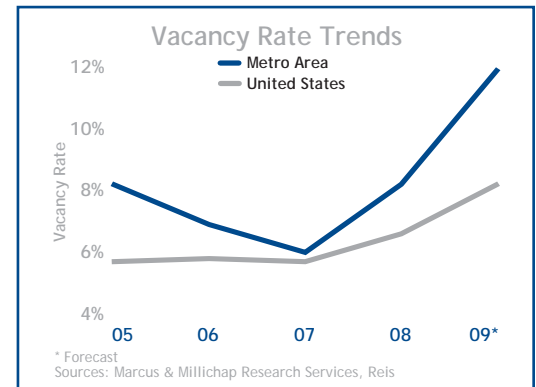
- ◆ Permits for 2,600 units of multi-family housing have been issued over the past 12 months, a decline of 87 percent from the preceding year. Single-family permit issuance totals 5,000 units in the last year, down 17 percent.
- ◆ Sales of distressed properties have helped to lower the median price of an existing single-family home to \$179,000, 11 percent less than one year ago. Transaction velocity also has decreased by 11 percent, although activity accelerated slightly in recent months.
- ◆ The typical mortgage obligation on a median-priced home exceeds the average Class A asking rent by \$20 per month. Despite the relative affordability of single-family homes in the Charlotte metro, potential homebuyers' concerns regarding job stability and tighter mortgage requirements are keeping many in the renter pool.
- ◆ **Outlook:** Above-average household formation, along with an expected reduction in new housing supply, as suggested by declines in permitting activity, points to steady demand for Charlotte apartments over the long term.

CONSTRUCTION

- ◆ Nearly 2,900 units were added in the market in the 12 months ending the third quarter, a stock increase of 3.2 percent. In the preceding year, 1,200 units were delivered.
- ◆ Approximately 4,500 units are under construction, an amount equal to almost 5 percent of existing inventory. The projects under way are large in size, averaging nearly 350 units each.
- ◆ The planning pipeline in Charlotte currently contains 9,600 units, including 3,000 units in the Harris Boulevard/Mallard Creek Church Road submarket.
- ◆ **Outlook:** Developers are expected to deliver 3,100 apartment units in 2009, up from 2,400 units last year. Over the past five years, completions have averaged 1,800 units annually.

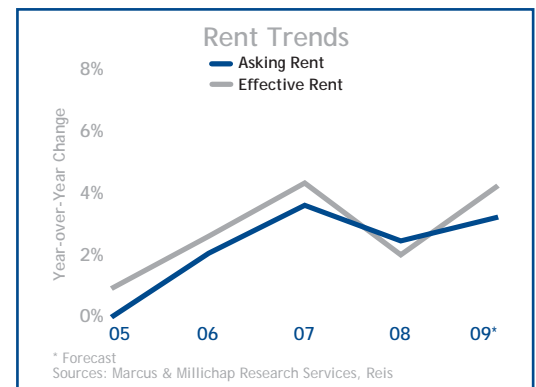
VACANCY

- ◆ Supply growth and soft demand have contributed to a 300 basis point rise in the vacancy rate this year to 11.2 percent. On a year-over-year basis, vacancy has increased 380 basis points.
- ◆ Over the past 12 months, additions to inventory and staff reductions within the professional and business services sector have underpinned a 390 basis point spike in Class A vacancy to 10.8 percent.
- ◆ The vacancy rate in the lower tiers has pushed up 340 basis points in the last year to 11 percent. The increase is partly attributable to job cuts in the construction and manufacturing sectors.
- ◆ **Outlook:** A weak employment market will limit housing demand, while rental stock will expand in the short term. As a result, vacancy is forecast to increase 400 basis points this year to 12.2 percent, following a 220 basis point rise in 2008.



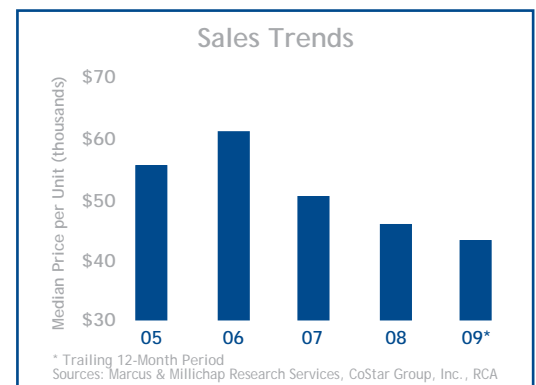
RENTS

- ◆ In the third quarter, asking rents were estimated at \$786 per month, a decline of 1.5 percent from year-end 2008 and 1.6 percent from one year earlier. Effective rents of \$693 per month were down 3.3 percent so far in 2009 and 3.5 percent since the third quarter of last year.
- ◆ Class B/C asking rents advanced 2.7 percent to \$732 per month during the year ending in the third quarter, while a 3.1 percent gain to \$995 per month was posted in the Class A sector.
- ◆ Owners continue to increase concessions as a result of rising vacancy and growing competition from new units entering the market. As of the third quarter, concessions accounted for 11.8 percent of asking rents, up from 10.1 percent of asking rents one year earlier.
- ◆ **Outlook:** In 2009, asking rents are expected to drop 3.2 percent to \$772 per month, while effective rents will fall 4.2 percent to \$686 per month, pushing up concessions. Asking rents rose 2.4 percent last year, and effective rents gained 2 percent.



SALES TRENDS**

- ◆ Transaction velocity has declined 79 percent during the past 12 months, as investors are exercising caution due to uncertainty within the economy, especially the local banking industry.
- ◆ The median price in deals recorded in the last year was \$43,300 per unit, nearly 16 percent less than in the previous 12 months.
- ◆ Over the last 12 months, cap rates for Class A properties have averaged in the 8 percent range, while Class B assets have traded in the low-9 percent range and above. After several years of compression, cap rates are rising as buyers underwrite for higher vacancy and increased leasing incentives.
- ◆ **Outlook:** Investment activity has been very constrained during the past 12 months and will remain limited until a clearer indication of a bottom is apparent. Owners looking to exit the market should sell, as cap rates will likely tick higher over the next 12 months, and the pace may accelerate due to softer operations.



** 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

- ◆ The Harris Boulevard/Mallard Creek Church Road submarket will receive approximately 50 percent of the metro's completions this year. As a result, vacancy in the area is expected to rise to nearly 10 percent by year end.
- ◆ Staff reductions and shadow stock from condo reconversions have driven vacancy higher for apartments in the Downtown submarket. As of the third quarter, vacancy was a market-high 15 percent, while concessions were 15.8 percent of asking rents, 730 basis points higher than one year earlier.
- ◆ Limited construction and more stable tenant demand are expected to keep vacancy in the Fairview North submarket tight in the high-8 percent to low-9 percent range. Just 360 units are under way in area, and no projects are scheduled for delivery in the near term.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Fairview North	8.6%	270	\$766	-6.1%
2	Harris Blvd./Mallard Creek Church Road	9.0%	250	\$764	-4.9%
3	West/Charlotte Airport	9.4%	200	\$552	-1.6%
4	Northwest Charlotte	10.2%	140	\$802	-2.3%
5	Carmel	10.3%	270	\$794	-2.9%
6	North Pineville	10.6%	310	\$670	-4.9%
7	East Charlotte/Albemarle Corridor	11.1%	320	\$597	-2.2%
8	Gaston County	11.2%	510	\$602	-3.0%
9	North Tryon Street/The Plaza	12.4%	350	\$547	-3.0%
10	East Charlotte/Central Avenue	14.4%	840	\$648	0.7%