

# ApartmentResearch

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

Marcus & Millichap

Wasatch Front

Third Quarter 2010

## SURGE IN COMPLETIONS TO DRIVE UP SALT LAKE CITY VACANCY

Despite a lack of job growth in late 2009 and early 2010, vacancy in the Salt Lake City apartment market remained relatively stable due to a temporary lull in completions. Job creation resumed in the second quarter and will accelerate during the second half, but apartment deliveries will surge, offsetting employment-generated renter demand and applying upward pressure to the vacancy rate. Weakening in fundamentals will be most pronounced in the West Jordan submarket, where construction remains concentrated. Completions this year will stay limited in the Central Salt Lake City, Davis County, Murray and Weber County submarkets, which will keep vacancy rates in these areas below the metrowide average.

More investors will move off the sidelines this year, but transaction velocity will continue at a reduced pace as for-sale inventory falls short of buyer demand. During the past two years, investors raised a significant amount of capital to purchase distressed properties, which have yet to materialize en masse within the Salt Lake City metro area, despite softening fundamentals. As lenders continue to opt for modifications and extensions over foreclosures this year, private investment groups will instead target stabilized assets, showing a strong preference for Class A and better-quality Class B projects of 100 units or more. As of midyear, Class A properties were being listed at cap rates in the low-7 percent range, down modestly from a year ago, while better-quality Class B properties generally came to market between 8.0 percent and 8.5 percent. While demand for larger properties will increase further this year, smaller Class B/C assets will account for the bulk of closed transactions, with cap rates starting around 8 percent and pushing into the 9 percent range for lesser-quality deals.

## 2010 ANNUAL APARTMENT FORECAST



**Employment:** Modest job gains through most of 2010 will offset losses recorded during the first quarter. Overall, employers in the Salt Lake City metro area will add 1,800 positions this year, a 0.3 percent increase.



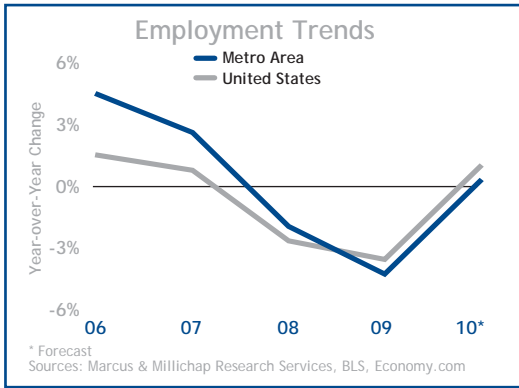
**Construction:** Approximately 2,900 apartments will come online in the metro during 2010, up from 1,960 units last year. Most of the new units will be completed in the second half.



**Vacancy:** After declining modestly in the first six months of 2010, vacancy will rise in the second half as significant new supply comes online. For the year, vacancy will increase 150 basis points to 8.7 percent, following a 220 basis point jump in 2009.

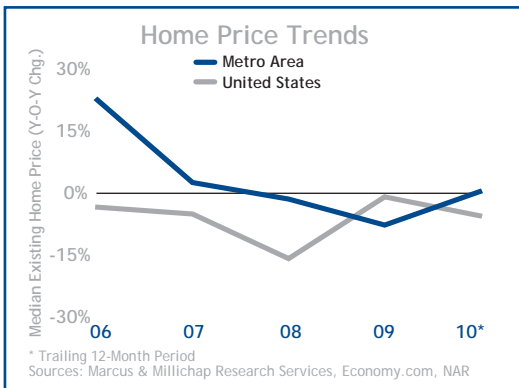


**Rents:** Asking rents will retreat 1.8 percent in 2010 to an average of \$719 per month, while effective rents will slip 2.1 percent to \$661 per month. Last year, asking and effective rents lost 2.7 percent and 4.5 percent, respectively.



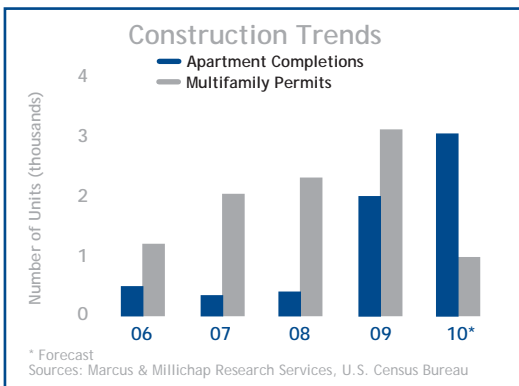
## ECONOMY

- ◆ Despite modest job growth during the second quarter, Salt Lake City employment declined by 3,000 jobs in the first half of 2010. Over the past year, payrolls contracted by 7,800 positions, or 1.3 percent, compared to a 5.5 percent drop registered during the previous 12-month period.
- ◆ The government and education and health services sectors, which posted growth through the recession, continued to outperform the broader economy in the first half, adding a total of 1,600 positions. During the same period, the manufacturing; trade, transportation and utilities; and financial activities sectors recorded the heaviest cutbacks.
- ◆ The leisure and hospitality, and professional and business services sectors, which, combined, accounted for nearly 14,000 job losses in 2008 and 2009, registered slight gains in the first half of 2010. In addition, the construction sector, which lost 13,000 positions during the recession, appears to be nearing stabilization.
- ◆ **Outlook:** Modest job gains through most of 2010 will offset losses recorded during the first quarter. Overall, employers in the Salt Lake City metro area will add 1,800 positions this year, a 0.3 percent increase.



## HOUSING AND DEMOGRAPHICS

- ◆ Developers pulled 1,800 multifamily permits over the past 12 months, down 42 percent from one year earlier. Single-family permitting activity, on the other hand, increased 39 percent year over year to 3,100 units.
- ◆ Home prices in Salt Lake City held up relatively well during the recession when compared to the national trend. As of mid-2010, the median price for an existing single-family home in the metro area was \$214,000, a 10 percent decline from the peak achieved in the third quarter of 2007.
- ◆ Assuming a 30-year fixed-rate mortgage and 20 percent downpayment, the mortgage obligation on a median-priced home exceeds the average Class A asking rent by approximately \$260 per month, down from \$570 per month two years ago.
- ◆ **Outlook:** Housing affordability increased in the Salt Lake City metro area over the past two years due to low mortgage rates and a 10 percent reduction in the median home price. Tighter residential lending standards and increased downpayment requirements, however, will continue to limit the loss of renters to homeownership.

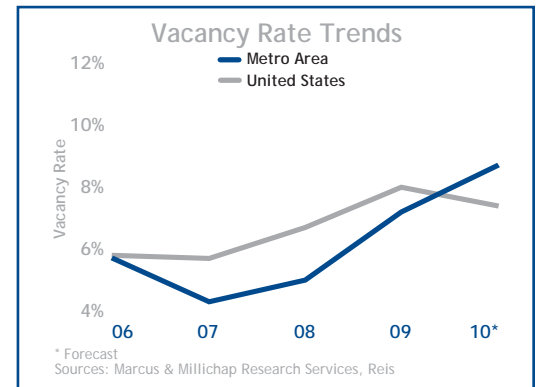


## CONSTRUCTION

- ◆ During the past 12 months, developers delivered almost 2,500 apartments to the metro area, up 164 percent from the prior 12-month period.
- ◆ Approximately 1,200 apartments came online in the first half of 2010, accounting for 40 percent of this year's forecast completions.
- ◆ Construction will remain concentrated in the West Jordan submarket this year. Looking ahead, however, one of the largest projects proposed for the metro area, a 324-unit complex, is located in Davis County.
- ◆ **Outlook:** Approximately 2,900 apartments will come online in the Salt Lake City metro area during 2010, up from 1,960 units last year. Most of the new units will be completed in the second half.

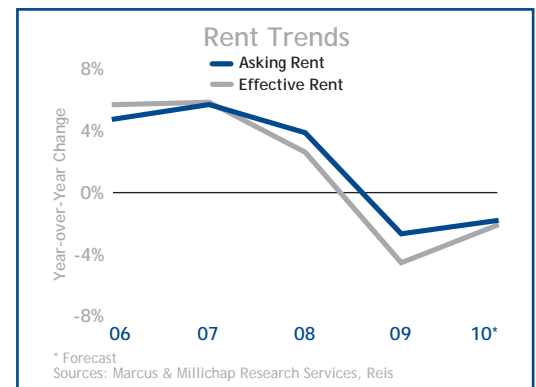
## VACANCY

- ◆ The vacancy rate retreated 10 basis points during the first half of 2010 to 7.1 percent but remained 120 basis points higher than year-earlier levels.
- ◆ Vacancy improvement earlier this year can be attributed mostly to stronger demand for top-tier units. Class A vacancy slipped 50 basis points to 7.5 percent during the first half, compared to a 10 basis point increase to 7 percent in the Class B/C sector.
- ◆ Vacancy in West Jordan increased during the second quarter, but at 11.9 percent, it remained 60 basis points below year-end 2009 levels. As a significant number of new apartments are completed in the submarket during the second half, vacancy will rise substantially.
- ◆ **Outlook:** After decreasing modestly in the first six months of 2010, vacancy will rise in the second half as new supply comes online. For the year, vacancy will increase 150 basis points to 8.7 percent, following a 220 basis point jump in 2009.



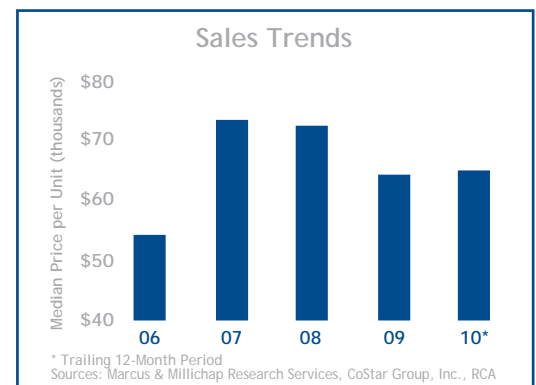
## RENTS

- ◆ The average asking rent in the metro area slipped 1.5 percent over the past year to \$730 per month, while effective rents declined 1.6 percent to \$673 per month. Through the first half of 2010, asking rents lost 0.3 percent, while effective rents gained 1 percent.
- ◆ As of midyear, leasing incentives in the Salt Lake City apartment market averaged 3.5 weeks of free rent on a one-year lease, up from 2.5 weeks in late 2007.
- ◆ Lower-tier properties registered more dramatic hits to occupancy over the past year and above-average reductions in rents. Class B/C rents slipped 2.9 percent in that time, compared to a 0.1 percent decline for Class A units.
- ◆ **Outlook:** Asking rents will retreat 1.8 percent this year to an average of \$719 per month, while effective rents will drop 2.1 percent to \$661 per month. Last year, asking and effective rents lost 2.7 percent and 4.5 percent, respectively.



## SALES TRENDS\*\*

- ◆ Sales velocity will continue at reduced levels in the near term as for-sale inventory remains limited. Similar to the first part of 2010, the majority of apartment deals in the second half will involve private, in-state buyers.
- ◆ The median price per unit for local apartments increased during the first half of 2010 to approximately \$67,500, up from \$64,300 per unit in 2009.
- ◆ Cap rates for the few Class A properties that have become available in recent quarters tend to start in the low-7 percent range. Class B deals generally trade between 8.0 percent and 8.5 percent, with Class C cap rates pushing into the 9 percent range.
- ◆ **Outlook:** Investors who raised capital in anticipation of a wave of distressed deals will continue to shift their focus to stabilized Class A and Class B assets this year, as REO listings remain scarce.



\*\* 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

- ◆ The Central Salt Lake City submarket may weaken in the near term alongside the metro, but local apartment owners should receive a boost from the City Creek project. The mixed-use development is slated for completion in 2012 and will draw new businesses and residents to the area.
- ◆ Vacancy in the West Jordan submarket declined in early 2010 but will increase significantly during the second half as a wave of new supply comes online. Developers will deliver approximately 2,100 units to the submarket in 2010, up from 1,100 units last year.
- ◆ Concessions vary widely throughout the metro, ranging from two weeks of free rent in the Davis County and West Valley city submarkets to more than five weeks of free rent in West Jordan. This discrepancy will become more pronounced this year as new stock drives up vacancy in parts of the metro.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Northwest Salt Lake/Airport	4.7%	50	\$584	-2.7%
2	West Valley City	5.0%	30	\$650	-1.4%
3	Davis County	5.2%	-60	\$668	0.5%
4	Murray	5.8%	0	\$722	-1.4%
5	Central Salt Lake City	5.9%	80	\$735	0.7%
6	Midvale/Sandy	6.7%	150	\$734	-0.3%
7	Weber County	6.8%	-80	\$619	-0.8%
8	Southwest Salt Lake City	7.5%	100	\$622	-1.9%
9	South Salt Lake/Cottonwood	8.9%	210	\$633	-3.2%
10	West Jordan	11.9%	510	\$775	3.3%