ApartmentResearch

MARKET UPDATE

Marcus & Millichap

Chicago Metro Area *Fourth Quarter 2009*

Investment Activity Gaining Momentum in Chicago

In Chicago, the weak labor market, ongoing construction activity and competition from alternative housing options are expected to weigh down fundamentals into the first half of 2010. Demand has contracted for four consecutive quarters, the longest stretch of negative net absorption since the 2001 recession, mainly driven by weakness in the suburban submarkets. Supply-side pressure in the suburbs is expected to dissipate going forward, however, resulting in stabilizing conditions. On the other hand, development in the city is accelerating, which will likely push vacancy higher through the next few quarters. As a result, area owners will elevate leasing incentives to attract and retain renters. By year end, concessions in the city are forecast to approach 8 percent of asking rents, the highest mark in more than 20 years, with additional increases in concessions expected in 2010 as weakness in the employment market persists.

Transaction velocity throughout Chicago has increased recently, driven largely by distressed sales that are pushing down prices and luring sidelined players back into the market. Diverging strategies have begun to emerge among local and out-of-state buyers, however. Locally based investors are targeting smaller Class B/C assets, particularly those priced in the $1 million range. These properties currently have cap rates near 9 percent downtown and initial yields in the mid-10 percent range in the suburbs. Although this trend is marketwide, the re-emergence of local investors in the city is a result of falling valuations. Regional buyers, particularly REITs and institutions, continue to seek larger, stabilized assets that are priced near $5 million, as these properties are expected to maintain operations better than smaller, low-priced complexes. Initial yields in this segment are averaging in the low-7 percent range downtown and approximately 100 basis points higher in the outlying cities.

2009 Annual Apartment Forecast

3.7% decrease in total employment

Employment: Job losses are expected to ease through the coming quarters, but overall weakness persists. Chicago employers are projected to eliminate 167,000 positions this year, thinning head counts by 3.7 percent, following a 2.4 percent decrease in 2008.

1,990 units will be completed

Construction: Developers are on pace to complete 1,990 units across the metro in 2009, a 0.4 percent uptick in inventory. Last year, approximately 2,180 units came online.

200 basis point increase in vacancy

Vacancy: Renter demand for Class A apartments is contracting due to steep job losses and competition from shadow stock, while many Class B/C tenants are doubling up to manage costs. As a result of these trends, metrowide vacancy is forecast to reach 7.5 percent this year, 200 basis points higher than in 2008, when vacancy rose 70 basis points.

1.6% decrease in asking rents

Rents: Owners are expected to reduce rents and elevate incentives to counteract waning demand. Asking rents are projected to end 2009 at $1,054 per month, while effective rents will fall to $970 per month, annual declines of 1.6 percent and 2.6 percent, respectively.

Economy and Housing

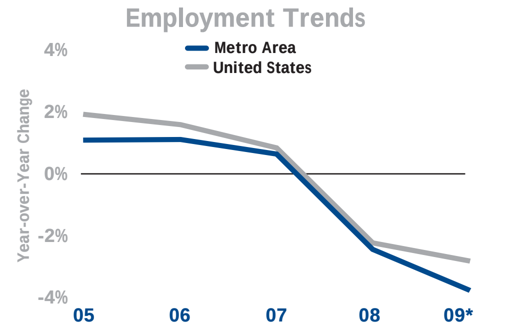
- During the last 12 months, approximately 198,000 jobs have been eliminated from Chicago payrolls, a 4.4 percent contraction. Losses appear to be easing, though, as 72,000 spots have been trimmed in the past two quarters.

- Operational challenges will continue to come from losses in traditionally lower-paying industries such as construction and manufacturing. These segments have posted annual declines of 13.2 percent and 9.2 percent, respectively, in losses totaling roughly 70,000 positions.

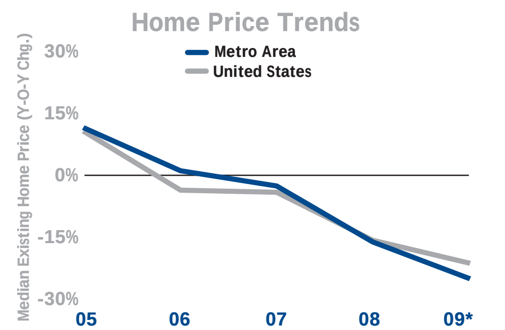
- Single-family permit issuance has fallen 38 percent in the past year to just over 6,100 units. The pace of multi-family permitting activity has plunged 74 percent to 2,800 units; however, after coming to a near standstill at the end of 2008 and during the early part of 2009, the number of multi-family permits pulled has accelerated in each of the past two quarters, indicating a growing confidence among developers regarding long-term conditions.

- The metro's median home price has dropped 25 percent in the last year to $181,250, while the median household income has retreated 11 percent to $53,800 per year. The steep decline in values has made homes more affordable in relation to incomes; the median household income is now $8,300 above the income needed to finance a median-priced home.

- **Outlook:** Job losses are expected to ease through the coming quarters, but overall weakness persists. Chicago employers are projected to eliminate 167,000 positions this year, thinning head counts by 3.7 percent, following a 2.4 percent decrease in 2008.



* Forecast
Sources: Marcus & Millichap Research Services, BLS, Economy.com



* Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, Economy.com, NAR

Construction

City

- Developers added 860 units to city stock in the 12-month period ending in the third quarter; however, just 120 units have come online since the beginning of the year.

- Supply concerns will likely become an issue over the next few years. There are roughly 3,740 units under way in downtown submarkets, though only 875 of these units are scheduled to be delivered in the fourth quarter.

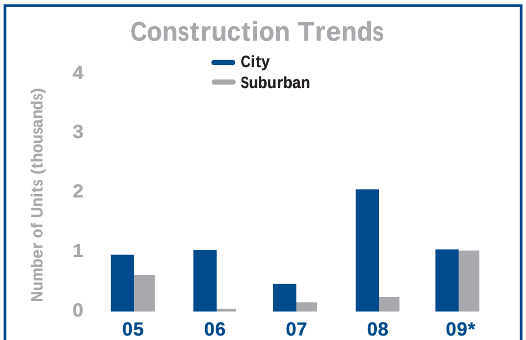
- **Outlook:** Following the completion of roughly 1,975 units in 2008, the pace of construction is expected to slow to approximately 1,000 units this year, expanding city inventory by 0.6 percent.

Suburban

- Nearly 990 units have been delivered in the suburban submarkets over the past year, all of which were finished in the first half of 2009.

- The only project under way in the suburbs is the 390-unit first phase of the Arboretum Landmark in the Woodbridge/Lisle submarket. The planning pipeline, however, has more than doubled in the last year to 4,950 units, most of which are located in the Glenview/Evanston submarket.

- **Outlook:** All of the units slated to come online in the suburbs this year were completed in the first half. These 990 units represented a modest 0.3 percent inventory growth.



* Forecast
Sources: Marcus & Millichap Research Services, U.S. Census Bureau

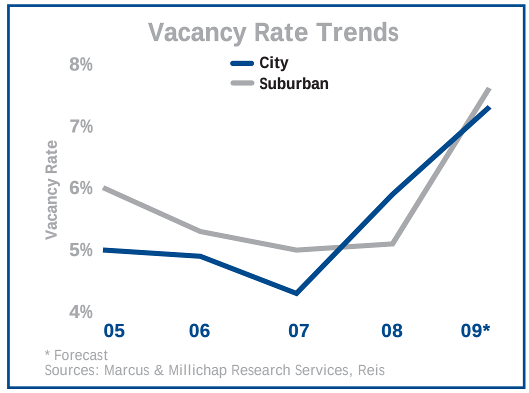
Vacancy and Rents

City

- According to early estimates, city vacancy climbed 130 basis points over the last year to 7 percent in the third quarter. The rise was due primarily to ongoing job losses.

- Asking rents have dipped 0.2 percent annually to $1,194 per month, and effective rents have dropped 1.5 percent to $1,101 per month. Concessions will likely increase further as owners attempt to counteract rising vacancy.

- **Outlook:** The weak labor market will continue to hinder apartment conditions in the city. Vacancy is forecast to climb 140 basis points to 7.3 percent this year. Asking rents are expected to drop to $1,187 per month while effective rents slip to $1,093 per month, annual declines of 1.2 percent and 2.4 percent, respectively.

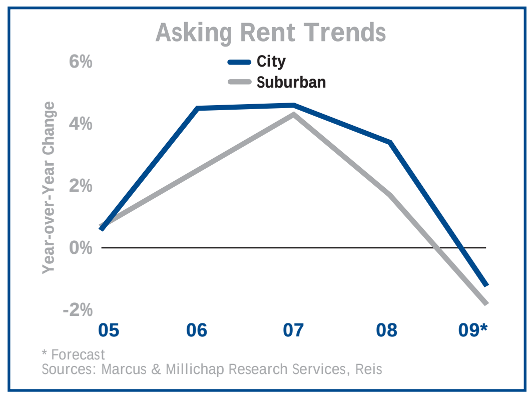


Suburban

- Demand for suburban apartments has weakened recently. Preliminary figures suggest that vacancy rose 210 basis points year over year to 7.1 percent in the third quarter, 130 basis points higher than the rate at year-end 2008.

- In the past 12 months, owners have dropped asking rents 1.5 percent to $986 per month and cut effective rents 2.2 percent to $909 per month. The largest contractions have been posted in the O'Hare submarket, where effective rents have fallen 6.3 percent year over year.

- **Outlook:** Vacancy in the suburbs is projected to climb 250 basis points to 7.6 percent this year. In response to rising vacancy, owners are expected to reduce asking rents by 1.8 percent to $978 per month and raise concessions, driving down effective rents 2.8 percent to $899 per month.



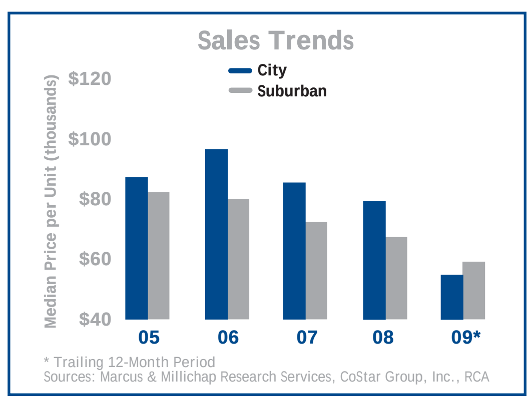
Sales Trends**

City

- Transaction velocity in the city was minimal in the first three months of 2009 but has since jumped, fueled by a rise in distressed-asset and portfolio sales.

- With the number of deals involving weak-performing properties climbing in recent months, the median sales price has decreased 34 percent year over year to roughly $54,100 per unit.

- **Outlook:** Despite some recent softening, conditions in the Rogers Park/Uptown submarket are expected to recover at a relatively quick pace due to strong contingents of young professionals, which should attract investors.



Suburban

- Deal flow has increased modestly in the suburbs over the past year, though attractive pricing in a few city submarkets has lured away some local buyers.

- Similar to trends recorded in the city, transactions involving distressed properties have driven down the median price to $58,300 per unit, a 12-month contraction of 17 percent.

- **Outlook:** Investors continue to seek close-in suburban properties. As such, buying activity has increased in the Oak Park submarket due to the area's proximity to arterial routes and commuter rail lines.

*** 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

- Compared to other core property sectors, apartments have fared best due to the availability of financing through government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Recent modifications to GSE guidelines will impact lender decisions, however, as borrower requirements include more substantial apartment ownership experience.
- Loan-to-value requirements range from 55 percent to 75 percent. Portfolio lenders are issuing loans at all-in rates of 6.00 percent to 6.75 percent for a five-year term and 6.9 percent to 8.0 percent for a 10-year term. Rates among agency lenders are roughly 150 basis points to 175 basis points lower. The government recently assumed full control of Fannie Mae and Freddie Mac, which may boost confidence in the GSEs, putting downward pressure on rates, but it also creates several near-term uncertainties.
- Delinquencies will rise further as a wave of maturities approaches; however, at-risk borrowers may find lenders amenable to loan extensions/modifications. Furthermore, Freddie Mac is under way on its second securitization of multi-family debt this year, and the government's TALF program is expected to at least provide a much-needed spark to the traditional CMBS market.

City Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Lincoln Park	4.0%	120	$1,154	-4.4%
2	Belmont to Montrose	4.2%	90	$1,131	0.6%
3	Rogers Park/Uptown	5.4%	230	$773	-3.2%
4	South Shore	6.4%	50	$868	-1.4%
5	Gold Coast	7.8%	60	$1,575	-0.7%
6	City West	11.0%	70	$927	-1.7%
7	The Loop	14.0%	630	$1,561	-1.8%

Suburban Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	O'Hare	4.8%	70	$826	-6.3%
2	Southwest Cook County	5.6%	-40	$771	-3.0%
3	Glendale Heights/Lombard	5.8%	150	$1,010	-0.3%
4	Southeast Cook County	6.2%	220	$768	-3.9%
5	Wheeling	6.3%	200	$965	-3.0%
6	Woodridge/Lisle	6.7%	160	$905	-0.9%
7	Joliet	6.8%	120	$747	-4.5%
8	Schaumburg/Hoffman	6.9%	230	$945	-4.3%
9	Glenview/Evanston	6.9%	320	$999	-5.5%
10	Aurora/Naperville	7.2%	180	$977	-1.6%
11	East Lake County	7.5%	180	$920	1.7%
12	Kane County	7.5%	310	$935	1.0%
13	Glen Ellyn/Wheaton	8.3%	270	$904	-4.1%
14	McHenry County	8.3%	250	$877	-0.4%
15	West Lake County	8.7%	150	$856	-4.0%

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