Salem Multifamily Report

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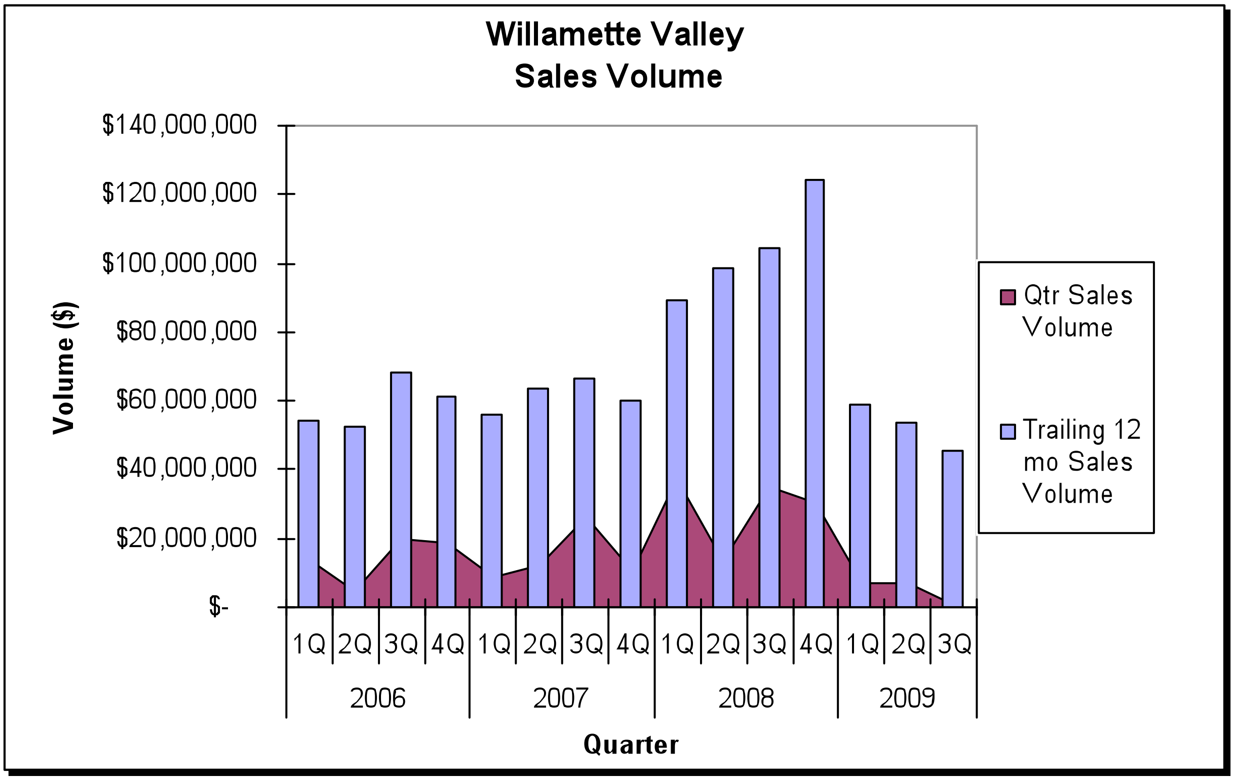
Over the last 12 months, the Willamette Valley (WV) has quickly joined the rest of the nation in the grip of the economic recession. My annual forecast in February highlighted that 2009 was likely to be a back to basics year. I said then that landlords must stay ahead of market conditions as the recession continues and especially keep a close eye on proposed state and local government job cuts during the current legislative session. The unemployment rate then was 9 percent but rose to 11.2 percent by August 2009. I noted earlier that the unemployment rate threatened continued low vacancy in the market and suggested that sales would occur as investors realized the underlying strength of the Willamette Valley market. Since that time, the Willamette multifamily market has seen a steep decline in occupancy rates and transaction volume and the reemergence of rent concessions as the national recession has deepened. The



current operating conditions, coupled with the tightening of the credit market, have brought the multifamily investment market to a near standstill.

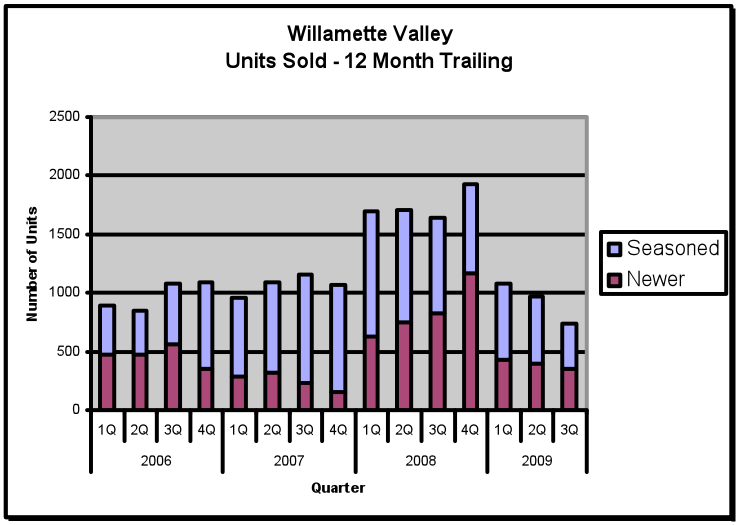
Transactions

The year-to-date numbers for the WV multifamily sales market are in line with national trends. According to Real Capital Analytics (REAL), nationally, multifamily investment-sales volume of properties >$5 million declined 79 percent over the first half of 2009 as compared to the prior year. In the WV, multifamily investment sales volume of properties >5 units declined 72 percent during the same period as sales of only 275 units for $14,109,000 were closed. This is the lowest transaction volume since the first two quarters of 2005 yielded closings on 301 units for $14,258,000.

The 12-month trailing sales volume for the WV fell to $45,312,900, off from $103,304,300 one year ago (Figure 1). The number of transactions dropped from 36 to 20, and units sold decreased from 1,640 to 734 in the same time period. As sales volume has decreased, listing volume has picked up due in large part to properties sitting with little activity or interest.

Currently in the WV, LoopNet, RMLS, and the Willamette Valley MLS have 109 >5 unit multifamily properties listed for sale. Of those 109 multifamily projects on the market, only 17 are listed with capitalization rates greater than 7.0, and several of those have cap rates based on proforma financials. Year to date, Oregon has only seen three transactions with properties greater than 100 units in size. Two of those traded at a reported 7.6 cap rate: Pacific Crest in Tigard and McKenzie Meadow in Springfield. It is likely that one year ago these projects would have traded in the 6.25-6.75 percent cap rate range.

Due in part to the disparity between asking CAP rate and selling CAP rate, the number of properties on the market and the average length of time a property is on the market is increasing. This increase in supply has had some impact on the price paid per unit, although with so few transactions in the WV it is difficult to compare sales today with past activity. According to REAL, properties purchased between 2005 and 2008 have suffered price drops of more than 20 percent, with multifamily properties purchased at the market's peak in 3Q 2007 dropping 32.2 percent peak to trough. The 12-month trailing price paid in the WV for seasoned units peaked in 3Q 2008 at $59,991; that average price paid fell to $42,434 in 2Q 2009. For new units, the price peaked with the national market in 3Q 2007 at $81,106, fell sharply to $63,832 in 2Q 2008, and has since recovered to $72,672.



Notable WV sales in 2Q 2009 include: Hollywood Park Apartments in Salem, 52 units built in 1979, at $42,308/unit; Typres Gardens in Newberg, 20 units built in 1973 at $42,500/unit and at a 7.6 percent cap.

Vacancy/Concessions

In her most recent Apartment Survey, Shirley Layne, an appraiser at Powell Valuation Inc, states that Salem/Keizer "vacancy has more than doubled from 2.95 percent to 6.17 percent since the fall 2008 survey, and concessions or inducements to occupy are being offered at almost every apartment complex." Concessions have reentered the market with one-month free rent fairly standard on a 12-month lease in addition to move-in fee waivers. The waiver of move-in fees may also be in response to Oregon SB 771-B as landlords prepare for new limits on allowable fees which will begin January 1, 2010.

The outlook for a reduction of vacancy rates is not optimistic as long as unemployment rates remain high, especially for those workers under 29 years of age. Nationally, 78 percent of households under age 25, and 63 percent of households under age 29 are renters. According to Dr. Sam Chandin, President and Chief Economist Real Estate Econometrics, "Among the current challenges for multifamily investors and operators, the absence of new jobs for recent graduates and other young people has resulted in a sharper increase in the unemployment rate for these groups. But without jobs and the resulting income streams, the members [of that demographic group] demonstrate a lower propensity to form new households. Some move home after college; others double-up. In both cases, a keystone of rental demand softens, resulting in lower apartment occupancy and rental rates."

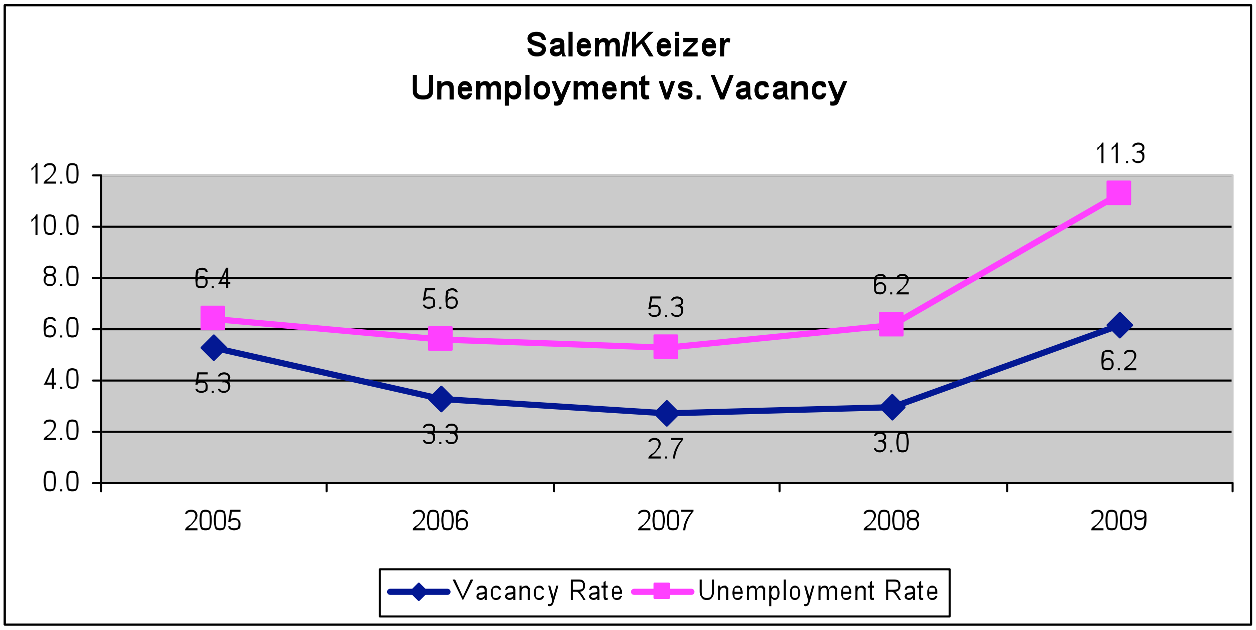


Chart data provided by Shirley Layne, Powell Valuation Inc

As clearly demonstrated in the chart above, there is a high degree of correlation between unemployment rates and vacancy rates. The greatest concentration of vacancies in newer projects is in two-bedroom, two-bathroom units (exceeding 8 percent vacancy), while two-bedroom, one-bathroom units have the highest rate in seasoned properties (exceeding 5 percent vacancy). This is telling for the overall market in that these unit types represent the greatest number of total units in their respective categories. Non-stabilized projects completed in 2008 and 2009 are reporting 20-50 percent vacancy rates and are finding it difficult to obtain permanent financing.

There is speculation that much vacancy is due to renters moving into homeownership. One should hesitate to place much weight on that theory. Although interest rates remain low and there is the first time home buyer tax credit available for purchases through December 1, 2009, potential homebuyers need to be employed, need to have a downpayment saved and need to qualify in today's new lending environment. The barriers to entry as a homebuyer are much higher today than at the market's peak in 2007.

As vacancies have escalated, market rents have flattened with little change from 2008. Two-bedroom, one-bathroom rents in seasoned properties range from $464 in East Salem to $659 in Keizer. Two-bedroom, two-bathroom rents in newer properties range from $678 in East Salem to $765 in Southeast Salem. Projects in a rent up period offer two-bedroom floor plans from $725 at Santiam Village in East Salem to $875 at Hawks Point in Keizer. Concessions have not dramatically affected rent collection year-to-date, but watch for a greater impact on economic rent collection (i.e. gross rent, less vacancy, less concessions) in 2010.

Summary

Economic headlines have been anticipating the bottoming out of the recession. However, for the next 12 to 36 months, the bottom will be rocky for multifamily investors as anticipated:

- by the acceleration of delinquency rates in the collateralized mortgage-backed securities (CMBS) universe;
- by the resetting of partial interest-only loans;
- by the failure of pro forma loans to stabilize;
- by the threat of loans reaching maturity, then not qualifying for a large enough refinancing to retire existing debt; and
- by vacancy rates continuing to climb to match high unemployment rates during a projected long, jobless recovery from the current recession.

Capitalization rates will continue to rise as nonperforming assets reach the market and income will suffer due to pressure on rents from concessions and ongoing vacancy. Finally, apartment sales will continue to lag due to the difficulty of obtaining financing and the remaining gap between buyer and seller expectations of value.