

Apartment Research

MARKET REPORT

Marcus & Millichap

Dallas/Fort Worth Metroplex

Third Quarter 2012

Despite Compression, Cap Rates Remain Attractive

Dallas/Fort Worth's robust economy is generating new households, creating the tightest apartment conditions in over a decade and facilitating healthy rent growth. Employment gains in the Metroplex will approach 3 percent this year, well above the national rate of 1.7 percent. With business booming, job seekers will flock to the area from some late-recovery markets in the Midwest and the West Coast. As a result, leverage in lease negotiations will remain firmly on the side of apartment operators through the end of the year, spurring strong revenue gains. Some headwinds are forming, however. Year over year, home sales are up 20 percent, an indication that more renters are transitioning into single-family homes. Foreclosure activity, meanwhile, is up more than 10 percent from the second quarter of 2011, mitigating attrition from apartments to the housing market. As foreclosure activity begins to abate and new construction accelerates next year, apartment operators may have to react quickly with concession offerings to maintain tight occupancies.

Transaction velocity will continue to escalate this year as out-of-state investors target large, better-quality deals in the Metroplex. Despite cap rate compression through the past several quarters, local apartment properties continue to spin off stronger returns than similar assets in coastal markets. Class A cap rates in Dallas/Fort Worth, for example, can start as low as 5.5 percent, which still offers a 50- to 75-basis point premium over East Coast and coastal California metros. While investor demand for top-quality assets remains elevated, in many instances, prices are hovering near new construction costs, which may hamper the pace of appreciation over the next year. At the same time, though, the Class B sector may record further price growth, as many investors priced out of the Class A market have shifted their focus to large Class B+ properties. Within this segment, prices for well-located 1980s assets have pushed above \$40,000 per unit. These deals generally change hands at cap rates in mid-7 percent range, and may offer significant rental upside with only moderate investments in upgrades.

2012 Annual Apartment Forecast



Employment: In 2012, Metroplex employment growth will reach 2.8 percent with the addition of 82,000 jobs, up from 1.9 percent last year. Acceleration will be attributable in part to a turnaround in the construction industry, which will add jobs for the first time since 2007.



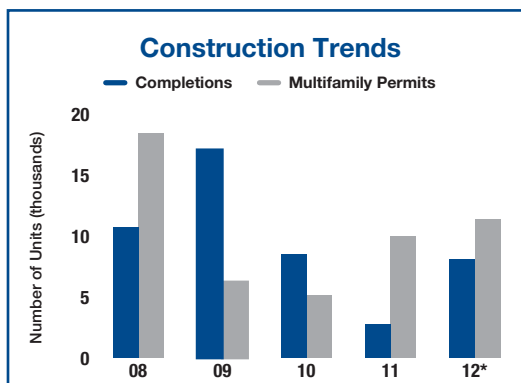
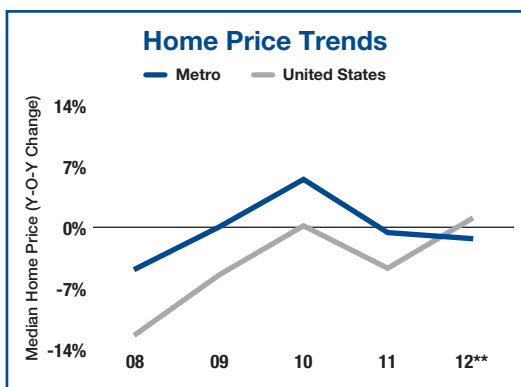
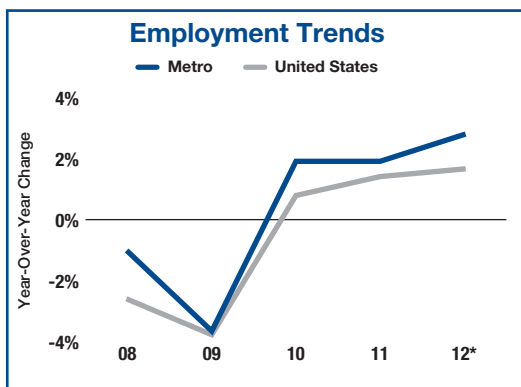
Construction: Apartment completions will nearly triple in 2012 as approximately 8,100 units come online. Based on the rapidly expanding development pipeline, another dramatic increase in deliveries appears likely next year.



Vacancy: The pace of vacancy improvement will slow through the second half as deliveries rise. Nonetheless, vacancy in the Metroplex will end the year at 5.4 percent, down 90 basis points from 2011. As of midyear, vacancy had already tightened to its lowest level on record since 2001.



Rents: In 2012, asking rents will rise 3.4 percent to \$823 per month. Effective rents will rise at a fast clip of 4.2 percent as owners pare concessions, pushing the average to \$744 per month by year end.



* Forecast

** Through 2Q

Economy

- Over the past 12 months, Dallas/Fort Worth employment grew an estimated 2 percent with the addition of 57,000 jobs. While all major private-employment sectors recorded growth over the past year, government payrolls contracted.
- The trade, transportation and utilities sector logged the most significant job creation over the past 12 months and stands to post outsized gains through 2013, as residential development fuels retailer expansion and major chains grow their local warehouse/distribution operations.
- Over the past year, Class B/C demand received a boost from the creation of an estimated 9,000 jobs in the typically lower-paying leisure and hospitality sector. The Class A sector, on the other hand, benefited from the addition of a combined 13,000 positions in financial activities, and professional and business services.
- **Outlook:** In 2012, Metroplex employment growth will reach 2.8 percent with the addition of 82,000 jobs, up from 1.9 percent last year. Acceleration will be attributable in part to a turnaround in the construction industry, which will add jobs for the first time since 2007.

Housing and Demographics

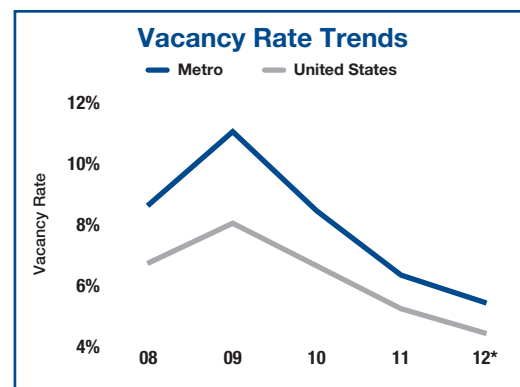
- The median price of an existing single-family home in the Metroplex held stable through the first half of this year at \$148,000. Compared with year-earlier levels, the median was down approximately 1.5 percent.
- While home prices were relatively flat over the last four quarters, the affordability gap between renting and owning narrowed due to an 80-basis point reduction in mortgage rates. Despite lower payments, many renters remain unable to meet today's elevated down payment requirements.
- The 20- to 34-year-old population will expand more than 2 percent in 2012 with the addition of 30,000 individuals. This marks a sizable acceleration from the previous five years, when growth averaged 20,000 individuals annually.
- **Outlook:** Relatively strict lending standards, high down payments and strong growth in the prime renter age population will help support the absorption of nearly 13,000 Metroplex apartments this year.

Construction

- Developers delivered 3,800 units to the Dallas/Fort Worth apartment market over the past 12 months, including 2,300 units in the first half of 2012.
- Approximately 80 percent of this year's new supply will come online in Dallas. Within the area, completions will be heaviest in the Plano/Allen/McKinney and Lewisville submarkets. In Fort Worth, the Southeast submarket will account for the most new supply, followed by North Arlington and Grapevine.
- At midyear, approximately 12,500 apartments were under way in the Metroplex and another 30,000 units were planned or proposed. Next to the typical higher-growth areas, the Central Dallas submarket accounts for the largest share of planned units.
- **Outlook:** Apartment completions will nearly triple in 2012 as approximately 8,100 units come online. Based on the rapidly expanding development pipeline, another dramatic increase in deliveries appears likely next year.

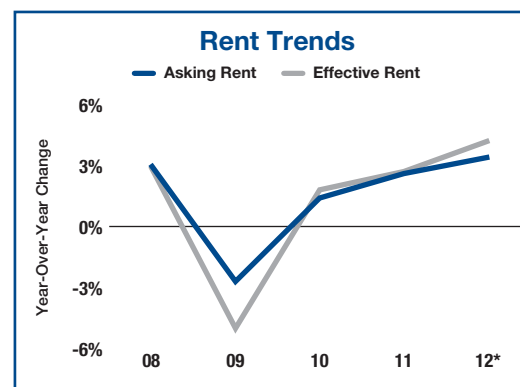
Vacancy

- Overall apartment vacancy declined 180 basis points over the past four quarters to 5.5 percent. Improvement was widespread, with tightening recorded in all but three of the Metroplex's 33 submarkets.
- Class A vacancy declined 120 basis points during the past year to 4.7 percent. Among submarkets with larger luxury inventories, Southwest Fort Worth logged the biggest decrease, with vacancy falling 250 basis points to 4 percent. In Dallas, the Plano/Allen/McKinney and Central submarkets outperformed.
- Year over year, Class B/C vacancy slid 220 basis points to 6.4 percent. Submarkets with limited affordable supply, such as Grapevine and Oaklawn/Uptown, continued to post the tightest conditions.
- **Outlook:** The pace of vacancy improvement will slow through the second half as deliveries rise. Nonetheless, vacancy in the Metroplex will end the year at 5.4 percent, down 90 basis points from 2011. As of midyear, vacancy had already fell to its lowest level on record since 2001.



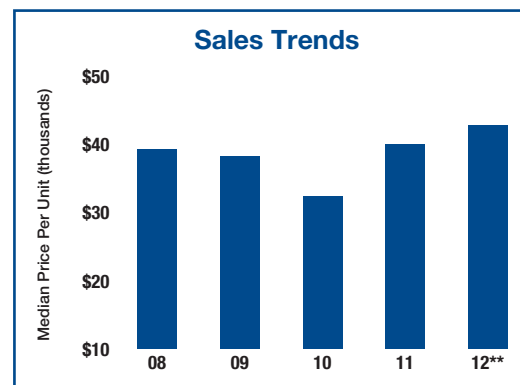
Rents

- Asking rents rose 3.2 percent during the past year to \$810 per month, while effective rents increased 3.8 percent to \$730 per month. The strongest gains in Dallas occurred in the East and Oaklawn/Uptown/CBD submarkets. In the Fort Worth area, the Grapevine and the Northwest submarkets outperformed.
- Class A asking rents grew 3.7 percent over the past 12 months to \$987 per month. During the same period, Class B/C rents increased 2.6 percent to \$640 per month.
- Concessions average 5 weeks of free rent on a year-long lease, down 8 percent from their late-2009 peak. The most generous incentives can be found in the Plano/Allen/McKinney and North Irving submarkets, where owners offer an average of more than six weeks of free rent.
- **Outlook:** In 2012, asking rents will rise 3.4 percent to \$823 per month. Effective rents will rise at a fast clip of 4.2 percent as owners pare concessions, pushing the average to \$744 per month by year end.



Sales Trends**

- Transaction velocity rose 25 percent over the past 12 months. The most significant acceleration occurred in the 100- to 300-unit segment of the market, which is attracting a significant number of out-of-state and Canadian buyers.
- During the past year, the median price rose to \$42,700 per unit, attributable in part to fewer distressed property sales. At the same time, though, values increased thanks to strengthening operations and heightened demand.
- Healthy fundamentals and exceptionally low interest rates contributed to cap rate compression over the past several quarters. On average, Class A assets are trading between 5.5 and 6.5 percent, while Class B properties tend to change in the 7 to 8 percent range, depending on condition and location.
- **Outlook:** Deals requiring debt assumption will remain challenging to sell in the near term, assuming interest rates hold near current levels. Even at discounted prices, such deals will appeal to a limited number of buyers.



* Forecast

** Trailing 12-Month Period

Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics

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Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- The Federal Reserve recently pledged to sell \$267 billion in short-term securities to buy long-term Treasuries in order to maintain low borrowing costs for consumers and businesses to continue to support an economic recovery. The purchases will occur in the second half of 2012 and extend a program known as "Operation Twist." The target to keep short-term interest rates low is now late-2014.
- Pipelines of under way and planned apartment projects are expanding in many metro areas and several major lenders appear willing to underwrite construction on select projects. The primary considerations for lenders include the quality of sponsorship and strong market fundamentals, including low vacancy and rising rents.
- The potential for elevated development may encourage the GSEs to underwrite acquisitions more conservatively in markets with large pipelines. In many metros, however, the agencies will underwrite deals at up to 80 percent LTV and rates 200 to 250 basis points above the 10-year U.S. Treasury. Life companies, meanwhile, are also active in the Class A arena, offering rates that are competitive with the GSEs.
- Commercial banks generally offer shorter-term financing for acquisitions from \$1 million to \$5 million at interest rates starting in the low-3 percent range for three-year terms and up to 4.5 percent for seven-year loans. In the growing CMBS market, looming issuance of several billion dollars in the next few months will affirm spreads for AAA bonds and establish investor appetites for B-rated tranches.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Grapevine	3.5%	-240	\$823	6.1%
2	Far North Dallas	3.6%	-180	\$755	4.6%
3	South Irving	3.7%	-230	\$638	4.6%
4	Garland	3.8%	-180	\$630	2.1%
5	Oaklawton/Uptown/CBD	3.9%	-240	\$1,182	7.7%
6	North Dallas	4.0%	-160	\$766	3.2%
7	Far Northwest/Farmers Branch	4.0%	-250	\$642	2.1%
8	Richardson	4.3%	-80	\$765	2.1%
9	Hurst/Bedford/Euless	4.3%	-190	\$727	4.1%
10	Plano/Allen/McKinney	4.4%	-190	\$876	4.8%
11	Carrollton/Addison/Coppell	4.6%	-160	\$743	4.4%
12	North Irving	4.7%	-110	\$784	4.9%
13	Northwest Fort Worth	4.7%	-170	\$762	5.6%
14	Southwest Fort Worth	4.7%	-320	\$664	3.8%
15	East Dallas	4.7%	-380	\$802	6.8%
16	Northern Tarrant County	4.9%	-240	\$763	4.4%
17	Grand Prairie	5.0%	-210	\$628	3.8%
18	Southeast Tarrant County	5.1%	-130	\$699	3.2%
19	Central Arlington	5.7%	-260	\$537	2.4%
20	Mesquite/Seagoville	5.8%	-110	\$643	2.1%
21	Central Dallas	6.0%	-190	\$1,585	2.6%
22	Southern Dallas	6.4%	30	\$657	3.3%
23	North Arlington	6.4%	-280	\$617	3.6%
24	Northwest Denton County	6.5%	50	\$819	3.0%
25	Lewisville	6.8%	-10	\$818	4.5%