

## CONCESSIONS IN ST. LOUIS AT HISTORICALLY HIGH LEVELS

Several factors have contributed to softness in the St. Louis apartment market and are expected to continue to present operational challenges in the near term. A spike in construction has been met with weak demand caused by the slumping labor market. In fact, demand for rental housing contracted 2.2 percent year over year in the third quarter, the largest decline in more than 20 years, and will likely fall until payrolls begin to expand. As a result, owners have increased concessions to roughly 26 days of free rent. With vacancy on track to rise further this year, concessions will remain elevated, particularly in the Maryland Heights/Northwest County submarket. Area operators are currently offering renters nearly 40 days of free rent, the most of any submarket in the metro and 11 days more than was offered one year ago. Nonetheless, many residents are opting to relocate out of the area and into St. Charles to capture lower rents or into Clayton to be near the metro's healthiest employment corridors. As such, owners in the Clayton/Mid-County submarket have kept concessions relatively flat over the last 12 months.

Transaction velocity has slowed in the St. Louis market, due primarily to reduced listings and increased buyer caution regarding weakened fundamentals. Additionally, activity from out-of-state investors has dropped off considerably; there have been no sales involving out-of-state buyers over the last six months. The handful of local buyers who remain active in the metro are targeting smaller assets with relatively healthy occupancy rates, as these properties are generally best positioned for revenue growth once the local economy gains traction. Recent deal flow has been concentrated in the East of I-44 and St. Louis City South submarkets, especially near interstates 64 and 44. Asking rents in these areas are among the metro's lowest, attracting residents seeking to control costs. Furthermore, initial yields in these submarkets are approximately 25 basis points higher than the metro average, making financing somewhat easier to obtain.

## 2009 ANNUAL APARTMENT FORECAST



**Employment:** Following the elimination of 18,700 positions last year, employers are expected to cut 43,000 jobs in 2009, an annual decline of 3.2 percent, led by significant weakness in the office-using segments.



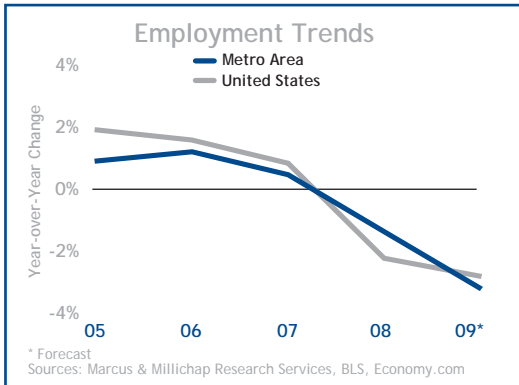
**Construction:** Developers are projected to complete 795 units in St. Louis this year, a 0.7 percent increase in inventory. In 2008, just 230 units were delivered.



**Vacancy:** Renter demand is expected to remain weak through the coming quarters due to job losses and an increase in the number of alternative housing options. As such, vacancy is forecast to end 2009 at 9.6 percent, 180 basis points higher than last year.



**Rents:** Owners will continue to curtail asking rents and expand incentives to counteract waning demand. Asking rents are expected to finish the year at \$720 per month and effective rents will be \$687 per month, decreases of 1.3 percent and 2.7 percent, respectively.

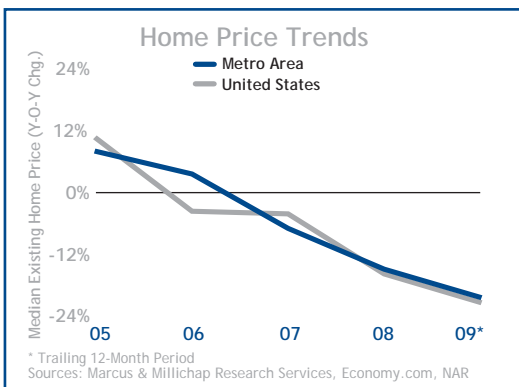


## ECONOMY

- ◆ During the last 12 months, metro employers have shed roughly 49,300 positions, reducing payrolls by 3.6 percent. Losses appear to be easing, however, as approximately 17,800 jobs have been eliminated in the past two quarters.
- ◆ Ongoing weakness in the manufacturing and construction segments will continue to hinder apartment demand. The manufacturing sector has been thinned by 13,800 spots in the last year, a 10.7 percent drop, while construction employment has contracted by 15.2 percent with the loss of 11,300 jobs.
- ◆ The metro's unemployment rate reached an estimated 9.5 percent in the third quarter, slightly better than the national average but 260 basis points higher than one year earlier.
- ◆ **Outlook:** Following the elimination of 18,700 positions last year, employers are expected to cut 43,000 jobs in 2009, an annual decline of 3.2 percent, led by significant weakness in the office-using segments.

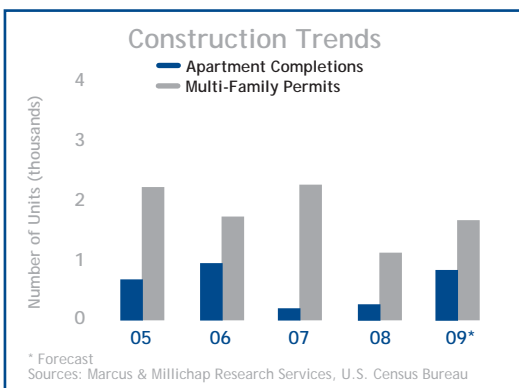
## HOUSING AND DEMOGRAPHICS

- ◆ In the 12 months ending in the third quarter, nearly 3,700 single-family housing permits were issued. While this represents a year-over-year decrease of 35 percent, the total is 12 percent more than six months ago, indicating that local builders feel the housing market has reached a bottom.
- ◆ In the multi-family sector, permit issuance declined 32 percent annually to 930 units in the third quarter. Multi-family permit activity will likely remain modest through the coming quarters due to waning renter demand and ongoing difficulty obtaining construction loans.
- ◆ The median home price has fallen 20 percent in the last 12 months to \$107,900, one of the most affordable prices in the Midwest. Despite just a 6 percent annual decrease in the median household income to \$46,700 per year, the figure is still \$18,500 above the minimum needed to service debt on a median-priced home, up from a \$10,400 surplus one year ago.
- ◆ **Outlook:** While multi-family permitting activity remains below levels recorded in recent years, a forecast rise in permitting may cause supply-side pressure to build ahead of a recovery in demand.



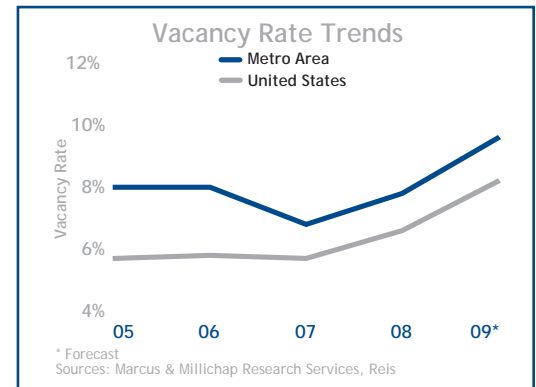
## CONSTRUCTION

- ◆ Builders have added nearly 200 units during the past 12 months, all of which came online in the first quarter of 2009.
- ◆ While completions have been modest year to date, deliveries are on pace to accelerate in the coming months. There are approximately 600 units under way marketwide, all of which are slated for arrival in the fourth quarter.
- ◆ Supply-side pressures will mount in the St. Louis North submarket, where 85 percent of current apartment units under construction in the metro are located. Additionally, there are 375 for-sale units being built in the area, some of which could enter the market as rentals.
- ◆ **Outlook:** Developers are projected to complete 795 units in St. Louis this year, a 0.7 percent increase in inventory. In 2008, just 230 units came online.



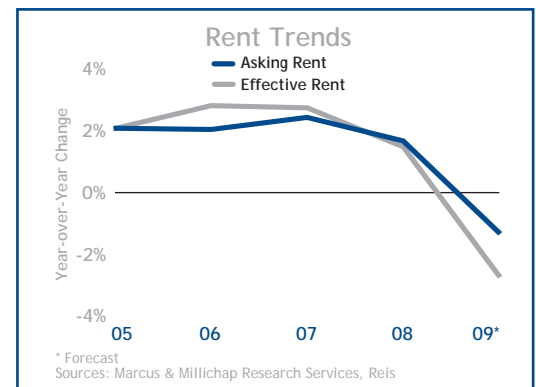
## VACANCY

- ◆ Early figures indicate that metrowide vacancy reached 9.1 percent in the third quarter, 220 basis points higher than one year earlier, as ongoing weakness in the labor market has caused many lower-tier renters to double up, while some Class A renters have made the transition into ownership.
- ◆ Class A vacancy has risen 250 basis points in the last 12 months to 9.3 percent. Year to date, the top-tier vacancy rate has climbed 220 basis points.
- ◆ Continuing layoffs in the metro's traditionally lower-paying employment sectors have pushed up Class B/C vacancy 200 basis points over the past year to 9 percent, the highest rate in more than two decades.
- ◆ **Outlook:** Renter demand is expected to remain weak through the coming quarters due to job losses and increased alternative housing options. As such, vacancy is forecast to end 2009 at 9.6 percent, 180 basis points higher than last year.



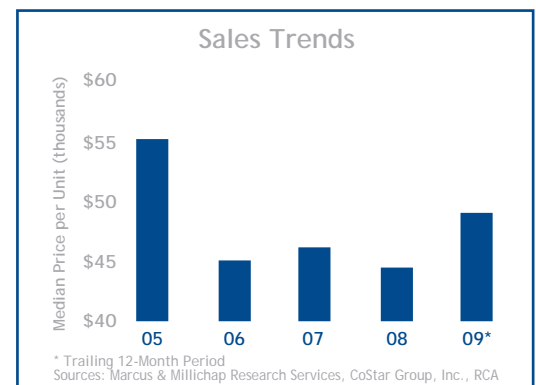
## RENTS

- ◆ According to preliminary estimates, asking rents ended the third quarter at \$723 per month, a 12-month decline of 0.9 percent. Effective rents, meanwhile, retreated to \$673 per month, a 2.5 percent year-over-year contraction.
- ◆ Asking rents in the metro's Class A segment have fallen 1.2 percent to \$904 per month in the last 12 months, while Class B/C asking rents have slipped 0.9 percent to \$634 per month.
- ◆ As vacancy has climbed and effective rents have dropped over the past year, average revenues have declined 4.8 percent. Concessions are expected to rise into 2010, placing further downward pressure on revenues.
- ◆ **Outlook:** Owners will continue to curtail asking rents and expand incentives to counteract waning demand. Asking rents are expected to finish the year at \$720 per month and effective rents will be \$667 per month, decreases of 1.3 percent and 2.7 percent, respectively.



## SALES TRENDS\*\*

- ◆ Due in part to a large drop-off in activity from out-of-state buyers, transaction velocity slowed 17 percent during the most recent 12-month period. Deal flow has decelerated 46 percent in the last two quarters when compared to the preceding six-month stretch.
- ◆ Flight-to-safety patterns and a shift in investor focus to smaller properties have driven up the median sales price 8 percent in the past year to \$49,000 per unit.
- ◆ Cap rates for quality assets in the metro's best locations are currently in the mid- to high-8 percent range, slightly higher than one year ago. Properties with operational challenges and complexes in submarkets with weak demand are being listed with initial yields from 10 percent to 11 percent.
- ◆ **Outlook:** Buyers with low risk tolerance will likely target assets in the Clayton/Mid-County submarket, which is expected to lead the metro in a recovery due to its comparatively strong employment base. Despite an annual rise in vacancy of 280 basis points, area revenues only contracted by 1.3 percent, the smallest decline in the metro.



\*\* 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

- ◆ Near-term supply pressure is concentrated in the St. Louis City North submarket, but inventory additions spurred by the proposed NorthSide project will create long-term issues in the area. The 500-acre, \$8.1 billion development is scheduled to include up to 7,800 apartments and 1,200 homes.
- ◆ Renter demand remains relatively strong in the South submarket. The vacancy rate in the area is 6.2 percent and concessions are just 2.9 percent of asking rents; both measurements are the lowest in the metro.
- ◆ DeVry Inc. is consolidating its operations to the Maryland Heights/Northwest County submarket. The DeVry University and Chamberlain College of Nursing campuses will be merged into the area, bringing hundreds of new jobs and potentially generating increased renter demand from students.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	South	6.2%	150	\$628	-1.2%
2	St. Charles County	6.9%	30	\$693	-1.6%
3	East of I-44	7.3%	200	\$597	-3.8%
4	Manchester/West County	9.0%	340	\$809	-1.0%
5	Clayton/Mid-County	9.3%	280	\$823	1.7%
6	Maryland Heights/Northwest County	9.5%	250	\$728	-2.9%
7	St. Louis City South	9.8%	130	\$572	-3.6%
8	Airport/I-70	10.1%	190	\$516	-0.5%
9	Florissant/North County	10.4%	370	\$590	-4.9%
10	St. Louis City North	10.5%	210	\$739	-4.8%