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Long-term growth prospects remain strong in Hartford multifamily fundamentals

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The U.S. economy showed signs of improvement in late 2009, as GDP growth beat expectations and signaled the end to the technical recession. Accelerating exports and stabilized consumer spending fueled growth in the third quarter. The dollar's weakness against foreign currencies coupled with a recovery of global demand, should support further export gains. Government programs and tax incentives, such as the first-time home buyer credit, drove the rise in spending in the third quarter. As the impact of government action abates; however, traditional demand drivers such as job growth and improved consumer sentiment will be needed to sustain an economic recovery. Companies should resume hiring in 2010, albeit at a modest rate starting well into the year.

Apartment renter demand in Hartford declined in 2009 in response to employment loss; however the vacancy rise appears to be reaching more normalized levels from a low of 4.4% in 2007. In the third quarter of 2009, multifamily vacancy rose 130 basis points to 5.8%, which is still healthy relative to the current national average.

Unlike in previous cycles, vacancies in the current recession have not risen as severely and developers did not overbuild multifamily product, trends which are expected to hasten the recovery. In the Hartford MSA, 55 new apartment units are expected to come online by year-end 2009, compared to 386 units in 2008 and 160 units in 2007.

An improvement in fundamentals, highlighted by above-average absorption and strong rental growth, is expected by 2011-2012. Job creation and accelerated renter-household formation will spur this upturn. In the current recession, many young adults have deferred entering the workplace, choosing instead to pursue advanced degrees or to wait out the recession while living with their parents or friends. As a result, despite a nearly 1% population increase over the last three years of those aged between 20-24, new household formations within this age group have declined by nearly 3.5%. As new jobs are formed in coming years, these deferred households will emerge and begin renting apartments. By 2020, another five million people will enter the prime renter age cohort of 20 to 34 years old. An additional one million legal immigrants who are more likely to rent at first - regardless of age - should further support demand. At the same time, supply will become scarce as construction starts plummeted in 2009 and will remain low in 2010, and the shadow market effects starts to subside in 2011.

Multifamily investment activity in Hartford slowed by 6.3% on a volume basis through the first half of 2009 versus the same period last year. Velocity will remain limited next year, especially when compared to peak levels in 2004-2007. In the fourth quarter of 2009, activity was concentrated among local private buyers. Larger private buyers, such as non-traded REITs with access to capital, also began to reemerge. In 2010, smaller deals priced between \$1 million and \$10 million will drive

the market as larger transactions continue to face financing hurdles. REITs and other institutional buyers will begin to shift toward more acquisitions in 2010, having improved their capital position and lowered leverage in 2009. Major private investor groups and fund advisers will also seek larger acquisitions resulting in more transaction volume in 2010, albeit still far below historical normal levels. Foreign investors will be active in the U.S. market next year, due to the weakened dollar and strong fundraising by foreign funds.

Looking ahead to 2010, GSEs will remain a prime source of capital for apartment investors. Fannie Mae and Freddie Mac are reporting low delinquency rates and both GSEs continue to provide loans for multifamily product. Through the third quarter of 2009, GSEs accounted for approximately 40% of apartment lending, a trend that is expected to continue in 2010. At the time of this report, Freddie Mac was about to issue its second securitization of \$1 billion in multifamily debt in 2009, which may indicate its intention of a quarterly offering. This bodes well for borrowers seeking acquisition loans or refinancing packages.

Through the third quarter of 2009 in Hartford County, 1,226 multifamily units traded for \$87,630,376 with an average per-unit value of just over \$70,000. For the year ending 2008 1,500 units traded for \$128,196,000 with an average per-unit price of around \$85,000.

Investors will continue to find some opportunities in the distressed asset market; however, this trend is expected to fall short of buyers' expectations. In 2008 and 2009, multifamily delinquencies steadily increased. Multifamily delinquencies exceeded \$33 billion in September 2009, compared to \$4.64 billion in delinquencies in September 2008. Despite this rise, the complexity of the CMBS market and commercial banks' need to avoid further losses will continue to limit foreclosures and distressed asset sales.

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