

LOCAL BUYERS RE-EMERGE AS PRICING GAP NARROWS

The Detroit economic recovery will lag that of the nation this year as job losses persist, but greater stability in a few suburban submarkets will ease the pace of fundamental erosion marketwide. Despite resumed expansion in some employment sectors, renter demand will not increase considerably until the key auto industry stabilizes. Automakers may be on the verge of a recovery, but the metro's payrolls will continue to shrink through year end, and out-migration trends will weigh on absorption, sustaining near-term operational challenges. Top-tier complexes in some suburban submarkets will improve in 2010, however, especially in areas with small Class A inventories. The improvement stems primarily from record-high foreclosure filings earlier this year driving some homeowners into top-tier apartment units, particularly in locations where home values remain above the metro median. Top-tier absorption levels are already strengthening in parts of Troy and the eastern portion of the Pontiac/Waterford submarket, and with completions remaining minimal in both areas, modest occupancy gains will persist in the coming quarters. In Ann Arbor, meanwhile, extended job searches by graduates will buoy demand for mid- and top-tier assets, resulting in metro-low vacancies.

Deep discounts and elevated cap rates will entice local buyers back into the market as more lender-owned properties emerge. While sales velocity trends differ by county, financially troubled assets remain the focal point for most area buyers. During the past year, properties with cash-flow challenges accounted for more than a quarter of the metro's closings. Cap rates for these distressed assets averaged above 12 percent in that time, high enough to draw yield-seeking investors with a penchant for risk. The Ann Arbor submarket also remains attractive to risk-averse, long-term buyers, as the student population at the University of Michigan historically supports healthy operations at area properties. As a result, cap rates for assets in the submarket can trade with initial yields as much as 300 basis points to 400 basis points below the metrowide average.

2010 ANNUAL APARTMENT FORECAST



Employment: Over the past three years, employers cut 281,300 local positions, largely due to weakness in the manufacturing sector. This year, companies will eliminate 8,000 jobs, decreasing metrowide payrolls by 0.5 percent.



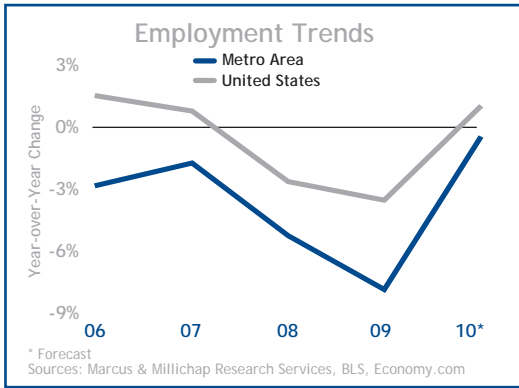
Construction: After builders delivered 200 apartments last year, fewer than 30 units will come online in 2010. Over the past five years, completions averaged 385 units annually.



Vacancy: Although operations will start to stabilize this year, a projected 0.7 percent decrease in the local population will weigh on renter demand. The average vacancy rate in the Detroit metro will increase 20 basis points in 2010 to 8.3 percent, after spiking 120 basis points last year.



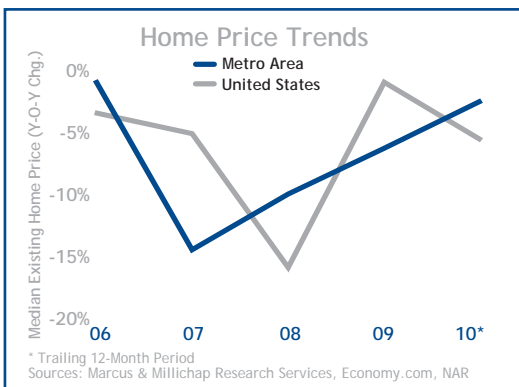
Rents: Metrowide rents will continue to fall as vacancy edges higher. Asking rents will retreat 0.6 percent to \$803 per month this year, while effective rents will slide 0.7 percent to \$724 per month.



ECONOMY

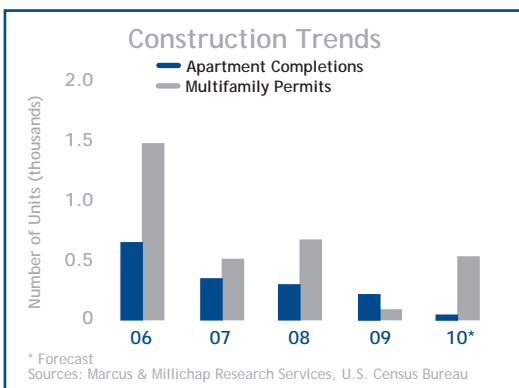
- ◆ Detroit employment levels shrunk by 16,600 positions year over year through the second quarter, or 1 percent, following the loss of nearly 196,000 workers in the previous 12-month stretch. Year to date, local employers shed just 2,100 positions.
- ◆ Chrysler Group LLC has begun production on its new Jeep Grand Cherokee model. In anticipation of strong sales of the new sport utility vehicle, the company has hired 1,100 workers to run a second production shift at its Jefferson North Assembly Plant.
- ◆ As of the second quarter, the unemployment rate in Detroit was 14.3 percent, down from the November 2009 peak of 16.1 percent. The local unemployment rate remains 480 basis points higher the national average.
- ◆ **Outlook:** Over the past three years, employers cut 281,300 positions in Detroit, primarily stemming from softness in the manufacturing sector. In 2010, companies will eliminate 8,000 jobs, decreasing payrolls by 0.5 percent.

HOUSING AND DEMOGRAPHICS



- ◆ Through the second quarter, annual permit issuance for single-family housing increased to 360 units, up 18 percent from the prior 12-month stretch. Multifamily permitting activity fell 45 percent to 130 units.
- ◆ The median price of a single-family home in the Detroit MSA was estimated at \$114,500 in the second quarter, a year-over-year decrease of 2.4 percent. Household incomes of \$50,200 per year are 75 percent more than the income needed to qualify for a mortgage on a median-priced metro home.
- ◆ Using traditional financing, the monthly mortgage payment on a median-priced home in Detroit is currently \$355 less than the average Class A asking rent.
- ◆ **Outlook:** The spread between the average Class A asking rent and the typical monthly mortgage payment will deter multifamily developers from breaking ground on recently approved projects and keep concessions in the top tier at current levels.

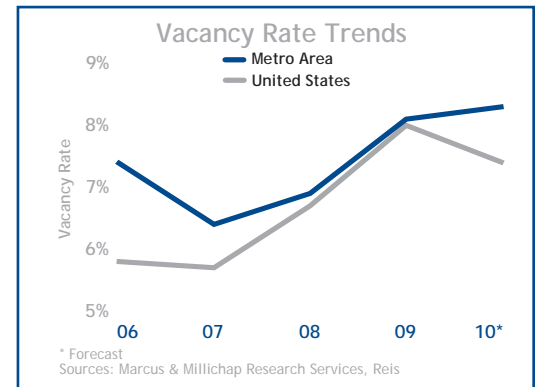
CONSTRUCTION



- ◆ Builders continue to slow apartment construction in Detroit. Year over year, 184 units were brought online, down from 326 units during the previous 12-month stretch. So far this year, fewer than 30 units have been completed.
- ◆ The only multifamily projects under way are a 150-unit subsidized/low-income complex in the Midtown/West Detroit submarket and a 100-unit seniors housing development in Dearborn. The pipeline of market-rate projects under construction, however, remains empty.
- ◆ Proposed market-rate developments total 2,400 units, though none of the projects has an announced groundbreaking date.
- ◆ **Outlook:** After builders delivered 200 apartment units last year, fewer than 30 units will come online in 2010. Over the past five years, completions averaged 385 units annually.

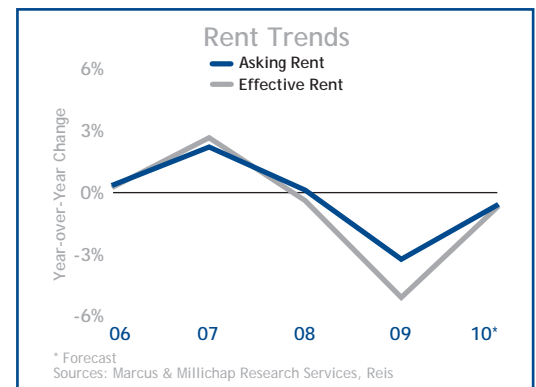
VACANCY

- ◆ Supported by minimal construction activity and a considerable slowdown in job losses, vacancy improved 20 basis points year to date to 7.9 percent. During the past year, vacancy rose 30 basis points.
- ◆ The current Class A vacancy rate of 6.8 percent is down 40 basis points from one year ago and 90 basis points below the year-end 2009 level. The decline is attributable to a slight uptick in demand at a time when building remains subdued, supporting modest absorption.
- ◆ The vacancy rate in the lower tiers pushed up 60 basis points in the last year to 8.5 percent. The rise was the result of ongoing weakness in blue-collar employment sectors.
- ◆ **Outlook:** Although operations will start to stabilize this year, a projected 0.7 percent decrease in the local population will weigh on renter demand. The average vacancy rate in the Detroit metro will increase 20 basis points in 2010 to 8.3 percent, after spiking 120 basis points last year.



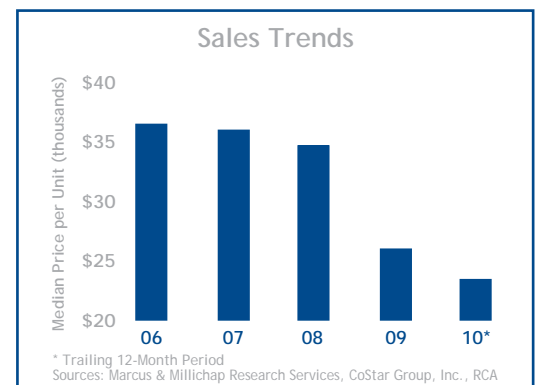
RENTS

- ◆ During the 12 months ending in the second quarter, asking rents decreased 0.9 percent to \$809 per month, while effective rents slipped 1.3 percent to \$734 per month.
- ◆ Class A asking rents ended the second quarter at \$1,000 per month, down 1.5 percent year over year. Lower-tier rents retreated 0.3 percent in that time to \$699 per month, an average rate on par with mid-2006 levels.
- ◆ Revenue declined 1.7 percent during the most recent 12-month stretch as concessions crept to one of the highest levels on record. Incentives currently average nearly 34 days of free rent, up from 32 days of free rent a year ago.
- ◆ **Outlook:** Rents will continue to fall as vacancy edges higher. Asking rents will recede 0.6 percent to \$803 per month this year, and effective rents will slide 0.7 percent to \$724 per month.



SALES TRENDS**

- ◆ Once-sidelined local buyers have re-entered the market in search of steeply discounted assets, supporting a 20 percent year-over-year increase in overall transaction velocity. Activity among local investors accelerated roughly 50 percent in that time.
- ◆ With half of the metro's deals occurring in Wayne County, and with REO sales accounting for a greater share of trades, the median price decreased 23 percent over the past year to \$23,400 per unit.
- ◆ In the last year, cap rates averaged in the high-9 percent to mid-10 percent range. Several better-performing assets in suburban communities, however, traded with first-year returns in the high-8 percent range.
- ◆ **Outlook:** A recent proposal to create "urban villages" downtown could present opportunities for long-term investors. Current plans call for demolishing 3,000 structures this year and a total of 10,000 abandoned buildings by 2013 in order to strengthen city neighborhoods and the use of the city's 140 acres. Funding for the demolition and stabilization program will come from \$20 million in federal funds.



** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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NATIONAL MULTI HOUSING GROUP

Visit www.NationalMultiHousingGroup.com or call:

Linwood C. Thompson

Senior Vice President, Managing Director

National Multi Housing Group

Tel: (678) 808-2700

lthompson@marcusmillichap.com

Marcus & Millichap

Real Estate Investment Services

Prepared and edited by

Michael L. Brown

Research Analyst

Research Services

For information on national
apartment trends, contact

John Chang

Vice President, Research Services

Tel: (602) 687-6700 ext. 6803

john.chang@marcusmillichap.com

Detroit Office:

Jonathan Dwoskin

Regional Manager

jdwoskin@marcusmillichap.com

28411 Northwestern Highway

Suite 750

Southfield, Michigan 48034

Tel: (248) 415-2600

Fax: (248) 352-3813

Price: \$150

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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

- ◆ The recent decision by General Motors Corp. to keep 3,000 workers in the Renaissance Center downtown will help preserve area top-tier operations and sustain a Class A vacancy rate in the low-6 percent range through 2010.
- ◆ General Electric will open a technology center in the Westland submarket this year. The Advanced Manufacturing and Software Technology Center will provide a significant boost to renter demand in the area by creating 1,200 new jobs.
- ◆ An \$11 billion investment to transform 60,000 acres in Wayne and Washtenaw counties into an airport hub of commerce and logistics strengthens the long-term outlook for housing near the Detroit Metro and Willow Run airports. If the project comes to fruition, it would eventually add 64,000 jobs in the areas.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Oak Park/Royal Oak	5.3%	100	\$620	-1.7%
2	Westland	5.9%	10	\$684	-1.6%
3	Ann Arbor	6.3%	-110	\$819	1.4%
4	Farmington Hills	6.8%	40	\$868	-3.2%
5	Macomb County	6.9%	0	\$673	1.8%
6	Downriver/South Wayne	7.5%	50	\$650	0.0%
7	Troy	8.0%	90	\$867	-6.8%
8	Southfield	8.0%	230	\$788	-0.5%
9	Dearborn/Dearborn Heights	8.7%	0	\$706	-0.3%
10	Pontiac/Waterford	8.8%	-10	\$722	-2.4%