

ApartmentResearch

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

Marcus & Millichap

San Antonio Metro Area

Fourth Quarter 2009

GOVERNMENT, HEALTHCARE SECTORS SUPPORTING ECONOMY

San Antonio's major industries have left the market largely insulated from the national recession, though apartment fundamentals are weakening due to modest job losses and a glut of new units. The large presence of military and healthcare firms is offsetting employment cuts in other areas, which will help mitigate the rise in vacancy in the near term. Both Medtronic and the U.S. Air Force recently announced the addition of hundreds of new jobs in the metro. Also, Toyota plans to relocate the production of the Tacoma truck line to the company's existing plant in southern San Antonio, a move that could create as many as 1,100 jobs, boosting demand in the already tight submarket and helping the metro recapture some lost manufacturing positions. On the supply side, development remains robust, and little relief is projected in 2010, as several large projects are already under way. Permitting activity in the multi-family segment has retreated, however, indicating a slowdown in apartment construction is likely in early 2011.

After staggering through the first part of 2009, the investment market rebounded somewhat late in the second quarter, and preliminary results from the third quarter point to stabilizing velocity. As leading economic indicators increasingly signify a shallow recession for San Antonio, some local buyers have moved off of the sidelines. Investor preference has changed little through the downturn, however, and first-year yields that have risen above 8 percent are now high enough to attract local capital. A modest uptick in distressed and REO sales has occurred over the past six months and should persist into the first half of 2010, though neither deal type is expected to make up a significant number of transactions. Properties with deferred maintenance, meanwhile, may offer cash-heavy buyers an opportunity to move into the market at discounted rates, especially in infill areas with a large amount of Class C stock, such as the Airport/Northeast submarket.

2009 ANNUAL APARTMENT FORECAST



Employment: Though payroll expansion is projected to resume in the fourth quarter, a total of 6,300 jobs will be lost in the metro this year, a 0.7 percent decrease. In 2008, roughly 4,900 positions were added.



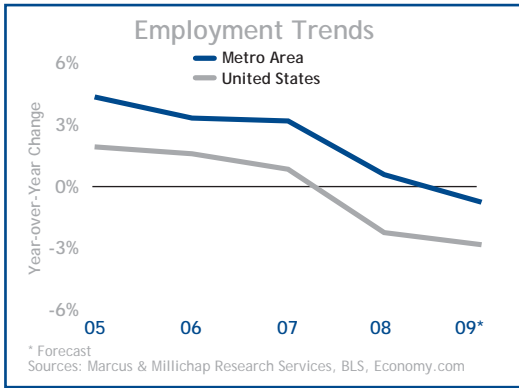
Construction: Builders are expected to complete 4,100 units in 2009, well above the metro area's five-year average of 2,600 units annually. Last year, approximately 1,700 apartments were delivered.



Vacancy: Supply-side pressure will be the major contributor to a fourth quarter increase in vacancy to 11.3 percent, a rate that is up 230 basis points annually. In 2008, vacancy climbed 240 basis points.

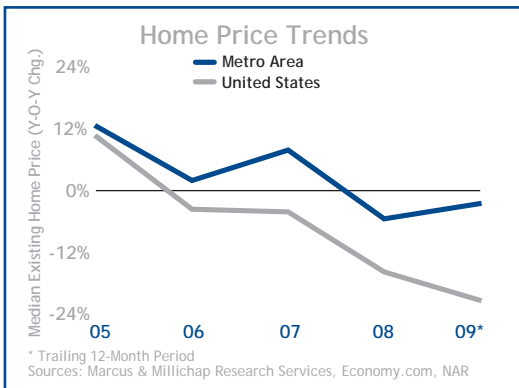


Rents: As occupancy continues to fall, asking rents will finish the year at \$690 per month while effective rents are expected to hit \$639 per month, declines of 1.6 percent and 3.3 percent, respectively, from year-end 2008.



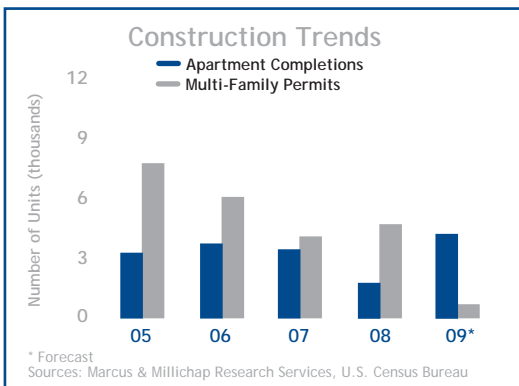
ECONOMY

- ◆ According to preliminary estimates, payrolls in San Antonio have contracted by 7,800 positions in the past year, a 0.9 percent decline. The rate of losses has abated in the last six months, when 3,300 jobs were cut.
- ◆ San Antonio's healthcare and government sectors have alleviated some pressure on the local employment market this year. In the first three quarters of 2009, employers added nearly 4,800 jobs in the education and health services and government segments.
- ◆ Medtronic is hiring ahead of its original schedule, and total employment at the company's 150,000-square foot Rim office building is anticipated to reach 230 workers by year end. The company has announced plans to add 1,400 positions over the next five years.
- ◆ **Outlook:** Though payroll expansion is projected to resume in the fourth quarter, a total of 6,300 jobs will be lost in the metro this year, a 0.7 percent decrease. In 2008, roughly 4,900 positions were added.



HOUSING AND DEMOGRAPHICS

- ◆ During the most recent 12-month period, developers pulled permits for 4,900 single-family homes, a 25 percent decrease from the previous year. Multi-family permitting activity has dropped 59 percent to 1,770 units.
- ◆ Home prices in the metro have slipped just 2.5 percent year over year to a median of \$147,900. The median household income has fallen 2.9 percent in the last 12 months to \$46,400 annually, which is nearly \$6,000 above the minimum qualifying income for a median-priced residence.
- ◆ Due to relatively low mortgage rates, the mortgage obligation for a median-priced home is just \$91 per month higher than the average Class A asking rent. One year ago, the gap was \$210 per month.
- ◆ **Outlook:** Home affordability is increasing in an already inexpensive market, which is expected to draw some renters out of Class A apartments and into ownership when employment stabilizes.

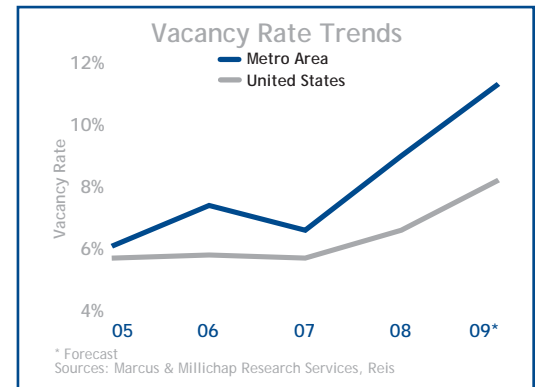


CONSTRUCTION

- ◆ Year to date, developers have expanded marketwide apartment stock by 1.8 percent with the addition of 2,700 units. Nearly 1,500 units came online in the first quarter.
- ◆ More than 4,800 units are under way in the metro, including 3,500 apartments that are scheduled to be delivered in 2010 or later. The planning pipeline consists of 7,300 units, indicating little slowdown in development activity next year.
- ◆ Although construction is dispersed throughout the northern half of the city, the Far West submarket will receive the metro area's largest amount of new stock this year as 1,150 units come online, increasing inventory in the area by 7 percent.
- ◆ **Outlook:** Builders are expected to complete 4,100 units in 2009, well above the five-year average of 2,600 units annually. Last year, nearly 1,700 apartments were delivered.

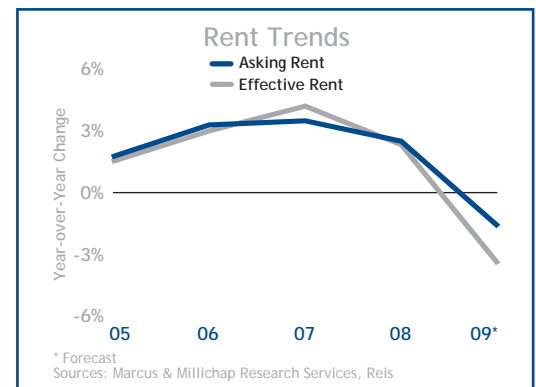
VACANCY

- ◆ The vacancy rate reached 10.7 percent in the third quarter, according to preliminary estimates, an annual climb of 250 basis points. During the past six months, however, vacancy has ticked up just 70 basis points.
- ◆ An influx in new supply pushed Class A vacancy up 280 basis points to 10.1 percent in the third quarter. In the first quarter of this year, top-tier vacancy jumped 120 basis points after nearly 1,500 new units were added to stock.
- ◆ In the metro's lower tiers, marketwide vacancy reached 11.1 percent in the third quarter, a rise of 230 basis points annually. Much of the increase is attributed to job losses in traditional blue-collar sectors; in the manufacturing segment, for instance, payrolls are down nearly 9 percent.
- ◆ **Outlook:** Supply-side pressure will be the major contributor to a fourth quarter increase in vacancy to 11.3 percent, a rate that is up 230 basis points annually. In 2008, vacancy climbed 240 basis points.



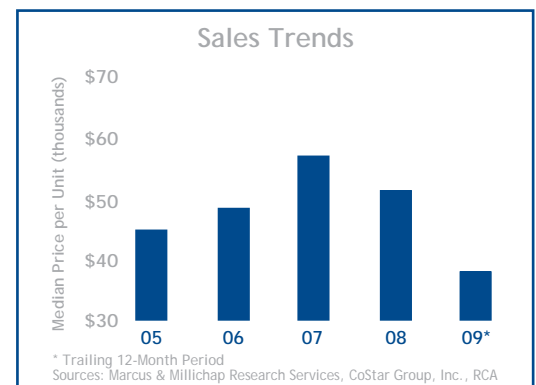
RENTS

- ◆ Asking rents retreated to \$696 per month in the third quarter, down 0.4 percent from one year earlier. Owners have responded to rising vacancy by widening concessions and lowering effective rents 2 percent year over year to \$649 per month.
- ◆ Class A asking rents declined 1.7 percent annually to \$818 per month in the third quarter as improving housing affordability became a more pressing concern for local owners. In the Class B/C segment, asking rents were flat in the past year but have slipped 0.3 percent in the last three months to \$599 per month.
- ◆ Marketwide concessions have climbed to 25 days of free rent, up from 19 days of free rent in the third quarter of 2008.
- ◆ **Outlook:** As occupancy continues to fall, asking rents will finish the year at \$690 per month while effective rents are forecast to hit \$639 per month, declines of 1.6 percent and 3.3 percent, respectively, from year-end 2008.



SALES TRENDS**

- ◆ After a lull in the first few months of 2009, transaction velocity appears to be gaining some traction in the San Antonio apartment market. Local investors have stepped up activity recently, mitigating the significant drop-off in out-of-state capital.
- ◆ Buyers are targeting much smaller properties to alleviate risk. The median sales price in the most recent 12-month period was \$38,100 per unit, down 26 percent from the previous year.
- ◆ The average cap rate for properties that changed hands in the last year was in the high-7 percent range. Since the beginning of 2009, however, first-year yields have surpassed 8 percent.
- ◆ **Outlook:** Activity jumped at the end of the second quarter, and preliminary figures indicate that the third quarter will post similar results, a sign that trading has reached a sustainable pace. In the next few months, some residual out-of-state capital is expected to leak back into the market to take advantage of Class A listings.



** 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

- ◆ Although the Southwest submarket has a metro-high 18 percent vacancy rate, the area is expected to get a boost from the relocation of the Air Force's Cyber Command to Lackland AFB. The facility will employ 400 new people and should create some additional private-sector positions.
- ◆ The Southeast submarket currently has the second-highest vacancy rate in the metro at 17.3 percent, 660 basis points above the marketwide average. In response to soft conditions, owners have widened concessions by 10 days of free rent in the past year, the largest increase among all submarkets.
- ◆ In addition to receiving a significant amount of new units this year, the Far West submarket is struggling with a decrease in tourism. Hotel room occupancy has slipped 11.5 percent year over year, which has limited staff levels at the area's major tourist attractions, weighing on apartment demand.

SUBMARKET VACANCY RANKING

| Rank | Submarket | Vacancy Rate | Y-O-Y Basis Point Change | Effective Rents | Y-O-Y % Change |
|------|---------------------|--------------|--------------------------|-----------------|----------------|
| 1 | Central San Antonio | 6.4% | 0 | \$616 | -2.8% |
| 2 | South | 7.8% | 0 | \$545 | -2.5% |
| 3 | Northwest | 8.4% | 340 | \$492 | -2.3% |
| 4 | Far North Central | 9.9% | 130 | \$695 | -2.8% |
| 5 | East | 9.9% | 260 | \$718 | -1.1% |
| 6 | Far Northwest | 10.3% | 270 | \$670 | -1.0% |
| 7 | Far Northeast | 11.0% | 40 | \$612 | -2.8% |
| 8 | Airport/Northeast | 12.0% | 250 | \$685 | -2.6% |
| 9 | Far West | 12.2% | 550 | \$620 | -0.3% |
| 10 | Southeast | 17.3% | 30 | \$507 | -2.4% |