ApartmentResearch
MARKET UPDATE

Marcus & Millichap

Indianapolis Metro Area *Fourth Quarter 2009*

Renter Demand Rising in Central and East Submarkets

Despite ongoing job losses, accelerating completions and affordable home prices that have deteriorated apartment property fundamentals, some pockets of strength have emerged recently in the Indianapolis market. In the East submarket, for instance, renter demand has increased in the last year due to the area's relatively low rents, with vacancy in the submarket's Class B/C complexes improving 110 basis points. Demand also remains healthy in the Central submarket, where Class A vacancy has fallen 300 basis points during the past 12 months. Developers have responded to strong renter demand in the Central submarket by resuming construction of the 218-unit Cosmopolitan on the Canal project, which will be ready for lease-up early next year. Additionally, two vacant buildings at Senate and North streets were purchased recently for conversion into one-bedroom and studio apartments and a 250-unit complex is planned at Indiana Avenue and Montcalm Street. While newer condominium developments in the area will likely compete with apartments for renters, a strong contingent of young professionals will continue to support operations and drive comparatively sturdy fundamentals in the coming quarters.

Transaction velocity has been subdued this year and will likely remain modest through the near term. Many owners are opting to ride out the recession, reducing the number of listings, while heightened lending standards have kept a number of investors on the sidelines. Buyers are targeting distressed or short-sale listings, as these assets require less initial capital and could be poised for NOI growth once the labor market and economic conditions improve. Most of these deals have been in the East and Far Northeast submarkets and are trading at cap rates between 10 percent and 12 percent, roughly 200 basis points above the metro average. The number of distressed offerings is expected to creep up in the coming months, which will push initial yields higher and place downward pressure on prices.

2009 Annual Apartment Forecast

3.7% decrease in total employment

Employment: Total employment is projected to contract by 3.7 percent this year, or 33,000 jobs, more than half of which will be in traditionally lower-paying industries. In 2008, approximately 21,300 positions were cut.

1,060 units will be completed

Construction: After 370 apartment units were completed in the metro last year, nearly 1,060 units are slated to come online in 2009, more than double the five-year average and an inventory expansion of 1 percent.

100 basis point increase in vacancy

Vacancy: Although job losses are easing, an increase in new supply will push occupancy rates lower this year. Vacancy is forecast to end 2009 at 8.7 percent, 100 basis points higher than last year, when the average rate improved 60 basis points.

0.9% decrease in asking rents

Rents: New-space premiums will mitigate asking rent decreases this year, but steadily rising concessions will continue to weigh down effective rents. Asking rents are expected to slip 0.9 percent to $669 per month, while effective rents will recede 2.2 percent to $623 per month.

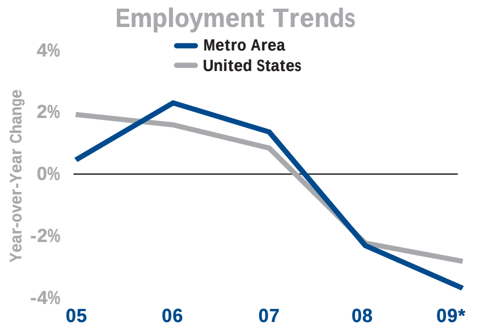
Economy

- Over the past year, employers in the Indianapolis metro have trimmed 36,500 positions, a 4 percent payroll decrease. The pace of cuts has been fairly steady, as more than 17,000 jobs have been lost in the last six months.

- Only one employment sector has expanded in the past 12 months. Government head counts have increased by nearly 2,900 spots during that span, a 2.3 percent gain.

- Ongoing weakness in the professional and business services segment continues to pressure unemployment in the metro. The jobless rate hit 9.2 percent in the third quarter, 50 basis points higher than in the previous quarter and up 360 basis points from one year earlier.

- **Outlook:** Total employment is projected to contract by 3.7 percent this year, or 33,000 jobs, more than half of which will be in traditionally lower-paying industries. In 2008, approximately 21,300 positions were cut.



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

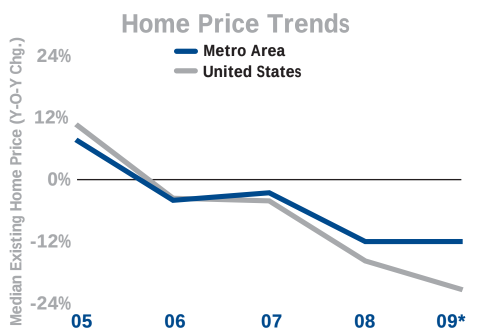
Housing and Demographics

- Single-family permit issuance dropped 33 percent annually through the third quarter to 3,440 units; issuance fell just 10 percent in the previous 12-month period. Multi-family activity remains weak, as just 1,430 permits have been pulled during the last year, a 40 percent decline.

- With a median home price of $99,750, Indianapolis is one of the nation's most affordable housing markets. Over the last 12 months, metro home prices have slipped 12 percent, following a 4.4 percent dip in the prior year.

- Although household incomes in the Indianapolis metro have slipped 7.2 percent annually to $50,600 per year, affordability has improved slightly due falling home prices. The current income level is nearly two times the amount needed to meet the monthly mortgage obligations for a median-priced home.

- **Outlook:** The government incentives that have been pressuring Class A fundamentals are expiring, which should keep some renters from making the transition into homeownership in the coming quarters.



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

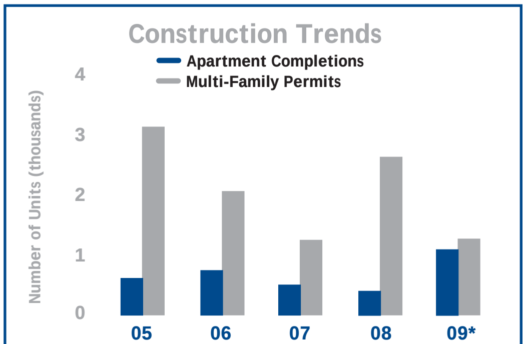
Construction

- Developers have added nearly 840 units to apartment stock during the last year, all of which came online in 2009. In the previous 12-month period, only 450 units were completed.

- Construction activity will remain elevated in the coming quarters, as there are currently 1,020 units under way throughout the metro, including just over 800 units in Hamilton County.

- Builders continue to move ahead with for-sale projects, despite the slumping housing market. Roughly 335 condos are slated to debut this year, nearly 90 percent of which are located in the Central submarket. Another 450 for-sale units are expected to be delivered in 2010, all in Hamilton County.

- **Outlook:** After 370 apartment units were completed in the metro last year, nearly 1,060 units are scheduled to open in 2009, more than double the five-year average and an inventory expansion of 1 percent.



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

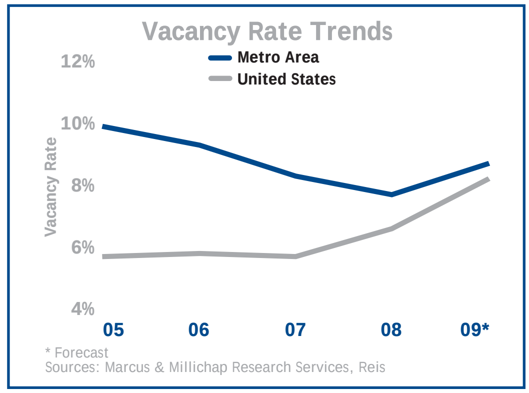
Vacancy

- Early estimates indicate that during the year ending in the third quarter, metrowide vacancy climbed 110 basis points to 8.5 percent, though the rate is only 20 basis points higher than in the first quarter of 2009.

- Due to supply-side pressure, vacancy in Class A complexes has increased 70 basis points over the past 12 months to 7.1 percent. In the last six months, however, top-tier vacancy has improved 30 basis points.

- Job losses are pressuring many lower-tier renters to double up, resulting in a drop-off in renter demand in the lower tiers. Class B/C vacancy reached 9.6 percent in the third quarter, a 140 basis point jump from one year earlier.

- **Outlook:** Vacancy is forecast to end 2009 at 8.7 percent, 100 basis points higher than last year, when the average rate declined 60 basis points.



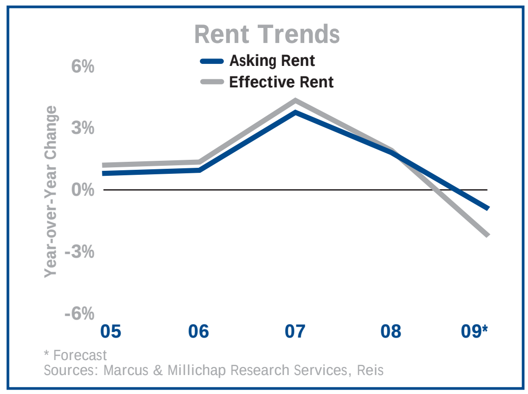
Rents

- Rents began to retreat in the second quarter and are expected to fall further in the coming months. According to preliminary figures, asking rents ended the third quarter at $670 per month, a 12-month drop of 0.4 percent, while effective rents slipped 1.4 percent to $629 per month.

- A recent rise in demand for Class A units has allowed owners to curtail the rate of rent reductions. Early estimates indicate that upper-tier asking rents slid 0.5 percent to $772 per month in the year ending in the third quarter. Class B/C rents, meanwhile, fell to $592 per month, a 0.7 percent decrease.

- As owners attempt to retain renters, lease incentives are forecast to continue climbing. In the third quarter, concessions were 6.2 percent of asking rents, up from 5.2 percent in the same period last year.

- **Outlook:** New-space premiums will mitigate asking rent decreases this year, but steadily rising concessions will continue to weigh down effective rents. Asking rents are expected to slip 0.9 percent to $669 per month, while effective rents will recede 2.2 percent to $623 per month.



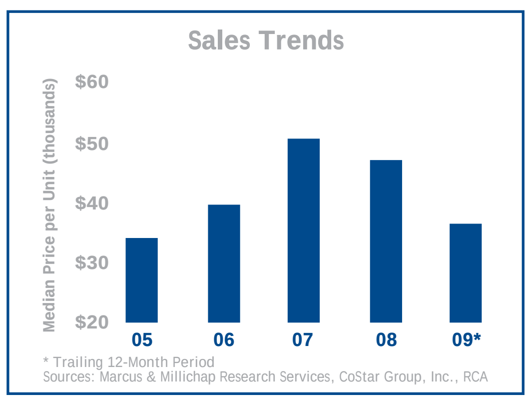
Sales Trends**

- Fewer listings and ongoing tightness in the credit markets have resulted in a modest slowdown of transaction velocity during the last 12 months. The growing number of distressed deals is currently driving sales activity.

- With REO and short sales making up the majority of recent deals and sellers of relatively stabilized assets adjusting pricing to attract offers, the median price has decreased 24 percent over the past year to $36,400 per unit.

- Initial yields have climbed approximately 125 basis points in the last 12 months to an average in the high-8 percent to low-9 percent range.

- **Outlook:** Buyers are actively targeting short-sale opportunities, particularly in the eastern portion of the metro, where the number of distressed and REO assets is growing. These properties allow for lower equity requirements and have a relatively short cash-flow timeline.



*** 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

- A stable contingent of young professionals in the Central submarket has attracted developers, as construction activity in the area has accelerated in recent years. Nonetheless, declining vacancy rates spurred an average revenue improvement of 0.2 percent during the last 12 months.

- In response to a decrease in occupancy, owners in the Hancock/Shelby submarket raised leasing incentives to more than seven days of free rent in the last year, nearly double the amount offered one year ago. Further increases are expected in the coming months.

- Despite healthy population and household growth in Hamilton County, investors will want to monitor future construction activity. Developers have 2,600 units planned for the area, which will likely lead to elevated competition for renters.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Central	2.9%	-60	$797	-0.4%
2	Boone/Hendricks	5.3%	-10	$765	-3.0%
3	East	6.5%	-230	$538	-3.1%
4	Far Northwest	7.0%	110	$631	-3.7%
5	Castleton	7.8%	120	$695	-3.4%
6	Southwest/Johnson	7.9%	90	$600	0.2%
7	Near Northwest	8.6%	60	$575	-2.0%
8	Hamilton County	8.9%	160	$790	0.4%
9	Southeast	9.1%	30	$603	-0.3%
10	Far Northeast	9.4%	80	$536	-2.3%