The Barry Apartment Report

Summer 2010

The Barry Apartment Report is a publication covering economic, financial, and valuation trends affecting apartments in the greater Portland area.

Mid Year Update - Slow Transition From Great Recession to Recovery

Current Portland Metro Trends

- Unemployment: 10.3%
- Job Growth: -2.0%%
- Population Growth: 1.2%
- Portland CPI: 0.5%
- Apartment Construction: Dead; at record low levels
- Apartment Sales: Sales volume down 70% from 2008
- Apartment Values: down around 15% to 18% from the peak in early 2008; stable for YTD 2010
- Apartment Income: Flat; income showing a slight decline at many properties
- Apartment Vacancies: 5.1%

5/10 Sale- $95,000 Unit
10 unit Apartment
610 SE 17th Avenue

Inside this issue:

This issue of the Barry Apartment Report is based on two recent speeches given by Mark D. Barry, MAI, Apartment Appraisal Specialist, with research and professional contribution from Phillip E. Barry, Apartment Real Estate Broker.

In late 2009, there were high hopes the our economy had hit bottom, and would be well on the road to recovery by mid 2010. While there was some growth in the first quarter, the recovery is slowing down in both the US and Portland, and seems to be losing steam. Issues impacting the national economy are the US deficit, the Gulf oil spill, slumping housing sales, the debt crisis in Europe, and lackluster private sector hiring that is sapping the strength from the economic recovery. Local issues include the 9% across the board proposed state budget cuts, a lack of any job growth, slow single family sales, and recent figures showing Oregon as having the third highest rate of foreclosures in the country. So just what is happening here as of mid 2010?

Portland Economy: Over the twelve months ending in May 2010, we have lost 20,000 wage and salary jobs, or 2.0% of our employment base. While the job figures for some months of YTD 2010 has been positive, we have actually lost 2,000 jobs in YTD 2010, and our unemployment rate is 10.3%. Good news of late includes IBM announcing that they will add 600 jobs in Beaverton, and Daimler announcing they will continue manufacturing trucks at their Swan Island plant "well into the future."

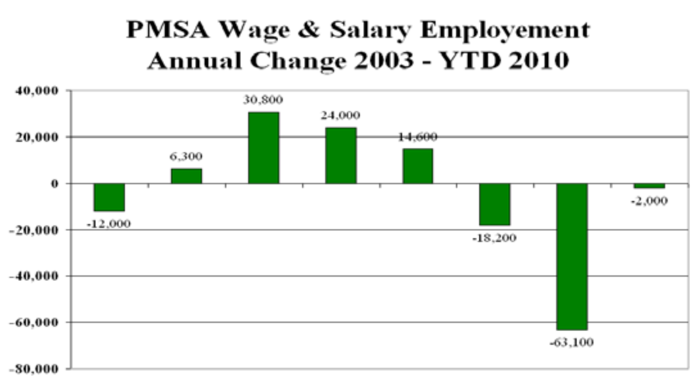
Apartment Construction: 2010 will go down as the slowest year for apartment construction since the early 1960's. Permits have been

issued for just 242 apartment units in the four county metro area for 2010 through May vs. an average of around 4,000 units per year for the previous ten years. To say that apartment construction is slow is an understatement—apartment construction is dead!

Single Family Market: Home values fell by 8.5% in 2008, and 9.8% in 2009. YTD 2010 figures through May show an annual 5.5% decline in the

average sales price to $275,500, with seven months of inventory. Home sales are down due to the tax credit accelerating sales which would have occurred later in the year. Single family constriction is exceptionally slow. Permits have been issued for 1,480 new homes through May 2010 vs. 2,669 homes in 2009. This is in comparison with an average of 8,500 homes built per year from 2003 to 2008. Only Florida and Nevada have a higher rate of foreclosures than Oregon.

Apartment Vacancies and Rental Rates: Apartment vacancies were reported at 5.1% in the Spring 2010 MMHA Apartment Report, though rents were reported to have dropped slightly here in Portland. Apartment



vacancies are stable in most areas. The only areas with apartment vacancies over 7.0% are Oregon City/Gladstone, Aloha, Hillsboro, and E. Vancouver.

Our analysis of YTD 2010 operating statements shows that income at most apartments is basically flat, with more properties showing a slight decline than a slight increase. The biggest problem impacting landlords is tenants who have lost their jobs and who are forced to move.

Apartment Expenses: The two culprits remain property taxes and utilities. With a flat income, expenses are up around 4%, with net income down by 2.5%. Don't expect any relief in the 2010-2011 tax year despite decline in values, and expect to see a noticeable increase in utility costs.

Apartment Values: A flat income, some increases in expenses, and higher cap rates have impacted apartment values in recent years. The median cap rate increased from 6.1% in 2008 to 6.8% in 2009. But what really happened was that cap rates showed a noticeable

increase in the second half of 2009 in comparison with the first half. Co Star figures show a 7.39% median cap rate for the second half of 2009, and a 7.25% median cap rate for the first half of 2010. Our analysis shows a decline in value of 15% to 18% from the peak in late 2007 and early 2008. However, apartment values have been stable over the last twelve months. **The median price per unit and price per Sq. Ft. is virtually identical in the last half of 2009 in comparison with the first half of 2010.**

Apartment Sales Volume: YTD 2010 has continued to be a major challenge for even the best of apartment brokers. There were 40 apartment sales for

2/10 Sale– $73,684/Unit
76 unit Hallwood Apartments
7475 SW Hall Blvd.

$123.7 million in the first half of 2010 vs. 81 sales for $281.8 million in 2009. There have been just three sales of over $5.0 million in the first half of 2010 vs. nine such sales in 2009 and an average

of around 35 such sales from 2005 to 2008. Apartment sales volume averaged $800 million per year from 2003 to 2008. Thus, the current sales volume is off by around 75%. Many buyers are looking for distress assets, though there is only limited such distress.

FORECAST FOR BALANCE OF 2010

So where is our apartment market going in the balance of 2010? Some thoughts are as follows:

Economy: May was the second month in a row with lackluster hiring by American businesses, and is sapping the strength from the economic rebound. From a tethering housing market to falling factory orders, the recovery is limping along as we enter the second half of the year, and is coming at a time when the benefits of most of the government stimulus spending will begin to wear off. The US economy needs 200,000 jobs per month to bring the unemployment rate down. No one expects that to happen in the near future. In addition, low interest rates, which can encourage borrowing to spur economic growth, are already at near zero. In addition, President Obama is meeting considerable opposition to additional stimulus spending. The Oregon Office of Economic Analysis expects that there will be job losses in 2010, and that employment will not reach pre-recession levels until mid 2014.

Apartment Construction: One thing you won't have to worry about in 2010 will be apartment construction. 2010 will be the slowest year for apartment construction in our adult lifetime. There will be some government sponsored urban projects, but that is about it. If you are an apartment developer, the balance 2010 will be a good year spend more time with your wife and children. **I expect we will see permits for 600 to 800 units in 2010.**

Apartment Vacancies and Rental Income: The balance of 2010 will be a year to concentrate on keeping your tenants happy, and holding on to what you have. Apartment vacancies should remain in the range of 4.75% to 5.25%. **But income will remain flat, with concessions balancing out any attempt to increase rents and implement utility bill backs.** Looking beyond 2010, apartment vacancies should rebound quickly once the economy turns around. There will be a shortage of apartments by 2012. The close-in urban market will remain in balance, with the higher vacancies concentrated in more expensive units and the more outlying suburban areas, particularly Clark County.

Apartment Values: I make a point of following every sale of every apartment, and

2/10 Sale—$41,837/Unit
49 unit Lantana Apartments
17730 E. Burnside Street

do some analysis. We saw lower value indicators and higher cap rates in the second half of 2009, though apartment values seem to have stabilized in the first half of 2010. Even with the higher cap rates, we are below the trend line of cap rates seen prior to 2004. I expect that **apartment values will remain stable in the balance 2010 due to low interest rates, and stable apartment income despite some increasing expenses.** Expect to see typical cap rates of 6.50% to 7.75% for suburban properties, and 6.00% to 7.25% for more urban properties.

Apartment Sales Volume: In 2009 and YTD 2010, we have seen the lowest level of apartment sales activity over the last decade. Based on the 2009 and YTD apartment sales volume, we have nowhere to go but up. **The next two years will be a far better environment for apartment sales.** This will be due to many owners getting better educated on values, some capitulation on the part of sellers, motivated sellers who need the funds, seller motivated by possible increases in capital gains, and

5/10 Sale- $63,500/Unit
10 unit Calico Court Apartments
12200 SW Calico Court

buyers who sense that we are close to a bottom. We are seeing a two tired market. There is good investor demand and often multiple offers for well performing, well kept apartments in stable locations. However, I have seen more foreclosure appraisals over the last few months than any time since the early to mid 1980's.

CONCLUSION

The recent job figures show that the rate of job losses is slowing, but that we are not yet there on any positive employment news. I expect the second half of 2010 to be lackluster, with some limited signs of recovery by year end and in the first part of 2011, but no real recovery until mid 2011 and 2012. Apartment construction will be at record lows,

5/10 Sale—$53,000/Unit
50 Unit Alder Village Apartments
16000 SE Alder Street

which will help in maintaining stable apartment vacancies, though we expect apartment income to remain flat for the rest of the year. There will continue to be a two tiered market, with good demand for performing well kept and well located assets, but some overhang of poorly performing assets in marginal locations, with most of these being owner managed. We all like to think that we are close to hitting bottom. However, the most recent data seems to point to an anemic recovery in the second half of 2010 and into 2011. It is likely that we will have to wait until mid 2011 and 2012 for any significant recovery.

"I'm just going to rip the Band-Aid off this one and say it: Increasing labor costs will be a big contributor to future deficits if we do not change the way we provide compensation to public employees." Governor Ted Kulongoski in his recent City Club speech on how to close the $2 billion gap between the cost of current public services and the revenue the state expects to have to pay them.

"I don't think anyone is getting rich off unemployment benefits, and I'm not saying people are lazy. The fact is, when you have a check coming in, even if it's a fairly low check, you are less motivated to either look for work or accept less optimal jobs." Michael Tanner, the Cato Institute, a Washington DC think tank.

"We all knew that there would be a housing hangover from the expiration of the tax credit. But this takes your breath away." Mike Larson, real estate and interest rate analyst with Weiss Research on the depth of the drop in single family sales in May 2010.

""If you have a bigger yacht than your clients, they won't trust you." Paul Mellon

"Our economy increasingly must rely on small banks to fund small businesses, but many of the same small banks are themselves in trouble. Commercial real estate loans have left huge holes in the balance sheet of many of these banks, and there's more trouble on the horizon. Frankly, I'm worried." Elizabeth Warren, Congressional TARP watchdog.

"The foreclosures are an ominous sign for the regions struggling economy. Tens of thousands of Northwesterners, their personal finances shattered by unemployment, pay and benefit cuts, and foreclosure's cousin, declining home values, are losing what for most is their largest single asset at a rate not seen since the Great Depression." Jeff Manning, Oregonian
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Turn Back the Clock . . .

*1912– The Vice Commission final report , concluding a nine month investigation, cited 443 properties for "wholly given to immorality." The property owners came from the highest stratum of the Portland Establishment, with Waverly, Arlington, and Concordia club members well represented. City Council President George Baker and Fred Merrill led the opposition to any repercussions. The concern was that the low class women would be dispersed to high class neighborhoods. "Where should the sporting woman go?" asked Baker.

*1919– Portland Catholic Diocese's Father Edwin Vincent O'Hara charged in a speech on "Housing the Multitudes" that "neglect, ignorance and greed were the causes of bad housing." Portland's first housing code was proposed in the spring of 1919. The Portland Realty Board filed 26 objections. Underlying such strong opposition was the notion that a property owner had the right to build as he pleased on his own land.

*1938— Commissioner Ormond Bean strongly advocated public approval of a new housing authority ordinance. Bean took Commissioners Carson and Riley on a tour so some of Poland's blighted housing. They were shown rooms with little if any ventilation, kitchens with woodstoves but no water, buildings with 30 or more residents using one toilet, families living in 20 foot square confinement, and garbage piled high on fire escapes. The Oregon Voter concluded "craving advances toward Utopia equally with our most revered idealists, we recommend voting against creation of a housing authority.

7/10 Sale– $56,944/Unit
18 unit Springwater Trail Apartments
8737-8807 SE Flavel Street

**1983— The Portland apartment market bottoms out after a severe recession. The average price per unit is $18,000 in East Multnomah County, $14,000 in North Portland, and $22,000 in Washington County. Northwest Portland, with a less desirable inventory of older units, shows an average price per unit of $13,000 .

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NOTE: Most of the information on this page is from Growth of a City by E. Kimbark MacColl.