Smaller Deals Getting Done in the Metroplex

Occupancy rates in the two major cities of the Metroplex are expected to merge this year for the first time since 2003. In Fort Worth, vacancy has begun to decline in response to rent adjustments by local owners. In Dallas, meanwhile, development is surging, with more deliveries on the way in the second half of the year. As a result, the 200 basis point gap in vacancy between the two MSAs has dissipated to 110 basis points as of mid-2009. With Class A vacancy pushing higher in Dallas due to supply-side pressure; the marketwide rate is expected to settle in the mid-9 percent range by year end. The resulting balance will force up concessions across the city as renter housing options escalate. A rebound in the local job market and declining development activity in 2010 will likely lead to a jump in household formation, pushing absorption rates higher and returning the market to a more localized competitive environment.

Local buyer activity will set the tone for the investment market during the next six months as some buyers move off the sidelines. Transaction velocity is significantly lower among out-of-state investors, especially from California, where deal flow slowed by 73 percent in the most recent 12-month period. The properties that are changing hands with outside capital are much more in line with traditional Texas-based deals, as older and smaller assets are trading. A combination of tight credit markets, which have made larger loans more difficult to obtain, and limited cash are the primary drivers for the shift. First-year yields, meanwhile, have ticked up to the mid-8 percent range for assets under contract and will likely stretch higher as the year progresses, as listings include considerable deferred maintenance. Nonetheless, the local investment climate is expected to be one of the first to rebound as the credit markets thaw, due primarily to low per-door prices and robust population growth.

2009 Annual Apartment Forecast

2.5% decrease in total employment

Employment: Payrolls are expected to retract by 73,000 jobs in 2009, an annual decline of 2.5 percent. Last year, 2,400 positions were created in the Metroplex, despite deep cuts in the fourth quarter.

15,500 units will be completed

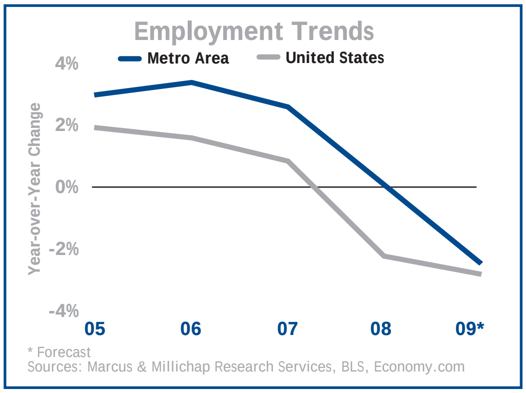
Construction: Developers are ramping up construction this year, adding 15,500 apartments to the Metroplex. Completions represent a 2.9 percent increase to existing stock.

230 basis point increase in vacancy

Vacancy: In 2009, a significant wave of new development will be the primary driver of a 230 basis point increase in vacancy to 9.6 percent. Last year, vacancy rose 120 basis points.

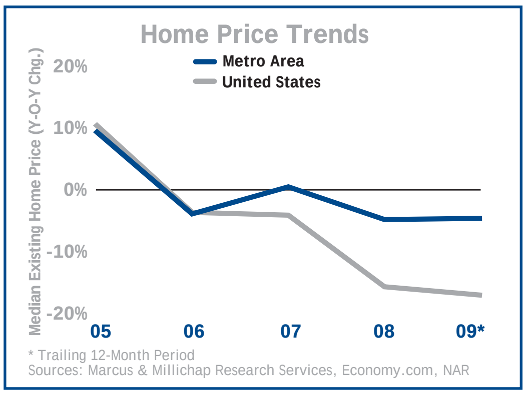
0.9% decrease in asking rents

Rents: Asking rents are forecast to end 2009 at $780 per month, a 0.9 percent decline, while effective rents slip 3.1 percent to $697 per month.



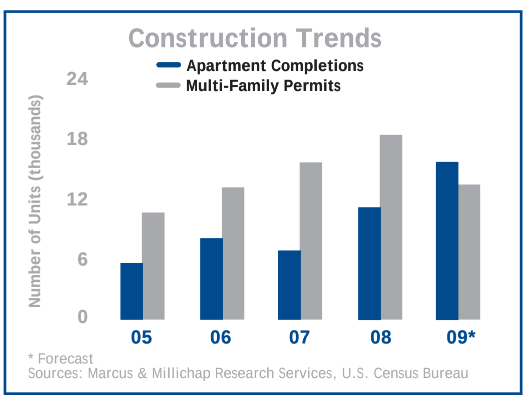
Economy

- Employers in the Metroplex slashed 44,800 jobs in the first six months of the year due to the deteriorating local economy. Year over year, payrolls have slipped by 58,100 positions, a 1.9 percent decline.
- The professional and business services sector has been the largest drag on employment rosters lately, shedding 20,400 jobs in the first half of 2009. Most of the local Fortune 500 companies headquartered in the area have stalled expansion plans, reducing their need for support services.
- Businesses reduced head counts by 12,100 workers in the second quarter, compared to 32,700 cuts during the first three months of the year, indicating that the market could begin to stabilize by year-end 2009.
- **Outlook:** Payrolls are expected to retract by 73,000 jobs in 2009, an annual decline of 2.5 percent. Last year, 2,400 positions were created in the Metroplex, despite deep cuts in the fourth quarter.



Housing and Demographics

- Over the past year, developers have pulled 14,000 permits for single-family homes in the Metroplex, a 39 percent decrease from the previous 12-month period. Multi-family permitting activity, which includes condos, has dropped 26 percent to 13,200 units.
- Home prices in the market have been more resilient than those of the nation, slipping just 4.6 percent year over year to $138,900 in the second quarter. Despite a 2 percent dip, the median household income of $55,900 annually is 43 percent higher than the minimum qualifying income.
- Using typical financing methods, current mortgage obligations are $88 per month less than the average Class A asking rent. Top-tier rents have been moderately higher than mortgage payments for three consecutive quarters.
- **Outlook:** Changes in home values will have a muffled effect on apartment demand in the Dallas/Fort Worth area. Since a steep increase in market-wide prices never materialized, the modest correction is unlikely to lure a significant number of renters into ownership.

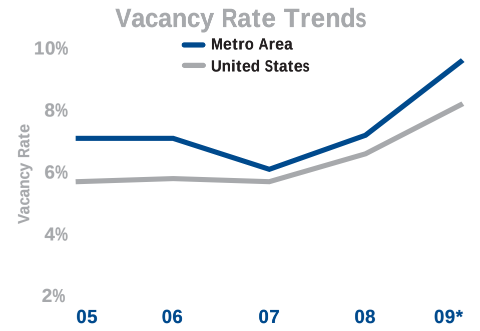


Construction

- During the 12-month period ending in the second quarter, builders completed 9,700 apartment units, a 1.8 percent expansion of stock. Over the last five years, annual deliveries have averaged 7,400 units.
- Nearly 16,000 units are under construction in the area, including 5,000 units in the Plano/Allen/McKinney submarket. The planning pipeline contains 11,000 apartments, indicating that the current building boom should ease in the next 12 months.
- Supply-side pressure will be focused on the eastern half of the metro this year. Tarrant County is scheduled to receive only 2,000 units in 2009, a modest 1.3 percent increase to inventory.
- **Outlook:** Developers are ramping up construction this year, adding 15,500 apartments to the Metroplex. Completions represent a 2.9 percent expansion of existing stock.

Vacancy

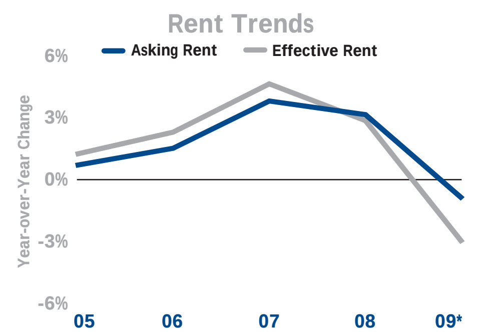
- Vacancy reached 8.3 percent in the second quarter, an increase of 170 basis points over the past 12 months. Year to date, vacancy has jumped 100 basis points due to new supply and waning demand.
- In the Class A segment, vacancy has climbed 210 basis points in the last year to 7.9 percent, including a 140 basis point rise since year-end 2008. Class B/C vacancy, which has been affected by job losses, has advanced 90 basis points year to date to 8.7 percent.
- New stock has created opposing vacancy trends in the Metroplex. During the second quarter, the rate dropped 40 basis points in Fort Worth to 9.1 percent, while pushing up 80 basis points to 8 percent in Dallas.
- **Outlook:** In 2009, a significant wave of new development will be the primary driver of a 230 basis point increase in vacancy to 9.6 percent. Last year, vacancy rose 120 basis points.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Rents

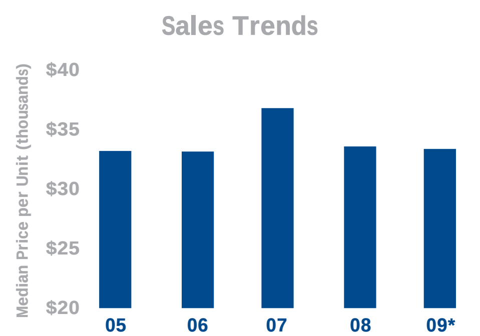
- Apartment owners began widening concessions during the first half of the year to combat falling occupancy. In that time, asking rents ticked up 0.5 percent to $791 per month, and effective rents slipped 0.3 percent to $717 per month.
- Class A asking rents were $967 per month in the second quarter, a year to date gain of 0.6 percent, while Class B/C asking rents were $637 per month, unchanged since during the first two quarters.
- Asking rents in Dallas increased 0.5 percent in the second quarter to $820 per month, partially due to the addition of new Class A stock. In Fort Worth, asking rents dipped 0.3 percent as owners attempted to fill vacant units.
- **Outlook:** Asking rents are forecast to end 2009 at $780 per month, a 0.9 percent decline, while effective rents slip 3.1 percent to $697 per month.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Sales Trends**

- Sales velocity fell 57 percent in the most recent 12-month period. Deal flow among local buyers dropped only 41 percent in that time, as some capital moved off the sidelines in the wake of higher cap rates.
- The median sales price has decreased 19 percent over the past year to $28,700 per unit. Buyers are targeting much smaller properties, as the average property size that changed hands during that period decreased 45 percent to 140 units.
- Since the beginning of the year, average cap rates have been in the high-7 percent range, with several deals closing above 8 percent. Assets currently in escrow are trading in the mid-8 percent range.
- **Outlook:** Buyers are seeking deals with a short-term cash flow horizon. As a result, top-tier properties will remain the slowest movers in the Metroplex, while stabilized Class B assets should attract investor attention if they are priced reasonably.



* 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.*

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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 Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Northwest Denton County	5.8%	20	$813	1.9%
2	North	6.1%	20	$773	2.2%
3	Far North	6.8%	220	$747	-0.1%
4	Oaklawn/Uptown/CBD	6.8%	-40	$1,071	-4.7%
5	Lewisville	7.2%	110	$792	-0.3%
6	Carrollton/Addison/Coppell	7.5%	290	$742	-0.5%
7	South Irving	7.6%	280	$624	0.8%
8	Garland	7.9%	170	$661	-1.2%
9	Hurst/Bedford/Euless	7.9%	110	$712	-0.6%
10	Mesquite/Seagoville	8.0%	180	$653	0.2%
11	Grapevine	8.0%	140	$795	-0.9%
12	Richardson	8.3%	230	$779	2.6%
13	Northwest Dallas	8.4%	-20	$708	-2.2%
14	Far Northwest/Farmers Branch	8.5%	80	$629	0.8%
15	Southeast Tarrant County	8.6%	120	$697	0.7%
16	South Dallas County	8.8%	-230	$661	2.2%
17	Grand Prairie	9.3%	-170	$626	-1.4%
18	North Irving	9.7%	70	$786	0.8%
19	Southwest Dallas	10.0%	230	$612	-0.2%
20	Plano/Allen/McKinney	10.0%	170	$854	0.2%
21	Southeast Dallas	10.4%	50	$522	0.6%
22	Southwest Fort Worth	10.5%	190	$648	0.3%
23	Central Arlington	10.8%	-30	$534	-1.8%
24	North Arlington	10.8%	220	$620	-1.4%
25	North White Rock	10.9%	260	$611	2.7%
26	East Fort Worth	12.1%	-130	$510	-1.9%
27	Northern Tarrant County	12.5%	270	$727	0.0%
28	Far Northeast Dallas	12.7%	80	$557	-1.2%
29	South White Rock/I-30	12.8%	150	$559	-0.9%
30	South Dallas	12.8%	-180	$682	-1.9%
31	East Dallas	13.1%	660	$757	4.6%
32	Northwest Fort Worth	13.2%	500	$710	3.0%
33	Central Dallas	14.4%	200	$1,634	3.4%