

ApartmentResearch

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

Marcus & Millichap

Sacramento Metro Area

Fourth Quarter 2009

APARTMENT CLOSINGS GAIN MOMENTUM IN THIRD QUARTER

Severe job cuts and a glut of shadow stock in the Sacramento metro will continue to hinder the absorption of apartment units during the final months of 2009, driving vacancy and concessions higher. The metro's housing meltdown has weighed heavily on local Class A fundamentals over the past year, as an influx of investor-owned single-family homes and condos have hit the rental market. As a result, some local residents have moved into houses that can accommodate roommates to achieve lower rents than apartments. In areas like the Downtown submarket, soft condo sales have led to a rise in fractured condo projects being recast as upscale rentals, providing residents with additional housing alternatives. These trends will send rents lower across the metro, particularly in submarkets with above-market rents. In Roseville, for instance, where apartment rents are among the highest in the metro, local owners have aggressively scaled back effective rents to stabilize operations. As for development activity, apartment building has come to a standstill in the Sacramento market due to an existing supply/demand imbalance.

Though sales activity has slowed over the past year as prices have fallen, deal flow is starting to gain traction, as some buyers have re-entered the investment arena to acquire recently discounted assets, indicating a narrowing of the bid-ask gap. Both the number of closings and total dollar volume during the third quarter exceeded those recorded during the first six months of 2009. Since the start of the year, assets containing fewer than 30 units have been the most sought after due to the greater availability of financing. Sales velocity for larger properties, meanwhile, particularly those with over 100 units, has dropped off nearly 50 percent year over year. As a result, cap rates for these larger assets will likely need the most significant adjustments to generate bids.

2009 ANNUAL APARTMENT FORECAST



Employment: A total of 33,400 workers will be laid off in the Sacramento metro this year, a 3.9 percent decline, after local employers shed 37,300 jobs in 2008.



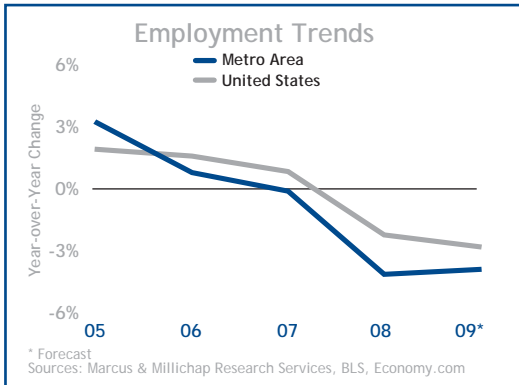
Construction: A year after builders delivered 170 apartment units, no units are slated for addition in 2009. Condo developers, meanwhile, are projected to complete 240 units.



Vacancy: Despite the absence of new stock, a lack of new demand is forecast to fuel a 180 basis point jump in metrowide vacancy to 9 percent this year. In 2008, vacancy rose 70 basis points.



Rents: Employment losses will continue to stifle new demand for apartment units, resulting in further rent reductions. Asking rents are expected to decline 3.8 percent in 2009 to \$929 per month, while effective rents will fall 6.6 percent to \$860 per month.

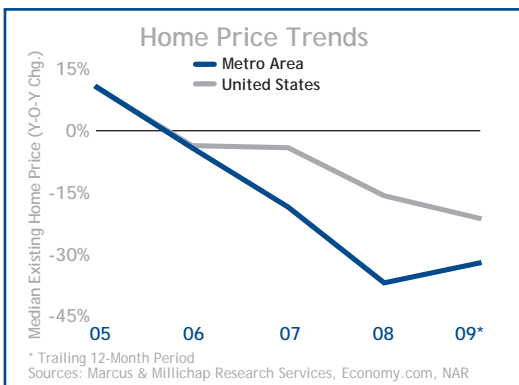


ECONOMY

- ◆ During the 12 months ending in the third quarter, Sacramento employment decreased by an estimated 34,600 workers, or 4 percent, after 30,200 employees were let go in the previous year. Since the start of 2009, approximately 26,400 jobs have been cut in the metro.
- ◆ After 2,300 positions were added in the education and health services sector during the 12-month period ending one year ago, nearly 4,000 new hires have been made year over year through the third quarter. More than 1,100 of those jobs have been created during the past six months.
- ◆ The struggling construction sector continues to post the largest employment losses. Over the past year, this segment has been thinned by 12,200 spots, following the release of 10,300 workers in the preceding 12 months.
- ◆ **Outlook:** A total of 33,400 employees will be laid off in the Sacramento metro this year, a 3.9 percent decline, after local employers shed 37,300 jobs in 2008.

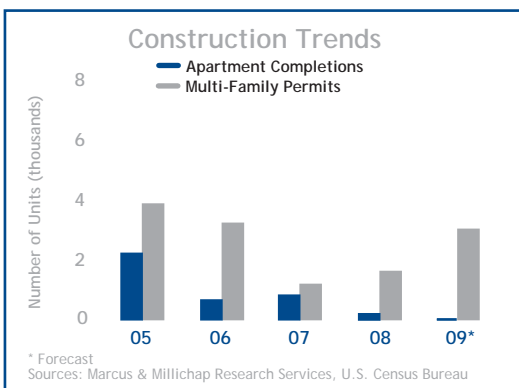
HOUSING AND DEMOGRAPHICS

- ◆ Permits for 2,960 multi-family units have been issued in the last year, down from 4,150 units in the previous 12 months. Single-family permitting activity has declined 26 percent year over year to 1,010 units.
- ◆ The median price of a single-family home in the metro was estimated at \$142,400 in the third quarter, a 32 percent decrease from one year earlier. Although the region's median household income has shrunk by more than 6 percent to \$55,200 in the past year, income levels remain 50 percent above the minimum amount required to qualify for a median-priced home.
- ◆ As of the third quarter, the metro's average Class A asking rent was \$260 per month more than the mortgage obligation for a median-priced home, using traditional financing methods.
- ◆ **Outlook:** While homes have become more affordable, a tight residential lending market and ongoing price uncertainty are expected to dampen demand for home purchases until the local job market begins to steady.



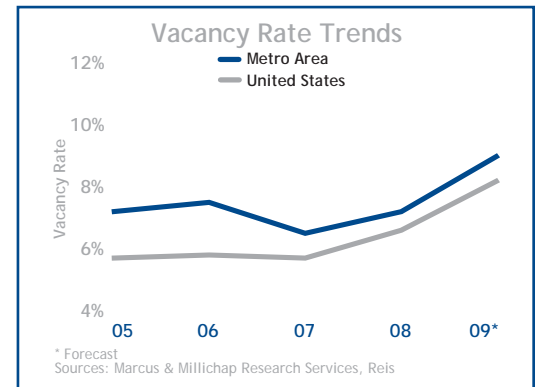
CONSTRUCTION

- ◆ Apartment building activity has stalled across the metro, as no units were brought online during the 12 months ending in the third quarter. One year earlier, nearly 500 apartment units were completed.
- ◆ At present, no apartment projects are under construction in Sacramento, while 4,180 units are planned. Most of the proposed projects lack a ground-breaking date, however, indicative of builders' wait-and-see sentiment.
- ◆ Over the past year, condo builders have delivered 320 for-sale units. There are more than 1,600 condo units under way across the metro, and an additional 4,700 units are in planning. Given the current state of the housing market, some of the unfinished units may come online as rentals.
- ◆ **Outlook:** A year after builders delivered 170 apartment units, no units are slated for addition in 2009.



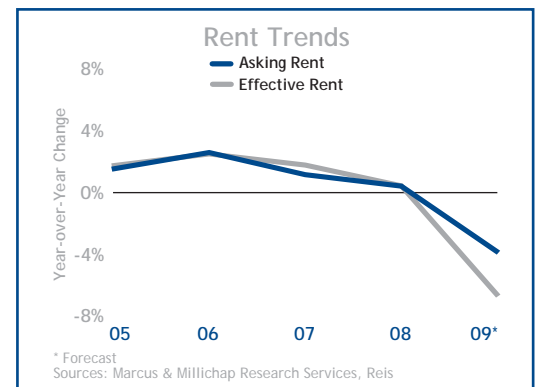
VACANCY

- ◆ During the past 12 months, metrowide vacancy has climbed 250 basis points to 8.7 percent, after rising 50 basis points in the preceding year. Vacancy has increased 150 basis points since year-end 2008.
- ◆ Over the last year, the region's surplus of attractively priced single-family rental homes has absorbed some space demand. As a result, Sacramento's top-tier vacancy rate has pushed up 240 basis points to 8.9 percent.
- ◆ The vacancy rate in the lower tiers has increased 260 basis points in the past 12 months to 8.6 percent, driven by widespread job cuts that have forced some residents to double up.
- ◆ **Outlook:** Despite the absence of new stock, a lack of new demand is forecast to fuel a 180 basis point jump in metrowide vacancy to 9 percent this year. In 2008, vacancy rose 70 basis points.



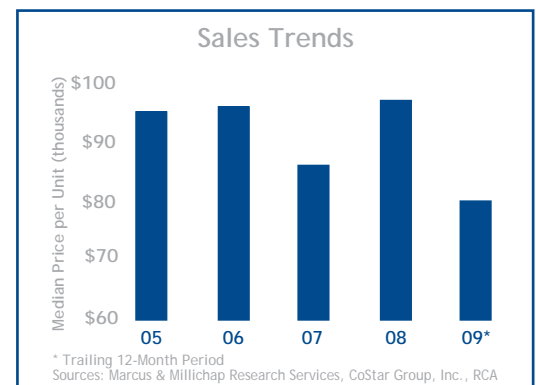
RENTS

- ◆ Asking rents have retreated 3.8 percent during the past year to \$937 per month, while effective rents have decreased 6.1 percent to \$874 per month. In the previous 12-month period, asking and effective rents rose 1.4 percent and 1.6 percent, respectively.
- ◆ Asking rents in Sacramento's Class A properties fell an estimated 4.3 percent to \$1,081 per month during the 12 months ending in the third quarter due to competition from a surplus of alternative housing, along with rising unemployment levels. In the lower tiers, rents have declined 3.4 percent year over year to \$840 per month.
- ◆ Lower occupancy levels and an uptick in concessions have eroded revenues. Over the past year, average revenues have dropped 8.6 percent, after increasing 1.1 percent in the previous 12 months.
- ◆ **Outlook:** Employment losses will continue to stifle new demand for apartment units, resulting in further rent reductions. Asking rents are expected to decline 3.8 percent in 2009 to \$929 per month, while effective rents will fall 6.6 percent to \$860 per month.



SALES TRENDS**

- ◆ While closings have slowed 25 percent over the past year, sales recorded in the third quarter increased considerably from the first half of 2009.
- ◆ The median price of an apartment property in Sacramento has fallen 21 percent year over year to \$80,000 per unit, due largely to weaker fundamentals and conservative underwriting.
- ◆ Cap rates for assets that have changed hands year to date have averaged in the mid-7 percent range, though a handful of properties with deferred maintenance issues have traded with first-year returns above 8 percent.
- ◆ **Outlook:** Fractured condo developments downtown and in the West Sacramento submarket may present opportunities in the coming quarters. Some of these newer properties have yet to meet sales projections and will likely face significant rental competition from existing stock.



** 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.

SUBMARKET OVERVIEW

- ◆ Sacramento County officials are reviewing a plan to open up a total of 20,000 acres for development to accommodate 145,000 new housing units by 2030. The proposed sites are 8,000 acres in the Grant Line East area, east of Rancho Cordova, and 12,000 acres in the Jackson Highway corridor, between Watt Avenue and Sunrise Boulevard.
- ◆ Condos being recast as rentals will add to supply strains. The new owners of the 42-unit residential and retail project at 16th and H streets downtown, for example, announced plans to rent the units.
- ◆ The fallout from the recession is impacting employment in West Sacramento. While eliminations by YRC Worldwide Inc. and Xyratex Ltd. have totaled 340 jobs year to date, the city's single largest layoff so far this year was made by C&S Grocer Inc., which let go 300 workers in August.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Davis	3.0%	100	\$1,088	-4.6%
2	North Highlands	6.8%	60	\$793	-4.0%
3	Woodland	7.3%	300	\$763	-5.5%
4	South/Elk Grove	8.0%	110	\$696	-8.6%
5	Florin Road West	8.1%	130	\$910	-6.9%
6	Rancho Cordova	8.7%	310	\$804	-8.7%
7	Arden Way	8.8%	110	\$746	-6.2%
8	North Sacramento	8.8%	220	\$922	-9.9%
9	Roseville	9.0%	280	\$1,002	-10.2%
10	Carmichael	9.0%	550	\$750	-5.9%