RED CAPITAL GROUP®

Market Overview

Saint Louis, MO

Multifamily Housing Update — **March 2008**

EXECUTIVE SUMMARY

Metropolitan job growth waned in the final months of 2007, dragging the annual number of jobs created down to 7,300 (0.5%), the slowest metric since 2004. Year-over-year growth in the fourth quarter was 3,400 (0.2%) down from 5,800 (0.5%) in the previous quarter.

Sector weakness was widespread. Construction and manufacturing firms lost 4,200 workers combined last year, compared to 1,400 lost jobs in the previous year. Transportation equipment producers lost 3,400 employees last year alone. Temporary staffing services, management consulting firms and leisure service providers hired 6,300 fewer workers in 2007 as compared to 2006.

Companies in the St. Louis *BioBelt* posted solid employment growth. Private investment via venture capital and partnerships with metro universities contributed to accelerated job growth among scientific research and development firms. A net of 1,100 workers was added in 2007, up from 400 in 2006. In addition, the sector's average annual wage ($115,569) was well above the metro average of $41,664.

RED expect payroll growth to bounce back following sluggish trends in 4Q07. Our econometric model generates a point estimate of 9,000 (0.7%) new jobs in 2008. The confidence interval ranges from 6,000 (0.4%) to 12,000 (0.9%). In 2009, **RED** anticipate job growth to accelerate to 17,000 (1.2%).

According to the National Association of Realtors, the median 2007 home price in Saint Louis was $145,400, down 2.0% from 2006. Fannie Mae reports a decrease in conventional 30-year mortgage interest rates from 6.31% in 2006 to 6.24% last year. Combined, one may expect home sales velocity to increase considerably. Instead, metro home sales were sluggish and a 70 basis point decrease in the homeownership rate was reported by the Census Bureau. Tighter credit standards are partially to blame but were not the only culprit. Negative price trends caused the perspective of buyers to change as households realized that home prices can move in more than one direction.

If a turn-around in the for-sale segment of the metro housing market is still a year away, as some suggest, apartment fundamentals in 2008 may mirror trends exhibited last year. Slower job growth constrained apartment demand toward the end of the year but the change in tenancy preference in favor of rentals lead to a 1,818 unit surge in absorption on an annual basis. The combination of robust demand and limited supply allowed the occupancy rate to rise 130 basis points y-o-y to 93.3%. Effective rents rose 2.7%, on par with the average growth rate over the past two years.

Despite strong fundamental gains, investor interest in Saint Louis properties was weaker last year. For the year, Real Capital Analytics report 15 large property trades, totaling $221 million in proceeds. The average price per unit rose 14% to $63,753 and the average cap rate fell 10 bps to 6.8%.

Assuming a 6.2% going-in yield, **RED** calculate a 6.2% expected rate of return in generic metro investment. The pessimistic Reis forecast for rent growth and occupancy trends depress the return outlook. While we believe that near-term fundamentals will outperform the Reis forecast, we are less certain about the later years of the assumed five-year holding period. As a result, we recommend that investors assume an ***opportunistic*** posture.

SNAP SHOT

	Y-o-y change	Projected 2008
Vacancy (6.7% - 4Q07)	↓ 130bps	↑ 50bps
Effective Rents ($676 - 4Q07)	↑ 2.7%	↑ 2.7%
Cap Rate (7.3% - 4Q07)	↑ 20bps	↔ unch
Employment (1,367.3k - 4Q07)	↑ 3.4k	↑ 9k

KEY POINTS

- The vacancy rate fell 10 basis points sequentially and 130 basis points year-over-year to 6.7% in 4Q07. Reis expect vacancy to rise to 7.2% this year and 7.8% in 2009, due to weak tenant demand.
- Asking and effective rents increased 2.4% and 2.7% year-over-year, respectively in 4Q07. The value of the average concession package was 5.7% of asking rent, ranking 32nd among the **RED** 50.
- Apartment development was limited last year. Only 248 units were delivered, the smallest total since 1996 when 96 units were completed. Reis forecast less supply this year. The service identifies three projects, containing 166 units. On the other hand, the condo development pipeline is large and deteriorating housing market conditions could lead developers to re-purpose condo units as rentals.
- **RED** expect market fundamentals to improve in 2008, despite the pessimistic forecast from Reis. But our convictions are not so strong that we recommend an active buying strategy. Rather, we propose that investors take an **opportunistic** approach.