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MULTIFAMILY MARKET ANALYSIS

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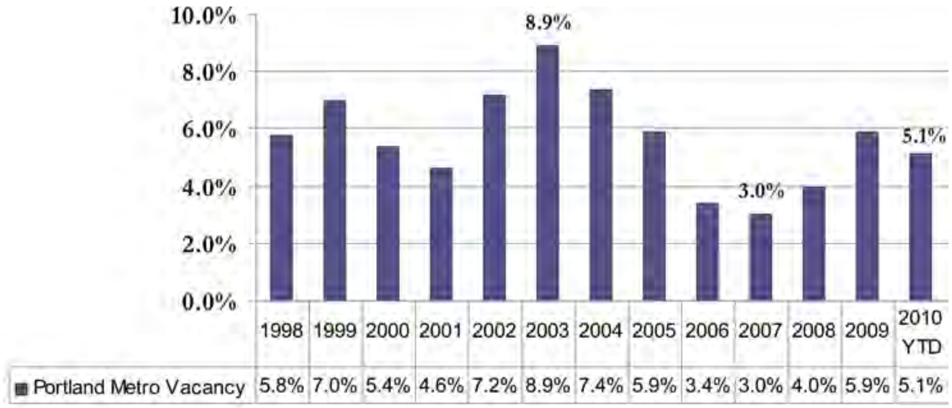
Through the first half of 2010 the local multifamily market has improved. According to the Spring 2010 survey by the Metropolitan Multifamily Housing Association (MMFHA), vacancy dropped to 5.1 percent in the metropolitan Portland market, down from 5.9 percent in the fall 2009. Similar results are seen in a more recent survey completed by Norris & Stevens, a local brokerage firm specializing in multifamily. The summer 2010 Norris & Stevens survey showed that the Portland area vacancy rate dropped to 5.75 percent, down 1.14 percent from the last survey in the fall of 2009. At this time many owners and managers are reporting improved conditions within the market and have scaled back the use of concessions and started to introduce modest rent increases in some cases. The encouraging signs seem to have indicated that the worst conditions in the multifamily market have passed and investment interest in the market is picking up as illustrated by several large sales in the last two months. Whether or not this growth can be sustained in the face of high unemployment and continued turmoil within investment markets remains to be seen.

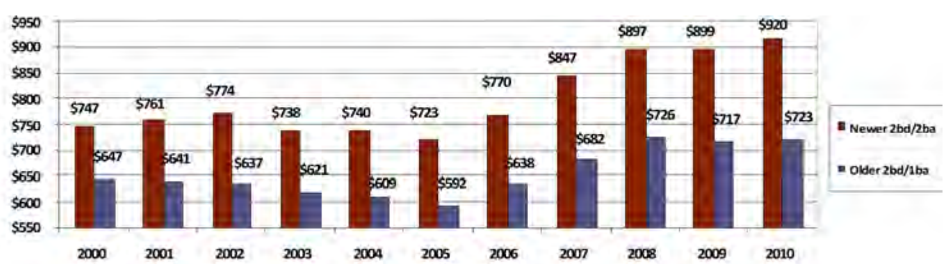
The drop in the local vacancy rate reflects similar conditions in the national apartment market. Data released by Reis Inc., a New York real estate research firm, showed that the national multifamily vacancy rate stood at 7.8 percent at the end of June. The *Wall Street Journal* reports this was a modest decrease from the 8 percent vacancy reported in the first quarter of 2010, which was the highest national vacancy rate in 30 years.



Source: Mark Barry \& Assoc. and the Metropolitan Multifamily Housing Association

Figure 10.1 Multifamily vacancy, Portland metro

The recent Norris & Stevens survey shows asking rents for older two-bedroom/one-bath units to be flat since 2008 (see graph below). Asking rents for newer two-bedroom/two-bath units have increased slightly over this time period, going from $897 per month to $920 per month in 2010. This survey, however, only pertains to asking rents and does not make an adjustment for rent concessions, which were prevalent in the market last year and still common today. As reported by Norris & Stevens in their Summer 2010 Apartment Investors Journal "Most submarkets are currently seeing some concessions, but rents seem to be holding steady, or increasing slightly. Downtown rents in new construction are pushing the average gains up for newer units citywide, but most areas have seen at least small increases."



Source: Norris \& Stevens Summer 2010 Rent Survey

Figure 10.2 Multifamily rents, average, Portland metro

Since the fall/winter 2009 survey, Kirk Ward, a broker at Norris & Stevens, reports that conditions within the multifamily market are improving. In addition to conducting a survey of the metropolitan rental market, Norris & Stevens also manages 9,000 units within 135 multifamily properties, most within the Portland area. According to Mr. Ward, only 12 of the 135 properties managed by Norris & Stevens were experiencing vacancy rates above 5 percent at the end of June. Sean Keyes, who operates Steed Properties, reports similar conditions within the 1,500 unit portfolio that his company owns within Oregon and southwest Washington. As of mid-July, 2010, the Steed portfolio was 98.5 percent occupied and the company was beginning to increase monthly rents by $50 to $100 per month at a majority of their locations.

At this time the multifamily sector appears to be benefitting from a few trends. The first is tighter mortgage standards, which is preventing a number of renters from owning homes. Prior to the recession some individuals that didn't quality to rent were able to obtain home mortgage loans. This is no longer the case. Also, the current turbulence within the home market may be keeping some qualified home buyers on the sidelines longer until homes stop depreciating. Lastly, there are some supply concerns as new apartment construction in the last 18 months has slowed to a fraction of the construction levels seen in the last decade. As the region continues to gain new population there is a concern that the Portland area may actually be facing an apartment shortage in the next few years.

As indicated by Mr. Ward, multifamily is the only commercial asset class that has experienced lower vacancy and has also been able to raise asking and renewal lease rates. Financing terms for multifamily are also more favorable, with low rates available from Fanny Mae. Overall, the multifamily market appears to be improving at a faster rate than predicated, considering the poor results from 2009. Both nationally and locally apartments are getting significant attention from large institutional players and investors. Within Portland there have been five sales of multifamily properties since December, 2009, that have each exceeded $38 million. The chart below highlights four of the most recent sales, in addition to the December, 2009 sale of Gerding Edlen's 352-unit Cyan for $65,000,000, or $184,659 per unit.

Major Sale Transactions

Date	Building	Buyer	Price	Units	Price/Unit	Submarket
6/10	Harrison Tower	Alecta Real Estate Invest.	\$39,500,000	186	\$212,366	Downtown
6/10	Meridian at Murrayhill	Gerson Baker \& Assoc.	\$24,500,000	312	\$78,526	Beaverton
6/10	Clackamas Village	Matteson Co.	\$20,750,000	372	\$55,780	Clackamas
5/10	Tupelo Alley	Behringer Harvard Hold.	\$38,750,000	188	\$206,117	Close-in N.E.

These high profile multifamily sales in Portland were highlighted by the May, 2010, sale of Trammall Crow's 188-unit Tupelo Alley for $38,750,000 ($206,117 per unit) and the Matteson Co.'s June, 2010, sale of the 186-unit Harrison Tower for $39,500,000 ($212,366 per unit). June also saw the purchase of two 300+ unit garden-style suburban properties, Meridian at Murrayhill and Clackamas Village, by separate California-based real estate investment companies. Based on these sales, it appears that Portland is on the national radar of large real estate companies and institutional investors. The Dallas-based REIT of Behringer Harvard Holdings, which purchased both the Cyan and Tupelo Alley, saw an opportunity to purchase new, well-located assets at a discount (both sales are believed to be below current replacement cost). According to Scott Bader, an acquisitions analyst at Behringer Harvard, the recent purchases were attractive based on the perception that the Portland market was at or near the bottom in terms of vacancy and rents. Since there are strong barriers to construct new development in Portland due to high land costs, system development fees, and long design/review periods, the acquisitions of two centrally located properties made sense. Considering the location and quality of Tupelo Alley and the Cyan, Behringer feels that each property offers significant upside potential for future rent appreciation.

The largest multifamily asset currently listed for sale in Portland is the 23-story, 332-unit Ladd Tower. The building was completed by Opus Northwest in May 2009, and was 80 percent leased as of early July. Opus and its lenders jointly decided to list the building on the market in an effort to capitalize on the recent sales within Portland. The current asking price is not known, but the property is being marketed by the local CB Richard Ellis office. As reported in the Oregonian, the construction loan for Ladd Tower is believed to be in excess of $80 million , which would indicate a sale price of around $241,000 per unit needed to cover the cost of the loan.

Despite the recent large multifamily sales, however, the number of transactions within the current market is still down significantly from levels seen in 2002 through 2008. The graph below shows the sharp drop-off in transactions and total dollar value in 2009 and continuing through the first part of this year. For smaller properties that are not being sought by larger institutional buyers, the market appears to be affected by a large bid-ask gab between buyers and sellers. Other issues include stricter lending guidelines that require a larger equity investment, lenders "blending and extending" troubled assets instead of disposing of them, and potential buyers attempting to low-ball owners based on the perception that all properties are in difficulty. The end result is that there is currently a lack of good quality smaller properties that are listed for sale, leading to the current low sales levels.

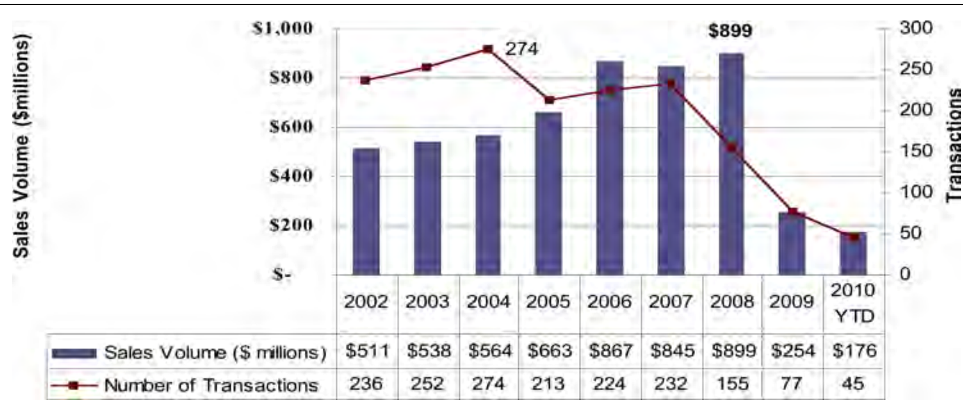
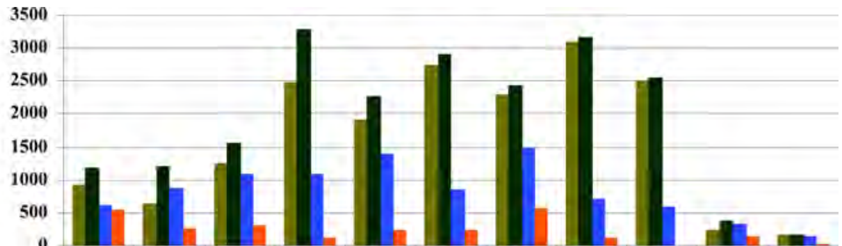


Figure 10.3 Multifamily transactions and sales volume, Portland metro

These issues, however, are gradually starting to resolve within the market, according to Gary Winkler, a multifamily broker and principal of Winkler & DuPont. Winkler reports that potential sellers are gradually coming to terms with the reality of the current market. Coupled with the desire of investors for good-quality properties, Winkler anticipates more sales activity in the market for the second half of 2010.



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 YTD
Portland	932	632	1,246	2,473	1,926	2,755	2,295	3,088	2,499	235	164
Multnomah Co.	1,171	1,208	1,564	3,289	2,275	2,914	2,431	3,166	2,551	390	166
Washington Co.	606	870	1,087	1,092	1,392	847	1,493	720	589	332	152
Clackamas County	550	261	312	116	229	230	572	108	0	135	31

Source: U.S. Census Bureau

Figure 10.4 Multifamily permits issued, number of units, Portland metro

Not surprisingly, new apartment construction has followed a path similar to multifamily sales. As shown by the graph above, multifamily permits experienced a strong drop-off in 2009 when only 235 multifamily units were permitted within the city. This was well below the yearly average of 1,982 permits issued between 2000 and 2008. Much of the increase in multifamily development in the years 2003 through 2008 was related to the construction of large condominium and luxury apartment towers within the Pearl District, downtown and the South Waterfront. Still, factoring out the large-scale multifamily development in Portland still shows current construction to be well behind historical levels. This trend is also consistent in suburban areas. Through the first six months of 2010, only 166 multifamily units have been permitted in Multnomah County, with 152 units and 31 units permitted in Washington and Clackamas County, respectively. Based on these numbers, 2010 will be another slow year for apartment construction. Factors contributing to the current void in new construction include the weak economy, difficulty obtaining financing, and the current gap between replacement cost and market value. In light of the current low 5.1 percent vacancy rate in the metropolitan region and lack of new construction, many knowledgeable multifamily brokers and investors are predicting a shortage in apartments by 2012. This shortage will be felt first within the urban core and later in the suburbs, where there is slightly more inventory. ■

Greg LeBlanc is a Certificate of Real Estate Development Graduate Student and Portland State University and is a Regional Multiple List Service (RMLS) fellow.