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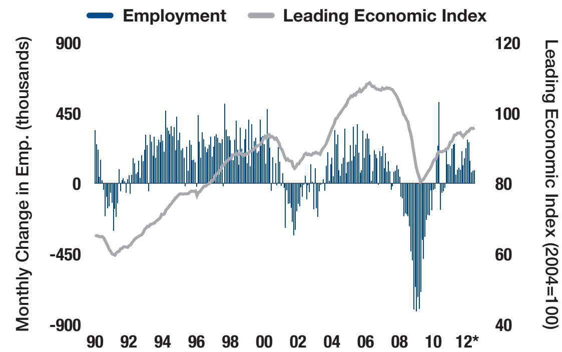
THE OUTLOOK

U.S. Economic Expansion Once Again Mired in Uncertainty

For the third consecutive year, the U.S. economy faces summer doldrums as a series of recurring issues quell economic growth and business optimism. Troubles rippling through Europe, election year fiscal politics, and an increasing number of weakening economic indicators converged to impede economic growth. European countries, crippled by high levels of bad debt and only marginal growth, have deepened the debt crisis and eroded demand for U.S. products. In addition, the U.S. faces a "fiscal cliff" as numerous critical policies sunset early next year, adding to the uncertainty inherent in a slow growth economy and election year. Payroll and Bush-era tax cuts, which reduced burdens on consumers and business, will expire early next year, potentially impairing growth rates. In addition, changes in spending policies will shear government consumption and expiring emergency unemployment benefits could diminish disposable income for consumers, generating a drag on GDP. Although it is highly unlikely the current administration will permit this scenario to play out, the prospect of these changes overshadows business and consumer confidence and have manifested in slower hiring, inventory building, and equipment and software spending.

Employment vs. Leading Economic Index



* Employment through June; Leading Economic Index through May
Sources: Marcus & Millichap Research Services, BLS, The Conference Board

The slower pace of growth aligns with expectations of nearly one year ago that anticipated a deceleration in U.S. productivity, as reflected in the 1.9 percent GDP growth of the first quarter this year. Many GDP components reflect the adverse impact of slower global growth, but others highlight recovery in key areas of the domestic economy. Despite tepid GDP gains, corporate profits have advanced well beyond pre-recession levels and companies remain flush with cash, benefiting from low leverage and access to low-cost capital. Consumer fundamentals remain in flux, weathering protracted slow job and income growth, but emerging from the recession with strengthened balance sheets, greater credit availability and benefiting from low inflation and declining energy prices. Retail sales still reflect solid performance, despite the emergence of a downward bias in monthly trends; however, the nascent recovery in the residential sector will lift consumer spending as home sales gain momentum. New and existing home sales now evince solid traction in sales volume and pricing, while permit issuance, especially for multifamily units, now approaches the highest levels in three years.

- **Declines in key metrics result in lower, slow-growth expectations.** Given the slack in the economy, the Fed extended Operation Twist and continued to rollover short-term debt to longer-dated securities, with the goal of containing mortgage rates and spurring corporate investment. The Leading Economic Index and current conditions in key indicators exhibit significant stalling or outright declines, but forward-looking components appear optimistic.

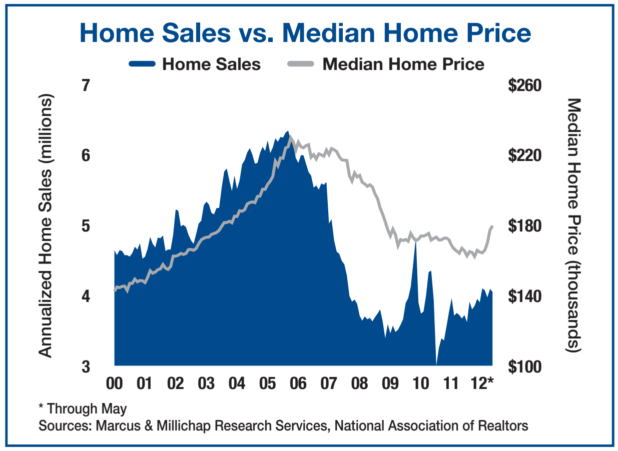
- **The Philadelphia Fed Manufacturing Survey showed a contraction in the new orders component, reflecting deteriorating sentiment in current conditions.** Factory orders have declined in four of the last five months; however, notably lower input continue to sustain healthy corporate profits. In addition, the number of employees component increased modestly, signaling the need for future hiring.

- **Sluggish income growth, stalling retail sales, and a lull in other retail segments point to a weaker spending trajectory.** Total retail sales dipped in June, declining 0.5 percent, but reflect 3.8 percent growth on an annualized basis. Auto sales continue to be a pillar of support, measuring 7.5 percent higher over the year. The recent easing in gas prices and a contraction in building materials sales accounted for the majority of June's headline sales decline, although lower gas prices clearly benefit consumers' disposable income. Online retail sales represent a bright spot, posting annualized growth of 12.8 percent.

• **Private-sector employment growth mitigates public-sector job losses.** June's discouraging employment report noted a net addition of 80,000 jobs, reflecting both the resumption of government job losses, totaling 4,000 and the addition of 84,000 private-sector jobs. Annualized job growth as of June rose 1.4 percent, totaling 1.8 million positions, although year-to-date employment is up 0.7 percent. The professional and business services, leisure and hospitality, and manufacturing sectors led June's monthly employment gains. In perspective, although the U.S. remains five million jobs shy of the pre-recession peak, it has restored nearly 3.9 million positions to the labor market.

Forecast:

The Fed downgraded its near-term outlook for the U.S. economy in response to the disappointing pullback in business cycle indicators, loss of momentum in the labor markets, and perpetuation of the eurozone debt crisis. GDP will reach the low 2.0 percent range in 2012, while payrolls are forecast to expand by another 2.2 million jobs, reducing the unemployment rate to 8.0 percent. Employment growth may trend at sub-par levels until GDP moves beyond its historical average of 2.8 percent. Clarity from political elections and fiscal policy will help dissipate the current "wait and see" sentiment.



• **A still-vulnerable residential sector show signs of recovery.** Sales of existing single-family homes returned to its long-term trend, approaching an annualized 4.6 million units in May, and resulting in a 21 percent decline in inventory to 6.6 months at the current sales pace. The median sale price increased by 7.9 percent to $179,190, lifted by a reduction in distress sales. In addition, new home sales rose an annualized 7.6 percent in May, along with a 5.6 percent increase in the median sales price to $234,500. Residential permits increased 49 and 10 percent for multi- and single-family units, respectively, as of April this year. Multifamily permits are forecast to comprise more than 40 percent of total permits in 2012 and 2013, a ratio well above trends of the past 25 years.

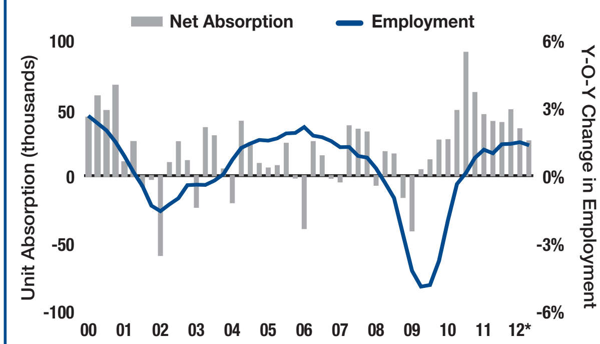
• **Consumer spending continuing to advance based on stabilized balance sheets and improved financial health.** Consumers have regained traction in their finances and exhibited a willingness to spend. Household debt service payments as a percentage of disposable income has fallen sharply from its 2008 peak to the current 11.25 percent. In addition, credit card delinquency rates have fallen from their record highs of 2009 and consumer loans have declined to levels lower than the average rate of the last two decades. Private-sector wages rose 5.3 percent in 2011, while personal consumption overall rose 4.7 percent.

• **U.S. banks will remain well-capitalized and profitable.** Although downgrades to bank bonds and financial regulatory reform loom on the horizon, banks will gradually expand their lending capacity, which will stimulate the residential and commercial real estate sectors. CMBS issuance increased to $4.7 billion in May, the highest monthly volume in 15 months, despite a high 9.1 percent delinquency rate.

• **Modest economic growth offering unique opportunities.** The economy remains strong enough to generate a moderate recovery in property fundamentals but tepid enough to restrain inflationary pressure and interest rates. Treasury rates remain so low that risk-averse investors have been able to maintain positive leverage even on core commercial real estate, allowing them to fulfill the requisite balance of safety against yield.

Apartment Demand Undeterred by Summer Doldrums and Slower Hiring

Apartment Absorption vs. Employment



* Through 2Q
Sources: Marcus & Millichap Research Services, BOC, Reis

The disappointing and markedly slower pace of employment gains had little impact on the steady demand for apartments in the second quarter. Rental housing remains essential for a growing population, even in periods of uncertainty and economic malaise. Conditions remain favorably aligned for sustainable, strong apartment performance. Robust demographic trends, including higher levels of immigration, the surge in echo boomers forming their own households, a further shift away from homeownership, and the growing diversity in household composition support continued demand for rental housing. In addition, economic trends maintain a favorable bias toward renting as the sluggish pace of growth slows even further and payroll expansion cools. Other factors influencing the market include the often high level of college debt diminishing the purchasing power of young people as well as the significant decrease in the net wealth of baby boomers, which has limited their ability to help with downpayments.

As the national vacancy rate dipped to a decade low, rent growth and inflation continued to outpace income growth. Second-quarter net absorption totaled more than 30,000 units. The second-quarter apartment vacancy rate measured 4.7 percent, representing a 20-basis point decline from last quarter and 120-basis point plunge from one year earlier. Effective rents grew 3.5 percent nationally measured on a year-over-year basis, with coastal and supply constrained markets continuing to garner double-digit increases. Effective rents across most markets now meet or exceed their prior peaks. The trough of rent declines occurred in the fourth quarter of 2009. Since then, the U.S. has posted cumulative effective rent growth of 6.9 percent to the current $1,002 monthly rent, or 2.7 percent annually. In fact, half of the major U.S. metro markets increased rents by 3.0 percent or more. In comparison, the compounded annual growth rate for hourly wages over the past year has been 1.9 percent, eroded by a 2.3 percent inflation rate, thereby causing a decline in discretionary income. In many markets, annualized rent increases have been much more robust than the national average and renters have displayed increased sensitivity to strong rent hikes. In addition, employment gains historically exhibit a stronger correlation to rent growth than to net absorption, so a weaker pace of job growth implies temporary near-term moderation in the magnitude of rent increases.

The low cost of funds and ample liquidity for apartment development has ignited a new construction cycle. Last year's record-low completions totaled less than 40,000 units. The forecast for supply in 2012 calls for 85,000 units, of which less than 15 percent was delivered in the first quarter. Whether the other 85-plus percent will deliver as scheduled remains a question as construction loans and the potential for development delays can shift timing unpredictably. Apartment REITs will lead the development charge. Avalon Bay (AVB) focuses on coastal, high-barrier-to-entry markets and reportedly has a $1.6 billion development pipeline, while Camden Properties has $550 million of product underway in high-growth, affordable markets such as Dallas/Fort Worth and Atlanta. Dallas, Houston, Austin, New York, Washington, D.C., Seattle and San Jose will receive the majority of new supply in 2012, but only San Jose, New York and Washington, D.C., really stand out in terms of risk with new supply to inventory ratios running well above their long-term averages. These three markets, however, have expensive housing costs that create a large base of renter households and the lowest vacancy rates in the country at 2.7, 1.8 and 3.9 percent, respectively. Therefore, they tend to assimilate new product relatively quickly in a rising economy.

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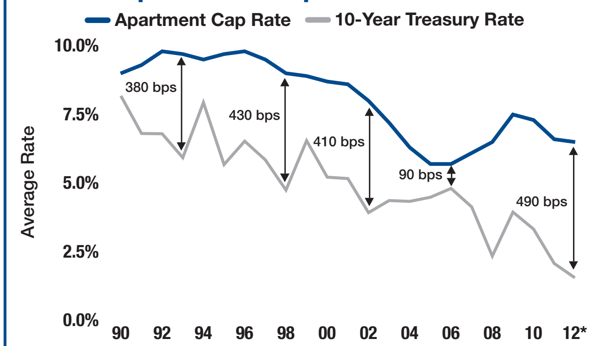
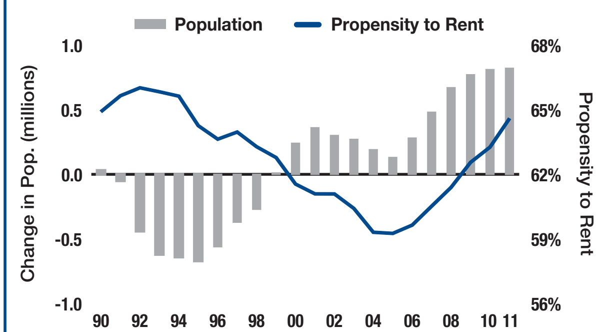
Ready capital availability, favorable demographic forces, and a lower investment risk profile continue to attract investors to apartments. Second-quarter apartment sales volume totaled $24.9 billion, representing a 38.6 percent year-over-year increase. Although the number of transactions in the $40 million-plus market segment declined modestly, the dollar volume for $40 million-plus transactions surged nearly 79 percent on a year-over-year basis, boosted by a surge in portfolio sales. The average price per unit rose 6.6 percent to $101,000, nudging cap rates down 30 basis points to 6.2 percent. Portfolio sales of garden apartments drove an 8.2 percent rise in the price per unit to $78,000, still 12.0 percent lower than the 2007 peak. A significant increase in distressed sales reflects investor confidence in improving market fundamentals for Class B and C properties and secondary markets. To date this year, Class C properties have made the biggest strides in occupancy, up 100 basis points in the first half of the year. Stronger sales will ease value and financing challenges and create a broader spectrum of opportunities and investment strategies.

Apartment Cap Rate Trends



* Through July 16
Includes sales $1M+
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

Change in Population vs. Propensity to Rent
20- to 34- Year-Old Cohort



Sources: Marcus & Millichap Research Services, BOC

Forecast:

• Interest rates are forecast to remain low until the economy proves it is in a self-sustaining recovery and less reliant on aggressive monetary policy support. Low long-term interest rates support home mortgages and suggests home sales will continue to strengthen. While this does pose some risk to apartment demand, with home sales having already trended back to the long-term average, most apartment owners and managers report that the incidence of residents leaving to purchase homes remains well below their historical norm. It is likely that prospective homeowners do not feel significant pressure to lock in current interest rates as most perceive the opportunity will remain open for some time to come. Assuming the economy strengthens and employment forecasts come to fruition, housing demand will be adequate to support both the multifamily and single-family sectors.

• The U.S. apartment market shows no signs of weakening, as demand for apartments transcends age cohorts and income groups. The U.S. is expected to add 2.4 million residents in the prime renter age cohort of 20 to 34 year olds over the next five years at annual growth rates not attained since the early 1980s. The momentum of increasing numbers of echo boomers entering the work force and forming their own rental households, and rising immigration levels will continue to significantly surpass new construction of rental units.

• Forecast completions of 85,000 units will total about half of what is necessary to accommodate expected demand, pushing the national vacancy rate down another 30 basis points to 4.4 percent by year end, the lowest rate in 11 years. Tight supply conditions will narrow the gap between monthly asking and effective rents, with annualized effective rent growth expected to approach 5.0 percent and set a new peak at $1,027.

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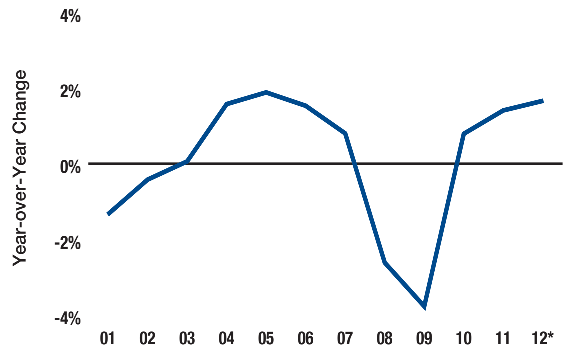
THE APARTMENT OUTLOOK

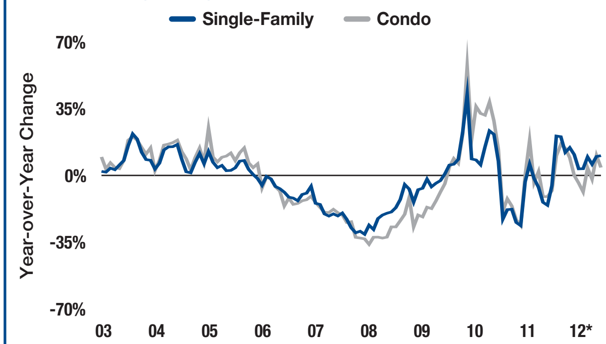
Apartment Market Vital Signs

U.S. Employment Trends



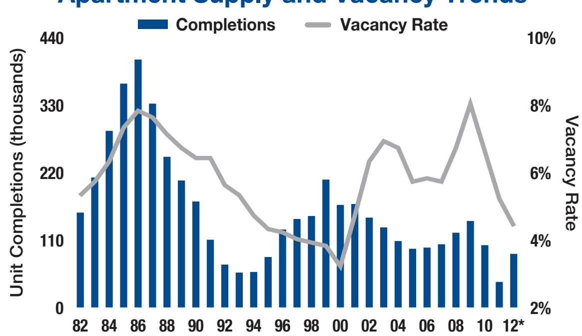
* Forecast
Sources: Marcus & Millichap Research Services, BLS

Existing Single-Family and Condo Sales



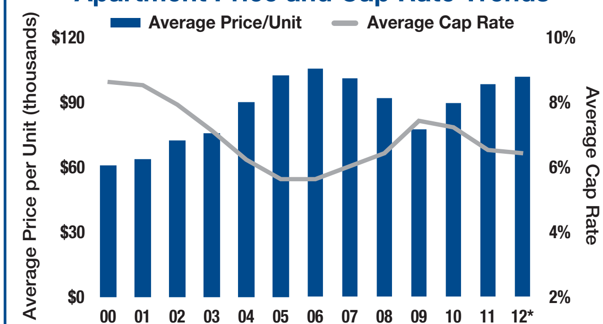
* Through May
Sources: Marcus & Millichap Research Services, National Association of Realtors

Apartment Supply and Vacancy Trends



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Apartment Price and Cap Rate Trends



* Trailing four quarters through 2Q
Includes sales $1 million and greater
Sources: Marcus & Millichap Research Services, CoStar Group, Inc.

2Q 2011 to 2Q 2012 Change in Apartment Vacancy

Top Markets by Change in Vacancy

Metro	2Q 2012	Y-O-Y Chg. (bps)
Houston	7.6%	-220
Charlotte	5.2%	-190
Phoenix	6.4%	-190
Columbus	6.1%	-190
Atlanta	7.1%	-170
Austin	4.3%	-170
Tucson	5.7%	-170
Jacksonville	8.2%	-160
Dallas/Fort Worth	5.7%	-160
Salt Lake City	4.0%	-160
U.S. Metro Average	**4.7%**	**-120**

Bottom Markets by Change in Vacancy

Metro	2Q 2012	Y-O-Y Chg. (bps)
Boston	3.7%	-70
San Francisco	3.1%	-70
San Jose	2.5%	-70
St. Louis	6.2%	-70
Milwaukee	3.5%	-60
Minneapolis	2.4%	-50
New York	2.2%	-50
Louisville	4.7%	-20
New Haven	4.1%	-10
Denver	5.1%	30
U.S. Metro Average	**4.7%**	**-120**

Sources: Marcus & Millichap Research Services, Reis

For more information, contact John Chang, Vice President, Research Services, at john.chang@marcusmillichap.com.