

The Seattle Apartment Market Report

Volume 6, Issue 1, January 2009

Rocky Road

The apartment market was hit hard in the second half of 2008, and we didn't see it coming. In June, regional vacancies were 3.0% and there was only 800 units of new supply anticipated to impact the market. What happened? How could vacancies rise 2.0%, which is about 7,000 units, in six months?

While traditional apartment demand did decline a bit, the big hit was about 5,000 single family homes hitting the rental market. Essentially, the apartment market had a spike in new supply that we didn't see coming. I later learned that this phenomena has occurred across the nation.

We saw apartment demand decline due to an increase in roommates, younger renters moving home and a simple decline in the number of renter households. However, this normal reaction to a recessionary economy would not swing vacancies by 2.0% in six months.

Now that we understand what is happening, we can see the future a bit more clearer than before. We will see 3,790 new apartment units coming on-line during 2009, followed by 4,000 units in 2010. Apartment demand will be lower than the supply in 2009 and 2010 pushing regional vacancies up close to 6.0%, and keeping rents level at best.

The worst of the rising vacancies should be over by mid to late 2010, and then vacancies will begin a steep decline toward 3.0% by 2012.

Due to the extreme difficulty of obtaining construction loans, new starts will decline to only 1,500 units in 2009 and 2010. This means that as apartment demand begins to significantly increase, the supply of new units will be at a remarkably low level.

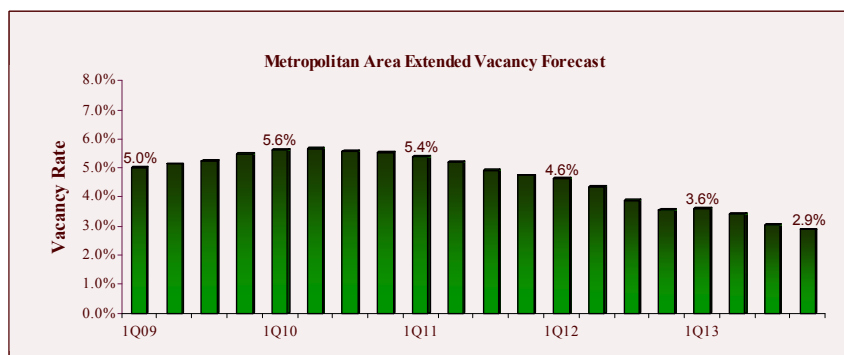
The demand for apartments is expect to radically shift up over the next few years. Many of the new households that were buyers in 2003 to 2008, are now renters. A buyer needs a real down payment, a good credit score and an income that actually qualifies the buyer.

In 1990/1991 we saw that 55% of all new

Seattle Metropolitan Vacancy History			
Submarket	Winter 2006	Winter 2007	Winter 2008
Seattle	2.8%	2.6%	4.4%
Eastside	4.2%	4.2%	5.2%
Southend	3.9%	4.2%	6.3%
Snohomish	3.4%	4.0%	4.7%
Metro Total	3.4%	3.5%	5.0%

Seattle Metropolitan Vacancy Forecast			
Submarket	Winter 2009	Winter 2010	Winter 2011
Seattle	4.5%	5.5%	5.5%
Eastside	5.2%	6.8%	7.0%
Southend	6.3%	6.2%	5.9%
Snohomish	4.7%	4.3%	4.3%
Metro Total	5.0%	5.6%	5.4%

households were renters. By 2003/2004 this ratio dropped to only 13%. Everyone was buyer! By June of 2008, the ratio climbed back to 35% and by December it was 55% and still climbing. This is a significant shift in apartment demand. Even if the growth of new households decline, the near four fold increase in the propensity to rent represents a shift in demand on the magnitude of 300%.



In total numbers the shift in regional demand is from approximately 2,500 units to 7,500. It means we are getting back to the old ratios between ownership and rental. The long term equilibrium rate is about 40% renters and 60% owners. We will probably exceed the 40%

renter ratio for a few years and then settle back down towards the long term equilibrium rate.

This means that while 2009 and 2010 will be a rocky road, by 2011 and certainly 2012 we expect to one of the strongest apartment markets we have had in 20 years. ~Brian O'Connor, MAI

Seattle Metro Market Summary					
Sub Market	% Vacant	2 Year Demand	2 Year Supply	S/D Net	2 Yr. Vac. Rate
Eastside	5.2%	1,512	2,814	1,302	7.0%
Seattle	4.4%	2,382	4,344	1,963	5.6%
Southend	6.3%	911	649	(262)	5.9%
Snohomish	4.7%	655	416	(239)	4.2%
Metro *	5.0%	5,460	8,224	2,764	5.7%

* Weighted Average

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The *Seattle Apartment Market Report* is a publication of the O'Connor Consulting Group, a Seattle-based real estate appraisal and consulting firm specializing in mixed-use multifamily and commercial property valuation and consultation.

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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 points above physical

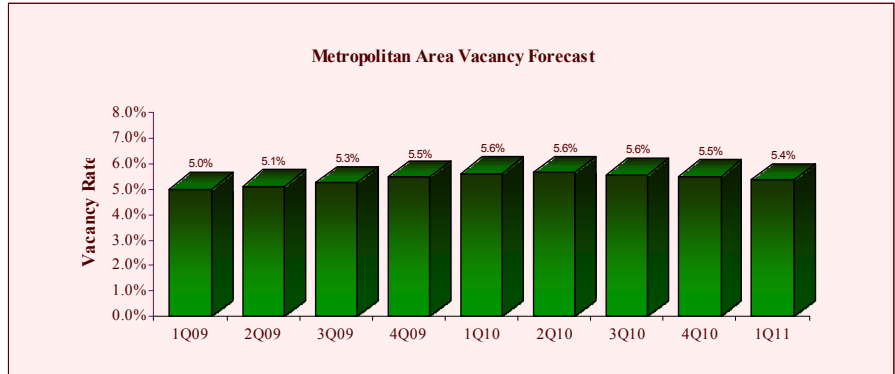
vacancies. Continued low levels of demand will put slight upward pressure on vacancy rates over the near term. However, a relatively low supply pipeline coupled with incrementally improving demand should begin to tighten the market.



Vacancy

Our December 2008 vacancy survey covered approximately 120,000 units. Overall, physical vacancy was estimated at 5.0% for the Metro region and is allocated among the primary markets and submarkets as shown below.

Vacancy rates climbed significantly over the year from 3.5% at the end of 2007. One factor that had a strong influence on this rise in vacancy was the emergence of a significant single-family home and condo rental pool. Due to the deterioration of the sales market, many would-be sellers chose to rent out their homes while awaiting an



improvement in market conditions. The emergence of this sector of new rental supply captured a significant share of renters who would have otherwise chosen apartment housing. It is believed that this effect could swing in the opposite direction once the single-family market improves.

SEATTLE			
Submarket	Units	Vacancy	Percent
Ballard/Fremont	455	20	4.4%
Beacon Hill/Central District	422	17	4.0%
Capitol Hill/Eastlake	1,050	49	4.7%
Denny Regrade/Belltown	2,741	130	4.7%
Downtown/First Hill	3,367	187	5.6%
Greenlake/Greenwood	664	10	1.5%
Lake City	889	28	3.1%
Lake Forest Park	242	18	7.4%
Magnolia/Queen Anne	1,163	45	3.9%
Northgate	1,289	38	2.9%
Northwest Seattle/North City	1,360	63	4.6%
Rainier Valley/South Seattle	708	34	4.8%
University/Ravenna/Sandpoint	752	13	1.7%
West Seattle	1,031	59	5.7%
Total	16,133	711	4.4%

EASTSIDE			
Submarket	Units	Vacancy	Percent
Suburban Bellevue	8,754	407	4.6%
Downtown Bellevue	774	50	6.5%
Bothell/Woodinville	4,035	161	4.0%
Issaquah	2,593	156	6.0%
Kirkland	3,088	195	6.3%
Mercer Island	795	64	8.1%
Redmond	3,017	162	5.4%
Total	23,056	1,195	5.2%

SOUTH END			
Submarket	Units	Vacancy	Percent
Auburn	2,850	146	5.1%
Burien/Des Moines	3,520	189	5.4%
Enumclaw	219	12	5.5%
Federal Way	8,792	631	7.2%
Kent	9,954	682	6.9%
Renton/Maple Valley	8,328	511	6.1%
SeaTac/Tukwila	2,701	114	4.2%
Total	36,364	2,285	6.3%

SNOHOMISH COUNTY			
Submarket	Units	Vacancy	Percent
Edmonds	1,298	33	2.5%
Everett	8,329	495	5.9%
Lynnwood/Shoreline	5,664	197	3.5%
Marysville	317	5	1.6%
Mill Creek/Canyon Park	1,118	74	6.6%
Monroe	248	6	2.4%
Mukilteo	1,606	71	4.4%
Mountlake Terrace	1,416	52	3.7%
Total	19,996	933	4.7%

PIERCE COUNTY			
Submarket	Units	Vacancy	Percent
Fife/Milton	1,338	71	5.3%
Firecrest/University	1,465	71	4.8%
Gig Harbor	647	37	5.7%
Lakewood	2,016	77	3.8%
Puyallup/Sumner	3,969	267	6.7%
Tacoma	10,063	583	5.8%
Total	19,498	1,106	5.7%

Vacancy Summary			
County	Market Size	Survey	Weighted*
King and Snohomish	350,105	5.5%	5.0%
King	288,831	5.5%	5.1%
Snohomish	61,274	4.7%	4.7%
Pierce	19,498	5.7%	5.7%

*Weighted by market size

Employment Forecast

National economic conditions have deteriorated over the past year. As precipitated by the collapse of the subprime mortgage industry, the national economy has entered into a recession.

As the effects of the economic climate ripple through the region, many major employers have been greatly affected. Locally headquartered Washington Mutual became the largest bank failure in US history and was subsequently sold to JP Morgan/Chase, leading to 3,400 layoffs locally. In addition, other major local employers

have also recently announced mass layoffs including Starbucks (~1,500), Boeing (~4,500), Weyerhaeuser (~1,500), and Microsoft (~3,500), although the specific number of how many of these layoffs are located locally is currently unclear.

Overall, during 2008 Seattle added approximately 25,900 new jobs which represents a 1.8% growth rate over year-end 2007 data. This annual growth of Puget Sound employment is markedly lower than what was seen in 2007 and 2006 which experienced 41,800 and 44,700 new jobs added,

respectively. All indications are that this weakened job climate will continue for the next two years and more layoffs are anticipated.

Local economists Dick Conway and Doug Pederson predict a contraction in employment of -0.8% in 2009 and essentially no growth in 2010 (0.6%). If these projections hold true, it would mark the first time the region has experienced net job loss since the recession in 2001.

Still, compared to the rest of the nation, the Seattle area market is considered one of the healthiest regions.

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, 2008 population estimate, the Seattle metropolitan area experienced a net in-

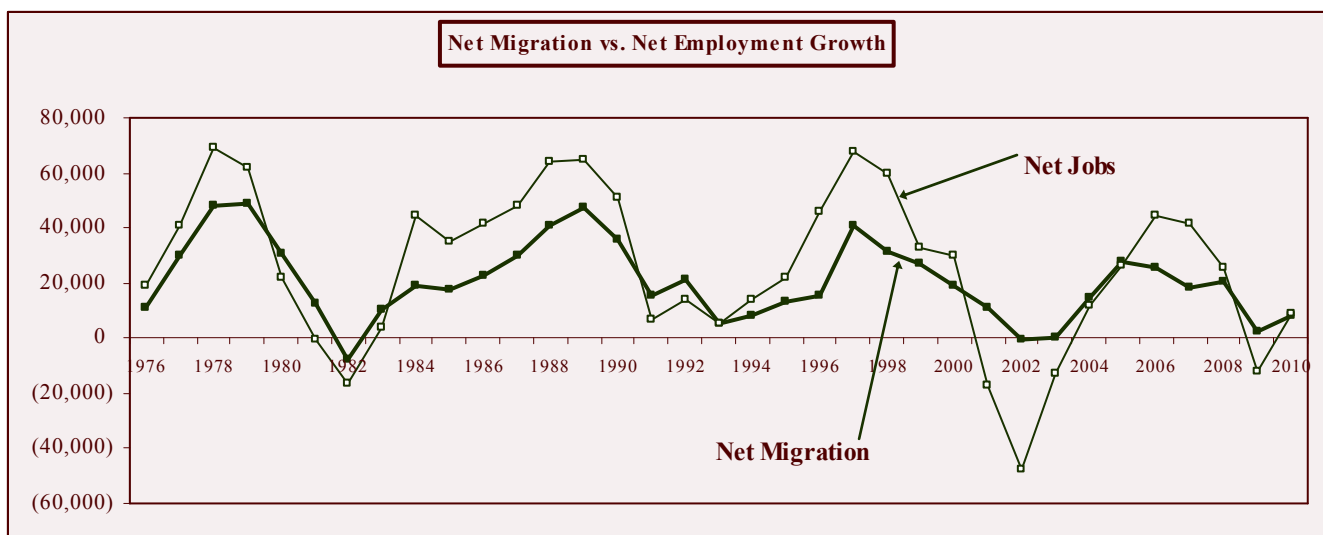
migration of approximately 18,200 people in 2007. Trending forward, we anticipate net migration to decline significantly as job growth weakens, although negative net migration is not anticipated.

As noted in the chart below, previous periods of significant job losses have resulted in substantial net out migration. More recently, the 2001 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 remains one of the healthier regional economies in the nation. Due to this factor, we believe net migration will follow similar patterns as the recession of 2001 as significantly better alternatives to the Seattle region do not exist.



Apartment Demand

The national recession, along with weakened employment growth in the region has contributed to low levels of net migration.

During 2008, the Seattle metropolitan area reported its fifth year of positive employment growth since 2000. However job growth in 2008 was only 62% what it was in 2007 and forecasts for the immediate future indicate negative employment growth in 2009. New apartment supply increased in 2008 to 2,094 completions but supply is still low compared to historic levels.

Vacancy rates have climbed over the year from 3.5% to 5.0%, coinciding with the emergence of a burgeoning supply of single-family and

Absorption

Absorption rates in the metro area, measured on a per-project basis, ranged from 9 to 18 units per month, with an average of 14 units per month. This average absorption rate is similar to what was experienced in 2006 and 2007. The Eastside and Southend markets exhibited the highest absorption rates.

During 2008, 1,659 new units were absorbed by the market. This figure is 35% lower than the number of units absorbed in 2007, however it is on par with what was experienced in 2006.

Supply Forecast

Our estimate of new multi-family supply is derived from a survey of all units currently in lease-up, projects under construction, and know projects in their pre-development stage. To gauge the number of units in the pipeline, we track all multifamily building permits, physically inspect the permitted sites, and reconfirm the number of units and the property type (apartment or condominium). This information was

calculated for each of the four major markets within the Seattle metropolitan area.

condominium rentals. This new source of supply was caused by the downturn in the sales market. As sales slowed and values dropped, many would-be sellers instead chose to lease their property's.

We are estimating that approximately 50% of all new households are choosing rental housing. In addition, we have estimated that up to half of this rental demand is being captured by the single-family and condominium rental market that emerged in 2008. This proportion of households choosing rental housing is high compared to historic levels.

Looking forward, we are anticipating continued low levels of demand in 2009 with demand increasing in 2010 and 2011.

Metro Area Market Demand Summary			
	2006	2007	2008
Vacancy Rate	3.4%	3.5%	5.0%
Market Size	345,185	347,625	350,541
Occupied Units	333,552	335,560	332,954
Change in Occupied Units	3,957	2,008	-2,606
New Units Absorbed	1,751	2,537	1,659
Total Demand	5,708	4,545	-947

Multifamily Demand Forecast by Submarket (in Units)			
Submarket	2009	2010	2011
Seattle	728	1,345	1,829
Eastside	474	876	1,191
Southend	288	532	723
Snohomish	203	375	510
Metro Total	1,694	3,129	4,254

2008 Absorption Summary			
Submarket	Units Leased	Vacant Units Remaining	Average Absorption/Mo.
Seattle	758	368	9.5
Eastside	465	144	16.9
Southend	381	31	18.2
Snohomish	55	25	9.2
Metro Total	1,659	568	13.5

calculated for each of the four major markets within the Seattle metropolitan area.

As of December 2008, the Seattle metropolitan area had 568 vacant units in lease-up. This number is lower than historical levels. The Eastside and Seattle markets are the leading contributors to this total, with 144 and 368 vacant new units respectively. The

Eastside and Seattle markets have the largest number of units under construction with 2,627 and 2,934 units respectively.

The entire Seattle metropolitan area has a total of 6,277 units under construction, resulting in a two year pipeline of 6,845 units.

Seattle Metro Supply Survey					
Sub Market	Dec-07 % Vacant	Average Absorption Complex/Mo.	Vacant In Lease-Up	Under Constr.	Total 2 Yr. Pipeline
Eastside	5.2%	17	144	2,627	2,771
Seattle	4.4%	10	368	2,934	3,302
Southend	6.3%	18	31	608	639
Snohomish	4.7%	9	25	108	133
Metro *	5.0%	13	568	6,277	6,845

* 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 showed exhibited a rise in vacancy rates over the year. The Southend market showed the largest increase in vacancy, increasing from 4.2% at the end of 2007 to 6.3% in 2008. The Seattle submarket increased by the second highest amount, from a very low 2.6% in 2007 to 4.4% in 2008. The Eastside and Snohomish submarkets each saw their vacancy rates rise close to one percent.

As explained elsewhere in this newsletter, 2008 saw an explosion in the

supply of single-family and condominium rentals as the sales market imploded. This phenomenon was especially acute in the Southend market as this region was particularly overbuilt during the real estate boom period.

Very little new supply is forecasted in the Southend market which should help put downward pressure on vacancy rates as the amount of new supply is less than the 2-year demand forecast.

Our forecast for the submarkets is split between significant oversupplies in the Eastside and Seattle markets and moderate undersupplies in the Southend and Snohomish markets. On balance, we are forecasting a 2-year oversupply in the region which should push vacancy rates to the to the upper

5% range in 2010.

In response to the recent low vacancy rates and two years of strong rental rate increases, development in the core areas of Seattle and the Eastside saw an increase in development activity. So much so that current data indicates both market are facing significant 2-year supply surpluses. This situation is especially the case in the Eastside market where current projections indicate vacancy rates rising to 7% over the next two years.

The Southend and Snohomish markets did not experience this rush of new development. Instead, the deteriorated sales markets in these areas caused some apartment demand to be siphoned off by larges amounts of new single-family rental housing.

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	61,314	5.2%	3,178	1,512	2,814	1,302	64,128	7.0%	4,480
Seattle	147,502	4.4%	6,501	2,382	4,344	1,963	151,846	5.6%	8,463
Southend	80,015	6.3%	5,028	911	649	(262)	80,664	5.9%	4,766
Snohomish	61,274	4.7%	2,859	655	416	(239)	61,690	4.2%	2,620
Metro *	350,105	5.0%	17,565	5,460	8,224	2,764	358,329	5.7%	20,329

* Weighted Average

Seattle Metropolitan Apartment Market Data & Forecast											
Apartment Trend Analysis Seattle Metro Area, 2000-2008											
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.	Apartments Under Construction	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%	1,399,500	-1.2%	946,135	1.1%	336,389	(8,500)	7,229	6.9%	2.1%
2002	2,402,300	1.1%	1,352,000	-3.4%	952,054	0.6%	339,093	2,472	5,877	6.9%	-8.4%
2003	2,416,800	0.6%	1,339,100	-1.0%	958,574	0.7%	342,165	3,801	4,976	6.6%	0.1%
2004	2,433,100	0.7%	1,351,100	0.9%	971,175	1.3%	343,140	1,259	6,507	6.5%	1.9%
2005	2,464,100	1.3%	1,377,600	2.0%	988,726	1.8%	339,390	1,300	4,902	5.1%	2.0%
2006	2,507,100	1.7%	1,422,300	3.2%	1,005,257	1.7%	339,577	5,969	4,853	3.4%	13.0%
2007	2,547,600	1.6%	1,464,100	2.9%	1,018,808	1.3%	344,494	4,629	5,944	3.5%	8.5%
2008	2,580,800	1.3%	1,490,000	1.8%	1,025,583	0.7%	348,988	(947)	6,931	5.0%	1.4%
5 Yr. Avg.		1.3%		2.2%		1.4%		2,442	5,827	4.7%	5.4%
Apartment Demand Forecast Seattle Metro Area, 2009-2012											
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
2009	2,598,414	0.7%	1,478,080	-0.8%	1,034,522	0.9%	352,776	1,694	4,141	5.5%	0.0%
2010	2,621,656	0.9%	1,486,948	0.6%	1,047,788	1.3%	356,184	3,129	5,000	5.5%	2.0%
2011	2,656,149	1.3%	1,524,122	2.5%	1,061,615	1.3%	358,984	4,975	6,000	4.9%	3.0%
2012	2,692,097	1.4%	1,559,177	2.3%	1,076,383	1.4%	361,384	6,567	7,000	3.7%	5.0%
4 Yr. Avg.		1.1%		1.2%		1.2%		4,091	5,535	4.9%	2.5%
(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 2006 and 2007, rental rates rose aggressively as vacancy rates remained in the sub-4% range. The market shifted in 2008 as a deteriorating single-family and condominium sales market lead to the emergence of a significant single-family rental market. Vacancy rates climbed to 5.0% as many would-be home sellers instead chose to rent their homes while waiting for an improvement in market conditions. As a result, rents remained flat. We do not expect any rental growth in 2009.

Conclusion

The year 2005 was considered the turnaround year for the apartment housing market in the Seattle metropolitan region and 2006 built upon that growth. For the second year in a row, the region had experienced positive employment growth following three years of employment losses. These employment gains stimulated increases in net migration and ultimately, apartment demand.

During 2006, the vacancy rate for the Seattle metropolitan region plummeted from 5.1% in 2005 to 3.4% by the end of 2006. The vacancy rate remained a very low 3.5% through 2007. During this period, single-family and condominium values were skyrocketing, forcing many new households into apartment housing due to affordability. Meanwhile a significant amount of apartment supply was being siphoned off by condominium converters rushing to get condominium product onto the market. Increased demand for apartment housing coupled with an erosion in apartment supply caused vacancy rates to remain in the mid-3% range and helped spur strong rental rate increases of 13% in 2006 and 8.5% in 2007.

The downturn in the housing market and economy as a whole over the past year and a half has caused a shift in the apartment market.

Vacancy rates continued to tighten during the first half of the year, declining slightly from 3.5% at the end of 2007 to 3.1% in June 2008. However vacancy rates climbed sharply over the

Seattle Metropolitan Rental Rate History			
Submarket	2006	2007	2008
Seattle	15.3%	7.6%	0.6%
Eastside	12.5%	7.9%	0.8%
Southend	7.3%	9.8%	4.8%
Snohomish	15.5%	9.5%	-0.6%
Metro Total*	13.0%	8.5%	1.4%

*Weighted Average

Seattle Metropolitan Rental Rate Forecast			
Submarket	2009	2010	2011
Seattle	0.0%	2.0%	3.0%
Eastside	0.0%	2.0%	3.0%
Southend	0.0%	2.0%	3.0%
Snohomish	0.0%	2.0%	3.0%
Metro Total*	0.0%	2.0%	3.0%

*Weighted Average

subsequent last half of the year. Our December 2008 survey indicates that vacancies climbed 1.5% to 5.0% from June to December 2008. One of the main contributing factors to this rapid spike in vacancy rates is believed to be related to the emergence of a significant pool of single-family and condominium rentals.

When the housing market began to turn south with sales velocities and homes values declining, many would-be home/condominium sellers have found it very difficult to sell. As the national economic situation continued to get grimmer by the week, many of the would-be sellers decided to rent their homes/condominiums in the interim while awaiting an improvement in the market. The effect has been a sharp increase in the supply of single-family and condominium rental housing. Many new households to the area who would have otherwise rented an apartment unit have instead chosen to rent a single-family home or condominium. This phenomenon was especially relevant in the Southend and Snohomish markets, two areas that experienced a huge surge in new home construction in recent years. As sales in these areas deteriorated quickly, some developers resulted to marketing entire subdivisions as rental homes in order to generate cash flow to cover debt obligations. Unfortunately, it is very difficult to quantify the amount of new supply that impacted the market in this fashion.

It is important to note that while

the previous six months saw a sharp increase in vacancy rates over a short time period, we believe that the potential exists for an equally strong and rapid swing in the opposite direction within the next two years. When the single-family market begins to turn around, many of the would-be home sellers who had chosen to lease out their homes in the interim will again put their homes in the for-sale market. Depending on the strength of the single-family market rebound, the effect could be a swift contraction in the supply of single-family rental homes which should precipitate a shift in demand for rental housing to apartments, ultimately influencing a sharp decline in apartment vacancy rates.

Looking forward, the lingering effects of the downturn in the economy will continue to dampen employment growth in the region. In turn, we are forecasting continued low levels of net migration to the region which will influence low levels of demand in the near future. Vacancy rates are anticipated to gradually edge higher through 2009 and then begin to incrementally improve through 2010 as levels of demand begin to increase.

Naturally, the main factor that will influence future apartment market trends will be the state of the economy.





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