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The Seattle Apartment Market Report

Volume 8, Issue 2, August 2011

Apartments Riding High

The first half of 2011 has continued the fascinating story begun in 2010, in which we began a new apartment market cycle with a bang. Within this newsletter, we will regularly refer to the Seattle MD, which is more formally known as the Seattle-Bellevue-Everett Metropolitan Division, or the combined area of King and Snohomish county. By the end of 2nd quarter 2011, Seattle MD vacancies declined to 3.3%, down from 4.2% at the end of 2010, and we witnessed a healthy total demand figure of 4,224 units (1,256 new units, 2,968 existing units).

We have estimated a total annual demand for approximately 4,600 apartment units in 2011 in the Seattle MD. While this figure is well below the previous year's surprising total (9,427 units) it still represents a healthy level of demand. In fact, if we discount 2010, we have not witnessed apartment demand of this magnitude since 2005. The reader may have also noted that this figure is not much greater than the apartment demand already exhibited by the Seattle MD in the first half of 2010. While it's known that apartment demand tends to be lower in the second half of a given year, the primary reason for this is the drastic tightening of currently available supply.

The ongoing slump in the ownership market continues to play a significant role in the resurgence of the apartment market. The market conditions that characterize our national and local economy have resulted in tighter lending practices and rising equity requirements. Similar to the banks, private equity firms have become quite selective, with most looking to reduce the amount of risk in their portfolios during a time of continued uncertainty. The difficulty financing new apartment projects lead to a dwindling amount of supply in the pipeline. New apartment supply will be especially constrained from late 2011 through most of 2012, during which time, only 2,169 new apartment units will impact the Seattle MD.

Seattle-Bellevue-Everett MD Vacancy History

Submarket	Summer 2010	Winter 2010	Summer 2011
Seattle	3.4%	3.6%	2.8%
Eastside	3.4%	4.2%	2.3%
Southend	5.5%	4.9%	5.1%
Snohomish	5.0%	4.6%	3.4%
Metro Total	**4.2%**	**4.2%**	**3.3%**

Seattle-Bellevue-Everett Vacancy Forecast

Submarket	Winter 2011	Summer 2012	Winter 2012
Seattle	2.6%	2.0%	1.7%
Eastside	1.8%	1.5%	1.4%
Southend	5.0%	3.9%	2.8%
Snohomish	3.4%	2.8%	2.0%
Metro Total	**3.2%**	**2.5%**	**2.0%**

Looking ahead, we expect to see vacancy rates continue to drop, though somewhat less drastically than in 2010 and early 2011. For the remainder of our forecast, we expect Seattle MD vacancies to drop to 3.2% by the end of 2011 and continue to decline as demand remains high in the face of a 2012 supply shortfall. We would like to note that our model of market balance projections indicates a potential vacancy of 2.0% by year-end 2012. It is our belief that as the market reacts to rapidly declining vacancies, rents will be increased, and demand will be somewhat dampened, resulting in a slightly higher point of balance for market vacancy, though well below the 5.0% benchmark.

~Brian O'Connor, MAI

Seattle Metro Market Summary

Sub Market	% Vacant	2 Year Demand	2 Year Supply	S/D Net	2 Yr. Vac. Rate**
Seattle	2.8%	6,132	3,933	(2,199)	1.3%
Eastside	2.3%	1,533	878	(655)	1.2%
Southend	5.1%	3,081	799	(2,283)	2.3%
Snohomish	3.4%	1,761	577	(1,184)	1.5%
Seattle MD*	**3.3%**	**12,507**	**6,187**	**(6,320)**	**1.5%**

* Weighted Average

**Vacancies unlikely to reach lows presented here. Rising rents will either decrease demand or push demand out to other markets

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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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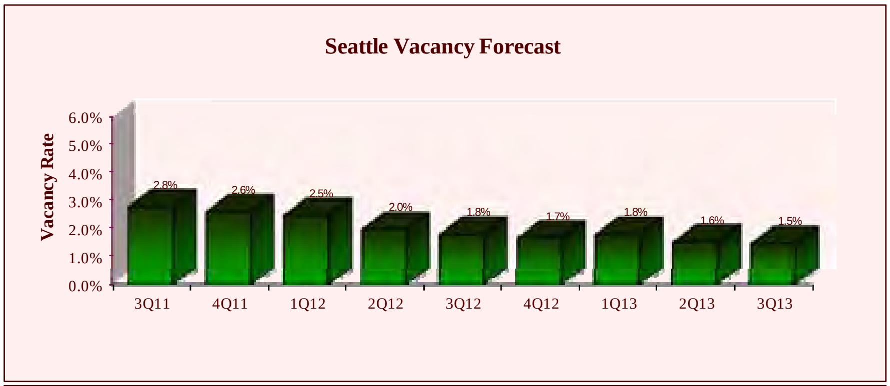
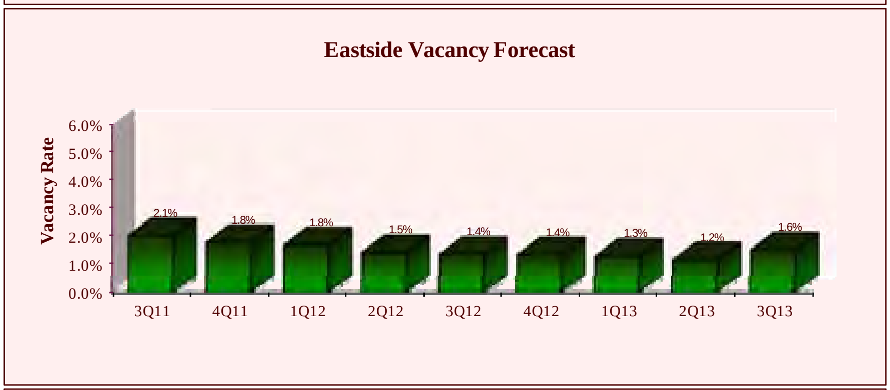
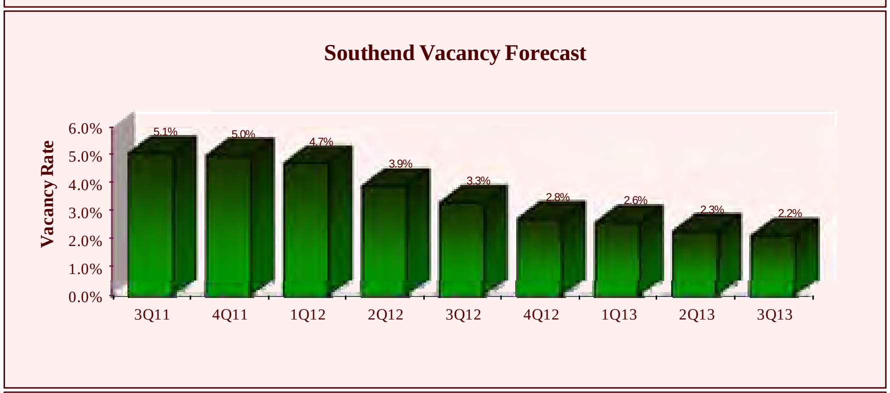
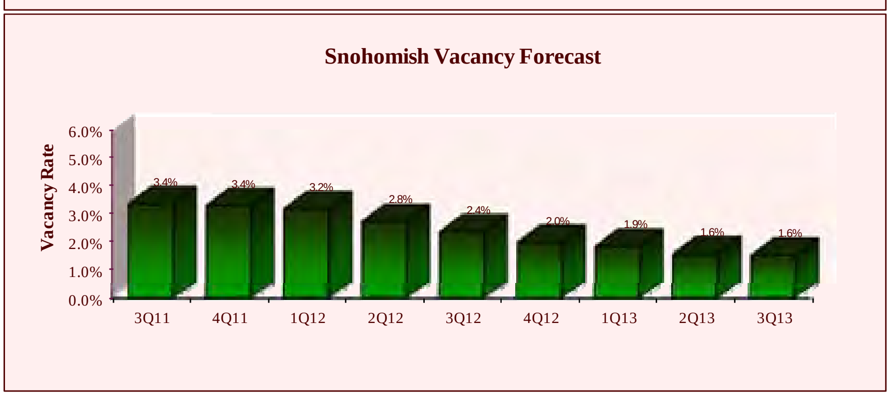
Vacancy Forecast

The graphs below illustrate 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. Currently, we estimate that there is downward pressure on vacancy rates over the near term. It should be noted that rising rents could dampen or shift demand, resulting in vacancies slightly higher than those forecasted.



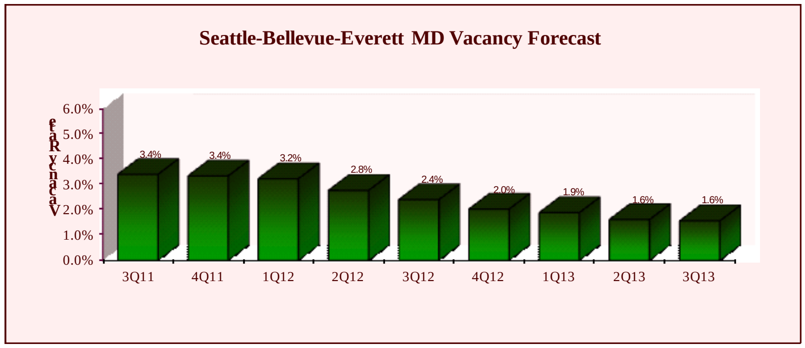






Vacancy

Our July 2011 vacancy survey covered approximately 220,000 units. Overall, physical vacancy was estimated at 3.3% for the Seattle MD and is allocated among the primary markets and submarkets as shown below. Vacancy rates declined over the past six months from 4.2% at the end of 2010.



The rapid drop in vacancy can be partially explained by looking back. The economic turmoil of years past resulted in negative apartment demand in 2008 and diminished demand in 2009. Many potential apartment renters sought financial relief by entering roommate situations or leasing single-family homes. The decline in rents experienced in 2009, coupled with significant rent concessions, brought demand back to traditional multifamily product in 2010. A diminished supply pipeline hastened declines in vacancy.

SEATTLE			
Submarket	**Units**	**Vacancy**	**Percent**
Ballard/Fremont	711	8	1.1%
Beacon Hill/Central District	237	3	1.3%
Belltown	3,343	100	3.0%
Capitol Hill/Eastlake	2,273	56	2.5%
Downtown	1,536	51	3.3%
International District	258	8	3.1%
First Hill	1,771	27	1.5%
Greenlake/Greenwood	717	10	1.4%
Lake City	1,178	23	2.0%
Lake Forest Park/North City	414	15	3.6%
Magnolia/Queen Anne	1,729	46	2.7%
Northgate	1,696	70	4.1%
Northwest/Shoreline	1549	70	4.5%
Rainier Valley/South Seattle	621	32	5.2%
South Lake Union	1,432	19	1.3%
University/Ravenna/Sandpoint	1,096	30	2.7%
Fauntleroy/Delridge	344	6	1.7%
West Seattle	893	41	4.6%
Subtotal	**21,798**	**615**	**2.8%**

EASTSIDE			
Submarket	**Units**	**Vacancy**	**Percent**
Suburban Bellevue/Newcastle	8,537	146	1.7%
Downtown Bellevue	2,128	52	2.4%
Bothell/Woodinville	3,216	92	2.9%
Issaquah	1,629	19	1.2%
Kirkland	3,622	79	2.2%
Mercer Island	1,201	44	3.7%
Redmond	4,834	106	2.2%
Sammamish/North Bend	1,640	66	4.0%
Subtotal	**26,807**	**604**	**2.3%**

Note: The figures presented in the tables above are derived from our July 2011 vacancy survey.

*Weighted vacancies at right calculated based on area proportion of total market size.

**Includes King, Snohomish, and Pierce Counties

SOUTH END			
Submarket	**Units**	**Vacancy**	**Percent**
Auburn	2,464	97	3.9%
Burien/Des Moines	2,424	72	3.0%
Enumclaw	219	13	5.9%
Federal Way	9,931	505	5.1%
Kent	11,669	724	6.2%
Renton	9,957	445	4.5%
Maple Valley	342	21	6.1%
SeaTac/Tukwila	4,120	217	5.3%
Subtotal	**41,126**	**2,094**	**5.1%**

SNOHOMISH COUNTY			
Submarket	**Units**	**Vacancy**	**Percent**
Edmonds	1,089	35	3.2%
Everett	9,919	365	3.7%
Lynnwood	5,115	226	4.4%
Marysville	447	4	0.9%
Mill Creek/Canyon Park	1,986	30	1.5%
Monroe	248	3	1.2%
Mukilteo	1,600	44	2.8%
Mountlake Terrace	1,742	50	2.9%
Subtotal	**22,146**	**757**	**3.4%**

PIERCE COUNTY			
Submarket	**Units**	**Vacancy**	**Percent**
Fife/Milton	**1,492**	**57**	**3.8%**
Fircrest/University/Dupo	1,299	34	2.6%
Gig Harbor	630	27	4.3%
Lakewood	522	40	7.7%
Puyallup/Sumner	4,168	214	5.1%
Tacoma	12,134	648	5.3%
Downtown Tacoma	1,489	60	4.0%
Subtotal	**21,734**	**1,080**	**5.0%**

Summary by County			
County	**Units**	**Survey**	**Weighted***
King and Snohomish	111,877	3.6%	3.3%
King	89,731	3.7%	3.3%
Snohomish	22,146	3.4%	
Pierce	21,734	5.0%	
Metro Area Totals**	**133,611**	**3.9%**	

Employment Forecast

National economic conditions have begun to improve, though at a pace that is frustratingly slow for many of us. Thankfully, unemployment is finally trending downward, however gradually. As of June 2011, national unemployment is at 9.1%, Washington state is at 9.2%, and the Seattle MD is at 8.8%.

To say the least, 2009 was a difficult year for the Seattle MD job market. While the most significant cuts were in January of that year, continued losses in nearly every sector of employment resulted in a total annual loss of approximately 76,500 jobs, nearly as many as were lost in 2001, 2002, and 2003, combined (-80,200). A loss of this magnitude implies a negative growth rate of 5.5% for that year. A further 26,100 jobs were lost in 2010. However, most of these loses occurred in January of that year, with generally positive gains thereafter.

To date, 2011 has been a good year for Seattle MD job seekers. According to preliminary September 2011 data, the Seattle MD has increased employment by 32,900 new jobs in 2011, which represents a healthy 2.0% growth rate since September 2010. Considering the recent expansions of major area employers such as Boeing, Microsoft, and Amazon, we believe this upward trend in employment will continue through at least the next year.

Local economists Dick Conway and Doug Pederson predict healthy growth in employment in the Seattle MD of 2.1% in 2011, 1.8% in 2012, and 1.7% in 2013. If these projections hold true, it would mean that we are possibly “over the hump” and are now building towards a generally positive economic climate.

Population Forecast

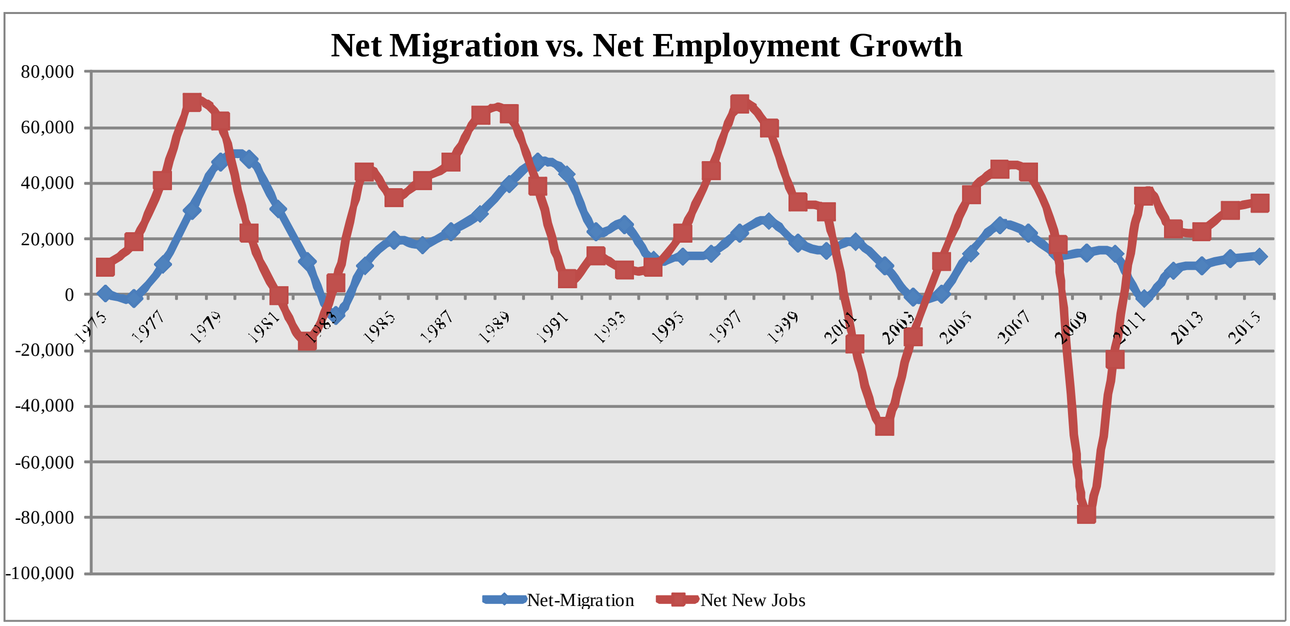
Our forecast of vacancy and rental changes are driven primarily by anticipated population growth in the region. The chart below displays the historical relationship between net migration and net employment growth in the Seattle metropolitan area.

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, 2011 population estimate, the Seattle MD experienced a net in-migration of approximately –1,234 people in 2010. This is the first year since 2003 (and before that 1983) in which the Seattle MD had a net negative in-migration. It should be noted that total population change was still positive (15,016), though only about half of what we witnessed in each of the past five years.

It is fascinating that despite negative net migration, the Seattle MD continues to absorb a healthy amount of apartment units. We believe that this is due in large part to a shift in household tenureship. We are currently experiencing a significant shift away from ownership and toward the rental market. Despite historically low interest rates, there are a multitude of factors that are currently acting upon potential buyers that make renting a more attractive option. We believe that this trend may be the most significant factor acting upon the Seattle MD apartment market today and strongly encourage the reader to download our PDF on Housing Tenure, which can be found on the same download page as this newsletter.

Despite the hiccup in net migration experienced in 2010/2011, Seattle remains one of the healthier regional economies in the nation. Due to this factor, we believe net migration will be positive moving forward (approximately 8,700-13,800 per annum) despite the notably slow national recovery.



Apartment Demand

Despite the recession of 2008-2009, the negative employment growth through that period, and the net negative migration displayed in 2010, the Seattle MD remains one of the most economically attractive regions in the nation. We believe that positive net migration and gains in employment, and thus healthy apartment demand, will be the norm in years to come.

Though the Seattle MD experienced notable job loses in early 2010, employment growth has been mostly positive through the majority of 2011. Based upon the forecast of Dick Conway and Doug Pederson, we believe that positive job growth will continue, on an annual basis, through 2015.

The drop in vacancy in 2011 (4.2% to 3.3%) is due in part to the expression of pent up demand, temporarily satisfied by the ownership market, though also due in large part to significant rent reductions in 2009 and early 2010. The market has already begun to react to the decline in vacancy, exhibiting significant rent hikes through most of 2010.

Our future expectations have resulted in healthy estimates of future demand. Historically, an approximate average of 35% of all new households have been expected to choose apartments. We expect that the proportion of new households that will choose rental housing is currently hovering around 60% to 70%. Please see the PDF on our website titled Housing Tenure for more on this topic.

Metro Area Market Demand Summary			
	2009	**2010**	**Mid-2011**
Vacancy Rate	5.7%	4.2%	3.3%
Market Size	353,989	358,120	359,376
Occupied Units	333,742	343,169	347,393
New Units Absorbed	3,884	4,435	1,256
Existing Units Absorbed	-2,682	4,992	2,968
Total Demand	**1,202**	**9,427**	**4,224**
Multifamily Demand Forecast by Submarket (in Units)			
Submarket	**2011**	**2012**	**2013**
Seattle	2,302	3,582	3,497
Eastside	1,151	501	1,140
Southend	691	2,006	1,824
Snohomish	460	1,075	1,140
Metro Total	**4,604**	**7,164**	**7,601**
Mid-2010 Absorption Summary			
Submarket	**New Units in 2011**	**Units Abs. in 2011**	**Average Absorption/Mo.**
Seattle	676	491	14.5
Eastside	66	517	13.5
Southend	107	248	13.5
Snohomish	0	0	N/A
Metro Total	**849**	**1,256**	**14.2**

Absorption

In the first half of 2011, absorption rates in the Metro area, measured on a per-project basis, ranged from 5 to 25 units per month, with an average of 14.2 units per month. This does not include certain projects that we consider to be outliers. The Snohomish market had no 20+ unit projects through which to track absorption. A shift in housing tenureship contributed to the 4,224 units absorbed by mid-2011, a very healthy amount, despite net negative migration in 2010.

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 known 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.

As of July 2011, the Seattle MD had 1,228 vacant units in lease-up. The Seattle and Southend markets are the leading contributors to this total, with 480 and 334 vacant new units respectively. The Seattle submarket has the largest number of units under construction (3,863 units) .

The entire Seattle MD area has a total of 5,001 units under construction, resulting in a two year pipeline of 6,229 units. It must be noted that a relatively small portion of the two-year supply will reach completion in 2012. We expect demand to far outpace supply through most of that year.

Seattle Metro Supply Survey					
Sub Market	**July 2011 % Vacant**	**Average Absorption Complex/Mo.**	Vacant **Units In Lease-Up**	Units **Under Construction**	**Total Two Year Pipeline**
Eastside	2.8%	13.8	480	3,863	4,343
Seattle	2.3%	15.8	219	634	853
Southend	5.1%	14.9	334	227	561
Snohomish	3.4%	5.9	195	277	472
Seattle MD *	**3.3%**	**14.9**	**1,228**	**5,001**	**6,229**

*** 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.

As the reader may recall, Seattle MD vacancies were stagnant in 2009, holding at the 5.7% mark. Making note of this, apartment owners and managers sought to create demand by decreasing rents and offering rent concessions at many properties. Combined with a slowly improving economic situation, these tactics brought many renters back from temporary housing in the single-family and/or condominium market.

The year 2010, characterized by a staggering 9,427 units absorbed and a 1.5% drop in vacancies (Seattle MD), clearly showed that the upward leg of a new cycle has begun. However, it is unlikely that the Seattle MD has had an apartment market cycle quite like this. While the beginning of a new cycle is often typified by a supply shortfall, the dearth of new supply coming online in 2012 is surprising.

Despite the previously mentioned net negative migration in 2010, projected employment growth in years to come and the fact that relatively little new supply will impact the market in 2012, means that there is potential for vacancies to reach historic lows. Clearly, the tightening of the credit markets in 2008-2009 has had a significant impact on the development pipeline.

In the table below, we can see that our in-house supply/demand models predict vacancies at, or in most cases below, the 3.0% mark within two years. Though, it should be noted that as vacancies drop below that mark, rents will be driven upward, which will likely have a mitigating effect on demand and/or shift demand away from core areas. It is likely that vacancies in most areas will not get quite as low as our models predict, however, they will certainly trend downwards in the face of strong demand (over, 7,000 units per annum through 2013) and a supply shortfall.

Seattle Metro Market Summary

Sub Market	Market Size	% Vacant	No. Vacant	2 Year Demand	2 Year Supply	D-S Net	2 Yr. Mkt Size	2 Yr. Vac. Rate**	Total Vacant
Seattle	152,415	2.8%	4,300	6,132	3,933	-2,199	156,348	1.3%	2,101
Eastside	64,455	2.3%	1,452	1,533	878	-655	65,333	1.2%	797
Southend	81,210	5.1%	4,135	3,081	799	-2,283	82,009	2.3%	1,852
Snohomish	61,296	3.4%	2,095	1,761	577	-1,184	61,873	1.5%	911
Metro *	**359,376**	**3.3%**	**11,983**	**12,507**	**6,187**	**-6,320**	**365,563**	**1.5%**	**5,662**

*** Weighted Average**

****Vacancies unlikely to reach lows presented here. Rising rents will either decrease demand or push demand out to other markets**

Seattle Metropolitan Apartment Market Data & Forecast

Apartment Trend Analysis
Seattle MD, 2003-2010

	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 Rent Change**
2003	2,416,800	0.60%	1,322,100	-1.14%	973,240	0.67%	347,423	3,947	4,976	6.6%	0.1%
2004	2,433,100	0.67%	1,334,100	0.91%	985,640	1.27%	348,343	396	6,507	6.7%	1.9%
2005	2,464,100	1.27%	1,369,800	2.68%	1,002,840	1.75%	347,155	4,648	4,902	5.1%	2.0%
2006	2,507,100	1.75%	1,414,800	3.29%	1,019,040	1.62%	345,185	3,959	4,853	3.4%	13.0%
2007	2,547,600	1.62%	1,458,900	3.12%	1,032,320	1.30%	347,625	2,021	5,944	3.5%	8.5%
2008	2,580,800	1.30%	1,476,700	1.22%	1,045,440	1.27%	350,105	(3,035)	6,931	5.0%	1.4%
2009	2,613,600	1.27%	1,398,100	-5.32%	1,057,834	1.19%	353,989	1,202	2,856	5.7%	-10.3%
2010	2,644,584	1.19%	1,375,100	-1.65%	1,063,840	0.57%	358,120	9,427	3,320	4.2%	4.0%
5 Yr. Avg.		1.34%		0.13%		1.19%		2,715	4,781	4.4%	3.3%

Apartment Demand Forecast
Seattle MD, 2011-2014

	Population Forecast		Employment Forecast		Household Forecast		Apartment Demand Forecast				
Year	**Total Persons**	**Percent Change**	**Total Jobs**	**Percent Change**	**Total Households**	**Percent Change**	**Total Units**	**Total Demand**	**Units Under Const.**	**Vacancy Rates**	**Rent Change**
2011	2,659,600	0.57%	1,410,700	2.59%	1,074,114	0.97%	359,336	4,604	3,114	3.2%	9.1%
2012	2,685,284	0.97%	1,434,292	1.67%	1,085,117	1.02%	362,193	7,164	N/A	2.0%	7.4%
2013	2,712,793	1.02%	1,457,074	1.59%	1,097,062	1.10%	367,216	7,602	N/A	1.3%	5.0%
2014	2,742,656	1.10%	1,487,568	2.09%	1,109,365	1.12%	375,216	7,667	N/A	1.3%	4.9%
4 Yr. Avg.		0.9%		2.0%		1.05%		6,759		2.0%	6.6%

(1) Population as of April 1st.
(2) Excludes Military & Self-Employed
(3) Total households are estimates

Metropolitan Area is King & Snohomish Counties
Sources: WA State Employment Security & WA State Office of Financial Management
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 2008 rent growth effectively stopped. Vacancy continued to decline into the first half of 2009, which lead to aggressive rent cuts. Quickly responding to a rapid drop in vacancies, Seattle MD rents grew by 5.4% in 2010. Based upon our estimates of new apartment supply and demand, we estimate healthy rent growth going forward. We anticipate annual rent growth factors of 9.1% in 2011, 7.4% in 2012 and 5.0% as supply catches up with demand in 2013.

Seattle Metropolitan Re	
Submarket	**2004**
Seattle	2.1%
Eastside	0.9%
Southend	2.2%
Snohomish	2.3%
Metro Total*	**1.9%**

***Weighted Average**

Seattle Metropolitan Re	
Submarket	**2007**
Seattle	4.6%
Eastside	14.2%
Southend	9.8%
Snohomish	19.2%
Metro Total*	**10.1%**

Looking Back & Moving Forward

The current story of the Seattle MD apartment market is one of market imbalance. To understand this story, it helps to take a look back at previous years and the factors that lead to the current supply shortfall (in the face of strong demand, no less).

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

During 2006, the vacancy rate for the Seattle metropolitan region dropped from 5.1% in 2005 to 3.4% by the end of 2006. The vacancy rate remained 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. Healthy 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.

In 2008 we saw vacancy rates experience a rise of about 1.5% to end that year at 5.0%. They edged higher, to 5.7% by mid-2009, where they remained for the rest of that year. The previously mentioned pool of single-family and condominium rentals, or “shadow market,” was a significant factor in the rise in vacancies, however, it is not the only one.

Similar to a trend witnessed in the late 90’s, we were experiencing substantial growth in the roommate market. This trend, along with the greater effects of the shadow market supply, was visible in our collected data in the form of negative apartment demand in 2008. The following positive demand experienced in 2009 was mainly attributed to new projects, most of which were offering significant rent concessions.

As market conditions improved, we have begun to see a reversal of the above trends. Initially, we believed that it may take years for the market to recover. However, 2010 displayed that the market has a capacity to react rapidly when the right conditions are present. Certainly, the deep rent cuts in 2009 (-10.3%, Seattle MD) and offering of significant concessions was a major factor in bringing the renters back to traditional multi-family apartment product.

While the consumers of apartment product have reacted rather quickly, the producers, or developers, have had their hands tied for some time. In the face of difficult economic conditions and often dire reports from many economic news outlets, lending institutions and potential equity partners greatly tightened their policies and practice. The lack of available financing has prevented the precipitation of an adequate supply pipeline. The year 2012 will be especially evocative of this trend as nearly no new apartment supply will be completed that year. By mid-2013, significant supply will begin to affect the market, however, supply won’t likely outpace demand until 2014.

Throughout this period, we recommend that the reader stay abreast of the housing tenure relationship between the ownership and rental markets. This topic can be further explored in the PDF found on our website titled Housing Tenure. The significant shift towards rental housing is likely to remain the greatest factor affecting apartment demand in the next few years.

As previously mentioned, both net migration and employment growth are expected to be positive and healthy going forward for the next few years. Given these factors, we have estimated demand to be over 7,000 units until 2014, the first year in which new supply will likely have a chance to outpace with demand. Until then, vacancies will continue to drop, potentially reaching historic lows in some submarkets, and there will be solid upward pressure on rents.

For more information on services offered by the

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