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Financing Challenges, by Sean Hallissey, Director of Finance

The past year and a half has been a very challenging time for those needing to borrow money. In the wake of the sub-prime disaster, lending institutions have either closed their doors all together or tightened the purse strings. This has been especially true for new multi-family loans or refinances. In these times it is important for owners to understand the different underwriting levels being used by lending institutions and remain proactive. The following is what is seen in the current market:



- Lenders are now requiring a Debt Service Coverage Ratio (DSCR) of 1.25% rather than 1.15% DSCR = Net Income + Depreciation + Amortization + Discretionary Exp/Debt Payments
- Loan to Value (LTV) requirements have gone from 80% to 65-75% and values for both ratios are being calculated on the lower of a 3, 6, or even 12 month trailing trend.

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The Rental Market, by Matt Geise, Executive Director

The rental market continues to be challenging, although some improvement has been seen since the seasonal slow down typical of the winter months. Vacancy rates for the broader Tri County Region are now averaging 6.3% and gross vacancy losses are averaging 7.4% per Dupre+Scott Apartment Advisors Spring 2010 Report. Up to 60% of landlords are offering incentives and many have lowered rental rates on turnover. We at Phillips consistently remain ahead of market trends with our portfolio's averages outperforming the published statistics. Our refreshed marketing program with enhanced internet presence, professional color flyers and our continued push for first class signage and quality

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New Government Regulations, by Diane Castanes, Vice President

Recently, new government driven regulations have been enacted that may have an adverse affect your bottom line and will affect the way your property management team works. While we have worked with industry associations as members, board members and contributors to industry Political Action Committee (PAC) Funds to argue the merits of most of these actions with our legislators, there are some we could not stop. We also have a report of successes in Olympia. "Success" meaning that the rental housing industry created new legislation to curbs costs to Washington landlords.

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NEW GOVERNMENT REGULATIONS

Lead Paint (Environmental Protection Agency) – Certified Lead Renovator Required

Beginning April 22, 2010, the Environmental Protection Agency (EPA) will enact rules requiring certification of contractors working on homes and rental units built before lead paint was banned in 1978. The rule is aimed at limiting exposure to lead and applies to carpenters, plumbers, heating and air conditioning workers, painters, window installers and others, including onsite apartment managers. The new ruling affects the process for renovation and repair of non-owner occupied units and common areas within residential properties older than 1978. To view the full details visit www.epa.gov/lead and click on the "Get Lead Safe" link.

In summary, any disturbance of a painted area larger than 6 square feet in total, which may contain lead paint, even if several layers below the surface; must either be tested for lead before disturbed or tightly contained. This is intended to help prevent the incidental ingestion of airborne lead dust or residue proven to adversely affect the health of children. Children and pregnant women are of the utmost concern whether residing in or visiting a leased premise. If lead is detected in the interior of a residential unit, it must be enveloped using a specific multi-step sheathing process, have pre and post inspections by a Certified Lead Renovator, and the premise must be cleaned using a HEPA filter/vacuum to filter out any residual fine dust upon completion. If lead is detected in *exterior* paint, special steps must be taken to prevent paint or sanding dust from getting in the soil or airborne if the area to be disturbed exceeds twenty (20) square feet in total.

Lead paint testing kits run about \$3/each and must be used on each wall, ceiling and window frame to be renovated prior to work commencing to determine if lead-free. Phillips is recommending that our clients allow the expense for their onsite staff to pre-test for lead when a disturbance to a painted surface is necessary. *If lead is not present* the onsite staff or any licensed outside contractor can complete the work. *If lead is present*, only a licensed contractor with proof EPA Lead Renovator Certification can be used. Copies of the informative and procedural documents provided by the EPA and a sample lead test kit will be sent to all of the onsite managers within our portfolio of properties built prior to 1978. The cost of this package will be \$15 per location. This will allow the site staff to better understand the process, risks and significant fines, exceeding \$30,000 and jail time, which could result from non-compliance. If you own a pre-1978 rental property, you can expect the annual cost of painting and remodeling to begin to rise come mid-April.

Carbon Monoxide (WAC 51-51-0315 Section R315, SB 5561) - CO2 Detectors Soon to be Required

In addition to requiring smoke detectors, a state law is slated to pass without opposition this year to require that all rented residential units become equipped with one carbon monoxide detector per bedroom or one for the common hall if the bedrooms share a common hall **effective July 1, 2011**. The compliance date may move to 2013. With this law in mind, the detector manufacturers seemed to have responded with price increases. These detectors now run from \$40 to \$60 a piece, when they were previously similar in cost to smoke detectors that range from \$10 to \$25. We are looking into resources for bulk purchasing combined Smoke/CO2 detectors to make installation easier and the cost more affordable for our clients. If you prefer to add these detectors to your units over the next year rather than in one bulk installation, please advise your property manager. If your property has a hard-wired fire protection system the cost may exceed \$60 to integrate an additional device.

B & O Tax Changes Pending (SB6143/Sect 1701) – Taxation of On Site Manager's Payroll

In effort to balance Washington State's budget the legislature is overturning amendments that exempted certain income sources from taxation through Senate Bill 6143. Section 1701 of this bill effects property management companies across that state. Companies like Phillips that handle payroll for client's site employees, in a manner that allows for efficiency and cost savings to the client. The subject amendment exempted our industry from paying B & O Taxes on the funds we receive from our managed properties to cover payroll for our clients' onsite staff; because the funds are a reimbursement or pass through of a direct expense, rather than a profit center for management companies. These reimbursements may become taxable if the amendment is not better understood and reversed during the extended session. This 1.5% tax on payroll could result in an increase in payroll processing fee to the property management client, or may create the need to establish individual employer identification numbers for each property. The **senate bill is still pending**, so if this writing precedes the decision to pass or oppose 6143 and you reside in Washington State, your efforts to contact your area representatives would be appreciated (visit access.wa.gov/government/index for an email portal to communicate with state legislators). We have been actively opposing this with the support of our staff, friends in the industry and our industry membership groups: RHA, IREM, MHCW, BOMA and WMFA. We are appreciative of the industry's support and remain hopeful for success in our efforts.

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- For current loans that have dropped below required underwriting levels, banks may require more frequent reporting, or even action to rebalance the loan at today's rates and terms. This can be done through a capital infusion or the owner may have to negotiate a forbearance or modification of the payments that rebalances the loan over time.
- If you are reaching the end of your loan term, be prepared for your lender to require the asset to meet the ratio levels noted above and know that they will be far more thorough in their evaluation, looking at actual past performance rather than budgeted. A property in good condition with ample reserves will be far more attractive to a lender than one with obvious deferred maintenance. One common requirement of lenders is professional property management with interest in the continued upkeep of the property and added fiscal controls. You can also expect loan documents with terms and conditions that may strongly favor the lender. Read the fine print. Where possible negotiate to a reasonable fair level for your asset. Phillips has some strong relationships with lenders that have proven to do an excellent job for a number of our clients. We would be glad to provide contacts if you are considering refinancing.

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site staff have proven to add prospective tenant traffic and leasing success at our properties. The on-line photos in vacancy ads can draw traffic on their own merit, so with Spring nearing we look for opportunities to enhance curb appeal with extra touches to entry ways and landscaping to best showcase your property online and to better compete with the increasing number of discounted rentals at newer apartments and condominiums.

Commercial sales of apartments have seen some movement. If you are interested in expanding your apartment portfolio, considering selling or interested in hearing about our newest listings, contact Lou Micheli, President/Broker, at ljm@phillipsre.com or Matt Geise, Phillips' Executive Director/Associate Broker at mjg@phillipsre.com or 206.622.8600 at anytime.

Phillips Residential Group, by Julia Schwab, Director

Our residential team has successfully represented buyers and sellers in home sales this year with the most recently closed sale of a \$1.5 million eastside waterfront property. Julia Schwab leads the Phillips Residential Group, as Director, in their sales, leasing and management of single family homes, condominiums and duplexes.

If you have interests in the single family market or are considering downsizing to condominium living Julia would enjoy hearing from you at 206.695.1714 or jschwab@phillipsre.com. It is best to do business with an experienced firm like ours that you know and trust.



A Word from Our President, by Louie Micheli, Broker / President

The Rental Housing Association (RHA) has made a Herculean effort to help rental property owners through legal and government processes this year and last. If you do not already contribute to their Political Action Committee, you may want to show your appreciation by doing so at www.rha-ps.com or 206.283.0816. Their efforts are supported by membership fees and contributions.

While we continually strive to improve our service product in maximizing revenues and controlling expenses, we value your feedback. Feel free to contact any member of our team if you wish to suggest ways that we can improve our service to you and/or your property. Thank you for your continued business.

Resolved Issues in Rental Housing

The Governor has signed three bills that we have supported through our affiliate membership organizations that curb the potential hardships that could have resulted from misinterpretation of the prior bills. Following is a summary of our industry's success in Olympia this session:

SB 5742 - Crime Free Housing Programs: These programs will now be *voluntary* rather than mandatory. If an owner agrees to participate a fee can be chargeable, when previously a mandatory charge was proposed throughout several municipalities. For example, the City of Tacoma charges \$35 for a two day Crime Free Housing Training Program.

SB 6261 - Tenant Utility Bills: For a number of years the state utility companies were allowed to charge unpaid Tenant utilities for one's full span of tenancy to the property owner and suspend service to the unit or home until payment in full was received. With this new bill, owners will be subject to *no more than four months* of utility billings. Seattle City Light has a program where the on-site manager can set up the new Tenant's utility bill in a way that a copy of the utility bill is sent to our offices if past due over 60 days, so that we can be alerted and can take action in attempt to curb this potential loss for our clients.

SB 6459 - Mandatory Inspection Program (RCW 59.18.125) – In the late 80s RHA prevailed in Margola vs City of Seattle and the city's mandatory fee driven inspection program ceased as a result. Recently several municipalities began to consider similar programs. Using this case as a basis for this bill, RHA was successful in limiting inspection programs at the state level to focus exclusively on building and housing code violations that substantially endanger or impair the health and safety of tenants and their neighbors as required by RCS 59.18.115. The details of what might be considered a danger were further defined with the cooperation of RHA, government and tenant advocate groups. It was this balanced group effort that lead to success in Olympia.

Phillips' Vision Statement:

Our future is filled with high-quality tenants and long-term customers who bring sustainability to our business. We have achieved this by growing and nurturing a staff of professionals who deliver a consistent, high-quality experience to our customers. This vision for success starts at the top and filters throughout the organization, producing internal pride and flowing outward into the community.