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BANK OF ONE
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 NEW YORK, NEW YORK 10033

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 :2080465240: 807793

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For *RENT*
 :8273365322: 46670067899*4228

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 :8273365322: 46670067899*4228

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1-668 499
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BANKLANDIA
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 :2226785940: 86779445270*0622

Anne Beckan

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Charlotte Andrews
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 WINDYBROOK, OH 44095

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 228 978
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 LANSING, MI 48209

For *MAY RENT*
 :1208975682: 99040055690*308

Charlotte Andrews

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After 2010 brought an entirely unexpected and totally jobless rally to apartment fundamentals, the multifamily industry tries to keep its exuberance in check as it enters what many market veterans predict will be the greatest period of rental revenue growth in history.

Outta Sight

BY CHRIS WOOD

ILLUSTRATION BY MATT WOOD

SO THIS IS HOW THE GREAT RECESSION ends in the multifamily industry? Not with a whimper, but with a bang, and not just any bang, but a screaming eagle, sonic-booming, avenging angel bang that is blasting apartment operators to an unheard of zenith in rent fundamentals. Mark 2010 down as the year of the recovery, and then fasten your seat belts for 2011 and beyond.

With concessions burned off, occupancies high, supply short, and colossal demographic data pointing to consumers entering their age-appropriate renting years (or otherwise disdaining single-family housing), it's time to push rents. And for most apartment operators, the question isn't how high will rents go, but how high won't they go?

With some rent growth predictions for 2011 eclipsing the double-digit mark, talk abounds of rent records being shattered as the industry enters the beginning of the best years multifamily has ever seen. In fact, nary a critic of irrational exuberance or overoptimism is to be found.

"Do I think there are extremely aggressive rent growth assumptions in the multifamily industry right now? Yes, absolutely," says Encino, Calif.-based Marcus & Millichap managing director of research and advisory services Hessem Nadji. "But for 2011 and 2012, I think those assumptions are justified. Because of the supply-demand dynamics, we are going to have record rent growth over that two-year period. Definitely the strongest performance since 1999 to 2000, and we might even beat that record."

Nadji's projections are shared by many in the apartment sector and need little translation. With three years of little new apartment stock developed due to a continuing lending crisis—and existing apartments already at peak occupancy levels—landlords are firmly in the driver's seat when it comes to pricing rents. Despite the fact that job creation (a traditional metric for apartment demand that sees roughly one unit rented for every six jobs created, according to industry executives) was

relatively flat in 2010, apartment absorption soared. Apartment managers who were giving away two or three months in free rent just to get prospects in the door suddenly saw those prospects converting into leases and occupancy numbers not seen since before the recession.

"2009 was a horrible year, and the industry was still expecting the worst when suddenly the numbers just kept getting better every month across 2010, ending the year with effective rent growth of about 4.4 percent and vacancy at 6.5 percent nationally," attests Ron Johnsey, president and founder of Dallas-based apartment research and consulting firm Axiometrics. "So you have this anomaly where we had great rent performance in 2010, but you look at the job growth, and it's just not there. Let's say job growth ends up at 0.7 percent. That is too anemic to explain the recovery we saw in multifamily last year. So you have to look at other things."

NOWHERE TO RUN

So why, despite a still-flagging economy, have apartments performed so well over the past year? The answer is one of a confluence of market factors that not only explain 2010 improvements to rent funda-

5.9%

Apartment sector revenue growth forecast for 2011, based on a 5.1 percent jump in rents and a 0.8 percentage point increase in occupancy levels

Source: M/PF Research

mentals but also—barring any unforeseen cosmic interventions in the macroeconomy—position multifamily operators to aggressively price rental units over the next 12 months, even if that means pricing existing residents out of their apartments.

"In 2010, I think virtually everyone underestimated the rent growth and the recovery that was going to happen," says Keith Oden, president of Houston-based apartment REIT Camden Property Trust. "We raised our guidance twice during the year, and other public companies did likewise, and that was all attributable to NOI growth."

Virtually the entire multifamily industry, from CEOs to asset managers to property managers, including Oden, never expected consumer confidence to power apartment rentals last year. Indeed, if job numbers alone were to tell the story, the economy is still going nowhere fast—unemployment closed out 2010 at 9.1 percent, down from its peak of 10.6 percent in January 2010, according to the Bureau of Labor Statistics, but still well above the 4 percent to 6 percent level that financial experts consider "healthy" for the economy.

What that employment stagnation did result in, however, is more time for working out single-family home loans that would otherwise have headed for foreclosure or the shadow rental market (ultimately

RENTERS NOT BALKING

As owners push rents, and renters sign on at higher prices, leasing prospects are faced with daily changes in unit pricing. Yet apartment shoppers aren't irked.

THE PERCEIVED "BAIT AND SWITCH" from the difference between the advertised rent of an apartment unit and the price at time of lease signing is largely a passé issue, apartment Internet marketing experts say. Concerns over whether rental prospects would balk at price differences generated by either revenue management systems or traditional market comps appear to have been largely overblown, with most multifamily technology and marketing experts pointing to real-time data feeds and a changing consumer psychology.

"We are not seeing that friction at all," says Peggy Abkemeier-Alford, president of Santa Monica, Calif.-based apartment ILS Rent.com. "Most of our clients are on a direct

feed to Rent.com with their property management system, so as their pricing is updated in the system, it is updated on their listing, as well, often several times a day."

Such real-time data links have taken the industry a long way from static apartment advertisements with prices set in stone, prices that could be vastly different by the time a prospect visits a community to sign a lease. With revenue management technologies automatically recasting unit prices based on daily demand, apartment hunters could still feasibly see a perceived "teaser" rate on a unit, only to be quoted a different price as early as the following day. While data feeds close the window on that possibility significantly, revenue

management pros say consumers have come to expect a different shopping experience for apartments, and price differentials—should they occur—can just as likely be the beginning of a successful conversion conversation.

"Everyone using revenue management is also using CrossFire or Vaultware or another product that is taking the data out of your property management system and is populating all of the ILSs, your website, and your call center, and everyone is typically on the same pricing every day," says Janine Steiner Jovanovic, president of Carrollton, Texas-based RealPage's YieldStar revenue management division. "You do have daily changes because of the flow of supply and demand, but I think renters are really getting used to that. They understand that apartments are now being priced the same way as a rental car, a hotel room, or an airline ticket. It is a transaction process that folks are a lot more comfortable with."

Abkemeier-Alford agrees and points to changes in how consumers look for information on the Internet. While price is still a primary qualifier, instant access to property

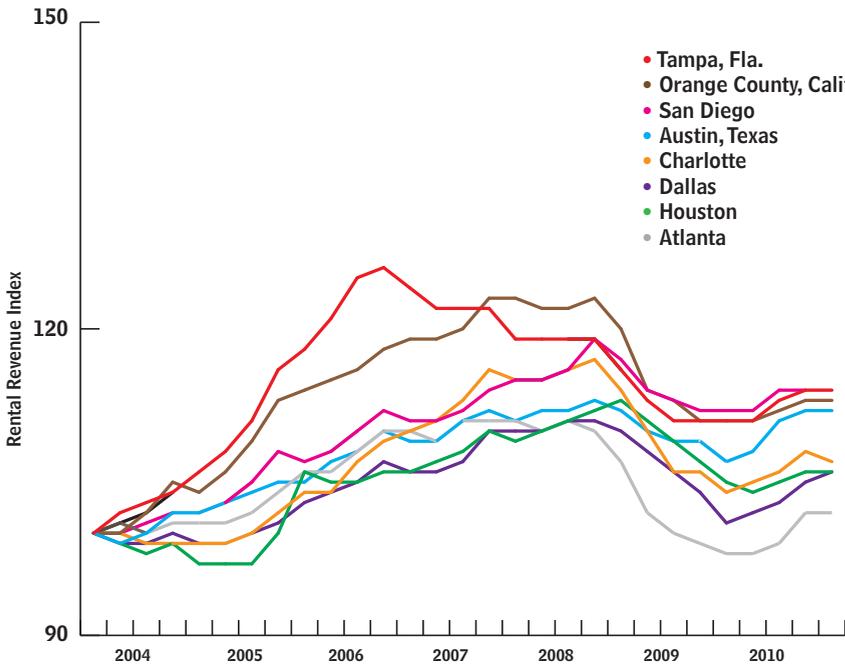
information, guest cards, and leasing documents have created a hybrid renter prospect who completes a leasing process both on- and offline and not only recognizes but expects the transaction possibilities and limitations in both realms. "One of the other trends affecting apartment marketing is in the transparency and availability of that information," Abkemeier-Alford says. "It's becoming increasingly clear that mobile and social computing trends both play a big role in making it easier for renters to find a perfect apartment in the perfect location for their perfect price at the perfect time."

Not everyone is completely sold on tech-powered transactions for apartments, however. While recognizing that property management and revenue management software accomplish a great deal for apartment marketers, Bend, Ore.-based G5 Marketing CEO Dan Hobin says advertising a price range can do a good job of qualifying prospects and still provide on-site flexibility for price changes. "Apartment prospects are still shopping on price, and driving semi-qualified leads by using a range is better than driving zero leads at all."

SPECIAL EFFECTS

Rental revenue seems to be in a steady growth cycle.

IN AN INDUSTRY WHERE everything is cyclical, it's no surprise that rents are up one year and down the next. As apartment marketers struggle to match comps and convert prospects, asking rents don't always tell the true story. Effective rents (rent levels after concessions and specials) tell a truer story of rent growth. Despite a relatively volatile economic climate over the past decade, rents for multifamily assets in the top 20 metros have increased slowly but surely (see chart at right). Starting at a 2003 fourth-quarter index year, Dallas-based Axiometrics has tracked those metro highs and lows over the past seven years to paint a succinct portrait of dependable sector gains. For example, eight of the largest Sun Belt rental markets (see graph below) show signs of steady growth in the past four quarters.



TOP 20 RENTAL MARKETS	COMPOUND ANNUAL GROWTH RATE*
San Francisco	3.90%
Washington, D.C.	3.15%
Seattle	3.08%
New York City	2.27%
Chicago	2.25%
Denver	2.09%
Tampa, Fla.	1.88%
San Diego	1.86%
Orange County, Calif.	1.80%
TOP 20 MARKETS (AVERAGE)	1.70%
ALL 254 MARKETS (AVERAGE)	1.67%
Orlando	1.64%
Austin, Texas	1.58%
Los Angeles	1.51%
Boston	1.36%
Phoenix	1.09%
Charlotte, N.C.	1.02%
Riverside, Calif.	1.01%
Houston	0.82%
Dallas	0.80%
Atlanta	0.26%
Las Vegas	0.08%

*Data from 4Q 2003 to 4Q 2010
Source: Axiometrics

decreasing competitive rental stock). A perceived bottoming of the recession seems to have also bolstered optimism among younger renters who had moved home and cash-conscious renters who had doubled up. With free rent deals on the table and a thought that the worst is behind us, rental prospects were eager to pull the trigger on a place of their own in 2010, particularly in the second half of the year.

"We have seen just a remarkable improvement on properties over the past year despite job losses, and that is a phenomenon that took everyone by surprise," says Brad Miller, president of Dallas-based apartment owner and developer Encore Multifamily. "When you peel the onion back, one of the reasons is a decoupling of those who had doubled up. I think you are seeing some interesting bifurcation in improvement in rents and occupancy in one-bedroom apartments versus two-bedrooms to support that—and those who have a heavier one-bedroom blend are doing extremely well."

Johnsey agrees that decoupling played a major role in 2010 rent fundamentals and says that unit demand in 2011 will continue its reversal from two- and three-bedroom suites back to one-bedroom and studio apartments. "The REIT earnings calls are all mentioning the unwinding of the demand for [multitenant units], and I think

there is a lot to that," he explains. "We are already seeing greater demand, and, consequently, greater pricing power, for one-bedroom floor plans compared to two- and three-bedroom units."

And while tepid economics have encouraged cagey apartment seekers to finally strike out on their own, they've done nothing to bolster interest in single-family home purchases, traditionally the greatest drain on both apartment prospecting and move-outs. That market dynamic is likely to continue into the near future.

"As the demographics are working in our favor, simultaneously the long-term relationship between owning and renting is clearly turning to a figure that is more favorable to renting than it has been in the past," explains Greg Willett, vice president, research and analysis, at Carrollton, Texas-based RealPage's M/PF Research division, which is forecasting an average 5.1 percent jump in 2011 rents nationally and another 0.8 percentage point increase in occupancy levels that collectively should increase revenues by 5.9 percent for apartment owners.

"I don't think you are going to see too many people opting for home purchases," Willett adds. "As a consumer, you'd have to be more confident in your employment picture, and you'd have to be confident that housing prices have hit bottom or are close to bottom.

“The supply situation is pretty much cast in stone. It’s not like cornflakes. You can’t go to the grocery store and just buy more multifamily housing.”

—KEITH ODEN, PRESIDENT, CAMDEN PROPERTY TRUST, HOUSTON

I don’t think that describes very many people.”

Nor can those seeking a place of their own avail themselves of a brand-new apartment. According to the Washington, D.C.-based National Association of Home Builders, the number of multifamily construction starts forecast for 2011 stands at 133,000, “far short of the 250,000 to 300,000 units that would be required to keep supply and demand in balance,” says NAHB chief economist David Crowe. Given that multifamily starts in 2010 and 2009 were 116,700 and 108,900, respectively, Willett says that some analysts think market demand could even support absorption of 400,000 to 450,000 multifamily starts.

“The supply situation is pretty much cast in stone,” Oden says. “It’s not like cornflakes. You can’t go to the grocery store and just buy more multifamily housing. At some point, starts will get back to more historical norms, but I don’t see that happening in the time frame of 2011 to 2013.”

The combined collapse of the single-family housing market and lack of new apartment stock has rental prospects flocking to existing apartments as the economy begins to improve, most evident in the drastic boost to effective rents (rents net of

concessions and specials) in the third and fourth quarters of 2010. (For more on this trend, see “Special Effects,” on page 39.)

“The whole universe of potential home buyers shrunk because of bad credit and availability of loans, and for the year we had 3.4 percent effective rent growth,” says Mike Hefly, director of asset and property management for Atlanta-based Wood Partners. “Our actual rent potential in 2010 was flat—that is all burn-off of concessions. But to put it in context of how the growth accelerated, the trailing six months at January 2011 annualized was an effective rent increase of 5.1 percent.”

HOT MARKETS

The top 10 multifamily markets of 2011 have a foundation of strong fundamentals.

SO WHAT WILL BE THE BEST apartment markets this year? Like most things, it depends on whom you ask. For the investment-minded executive, Encino, Calif.-based multifamily brokerage and advisory firm Marcus & Millichap has pegged New York City to outpace Washington, D.C., when considering employment growth, vacancy rates, and asking rents together.

“The coastal markets that took a hard hit on the way down are leading the recovery on the way back, and that includes New York City, D.C., Boston, the San Francisco Bay area, Seattle, and San Diego,” says Marcus & Millichap managing director of research and advisory services Hessam Nadji.

When it comes to pure rental

revenue, M/PF Research’s Greg Willett pegs San Jose, Calif., as the nation’s top growth contender in 2011, with revenues poised for a 10.2 percent surge from a forecasted rent increase of 9.6 percent against an occupancy level that is tightening 0.6 percentage points to 97.1 percent.

“Markets like San Jose; Washington, D.C.; and even Baltimore are obviously already doing well,” Willett says. “The markets that are a little more interesting are in the middle of the pack but are ready to charge ahead in a big way: markets like Austin, Raleigh, and Fort Lauderdale are the ones that are surging at a much stronger rate.”

	EMPLOYMENT GROWTH	VACANCY RATE	ASKING RENT
New York City	2.3%	3.0%	\$3,010
Washington, D.C.	2.8%	4.3%	\$1,435
Boston	2.0%	4.5%	\$1,777
San Jose, Calif.	2.5%	3.4%	\$1,505
Orange County, Calif.	2.6%	4.4%	\$1,535
San Diego	1.9%	3.6%	\$1,370
San Francisco	2.2%	3.9%	\$1,884
Minneapolis-St. Paul	1.5%	3.6%	\$ 965
Austin, Texas	3.6%	6.2%	\$ 901
Philadelphia	1.0%	3.9%	\$1,055

Note: All figures are as of year-end 2010.
Source: Marcus & Millichap

PUSH IT REAL GOOD

The resulting occupancy in a market devoid of concessions puts 2011 apartment property managers in a vacancy sweet spot allowing them to aggressively raise rents on both renewals and new lease-ups, provided they've got the guts to push for a premium. After two-plus years of economic malaise and hard-bargaining prospects, leasing agents could be slow to recognize—or believe—that they've got pricing power on their side.

“One of the toughest things to do at the community manager level is to anticipate that things are going to get better when your experience over the past two years is that things are only getting worse,” Oden says. “It is hard to get rid of lingering concessions; it is hard to push rental rates on certain floor plans. It is just against the human experience to get your teeth kicked in for two years and then all of a sudden think that the supply-demand scenario has shifted, and you suddenly have pricing power.”

Palo, Alto, Calif.-based Essex Property Trust, too, adopted an “occupancy first” strategy as rents began to fall during the recession. “Now, we are in a different market where we think it is important to focus on rent growth as opposed to occupancy,” says Essex CEO Michael Schall. “So we are trying to regear the company to be willing to accept more vacancy, although not a lot more vacancy. If you push occupancy into the 93 percent range, then typically rents are going down, not up. You eventually hit a point of diminishing returns on that trade-off.”

But so it is, and operators, like Camden, that are plugged into revenue management technologies might have an upper hand when it comes to pushing rents in 2011. In addition to offering leasing professionals a little algorithmic confidence, demand forecasting software is likely to continue its demonstrative track record of achieving rent premiums relative to market.

“We are looking for a 2 percent to 3 percent real rent growth just based on the market rebounding, and we think you'll see a 3 percent to 5 percent increase if you are using a revenue management system,” says Phoenix-based Alliance Residential managing director of asset management Brad Cribbens, who says his firm recently boosted an existing \$100 rent premium over comps in the Albuquerque, N.M., market to a \$300 premium after implementing revenue management technology. “It is just a smart way to look at supply and demand factors. It takes the emotion out of the decision and looks simply at availability, demand, and historical traffic patterns.”

And emotion is likely to cloud the renewal process in 2011. After leasing agents desperately tried to keep residents in place to maximize occupancy and cash flow during the recession, sharp increases in 2011 asking rents will put pressure on agents to about-face and boost renewal rents. For renewing residents rebuffed by apartment firms offering deeper discounts to new lease-ups in 2009 and 2010, the future isn't getting any brighter, as the market is anticipated to bear take-it-or-leave-it renewal hikes of up to 20 percent.

“Say renewals in general should be 40 percent to 50 percent or better,” Cribbens says. “Right now, we don't mind if we start dipping into the 35 percent capture rate, because that means that we are actually getting \$100 to \$150 increases. In our case, we are not looking for \$15 to \$20 bumps; we are looking for significant gains, and we recognize—and I think the industry recognizes—that you have

1:6

Standard industry ratio that shows one unit rented for every six jobs created.

Source: Wood Partners

to concede some renewal stability in that conversation.”

COMMUNITY CACHE

Not that apartment firms will be kicking residents to the door. Cribbens cautions that no property should totally cannibalize NOI for rent gains, but says “smart and deliberate decisions” will help to push rents and result in a corresponding capital-to-valuation increase of asset worth. Creating

a sense of community will continue to be vital in that regard, and the emergence of social networking could prove to be a valuable ally in retaining residents and raising prices at the same time.

“I've always believed in the basics of blocking and tackling and providing superior customer service, and the best way to get rent increases is to have satisfied customers,” Encore Multifamily's Miller sums up. “We've proved over and over again in the apartment business that if residents can recruit or make friends, it creates a sense of community where renters are less likely to move out strictly because of cost. Social media is a continuation and enhancement of that.”

Even at the highest end of the market, there will be a push/pull dynamic at play when it comes to resident renewals, especially as market rents rise and firms attempt to differentiate themselves to current renters and new prospects. As prices spread out and concessions come to an abrupt end, residents are also likely to settle back into asset classes corresponding to their economic demographic, making asset-appropriate marketing and customer service efforts vital to rent competitiveness.

“When you go through a period of mass concessions, what you get is multiple segments of consumers living at your properties,” says David Doyle, president of Beverly Hills, Calif.-based high-end apartment ILS LuxeList. “As that unwinds, the more precise and targeted you are in marketing, the more capable you will be of achieving your highest rent objectives. Creating community will assist with that effort, because people who are connected to their neighbors are more likely to absorb rent increases than residents who are disengaged and detached from their housing experience.”

With community building and revenue management technologies plugged in, occupancies at a pricing power inflection point, and on-site personnel advised to reach beyond market comps at the expense of slight vacancy increases, the question remains: How high will 2011 rents get?

The answer, it turns out, is not a simple one to generalize: While improvements will be location dependent (see “Hot Markets,” on page 40), it is likely that all major markets will get a real rent boost. According to Marcus & Millichap's Nadji, 2010 was the first time since 1990 that his firm registered a drop in vacancy rates across all 55 metros it tracked, and 2011 is expected to be strong across the board.

“2010 was the best market we have seen, and 2011 should stay the pace,” agrees Axiometrics' Johnsey, who is expecting further improvements in apartment market fundamentals, with effective rent growth going from 4.4 percent to about 5 percent, and with substantial absorption along the way cutting a 6.5 vacancy rate down to 5.8 percent. “I've been in this business for 30 years, and I have never seen apartment markets this strong. It is astounding, and I think it will keep on going into 2011.” [M]