

Suburban Maryland

Multifamily Housing Update

February 2008



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EXECUTIVE SUMMARY

On the whole, employment growth in Suburban Maryland was significantly weaker in 2007. Re-benchmarked BLS data revealed that 5,800 (0.6%) employees were added, down from the 8,000 (0.8%) job gain in the previous year. Payroll growth in the northern counties (Montgomery and Frederick) decelerated considerably from 7,000 (1.2%) in 2006 to 500 (0.1%). Conditions in Southern Maryland (Calvert, Charles and Prince George's counties) improved as net hiring rose from 1,000 (0.3%) to 5,300 (1.4%).

RED expect further deceleration over the next two years. Our econometric model generates point estimates of 4,000 (0.4%) new jobs in 2008 and 1,000 (0.1%) new jobs 2009. Economy.com are in agreement for 2008, forecasting 4,550 (0.5%) new jobs.

The National Association of Realtors report a 4Q07 median home price of \$400,100 in the Washington DC metro area, down 5.1% y-o-y. Data from the Maryland Association of Realtors indicate that the price declines were steeper in the Maryland suburbs. Y-o-y median price declines in January were 6.0% in Montgomery County, 9.1% in Prince George's County and 8.5% in Frederick County. Moreover, the source indicates that the market inventory of unsold homes rose to 6.6-months in January 2008 from 6.0 during the same month of 2007.

The occupancy rate in Suburban Maryland fell 10 basis points to 95.5% in 4Q07, ranking 18th among the **RED** 50. The drop was attributable to supply of 397 units and only 254 net leases. Negative net absorption in 1H07 contributed to a 30 basis point decrease in the occupancy rate on a year-over-year basis.

Average effective rent increased 0.8% sequentially in 4Q07 to \$1,158. The

metric rose 4.4% y-o-y, down from 5.0% in the previous quarter. Asking rents advanced at a moderately slower 4.2% y-o-y pace to \$1,213. The value of the average concession package fell from 4.7% of asking rent to 4.5%.

Owners of assets in the southern Prince George's County submarkets of Forest Heights and District Heights garnered the largest gains in effective average rents of 9.3% and 7.8%, respectively. Conversely, effective rents in the upscale Rockville submarket rose only 0.7% y-o-y, despite generating a 100 basis point improvement in occupancy.

Reis anticipate market conditions will deteriorate in 2008 due to increased supply and slow household income growth. The service forecasts completions of nearly 2,200 units to cause market occupancy to drop 30 bps to 95.2%. The slight up-tick in vacant stock and slower income growth is expected to hamper rent trends; Reis forecast effective rent growth of 3.6%.

Property sales were brisk in Suburban Maryland in 2007. Real Capital Analytics count 41 investor grade property transactions totaling \$1.836 billion in sales proceeds. The composition of sales was heavily weighted toward mid/high rise properties which accounted for \$1.2 billion in volume. The average price was \$114,011 per unit, down 2% from 2006.

RED estimate generic metro asset 5-year holding period total returns of 7.8%, ranking 6th among the **RED** 50. The market ranks 9th with regard to risk-adjusted returns, indicating that investors are adequately compensated for market volatility. **RED** assign a rating of "Accumulate" to Suburban Maryland assets. Market fundamentals and current pricing support an active buying program.

SNAP SHOT

	Y-o-y change	Projected 2008
Vacancy (4.5% - 4Q07)	↓ 30bps	↑ 30bps
Effective Rents (\$1,158 - 4Q07)	↑ 4.4%	↑ 3.6%
Cap Rate (6.8% - 4Q07)	↓ 20bps	↔ unch
Employment (984.2k - 4Q07)	↑ 7.7k	↑ 4k

KEY POINTS

- The metro vacancy rate rose 10 basis points to 4.5% in 4Q07. Sluggish demand caused the vacancy rate to increase 30 basis points year-over-year.
- Asking and effective rents increased 4.2% and 4.4% year-over-year, respectively. Reis expect slower household income to act as a cap on effective rent growth in 2008.
- The median metro Washington home prices fell 5.1% year-over-year to \$400,100 in 4Q07. Data from the Maryland Association of Realtors suggest the Maryland suburbs experienced a sharper decline.
- Multifamily trade volume rose 6% in 2007 to \$1.836 billion. Mid- and high- rise property sales rose 174% to \$1.2 billion. According to Reis, garden cap rates averaged 7.0% and mid/high rise cap rates averaged 6.4% in 2007.
- **RED** estimate NOI growth of 5.5% in Suburban Maryland in 2007, equating to a 21.4% total return. This compares to 6.4% NOI growth and a 20.8% total return for the **RED** 50.