MAY 2009
VOL 7 ISSUE 2

APARTMENT TALK BY BOB KAPLAN

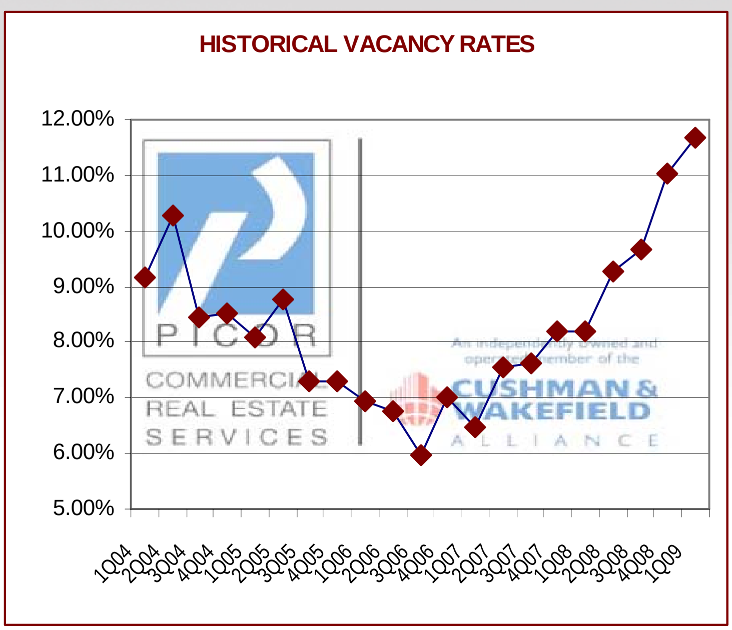
APARTMENT FUNDAMENTALS

Vacancy Rate ↓ Lease rates → Absorption ↓

The vacancy rate increased an additional 0.65% to 11.66% in the first quarter of 09 which is a 3.48% increase from the first quarter of 2008. This is the highest first quarter vacancy since 1988. Poor occupancy levels continue to affect moderate income and C class properties much more than well located A and B properties with the disparity between markets extremely high. The South Tucson (airport) recorded a 17.93 vacancy rate and the near Northwest and West submarkets recorded vacancies of 15.45% and 14.61% respectively, these are both submarkets comprised primarily of moderate income properties in moderate income neighborhoods. The Catalina Foothills and Northeast submarket, both markets of generally B or better properties in B or better locations recorded vacancy rates of 7.78% and 4.55% respectively.

Net Absorption was a negative 336 units in the 1st quarter which brings the total net absorption over the past year to negative 1724 units. Lease rates have generally been flat to lower during the past year with owners unable to push through any meaningful rental rate increases during a time of such weak demand. Any rental rate increases have been more than offset by the more extensive concessions which owners have used to attract new tenants.

We can expect to see these trends to continue this summer. Vacancy rates will increase during the 2nd quarter somewhere between another 75 and 150 basis points and we will see negative absorption again as students and winter visitors leave for the summer. The above factors will lead to continued pressure on lease rates and concessions through the next one or two quarters at a minimum before slow improvement to the leasing environment returns.



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APARTMENTS SALES:

Sales volume has come to a complete halt. There were no arms length sales of properties of stabilized properties of 40 or more units in Tucson during the first quarter of 2009. It is virtually unheard of to not have any properties trade during a calendar quarter. When appraisers or your friendly broker suggest that it is difficult to value an asset because so little is trading they are not joking. The industry has been forced to become more creative and dig deeper to determine value in an environment with so little product trading hands. A few ways we have been able to determine value include: 1) Looking at values in Phoenix and other surrounding markets and adjusting the values for Tucson. 2) Looking at the asking price of properties that are currently on the market.

It is my opinion that on a CAP rate basis Tucson apartment properties should be trading at a slightly lower CAP rate than a property of similar quality in a similar location in Phoenix. This is the opposite of what has been the norm. The reasoning for this is that financing is more expensive and less available for Phoenix apartments due to Phoenix being on a watch list with FNMA and FDMA. The situation is further exasperated by the more volatile market in Phoenix and market fundamentals which are considerably worse in Phoenix than in Tucson.

In the face of no transactions brokers and appraisers have been forced to look at asking prices on currently marketed properties in an effort to gauge current values. Obviously a current fair market value needs to be somewhere lower than where a number of properties are offered for sale.

The investment real estate market, and by implication the multifamily market in Tucson, has reverted back to the fundamentals which in the long run is very healthy. Cash Flow, cash on cash returns and projected ROI based on reasonable appreciation and underwriting assumptions are back. Currently the numbers for value that seem to keep coming back are a 12% Cash on Cash return during the first year and a 20% or better ROI for a stabilized B asset.

Look for a continued slow investment sales environment during the 2nd and 3rd quarter before the market becomes more active in the 4th quarter of 09. Distressed properties, either lender owned, foreclosed, or owners needing to raise capital are on the horizon. Today's extremely challenging operating environment simply does not allow many of the properties which traded hands during the peak years to service their debt and a restructuring is required. There is substantial investor demand for multifamily investments at the adjusted lower prices and it remains to be seen if the distressed properties coming to market will push down prices below where they appear to be now.

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ECONOMIC INDICATORS			
National	2007	2008	2009 1st Quarter
GDP Growth	2.0%	1.1%	- 6.1%
CPI Growth	2.4%	1.8%	2.2%
Arizona			
Unemployment	4.3%	6.6%	7.8%
Employment Growth	1.85%	0.86%	- 2.68%
U.S. Department of Labor Statistics			