RED CAPITAL GROUP®

Market Overview

Pittsburgh, Pennsylvania

Multifamily Housing Update **August 2010**

EXECUTIVE SUMMARY

An abundance of bituminous coal resources powered Western Pennsylvania's massive steel industry during the 20th Century. Can the area's developing natural gas production provide the same kind of catalyst to Pittsburgh's 21st Century economy? Perhaps. Even at current depressed prices, gas exploration activity is humming in the huge Marcellus Shale fields, injecting a dynamic new element into a once staid local business scene.

The future economic impact of the energy industry is uncertain, but the scramble by drillers to establish a beachhead on the Marcellus battlefront already is having a measurable effect on metro payroll aggregates. Extraction industry employment climbed 500 jobs from February to June, while the field-service sensitive scientific and technical business service sector erased a 3,600-job year-on-year deficit over the same period.

Metro payrolls fell only 1,200 (-0.1%) jobs y-o-y in 2Q10, the smallest quarterly setback posted since 3Q08, and 12-month comparisons turned positive in June for the first month since October 2008. The recovery was powered by improved trends in manufacturing, retail trade and business services, which collectively turned an 18,700-job annual deficit in December into an 1,800-job advance in June.

Trends in the seasonally-adjusted data were equally promising. Pittsburgh establishments hired a net of 12,000 workers March to June, representing the most robust payroll expansion observed since 2001. Although hiring of about 4,000 temporary Census workers inflated the data to a degree, signs of recovery are unmistakable.

RED Research's latest econometric payroll forecast suggest that the spring surge is a portent of better tidings. Our model projects a 7,800-job y-o-y payroll advance in 3Q10, building to an 11,000-job gain in 4Q. After posting a small 300-job FY10 loss, the Renaissance City is on the cusp of an 11,800-job gain in 2011 and as many as 15,800 jobs in 2012, should an optimistic 3.8% GDP growth forecast for that year materialize.

Apartment demand wasn't as strong as one might expect under the circumstances. Owners net leased only 61 units, down from 133 units in the seasonally weaker winter period. Anecdotally, managers of class-A properties reported an increase of tenant attrition due to buyer-credit inspired migration to homeownership. Delivery of 62 new units offset the occupancy gains, holding the market average at 94.4%, still the 9th highest metric among the **RED 50** markets.

Rent growth also stalled, perhaps under competitive pressure from the very affordable for-sale market. Average asking rents fell $3 (-0.4%) sequentially to $832, and occupied unit revenue yields slipped $4 (-0.5%) as effective rents faded to $781. Notable rent declines were observed in the heretofore bulletproof Belleville and U.S.C. submarkets, where effective rents declined -1.4% and -3.3%, respectively, between March and June.

Reis foresee improved performance in the second half. The service expects tenants to lease 262 net units, offsetting 243 units of supply to hold average occupancy steady at 94.4%. Face rents are projected to rise 0.7% June to December even as concessions recede 4%, allowing effective rents to advance by a very useful $8 (1.0%).

The number of investors interested in Steel City properties is on the rise but actual closed transactions were few. A large South Hills-area sale was inked in May and provides some visibility on value. We estimate the cap rate at 6.5%, establishing a class-A standard.

SNAP SHOT

	Y-o-y change	Projected YE 2010
Vacancy (5.6% - 2Q10)	20 bps	Unchd
Effective Rents ($781 - 2Q10)	1.2%	0.9%
Cap Rate (6.5% - 2Q10)	20 bps	Neutral
Employment (1,128.2.m - 2Q10)	1.2m	0.3m

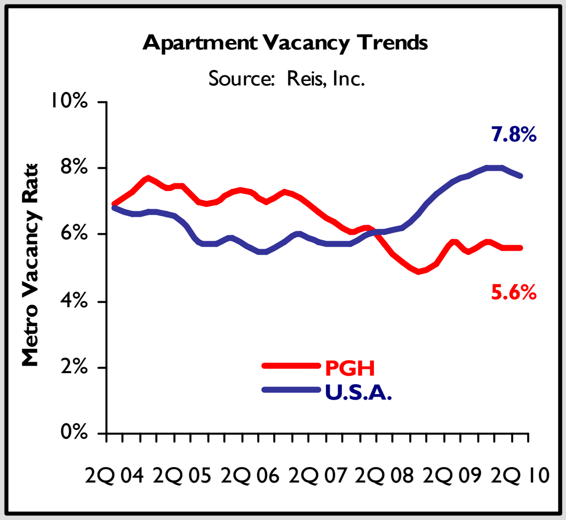
KEY POINTS

- The rush to exploit the natural gas deposits in the Marcellus Shale formation added an exciting element to the Pittsburgh economic scene, catalyzing a dramatic improvement in year-over-year payroll growth trends. After posting a disappointing 18,800-job, -1.7% decline in 1Q10, payrolls fell only 1,200 jobs in 2Q10 and actually increased 4,800 over the 12 months ended in June.
- **RCR**'s econometric payroll model produces a constructive forecast for the next 10 quarters. The model anticipates that y-o-y comparisons will shift decisively into the black during 3Q10, setting the stage for five-figure job gains in 2011and 2012.
- In contrast to many major metro areas across the county Pittsburgh apartment absorption trends slowed after a solid 1Q, falling from a 133 unit net to 62. Average occupancy held steady at 94.4%, 9th highest among the **R50.**
- Rent trends also were softer. Average asking and effective rents declined sequentially, dropping –0.4% and –0.5%, respectively.
- **RCR** estimate that a generic Steel City property offers a 7.4% expected 5-year total rate of return, in line with the **R50** average.

VACANCY TRENDS

- Metro apartment owners net leased an average of 203 units per quarter from July 2009 to March 2010; but apartment demand eased during 2Q10 and only 61 units were absorbed. Competition from homeownership probably played a prominent role in the phenomenon.
- Supply of 62 market rate units (16 in Squirrel Hill, 46 Downtown) counterbalanced absorption, holding occupancy steady at 94.4%.
- Occupancy in the tight Belleville submarket (Point / S.H. / Oakland) grew still tighter, rising 30 basis points to 96.7% March to June.
- Tenant losses in the Wilkinsburg / Penn Hills submarket continued. After reaching 96.4% in 4Q08, average submarket occupancy declined steadily, settling at a 94.8% rate in June.

RANK: 9th out of 50

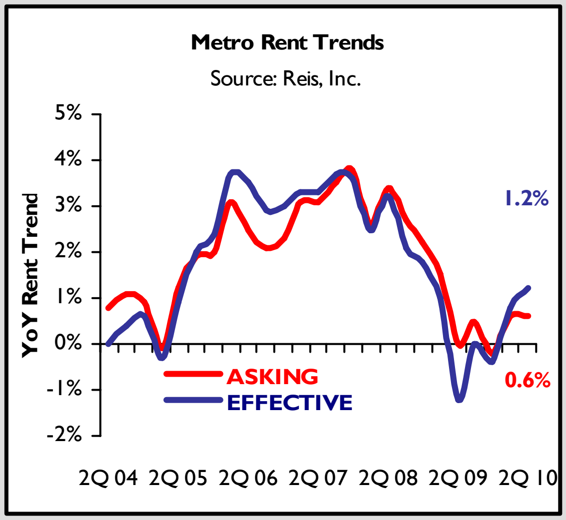


RENT TRENDS

- After taking two pricing steps forward over the previous three quarters, owners took one step back in 2Q10. Average asking rents declined $3 sequentially to $832, and average effective rents fell $4 to $781, representing –0.4% and –0.5% declines, respectively.
- Upper Saint Clair submarket was the price discounting epicenter. Average asking rents tumbled $19 (-2.5%) sequentially and concession levels advanced 14%, producing a $24 (–3.3%) decrease in average effective rent to $706. For-sale competition was largely responsible.
- Data suggest that West submarket properties were less prone to tenant move-outs and downward price pressure owing to for-sale competition. Reis report a 1.4% q-o-q same store sequential effective rent increase.

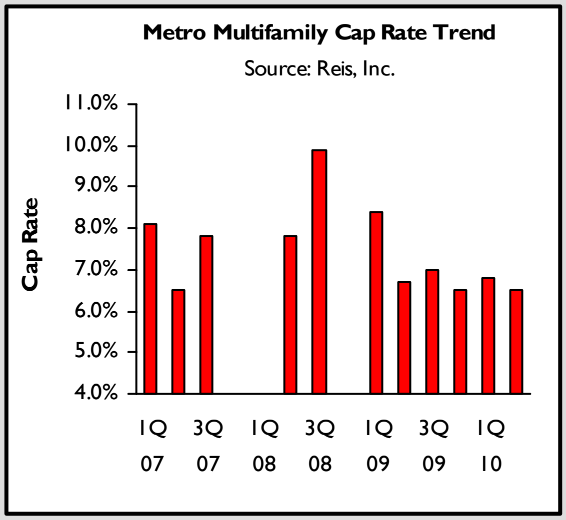
RANK: 14th out of 50

Reis expect effective rents to rebound to an average of $789 (+1.0%) by YE2010.



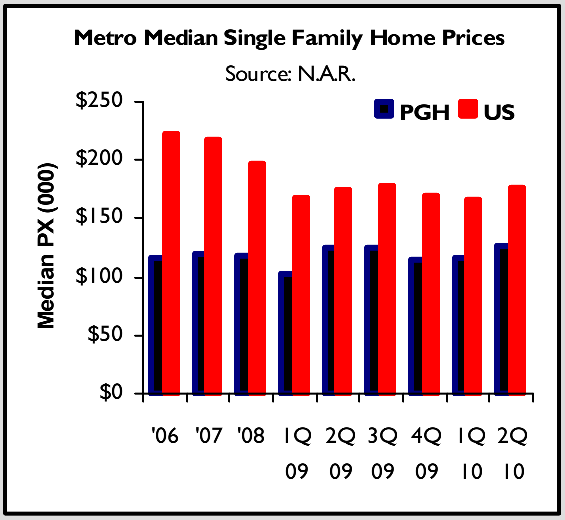
PROPERTY MARKET & CAP RATE TRENDS

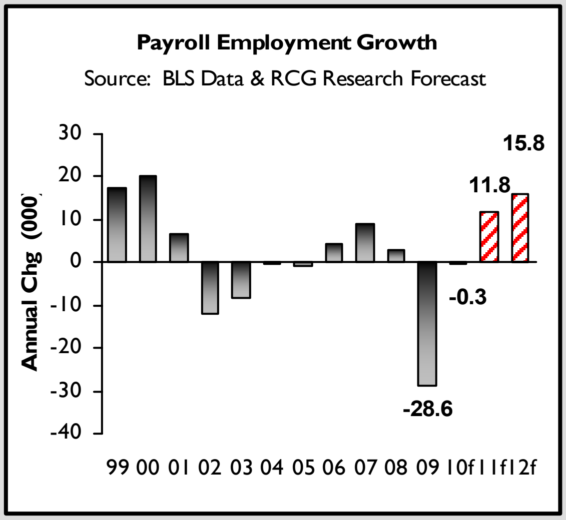
- Pittsburgh is definitely on more institutional investor radar screens these days in spite of **RCR**'s incessant cheerleading, which typically produces the opposite effect. But the velocity of trade remains relatively slow. We identified just three trades valued at $1 million or more closed year-to-date of which only one exceeded $2 million.
- The one trade valued at more than $2 million was significant, however, providing valuable insight into the local value proposition. In this case, a New York-based regional owner / manager outbid more than 20 other prospective buyers for a 316-unit, nine-year old class-A property in a golf course community near Carnegie. Although final terms were not available, **RCR** believe pricing was near the asking price of $24mm. We estimate that the property would yield 6.5% at that level. This is consistent with our estimate of a 6.5% cap for a $30mm purchase of a North Side mid-rise in December 2009.

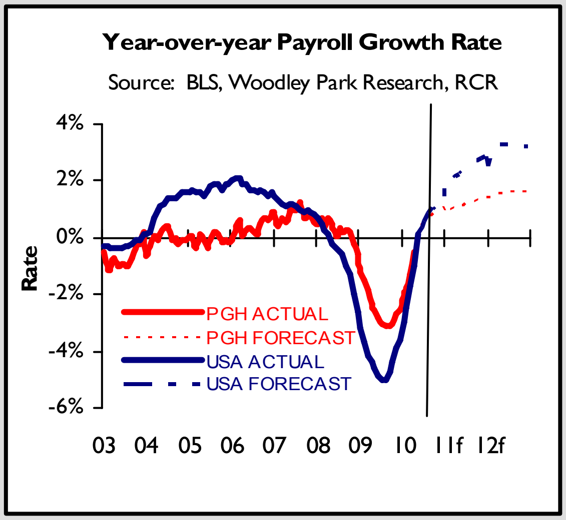


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class	Date of	Total Price	Price per unit	Estimated Cap
Waterford @ Nevillewood (West)	A	28-May-2010	$24.0 (est.)	$75,950 (est.)	6.5%







DEMOGRAPHICS & HOUSING MARKET

- Pittsburgh home prices remained almost ineffably stable during the spring buying season. Even as regional market peers like Cleveland, Columbus, Indianapolis and Philadelphia experienced 6% to 11% year-over-year median price appreciation in the N.A.R. 2Q10 data, Pittsburgh prices hardly budged, rising 1.9% to $126,600.
- After decelerating in four consecutive years, the rate of city of Pittsburgh population decline increased in 2009. City population fell 472 (-0.2%) persons over the 12 months ended July 1, down from a 203-resident decline registered in the year-earlier period.
- Although mortgage distress in Pittsburgh is low by national standards (RealtyTrac ranks Pittsburgh the 52nd best of 206 U.S. metros), measurements of foreclosure and delinquency increased in 2010. According to CoreLogic Inc., 1.87% of Western Pennsylvania homes were in a stage of foreclosure in June, up from 1.43% in January 2009.

EMPLOYMENT TRENDS

Non-Seasonally Adjusted

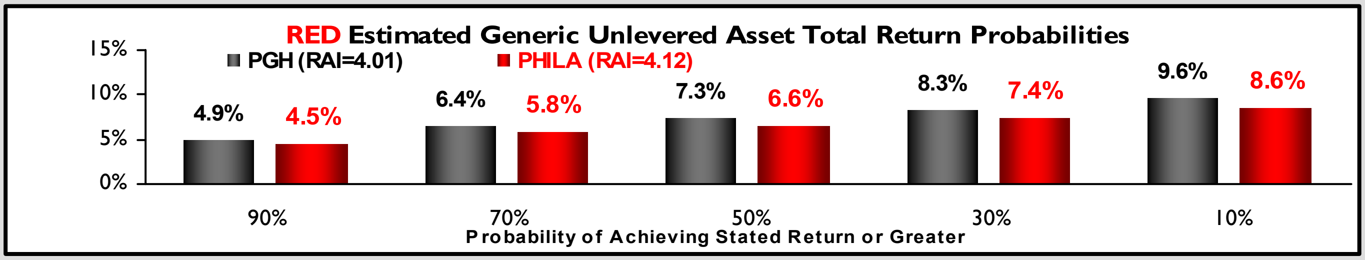
- Metro payroll trends improved dramatically during the spring. After posting job losses at a 18,800-job and 32,000-job annual rates in 1Q10 and 4Q09, respectively, Pittsburgh payrolls declined by only 1,200 jobs year-over-year in 2Q10.
- Spring gains were largely attributable to stronger manufacturing, retail trade and business service sector trends. The foregoing sectors accounted for attrition at a 19,700 y-o-y rate in 4Q09, but losses at a pace of only 1,000 jobs in the second quarter.
- The rush to develop Marcellus shale gas production played a role in the process. Field extraction activities led to hiring of as many as 500 workers from February to June and geological and technical support positions figured in a strong rebound in business service hiring.
- June payrolls were 4,800 (0.4%) jobs above the 2009 comparison, representing the first year-on-year gain recorded since October 2008.

Seasonally-Adjusted

- After posting sequential month payroll losses during December, January and February, Pittsburgh establishments added employees in each of the next four months, increasing headcounts by 12,000 overall.
- Spring job gains include about 4,000 temporary Census workers hired between April and June. Adjusted for this factor, Pittsburgh payrolls would have increased by about 9,500 jobs from March to June.

Forecast

- RCR's econometric payroll model indicates that Pittsburgh payroll trends should continue to improve at a brisk clip through year-end, producing growth at a 7,800-job pace in 3Q10 and a 11,000-job pace in 4Q10. Gains should level off during 2011, giving rise to an 11,800 job pick-up next year. The model projects a probable 15,800-job advance in 2012, but we maintain a logical bias for a lower figure.

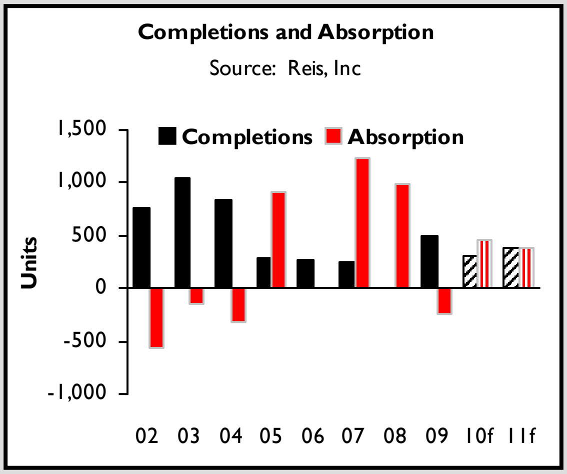


SUBMARKET TRENDS

Submarket	Effective Rent 2Q09	Effective Rent 2Q10	Effective Rent Change	Physical Vacancy 2Q09	Physical Vacancy 2Q10	Physical Vacancy Change
Bellefield / Shadyside / OAK	$897	$909	1.4%	3.8%	3.3%	-50 bps
Monroeville / McKeesport	$689	$691	0.3%	4.6%	6.6%	200 bps
North	$806	$808	0.2%	6.9%	6.4%	-50 bps
Upper Saint Clair / Bethel Park	$727	$706	-2.9%	6.7%	6.1%	-60 bps
West / Mt. Lebanon	$809	$833	3.0%	4.6%	4.5%	-10 bps
Whitehall / Baldwin	$596	$609	2.3%	13.8%	12.8%	-100 bps
Wilkinsburg / Penn Hills	$644	$654	1.5%	4.8%	5.2%	40 bps
Metro	**$772**	**$781**	**1.2%**	**5.8%**	**5.6%**	**-20 bps**

SUPPLY TRENDS

- Developers received final certificates of occupancy for two new properties during 2Q10. The first is a 54-unit (16 market rate) mixed-income, four-story building with 11,000 sf of street level retail space on Penn Avenue in Shadyside. Pricing information were not available. The second project is a 54-unit mixed-use downtown loft conversion on a Fifth Avenue address. The project has been in lease-up since last September. Rents range from $750 to $3,000. Media reportage suggest that most of the lower-priced units were occupied by the spring.
- A 54-unit mixed-use, mixed-income substantial rehabilitation project in East Liberty debuted in July. The $12.3mm project offers affordable units renting from $350 to $435, and market rate units renting from $825 to $1,100. The developer reports that the project was over 90% pre-leased prior to its debut.
- Reis identify only one project currently under construction: a townhouse phase of a class-A garden project located near Cranberry Township. Some units were available in August at rents ranging from $1,500 to $1,730, equating to about $1.00 per square foot of living space. Townhouse units also include first floor garage and storage / laundry space.
- A long-anticipated 17-story high rise proposed for Oakland finally progressed from the planning phase. Developers of the "po-mo" designed project, located at the intersection of Centre Avenue and North Craig Street, are expected to break ground in September.



- A 16-story Downtown state office building was tapped for a substantive re-use to 218 apartment units. Rents are expected to range from $800 to $3,000. Construction may begin as early as the fall if permits can be obtained.
- The median vacancy rate of 28 class-A apartment buildings (approx. 4,600 units) located between the Allegheny and Monongahela Rivers and west of Churchill was 2.1% in June. Rents averaged $1,299.

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