ApartmentResearch
MARKET UPDATE
Marcus & Millichap

Memphis Metro Area *Fourth Quarter 2009*

Opportunistic Out-of-State Buyers Active in Memphis

While the pace of job cuts in Memphis has been much less severe compared to national trends, employment reductions will persist into 2010, further dampening apartment operations. The effects of the recession have been most evident in the marketwide vacancy rate, which has climbed an average of 30 basis points per quarter since the start of the downturn. Rising vacancy has pressured operators to cut rents, though asking rents are down just 0.6 percent year over year, and quarterly rent growth persists in some submarkets. In the Southeast Shelby County/Ridgeway area, for example, below-market rental rates have stimulated demand and allowed owners to decrease vacancy levels while steadily raising asking rents. Also, in the East Memphis/University submarket, affordable rents and a high concentration of students have buttressed demand, increasing average revenues over the past year. In the South Memphis submarket, however, which has a large share of older and less desirable apartment stock, asking rents that are already the lowest in the metro have been reduced significantly to combat rapidly rising vacancy, although the rent cuts have had limited impact on retaining tenants.

Investment activity in the Memphis apartment market has been dominated by aggressive out-of-state buyers who are looking for fire-sale prices rather than traditional investment strategies involving stabilized assets. These distressed sales have occurred primarily in outlying parts of the metro, where reduced prices — often less than $10,000 per unit — are encouraging the acquisitions of high-vacancy, low-rent properties. Despite the prevalence of these transactions, opportunities exist for conservative investors. Specifically, a number of 1970s-vintage Class B/C complexes are available at cap rates near 9 percent. Buyers have largely ignored these assets, however, in favor of lender-owned buildings, despite their higher risk.

2009 Annual Apartment Forecast

1.6% decrease in total employment

Employment: Memphis employers are expected to eliminate 10,000 jobs, or 1.6 percent of the metro's work force, in 2009. Total employment was reduced by 14,800 positions last year.

370 units will be completed

Construction: Builders are on pace to expand Memphis apartment inventory by 370 units this year, well below the 910 units delivered in 2008 and the five-year average completion of 635 apartments annually.

40 basis point increase in vacancy

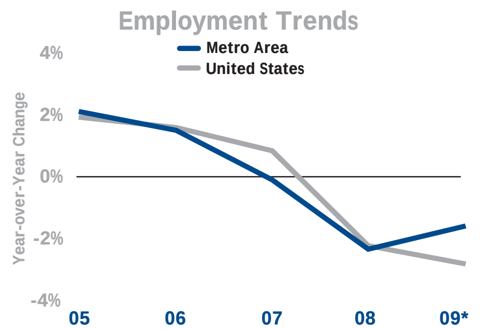
Vacancy: Marketwide vacancy is forecast to rise 40 basis points in 2009 to 12.4 percent due to job losses and slower household creation. Last year, vacancy increased 140 basis points.

0.8% decrease in asking rents

Rents: In an effort to retain tenants, owners are expected to trim asking rents 0.8 percent to $670 per month this year, while effective rents are projected to retreat 2.5 percent to $619 per month. In 2008, asking and effective rents advanced 1.8 percent and 1.6 percent, respectively.

ECONOMY

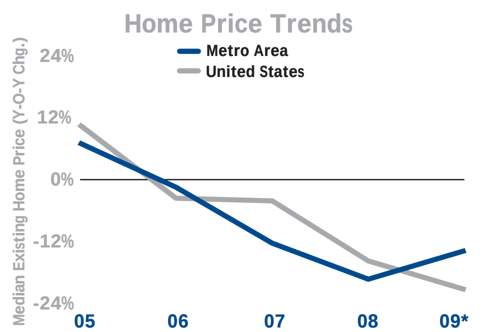
- Local employers shed 15,600 positions, or 2.5 percent of payrolls, in the 12-month period ending in the third quarter. In the previous year, 8,100 workers were let go.
- During the past year, education and health services employers have added approximately 1,600 hires, while government agencies have expanded head counts by 1,000 positions. Alternately, the trade, transportation and utilities and professional and business services sectors have eliminated a total of 9,400 jobs in that time.
- As of the third quarter, the metrowide unemployment rate was 9.4 percent, 240 basis points more than one year earlier but up just 80 basis points over the past six months.
- **Outlook:** Memphis employers are expected to trim 10,000 jobs, or 1.6 percent of the metro's work force, in 2009. Total employment was reduced by 14,800 positions last year.



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

HOUSING AND DEMOGRAPHICS

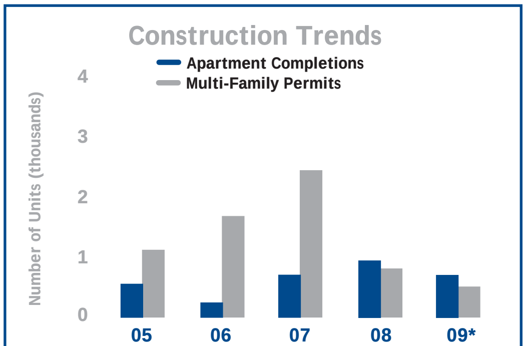
- In light of economic stresses and declining residential demand, builders are reining in construction. The number of single-family permits issued has decreased 44 percent to 1,690 units in the past 12 months, while multi-family permitting activity has receded 69 percent to 200 units.
- Foreclosure purchases have rekindled single-family sales activity, though velocity is still down 3 percent year over year. Additionally, the median price of an existing home has fallen 14 percent annually to $105,500.
- The typical mortgage payment associated with the metro's median-priced home is $620 per month, well below the average Class A asking rent of $840 per month but higher than the average Class B/C asking rent of $566 per month.
- **Outlook:** Although homeownership is affordable to most Memphis residents, ongoing job losses and uncertainty regarding home values will keep many renters from moving into the single-family housing market.



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

CONSTRUCTION

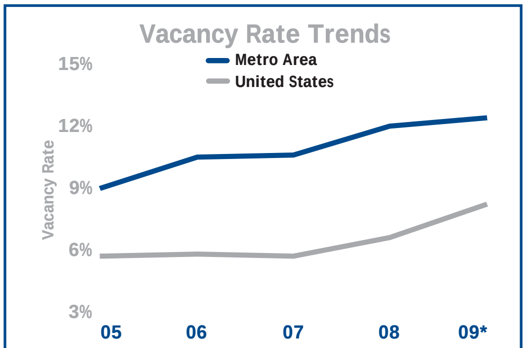
- The effects of the recession are beginning to materialize in the construction pipeline, as just 490 apartment units have been completed in the past year, down from 735 units during the preceding 12 months.
- Metrowide, there are 10 projects with approximately 2,550 units in planning. Although 1,400 units are under consideration in the Germantown/Collierville submarket, declining residential demand and tight capital markets will likely prevent some projects from proceeding.
- The 176-unit Centennial Gardens complex is the a largest project under way. The development is located in Southeast Shelby County/Ridgeway submarket; no completion date has been determined.
- **Outlook:** Builders are on pace to expand Memphis apartment inventory by 370 units this year, well below the 910 units delivered in 2008 and the five-year average addition of 635 apartments annually.



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

VACANCY

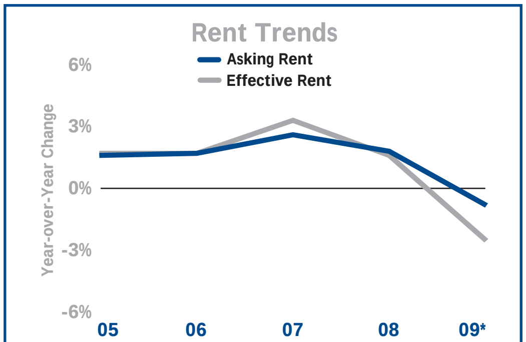
- Marketwide vacancy was 12.1 percent in the third quarter, up an estimated 80 basis points from one year earlier. Vacancy increased 130 basis points in the previous 12-month period.
- Despite fluctuations over the last year, third quarter vacancy at the metro's Class A apartment properties is currently 8.7 percent, just 20 basis points higher than the rate at this time in 2008. In the previous one-year span, vacancy surged 200 basis points.
- Vacancy among Memphis' Class B/C properties has increased an average of 110 basis points to 14.1 percent over the past 12 months, up slightly from the 100 basis point jump recorded in the preceding year.
- **Outlook:** Marketwide vacancy is forecast to rise 40 basis points in 2009 to 12.4 percent due to job losses and slower household creation. Last year, vacancy increased 140 basis points.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

RENTS

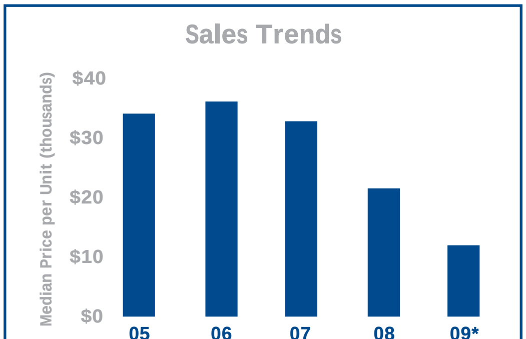
- Asking rents dipped 0.6 percent annually to an estimated $672 per month in the third quarter, while effective rents retreated 1.7 percent to $622 per month. In the previous year, asking and effective rents appreciated 2.7 percent and 2.1 percent, respectively.
- Despite economic stresses, the average Class A asking rent is $840 per month, 0.1 percent higher than one year ago. Conversely, lower-tier asking rents have receded 1.3 percent in the past 12 months to $566 per month.
- Rising vacancy and concessions are eroding cash flows, with the average revenue retreating 2.6 percent over the last year. In the previous 12-month period, revenues pushed up 0.6 percent.
- **Outlook:** In an effort to retain tenants, owners are expected to trim asking rents 0.8 percent to $670 per month this year, while effective rents are projected to fall 2.5 percent to $619 per month. In 2008, asking and effective rents advanced 1.8 percent and 1.6 percent, respectively.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

SALES TRENDS**

- Sales of distressed and REO properties have boosted transaction velocity in Memphis, with deal flow increasing 18 percent over the past year. In the previous 12 months, the number of purchases increased 38 percent.
- Distressed-asset sales have caused the median price to plummet 50 percent to $11,770 per unit during the last 12 months. Excluding these deals, however, the median price fell in the $14,000 per unit to $24,000 per unit range.
- In the past 12 months, distressed, older apartment properties typically have changed hands at prices in the $6,000 per unit to $21,000 per unit range. Meanwhile, 1980s-vintage distressed assets have sold from $24,000 per unit to $59,000 per unit.
- **Outlook:** Although cap rates remain a useful investment metric, the prevalence of REO sales and deals involving stabilized properties muddles initial yield comparisons. In addition to cap rates, investors should consider cash-on-cash returns, vacancy, rents compared to market rates and returns on value-add improvements.



* Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

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

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

- Construction efforts are elevated in the Riverside submarket, where there are five projects amounting to 634 units under way. Included in that total, however, is the Horizon development, which was recently purchased at a foreclosure auction by the lender and is now stalled.

- Limited construction in recent years and spillover student housing demand have buttressed fundamentals in the East Memphis/University submarket. Vacancy has decreased in the last year, and rent declines have been modest, resulting in an average revenue appreciation of 0.9 percent.

- In addition to rising vacancy, concessions have surged in the South Memphis submarket due to tepid demand. In the past 12 months, concessions have increased nearly 900 basis points to 20.7 percent of asking rents.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Germantown/Collierville	6.4%	-120	$807	-1.8%
2	Downtown/Midtown	7.7%	10	$528	-2.1%
3	Riverside	8.0%	140	$899	-3.0%
4	Cordova	8.3%	110	$743	-2.4%
5	East Memphis/University	9.7%	-120	$601	-0.5%
6	Raleigh/Bartlett	13.2%	50	$586	-1.5%
7	Southeast Shelby County/Ridgeway	13.7%	30	$577	0.2%
8	Whitehaven/Airport/Southhaven	15.0%	30	$512	-2.7%
9	Frayser	18.6%	310	$420	-4.2%
10	South Memphis	21.0%	880	$373	-1.3%

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