

ApartmentResearch

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

Marcus & Millichap

Oakland Metro Area

Fourth Quarter 2009

BLUE-COLLAR JOB LOSSES TO DRAG ON LOWER-TIER OPERATIONS

Although rent declines in the Oakland apartment market are expected to persist into 2010, softening will likely subside in the coming quarters, as the metro entered the recession earlier than many nearby markets. Job cuts have resulted in contracting renter demand and have been a drag on occupancy levels in recent months, prompting operators to discount rental rates to stabilize conditions. Steep rent cuts in the first half of 2009 and the delivery of newer, more expensive inventory, however, will help to offset significant rent declines through the end of the year. While overall employment contraction is projected to ease in the next few quarters, some sectors continue to struggle. The manufacturing segment will be dealt a significant blow in early 2010, when Toyota plans to shutter its NUMMI plant in Fremont, eliminating 4,700 positions. This will weigh on renter demand in the Fremont/Newark/Union City area, as well as in adjacent submarkets. Job losses in the construction trade will likely affect areas where residential and commercial development was concentrated during the most recent period of economic expansion, such as the North Alameda submarket and the northeastern stretches of Contra Costa County.

Investment activity has been limited in recent months, as buyers and sellers are attempting to evaluate how the market has shifted since the economic downturn began to weigh on apartment operations. Many owners of stabilized assets are hesitant to list properties until a pricing floor emerges. Valuations have softened since the start of the year, though distress-level pricing has yet to fully materialize. As owners struggle to meet debt obligations in the next few quarters, however, distressed listings are expected to increase, which could stimulate trading. Recent sales activity has been comprised largely of Class B/C properties in the North Alameda submarket, but discounting has not been significant for these properties due to the area's attractive location and assumptions for solid renter demand in the long term.

2009 ANNUAL APARTMENT FORECAST



Employment: East Bay employers are forecast to trim staffing levels by 3.7 percent in 2009, or 37,000 positions, slightly less than last year, when 39,900 jobs were cut.



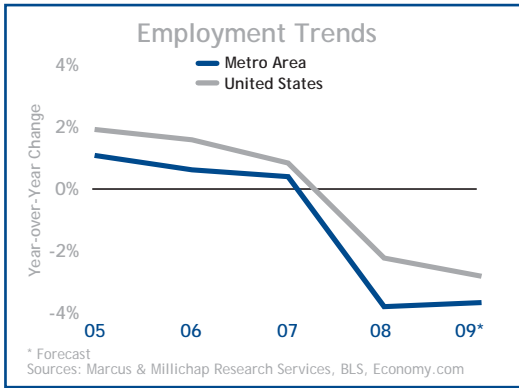
Construction: Developers are on pace to complete roughly 1,200 units this year, a 0.8 percent inventory addition. In 2008, approximately 2,000 units came online.



Vacancy: Despite the slowdown in deliveries in 2009, the metro's supply/demand imbalance is expected to push vacancy 210 basis points higher to 7.4 percent. Last year, vacancy ticked up 20 basis points.

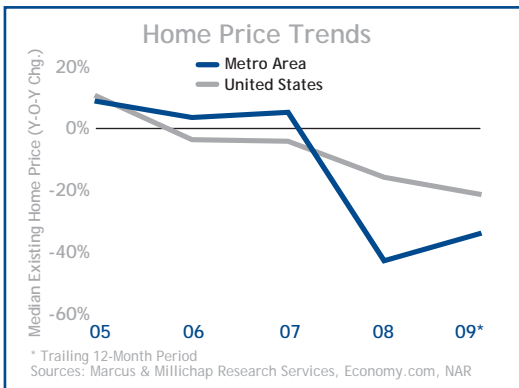


Rents: Weakened occupancy levels will place further downward pressure on rental rates. In 2009, asking rents are forecast to drop 7.5 percent to \$1,297 per month. Effective rents will end the year at \$1,210 per month, a 9.2 percent annual contraction.



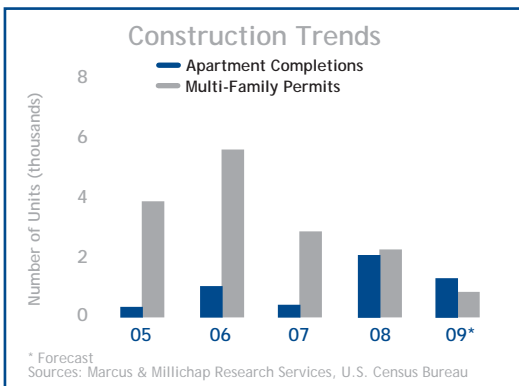
ECONOMY

- ◆ According to preliminary estimates, employment levels retreated 4.4 percent, or 44,600 positions, during the 12 months ending in the third quarter. Payroll reductions have subsided to 18,800 workers the past six months, as the metro was hit hard early in the economic downturn.
- ◆ Contractions in the construction and trade, transportation and utilities sectors have accounted for nearly half of the metrowide employment losses over the last year, with employers in these segments laying off a combined total of roughly 20,000 positions through the third quarter.
- ◆ Weakness in the manufacturing sector also is significantly affecting employment in the metro. Steel manufacturer USS-POSCO Industries plans to thin head counts at its Pittsburg plant by more than 800 workers in December as a result of reduced demand.
- ◆ **Outlook:** East Bay employers are forecast to trim staffing levels by 3.7 percent in 2009, or 37,000 positions, slightly less than last year, when 39,900 jobs were cut.



HOUSING AND DEMOGRAPHICS

- ◆ Approximately 1,600 single-family housing permits have been issued during the past 12 months, a 31 percent drop from one year ago. The decline in multi-family permitting activity is steeper at 59 percent, with 1,100 permits issued through the third quarter.
- ◆ The median price for a single-family home in the Oakland metro was estimated at \$287,000 in the third quarter, down 47 percent from one year earlier. The median household income has declined 4 percent over the last 12 months to \$67,500 annually, \$3,700 short of the minimum amount required to qualify for a median-priced residence.
- ◆ Using traditional financing, the typical mortgage payment is only \$24 per month more than the average Class A asking rent in the metro.
- ◆ **Outlook:** While home values have dropped dramatically in the past year and homeownership has come within reach of many residents, an uncertain job market will likely help to retain a large portion of the renter pool.

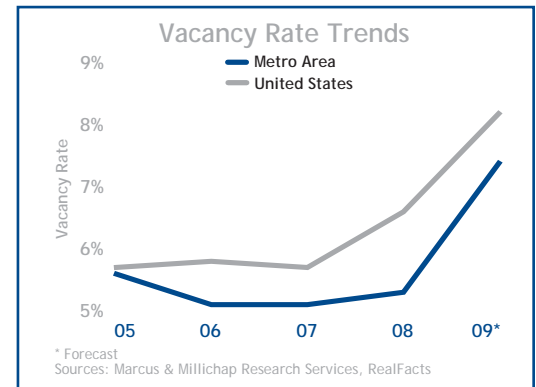


CONSTRUCTION

- ◆ Developers have remained active during the past 12 months, expanding apartment inventory by 1.1 percent with the delivery of 1,500 units. In the last six months, close to 550 units have been delivered.
- ◆ Approximately 1,200 units are under way, almost all of which are scheduled for completion in 2010. Another 4,800 units are in the planning phases and located mostly in the North Alameda submarket, where construction has been concentrated in recent years.
- ◆ One notable project under construction is Avalon Union City, situated in the Fremont/Newark/Union submarket. Builders are expected to finalize construction on the 440-unit development in the fourth quarter.
- ◆ **Outlook:** Developers are on pace to complete roughly 1,200 units in 2009, a 0.8 percent inventory addition and down from last year, when 2,000 units came online.

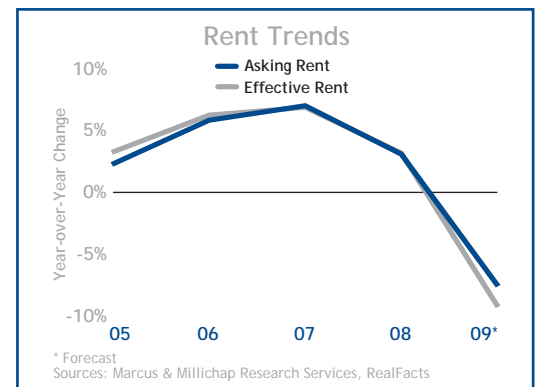
VACANCY

- ◆ Moderate construction activity and contracting renter demand drove up vacancy to 6.9 percent in the third quarter, 260 basis points higher than the rate one year earlier.
- ◆ Top-tier inventory additions placed upward pressure on Class A vacancy levels in the past year, as the average top-tier rate climbed 380 basis points to 8.1 percent in the third quarter.
- ◆ Significant job losses in traditionally lower-paying sectors have dragged on tenant demand in the lower tiers, as many residents are opting to double up to cut costs. Class B/C vacancy has risen 200 basis points year over year to 6.3 percent.
- ◆ **Outlook:** Despite the slowdown in deliveries in 2009, the metro's supply/demand imbalance is expected to push up vacancy 210 basis points to 7.4 percent. Last year, vacancy increased 20 basis points.



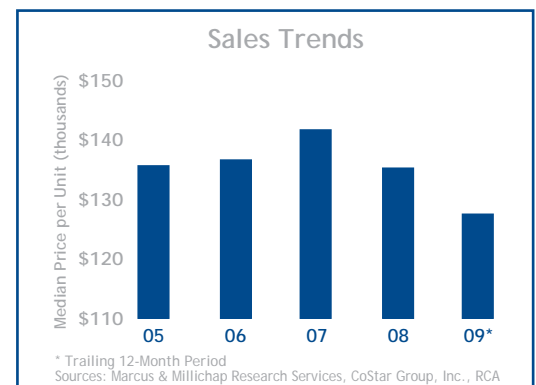
RENTS

- ◆ Over the past 12 months, asking rents have dropped 6.4 percent to \$1,317 per month, while effective rents have fallen 8 percent to \$1,230 per month. Since the start of 2009, asking and effective rents have dipped 6.2 percent and 7.9 percent, respectively.
- ◆ Class A asking rents retreated to \$1,577 per month in the third quarter, a 6.7 percent year-over-year decline. In the lower tiers, asking rents have slipped 6.3 percent during the past year to \$1,201 per month.
- ◆ Steep decreases in effective rents have resulted in average revenues falling 10.5 percent over the last 12 months, compared to the 5 percent gain posted in the previous year. Widening concessions are expected to reduce revenues further by the end of 2009.
- ◆ **Outlook:** Weakened occupancy levels will place additional downward pressure on rental rates this year. Asking rents are forecast to drop 7.5 percent to \$1,297 per month, while effective rents will contract 9.2 percent to \$1,210 per month.



SALES TRENDS**

- ◆ Transaction velocity has fallen off by 46 percent during the past 12 months, as buyers have taken a more cautious stance when approaching deals. The smaller number of quality offerings also has contributed to the slowdown.
- ◆ A reduced bidding climate has resulted in the median sales price declining 7 percent over the last year to \$127,500 per unit. Year to date, properties have traded at a median price of \$122,700 per unit.
- ◆ Cap rates for recently closed transactions have averaged in the high-6 percent to low-7 percent range, though some lesser assets have traded with initial yields 200 basis points higher.
- ◆ **Outlook:** Investment trends have shifted since the start of the year, as an increasing number of mid-sized properties with 20 units to 50 units have changed hands, including a few larger deals in recent months. While smaller, stabilized properties continue to garner interest from buyers, activity involving mid-range and larger assets could tick up, as REITs and institutions have begun to move off of the sidelines.



** 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 100 basis points to 150 basis points lower. The government's creation of a conservatorship for Fannie Mae and Freddie Mac has most likely boosted confidence in the two GSEs, putting downward pressure on rates, but it also creates several near-term uncertainties, as the conservatorship is due to expire at the end of the year.
- ◆ 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

- ◆ Solar panel manufacturer Solyndra recently broke ground on a factory in Fremont. At full capacity, the facility is expected to employ 1,000 permanent workers and will bolster long-term demand for apartments in the Fremont/Newark/Union City submarket.
- ◆ Ongoing construction in the North Alameda submarket has spiked Class A vacancy more than 1,000 basis points during the past year to above 20 percent. The threat of unsold condos reverting to rentals could push top-tier vacancy in the area even higher over the next few quarters.
- ◆ Buyers with extended horizons may want to track opportunities in the traditionally strong San Ramon/Walnut Creek submarket. Recent operational weakness has been a drag on NOIs, placing downward pressure on valuations, as the median sales price has slipped 22 percent in the last year.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	San Leandro/Hayward	4.4%	70	\$1,105	-8.8%
2	Fremont/Newark/Union City	4.6%	140	\$1,300	-7.3%
3	Concord/Martinez	5.3%	140	\$1,101	-8.6%
4	San Ramon/Walnut Creek	5.8%	210	\$1,254	-11.1%
5	West Contra Costa	6.5%	220	\$1,237	-10.9%
6	East Alameda	7.3%	200	\$1,385	-9.0%
7	East Contra Costa	7.4%	250	\$1,088	-5.7%
8	North Alameda	13.0%	710	\$1,316	-4.0%