

Cleveland, Ohio

Multifamily Housing Update

February 2011

EXECUTIVE SUMMARY

Economic conditions in the Cleveland metropolitan area improved in the second half of 2010. Payroll headcounts increased 7,900 (0.8%) year-over-year in 3Q10 and 10,600 (1.1%) y-o-y in 4Q10. US payroll growth was weaker by comparison, rising only 0.2% in 2H10.

Increased demand for manufactured goods was partially responsible for the improvement. Manufacturing employment rose 6,800 y-o-y in 4Q10, marking the second consecutive quarterly y-o-y gain. Additionally, wholesale, retail, business service, health care and leisure service employers added a combined 16,400 jobs y-o-y in the fourth quarter.

Measured on a seasonally-adjusted basis, total employment (from the BLS's household survey) increased 24,432 jobs in the twelve-month period ended in December. As a result, the metro unemployment rate fell from 9.5% in December in 2009 to 9.2% in the same month last year.

The Manpower Employment Outlook Survey suggests that growth will continue in the first quarter. Specifically, 13% of surveyed firms expressed plans to add workers during 1Q11 as compared to 11% that planned to contract.

RED CAPITAL Research (RCR) expect annual job trends to continue to improve this year. Our econometric model produces point estimates of 12,300 (1.2%) new jobs this year followed by a 2012 gain of 16,900 (1.7%) jobs. By comparison, Economy.com project slower job growth (6,880 jobs) in 2011 but robust growth (18,510 jobs) in 2012.

Metro home prices rose in the fourth quarter, despite elevated foreclosure activity. According to the National

Association of Realtors, the median price of a single-family MSA home increased 4.2% y-o-y from \$110,100 in 4Q09 to \$114,700 in 4Q10. RealtyTrac.com report a 2.49% foreclosure rate in 2010, ranking 60th highest among the 206 markets tracked by the source.

Partially owing to the improving labor market, apartment absorption was strong in the fourth quarter. Positive net absorption totaled 578 units from October to December. As a result, the metro occupancy rate rose 50 basis points sequentially from 93.9% in 3Q10 to 94.4% in 4Q10. Likewise, occupancy surged 130 basis points in the year-ended in December, owing to robust demand for Class-A (744 units) and Class B/C (904 units) assets, alike.

Property managers achieved stronger rent growth as occupancy improved. The average effective rent increased 0.3% sequentially—after falling -0.1% in 3Q10—and rose at a strong 1.2% y-o-y pace to \$695 in 4Q10. Rent trends were particularly strong for Class-A assets. Class-A asking rent increased 1.4% y-o-y, comparing favorably to the 0.5% advance recorded among Class B/C assets.

Real Capital Analytics identify eight transactions involving properties priced at or above \$5 million in 2010. Sales volume totaled \$75 million and the average price per unit was \$53,791. Marcus & Millichap note that cap rates for the highest quality assets ranged from 7.0% to 7.5% at year-end.

Based on a 7.5% generic metro average cap rate, **RCR** calculate a 9.9% unlevered base-case total return, 16th highest among the **RED 50**. Moreover, low levels of historic NOI growth volatility produce the 8th highest measure of risk-adjusted return.

SNAP SHOT

	Y-o-y change	Projected 2011
Vacancy (5.6% - 4Q10)	↓130bps	↓10bps
Effective Rents (\$695 - 4Q10)	↑1.2%	↑3.1%
Cap Rate (8.2% - 4Q10)	↓150bps	↓
Employment (1,005.4m - 4Q10)	↑10.6m	↑12.3m

KEY POINTS

- The metro vacancy rate decreased 50 basis points sequentially and 130 basis points year-over-year to 5.6% in 4Q10. Strong tenant demand was responsible. Positive net absorption totaled 578 units during the fourth quarter and 1,646 units in 2010.
- The size of the average concession package fell from 5.3% of asking rent in 3Q10 to 5.1% in 4Q10. As a result, the average effective rent rose 0.3% quarter-to-quarter from \$693 to \$695.
- Apartment development activity will remain muted this year. Developers completed only one project totaling 236 units in 2010 and Reis forecast the delivery of only 91 units this year.
- The National Association of Realtors report solid 4.2% home price appreciation in the Cleveland MSA year-over-year in 4Q10. By comparison, the median US home price rose only 0.2%.
- Real Capital Analytics count eight investor-grade trades last year, totaling \$75 million in sales proceeds. The source calculates an average price per unit of \$53,791.



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