

Market Update

Yesterday

- Between 1996 and 2002, Chicago area apartment rents increased more than 30%.
- Between 1996 and 2002, interest rates declined to historically low levels, with the ten-year Treasury falling to under 4.0%.
- Between 1996 and 2002, Chicago area capitalization rates fell by approximately 300 basis points.

Result:

Since 1996, Chicago area apartment properties have nearly doubled in value.

Today

- Currently, physical vacancies for Chicago area apartment properties are approximately 11%.
- Rental concessions of one month or more are pervasive.
- Insurance, fuel and other operating expenses have risen dramatically, further depressing Net Operating Incomes (NOI).

Result:

Thank goodness for low interest rates.

Tomorrow

Predicting the future is as much about one's unique perspective and gut instincts as it is about the events of yesterday and today. Among entrepreneurial apartment investors, this forecasting is more than cocktail party conversation, it is largely the determinant of whether or not to buy, sell, or maintain the status quo regarding significant investment dollars.

Although forecasting has never been an easy task, seemingly long gone are the days of simply spread sheeting smooth 3% income growth and 2% expense inflation. Instead, merely predicting whether effective rents will increase or decrease this spring seems confounding enough.

Put another way, the standard deviation in NOI forecasting is far greater today than it has been in recent history. Intellectually, this greater element of risk would suggest an increase in capitalization rates and an adjustment downward in pricing, but low interest rates, high availability of investor capital, and positive long-term fundamentals have held values steady.

While this uncertainty has not affected prices, it has significantly increased average marketing times. The one-week listing has disappeared along with tenant waiting lists.

Liability & Property Insurance Update

Underwriting insurance expense has become one of the most challenging aspects of apartment ownership in recent years. Gone are the days of either guesstimating \$100 per unit or forecasting nominal increases from the current owner's premium.

To better understand the source of this problem, it is helpful to understand the supply side of the equation. Ten years ago, there were approximately 20 insurance carriers competing for Chicago area apartment properties. During the 1990's that number declined approximately 25%. In the last eighteen months, that number has plummeted to approximately four carriers. Consequently, the competition among insurers has evaporated, leaving owners at the mercy of the remaining providers.

This decrease in competition, combined with huge losses by insurance companies from both a depressed stock market and staggering claims, has resulted in

exponential premium increases.

These increases during the past twelve months have been averaging approximately 25% on renewals, while for new acquisitions, rates have skyrocketed to \$250 to \$300 per unit. And that is if an existing carrier even offered to renew.

If a carrier did not renew, an owner could expect an increase of 100% or more when changing companies. Worse yet, if an owner was not renewed due to prior claims or losses, they could expect premium increases with a new carrier of as much as 300% to 400%.

There is little to do until more carriers enter the market. However, two strategies many owners are following are to increase deductible amounts and to cover small claims out of pocket. Lastly, when buying a new property, it is important to obtain three to five years of loss history from the seller, as most carriers have started to require this prior to quoting new coverage.

Marketing times now seem to be more in line with traditional marketing periods of three months or longer. In other words, finding the right buyer at the right time has supplanted everyone being a buyer all the time.

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This regression to the mean, or reversion to more normal marketing times, has actually produced several unintended benefits. First, buyers who may not have had an opportunity even to see a deal eighteen months ago because properties sold so quickly are now often the successful bidders. Additionally, the market fervor of eighteen months ago resulted in the frequent submittal of no contingency offers. While it is still commonplace for

offers to contain no financing contingencies, short inspection contingencies are now more commonplace. Consequently, in certain respects, it has actually become easier to buy properties.

Coupled with these changes in market conditions, there has grown a camp of owners who believe that now is an ideal market in which to sell property. In recent years, owners often have been reluctant to sell because of the fear that twelve months later their property could be worth 20% more. With Net Operating Incomes declining, this risk of leaving money on the table seems much smaller today.

Conversely, there has grown a camp of investors who believe that the rental market downturn is temporary and not chronic. They believe that now is the optimal time to invest because the competition is less fierce and they can weather the storm utilizing fixed rate, long term financing or lower, floating rate debt.

In so many words, this latter camp perceives the current rental market softness as the result of three primary forces occurring simultaneously. First, the larger economic slowdown

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has reduced new household formation, forcing vacancies higher and exacerbating the threat from overbuilding in the condominium sector; Second, since September 11, the flow of immigration has been dramatically reduced, further depressing new household formation; and Third, the availability not only of low interest rates, but also of 95% to 97% loan to value home mortgages has made home ownership easier and more affordable than ever before.

The more bullish buyers view this confluence of bad news as being offset by several encouraging factors. First, despite the overbuilding of condominiums, which has a tangible, albeit difficult to measure, impact on the rental market, Chicago remains a very insulated market from new apartment construction. Only the Gold Coast and a few growth collar suburban markets have experienced any notable rental construction in recent years.

Similarly, on the demand side, Chicago's economic vibrancy, combined with its affordability relative to other major metropolitan

markets provides further comfort to bullish apartment investors. Finally, low interest rates and an anemic stock and bond market make real estate, particularly lower-risk, multi-family investments, that much more attractive.

Email Update

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www.essexrealtygroup.com

Top Ten Reasons To Invest In Apartments

1. The thrill of recourse loans.
2. I've always been fascinated by mold, asbestos, and lead paint.
3. Phone calls in the middle of the night prevent annoying REM sleep.
4. You can't lose money!
5. Property management helps me to relax.
6. Working with brokers makes me feel better about working with my attorney.
7. At least with apartments one is spared the pain of daily stock updates.
8. Nothing says "Hot Investment" like a clogged toilet on a holiday weekend.
9. Working with the building department.
10. Feeling good about yourself when giving rent concessions.

DEAL SUMMARY



INVESTMENT REAL ESTATE SERVICES

We are pleased to announce the following partial list of investment real estate we have recently closed, placed under contract or listed for sale on behalf of our clients:

59 Units ~ Lincoln Park	25 Units ~ Old Irving
63 Units ~ Uptown	69 Units ~ Rogers Park
60 Units ~ Glen Ellyn	5 Units ~ Bucktown
12 Units ~ Riverdale	19 Units ~ Wicker Park
13 Units ~ Avondale	38 Units ~ North Park
10 Units ~ North Lake	9 Units ~ Edison Park
46 Units ~ Rogers Park	30 Units ~ Lakeview
6 Units ~ Hillside	41 Units ~ Lincoln Park
13 Units ~ Evanston	4 Units ~ Lakeview
16 Units ~ Old Irving	76 Units ~ Rogers Park

If you are planning to buy or sell Chicago area investment real estate, please contact us to discuss your individual needs.

~ Personal Service ~ Market Expertise ~
~ Exceeding Expectations ~

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