

DESPITE RISING COMPLETIONS, VACANCY TO REMAIN TIGHT

Vacancy in the Milwaukee apartment market is forecast to exceed 5 percent this year for the first time since mid-2006 due to elevated construction and ongoing job losses. As the manufacturing and trade, transportation and utilities sectors, which comprise the largest portion of metro payrolls, continue posting losses, demand for apartments is expected to deteriorate during the second half of the year. As a result, owners are increasing incentives to attract tenants; concessions of 4.6 percent of asking rents in the second quarter were up from just under 4 percent of asking rents one year earlier and are expected to be higher than 5 percent of asking rents by early 2010. Pressure to raise incentives will also be derived from the increased competition generated by new deliveries. Developers are scheduled to add the highest number of apartment units this decade, nearly all of which are concentrated in close-in areas. As such, conditions in the City East and City West submarkets are expected to lag those in outlying suburbs through the second half of the year.

Transaction velocity in Milwaukee has slowed recently due to fewer listings, as many owners are opting to hold through the recession. This factor has coincided with a reduction in the number of buyers in the market, keeping cap rates relatively consistent over the last year. Initial yields are expected to creep higher in the coming months, however, as refinancing issues mount, which will ultimately produce an uptick in the number of distressed offerings. Owners who are currently looking to sell have lowered prices in response to waning demand, luring some buyers off the sidelines. Nonetheless, valuations will likely drop as a result of weakened conditions and distressed assets coming to market. Some investors, meanwhile, are targeting affordable housing; renter demand for this property class is increasing, and with job losses among Class C/D renters forecast to persist through the near term, these assets will likely continue to offer steady cash flow.

2009 ANNUAL APARTMENT FORECAST



Employment: While employment in Milwaukee will remain soft, losses are projected to moderate. Slightly more than 44,000 jobs are expected to be cut this year, a payroll decrease of 5.3 percent, following a 2.2 percent decline in 2008.



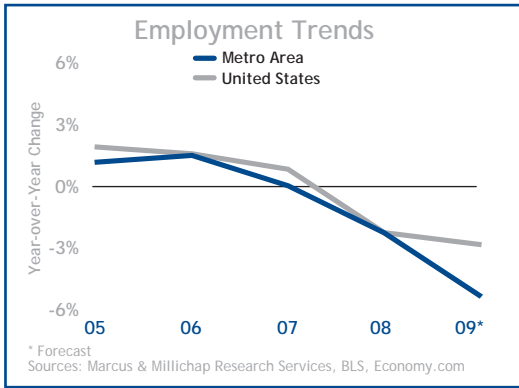
Construction: Completions are on pace to accelerate, as 545 units are slated to come online in 2009, well above the 230 units delivered last year and more than double the five-year annual average.



Vacancy: The renter pool is being thinned by job losses and the implementation of tax credits for first-time homebuyers. As such, apartment vacancy is forecast to reach 5.4 percent this year, 170 basis points higher than in 2008, when vacancy improved 40 basis points.

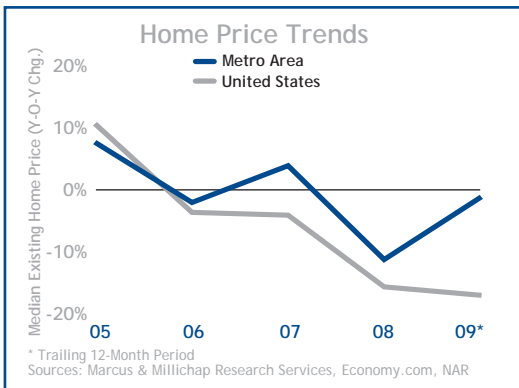


Rents: Rents in the Milwaukee metro are expected to fall to pre-2007 levels this year. Asking rents are projected to end 2009 at \$824 per month, 2 percent lower than last year, and effective rents are forecast to drop 3.1 percent to \$782 per month.



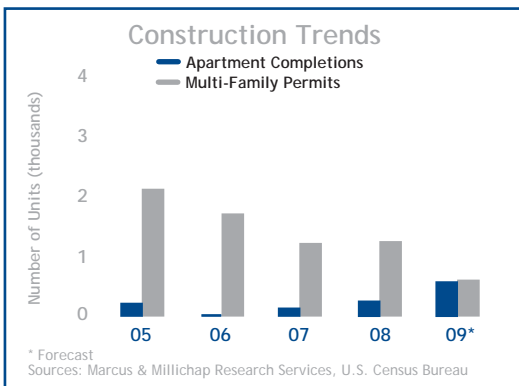
ECONOMY

- ◆ During the last 12 months, Milwaukee-area employers have eliminated approximately 47,000 jobs, a 5.5 percent contraction and the steepest annual decline since 1982. Losses accelerated in the first six months of the year, as 29,600 spots were trimmed.
- ◆ Ongoing weakness in the trade, transportation and utilities segment continues to weigh on the local labor market. This sector has been thinned by 6.5 percent in the last year with the loss of 9,900 positions.
- ◆ Highlighting the metro's manufacturing sector struggles is the recent announcement of additional layoffs by locally based Harley-Davidson Inc. The company plans to eliminate 380 line workers and roughly 100 salaried employees in the coming months.
- ◆ **Outlook:** While employment in Milwaukee will remain soft, losses are projected to moderate. Slightly more than 44,000 jobs are expected to be cut this year, a payroll decrease of 5.3 percent, following a 2.2 percent decline in 2008.



HOUSING AND DEMOGRAPHICS

- ◆ Difficulty obtaining construction loans and waning demand have slowed permitting activity. Permits for roughly 695 single-family units have been issued over the past year, while developers have pulled permits for 670 multi-family units, declines of 59 percent and 53 percent, respectively.
- ◆ Home prices in Milwaukee appear to be stabilizing, as the median price slipped only 1.3 percent in the last year to \$210,600 in the second quarter. Income levels, however, dropped 5.4 percent during that span, causing a \$5,100 shortfall in the income needed to finance a median-priced home.
- ◆ Using traditional financing methods, the typical mortgage payment for a median-priced residence in Milwaukee is \$135 per month more than the average Class A asking rent.
- ◆ **Outlook:** Despite persistent job losses, household creation remains relatively healthy. This trend, coupled with a dramatic drop-off in permit issuance, will help apartment demand to outpace supply in the coming years.

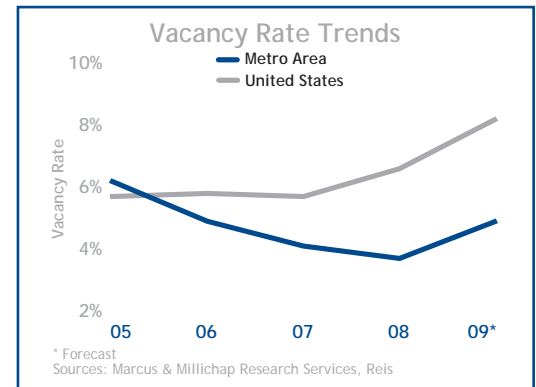


CONSTRUCTION

- ◆ Marketwide inventory has increased by 0.5 percent in the last year with the completion of just over 500 units, after only 55 apartments were delivered in the previous 12-month period.
- ◆ Construction activity remains relatively robust, despite weak demand. Developers have 980 units under way throughout the metro, more than half of which are being built in the City East and City West submarkets.
- ◆ While builders are focusing on core areas, the suburban Wauwatosa/West Allis submarket received this year's largest project in the second quarter. The first phase of the Six Points complex, located at 6516 W. National Road in West Allis, added 178 units to local stock.
- ◆ **Outlook:** Completions are on pace to accelerate, as 545 units are slated to come online in 2009, well above the 230 units delivered last year and more than double the five-year annual average.

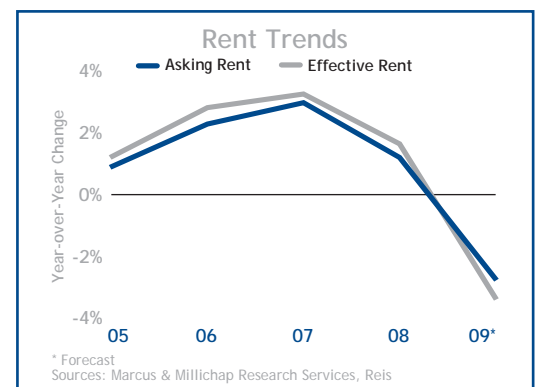
VACANCY

- ◆ Despite an improvement in the second half of last year, vacancy has increased 80 basis points year over year to 4.9 percent due to the recent spike in completions and waning renter demand. The rate is currently 120 basis points higher than at the end of 2008.
- ◆ The metro's relatively small inventory of Class A properties is prone to large swings in vacancy. Over the last year, vacancy in the upper tier has climbed 160 basis points to 5.2 percent and is 80 basis points higher than in the first three months of 2009.
- ◆ Increased cost-consciousness has kept Class B/C vacancy relatively tight, ticking up 50 basis points during the past 12 months to 4.8 percent.
- ◆ **Outlook:** The renter pool is being thinned by job losses. As a result, apartment vacancy is forecast to reach 5.4 percent this year, 170 basis points higher than in 2008, when vacancy improved 40 basis points.



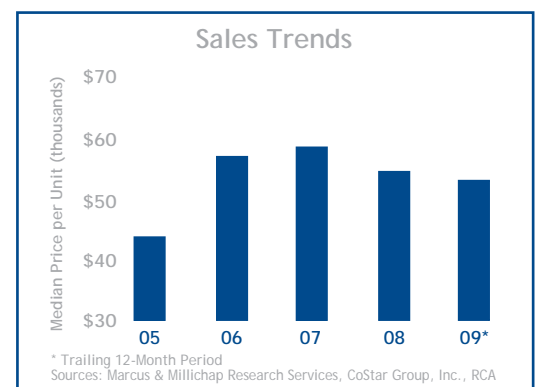
RENTS

- ◆ Owners began to drop rents and increase concessions earlier this year to counteract rising vacancy. Asking rents fell to \$832 per month in the second quarter, 1.7 percent lower than one year earlier, while effective rents slipped 2.3 percent to \$793 per month.
- ◆ Class A asking rents are \$1,056 per month, a year-over-year decline of 1.9 percent, while Class B/C asking rents have dropped 1.6 percent over that span to \$749 per month.
- ◆ The recent rise in vacancy played a large role in the 4.6 percent contraction of revenues during the last year. In the previous 12-month period, revenues dropped 4 percent.
- ◆ **Outlook:** Asking rents are projected to end 2009 at \$824 per month, 2 percent lower than last year, and effective rents are forecast to drop 3.1 percent to \$782 per month.



SALES TRENDS**

- ◆ While transaction velocity during the most recent 12-month span is similar to the previous year, deal flow has slowed recently. Sales activity in the first half of this year was down 31 percent when compared to the first six months of 2008.
- ◆ Flight-to-safety strategies have contributed to a 5 percent year-over-year increase in the median sales price to \$52,500 per unit. In the coming quarters, however, the number of distressed and REO listings is expected to rise, which will put upward pressure on cap rates and weigh down prices.
- ◆ Cap rates for Class A assets are currently in the high-7 percent range. Class B/C properties, meanwhile, are trading with initial yields approaching 10 percent, though some recent transactions involving lower-tier complexes have closed with cap rates nearing 12 percent.
- ◆ **Outlook:** Buyers have started to target the Juneau Town area in the City East submarket and assets near Interstate 94 in the City West submarket, as traditionally elevated prices in both areas have dipped recently due to weakened conditions, though renter demand in these locations is expected to rebound once economic conditions firm.



** 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

- ◆ Consistently tight occupancy levels in the Brookfield/New Berlin submarket have allowed owners to maintain rent growth while neighboring submarkets enact reductions. As such, area owners have recorded a 3 percent annual gain in revenues, the largest revenue advance in the metro.
- ◆ Investors should monitor future construction activity in the City East submarket. Developers have 630 apartments and 860 for-sale units in the planning pipeline, some of which may be employed as rentals upon completion.
- ◆ Plans were recently announced for a business park at the corner of Howell Avenue and Oakwood Road in the Cudahy/South Milwaukee/Oak Creek submarket. The 250-acre site is scheduled to include office buildings and a new school, which will likely generate increased apartment demand in the coming years.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	West Waukesha County	2.9%	30	\$789	-2.6%
2	Brookfield/New Berlin	3.1%	50	\$949	3.5%
3	Cudahy/South Milwaukee/Oak Creek	3.6%	0	\$746	0.3%
4	Greenfield/Greendale/Franklin	3.8%	30	\$689	-6.5%
5	City East	5.7%	90	\$1,050	-4.2%
6	Northshore/Northwest Milwaukee	6.2%	-20	\$790	-4.2%
7	Wauwatosa/West Allis	6.3%	360	\$749	2.6%
8	City West	7.8%	200	\$680	-1.3%