

## MINIMAL DEVELOPMENT LIMITING VACANCY RISE IN DETROIT

While the recession has had a considerable impact on the local economy, particularly among automakers and their suppliers, apartment fundamentals in Detroit have softened far more modestly than in many other metro areas across the country. The recent "Cash for Clunkers" program increased auto sales, spurring some automakers to step up production, which should ultimately help stabilize the local economy. Still, vacancy is edging up and rents continue to creep lower, although construction activity has had only a minimal impact on inventory levels for the past several years. Weakness in the housing market and uncertainty surrounding future employment prospects are making rental housing a preferred choice for many of the metro's residents. As a result, apartment operators, particularly in the top tier, continue to be able to charge rents that are higher than the mortgage payments for a single-family home. While the local economy will face considerable stresses in the near term, a number of redevelopment programs are being implemented, especially in the Midtown area, which could support future demand for apartment properties.

Sales velocity throughout the Detroit metro has eased from year-earlier levels, although a modest uptick occurred during the third quarter. In recent months, investors have been purchasing distressed assets at deep discounts, a trend that has driven the median price in all closed deals to an artificially low level. Buyers are making investment decisions on distressed properties based primarily on per-unit valuations rather than current cash flows. Stabilized properties still attract offers at prices in line with the past few years, with cap rates typically in the 8.5 percent to 10.0 percent range. In-state private buyers who have market knowledge and existing relationships with local banks are expected to remain the main players in the coming quarters, as lenders are less willing to finance deals in the metro without strong sponsorship. Risk-averse investors will likely target assets in the Ann Arbor submarket, where the large population of students and recent graduates generates some of the most stable renter demand in the metro area.

### 2009 ANNUAL APARTMENT FORECAST



**Employment:** Payrolls in Detroit are expected to be trimmed by 130,000 jobs, or 7.1 percent, in 2009, following the loss of 112,500 workers last year.



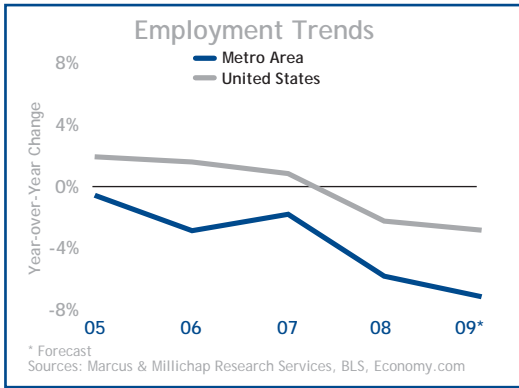
**Construction:** Deliveries are forecast to total 450 units this year, after just 280 rentals were completed in 2008. Developers have added an average of 400 apartments annually to the metro since 2005.



**Vacancy:** As the local economy continues to contract, vacancy is forecast to increase 140 basis points to 8.3 percent in 2009, despite modest construction. Last year, vacancy rose 50 basis points, as completions were largely offset by removals of old stock from inventory.

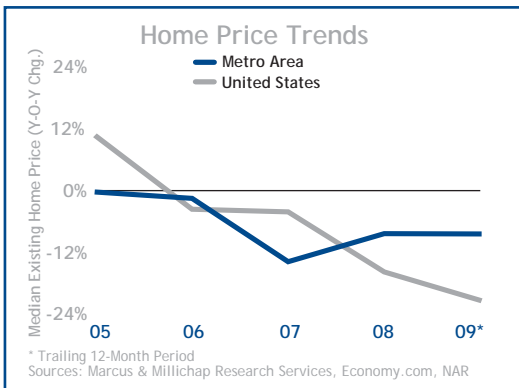


**Rents:** With household incomes on the decline, asking rents will creep lower. Asking rents are expected to fall 1.7 percent this year to \$821 per month, while effective rents will drop 2.6 percent to \$748 per month.



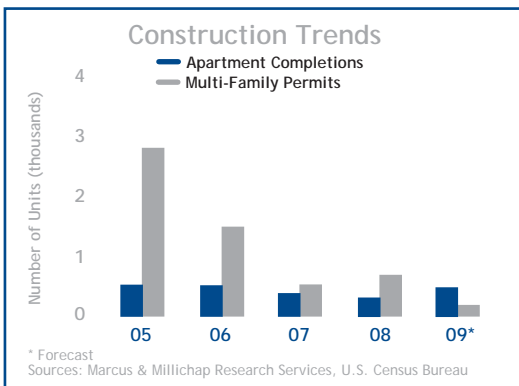
## ECONOMY

- ◆ Employers cut an estimated 161,300 workers from Detroit payrolls year over year through the third quarter, an 8.6 percent decline. Losses were strongest in the second quarter of 2009, when nearly 56,000 positions were eliminated. Year to date, metro head counts have contracted by 114,300 jobs.
- ◆ Restructuring among automakers has driven a 22.4 percent annual decrease in the manufacturing sector, as 51,300 jobs have been shed. In addition, 46,600 professional and business services positions have been eliminated in the past year, a 14.1 percent drop.
- ◆ Late in the third quarter, Ford Motor Co. announced an agreement to sell its abandoned assembly plant in Wixom. Three alternative energy companies are expected to redevelop and occupy the former plant, which could create as many as 4,000 jobs in the area.
- ◆ **Outlook:** Payrolls in Detroit will be trimmed by 130,000 jobs, or 7.1 percent, in 2009, following the loss of 112,500 workers last year.



## HOUSING AND DEMOGRAPHICS

- ◆ Developers are exercising caution before committing to new residential projects in the metro. During the past year, fewer than 250 multi-family permits have been issued, a 61 percent decline from the previous 12-month period. Single-family permit issuance has fallen 47 percent to 1,200 units.
- ◆ In the last year, the metrowide median home price slipped 8.4 percent to an estimated \$114,800 in the third quarter. Severe job losses have led to a 5.7 percent year-over-year drop in the median household income to \$51,400 annually, which is still nearly \$30,000 more than the amount required to qualify for a median-priced home.
- ◆ The average Class A asking rent is approximately \$350 per month more than the mortgage payment on a median-priced home. Nevertheless, home prices have fallen in each of the past five years, causing many residents to choose to rent rather than transition to homeownership.
- ◆ **Outlook:** Home prices in Detroit remain affordable, but expectations for future declines persist, and the uncertainty surrounding the metro's long-term economic outlook remains a driver of renter demand for apartments.

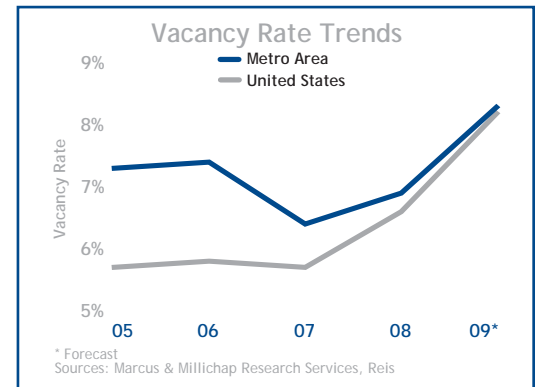


## CONSTRUCTION

- ◆ In the past year, 310 apartment units have been completed, increasing metrowide inventory by just 0.1 percent. Approximately 150 units came online during the third quarter of this year.
- ◆ Only 230 rental units are under construction in the metro, although the planning pipeline includes nearly 2,900 apartments. Most of the planned projects are in the Ann Arbor and Macomb County submarkets.
- ◆ During the last year, a few small projects have been delivered in the Midtown/West Detroit submarket, amounting to 102 units. While no developments are under way in the area, 320 units are planned.
- ◆ **Outlook:** Deliveries are forecast to total 450 units this year, after just 280 rentals were completed in 2008. Developers have added an average of 400 apartments annually to the metro since 2005.

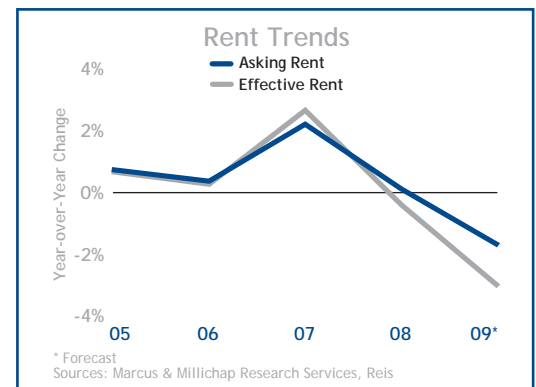
## VACANCY

- ◆ In the past 12 months, the metrowide vacancy rate rose 150 basis points to an estimated 8.1 percent through the third quarter. While additions to stock were minimal, renter demand diminished by 1.4 percent during that time, and negative net absorption totaled approximately 2,900 units.
- ◆ Class A vacancy has increased 160 basis points in the last year to 7.8 percent, including an estimated 70 basis point uptick in the third quarter.
- ◆ In the lower tiers, vacancy is 140 basis points higher than one year ago at 8.2 percent. Class B/C vacancy has spiked 120 basis points year to date on negative net absorption of more than 1,600 units.
- ◆ **Outlook:** As the local economy continues to contract, vacancy is forecast to increase 140 basis points to 8.3 percent in 2009, despite modest construction. Last year, vacancy rose 50 basis points, as completions were largely offset by removals of old stock from inventory.



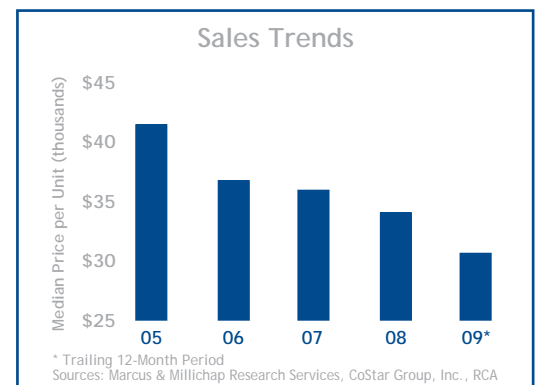
## RENTS

- ◆ Year over year through the third quarter, asking rents dropped 1.3 percent to an estimated \$825 per month, while effective rents declined 2.6 percent to \$752 per month.
- ◆ Asking rents in Class A properties were \$1,031 per month in the third quarter, 1.1 percent lower than one year earlier. Asking rents in the metro's Class B/C properties have contracted 1.5 percent during the past 12 months to \$711 per month.
- ◆ Over the last year, average revenues have decreased 4.3 percent due to rising vacancy levels. Concessions now total 33 days of free rent, up from 28 days of free rent one year ago.
- ◆ **Outlook:** With household incomes on the decline, asking rents will creep lower. Asking rents are expected to fall 1.7 percent this year to \$821 per month, while effective rents will drop 2.6 percent to \$748 per month.



## SALES TRENDS\*\*

- ◆ In the past 12 months, apartment sales velocity has slowed 19 percent. According to preliminary data, investment activity in the third quarter ticked up slightly when compared to both the first and second quarters of 2009.
- ◆ During the last year, the median price has fallen 10 percent to \$30,600 per unit. In deals closed year to date, however, the median price has dropped to \$16,600 per unit, as aggressive buyers have targeted properties in distress.
- ◆ Excluding transactions for distressed assets, where the primary objective is a turnaround opportunity rather than immediate cash flow, cap rates for stabilized properties are currently between 8.5 percent and 10.0 percent.
- ◆ **Outlook:** Investment activity, particularly over the past few months, has been concentrated among the area's bank-owned and distressed assets. As these properties filter through the system in the coming quarters, the median price will likely fall to an artificial low before rebounding when trading of stabilized assets resumes.



\*\* 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 third quarter groundbreaking of a 200,000-square foot corporate campus for BAE Systems is one of three projects that is expected to add hundreds of defense jobs in the Macomb County submarket. The new positions could bolster demand for Class A apartments in the area.
- ◆ Properties in the Midtown/West Detroit submarket may present some upside potential for investors. While the current vacancy rate is the highest in the metro, a number of redevelopment projects are in the pipeline, including a planned pediatric clinic across from Children's Hospital that should add jobs and increase renter demand in the coming years.
- ◆ In the third quarter, Unity Studios broke ground on a facility in Allen Park that is expected to ultimately employ 3,000 workers. The anticipated job growth could support demand in the Downriver/South Wayne submarket.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Oak Park/Royal Oak	4.8%	120	\$637	-3.0%
2	Westland	5.8%	-10	\$701	-2.8%
3	Southfield	6.1%	70	\$799	-3.3%
4	Farmington Hills	7.0%	200	\$905	-2.7%
5	Downriver/South Wayne	7.2%	110	\$655	-2.9%
6	Macomb County	7.3%	90	\$667	-2.6%
7	Troy	7.5%	210	\$938	0.4%
8	Ann Arbor	8.0%	170	\$815	-5.1%
9	Dearborn/Dearborn Heights	8.9%	280	\$714	-4.5%
10	Novi/Livonia	9.5%	50	\$783	-0.6%