ApartmentResearch

MARKET UPDATE

Marcus & Millichap

Cincinnati Metro Area *Fourth Quarter 2009*

Turnover Increasing Concessions, Competition for Renters

Reductions in the Cincinnati work force continue to drag on the local apartment market. Nearly 39,000 workers have been laid off year to date, with vacancy rising 60 basis points during that span. Staff cuts have been most acute in the blue-collar construction; trade, transportation and utilities; and manufacturing sectors, which have shed more than 28,000 jobs in the last year. Consequently, vacancy increases have been pronounced among lower-tier properties, and concessions in this segment have increased significantly. Furthermore, abundant supply and high tenant turnover rates in Class B/C properties are pushing owners to offer $99 move-in specials or markedly reduced security deposits. Among the metro's Class A apartments, limited stock and the faltering single-family home market have buttressed renter demand. Much like Class B/C properties, however, fundamentals in the top tier have weakened due to tenant turnover, as many renters are moving to other luxury communities with more affordable rents. In the Southwest submarket, for instance, the metro's lowest Class A asking rents are drawing tenants, and vacancy has decreased 350 basis points year over year. On the marketwide development front, this year's construction output was limited to the first two quarters, and modest supply growth in 2010 should provide some relief to struggling properties.

Although falling revenues are tempering investors' demand for local apartment assets, tighter lending standards and limited credit availability are the most significant impediments to sales activity. In the Downtown and Butler/Warren submarkets, where activity was elevated in recent years, velocity is down more than 60 percent year over year; conversely, deal flow remains low but consistent in tertiary locations. Buyers' interest in fire-sale pricing has led to cooler demand for Class A apartment assets in core areas, a trend that could accelerate cap rates increases going forward. Sales of distressed properties or those with high vacancy rates persist within the Butler/Warren and Downtown submarkets, however, as investors with cash on hand are able to acquire possible value-add properties at under $20,000 per unit.

2009 Annual Apartment Forecast

4.7% decrease in total employment

Employment: In 2009, employers are expected to eliminate 48,000 jobs metrowide, a 4.7 percent decline. In comparison, 20,900 employees were let go last year.

644 units will be completed

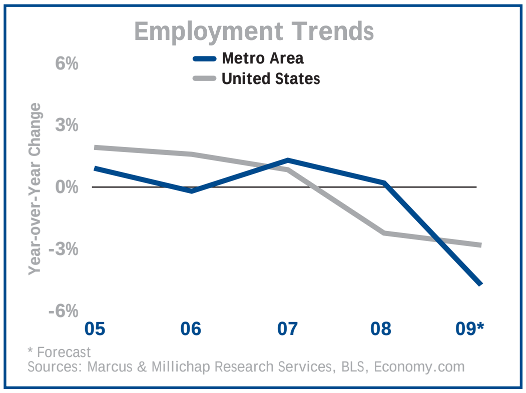
Construction: Developers will expand local apartment inventory by 644 rental units this year, after 170 units were completed in 2008. An average of 460 apartments have been delivered annually over the past five years.

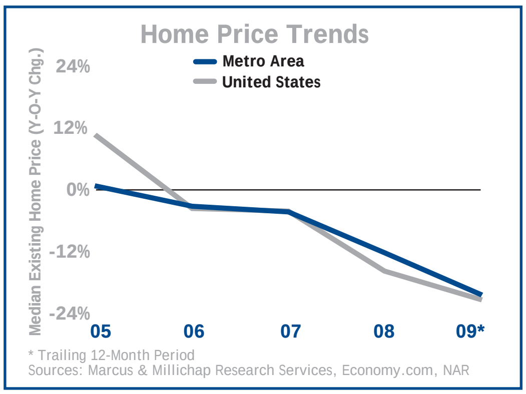
100 basis point increase in vacancy

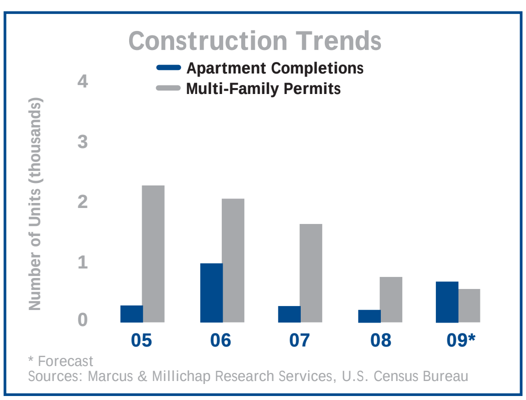
Vacancy: Elevated construction amid weakening demand will underpin a 100 basis point rise in vacancy to 7.8 percent in 2009. Last year, vacancy improved 20 basis points.

0.5% decrease in asking rents

Rents: Asking rents are forecast to dip 0.5 percent this year to $706 per month, while effective rents will decline 1.2 percent to $664 per month. In 2008, asking rents gained 2.6 percent, and effective rents increased 2.9 percent.







Economy

- Employers trimmed Cincinnati staffing levels by 45,900 positions, or 4.4 percent, in the 12-month period ending in the third quarter. In the previous year, 9,900 workers were let go.
- Aside from the education and health services and other services sectors, which added a combined 800 jobs year over year, layoffs have affected all industries. Payroll cuts have been significant in the manufacturing and professional and business services segments, which have eliminated a combined 27,100 positions over the past 12 months.
- In the third quarter, the unemployment rate reached an estimated 10.3 percent, 200 basis points higher than six months earlier and 410 basis points above unemployment in the same quarter last year.
- **Outlook:** This year, employers are expected to eliminate 48,000 jobs, a 4.7 percent decline. In comparison, 20,900 employees were trimmed in 2008.

Housing and Demographics

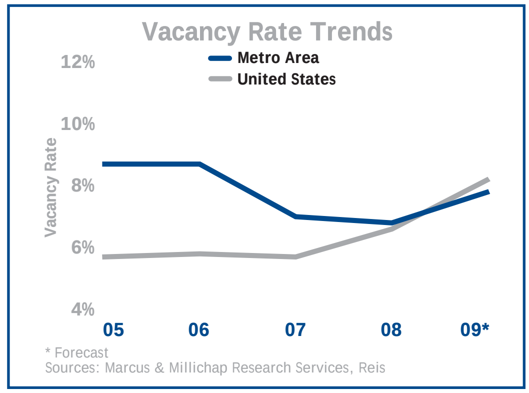
- Permitting activity continues to wane in response to declining residential demand. Single-family permit issuance has fallen 30 percent in the last year to 2,570 units, compared with a 37 decline in the previous 12-month stretch. The number of multi-family permits pulled has dropped 57 percent to 510 units, after receding 20 percent during the preceding year.
- Over the past 12 months, tepid demand and foreclosure sales have pushed down the median price of an existing single-family home 20 percent to $105,440. Meanwhile, declining values have attracted buyers, and single-family home sales velocity has increased 3 percent.
- Homeownership remains highly affordable in Cincinnati. The typical mortgage payment on the area's median-priced home is approximately $606 per month, $274 per month lower than the average Class A asking rent and $10 per month below the metrowide Class B/C asking rent.
- **Outlook:** Although most households in the metro can afford homeownership, ongoing job losses and uncertainty regarding future declines in home values will dissuade many renters from entering the for-sale market.

Construction

- Over the past 12 months, construction output has swelled to 815 units metrowide. Builders brought online just 72 apartments in the previous year.
- Although no deliveries are scheduled for the remainder of 2009, there are three projects consisting of nearly 500 units under way. Additionally, nine projects totaling 930 units are in planning.
- The largest project under construction is an unnamed 240-unit complex in Lebanon that is on pace to be completed in the first quarter of 2010.
- **Outlook:** Developers will expand local apartment inventory by 644 rental units this year, after 170 units were added in 2008. An average of 460 apartments have been delivered annually over the past five years.

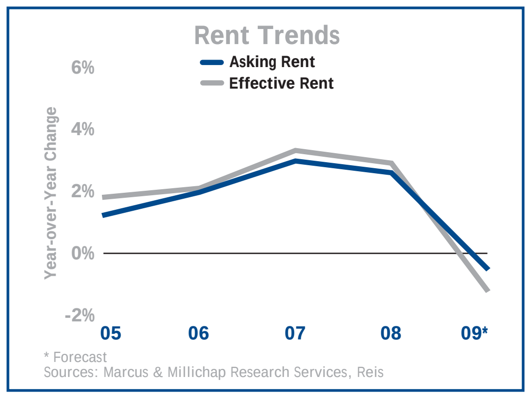
Vacancy

- In the past year, moderating apartment demand pushed up metrowide vacancy 100 basis points to an estimated 7.4 percent in the third quarter. Vacancy declined 110 basis points in the previous 12 months.
- Vacancy in Class A apartments has risen 70 basis points to 6.5 percent over the last 12 months. In the preceding one-year span, top-tier vacancy improved 160 basis points.
- Softer demand for the metro's lower-tier rental stock has generated a 120 basis point year-over-year increase in vacancy to 7.9 percent, compared to an 80 basis point drop in the previous stretch.
- **Outlook:** Elevated construction amid weakening demand will underpin a 100 basis point rise in vacancy to 7.8 percent in 2009. Last year, vacancy fell 20 basis points.



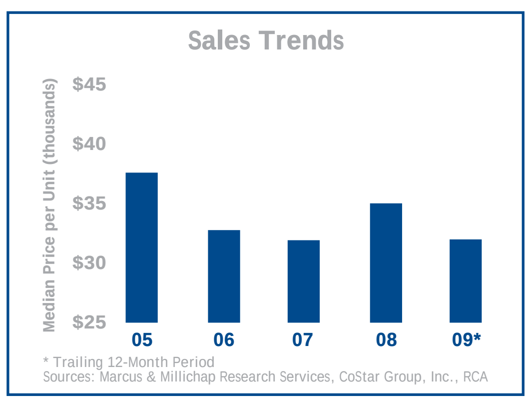
Rents

- In step with increasing vacancy, asking rents have slipped 0.2 percent in the last year to $707 per month, while effective rents have receded 1.3 percent to $664 per month. Asking and effective rents appreciated 3.1 percent and 4.0 percent, respectively, in the previous 12-month period.
- Although top-tier asking rents retreated 1 percent year over year to $880 per month in the third quarter, Class B/C asking rents inched 0.1 percent higher to $616 per month.
- Concessions are currently just over three weeks of free rent. In the past 12 months, concessions have increased 110 basis points to 6.1 percent of asking rents, compared to a 90 basis point decline during the preceding year.
- **Outlook:** Asking rents are forecast to dip 0.5 percent this year to $706 per month, while effective rents will slide 1.2 percent to $664 per month. In 2008, asking rents gained 2.6 percent, and effective rents increased 2.9 percent.



Sales Trends**

- Tighter lending standards and declining NOIs are reducing investment demand in Cincinnati, with sales velocity retreating 34 percent in the last year. Deal flow decreased 14 percent in the previous 12 months.
- Prices are falling in tandem with cash flows. In the past year, the median price has dropped 8 percent to $31,890 per unit, following a 9 percent appreciation during the preceding 12-month span.
- Currently, cap rates for the metro's top-tier assets are averaging between 7.6 percent and 8.2 percent, with initial yields for Class B properties starting approximately 75 basis points higher. Cap rates for most Class C complexes are in the 10 percent range.
- **Outlook:** Apartment assets in Cincinnati will remain stable investments capable of generating consistent cash flows. Although exit strategies typically involve modest capital gain potential, asking rents have appreciated at an average of 3.7 percent annually since 1980, providing operators with steady revenue growth.



*** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.*

Marcus & Millichap

NATIONAL MULTI HOUSING GROUP

Visit www.NationalMultiHousingGroup.com or call:
Linwood C. Thompson
Senior Vice President, Managing Director
National Multi Housing Group
Tel: (678) 808-2700
lthompson@marcusmillichap.com

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.

Submarket Overview

- Despite the recession, developers remain bullish on the viability of downtown Cincinnati, where five projects totaling 770 units are planned. Along with the 300 rental units expected to be included in the Banks project, the Rookwood Exchange development may add another 200 units to inventory.

- Good Samaritan Hospital and Mercy Health Partners will both build new hospitals near Cheviot and the Highway 27/127 and Southwest submarket border. Although the first hospital, Good Samaritan, is not expected to open until late 2010, several hundred jobs are expected to be created, boosting residential demand in the area.

- Steady demand for newer apartments in the Northeast submarket has underpinned vacancy and rent improvements over the last year. Consequently, average revenues have appreciated 1.3 percent during that span.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Downtown	5.2%	0	$733	-1.5%
2	Southeast Cincinnati	5.5%	40	$747	-2.5%
3	Northeast Cincinnati	5.6%	-40	$852	0.9%
4	Butler/Warren Counties	6.8%	80	$721	0.1%
5	Northern Kentucky	7.4%	170	$669	-0.3%
6	Clermont County	7.7%	210	$583	-2.6%
7	North Cincinnati	8.0%	180	$698	-1.0%
8	Blue Ash/Amberley	8.5%	210	$671	-3.9%
9	Highway 27/127	8.5%	90	$558	-0.6%
10	Southwest Cincinnati	9.2%	-20	$528	-2.6%

Marcus & Millichap
Real Estate Investment Services

Prepared and edited by
David Delich
Research Analyst
Research Services

For information on national apartment trends, contact
John Chang
National Research Manager
Tel: (602) 687-6700 ext. 6803
john.chang@marcusmillichap.com

Cincinnati Office:
Josh Caruana
Regional Manager
jcaruana@marcusmillichap.com
201 E. Fifth Street
Suite 2050
Cincinnati, Ohio 45202

Tel: (513) 878-7700
Fax: (513) 878-7710

Price: $150