

ApartmentResearch

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

Marcus & Millichap

Orange County

Fourth Quarter 2009

WAVE OF DISTRESSED-ASSET LISTINGS HAS YET TO ARRIVE

Payroll cuts in Orange County will continue to moderate renter demand, causing vacancy to rise and rents to retreat further in the coming months. As of the third quarter, vacancy was in the mid-6 percent range, 270 basis points above the five-year annual average, resulting in rent reductions in every submarket. During the past year, rent declines have been steepest in submarkets where rental rates are elevated, driven by cost-conscious residents doubling up to ease living expenses. In Irvine, for example, where vacancy is approaching 9 percent, effective rents have fallen by 7.2 percent year over year. Rent cuts and concession increases also have been aggressive in low-cost locations like Anaheim, specifically in the northern and northeastern portions of the area, due to competition from an abundance of apartment units and affordable single-family rental homes. Marketwide, accelerated building activity will intensify supply strains this year, adding to the supply/demand imbalance.

Deal flow in the local apartment market continues to slow, due in part to restrictive underwriting standards and fewer quality offerings. Buyers who have delayed investment decisions in anticipation of an influx of bank-owned listings have found limited opportunities, as lenders have increasingly worked with owners to avoid foreclosures. Further, the absence of large, institutional investors has decelerated transactions among Class A assets. REITs have begun to raise capital in recent months, though many are still taking a wait-and-see approach. Once local economic conditions start to stabilize, these buyers may re-enter the market in search of discounted properties. With affordable units remaining in strong demand among renters, stabilized lower-tier operations in centrally located, dense areas of the metro like the South Anaheim and North Santa Ana submarkets should garner the most near-term investor interest.

2009 ANNUAL APARTMENT FORECAST



Employment: Employers are forecast to trim head counts by 3.5 percent in 2009, or 51,100 workers, after eliminating 56,800 positions last year.



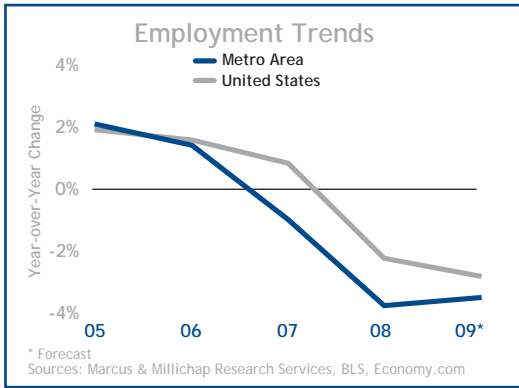
Construction: Following the addition of 1,520 apartments in 2008, developers are projected to complete 3,800 units this year, expanding inventory by 1.9 percent. During the past five years, builders have delivered an annual average of 1,720 units.



Vacancy: In 2009, above-average supply growth and softer renter demand are forecast to push up metrowide vacancy 200 basis points to 7.1 percent, after vacancy rose 140 basis points last year.



Rents: Robust construction activity will maintain the metro's supply/demand imbalance, suppressing rents. This year, asking rents are forecast to decrease 4.3 percent to \$1,504 per month, while effective rents will contract 6.7 percent to \$1,413 per month.

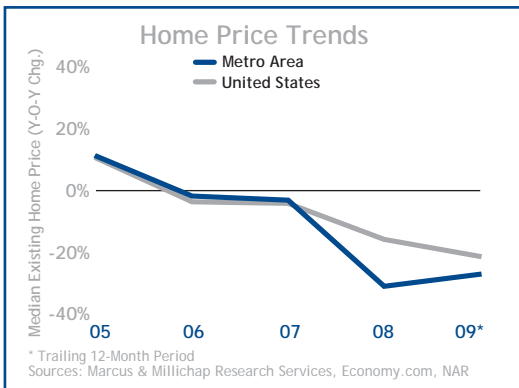


ECONOMY

- ◆ According to preliminary data, local employment retreated 4.3 percent during the year ending in the third quarter with the elimination of 63,700 positions. Since the start of 2009, an estimated 42,300 jobs have been cut.
- ◆ The trade, transportation and utilities and construction sectors have led the metro in contractions over the last year, cutting a combined 30,200 workers through the third quarter.
- ◆ Education and health services was the only local industry to record a net gain on a year-over-year basis, adding 2,350 jobs, or growth of 1.6 percent. Year-to-date hiring, however, has slowed considerably, as a mere 300 positions have been added.
- ◆ **Outlook:** Employers are forecast to trim head counts by 3.5 percent in 2009, or 51,100 workers, after eliminating 56,800 jobs last year.

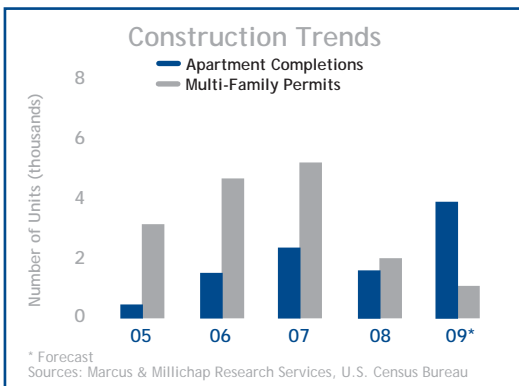
HOUSING AND DEMOGRAPHICS

- ◆ Weakness in the local economy has led to a drop-off in permit issuance. Over the past year, single-family builders have obtained permits for approximately 1,180 units, down 25 percent from the previous 12-month period. Multi-family permitting activity has declined 65 percent to 990 units.
- ◆ The median price of a single-family home in Orange County was estimated at \$373,000 in the third quarter, an annual decrease of 27 percent. At \$69,500 per year, the metro's median household income has fallen nearly 5 percent over the past 12 months and is currently \$22,400 short of the amount required to qualify for a median-priced home.
- ◆ Using traditional financing, the typical mortgage payment for a median-priced residence in the metro is roughly \$275 per month more than the average Class A asking rent. One year ago, mortgage payments were \$1,350 per month more than asking rents for premier rental units.
- ◆ **Outlook:** Although home prices have decreased, housing affordability remains low. Moreover, the soft job market will continue to limit purchases by first-time homebuyers through 2009, maintaining a sizable renter pool.



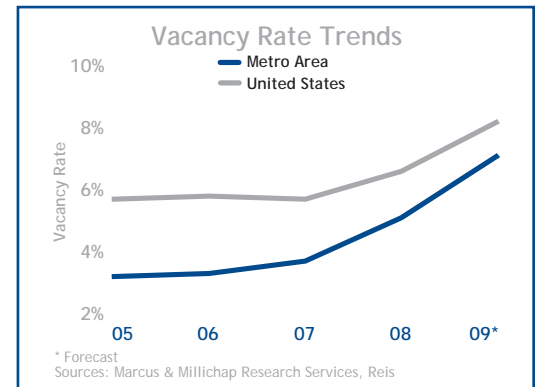
CONSTRUCTION

- ◆ Year over year through the third quarter, rental inventory in the metro expanded by 1.3 percent with the addition of 2,660 apartments. During the previous 12 months, 2,335 units were brought online.
- ◆ At present, 2,940 units are under construction, and another 2,260 units are in the planning pipeline.
- ◆ More than 2,250 condo units are under way in the Orange County market, including 1,240 units that are scheduled for completion this year. In 2008, 2,366 for-sale units were added, some of which are now employed as high-end rentals.
- ◆ **Outlook:** Following the addition of 1,520 apartments last year, developers are projected to complete 3,800 units in 2009, increasing stock by 1.9 percent. During the past five years, builders have delivered an annual average of 1,720 units.



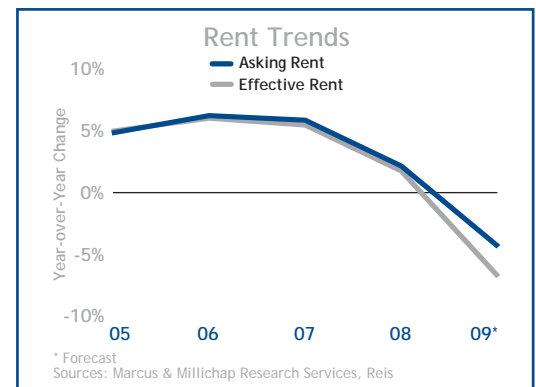
VACANCY

- ◆ Vacancy increased an estimated 180 basis points year over year to 6.5 percent in the third quarter. During the prior 12 months, vacancy rose 150 basis points.
- ◆ Based on early figures, vacancy in the Class A apartment sector pushed up 200 basis points year over year to 7.7 percent in the third quarter, largely driven by a nearly 4 percent expansion in top-tier inventory.
- ◆ Over the past year, the vacancy rate in the metro's larger supply of lower-tier units has risen 160 basis points to 5.8 percent, as more residents have sought to rein in living expenses by doubling up.
- ◆ **Outlook:** In 2009, above-average supply growth and softer renter demand are forecast to increase metrowide vacancy 200 basis points to 7.1 percent, after vacancy rose 140 basis points last year.



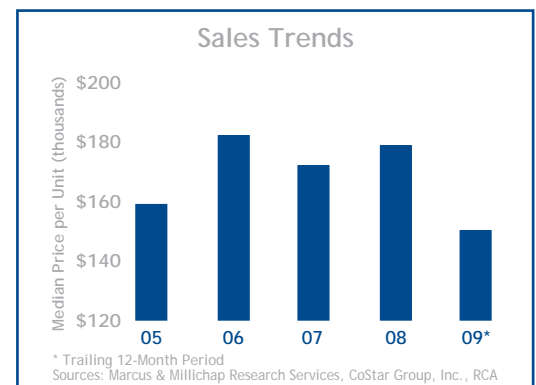
RENTS

- ◆ During the 12 months ending in the third quarter, asking rents dropped 3.8 percent to \$1,519 per month, and effective rents fell 6 percent to \$1,436 month. In the previous year, asking and effective rents rose 4.0 percent and 3.7 percent, respectively.
- ◆ Class A asking rents have declined 4.2 percent in the past year to \$1,765 per month due to light occupancy levels in recently finished complexes. Lower-tier rents have fallen 3.8 percent year over year to \$1,380 per month.
- ◆ Owners' attempts at maintaining occupancy levels have dragged down revenues. Over the last year, the average revenue has decreased 7.8 percent, following a 2.1 percent gain in the previous 12-month period.
- ◆ **Outlook:** Robust construction activity will sustain the metro's supply/demand imbalance, suppressing rents. This year, asking rents are forecast to fall 4.3 percent to \$1,504 per month, while effective rents will contract 6.7 percent to \$1,413 per month.



SALES TRENDS**

- ◆ Sales activity slowed by 26 percent over the most recent 12-month stretch, driven by tightened lending standards and investors' reluctance to act in the current economy.
- ◆ Measured on a year-over-year basis, the median price of an apartment property in Orange County has contracted 14 percent to \$150,000 per unit, with 91 percent of transactions during that time involving properties sold below \$5 million.
- ◆ In the last 12 months, cap rates have averaged in the mid- to high-6 percent range, roughly 150 basis points above initial yields in the previous period. Several properties have traded recently with cap rates above 7 percent.
- ◆ **Outlook:** In the coming quarters, prices may come under additional pressure as abatements strengthen and vacancy rates climb higher. Investors will continue to underwrite conservatively, taking into consideration competition from the influx of new apartment units, as well as the growing number of single-family homes and fractured condo units entering the rental market.



** 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 100 basis points to 150 basis points lower. The government's creation of a conservatorship for Fannie Mae and Freddie Mac has most likely boosted confidence in the two GSEs, putting downward pressure on rates, but it also creates several near-term uncertainties, as the conservatorship is due to expire at the end of the year.
- ◆ 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 second quarter delivery of the 890-unit Enclave complex in the Costa Mesa submarket pushed up Class A vacancy in the area more than 1,000 basis points over the past year to the high-14 percent range. As of the third quarter, the submarket had the metro's only double-digit vacancy rate.
- ◆ The South Anaheim submarket will receive the bulk of the county's apartment deliveries this year, with developers slated to complete 1,720 units. Most of the projects currently being built in the metro, however, are located in the Irvine submarket.
- ◆ While Class A vacancy in the Placentia/Northeast Anaheim submarket remains tight in the low-3 percent area, layoffs in blue-collar sectors have forced many lower-tier renters to double up or relocate, raising this sector's vacancy rate into the high-7 percent range. As such, concessions in the submarket are the highest in the metro at 7.9 percent of asking rents.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Buena Park	4.2%	120	\$1,261	-6.3%
2	Newport Beach	4.4%	80	\$1,967	-9.1%
3	Huntington Beach	4.6%	170	\$1,377	-6.8%
4	North Santa Ana	4.9%	140	\$1,158	-6.0%
5	Westminster/Fountain Valley	5.7%	120	\$1,273	-7.0%
6	South Anaheim	5.9%	40	\$1,265	-7.3%
7	Fullerton	6.1%	290	\$1,245	-7.3%
8	Laguna Beach/Dana Point	6.1%	50	\$1,633	-1.4%
9	Brea	6.2%	220	\$1,302	-3.4%
10	Tustin	6.2%	180	\$1,404	-7.7%