

The Seattle Apartment Market Report

Volume 4, Issue 1, March 2007

You want me to pay what?

The story of the regional apartment market in 2006 is that of region wide rent increases. Our survey of rental properties in the region has shown a 13% increase in rents over the year. This is compared to a 1.9% increase in 2005.

The Snohomish submarket lead the way with an astounding 15.5% rent increase over the year. The Seattle submarket showed a similar growth in average rents at 15.3%. The Eastside was not far behind with average rents increasing approximately 12.5% over 2006. The Southend market was the only market that didn't experience double-digit rent increases over the last year. However, the Southend did see growth of 7.3% in average rents, compared to less than one percent (0.8%) in 2005.

Most of the rent increases occurred during the first half of the year. For example, our mid year rent survey showed that the Seattle submarket's average rents rose by 12.5% between December 2005 and June 2006. When our end of year survey was completed, the Seattle submarket showed a 2.8% increase from June. This leads to an overall increase of 15.3%, with the vast majority of the increase occurring in the first half of the year.

Why have rents risen so aggressively? In a word: vacancy. The vacancy rate for apartment units in the Seattle metropolitan region has fallen to 3.4%, down from an already low 5.1% in 2005. As the number of vacant units in the market has decreased, landlords responded with aggressive increases in rents.

It should be important to note that this decrease in vacancy rates is not necessarily demand driven. In fact, the major stimulus is supply driven. This is due to the fact that while

Seattle Metropolitan Vacancy Forecast

Submarket	Winter 2006	Winter 2007	Winter 2008
Seattle	2.8%	2.3%	2.4%
Eastside	4.1%	3.1%	4.0%
Southend	3.8%	2.6%	2.3%
Snohomish	3.4%	2.3%	2.0%
Metro Total	3.4%	2.6%	2.6%

the number of new apartment completions increased over 2005, an even larger quantity of supply was lost to conversion to condominiums. Total apartment demand remained fairly consistent with last year's figures. Therefore the large decrease in the supply of apartment units due to condo conversions drove vacancy rates to low levels.

Looking towards the future, our market research indicates approximately 4,853 apartment units that are currently under construction in the region. Of that total, 37% (1,781 units) are located in the Seattle submarket, followed by 35% (1,681 units) in the Southend market, 27% (1,287 units) in the Eastside, and 2% (104 units) in the Snohomish submarket. These units are expected to be completed and absorb into the market over the next three years.

Our forecast for the Seattle regional apartment market shows rents increasing in 2007 at a lower rate, albeit still strong at 10%. We anticipate the quantity of new apartment product coming on line next year will increase and the loss of supply to conversions will occur at a lower rate. The market will remain tight for at least the next three to four years as it takes developers around 18 months to 2 years to bring new product online in response to market conditions.

Rent Change	
Submarket	2006
Seattle	15.3%
Eastside	12.5%
Southend	7.3%
Snohomish	15.5%
Metro Total*	13.0%

*Weighted Average

Seattle Metro Market Summary

Sub Market	% Vacant	2 Year Demand	2 Year Supply	S/D Net	2 Yr. Vac. Rate
Eastside	4.2%	2,572	2,403	(169)	3.7%
Seattle	2.8%	4,173	3,580	(594)	2.3%
Southend	3.9%	3,641	2,345	(1,295)	2.2%
Snohomish	3.4%	2,063	1,243	(820)	2.0%
Metro *	3.4%	12,449	9,571	(2,878)	2.5%

* Weighted Average

Table of Contents

- Vacancy Forecast.....1
- Vacancy Forecast Charts.....2
- Vacancy.....3
- Absorption.....4
- Employment Forecast.....4
- Population Forecast.....4
- Apartment Demand.....5
- Supply Forecast.....5
- Supply and Demand.....6
- Rental Rate Forecast.....7
- Conclusion.....7
- The Back Story.....8

The *O'Connor Advisor* is a publication of the O'Connor Consulting Group, a Seattle-based real estate appraisal and consulting firm specializing in multifamily and residential mixed-use property valuation and consultation. The *O'Connor Advisor* is edited by Andrew Murray.

For more information regarding these services please contact



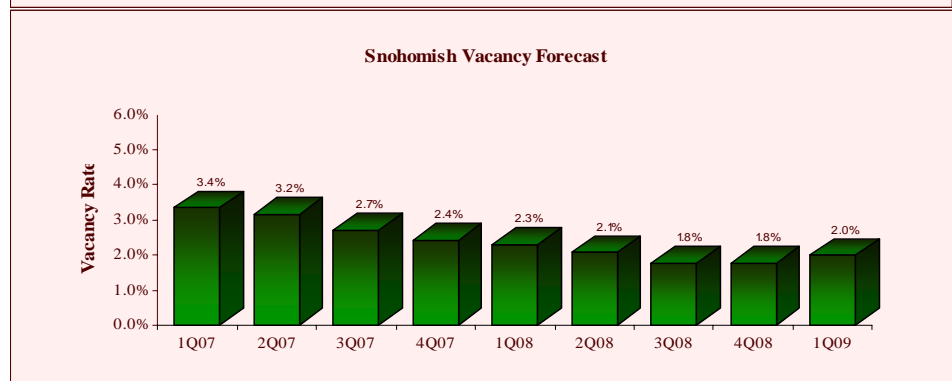
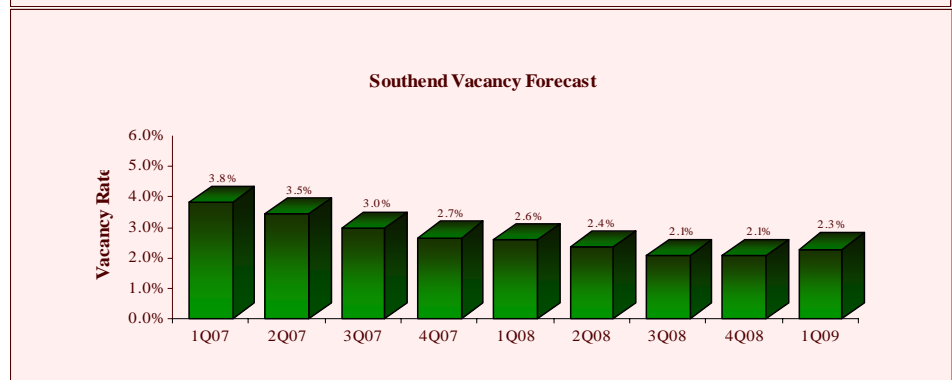
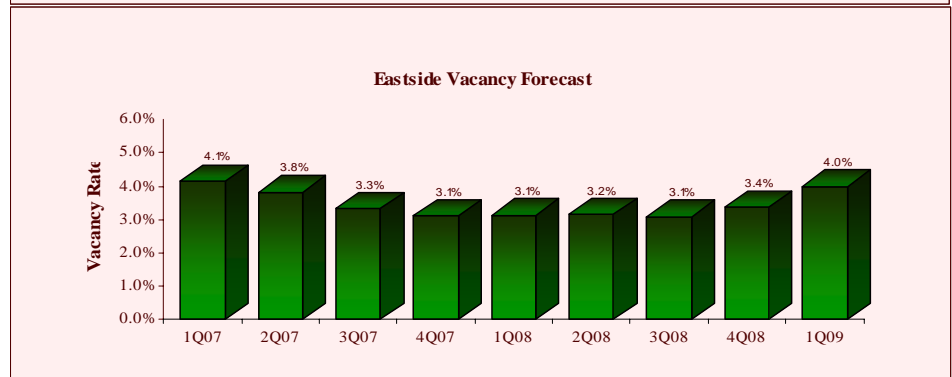
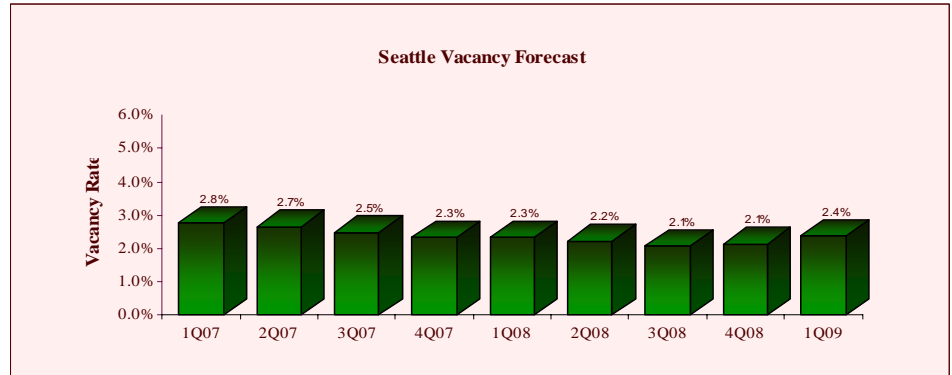
**O'CONNOR
CONSULTING
GROUP, LLC**
500 UNION STREET
SUITE 650
SEATTLE, WA 98101

Brian O'Connor, MAI at
206-622-5100

Vacancy Forecast

The graphs below show our vacancy forecast for each of the four primary Puget Sound markets. *Please note that these graphs reflect physical vacancy, not economic vacancy.* Economic vacancies are typically one or two percentage points above

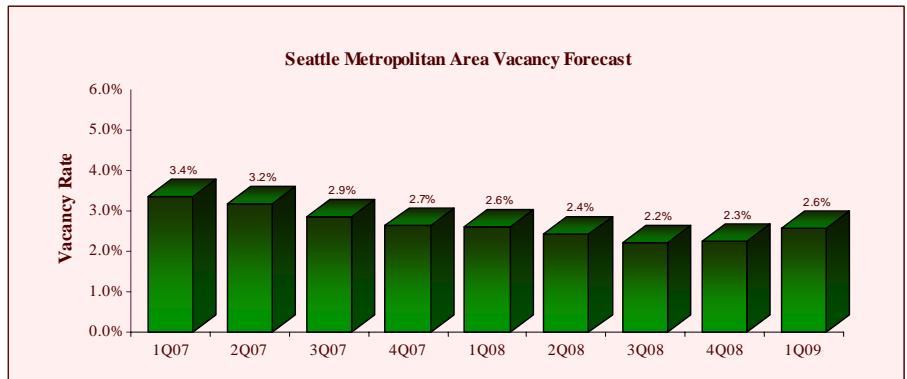
physical vacancies. This is due primarily to monthly turnover. The close-in markets are reporting rent concessions have become nearly non-existent due to the tightness of the current market conditions.



Vacancy

Our December 2006 vacancy survey covered over 110,000 units. Overall, physical vacancy was estimated at 3.4% and is allocated among the primary markets and submarkets as shown below.

Vacancy rates have decreased significantly over 2006, down from 5.1% at the end of 2005. Our vacancy rate forecast for the Seattle Metropolitan Area shows vacancy rates should continue trending lower as the market tightens.



SEATTLE			
Submarket	Units	Vacancy	Percent
Ballard/Fremont	429	12	2.8%
Beacon Hill/Central District	371	5	1.3%
Capitol Hill/Eastlake	591	9	1.5%
Denny Regrade/Belltown	3,143	147	4.7%
Downtown/First Hill	1,485	39	2.6%
Greenlake/Greenwood	272	2	0.7%
Lake City	1,215	18	1.5%
Lake Forest Park	402	5	1.2%
Magnolia/Queen Anne	1,215	58	4.8%
Northgate	1,338	21	1.6%
Northwest Seattle/North City	905	15	1.7%
Rainier Valley/South Seattle	443	9	2.0%
University/Ravenna/Sandpoint	1,396	17	1.2%
West Seattle	1,024	35	3.4%
Total	14,229	392	2.8%

SNOHOMISH COUNTY			
Submarket	Units	Vacancy	Percent
Edmonds	1,214	27	2.2%
Everett	8,654	318	3.7%
Lynnwood/Shoreline	6,022	209	3.5%
Marysville	316	6	1.9%
Mill Creek/Canyon Park	1,008	22	2.2%
Monroe	248	1	0.4%
Mukilteo	1,026	58	5.7%
Mountlake Terrace	1,374	27	2.0%
Total	19,862	668	3.4%

EASTSIDE			
Submarket	Units	Vacancy	Percent
Suburban Bellevue	8,598	336	3.9%
Downtown Bellevue	717	28	3.9%
Bothell/Woodinville	3,811	127	3.3%
Issaquah	2,320	121	5.2%
Kirkland	2,759	146	5.3%
Mercer Island	646	60	9.3%
Redmond	3,473	112	3.2%
Total	22,324	930	4.2%

PIERCE COUNTY			
Submarket	Units	Vacancy	Percent
Fife/Milton	1,468	41	2.8%
Fircrest/University	2,205	150	6.8%
Gig Harbor	300	12	4.0%
Lakewood	2,607	156	6.0%
Puyallup/Sumner	4,748	242	5.1%
Tacoma	11,221	665	5.9%
Total	22,549	1,266	5.6%

SOUTH END			
Submarket	Units	Vacancy	Percent
Auburn	2,486	97	3.9%
Burien/Des Moines	3,102	61	2.0%
Enumclaw	247	7	2.8%
Federal Way	8,044	348	4.3%
Kent	8,582	340	4.0%
Renton/Maple Valley	8,022	319	4.0%
SeaTac/Tukwila	3,753	161	4.3%
Total	34,236	1,333	3.9%

Vacancy Summary			
County	Market Size	Survey	Weighted*
King and Snohomish	351,236	3.7%	3.4%
King	290,370	3.8%	3.4%
Snohomish	60,866	3.4%	3.4%
Pierce	22,549	5.6%	5.6%

*Weighted by market size

Employment Forecast

Given that Boeing is a driving force in the Seattle area, the fate of the local economy is strongly influenced by the performance of the aerospace giant.

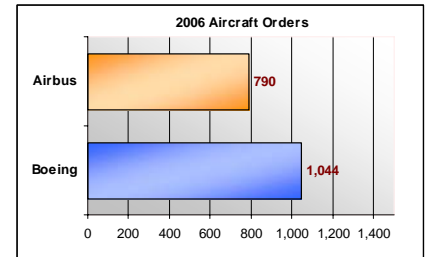
Marked by ten-year cycles, the first five years of a decade have been a recovery and stabilizing period, while the latter half of the decade has historically been a time of expansion.

Given the record breaking number of orders for Boeing in 2006 and the continued struggles of Airbus, Boeing is projected to continue its growth in 2007 and 2008 according to Merrill Lynch analyst Ronald Epstein.

Boeing set a record for orders of their 737 and ended the year at 1,044 total orders. This is part of the reason why analysts predict Boeing to be the top of the aerospace industry by 2008.

Employment numbers as of December 2006 indicate that the Puget Sound has added 65,300 new jobs, a 2.8% increase from the January 2006 employment numbers. The annual growth of Puget Sound employment gained 3.3% in 2006 which is the best showing in eight years. A large portion of those jobs are through the continued success of the aerospace industry.

Local economists Dick Conway and Doug Pederson predict a deceleration in growth down to 2.9% in 2007 and 2.7% in 2008, which is still twice the forecasted national rate. This growth could bring in approximately 42,067 new jobs to the Puget Sound area in 2007.



Population Forecast

Our forecast of vacancy and rental changes are driven primarily by anticipated population growth in the region. The chart below displays the historical relationship between net migration and net employment growth in the Seattle metropolitan area.

As is evident in the chart below, net migration is heavily dependent upon net employment growth. Between the years 2001 and 2003, the Seattle metropolitan area lost 73,300 jobs. This led to a considerable decrease in the number of people relocating to the area.

Based on the April 1, 2006 population estimate, the Seattle metropolitan area experienced a net in-

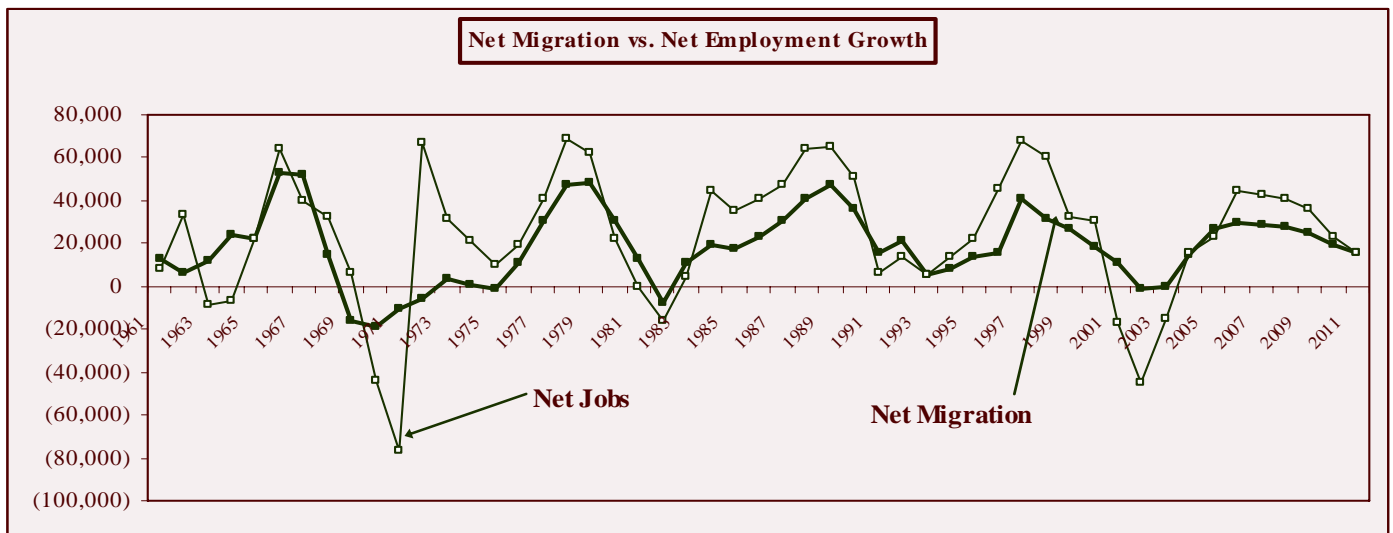
migration of approximately 26,950 people in 2006. This resulted in a total population increase (natural increase plus net migration) of approximately 43,000 people, or 1.8%.

As noted in the chart below, previous periods of significant job losses resulted in substantial net out migration. The last economic downturn that we have since recovered from did not follow this trend. While the "push" factor was clearly evident in Seattle's poor job market, the "pull" factor from competing metropolitan areas was not strong enough to lure away large numbers of Seattle residents. To put it simply, local residents did and do not have a significantly better alternative to Seattle

to pull them towards.

We believe that the relationship between net migration and net employment growth has changed from previous years. Seattle area residents are less responsive to decreases in employment growth than they once were. This bodes well for the prospect of continued population growth in the Seattle metropolitan area.

As for the future, Seattle's steady anticipated job growth, along with the abundance of natural amenities within the area will continue to make this a desirable destination. During 2007 we expect population growth to increase by 45,388, or approximately 1.8%.



Apartment Demand

Strong employment growth in the region has led to high levels of positive net migration.

During 2006, the Seattle metropolitan area reported its third year of positive employment growth since 2000. This continuation of growth in the employment sector has led to increased net migration and thus, increased levels of new apartment demand. This is in contrast to 2004, where net migration remained low and thus, new apartment demand remained low as well. New apartment supply has increased dramatically over 2005, but is still low compared to historic levels. Vacancy rates have continued to plummet as apartment demand increases and an

Absorption

Absorption rates in the metro area, measured on a per-project basis, ranged from 10 to 23 units per month, with an average of 14 units per month. During 2006, 1,928 new units were absorbed by the market. The Southend submarket lead the way with 680 units with Seattle close behind at 605 units. In comparison, the year 2005 saw a total of 1,300 units absorbed by the market. At the end of 2006, there were 1,312 vacant new units remaining to be absorbed by the market.

Supply Forecast

Our estimate of multifamily supply includes an inventory of all units currently in lease-up but not yet leased, and all units currently under construction. This number does not include proposed projects. To gauge the number of units in the pipeline, we tracked all multifamily building permits, physically inspected the permitted sites, and reconfirmed the number of units and

increasing amount of supply is converted to condominiums.

We estimate that 30% of all new households during 2007 will select multifamily housing. This leads to a 2007 new apartment demand estimate for the Seattle metropolitan area of 5,558 units. New apartment demand during the years 2008 and 2009 will increase to around 5,739 units during

both years.

We expect the growth in new apartment demand to begin in the core areas of Seattle and the Eastside, with some additional improvement in Snohomish County due to increased Boeing employment.

Multifamily Demand by Submarket (in Units)			
Submarket	2007	2008	2009
Seattle	1,890	1,894	1,837
Eastside	1,056	1,148	1,205
Southend	1,667	1,722	1,722
Snohomish	945	976	976
Metro Total	5,558	5,739	5,739

2006 Absorption Summary			
Submarket	Units Leased	Vacant Units Remaining	Average Monthly Absorption
Seattle	605	297	10
Eastside	341	210	13
Southend	680	531	17
Snohomish	302	274	23
Metro Total	1,928	1,312	14

the type of property (apartment or condominium). This information was calculated for each of the four major markets within the Seattle metropolitan area.

As of December 2006, the Seattle metropolitan area had 1,279 vacant units in lease-up. This number is lower than historical figures. The Southend and Seattle markets are the

leading contributors to this total, with 498 and 302 vacant new units respectively. The Eastside and Seattle markets also have the largest number of units under construction with 1,041 and 1,648 units respectively.

The entire Seattle metropolitan area has a total of 3,636 units under construction, resulting in a two year pipeline of 4,915 units.

Seattle Metro Supply Survey					
Sub Market	Dec-06 % Vacant	Average Absorption Complex/Mo.	Vacant In Lease-Up	Under Constr.	Total 2 Yr. Pipeline
Eastside	4.2%	13	210	1,041	1,251
Seattle	2.8%	10	297	1,648	1,945
Southend	3.9%	17	498	855	1,353
Snohomish	3.4%	23	274	92	366
Metro *	3.4%	14	1,279	3,636	4,915

* Weighted Average

Supply and Demand Summary

The table below illustrates the two year forecast of both apartment supply and apartment demand for each submarket of the Seattle metropolitan area. The supply estimates below include proposed projects that have not yet begun construction.

Each of the submarkets have shown improvement in vacancy rates versus the previous year. The Eastside market showed the smallest change, dropping from 4.5% a year ago to 4.2% this year. The Seattle market improved considerably, dropping from 4.4% in 2005 to 2.8% by the end of 2006. The Southend saw their vacancy rates plummet from 6.5% a year ago to a tight 3.9% this year. We forecast 3,641 units of new apartment demand in the Southend market during the next two

years. This figure is significantly larger than the amount of new supply (2,345 units) during the same time period and will cause the Southend vacancy rate to decrease, ceteris paribus, to 2.2% by the beginning of 2009.

The Snohomish County and Seattle markets are also expecting an undersupply of new units during the next two years. We forecast new apartment demand for the next two years in the Snohomish County and Seattle markets of 2,063 and 4,173 units respectively. The amount of new apartment supply during this timeframe is significantly lower (1,243 units and 3,585 units respectively) and will cause the vacancy rates to decrease from their current levels of 3.4% for Snohomish County and 2.8% for Seattle to 2.0% and 2.3%

respectively.

The Eastside market is in relative balance. We forecast two-year, new apartment demand of 2,572 units in the Eastside market. The new apartment supply during the same timeframe is estimated at 2,403 units. This will cause the vacancy rate to decrease slightly from its current level of 4.2% to 3.7% by the beginning of 2009.

Overall, the two-year new apartment demand for the Seattle metropolitan area is estimated at 12,449 units and two-year new apartment supply will total 9,576 units. New apartment demand is expected to outnumber supply by 2,873 units and vacancy rates can be anticipated to fall from 3.4% to 2.5% overall.

Seattle Metro Market Summary									
Sub Market	Market Size	% Vacant	No. Vacant	2 Year Demand	2 Year Supply	S/D Net	2 Yr. Mkt Size	2 Yr. Vac. Rate	Total Vacant
Eastside	59,422	4.2%	2,475	2,572	2,403	(169)	61,825	3.7%	2,307
Seattle	142,921	2.8%	3,937	4,173	3,585	(589)	146,506	2.3%	3,349
Southend	78,662	3.9%	3,063	3,641	2,345	(1,295)	81,007	2.2%	1,768
Snohomish	60,480	3.4%	2,034	2,063	1,243	(820)	61,723	2.0%	1,214
Metro *	341,485	3.4%	11,510	12,449	9,576	(2,873)	351,061	2.5%	8,637

* Weighted Average

Seattle Metropolitan Apartment Market Data & Forecast											
Apartment Trend Analysis Seattle Metro Area, 2000-2006											
Population Estimates (1)			Employment (2)		Households (3)		Apartment Data				
Year	Total Persons	Percent Change	Total Jobs	Percent Change	Total Households	Percent Change	Total Units	Net New Absorp.	Historical Building Permits (4)	Year End Vacancy Rates	Average Rents Increases
2000	2,343,058	3.7%	1,416,800	2.2%	935,768	0.3%	331,819	9,685	9,562	3.1%	7.0%
2001	2,376,900	1.4%	1,399,400	-1.2%	946,135	1.1%	336,389	(8,500)	7,229	6.9%	2.1%
2002	2,402,300	1.1%	1,354,500	-3.2%	952,054	0.6%	339,093	2,472	5,877	6.9%	-8.4%
2003	2,416,800	0.6%	1,339,100	-1.1%	958,574	0.7%	342,165	3,801	4,976	6.6%	0.1%
2004	2,433,100	0.7%	1,355,200	1.2%	971,175	1.3%	343,140	1,259	6,507	6.5%	1.9%
2005	2,464,100	1.3%	1,377,900	1.7%	988,726	1.8%	339,390	1,300	4,902	5.1%	2.0%
2006	2,507,100	1.7%	1,422,700	3.3%	1,007,252	1.9%	335,265	1,928	4,853	3.4%	13.0%
5 Yr. Avg.		1.1%		0.4%		1.3%		2,152	5,423	5.7%	1.7%
Apartment Demand Forecast Seattle Metro Area, 2007-2010											
Population Forecast			Employment Forecast		Household Forecast		Apartment Demand Forecast				
Year	Total Persons	Percent Change	Total Jobs	Percent Change	Total Households	Percent Change	Total Units	Net New Absorp.	Apt Units Permitted	Vacancy Rates	Rents Increases
2007	2,552,488	1.8%	1,465,381	3.0%	1,025,187	1.8%	336,495	5,558	3,747	2.1%	10.0%
2008	2,597,326	1.8%	1,506,412	2.8%	1,042,651	1.7%	340,211	5,739	4,000	1.5%	10.5%
2009	2,640,986	1.7%	1,542,566	2.4%	1,059,023	1.6%	346,211	5,588	6,000	1.6%	9.5%
2010	2,681,916	1.5%	1,565,704	1.5%	1,073,087	1.3%	354,211	5,239	7,000	2.3%	5.0%
4 Yr. Avg.		1.7%		2.4%		1.6%		5,531	5,187	1.9%	8.8%
(1) Population as of April 1st.						Metropolitan Area is King & Snohomish Counties					
(2) Excludes Military & Self-Employed						Sources: WA State Employment Security & WA State Office of Financial Management					
(3) Total households are estimates											
(4) Historical Permits Include Condominiums, Source HUD						O'CONNOR CONSULTING GROUP,LLC: Brian R. O'Connor, MAI					

Rental Rate Forecast

The two tables to the right illustrate the recent history and our forecast of changes in rental rates for each submarket of the Seattle metropolitan area. During 2004 and 2005, rental rates essentially did not change, as their levels of increases did not even cover inflation. The year 2006 saw rents rise by a historic rate of 13.0%. As vacancy rates plummeted, landlords responded with large increases in rental rates. Looking forward, we are expecting rental rates to continue to post significant increases in 2007 at approximately 10.0%, with strong gains between 9.5% and 10.5% to follow in the coming years.

Conclusion

2005 can be considered the turnaround year for the apartment housing market in the Seattle metropolitan region and 2006 appears to have built upon this growth. For the third straight year, the region has experienced positive employment growth following three years of employment losses. Employment increased by approximately 1.2% in 2004, by approximately 1.7% in 2005, and by 3.3% in 2006. These employment gains are stimulating increases in net migration and ultimately, apartment demand.

During the first six months of 2006, the vacancy rate for the Seattle metropolitan region plummeted from 5.1% in December 2005 to 2.5% in June of 2006. However, the vacancy rate climbed back to 3.4% by the end of the year. This is mainly due to seasonal factors. New supply has increased over the historic low of 2005 but is still low when compared to previous years. In addition, an ever increasing amount of apartment supply is being siphoned off by conversion to condominiums. We have estimated that approximately 6,500 apartment units were converted to condominiums in 2006. We forecast vacancy rates to continue to fall to around 2.6% by the end of 2007.

Following a year of record orders at Boeing, the regions economy is expected to continue at a healthy pace into the near future. The housing slump that has affected different regions in the country has not been felt in the Seattle

Seattle Metropolitan Rental Rate History			
Submarket	2004	2005	2006
Seattle	2.1%	1.7%	15.3%
Eastside	0.9%	4.3%	12.5%
Southend	2.2%	0.8%	7.3%
Snohomish	2.3%	1.7%	15.5%
Metro Total*	1.9%	1.9%	13.0%

*Weighted Average

Seattle Metropolitan Rental Rate Forecast			
Submarket	2007	2008	2009
Seattle	10.0%	12.0%	10.0%
Eastside	10.0%	10.0%	10.0%
Southend	8.5%	7.0%	8.0%
Snohomish	12.0%	12.0%	10.0%
Metro Total*	10.0%	10.5%	9.5%

*Weighted Average

region.

As of December 2006, the Seattle market has a two-year supply of 9,576 new apartment units. These are units that are currently in lease-up, under construction, or proposed. During this same time period, we forecast 12,449 new units of apartment demand in the Seattle market. This leads to an undersupply of 2,873 apartment units and will put downward pressure on the vacancy rate of the Seattle market to around 2.5% by year end 2009.

The Eastside market has a two-year supply of 2,403 new apartment units. This is less than our forecasted demand of 2,572 new apartment units, indicating an undersupply of 169 units that should decrease the vacancy rate of the Eastside market to 3.7% by the end of 2008.

The Southend market is showing the largest discrepancy between the number of new apartment units scheduled to impact the market during the next two years and amount by which apartment demand will increase during the same time period. The Southend market shows a two-year supply of 2,345 new apartment units. When compared to the new apartment demand of 3,641 units, this leads to an undersupply of 1,295 units. This undersupply should decrease the vacancy rate to around 2.2% by the end of 2008.

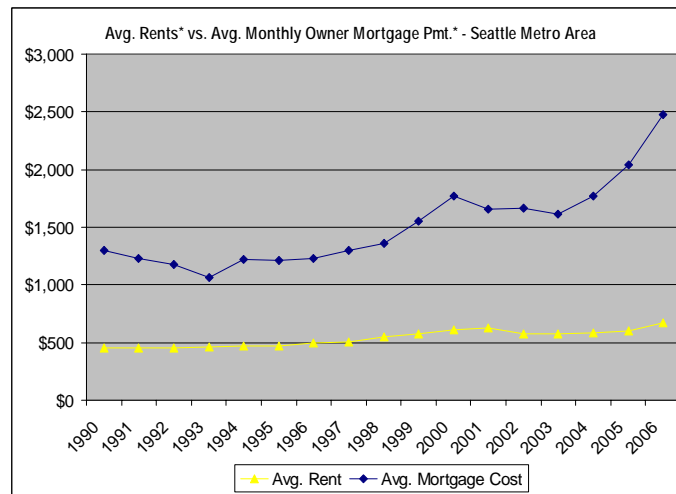
The Snohomish County market also indicates a significant discrepancy

between the number of new apartment units scheduled to impact the market during the next two years and amount by which apartment demand will increase during the same time period. Our forecast shows scheduled new supply of 1,243 new apartment units and an increased level of apartment demand at 2,063 units, the Snohomish County market is forecasted to have an undersupply of 820 apartment units during the next two years. This will decrease the vacancy rate from its current level of 3.4% to approximately 2.0%.

The overall Seattle metropolitan market is forecasted to face a significant undersupply of 2,873 apartment units during the next two years. This should cause the vacancy rate to fall from 3.4% to 2.5% by the end of 2007, ceteris paribus. This undersupply is due to increases in new apartment demand, the limited amount of new apartment supply that will impact the market during the next two years, and most importantly, the continued siphoning off of apartment supply due to conversion to condominiums.

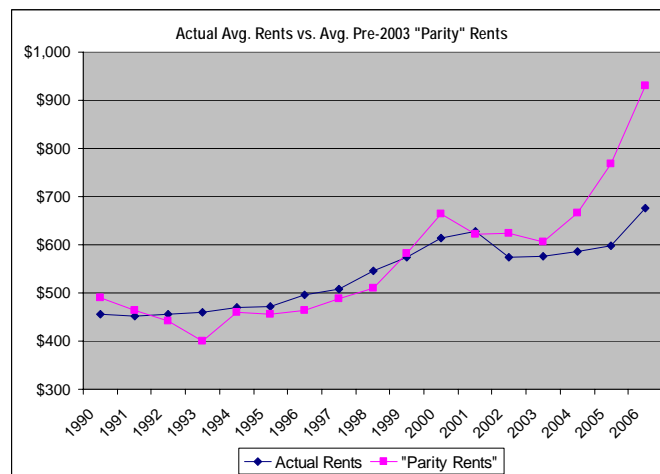
The Back Story: The Rising Tide Lifts All Boats

The owner and rental housing sectors tend to function in a loosely synchronized, if often counter-cyclical, relationship with one another. The counter-cyclical aspect of this relationship reflects the shifts in demand that result, in part, from the relative pricing between the two sectors.



Like nature, the market abhors a vacuum. Growth pressures in one sector eventually create just such a vacuum – or “gradient effect” – in the form of an untenable pricing gap. In this case, rapid pricing growth in the owner sector during the past several years must, inevitably, lead to “corrective” pricing in the rental market.

The process begins as pricing growth starts to deter buyers in sufficient quantity to absorb excess vacancy – as occurred in 2005. Considering improved occupancy levels, apartment managers begin to test the water. Given a whopping 13% rent hike in 2006, the question remains: How high do rents need to grow to re-establish parity with the owner market? As can be noted below, the answer seems to be, quite a bit yet. Based on average (pre-2004) pricing differentials, current rents are still more than 30% below “par”.



The competition between the apartment and condominium sectors remains hot, and should get hotter still – both for households and for land (or conversion projects). The fast growing condo sector has, in effect, become the front-line of the battle over household tenure. Thus far, pricing growth in the more affordable used condo market has been consistent with the rest of the owner sector.

As rents rise to keep pace with this most affordable alternative, the feasibility prospects for new apartment development will continue to improve and conversions will become less attractive. Although the balance between these two sectors will fluctuate, in a market constrained by a short supply of viable development lands, the only sure bet is that the tide is rising and both “boats” will rise with it.

~ Scott A. Wilson, Senior Analyst, O'Connor Consulting Group, LLC.

*Average Rents based on OCG survey data.. **Average Mortgage based on average annual MLS sales prices, 90% loan amounts, and average annual national mortgage interest rates.