Griffin Consulting

MARKET OVERVIEW
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Economic data indicates that the recession is apparently over, but the length of the recovery time frame is uncertain, but will likely not be short.

The U.S. apartment market turned in one of its weakest performances ever in the third quarter 2009 as the national vacancy rate hit a 23-year high despite being propped up by landlords willing to take lower rent to keep tenants. The U.S. apartment vacancy rate rose to 7.8 percent in the third quarter, its highest since 1986. Vacancies have been rising since the third quarter of 2007.

In the third quarter 2009, the U.S. apartment asking rental rate fell 0.5 percent to $1,035 per month, the fourth consecutive declining quarter for gross rent. Factoring in months of free rent and other perks landlords have been using to lure or keep tenants, effective rent fell 0.3 percent to $972, the fourth consecutive quarter of declining net rent.

Complicating the problem is the ongoing supply of new apartment complexes. Nationally, more than 100,000 units are expected to be added to the rental market in 2009. Of that, 73,000 units had already come online in the first three quarters of the year, and these units were 42 percent vacant on average. However, Griffin Consulting has seen affordable occupancy rates hold strong in several niches/municipalities where market rate complexes were experiencing difficulties.

Our workload at Griffin Consulting has shifted from 80 percent market rate residential and standard commercial research to 75 percent affordable housing research. This is indicative of the skepticism of both developers and lending institutions on the extent of the recovery to date.

While the past decade's focus has been on affordable rental projects (mainly LIHTC), affordable owner-occupied housing development efforts (primarily Affordable Housing Program – as set forth by the Federal Home Loan Bank Board of San Francisco) now represent a growing portion of our research base.

In February 2009, new federal funding mechanism for affordable rental housing has emerged via the American Recovery & Reinvestment Act ("ARRA") stimulus package funding. The Tax Credit Assistance Program ("TCAP") was designed to assist developers who are having difficulties financing and developing approved LIHTC rental projects which were approved between October 1, 2006 and September 30, 2009. The federal government's stimulus package has appropriated $2.250 billion to this program. These funds have been allocated to the states on the basis of the FY 2008 HOME program appropriation ratios. The states' appropriations must be 75 percent committed by February 16, 2010, 75 percent expended by February 16, 2011, and 100 percent expended by February 16, 2012. A number of states are have made their initial TCAP allocations in the past two to three months.

Arizona

The obvious primary issue hindering both renter- and owner-occupied housing performance and development in Arizona is the bulk of lender-owned properties on the market. These deep-discounted properties have necessitated price cuts across the state's housing market, inhibited new development, and resulted in heavy losses in Arizona's critical construction industry. Further, the recent influx of investors attracted to the market by the aforementioned lower single family and condo/townhome prices as resulted in a high volume of previously owner-occupied homes into the rental mix. This, in turn, has negatively impacted apartment complexes in terms of both net lease rates and occupancy levels.

In metropolitan Phoenix, the average vacancy rate has grown from 8.5 percent in 2007 to a forecast 12.8 percent in 2009. Average monthly rent in metro Phoenix fell from an all-time high of $777 in the first quarter of 2008 to $760 in the first quarter of 2009. The Ahwatukee submarket had metro Phoenix's apartment vacancy rate at 8.2 percent, while the West County submarket had the highest at 21.8 percent.

In metropolitan Tucson, the apartment vacancy rate grew from 8.3 percent in the first quarter of 2008 to 12.1 percent in the first quarter of 2009. Over the same time frame, average monthly rent fell from $651 to $649 in metro Tucson. Further, the City of Tucson is considering a proposal to impose a two percent sales tax on rents in order to generate approximately $10 million annually in a move toward balancing the city budget.

However, clear indications of market correction are now visible. Anticipated single family permitting in metropolitan Phoenix in 2009 is just under 6,000 units. This represents a decline of over 90 percent from the 'over-heated' market high of nearly 63,600 units in 2005.

Further, progress is evident in reducing the plethora of units on the resale market. The number of active listings in metro Phoenix has declined from 58,300

in October 2007 to 55,100 in October 2008 to 38,700 in October 2009. On the basis of prior years' sales levels, the listing totals translated to relative inventory levels of 11.9 months of supply in October 2007 to 12.0 months in October 2008 to 5.4 months in 2009. While discussion persists that the situation may worsen with an influx of balloon payments and rate adjustments coming due in the next two years, the data is nonetheless encouraging.

The correction is evidenced by a decline in average active listing price per square foot from $201 in October 2007 to $163 in October 2009, equating to a decline of 19 percent. The lack of recognition of market realities by sellers remains evident, however. Average resale prices in the same months fell from $163 in 2007 to $89 in 2009, or by a more representative 45 percent. The fact that October 2009 average resale price per square foot is a coincidental 45 percent below the October 2009 average active listing price per square foot is suggestive of two issues. First, sellers are not yet fully cognizant of the depth of the decline in the market and their home values. Second, the upscale market is in worse condition that the more affordable niches. In fact, it is new home product priced below approximately $225,000 and resale units priced below approximately $150,000 that are driving the current market.

On a cautionary note, approximately half of the market's recent sales were of foreclosed properties or 'short sales', mortgage financing remains tight (particularly for jumbo loans), and migration flows remain well below recent historical levels. Relative to the latter factor, net migration to the State of Arizona currently represents less than one percent growth. This compares to levels typically in the two to three percent range through the 1990s and early 2000s.

Average home price changes in 2009, all declines, are forecast at (11.8%) for Flagstaff, (12.7%) for Yuma, (12.8%) for Tucson, (16.3%) for Scottsdale, and (21.5%) for Allentown.

Northern Arizona's scenic Sedona is undergoing a rapid housing recovery as vacation home buyers return to buy at prices not seen in the market since 2003.

There is an interesting side effect of the down market. On the basis of current median home prices and median two-bedroom apartment monthly rents, it is now cheaper to own than rent in Casa Grande (by 8%), Coolidge (36%), Eloy (25%), Florence (34%), Kingman (1%), and Parker (26%). Among other things, this depicts the particularly difficult times the Pinal County single family housing market is experiencing. This once booming bedroom community for the Southeast Valley of metropolitan Phoenix is home to the former four of the six municipalities noted.

Pennsylvania

Within HUD Region III (the mid-Atlantic states of Pennsylvania, Delaware, Maryland, Virginia and West Virginia), Pennsylvania had the largest decline in employment from June 2008 to June 2009, losing approximately (81,000) jobs. Pennsylvania also had the highest unemployment rate in these states in June 2009 at 6.9 percent.

Multi-family permitting in Pennsylvania fell from approximately 5,280 units in the year ending June 2008 to 2,800 units in the year ending in June 2009, equating to a decline of (47) percent. Considering the negative impact of the single family/townhome/condominium housing crisis on the rental market, this decline represents a responsive and healthful market correction. In Philadelphia, the 1,710 multi-family units permitted in the year ending June 2009 represented a decline of (57) percent from the prior fiscal year's total.

The apartment market in metropolitan Philadelphia weakened moderately during the year ending June 2009, with the vacancy rate growing to 11.7 percent from 10.2 percent in the prior fiscal year. In June 2009, monthly apartment rents averaged $1,499 in metropolitan Philadelphia and $1,968 in Center City Philadelphia. Rent concessions were equal to 7 percent of rent in metro Philly in June 2009, up from 2 percent in June 2008. The number of new apartment units projected to come on line in metro Philadelphia over the following three years fell from 5,825 in June 2009 to 3,650 in June 2009, again representing a needed market correction. As of June 2009, approximately 20 percent of the expected additions over the following three years were expected to be located in Center City Philadelphia, up from 12 percent one year earlier.

Housing values have declined in every market in the state, but Pennsylvania is holding up through the financial and housing crises about as well as any other state. With regions having historically battled the declines of the steel and coal businesses on which the depended heavily in the past century, the state has substantive experience when it comes to economic recovery.

During the first quarter of 2009, homes were sold at annual rate of 143,600 in Pennsylvania, a decline of (19) percent from the annualized rate for the first quarter of 2008.

Pennsylvania had the mid-Atlantic region's largest numerical decline in owner-single family permitting, with the 14,600 single family homes permitted in the year ending June 2009 represented a decline of (38) percent from the prior fiscal year. The 5,125 homes permitted in metropolitan Philadelphia in the year ending June 2009 represented a decline of (37) percent from the prior fiscal year.

Average home price changes in 2009, all declines, are forecast at (6.7%) for Pittsburgh, (6.9%) for Lancaster, (7.2%) for Philadelphia, and (8.1%) for Allentown.

Perhaps Pittsburgh currently has the state's strongest housing market, as an older population (attracted by the area's affordability) has provided stability for the marketplace that is not seen in most regions of the country. Further, investors have arrived to pick up deals in Pittsburgh.

The federal government's first-time buyer's tax credit has lifted home sales in the Lancaster area.

The eight-county Philadelphia metropolitan area experienced substantial home sales and price growth during the mid-decade boom, but has weathered the downturn relatively well. The impact of growing foreclosures is expected to have a more serious impact in the Philly area in coming months, however.

Allentown also rode a wave of prosperity through the housing boom period. However, the area's decline in the course of the recession was moderately more steep than typical in Pennsylvania terms. Among other factors, a casino recently built (on the site of a former steel mill) in the area has seen little traffic and has not been the economic driver that it was originally expected to be.

Very truly yours,
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Brian J. Smargiassi
Owner

Sources: Arizona Department of Commerce, U.S. Department of Housing & Urban Development (Community Planning & Development), ASU Polytechnic (Realty Studies), Cromford Report, Arizona Republic (September 16, 2009), ASU ***Metro Phoenix Blue Chip Economic Forecast*** (of which Brian Smargiassi of Griffin Consulting is a panelist), Arizona Multiple Listing Service, Hanley Wood market Intelligence, U of A ***Arizona's Economy*** (Eller College of Management), ***Housing Predictor***, ***Townhall Finance Daily***, Associated Press, National Association of Realtors, Delta Associates, Reis Inc., & the Arizona Multihousing Association – ***Apartment News***