RED CAPITAL GROUP®

Market Overview

Boston, Massachusetts

Multifamily Housing Update — **March 2011**

EXECUTIVE SUMMARY

According to revised payroll statistics published by the Bureau of Labor Statistics, Boston labor markets were stronger than previously understood last year. The "re-benchmarked" data released on March 10 reveal that employment measured on a year-on-year basis turned positive in April 2010 rather than June as reported earlier, and that July to December y-o-y payroll gains averaged 16,100 jobs, up from the 15,000-job initial estimate.

Revised data indicate that metro establishments hired at a 17,300-job, 1.0% y-o-y rate in 4Q10, up from 3Q's 14,700-job, 0.9% performance. Meaningful improvement in the professional, technical and education service sectors — which collectively grew at a 4,400-job pace after declining -400 jobs in 3Q - was primarily responsible for faster metro growth.

Seasonally-adjusted data suggest that the economy got off to a strong start in January. Establishments added 12,500 workers month-to-month, after net hiring only 100- and 1,900-workers during November and December, respectively. The 12-month non-seasonally adjusted January comparison was not as robust, showing a gain of only 14,700 jobs y-o-y.

The **RED Research** econometric forecast model foresees faster job creation evolving over the next two years. The point estimate for 2011 growth is 21,900 jobs, followed by a 23,900-job advance in 2012. Should the U.S. economy grow at about 2.8% in 2013, the Hub should generate about 26,000 jobs in that year.

Robust job creation supported healthy apartment demand, fueling some of the strongest ever fourth quarter absorption. Tenants net leased 1,024 units October to December, according to Reis, the second highest 4th quarter total posted in the service's 12-year quarterly data series. Occupancy improved 30 basis points sequentially and 130 bps year-on-year, reaching 94.9%, the highest level recorded in four years. Occupancy increased sequentially in 8 of Boston's 9 submarkets and was unchanged in the ninth. South suburban submarkets posted the largest gains (60 to 70 bps) while urban submarkets (Boston, Brookline, Cambridge) maintained the highest (near 96%) average occupancy rates.

Average effective rents increased $9 (0.5%) sequentially to $1,649. Although moderately slower than the $15 (1.0%) and $28 (1.7%) quarter-to-quarter hikes observed in 3Q10 and 2Q10, respectively, the 4Q advance was sufficient to raise the year-over-year growth comparison to 3.1%, the fastest pace recorded in two years.

Submarket trends were mixed. North Shore and West suburban submarkets registered 1.3% to 2.5% sequential effective rent gains, elevating y-o-y advances to 4.3% and 5.2%, respectively. By contrast, rents trends were subdued in infill precincts, declining –0.3% and –0.2% in Boston City and Cambridge, respectively, while rising only 0.3% in the Back Bay.

Reis expect net apartment absorption to moderate in 2011 and 2012, falling to 1,540 units and 1,772 units, respectively, from 3,031 last year. Still, average occupancy will rise further, topping 96% by 2013. Rent trends are expected to crest at 4.4% and 4.3% in 2011 an 2012, before easing to a 3.2% compound annual rate through 2015.

RCR observe that institutional quality Boston asset cap rates currently average about 4.5%, while trophy properties trade at still lower rates. At this level, an investor would expect to achieve a 7.3% 5-year un-levered total return (with a 5.)% exit cap rate), 170bps below the **RED 50** mean, and a 44th ranked risk-adjusted index.

SNAP SHOT

	Y-o-y change	Projected 2011
Vacancy (5.1% - 4Q10)	▼ 1.3%	▼ 0.4%
Effective Rents ($1,649 -4Q10)	▲ 3.0%	▲ 4.4%
Cap Rate (4.2% - 4Q10)	▼ 0.5%	Neutral
Employment (1,691.4m - 4Q10)	▲ 17.3m	▲ 21.9m

KEY POINTS

- Case-Shiller data suggest that Boston home prices weakened late in the year. The monthly same-property index declined sequentially in five consecutive months from July to December, dropping -4.0% over all.
- Rental housing demand, by contrast, was exceptional. Tenants absorbed a net of 1,024 units in 4Q10, the second strongest October-December period in the 12-year Reis quarterly data series. Average occupancy increased 30 basis points sequentially and 130 bps y-o-y to 94.9%, a four-year high.
- Rent growth moderated from the white hot rates observed at mid-year. The average occupied apartment generated $1,649 per month of net rent revenue in 4Q, up $9 (0.5%) from September. These data compare to $15 (0.9%) and $28 (1.7%) increases observed in 3Q10 and 2Q10, respectively.
- Institutional investors intensified efforts to acquire Bay State trophy assets. In early 2011, a publicly-traded REIT invested $92 mm in a class-B Longwood tower (estimated going-in yield 4.5%) and a global finance company purchased a Quincy class-A- mid-rise at an estimated 4.2% cap. Development likely yields materially higher returns now.