

Pittsburgh, Pennsylvania



Multifamily Housing Update

June 2008

EXECUTIVE SUMMARY

Within the last year Pittsburgh earned two coveted beauty awards: cited first for being America's "Most Livable City" and more recently as the "Best City for Relocating Families." With the NHL Penguins battling for the Stanley Cup, Steel City residents have a host of reasons to feel optimistic for the future.

The economy isn't performing badly either. After reporting the decade's strongest job creation (8,400/0.7%) in 2007, the metro economy recorded a solid 7,700-job, 0.7% year-over-year add in 1Q08. The principal impetus for the advance came from the skilled services: education services grew at an 1,800-job, 3.5% rate, while health care and social services employers added 3,300 workers for 1.8% growth. Financial, professional and technical services contributed another 1,300 jobs, representing a 1.0% gain.

Pittsburgh also enjoyed a rare net contribution from the construction sector. Indeed, builders accelerated hiring in the first quarter, adding workers at a 2,200-job, 3.8% rate, up from 2,100 jobs in 4Q07 and 1,800 slots for calendar 2007.

Metro growth shrugged off the nation's difficulties in April, posting a solid 8,900-job, 0.8% gain relative to 2007. At the same time, the unemployment rate dropped 70 basis points to 4.5%, reversing an upward trend observed since January.

It's hard to find fault with the direction of Pittsburgh's economic metrics. It is therefore no surprise that **RED CAPITAL Research's** econometric payroll model detects better tidings than it did before. Following last quarter's dour forecast of no growth in 2008 and a net loss of 2,000 jobs in 2009, the **RED** model produces respective point estimates of 7,000 jobs in 2008 and 4,000 jobs next year.

Unfortunately, job creation did not translate to robust 1Q08 housing demand. April homes sales and prices fell y-o-y for only the second time since 2005, and the apartment market registered its first quarter of negative net absorption since 4Q06. Owners lost a net of -271 tenants, causing vacancy to rise 30 bps to 6.4%.

As occupancy fell, rent traction evaporated. Asking rents inched \$1 higher to an average \$817, but increased lease concessions offset the advance, leaving effective rents unchanged at \$771. Year-over-year effective rent trends tumbled from 4Q07's 7-year high 3.8% to 2.7%, dropping the 'burgh from 32nd to 40th among the **RED 50** markets.

Reis are pessimistic about U.S. apartment fundamentals and make no exception for Pittsburgh. The service foresees occupancy falling steadily to 92.4% by 2010, and rent rising only 2.1% this year followed by a below average 3.1% p.a. pace through 2012. **RCR's** internal models largely validate Reis's conservative outlook.

Investors seem to be heeding **RCR's** advice to accumulate assets in our top high-yield markets, especially Columbus and Indianapolis, where sales are up 169% and 55% y-t-d, respectively. But sales velocity remains slow in Pittsburgh. Real Capital Analytics report no trades y-t-d through April and **RED** uncovered only one sale as of May 31: a Shadyside apartment targeted at students. The initial yield of this trade is estimated at 6.2%.

Notwithstanding the weak fundamental outlook, **RCR** continue to find much to like in Pittsburgh investments. Using a 6.5% going-in cap rate we estimate 7.6% expected 5-year unlevered returns, ranking 10th among the **RED 50**. Risk-adjusted returns are pretty useful, too, allowing us to affirm an **Accumulate** rating.

SNAP SHOT

	Y-o-y change	Projected 2008
Vacancy (6.4% - 1Q08)	↓ 70 bps	↑ 30 bps
Effective Rents (\$771 - 1Q08)	↑ 2.7%	↑ 2.1%
Cap Rate (6.5% - 1Q08)	↔ n/m	↔
Employment (1,123.7m - 1Q08)	↑ 7.7m	↑ 7

KEY POINTS

- The Pittsburgh economy maintained solid forward momentum in 1Q08, producing employment opportunities at a 7,700-job 0.7% year-over-year pace. Skilled service industries made the largest contribution.
- **RED CAPITAL Research** have a constructive view of the metro payroll outlook. The econometric payroll model produces forecasts of 7,000 and 4,000 jobs for 2008 and 2009, respectively.
- First quarter housing demand was weak. Home sales were disappointing and apartment owners experienced negative absorption for the first time in 15 months.
- Metro vacancy increased 30 basis points to 6.4% of the apartment inventory.
- Effective rents were unchanged quarter-to-quarter. Consequently, year-over-year rent trends declined from 3.7% in 4Q07 to 2.7%.
- Trade liquidity remained thin. Only one significant asset traded January-May 2008.
- Pittsburgh ranks #10 for total returns and #5 for risk-adjusted returns among the **RED 50**, earning an **Accumulate** investment rating.

VACANCY TRENDS

- In 2H07, apartment owners net leased a total of 522 units and thereby reduced metro vacancy 60 basis points to 6.1%. But much of the ground gained was lost in 1Q08. Negative net absorption of -271 units resulted in a 30 bps vacancy rate increase to 6.4%.
- Reis affirmed for the third consecutive quarter its 6.7% vacancy rate forecast for YE2008; but the out-year outlook turned gloomier. Last November, the service published a forecast of 7.1% vacancy for YE2010 but revised the outlook to 7.6% in May.
- Sequential occupancy dropped materially in the North and Baldwin / Whitehall submarkets. Conversely, the core Bellefield / Shadyside submarket enjoyed a 60 bps advance to 94.5%.

RANK: 28th out of 50

COMMENT: RCR's internal models foresee 93.5%+ occupancy through 2012.

RENT TRENDS

- The momentum that carried Pittsburgh rents to a 7-year high 3.8% year-over-year surge in 4Q07 came to an abrupt halt in 1Q08. Asking rents barely registered a gain, rising \$1 (0.1%) to \$817; but rising concessions levels counter-balanced the hike, producing no net rise in effective rents. This was the first quarter in three years that Pittsburgh apartment owners did not manage to advance occupied unit revenue.
- Year-over-year rent trends dropped 110 bps to 2.7% in 1Q08.
- Sequential effective rents declined in the Bellefield and Upper St. Clair submarkets. Both submarkets enjoyed strong tenant demand in 2006 and 2007. Owners appear to be assuming a more defensive posture, shifting pricing strategy to maintain maximum occupancy.

RANK: 40th out of 50

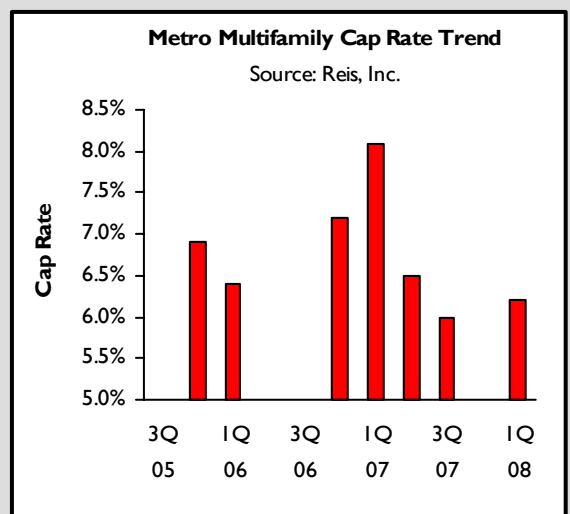
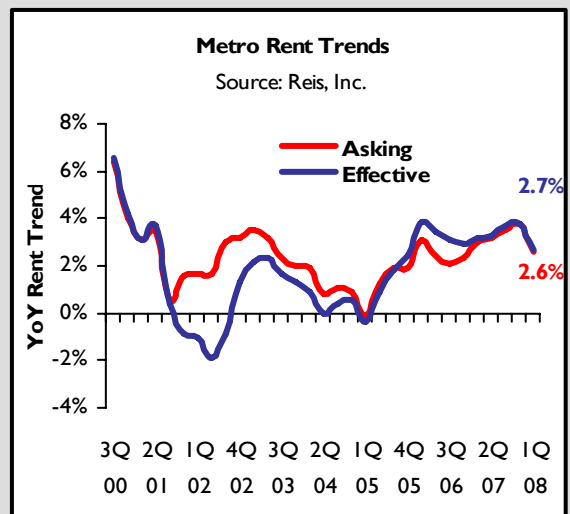
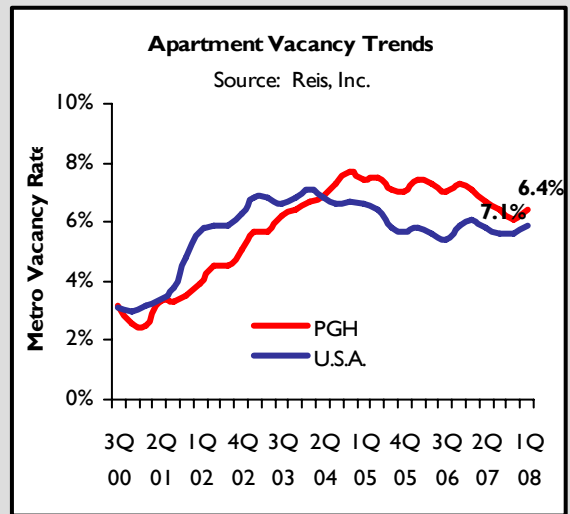
COMMENT: RCR expect rent growth to exceed Reis projections by approximately 50 bps per year, averaging in the mid- to high-3% range.

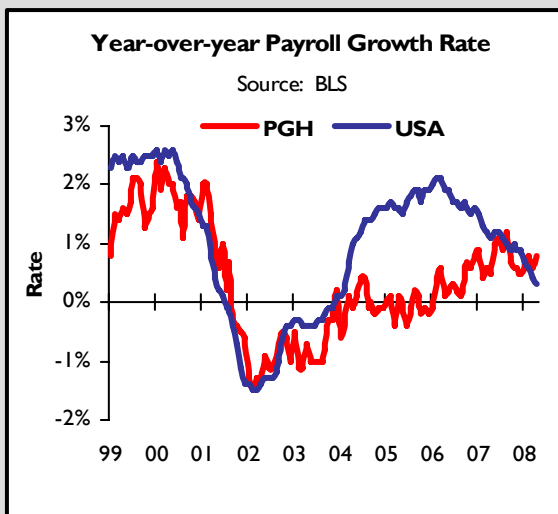
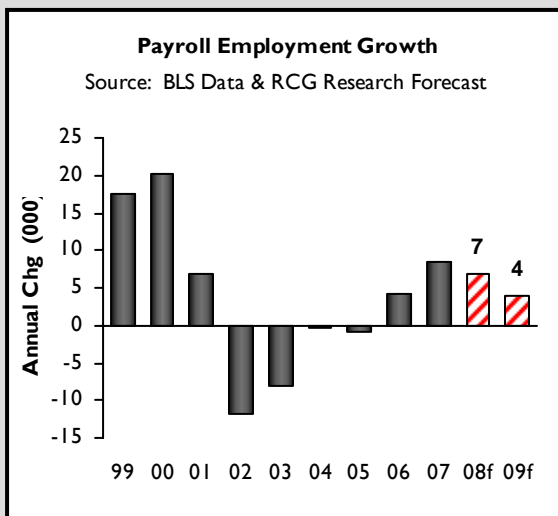
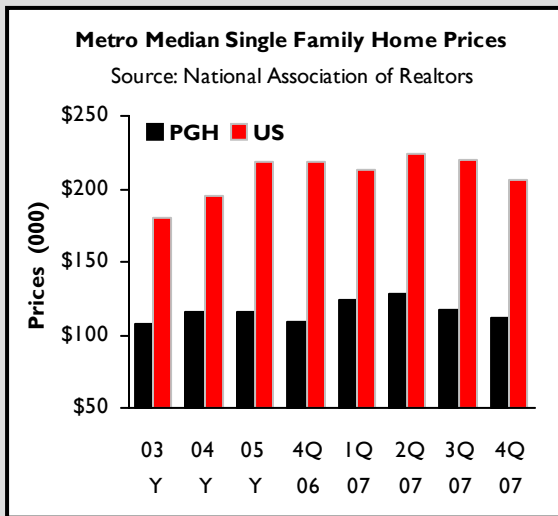
PROPERTY MARKET & CAP RATE TRENDS

- Investment activity was all but non-existent in 1Q08. Real Capital Analytics reported no trades during the first 4 months of the year. Reis identified a sale closed in May: the acquisition of a Shadyside mid-rise (see Notable Transactions below) tenanted principally by students. RCR reverse-engineered a 6.2% cap rate for this particular exchange.
- Real Capital Analytics reported that six apartment properties were listed for sale in the first quarter. The average listed cap rate was 7.4%, while the average price per unit was \$50,867.
- Using a 6.5% going-in cap rate, RCR estimate 5-year unlevered total returns of 7.6%, ranking 10th among the RED 50. The metro's risk-adjusted index is 4.30, 5th highest in the group. These metrics coupled with the metro's improving economy produce the conditions necessary and sufficient to earn an *Accumulate* rating for yield-oriented buyers.

NOTABLE TRANSACTIONS

Property Name	Property Class	Date of Transaction	Total Price (in millions)	Price per unit	Estimated Cap Rate
Kenmawr Apts (Bellefield)	Student	May-2008	\$26.1	\$108,750	6.2%





DEMOGRAPHICS & HOUSING MARKET

- The median priced Pittsburgh home traded for \$111,600 in 1Q08, representing a 2.4% increase over the comparable period of 2007.
- Pittsburgh ranked 30th among the 148 markets in the NAR report.
- The Office of Federal Housing Enterprise Oversight reported that the average Pittsburgh home increased in value by 3.61% in the year ended March 31, 2008, ranking 68th among the 291 metro areas analyzed. OFHEO estimated that homes appreciated 1.52% from December 31.
- Metro population declined for the 14th consecutive year in 2007, falling by 7,502 individuals or -0.3%. The loss was the smallest since 1995, benefiting from the lowest net domestic out-migration performance recorded in four years.
- Homeownership increased 140 bps to 73.6% in 2007, a 3-year high.

EMPLOYMENT TRENDS

Past 12 Months

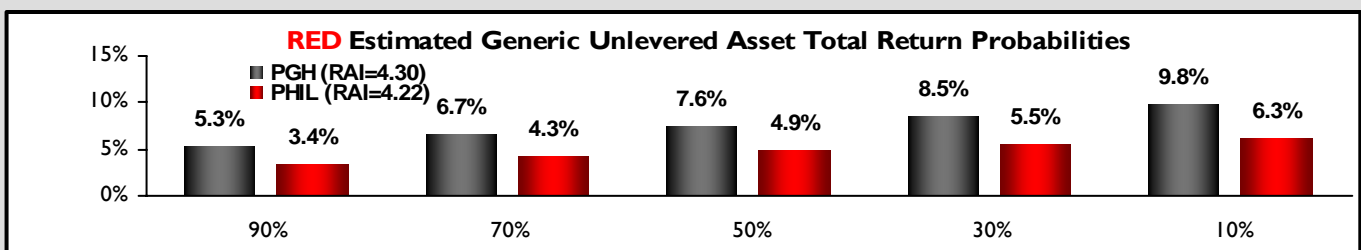
- The BLS's re-benchmark of its Current Employment Statistics series provided welcome news to Pittsburgh real estate owners and investors. Revised data showed that Steel City establishments created nearly twice as many jobs in 2007 as previously reported. Rather than 4,500 payroll positions, Pittsburgh employers added 8,400 jobs last year, a 0.7% advance.
- Skilled service industries made the largest contributions to net job creation. Business services establishments added a net of 6,000 employees, producing a 4.0% gains. Health care and private education service employment advanced by 3,100 jobs.

First Quarter 2008

- Metro employers continued to expand at a measured pace. Total payrolls increased at a 7,700-job, 0.7% year-over-year rate, bolstered by faster expansion in the construction, finance, health care, private education and hospitality industries.
- Conversely, business service employment growth slowed considerably, falling to a 3,800-job year-over-year pace.
- The April unemployment rate fell 70 bps month-over-month to 4.5%.
- The over-the-year growth comparison in April bounced back to 0.8%.

Forecast

- RCR have a considerably more optimistic view of Pittsburgh payroll trends owing to the impact of the BLS re-benchmark.
- The group's econometric payroll model now forecasts a net addition of 7,000 (0.7%) jobs in 2008, within a 5,000- to 9,000-job confidence interval. For 2009, the interval shifts left to no growth to 7,000 jobs, with point estimate of 4,000 (0.3%).



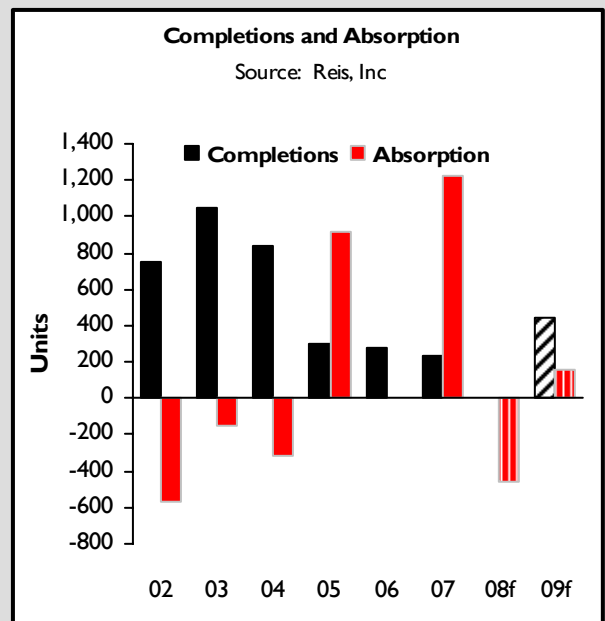
SUBMARKET TRENDS

Submarket	Effective Rent			Physical Vacancy		
	1Q07	1Q08	Change	1Q07	1Q08	Change
North / Butler Co / Beaver .Co	\$778	\$807	3.7%	9.7%	9.5%	-20 bps
Bellefield / Shadyside	\$896	\$899	0.3%	6.0%	5.5%	-50 bps
Wilkinsburg / Penn Hills	\$631	\$655	3.8%	3.8%	3.7%	10 bps
Whitehall / Baldwin	\$588	\$595	1.2%	12.9%	11.5%	-140 bps
Upper St Clair / Bethel Park	\$685	\$708	3.4%	3.4%	3.1%	-30 bps
West	\$777	\$803	3.4%	7.6%	6.2%	-140 bps
Monroeville / McKeesport	\$665	\$702	5.5%	6.2%	5.3%	-90 bps
Metro	\$751	\$771	2.7%	7.1%	6.4%	-70 bps

SUPPLY TRENDS

- Reis report that no new investor grade supply will reach the market during 2008. Should this come to pass, 2008 will be the first year in the 19-year Reis data series in which no units were added to stock.
- Although Reis project 2009 deliveries totaling 444 units, the service identified only one project underway as of May 2008. The project in question is a 56 unit phase of the Somerset at Frick Park project.
- Reis reports that the project known as The Chelsea is scheduled for 2009 delivery. The Chelsea is a 17-story mixed-use high-rise planned for a 1.7-acre site near Carnegie-Mellon University in North Oakland. The 334-rental unit building will be the first new apartments constructed in Oakland in more than 30 years. Developers expect to break ground in the summer and begin leasing within 24 months.
- RCR are of the view that most of the projects currently in the “proposed and planned” pipeline will not be delivered prior to 2011. Therefore, supply is likely to be lower that projected by Reis and occupancy higher.
- A Strip District loft rehab was reported 85% occupied by Reis 12 months after delivery.

COMMENT: The supply situation makes the Pittsburgh investment option even more compelling.



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