RED CAPITAL GROUP®

Market Overview

Oakland-East Bay

Multifamily Housing Update | **March 2011**

EXECUTIVE SUMMARY

Following seven consecutive quarters of dismal payroll job performance, progress was evident in the service component of the East Bay economy during the fourth quarter. Moderate year-on-year gains developed in the key business, health care and leisure services industries, boosted by improving tourist spending and stabilizing business activity. But further heavy job losses in government, trade and goods producing sectors over-balanced the gains, submerging metro payroll comparisons in a deep pool of red ink.

Total metro payrolls declined at a 17,900-job, -1.9% annual rate in 4Q, a modest up-move relative to 3Q's 23,900-job loss. The sequential improvement was large attributable to hiring in skilled and consumer service sectors. Specifically, year-over-year comparisons in business, health care and leisure services showed an 1,100-job advance in 4Q, up from 3Q's 600-job setback. Slower local government cuts also contributed: municipalities trimmed at a -2,700-job rate in 4Q, up from 3Q's -6,000-job pace

But weakness persisted in the goods producing and retail trade sectors. Construction and manufacturing concerns cut headcounts at a 9,600-job, -7.2% y-o-y rate, down from a 9,300-job, -7.0% pace in 3Q. Likewise, retailers trimmed headcounts at a 2,500-job, -2.5% rate following attrition of 2,100 (-2.1%) jobs in the prior period.

Seasonally-adjusted data trends were more encouraging. This series reports creation of 900 nets jobs in 4Q10, the first such gain recorded in three years, including the first sequential month gain in December since 2005.

Firmer late-2010 trends notwithstanding, the **RCR** econometric payroll forecast model still foresees net job attrition in 2011. Following a projected -5,100-job setback this year, the model foresees respective 5,600- and 9,600-job gains in 2012 and 2013.

Apartment demand in the seasonally-slow fourth quarter was constructive as tenants net leased 717 units, according to Reis surveys. Although down from 3Q's two-year high 822 units, 4Q absorption was the strongest observed in a October-to-December period in the 12-year Reis quarterly data series. As no units were added to the metro inventory, average occupancy increased 40 basis points sequentially and 130bps y-o-y to 95.5%.

Each metro submarket recorded a sequential occupancy increase with the exception of Fremont (-0.1%). The infill North Alameda submarket posted the largest gains as owners filled a net of about 370 units, sending average submarket occupancy up 140 bps to 93.9%, a nine-quarter high.

Leasing agents were reluctant to press for material rent increases, however, electing to build occupancy in an unsettled economic environment. Average asking rent inched $6 (0.4%) higher to $1,345 September-to-December, roughly back to year-end 2007 levels. Effective rent gained $7 (0.6%) to $1,276, still $40 (-3.0%) below the series high set in 3Q08.

Only one submarket registered a sequential quarter rent decline (East Alameda), while two (Concord, San Leandro) posted 1.3% or stronger increases. The infill North Alameda submarket posted a modest 0.4% advance to $1,356, $21 shy of its 4Q08 historical peak level.

Trade remained erratic, largely consigned to distressed recent construction and class-B interior valley properties. The cap rate central tendency gravitated toward the mid-5% area, providing for the potential for attractive total returns should rents rise at the pace projected by Reis.

SNAP SHOT

	Y-o-y change	Projected 2011
Vacancy (4.5% - 4Q10)	▼ 1.3%	▼ 0.7%
Effective Rents ($1,276 -4Q10)	▲ 1.9%	▲ 6.0%
Cap Rate (5.7% - 4Q10)	▼ 30 bps	▼ 20 bps
Employment (936.9m - 4Q10)	▼ 17.9m	▼ 5.1m

KEY POINTS

- A tenuous economic recovery encouraged young adults who had delayed independence or cohabitated with roommates to form new households. At the same time, the volatile for-sale housing market convinced many that rental options were the most appropriate under the circumstances. As a result, large apartment properties absorbed 717 units during 4Q10, the largest catch netted in a final calendar quarter in the 12-year Reis quarterly metro market data series.
- Average occupancy increased 40 basis points September-to-December and 130 bps year-over-year, reaching a two-year high 95.5%.
- Street rents increased in a third consecutive quarter and concessions receded slightly, producing an average $7 (0.55%) metro effective rent advance to $1,376.
- Property market activity picked up in 2H10. Investors acquired 19 East Bay properties valued at $2.5mm or greater, up from 4 in the first half. Proceeds totaled only $179mm, however, as trade was dominated by smaller communities and class-B repositioning plays. Cap rates averaged about 5.7% during the period, roughly 30 bps below levels observed last year.