ApartmentResearch
MARKET UPDATE

Marcus & Millichap

San Antonio Metro Area *Third Quarter 2010*

Metrics Poised for Rebound as Job Gains Increase, Building Slows

Following a slow start in the first half of 2010, the San Antonio apartment market will begin to firm through the rest of the year as employment growth and household creation pick up and the construction cycle decelerates. Along with strengthening job growth, elevated residential foreclosures also will generate renter demand in the coming quarters. The largest catalyst of apartment demand this year, however, will stem from Base Realignment and Closures (BRAC) actions. As part of the BRAC military base consolidation efforts, Fort Sam Houston will become the world's largest medical training campus. The base restructuring will bring nearly 10,000 new households to the metro through 2010 and into next year, with some of these relocations already under way. Metrowide, supply growth will drop off considerably in the coming months, as 86 percent of this year's scheduled completions came online in the first half. As a result, apartment operations will begin to tighten, particularly in complexes catering to military personnel, facilitating some rent increases and concession withdrawals.

Few quality assets have come to market, hindering deal flow, but as more owners re-evaluate portfolios and consider divesting noncore holdings, investment opportunities will emerge. Private, out-of-state owners who acquired mid- and lower-tier assets during the run-up have begun to retrench to their native markets. In addition, a potential capital gains tax increase could lead to the disposition of assets, allowing local investors to capitalize on attractively priced properties. Institutions, meanwhile, will likely remain cautious, delaying acquisitions until more vigorous employment growth materializes next year. In fact, some REITs, pension funds and developers will continue to downsize their local portfolios, presenting high-net-worth buyers with unique opportunities to acquire rarely listed Class A buildings. Cap rates in transactions made this year will average in the mid-8 percent to low-9 percent range, where they should remain as fundamentals firm.

2010 Annual Apartment Forecast

0.9% increase in total employment

Employment: Following the loss of 20,600 jobs last year, local employers will increase head counts by 7,500 spots in 2010, a 0.9 percent gain.

2,680 units will be completed

Construction: Builders will deliver 2,680 apartment units this year, down from 4,770 units in 2009. Completions will expand stock by 1.8 percent, down from the five-year average of 2.5 percent.

30 basis point decrease in vacancy

Vacancy: As completions slow to a trickle in the second half and companies expand payrolls modestly, the San Antonio apartment market will tighten. This year, vacancy will reach 9.9 percent, a 30 basis point improvement, following a 120 basis point spike in 2009.

2.2% increase in asking rents

Rents: Occupancy gains in the coming quarters will encourage owners to recoup lost rents. Asking rents will rise 2.2 percent in 2010 to $700 per month, and effective rents will increase 2.4 percent to $651 per month.

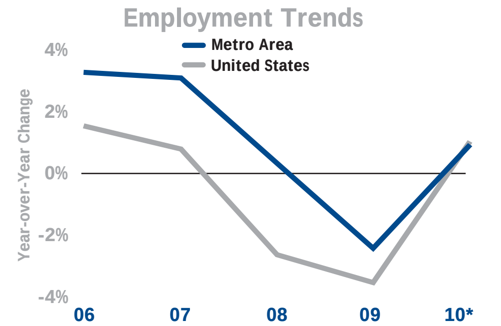
Economy

- Year-over-year payroll reductions in the San Antonio metro area slowed to 2,200 spots, a 0.3 percent decrease, supported by the hiring of 3,700 workers in the first half of 2010. During the prior 12-month stretch, local employers eliminated 18,800 positions.

- Most sectors have begun to re-expand staffing levels. The government segment posted the largest year-to-date gain, adding almost 2,900 workers, though some of the increase was due to the hiring of temporary census positions that will be cut in the third quarter. The education and health services sector grew by 750 employees during the first half, bringing its annual gain to 1,500 jobs.

- InCube Labs plans to open five life-science laboratories in the metro over the next five years. The addition of the facilities will create 50 jobs in that span, though city officials anticipate at least 400 local jobs could be generated by the labs within the next 10 years.

- **Outlook:** Following the loss of 20,600 jobs last year, local employers will increase head counts by 7,500 spots in 2010, a 0.9 percent gain.



* Forecast
Sources: Marcus & Millichap Research Services, BLS, Economy.com

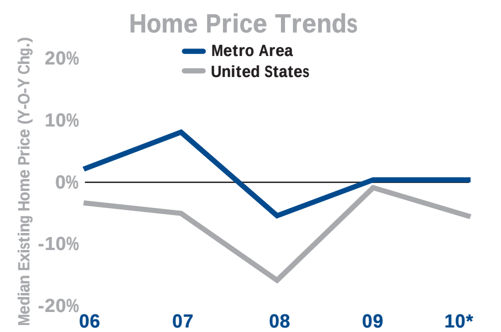
Housing and Demographics

- Single-family permit issuance totaled 6,040 units in the past 12 months, up from 5,200 units one year earlier. Permitting activity for multifamily housing plunged 58 percent year over year to 765 units.

- Despite fluctuating from quarter to quarter, the metrowide median existing home price increased 0.4 percent during the past year to $150,500. Layoffs in that time drove down the median household income 2.9 percent to $43,500 per year. Still, annual earnings remain nearly $6,000 more than the required income to qualify for a mortgage on the median-priced home.

- Renting will remain the most affordable option for residents. Using traditional financing, the average Class A asking rent is roughly $100 per month less than the typical mortgage payment on a median-priced home.

- **Outlook:** While home purchases will continue to pose a considerable threat to apartment owners as job growth picks up, many residents remain unable to qualify for a home loan or are reluctant to commit to substantial debt. As demand for rental units intensifies early in the recovery, the rent/own affordability gap will enable Class A owners to gradually raise rents this year.



* Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, Economy.com, NAR

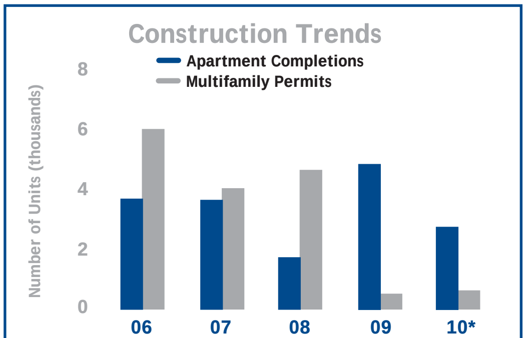
Construction

- Metro apartment inventory levels swelled over the past year as developers finalized the few remaining projects in the pipeline. Year over year, roughly 4,740 apartment units came online, increasing stock by 3.3 percent. One year earlier, deliveries totaled 2,930 units.

- Apartment builders are slowing activity, as fewer than 650 units are under way. Proposed projects account for 6 percent of existing inventory, or 8,500 units, though no groundbreaking dates have been set.

- The largest project completed this year, the 436-unit Haven Blanco, came online in the Far North Central submarket during the first quarter and expanded the area's inventory by 1.3 percent.

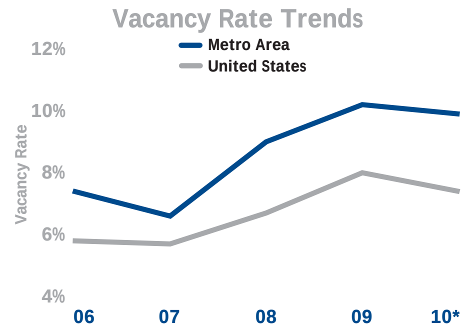
- **Outlook:** Builders will deliver 2,680 apartment units this year, down from 4,770 units in 2009 and a stock expansion of 1.8 percent.



* Forecast
Sources: Marcus & Millichap Research Services, U.S. Census Bureau

Vacancy

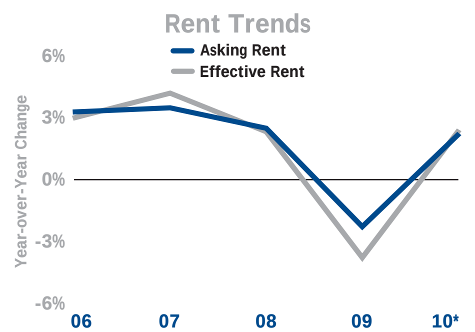
- Despite an influx of new supply, the metro's vacancy rate held flat year over year at 10.2 percent. Job gains, demand generated by Fort Sam Houston and foreclosures contributed to the absorption of recently delivered units.
- In addition to generous concessions offered at newer complexes, financially secure lower-tier renters continue to upgrade. As a result, the Class A vacancy rate in the market improved 20 basis points over the past year to 9.6 percent.
- The vacancy rate in the lower tiers pushed up 10 basis points in the last year to 10.7 percent, as Class B/C renters moved into newer assets with additional amenities. Over the past two quarters, however, lower-tier vacancy improved 30 basis points.
- **Outlook:** As completions slow in the second half and companies expand payrolls modestly, the San Antonio apartment market will tighten. This year, vacancy will reach 9.9 percent, a 30 basis point annual improvement, following a 120 basis point spike in 2009.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Rents

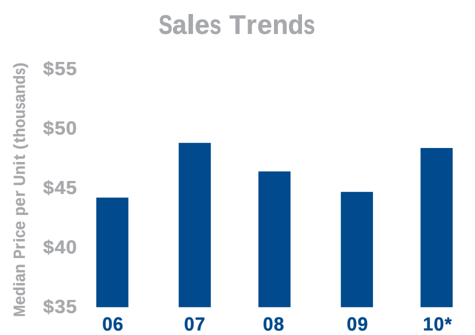
- Stabilized occupancy levels, along with the delivery of newer, more expensive space, helped push up asking rents in the metro by 1.3 percent over the past year to $695 per month. As owners raised concessions to fill units, however, effective rents grew just 0.8 percent to $648 per month.
- Top-tier asking rents advanced 1.4 percent during the 12 months ending in the second quarter to $818 per month, while Class B/C owners scaled back rents 0.2 percent to $587 per month. Year to date, however, lower-tier rents increased 0.5 percent.
- Concessions averaged 25 days of free rent in the second quarter, up from 23 days of free rent in the same period last year.
- **Outlook:** Modest occupancy gains in the coming quarters will encourage owners to raise rents. Asking rents will advance 2.2 percent in 2010 to $700 per month, and effective rents will increase 2.4 percent to $651 per month.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Sales Trends**

- Although sales velocity held steady over the last year, the bulk of closings occurred in the early part of that period, with the number of sales during the first half of 2010 accounting for just 23 percent of the trailing 12-month total.
- The median price of an apartment complex in the metro increased 16 percent year over year to $48,250 per unit. While some buyers are targeting distressed assets, most remain highly selective and are purchasing the few cash-flowing listings that come to market.
- During the second half of 2010, cap rates will likely average in the mid-8 percent to low-9 percent range.
- **Outlook:** Stability-seeking buyers will show strong interest for assets around Fort Sam Houston and the South Texas Medical Center, as renter demand near these employment hubs historically helps to sustain healthy operations.



* Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

*** 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 city of San Antonio was awarded a $1.3 million grant to aid in neighborhood revitalizations around Fort Sam Houston. The efforts aim to attract retail development to the Walters Street corridor, which will, in turn, spur job growth and renter demand of nearby apartment units.
- The Far Northwest submarket will receive a boost from the new Allstate Insurance Co. customer information center, which opened during the second quarter. Thus far, the new facility has created roughly 270 jobs, and the company is seeking to fill another 300 positions at the site.
- Supply additions during the first half of this year were largely concentrated in the Far North Central submarket, where roughly 1,490 units came online, expanding area inventory by 4.5 percent. As owners attempt to fill these units, concessions will total more than one month of free rent by year end.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	South	7.1%	-20	$544	0.7%
2	East	8.1%	-140	$730	2.5%
3	Airport/Northeast	9.4%	-160	$680	0.1%
4	Central San Antonio	9.6%	360	$659	7.9%
5	Far Northwest	9.8%	40	$668	0.6%
6	Northwest	9.8%	50	$485	-0.4%
7	Far West	10.1%	-320	$621	1.0%
8	Far North Central	10.6%	130	$684	-0.7%
9	Far Northeast	10.7%	60	$614	1.2%
10	Southwest	16.5%	10	$505	0.6%

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