

ApartmentResearch

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

Marcus & Millichap

Cincinnati Metro Area

Third Quarter 2009

CLASS A STOCK HOLDING STRONG IN CINCINNATI

Job losses continue to challenge the Cincinnati apartment market, though difficulties have not permeated all areas and property classes. White-collar employment sectors, for example, have accounted for only 22 percent of all layoffs in the last year, supporting Class A apartment demand. In areas such as Hyde Park, Oakley and Madisonville, top-tier renter demand generated by higher concentrations of young professionals has kept vacancy at luxury complexes in the 2 percent to 4 percent range so far this year, with asking rents averaging well over \$1,000 per month. Among Class B/C buildings, the effects of the recession have been more apparent. In the manufacturing sector alone, an average of 2,100 workers have been let go each month since the beginning of the year. Consequently, lower-tier vacancy is up 80 basis points year over year, and rents have fluctuated up and down during the first half of 2009. Declines in lower-tier renter demand are pronounced in Westwood, Fairfield and Avondale due to the areas' lower income levels and oversupply of Class C properties. In the marketwide development pipeline, construction output will rise in 2009; however, no completions are expected during the remainder of the year, while pent-up renter demand and the short supply of new and existing Class A space will likely expedite lease-up times.

Although apartment transactions continue to be recorded throughout the metro, several factors are limiting activity. Owners of Class A apartment complexes have largely avoided bringing their properties to market so far in 2009, despite demand for assets with stable operations and revenues. Additionally, expectations for fire-sale pricing are causing a number of solid Class B assets with stable historical performance to remain on the market due to the wide buyer/seller expectations gap, while Class C activity has been stymied by tight debt markets. Nevertheless, local banks are facilitating deals, albeit conservatively. In recent quarters, sales velocity was moderately stronger downtown and in the suburbs of Hyde Park and Oakley, where Class A demand is resilient.

2009 ANNUAL APARTMENT FORECAST



Employment: Metrowide work force reductions are forecast to total 48,000 jobs this year, a 4.7 percent decrease in payrolls. In 2008, 20,900 positions were trimmed.



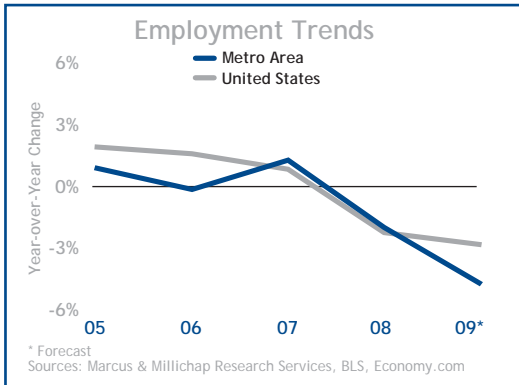
Construction: Builders are on pace to expand Cincinnati apartment inventory by 720 units in 2009, more than the 170 units brought online last year but below the average of 920 units recorded annually since 2000.



Vacancy: Persistent job cuts and waning demand will underpin a 100 basis point rise in vacancy to 7.8 percent this year. In contrast, vacancy improved 20 basis points in 2008.



Rents: In 2009, asking rents are projected to dip 0.5 percent to \$706 per month, while effective rents will recede 1.2 percent to \$664 per month. Last year, asking and effective rents gained 2.9 percent rents and 3.1 percent, respectively.

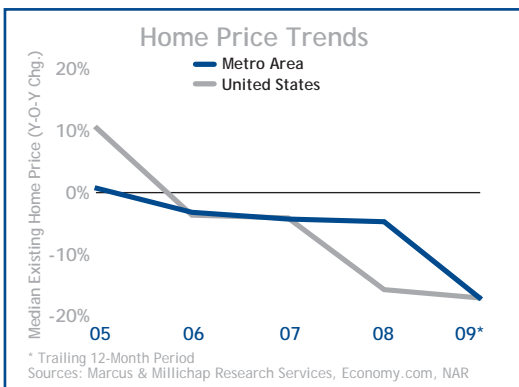


ECONOMY

- ◆ In the 12-month period ending in the second quarter, Cincinnati employers eliminated 43,900 positions, a 4.2 percent decline. In the previous year, 6,100 employees were let go.
- ◆ Nearly 40 percent of all job cuts that have occurred in the last year have been recorded in the manufacturing sector, which has shed 17,400 positions during that span. Alternately, hiring in the education and health services sector has been resilient, as approximately 900 employees have been added in the same stretch.
- ◆ The unemployment rate in Cincinnati ended the second quarter at 9.7 percent, 270 basis points higher than at the close of 2008 and 400 basis points more than a year earlier. Currently, unemployment in the metro is at the second lowest level in the state behind Columbus.
- ◆ **Outlook:** Work force reductions are forecast to total 48,000 jobs this year, a 4.7 percent decrease in payrolls. In 2008, 20,900 positions were trimmed.

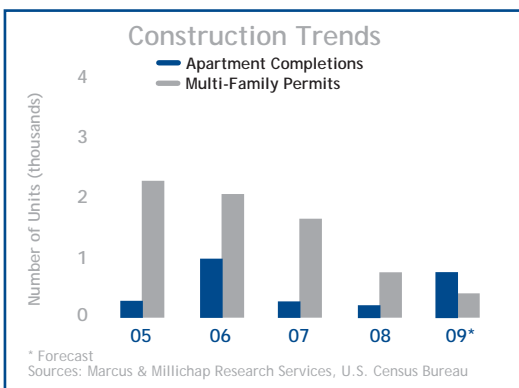
HOUSING AND DEMOGRAPHICS

- ◆ Permitting activity, an indicator of future residential supply, has waned in Cincinnati. In the second quarter, the number of single-family housing permits retreated 49 percent to an annualized 2,110 units, while the number of requests for multi-family permits plunged 70 percent to 400 units.
- ◆ Economic contraction continues to slow household creation and erode housing demand. Since the second quarter of 2008, the median home price has fallen 18 percent to \$109,970. The number of sales also decreased 9 percent during that span.
- ◆ Homeownership remains affordable to most Cincinnati households. The typical mortgage payment on the metro's median-priced home is \$644 per month, well below the average Class A asking rent of \$884 per month.
- ◆ **Outlook:** As evidenced by the number of existing home sales reaching an almost 10-year low, persistent layoffs and uncertainty regarding home values will prevent most renters from making the jump to homeownership.



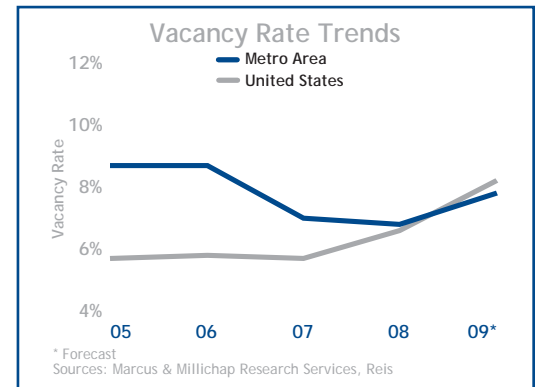
CONSTRUCTION

- ◆ Apartment construction efforts have surged over the past 12 months, as builders have brought online 890 units. In comparison, 70 units were added to inventory in the preceding year.
- ◆ Despite the reduction in housing demand due to economic stress, there are nine projects totaling more than 930 units in the planning pipeline. The Downtown submarket leads all other areas in the metro, with 770 units planned.
- ◆ Delivered in the first quarter, Shaker Point Apartments in Harrison will be the largest addition to stock this year. The 276-unit complex is located in the Highway 27/127 submarket.
- ◆ **Outlook:** Builders are on pace to expand Cincinnati apartment inventory by 720 units in 2009, more than the 170 units brought online last year but below the average of 920 units recorded annually since 2000.



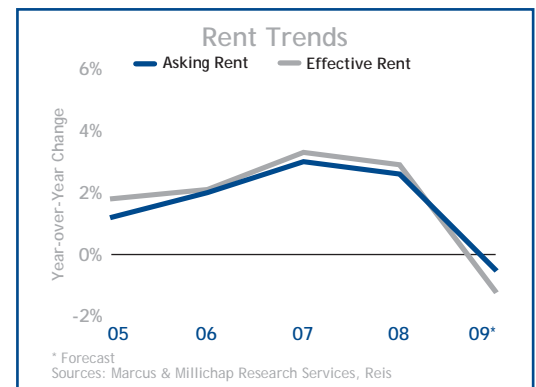
VACANCY

- ◆ Despite declining 30 basis points over the past three months, vacancy of 7.2 percent in the second quarter was 60 basis points higher than one year earlier. In the previous 12-month period, vacancy fell 110 basis points.
- ◆ Class A apartment vacancy is currently 6.3 percent. Although vacancy has fluctuated over the past year, the second quarter rate was only 10 basis points higher than 12 months ago.
- ◆ Reflecting large-scale blue-collar job cuts, vacancy in Class B/C properties has increased 80 basis points in the last year to 7.6 percent, after declining 100 basis points in the preceding 12 months.
- ◆ **Outlook:** Persistent employment losses and waning demand will underpin a 100 basis point rise in vacancy to 7.8 percent this year. In contrast, vacancy improved 20 basis points in 2008.



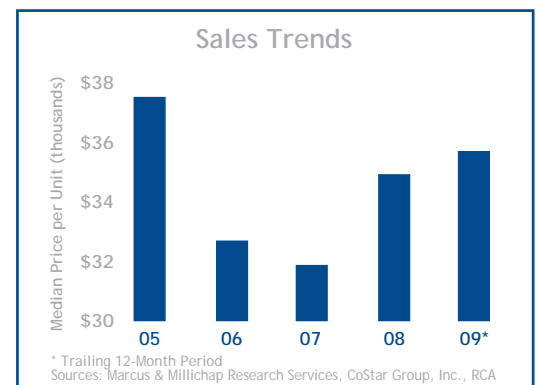
RENTS

- ◆ So far in 2009, asking and effective rents have dipped 0.1 percent and 0.6 percent to \$709 per month and \$668 per month, respectively. In the preceding six-month stretch, asking rents appreciated 1.1 percent, while effective rents climbed 1.2 percent.
- ◆ Class A asking rents inched downward 0.7 percent to \$893 per month during the first half of this year. Meanwhile, lower-tier asking rents have remained flat at \$614 per month, despite falling in the first quarter.
- ◆ Offsetting vacancy increases, resilient rents have preserved revenues in Cincinnati, as gross revenue have not changed over the past 12 months.
- ◆ **Outlook:** In 2009, asking rents are projected to dip 0.5 percent to \$706 per month, while effective rents will recede 1.2 percent to \$664 per month. Last year, asking and effective rents gained 2.9 percent rents and 3.1 percent, respectively.



SALES TRENDS**

- ◆ Apartment sales velocity has declined for the fourth consecutive 12-month period. The number of deals has fallen 47 percent in the most recent year, after a 14 percent decrease was recorded during the preceding stretch.
- ◆ Despite the slowdown in apartment transactions, the median sales price in Cincinnati has appreciated 7 percent to \$35,680 per unit in the past year. The increase is partially attributable to tighter lending standards that are slowing deal flow among lower-tier properties, thereby boosting the percentage of Class A assets sold.
- ◆ Although sales prices have risen, cap rates are climbing due to buyers' increased risk premiums. In the last 12 months, initial yields for most properties have ascended an average of 30 basis points to the high-8 percent range.
- ◆ **Outlook:** Operating fundamentals in Cincinnati have softened, but not to the extent of many metros, especially other Ohio and Midwestern markets. Nevertheless, economic concerns are pushing cap rates upward, potentially creating greater acquisition opportunities at higher initial yields.



** 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

- ◆ During the first quarter, multi-family mortgage originations were 61 percent below year-earlier levels and 79 percent lower than the late-2006 peak. Though considerable, the reduction in apartment originations remains less significant than declines among other core commercial property types, due largely to the availability of financing through Fannie Mae and Freddie Mac.
- ◆ Portfolio lenders are issuing apartment financing at all-in rates of 6.0 percent to 6.3 percent for three-year loans and up to 6.8 percent to 7.5 percent for a 10-year term. Loan-to-value requirements range from 55 percent to 75 percent.
- ◆ Agency lenders are offering five-year loans at all-in rates of 4.8 percent to 5.0 percent with 10-year mortgages available at rates averaging 5.35 percent and 5.7 percent, respectively. Maximum leverage among agency lenders ranges from 55 percent to 75 percent.
- ◆ Freddie Mac recently completed a \$1 billion securitization of multi-family debt, the first issuance to hit the market since last June. The securities, dubbed "K Certificates," vary from traditional CMBS in that buyers are provided a guarantee by Freddie Mac. In addition to the potential for another similar offering, government programs designed to increase credit flows into commercial real estate could be operational by late summer/early fall.

SUBMARKET OVERVIEW

- ◆ With apartment demand waning, operators in the Southeast submarket have utilized concessions to mitigate a rise in vacancy. Since the second quarter of 2008, vacancy in the area has improved 60 basis points to 5.3 percent, though concessions have risen 160 basis points to 7.1 percent of asking rents.
- ◆ Builders are cautiously moving forward on projects elsewhere in the Southeast, Southwest and Butler/Warren Counties submarkets, where between 45 units and 60 units each are tentatively slated.
- ◆ Supported by persistent demand for the small stock of Class A apartments in the Butler/Warren Counties submarket, area rents have been resilient. In the past 12 months, an effective rent increase of 2.7 percent has generated gross revenue growth of the same measure due to static vacancy.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Downtown	5.0%	-40	\$737	2.6%
2	Southeast	5.3%	-60	\$751	-2.2%
3	Northeast	5.4%	-120	\$857	2.0%
4	Butler/Warren Counties	6.6%	0	\$725	2.7%
5	Northern Kentucky	7.2%	140	\$673	1.1%
6	Clermont County	7.5%	140	\$587	0.3%
7	North	7.8%	120	\$702	0.9%
8	Blue Ash/Amberley	8.2%	190	\$675	-2.6%
9	Highway 27/127	8.2%	110	\$561	-0.7%
10	Southwest	8.9%	-20	\$531	-0.4%