ESSEX REALTY GROUP
INVESTMENT REAL ESTATE SERVICES

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Chicago's New Apartment Market

Chicago's apartment market has experienced a dramatic, yet seemingly unheralded transformation in the past six months. Specifically, there has been a profound rebound in the rental market, an ebbing in condominium conversion activity and a record level of transaction velocity. These forces are quickly changing the landscape and are requiring investors to reevaluate their strategies for a new apartment market.

Record Activity

To begin with, 2005 was a record year for transaction velocity in Chicago's apartment market. In the city of Chicago, there were 417 closed apartment transactions of over $1 million with an aggregate volume of $1.787 billion. By comparison, in 2004, there were 386 sales with an aggregate volume of $1.339 billion. Similarly, in 2005 the average price per unit jumped to $111,346 from $90,634 just one year earlier.

This heightened velocity is in contrast to a more typical year such as 2001 when only 171 sales occurred and the average price per unit was just $66,585.

Year	# of Deals > $1 Mil.	Total Value	Average Deal Size	Average $/Unit
2001	171	$529,448,469	$3,096,190	$66,585
2002	210	$496,231,580	$2,363,008	$59,975
2003	232	$716,915,044	$3,090,151	$89,311
2004	386	$1,339,919,104	$3,471,293	$90,634
2005	417	$1,787,606,379	$4,286,826	$111,346

Obviously, this increase in velocity is correlated to an increase in values. As prices increase, so too is an owner's willingness to sell. Less obvious, however, is that since 2001, there has been an inverse correlation between Net Operating Incomes (NOI's) and values. NOI's declined dramatically between 2001 and 2005, yet values increased dramatically. This created further incentive for owners to sell. Not only were prices skyrocketing, but incomes were dropping severely.

> ***While interest rates deserve much of the credit for these price increases, it was the condominium converters who most exploited these low rates, increasing values and ultimately accelerating velocity.***

Conversion Aversion?

But now condominium converters are working on thinner margins than at any time in recent years. First, lenders are starting to tighten their terms in response to the increasing inventory in a number of sub-markets. Second, construction costs have substantially increased. Third, there is an ever-growing competition among converters competing for fewer and fewer prime conversion properties. Fourth, according to the Multiple Listing Service, marketing times have increased by as much as 35% since last fall in most sub-markets, thereby increasing carrying costs. These forces are all cutting deeply into converters profits.

Using Essex as a market barometer, since mid-2001, condominium converters have been outbidding apartment investors, in general, from 10% to 20% on properties that have strong conversion potential. This is in contrast to the period from 1997 through early 2001 when apartment investors frequently outbid condominium converters.

It is highly unlikely that condominium converters will disappear from the landscape. But a compression on developers' margins may dampen the premiums which they can pay to sellers. Initially, this has already been noticed in marginal conversion deals; that is, properties in weaker locations or properties with below average unit layouts that in recent years have been successfully converted due to strong end user demand.

This in turn begs the question, "Will a slow down in conversion activity lead to a slow down in velocity?" If owners can not obtain the same premium pricing, will they be as inclined to sell. Of course, this presumes that future premium pricing would come as it has in recent years, from converters. It may well come from apartment operators seeking to take advantage of the new apartment market.

Rental Rebound

According to Essex' Apartment Market Analysis, in early 2005, many apartment owners were battling physical vacancies of 8% to 12%,

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Chicago's New Apartment Market

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depending on the sub-market. In addition, rental concessions, renewal concessions and bad debt expenses were adding an additional 6% to 10% in economic vacancy, depending on the sub-market. Beginning in mid-2005, however, physical occupancies began rebounding and have been steadily improving since.

> *Most sub-markets are reporting physical vacancies today of 4% to 7%, with virtually no remaining rental concessions. The speed of this rebound is astounding and seemingly unheralded.*

In addition, there has been a noticeable improvement in the quality of rental applicants. This appears to be as a result of an improving entry level employment market. Beginning in 2001, qualitatively the top traunch of the rental pool became first time home buyers. This traunch represented as much as a third of the rental market in many sub-markets. Apartment operators not only had to recover from the economic impact due to vacancy loss, but also had to adjust their management and marketing strategies to account for this qualitative change. In recent months, however, it appears that the rental rebound has positively affected both the quantity and quality of income stream.

Rent increases, a term nearly forgotten in apartment circles, have sparingly reappeared in a few sub-markets. If this rebound continues, owners may soon be able to pass thru rent increases to offset the rising operating expenses that have been eroding NOI's in recent years. In a related vein of relief, the Cook County Board just approved a plan to reduce tax assessment levels for buildings with seven or more residential rental units from 26% to 24% starting in 2006. By 2008 the assessment level will be 20%.

The New Apartment Market

What does the new apartment market look like? Less pricing differential between condominium converters and apartment investors; stabilized occupancy rates; no rent concessions; rent increases; and operating expense relief.

After five years of challenging buying opportunities and disheartening NOI's, Chicago's apartment investors are on the verge of a new market.

Surging Popularity of Hyde Park/South Shore

The South Side market presents tremendous opportunity for investors seeking superior cash flows or value-added apartment and conversion investments. Here at Essex, David Goss, Jim Darrow and Jon Morgan have dedicated a substantial amount of their time and resources to the Hyde Park, South Shore and surrounding neighborhoods. Through their hard work and team approach, all of Essex' brokers and many of Essex' clients have been able to efficiently access their expertise and take advantage of the numerous investment opportunities they have generated.

To begin with, South Shore, which is generally identified as the area bounded by 67th Street on the north, 79th Street on the south, Stony Island on the west and Lake Michigan on the east contains close to 400 apartment buildings of 20 units or more. Hyde Park, which is generally viewed as the area bounded by 47th Street on the north to 63rd street on the south, Cottage Grove on the west and Lake Michigan on the east has close to 200 apartment buildings of 20 units or more.

> *For a long time and for many investors, the City seemed to end at Madison Street. Recently, however, the quality and abundance of housing stock in the South Side neighborhoods is attracting a large inflow of investors.*

Both neighborhoods, once home to Chicago's elite, are experiencing a surge in popularity for investment and redevelopment.

Hyde Park: Anchored by the University of Chicago and the Museum of Science and Industry, Hyde Park is the Evanston of the south. In the past 24 months, 37 buildings containing approximately 3,000 units sold with an aggregate value of $254 million. This resulted in an average price per unit of nearly $85,000. Sales ranged from as low as $25,000 per unit to a high of $123,000 per unit for a Lake Shore Drive modern hi-rise. This large variation can be attributed to the substantial deviation in building conditions as well as the investment versus conversion use. Moreover, as with many developing neighborhoods, revitalization is a block by block proposition and contributes to the large variance in values. Notwithstanding, stabilized properties in Hyde Park are currently trading for gross rent multipliers between 7.0 and 8.0 times current rents.

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Essex Realty Group, Inc. is 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.


CRYSTAL LAKE
560-593 Darlington Lane
235 Units


SOUTH SHORE
7131-7133 S. Bennett
61 Units


LAKE VIEW
433 W. Briar Place
34 Units


HYDE PARK
1424-1428 E. 53rd
34,000 SF Retail/Office


NORTH CHICAGO
1111-1123 Broadway
18 Units


GURNEE
1600-1800 Wedgewood
201 Units

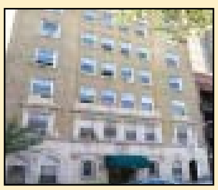

ROGERS PARK
1331 W. Loyola
46 Units


EVANSTON
1509-1519 N. Hinman
33 Units


ROGERS PARK
1329-1337 W. Touhy
43 Units


HYDE PARK
5135 S. Blackstone
36 Units


ROGERS PARK
7301 N. Sheridan
105 Units


LAKEVIEW
622 W. Patterson
91 Units


LAKEVIEW
733-743 W. Waveland
14 Units


EVANSTON
618 N. Hinman
26 Units

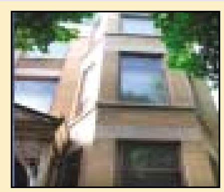

LINCOLN PARK
2535 N. Seminary
13 Units

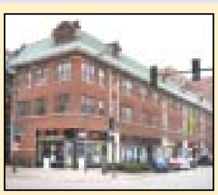

ROGERS PARK
1154 W. Lunt
66 Units- Mixed Use


PARK RIDGE
304 W. Touhy
41 Units


EVANSTON
326-328 W. Dempster
19 Units


LINCOLN PARK
1157 W. Webster / 2149 N. Racine
12 Units - Mixed Use

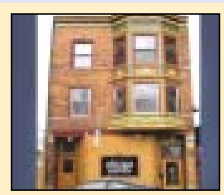

LINCOLN PARK
1141 W. Wolfram
5 Units


EVANSTON
1576-1598 N. Oak
61 Units


LAKEVIEW
1250 W. Addison
18 Units


OLD IRVING PARK
3727 N. Keeler
10 Units


ROGERS PARK
1640 W. Fargo
6 Units


ROSCOE VILLAGE
2230 W. Belmont
6 Units

Surging Popularity Of Hyde Park/South Shore

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South Shore: Among many notable distinctions, historic South Shore is home to Jackson Park Highlands, an enclave of mansions where many of Chicago's aristocrats once lived. The structures still exist today and one by one are being rehabilitated to their former splendor. Containing a larger number of buildings than Hyde Park, in the past 24 months, 67 buildings with an aggregate value of approximately $122 million were sold. This resulted in an average price per unit of nearly $45,000. The average gross rent multiplier was between 5.0 to 6.0 times the current rent, but this excludes a large number of dilapidated buildings which were bought for rehabilitation. In South Shore there are numerous opportunities to "add value", a key desire of many investors.

While the values in Hyde Park have remained strong for many years, South Shore has been rapidly appreciating in recent years. Well maintained and well located properties are beginning to sell for prices in the mid to high $60,000's per unit range with some reported sales in the $70,000+ per unit range. Rents are increasing, vacancies are declining and condominium conversions are becoming more commonplace. While the water is rising for all, as in most developing areas, the better the property management, the better the results.

If you have any questions regarding the South Side neighborhoods, please contact your Essex broker for a list of properties we currently have available for sale or for data regarding properties we have recently sold.

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