



## Recession Deepens Amid Accelerated Job Losses and Credit Freeze; Massive Stimulus and Other Measures Underpin Stabilization in Late 2009

**First quarter job cuts remain extreme in reaction to financial crisis.** The escalation of the credit crunch to a full-blown financial crisis was reflected in a fourth quarter GDP decline of 6.25 percent, the most severe contraction since 1982. Furthermore, the near standstill of the commercial paper market in late 2008 led to an acceleration in job losses, as some companies were unable to make payrolls. Since November, cuts have averaged 650,000 jobs per month, compared to an average decrease of 180,000 positions during the first 10 months of 2008.

**Most economic news grim, but positive points should not be overlooked.** The housing market appears to be nearing a bottom in some markets, inflation concerns have subsided due to dramatic declines in oil prices, retail sales figures have been encouraging in early 2009 compared to previous months, and massive stimulus and liquidity injections will ultimately help generate economic activity once credit markets begin to unclog. Government intervention during this downturn has reached unprecedented levels, with additional Federal action likely in the coming months. Unlike other recessions in recent history, consumers lack the confidence and resources necessary to mitigate this downturn, as home equity, credit, household wealth and jobs have evaporated in recent quarters. This time around, business confidence must first be restored, which will require the stabilization of credit markets and the financial sector.

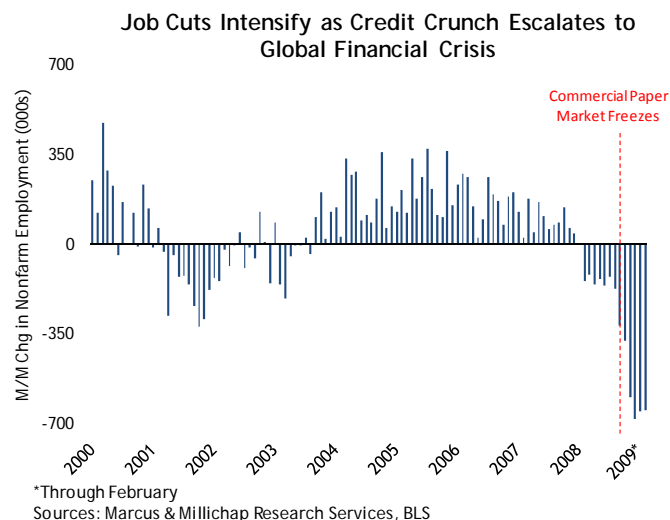
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**Concerns regarding the national debt warranted, but government intervention is necessary to reverse the negative feedback loop.** As 2009 comes to a close, public debt as a share of U.S. GDP is forecast to exceed 85 percent, up from roughly 60 percent in 2000 but still well below post-World War II levels of 120 percent. In addition to the \$787 billion stimulus package recently passed by Congress, a housing bill is expected to be enacted in the near term that would mitigate the pace of residential foreclosures and increase the availability of mortgage credit. Assuming the bill passes soon, a pricing floor should be established by early 2010.

### Forecast:

**Elevated job losses should ease by midyear; at least modest growth of 1 percent forecast for 2010.** Since the contraction began, 4.4 million jobs have been cut, and peak-to-trough losses will likely approach 6 million positions. The unemployment rate already has spiked to 8.1 percent and is expected to reach 9.5 percent later this year.

**Recession expected to be on par with the mid-1970s; housing will greatly influence 2010 growth pace.** U.S. GDP is forecast to contract by more than 3 percent from the third quarter of 2008 through the second quarter of 2009. Growth of approximately 1.9 percent is projected for 2010, assuming the housing market begins to stabilize by the end of this year. Residential investment has subtracted between 50 basis points and 140 basis points from GDP every quarter since mid-2006; even a bottoming-out of the market will provide much-needed relief to the U.S. economy.





## Heavy Job Cuts Snag Apartment Demand; Reduced Homeownership, Limited New Supply in 2009-2010 Support Outlook for Swift Recovery by 2011

**Reduced confidence, deteriorating job market push vacancy higher.** Apartment vacancy increased to 6.6 percent in the fourth quarter of 2008, up 40 basis points from the previous quarter and 90 basis points from one year earlier. Rising unemployment discourages household formations and forces many renters to double-up, offsetting the impact of tighter residential lending standards on demand. During the last six months of 2008, when unemployment pushed up 160 basis points to 7.2 percent, the number of vacant units rose 13 percent, or by nearly 79,000 units.

**Hardest-hit markets those that flourished during housing boom.** Strong-growth markets such as Phoenix, Tucson, Las Vegas, Tampa and Orlando were a focus for residential developers. The loss of housing-related jobs and the dearth of new employment opportunities in these markets have given way to above-average increases in vacancy over the past year, ranging from 160 basis points to 300 basis points. Slower-growth Midwestern metros and land-constrained coastal markets also are recording weaker fundamentals but are among the more stable markets nationwide.

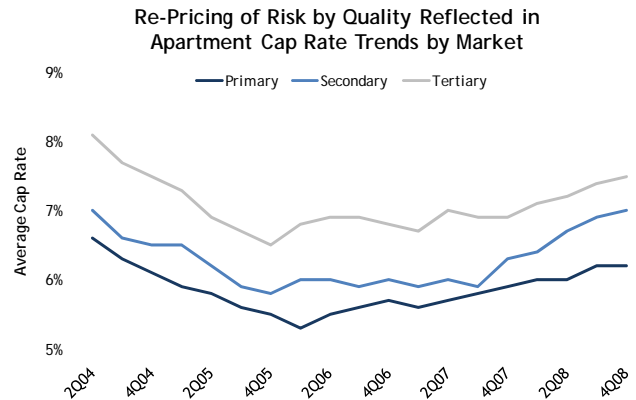
**Disconnect persists; sellers adjust pricing expectations.** Apartment property sales slipped 50 percent last year due to a wide buyer/seller expectation gap, a shift in the buyer mix and the constrained capital environment. While Fannie Mae and Freddie Mac remain active lenders, CMBS financing is nearly nonexistent and tighter underwriting prevails marketwide. As a result, cap rates have increased 65 basis points to 200 basis points since the recession started, with properties in secondary/tertiary markets giving the most ground. Though many owners are well positioned to ride out the downturn after several years of strong NOI growth and price appreciation, distress is on the rise. In addition, many institutions and REITs will need to rebalance their portfolios and increase liquidity, resulting in the availability of some top-tier properties this year. Cap rates are expected to rise further in 2009, still driven by quality.

### Forecast:

**Construction pullback under way.** Developers are expected to complete 80,000 apartments in 2009, down from 93,000 units last year and the lowest level of completions since the mid-1990s. This figure could decline further over the course of the year, as some projects may be delayed until 2010 or abandoned due to difficulties obtaining construction financing. Construction costs have ebbed, but declining rents will make the justification of new development difficult in many major markets, in turn setting the stage for a recovery starting in 2010 when completions will fall even further.

**Demand-side weakness to outweigh impact of reduced development in short term.** The vacancy rate is forecast to increase 110 basis points in 2009 as job losses hinder renter household formation. Vacant houses and condos employed as rentals also will divert demand from apartments in the near term.

**Competition for renters intensifies; owners reduce rents, sweeten concessions.** The combination of weaker demand and competition from shadow stock will place downward pressure on rents, resulting in a drop of 3 percent to 4 percent in effective rents nationally, driven by rising concessions. The degree of rent decline will vary greatly by market.

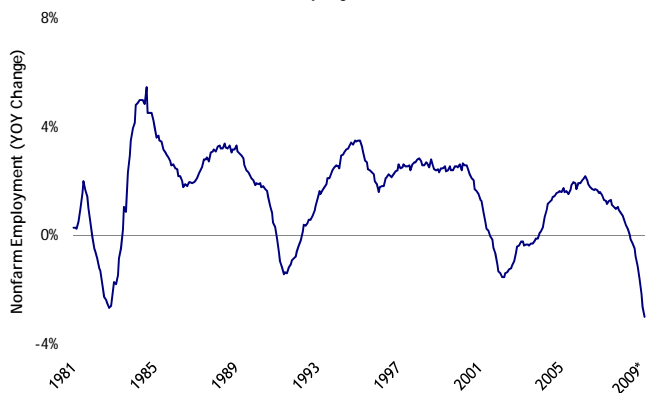


Sources: Marcus & Millichap Research Services, Real Capital Analytics



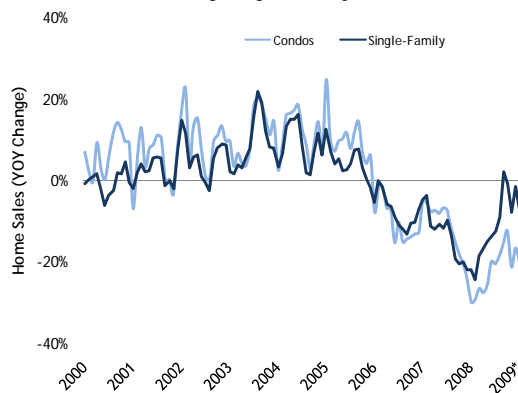
## Apartment Market Vital Signs

Non-Farm Employment Growth



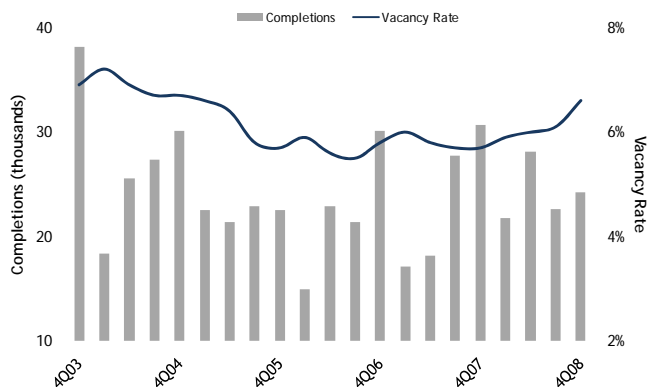
\*Through February  
Sources: Marcus & Millichap Research Services, Economy.com

Existing Single-Family and Condo Sales



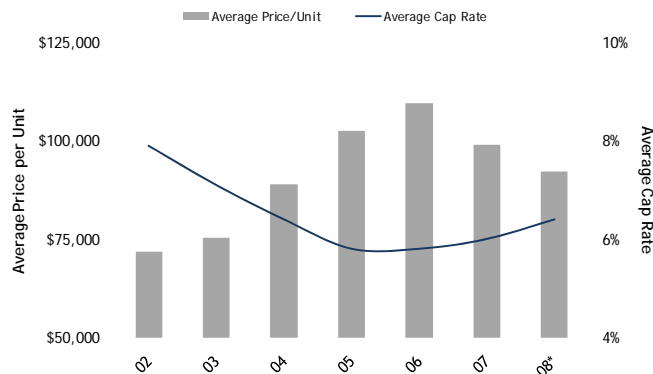
\*Through January  
Sources: Marcus & Millichap Research Services, Economy.com

Apartment Supply and Demand Trends



Sources: Marcus & Millichap Research Services, Reis

Apartment Price and Cap Rate Trends



\*Sales figures represent transactions of \$1 million+  
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

### 4Q 2007 to 4Q 2008 Change in Apartment Vacancy

Top 10 Markets by Change Vacancy

Metro	4Q 2008	YOY Chg (bps)
Indianapolis	7.6%	-70
Milwaukee	3.7%	-40
West Palm Beach	7.6%	-40
Cincinnati	6.7%	-30
San Francisco	3.6%	-30
Minneapolis	4.3%	20
New York	2.3%	20
Oakland-East Bay	5.3%	20
San Diego	3.9%	20
Boston	6.0%	30
US Metro Average	6.6%	90

Bottom 10 Markets by Change in Vacancy

Metro	4Q 2008	YOY Chg (bps)
San Jose	5.2%	130
Las Vegas	7.7%	160
Jacksonville	11.6%	170
Tampa-St. Petersburg	8.6%	170
Atlanta	10.2%	200
Charlotte	8.0%	200
San Antonio	8.7%	210
Orlando	9.7%	250
Phoenix	10.9%	260
Tucson	11.2%	300
US Metro Average	6.6%	90

Sources: Marcus & Millichap Research Services, Reis

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