

RESURGENCE IN OFFICE-USING JOBS TO DRIVE CLASS A IMPROVEMENTS

The Indianapolis apartment market will improve through 2010 as a recovery takes shape and job gains encourage residents who doubled up during the recession to return to rental units. With the development pipeline anticipated to thin during the second half, job-generated demand will help tighten apartment vacancy rates, allowing owners to push up rents and trim concessions. The Class A sector will begin to outperform in the final quarters of 2010, fueled by recovering professional and business services employment and generous concessions at recently built properties enticing renters to upgrade. Top-tier occupancies will remain highest close to employment centers in the Central submarket, where renter demand from young professionals and students will support a vacancy rate near 3 percent. As the recovery cycle progresses over the next year, more robust population and job growth will strengthen renter demand rapidly in densely populated pockets of Hamilton and Hendricks counties. Metrowide, Class B/C vacancy will trend lower this year, with stronger improvements expected when blue-collar hiring activity picks up in early 2011.

As the local economy turns the corner and financing availability improves, apartment investment activity will accelerate in the second half. The bulk of closings this year will involve private buyers targeting financially distressed lower-tier assets. Although few of these listings have come to market thus far, more are gradually working through the system. For the most part, cap rates for these assets will average in the mid- to high-9 percent range, a level that should start to re-attract out-of-state capital. These value-add deals will emerge in greater numbers in outlying areas far from employment centers and in blue-collar communities hit hard by the recession and downturn in the housing market. Institutions and high-net-worth buyers, meanwhile, will focus on cash-flowing, high-quality properties in the metro's northern cities. Stabilized assets in expanding communities, in particular, will receive multiple offers and command initial yields in the mid-8 percent range.

2010 ANNUAL APARTMENT FORECAST



Employment: Metrowide employment levels will expand by 1.4 percent this year with the creation of 12,000 positions. Through the recession, total employment decreased by 61,400 jobs, with 37,600 workers let go in 2009 alone.



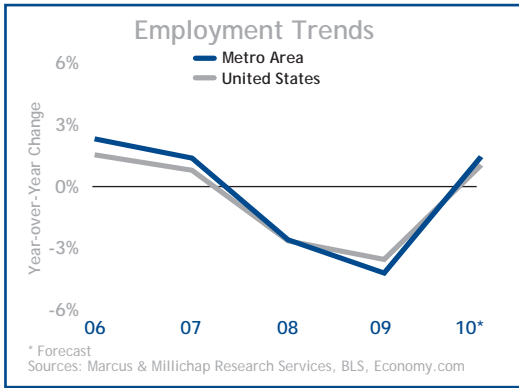
Construction: Approximately 1,300 apartment units will be added to the market's inventory in 2010, down from the 1,640 units delivered last year. During the past five years, completions averaged 680 units annually.



Vacancy: Stabilizing employment will release pent-up renter demand. During 2010, the vacancy rate will fall 90 basis points to 9.2 percent, after jumping 230 basis points last year.

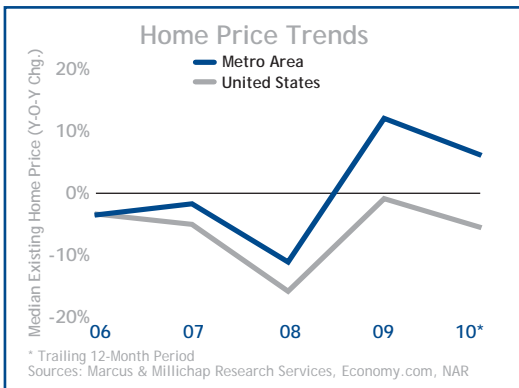


Rents: Asking rents will advance 1.5 percent this year to \$659 per month, while effective rents will increase 1.8 percent to \$619 per month. In 2009, asking and effective rents slipped 3.9 percent and 4.6 percent, respectively.



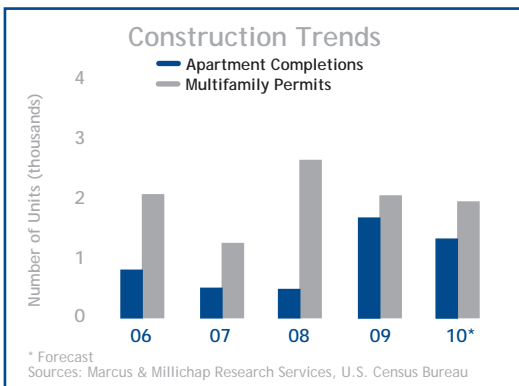
ECONOMY

- ◆ The addition of 7,800 positions during the first half of 2010 eased the Indianapolis metro's year-over-year decline in payrolls to 3,700 jobs, a 0.4 percent reduction. In the prior 12 months, layoffs totaled 46,100 positions.
- ◆ Recent job gains were driven by the professional and business services sector, which has increased by 8,200 workers year to date. Despite ongoing cuts in other white-collar job sectors, office-using employment grew by nearly 7,000 positions in that time, which will help stimulate Class A renter demand.
- ◆ Late in the second quarter, Whirlpool closed its plant in Evansville to transfer its refrigerator and freezer production lines to Mexico. The closure resulted in the loss of 530 positions in March and nearly 680 jobs in June.
- ◆ **Outlook:** Metrowide employment will expand by 1.4 percent this year with the creation of 12,000 positions. Through the recession, total employment decreased by 61,400 jobs, with 37,600 workers let go in 2009 alone.



HOUSING AND DEMOGRAPHICS

- ◆ The Indianapolis housing market has begun to mend. Although single-family housing completions slowed by 20 percent over the past year, housing starts and permit issuance recovered from lows recorded during the recession. Year over year, single-family permit issuance climbed 21 percent to 4,400 units, while starts rose 18 percent to 4,300 units. Multifamily permitting activity, however, slid 15 percent to 1,700 units.
- ◆ The median price of a single-family home in the metro was \$121,300 in the second quarter, a year-over-year increase of 6.2 percent. Sales velocity involving single-family homes accelerated 4.6 percent in that time.
- ◆ Homes remain highly affordable, as the median household income of \$50,534 per year is 69 percent greater than the income needed to meet the monthly mortgage obligations on a median-priced residence.
- ◆ **Outlook:** Foreclosure activity and severe price corrections catalyzed renters' transition into homeownership in many other housing markets but did not emerge in Indianapolis to a considerable extent. As a result, the metro will maintain a large pool of renters through 2010, further buoyed by the recent expiration of the homebuyer tax credit.

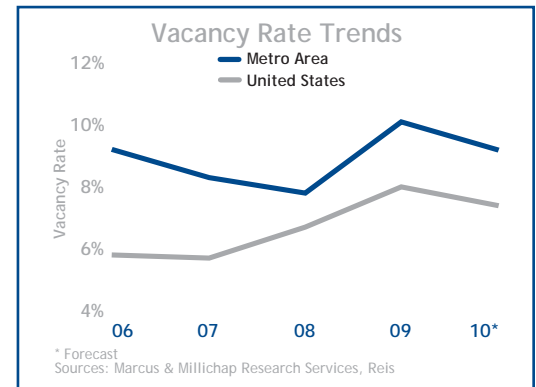


CONSTRUCTION

- ◆ The delivery of 840 apartment units year to date brought the 12-month total to roughly 1,370 units, or an inventory expansion of 1.3 percent. One year earlier, developers completed 1,480 units.
- ◆ Approximately 1,170 units are under way in the metro. Most of the projects are slated for the Hamilton County submarket, which received 1,000 units in 2009, and where 550 units are expected to come online this year.
- ◆ Although 5,500 apartment units are planned marketwide, current economic conditions have caused most builders to put off projects, as fewer than 1,000 units have established groundbreaking dates.
- ◆ **Outlook:** About 1,300 apartment units will be added to the market's inventory in 2010, down from the 1,640 units delivered last year. During the past five years, completions averaged 680 units annually.

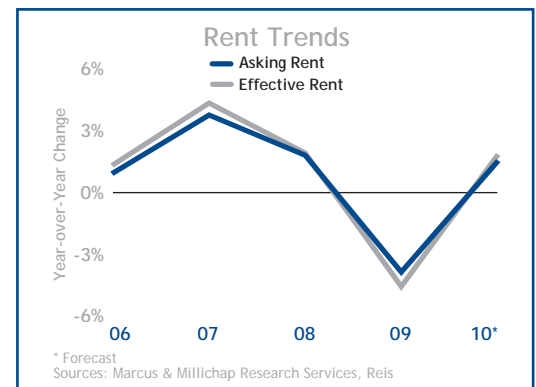
VACANCY

- ◆ During the last 12 months, the metrowide vacancy rate increased 110 basis points to 9.6 percent. Since peaking in the fourth quarter of 2009, however, vacancy has improved 50 basis points, driven by recent employment gains.
- ◆ More households are taking advantage of Class A leasing incentives, driving down top-tier vacancy by 20 basis points year to date to 8.7 percent. Measured year over year, the rate climbed 140 basis points.
- ◆ Lower-tier absorption trends also continue to gain momentum, supported by modest job growth and six years of no Class B/C stock additions. In the first half of 2010, lower-tier vacancy decreased 70 basis points to 10.3 percent. During the past 12 months, vacancy rose 80 basis points.
- ◆ **Outlook:** Improving employment will release pent-up renter demand. In 2010, the vacancy rate will fall 90 basis points to 9.2 percent, after jumping 230 basis points last year.



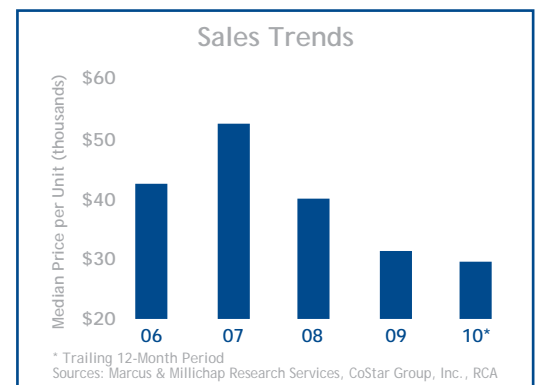
RENTS

- ◆ Over the past 12 months, asking rents contracted by 2.2 percent to \$654 per month, and effective rents retreated 2.5 percent to \$613 per month. With conditions improving, however, owners have raised both asking and effective rents by 0.8 percent year to date.
- ◆ Class A asking rents advanced 0.4 percent in the first half to \$749 per month, while owners of lower-tier complexes raised asking rents by 0.9 percent to \$576 per month. On a year-over-year basis, however, top-tier and Class B/C asking rents dropped 2.5 percent and 2.2 percent, respectively.
- ◆ Apartment concessions in Indianapolis metro averaged 23 days of free rent in the second quarter, nearly identical to offerings one year earlier. Recent occupancy gains and rent growth raised the average revenue by 1.4 percent in the first half of this year, an improvement from the 5 percent decrease registered in the prior two quarters.
- ◆ **Outlook:** Asking rents will rise 1.5 percent to \$659 per month in 2010, while effective rents will advance 1.8 percent to \$619 per month.



SALES TRENDS**

- ◆ Investors waiting for a spike in distressed assets curtailed deal flow over the past year. Transaction volume slowed 60 percent in that time.
- ◆ The median price of an apartment property in Indianapolis decreased 22 percent year over year to \$29,400 per unit. The drop was due to weakened rent rolls, particularly among smaller assets.
- ◆ Cap rates averaged in the mid- to high-9 percent range over the past year, up 50 basis points from year-earlier levels. Initial yields for stabilized assets will average in the mid-8 percent range in 2010.
- ◆ **Outlook:** Areas with strong renter demand, including the Central submarket and high-growth communities within Hamilton and Hendricks counties, will garner the most interest from institutional and high-net-worth investors, which may result in modest cap rate compression. Conversely, owners of distressed assets far from major employment hubs could lower prices further and increase cap rates slightly to draw buyers.



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

Marcus & Millichap

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

Indianapolis Office:

Joshua Caruana

Regional Manager

jcaruana@marcusmillichap.com

900 E. 96th Street

Suite 150

Indianapolis, Indiana 46240

Tel: (317) 218-5300

Fax: (317) 218-5310

Price: \$150

© Marcus & Millichap 2010

www.MarcusMillichap.com

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

- ◆ Growth patterns in Fishers have outpaced metrowide trends. Since 2000, the city has grown by 86 percent, or 33,000 new residents. While additions slowed to 2,400 residents in 2009, the area's growth rate is poised to rebound as the economy turns the corner, driving renter demand.
- ◆ In Noblesville, company relocations and consolidations will strengthen the area's extended outlook. Performance Marketing Group expects to consolidate operations into a new facility, while Miller Consulting Group Inc. plans to relocate its headquarters to the area, creating 230 jobs.
- ◆ Blue-collar job cuts have weighed heavily on the Class B/C operations in the Far Northeast submarket, where vacancy increased 500 basis points year over year to the mid-14 percent range. As a result, concession burn-off will not likely occur in the area until 2011, when job growth will accelerate.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Far Northwest	6.4%	-60	\$610	-3.2%
2	Johnson County	7.2%	-150	\$594	-2.8%
3	Near Northwest	7.5%	-120	\$556	-3.1%
4	Southwest	7.8%	0	\$578	-3.5%
5	Hancock/Shelby	8.0%	-250	\$575	-2.0%
6	Central	8.1%	50	\$767	-3.6%
7	Castleton	8.4%	70	\$688	-0.7%
8	Boone/Hendricks	8.6%	50	\$760	-2.3%
9	East	8.8%	260	\$526	-2.0%
10	Southeast	9.9%	120	\$591	-1.8%