ApartmentResearch
MARKET REPORT

Marcus & Millichap

Phoenix Metro Area *Second Quarter 2012*

Renewed Hiring Sparks Demand; Builders Not Far Behind

Employment and population growth is spurring apartment demand in Phoenix, encouraging developers to ramp up construction. Although Class A rents are above mortgage payments on a median-priced home, many potential homebuyers will be unable to compete against investors that purchase bank-owned houses to operate as rentals. The metro is a target for these well-capitalized buyers, as home prices have dropped nearly 60 percent since the peak, while the local economy is gaining traction. By the close of this year, over 80,000 positions will have been recouped in Phoenix, marking three consecutive years of job gains. The rental pool will grow as many lower-priced homes are purchased by cash buyers and residents contend with qualifying hurdles due to short employment histories. As a result, strong apartment demand will enable most operators to boost rents to all-time highs, pushing residents down the quality ladder. Distant headwinds are starting to form, however, as builders recently broke ground on multiple projects that will add thousands of units to inventory over the next few years. Coupled with competition from houses employed as rentals, apartment owners could face significant competition as early as 2013.

Elevated prices in the Class A sector will encourage investors to consider lower-tier apartments for higher returns. Buyers from California and Canada will target Class B/C properties located near major demand drivers such as universities, employment centers and mass transit hubs. The continued redevelopment of downtown, meanwhile, is attracting buyers attempting to capitalize on the expansion of the Arizona State University and Phoenix Biomedical campuses, where the student population is expected to grow 60 percent by 2020. Some investors will acquire older assets in the area and update the property with modern amenities to capture student demand. Other sought-after areas, including midtown, Tempe and pockets along the Interstate 17 corridor will garner interest from local syndicates seeking properties priced below $5 million. Buildings with deferred maintenance will receive a cash infusion and be repositioned over the course of 18 months to enhance the rent rolls.

2012 Annual Apartment Forecast

2.0% increase in total employment

Employment: Spearheaded by white-collar job growth and tourism, the local economy will perform well this year as companies boost payrolls by 35,000 jobs, or 2 percent. In 2011, 28,600 employees were added in the metro.

1,260 units will be completed

Construction: Builders will add 1,260 apartments to the Phoenix metro this year, expanding inventory by 0.5 percent, while another 4,200 rental units are under construction in the metro. In 2011, 450 units came online.

110 basis point decrease in vacancy

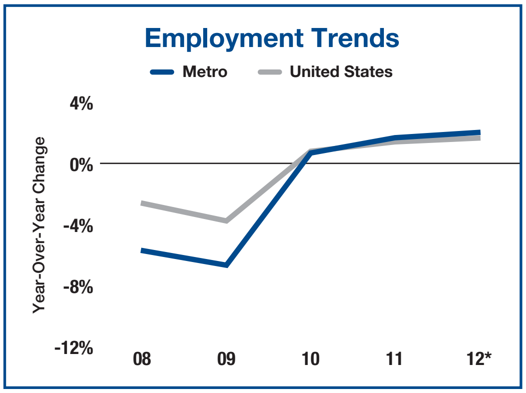
Vacancy: Despite the rise in construction, every submarket will record positive net absorption this year. As a result, marketwide vacancy will drop 110 basis points in 2012 to 6.2 percent. Last year, vacancy declined 240 basis points.

2.9% increase in asking rents

Rents: Strong demand will drive up average rents into uncharted territory by year end as asking rents jump 2.9 percent to $787 per month. Effective rents will spike 3.4 percent to $720 per month. In 2011, asking and effective rents increased 2.0 percent and 2.2 percent, respectively.

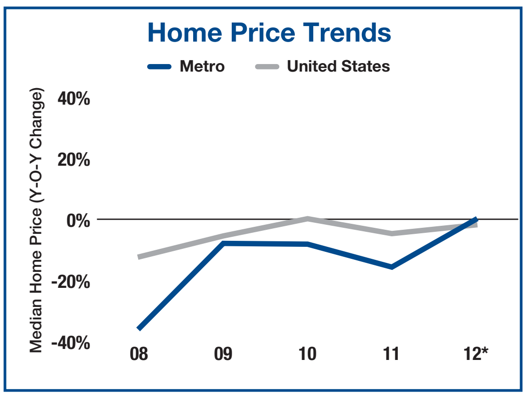
Economy

- Every employment sector posted job growth in the past year as businesses added 45,000 workers to payrolls, including an estimated 23,300 positions in the first quarter. In the previous year, 17,800 positions were created.
- After losing a total of 95,000 jobs since late 2007, employers in the construction industry hired 4,500 workers in the last year, an increase of 5.2 percent. Additionally, the education and health services and the leisure and hospitality sectors recorded gains totaling 20,000 jobs.
- As the economy show signs of improvement, financial firms will ramp up hiring efforts this year. Wells Fargo, JPMorgan Chase & Co., and American Express, for example, are in the process of filling over 700 empty spots at offices in Phoenix, which will support demand for rental units over the course of 2012.
- **Outlook:** The local economy will continue to perform well this year as companies boost payrolls by 35,000 jobs, or 2 percent.



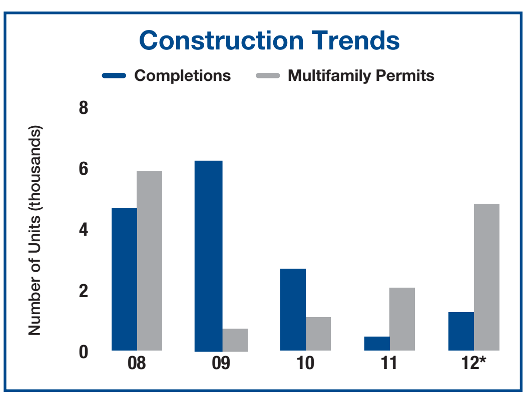
Housing and Demographics

- Builders pulled over 8,000 single-family permits over the past 12 months, marking an increase of 30 percent from the preceding year. Intense demand for apartments accelerated multifamily permitting activity 200 percent in the past year to 2,800 units.
- The uptick in sales activity put the brakes on declining single-family values for the first time in years. As such, the median price remained constant at $130,000 in the past year. Healthy employment gains supported a 3 percent increase in the median household income to $52,400 per year, which is over 50 percent above the minimum qualifying income to buy a median-priced home.
- Class A asking rents are currently $302 per month above the typical mortgage obligation on a median-priced home as low interest rates and increasing rental rates widen the gap.
- **Outlook:** Single-family home sales will pick up this year as investors compete for new listings. The foreclosure pipeline is thinning and, coupled with the intense demand, home values should begin to tick up by next year.



Construction

- Developers completed nearly 820 apartments in the past year, including 400 units in the first quarter. The 375-unit West Sixth complex expanded inventory in the North Tempe submarket by 2.3 percent.
- Approximately, 4,200 units are under construction with finishing dates stretching into 2014, representing a 1.1-percent increase to apartment inventory. An additional 12,000 units are in the planning pipeline.
- The transformation of the McDowell corridor in south Scottsdale is attracting multifamily developers to the area. A $75-million, 536-unit luxury-apartment community by Mark Taylor is expected to break ground by mid-year, though no completion date has been set.
- **Outlook:** Builders will add 1,260 apartments to the Phoenix metro this year, expanding inventory by 0.5 percent. In 2011, 450 units came online.



* Forecast

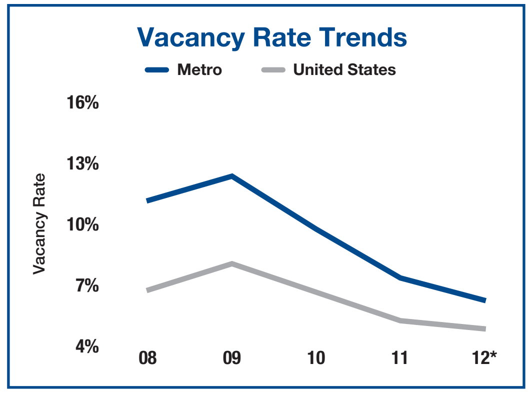
Vacancy

- A sharp rise in leasing activity during the past 12 months led to a vacancy plunge of 230 basis points to 6.7 percent in the first quarter. In the first three months of 2012, vacancy declined 60 basis points.

- Vacancy at Class A properties fell 150 basis points year over year to 5.4 percent in the first quarter, which is the lowest level since the mid-'90s. Robust demand for high-end units in the Chandler/Gilbert submarket pushed down top-tier vacancy in the area 160 basis points in the past year to a historic low of 4.8 percent.

- Firm growth in lower-paying employment sectors ignited demand for Class B/C rentals during the past 12 months, while muted construction in the lower-tier supported a 280-basis-point decrease in vacancy to 7.9 percent.

- **Outlook:** Marketwide, vacancy will drop 110 basis points in 2012 to a low of 6.2 percent. Last year, vacancy fell 240 basis points.



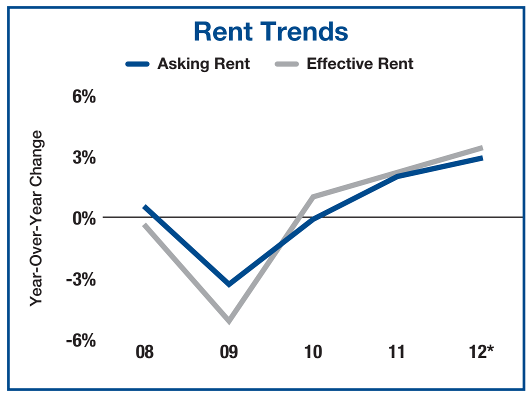
Rents

- As demand remained brisk in the past year, operators exerted greater pricing power to hike asking rents 1.7 percent to $768 per month. Effective rents rose 2.5 percent over the last 12 months to $702 per month, tightening concessions to one month of free rent.

- Asking rents in the Class A sector climbed 1.8 percent in the last year to a new high of $920 per month in the first quarter. Operators of Class B/C properties, meanwhile, increased asking rents 1.8 percent during the same stretch to $635 per month.

- As occupancy improved during the most recent 12-month period, revenues also grew 5.1 percent to pre-recession levels. In the previous year, average revenues increased 5.1 percent.

- **Outlook:** In 2012, asking rents will jump 2.9 percent to an all-time high of $787 per month, while effective rents will spike 3.4 percent to $720 per month.



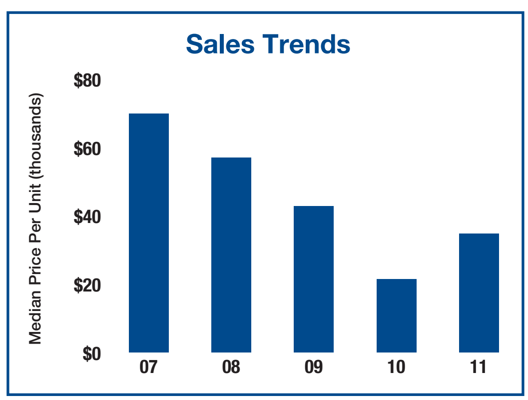
Sales Trends**

- Investment activity ticked up 8 percent in the past year as cash-heavy investors from Canada and California expanded their presence in the metro. Local buyers also increased their holdings, targeting older, value-add properties below the $5 million threshold.

- As well-capitalized, out-of-state investors acquired best-in-class properties, the median price for all asset classes surged over 40 percent to $34,000 per unit in the past 12 months. The median price for Class B/C apartments rose 30 percent to $28,000 per unit.

- Firm investor demand applied downward pressure on cap rates, which tightened 30 basis points year over year to the sub-7 percent range. Initial yields for institutional-quality assets in the metro compressed to the mid-5 percent range during the same span.

- **Outlook:** Owners looking for less-management-intensive investments, or wanting to avoid a potential increase in capital gains taxes, will bring their multifamily properties to market this year. Newly listed Class A assets will receive multiple offers from institutional investors with quick access to debt and equity.



* Forecast
** Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics

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Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- The national apartment market's strong performance continued in the first three months of 2012 as the vacancy rate slipped 30 basis points to 4.9 percent, marking the eighth consecutive quarterly decline. As conditions continue to improve, refinancing and disposition options for owners will expand to some owners that were underwater two years ago.
- Despite a brief increase to approximately 2.3 percent during the period, the interest rate on the 10-year Treasury ended the first quarter at about 2 percent. Capital continues to flow into safe-haven investments such as U.S. government debt amid lingering uncertainty over the eurozone.
- Fannie Mae and Freddie Mac will have unlimited financial support from the federal government through the end of this year. However, Congress will weigh a number of proposals to sunset the GSEs over the next decade and privatize the secondary mortgage market. The entities accounted for 65 percent of apartment mortgage originations last year.
- Access to acquisition financing continues to improve. Loans from portfolio lenders are issued at LTVs ranging from 70 percent to 80 percent, while the government agencies will work at the high end of the range on the highest-quality properties. All-in rates on mortgages of $3 million and more start in the mid-3 percent range for terms of five years, while 10-year debt varies from the low- to mid-4 percent region. Rates for smaller assets can rise up to 30 basis points to 75 basis points higher.

Submarket Overview

- The planning pipeline in Scottsdale currently has 18 projects totaling 5,700 apartments waiting for approval. Multiple communities have been approved and broken ground, including the 440-unit Optima Sonoran Village. Phase one will deliver 220 apartments to the corner of 68th Street and Camelback by mid-2013.
- Wireless phone service provider Consumer Cellular announced plans to open a second call center in the Deer Valley submarket this year, which will result in 300 back-office jobs. The move will spur demand for Class B/C units, and help reduce lower-tier vacancy in the area below 8 percent by the close of 2012.
- As residents moved back to the urban core to be near employment hubs and the METRO Light Rail, vacancy at lower-tier complexes in the Central Phoenix North submarket plunged 520 basis points from its peak in early 2010 to 10.9 percent. As such, owners should withdraw concessions considerably this year.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	South Scottsdale	3.9%	-130	$761	3.0%
2	Chandler/Gilbert	4.6%	-160	$796	1.4%
3	North Scottsdale/Fountain Hills	5.2%	-130	$925	2.1%
4	North Tempe	5.4%	-140	$775	3.7%
5	Goodyear/Avondale/Tolleson	6.4%	-280	$833	1.8%
6	Northeast Phoenix	7.4%	-130	$684	1.9%
7	West Mesa	7.9%	-460	$583	3.9%
8	Central Phoenix South	8.0%	-320	$672	3.0%
9	Central Phoenix North	10.1%	-340	$588	2.4%
10	Maryvale	10.3%	-440	$534	2.0%

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