

# ApartmentResearch

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

Marcus & Millichap

Kansas City Metro Area

Third Quarter 2009

## MIDDLE-TIER ASSETS EXPECTED TO POST HEALTHIEST CONDITIONS

The apartment market in Kansas City is expected to remain relatively weak through the rest of 2009 as ongoing job losses soften operating conditions. While one-bedroom apartments received the most tenant demand in recent years, when overall economic metrics were robust, many renters are now targeting two-bedroom units for the purpose of doubling up to cut costs. This trend will greatly impact the metro's Class C assets, particularly in areas where traditionally lower-paying industries are concentrated, like the Raytown and Southwest Kansas City submarkets. Fundamentals in Class A properties, meanwhile, have declined at a more rapid pace than in the lower tiers recently, due in large part to falling home values, available FHA financing and first-time homebuyer tax credits thinning the size of the upper-tier renter pool. As a result, Class B conditions are expected to remain the strongest this year, especially in high-demand suburban areas such as Olathe and Overland Park. Middle-tier vacancy rates in these locations have improved over the last year and will likely stay among the tightest in the metro through the second half of 2009.

Kansas City largely avoided the drastic price run-up in recent years, which has mitigated many owners' need to sell and thinned the pool of conventional and traditional product on the market. While offerings of well-performing properties are projected to remain limited in the coming quarters, the number of distressed complexes is forecast to tick up and help to drive overall sales activity. Investors are expected to remain attracted to distressed listings, as most of these assets are trading at discounts, which facilitates cash purchases and alleviates much of the need to obtain financing, especially as the credit markets continue to be sluggish. Local buyers are expressing the greatest interest in distressed properties, and activity involving these assets will likely be concentrated in lower-income areas like Jackson County, where the number of these listings is expected to outpace that in other parts of the metro.

## 2009 ANNUAL APARTMENT FORECAST



**Employment:** After payrolls remained level in 2008, employers are expected to trim head counts by 3.4 percent this year through the loss of nearly 34,500 jobs. Cuts are projected to be heaviest in the professional and business services and trade, transportation and utilities sectors.



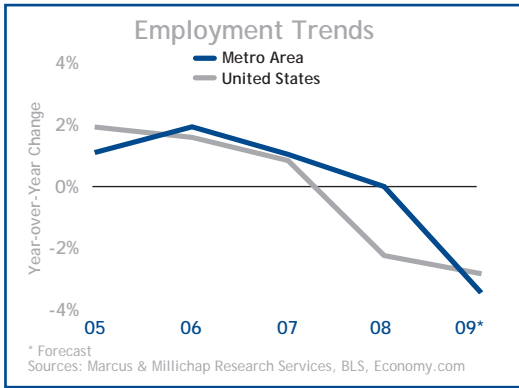
**Construction:** Despite easing demand, completions are on pace to accelerate. Following the addition of 500 units last year, approximately 930 apartments are slated to come online in 2009, a 0.8 percent increase in inventory.



**Vacancy:** Increasing supply-side pressure and ongoing job losses are forecast to push up vacancy 120 basis points to 8.9 percent this year. In 2008, vacancy rose 100 basis points.



**Rents:** Rents are projected to fall in 2009 as owners attempt to counteract rising vacancy. Asking rents are expected to decline to \$691 per month while effective rents drop to \$640 per month, contractions of 1.4 percent and 2.5 percent, respectively.

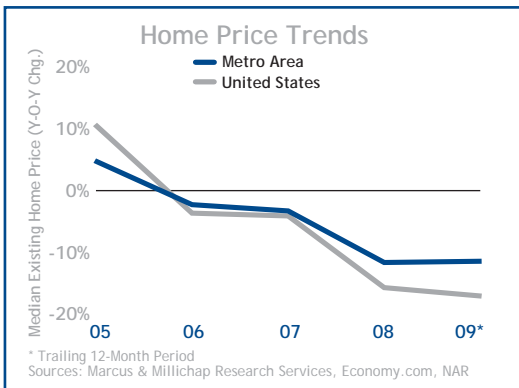


## ECONOMY

- ◆ The labor market in Kansas City began to contract earlier this year. Over the last 12 months, roughly 23,000 jobs have been cut, thinning payrolls by 2.3 percent, following a 0.6 percent gain in the preceding 12-month period.
- ◆ The construction and manufacturing industries have posted the largest job losses during the past year. Construction employers have shed 6,600 spots in that time, or a 13.6 percent decline, while 6,900 manufacturing positions were trimmed, marking a decrease of 8.5 percent.
- ◆ Chrysler Financial recently announced plans to close its call center in Overland Park. The shuttering will eliminate 240 traditionally lower-paying positions, potentially affecting Class B/C apartment demand in the area.
- ◆ **Outlook:** After payrolls remained level in 2008, employers are expected to trim head counts by 3.4 percent this year through the loss of nearly 34,500 jobs.

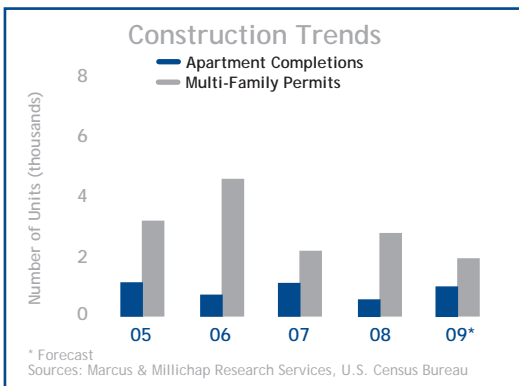
## HOUSING AND DEMOGRAPHICS

- ◆ The pace of permit applications is easing as demand for both single- and multi-family housing wanes due to weak labor conditions. During the last year, single-family permit issuance has slowed 64 percent to 1,480 units, while 1,830 multi-family permits have been pulled, a 34 percent decline.
- ◆ The median home price was \$131,500 in the second quarter, down 11.4 percent from one year earlier. While income levels dropped 9.1 percent during that stretch, they are still nearly 50 percent higher than the amount required to qualify for a mortgage on a median-priced home.
- ◆ Given relatively low home prices, upper-tier rents currently exceed the typical mortgage obligations for a median-priced home by approximately \$35 per month.
- ◆ **Outlook:** Household creation is slowing, and permit issuance is falling rapidly. These trends will facilitate a balance between housing supply and demand in the coming quarters, which will allow for apartment fundamentals to firm.



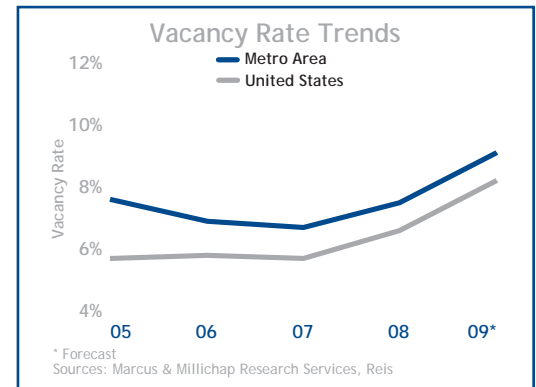
## CONSTRUCTION

- ◆ Completions have ramped up since the start of the year. During the past 12 months, developers have added 860 units to metro inventory; nearly 580 apartments came online in the previous year.
- ◆ There are approximately 420 units under way throughout the metro, including the 329-unit Market Station project in the Downtown/East Kansas City submarket. This complex is slated to open in the fourth quarter as part of the redevelopment of the River Market neighborhood.
- ◆ The planning pipeline contains 5,180 units, 62 percent more than one year ago. Developers are focused on the Downtown/East Kansas City and Overland Park South submarkets due to their consistent renter demand, with each area slated to receive 22 percent of the metro's planned units.
- ◆ **Outlook:** Despite easing demand, completions are on pace to accelerate. Following the addition of 500 units last year, approximately 930 apartments are slated to come online in 2009, a 0.8 percent increase in inventory.



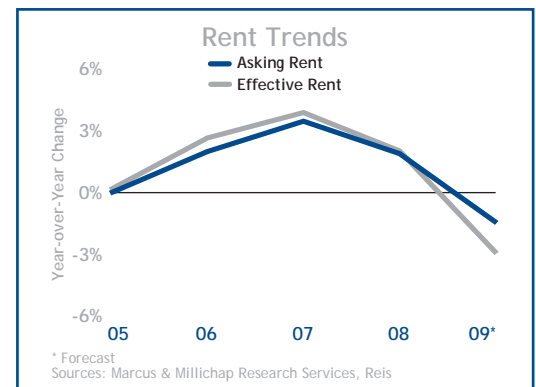
## VACANCY

- Due largely to employment cuts, vacancy reached 8.2 percent in the second quarter, 120 basis points higher than one year earlier but down 40 basis points from the first three months of the year.
- Vacancy in the metro's Class A segment was 7.5 percent in the second quarter, an annual hike of 170 basis points. Some upper-tier renters are taking advantage of tax credits and falling home values to transition into ownership, while others are seeking more affordable living options.
- As cost-consciousness increases, Class B/C vacancy is outperforming vacancy in the top tier. During the last year, vacancy in the lower tiers has risen 80 basis points to 8.6 percent. The rate was down 40 basis points from the first quarter, however, driven primarily by steady conditions in Class B properties.
- Outlook:** Increasing supply-side pressure and ongoing job losses are forecast to push up vacancy 120 basis points to 8.9 percent this year. In 2008, vacancy rose 100 basis points.



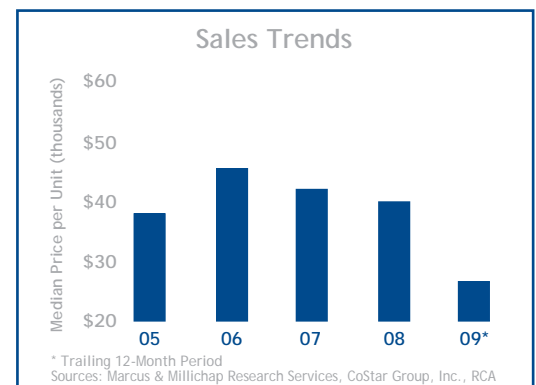
## RENTS

- Owners have been reluctant to enact asking rent reductions, choosing instead to raise concessions. Asking rents ended the second quarter at \$701 per month, 0.3 percent higher than the same period last year. Effective rents, on the other hand, declined 0.5 percent to \$651 per month.
- Class A asking rents slipped 0.2 percent year over year through the second quarter to \$815 per month. Asking rents in the lower tiers, however, advanced 0.6 percent to \$625 per month.
- The large jump in vacancy resulted in a 1.8 percent annual contraction in revenues, the steepest decline in six years. Revenues gained 3.4 percent in the previous 12-month span.
- Outlook:** Rents are projected to fall in 2009 as owners attempt to counteract rising vacancy. Asking rents are expected to decline to \$691 per month while effective rents drop to \$640 per month, contractions of 1.4 percent and 2.5 percent, respectively.



## SALES TRENDS\*\*

- Investors' elevated concerns regarding weakened fundamentals and ongoing difficulty obtaining financing cooled transaction velocity by 22 percent during the most recent 12-month period.
- With a higher number of less stabilized listings, or properties with deferred maintenance issues, coming on the market, the median sales price has dropped 30 percent in the last year to roughly \$26,600 per unit.
- Cap rates for the metro's Class A properties are currently in the mid-7 percent range, while Class B assets are trading in the mid- to high-8 percent area. Class C complexes, meanwhile, typically close with per-door pricing.
- Outlook:** Investors seeking assets that will likely withstand recessionary pressures are targeting listings in northern Johnson County. Buyers who are searching for value-add or repositioning plays may find opportunities in the CBD or Plaza areas of the Downtown/East Kansas City submarket, where renter demand is expected to mount in the coming years.



\*\* 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

- ◆ Owners in the Platte submarket have recorded a 7 percent year-over-year decrease in revenues, the largest contraction in the metro, driven largely by a 3.6 percent decline in effective rents during that time.
- ◆ There are currently 400 condos planned for the Merriam/Mission/Prairie Village submarket, nearly half of which are slated to break ground in the third quarter. Some of these units may be employed as rentals upon completion, however, which would increase apartment competition in the area.
- ◆ City officials in Shawnee recently unveiled a program to attract additional employment centers and commercial construction by giving tax abatements to developers who sign leases from bioscience companies. As a result, apartment demand in the Shawnee/Lenexa submarket will likely increase in the coming years.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Olathe/Gardner	4.7%	-10	\$608	-2.4%
2	North Kansas City	5.0%	20	\$588	0.3%
3	Lee's Summit/Prairie	6.0%	-180	\$616	0.0%
4	Overland Park South	6.5%	30	\$848	-0.6%
5	Grandview/Far South	6.7%	100	\$616	1.7%
6	Overland Park North	6.7%	100	\$759	6.0%
7	Independence	7.1%	-20	\$592	-2.0%
8	Downtown/East Kansas City	7.5%	-160	\$630	-3.8%
9	Merriam/Mission/Prairie Village	7.6%	200	\$645	-0.9%
10	Shawnee/Lenexa	7.8%	260	\$694	-2.8%