

# Saint Louis, Missouri



Multifamily Housing Update

August 2010

## EXECUTIVE SUMMARY

**A**fter 130 years, Saint Louis's iconic Budweiser beer is struggling for relevancy after watching its market share tumble by two-thirds since 1988. Owner In-Bev is pursuing foreign markets and trendier advertisements to breathe new life into the brand. Likewise, the metro area is seeking trendier new industries, like high tech and biotechnology, to offset employment attrition in its traditional mainstays: manufacturing, transportation and finance.

While there is much to be said for the strategy, lately it's been the mainstays that are making the largest contributions to payroll growth. Between February and June, durable good manufacturing headcounts increased nearly 3,000 jobs, in the process turning a 7,800-job year-over-year deficit into a 1,000-job 12-month gain. Smaller but significant progress also was observed in the transportation and financial services industries wherein material winter headcount deficits were converted to moderate gains in June.

Some of the Gateway City's contemporary obsessions also contributed to employment growth. Scientific R&D (largely biotech and bio-med) reversed a -5.4% 12-month slide in February, posting a 3.4% y-o-y advance in June, while private and higher education establishments ratcheted up hiring from 300 workers y-o-y to 1,100 during the comparable period.

Overall labor market conditions in spring were firmer but total payrolls continued to decline, falling 7,900 (-0.6%) jobs year-over-year in 2Q10, including a 5,000-job, -0.4% 12-month setback in June. The losses stemmed principally from continued weakness in the construction, retail trade and business service sectors.

Seasonally-adjusted data also depict a growth spurt from March to May, when job aggregates surged by

10,700. But nearly half these gains were attributable to temporary Census hires and seasonally-adjusted trends were heading south again in June.

The outlook is cautiously optimistic. Our econometric model projects a return to stable y-o-y job growth by early next year, giving rise to a moderate 8,900-job gain in 2011, followed by a 22,100-job advance in 2012.

Employment opportunities were encouraging enough to motivate a growing number of residents to assume the risk of an apartment lease. After vacating a net of 2,385 units during 2008 and 2009, tenants absorbed 334 units in 2Q10, representing the strongest one quarter performance in nearly three years. Average occupancy improved 20 basis points as a result, rising to 91.2%. Every metro submarket chalked down sequential occupancy gains save for Clayton and Maryland Heights, which feature the metro area's highest average rents.

In respect to pricing, owners inched face rents \$3 (0.4%) higher to \$726 quarter-to-quarter but returned tenants the favor by inflating lease concessions to the identical degree, holding effective rent steady at \$680. Rents in submarkets below the I-55 divide were mostly lower as St. Louis South, East of I-44 and South County properties posted -0.2% to -1.5% q-o-q declines. By contrast, western suburban areas with largely class-A and -B inventories recorded 0.4% to 0.9% sequential gains, including Clayton, Manchester and Maryland Heights.

Reis have a benign outlook for market performance, forecasting 30 bps and 0.4% respective occupancy and effective rent growth by year-end. Gains are expected to continue through 2014 at a moderately slower pace than the national average, which, in combination with a 6.75% generic cap rate hold expected total returns to 7.1%.

## SNAP SHOT

	Y-o-y change	Projected YE 2010
Vacancy (8.8% - 2Q10)	Unchd	20 bps
Effective Rents (\$680 - 2Q10)	0.3%	0.7%
Cap Rate (8.0% - 2Q10)	50 bps	
Employment (1,302.2m - 2Q10)	7.9m	11.3m

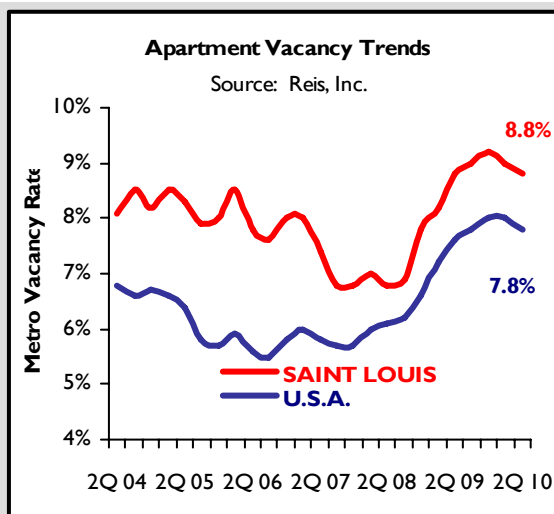
## KEY POINTS

- Encouraging trends in the durable goods manufacturing, transportation and financial services industries contributed to more stable employment conditions in the Saint Louis area. But overall payrolls continued to decline and our payroll model forecasts further losses through year-end.
- Apartment demand gained strength, however, suggesting that job opportunities may be stronger than the payroll data suggest. Tenants absorbed 334 units in 2Q, up from 228 in the prior quarter, representing the first consecutive positive quarters recorded in three years. Average occupancy increased 20 basis points to 91.2%.
- Rental agents pushed face rents aggressively, particularly in submarkets appealing to young professionals (Clayton / Manchester), but ultimately had to sweeten concessions to maintain occupancy. As a result, effective rents ended the quarter unchanged at \$680.
- Property trade remained very thin, limited to distressed assets and smaller repositioning plays. We estimate that a typical institutional quality property will trade at about a 6.75% cap rate, producing a 7.1% expected total return, 30 bps below the **RED 50** mean.

## 2Q10 VACANCY TRENDS

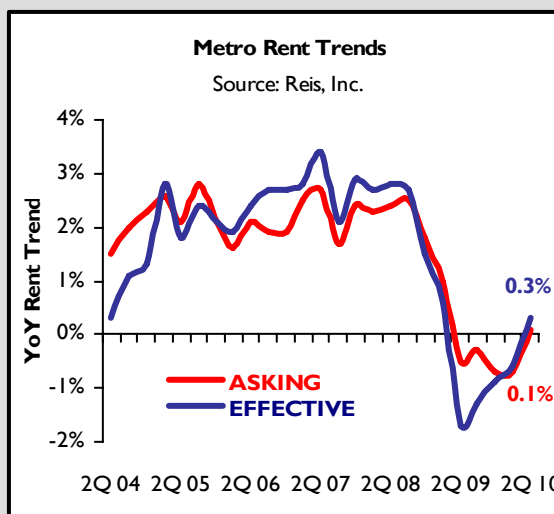
- After a strong winter quarter when Reis recorded net absorption of 288 units (the best 1Q haul in 10 years), property agents encountered further constructive demand during the spring when tenants absorbed a net of 334. Average vacancy fell 0.2% sequentially to 8.8%.
- Owners pushed rents aggressively in the metro’s higher rent neighborhoods like Forest Park and Maryland Heights, perhaps too aggressively. Occupancy fell sequentially in the popular Clayton /Mid-county submarket and was unchanged in Maryland Heights. All other metro submarkets posted sequential quarter occupancy rate gains.
- Almost non-existent supply levels contributed to the occupancy gains observed in 2010. Reis don’t expect any additions to stock before May 2011, allowing occupancy to rise another 30 to 50 bps by that time.

**RANK:** 34<sup>th</sup> out of 50



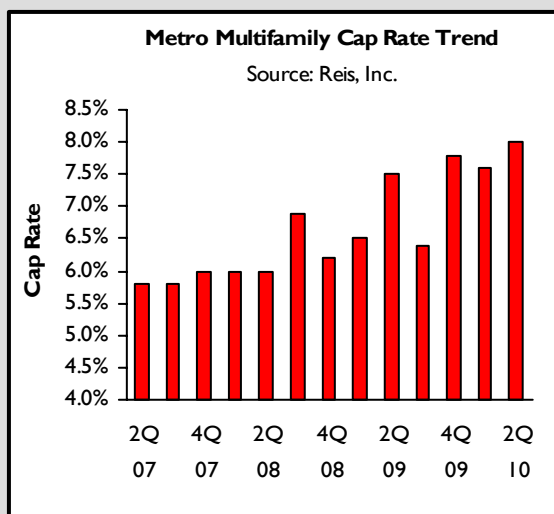
## 2Q10 RENT TRENDS

- Led by aggressive rent hikes in Clayton/Mid-county (+1.8%) and Manchester (+1.4%) submarkets, the average metro asking rent increased \$3 (0.4%) sequentially to \$726. Just three submarkets registered sequential face rent cuts: Florissant, Saint Charles and Saint Louis South. The last suffered a sharp \$9, -1.5% plunge.
- Owners appeared to be too aggressive in some cases, bringing on the necessity to increase concession levels. The value of the typical concessions package increased 14% or more quarter-to-quarter in the Clayton, Manchester and East of Interstate-44 submarkets.
- Reis project that effective rents will rise \$5 (0.7%) by year-end, followed by compound annual growth averaging 2.5% through 2014. The average 2010-14 CAGR for the **RED 50** is 2.7%.



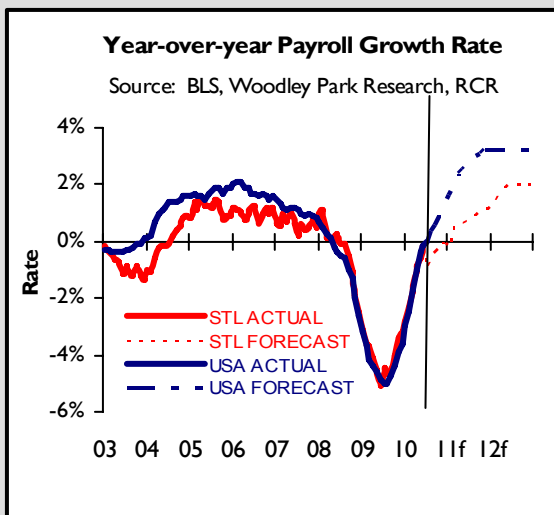
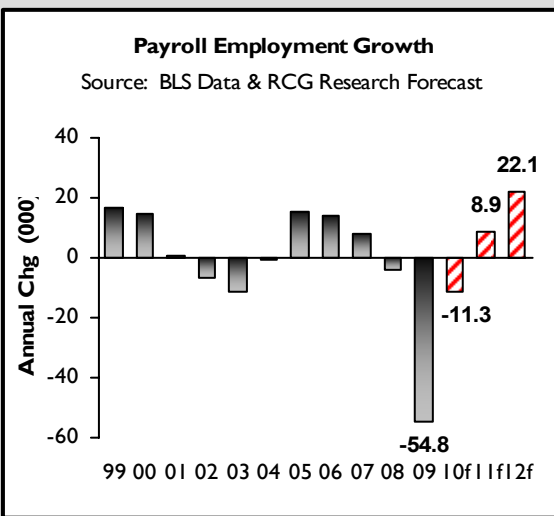
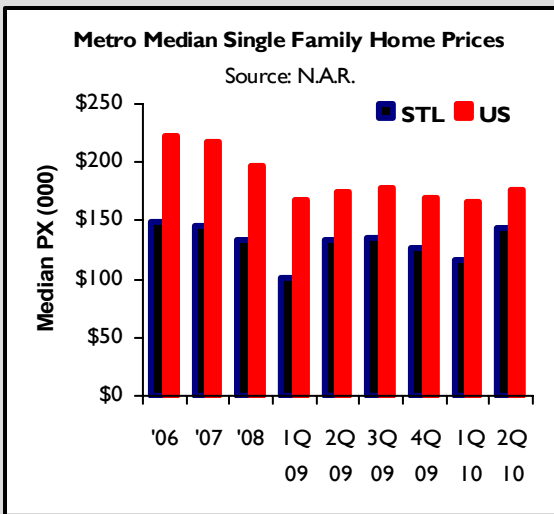
## PROPERTY MARKET & CAP RATE TRENDS

- While the ice began to crack in some other Midwest markets, transaction velocity didn’t accelerate much in Saint Louis from its 2009 torpor. Only three garden projects exchanged hands in the first half valued at a total of \$59mm, of which nearly half was attributable to a class-B+ Manchester trade closed in March.
- Investors seemed largely interested in rehab and repositioning plays. The most interesting involved a iconic but dated five-tower high-rise community near downtown acquired by the property manager for less than \$10,000/unit. Buyer plans to invest about \$4 million in a rehab of three towers and seeks to sell two, possibly to a senior housing developer. **RCR** believe the property could generate a 12% yield if physical occupancy can be elevated from 60% currently to 85%.
- Using a 6.75% generic cap rate, **RCR** estimate that typical STL assets will produce 7.1% annual total returns over 5-years, ranking 37th among the **R50**. But due to low historical volatility, risk-adjusted returns rank a useful 9th.



## NOTABLE TRANSACTIONS

Property Name	Property Class	Date of	Total Price	Price per unit	Estimated Cap
CityView (North St. Louis)	C	May-2010	\$13.0	\$13,889	\$12.0% p.f.
Schoettler Village (Manchester)	B+	Mar-2010	\$24.5	\$81,667	8.0%
5622 Delmar (Forest Park)	B	29-Jun-2010	\$3.3	\$47,429	8.7%



## DEMOGRAPHICS & HOUSING MARKET

- City of Saint Louis population declined in 2009, falling by 143 people. It was the first annual decrease in six years, suggesting that the city's urban renaissance has stalled, at least temporarily. Metro population increased by 0.4%, also the slowest growth recorded in six years.
- The median price of a metro home sold during 2Q10 was \$143,100 (NAR), representing a 7.1% year-on-year increase. This compares to gains of 1.5% and 1.4% for the U.S. and Midwest Region, respectively.
- Early 3Q10 data suggest that the market continued to exhibit solid traction in the post-buyer credit environment. HousingTracker.net report that for-sale inventory declined -3.4% during the month ended August 16, while the median asking price declined only -0.6%.
- One of every 414 Saint Louis Co. households received a foreclosure notice during July (Realtytrac). The national average was 1 of every 699 households.

## EMPLOYMENT TRENDS

### Non-Seasonally Adjusted

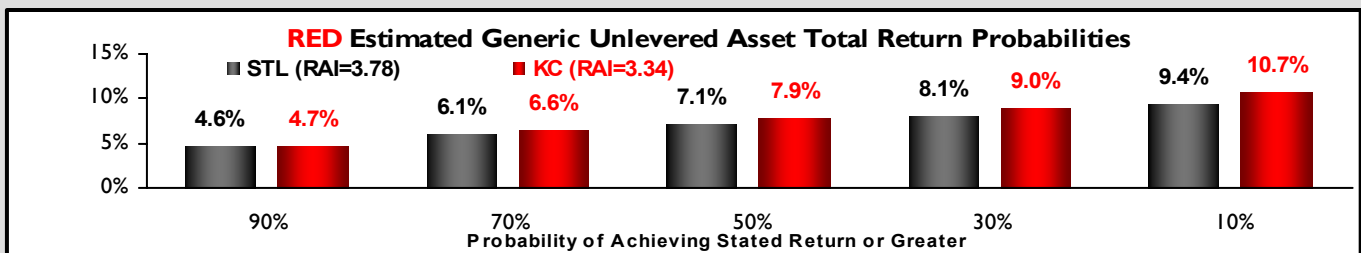
- The pace of year-over-year payroll job losses slowed dramatically in the second quarter, declining from a 30,100-job, -2.3% rate in 1Q10 to 7,900 (-0.6%) jobs.
- Hiring by manufacturing, transportation and business services establishments was largely responsible. Total payrolls in these sectors increased nearly 7,400 jobs between the first and second quarters, causing year-on-year comparison losses to decrease from a -17,800-job rate in 1Q10 to -4,500 jobs in 2Q and only -900 jobs in June.
- Year-on-year trends in the business services sector were encouraging. Employment in the tech and biotech sensitive scientific research and development subsector increased for the first time in a year and corporate use of contract labor increased materially, a common precursor of labor market recovery.

### Seasonally-Adjusted

- Measured on a seasonally-adjusted basis, metro payrolls increased 10,700 jobs in the three-month period ended in May. Temporary Census workers accounted for approximately 3,500 of these jobs.
- Employment momentum seemed to stall in June, as payrolls plunged by 2,600 jobs. The expiration of temporary Census jobs was partially responsible. Preliminary data suggest that hiring bounced back in July, however; payrolls rose 7,800 jobs month-to-month, the largest one-month gain recorded in a decade.

### Forecast

- Although preliminary July data show a 2,600-job year-over-year gain, the RCR econometric payroll model indicates that it may be several months before Saint Louis posts consistent positive annual comparisons. The Gateway City should lose about 11,300 jobs in 2010, before recording gains totaling 8,900 jobs in 2011; 22,100 jobs in 2012.

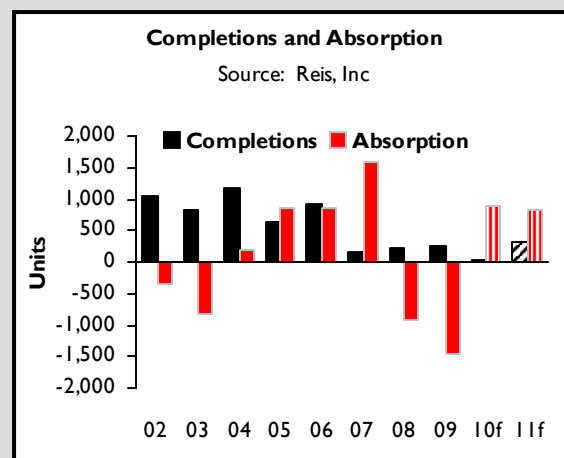


## SUBMARKET TRENDS

Submarket	Effective Rent			Physical Vacancy		
	2Q09	2Q10	Change	2Q09	2Q10	Change
Airport / Interstate-70	\$520	\$524	0.7%	9.7%	9.9%	20 bps
Clayton / Mid-County	\$829	\$802	-3.2%	8.9%	10.8%	190 bps
East of Interstate-44	\$601	\$604	0.5%	7.0%	7.2%	20 bps
Florissant / North County	\$594	\$598	0.6%	10.0%	10.6%	60 bps
Manchester / West County	\$815	\$812	-0.4%	8.7%	7.9%	-80 bps
Maryland Heights / NW Co.	\$733	\$743	1.3%	9.1%	8.6%	-50 bps
South	\$633	\$616	-2.7%	6.0%	5.5%	-50 bps
Saint Charles County	\$698	\$711	1.8%	6.6%	6.1%	-50 bps
Saint Louis City North	\$744	\$759	2.0%	10.1%	10.6%	50 bps
Saint Louis City South	\$576	\$562	-2.4%	9.4%	8.2%	-120 bps
<b>Metro</b>	<b>\$678</b>	<b>\$680</b>	<b>0.3%</b>	<b>8.8%</b>	<b>8.8%</b>	<b>Unchd</b>

## SUPPLY TRENDS

- Developers broke ground in April on a \$27 million rehab project of a soda syrup factory in the Carondelet neighborhood of South Saint Louis. The project will receive historic preservation tax credits and other tax credit financing. Seventy-seven apartments will be constructed in the plant building and another 32 apartments will be added in outbuildings nearby. Rents are projected to range from \$500 to \$1,000. Some apartments may be ready for occupancy in the fall and Reis forecast that the project will receive a final certificate of occupancy in May 2011.
- Work on the repurposing and substantial rehabilitation of a vacant art-deco style office building in the Central Business District began in May. The mixed-use property will offer 232 rental apartments as well as 45,000 square feet of office space and 35,000 square feet of street level retail space. Reis forecast that construction will be complete by December 2011.
- A Washington Avenue corridor loft conversion was partially completed in August and offered units for rent. The first phase of the \$25 million repurpose and rehab of a vacant shoe factory encompasses three floors of the building with ten units on each floor. At this writing, four units were available for occupancy at rents ranging from \$1,100 to \$1,400 per month.
- A former department store in the Washington Avenue corridor is being converted to 205 apartments and a hotel. The project is expected to be in lease up by late 2011.



- A 197-unit mid-rise located near Saint Louis University was completed in early 2009. The project was about 78% occupied in June at rents averaging \$1,505 per month.
- Eight stabilized Downtown and Washington Avenue corridor rental buildings constructed or rehabbed since 2005 were 87% occupied in June at rents averaging \$1,144. The properties offer a total of 624 units.

**Daniel J. Hogan**  
Director of Research  
djhogan@redcapitalgroup.com  
614-857-1416

**William T. Hinga**  
Business Development  
wthinga@redcapitalgroup.com  
614-857-1499

**RED CAPITAL GROUP**  
Two Miranova Place  
Columbus, OH 43215  
www.redcapitalgroup.com  
800.837.5100



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