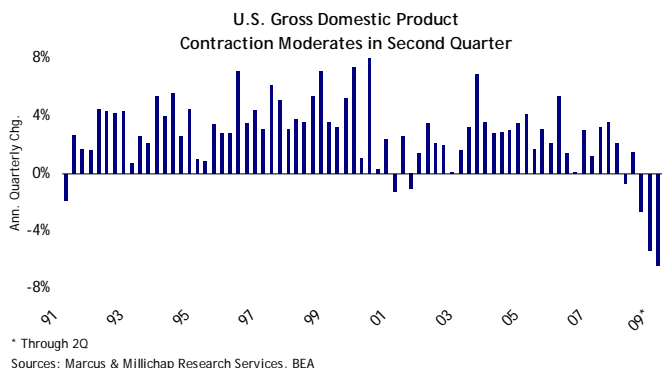




Technical End to Recession Likely in Current Quarter, but Real Economic Growth Yet to Come

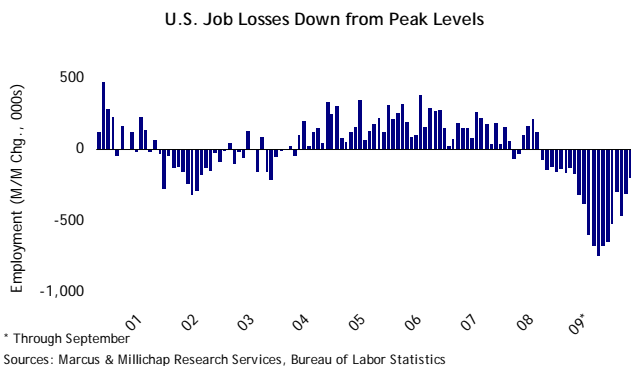
Several indicators offer cause for guarded optimism, though the economy has not yet cleared the woods. While U.S. GDP contracted for the fourth consecutive period in the second quarter, the rate of decline slowed dramatically. Government spending and net exports posted moderate growth during the quarter; however, personal consumption, which accounts for 70 percent of GDP, weakened further. Employment trends continue to reflect softening across industries, though job losses have decelerated.

Until meaningful and sustainable job growth resumes, which is unlikely until at least mid-2010, consumers will remain cautious. Since the U.S. economy is largely consumer-driven, this greatly reduces the chances of a snapback recovery, which has followed some recessions. Instead, the economy will likely stabilize and post only modest expansion starting in late 2009. The outlook for even mild GDP growth is based on assumptions that housing has touched bottom and the stimulus package has started contributing to growth.



GDP Contraction Decelerates, Likely to Turn Positive in Current Quarter. U.S. GDP contracted at an annualized rate of 0.7 percent in the second quarter, following a 6.4 percent drop in the previous quarter. The latest release suggests that the most severe recession since the Great Depression has finally begun to lose steam. Although businesses have yet to increase spending, they have stopped slashing expenditures at a double-digit pace. For perspective, business spending shaved just 1 percentage point from GDP during the second quarter, compared with 5.3 percentage points in the first quarter. There were a few true bright spots in the latest GDP release. Government spending, which lost ground earlier this year, added 1.3 percentage points to GDP in the second quarter, while net exports contributed 1.65 percentage points. Third quarter GDP is expected to reflect growth, mainly due to an end to inventory reductions.

Job Losses Down from Extreme Levels. In September, employment declined by 263,000 jobs, the second-lowest monthly loss reported since the global financial crisis began a year ago. Payroll cuts remain widespread and high by historical measures, however, with a record-setting 7.2 million positions lost since the start of the recession. During September, manufacturers shed 51,000 jobs, which is a substantial decrease, though it pales in comparison to the average elimination of 150,000 positions per month in the first half of the year. Similarly, office-using employment contracted for the 21st consecutive month in September, though the decline was the smallest recorded since late 2007. This may come as little consolation to office property owners who have lost tenants in recent months, though it appears to be a step in the right direction. Unemployment increased to 9.8 percent in September and is



forecast to surpass 10 percent by year end as those who suspended job searches begin to re-enter the labor pool. On a positive note, reduced staffing and other cost cuts have resulted in stronger corporate profit margins.

Housing Near Bottom. Low residential mortgage rates and attractive pricing have moved many prospective homebuyers off of the sidelines, leading to reduced for-sale inventory and increased sales in four of the past five months. The \$8,000 tax credit available to first-time buyers has also encouraged purchases ahead of the program's deadline of Nov. 30. Although sales have improved, 25 percent of activity involves bank-owned homes, which typically sell at deep discounts. With roughly 13 percent of homeowners with a mortgage behind on payments or in foreclosure, further price reductions may occur in some markets, even as transactions increase. Nationwide, housing affordability has risen dramatically, and the overhang of for-sale homes could be steadily absorbed once job growth resumes.

"U"-Shaped Recovery Likely. With additional losses expected in the fourth quarter of 2009, employment forecasts call for a 4.5 million contraction this year, bringing the total lost during the recession to 7.6 million positions. Aside from the recent rise in auto sales spurred by the now-expired "Cash for Clunkers" program, consumers and businesses will continue to limit spending until clear signs of an economic recovery emerge. Government stimulus will help to offset the consumption gap in the near term; however, the full effects of legislative action may not be felt until mid-2010, as only a fraction of the available funding through the stimulus package has been spent to date. The recovery will require several months to gather momentum.

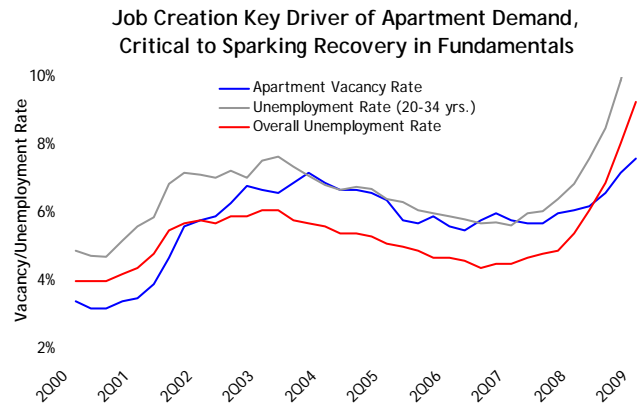
Maturing Debt Remains Key Challenge for Commercial Real Estate. An estimated \$535 billion of commercial mortgage debt will mature over the next two years. Due to declining NOIs and values, as well as tighter lending criteria, a large share of these mortgages may not qualify for refinancing without significant equity contributions from owners. After witnessing the devastating impact of foreclosures on residential property values, portfolio lenders have become increasingly willing to work with commercial borrowers to avoid foreclosures. Borrowers with CMBS debt are in a more challenging position, since delinquent loans are transferred to special servicers, which have tighter regulations on the modifications they can offer.

Government Programs Aimed at Unlocking Credit Markets Show Promise. The complexity of financial sector challenges caused the Term Asset-Backed Securities Loan Facility (TALF) and the Public-Private Investment Program (PPIP) to get off to a slow start. A scaled-down version of PPIP has begun moving forward, however, and the component of TALF focused on commercial mortgage-backed securities (CMBS) is gaining momentum. At least two major REITs are close to completing new-issue, TALF-eligible CMBS deals, and more could follow. Much of the capital raised will likely be used to pay down maturing mortgage debt, which has become increasingly difficult to refinance through traditional lending channels. The legacy CMBS component of TALF is already operational, with approximately \$3.5 billion in loans funded to date. These programs, designed to help restart the CMBS market, will increase lending for new property acquisitions and the refinancing of maturing debt.

Opportunities Emerging for Commercial Real Estate Investors. Economic recovery will require several quarters to gain momentum; therefore, investors awaiting the return of strong economic expansion to redeploy capital into commercial real estate are at risk of missing attractive acquisition opportunities. A tremendous amount of capital waiting for well-priced, quality assets to be offered for sale has been accumulated, and many investors have begun to move off of the sidelines.

Apartment Fundamentals Remain Weak, but Construction Starts at 16-Year Low, Supporting Recovery Outlook for Late 2010 and 2011

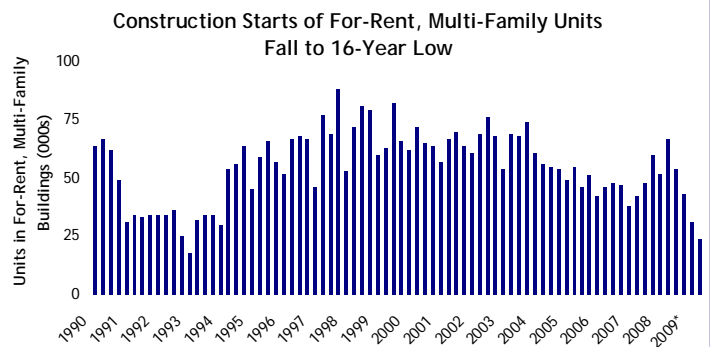
Apartment Vacancy Pushes Past Previous Cyclical Peak Set in 2004. Vacancy increased 30 basis points in the second quarter of 2009 to 7.7 percent, bringing the year-over-year change to 160 basis points. Persistent job losses have hampered new household formation and led renters to double up or move in with family, cutting severely into apartment demand. Greater housing affordability and the first-time homebuyer tax credit also have negatively affected demand, though to a lesser degree. Aggravating the impact of stalled demand on operators is the rising inventory of shadow rentals entering the market. In addition, many condo developments are being delivered as rentals.



Sources: Marcus & Millichap Research Services, BLS, Reis

Completions Outpacing Demand, but Construction Starts Falling. Approximately 23,000 apartments were completed during the second quarter, only slightly below the five-year quarterly average. Most projects coming online this year broke ground before the credit crunch escalated to a global financial crisis and job losses spiked last fall. Until that point, the apartment market showed considerable resilience to the economic downturn, posting only modest increases in vacancy. Starting in the fourth quarter of 2008, construction starts began to fall rapidly as the recession deepened and expectations for any improvements in 2009 vanished. As of second quarter 2009, starts were 50 percent below year-earlier levels and at their lowest point since 1993.

Apartment Sales Remain in Lull; Some Encouraging Signs Emerge. As of the second quarter of 2009, apartment sales dollar volume was down 70 percent from one year earlier and nearly 90 percent below peak levels achieved in the fourth quarter of 2006. Although sales remain depressed relative to year-ago levels, the market recorded a 25 percent increase in dollar volume from the first to second quarter of 2009. Led by a handful of REITs, activity in the higher price ranges began to pick up by midyear after falling precipitously for several quarters; however, smaller deals continue to account for the majority of transactions in the marketplace.



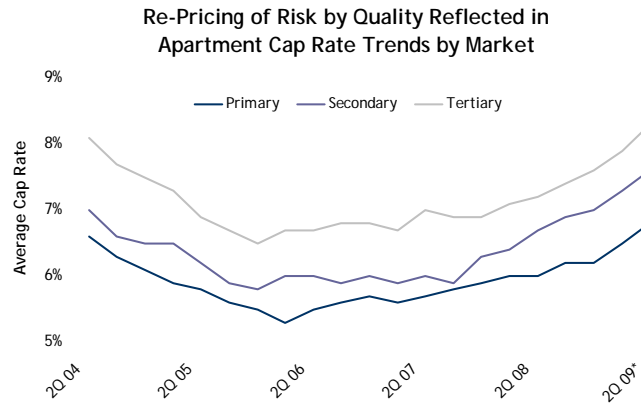
* Through 2Q

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

Cap Rate Adjustments Continue; More Buyers Becoming Active.

Nationwide, the average apartment cap rate increased 160 basis points from its 2006 low to 7.2 percent. Although cap rates are rising across the board, the degree of change is most pronounced for lower-quality assets in secondary/tertiary markets and among some of the most expensive properties in the nation. During the recent liquidity boom, top-tier assets and large portfolios were attractive to major private investors and lenders, allowing for quick deployment of large amounts of capital. Major properties and portfolios were commanding premiums as a result, driving down cap rates at the high end of the market.

In the current climate, financing deals over \$15 million has become increasingly difficult, giving major investors with cash on hand additional negotiating leverage with highly motivated sellers. Approximately 94 percent of apartment sales during the first half of 2009 were below \$20 million, compared with 77 percent in the fourth quarter of 2007. Well-priced A- and B-quality assets are seeing strong buyer interest and multiple offers.



Sources: Marcus & Millichap Research Services, Real Capital Analytics

Delinquency Up, but Quality Assets Account for Minor Share of Distress Sales. Many apartment owners are benefiting from continued lending by Fannie Mae and Freddie Mac, which continue to post low delinquency rates due to their adherence to conservative underwriting standards in recent years. Maturing debt and weakening fundamentals are nonetheless resulting in rising delinquency rates and growing distress, particularly in the CMBS sector. Many portfolio lenders are showing an increased willingness to work with at-risk borrowers, preventing a more significant surge in high-quality, bank-owned inventory. In order to avoid foreclosure-related losses in the near term, many lenders are extending loan terms.

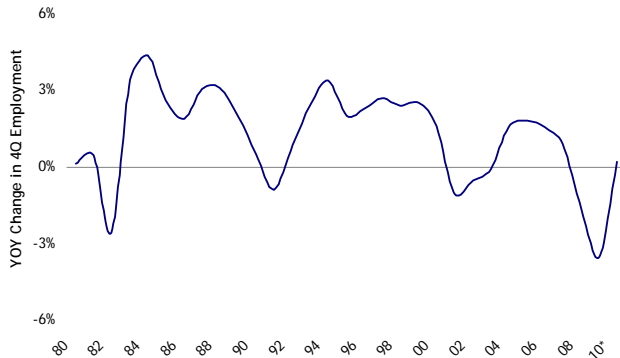
Forecast:

Weakness to Persist into 2010. Without any meaningful job creation expected until the second half of 2010, apartment vacancy is forecast to weaken further. By year-end 2009, vacancy will likely surpass 8 percent, its highest level since at least 1980. Nationwide, effective rents are forecast to decline by approximately 6 percent this year, though double-digit reductions will afflict the hardest-hit markets. As construction comes to a virtual halt later next year and job growth gains traction, vacancy rates should stabilize. Owners, however, are expected to maintain their focus on filling vacant units.

Development Pullback Brightens Outlook for Second Half of 2010 and 2011. Based on the current development pipeline, roughly 94,000 apartments will be delivered in 2009. Completions are forecast to decline to 65,000 units in 2010, with a large share of the units likely to come online earlier in the year. From that point, completions will taper dramatically, reflecting the drastic cutback in new starts recorded in recent quarters. The falloff in new supply is expected to coincide with the resumption of sustainable employment and economic growth. As demand gains momentum and new supply stalls, apartment operations should strengthen significantly.

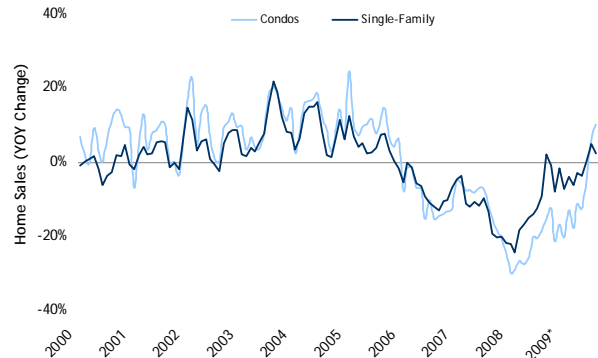
Apartment Market Vital Signs

Nonfarm Employment Change



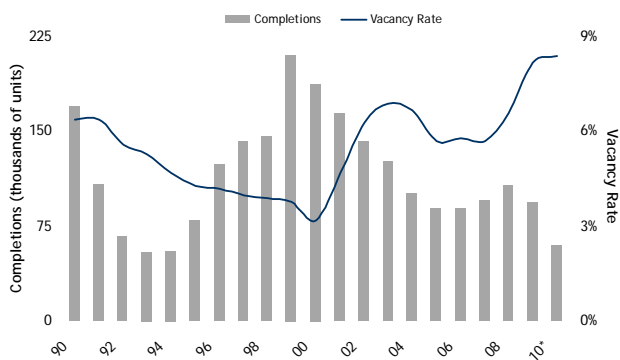
* Forecast
Sources: Marcus & Millichap Research Services, Economy.com

Existing Single-Family and Condo Sales



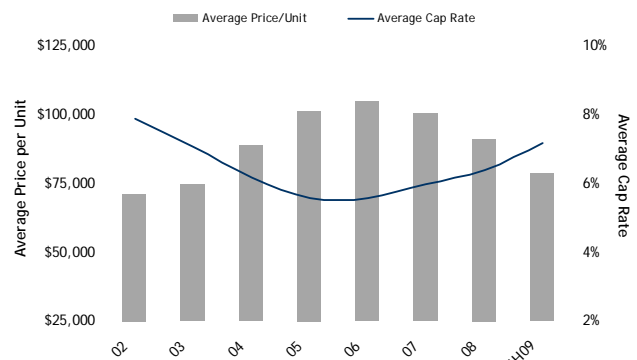
* Through August
Sources: Marcus & Millichap Research Services, Economy.com

Apartment Supply and Vacancy Trends



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Apartment Price and Cap Rate Trends



Sales figures represent transactions of \$1 million+
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

2Q 2008 to 2Q 2009 Change in Apartment Vacancy

Markets by Least Change in Vacancy

Metro	2Q 2009	YOY Chg. (bps)
Raleigh-Durham	7.3%	-90
West Palm Beach	8.2%	0
Louisville	6.6%	30
Minneapolis-St. Paul	4.4%	30
Boston	6.5%	40
Salt Lake City	5.7%	40
Columbus	8.0%	60
New York City	2.9%	60
Cincinnati	7.2%	60
Indianapolis	8.2%	70
U.S. Metro Average	7.7%	160

Sources: Marcus & Millichap Research Services, Reis

Markets by Greatest Change in Vacancy

Metro	2Q 2009	YOY Chg. (bps)
Seattle-Tacoma	6.9%	200
Oakland	6.4%	210
San Antonio	9.8%	210
Denver	9.1%	220
Atlanta	11.2%	240
Jacksonville	13.1%	240
Las Vegas	9.7%	260
Austin	10.1%	300
Tucson	9.9%	300
Charlotte	10.1%	350
U.S. Metro Average	7.7%	160

The information in this report is deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, expressed or implied, may be made as to the accuracy or reliability of the information contained herein. Sources: Marcus & Millichap Research Services, CoStar Group, Inc., DataQuick, Deutsche Bank, Economy.com, Federal Reserve, MBAA, NAR, Real Capital Analytics (RCA), Reis, U.S. Census Bureau.

Written by Erica Linn

September 2009

For more information, contact John Chang, National Research Manager, at (602) 687-6700, ext. 6803.

© 2009 Marcus & Millichap