

LOCAL INVESTORS TARGETING SMALLER SUBURBAN PROPERTIES

While occupancy levels in the Kansas City apartment market improved during the second quarter, early estimates show conditions softening in the most recent three months and overall fundamentals are expected to continue weakening into 2010. Specifically, vacancy is forecast to rise above 9 percent for the first time in two decades, resulting in the metro area's largest decrease in revenues since 2002. Operational weakness will most significantly impact areas with a large percentage of lower-tier space, like the North Kansas City and University/Plaza submarkets. Many Class B/C renters in these locations are doubling up to reduce costs, causing owners to raise concessions to maintain occupancy levels. Furthermore, key renter cohorts in both submarkets are forecast to contract in the coming years, placing additional strain on fundamentals. Demand will remain strong in Overland Park, however, where the job market is relatively stable and the demographic outlook is favorable. As a result, revenues in this area are expected to stay healthier than the metro average through the near term.

Distressed-asset and foreclosure sales have increased rapidly in recent months, generating mixed results in the investment arena. Transaction velocity is fairly consistent, but prices have plunged, as local buyers have shifted their focus to smaller properties that offer possible appreciation through occupancy and capital improvements. The average size of complexes traded during the last year was roughly 75 units, down 35 percent from the previous 12-month period. Locations that are receiving the most interest include Overland Park and Lenexa, where demand is expected to recover ahead of the metro. While local investors continue to comprise the majority of the buyer pool, out-of-state players remain in the market and are mainly targeting stabilized properties, as favorable pricing is facilitating portfolio expansion. Indeed, the number of multi-property sales involving out-of-state buyers has ticked up recently, particularly in the downtown and Northland areas.

2009 ANNUAL APARTMENT FORECAST



Employment: Led by persistent weakness in the professional and business services and construction sectors, Kansas City payrolls are expected to decline by 2.7 percent this year as 27,750 spots are eliminated.



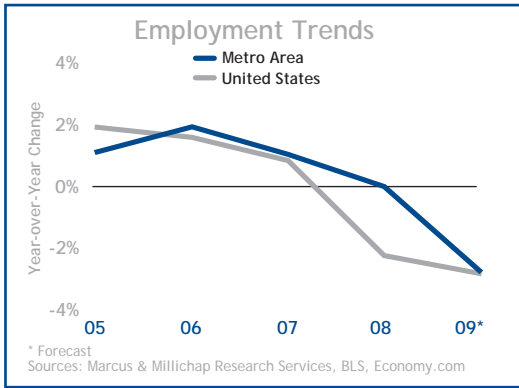
Construction: Roughly 930 units are slated to open across the metro in 2009, double last year's completions but in line with the five-year average.



Vacancy: Job cuts in traditionally lower-paying industries will continue to erode apartment demand. Vacancy is forecast to end the year at 9.2 percent, 150 basis points higher than in 2008, when vacancy rose 100 basis points.

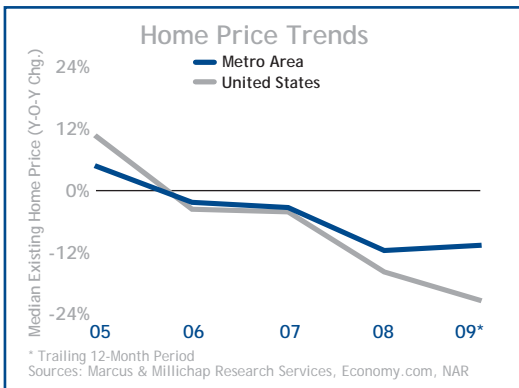


Rents: Asking and effective rents are projected to reach \$695 per month and \$638 per month in 2009, decreases of 0.9 percent and 2.8 percent, respectively. Revenues are on pace to contract by 8.2 percent this year.



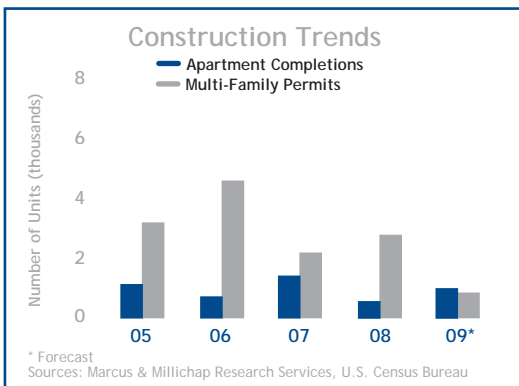
ECONOMY

- ◆ After declining sharply earlier this year, employment losses in the Kansas City market are stabilizing. Approximately 22,400 jobs have been cut in the last 12 months, a 2.2 percent decrease. In fact, during the last six months, just 7,500 spots have been eliminated.
- ◆ Professional and business services and trade, transportation and utilities remain the metro's weakest sectors. Head counts in these industries have been thinned by annual rates of 5.2 percent and 3.6 percent, respectively, for a total loss of 15,100 positions.
- ◆ The metro's unemployment rate has crept up steadily since jumping in the first quarter. The jobless rate reached an estimated 8.9 percent in the third quarter, a 280 basis point increase from one year earlier but just 20 basis points higher than in the previous quarter.
- ◆ **Outlook:** Kansas City payrolls are expected to decline by 2.7 percent this year as 27,750 spots are eliminated.



HOUSING AND DEMOGRAPHICS

- ◆ Builders have decreased single-family permit applications by 44 percent over the last year to roughly 1,900 units. Multi-family development continues to slow, as permits for 1,030 units have been issued during the same stretch, a 65 percent decline.
- ◆ While the median home price has decreased by 10.6 percent year over year to \$128,500, Kansas City largely avoided the price run-up that many other metros recorded in recent years; the median home price in Kansas City is down just 18 percent from peak valuations in late 2006.
- ◆ As job losses continued in the third quarter, the median household income slipped 6 percent to \$52,800 per year. Despite this drop, falling home values have resulted in a 60 percent surplus in the amount needed to finance a median-priced home in the metro.
- ◆ **Outlook:** Home values are expected to decline further as the weak employment market impacts income levels, subsequently hindering apartment demand. A drop-off in construction activity next year, however, should bring supply and demand closer to a balance.

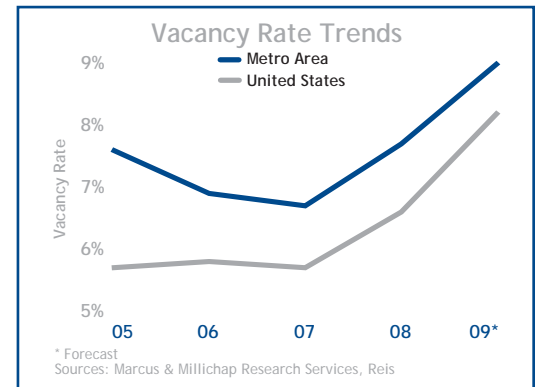


CONSTRUCTION

- ◆ During the past 12 months, developers have added 580 units to metro stock, a 0.5 percent inventory expansion; however, no new units have been delivered in the last two quarters.
- ◆ Nearly 700 units are under way in the Kansas City market. The projects are spread across the metro, though, which minimizes any localized spike in supply-side pressure.
- ◆ The largest development slated to come online this year is the 329-unit Market Station in the Downtown/East Kansas City submarket, scheduled to debut in the fourth quarter. Rents in this project are expected to be among the highest in the metro.
- ◆ **Outlook:** Roughly 930 units are slated to open across the metro in 2009, double last year's completions but in line with the five-year average.

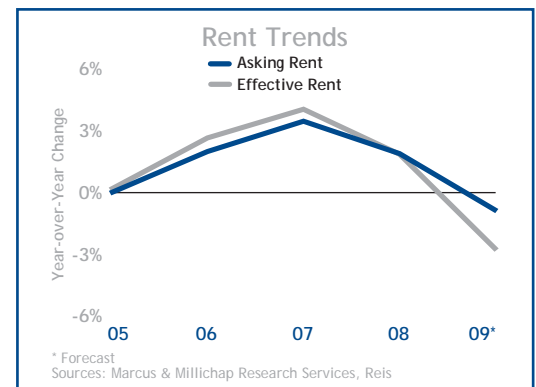
VACANCY

- ◆ After improving in the second quarter, metrowide vacancy rose 20 basis points to an estimated 8.4 percent in the third quarter, a rate that is also 140 basis points higher than one year earlier.
- ◆ Supply-side pressure in late 2008 and early 2009 pushed up Class A vacancy 190 basis points year over year to 7.7 percent; however, the lull in construction during the past two quarters has resulted in a 30 basis point improvement since the end of the first quarter.
- ◆ Vacancy in the metro's Class B/C properties reached 8.8 percent in the third quarter, an annual rise of 100 basis points.
- ◆ **Outlook:** Job cuts in traditionally lower-paying industries will continue to erode apartment demand. Vacancy is forecast to end the year at 9.2 percent, 150 basis points higher than in 2008, when vacancy rose 100 basis points.



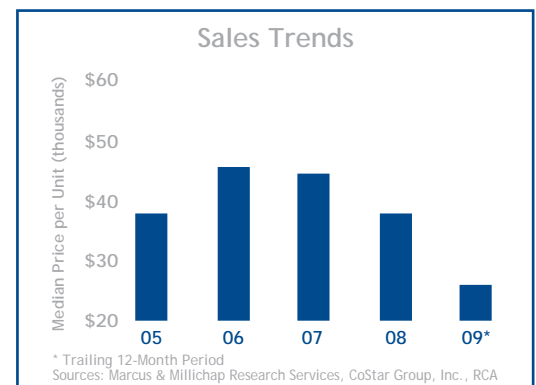
RENTS

- ◆ Early estimates indicate that asking rents declined 0.4 percent to \$697 per month during the year ending in the third quarter, the first annual contraction in two decades. Effective rents began to retreat earlier this year and are currently \$644 per month, 1.7 percent lower than one year ago.
- ◆ During the past 12 months, Class A asking rents have declined 0.9 percent to \$810 per month, while Class B/C asking rents are down 0.2 percent to \$622 per month.
- ◆ Owners have increased incentives to counteract climbing vacancy. Concessions are now 7.6 percent of asking rents, up from 6.4 percent at this time in 2008. As the weak job market continues to soften renter demand, concessions are expected to rise further.
- ◆ **Outlook:** Asking and effective rents are projected to reach \$695 per month and \$638 per month in 2009, decreases of 0.9 percent and 2.8 percent, respectively. Revenues are on pace to contract by 8.2 percent this year.



SALES TRENDS**

- ◆ Transaction velocity during the most recent 12-month period was relatively in line with the previous year, due in large part to a recent increase in distressed-asset deals.
- ◆ Owners of properties that have not met rent projections are listing their assets before they face refinancing hurdles. As such, the median sales price has dropped 34 percent in the last year to \$25,800 per unit. Much of this decline came recently, as values in the past two quarters are down 73 percent from the preceding six-month span.
- ◆ As a result of elevated activity involving distressed complexes and growing near-term risk for stabilized assets, cap rates have climbed roughly 125 basis points year over year to the high-8 percent range.
- ◆ **Outlook:** Investors seeking stability will likely target assets in Overland Park or Lee's Summit, as demand in these areas has held up well through the recession. Buyers with greater risk tolerance, on the other hand, may find opportunities in Independence or Raytown, where job losses have been heavy, but prices are below the metro average.



** 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 Platte submarket, vacancy has increased 370 basis points to 10.4 percent in the last year, the largest jump in the metro. This hike was driven primarily by weak demand for Class A space, as Class B/C vacancy in the area ticked up only 90 basis points.
- ◆ Due to a large contingent of young professionals that has supported steady rent growth in the Overland Park North submarket, area owners have posted a 2 percent gain in revenues over the past 12 months, marking the only revenue improvement in the Kansas City metro area.
- ◆ Transaction velocity in the Olathe/Gardner submarket accelerated during the most recent 12-month period, as investors seeking more stable operations have been attracted to the area's consistent demand and the tightest average vacancy rate in the metro.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Olathe/Gardner	4.8%	30	\$601	-3.6%
2	North Kansas City	5.1%	-90	\$582	-2.6%
3	Lee's Summit/Prairie	6.2%	-120	\$609	-1.1%
4	Overland Park South	6.7%	70	\$839	-1.5%
5	Grandview/Far South	6.9%	60	\$609	-0.9%
6	Overland Park North	6.9%	130	\$751	3.4%
7	Independence	7.3%	100	\$586	-3.5%
8	Downtown/East Kansas City	7.7%	90	\$623	-5.9%
9	Merriam/Mission/Prairie Village	7.8%	130	\$638	-2.4%
10	Shawnee/Lenexa	8.0%	260	\$687	-2.1%