

SUBMARKETS PROXIMATE TO CENTER CITY OUTPERFORMING METRO

Despite a reduction in deliveries, job losses continue to moderate operations in the Philadelphia apartment market, further pushing up vacancy rates. Manufacturing cuts due to auto industry-related closures, along with considerable staff reductions within the professional and business services sector, are expected to weigh heavily on employment through year end, accounting for nearly 40 percent of all job losses in the metro. On the supply side, development activity will fall nearly 67 percent below the five-year average due to conservative near-term market expectations and more controlled construction financing. Close-in submarkets with above-average occupancy levels and generally higher tenant demand, such as the Main Line and Center City, will receive the majority of this year's new units. Even with curtailed construction activity, vacancy marketwide is projected to tick higher in all property segments due to weaker employment, although Class B/C assets are expected to operate at tighter vacancy levels than their top-tier counterparts as residents opt for more affordable housing alternatives. Softer renter demand is driving an increase in concessions; leasing incentives are forecast to rise to 4.5 percent of asking rents by year end, up from 3.8 percent of asking rents at the close of 2008 and the highest level this decade.

The outlook for the local investment market will remain conservative in the near term due to weaker operations and tighter underwriting. Declining investor demand and projections for higher vacancy rates and increased concessions are driving up cap rates. Over the past year, initial yields for well-located, stable Class A properties have averaged in the high-6 percent to low-7 percent range, while Class B assets have sold in the high-7 percent to low-8 percent range, up about 50 basis points from a year ago. Owners looking for exit strategies should consider selling properties at higher initial yields to meet buyers' expectations for rising cap rates. More Class B/C properties are expected to reach the market, as challenging operations are driving some owners to seek exit strategies. Stabilized assets, meanwhile, are receiving more favorable financing through Freddie and Fanny Mae.

2009 ANNUAL APARTMENT FORECAST



Employment: Total employment is expected to decline by 2.8 percent, or 79,000 positions, this year due to reductions in the professional and business services and manufacturing sectors. In 2008, 46,100 jobs were eliminated.



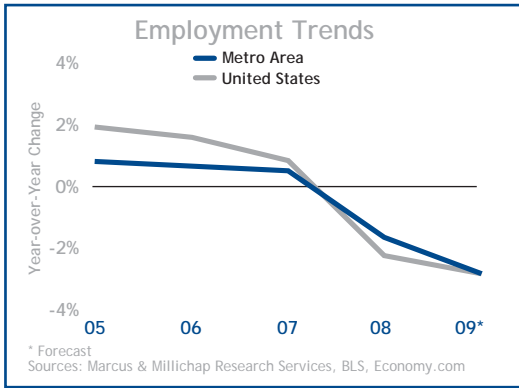
Construction: In response to waning renter demand, developers are decreasing completions in 2009 by approximately 55 percent to 600 units, a 0.3 percent addition to stock.



Vacancy: Despite a reduction in development activity, employment losses will weaken demand for apartments, causing vacancy to rise 110 basis points to 6.8 percent this year. In 2008, vacancy increased 150 basis points.

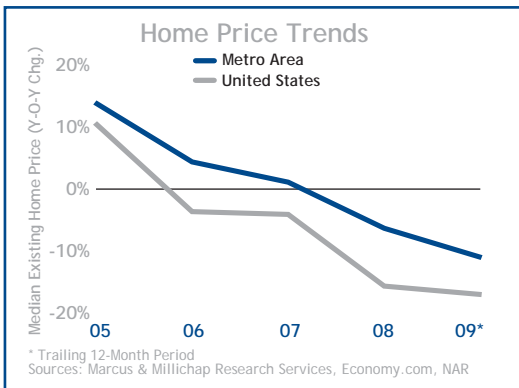


Rents: Asking rents are forecast to drop 1.7 percent to \$1,006 per month in 2009, while effective rents are expected to decline 2.4 percent to \$960 per month.



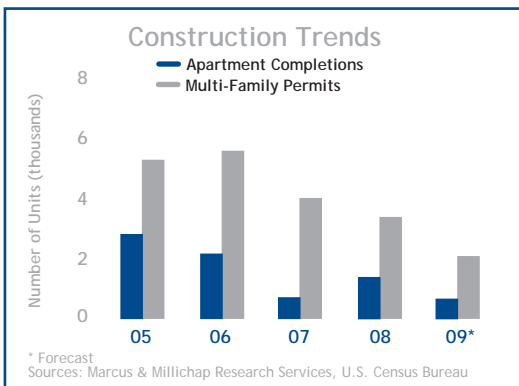
ECONOMY

- ◆ Due to major cuts in the professional and business services and trade, transportation and utilities sectors, total employment declined by 12,400 positions in the second quarter, down from 34,700 jobs in the first quarter. Year over year, payrolls have contracted 3.2 percent, or by 89,200 positions.
- ◆ A strong higher-education presence within the Philadelphia metro continues to drive job growth in the education and health services sector. Nearly 4,300 new hires have been added in this segment over the past year, after 12,000 positions were created in the previous 12 months.
- ◆ As of the second quarter, the local unemployment rate was 8.5 percent, the highest rate since the third quarter of 1992. Forecasts point to rising unemployment through year end.
- ◆ **Outlook:** Total employment is expected to decline by 2.8 percent, or 79,000 positions, this year due to reductions in the professional and business services and manufacturing sectors. In 2008, 46,100 jobs were eliminated.



HOUSING AND DEMOGRAPHICS

- ◆ Over the year ending in the second quarter, permits for 2,200 units of multi-family housing were issued, down from 3,900 units 12 months earlier. Permits for single-family housing declined nearly 42 percent during the most recent stretch to 4,800 units.
- ◆ The median price of a single-family home in Philadelphia was estimated at \$203,600 in the second quarter, a year-over-year drop of 11 percent. Single-family home sales have increased 8 percent in the past year.
- ◆ The metro's median household income of \$57,800 per year is 17 percent greater than the income needed to meet the monthly mortgage obligations on a median-priced residence.
- ◆ **Outlook:** Although homes remain relatively affordable, single-family price volatility and conservative mortgage lending will continue to support demand for Philadelphia apartments.

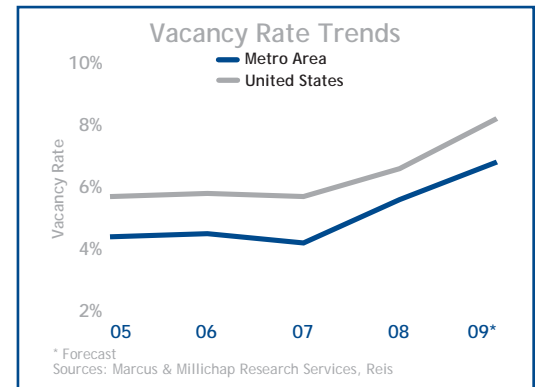


CONSTRUCTION

- ◆ Philadelphia's apartment stock has increased by 1,400 units over the past year, or 0.7 percent. In the previous 12-month period, 720 apartments were added in the metro.
- ◆ Approximately 3,000 apartment units are planned in the market, although no start dates have been set for any of the projects. In addition, nearly 3,000 condos are slated for delivery this year. Year to date, 1,400 condos have been completed, though some of these units are expected to enter the shadow rental market due to weak for-sale conditions.
- ◆ The largest addition to stock since the beginning of the year occurred in the Center City submarket, where approximately 155 units were brought online. Developers continue to target high-demand areas of the market that will maintain renter demand, despite moderating economic conditions.
- ◆ **Outlook:** In response to waning renter demand, developers are decreasing completions in 2009 by approximately 55 percent to 600 units, a 0.3 percent addition to stock.

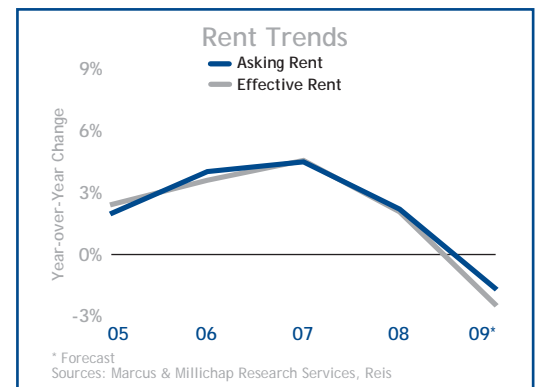
VACANCY

- ◆ The marketwide vacancy rate of 6 percent in the second quarter was down 30 basis points from the previous quarter but 140 basis points higher than during the second quarter of 2008.
- ◆ Despite more affordable housing, ongoing job losses within the professional and business services sector have resulted in Class A vacancy rising 190 basis points to 6.9 percent in the past year.
- ◆ Vacancy in the Class B/C sector was 5.2 percent in the second quarter, up 100 basis points from the same period in 2008 but down 30 basis points during the last three months.
- ◆ **Outlook:** Despite a reduction in development activity, employment losses will weaken demand for apartments, causing vacancy to rise 110 basis points to 6.8 percent this year. In 2008, vacancy increased 150 basis points.



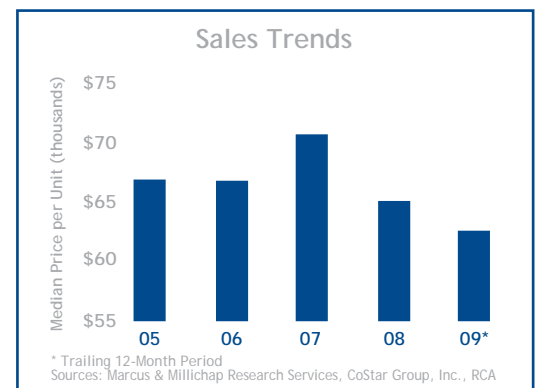
RENTS

- ◆ Asking rents ended the second quarter at \$1,028 per month, up 0.8 percent from one year earlier, while effective rents rose 0.1 percent year over year to \$980 per month.
- ◆ In Class A properties, asking rents increased 0.7 percent over the past 12 months to end the second quarter at \$1,228 per month. Most of the growth occurred in 2008, when vacancy was lower. In the Class B/C segment, rents have ticked up 0.8 percent during the last year to \$845 per month.
- ◆ Revenues have declined due to rising vacancy. Year over year, gross revenues have fallen 1.6 percent, compared to the 3 percent increase recorded in the previous 12 months.
- ◆ **Outlook:** Asking rents are forecast to drop 1.7 percent to \$1,006 per month in 2009, while effective rents are expected to decrease 2.4 percent to \$960 per month.



SALES TRENDS**

- ◆ Sales velocity has slowed by approximately 28 percent over the last year, as tighter lending standards and softer economic conditions have sidelined many prospective buyers.
- ◆ The median price for an apartment asset in the metro has declined by 9.6 percent year over year to \$62,500 per unit due to investors' expectations for higher near-term vacancy rates and increased concessions.
- ◆ In the last 12 months, cap rates have averaged from 6.5 percent to 7.0 percent for Class A assets and 7.5 percent to 8.0 percent for lower-tier properties, both up about 50 basis points year over year.
- ◆ **Outlook:** With moderating fundamentals and tight capital markets continuing to drive cap rates higher, owners seeking exit strategies should list properties now. Distressed-asset opportunities may begin to present themselves among lower-tier properties facing greater operational challenges, and motivate owners to seek exit strategies.



** 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	Somerton/Bustleton	4.1%	-80	\$796	1.9%
3	Foxchase/Lawndale	4.2%	-120	\$719	1.8%
4	N.E. Chester/Upper Montgomery County	4.3%	-620	\$939	-1.1%
5	Torresdale/Bensalem	4.4%	190	\$854	-0.5%
6	Upper/Lower Merion	4.4%	50	\$1,109	2.6%
7	Upper Bucks County	4.5%	-210	\$1,046	-0.8%
8	Lower Bucks County	4.5%	130	\$872	1.4%
9	East Delaware County	4.5%	140	\$760	0.0%
10	West Delaware County	4.5%	100	\$830	-1.2%
11	Central Chester	4.7%	150	\$1,116	-2.4%
12	North Delaware County	4.9%	70	\$1,124	4.3%
14	Bala-Cynwyd	4.9%	20	\$986	-0.4%
15	Moorestown/Maple Shade/Mt. Laurel	4.9%	10	\$939	-1.7%
16	Burlington County	5.0%	-10	\$846	1.0%
17	Gloucester County	5.3%	200	\$875	1.7%
18	Germantown	5.5%	20	\$851	2.9%
19	Lansdale/Gwynedd	5.5%	180	\$1,039	-0.8%
20	Olney/Oak Lane	5.6%	20	\$729	0.1%
21	Center City	5.8%	210	\$1,558	-1.1%
22	Roxboro/Chestnut Hill	6.1%	30	\$1,033	1.2%
23	Camden	6.3%	-170	\$836	-0.6%
24	Camden West	7.2%	300	\$833	2.8%
25	Moreland/Abington/Upper Dublin	7.4%	420	\$1,147	-2.9%
26	West Philadelphia	7.7%	-80	\$915	0.8%
27	West Chester	8.7%	370	\$943	-2.9%
28	Norristown/Plymouth/Norriton	8.8%	320	\$1,107	2.6%
29	Cherry Hill/Eversham/Medford	8.8%	250	\$1,052	-0.1%
30	North/Frankford/Holmesburg	8.9%	400	\$747	0.5%