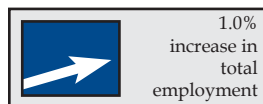


## WAVE OF DISTRESSED PROPERTIES WEIGH ON VALUES

Despite expanding employment levels throughout the Columbus metro, the currently uneven pace of the local recovery has set the stage for a choppy rebound in apartment demand during the second half. The first half of 2010 marked the first consecutive quarterly job gains since mid-2007, but sustained hiring continues to elude a number of sectors. Nonetheless, the gradual start of the economic recovery has released some pent-up demand for Class A properties, fueling both rent and occupancy improvements. Additionally, deliveries will slow measurably this year from 2009, limiting competition for tenants. The Class A segment remains strongest in the Dublin/Powell and Hilliard submarkets due to the areas' affluence and employer concentrations. Alternately, tight vacancy rates persist in the Downtown/University submarket, though metro-high asking rents have caused area owners to offer significant concessions to compete for renters. Meanwhile, many operators of the metro's lower-tier properties remain pressured to sustain elevated concessions in order to stabilize operations. Rising rents at Class A units, though, will likely stimulate leasing in the Class B/C segment by late year.

Deals involving financially distressed and operationally challenged properties will continue to dominate the Columbus investment market. As a result, sales prices will remain depressed this year, with the most aggressive buyers finding substantially troubled assets priced between \$5,000 per unit and \$10,000 per unit. Despite the large percentage of distressed acquisitions, some local buyers continue to target stabilized product. Among small- to mid-sized complexes, for instance, newer properties priced from \$40,000 per unit to \$60,000 per unit and averaging cap rates in the low-8 percent range continue to receive high investor interest. Meanwhile, the still-thin pool of institutional-sized buyers will seek attractive opportunities in larger assets this year, with initial yields at these properties starting near 8 percent.

## 2010 ANNUAL APARTMENT FORECAST



**Employment:** With economic woes abating, Columbus employers will boost head counts by 9,000 positions in 2010, a 1 percent gain. Last year, local companies let go 33,600 workers.



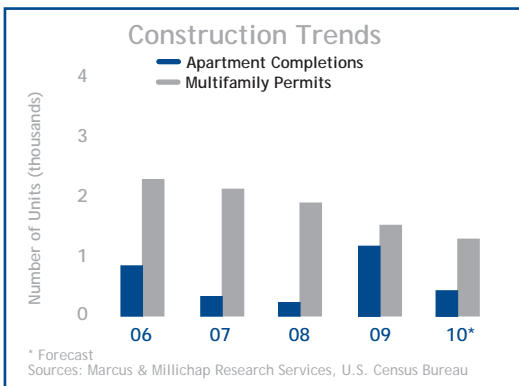
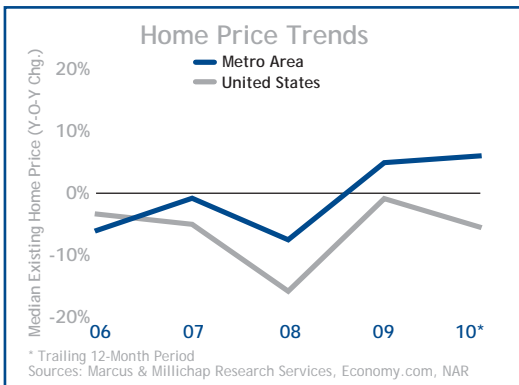
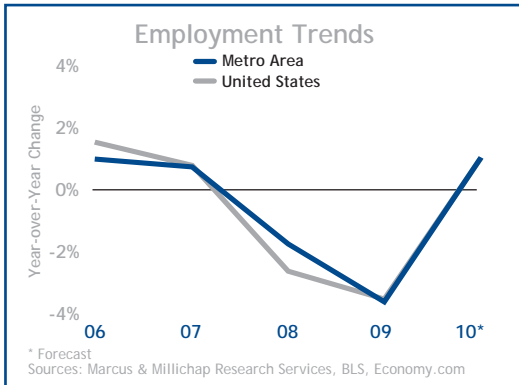
**Construction:** Developers will slow completions to 400 units this year, down from 1,145 units in 2009 and well below the annual average of 1,555 units since 2000.



**Vacancy:** Weak renter demand will underpin a 70 basis point rise in the apartment vacancy rate to 9.9 percent in 2010, after vacancy increased 110 basis points last year. In the three years preceding the recession, vacancy averaged 8.1 percent.



**Rents:** This year, asking rents will appreciate 1 percent to \$666 per month, and effective rents will tick 1.5 percent higher to \$622 per month. Asking rents fell 2.7 percent in 2009, while effective rents slid 3.3 percent.



## ECONOMY

- ◆ So far this year, 3,800 new hires have been made in the Columbus metro area, marking growth of 0.4 percent; 3,100 jobs were added in the second quarter alone. During the preceding six months, employers slashed 13,900 positions from local payrolls.
- ◆ After losing 2,500 jobs during the second half of 2009, the professional and business services sector recorded the metro's strongest rate of growth in the first half of this year, expanding by 5,600 positions, or 3.9 percent. Conversely, financial activities employers let go 2,000 workers in the first six months of 2010, a 2.9 percent decrease, after releasing just 600 employees during the final half of last year.
- ◆ The Columbus unemployment rate remains on par with the national average. At the close of the second quarter, the local unemployment rate was 9.6 percent, 60 basis points higher than at the start of 2010 and 100 basis points above the rate recorded during the corresponding period in 2009.
- ◆ **Outlook:** As economic woes abate, Columbus employers will boost head counts by 9,000 positions in 2010, a 1 percent gain. Last year, local businesses laid off 33,600 workers.

## HOUSING AND DEMOGRAPHICS

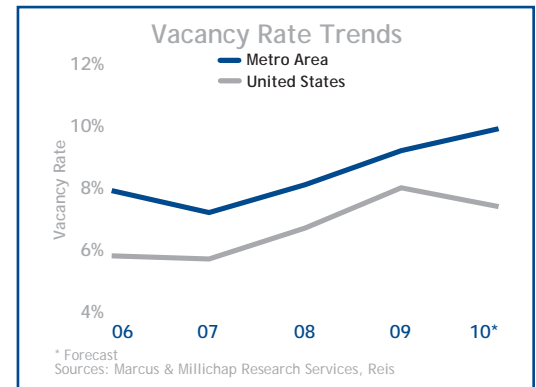
- ◆ Single-family permitting activity increased 25 percent in the past year to 3,025 units, after falling 30 percent in the previous 12 months. The number of multifamily permits requested climbed 23 percent to 1,970 units in the most recent 12-month period, following a 19 percent decline in the prior year.
- ◆ After the first-time homebuyer tax credit boosted sales in 2009, activity slowed by more than 20 percent during the first half of 2010. The median price of an existing single-family home fell 1 percent to \$136,960 in that time.
- ◆ Homeownership remains affordable to most Columbus households, as the median household income of \$53,400 annually is 38 percent higher than the income necessary to support the monthly mortgage payment on a median-priced home.
- ◆ **Outlook:** Despite low barriers to homeownership, the first-time homebuyer tax credit likely siphoned most pent-up demand from the single-family market and will keep many households from leaving the renter pool.

## CONSTRUCTION

- ◆ A late-2009 surge in deliveries helped raise construction output to 1,135 apartment units over the past 12 months, after 360 units came online during the previous year.
- ◆ There are 620 units under way metrowide with completion dates stretching into 2012. Another 1,630 units in planning could expand apartment inventory by roughly 1.3 percent if all come to fruition.
- ◆ The 176-unit Ashbrook Run in Canal Winchester will be delivered in the third quarter of 2010, with rents ranging from \$625 per month to \$740 per month, in line with the submarket's Class A average of \$680 per month.
- ◆ **Outlook:** Developers will slow completions to 400 units this year, down from 1,145 units in 2009 and well below the annual average of 1,555 units since 2000.

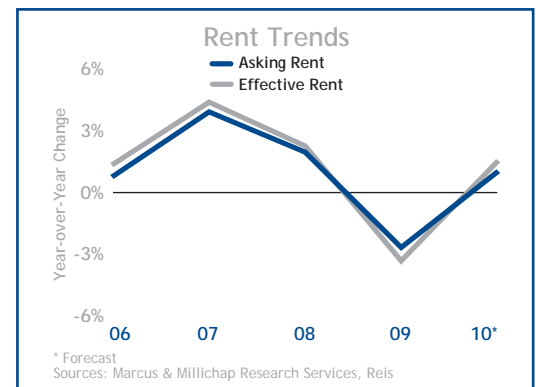
## VACANCY

- ◆ Weak demand contributed to escalating the vacancy rate 170 basis points in the past 12 months to 9.7 percent. In the previous year, marketwide vacancy increased 70 basis points.
- ◆ Stabilized demand for top-tier apartments has allowed owners of these properties to trim vacancy 10 basis points to 6.4 percent year to date, following an 80 basis point rise during the preceding six months.
- ◆ Vacancy continues to rise at Class B/C properties, increasing 70 basis points to 11.4 percent so far this year, after surging 150 basis points in the second half of 2009.
- ◆ **Outlook:** Weak renter demand will underpin a 70 basis point increase in vacancy this year to 9.9 percent, after the rate jumped 110 basis points in 2009. In the three years preceding the recession, vacancy averaged 8.1 percent.



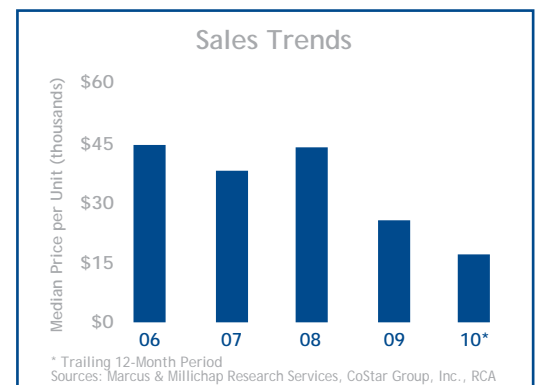
## RENTS

- ◆ To minimize vacancy increases, operators cut asking rents 2.2 percent year over year to \$663 per month, while effective rents dropped 2.1 percent to \$619 per month. During the prior year, asking and effective rents receded just 0.3 percent and 0.6 percent, respectively.
- ◆ Resurgent leasing activity at Class A properties has allowed owners in the segment to raise asking rents 1 percent to \$796 per month so far this year. Lower-tier operators, however, advanced rents just 0.2 percent to \$588 per month due to comparatively tepid demand.
- ◆ Rising vacancy nearly offset rent gains during the first half of the year, as revenues ticked up 0.4 percent. In 2009, revenues plummeted 4.5 percent.
- ◆ **Outlook:** In 2010, asking rents will appreciate 1 percent to \$666 per month, and effective rents will tick 1.5 percent higher to \$622 per month. Asking rents fell 2.7 percent last year, while effective rents slid 3.3 percent.



## SALES TRENDS\*\*

- ◆ Despite fewer creditworthy buyers, a glut of distressed-property sales helped keep deal flow steady for the second consecutive 12-month period. During the previous one-year stretch, the number of sales fell more than 40 percent.
- ◆ The prevalence of sales involving REO, high-vacancy and deferred-maintenance properties weighed down property values during the past year. In that time, the median price plummeted more than 60 percent to \$15,625 per unit, after decreasing just 6 percent in the preceding 12 months. Since the start of 2010, the median price has hovered below \$10,000 per unit.
- ◆ Cap rates for most stabilized apartment assets average in the low-8 percent range, while initial yields for lower-tier product typically exceed 8.5 percent. Cap rates vary widely among distressed assets, though prices have typically ranged between \$5,000 per unit and \$20,000 per unit.
- ◆ **Outlook:** Although distressed sales constitute the bulk of sales year to date, buyer demand remains strong for stabilized top-tier listings. As a result, Class A cap rates will likely range from 7.5 percent to 8.0 percent through the second half of the year.



\*\* 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

- ◆ Penn National Gaming recently won approval to move its Hollywood Casino Columbus from the downtown area to the former Delphi plant near the Interstate 270 and Broad Street junction at the northern border of the Grove City submarket. The move will buoy area property values over the near term and boost the local employment base and residential demand once open in 2012.
- ◆ Class A demand remains healthy in the Hilliard submarket, where vacancy averaging in the 4 percent range during the past year allowed owners to raise rents at a healthy clip. As a result, average revenues appreciated 2.5 percent in that time.
- ◆ Seven projects composed of 400 units are proposed for the Downtown/University submarket. The largest of these developments is the 220-unit Vine Street complex, slated for Kilbourne Street. No start date has been announced.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	University/Downtown	4.2%	30	\$715	-4.7%
2	Dublin/Powell	5.3%	60	\$687	-3.0%
3	Upper Arlington/North Columbus	5.7%	30	\$670	-1.9%
4	Hilliard	6.3%	90	\$652	-1.8%
5	Westerville	7.6%	220	\$765	0.1%
6	Sharon/Worthington	9.3%	340	\$603	-2.1%
7	Whitehall/Gahanna/Reynoldsburg	9.4%	90	\$580	-3.5%
8	Groveport/Canal Winchester	9.6%	240	\$574	-2.0%
9	Northeast/Minerva Park	11.2%	120	\$546	-3.2%
10	Grove City	21.0%	170	\$578	-0.9%