

Charlotte, North Carolina



Multifamily Housing Update

June 2009

EXECUTIVE SUMMARY

After earning outsized benefits from its status as one of the nation's two major banking centers, Charlotte experienced the negative consequences that sometimes unfold when an economy is characterized by less than ideal diversification. The challenges befalling the banking industry during the Great Recession yielded deep cuts in financial service industry payrolls, which in due course led to layoffs at hundreds of establishments dependent on the banks and their employees for business. Thus, attrition of 6,700 (-9.6%) financial service jobs in 1Q09 spread like wildfire to the business services sector, giving rise to 8,800 (-7.0) layoffs there. Elimination of these mostly high wage jobs in turn had a dramatic effect on consumer behavior, contributing to 11,400 (-6.4%) redundancies at stores and leisure service establishments and 10,600 (-24.6%) construction layoffs. Metro payrolls fell at a 44,500-job, -5.4% year-over-year pace overall, easily the most severe setback dealt the Queen City in the post-war era.

Adjudged on a y-o-y basis, conditions deteriorated further in April and May. Payroll losses accelerated to a 52,000-job, -6.0% rate and the unemployment hovered above 11%, this in a region that did not report a rate above 6.7% in either of the previous two recessions. But seasonally-adjusted monthly payroll data revealed a morsel of hopeful news — Charlotte payrolls declined by only 300 jobs April to May—representing the strongest month-to-month trend observed since last August, offering the best evidence yet that the Charlotte economy was near a trough in the down-cycle.

Although conditions will improve moderately in 3Q09, Charlotte is not out of the woods yet. The **RED CAPITAL Research** econometric payroll model projects y-o-y losses

extending into 2H10. Metro payrolls are expected to fall 51,400 (-6.0%) jobs in 2009; 16,500 (-2.0%) in 2010.

Apartment demand held up well under the stress as owners lost a net of only 28 tenants (Reis) in the seasonally weak winter quarter. But average occupancy fell 50 basis points to 91.5% anyway after a 462-unit repurposed high-rise Uptown condo was added to inventory. The resulting 980 bps increase in Downtown submarket vacancy notwithstanding, only three other metro neighborhoods experienced occupancy declines greater than 50 bps, while two (Harris, Carmel) managed to add a few tenants.

Owners were compelled to discount to bolster occupancy and effective rents suffered, falling \$9 (-1.3%) from December. Three submarkets recorded -2% sequential declines or more (Concord, Harris and North Pineville), while Downtown prices receded \$12 (-1.1%) despite delivery of the aforementioned condo, where tariffs average about \$1,600 a month.

Reis expect market conditions to deteriorate further through year-end. Supply of 4,040 units scheduled to hit the market by December will grow metro inventory by 4.4%, exerting tremendous downward pressure on occupancy and effective rent levels. The service expects the former to fall another -150 bps to 90.0% and the latter to tumble \$17 (-2.4%) to \$689.

Investors were understandably cautious under the circumstances and property trade ground to a standstill. Only one \$2.5 million sale was consummated year-to-date, a distressed B+ garden project in Gastonia. Nor were owners anxious to sell: only one arguably institutional quality asset was listed for sale. Motivated sellers may have to price to 7.5%-8.0% yields in order to move quality projects at this moment in time.

SNAP SHOT

	Y-o-y change	Projected YE09
Vacancy (8.5% - 1Q09)	↑ 200 bps	↑ 150 bps
Effective Rents (\$706 - 1Q09)	↓ 0.6%	↓ 3.6%
Cap Rate (NA - 1Q09)	↔ No Trade	↔
Employment (818.6m - 1Q09)	↓ 44.5m	↓ 51.4m

KEY POINTS

- The financial services sector led the Charlotte economy downhill in the first half 2009. Sector payrolls plunged at -9.7% rate in May, dragging overall metro payrolls lower by 52,000 (-6.0%) jobs.
- Seasonally-adjusted May payroll data suggest that the freefall is over and the Charlotte economy is stabilizing and scraping along the bottom of the cycle. Still, **RCR** forecast annual losses of 51,400 jobs in 2009 and 16,500 jobs in 2010.
- By way of demand, apartment performance was constructive in 1Q09: owners lost a net of only 28 tenants. But the effects of supply sent occupancy falling 50 basis points nevertheless to 91.5%.
- Owners lost their grip on pricing power and were compelled to discount face rents and augment lease concession offers. Asking rents dropped \$2 (-0.3%) and effective rents \$9 (-1.3%) to \$796 and \$706, respectively. Further decay is forecast through year end.
- Investors took a rain check: after closing on 16 trades for \$190mm in 1H08 buyers closed on only one distressed Gastonia property January through June for \$2.5mm.

VACANCY TRENDS

- Metro vacancy rates continued on the upward slope that began in 1Q08, rising 50 basis points December to March to 8.5%, according to Reis. Average occupancy was 200 bps below the year-earlier level and 250 bps below the 94.0% cycle peak reached in December 2007.
- Properties in the Downtown submarket continued on a wild roller-coaster ride. After rising to a 95.2% average occupancy rate at mid-year 2008 and recovering 2004 peak effective-rent levels, the delivery of a 462-unit repurposed Uptown rental condo unsettled the market. Vacancy ballooned to 16.7% and rents tumbled to the 2007 cycle-lows.
- Supply will burden the market further in 2009. Reis expect developers to bring 4,040 more units to market this year, sending occupancy down 150 bps to 90.0%. Supply and demand equilibrium will return in 2010.

RANK: 41st out of 50

RENT TRENDS

- Tenant job losses, shadow market competition and the specter of a full menu of express rental properties in the pipeline had owners adjusting prices down to retain tenants and maintain occupancy rates. Face rents were fairly firm so far, falling only \$2 (-0.3%) to \$796 in 1Q09, but concessions increased materially, rising \$7 to an average of \$90/month or 11.3% of gross rent revenue (highest percentage in the **RED 50**).
- Average effective rents fell \$9 (-1.3%) to \$706. Reis expect the metric to fall another \$20 (-2.6%) by YE09. Only 3 **RED 50** markets are expected to post weaker trends, each a high-cost West Coast market.
- Downtown submarket rents declined \$61 (-5.3%) to \$1,099 year-over-year, despite the addition of the aforementioned 462-unit luxury tower which advertised rents ranging from \$1,500 to \$2,400 per month.
- Gaston County was the only metro submarket to record sequential rent growth in 1Q09, posting a \$2 (0.2%) advance to \$622.

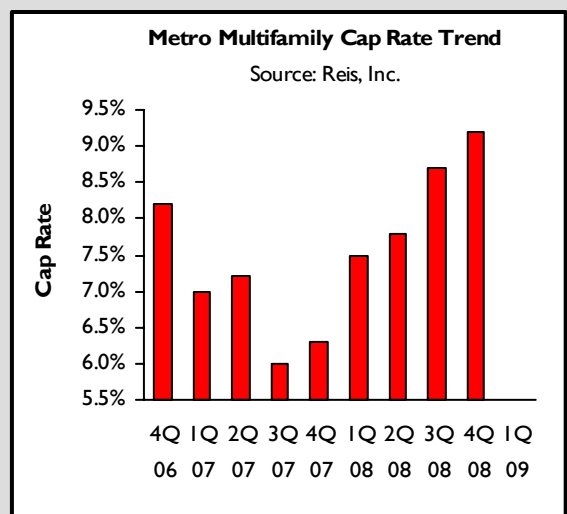
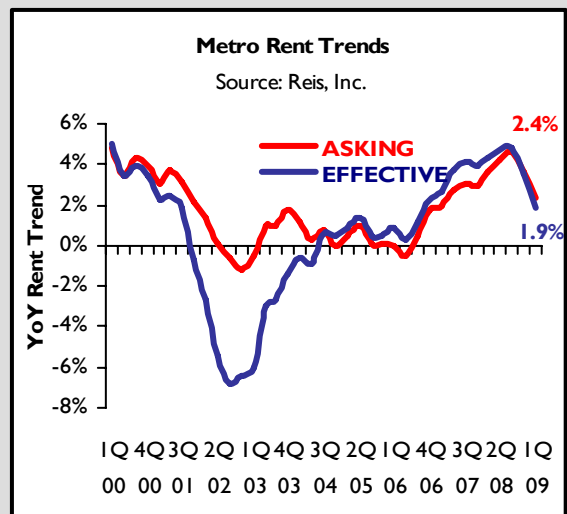
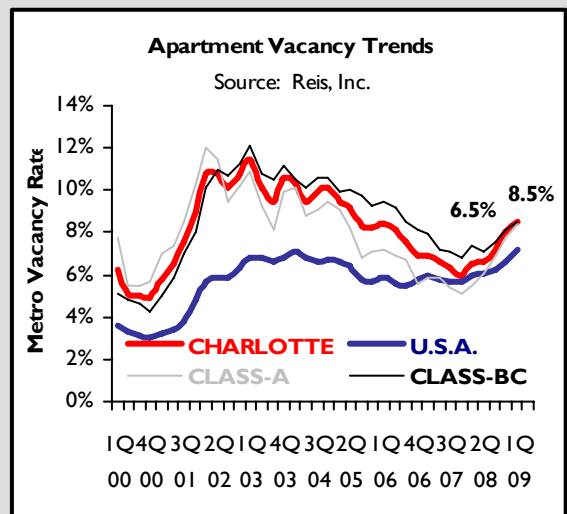
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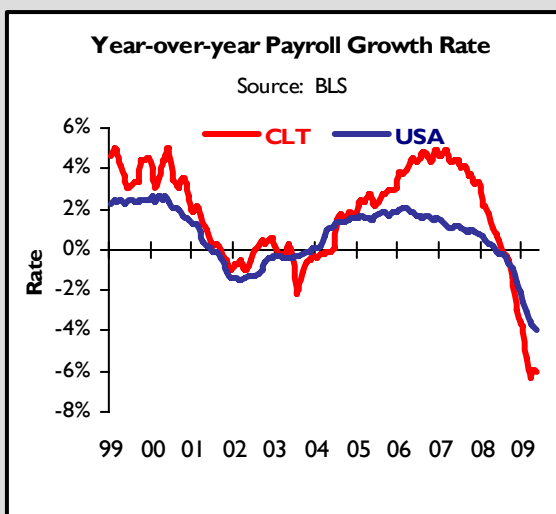
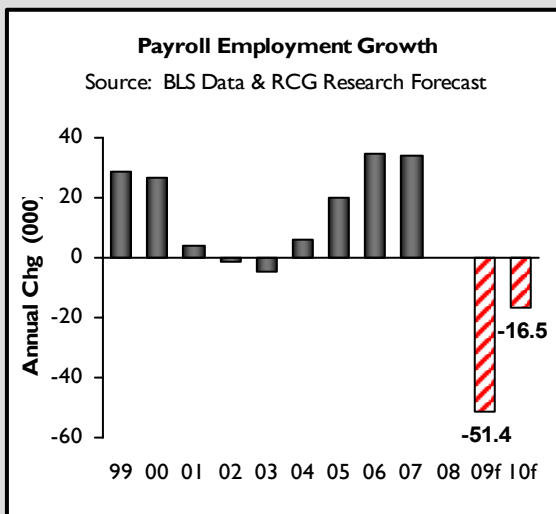
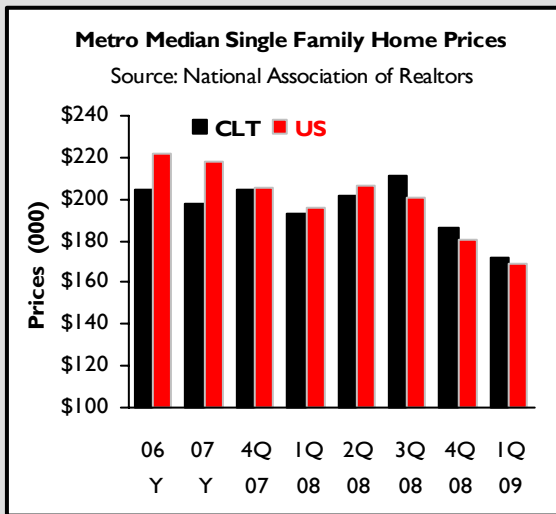
PROPERTY MARKET & CAP RATE TRENDS

- Investors chose to move to the sidelines as Charlotte's recently thriving multifamily market entered choppy waters. Only one property exchanged hands in the first half of 2009, a 126-unit, 1969-vintage, class-B- garden project in Gastonia. The 63% occupied complex traded at a \$2.5mm, \$16,667/unit price yielding an estimated 4%.
- Loopnet.com listed 10 multifamily projects for sale by brokers in late June. Only one of these was of institutional quality and it is located in a thinly populated outer rim suburban area of the city of Charlotte.
- The breathtaking speed at which NOI levels declined in 1Q09 may place stress on some over-levered assets. Investors with access to equity may wish to be prepared to take advantage of this situation.

NOTABLE TRANSACTIONS

Property Name	Property Class	Date of Transaction	Total Price (in millions)	Price per unit	Estimated Cap Rate
Beaver Brook Apts (Gaston Co.)	C	Feb-2009	\$2.4	\$16,667	N/M





DEMOGRAPHICS & HOUSING MARKET

- Charlotte MSA's super-charged population growth slowed down moderately in 2008. The six-county metro area added 55,368 (3.4%) residents last year, down 66,361 (4.2%) in 2007.
- The Queen City's real estate market performed in line with national and regional norms in the first quarter. The NAR report that the median price of a metro home declined -11.0% from March 2008 to \$171,500. The comparable United States and South Region metrics were -13.8% and -10.8%, respectively.
- The Case-Shiller repeat sales index reveals that the value of Charlotte MSA homes fell -9.3% during the 12 months ended in March. On the other hand, the index advanced 0.3% February to March, one of only three metros among the twenty in the index to post a sequential month gain. The others were Dallas (0.03%) and Denver (0.1%)

EMPLOYMENT TRENDS

First Quarter 2009

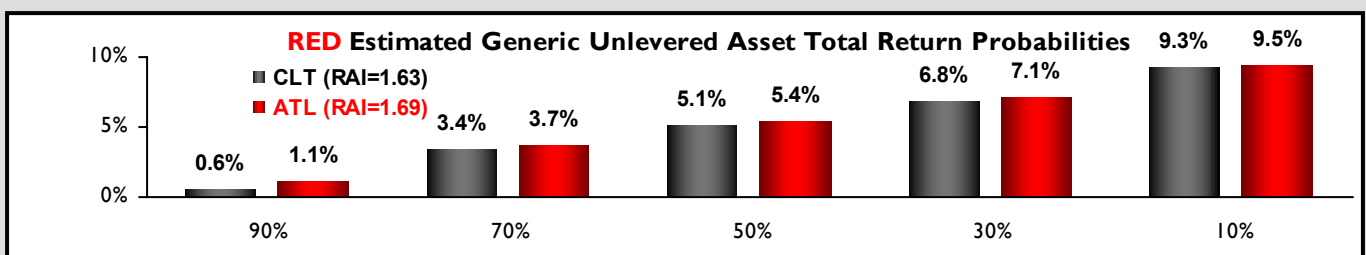
- Payroll trends deteriorated rapidly in the first quarter. After posting a 23,400-job, -2.4% year-over-year loss in 4Q08, Charlotte payrolls declined at a 44,500-job, -5.2% rate in 1Q09. This compares to a 3.1% rate of job loss recorded around the nation in the first quarter.
- The goods producing industries contributed to the decline. Construction, manufacturing and wholesale trade payroll aggregates dropped at a 20,500-job pace in the quarter, down from a 13,500-job rate in 4Q08.
- Attrition also accelerated in commerce-sensitive sectors, as retail trade and financial and business service headcounts declined at a 22,300-job rate, down from a 13,400-job loss in 4Q. Likewise, job losses in the transportation and warehousing industry increased from a 600-job y-o-y rate in 4Q08 to a 2,100-job pace in 1Q09.

April and May 2009

- The pace of payroll job losses stabilized in April and May, holding steady at about the 52,000-job, -6.0% level.
- On a seasonally-adjusted basis, job attrition in the metro area slowed to only 300 jobs April to May, another sign the economy was scraping along the bottom. A recovery may begin to take shape by 4Q09.
- After peaking at 11.7% in February, the unemployment rate moderated to 10.6% in March and 10.4% in April.

Forecast

- PNC chief economic Stuart Hoffman expects US GDP to fall -2.9% in real terms during 2009 before rebounding 1.9% in 2010.
- RCR's econometric payroll model indicates that job losses measured on a y-o-y basis will continue through 2010. The model yields a forecast of -51,400 (-6%) jobs in 2009 and -16,500 (-2%) jobs for 2010.

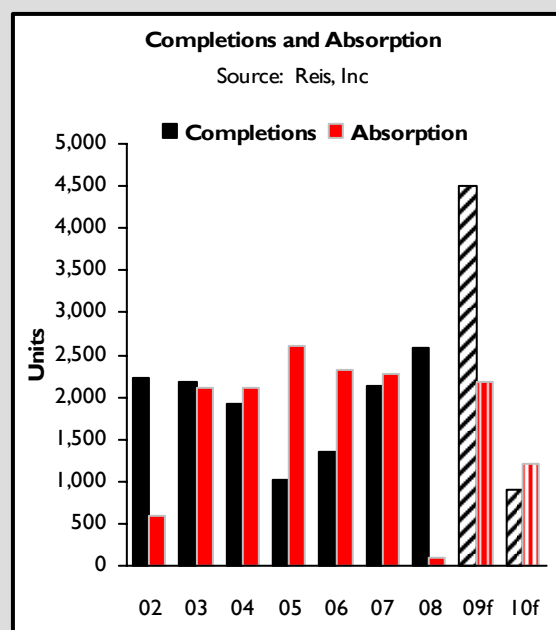


SUBMARKET TRENDS

Submarket	Effective Rent			Physical Vacancy		
	1Q08	1Q09	Change	1Q08	1Q09	Change
Harris Blvd / Mallard Creek	\$795	\$785	-1.3%	4.5%	6.4%	190 bps
North Tryon St	\$560	\$551	-1.6%	8.5%	10.8%	230 bps
East Charlotte / Central Ave.	\$634	\$644	1.6%	4.3%	7.2%	290 bps
Carmel	\$804	\$812	1.0%	4.6%	8.9%	430 bps
North Pineville	\$710	\$687	-1.0%	5.8%	8.6%	280 bps
West Charlotte / Airport	\$551	\$546	-0.9%	9.0%	8.0%	-100 bps
East / Albemarle	\$613	\$601	-1.9%	8.2%	9.0%	80 bps
Fairview North	\$790	\$780	-1.3%	6.8%	5.8%	-100 bps
Gaston County	\$621	\$622	0.1%	6.5%	8.7%	220 bps
Downtown	\$1,160	\$1,099	-5.3%	6.0%	16.7%	1070 bps
Concord / North Concord	\$625	\$630	0.8%	5.6%	8.7%	310 bps
Northwest Charlotte	\$789	\$821	4.1%	8.6%	9.6%	100 bps
Metro	\$710	\$706	-0.6%	6.5%	8.5%	200 bps

SUPPLY TRENDS

- Six metro projects were issued final certificates of occupancy in the first half of 2009. The properties encompass a total of 1,205 units.
- Seventeen properties were under construction in early June, according to Reis. When complete these communities will add 4,858 units to the metro inventory. Twelve of the projects containing 3,547 units will debut in 2009.
- The largest percentage increase in inventory will occur in the West Charlotte / Airport submarket, which currently has only 3,719 investor grade units. Developers will add 910 units in three projects by year-end, boosting inventory by 25%. Each of the three properties is a mid-rise building located in the emerging South End neighborhood that borders Uptown. Asking rents will be in the \$1.25 to \$1.50/ft² range, rather more than the \$0.65 to \$0.80/ft² typical of the existing submarket inventory.
- Four projects containing 1,218 units are on tap for 2009 delivery to the Harris Boulevard / Mallard Creek submarket. Construction on another 437 units is underway in two projects scheduled for 2010 delivery. The submarket inventory will expand 12.1% to 15,343 units by year-end 2010.
- Over 1,000 condo units are under construction in the Downtown / Uptown submarket. These units form the nucleus of a possible shadow apartment rental market should soft demand for infill condos persist.
- Uptown Charlotte properties built 2000—2006 were on average 15.3% vacant in March at mean asking rent of \$1,346.



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