

# Seattle, Washington



Multifamily Housing Update

February 2010

## EXECUTIVE SUMMARY

**P**uget Sound economic trends tend to run hot or cold. Unfortunately, the region has been on a chilly streak lately, with negative implications for payroll and housing market conditions. Seattle's flagship software publisher is playing an unaccustomed game of catch-up with its chief Silicon Valley rivals in the high-end PC operating system and search engine arenas, and it continues to search in vain for the next "killer app" that will return it to the top of global high-tech ranks. At the same time, Seattle's bedrock aerospace equipment industry encountered recessionary turbulence, leading to the announcement of the first material layoffs in recent memory, while a paucity of venture capital funding kept the local entrepreneurial tech sector moored securely to the ground.

The foregoing events evolved before a weak global and national economic backdrop, combining to yield a set of decidedly below average metro payroll trend data. By the numbers, Seattle payrolls declined at a 52,700-job, -3.6% year-over-year pace in 4Q09, up from a 66,200-job setback in 3Q. But the advance wasn't as great as these data suggest: the 4Q08 comparisons were deflated by the effects of an October 2008 Boeing strike. Adjusting for this event, the y-o-y comparison would have shown a loss of more than 60,000 (-4.1%) jobs, weaker than the overall U.S. average.

In spite of a surge of unemployment to 9.2% (a 20-year high), December job data contained a few hopeful signs. Twelve-month payroll losses declined to 49,100 (-3.4%) jobs, the smallest decline recorded since February. Use of contract labor increased to the highest volume in 12 months, typically a good leading indicator of near-term permanent hiring; retail store headcounts rebounded to a 12-month high; and seasonally-adjusted

payroll trends swerved into the black.

**RED Research's** econometric payroll model suggests that the December thaw is the beginning of better tidings to come. Seattle has another rough quarter to endure, but conditions should begin to improve in the spring. Net hiring will resume next summer, setting the stage for a solid 30,500-job advance in calendar year 2011.

After suffering a 230 basis point vacancy rate rise during the 12 months ended in September, metro apartment owners cut rents aggressively in 4Q to retain tenants. Reis report that average effective rents tumbled \$28 (-2.9%) quarter-to-quarter, the largest decline recorded among the **RED 50** (only Las Vegas and Phoenix declined -2% or more). Cuts were deepest in precincts heavily exposed to "B" and "MSN" workers, especially Bellevue, Redmond and Everett, which posted sequential declines of -3.8% or more. Rents in submarkets catering to the young professional demo also retreated, falling -5.4% in Beacon Hill and -3.4% in North Seattle.

The gambit apparently had the intended effect as tenants responded by absorbing 526 net units. The tally matched the volume of new supply added to metro stock, holding occupancy constant at 92.6%. Beacon Hill and Redmond were notable exceptions as steep rent discounts weren't enough to prevent supply-effected 100+bps q-o-q vacancy rate increases.

Reis expect tenant demand to recover smartly in 2010 — the service projects absorption of 3,500 units this year - but pipeline supply will prohibit any net occupancy progress. Conditions should improve in 2011 when the latest supply wave ebbs, but rent trends promise to be slightly weaker than the **RED 50** average, holding prospective total returns (6.3%) below the 6.7% group mean.

## SNAP SHOT

	Y-o-y change	Projected 2010
Vacancy (7.4% - 4Q09)	↑ 160bps	↑ 20bps
Effective Rents (\$937 - 4Q09)	↓ 6.3%	↓ 0.6%
Cap Rate (5.8% - 4Q09)	↓ 30bps	↑
Employment (1,414.5m - 4Q09)	↓ 52.7m	↑ 0.2m

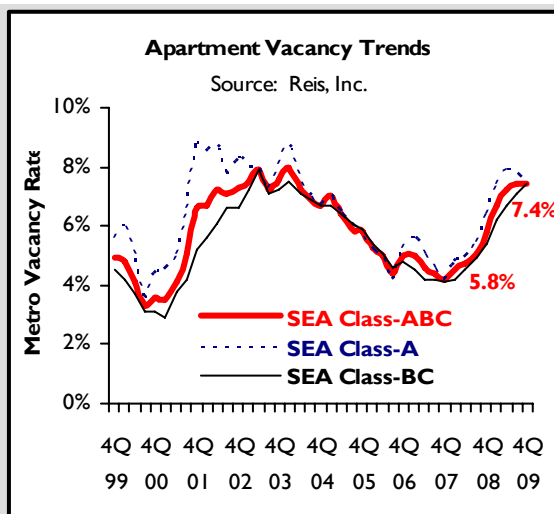
## KEY POINTS

- Seattle job losses continued at an accelerated rate in 4Q. Adjusting for a 2008 Boeing strike, payrolls declined at a 63,000-job year-on-year rate or -4.3%, sending the unemployment rate to a 20-year high 9.2%.
- **RCR** project flat payroll trends this year, but a solid 30,500-job advance in 2011.
- Apartment owners slashed rents to stem a growing tenant exodus. Average effective rents fell -2.9% sequentially, the largest drop recorded among the **RED 50** markets.
- Tenants responded affirmatively, net leasing 526 units; but supply offset the gain, leaving average occupancy unchanged at 92.6%.
- Heavy supply in 2010 will continue to exert downward pressure on occupancy and rent levels. Reis expect deliveries to decline next year, however, laying the groundwork for stronger fundamental performance.
- Despite challenging fundamentals, cap rates for class-A infill assets remained remarkably low. Three institutional quality properties exchanged hands after the winter solstice at estimated initial yields below 5%.

## VACANCY TRENDS

- Deep rent discounts encouraged renters to commit to apartment leases. Owners filled a net of 526 units during 4Q, down from 3Q's 847-unit tally but up sharply from negative net absorption of 988 units in 4Q08.
- Reis aver that supply of 526 units offset 4Q09 absorption, holding occupancy steady at 93.6%. A group of five publicly-traded REITs managing a total of 15,300 units achieved a 40 bps q-o-q advance to 92.4%. M/PF Research also reported a 92.4% average occupancy rate.
- Three higher rent submarkets (Bothell, Redmond and Beacon Hill) experienced 100 bps sequential quarter vacancy rate increases, despite significant rent discounting, reflecting economic pressure on key young professional and tech industry renter demographics.
- Reis expect supply pressure to cut occupancy 20 bps in 2010; but recovery in 2011.

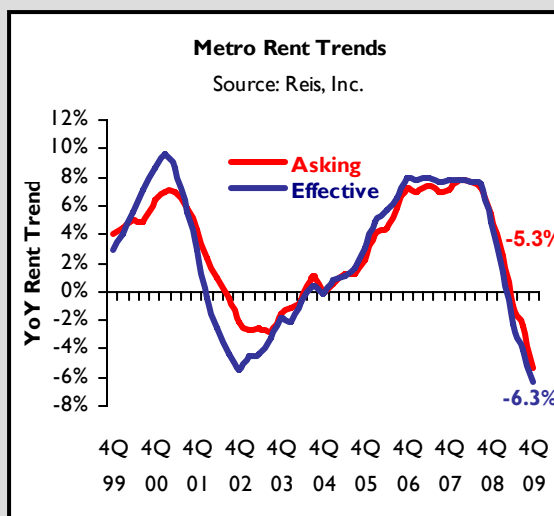
**RANK:** 26<sup>th</sup> out of 50



## RENT TRENDS

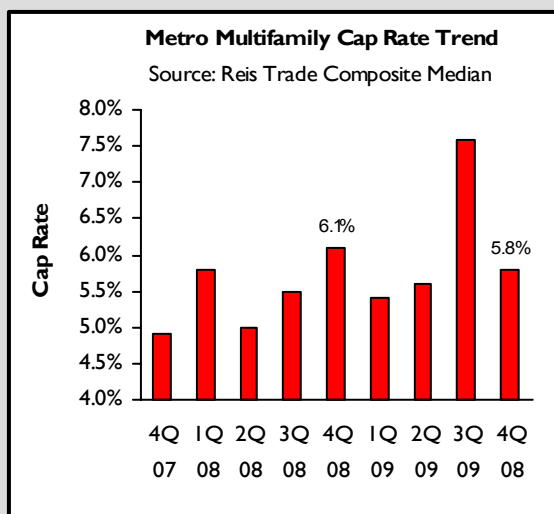
- Reis surveys indicate that Seattle effective rents plunged -2.9% in the fourth quarter, falling from an average of \$965 and \$937.
- M/PF Research report that effective rents fell more than -3% sequentially in 4Q09 and -10.3% year-on-year. A group of six public REITs (19,600 units) experienced weighted average -3.9% and -10.1% sequential and year-over-year declines, respectively.
- Reis data show three Seattle submarkets suffering -4% sequential quarter effective rent declines: Bellevue (-4.3%), Redmond (-4.8%) and Beacon Hill (-5.3%). Each is an area heavily exposed to tenants employed in the high-tech or aerospace manufacturing industries.
- After falling -6.3% in 2009, Reis expect Seattle rents to drop another -0.6% in 2010.

**RANK:** 49<sup>th</sup> out of 50



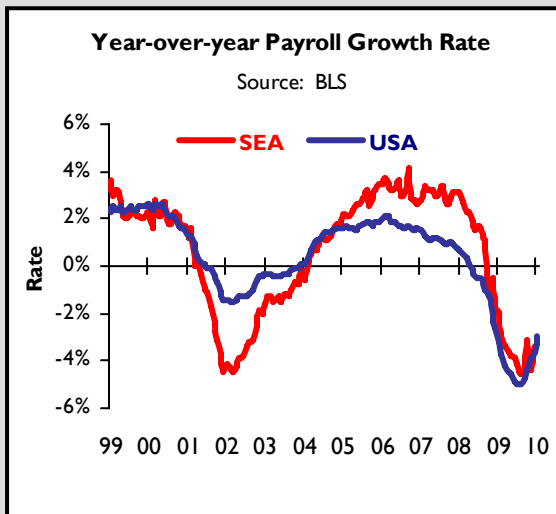
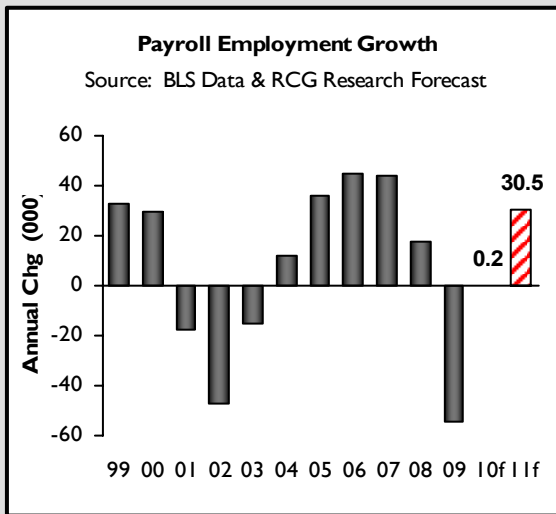
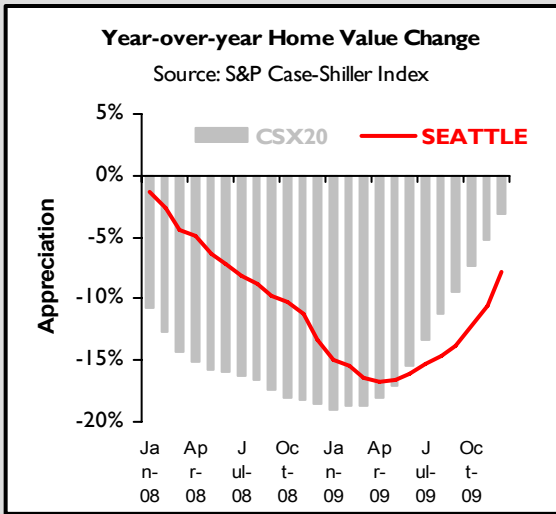
## PROPERTY MARKET & CAP RATE TRENDS

- Trade in Seattle properties was thin in the second half of 2009. Real Capital Analytics identified only eight closed transactions valued at \$4mm or more, with aggregate proceeds totaling \$99mm. By way of comparison, 31 trades valued at \$4mm or more were consummated in 2H08, generating aggregate proceeds of \$469mm.
- Investors followed disciplined acquisition strategies, targeting specific neighborhoods or in some cases waited on the sidelines for distressed properties to come to market.
- A large publicly-traded REIT broke the ice in 2010, purchasing a two-property Queen Anne portfolio in February. The class-A mid-rise projects were priced to yield less than 5% by our estimate.
- Below average rent growth will hamper investment returns from Seattle assets. Using a 6.8% generic cap rate, RCR estimate a 6.3% expected 5-year holding period total return, 40 bps below the RED 50 average, ranking 38th among the group.



## NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class	Date of Transaction	Total Price (in millions)	Price per unit	Estimated Cap Rate
Rianna II (Downtown / Q. Anne)	A	08-Feb-2010	\$16.3	\$209,410	4.9%
Rianna I (Downtown / Q. Anne)	A	08-Feb-2010	\$17.1 (Retail Incl)	\$219,572	4.5%
Regent at Bellevue (Bellevue)	A-	21-Dec-2009	\$35.0	\$182,280	4.7%
Country Home (Kent)	B-	10-Dec-2009	\$10.9	\$62,000	7.0%



## DEMOGRAPHICS & HOUSING MARKET

- The N.A.R. report that the median price of a Seattle-Tacoma MSA home was \$305,000 in 4Q09, down -6.3% year-over-year and -5.0% quarter-to-quarter. Western Region home values decreased -8.9% year-over-year in 4Q, but advanced 0.7% from the September quarter level.
- The S&P Case-Shiller repeat sales index indicates Seattle home prices continued to lag the firm's 20-metro index in late 2009. Values in December reflected a -7.9% year-over-year decline, trailing the -3.1% drop registered by the CSX-20 index. Moreover, the Seattle index decreased for the second consecutive month, falling -0.7% from November to 147.54, the lowest metric recorded since April 2005.
- Home foreclosures were a growing problem for Seattle-Tacoma households last year. RealtyTrac reported that 1 of every 62 metro households was embroiled in a foreclosure action, a 43% increase from 2008 and the 86th highest rate recorded among the top 203 US metros.

## EMPLOYMENT TRENDS

### Non-Seasonally Adjusted

- Nominal payroll totals declined at a 52,700-job, -3.6% rate in the fourth quarter, up from 3Q's 66,200-job, -4.5% decline. Adjusted for a weak October 2008 comparison (due to a Boeing strike), 4Q09 results were considerably weaker. The year-over-year pace of job loss would have been approximately 60,000 positions or -4.0%.
- The not seasonally-adjusted unemployment rate in December was 9.0%, down 10 basis points from the 20-year high June 2009 metric.
- December payroll trends took an optimistic turn. Twelve-month job losses declined to a 49,100-job, -3.4% pace, the best comparison recorded since February 2009. Decelerating job losses in retail sales and temporary employment services as well as a significant uptick in government headcounts were primarily responsible.

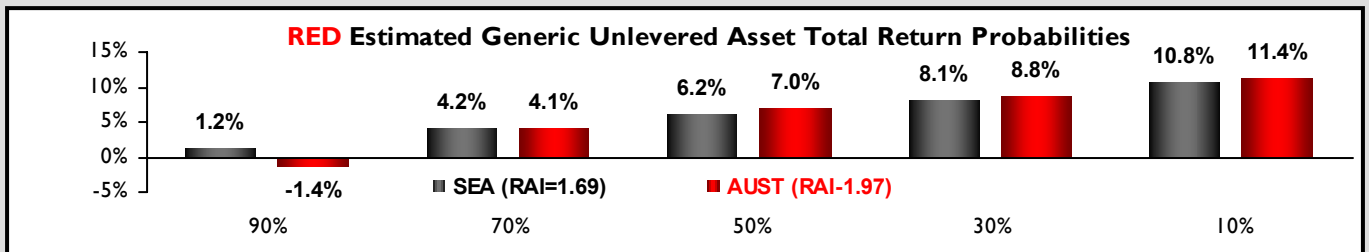
### Seasonally-Adjusted

- After posting a 9,700-job setback in 3Q09, job losses expressed on a seasonally-adjusted basis declined to 6,600 in 4Q, representing the smallest quarterly headcount decline since 3Q08.
- Preliminary seasonally-adjusted December data also exhibited some positive momentum. Payrolls actually increased 4,400 jobs month-to-month, representing the first net gain registered in twelve months.

### Forecast

- Seattle entered the Great Recession a bit later than the rest of the county and evidence suggests that it will be tardy to the recovery party as well. The RCR econometric payroll forecasting model tells us that year-over-year comparisons are likely to remain in the red through mid-year but gain momentum quickly beginning in the summer. Total payrolls will be nearly unchanged this year, but gains should exceed 30,000 jobs in 2011, if GDP growth reaches 3%, as projected by the PNC Economics team.

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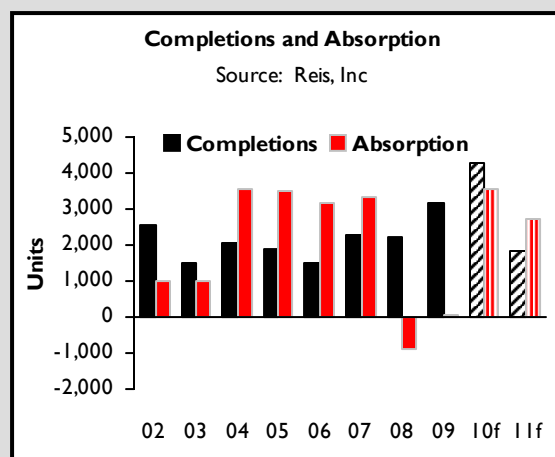


## SUBMARKET TRENDS

Submarket	Effective Rent			Physical Vacancy		
	4Q08	4Q09	Change	4Q08	4Q09	Change
West Seattle / Burien	\$839	\$814	-3.0%	3.8%	7.6%	380 bps
Des Moines / West Kent	\$846	\$791	-6.5%	4.4%	7.7%	330 bps
Tukwila / Sea-Tac	\$805	\$737	-8.4%	4.0%	5.9%	190 bps
Bellevue / Issaquah	\$1,159	\$1,087	-6.2%	6.3%	8.0%	170 bps
Edmonds / Lynnwood	\$904	\$829	-8.3%	4.0%	5.9%	190 bps
Downtown / Capital Hill	\$1,304	\$1,206	-7.5%	6.5%	7.4%	90 bps
Kirkland / Juanita	\$1,227	\$1,149	-6.4%	9.4%	7.0%	-240 bps
Bothell	\$1,052	\$1,003	-4.6%	4.9%	9.6%	470 bps
Renton	\$933	\$861	-7.8%	5.5%	7.5%	200 bps
Redmond	\$1,156	\$1,037	-10.3%	5.5%	7.8%	230 bps
Kent	\$851	\$822	-3.4%	5.0%	6.7%	170 bps
Beacon Hill / Rainier	\$958	\$897	-6.4%	9.8%	10.7%	90 bps
North Seattle	\$1,008	\$953	-5.5%	3.7%	7.2%	350 bps
Federal Way	\$816	\$792	-2.9%	6.8%	8.1%	130 bps
Auburn / Enumclaw	\$794	\$767	-3.4%	4.5%	5.8%	130 bps
Everett / Mukilteo	\$908	\$837	-7.8%	6.4%	7.1%	70 bps
<b>Metro</b>	<b>\$1,000</b>	<b>\$937</b>	<b>-6.3%</b>	<b>5.8%</b>	<b>7.4%</b>	<b>160 bps</b>

## SUPPLY TRENDS

- A roll of supply waves inspired by the strong NOI growth observed in 2005 - 2008 will continue to break on the shores of the Puget Sound through mid-2011. At this writing, nineteen major projects were under construction encompassing a total of 3,777 units. Twelve projects incorporating 2,135 units are scheduled to debut in 2010.
- The Downtown / Queen Anne submarket will add four properties to the rental inventory in 2010, yielding an increase of 581 units to stock. A substantial rehab of a 117-unit hotel in the International District is tipped for a 1Q10 delivery date. No pre-leasing details were available. A 118-unit mid-rise on Broadway due in the spring posts pre-lease pricing as follows: studios renting from \$860 to \$1,895; 1-bedroom units from \$1,221 to \$2,396 and 2-bedroom units from \$1,580 to \$2,490. Rents equate to \$2.25—\$2.50/sf. A public REIT will bring a 290-unit, 6-story building to Capitol Hill in the late spring or summer, and a condo / hotel / apartment project sited near the Convention Center with 56 rental units will debut in the spring. No price details were available for either property.



- About 90 of the 224-units of a 27-story high-rise near Pacific Place were occupied in December after about nine months of lease-up. Rents averaged \$3,745.

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