

ApartmentResearch

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

Marcus & Millichap

Cincinnati Metro Area

Third Quarter 2010

CLASS B/C RENTER DEMAND RISING WITH BLUE-COLLAR PAYROLLS

The resumption of hiring in Cincinnati remains limited, which will moderate overall payroll expansion during the second half and, in turn, slow improvement in the apartment market. Employment levels in blue-collar sectors grew the most in the first six months of the year, with construction and manufacturing employers adding 5,800 positions. Conversely, the white-collar information, financial activities, and professional and business services sectors shed approximately 2,500 jobs. While the delayed recovery in office-using sectors held vacancy improvements in top-tier rentals to just 10 basis points year to date, a more rapid recovery in blue-collar employment will enable Class B/C property owners to build on the 50 basis point decline in vacancy recorded during the first half. Revenues have risen measurably in the close-in Southeast and Northeast Class B/C submarkets, in particular, with stabilized vacancy rates allowing area owners to boost rents. In outlying locations, lower-tier fundamentals remain weak due to competition with Class A properties that offer significant concessions. With little new demand forming for these top-tier assets, operators will continue to elevate leasing incentives to entice renters to upgrade, limiting rent gains through year end. As demand strengthens and supply growth slows in the first half of 2011, though, these owners should begin to withdraw concessions.

Investor demand persists for stabilized Class A and higher-quality Class B properties, but owners will remain hesitant to sell as distressed deals compress prices. While cap rates for most lower-tier assets currently start near 9 percent, initial yields for Class A product will average in the mid-7 percent to low-8 percent range due to the dearth of such listings. Consequently, sales of distressed and lower-tier complexes will dominate transaction activity during the second half. Mid-sized Class B/C properties just north of downtown Cincinnati, for instance, have received greater investor interest recently, as prices in this area currently average between \$10,000 per unit and \$30,000 per unit.

2010 ANNUAL APARTMENT FORECAST



Employment: Steady payroll expansion as the year progresses will result in the annual addition of 6,000 positions, a 0.6 percent gain. In 2009, approximately 37,200 workers were let go.



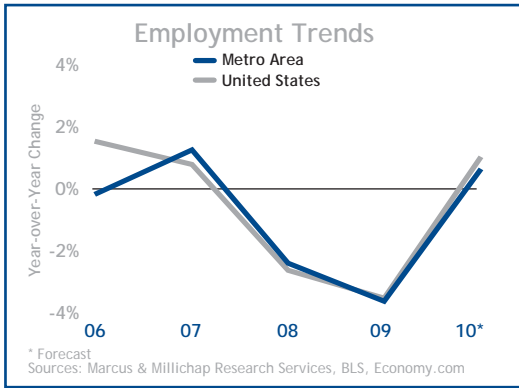
Construction: Cincinnati apartment stock will increase by 350 units in 2010, or 0.3 percent. Last year, builders brought online nearly 645 units. Over the past five years, overall apartment inventory only increased 1.8 percent.



Vacancy: Despite a projected rise for the second half, vacancy will finish the year at 7.9 percent, down 10 basis points from 2009, when steep job losses underpinned a 120 basis point increase in the vacancy rate.

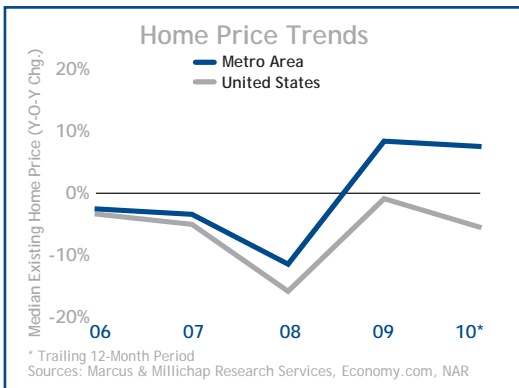


Rents: In 2010, asking rents will tick up 0.5 percent to \$696 per month, and effective rents will advance 1.7 percent to \$661 per month. Asking and effective rents fell 2.5 percent and 3.3 percent, respectively, last year.



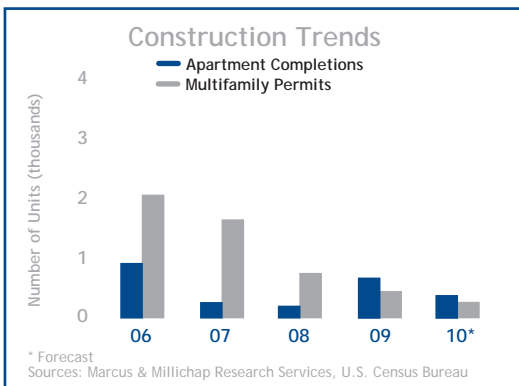
ECONOMY

- ◆ Despite a slow start, Cincinnati businesses added 2,800 jobs during the first half, a 0.3 percent gain. In the previous six-month stretch, 5,500 workers were laid off in the metro.
- ◆ Cuts persist in white-collar segments, as the professional and business services and financial activities sectors contracted by 2,200 positions, or 1 percent, in the past six months, following cuts totaling 600 positions in the previous half year. Conversely, additions to payrolls are robust in the manufacturing industry, which has created 4,100 jobs year to date, the sector's largest six-month gain in more than 20 years.
- ◆ Since peaking at 10.5 percent in March, the metrowide unemployment rate has fallen 30 basis points to 10.2 percent. In the three years preceding the recession, the jobless rate averaged 5.2 percent.
- ◆ **Outlook:** Steady payroll expansion as the year progresses will result in the annual addition of 6,000 positions, a 0.6 percent gain. In 2009, approximately 37,200 workers were let go.



HOUSING AND DEMOGRAPHICS

- ◆ After falling 32 percent in the previous year, the number of single-family permits pulled increased 27 percent over the past 12 months to 3,530 units. Conversely, builders expect multifamily demand to remain weak, as reflected in the number of permits requested in the last year decreasing 29 percent to 320 units, following a 65 percent decline in the prior 12 months.
- ◆ The median price of an existing single-family home in the metro was \$132,930 at mid-2010, up 8 percent annually. Home sales accelerated 49 percent last year, due largely to the original expiration of the first-time home-buyer tax credit at year end, but have since fallen 25 percent.
- ◆ Homeownership remains affordable to most Cincinnati households, as the median household income of \$55,099 per year is 41 percent above the income necessary to support the monthly mortgage payment on the area's median-priced home.
- ◆ **Outlook:** Uncertainty regarding home values and the slow employment rebound will continue to keep many renters from making the transition into homeownership this year.

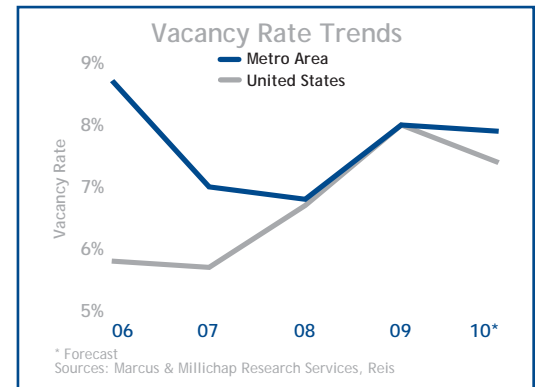


CONSTRUCTION

- ◆ The troubled economy has limited construction of new apartments, with deliveries falling to 320 units since the second quarter of 2009. In the previous 12-month stretch, inventory expanded by 815 units.
- ◆ Developers have 17 projects comprising 2,375 units in the planning pipeline, though just two complexes, totaling 345 units, have established ground-breaking dates.
- ◆ A metro-leading 330 units are under way in the Downtown submarket, and 1,040 units are proposed for the area.
- ◆ **Outlook:** Cincinnati apartment stock will increase by 350 units this year, or 0.3 percent. In 2009, builders brought online nearly 645 units.

VACANCY

- ◆ As economic concerns ease, so, too, have rising apartment vacancy rates in Cincinnati. Over the past 12 months, vacancy ticked up just 40 basis points to 7.7 percent, following a 70 basis point increase during the previous year.
- ◆ Class A vacancy has improved 10 basis points since the start of the year to 7.1 percent. During the last half of 2009, the top-tier vacancy rate climbed 60 basis points.
- ◆ Steady demand at lower-tier properties during the first half supported a 50 basis point decrease in vacancy to 8 percent. In the prior six months, vacancy increased 80 basis points.
- ◆ **Outlook:** Despite rising slightly during the second half, vacancy will finish 2010 at 7.9 percent, down 10 basis points from last year, when steep job losses underpinned a 120 basis point jump in vacancy.



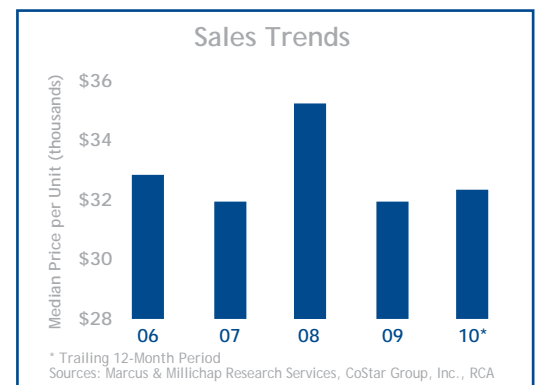
RENTS

- ◆ In the past year, asking rents slid 1.4 percent to \$693 per month, while effective rents fell 0.9 percent to \$656 per month. Asking rents inched 0.1 percent higher during the prior year, though effective rents regressed 0.3 percent.
- ◆ Class A operators have cut asking rents 0.6 percent year to date to \$855 per month to keep rising vacancy rates in check. Class B/C asking rents, on the other hand, have appreciated 0.6 percent in that time to \$608 per month.
- ◆ Since the beginning of 2010, revenues have increased 1.3 percent, after retreating 2.6 percent in the previous six months.
- ◆ **Outlook:** In 2010, asking rents will tick up 0.5 percent to \$696 per month, and effective rents will advance 1.7 percent to \$661 per month. Asking and effective rents fell 2.5 percent and 3.3 percent, respectively, last year.



SALES TRENDS**

- ◆ Tight lending criteria and operational uncertainty continue to limit sales velocity in Cincinnati. Deal flow declined 47 percent over the past 12 months, after slowing 49 percent in the previous year.
- ◆ Lower NOIs are eroding values. During the most recent 12-month period, the median apartment price retreated 6 percent to \$32,330 per unit. The median price decreased 2 percent over the preceding year.
- ◆ Distressed sales and buyers' increasing risk premiums have maintained upward pressure on cap rates, as marketwide initial yields have increased 50 basis points annually to the high-8 percent range. Cap rates for most lower-tier apartment complexes average above 9 percent.
- ◆ **Outlook:** Banks will continue to relinquish distressed properties during the second half of the year, though activity will be dominated by experienced buyers as sales remain limited to assets with high vacancy rates and deferred maintenance issues.



** 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

- ◆ Mixed economic indicators, stock market volatility and concerns surrounding the European debt crisis continue to drive investors to safety. As a result, the yield on the 10-year U.S. Treasury has declined since peaking at 4 percent in April; as of late July, the yield had fallen to 3 percent.
- ◆ Capital markets loosened over the past year, with life insurance companies ramping up lending and CMBS showing renewed signs of life. Nonetheless, the agencies remain the dominant sources of multifamily lending. This trend will continue through 2010 as the GSEs' multifamily portfolios outperform their residential mortgage operations, reducing the likelihood of drastic government-mandated changes to their apartment lending arms.
- ◆ Multifamily loan originations increased 37 percent in the second quarter but remained below levels reported during the same period last year. Fannie Mae and Freddie Mac's origination volume followed a similar pattern, rising in the second quarter but falling short of year-earlier levels.
- ◆ Loan-to-values range from 60 percent to 75 percent for portfolio lenders and push up to around 80 percent for best-of-class, agency-financed deals. All-in rates for five-year agency loans fall into the low-4 percent range, while 10-year loans price between 4.75 percent and 5.15 percent. While life companies will compete at these levels for best-of-class deals, most portfolio lenders are 100 basis points to 225 basis points higher.

SUBMARKET OVERVIEW

- ◆ In the past six months, measurable vacancy improvements amid fluctuating effective rents Blue Ash/Amberley submarket supported a 2.5 percent increase in revenues, compared to a 0.1 percent uptick during the preceding two quarters.
- ◆ Clermont County's outlying location and older apartment stock forced owners to increase incentives 120 basis points in the past year to 7 percent of asking rents. Marketwide concessions, in comparison, currently average 6 percent of asking rents.
- ◆ Inventory growth has been significant in the Northern Kentucky submarket, where 470 units have come online in the past three years. Additionally, 290 units are under construction in the area, and 510 units are proposed.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Northeast	5.5%	-30	\$836	-1.4%
2	Southeast	6.3%	90	\$732	-1.5%
3	Downtown	6.8%	180	\$727	-0.3%
4	Blue Ash/Amberley	7.1%	-110	\$677	1.3%
5	Northern Kentucky	7.1%	-60	\$666	0.0%
6	North	7.6%	-20	\$683	-1.7%
7	Butler/Warren Counties	7.8%	120	\$701	-2.2%
8	Clermont County	8.0%	50	\$586	0.9%
9	Highway 27/127	9.4%	100	\$558	0.5%
10	Southwest	9.7%	80	\$505	-3.8%