

MILDER LEASING TRENDS EXPECTED AFTER ROUGH START TO YEAR

Through the end of last year, operating fundamentals in the Brooklyn apartment market were seemingly immune to the effects of the recession, as the borough's large, free-market properties recorded annual rent growth of 4.8 percent, while vacancy was nearly cut in half. So far in 2009, however, deep job cuts have accelerated a decline in leasing activity. The first quarter was particularly challenging for owners, as vacancy surged 240 basis points to the highest level on record. While vacancy and rents are expected to fluctuate throughout the year, owners should note that the most extreme market adjustments are likely over, a projection supported by a 180 basis point vacancy decline in the second quarter and milder rent reductions. Rent-stabilized units, alternately, will provide some relief to revenue streams. Beginning in the fourth quarter, the Rent Guidelines Board will allow for a 3 percent and 6 percent increase on one- and two-year leases, respectively, for units where the owners provide heat. In units where tenants pay for heating costs, rents may ascend a maximum of 2.5 percent for one-year agreements and 5 percent for two-year contracts. On the development front, completion of The Brooklynier has been pushed into early 2010, and, with more shadow rentals expected this year upon the delivery of 2,300 for-sale units, greater competition for Class A renters is likely.

Declining revenues, slipping property values and a significant buyer/seller expectations gap all have constrained investment activity in the local apartment market. Nevertheless, experienced buyers are still finding opportunities. In Bushwick, particularly between Flushing and Myrtle avenues, purchasing activity has been stimulated by exiting out-of-state owners and cap rates that have increased an average of 150 basis points in the last year to the low- to mid-8 percent range. Some distressed acquisitions are occurring in the desirable northern neighborhoods, though the long-term financial viability of these assets has moderated sales price decreases. In southern Brooklyn, meanwhile, opportunistic and exchange buyers have capitalized on depressed pricing, especially among larger apartment properties.

2009 ANNUAL APARTMENT FORECAST



Employment: Ongoing economic headwinds will keep the pace of layoffs elevated in the near term, with New York City head counts projected to fall by 114,300 employees in 2009. In Brooklyn, personnel levels will be cut by 3.5 percent, or 17,000 workers, after 5,500 positions were shed in 2008.



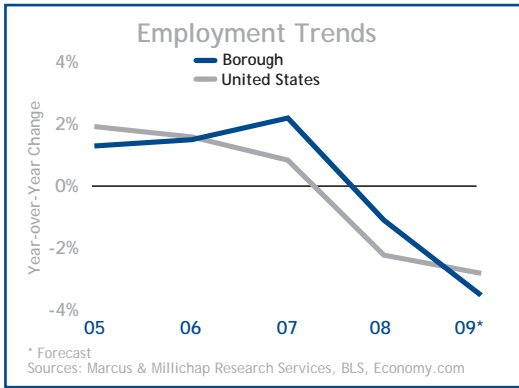
Construction: Following the delivery of just 32 units in large, free-market complexes last year, no major completions are scheduled in 2009.



Vacancy: Underpinned by persistent job losses and decreased household budgets, vacancy in large, free-market apartment properties is expected to climb 110 basis points to 2.9 percent this year. In 2008, vacancy improved 140 basis points.



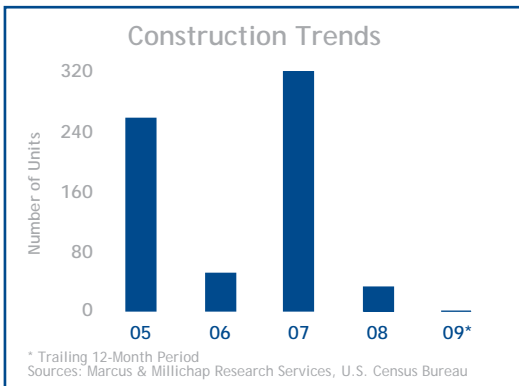
Asking Rents: In step with rising vacancy and falling demand, asking rents are projected to decline 3 percent to \$1,397 per month in 2009, compared to a 4.8 percent gain last year.



ECONOMY

- ◆ Citywide, economic stresses originating from the financial services collapse in late 2008 continue to spread to other sectors. In the 12-month period ending in the second quarter, local employers cut payrolls by 2.7 percent, or 104,000 positions. In the previous year, 58,600 new hires were added.
- ◆ In step with metrowide contraction, Brooklyn employers have downsized head counts by 14,800 positions, or 3 percent, over the past year. During the preceding 12 months, 8,200 jobs were created.
- ◆ The borough's year-over-year loss of 4,400 jobs in the trade, transportation and utilities sector leads Kings County in terms of largest absolute reductions. Additionally, 4,600 workers have been trimmed from the professional and business services and construction industries during the same period.
- ◆ Since October of 2008, the borough's unemployment rate has increased by an average of 30 basis points per month. The second quarter rate of approximately 7.6 percent is 310 basis points higher than one year earlier.
- ◆ **Outlook:** Ongoing economic headwinds will keep the pace of layoffs elevated in the near term, with New York City head counts projected to fall by 114,300 employees in 2009. In Brooklyn, personnel levels will be cut by 3.5 percent, or 17,000 workers, after 5,500 positions were shed in 2008.

HOUSING TRENDS



- ◆ Multi-family permitting activity has accelerated 8 percent to 8,720 units over the past 12 months. The surge in permit requests was due to the expiration of the 421a tax abatement. Factoring out the 421a-related permits, the number of requests is 1,920 units, a 72 percent year-over-year decline.
- ◆ Sales activity continues to reel at new condominium developments. Although the median price per unit for all condo sales has fallen 8 percent over the past 12 months, prices at new for-sale projects have declined by more than 15 percent. In response to sellers' discounts, market time inched down to 161 days in the second quarter, but the nearly 1,800 for-sale units expected to come online during the remainder of the year will further stymie activity.
- ◆ While economic stresses are creating challenges for affordable housing projects, development persists. The Cook Street Housing complex in Williamsburg, for example, is expected to add 152 affordable units to inventory in the third quarter of 2009. Additionally, Hudson Development recently secured \$43 million in financing for a 176-unit environmentally friendly building in East New York; groundbreaking is scheduled for July.
- ◆ Down-zoning movements are gaining traction in the Carroll Gardens/Columbia Street Waterfront District and Sunset Park neighborhoods. Also, a recent 850-building landmark designation in Prospect Heights is the largest in the city since 1990.
- ◆ **Outlook:** Although the rebound in residential demand is expected to occur slightly after the eventual turnaround in employment, the number of failed condo projects and the excess supply on the market will likely keep for-sale development muted for the foreseeable future.

CONSTRUCTION

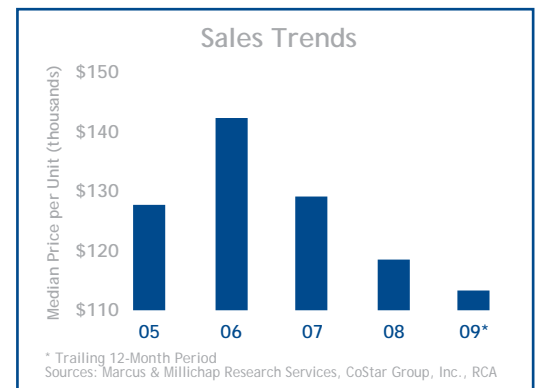
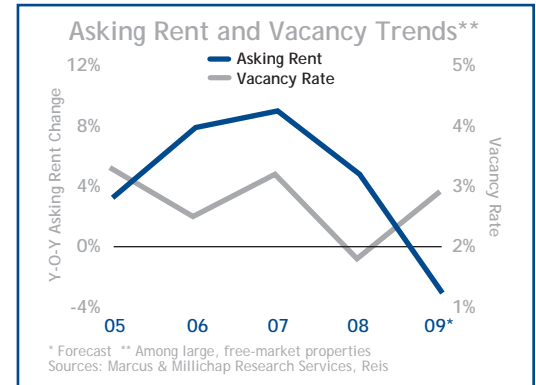
- ◆ Construction of large, free-market apartment complexes remains limited in Brooklyn, as just one 32-unit building has been delivered in the past 12 months. No major completions were recorded in the preceding year.
- ◆ Four large, free-market complexes that were planned and financed during more economically robust times are under way in the borough, containing 1,500 units. Of this total, nearly 1,000 units are slated to be completed next year.
- ◆ The Clarett Group's Brooklynier is expected to be the next major completion and will replace the Williamsburgh Savings Bank Tower as the borough's tallest building. The project, located downtown at 111 Lawrence Street, is anticipated to be delivered in early 2010 and will contain 491 market-rate rental units.
- ◆ Despite the challenging economic environment, there are three apartment complexes totaling more than 580 units in planning.
- ◆ **Outlook:** Following the delivery of just 32 units in large, free-market complexes last year, no major completions are scheduled in 2009.

VACANCY AND ASKING RENTS

- ◆ Steady residential demand kept operating fundamentals in check in 2008. Since the beginning of this year, however, vacancy in large, free-market properties has climbed 60 basis points to 2.4 percent, compared to a 50 basis point improvement during the preceding six-month stretch.
- ◆ Falling tenant demand has put downward pressure on rents in large, free-market buildings. Asking rents have fallen 2 percent to \$1,411 per month so far in 2009, after increasing 4.8 percent last year.
- ◆ **Outlook:** Underpinned by persistent job losses and decreased household budgets, vacancy in large, free-market apartment properties is expected to ascend 110 basis points to 2.9 percent this year. Asking rents, meanwhile, are forecast to retreat 3 percent to \$1,397 per month.

SALES TRENDS**

- ◆ Although fears of a deepening recession are deterring some investors, the declines in activity have become less severe. In the past 12 months, apartment purchases have decreased 34 percent, compared to a 53 percent slowdown during the previous year.
- ◆ The median price has receded 8 percent in the last year to \$113,070 per unit, half of the percentage drop recorded in the preceding 12-month period.
- ◆ Cap rates averaged approximately 6.8 percent in 2008; however, falling revenues are causing owners to push for greater risk premiums, and initial yields for most properties now start in the low- to mid-7 percent range.
- ◆ **Outlook:** The median price for closed or in-contract deals with six or more units was \$99,000 per unit year to date. The median price for buildings currently for sale, however, is \$127,000 per unit, indicating a still-wide buyer/seller expectations gap.



** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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CAPITAL MARKETS

By WILLIAM E. HUGHES, SENIOR VICE PRESIDENT, MARCUS & MILLICHAP CAPITAL CORPORATION

- ◆ During the first quarter, multi-family mortgage originations were 61 percent below year-earlier levels and 79 percent lower than the late-2006 peak. Though considerable, the reduction in apartment originations remains less significant than declines among other core commercial property types, due largely to the availability of financing through Fannie Mae and Freddie Mac.
- ◆ Portfolio lenders are issuing apartment financing at all-in rates of 6.0 percent to 6.3 percent for three-year loans and up to 6.8 percent to 7.5 percent for a 10-year term. Loan-to-value requirements range from 55 percent to 75 percent.
- ◆ Agency lenders are offering five-year loans at all-in rates of 4.8 percent to 5.0 percent with 10-year mortgages available at rates averaging 5.35 percent and 5.7 percent, respectively. Maximum leverage among agency lenders ranges from 55 percent to 75 percent.
- ◆ Freddie Mac recently completed a \$1 billion securitization of multi-family debt, the first issuance to hit the market since last June. The securities, dubbed "K Certificates," vary from traditional CMBS in that buyers are provided a guarantee by Freddie Mac. In addition to the potential for another similar offering, government programs designed to increase credit flows into commercial real estate could be operational by late summer/early fall.

BROOKLYN SALES HIGHLIGHTS

| Property Address | Sales Price | Number of Units | Price per Unit | Price per Square Foot |
|------------------------|-------------|-----------------|----------------|-----------------------|
| 951 Carroll Street | \$3,375,000 | 43 | \$78,488 | \$110 |
| 40 E. 17th Street | \$3,300,000 | 42 | \$78,571 | \$78 |
| 1280-1288 Dean Street | \$3,150,000 | 32 | \$98,438 | \$90 |
| 84 Lawrence Avenue | \$3,150,000 | 35 | \$90,000 | \$98 |
| 531 E. 22nd Street | \$2,992,200 | 35 | \$85,491 | \$83 |
| 1852 67th Street | \$1,900,000 | 19 | \$100,000 | \$133 |
| 239 Prospect Place | \$1,750,000 | 12 | \$145,833 | \$204 |
| 2708 Cortelyou Road | \$1,600,000 | 23 | \$69,565 | \$83 |
| 334 Dean Street | \$1,545,000 | 12 | \$128,750 | \$227 |
| 906 Avenue S | \$1,375,000 | 12 | \$114,583 | \$132 |
| 209 Avenue F | \$1,300,000 | 16 | \$81,250 | \$74 |
| 1723 Dahill Road | \$1,010,000 | 6 | \$168,333 | \$187 |
| 423 Clinton Avenue | \$990,000 | 7 | \$141,429 | \$264 |
| 2033 78th Street | \$955,000 | 6 | \$159,167 | \$171 |
| 60 Sixth Avenue | \$950,000 | 8 | \$118,750 | \$168 |
| 1719 Voorhies Avenue | \$875,000 | 6 | \$145,833 | \$207 |
| 96 George Street | \$850,000 | 6 | \$141,667 | \$202 |
| 131 Starr Street | \$800,000 | 8 | \$100,000 | \$103 |
| 212 Kingsland Avenue | \$775,000 | 8 | \$96,875 | \$103 |
| 1136 Willoughby Avenue | \$675,000 | 6 | \$112,500 | \$158 |
| 323 Menahan Street | \$662,000 | 6 | \$110,333 | \$136 |
| 161 Troutman Street | \$650,000 | 6 | \$108,333 | \$158 |
| 237 Troy Avenue | \$645,000 | 8 | \$80,625 | \$107 |
| 254 Melrose Street | \$630,000 | 6 | \$105,000 | \$118 |
| 824 Classon Avenue | \$630,000 | 8 | \$78,750 | \$110 |
| 29 Beaver Street | \$550,000 | 6 | \$91,667 | \$131 |

Price: \$150

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