

Seattle, Washington

Multifamily Housing Update

February 2010

EXECUTIVE SUMMARY

Puget Sound economic trends tend to run hot or cold. Unfortunately, the region has been on a chilly streak lately, with negative implications for payroll and housing market conditions. Seattle's flagship software publisher is playing an unaccustomed game of catch-up with its chief Silicon Valley rivals in the high-end PC operating system and search engine arenas, and it continues to search in vain for the next "killer app" that will return it to the top of global high-tech ranks. At the same time, Seattle's bedrock aerospace equipment industry encountered recessionary turbulence, leading to the announcement of the first material layoffs in recent memory, while a paucity of venture capital funding kept the local entrepreneurial tech sector moored securely to the ground.

The foregoing events evolved before a weak global and national economic backdrop, combining to yield a set of decidedly below average metro payroll trend data. By the numbers, Seattle payrolls declined at a 52,700-job, -3.6% year-over-year pace in 4Q09, up from a 66,200-job setback in 3Q. But the advance wasn't as great as these data suggest: the 4Q08 comparisons were deflated by the effects of an October 2008 Boeing strike. Adjusting for this event, the y-o-y comparison would have shown a loss of more than 60,000 (-4.1%) jobs, weaker than the overall U.S. average.

In spite of a surge of unemployment to 9.2% (a 20-year high), December job data contained a few hopeful signs. Twelve-month payroll losses declined to 49,100 (-3.4%) jobs, the smallest decline recorded since February. Use of contract labor increased to the highest volume in 12 months, typically a good leading indicator of near-term permanent hiring; retail store headcounts rebounded to a 12-month high; and seasonally-adjusted

payroll trends swerved into the black.

RED Research's econometric payroll model suggests that the December thaw is the beginning of better tidings to come. Seattle has another rough quarter to endure, but conditions should begin to improve in the spring. Net hiring will resume next summer, setting the stage for a solid 30,500-job advance in calendar year 2011.

After suffering a 230 basis point vacancy rate rise during the 12 months ended in September, metro apartment owners cut rents aggressively in 4Q to retain tenants. Reis report that average effective rents tumbled \$28 (-2.9%) quarter-to-quarter, the largest decline recorded among the **RED 50** (only Las Vegas and Phoenix declined -2% or more). Cuts were deepest in precincts heavily exposed to "B" and "MSN" workers, especially Bellevue, Redmond and Everett, which posted sequential declines of -3.8% or more. Rents in submarkets catering to the young professional demo also retreated, falling -5.4% in Beacon Hill and -3.4% in North Seattle.

The gambit apparently had the intended effect as tenants responded by absorbing 526 net units. The tally matched the volume of new supply added to metro stock, holding occupancy constant at 92.6%. Beacon Hill and Redmond were notable exceptions as steep rent discounts weren't enough to prevent supply-effected 100+bps q-o-q vacancy rate increases.

Reis expect tenant demand to recover smartly in 2010 — the service projects absorption of 3,500 units this year - but pipeline supply will prohibit any net occupancy progress. Conditions should improve in 2011 when the latest supply wave ebbs, but rent trends promise to be slightly weaker than the **RED 50** average, holding prospective total returns (6.3%) below the 6.7% group mean.

SNAP SHOT

	Y-o-y change	Projected 2010
Vacancy (7.4% - 4Q09)	↑160bps	↑20bps
Effective Rents (\$937 - 4Q09)	↓6.3%	↓0.6%
Cap Rate (5.8% - 4Q09)	↓30bps	↑
Employment (1,414.5m - 4Q09)	↓52.7m	↓0.2m

KEY POINTS

- Seattle job losses continued at an accelerated rate in 4Q. Adjusting for a 2008 Boeing strike, payrolls declined at a 63,000-job year-on-year rate or -4.3%, sending the unemployment rate to a 20-year high 9.2%.
- **RCR** project flat payroll trends this year, but a solid 30,500-job advance in 2011.
- Apartment owners slashed rents to stem a growing tenant exodus. Average effective rents fell -2.9% sequentially, the largest drop recorded among the **RED 50** markets.
- Tenants responded affirmatively, net leasing 526 units; but supply offset the gain, leaving average occupancy unchanged at 92.6%.
- Heavy supply in 2010 will continue to exert downward pressure on occupancy and rent levels. Reis expect deliveries to decline next year, however, laying the groundwork for stronger fundamental performance.
- Despite challenging fundamentals, cap rates for class-A infill assets remained remarkably low. Three institutional quality properties exchanged hands after the winter solstice at estimated initial yields below 5%.



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