

The Seattle Apartment Market Report

Volume 4, Issue 2, October 2007

Raising Rents Again?

"Did you hear how much he made on his condominium?" was the common refrain in 2005 and 2006. But as the condominium market has tempered in 2007, the new subject of interest is the apartment rental market. Specifically, "Your rents went up by how much?"

Seattle's apartment market languished post dot-com bust through early 2005. In 2006, everything changed and we saw record rent increases. The Seattle and Snohomish markets experienced rent increases of 15%, while rents increased 13% in the Eastside and a more modest 7% in the Southend. The major driver of this huge turnaround in apartment rents was due to a rapidly declining supply of apartments - everyone was building condominiums, or converting apartments into condominiums. The supply of existing and new apartment stock rapidly dwindled causing vacancy rates to plummet and rents to rise.

In 2007, the Seattle apartment market is still experiencing vacancy rates far below equilibrium (at 2.5% in Seattle and 2.2% on the Eastside) and as such, rents continue to leap forward. In the first half of 2007, our rent survey indicates that rents increased 2% in Seattle, 7% on the Eastside, 5% Southend and 10% Snohomish.

What does this mean in real dollars? If the typical good quality one-bedroom apartment in Belltown or Capitol Hill rented for \$1,500 in early 2006 - their rent would have risen \$225 to \$1,725 per month in 2006. Those same renters would have received a notice in mid-2007 that rent is increasing another \$35 per month. And, according to our forecasts, by the end of year 2007, they should receive a third notice to expect rents to increase another \$90 (+5%) to \$1,850. That is a \$350 per month increase, or 23%, during a two-year period (2006 & 2007).

Are these increases sustainable? The short answer appears to be yes. Vacancy rates are expected to continue at historically low levels. Current vacancy rates in Seattle are at 2.5%, the Eastside is at 2.2% with the Southend and Snohomish County exhibiting the highest rates at 3.5% and 3.4% respectively - all still considerably lower than an equilibrium vacancy rate at 5%.

Until apartment supply equals apartment demand, the Seattle market will continue to experience

Current Rent Change	
Submarket	1st Half 2007
Seattle	2.3%
Eastside	7.1%
Southend	4.9%
Snohomish	9.6%
Metro Total*	5.0%

*Weighted Average

Seattle Metropolitan Vacancy Forecast			
Submarket	Summer 2007	Summer 2008	Summer 2009
Seattle	2.4%	1.9%	2.3%
Eastside	2.1%	1.2%	1.5%
Southend	3.4%	1.8%	1.2%
Snohomish	3.2%	2.4%	2.7%
Metro Total	2.8%	2.0%	2.0%

strong rental rates increases. We are beginning to see an increase in apartment supply. But as of yet, the number of new apartment units planned does not yet exceed the demand for those units. In the next two years, 9,418 apartment units are expected to complete. Of these units, 4,003 will be located in Seattle (43% of total supply), with 1,986 units located on the Eastside (21% of total supply). The remaining units are proposed or under construction in the Southend (1,719 units) or Snohomish County (1,710 units).

Considering that total apartment demand projected over the next two years is approximately 12,963, the introduction of 9,418 new apartment units fails to meet demand; thus vacancy rates will continue to decline pushing rents even higher. Our projections indicate that vacancy rates for the Seattle Metro Area over the next two years will lower to 1.7%.

In summary, the 'wild' apartment rent increases experienced in 2006 are far from over. In 2007, rents are expected to increase 4.3% in Seattle, 14.2% in the Eastside, 9.8% in the Southend and 19.2% in Snohomish County. During the three year period between 2006 and 2008, apartment rents are forecasted to increase 32% in Seattle, 37% on the Eastside, 47% in Snohomish County and 24% in the Southend.

What is *great* news for landlords, is far from great new for renters! Until supply begins to meet demand, renters in the Seattle area will continue to experience percentage rent hikes in the double-digits. Looking at proposed supply and estimated demand, we do not foresee that renters will not enjoy any easing until after 2009.

~Jennifer Warren, Associate

Seattle Metro Market Summary					
Sub Market	% Vacant	2 Year Demand	2 Year Supply	S/D Net	2 Yr. Vac. Rate
Eastside	2.2%	2,586	1,986	(600)	1.2%
Seattle	2.5%	4,374	4,003	(371)	2.2%
Southend	3.5%	3,704	1,719	(1,985)	0.9%
Snohomish	3.4%	2,298	1,710	(588)	2.3%
Metro *	2.8%	12,963	9,418	(3,545)	1.7%

* 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. The *Seattle Apartment Market Report* is edited by Andrew Murray, Associate.

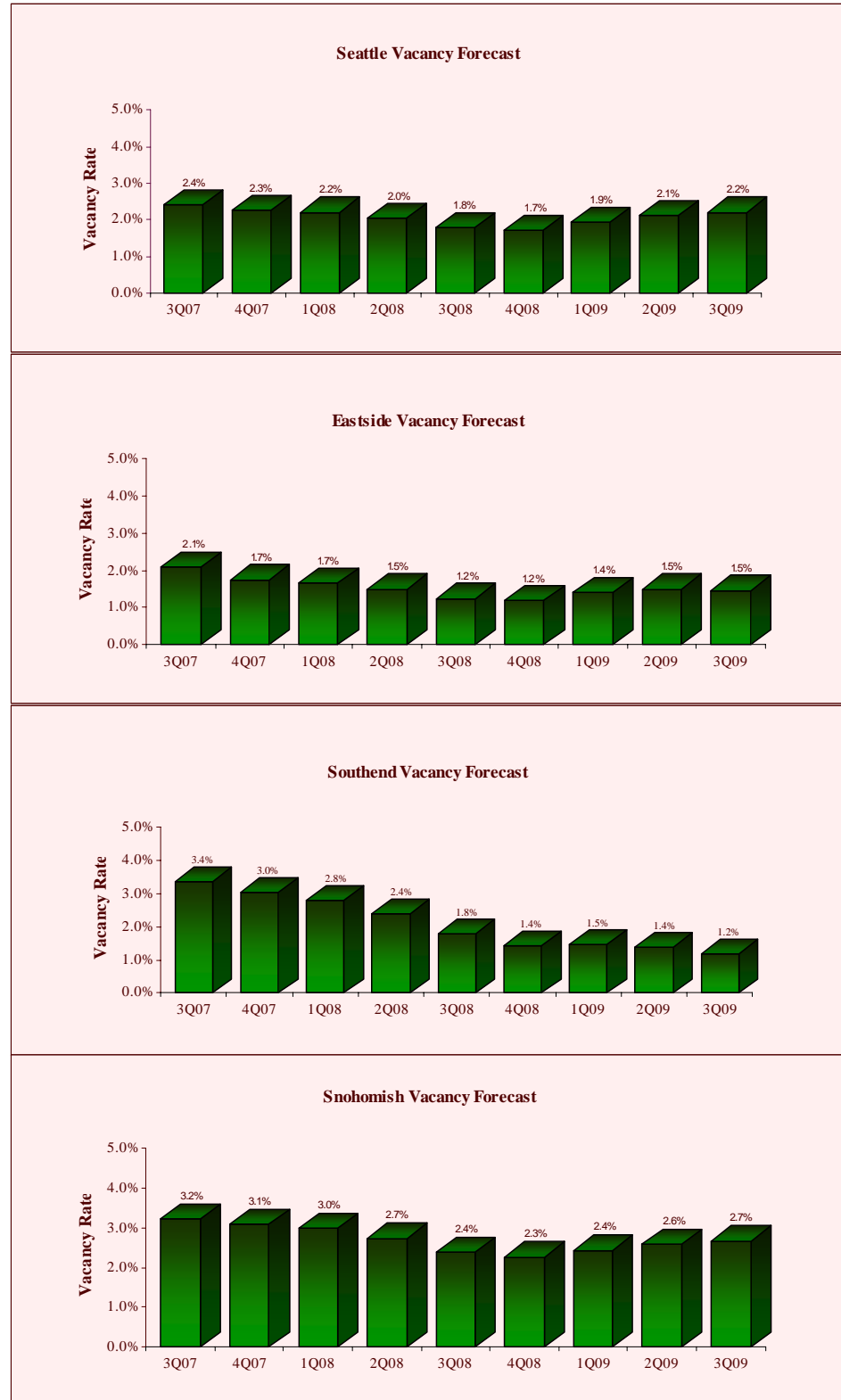
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Vacancy Forecast

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 percentage points above

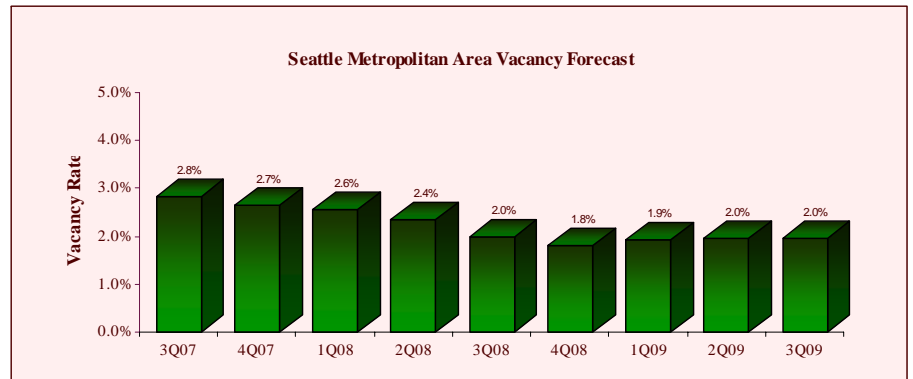
physical vacancies. This is due primarily to monthly turnover. The close-in markets are reporting that rent concessions have become nearly non-existent due to the tightness of the current market conditions.



Vacancy

Our June 2007 vacancy survey covered over 120,000 units. Overall, physical vacancy was estimated at 2.8% for the Metro region and is allocated among the primary markets and submarkets as shown below.

Vacancy rates have decreased significantly over the past year and a half, down from 5.1% at the end of 2005 and 3.4% at the end of 2006. Our vacancy rate forecast for the Seattle Metropolitan Area shows vacancy rates continuing to trend lower as the market tightens.



SEATTLE			
Submarket	Units	Vacancy	Percent
Ballard/Fremont	316	5	1.6%
Beacon Hill/Central District	308	11	3.6%
Capitol Hill/Eastlake	791	13	1.6%
Denny Regrade/Belltown	3,235	161	5.0%
Downtown/First Hill	2,835	55	1.9%
Greenlake/Greenwood	259	4	1.5%
Lake City	1,164	12	1.0%
Lake Forest Park	156	2	1.3%
Magnolia/Queen Anne	1,237	24	1.9%
Northgate	1,204	17	1.4%
Northwest Seattle/North City	845	18	2.1%
Rainier Valley/South Seattle	708	29	4.1%
University/Ravenna/Sandpoint	1,195	17	1.4%
West Seattle	1,438	23	1.6%
Total	15,691	391	2.5%

EASTSIDE			
Submarket	Units	Vacancy	Percent
Suburban Bellevue	8,595	185	2.2%
Downtown Bellevue	646	7	1.1%
Bothell/Woodinville	4,266	129	3.0%
Issaquah	1,806	35	1.9%
Kirkland	2,970	77	2.6%
Mercer Island	646	20	3.1%
Redmond	4,979	81	1.6%
Total	23,908	534	2.2%

SOUTH END			
Submarket	Units	Vacancy	Percent
Auburn	2,268	44	1.9%
Burien/Des Moines	3,668	121	3.3%
Enumclaw	247	9	3.6%
Federal Way	7,923	276	3.5%
Kent	11,155	427	3.8%
Renton/Maple Valley	8,526	354	4.2%
SeaTac/Tukwila	4,240	94	2.2%
Total	38,027	1,325	3.5%

SNOHOMISH COUNTY			
Submarket	Units	Vacancy	Percent
Edmonds	921	25	2.7%
Everett	7,941	384	4.8%
Lynnwood/Shoreline	4,715	135	2.9%
Marysville	316	9	2.8%
Mill Creek/Canyon Park	2,615	49	1.9%
Monroe	248	1	0.4%
Mukilteo	956	23	2.4%
Mountlake Terrace	1,665	30	1.8%
Total	19,377	656	3.4%

PIERCE COUNTY			
Submarket	Units	Vacancy	Percent
Fife/Milton	1,595	74	4.6%
Fircrest/University	3,464	136	3.9%
Gig Harbor	699	36	5.2%
Lakewood	2,669	120	4.5%
Puyallup/Sumner	4,107	250	6.1%
Tacoma	12,510	490	3.9%
Total	25,044	1,106	4.4%

Vacancy Summary			
County	Market Size	Survey	Weighted*
King and Snohomish	342,804	3.0%	2.8%
King	282,082	2.9%	2.7%
Snohomish	60,722	3.4%	3.4%
Pierce	25,044	4.4%	4.4%

*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 2007 and the continued struggles of Airbus, Boeing is projected to continue its growth through the end of 2007 and

into 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. Just recently, Boeing announced that the launch of the new 787 will be delayed 6 months due to assembly problems, however they do not anticipate any adverse financial impact as a result of this delay in production.

Employment numbers as of June 2007 indicate that the Puget Sound

has added 55,200 new jobs, a 3.9% increase from the December 2006 employment numbers. This annual growth of Puget Sound employment is the best showing in nine 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 2.3% in 2008 and 1.7% in 2009, which is still twice the forecasted national rate. .

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, 2007 population estimate, the Seattle metropolitan area experienced a net in-

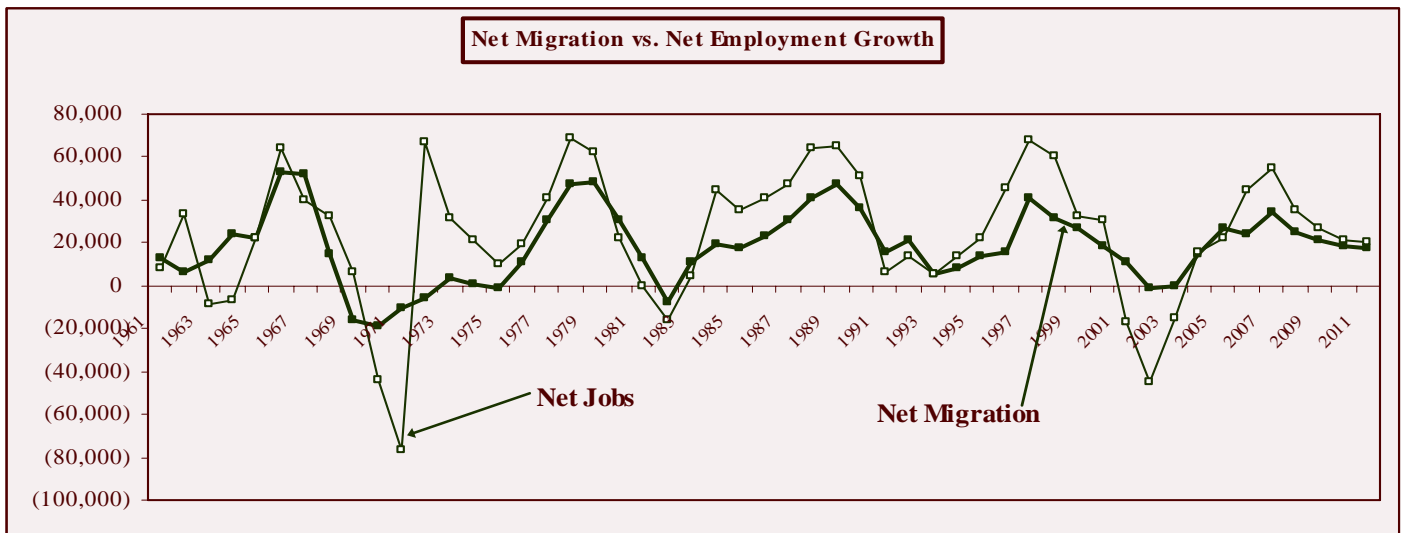
migration of approximately 24,450 people in 2007. This resulted in a total population increase (natural increase plus net migration) of approximately 41,000 people, or 1.6%.

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 and strong positive net migration to the region is expected to continue.



Apartment Demand

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

During 2007, the Seattle metropolitan area is reporting its fourth year of positive employment growth since 2000. This continuation of growth in the employment sector has lead to increased net migration and thus, increased levels of new apartment demand. This is in contrast to 2004, when net migration remained low and thus, new apartment demand remained low as well. New apartment supply has increased in 2007, continuing 2006's dramatic increase in supply over 2005's low point, but supply is still low compared to historic levels. Vacancy

Absorption

Absorption rates in the metro area, measured on a per-project basis, ranged from 10 to 22 units per month, with an average of 13 units per month. During the first half of 2007, 1,610 new units were absorbed by the market. This implies an annualized figure of 3,220 units. In comparison, the year 2006 saw a total of 1,928 units absorbed by the market.

In June 2007, there were 719 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 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.

rates have continued to plummet as apartment demand increases and an 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 apartment demand estimate for the Seattle metropolitan area of 4,959 units. New apartment demand during the years

2008 and 2009 will increase to around 5,982 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	1,736	2,034	1,974
Eastside	942	1,196	1,256
Southend	1,438	1,735	1,735
Snohomish	843	1,017	1,017
Metro Total	4,959	5,982	5,982

First Half 2007 Absorption Summary			
Submarket	Units Leased	Vacant Units Remaining	Average Monthly Absorption
Seattle	629	277	10
Eastside	171	55	10
Southend	493	253	17
Snohomish	317	134	22
Metro Total	1,610	719	13

condominium). This information was calculated for each of the four major markets within the Seattle metropolitan area.

As of June 2007, the Seattle metropolitan area had 719 vacant units in lease-up, implying an annual figure of 1,438 units. This number is lower than historical levels. The Southend and Seattle markets are the leading

contributors to this total, with 253 and 277 vacant new units respectively. The Eastside and Seattle markets have the largest number of units under construction with 1,372 and 1,381 units respectively.

The entire Seattle metropolitan area has a total of 3,661 units under construction, resulting in a two year pipeline of 4,380 units.

Seattle Metro Supply Survey					
Sub Market	Jun-07 % Vacant	Average Absorption Complex/Mo.	Vacant In Lease-Up	Under Constr.	Total 2 Yr. Pipeline
Eastside	2.2%	10	55	1,372	1,427
Seattle	2.5%	10	277	1,381	1,658
Southend	3.5%	17	253	472	725
Snohomish	3.4%	22	134	436	570
Metro *	2.8%	13	719	3,661	4,380

* 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.

Except for Snohomish County, which stayed the same, each of the submarkets showed tightening vacancy rates. The Eastside market showed the largest decrease in vacancy, dropping from 4.2% at the end of 2006 to 2.2% in June 2007. The Seattle submarket dropped slightly from an already tight 2.8% down to 2.5%. The Southend market also dropped slightly from 2.9% down to 3.5%. We forecast 3,704 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 (1,719 units) during the same time period and will cause the Southend vacancy rate to decrease, ceteris paribus, below 1% by the middle of 2009.

In fact, our forecast shows a two year undersupply of new units in all of the regional submarkets. Clearly, the Southend market is the least balanced submarket with an undersupply of nearly two-thousand units. Demand in the Southend has been increasing while supply has not kept pace. Elsewhere, the Seattle market is in relative balance with an undersupply of only 371 units. In the largest submarket in the region, this minor undersupply should only drop vacancy rates by thirty basis points. In recent years, the focus in the Seattle

submarket has been on condominium development. While this certainly is still occurring, new apartment development is beginning to pick up in response to rising rents and lower vacancy rates.

Both the Eastside and Snohomish markets are showing a two year undersupply of around 600 units. This undersupply shows vacancy rates dropping to 1.2% in the Eastside and 2.3% in Snohomish County.

Overall, the two-year new apartment demand for the Seattle metropolitan area is estimated at 12,963 units and two-year new apartment supply will total 9,418 units. New apartment demand is expected to outnumber supply by 3,545 units and vacancy rates can be anticipated to fall from 32.8 to 1.7% 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	58,683	2.2%	1,311	2,586	1,986	(600)	60,669	1.2%	710
Seattle	141,734	2.5%	3,532	4,374	4,003	(371)	145,737	2.2%	3,160
Southend	78,689	3.5%	2,742	3,704	1,719	(1,985)	80,408	0.9%	757
Snohomish	60,498	3.4%	2,048	2,298	1,710	(588)	62,208	2.3%	1,460
Metro *	339,604	2.8%	9,633	12,963	9,418	(3,545)	349,022	1.7%	6,087

* 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%	1,422,300	3.2%	1,005,257	1.7%	335,274	1,928	4,853	3.4%	13.0%
5 Yr. Avg.		1.1%		0.4%		1.2%		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	2,547,600	1.6%	1,477,500	3.9%	1,025,197	2.0%	334,484	4,959	4,141	1.7%	10.0%
2008	2,597,451	2.0%	1,512,960	2.4%	1,041,556	1.6%	337,700	5,982	4,000	0.8%	10.5%
2009	2,638,347	1.6%	1,540,193	1.8%	1,056,422	1.4%	343,700	5,235	6,000	1.1%	9.5%
2010	2,675,512	1.4%	1,561,756	1.4%	1,070,259	1.3%	351,700	4,757	7,000	2.0%	5.0%
4 Yr. Avg.		1.6%		2.4%		1.6%		5,233	5,285	1.4%	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						O'CONNOR CONSULTING GROUP,LLC: Brian R. O'Connor, MAI					
(4) Historical Permits Include Condominiums, Source HUD											

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%. Our half year survey of 2007 shows rents have risen by 5%. Annualized, rents are expected to increase by 10.1% through 2007.

Looking forward, we are expecting rental rates to continue to post significant increases in 2008 and 2009.

Conclusion

The year 2005 can be considered the turnaround year for the apartment housing market in the Seattle metropolitan region and 2006 built upon that 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 3.2% in 2006. First half 2007 figures show continued employment growth of 3.9%. These employment gains are stimulating increases in net migration and ultimately, apartment demand.

During 2006, the vacancy rate for the Seattle metropolitan region plummeted from 5.1% in December 2005 to 2.5% in June of 2006 and then back up to 3.4% by the end of the year. Following a similar pattern, the vacancy rate for the first 6 months of 2007 has fallen to 2.8%. This is mainly due to seasonal factors. New supply has increased over the historic low of 2005 but is still low when compared to historic rates. In addition, a significant amount of apartment supply is being siphoned off by conversion to condominiums. We have estimated that approximately 3,200 apartment units were converted to condominiums in 2007. We forecast vacancy rates to continue to fall to below one percent in the middle of 2008.

Following a year of record orders at Boeing, the regions economy is expected to continue at a healthy pace

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	4.6%	12.0%	10.0%
Eastside	14.2%	10.0%	10.0%
Southend	9.8%	7.0%	8.0%
Snohomish	19.2%	12.0%	10.0%
Metro Total*	10.1%	10.5%	9.5%

*Weighted Average

into the near future. The housing slump that has affected different regions in the country has been felt to a much lower degree in Seattle

As of June 2007, the Seattle market has a two-year supply of 3,795 new apartment units. These are units that are currently in lease-up, under construction, or proposed. During this same time period, we forecast 4,374 new units of apartment demand in the Seattle market. This leads to an undersupply of 579 apartment units and will put downward pressure on the vacancy rate of the Seattle market to around 2.0% by the middle of 2009.

The Eastside market has a two-year supply of 1,977 new apartment units. This is less than our forecasted demand of 2,586 new apartment units, indicating an undersupply of 609 units that should decrease the vacancy rate of the Eastside market to 1.2% by the middle of 2009.

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 1,719 new apartment units. When compared to the new apartment demand of 3,704 units, this leads to an undersupply of 1,985 units. This undersupply should decrease the vacancy rate to around 0.9% by the middle of 2009.

The Snohomish County market also indicates a 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 1,710 new apartment units and an increased level of apartment demand at 2,298 units, the Snohomish County market is forecasted to have an undersupply of 588 apartment units during the next two years. This will decrease the vacancy rate from its current level of 3.4% to approximately 2.3%.

The overall Seattle metropolitan market is forecasted to face a significant undersupply of 3,762 apartment units during the next two years. This should cause the vacancy rate to fall from the already tight rate 2.8% to 1.7% by the middle of 2009, 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. While condominium conversions will continue to impact supply, this effect will significantly decrease as the condominium market begins to cool off from its recent boom.





For more information on services offered by the **O'Connor Consulting Group**, please contact Brian O'Connor, MAI at (206) 622-5100 or visit our website at: www.ocgp.com



**O'CONNOR
CONSULTING
GROUP, LLC**

500 UNION STREET SUITE 650

SEATTLE, WA 98101