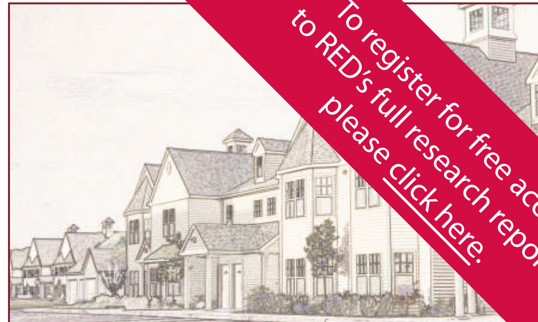
RED CAPITAL GROUP®

Market Overview

Sacramento, CA



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Multifamily Housing Update April 2011

EXECUTIVE SUMMARY

The River City economy remained weak in recent months as housing market conditions and government budget woes continued to stifle employment growth. Headline payroll job counts decreased –18,100 (-2.2%) year-over-year in the fourth quarter. Subdued loan demand contributed to the loss as financial service firms cut –3,700 jobs y-o-y. Additionally, construction and government payrolls fell –3,400 and –7,000 y-o-y respectively.

Job trends also were weak on a seasonally-adjusted basis. Metro payrolls fell –2,700 from October to December, marking the fourth consecutive quarterly decline. Moreover, headcounts fell –5,600 in the first two months of 2011.

But employers are optimistic about second quarter hiring. The Manpower Employment Outlook Survey reveals that 22% of surveyed firms planned to add workers from April to June. By contrast, only 10% of employers expressed plans to reduce staffs.

Total employment, from the BLS's household survey, declined –27,541 (-3.0%) in the twelve-month period ended in February. But the metro unemployment rate fell from 12.9% in February 2010 to 12.6% in the same month this year, owing to a sharp –3.3% drop in the labor force.

RED CAPITAL Research (**RCR**) predict that Sacramento employers will eliminated –12,200 (-1.5%) positions from payrolls in 2011, comparing favorably to the –23,600 (-2.8%) decrease recorded last year. Furthermore, our model projects a 9,200 (1.2%) job advance in 2012.

Area home prices continued to fall in recent months. According to the National Association of Realtors, the median price of a single-family MSA home decreased –5.7% y-o-y from $188,600 in 4Q09 to $177,800 in 4Q10. Furthermore, the California Association of Realtors note that the February single-family home price ($168,800) in Sacramento County was down –6.2% from the same month last year.

Although payroll trends were weak, apartment demand was stout last year. Managers of Class-A assets net leased 1,008 units during 2010. By comparison, Class B/C net absorption totaled 430 units. As a result, the metro occupancy rate rose 110 basis points from 92.7% in 4Q09 to 93.8% in 4Q10. Reis expect occupancy to continue to improve, rising to 94.6% in 2011 and 94.9% in 2012.

Rent trends also improved, fueled by strong apartment demand. On a sequential basis the average effective rent increased 0.6% during 3Q10 and 1.3% in 4Q10. Additionally, the pace of annual effective rent growth accelerated to 2.1%, the fastest increase observed since 4Q08 (+2.3%). Reis foresee faster rent growth in the future, rising to 4.7% in 2011 and 4.0% in 2012.

Investor demand accelerated last year. Real Capital Analytics identify 23 investor-grade trades totaling $284.1 million in sales proceeds. The average price per unit rose 17.1% y-o-y to $86,726. Moreover, CB Richard Ellis report that cap rates for stabilized Class-A assets ranged from 5.5% to 6.0% in February, down from a 6.0% to 7.0% range reported in the same period last year.

Based on an assumed 5.5% going-in yield, **RCR** calculate a strong 10.2% expected rate of total return, above the 9.0% **RED** 50 mean. Conversely, Sacramento registered the 29th highest measure of risk-adjusted return in the group, owing to elevated levels of historic NOI growth volatility.

SNAP SHOT

	Y-o-y change	Projected 2011
Vacancy (6.2% - 4Q10)	↓ 110bps	↓ 80bps
Effective Rents ($882 - 4Q10)	↑ 2.1%	↑ 4.7%
Cap Rate (6.0% - 4Q10)	↑ 70bps	↑
Employment (804.9m - 4Q10)	↓ 18.1m	↓ 12.2m

KEY POINTS

- The metro vacancy rate decreased 40 basis points sequentially and 110 basis points year-over-year to 6.2% in the fourth quarter. Steady apartment demand contributed to the improvement. Property managers net leased 646 units during the fourth quarter, outpacing supply of 275 units.
- Partially due to falling concessions the pace of year-over-year effective rent growth accelerated from 0.1% in 3Q10 to 2.1% in 4Q10. The size of the average concession package fell from 5.4% of asking rent in 4Q09 to 4.8%.
- Housing market conditions remained weak in the fourth quarter. The National Association of Realtors report that the median price of a single-family MSA home decreased –5.7% year-over-year to $177,800. Similarly, the FHFA home price index declined at a –4.4% annual rate.
- Real Capital Analytics count 23 trades involving properties priced at or above $5 million in 2010. Asset sales volume totaled $284.1 million and the average price per unit was $86,726.